

ECB BMCG – BOND MARKET DEVELOPMENTS

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BNP Paribas
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BNP PARIBAS

The bank for a changing world

EGBs Rates dynamics since September

Core/semi-core: Tight range but bias on lower yields

- **Late August to early September:** Bund sold off before the September EGB supply to -40bp but the move was short lived
- **September & October:** Rising speculations of a PEPP increase fuel fears of a bund scarcity + risk off on equities leads to a short squeeze on Bunds.
- **Vaccine news:** leading to a 20bp bund sell-off in a few days and a curve steepening but the move reversed again to reach new lows early December.

Risk on/risk off: three periods

- **Early September to mid-October:** although new covid-19 cases rise back in Europe (Spain and France), markets remain confident on an extension of the PEPP and spreads tighten: 35bp on 10y Italy vs Germany.
- **Mid-October to early November:** a few European countries announce lockdown which creates a panic selling on European equities and a risk off rally on bunds. 10y Italy cheapens back by almost 20bp.
- **Since early November:** S&P changes its rating outlook of Italy to stable and C. Lagarde has been seen as very dovish at the ECB meeting. Positive outcome of the US elections. Investors return into peripherals with the 10y BTP/bund tightening by 25bp.

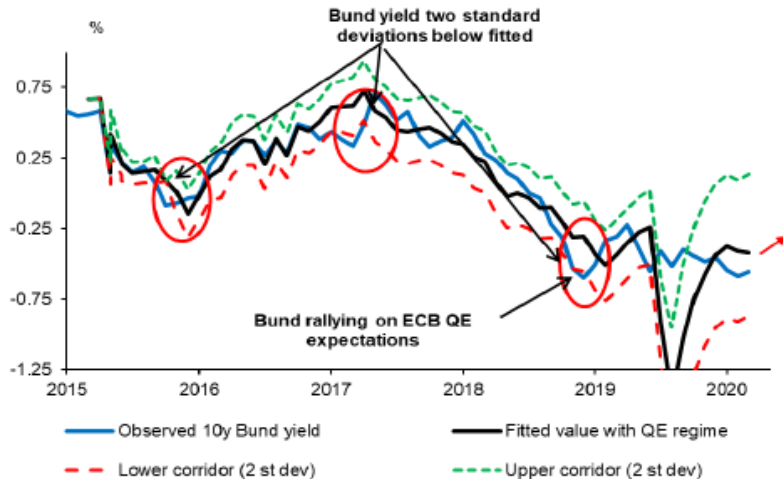
Lessons learnt?

- **Market expects CBs to maintain very accommodative monetary policies and well absorbs the increasing supply in general and the new comer EU in particular**
 - **Market pays less attention to fundamentals since the vaccine news as they are seen as less informative and backward looking**
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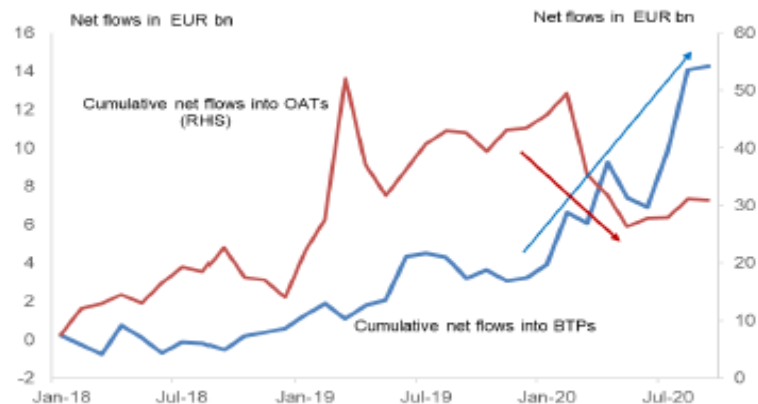
10Y Bund still expensive & flows have supported Peripherals in 2020

10y Bund yield was up to 20bp below its intrinsic value



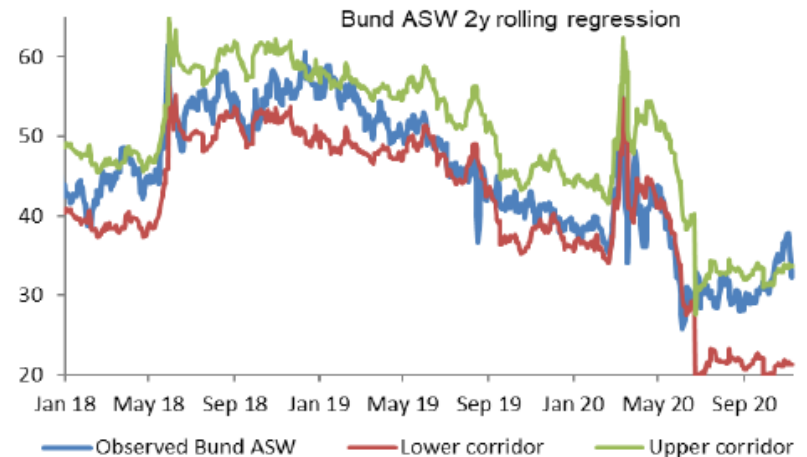
Source: BNP Paribas

Are BTPs the new OATs for Japanese investors?



Sources: Bloomberg, BNP Paribas

10y Bund still too rich versus swap



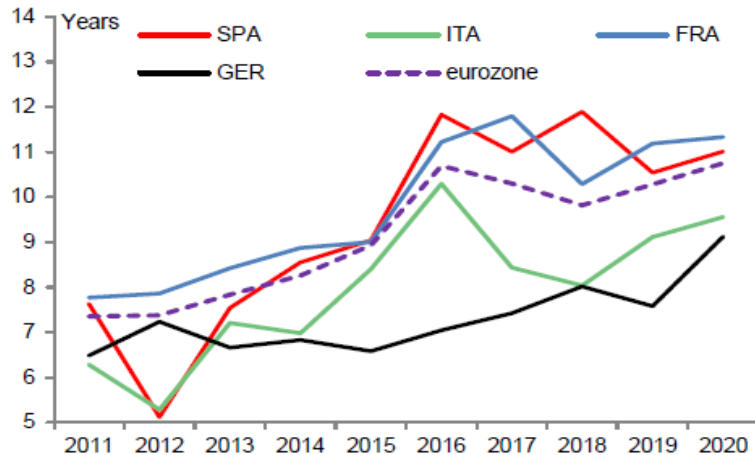
Source: BNP Paribas

- 10y Bund yield intrinsic value rose back from Q1 record lows (-0.67% in June & -0.44% in November) with the rise of the leading indicator. 10y yield was 20bp below its fair value before the vaccine announcement, it is now 11bp below.
- 10y Bund remains too rich versus swap.
- Noticeable change in Japanese investors behaviour in 2020, who have switched from OAT & Bund to BTP since March with a review interest for UST.



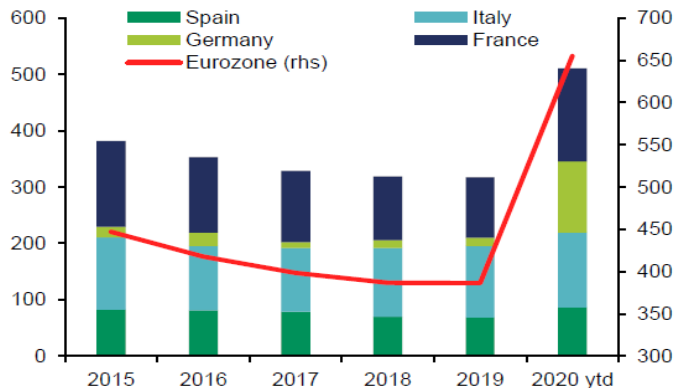
EGB scarcity, 2021: limited decline in supply, bigger QE purchases

Fig. 4: Weighted average maturity at issuance



Sources: National treasuries, BNP Paribas

Fig. 3: T-bills outstanding on the rise (EURbn)



Sources Bloomberg, BNP Paribas

Fig. 5: 2020 vs 2019 use of syndications

Syndications	2020 (EURbn)	% YTD issuance	2019 (EURbn)	% total issuance
Austria	15	39%	10	50%
Belgium	19	41%	11	37%
Finland	9	71%	6	67%
France	15	6%	7	3%
Germany	20	9%	0	0%
Greece	12	100%	9	100%
Ireland	16	67%	10	69%
Italy	64	19%	27	11%
Netherlands	0	0%	0	0%
Portugal	13	51%	4	29%
Spain	52	29%	21	18%
2020 Total	235	20%	105	12%

Sources: National treasuries, BNP Paribas

2021 EGBs supply: a replay of 2020 ?

- Record use of syndications, 25% of total issuance in 2020 versus 15 % in 2019.
- Extension into longer maturities. The weighted average maturity at issuance rose by 6 months in 2020.
- But less reliance on the money market in 2021.



Points for Discussion

- **Covid-19 crisis has resulted in higher debts across the world.**
 - Will the market be able to absorb a new shock in supply?
 - How long the current policy mix (fiscal stimulus combined with accommodative monetary policy) can last.
 - How temporary extraordinary measures can be and how getting out?
- **What is policy makers leeway in case of a 3rd wave /lockdown and/or if the vaccine takes more time than expected to be efficient?**
- **There is a large consensus for the reflation trade.**
 - How big is the risk of the large rebound in inflation.
- **UST are turning much more attractive than Bunds or OAT for Japanese investors once hedged into Yen**
 - What impact for EGBs and spreads?
- **How much competition EU represents for core sovereign issuers?**

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