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The next edition of the CSV will be published on **08 November 2023**.

Covered Bond & SSA View

NORD/LB Markets Strategy & Floor Research

25 October 2023 ♦ 31/2023
Marketing communication (see disclaimer on the last pages)

Agenda

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Market overview Covered Bonds

Author: Dr Frederik Kunze

The ECB and the covered bond market: new “distortions” underway already?

During the extended period in which the ECB has been conducting its purchase programmes or offering attractive refinancing options via the central bank, we have repeatedly commented on the distortions to the covered bond segment, which materialised on both the supply and the demand side. While the impact of these distortions has declined perceptibly, we are already seeing new stimuli in ECB monetary policy that will have an impact on banks’ funding and consequently also on future supply in the EUR benchmark segment. The influence of the level of interest rates on lending and on demand for new mortgage loans as well as general sentiment on the market, which covered bonds, as an asset class, cannot escape entirely, is also certainly apparent. This should not, however, be generally interpreted as a decline in the need for refinancing. It should be noted that funding via senior bonds can become relatively more expensive during periods of market volatility. However, in the battle to contain inflation in the eurozone, the ECB’s Governing Council is also looking at other instruments (see ECB Preview). Halting PEPP reinvestment earlier (i.e., earlier than the end of 2024) would certainly have a more indirect impact. An adjustment to the minimum reserve requirements (which we do not expect at the upcoming meeting) could make funding via covered bonds more attractive for some issuers if the banks focus more closely on monitoring their LCR ratio. Overall, however, we believe that the covered bond market and, in particular, the EUR benchmark segment, is exposed to fewer specific distortions here and hope that there will be no “cannibalisation à la CBBP3 and TLTRO II/III” once again. In 2024, we expect a respectable supply in the order of magnitude of EUR 150-155bn at least. However, the figure is subject to the specific funding in the current year. Spreads are likely to have largely completed their repricing at the end of 2023 and increased “somewhat” from their current levels.

Primary market: four benchmarks and the first sub-benchmark for more than four weeks

Caution is currently the watchword on the primary market. However, we can report four new benchmarks. Nordea (FI) approached investors on Thursday and placed EUR 1.0bn (maturity: 5.0y) at a – rather pricey – ms +26bp. The secondary market’s performance was correspondingly subdued. It was joined by BNP Paribas Fortis (BE), which was no longer on our list of potential issuers for 2023, the following day. A total of EUR 1.0bn was allocated at ms +32bp (new issue premium: +9bp). The notable premium compared with fair value did not really help in the secondary market. Yesterday (Tuesday), Helaba (DE) placed a public sector Pfandbrief (3.8y). A total of EUR 750m was allocated at ms +15bp. The appearance of Sparebank 1 Boligkreditt (NO) is most welcome. The third benchmark (EUR 1.0bn; 4.75y) from Norway was priced at ms +36bp and therefore narrowed by four basis points in the marketing phase. With low levels of issuing activity in the EUR benchmark segment, we are definitely seeing a certain scarcity value. Thanks to Stadtsparkasse München (DE), we were also able to welcome the first sub-benchmark for more than four weeks. A deal for EUR 250m (5.0y; WNG) was placed at ms +27bp.

Issuer	Country	Timing	ISIN	Maturity	Size	Spread	Rating	ESG
SpareBank 1 Boligkreditt	NO	24.10.	XS2710358297	4.8y	1.00bn	ms +36bp	- / Aaa / -	-
Helaba	DE	24.10.	XS2711420054	3.8y	0.75bn	ms +15bp	AAA / Aaa / -	-
BNP Paribas Fortis	BE	20.10.	BE0002974559	5.0y	1.00bn	ms +32bp	- / Aaa / -	-
Nordea	FI	19.10.	XS2708690685	5.0y	1.00bn	ms +26bp	- / Aaa / -	-

Source: Bloomberg, NORD/LB Markets Strategy & Floor Research (Rating: Fitch / Moody's / S&P)

Internal matters: Deutsche Hypo Real Estate Economic Index starts subdued Q4

Current figures for the Deutsche Hypo Real Estate Economic Index were published a few days ago. A fall of 4.9% compared with the previous month (to 66.4 points) was reported for the month of October for the index, which is based on responses from around 1,200 real estate experts. This was caused by setbacks in both the investment climate and the earnings climate. Growth (+2.4% to 103.1 points) was reported solely for the logistics climate. For Ingo Martin (Head of Real Estate Finance Origination), it is also true that there are signs of "selective" movement in the market once again. For instance – unlike the 2008 financial crisis – there is enough liquidity. However, project developers are confronted with more stringent requirements in terms of their debt servicing abilities. With regard to the office property market, Martin is seeing a "flight to quality" – towards properties in "top locations", for example. The retail industry is still facing significant challenges as well (see also the NORD/LB Real Estate Special on the Future of City Centres [German only]). In particular, the market for German Pfandbriefe is characterised by comparatively substantial shares of commercial property financing. We recently committed ourselves to this sub-segment in a public and online series of lectures featuring well-known lecturers. You can see the presentation documents here: NORD/LB Capital Markets Spotlight: Commercial Real Estate – Bow Wave or Tsunami? [German only]. We would like to thank all our speakers and participants for their valuable contributions and their active participation in the round table discussions.

EMF review of Q2: further slowdown on European mortgage markets

Looking at the real estate segment at a European level too, it is clear that the situation is sobering at least. In the context of our weekly publication, we regularly refer to the analyses of the real estate and mortgage markets presented by the European Mortgage Federation (EMF). Not surprisingly, the current quarterly review for Q2 2023 states that the general slowdown has continued. We derive the majority of the data from both the aggregate and the comparative market analysis of the individual jurisdictions (EU27 plus UK). Accordingly, the dramatic impact of current monetary policy throughout the world and somewhat sluggish economic activity are uniting the mortgage markets. At the same time, labour markets overall remain extremely strong, which will reduce the risk of payment defaults or arrears on mortgage loans in the longer term. As far as changes in property prices are concerned, the picture is definitely less uniform. Markets in Northern Europe recorded significant falls here, while prices were still trending upwards in Italy, Spain and Greece during the second quarter. At a national level, the decision-makers have also taken measures in more and more jurisdictions that are expected to further ease the pressure on budgets. In Poland, for example, the supervisory authority introduced a new quota for long-term loans in May 2023, which should also benefit covered bond funding. Some governments (including France, for instance) have also focused more closely on the supply side of the real estate market.

Focus on property markets: S&P presents Global Covered Bond Insight Q4/2023…
Not surprisingly, developments on the real estate markets are also preoccupying the rating experts tasked with evaluating covered bonds. Solely the fact that the composition of cover pools for the vast majority of jurisdictions is based on the specific requirements of national covered bond legislation ultimately gives investors additional stability, especially in volatile real estate markets. Nevertheless, the current falls in property prices seen in many economies and their (possible) impact on ratings cannot be ignored. Within the current issue of its Global Covered Bond Insight, the experts at S&P focused on the price correction on the real estate market. Accordingly, the price trend will also affect the risk assessment of the cover assets, although immediate consequences for the ratings or their outlook are not expected here. S&P attributes this not least to the more than respectable state of employment markets in European economies. Nevertheless, the current period of economic weakness has led to certain downside risks, also supported by the trend in interest rates. The rating experts also assume that the pressure on property prices will continue into 2025.

S&P forecasts at country level: nominal house prices (Y/Y in %; in Q4 in each case)

Issuer	2020	2021	2022	2023	2024	2025	2026
Germany	8.7	12.6	-3.6	-4.9	-1.5	1.0	2.0
France	6.3	7.0	4.6	-2.6	-4.0	1.5	2.5
Italy	1.6	4.1	2.8	0.0	-4.9	-2.0	1.0
Spain	1.7	6.3	5.5	-4.0	-2.0	1.5	2.0
Netherlands	8.8	19.0	5.3	-5.4	-1.5	1.0	2.3
Belgium	5.7	6.1	4.7	-2.4	-1.0	2.0	2.4
Portugal	7.9	11.5	11.3	-4.4	-3.0	2.0	4.1
Switzerland	5.4	8.3	5.5	0.3	0.0	1.5	2.0
UK	6.0	8.3	9.6	-6.6	-4.9	1.4	3.0
Ireland	0.7	13.8	8.6	-5.1	-4.3	1.0	3.5
Sweden	5.4	11.0	-3.7	-5.4	1.8	2.8	3.2

Source: S&P, NORD/LB Markets Strategy & Floor Research

…and also discusses the impact on the covered bond market in this context
In their Covered Bond Insight, the experts at S&P approach the possible impacts of current developments on international property markets on covered bond ratings via the conceivable route of sustained payment arrears on the part of borrowers. As previously mentioned, the current employment situation, which is still sound, limits this risk considerably. As part of a scenario analysis (for the jurisdictions Ireland, Spain, Italy and the UK), S&P rated the impact of the forecast trends on real estate markets and their own economic expectations. In our opinion, the inferences based on the downside scenario (including a summarised increase in the employment rate of three percentage points and a corresponding fall in property prices of 20%) must be highlighted in this connection. There would still be sufficient credit enhancements for the rated programmes to ensure that it is unlikely that there would be any changes to ratings. Nevertheless, the proportions of past due cover pool assets increase under the downside scenario – most significantly in Italy (+4.3 percentage points) and Ireland (+3.4 percentage points).

Portugal: Moody's presents current assessment of the Covered Bond Act …

The minimum standards introduced by the Covered Bond Directive in Europe, which have been applicable since July 2022, have necessitated amendments to national legislation. Amendments have also been included in the Covered Bond Act in Portugal. A few days ago, the risk experts at Moody's presented an updated version of their Covered Bond Report on the legal framework in Portugal. The agency highlights the mandatory exclusion of non-performing loans (more than 90 days in arrears) from the cover pool as one of the legislation's strengths. In the event of an issuer default, Moody's also appreciates the nomination of the cover pool administrator by the regulator and the framework for asset sales, whereas the act is weaker with regard to overcollateralisation requirements, among other matters. For instance, the act sets the requisite OC at 0%, which is below the requirements of the CRR, meaning that issuers must set themselves more stringent requirements than those required by the act in their respective programmes if they wish to achieve a CRR risk weighting of 10%, for example, in the best case. Moody's also cites the absence of guidelines for stress tests (including interest and currency risks) and the theoretical possibility of taking in non-CRR compliant assets as cover assets as weaker characteristics. According to Moody's, the latter option is not used by active issuers. It also states that the banks providing housing finance are still performing very well despite the increase in mortgage rates – which are also regarded as triggers of the fall in prices.

… and we take a current look at the market for Portuguese covered bonds

The "active" institutions include Banco BPI, Banco Comercial Portugues, Banco Santander Totta, Caixa Economica Montepio Geral, Caixa Geral de Depositos and Novo Banco, whereby only Banco BPI, Banco Santander Totta and Caixa Economica Montepio Geral currently feature in the EUR benchmark segment. In 2023, Banco Santander Totta approached investors with two EUR benchmarks, while Banco BPI placed a deal successfully and even tapped this same issue in 2023. The outstanding volume of EUR benchmarks stands at EUR 5.35bn. This figure is well below the total volume on the market, which still contains around EUR 20bn of covered bonds not placed by joint leads and around EUR 13bn (which was explicitly categorised as retained deals in Bloomberg). We definitely see the potential here for a shift in the balance of power towards the EUR benchmark segment and also expect the group of active benchmark issuers to widen in this context. The issuer Novo Banco is cited as an example here. It has over EUR 5.50bn in outstanding covered bonds, which are all classified as retained issues. In the current Investor Presentation, we see both the reference to the amended repayment structure (from CPT to soft bullet) and quantification of the issuance potential (at EUR 1.25bn) as noteworthy. In our opinion, the switch of rating provider (from DBRS to Moody's) is also worth mentioning. Regarding the changes to the covered bond programme, in addition to the amendment to the repayment structure and the introduction of the statutory 180-day liquidity buffer, Novo Banco also lists the new Aa2 rating from Moody's, which will replace the A rating from DBRS. However, we must go far back with regard to the bank's earlier presence in the EUR benchmark segment: the only EUR benchmark that we have recorded in the database fell due as far back as February 2015. The most recent Portuguese issuers to no longer have bonds outstanding were Banco Comercial Portugues in May 2022 and Caixa Geral de Depositos in January 2022.

Market overview
SSA/Public Issuers

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ECB interest rate decision: Wait and see without calling it a pause

When the ECB Governing Council announces its interest rate decision on Thursday, it would be a huge surprise to read “adjustment of key interest rates” after the event. As we reported in our ECB preview , a pause is clearly to be expected. The wait-and-see attitude of the central bankers actually has some advantages. Once again, this would avoid making the wrong decision in an acute crisis situation. Certainly, a wait-and-see attitude should not be confused with an opportunity to sit back and relax, as there are plenty of topics up for discussion. More hawkish central bankers would certainly like the topic of PEPP or even other monetary policy instruments, such as minimum reserve requirements, to be a little more prominent on the agenda. Discussions on the economic situation are likely to be equally spirited. At the end of the day, many exits are conceivable given the current developments. Here, emerging inflation fears need to be weighed against the threat of a hard landing. This week, they are “just discussing”. In a meeting-by-meeting approach, they might not need to think about December or 2024 yet - but then it is not that simple. The ECB’s decision-makers should already be thinking now about how an interest rate climbdown could be achieved without causing market distortions. This will certainly not be a mirror image of the series of interest rate hikes.

EIB: Multilateral development banks with record climate financing in 2022

On 12 October, the report by the Multilateral Development Banks (MDBs) for 2022 was presented in Marrakech under the auspices of the EIB (ticker: EIB), which bundled data from the African Development Bank (ticker: AFDB), Asian Development Bank (ticker: ASIA), Council of Europe Development Bank (ticker: COE), European Bank for Reconstruction and Development (ticker: EBRD), Inter-American Development Bank Group (ticker: IADB) and the Islamic Development Bank (ticker: ISDB), among others organizations. Last year, around EUR 94bn was made available worldwide for climate protection measures - a new record following the value of just under EUR 78bn in 2021. The total amount is distributed as follows: low- and middle-income economies received around EUR 58bn of MDB climate finance in 2022, of which 63% (EUR 36bn) was for climate change mitigation finance and around 37% (EUR 22bn) for climate change adaptation finance. Around EUR 36bn was allocated to high-income economies. Of this total, just under 94% (EUR 34bn) was for climate change mitigation finance, and around 6% (EUR 2bn) was for climate change adaptation finance. With the figures presented, the MDBs in 2022 now exceed the 2025 climate finance targets for the second time in a row. These were defined within the framework of the UN Climate Action Summit in 2019 and provide for the equivalent of around EUR 47bn annually. “The remarkable efforts made by MDBs to increase climate finance in 2022 show that we are moving together in the right direction. Addressing the climate crisis can bring about positive social change, as climate change [...] exacerbates existing patterns of inequality." says CEB Governor Carlo Monticelli.

MuniFin presents new sustainability agenda

On 13 October, Municipality Finance (ticker: KUNTA) unveiled its sustainability agenda entitled “Enabler of sustainable welfare in society”, which sets the framework and goals for the company’s long-term sustainability efforts until 2035. The company commits to increasing the proportion of sustainable finance and, for the first time, has defined emissions reduction targets for financed buildings. Esa Kallio, CEO of MuniFin, comments: “The sustainability agenda is our way of measuring and communicating what we aim to achieve through our work. Our goals are now more aligned with what we are already doing and what we aspire to achieve in the future.” Key themes include supporting societal welfare and accelerating Finland’s green transition. The sustainability agenda consists of three parts. The first part addresses MuniFin’s business environment from the perspective of sustainable development and how its operations relate to national and international goals. The agenda’s second and most important part includes the actual themes, goals, and metrics for MuniFin’s sustainability efforts. The third part discusses the future of the company’s sustainability work. However, as indicated above, one of the most notable changes is the establishment of concrete emissions reduction targets for the financed buildings. Specifically, emissions are to be reduced to 8 kg of CO_2 equivalent per square metre by 2035, which represents a 38% reduction against the 2022 levels. Goal achievement will be monitored annually in future as part of the annual reporting, and goals may be expanded or tightened as necessary.

NRW.BANK.ifo Business Climate September 2023: Economy in NRW ends downturn

On 5 October, the results of the survey were presented in the course of the NRW.BANK.ifo business climate conference in Düsseldorf. The mood in the North Rhine-Westphalian economy improved slightly in September for the first time since March this year. The NRW.BANK.ifo business climate improved by 1.4 points to -12.0 balance points compared with the previous month. Although the surveyed companies’ assessment of their current business situation deteriorated once again at -2.8 balance points (August: -0.8), pessimism about future developments decreased significantly. Business expectations rose by 4.5 points and now stand at -20.8 balance points. “The good news from the survey is that we seem to have the bottom of the economic trough in sight in North Rhine-Westphalia. There is unlikely to be a deep slump in economic output in 2023,” said Eckhard Forst, Chairman of Managing Board at NRW.BANK. The situation in the individual sectors is as follows: The climate improved most in the service sector, where companies were more satisfied with their current business situation. And business expectations were also significantly less pessimistic. The sentiment in the retail sector also improved somewhat. Although retailers’ assessment of their current business was more negative, the outlook for the next six months improved noticeably. In the manufacturing sector, there was little change in the business climate - the more negative assessments of the business situation were offset by less pessimistic business expectations. A positive signal is coming from demand for industrial goods, which is stabilising. Only in the construction sector did the downturn in sentiment continue in September. Here, the NRW.BANK.ifo business climate fell to its lowest level since July 2009. Both current business and expectations for the next six months were rated significantly worse by construction companies. The mood in residential construction was particularly poor. Here expected construction activity in the coming three months fell to a new all-time low.

Quebec: Strengthening cooperation with Luxembourg

At the end of August, the Minister of International Relations and Francophonie and Women’s Affairs of the Provincial Government of Quebec (ticker: Q), Martine Biron, travelled to Luxembourg. Among others, she met with the Prime Minister of Luxembourg, Xavier Bettel, as well as representatives of the EIB and the Luxembourg Chamber of Commerce. The main topics discussed were relations with Luxembourg partners and an intensification of bilateral, strategic cooperation. The focus was again on economic components, such as highlighting Quebec's expertise in sectors of bilateral interest in order to identify further possible partnerships, particularly in the areas of transport, sustainable technologies, the circular economy and infrastructure. Biron further reiterated the desire to accelerate foreign trade. The background to this is that Quebec is the second largest province in Canada as measured by both population and economic output behind Ontario. In 2022, the GDP of Quebec grew by 2.6% to CAD 391.2bn. Quebec is also very active in the capital market. Bonds amounting to the equivalent of EUR 170.3bn are currently outstanding, which corresponds to about 33% of the total bond volume of Canadian provinces. Bonds denominated in EUR account for EUR 19bn of this amount.

Primary market

After rather subdued primary market activity in recent weeks, we are pleased to report five benchmark deals and one sub-benchmark today. Schleswig-Holstein (ticker: SCHHOL) kicked things off with a five-year FRN in the amount of EUR 500m, which was placed at -12bp against the six-month Euribor in accordance with the guidance. Information on the order book was not published. Instituto de Crédito Oficial (ticker: ICO) then ventured onto the trading floor with a new deal featuring a term to maturity in excess of five years, with a figure of EUR 1.0bn in mind. With a bid-to-cover ratio of 2.3x, the deal was priced 18bp above the Spanish curve (reference: SPGB 3.5% 05/31/29), two basis points tighter than the guidance. At the beginning of the week, there was news from France: Bpifrance (ticker: BPIFRA) raised EUR 1.25bn in a social bond with a term of just under four years. With a guidance of OAT +41bp area above the French curve (references: FRTR 0% 2/2027 and FRTR 0.75% 2/2028), the order books filled to almost EUR 3bn, so that the deal was closed at OAT +39bp. In the meantime, the International Development Association (ticker: IDAWBG) raised EUR 550m (SDB) in a 30-year maturity at ms +74bp without much fanfare. No further information on this deal was made public. Finally, back to Germany in the EUR benchmark segment: NRW (also the issuer’s ticker) issued a fresh deal worth EUR 1.0bn with a term of five years. At guidance of ms +2bp area, and a bid-to-cover ratio of 2.8x, the deal was finally in the bag at ms flat. The activity from our neighbours in France was on a smaller scale: Ville de Paris (ticker: VDP) made an appearance with a sub-benchmark. Here, a total of EUR 295m was issued as part of a 14y deal, with the whole thing processed in line with the guidance of OAT +40bp (no “area” required here). The EU bond auction also took place on 23 October. Around EUR 4.5bn was successfully raised through taps of the 2030 bond (EUR 2,203m) and the 2038 bond (EUR 2,257m).

Issuer	Country	Timing	ISIN	Maturity	Size	Spread	Rating	ESG
IDAWBG	SNAT	24.10.	XS2711350848	30.0y	0.55bn	ms +74bp	- / Aaa / AAA	X
NRW	DE	23.10.	DE000NRW0N83	5.0y	1.00bn	ms flat	AAA / Aa1 / AA	-
BPIFRA	FR	16.10.	FR001400LPZ1	3.9y	1.25bn	ms +9bp	AA- / Aa2 / -	X
ICO	ES	16.10.	XS2708407015	5.6y	1.00bn	ms +35bp	A- / Baa1 / A	-
SCHHOL	DE	16.10.	DE000SHFM915	5.0y	0.50bn	6mE -12bp	AAA / - / -	-

Source: Bloomberg, NORD/LB Markets Strategy & Floor Research (Rating: Fitch / Moody’s / S&P)

Covered Bonds
Banks in Europe: the EBA Risk Dashboard in Q2 2023

Author: Dr Frederik Kunze

EBA Risk Dashboard in Q2 2023

On 9 October 2023, the European Banking Authority (EBA) presented up-to-date figures on its highly regarded "Risk Dashboard" (RDB) (reporting period: Q2 2023). The database comprises a large number of indicators (including capital adequacy, liquidity, asset quality and profitability), which are compiled from supervisory data supplied by commercial banks. In addition, we draw on continuing trends from the EBA's latest Risk Assessment Questionnaire (RAQ), which was carried out with the participation 85 banks in the spring of this year. Similarly, data on compliance with the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) is now provided with each publication of the EBA RDB. In this context – in addition to the annual EBA MREL Quantitative Monitoring Report and Impact Assessment – expanded information is provided. However, this is with a one quarter time lag, so the most recent reporting date here is 31 March 2023. In its report, the EBA states that bank profitability has continued to improve, but that macroeconomic uncertainty is not having a positive impact on credit growth. In the press release it was also highlighted that the gloomier economic outlook in the EU and China as well as the proposed bank levies have contributed to additional uncertainty in the markets. Contrary to these negative effects on credit growth, credit quality remains robust on average – with only isolated increases in NPL ratios. However, there is a risk that these could increase more rapidly in the near future. The EBA RDB is an important source of information for us. Ultimately, we believe that the publication not only provides important insights into the state of the European banking sector, but also refers to the funding behaviour of European institutions. In the context of covered bonds, the insights into the refinancing activities as well as the lending business of European banks are of particular importance. The dashboard also includes the TLTRO III tenders that are expiring or have already expired, in addition to referring to important liquidity metrics.

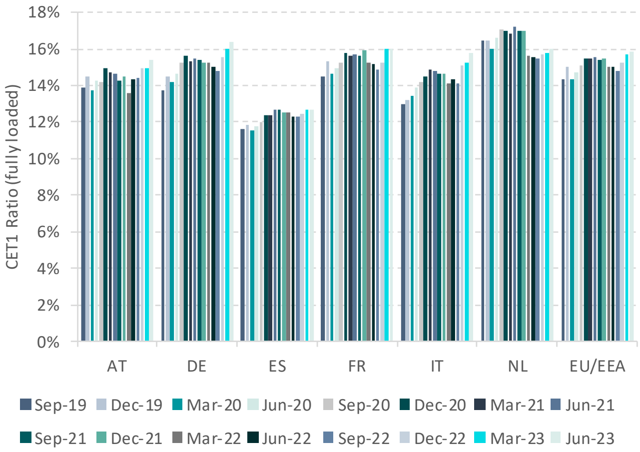
Profitability improved initially...

According to the EBA, the economic situation will continue to deteriorate in the second quarter of 2023, driven by weaker consumption and foreign trade. Global economic activity was stronger than expected in the first quarter. However, uncertainties regarding macroeconomic and geopolitical developments remained high. In the context of the publication of the RDB data, the EBA also notes that banks' profitability in Q2 continued to be supported by higher interest rates. However, the strength of the increase is heterogeneously distributed across the European banking landscape and is more or less pronounced depending on the balance sheet structure. Year-on-year, net interest income increased by an average of 20%. On the cost side, the EBA also highlights the declines in the cost-to-income ratio (Q2 2023: 56.5%) by three percentage points to an all-time low.

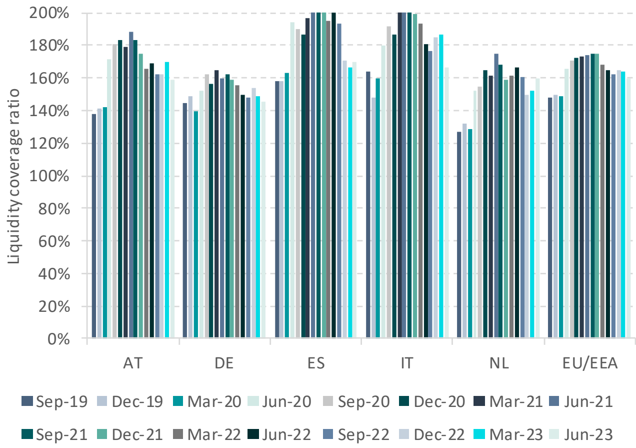
...but deposit betas and rising credit risk could have a negative impact moving forwards

For the time being, the average return on equity (RoE) in the EU is 10.8%. However, the EBA sees major challenges for banks to maintain current profitability at this level. The EBA cites rising operating costs – in connection with the repricing of liabilities – and subdued credit growth as reasons for this assessment. A prolonged phase of weakness on the credit market would also have a negative impact on future issuing activity in the covered bond segment. The refinancing costs for covered and uncovered bonds continued to rise in Q2 2023. Banks with a higher deposit ratio were able to keep their funding costs at a comparable level due to a lower "deposit beta". After a temporary standstill in the capital market in March 2023, funding activity for secured and unsecured bonds quickly regained strong momentum. The share of green funding continued to rise in the second quarter for senior non-preferred bonds and remained stable for covered bonds.

Risk Dashboard: CET1-Ratio (fully loaded)



Risk Dashboard: LCR (in %)



Source: EBA, NORD/LB Markets Strategy & Floor Research

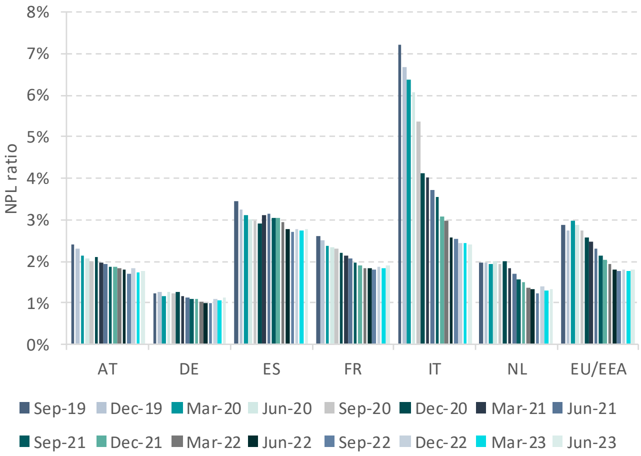
Capital and liquidity ratios in Q1 2023

In its current statement, the EBA says the banks have strong liquidity ratios on average (LCR: 159.5%, NSFR: 126.5%). However, it is important to note that the LCR had to cope with a decline (-3.3 percentage points), which is due in particular to outflows from the liquidity buffers. The excess liquidity was used to repay the TLTRO III facilities. On the capital ratio side, the CET1 ratio (fully loaded) increased by 0.2 percentage points to 15.9% compared with the previous quarter. The capitalisation in the numerator of the ratio benefited from increased earnings, while the denominator from risk-weighted assets (RWA) also increased as a result of higher credit risks – but at a much slower pace.

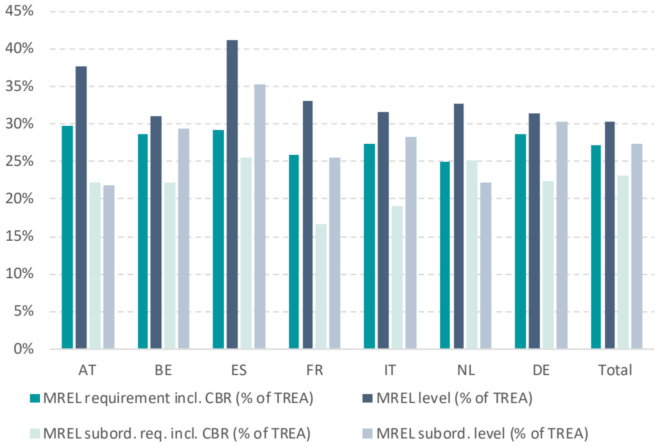
Credit quality: NPL ratios not (yet) picking up

The EBA clarifies that despite the challenging macroeconomic environment, banks' asset quality ratios remain robust. The NPL ratio shows no change compared with the first quarter of 2023 and remains at a low level of 1.8%. In some jurisdictions, however, increases in NPL ratios can already be observed, which could intensify in the future due to the sensitivity with regard to higher interest rates.

Risk Dashboard: Ratio of Non-performing Loans and Advances (NPL ratio)



MREL Risk Dashboard: External MREL requirement and level (% of TREA)



Source: EBA, NORD/LB Markets Strategy & Floor Research; TREA = Total Risk Exposure Amount

MREL Dashboard indicates further decrease in MREL shortfall

The third edition of the MREL Dashboard shows an MREL shortfall of EUR 29.2bn across the analysed countries and banks as at the end of March 2023 (Q4 2022: EUR 28.2bn), which corresponds to a share of 0.38% of the total risk-weighted exposure. However, a comparison of countries shows clear differences. The share of MREL shortfall in total risk-weighted assets varies between countries in a range from 0.1% (Denmark) to 8.2% (Bulgaria). Furthermore, the PIIGS countries are those with the highest shortfalls. Supervisory authorities are monitoring the development and have already approved longer compliance periods for some banks.

Conclusion

The EBA RDB indicates the robust state of European commercial banks in Q2 2023 as well. This is true both in terms of capital and liquidity and with regard to the quality of the assets on the banks' balance sheets. Nevertheless, a somewhat less friendly picture is already crystallising for the future. Profitability is therefore expected to come under greater pressure in the coming months due to rising costs. Capital ratios could also be burdened by a risk-induced increase in RWA positions. In addition, a larger number of loans in default is to be expected, which could cause NPL ratios to rise from the low starting values. Overall, however, we see the banking sector in Europe as still in robust shape and see the gloomier outlook as a logical consequence of the current market environment. We do not see the credit quality of covered bonds from Europe as being jeopardised in any way, and we also anticipate continued momentum in covered funding.

SSA/Public Issuers
Teaser: Issuer Guide – Spanish Agencies 2023

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Spanish agency market dominated by two large issuers

Today, we are going to take a brief look at the Spanish agencies market. There are four Spanish agencies included in our coverage, which currently have 61 outstanding bonds with a total volume of EUR 20.9bn. In a European comparison, the Spanish agency market can therefore be described as relatively small, albeit pretty diverse in nature at the same time. In addition to the promotional bank Instituto de Crédito Oficial (ICO), there is also a securitisation vehicle, a rail network operator and an institution responsible for administering Spain's strategic oil reserves. In the following, we shall be looking in greater detail at Fondo de Amortización del Déficit Eléctrico (FADE), which was founded in 2010 with the aim of securitising claims, or tariff deficit receivables, on the part of Spanish electricity providers against the government. Owing to the regulatory framework conditions, these electricity providers had generated losses, which were to be offset by the government. The purpose of FADE is to ensure that the deficits incurred by the electricity providers are offset more rapidly. The sale of their tariff deficit receivables to FADE has since led to the issuance of bonds, some of which have been in benchmark format. The second-largest agency measured in terms of total assets is ICO, the Spanish promotional bank. The importance of ICO increased during the Spanish banking crisis in particular, as many financial institutions reduced their lending activities, in some cases significantly so, on account of recapitalisation and restructuring processes. The promotional bank's influence also increased because market access became more difficult for the Spanish regions. The third agency covered in this article today is Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES), which is responsible for administering Spain's strategic oil reserves in its role as a stockholding entity. Founded in 2013, ADIF Alta Velocidad (ADIF-AV) is the largest Spanish agency as measured by total assets. Its remit is to operate Spain's high-speed railway network and has been using the capital market since 2015 as one option of meeting its funding requirements. In comparison with other jurisdictions, attention must always be paid to ratings in the case of Spanish agencies, which are often lower than is the case, for example, for other issuers from Germany, France, the Netherlands and even Austria.

Spanish agencies – an overview

Institution	Type	Owner(s)	Guarantee	Risk weight
Instituto de Crédito Oficial (ICO)	Promotional bank	100% Spain	Explicit guarantee & EPE status	0%
Fondo de Amortización del Déficit Eléctrico (FADE)	Securitisation vehicle	-	Explicit guarantee for all bonds	0%
ADIF Alta Velocidad (ADIF-AV)	Rail network operator	100% Spain	EPE status	0%
Corporación de Reservas Estratégicas de Productos Petrolíferos (CORES)	Administrator of strategic oil reserves	-	-	50%

Source: Issuers, NORD/LB Markets Strategy & Floor Research

Explicit guarantees result in risk weighting of 0%

ICO and FADE have explicit guarantees from the Spanish state. As such, a risk weighting of 0% is possible according to the standard approach of CRR/Basel III.

Implicit liability due to EPE status with exception of CORES (RW 50%) and ICO
In Spain, the legal status of Entidad Pública Empresarial (EPE; public law institution) exists as a special form of liability mechanism. Both ICO and ADIF-AV operate under this status, which implies a strong dependency on the central government. EPEs are exempt from insolvency law and can only be liquidated through legislation. If liquidation occurs, the remaining assets and liabilities are transferred to the state or another institution with a comparable legal status. According to our understanding, there consequently exists an implicit guarantee for ADIF-AV, but this is weaker than the comparable liability mechanisms of the French établissement public (EP) status or the German Gewährträgerhaftung (guarantor liability), for example. Conversely, in the case of ICO, the statutes stipulate direct liability on the part of the Spanish state in addition to EPE status. However, in view of the absence of a liability mechanism, a 0% risk weighting is not possible in the case of CORES. Under the standard approach of CRR/Basel III, the applicable risk weighting is derived from the rating and amounts to 50% at present.

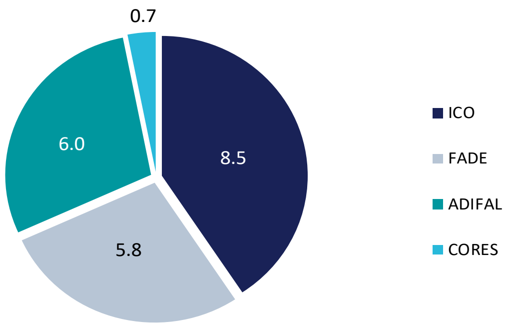
Special case: ADIF-AV
Another special case is that of ADIF-AV. A risk weighting of 0% applies for ADIF-AV, even without a corresponding liability mechanism having been put in place. Based on this risk weighting of 0%, ADIF-AV bonds also qualify as Level 1 assets under the LCR. In addition, ADIF-AV benefits from an implicit guarantee from the Spanish government due to its status as a government-related issuer.

Spanish agencies – an overview (EURbn/EUR equivalent)

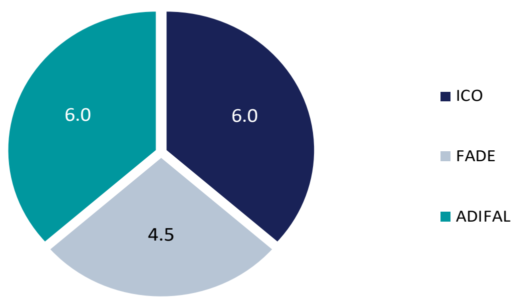
Name	Ticker	Rating (Fitch/Moody's/S&P)	Outstanding Volume	EUR volume	Funding target 2023	Maturities 2023	Net Supply 2023	Number of ESG bonds	ESG volume
ICO	ICO	A-/Baa1/A	8.5	7.9	5.5	1.0	4.5	10	5.0
FADE	FADE	-/-/-	5.8	5.8	1.0	3.5	-2.5	0	0.0
CORES	CORES	A-/-/A	0.7	0.7	0.5	0.0	0.0	0	0.0
ADIF-AV	ADIFAL	A-/Baa2/-	6.0	6.0	0.6	0.6	0.5	6	3.4
Total			**21.0**	**20.4**	**7.6**	**5.1**	**2.5**	**16**	**8.4**

NB: Fitch, Moody's and S&P rate FADE's bonds on a par with Spain's credit rating; FADE is not assigned an issuer rating.
Foreign currencies are converted into EUR at rates as at 19 October 2023.
On account of the issuer's individual funding mix, the values for "funding target" and "net supply" in particular may deviate from reality.
Source: Bloomberg, issuers, NORD/LB Markets Strategy & Floor Research

Outstanding bond volumes (EURbn)

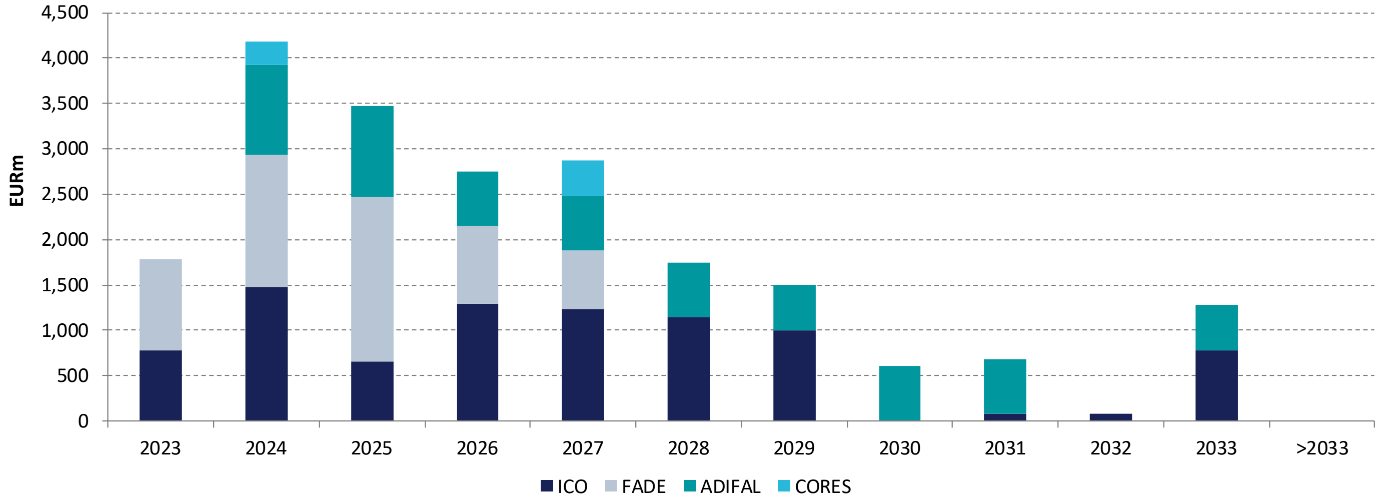


Outstanding EUR benchmarks (EURbn)

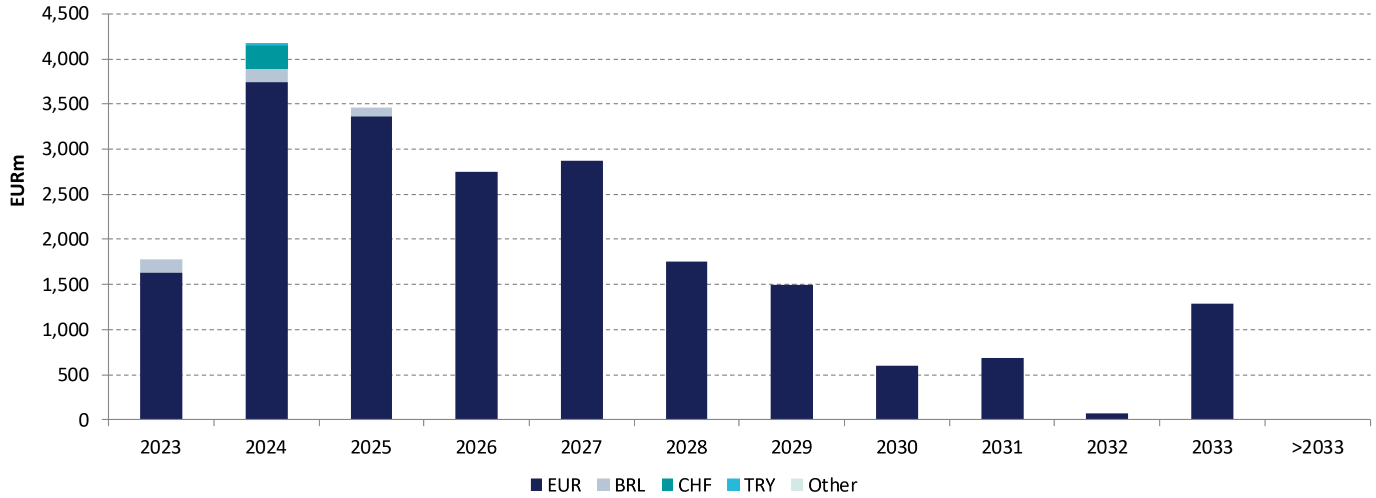


NB: Benchmarks are defined as bonds with a minimum volume of EUR 0.5bn.
Foreign currencies are converted into EUR at rates as at 19 October 2023.
Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

Spanish agencies: outstanding bonds by issuer



Spanish agencies: outstanding bonds by currency



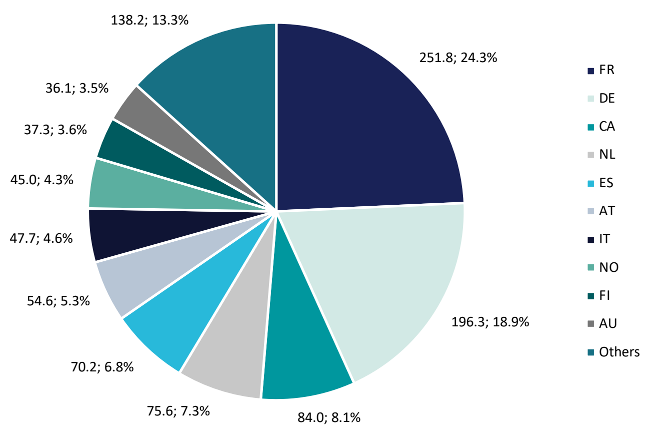
NB: Foreign currencies are converted into EUR at rates as at 19 October 2023.
Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

Conclusion and comment

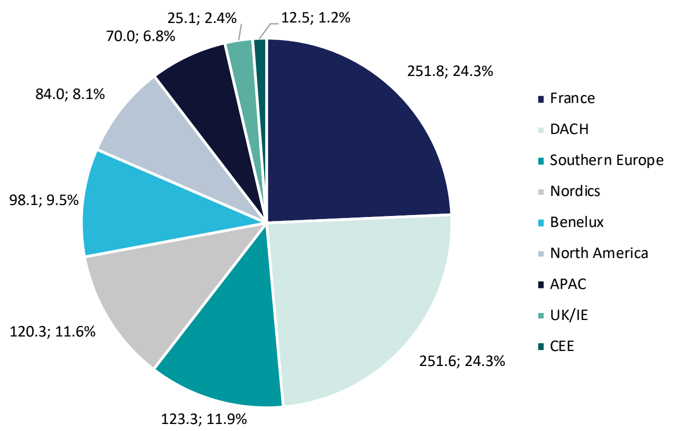
After a brief high in 2011, issuance volumes on the part of Spanish agencies plummeted up to 2018. For more than five years now, issuance volumes have been at a comparable level (gross supply of roughly EUR 1.5-3bn per year). FADE will continue to refinance existing bonds via new issuances, meaning that the net supply of bonds will amount to a maximum of 0. In the meantime, ICO also reported declining primary market supply. Nevertheless, its primary market activities have since picked up pace again due to an abundance of maturing bonds and the COVID-19 pandemic. Supply from CORES is relatively marginal when compared with the other issuers, a situation reflected in the fact that this issuer currently has no EUR benchmark bonds outstanding. However, the fact that ADIF-AV has established itself on the primary market looks set to have a stabilising effect moving forwards. The supply of ESG bonds has also seen steady growth over recent years.

Charts & Figures
Covered Bonds

EUR benchmark volume by country (in EURbn)



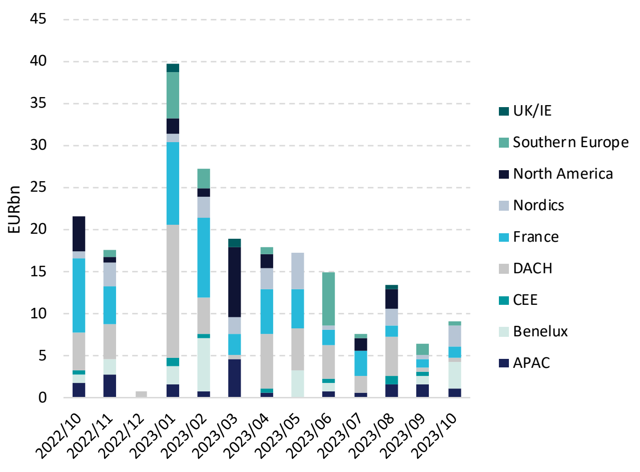
EUR benchmark volume by region (in EURbn)



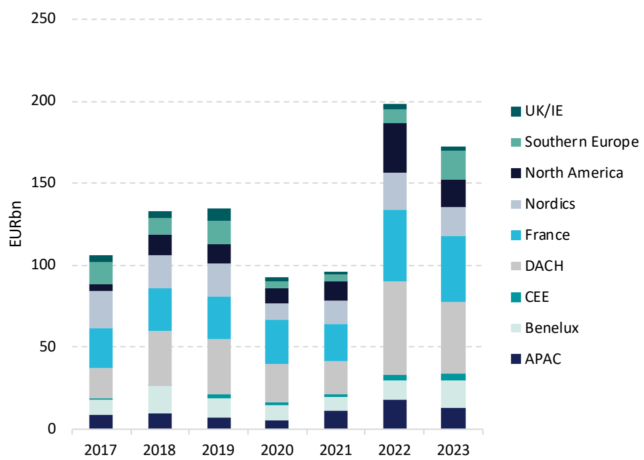
Top-10 jurisdictions

Rank	Country	Amount outst. (EURbn)	No. of BMKs	There of ESG BMKs	Avg. issue size (EURbn)	Avg. initial maturity (in years)	Avg. mod. Duration (in years)	Avg. coupon (in %)
1	FR	251.8	243	21	0.96	9.4	5.0	1.26
2	DE	196.3	280	34	0.65	8.0	4.1	1.15
3	CA	84.0	62	0	1.33	5.5	2.9	1.12
4	NL	75.6	77	2	0.92	10.6	6.3	1.13
5	ES	70.2	55	6	1.16	11.2	3.4	1.97
6	AT	54.6	93	4	0.58	8.2	4.7	1.35
7	IT	47.7	57	2	0.80	8.9	3.7	1.52
8	NO	45.0	54	12	0.83	7.4	3.7	0.68
9	FI	37.3	41	4	0.89	7.0	3.5	1.34
10	AU	36.1	35	0	1.03	7.1	3.3	1.49

EUR benchmark issue volume by month

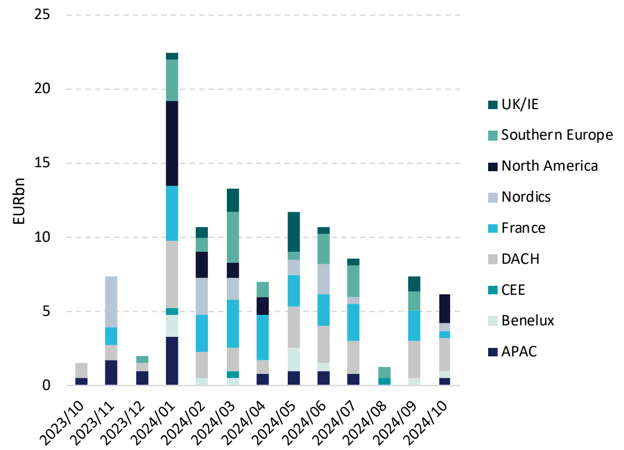


EUR benchmark issue volume by year

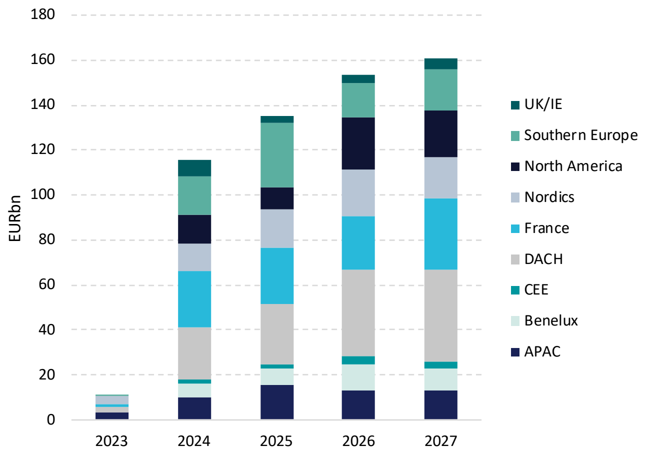


Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

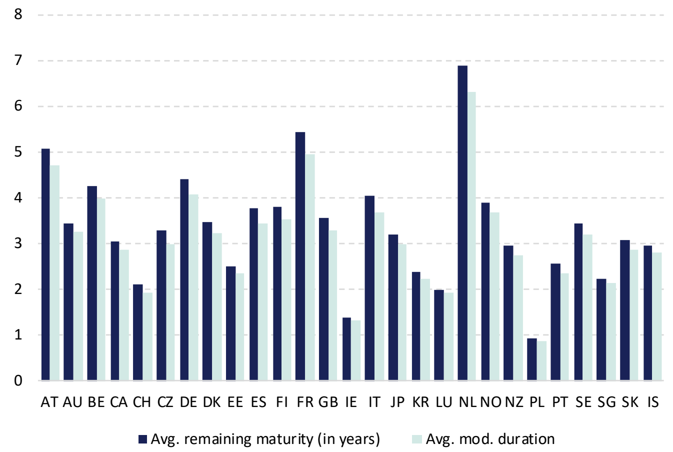
EUR benchmark maturities by month



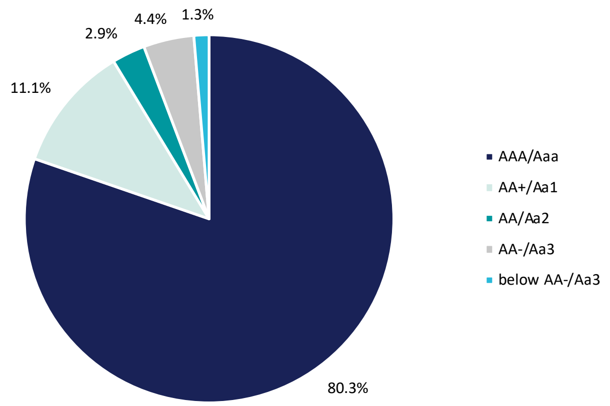
EUR benchmark maturities by year



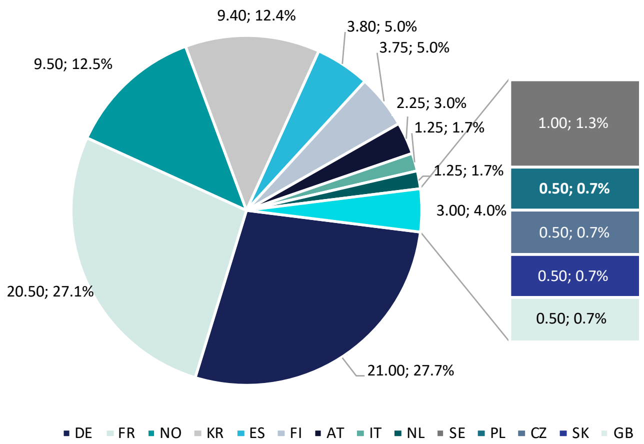
Modified duration and time to maturity by country



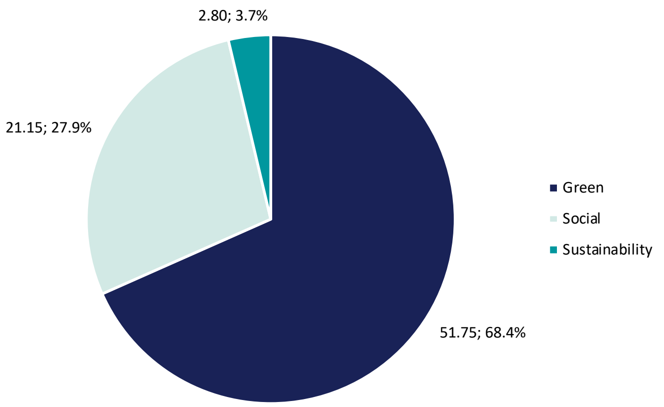
Rating distribution (volume weighted)



EUR benchmark volume (ESG) by country (in EURbn)

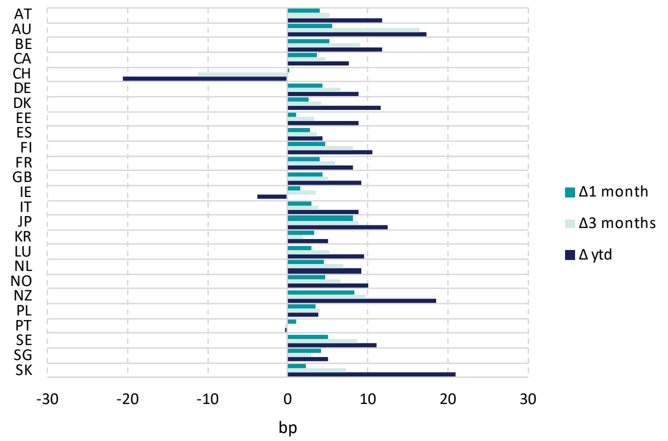


EUR benchmark volume (ESG) by type (in EURbn)

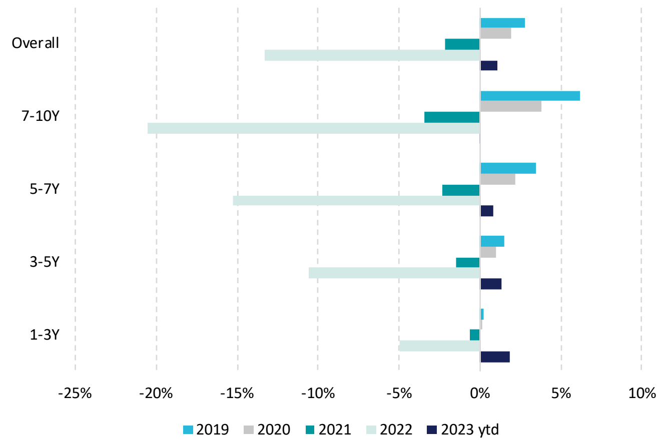


Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

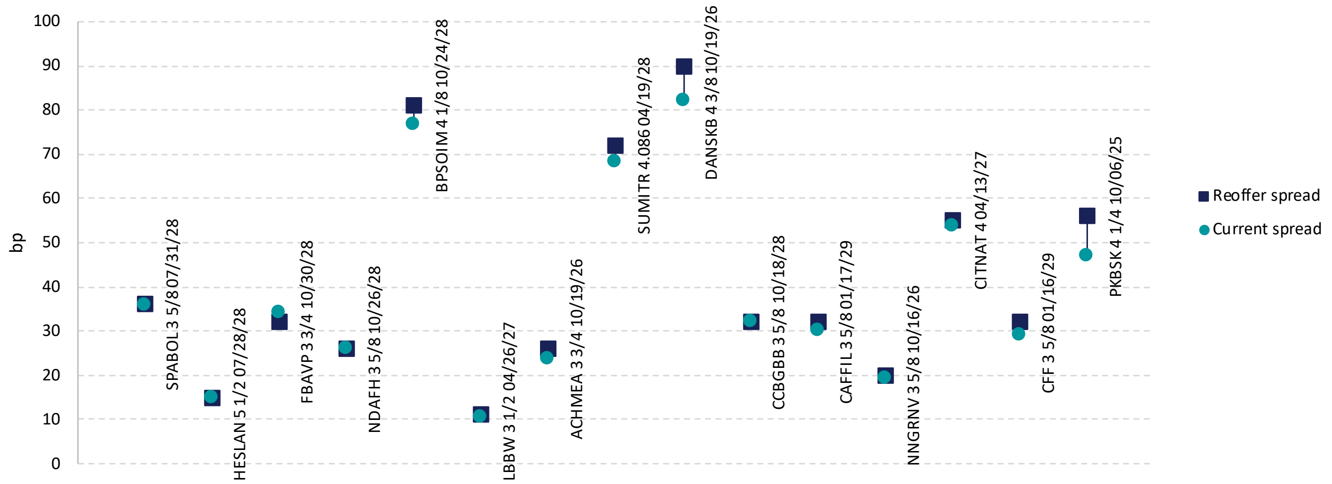
Spread development by country



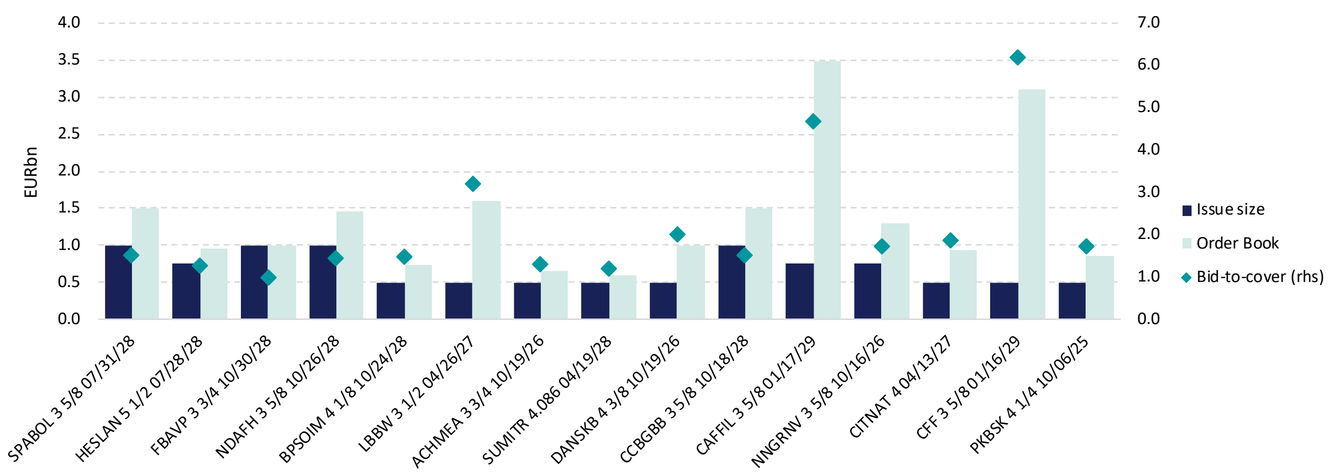
Covered bond performance (Total return)



Spread development (last 15 issues)



Order books (last 15 issues)

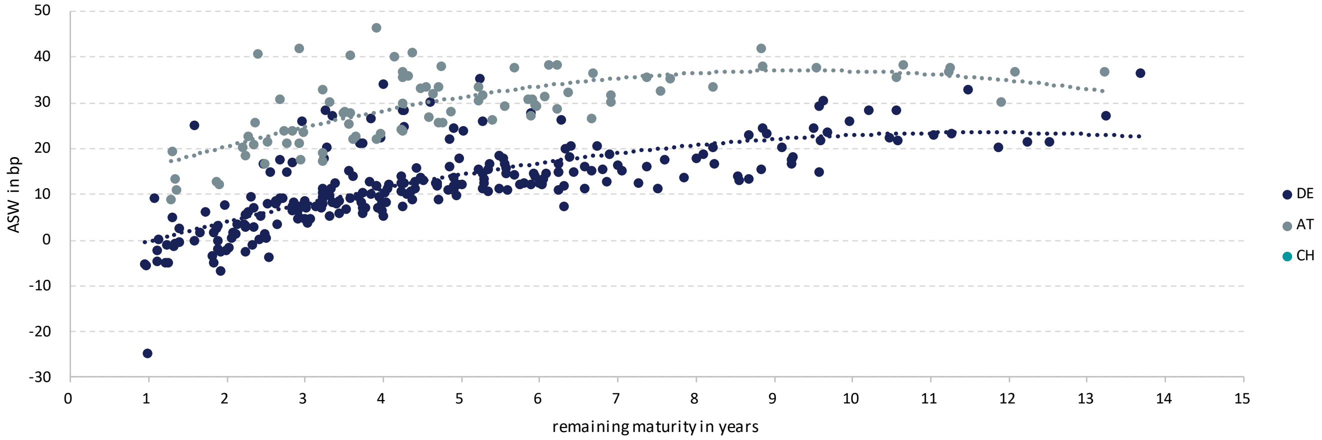


Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

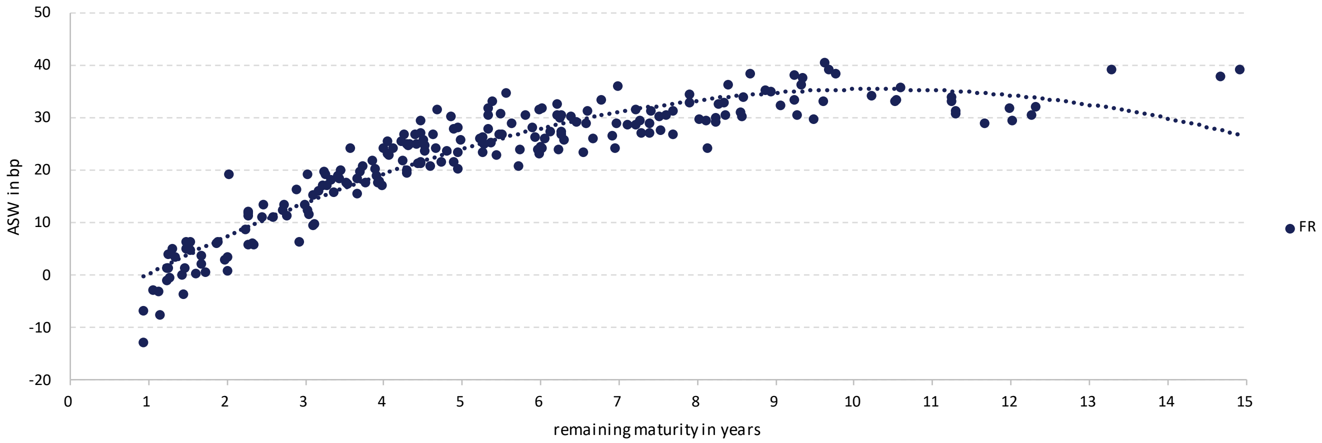
NORD/LB

Spread overview[1]

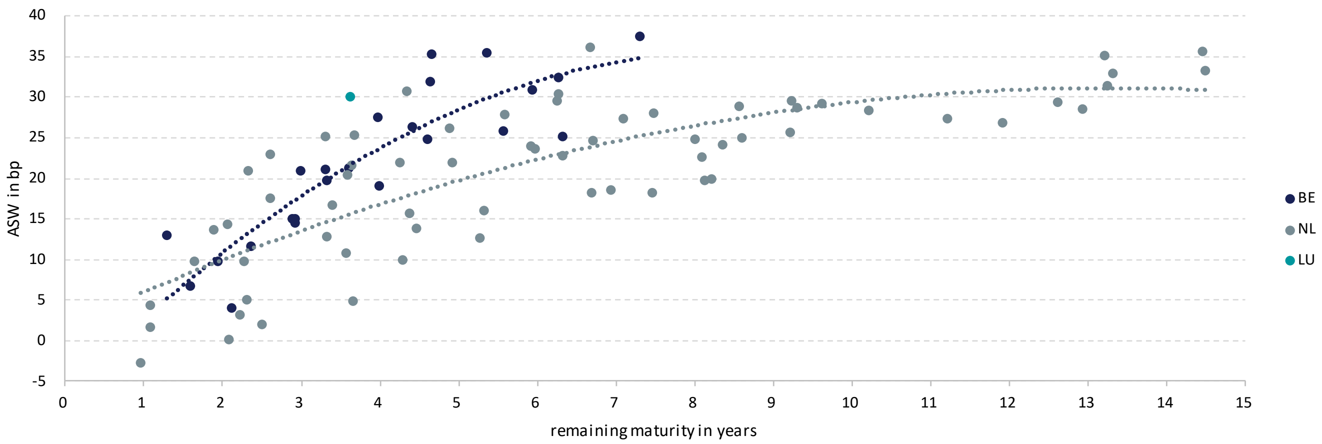
DACH



France

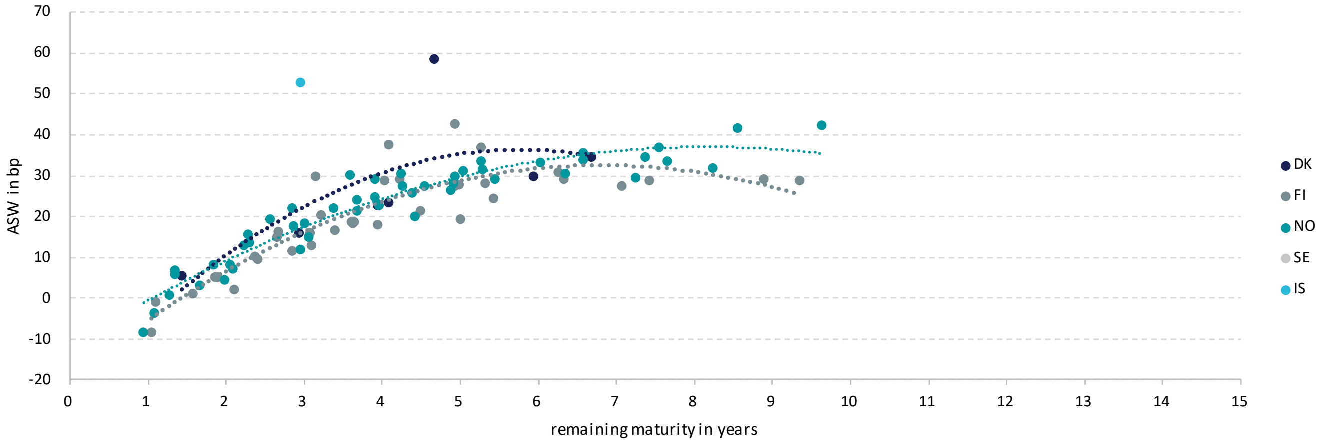


Benelux

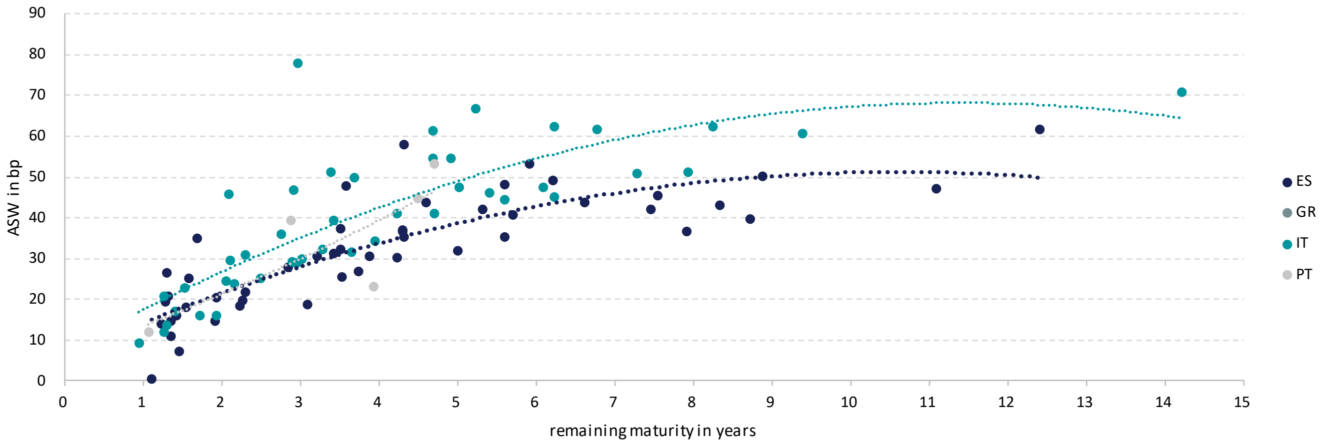


Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research [1]Time to maturity 1 ≤ y ≤ 15

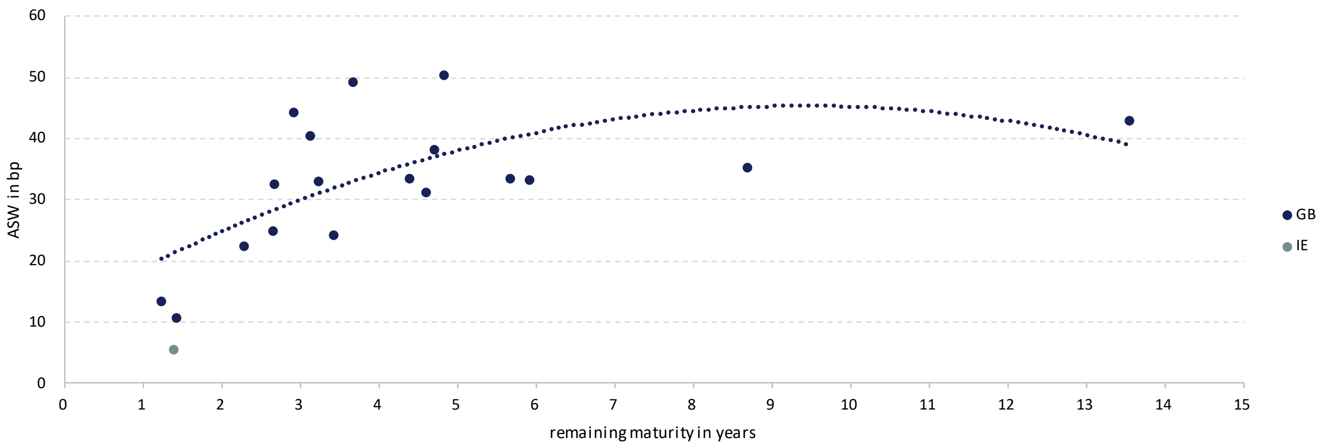
Nordics



Southern Europe

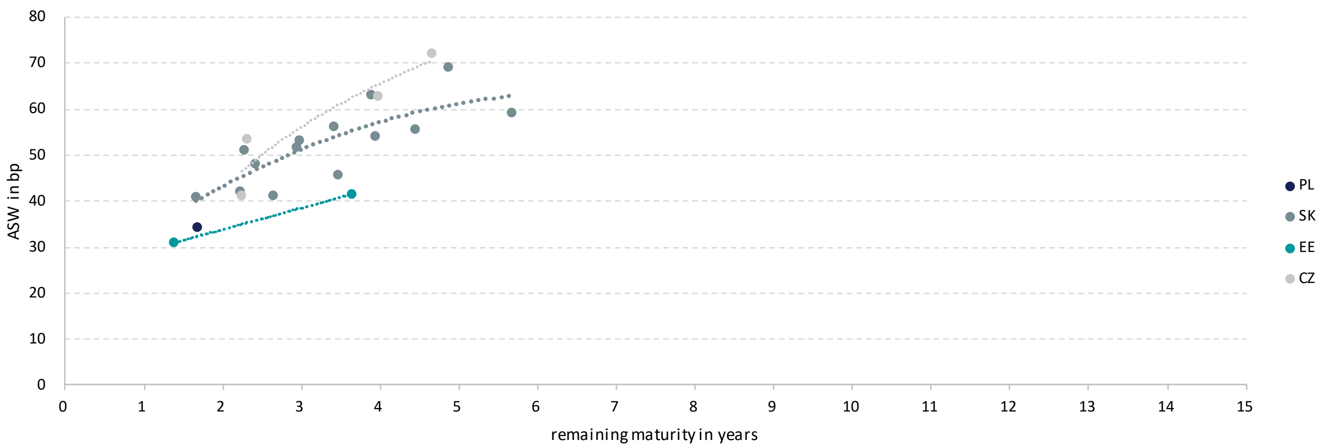


UK/IE

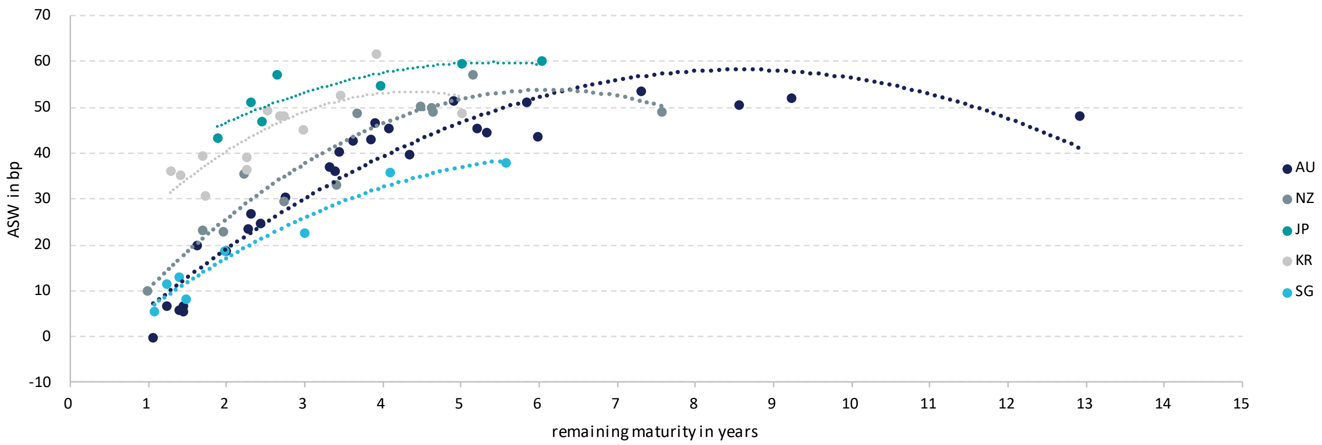


Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

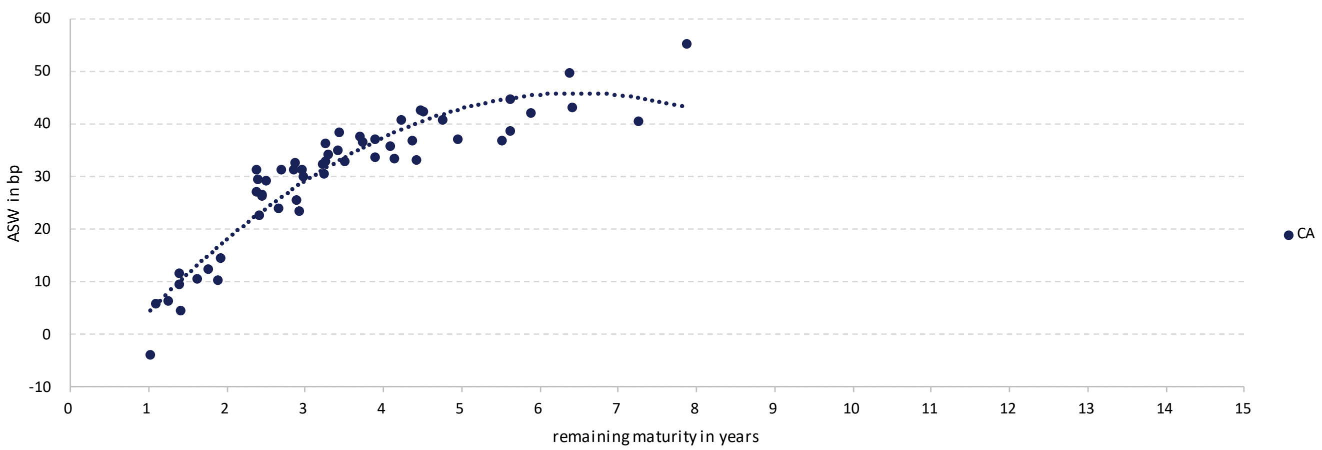
CEE



APAC



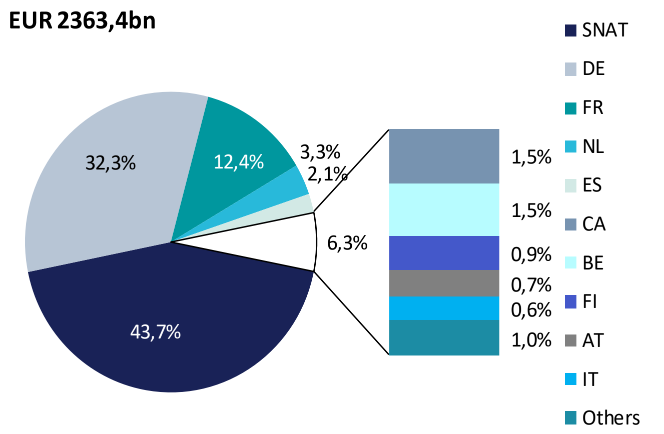
North America



Source: market data, Bloomberg, NORD/LB Markets Strategy & Floor Research

Charts & Figures
SSA/Public Issuers

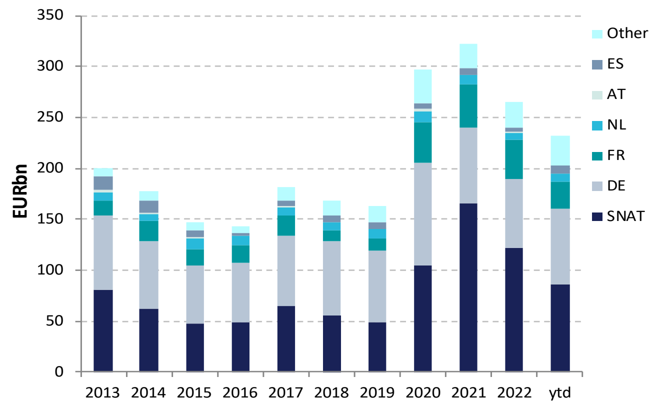
Outstanding volume (bmk)



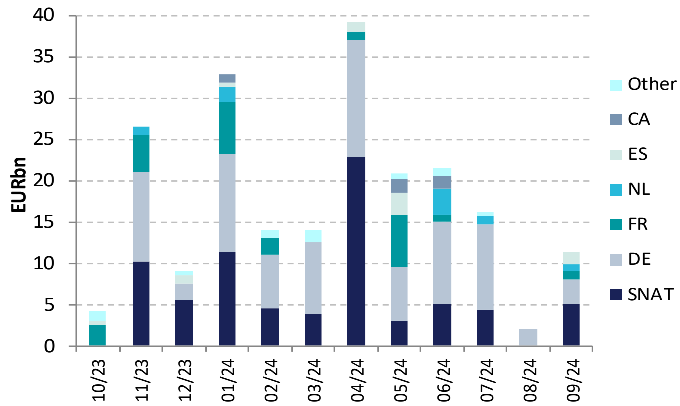
Top 10 countries (bmk)

Country	Vol. (€bn)	No. of bonds	ØVol. (€bn)	Vol. weight. ØMod. Dur.
SNAT	1.031,9	230	4,5	7,9
DE	764,0	568	1,3	6,1
FR	292,3	198	1,5	5,9
NL	78,2	68	1,2	6,6
ES	48,5	66	0,7	4,6
CA	35,6	25	1,4	4,2
BE	35,2	38	0,9	10,6
FI	22,2	24	0,9	4,8
AT	17,3	21	0,8	4,6
IT	15,0	19	0,8	4,6

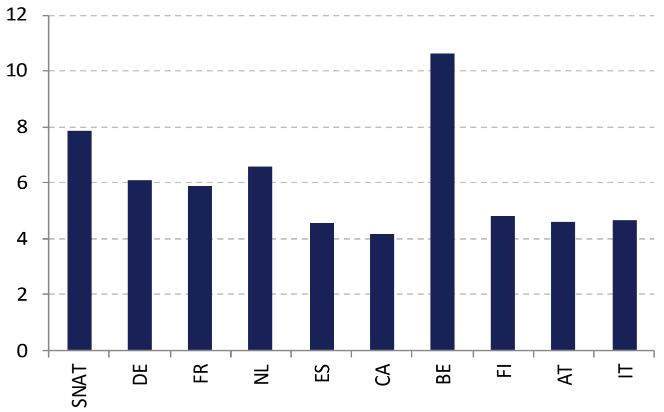
Issue volume by year (bmk)



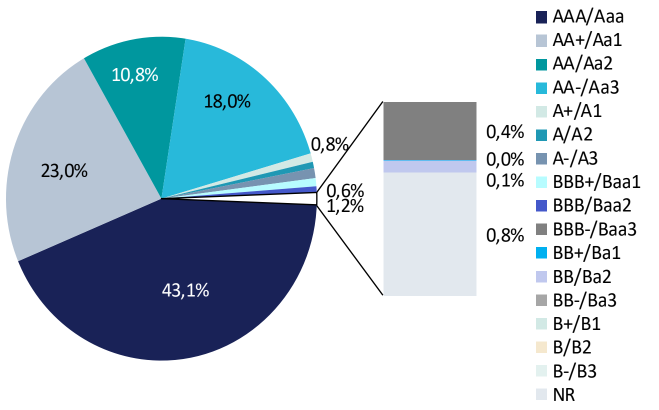
Maturities next 12 months (bmk)



Avg. mod. duration by country (vol. weighted)



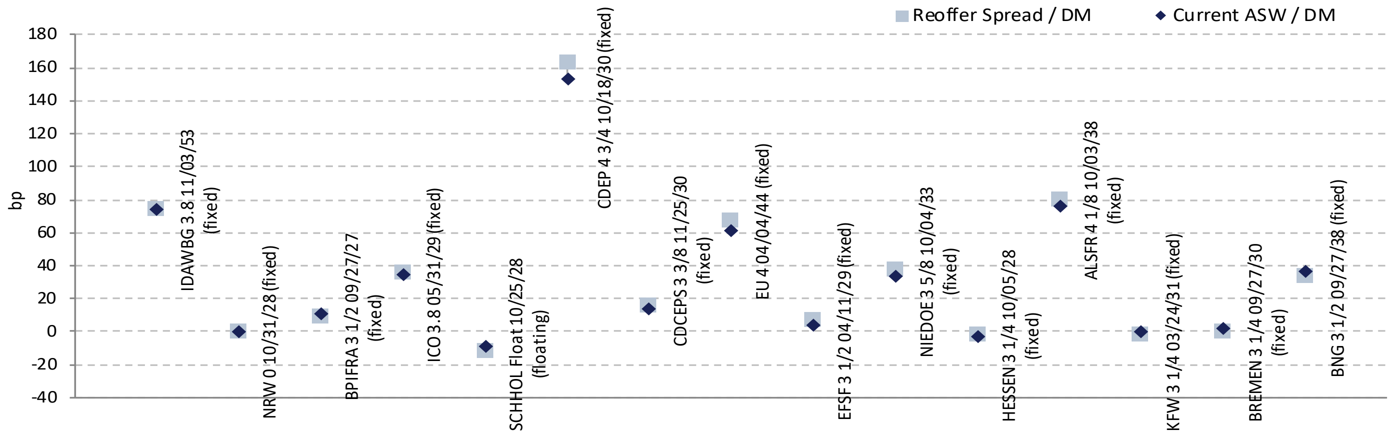
Rating distribution (vol. weighted)



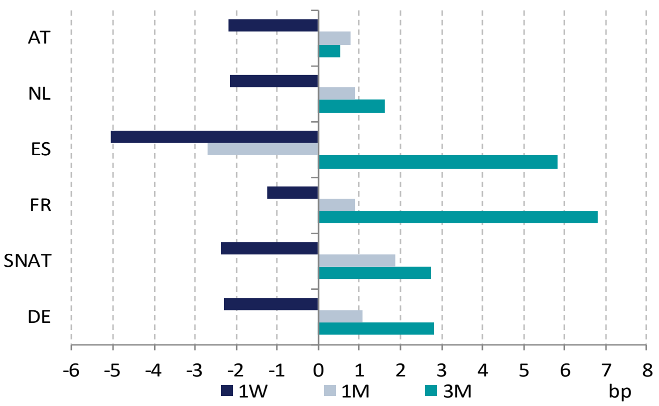
Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

NORD/LB

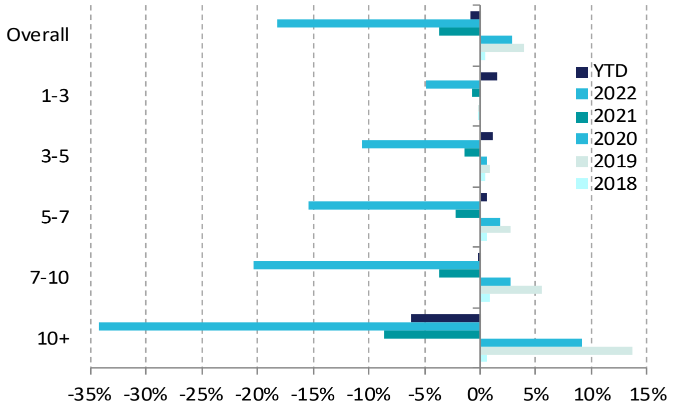
Spread development (last 15 issues)



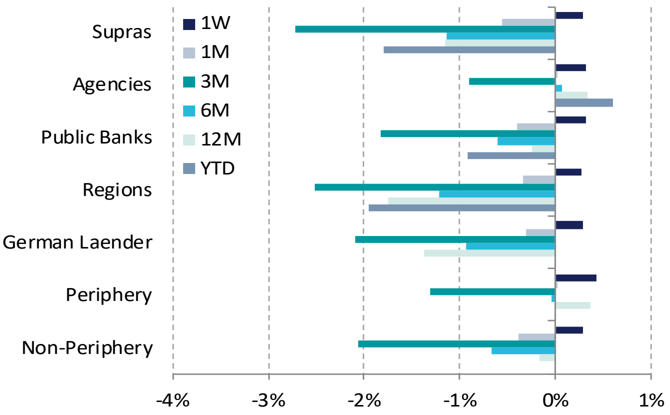
Spread development by country



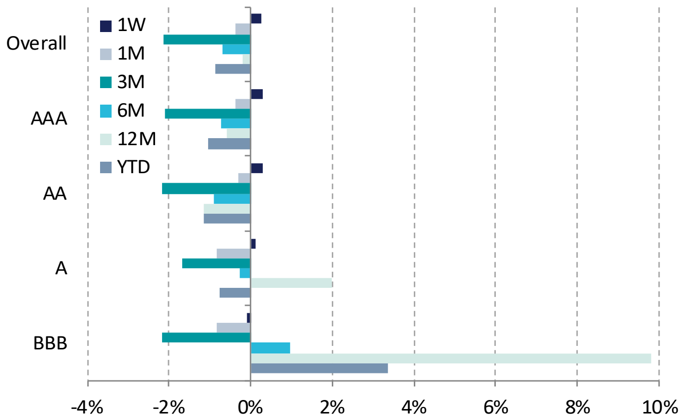
Performance (total return)



Performance (total return) by segments

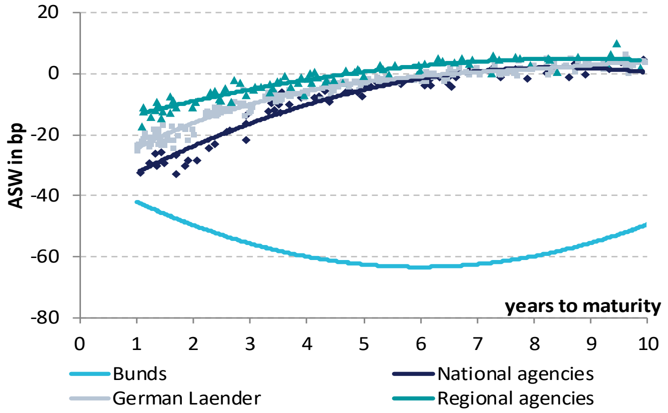


Performance (total return) by rating

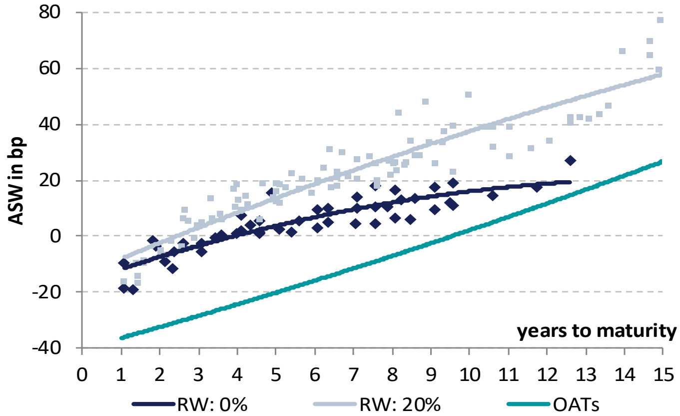


Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

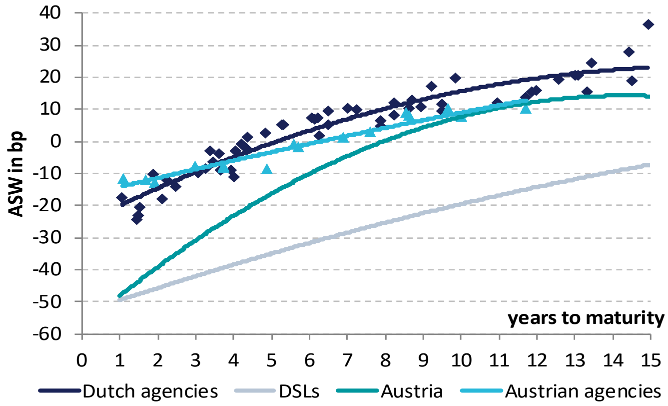
Germany (by segments)



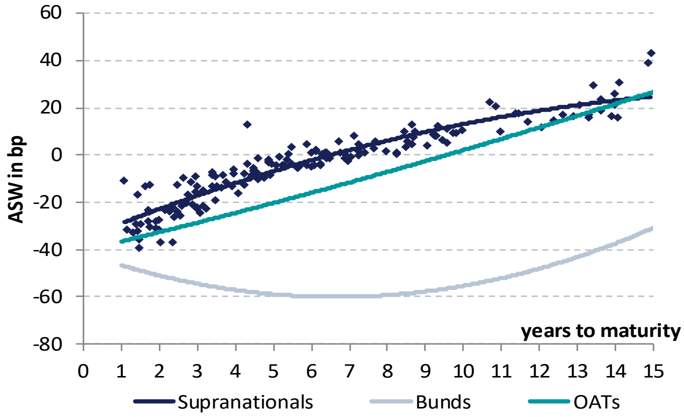
France (by risk weight)



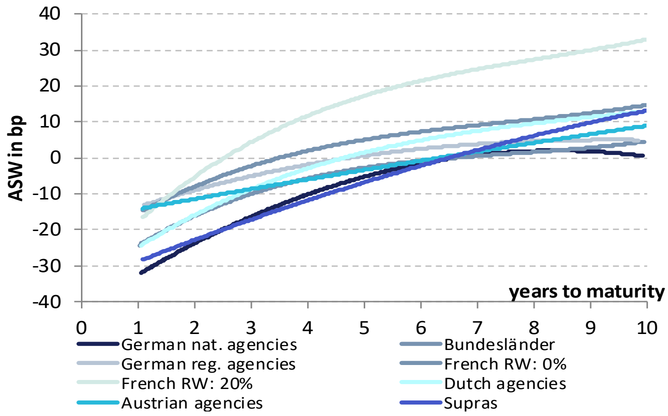
Netherlands & Austria



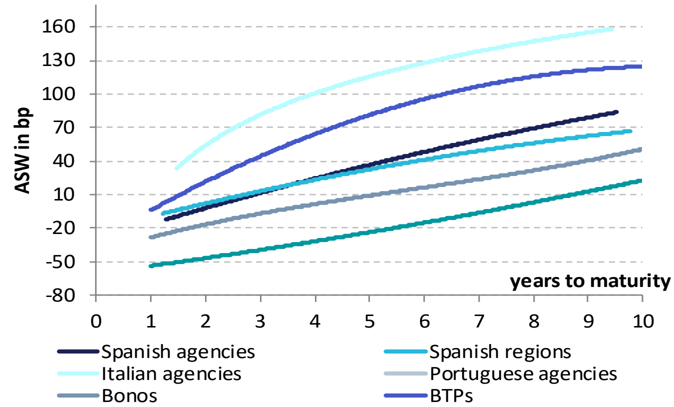
Supranationals



Core



Periphery



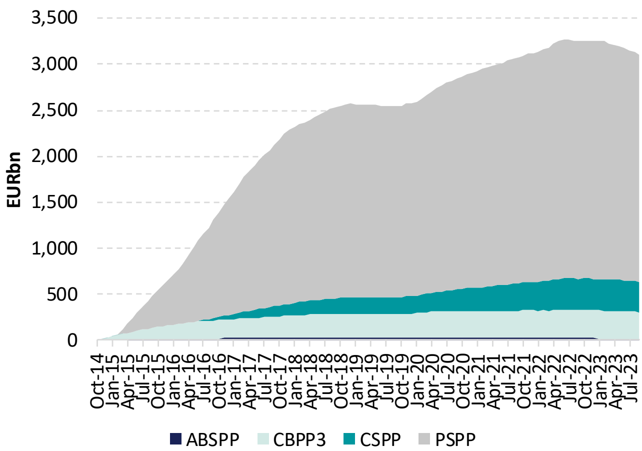
Source: Bloomberg, NORD/LB Markets Strategy & Floor Research

ECB tracker

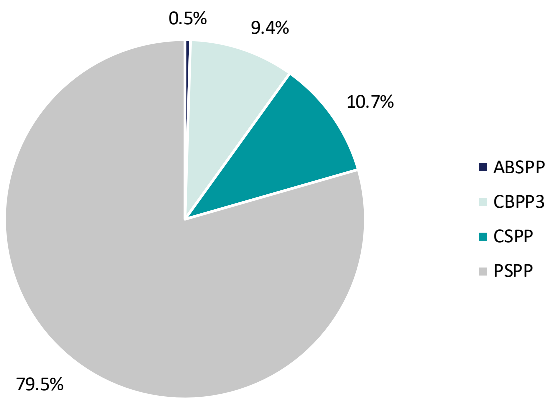
Asset Purchase Programme (APP)

	ABSPP	CBPP3	CSPP	PSPP	APP
Aug-23	16,436	295,503	334,738	2,487,900	3,134,577
Sep-23	15,324	291,992	331,156	2,470,598	3,109,070
Δ	-1,096	-3,346	-3,377	-13,434	-21,253

Portfolio development

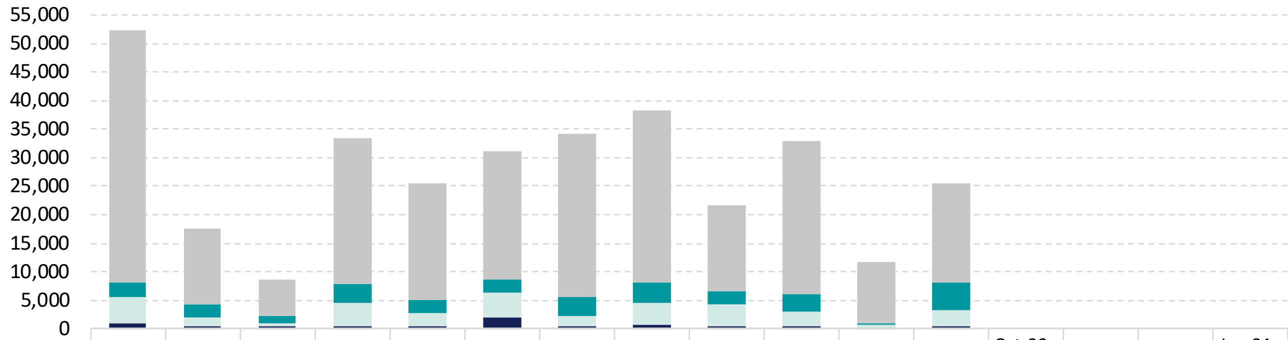


Portfolio structure



Source: ECB, NORD/LB Markets Strategy & Floor Research

Expected monthly redemptions (in EURm)

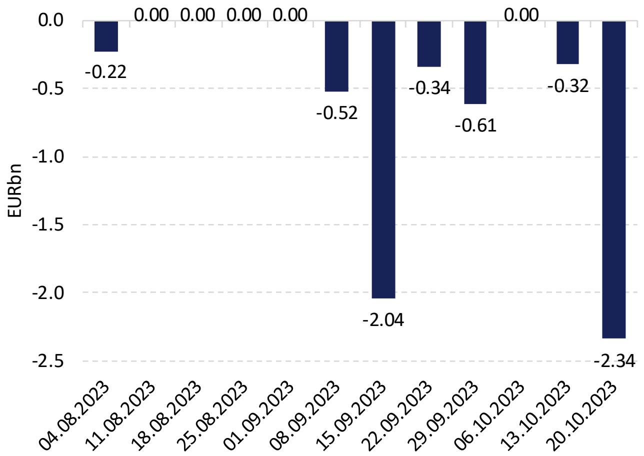


	Oct-23	Nov-23	Dec-23	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-23 - Sep-24	2022	2023	Jan-24 - Sep-24
APP	52,271	17,548	8,541	33,359	25,585	31,034	34,251	38,273	21,625	32,972	11,577	25,468	332,504	299,142	331,156	254,144
PSPP	44,186	13,277	6,336	25,524	20,470	22,413	28,712	30,194	14,974	26,877	10,533	17,401	260,897	228,585	255,017	197,098
CSPP	2,589	2,393	1,336	3,243	2,325	2,188	3,316	3,463	2,462	3,204	244	4,738	31,501	17,670	30,797	25,183
CBPP3	4,467	1,351	408	4,109	2,449	4,434	1,814	3,836	3,777	2,558	541	2,993	32,737	41,244	35,147	26,511
ABSPP	1,029	527	461	483	341	1,999	409	780	412	333	259	336	7,369	11,643	10,195	5,352

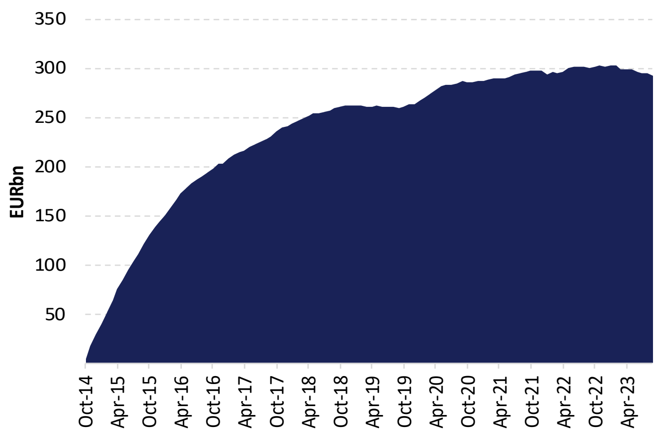
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Covered Bond Purchase Programme 3 (CBPP3)

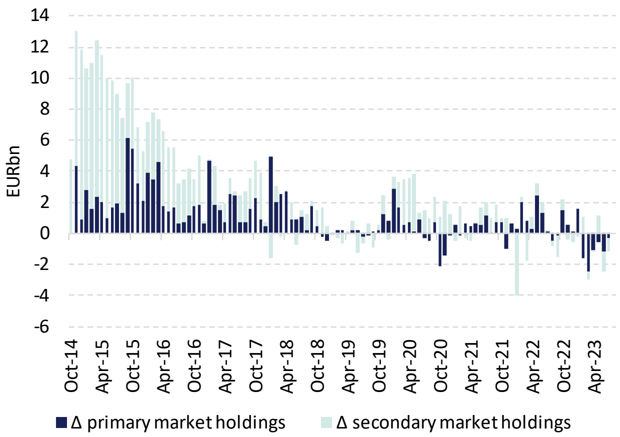
Weekly purchases



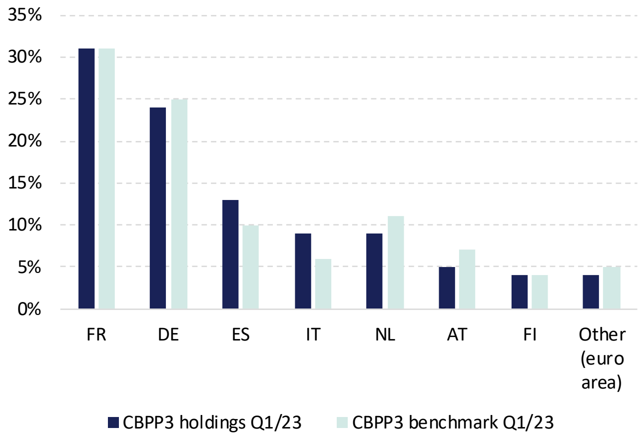
Development of CBPP3 volume



Change of primary and secondary market holdings

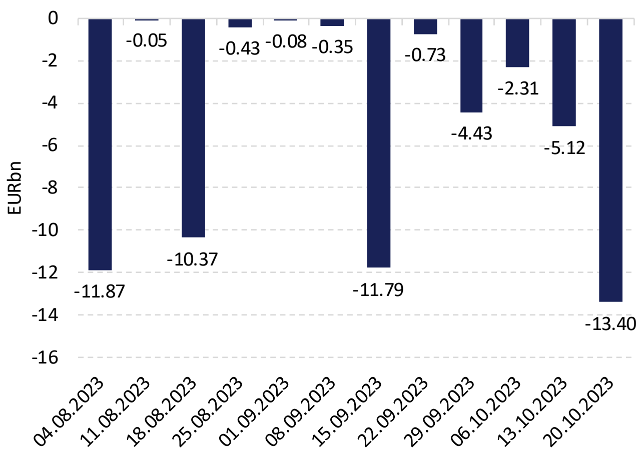


Distribution of CBPP3 by country of risk

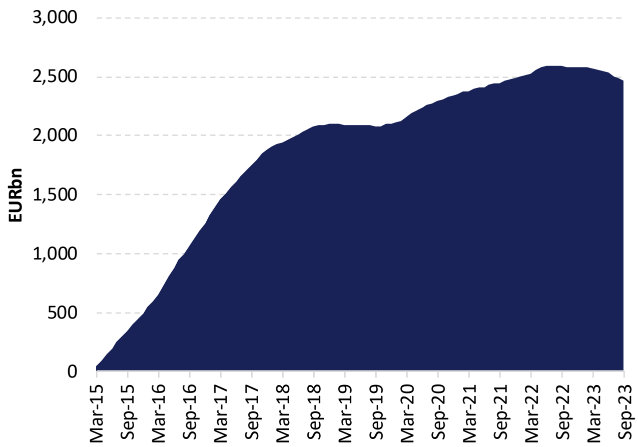


Public Sector Purchase Programme (PSPP)

Weekly purchases



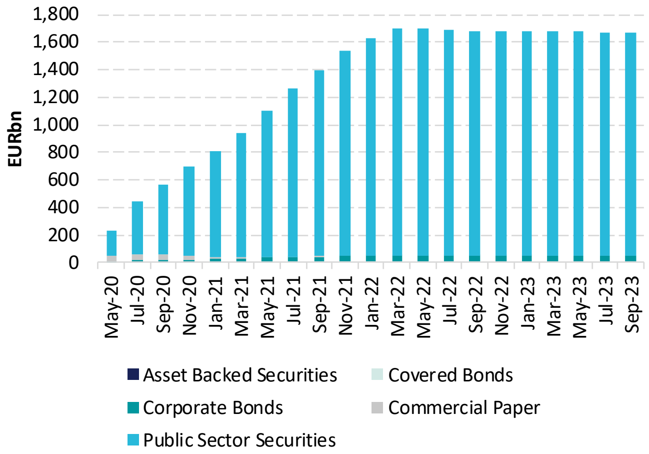
Development of PSPP volume



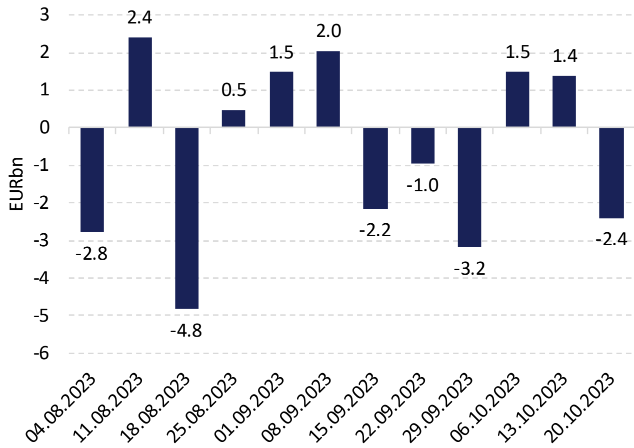
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Pandemic Emergency Purchase Programme (PEPP)

Portfolio development



Weekly purchases



Breakdown of public sector securities under the PEPP

Jurisdiction	Holdings (in EURm)	Δ Holdings previous period	Adj. distribution key[1]	PEPP share	Deviations from the adj. distribution key[2]	Current WAM[3] (in years)	WAM of eligible universe[4] (in years)
AT	44,129	-1,028	2.6%	2.7%	0.0%	7.2	7.8
BE	56,941	-610	3.3%	3.4%	0.2%	6.0	9.4
CY	2,423	-156	0.2%	0.1%	0.0%	8.4	8.2
DE	393,313	1,135	23.7%	23.7%	0.0%	6.7	7.0
EE	256	0	0.3%	0.0%	-0.2%	6.7	6.5
ES	193,041	-2,722	10.7%	11.6%	0.9%	7.2	7.4
FI	25,953	565	1.7%	1.6%	-0.1%	7.5	7.7
FR	298,322	1,717	18.4%	18.0%	-0.4%	7.3	7.8
GR	38,260	-172	2.2%	2.3%	0.1%	8.5	9.1
IE	25,541	133	1.5%	1.5%	0.0%	8.8	9.2
IT	292,198	938	15.3%	17.6%	2.3%	7.0	6.9
LT	3,145	-2	0.5%	0.2%	-0.3%	9.3	8.6
LU	1,858	-110	0.3%	0.1%	-0.2%	6.0	8.3
LV	1,843	23	0.4%	0.1%	-0.2%	7.9	7.5
MT	604	-4	0.1%	0.0%	-0.1%	9.8	8.5
NL	80,598	-2,269	5.3%	4.9%	-0.4%	7.6	8.9
PT	33,921	127	2.1%	2.0%	-0.1%	7.0	7.7
SI	6,493	44	0.4%	0.4%	0.0%	8.4	8.8
SK	8,040	65	1.0%	0.5%	-0.5%	7.9	8.3
SNAT	153,089	2,000	10.0%	9.2%	-0.8%	9.9	9.0
Total / Avg.	**1,659,970**	**-327**	**100.0%**	**100.0%**	**0.0%**	**7.4**	**7.6**

[1] Based on the ECB capital key, adjusted to include supras [2] Based on the adjusted distribution key
[3] Current WAM of public sector securities holdings under the PEPP [4] WAM of eligible universe of public sector securities holdings under the PEPP
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Appendix
Overview of latest Covered Bond & SSA View editions

Publication	Topics
30/2023 ♦ 18 October	▪ Focus on covered bond jurisdictions: Canada in the spotlight ▪ A closer look at Newfoundland and Labrador
29/2023 ♦ 11 October	▪ A covered bond view of Belgium ▪ Funding of Canadian provinces – an overview
28/2023 ♦ 27 September	▪ The covered bond universe of Moody's: an overview ▪ Update on DEUSTD – Joint German cities (bond No. 1)
27/2023 ♦ 20 September	▪ Newcomer to the EUR benchmark segment: Bendigo and Adelaide Bank set to expand issuer base in Australia ▪ Teaser: Issuer Guide – Austrian Agencies 2023
26/2023 ♦ 13 September	▪ ECBC publishes annual statistics for 2022 ▪ Teaser: Issuer Guide – Dutch Agencies 2023
25/2023 ♦ 06 September	▪ Covered bond market on the growth path: OLB looks set to join the ranks of EUR benchmark issuers ▪ NORD/LB Issuer Guide German Laender 2023 published
24/2023 ♦ 19 July	▪ Banks in Europe: EBA Risk Dashboard in Q1 2023 ▪ ECB repo collateral rules and German Laender
23/2023 ♦ 12 July	▪ Covereds: Half-year review and outlook for the second half of 2023
22/2023 ♦ 28 June	▪ Special publication on LCR classification and risk weights: a (regulatory) overview of the EUR benchmark segment ▪ ESG bonds of German Laender – significant further development
21/2023 ♦ 21 June	▪ ESG covered bonds: a look at the supply side ▪ Increasing exposure of E-supras to Ukraine
20/2023 ♦ 14 June	▪ Moody's covered bond universe – an overview ▪ Beyond Bundeslaender: Spanish regions
19/2023 ♦ 07 June	▪ ECB Preview: ECB's 25th anniversary and is still going strong ▪ Focus on legal requirements for covered bonds
18/2023 ♦ 24 May	▪ Repayment structures on the covered bond market: an update ▪ Stability Council convenes for 27th meeting
17/2023 ♦ 17 May	▪ ESG update 2023 in the spotlight ▪ Development of the German property market ▪ Transparency requirements §28 PfandBG Q1/2023
16/2023 ♦ 10 May	▪ The ECB and the covered bond market: influences old and new ▪ Update: Joint Laender (Ticker: LANDER)
15/2023 ♦ 26 April	▪ ECB preview: caught in two minds? ▪ EBA Risk Dashboard paints solid picture of Q4 2022
14/2023 ♦ 19 April	▪ Lending in the Eurozone and Germany ▪ The French agency market – an overview
13/2023 ♦ 05 April	▪ Supply forecast requires no great adjustment ▪ Current risk weight of supranationals & agencies

Appendix
Publication overview

Covered Bonds:

Issuer Guide Covered Bonds 2023

Covered Bond Laws

Covered Bond Directive: Impact on risk weights and LCR levels

Risk weights and LCR levels of covered bonds (updated semi-annually)

Transparency requirements §28 PfandBG Q2/2023 (quarterly update)

Covered bonds as eligible collateral for central banks

SSA/Public Issuers:

Issuer Guide – German Laender 2023

Issuer Guide – European Supranationals 2023

Issuer Guide – French Agencies 2023

Issuer Guide – Dutch Agencies 2023

Issuer Guide – German Agencies 2022

Beyond Bundeslaender: Belgium

Beyond Bundeslaender: Greater Paris (IDF/VDP)

Beyond Bundeslaender: Spanish regions

Fixed Income Specials:

ESG-Update 2023

ECB preview: Wait and see without calling it a pause

ECB: This rate terminates here – 99.9% sure

ECB preview: Knives out… It's edging-time

Appendix
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