

Fixed Income Special

NORD/LB Markets Strategy & Floor Research

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ECB holds course, but ups the ante – PEPP running until 2022

Authors: Dr Frederik Kunze // Dr Norman Rudschuck, CIIA // Henning Walten, CIIA

ECB adapts many existing instruments

At today's and last Governing Council meeting for the year 2020, the European Central Bank reacted to the Corona pandemic situation, which has again worsened significantly, and made targeted adjustments (cf. [ECB press release](#)). As expected, the Pandemic Emergency Purchase Programme (PEPP) was expanded both in terms of volume and maturity. The same applies to the TLTRO III operations, whose parameters were also accustomed to the current situation in terms of maturity and conditions. The ECB left the interest rates at the previous levels of 0.00% (interest rate on the main refinancing operations) and -0.50% (deposit facility). The regular asset purchase programme also remained untouched. Here, the monthly net purchases in the volume of EUR 20 billion will remain in place until shortly before the ECB starts raising its key interest rates. The same applies to the maturities under the programme, whereby these are to be reinvested in the market even beyond the time of an interest rate hike. Moreover, in addition to the instruments most in focus, further measures to combat the consequences of the pandemic were decided or expanded. These include four further rounds of [PELTROs](#) as well as an extension of the relaxed requirements for central bank collateral until June 2022. An adjustment to the [tiering factor](#), which we had also discussed in advance, did not take place at today's meeting. However, we still consider such a step conceivable in 2021. All in all, the ECB's decisions today are likely to have clearly set the course for 2021. We consider the measures to be neither restrained nor clearly expansionary, which confirms our expectations.

PEPP will be expanded as expected

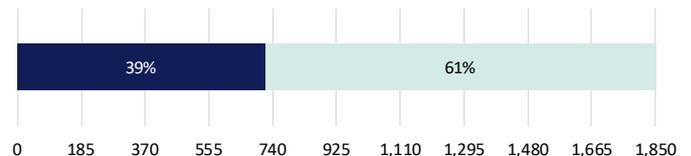
As expected, the ECB has extended the volume and duration of the PEPP programme, which was set up specifically to combat the Corona pandemic. With EUR 500 billion, it is increasing the programme volume to EUR 1,850 billion and extending the programme, which previously ran until at least June 2021, by nine months until March 2022. What remains unchanged is that this is a minimum term and net purchases will be carried out as long as the ECB comes to the conclusion that the Corona crisis has not yet been overcome. In the course of the maturity extension, the period of reinvestment under the PEPP was also adjusted. Accordingly, reinvestments will now be carried out until at least the end of 2023 and thus twelve months longer than previously communicated.

TLTRO: Additional tenders and extension of the validity of the preferred interest rate

The adjustments to the TLTRO III tender that have now been announced were also to be expected in our view. The programme will be extended beyond March 2021 (III.7) by three further rounds (June, September and December). This extension will be accompanied by an adjustment of the interest rate conditions. The period of the preferred interest rate of 50bp below the deposit rate, i.e. currently -1.0%, will also be adjusted and is now valid between June 2020 and June 2022. This corresponds to an extension of an additional twelve months and thus a doubling of the time period. In addition, the maximum amount per institution was increased from 50% to 55% of the eligible loans. The interest rate conditions are to apply only to those institutions that [meet a new lending performance target](#), which we will discuss in more detail in the upcoming Covered Bond & SSA View.

Pandemic Emergency Purchase Programme (PEPP)**Holdings (in EURm)**

	PEPP
Oct-20	629,169
Nov-20	700,003
Δ	+70,835

Volume already invested (in EURbn)**Estimated portfolio development**

Assumed pace of purchases	Weekly net purchase volume	PEPP limit hit in ...
Average weekly net purchase volume so far	EUR 19.9bn	57 weeks (07.01.2022)

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

Impact on the SSA segment

We expect the SSA segment in 2021 to continue to be dominated by Corona, the measures taken by public issuers against the pandemic and the measures adopted by the ECB today. The described increase of the PEPP by EUR 500bn to now EUR 1,850bn exceeds our expectations. The extension of the PEPP until March 2022 is reasonable and appropriate. In our base scenario for 2021, we do not expect any drastic movement in the spread landscape, but at best a sideways movement. Although the segments of Supnationals, sub-sovereigns and agencies have once again become more heterogeneous due to the pandemic, the bulk of the PEPP (more than 90% of the bonds purchased come from the SSA segment) relates to the public sector and thus has a significant influence on past and future spread development. In our opinion, this view is confirmed not only by the fresh billions of net purchases decided today in the framework of PSPP and PEPP, but also against the background of the billions of euros in reinvestments in both programme segments. On a three to five year horizon, the spread levels from 2016 could be a realistic target for most issuers within our coverage – a kind of natural cap. We are also curious about the seasonal patterns, how strong January will be (also due to EU issuance alone) and whether the EU will be able to successfully conclude its SURE programme before Easter. EUR 60.5bn will be required for this in Q1/2021, so the Eurosystem's increased demand will be met by an increasing supply from public issuers. According to our findings, the EU would need to bring at least EUR 150bn of fresh new material to the primary market next year. This would be an average of EUR 3bn per week. The German Bundeslaender as well as the other European regions also continue to face major challenges and considerable refinancing needs. Unaffected by this are political discussions and economic developments that could be induced, for example, by a trade war, various elections, a never-ending Brexit and/or the pandemic situation. In this context, the green transformation of the EIB, the EU and the ESM into a European Monetary Fund are almost marginal issues – albeit of a promising nature.

ECB decisions weigh on covered bond supply in 2021 as expected

In our view, the announcements by the monetary policymakers clearly show that the ECB will continue to leave its mark on the covered bond segment over the next twelve months, as it did in 2020. This is most evident once again with regard to the impact on the supply of EUR benchmarks. The extension of the best possible conditionality for TLTRO III tenders by twelve months undoubtedly increases the attractiveness of raising central bank liquidity. The continuation of the relaxation in collateral eligibility under the ECB Collateral Management also favours corresponding funding via the Eurosystem. The extension of the third TLTRO round by three additional tenders from June to December 2021 also theoretically opens up the possibility for banks to roll the funds raised into a new tender. The TLTRO III.1 to TLTRO III.5 tenders can thus be repaid early for the first time on 29 September 2021, while for TLTRO III.6 early repayment is possible on 22 December 2021 at the earliest. In conjunction with the also increased cap from 50% to 55%, the new parameterisation of TLTRO III continues to argue for a subdued covered bond supply, which we have already taken into account in our forecast of an issuance volume of EUR 105bn for 2021. On the demand side, the PEPP increase will have a rather indirect impact on covered bonds, whereas the continuation of the APP with EUR 20bn per month should result in purchases of covered bonds under the CBPP3 in the order of EUR 2bn or 10% per month. In combination with the reinvestment of maturities from CBPP3 (EUR 33bn will mature in 2021), the ECB will have a decisive influence on the demand side. Overall, we maintain our expectation of narrowing spreads across all maturity bands and jurisdictions in the first half of 2021.

Conclusion

Last week, we preceded [our respective outlooks for 2021](#) with a view to the fixed income segments SSA and covered bonds with a preview of the decisive last ECB meeting of the year. For example, in recent weeks the ECB announced a major review of its entire toolkit. Moreover, in the course of appearances and interviews, high-ranking representatives of the central bank from the Main have already made some possible considerations available to the general public. Today, the ECB has at least lived up to these expectations. In this context, we assess the measures as neither restrained nor clearly expansionary, which confirms mainly our expectations. In our view, the ECB was forced to react dynamically to the situation as part of its monetary policy decision-making process. Moreover, we are still a long way from herd immunity, which may also be one reason why the economic recovery process in 2021 is by no means likely to be fully broad-based and steady. This is also reflected in the ECB's economic projections, which cover 2023 for the first time. 2020 ends in three weeks, but not only today's ECB decision-making, but also Covid-19 will continue to have us firmly in its grip over the turn of the year, not least for this reason. We will provide more details for you in our year-end edition of "Covered Bond & SSA View" next Wednesday.

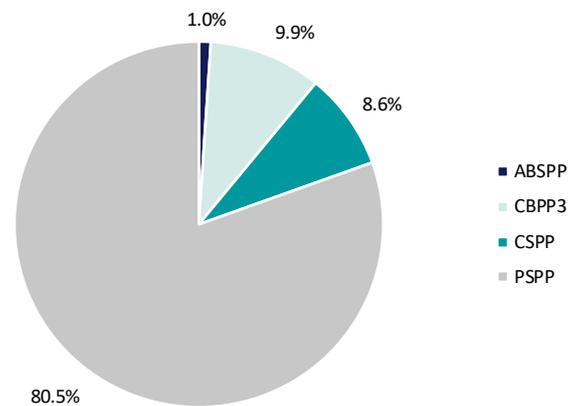
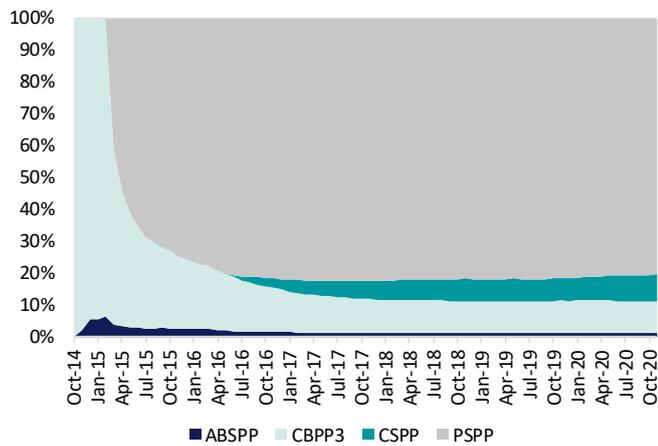
ECB tracker

Asset Purchase Programme (APP)

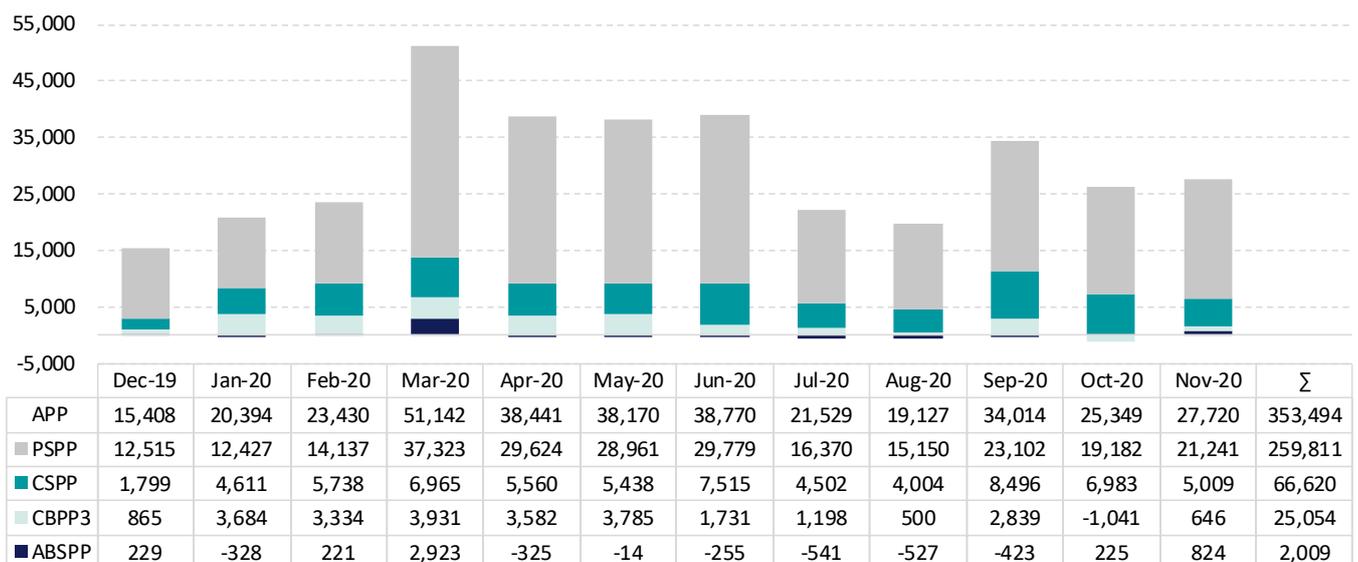
Holdings (in EURm)

	ABSPP	CBPP3	CSPP	PSPP	APP
Oct-20	29,337	285,811	243,331	2,309,322	2,867,802
Nov-20	30,161	286,458	248,340	2,330,562	2,895,521
Δ	+824	+646	+5,009	+21,241	+27,720

Portfolio structure

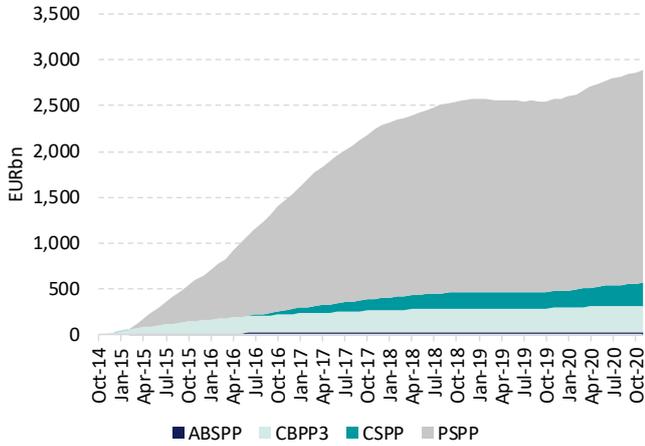


Monthly net purchases (in EURm)

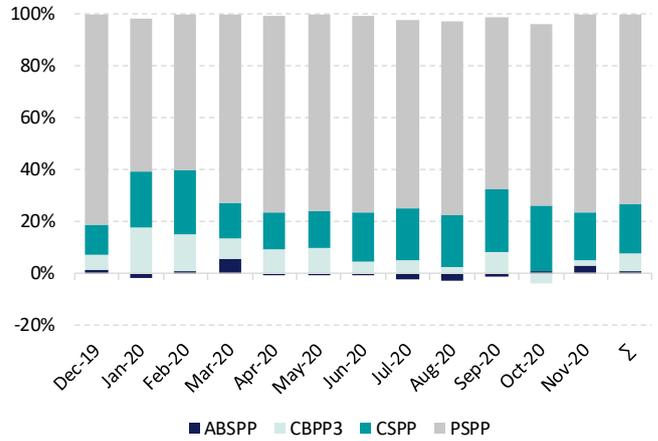


Source: ECB, NORD/LB Markets Strategy & Floor Research

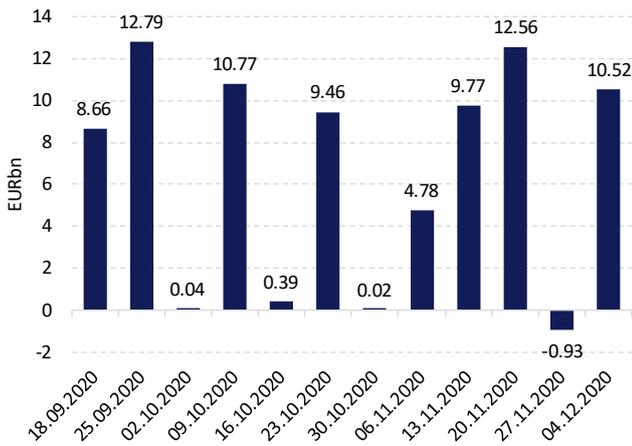
Portfolio development



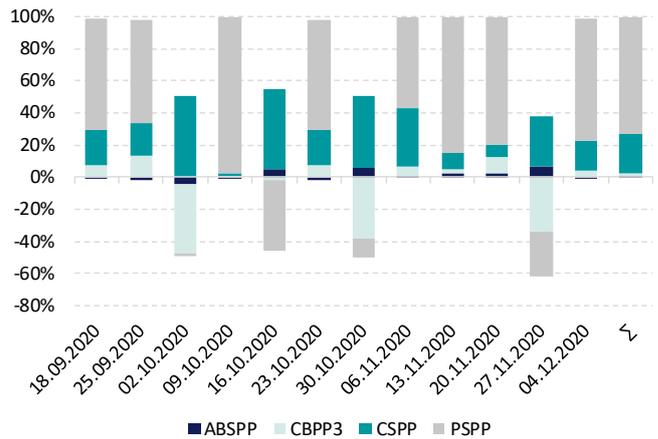
Distribution of monthly purchases



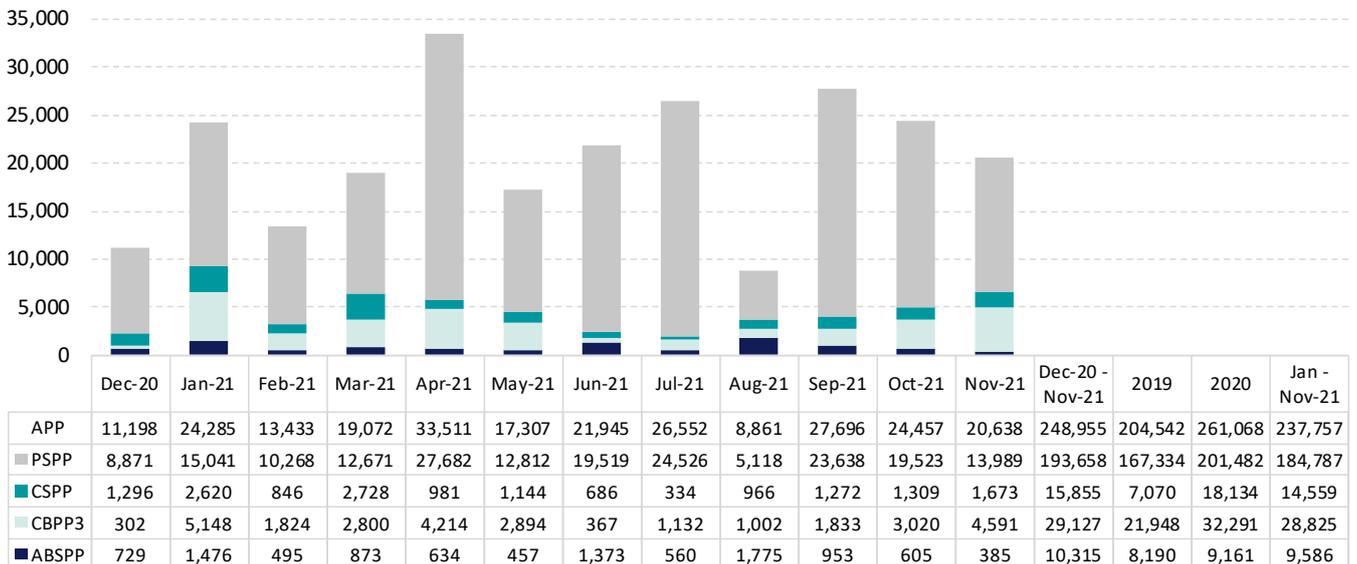
Weekly purchases



Distribution of weekly purchases



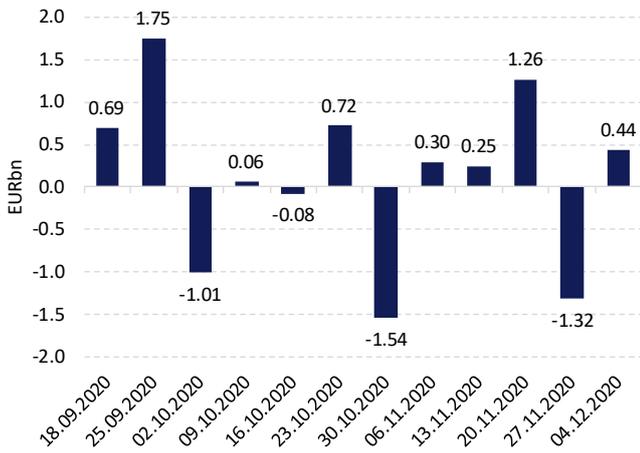
Expected monthly redemptions (in EURm)



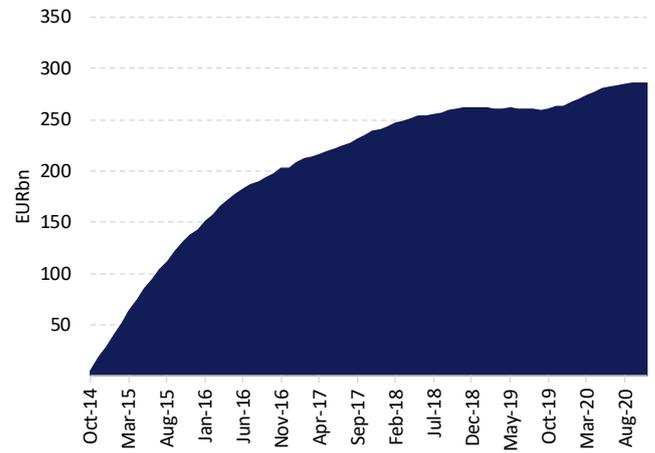
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Covered Bond Purchase Programme 3 (CBPP3)

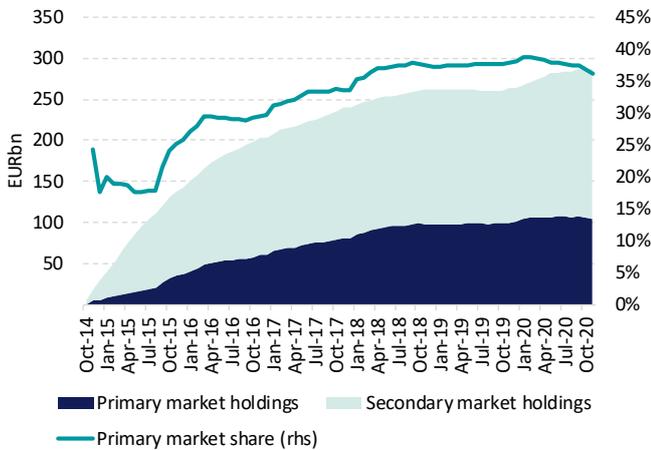
Weekly purchases



Development of CBPP3 volume



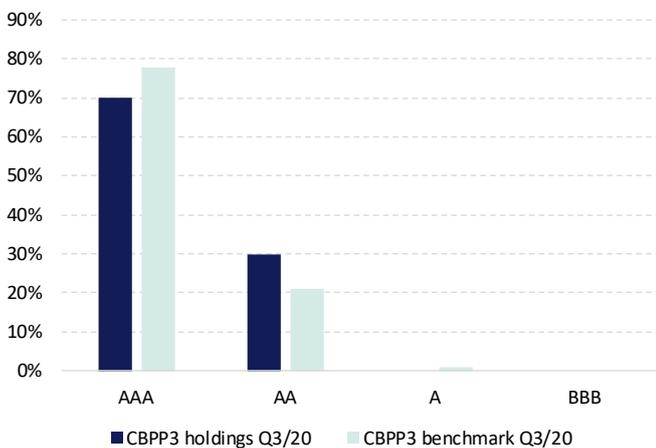
Primary and secondary market holdings



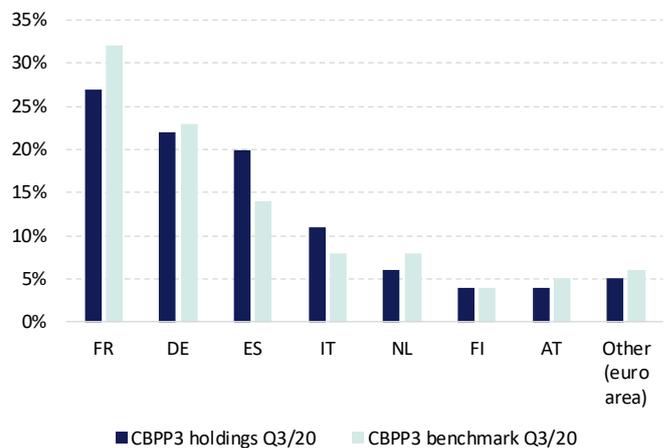
Change of primary and secondary market holdings



Distribution of CBPP3 by credit rating

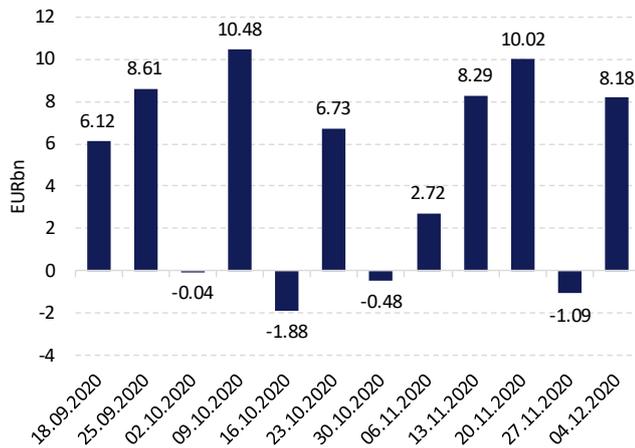


Distribution of CBPP3 by country of risk

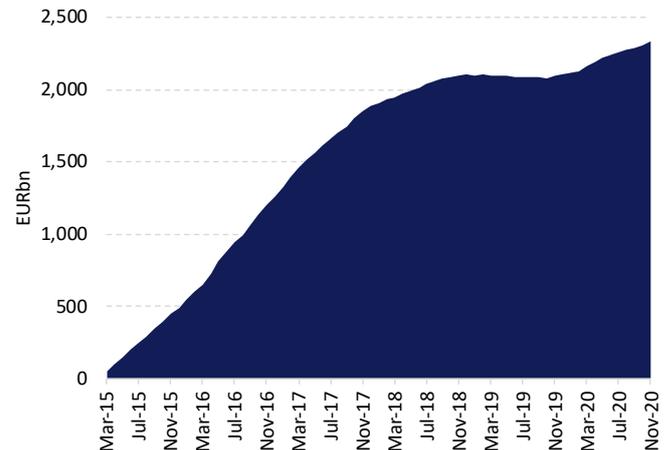


Public Sector Purchase Programme (PSPP)

Weekly purchases



Development of PSPP volume



Overall distribution of PSPP buying at month-end

Country	Adjusted distribution key ¹	Purchases (EURm)	Expected purchases (EURm) ²	Difference (EURm)	Average time to maturity in years	Market average in years ³	Difference in years
AT	2.701%	66,722	65,474	1,248	7.80	8.12	-0.3
BE	3.362%	84,991	81,499	3,492	8.35	10.31	-2.0
CY	0.199%	3,021	4,813	-1,792	10.00	9.16	0.8
DE	24.327%	562,019	589,701	-27,682	6.55	7.60	-1.0
EE	0.260%	225	6,302	-6,077	9.61	9.58	0.0
ES	11.004%	288,271	266,751	21,520	8.10	8.33	-0.2
FI	1.695%	34,826	41,090	-6,264	7.15	7.95	-0.8
FR	18.848%	485,477	456,888	28,589	7.15	8.13	-1.0
IE	1.563%	36,261	37,881	-1,620	8.77	9.86	-1.1
IT	15.677%	413,443	380,029	33,414	7.11	7.72	-0.6
LT	0.360%	4,365	8,716	-4,351	9.61	11.14	-1.5
LU	0.304%	2,773	7,369	-4,596	5.21	6.43	-1.2
LV	0.534%	2,851	12,947	-10,096	9.89	10.38	-0.5
MT	0.097%	1,203	2,346	-1,143	9.96	9.57	0.4
NL	5.408%	115,902	131,097	-15,195	7.57	8.49	-0.9
PT	2.160%	44,950	52,357	-7,407	7.20	7.43	-0.2
SI	0.444%	8,785	10,771	-1,986	9.29	9.97	-0.7
SK	1.057%	13,885	25,619	-11,734	8.29	8.60	-0.3
GR	0.00%	0	0	0	0.00	16.01	0.0
SNAT	10.00%	254,084	242,406	11,679	7.34	8.52	-1.2
Total / Avg.	100.0%	2,424,055	-	-	7.26	8.22	-1.0

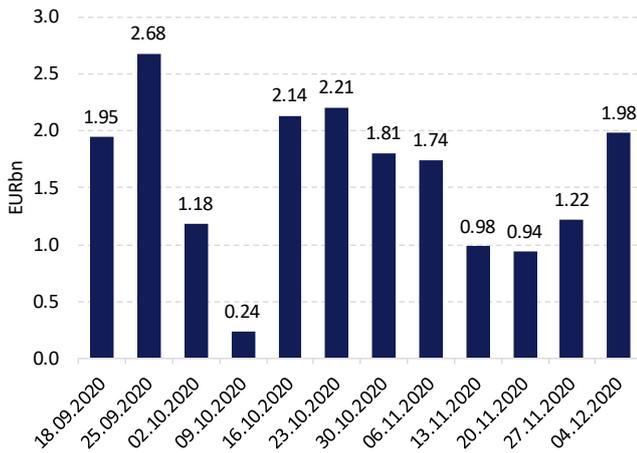
¹ Based on the ECB capital key, adjusted to include supras and the disqualification of Greece

² Based on the adjusted distribution key ³ Weighted average time to maturity of the bonds eligible for purchasing under the PSPP

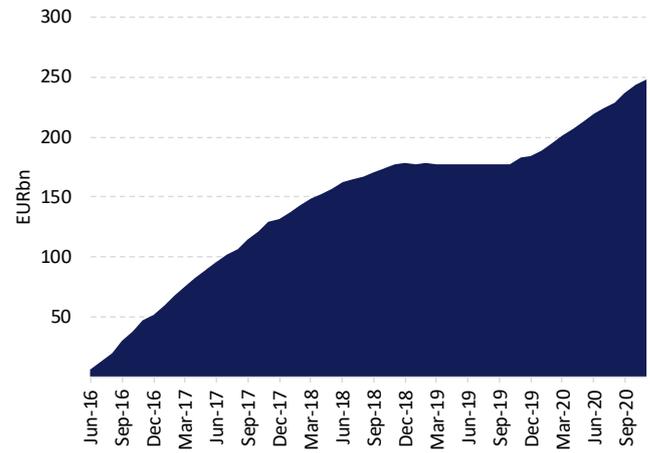
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Corporate Sector Purchase Programme (CSPP)

Weekly purchases

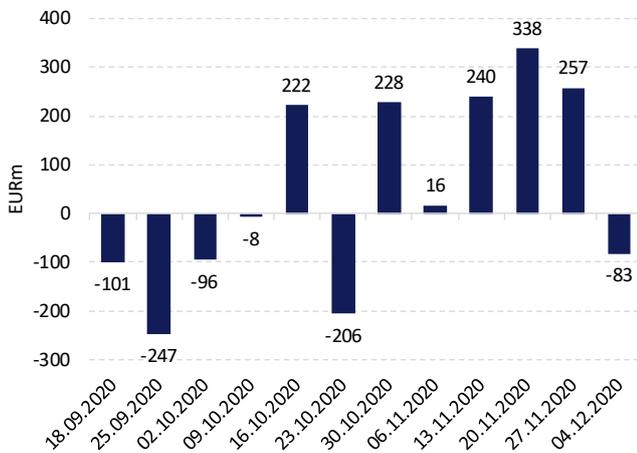


Development of CSPP volume

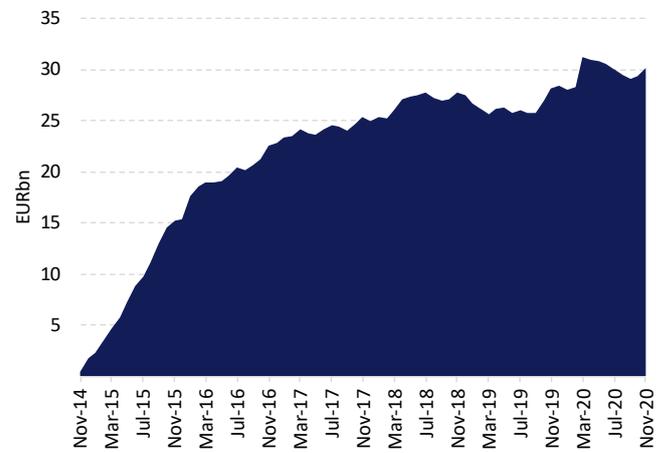


Asset-Backed Securities Purchase Programme (ABSPP)

Weekly purchases



Development of ABSPP volume



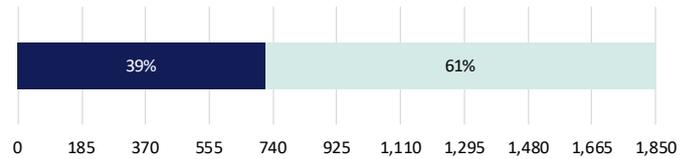
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Pandemic Emergency Purchase Programme (PEPP)

Holdings (in EURm)

	PEPP
Oct-20	629,169
Nov-20	700,003
Δ	+70,835

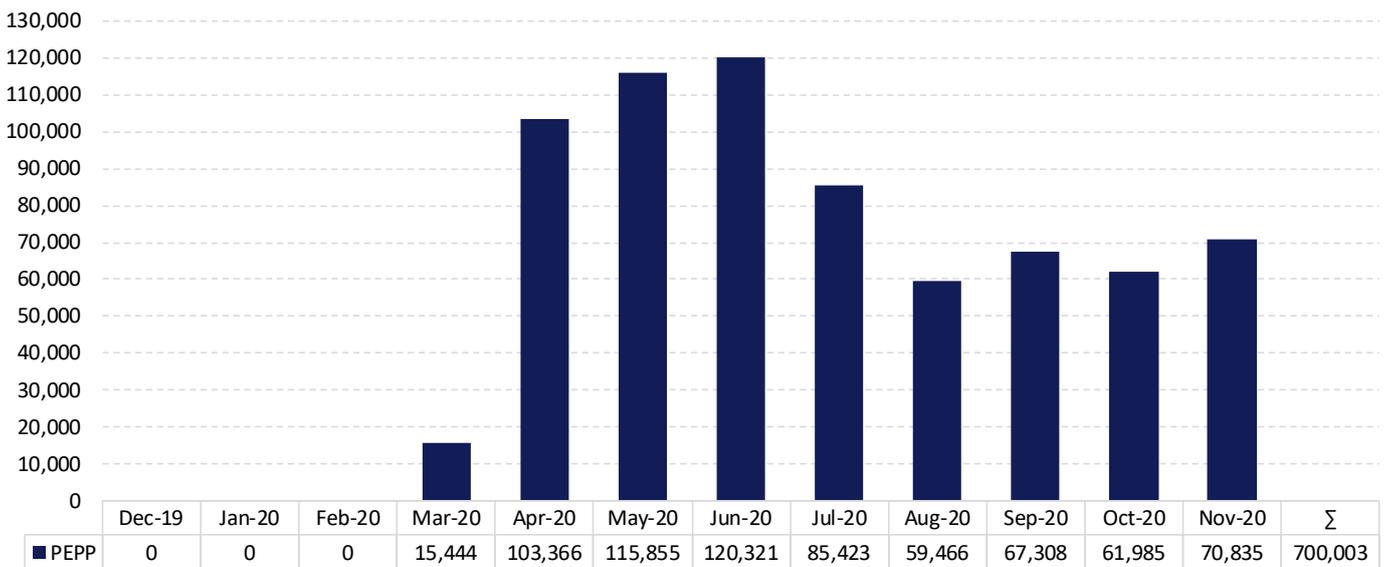
Volume already invested (in EURbn)



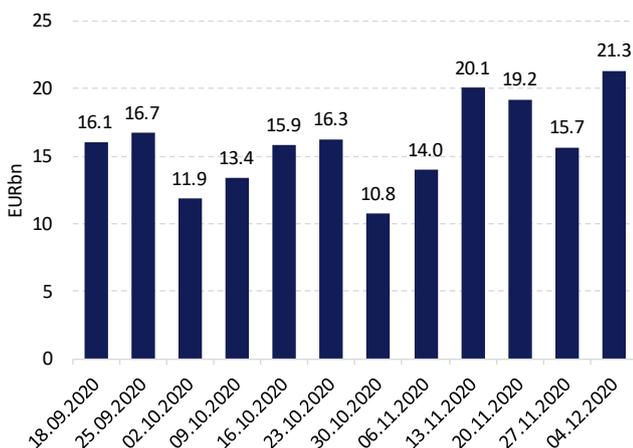
Estimated portfolio development

Assumed pace of purchases	Weekly net purchase volume	PEPP limit hit in ...
Average weekly net purchase volume so far	EUR 19.9bn	57 weeks (07.01.2022)

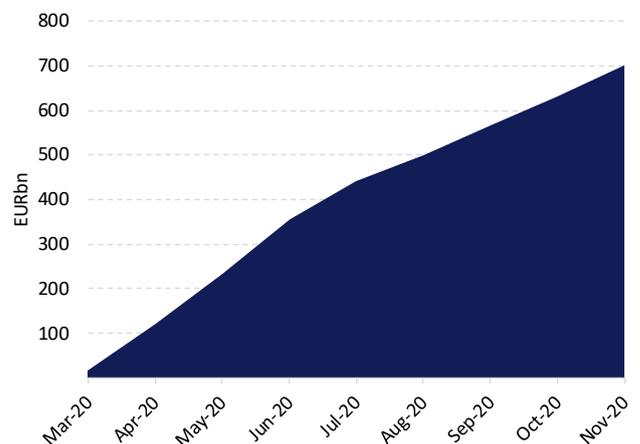
Monthly net purchases (in EURm)



Weekly purchases



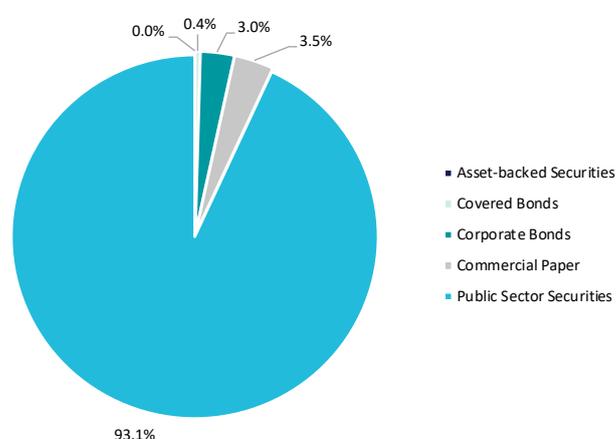
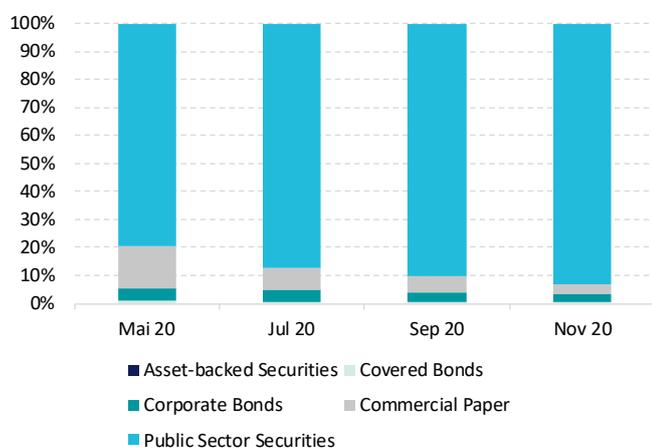
Development of PEPP volume



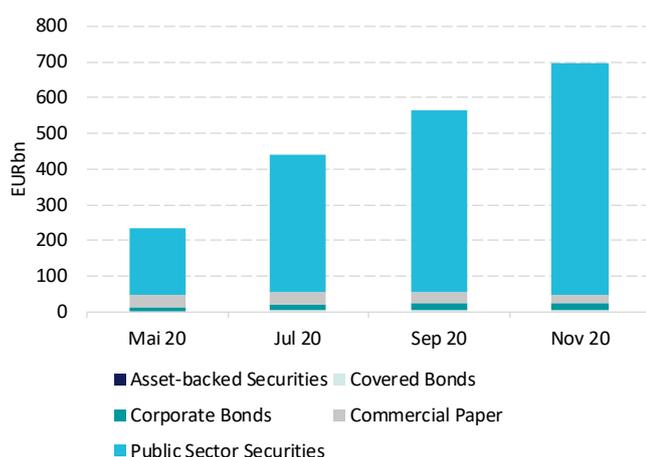
Holdings under the PEPP (in EURm)

	Asset-backed securities	Covered bonds	Corporate bonds	Commercial paper	Public sector securities	PEPP
Sep-20	0	3,123	20,418	31,988	510,112	565,641
Nov-20	0	3,123	20,760	24,306	650,272	698,461
Δ	0	0	342	-7,682	140,160	132,820

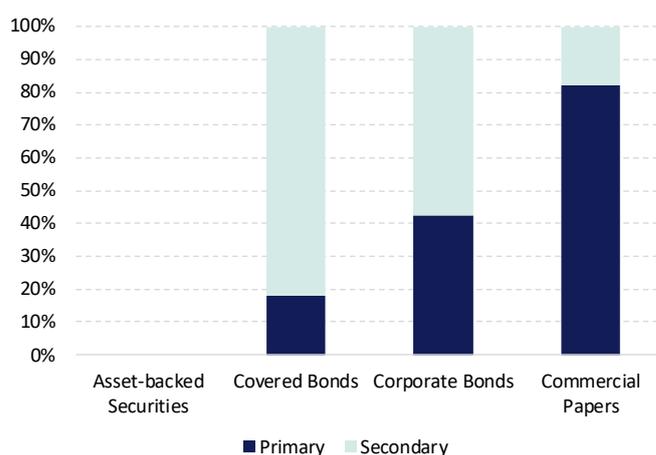
Portfolio structure



Portfolio development



Share of primary and secondary market holdings



Breakdown of private sector securities under the PEPP as of July 2020

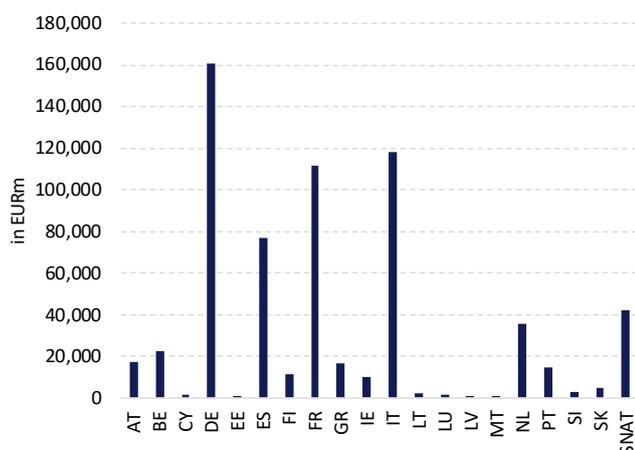
	Asset-backed securities		Covered bonds		Corporate bonds		Commercial papers	
	Primary	Secondary	Primary	Secondary	Primary	Secondary	Primary	Secondary
Bestand in EURm	0	0	557	2,566	8,842	11,918	20,001	4,305
Anteil	0.0%	0.0%	17.8%	82.2%	42.6%	57.4%	82.3%	17.7%

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

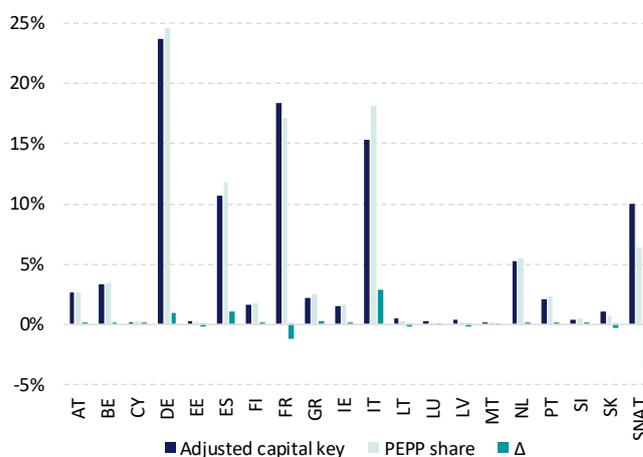
Breakdown of public sector securities under the PEPP

Jurisdiction	Holdings (in EURm)	Adj. distribution key ¹	PEPP share	Deviations from the adj. distribution key ²	Ø time to maturity (in years)	Market average ³ (in years)	Difference (in years)
AT	17,567	2.6%	2.7%	0.1%	10.9	7.1	3.9
BE	22,197	3.3%	3.4%	0.1%	6.3	9.4	-3.1
CY	1,484	0.2%	0.2%	0.0%	10.9	8.3	2.5
DE	160,619	23.7%	24.6%	0.9%	4.8	6.7	-1.9
EE	207	0.3%	0.0%	-0.2%	9.1	7.5	1.6
ES	77,128	10.7%	11.8%	1.1%	8.5	7.4	1.0
FI	11,169	1.7%	1.7%	0.1%	7.2	7.0	0.3
FR	111,810	18.4%	17.2%	-1.2%	8.6	7.3	1.4
GR	16,307	2.2%	2.5%	0.3%	8.4	9.4	-1.0
IE	10,317	1.5%	1.6%	0.1%	8.9	9.6	-0.7
IT	118,169	15.3%	18.1%	2.8%	6.8	6.9	0.0
LT	2,080	0.5%	0.3%	-0.2%	11.8	10.6	1.2
LU	1,244	0.3%	0.2%	-0.1%	7.1	6.4	0.8
LV	907	0.4%	0.1%	-0.2%	9.1	10.3	-1.2
MT	261	0.1%	0.0%	-0.1%	7.5	8.1	-0.7
NL	35,705	5.3%	5.5%	0.2%	4.1	7.3	-3.2
PT	14,809	2.1%	2.3%	0.2%	6.8	6.6	0.2
SI	3,131	0.4%	0.5%	0.0%	8.3	9.5	-1.2
SK	4,707	1.0%	0.7%	-0.3%	7.8	8.2	-0.4
SNAT	41,991	10.0%	6.4%	-3.6%	8.9	7.6	1.3
Total / Avg.	651,810	100.0%	100.0%	-	7.0	7.2	-0.3

Distribution of public sector assets by jurisdiction



Deviations from the adjusted distribution key

¹ Based on the ECB capital key, adjusted to include supras ² Based on the adjusted distribution key³ Weighted average time to maturity of the bonds eligible for purchasing under the PEPP

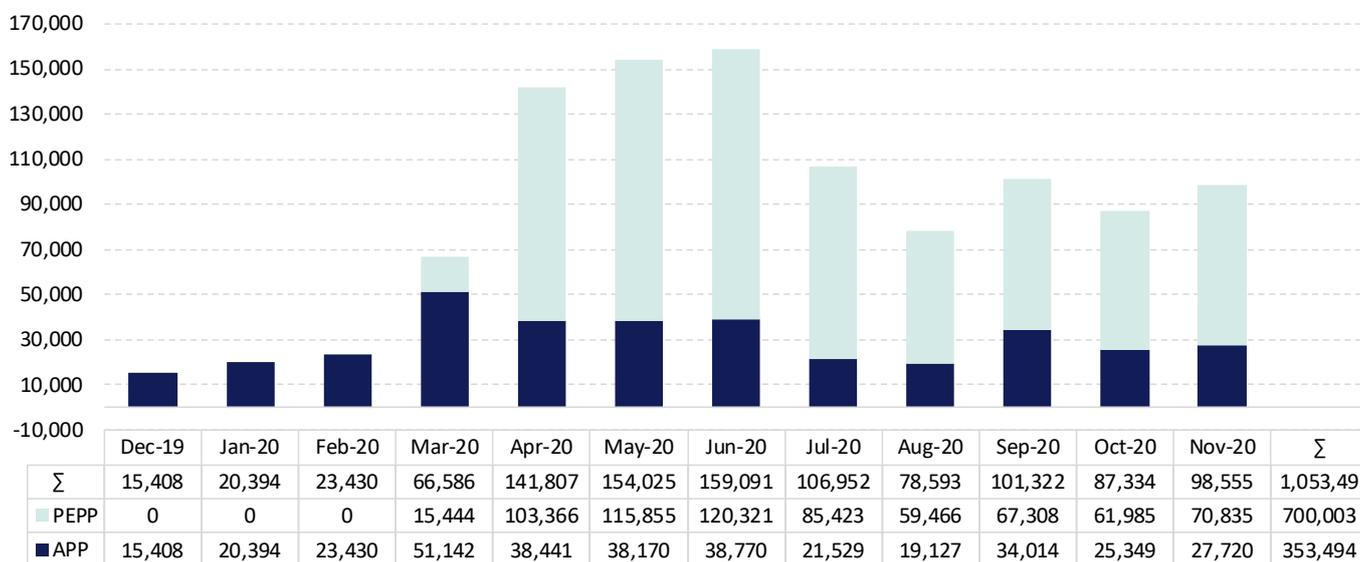
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Aggregated purchase activity under APP and PEPP

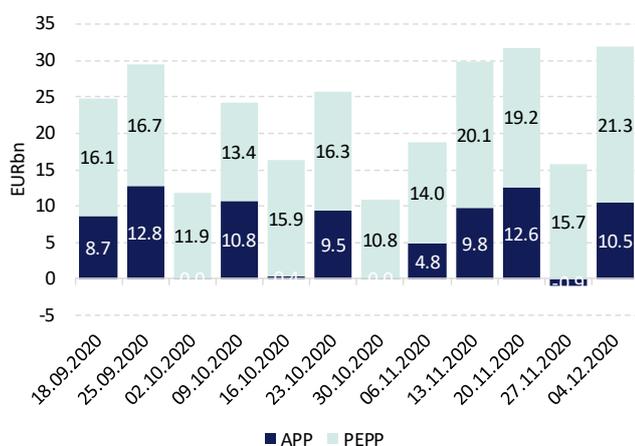
Holdings (in EURm)

	APP	PEPP	APP & PEPP
Oct-20	2,867,802	629,169	3,496,971
Nov-20	2,895,521	700,003	3,595,524
Δ	+27,720	+70,835	+98,555

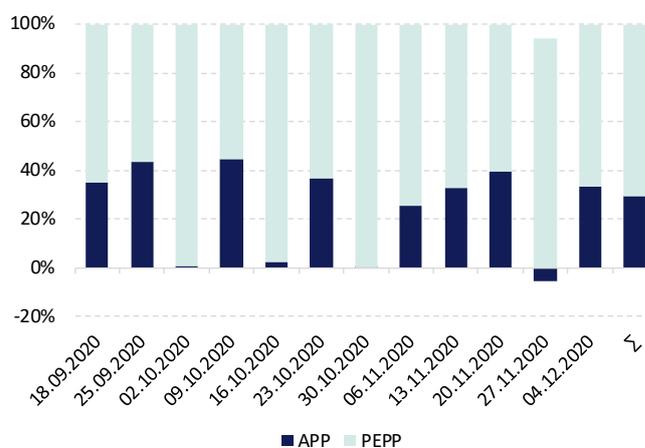
Monthly net purchases (in EURm)



Weekly purchases



Distribution of weekly purchases



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

Appendix

Overview of latest Covered Bond & SSA View editions

Publication	Topics
47/2020 ♦ 09 December	<ul style="list-style-type: none"> Fourth and final round of PEPP reporting in 2020 Investment alternative: Paris metropolitan area (IDF and VDP)
46/2020 ♦ 02 December	<ul style="list-style-type: none"> The ECB ahead of its course-setting meeting for 2021 Covered Bonds – Outlook 2021: Waiting for the game changer? SSA – Outlook 2021: Coronavirus and ECB dominate public-sector segment
45/2020 ♦ 25 November	<ul style="list-style-type: none"> UOB ends the state of hibernation on Singapore’s primary market The covered bond universe of Moody’s: an overview Update: Belgium regions as investment alternatives
44/2020 ♦ 18 November	<ul style="list-style-type: none"> Primary market 2021: real prospect of Hungarian EUR benchmarks? German Pfandbrief savings banks in Q3 2020 Development of the German property market
43/2020 ♦ 11 November	<ul style="list-style-type: none"> Newcomer to the benchmark segment: HSBC Bank Canada sets sights on EUR debut OP Mortgage Bank: First green covered bond from Finland Transparency requirements §28 PfandBG Q3/2020
42/2020 ♦ 04 November	<ul style="list-style-type: none"> Covered Bond Framework and Liquidity Coverage Ratio: European Commission presents draft version of amendments to LCR regulation An overview of the Fitch covered bond universe
41/2020 ♦ 28 October	<ul style="list-style-type: none"> ECB: The year of the owl – review and outlook Yield developments on the covered bond market
40/2020 ♦ 21 October	<ul style="list-style-type: none"> German building societies: EUR benchmark debuts and requirements for investing in soft bullet bonds NPLs in cover pools – lack of unified approach at national level
39/2020 ♦ 14 October	<ul style="list-style-type: none"> Spain: Issuer consolidation ahead? PfandBG to include extendable maturity structures The EU has big plans – “SURE” and “Next Generation EU”
38/2020 ♦ 07 October	<ul style="list-style-type: none"> New issuer from Japan – Sumitomo Mitsui Trust Bank places inaugural EUR benchmark bond PEPP – taking stock six months on
37/2020 ♦ 30 September	<ul style="list-style-type: none"> Cover pool characteristics – international comparison
36/2020 ♦ 23 September	<ul style="list-style-type: none"> Bausparkasse Schwäbisch Hall plans inaugural EUR benchmark Update: Auckland Council – Investment alternative in Down Under
35/2020 ♦ 16 September	<ul style="list-style-type: none"> Moody’s covered bond universe: an overview Update Down Under: Victoria (TCV)
34/2020 ♦ 26 August	<ul style="list-style-type: none"> Covered bonds as central bank-eligible collateral – European Central Bank presents Q2 2020 figures Update: New South Wales (NSWTC)
33/2020 ♦ 19 August	<ul style="list-style-type: none"> German Pfandbrief savings banks in Q2 2020 ECBC publishes annual statistics for 2019

Appendix

Publication overview

Covered Bonds:

[Issuer Guide Covered Bonds 2020](#)

[Risk weights and LCR levels of covered bonds](#)

[Transparency requirements §28 PfandBG](#)

[Transparenzvorschrift §28 PfandBG Sparkassen \(German only\)](#)

SSA/Public Issuers:

[Issuer Guide – Supranationals & Agencies 2019](#)

[Issuer Guide – Canadian Provinces & Territories 2020](#)

[Issuer Guide – German Bundeslaender 2020](#)

[Issuer Guide – Down Under 2019](#)

Fixed Income:

[ESG update](#)

[Analysis of ESG reporting](#)

[ECB launches corona pandemic emergency](#)

[ECB responds to corona risks](#)

Appendix

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Time of going to press: 10 December 2020 08:51h (CET)

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Issuer / security	Date	Recommendation	Bond type	Cause
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