Market Commentary – Euro area sovereign issuance off to a good start

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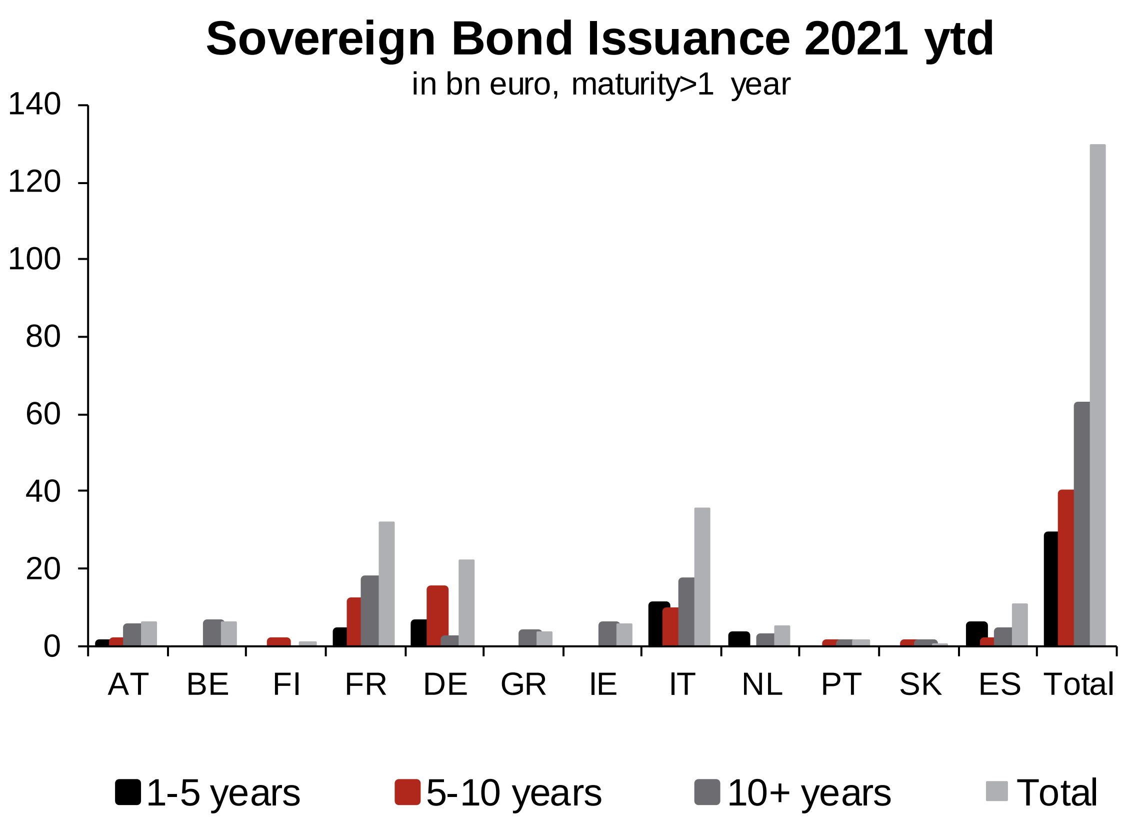
Macro & Market Research, Generali Insurance Asset Management S.p.A. SGR

- **Euro area sovereign issuance has started the year well. At the end of January treasurers have already placed around €130 bn of new bonds.**
- **Noteworthy, particularly very long-dated bonds were issued. Almost half of the volume has a maturity of more than 10 years.**
- **The ECB released also data regarding its QE purchases yesterday. According to this, the central bank reduced its buying compared to the previous months. This resulted in a positive sovereign bond net supply in January.**
- **Considering the new data, we adjust the volume the ECB is forecast to absorb over the course of the year slightly downwards. Notwithstanding that, annual net supply will remain in negative territory.**

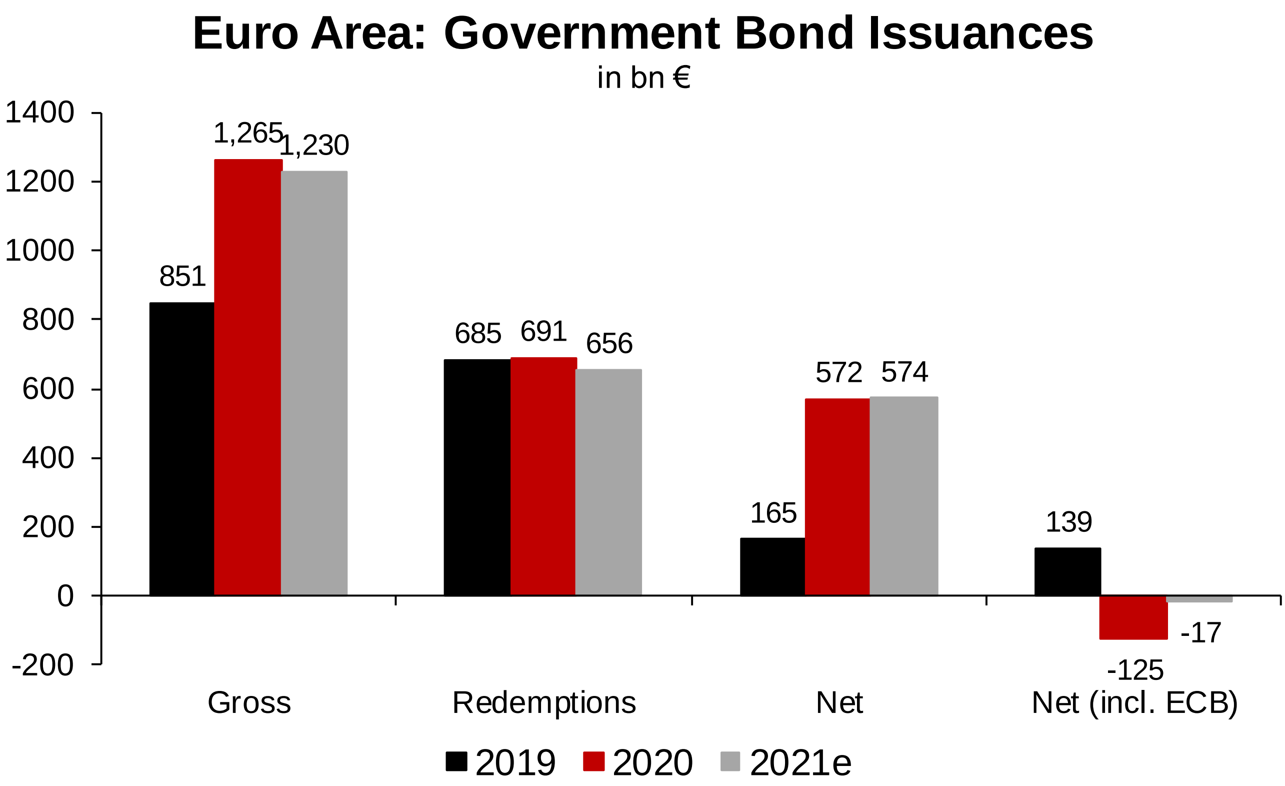
As the Covid-19 pandemic is still lingering the budget situation remains tense in 2021. According to our calculations, **euro area sovereign gross issuance will decrease only slightly compared to the last year** (€1230 bn vs. €1265 bn). After the holiday break at the end of December, treasurers started the new year with momentum. This is a usual pattern as in the first quarter of the year up to one third of the scheduled annual issuance volume is issued.



This year is no exception. If anything, primary activity has been even more pronounced than in previous years. At the end of January **treasurers have placed around €130 bn of new bonds** (more than 10% of the annual issuance). As already announced before, many treasurers have emitted particularly very long-dated bonds. **Almost 50% of the overall volume has a tenor of more than 10 year**.

This way, the countries would like to secure the very low level of interest rates for a long period of time. This has become even more important as the economic crisis and the high deficit have once again increased the debt ratios – and a lasting turn for the better is not in sight yet. Accordingly, low funding costs are of crucial importance to keep the debt situation sustainable. Then again, treasurers respond to the needs of investors. To achieve an adequate current income market participants are forced to go further out the yield curve. In light of the only moderate forecast yield increase we expect this pattern to prevail over the course of the year.

Additionally, the ECB released data about its QE programmes yesterday. According to the data, the central bank did not increase its purchases compared to the months before. Instead, in the Public Sector Purchase Programme (PSPP) the **total net change was €13.7 bn in January (versus €17.8 bn in December)**. It is important to mention that the ECB did not extend the additional envelope of €120 bn announced in March 2020. Hence, the volume is **roughly in line with the Asset Purchase Programme target of €20 bn** (including corporate and covered bonds and the ABS programme) per month. The main beneficiaries of the programme remain France and Italy. More than one third of all purchases were directed towards French OATs and close to 28% to Italian BTPs. In contrast, German Bunds experienced negative net purchases in January.



The ECB purchased also bonds under the **Pandemic Emergency Purchase Programme** (PEPP). Although the central banks releases data only every two months one can calculate using weekly purchases that the **total volume fell moderately in January compared to December** (€51 bn vs. €59 bn). In terms of geographical distribution, Germany remains the leader (27.2%) followed by France (21.0%) and Italy (17.5%).

Therewith, the volume continued its downward trend already visible in H2 2020. However, this trend is not expected to continue. Rather, we expect at least a stabilisation at this level. Moreover, the ECB has stressed several times the **flexibility of the PEPP**. Hence, if necessary, the central bank is forecast to act quickly and decisively in times of market turmoil. This includes a massive expansion of purchases.

Considering the data and the market development we **reduce the forecast annual ECB purchase volume slightly to €780 bn (from €900 bn)**. This volume would also fit with recent comments by the ECB that the PEPP may not be fully exhausted. But, it will still be enough to ensure a negative net supply in 2021. However, as the chart above shows, the support for sovereign bond markets will be somewhat lower than in 2020. This includes the possibility that some months may have a positive net supply – as January and the entire first quarter 2021.

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