

# Fixed Income Research

## EUR Covered Bonds

Nordea Research, 6 November 2015

- The CBPP3 will remain unchanged if ECB launches QE2
- The ECB will own 40% of the Euro area market by September 2016
- Norwegian trading close to Spanish covered bonds

### Don't expect changes to CBPP3

Since Draghi's last speech on the 22 October markets have been expecting a QE2 program which will be larger in both size and scope, and possibly coupled with a deposit rate cut. This naturally begs the question as to what will happen with the Covered Bond Purchase programme (CBPP3). We find that the CBPP3 already has been very aggressive, with some even calling for the programme to be scaled back. We doubt that this will happen.

Size-wise the CBPP3 plays a vital role in fulfilling the ECB's balance sheet target. The ECB has so far disregarded liquidity worries as its focus lies on inflation and the balance sheet, and we don't think this strategy will change. Further, if CBPP3 is scaled back then more government bonds will have to be bought, which would come on top of a possible December increase in QE. This would again bring into question if there are enough government bonds.

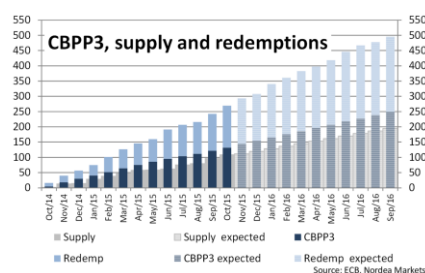
### Nordic covered spreads approaching Spanish

The latest Nordic issuance continues to lie significantly above secondary levels. The worry was initially that secondary levels had to catch up (rise) to primary levels, but in October there has been decent performance in the primary market, while secondary levels have widened only slightly. The Nordic New Issue Premiums (NIP) have been high, and with select secondary curves approaching Spanish (BBVASM/SANTAN), we find that Nordic issues are cheap and have large tightening potential (see page 4).

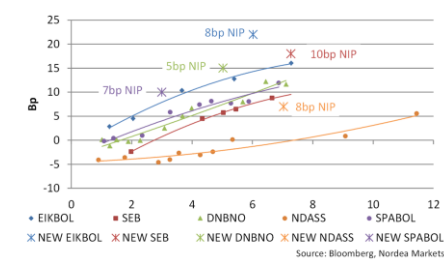
### Supply will fall as yearend approaches

Issuance in 2015 has so far caught up with our expectations, and will therefore very likely surpass these as we still have a couple of months to go before the year ends. Nordic supply has pretty much stayed in line with redemptions, and despite bonds maturing from Nordea and Danske Bank Finland we don't expect further Nordic issuance after yesterday's 3Y SPABOL.

### ECB set to own 40% of the market



### Nordic NIPs have been generous



Uffe Kalmar Hansen

Senior Analyst

Fixed Income and Sales

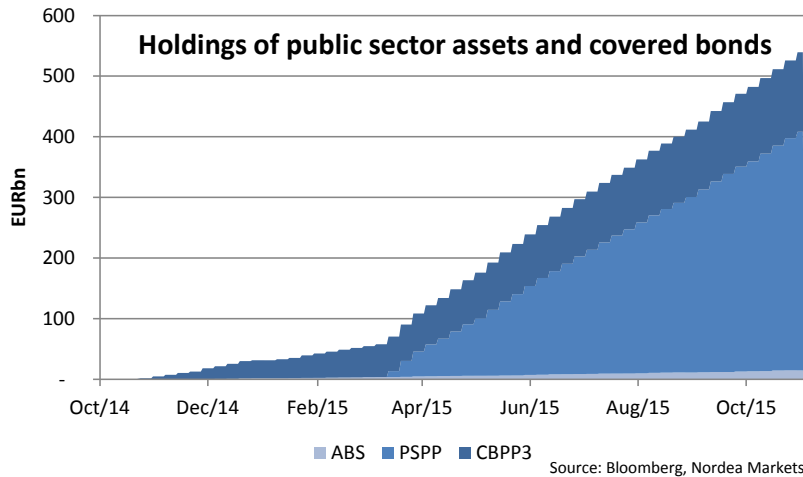
+45 3333 5365

uffe.kalmar.hansen@nordea.com

### Contents

- Don't expect changes to CBPP3 .....1
- Nordic covered spreads approaching Spanish .....1
- Supply will fall as yearend approaches .....1
- ECB won't scale down CBPP3 2
- The CBPP3 is vital in reaching ECB's balance sheet target .....3
- The ECB will own 40% of the market by September 2016.....3
- Dissecting performance of October issuance .....4
- Relative value: Should Scandi's trade close to Spanish? .....4
- Factors currently speak in favour of Nordic covered bonds: .....5
- Supply .....5
- Is the issuance window closing? .....5

Public sector bond purchases relative to covered bond purchases



ECB won't scale down CBPP3

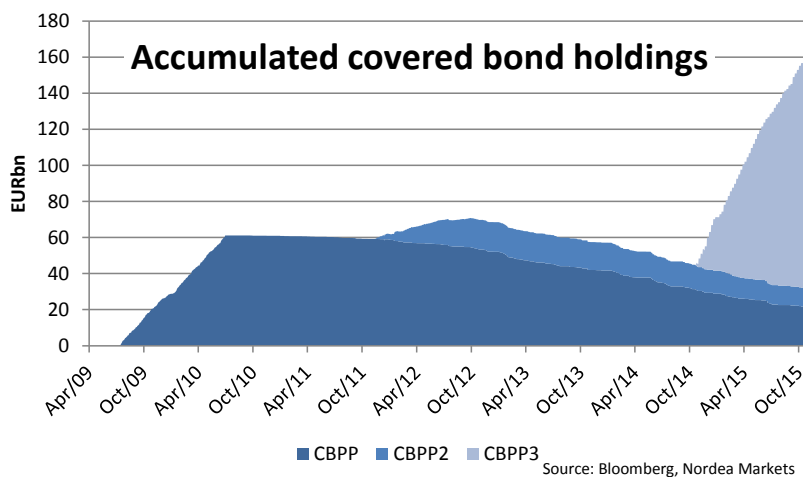
The CBPP3 can be viewed as a buy-and-hold investor buying specific amounts regardless of market conditions. As a whole this should therefore be viewed as a force of stability, continuously exerting a downward pressure on spreads.

Even so market participants have increasingly been voicing concern as to the unintended consequences the CBPP3 is exerting on the covered bond market. The focus is centered on particularly two things:

- Markets have in 2015 been suffering from a lack of liquidity where the CBPP3 is seen as the culprit.
- Further, the covered bond market was fully functioning before the ECB stepped in with CBPP3 resulting in an investor squeeze-out, and skewed allocations.

*Even as these are weighty arguments speaking in favor of change, we find it highly unlikely that the ECB will change CBPP3, if QE2 becomes reality.*

CBPP, CBPP2 and CBPP3 holdings



**The CBPP3 is vital in reaching ECB’s balance sheet target**

Currently the CBPP3 plays a major part in fulfilling the balance sheet objective of the ECB, and the volumes bought make up a significant part of the total QE programme.

*Based on the current programme the distribution between covered bonds and public sector bonds is 1:3. Meaning for every EUR 1bn covered bond owned, the ECB owns EUR 3bn public sector bonds (EUR 131bn vs. 394bn).*

It should be noted that the current distribution is a reflection of the fact that the CBPP3 started in October 2014 whereas the PSPP started in March 2015. The ratio will therefore fall going forward as the ECB buys covered bonds worth around EUR 10bn a month, while the public sector purchases amount to around EUR 50bn a month. Nevertheless it’s a clear reflection of the importance of the CBPP3 if the ECB is to reach its balance sheet target.

Ahead of us we still have at least 11 more months of covered bond buying where the average so far is close to EUR 10bn a month. Any reduction will have to be found elsewhere, and most likely in the government bond segment. On top of this comes a possible QE2 programme which would entail further purchases of government bonds or other public sector assets. This would only add further fuel to the question as to which bonds the ECB can buy, as there could easily be a shortage of government bonds available.

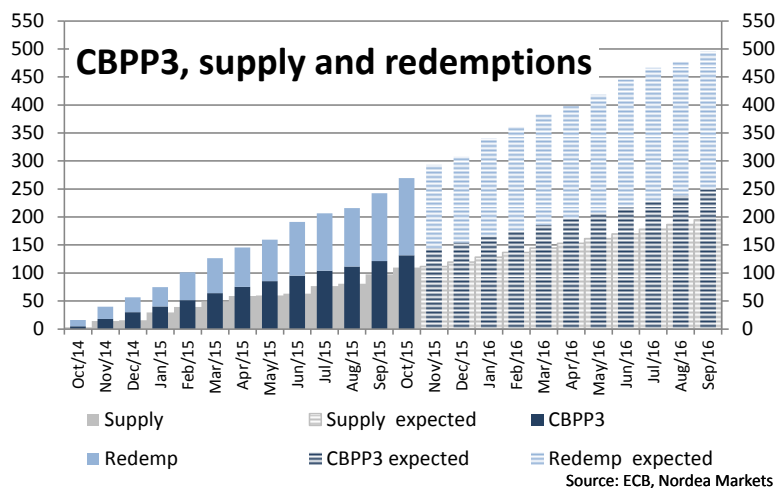
*Reducing covered bond purchases, without there being other obvious viable choices, therefore seems highly unlikely.*

**The ECB will own 40% of the market by September 2016**

We have taken a closer look at the CBPP3 relative to the Euro Area covered bond market trying to estimate just how aggressive it has actually been. In doing so we need to take into account and define the current actual market size, expected issuance, expected redemptions and expected purchases under the CBPP3. The CBPP3 will absorb 36% of the market by September 2016.

*Including the legacy covered bond purchase programmes the ECB will own 40% of all fixed rate Euro area covered bond market.*

**CBPP3 buying relative to supply and redemptions**



Nordic October issuance, ranked by performance

13 Oct 2015	DNBNO	NO	0.375%	20 Oct 2020	XS1308759718	Aaa/AAA-	1.250	15	10	
26 Oct 2015	SEB	SW	0.625%	30 Jan 2023	XS1314150878	Aaa/-/-	1.000	18	13	
19 Oct 2015	NWIDE	EN	0.750%	26 Oct 2022	XS1308693867	Aaa/AAA/AAA	1.000	20	15	
27 Oct 2015	SABSM	SP	0.625%	03 Nov 2020	ES0413860505	(P)Aa2/-/-	1.000	48	43	
01 Oct 2015	BKTSM	SP	0.625%	09 Oct 2020	ES0413679350	Aa2/A+/-	0.750	40	35	
19 Oct 2015	SANTAN	PO	0.875%	27 Oct 2020	PTBSRBOE0021	A1/-/BBB+	0.750	55	51	
12 Oct 2015	BKIR	IR	0.625%	19 Feb 2021	XS1308351714	Aa1/-/-	0.750	33	30	
15 Oct 2015	CAJARU	SP	1.000%	22 Oct 2020	ES0422714040	-(P)BBB+/BBB	0.750	80	77	
20 Oct 2015	MONTE	IT	1.250%	20 Jan 2022	IT0005140188	A2/-/BBB	0.750	85	82	
21 Oct 2015	EIKBOL	NO	0.625%	28 Oct 2021	XS1312011684	Aa1/-/-	0.500	22	19	
19 Oct 2015	BANCAR	IT	1.250%	28 Jan 2021	IT0005139859	Ba1/-/BBB-	0.500	100	97	
13 Oct 2015	CAFFIL	FR	0.625%	26 Jan 2023	FR0013019510	Aaa/AA+/AA	1.000	5	3	
12 Oct 2015	NDASS	FI	0.625%	19 Oct 2022	XS1308350237	Aaa/-/-	1.250	7	5	
20 Oct 2015	CFF	FR	0.375%	29 Oct 2020	FR0013031614	Aaa/AAA/AAA	1.250	2	1	
06 Oct 2015	MUNHYP	GE	0.375%	10 Nov 2021	DE000MHB16J0	Aaa/-/-	0.500	-10	-11	
15 Oct 2015	BHH	GE	0.125%	22 Oct 2020	DE000BHY0BA8	Aaa/-/AA+	0.500	-10	-11	
13 Oct 2015	RFLBNI	AS	0.500%	20 Apr 2021	XS1308628707	Aaa/-/-	0.500	12	11	
20 Oct 2015	UBIIM	IT	1.000%	27 Jan 2023	IT0005140030	Aa2/-/-	0.750	36	36	
19 Oct 2015	LBBW	GE	0.250%	26 Oct 2021	DE000LB06DE3	Aaa/-/AAA	0.500	-10	-10	
20 Oct 2015	WLBANK	GE	0.625%	27 Oct 2023	DE000A161ZL4	-/AAA/-	0.500	-8	-8	
29 Oct 2015	NDB	LX	0.125%	06 Nov 2018	XS1316421137	-/-/AAe	0.500	10	10	

Source: Bloomberg, Nordea Markets

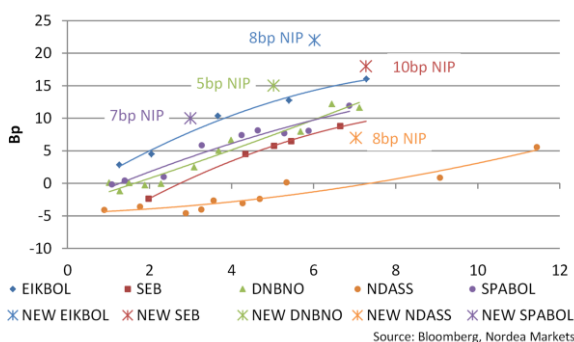
Dissecting performance of October supply

In the above table we have depicted supply in October ranked by performance. It seems quite clear that Nordic supply has performed well, which is due to the high NIPs being offered while German Pfandbriefe are among the laggards. Peripheral bonds have also fared well, but if we measure tightening relative to the size of the spread offered, then the Nordics come out on top. Further, we find there is room for further tightening as supply pressures are easing and Nordic levels are still well above peers in continental Europe.

Relative value: Should Scandi's trade close to Spanish?

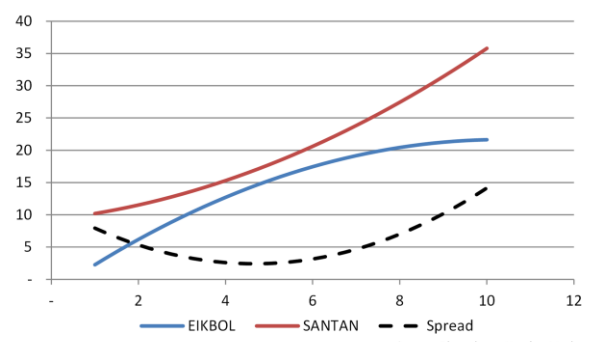
Well we think the obvious answer to the above question is no. And yet looking at Norwegian spread curves and comparing to SANTAN and BBVASM this nevertheless seems to be the case. Indeed the difference in secondary market spreads in the 4-6-year segment is miniscule, see graph below right.

October Nordic issuance, NIP and curves



Source: Bloomberg, Nordea Markets

SANTAN vs. EIKBOL



Source: Bloomberg, Nordea Markets

We have now for a prolonged period put the spot-light on Norwegian covered bonds and their relative cheapness to both German, Dutch and French covered bonds. Even as there might be concerns regarding the Norwegian economy, and Euro Area covered bonds being favoured by the CBPP3, we continue to find the current spread levels of Norwegian covered bonds as very attractive.

**Factors currently speak in favour of Nordic covered bonds:**

- Spreads are still elevated when compared to continental European peers (Germany, Netherlands and France).
- Nordic (Norwegian in particular) secondary levels should not trade next to Spanish.
- Recent performance of Nordic supply clearly indicates that the NIP has been (perhaps too) generous.
- Secondary market spreads will not widen towards primary market levels.
- Nordic supply for the remainder of the year will be minimal, meaning there will be no upward pressure on spreads.
- IF the ECB should decide to reduce CBPP3 buying, then this should clearly benefit covered bonds not part of the program (e.g. Scandi's).

**Supply**

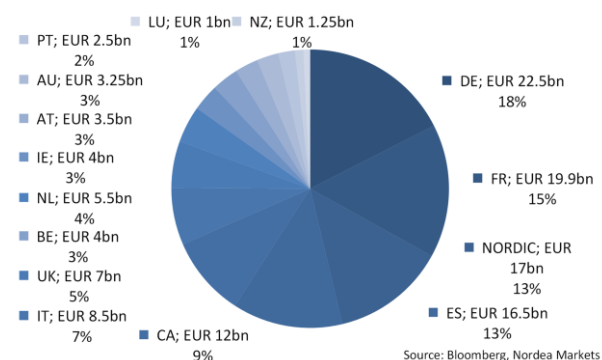
Issuance in 2015 has so far caught up with our expectations, and will therefore very likely surpass these as we still have a couple of months to go before the year ends. Those expecting a continuation of the high levels of supply could very well be disappointed. In Norway and Sweden a lot hinges on the level of the cross currency basis swap (xCcy), since these issuers have the opportunity to take advantage of misalignments between pricing of different currency bonds.

Nordic supply has pretty much stayed in line with redemptions, and for the remainder of the year we only have a EUR 2bn issue from Nordea maturing mid-November, and Danske Bank Plc (Finland) where a EUR 1bn matures at the very beginning of December, and these will most likely not be refinanced.

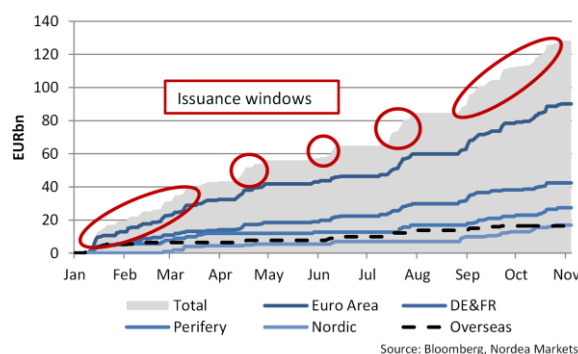
**Is the issuance window closing?**

We don't think the issuance window is closed from a Nordic perspective, but as issuers seem to have wrapped up funding needs for the year, there simply isn't any need to tap the market.

Issuance year-to-date



Issuance is slowing down



Nordea Markets is the name of the Markets departments of Nordea Bank Norge ASA, Nordea Bank AB (publ), Nordea Bank Finland Plc and Nordea Bank Danmark A/S. The information provided herein is intended for background information only and for the sole use of the intended recipient. The views and other information provided herein are the current views of Nordea Markets as of the date of this document and are subject to change without notice. This notice is not an exhaustive description of the described product or the risks related to it, and it should not be relied on as such, nor is it a substitute for the judgement of the recipient.

The information provided herein is not intended to constitute and does not constitute investment advice nor is the information intended as an offer or solicitation for the purchase or sale of any financial instrument. The information contained herein has no regard to the specific investment objectives, the financial situation or particular needs of any particular recipient. Relevant and specific professional advice should always be obtained before making any investment or credit decision. It is important to note that past performance is not indicative of future results. Nordea Markets is not and does not purport to be an adviser as to legal, taxation, accounting or regulatory matters in any jurisdiction. This document may not be reproduced, distributed or published for any purpose without the prior written consent from Nordea Markets.