

European Financial Markets:
recent trends and further insights

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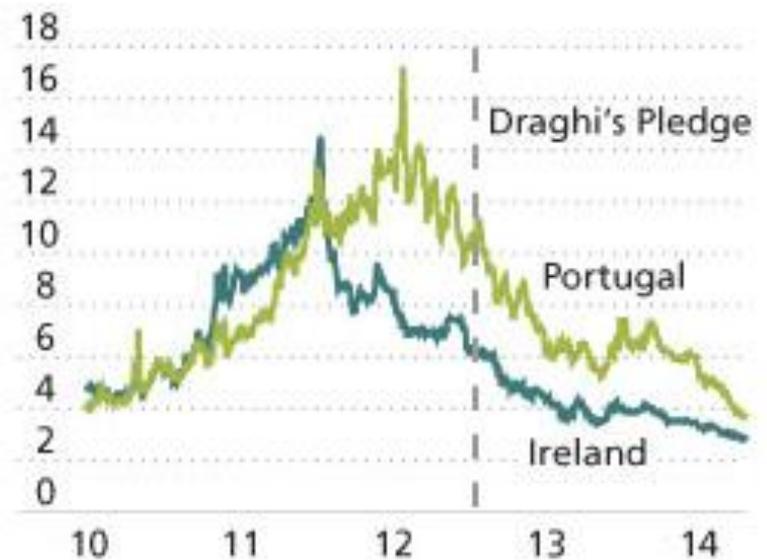
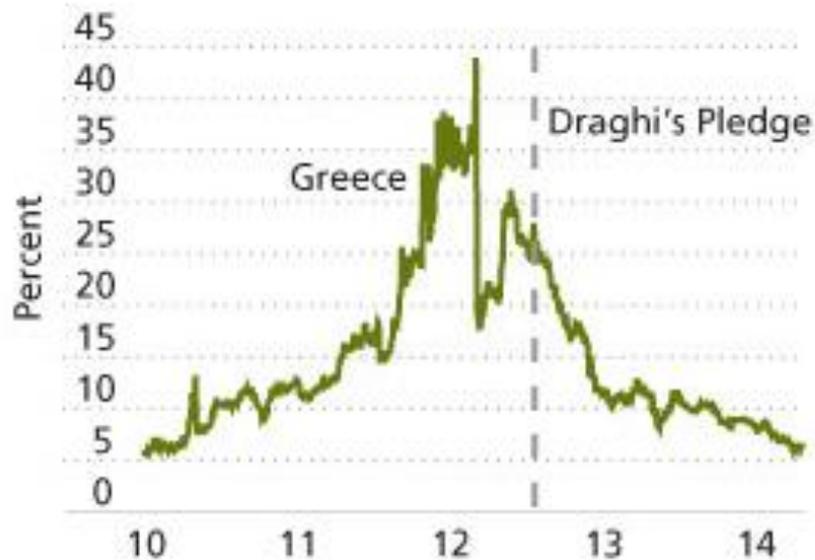
- Sovereigns
 - The Draghi effect
 - Peripherals return to the fold
 - Two down and one to go
- Corporates
 - Performance overview
 - Significant increase in size and number of issuers
 - Alternative to bank lending
 - But not for everyone
- ECB Policy
 - QE... probably
 - Inflation
 - Bank Lending

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

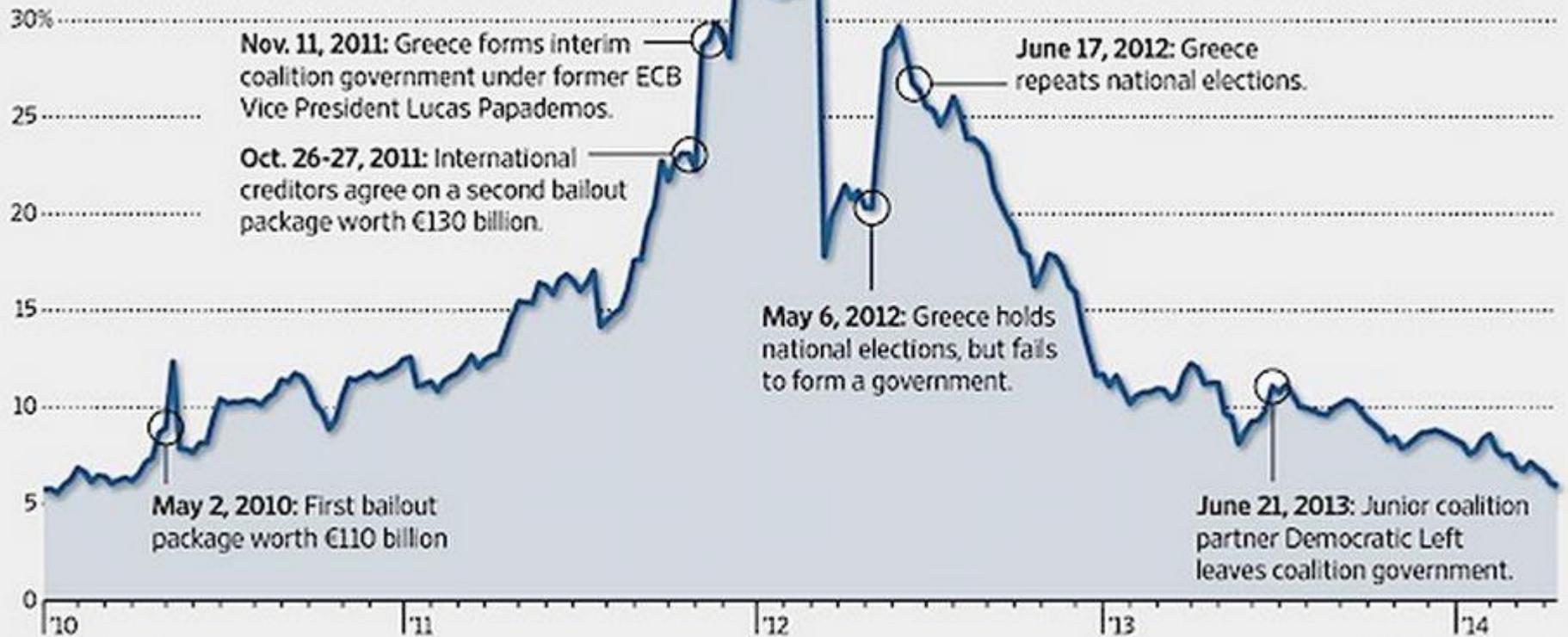
- Portugal made its bailout exit in May
 - a “clean” exit like Ireland
- It has returned to the (syndicated) market
 - With €3.25 bn 5-yr tapped in January
 - And €3 bn 10-yr tapped in February
 - (as well as some bond buy-backs)
- It has raised its 2014 funding target
 - Has issued in USD (\$4.5bn 10 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!

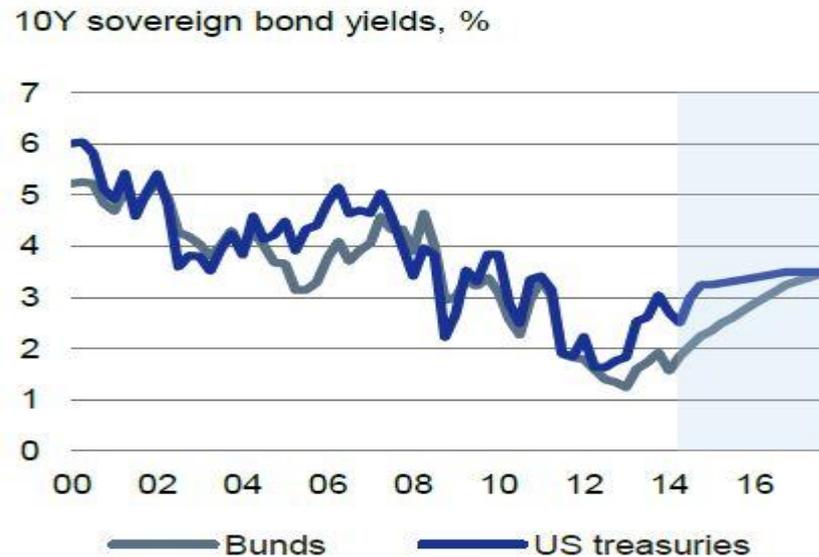
Perspective on a “crisis”

- 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 

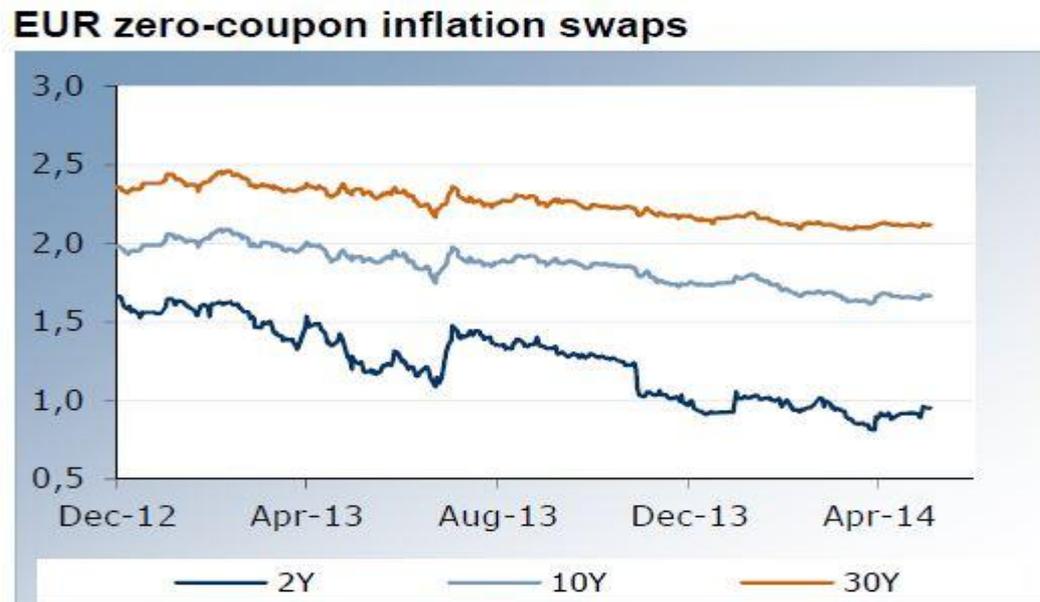
— Harmonized Index of Consumer Prices: All Items for Euro area (17 countries)©
— Consumer Price Index of All Items in Germany©



Overview

Inflation Expectations

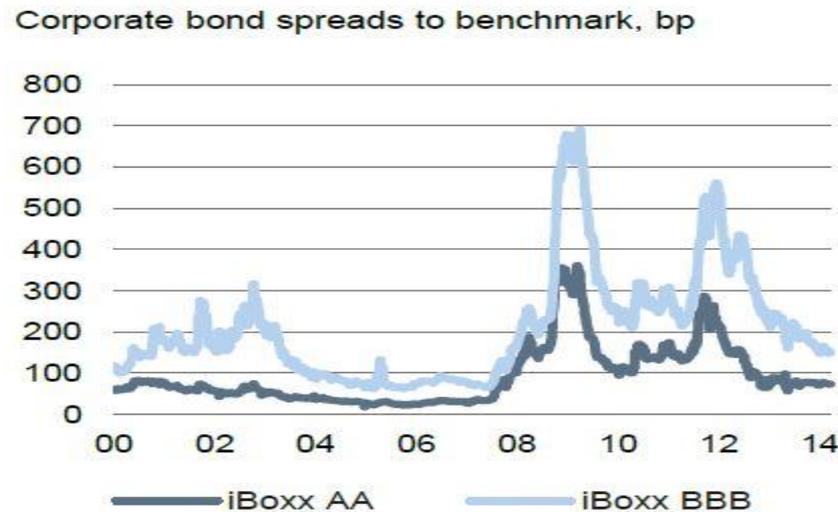
- The market expects low inflation to stay awhile



- And the trend is not upwards

Overview Corporates

- But (either way) there is still room

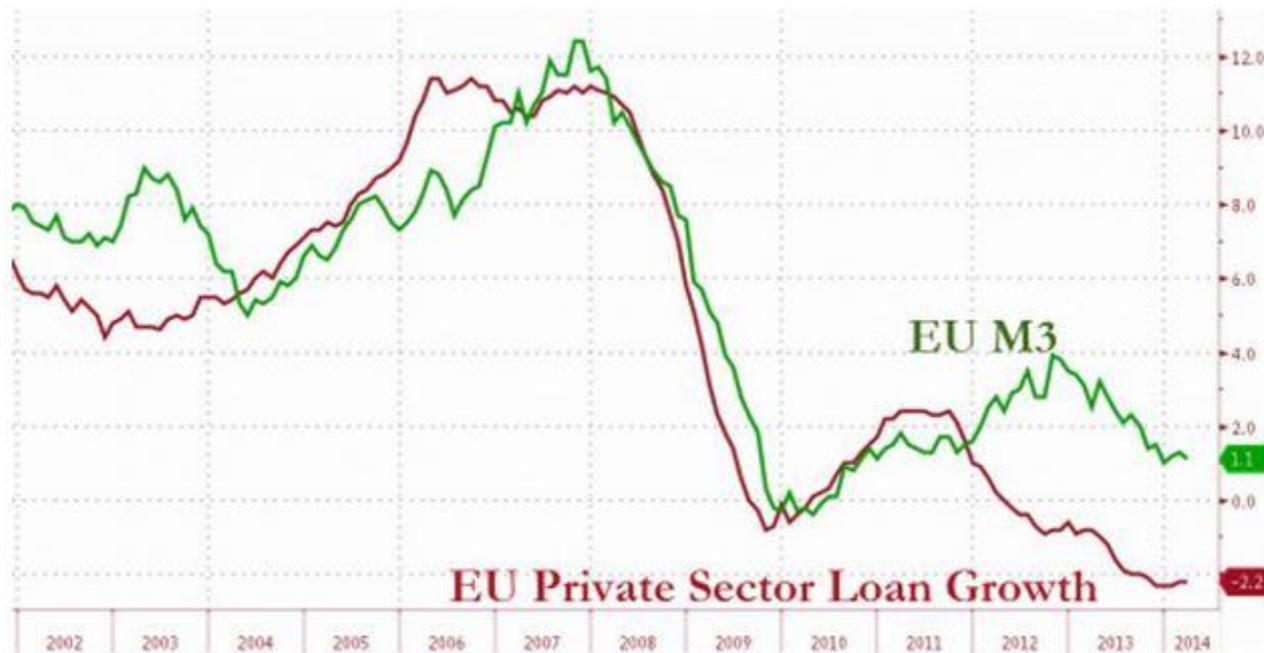


Source: Markit, Bloomberg, Deutsche Bank Research

- for corporate spreads to tighten

Corporates

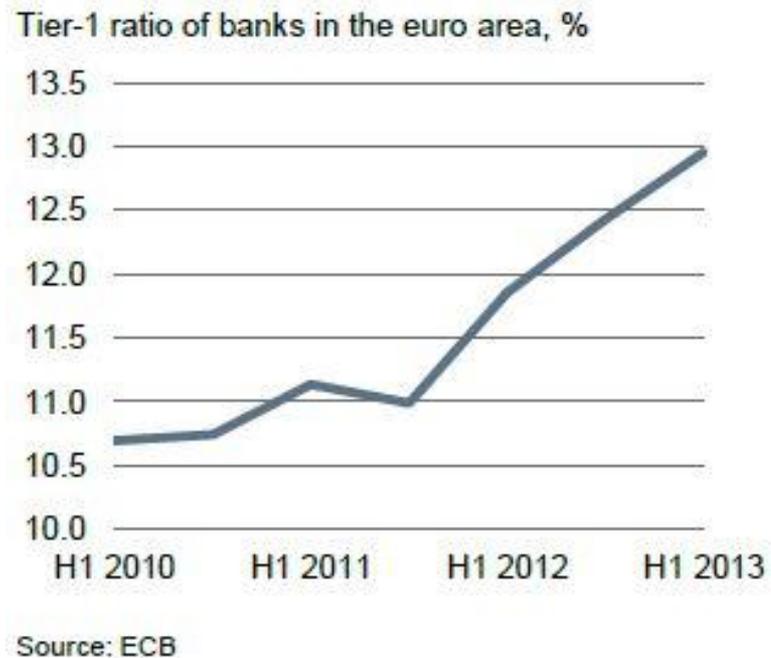
- Growth in bank lending.....



- is worse now than it was during the crisis

Corporates

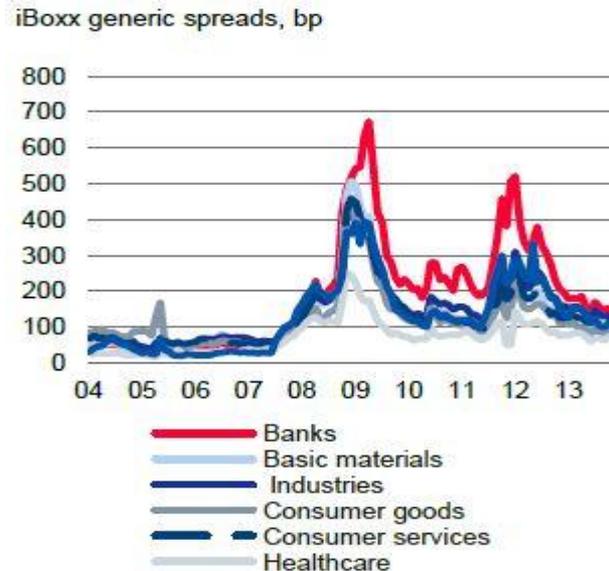
- But Banks have had to



- improve their capital ratios

Corporates

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

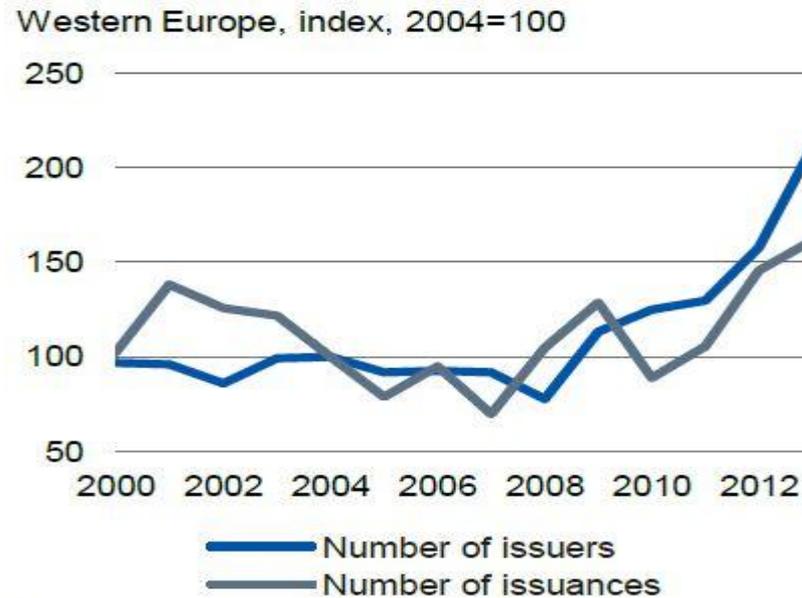


Sources: Markit, Deutsche Bank Research

- than their customers do

Corporates

- The number of corporate issuers has increased...



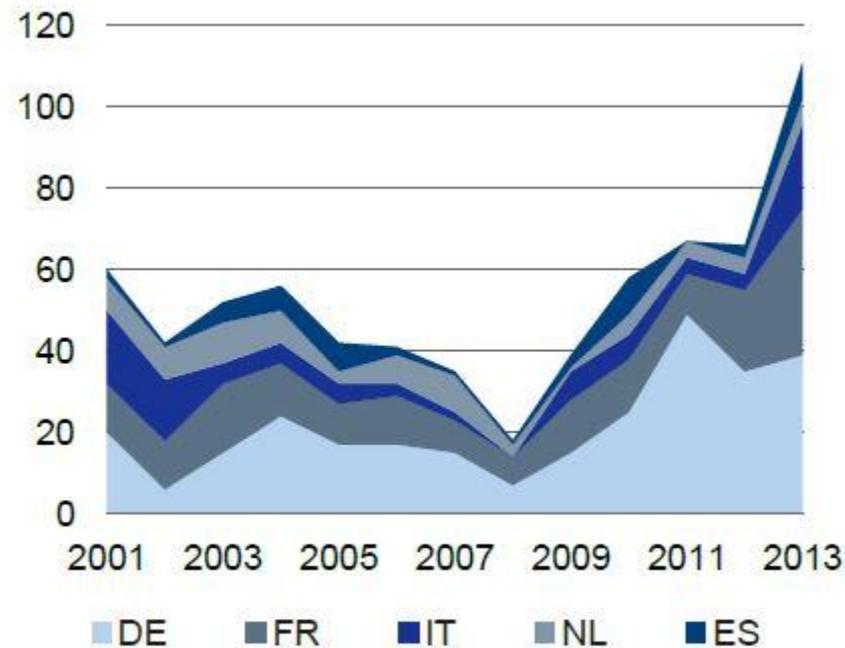
Western Europe = Germany, France, Italy, Spain, Netherlands

Sources: Bloomberg, Deutsche Bank Research

- and so has the number of bond issues

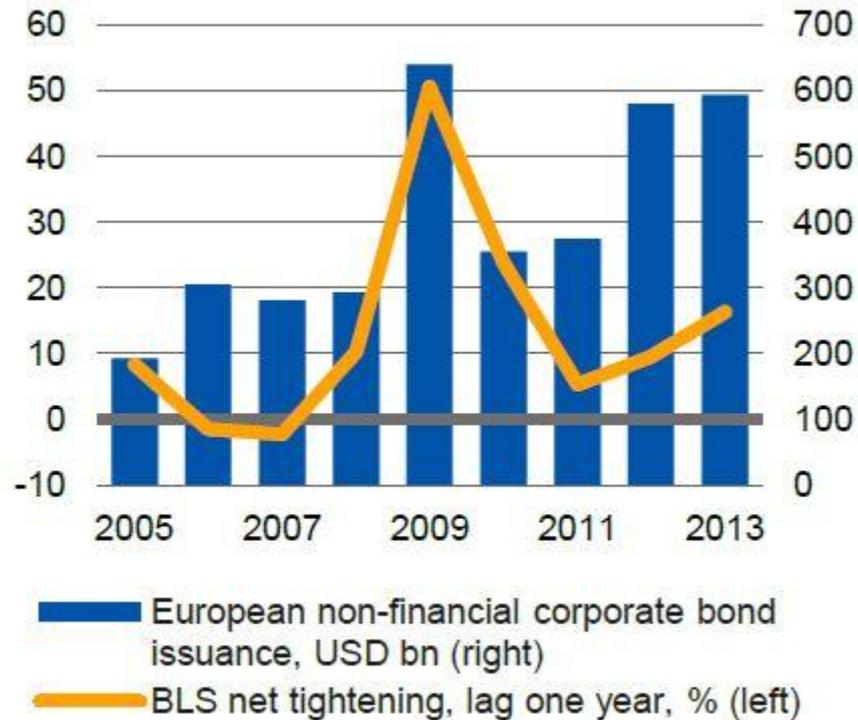
Corporates

- As has the number of NEW issuers



*Corporations that have not issued a debt security since 2000

Corporates

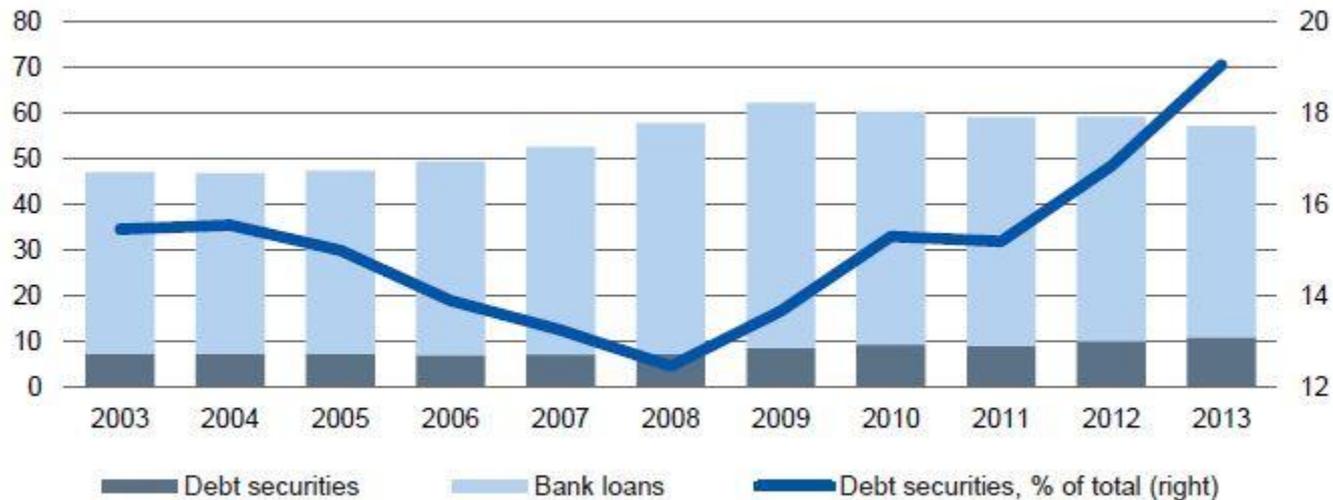


Sources: Deutsche Bank Research, Dealogic, ECB

Corporates

- Even though European corporates use bonds

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

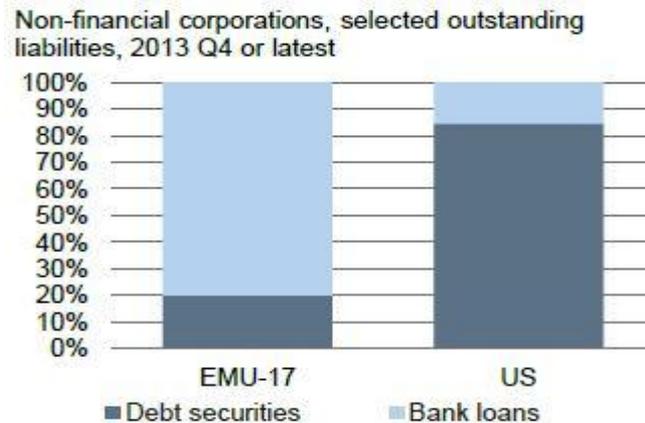


Sources: ECB, Deutsche Bank Research

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

Corporates

- They still rely on bank lending



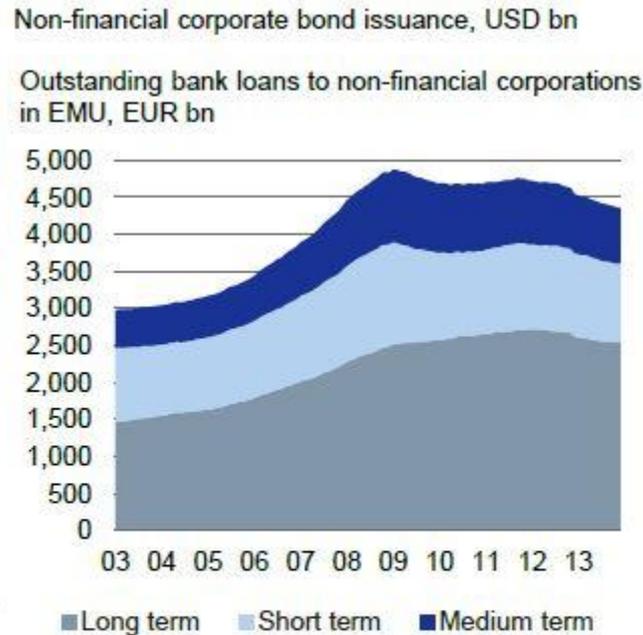
Bank loans represent loans from domestic depository institutions. Loans from other financial institutions such as insurance corporations, pension funds, financial auxiliaries as well as loans from government, households, other non-financial firms and from foreign banks are excluded.

Sources: ECB, Fed, Deutsche Bank Research

- ...much more than US corporates

Corporates

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



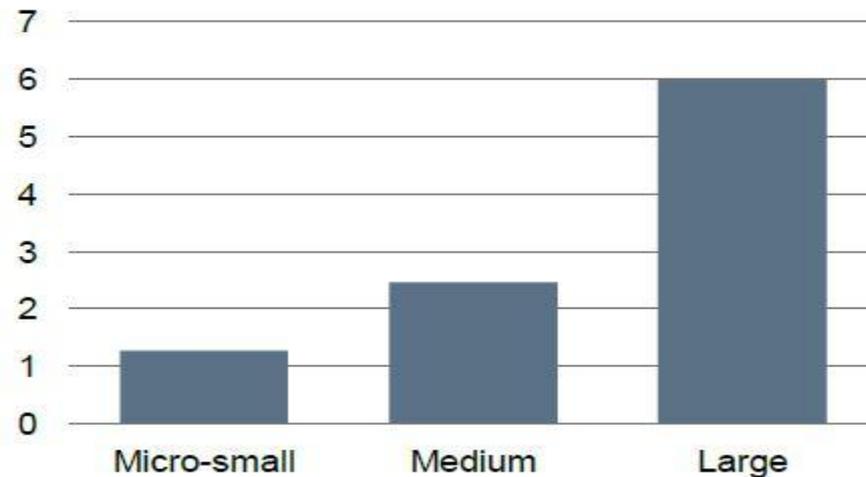
Working day and seasonally adjusted

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

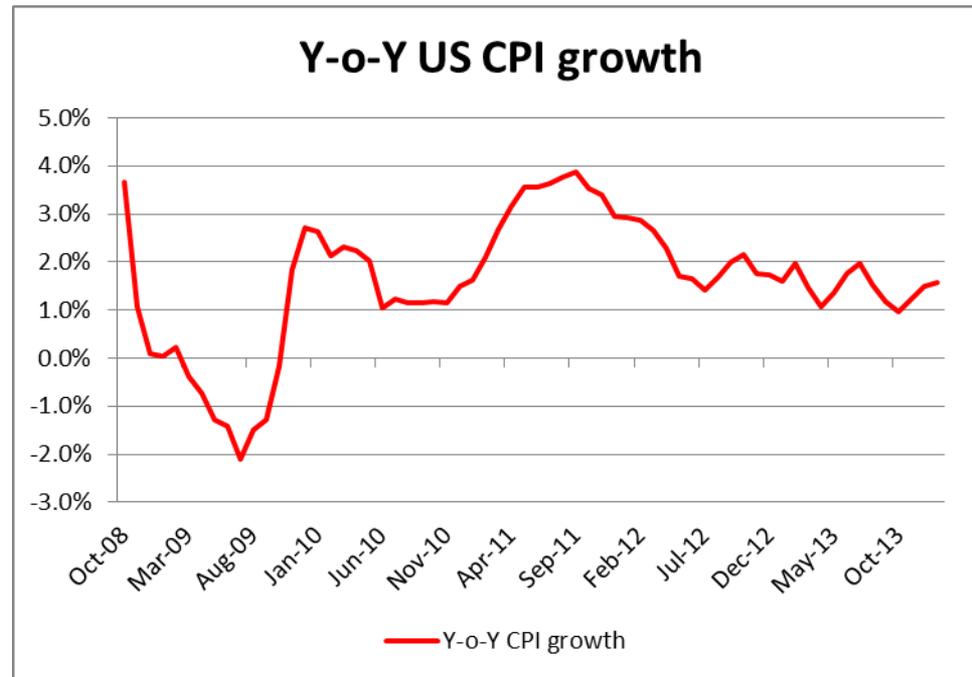
- So will the ECB adopt unorthodox measures
 - i.e. QE ?
- Draghi announced ABS purchases to come
- But there is opposition from...
 - The usual suspect
- And if ECB does QE with ABS ...
 - Will we get hyperinflation?
 - Will the stock market boom ?
 - (all that money has to go somewhere.....)
 - Will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

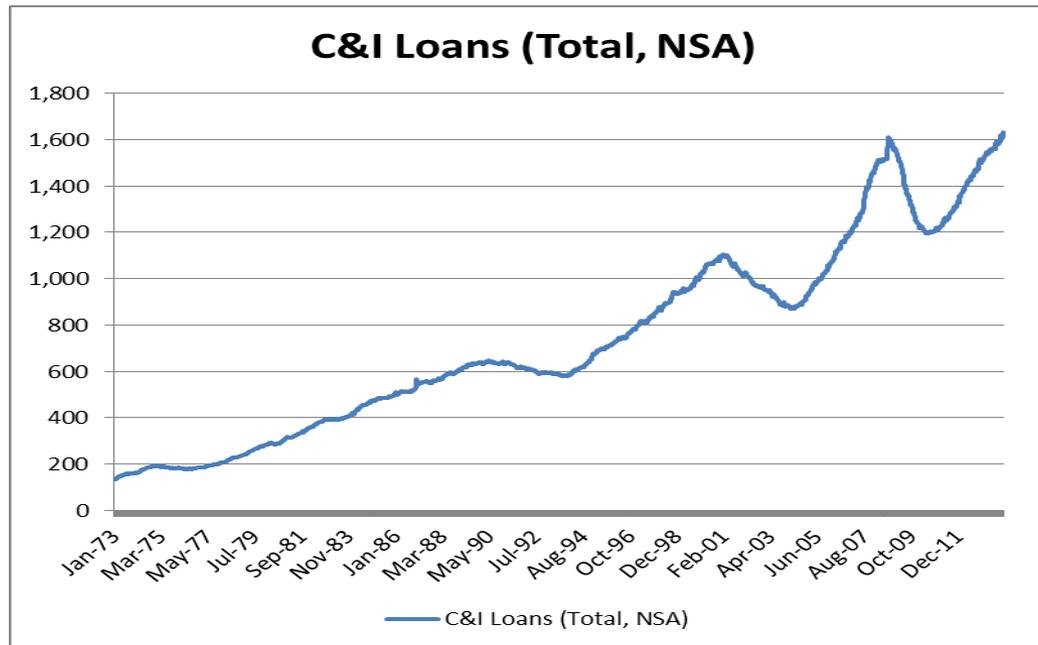
- Move along



- No inflation to see here.....

ECB Policy

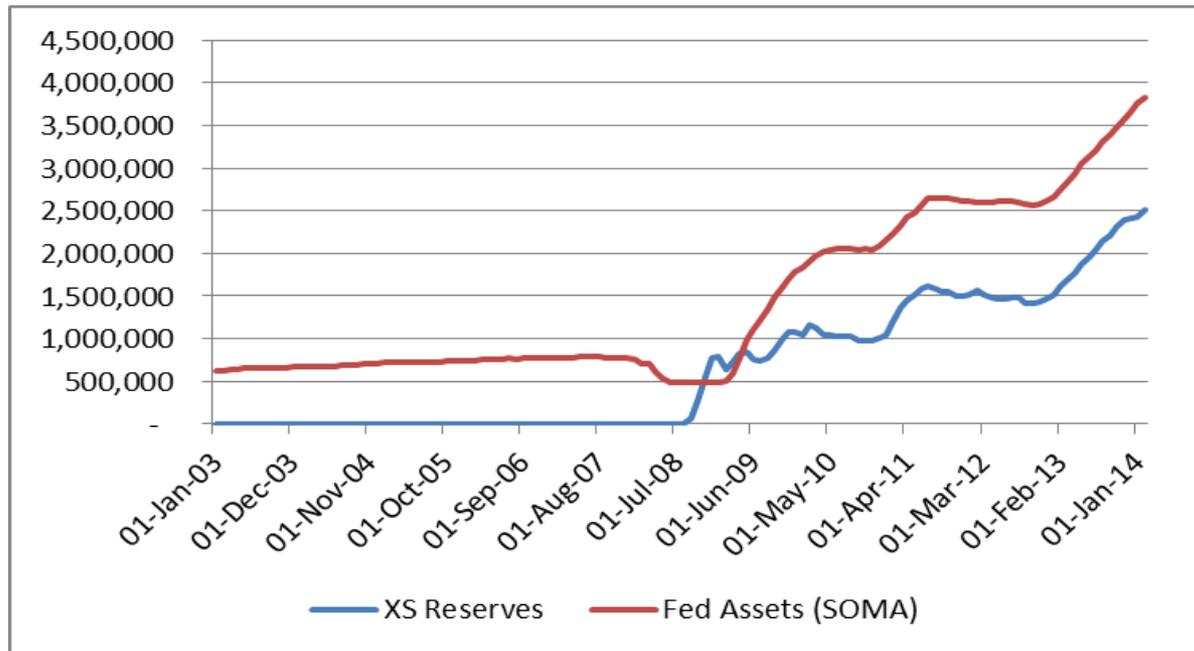
- US bank lending collapsed.....



- But eventually recovered (after lots of QE)

ECB Policy

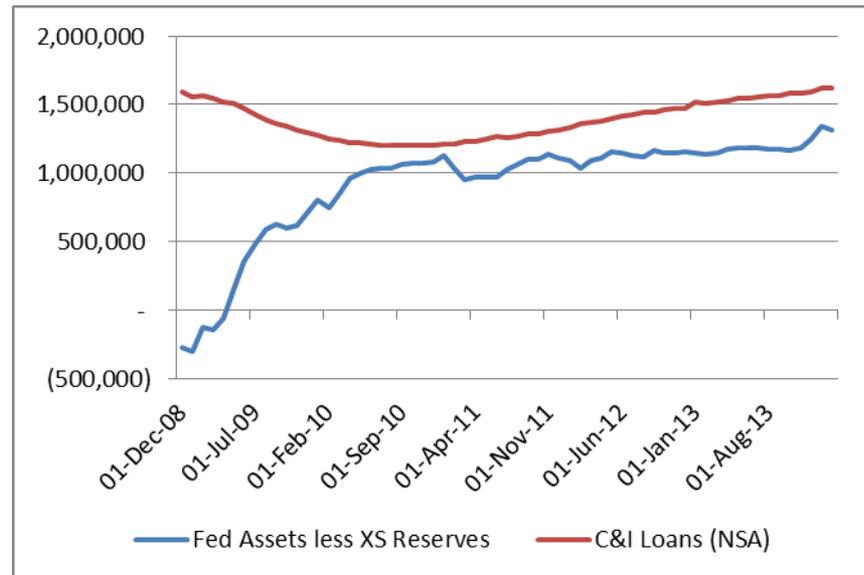
- Most of the growth in Fed Assets....



- 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

- **You can contact me at :**
 - Mail@ChrisGolden.com