I Securities markets and their agents: Situation and outlook

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1 Executive summary

- Since the year's outset, the global macroeconomic and financial landscape has been dominated by concerns over the growth slowdown in China and other emerging market economies and the fallout from the oil price tumble. Financial market turbulence has tended to die down from mid-February onward, but some uncertainties persist; among them, the state of the banking sector, above all in Europe, where ultra-reduced rates are eating into business margins. In recent weeks, doubts about the outcome of the referendum in the United Kingdom and the timing of the next interest rate hike in the United States have kept the economy and financial markets significantly on edge. On the monetary policy front, the gap between US and euro-area business cycles explains the divergent paths pursued by their respective central banks. While the US economy is returning to interest-rate normality, the euro-area monetary authority has stepped up the size and scope of its asset purchase programme, which now extends to investment grade corporate bonds.

- Against this backdrop, world financial markets had a somewhat calmer ride over most of the second quarter, although volatility appeared to edge higher around mid-June.[1] After recouping some of the ground lost in the opening quarter, stock market indices tumbled anew in the year's central weeks leaving a trail of losses in Europe and Japan. Long-term government bond yields continued at lows in these two regions due to their expansionary monetary stances and also to safe-haven demand for certain benchmarks alongside US and UK sovereign debt. A growing number of bonds were trading at sub-zero yields on secondary markets, most of them for the first time ever. And the trend was not confined to shorter-dated instruments: by mid-June, the German ten-year benchmark had also slipped into negative territory. In currency markets, dollar and yen exchange rates against the euro and, latterly, the pound sterling experienced various surges in volatility.

- Spain's macroeconomic situation remains broadly favourable. Although the pace has slowed in recent months, GDP growth (3.4% in the first quarter of 2016) continues to far outstrip the euro area as a whole (1.5%). On the labour market front, employment is improving steadily (3.2% in the opening quarter), although the jobless rate remains extremely high at 21%. Falling energy prices have kept inflation moving at sub-zero rates (-1% in May), but the core rate (stripping out more volatile items) remains positive at just under 1%. The country's fiscal deficit was reined in significantly over full-year 2015 (from 5.9% of GDP to 5.1%), but still overshot the Government's target of 4.2%. Against this generally upbeat macroeconomic backdrop, certain risks hang over the country's mid-term outlook. Some are common to other euro-area economies (the repercussions of

1 The closing date for this report in 15 June.

ultra-reduced interest rates or bank sector weakness), while others affect Spain alone (political uncertainty, exposure to troubled economies...).

- Supportive economic conditions are allowing steady inroads into bank sector NPL ratios, although the volume of doubtful loans remains relatively high. Yet the low interest rates that have contributed to this progress are at the same time eroding banks' earning power to the extent that profitability ratios are trailing the historical average, in line with those of other euro-area countries. In Spain's case, moreover, banks have to cope with the risks entailed by the slowdown in Latin American economies, in view of their considerable exposure to the region.

- Non-financial listed companies obtained 17.16 billion euros profits in 2015, 6.9% less than in 2014. Almost all of this decline traced to firms in the energy sector as the oil price slide bit deeper into earnings. Other non-financial sectors reported stable or advancing profits. Aggregate debt levels inched up by 1.6% in 2015 to 255 billion euros, not enough to impede a small decrease in leverage.

- Prices on domestic equity markets slid backwards around mid-year after recovering strongly from February lows, pressured by doubts about the outcome of the UK referendum on European Union membership – the so-called Brexit – and the timing of rate hikes in the United States. The Ibex 35 accumulated two quarterly falls for a year-to-date loss of 13.6%, round about the median performance mark in Europe. The climate of uncertainty that has dominated much of the year also depressed trading volumes and reduced the volume of equity issuance.

- Domestic fixed-income markets remained strongly reactive to ECB monetary policy decisions in a period when the bank's latest programme of corporate debt purchases drove bond yields lower still (see Exhibit 2). Yields on short- and long-term government and corporate bonds are trading at historical lows or even in negative territory (the case, for instance, of short-dated public debt). The sovereign risk premium has likewise benefited from the direction of monetary policy, despite a small uptick around mid-year in response to the uncertain political climate. In June, concretely, the Spanish spread was 157 basis points (bp), 42 bp above the values of end-2015. Finally, the volume of fixed-income issues registered with the CNMV has expanded 6% year to date (to 62.38 billion euros), led by the modalities targeted in the ECB's asset purchase programme. These programmes have also impacted positively on long-term bond issuance abroad.

- Assets under management in mutual funds dropped by 1.7% in the first quarter of 2016 to 218 billion euros, breaking with the expansion trend of the last three years. The fall owed essentially to the decline in value of portfolio assets during the turmoil of the opening months. Also apparent was a certain shift in investor preferences towards fixed-income and guaranteed equity funds. Industry growth in 2015 translated as a 15% advance in profits of CIS management companies to 626 million euros, and a decrease in the number of loss-making entities to 11 at year-end 2015 (14 in 2014).

- This year's unsettled markets also impacted negatively on investment firm business, driving pre-tax profits down by 30.8% in the opening quarter to 49.2 million euros. Despite the bad patch, firms' solvency conditions held up strongly.

Financial advisory firms, meantime, went from strength to strength in 2015, closing with an 18.6% increase in assets under advice to 25.40 billion euros.

- This report includes three exhibits:

  – Exhibit 1 summarises a CNMV communication aimed at facilitating issuers' compliance with the obligation to consider engaging a small rating agency when they choose to engage two or more agencies.

  – Exhibit 2 looks at the repercussions of the extension of the ECB's asset purchase programme to corporate debt instruments.

  – Exhibit 3 describes the legal framework for the restructuring and resolution of credit institutions and investment firms, with particular attention to CNMV guidelines for the drawing-up of investment firm recovery plans.

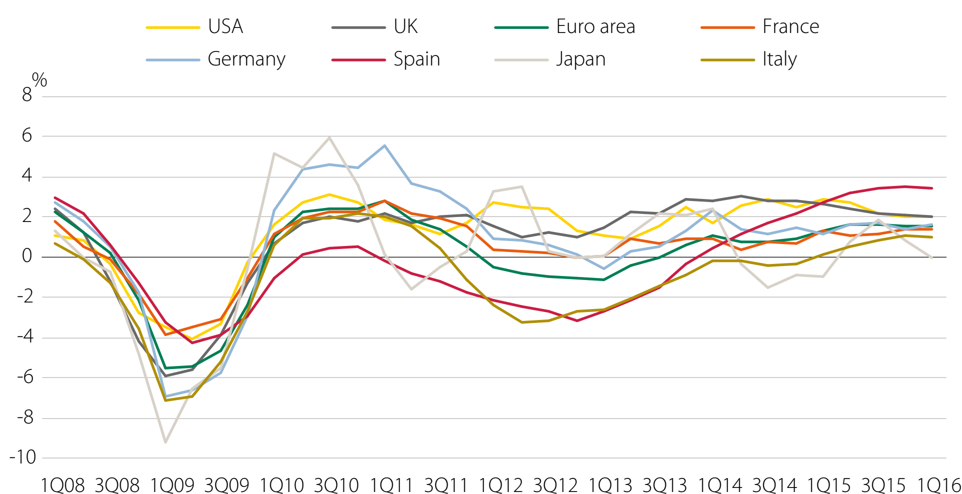
2 Macro-financial background

2.1 International economic and financial developments

First-quarter activity is reasonably buoyant, despite concerns over the outlook for world growth.

Despite the concerns aroused by what was a shaky start to 2016, activity figures for the opening quarter, published last May, showed GDP growth to be progressing on an even keel in the majority of advanced economies (see Figure 1) – annual rates of 2% in the United States and United Kingdom and 1.5% in the euro area were a near repeat of the registers of the fourth quarter of 2015. The sole exception was Japan where activity contracted sharply in the first months of 2016. Within the euro area, Germany and France advanced at a similar pace, close to 1.5%, and Italy and the Netherlands at just under 1%. Spain retained its lead with growth of 3.4%, just 0.1 points less than in the closing quarter of 2015. In Asia, the Chinese economy managed a robust advance of 6.7%, just short of the 6.9% of 2015.

Annual % change in GDP FIGURE 1



Source: Thomson Datastream.

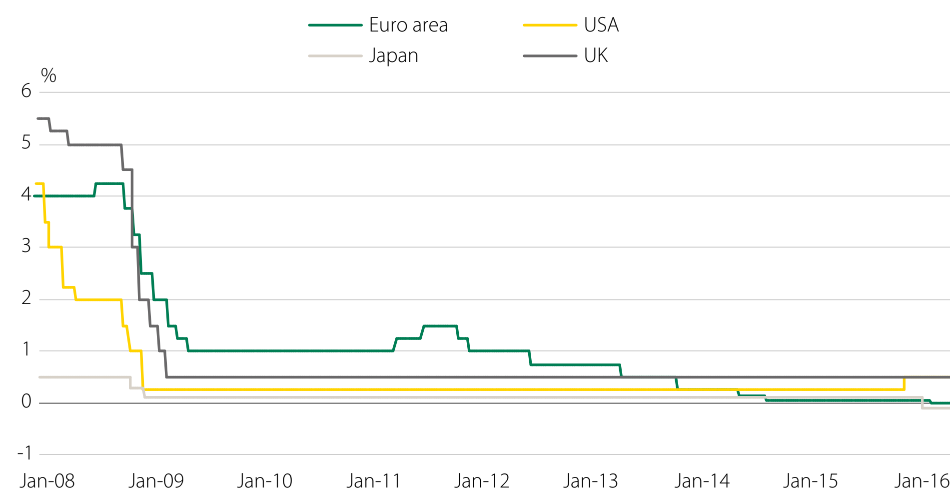
Divergent monetary policies in the United States and Europe reflect the gap between their business cycles. The ECB continues to enlarge the number and scope of easing measures…

Cyclical differences between the United States and the euro area kept their respective monetary policies moving along divergent paths. In the euro area, where recovery remains less than robust and, above all, inflation remains well below its mid-term target, the monetary authority has enlarged both the number and scope of its expansionary measures. From its conventional armoury, the ECB decided on a 5 bp rate cut in March 2016, leaving the official rate at an all-time low of 0%[2] (see Figure 2). At the same time it cut its marginal lending rate by 5 bp (to 0.25%) and its deposit facility rate by 10 bp (to -0.40%). Among non-standard measures, it opted to scale up monthly purchases under its bond-buying programme to 80 billion euros and to extend the programme to investment grade bonds issued by euro-area non-financial corporations.

… while the Federal Reserve presses on with its interest rate upcycle citing the firm tone of the economy.

In the United States, conversely, a set of solid activity and employment figures (despite a first-quarter growth rate slightly short of expectations) and an inflation upturn to almost 1% (with core rates topping 2%) has strengthened the Federal Reserve's resolve to raise policy rates. The next hike is expected in July, with forward rates already pricing in the move.

Official interest rates FIGURE 2



Source: Thomson Datastream. Data to 15 June.

Short-term rates are still moving at lows, albeit somewhat higher in the United States and United Kingdom, while rates in the euro area and Japan have in some cases slipped into negative territory.

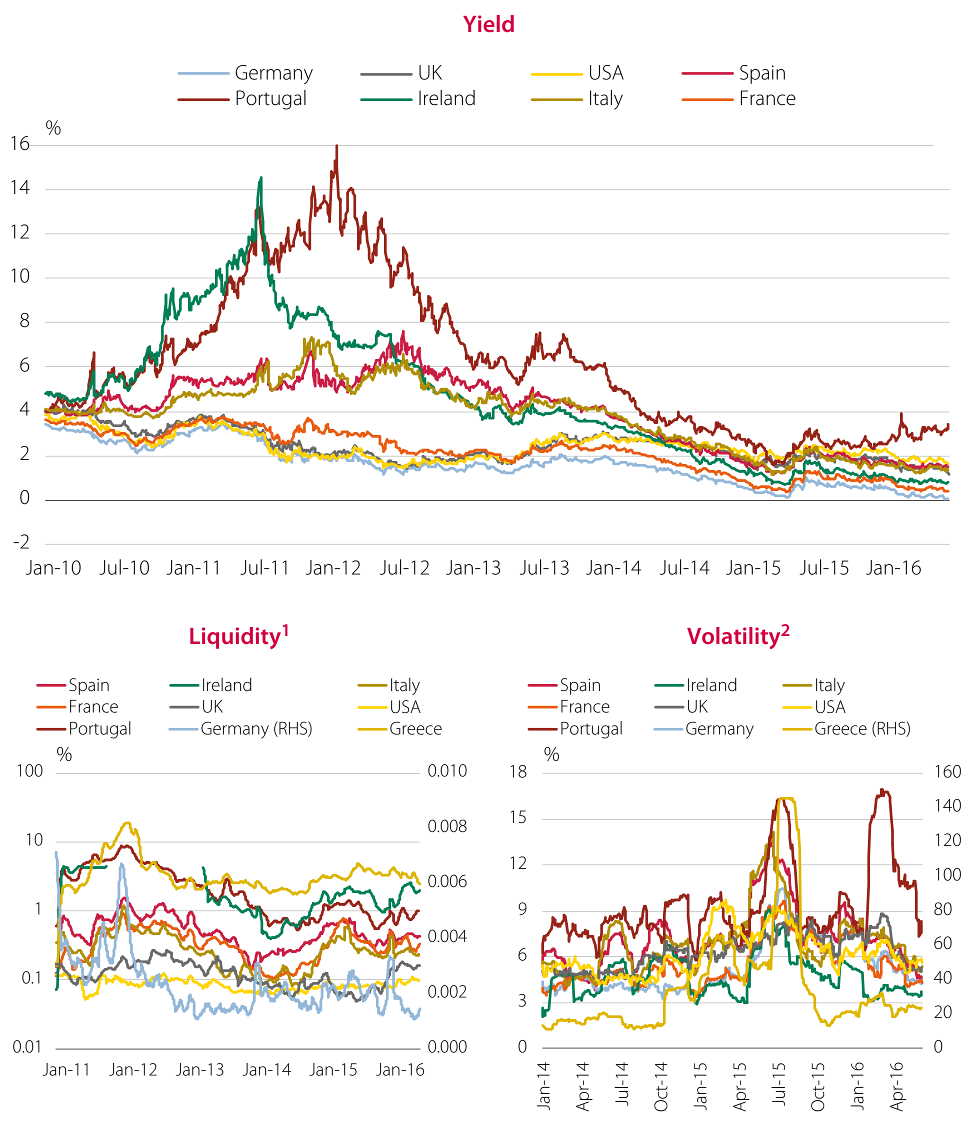
Short-term interest rates moved in tune with the monetary policies implemented in each of the advanced economies. Hence short rates in the United States and United Kingdom, though low, have held above the levels of the euro area or Japan. By mid-year, US interbank rates ranged from 66 bp at three months to 129 bp at one year (between 12 bp and 20 bp more than at end-2015). In the euro area and Japan, by contrast, a growing number of short-term instruments are trading at sub-zero yields. For instance, three-, six- and twelve-month interbank rates in the euro area were all below zero at mid-year 2016 (June averages of -26 bp, -16 bp and -2 bp respectively), as were numerous short-term governments.

2 In Japan, the central bank had decided a few days earlier (in mid-February) to cut the official rate from 0.1% to a historical low of -0.1%.

Yields on ten-year government bonds performed more unevenly on global debt markets after the widespread falls of the opening quarter. The second quarter began with yields edging higher, until the imminence of the EU referendum (Brexit) in the UK and doubts about the timing of Federal Reserve rate hikes prompted a fall among the bonds of more solid economies, on safe-haven demand, and minor rises across the rest of the board. Year to date, most of these assets have seen a decline in yields, exceeding 50 bp in many cases.

Long-term government bond yields diverge somewhat in the second quarter…

10-year sovereign debt market indicators FIGURE 3



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

1 One month average of daily bid-ask spread for yields on ten-year sovereign bonds (logarithmic scale). In the case of the German bond, the one month average of the bid-ask spread is represented without dividing by the yield average to avoid the distortion introduced by its proximity to zero.

2 Annualised standard deviation of daily changes in 40-day sovereign debt prices.

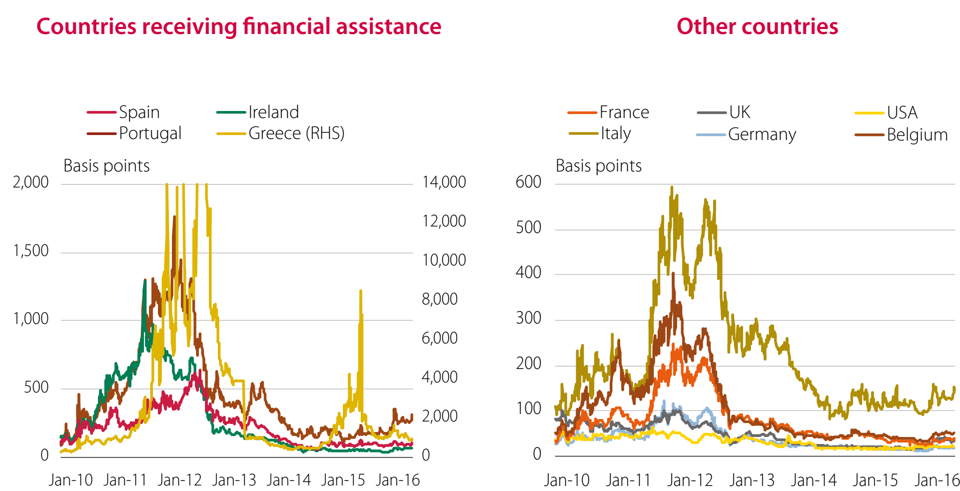
... but continue, in most cases, to hover near historical lows.

By mid-June, yields were highest in the United States and United Kingdom, true to the more advanced stage of their business cycles, and moving at lows[3] in the euro area, in tune with the ECB's ultra-expansionary policy. In Germany, sovereign yields actually turned negative around mid-June, as had occurred in late February in Japan. By mid-year, ten-year governments were yielding 1.59% in the United States and 1.12% in the United Kingdom (see Figure 3), substantially ahead of the levels recorded for most euro-area economies and Japan (-0.19% in Japan, -0.01% in Germany, 0.23% in the Netherlands and 0.40% in France).

European sovereign spreads hold more or less flat in the second quarter, except for mid-year surges in Portugal and Italy.

Sovereign risk premiums in Europe, as gleaned from the five-year CDS of government bonds, have barely moved so far this year. The only developments of note, as Figure 4 shows, were mid-February surges in Portugal and, to a lesser extent, Italy, which tended to unwind a few weeks later, followed by another surge in June. By mid-year, specifically, peripheral spreads stood at 70 bp in Ireland, 106 bp in Spain, 146 bp in Italy and 303 bp in Portugal.

Credit risk premiums on public debt (five-year CDS) FIGURE 4



Source: Thomson Datastream. Data to 15 June.

Spreads on high-yield corporate bonds also recover in part from their February spike, especially intense in the United States.

In corporate bond markets, high-yield spreads in the United States narrowed once more after their mid-February surge, albeit without recouping the pre-turbulence levels of the year's first weeks. These spreads, specifically, rebounded to over 850 bp in February before working their way back to mid-June levels of 600 bp (see left-hand panel of Figure 5). Meantime, high-yield spreads in the euro area traced a more moderate course than their US equivalents, from February highs of 650 bp to 542 bp in mid-June.

3 Except in Portugal, where doubts about the country's bank sector drove bond yields and volatility differentially higher.

Net long-term issuance on global debt markets summed 820 billion dollars in the first six months, almost half the total for the same period 2015. Although the reduction in net terms took in both government and corporate instruments, it was far more intense in the former case – just 197 billion dollars in the first six months against the 789 billion of full-year 2015, while corporate issuance was 622 billion dollars against 775 billion in 2015.

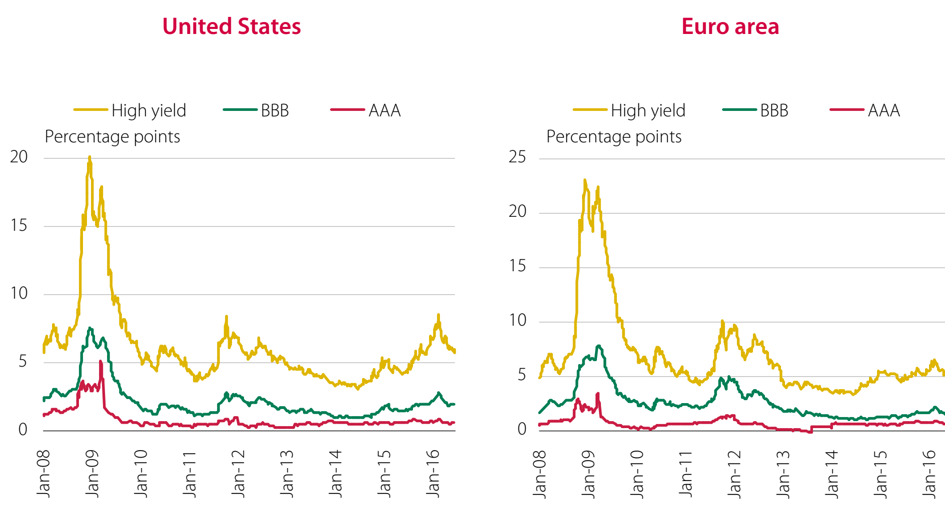
Net debt issuance recedes in the first half-year…

Lower net sovereign issuance had its dual origin in more subdued public sector borrowing requirements, derived from ongoing fiscal consolidation drives, and the persistence of large redemption volumes. In fact, net issuance was negative in both the euro area and Japan, with the redemptions bill exceeding the volumes borrowed (see upper right-hand panel of Figure 6).

… with the public sector leading the decline…

Corporate bond yields
Spread vs. ten-year governments[1]

FIGURE 5



Source: Thomson Datastream and CNMV. Data to 15 June.

1 In the euro area versus the German benchmark.

Corporate issuance dropped among financial sector borrowers (down 10% to 205 billion dollars) and non-financial corporations (down 24% to 417 billion). Net financial sector issuance slowed in both the United States and Europe, and in fact turned negative in the latter case on lower financing needs. Europe's banks are striving to cope simultaneously with ultra-low rates persisting over a lengthy period, and an upsurge in competition from new investment service providers and technological platforms.

… some way ahead of private-sector issuers.

Net international debt issuance

FIGURE 6

Source: Dealogic. Half-year data. Data for the first half of 2016 are to 15 June but restated on a semi- annual basis to facilitate comparison.

Net corporate bond issuance in Europe is spurred on by the ECB's announcement of its latest purchase programme.

Certain details may serve to contextualise this year-on-year decline in corporate issuance: i) first-half issuance was particularly high in the United States as corporations brought forward their placements to lock in lower costs ahead of the expected hike in interest rates; and ii) in Europe, corporate debt issuance climbed by 4% in first half 2016, encouraged in part by the ECB's announcement that it would extend its purchase programme to investment grade bonds issued by non-financial corporations. The result is that most of these firms are managing to fund themselves at exceptionally low costs (see Exhibit 2).

CNMV initiative to facilitate issuers' compliance with the obligation to consider engaging small rating agencies when they appoint two or more

EXHIBIT 1

Regulation (EU) No. 462/2013 of the European Parliament and of the Council, of 21 May 2013, amending Regulation (EC) No. 1060/2009 on credit rating agencies came into force on 20 June 2013. Among other novelties, the text placed new obligations on issuers planning to simultaneously engage two or more rating agencies.

According to its preamble, the measure seeks to increase competition in a market that has been dominated by the big credit rating agencies by encouraging issuers to make use of smaller agencies. As it is standard practice for issuers or related third parties to seek two or more credit ratings from distinct agencies, the regulator urges the issuer, where two or more credit ratings are sought, to consider appointing at least one credit rating agency which does not have more than 10% of the total market share. The final decision lies exclusively with the issuer, but the Regulation takes an approach based on "comply or explain" to require that when a smaller agency is not appointed, this should be documented.

Specifically, Article 8 *quinquies* on the use of multiple credit rating agencies states that where an issuer or a related third party intends to appoint at least two credit rating agencies for the credit rating of the same issuance or entity, it should consider appointing at least one credit rating agency with no more than 10% of the total market share (by turnover) from among the list published annually by the European Securities and Markets Authority (ESMA), provided the issuer considers that agency capable of rating the relevant issuance or entity.

When an issuer or related third party opts not to engage at least one small agency, this fact should be recorded. The Regulation, in effect, does not oblige issuers to appoint a small agency but simply to document any decision not to do so.

The CNMV began supervising this requisite at the start of 2016, further to the supervision schedule approved in the second half of 2015. The conclusions of its initial analyses are that the content of this article needs to be clarified, with particular regard to its documentary requirements. In order to facilitate and standardise the recording of appointment decisions, in April last the CNMV posted a form on its website (CNMV Communication of 26 April 2016, available at www.cnmv.es), whose completion is voluntary, which issuers or related third parties can use to comply with the terms of the above Article 8 *quinquies*.

This optional form has two main elements. The first is the identification of the various agencies considered for appointment. The second, a statement of the reason or reasons for the decision not to engage an agency with no more than 10% of the total market share. To facilitate standardised responses, the form offers the issuer or related third party a set of generic reasons by way of example, specifically: acceptability to investors, the expected quality of the analysis, methodology employed, past performance of credit ratings or mapping of ECAISs' credit assessment, and price. Other reasons can be given.

The CNMV Communication stresses that the record of the issuer's decision (the optional form, for instance) need not be publicly disclosed but only made available to the CNMV.

It also reminds issuers that the obligation to appoint at least two agencies when soliciting a credit rating of a structured finance instrument (Article 8 *quater* of the Regulation) is likewise subject to compliance with the provisions of article 8 *quinquies* on the use of smaller agencies.

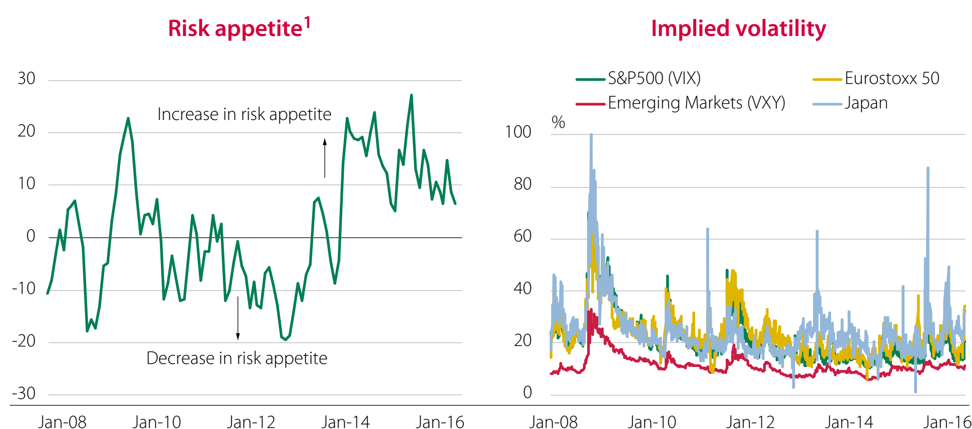
Leading stock indices fall once more on concerns over Brexit and the timing of the next rate hike in the United States.

By end-May, major stock indices were working back to strength after the heavy losses of the opening quarter. But then came a new downward correction on market jitters over the result of the UK referendum on European Union membership (Brexit) and the timing of the next interest rate hike in the United States (see Table 1). Falls year to date have been steepest in Japan (Nikkei -16.4%) and in the euro area, ranging from the 10% of the French Cac 40 to the 22.9% of Italy's Mib 30. The Ibex 35, with a fall of 13.6%, retained its middling position. US indices performed a lot more evenly, with the Dow Jones and S&P 500 both managing a small first-half advance (1.2% and 1.3%, respectively) and the tech-heavy Nasdaq shedding 3.4%. Volatility indicators retreated from their mid-February highs but began to turn up again around mid-year, most notably in the euro area and Japan, where readings exceeded 30% (see right-hand panel of Figure 7).

Disparities among emerging economy stock markets, with gains in Latin America and Eastern Europe and losses on the Asian markets most exposed to the Chinese economy.

In emerging stock markets, the MSCI index slipped back 2% after a first-quarter gain of 2.4%, leaving it just 0.4% ahead of its start-out level. However, the underlying pattern was very different depending where you looked. Overall, Latin American and Eastern European markets fared better than Asia, as doubts mounted about the extent of the growth slowdown in the region. The sharpest falls were reserved for indices tied in with the Chinese economy (-18.4% for the Shanghai Composite and -6.6% for the Hang Seng). In Latin America, Argentina's Merval index and Brazil's Bovespa advanced 12.3% and 12.8%, respectively, and in Eastern Europe the Russian benchmark gained 20.2% on the year.

Financial market indicators FIGURE 7



Source: Thomson Datastream and CNMV.

1 State Street indicator.

Performance of main stock indices[1]

TABLE 1

%	2012	2013	2014	2015	2Q 15	3Q 15	4Q 15	1Q 16	2Q 16 (to 15 June) %/prior quarter	2Q 16 (to 15 June) %/Dec 15
World										
MSCI World	13.2	24.1	2.9	-2.7	-0.3	-8.9	5.1	-0.9	-0.9	-1.7
Euro area										
Eurostoxx 50	13.8	17.9	1.2	3.8	-7.4	-9.5	5.4	-8.0	-5.8	-13.4
Euronext 100	14.8	19.0	3.6	8.0	-4.5	-8.7	5.6	-4.6	-4.4	-8.8
Dax 30	29.1	25.5	2.7	9.6	-8.5	-11.7	11.2	-7.2	-3.6	-10.6
Cac 40	15.2	18.0	-0.5	8.5	-4.8	-7.0	4.1	-5.4	-4.9	-10.0
Mib 30	10.2	18.8	-0.4	12.7	-2.7	-5.2	0.6	-15.4	-8.8	-22.9
Ibex 35	-4.7	21.4	3.7	-7.2	-6.5	-11.2	-0.2	-8.6	-5.4	-13.6
United Kingdom										
FTSE 100	5.8	14.4	-2.7	-4.9	-3.7	-7.0	3.0	-1.1	-3.4	-4.4
United States										
Dow Jones	7.3	26.5	7.5	-2.2	-0.9	-7.6	7.0	1.5	-0.3	1.2
S&P 500	13.4	29.6	11.4	-0.7	-0.2	-6.9	6.5	0.8	0.6	1.3
Nasdaq Composite	15.9	38.3	13.4	5.7	1.8	-7.4	8.4	-2.7	-0.7	-3.4
Japan										
Nikkei 225	22.9	56.7	7.1	9.1	5.4	-14.1	9.5	-12.0	-5.0	-16.4
Topix	18.0	51.5	8.1	9.9	5.7	-13.4	9.6	-12.9	-5.2	-17.5

Source: Datastream.

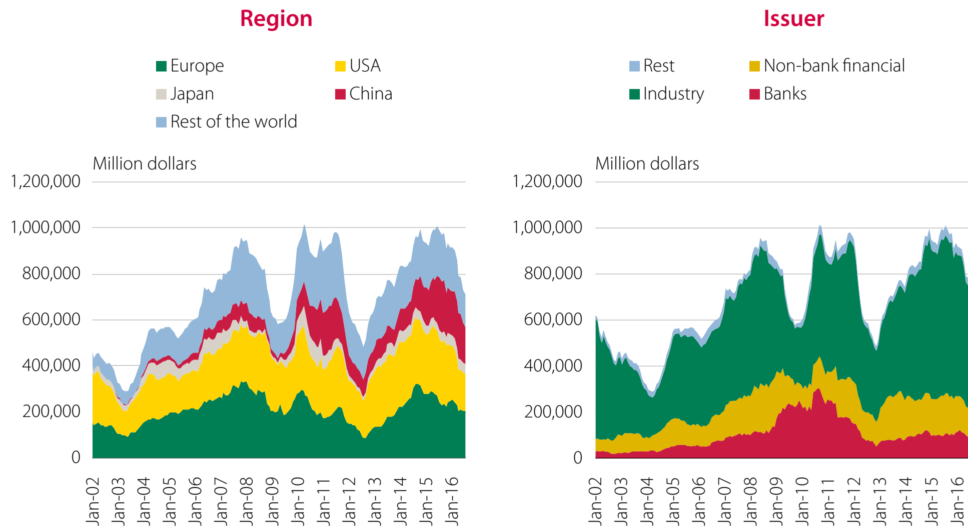
1 In local currency.

Share issue volumes tail off significantly in first half 2016.

Equity issuance in the first half-year was 352 billion dollars, 36% less than in the same period 2015 (714 billion in cumulative twelve-month terms – see Figure 8 – well below the peak levels of May last year). The decline, presumably due in part to the year's unsettled markets, extended across all main regions (Europe -35%, United States -45%, Japan -34%, China -21%). By sector, issuance fell off sharply in all sectors except utilities, up 36% in the first half-year though the figures involved were small. The bank sector saw the steepest percentage decline (81%), but the drop among industrials was the largest in money terms (down from 371 to 247 billion dollars).

Global equity issuance

FIGURE 8



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

2.2 National economic and financial developments

Spanish GDP grows 0.8% in the opening quarter (3.4% annualised), sizeably ahead of the euro area (1.5%).

Spanish GDP kept up a solid advance in the opening quarter and retained its growth lead over the euro area, albeit slowing somewhat versus the fourth quarter of 2015. Specifically, GDP expanded 3.4% in year-on-year terms (0.8% in the quarter), 0.1 points less than in the previous quarter and almost two points ahead of the euro area (with an annual rate of 1.5%).

Private consumption holds up strongly, but other demand components have flagged to some extent.

Domestic demand contributed slightly less to GDP growth, down from 4.1 to 3.8 percentage points, against a rising contribution from the net exports side. By domestic demand component, private consumption growth picked up from 3.5% to 3.7%, while government consumption cooled slightly (from 3.7% to 2.6%) as did gross fixed capital formation (from 6.4% to 5.2%). Construction and equipment investment lost some momentum versus the fourth quarter of 2015. In the external sector, growth of exports and imports slowed from 5.3% and 7.7%, respectively, at end-2015 to 3.7% and 5.4%, while the sector as a whole upped its growth contribution from -0.6 to -0.4 percentage points.

On the supply side, only the services sector picks up speed.

Supply side sectors grew at a decelerating pace, the exception being services, which raised its gross value added by 3.5% (3.4% in the previous quarter). The value added of primary industries climbed by 5.5% (6.2% previously) against 2.6% for industry (3.4%) and 2.6% for construction (4%).

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

	2012	2013	2014	2015	EC[1] 2016F	EC[1] 2017F
GDP	**-2.6**	**-1.7**	**1.4**	**3.2**	**2.6**	**2.5**
Private consumption	-3.5	-3.0	1.2	3.1	3.0	2.3
Public consumption	-4.5	-2.8	0.0	2.7	1.0	1.0
Gross fixed capital formation, of which:	-7.1	-2.4	3.5	6.4	4.7	5.0
Construction	-8.2	-7.1	-0.1	5.3	N/A	N/A
Equipment and others	-8.5	4.3	10.7	10.1	7.7	6.5
Exports	1.1	4.3	5.1	5.4	4.5	5.2
Imports	-6.2	-0.3	6.4	7.5	5.8	5.8
Net exports (growth contribution, p.p.)	2.1	1.4	-0.2	-0.5	-0.3	-0.1
Employment[2]	**-4.9**	**-3.5**	**1.1**	**3.0**	**2.5**	**2.0**
Unemployment rate	**24.8**	**26.1**	**24.4**	**22.1**	**20.0**	**18.1**
Consumer price index	**2.4**	**1.4**	**-0.1**	**-0.5**	**-0.1**	**1.4**
Current account balance (% GDP)	**-0.2**	**1.5**	**1.0**	**1.4**	**1.5**	**1.3**
General government balance (% GDP)[3]	**-10.4**	**-6.9**	**-5.9**	**-5.1**	**-3.9**	**-3.1**
Public debt (% GDP)	**85.4**	**93.7**	**99.3**	**99.2**	**100.3**	**99.6**
Net international investment position (% GDP)[4]	**-68.7**	**-85.5**	**-88.2**	**-79.9**	**N/A**	**N/A**

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

1 European Commission forecasts of May 2016.

2 In full-time equivalent jobs.

3 Figures for 2012, 2013, 2014 and 2015 include government aid to credit institutions amounting to 3.8%, 0.5%, 0.1% and 0.1% of GDP, respectively.

4 Ex. Banco de España.

N/A: [data] not available.

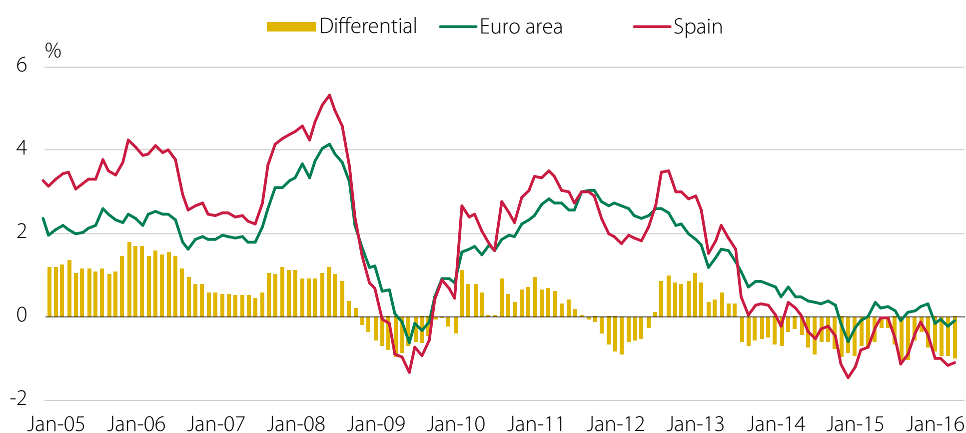
Falling energy prices keep headline inflation negative, while the core rate softens to 0.7%.

For all this year (and much of last), Spanish inflation has moved in negative terrain on still falling energy prices (an annual -13.6% on average). May's headline rate was -1.0%, sizeably below the 0% of the 2015 close and that year's average of -0.5%. A small decline in other, less volatile inflation components took core inflation down from the 0.9% of December 2015 to an April rate of 0.7%. Finally, Spain's inflation differential versus the euro area widened from -0.4 percentage points at end-2015 to -1.0 percentage points in May (see figure 9).

Job creation continues apace at rates exceeding 3%, though unemployment ends the first quarter at 21%.

Job creation is gathering speed as domestic activity continues its advance. In the opening quarter, the number of people in employment rose by 3.2% year on year (3.0% on average in 2015). The result was that the Spanish economy had 17.18 million full-time equivalent jobs, 533,000 more than at the same time last year. The unemployment rate ended the first quarter at 21%, a little below the full-year average of 2015 (22.1%). Growth of unit labour costs, calculated as the difference between the increase in compensation per worker and productivity growth, was slightly negative in the first quarter of 2016 (-0.5% vs. the 2015 average of 0.3%) on lower worker compensation (-0.3%) and a small advance in productivity (0.2%).

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



Source: Thomson Datastream. Data to May.

Spain's 2015 public deficit of 5.1% of GDP is down almost one point vs. 2014 but still well ahead of the government's target.

The general government deficit closed last year at 5.1% of GDP, improving on the 2014 outcome (5.9%), but still almost one point higher than the government's target (4.2%). By branch, central government returned a deficit of 2.5% of GDP against the 1.7% of the autonomous regions and the 1.3% of the social security administration, while local authorities recorded a fiscal surplus equating to 0.4% of GDP. According to the excessive deficit protocol, public debt as a ratio of GDP inched down to 99.2% in 2015 from the 99.3% of the previous year, only to rebound to 100.5% in the first quarter of 2016. Budgetary execution figures to March put the consolidated general government deficit ex. local authorities at 0.8% of GDP, on a par with the first quarter of 2014. The latest updated Stability Programme, for 2016-2019, projects a deficit of 3.6% of GDP this year and 2.9% in 2017.

A supportive macro environment has helped banks rein in non-performing loans, but low interest rates remain a major business hurdle.

The pickup in domestic activity and employment is allowing further inroads into bank sector NPL ratios, although the volume of doubtful loans remains relatively high. The low interest rate environment, which seems set to continue, is an added factor in the bad debt decline, but it also constrains banks' earning power, as evidenced by returns trailing the historical average (albeit in line with other euro-area countries). Moreover, Spanish banks' considerable Latin American exposure leaves them vulnerable to the slowdown affecting economies in the region.

NPLs drop to 10% of total loans in March, improving slightly on the ratio for end-2015.

NPL ratios have continued to decline in the opening months of 2016, but at a rather slower pace. By March, non-performing loans to other resident sectors (non-financial corporations and households) amounted to 10% of total loans, compared to the 10.1% of end-2015 and the 13.6% high of late 2013. The income statements of deposit taking entities showed 2015 profits of 9.30 billion euros, down from 11.34 billion in 2014. Net operating income deteriorated slightly with respect to 2014 (12.8 billion euros versus 12.93 billion respectively), due to gross margin falling more steeply than financial asset impairment losses. Finally, the drop in 2015 earnings was mainly attributable to impairment losses on other assets, up from 1.53 billion in 2014 to 3.41 billion euros.

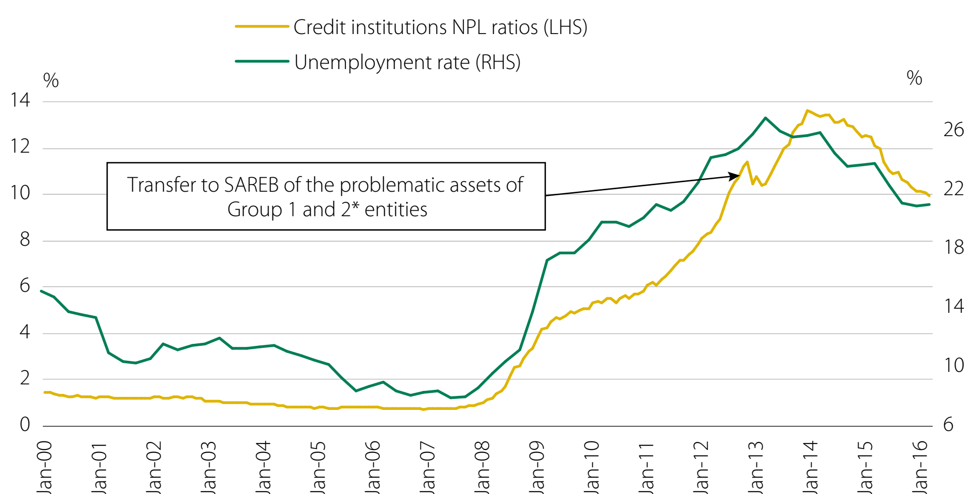
Lending to the non-financial resident sector falls 2.1% to April, up from the -1.4% of last year's close.

Bank lending to the non-financial resident sector (businesses and households) contracted further in the opening months of 2016, and also rather more intensely than at end-2015. By April, the flow of finance (loans and securities other than shares) to non-financial corporations and households was down 1.8% and 2.4% respectively year on year (-0.8% and -2.2% in December 2015). Among non-financial corporations, the contraction stemmed from faster declining loans and debt financing, while the more pronounced drop in total credit flows to households has its origins in the performance of home purchase loans. In the euro area, conversely, the growth rate of outstanding loans to non-financial corporations and households was positive and rising, with the stock of lending to businesses up 0.9% in April (0.1% in December 2015) and that of lending to households up 2.2% (1.9% in December).

The banking sector's balance sheet contracts further across all funding heads in the opening months of 2016.

Bank sector balance sheets continued shrinking in the first months of the year. Other constraints on sector business volumes, particularly low interest rates, gain greater currency in the present context. The sector-wide balance sheet, finally, stood at 2.74 trillion at end-March 2016 (21 billion less than at end-2015). All funding sources contracted to some degree: deposits by almost 14.6 billion euros, outstanding debt by 14 billion and equity by almost 3.5 billion. Banks also reduced their net Eurosystem borrowings from 133 billion at the 2015 close to just under 130 billion in the month of April.

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



Source: Banco de España and National Statistics Office (INE). Data to March de 2016.

1 Percentage of the active population.

* Group 1 transfers took place in December 2012 (36.70 billion euros) and Group 2 transfers in February 2013 (14.09 billion euros).

Profits of non-financial listed companies fall by 7% in 2015 with most of the decline located in the energy sector.

Non-financial listed companies obtained full-year profits of 17.16 billion euros in 2015, 6.9% less than in 2014. Almost all the decline owed to the oil-price-induced slump in energy firm profits from 10.81 billion euros in 2014 to 5.2 billion in 2015. Remaining non-financial sectors posted stable or rising profits in full-year 2015. Out in front were construction and real estate companies, which more than tripled their earnings in the year (from 1.1 billion to 3.43 billion euros) and firms in retail and services with a 43% advance to 6.84 billion euros. Industrial firm profits held broadly flat versus 2014 at just over 1.60 billion euros (see Table 3).

Earnings by sector:[1] Non-financial listed companies TABLE 3

Million euros	EBITDA[2] 2014	EBITDA[2] 2015	EBIT[3] 2014	EBIT[3] 2015	(Consolidated) profit for the year 2014	(Consolidated) profit for the year 2015
Energy	10,378	7,979	8,926	6,087	10,807	5,202
Industry	3,155	3,000	2,452	2,338	1,693	1,631
Retail and services	13,594	8,732	7,849	2,776	4,781	6,836
Construction and real estate	2,723	5,312	1,072	3,024	1,097	3,434
Adjustments	40	34	-61	-68	-47	-55
Total	**29,811**	**24,988**	**20,359**	**14,294**	**18,424**	**17,157**

Source: CNMV.

1 Year-to-date earnings.

2 Earnings before interest, taxes, depreciation and amortisation.

3 Earnings before interest and taxes.

Corporate borrowings edge higher (1.6%) in 2015, but growth in equity brings leverage down from 1.28 to 1.22.

The aggregate debt of non-financial listed companies, at 255.36 billion euros, was 1.6% more than at end-2014 (see Table 4). All sectors increased their debt total in the year, except construction and real estate where deleveraging continued apace. The most heavily indebted in absolute terms were retail and services, with levels up 1.3% to 107.62 billion, and the energy sector, up 7.7% to more than 77 billion euros. The average leverage of non-financial listed firms edged down from 1.28 in 2014 to 1.22 in 2015, on an increase in equity ahead of debt. Further, companies' debt coverage ratio (debt/EBITDA) worsened slightly across all sectors except construction and real estate, increasing in the year from 8.4 to 10.2.

Gross debt by sector: Listed companies TABLE 4

Million euros	Debt[1] 2014	Debt[1] 2015	Debt/Equity 2014	Debt/Equity 2015	Debt/EBITDA[2] 2014	Debt/EBITDA[2] 2015
Energy	71,572	77,051	0.74	0.75	6.9	9.7
Industry	16,261	16,744	0.86	0.83	5.2	5.6
Retail and services	106,193	107,618	1.78	1.89	7.8	12.3
Construction and real estate	58,623	55,275	2.56	1.86	21.5	10.4
Adjustments	-1,381	-1,328				
TOTAL	**251,268**	**255,360**	**1.28**	**1.22**	**8.4**	**10.2**

1 In million euros.

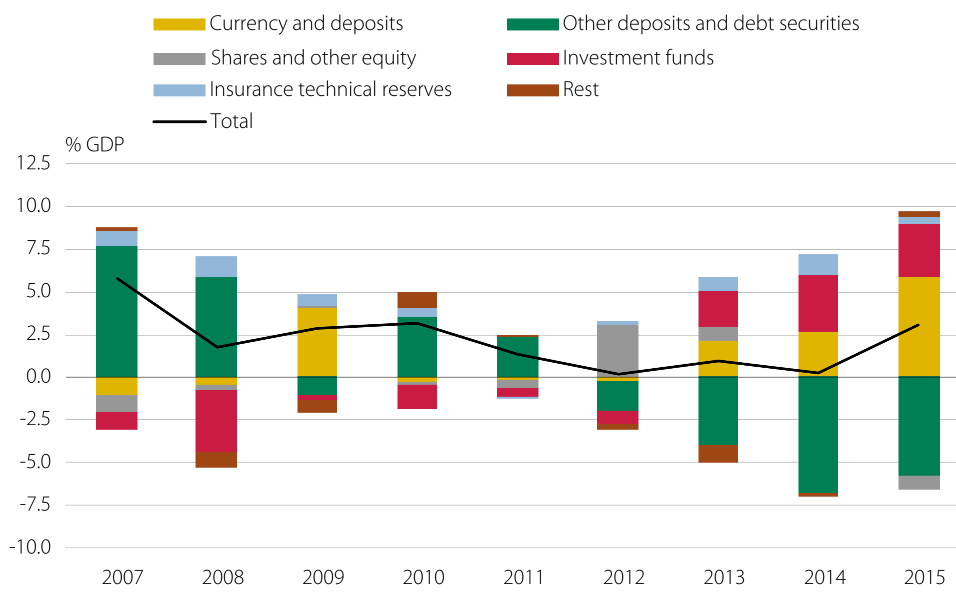
2 Earnings before interest, taxes, depreciation and amortisation.

A number of factors combine to boost households' financial position. Increased investment in financial instruments finds its way mainly to cash and sight deposits and mutual funds.

Indicators for the financial position of Spanish households in 2015 reveal that saving rates held broadly flat at just over 9% of gross disposable income (GDI). Improvement in this indicator came from an annual reduction in debt-to-income and debt burden ratios. The former decreased from 112.1% of GDI at end-2014 to 106.1% in December 2015 on a combination of lower indebtedness and rising household income on account of cheaper oil, personal income tax cuts and higher wages per employee, among other factors. The fall in the debt burden ratio from 12.6% to 12% rested also on the lower average interest on borrowed funds. Household financial

investments, finally, came to 3% of GDP, a large increase with respect to the previous years (0.2% in 2014, 0.9% in 2013 and 0.2% in 2012). The pattern of investment was similar to 2014 with households withdrawing massively from time deposits and debt instruments (5.8% of GDP), due to the poor returns on offer, in favour of cash and sight deposits (5.8% of GDP) and mutual funds (3.1% of GDP). The other salient trend was a gathering move out of shares and other equity participations.

Households: Financial asset acquisitions (net) FIGURE 11



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

2.3 Outlook

The global economy set for 3.2% growth this year, 0.1 points ahead of 2015.

The latest IMF forecasts project global GDP growth of 3.2% this year and 3.5% in 2017, improving on the 3.1% of 2015. This represents a small mark-down on the organization's previous forecasts, with the pickup in activity now expected to be more gradual in both advanced and emerging economies – 1.9% and 2% for the former group in 2016 and 2017, respectively (1.9% in 2015) and, for the latter, 4.1% and 4.6% (4% in 2015).

The most prominent risks remain Brexit, the speed of the rates upcycle in the United States and the deceleration of emerging economies.

The main risks that could alter this growth scenario and trigger new flare-ups in financial market volatility have to do with the uncertain time scale of Federal Reserve interest rate hikes and, especially, the end-June referendum on the United Kingdom's possible exit (Brexit) from the European Union. Other risks are attached to the slowdown in some emerging markets and the weakness of the banking sector, particularly in Europe. The region's banks are having to negotiate a business landscape characterised by still frail economic activity and ultra-low interest rates (likely to persist for some time to come), which has called into question both their revenue potential and the viability of traditional business streams. Not only that, the industry faces growing competition from other agents, notably the "shadow banking" intermediaries providing loans outside the banking channel, and firms in the "fintech" industry using innovative tech platforms to offer traditionally bank-related services.

Finally, the prolongation of international geopolitical conflicts is another downside risk for this baseline scenario.

Gross domestic product (annual % change) TABLE 5

	2012	2013	2014	2015	IMF[1] 2016F	IMF[1] 2017F
World	3.5	3.3	3.4	3.1	3.2 (-0.2)	3.5 (-0.1)
United States	2.2	1.5	2.4	2.4	2.4 (-0.2)	2.5 (-0.1)
Euro area	-0.9	-0.3	0.9	1.6	1.5 (-0.2)	1.6 (-0.1)
Germany	0.6	0.4	1.6	1.5	1.5 (-0.2)	1.6 (-0.1)
France	0.2	0.7	0.2	1.1	1.1 (-0.2)	1.3 (-0.2)
Italy	-2.8	-1.7	-0.3	0.8	1.0 (-0.3)	1.1 (-0.1)
Spain	-2.6	-1.7	1.4	3.2	2.6 (-0.1)	2.3 (0.0)
United Kingdom	1.2	2.2	2.9	2.2	1.9 (-0.3)	2.2 (0.0)
Japan	1.7	1.4	-0.0	0.5	0.5 (-0.5)	-0.1 (-0.4)
Emerging economies	5.3	4.9	4.6	4.0	4.1 (-0.2)	4.6 (-0.1)

Source: IMF.

1 In brackets, change vs. the previous forecast. IMF, forecasts published April 2016 vs. January 2016.

Growth of the Spanish economy will again easily outpace that of the euro area, although risks are also present. Some are shared with other European countries (bank sector weakness) but others are of a local nature (political uncertainty).

In the case of the Spanish economy, the IMF is looking for 2.6% growth in 2016 (0.1 points less than its previous forecast) followed by 2.3% in 2017 (no change). Despite this minor mark-down, Spain is expected to conserve its strong lead with respect to euro-area growth rates (1.5% and 1.6%, respectively). The success of structural reforms, tumbling oil prices and a weaker euro are among the factors favouring this scenario of robust growth and employment creation. However the Spanish economy faces several important risks. Most it shares with other European economies; for instance, those associated with the emerging market economies, problems of bank sector profitability or fallout from geopolitical conflicts. But others of a more specific nature must also be addressed. The most prominent have to do with the country's political impasse, which to date has not materially impacted on domestic financial markets, and certain companies' high exposure to distressed Latin American economies, and the UK economy in the event that Brexit comes to materialise.

3 Spanish markets

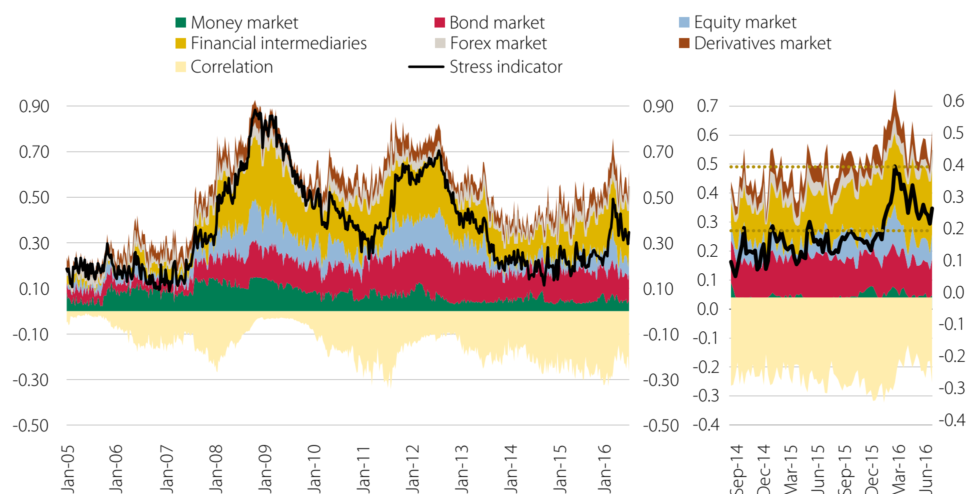
The indicator measuring stress on Spanish financial markets has retreated from the peak levels of mid-February, but remains in the interval of medium risk.

The uncertainty that stalked world financial markets in the year's first weeks in response to diverse risk factors (deceleration in China and faltering growth in general, falling oil prices, etc.) caused the stress indicator for Spanish financial markets to spike at 0.49[4] in the middle of February (see Figure 12). Although the general

4 The stress indicator developed by the CNMV provides a real-time measurement of systemic risk in the Spanish financial system in the range of zero to one. To do so, it assesses stress in six segments (equity, bonds, financial intermediaries, the money market, derivatives and the forex market) and aggregates them into a single figure bearing in mind the correlation between them. Econometric estimations

indicator has since eased back to what we could consider the medium risk interval, stress readings are still high for certain segments like financial intermediation, exchange rates or the derivatives market.

Spanish financial market stress indicator FIGURE 12



Source: CNMV. See Estévez and Cambón (2015).[5]

3.1 Equity markets

In June, a string of uncertainty factors (Brexit, the timing of US rate hikes, the health of the financial system…) sparked a new bout of volatility and a stiff downward correction that reversed the gains of the previous weeks.

Spanish stock markets began the year with a stiff price correction that by mid-February had the Ibex 35 trading at its lowest point since July 2013. Driving the decline were investor fears of a slowdown in the world economy, or even a new recession, as concerns multiplied around the situation of the emerging economies, the slump in oil prices, and, again, the health of the European financial system. Later, an uptick in oil prices, the new monetary stimulus package announced by the ECB and better macroeconomic data in the United States and Europe allowed markets to recoup some of the ground lost at the start of the year. However this was not to last. By end-June, doubts about the outcome of the UK referendum on European Union membership (Brexit) and the timing of interest rate hikes in the United States sent markets falling once more. Losses in Spain were steeper than in Germany and France, smaller than in Italy and on a par with those of the Eurostoxx 50 benchmark index, and came on top of the negative numbers accumulated in 2015. Volatility, meantime, retreated from its early-year highs of over 40% and tended to moderate as markets regained their composure. Trading volumes were 444 billion on the year (21% down in year-on-year terms), with the decline steepening quarter after quarter. Meantime trading in Spanish shares on platforms other than their home market continued its advance and now accounts for over 25% of the total. In primary

consider that market stress is low when the indicator stands below 0.27, intermediate in the interval of 0.27 to 0.49, and high when readings exceed 0.49. For more information see Exhibit 1.1 of the *CNMV Annual Report* for 2014 and Estévez, L. and Cambón, M.I. (2015). *A Spanish Financial Market Stress Index (FMSI)*. CNMV Working Paper No. 60. Available at: http://www.cnmv.es/portal/Publicaciones/monografias.aspx

5 Estévez and Cambón (*op. cit.*).

markets, finally, issuance bounced back after the lull of last year's second half, led by three new share flotations.

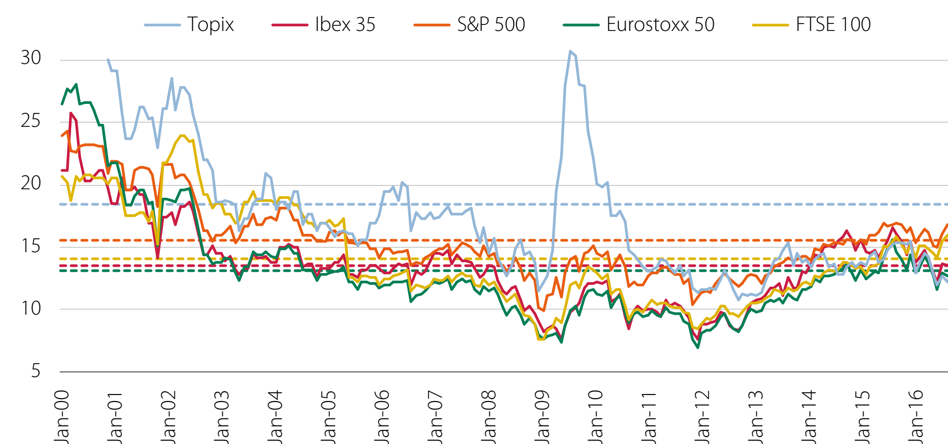
The Ibex 35 shed 5.4% in the second quarter lifting year-to-date losses to 13.6%. Other indices fared similarly except the Ibex Small Cap whose fall was contained at 5.2%. By contrast, Latibex indices powered higher in the year, buoyed by the appreciation of Latin American currencies.

Against this backdrop, the Ibex 35 added a further -5.4% to the 8.6% losses of the opening quarter for a year-to-date fall[6] of 13.6% (-7.2% in full-year 2015). Other Spanish indices posted second-quarter losses on a similar scale, from -4% to -5.6%, but showed sharp variations in their year-to-date performance. Specifically, the Ibex 35, the Madrid General Index (IGBM) and the Ibex Medium Cap were down by around 13% or more at the closing date for this report, while the Ibex Small Cap shed a considerably smaller 5.2% (see Table 6). Conversely, the indices grouping Latin American securities traded in euros fell sharply in the second quarter, but managed sizeable progress year to date, on top of which local money gains were magnified by the strength of currencies like the Brazilian real.[7] Hence the 16.9% and 8.6% advances of the FTSE Latibex All-Share and FTSE Latibex Top on the year, even after second-quarter losses of 5.4% and 7.5%, respectively.

Sector performances were mixed in the second quarter, with financials and telecommunications losing ground and oil stocks gaining. All sectors, however, are down on the year.

Performances varied from sector to sector in the second quarter. The biggest losses were in the financial sector as banks struggled to generate profits in a low interest-rate environment, and technology and telecommunications, due to difficulties faced by the top Spanish telecoms operator in disposing of its UK subsidiary. By contrast, the oil and energy sector benefited from the recovery of oil prices (24% in the second quarter and 31% since January). All sectors stand in negative territory year to date, with financial services as the worst performer, held back by the banks. Other major losers were the telecommunications sector and, to a lesser extent, consumer goods and services, on growing fears of an economic slowdown (see Table 6).

Price-earnings ratio[1] (P/E) FIGURE 13



Source: Thomson Datastream. Data to 15 June.

1 Twelve-month forward earnings.

6 Data to 15 June.

7 The Brazilian currency has gained around 10% against the euro year to date.

Performance of Spanish stock market indices and sectors (%) TABLE 6

Index	2012	2013	2014	2015	4Q 15[1]	1Q 16[1]	2Q 16 (to 15 June) %/prior quarter	2Q 16 (to 15 June) %/Dec 2015
Ibex 35	-4.7	21.4	3.7	-7.2	-0.2	-8.6	-5.4	-13.6
Madrid	-3.8	22.7	3.0	-7.4	-0.1	-8.8	-5.6	-14.0
Ibex Medium Cap	13.8	52.0	-1.8	13.7	5.5	-9.3	-4.0	-12.9
Ibex Small Cap	-24.4	44.3	-11.6	6.4	6.6	-0.2	-5.1	-5.2
FTSE Latibex All-Share	-10.7	-20.0	-16.1	-39.2	-7.8	23.5	-5.4	16.9
FTSE Latibex Top	-2.6	-12.4	-11.1	-34.6	-4.9	17.4	-7.5	8.6
Sector[2]								
Financial and real estate services	**-4.7**	**19.9**	**1.4**	**-24.2**	**-5.4**	**-14.3**	**-9.3**	**-22.3**
Banks	-4.8	18.8	1.6	-26.0	-6.3	-14.5	-9.8	-22.9
Insurance	-2.0	47.3	-9.2	-5.0	6.7	-19.3	2.6	-17.2
Real estate and others	-14.4	38.3	36.3	18.4	2.6	0.1	0.6	0.7
Oil and energy	**-16.0**	**19.0**	**11.8**	**0.6**	**5.6**	**-6.7**	**0.0**	**-6.7**
Oil	-35.4	19.5	-15.1	-34.9	-2.8	-2.0	10.6	8.4
Electricity and gas	-5.4	18.7	21.7	9.6	7.0	-7.4	-1.7	-9.1
Basic materials, industry and construction	**-8.0**	**28.9**	**-1.8**	**2.1**	**2.8**	**-3.5**	**-5.3**	**-8.7**
Construction	-9.3	26.5	8.9	4.9	1.9	-6.6	-5.9	-12.2
Manufacture and assembly of capital goods	-8.8	55.4	-18.3	49.0	17.4	3.0	-6.5	-3.7
Minerals, metals and metal processing	-8.7	11.5	4.5	-30.8	6.8	10.9	-0.2	10.7
Engineering and others	3.8	7.6	-17.0	-39.6	-23.1	-12.7	-2.2	-14.6
Technology and telecommunications	**-18.3**	**22.8**	**2.5**	**-5.2**	**-2.2**	**-5.0**	**-9.2**	**-13.7**
Telecommunications and others	-23.0	17.1	2.6	-12.3	-4.8	-4.6	-12.8	-16.9
Electronics and software	39.4	56.8	2.3	22.2	5.7	-6.1	2.8	-3.4
Consumer goods	**55.6**	**17.1**	**-1.5**	**30.9**	**6.9**	**-6.4**	**-0.7**	**-7.0**
Textiles, clothing and footwear	66.2	13.5	-1.1	33.6	5.9	-6.7	-0.2	-6.8
Food and drink	25.0	4.7	-5.2	26.4	3.2	-1.1	-1.4	-2.4
Pharmaceutical products and biotechnology	68.3	39.6	-1.0	23.5	11.1	-8.7	-2.4	-10.9
Consumer services	**12.7**	**58.9**	**10.0**	**10.4**	**3.1**	**-5.4**	**-4.1**	**-9.2**
Motorways and car parks	5.7	36.5	6.8	-7.9	2.0	0.3	-8.0	-7.8
Transport and distribution	29.7	116.4	27.9	29.6	5.3	-6.9	-7.7	-14.1

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.

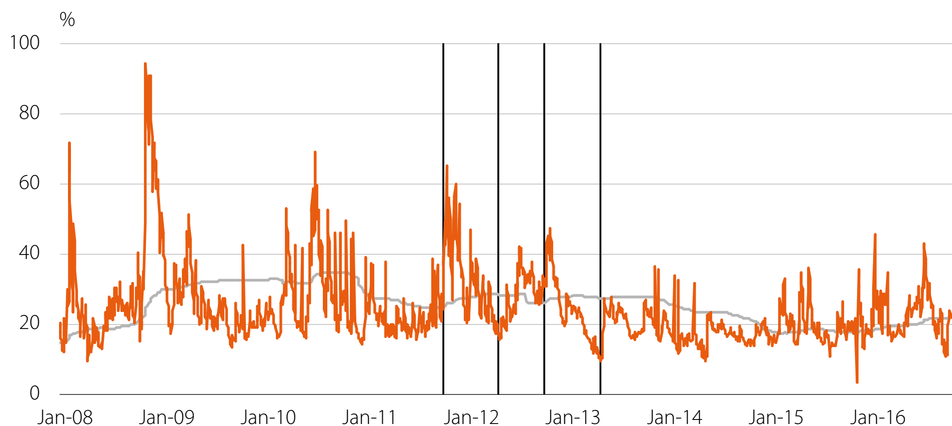
The price-earnings ratio ticks up in the quarter despite falling prices, anticipating more modest corporate earnings.

Despite falling share prices, the expectation of more moderate corporate earnings in coming months lifted the price-earnings ratio (P/E) of the Ibex 35 from 13.6 to 14.1 in the second quarter. Year to date, however, the multiple has held more or less stable since markets and estimated earnings have fallen by a similar margin. As Figure 13 shows, the P/Es of all major stock indices ticked up in the quarter, evidencing expectations of a slowdown in the advanced economies. With the exception of the Eurostoxx 50 and Japan's Topix, multiples in all markets stood above their average levels for 2000-2015.

Volatility touches 40% in February on market jitters before dropping back to around 20%. June readings stand above the 2Q average as concerns grow over Brexit.

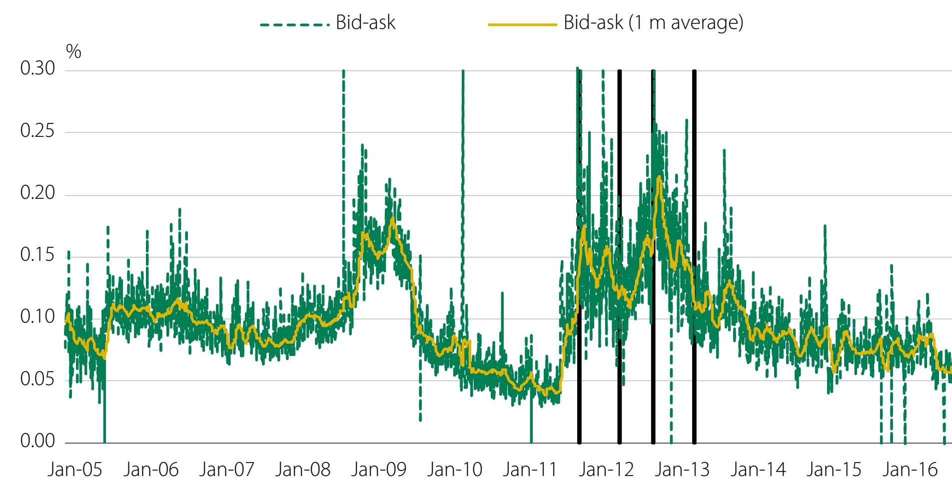
Volatility of the Ibex 35 turned up sharply in the first two months (peaking at over 40%), then died down significantly in the second quarter to just under 24%. This was higher than the second-quarter average (20%) but a good way below the average for the first three months (29.55%). A similar pattern could be observed on other European indices, like the Eurostoxx 50, though US indices like VIX registered more subdued mid-year levels of around 20%.

Historical volatility of the Ibex 35 FIGURE 14



Source: Thomson Datastream and CNMV. Data to 15 June. The red line indicates conditional 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. Bid-ask spread FIGURE 15



Source: Thomson Datastream and CNMV. Data to 15 June. 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.

Ibex 35 liquidity, as measured by the bid-ask spread, traced a smooth progression, and worsened only briefly – a widening movement – at the end of the second quarter coinciding with opinion polls showing majority support for Brexit. The bid-ask spread widened from 0.064% at the end of the first quarter to 0.077% at mid-June, still below the indicator's historical average (0.10%).

Ibex 35 liquidity remains satisfactory.

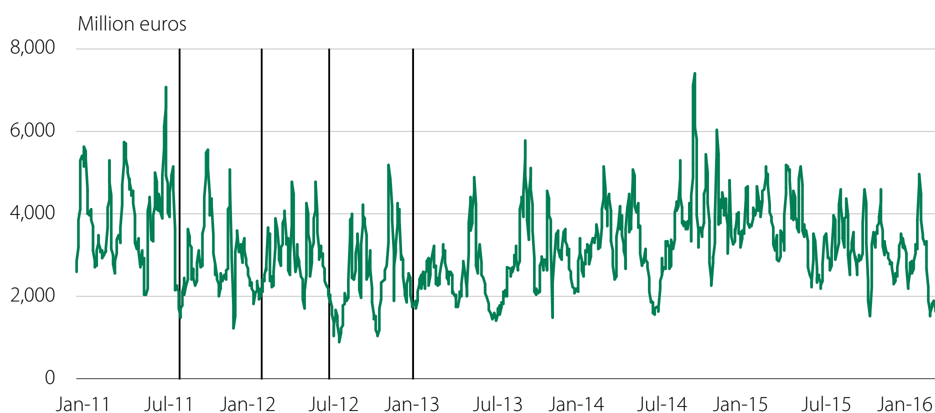
Trading in Spanish equities came under dual pressure from political uncertainty at home, with new elections imminent, and concerns over the possible outcome of the Brexit referendum, with volumes down by 25% compared to the first quarter and 23% year on year. Cumulative figures to June were above 444 billion euros, 21% down on the same period 2015.[8] The trading slump was more intense than on other major European bourses. Daily volumes on the continuous market averaged 2.74 billion euros, trailing the 3.28 and 3.13 billion of the two preceding quarters and the 3.67 billion average of 2015 (see Figure 16).

Trading volumes in Spanish stocks fall off in the quarter and year on year, depressed by political uncertainty at home and in Europe.

We have already referred to the upward trend in Spanish share trading on other European regulated markets and multilateral trading facilities (MTFs). So far this year, these external markets channelled over 108 billion euros in trades, a bare 3 billion euros less than in the same period 2015. This sum equated to nearly a quarter of overall trading in Spanish shares (20% and 24% in the fourth quarter of 2015 and first quarter of 2016 respectively, and 20% over full-year 2015). Again the Chi-X stands out for the scale of volumes – over 54 billion euros and half of all foreign trading – although it has lost some ground to competing platforms.

Trading of Spanish shares on other European regulated markets and MTFs has now reached almost 25% of the total.

Daily trading on the Spanish stock market[1] FIGURE 16



Source: CNMV. Data to 14 June. 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.

8 Not including trading on MAB and Latibex and in ETFs.

Trading in Spanish shares listed on Spanish exchanges[1]

TABLE 7

Million euros	2012	2013	2014	2015	4Q 15	1Q 16	2Q 16[2]
Total	**709,902.0**	**764,986.6**	**1,002,189.0**	**1,161,482.8**	**266,113.7**	**253,912.3**	**190,492.7**
Listed on SIBE (electronic market)	**709,851.7**	**764,933.4**	**1,002,095.9**	**1,161,222.9**	**266,089.8**	**253,910.6**	**190,489.1**
BME	687,456.1	687,527.6	849,934.6	925,978.7	212,179.0	192,651.7	143,822.4
Chi-X	16,601.3	53,396.7	95,973.0	150,139.9	33,791.6	33,384.3	21,274.8
Turquoise	3,519.6	11,707.9	28,497.5	35,680.5	7,458.6	12,606.1	9,342.3
BATS	2,261.9	10,632.1	18,671.0	35,857.6	10,513.1	11,629.0	9,970.0
Others[2]	12.8	1,669.2	9,019.8	13,566.2	2,147.6	3,639.6	6,079.6
Open outcry	**49.9**	**51.4**	**92.4**	**246.1**	**23.7**	**1.6**	**3.2**
Madrid	3.0	7.3	32.7	19.4	11.0	1.4	1.0
Bilbao	8.5	0.1	14.3	7.5	4.7	0.0	0.0
Barcelona	37.7	44.1	45.2	219.1	8.0	0.2	2.2
Valencia	0.7	0.0	0.3	0.1	0.0	0.0	0.0
Second market	**0.4**	**1.7**	**0.7**	**13.8**	**0.2**	**0.1**	**0.4**
Pro memoria							
BME trading of foreign shares[3]	4,102.0	5,640.0	14,508.9	12,417.7	985.7	1,295.8	1,295.2
MAB	4,329.6	5,896.3	7,723.2	6,441.7	1,720.3	1,134.0	847.3
Latibex	313.2	367.3	373.1	258.7	46.4	53.4	17.0
ETFs	2,736.0	4,283.9	9,849.4	12,633.8	2,632.2	2,273.4	976.4
Total BME trading	698,987.5	703,768.7	882,482.3	957,990.5	217,587.5	197,409.8	146,961.9
% Spanish shares on BME vs. total Spanish shares	96.8	89.9	84.8	80.1	80.1	76.2	75.7

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 14 June.

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.

Equity issuance jumps by 35% in the second quarter due to larger capital increases and initial public offerings of three companies, but falls back in annual terms.

Equity issuance on domestic markets swelled by 35% in the second quarter to 6.60 billion euros, lifting the first-half total to 11.49 billion. Growth in the quarter stemmed from larger capital increases, notably a macro-increase at a steel conglomerate listed on various European exchanges (besides the Spanish continuous market), and the initial offerings of three newly floated firms. Issue volumes were the highest since the second quarter of 2015, but still trailed this recent high by 44%.[9] Breaking down issuance by type, capital increases with and without preferential subscription rights accounted for 65% of second-quarter volumes (18% in the first quarter and 58% in 2015). Amounts raised by scrip dividend issues rose slightly to 1.10 billion euros, reducing the share of this modality to 18%. Finally, capital increases by debt conversion raised a bare 225 million euros in the period.

9 The second quarter of 2015 saw two major share offerings (one firm in the telecommunications sector and another in railways), as well as a number of capital increases.

Capital increases and public offerings

TABLE 8

	2013	2014	2015	3Q 15	4Q 15	1Q 16	2Q 16
NUMBER OF ISSUERS[1]							
Total	**39**	**49**	**52**	**24**	**19**	**17**	**17**
Capital increases	39	47	47	23	19	17	17
Public offer for subscription	5	6	0	0	0	0	3
Public offering of shares	0	4	6	1	0	0	2
NUMBER OF ISSUES[1]							
Total	**145**	**147**	**115**	**27**	**24**	**21**	**21**
Capital increases	145	140	103	25	24	21	19
Public offer for subscription	5	8	0	0	0	0	4
Public offering of shares	0	7	12	2	0	0	2
CASH AMOUNT[1] (million euros)							
Total	**39,126.2**	**32,762.4**	**37,067.4**	**4,458.9**	**5,160.0**	**4,891.5**	**6,601.4**
Capital increases	39,126.2	27,875.5	28,735.8	3,618.6	5,160.0	4,891.5	6,094.8
Public offer for subscription	1,742.8	2,951.5	0.0	0.0	0.0	0.0	807.6
Paid-in capital increases	9,932.8	12,650.8	9,627.8	1,387.9	2,749.1	966.6	1,099.2
of which scrip dividend[2]	9,869.4	12,573.8	9,627.8	1,387.9	2,749.1	966.6	1,099.2
Capital increases by debt conversion[3]	7,478.8	3,757.9	2,162.5	465.6	1,015.7	3,008.6	224.6
Capital increases against non-monetary consideration[4]	231.6	2,814.5	367.0	123.2	0.1	50.8	0.0
With preferential subscription rights	11,463.1	2,790.8	7,932.6	1,196.1	1,047.1	799.9	3,028.5
Without rights trading	8,277.1	2,909.9	8,645.9	445.9	348.0	65.5	935.0
Public offering of shares	0.0	4,886.9	8,331.6	840.3	0.0	0.0	506.6
Memorandum item: MAB transactions[5]							
Number of issuers	7	9	16	3	7	2	3
Number of issues	14	15	18	3	7	2	3
Cash amount (million euros)	45.7	130.1	177.8	28.5	133.8	7.2	4.1
Capital increases	45.7	130.1	177.8	28.5	133.8	7.2	4.1
of which, through public offer for subscription	1.8	5.0	21.6	3.8	12.9	0.0	0.0
Public offering of shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: BME and CNMV. Data to 15 June.

1 Transactions filed with the CNMV. Not including figures for MAB, ETFs or Latibex.

2 In scrip dividends, the issuer gives existing shareholders the option of receiving their dividend in cash or converting it into shares in a paid-in capital increase.

3 Includes capital increases to allow conversion of bonds and other debt into shares by the exercise of employee stock options or execution of warrants.

4 Capital increases for non-cash consideration have been measured at their market value.

5 Transactions not filed with the CNMV.

3.2 Fixed-income markets

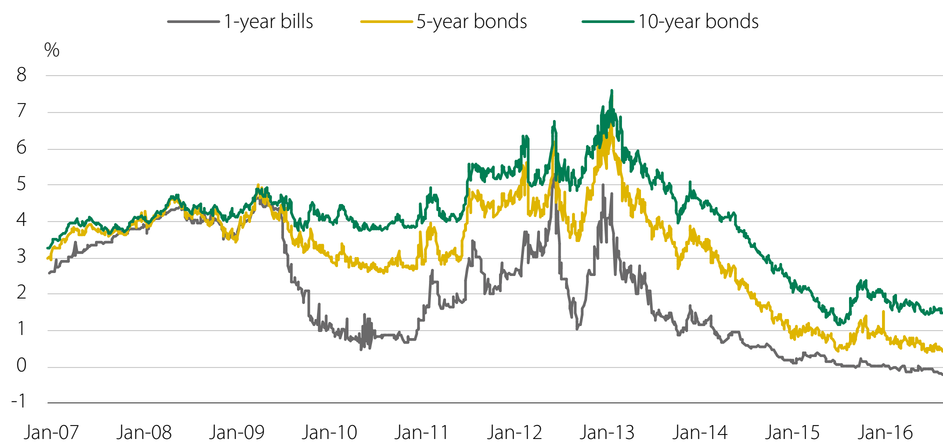
Fixed-income markets see a downtrend in yields of public and corporate debt instruments, supported by the ECB's purchase programmes…

Fixed-income markets in Spain and other major European countries began the year with rising prices and falling yields, as investors sought refuge from the instability of equity markets. This process intensified in early March, when the ECB announced the launch of a corporate debt purchase programme, to be effective as of the second week in June. The announcement had the effect of driving yields on both government and corporate debt to annual lows across the length of the curve, with the decline extending to high-yield instruments. As the second quarter advanced, however, bond yields began to creep back up on concerns about the political impasse and calling of new elections in Spain and the outcome of the UK referendum on European Union membership (Brexit).

… which have helped stabilise risk premiums while driving up long-term corporate debt issuance.

Risk premiums also felt the beneficial impact of monetary policy, though here too political uncertainty at home and in Europe has begun to take its toll. Spanish sovereign spreads, particularly, have widened by 42 bp year to date. Further, the ECB's announcement on corporate debt purchases, which brought firms big savings on their borrowing costs, drove a second-quarter surge in long-term debt issuance, most of it sold abroad. The volume of issues filed with the CNMV climbed by 6% in the first half-year to 62.38 billion euros.

Spanish government debt yields FIGURE 17



Source: Thomson Datastream. Data to 15 June.

Yields on short-term government and corporate debt securities touch new historical lows.

In this context, short-term treasury yields fell again in the second quarter on the calming effect of the ECB's bond-buying programmes[10] and reached new historical lows on both the primary and secondary market. For the moment, domestic political uncertainty seems to be having little impact on public and private debt prices. At mid-June, yields on three-month, six-month and twelve-month Letras del Tesoro stood at -0.28%, -0.24% and -0.18% respectively, having fallen between 2 and 13 bp. This puts them very close to the -0.4% threshold (the marginal deposit rate) set by the ECB in its purchase programme. Also, the latest Tesoro Público auctions were settled at negative rates, with yields touching historical lows across all curve terms. Short-term corporate bonds traced a similar path, with yields likewise at historical lows, although in this

10 By end-May 2016, the ECB had purchased 806.19 billion euros worth of public debt, of which 94.10 billion corresponded to Spanish paper.

case the decrease was sharper (between 1 and 28 bp) and also concentrated in six- and twelve-month tenors. Rates at issuance on three-, six- and twelve-month commercial paper dropped to 0.27%, 0.37% and 0.35%, respectively (see Table 9).

Short-term interest rates[1]

TABLE 9

%	Dec 13	Dec 14	Dec 15	Dec 15	Mar 16	Jun 16[2]
Letras del Tesoro						
3 month	0.54	0.12	-0.15	-0.15	-0.26	-0.28
6 month	0.70	0.25	-0.01	-0.01	-0.11	-0.24
12 month	0.91	0.34	-0.02	-0.02	-0.06	-0.18
Commercial paper[3]						
3 month	1.09	0.55	0.31	0.31	0.28	0.27
6 month	1.36	0.91	0.42	0.42	0.65	0.37
12 month	1.59	0.91	0.53	0.53	0.48	0.35

Source: Thomson Datastream and CNMV.

1 Monthly average of daily data.

2 Data to 15 June.

3 Interest rates at issuance. Figures for 6-month commercial paper correspond to the month of May, due to the shortage of relevant input for June.

Long-term yields also fall to annual lows.

Medium and long-term government bond yields also narrowed in the second quarter, by between two and seven bp, to reach their lowest levels year to date. Yields in all cases were below end-2015 values, with the ten-year benchmark, the most liquid, down 23 bp since the start of 2016. At mid-June, three-, five- and ten-year governments were paying 0.07%, 0.48% and 1.49%, respectively (see Table 10). Corporate bond yields likewise declined with respect to the opening quarter, after the ECB announced that it would make corporate debt purchases from June this year. The fall in yield was steepest in the five-year tenor, where it stretched to 32 bp. At the closing date for this report (15 June), three-, five- and ten-year notes were yielding 0.61%, 1.33% and 1.91%, respectively.

Medium and long bond yields[1]

TABLE 10

%	Dec 13	Dec 14	Dec 15	Dec 15	Mar 16	Jun 16[2]
Government bonds						
3 year	2.00	0.65	0.24	0.24	0.13	0.07
5 year	2.68	0.96	0.72	0.72	0.55	0.48
10 year	4.15	1.77	1.72	1.72	1.51	1.49
Corporate bonds						
3 year	2.63	0.84	0.66	0.66	0.63	0.61
5 year	2.84	1.88	1.95	1.95	1.65	1.33
10 year	4.46	2.32	2.40	2.40	2.11	1.91

Source: Thomson Datastream, Reuters and CNMV.

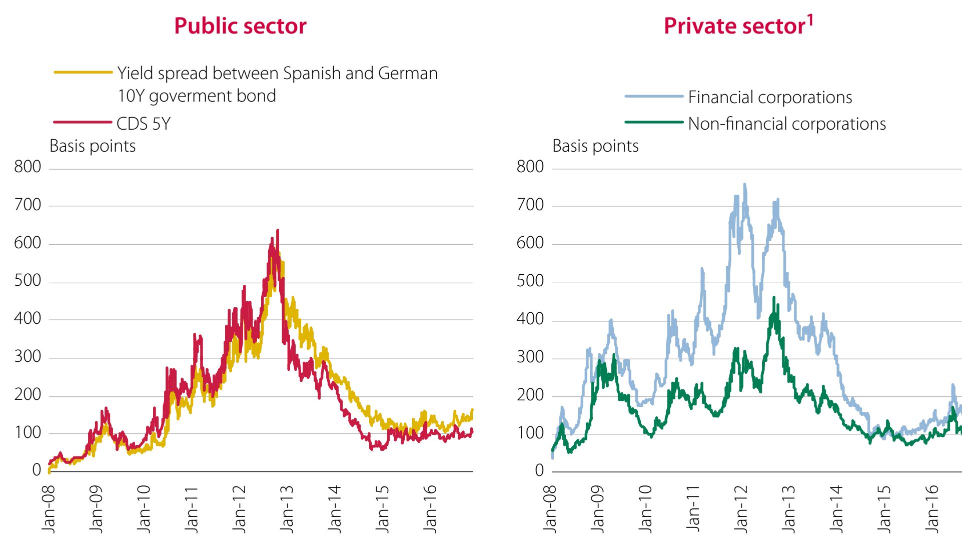
1 Monthly average of daily data.

2 Data to 15 June.

Risk premiums widen on political instability and a possible Brexit. The spread of the government benchmark reaches 157 bp, compared to 115 bp at the year's outset...

The credit risk premiums of the economy's private sectors traced an opposite course from sovereign spreads in the year's second quarter. This was because sovereigns felt the chill of political instability as new elections approached plus the uncertainty of the outcome of the Brexit vote, despite the support of the ECB's bond-buying programme, compared to the clear boost effect on corporate debt of the Bank's decision to add a corporate sector purchase programme. In the public sector, the spread of the Spanish ten-year bond over the German benchmark turned a little more volatile, moving for most of the quarter in the range of 130 to 150 bp. By mid-June, this was up to 157 bp, ahead of the 128 bp of end-March and the 115 bp of the 2015 close, as political risks loomed larger. The CDS spread on the Spanish sovereign bond fluctuated less widely to close the period at 106 bp, just slightly up on the 94 and 89 bp recorded at the outset of the quarter and year respectively (see left-hand panel of Figure 18).

Risk premium paid by Spanish issuers FIGURE 18



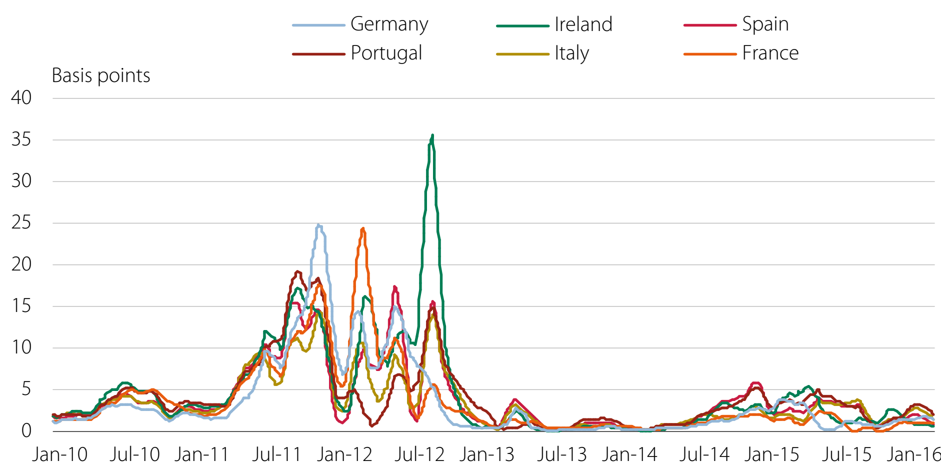
Source: Thomson Datastream and CNMV. Data to 15 June.

1 Simple average of five-year CDSs from a sample of issuers.

… while in the private sector, financial issuer spreads widen slightly against the more stable performance of non-financial corporations.

Credit risk premiums on corporate bonds showed a small rise for financial issuers against the more stable spreads of non-financial corporations. Financial issuer risk premiums have been volatile since the year's outset, with occasional spikes to upwards of 200 bp, due to worries about the strength of the European economy, the squeeze on business margins in a scenario of ultra-low or even negative rates and some groups' exposure to emerging economies, especially in Latin America, which appear to be slipping into slowdown. As we can see from the right-hand panel of Figure 18, the average CDS spread of Spanish financial institutions was 174 bp at mid-June, exceeding the 167 and 144 bp respectively of the prior quarter and end-2015. The average spread of non-financials, by contrast, was 109 bp at mid-June, down from the 114 and 112 bp of the prior quarter and the 2015 close.

Indicators of sovereign credit risk contagion in the euro area: shocks from Greece[1] FIGURE 19



Source: Thomson Datastream and CNMV. Data to 15 June.

1 For further details on the methodology used to compile these indicators see Exhibit 1.2 in the *CNMV Annual Report* for 2010 and the first section of the *CNMV Bulletin* corresponding to first quarter 2011.

Indicators of sovereign credit risk contagion from Greece to other euro-area countries have headed lower overall, despite small, short-lived increases in some second-quarter sessions on concerns over the progress of talks between the European Union, the IMF and the Greek government on releasing the next tranche of the bailout. As Figure 19 shows, contagion readings are now residual only and the effects of the associated European sovereign debt crisis appear to be safely in the past.

Uncertainty over Greece has had next to no impact on other European economies to judge by indicators of sovereign credit risk contagion.

Gross debt issuance filed with the CNMV summed 21.66 billion euros in the second quarter (to 15 June), barely half that of either of the two preceding quarters. This is in fact the lowest total since the third quarter of 2014, at a time when traditional bank finance is cheaper and more widely available. The decline extended across most instruments, led by asset-backed securities, where issuance slumped by almost 14 billion euros to around a fifth of the first-quarter total and, some way behind, mortgage covered bonds and convertible bonds and debentures (39% and 58% lower respectively than one quarter before). Year-to-date issuance, at 62.38 billion euros, was almost four billion higher than in the same period 2015, thanks to a busy first quarter, particularly in asset-backed securities and, less so, mortgage covered bonds.

Registered issuance is the lowest since 3Q 2014, although the year-to-date total of 62.38 billion euros is almost four billion more than in the same period 2015.

Gross fixed-income issues registered[1] with the CNMV

TABLE 11

Registered[1] with the CNMV	2012	2013	2014	2015	2015 4Q	2016 IQ	2016 2Q[2]
NOMINAL AMOUNT (million euros)	**357,830**	**138,839**	**130,258**	**136,607**	**46,949**	**40,722**	**21,659**
Mortgage covered bonds	102,170	24,800	23,838	31,375	7,000	9,943	6,050
Territorial covered bonds	8,974	8,115	1,853	10,400	400	0	2,750
Non-convertible bonds and debentures	86,442	32,537	41,155	39,100	18,944	8,344	3,506
Convertible/exchangeable bonds and debentures	3,563	803	750	53	53	0	0
Asset-backed securities	23,800	28,593	29,008	28,370	11,646	17,038	3,356
Domestic tranche	20,627	24,980	26,972	25,147	10,691	15,234	3,356
International tranche	3,173	3,613	2,036	3,222	956	1,805	0
Commercial paper[3]	132,882	43,991	33,654	27,310	8,906	5,396	5,998
Securitised	1,821	1,410	620	2,420	600	560	280
Other commercial paper	131,061	42,581	33,034	24,890	8,306	4,836	5,718
Other fixed-income issuance	0	0	0	0	0	0	0
Preference shares	0	0	0	0	0	0	0
Pro memoria:							
Subordinated issues	7,633	4,776	7,999	5,452	2,241	1,980	0
Other issues	0	193	196	0	0	421	0

abroad by Spanish issuers	2012	2013	2014	2015	2015 4Q	2016 1Q	2016 2Q[4]
NOMINAL AMOUNT (million euros)	**91,882**	**47,852**	**56,736**	**65,602**	**17,697**	**12,273**	**10,984**
Long term	50,312	34,452	35,281	32,362	9,082	4,177	8,402
Preference shares	0	1,653	5,602	2,250	0	600	1,000
Subordinated debt	307	750	3,000	2,918	1,418	0	1,500
Bonds and debentures	50,005	32,049	26,679	27,194	7,664	3,577	5,902
Asset-backed securities	0	0	0	0	0	0	0
Short term	41,570	13,400	21,455	33,240	8,615	8,096	2,583
Commercial paper	41,570	13,400	21,455	33,240	8,615	8,096	2,583
Securitised	11,590	0	0	0	0	0	0

***Pro memoria*: Gross issuance by subsidiaries of Spanish companies resident in the rest of the world**

	2012	2013	2014	2015	2015 4Q	2016 1Q	2016 2Q[4]
NOMINAL AMOUNT (million euros)	**49,392**	**48,271**	**41,682**	**55,835**	**12,368**	**12,038**	**5,726**
Financial corporations	18,418	8,071	9,990	15,424	2,668	2,964	224
Non-financial corporations	30,974	40,200	31,691	40,411	9,700	9,074	5,503

Source: CNMV and Banco de España.

1 Incorporating issues admitted to trading without a prospectus being filed.
2 Data to 15 June.
3 Figures for commercial paper issuance correspond to the amount placed.
4 Data to 30 April.

Breaking issues down by type of instrument, mortgage covered bonds grew in popularity, despite lower sales, and came to represent 26% of year-to-date issuance against 23% in full-year 2015. Issuance of these assets reflects the positive impact of the ECB's covered bond purchase programme on demand and costs of issue (the so-called CBPP3, summing purchases to 3 June of over 178 billion euros, 29% transacted on the primary market). Commercial paper also advanced in relative terms to 28% of total issuance from 13% in the prior quarter, supported by falling sales of these instruments abroad.

Mortgage covered bonds again feel the benefit of the ECB's purchase programme, which has kept issue volumes running ahead of the pack.

Fixed-income issuance abroad saw a moderate decline for the second quarter running, with an increase in long-term borrowings (which doubled) failing to offset the drop in sales of short-term commercial paper. Even so, low-key activity at home meant that business abroad accounted for 34% of Spanish borrowers' second-quarter issuance (against 23% in the first quarter of 2016 and 32% in 2015). Sales to April stood at 23.26 billion euros, down from almost 27.80 billion in the same period 2015. As regards the mix, low interest rates favoured long-term issuance at the expense of commercial paper, which slumped to 24% of total volumes from 66% the previous quarter and 81% in 2015. The period also saw a small decrease in issues by foreign subsidiaries of Spanish companies which placed 17.76 billion euros to April compared to 20.23 billion in the first four months of 2015.

Debt issues abroad continue to contract, but increase their share of total issuance. Long-term debt has raised its weight at the expense of short-term commercial paper.

The ECB's corporate sector purchase programme EXHIBIT 2

The European Central Bank had launched a series of programmes for the purchase of assets on financial markets (expanded asset purchase programmes, APP) as an instrument of its expansionary monetary policy, which includes a battery of non-standard measures.

In 2014, the ECB's Governing Council set in train two private debt purchase programmes: the third covered bond purchase programme (CBPP3)[1] and the asset-backed securities purchase programme (ABSPP). Subsequently, the institution extended the scope of its purchases to bonds issued by euro-area governments and European agencies and institutions under the public sector purchase programme (PSPP)[2], which kicked off in March 2015.

APP purchases to 31 May this year totalled 1.003 trillion euros, corresponding 80% to the PSPP, 18% to the CBPP3 and the other 2% to the ABSPP (see Table E2.1). Of the 806.19 billion euros laid out on public sector instruments in the framework of the PSPP, 94.10 billion went on Spanish bonds with an average maturity of 9.66 years.

Despite the scale of the monetary policy effort, euro-area growth and inflation have continued to weaken, forcing the ECB to revise down its forecasts for both variables. In this framework, the ECB's Governing Council of 10 March 2016 announced a series of supplementary monetary policy measures, including further interest rate cuts (leaving the official rate at 0%, and rates on the deposit and lending facilities at -0.4% and 0.25%, respectively) and new targeted longer-term refinancing operations, (TLTRO), as well as the enlargement of its asset purchase programme to include corporate debt (the corporate sector purchase programme, CSPP). The institution also agreed to scale up its monthly asset purchases from 60 to 80 billion euros and run them until March 2017.

ECB asset purchase programme (31 May 2016) TABLE E2.1

	ABSPP	CBPP3	PSPP	
Billion euros	Total Europe	Total Europe	Spain	Total
Start of programme	Nov 14	Oct 14	Mar 15	
Secondary market purchases	13.2	125.7	96.1	806.2
Primary market purchases	5.8	52.0	–	–
Weighted average maturity (WAM)	–	–	9.66	8.13

Source: ECB. Amounts in billion and maturity in years.

Corporate bonds eligible for the CSPP programme must be denominated in euros, hold a credit rating equivalent to investment grade (BBB- or higher), be issued by corporations established in the euro area and not belonging to a banking group (although debt issued by insurers will qualify), and have a minimum remaining maturity of six months and a maximum of thirty years. Further, the ECB can buy up to 70% of the total volume of bonds issued by a single borrower or of each individual issue.

The idea behind the CSPP is to lower firms' borrowing costs – something that has largely happened since its launch was announced – and encourage them to raise funds and step up investment as a means to boost economic growth. Indirectly, the ECB would also like to see banks direct more of their lending to firms with fewer possibilities of tapping the market.

According to Bloomberg and Standard & Poor's, outstanding debt that meets the ECB's conditions could sum over 500 billion euros, of which around 80 billion would correspond to Spanish corporations. The condition whereby debt must be investment grade is something of a barrier to firms in countries with lower sovereign ratings, since these tend to act as a ratings ceiling. Spanish firms rated investment grade and with outstanding euro-denominated issues numbered 14 at the time of writing this report.

The first corporate bond purchases went through in the second week in June, but the effects of the measure were felt on both the primary and secondary corporate debt market practically from the instant it was announced.

Corporate bond issuance, in effect, picked up significantly in March when the move was made public, after two months of low-key activity due to the uncertain climate prevailing. The situation improved from that point on, and European and Spanish firms took advantage of the more favourable market conditions and lower issuance costs to borrow funds more cheaply, in many cases at historical lows for the corresponding curve term. Table E2.2 tracks Spanish firms' issuance since March in volume and issuance cost (measured as the spread over the prevailing mid-swap rate), looking also at how the market spread has varied (at 15 June) after the first round of purchases under the programme. As we can see, not only primary but also secondary market yields have fallen since the announcement of additional measures. In particular, the

spread to mid-swap has narrowed across all the issues in Table E2.2 to below the levels paid at issuance.

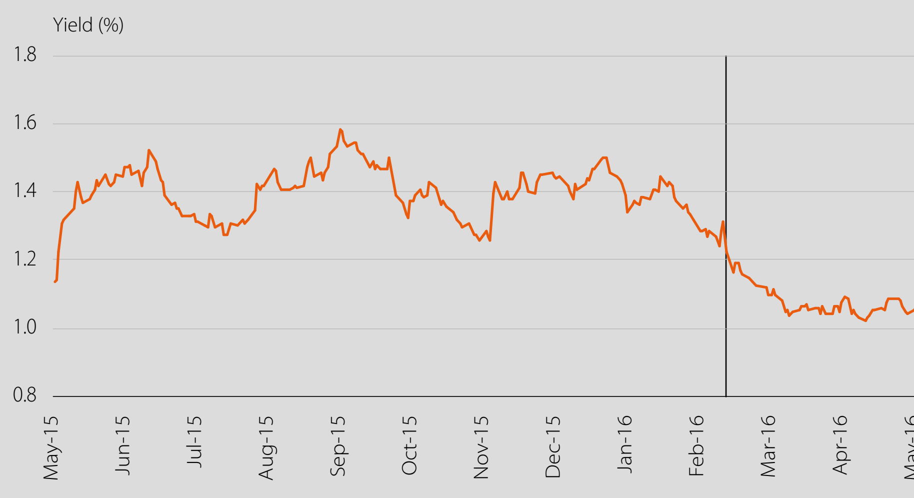
Spanish corporations' debt issuance since March 2016 TABLE E2.2

Issuer	Date	Amount (million euros)	Coupon (%)	Spread over mid-swap (bp)		Maturity
				Issue date	15 June	
Telefónica	6/4/2016	1,350	1.460	95	82	4/2026
Telefónica	6/4/2016	1,400	0.750	65	40	4/2022
Red Eléctrica	7/4/2016	300	1.000	53	36	4/2026
Gas Natural	12/4/2016	600	1.250	75	59	4/2026
Iberdrola	14/4/2016	1,000	1.125	63	45	4/2026
Merlin Prop.	14/4/2016	850	2.225	200	137	4/2023
Dia	18/4/2016	300	1.000	110	59	4/2021
Enagás	26/4/2016	750	1.375	62	50	5/2028
Gestamp	4/5/2016	500	3.500	Bund + 366	Bund + 353	5/2023
Mapfre	10/5/2016	1,000	1.625	115	100	5/2026
Abertis	10/5/2016	1,150	1.375	95	67	5/2026

Source: CNMV.

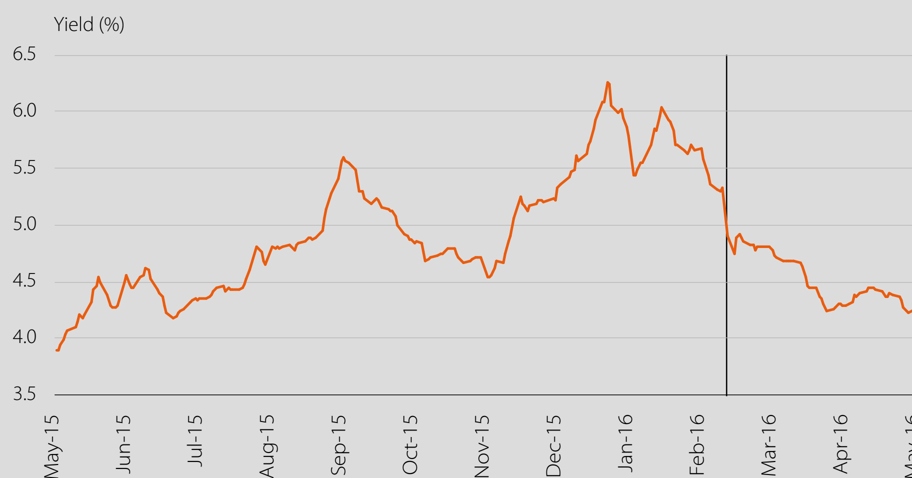
Even before the programme's announcement date, expectations for its launch were being priced in on secondary markets, where yields on investment grade corporate bonds have dropped to historical lows since the year's outset (see Figure E2.1). Lower-rated debt, outside the direct scope of the purchase programme, has benefitted nonetheless from investors' search for yield, which has led them to switch some of their investment grade holdings for riskier assets. Lower quality borrowers too have thus enjoyed a substantial cut in their credit spreads (see Figure E2.2).

Corporate debt FIGURE E2.1



Fuente: Bloomberg (Bank of America Merrill Lynch Euro Corporate Index).

High yield debt FIGURE E2.2



Fuente: Bloomberg (Bank of America Merrill Lynch Euro High Yield Index).

Some analysts and fund managers have voiced concerns that the ECB's programme could impact indirectly on fixed-income markets by thinning the liquidity of an asset class where it is already none too abundant. This effects could be partially mitigated by reducing the programme's primary market purchases in order to conserve secondary market liquidity. Other potential risks flagged include the forming of bubbles, and the chance that yield-seeking investors might be encouraged to take on greater risk. Also, some beneficiary companies might employ the funds raised so cheaply for non-productive investments, like share buybacks or corporate acquisitions at excessively high premiums.

Finally, if the additional package of measures announced by the ECB fails to achieve the stated objectives of restoring higher inflation and boosting economic growth, the bank may again opt to increase the amount of stimulus measures or extend the length of the debt purchase programme beyond March 2017.

1 CBPP3 is the third programme dealing in this asset class. The first two were initiated in 2009 and 2011.
2 The securities market programme (SMP) which ran from 2010 to 2012 included the purchase of public debt issued by euro-area governments.

4 Market agents

4.1 Investment vehicles

Mutual funds[11]

Portfolio losses in the opening quarter skim 1.7% off mutual fund assets, breaking with three years of expansion.

Assets under management in mutual funds fell by 1.7% in the opening quarter to 218 billion euros, the first decline after growing 79.1% over three years of unbroken

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 subsection further ahead.

expansion (see Table 13). Most of the decrease, almost 90%, stemmed from the decline in value of fund portfolios, with returns negative to the tune of -1.36% (0.89% in 2015). Portfolio losses extended across all fund categories except fixed income and guaranteed fixed income, which scraped positive returns of 0.16% and 0.09% respectively (-0.02% and 0.32% in 2015). Of remaining categories, euro equity funds suffered the heaviest losses, at -6.99%, followed by international equity funds (-4.62%), reflecting the adverse performance of stock markets in the period. These precisely were the funds that had gained most in 2015, notably the 4.12% and 6.3% respectively of the fourth quarter (3.44% and 7.84% in the full-year period). Returns in remaining categories ran from the -2.84% of balanced equity funds to the -0.51% of absolute return products.

Net redemptions were not that high and mainly concentrated in balanced and guaranteed fixed-income funds, while subscriptions tended to favour less risky categories.

Net first-quarter outflows of 492 million euros accounted for just over 10% of asset shrinkage (see Table 12). Investors tended to seek out less risky categories in the period, such that the largest net redemptions, summing 1.60 billion, corresponded to the balanced fixed-income products that had attracted most subscriptions in 2014 and 2015 (almost 37 billion in these two years). The next biggest outflows were from guaranteed fixed-income funds. Net redemptions in this case totalled 1.27 billion euros in January-March, prolonging the downtrend begun at end-2012 that has slashed their assets from 36.44 to 10.82 billion. Conversely, absolute return funds saw net inflows of 77.4 million euros, trailing the progress of 2015, while leading the pack were fixed-income funds, with net subscriptions of 2.08 billion, and guaranteed equities (1.75 billion), which returned to positive numbers for the first time in three years.

Net mutual fund subscriptions

TABLE 12

				2015			2016
Millones de euros	2013	2014	2015	2Q	3Q	4Q	1Q
Total mutual funds	**24,133.0**	**35,972.7**	**23,466.6**	**7,566.1**	**2,140.1**	**353.0**	**-492.4**
Fixed income[1]	13,783.1	13,492.7	-5,351.4	-3,926.8	-924.1	-1,577.6	2,078.5
Balanced fixed income[2]	2,059.3	15,712.0	21,167.5	9,335.9	1,864.1	966.1	-1,604.4
Balanced equity[3]	1,881.9	6,567.7	8,153.8	3,548.2	1,188.3	750.5	-712.8
Euro equity[4]	1,730.3	2,184.9	468.9	231.9	112.7	221.6	-251.6
International equity[5]	900.2	531.8	4,060.5	1,269.5	730.9	619.8	-324.4
Guaranteed fixed income	-4,469.2	-10,453.6	-6,807.4	-2,929.7	-1,227.3	-823.0	-1,268.2
Guaranteed equity[6]	-2,070.2	-909.5	-2,599.8	-1,426.5	-352.0	100.3	1,752.9
Global funds	847.4	2,182.3	5,805.3	2,145.2	656.1	651.2	-78.0
Passively managed[7]	9,538.2	4,970.9	-6,264.2	-2,516.0	-695.5	-1,130.6	-152.4
Absolute return[7]	-67.8	1,693.9	4,811.4	1,834.4	752.5	587.1	77.4

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.

Main mutual fund variables*

TABLE 13

				2015			2016
Number	**2013**	**2014**	**2015**	**2Q**	**3Q**	**4Q**	**1Q**
Total mutual funds	**2,045**	**1,951**	**1,804**	**1,862**	**1,846**	**1,804**	**1,799**
Fixed income[1]	384	359	319	359	350	319	309
Balanced fixed income[2]	122	123	132	126	128	132	135
Balanced equity[3]	128	131	142	132	134	142	147
Euro equity[4]	108	103	109	109	108	109	111
International equity[5]	193	191	200	196	195	200	201
Guaranteed fixed income	374	280	186	226	202	186	171
Guaranteed equity[6]	308	273	205	225	215	205	204
Global funds	162	162	178	172	176	178	185
Passively managed[7]	169	227	213	221	218	213	221
Absolute return[7]	97	102	97	96	97	97	92
Assets (million euros)							
Total mutual funds	**156,680.1**	**198,718.8**	**222,144.6**	**222,058.0**	**218,773.8**	**222,144.6**	**218,339.2**
Fixed income[1]	55,058.9	70,330.9	65,583.8	67,600.0	66,979.3	65,583.8	67,765.4
Balanced fixed income[2]	8,138.0	24,314.3	44,791.8	42,820.0	43,536.3	44,791.8	42,585.9
Balanced equity[3]	6,312.4	13,570.4	21,502.9	20,056.7	20,138.7	21,502.9	20,170.2
Euro equity[4]	8,632.8	8,401.5	9,092.9	9,377.7	8,535.9	9,092.9	8,160.0
International equity[5]	8,849.0	12,266.4	17,143.2	16,320.9	15,545.7	17,143.2	16,162.8
Guaranteed fixed income	31,481.2	20,417.0	12,375.6	14,702.3	13,437.4	12,375.6	10,818.8
Guaranteed equity[6]	12,503.8	12,196.4	9,966.6	9,996.9	9,567.6	9,966.6	11,862.3
Global funds	4,528.1	6,886.3	12,683.3	11,587.0	11,743.2	12,683.3	12,300.8
Passively managed[7]	16,515.9	23,837.5	17,731.1	19,608.4	18,636.8	17,731.1	17,403.6
Absolute return[7]	4,659.9	6,498.1	11,228.1	9,988.1	10,595.6	11,228.1	11,073.7
Unit-holders							
Total mutual funds	**5,050,719**	**6,409,806**	**7,682,947**	**7,396,161**	**7,505,825**	**7,682,947**	**7,699,646**
Fixed income[1]	1,508,009	1,941,567	2,203,847	2,113,775	2,135,489	2,203,847	2,222,005
Balanced fixed income[2]	240,676	603,099	1,130,190	1,047,453	1,093,235	1,130,190	1,113,180
Balanced equity[3]	182,223	377,265	612,276	559,016	588,211	612,276	596,136
Euro equity[4]	293,193	381,822	422,469	423,996	410,777	422,469	412,495
International equity[5]	457,606	705,055	1,041,517	955,135	988,191	1,041,517	1,052,810
Guaranteed fixed income	1,002,458	669,448	423,409	498,140	453,383	423,409	378,017
Guaranteed equity[6]	608,051	557,030	417,843	438,262	419,718	417,843	463,423
Global funds	128,741	223,670	381,590	371,784	396,176	381,590	383,066
Passively managed[7]	441,705	686,526	554,698	584,270	574,816	554,698	557,262
Absolute return[7]	188,057	264,324	479,182	404,330	429,512	479,182	505,442
Return[8] (%)							
Total mutual funds	**6.50**	**3.67**	**0.89**	**-1.98**	**-2.36**	**1.51**	**-1.36**
Fixed income[1]	2.28	2.41	0.10	-1.24	-0.02	0.38	0.16
Balanced fixed income[2]	4.16	3.67	0.16	-2.14	-1.84	0.97	-1.27
Balanced equity[3]	10.85	4.70	0.15	-2.53	-4.97	2.43	-2.84
Euro equity[4]	28.06	2.09	3.44	-4.81	-9.98	4.12	-6.99
International equity[5]	20.30	6.61	7.84	-2.75	-8.71	6.30	-4.62
Guaranteed fixed income	4.96	2.54	0.27	-0.65	0.32	0.09	0.09
Guaranteed equity[6]	6.15	2.64	1.07	-2.76	-1.48	1.18	-0.87
Global funds	8.71	4.63	2.45	-1.82	-4.38	2.33	-2.21
Passively managed[7]	8.88	7.74	0.53	-2.68	-1.44	1.23	-1.13
Absolute return[7]	2.46	1.98	0.12	-1.47	-1.31	0.45	-0.51

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 2Q 2009. All absolute return funds were previously classed as Global funds.

8 Annual return for 2013, 2014 and 2015. Quarterly data comprise non-annualised quarterly returns.

The number of funds appears to be stabilising after falling sharply since 2013. By end-March this year, a total of 1,799 were on the register, just 5 fewer than at end-2015 compared to the 147 reduction of 2014 (42 in the closing quarter). Like last year, the sharpest drop was in guaranteed fixed-income funds (15), followed by fixed income (10). Conversely, the biggest additions were among global funds (7) and, notably, passively managed funds (8), recalling their growth spurt of 2014.

Fund numbers start to stabilise after the declines of recent years…

Fund unit-holder numbers were practically unchanged at 7.7 million (up 0.2%). In line with asset movements within the industry, the biggest increase, of 45,580, was in guaranteed equity, ahead of global and fixed-income funds with an additional 26,260 and 18,158 respectively. The rush out of guaranteed fixed-income funds has continued year to date, with the additional loss of 45,392 investors leaving total membership at 378,017 (compared to more than one million when their popularity was at its height).

… as do the number of unit-holders.

Preliminary data for April 2016 point to a degree of industry recovery, with assets and unit-holder numbers up by around 1% with respect to March and fixed-income and guaranteed equity funds apparently continuing their ascent.

April figures point to renewed industry expansion after the turmoil of the opening months.

The liquidity of the fixed-income portfolio deteriorated again in 2015 after several years' improvement, but has fought back somewhat in the opening months of 2016. The volume of less-liquid fund assets rose by 2 billion last year to 4.19 billion euros, before easing to 3.79 billion in March this year (see Table 14). This amounts to 1.7% of total fund assets (1.9% at the 2015 close), against the 1.1% of twelve months ago. Even so, thinly liquid assets are less of a problem than in 2009, when they exceeded 8% of the industry-wide total. By category, the biggest development was the increase in less-liquid assets under financial fixed income rated below AA, up by 380 million euros (+41%) since March 2015 after climbing 562 million to December that same year.

Less-liquid assets drop slightly in the first quarter as a proportion of the mutual fund fixed-income portfolio after the rebound experienced in 2015.

Estimated liquidity of mutual fund assets TABLE 14

	Less-liquid investments					
	Million euros			% total portfolio		
Type of asset	Sep 15	Dec 15	Mar 16	Sep 15	Dec 15	Mar 16
Financial fixed income rated AAA/AA	36	53	71	3.4	4.6	6.0
Financial fixed income rated below AA	1,314	1,497	1,315	6.0	6.9	6.5
Non-financial fixed income	401	481	383	4.1	4.6	3.6
Securitisations	1,194	1,077	1,010	46.8	41.8	48.2
AAA-rated securitisations	50	31	26	90.6	87.1	86.6
Other securitisations	1,144	1,046	984	45.8	41.2	47.6
Total	**4,139**	**4,187**	**3,790**	**17.4**	**17.3**	**16.7**
% of mutual fund assets	**1.9**	**1.9**	**1.7**			

Source: CNMV.

Real estate schemes

Main real estate scheme variables remained largely unchanged in the first three months of 2016, as they had done in the closing stretch of 2015.

The industry enjoys relative stability over the year's first months.

No major change in the number or size of real estate funds, though their profitability is steadily improving.

The funds segment, in recent years the worst hit by the real estate downturn, closed the period with the same three schemes operative as at year-end 2014. Their combined assets, at 390.2 million euros, were a bare 0.2% down versus the 2015 close after falling 4% that year. Unit-holder numbers stood at 3,928, ten more than at end-2015. Finally, fund returns picked up to -0.21% in the opening months on a timid recovery in sector prices, still negative but a large improvement on the -7% of 2015.

The number of companies and shareholders stays flat in the opening quarter, while their assets climb by 3.6%.

The six real estate investment companies in operation since the second quarter of 2015 grew their assets 3.6% in the first quarter of 2016 to 727.5 million euros, with shareholder numbers practically unaltered at 582 (one fewer than last December).

Hedge funds

Spanish hedge fund assets shrink slightly in the first two months of 2016.

Hedge fund assets contracted by 7.3% in the first two months of 2016 to 1.93 billion euros. The number of schemes filing statements with the CNMV was unchanged with respect to mid-2015: ten funds of hedge funds and 37 hedge funds *per se*.

In the case of pure hedge funds, the decrease stems from 72 million in net redemptions plus negative portfolio returns (-3.9%).

As we can see from Table 15, pure hedge funds had 1.62 billion euros in assets in February 2016. This was 8.1% down on the figure for the fourth quarter of 2015 after two years of robust growth (+70.2% between 2013 and 2015). The decline in assets stemmed from both net redemptions (71.6 million between January and February 2016) and portfolio losses of -3.87% following on from years of ample returns. Unit-holder numbers fell by 1.9% to 3,030.

Funds of hedge funds also shed assets (-2.9%), but the number of schemes stays constant after several years' decline.

Fund of hedge fund assets, meantime, shrank by 2.9% versus the fourth quater of 2015 to a February total of 311 million euros, while unit-holder numbers stayed practically flat at 1,261 (after a series of 2015 closures left their numbers reduced to less than half). Portfolio returns were -1.55%, the first negative outcome in several years, repeating the experience of the pure hedge fund segment.

Main hedge fund and fund of hedge fund variables

TABLE 15

				2015			2016
	2013	2014	2015	2Q	3Q	4Q	1Q[1]
FUNDS OF HEDGE FUNDS							
Number[2]	19	14	10	10	10	10	10
Unit-holders	3,022	2,734	1,265	1,363	1,365	1,265	1,261
Assets (million euros)	350.0	345.4	320.0	346.0	338.0	320.0	310.7
Return (%)	4.39	8.48	6.16	-3.29	-1.90	2.07	-1.55
HEDGE FUNDS							
Number[2]	28	36	37	38	37	37	37
Unit-holders	2,415	2,819	3,089	3,120	3,121	3,089	3,030
Assets (million euros)	1,036,70	1,369.5	1,764.8	1,704.1	1,708.5	1,764.8	1,622.7
Return (%)	16.48	5.30	4.97	-2.49	-5.56	3.90	-3.87

Source: CNMV.

1 Data to February 2016.

2 Number of funds that have filed financial statements (i.e., not including those in the process of winding-up or liquidation).

Foreign UCITS marketed in Spain

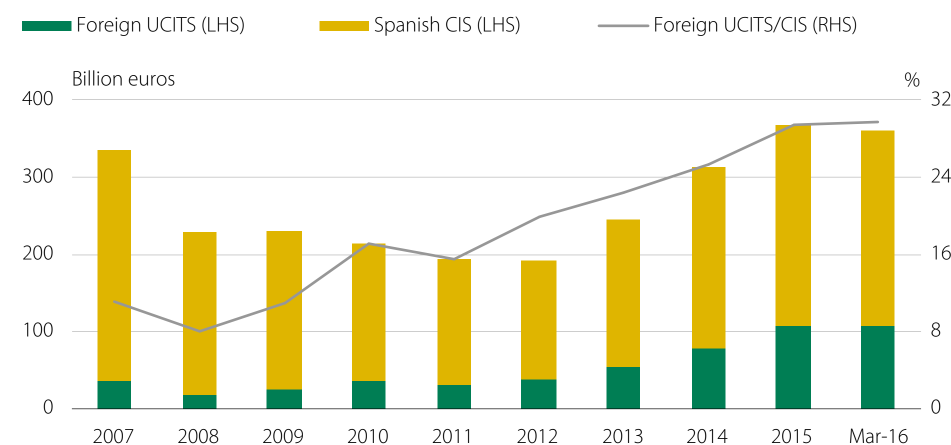
The strong expansion enjoyed by this segment since 2012 (with investment volumes tripling to 2015) seems to have run out of steam in the opening quarter of 2016, which saw its combined assets slip back 0.7% to 107.33 billion euros. As we can see from figure 20, this was 29.7% of all assets managed by UCITS sold in Spain, on a par with the percentage recorded at end-2015.

The expansion of foreign UCITS maintained since 2012 appears to have halted in the first months of 2016…

This small decline in the size of foreign UCITS was explained by a 2% drop in investment company assets to 90.96 billion euros, while fund assets expanded by 7% versus the 2015 close to 16.37 billion. Investor numbers mirrored these movements with a 1.8% decrease for companies contrasting with an 8.8% gain for funds. The resulting total of 1.6 million represented an increase of 0.1%. The number of schemes increased in both cases, with 3 more funds and 21 more companies registered with the CNMV (428 and 476 respectively at end-March 2016). Most new entrants, as in previous years, came from Luxembourg and Ireland.

… albeit with notable divergence between the still expanding funds segment and the companies segment, with declines in both asset volumes and investor numbers.

Assets of foreign UCITS marketed in Spain FIGURE 20



Source: CNMV.

Outlook

The collective investment industry has fought back strongly since 2012 after a run of tough years, and now appears to be entering a period of stability. It should continue to benefit from low interest rates in the financial sector, but must cope with the risks posed by bond market turbulence and volatile equity prices. Investors have apparently reacted to this volatility by switching into products such as guaranteed funds, which for two or three years had been losing out to riskier categories of funds.

Current interest rates are good news for the fund industry, though unsettled markets could hold back growth as investors turn to less risky products.

4.2 Investment firms

Investment firms have again had to contend with jittery financial markets. Their aggregate pre-tax profits were 49.2 million euros in the first quarter of 2016, 30.8% down on the same period 2015, suggesting that last year's business stall after two

The pattern of 2015 repeats, with investment firm profits down 31% in 1Q 2016 on the unsettled state of financial markets.

years of solid recovery has continued to the present day. At end-May, a total of 80[12] firms were listed on the CNMV registers, down from 81 at the 2015 close after four deregistrations and three new entries. Of this total, five were passported to operate in other EU countries via a branch, one fewer than at end-2015, and 38 under the free provision of services, two fewer than five months before.

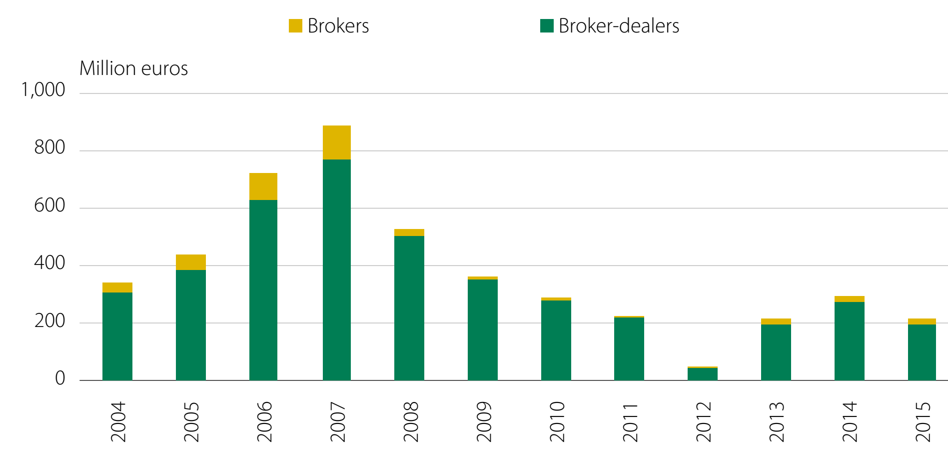
Aggregate profits of broker-dealers fall 10% after a 19% contraction in fee income led by order processing and execution (-31%). Income from CIS marketing, conversely, rises 5%.

Broker-dealers saw business contract in the opening quarter, when their pre-tax profits fell by 9.6% to 47.4 million euros. This sum comprised 90% of total sector earnings (see Table 16). The profits stall had its origin in falling fee income and poorer results from financial investments. Fee income, specifically, dropped by 19.3% compared to January-March 2015 as far as 137.5 million euros (-2.9% in 2015). The biggest loss in fee income came from processing and execution, down 31.4% versus the first quarter of 2015 to 65.2 million euros. This item furthermore brings in around 50% of all broker-dealer fees. The second most important earner, fees from CIS marketing, moved up 5.3% to 18.3 million, building on the 17.4% advance of 2015.

Other downside factors were 61% lower results from financial investments and operating expenses down significantly less than income.

Still above the net operating income line, results of financial investments plunged by 60.9% to 21.8 million euros, driving gross margin down by 21.5% from 158.6 to 124.5 million euros. Factoring this decline and the fact that operating expenses fell significantly slower than income (7.5% to 85.8 million euros), net operating income at March 2016 was 37.1 million euros, 39.7% less than in the same period 2015.

Investment firm pre-tax profits[1] FIGURE 21



Source: CNMV.

1 Except investment advisory firms and portfolio management companies.

Brokers' profits slump by 81%, the main reason being lower fee income, especially from order processing and execution (-36%) and CIS marketing (-3%).

Brokers also experienced a business downturn in the period analysed, with profits falling 81.0% to 1.8 million euros. The cause of this poor result, as with broker-dealers, lay primarily in net fee income. The difference was that CIS marketing fees, the biggest earner for brokers, dropped by just 3.3% to 12.5 million euros. Still under the fees caption, order processing and execution brought in 6.4 million (-35.9%), and investment advisory services 1.7 million (-31.3%), while portfolio management fees rose 26.6% to 2.8 million, lifting this item into third place. Gross margin contracted 25% in the first quarter to 24.4 billion euros, and operating expenses fell just 3.4% to 22.4 million euros.

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

Aggregate income statement (Mar 16)

TABLE 16

	Broker-dealers			Brokers		
Thousand euros	Mar 15	Mar 16	% change	Mar 15	Mar 16	% change
1. Net interest income	7,985	7,216	-9.6	175	159	-9.1
2. Net fee income	118,547	91,676	-22.7	31,049	24,770	-20.2
2.1. Fee income	170,459	137,511	-19.3	35,222	29,949	-15.0
2.1.1. Order processing and execution	95,029	65,205	-31.4	9,993	6,404	-35.9
2.1.2. Placement and underwriting	239	629	163.2	1,183	229	-80.6
2.1.3. Securities administration and custody	5,934	12,323	107.7	113	147	30.1
2.1.4. Portfolio management	6,276	5,453	-13.1	2,246	2,844	26.6
2.1.5. Investment advising	1,497	647	-56.8	2,441	1,676	-31.3
2.1.6. Search and placement	55	80	45.5	0	18	–
2.1.7. Margin trading	0	0	–	0	0	–
2.1.8. CIS marketing	17,379	18,307	5.3	12,883	12,457	-3.3
2.1.9. Others	44,050	34,868	-20.8	6,363	6,174	-3.0
2.2. Fee expense	51,912	45,835	-11.7	4,173	5,179	24.1
3. Results of financial investments	55,799	21,838	-60.9	885	-94	–
4. Net exchange differences	-27,423	-2,439	91.1	615	-163	–
5. Other operating income and expense	3,648	6,232	70.8	-170	-258	-51.8
GROSS INCOME	**158,556**	**124,523**	**-21.5**	**32,554**	**24,414**	**-25.0**
6. Operating expenses	92,743	85,761	-7.5	23,191	22,409	-3.4
7. Depreciation and other charges	3,725	1,444	-61.2	265	299	12.8
8. Impairment losses	510	180	-64.7	2	4	100.0
NET OPERATING INCOME	**61,578**	**37,138**	**-39.7**	**9,096**	**1,702**	**-81.3**
9. Other profit and loss	213	10,304	4,737.6	194	61	-68.6
PROFITS BEFORE TAXES	**61,791**	**47,442**	**-23.2**	**9,290**	**1,763**	**-81.0**
10. Corporate income tax	11,231	6,747	-39.9	909	275	-69.7
PROFITS FROM ONGOING ACTIVITIES	**50,560**	**40,695**	**-19.5**	**8,381**	**1,488**	**-82.2**
11. Profits from discontinued activities	0	0	–	0	0	–
NET PROFIT FOR THE YEAR	**50,560**	**40,695**	**-19.5**	**8,381**	**1,488**	**-82.2**

Source: CNMV.

Investment firm profitability is eroded by the earnings slump.

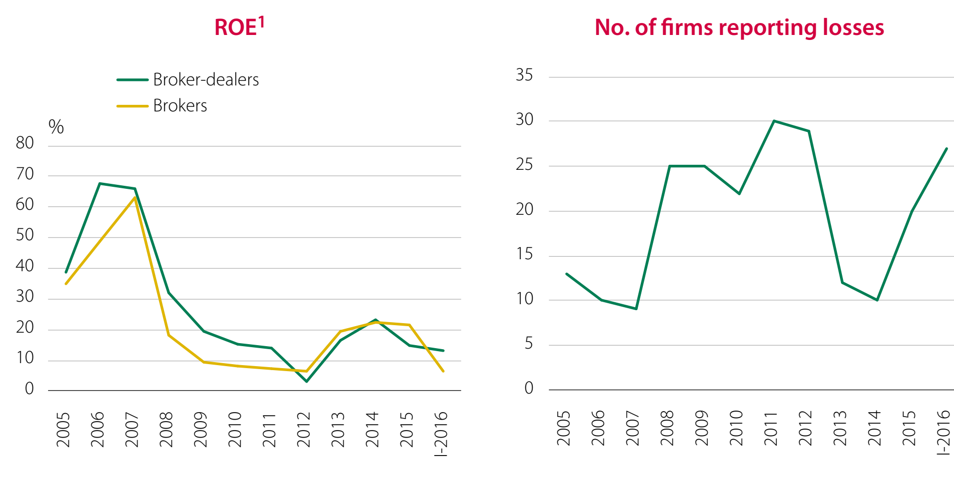
The return on equity (ROE) earned by investment services firms sank from 15.3% to 12.7% between December 2015 and March 2016 on the sector-wide contraction in earnings. Worst to suffer were brokerage houses whose ROE slumped from 21.5% to 6.3% against the more moderate decline of the broker-dealer segment, from 14.8% to 13.1% (see left-hand panel of Figure 22).

Increase in both loss-making firms and the amount of their losses in 2015 and the first months of 2016.

The number of loss-making entities rose steadily through 2015 and the first quarter of 2016 as business turned down. By end-March, a total of 27 firms were in this situation compared to twenty at the 2015 close and ten in December 2014 (see right-hand panel of Figure 22). Both broker-dealers and brokers shared in the increase. Broker-dealers reporting losses climbed from four in 2014 to eight in 2015

and eleven at end-March, while loss-making brokers numbered six, twelve and sixteen respectively. The combined 8 million euros losses reported in the first quarter of 2016 were more than double the total for the same period 2015.

Pre-tax ROE of investment firms and loss-making entities FIGURE 22



Source: CNMV.

1 ROE based on annualised pre-tax earnings.

Investment firm solvency remains optimal in 1Q 2016.

Investment firms' solvency conditions remained optimal in the first quarter of the year. In March 2016, the capital adequacy ratio of firms that have to file solvency statements,[13] calculated as regulatory capital over minimum capital requirement, was 4.3 for broker-dealers and 2.3 for brokers. This compares to 4.8 and 2.2 respectively at the end of 2015 (see Figure 23).

Assets under advice by IAFs grow a further 19% in 2015 to over 25 billion euros...

Investment advisory firms (IAFs) continued to grow their business through 2015, which closed with assets under advice up by 18.6% to 25.40 billion euros (see Table 17). The fastest expanding client segment was eligible counterparties[14] (the "others" heading) with assets up by 24.3% to 13.5 million euros (after shrinking to almost half in 2014), while the assets under advice of retail and professional customers climbed by 18.5% and 5.8% respectively.

... while the number of firms climbs by 11 to 154, 21 of them passported to do business in other EU countries besides Spain.

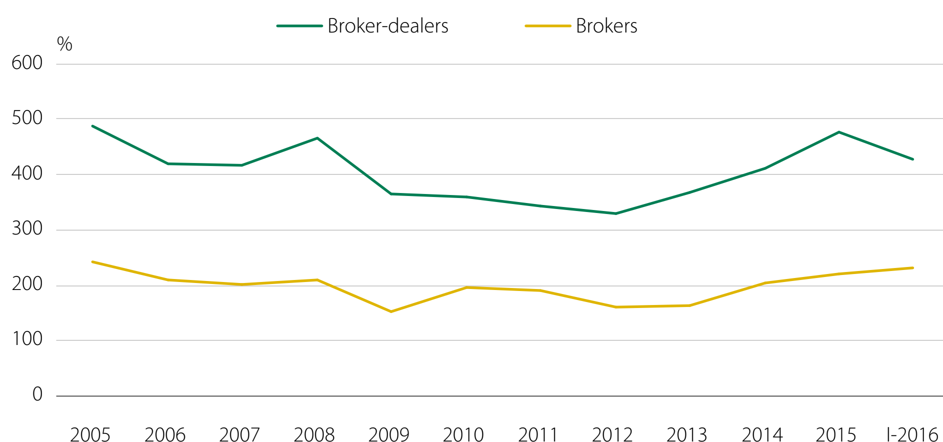
Retail customers may not have led the growth spurt in 2015, but they have come to acquire a major share of total IAF business, up from 10.6% of assets under advice at the end of 2010, when they entered the market, to 26.7% at the 2015 close. Fee income, meantime, rose by 16.1% to 55.5 million euros mirroring the upward progression of sector assets. The number of IAFs, finally, increased from 143 at end-2014 to 154, of which 21 were passported to provide investment advice in other EU countries under the free provision of services, ten more than at the 2014 close.

13 As of 1 January 2014, CNMV Circular 2/2014, of 23 June, on the exercise of various regulatory options regarding the solvency of investment firms and their consolidable groups exempts some firms from the requirement to report on their compliance with solvency standards, an exemption that currently extends to 5 of the 78 investment firms registered with the CNMV.

14 Eligible counterparty is a MiFID classification denoting less need for protection, normally assigned to banks, other financial institutions and governments.

Investment firm capital adequacy (surplus of eligible capital to the minimum requirement)[1]

FIGURE 23



Source: CNMV.

1 There have been minor changes to the way capital adequacy requirements are calculated since 2014 when Regulation (EU) No. 575/2013 of the European Parliament and of the Council, of 26 June 2013, on prudential requirements for credit institutions and investment firms came into effect.

Main investment advisory firm variables

TABLE 17

Thousand euros	2012	2013	2014	2015	% change 15/14
NUMBER OF FIRMS	**101**	**126**	**143**	**154**	**7.7**
ASSETS UNDER ADVICE	**14,776,498**	**17,630,081**	**21,391,510**	**25,366,198**	**18.6**
Retail customers	3,267,079	4,991,653	5,719,292	6,777,181	18.5
Professional customers	3,594,287	3,947,782	4,828,459	5,109,979	5.8
Others	7,915,132	8,690,646	10,843,759	13,479,037	24.3
NUMBER OF CUSTOMERS[1]	**–**	**–**	**–**	**5,652**	**–**
Retail customers	–	–	–	5,160	–
Professional customers	–	–	–	318	–
Others	–	–	–	174	–
NUMBER OF CONTRACTS[1]	**3,484**	**4,002**	**4,639**	**–**	**–**
Retail customers	3,285	3,738	4,323	–	–
Professional customers	175	235	276	–	–
Others	24	29	40	–	–
FEE INCOME	**26,177**	**33,272**	**47,767**	**55,469**	**16.1**
Fees received	26,065	33,066	47,188	54,525	15.5
From customers	20,977	26,530	37,943	43,964	15.9
From other firms	5,088	6,537	9,245	10,561	14.2
Other income	112	206	579	944	63.0
EQUITY	**13,402**	**21,498**	**26,538**	**24,357**	**-8.2**
Share capital	4,365	5,156	5,576	5,881	5.5
Reserves and retained earnings	4,798	9,453	8,993	7,451	-17.1
Profit/loss for the year[2]	4,239	6,890	11,969	11,034	-7.8

1 With the entry to force of CNMV Circular 3/2014, firms ceased to report number of contracts, instead reporting the number of active customers.

Unstable equity markets and competition from the banks are complicating the outlook for investment firms.

After two or three better years, equity market instability is starting to weigh on investment firm earnings, since their main business lines are tied in with market trading. The prospects for the sector are further clouded by growing competition from domestic credit institutions, which are starting to muscle in on traditional investment firm activities like order processing and execution. Note finally that the restructuring of the Spanish banking system has so far had little corporate impact on the investment services sector: of the ten deregistrations in 2015 and the first five months of 2016, only three were the result of a takeover (the remainder corresponding to changes of corporate form or the firm's liquidation).

CNMV Guidelines for the Preparation of Investment Firm Recovery Plans

EXHIBIT 3

Law 11/2015, of 18 June 2015, on the recovery and resolution of credit institutions and investment firms and its implementing Royal Decree 1012/2015,[1] of 6 November, mark the transposition to Spanish legislation of Directive 2014/59/EU of the European Parliament and the Council, of 15 May, establishing a framework for the recovery and resolution of credit institutions and investment firms.[2] The new text takes over in almost every respect from Law 9/2012, of 14 November, on credit institution restructuring and resolution, which governed the recent restructuring of Spain's financial sector. The European Banking Authority (EBA) has issued the competent authorities with guidelines and technical standards to ensure uniform application of Directive 2014/59/EU.

One substantive novelty of the Directive and the corresponding Spanish text is its extension to investment firms, albeit excluding those with a business scope below that of broker-dealers (brokers, portfolio management companies and investment advisory firms), as well as broker-dealers not engaging in own account trading, placement and underwriting or securities custody and administration.

The new Law establishes a specific legal procedure over and above standard insolvency proceedings for financial corporation restructuring or liquidation when the public interest is deemed to be at stake. This treatment is warranted by the singular nature of such corporations and their degree of interconnectedness with a country's financial system and indeed its economy. The idea is to limit the impact of restructuring and resolution processes on the real economy and financial stability, so one failing corporation does not end up contaminating the whole system. The intention also is to internalise the cost of such processes, so shareholders and creditors bear more of the losses, reducing the call on taxpayers' resources, while guaranteeing stronger protection of depositors and the holders of repayable funds.

Rules are also laid down for early intervention (applicable to a credit institution when it does not comply, or will foreseeably be unable to comply in the near future, with solvency, regulatory and disciplinary rules, but is in a position to return to compliance through its own means), one of whose main instruments is the recovery plans. Under Law 9/2012, such plans were only obligatory for institutions suffering difficulties. Now, however, their use is prescribed across the board in view of their eminently preventive nature. Consequently, all entities must draft and keep updated an action plan envisaging the measures and actions

necessary to restore their financial position in the event that it undergoes significant deterioration. The plan should include a set of quantitative and qualitative indicators that will serve as a reference for undertaking the actions envisaged, along with diverse scenarios of financial and macroeconomic instability hypothetically affecting the financial system as a whole or the institution or its group.

Both Law 11/2015 and Royal Decree 1012/2015 call on the CNMV to adopt implementation guidelines, as the competent supervisory authority for investment firms. The CNMV has accordingly prepared a set of guidelines in accordance with its Activity Plan for 2016, defining both the obligated subjects for the drafting of recovery plans and the plans' preparation and evaluation, drawing on the guidelines and technical standards issued by the EBA. These guidelines take on board the proportionality principles expressed in the legislation and the economic realities of the firms involved.

In December 2015, a total of 38 broker-dealers were subject to these obligations. Their combined assets barely exceeded 7 billion euros, such that none would appear *a priori* to represent a significant systemic risk, although any conclusion must of course await individual analysis of each case.

Prior to their approval, the guidelines were reviewed by the FROB (Fund for Orderly Bank Restructuring), Banco de España and the Fondo de Garantía de Inversiones (investors compensation scheme). Their content is as follows:

Guideline 1: *Recovery plans will not be obligatory for broker-dealers that do not render investment services giving rise to the obligation to draw up recovery plans, and have applied to eliminate them from their activity programmes.*

Compliance will be required of those broker-dealers authorised to provide one or several of the services of own account trading, placing of financial instruments without a firm commitment basis, underwriting or placement of financial instruments on a firm commitment basis and the management of multilateral trading facilities, or authorised to provide ancillary securities custody and administration services and to hold customer cash or securities on deposit.

Guideline 2: *Individual recovery plans will not, as a rule, be obligatory for broker-dealers belonging to a group subject to consolidated supervision by Banco de España, the CNMV or other competent authorities within the European Economic Space. Individual plans, however, may be sought when the supervisory circumstances so advise.*

Guideline 3: *For the first round of plans, all broker-dealers should be allowed the choice of drafting and approving simplified recovery plans unless the available information suggests otherwise. In later years, the regulator will consider the decision adopted for each institution within scope of the resolution regime, and those that will not* a priori *enter normal insolvency proceedings may be required to draft and approve full recovery plans.*

The law empowers the competent supervisor to establish simplified conditions for the content and details of recovery plans in view of the particular circumstances deriving from each entity's structure, nature and business profile. The EBA has published Guidelines 2015/16 on the application of simplified obligations,

setting out a list of optional and mandatory criteria and indicators against which competent and resolution authorities should assess institutions to decide their eligibility for the simplified regime. These criteria are: size, interconnectedness, scope and complexity of activities, risk profile, nature of business, shareholder structure, legal form and membership of an institutional protection system. In view of the characteristics of the broker-dealer sector, the CNMV considers that all firms are theoretically eligible for the simplified obligation.

Guideline 4: *Use the key elements of information specified by the EBA as a blueprint for the preparation of simplified recovery plans.*

The reference here is to the draft technical standards prepared by the EBA (RTS/2014/11) for submission to the European Commission, setting out the minimum content of the recovery plans of entities qualifying for simplified obligations. This document groups the required information under five headings: a summary of the recovery plan; information on governance; a strategic analysis; a communication plan and a description of preparatory measures. These cover the essential items a simplified recovery plan is expected to include.

Guideline 5: *Broker-dealer recovery plans should posit a single scenario combining systemic and idiosyncratic events.*

The purpose of scenarios is to define a series of hypothetical events with which to test both the effectiveness of restructuring options and the design of the indicators used in the recovery plan. For firms electing the simplified version it will suffice for recovery plans to include a single scenario combining systemic and idiosyncratic events.

Guideline 6: *Recovery plans should include at least one indicator from each of the four mandatory categories, although the CNMV may refrain from applying any that are irrelevant having regard to the institution's business model.*

Plans should include a series of indicators that serve to trigger the actions envisaged. Such indicators, qualitative or quantitative, will refer to the firm's financial situation. In its Guidelines 2015/02, the EBA specifies a series of qualitative and quantitative indicators for mandatory inclusion in sector recovery plans, to cover at least the following categories: capital, liquidity, profitability and asset quality.

Guideline 7: *The deadline for submitting the first recovery plans is set at 30 June 2016. Plans should be updated on a two-yearly basis. Finally, the first recovery plan of new broker-dealers will be submitted to the CNMV before the first 30 June after its entry in the CNMV registers, provided at least one year has elapsed.*

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1 Royal Decree 1012/2015, of 6 November, implementing Law 11/2015, of 18 June, on the recovery and resolution of credit institutions and investment firms, and amending Royal Decree 2606/1996, of 20 December, on the deposit guarantee funds of credit institutions.

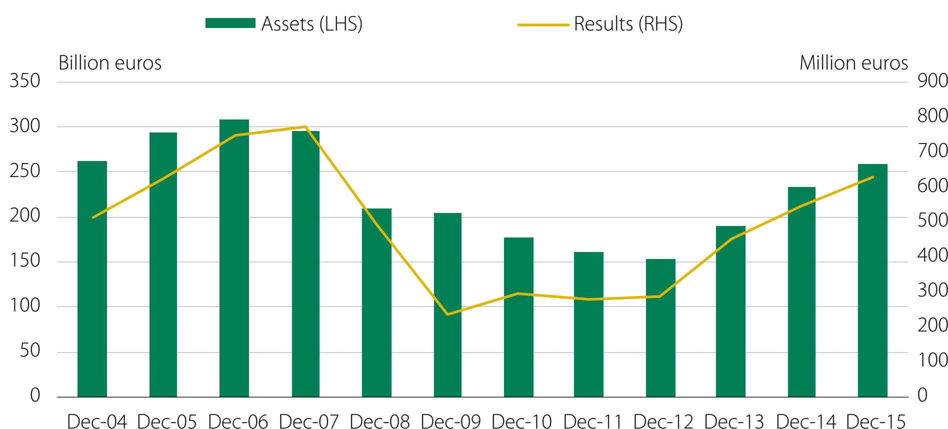
2 Directive 2014/59/EU of the European Parliament and of the Council, of 15 May, establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No. 1093/2010 and (EU) No. 648/2012, of the European Parliament and of the Council.

4.3 CIS management companies

CIS managers report a 2% drop in assets in 1Q 2016. Note, though, that 2015 was a year of industry expansion when assets and profits grew by 11% and 15% respectively.

CIS management companies did slower business in the first quarter of 2016, with assets under management dropping 2% with respect to the year-ago period (see Table 18). It bears mention, however, that 2015 had been a particularly good year, which closed with assets under management up 11.2% to 258 billion euros and pre-tax profits up 14.8% to 626.4 million euros (see Figure 24). More than 90% of asset growth traced to the mutual fund segment, though companies too fared well in the year. Finally, sector concentration remained a stand-out, with the three top managers combined commanding a 43% share of total assets (36% at end-2014).

CIS management companies: Assets under management and pre-tax profits FIGURE 24



Source: CNMV.

ROE moves higher in 2015 accompanied by a fall in the number of loss-making managers.

Business improvement was mirrored in CIS management fees, the biggest component of managers' income. These were 4.88 billion euros at end-March 2016, up 21.8% since the 2015 close. The average management fee was 0.95% of managed assets compared to the 0.85% of end-2014, principally because mutual funds have restructured their portfolios toward riskier types of assets that generally pay higher fees. Similarly, the ROE of the CIS management sector increased sizeably, continuing the pattern of recent years, from 48.5% in December 2014 to 54.7% in December 2015. The number of loss-making managers fell from 14 to 11, although the combined volume of their losses rose by 24.7% to 3.5 million euros.

A total of 101 collective investment scheme managers were registered in May, five more than at the 2015 close, suggesting that sector reorganization is near to its end.

Restructuring in the sector, which followed the restructuring of the financial system, seems to be nearing its end. In the year 2015, only two out of five fund manager closures were attributable to this process, while not one deregistration has been notified in the first five months of 2016. The five new entrants in this period lifted the number of operators to 101 at 31 May compared to the 96 of end-2015.

CIS management companies: Assets under management, management fees and fee ratio TABLE 18

Importes en millones de euros

	Assets under management	CIS management fee income[2]	Average CIS management fee (%)	Fee ratio (%)[1]
2009	203,730	1,717	0.84	68.1
2010	177,055	1,639	0.93	67.2
2011	161,481	1,503	0.93	65.6
2012	152,959	1,416	0.93	64.6
2013	189,433	1,588	0.84	62.0
2014	232,232	2,004	0.85	61.8
2015	258,201	2,440	0.95	63.7
Mar 2016	253,157	–	–	–

Source: CNMV.

1 Ratio of fee expenses for fund marketing to fee income from CIS management.

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

4.4 Other intermediaries: Venture capital

The entry of Law 22/2014, of 12 November, paves the way for new closed-ended investment vehicles intended to promote venture capital as an alternative financing route.

Law 22/2014, of 12 November, provides the option of creating new types of vehicle to promote venture capital as an alternative financing route. The vehicles in question are SME venture capital entities (companies and funds), European venture capital funds, European social enterprise funds and closed-ended collective investment schemes (companies and funds). It also regulates closed-ended collective investment scheme management companies, a name now in use for both old-style venture capital entity management companies and the managers of the new closed-end schemes. All are obliged to register previously with the CNMV.

The number of VCEs increases in the first five months of 2016, after the contraction of 2015, despite multiple investment company closures.

The number of venture capital entities (VCEs) rose from 265 to 274 in the first five months of 2016, compared to the five deregistrations of full-year 2015 (see Table 19). By contrast, the number of venture capital companies (VCCs) fell sharply in both periods, with a total of 33 deregistrations (25 in 2015 and 8 in 2016) against just seven new entries (three last year and four this). Note that many of the firms deregistering were single-shareholder corporations, which stand outside the scope of the new Law. Finally, the segment of venture capital funds (VCFs) welcomed three entrants in 2015 and a further three in January-May 2016, leaving the end-May total at 151.

23 SME VCEs have been set up in 2015- 2016 (11 funds and 12 companies) along with one European venture capital fund.

The first SME venture capital entities made their appearance in 2015; eight funds and six companies joined by three and six, respectively, in 2016 to make eleven and twelve in operation at 31 May this year. Many of them, especially funds, were transformations of existing VCEs investing in SMEs which complied with the new rules for setting up as SME venture capital entities. They were joined this February by the only European venture capital fund operative at the time of writing.

As to closed-ended vehicles, there were four in all (three companies and a fund) by May 2016, each of them created after December 2015. A total of 81 closed-ended investment scheme management companies (taking in former VCE management companies) were operative at this same date, following seven entries and three de-registrations. Most of the new managers set up in 2015 and 2016 operate investment policies geared to sectors linked to new technologies and the information society.

Three closed-ended companies and one fund have been launched since December 2015. A total of 81 management companies were operative at end-May 2016, four more than at the 2015 close and seven more than in 2014.

At December 2015, the most common strategy, extending to 87 VCEs (seven fewer than at the 2014 close), was to invest preferably in expansion phase concerns. These accounted for 20.3% of sector-wide assets (36.3% if we strip out VCEs investing in other venture capital operators). One development of note has been the surge in VCEs investing mainly in start-ups, up from 33 in 2013 to 46 in 2015 and representing 6.2% of the total (11.1% excluding VCEs that invest in VCEs).

The most widespread VCE investment strategy, extending to 87 firms, is targeted on expansion phase companies, though start-up specialists have been coming up fast in recent years.

Movements in the VCE register in 2015 TABLE 19

	Situation at 31/12/2014	Entries	Retirals	Situation at 31/12/2015	Entries	Retirals	Situation at 31/05/2016
Entities							
Venture capital funds	145	16	13	148	5	2	151
SME venture capital funds	0	8	0	8	3	0	11
European venture capital funds	0	0	0	0	1	0	1
Venture capital companies	125	3	25	103	4	8	99
SME venture capital companies	0	6	0	6	6	0	12
Total venture capital entities	**270**	**33**	**38**	**265**	**19**	**10**	**274**
Closed-ended collective investment funds	0	0	0	0	1	0	1
Closed-ended collective investment companies	0	1	0	1	2	0	3
Total closed-ended collective investment schemes	**0**	**1**	**0**	**1**	**3**	**0**	**4**
Closed-ended investment scheme management companies	**74**	**10**	**7**	**77**	**7**	**3**	**81**

Source: CNMV.

VCE assets decreased by 8.5% in 2015 to 7.77 billion euros. The company segment accounted for 100% of this decline after shedding 23.2% if its assets (to 3.42 billion euros) due in part to a spate of deregistrations. Funds, conversely, grew their assets 7.8% to 4.35 billion.

VCEs assets fell by 8.5% in 2015 with the companies segment bearing the brunt. Funds, conversely, grew their assets in the period.

The funds segment, including both traditional and new modalities, underwent a small shift in its investor mix in 2015. Specifically, incoming investment from foreign VCEs surged by 85.7% to 363 million euros, and public sector investment climbed by 25.5% to over 700 million, giving public authorities top spot in the VCF portfolio (see Table 20). At the other extreme, other foreign entities cut their investment by 16.9% to 625 million euros.

Foreign entities reduce their share of the VCF investor mix, in favour basically of foreign VCEs and the government sector.

In the VCC segment, likewise including SME venture capital firms, the two biggest investors, banks and non-financial corporations, scaled back considerably in 2015. The banks, specifically, slashed their investment by 62.1% to just above 500 million (compare this with the 1.60 billion plus of 2013), while investment by non-financials

Public authorities, by contrast, raise their investment in VCCs in contrast to the declining weight of banks and non-financial corporations.

fell by 33.8% to 861 million. Government authorities, less important in the VCC segment, raised their investment by 51.2% to 408 million euros. Finally, investment by natural persons amounted to 7.3% and 2.9% of VCF and VCC assets respectively, on a par with 2014.

Venture capital entities: Assets by investor group TABLE 20

	Funds		Companies	
Million euros	**2014**	**2015**	**2014**	**2015**
Natural persons				
Residents	288.9	317.7	133.6	99.8
Non-residents	9.1	6.8	4.3	153.9
Legal persons				
Banks	276.4	294.4	1,339.8	507.2
Savings banks	97.0	50.2	26.1	22.0
Pension funds	484.7	542.4	25.1	26.2
Insurance corporations	133.2	208.4	41.1	43.8
Broker-dealers and brokers	0.5	1.3	0.2	0.2
Collective investment schemes	54.7	65.4	18.9	4.0
Domestic VCEs	147.7	166.9	81.2	45.4
Foreign VCEs	195.5	362.9	0.0	0.0
Public authorities	564.4	708.5	269.5	407.5
Sovereign funds	102.5	31.7	0.0	0.0
Other financial corporations	312.8	302.6	951.7	989.8
Non-financial corporations	475.1	462.9	1,300.7	861.4
Foreign entities	751.9	624.7	113.7	114.7
Others	141.6	203.0	143.6	142.4
TOTAL	**4,035.8**	**4,349.8**	**4,449.4**	**3,418.2**

Source: CNMV.

According to ASCRI, VCE investment was down 16% in 2015 on account of a lull in large-scale transactions, contrasting with the dynamism of midmarket transactions and venture capital investments.

According to the 2015 data furnished by industry association Asociación Española de Entidades de Capital Riesgo (ASCRI), VCE investment in Spain fell by 15.5% to 2.94 billion euros, contrasting with a 23% jump in transaction numbers to a total of 657. The investment decline was concentrated in large-scale transactions; just five in the year compared to eleven in 2014, all of them headed by international venture capital funds. Much of the slack was taken up by midmarket transactions, with 57 deals (33 in 2014) and an overall investment comprising 56.5% of the annual total. Venture capital investments (seed and start-up phases) grew in popularity with an annual volume of 534 million, 84% more than in 2014.

The strength of Spain's economy should ensure the sector conserves its attraction for national and international investors.

The 2016 outlook for venture capital remains broadly positive. The Spanish economy looks set to continue its solid recovery, though forecasters expect a slight deceleration. The political impasse led to some transactions being put on hold in late 2015 and early 2016, but investment in shaping up to be on a par with last year's. The medium- and small-sized deal market, in particular, should conserve its positive tone.