THE CNMV'S MARKET STRESS INDICATOR DROPS SIGNIFICANTLY

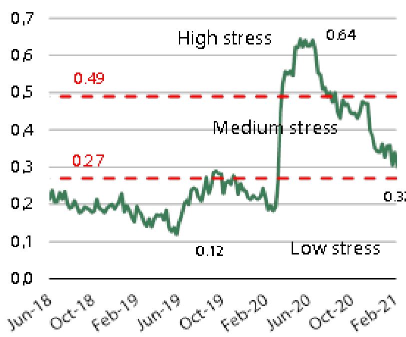
22 February 2021

- The CNMV's Financial Stability Note analyses the risks that affect Spanish markets on a quarterly basis

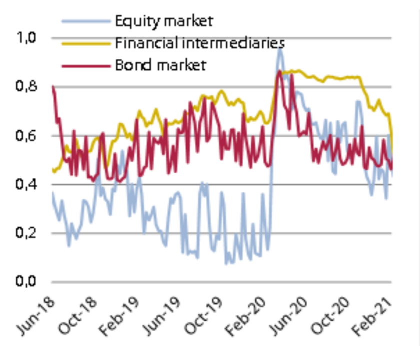
- Since the publication of the last note in November, the stress indicator for the Spanish financial markets has been close to the low stress threshold due to the positive performance of the six segments of the financial system considered

The Spanish National Securities Market Commission (CNMV) has published the January 2021 Financial Stability Note, which reflects a significant decrease in the level of stress in the financial system. This index has gone from levels close to 0.50 in the last issue of this note to just over 0.30, very near the threshold that separates medium stress level from low stress level. All segments have shown declines, although financial intermediaries (banks) continue to be the largest. The system correlation remains high.

Total bond and equity stress indicator



Indicators in the bonds, financial intermediaries and securities segment



The evolution of the macroeconomic situation in Spain continues to show the harshness of the Coronavirus crisis. The note considers this risk to be the highest of all the risks and sources of uncertainty analysed in this report. GDP contracted substantially in 2020 (11%),

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more sharply than in the euro zone (6.8%) and the unemployment rate rose to 16.1% of the labour force (13.8% in 2019). Moreover, the latest available data on the public sector suggest that the deficit may have exceeded 10% of GDP in 2020 while public debt is thought to have risen to over 116% of GDP. Indicators for the fourth quarter of last year pointed to some improvement in activity and employment, but they predate the development of the third wave of contagions. Therefore, the recovery forecasts, which place GDP growth this year in a range between 4.2% and 8.6%, continue to be shrouded in a high degree of uncertainty.

Trends in domestic financial markets since the publication of the last note point to something of a turnaround in the case of equities, where revaluations have predominated. The bullish period at the end of 2020 was somewhat more intense than in other European stock markets, and was associated with different favourable news, but it did not prevent the annual balance of the Ibex 35 from being one of the most negative in Europe. As indicated in other issues of this report, the Spanish index has a higher weighting of the sectors most affected by the crisis, which partly explains its weaker performance. However, recent sessions have seen share price increases in some companies and sectors that have mitigated the heavy losses accumulated since March 2020. The same patterns continue to be observed in the fixed-income markets: very low yields and risk premiums, consistent with current monetary policy, which encourage return-seeking investment strategies.

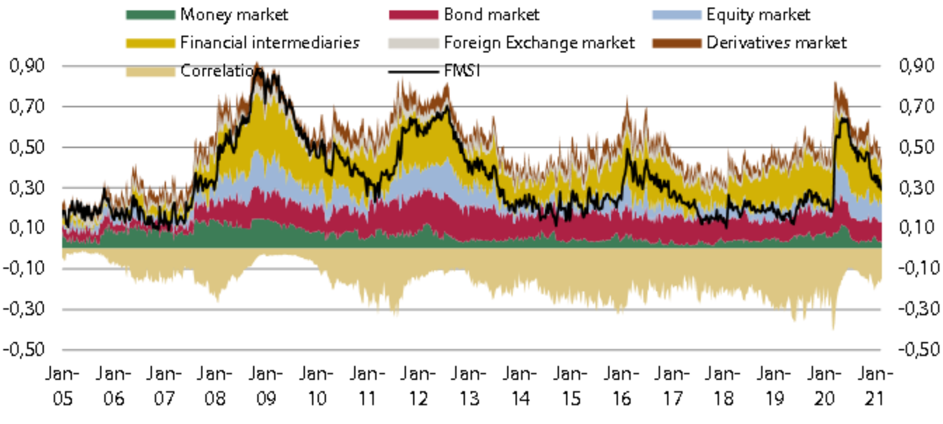
The most significant financial risks identified in this note relate to market risk in certain categories of fixed-income assets, which could undergo a rise in their risk premiums (and, therefore, a fall in their price) if a risk event materialises. This risk is relevant for the issuers of these assets and also for investors with exposure to them, who may also be affected by liquidity risk. In this context, one of the CNMV's most important tasks is the ongoing assessment of the exposure of investment funds to potentially less liquid assets of lower credit quality.

Finally, the usual indicators of credit risk do not point to a significant deterioration in this area, although caution should be exercised in this assessment, since these indicators do not take into account the performance of smaller companies which, in general, are being more affected by the crisis.

Lastly, the note alludes to various sources of risk that may end up having relevance in terms of financial stability in the current context. These include those related to the increase in non-face-to-face activities and all that this entails in relation to cybersecurity risk and increased activity by individual investors, with the implications of the current context of low interest rates and some of a political nature. It also refers to the evolution of cryptocurrencies to point out that their trends do not represent, for the time being, a relevant risk for financial stability, but that it could raise concerns related to investor protection due to aspects such as their high risk, their complexity, their illiquidity and lack of transparency or the absence of a regulatory framework.

The Financial Stability Note *presents a broad set of indicators, including most notably the Spanish financial market stress indicator and what are known as colour maps (also known as heat maps). The first one provides a real-time measurement of systemic risk in the Spanish financial system, ranging from 0 to 1, which is obtained by weighted aggregation of the stress levels estimated in the following six segments: securities, fixed income, financial intermediaries, currency markets, derivatives and the foreign exchange market. Heat maps allow us to visualise the changes witnessed in the various risk categories.*

The Spanish financial markets stress indicator



Complete document: [Financial Stability Note No.17 January 2021]

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