

PRIMARY EURO AREA BOND MARKETS AND THE IMPACT OF THE UPCOMING EU ISSUANCE ON NATIONAL ISSUANCE AND THE DEVELOPMENT OF A SAFE ASSET FOR THE EURO AREA

European Stability Mechanism



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OVERVIEW

- EU SURE Program – Characteristics
- EU SURE Program – Issuer Perspective
- Year to date Performance in main SSA
- Impact of EU SURE on the SSA primary market
- Positive Environment for EU
- Feedback from Investors
- EFSF as a precedent?
- Recovery Fund
- Questions?

1. EU SURE PROGRAM – CHARACTERISTICS (1.1)

- **What is it?**

- It means **S**upport to mitigate **U**nemployment **R**isks in an **E**mergency (SURE).
- It was created to protect citizens and mitigate the severely negative socio-economic impact of the coronavirus pandemic.
- It will be available to Member States that need to mobilise significant financial means to fight the negative economic and social consequences of the coronavirus outbreak on their territory.
- It will provide Loans to Member State(MS) under the SURE instrument.
- The EU budget is protected through additional bilateral guarantees from all Member States totalling EUR 25 billion (or 25% of the maximum amount). Although the guarantees are voluntary, the program can only be started once all guarantees are in place.
- SURE can provide financial support of up to €100 billion in total to all Member States.
- **Ursula von der Leyen:** *“SURE is a clear symbol of solidarity in the face of an unprecedented crisis. Europe is committed to protecting citizens.”*

(based on information provided by the EC)

1. EU SURE PROGRAM - CHARACTERISTICS (1.2)

- **What we know so far:**

- In a first round, 18 member states have requested around EUR 90 billion of loans – it is expected that at least 16 member states will participate, subject to the Commission confirming compliance with the eligibility criteria laid down in the SURE regulation.
- Funding back to back to lending.
- 15 years as the maximum average (and targeted) maturity for lending / funding.
- The EU will be present in 3y to max. 30y. Focus is on 5y to 30y.
- Funding only in **EUROS**.
- Concentration risk limit of €10 billion per maturity year.
- To manage cash flow risk loans will pay 20 business days in advance to the underlying funding (interest + notional)
- Lending rate = EU funding costs + a small cost recovery for external costs (subtracting less than 1bp from proceeds)
- Funding at negative rates will be passed through to the Beneficiary MS.
- No option for short term funding, only considered for Recovery Fund.

(based on information provided by the EC)

1. EU SURE PROGRAM – ISSUER PERSPECTIVE

- **Framework gives several restrictions:**

- back to back funding
- average maturity 15y (will be set in the Council Implementing Decision)
- maximum maturity 30y
- maximum volume maturing in one year €10bn
- no tool to bridge liquidity needs with money market

- **As a consequence:**

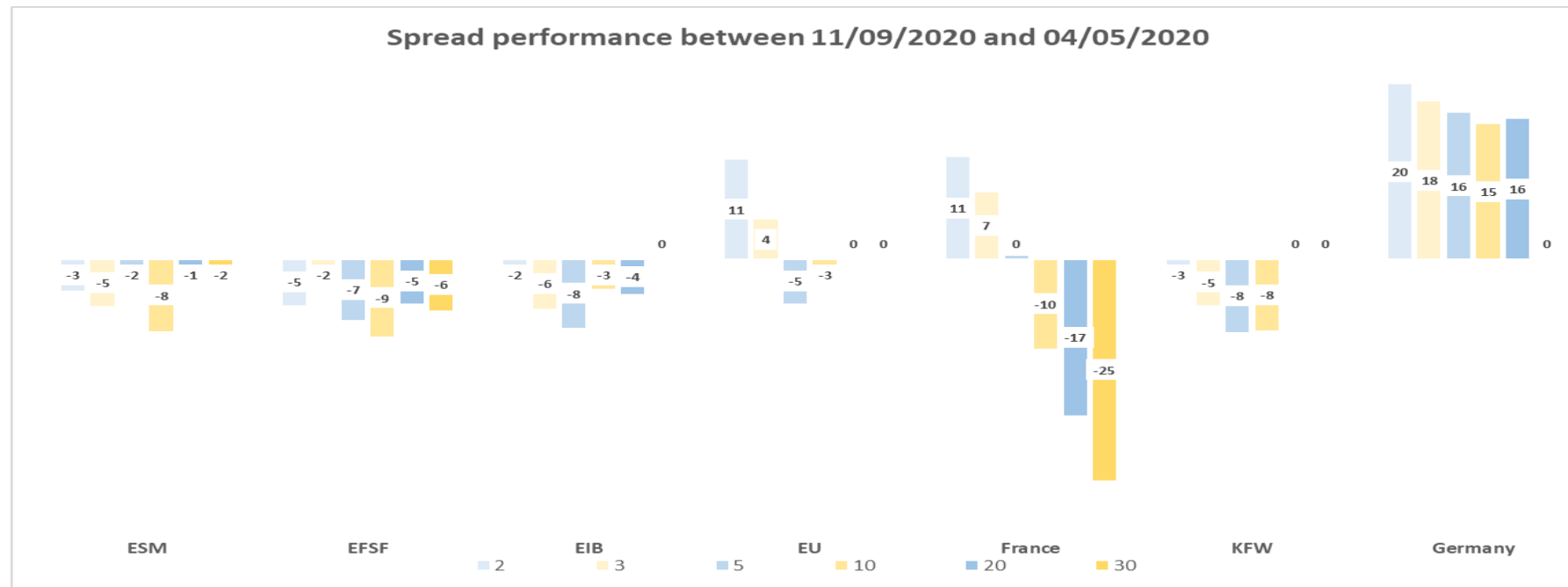
- limited flexibility in terms of timing
- around €10bn funding p.m. needed (taking into account months of low activity)
- relatively high volumes needed at the long end (e.g. around €30bn with 25-30y maturity) to achieve average maturity
- the curve built with the issuances for SURE will be the benchmark for the funding of the recovery fund

- **In addition:**

- EU is an established issuer yet with lower volumes
- outstanding curve is of different nature in terms of maturity, liquidity and with scarcity value
- EC has to amend internal set-up to deal with upcoming volumes and frequency

2. YEAR TO DATE PERFORMANCE IN MAIN SSA

- **Since May most spreads tightened**
 - mainly due to the PEPP program and the fact that there was a lot of cash available from Investors
 - EU curve shows widening mainly in the short end



3. IMPACT OF EU SURE ON THE SSA PRIMARY MARKET

After the first SSA deals we identify a few key changes:

- **New Issue Premium is higher than prior to the summer.**

EIB started with a price guidance at MS -3bps and priced only 1bp tighter at MS-4bps. This represents a NIP of +6.5/+7bps. Prior to the summer break in May, June and July NIP were 4-5bp. Following trades (KfW, Cades) had a slightly lower NIP.

- **Book building is solid (size wise) yet less dynamic. Orderbook qualities limited deal sizes and secondary market performance of some transactions.**

Investors are anticipating the supply of the SURE-programme. EIB was even measured ag. a potential synthetic SURE funding level.

- **Issuers rush into the EUR market to be ahead of SURE funding.**

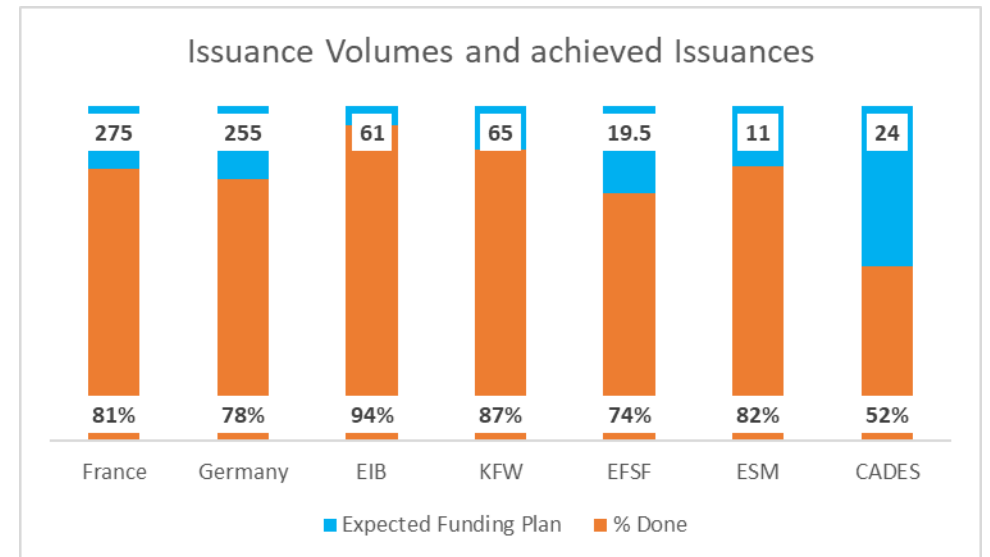
Ahead of the EU supply we see some opportunistic Funding from a broad issuer range (GE Länder, Cities, Covered bonds yet also sovereigns).

- **A Repricing of the SSA-Euro curve has started.**

Higher NIP and the non-performance in the secondary market are for us key indicators ahead of the EU SURE programme.

4. POSITIVE ENVIRONMENT FOR EU

- Overall the main issuers are well funded for the remaining of 2020
- Market is supported by PSPP and PEPP
- Redemptions in October are high
- Market Makers are very light in terms of Inventory
- Additional supply is expected and market participants have started to prepare



5. FEEDBACK FROM INVESTORS

We have recently analysed the current investor sentiment, and while market is reacting, it also shows that investors are ready and open to take the additional supply

Market sentiment:

- Investors have been unwinding positions and are keeping cash to be prepared for the upcoming supply. They are ready to invest.
- Following the quiet summer period, with less supply and just some profit taking trades, investors are now focussing on primary deals.
- Investors expect further repricing and act carefully.

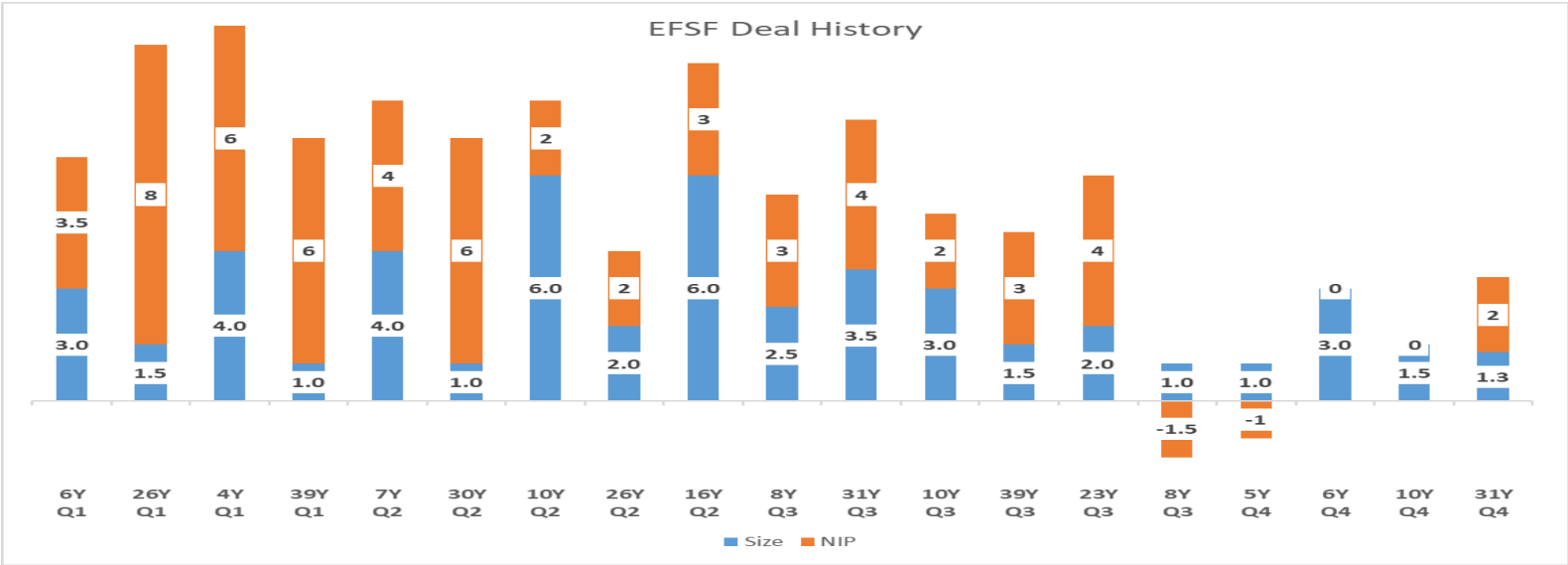
Feedback on EU's response and additional supply:

- Investors look closely to all EU measures. Key investors are very well informed.
- The EU name will be attractive. But some uncertainty about its re-establishment as a regular issuer (performance, new issue premium, communication, etc).
- Concerns about the the high level of supply, and the spread directionality that markets might show. No concerns on individual names.

6. EFSF AS A PRECEDENT?

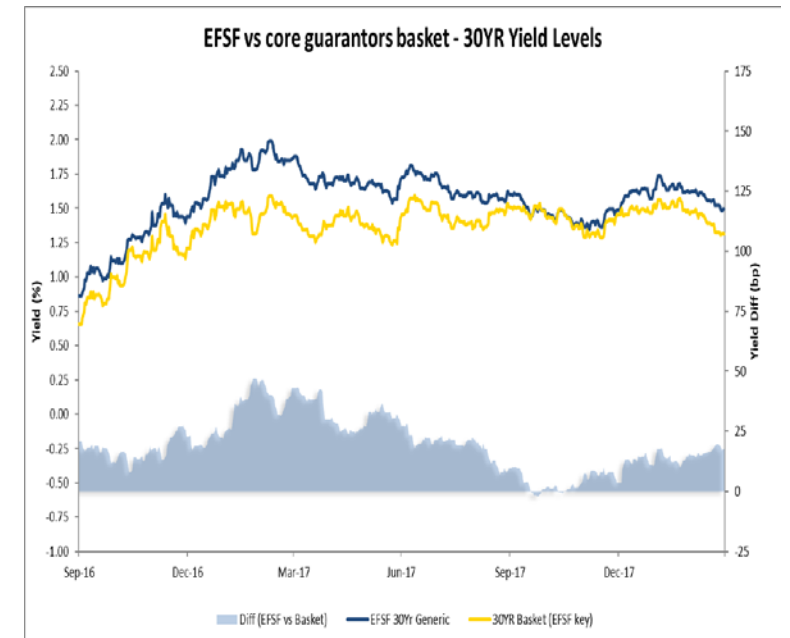
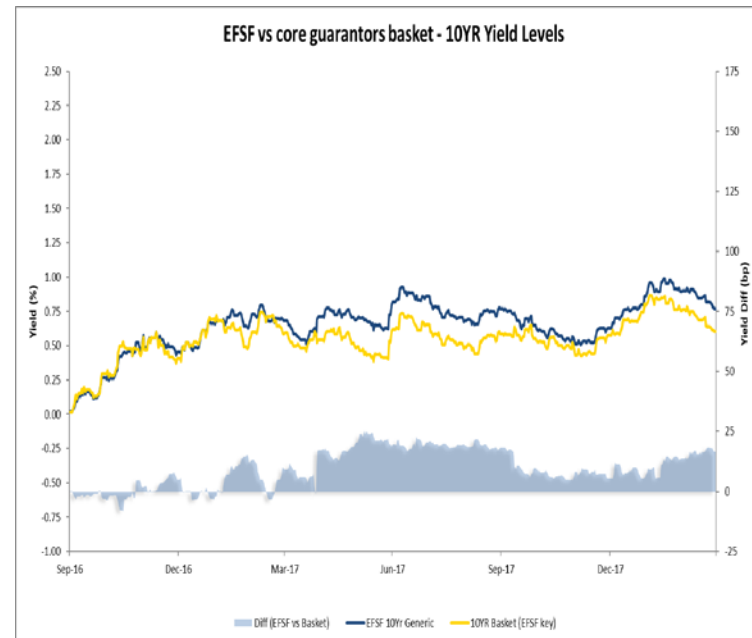
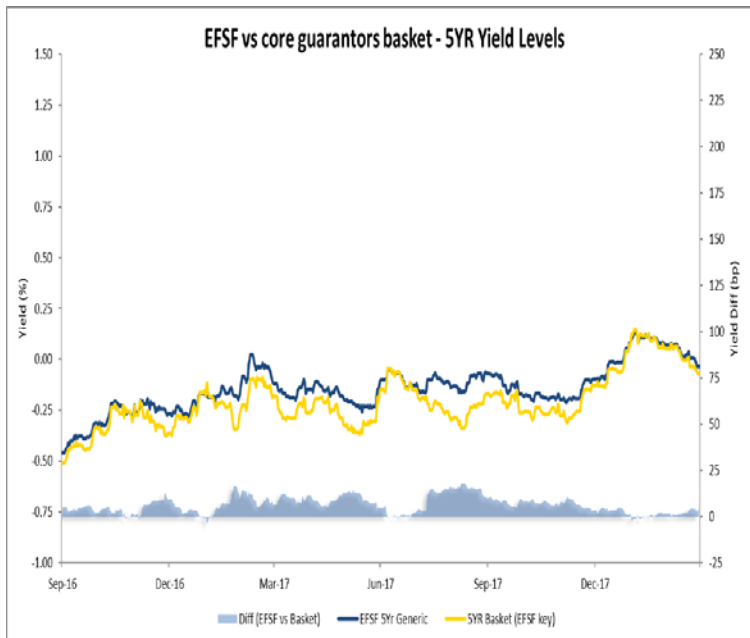
- **2017 EFSF Funding Program**

- Increased the Funding Plan due to the Short Term Measures for Greece
- EFSF was active on all parts of the curve with the main focus being the long end
- Out of €49bn around €20bn were raised with maturities >15y
- NIP requested by investors decreased over time



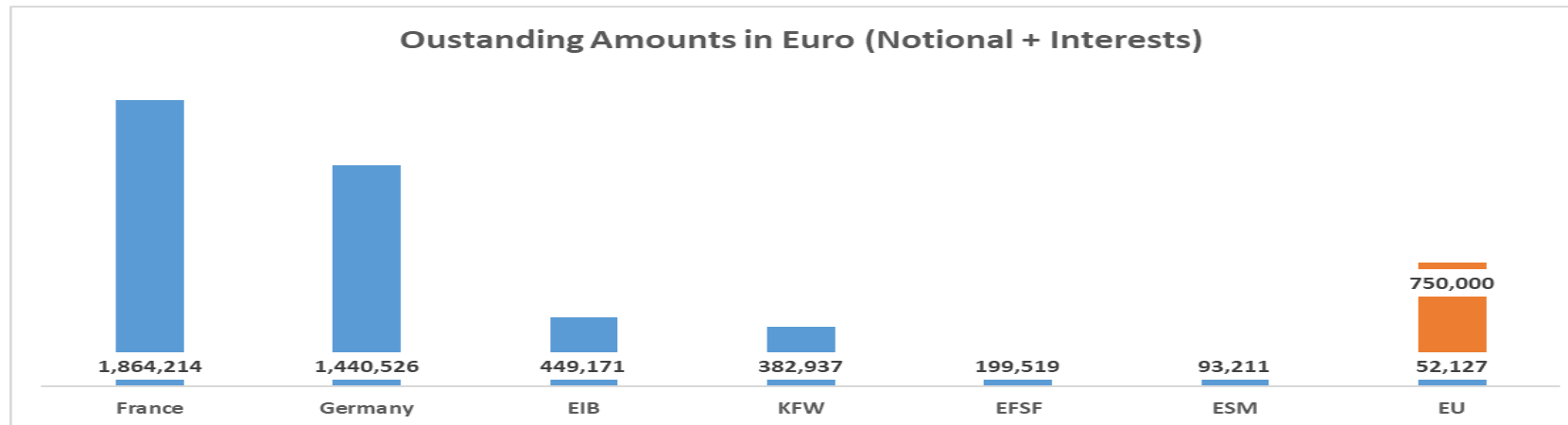
6. EFSF AS A PRECEDENT?

- EFSF represents a basket of 6 best rated EA sovereigns, which represents fair value from a credit perspective
 - We saw the widening of the spreads in all our main tenors
 - Longer end showed higher impact



7. RECOVERY FUND

- Size: €750bn in 2018 prices, real nominal amounts will be above €800bn
- Diversified funding, no back to back funding
- Yearly funding volume €150-200bn during the building phase
- Afterwards roll-over needs est. around €50-60bn (assumed 7y average maturity)
- **Enough to become a safe asset for the euro area?**



(based on information provided by the EC)

QUESTIONS

- **Should the EU offer a repo facility to support secondary market liquidity?**
- **Should the EU become active in the secondary market ? Only sell-side or buy and sell?**
- **What should be the targeted final outstanding amount of an issuance?**
- **Are there any regulatory changes, which could increase the attractiveness of EU bonds?**



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