BME
BOLSAS Y MERCADOS ESPAÑOLES

3. The Market Environment

Activity in securities markets in 2019 was marked by a generalised global slowdown that started in the first half of 2018, followed by a return to growth following the reactions of monetary authorities.

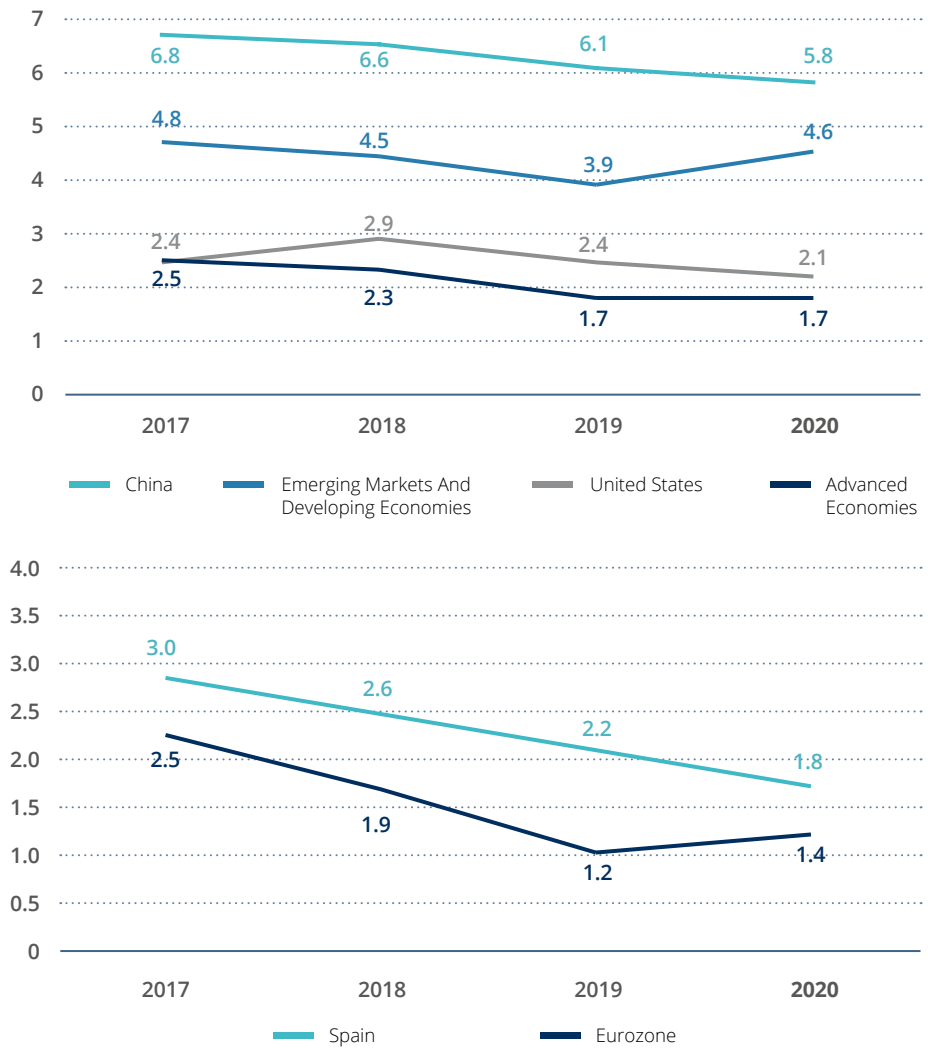
At a time of geopolitical and trade risks affecting both developed and emerging economies, the activity and results of listed Spanish companies have flagged somewhat. However, they are continuing to shore up their solvency and restructure their funding structures, even if the rapid reduction in debt levels on their balance sheets over recent years braked in 2019.

In summary, the global economic slowdown, political and internal sector factors, low volatility and very low rates contributed to lower trading in equities in 2019, but fostered the use of fixed income products by companies and investors. It seems likely that these trends will continue over the coming months.

In terms of business finance, this backdrop of economic pessimism, together with rock bottom interest rates, is making it difficult for companies to make decisions, such as whether to float on the stock market. However, it is encouraging financial leverage with lower public exposure (venture capital, for example) and other alternatives drawing on outside funds offering historically low financing costs. At the same time, equities and stable remuneration in the form of dividends have become more attractive for building portfolios, helping to explain the increases in share prices during the year. These trends were reflected in the figures for the Spanish securities markets during the year, like others worldwide. However, Spanish securities markets have been among the most active in terms of new funding and investment flows for their listed companies for more than a decade.

THE SLOWDOWN IN ECONOMIC GROWTH CONTINUED IN 2019

GDP (% ANNUAL VARIATION)



IMF Outlook October 2019

Many of the business and macroeconomic factors in play a year ago remain:

- The change in the monetary policy cycle started by the US in 2018 came to a halt in 2019. This was reflected very intensively in Europe, taking the 10-year German bond to negative rates. This is unexplored financial territory, which is generating distortions and wide-ranging debate about the direct and collateral effects of this situation. Calls for a coordinated expansionary fiscal policy response from countries with the capacity to commit resources point to a path that seems essential for redirecting monetary policy to more recognisable terrain

- The euro continued to weaken against the dollar throughout the year, while oil prices repeated the pattern from 2018, when they rose continuously during the year before falling sharply by around 35% in the final quarter. However, the timing was somewhat different in 2019, with the price of Brent crude climbing 40% in the first four months of the year but falling by about 20% since then.

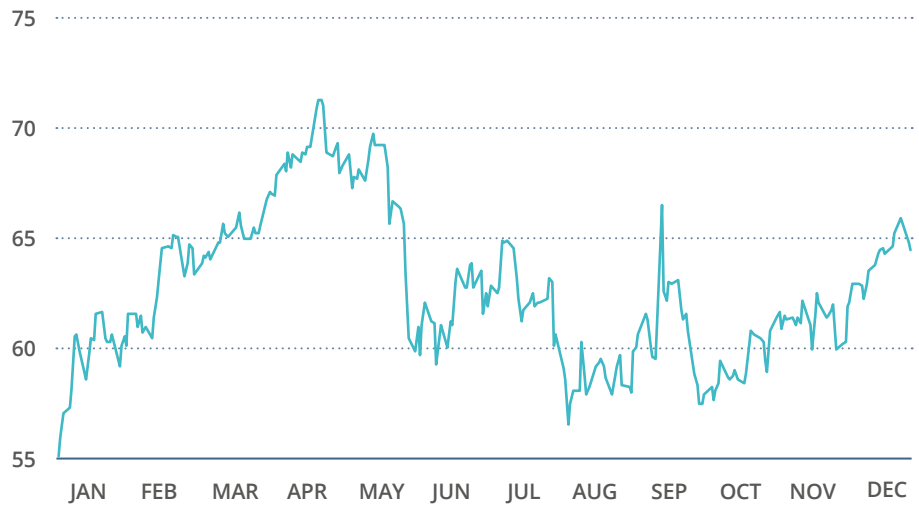
- This weakness of the euro is directly linked to the weakening of economic activity in Germany, the driver of the European economy. This is, after monetary policy, one of the the main drivers of the behaviour of the Spanish risk premium, which increased by almost 80% in 2018, before falling from 120 basis points to almost half that in 2019.

- Listed companies are skirting these difficulties, reporting a slight decrease in aggregate profit (in the first half of the year), but improving their financial position by capitalising on favourable funding conditions.

- The aggregate net profit of IBEX 35® companies fell back by around 2.5% in the first six months of the year, compared to the same period in 2018. However, turnover increased by 3.5%, supported somewhat more than in recent years by a slight improvement in the domestic market.

OIL PRICE 2019 (BRENT $)

DAILY DATA



>> The Market Environment

The macroeconomic backdrop displayed a gradual loss of steam in 2019, particularly in the manufacturing and, to a lesser extent, service sectors. Leading international economic organisations have repeatedly revised down their estimates of global GDP growth for 2019 and 2020. In October, the IMF estimated global growth for 2019 at 3%, six tenths less than in 2018 and the lowest rate of the last decade since the financial crisis. The world economy will grow by 3.4% in 2020, with developed countries growing by 1.7% in 2019 and 2020.

Turning to the European economy and the Eurozone in particular, the pace of the slowdown already noticeable at the end of 2018 has quickened, with the downturn in the German industrial sector and the uncertainty generated by Brexit. According to the IMF's October forecasts, the Eurozone will grow by 1.2% this year, 7 tenths less than in 2018, and will grow by hardly two tenths in 2020.

In Spain, the economy has confirmed that it has entered a more mature phase of the cycle, largely reined back by the global and European slowdown, the tensions and fall in international trade, and global and external political uncertainty. According to the IMF, Spanish GDP will grow by 2.2% and 1.8% in 2019 and 2020, compared to 1.2% and 1.4% in the Eurozone.

The global slowdown, and the European slowdown in particular, have also been characterised by inflation remaining well below the targets of the central banks of the main developed areas. This has led them to turn to expansionary monetary policies again, contributing to a scenario of very low and even negative interest rates in the main public debt and private fixed income markets. This has had significant collateral effects.

Turning to fiscal policy, the exhaustion of monetary policy in the Eurozone has increased pressure for fiscal stimuli by countries with the slack to do this, such as Germany and Holland. The financing of this increase in public spending would be facilitated by current funding conditions, with very low or negative interest rates.

MACROECONOMIC SCENARIO FOR SPAIN 2019-2020

ANNUAL VARIATION (%) UNLESS INDICATED

	2019				2020			
	IMF (October 2019)	European Commission (November 2019)	Government (October 2019)	Spanish analyst consensus (November 2019) (1)	IMF (October 2019)	European Commission (November 2019)	Government (October 2019)	Spanish analyst consensus (November 2019) (1)
Macroeconomic scenario								
GDP	**2.2**	**1.9**	**2.1**	**2.0**	**1.8**	**1.5**	**1.8**	**1.6**
Household consumption	1.5	0.8	0.9	1.1	1.5	1.0	1.2	1.2
Public consumption	1.6	2.0	2.0	2.1	1.1	1.5	1.5	1.7
Fixed gross capital formation	2.9	2.5	3.1	2.6	2.7	2.5	3.0	2.4
Capital goods		1.9		3.2		2.3		2.7
Construction				2.4				2.3
Domestic demand	1.8			1.5	1.7			1.5
Exports	2.4	2.0	1.7	1.9	3.3	2.3	2.3	2.3
Imports	1.3	0.5	0.1	0.7	2.9	2.0	2.0	2.4
Other indicators								
Employment	2.2	2.2	2.3	2.2	1.4	1.0	2.0	1.4
Unemployment rate (% of active population), Active Workforce Survey	13.9	13.9	13.8	14.1	13.2	13.3	12.3	13.3
Wages and salaries	1.5	2.4	2.1	1.9	1.3	2.2	2.2	1.7
CPI (annual average)	0.7	0.9		0.7	1.0	1.1		1.0
Current account balance of payments (% GDP)	0.9	2.4	1.8	1.4	1.0	2.5	1.6	1.1
Public Administrations balance (% GDP)	**-2.2**	**-2.0**	**-2.0**	**-2.3**	**-1.9**	**-1.4**	**-1.7**	**-2.0**

Source: FUNCAS. (1) Source: FUNCAS forecasts panel (percentage points)

Business results

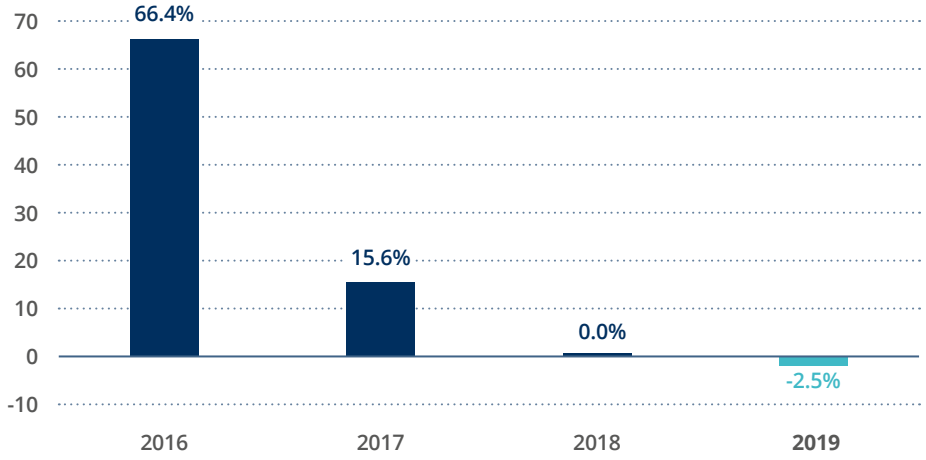
The loss of dynamism in the economy and the decline in the confidence of companies and investors in Spain and Europe over the last two years have also fed into the reduced expansionary dynamism of business results.

According to the Bank of Spain's annual central balance sheet survey, the decline in the pace of expansion that began three years ago has been extended and intensified by the activity of domestic non-financial companies. At the end of the third quarter, these companies, in which listed companies have significant weight, noted smaller increases in their ordinary profits and employment than in the previous year. This slowdown in ordinary profits in 2019 affected most sectors (except energy) and was particularly intense in industry (manufacturing of mineral and metal products and refining).

Although this sample of companies on the Spanish stock exchange also includes financial sector companies, particularly banks, the slowdown in the pace of growth of profits could also be seen in the aggregate data for IBEX 35® companies. The first-half results for the companies in the domestic selection were the worst in the last five semesters, similar to those for June 2016.

THE RESULTS FOR LISTED COMPANIES ALSO SUFFERED FROM THE ECONOMIC SLOWDOWN

AGGREGATE DATA FOR THE NET PROFIT OF IBEX 35 COMPANIES. VARIATION (%) COMPARED TO THE SAME PERIOD THE PREVIOUS YEAR.



Source: MSCI and in-house

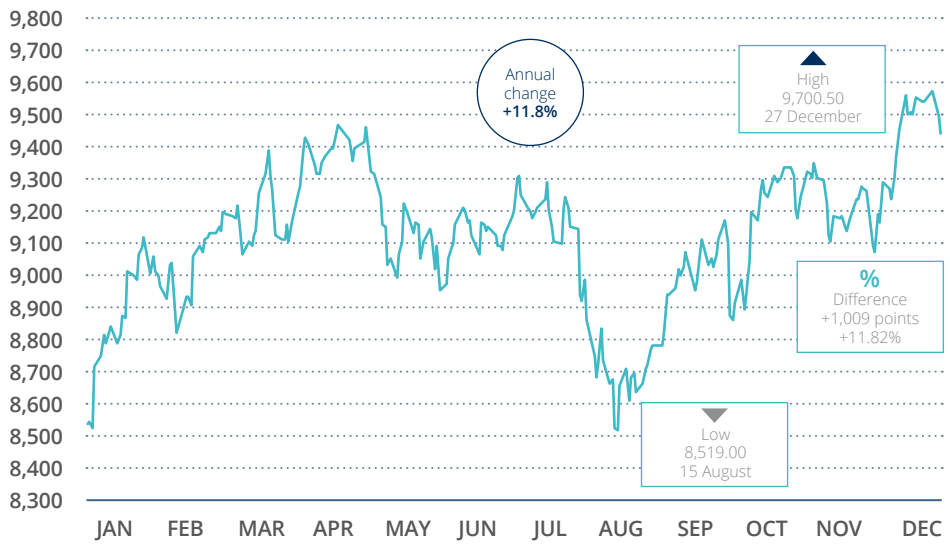
The profits of IBEX 35® companies fell by 2.5% in the first six months of the year, to 19.99 billion euros compared to 20.51 billion in the previous year. Revenues grew by 3.5%, compared to 5.5% in the same period in 2018.

The export market continues to contribute around 65% of their turnover, demonstrating their increasing internationalisation.

Although the IBEX 35® was up by 11.8% (16.6% with dividends) at year-end 2019, these increases were insufficient to raise their price-earnings ratios (PER) above their historical averages. According to calculations from the Morgan Stanley Capital International (MSCI) historical series, the current aggregate PER of the largest Spanish listed companies is close to 12.5 times, compared to an average of 15 times over the last 30 years, while the ratio of the share price to the book value of these companies was 1.2, compared to a historical average of 1.5. From this perspective, the classical theory indicates that the Spanish stock market is currently attractively priced.

IBEX 35 IN 2019

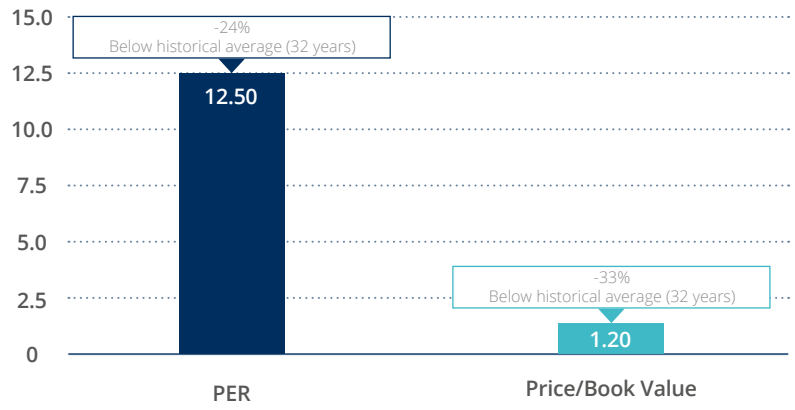
DAILY DATA. IN POINTS.



Spanish listed companies have taken advantage of recent years to reduce the financial cost of their indebtedness and change the debt structure of their balance sheets, reducing their vulnerability to recessions or slowdowns.

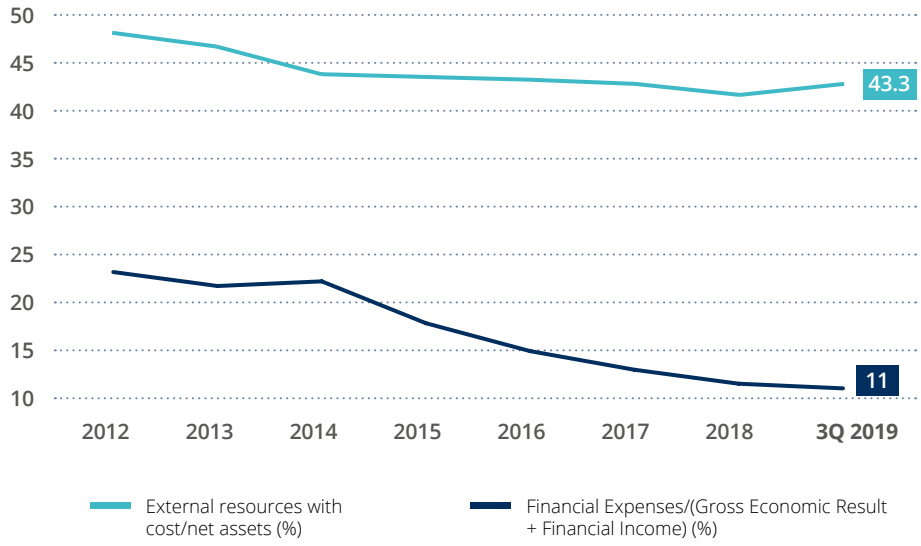
THE SPANISH STOCK MARKET BELOW ITS HISTORICAL FUNDAMENTAL LEVELS

OCTOBER 2019. AGGREGATE FIGURES FOR SPANISH LISTED COMPANIES SELECTED BY MSCI



Source: MSCI

FUNDING COSTS ARE FALLING FOR SPANISH COMPANIES



Source: Bank of Spain Quarterly Central Balance Sheet (CBT)

At the end of September, the net financial debt of non-financial companies in the IBEX 35® was around 165 billion euros, 5 billion euros higher than a year previously but 14% lower than in 2010, and slightly more than 23% lower if we consider the same IBEX 35® companies at the two ends of the period (the aggregate data for 2019 and 2018 are disproportionately affected by the application of IFSR 16 and the pro rata recognition of leases as debt).

SOLVENCY RATIO FOR NON-FINANCIAL IBEX 35 COMPANIES

THE FIGURE SHOWS THE WEIGHT (%) OF NET FINANCIAL DEBT OVER EBITDA