GENERALI INVESTMENTS

Focal Point

ECB to soak up almost entire EGB net supply in 2020

Date: October 28, 2019

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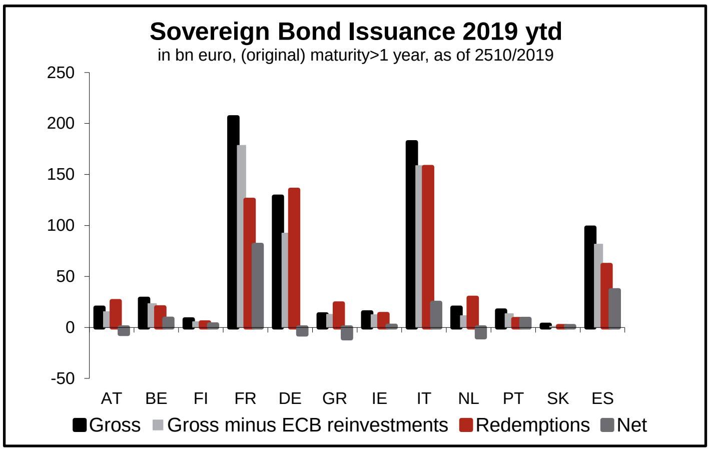
- Euro area government bond issuance activity has progressed in line with the historical pattern in 2019. The remaining net funding needs for the rest of the year are very manageable.
- Due to marginally higher redemptions and net issuance, the gross issuance is expected to increase slightly in 2020.
- Even without net purchases in 2019, the ECB still holds almost 25% of all outstanding euro area government bonds. With the restart of its purchase programme this share will increase again close to 26% by 2020. The central bank will absorb almost the complete net issuance next year.
- As the ECB holds already more than € 500bn of German debt, a possible scarcity of German Bunds is expected to come to the fore again over the course of 2020. However, given the limited size of the forthcoming QE programme, the self-imposed issue limit of 33% will be binding not earlier than the middle of 2021.

As usual, issuance activity is expected to slow significantly in the final months of the year. In fact, net issuance is forecast to be only moderately positive. Moving into 2020, gross issuance is likely to increase slightly from 2019 levels. With the restart of the APPs (asset purchase programmes), the ECB will impact bond markets strongly. However, given the limited size of monthly purchases, the additional distorting effect on government bond markets is estimated to remain rather muted.

Bond issuance in line with last years' pattern

As we have entered the last quarter of the year, it is time to have a deeper look at the issuance activity of euro area governments so far. Treasurers have exploited the friendly market environment and there were no meaningful problems to issue the planned volumes. The issuance activity at this time of the year is in line with last years' average. To date, the gross issuance volume has reached around € 740bn. This is more than 85% of the total annual issuance. As there are still some heavy redemptions in the pipeline, the net issuance will be only moderately positive until the end of the year. However, the maturity profile is not evenly distributed. Hence, there will be both weeks with positive and with negative net supply. Overall, however, the low remaining issuance volume and the high redemptions will support government bond markets until the end of the year.

The weighted average maturity of new bonds increased marginally compared to last year. New government bonds sold in 2019 had an average maturity of around 10 years. More than 30% of new euro area government bonds issued in 2019 had an initial maturity of more than 10 years. Particularly semi-core countries focused on very long-dated bonds. For example, the average maturity of new Belgian bonds was above 15 years. In contrast, core countries confined mainly to medium-dated bonds. The average maturity of new German bonds has been below 8 years so far.

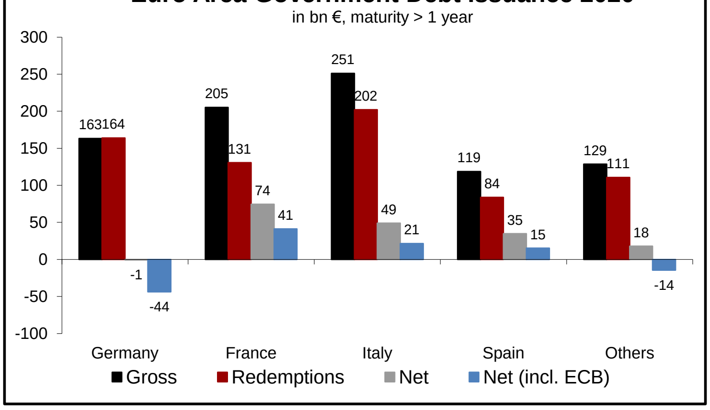


Analyzing the numbers at a more disaggregated country level reveals some interesting features. Some countries have already almost completed their gross issuance schedule. Most noteworthy, Belgium and Austria are nearly done. In contrast, beside some smaller countries, Italy will be rather active in the remaining weeks of the year. It is not only lagging behind other countries, but also compared to its own historical pattern. With respect to the net issuance, France stands out. After the huge redemptions in October, there will be another one in November (more than € 20bn). As France's issuance activity is well advanced, this implies a negative net supply by the end of 2019. Against it, Italy's issuance activity during the remainder of the year will be carried out to cover net funding needs. However, given the benign market environment, we do not expect any serious problems. The market is forecast to take down Italy's new bonds smoothly.

Overall, the advanced issuance activity in combination with the restart of the ECB's APP (see for more details below) will be an important factor supporting euro area government bond markets until year-end.

Sovereign bond supply to rise slightly in 2020

Moving into 2020, gross issuance of euro area government bonds is forecast to rise slightly. Restricting the analysis to fixed income paper with a maturity above 1 year, we estimate total issuance to increase from € 858bn to € 867bn. Although some euro area Treasuries have already released projections and made announcements concerning 2020's funding requirements, these numbers are still subject to a certain degree of uncertainty as revisions due to changes in funding requirements can occur over the course of 2020. In addition to the Treasuries' announcements, we base our estimates on the draft budget plans submitted to the EU Commission this month and own estimates. We expect the euro area fiscal deficit to rise marginally compared to 2019 (for more details, see our recent Focal Point – Euro area: How much fiscal boost can we expect?). Overall, net issuance is seen to increase from € 173bn to € 176bn. Net cash flow (net issuance less coupons) will even rise by € 12bn. As issuers have been able to refinance high-coupon bonds with low-coupon bonds over recent years, the coupon flow will decrease further in 2020. In addition, the volume of redemptions will rise as well (from € 685bn to € 691bn).



Euro Area Government Debt Issuance 2020

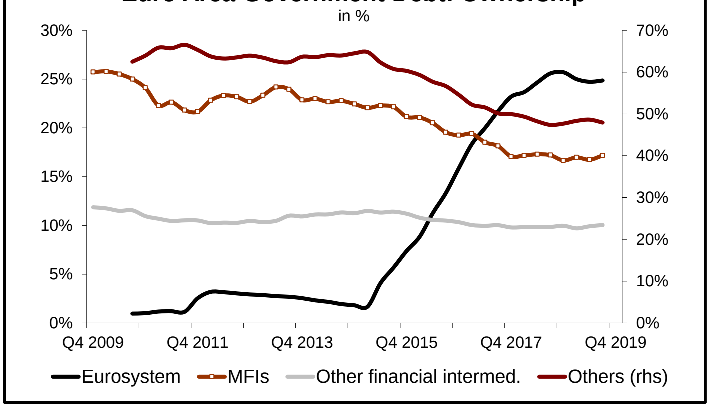
The individual country profile, however, varies somewhat. Due to an increase in redemptions and a less advantageous fiscal position, gross issuance in Germany is expected to rise to € 163 bn. Nonetheless, assuming Germany will not embark on a broad-based expansionary fiscal stance net issuance is seen to remain slightly negative. Gross issuance in France and Italy is forecast to remain around this year's levels. Neither redemptions nor net issuance is seen to change substantially. In contrast, gross issuance in Spain is likely to decrease by around € 17bn. Driven by modestly lower redemptions and funding needs, Spain will be able to reduce its primary market activities in 2020.

Among the smaller countries, gross issuance is forecast to rise in the Netherlands (circa € 8bn) and in Finland (circa € 10bn). In the case of the Netherlands this is mainly driven by a higher net issuance, in the case of Finland by a rise in redemptions. A further improvement of the fiscal situation allows Portugal to scale back its gross issuance next year (by € 5bn to € 10 bn).

As usual, we expect treasurers to be most active at the start of the year and issuance activity to be rather front-loaded. Almost one third of the issuance activity is likely to take place in Q1. Up to the middle of the year 2020, nearly 60% of the gross issuance should be taken down already.

ECB's impact to rise again in 2020

Until the end of 2018, the ECB purchased government bonds under the APP. Since then, however, the central bank has not increased its holdings of government bonds, but only reinvested maturing bonds. In fact, as the ECB does not reinvest maturing government bonds purchased under the Securities Market Programme the stock of sovereign bonds decreased slightly. But, the central bank still holds almost 25% of all outstanding euro area government bonds.



Euro Area Government Debt: Ownership

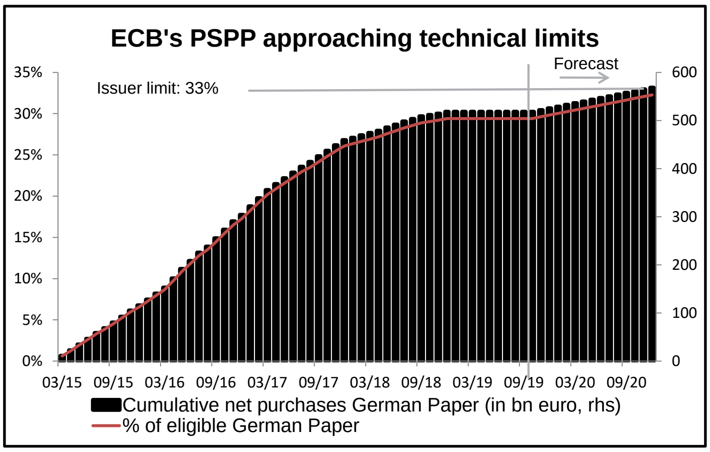
From next month on, the ECB will resume its QE programme with monthly purchases of € 20bn. We assume that the central bank will on average allocate € 13bn to the government bond market. This is slightly below the share during the period from 2015 to 2018, reflecting the expected stronger focus on private debt. This implies that the ECB will invest € 156bn in the euro area government bond market in 2020 (in addition to the reinvestments). As in our base scenario the net issuance next year will be around € 176bn, this means that almost the complete net issuance will be absorbed by the central bank. This also means that the ECB's share of government bonds will rise above last year's level and will mark a new record close to 26%.

Although the ECB's market intervention was much stronger in the past (e.g., in 2016 the ECB allocated almost € 700bn to the government bond market), the resumption of QE limits other investors' possibility to invest in euro area government bond markets. The emergence of a price-inelastic new buyer will support government bond markets for the time being (and other segments of the market of course). Not least the knowledge of the existence of a buyer of last resort will prevent a sharp increase in yields for the time being.

Taking into account the new QE programme, next year's net supply will shrink well below the level of 2019 (from € 146bn to € 20bn). At the country level, net issuance (after QE) will be negative for many countries. Not least due to the high ECB capital share, Germany will have a negative net issuance of around € 44bn. France will remain the country with the highest net issuance. However, it is forecast to be only around € 41bn.

Scarcity of German Bunds to resurface again

The fiscal situation of Germany was benign over recent years. Germany has achieved for some years a fiscal surplus and has reduced its debt not only relative to GDP, but also in absolute terms. This led to a shrinking outstanding volume of German government bonds. Given the ECB's self-imposed issue limit of 33%, the scarcity of German Bunds is likely to come to the fore again over the course of 2020.



Meanwhile, the book value of German government bonds purchased by the ECB under the Public Sector Purchase Programme amounts to more than € 518bn. Already in the past the ECB allocated a high proportion of net purchases to national agencies to bypass the limit restrictions. However, this will increasingly run into problems as even considering national agencies the ECB's share is close to 30% by now.

Assuming that the ECB will buy according to Germany's capital share, the central bank will buy from November around € 3.6bn of German government bonds on average. This means that by the end of 2020 the ECB will hold nearly € 570bn of German government bonds. As the net issuance of sovereigns will be close to zero and funding requirements of agencies are limited as well the ECB's share will have risen to around 32%. Hence, due to the limited size of the new QE programme, the self-imposed issue limit of 33% will not yet be broken over the course of 2020.

On the basis of a slight fiscal deterioration and a low positive net issuance in 2021, the limit will become binding by the middle of 2021. The prerequisite, however, is that the central bank is able to buy up to the technical limit in all issuances. Otherwise, the limit will become binding earlier. Another alternative to avoid running into this constraint is to deviate temporarily from the capital key. The ECB followed this pattern in the past (not only in the case of Germany). However, given the size of the German market, this is unlikely to be a sustainable solution to the scarcity problem.

In fact, the situation can become worse before if the financial or macroeconomic environment deteriorates and the ECB decides to increase its monthly purchases. Assuming e.g. that the ECB doubles its monthly purchases to € 40bn from the start of 2020, but leaves all other conditions unchanged the issue limit for German bonds will be reached by the end of 2020 already.

Imprint

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