TRV Risk Monitor

ESMA Report on Trends, Risks and Vulnerabilities, No. 2, 2023

ESMA Webinar, 7 September 2023

ESMA Economics, Financial Stability and Risk Department

ESMA50-524821-2818

Overview

1. Risk publications – overview of 2023-2024 schedule
2. TRV risk assessment: Overview
3. Risk assessment by market segments

Overview of 2023 schedule

	2023			
	1Q	2Q	3Q	4Q
TRV Risk Monitor Incl. Statistical Annex	×		×	
ESMA Market Report (EMR) Cost and Performance	×			
EMR Prospectuses				×
EMR Derivatives				×
EMR Securities Markets				×
EMR MMR	×			
EMR CRA	×			
TRV Risk Analysis articles	(×)	(×)	(×)	(×)
ESMA Working Papers	(×)	(×)	(×)	(×)

For a full list of publications, visit our ESMA Risk Analysis webpage.

Overall assessment: High risks, fragile markets

Risk categories

	Level	Outlook
Overall ESMA remit	○	→
Liquidity risks	○	→
Market risks	○	→
Credit risks	○	↗
Contagion risks	○	→
Operational risks	○	→
Environmental risks	○	↗

Risk areas

	Level	Outlook
– Securities	○	→
– Asset management	○	→
– Consumers	○	↗
– Infrastructures and services	○	→

Risk drivers

	Outlook
Geopolitical risks	→
Macroeconomic environment	→
Inflation and interest rate environment	→
Public and private indebtedness	↗
Infrastructure disruptions	→
Other event risks	↗

Status: Rebound amid high volatility and event-driven stress

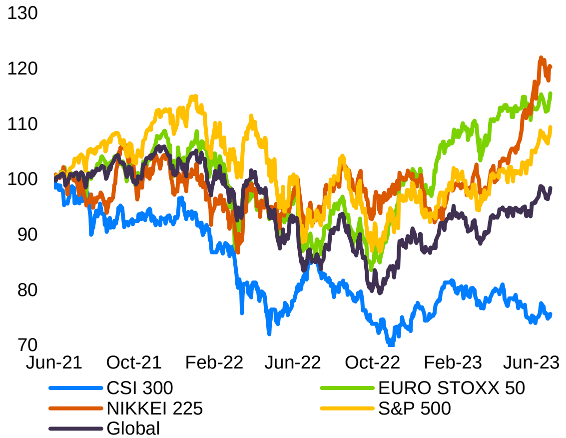
- Markets: Securities markets rebound in 1H23 despite high volatility in March; impact from bank stress non-lasting, but markets remain nervous
- Risks: Risk levels unchanged compared to last TRV (Feb 2023)

Outlook: Market nervousness linked to ongoing macrofinancial uncertainty

- Risk drivers: Transition to a new regime of higher rates and inflation; rise in already high public and private indebtedness; continuing macrofinancial and geopolitical risks
- Risk outlook: Ongoing uncertainty related to macrofinancial environment (higher growth forecasts vs. weak actual growth figures; receding inflation vs. long term inflation outlook); high risk of corrections (fragile market liquidity; sensitivity to news and event risks) in equity, bond and crypto markets; significant short-term risks for consumers (market volatility, losses from negative real interest rates); AI developments pointing to further significant industry change

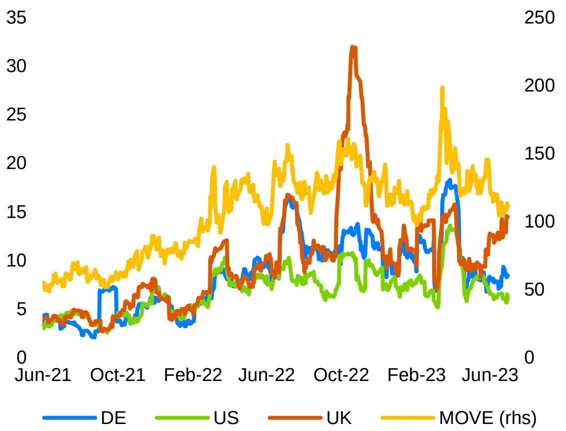
Securities markets: Rebound amid high volatility

Equity markets rebound



Note: Regional equity return indices. 01/06/2021=100.
Sources: Refinitiv Datastream, ESMA.

Volatility peaks in March



Note: Annualised 20D volatility of sovereign bond futures in % and MOVE index which measures US Treasury bond volatility derived from options.
Sources: Refinitiv Datastream, ESMA

Equity markets up, despite March stress episode

– Markets: Equity market up over the reporting period, despite volatility in March, with large daily swings in valuations driven by bank sector shares

– Bank turmoil impacts: Drops in equity prices in March before rebounding; European banking sector valuations overall increased by 16% in 1H23

Bonds: Decline in yields, surge in volatility

– Sovereign: Temporary decline in yields in March linked to banking turmoil, investors moving away from EQ

– Corporate: In contrast to sovereign, yields increased in March in IG and HY, spreads peaked

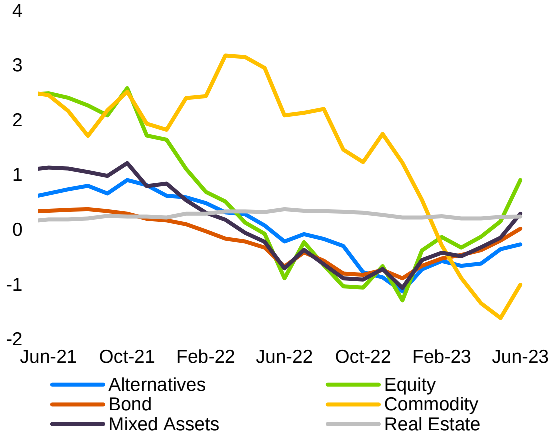
– CS deal impact on AT1 bonds: Peak-to-trough fall of 18% in March; continued lower valuation levels

Credit quality: early signs of a deterioration

– European corporate high-yield defaults: Up to 0.76% in 1H23 (0.5% in 2H22)

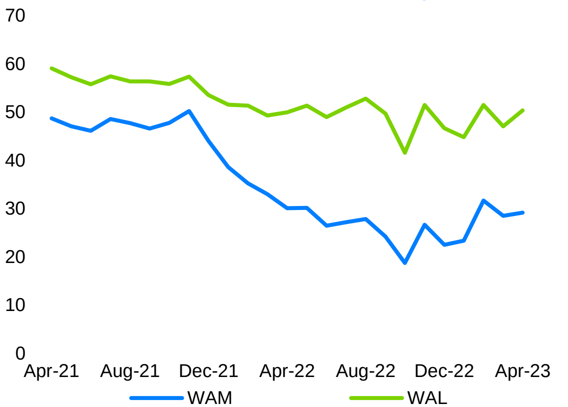
Asset management: Slow recovery

Performance improves



Note: EU27-domiciled investment funds' annual average monthly returns, asset weighted, in %.
Sources: Thomson Reuters Lipper, ESMA.

MMF WAL low but increasing



Note: Weighted average maturity (WAM) and weighted average life (WAL) of Europe-domiciled MMFs, in days. Aggregation carried out by weighting individual MMFs' WAM and WAL by AuM.
Sources: Fitch Ratings, ESMA.

Slow recovery in 1H23

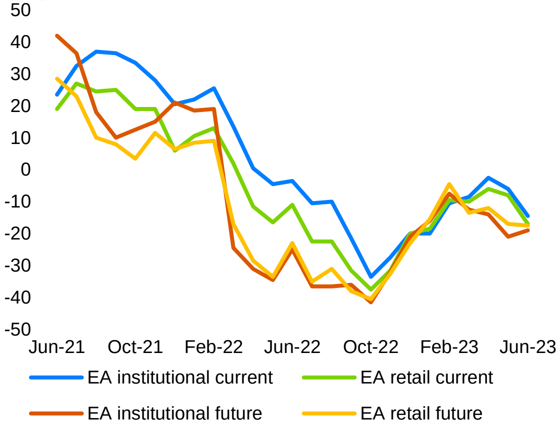
- Assets: AuM increase (+3%), but still EUR 1.4tn below end-21
- Performance: Higher (except commodities), now positive year-on-year
- Flows muted: Only bond funds clearly positive after significant outflows in 2022, likely linked to monetary policy expectations; EU USD MMF flow sensitivity during US regional bank stress

Adaptation to the macro environment

- MMFs: WAM at historic low in 2022; slight increase in 1H23
- Bond funds: Continued decrease of maturity transformation and portfolio duration
- Credit risk: Still elevated for HY funds
- Unrealised losses: Concerns in areas not subject to MtM valuation (esp. REIFs, PE)

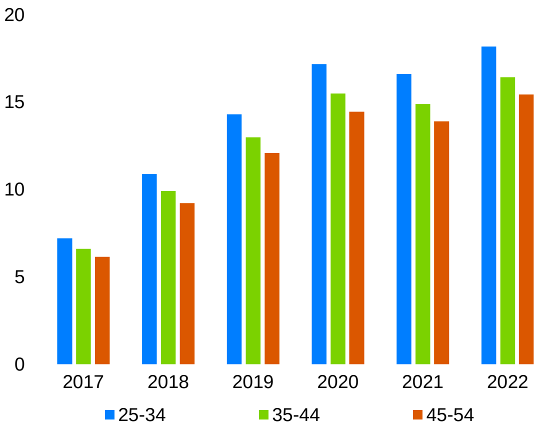
Consumers: Low sentiment, digitalisation continues

Improved current investor confidence



Note: Sentix Sentiment Indicators for the EA retail and institutional investors on a ten-year horizon. The zero benchmark is a risk-neutral position.
Sources: Refinitiv Datastream, ESMA.

Digitalisation continues



Note: Number of EU customers (or accounts) over total population by age group, %. Neo-brokers exclude cryptocurrencies and robo-advisors.
Sources: Statista, ESMA.

Investor confidence remains negative

- Confidence: Overall slightly negative, though up from lows in 3Q22
- Outlook: Uncertainty in economic outlook and inflationary developments, especially in the longer term

Bond holdings increase

- Financial assets: Debt securities holdings increase (+7%), alongside rising interest rates; equity and investment fund holdings decrease

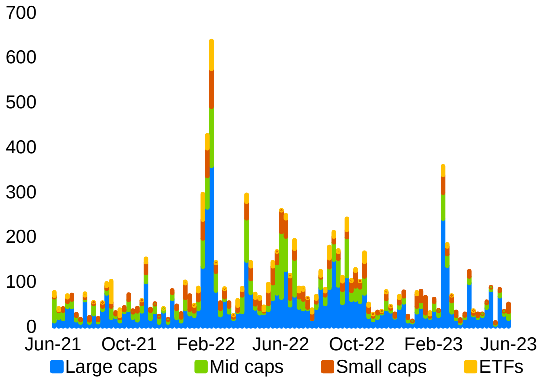
Rising use of digital financial services

- Digitalisation: Neo-brokers market penetration among younger generations rising, with 18% of 25 to 34 year olds using digital brokerage. Risk of exclusion of investors not digitally literate

ESMA European Securities and Markets Authority

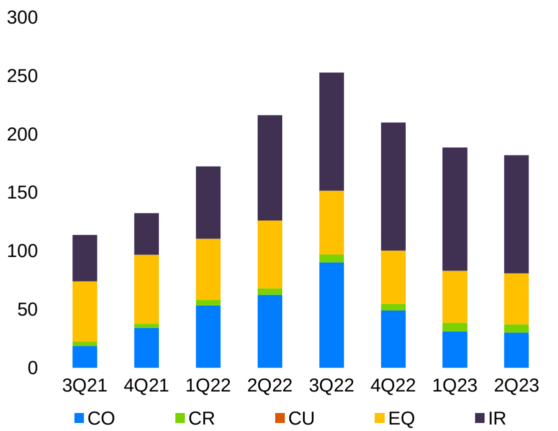
Infrastructures: Functioning well in stressed conditions

Circuit breakers surge in March



Note: Weekly number of circuit-breaker trigger events by type of financial instrument and by market cap registered on 29 EEA30 trading venues for all constituents of the STOXX Europe Large/Mid/Small 200 and a large sample of ETFs tracking these indices or some of their subindices.
Sources: Morningstar Real-Time Data, ESMA.

Commodity margins down significantly



Note: Outstanding amounts of intital margin required and excess collateral received by EU27 CCPs for derivatives . in EUR bn.
Sources: TRs, ESMA.

Uptick in circuit-breakers in March

– Trading venues: Surge in circuit breakers in March 23 (65% of trading halts in 1H23 on financials)

– Equity trading volumes: Turnover increased again in 1H23 (+12%), in line with market volatility

Commodity margins down to pre-war level

– CCP margins: Commodity margins decreased in 1H23, in line with drop in energy derivative prices

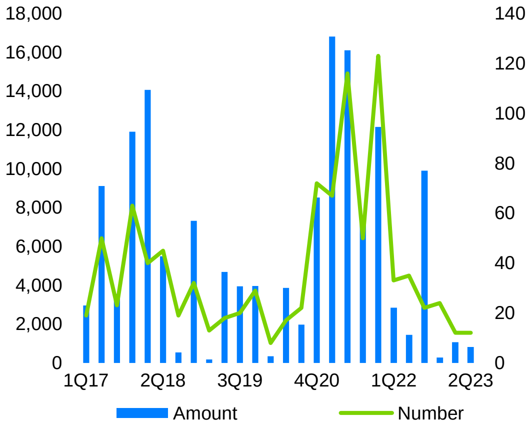
CRAs: over 14,000 new EEA ratings issued

– Rating activity: CRA issued over 50,000 new ratings, of which 14,000 EEA issuers.

– Market share: 58% of new EEA ratings from small CRA. Big Three still represent 92% of solicited ratings

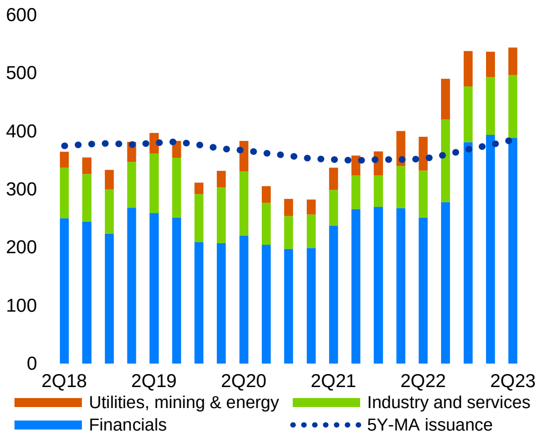
Market-based finance: Bond issuance rises

Sharp drop in IPOs



Note: Quarterly number and amount (n EUR bn) of IPOs deals issued by EEA firms.
Sources: Refinitiv Eikon, ESMA.

Record bond issuance in 1Q23



Note: Short-term corporate debt gross issuance in the EEA30 by sector, EUR bn. Short-term=Maturities < 12 months.
Sources: Refinitiv EIKON, ESMA.

Subdued equity issuance amid market uncertainty

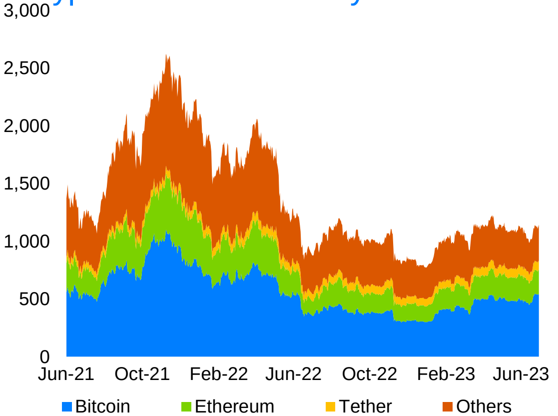
- IPOs: Subdued in 1H23, most deals waiting for more favourable secondary market conditions
- Outlook: Market uncertainty remains the main factor shaping equity primary markets

Renewed confidence in bond markets

- Levels: Corporate bond issuance increased by 50% in 1H23 esp. in 1Q23 (EUR 543bn; 45% above the 5Y moving average)
- Risks: 90% of IG issuance; uncertainty around riskier issuers following the banking turmoil
- Outlook: High level of outstanding corporate debt (EUR 10.4tn) implies significant refinancing risk in upcoming years

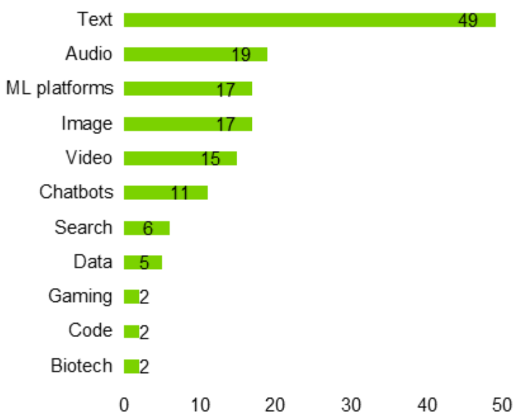
Innovation: Crypto rebounds and generative AI gains popularity

Crypto rebounds in early 2023



Note: Market capitalisation of Bitcoin, Ethereum, Tether and other crypto-assets, in EUR bn.
Sources: CoinMarketCap, ESMA.

Many generative AI startups established



Note: Number of European generative AI startups by field, January 2023. The figures are based on 60 startups domiciled in the EU and 63 startups domiciled in other European countries. "ML" = Machine Learning.
Sources: Sifted.eu, ESMA

Crypto-assets rally, with market value back to pre-FTX levels

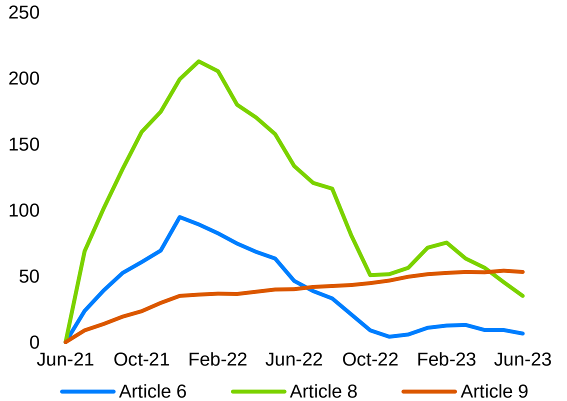
- Market cap: EUR 1.2tn, +40% since end-22 but still half below peak of Nov 21
- Investors: Rally largely driven by technical factors, including low liquidity and seller exhaustion, rather than renewed investor appetite
- Regulation: Tougher regulatory stance with series of enforcement actions by US regulators

Generative AI gaining increasing popularity

- Potential: Generative AI technologies, like ChatGPT, well positioned to enter a wide range of financial market operations, including information processing, compliance, reporting, and customer services
- Concentration trend: Large, general-purpose AI models developed by few providers while generative AI start-ups space is turning increasingly crowded

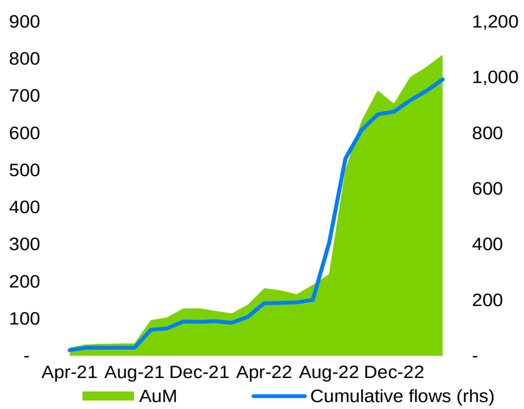
Sustainable finance: Investor attention to ESG products remains high

Fund flows by SFDR disclosure regime



Note: Cumulative monthly net flows of EU domiciled funds since March 2021 by SFDR disclosure regime, EUR bn.
Sources: Morningstar, Refinitiv Lipper, ESMA.

Biodiversity fund flows and AuM



Note: Assets under Management and cumulative fund flows (right axis) of EEA-domiciled funds that make reference to biodiversity in their name, EUR million.
Sources: Morningstar Direct, ESMA.

Flows into SFDR Art 9 funds particularly resilient

- SFDR Art 9 funds: No outflows from Art 9 funds (with a sustainable investment objective) since SFDR application in Mar 21 despite recent waves of reclassification from SFDR Art 9 to Art 8
- SFDR Art 8 funds: Investors pulled EUR 177bn out of Art 8 funds (with environmental or social characteristics) in 2022

Biodiversity as the next frontier in ESG investing

- Assets: Still small market niche, EUR 933mn AuM (around 0.1% of SFDR Art 8-9 AuM)
- Flows: Cumulative inflows surged, reaching EUR 116mn in 1Q23, 6x 1Q22 volumes; 73% of EEA biodiversity funds launched since 2022, confirming growing appetite

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