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Press release

Remarkable resilience of financial markets in a higher-for-longer interest-rate environment

The European Securities and Markets Authority (ESMA), the EU's financial markets regulator and supervisor, today publishes its first risk monitoring report of 2024, where it sets out the key risk drivers currently facing financial markets.

Verena Ross, ESMA's Chair, said:

> *"At ESMA we are observing a financial system that has shown a high level of resilience. Looking ahead, markets are set to remain very sensitive and risks of market corrections continue to be high, given geopolitical and macro-financial uncertainty. In this context, maintaining trust in financial markets is of particular concern to ESMA, and key to achieving our mission to protect investors.*
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> *Retail investors increasingly get their updates through social media, and we again stress the need to be aware of the risk of receiving false or misleading information through these media. All investors should verify the reliability and the quality of the information they use in their investment decisions.*
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> *Financial stability and investors will be impacted by increased interest rates which are expected to remain higher for longer. This environment has a negative impact on credit quality and real estate valuations. Finally, greenwashing entails the risk of limiting the role finance can play in the transition to a more sustainable future."*

Beyond the risk drivers, ESMA's report provides an update on structural developments and the status of key sectors of financial markets, during the second half of 2023.

Structural developments

Market-based finance: Access to capital markets for European corporates continued to be mainly through fixed income markets and securitised products in 2H23. Equity primary markets slightly picked up, but IPO activity was strained due to uncertain market conditions. Corporate bond issuance remained strong during 2H23. The corporate bond outlook will be shaped by a significant upcoming maturity wall from 2024 until 2028, with corporate debt sustainability remaining a considerable risk, especially in lower quality segments.

Sustainable finance: Following several years of uninterrupted growth, the take up of ESG investing and growth of ESG markets have levelled off in recent quarters. The ESG bond market grew at a slower pace, while gross issuance volumes declined. SFDR Article 9 funds with a sustainable investment objective faced net outflows for the first time in 4Q23, and outflows from SFDR Article 8 funds promoting environmental or social characteristics accelerated, with the use of ESG-related terms in fund names a key factor of differentiation between these funds.

Financial innovation: Crypto-asset valuations rebounded in 2023, fuelled by the hope that spot crypto ETFs would obtain approval by the US SEC, which they did in January 2024. Still, at EUR 1.5tn, total market capitalisation of crypto assets remains half of the 2021 historical peak. The use of artificial intelligence in finance is growing around a wide range of applications, even though dedicated AI-investment instruments remain limited.

Market monitoring

Securities markets: Equity valuations were moderately up in 2H23 driven by an end-of-year rally linked to expectations of 2024 interest rate decreases. Volatility remained contained, while bid-ask spreads increased, highlighting market nervousness. Fixed-income markets were lower overall towards the end of 2023, with marked declines in yields for sovereign and corporate bonds in December. Credit quality of high-yield non-financials continued to decline, particularly associated with real estate, with default rates trending upwards.

Asset management: EU fund performance and flows were volatile in 2H23. Investors preferred fixed income funds over equity funds, and MMFs specifically attracted significant inflows on higher interest rates and the inversion of the yield curve. Overall, risks stabilised but remained elevated, especially liquidity and credit risk. While funds managed the transition to higher interest rates, concerns remained regarding the valuation of real-estate fund assets in a falling market.

Consumers: Sentiment among consumers remained weak amid geopolitical uncertainty and subdued growth, despite falling inflation. At higher interest rates, consumers raised holdings of bonds, both directly and via investment funds, and average performance of retail investments improved in 3Q23. Real-estate exposures via retail AIFs are a source of risk.

Infrastructures and services: Equity-trading volumes showed a slight year-on-year decrease amid low volatility. Settlement fails remained broadly stable in 2H23, after their 1H23 fall. Cyber incidents in the financial sector globally remain elevated, even if they went down in 3Q23.

Notes for editors

1. ESMA50-524821-3107 Trends, Risks and Vulnerabilities (TRV) Report
2. ESMA50-524821-3106 Trends, Risks and Vulnerabilities (TRV) Statistical Annex
3. ESMA is the European Union's financial markets regulator and supervisor. Its mission is to enhance investor protection and promote stable and orderly financial markets.
4. It achieves this objective through three strategic priorities:
    - fostering effective markets and financial stability,
    - strengthening supervision of EU financial markets,
    - enhancing protection of retail investors,

   and two thematic drivers:
    - enabling sustainable finance; and
    - facilitating technological innovation and effective use of data.
5. ESMA achieves its mission within the European System of Financial Supervision (ESFS) through active cooperation with the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Systemic Risk Board, and with national authorities with competencies in securities markets (NCAs).

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