

# European Financial Markets: *recent trends and further insights*

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# European Financial Markets:

## *recent trends and further insights*

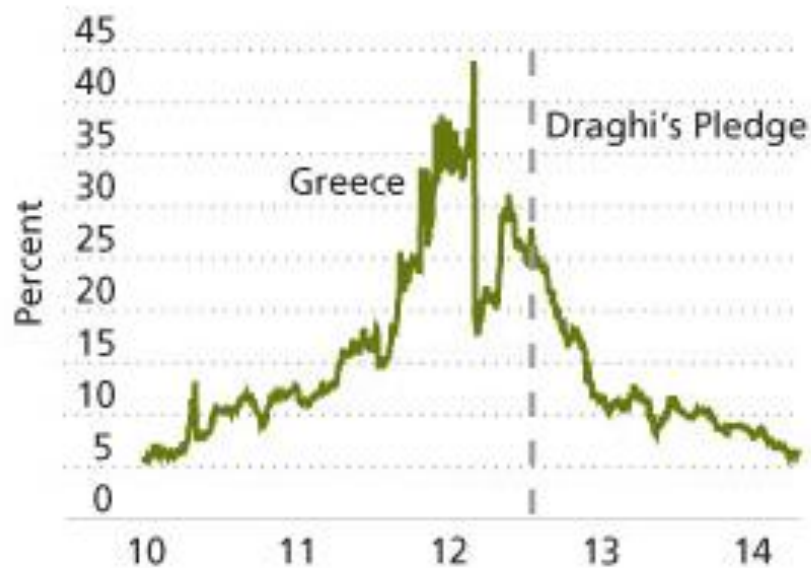
- Sovereigns
  - The Draghi effect
  - Peripherals return to the fold
    - Two down and one to go
- Corporates
  - Performance overview
  - Significant increase in size and number of issuers
  - Alternative to bank lending
    - But not for everyone
- ECB Policy
  - QE... probably
  - Inflation
  - Bank Lending

# The Draghi Effect

- In July 2012 Draghi pledges
  - to do “whatever it takes” to save the Euro
- The pledge is obviously credible
  - Since that is precisely what has happened
  - Without the ECB spending a €
- We are almost out of the woods on Eurozone sovereign debt crisis
- But NOT out of the economic one

# The Draghi Effect

Recovery in Peripheral Bond Yields  
10-Year Government Bond Yield



As of April 28, 2014  
Source: Financial Times

# Centripetal Peripherals

## Ireland

- Ireland left its EU/IMF bailout after 3 years, in December last year
- Without added support and/or intervention
- Returned to the capital markets in July **2012**
- Resumed bond auctions in March 2014
- Has issued > €8bn so far in 2014, prefunding 2015
- Launched a new 10-yr benchmark
  - Which now has > €8.0 bn outstanding
  - Last tranche of €1bn auctioned last week at 1.63%
- Two-year issue trading at 0%
- Irish 10-yr now trades THROUGH UK 10-yr Gilt
  - Spread to Bunds now <80bp, vs 150bp in January

# Centripetal Peripherals

## Portugal

### Rally in Portuguese Yields

Portugal 10-Year Government Bond Yield



As of March 27, 2014

Source: *Financial Times*

# Centripetal Peripherals

## Portugal

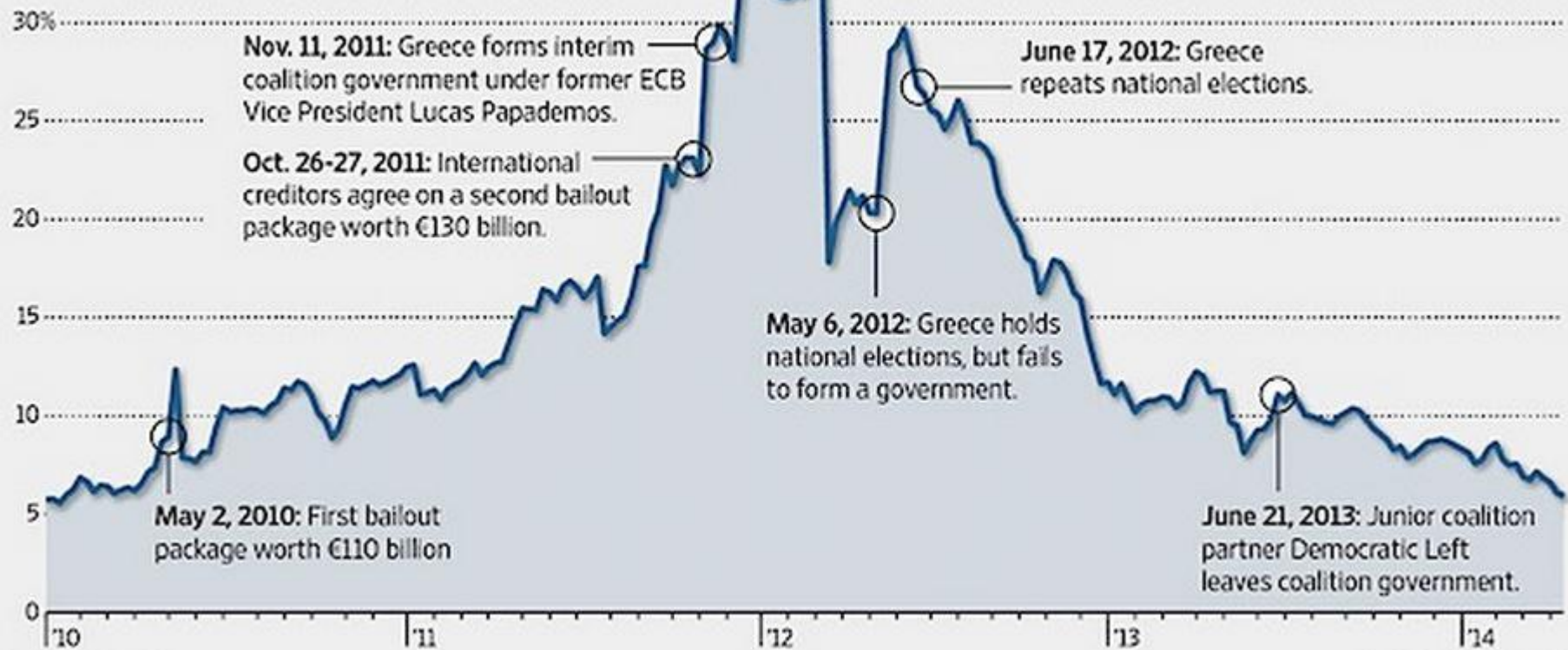
- Portugal made its bailout exit in May
  - a “clean” exit like Ireland
- It has returned to the (syndicated) market
  - With €3.25 bn 5-yr tapped in January
  - And €3 bn 10-yr tapped in February
  - (as well as some bond buy-backs)
- It has raised its 2014 funding target
  - Has issued in USD (\$4.5bn 10 yr)
  - And is prefunding 2015
- Yields reached record low of 2.92% on Oct 10

# Centripetal Peripherals

## Greece

### Back From the Brink

Greece's 10-year government bond yield, weekly data



Source: Tradeweb

The Wall Street Journal



# Centripetal Peripherals

## Greece

- Greece returned to the markets in April
  - With a new €3 bn 5-yr bond
  - The 5-yr was massively oversubscribed:
    - >€20 bn demand from 550 different investors
    - Priced to yield 4.95%
  - But the subsequent 3-yr issue was disappointing
- After peaking well over 40% in 2012
  - 10-yr yields reached <5.5% in September
  - But have now backed up >7% on political fears
- The draft budget provides for €9bn of issuance in 2015
  - 7-yr and 10-yr bonds
- But will it exit bailout early (like Ireland and Portugal)?

# Perspective on a “crisis”

- In the four ½ years since Greece admitted
  - that previous governments had cooked the books
- We had a fully fledged Sovereign Debt Crisis
- We are out of it now
- But was it really justified?
- R&R is now proved to be nonsense
  - As we said from the start
- Reforms were needed (they always are)
  - But at what cost
- Austerity was never (and is never) a sensible solution to anything
- Especially government indebtedness

# Perspective on a “crisis”

- Debt/GDP ratio is a pathetically limited way to measure sovereign default risk
- But if you do want to reduce it
  - Do so by INCREASING growth
- Low growth will tend to increase Debt/GDP
- High growth will tend to reduce it
- When the UK lowered its Debt/GDP
  - from >250% (1815) to <25% (1914)
  - Nominal debt only fell by 17%
  - The rest of the improvement came from growth!

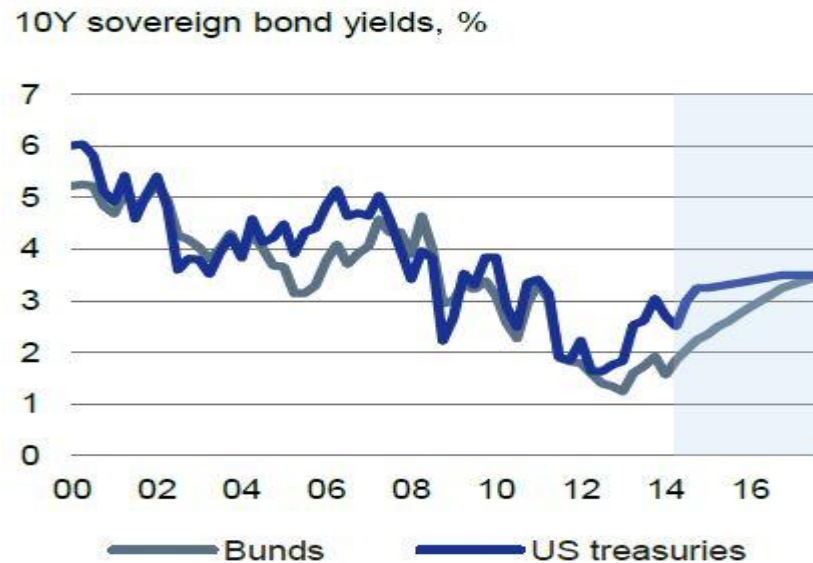
# Perspective on a “crisis”

- On the (very slightly) more positive side
- Europe only really moves forward
  - as a result of a crisis
- And we have made some strides forward
- Especially on the side of “Euro Banks”
- Things were not really as bad as they seemed
- But our policy responses made them FAR worse

# Overview

## Sovereigns/Corporates

- Consensus is that sovereign yields are heading up



Source: Deutsche Bank Research

- But we respectfully disagree... we are in lowflation

# The real European Problem

**FRED**  — Harmonized Index of Consumer Prices: All Items for Euro area (17 countries)©  
— Consumer Price Index of All Items in Germany©



# Overview

## Inflation Expectations

- The market expects lowflation to stay awhile

EUR zero-coupon inflation swaps

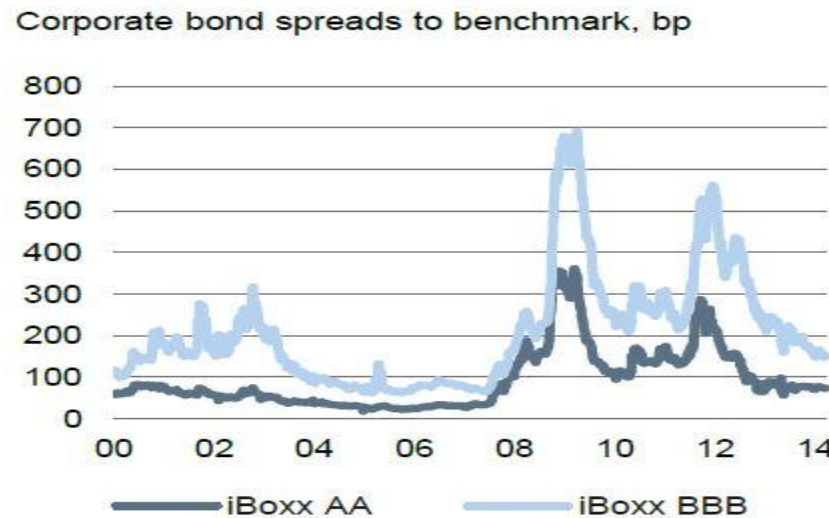


- And the trend is not upwards

# Overview

## Corporates

- But (either way) there is still room



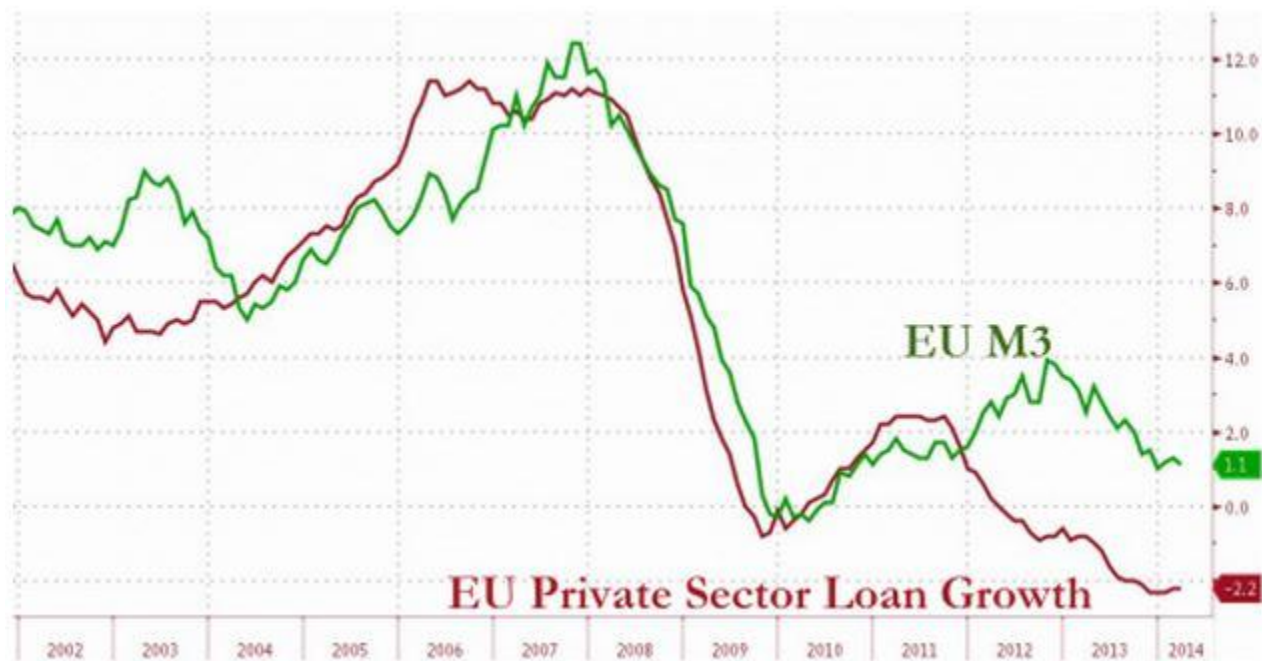
Source: Markit, Bloomberg, Deutsche Bank Research

- for corporate spreads to tighten



# Corporates

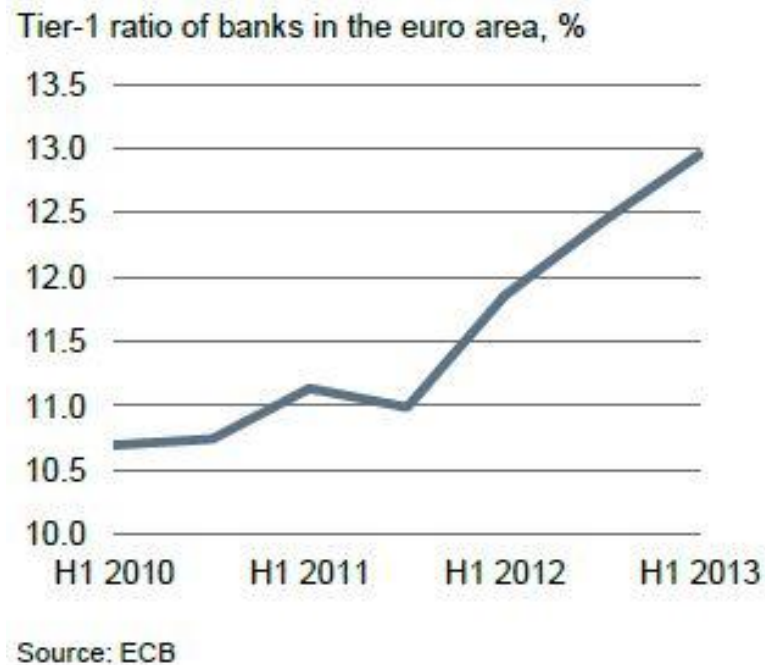
- Growth in bank lending.....



- ..... is worse now than it was during the crisis

# Corporates

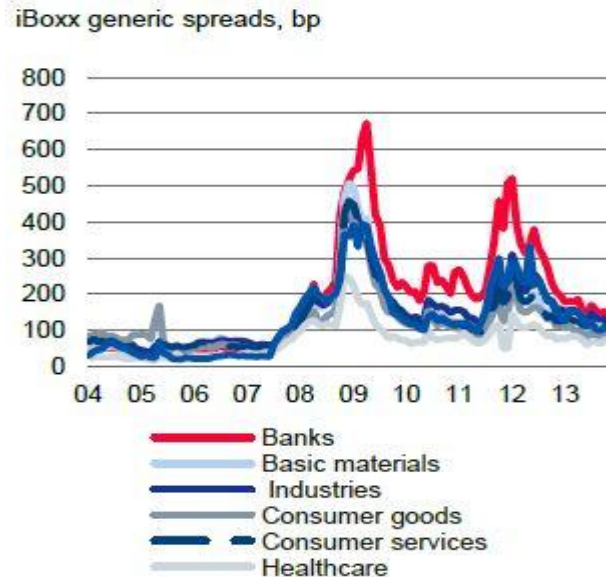
- But Banks have had to ....



- .... improve their capital ratios

# Corporates

- And banks pay more for their funds.....

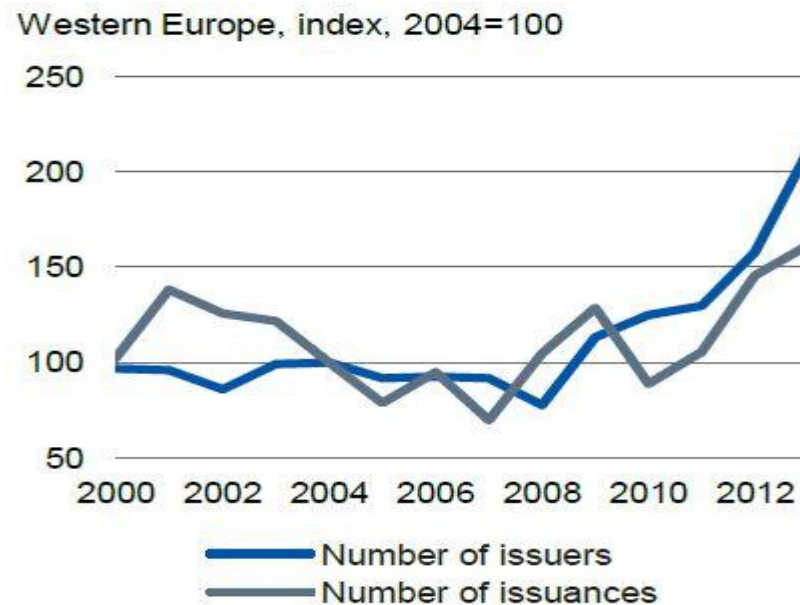


Sources: Markit, Deutsche Bank Research

- .... than their customers do

# Corporates

- The number of corporate issuers has increased...



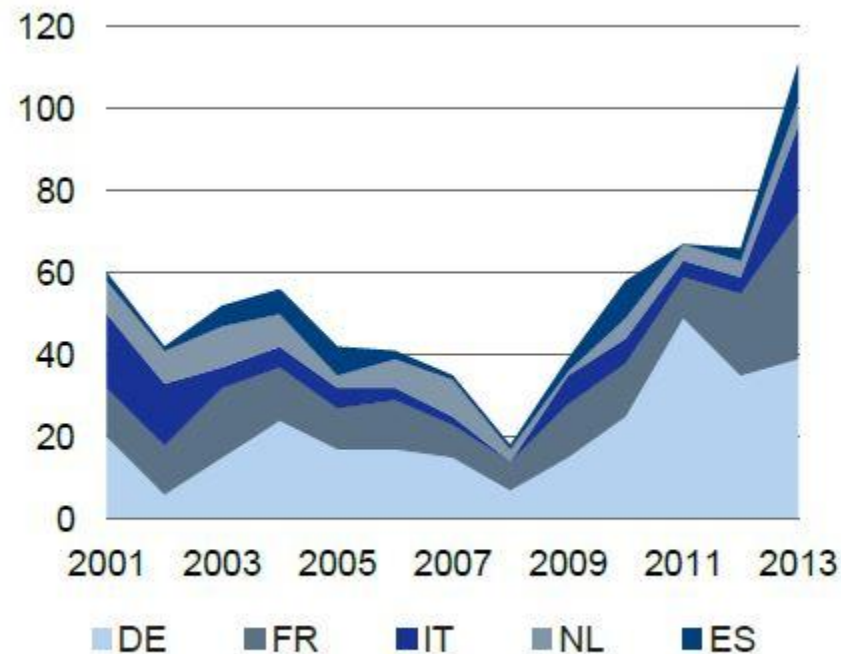
Western Europe = Germany, France, Italy, Spain, Netherlands

Sources: Bloomberg, Deutsche Bank Research

- and so has the number of bond issues

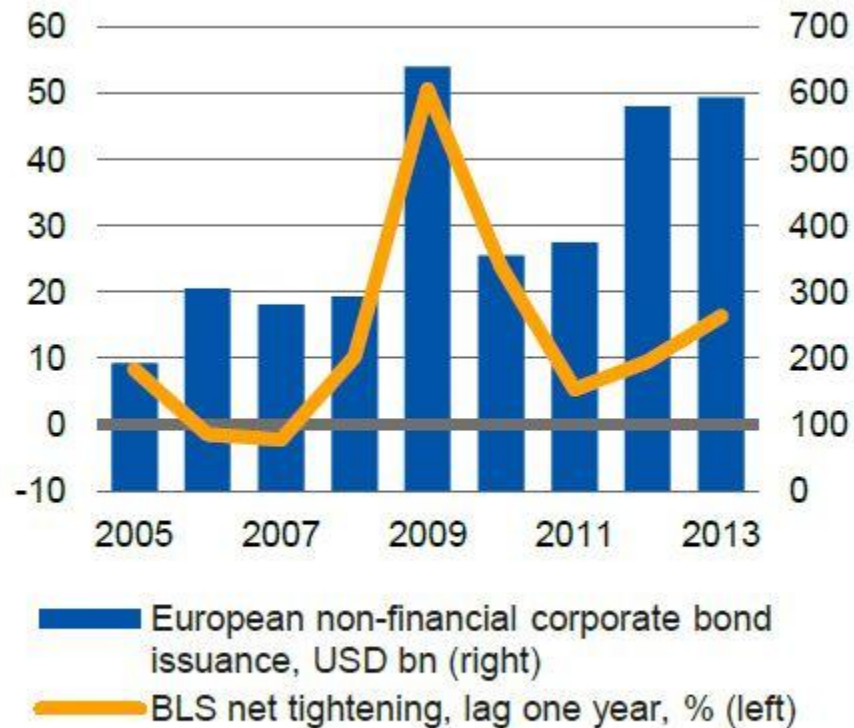
# Corporates

- As has the number of NEW issuers



\*Corporations that have not issued a debt security since 2000

# Corporates

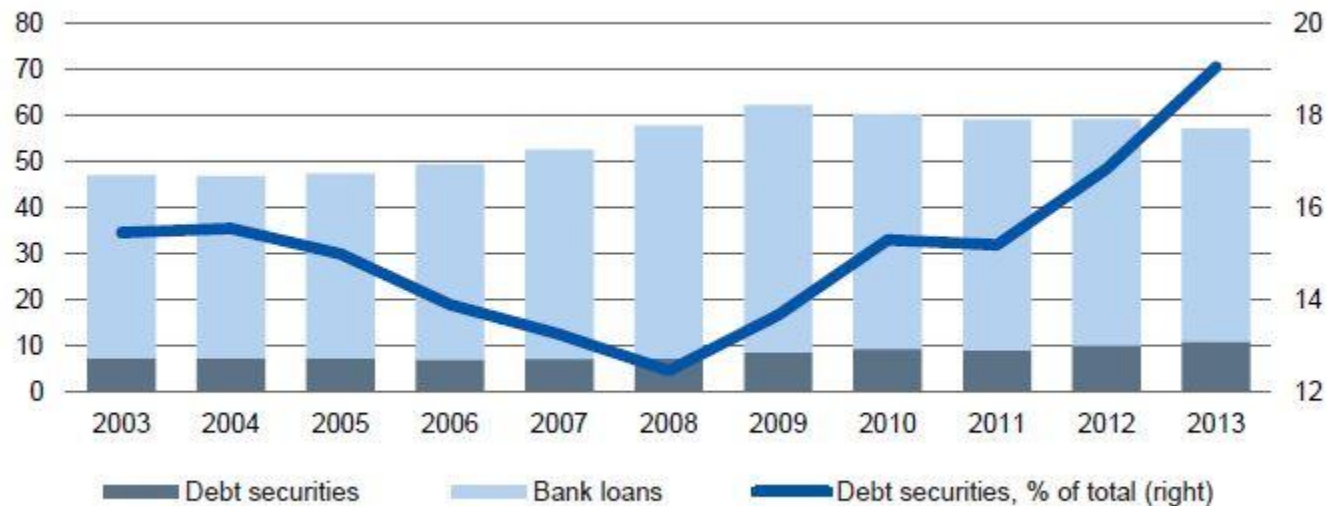


Sources: Deutsche Bank Research, Dealogic, ECB

# Corporates

- Even though European corporates use bonds

Outstanding amounts with non-financial corporations in the euro area, % GDP (left)

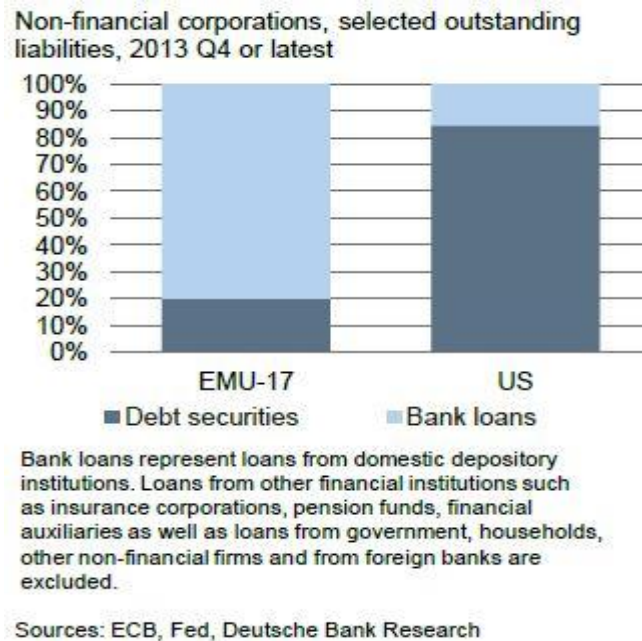


Sources: ECB, Deutsche Bank Research

- To raise funds much more than they did...

# Corporates

- They still rely on bank lending

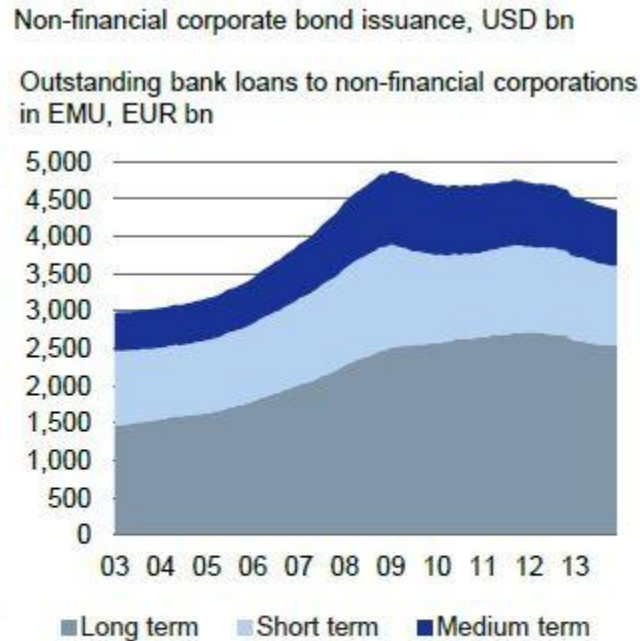


- ...much more than US corporates



# Corporates

- Especially for long-term funds.....



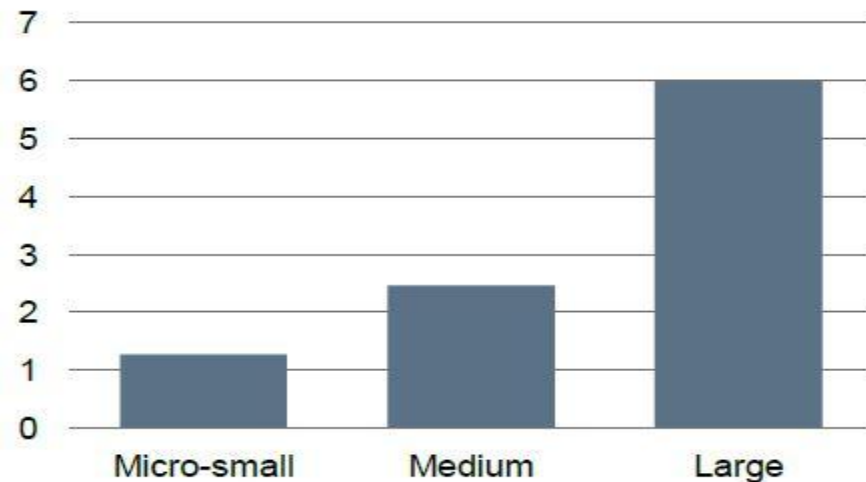
Working day and seasonally adjusted

Source: ECB

# Corporates

- And though there is clear evidence of substitution

Survey: Firms saying they have used debt securities for financing during the past 6 months, by size (%)



Sources: ECB, Deutsche Bank Research

- .... The bond market is not open to all corporates

# ECB Policy

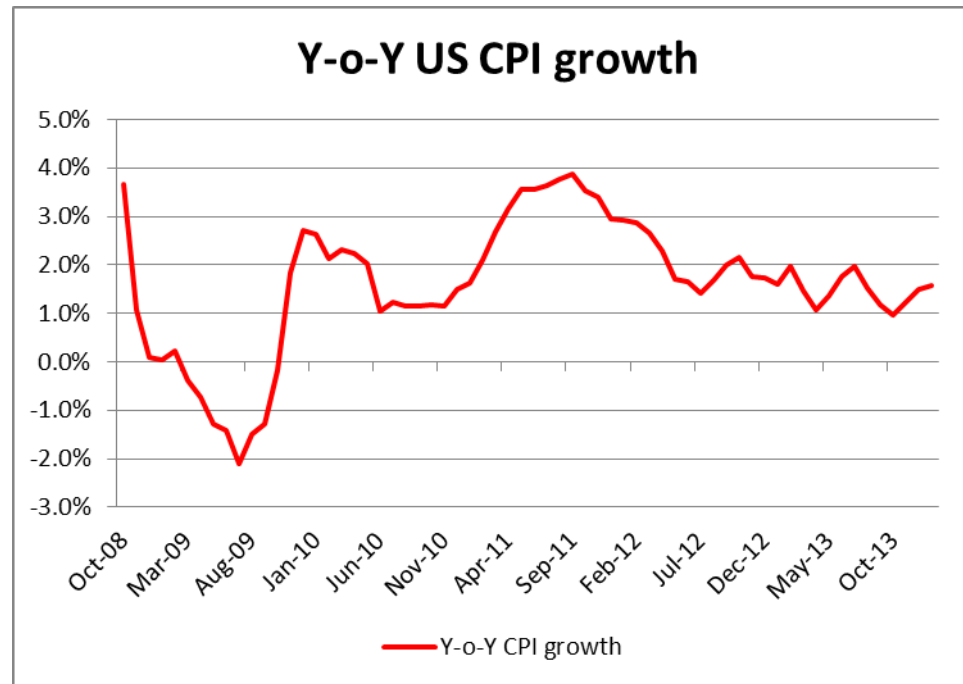
- So will the ECB adopt unorthodox measures
  - i.e. QE ?
- Draghi announced ABS purchases to come
- But there is opposition from...
  - The usual suspect
- And if ECB does QE with ABS ...
  - Will we get hyperinflation?
  - Will the stock market boom ?
    - (all that money has to go somewhere.....)
  - Will bank lending pick up?

# ECB Policy

- If the US experience is anything to go by...
  - No
  - Maybe yes, maybe no... but nothing to do with QE
  - Yes, in a while.....
- US QE has been matched by growth in excess bank reserves
- But eventually by growth in C&I loans
- Which are now above their October 2008 high

# ECB Policy

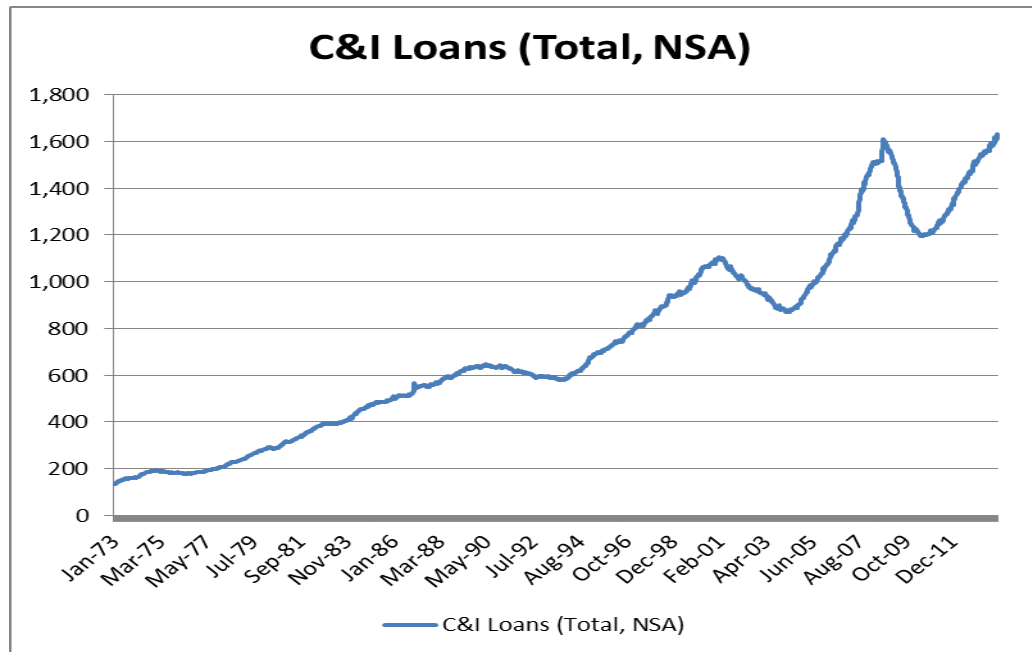
- Move along



- No inflation to see here.....

# ECB Policy

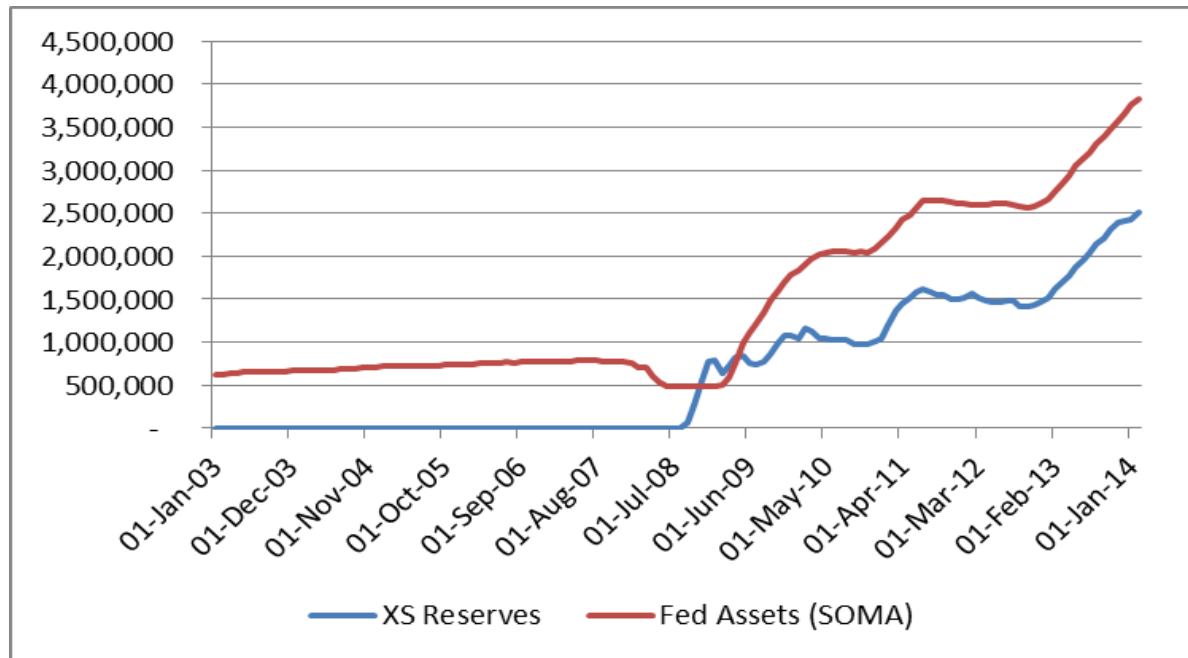
- US bank lending collapsed.....



- But eventually recovered (after lots of QE)

# ECB Policy

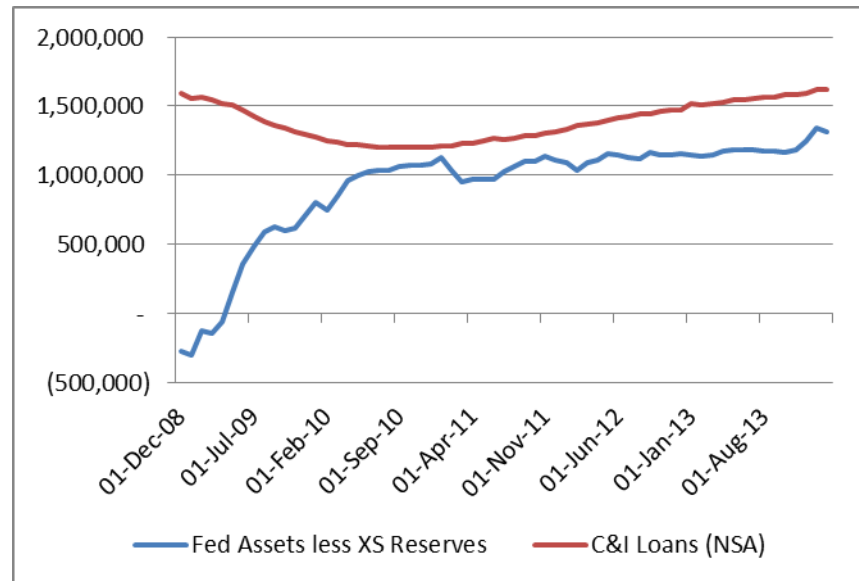
- Most of the growth in Fed Assets....



- Has stayed in the Fed as Excess Reserves

# ECB Policy

- And what “leaked” .....



- Eventually turned into loans
- QE WORKS....! But it takes time



# Thank You

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