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2017 | THE FIXED INCOME MARKET

BME

RELEVANT EVENTS

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Euro zone monetary policy

- In April, the **ECB** reduced the volume of **QE** from EUR 80 billion to EUR 60 billion per month. In October, it was agreed to extend the purchase programme until September 2018, with the amount reduced to EUR 30 billion per month.
- Approximately **half** of the ECB's balance sheet corresponds to securities acquired (EUR 2.3 billion). **83%** are **public debt** securities, **11% are covered bonds** and the rest are investment-grade **corporate bonds** and asset-backed securities (ABS).
- The **limit of 30%** of the outstanding balance was reached in numerous covered and corporate bond issuances, which was damaging to the liquidity of **secondary markets**.
- The 1-year **Euribor** once again ended 2017 at a new **record low (-0.190%)**. The interest rates controlled by the ECB remain stable:
    - Credit facility: +0.25%.
    - Repo: 0%.
    - Deposit facility: -0.40%.
- Despite this **penalty**, bank deposits with the ECB continued to rise to **EUR 1.85 trillion** (EUR 1 trillion in December 2016), which offers a measurement of the existing **liquidity surplus** in the system.

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International debt market

- The **bad omens** regarding the performance of the bond market in 2017 **were not met**, due to the higher-than-expected growth of the global economy, the monetary policies of high liquidity and low interest rates, and the even lower inflation. With the exception of the German bond, European **bond portfolios generated earnings** as a result of the drop in yields.
- The **FED** complied with the envisaged plan and **increased** interest rates three times **from 0.75% to 1.50%**, despite the fact that the indicated level of inflation was not reached (2%). In addition, it began to **reduce** its balance sheet by not reinvesting a portion of the maturities of its portfolio.
- Despite these severe measures, the **reaction** of the markets was quite **smooth**. The yields on the secondary debt market gradually **rose**, while the equity market continued to drop and, surprisingly, the **US dollar** had **depreciated** against other currencies.
- The strong demand for European bonds with **speculative ratings** caused their average return to drop to below 2%, **less** than the US 10-year treasury bond. Institutional investors also opted for the profitability of the **emerging debt markets**.

Spanish economy

- The **Spanish economy** grew by more than **3%** for the third year in a row, showing a slight slowdown in the last quarter. **Domestic demand** was the main supporting factor of this growth. **Inflation** ended the year at **1.1%**.

- The **risk premium** of the 10-year bond compared to the German *bund* rose during the **first third of the year**, and then hit record lows at around 90 basis points. The political instability during the last quarter caused the bond to end the year at 114 points, a value similar to that of January.

- **GDP** stood at EUR 1.163 billion, a record high, and **public deficit** is expected to reach **3.1%** of this figure.

- The **debt** of all public entities reached **EUR 1.144 trillion**, up **3.4%** on the previous year and **98.08%** of the **GDP**, within the limit agreed upon with Brussels.

- The volume of **Spanish assets** acquired by the ECB within three years exceeded EUR 235 billion.

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Issuing activity of the Treasury

- The Treasury had **net issuances** throughout the year of **EUR 45,031 million**, up **28.5%** on 2016, and **EUR 10 billion** on that envisaged in the strategic financing plan. The **maturities** during the year were **EUR 188,869 million**, 52% of which corresponded to bills.
- The **average cost** of the issuance stood at **0.62%**, a level similar to the previous year. The **average cost** of the **outstanding debt** recorded a new low of **2.55%**. The **average life** was extended to **7.13 years**, due to the decrease of the outstanding balance of the bills. **11%** of the total amount issued in bonds and debentures corresponded to issuances from **30** to **50 years**.
- By means of **syndicated** bank loans, the Spanish Treasury raised **EUR 26,836 million** in **four debenture issuances**, three of them at 10 years and one at more than 15 years.
- The volume of **inflation-linked** European government bonds and debentures totalled **EUR 12,406 million**, with 8.9% of the total expiring in the medium to long term.

INDICATORS

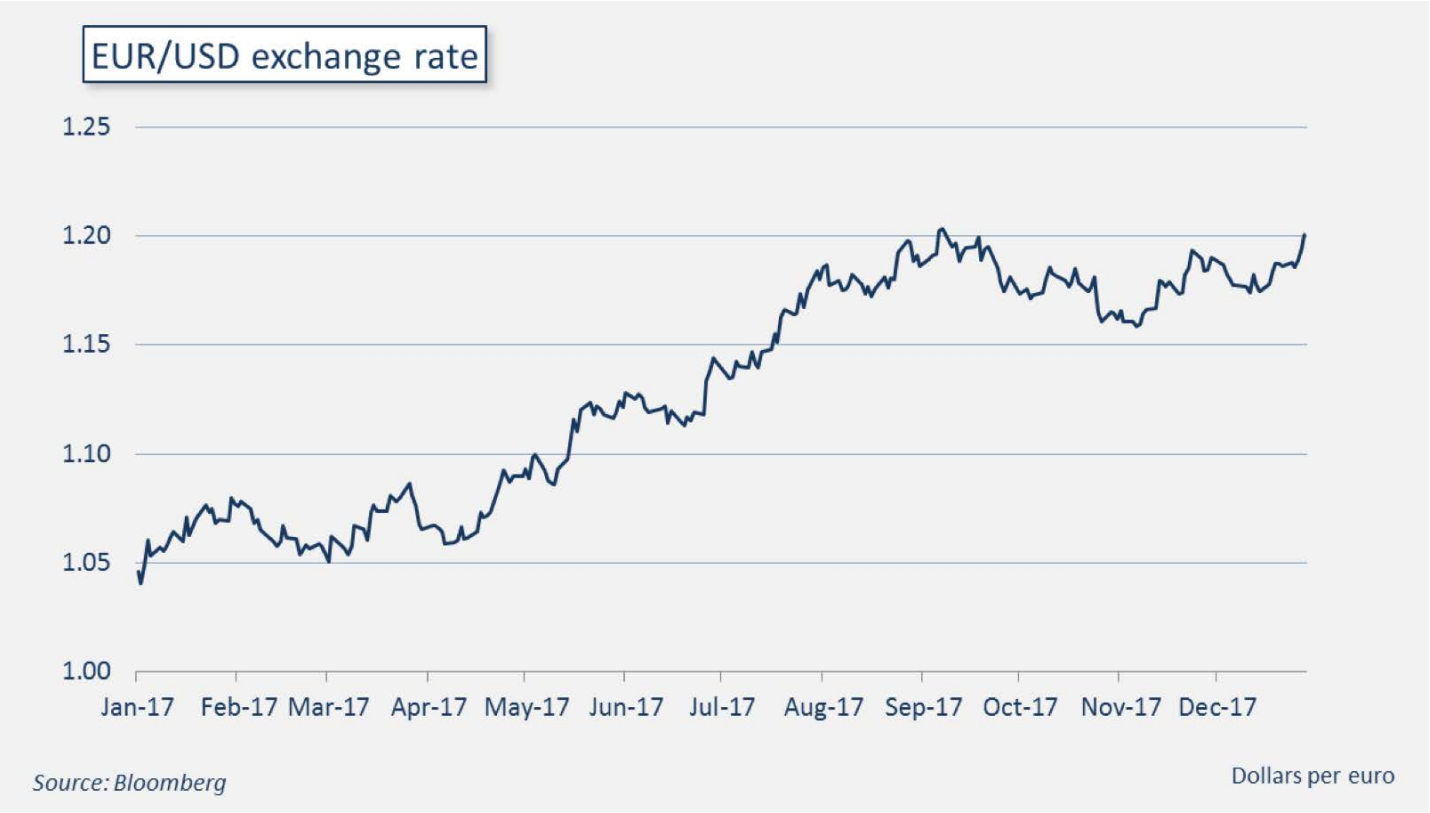
Brent

The stability of the first few months of the year gave rise to a period of volatility, reaching a low of USD 44.21 per barrel, and subsequently rebounding before ending December at a high of USD 66.82 per barrel.

Gold

After beginning the year at minimum values (USD 1,152 per ounce), the levels of support increased, reaching a high of USD 1,349 at the beginning of September, and ending the year at USD 1,303 per ounce.

US dollar

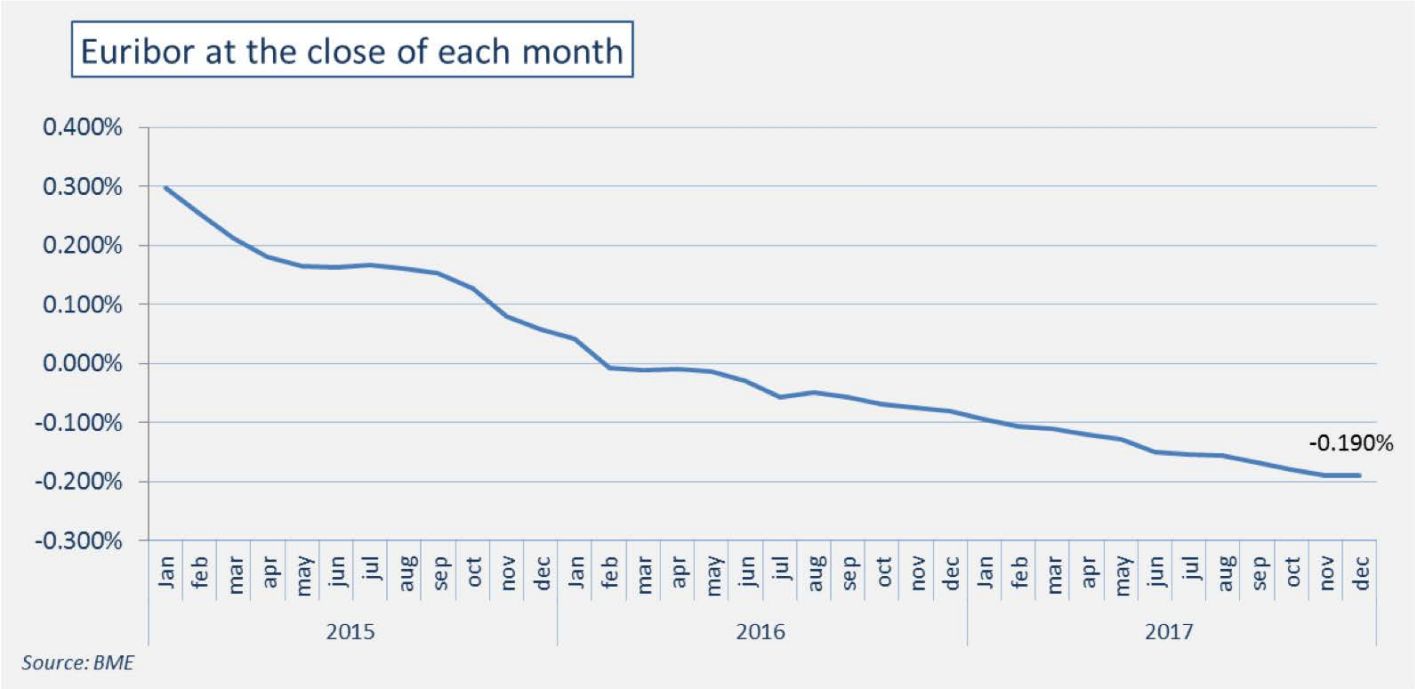


The euro was revalued throughout the year with respect to the American currency. After a start very close to parity, it closed the year at $ 1.201 per euro, with an increase of 15%.

Risk premium over German bond

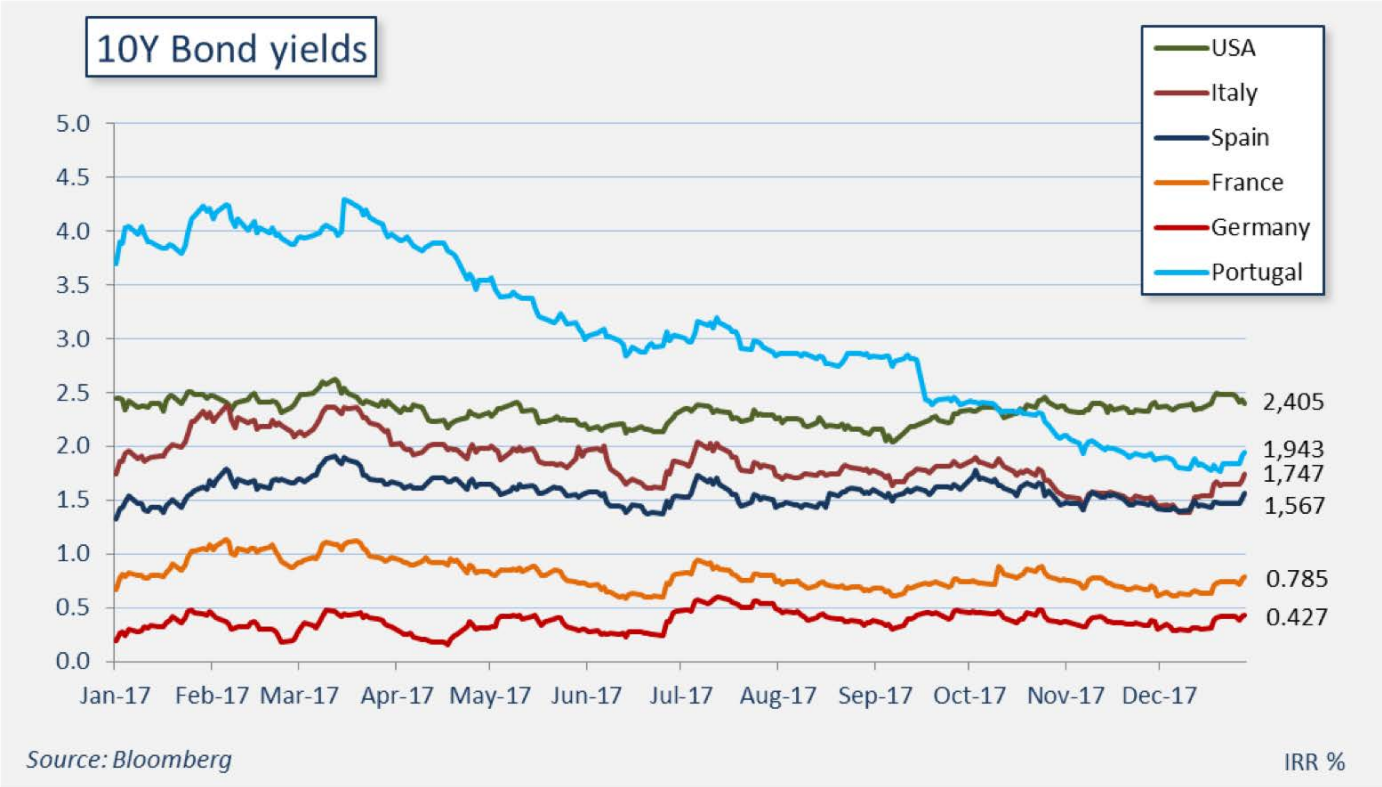
It ended December at a value of 114 bp, which was similar to that at the beginning of the year, after undergoing significant fluctuations, reaching a high of 155 bp in February and a low in August of 94 bp.

Euribor



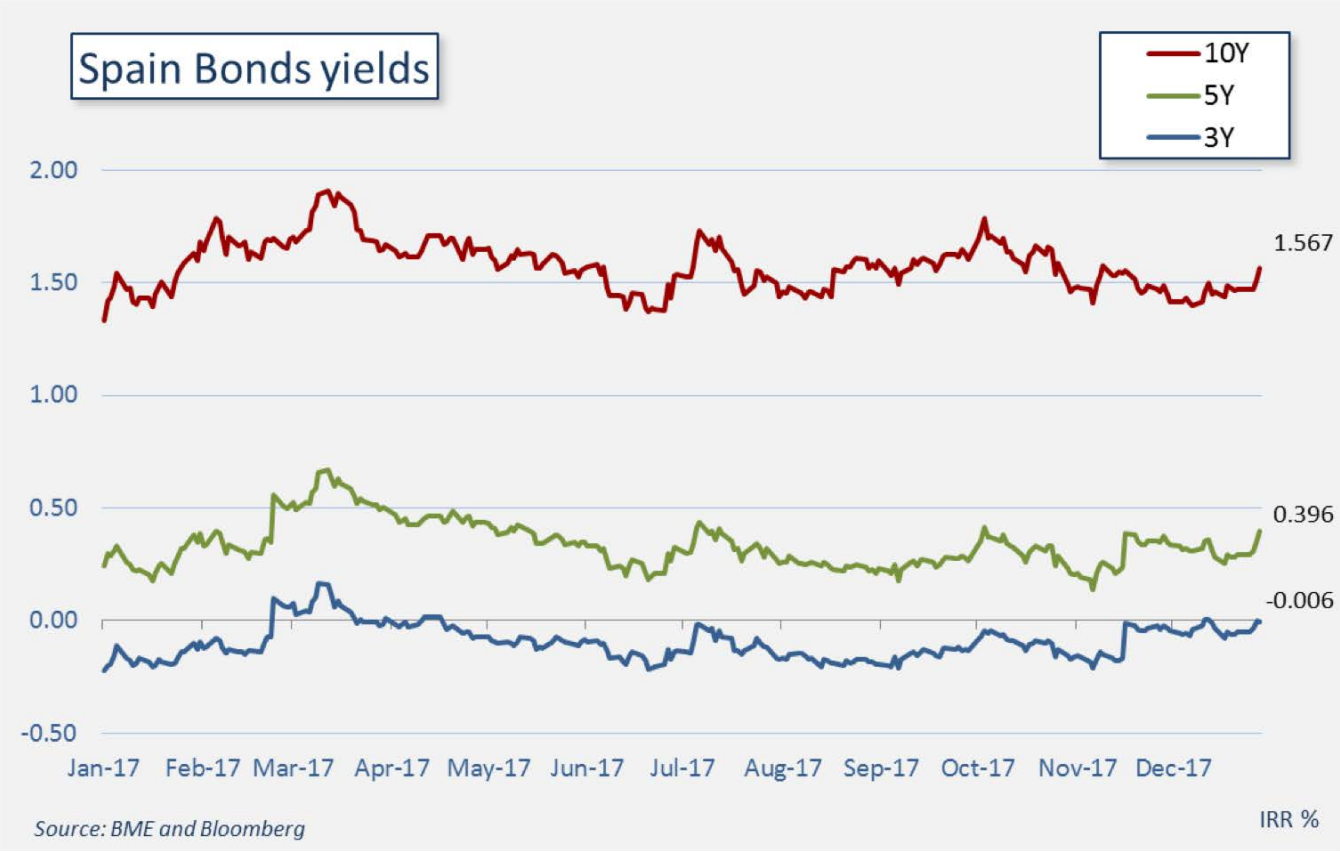
The Euribor, which began the year in negative territory, continued its downwards trend fostered by the ECB's monetary policy to reach -0.190% in December, dropping one tenth compared to January.

Government debt



The last part of the year was highly favourable for Spain, with return on the 10-year bond below that of Italy. The improved performance was recorded in Portugal, with a drop from the record high of 4.3% to 1.9%, less than the US bond.

Debt of the Treasury



The return on the 3-year bond remained negative for most of the year. The 10-year bond ended December at 1.567%, with a positive outlook for 2018 due to the improvement in the rating.

MARKET PERFORMANCE

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Primary market and Balance

- In the AIAF Market, the **new private fixed-income issuances** exceeded EUR 120 billion **(-6.6%)** and gross **Treasury** issuances admitted to trading amounted to more than EUR 230 billion **(+5.8%)**.
- Of the amount corresponding to private fixed income, **15.1%** were **commercial paper issuances**. Short-term issuances dropped by 19.2% year on year, while **medium- and long-term assets** dropped by **3.9%**.
- **Bonds and debentures** with no additional guarantees grew by **36.1%**, while issuances of **covered bonds** declined by **24.4%**. The volume of **securitised** bonds issued decreased by **19.3%**.
- The **outstanding balance** at the end of December of public debt and corporate bonds listed on the AIAF rose by **4.8%** to **EUR 1.44 trillion**, due to the 9.5% increase in state debt, since private sector debt continued to fall (-3.2%). **Short-term assets** (promissory notes and bills) only represented **6.3%** of the total.
- The CNMV **streamlined the procedures** for listing Fixed Income issues in the Spanish market in order to make it more competitive and **attract new issues**

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Secondary market: AIAF and SENAF

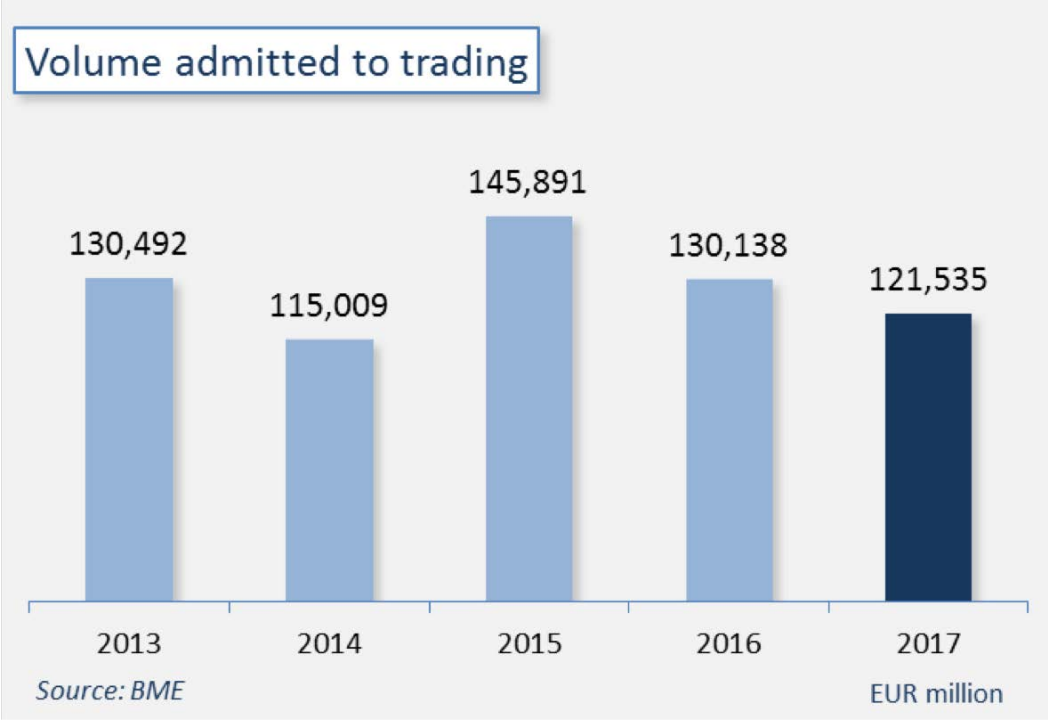
- The purchase policy of the ECB, the high liquidity and a scenario of low or negative interest rates have **deflated** the **secondary fixed-income market** for the third year in a row.
- For regulatory reasons, the AIAF Market stopped publishing the **bilateral** volume between Market Members as of **mid-September**, coinciding with the entry into T2S. As of the entry into force of the **MiFID II** Directive, the Market only publishes the trades carried out on its electronic trading **platform**.
- The annual volume **traded** in 2017 was **EUR 213,663 million**, of which EUR 137,763 million related to public debt, and EUR 75.9 billion to private fixed income. The last figure is affected by the previously mentioned circumstance.
- Trading volume on the **SENAF** wholesale public debt platform, where the Treasury's market makers are active, **dropped** by **21.3%** and its operations by 13.1%.

MARF

- With an ongoing scenario of low interest rates, institutional investors have opted for the higher yields offered by **MARF**.
- After four years in operation, **MARF** continues to contribute to expanding the financing options for companies. The volume of new issuances listed on this market in 2017 grew by **74.1%** year on year to **EUR 3.97 billion**.
- Since its establishment, the MARF has handled over **EUR 7.57 billion** of funding through **new issuances** and at the end of the year had an outstanding balance of **EUR 2.26 billion**.
- With the additions from 2017, a total of **41 companies** have been directly financed through this market.

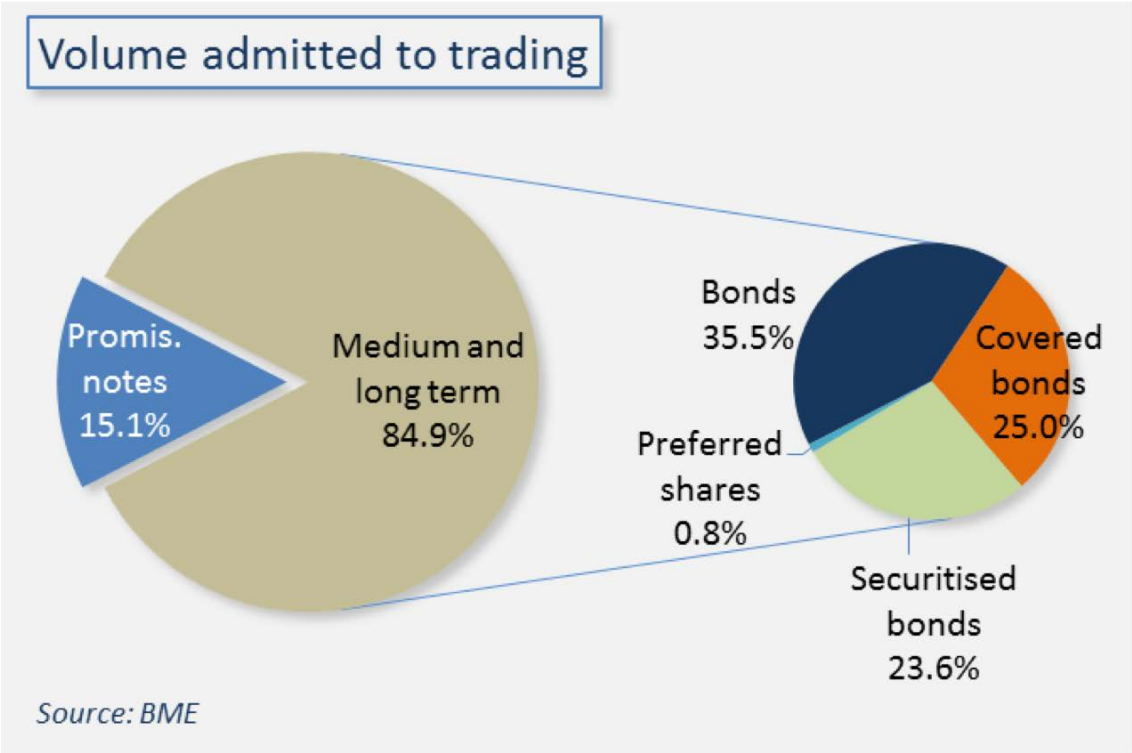
ACTIVITY DATA

AIAF. Primary market. Private debt



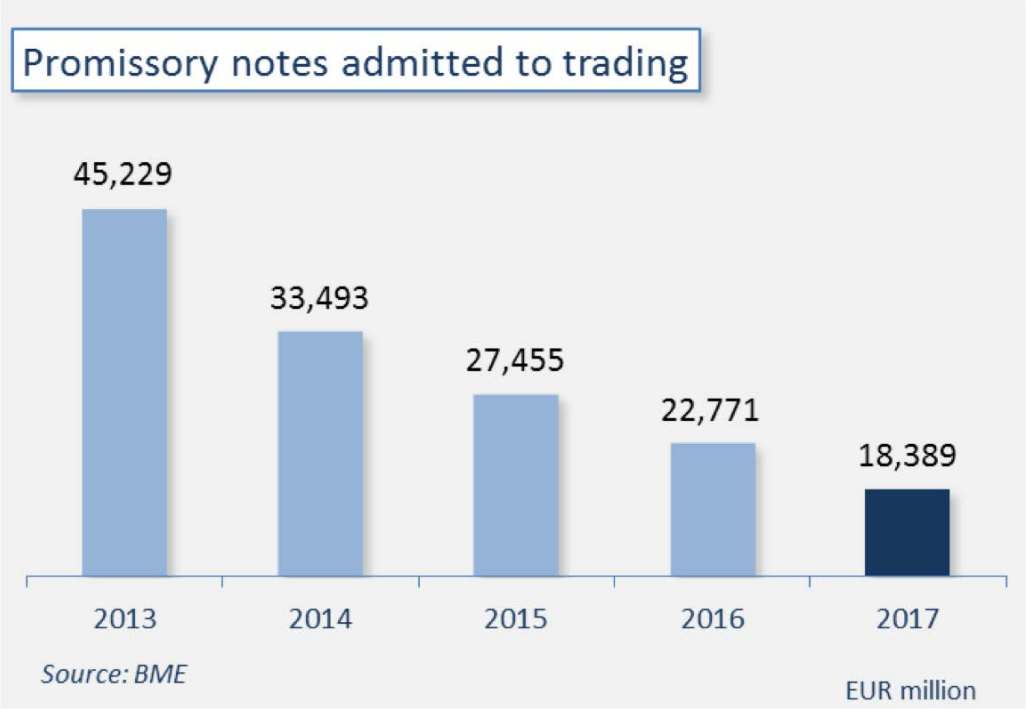
The total volume admitted to trading in 2017 reached EUR 121,535 million, representing a decrease of 6.6% compared to the previous year.

AIAF. Primary market. Private debt



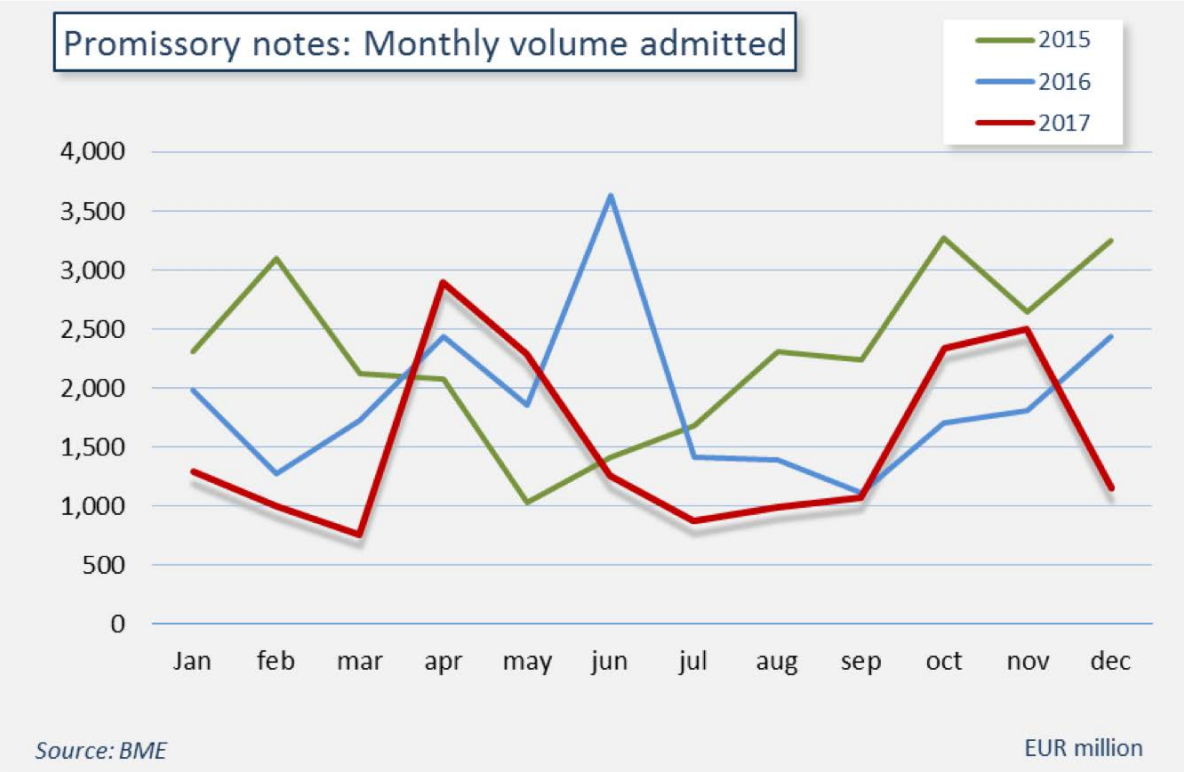
Short-term issuances lost 2.4 points out of the total. However, simple bonds and debentures grew by more than 11 points. Covered bonds made up one fourth of total new admissions.

AIAF. Primary market. Promissory notes.



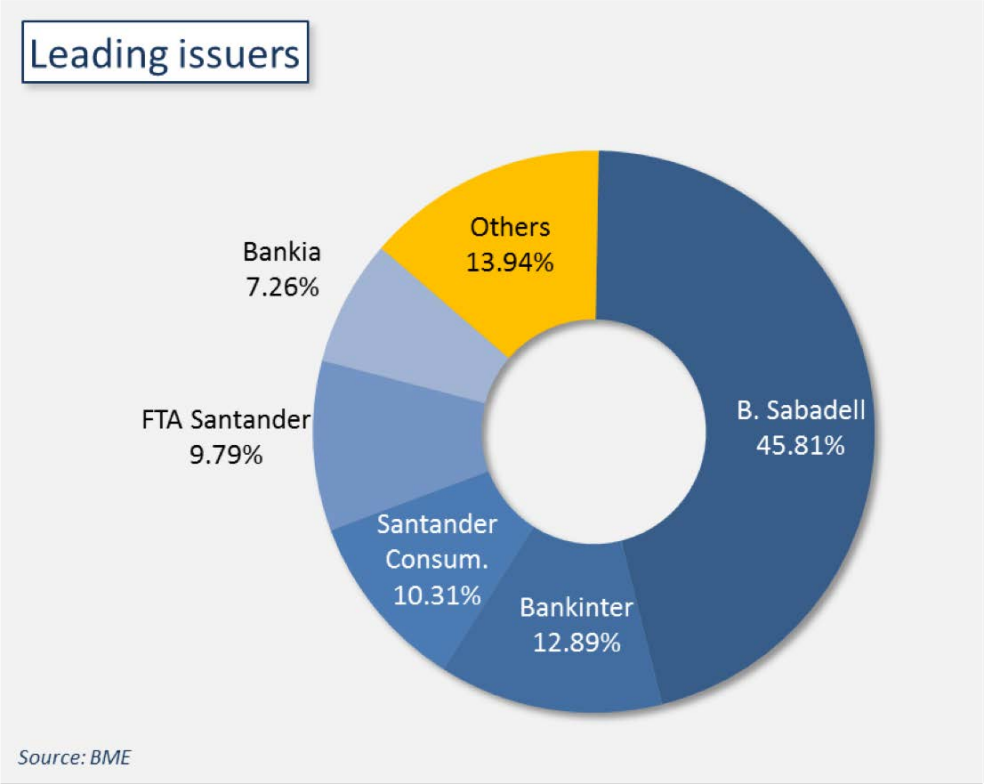
The drop in promissory note issuances shows the scant interest that investors have in these issuances. With returns close to zero, it is difficult to compete with bank deposits or with commercial paper of MARF.

AIAF. Primary market. Promissory notes.



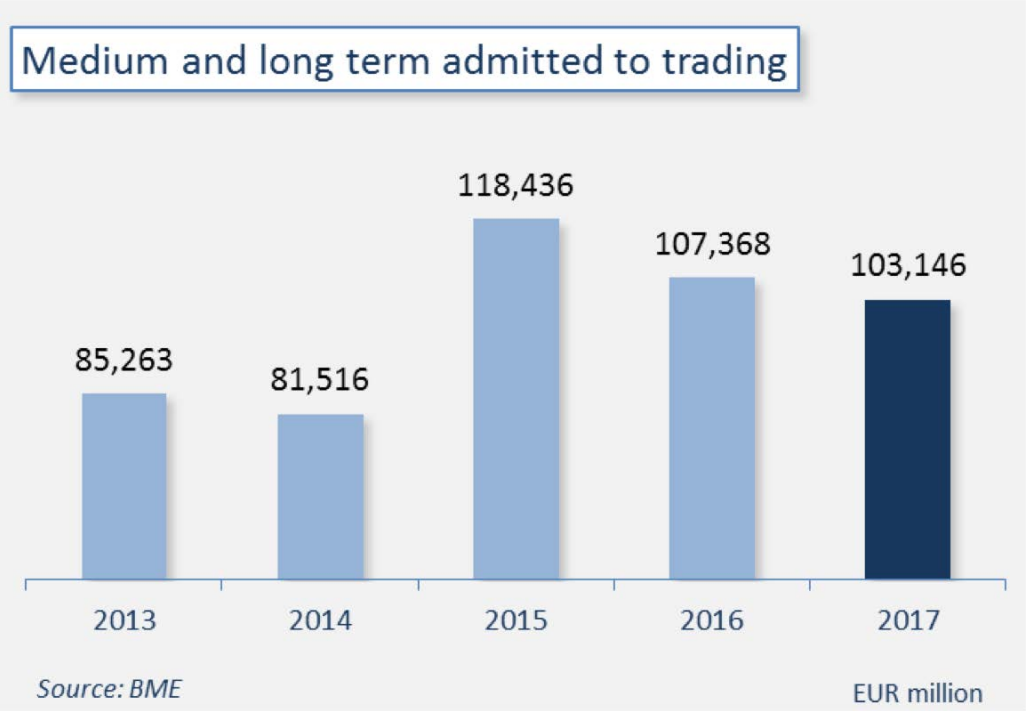
The monthly average of note issues was only EUR 1,532 million, compared to EUR 1,898 million a year earlier. A monthly high of EUR 2,897 million was posted in April.

AIAF. Primary market. Promissory notes.



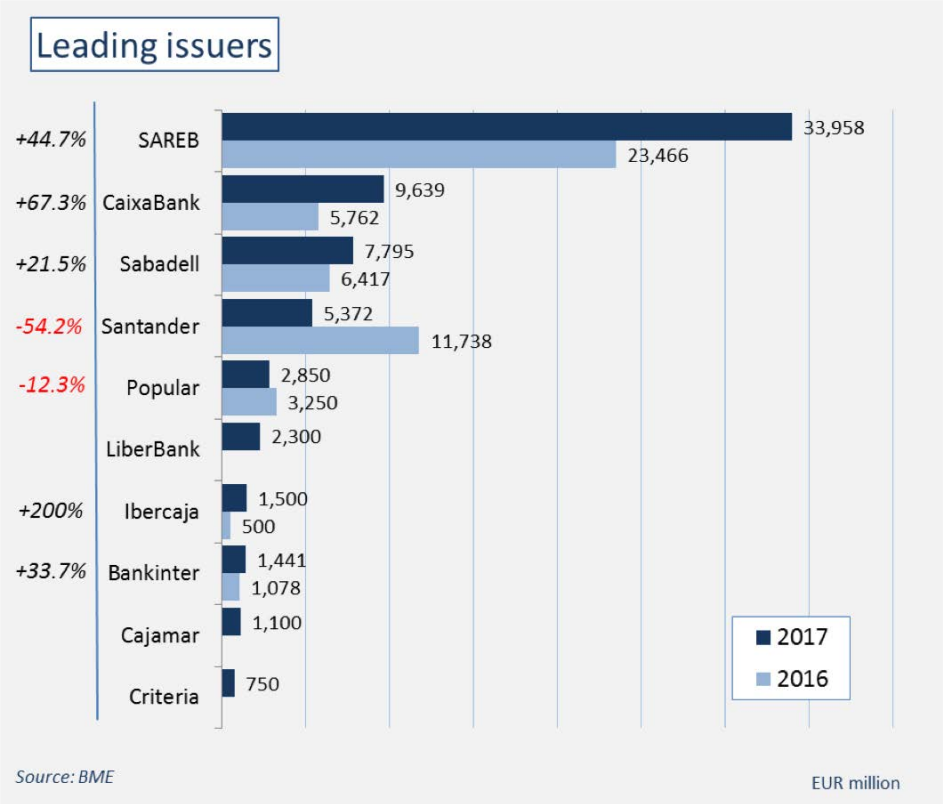
Sabadell was the bank that was most active and the only bank that used its issuance programme in full, with a share of over 45%. The five leading banks issued upwards of 86% of the total volume.

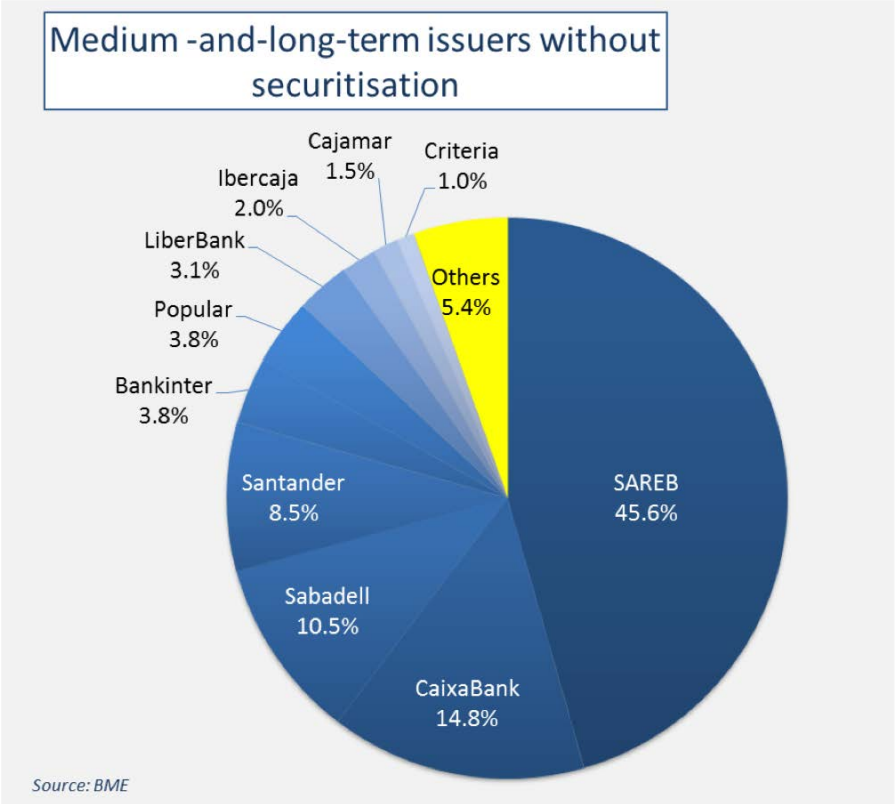
AIAF. Primary market. Medium and long term



The volume of new medium- and long-term asset issuances fell for the second year in a row (-3.9%). The most significant drop corresponded to covered bonds (-24.4%).

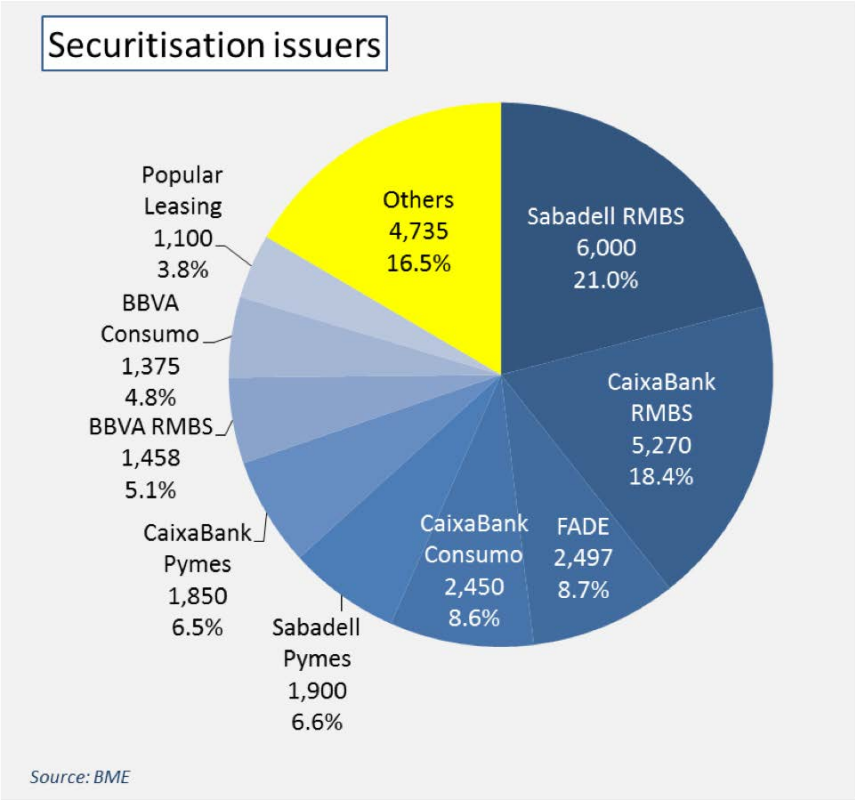
AIAF. Primary market. Bonds, covered bonds and debentures

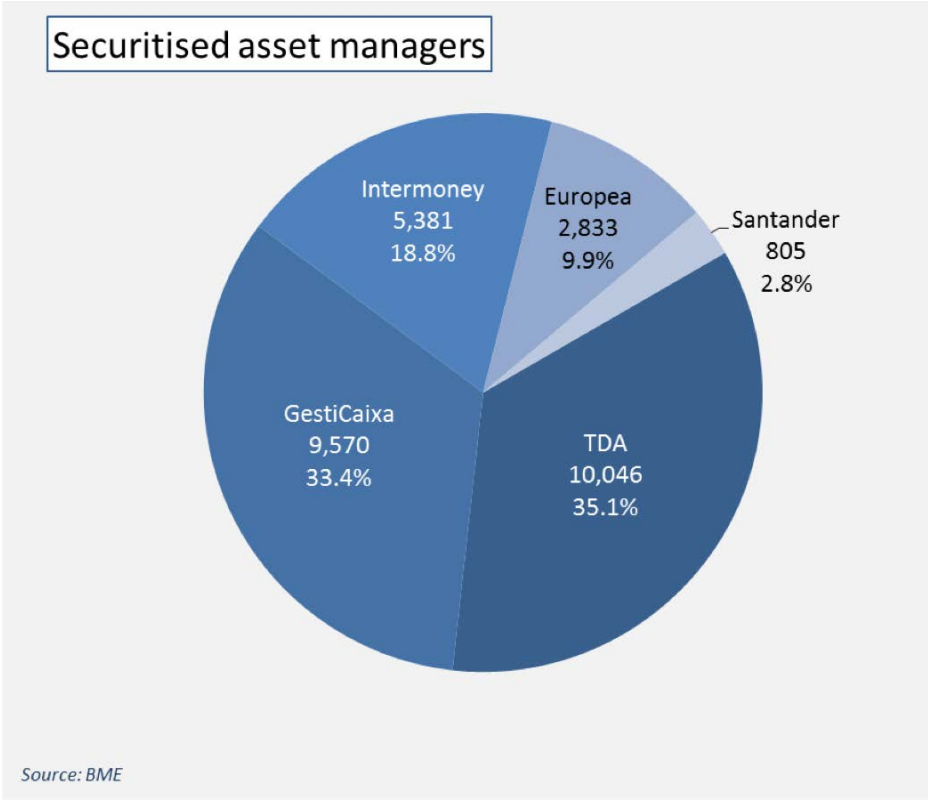




SAREB was the most active issuer, with a share of 45.6% and an increase in volume of 44.7% compared to the previous year. They were followed by Caixabank, with a share of 14.8%, and Sabadell with a share of 10.5% out of the total.

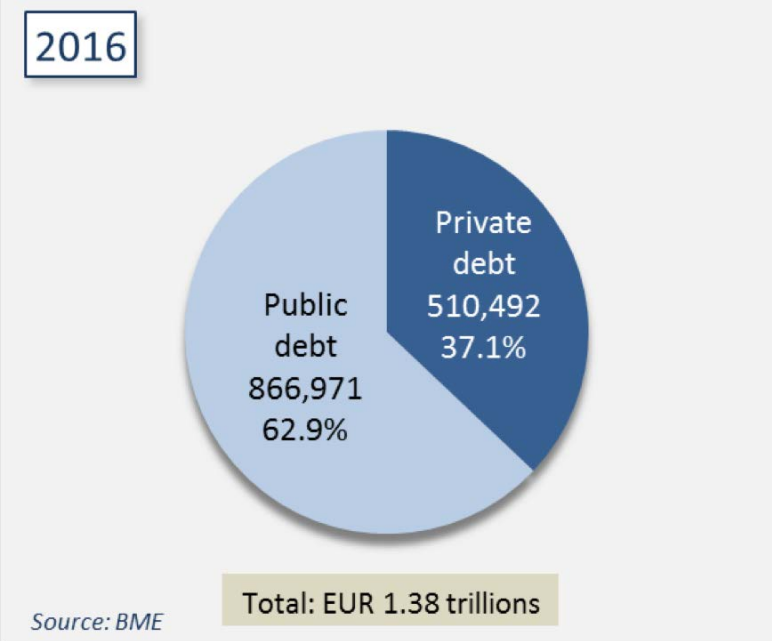
AIAF. Primary market. Securitisation

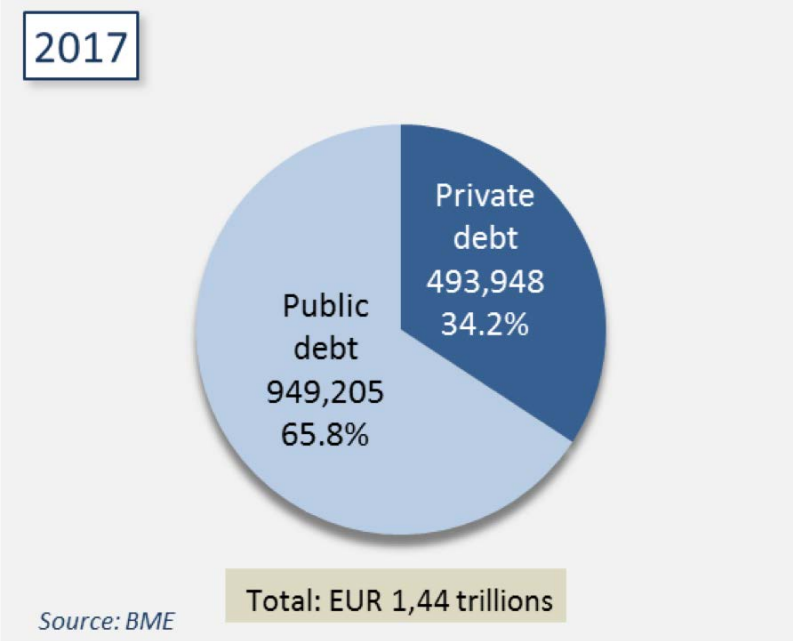




Banco Sabadell was the largest issuer, with a fund for residential mortgages of EUR 6 billion. They were followed by CaixaBank, with two similar funds amounting to a total of EUR 5.27 billion. By Managers, TDA led the mandates of funds, with a share of 35.1%, followed by GestiCaixa with 33.4%.

AIAF. Outstanding balance





The outstanding balance of the AIAF Market at year-end was EUR 1.44 trillion (+4.8%). Public debt rose by 2.8 points in relative terms, due to the inclusion of regional debt for an amount of EUR 30,440 million.

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AIAF. Outstanding balance

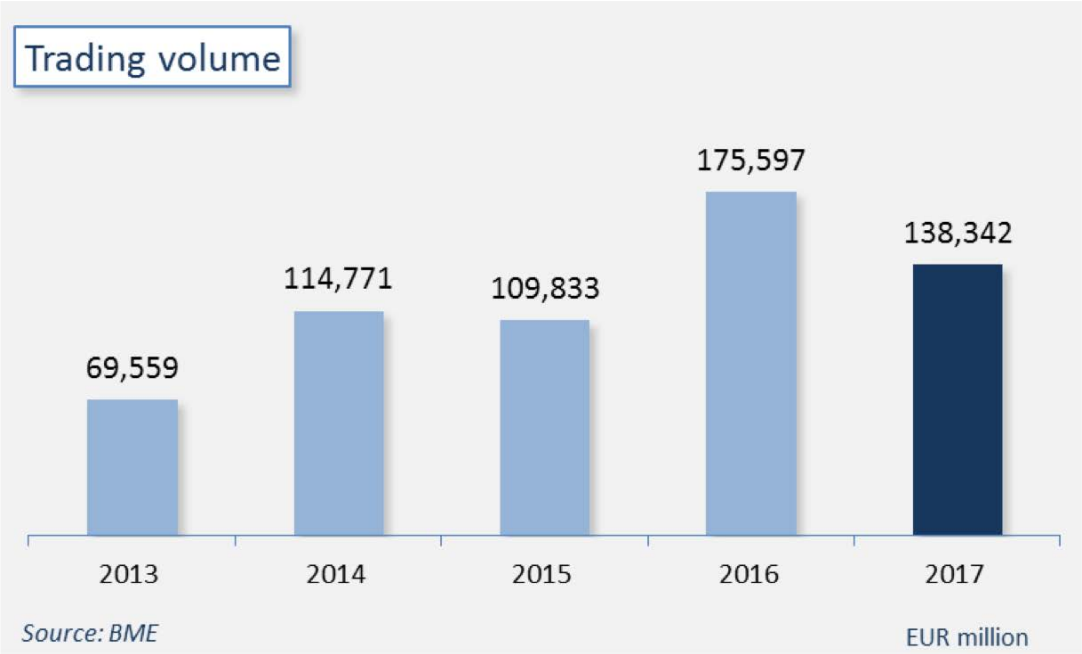
Outstanding balance		
	Short term	Medium and long
Private debt	12,346	481,603
Public debt	78,835	870,369
Total	91,181	1,351,972

Number of issues (ISIN)		
	Short term	Medium and long
Private debt	179	1,924
Public debt	12	125
Total	191	2,049

Source: BME EUR million

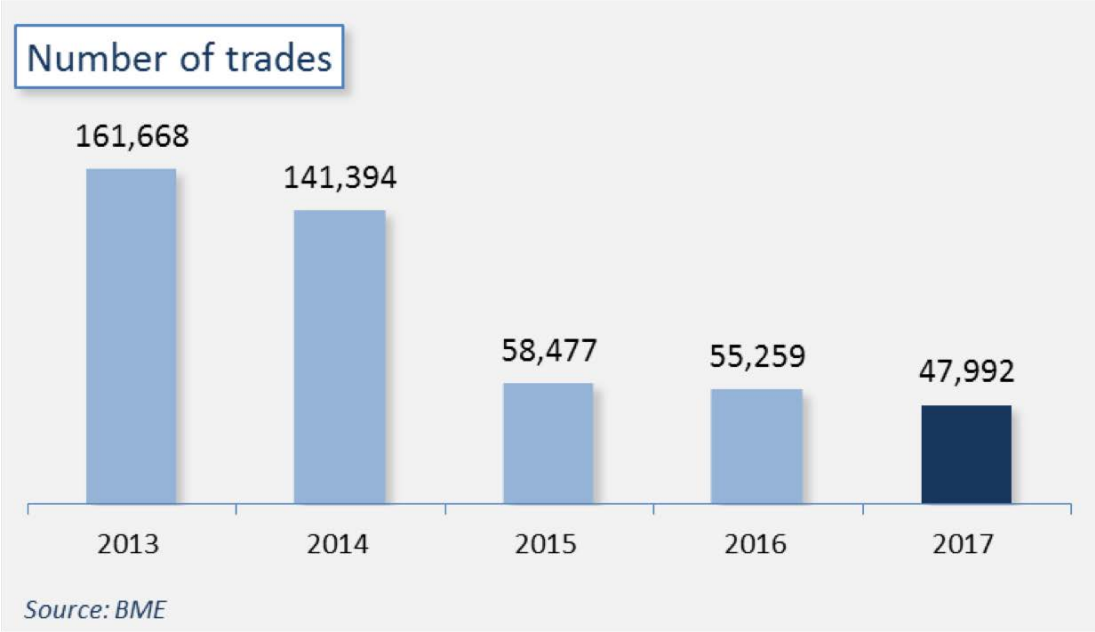
At 31 December, the outstanding balance of short-term assets (government bonds and promissory notes) accounted for 6.3% of the total. There were 2,240 issues (ISIN references) outstanding at that date.

AIAF. Platforms. Volume traded



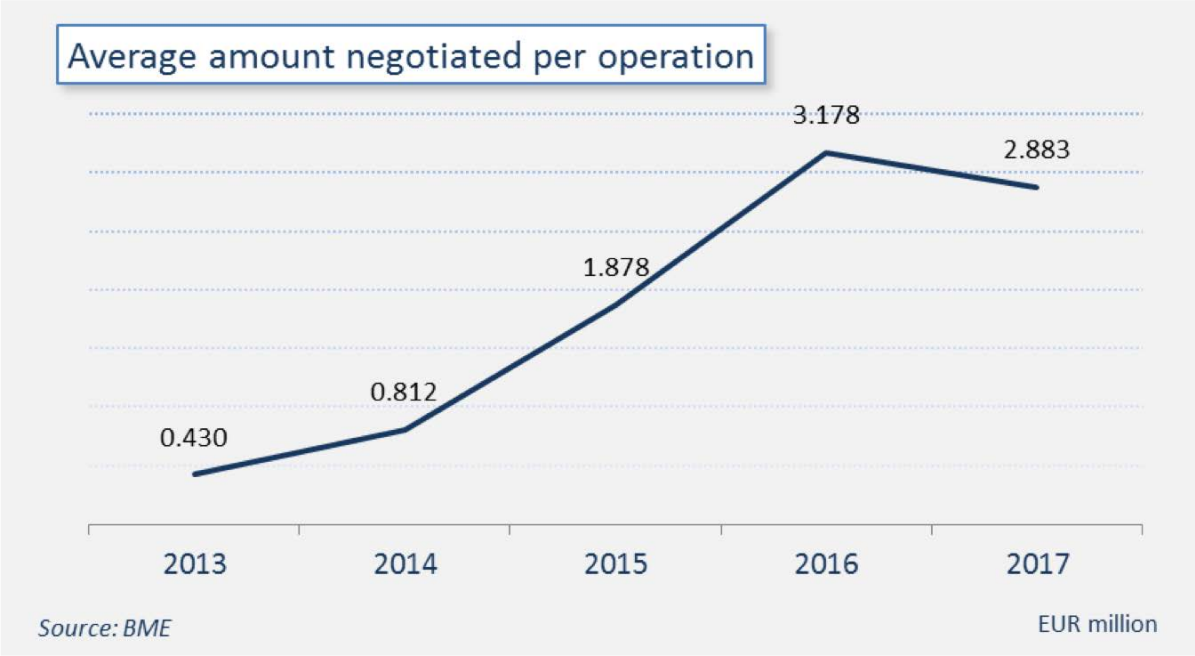
Trading on the Market's electronic platforms (SENAF and SEND) amounted to EUR 138,342 million, down 21.2% on the previous year. The average amount traded per session was EUR 543 million, compared to EUR 683 million in 2016.

AIAF. Platforms. Trades made



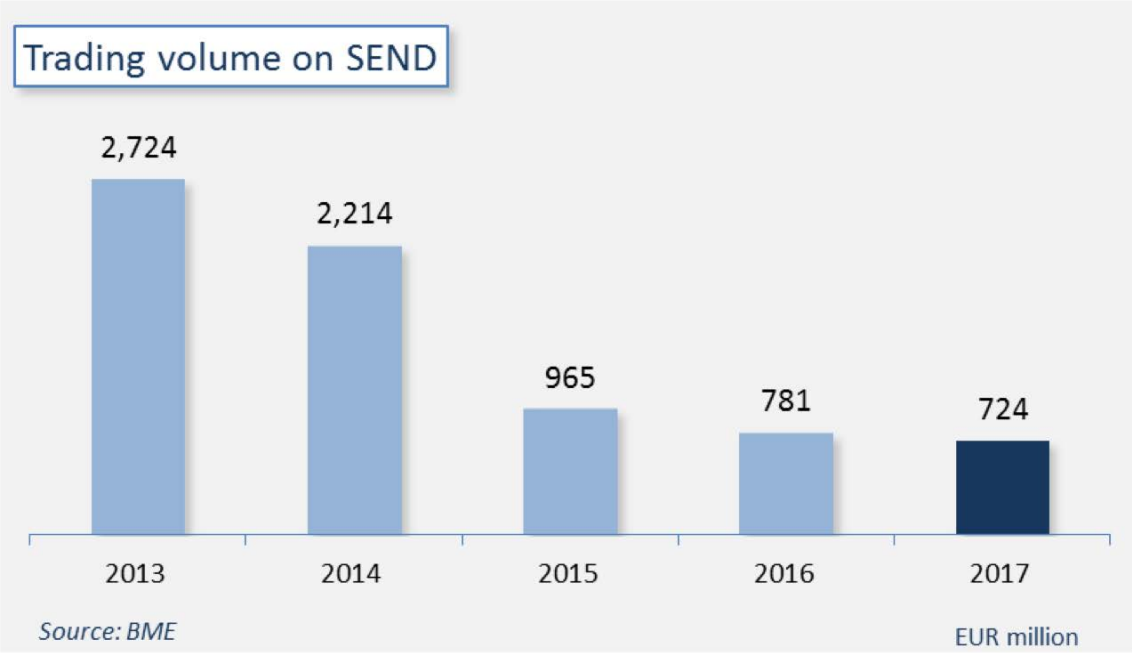
The number of trades made using the Market's electronic platforms (SEND and SENAF) dropped by 13.1%.

AIAF. Platforms. Trading volume



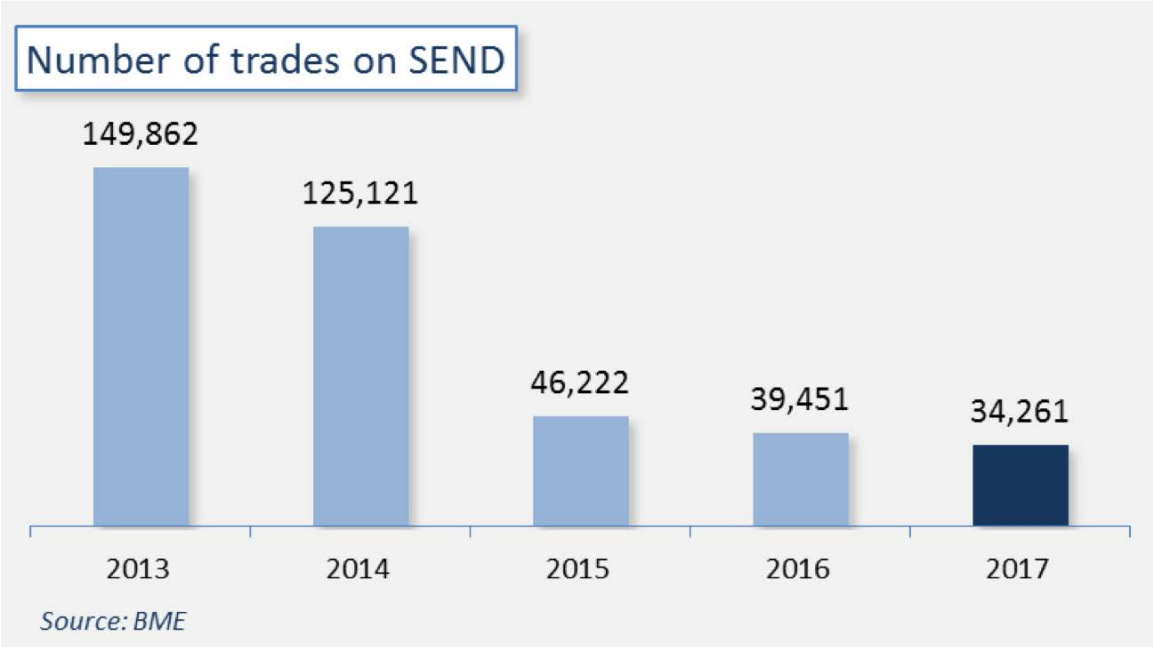
The average cash volume per trade dropped by 9.3% on the previous year, after four years of increases.

AIAF. Volume traded. SEND



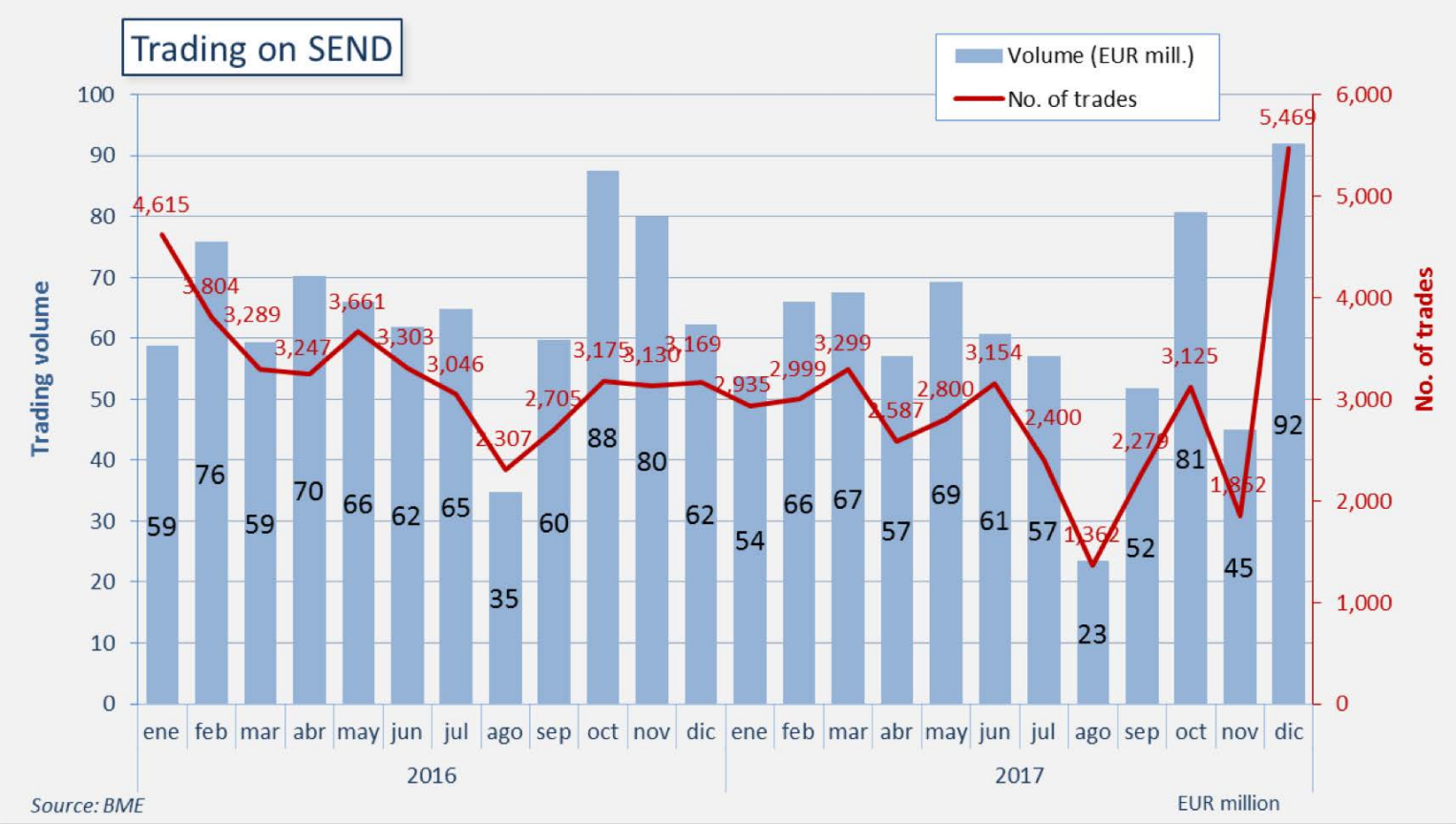
Trading on the platform for retailers was similar to that of the previous year, due to the absence of new issuances aimed at this group of investors. Prior to the end of the year, the market restructured this platform in order to allow for issuances for institutional investors.

AIAF. Trades made. SEND



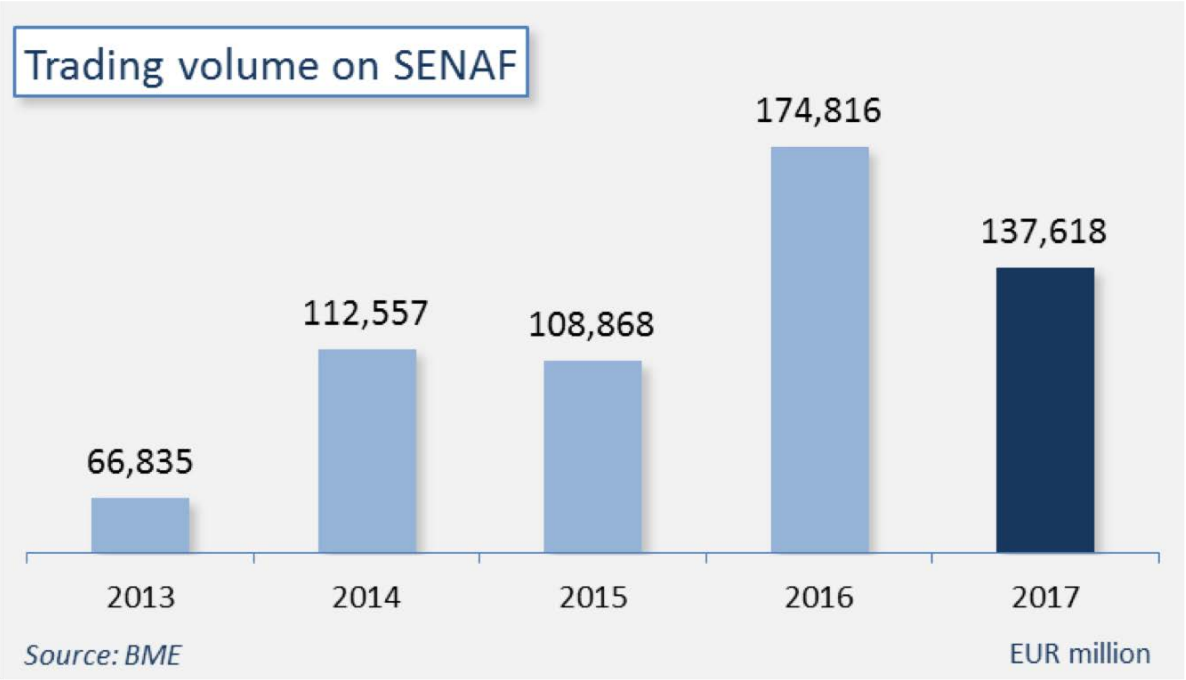
A total of 34,261 trades were carried out on the retail platform, which represents a decrease of 13.1%. The most traded securities included subordinated debentures.

AIAF. Trading on SEND



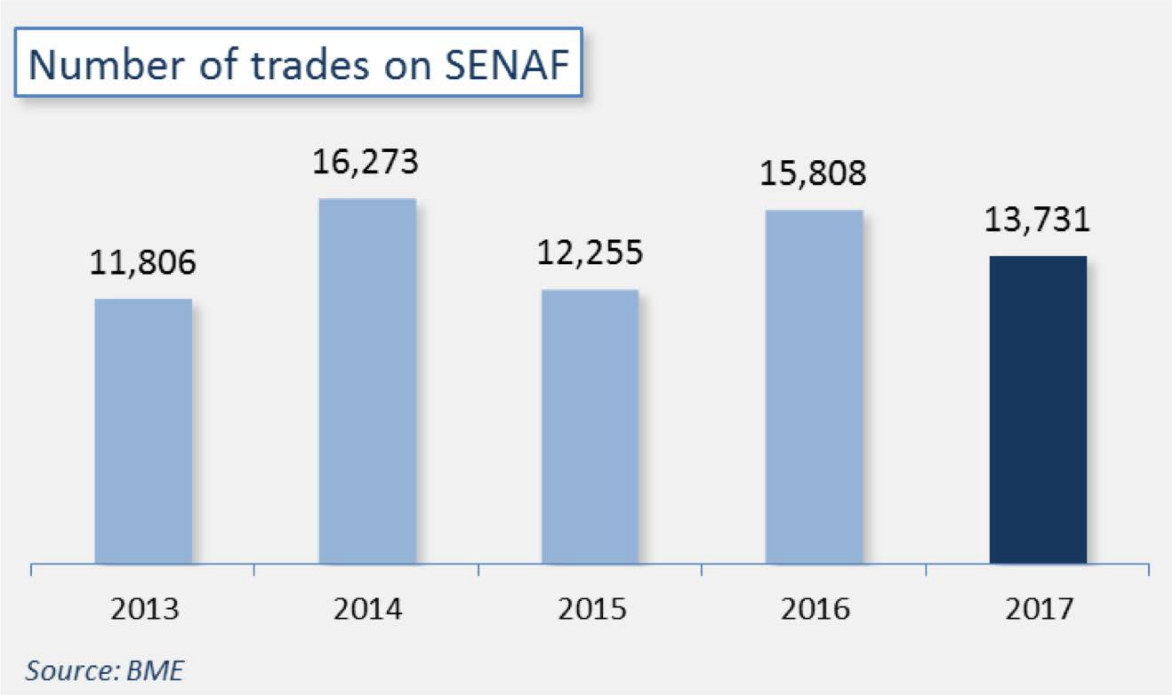
The number of cross-transactions on the platform depends to a large extent on the new issuances aimed at individual investors, as can be seen in December.

AIAF. Volume traded. SENAF



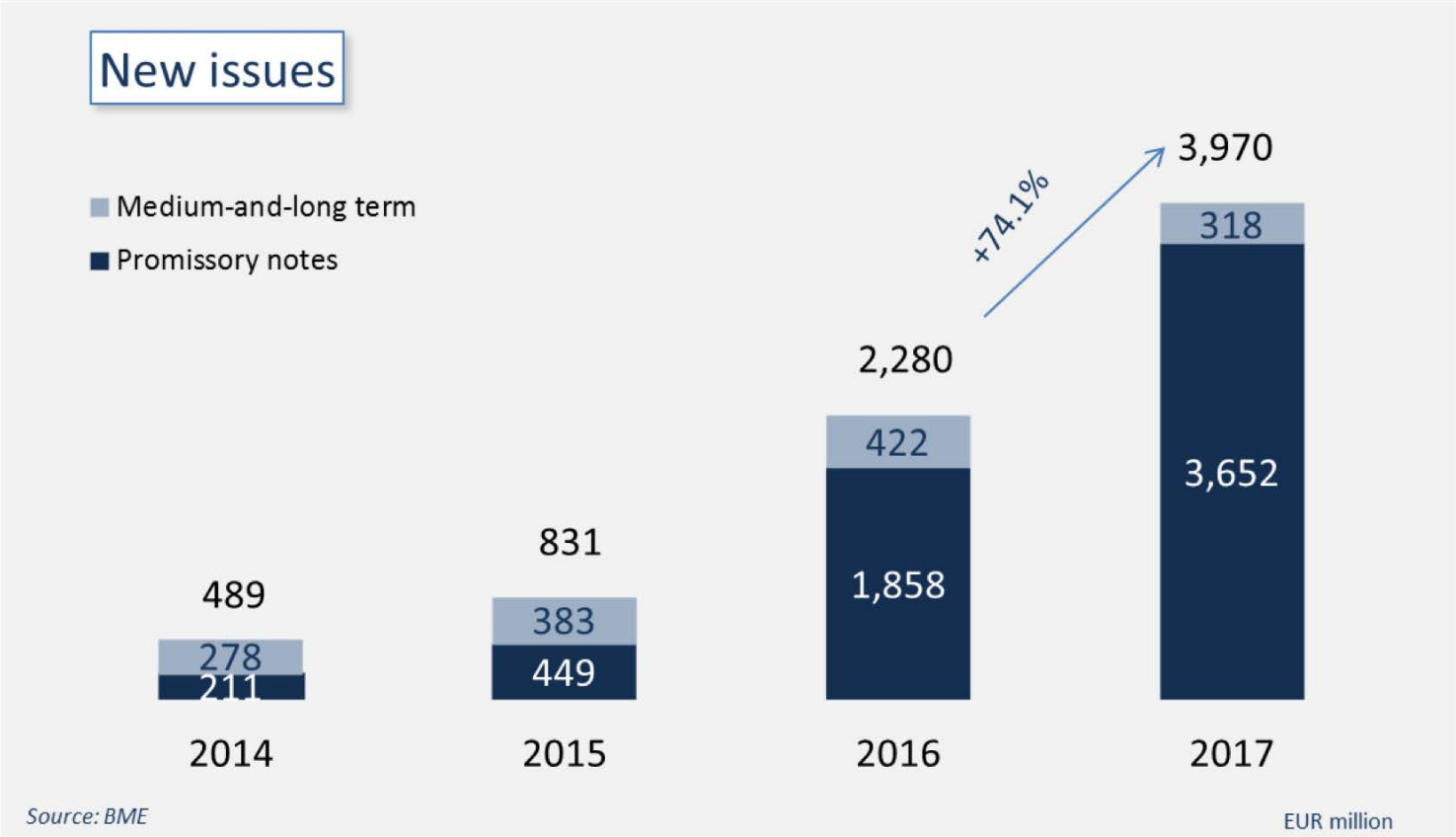
Trading on the platform for public debt market makers dropped by 21.3% to EUR 137,618 million, which is in line with other European operators. The negative returns affected the trading of bills, which dropped by 30%.

AIAF. Trades made. SENAF



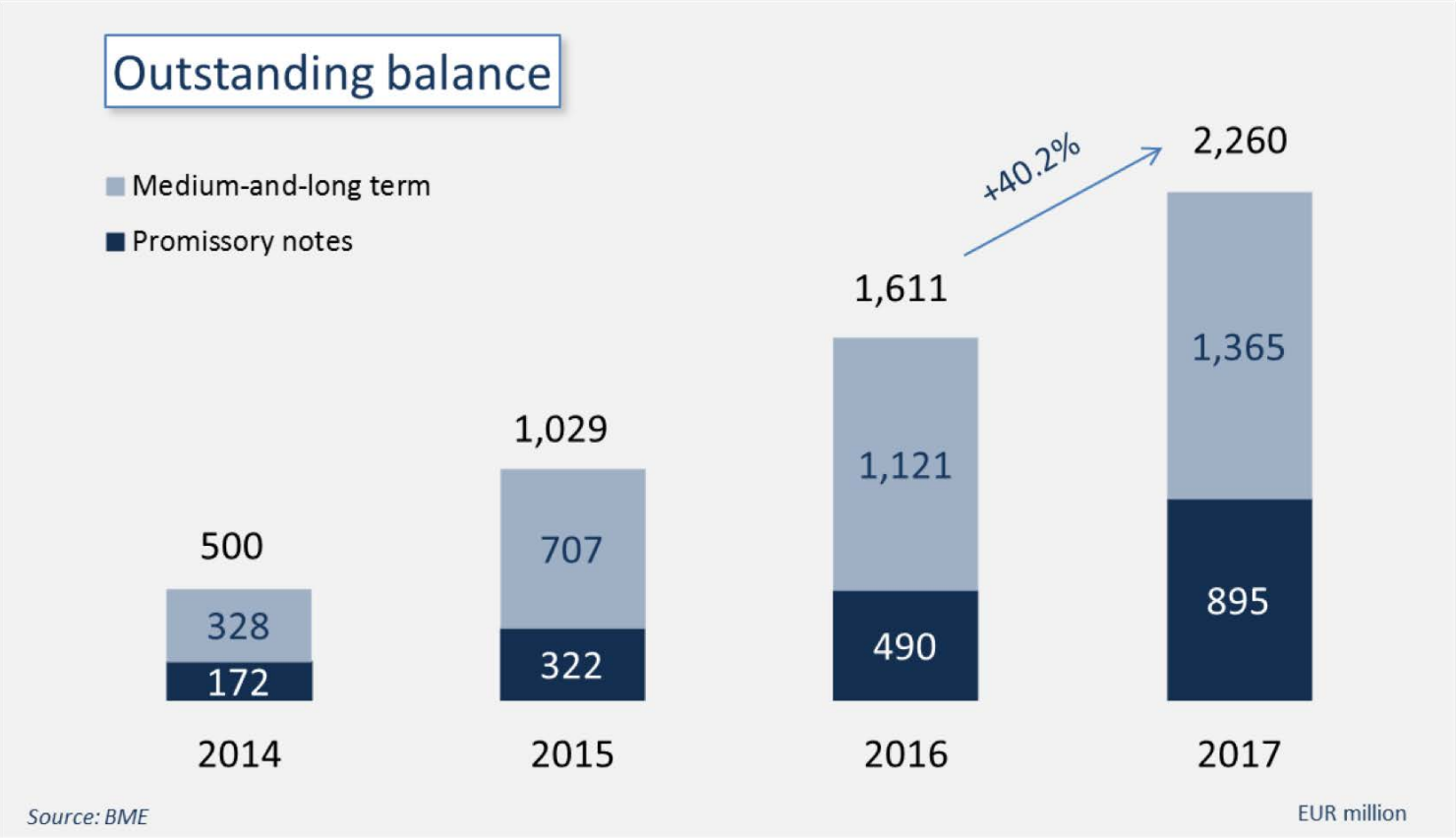
A total of 13,731 trades were carried out on the SENAF platform, which represents a decrease of 13.1%. The most traded securities included government debentures.

MARF. Volume issued



The volume of issuances added to the MARF amounted to EUR 3.97 billion, which represents an increase of 74.1%.

MARF. Outstanding balance



The outstanding balance, composed of all outstanding issuances added to the market, amounted to EUR 2.26 billion (+40.2%), of which 60.4% corresponded to medium- and long-term assets.

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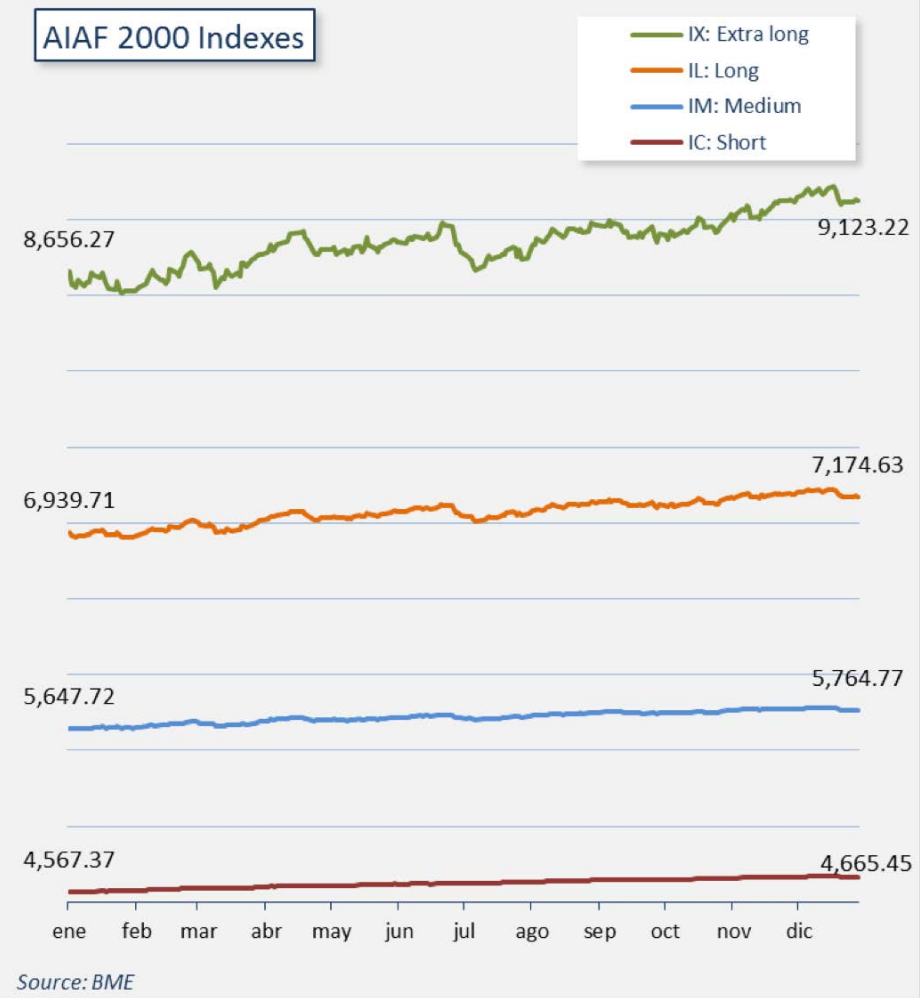
AIAF 2000 Indexes

	Performance of AIAF 2000 Indexes				Durations			
	Index	Maximun	Minimum	Latest	Average	Maximun	Minimum	Latest
IG	General	5,957.13	5,747.65	5,932.16	5.20	5.38	5.07	5.07
IC	Short	4,670.47	4,567.37	4,665.45	1.92	2.09	1.74	2.01
IM	Medium	5,781.31	5,640.63	5,764.77	3.80	3.87	3.72	3.72
IL	Long	7,217.97	6,906.89	7,174.63	6.73	6.86	6.54	6.61
IX	Extra long	9,223.38	8,509.04	9,123.22	12.32	13.09	11.12	12.63



Market Outlook

Economy

- **International**. Against the background of the good performance of the US macroeconomic indicators, the FED will continue to tighten its monetary policy. To this end it has scheduled four new interest rate hikes throughout the year and has announced the gradual contraction of its balance sheet. After a year with higher-than-expected growth (+ 6.9%), China will face a slight slowdown with a gradual rise in rates. Emerging countries could be harmed by the depreciation of their currencies against the dollar.
- **Eurozone**. Growth forecast for 2018 is 2.4%, one tenth higher than the previous year. The ECB will not extend its debt purchases beyond September, but has guaranteed that it will continue to reinvest the maturities of its portfolio, thus reducing the impact of the elimination of stimulus in the markets. No variations in interest rates are expected, at least until 2019. The strength of the euro against the dollar does not help achieve the inflation target (+ 2%).
- **Spain**. It will continue to grow above the European average within a range of 2.8-3%. Investment will grow, both in capital goods, as in construction, driven by the rise in real estate prices. The CPI stands at 1.1% in the first few months of the year.

Debt

- **Risk premium.** After achieving an improvement in the rating, at the beginning of February it fell below 70 basis points, a level not seen since 2010. Stability is expected around 80-90 bp.
- **Fixed Income.** The withdrawal of monetary stimulus in the last quarter will lead to a rise in returns in the secondary market, although this impact is expected to be moderate.
- **Public Debt.** The Treasury plans to reduce net issuance by 5 billion euros in 2018, after facing maturities of 180 billion. The reduction will be made in the volume of bills issued, which will increase the average life of the outstanding balance.
- **Private Debt.** Expected long and medium term maturities of assets in the AIAF market amount to nearly 95 billion euros, of which 17 billion correspond to mortgage-bonds and some 30 billion to a reduction in the securitisation outstanding balance.

Markets

- **AIAF.** As of September 2017, the **SEND** platform, which in principle hosted only issues for private investors, was extended to accommodate **all the instruments** admitted to the market.
- Additionally, since the entry into force of the MiFID II Directive in January, the regulated market has carried out various initiatives to **expand** the range of **listed assets**.
- The **regional debt** under the old CADE environment has been listed, which has brought about an increase in the outstanding balance of 33 billion euros.
- Also, the main **European government issues** have begun to be added to the platform, starting with Germany, Austria and the Netherlands, with a volume close to **1.1 trillion** euros.
- **MARF.** During the first two months of 2018, MARF listed **new issues** for a volume equivalent to **30%** of the total posted the previous year. Everything indicates that the expansion of this market will continue, both in terms of issues and outstanding balance, as well as new issuers.

Plaza de la Lealtad, 1 · 28014 Madrid