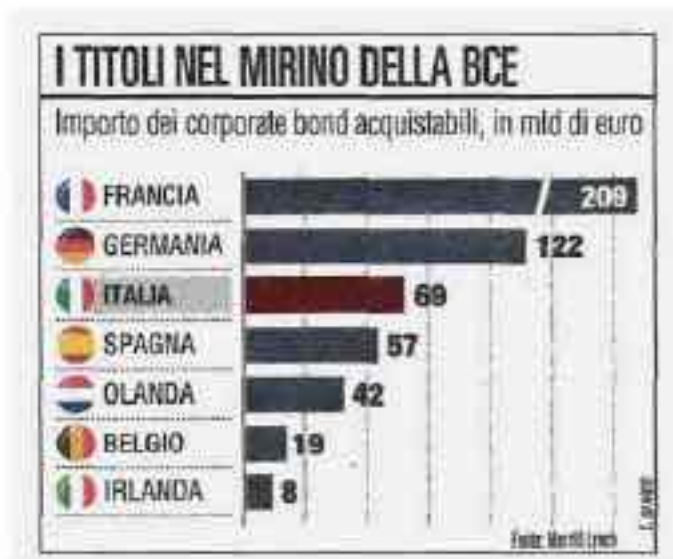


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The ECB's 69 billion treasure hunt

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BONDS IN THE ECB'S SIGHTS

Amounts of corporate bonds eligible for purchase, in billions of euro

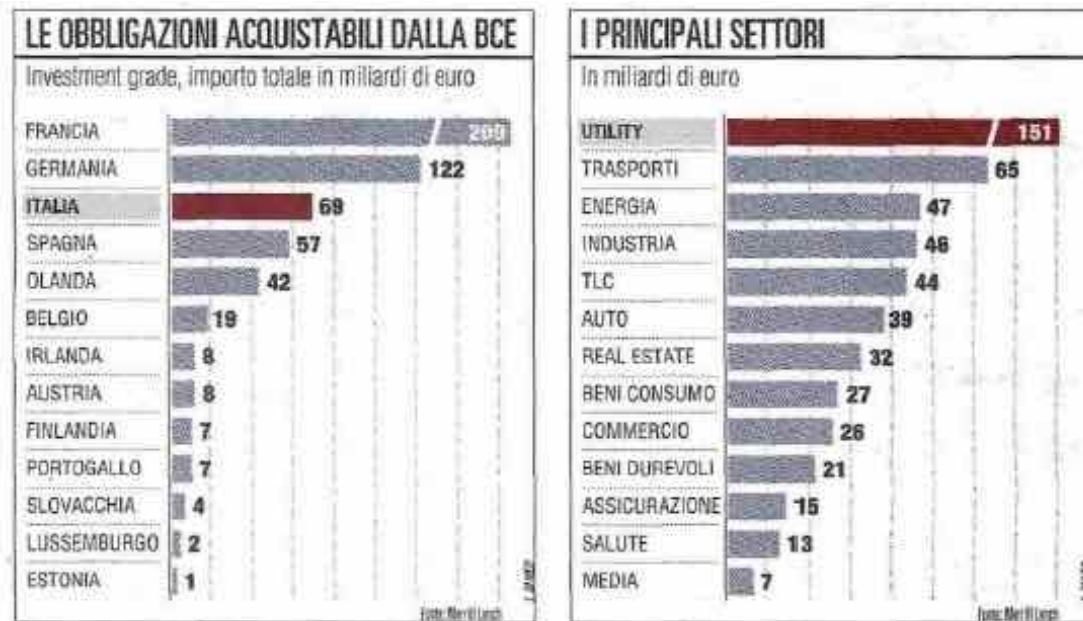
In the run-up to his historic announcement on "QE Plus", as the ECB's composite operation is called in financial circles, Mario Draghi had informal meetings on 10 March with some of the world's most distinguished economists. To each of them, he repeated one concept: "I'll be increasing bond purchases from 60 to 70 billion, that's for sure, and I won't need to justify myself with anybody because some 'cosmetic' adjustments will suffice. But if I opt to increase them to 80 billion, I'll most definitely need to bow to the German and French requests to extend QE to corporate bonds". And that's exactly what happened: purchases increased to 80 billion and extended to the bonds of major groups on the Rhine axis, like Volkswagen and Siemens, but also to those of Auchan, LVMH, Kering, Lactalis and so, *en français*, on.

Italy, however, got more than just the crumbs. Merrill Lynch calculates that while "eligible" French corporate bonds amount to 209 billion and German ones to 122 billion, Italian bonds that fit the requirements amount to 69 billion: bonds worth 9.5 billion for Snam, 18 billion for Eni, about 25 for ENEL and 770 million for Terna, and so on, are currently circulating in the markets.

The ECB's treasure hunt is under way, corporate bonds are having their day. 69 billion already eligible for purchase in Italy

BONDS ELIGIBLE FOR PURCHASE BY THE ECB *PRINCIPAL SECTORS*

Investment grade, total in billions of euro *in billions of euro*



THE EXTENSION OF QUANTITATIVE EASING TO THE HIGHEST-RATED CORPORATE BONDS IS TRIGGERING A RUSH TO ISSUE. AT PRESENT GERMAN AND FRENCH GROUPS ARE FAVOURED BUT THE MARKET IS MOVING AND EXPANDING RAPIDLY IN ITALY TOO

Prices reacted immediately to the ECB's moves, confirming that the operation will have a profound effect on the financial markets, on companies and on investors. In just a few hours, before Draghi had even finished his press conference, ENI's January 2024 bond, coupon 1.750%, fell from a yield of 1.58% to 1.45% while the value soared. For the A2a January 2022 bond, coupon 3.625%, the yield fell to 1% from its previous 1.26%; the Atlantia February 2021 bond, coupon 2.875%, fell in yield terms by 15 cents and rose in value terms by 0.8 points; Luxottica February 2024, coupon 2.625%, saw its yield fall from 1.18% to 1.12%. The next few days saw a surge in emissions: first Deutsche Bank, with a 4 billion bond, then the Belgian multinational, AbInBev, with a bond of a whopping 13.25 billion in six tranches, and so on.

In the week between Draghi's announcement and last Thursday, new bond issues topped 34 billion. "The fact of extending quantitative easing to corporate bonds was undoubtedly a concession to the Germans in

exchange for increasing the ECB's commitment", is how Brunello Rosa, managing director of RGE, Nouriel Roubini's think-tank, sums it up. "The big northern companies now feel safer, if for nothing else then because a backstop has been created against possible catastrophic losses resulting from unforeseeable events, from the Volkswagen scandal to the crisis in the Mediterranean countries. But now the Italian market too, smaller though it may be, will benefit from all of this".

The qualitative change is era-defining. "The ECB has entered the market directly", explains Angelo Billion, economist at the University Catholic in Milan. "It's maybe an exaggeration to say that the transmission of the benefits of QE to the real economy, as entrusted to the banks, hasn't worked, because some credit has in fact been distributed. But we can say with certainty that Draghi decided to add this direct intervention in the corporate sphere to revitalise investment and, hopefully, consumption".

Back in the autumn, the ECB had already begun, softly, softly, to buy corporate bonds and had published a list of a small number of "eligible" groups from all over Europe, all of them companies with a strong state presence in their capital (for Italy, the list included Snam, Enel, Eni and Terna). But in actual fact this instrument was scarcely used. The rush to purchase is starting now that the possibility has been extended to all groups rated "investment grade" by the agencies. As Frankfurt has explained, the operational arrangements have still to be defined: this will be done by the end of April, when the operation will start.

Independent economists calculate that of the 2000 billion in QE, if it ends in March 2017 as currently envisaged, 200 to 300 billion will go on corporate bonds. Bonds issued by companies with a sufficiently high rating amount to 546 billion in Europe (of which, as we mentioned, 69 billion in Italy), out of 1600 in existing credit instruments. According to Barnaby Martin, head of credit strategy for Europe at Merrill Lynch, "the buying fever will end up also infecting the latter because investors will start to seek better yields, once purchases of the 'select' securities have realistically produced a lowering of their rates because values have risen". And there's more: "Other bonds that are still outside the scope of ECB purchases will also benefit. Reverse Yankees [ed.'s note: bonds in euro issued by American companies], credit instruments in other currencies, starting with British bonds, and subordinate bancassurance bonds".

"The world of 'investment grade' bonds experienced a 'squeeze' on interest rates, from an initial 90 basis points to 70", confirms Rocco Bove, head of the bonds desk at Kairos, which manages the KIS Bond and KIS Bond Plus segments and is one of the leading actors in the European corporate bond segment. "And we're also starting to see indirect effects on other bonds. The high yield segment has gone from 375 basis points to 310, so a restriction of 65 basis points. That's because the new QE has indirect repercussions on all the other issues, including on companies with a lower than investment-grade rating. And the effects have been seen even on the rates of bank bonds".

The ECB is working on two fronts: "to provide additional liquidity for banks

with a view to financing businesses”, says Bove, “and at the same time encourage businesses themselves to make more use of bonds. Because in Europe, and above all in Italy, the banking channel plays too big a role and partial disintermediation would be desirable. The ultimate goal of the entire operation, however, remains a reflation of the economy”.

In just a few hours or days, many operators have bought or sold. “We’ve already done so, in part”, says Luca Riboldi, chief investment officer at Banor. “We had, for example, a position on bonds: after the news we continued to buy at 96 and have already partly sold again at 99. The market, however, has already lined up with the new values. But when the ECB really starts buying then we’ll see other opportunities. This is undoubtedly the best year, for the financial sector, to be trading”.

The corporate bond operation is particularly delicate. As the experts see it, one model might be the one used for covered bonds. These have already begun to be included in QE, are asset-backed and can be bought – unlike government bonds – on the primary market, so at the time of issue, and not just on the secondary market. Central banks, and so ours too, will be trading very carefully, when buying corporate bonds, not to distort the market. That means that they will need, essentially, to respect the proportions between the different securities. So they won’t be able to buy too many bonds of a given company unless in proportion to those already in circulation or being issued. Great caution will be shown in filling the Bank of Italy’s “shopping basket”.

But the operation will not last indefinitely. “In my opinion”, says Antonio Patuelli, president of the Italian Banking Association (ABI), “the window of opportunity will stay open for a year. After the US elections, the Federal Reserve will probably begin to slowly increase rates. Until then it will do little or nothing, so as not to disturb the markets”.

That’s not the only part of “QE Plus” that’s focusing directly on the real economy. The impact of the new Targeted long term refinancing operations (TLTROs) could be equally strong. These represent a sort of upside down world of credit where banks borrowing money from the ECB, instead of paying an interest rate, receive interest from the central bank, up to 0.40%, if they fully exploit the opportunity, or rather the “duty”, to finance the economy.

Prometeia has calculated that Italian banks could borrow up to 317 billion from the ECB. If they succeeded in passing all these resources on to the economy, they would earn as much as 1.27 billion. Getting paid to borrow money. The problem, at this point, shifts to the banks and to the actual market (and the remaining risks) they’re presented with.

As Patuelli explains, “People often forget that, after Basel 1 and 2, the banks can only lend to businesses that meet their tax obligations and whose accounts are in order. That’s the main obstacle limiting banks’ ability to lend. They could be criminally liable if they gave money to a company that was less than healthy. The credit crunch is over, indeed the situation now is the opposite: the banks are hunting for good customers

and snatching them from each other. It's a sort of customer substitution. Branch managers are using and cross-checking bank databases and checking in person whether there are companies in their locality with healthy accounts".

The banks themselves, in the face of such a complex and ambitious operation, have one complaint, comments economist Rainer Maser. "The operation could perhaps have been extended to securitised bonds, even non-performing loans. That would have helped solve a problem that the European authorities have, culpably, addressed only halfway".

THE COMPANIES WHERE THE ECB WILL TAKE ACTION

BCE, LE AZIENDE DOVE SI INTERVERRÀ

Emittenti già qualificati

- A2A
- ACEA
- ATLANTIA
- EDISON
- ENI
- EXOR
- FERROVIE DELLO STATO
- HERA
- IREN
- LUXOTTICA GROUP
- POSTE ITALIANE
- SNAM
- TERNA
- RAI
- ZIRETE GAS
- AUT. BRESCIA-PADOVA

Beneficiari indiretti

- ASTALDI
- IVS
- PIAGGIO
- GUALA CLOSURES
- FINCANTIERI
- ANSALDO
- INDESIT
- KEDRION
- PRYSMIAN
- TWIN SET
- AMPLIFON
- MANUTENCOOP
- EITOWERS
- MEDIASET
- BENI STABILI
- CMC RAVENNA
- BORMIOLI ROCCO HOLD.
- BUZZI UNICEM
- FINMECCANICA
- MARCOLIN
- ICBPCI
- OFFICINE MACCAFERRI
- ONORATO ARMATORI
- SALINI IMPREGILO
- SISAL
- SNAI
- TELECOM ITALIA
- WIND ACQUISITION FIN. SA
- ZOBELE HOLDING