



# Bond market outlook and other topics of relevance

ECB BMCG

16 May 2017

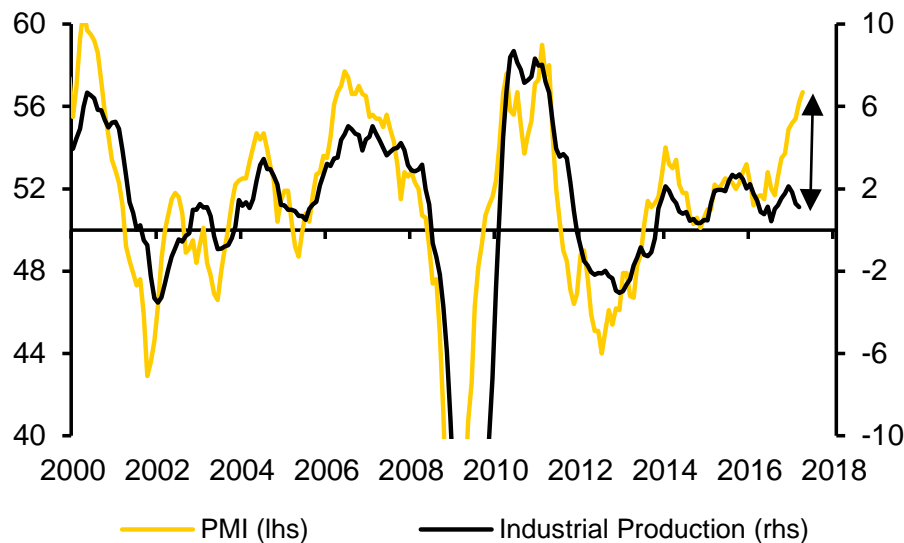
## Key themes

- › **Macro:** Positive euro area growth momentum but no signs of a sustainable increase in underlying inflation
- › **Forward Guidance:** Market questions ECB exit sequencing
- › **Asset Purchase Programme:** ECB uses in-built flexibility
- › **Sovereigns:** French politics in the driving seat, Italy about to take over
- › **Credit:** CSPP shields corporates but premium diminishes
- › **Banks:** Diverse MREL issuance picking up despite legislative delays

# Sentiment bubble or is the economy shifting gear?

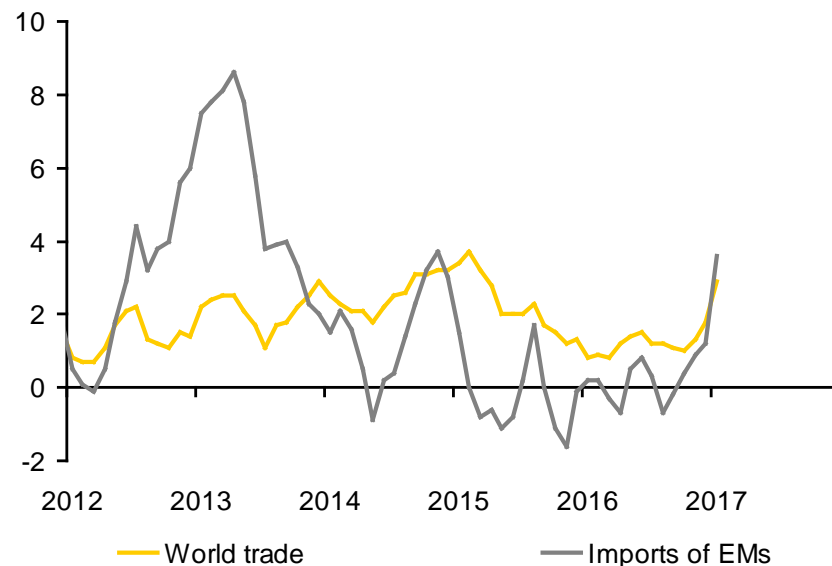
## Sentiment is driving euro area recovery...

Euro area manufacturing PMI and industrial production, yoy in %, 3m moving average



## ... as Emerging Markets recover!

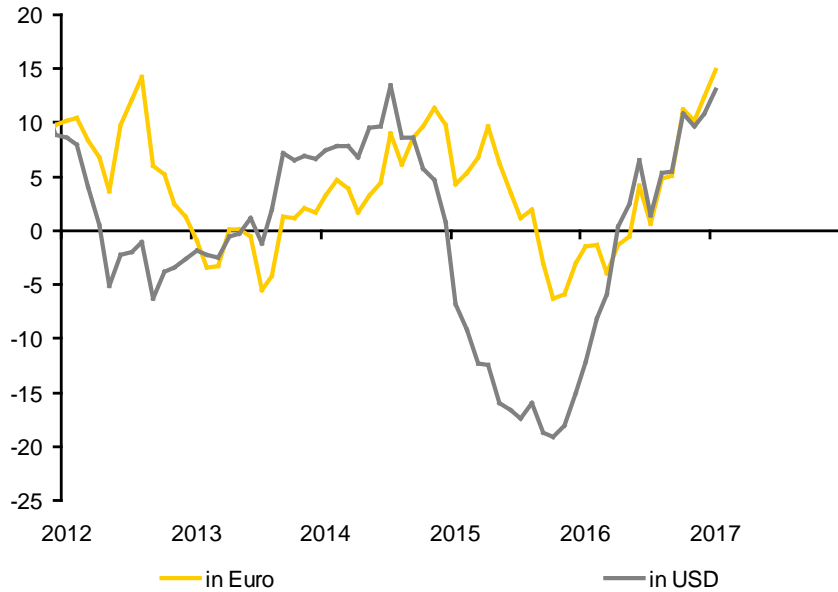
World trade and imports of the Emerging Markets, change on year in percent



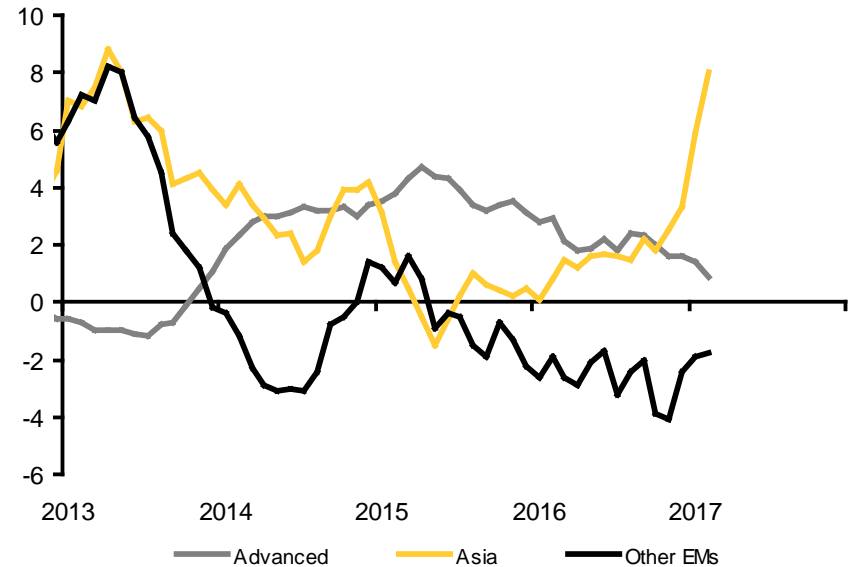
Source: Bloomberg, Eurostat, Centraal Planbureau, Commerzbank Research

# Germany enjoys tailwinds from Asia

German exports to Asia, change on year in percent



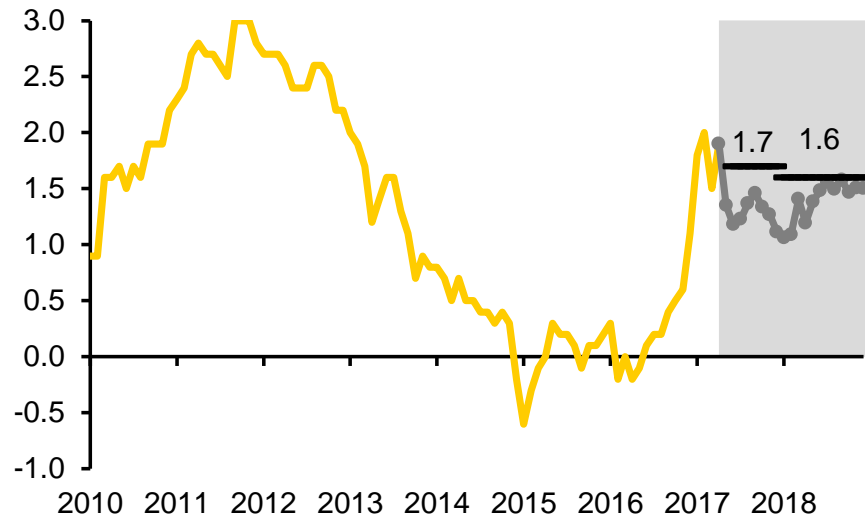
Imports, Volume, change on year in percent, 5-months-average



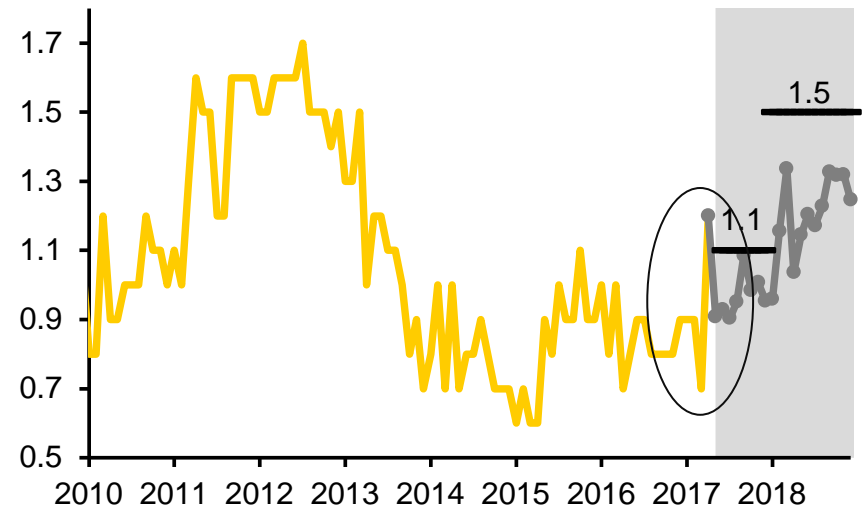
Source: Destatis, Commerzbank Research

# Headline inflation is past its peak

**Headline** HICP and ECB projection (black line) and Commerzbank forecast (grey), in %



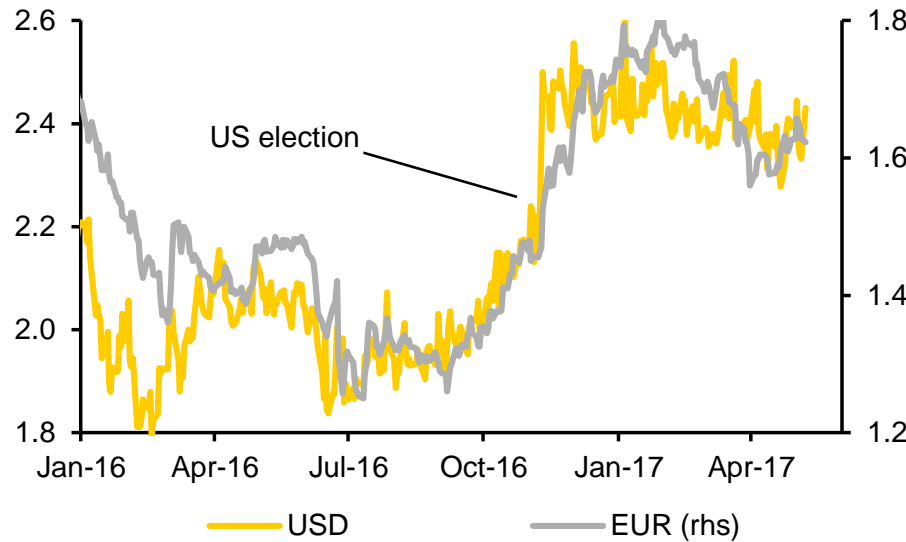
**Core** HICP and ECB projection (black line) and Commerzbank forecast (grey), in %



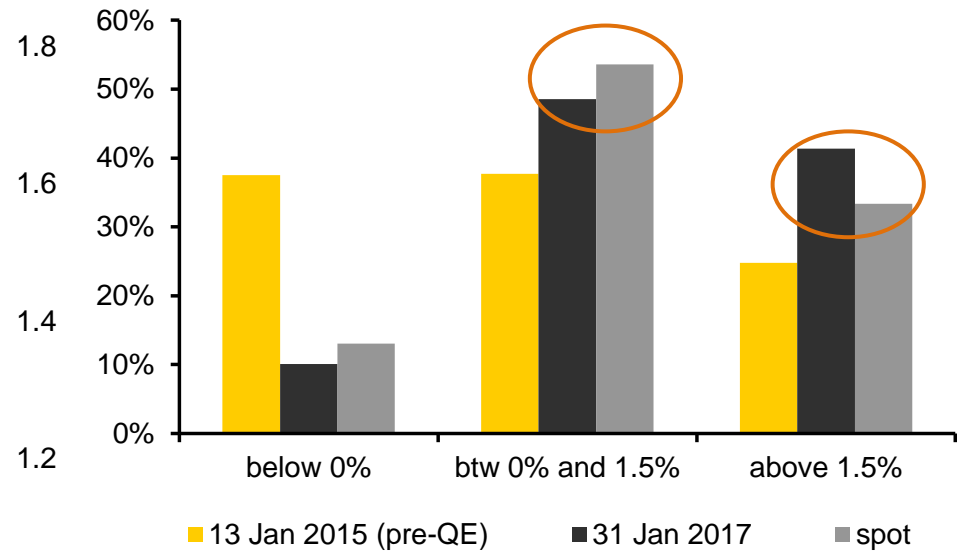
Source: ECB, Bloomberg, Commerzbank Research

# Trumpflation is running out

5y5y inflation expectations from ILS, in %



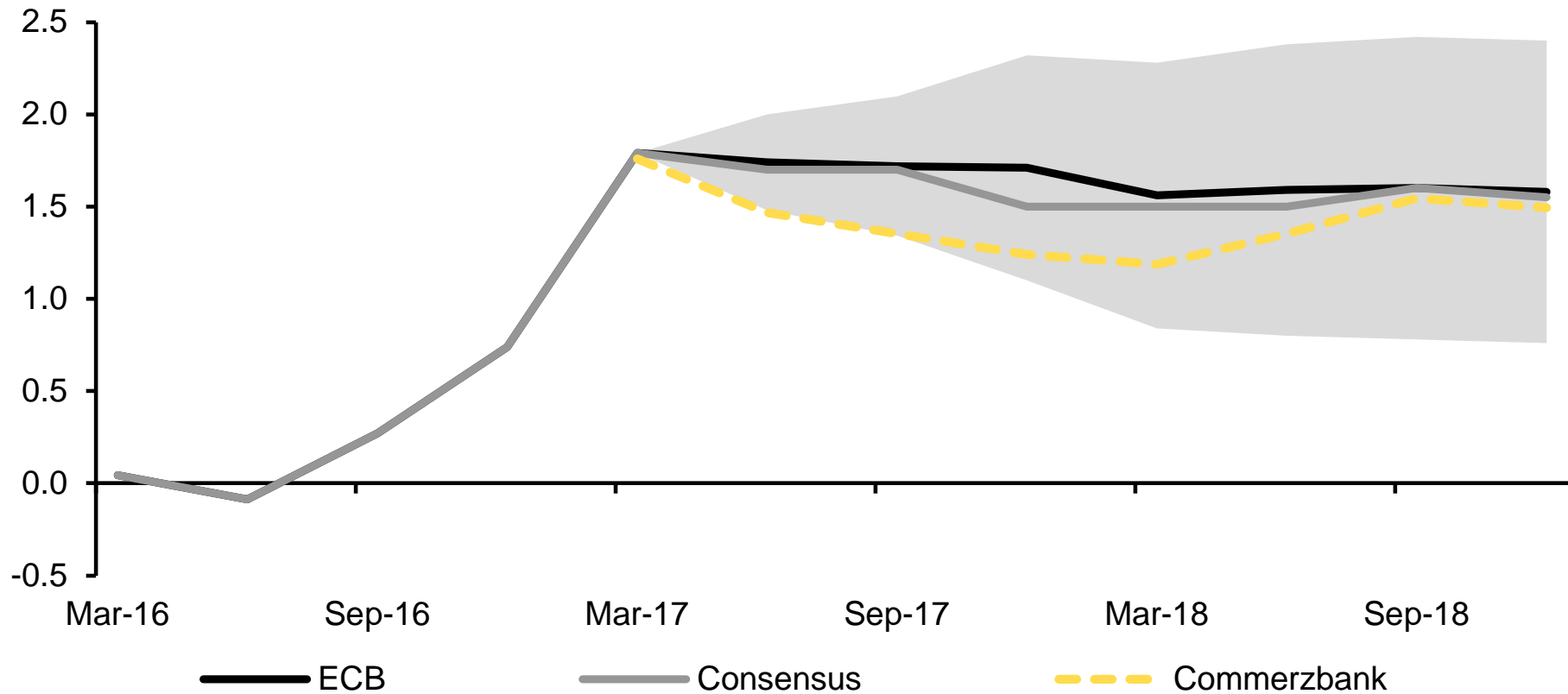
Option implied inflation expectations, from 5y HICPx Caps/Floors



Source: Bloomberg, Commerzbank Research

# ECB projections unlikely to be beaten during remainder of this year

HICP: Commerzbank forecast, ECB projection (incl confidence bands), consensus, in %



Source: ECB, Bloomberg, Consensus Economics, Commerzbank Research

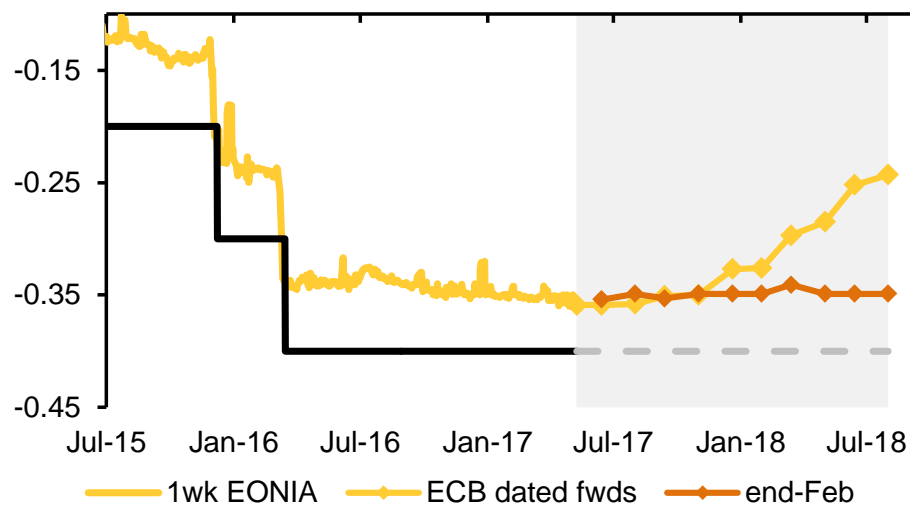
# Rates: Money markets starting to question ECB forward guidance

## ECB forward guidance:

*“We continue to expect them (interest rates) to remain at present or lower levels for an extended period of time, and well past the horizon of our net asset purchases.”*

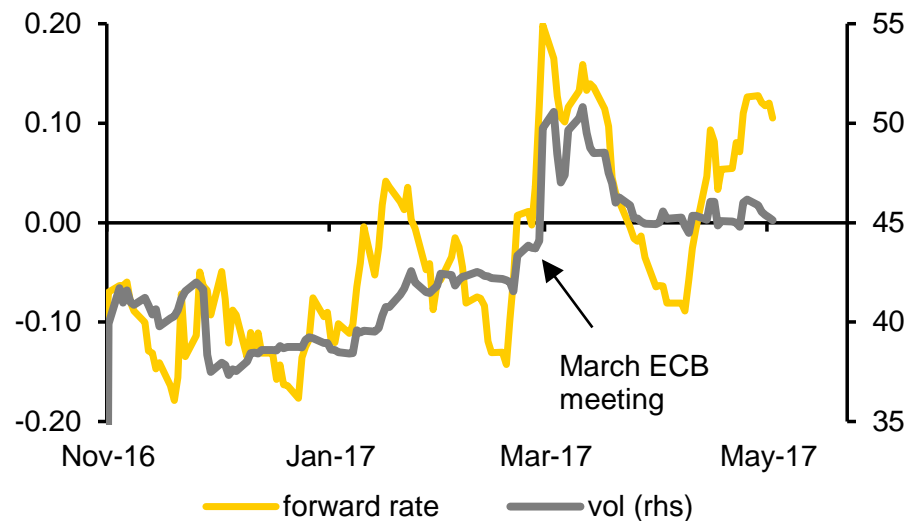
### Rate hike speculation from spring 2018

One week EONIA swap and ECB dated EONIA forwards, in %



### Data and ECB uncertainty on the rise

2y2y EONIA, in %, and normalised swaption vol, in bp



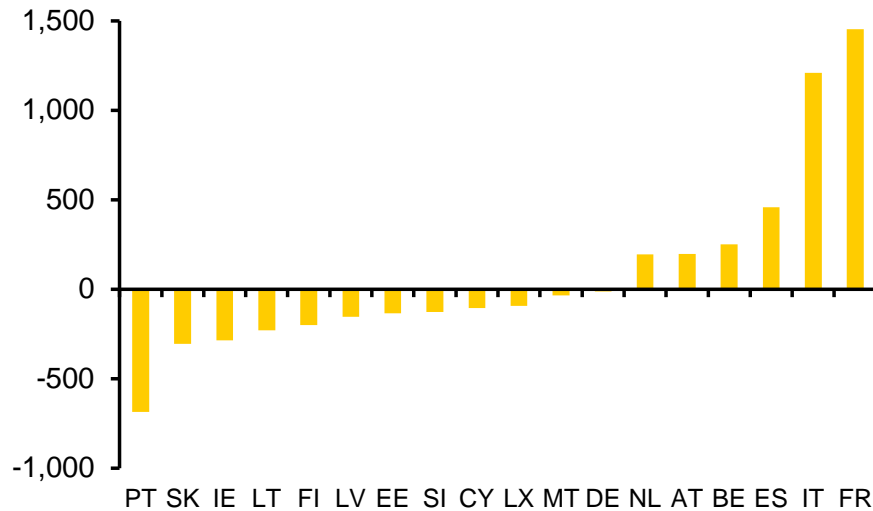
Source: Bloomberg, ECB, Commerzbank Research



# Programme looking increasingly stretched

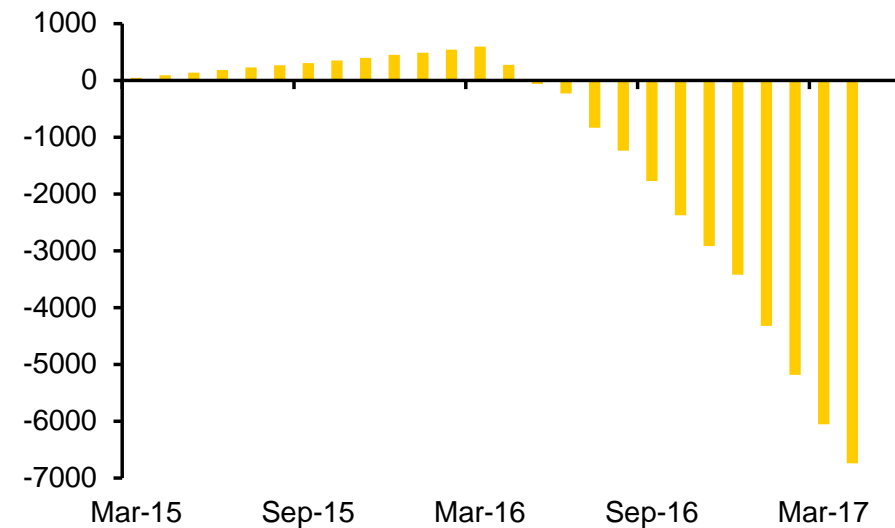
## ECB not meeting the capital key in 13 of the 19 euro area sovereigns

April buying vs. capital key target, in €mn



## Portugal: BoP is now 'short' almost €6bn

Cumulative excess PSPP purchases vs. capital key, in €mn

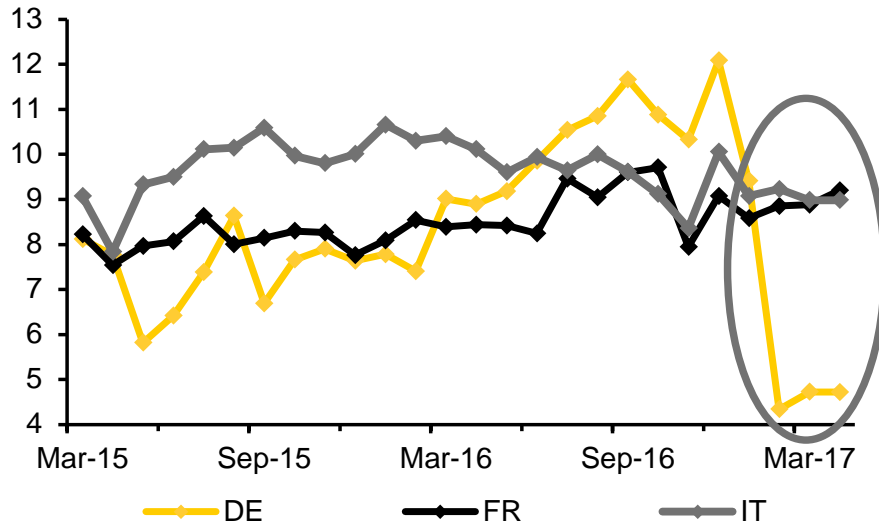


Source: Bloomberg, Commerzbank Research

# Testing the limits

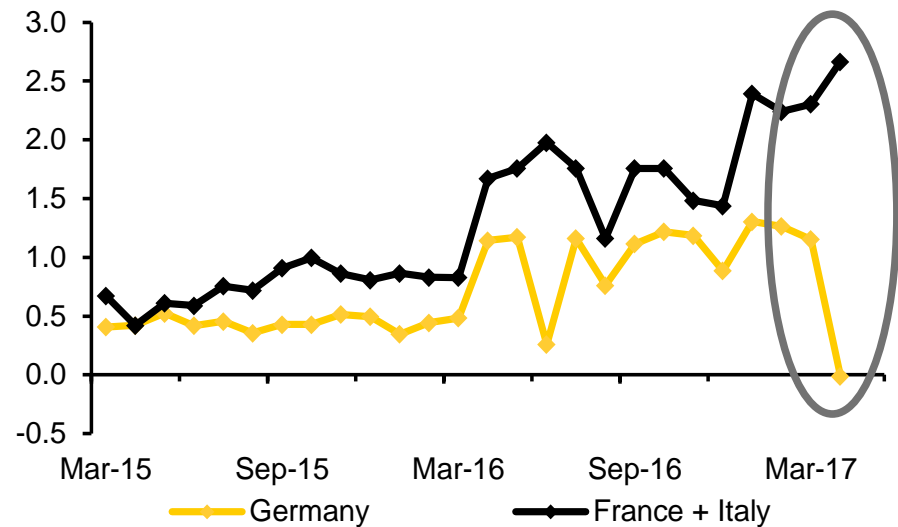
## Bundesbank taking advantage of new parameters

Weighted average maturity of PSPP buying, in years



## ECB maxing out in-built flexibility

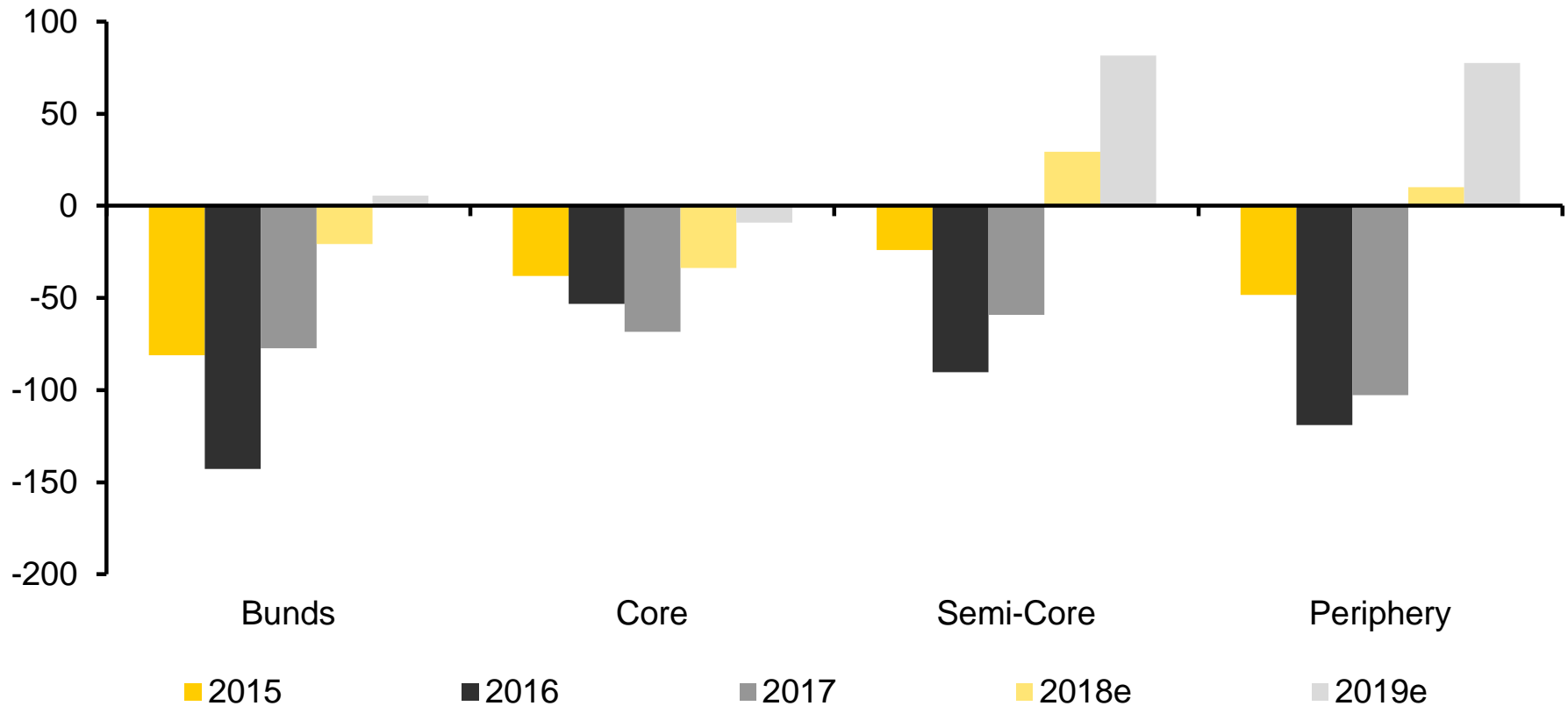
Deviation in PSPP purchases from the target implied by the ECB capital key, in €bn



Source: ECB, Commerzbank Research

## QE exit could become most challenging for periphery

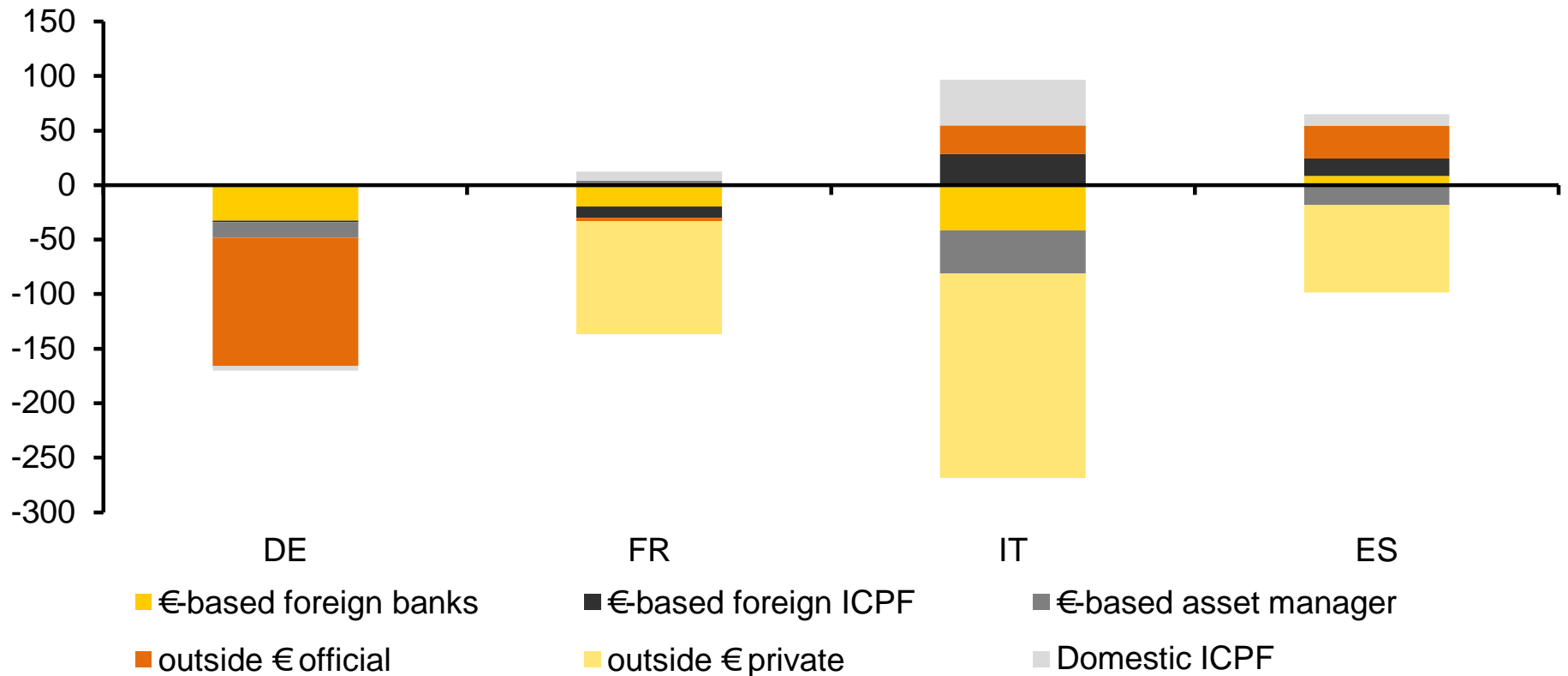
QE-adjusted net supply (issuance - redemptions & PSPP purchases), including CBK forecast\*, in €bn



\* Assumes €5bn tapering per month starting in Jan18  
 Source: Bloomberg, ECB, Commerzbank Research

# Who will fill the PSPP gap?

Net sovereign bond purchases\* since the start of €QE by investor type, in €bn as of end-Q4 2016

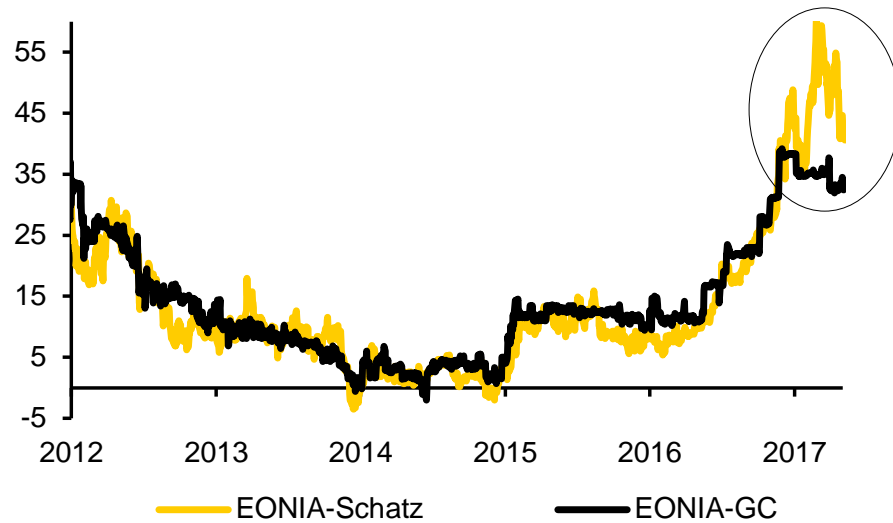


Source: ECB, Eurostat, IMF, EIOPA, Commerzbank Research, \*) general government bonds with 1y+ original maturity

# Supply/demand imbalances driving short-end Bund valuations

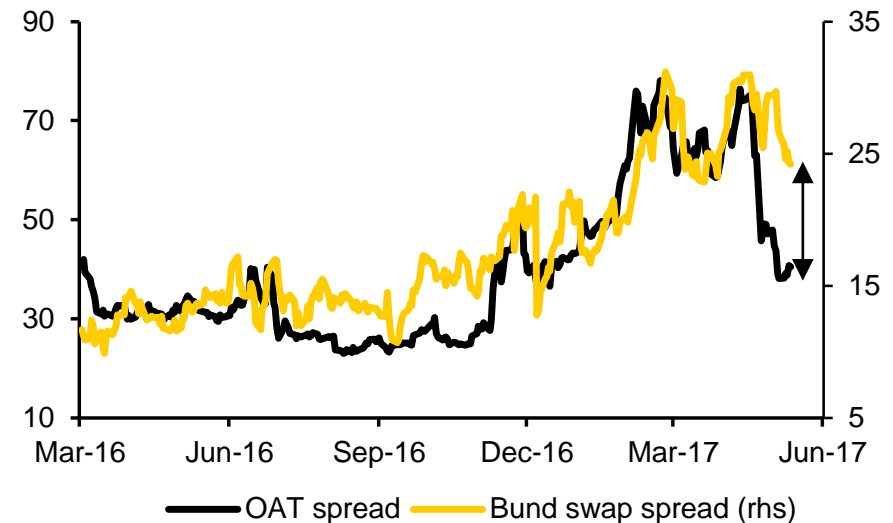
**Cash buying has taken over from GC squeeze as driver of asset swap spreads!**

Generic 2y EONIA-Schatz and 3m EONIA-GC spread in bp



**Bund premium stays elevated after French election**

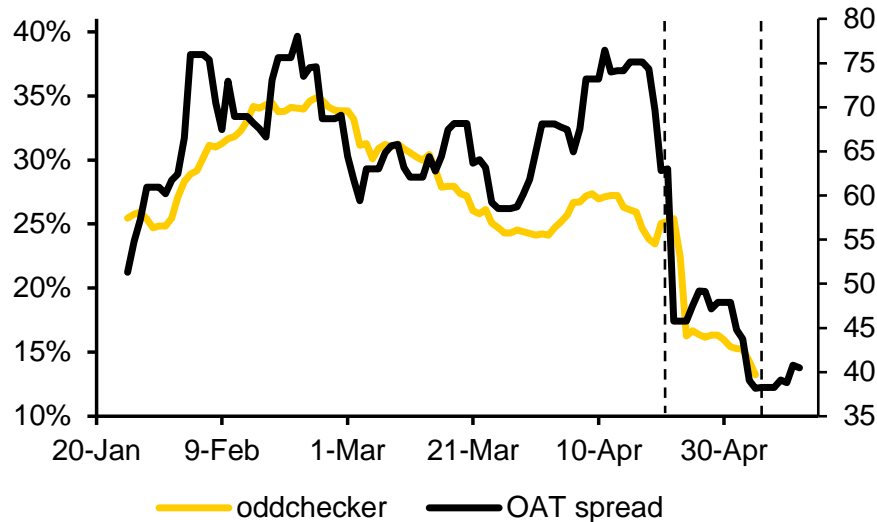
Bund-EONIA spread (vs generic 1<sup>st</sup> future) and 10y OAT-Bund spread (asset swap spread difference of on-the-run benchmarks), in bp



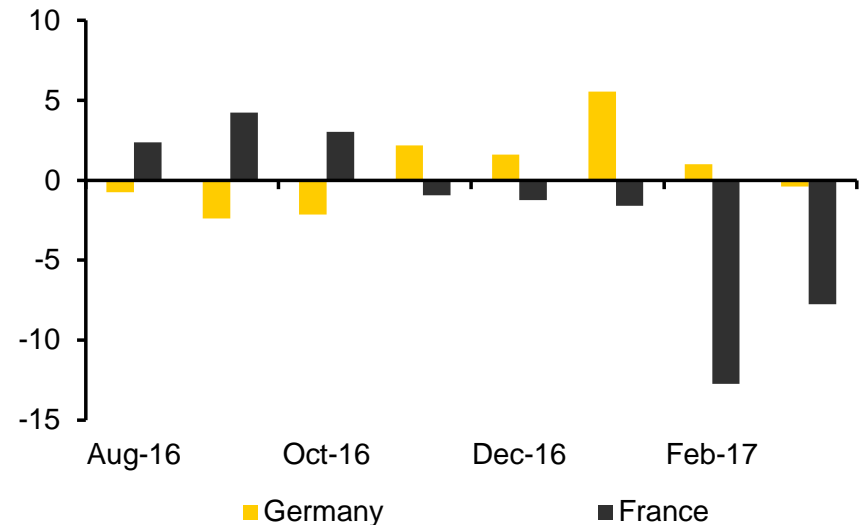
Source: Bloomberg, Commerzbank Research

# French flows driving spreads

Oddchecker probability for Le Pen election win and 10y OAT-Bund spread (Nov26 ASW, rhs), in bp. Dotted lines denote 1<sup>st</sup> and 2<sup>nd</sup> round of presidential election



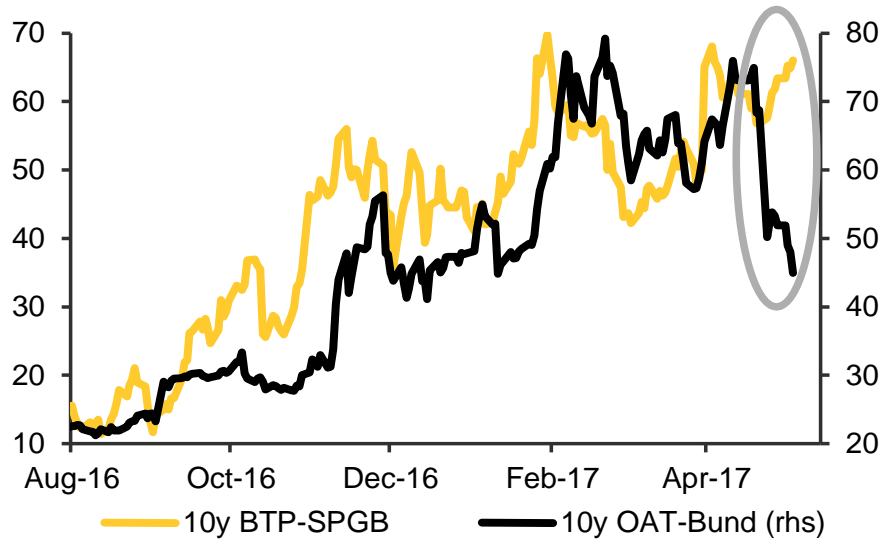
Net sovereign bond purchases by Japanese investors, in € bn



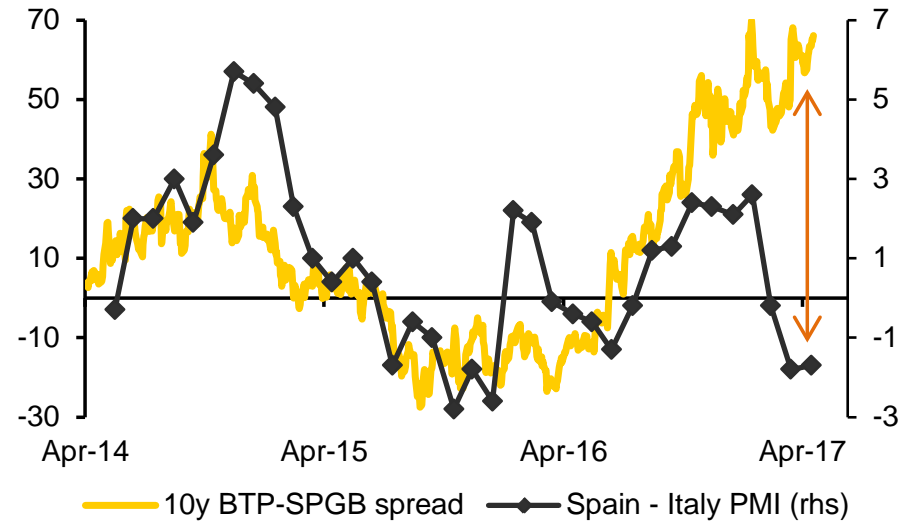
Source: Japan MoF, Commerzbank Research

# Italian domestic political issues taking over for BTP spreads

10y BTP-SPGB and OAT-Bund spread, in bp



10y BTP-SPGB spread in bp and Spain vs Italy PMI differential in points

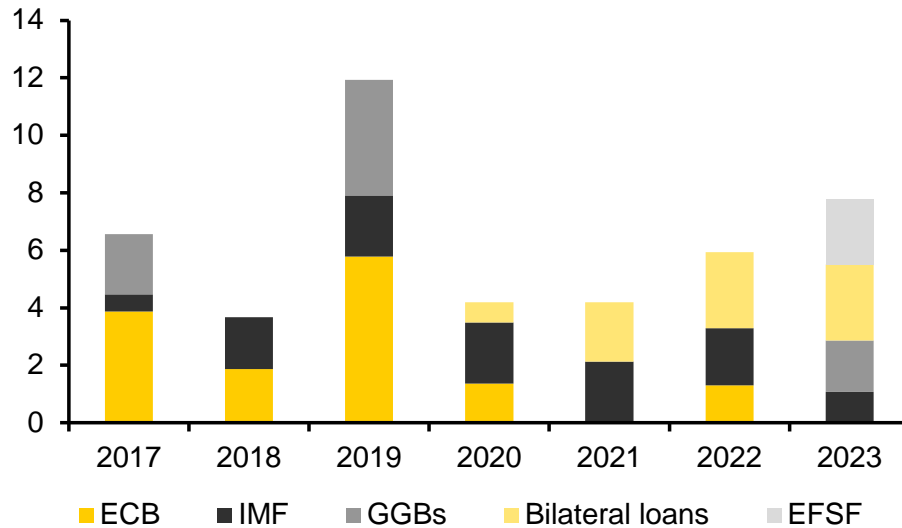


Source: Bloomberg, Commerzbank Research

# Greece outperforms on hopes for debt relief and ECB buying, Portugal outperforms on fundamentals \*

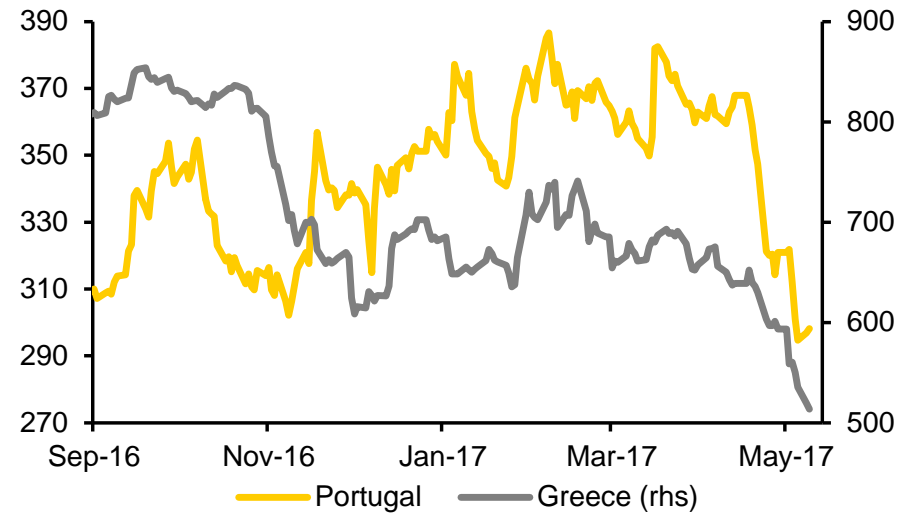
## Coming tranches to clear the table until hump in 2019 maturities

Loans to Greece falling due in coming years, in €bn



## GGBs perform because of ECB, PGBs despite ECB!

10y PGB and GGB spread over Bunds, in bp



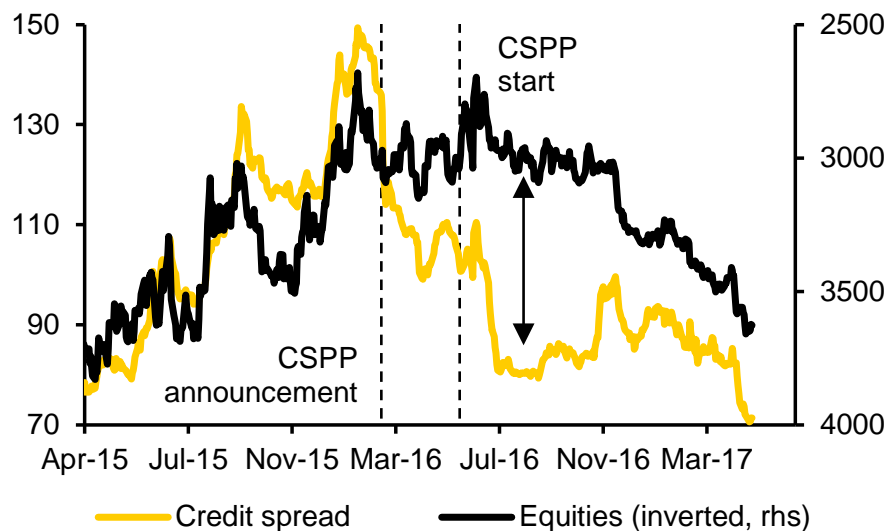
\*see *Ahead of the Curve*, 11 May for details

Source: Bloomberg, Commerzbank Research

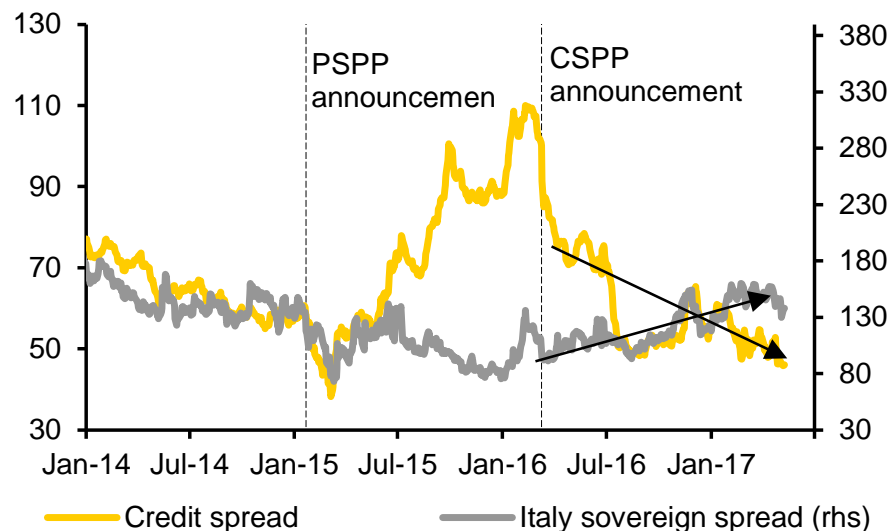


# Credit squeezing tighter...

**Risk-on, positive data/earnings, ECB buying and lack of supply are all squeezing Credit**  
 iBoxx € non-financials asset swap spread, in bp, and Euro Stoxx 50 Index



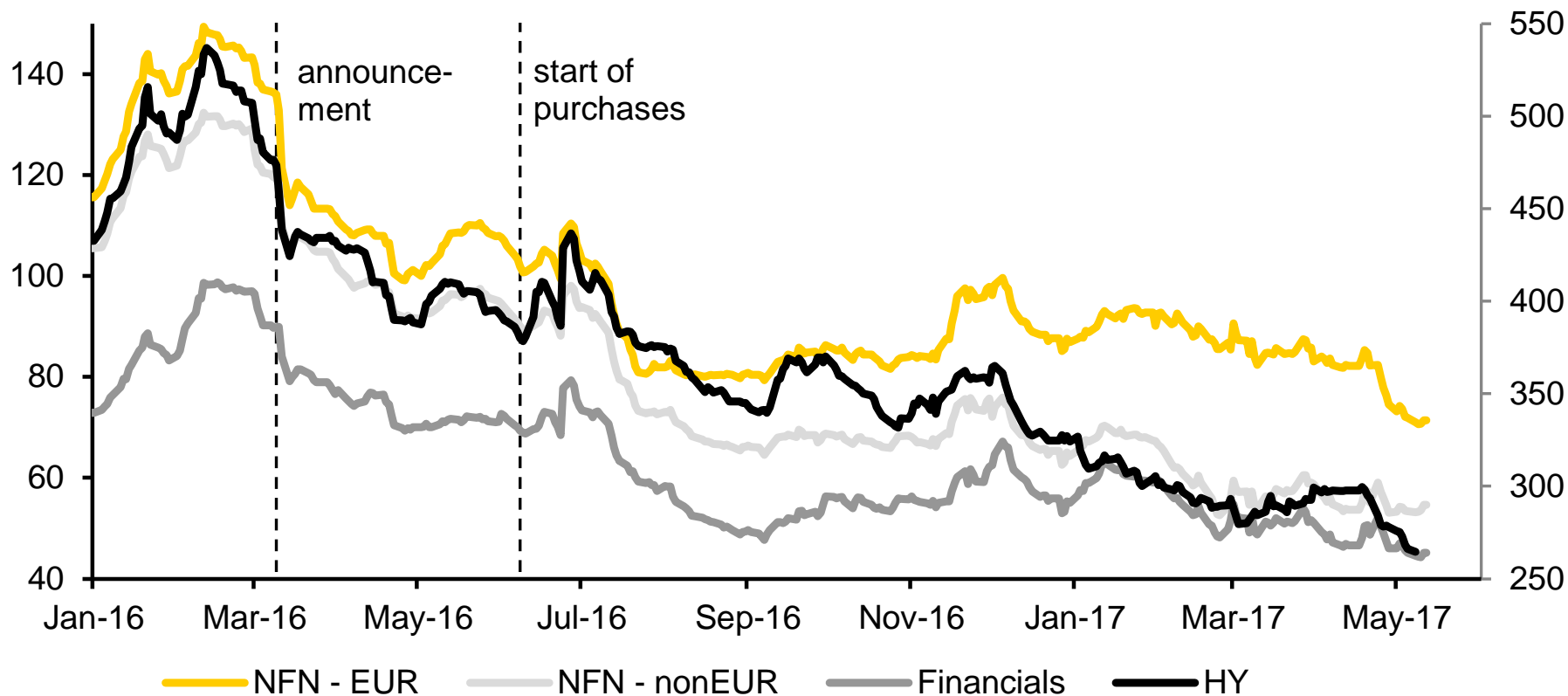
**Protective ECB shield is more effective in Credit**  
 iBoxx € non-financial seniors and Italy sovereign index asset swap spreads, in bp



Source: Markit, Bloomberg, Commerzbank Research

## ... with CSPP lifting all boats!

iBoxx asset swap spreads, in bp



Source: Markit, Bloomberg, Commerzbank Research

## Banks: NPS issuance volumes picking up

---

- French banks expected political volatility in Q1 17 and planned for a flexible issuance process. Post-election, more issuance likely. French banks issuance:  
**BNP** plans for €10bn p.a. NPS in 2017-19, had issued €4.6bn by mid-March.  
**SocGen** plans to issue €15bn by end-2018. Issuance principally structured to meet TLAC term sheet.  
**Credit Agricole** already meets 2019 requirements but plans to issue more NPS to protect other senior.  
**BPCE** plans up to €3.5bn of NPS p.a.
  - UniCredit plans €13.5bn of NPS by 2019, Santander €28-35bn (split between entities).
  - Banks in Germany, UK and France are already en-route to compliance and have an established investor base for their NPS/HoldCo product. Non-G-SIBs, especially in other countries are challenged by the lack of legislative clarity on requirements and timescale and so are likely to concentrate on Tier 2 and “normal” senior for now.
  - NPS adds to cost of funding, driving margin pressure and at the limit may slow balance sheet growth. No current sign of constraints to investible funds, especially with low rates and spreads. However, should this happen, e.g. following a bank failure, refinancing costs could rise significantly across the funding curve if fixed supply requirements meet very elastic demand.
-

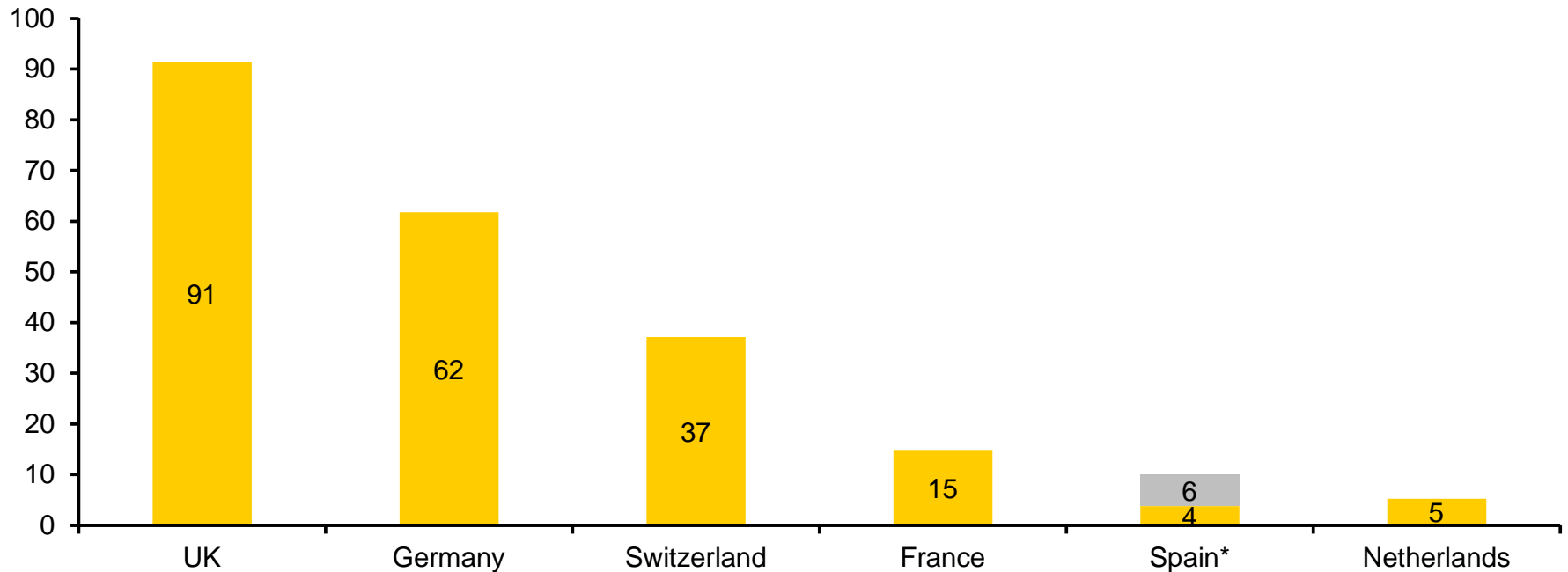
## MREL & French NPS: TLAC more important for now

---

- MREL legislative delays are affecting issuance dynamics of senior and Tier 2 across Europe. G-SIBs reacting more as TLAC perceived to be the proximate constraint.
  - Legislative and structural frameworks for issuance of bail-inable senior only clear in France, Germany, Switzerland and the UK. Banks in other countries, apart from Spain, continue to issue Tier 2 or existing senior. From 'other country' G-SIBs, Santander has issued an "as and when" bond, ING has used its HoldCo, Nordea total capital ratio is 24%, UniCredit is only just post-rights issue but needs to issue.
  - France has 4 G-SIBs so TLAC pressure drove legislative change and recent issuance.
  - Commission package on CRR/CRD/BRRD updates and any subsequent Parliament changes raise risks that existing issuance doesn't meet final requirements, hence non-G-SIBs more cautious.
  - European Parliament currently refusing to fast-track NPS legislation: unclear if this is political bargaining or more fundamental. Delay means timeline of 2019 implementation increasingly difficult to meet.
  - Non-G-SIBs likely to continue to delay NPS issuance as it is expensive compared with preferred senior especially if there is no regulatory benefit in near term until regulatory requirements are finally defined.
-

## Estimated outstanding bail-inable debt

### Outstanding NPS / holdco debt / statutorily subordinated senior for selected EU banks by country (€bn)



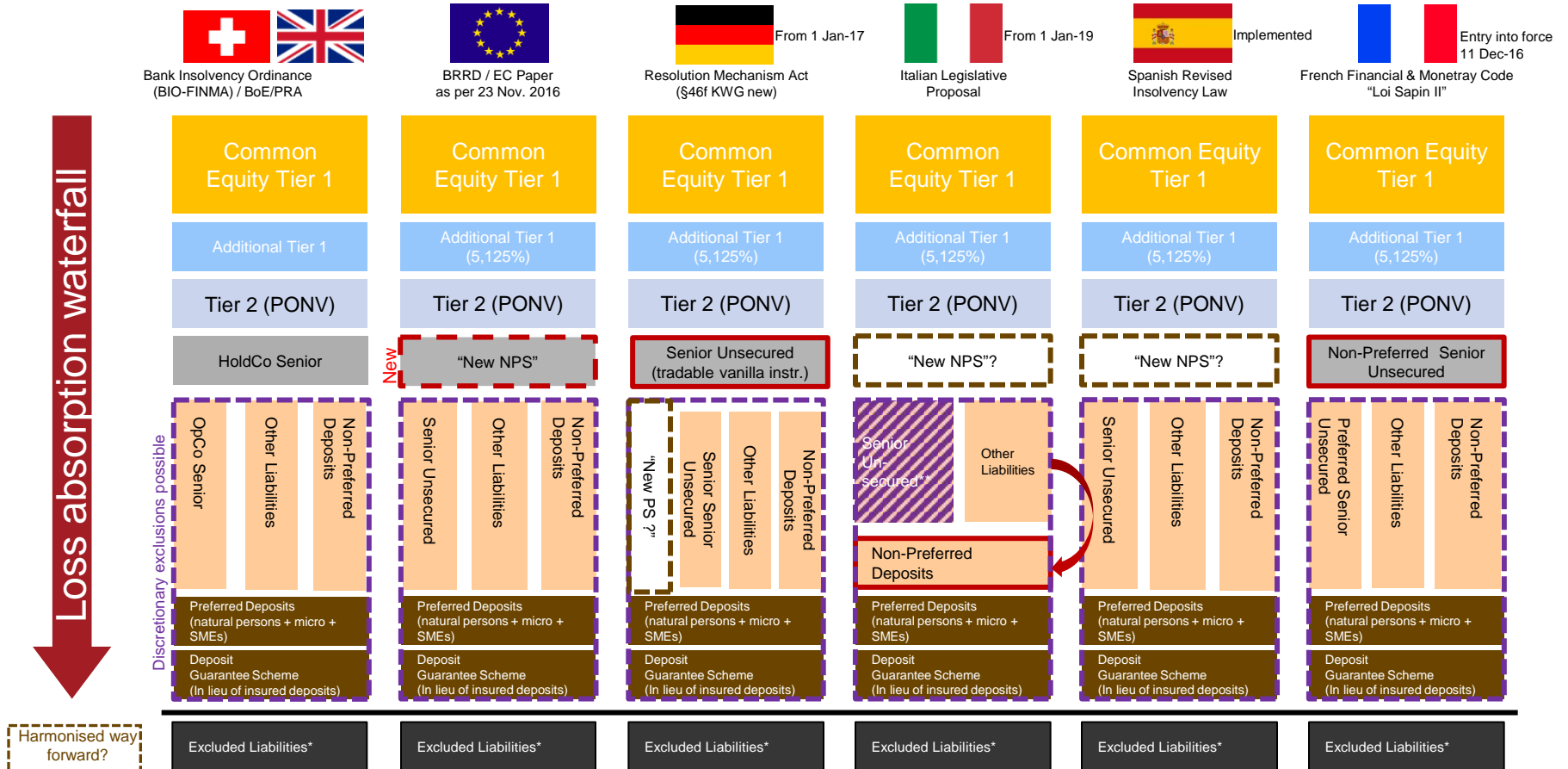
Source: Bloomberg, company data, Commerzbank Research

\* €6bn issued by Santander UK Group Holdings

Sample of banks: ACAFP, BNP, BPCE, SOCGEN, SANTAN, BACR, HSBC, LLOYDS, RBS, STANLN, INTNED, DB, CS, UBS

# Overview of Creditors Hierarchies in the EU

Harmonised national insolvency of unsecured debt instruments on its way, i.e. new NPS layer



Source: CBK \* Sec. Obligations as well as Retail & SME Deposits <100k under DGS \*\* TLAC-eligible as long as TLAC-excl. liabilities ranking pari-passu with SU debt comprise <5% of total TLAC-eligible liabilities

In accordance with ESMA MAR requirements this report was completed 14 May 2017 at 15:17 CEST and disseminated 14 May 2017 at 15:17 CEST.

In respect to Article 4 of ESMA MAR, for an overview of recommendations made in the previous 12 months on any instrument or issuer covered in this report as well as an overview of all recommendations made by the producer(s) of this report in the previous 12 months, please follow this link: <https://research.commerzbank.com/RecommendationHistoryCredit>

This document has been created and published by the Research division within the Corporate Clients segment of Commerzbank AG, Frankfurt/Main or Commerzbank's branch offices mentioned in the document.

**If this report includes an analysis of one or more equity securities, please note that the author(s) certify that (a) the views expressed in this report accurately reflect their personal views; and (b) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document. The research analyst(s) named on this report are not registered / qualified as research analysts with FINRA. Such research analyst(s) may not be associated persons of Commerz Markets LLC and therefore may not be subject to FINRA Rule 2241 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account.**

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

#### Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document\*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts:

<https://research.commerzbank.com/web/commerzbank-research-portal/public-page/disclosures>

*\*Updating this information may take up to ten days after month end.*

#### › Recommendation Key

##### › I) Recommendations versus benchmarks:

- › Overweight (OW)                      We expect outperformance versus the benchmark in spread and/or total return terms
- › Marketweight (MW)                  We expect performance in line with the benchmark in spread and/or total return terms
- › Underweight (UW)                   We expect underperformance versus the benchmark in spread and/or total return terms
- › **Benchmark:**                        Unless stated otherwise, the benchmark is the iBoxx € Corporate for IG-rated names/instruments, and the iBoxx € High Yield core cum crossover LC for HY-rated names/instruments

##### › II) Outright recommendations:

- › Buy                                        We suggest entering / expanding positions in the relevant names/instruments
- › Sell                                        We suggest reducing / closing positions in the relevant names/instruments
- › **Time Horizon:**                      Unless stated otherwise, the time horizon for our recommendations is three months.

##### › Risks related to these recommendations

- › A variety of factors and events may adversely affect the performance of any recommendation, and in case of investment in bonds can also lead to the non-payment of coupons as well as principal losses.
- › These risk factors include general macroeconomic and political conditions, central bank action, or any other factor directly affecting overall risk sentiment.
- › In addition, industry or sector specific legal frameworks and regulation, as well as rating or rating methodology changes and any other factors directly or indirectly influencing the credit quality, the operating and/or refinancing environment of the specific issuer may also affect performance.

## Distribution of Commerzbank AG credit research recommendations as of 31 December 2016\*

	All covered instruments	The proportion of issuers in each of these categories for which Commerzbank provides investment banking services
Overweight	33%	21%
Marketweight	37%	43%
Underweight	30%	28%

Source: Commerzbank Research

## Distribution of Commerzbank AG credit research recommendations as of 31 December 2016\*

	All covered instruments	The proportion of issuers in each of these categories for which Commerzbank provides investment banking services
Long/Buy	48%	4%
Neutral	43%	4%
Short/Sell	9%	0%

Source: Commerzbank Research

### Disclaimer

This document is for information purposes only and does not take into account specific circumstances of any recipient. The information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions.



By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

## Additional notes to readers in the following countries:

**Germany:** Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

**United Kingdom:** This document has been issued or approved for issue in the United Kingdom by Commerzbank AG London Branch. Commerzbank AG, London Branch is authorised by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), and the European Central Bank and is subject to limited regulation by the Financial Conduct Authority and Prudential Regulation Authority. Details on the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request. This document is directed exclusively to eligible counterparties and professional clients. It is not directed to retail clients. No persons other than an eligible counterparty or a professional client should read or rely on any information in this document. Commerzbank AG, London Branch does not deal for or advise or otherwise offer any investment services to retail clients.

**United States:** This document has been approved for distribution in the US under applicable US law by Commerz Markets LLC ("Commerz Markets"), a wholly owned subsidiary of Commerzbank AG and a US registered broker-dealer. Any securities transaction by US persons must be effected with Commerz Markets, and transaction in swaps with Commerzbank AG. Under applicable US law; information regarding clients of Commerz Markets may be distributed to other companies within the Commerzbank group. This research report is intended for distribution in the United States solely to "institutional investors" and "major U.S. institutional investors," as defined in Rule 15a-6 under the Securities Exchange Act of 1934. Commerz Markets is a member of FINRA and SIPC. Commerzbank AG is a provisionally registered swap dealer with the CFTC.

**Canada:** The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerz Markets LLC deals pursuant to the international dealer exemption. To the extent that the information contained herein references securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, any trades in such securities may not be conducted through Commerz Markets LLC. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

**European Economic Area:** Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA.

**Singapore:** This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor as defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore ("SFA") pursuant to section 274 of the SFA.

**Hong Kong:** This document is furnished in Hong Kong by Commerzbank AG, Hong Kong Branch, and may only be received in Hong Kong by 'professional investors' within the meaning of Schedule 1 of the Securities and Futures Ordinance (Cap.571) of Hong Kong and any rules made there under.

**Japan:** This research report and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA). This document may be distributed in Japan solely to "professional investors" as defined in Section 2(31) of the FIEA and Section 23 of the Cabinet Ordinance Regarding Definition of Section 2 of the FIEA by Commerzbank AG, Tokyo Branch. Note, however, that Commerzbank AG, Tokyo Branch has not participated in its preparation. Not all financial or other instruments referred to in this document are available within Japan. Please contact Commerzbank AG, Tokyo Branch for inquiries on the availability of such instruments. [Commerzbank AG, Tokyo Branch] Registered Financial Institution: Director of Kanto Local Finance Bureau (Tokin) No. 641 / Member Association: Japanese Bankers Association.

**Australia:** Commerzbank AG does not hold an Australian financial services licence. This document is being distributed in Australia to wholesale customers pursuant to an Australian financial services licence exemption for Commerzbank AG under Class Order 04/1313. Commerzbank AG is regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) under the laws of Germany which differ from Australian laws.

© Commerzbank AG 2017. All rights reserved. Version 9.26

## Commerzbank Corporate Clients

### Frankfurt

Commerzbank AG  
DLZ - Gebäude 2, Händlerhaus  
Mainzer Landstraße 153  
60327 Frankfurt

Tel: + 49 69 136 21200

### London

Commerzbank AG  
PO BOX 52715  
30 Gresham Street  
London, EC2P 2XY

Tel: + 44 207 623 8000

### New York

Commerz Markets LLC  
225 Liberty Street, 32nd floor,  
New York,  
NY 10281-1050

Tel: + 1 212 703 4000

### Singapore

Commerzbank AG  
71, Robinson Road, #12-01  
Singapore 068895

Tel: +65 631 10000

### Hong Kong

Commerzbank AG  
15th Floor, Lee Garden One  
33 Hysan Avenue,  
Causeway Bay  
Hong Kong  
Tel: +852 3988 0988