CNMV'S MARKET STRESS INDICATOR CONTINUES ITS DOWNWARD TREND AND ENDS THE YEAR AT A LOW-RISK LEVEL

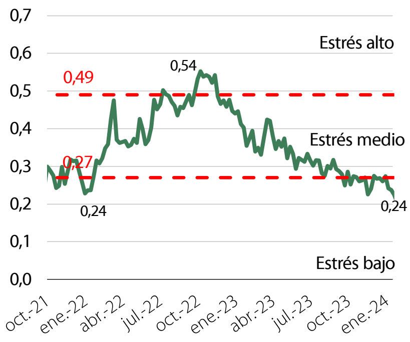
01 February 2024

- After this issue, the Note includes panels of indicators related to crypto-assets and sustainable finance.

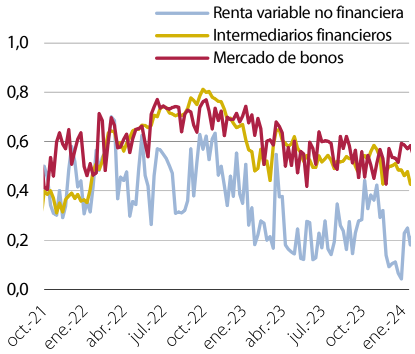
The Spanish National Securities Market Commission (CNMV) has published The Financial Stability Note for December 2023, describing the drop in the stress indicator of financial markets to 0.24 (low risk), prolonging the downward trend seen throughout most of last year. The highest level reached last year was 0.44. Since mid-September, the indicator has fluctuated between 0.24 and 0.27, while the highest levels of stress can continue to be found in the segments related to fixed income instruments (money markets and debt), mainly due to volatility spikes.

In the case of the financial intermediaries (banks) segment, the stress level has shown certain reluctance to downsizing, as the effect of the recovery in stock prices has been offset by the slight increase in volatility. The substantial decline in the stress of the non-financial equity segment can be highlighted, previously at 0.25 and then reaching 0.04 at the end of December. It is also worth noting the decline in the correlation of the system, common at times of lower stress.

Total stress indicator



Indicators in the segment of bonds, financial intermediaries and equity



There is a clear slowdown in the country's economic activity, despite the fact that the relative strength of private consumption allowed maintaining growth rates higher than those in the euro area. There still is, however, a high degree of uncertainty partly related to the consequences of the rise in interest rates at high levels, accumulated price increases and other possible second-round effects, as well as ongoing international geopolitical uncertainties.

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There were significant gains in the securities markets over the year as a whole, particularly in the first and last quarter. The annual appreciation of Ibex 35, at 22.8%, was relevant, just below that of the Italian index at a European level. Liquidity and volatility conditions were favourable, but the trading volume of securities suffered another decline. **What can be highlighted, regarding fixed-income markets, was the rise in yields on the various instruments up to October**, as well as their reversal towards the end of the year, and **the sharp flattening of the yield curve**. By the end of 2023, the yield on the 10-year sovereign bond stood at 3% (3.6% at the end of 2022) and the risk premium at 97 p.b. (109 in 2022).

Sources of uncertainty

Keeping interest rates at relatively high levels, although slightly lower than in 2023, means prolonging the financial effort of agents with greater debt, which, consequently, may affect credit risk. There is also a risk of a readjustment or reassessment of market expectations based on economic development.

The growing use of technological developments applied to finance has a multitude of aspects ranging from crypto-assets to cyber risks and, more recently, issues related to generative artificial intelligence. All these areas could be potential sources of instability to the financial system and, therefore, a growing interest to financial regulators and supervisors. Lastly, the presence of relevant geopolitical uncertainties can be a source of the market's negative spiral and loss of confidence.

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: equity, fixed income, financial intermediaries, currency markets, derivatives and the foreign exchange market. Heat maps allow us to visualise the changes undergone by the various risk categories.*

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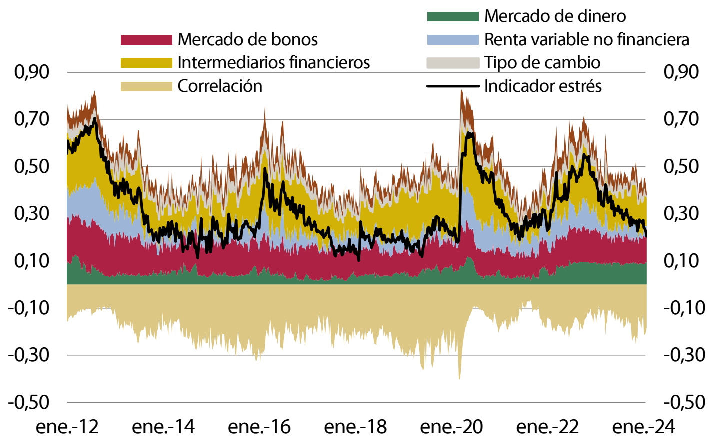
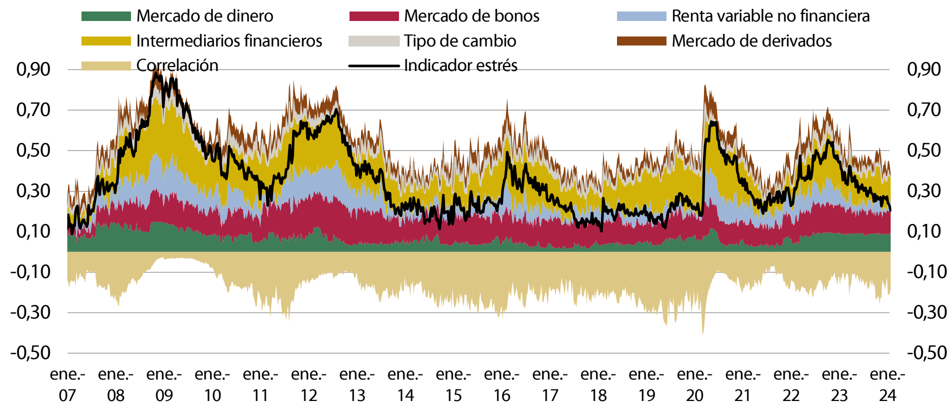
Spanish financial market stress indicator





Full document: [Financial Stability Note No. 25, December 2023]

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