

European Financial Markets:
recent trends and further insights

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recent trends and further insights

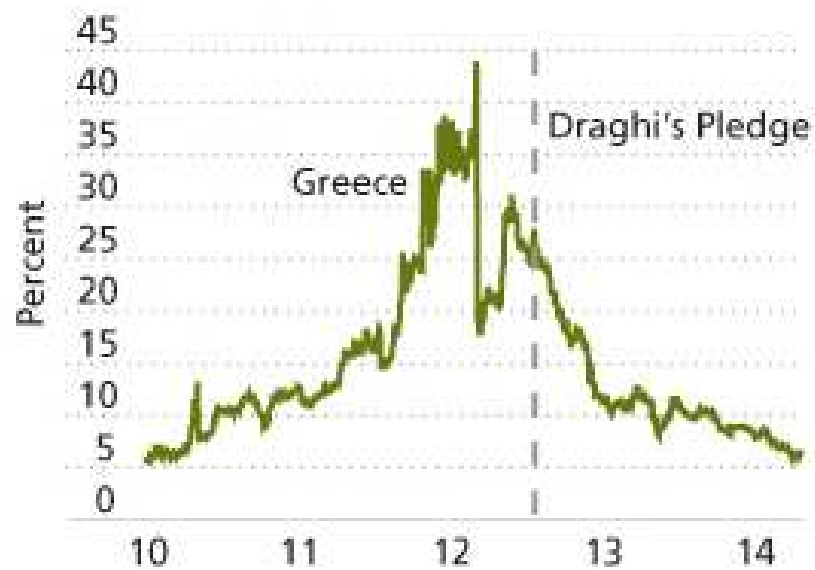
- Sovereigns
 - The Draghi effect
 - Peripherals return to the fold
 - Two down and one to go
- Corporates
 - Performance overview
 - Significant increase in size and number of issuers
 - Alternative to bank lending
 - But not for everyone
- ECB Policy
 - QE... probably
 - Inflation
 - Bank Lending

The Draghi Effect

- In July 2012 Draghi pledges
 - to do “whatever it takes” to save the Euro
- The pledge is obviously credible
 - Since that is precisely what has happened
 - Without the ECB spending a €

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 three-year 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 >80% of its 2014 funding target
- Launched a new 10-yr benchmark
 - Which now has €6.5 bn outstanding
- Irish 10-yr now trades THROUGH UK 10-yr Gilt

Centripetal Peripherals

Portugal

Rally in Portuguese Yields

Portugal 10-Year Government Bond Yield



As of March 27, 2014

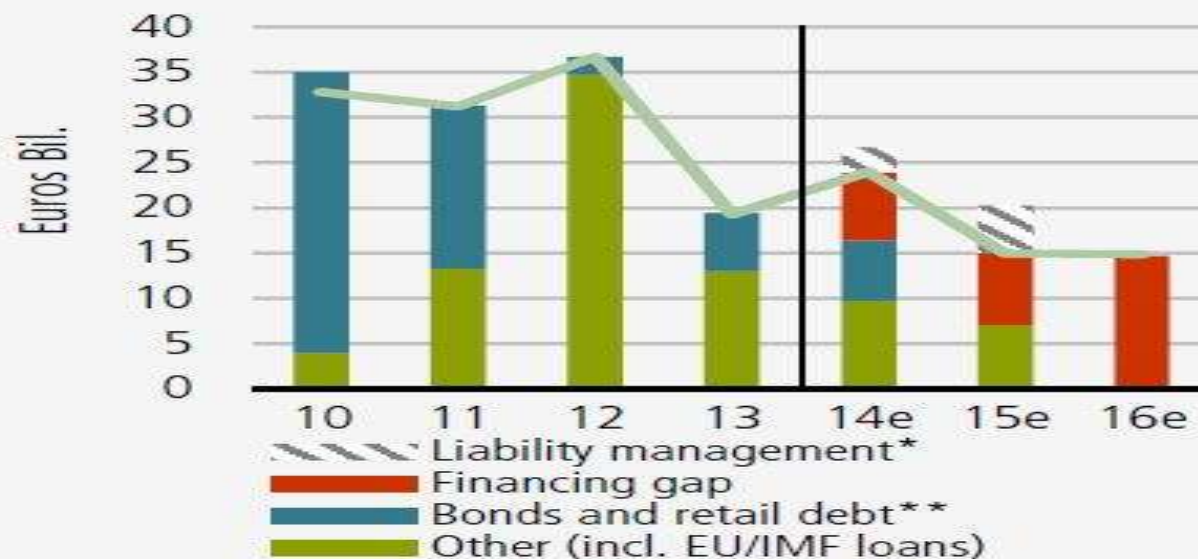
Source: *Financial Times*

Centripetal Peripherals

Portugal

Improvements in Funding Needs

Financing Requirements by Source of Financing



As of March 28, 2014

*The shaded area represents the reduction in funding needs for 2014/2015 due to the debt exchange and debt buybacks.

**2014 bar includes the €6.25 billion already issued this year.

Source: European Commission, IMF, Portuguese Treasury and Debt Management Agency and AllianceBernstein

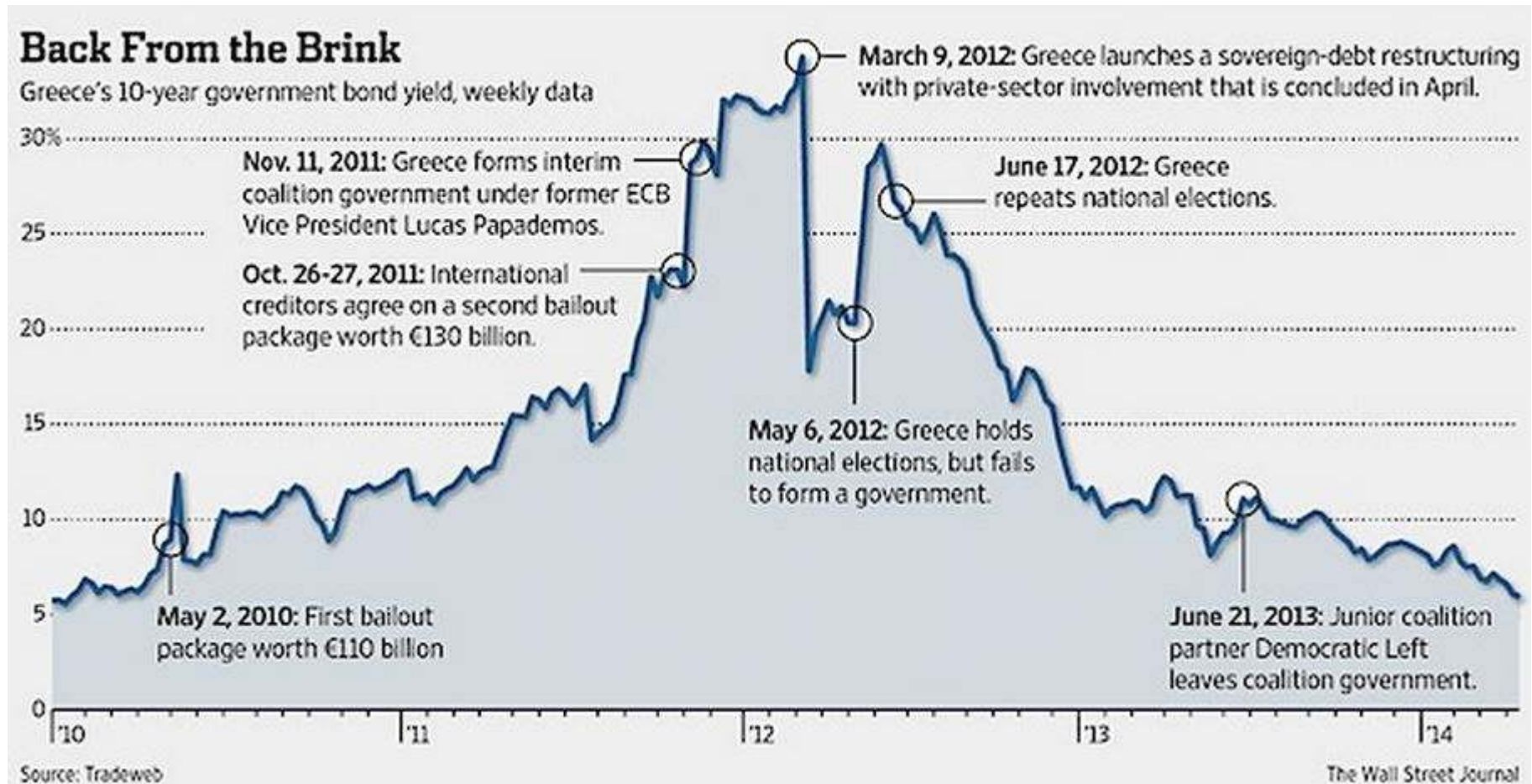
Centripetal Peripherals

Portugal

- Portugal will make its bailout exit on 17th 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 €14.7bn so far in 2014
 - almost 50% of its 2014/5 funding target of €30bn
- Yields are at an 8-year low

Centripetal Peripherals

Greece

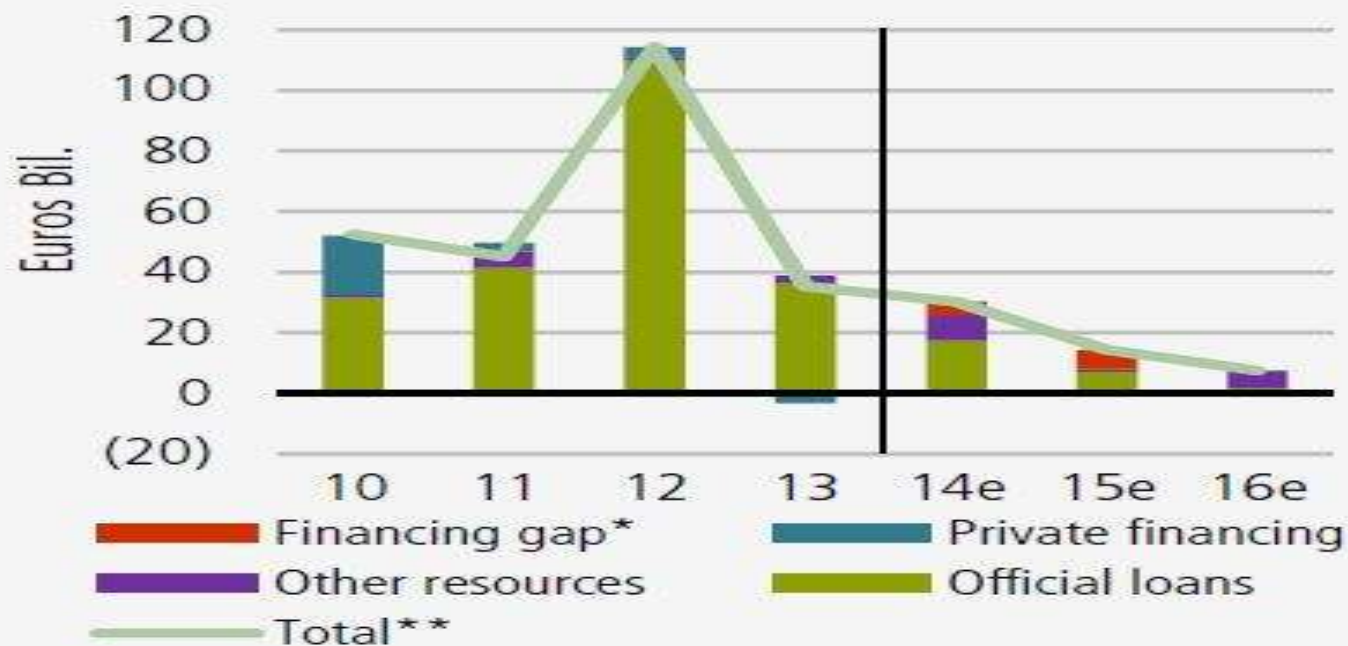


Centripetal Peripherals

Greece

Fall in Funding Needs

Financing Requirements by Source of Financing



*Financing gap shown is prior to this week's issuance.

**The funding requirements for 2012 are elevated owing to the PSI sweetener and bank recapitalizations.

Source: European Commission, IMF and AllianceBernstein

Centripetal Peripherals

Greece

- Greece returned to the markets in April
 - With a new €3 bn 5-yr bond
 - 10-yr yields are now at 6.1%
 - After peaking well over 40% in 2012
- It has an estimated €11 bn to raise in 2014/5
 - But the 5-yr was massively oversubscribed:
 - >€20 bn demand from 550 different investors
 - Priced to yield 4.95%

Perspective on a “crisis”

- In the four years since Greece admitted
 - that previous governments had cooked the books
- We had a fully fledged Sovereign Debt Crisis
- 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!

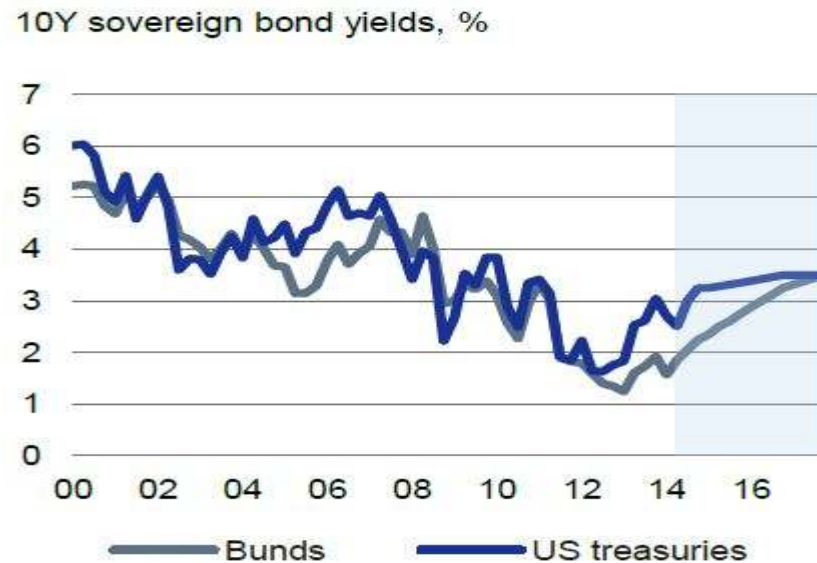
Perspective on a “crisis”

- 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

Overview

Inflation Expectations

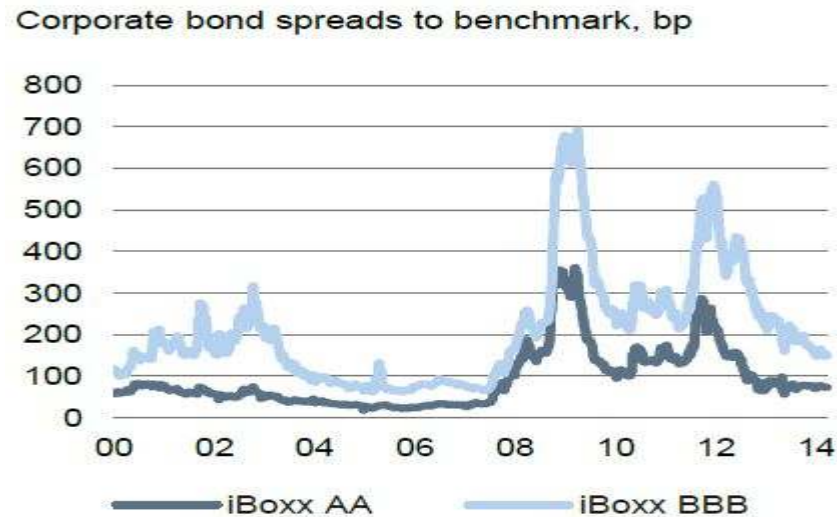
- The market expects lowflation to stay awhile



- And the trend is not upwards

Overview Corporates

- But (either way) there is still room

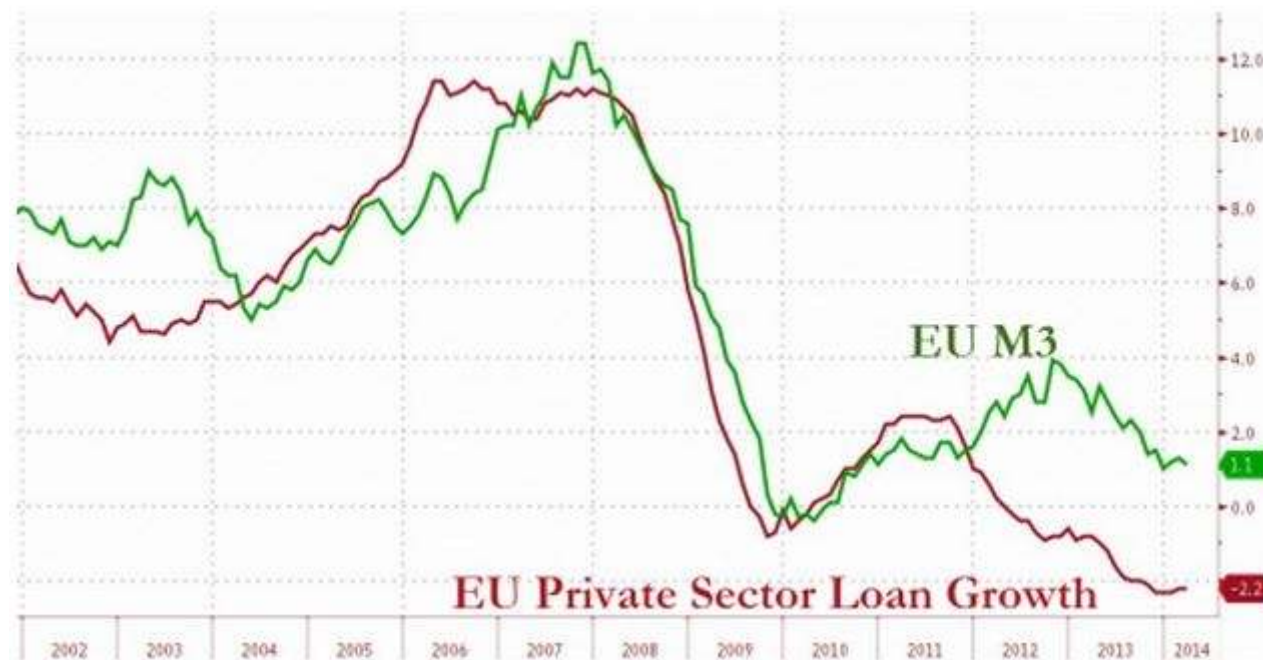


Source: Markit, Bloomberg, Deutsche Bank Research

- for corporate spreads to tighten

Corporates

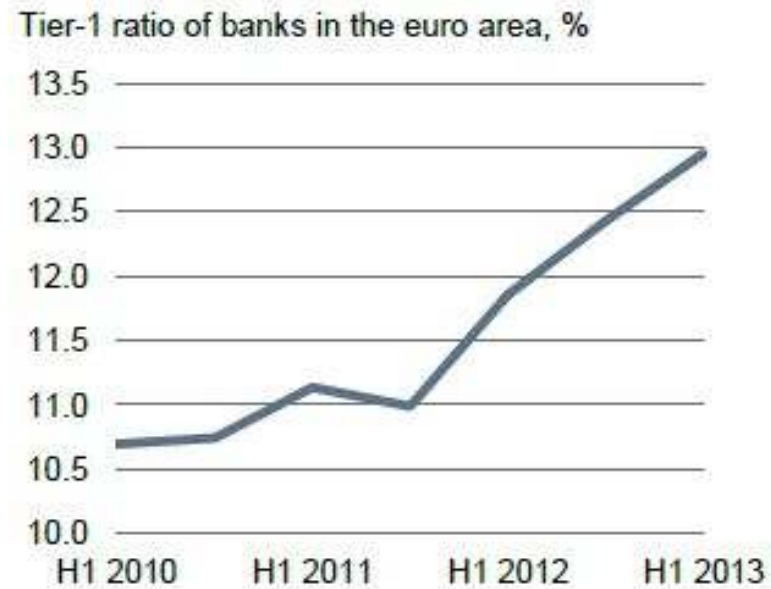
- Growth in bank lending.....



- is worse now than it was during the crisis

Corporates

- But Banks have had to

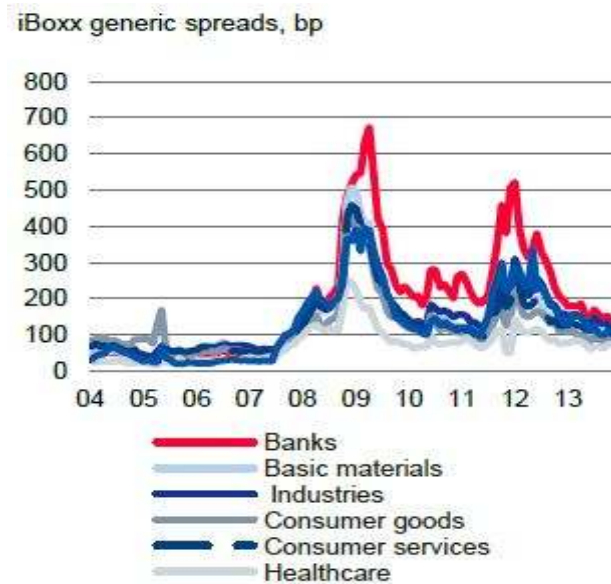


Source: ECB

- improve their capital ratios

Corporates

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

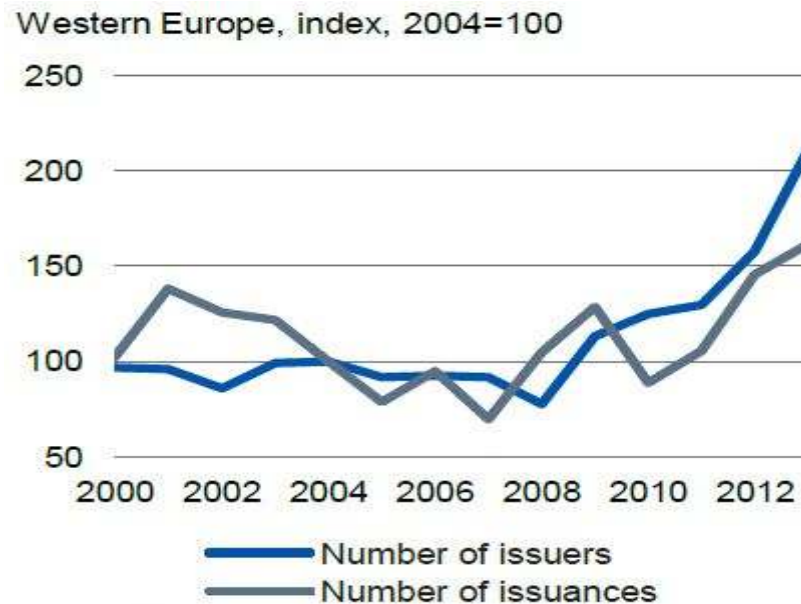


Sources: Markit, Deutsche Bank Research

- than their customers do

Corporates

- The number of corporate issuers has increased...



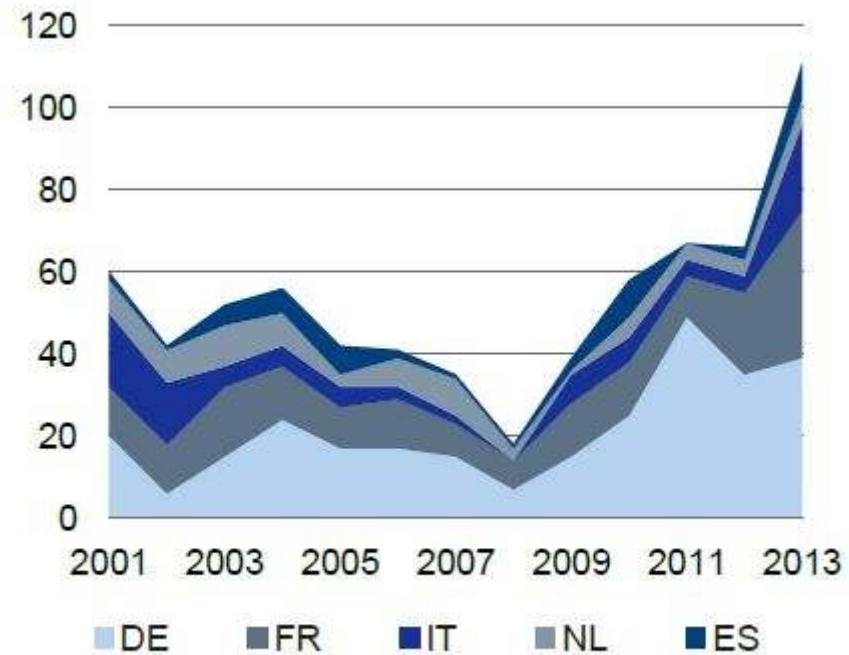
Western Europe = Germany, France, Italy, Spain, Netherlands

Sources: Bloomberg, Deutsche Bank Research

- and so has the number of bond issues

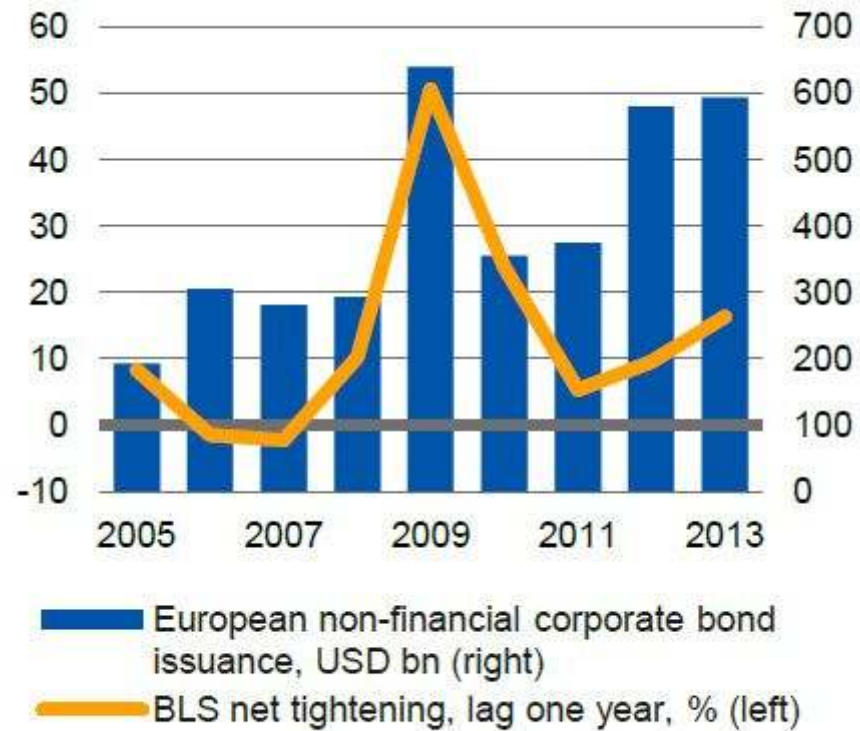
Corporates

- As has the number of NEW issuers



*Corporations that have not issued a debt security since 2000

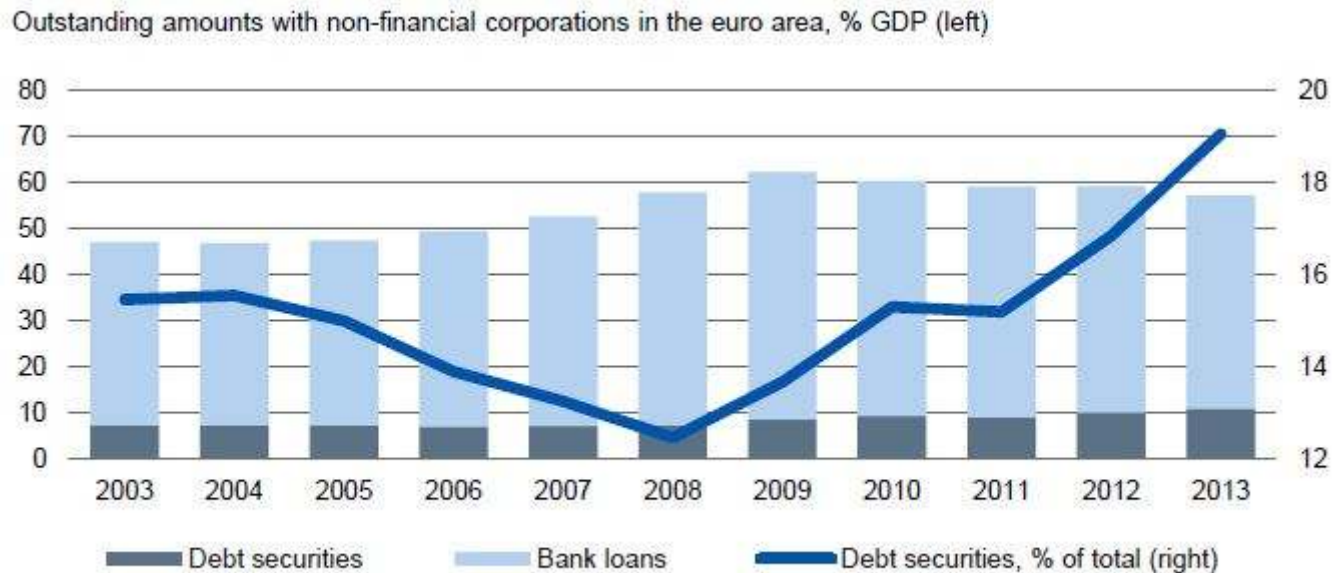
Corporates



Sources: Deutsche Bank Research, Dealogic, ECB

Corporates

- Even though European corporates use bonds

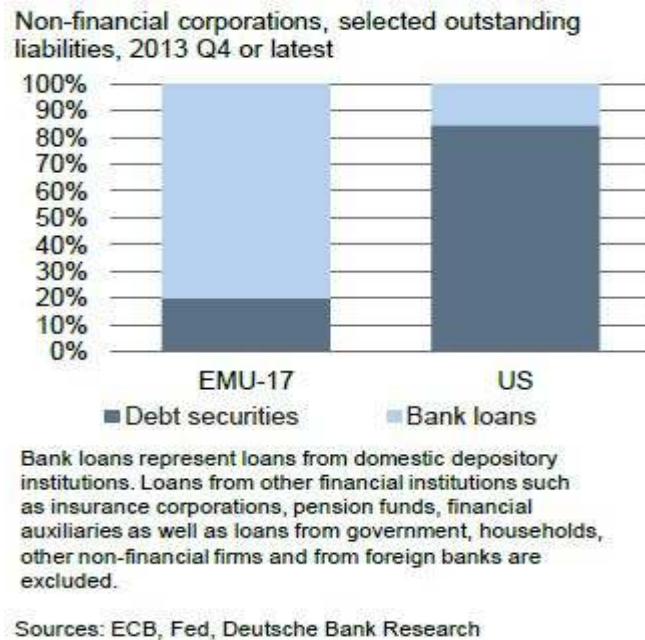


Sources: ECB, Deutsche Bank Research

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

Corporates

- They still rely on bank lending



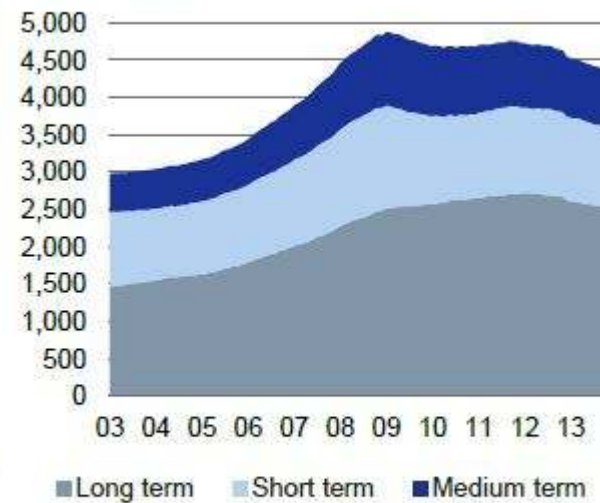
- ...much more than US corporates

Corporates

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

Non-financial corporate bond issuance, USD bn

Outstanding bank loans to non-financial corporations
in EMU, EUR bn



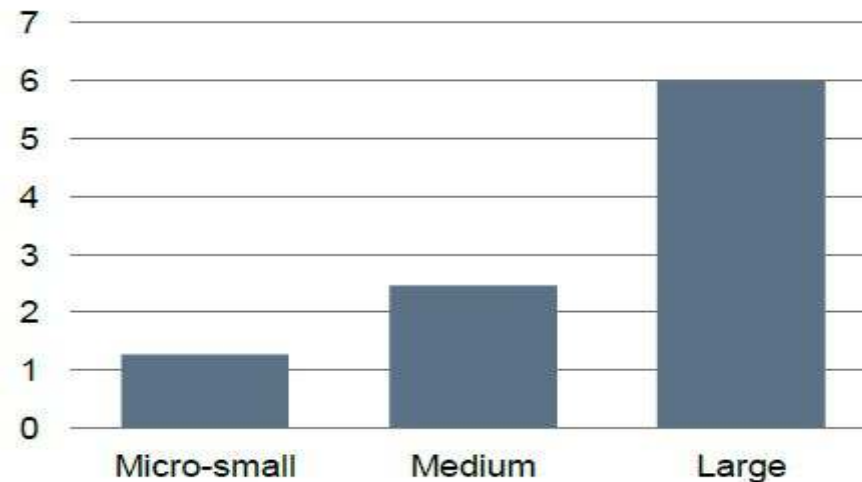
Working day and seasonally adjusted

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 ?
- And if it does ...
 - 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

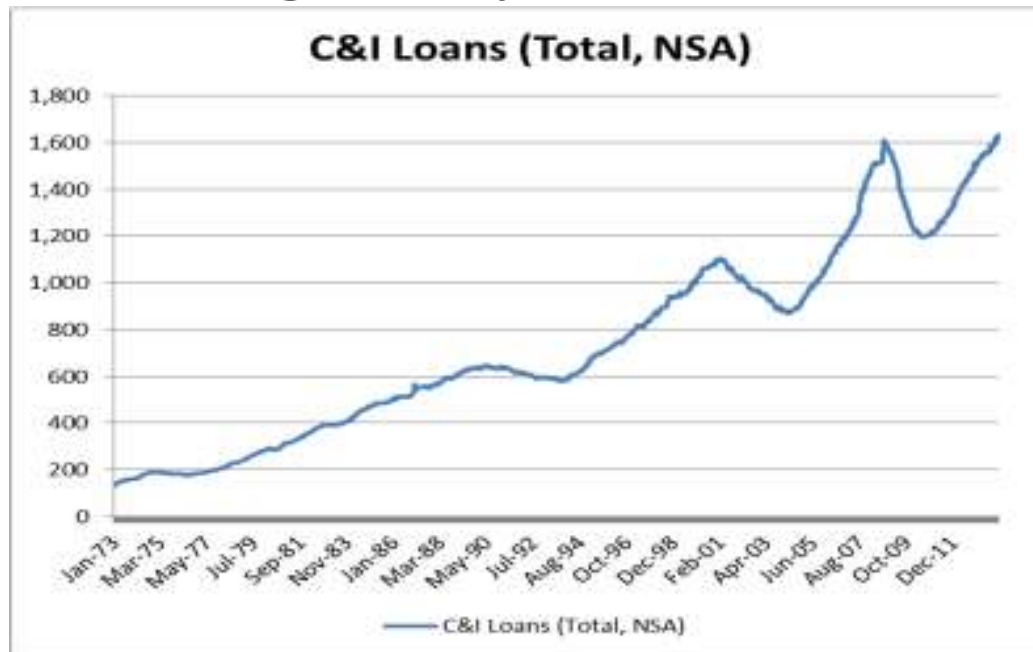
- Move along



- No inflation to see here.....

ECB Policy

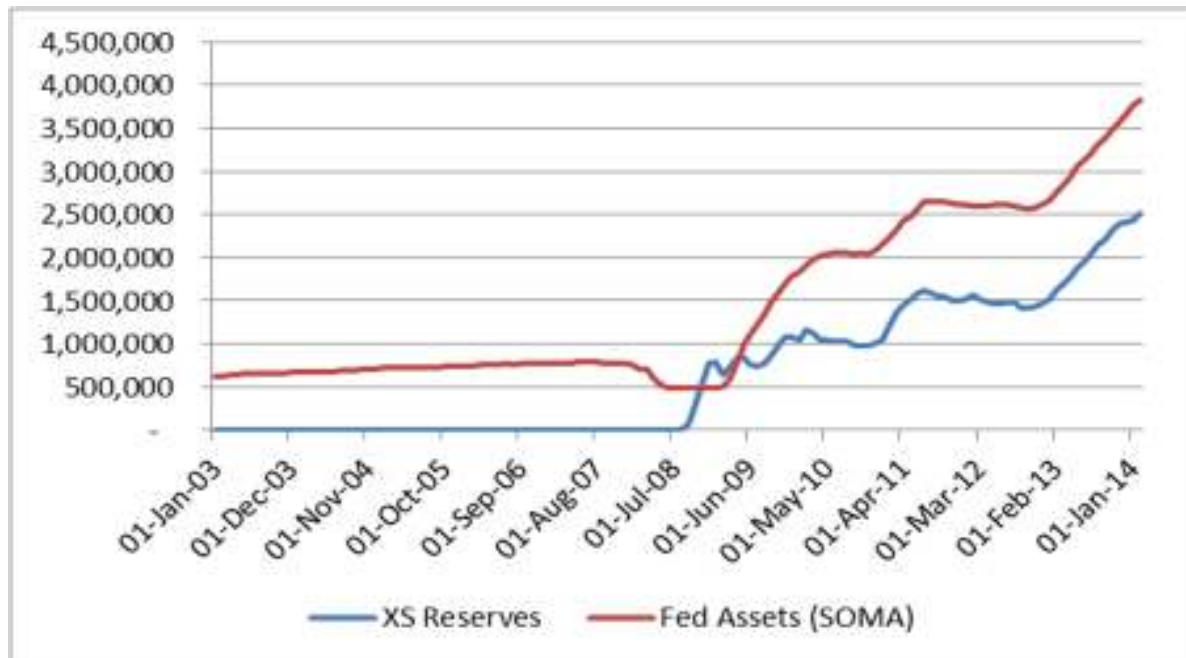
- US bank lending collapsed.....



- But eventually recovered (after lots of QE)

ECB Policy

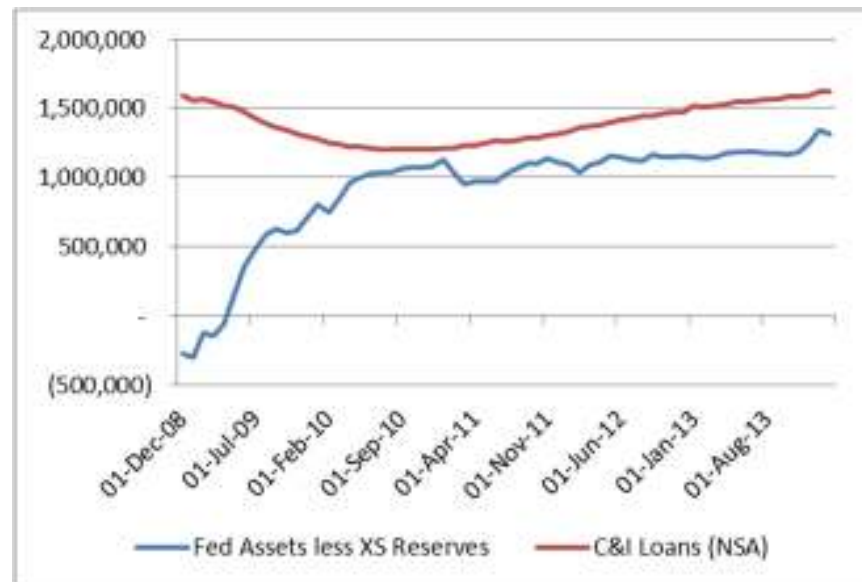
- Most of the growth in Fed Assets....



- Has stayed in the Fed as Excess Reserves

ECB Policy

- And what “leaked”



- Eventually turned into loans

Thank You

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