

Fixed Income Research

EUR covered bonds

Nordea Research, 17 December 2015

- Norwegian and Swedish EUR covered bonds are our favourite pick.
- Compared to peers, Nordic spreads appear to have peaked.
- Nordic net supply will be positive, but continues to be negative in Europe.
- 2015 supply has been high, keeping hopes alive for a vibrant 2016.

ECB continues to be in the spotlight

2015 has almost come to an end and so has supply, which is customary in December as market participants are preparing for year-end. Supply in 2015 has been high when compared to the years since the start of the financial crisis (2008) and was actually only surpassed in 2010 and 2011 (see chart below).

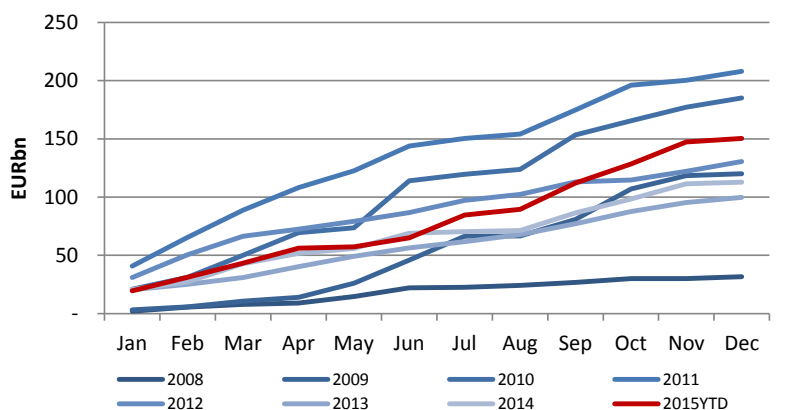
Against this background, the ECB could therefore be seen as a successful catalyst in driving supply higher. That said, we find it difficult to measure success since it all depends on what one chooses to focus on, and even if successful, we find that it has come at a high price.

Nevertheless, the CBPP3 will continue to keep spreads low as the ECB has now extended QE into Q1 2017, and we will therefore continue to see non-Euro area covered bonds trading at a discount, creating opportunities in these markets. We particularly see Norwegian and Swedish covered bonds as attractive.

Looking into 2016

We have taken a look at what to expect from EUR covered bond supply in 2016, with a more detailed look at the Nordic region. We expect EUR 21bn from the Nordics and EUR 103bn from the Euro area, including the UK. Net supply in the Nordics will be positive with EUR 18bn maturing, but negative in the Euro area (including the UK). If we were to include overseas supply (Canada, Australia and New Zealand), we are close to status quo.

Public sector bond purchases relative to covered bond purchases



Source: Bloomberg, Nordea Markets

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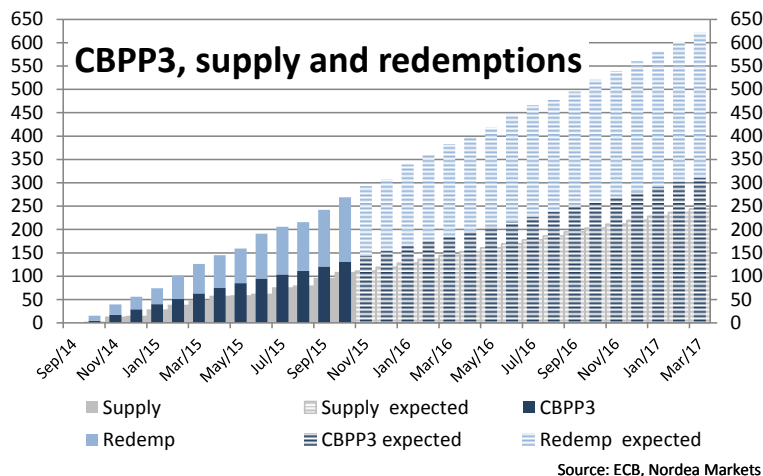
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If unchanged the ECB will own 45-50% of Euro-area covered bonds



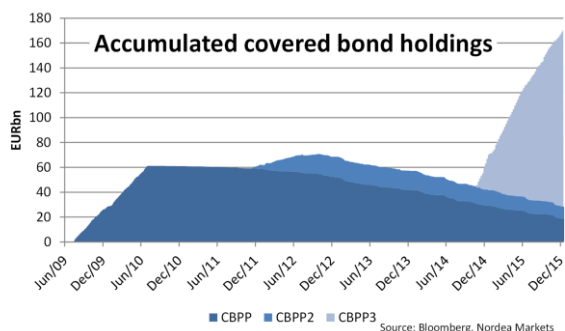
No changes expected to CBPP3

We would argue that as the ECB via the CBPP3 owns an ever-larger share of the market, liquidity in that same market has been eroded, and investors once present have been forced out as yields and spreads are kept unnaturally low. Even the talk of the ECB having boosted supply could be questioned. Looking at issuance in 2014 (before the CBPP3 started), supply was healthy and on the increase compared to 2013. Plainly put, the market was not in the need of a supporting covered bond purchase programme.

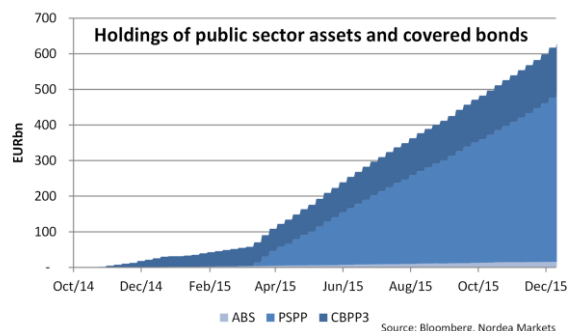
Indeed, the above highlights the dilemma as to the purpose of the CBPP3. Is it merely a part of the ECB's balance sheet target or is the purpose to aid funding? As we have argued in previous research, the CBPP3 should not be viewed as a construct, supporting the covered bond market. It should be viewed as part of the ECB's objective in reaching their balance sheet target, the aim of which is to push inflation higher.

No changes were mentioned in respect of the CBPP3 at the latest ECB meeting on 3 December. We have previously estimated that by the end of September the ECB would own 40% of the Euro-area covered bond market, including legacy covered bond programmes. If the CBPP3 continues unchanged until March 2017, this figure will have risen to between 45-50%.

Covered bonds owned by the ECB



Public sector assets and covered bonds



Supply expectations for 2016

Issuance expectations						
	2014	2015			2016	
	Issuance	Maturities	Expected	Actual	Maturities	Expected
Norway	2.25	4	4	5.75	5.75	7.5
Sweden	5	7	5	7.25	6	7.5
Finland	6	5	5	7	4.1	6.5
Denmark	2	1	1	2	2.25	2.0
Sum	15	17	15	22	18.1	23.5

	2014	2015			2016	
	Issuance	Maturities	Expected	Actual	Maturities	Expected
Spain	8.75	37	15	19.75	39	25
France	17.75	28	20	23.3	26	25
Germany	17.8	20	15	25.5	23	25
UK	6.25	13	7.5	7.5	16	8
Italy	11.5	7	10	10.75	12	12
Ireland	1.25	7	2.5	4	3	3
Netherlands	3.5	5	5	6.25	2	5
Austria	3	3	2.5	3.5	0	4
Portugal	3.25	2	2.5	2.5	2	3
Belgium	3.5	0	2.5	4	3	3
Sum	76.55	121	82.5	107.05	124	113

Source: Nordea Markets

2016 supply and outlook

We expect Nordic issuance in Finland, Norway and Sweden to be largely at the same level. There will still be **focus on the housing markets in Norway and Sweden, whereas in Finland focus will be on the overall health of the economy**, and these factors could influence levels. That said, these themes are not new, and we expect that markets to some extent have grown a little immune to the negative headlines. More negative news is nevertheless not supportive, but barring any major surprises, the actual impact will gradually fade.

An important factor in Scandinavian supply is the cross-currency basis swap (xCcy). This is important as Scandinavian issuers issue in several currencies optimizing their funding structure. Thus even if EUR is the largest market for Scandinavian issuers, there are USD 4.25bn covered bonds maturing in 2016 from Norway.

As the EUR-USD xCcy is negative this implies an advantage for Euro area issuers when issuing in USD, and the picture is the same for the Scandinavian currencies. **Yet currently despite the level of the xCcy, issuance is predominantly done in Euro.** One of reasons is the low depth of the USD covered bond market, and that covered bonds issued in USD also tend to be less liquid than their EUR equivalent. We therefore expect new issue premiums in the USD market to be higher than in the EUR market, which will weigh negatively on the relative attractiveness of the USD supply seen from the side of issuers.

Actual yield levels also play into the equation as domestic credit events can impact curves regardless of xCcy levels. Further with the Fed set on a path towards higher yields, this could easily translate into higher volatility in the USD market. This particularly when comparing with the EUR market

where we know that the ECB purchase programme will continue growing until March 2017, likely keeping yields low throughout 2016.

If we take a look at the actual levels of Scandinavian EUR and USD curves, we do not find that there is any comparative advantage of issuing in USD, when taking into account the level of cross-currency basis swap levels. We therefore in the current environment (and at current levels) see a propensity towards the issuance of EUR instead of USD and indeed local currency bonds.

Monthly redemptions 2016

2016	DK	FI	NO	SE	Sum
Jan	0	0	2	2.25	4.25
Feb	0	0	0.5	0	0.5
Mar	1	0	0	0	1
Apr	0	1	0	1	2
May	0	0	0	1.5	1.5
Jun	0	0.6	0	0	0.6
Jul	1.25	0	0	0	1.25
Aug	0	0	0	0	0
Sep	0	1.5	0	0	1.5
Oct	0	1	2	1.25	4.25
Nov	0	0	1.25	0	1.25
Dec	0	0	0	0	0
Sum	2.25	4.1	5.75	6	18.1

Expected supply by issuer

Issuer	Country	EURbn	Sum
DNB NOR	NO	3	7.5
EIKBOL	NO	1 (2*0.5)	
SPABOL	NO	2	
SRBANK	NO	0.5	
SVEGNO	NO	1 (2*0.5)	7.5
LANSBK	SE	0.5	
SBAB	SE	1 (2*0.5)	
SEB	SE	2	
SHBASS	SE	2	6.5
SWEDA	SE	2	
AKTIA	FI	0.5	
NDASS	FI	3	
POHBK	FI	2	2
SAMBNK	FI	1	
New: Savings Bank	FI	0.5	2
DANBNK	DK	2	

Source: Nordea Markets

Redemptions in 2016

Country	Short Name	Ticker	Coupon	Currency	Amt (bn)	Country	Issue Date	Maturity Date
DENMARK	DANSKE BANK A/S	DANBNK	3.25	EUR	1	DK	09/03/2011	09/03/2016
DENMARK	DANSKE BANK A/S	DANBNK	4.5	EUR	1.25	DK	01/07/2009	01/07/2016
FINLAND	AKTIA REAL ESTAT	AKTIA	3.125	EUR	0.6	FI	22/06/2011	22/06/2016
FINLAND	NORDEA BANK FIN	NDASS	2.375	EUR	1.5	FI	02/09/2011	02/09/2016
FINLAND	OP MORTGAGE BANK	POHBK	3.25	EUR	1	FI	01/04/2011	01/04/2016
FINLAND	SAMPO BANK PLC	SAMBNK	2.75	EUR	1	FI	19/10/2011	19/10/2016
NORWAY	DNB NOR BOLIGKRE	DNBNO	2.625	EUR	2	NO	11/01/2011	11/01/2016
NORWAY	DNB NOR BOLIGKRE	DNBNO	2.5	EUR	2	NO	18/10/2011	18/10/2016
NORWAY	BOLIGKREDITT	SPABOL	2.375	EUR	1.25	NO	22/11/2011	22/11/2016
NORWAY	SPAREBANKEN V BO	SVEGNO	3.125	EUR	0.5	NO	08/02/2011	08/02/2016
SWEDEN	SWEDISH COVERED	SBAB	3.375	EUR	1	SE	20/04/2011	20/04/2016
SWEDEN	SKANDINAV ENSKIL	SEB	3	EUR	1.25	SE	20/01/2011	20/01/2016
SWEDEN	STADSHYPOTEK AB	SHBASS	3.375	EUR	1.5	SE	11/05/2011	11/05/2016
SWEDEN	SWEDBANK HYPOTEK	SPNTAB	3	EUR	1	SE	21/01/2011	21/01/2016
SWEDEN	SWEDBANK HYPOTEK	SPNTAB	3.625	EUR	1.25	SE	05/10/2009	05/10/2016

Source: Nordea Markets

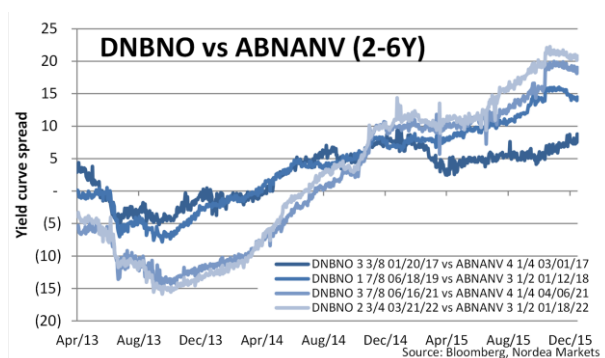
Relative value: factors in favour of Nordic covered bonds

The CBPP3 implies that there will continue to be a spread differential on covered bonds between the Euro area and non-Euro-area countries. Since this is estimated at approximately 5 bp (estimated on the back of spreads movements on the wake of CBPP3 starting) we still find that is plenty of value in Norwegian and Swedish covered bonds. Comparing Norwegian covered bonds to Dutch and French covered bonds, we find that the pick-up on bonds with maturities between 2-6Y is in the 15-20 bp range. Compared to German Pfandbriefe, this spread stands at 15-30 bp (see chart on next page).

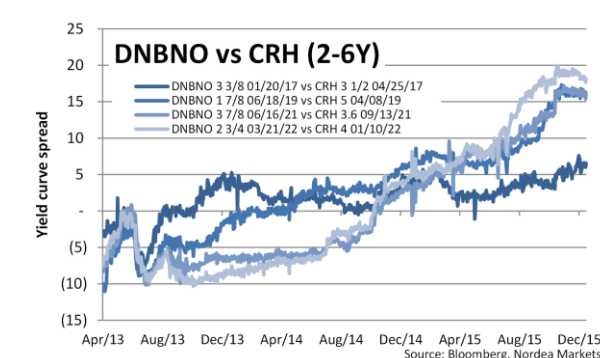
Looking closer at spreads, we find that spreads on Norwegian covered bonds seem to have peaked relative to their peers (the Netherlands, France and Germany), and indeed we are seeing the first signs of the spread differential going tighter between these. When taking a look at supply in the second half of 2015 when new issue premiums were surprisingly high, this perhaps is not really that much of a surprise.

- Spreads are still elevated when compared to continental European peers (Germany, the Netherlands and France).
- Nordic (Norwegian in particular) secondary levels should not trade next to Spanish.
- Recent 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 its CBPP3 buying, this should clearly benefit covered bonds not part of the program (eg Scandies).

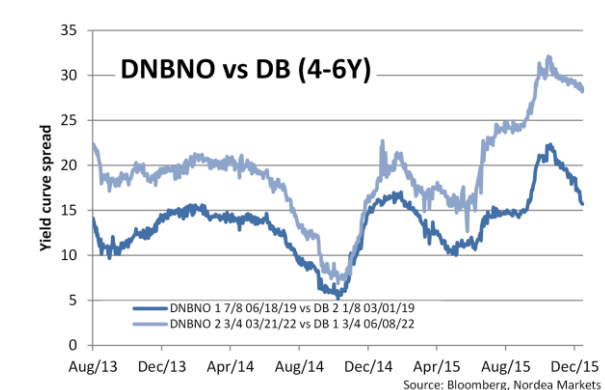
Norwegian relative to Dutch covered bonds



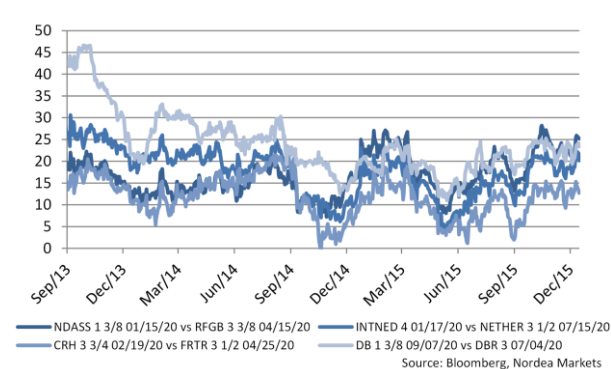
Norwegian relative to French covered bonds
























Norwegian relative to German covered bonds



Spreads on selected bonds relative to govt bonds



Nordic Euro supply in 2015

Announcement date	Ticker	Country	Coupon	Maturity	ISIN	Rating (M/S/F)	Amount (EURbn)	Issue spread	Current ASW	Spread development
26 Oct 2015	SEB	SW	0.625%	30 Jan 2023	XS1314150878	Aaa/-/-	1,000	18	13	
21 Oct 2015	EKBOL	NO	0.625%	28 Oct 2021	XS1312011684	Aaa/-/-	0,500	22	19	
13 Oct 2015	DNBNO	NO	0.375%	20 Oct 2020	XS1308759718	Aaa/AAA/-	1,250	15	10	
12 Oct 2015	NDASS	FI	0.625%	19 Oct 2022	XS1308350237	Aaa/-/-	1,250	7	6	
28 Sep 2015	SBAB	SW	0.375%	05 Oct 2020	XS1300812077	Aaa/-/-	0,750	11	9	
22 Sep 2015	SWEDA	SW	0.375%	29 Sep 2020	XS1296948588	Aaa/AAA/-	1,250	7	7	
21 Sep 2015	SRBANK	NO	0.500%	28 Sep 2020	XS1297977115	Aaa/-/-	0,500	12	13	
14 Sep 2015	SVEGNO	NO	0.375%	22 Sep 2020	XS1294537458	Aaa/-/-	0,500	7	11	
31 Aug 2015	DANBNK	DE	0.375%	08 Sep 2020	XS1287931601	-/AAA/AAA	1,000	5	9	
28 Aug 2015	POHBK	FI	0.625%	04 Sep 2022	XS1285892870	Aaa/AAA/-	1,000	-1	5	
28 Aug 2015	SPABOL	NO	0.750%	05 Sep 2022	XS1285867419	Aaa/-/AAA	1,000	8	13	
11 Jun 2015	SBAB	SW	0.750%	17 Jun 2022	XS1248348721	Aaa/-/-	0,500	2	11	
09 Jun 2015	SEB	SW	0.750%	16 Jun 2022	XS1246782269	Aaa/-/-	1,000	-3	11	
22 Apr 2015	SVEGNO	NO	0.250%	29 Apr 2022	XS1225004115	Aaa/-/-	0,500	-5	13	
16 Apr 2015	LANSBK	SW	0.250%	22 Apr 2022	XS1222454032	Aaa/AAA/-	0,500	-4	10	
19 May 2015	AABHFH	FI	0.375%	26 May 2020	XS1238023813	-/AAA/-	0,250	9	11	
23 Mar 2015	AKTIA	FI	0.250%	31 Mar 2022	XS1210338015	Aaa/-/-	0,500	-4	3	
10 Mar 2015	NDASS	FI	0.125%	17 Jun 2020	XS1204134909	Aaa/-/-	1,000	-10	0	
10 Mar 2015	NDASS	FI	0.625%	17 Mar 2027	XS1204140971	Aaa/-/-	1,000	-2	8	
03 Mar 2015	SWEDA	SW	0.375%	11 Mar 2022	XS1200837836	Aaa/AAA/-	1,000	-5	9	
25 Feb 2015	DANBNK	DE	0.250%	04 Jun 2020	XS1197037515	-/AAA/AAA	1,000	-2	8	

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