Covered Bond & SSA View

NORD/LB Markets Strategy & Floor Research

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Marketing communication (see disclaimer on the last pages)

Agenda

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Market overview Covered Bonds

Author: Dr Frederik Kunze

Primary market: weak end to the year

Just a few trading weeks ago, we more or less decided to stick with our issuance forecast for the covered bond segment at a total volume of EUR 202.00bn. The recently observed phase of uncertainty on the international capital markets has also impacted the primary market for EUR benchmarks. Moreover, noticeable saturation effects on the investor side have contributed to the degree of caution in terms of issuance activity. In this respect, the question has arisen as to how likely a spate of deals before the end of the year might be. In fact, this would certainly be needed to achieve such a high gross supply projection. After a period of real weakness, the primary market has experienced an almost "brutal" start to the new trading week. In essence, this is not really a surprise as there is still a significant need for refinancing on the part of the issuers and carefully executed pre-funding activities cannot be ruled out as a strategic option. After all, things are likely to be pretty hectic on the primary market in January 2024. With all this in mind, we are of the view that it would still be a little premature to think about revising our primary market forecast downwards. In retrospect, since the last edition of our weekly publication on 25 October, six issuers from five jurisdictions have been active on the market, placing EUR 4.5bn in fresh deals in the process. The only deal placed before the end of October was attributable to Iccrea Banca (IT). The bank approached investors on 31 October and kicked off the marketing phase for its deals with guidance in the area of ms +75bp, which is exactly where the final spread was ultimately fixed. This indicates a high new issue premium (+10bp) and, of course, no narrowing compared with the original guidance could be reported for this transaction. The order book totalled EUR 720m. Ultimately, the issuer opted for a volume of EUR 500m, which is certainly worth mentioning due to the fact that a EUR benchmark without a specific volume was initially announced.

…or simply a case of "gone till November"?

As mentioned above, the new trading week started off in stark contrast to the weak period seen in October. In the first full trading week in November, a total of EUR 2.25bn was placed on Monday alone. Deutsche Bank (DE) opted for a volume of EUR 500m for its mortgage Pfandbrief with a term to maturity of 5.3 years (WNG; guidance: ms +30bp area). The re-offer spread was finally set at ms +26bp, which indicates a new issue premium of +6bp. Erste Bank (AT) chose a similar maturity (5.5y) for its EUR benchmark, with the books opening for orders at ms +42bp area. The issuer eventually placed a volume of EUR 750m at ms +40bp (order book: EUR 1.0bn; new issue premium: +8bp). OP Mortgage Bank (FI) also approached investors with a new benchmark, albeit with a shorter term of just 3.3 years (guidance: ms +28bp area). The deal, which featured a volume of EUR 1.0bn (new issue premium: +6bp), was priced five basis points tighter (ms +23bp) and ultimately generated orders in the amount of EUR 1.5bn. The high level of issuance activity this week continued into Tuesday, when another two deals were placed. In addition to a covered bond issued by DZ HYP (DE), DNB Boligkreditt (NO) also successfully approached investors with a covered bond in the amount of EUR 1.25bn. As such, the new issuance volume for the first two trading days of this week alone stands at EUR 4.0bn – and there's more where that came from!

Issuer	Country	Timing	ISIN	Maturity	Size	Spread	Rating	ESG
DNB Boligkreditt AS	NO	07.11.	XS2717426220	5.0y	1.25bn	ms +30bp	- / Aaa / AAA	-
DZ HYP AG	DE	07.11.	DE000A351XS1	3.7y	0.50bn	ms +16bp	- / Aaa / AAA	-
OP Mortgage Bank	FI	06.11.	XS2717292788	3.3y	1.00bn	ms +23bp	- / Aaa / -	-
Erste Group Bank AG	AT	06.11.	AT0000A38H91	5.5y	0.75bn	ms +40bp	- / Aaa / -	-
Deutsche Bank AG	DE	06.11.	DE000A352BT3	5.3y	0.50bn	ms +26bp	- / Aaa / -	-
Iccrea Banca SpA	IT	31.10.	IT0005569964	4.0y	0.50bn	ms +75bp	- / Aa3 / -	-

Source: Bloomberg, NORD/LB Markets Strategy & Floor Research (Rating: Fitch / Moody's / S&P)

EUR sub-benchmark segment: green deal from Austria

Yesterday, Oberösterreichische Landesbank (ticker: OBLB) made an appearance on the EUR sub-benchmark market with a green covered bond. OBLB opted to place a 4y bond in the amount of EUR 250m with investors. The re-offer spread was finally fixed at ms +50bp (guidance: ms +50bp area). At present, including yesterday's deal, OBLB has five EUR sub-benchmark issues outstanding, including two in green format, which makes the bank one of the most active Austrian issuers in this market segment. Overall, with an issuance volume of EUR 6.8bn in 2023 (FY 2022: EUR 8.0bn), the EUR sub-benchmark segment has been slightly weaker than in the previous year. In terms of potential spread widenings, we believe that the EUR sub-benchmark segment is actually somewhat more exposed than the EUR benchmark segment, which we would put down to the lower liquidity in this sub-market.

The covered bond market under the influence of the ECB's decisions and...

As we had expected, the ECB opted not to make any further adjustments to the key interest rates at the most recent meeting of the Governing Council on 26 October, thereby ushering in an initial pause to interest rate movements at the very least (cf. NORD/LB Fixed Income Special). We see this pause – which most likely also marks the interest rate peak for the single currency area – as a result of weak economic activity. Although some yield-oriented investors who share this view could see increased interest in buying covered bonds at the interest rate peak, we see little new impetus for covered bonds in view of the ECB meeting. This is also because the Governing Council has not given any guidance on other monetary policy control parameters that could at least indirectly influence the segment of covered issuances.

...developments with regard to lending and deposits

In addition to the published economic indicators, the Governing Council may have based its decision on weakening lending data. In this context, the ECB Bank Lending Survey does at least paint a clear picture of the (weak) situation (cf. press release). The falling demand for private real estate financing is also relevant for the covered bond segment. Another finding is that the contraction of the ECB's balance sheet also increases the pressure on liquidity and funding. In terms of retail funding, the risk experts at Scope have taken a closer look at the worsening situation and have reached the conclusion that the refinancing component of retail customer deposits has reached a turning point, as they have declined for the first time in 20 years. From the perspective of Scope, the elimination of a cheap source of refinancing would also have an impact on the profitability of European financial institutions. In the past, we have repeatedly pointed out the implications of dwindling customer deposit portfolios, including for the covered bond segment. In fact, both the supply forecast for 2023 and 2024 are based on significantly positive impetus for issuance activities in the EUR benchmark segment.

Moody's presents Sector Report on the South Korean covered bond market

As part of a recent Sector Report, Moody's commented on South Korea (officially: Republic of Korea). The discussion focuses on the implications of the new interest rate environment and property prices on the affordability of home ownership. On the one hand, the combination of high mortgage rates and recovering house prices would increase the risk profile for new loans, while on the other, growth in real estate prices would improve the credit quality of loans that have been in South Korean issuers' cover pools for a long time already. Also based on the assumption that the Bank of Korea has reached the end of its cycle of interest rate hikes, Moody's also expects a further (albeit marginal) recovery in real estate prices in the course of 2024. At the same time, financing costs for private households remain high due to the fact that interest rate cuts are not expected any time soon. Despite activity in the South Korean economy being robust, no sustained improvement in terms of affordability is expected. In our opinion, the credit quality – especially of EUR benchmarks – remains unaffected by this. The risk experts from Moody's have also underlined that the primary source of payment is not the cover pool, but the issuer itself. In South Korea, three issuers have outstanding covered bonds in the EUR benchmark format. At 100%, the exceptionally high proportion of ESG deals is certainly worth highlighting. We expect robust generic growth in the sub-market, which we believe is also likely to extend to inaugural EUR benchmark deals.

Market overview
SSA/Public Issuers

Authors: Dr Norman Rudschuck, CIIA // Christian Ilchmann

LfA autumn balance sheet: Q3 lending highest to date in 2023

On 2 November, LfA Förderbank Bayern (ticker: BAYLAN) published a review of the first three quarters of 2023. Loans of almost EUR 1.6bn were granted to support the Bavarian economy in the first nine months, of which more than EUR 1.2bn were made available under financing programmes. Demand for promotional loans was also stronger in the third quarter than in the previous two quarters. Compared with the record-breaking first nine months in 2022, this had meanwhile returned to normal (-20%). Over 2,600 small and medium-sized enterprises (SMEs) and municipalities received support from LfA up to the end of September. Once again, demand was strongest for the LfA promotional pro-grammes for start-ups and succession arrangements (EUR 325m) as well as growth pro-jects including modernisation measures (EUR 575m). The growth in demand for the Innovation Loan 4.0 programme recorded since the beginning of the year also continued in Q3, allowing the bank to support SMEs as well as start-ups and freelancers with digitalisation and innovation projects. Under its Innovation Loan 4.0 programme, LfA committed loans of around EUR 150m up to the end of September (+50% Y/Y). Hubert Aiwanger, Bavarian Minister of Economic Affairs, Regional Development and Energy, commented: “A strong promotional bank plays a key role for the economy, especially in times of heightened uncertainty. Despite the fall in demand compared with last year’s strong figures, many companies still make use of the LfA’s attractive products to face the future with confidence. The Bavarian economy remains innovative and dynamic, while benefiting from the financing provided by LfA.” Dr Bernhard Schwab, Chairman of the Management Board of LfA, added: “The third quarter revealed increased demand for our promotional products. Besides those designed to help start-ups and promote growth, there was particular interest in our Innovation Loan 4.0 programme. This is a pleasing result, particularly against the background of the current uncertainty dominating the overall economic situation. Working with our partner banks, we carry out regular reviews to identify how we can best meet the needs of SMEs with our products.”

Bremen: October tax estimates project additional revenues fraught with risk

The result of the October estimate of taxes reveals a slight improvement in revenues for Bremen (ticker: BREMEN). The Tax Estimation working group forecasts a net increase of EUR 99m for the city over the coming year compared with the estimate of taxes in May 2023. The city state can expect total revenues of around EUR 4.2bn overall in 2024. Growth in revenues of EUR 220m is expected for 2025 (total: EUR 4.4bn), however, only EUR 40m of this is secured to some extent, while the far greater part is still fraught with risk. In addition to higher allocations under the municipal financial equalisation scheme (2023: EUR 471m; 2025: EUR 498m), one reason for this is the positive trend in trade tax revenues, which are expected to increase by EUR 30m next year and EUR 73m in 2025 compared with 2023. More detailed insights into the situation facing the German Laender can also be found in our NORD/LB Issuer Guide – German Laender 2023.

NIB: results for Q3 – strong earnings and green transformation

The Nordic Investment Bank (ticker: NIB) presented its Q3 results on 1 November. In the first nine months of 2023, NIB achieved a net profit of EUR 195m (previous-year period: EUR 84m). The increase is primarily attributable to higher key results in the form of net interest income and unrealised gains from financial transactions. At the same time, new commitments came to around EUR 2bn (EUR 2.8bn). These were mainly used to finance decarbonisation measures as well as the expansion of renewable energies and the electricity distribution networks in Scandinavia. In the first nine months of 2023, projects that were rated "good" or "excellent" for ESG purposes accounted for 99.8% of the total amount of loans disbursed and consequently exceeded the self-imposed target of 95%. The focus on green transformation is clear in the result of the environmental mandate, the share of which has reached a historic high for NIB. In August, NIB expanded its presence in the Baltics by opening a new office in Riga. André Küüsvek, NIB Chairman and CEO, commented: "It is a matter of the utmost importance for NIB to recognise the priorities of our member countries and to know how we can support them. […] (A) continuous dialogue is particularly valuable, as we are faced with major geopolitical challenges throughout the world that also affect our region. As an international financial institution, we play a stabilising role in our region and simultaneously support our clients." To be able to satisfy high demand for financing, NIB raised new funding of EUR 6.7bn on the capital market in the first nine months of 2023, including two benchmark bonds in USD and a sustainability bond of SEK 2bn.

CEB present half-yearly results

At the end of October, the development bank of the Council of Europe (ticker: COE) presented its half-yearly report. Despite a challenging and volatile financial environment, the CEB's financial situation proved to be resilient in the first half of the year. As of 30 June 2023, the net profit came to EUR 54.6m (H1/2022: EUR 48.2m), representing growth of around 13%. This is primarily due to the positive trend in the interest margin (growth: EUR 9.7m), which was attributable to higher earnings from securities and the active management of liquidity and interest rate positions. The CEB's balance sheet total amounted to EUR 35.7bn (+13.2%) at the end of June, which was in turn attributable to cyclical activity in Finance/Treasury during the year. Furthermore, the accession of Ukraine as a full member of the bank in June 2023 was a particular milestone. The CEB's regulatory indicators remained within the approved limits in the first half of 2023. The bank reported neither NPLs nor any defaults in the period under review. Up to 30 June 2023, 22 new projects amounting to EUR 2.2bn were approved and loans of EUR 935m were disbursed. The portfolio of approved projects awaiting financing has now reached EUR 10.4bn (growth: EUR 1.3bn). CEB was not inactive on the capital market either, issuing 21 bonds with a maturity of more than one year worth EUR 5.3bn in total in the first half of 2023, compared with 15 bonds worth a total of EUR 5.4bn in the first half of 2022. They included three social inclusion bonds (SIB) – one SIB with a maturity of seven years in the amount of EUR 1.0bn in April as well as an SEK-denominated SIB with a maturity of five years in the amount of 650m and an SIB with a maturity of three years in the amount of USD 1.0bn (both in May). CEB has been a pioneer in this segment since it issued its first SIB in 2017.

EIB and ICO: just under EUR 1bn to finance SMEs and green projects

The EIB (ticker: EIB) participated in the first issue of asset-backed securities by Sabadell Consumer Finance totalling EUR 380m. Instituto de Crédito Oficial (ticker: ICO) invested EUR 95m at the same time to facilitate access to funding for SMEs and the self-employed in Spain. The transaction will support green projects, while simultaneously supporting less developed regions in Spain, where the per capita GDP is less than 75% of the EU average. "The EIB Group works with ICO and Banco Sabadell on a regular basis to make it easier for SMEs and midcaps to access funding and, by doing so, to boost their competitiveness and resilience. Together, we shall adopt a new approach to develop attractive lending solutions that will help companies remain in business and encourage investment. The transaction will generate substantial additional benefits by encouraging equitable growth and convergence between EU regions, which is one of the key objectives of the EIB's financing activity," says EIB Vice-President Ricardo Mourinho Félix.

Primary market

Following our break over the public holiday, we can report on three benchmark deals, two taps and various new mandates today. Yesterday (Tuesday) was particularly eventful, with the Free State of Thuringia (ticker: THRGN) starting proceedings. The aim was to raise a total of EUR 500m (WNG) with a five-year maturity. The spread was already fixed in advance at ms -2bp, but no information on the order book has been published in the meantime. Subsequently, our French neighbour in the shape of Société Anonyme de Gestion de Stocks de Sécurité (ticker: SAGESS) issued a new benchmark in the amount of EUR 500m (WNG) with a six-year maturity. With guidance of 60 basis points (area) above the French curve (reference: FRTR 0% 11/25/29), the order books rose to over EUR 6.2bn, meaning that the deal finally went through six basis points tighter. They were followed on the market by Islamic Development Bank (ticker: ISDB) with a benchmark deal worth EUR 550m with a five-year maturity. At ms +33bp, the deal was ultimately marginally oversubscribed at EUR 580m. Last week, Hesse (ticker: HESSEN) increased its 2028 bond by EUR 250m. In line with the guidance, it was printed at ms -1bp, with the bid-to-cover ratio amounting to 2.06x. Following Reformation Day, it was followed by Kreditanstalt für Wiederaufbau (ticker: KFW) with a tap of its green 2032 bond worth EUR 1bn. With a guidance of ms +3bp area, the order books ultimately reached EUR 2.3bn, meaning that the final spread tightened to ms +2bp. We have noted the following new mandates to report on: a newcomer to the capital market is planning to make its debut with a five-year EUR benchmark, namely Hungarian Export-Import Bank (ticker: MAEXIM). We shall rapidly see Österreichische Kontrollbank (ticker: OKB) come to the market with the same target maturity but a specific amount of EUR 500m (WNG) and a green label. Subsequently, mandates were issued for a tap of the 2030 bond issued by Agence France Locale (ticker: AFLBNK), which is to be increased by EUR 250m (WNG). We expect the associated deals to feature on screens within the next few days.

Issuer	Country	Timing	ISIN	Maturity	Size	Spread	Rating	ESG
ISDB	SNAT	07.11.	XS2708355115	5.0y	0.55bn	ms +33bp	AAA /Aaa / AAA	-
SAGESS	FR	07.11.	FR001400M048	6.0y	0.50bn	ms +39bp	- / - / AA	-
THRGN	DE	07.11.	DE000A352BS5	5.0y	0.50bn	ms -2bp	AAA / - / -	-

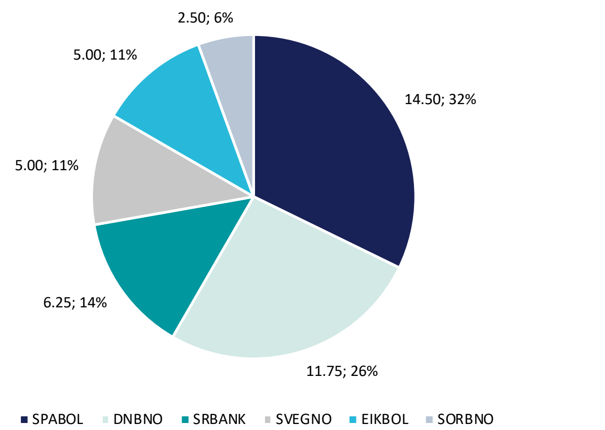
Source: Bloomberg, NORD/LB Markets Strategy & Floor Research (Rating: Fitch / Moody's / S&P)

Covered Bonds
Norway: Creation of SpareBank 1 Sor-Norge
Author: Dr Frederik Kunze

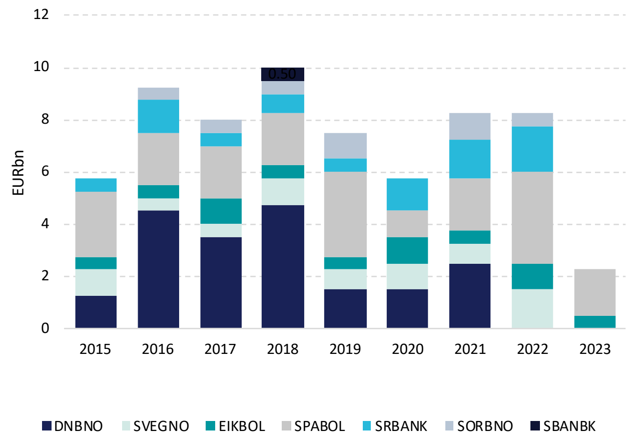
Two becomes one: SpareBank 1 Sor-Norge
On 26 October 2023, the executive bodies of SpareBank 1 Sorost-Norge (ticker: SOON) and SpareBank 1 SRBANK ASA (ticker: SRBANK) gave the green light for a merger of the two banks. Approval from the shareholders' meetings of both banks and the Norwegian supervisory authorities is still outstanding, meaning that the merger is, according to the two banks, unlikely to be completed before July 2024. The merger will create Norway's largest savings bank, SpareBank 1 Sor-Norge. Initial estimates indicate that the new bank will have assets under management of NOK 500bn (approximately EUR 42bn) and a gross loan book of NOK 375bn (EUR 32bn). The merger is expected to increase competitiveness, expand the bank's market presence and make it more attractive to clients, employees and shareholders. The newly created bank will have a strong presence in the south of Norway. An active issuer in the EUR benchmark segment for covered bonds, namely SRBANK, will be part of the newly created bank. We therefore deduce that the "new" SpareBank 1 Sor-Norge will also have recourse to funding via covered bonds.

Classification in the Norwegian EUR benchmark segment
Six Norwegian issuers in total have issued covered bonds in the EUR benchmark segment, which currently have an outstanding volume of EUR 46.3bn. SRBANK is one of the three largest Norwegian covered bond issuers with nine deals amounting to EUR 6.25bn. To date, three Norwegian issuers have ventured onto the market in 2023, successfully placing covered bonds worth EUR 3.5bn with investors. Th new issuance volume in the EUR benchmark segment is therefore somewhat lower than in previous years. One possible explanation is that placements in domestic currency (NOK) also play a significant role for Norway's covered bond issuers in addition to EUR issues.

NO: EUR benchmarks (outstanding; EURbn)



NO: EUR benchmarks (maturities; EURbn)



Source: NORD/LB Markets Strategy & Floor Research

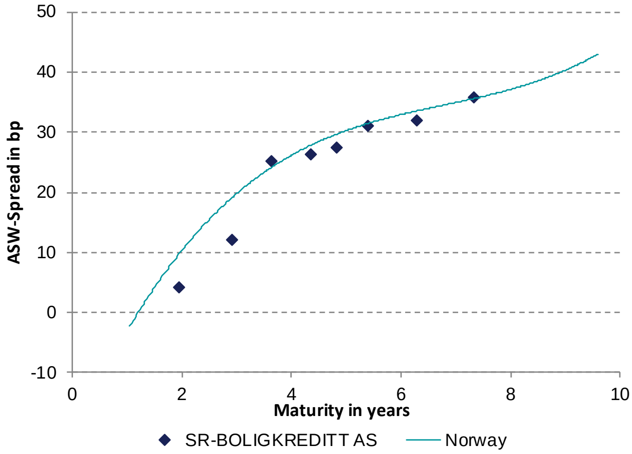
SpareBank 1 Sorost-Norge: already indirectly active on the covered bond market
SpareBank 1 Sorost-Norge, which is based in Sandefjord in the south of Norway, is Norway's seventh largest savings bank and focuses its business activities on the "Vestfold og Telemark" region as well as the southern part of the former Buskerud region. SOON has only been operating in its present form and under its current name since 2022 – following the successful mergers with two other savings banks, which meant that it was better able to exploit economies of scale and increase its competitiveness. The bank offers its retail and corporate clients all the services of a universal bank. The funding structure of SOON consists largely of customer deposits and is supplemented selectively by capital market-based funding instruments. As part of the SpareBank 1 Alliance, SOON can also raise funding on the market via its investments in SpareBank 1 Boligkreditt and SpareBank 1 Naeringskreditt. To this end, the bank will transfer parts of its loan portfolio to one of the other two banks. SOON is also indirectly active on the covered bond market via its investment in SpareBank 1 Boligkreditt (January 2023: 12.2%). The bank's wholesale funding is also supplemented by issues of senior preferred and senior non-preferred bonds. The bank last approached the market with a green senior non-preferred bond worth NOK 700m.

SpareBank 1 SRBANK ASA: also part of the SpareBank 1 Alliance
SpareBank 1 SRBANK is also part of the SpareBank 1 Alliance but does not have any investments in SpareBank 1 Boligkreditt. Rather, SRBANK operates on the covered bond market through its 100% subsidiary SR-Boligkreditt. The bank last placed a covered bond worth EUR 1.0bn on the market for EUR benchmarks in August 2022. With its first green covered bond in 2019, the bank highlighted its efforts to support the sustainable transformation of Norwegian society. Benedicte Schilbred Fasmer (CEO of SRBANK) emphasises the fact that the merger will create Norway's largest saving bank, which will be a strong competitor among the commercial banks in Norway as well as the Nordic countries in general. In terms of its balance sheet total (Q3 2023: NOK 362.8bn), SRBANK is almost four times as big as SOON. SRBANK concentrates its business in the south and west of Norway and is the market leader in its home market Rogaland. The business areas of the two banks involved in the merger therefore overlap. Please refer to the NORD/LB Issuer Guide – Covered Bonds for a more detailed analysis of the issuer.

Programme data

30 September 2023	Mortgage
Covered bonds outstanding	EUR 9,033m (NOK 81,682m)
Cover pool volume	EUR 7,197m (NOK 102,522m)
Current OC (voluntary / legal)	20.5% / 5.0%
Type primary cover	100% Residential
Main country	100% Norway
Number of loans	50,298
Average loan size	EUR 0.175m (NOK 1.988m)
Share of 10 largest exposures	0.2%
NPL	0.0%
Fixed interest (Cover Pool / CBs)	0.0% / 84.2%
WAL (Cover Pool / CBs)	17.1y / 5.8y
CB Rating (Fitch / Moody's / S&P)	- / Aaa / -

Spread overview (BMK) – Norway



Source: Issuer, rating agencies, Bloomberg, NORD/LB Markets Strategy & Floor Research

New bank offers the opportunity to leverage synergies

The merger of the two banks under the newly created name SpareBank 1 Sor-Norge will create Norway's second largest financial institution. The overlapping business models, regional links and the structure of the two banks offer the opportunity to leverage various synergies, reduce costs and ultimately boost earnings. The merged bank is expected to have a market-leading position in the brokerage of real estate and in accounting and consulting services. The two banks view the merger as a good basis for generating further growth. SOON has a 6.28% stake in the SpareBank 1 Alliance via SpareBank 1 SamSpar, although it is expected to sell off this stake in future. However, the newly created bank intends to remain a driving factor in the SpareBank 1 Alliance via its participation in SRBANK. It was not clear from the press releases which bank will issue covered bonds in future. However, it must be assumed that the newly created bank will carry out its covered bond issues under the umbrella of SRBANK Boligkreditt. The merger of the two banks is planned to be completed on 1 July 2024, until then it will be business as usual for both banks.

Conclusion

The merger of the two banks will create a new heavyweight on the Norwegian banking market with an estimated loan portfolio of NOK 375bn, of which 65% is attributable to retail banking. The striking synergy effects should allow the bank to protect its good earnings situation and strong capital ratios (compared with others in the sector) – it may even be able to improve these. We expect that the new bank's issuance activity on the covered bond market for EUR benchmarks will increase in line with the expansion in its loan portfolio and look forward to reporting on the first bonds to be issued by SpareBank 1 Sor-Norge.

SSA/Public Issuers
ECB: PEPP versus TPI – or: (re)investing where others like to go on holiday

Authors: Dr Norman Rudschuck, CIIA // Christian Ilchmann

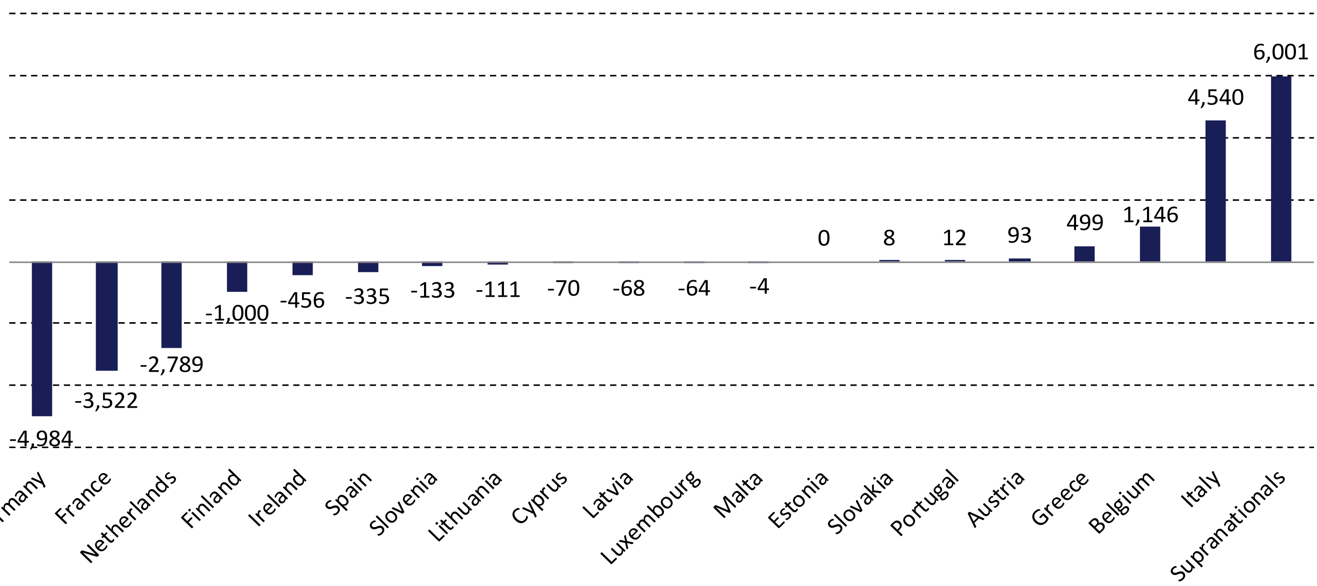
PEPP – where things stand at present

We last reported on developments in the context of the Pandemic Emergency Purchase Programme (PEPP) in March of this year. Back then, there were, if anything, signs of a reduction in holdings from periphery countries. The ECB seemed to have resumed acting more on the basis of the adjusted capital key in order to smooth percentage differences. Eight months have since passed, but geopolitical and (macro)economic conditions have so far not improved for the better. As a reminder: the PEPP was launched in March 2020 in response to the risks posed to the monetary policy transmission mechanism and prospects for the eurozone arising from the outbreak of COVID-19. The programme was increased by EUR 600bn from its original size of EUR 750bn as early as 04 June 2020, and then by a further EUR 500bn on 10 December 2020 to a total of EUR 1,850bn. Fundamentally, any security that was eligible for purchase under the APP would also be eligible for purchase under the PEPP, plus Greek sovereign paper. The ECB's Governing Council announced on 15 June 2023 that reinvestments under the APP would be discontinued from July 2023. Net purchases under the PEPP were carried out until the end of March 2022, although not to the full EUR 1,850bn. On a cumulative basis, the portfolio as per 30 September 2023 amounted to a total of nearly EUR 1,668bn. Announcements regarding reinvestments made by the ECB have been noteworthy and relatively transparent compared with those relating to the APP: according to the forward guidance, the principal amounts of securities maturing are to be reinvested on a flexible basis at least until the end of 2024 in order to avoid adversely affecting the course of monetary policy. However, the size of forthcoming maturities remains shrouded in mystery. This is especially relevant in the case of the SSA segment: the securities of public issuers account for nearly 97% or EUR 1,616bn. Next year, the ECB will again be among the biggest investors in the secondary market through its reinvestments. In addition, apart from the PEPP, the ECB Governing Council approved the establishing of a monetary-policy instrument in July 2022 to ensure monetary policy transmission – the Transmission Protection Instrument (TPI). The aim of the TPI is to ensure an effective transmission of monetary policy and to support a uniform monetary policy across all eurozone countries. The "singleness" of the monetary policy is a precondition for the ECB to be able to deliver on the primary mandate of the Eurosystem, namely ensuring price stability. The TPI could be activated especially in order to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area. Purchases are not restricted in terms of volume. The TPI has not been used to date. As President Lagarde again stressed at the ECB press conference in September, the first line of defence remains flexibility in the reinvestment of principal amounts of maturing securities in the Pandemic Emergency Purchase Programme (PEPP) portfolio.

Reinvestment overwhelmingly in southern states

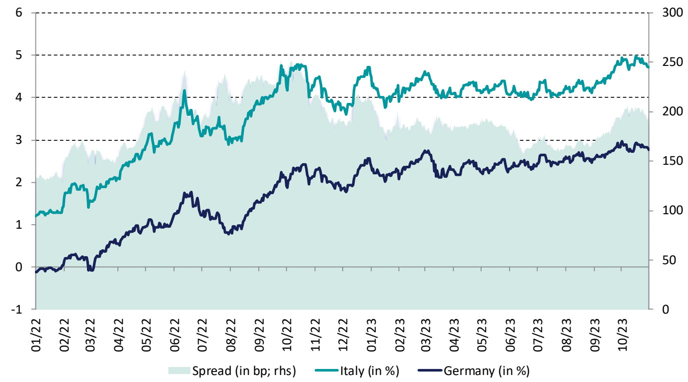
The data published every two months by the ECB gives some indication of how the PEPP portfolio is being restructured through reinvestment. In the past, we have stressed on a number of occasions that portfolios "breathe" and therefore that a strict analysis of (historical) purchases under the ECB capital key makes little sense. In addition, ECB President Lagarde repeatedly stresses the flexibility of PEPP purchases. Meanwhile, data for the months of March to September seem to confirm that the first line of defence is working. The high maturities of Germany, the Netherlands and Spain – EUR 17.9bn in total – stand out above all and have been restructured mainly towards Greece, Italy, Belgium and supranationals since the spring. As regards the frequently discussed spreads of German sovereign bonds versus Italian, Greek, French and Spanish paper, there has been a degree of volatility since July 2022. In contrast, a temporary spread high between Italian and German sovereign bonds of up to 242 basis points did prompt the ECB to convene an emergency meeting. For comparison purposes: during the euro crisis at the end of 2013, these spreads stood at around 500 basis points. At the beginning of March, fuelled not least by a potential conflict between the Italian government under Giorgia Meloni and the European Commission surrounding an increase in budget targets, the yield of Italian sovereign bonds came very close to the level during the financial crisis. It is likely that the ECB felt encouraged to act again once new investment under the PEPP had come to an end. Since then, there has been around EUR 4.5bn in net reinvestment in Italian paper, although the amount had come down again by the end of Q3 2023. There were also positive net reinvestments during the same period involving supras (EUR 6bn), Belgium (EUR 1.1bn), Greece (EUR 500m) and to a much lesser extent Austria (EUR 93m), Portugal (EUR 12m) and Slovakia (EUR 8m). On the other hand, since March, German paper amounting to around EUR 5bn has matured and been reinvested elsewhere. In France, the equivalent figure is around EUR 3.5bn, followed by the Netherlands at EUR 2.8bn, although this amount was not reinvested. Consequently, there is very clear evidence of a reallocation of reinvestment amounts in the direction of southern and south-eastern Europe.

Net reinvestment by the ECB under the PEPP by issuer (March to September 2023; EURm)

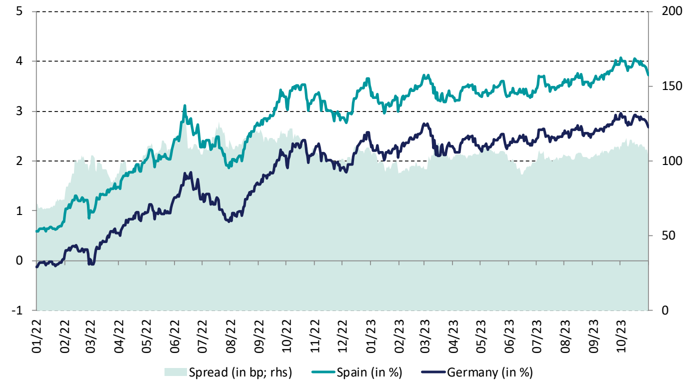


Source: ECB, NORD/LB Markets Strategy & Floor Research

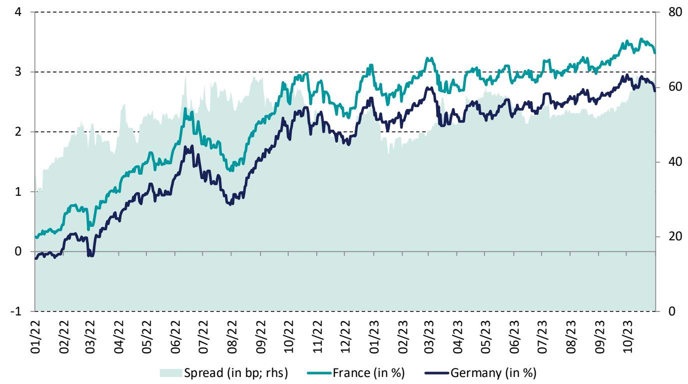
Spreads – Bunds vs. BTPs (10Y)



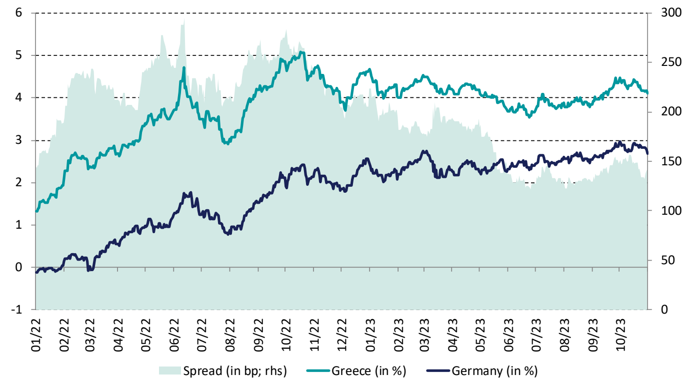
Spreads – Bunds vs. SPGs (10Y)



Spreads – Bunds vs. OATs (10Y)



Spreads – Bunds vs. GGBs (10Y)



Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

Where does the ECB's focus lie? Probably not so much on the TPI

According to the ECB, the TPI enhances the tools at its disposal and it could be activated in order to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area. By safeguarding the transmission mechanism, the TPI will allow the ECB Governing Council to deliver more effectively on its price stability mandate. But who and what actually decides the whole tenuous issue of what constitutes "unwarranted" market dynamics?

Without preliminary restrictions on volume

Subject to the set criteria being met, the Eurosystem will be in a position to purchase securities in the secondary market that have been issued in countries where financial conditions have deteriorated – something that would not be justified by country-specific fundamentals – in order to counter risks to the transmission mechanism to the requisite extent. Who then decides when and to what extent a widening of BTPs in the context of a political resignation is or was still fundamentally warranted after a downgrade or any other events? And at what point does this stop being the case? From a surge of 13 basis points, or not until 29.3 basis points onwards? In this respect, we are still just as much in the dark as before. According to a press release of July 2022, the extent of TPI purchases would definitely depend on the severity of risks to monetary policy transmission. From our point of view, this answer was especially important last year: at the start of the programme (i.e. ex ante), purchases were **not** limited in terms of volume.

What parameters is the ECB setting for itself?

Purchases under the TPI will concentrate mainly on public-sector securities (marketable securities from central and regional governments and agencies as defined by the ECB). In this instance, there should not be any major differences in relation to the PEPP or PSPP – i.e. sovereign bonds, supranationals, Laender and other regions, development banks and other European agencies. The framework is clearly limited to one to ten years. Under the PSPP and PEPP, purchases of up to 31 years (minus one day) were possible. The purchase of private sector paper might also be considered if applicable (at a later stage).

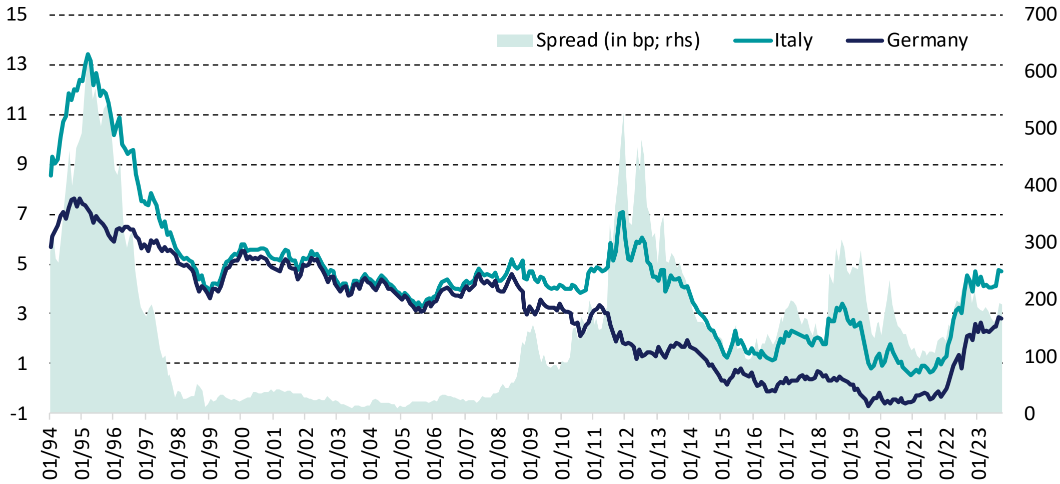
Eligibility criteria

The ECB Governing Council will – for whatever reason it may be – take into account an only partly disclosed, but nevertheless cumulative list of criteria in order to judge whether states in which the Eurosystem is able to make purchases under the TPI pursue sound and sustainable financial and macroeconomic policies. The criteria will be input into the ECB Governing Council's decision-making process and will be adjusted dynamically to the unfolding risks and conditions to be addressed. Publicly accessible criteria include: **(1) compliance with the EU fiscal framework:** not being subject to an excessive deficit procedure, or not being assessed as having failed to take effective action in response to a European Council recommendation under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU); **(2) absence of severe macroeconomic imbalances:** not being subject to an excessive imbalance procedure or not being assessed as having failed to take the recommended corrective action related to a European Council recommendation under Article 121(4) TFEU; **(3) fiscal sustainability:** in ascertaining that the trajectory of public debt is sustainable, the Governing Council will take into account, where available, the debt sustainability analyses by the European Commission, the European Stability Mechanism, the International Monetary Fund and other institutions, together with the ECB's internal analysis; **(4) sound and sustainable macroeconomic policies:** complying with the commitments submitted in the recovery and resilience plans for the Recovery and Resilience Facility and with the European Commission's country-specific recommendations in the fiscal sphere under the European Semester.

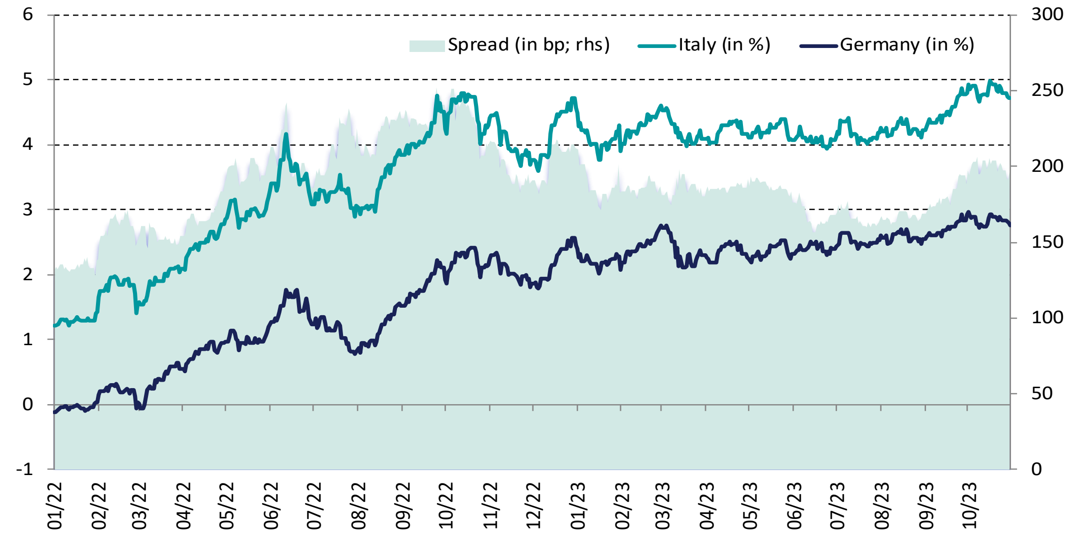
TPI: Does the "I" stand for Italy? A case study

Normally, we do not express any decided opinion on the spreads of sovereign bonds since our coverage is first and foremost focused on supranationals, sub-sovereigns and agencies (or SSAs for short), and secondly on covered bonds. To a certain extent, the ECB is now forcing us to do the same with the TPI. Accordingly, we look first at the long-term chart since 1994 and come to the conclusion that prior to the introduction of the euro, Italy already had to pay interest of over 13% on its ten-year bonds. Even the 8% on German bonds may have driven out or missed the odd market participant. In anticipation of the introduction of the euro which had been decided, there was then what we regard as an unhealthy convergence of interest rates in the whole of Europe. It was thought that Germany would rescue everybody if there was ever a crisis. How was it going to work with an ever-increasing debt mountain? If anything, Germany was the sick man of Europe until well into the 2010s and had enough to cope with in terms of its own restructuring. It succeeded in this and the euro crisis in particular (PIIGS) showed a marked differentiation in spreads in keeping with risk (flight-to-quality and flight-to-safety). Moreover, the average monthly spread of both countries since 1994 has been at 150.0bp. In 2023 so far, the equivalent value stands at 181.4bp on a daily basis. So, what was now the healthiest time and fair value?

Germany and Italy: yields (10y %) incl. spread



Graph since the beginning of 2022 on a daily basis (similar to above)



Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

What is worrying Italy at the moment?

There is no doubt that Mario Draghi's resignation last year came at an unfortunate moment: after all, a reform package of EUR 191.5bn that Italy had designs on sourcing from the NGEU programme had previously been presented. As expected, the new government ranted about this and that relating to Brussels. Although these are just words on the face of it, the rating agencies are listening, and when it comes to other matters, they have to pay particular attention: in October, Giorgia Meloni's right-wing, populist government upgraded its deficit forecast for the full year 2023 from 4.5% to 5.3%. The projection for 2024 was corrected upwards from 3.7% to 4.3%. The government cited slower growth, rising interest rates and costly incentives for schemes aimed at renovating buildings and improving energy efficiency introduced by previous governments. It's always someone else's fault. And although this may be a popular sentiment among faithful voters, Meloni should bear in mind that pointing a finger at others always means pointing several fingers at oneself. It is not just investors who see it this way; the rating agencies do too. So, has Italy met the four criteria for activating the TPI mentioned above?

Activating the TPI

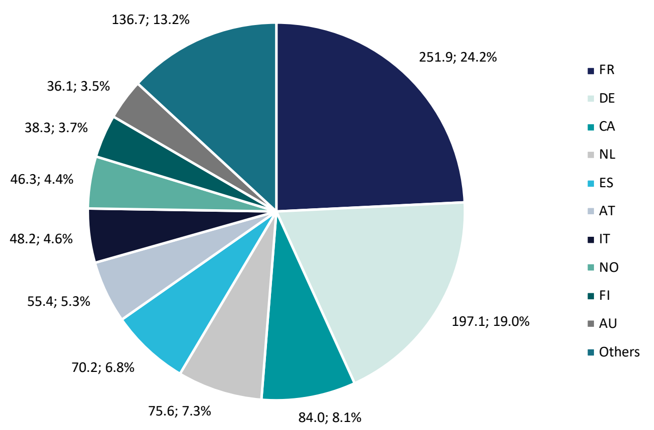
According to Madame Lagarde, any decision by the ECB Governing Council to activate the TPI would be based on a comprehensive assessment of market and transmission indicators, an evaluation of eligibility criteria and a judgement that the activation of purchases under the TPI is proportionate to the achievement of the ECB's primary objective (namely inflation of 2%). Purchases would either be terminated in the event of a lasting improvement in transmission or based on an assessment that persistent tensions can be attributed to country fundamentals. The example of Italy shows how difficult it is to understand these criteria from an external perspective. Italy would plunge into chaos if it occurred to a rating agency either to factor in a downgrade or link such a downgrade to the TPI. This would create a vicious circle. The fact that Italy is moving away from the criteria listed above is shown in every deterioration in the economic and financial situation. In view of a lack of transparency and the fact that only some criteria are in the public domain, it is hardly possible from an outside standpoint to make any serious judgement about whether or not Italy would be eligible for the TPI according to the ECB: the aim of protecting Italy would then be irrelevant. In any case, we have doubts as to whether the "new" instrument in the tool box is necessary at all. There would have been alternatives in view of the first line of defence of PEPP reinvestments and the OMTs, which have never been used.

Summary

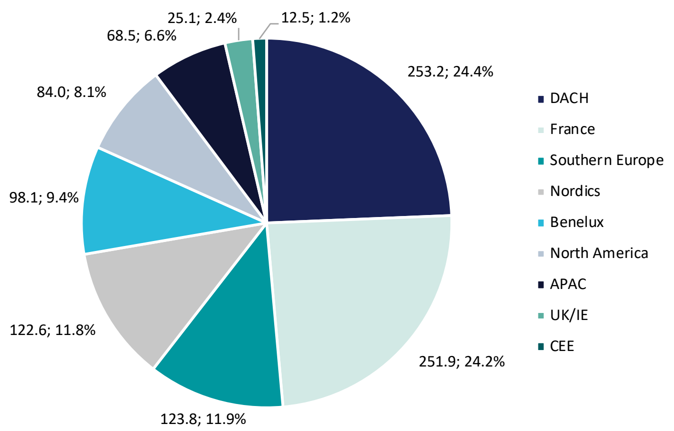
The ECB has already demonstrated that it is flexible on several occasions, but it has also demonstrated a lack of transparency when it comes to reinvestments and volumes maturing. However, at this point in time, based on the data, we are able to say a posteriori that the first line of defence is working so far. Whereas spreads between German and Italian and between German and Greek sovereign bonds have stabilised in the wake of increased reinvestment by the ECB, the spreads of French paper have generally continued to rise. We will have to wait until the publication of new data at the beginning of December to get an idea of whether the ECB will respond and, if so, how. After the last meeting of the ECB Governing Council, President Lagarde stressed once again that principal amounts from securities purchases under the PEPP would continue to be reinvested at least until the end of 2024. At any rate, the future termination of the PEPP portfolio should be steered in such a way as to avoid any negative impact on the appropriate monetary policy course. So far, the newest instrument in the ECB's toolbox – the TPI – has not been used. In our view, if all the leeway in reinvestment under the PEPP is used, it will not be necessary to activate the TPI either in the short or medium term. It seems that the first line of defence is holding up. But what will the ECB do once PEPP reinvestments are discontinued at the end of 2024? This will depend on a range of factors: the macroeconomic situation in Europe, inflation, geopolitical goal posts. Given growing disparities within Europe lately, it seems entirely possible that the ECB will have to review the TPI at the latest in the second half of 2024. Until then, the ECB will continue to reinvest where others are fond of spending their holidays – let's be thankful for the PEPP as the first line of defence.

Charts & Figures
Covered Bonds

EUR benchmark volume by country (in EURbn)



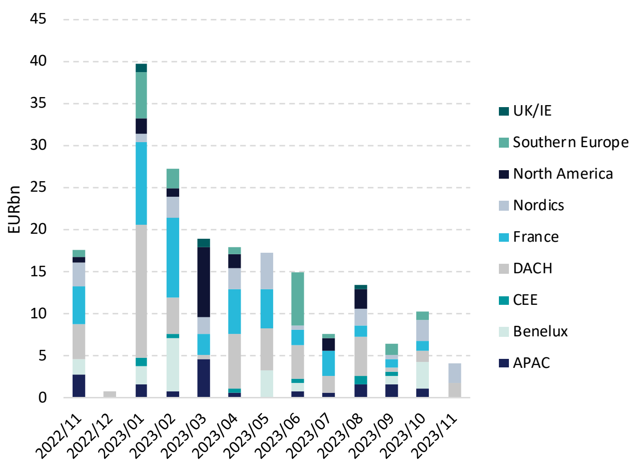
EUR benchmark volume by region (in EURbn)



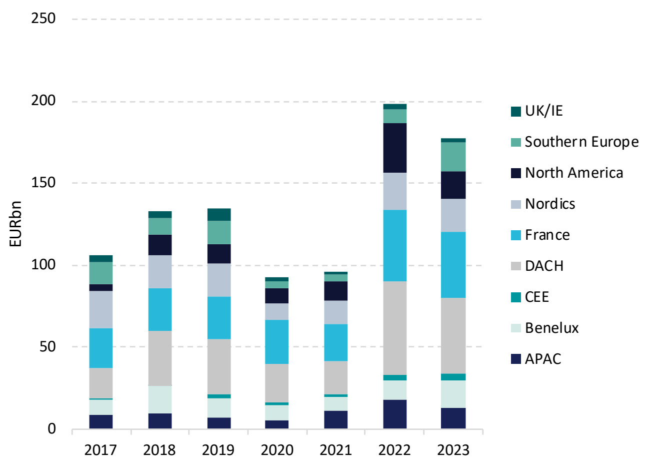
Top-10 jurisdictions

Rank	Country	Amount outst. (EURbn)	No. of BMKs	There of ESG BMKs	Avg. issue size (EURbn)	Avg. initial maturity (in years)	Avg. mod. Duration (in years)	Avg. coupon (in %)
1	FR	251.9	243	21	0.96	9.4	4.9	1.26
2	DE	197.1	281	34	0.65	7.9	4.1	1.18
3	CA	84.0	62	0	1.33	5.5	2.8	1.12
4	NL	75.6	77	2	0.92	10.6	6.3	1.13
5	ES	70.2	55	6	1.16	11.2	3.4	1.97
6	AT	55.4	94	4	0.58	8.2	4.7	1.37
7	IT	48.2	58	2	0.80	8.8	3.7	1.56
8	NO	46.3	55	12	0.84	7.3	3.6	0.73
9	FI	38.3	42	4	0.90	6.9	3.5	1.39
10	AU	36.1	35	0	1.03	7.1	3.5	1.49

EUR benchmark issue volume by month



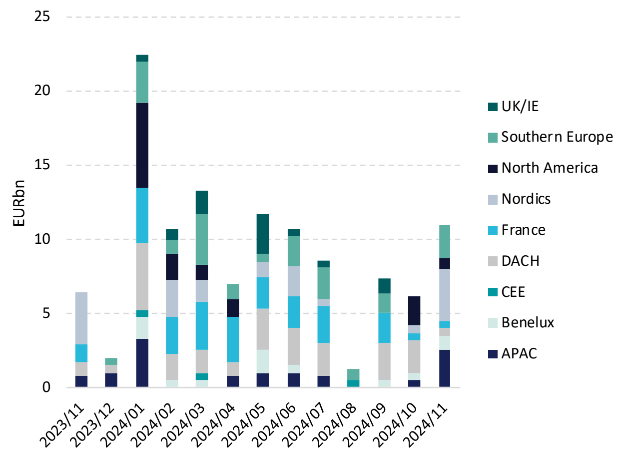
EUR benchmark issue volume by year



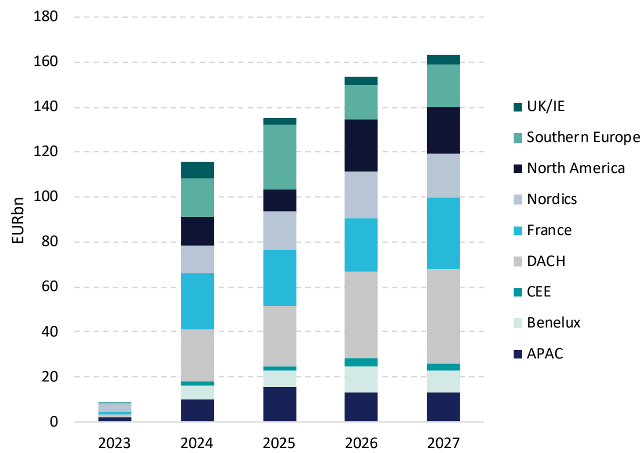
Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

NORD/LB

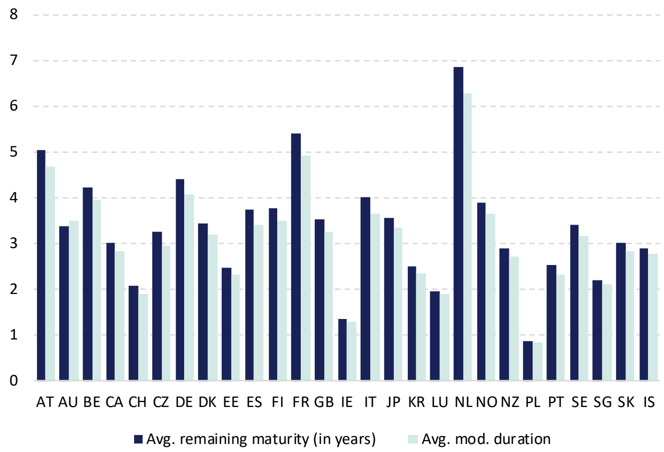
EUR benchmark maturities by month



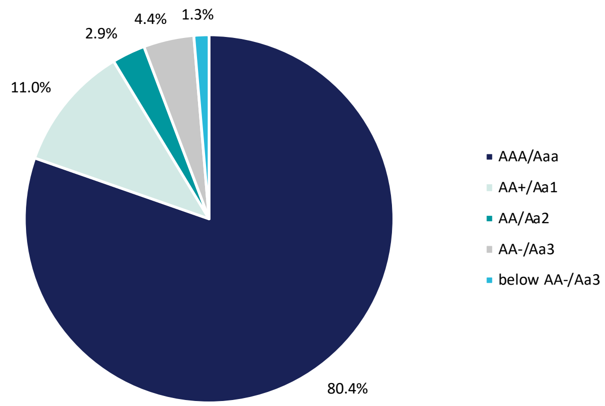
EUR benchmark maturities by year



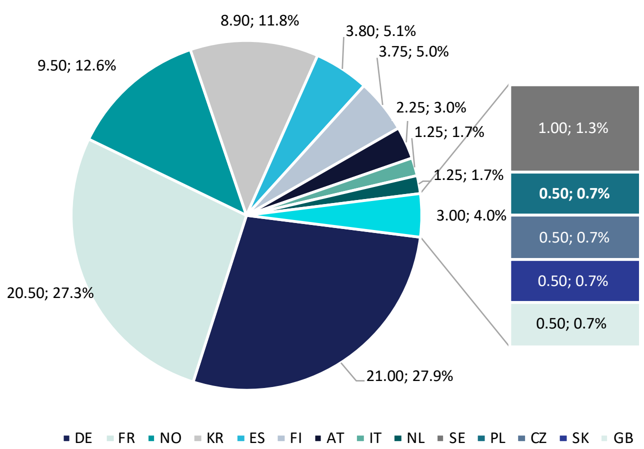
Modified duration and time to maturity by country



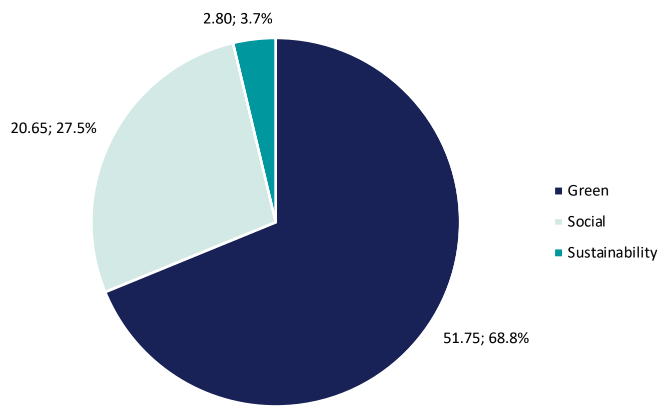
Rating distribution (volume weighted)



EUR benchmark volume (ESG) by country (in EURbn)

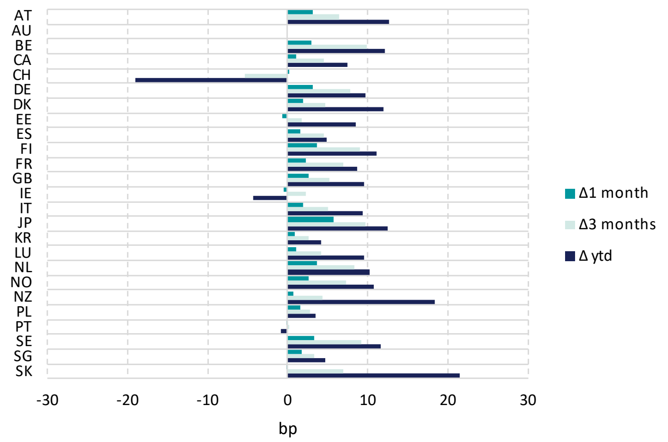


EUR benchmark volume (ESG) by type (in EURbn)

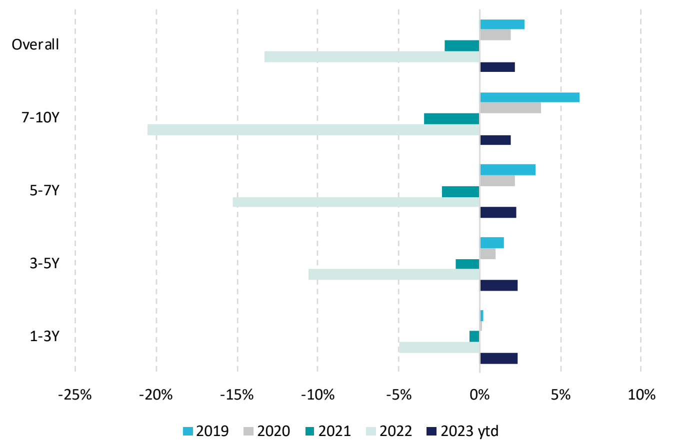


Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

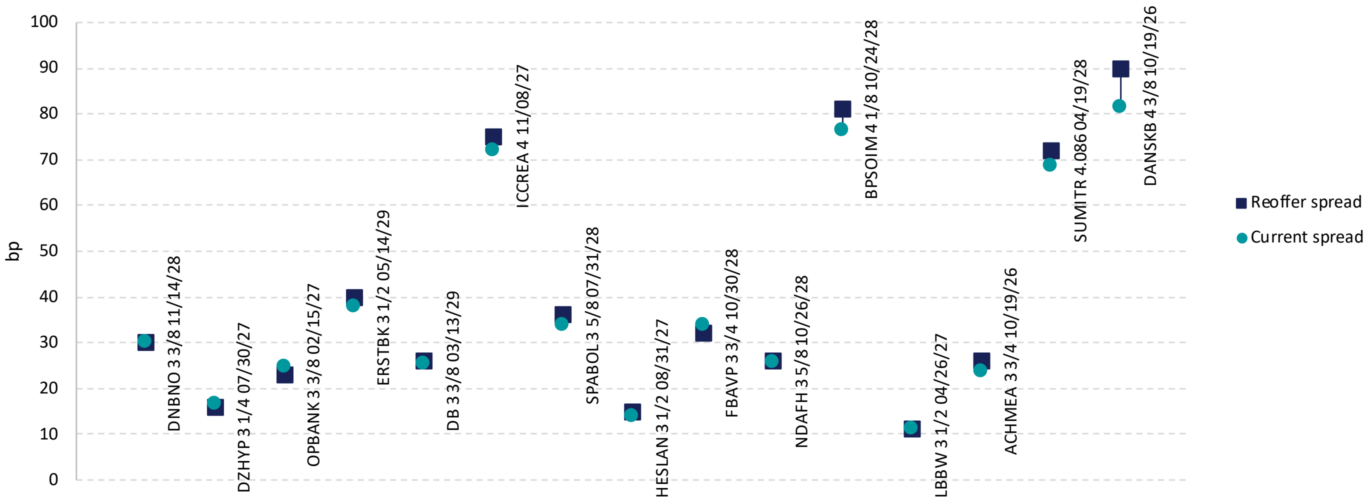
Spread development by country



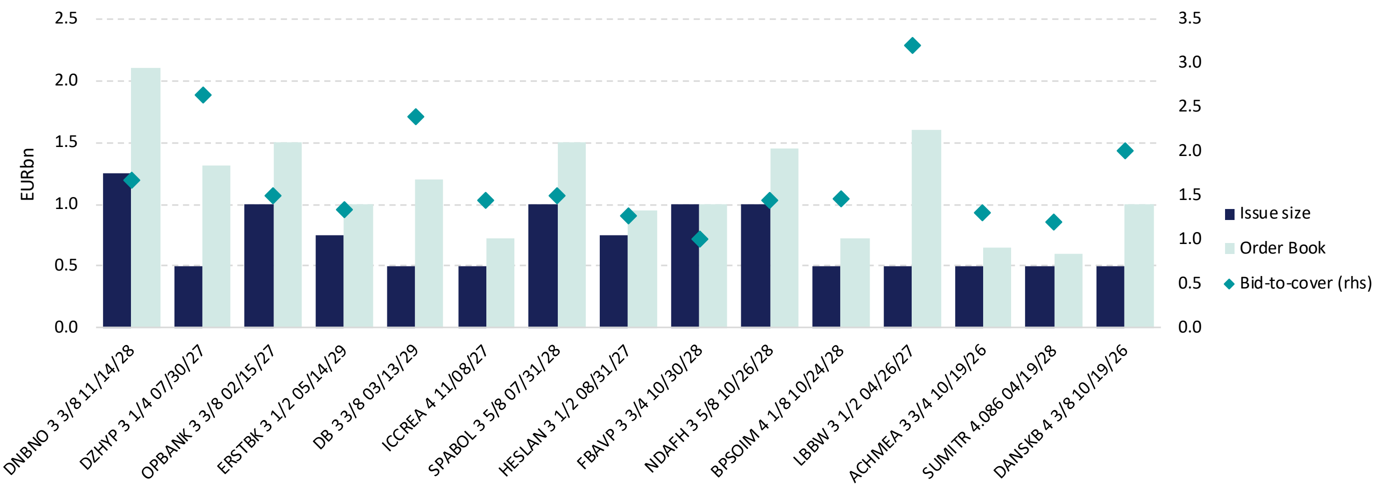
Covered bond performance (Total return)



Spread development (last 15 issues)



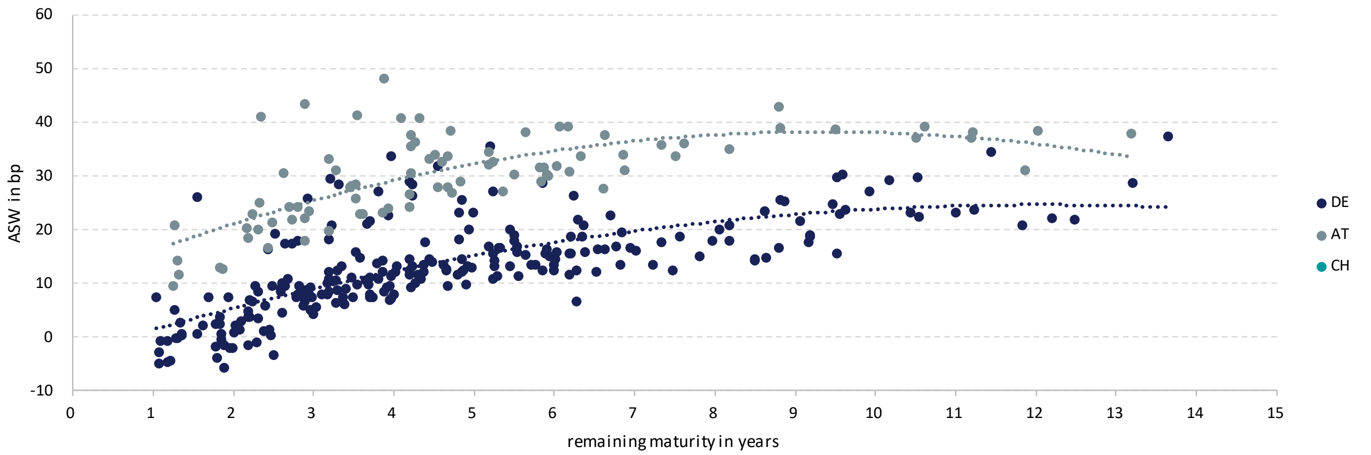
Order books (last 15 issues)



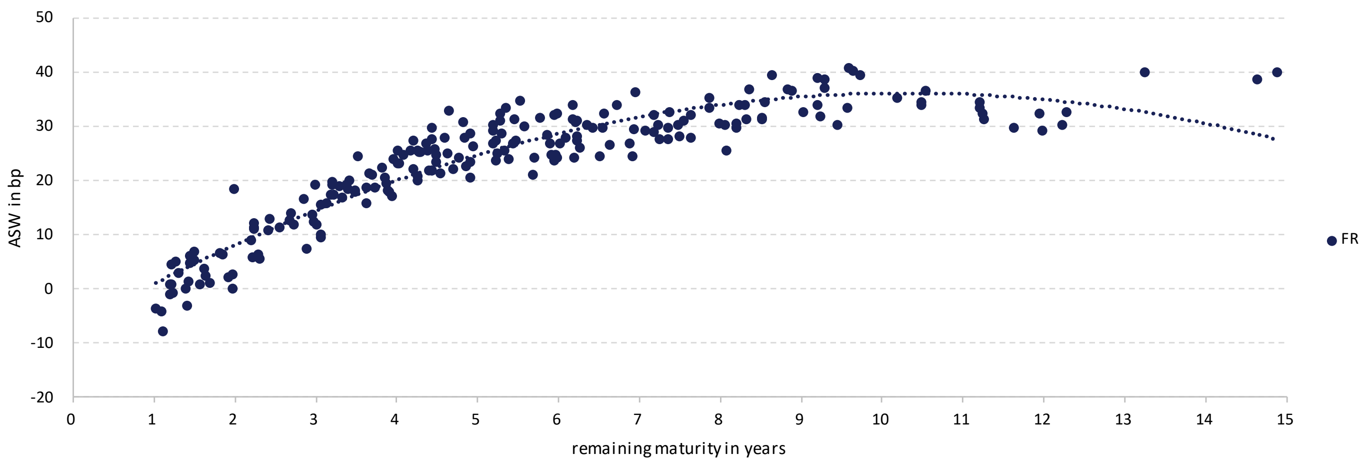
Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

Spread overview[1]

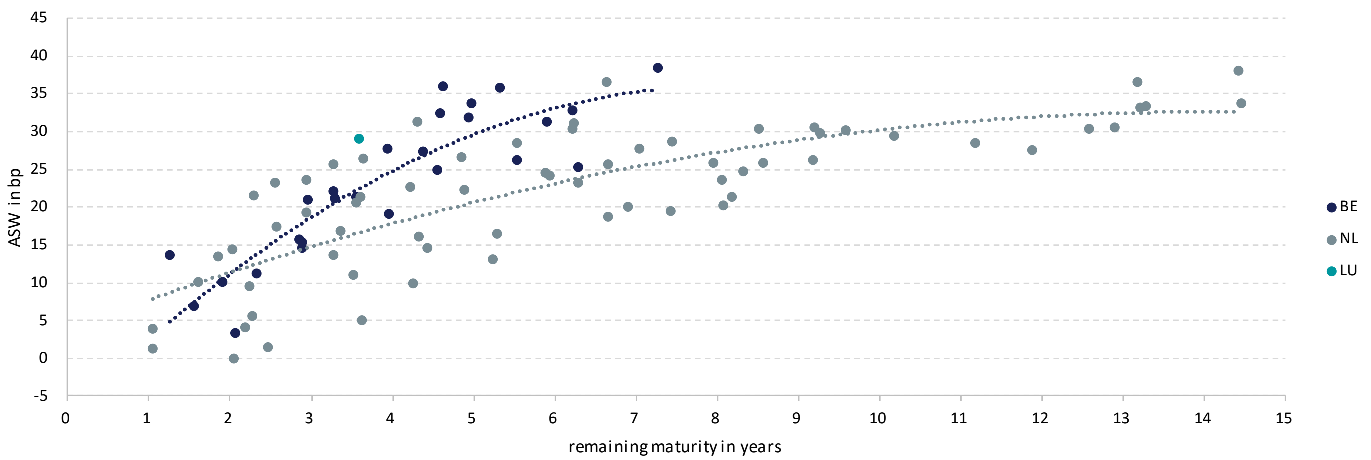
DACH



France

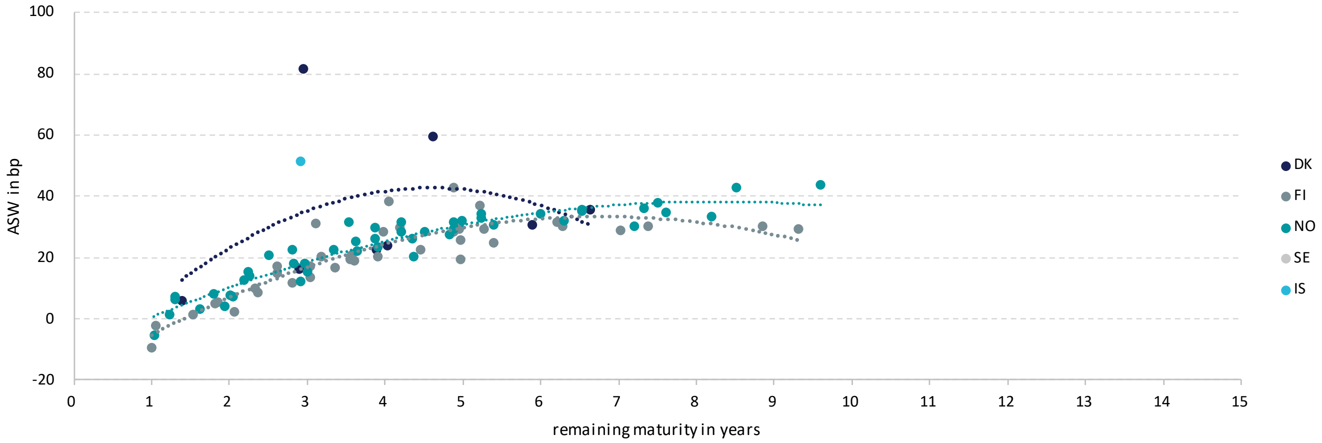


Benelux

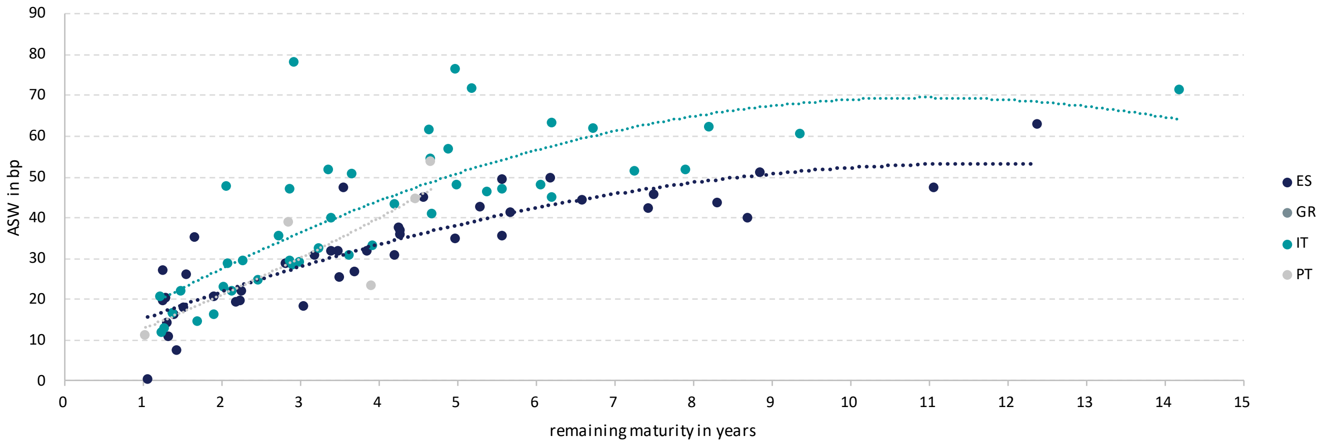


Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research [1]Time to maturity 1 ≤ y ≤ 15

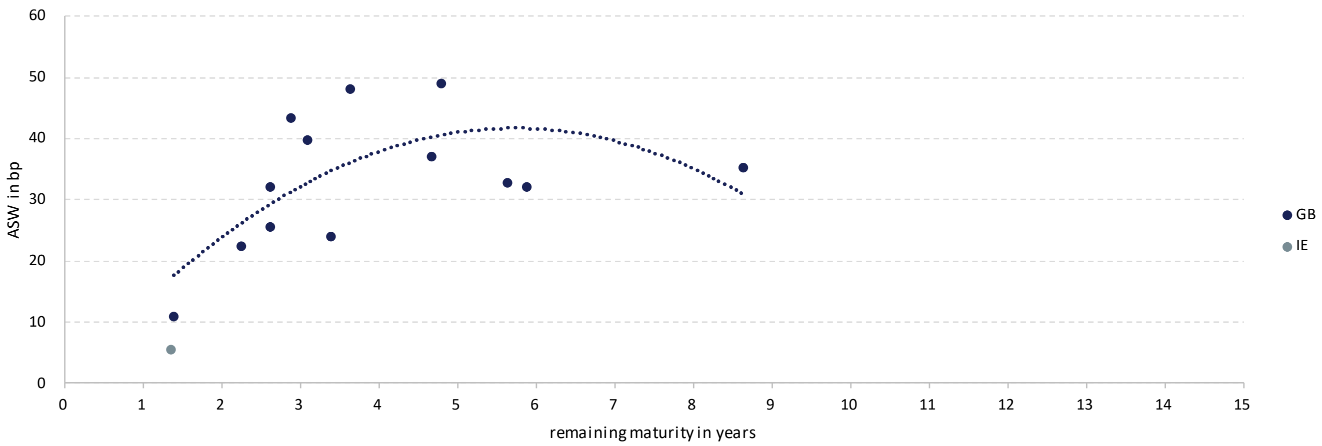
Nordics



Southern Europe

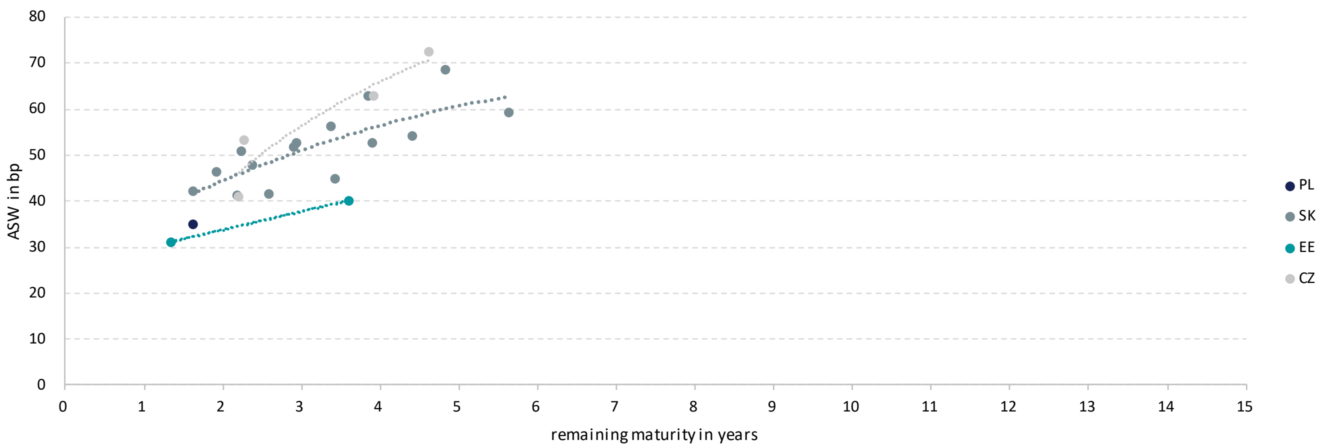


UK/IE

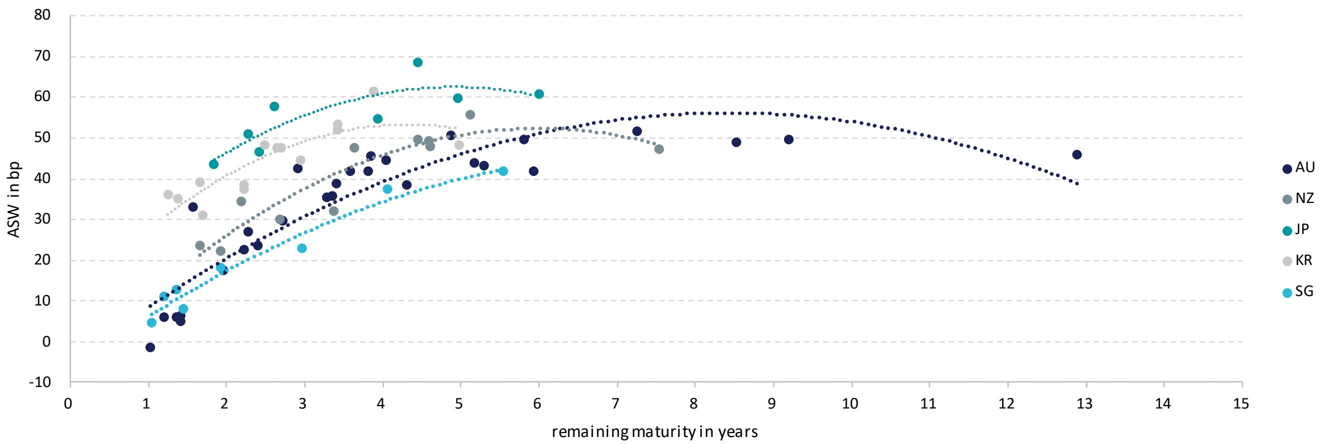


Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

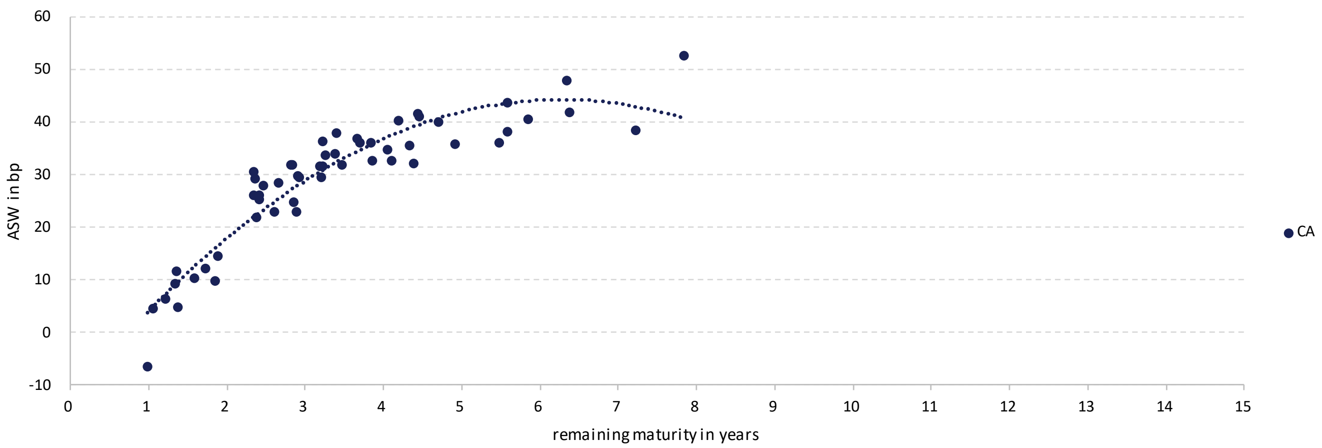
CEE



APAC



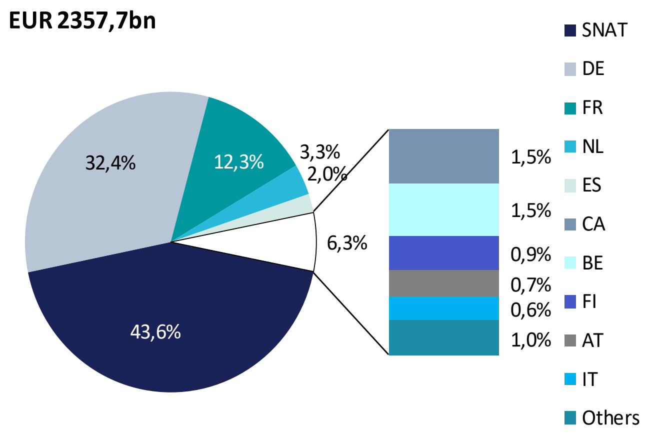
North America



Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

Charts & Figures
SSA/Public Issuers

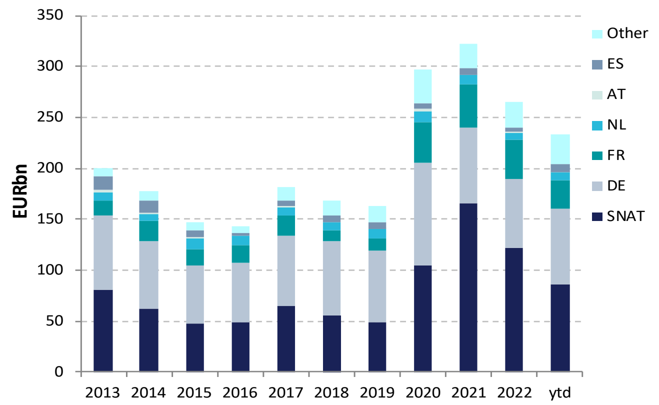
Outstanding volume (bmk)



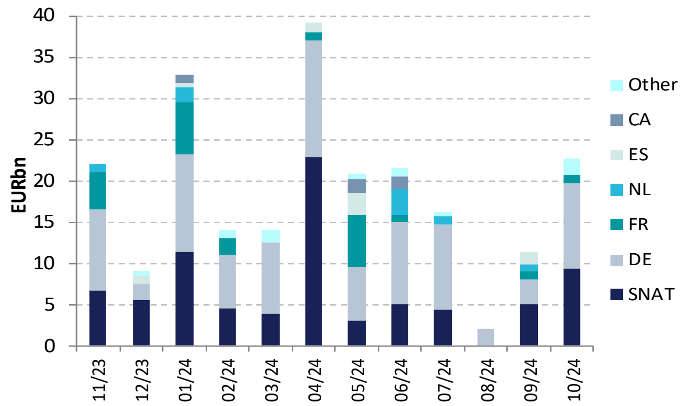
Top 10 countries (bmk)

Country	Vol. (€bn)	No. of bonds	ØVol. (€bn)	Vol. weight. ØMod. Dur.
SNAT	1.028,5	230	4,5	7,9
DE	764,8	568	1,3	6,1
FR	289,8	198	1,5	5,9
NL	78,3	68	1,2	6,6
ES	48,0	66	0,7	4,6
CA	35,6	25	1,4	4,1
BE	35,2	38	0,9	10,7
FI	22,2	24	0,9	4,8
AT	17,3	21	0,8	4,6
IT	15,0	19	0,8	4,6

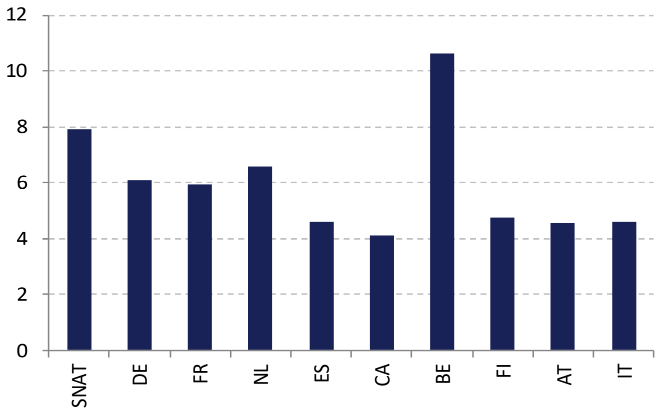
Issue volume by year (bmk)



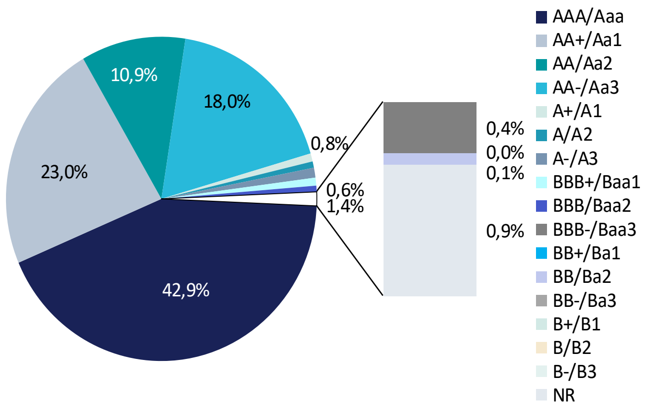
Maturities next 12 months (bmk)



Avg. mod. duration by country (vol. weighted)

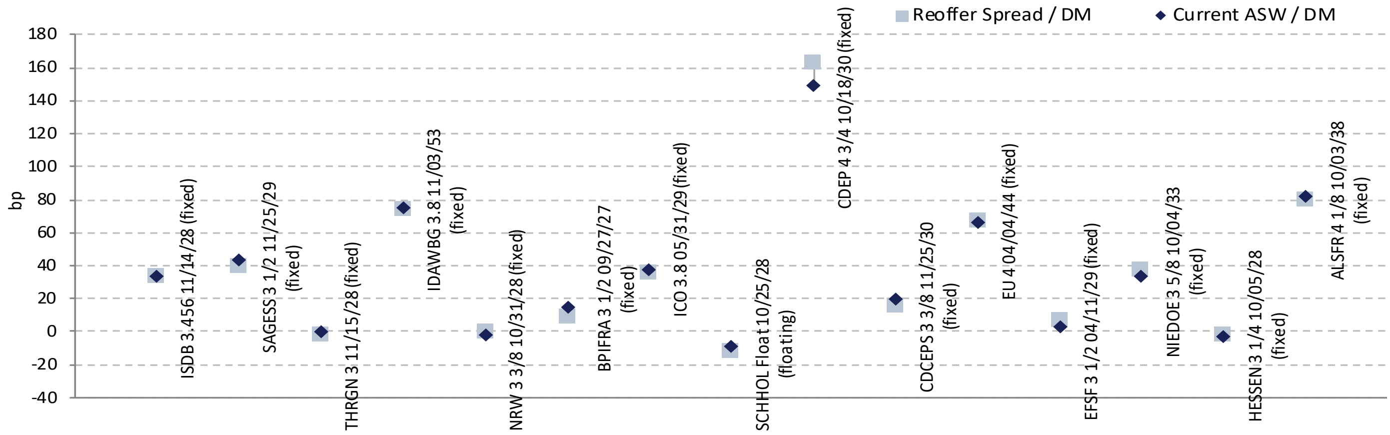


Rating distribution (vol. weighted)

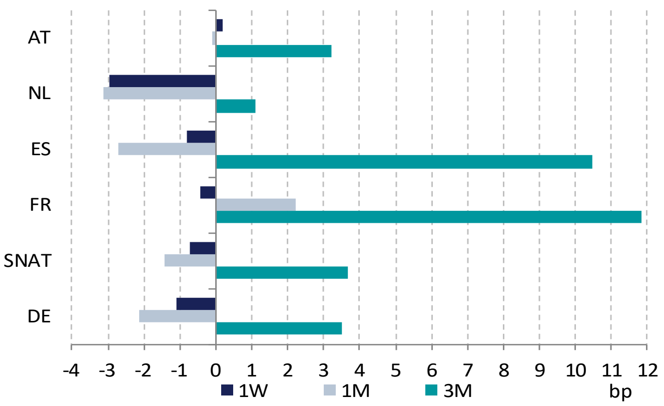


Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

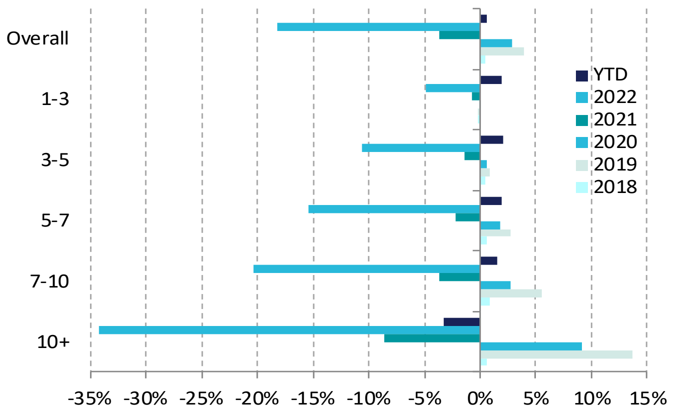
Spread development (last 15 issues)



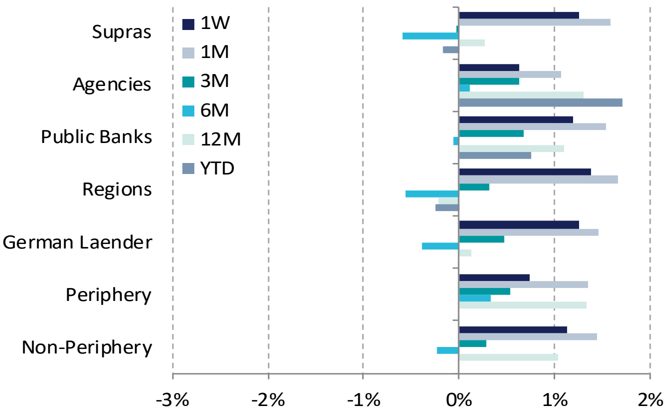
Spread development by country



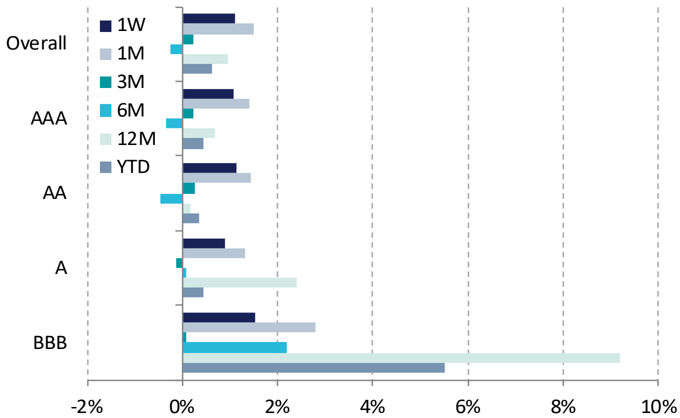
Performance (total return)



Performance (total return) by segments

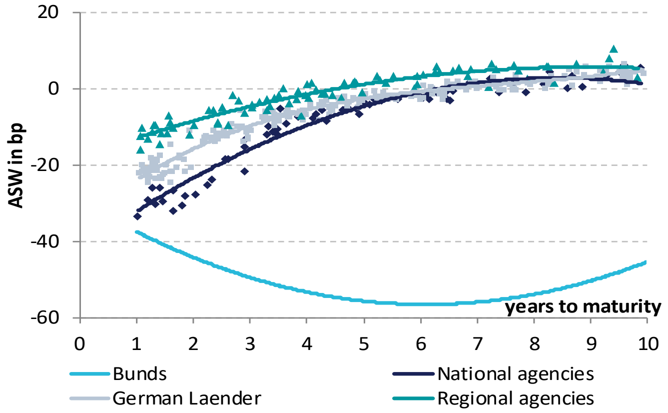


Performance (total return) by rating

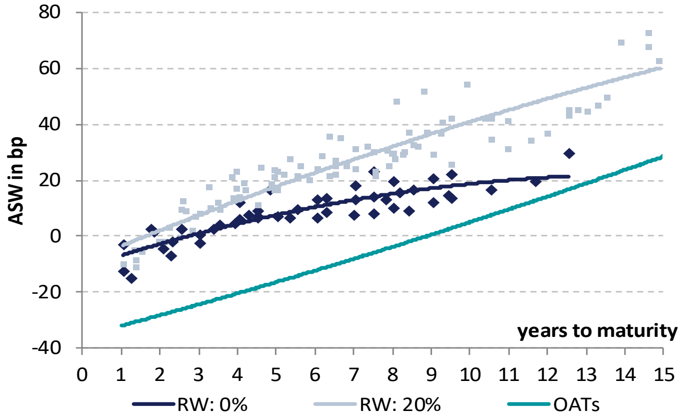


Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

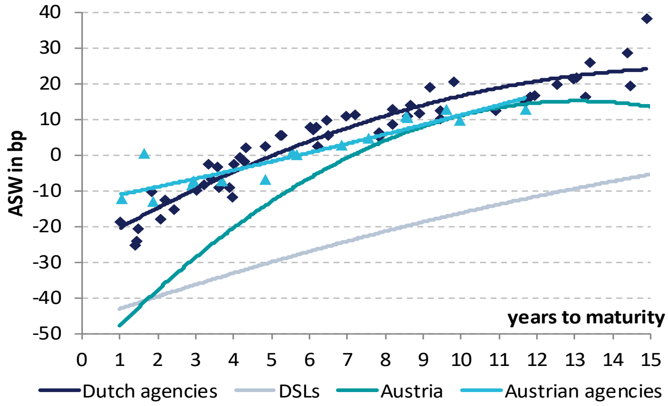
Germany (by segments)



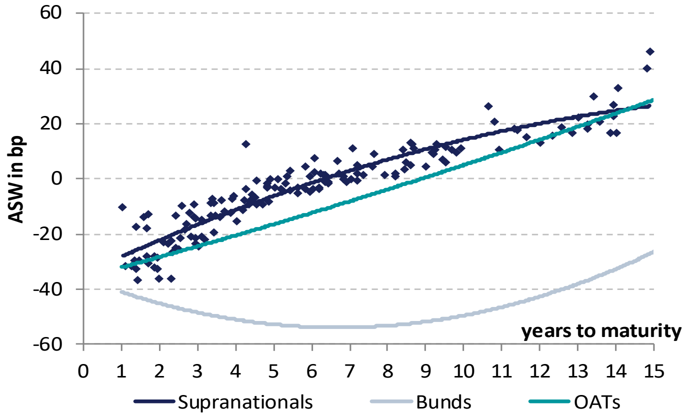
France (by risk weight)



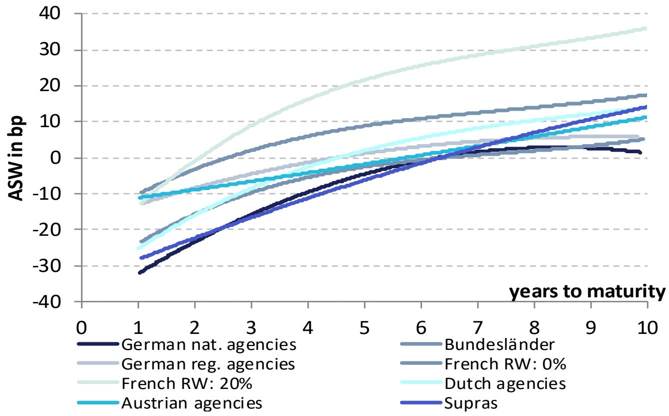
Netherlands & Austria



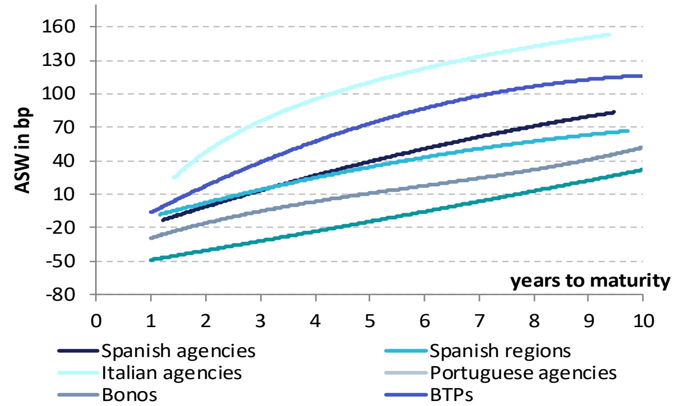
Supranationals



Core



Periphery



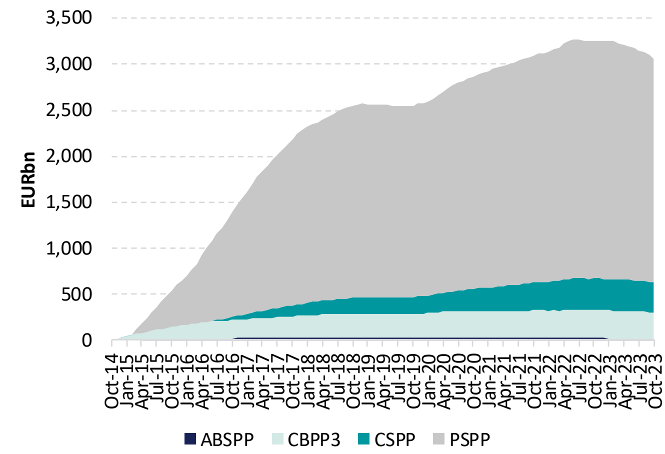
Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

ECB tracker

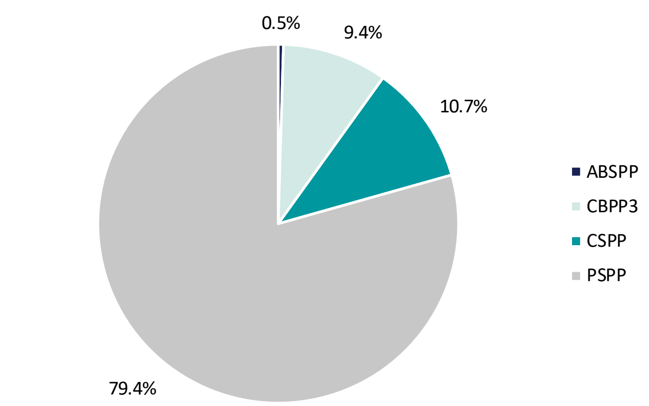
Asset Purchase Programme (APP)

	ABSPP	CBPP3	CSPP	PSPP	APP
Aug-23	16,436	295,503	334,738	2,487,900	3,134,577
Sep-23	15,324	291,992	331,156	2,470,598	3,109,070
Δ	-1,096	-3,346	-3,377	-13,434	-21,253

Portfolio development

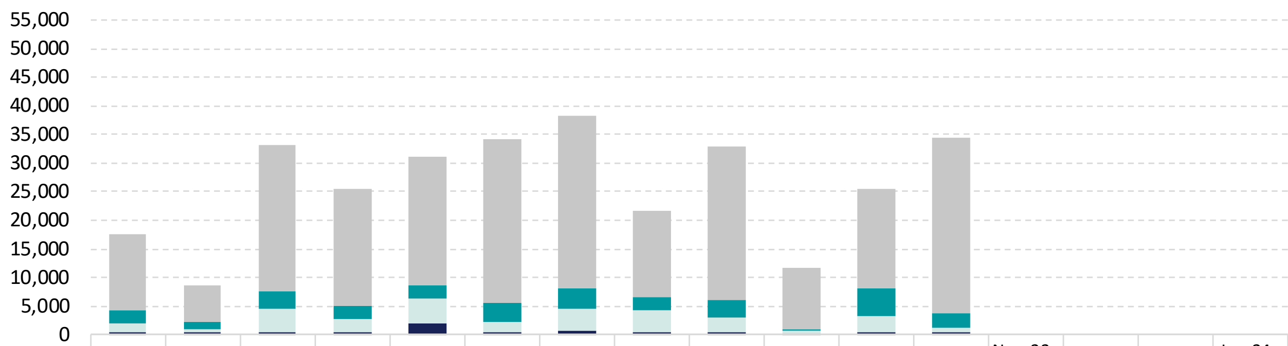


Portfolio structure



Source: ECB, NORD/LB Markets Strategy & Floor Research

Expected monthly redemptions (in EURm)

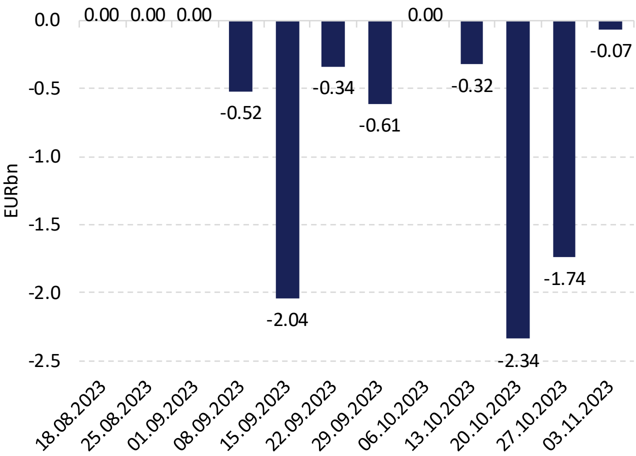


	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-23 - Oct-24	2022	2023	Jan-24 - Oct-24
APP	17,560	8,548	33,226	25,570	31,041	34,259	38,283	21,633	33,011	11,587	25,504	34,440	314,662	299,142	331,493	288,554
PSPP	13,282	6,336	25,524	20,445	22,413	28,712	30,194	14,974	26,910	10,533	17,424	30,578	247,325	228,585	255,022	227,707
CSPP	2,393	1,336	3,101	2,325	2,188	3,316	3,463	2,462	3,204	244	4,738	2,720	31,490	17,670	31,170	27,761
CBPP3	1,351	408	4,109	2,449	4,434	1,814	3,836	3,777	2,558	541	2,993	736	29,006	41,244	35,147	27,247
ABSPP	534	468	492	351	2,006	417	790	420	339	269	349	406	6,841	11,643	10,154	5,839

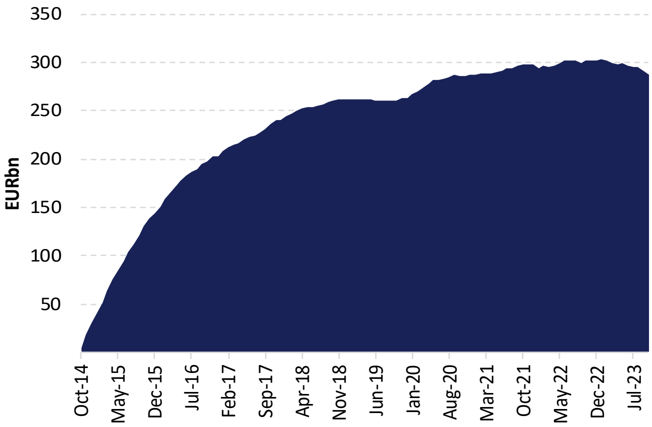
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Covered Bond Purchase Programme 3 (CBPP3)

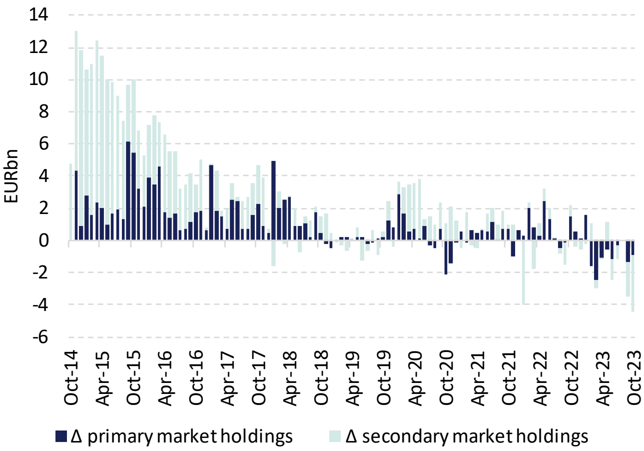
Weekly purchases



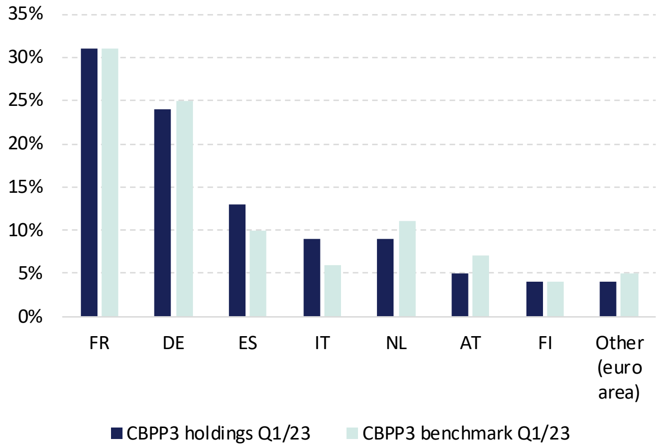
Development of CBPP3 volume



Change of primary and secondary market holdings

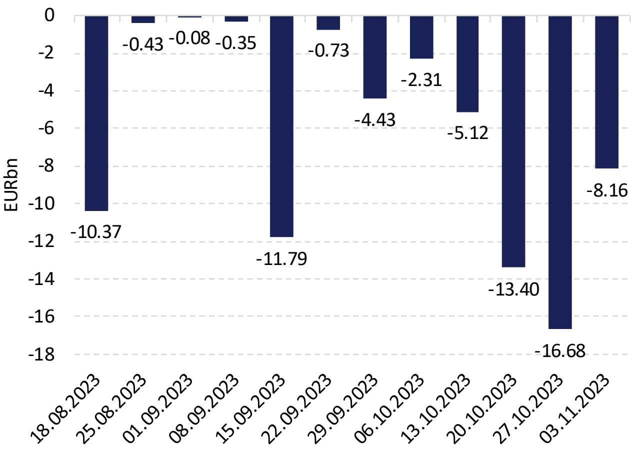


Distribution of CBPP3 by country of risk

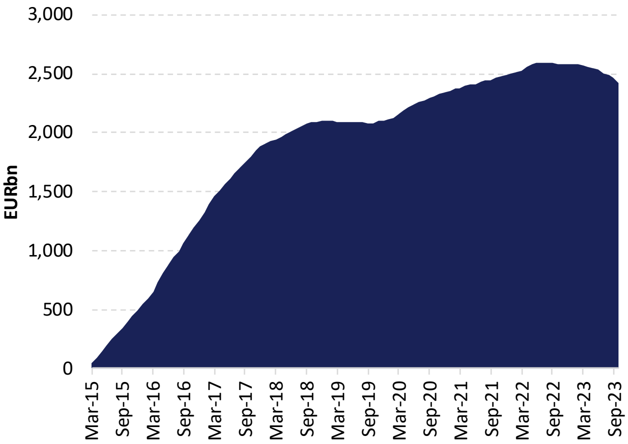


Public Sector Purchase Programme (PSPP)

Weekly purchases



Development of PSPP volume

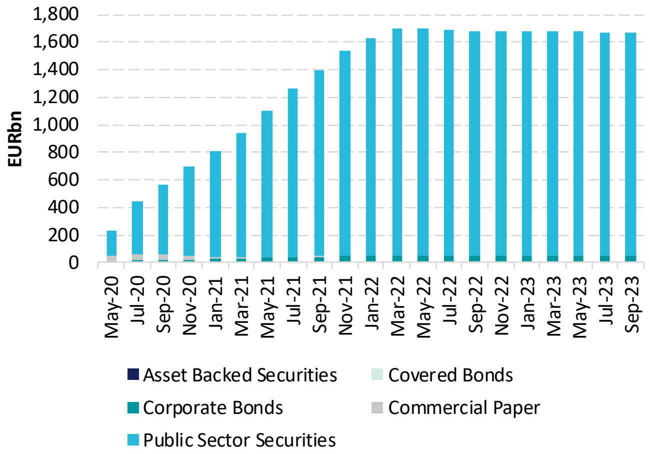


Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

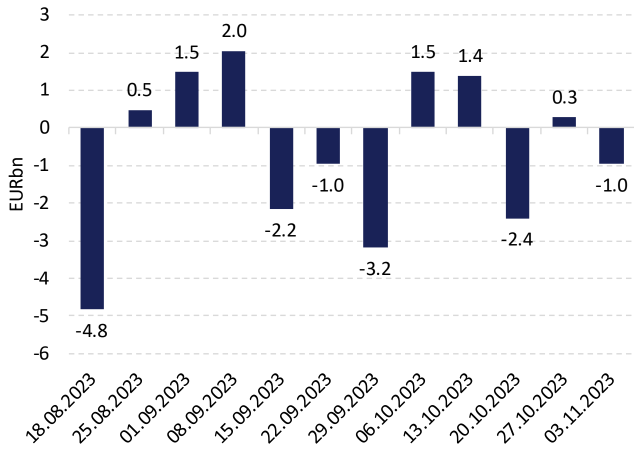
NORD/LB

Pandemic Emergency Purchase Programme (PEPP)

Portfolio development



Weekly purchases



Breakdown of public sector securities under the PEPP

Jurisdiction	Holdings (in EURm)	Δ Holdings previous period	Adj. distribution key[1]	PEPP share	Deviations from the adj. distribution key[2]	Current WAM[3] (in years)	WAM of eligible universe[4] (in years)
AT	44,129	-1,028	2.6%	2.7%	0.0%	7.2	7.8
BE	56,941	-610	3.3%	3.4%	0.2%	6.0	9.4
CY	2,423	-156	0.2%	0.1%	0.0%	8.4	8.2
DE	393,313	1,135	23.7%	23.7%	0.0%	6.7	7.0
EE	256	0	0.3%	0.0%	-0.2%	6.7	6.5
ES	193,041	-2,722	10.7%	11.6%	0.9%	7.2	7.4
FI	25,953	565	1.7%	1.6%	-0.1%	7.5	7.7
FR	298,322	1,717	18.4%	18.0%	-0.4%	7.3	7.8
GR	38,260	-172	2.2%	2.3%	0.1%	8.5	9.1
IE	25,541	133	1.5%	1.5%	0.0%	8.8	9.2
IT	292,198	938	15.3%	17.6%	2.3%	7.0	6.9
LT	3,145	-2	0.5%	0.2%	-0.3%	9.3	8.6
LU	1,858	-110	0.3%	0.1%	-0.2%	6.0	8.3
LV	1,843	23	0.4%	0.1%	-0.2%	7.9	7.5
MT	604	-4	0.1%	0.0%	-0.1%	9.8	8.5
NL	80,598	-2,269	5.3%	4.9%	-0.4%	7.6	8.9
PT	33,921	127	2.1%	2.0%	-0.1%	7.0	7.7
SI	6,493	44	0.4%	0.4%	0.0%	8.4	8.8
SK	8,040	65	1.0%	0.5%	-0.5%	7.9	8.3
SNAT	153,089	2,000	10.0%	9.2%	-0.8%	9.9	9.0
Total / Avg.	**1,659,970**	**-327**	**100.0%**	**100.0%**	**0.0%**	**7.4**	**7.6**

[1] Based on the ECB capital key, adjusted to include supras [2] Based on the adjusted distribution key
[3] Current WAM of public sector securities holdings under the PEPP [4] WAM of eligible universe of public sector securities holdings under the PEPP
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

NORD/LB

Appendix
Overview of latest Covered Bond & SSA View editions

Appendix
Publication overview

Covered Bonds:

Issuer Guide Covered Bonds 2023

Covered Bond Laws

Covered Bond Directive: Impact on risk weights and LCR levels

Risk weights and LCR levels of covered bonds (updated semi-annually)

Transparency requirements §28 PfandBG Q2/2023 (quarterly update)

Covered bonds as eligible collateral for central banks

SSA/Public Issuers:

Issuer Guide – German Laender 2023

Issuer Guide – European Supranationals 2023

Issuer Guide – French Agencies 2023

Issuer Guide – Dutch Agencies 2023

Issuer Guide – German Agencies 2022

Beyond Bundeslaender: Belgium

Beyond Bundeslaender: Greater Paris (IDF/VDP)

Beyond Bundeslaender: Spanish regions

Fixed Income Specials:

ESG-Update 2023

ECB: Now is not the time for forward guidance!

ECB preview: Wait and see without calling it a pause

ECB: This rate terminates here – 99.9% sure

Appendix
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Sales Sparkassen & Regionalbanken	+49 511 9818-9400
Sales MM/FX	+49 511 9818-9460
Fixed Income Relationship Management Europe	+352 452211-515

Trading

Covereds/SSA	+49 511 9818-8040
Financials	+49 511 9818-9490
Governments	+49 511 9818-9660
Länder/Regionen	+49 511 9818-9550
Frequent Issuers	+49 511 9818-9640

Origination & Syndicate

Origination FI	+49 511 9818-6600
Origination Corporates	+49 511 361-2911

Sales Wholesale Customers

Firmenkunden	+49 511 361-4003
Asset Finance	+49 511 361-8150

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Relationship Management

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Öffentliche Kunden	rm-oek@nordlb.de

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