I Securities markets and their agents: Situation and outlook

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1 Executive summary

- The latest available data[1] evidence a notably uneven growth pace across major economies. The emerging market group and, of the advanced economies, the US and the United Kingdom kept up a sturdy expansion in the second quarter, while other advanced economies like Germany and France surprised on the downside. This growth diversity justifies the differing monetary policy tacks being taken in each zone. In the US, the Federal Reserve has continued tapering its asset purchases, and the consensus is that interest rates will start to rise in the second half of 2015. The ECB, in contrast, has addressed the current low-growth, low-inflation scenario by cutting its policy rate to a record 0.05% and launching new unconventional measures in a bid to reinvigorate bank lending.

- In global debt markets, benchmark bond yields have fallen with varying intensity throughout the year. The faster rate of decrease in euro-area bonds reflects the weaker state of national economies. Hence ten-year government yields in Germany and France dropped to 1% and 1.4% in mid-September, compared to 2.6% in the United States. In Europe's peripheral economies, improved investor confidence accelerated the fall in bond yields and risk premiums to below their respective pre-crisis levels.

- Equity markets were buoyed up during the first-half period by plentiful liquidity and a keen appetite for risk, which drove leading indices sharply higher. In the third quarter, however, their performances diverged in response to at times opposing forces, with weak activity figures in Europe and geopolitical risks bearing down on prices, in contrast to the boost effect of new ECB measures. Finally, US indices came out the strongest performers year to date (with both the S&P 500 and Nasdaq gaining over 7%), against the more mixed fortunes of European bourses.

- Spanish GDP expanded 0.6% in the second quarter (1.2% in annual terms), sizeably ahead of the average for the euro area. The upswing in activity, with its roots in improved domestic demand momentum, delivered a small recovery in jobs and a lower unemployment rate. Inflation, meantime, fell to -0.5% in August after hovering near zero for the first six months. On the budget front, the central government deficit to July stood at 3.08% of GDP, half a point lower than one year before. General government debt crossed the one trillion mark at mid-year, although around six billion euros of the increase owed to an accounting change.

1 The closing date for this report is 15 September.

- The Spanish banking system continues to negotiate a difficult landscape, with economic activity still short of speed, despite recent improvement, and NPL ratios in excess of 13% of total loans. But the solid progress made is appreciable in strengthening income statements, rising share prices and the easier financing conditions available to banks. The stress test results due in October will be key to shoring up confidence in the sector.

- The recovery in domestic activity is starting to work through to listed firm earnings. The aggregate profits of non-financial listed companies rose by 3.9% in the first-half period to 8.63 billion euros. This advance rested largely on a profits rebound in the construction and real estate sector. Companies' gross debt, finally, decreased by 3.3% to 265 billion, though leverage was unchanged at 1.32.

- Prices on domestic equity markets have tended to steady after the run-up of the opening half. The Ibex 35, which had risen 10.2% in the first six months, shed 0.8% of its value in the third quarter. Even so, the Spanish index managed to sizeably outperform other leading European indices with a year-to-date gain of 9.3%. Domestic trading volumes continued to swell (up 27% in the year) on Spanish equities' attractiveness vs. alternative investments, and despite the growing business in Spanish shares on foreign regulated markets and MTFs. Market volatility has remained muted to date, at under 20%.

- Spanish fixed-income markets experienced a renewed fall in yields in a supportive climate characterised by abundant liquidity and the improved outlook for the national economy. Yields on benchmark public and private debt instruments reached new historical lows in the third quarter, leaving little room on the downside, with ten-year governments, for instance, trading at 2.3% in mid-September compared to the 4.1% of the 2013 close. Meantime, the credit risk premiums of Spanish issuers declined across the board, driving down financial costs throughout the economy. In some market segments, there are signs that prices might have edged out of step with economic fundamentals, making them more sensitive to possible instability episodes or unexpected interest rate hikes. Finally, the volume of debt issues registered with the CNMV has fallen by 28.5% to 67.31 billion euros[2], in tune with issuers' lower funding needs.

- Assets under management in investment funds climbed by 16.6% in the year's first half to 182.7 billion euros, prolonging the upward trend initiated in 2013 and restoring industry assets to levels unseen since late 2008. Eighty percent of this advance owed to net subscriptions, which were concentrated mainly in fixed-income, balanced fixed-income and passively managed funds. Investment in foreign UCITS also moved up strongly (24.2%) and now represents nearly a quarter of the assets of collective investment schemes marketed in Spain. UCITS management companies grew their management fee income (16.7%) and profits (14%) on the back of this expansion, though the number of loss-making entities rose from eleven last December to thirteen in June 2014.

2 Or a lesser 11.5% if we factor growing issuance abroad.

- Increased trading volumes on equity markets and the recovery of collective investment were good news for investment firms, whose aggregate profits rose by almost 60%, accompanied by a sturdy advance in return on equity (up from 16.5% at the 2013 close to 23.8% in mid-2014). The sector's solvency conditions remain optimal, as calculated under the new criteria introduced by Regulation (EU) 575/2013. In the investment advisory firm segment, the salient development was an 18% drop in assets under advice as far as a June total of 14.4 billion euros, due to the cancellation of one large contract. Without this circumstance, assets would have moved up 5% in the same period.

- The report includes four exhibits:

  – The first considers the revise-up in the growth forecasts for the Spanish economy in 2014 and 2014, with reference to both the issuing institution and underlying causes.

  – The second runs through the main MiFID II novelties affecting financial markets.

  – Exhibit three tracks the changes in the volume and destination of foreign investment in Spain throughout the crisis.

  – Finally, the fourth exhibit sets out the conclusions of a CNMV review of the results obtained by clients trading in CFDs (contracts for difference).

2 Macro-financial background

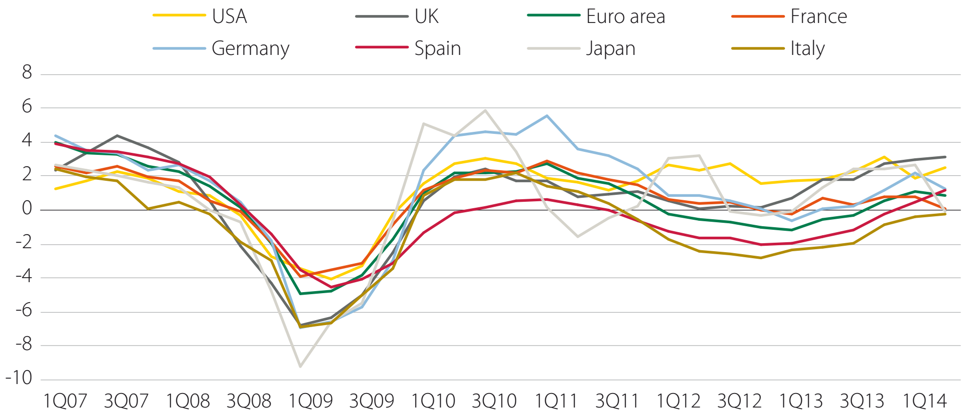
2.1 International economic and financial developments

Mixed fortunes in the second quarter of 2014, with downside surprises in Germany and France and better news for Spain, Portugal and the Netherlands.

Economic activity progressed unequally among the advanced economies in the second quarter of 2014. Growth was strongest in the United States and United Kingdom, whose economies expanded 2.5% and 3.2% in annual terms, in the first case after a first-quarter dent due to temporary factors. In the euro area, however, activity figures caused a degree of consternation, as core economies were revealed to have stalled or even reversed (a quarterly -0.2% in Germany and Italy and zero growth in France), while peripheral economies shook off earlier weakness to advance at a solid rate (0.6% in Spain and Portugal and 0.5% in the Netherlands). The Chinese economy, meantime, grew 7.4% in the first six months, just slightly behind the 7.6% of the same period last year.

Gross domestic product (annual % change)

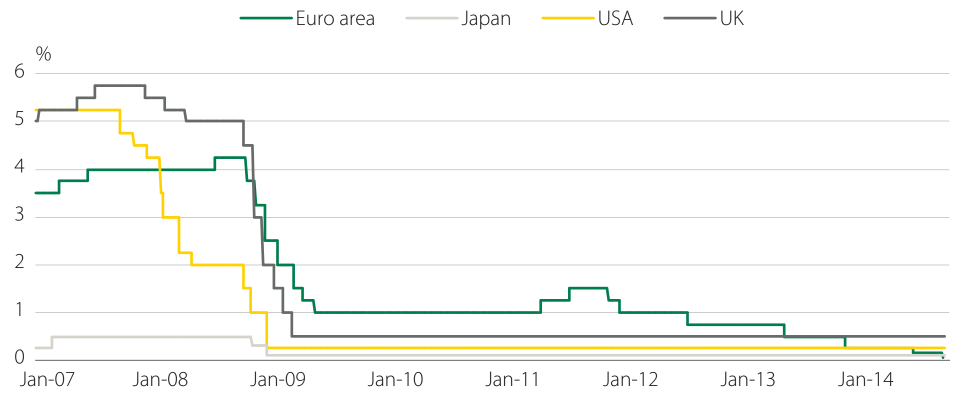
FIGURE 1



Source: Thomson Datastream.

Official interest rates

FIGURE 2



Source: Thomson Datastream. Data to 15 September.

Inflation is running at around 2% in the US and United Kingdom and under 1% in the euro area. Hence the disparate strategies being pursued by central banks.

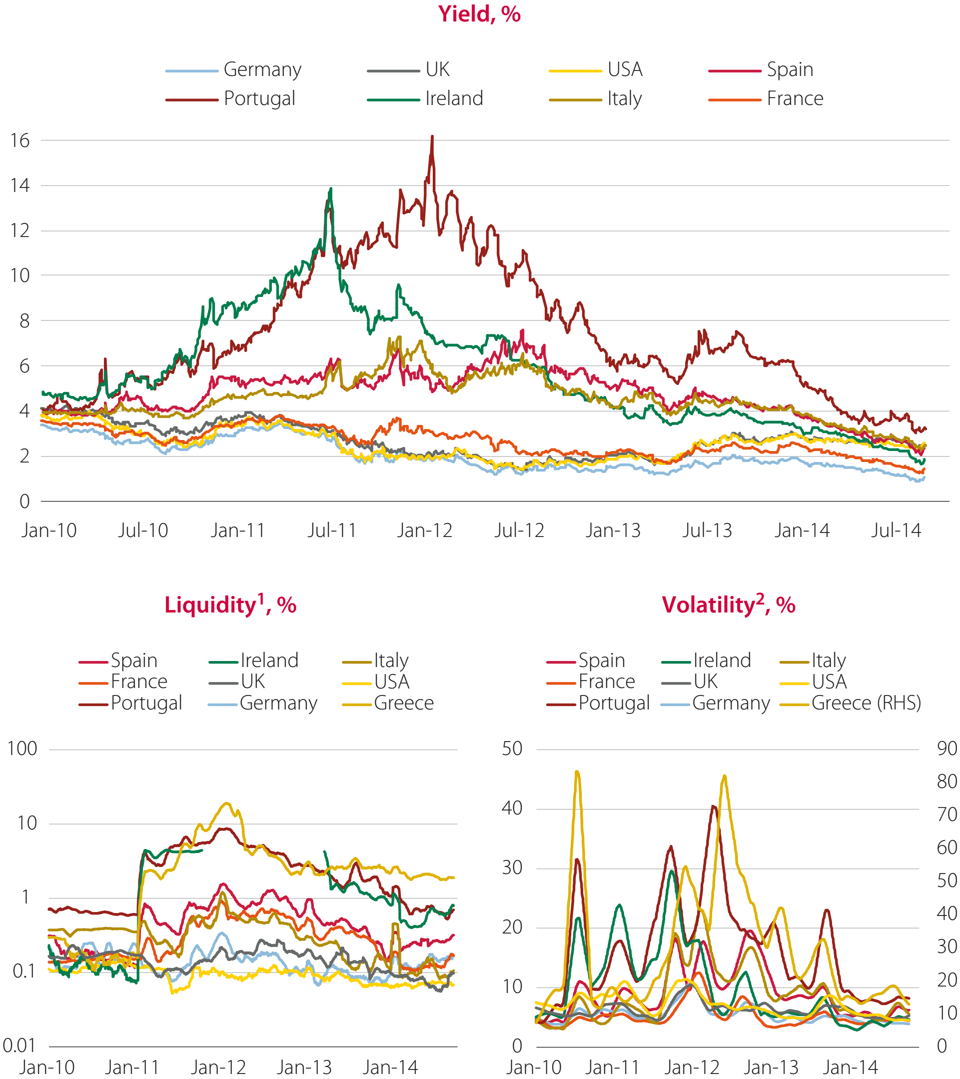
Inflation rates held near 2% in recent months in both the United States and the United Kingdom. In the euro area, growth in consumer prices has been running below 1% since October 2013, conjuring the spectre of deflation. Monetary policies, meantime, remained broadly accommodative though with certain major differences. In the United States, for instance, the rebound in activity and employment has enabled the monetary authority to wind down its monthly bond purchases. These now stand at 25 billion dollars, a full 60 billion less than at year-end 2013, and the Federal Reserve has announced a further cut to 15 billion starting in October. In the euro area, conversely, the ECB cut its policy rates in June and September to a record low of 0.05%, and has unveiled new unconventional measures: among them, its targeted longer-term refinancing operations (TLTRO), which banks can tap as a function of their (non-mortgage) lending. Europe's central bank will also activate a new programme in October for the purchase of private-sector assets, including mortgage covered bonds and certain asset-backed securities[3].

3 The ECB will buy asset-backed securities (ABS) whose underlying assets are claims against the euro area non-financial private sector under the ABSPP (ABS Purchase Programme), and mortgage covered bonds under the newly launched CBPP3 (Covered Bonds Purchase Programme).

In international debt markets, the long-term yields of main sovereign benchmarks have headed lower in the main, with rather less intensity in the case of US treasuries and UK gilts. In these two economies, yields narrowed by a bare 50 bp vs. year-end 2013 to mid-September values of 2.6% and 2.5% respectively. The greater strength of their activity is presumably the prime cause of this downside resistance.

Yields of long-term sovereign benchmarks have trended lower in the year…

Ten-year sovereign bond market indicators FIGURE 3



Source: Bloomberg, Thomson Datastream and CNMV. Data to 15 September.

1 Monthly average of the daily bid-ask spread of ten-year sovereign yields (on a logarithmic scale).

2 Annualised standard deviation of daily changes in 40-day sovereign bond prices. Moving average of 50 periods.

Euro-area yields have to date run down more steeply. The improved prospects for Europe's peripheral economies have spurred purchases of their debt, thereby further compressing sovereign yields –to 1.9%, 2.3% and 2.5% in Ireland, Spain and Italy respectively after year-to-date declines upwards of 1.5 pp. These values, improving on pre-crisis levels, may denote a degree of uncoupling from macroeconomic fundamentals. Among the larger European economies, German bond yields fell by 0.92 pp to 1.02% while the yield on the French bond tightened by 1.1 pp to

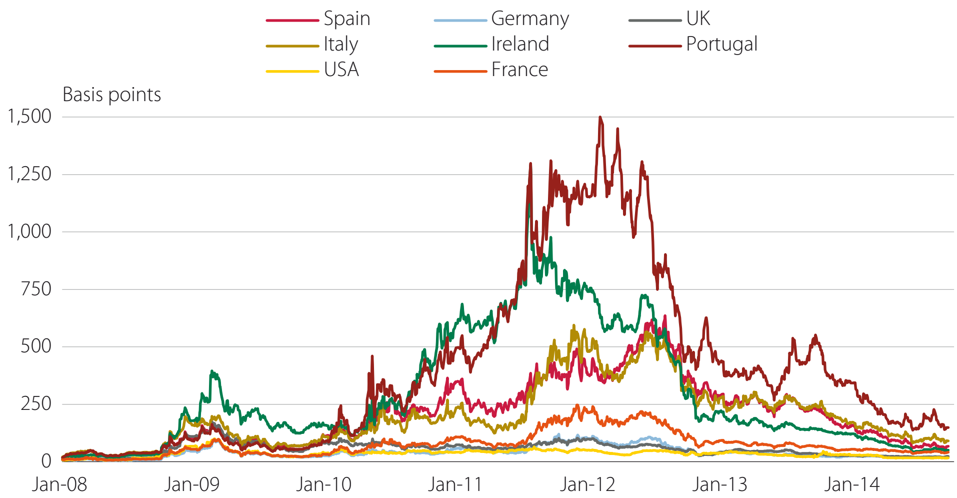
… more steeply among European economies, on account of their greater macroeconomic frailty and increased investment flows to peripheral countries.

1.4%. This converging performance, at odds with the experience of prior years, may respond to the frailty of both countries' second-quarter economic figures.

Sovereign risk spreads are near or below their pre-crisis levels.

The compression of peripheral risk premiums has continued all year, in line with the moderation of debt market tensions and countries' improved economic outlooks. From December 2013 to mid-September 2014, the 5-year CDS spreads on 10-year sovereign bonds fell by between 70 and 180 bp. As we can see from figure 4, these risk spreads are, in most cases, near to or lower than the values prevailing at the start of the crisis. In corporate bond markets, reduced levels of high-yield spreads reflected the continuing predominance of "search for yield" strategies. The downtrend, however, reversed at the start of June, with spreads widening thereafter by around 60 bp in the US and 85 bp in Europe (see figure 5).

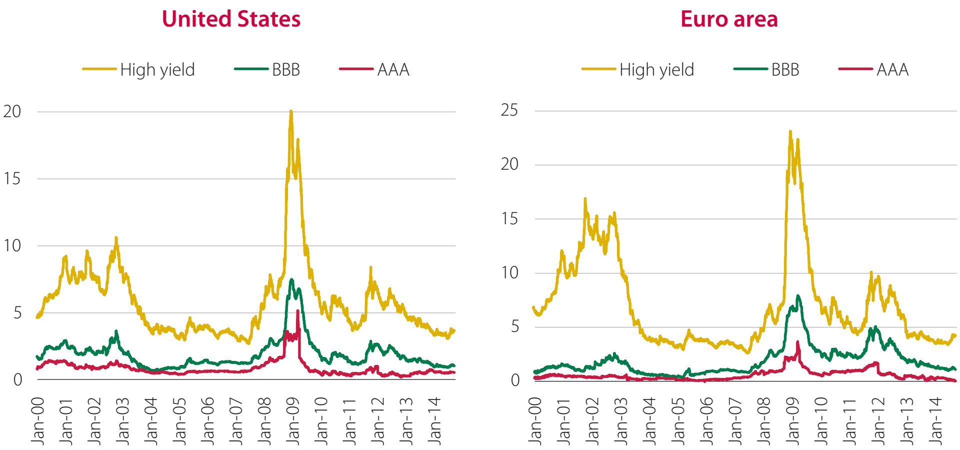
Sovereign credit spreads (five-year CDS) FIGURE 4



Source: Thomson Datastream. Data to 15 September.

Corporate bond spreads FIGURE 5

Spread vs. the 10-year government bond, in percentage points[1]



Source: Thomson Datastream and CNMV.

1 In the euro area, versus the German benchmark.

Net long-term issuance on global debt markets summed just over 2.5 trillion dollars year to date (in annualised terms), 29.5% less than in the same period in 2013. Leading the decline was public sector issuance, which slowed to a trickle, in Europe especially, during the first months of the second-half period (see figure 6). In this region, the reduction in public sector borrowing requirements ensuing from fiscal consolidation was intense enough to take net issuance into negative territory (i.e., with redemptions of long-term bonds exceeding the amounts issued). In the private sector of the economy, net year-to-date issuance by financial corporations climbed to 357 billion dollars from last year's 223 billion, while that of non-financial corporations fell from 851 to 574 billion. However, as we can see from figure 6, there were major differences both between regions and in the timing of issuance. Among US financial corporations, net debt volumes have been positive for several quarters, while in the case of Europe they turned negative once more in the middle months of 2014. Among non-financial corporations, the issuance decline was similar across main economic regions.

Net debt issuance recedes by 29.5% to 2.5 trillion dollars on lower public sector borrowing requirements.

Gross international debt issuance FIGURE 6

Source: Dealogic. Half-year data. Data for the second half of 2014 run to 15 September, but are restated on a semiannual basis to facilitate comparison.

Risk appetite and low-key volatility continue to set the tone for equity markets. The index gains of the first six months give way to a more disparate third-quarter performance…

Equity markets continued to reap the benefits of investors' growing appetite for risk in a context of muted volatility. That said, advanced economy stock indices began pulling apart in the third quarter after a strong first-half advance. In Europe, particularly, weak activity figures for core economies and the geopolitical tensions emanating from conflict areas weighed heavily enough on key indices to annul the boost effect of the ECB's announced measures, resulting in quarterly price variations ranging from the -2.2% of the Mib 30 to the 0.7% of the Euronext 100.

… with some European indices pressured by weak macro data and geopolitical tensions, despite the soothing balm of ECB measures.

The lead in year-to-date terms goes to US indices with gains ranging from the 2.7% of the Dow Jones to the Nasdaq's 8.2%. Euro-area indices, meantime, posted advances running from the 1.1% of the Dax 30 to the 9.3% of the Ibex 35, despite the reversal experienced in the middle months. In Japan, the Topix rose by 0.9% while the Nikkei ceded 2.1%. Japanese indices strengthened in both the second and third quarters, but their year-to-date performance was marred by heavy losses in the opening months.

Performance of main stock indices[1] TABLE 1

									3Q 14 (to 15 September)		
%	2010	2011	2012	2013	3Q 13	4Q 13	1Q 14	2Q 14	%/prior qt.	%/ Dec 13	% y/y[2]
World											
MSCI World	9.6	-7.6	13.2	24.1	7.7	7.6	0.8	4.2	-0.9	4.0	12.6
Euro area											
Eurostoxx 50	-5.8	-17.1	13.8	17.9	11.2	7.5	1.7	2.1	0.1	3.9	12.7
Euronext 100	1.0	-14.2	14.8	19.0	10.3	4.4	2.7	1.1	0.7	4.5	9.6
Dax 30	16.1	-14.7	29.1	25.5	8.0	11.1	0.0	2.9	-1.8	1.1	13.5
Cac 40	-3.3	-17.0	15.2	18.0	10.8	3.7	2.2	0.7	0.1	3.1	7.6
Mib 30	-8.7	-24.0	10.2	18.8	11.8	9.4	13.6	-2.2	-2.2	8.6	17.9
Ibex 35	-17.4	-13.1	-4.7	21.4	18.3	8.0	4.3	5.6	-0.8	9.3	21.2
United Kingdom											
FTSE 100	9.0	-5.6	5.8	14.4	4.0	4.4	-2.2	2.2	0.9	0.8	3.3
United States											
Dow Jones	11.0	5.5	7.3	26.5	1.5	9.6	-0.7	2.2	1.2	2.7	10.8
S&P 500	12.8	0.0	13.4	29.6	4.7	9.9	1.3	4.7	1.2	7.3	17.5
Nasdaq-Cpte	16.9	-1.8	15.9	38.3	10.8	10.7	0.5	5.0	2.5	8.2	21.4
Japan											
Nikkei 225	-3.0	-17.3	22.9	56.7	5.7	12.7	-9.0	2.3	5.2	-2.1	10.7
Topix	-1.0	-18.9	18.0	51.5	5.3	9.1	-7.6	5.0	4.1	0.9	10.8

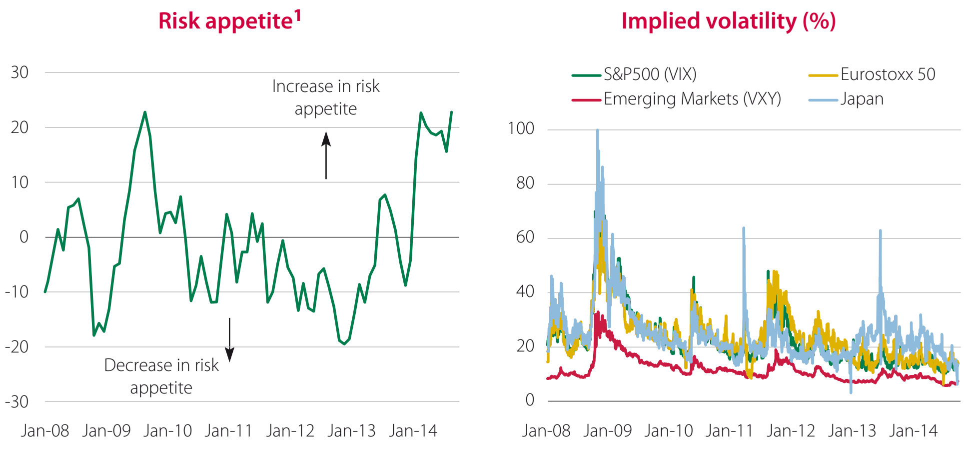
Source: Datastream.

1 In local currency.

2 Year-on-year change to the reference date.

Financial market indicators

FIGURE 7



Source: Thomson Datastream and CNMV.

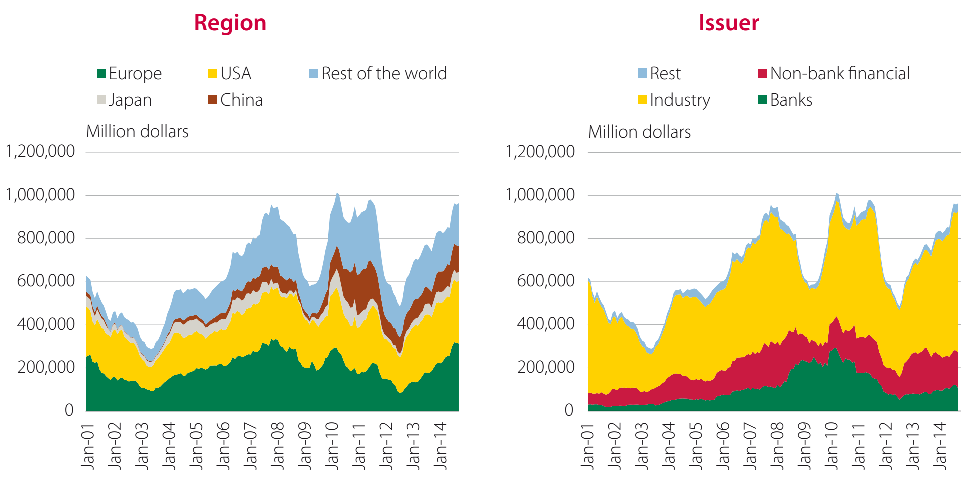
1 State Street indicator.

The value of equity issues on world financial markets came to 692 billion dollars between January and mid-September, a 23.2% increase over the year-ago period. Of the various issuance formats, the most popular were public offers for subscription, which raised over 154 billion dollars in all (54.3% more than in 2013). Investors' keener appetite for risk combined with generally buoyant markets favoured the issuance of shares to the detriment of less risky instruments. This was especially true in Europe and China, where rates of advance reached 63.5% and 48.8% respectively. A breakdown by sector gives industrial firms (ex. utilities) a growth lead, with 33.9% more capital raised, followed by the +11% of the banking sector. In cumulative twelve-month terms, global equity issuance stood at 964 billion dollars, closing in on the ten-year highs recorded in spring 2010 (see figure 8).

Global equity issuance approaches 700 billion euros, 23% more than in 2013, with Europe and China especially dynamic.

Global equity issuance

FIGURE 8



Source: Dealogic. Cumulative twelve-month data to 15 September. For comparative purposes, the figure for this month is restated on a monthly basis.

2.2 National economic and financial developments

Spain records second-quarter GDP growth sizeably ahead of the euro area.

According to the latest data from Quarterly National Accounts, corresponding to the second quarter of 2014, the Spanish economy expanded 0.6% in quarterly terms, lifting the year-on-year rate to 1.2%. This brisker activity stands in contrast to the muted growth of the euro area (0.05% quarterly and 0.8% annual rate in the second quarter), weighed down by the worsening figures for Germany and France. The result was that Spain outperformed the euro area in annual GDP rates for the first time in five years.

The domestic demand contribution expands from 0.7 to 1.9 points while net exports detract 0.7 points (-0.2 in the first quarter).

Domestic demand came forward strongly with a growth contribution of 1.9 points, up from 0.7 in the first quarter, while the negative contribution of net exports deepened from -0.2 to -0.7 points. The two main domestic demand components gained speed vs. the opening quarter, with final household consumption advancing 2.4% (0.7 points more) and gross fixed capital formation up by 1.2% (2.4 points more). An encouraging development here was the slower decline of the construction sector (just -3.4% in the second quarter against -8.6% in the first). Finally, both exports and imports, particularly the former, lost steam compared to the first quarter.

Excepting primary activities, all sectors of the economy strengthen vs. the previous quarter.

As supply side analysis of GDP shows that industry, construction and services all improved on their first-quarter showing, with annual growth in gross value added quickening from 0.5% to 1.1%, -8.1% to -3.1%, and 0.9% to 1.5% respectively, in contrast to the GVA shrinkage of primary activities.

Spain: Main macroeconomic variables (annual % change) TABLE 2

					EC[1]	
	2010	2011	2012	2013	2014F	2015F
GDP	**-0.2**	**0.1**	**-1.6**	**-1.2**	**1.1**	**2.1**
Private consumption	0.1	-1.2	-2.8	-2.1	1.3	1.6
Government consumption	1.5	-0.5	-4.8	-2.3	-0.8	-0.7
Gross fixed capital formation, of which:	-5.5	-5.4	-7.0	-5.0	-1.4	4.2
Construction	-9.9	-10.8	-9.7	-9.6	n.a.	n.a.
Equipment and others	5.0	5.6	-3.9	2.3	6.5	8.2
Exports	11.7	7.7	2.1	4.9	5.5	6.7
Imports	9.4	0.0	-5.7	0.4	3.4	5.8
Net exports (growth contribution, p.p.)	0.4	2.1	2.5	1.5	0.8	0.5
Employment[2]	-2.3	-2.2	-4.8	-3.4	0.4	1.2
Unemployment rate	19.9	21.4	24.8	26.1	25.5	24.0
Consumer price index	1.8	3.2	2.4	1.4	0.1	0.8
Current account balance (% GDP)	-4.5	-3.7	-1.2	0.8	1.4	1.5
General government balance (% GDP)[3]	-9.6	-9.6	-10.6	-7.1	-5.6	-6.1
Public debt (% GDP)	61.7	70.5	86.0	93.9	100.2	103.8
Net international investment position (% GDP)[4, 5]	-92.0	-83.6	-68.4	-84.4	n.a.	n.a.

Source: Thomson Datastream, European Commission, Banco de España and National Statistics Office (INE).

1 European Commission forecasts of May 2014.

2 In full-time equivalent jobs.

3 Figures for 2011, 2012 and 2013 include government aid to credit institutions amounting to 0.5%, 3.8% and 0.47% of GDP respectively.

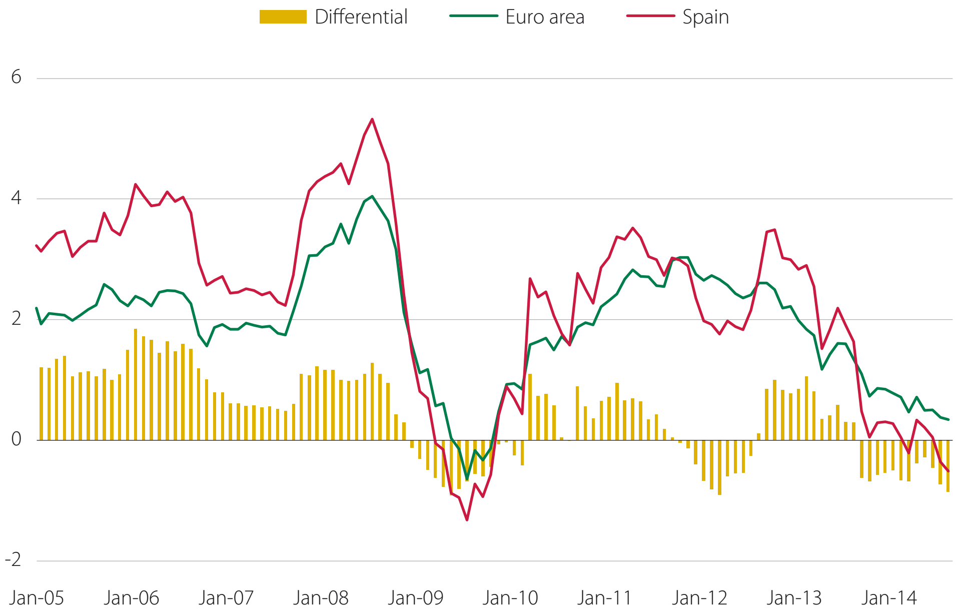
4 Ex. Banco de España.

n.a.: Not available.

After hovering near zero over the first half of the year, Spanish inflation turned negative in the summer months. August's -0.5% was substantially below the euro area headline rate (see figure 9), while the core rate stood at zero for the fourth consecutive month. By component, prices of non-energy industrial goods moved in negative terrain (as they have for a year), joined more recently by food prices, especially of fresh produce. Service prices, finally, made a slightly positive contribution in year-on-year terms.

CPI rates border on zero for the first six months, then fall steeply into negative territory.

Harmonised index of consumer prices: Spain *vs.* euro area (annual % change) FIGURE 9



Source: Thomson Datastream. Data to August.

Labour market figures are beginning to reflect the recent upturn in economic activity. Employment in terms of full-time equivalent jobs rose by 0.6% in the second quarter and 0.8% year on year (127,000 jobs in a year) in what was the first positive annual variation since the second quarter of 2008. The unemployment rate eased in consequence from 25.9% in the first quarter to 24.5% in the second, equating to just over 5.6 million people without work.

The labour market begins to reflect the pick-up in domestic activity, in the shape of 127,000 new jobs in a year and a 1.5-point cut in the unemployment rate to 24.5% of the active population.

According to available budgetary execution figures, the public deficit to the month of July was 3.08% of GDP compared to the 3.6% of one year before. The decline in the central government deficit was secured on a combination of 3% higher non-financial resources and 2.6% lower non-financial uses. The deficit to May of all branches of government except local authorities came to 2.35% of GDP (2.48% in 2013), of which 0.6% corresponded to the regions (autonomous communities). Finally, the social security system recorded a surplus of 0.52%.

The public deficit is also being reined back, though progress is slow.

General government debt stood at just over one trillion euros in the second quarter, according to the methodology of the European System of National and Regional Accounts (ESA 2010), whose Regulation came into force on 1 September 2014. The enlarged perimeter of general government introduced by the new system adds al-

Public debt tops the one trillion mark in the second quarter, due partly to the effects of an accounting change.

most 6 billion euros to the debt figure[4] with respect to the old format. Note, in this respect, that GDP too will be revised upwards under ESA 2010, leading in all probability to a sizeable reduction in the public debt ratio[5].

Forecasts for the Spanish economy

EXHIBIT 1

Short and medium-term forecasts for the Spanish economy have improved in recent months, with both domestic institutions and international organisations revising up growth expectations for this year and next. In its July forecasts, for instance, the Banco de España boosted its GDP growth estimates by 0.1 points (from 1.2% to 1.3%) for 2014 and 0.3 points for 2015 (from 1.7% to 2.0%) with respect to the figures published last March. And in a similar move, the forecasting panel of savings bank foundation FUNCAS raised its growth projections for this year and next from 1.0% and 1.8% in March respectively to 1.2% and 1.9% in the survey of July.

International organisations the International Monetary Fund (IMF) and OECD also revised up forecasts for Spain in the latest of their regular analyses of the global economy. The Fund, in its *World Economic Outlook* (WEO) of last July, projected growth rates of 1.2% and 1.6% for this and next year, against its April forecast of 0.9% this year, rising to 1% in 2015. In the same publication, it lowered its global growth estimate for 2014 by 0.3 points (from 3.7% to 3.4%)[1], while leaving its 2015 forecast unchanged at 4%.

Forecast for main macro-variables

TABLE E.1.1

Change[1]

	Banco de España		FUNCAS		IMF		OECD	
	2014	2015	2014	2015	2014	2015	2014	2015
GDP	1.3 (0.1)	2.0 (0.3)	1.2 (0.2)	1.9 (0.1)	1.2 (0.3)	1.6 (0.6)	1.2 (0.2)	1.6 (0.1)
Private consumption	1.6 (0.5)	1.6 (0.4)	1.5 (0.5)	1.6 (0.2)	–	–	2.1 (1.1)	1.8 (0.8)
Government consumption	-0.8 (0.7)	-1.5 (1.0)	-0.9 (1.1)	-0.5 (-0.2)	–	–	-0.3 (3.3)	-1.5 (1.0)
Gross capital formation	1.8 (1.8)	4.2 (0.0)	0.5 (0.4)	2.9 (0.4)	–	–	0.6 (0.3)	2.9 (0.9)
Exports of goods and services	4.6 (-0.5)	5.9 (-0.2)	5.2 (-0.2)	5.7 (-0.2)	–	–	3.7 (-1.9)	5.9 (-0.4)
Imports of goods and services	4.7 (1.7)	4.5 (0.1)	4.6 (1.3)	4.8 (-0.1)	–	–	4.3 (1.7)	5.2 (1.4)
Employment	0.4 (0.0)	1.4 (0.5)	0.5 (0.1)	1.3 (0.2)	–	–	0.8	1.1

Source: CNMV.

1 The figures in brackets correspond to the difference between the organisation's latest and previous forecast. In the case of FUNCAS, the previous forecast is as published in its March report as opposed to its subsequent report in May (to maintain a comparable time lag between predictions).

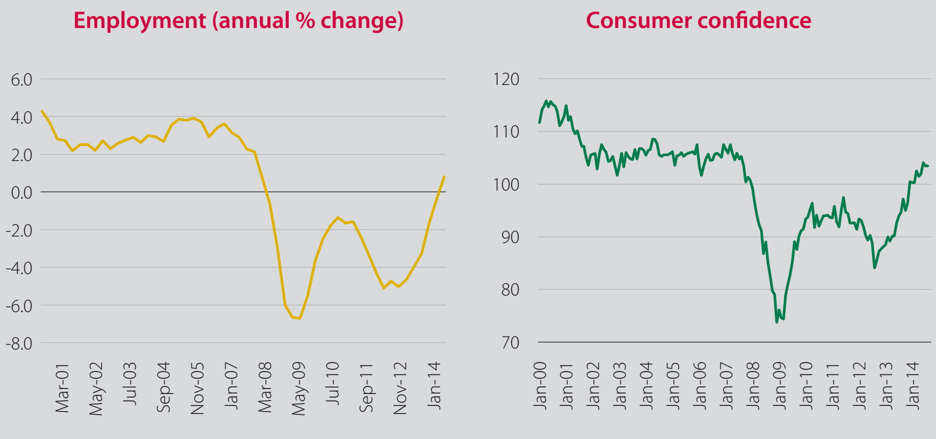
4 In accordance with the EDP (Excessive Deficit Procedure).

5 Banco de España has announced that it will update the public debt/GDP ratios on its website following the National Statistics Office's publication of annual GDP estimates on 25 September and quarterly estimates in October.

The latest report is the OECD's economic survey, released in early September 2014, in which this organisation revisits its own projections for the Spanish economy, made last May. The result is a revise-up in growth forecasts to 1.2% in 2014 and 1.6% in 2015, an increase of 0.2 points and 0.1 points respectively.

But what are the reasons that moved these organisations to revise their forecasts in the last quarter? On the one hand, financial conditions have become more supportive, in the shape of lower long-term interest rates in the advanced economies and a degree of stabilisation on financial markets. In the euro area, specifically, lower-than-expected inflation has enabled the ECB to cut its policy rates at the same time as it has activated a series of expansionary measures over and above existing programmes. On the other, referring to the particular circumstances of Spain, the more upbeat projections for short and mid-term growth hang particularly on a growing contribution of domestic demand, assisted by the gradual restoral of confidence and improved labour market readings. Banco de España, for example, forecasts that private consumption will rise by 1.6% both this year and next (against its March predictions of 1.1% and 1.2%), while the OECD augurs 2.1% growth in 2014 and 1.8% in 2015. Other upside factors in view of their potential growth benefits are the recent tax reform and the fiscal strategy mapped out in the Government's Stability Programme for 2014-2017. Further, the process of financial system recapitalisation and restructuring has strengthened the liquidity and capital positions of Spanish banks and lowered the cost of capital market financing, thanks to the efforts of individual institutions and the reform package implemented by the Government with the help of the EU. And this seems certain to have influenced forecaster sentiment.

Employment and confidence FIGURE E.1.1



Source: Thomson Datastream.

Forecasters also point to the persistence of downside risks for growth projections, especially in 2015. In a country with its particularities, Spain's high level of public debt is a major vulnerability factor in the event of an upturn in sovereign rates. Also, concerns have been voiced that meeting the current deficit targets (5.5% for

2014 and 4.2% for 2015) will require deeper-than-projected budgetary consolidation, which could end up sapping domestic demand.

On the external demand front, the growth weakness of Spain's main trading partners could hurt its export markets, and demand some adjustment of forecasts under this head[2].

1 The main cause of the revise-down in global growth for 2014 was the weakness of the US economy in the opening months, which has dampened growth expectations from 2.8% to 1.7%.
2 Some reports have already cut projections of export growth in view of the poorer expectations for certain emerging market economies. Banco de España, for instance, has reduced them by 0.5 points for 2014 and 0.2 points for 2015, as far as 4.6% and 5.9% respectively.

The Spanish banking system is making progress even in the face of weak activity and high bad debt. Factors in support include income statement and share price growth along with easier funding conditions. Stress test results will be key to shoring up confidence in the sector.

Spain's banking sector remains immersed in the clean-up and restructuring process initiated in 2012. The task of rationalising institutions is proceeding to plan, but banking business itself is still having to contend with weak economic activity, which has yet to fully revive despite recent improvement. NPL ratios are still running high, since they reflect the macro situation with a certain time lag, but other fundamental sector variables have begun to turn around. Bank income statements have improved, even among intervened entities, thanks to dwindling provision charges. And funding has become easier now markets have steadied, alleviating the fragmentation observable in the euro area. Banks, it appears, are also readier to lend: the amount of outstanding loans continues to fall, but the pace is decelerating. Looking ahead, the results of Europe's planned stress tests could prove crucial in determining agent expectations for the sector.

Banks' aggregate profits climb from 621 million in 1Q 2013 to 3.70 billion in the same period this year.

The Spanish banking sector obtained first-quarter profits of 3.70 billion euros, well clear of the 621 million reported in 2013. At the top of income statements, net interest income decreased by an additional 7.4% to 6.40 billion euros, due to the slowness of business and, more so, the persistence of reduced interest rates, which complicate life for these institutions. However, higher income from equity instruments, operating cost savings and lower financial asset impairment losses did enough to boost earnings sector wide.

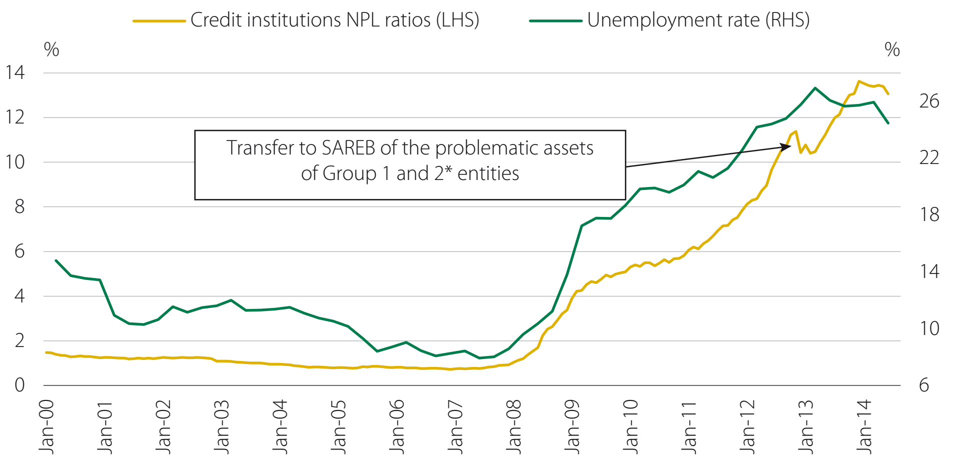
Lending to the private sector of the economy continues to decline, but the pace is slowing.

In this context, bank lending to non-financial sectors of the economy continued to decline, albeit less so than in preceding months. The stock of lending to non-financial corporations contracted 4.7% in July (vs. an annual low in February of -5.9%) with lending to households down 4.5% (-5% in January). In the euro area, loans to businesses and households fell by a lesser 2.3% and 0.5% respectively. The prospect now is that the decline in lending to the Spanish private sector will be tempered further by the upswing in domestic activity and the somewhat easier line on loan approvals being taken by the banks. According to figures from the Encuesta de Préstamos Bancarios (bank lending survey), this relaxation is more apparent in short maturities and loans to SMEs.

The June NPL ratio stands at 13.1% of total loans.

Bank sector NPL ratios stood at 13.1% of total loans (see figure 10), a small improvement over the four previous months (13.4%).

Credit institution NPL ratios and the unemployment rate[1] FIGURE 10



Source: Banco de España and National Statistics Office. Data to June 2014.

1 Percentage of the active population.

* Group 1 transfers took place in December 2012 (36.69 billion euros) and those of Group 2 in February 2013 (14.09 billion euros).

Key developments include a smaller sector balance sheet and the realignment of funding sources with the emphasis on capital.

Bank sector funding requirements have continued to ease, so the far better financing conditions available have not brought a significant increase in fixed-income issuance. In fact, a look at the liabilities of financial institutions, now at less than three trillion euros[6] overall, reveals a shift in the funding mix towards capital sources and away from deposits[7], bonds and Eurosystem borrowings[8].

Non-financial listed companies grow their profits 3.9% in the first six months with construction and real estate operators to the fore…

Non-financial listed companies obtained 8.63 billion profits in the first half of 2014, 3.9% more than in the same period last year. Heading the list were companies in the construction and real estate sector, with 829 million profits contrasting with more than 500 million losses in first-half 2013 (see table 3). Industrial firms too performed strongly, with profits growth of 5.2% to 664 million euros. Conversely, the profits of energy and, above all, retail and services operators fell by 3.8% to 5.48 billion and by 35% to 1.62 billion euros respectively compared to the year-ago period. That said, energy sector earnings remain the highest in straight-money terms, amounting to 64% of the June 2014 total (68% in June 2013).

… as well as trimming their debt by 3.3% to 265 billion euros.

The aggregate debt of non-financial listed companies dropped by 3.3% in the first-half period to 265 billion euros, with the energy sector contributing 76% of the decline. Aggregate leverage, defined as debt to equity, reduced in all sectors with the exception of industry (up from 0.6 to 1.0) to close the first six months at 1.32 vs. 1.33 one year before (see table 4). Companies' debt coverage ratio, measuring the years needed to repay existing debt assuming constant EBITDA, was largely unchanged at 4.3. Finally, interest cover (EBIT/interest expenses) improved between end-2013 and June 2014 after deteriorating solidly since 2010, with all sectors, except industrial companies, sharing in the advance.

6 For the first time since March 2008.

7 Especially credit system deposits. Deposits of other resident sectors (business and households) held more or less flat in 2014 at 1.3 trillion euros.

8 Net Eurosystem borrowing was 162.5 billion euros in August (188.8 billion in January).

Earnings by sector[1]: Non-financial listed companies

TABLE 3

	EBITDA[2]		EBIT[3]		Profit for the year	
Million euros	1H 13	1H 14	1H 13	1H 14	1H 13	1H 14
Energy	10,471	11,775	6,176	7,282	5,690	5,479
Industry	2,085	2,236	1,311	1,414	631	664
Retail and services	13,698	13,656	6,456	7,198	2,496	1,624
Construction and real estate	3,182	3,021	1,654	1,850	-517	829
Adjustments	-69	-59	-21	-16	7	32
TOTAL	**29,367**	**30,629**	**15,576**	**17,728**	**8,307**	**8,628**

Source: CNMV.

1 Year to date.

2 Earnings before interest, taxes, depreciation and amortisation.

3 Earnings before interest and taxes.

Gross debt by sector: Listed companies

TABLE 4

Million euros		2010	2011	2012	2013	Jun 14
Energy	Debt	98,283	95,853	91,233	82,146	75,363
	Debt/ Equity	0.95	0.92	0.85	0.75	0.68
	Debt/ EBITDA[1]	2.81	3.27	3.26	3.41	3.20
	EBIT[2]/ Interest expenses	4.15	3.30	3.14	2.90	3.48
Industry	Debt	14,948	17,586	17,232	16,609	18,145
	Debt/ Equity	0.58	0.63	0.63	0.62	1.03
	Debt/ EBITDA	2.11	2.54	2.38	2.17	4.06
	EBIT/ Interest expenses	5.00	3.90	3.82	4.56	2.41
Retail and services	Debt	115,413	113,142	117,359	111,795	109,503
	Debt/ Equity	1.60	2.01	2.00	1.99	1.95
	Debt/ EBITDA	3.38	3.78	4.01	3.90	4.01
	EBIT/ Interest expenses	3.94	2.45	2.02	2.08	2.21
Construction and real estate	Debt	99,917	83,716	76,236	65,066	63,637
	Debt/ Equity	3.42	2.98	3.51	4.46	3.59
	Debt/ EBITDA	11.18	15.00	15.17	18.87	10.53
	EBIT/ Interest expenses	0.98	0.52	0.32	0.09	0.92
Adjustments[3]	Debt	-1,792	-1,404	-1,429	-1,395	-1,376
TOTAL	**Debt**	**326,769**	**308,893**	**300,633**	**274,221**	**265,271**
	Debt/ Equity	1.43	1.44	1.41	1.33	1.32
	Debt/ EBITDA	3.84	4.29	4.32	4.29	4.33
	EBIT/ Interest expenses	3.12	2.30	2.06	1.99	2.24

Source: CNMV.

1 Earnings before interest, taxes, depreciation and amortisation.

2 Earnings before interest and taxes.

3 In drawing up this table, we eliminated the debt of issuers consolidating accounts with some other Spanish listed group. The figures in the adjustments row include eliminations corresponding to subsidiary companies with their parent in another sector.

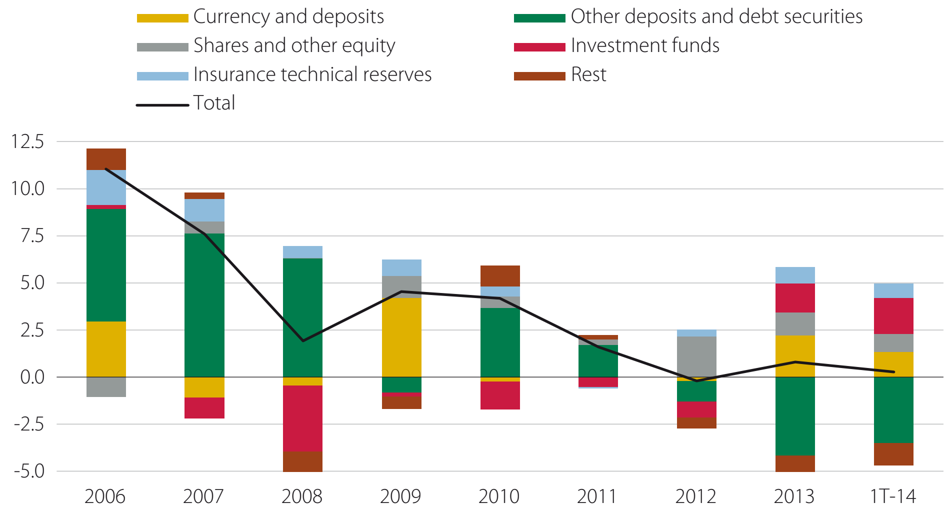
The latest indicators on the financial position of households show that the savings rate slide has lasted into 2014 on a combination of lower disposable income and a small upturn in consumer spending. The first-quarter rate stood at 9.4% of disposable income (average of the last four quarters), below the 10.4% of December 2013 and distant from the 18% levels of late 2009. Households' net wealth (financial and real estate assets minus liabilities) moved up slightly in a break with the downtrend of recent years on the rising value of shares and lower debt. Real estate assets continued to depreciate.

Household savings rates drop below 10% of disposable income, while their net wealth rises slightly on financial asset appreciation and lower levels of debt.

Cumulative four-quarter data to the first quarter of 2014 put households' net financial asset acquisitions at 0.3% of GDP (0.8% in 2013 and -0.2% in 2012). Divestments again centred on time deposits and fixed-income assets (a combined 3.5% of GDP) as households prolonged their growing preference for investment funds (1.9% of GDP), currency and deposits (1.3%) and shares and other equity (1%).

Households scale back their financial investments with a preference for investment funds, currency and deposits, and shares.

Households: Financial asset acquisitions (% GDP) FIGURE 11



Source: Banco de España, *Cuentas Financieras*. Cumulative four-quarter data.

2.3 Outlook

In its latest forecasts, the International Monetary Fund (IMF) projects global growth of 3.4% in 2014 and 4% in 2015 (see table). In the case of 2014, this is 0.3 points less than in the previous round due to revised-down estimates for both the US economy, after the growth dent of the first quarter, and, to a lesser degree, the emerging market economies. The emerging group are now expected to expand 4.6% this year, in line with 2013, and resume growth upwards of 5% in 2015.

Global GDP growth of 3.4% in 2014 and 4% in 2015, according to the IMF…

The following main risks are identified for the macroeconomic scenario : (i) prolonged geopolitical tensions in certain regions or countries, leading to sharply higher oil prices and a deterioration of investor confidence; (ii) interest rate rises earlier and sharper than expected, particularly in the United States, causing a reversal of risk sentiment and risk spread compression, and (iii) persistently low inflation and growth rates in Europe, in view of the faltering mid-year figures of some of its largest economies.

… though downside risks loom large in the shape of geopolitical tensions, a possible upturn in interest rates and stagnation in Europe.

Gross domestic product (annual % change) TABLE 5

	2010	2011	2012	2013	IMF[1] 2014F	IMF[1] 2015F
World	5.2	3.9	3.5	3.2	3.4 (-0.3)	4.0 (=)
United States	2.5	1.6	2.8	1.9	1.7 (-1.1)	3.0 (+0.1)
Euro area	1.9	1.8	-0.7	-0.4	1.1 (=)	1.5 (+0.1)
Germany	3.9	3.7	0.9	0.5	1.9 (+0.2)	1.7 (+0.1)
France	1.9	2.1	0.3	0.3	0.7 (-0.3)	1.4 (-0.1)
Italy	1.7	0.6	-2.4	-1.9	0.3 (-0.3)	1.1 (=)
Spain	-0.2	0.1	-1.6	-1.2	1.2 (+0.3)	1.6 (+0.6)
United Kingdom	1.7	1.1	0.3	1.7	3.2 (+0.4)	2.7 (+0.2)
Japan	4.7	-0.4	1.4	1.5	1.6 (+0.3)	1.1 (+0.1)
Emerging economies	7.5	6.3	5.1	4.7	4.6 (-0.2)	5.2 (-0.1)

Source: Thomson Datastream and IMF.

1 In brackets, change vs. the previous forecast. IMF, forecasts published July 2014 with respect to the month of April.

Growth forecasts for Spain have been revised up strongly in recent months, but the more upbeat scenario is not devoid of risks.

The IMF projects that the Spanish economy will grow 1.2% in 2014 and 1.6% in 2015. This marks an upward revision of 0.3 and 0.6 points respectively over the previous forecast, but still stands slightly below the estimates of other institutions and analysts, for 2015 especially (see exhibit 1). The main risks confronting the economy refer to the stringencies of fiscal consolidation in a context of less-than-robust growth (with public debt approaching 100% of GDP), the successful conclusion of the bank sector clean-up and restructuring, and the need to make inroads into jobless totals.

3 Spanish markets

3.1 Equity markets

Share prices steady after the run-up of the first six months against a backdrop of increased trading and low-key volatility.

Equity markets entered a more settled phase after the bull run of the first-half period. Market-relevant news emerging in the third quarter exerted contrasting effects that tended to cancel each other out: geopolitical tensions and the weakness of euro-area macro figures bearing down on prices, and the ECB's measures helping to buoy them up. Trading volumes continued to expand on the raft of available liquidity and the attractiveness of equities relative to other instruments with a lower expected return. Market volatility was contained at lower than 20%, while liquidity conditions remained well within the comfort zone.

The Ibex 35 trades sideways after the advances of the previous quarters, and posts a year-to-date rise of 9.3%, ahead of other leading European indices.

The Ibex 35 followed up the 4.3% and 5.6% gains of the first and second quarter respectively with a jagged sideways movement, and finally closed the third quarter 0.8% down, giving a year-to-date advance of 9.3%. Other Spanish share indices traced a similar course, with the Madrid General Index (IGBM) posting 4.4%, 5.7% and -1.0% in the first three quarters and 9.2% since the start of the year. Small and medium cap indices managed a lower-key 2.8% and 6.2% respectively, after heavy losses in the third quarter. Finally, the indices tracking the Latin American stocks traded on domestic platforms surged by 8.5% (FTSE Latibex Top) and 12.7% (FTSE Latibex All-Share) in the same period, with second and third-quarter gains amply compensating the losses of the opening months (see table 6).

Performance of Spanish stock market indices and sectors (%)

TABLE 6

							3Q 14 (to 15 September)		
Index	**2010**	**2011**	**2012**	**2013**	**1Q 14[1]**	**2Q 14[1]**	**%/prior qt.**	**%/ Dec 13**	**% y/y**
Ibex 35	-17.4	-13.1	-4.7	21.4	4.3	5.6	-0.8	9.3	21,2
Madrid	-19.2	-14.6	-3.8	22.7	4.4	5.7	-1.0	9.2	22,0
Ibex Medium Cap	-5.6	-20.7	13.8	52.0	6.8	2.4	-6.0	2.8	22,0
Ibex Small Cap	-18.3	-25.1	-24.4	44.3	20.5	-1.3	-10.7	6.2	27,2
FTSE Latibex All-Share	9.0	-23.3	-10.7	-20.0	-5.6	6.9	11.7	12.7	6,2
FTSE Latibex Top	9.7	-17.1	-2.6	-12.4	-6.3	7.2	8.0	8.5	6,2
Sector[2]									
Financial and real estate services	**-31.7**	**-18.9**	**-4.7**	**19.9**	**6.4**	**6.1**	**1.1**	**14.0**	**30.3**
Banks	-33.1	-20.3	-4.8	18.8	6.5	6.3	1.5	14.9	31.0
Insurance	-26.4	12.5	-2.0	47.3	2.0	-6.3	-4.8	-9.1	5.5
Real estate and others	-53.3	-47.5	-14.4	38.3	42.3	10.8	-3.8	51.6	101.7
Oil and energy	**-8.6**	**-2.7**	**-16.0**	**19.0**	**8.8**	**8.6**	**-0.3**	**17.8**	**28.0**
Oil	10.2	14.9	-35.4	19.5	1.1	4.0	-2.8	2.2	1.1
Electricity and gas	-14.2	-10.8	-5.4	18.7	11.9	10.4	0.5	24.1	41.0
Basic materials, industry and construction	**-15.2**	**-14.3**	**-8.0**	**28.9**	**11.6**	**6.2**	**-6.3**	**11.1**	**21.4**
Construction	-14.9	-6.9	-9.3	26.5	16.0	6.5	-7.3	14.4	21.3
Manufacture and assembly of capital goods	-29.2	-12.2	-8.8	55.4	-2.4	6.0	-10.9	-7.8	7.2
Minerals, metals and metal processing	-9.1	-33.7	-8.7	11.5	9.2	5.6	3.4	19.2	35.5
Engineering and others	-0.1	-29.0	3.8	7.6	22.0	9.5	-5.5	26.3	36.8
Technology and telecommunications	**-12.8**	**-20.9**	**-18.3**	**22.8**	**-1.3**	**6.3**	**-4.6**	**0.05**	**8.5**
Telecommunications and others	-12.8	-20.8	-23.0	17.1	-1.4	8.2	-4.1	2.3	8.0
Electronics and software	-12.0	-21.3	39.4	56.8	-0.7	-1.4	-7.2	-9.1	10.7
Consumer goods	**17.0**	**5.7**	**55.6**	**17.1**	**-4.3**	**2.8**	**-0.5**	**-2.1**	**7.1**
Textiles, clothing and footwear	28.6	12.7	66.2	13.5	-9.1	3.2	4.5	-1.9	6.8
Food and drink	25.3	-6.3	25.0	4.7	-4.2	5.7	-4.8	-3.6	0.0
Pharmaceutical products and biotechnology	-22.2	-7.3	68.3	39.6	12.1	1.8	-13.4	-1.1	11.5
Consumer services	**-0.1**	**-24.2**	**12.7**	**58.9**	**2.8**	**-1.4**	**-2.5**	**-1.3**	**16.9**
Motorways and car parks	-10.1	-3.7	5.7	36.5	2.6	6.4	-5.5	3.3	22.7
Transport and distribution	55.3	-34.9	29.7	116.4	4.6	-8.5	0.9	-3.4	24.3

Source: BME and Thomson Datastream.

1 Change vs. the previous quarter.

2 IGBM sectors. Under each sector, data are provided for the most representative sub-sectors.

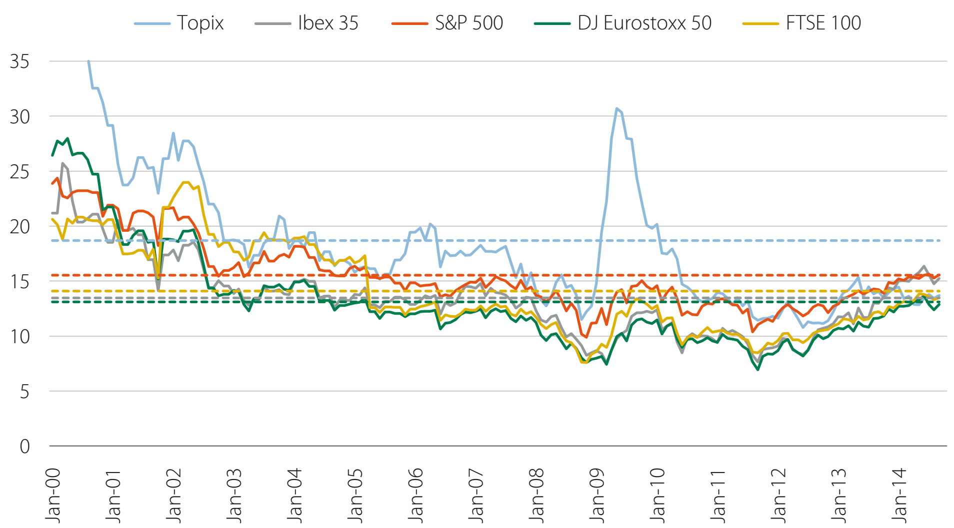
By sector, gains to date run from 0.05% to 17.8%, while consumer goods and services lag behind.

Sector-by-sector analysis reveals a broad-front advance in the first six months, and more mixed results in the third quarter, when the boost effect of the ECB's September package was in some cases insufficient to make up the losses of the preceding weeks. Specifically, five of the market's six major sectors posted third-quarter losses, ranging from the -0.3% of oil and energy to the -6.3% of basic materials, industry and construction. Only one sector, financial and real estate services, posted a timid advance (1.1%), thanks to rising bank shares. On a year-to-date basis, consumer goods and services are the only sectors in negative terrain. Elsewhere, advances run from the 0.05% of technology and telecommunications to the 17.8% of oil and energy (see table 6), by way of financial and real estate services and basic materials, industry and construction with gains of over 10% in the year, and more than 20% in year-on-year terms. The consumer goods sector, meantime, has shed 2.1% of its value and consumer services 1.3%.

Despite some third-quarter slippage, P/E advances to 15.2 times in September, surpassing the average for 2000-2014.

The price/earnings ratio (P/E) of the Ibex 35 jumped from 14.2 to 16.3 times in the first-half period as share prices surged, then sank back to 15.2. As we can see from figure 12, the multiples of leading world indices have headed steadily higher since around mid-2011 and now stand close to their 2000-2014 average. In the case of the Ibex, the average since 2000 (13.5) is below the 15.2 of September 2014. The progress of this indicator could be saying that, in Spain and other countries, current prices are not fully aligned with economic fundamentals.

Price-earnings ratio[1] (P/E) FIGURE 12



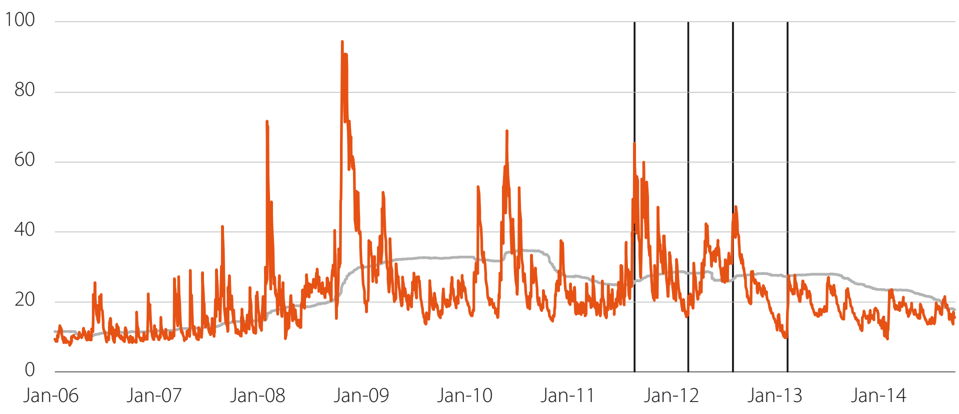
Source: Thomson Datastream. Data to 15 September.

1 Twelve-month forward earnings.

Market volatility holds below 20% practically all year, mirroring the trend observed in other markets.

Ibex 35 volatility has held below the 20% mark practically all year, far from the levels observed during the outbreaks of tension endured by financial markets since 2008. The fall and subsequent stabilisation of market volatility as of 2013 is a trend shared with other equity markets. In September 2014, Ibex volatility stood at 15.6% against a year-to-date average of 17.1% (18.5% in 2013).

Historical volatility of the Ibex 35 FIGURE 13

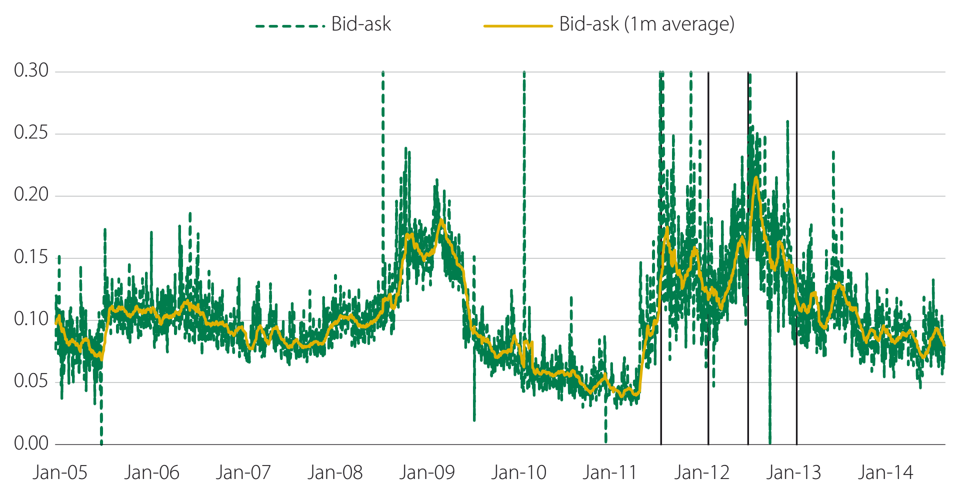


Source: Thomson Datastream and CNMV. Data to 15 September. The red line indicates volatility and the grey line unconditional volatility. The vertical lines refer to the introduction and lifting of the short-selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

Ibex 35 liquidity conditions remained favourable in the third quarter despite a marginal increase in the bid-ask spread around mid-August (see figure 14). Average spreads moved in the 0.081% to 0.087% interval over the first three quarters, below the average recorded since 2003 (0.104%).

Ibex 35 liquidity continues strong despite a small mid-August jump in the bid-ask spread.

Ibex 35 liquidity. Bid-ask spread (%) FIGURE 14

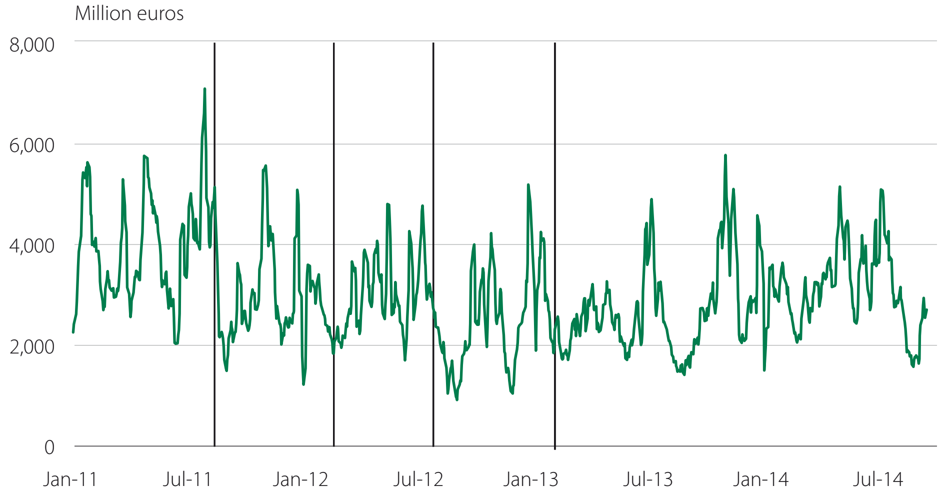


Source: Thomson Datastream and CNMV. Data to 15 September. The curve represents the bid-ask spread of the Ibex 35 along with the average of the last month. The vertical lines refer to the introduction and lifting of the short-selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

Trading on Spanish stock markets summed nearly 578 billion euros in the first three quarters of 2014, 26.8% ahead of the year-ago levels. This upswing, mirrored furthermore on other leading venues, reflects the large-scale move into equity instruments, whose attraction is enhanced at times like the present of surplus liquidity and ultra low interest rates. Average daily volume in the period was 3.20 billion euros, compared to 2.76 billion in 2013 and 2.73 billion in 2012.

Stock market trading expands almost 27%...

Daily trading on the Spanish stock market[1] FIGURE 15



Source: CNMV. Data to 15 September. The vertical lines refer to the introduction and lifting of the short-selling ban running from 11 August 2011 to 16 February 2012, and the later ban starting on 23 July 2012 and ending on 1 February 2013.

1 Moving average of five trading days.

Main novelties of MiFID II affecting market operation EXHIBIT 2

On January 14, 2014, the European Parliament and Council agreed to approve the amendment of Directive 2004/39/EC[1] on Markets in Financial Instruments (henceforth MiFID). The modification will be effected through a Directive[2] (MiFID II) and Regulation (MiFIR) based on the legislative proposals published by the European Commission in 2011.

There follows an outline of the main novelties relative to markets envisaged in the agreement between the European Parliament and Council:

– The regime governing trading infrastructure is modified, while new measures seek to channel the trading of derivatives and equity instruments through recognised trading venues.

– Two reforms are enacted: i) in regard to equities, investment firms running internal order matching systems on a multilateral basis are required to register as multilateral trading facilities, and ii) a new type of multilateral trading system known as an organised trading facility (OTF) comes to join the existing list of systematic internalisers, regulated markets and multilateral trading facilities (MTFs). OTFs will be focused on non-equity instruments, and operators will face restrictions on the use of their own capital to match client orders.

– Shares may only be traded on legally recognised trading venues. This obligation also extends to derivative products listed in the EMIR as being suitable for central clearing, when these are sufficiently liquid.

– Competition is encouraged between trading and clearing systems.

MiFID II establishes a harmonised regime of non-discriminatory access to trading platforms and central counterparties. The former will be obliged to send pertinent trading data to all central counterparties (CCPs) so requesting, and CCPs, in turn, will have to give any requesting platform access to their services. Likewise, those persons with proprietary rights to benchmarks will provide access to their data and calculation methodology.

Transparency requirements are extended to platforms supporting trades in financial instruments other than shares, including bonds or derivative products. Trading venues must make public their pre- and post-trade transparency data on reasonable commercial terms, in order to promote the consolidation of information and its efficient dissemination.

– The revised text strengthens supervisory powers vis à vis commodity derivative markets.

Further to the commitments undertaken by the G20, it introduces a harmonised regime of limits on open positions in these markets in order to improve transparency, promote efficient price formation and prevent market abuse. ESMA will decide the calculation methodology for applying limits on the size of individual net positions. Also, it lays down position reporting obligations for the diversity of market participants, so supervisors and the market itself are better placed to monitor its functioning.

– Controls are imposed on algorithmic trading.

This kind of trading has changed the face of financial market operation. It has at times caused incidents with a distorting effect on price formation, as in the US "flash crash" of May 2010, and is regarded as a possible source of systemic risk. Under MiFID II, specific conditions are imposed on investment firms engaging in this activity and the venues where it is practised.

Firms engaging in algorithmic trading, specifically when pursuing a market-making strategy, will be obliged to provide liquidity to the market. Also, investment firms providing direct electronic access to trading platforms should operate regularly updated risk control systems to avoid creating a disorderly market or facilitating abusive practices.

Finally, the biggest novelty from an investor protection standpoint are the new powers set out in article 42 of the MiFIR authorising supervisory authorities to exercise "product intervention", meaning they can restrict or even ban activities and financial products that pose a threat to financial stability, the orderly functioning of markets or investor protection. This is accordingly a preventive tool that allows them to anticipate and prevent problems arising from the misselling of financial products to retail investors. The UK authority made use of this faculty, when it imposed a one-year ban, starting from 1 October 2014, on the sale of contingent convertibles or CoCos to retail investors, in view of their high complexity and risk.

1 Directive 2004/39/EC of the European Parliament and of the Council of 21 April on markets in financial instruments, transposed into Spanish legislation by Law 47/2007 of 20 December, amending the Securities Market Law, and Royal Decree 217/2008 of 15 February.

2 Directive 2014/65/EU of the European Parliament and of the Council of 15 May on markets in financial instruments, repealing directives 2002/92/EU and 2011/61/EU, and Regulation 600/2014 of the European Parliament and of the Council of 15 May on markets in financial instruments, amending the EMIR Regulation relative to OTC derivatives, central counterparties and trade repositories.

… amid the ongoing fragmentation of markets.

Trading in Spanish listed shares on other regulated markets and European MTFs continued to augment. Business on these foreign markets has exceeded[9] 98 billion euros year to date, almost 15% of the shares' total turnover (10% in full-year 2013).

Trading in Spanish shares listed on Spanish exchanges[1]

TABLE 7

Million euros

	2010	2011	2012	2013	1Q 14	2Q 14	3Q 14[2]
Total	**1,030,498.6**	**926,873.7**	**709,902.0**	**764,986.6**	**218,532.7**	**254,003.2**	**183,270.1**
Listed on SIBE (electronic market)	**1,030,330.2**	**926,828.6**	**709,851.7**	**764,933.4**	**218,511.6**	**253,996.2**	**183,255.8**
BME	1,020,063.2	912,176.9	687,456.1	687,527.6	182,995.1	218,004.1	156,536.7
Chi-X	8,383.6	11,120.3	16,601.3	53,396.7	25,230.6	20,074.6	15,798.6
Turquoise	269.1	707.7	3,519.6	11,707.9	3,405.8	7,193.1	6,883.9
BATS	272.4	1,276.4	2,261.9	10,632.1	5,106.7	4,219.4	3,338.6
Others[2]	1,341.90	1,547.3	12.8	1,669.2	1,773.4	4,504.9	698.1
Open outcry	**165.4**	**42.8**	**49.9**	**51.4**	**20.9**	**6.8**	**14.1**
Madrid	15.7	16.1	3	7.3	1.0	3.7	2.5
Bilbao	3.9	0.1	8.5	0.1	14.2	0.0	0.0
Barcelona	143.9	26.4	37.7	44.1	5.7	2.9	11.6
Valencia	1.9	0.3	0.7	0.0	0.0	0.2	0.0
Second market	**3.0**	**2.3**	**0.4**	**1.7**	**0.2**	**0.2**	**0.2**
Memorandum item							
BME trading of foreign shares[3]	6,415	5,206	4,102	5,640	2,576.7	3,127.2	2,050.9
MAB	4,147.9	4,379.9	4,329.6	5,896.3	2,092.0	2,098.2	1,486.5
Latibex	521.2	357.7	313.2	367.3	137.3	76.7	58.5
ETFs	5,968.2	3,495.4	2,736.0	4,283.9	2,696.6	1,894.9	2,140.5
Total BME trading	1,037,284.3	925,661.3	698,987.5	703,768.7	190,518.8	225,208.1	162,287.9
% Spanish shares on BME vs. total Spanish shares	99.0	98.4	96.9	90.0	83.9	85.9	85.5

Source: Bloomberg and CNMV.

1 Spanish shares listed on Spanish exchanges are those with a Spanish ISIN that are admitted to trading in the regulated market of Bolsas y Mercados Españoles, i.e., not including alternative investment market MAB. Foreign shares are those admitted to trading in the regulated market of Bolsas y Mercados Españoles whose ISIN is not Spanish.

2 Data to 15 September.

3 Difference between the turnover of the EU Composite estimated by Bloomberg for each share and the turnover of the markets and MTFs listed in the table, i.e. including trading on other regulated markets, MTFs and OTC systems.

9 On the basis of Bloomberg data.

Equity issuance on domestic markets summed 5.81 billion in the third quarter, for a year-to-date total of 19.75 billion (see table 8). This is less than in the same period last year, but remember that bank restructuring in 2013 called for various large-scale capital increases which will not necessarily repeat this year. Note also that 2014 issuance originated in multiple productive sectors (not just the banks). Finally, the amount raised through scrip dividends has continued to augment, as far as 8.24 billion euros year to date or 41.7% of total issuance (25.2% in 2013).

Equity issuance nears 20 billion year to date, with the scrip dividend option increasingly popular.

Capital increases and public offerings TABLE 8

	2011	2012	2013	4Q 13	1Q 14	2Q 14	3Q 14[1]
CASH AMOUNTS (million euros)	**20,970.3**	**29,557.4**	**39,171.9**	**4,982.5**	**4,829.1**	**9,113.3**	**5,811.4**
Capital increases	20,843.3	28,326.0	39,171.9	4,982.5	4,829.1	7,877.0	5,293.6
Of which, scrip dividend	3,862.0	8,357.8	9,869.4	2,466.6	2,867.5	2,439.5	2,931.7
Of which, through public offer for subscription	6,238.8	2,457.3	1,744.6	0.0	900.0	1,655.0	401.5
National tranche	5,827.1	2,457.3	1,744.6	0.0	98.7	348.1	8.9
International tranche	411.7	0.0	0.0	0.0	801.3	1,306.9	392.7
Public offering of shares	127.0	1,231.4	0.0	0.0	0.0	1,236.2	517.7
National tranche	124.7	1,231.4	0.0	0.0	0.0	55.7	58.5
International tranche	2.3	0.0	0.0	0.0	0.0	1,180.5	459.2
NUMBER OF FILINGS	**91**	**106**	**159**	**49**	**35**	**46**	**39**
Capital increases	90	103	159	49	35	43	37
Of which, bonus issues	24	24	38	7	7	7	11
Of which, through public offer for subscription	8	7	6	0	2	5	2
Public offering of shares	1	3	0	0	0	3	2
NUMBER OF ISSUERS	**44**	**39**	**46**	**23**	**21**	**30**	**29**
Capital increases	44	39	46	23	21	30	28
Of which, through public offer for subscription	8	7	6	0	2	5	2
Public offering of shares	1	3	0	0	0	2	1

Source: CNMV.

1 Data to 15 September 2014.

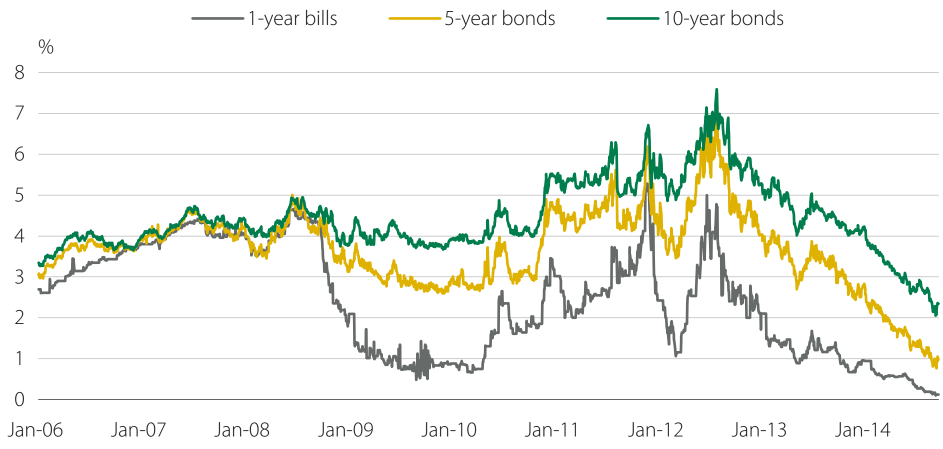
3.2 Fixed-income markets

Spanish fixed-income markets again felt the benefit of plentiful liquidity and the improved macro prospects for the domestic economy. Yields on benchmark public and private debt instruments fell to new historical lows, and with them the credit risk premiums of Spanish issuers, driving down financing costs throughout the economy. In some cases, the high prices fetched by debt instruments may be out of step with the fundamentals of the Spanish economy, making them keenly sensitive to renewed outbreaks of market instability or unexpected interest rate rises. In this context, debt issues registered with the CNMV dropped back 28.6% (-11.5% if we factor growing bond issuance abroad) in tune with issuers' more subdued financing needs.

Spanish debt yields fall to new historical lows. In some cases, debt prices may be out of step with economic fundamentals.

Spanish government debt yields

FIGURE 16



Source: Thomson Datastream. Data to 15 September.

Short-term yields hit new lows, with little downside room remaining…

Short-term treasury yields hit new lows in the third quarter of 2014, with the cumulative decline in benchmark bills in the interval of 51 to 77 bp. By mid-September, three-month, six-month and one-year Letras del Tesoro were yielding 0.03%, 0.06% and 0.12% respectively, with little downside scope remaining. In a similar vein, yields on commercial paper headed lower in the year by between 45 and 63 bp, with rates at issue in three-month, six-month and one-year tenors down to September averages of 0.64%, 0.79% and 0.96% respectively (see table 9).

Short-term interest rates[1]

TABLE 9

%	Dec 11	Dec 12	Dec 13	Mar 14	Jun 14	Sep 14[2]
Letras del Tesoro						
3 month	2.20	1.14	0.54	0.26	0.14	0.03
6 month	3.47	1.68	0.70	0.41	0.20	0.09
One year	3.27	2.23	0.91	0.56	0.42	0.13
Commercial paper[3]						
3 month	2.74	2.83	1.09	1.01	0.93	0.64
6 month	3.52	3.58	1.36	1.34	1.23	0.79
One year	3.77	3.83	1.59	1.34	1.32	0.96

Source: Thomson Datastream and CNMV.

1 Monthly average of daily data.

2 Data to 15 September.

3 Interest rates at issue.

… but long bond yields drop even faster, in the case of the ten-year sovereign to an end-September low of just over 2%.

The fall in medium and long-term government bond yields outstripped that of shorter-dated instruments as well as lasting practically all year. Specifically, yields raced lower by between 150 and 191 bp as far as average September values of 0.5%, 0.93% and 2.24% in three, five and ten-year tenors (see table 10). Corporate bonds also headed lower, with longer maturities to the fore, and by mid-September were yielding 1.13%, 1.6% and 2.77% respectively. The historical lows of government bond yields spell a substantial saving for the Spanish public sector. That said, the bond's very high prices leave it keenly exposed to unforeseen interest rate rises or upswings in financial market volatility.

Medium and long bond yields[1]

TABLE 10

%	Dec 11	Dec 12	Dec 13	Mar 14	Jun 14	Sep 14[2]
Government bonds						
3 year	4.01	3.40	2.00	1.26	0.85	0.50
5 year	4.65	4.22	2.68	1.96	1.36	0.93
10 year	5.62	5.35	4.15	3.34	2.70	2.24
Corporate bonds						
3 year	5.43	4.19	2.63	1.78	1.40	1.13
5 year	5.91	4.66	2.84	2.18	1.90	1.60
10 year	8.06	6.79	4.46	3.66	3.07	2.77

Source: Thomson Datastream, Reuters and CNMV.

1 Monthly average of daily data.

2 Data to 15 September.

Sovereign risk premiums fall by nearly 90 bp year to date…

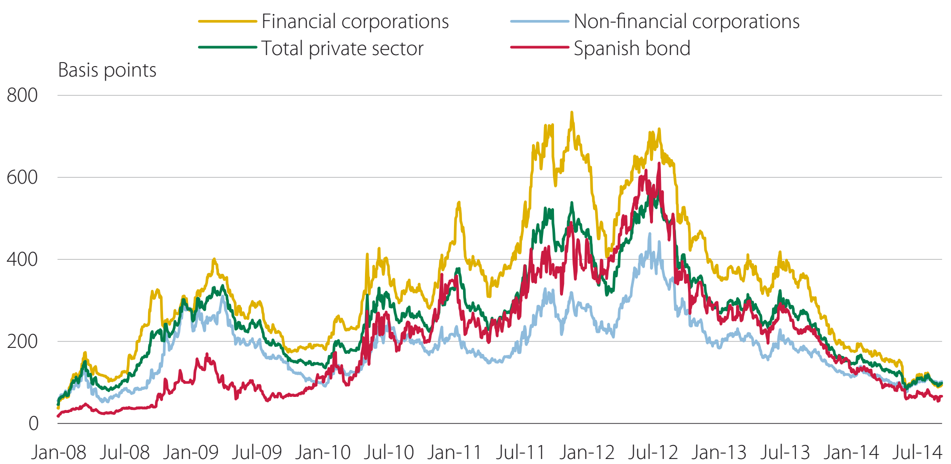
In line with this general downtrend in the interest rates of the economy, sovereign spreads relaxed further in the third quarter after the run-down of the first six months. The spread between the Spanish 10-year bond and equivalent German benchmark narrowed from 220 bp at end-December 2013 to 167 bp, 142 bp and 132 bp at the close of each quarter in 2014. Likewise, the CDS spread of the Spanish sovereign bond sank to 67 bp in mid-September from the 153 bp of year-end 2013.

… and those of financial corporations by a similar margin. Spreads of the non-financial sector, less affected by the crisis, narrow by just over 15 bp.

Credit risk premiums on corporate bonds have also narrowed sharply year to date, albeit with some levelling-off in the recent weeks. The average CDS spreads of financial corporations progressed from 186 bp at end-2013 to 165 bp, 107 bp and 94 bp at successive quarterly closes, and those of non-financial borrowers from 119 bp, to 112 bp, 99 bp and 103 bp.

Aggregate risk premium[1] based on the five-year CDS of Spanish issuers

FIGURE 17



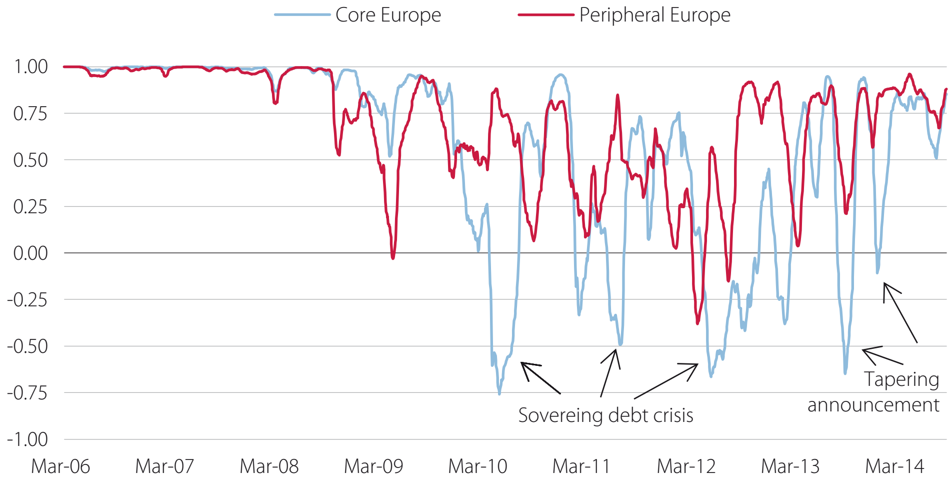
Source: Thomson Datastream and CNMV.

1 Simple average. Data to 15 September.

Elevated correlation between Spanish government bonds and other debt instruments and shares.

Spanish government bonds currently exhibit a strong correlation in prices with assets like the sovereign bonds of other European economies or equity securities. This is a step away from the dominant pattern during the European sovereign debt crisis of a clear decoupling between movements in these instruments and Spanish public debt, which tended to mirror the trajectory of euro-area periphery sovereigns (see figure 18). Despite these high correlations, there is little indication of credit risk contagion, due partly to the reduced levels of government spreads.

Correlation between Spanish bond yields and those of other European sovereigns[1] FIGURE 18



Source: Thomson Datastream and CNMV. Data to 15 September 2014.

1 Correlation coefficient of ten-year government bond yields, measured over three-month windows. The Core Europe group includes Germany, France, Belgium and the Netherlands, Peripheral Europe comprises Italy, Ireland, Portugal and Greece. The correlation coefficients between the yield of the Spanish bond and the yields of each of the European bonds included is then averaged out for each group.

Fixed-income issues filed with the CNMV contract by 28.5% to 67 billion euros, or a lesser 11.5% factoring issuance abroad.

The gross volume of fixed-income issues registered with the CNMV summed 67.31 billion euros in the first three quarters, 28.5% less than in the same period last year. Part of the decline owes to lower issuance by the SAREB (asset management company for assets arising from bank restructuring) after the intense schedule of 2013[10], and part to Spanish companies' growing issuance abroad (up by 12%), with an accent on short-term instruments and preference shares. Adjusting for these factors, the decline lessens to 11.5%, with its origin essentially in issuers' lower financing needs. In the case of financial corporations, an additional reason is their growing preference for equity over debt financing.

Sharply falling sales of commercial paper…

Where issuance receded most in absolute terms was in the commercial paper segment, with year-to-date sales of twenty billion euros, 12.5 billion less than in 2013. Note, however, that commercial paper sales abroad rose by three billion in the same period to 11.3 billion euros (see table 11).

… non-convertible bonds (on the impact of SAREB issues) and mortgage and territorial covered bonds.

Gross non-convertible bond issues filed with the CNMV came to 13.20 billion euros, 33.6% less than in 2013. However, stripping out SAREB issues this turns around to a 57% increase as far as 9.12 billion. Covered bond sales also tailed off sharply in both their mortgage and territorial variants (down by 17.7% and 67% to 17.95 and 1.85 billion respectively).

10 SAREB issues summed 14.09 billion in the first three quarters of 2013, compared to 4.08 billion this year to date.

Sales of asset-backed securities declined by a smaller margin than other instruments to 13.34 billion in the first three quarters, compared to the 13.90 billion of 2013.

Sales of asset-backed securities on a par with last year's.

Gross fixed-income issues

TABLE 11

Registered[1] with the CNMV	2010	2011	2012	2013	2014 1Q	2014 2Q	2014 3Q[2]
NOMINAL AMOUNT (million euros)	**226,449**	**287,490**	**357,830**	**138,839**	**20,593**	**28,009**	**18,709**
Mortgage bonds	34,378	67,227	102,170	24,800	3,450	11,000	3,500
Territorial bonds	5,900	22,334	8,974	8,115	1,500	218	135
Non-convertible bonds and debentures	24,356	18,692	86,442	32,537	5,988	4,855	2,361
Convertible/exchangeable bonds and debentures	968	7,126	3,563	803	0	1,000	1
Asset-backed securities	63,261	68,410	23,800	28,593	1,850	3,855	7,640
Domestic tranche	62,743	63,453	20,627	24,980	1,389	3,573	7,550
International tranche	518	4,957	3,173	3,613	461	282	90
Commercial paper[3]	97,586	103,501	132,882	43,991	7,804	7,081	5,072
Securitised	5,057	2,366	1,821	1,410	200	420	0
Other commercial paper	92,529	101,135	131,061	42,581	7,604	6,661	5,072
Other fixed-income issues	0	0	0	0	0	0	0
Preference shares	0	200	0	0	0	0	0
Memorandum item:							
Subordinated issues	9,154	28,549	7,633	4,776	0	2,244	1,545
Covered issues	299	10	0	193	196	0	0

Abroad by Spanish issuers	2010	2011	2012	2013	2014 1Q	2014 2Q	2014 3Q[4]
NOMINAL AMOUNT (million euros)	**127,731**	**120,043**	**91,882**	**47,852**	**17,421**	**15,116**	**3,896**
Long-term	51,107	51,365	50,312	34,452	12,526	10,849	1,710
Preference shares	0	0	0	1,653	3,000	1,102	0
Subordinated debt	0	242	307	750	0	0	0
Bonds and debentures	50,807	51,123	50,005	32,049	9,526	9,746	1,710
Asset-backed securities	300	0	0	0	0	0	0
Short-term	76,624	68,677	41,570	13,400	4,896	4,267	2,186
Commercial paper	76,624	68,677	41,570	13,400	4,896	4,267	2,186
Securitised	248	322	11,590	0	0	0	0

Memorandum item: Gross issuance by subsidiaries of Spanish companies resident in the rest of the world

	2010	2011	2012	2013	2014 1Q	2014 2Q	2014 3Q[4]
NOMINAL AMOUNT (million euros)	**191,266**	**108,396**	**49,123**	**48,271**	**13,463**	**9,610**	**2,843**
Financial corporations	161,897	79,199	18,389	8,071	2,549	2,989	60
Non-financial corporations	29,369	29,197	30,734	40,200	10,914	6,621	2,783

Source: CNMV and Banco de España.

1 Incorporating issues admitted to trading without a prospectus being filed.

2 Data to 15 September.

3 Figures for commercial paper issuance correspond to the amount placed.

4 Data to 31 July.

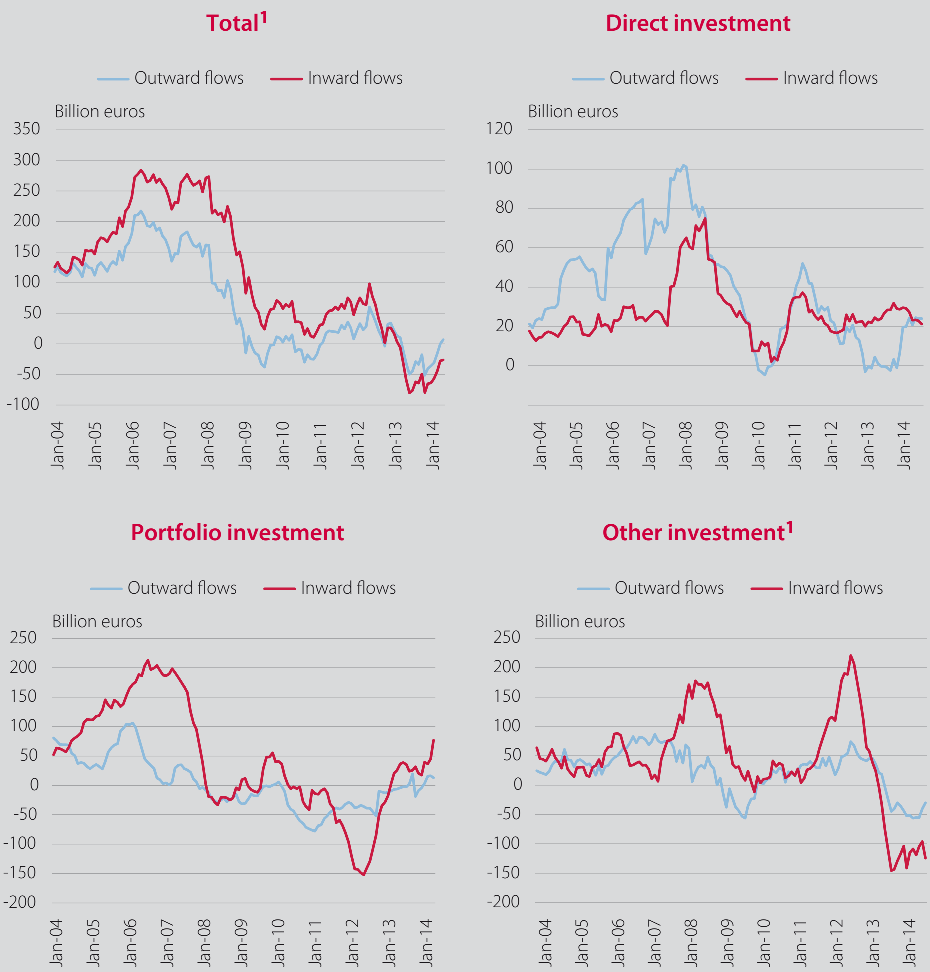
Foreign investment in Spain

EXHIBIT 3

In the years before the onset of the financial crisis, the Spanish economy was a major recipient of foreign investment. The country's financing requirement sprang from a high investment rate greatly outstripping the national savings rate. However, the correction of imbalances in the course of the recent crisis reduced financing needs to such an extent that Spain became a (net) lender to the rest of the world[1] at the end of 2012 (see upper left-hand panel of figure E.3.1). Financial account data reveal a new change in investment behaviour since mid-2013, consisting of large increases in both foreign investment in Spain and Spanish investment abroad. In this exhibit, we look briefly at the changing face of foreign investment in Spain, considering both modality and target sector.

Financial account: A breakdown by investment modality (Cumulative twelve-month data)

FIGURE E.3.1



Source: Banco de España, Balance of Payments. Data to June 2014.

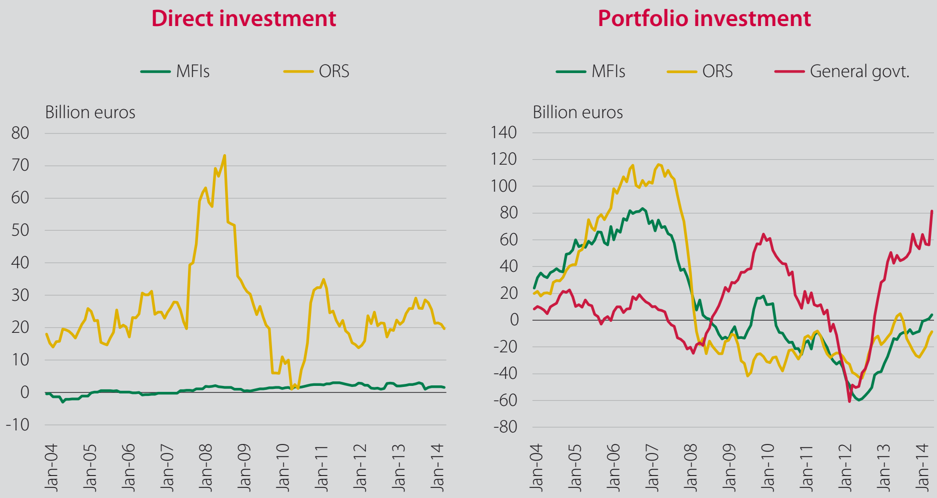
1 Except derivatives and reserves, for which no Spain/Non-resident breakdown is available.

Non-resident investment flows have passed through various stages since the start of the crisis. In the first stage (see upper left-hand panel of figure E.3.1), stretching from early 2008 to mid-2009, foreign investment in the Spanish economy plunged from over 250 billion (a year) to something under 25 billion. It then fluctuated less sharply during the episodes of turmoil accompanying the European sovereign debt crisis, before entering a new downward path in mid-2012. This was a time characterised by extreme uncertainty about the health of Spain's financial system and the economy's ability to exit recession. Since mid-2013, the easing of tensions around these points has permitted a notable recovery in non-resident investment volumes[2].

An analysis of investment modalities reveals differing patterns of behaviour. On the one hand, direct investment flows (upper right-hand panel of figure E.3.1), which receded sharply, in the non-financial corporate sector especially, between the end of 2008 and mid-2010, have since traced a steadier trajectory, while holding in positive terrain throughout the reference period (in cumulative twelve-month figures). This of course squares with the nature of foreign direct investment, with its longer time horizon. On the other, portfolio investment flows thinned out considerably in 2008, and tended to relapse again with subsequent outbreaks of sovereign debt market tensions. By mid-2012, portfolio outflows were up to more than 150 billion euros (in cumulative twelve-month figures). Since then, the restoral of confidence and an improved economic outlook have revived this investment modality, as far as almost 77 billion inflows in June 2014.

A breakdown of portfolio investment by sector reveals a recent shift in the destination of inward flows. Whereas in pre-crisis times, most funds found their way into private-sector corporations (financial and non-financial), the upswing of the last few months has been driven by acquisitions of public-sector instruments (see right-hand panel of E.3.2). Specifically, non-resident holdings of central government debt have recovered from a mid-2012 low of 32% to 44.6% in mid 2014[3] (see figure E.3.3).

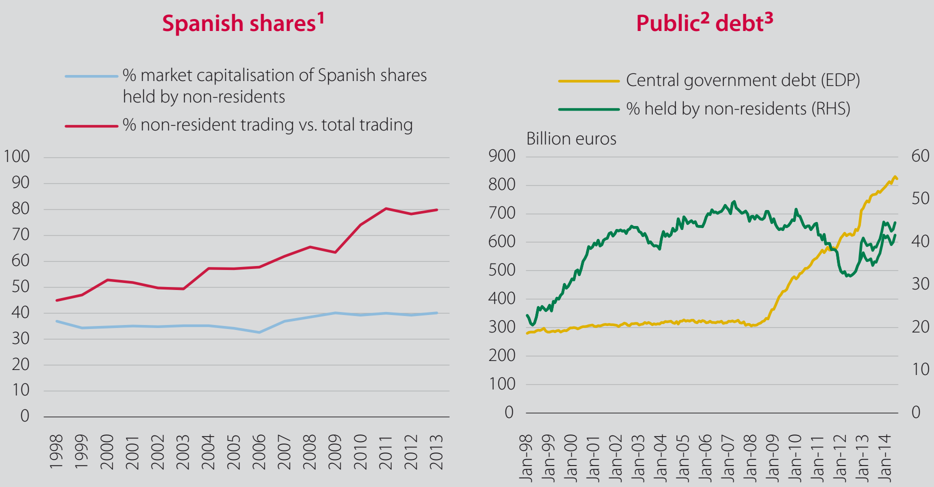
Foreign investment in Spain: Breakdown by economic sector (Cumulative twelve-month data) FIGURE E.3.2



Source: Banco de España, Balance of Payments. Data to June 2014.
MFIs: Monetary financial institutions, ex. Banco de España.

Two factors have heavily conditioned the evolution of foreign investment, with special bearing on the "other investment" category. As we can see from the lower right-hand panel of E.3.1, inflows under this head have recorded two peaks in recent years, tied in essentially with bank sector Eurosystem borrowings and the funds received from the European Stability Mechanism (ESM). During the crisis, Spanish banks made extensive use of the former channel, which took their net borrowings to a 388 billion euros high in August 2012. Meantime, ESM funding of over 41 billion euros (between December 2012 and February 2013) was earmarked for the clean-up and restructuring of Spanish credit institutions. The recent decrease in investment in this category reflects banks' lesser recourse to Eurosystem financing, since the first ESM payments have yet to show through in the statistics[4].

Non-resident holdings of: FIGURE E.3.3



Source: BME (data to 2013) and Banco de España (data to July 2014 for public debt outstanding and to June 2014 for the proportion of non-resident holdings).

1 Shares of Spanish listed companies.

2 Shown are the gross holdings of the non-resident sector, and non-resident holdings ex. ESM funding; 41.3 billion euros as of June 2014.

3 Debt according to the Excessive Deficit Procedure.

In conclusion, during these years of crisis Spain's economy has moved to a (net) lending position vs. the rest of the world after years as a large recipient of foreign investment. In recent months, however, improved confidence regarding economic activity and the strength of the banking sector have combined to push up incoming investment. For the moment, most of these funds are going into public debt. But if recovery firms, foreign investment could extend more strongly into private sectors of the economy. This is certainly the message from non-residents' growing share of bond and share issues registered with the CNMV, and in other financial products such as mutual funds.

1 The difference between Spanish investment abroad and foreign investment in Spain (cumulative 12-month figures) turned positive in December 2012. Not computing reserves and derivatives.

2 See the ECB's *Financial Stability Review* (May 2014), which sets out equity and bond portfolio flows for various economies in the past year, with Spain singled out as a major destination.

3 If we subtract the debt corresponding to ESM funding, this percentage stands at 41.7%.

4 Statistics run to June 2014 and the first ESM payments were scheduled for July.

4 Market agents

4.1 Investment vehicles

Financial UCITS[11]

Assets under management in investment funds grew 16.6% in the first six months of 2014, as far as 182.73 billion euros. This advance, which builds on the expansion trend of 2013, restores sector assets to around the levels of year-end 2008 (see table 13). Eighty percent of the first-half increase traced to net subscriptions summing over twenty billion euros (see table 12). The biggest inflows corresponded to balanced fixed-income (7.22 billion euros), fixed-income (6.64 billion) and passively managed (4.72 billion) funds, while net redemptions were heaviest in guaranteed funds in both their equity (2.95 billion) and fixed-income (1.46 billion) variants. This prolongs the pattern observed in previous quarters of investors shifting out of guaranteed funds and into fixed-income[12] and passively managed products.

Investment fund assets expand 16.6% in first-half 2014 to 182.7 billion euros. 80% of the increase comes from fund subscriptions.

Net investment fund subscriptions TABLE 12

				2013		2014	
Million euros	2011	2012	2013	3Q	4Q	1Q	2Q
Total investment funds inversión	**-10,838.6**	**-12,737.7**	**24,133.0**	**5,866.8**	**8,804.3**	**10,069.9**	**10,461.6**
Fixed income[1]	-10,427.7	-5,843.6	13,783.1	3,438.4	4,386.4	3,633.3	3,005.6
Balanced fixed income[2]	-1,925.7	-775.2	2,059.3	194.4	1,142.3	2,323.5	4,898.0
Balanced equity[3]	-320.5	-383.1	1,881.9	419.8	1,032.2	1,208.8	1,447.3
Euro equity [4]	152.0	-163.7	1,730.3	327.7	1,025.8	955.0	452.0
International equity[5]	-817.6	-420.6	900.2	197.3	430.0	422.8	388.9
Guaranteed fixed-income	7,228.3	-853.0	-4,469.2	-956.1	-3,706.3	-3,763.4	2,297.6
Guaranteed equity[6]	-3,061.6	-3,523.5	-2,070.2	-311.8	-343.0	-23.7	-2,926.0
Global funds	945.3	-7.5	847.4	178.3	288.7	413.7	-21.3
Passively managed[7]	-274.5	572.1	9,538.2	2,426.5	4,518.6	4,357.3	367.0
Absolute return[7]	-2,337.0	-1,339.4	-67.8	-47.8	29.9	542.7	552.5

Source: CNMV. Estimates only.

1 Includes: Euro and international fixed income and money market funds (as of 3Q 2011, money market funds encompass those engaging in money market and short-term money market investments, Circular 3/2011).

2 Includes: Euro and international balanced fixed income.

3 Includes: Euro and international balanced equity.

4 Includes: Euro equity.

5 Includes: International equity.

6 Includes: Guaranteed and partial protection equity funds.

7 New categories as of 2Q 09. Absolute return funds were previously classed as global funds.

11 Although this classification includes hedge funds and funds of hedge funds, we make no separate reference to them here, since they are the subject of their own sub-section further ahead.

12 Since 2013, much of the cash withdrawn from guaranteed funds has found its way into fixed-income funds with target returns but no guarantee (for more details, see exhibit 3 in this chapter of the CNMV Bulletin for the third quarter of 2013).

Main investment fund variables*

TABLE 13

Number	2011	2012	2013	2013 3Q	2013 4Q	2014 I	2014 2Q
Total investment funds inversión	**2.310**	**2.185**	**2.045**	**2.070**	**2.045**	**2.037**	**2.023**
Fixed income[1]	508	454	384	388	384	374	375
Balanced fixed income[2]	140	125	122	125	122	119	119
Balanced equity[3]	128	117	128	128	128	127	126
Euro equity[4]	148	127	108	113	108	103	104
International equity[5]	220	211	193	192	193	190	190
Guaranteed fixed-income	351	398	374	391	374	355	336
Guaranteed equity[6]	420	361	308	316	308	307	297
Global funds	203	192	162	168	162	160	163
Passively managed[7]	59	85	169	148	169	205	217
Absolute return[7]	133	115	97	101	97	97	96
Assets (million euros)							
Total investment funds	**132,368.6**	**124,040.4**	**156,680.1**	**145,168.5**	**156,680.1**	**169,513.6**	**182,735.8**
Fixed income[1]	46,945.5	40,664.6	55,058.9	50,381.0	55,058.9	59,381.8	62,740.7
Balanced fixed income[2]	5,253.6	5,500.9	8,138.0	6,873.4	8,138.0	10,600.2	15,666.0
Balanced equity[3]	2,906.1	3,179.9	6,312.4	4,783.4	6,312.4	7,648.6	9,242.9
Euro equity[4]	4,829.2	5,270.2	8,632.8	7,021.5	8,632.8	7,753.1	8,601.7
International equity[5]	6,281.2	6,615.0	8,849.0	7,967.6	8,849.0	11,693.7	12,426.8
Guaranteed fixed-income	35,058.0	36,445.0	31,481.2	35,504.7	31,481.2	27,529.5	24,920.1
Guaranteed equity[6]	18,014.5	14,413.2	12,503.8	12,767.2	12,503.8	12,810.3	12,940.7
Global funds	5,104.7	4,358.6	4,528.1	4,352.8	4,528.1	5,007.9	5,650.3
Passively managed[7]	1,986.2	2,991.2	16,515.9	10,926.5	16,515.9	21,847.0	24,898.6
Absolute return[7]	5,989.7	4,601.9	4,659.9	4,590.4	4,659.9	5,241.5	5,648.0
Unit-holders							
Total investment funds	**4,835,193**	**4,410,771**	**5,050,719**	**4,799,719**	**5,050,719**	**5,410.205**	**5,814.175**
Fixed income[1]	1,384,946	1,261,634	1,508,009	1,410,867	1,508,009	1,612.002	1,712.747
Balanced fixed income[2]	206,938	188,574	240,676	205,034	240,676	314.879	425.424
Balanced equity[3]	145,150	138,096	182,223	161,099	182,223	211.810	252.255
Euro equity[4]	237,815	220,450	293,193	254,009	293,193	323.474	347.335
International equity[5]	448,539	398,664	457,606	435,571	457,606	531.270	601.531
Guaranteed fixed-income	1,042,658	1,075,852	1,002,458	1,091,051	1,002,458	871.622	796.983
Guaranteed equity[6]	912,298	727,880	608,051	628,100	608,051	613.296	602.530
Global funds	127,336	101,321	128,741	117,838	128,741	146.223	168.796
Passively managed[7]	100,416	125,003	441,705	321,669	441,705	575.262	673.166
Absolute return[7]	229,097	173,297	188,057	174,481	188,057	210.367	233.407
Return[8] (%)							
Total investment funds	**-0.08**	**5.50**	**6.50**	**2.50**	**1.85**	**1.71**	**1.41**
Fixed income[1]	1.56	3.54	2.28	0.65	0.54	0.89	0.67
Balanced fixed income[2]	-1.34	4.95	4.16	1.85	1.62	1.57	1.34
Balanced equity[3]	-5.64	7.83	10.85	4.78	3.52	1.69	1.89
Euro equity[4]	-11.71	12.31	28.06	13.71	7.99	5.01	3.04
International equity[5]	-10.83	13.05	20.30	6.87	5.54	2.22	2.92
Guaranteed fixed-income	3.28	4.85	4.96	1.46	0.89	1.56	0.71
Guaranteed equity[6]	0.14	5.07	6.15	2.62	1.83	1.26	1.59
Global funds	-4.64	7.44	8.71	3.80	3.25	1.65	1.69
Passively managed[7]	-7.33	7.10	8.88	4.13	2.58	3.45	2.64
Absolute return[7]	-1.87	3.84	2.46	1.07	1.04	0.82	0.75

Source: CNMV. * Data for funds that have filed financial statements (i.e., not including those in the process of winding-up or liquidation).

1 Includes: Euro and international fixed income and money market funds (as of 3Q 2011, money-market funds encompass those engaging in money market and short-term money market investments, Circular 3/2011).

2 Includes: Euro and international balanced fixed income.

3 Includes: Euro and international balanced equity.

4 Includes: Euro equity.

5 Includes: International equity.

6 Includes: Guaranteed equity and partial protection equity funds.

7 New categories as of 2Q09. All absolute return funds were previously classed as global funds.

8 Annual return for 2011, 2012 and 2013. Quarterly data comprise non-annualised quarterly returns.

Investment fund returns held in positive territory (3.1%), though with some slippage versus the previous half-year (see table 13). The highest earning categories were euro equity and passively managed funds (8.2% and 6.2% respectively) on the back of share price rises in the period. These generally solid first-half returns did not stop fund numbers dropping further, albeit less intensely than before, with a total of 2,023 on the register at end-June, 22 fewer than in December 2013. The reduction was steepest (38) in the guaranteed fixed-income category, while passively managed funds confirmed their popularity with a jump from 169 at end-2013 to 217 in June 2014 (a difference of 48).

And the rest of the increase comes from portfolio returns.

Unit-holder numbers, meantime, climbed by over 760,000 to 5,814,175 between December 2013 and June 2014. Most of this new business found its way into the fastest-growing categories by assets, namely passively managed, fixed-income and balanced fixed-income funds (an additional 231,461, 204,738 and 184,748 unit-holders respectively vs. the last quarter of 2013). Only guaranteed funds lost investors in the period in both fixed-income and equity products.

An additional 760,000 unit-holders in first-half 2014 to more than 5.8 million.

Preliminary data for July 2014 point to further growth in industry assets and investor numbers, of around 2% in both cases with respect to the June figures. Also fund numbers, it seems, remain in decline, among guaranteed funds especially.

Growth in sector assets and unit-holders lasts through July, according to preliminary figures.

The liquidity conditions of fund fixed-income portfolios continued to improve over first-half 2014, with the sum of less-liquid assets down by over one billion euros (32.2%), from 3.32 billion in December 2013 to 2.25 billion in June 2014. On this showing, the ratio of less-liquid assets dropped from 2.1% of total fund assets at year-end 2013 to 1.2% in June 2014. As regards the composition of less-liquid assets, the big development was the declining weight (from 74% to 54%) of financial institution debt rated below AA, and the larger share falling to asset-backed securities (up from 14% to 23%).

The balance of less-liquid assets in fund portfolios shrinks by 32%, and stands at a bare 1.2% of industry assets in mid-year 2014.

Estimated liquidity of investment fund assets TABLE 14

	Less-liquid investments					
	Million euros			% total portfolio		
Type of asset	**Dec 13**	**Mar 14**	**Jun 14**	**Dec 13**	**Mar 14**	**Jun 14**
Financial fixed income rated AAA/AA	177	216	202	18%	20%	18%
Financial fixed income rated below AAA/AA	2,457	2,360	1,214	15%	14%	6%
Non-financial fixed income	177	207	280	6%	6%	6%
Securitisations	509	522	554	23%	21%	21%
AAA-rated securitisations	33	33	40	100%	100%	100%
Other securitisations	476	489	514	22%	20%	20%
Total	**3,320**	**3,304**	**2,249**	**16%**	**14%**	**8%**
% of investment fund assets	**2.1**	**2.0**	**1.2**			

Source: CNMV.

Real estate schemes

The ongoing adjustment in Spanish construction and real estate continued to weigh on the real estate investment sector, with all main variables retreating further over the first half of 2014.

The downturn in Spanish real estate continues to weigh on the sector.

Real estate funds endure a further drain in assets and unit-holder numbers (down 2.5% and 15% respectively), but manage to reduce portfolio losses with respect to previous years.

Six real estate funds were in operation at mid-year, a total that has stayed unchanged since 2011. Only four, however, can be regarded as active, with the other two in the process of winding up. Both unit-holder numbers and assets under management continued in decline, with the former down by 15% to 4,090 at the end of June, and the latter slipping back 2.5% to 3.52 billion euros. Although fund returns stayed negative (-1.59% in the first and -2.31% in the second quarter), the scale of losses was less than in previous years, possibly reflecting the slower fall in real estate sector prices.

Real estate investment companies drop 3.1% in assets, while their numbers fall from ten to nine.

Real estate investment companies also suffered setbacks in all main variables. The number of entities dropped from ten to nine[13] between December 2013 and June 2014, while their assets fell back 3.1% to 828.9 million euros after the rebound of 2013[14]. The number of shareholders, finally, held more or less flat at just over 1,050.

Hedge funds

A divergent path for hedge fund industry participants.

The keynote in the Spanish hedge fund sector was again the divergent performance of hedge funds proper and funds of hedge funds, with the first group continuing its expansion and the second steering back to stability after the losses of the previous years.

Fund of hedge fund assets and unit-holders stay more or less flat from January to May…

As we can see from table 15, fund of hedge fund assets stood at end-May levels of 354 million euros, a bare 1.1% higher than in the fourth quarter of 2013, while unit-holder numbers were down by 1.6% to 2,973. Portfolio returns in this sub-sector came to 0.7% and 1.3% in the first and second quarter respectively, or just under 4% in annualised terms, on a par with full-year 2013.

Main hedge fund and fund of hedge fund variables — TABLE 15

				2013		2014	
	2011	2012	2013	3Q	4Q	1Q	2Q[1]
FUNDS OF HEDGE FUNDS							
Number[1]	27	24	22	22	22	21	20
Unit-holders	3,805	3,338	3,022	3,218	3,022	2,994	2.973
Assets (million euros)	573	540	350	418	350	352	354
Return (%)	-1.71	0.88	4.39	0.25	1.89	0.66	1.26
HEDGE FUNDS							
Number[1]	36	36	29	33	29	28	30
Unit-holders	2,047	2,427	2,415	2,333	2,415	2,513	2,569
Assets (million euros)	728.1	918.6	1,036.7	994.8	1,036.7	1,172.4	1,206.5
Return (%)	-2.56	7.17	16.48	5.33	5.41	4.21	1.01

Source: CNMV.

1 Data to May 2014.

13 One company deregistered in May.

14 Due to the transformation of one public limited company into a real estate investment company in early 2013.

Pure hedge funds, in contrast, grew their assets 16.4% to 1.21 billion at the end of May, while unit-holder numbers rose by 6.4% to 2,659. Asset growth drew on both portfolio returns (4.2% and 1% in the first two quarters respectively) and net investor subscriptions (113 million euros between January and May 2014).

… against 16.4% and 6.4% advances respectively among pure hedge funds.

Foreign UCITS marketed in Spain

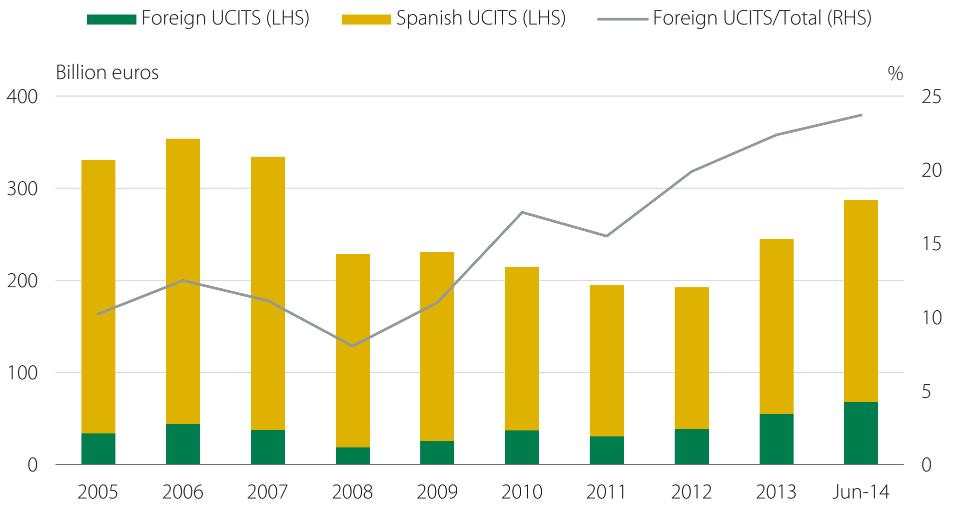
This segment kept up the strong expansion initiated in 2012, with a fresh surge that lifted assets under management to around 68 billion euros, 24.2% more than at end-2013. As we can see from figure 19, this amount represents almost 25% of the total assets under management in UCITS marketed in Spain, a long way from the 8% of 2008, at the start of the crisis.

Foreign UCITS make further headway in the Spanish market, with assets under management up by 24% to 68 billion euros…

Both funds and companies contributed to the jump in assets held by foreign UCITS, with growth of 12.7% and 26.3% as far as 9.61 billion and 58.37 billion euros respectively. Investor numbers rose by 18.4% to 1,263,699 and the number of schemes by 22 (eight funds and fourteen companies).

… and both funds and companies sharing in the advance.

Assets of foreign UCITS marketed in Spain FIGURE 19



Source: CNMV.

The outlook for the collective investment industry is globally positive, though certain constraints could limit its expansion going forward. Investor confidence has evidently rallied since last year, prompting a degree of asset rotation into investment funds and riskier products at the expense of more conservative options like bank deposits. This trend will likely firm in the coming months since the fund industry's offering targets both risk-averse profiles, through its fixed-income range (deposit rates remain unattractive), and more aggressive profiles through its equity, passively managed and hedge fund categories. That said, low private-sector saving will continue to curtail investment flows into the industry. And how saving responds will depend ultimately on the progress of disposable income; in other words, the speed at which the economy and employment can recover.

Renewed investor confidence augurs well for the industry, though growth, for the moment, remains curtailed by a dearth of private saving.

4.2 Investment firms

Buoyant financial markets in first-half 2014 power investment firm earnings 58.8% higher.

A more supportive climate on financial markets boosted investment firm earnings in the first half of 2014. The sector as a whole posted first-half profits before taxes of 345 million euros (in annual terms), a 58.8% increase with respect to 2013 (see figure 20). All groups of intermediaries –broker-dealers, brokers and portfolio management companies– shared in the advance. At the end of June, 85[15] firms were listed on the CNMV registers, two fewer than at end-2013 after one new entry and three deregistrations. Of this total, 46 were passported to operate in other EU countries, six of them via a branch (one fewer than at end-2013) and forty under the free provision of services.

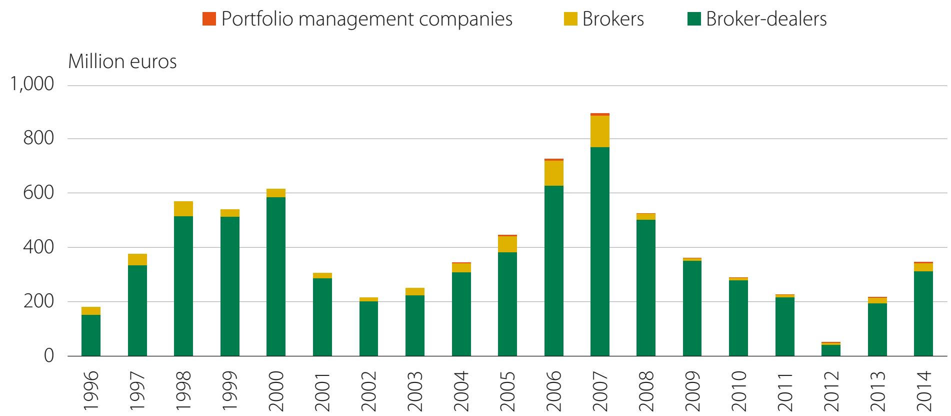
Broker-dealers double their profits with respect to first-half 2013 on the strength of higher fee income (16%) and lower costs.

Broker-dealers have seen business pick up since the first half of 2013. Their pre-tax profits, at 156.1 million euros, more than doubled the year-ago figure to account for 90% of the sector total (see table 16). Driving the improvement were higher fee income (15.9%) and a reduction in operating costs plus depreciation and other charges. Under the fee income caption, order processing and execution brought in 191.1 million euros, an additional 15 million euros –the largest increase in absolute terms. Portfolio management fees grew from modest levels to over 10 million euros, equating to a 45% increase between June 2013 and June 2014. By contrast, income from investment advising fell by 15.1% to 3.8 million euros, prolonging the downtrend of the past few years.

Broker-dealer gross income rises 26%, with strongly performing fee income and net exchange income offsetting the decline at the financial investment line.

Remaining items contributed unequally to the advance in gross income –up by 25.7% to 340.8 million euros– with a hefty 80% fall in the results of financial investments to 36.8 million euros offset by net exchange income, which returned to positive figures after three years in the red (43.4 million euros compared to 132.7 million losses in first-half 2013). Continuing down the income statement, a 3.3% decrease in operating costs (187.8 million euros) and 67.9% lower depreciation charges (two billion euros) lifted net operating income to 150.4 million in June, more than doubling the figure for the same period in 2013.

Investment firm[1] pre-tax profits[2] FIGURE 20



Source: CNMV.

1 Except investment advisory firms.

2 2014 earnings on an annualised basis.

15 Excluding investment advisory firms, which are dealt with separately in a later section in view of their different characteristics.

Brokers too managed a come-back in the first-half period, which closed with aggregate profits up by 60% to 14.6 million euros. Here too, the advance was led by fee income captions, notably order processing and execution, with an additional five million euros, and UCITS marketing, which brought in six million more. (These two items together account for over 60% of the total). Support also came from placement and underwriting fees, up by 96.8%, and investment advisory fees, up 48.5% (see table 16). Finally, brokerage firms closed the first-half period with gross income of 63.9 million euros (+23.9%), while operating costs climbed by 15.3% to over 48 million.

Broker pre-tax profits jump by 60% to 14.6 million euros, with resurgent fee income leading the advance.

Portfolio management companies performed similarly well, with growth in pre-tax profits of 88.5% to almost two million euros (see table 16). Improvement drew on a sizeable reduction in fees paid (down 76.8%) along with operating cost savings of 13.9%. Fee income, however, fell by 37.5% on the negative showing of portfolio management fees, which contracted in the period by 41.2%. This item makes up practically all the fee income earned by companies in this segment.

Portfolio management companies also grow their profits, but from different sources, as falling costs and fee expense outstrip the decrease in fee income.

Aggregate income statement (June 14) TABLE 16

	Broker-dealers			Brokers			Portfolio managers		
Thousand euros	Jun 13	Jun 14	% var.	Jun 13	Jun 14	% var.	Jun 13	Jun 14	% var.
1. Net interest income	26,865	25,055	-6.7	923	615	-33.4	341	125	-63.3
2. Net fee income	187,136	229,051	22.4	51,268	63,355	23.6	4,102	4,635	13.0
2.1. Fee income	278,910	323,269	15.9	59,205	75,553	27.6	9,384	5,861	-37.5
2.1.1. Order processing and execution	175,651	191,070	8.8	20,177	25,577	26.8	–	–	–
2.1.2. Issue placement and underwriting	8,367	7,390	-11.7	1,957	3,851	96.8	–	–	–
2.1.3. Securities custody and administration	8,944	10,442	16.7	306	311	1.6	–	–	–
2.1.4. Portfolio management	6,960	10,094	45.0	6,341	6,995	10.3	8,564	5,035	-41.2
2.1.5. Investment advising	4,508	3,829	-15.1	1,800	2,673	48.5	819	514	-37.2
2.1.6. Search and placement	30	3,956	13,086.7	55	0	-100.0	–	–	–
2.1.7. Margin trading	84	0	-100.0	11	0	-100.0	–	–	–
2.1.8. UCITS marketing	24,433	30,549	25.0	15,402	21,667	40.7	0	0	–
2.1.9. Others	49,934	65,938	32.1	13,155	14,480	10.1	1	312	31.100
2.2. Fee expense	91,774	94,218	2.7	7,937	12,198	53.7	5,282	1,226	-76.8
3. Result of financial investments	184,105	36,828	-80.0	35	565	1,514.3	-11	46	–
4. Net exchange income	-132,712	43,447	–	-32	-3	90.6	7	227	3,142.9
5. Other operating income and expense	5,737	6,440	12.3	-643	-661	-2.8	-2	-170	-8,400.0
GROSS INCOME	**271,131**	**340,821**	**25.7**	**51,551**	**63,871**	**23.9**	**4,437**	**4,863**	**9.6**
6. Operating expenses	194,152	187,841	-3.3	41,906	48,322	15.3	3,379	2,911	-13.9
7. Depreciation and other charges	6,404	2,056	-67.9	901	944	4.8	34	22	-35.3
8. Impairment losses	447	471	5.4	8	-4	–	0	0	–
NET OPERATING INCOME	**70,127**	**150,453**	**114.5**	**8,736**	**14,609**	**67.2**	**1,024**	**1,930**	**88.5**
9. Other profit and loss	7,843	5,691	-27.4	390	-8	–	0	0	–
PROFITS BEFORE TAXES	**77,970**	**156,144**	**100.3**	**9,126**	**14,601**	**60.0**	**1,024**	**1,930**	**88.5**
10. Corporate income tax	15,869	34,483	117.3	580	802	38.3	337	550	63.2
PROFITS FROM ONGOING ACTIVITIES	**62,100**	**121,661**	**95.9**	**8,546**	**13,799**	**61.5**	**687**	**1,380**	**100.9**
11. Profits from discontinued activities	0	0	–	0	0	–	0	0	–
NET PROFIT FOR THE YEAR	**62,100**	**121,661**	**95.9**	**8,546**	**13,799**	**61.5**	**687**	**1,380**	**100.9**

Source: CNMV.

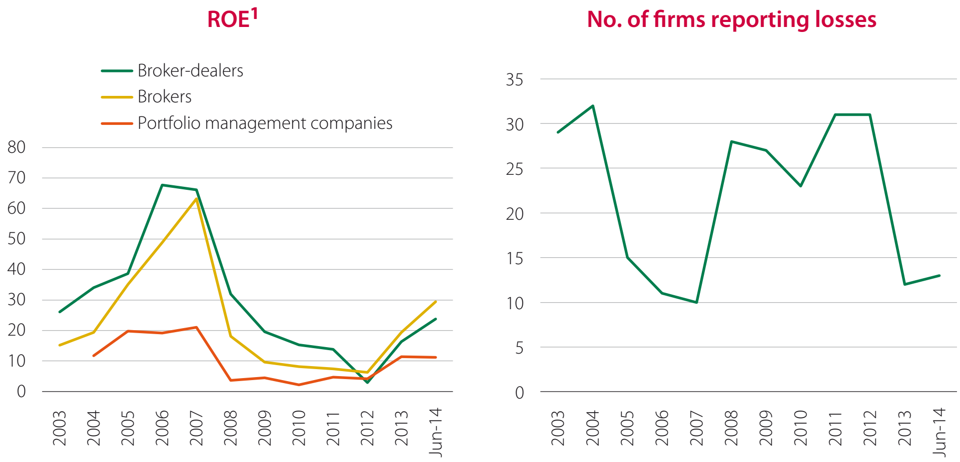
Investment firm ROE jumps from 16.5% to 23.8% on the back of first-half earnings growth…

Firms' strong earnings performance boosted sector return on equity (ROE) by a sizeable margin, from 16.5% in December 2013 to 23.8% in June 2014. By segment, the ROE of broker-dealers advanced from 16.4% to 23.7% and that of brokerage firms from 19.3% to 29.5%, while the ratio of portfolio management companies held more or less flat at just over 11% (see left-hand panel of figure 21).

… while sector losses shrink to almost half (albeit with a slightly higher number of loss-making entities).

Despite these advances, the number of firms reporting losses rose from twelve last December to thirteen in June 2014. The increase was confined to the broker segment, where the number of loss-making entities rose from seven to eleven, compared to only two firms among the broker-dealers, down from five at last year's close. As in the second-half of 2013, no portfolio management companies posted losses in the period. The result was to cut sector losses by almost half to less than eight million euros.

Pre-tax ROE of investment firms and loss-making entities FIGURE 21



Source: CNMV.

1 ROE based on annualised pre-tax earnings.

The sector's solvency conditions continue optimal under the reworked regulations.

Investment firms remain comfortably compliant with capital standards. It bears mention that since January this year, the solvency requirements for these entities are as set out in Regulation (EU) 575/2013, so the method for calculating eligible and required capital is slightly different. Under the new requirements, firms' capital adequacy ratio, defined as the surplus of eligible to required capital, stands at 4.4 for broker-dealers, 2.7 for brokers and 0.4 for portfolio management companies.

IAF business slows in the first half-year, with assets under advice down by 18%...

Investment advisory firms (IAFs) had a slow first half after doing lively business through 2013. The volume of assets under advice shrank by 18.1% with respect to last year's total of close to 14.4 billion euros[16] (see table 17). The customer mix also underwent substantial changes, with the advised assets of retail and professional clients up by 9.7% and 13.1% respectively, and those of eligible counterparties[17]

16 Note that this figure is based on data from the 95% of entities that had filed information by the closing date for this report.

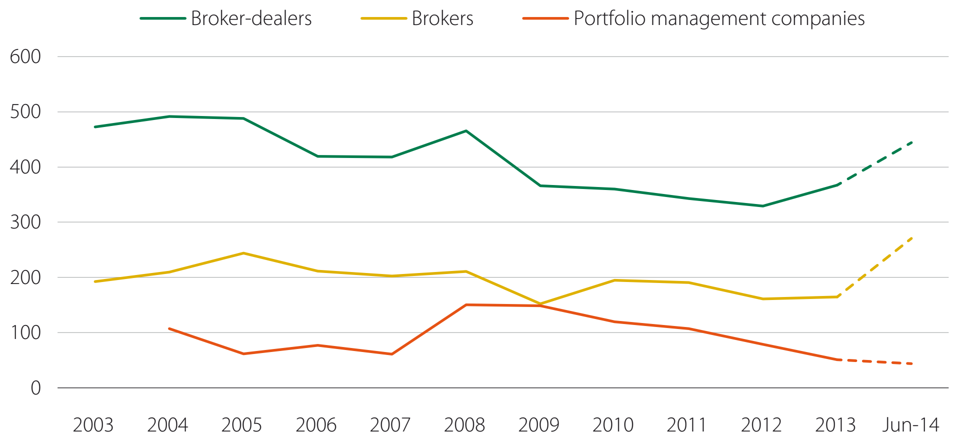
17 Eligible counterparty is a client category defined under the MiFID as requiring a lower degree of protection. It typically includes banks, other financial institutions and national governments.

(the “others” item) down by almost half. This steep fall, and the contraction in general, owed to one client cancelling a contract, without which total assets would have risen more than 5%.

Investment firm capital adequacy

FIGURE 22

(Surplus of eligible capital to the minimum requirement, %)



Source: CNMV.

Main investment advisory firm variables

TABLE 17

				2013		2014*	% var.
Thousand euros	2011	2012	2013	1H	2H	1H	in year
NUMBER OF FIRMS	**82**	**101**	**126**	**112**	**126**	**134**	**19.6**
ASSETS UNDER ADVICE[1]	**16,033,108**	**14,776,498**	**17,630,081**	**15,442,297**	**17,630,081**	**14,444,024**	**-6.5**
Retail customers	2,181,943	3,267,079	4,991,653	3,975,400	4,991,653	5,476,008	37.7
Professional customers	3,151,565	3,594,287	3,947,782	3,476,305	3,947,782	4,465,564	28.5
Others	10,699,600	7,915,132	8,690,646	7,990,593	8,690,646	4,502,452	-43.7
NUMBER OF CONTRACTS	**3,677**	**3,484**	**4,002**	**3,672**	**4,002**	**4,321**	**17.7**
Retail customers	3,542	3,285	3,738	3,446	3,738	4,022	16.7
Professional customers	119	175	235	195	235	263	34.9
Others	16	24	29	31	29	36	16.1
FEE INCOME[2]	**31,053**	**26,177**	**33,273**	**14,700**	**33,273**	**21,670**	**47.4**
Fees received	**30,844**	**26,065**	**33,066**	**14,676**	**33,066**	**21,229**	**44.7**
From customers	26,037	20,977	26,530	12,074	26,530	17,494	44.9
From other entities	4,807	5,088	6,537	2,601	6,537	3,735	43.6
Other income	209	112	206	25	206	441	1.664.0
EQUITY	**12,320**	**13,402**	**21,498**	**15,119**	**21,498**	**22,897**	**51.4**
Share capital	3,895	4,365	5,156	4,820	5,156	5,227	8.4
Reserves and retained earnings	950	4,798	9,453	7,251	9,453	9,865	36.1
Profit/loss for the year[2]	7,474	4,239	6,890	3,048	6,890	7,805	156.1

* Provisional data (except number of entities) based on data from 95% of IAFs registered with the CNMV.

1 Period-end data at market value.

2 Cumulative data for the period.

… and retail business strongly to the fore.

One development of note is the retail segment's growing share of assets under advice since IAFs came into being. Hence by June 2014 retail clients accounted for 37.9% of industry assets, against just 13.6% at end-2011. Despite the lower volume of assets handled, firms grew their fee income 47.4% in the first six months (to 21.7 million euros) with respect to the same period in 2013. Finally, the number of IAFs rose from 124 to 136 between January and June.

Livelier market trading and growth in collective investment will continue to drive the recovery of investment firm business.

It appears that the investment firm sector is getting back on its feet after some tough years, helped by the stabler climate on equity markets. The trend should persist, moreover, in the short term if the business lines essentially driving the recovery –collective investment and market trading– continue to improve. Meantime, the restructuring of Spain's banking sector has so far made little mark on the sector's corporate structure. Hence while the seven deregistrations of 2012 and 2013 (three and four respectively) were a product of takeover deals, not one this year stated the same cause (of the four deregistrations to end-August, three corresponded to a change of corporate form and the other was a winding-up).

Results of CFD trading for clients of the firms promoting them most actively: Main conclusions of a CNMV review

EXHIBIT 4

Background

In recent years, certain firms operating in Spain have prioritised the sale of contracts for differences (CFDs) aimed at the retail client.

These contracts stand out for the high risk carried, due to the multiplier effect produced by their leverage; the variety of underlying assets employed (marketable securities, indices, currencies, interest rates, commodities, etc.); their high short-term volatility, meaning investors must keep constant track of their positions; and the fact that these are bilaterally traded but not fully standardised products, meaning the CFD provider is free to apply its own fees and conditions. In light of these dangers, the European Securities and Markets Authority (ESMA) issued a warning to investors in February 2013, which was also published by the CNMV. In it, investors were advised that they should only consider trading in CFDs if they have extensive experience of trading in volatile markets, if they fully understand how the products operate (including the relevant risks and costs), and have sufficient time to manage their investment on an active basis.

These complex, risky products, it transpires, are being sold on the internet, with the aid of communication material and advertising campaigns that tend to stress their advantages, while playing down the fact that this is a sophisticated financial instrument not suitable for all investors.

Given the focus of supervisory interest on the sale of complex products to retail investors, particularly those carrying a high degree of risk, the CNMV has reviewed a sample of the advertising campaigns run by the firms most actively promoting CFDs.

To supplement the above review, it has analysed the results obtained by clients trading in these products. The main conclusions of this exercise are shown below, in view of their potential interest to retail investors.

Analyses were based on monthly data of the individual returns obtained by the clients of the most active CFD providers (three firms with a combined market share exceeding 85%), collected over a two-year period.

Main conclusions

– The number of clients transacting in CFDs over the reference period was around 8,000.

– The main conclusion of the analysis is that around 75% of clients incurred losses through CFD trading. This percentage varied from one provider to the next, and was in some cases higher than 85%.

– Turnover can be rated high in the case of clients holding CFDs, due, no doubt, to the frequency of advertising campaigns pushing the product, and, possibly, the negative returns obtained in trading. Around a quarter of the clients surveyed only concluded trades in one or two months of the reference period.

It appears, then, that investment in CFDs stands out for the high incidence of losses and customer turnover. The typical scenario is for clients to trade for a short time only, in which they obtain a loss, in some cases severe.

4.3 UCITS management companies

Assets under management in these companies rose by 16.4% to 218 billion euros in the first six months of 2014, building on the recovery that came in 2013 after five years of steady decline (see figure 23). As much as 84% of the improvement was sourced from the capital market fund segment, though investment companies too contributed strongly.

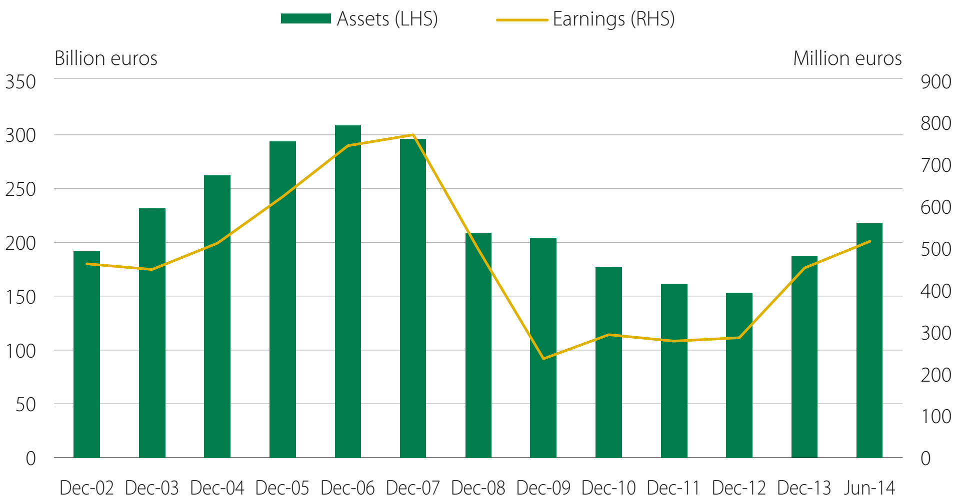
The recovery gains pace among UCITS managers, with asset growth of 16.4% in first-half 2014…

The increase in assets under management fed through to sector income statements as a 14% increase in pre-tax profits to 518.5 million euros (in annualised terms), and a 16.7% increase in management fee income to 1.86 billion (annualised). Return on equity moved up in tandem from 38.7% at the 2013 close to 42.5% in June this year. Despite this strong performance, the number of loss-making companies rose from eleven to thirteen, with their combined losses summing an annualised 2.9 million versus the 2.1 million of 2013.

… translating as a 14% advance in profits and management fee income up by 17%.

UCITS management companies: Assets under management and pre-tax profits

FIGURE 23



Source: CNMV. Results to June 2014 restated on an annual basis.

No change this year in UCITS manager numbers (96), as the effect of bank sector reorganisation begin to wear off.

The sector reorganisation prompted by bank sector restructuring appears to be nearing an end. In the first eight months of the year, only one deregistration was for this cause (the only one in the period). At the same time, one new manager entered the register, leaving the number unchanged, at ninety-six.

UCITS management companies: Assets under management, management fees and fee ratio

TABLE 18

Million euros

	Assets under management	UCITS management fee income[1]	Average UCITS management fee (%)[1]	Fee ratio (%)[2]
2007	295,922	3,194	1.08	70.50
2008	208,861	2,302	1.10	70.80
2009	203,730	1,717	0.84	68.08
2010	177,055	1,639	0.93	67.24
2011	161,481	1,503	0.93	65.60
2012	152,959	1,416	0.93	64.62
2013	189,433	1,594	0.84	61.94
Jun 14	218,011	1,860	0.85	61.26

Source: CNMV.

1 Data for fee income and average management fee restated on an annual basis.

2 Ratio of fee expenses for fund marketing to fee income from UCITS management.

4.4 Other intermediaries: Venture capital

Venture capital entities increase their numbers from 334 to 344 to August 2014.

The number of venture capital entities (VCEs) moved up from 334 last December to 44 in August 2014 (see table 19). Of this number, 140 were venture capital funds (VCFs), 128 were venture capital companies (VCCs) and 76 were VCE management companies. In all, 23 entities joined the register in the first eight months (sixteen VCFs, five VCCs and two VCE managers) against 13 retirals (two VCFs, seven VCCs and four VCE managers).

Movements in the VCE register in 2014 TABLE 19

	Situation at 31/12/2013	Entries	Retirals	Situation at 31/08/2014
Entities	**334**	**23**	**13**	**344**
Venture capital funds	126	16	2	140
Venture capital companies	130	5	7	128
Venture capital management companies	78	2	4	76

Source: CNMV.

VCF asset volumes vary only a fraction while those of VCCs fall by 6.5%.

VCEs lost 3% of their assets between December 2012 and December 2013, to close this last year at 8.26 billion euros. Industry sub-sectors performed divergently with VCF assets holding more or less flat at a little over 4.73 billion euros, against the 6.5% drop in VCC assets to 3.52 billion.

Key developments include a change in the VCE investor mix and lower VCC investment by banks and non-financial corporations, two of their big investor groups.

In the case of VCFs, one of last year's keynotes was a change in the investor mix. The savings banks cut back their investment (by 27% to 146 million de euros), as did pension funds (by 7% to 393 million) and foreign entities (by 3.2% to 897 million), contrasting with higher investment from the public authorities (up by 25% to 599 million) and other entities. Foreign entities remained the single most important investor group in the funds segment, with 19% of total assets (ahead of the 12.7% of public authorities, 12% of non-financial corporations and 11.3% of the banks). Turning to VCCs, two of the three biggest investor groups, non-financial corporations and banks, lowered their investment in 2013 (by 14.8% and 12.1% respectively), while the third (other financial corporations) raised its investment by 0.8% to 1.01 billion euros). Note in this respect that natural persons still account for less than 5% of venture capital assets in the case of VCFs and approximately 2% in VCCs.

The recovery begun in 2H 2013 has lasted through the first half of 2014, when VCE investment doubled to 1.20 billion euros.

Preliminary data furnished by industry association Asociación Española de Entidades de Capital Riesgo (ASCRI) for the opening months of 2014 appear to confirm that the recovery initiated in second-half 2013 is still safely under way. Investment in VCEs in Spain came to 1.20 billion over the first six months, more than doubling the figure for the same period in 2013. It bears mention that around 90% of this total corresponded to transactions of under five million euros in SMEs at the start-up or expansion stage. But the best news was undoubtedly the success of the industry's fund raising effort, which brought in 2.13 billion euros, a full 315% more than in first-half 2013. International funds enlarged their presence as far as 73% of the total invested vs. 47% in the same period last year.

Venture capital entities: Assets by investor group TABLE 20

	VCFs		VCCs	
Million euros	**2012**	**2013**	**2012**	**2013**
Natural persons				
Residents	209.3	214.5	72.4	75.1
Non-residents	4.0	4.3	1.2	1.1
Legal persons				
Banks	524.6	536.0	915.1	804.1
Savings banks	198.8	145.7	41.5	39.1
Pension funds	422.0	392.5	14.2	14.7
Insurance corporations	130.2	125.6	30.4	27.0
Broker-dealers and brokers	0.0	0.0	0.1	0.1
UCITS	34.9	35.5	6.6	7.0
Domestic VCEs	225.7	234.6	32.3	35.9
Foreign VCEs	328.1	328.7	1.1	1.2
Public authorities	574.5	599.3	237.0	280.6
Sovereign funds	27.1	26.3	0.0	0.0
Other financial corporations	358.6	359.6	997.9	1,006.2
Non-financial corporations	586.3	568.9	1,307.4	1,113.5
Foreign entities	926.5	896.7	40.0	41.1
Others	191.7	267.4	73.8	78.3
TOTAL	**4,742.2**	**4,735.5**	**3,770.9**	**3,525.0**

Source: CNMV.

A more encouraging outlook as various factors combine to boost interest in the sector.

The outlook for venture capital is now decidedly better, with a number of factors combining to boost interest in the sector. On the one hand, support will be forthcoming from the new FOND-ICO Global tender and, on the other, the July approval of draft legislation[18] regulating venture capital entities will give the market a new operational framework with more flexible formats, including, for instance, the SME venture capital scheme.

18 Draft Law of 18 July 2014 corresponding to the transposition to Spanish legislation of the Alternative Investment Fund Managers Directive.