FOCAL POINT

EGBs: Record issuance volume in Q1, but more to come

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April 9, 2024

Our Focal Point series explores topical issues on macro, markets and investment

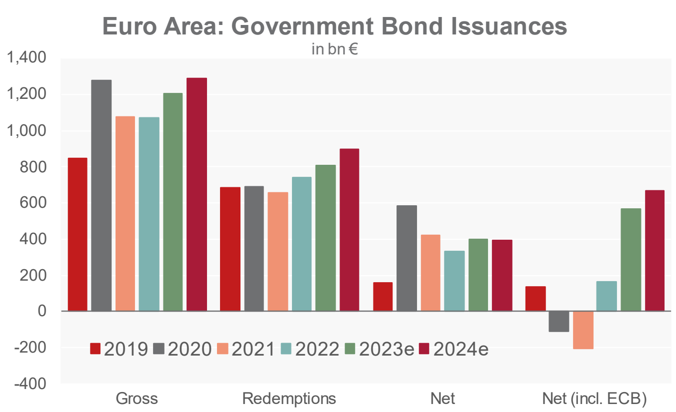
- **Euro area treasurers are on their way to setting a new record gross government bond issuance volume in 2024. In Q1, they issued over € 450bn in new bonds, around 35% of the scheduled annual volume.**
- **At over 40%, the proportion of very long-dated bonds has been comparatively high. Nevertheless, the supply met with solid demand from foreign and domestic investors. Many issuances were oversubscribed, and the new bonds were easily absorbed.**
- **The ECB's tapering of PEPP reinvestments from July onwards will be a headwind, though. € 430bn of the € 670bn net-net issuance is yet to be placed on the market by the end of 2024.**
- **The share of ESG bonds is seen to remain stable at around 5%, consistent with previous years.**

Euro area (EA) treasuries got the year off to a flying start, issuing a record volume of government bonds in Q1. The supply was easily absorbed, meeting robust demand from domestic and foreign investors. This is particularly noteworthy given the comparatively high share of very long-dated bonds.

However, in this report, we will show that it is too early to give an all-clear signal. Not only will more than € 200bn net have to be issued in the remaining months of the year, but the ECB also plans to increase tapering in July.

New historic highs for issuance activity in 2024

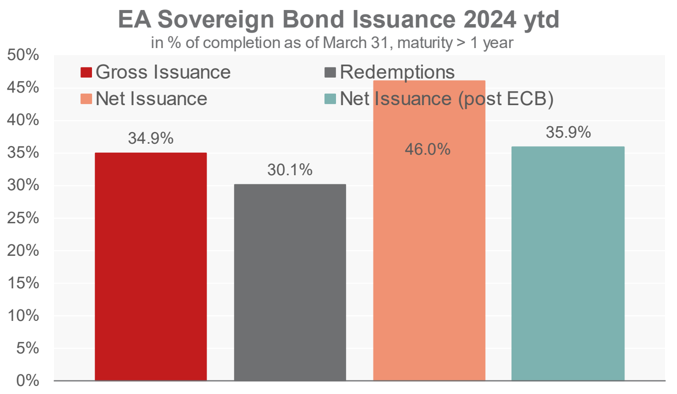
According to our current forecasts, 2024 will set a new record for gross issuance of EA government bonds. While net issuance will fall slightly to € 390bn (based on treasuries' announcements and given a moderately lower EA fiscal deficit in 2024 compared to 2023), rising redemptions will raise gross issuance to € 1290bn according to our calculations (restricting the analysis to fixed income paper with an original maturity above 1 year). However, it is particularly noteworthy that net-net issuance (i.e., including the ECB) will reach a new high. Due to the ECB's QT gaining



Source: Bloomberg, Datastream, GenAM

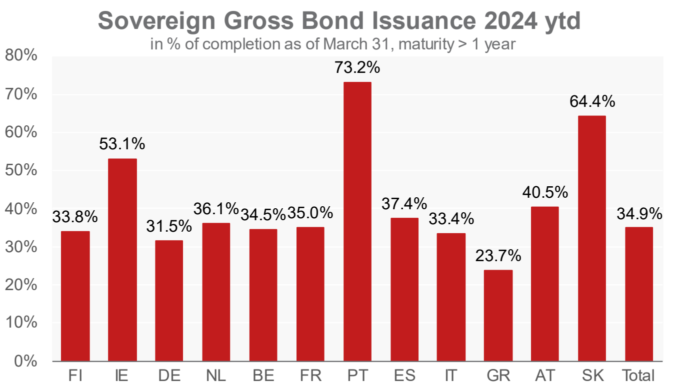
momentum, we expect that the net-net issuance will rise further from € 570bn to € 670bn in 2024 (more details below).

The first quarter is always the one with the busiest issuing activity, but the last quarter topped it off: EA treasurers have taken advantage of the favourable bond market environment to place some € 450bn in the first three months of the year. This is the highest-ever quarterly issuance and represents almost 35% of the estimated 2024 gross issuance (slightly above the long-term historical average). Given the looming PEPP QT from July onwards, we forecast a continuation of the brisk issuance activity in Q2 and anticipate the completion of the annual issuance programme of more than 60% by the end of H1.



Source: Datastream, Bloomberg, GenAM

With only € 270bn repaid in Q1, the net issuance is already € 180bn. This is almost half of the estimated net issuance of € 390bn for the year as a whole. Even taking the ECB's QT into account, more than 35% of the net-net issuance volume has already been placed on the market.

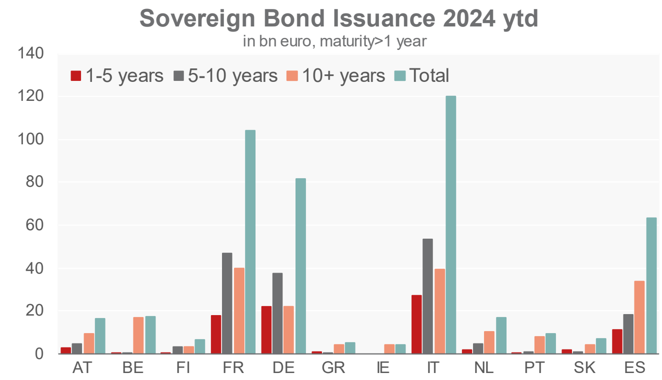


Source: Datastream, Bloomberg, GenAM

Almost all EA countries have issued more than 30% of this year's needs. Some smaller countries have even managed considerably more. Portugal, in particular, has already exceeded 70% of its annual target. However, Portugal is also a special case in that it only needs a small amount of funding given its balanced fiscal budget.

Noteworthy, the weighted average maturity of new (or tapped) bonds increased compared to last year. The average maturity of new bonds in Q1 was over 11 years. More than 43% of new EA government bonds had a maturity of more than 10 years (also favoured by the partial inversion of the yield curve). Although the trend has recently been slightly downwards, the share of very long-dated bonds (10+ years) is still moderately higher than the long-term historical average. While Belgium with 18 years and Finland with almost 19 years are well above the average (both countries issued new 30-year bonds in Q1), Italy is with less than 9 years at the lower end of the average maturity.

The offer met with very strong demand and the bonds were placed on the market without any problems. The book-to-issue ratio was over 10 in some cases. Moreover, the investor base was broadly diversified. Both, investors from abroad and domestic ones included the new bonds in their portfolio. The market was also relieved by retail bonds. Italy's BTP Valore's third issuance, for example, reached a new record volume of over € 18bn.



Source: Datastream, Bloomberg, GenAM calculations

An important aspect that has received little attention in the market is not only that net issuances remain at a high level in 2024 (despite the slight decline), but also that there are large differences between countries. For example, countries with balanced budgets (e.g., Portugal, Ireland) are contrasted with some large countries (notably France and Italy) that have not managed to significantly reduce their high Covid-19-related deficits. Net issuance of France will even increase slightly this year compared to 2023 to € 130bn (by far, the highest value among all EA countries), and Italy will have the highest gross issuance in 2024 with a new record of almost € 360bn. As we do not expect any major fiscal consolidation in these countries in the coming years, deficits will remain at elevated levels and the high debt-to-GDP ratio is unlikely to fall. Although an immediate crisis is not anticipated, the outlook for the medium term is at least challenging. In any case, the tense financial situation of the public sector will increasingly limit the room for manoueuvre.

ECB's tapering to gain momentum

The ECB will increasingly withdraw from the government bond market. It is continuing the tapering that began in 2023 and will not reinvest a total of around € € 280bn in maturing bonds (after not prolonging € 165bn in 2023). Most of this relates to the PSPP (Public Sector Purchase Programme), but from July, it will only partially reinvest maturing PEPP (Pandemic Emergency Purchase Programme) bonds.

€ 265bn will be due in 2024 under the PSPP, which will not be reinvested. However, supranationals still need to be deducted from these amounts, so a total of around € 235bn will be added to the *sovereign* bond market in 2024p. Additionally, the central bank will reduce its PEPP holdings by an average of € 7.5bn per month starting in July. This will result in a further addition of € 45bn to the government bond market by the end of the year (in total the € 280bn mentioned above).

In Q1, the ECB has already reduced its PSPP holdings by € 70bn. This means that another approximately € 195 (of which € 175bn are sovereign bonds) will be inserted into the bond market until year-end. Adding the € 45bn of not reinvested PEPP bonds and combined with the outstanding € 210bn in net issuances, this results in a net-net issuance volume of € 430bn that the EA treasurers still have to place.

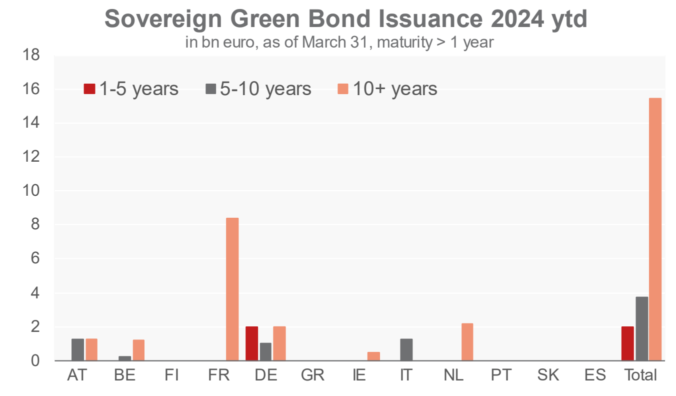
Hence, the gaining momentum of the ECB's tapering puts the very high pace of issuance in Q1 into perspective. Although € 240bn in net-net issuance has already been absorbed in Q1, the remaining volume of € 430bn is significantly more than the private sector typically handles in a year (between 2019 and 2023, the annual net-net issuance averages around € 110bn). The withdrawal of the ECB underlines the new situation for EA government bond markets in that the long-term trend of increasing importance of the ECB is reversed. A side effect of ECB tapering is that the scarcity of collateral paper is becoming less relevant. The free float of German federal bonds (outstanding Bunds ./. QE holdings) has increased by over € 200bn since the end of 2020 to currently over € 940bn.

Hence, the technical situation will remain challenging in the months to come despite the front-loading of the EA treasurers. Although the expected further decline in volatility in the bond market, a slight economic recovery, and the looming cycle of ECB key rate cuts will support the uptake of new bonds, we see the risk that a certain supply fatigue will set in as the year progresses. This means that more significant concessions to investors (e.g., maturity, volume, spreads, particularly from weak issuers) might become necessary in the future.

One new green bond from France in Q1

EA treasurers continued to expand their ESG portfolio in Q1 with € 21bn of new green bonds, representing nearly 5% of all new issuances. The proportion thus remained relatively constant year-on-year. As there were no redemptions, the volume of outstanding EA ESG sovereign bonds increased to around € 225bn. The increase was mainly due to the tapping of existing bonds. France was the only country to issue a new bond (25 years, amount issued: € 8bn). Noteworthy, 75% of the issuance had a maturity exceeding 10 years.

We expect around [€ 65 to 70bn in ESG sovereign bonds] for the year as a whole, slightly higher than in 2023. This reflects the endeavours of the treasurers to provide market participants with sufficient opportunities to invest in safe ESG bonds. As no ESG bond redemptions are due for the remaining months of 2024, the share of ESG bonds in all sovereign bonds will continue to rise. Germany will also issue further green bonds to build a green benchmark curve. However, ESG sovereign bonds will remain a niche product in the single digits of the overall market in the coming years.



Source: Datastream, Bloomberg, GenAM calculations

Ongoing high supply to slow yield decrease

Summing up, despite the record volume of issuances in Q1, no significant easing is expected on the primary market in the coming months. This in itself should put some upward pressure on core yields (and non-core spreads). Rather, we believe that the start of the ECB's interest rate reduction cycle, combined with a continued slight decline in inflation rates, will be the determining factors for the coming months. Accordingly, we expect core yields to fall slightly over the next 12 months (10-year Bunds at 2.25%). However, a rally in the EA government bond markets is unlikely with the ECB's key rate trough priced at 2.25%.

Imprint

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