An oversubscribed EU bond deal but a failed vaccination programme

Published 8 February 2021

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As Europe continues to grapple with a supply shortage of vaccines for their mass Covid-19 vaccination programme and the economic impact of widespread lockdown measures across the continent, the European Commission sheds some positive news on Europe with the successful sale of the first European Union (EU) SURE bond issuance in 2021. If we look at the two viable tools at Europe's disposal to repair the European economy from the scars of the health pandemic, we can probably point to the European Central Bank's (ECB) €1.85 trillion Pandemic Emergency Purchase Programme (PEPP) programme and the €850 billion expected issuances of EU bonds under Support to mitigate Unemployment Risk in an Emergency (SURE) and NextGenerationEU. PEPP is aimed at helping ensure favourable financial conditions meanwhile the EU bond programmes will help EU member states repair their economies by borrowing at favourable rates to fund their recovery plans. In this blog, we will explore the details of the latest EU bond SURE issuance and consider how the ECB's quantitative easing (QE) programme and the new EU bond issuance could possibly be intertwined to help facilitate a sustainable economic recovery in Europe.

According to the European Commission press release, on 26th January 2021 the European Union issued a €14 billion dual tranche social bond split over two distinct tenors: €10bn new line due in June 2028 and €4bn reopening of the outstanding November 2050 line. This was the first 2021 issuance and the fourth EU transaction under the Support to mitigate Unemployment Risk in an Emergency (SURE) programme. First EU bond issuance in 2021:

- The 7-year bond was priced at 16 basis points below mid-swaps which is equivalent to 20.0 basis points over the 0.500% Bund (German Government Bond) due 15-Feb-2028
- The 30-year bond reopening was priced at 5 basis points over mid-swaps, which is equivalent to 25.2 basis points over the 0.000% Bund due 15-Aug-2050

It was noted that investor demand was reconfirmed by the 829 orders received across both tenors, with meaningful interest by ESG investors in both tranches. EU SURE bonds fall under the social bond framework and are considered sustainable bonds.

PEPP is more flexible than prior QE

The ECB has long been judged on its ability to fulfil its Quantitative Easing programmes due to limitations on public debt purchases of Sovereign bonds guided by the Eurosystem capital key of the national central banks. The capital key provides a guide to the ratio of each Eurozone government's bonds that the ECB can purchase. Given the extraordinary economic situation that the health pandemic has posed, the new PEPP launched in March 2020 was given the flexibility to ignore the capital key if needed to support the smooth transmission of monetary policy1. Ultimately, greater flexibility means that PEPP can tilt their purchases of European government bonds and Supranational bonds as required to prevent a tightening of financing conditions which could weigh negatively on inflation.

Considering the cumulative net purchases by country under the PEPP programme, Germany continues to dominate the bulk of the purchases with France a close second. Among European Sovereigns, while the Netherlands is the second largest AAA rated issuer ranked by Sovereign debt outstanding, it is interesting to note that cumulative Supranational purchases have surpassed that of the Netherlands as at end of November 2020. The Supranational space includes several highly rated European Supranationals but the limited size of this market estimated at around €800bn2 has also put an imaginary upper limit on the ECB's potential purchases of these bonds.

Chart 1: Bimonthly breakdown of public sector securities under the PEPP1

Book value as at end-November 2020 (EUR millions)	Net purchases October-November 2020	Cumulative net purchases as at end-November 2020*	Current WAM of public sector securities holdings under the PEPP**	WAM of eligible universe of public sector securities under the PEPP as at end-November 2020**
Austria	3,953	17,567	10.93	7.07
Belgium	4,918	22,197	6.29	9.43
Cyprus	290	1,484	10.86	8.33
Germany	35,571	160,619	4.83	6.73
Estonia	14	207	9.08	7.51
Spain	16,099	77,128	8.47	7.43
Finland	2,480	11,169	7.24	6.96
France	27,573	111,810	8.61	7.25
Greece	3,341	16,307	8.38	9.36
Ireland	2,288	10,317	8.85	9.55
Italy	22,927	118,169	6.82	6.85
Lithuania	92	2,080	11.78	10.60
Luxembourg	250	1,244	7.13	6.38
Latvia	70	907	9.07	10.27
Malta	23	261	7.46	8.13
Netherlands	7,911	35,705	4.08	7.25
Portugal	3,159	14,809	6.78	6.62
Slovenia	650	3,131	8.31	9.53
Slovakia	369	4,707	7.78	8.16
Supranationals	8,180	41,991	8.90	7.58
Total	140,160	651,810	6.98	7.23

- **SURE**: Approved on 19 May 2020, the Support to mitigate Unemployment Risks in an Emergency (SURE) loan programme, is aimed at helping mitigate Unemployment Risks in an Emergency to EU member states by providing loans of up to €100bn total. EU bonds issuance fall under the social bond framework.

- **NextGenerationEU**: with an envelope of €750bn is a massive new source of funding to help repair the immediate economic and social damage brought about by the coronavirus pandemic. The goal is to make Europe greener, more digital, more resilient, and better fit for the current and forthcoming challenges.

Together the expected new issuance will position the EU as the second largest AAA rated issuer and will make the EU the largest €Supranational. Thus far, the new EU bonds issued under the SURE programme have benefitted from very strong investor demand in the primary markets3. The strong investor demand is a positive sign given the EU's ambition to raise their outstanding debt by nearly 17 times the level it was prior to the Covid-19 pandemic. EU bonds could add another highly rated and liquid instrument with the capacity to become a larger share of the ECB's asset purchases under their quantitative easing programmes. While the supply of EU bonds will rise, the demand for these bonds by investors appears to be strong and the ECB may not be too far behind in this game.

With 2021 already off to a rocky start as Europe's mass vaccination programme faces large supply delays, the ECB and the EU will need all the tools possible to restart an economy that continues to face weak inflation and an uncertain growth outlook in the first half of 2021.

1 European Central Bank website. https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html. As noted in "resolution 2020/440" of the ECB.

2 As at 31 December 2020, using the Bloomberg Barclays Euro Aggregate Bond Index (LBEATREU) as a reference for the Euro Aggregate universe and € Supranational debt.

3 European Commission website, as of 18 January 2021. European Commission European Union Investor Presentation, January 2021.

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