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Talking point

ECB's corporate bond purchase programme: More distortions

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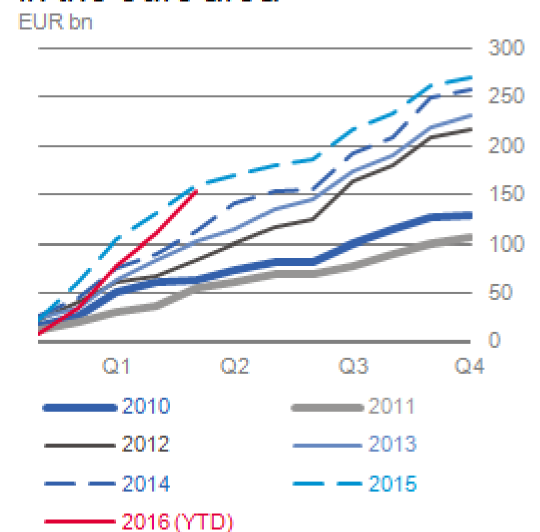
Since the ECB's announcement to include investment-grade corporate bonds in its QE programme (CSPP), corporate bond issuance has surged in the euro area. However, even though this is a boon for issuers, benefits for the real economy may be quite limited. The value added for SMEs is hard to see, and funds raised will most likely be used predominantly for refinancing of existing debt and for stock buybacks instead of new investments. Moreover, potential side effects of the corporate bond programme such as inefficiencies in the pricing of risks and deterioration in liquidity could increase the distortions in bond markets.

Corporate bond issuance in the euro area became the focus of attention recently. After a slow start in 2016, issuance gained significant pace in recent months. In March alone, non-financial investment-grade (IG) companies sold bonds worth EUR 44 bn, driving total issuance in Q1 to almost EUR 80 bn. By end-May 2016, year-to-date issuance had reached EUR 153 bn and March to May was the period with the second-highest issuance in a three-month window ever. With exceptionally low borrowing costs, firms are lining up to issue debt in Europe. US firms also benefit from these favourable conditions, tapping into European bond markets and accounting for 30% of issuance in 2016. The uptick in bond issuance is a boon for issuers, but whether it benefits the broader economy or instead creates substantial risks in this market segment requires a closer look.

The recent surge in corporate bond issuance coincided with the ECB's announcement to buy corporate bonds as part of its QE programme. The ECB plans to expand its monthly bond investment to EUR 80 bn, and its investment in IG corporate bonds is estimated to account for around EUR 5 bn. It is buying in both primary and secondary markets, and up to 70% of an individual issuance. However, the ECB's rating requirement for eligibility is rather relaxed; having an IG rating from just one of the big three credit-rating agencies suffices to be included in the programme. For example, one of the largest telecom companies in Europe, which is rated as sub-investment grade by two of the three major rating agencies, is included in the programme.



Which firms are benefiting from the bond-buying programme of the ECB? Indeed, looking at issuance activity between March and May, just 17 companies accounted for half of total issuance. Most of the issuers were large multinational firms, with the median issuer having around 80,000 employees and generating revenues of around EUR 23 bn. Put differently, bonds were mainly issued by an exclusive number of very large firms – by contrast, smaller companies seem unlikely to benefit directly from the upward trend in bond markets. While the ECB hopes that SMEs will enjoy secondary effects, such as large bond-issuing companies not competing with SMEs for bank loans – which may not have been the case anyway – it is unclear whether these advantages will materialise. In the end, according to the ECB's latest Survey on Access to Finance, only 10% of SMEs cite funding as their single most important problem, while almost one-third refers to finding customers as their main concern. Overall, it is the anaemic macro outlook that stifles European SMEs, not a lack of access to finance.

It is important to delve deeper into the motives for corporate bond issuance, to evaluate whether, e.g., other funding channels are broken or the funds will be used for additional investments. The ECB's Bank Lending Survey

sheds some light on the former and reveals that bank lending conditions for large companies have improved markedly over recent quarters, i.e., even before the ECB's CSPP announcement. But this implies that the bank funding channel had by and large been open for those firms that can usually also tap the debt capital markets. Meanwhile, half of the issuers between March and May stated refinancing of existing debt as the reason for bond issuance, and some have even indicated stock buybacks as a reason, using the bond proceeds to change their capital structure. In this vein, CSPP might provide very little stimulus for the real economy.

By contrast, the potential side effects of ever-looser monetary policies could make CSPP counterproductive. Negative benchmark rates and extensive liquidity injected into financial markets are pulling down bond yields for all rating classes to all-time lows. For example, European IG and high-yield (HY) benchmark corporate bond indices have come down by 34 bps to 0.75% and 115 bps to 4.5%, respectively, since the announcement of the ECB programme on the 10th of March. However, in an environment where especially HY bond risks are no longer offset by higher default premiums, fundamentals of asset pricing are violated. What is more, bond market liquidity, which has been deteriorating over the last two years, will probably suffer even more with the entrance of a single large buyer. Indeed, since the announcement of the ECB programme, bond market illiquidity, measured by bid-ask spreads, has risen by around 15%. This probably reflects increasing inefficiencies in price discovery mechanisms. The search for yield is leading to increased risk-taking among investors and distorts price discovery in yet another segment of the bond market, adding to the mounting negative side effects of the ECB's monetary policy.

See "The ECB must change course" for more information on this topic

Authors:
Orcun Kaya (+49) 69 910-31732
Johannes Petry

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