

ESMA sees potential for sudden reversal in investors' risk assessment

During the third quarter of 2020, EU financial markets have continued their recovery and equity market valuations have edged up further. There are increasing signs of strong geographical and sectorial differentiation across financial markets with fixed income markets seeing large-scale valuation increases across various segments such as emerging markets, investment grade and high yield. Credit rating downgrades have been slowing and investment funds recorded inflows across asset classes, especially for bond funds.

These developments, taken together, highlight the ongoing risk of decoupling between asset valuations and economic fundamentals. So, the potential for a sudden reversal in investor's risk assessment is the key risk currently seen for EU financial markets and so ESMA maintains its risk assessment.

Looking ahead, ESMA sees a prolonged period of risk to institutional and retail investors of further, possibly significant, market corrections and see very high risks across the whole of ESMA's remit. The extent to which these risks will further materialise will critically depend on three drivers:

- the economic impact of the pandemic;
- market expectations on monetary and fiscal support measures; and
- any occurrence of additional external events in an already fragile global environment

| ESMA remit | Level Outlook | Risk categories | Level Outlook | Risk drivers | Outlook |
|------------------------------|---|-----------------|---|------------------------------------|---|
| Overall ESMA remit |  | Liquidity |  | Macroeconomic environment |  |
| Securities markets |  | Market |  | Interest-rate environment |  |
| Infrastructures and services |  | Contagion |  | Sovereign and private debt markets |  |
| Asset management |  | Credit |  | Infrastructure disruptions |  |
| Consumers |  | Operational |  | Political and event risks |  |

Note: Assessment of the main risks by risk segments for markets under ESMA's remit since the last assessment, and outlook for the forthcoming quarter. Assessment of the main risks by risk categories and sources for markets under ESMA's remit since the last assessment, and outlook for the forthcoming quarter. Risk assessment based on categorisation of the European Supervisory Authorities (ESA) Joint Committee. Colours indicate current risk intensity. Coding: green=potential risk, yellow=elevated risk, orange=high risk, red=very high risk. Upward arrows indicate an increase in risk intensities, downward arrows a decrease and horizontal arrows no change. Change is measured with respect to the previous quarter; the outlook refers to the forthcoming quarter. ESMA risk assessment based on quantitative indicators and analyst judgement.

Risk dashboard 2 2020 – ESMA