CSPP 2.0: The "List"

Bank of America Merrill Lynch

Credit Analysis

25 September 2019

We've seen this movie before…and it ends well

QE is back in the Euro Area, and with it comes the return of the ECB's Corporate Sector Purchase Programme (CSPP). From November, we envisage the ECB buying €3bn to €4bn a month of Euro-denominated corporate bonds, but we think the risk is that they buy more than this, to help achieve the "QE infinity" tag. In a market that is already enjoying very favourable demand conditions, we see CSPP2.0 as being further bullish news for Euro corporate bond spreads.

Eligible or not eligible? That is the question

For investors, the return of CSPP means a return to thinking about credit based on "eligible" and "non-eligible" labels. The 2016-2018 QE experience highlighted the very straightforward, ETF-style, approach adopted by the ECB when purchasing eligible debt. Hence the importance of circling the universe of bonds likely to be in the ECB's scope. In this note, we provide – in a downloadable spreadsheet form – a list of ICE Bond Index constituents that we view as potentially eligible. We break-down further below the methodology underlying our screen.

A universe worth €803bn

1199 Euro-denominated corporate bonds – including 17 with a HY rating of BB1 – are included in our list of potentially CSPP-eligible debt securities. The sum total of this is €803bn, which we think offers the ECB plenty of QE "headroom". Note that to be CSPP-eligible, bonds must first be part of the ECB's *Eligible Eurosystem Collateral* list, which the central bank updates daily.

We find that French companies have the highest amount of potentially eligible debt, at €254bn. Yet, among large economies, Italy has the highest proportion of Euro-denominated corporate bonds potentially eligible – 58.7% of Italian corporate bonds might be eligible we think. Outside of the Eurozone, Swiss firms would benefit the most from CSPP2.0 as almost 40% of Swiss credits are currently CSPP eligible, in our view (because of their issuing entity). Conversely, just 4% of US credits meet the ECB's requirements.

By sector, CSPP feels friendlier – over the medium term – towards utilities and transportation, as over 70% of their outstanding debt is viewed as eligible. Euro-denominated autos offer a large pool of bonds (€163bn) but only around half of it meets eligibility criteria, we think, given auto bank debt is excluded from CSPP.

CSPP: Cosmopolitan credit

When launching CSPP1.0, the ECB were keen to see three things emerge: i) reduced fragmentation across corporate bond markets, ii) stronger company "animal spirits" via capex and employment growth and iii) wider access to credit, in particular to Small & Medium Enterprises (SMEs).

On this latter point, the ECB were keen to see the proof in the pudding, and hoped to see more "debut" issuers. CSPP1 was a success in this respect as 194 first-time issuers have tapped the € bond market since Mar '16. Interestingly, Reverse Yankees seem to have ridden this wave the most, with 56 US companies issuing a debut € bond over this period, more than any other country.

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Access the full list in Excel format here.

Refer to important disclosures on page 5 to 7.
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Unchanged criteria, with a (major) tweak

With limited information from Draghi on Sep. 12th regarding the design of CSPP2.0, we believe it will be fairly identical to CSPP1.0, with one important technical difference: the ECB will now be able to buy corporate bonds with a negative yield below the deposit rate, currently set at -0.5%.

Based on ICE/BofAML Euro Investment Grade (ER00) and High yield (HE00) credit indices, we apply the methodology below to build the list of potentially eligible corporate bonds provided in the spreadsheet available for download.

i) We check the ISIN of bond index members against the most recent *ECB Eligible Eurosystem Collateral* list. We exclude bonds not in the latter list.

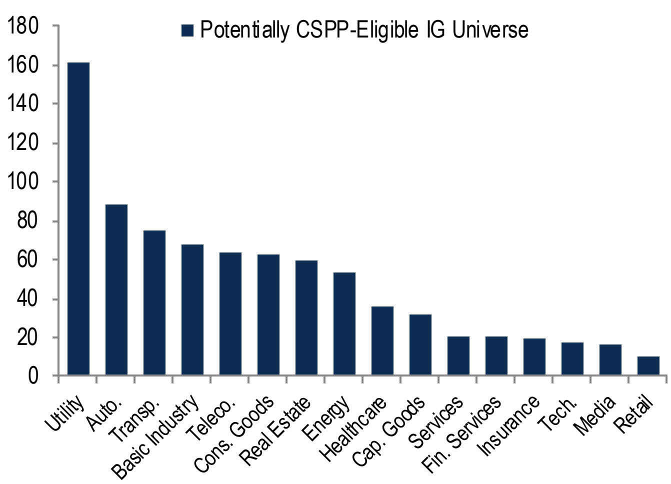
ii) Bonds issued by banks and internal banks of a non-bank parent are excluded. The latter are subsidiaries of car manufacturing firms.

iii) Subordinated bonds are excluded.

iv) We keep bonds with a remaining maturity of less than 31 years. Note that by definition, a bond must have a remaining maturity of at least one year to be a constituent of ER00 or HE00. We therefore miss the universe of eligible bonds with a remaining maturing between six months and less than one year.

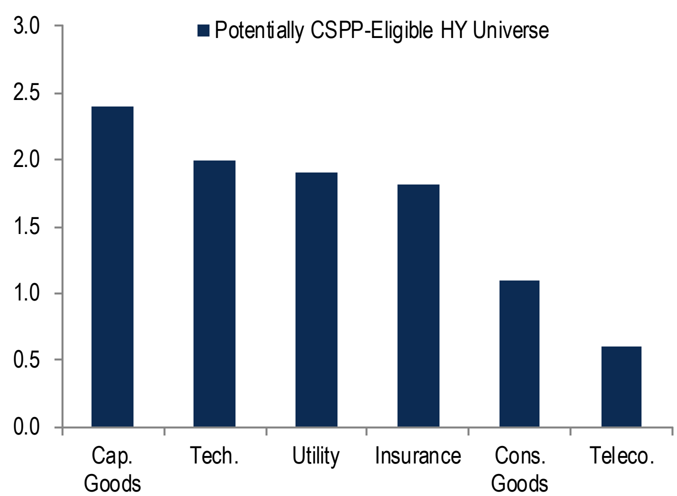
v) We keep bonds issued by firms whose ultimate risk is outside the Euro Area, but whose issuing entity is Eurozone-based. As such, a bond of a non-Eurozone company issued through a Eurozone-based subsidiary, and which meets all other criteria cited above, is viewed as potentially eligible.

Chart 1: Potentially CSPP eligible IG universe, by sector (Eur bn)



Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC.

Chart 2: Potentially CSPP eligible HY universe, by sector (Eur bn)



Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC.

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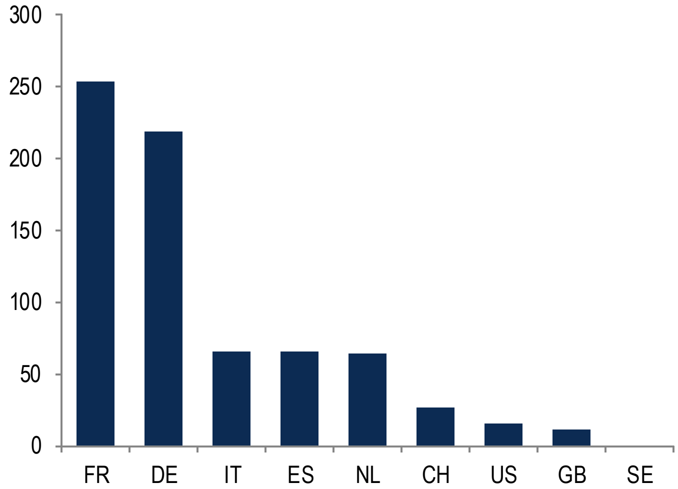
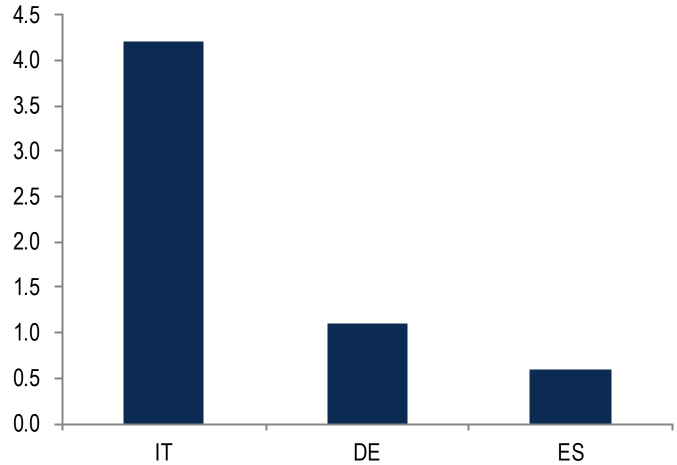
Chart 3: Potentially CSPP eligible IG universe, by country (Eur bn)



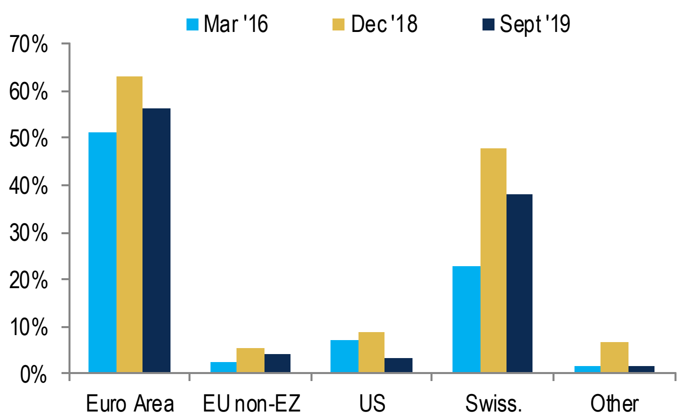
Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC.

Chart 4: Potentially CSPP eligible HY universe, by country (Eur bn)



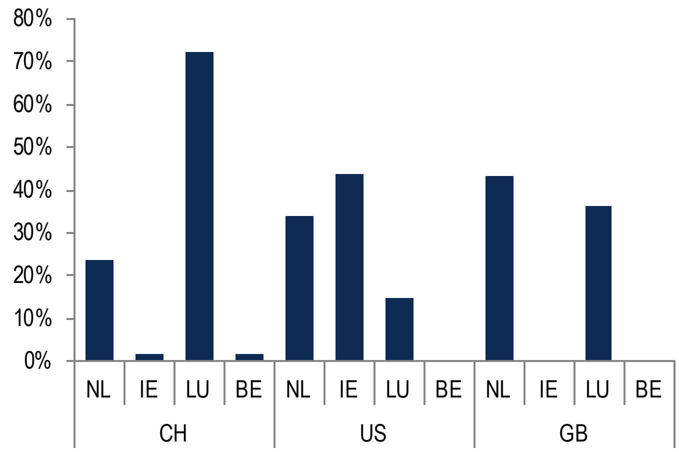
Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC.

Chart 5: CSPP sector eligibility: Euro IG, by country of risk: March '16, end '18 and today.



Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC.

Chart 6: Proportion of non-Eurozone (potentially) eligible debt issued via a Eurozone-based subsidiary. The Netherlands, Ireland and Luxembourg are favoured by non-Eurozone firms when registering a subsidiary.



Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC. % of CSPP-eligible debt.

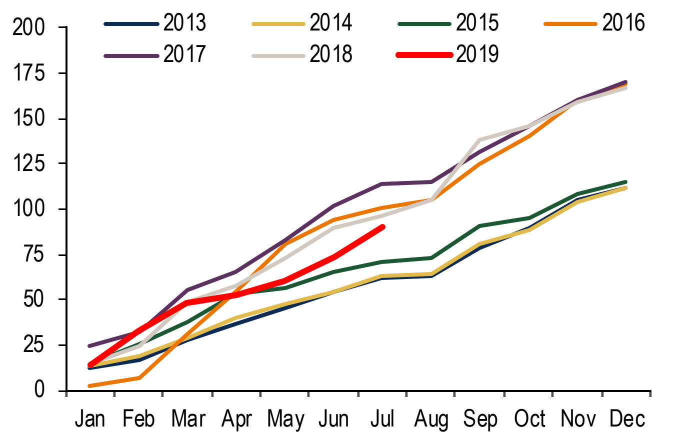
ECB will prioritize a rebalancing of its portfolio

2019 has seen a historically high volume of supply as more firms have aimed to benefit from plummeting yields. YTD, we estimate that just under €100bn of potentially eligible supply has been brought to the market (chart 7).

Throughout the CSPP1.0 years ('16, '17, '18), a materially higher proportion of eligible firms tapped the € bond market, as the ECB envisaged would happen. Chart 8 shows that in the three months that followed the end of CSPP1.0, the proportion of CSPP-eligible supply dropped to just 30% – against an average of around 45% between Jun '16 and Dec '18.

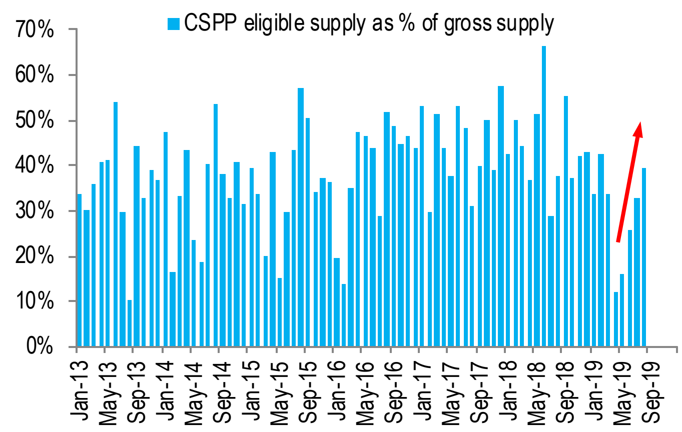
The (very) high volume of Reverse Yankee supply in 2019 – which is mostly non-eligible (although not all) – has contributed to this drop. Chart 9 highlights the material contribution from US firms to the growth of the € corporate bond market this year. Almost one in four deals in 2019 has involved a US firm, a record number.

Chart 7: CSPP-eligible supply (€ bn). Although CSPP-eligible supply is lower YTD than during the QE1 years ('16-'18), more eligible firms have issued lately.



Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC.

Chart 8: CSPP-eligible supply as % of gross supply. The Euro corporate bond market has seen a greater proportion of CSPP-eligible new supply lately...

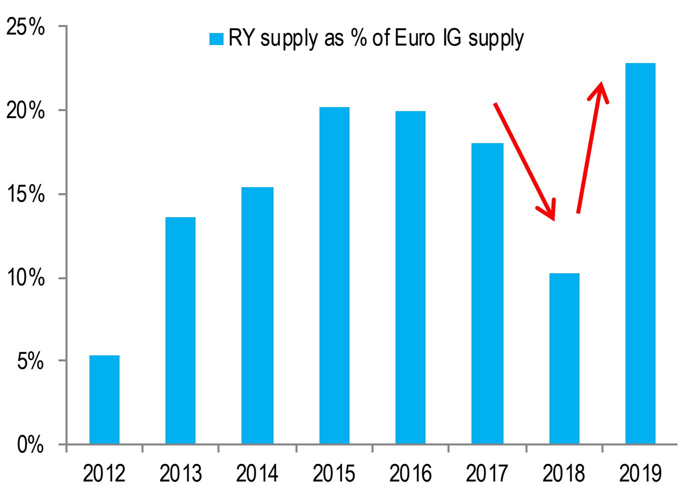


Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC. Index eligible gross supply.

This year's record volume of supply has had the effect of shifting the neutrality of the ECB's portfolio of corporate bonds.

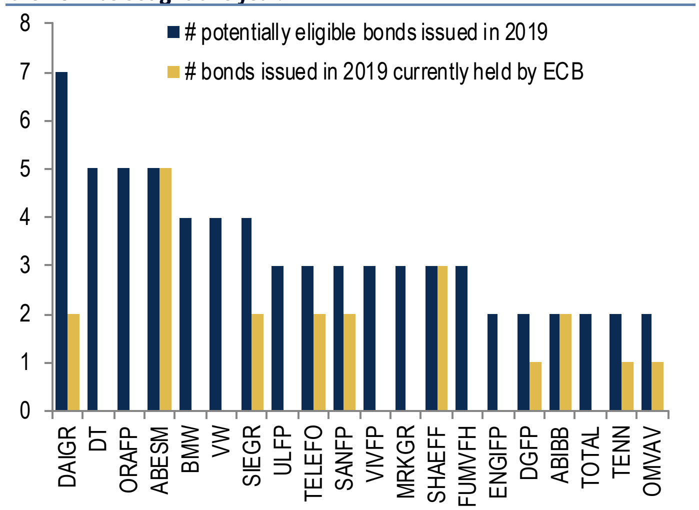
Chart 10 highlights those names that have issued the most eligible ISINs in 2019, and compares it to what the ECB have bought this year during reinvestment. From this chart, the ECB is likely to buy French and German names first. Daimler, Deutsche Telekom and Orange are this year's top 3 CSPP-eligible issuers.

Chart 9: ... as US firms have frontloaded their € issues in H1 '19. Reverse Yankee supply as % of Euro IG supply.



Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC. YTD volume for 2019.

Chart 10: The top eligible bond issues this year and how many of these the ECB has bought this year.



Source: BofA Merrill Lynch Global Research, ICE Data Indices LLC.

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