

ESMA TRV: Political uncertainty amid growth slowdown weighs on market sentiment

Uncertainty related to Brexit, amid weakening growth prospects, global trade tensions, and reduced global monetary policy stimulus have contributed to market risk remaining very high.

The fourth quarter of 2018 saw increasing volatility on equity and sovereign bond markets, a decrease in equity prices, continued repricing on corporate and sovereign bond markets, and regional developments leading to localised sell-offs and increased short-selling activity.

Overall risk levels for the European Union's (EU) financial markets remained stable but at high levels for most risk categories, particularly liquidity, market contagion and credit risk. Securities markets experienced several episodes of short-term volatility, and equity markets suffered sharp declines from October onwards, erasing all the gains made in the first half of 2018.

Going forward, EU financial markets can be expected to become increasingly sensitive to mounting political and economic uncertainty, with concerns over a no-deal Brexit weighing on economic and market expectations.

Areas of focus

ESMA, in a series of articles in the Vulnerabilities section of the TRV, also looks in more detail at the following issues:

- **RegTech and SupTech:** We examine how technology can help supervised entities and supervisors to perform their duties. New automated tools in areas such as fraud detection, regulatory reporting and risk management are available for firms, while potential applications of new tools for regulators include greater surveillance capacity and improved data collection and management.
- **Retail Alternative Investment Funds – heterogeneity across the EU:** We provide an overview of the EU market for Alternative Investment Funds (AIFs) sold to retail investors. Overall, the size of AIFs sold to retail investors accounts for 18% of the AIF market in terms of NAV in 2017. The data do not suggest significant signs of liquidity mismatch for AIFs held exclusively by retail clients in 2017.
- **Double Volume Cap mechanism – impact on EU equity markets:** We analyse the impact of the DVC mechanism on market liquidity in lit markets. For equities banned by the DVC mechanism, trading in dark pools dropped from 7% to less than 1% in August before increasing again above 5% in September 2018, when the ban was lifted. The share of trading in periodic auctions increased over the same period from virtually 0% to 4% of the total before declining to 2%. Market liquidity in lit markets improved in terms of breadth and depth, while it worsened in terms of

tightness, as measured by the spread between bid and ask

- **Money Market Funds in the EU – new stress-testing requirements:** This article provides an overview of potential financial stability risks posed by MMFs, and how the MMF Stress test guidelines aim at increasing the resiliency of the sector by addressing the issues identified, such as the “first-mover advantage”. The Regulation also introduces new stress-testing requirements, as part of fund risk management and regulatory disclosure. ESMA will design common parameters and scenarios to coherently capture the risks of the sector. Stress test results will be reported to ESMA and the National Competent Authorities (NCAs).