AUTORITÉ
DES MARCHÉS FINANCIERS

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The Autorité des Marchés Financiers publishes its 2021 Markets and Risk Outlook

The Outlook highlights the return to normal of market indicators despite continuing health, but also economic and financial vulnerabilities: the uneven nature of the recover, increase in public and private debt, the threat of rising interest rates and inflation, the proliferation of serious operational incidents in market infrastructures, or the risk of transition to new benchmarks. Post-Brexit financial market developments also highlight the risks to the Union's sovereignty and competitiveness.

The impact of the pandemic seems to be a thing of the past on the markets according to valuation and liquidity indicators, as well as investment flows in financial markets whether these are invested directed or via collective management. At a time when vaccination campaigns are proceeding at different speeds and variants are appearing, there is still a great deal of uncertainty as to the outcome of the health crisis, and the clear improvement in the economic outlook does not apply to all sectors and countries. For instance, the discontinuation of aid schemes for companies could mean solvency problems for those made vulnerable by the crisis. In addition, the risk related to the sustainability of public debt remains a concern in the medium term, in light of the rise in that debt driven by the response to the health crisis and the recession, and given the risk of a rise in interest rates fuelled by a return to growth and inflation which is becoming signficant.

The document also highlights the complexity of reconciling the sovereignty and competitiveness of the European Union in the wake of Brexit. UK-based clearing houses remain essential for certain activities, such as euro-denominated derivatives, while Brexit has also resulted in a shift of some derivatives activity from the UK to the US. In addition to these unfavourable developments, there is the risk of regulatory divergence with the United Kingdom, such as the Financial Conduct Authority's decision to no longer apply the MiFIR double volume cap mechanism aimed at limiting the level of "dark pool" trading to EU equities on UK trading venues.

The transition to new risk-free benchmark rates, with the IBOR transition at the end of 2021, remains an element of short-term risk. With the support of the authorities, the financial industry is devoting significant resources to systematising the identification of IBOR exposures, implementing transition processes and developing the appropriate systems. However, some types of contracts, such as syndicated loans, cannot be automated and some non-financial companies appear to have adopted a wait-and-see attitude, although they are also concerned.

The year 2021 has also been synonymous with multiple market incidents: the case of Archegos, for example, which found itself unable to meet its margin calls, highlighted the unsuspected scale of certain risks and the robustness of a banking system capable of absorbing very heaving losses without triggering a systemic crisis. The succession of serious operational incidents over the past year, without any malicious action, is also a reminder of the vulnerabilities of market infrastructures around the world.

In asset management, the Outlook describes a return to structural trends with the rise of passive management in a low interest rate environment which is putting increasing pressure on costs and fees, and the development of private equity which continues at a sustained pace. The risks associated with these developments, which were already identified before the pandemic, have been accentuated, as have the ever-increasing leverage and valuations for private equity. Nevertheless, private equity is called upon to play a role in supporting the equity financing of SMEs at a time when the health crisis has accelerated profound changes in productive sectors, such as the digital and climate transition.

Channelling savings into the equity capital needed by businesses remains the long-term challenge to ensure the successful exit from the pandemic crisis and the ecological transition. The Outlook raises questions about the diversification of retail investments and the meaning of the return of the French to the equity markets at a time when they were at their lowest point during the first semester of 2020. Although this is a welcome counter-cyclical phenomenon, confirmation is required that it is an informed long-term investment.

	Description of the risks	Level at mid-2020	2020-2021	Level at mid-2021	Outlook for 2022	
Financial stability	1. Increased risk premiums, weakening indebted firms or those with assets whose prices do not reflect their fundamentals, which could correct sharply High valuation levels, with very low risk premiums, despite the persistence of major hazards		→		→	
	2. Lack of international policy coordination Desynchronisation of economic cycles between major regions (United States leading) and within major regions (heterogeneity of the euro area) Rise in global interest rates under the influence of the rise in US rates Regulatory divergence, especially post-Brexit, with a view to defending competitiveness		→		→	↗
	3. Credit risk, unsustainable debt trajectories, non-performing loans Increase in both private and public debt due to the Covid-19 crisis Defaults remaining to be observed, having been retarded by government support policies		↗		→	↘
Market organisation and functioning	4. Volatility, sudden fluctuations in liquidity conditions, large-scale moves by investors from one asset class to another Resilience to the correction in 2020 Stimulus by the authorities (central banks, supervisors, etc.)		→		→	→
	5. Functioning of market and post-trade infrastructures Resilience to the 2020 episode But growing number of operating incidents even without any malicious attack UK clearing houses post-Brexit: uncertainty regarding the equivalence granted by the EU		↗		→	
Financing of the economy	6. Profitability of financial institutions faced with an environment calling into question their business model Rise in interest rates But expected rise in non-performing loans and risk of persistence of interest rates that are too low, calling into question business models Climate and digital transitions		→		↘	
	7. Difficult access to financing for companies, especially SMEs Financing ensured during the crisis But limits to debt financing Difficulties in guiding investors to capital products in the turnaround phase Difficulties in obtaining equity financing for long-term investments (climate transition)		→		→	
	8. Lack of protection of retail investors in the event of misinformation on the risks associated with certain investments or certain distribution channels Further series of scams Boundary between gambling and investment becoming blurred Pursuit of return in an environment in which the authorities would take measures to ensure that real interest rates remain low		↗		→	

Level of risk at mid-2021: Very high / High / Significant / Low

IN BLUE: main new information that changes the assessment

Change in risk since 2020 or outlook for 2022: Lower ↘ / Stable → / Higher ↗

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The AMF is an independent public authority responsible for ensuring that savings invested in financial products are protected and that investors are provided with adequate information. The AMF also supervises the orderly operations of markets.Visit our website https://www.amf-france.org URL = [https://www.amf-france.org/]

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