European Securities and Markets Authority

ESMA Risk Dashboard

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ESMA Risk Dashboard, No. 2, 2014

ESMA Economics and Financial Stability Unit

 The reporting period of this Report is 01 January 2014 to 31 March 2014, unless indicated otherwise. Legal reference of this Report: Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, Article 32 "Assessment of market developments", 1. "The Authority shall monitor and assess market developments in the area of its competence and, where necessary, inform the European Supervisory Authority (European Banking Authority), and the European Supervisory Authority (European Insurance and Occupational Pensions Authority), the ESRB and the European Parliament, the Council and the Commission about the relevant micro-prudential trends, potential risks and vulnerabilities. The Authority shall include in its assessments an economic analysis of the markets in which financial market participants operate, and an assessment of the impact of potential market developments on such financial market participants." The charts and analyses in this report are, fully or in parts, based on data not proprietary to ESMA, including data from commercial data providers and public authorities. ESMA uses these data in good faith and does not take responsibility for their accuracy or completeness. ESMA is committed to constantly improving its data sources and reserves the right to alter data sources at any time.

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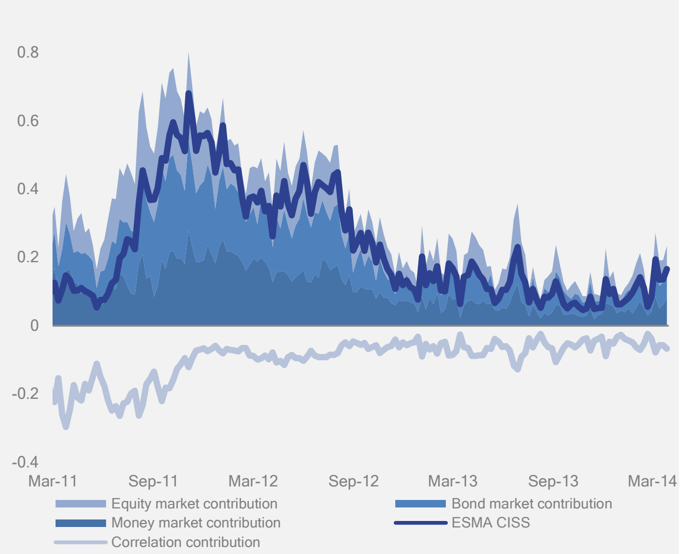
ESMA Risk Dashboard

Systemic stress: Systemic stress low but volatile R.1



Note: ESMA version of the ECB-CISS indicator measuring systemic stress in securities markets. It focuses on three financial market segments: equities, bonds and money markets, aggregated through standard portfolio theory. It is based on securities market indicators such as volatilities and risk spreads.

Sources: ECB, ESMA.

Main risks: Sources R.2

Economic environment	Change since 4Q13
Macroeconomic conditions	↘
Interest-rate environment	↗
Sovereign-bank nexus	→
Securities markets conditions	
Risks in EU sovereign debt markets	→
Market clustering	→
Funding risk	→
Valuation risk	↗
Market functioning	↗

Note: Assessment of main risk sources under ESMA's remit: change since the last assessment. Upward arrows indicate an increase in the contribution to risks, downward arrows indicate a decrease in the contribution to risks.

Main risks: Categories R.3

Risk category	Systemic risk	Change since 4Q13	Outlook for 2Q14
Liquidity risk	yellow	→	→
Market risk	yellow	↗	↗
Contagion risk	yellow	→	→
Credit risk	red	→	→

Note: Assessment of main risk categories for markets under ESMA's remit since last quarter and outlook for the following quarter. Systemic risk assessment based on categorisation of ESMA Systemic Risk Heat Map, green=low, yellow=moderate, orange=high, red=very high. Systemic Risk Heat Map measures current risk intensity. Upward arrows indicate a risk increase; downward arrows indicate a risk decrease.

Systemic stress indicators rose from a position of relative calm in EU financial markets, mirroring a re-emergence of heightened uncertainty at both global and EU levels. Uncertainty over future monetary policies continues to condition EU market developments. Political and macrofinancial tensions – growing economic and financial market risks in emerging markets (EM), especially the Crimean conflict – compound risks related to an uneven economic outlook, related policy responses, and their complex interactions. On the upside, several factors indicate that EU capital markets on the whole became more resilient, such as broadly improved macroeconomic prospects for several EU economies, well-performing EU sovereign debt markets and political agreement on the Single Resolution Mechanism.

Systemic stress: Both the development and distribution of risks were uneven across Member States (MS), while external risks increased. The CISS systemic stress indicator tended to increase in 1Q14, reaching mid-2013 levels. Back then, markets were adjusting to Fed tapering signals on a broader basis, including money and bond markets. Whereas, recent movements appear to have been mostly driven by geopolitical concerns, notably the Crimean conflict, that exacerbated general concerns about Emerging Markets (EM), with Turkey remaining a focal point since the turn of the year. Capital flows out of EM and into the EU and US remain the most visible hallmark of such dynamics, adding a growing potential for contagion across EM. These tensions revealed themselves in the heightened sensitivity of equity markets, but were also mirrored in FX markets. Concerns related to valuation risk persisted, as prices remained close to historic highs across various asset classes in several MS. Depending on the degree to which these highs are credit-fuelled, a deterioration in funding conditions could have significant implications. With the dynamics of the recovery being asymmetric across MS, risks related to legacy positions are also developing unevenly.

Economic environment

Macroeconomic conditions: Globally, activity picked up for several of the largest economies. While EU macroeconomic conditions continued to improve, however, the outlook of a tepid and fragile recovery remained. The EA returned to growth while both government and external current accounts continued to improve. Dynamics in vulnerable MS appeared to be increasingly positive. Nevertheless, significant risks persist. Within the EA, several economies continued to exhibit weak growth and labour markets. Thus, concerns remained over high unemployment and the lingering risk of disinflationary trends in the EA turning into deflation. This would exacerbate the burden associated with elevated levels of both public and private debt. On the other hand, recent political turmoil could lead to supply-side shocks, with exchange rates and commodity prices as potential channels. Different volatilities across currency and bond markets suggest that MS were affected asymmetrically by events in the Crimea and uncertainty in Turkey, with some newer MS more immediately exposed to these developments.

Interest rate environment: Interest rates remained near historic lows as leading central banks continued to provide monetary policy support. Cross-regional dynamics are highly complex, however, and the forward-looking nature of markets implies that yield curves can steepen ahead of policy moves.

Main risks: Summary assessment R.4

Risk category	Summary
Liquidity risk	Liquidity risk in 1Q14 remained broadly stable, with signals continuing to be mixed. Overall liquidity levels appeared ample. In assessing liquidity risk, however, one has to bear in mind the continued monetary policy support, which capital inflows into the EU would have augmented. Local sensitivities were also in evidence and the risk of reversal remained relevant. Liquidity in sovereign bond markets continued to improve. In equity markets, ESMA's illiquidity index shows that liquidity remained high by crisis standards, despite a brief deterioration earlier in the quarter. Bond market volatility indicated a heightened risk at the short end. Markets data did not indicate hedge fund liquidity concerns.
Market risk	Market risk rose in 1Q14 as the uncertainties of an uneven recovery and their implications for likely policy reactions intensified at both global and EU levels. Revaluation risks rose as risk premia compressed further across asset classes. Where funding costs are temporarily and unusually low, emerging imbalances may be masked by excess liquidity, especially for leveraged sectors. Balance sheets would be an important transmission channel, with factors including asset quality deterioration or lower profit outlooks. While EU-wide equity price-earnings (PE) ratios remained below the long-term average, in some markets valuations remained near historic highs. Lower-rated corporate bond spreads stabilised around pre-crisis levels and HY issuance remained solid. Though the EU continued to benefit from safe haven flows, this could also delay any potentially required revaluations.
Contagion risk	EU contagion risk remained broadly stable, though its nature appeared to shift somewhat. Vulnerable EA sovereigns' situations broadly improved along with one successful programme exit. Indeed, their yields converged and continued to approach those of core countries. Still, contagion risk remained elevated. While both core and vulnerable EA sovereigns benefitted from EM capital flow reversals, this was not the experience shared by some of the newer MS. As developments in FX markets suggest, tensions have risen in line with developments beyond the EU, notably at its Eastern frontiers.
Credit risk	Credit risk remained high in 1Q14, with the build-up of risks in new areas offsetting the continued improvement in others. EU debt issuance was mixed. The strength of sovereign and covered bond (CB) activity contrasted with the regressive activity in securitised markets. Sovereign and corporate maturity profiles continued to lengthen, which suggests that treasurers took advantage of the relatively low long-term interest rates, improved economic outlook or regained confidence. Vulnerabilities may stem from a deterioration in the outlook, legacy assets, or the accumulation of new imbalances due to access to low cost finance that could be shorter-lived than expected.

Note: Qualitative summary of assessment of main risk categories in markets under ESMA's remit.

Market functioning: Risk summary R.5

Risk	Summary
Bench-marks	A joint EBA-ESMA report finds that the Euribor-EBF has made significant progress in addressing weaknesses and shortcomings in its governance and technical framework. This notwithstanding the fact that the quality and continuity of key financial benchmarks in the EU remains a key concern. After almost half a year of stability, three banks left the Euribor panel in 1Q14. This brings the number of panel banks to 28 compared to 43 in November 2012. Beyond inter-bank offered rates, investigations of Swiss, UK and US authorities into forex manipulations have been initiated.
Market infra-structures	As in previous quarters, the operational stability of market trading venues and systems was tested on several occasions.
Shadow banking	The shadow banking system remained roughly stable in the second half of 2013 at around EUR 8.3tn (20% of EU banks liabilities). On the other hand, anecdotal evidence indicates a growing market interest in non-bank lending. Indeed, some investment funds that directly originate loans or participate in loans by buying loans originated by banks have gained traction. If the sector would become larger in the next few years, it could potentially raise financial stability risk as it facilitates credit growth outside of the banking sector and could also raise regulatory arbitrage opportunities. Therefore, despite the small size of the industry at the current juncture, this trend calls for regular monitoring.

Note: Qualitative summary of assessment of main risks to the functioning of markets under ESMA's remit.

Capital flows reversals out of EM and into the EU would have augmented monetary policy support. Yields continued to compress across sectors and risk categories.

Sovereign-bank nexus: With macroeconomic conditions more stable, both governments' and banks' positions continued to improve, thus tempering the risk of a vicious cycle. Spreads on the yields of vulnerable sovereigns continued to decline. Uncertainty about legacy assets remains an important factor, however, as reported differences over bank recapitalisation requirements in one crisis country indicated. Near-term, this uncertainty will likely remain given the looming ECB-coordinated asset quality review as well as the repayment of LTRO funds. The European Parliament and the Council reached a provisional agreement on the proposed Single Resolution Mechanism, which complements the Single Supervisory Mechanism, thus completing the Banking Union. This provides a strong architecture backed by EU-level funding arrangements and its implementation will address the core of the sovereign-bank nexus.

Conditions in securities markets

Risks in EU sovereign debt markets: EU sovereigns' 10Y bond yields broadly declined, with spreads of vulnerable sovereigns remaining at multi-year lows. Programme countries fared particularly well and even may have benefitted from safe haven flows. Maturities continued to lengthen. Important factors are the better macroeconomic outlook for programme countries, in particular, with both government deficits and external current accounts improved. Positive sentiment was reflected in the exit of one country from its programme and positive news flow from another. Given high levels of indebtedness and the tepid and fragile recovery, vulnerabilities remain significant, however.

Market clustering: Correlation among EU sovereign yields increased broadly, especially in the EA, while weakening vis-à-vis some newer MS. Though vulnerable sovereigns clustered more closely together, the coherence between this group and core economies increased. Greater correlation between corporate and sovereign yields shows that this greater coherence transmitted more widely.

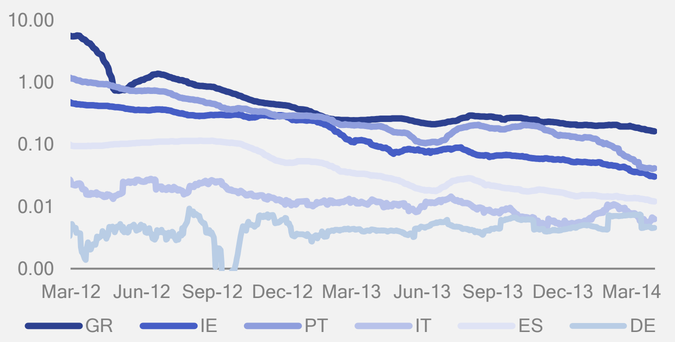
Funding risk: Evidence on funding risk was mixed as also reflected in uneven EU debt issuance activity across instrument classes. Sovereigns and banks issued debt at longer maturities, taking advantage of the relatively low long-term interest rates and improved market sentiment. Banks continued to deleverage and, after seasonally high repayments in 1Q14, their repayment profile is somewhat shallower over the remainder of the scheduled LTRO repayment horizon through 1Q15.

Valuation risk: The low interest rate environment continued to steer market behaviour, with spreads converging across sectors and risk classes. Indeed, capital flow reversals out of EM may be contributing to a broad fall in yields. These developments imply an increased probability of a continuation of a possible build-up of imbalances. The risk of a correction remains significant, however. For instance, asset prices are at highs across markets that would typically move in opposing directions, such as equity and bond markets. Search-for-yield behaviour based on overly optimistic assumptions continues to be a concern and can lead to significant misallocation of capital.

Market functioning: Key structural issues that may become relevant to EU financial markets' stability relate to benchmarks, market infrastructures and shadow banking. For a summary risk assessment see textbox R.5.

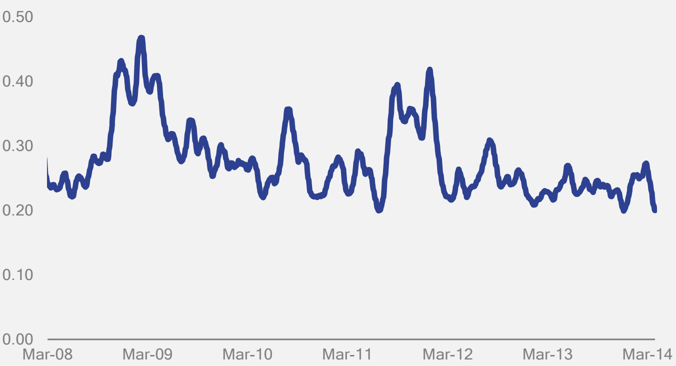
Liquidity risk

Sovereign bid-ask spreads: Contrasting trends R.6



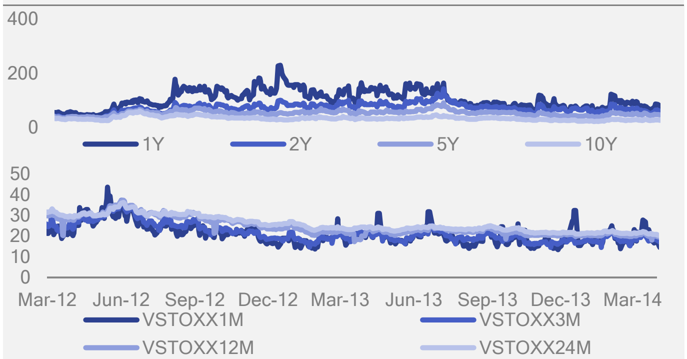
Note: 10Y EA sovereign bond bid-ask spread in percentage points; logarithmic scale, 30D moving average.
Sources: Thomson Reuters Eikon, ESMA.

Equity Illiquidity Index: Mild temporary deterioration R.7



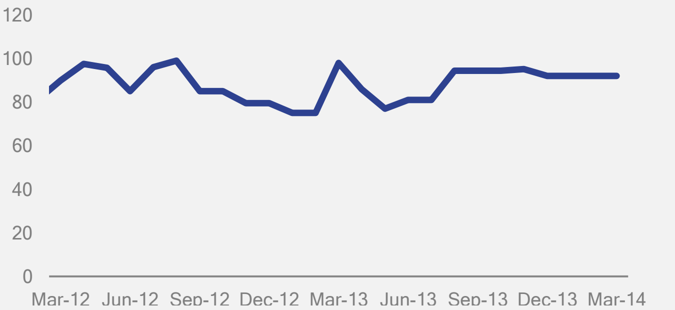
Note: Composite indicator of liquidity in the equity market for the Eurostoxx50 constituents, computed by applying the principal component methodology to six input liquidity measures (Amihud illiquidity coefficient; bid-ask spread, Hui-Heubel ratio, turnover value, inverse turnover ratio, MEC. The indicator range is between 0 (higher liquidity) and 1 (lower liquidity).
Sources: Datastream, ESMA.

Volatilities: Focus on the short-term R.8



Note: Stoxx 50-based implied volatilities measured as indices; per cent. 3M forward Euro-Euribor swaptions implied volatilities on top.
Sources: Thomson Reuters Datastream, ESMA.

Hedge fund shares: Low liquidity premia R.9



Note: Asset-weighted average trade of hedge fund shares in per cent of net asset value. It is a monthly price index for hedge fund shares as traded on secondary markets. The closer the value to 100% the closer the average share in hedge funds is being traded to book value.
Sources: Hedgebay, ESMA.

Liquidity risk in 1Q14 remained broadly stable, with signals continuing to be mixed. Overall liquidity levels appeared ample. In assessing liquidity risk, however, one has to bear in mind the continued monetary policy support, which capital inflows into the EU would have augmented. Local sensitivities were also in evidence and the risk of reversal remained relevant. Liquidity in sovereign bond markets continued to improve. In equity markets, ESMA's illiquidity index shows that liquidity remained high by crisis standards, despite a brief deterioration earlier in the quarter. Bond market volatility indicated a heightened risk at the short end. Markets data did not indicate hedge fund liquidity concerns.

Sovereign bond bid-ask spreads: Bid-ask spreads continued to converge. While those of the three largest EA sovereigns' 10Y bonds reverted back to end-2013 levels after having ticked up, they continued to edge downward for most of the vulnerable countries. The reversion of the spreads of the largest sovereigns' to lower levels may be due to safe haven flows. Similarly, concerns about EM growth and the impact of political turmoil at the Eastern frontier of the EU would have reinforced the improved sentiment vis-à-vis vulnerable MS on account of their continued stabilisation. Various factors may have counteracted safe haven effects, including concerns about political uncertainty, continuity of growth-enhancing structural reforms and legacy assets.

Equity Illiquidity Index: ESMA's broad-based illiquidity index derived from Eurostoxx 50 data indicates that liquidity conditions remained favourable in 1Q14 by comparison with its 7-Y average, albeit having ticked up briefly mid-quarter. While this short-lived mild deterioration was in line with the equity markets' contribution to the CISS, it perhaps also reflected some uncertainty after markets reached recent highs. Previously, such peaks corresponded to the period of EA bailout uncertainty around late-1H13, as well as during late-August 2013 when trading glitches in the US and China caused temporary uncertainty in global securities markets.

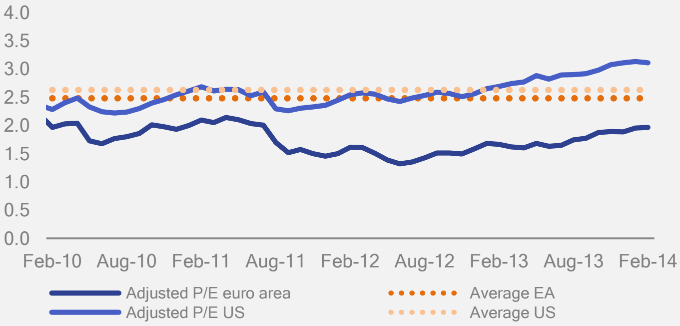
Bond volatility: Implied bond volatility gradually returned to end-2013 levels, fanning out suddenly across the maturity spectrum at the beginning of 1Q14, while remaining moderately above the average since 2010. Volatility remains considerably less settled at the short end of the curve compared to the more inert 10Y end. At the one-year end it ticked up sharply end-January, thus returning to levels witnessed in June 2013 but below highs witnessed after the mid-May emergence of *taper-talk*; developments in 2Y and 5Y spectra shadowed this movement. Overall, this fanning out across the spectrum continues a trend started end-October and signifies some heightened risk without pointing to any acute developments. Both valuation risks and EM concerns are likely feeding this re-emergence of volatility.

Equity volatility: Implied equity volatility remained around its 4Y average, remaining broadly stable at the longer end of the spectrum while implied volatilities at the shorter end tended to oscillate just below, breaching the longer-term volatility significantly mid-March. Overall, this indicates adequate equity market liquidity with lingering reversal risk.

Hedge fund shares' liquidity premia: The asset-weighted average discount of hedge funds' book value to valuation in the secondary market remained stable, as they traded at 92% of NAV. Overall, a low discount points to somewhat lower liquidity concerns vis-à-vis Hedge Funds.

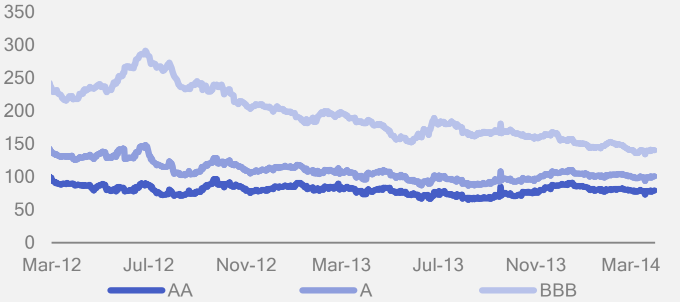
Market risk

Adjusted equity PE ratios: Increases paused R.10



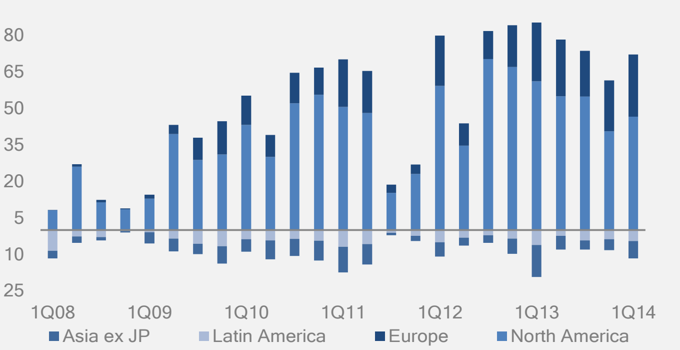
Note: Monthly earnings adjusted for trends and cyclical factors via Kalman filter methodology based on OECD leading indicators; units of standard deviation; averages computed over 2M73-2M14.
Sources: Thomson Reuters Datastream, ESMA.

Corporate bond spreads: Lower-rated drove yield compression R.11



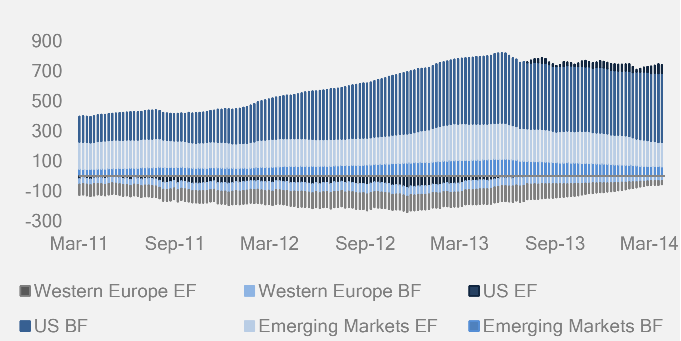
Note: Non-financial corporate bond spreads by rating grades between iBoxx non-financial corporate yields and ICAP euro euribor swap rates for different maturities; EA, basis points. AAA-Rated bond series momentarily suspended due to data discontinuity for AAA-rated bonds,related to a change in the basket of AAA eligible assets.
Sources: Thomson Reuters Datastream, ESMA.

HY issuance: Increased issuance from low level R.12



Note: Quarterly data on high-yield corporate bond issuance by region of issuer; EUR bn.
Sources: Dealogic, ESMA.

Cumulative investment fund flows: US and EM bond outflows R.13



Note: Net flows into bond and equity funds cumulated over time since 2004 (BF and EF, respectively) by regional investment focus; USD bn.
Sources: EPFR, ESMA.

Market risk rose in 1Q14 as the uncertainties of an uneven recovery and their implications for likely policy reactions intensified at both global and EU levels. Revaluation risks rose as risk premia compressed further across asset classes. Where funding costs are temporarily and unusually low, emerging imbalances may be masked by excess liquidity, especially for leveraged sectors. Balance sheets would be an important transmission channel, with factors including asset quality deterioration or lower profit outlooks. While EU-wide equity price-earnings (PE) ratios remained below the long-term average, in some markets valuations remained near historic highs. Lower-rated corporate bond spreads stabilised around pre-crisis levels and HY issuance remained solid. Though the EU continued to benefit from safe haven flows, this could also delay any potentially required revaluations.

Adjusted equity PE ratios: Both EA and US equity PE ratios stabilised over the last quarter. While US equity valuations remained at record highs, having soared ahead of the real economy's recovery, in EU stock markets they edged up to plateau somewhat below the long-term average. As valuation risks remain an important consideration at the local market level, price corrections sustained during the post-crisis period would be mitigating factors. This should be the case for more vulnerable countries, in particular, where asset price corrections had been significant.

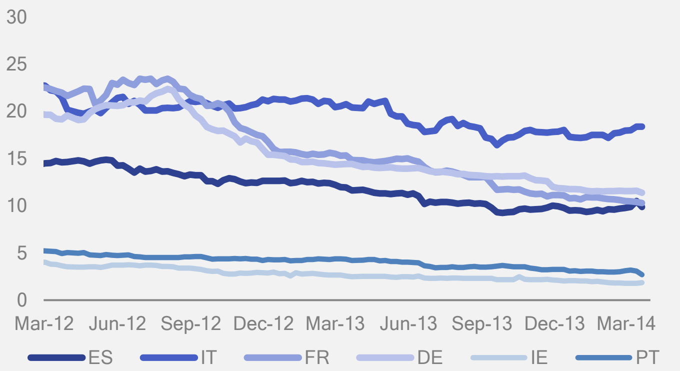
Corporate bond spreads: In 1Q14, non-financial corporate bond spreads in the EA continued to converge. Even when the downward trend characterising spreads for BBB-rated corporates 4Q13 paused end-1Q14, the yield on higher rated bonds edged up. Partly explaining this is the fact that the durations of baskets underlying the higher-rated indices edged up since the summer of 2013, thus presumably also commanding a higher yield. This was not the case for BBB-rated basket.

High-yield corporate bond issuance: In 1Q14, HY corporate bond issuance increased somewhat. On a year-on-year basis, however, the level of issuance is subdued especially for regions outside Europe. This may be due to increased concerns relative to the global economic outlook as well as change in the policy environment.

Investment fund flows: A reversal of funds flows from EM to developed economies characterised 1Q14. While EM economies registered bond fund outflows of 13bn as well as equity fund outflows of USD 36.6bn, both EU and US bond funds continued to witness net inflows of USD 14bn and USD 32.2bn, respectively. Further, both EU and US experienced equity inflows. What should be noted, however, is the large increase in equity inflows into the EU: USD 29bn in 1Q14 compared to USD 1.7bn in 1Q13. This contrasts with the US, which merely recorded inflows of USD 11.4bn for 1Q14 after having absorbed USD 35.2bn at the same stage last year. Positive news on economic prospects in a number of EU countries as well as higher uncertainties surrounding EM economic and financial environment may have made EU funds more attractive. This would also be consistent with the relative PE-ratios in R.10.

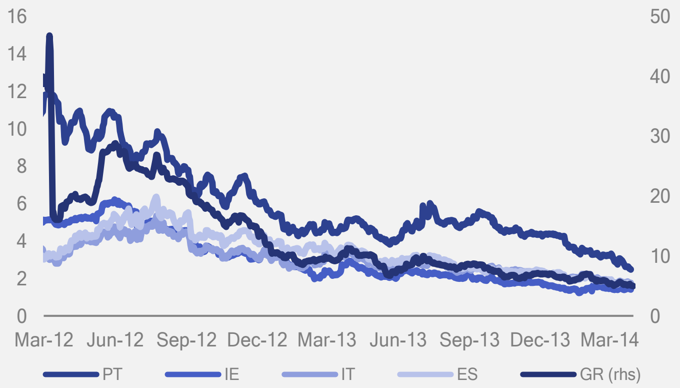
Contagion risk

Outstanding EU sovereign CDS: Focus on larger vulnerable MS R.14



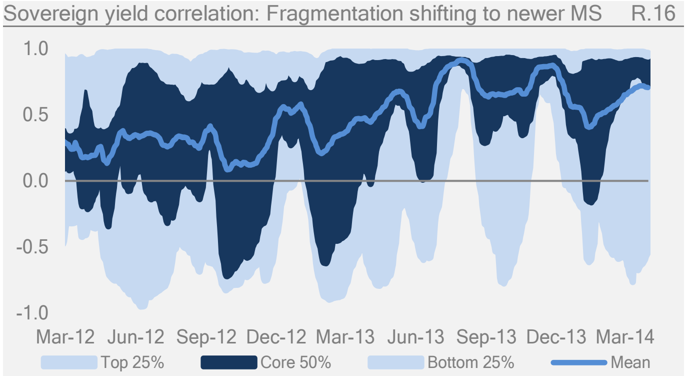
Note: Outstanding net notional amounts for selected countries; USD bn.
Sources: Thomson Reuters Eikon, ESMA.

Sovereign spreads: Vulnerable converged to new lows R.15



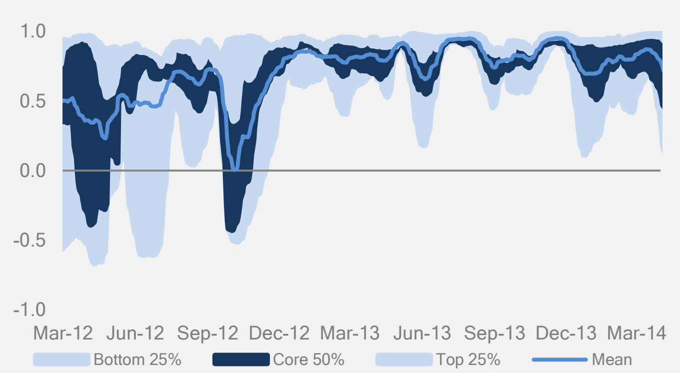
Note: Selected 10Y EA sovereign bond risk premia (vs. DE Bunds); percentage points.
Sources: Thomson Reuters Datastream, ESMA.

Sovereign yield correlation: Fragmentation shifting to newer MS R.16



Note: Dispersion of the correlations over 60D rolling windows of 10Y DE Bunds and other EU countries' sovereign bond redemption yields.
Sources: Thomson Reuters Datastream, ESMA.

Sovereign-corporate yield correlation: Dispersion narrowed R.17



Note: Dispersion of the correlation between Barclays Aggregate for corporate and 10Y sovereign bond redemption yields for BE, FI, FR, IT, NL.
Source: Thomson Reuters Datastream, ESMA.

EU contagion risk remained broadly stable, though its nature appeared to shift somewhat. Vulnerable EA sovereigns' situations broadly improved along with one successful programme exit. Indeed, their yields converged and continued to approach those of core countries. Still, contagion risk remained elevated. While both core and vulnerable EA sovereigns benefitted from EM capital flow reversals, this was not the experience shared by some of the newer MS. As developments in FX markets suggest, tensions have risen in line with developments beyond the EU, notably at its Eastern frontiers.

Outstanding EU sovereign CDS: Net volumes declined marginally across most MS in 1Q14, including those against smaller vulnerable sovereigns. By way of contrast, they recommenced to increase against two larger vulnerable sovereigns. Of the smaller, more vulnerable MS, one has exited successfully its programme and returned to market funding. This success appeared to have coincided with an improvement in sovereign funding conditions, notably for another sovereign with a programme coming to conclusion. Overall, this suggests that, compounding local improvements and reinforcing regional efforts, positive spillovers can result from programme-based adjustments, possibly representing a form of positive contagion.

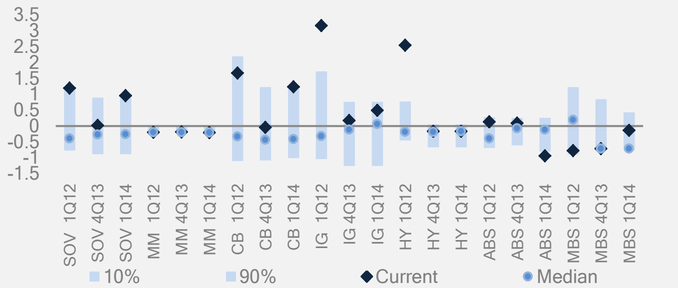
Sovereign spreads: Spreads of vulnerable EU sovereigns' 10Y bonds relative to Bunds fell in a broad movement, in line with wider developments across the EA. Within this movement, there was a degree of convergence as the trend decline of some smaller sovereigns appeared to be converging on a floor. This development would indicate that, against a background of continued international support, the perception is growing stronger that the reform efforts of crisis countries are beginning to bear fruit. With EM capital outflows continuing, EU countries likely benefitted from contagion among EM countries and political turmoil to the East of the EU. It remains to be seen how any concrete developments would affect the EU more widely, however.

Sovereign yield correlation: The cohesion of movement of European sovereigns' 10Y bond yields relative to Bunds reverted back to 4Q13 levels, having fragmented briefly to June 2013 levels. As in June, this represented a wider development rather than that of a few outliers. By comparison with June, however, the composition of the outliers shifted from acute crisis countries to a few of the newer MS. On the other hand, crisis countries clustered more closely around core movements. Overall, this indicates that financial market sentiment toward the EU has improved, notably on account of economic rebalancing achieved in MS that were buffeted by the crisis and even hinting at some positive contagion from successful programme completion. With global uncertainty rising, notably to the East, however, the lower correlation of newer MS sovereigns indicates that markets may perceive them as more vulnerable to recent events, as also evidence by recent foreign exchange movements.

Sovereign-corporate yield correlation: Correlation between corporate bond yields and those of the sovereign of localisation initially dropped to mid-2013 levels, thereafter recovering to approach end-2013 levels before. Late on in 1Q14 the recovery tapered off. Against the background of broadly declining sovereign yields, this is consistent with risk differentiation among sovereigns and corporates.

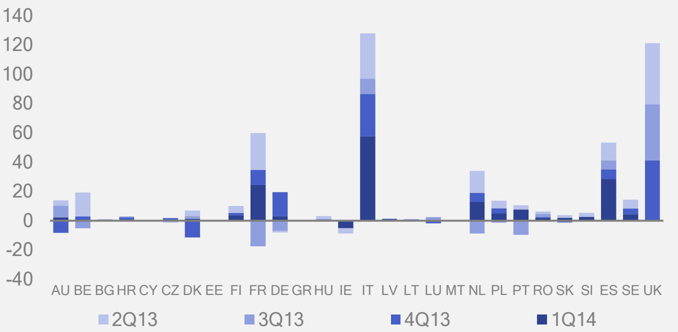
Credit risk

Debt issuance: Low ABS & sovereign contrasted with CB & IG R.18



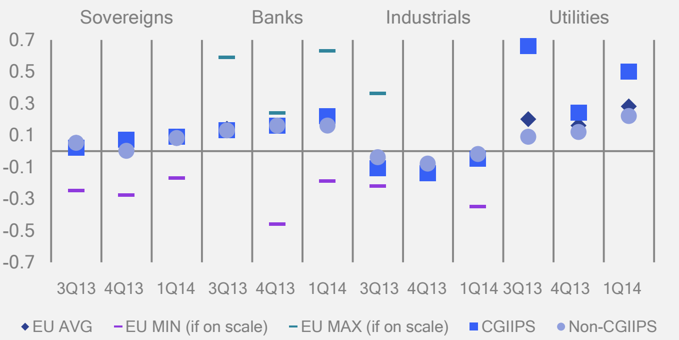
Note: Growth rates of issuance volume in per cent normalised by standard deviation for the following bond classes: sovereign (Sov); money market (MM); covered bonds (CB); investment grade (IG); high-yield (HY); asset backed securities (ABS); mortgage backed securities (MBS). Percentiles computed from 11Q rolling window. All data include securities with a maturity higher than 18 months. Bars denote the range of values between the 10th and 90th percentiles.
Sources: Dealogic, ESMA.

Net sovereign debt issuance: Continued growth R.19



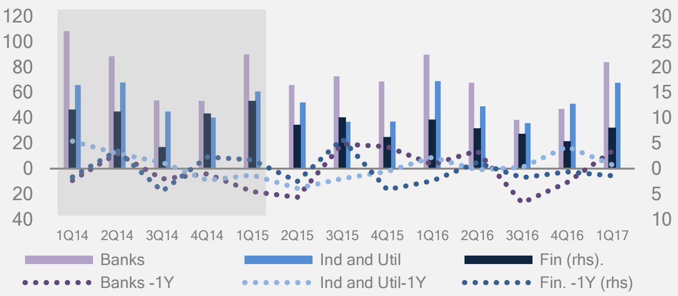
Note: Quartely net issuance of EU sovereign debt by country, EUR bn. Net issuance calculated as the difference between new issuance over the quarter and outstanding debt maturing over the quarter.
Sources: Dealogic, ESMA.

Debt maturity: Slight increase in most sectors R.20



Note: Quartely change in maturity of outstanding debt by sector and country groups. EU, years. CGIIPS include CY, GR, IT, IE, PT and ES.
Sources: Dealogic, ESMA.

Debt redemption profile: Banks' 12-M profile shallower R.21



Note: Quarterly redemptions over a 3Y horizon by European private corporates (banks, non-bank financials, and industrials and utilities), current and 1-year lagged data, EUR bn. Excluding bank redemptions to central banks (expiry of LTRO between Dec-12 and Mar-15). Sum over grey shaded area indicates additional financing needs for banks of about EUR 1,019bn, related to the ECB LTROs expiring in March 2015.
Sources: Dealogic, ESMA.

Credit risk remained high in 1Q14, with the build-up of risks in new areas offsetting the continued improvement in others. EU debt issuance was mixed. The strength of sovereign and covered bond (CB) activity contrasted with the regressive activity in securitised markets. Sovereign and corporate maturity profiles continued to lengthen, which suggests that treasurers took advantage of the relatively low long-term interest rates, improved economic outlook or regained confidence. Vulnerabilities primarily stem from a deterioration in the outlook, legacy assets, or the accumulation of new imbalances due to access to low cost finance that could be shorter-lived than expected.

Debt issuance: Bond issuance growth was mixed. Sovereign and CB issuance growth was strong. Yet, one should note that CB issuance growth remained over one-third lower when compared to levels over the past decade. Investment grade (IG) bond issuance was solid, especially in a few larger MS, while it was slightly regressive for money market (MM) and high yield (HY) bond issuance. EU issuance of securitised products also was regressive, with ABS activity having contracted markedly.

Net sovereign debt issuance: 1Q14 issuance was strong and in line with cyclical patterns, with some heterogeneity across sovereigns. While a few sovereigns exhibited low issuance, for the most part issuance remained in line with elevated fiscal deficits. Further, several peripheral sovereigns' market access continued to improve, benefiting from economic adjustment and positive investor sentiment. Risks of a reversal remain significant, however, in an environment where debt sustainability relies on growth supporting structural reforms and low real interest rates. Where net issuance appears significantly negative, sovereigns may have reduced cash holdings that may have been of a precautionary nature or that resulted as a consequence of recent maturity profile management.

Debt maturity: Against a background of improved market confidence, maturity profiles continued to lengthen across sectors. EU sovereign debt maturity profiles lengthened as some MS possibly made use of low interest rates, while others continued to re-establish themselves in the market. Regarding the average maturity of bank debt, it continued to increase over the last quarter with non-core banks' outstanding maturities extending beyond the average. For industrial corporations, the decrease in the maturity profile characterising previous quarters came to a halt. In the near-term, a lengthening of maturity profiles can reduce roll-over risk, especially where it is employed to reduce funding cliffs.

Debt redemption profile: Corporate redemption activity remained seasonally high in 1Q14, with 2Q14 similarly important. For the remainder of the LTRO repayment window through 1Q15, the repayment profile is shallower when compared with the flatter 2015 profile; as at end 1Q14 the remaining LTRO balance stands at EUR 553bn. This is consistent with smoothing of aggregate repayment profiles by banks' treasurers. On the other hand, non-financial companies' profiles are shifting outward, such as 4Q16. For both financial and non-financial sectors, it remains to be seen how the cyclically elevated refinancing needs of 1H14 will have been redistributed, however.

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