



EUROPEAN COMMISSION  
DIRECTORATE-GENERAL  
ECONOMIC AND FINANCIAL AFFAIRS

F1: Financial markets and financial intermediaries and  
SOF-B5: Borrowings and Treasury

ECFIN/629/01-EN

N° 28  
(July-September 2001)

## QUARTERLY NOTE ON THE EURO-DENOMINATED BOND MARKETS

### HIGHLIGHTS

The main developments in the euro-denominated bond markets during the **third quarter of 2001** were as follows:

- ◆ Issuance activity was disrupted by the terrorist attacks in the United States. A total of €308 billion was issued, implying a considerable decline from the total of €370 billion in the previous quarter. Nevertheless, third-quarter issuance almost equalled the €310 billion recorded in Q3/2000.
- ◆ Central governments were the dominant issuers. Private-sector issuance, particularly by corporates, was negatively affected by the events of 11 September.
- ◆ Increased uncertainty in bond markets was reflected in a shift towards smaller issues and shorter maturities.
- ◆ Issuance in euro came almost exclusively from within the euro-area and the share of the euro in international issuance declined to 32%.

---

The special feature is a review of developments in the euro-denominated bond markets in the three weeks following the terrorist attack

This series of notes, and a statistical annex, are available from the European Commission website at:

[http://europa.eu.int/comm/economy\\_finance/document/eurobond/eurobondidx\\_en.htm](http://europa.eu.int/comm/economy_finance/document/eurobond/eurobondidx_en.htm)

# THE EURO-DENOMINATED BOND MARKETS

## JULY - SEPTEMBER 2001

### GENERAL ASSESSMENT

*Bond issuance in euro was poised to record another strong performance in the Q3/2001, when the events of 11 September changed the situation dramatically. Nevertheless, the overall supply of euro-denominated bonds to the market equalled that of Q3/2000 despite the disruption experienced in the second half of September. The composition of supply reflected an increasing flow of government issuance, as the economic slowdown undermined budgetary consolidation and amid unfavourable issuing conditions for corporates in particular.*

### PART ONE

#### DOMESTIC AND INTERNATIONAL BOND ISSUANCE IN EURO

##### **Total bond issuance in euro**

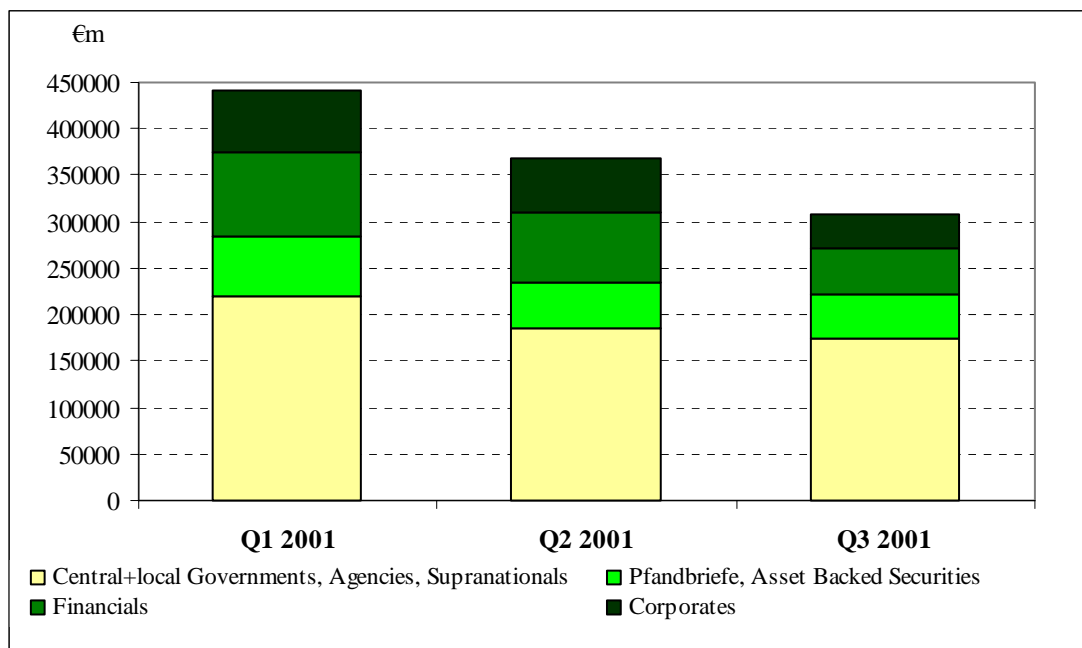
Euro-denominated bond issuance totalled €308 billion in Q3/2001, down by 17% from €370 billion in Q2/2001 but on par with the €310 billion recorded in the corresponding period of 2000<sup>1</sup>. Monthly issuance revealed the customary seasonal pattern, with issuance of €119 billion in July dipping to €77 billion in August and recovering to €113 billion in September. The trend in euro issuance up to 11 September was consistent with a favourable global trend, as continued weakness in equity markets shifted investor preferences towards fixed-income securities and an environment of low nominal interest rates encouraged corporate and financial issuers to raise their capital in the form of debt. Data from the US market indicate that for investment-grade corporate bonds, the average yield for intermediate maturities is now about 140 basis points lower than the average coupon, the largest such discount since the mid-1960's.

In terms of international issuance, the euro lost ground to the US dollar in Q3/2001. Based on Thomson financial securities data, US dollar issuance outpaced euro issuance by almost 75% compared to only 20% in Q2/2001, resulting in a decline in the euro's share in international issuance to 32% from 41% in Q2/2001. The shift toward dollar issuance reflected, among other things, the relative strength and resilience of the US dollar as a financing currency in volatile market conditions.

---

<sup>1</sup> Note: data from 1999 and 2000 have been revised from previous editions of this report. All figures quoted are from the DG ECFIN SOF database unless stated otherwise. In this database all euro denominated issues of an amount of EUR 50 mn or more are recorded. It should be noted that the database includes all issues of a maturity of 1 year or more (incl. in particular Italian and French discounted paper of usually significant issue amount). Throughout this note payment dates - as opposed to announcement dates - of new issues have been taken into account unless stated otherwise. Data are subject to revision.

**GRAPH 1 - ISSUING ACTIVITY IN EURO, VOLUMES AND COMPOSITION  
IN € MILLION**



	Q3 - 2000	Q3 - 2001
Central Governments	129.777	153.736
Other sovereign + agencies	19.307	19.910
Pfandbriefe	58.474	47.558
Financials	61.160	49.439
Corporates	41.445	38.072
<b>Total</b>	<b>310.163</b>	<b>308.715</b>

## Composition of bond issuance in euro

### Sovereign issuance

Total sovereign issuance was about €174 billion in Q3/2001, an increase of 16% relative to Q3/2000. All of this increase came from *central government issuance*, which rose by 18% to €154 billion as the economic slowdown has halted the improvement in public finances seen over the last two years. On the other hand, the declining quarterly trend in both 2000 and 2001 indicates a pattern of front-loading in this market segment. Current estimates suggest that full-year issuance by central government in 2001 will be up by €30-50 billion (about 6%-10%) relative to 2000.

*Issuance by agencies and other sovereigns* in Q3/2001 rose by 20% quarter-on-quarter but remained at the level seen in the corresponding period of 2000. The steady performance in this segment is partly due to the sustained activity of Freddie Mac, which began its euro issuance programme (€5 billion per quarter) in the third quarter of 2000.

## Financial-sector issuance

Financial-sector issuance was close to €50 billion in Q3/2001, a decline of 35% from the previous quarter and 20% lower than the level recorded in Q3/2000. While this segment was particularly affected by the events of 11 September, it has consolidated its share of total issuance in 2001. The growth in financial-sector issuance has reflected generally favourable issuance conditions in recent quarters and, more specifically, a relatively solid rating outlook for financial issuers as confirmed by earlier spread tightening relative to sovereign issues.

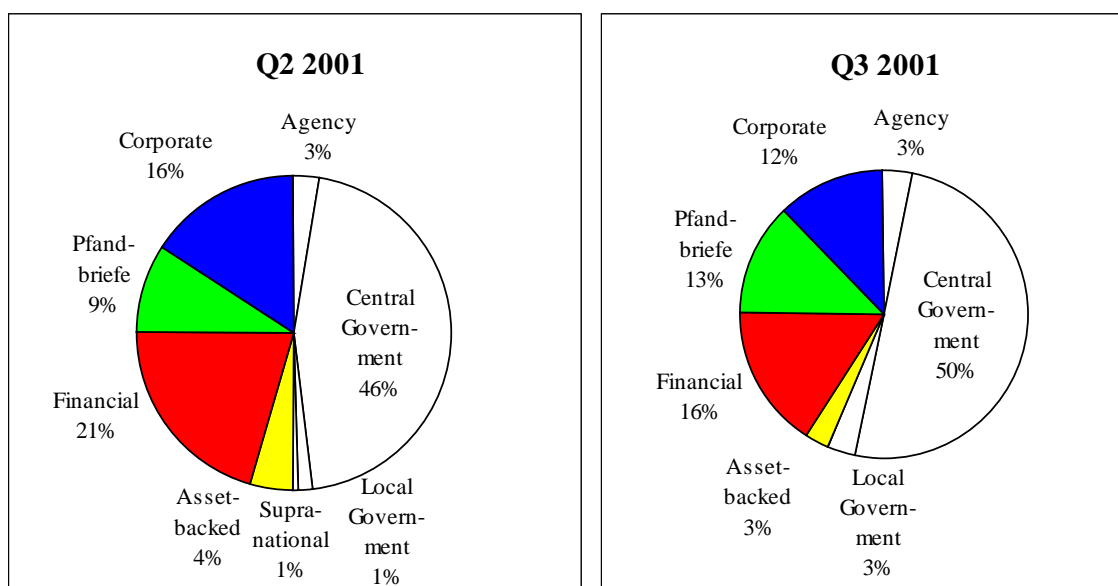
## Corporate-sector issuance

This market segment was the most adversely affected by events on 11 September, after which corporate issuance virtually dried up. Overall in Q3/2001, issuance declined to about €38 billion which is about 35% below issuance in the previous quarter. The market was unreceptive to lower-rated categories of issuers, with no issuance below triple-B. The lower-rated categories had enjoyed strong demand conditions earlier in 2001, as investors re-appraised their view of corporate bonds in light of the low government bond yields..

## Asset-backed issuance

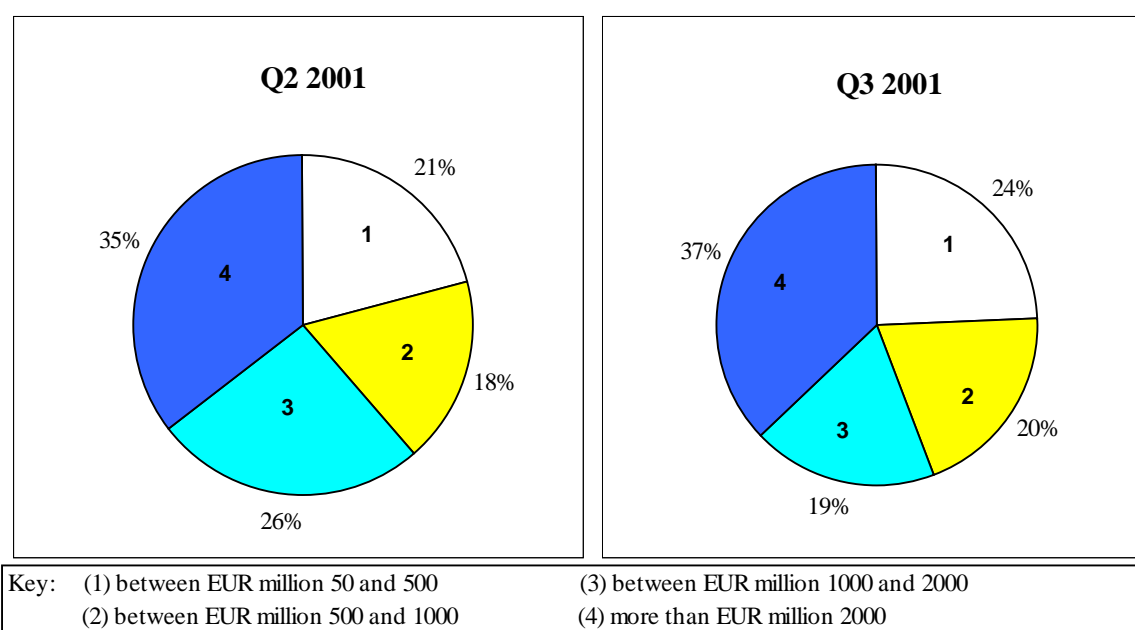
Asset-backed issuance was about €47 billion in Q3/2001, about 10% down on the previous quarter and also well down on Q3/2000. While there had been some spread tightening relative to LIBOR in the previous quarter, the asset-backed segment suffered badly from the events of 11 September with very poor liquidity in the segment as a whole. Pfandbriefe issuance held up reasonably well, while issuance of other asset-backed securities performed less well. This market segment had suffered some setbacks since the second half of 2000, with temporary reductions of liquidity and credit spread widening but had recovered somewhat in Q2/2001.

**GRAPH 2 - DIFFERENT TYPES OF ISSUER IN EURO, % OF TOTAL VOLUME ISSUED**



## Size of issues in euro

Reduced activity by all issuers except central governments has resulted in an increase in the share of very large euro-denominated issues in Q3/2001, although to a lesser extent than might have been expected. The share of medium-size issues declined from the previous quarter, as borrowers in this category issued less frequently and in smaller size as a reaction to the events of 11 September. Overall, there was a bias towards smaller-than-normal issues, with most issuers coming to the market with offerings below €500 million. Some stabilisation in issue size is likely in the future, as issuers respond to investors' demand for liquidity.



**GRAPH 3 - ISSUE SIZE IN EURO, % OF TOTAL VOLUME ISSUED<sup>2</sup>**

## Credit quality of issues in euro

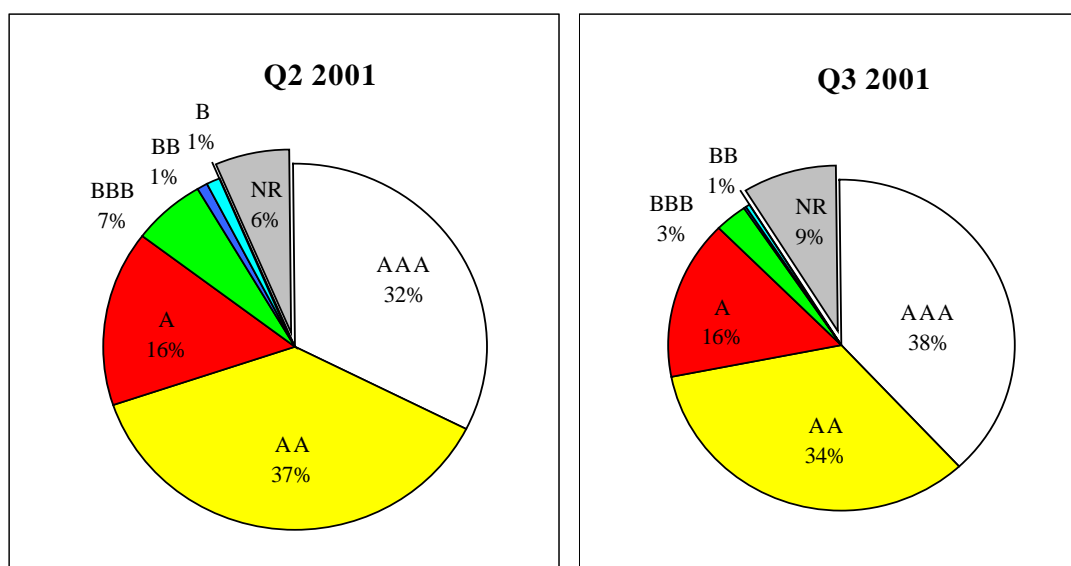
<sup>2</sup> It should be noted that the share of very big issues is substantially lower if only international issues are considered. This is because issues of domestic short-term instruments are usually very large in size.

The distribution of credit ratings on bonds issued in euro during Q3/2001 were as follows:

Bond Rating/ Distribution of issues	AAA	AA	A	BBB	BB	B	CCC	NR
% of total volume of issues	38%	34%	16%	3%	0%	0%	0%	9%
% of total number of issues	27%	20%	19%	4%	1%	1%	0%	28%

There share of AAA-rated issues in total issuance volume increased to 38% from 32% in the previous quarter. While the share of other A-rated issues was little changed, there was a 4-point drop in BBB-rated issues. The improvement in the average credit quality of issuance again reflects the stronger presence of sovereign issuers in the market. At the other end of the rating spectrum, the share of non-rated issues rose to 9% of issuance volume and to more than one quarter of the number of bond issues.

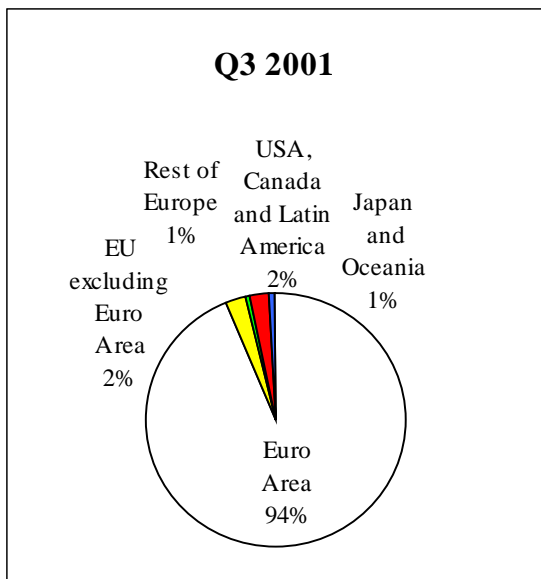
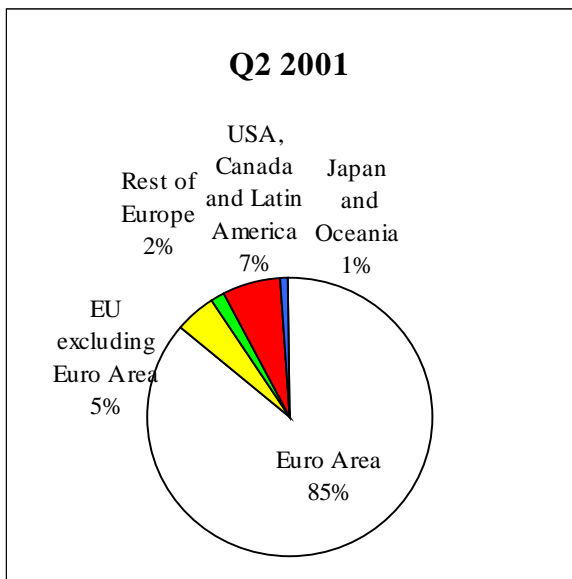
**GRAPHS 4 - RATINGS OF ISSUES IN EURO, AS % OF TOTAL VOLUME ISSUED**



### Geographical distribution of issuance in euro

The geographical distribution of issuance in euro has been stable for some time, with euro-area issuers dominating. The share of issues coming from outside of the euro area was 6%, well down from the 15% share (the highest since the launch of EMU) recorded in Q2/2001. This sharp decline is explained largely by the total absence of US issuers after 11 September.

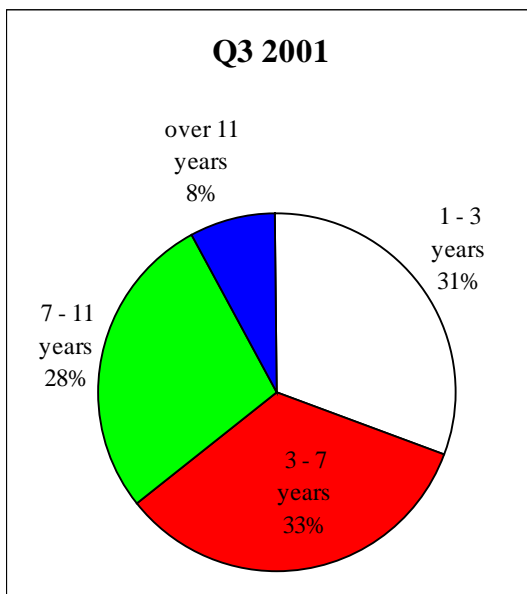
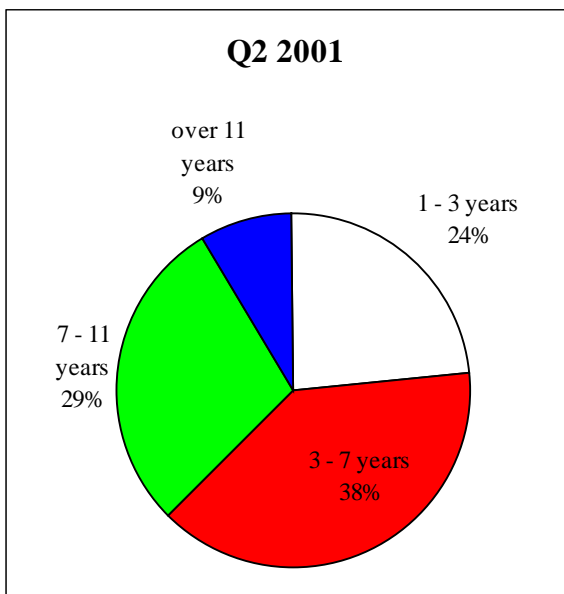
**GRAPHS 5- ORIGIN OF ISSUERS IN EURO, AS % OF TOTAL VOLUME ISSUED**



### Maturity structure of issuance in euro

The maturity of new issues in euro in Q3/2001 shifted toward the shorter end of the spectrum, with the share of issuance in the 1-3 year maturities rising mainly at the expense of issuance in intermediate maturities. There was also a marginal decline in issuance at longer maturities.

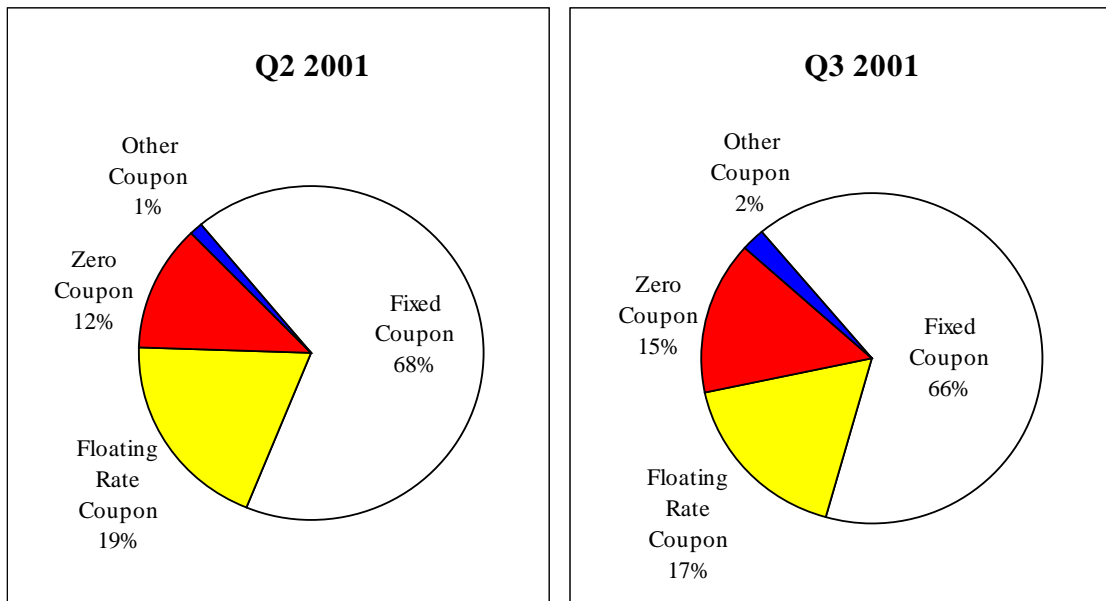
**GRAPHS 6 - MATURITY PROFILE OF ISSUANCE IN EURO, % OF TOTAL VOLUME ISSUED**



### Coupon types of issuance in euro

The coupon type of new issues in euro was little changed in Q3/2001 relative to the previous quarter. There was a slight increase in zero coupon bonds and a corresponding decline in both floating-rate and fixed-rate coupons.

**GRAPHS 7 – SHARE OF COUPON TYPE IN TOTAL VOLUME ISSUED IN EURO**



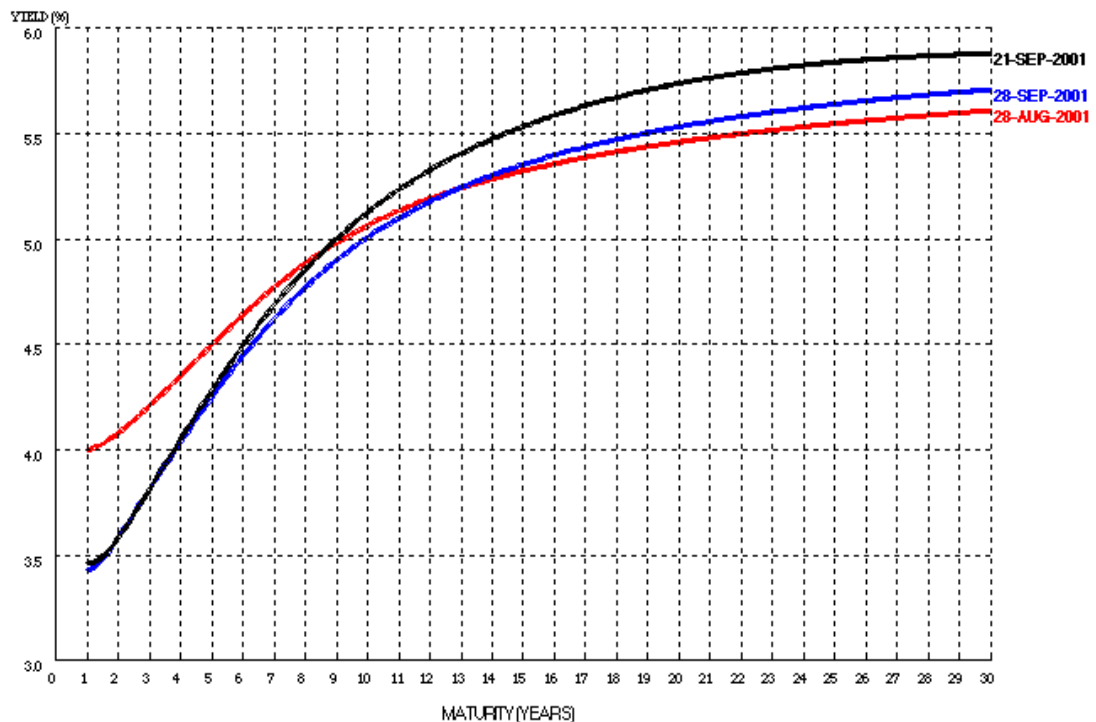


## PART TWO:

### EVOLUTION OF GOVERNMENT BOND YIELDS AND SPREADS

Long-term *government bond yields* have been variable within a range of 5% to 5.5% so far in 2001. The ten-year yield has fluctuated through the year, declining in Q1/2001, rising in Q2/2001, and then declining again to 5% in Q3/2001. Yields have also become more volatile as the year has progressed. The evolution in longer yields can be explained by several factors. In Q2/2001, yields were pushed higher as market participants reacted to growing evidence of a pick-up in euro-area inflation due to higher oil prices and a weaker exchange rate. In addition, there was a fall in demand for euro-denominated bonds amid heavy capital outflows from the euro area, mainly to the US markets. Evidence of a more pronounced slowdown in the global economy, together with a deceleration in capital outflows from the euro area, have led to a reversal of market expectations in Q3/2001. At the shorter end, the two-year yield fell by 75 basis points to 3.5% at the end of Q3/2001 from a relatively stable 4.3% in Q2/2001. The decline in shorter yields is largely due to the easing of monetary policy by the US FED and the ECB in the wake of the 11 September attacks.

GRAPH 8 – EURO YIELD CURVE <sup>3</sup>

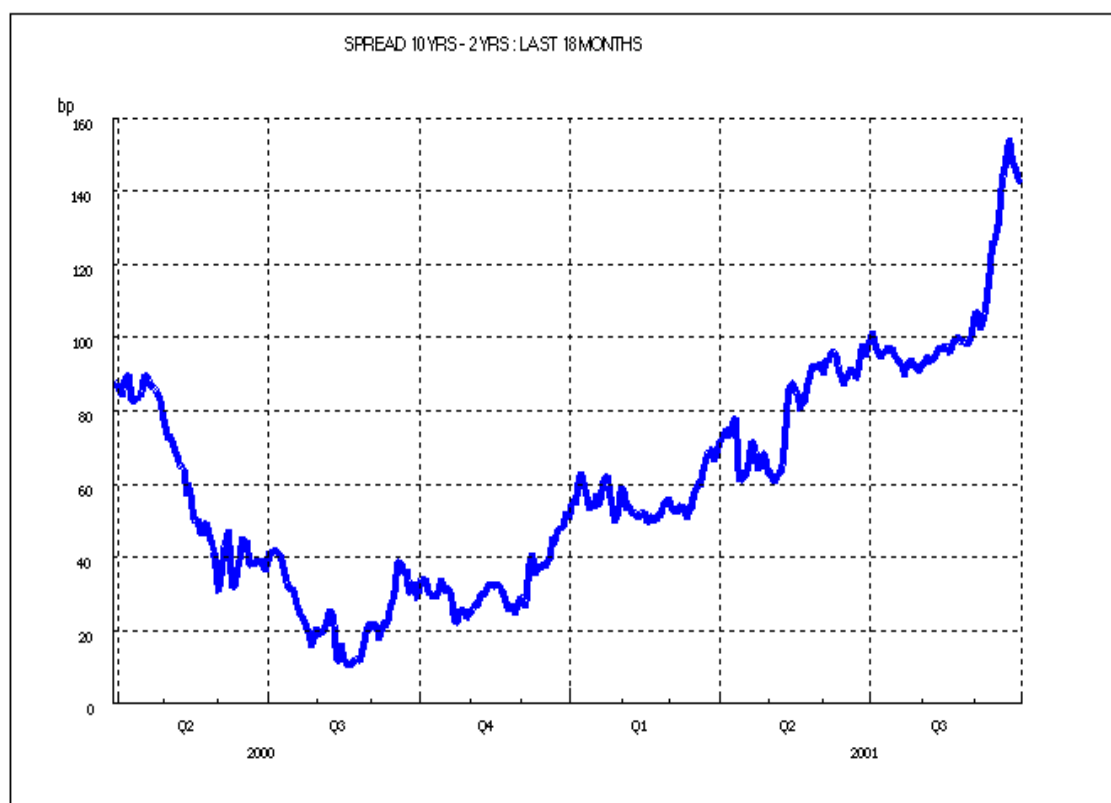


<sup>3</sup> Source: Eurostat (A daily update of euro yield curve can be found on the EUROSTAT internet site)

Maturity	1	2	3	4	5	6	7	8	9	10
31/12/99	3.70	4.27	4.56	4.77	4.94	5.08	5.21	5.31	5.41	5.49
31/03/00	4.18	4.53	4.74	4.89	5.02	5.12	5.21	5.29	5.35	5.41
30/06/00	4.90	5.06	5.12	5.16	5.21	5.27	5.32	5.37	5.41	5.45
30/09/00	5.13	5.17	5.20	5.24	5.27	5.31	5.35	5.38	5.42	5.45
31/12/00	4.68	4.60	4.60	4.64	4.72	4.80	4.89	4.97	5.04	5.11
30/03/01	4.27	4.26	4.33	4.42	4.52	4.62	4.72	4.82	4.90	4.97
29/06/01	4.26	4.35	4.47	4.62	4.76	4.91	5.04	5.15	5.25	5.33
28/09/01	3.42	3.59	3.81	4.04	4.25	4.45	4.62	4.77	4.90	5.01

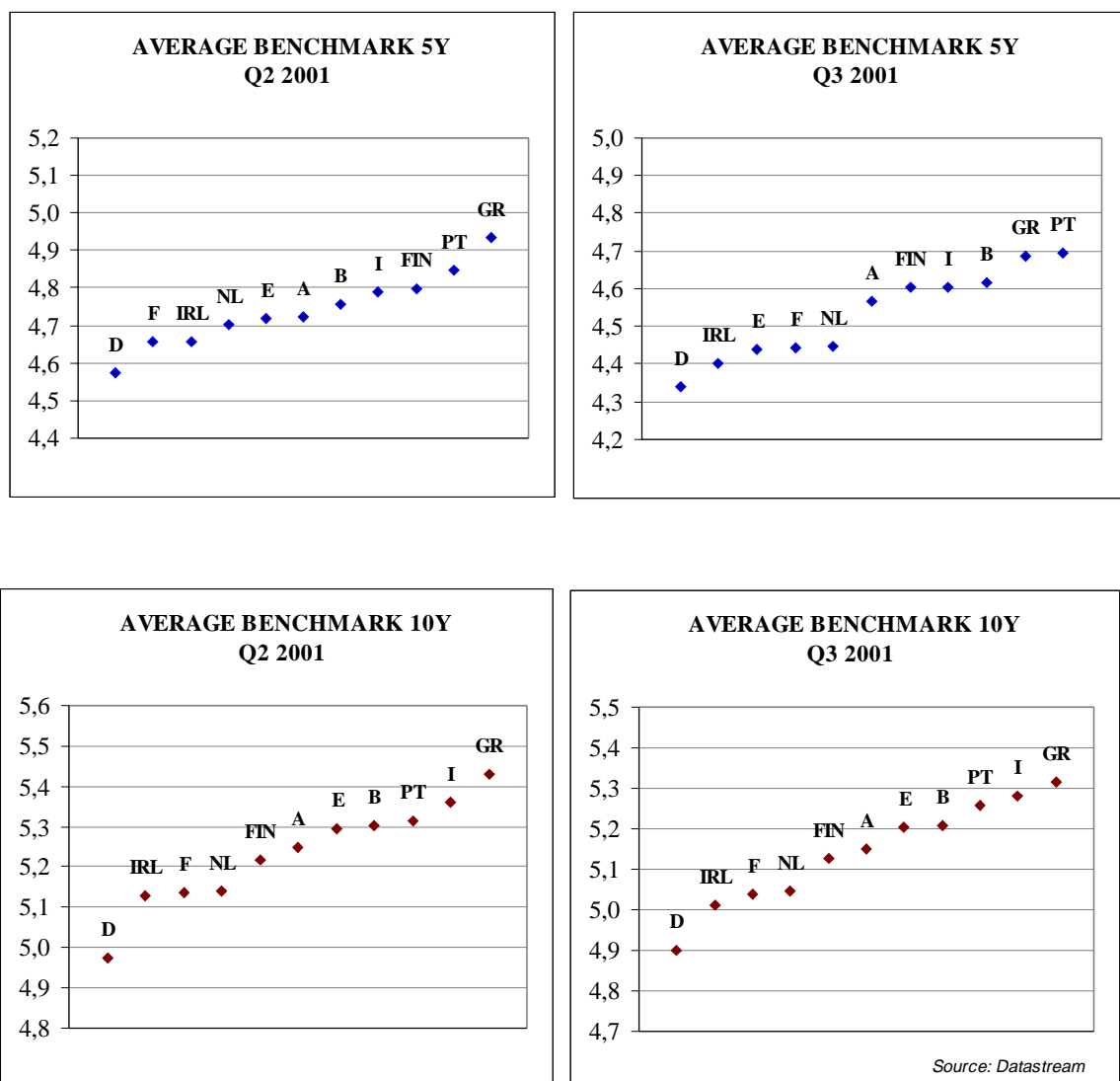
The trend widening in the *term spread* between two and ten-year yields (dating from August 2000) was reinforced in Q3/2001. The spread widened by 40 basis points to end the quarter just above 140 basis points. Market analysts attribute the steepening of the euro yield curve to the monetary policy decisions of the ECB, risk-averse behaviour among investors, and some minor concerns about supply at the long end as fiscal balances deteriorate.

**GRAPH 9 – EURO YIELD CURVE: SPREAD OF 10-YEAR OVER 2-YEAR YIELDS, Q4/1999 -Q1/2001**



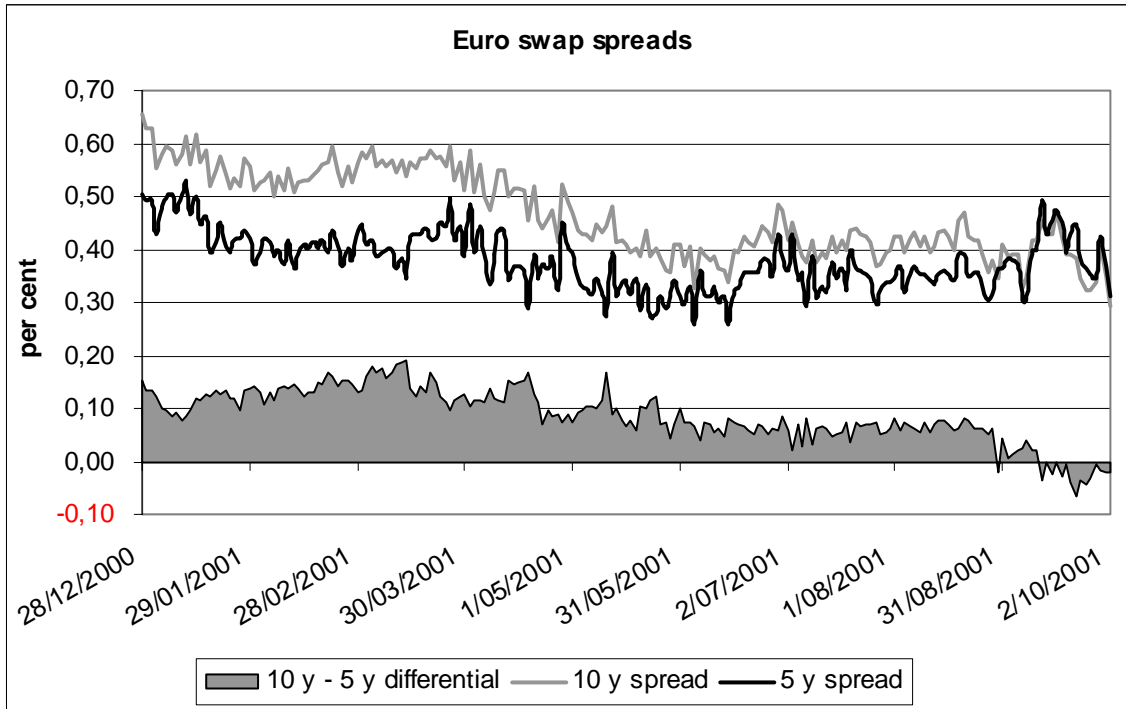
With respect to intra-area spreads in euro *government bond yields*, five-year spreads widened by a few basis points in Q3/2001 while ten-year spreads were stable in a range of 15-40 basis points. The widening of the five-year spread, even though very small, is notable in the context of a generalised reduction in other types of spreads. Swap spreads have fallen by 20 to 30 basis points since the beginning of the year for 5 and 10-year maturities (see graph 11). Also, according to Moody's investment services, AA-corporate bond spreads in the euro area have fallen by 20 basis points since March this year. It should be observed, however, that this presentation focuses only on the relative position of 5- and 10-year maturities, where the German bund has established benchmark status. At other maturities, the picture is somewhat different. For instance, at the 2-year maturity, spreads have declined substantially in recent weeks to single-digit figures for several government issuers.

**GRAPH 10 – YIELD SPREADS ACROSS SOVEREIGN DEBT ISSUERS IN 2001**



The graph below depicts the evolution of euro *swap spreads* so far in 2001. It is notable that the normal situation - with higher spreads for longer maturities - was inverted in the first half of September. Market commentators attribute this development partly to the events on 11 September and partly to an announcement by the French Trésor that it plans to undertake significant swap transactions this year and next year.

**GRAPH 11 – SWAP YIELD SPREADS AND DIFFERENTIAL 10-YEAR OVER 5-YEAR**

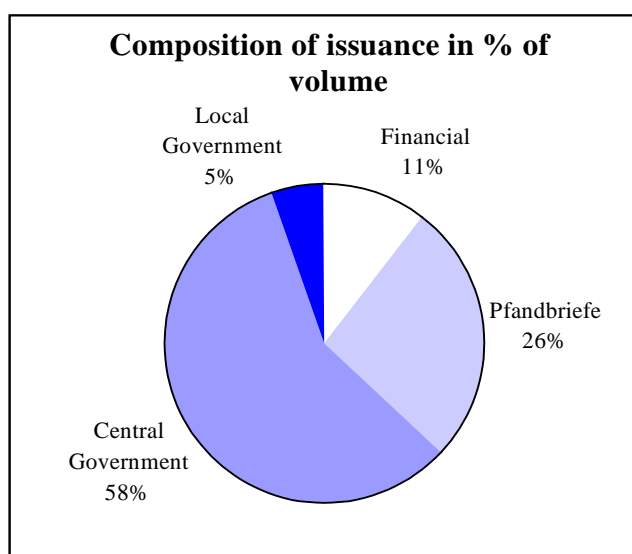


## PART THREE:

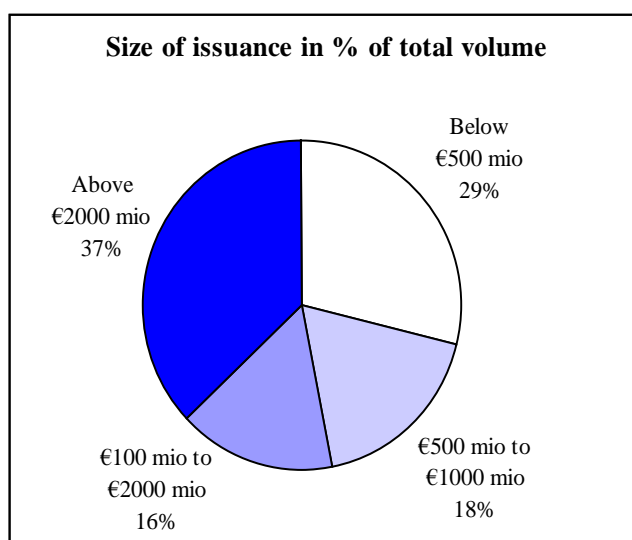
### **THE EURO-DENOMINATED BOND MARKET AFTER THE 11 SEPTEMBER TERRORIST ATTACK<sup>4</sup>**

The terrorist attacks in the United States on 11 September 2001 threatened major disruption in the functioning of financial markets. The scale of disruption was limited by the concerted action of major central banks and there has been no evidence of significant distress in the international financial system. Nevertheless, the functioning of the euro-denominated bond market was adversely affected in the weeks following the attacks, and did not return to normal until the beginning of October.

**In the period from 12 to 30 September as a whole**, only 99 euro-denominated bond issues - totalling €42 billion – were recorded in the Commission database. This pace of issuance is about 50% below normal. The composition of bond issuance also differed from normal, with central government issuers dominating. Scheduled government issuance went ahead as planned, but there was only limited issuance in smaller size from financial, Pfandbriefe and other sovereign issuers. There was no issuance in euro recorded from corporate, agency or supranational issuers and no issuance in euro from issuers outside of the EU.



**In the immediate aftermath of the attacks**, normal trading volumes were seen only in the bond futures market. Activity in all other market segments was well below normal. Trading of euro-denominated government bonds in the secondary market was at only half of its normal volume and the quoting requirements of the electronic markets were temporarily suspended. Secondary trading in corporate bonds was only 10% of normal with investors mainly on the sidelines. The bond repo market remained illiquid.

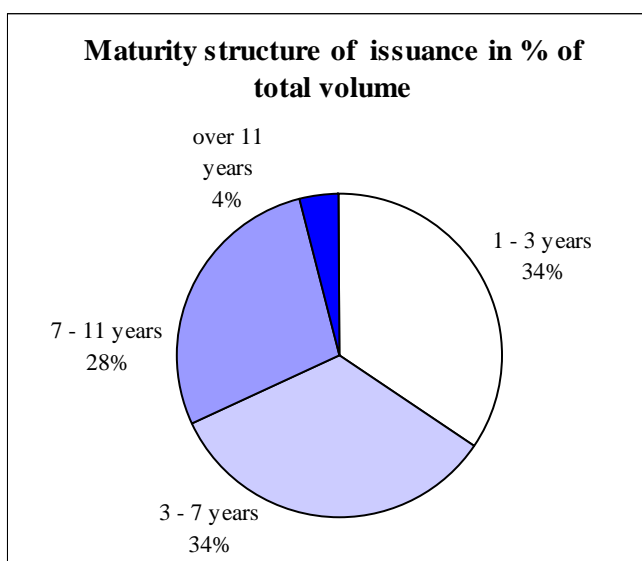


<sup>4</sup> This in-depth look at developments from 11 September to the end of September draws on information from the Commission database as well as market sources.

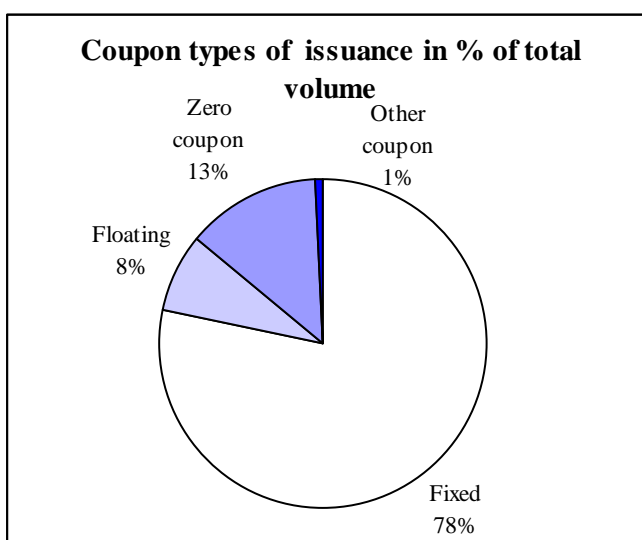
Settlement systems reported some failed trades, but these were limited and settlement operations were soon back to normal.

**In the third week of September**, most market segments struggled to restore normal levels of activity. Trading volume in bond futures remained strong, reflecting a sustained high demand for derivative instruments in volatile conditions. The usual quoting requirements on the electronic markets were reinstated at the beginning of this week, but normal trading activity was not restored for some days. Liquidity in the government bond market was more or less back to normal, although the bid-offer spreads remained wider than usual and prices were volatile in thin volumes. Bond repo markets were still in risk reduction mood, with limited liquidity.

Activity outside of the government sector began to pick up, with some limited issuance by financials and Pfandbriefe at much shorter maturities than normal. Spreads on corporate bonds continued to widen on all but the highest quality issues and trading remained below half of normal volume all through the week. There was no new corporate issuance. Holders of lower-rated bonds lacked the necessary liquidity to substantially reduce the size of their positions. Many investors, while not necessarily having reduced their positions, appeared reluctant to commit to new investments outside the government sector, despite relatively attractive valuations.



**In the last week of September**, the activity level of the euro-denominated bond market began to normalise, as investor sentiment appeared to improve. The government sector performed well early in the week with liquidity returning also to non-benchmark bonds. The publication of the German fourth quarter issuance calendar eased fears of over-supply and the Italian auction of 3-year securities was well received. The bulk of issuance brought to the market was in the form of plain vanilla fixed-rate bonds. Activity in the bond repo market remained somewhat below normal, with no real flows observed in the market.



The non-government sector of the market struggled with low volumes all through the week, making it difficult to price new issues. According to the Commission database<sup>5</sup>, corporate issuers remained absent from the market. In contrast, the pace of corporate bond issuance in the US market in the three weeks after 11 September fell by only one third relative to the average for 2001 up to that date.

---

<sup>5</sup> The Commission database use payment date to determine if an issue is included in the current period or not. In this case, this means that no corporate bonds were launched after 11 September with a payment date in September.