

GlobalCapital

# REVIEW 2022 OUTLOOK 2023

December 2022



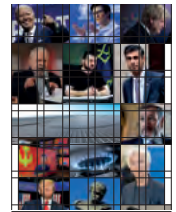
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# REVIEW OF THE YEAR 2022 AND OUTLOOK 2023

GlobalCapital  
REVIEW  
2022  
OUTLOOK  
2023  
December 2022

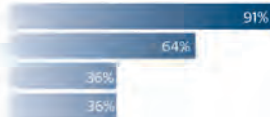


## Overview

- 4 DCM Survey**  
The *GlobalCapital* survey of heads of debt capital markets
- 12 Ukraine Interview**  
Ukraine takes the fight to the financial markets
- 20 Investment Banks**  
Toppled CEOs, new CFOs and Credit Suisse woes

## Public sector borrowers

- 24 SSA Bond Deals of the Year**  
Extraordinary deals for an extraordinary year
- 26 LBBW SSA Roundtable 2022**  
SSA issuers show strength and agility amid market turbulence
- 35 SSA Outlook Survey**  
SSA market braces for tough times but optimism remains
- 38 SSAs in Figures: Primary Market Monitor**  
When the going gets tough: end of easy money for SSAs laid bare
- 40 MDB Reform**  
Capital innovation will take MDBs some way, but not all
- 46 MDB Financial Engineering**  
Creative tension set to shake up MDB financing

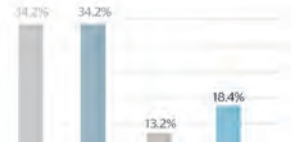


## Swiss Francs

- 50 Swiss francs**  
Swiss franc bond market returns to strength

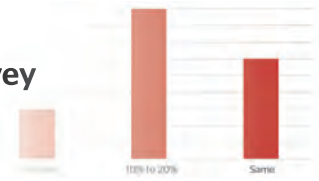
## Financial institutions

- 53 FIG Bond Deals of the Year**  
Winning deals give comfort to FIG market after rocky year
- 54 Covered Bonds**  
Covered bonds set to thrive in tricky 2023
- 57 FIG Bond Market Outlook Survey**  
Banks face heavy refinancing as expectations improve
- 62 FIG in Figures: Primary Market Monitor**  
A brave new FIG world as era of low spreads and coupons ends



## Corporates

- 64 Corporate Bond Deals of the Year**  
In fair markets and foul, winners found a way
- 66 IG Bond Market Survey**  
High hopes for corporate issuance in 2023
- 68 Company Treasurers' View**  
Worst markets for years keep treasurers on their toes
- 70 IG Corps in Figures: Primary Market Monitor**  
Companies cough up in public bond market
- 71 Loans Awards Nominations**  
The 20th Annual Syndicated Loan and Leveraged Finance Awards nominations
- 75 Syndicated Loan Market Outlook Survey**  
Loan market's cloudy outlook contains a ray of green light



**Emerging markets**

**77 EM Bond Deals of the Year**

Volumes drop and premiums vary in tough year for EM

**80 CEEMEA DCM Outlook Survey**

The only way is up for CEEMEA bond markets

**83 CEEMEA Bond Bookrunners**

CEEMEA bond houses: beaten but not broken

**85 Investor Flows**

EM investors hope inflation turn will draw cash back in

**87 LatAm Bond Market Outlook Survey**

LatAm bonds on the rebound but Fed to dictate recovery



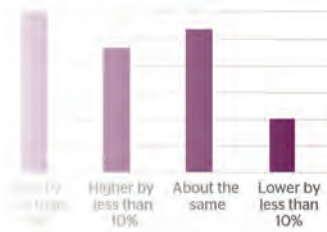
**Securitization**

**90 US Market Survey**

Challenges remain but US looks forward to a better year

**93 European Market Survey**

Buckle up: European ABS braces for bumpy ride in 2023



**Equity capital markets**

**96 Convertibles**

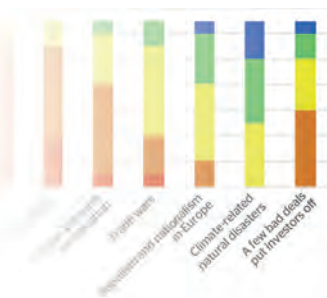
A strong option: convertibles market bullish after tough 2022

**98 IPOs**

Redemption beckons after 'worst IPO market any of us has seen'

**102 Middle East**

Middle East IPO boom set to run on into 2023 and beyond



**REVIEW 2022 2023 OUTLOOK**

**Euromoney Institutional Investor PLC**  
8 Bouverie Street, London, EC4Y 8AX, UK  
Tel: +44 20 7779 8888 • Fax: +44 20 7779 7329  
Email: first.name.last.name@globalcapital.com  
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CEO, Financial & Professional Services division, Euromoney Institutional Investor PLC: Jeff Davis  
CEO of NextGen Publishing, Financial & Professional Services division: Isaac Showman

Head of editorial development: Mariana Valle  
Managing editor: Toby Fildes  
Frequent issuers managing editor: Ralph Sinclair

**PEOPLE & MARKETS**  
People and markets editor: John Crabb

**PUBLIC SECTOR and MTNs**  
SSA and MTN editor: Addison Gong  
SSA reporter: Georgia Lee

**FINANCIAL INSTITUTIONS**  
Banking and Europe editor: Atanas Dinov  
Covered bond editor: Bill Thornhill  
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**SECURITIZATION**  
US bureau chief: Oliver West  
Deputy US securitization editor: Tom Lemmon  
US securitization reporter: Ayse Kelce

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Equities editor: Aidan Gregory  
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**EMERGING MARKETS**  
Emerging markets editor: Francesca Young  
Senior emerging markets reporter: George Collard

Head of visuals: Gerald Hayes  
Production: Sarah Minns, Antony Parselle  
Night editor: Julian Marshall  
Sub-editor: David Jones

Cartoonist: Oly Copplestone • smokingbiplane@hotmail.com

Publisher: Jack Thomson +44 20 7779 8083  
Commercial director of events: Katherine Tapper +44 20 7779 8607

**Marketing**  
Irena Gornja +44 20 7779 7374  
Louise Bellwood +44 20 7779 8345  
Kristina Lakstutyte +44 20 7779 8888

**Customer Success**  
James Anderson +44 20 7779 8338  
Customer Services: +44 20 7779 8610

**Subscriptions & Licensing**  
Dean Gounden +44 20 7779 8030  
Allan Uchendu +44 20 7779 7909  
Jordan Craig +44 20 7779 8888  
Giuliano Chianelli +44 20 7779 7385

**Directors:** Henry Elkington (Chairman of the Board), Wendy Pallot (CFO), Janice Babiak (Senior Independent Director), Colin Day (Independent Non-Executive Director), Imogen Joss (Independent Non-Executive Director), Tim Pennington (Independent Non-Executive Director), Lorna Tibbian (Independent Non-Executive Director).

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# GlobalCapital

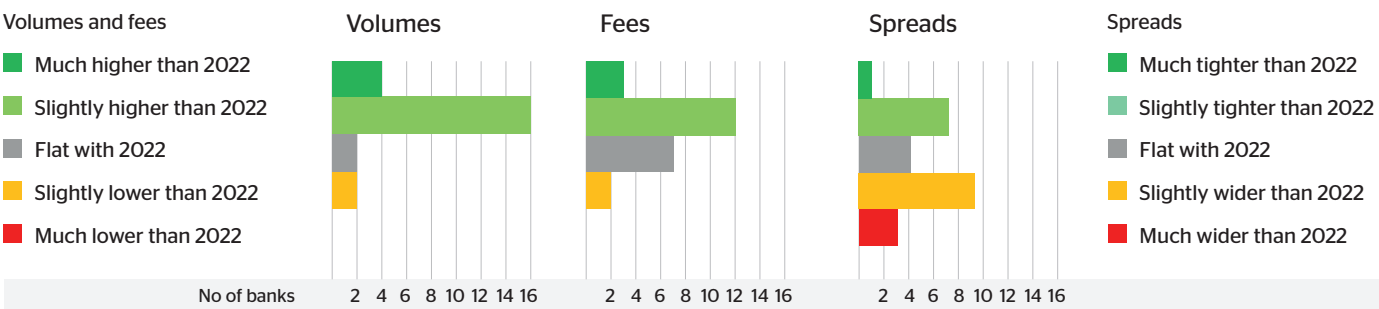
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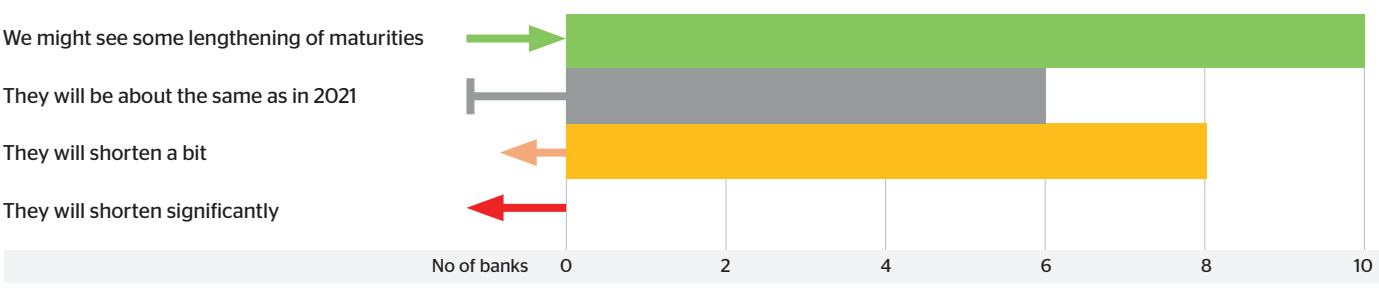
# The *GlobalCapital* survey of heads of debt capital markets

*GlobalCapital's* **Toby Fildes** surveyed the heads of debt capital markets at 24 of the top 25 banks in the bond market in November, to ask their views on how the market will evolve in 2023. While there are some signs of optimism, their stance overall is wary. The Russia-Ukraine war is still regarded as the biggest source of danger, but China-Taiwan has shot up the agenda. Information design **Jon Hay, Antony Parselle**

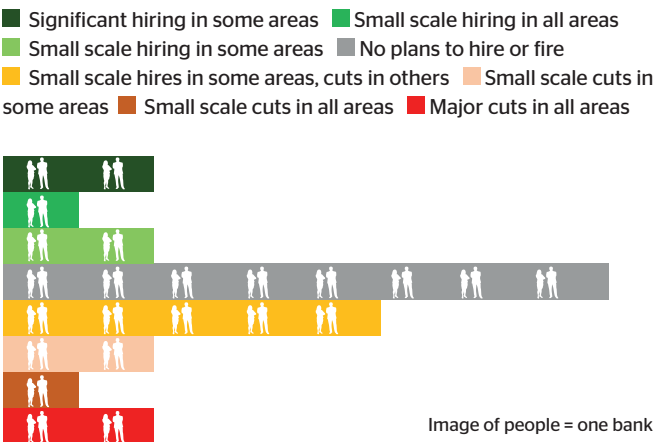
## What are your predictions for primary bond markets in EMEA in 2023?



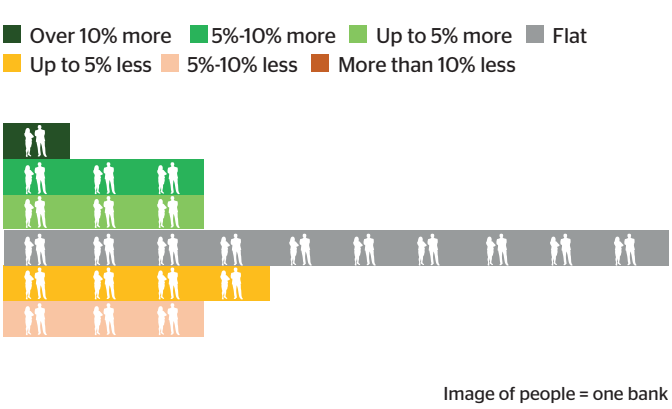
## What is your prediction for maturities in primary EMEA bond markets in 2023?



## Will you be hiring or firing in 2023?



## Overall, will there be more or fewer people working for you by the end of 2023 than now?



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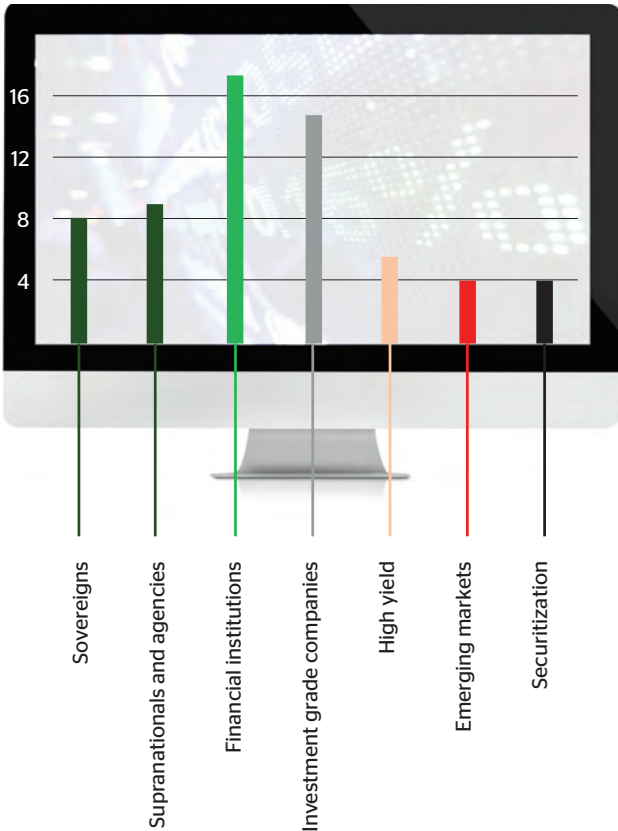
### In which countries or regions do you expect to increase or reduce headcount?

● Significant hiring  
 ● Small scale hiring  
 ● Significant firing  
 ● Small scale firing

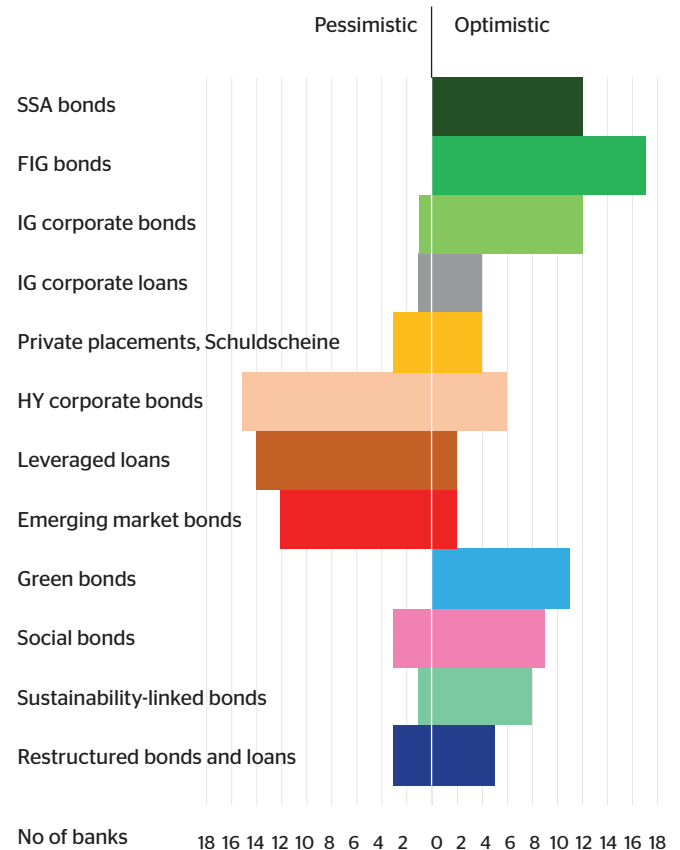
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EMEA	EU	UK	France	DACH	Luxembourg	Spain	Italy	Asia Pacific	Hong Kong	EM	ESG	SSA

### Which sectors/client groups are you most optimistic about for 2023 in terms of revenues?

No of banks

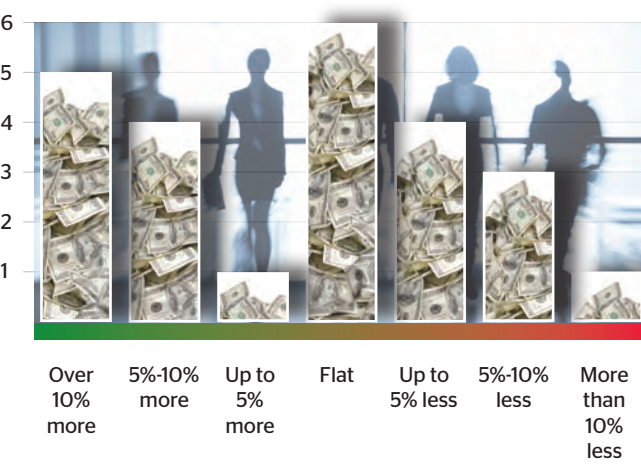


### Which products are you most optimistic and pessimistic about for 2023, by volume?

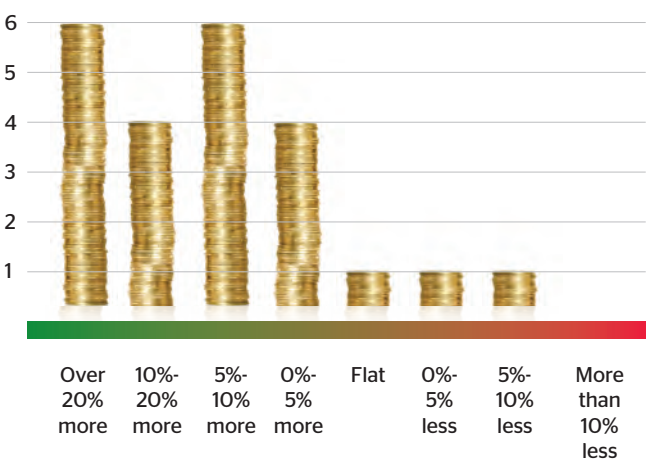




Do you expect your MDs and directors to be paid more or less in 2023 than in 2022?



Do you expect your business to make more or less money in 2023 than in 2022?



Thinking about 2022 compared with 2021, how has the rate at which competitors have poached or attempted to poach your staff changed?

For MDs and directors

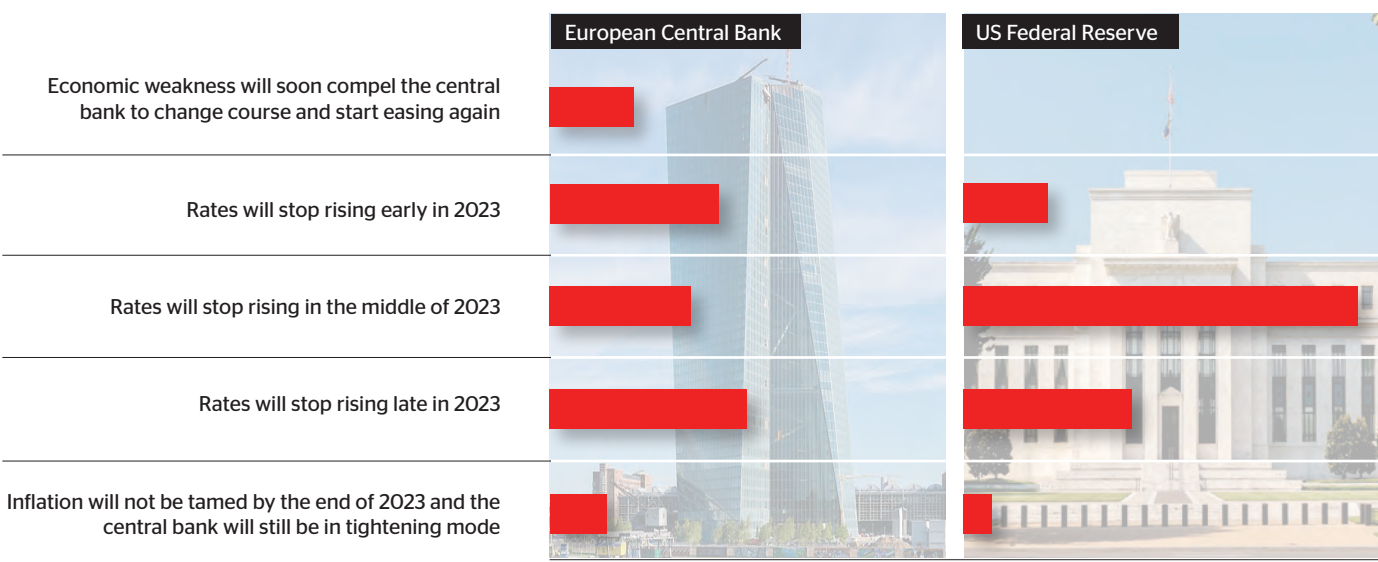


For associates and analysts



Decreased sharply    Somewhat decreased    Stayed the same    Somewhat increased    Increased sharply

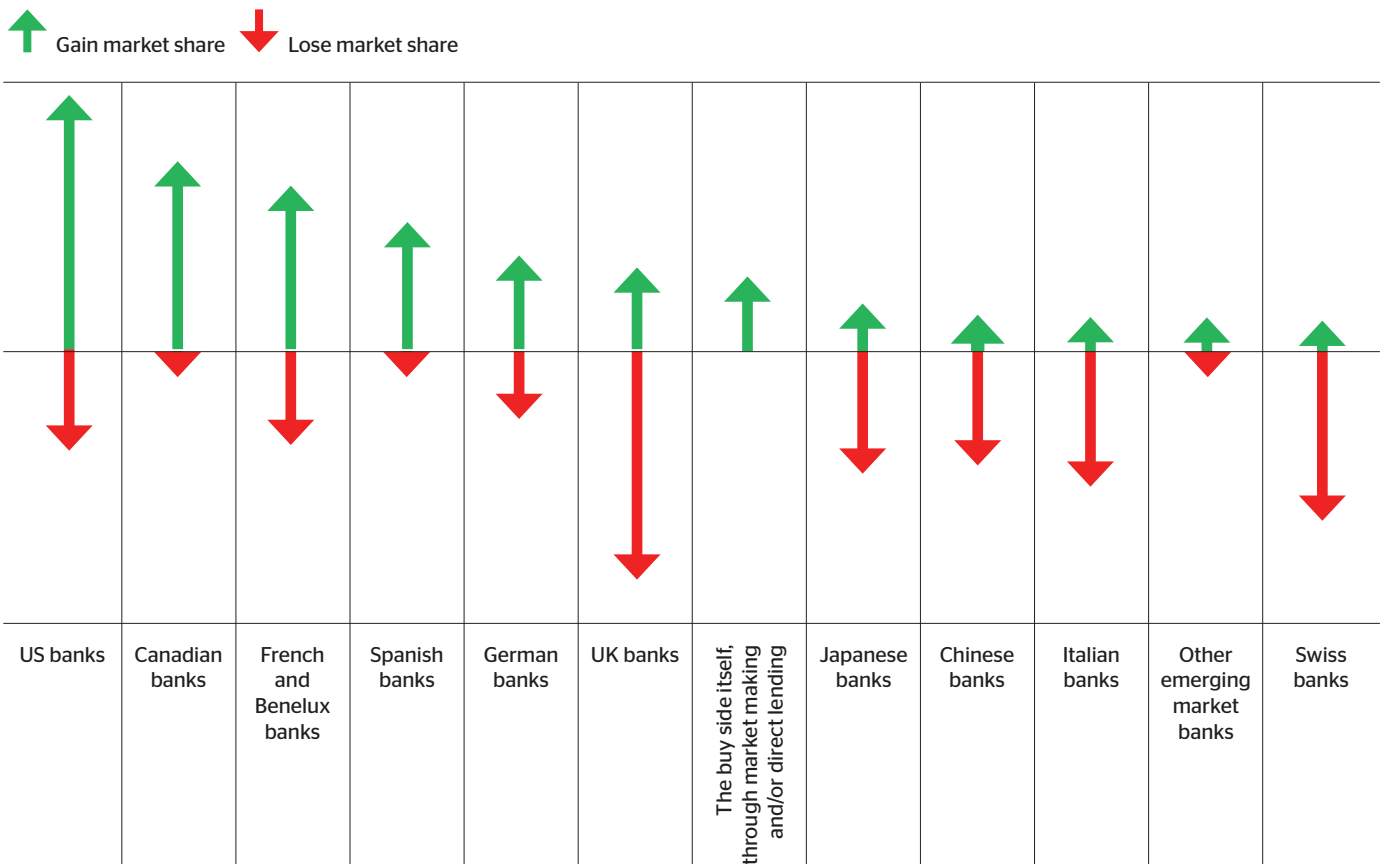
How aggressively will central banks tighten monetary policy in 2023?



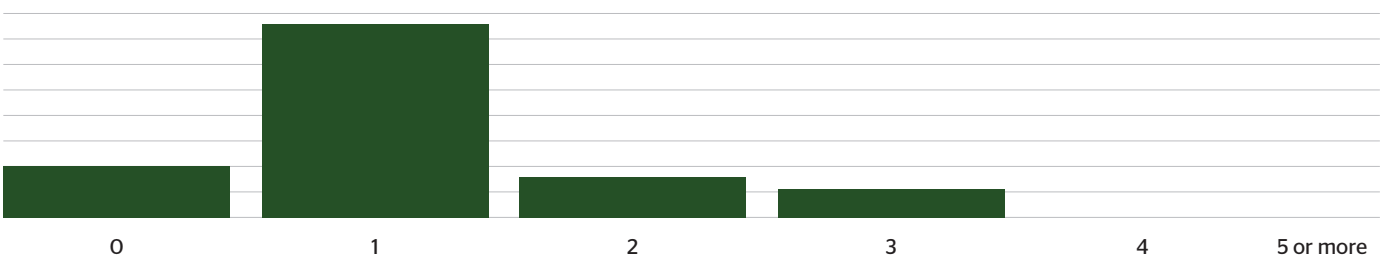
Which sectors of the market will have the most exciting technological developments?



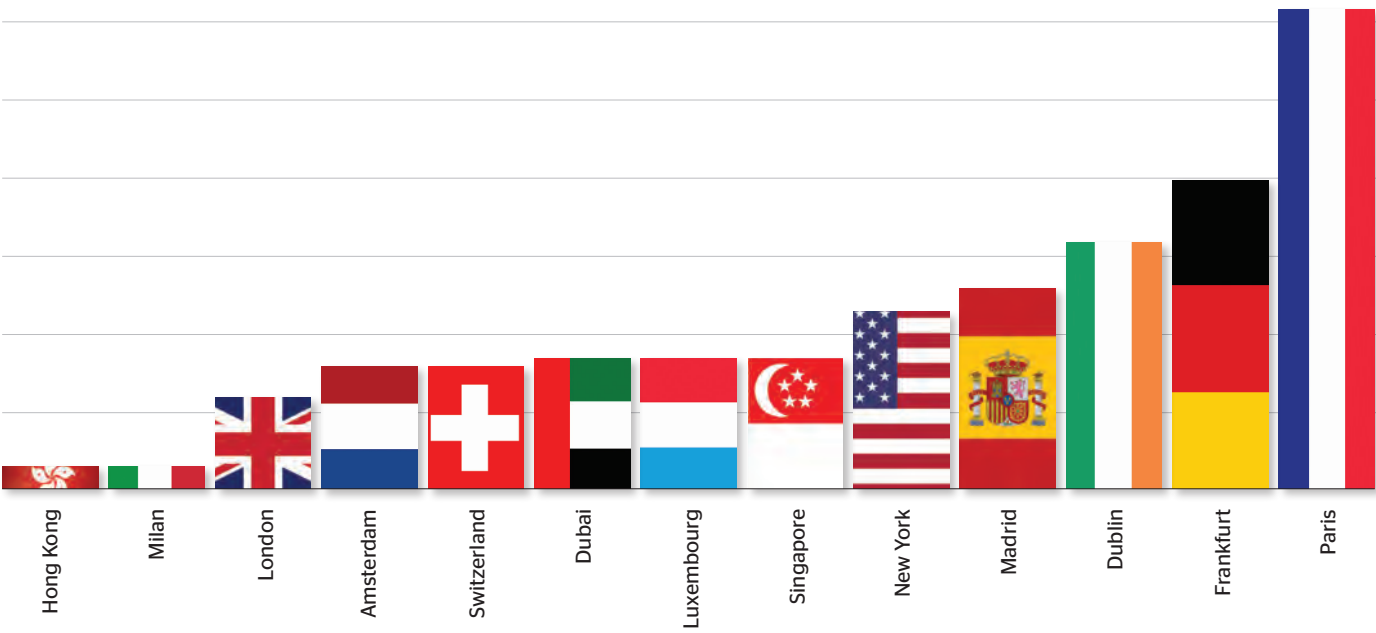
Which banks do you expect to gain/lose market share in EMEA DCM the most in 2023?



How many bank mergers (announced or completed) can we expect to see in 2023 that will involve a top 25 bookrunner bank?



Which financial centres will continue to benefit most from Brexit?



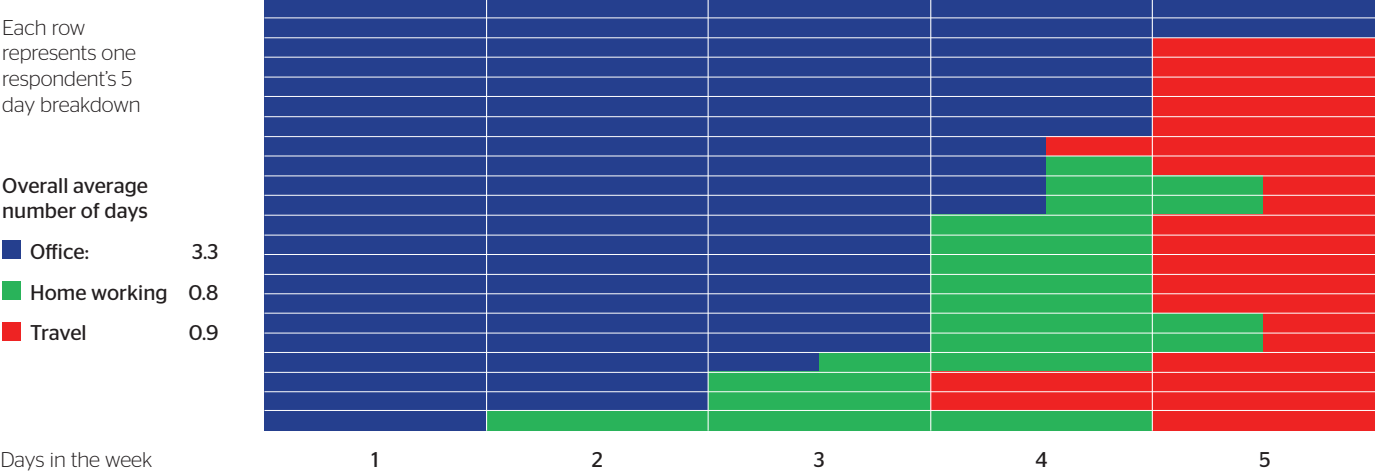
During 2022, front office capital markets staff continued to be shifted from London to European cities to meet demands from regulators in the wake of Brexit. How would you characterise the moves in your own firm?

- Relocations due to Brexit were mostly or completely finished in 2021
- Relocations due to Brexit were mostly or completely finished in 2022
- There will continue to be substantial relocations due to Brexit in 2023
- Future relocations due to Brexit cannot be predicted because they depend on the stance adopted by regulators



One DCM head said "Marginal relocations due to Brexit will continue over the next decade."  
 Another said "I don't think Brexit is going to make a difference as the plumbing is already in place."  
 A third did not think Brexit mattered any more.

What is your average split of time between the office, home working and travel?



### Which of the following risks to DCM in 2023 are the most likely, and which would have the most severe impact?



### Some of us have started to attend large market events in Europe. Will we return to pre-pandemic habits?

- Yes - we are now going to as many events as we did before
- Yes - but we are being more picky and only attend those that have critical mass and can be combined with other meetings
- We're only going to a few - and are happy to rely on remote attendance otherwise
- We are no longer travelling to events unless very local
- We are no longer attending events - remote is the way to go




### Have we returned to the same level of travelling as before Covid?




- Yes - we're earning even more airmiles than before
- About the same as before
- Less - we are still getting on planes but it is more controlled and efficient
- Much less travel is needed - Teams/Webex/Zoom are fine for nearly all purposes

### Sustainability-linked bonds grew sharply in 2022. What do you think of them?


A great product – they are an important part of the transition and will continue to grow



They are an interesting product but there are teething problems around KPI robustness and target dates

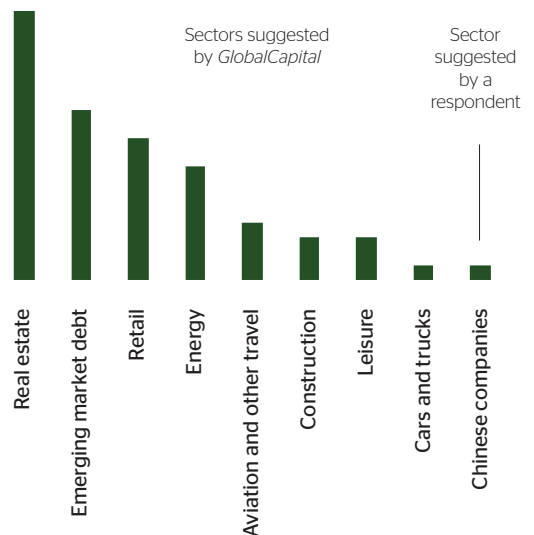


They have a role but should take a backseat compared with use-of-proceeds green and social bonds



They are basically market-endorsed greenwashing

### From which sectors can we expect the most debt restructurings?





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**KFW**

# Ukraine takes the fight to the financial markets

After a year in which global capital markets were utterly dominated by the war in Ukraine, **Toby Fildes** sits down with the country's finance minister **Serhiy Marchenko** and head of debt management **Yuriy Butsa**. They discuss what it would take to strike a peace deal with Russia, how Ukraine is financing itself and how it is determined that the Russian aggressor will pay up when it comes to rebuilding its villages, towns and cities.

**J**ust like every other citizen in Ukraine, those responsible for managing and financing the country's economy had their lives turned upside down on February 24.

But ever since that fateful Thursday when Russia invaded, Ukraine's finance ministry has been on the front foot, determined to win the economic war by waging a campaign of constant communication with the outside world — other finance ministries, investment banks, multilateral development banks, institutional investors and the financial press.

Keeping Ukraine's economy and financial needs at the top of the news agenda has been a central plank of the country's strategy of building support from allies all over the world, including the European Union, the US, Canada and the UK — support that has helped Ukraine not only resist Russia's advance but knock it back in some parts of the country.

The financial battle has often been fought remotely — on television, in publications such as *GlobalCapital*, and via effective campaigns on social media, especially LinkedIn, where Ukraine has given regular updates of its military bond auctions and news about budgets and deficits.

## On the road

In this sense, it has been a very modern financial war, despite regular power cuts making communications difficult.

But it has also been done the old fashioned way — in person. Officials, notably finance minister Serhiy Marchenko and head of debt management Yuriy Butsa, have spent much of the year on road trips to shore up diplomatic and financial support, lobby for debt moratoria and push for more cash, at times through innovative structures and diverse sources.

Often the journeys would involve driving from Kyiv to Poland, then flying to capital cities and financial centres across Europe and North America to attend conferences, including the IMF and World Bank annual meetings, and private talks with politicians, bankers and investors.

The journey from Kyiv to London, for example, typically takes the team 24 hours and involves driving along Ukraine's hazardous roads, subject to missile attacks at any time.

Often accompanying the finance team this year have been investment bankers including Borys Matiash, a member of BNP Paribas's emerging markets debt capital markets team in London who is also Ukrainian. He has seen how quickly and drastically conditions have changed for the country. Before February 24, Ukraine's economy had been performing well.



Serhiy Marchenko (centre) and Yuriy Butsa (r) on one of their road trips, this time at a BNP Paribas event in London. Borys Matiash (l) is moderating.

Its economy had recovered well after the pandemic, growing by 3.4% in 2021, the budget deficit was falling towards a target of 3% of GDP and the national debt had shrunk from 67% of output in 2015 to 43% in 2021.

“The country had gone from strength to strength in building up a very functional and diverse financing toolkit across international and local debt markets, supplemented by concessional financing channels,” Matiash says.

Since the invasion, government revenue has fallen by 30% and expenditure has spiralled, both military and social.

“The government has had to focus its sights on the financial battlefield, to expand and diversify its funding toolkit, to ensure that the required financing was channelled to support the economy and social needs,” Matiash says.

In his view, Ukraine's strong track record has helped it mobilise finance from international sources and gather support from investors for a debt moratorium.

“The goodwill and the image that Ukraine — as the economy and as the borrower — has managed to build within the last several years is outstanding,” Matiash says.

After the invasion, he says, “it took only a few days for the Ministry of Finance to get all its creditors on the global investor call on the following Monday, to give the entire bond market community a live update on the state of affairs, with reassurance, courage and unbreakable spirit.”

The following day, the first auction of military bonds took place. Matiash believes this is another example of how fleet-footed the ministry was in the early days of the war.

That proactivity “has exponentially grown ever since, in terms of diversification and expansion of financing channels through public and private sector, within and outside Ukraine's borders,” Matiash says. “Despite unprecedented work and life conditions, the Ministry of Finance team has continued its proactive investor engagement, with uninterrupted communication channels and high frequency of investor updates... on both sides of the Atlantic.”

The following interview with Serhiy Marchenko and Yuriy Butsa took place in early November in London. **GC**

**GC** As the winter gets colder and the pressure on energy prices rises even further — along with high levels of general inflation — are you concerned that the international community will force you to sue for peace?

**Serhiy Marchenko:** In the middle of summer we had some concern that the level of support for Ukraine was beginning to fall. But in the beginning of autumn, when we successfully liberated part of our territory — first in the east, and then in the south — I saw that in the West, and specifically in the EU countries, they realised that supporting Ukraine is worthy.

It's not just a charity act — it's an act of self-preservation. They are protecting their countries through supporting Ukraine.

You know, if you compare the cost of our war — including all the international support that has been provided and pledged to us, such as the grants from the US and from the EU via its Macro Financial Assistance Programme, as well as other donors — with the cost of war for all countries in the world, then it is in fact a small amount of money.

I don't overestimate this fact. We realise that there are cost pressures everywhere — oil and gas prices, general energy prices, food price inflation and the threat of recession — but this is the natural cost of war.

We urge countries all around the world to spend as much as they can to help us defeat Russia. If we do not defeat Russia, then the costs will be so much higher for the world. That's why I think it's natural to support Ukraine — it's less costly in comparison with the effects of war for all nations. So I urge the international community to continue with its financial support — as well as help us get enough military support.

**GC** So what does the retaking of the city of Kherson represent? Do you see it as a major breakthrough in the campaign to force Russia out of Ukraine?

**Marchenko:** It's a part of the process. It doesn't represent a particular milestone to us — it is just part of our campaign



Ukraine's financial warriors: Yuriy Butsa (left) and Serhiy Marchenko

to retake temporarily occupied territories back in the fastest possible way. It's not the middle or the end and it's not the start. It's a process. Now we move on to take the rest of the Kherson region, as well as the other regions such as Donetsk and Luhansk.

**GC** You mentioned how the international support for Ukraine was energised by some of the rapid victories you have achieved. But does this not show that to keep the international community energised and committed to supporting Ukraine, you now need to keep on retaking ground?

**Marchenko:** Of course we should continue to show progress on the battlefield. This is without doubt. But it shouldn't be at any cost, because the real cost of bringing back our lands is the lives of our soldiers and people. We don't want to sacrifice these very precious lives by being too hasty in our efforts to recover our lands.

We need to be wise. We have shown that we can use very modern weapons that other countries have provided us with to destroy Russian military assets, including their logistics operations. That makes them weaker, without having to engage in close combat, which of course endangers a lot of Ukrainian lives.

I think we showed this with Kherson — the Russians, who had been weakened by our efforts, decided it was better to withdraw rather than engaging in close combat.

**GC** So what you are saying is that you want victory but it cannot be at any cost. So, when is an appropriate time to enter peace talks? Is it only after Russia leaves all of Ukraine's territory or before?

**Marchenko:** Let me be clear: it's when Russia leaves all of our territories, as they were in 1991. Only then can we negotiate with Russia.

But it won't just be negotiation around peace or disputed territories. It will also be discussions around the cost of reconstruction and cost of damages — reparations. If they destroy parts of our lands, they should pay for them.

**GC** Increasingly, the international community is talking about a 21st century Marshall Plan to rebuild Ukraine. Is that a term you are using as well?

**Marchenko:** It's a very familiar and very successful name and we are OK with it. But to be clear, we are talking about the Marshall Plan for West Germany, because there were several not so successful examples of Marshall Plans, I understand. So, yes, a Western Germany Marshall Plan is the best example for Ukraine.

**GC** What should this Ukraine Marshall Plan look like? How should it work?

**Marchenko:** For us it's important to find a way how to better attract private investment. It shouldn't just be made up of concessional financing or international financial institution support.

If you really understand the cost of our damages, the cost of reconstruction will be hundreds of billions of dollars and that will not be possible without private investment. So we are interested in creating the right kind of environment to attract this investment and to structure it in the best way.

**GC** **Would one way be to create a dedicated supranational bank, let's say a Ukrainian Bank for Reconstruction and Development – a bit like the EBRD or the World Bank – that is owned by the international community so that it can borrow cheaply and crowd in private sector investment? Is that a sensible approach?**

**Marchenko:** I don't think so. Maybe it could be one part of the solution. But again, the question is around creating sufficient conditions within Ukraine to be able to attract billions of dollars of private sector investment. It shouldn't be one very easy solution, it should be about creating the

right environment in Ukraine so that businesses see it as natural to invest.

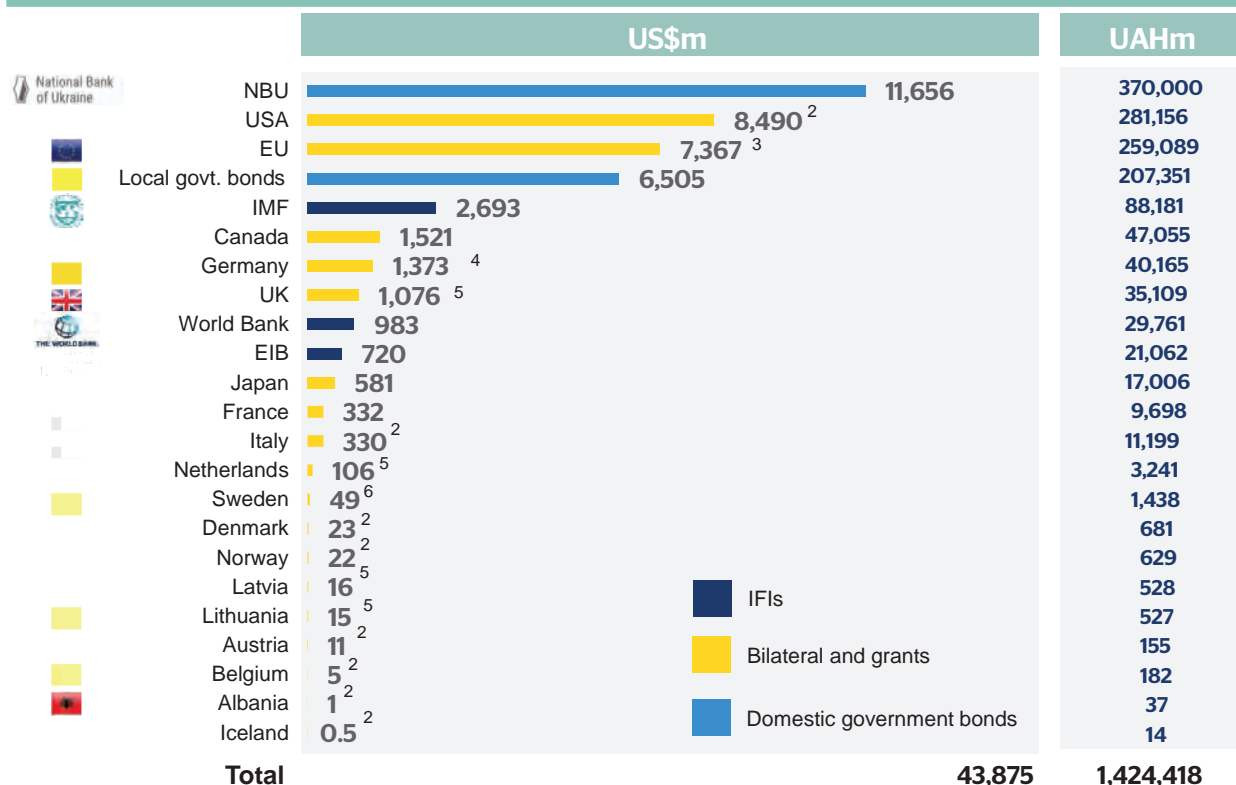
**GC** **I mentioned the supranational approach because private sector money wants return on risk and risk needs to be managed. So how would you balance that?**

**Marchenko:** It is perhaps more fundamental than that. Security is absolutely crucial and a precondition of external investment. For example, it means that we should have a very strong air defence system, so that we can protect ourselves.

The first and most important thing could be the EU accession. Because being part of the EU society means having the necessary commitments around security and defence — this is a natural way of life for Europeans. Of course, legislative changes are needed and it could take some time for us to implement such structural reforms.

**GC** **EU accession is crucial of course, but as Olaf Scholz, Germany's chancellor, recently said, reconstruction will be an enormous task that**

Received budget financing (general fund) during the war, split by sources<sup>1</sup>



Note 1 As of 30.11.2022

Note 2 Grant

Note 3 Including grant of €632m

Note 4 Including grant of €1bn

Note 5 Guarantee, including grant of \$128m (UK), €80m loan (Netherlands), €5m grant (Lithuania and Latvia)

Note 6 Guarantee

Source: Ukraine Ministry of Finance



### Ukraine cannot manage alone or that the European Union cannot manage alone. You are going to have pull in global investment.

**Yuriy Butsa:** In my view, it's not about creating one structure that miraculously can rebuild the country and has all the knowledge and capacity of the world in one place.

It's more about a very bottom-up approach. For example, businesses know much better what they want and need than any government or multilateral institution. The EU free markets give them many more opportunities than government financing, so we just need to create the right environment for them.

In this context, access to the EU market is crucial, especially given the current environment where businesses want to build supply chains in other countries that have similar values. We can represent the perfect case for such investments by being geographically close and economically integrated with the EU.

It's the same with physical infrastructure rebuilding. Nobody at the government level in the country knows better than the mayor of a town what is damaged there and

what are the most pressing needs, whether the priority is a school or ambulances, for example. It is important to leave the decision-making in the place where it's actually the most efficient — centralisation is not always the right answer, it's more about an efficient level of co-ordination.

### GC How are you dealing with the issue of deciding what to start rebuilding when the Russians can just destroy it again?

**Marchenko:** They can't destroy everything because they don't have the capacity to destroy everything. But we have no other choice but to repair what they destroy. They destroy, we will repair and so on and so on.

Our president has said we will have to live without Russian gas, without electricity, without water supply — but without any relationship with Russia as well. There is no doubt that it is going to be difficult and Russia will find ways to make us suffer — for example, with its air strikes targeted at our power infrastructure. But we will survive.

**Butsa:** As a personal story, I have that Keep Calm and Carry

## Bond market offers support

When Russia invaded Ukraine on February 24, members of the global financial community were shocked and appalled.

Since then they have been searching for ways to help Ukraine and its people. *GlobalCapital* knows of individual debt capital markets bankers who assisted first hand — for example, by driving to Poland and Ukraine to deliver items such as nappies, toilet roll, chocolate, medicines and blankets amid the sudden influx of refugees. They also worked with NGOs and charities on the ground to help raise money for new transport to take aid into the country — and bring people out.

Another way the financial community has helped Ukraine's cause is through bond markets. In August investors consented to a two year moratorium on repayments on \$20bn of bonds, enabling Ukraine to avoid default and save money.

However, bond markets have also been used to raise new money too, often in imaginative ways.

In November the Canadian government issued a C\$500m (\$372m) five year Ukraine Sovereignty Bond, a first-of-its-kind deal designed to allow Canadian retail investors to show their support in denominations of \$100.

The deal was in fact sold as a wholesale transaction, but with retail investors getting access to the bond via Canadian bank dealers and brokerages and their investment account platforms.

In the end, C\$50m of the bond, which was fully backed by Canada's AAA credit rating, was sold to individual citizens in one tranche, with the rest picked up in a second tranche by institutional investors, including bank



Chrystia Freeland: "Canadians can contribute to this critical effort"

treasuries, provincial central banks, pension funds and asset managers.

Overall, about 70% was sold to Canadian retail and institutional investors, while a large proportion, 40%, went to official institutions in Canada and in other countries, including central banks. Some investors told *GlobalCapital* that they treated it like a use-of-proceeds labelled bond, since it had documentation language about how the cash could be used by Ukraine.

The bond has a semi-annual interest payment of 3.245% and matures on August 24, 2027, Ukraine's Independence Day.

The Canadian Department of Finance will lend the proceeds to Ukraine through the International Monetary Fund Administered Account for Ukraine.

On poster in my office — it was a present given to me before the war started. But on the day the war started I took a selfie with it and sent it to everyone who was asking me if I was OK. So, the poster found its true purpose and that's how we manage things — by keeping calm and carrying on.

### **GC** You have introduced a moratorium on your bonds. How was that received?

**Butsa:** Well, it's not a moratorium; we got consent from our investors to postpone repayments for two years. It's not quite the same thing.

### **GC** Does that moratorium include the MDBs?

**Butsa:** It doesn't include MDBs because of their status as preferential creditors, but it does include all the official bilateral debts and Eurobonds.

### **GC** But looking at the numbers of your existing debt, the moratorium and the amount you will need in the future, don't you think

### that actually what you really need is a debt jubilee?

**Butsa:** Look, it's a question of what you want to see in the future, right? We used to be a self-sustainable country. We got financing from the international markets and we had transparent and credible relationships with investors. And we want and will need to rely on market financing in the future.

So any hostile or market-unfriendly steps with our debt actually go against this logic. We view the private sector as a key supporter, not only of our sovereign financing, but also our private sector and its borrowers. So the country in general needs to have good relations and access to the market.

Because of this, we will not look at solutions that go against our desire to be present in the market as soon as it is practically possible.

### **GC** But you must think a debt restructuring at some stage is inevitable?

**Butsa:** We don't know. To answer this question you need to have at least some sort of view on the macroeconomic

The country's deputy prime minister and minister of finance, Chrystia Freeland, said at the Rebuilding Ukraine Business Conference on November 23: "Canada remains unwavering in our commitment to support the people of Ukraine in their fight against Putin's illegal and barbaric invasion, and we will continue to do everything we can to ensure Ukraine has the resources it needs to win. Now, through a bond designated for Ukraine, Canadians can contribute to this critical effort through a new federally backed investment."



"This is certainly a model that other governments can build on, depending on the market they are active in and retail appetite — it sets a good template"

**Alex Caridia, RBC**

Speaking to *GlobalCapital*, Adrienne Vaupshas, press secretary at Freeland's office, added: "The Ukraine Sovereignty Bond was introduced to give Canadians an opportunity to directly support the brave people of Ukraine. The funds will assist the government of Ukraine so it can continue to provide essential services to Ukrainians this winter, such as pensions, the purchasing of fuel and restoring energy infrastructure. The deputy prime minister and the Canadian government are in frequent and regular contact with the government of Ukraine. As is widely reported, Ukraine continues to need financing and

liquidity and this was a latest idea, from Canada, to assist in that regard. It also follows numerous loans on the part of Canada and G7 partners to address Ukraine's urgent financing needs."

Although Ukraine will be obliged to pay interest, the loan will respect the spirit of the debt service suspension agreed by Ukraine's international creditors in August.

"Canada and its population want to help Ukraine," says Alex Caridia, head of public sector markets at RBC Capital Markets in Toronto, and one of the bankers who helped design and execute the deal. "The transaction managed to attract a significant amount of retail investors, which was one of its key aims. Overall it was fully subscribed. It sends a really strong message to Ukraine that Canada is supporting it."

Raising C\$500m from the Canadian private sector, including directly from its citizens, will surely be seen as a success by Ukraine, although as Yuriy Butsa, Ukraine's commissioner for public debt management, points out in the accompanying interview, he does not want foreign governments to replace grants with debt, even if it is priced at concessional levels.

As to whether Canada's Ukraine Sovereignty Bond could be copied by other governments keen to help out, Caridia is optimistic: "This is certainly a model that other governments can build on, depending on the market they are active in and retail appetite in the respective market. It sets a good template."

*GlobalCapital* understands that several other sovereign DMOs have since approached Canada's Department of Finance for more information on the Sovereignty Bond.



The Ukrainian army has liberated Kherson, but retreating Russian forces destroyed a lot of the infrastructure as they left

framework for some prolonged period of time. We quite recently did some work on extension of our planning horizon from three months to a year, which was itself subject to multiple assumptions.

So, how can we credibly come and say, 'OK guys, that's the framework for five years' if nobody can model the framework for five years for Ukraine?

One important thing to note is that it took us two years to return to the international markets after the first active phase of war with Russia in 2014. So if in the positive scenario we regain market access within the same timeframe, we have the experience of how to proactively manage our debt in a market-friendly manner. So that's how we think about it.

**GC** Are you happy with the financial support you have received from the international community so far?

**Butsa:** Are we happy with the commitment? Yes. But we cannot be 100% happy with the way disbursement has been happening this year — not fast enough and not predictable enough. The predictability is really important.

But our partners, including our biggest ones in terms of size of support, such as the US and EU, have recognised the seriousness of the problem and have redesigned their solutions in such a way that will give us visibility for the whole of next year. We have seen the EU announcing an €18bn financial support package for us for the next year and the US proposal to continue budget support for the first three quarters of next year. It's great that we have been heard and that the redesign is happening.

**Marchenko:** And, you know, because of the unpredictability, which meant we did not have stable financing for this year, we found it necessary to use monetary financing as a tool to cover our budget deficit. This year we have already issued about \$11bn of government bonds bought by the National Bank of Ukraine.

This is something we are not happy about, because it means that we are in danger of creating an inflationary spiral which could harm our economy. That's why it's so

important to have predictable money supply, because otherwise we will be just another state with huge damages to macroeconomic stability, which can be avoided with simple solutions.

So, it's much more efficient to commit \$3bn per month to support Ukraine than to look for the ways to solve multiple economic problems in the future, as happens now in some other countries.

**GC** In your budget you have basically achieved fiscal consolidation by reducing the monthly deficit from \$5bn to \$3bn. How have you managed that in the middle of a war?

**Marchenko:** First, and most importantly, we have decreased our expenditures by reducing all unnecessary spending over several stages. At first, the budget deficit was almost \$7bn but we have cut our costs effectively.

Meanwhile, our capacity to collect taxes has returned. For example, at the beginning of the war, customs was collecting only about 30% of pre-war taxes — now it is collecting up to 80% of the pre-war tax amount.

However, we are also battling inflation. This year inflation could be around 30% — it's now at 26.6% — and next year it could be 28%. Of course, it's the price of war. It's the price put on the ability of our people to earn high enough salaries to support their families and lives.

But another price is poverty — the level of poverty could increase from 5% to 25%. It's a huge, huge jump in the number of people living below the poverty line.

**GC** How much of your budget is going on military expenditure?

**Marchenko:** Up to 50%. This year, it could be 30% of GDP. Next year, it could be 18% of GDP.

**GC** And that presumably means you will continue to cut back on civilian spending?

**Marchenko:** Yes.

**GC** We have noticed with interest the C\$500m Ukraine Sovereignty Bond being issued by the Canadian government. Is it a template you hope can be replicated next year?

**Butsa:** The mechanics are interesting because it ticks a couple of boxes. First of all it provides us with the necessary financing, but it also helps to channel the support from the regular people — retail investors, in this case, in Canada.

One of the things that our domestic war bond issuance showed was that there was a lot of interest from outside our



country — not just from the Ukrainian diaspora — from different people asking if they could buy them.

Unfortunately, there is very little cross-border access to domestic markets for retail investors pretty much anywhere in the world. So what the Canadian ministry of finance has done is really that — they have given bond market access to its citizens who want to support Ukraine. We hope it will be successful.

The question is: where can we replicate this? It's still a loan, though, and of course we do not want it to replace the grants we receive from other countries with the loans. But we will look at the demand for the Ukraine Sovereignty Bond issued by Canada and see whether we can replicate it elsewhere if there is demand in other countries.

**GC** You mentioned earlier reparations and that you very strongly believe Russia should pay for this war and all the damage it has inflicted on Ukraine. But what mechanism can you use to ensure that they pay what some are estimating could be \$1tr of damages?

**Marchenko:** It is very much our desire for Russia to pay for the damage. One source, of course, is an amount of approximately \$400bn of frozen Russian assets seized around the world.

However, I understand that it will take a lot of time, even

if we have full support from our international partners. Maybe we can work on a way to use those frozen assets as a down payment on any reconstruction financing we receive in the short term. I believe we can seize this money, but the timing is unclear.

**Butsa:** In mid-November the United Nations General Assembly adopted a resolution that calls for Russia to pay reparations to Ukraine, which was very helpful. We are very committed to continue to work on the legal mechanics because we believe that those who created the damage have to pay for it.

Obviously, if Russia voluntarily agrees to repay then it's much simpler than to force them. But if not, we will go all the way down the legal route to force them.

**GC** When I spoke to you in April, Yuriy, you mentioned that you had a large team of people accounting for the damage. Is that still the case?

**Butsa:** The damage is so much more than it was, but the team is much more sophisticated. The first report of its kind was published by the World Bank, which they did in co-operation with the team in Ukraine, including the Kyiv School of Economics, some NGOs, etc, who used satellite images of each and every building and quantified the damage based on the level of destruction of the buildings and businesses.

They identified \$105bn of just physical damage, without economic loss, etc. Including economic loss and everything else, the number reached almost \$350bn. Now, the more territories we liberate, the more damage we see.

Our army liberated Kherson recently and there is no electricity there — the Russians blew up everything, including the TV tower. So the number is going to go up, unfortunately.

But what we are doing now is a very precise calculation of what has been damaged, and verifying it so that we have a bill we can present to Russia to compensate us in full for the damage they have caused.

But such calculations can also help us to understand how we can prioritise what needs to be rebuilt. We know that there will not be a magic day in the future when we have all the money in place so that we can start reconstructing the whole of Ukraine. It will be a question of priorities.

We liberated the east of the Kharkiv region and of course people want to come back to their homes but they cannot return safely if they don't have roads, electricity, running water or basic health services.

So, we use the scarce resources from the budget to do the basic repair work, such as to replace the bridge that was blown up for them to get back into their homes. This is happening right now because it's important for these areas to be livable. So we need to constantly work on the damage assessment and prioritise the most crucial areas to channel the funds from the budget. **GC**

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# Toppled CEOs, new CFOs and Credit Suisse woes

Across the Street, big names came and went as many of the big players mixed up their senior management teams. Some saw more activity than others, but the tumultuous market conditions meant most had a very busy 2022. **David Rothnie** reviews a year that may come to be remembered as the catalyst for a new world order in investment banking.

**T**his past year was not predicted to be particularly notable.

The two years before were so unexpectedly volatile that 2022 was supposed to provide some respite. Not long into the new year, Russia put this idea to rest when it invaded Ukraine and sent the global economy into disarray. The multiple social and political headwinds that blew in were wholly unwelcome following the impact of the Covid-19 pandemic, but have forced the finance industry to adapt — and adapt quickly.

Unsurprisingly, the impact on investment banks specifically across the biggest markets has been grave. Several have already announced cuts, and more are expected.

The biggest schism of the year came in October, with Swiss bank Credit Suisse.

In January 2022, Credit Suisse CEO Thomas Gottstein promised a return to profitability. What a difference a year makes.

By the end of April, with war in Ukraine raging and inflation soaring, Gottstein lowered his ambitions and pledged instead “a year of transition”.

By July he was gone, replaced by Ulrich Körner. And at the end of October the bank unveiled a radical overhaul, selling off prized assets and handing over its investment banking and capital markets business to Michael Klein, a former Citigroup M&A banker who plans to float it as a separate entity by 2025.

Gottstein was right. It was a year that Credit Suisse would ‘transition’ out of investment banking. Indeed, the bank plans to cut 2,700 jobs by the end of the 2022.

The restructuring was a rapid capitulation, but at the same time one that was long overdue as Credit Suisse became the last European bank to adapt to the reality of the global financial crisis. While the decisions made today will reverberate over the coming years, Klein’s plan will really evolve over the next 18 months, with uncertainty stalking the bank’s corridors in London, Paris and Frankfurt.

The ripple effect is already being felt across the industry. Credit Suisse’s retrenchment fed the ambitions of others, as the fight for the crown of leading European bank intensified.

Most notably, BNP Paribas mopped up its prime services division and launched a three-point plan for growth which put expansion in North America at its centre. If everything goes to plan, by the end of 2025, BNP Paribas will have laid to rest the ghost of failed attempts by European rivals to conquer the US, while CS First Boston will be

a New York-listed quasi partnership. If Credit Suisse is able to pull this off, Körner will be left reconsidering the deal with Klein earlier in the year.

Problems spun out of control for the bank very quickly as the year progressed. As former heavyweight boxer Mike Tyson once said, “everyone has a plan until you get punched in the face”. This past year was one where grand plans were thwarted for individuals and banks alike — and Christian Meissner, in particular, must be feeling punch drunk.

Having started the year as CEO of Credit Suisse’s investment bank with a remit to grow, he was sidelined in the strategy review and has now left the bank, raising the intriguing prospect of what he will do next.

## War does not determine who is right — only who is left

Elsewhere, soaring inflation and war in Ukraine quickly reduced banks’ corporate finance plans to dust — hiring plans were frozen and strategic growth initiatives were put on hold as leveraged buy-outs curdled. Just a week after Vladimir Putin invaded Ukraine, Jane Fraser held her first investor day since being appointed CEO of Citi in 2021.

The event was supposed to be held in person, until Fraser and members



Ulrich Körner



Christian Meissner



Jane Fraser

of her executive team contracted Covid and moved it online. Paco Ybarra, head of the bank's institutional clients group, set out his vision that included "leaning in" to leveraged finance. The bank had lost market share to rivals, which according to Ybarra was a result of a conservative risk appetite, something of a hangover from the financial crisis.

With the leveraged loan market freezing as Ybarra ran through his presentation slides, his timing could perhaps have been better, but as one senior banker told *GlobalCapital* at the time: "The only thing worse than not leaning into leveraged finance is having leant into leveraged finance six months ago."

The war had a widespread impact. In May the news broke that Frédéric Oudéa's reign as the longest serving CEO of a European bank was coming to an end, when he announced he would step down as CEO of Société Générale after his current term expires in May 2023. His departure came just a month after his decision to sell the bank's Russian subsidiary, Rosneft, to Vladimir Potanin, following the invasion of Ukraine.

The succession race that followed featured a small field of internal candidates that set the former political adviser and head of strategy Sebastien Proto against the 'outside insider' Slawomir Krupa. Proto's CV had been enhanced by his work restructuring the corporate and investment bank, which threatened to overshadow Oudéa's legacy. In the end, Krupa prevailed, much to the surprise — and chagrin — of the French banking establishment.



Frédéric Oudéa

Known for his direct, no-nonsense style, Krupa — who previously ran SocGen's business in North America — wants the CIB to expand globally, potentially setting it on a fascinating and uncertain journey.

The two-horse race to succeed Oudéa did not prevent the names of several high profile external candidates being bandied about.

### HSBC in the crosshairs

One mentioned in dispatches was Georges Elhedery, who announced in January he was taking a six-month sabbatical from his role as co-head of global banking and markets at HSBC. But rather than serving as a precursor to an exit, Elhedery's sabbatical provided him with the opportunity to recharge and upon his return he climbed the pecking order and was appointed CFO, replacing Ewen Stevenson. Having executed the heavy lifting of HSBC's restructuring, Stevenson himself stepped down after he was passed over as a candidate to succeed Noel Quinn as CEO.

"Ewen was a great guy but, for all his skills, he was never going to be CEO," says one former colleague. "HSBC always prefers insiders."

Elhedery, who joined HSBC in 2005, is now seen as the leading candidate to replace Quinn — who, it is suggested, plans to stick around.

Quinn will have a lot on his plate at HSBC, which has grown accustomed to occupying a unique position in the crosshairs of Sino-US tensions, while navigating the challenges of being a UK listed and regulated bank that relies on the Asia Pacific region for 80% of group profits.



Michael Klein

That challenge ratcheted up a notch for HSBC in 2022, when it emerged that its biggest shareholder, Ping An, was agitating for a break-up of the bank. HSBC, advised by Goldman Sachs and Robey Warshaw, quickly came up with a defence plan that involved reinstating the dividend, but it remains convinced its universal strategy is the right one. Ping An has shown no sign of tempering its approach.

### Fruits of the loom

While Credit Suisse finds itself at the start of a major rethink, Deutsche Bank's strategy is coming into focus. Three years after embarking on its own restructuring, the German bank proved this year that its transformation was complete as it posted its highest nine month profits in 11 years.

From being a near-basket case in 2019, the bank has regained its status as a top corporate finance house in its home market. Its progress was admired by Credit Suisse, which picked off the architects of its restructuring, hiring Dixit Joshi as CFO and Louise Kitchen to lead its wind-down unit, a job she performed with aplomb at Deutsche.

The bank was the biggest hirer of talent in 2021 as it plugged gaps. But, despite making progress, it continued to suffer departures from its senior investment banking ranks. Global head of advisory and origination Drew Goldman left to become head of real estate at Abu Dhabi Investment authority (Adia), while in London Richard Sheppard joined JP Morgan as co-head of investment banking. Chris Raff, head of UK



Georges Elhedery



CS Venkatakishnan



David Solomon

M&A, left to join Moelis. Citigroup also hired Deutsche veteran Patrick Frowein as a vice chairman for its banking and capital markets unit in EMEA.

Overall, the pace of hiring eased in 2022 but banks continued to hire senior talent to fill gaps in industry or country coverage. The UK remained a fierce battleground as banks looked to beef up their presence in Europe's biggest corporate finance fee pool.

While some rebalancing has taken place in other European locations, London has largely retained its status as a magnet for talent. Barclays began the year with a new executive team, following the appointments of CS Venkatakishnan as CEO and Anna Cross as CFO, and has maintained the commitment to its investment banking business that was a hallmark of Jes Staley's reign, which ended in November 2021.

Meanwhile, Jefferies, which has been the most prolific recruiter in European investment banking over the past decade, remained on the front foot with a fresh expansion — albeit with a counter-cyclical feel. In November, the bank hired Glen Cronin from Rothschild and David Burlison from Lazard as co-heads for restructuring in Europe, handing the pair a remit to expand the business.

### BofA's title challenge

Bank of America has enjoyed a resurgence in 2022, hiring bankers and winning market share as it looks to deliver on its mantra of being top three across all products and geographies, "with a relentless focus to be number one".

Despite this lofty ambition, the bank has suffered its fair share of detractors. Last year, one former banker compared Bank of America to Premier League club Arsenal in the scale of its ambition. "In banking you have Goldman, JP Morgan and Morgan Stanley, and the rest. In the Premier League, it's Manchester City, Liverpool and Chelsea. Arsenal are happy just to be top four."

No doubt Bank of America will be keen to point out that Arsenal currently sit five points clear at the top of the Premier League, which happily corresponds to the year to November 16 corporate finance fee rankings, where it has leapfrogged both Citi and Morgan Stanley.

In July, Morgan Stanley promoted London-based Simon Smith to the role of global head of investment banking. Smith's promotion was accompanied by a revamp of its senior banking set-up, as Morgan Stanley redeployed the current investment banking heads, Mark Eichorn and Susie Huang, to executive chairs of the division tasked with leading a newly formed group of senior bankers.

Meanwhile JP Morgan continued to refresh its senior ranks by looking outside its organisation for talent. Along with Sheppard — who joined from Deutsche — the bank hired Charlie Jacob from Freshfields to co-head its UK investment banking business.

### Goldman switches

Goldman maintained its stranglehold in M&A, and also doubled down on its commitment to investment banking with an eye-catching revamp

of its structure. Junking its distinctive investment banking structure — known across the Street as IBD — Goldman's new strategy looked more like its rivals. The reasons for enduring years of tradition and creating global banking and markets was, according to CEO David Solomon, simply a reflection of close collaboration of the bank's corporate finance and trading arms under his One Goldman Sachs strategy.

Solomon's decision in November to promote 80 professionals to the bank's coveted partnership pool in October — the highest number since 2016 — points to a shake-up of the established order in 2023.

Some suggest that some underperforming members of the old guard will be "de-fanged", which is Goldman-speak for losing partner status.

After a dire first half for corporate finance activity, when equity capital markets fees plummeted by as much as 80%, some bankers warned of job cuts on a scale with the aftermath of the dotcom boom in 2001. But so far banks have adopted a cautious tone.

In October, Goldman Sachs became the first bank to break cover by cutting underperforming staff, but — with the exception of Credit Suisse — rivals have so far opted to prune and trim rather than slash and burn, for fear of being caught flat-footed when markets turn.

Despite all the gloom and uncertainty, there is a flicker of optimism. But the time to judge what 2022 really meant for the shape of the investment banking industry will be in years to come, as the dust settles on a tumultuous year. **GC**



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# Extraordinary deals for an extraordinary year

Issuing bonds became a lot harder for every type of borrower in 2022 – and sovereigns, supranationals and agencies were no exception. After a long spell of issuing into a market buttressed by central bank bond buying and rock bottom interest rates, all of a sudden the capital markets became a less certain place as interest rates and yields rocketed in response to a host of macroeconomic and geopolitical shocks from soaring inflation to the effects of the invasion of Ukraine.

No longer did any deal work at any time, as had been the case, and the art of syndication was back. Execution for some could no longer be guaranteed as the number of pulled deals mounted but, despite this, there were a number of standout trades that helped to haul this group of borrowers through their funding tasks for the year by either re-opening markets in volatile times or by showing ingenuity and pragmatism to get funding done. By **Addison Gong** and **Ralph Sinclair**.

## SOVEREIGN DEAL OF THE YEAR

### United Kingdom

#### £4.5bn increase of 1.5% July 2053 green Gilt

Barclays, BNP Paribas, HSBC, JP Morgan, UBS

It is unusual to select a tap of an old issue as deal of the year, but then this was no ordinary year in the bond market. And this was a deal syndicated in a week of unprecedented disruption.

On September 23, the new UK government led by prime minister Liz Truss and chancellor of the exchequer Kwasi Kwarteng delivered a mini-budget to parliament aimed at unleashing growth.

Instead, it unleashed chaos as the bond market baulked at the prospect of funding tens of billions of pounds in tax cuts and energy bill support.

This syndication had already been postponed once because of the death of Elizabeth II. The market was in a much worse state by September 28, the day of the rescheduled syndication, but the Debt Management Office led by Sir Robert Stheeman, decided to push ahead – as any responsible sovereign issuer of the UK's calibre would.

Thirty year Gilt yields soared above 5% during the morning of execution – an unprecedented intra-day move for this market, according to DMO records – before the Bank of England stepped in with emergency bond buying, which pushed them down 30bp during the allocation process.

Despite the volatility, the UK still gathered £30bn of orders and got its deal away. Few if any other issuers could have syndicated a bond in such a market.

So bad was the upheaval and the damage to the UK's fiscal credibility, leaving the Bank and the DMO to deal with the mess, that it cost Truss and Kwarteng their jobs. Stheeman and his team still have theirs.

## AGENCY EURO BOND OF THE YEAR

### Landwirtschaftliche Rentenbank

#### €2bn 0.1% March 2027 bond

Danske Bank, Goldman Sachs, JP Morgan and LBBW

Rentenbank scored its largest ever euro benchmark with this deal but what was more impressive, perhaps, was the re-offer spread – 25bp through mid-swaps after 5bp of tightening during execution.

It was the tightest spread to mid-swaps not only in the German development bank's history, but also by any SSA issuer in the five year part of the euro curve since 2018.

The deal showed other issuers what was achievable. It also helped the market come to the realisation that primary market pricing had become dislocated from secondary spreads. The bond was priced with a new issue concession of minus 7bp versus Rentenbank's own curve but appeared to pay a slight premium when compared to what it would normally expect to pay compared to its compatriot peer, KfW

The issuer exploited swap spreads to offer a pick-up over Bunds of 48bp, which proved irresistible for investors for what was German federal state risk. "[Investors] hated us because of the level, but everybody came in," said a banker on the trade.

Other euro issuers such as Finland and Austria have since pushed even deeper through mid-swaps with similar deals but Rentenbank's deal led the way, coming at a time when the market was still accepting the fact that the Bund-swap spread would stay wide for a while. And sure enough, that theme remained dominant in the SSA market for the rest of 2022.

## SSA DOLLAR BOND OF THE YEAR

## World Bank

**\$4bn 3.125% June 2027**

Citi, Nomura, TD Securities and Wells Fargo

The dollar market has not been itself in 2022 as far as SSA issuers have been concerned, with volumes down compared to previous years. But the World Bank proved there was still life in this key funding arena for SSAs after a string of difficult transactions from peers.

Bankers had described the overall SSA market as “tough” before the summer, and conditions were tougher still in dollars.

So for the World Bank to be able to take \$4bn in one go with smooth execution was no easy task even for this most storied of issuers. The dollar market had, after all, effectively shut its door to some SSA names at the time.

The World Bank took \$5.5bn of orders to help it shave 2bp off initial price thoughts to land the five year note at 40bp over Sofr mid-swaps.

The transaction was seen as a positive omen by those on and off the deal, injecting a much needed shot of confidence into a market shaken by volatility.



## SUB-SOVEREIGN BOND OF THE YEAR

## Autonomous Community of Madrid

**€500m 2.822% October 2029 green bond**

BBVA (green structuring adviser), CaixaBank, Crédit Agricole, ING and Santander (lead managers)

Madrid has been, and continues to be, at the forefront of the development of Spain's green financing. It was the first government entity in the country to issue a green bond back in April 2020, ahead of even the sovereign. And with the new October 2019 line, which was the city's third green transaction, Madrid has become the most active Spanish green issuer from the public sector.

The bond was fully aligned with the EU Green Taxonomy, a rarity even in Europe. It was a first not only for Madrid, but for Spain.

While the trade might not have been especially large, or attracted a multiple-times subscribed book, it made an impression.

Over the years, Madrid has proved its willingness and ability to move Spain's green funding capabilities forward. This trade was another important milestone.

## SSA SRI DEAL OF THE YEAR

## Republic of France

**€4bn 0.1\$ June 2038 inflation-linked green OAT**

Barclays, BNP Paribas, Crédit Agricole, Natixis and Société Générale  
Several governments made their green bond debuts in 2022 with Austria, Canada and New Zealand all making their initial forays into the market.

Indeed, Austria brought a further innovation in the autumn by issuing the first ever green sovereign T-Bills – a product it plans to issue quarterly from next year.

However, it was one of the original sovereign green bond issuers that really caught the eye by bringing a new product that both broadened the suite of green securities on offer while also addressing a key theme of 2022 – protection from inflation.

Announcing its intention to explore a 10-15 year green OAT€I in December, the deal was priced in May – a day after Austria's €4bn debut – amassing €27.5bn of orders allowing the leads to tighten the spread 3bp during execution for a stellar result and opening a new front in the financial fight against global warming.

## SUPRANATIONAL EURO BOND OF THE YEAR

## European Investment Bank

**€4bn 1.5% June 2032 Climate Awareness EARN**

Bank of America, BNP Paribas, JP Morgan and NatWest Markets

One of the world's biggest issuers of green and sustainability bonds, the EIB first sold a Climate Awareness Bonds 15 years ago. But the issuer took its ESG credentials to the next level in 2022 by starting to issue Climate Awareness Bonds under its Euro Area Reference Note (EARN) programme – the brand for its benchmark deals in its home currency.

The move demonstrated the issuer's growing sustainability lending requirements as well as the boom in investor demand. EARNs

typically come bigger than the EIB's other euro issuance, usually weighing in at €3bn-€5bn.

This first Climate Awareness EARN from May not only marked a milestone for the supranational but provided an important test of demand for longer dated debt, which has been harder to sell in a year marked by rocketing interest rates.

The trade certainly delivered on all fronts, being the EIB's largest ever Climate Awareness Bond. The final book of €23bn allowed the issuer to tighten 2bp during execution to price 19bp through mid-swaps.

The EIB repeated the trick in September, this time pricing a €4bn March 2030 Climate Awareness EARN out of €33bn of demand. **G**

# SSA issuers show strength and agility amid market turbulence

The emergence of several major macro risks across the year caused a paradigm shift in primary markets, increasing the complexity and challenge of funding to a level many sovereign, supranational and agency issuers have not endured in over a decade. Yet, many SSA issuers rose to the challenge, demonstrating a strength, agility and composure in successfully executing their funding plans, some even earlier than planned. As we move into 2023, the macro environment will remain challenging, but how challenging and what does this mean for the SSA market? *GlobalCapital* discusses this, together with analysing the impact of the market turbulence during the past year, with some leading funding and investor participants from across the SSA market.

Participants in the roundtable were:

**Silke Weiss**, head of funding and investor relations, European Stability Mechanism

**Jörg Graupner**, vice-president, treasury funding, KfW

**Christian Engelen**, head of unit, borrowing and lending, DG Budget, European Commission

**Ralf Berninger**, head of investor relations and sustainability, SFIL

**Yiu Chung Cheung**, group treasury investments, ING

**Patrick Seifert**, managing director, head of primary markets and global syndicate, LBBW

**Richard Kemmish**, moderator and *GlobalCapital* contributor

**GlobalCapital:** Clearly, it's been a volatile year. There have been long periods when the market has been closed, when spread movements and rate movements have been more than we expected. Looking back at the year how have you changed your funding plans as the year has gone on from what you expected on 1st January?

**Silke Weiss, ESM:** The EFSF (European Financial Stability Facility) and ESM (European Stability Mechanism) funding plans for 2022 did not change and were kept at €27.5bn – €19.5bn for the EFSF and €8bn for the ESM. We have been active via auctions as well as syndications. What was different compared with 2021 was the timing and currency composition of our syndications.

We finished our funding programme exceptionally early this year. The last EFSF transaction was on 4 October and the last ESM transaction was on 17 October. We did not issue a dollar-denominated bond for the ESM as in previous years. The rationale for focusing on euros came from the fact that with higher European rates the demand for short-dated euro bonds increased and we were able to tap into that demand several times at attractive rates for our beneficiary member states, i.e. on September 20 we tapped the ESM September 23, 2025 bond with a coupon of 1% for a size of €2bn and a yield at 2.32%. Books reached €26.9bn and the new issue premium was negative 1.5bp.

We adopted a new communication strategy in 2022 as we ended the announcement of planned issuance windows at the end of 2021. This has given us flexibility on the timing when we could come to the market, which has been beneficial this year from the perspective of an issuer as well as for our investors. We were able to react to market demand and avoid heavy supply or volatile trading sessions for our executions.

We changed our auction activity slightly in May when we ended the 12-month bill we introduced during the pandemic. Bills remain an important tool in our instrument box to address liquidity needs. The ESM's liquidity needs in 2022 were lower and the additional line therefore stopped.

**Christian Engelen, EC:** As the EU we had our first full funding calendar year after the launch of our revised debt management operations for the roll out of Next Generation EU, a very big funding programme, and it was a year with a lot of challenges. The market was not giving us an easy time, but I think we are all in the same boat. For us, the funding needs are determined by the underlying programmes and because of that we don't have the luxury of modulating the funding needs over the full calendar year. This is why we decided to communicate funding targets in shorter funding semesters. So we actually communicate and structure our funding plans in six month cycles, which gave us the possibility to adapt in the middle of the year to new information about the programme needs but then also to communicate to the market our new funding target.

We communicated €50bn for both funding semesters so it was an even €100bn over the full calendar year but communicated in two semesters. It brings for us, and also hopefully for investors, a bit more stability in terms of the likelihood that we can meet our funding targets.

**GlobalCapital:** Jörg and Ralf, do you also communicate on an annual basis or do you go to a shorter period.

**Ralf Berninger, SFIL:** We communicate on an annual basis the volumes that we are targeting. We are a bit of an exception as, on the one hand, we are active in the SSA market, via regular benchmark issuance via

SFIL, and then we have a second leg where we issue public sector covered bonds via our subsidiary CAFFIL. Looking back at the year, our experience was that sometimes issuers needed to scale back ambitions. The market was more volatile and getting a smooth execution was the big topic.

**Jörg Graupner, KfW:** The initial announcement about our funding needs at the end of last year showed a number of €80-€85bn but the loan performance went well, so we increased our funding needs in July up to €90bn. We always communicate our funding needs two times a year, so also this year there was a slight increase of our funding volume. We have already reached this €90bn mark now. It was indeed an extraordinary year in the history of our activities and the external factors are well known. Once again, with our flexible funding approach, very smooth execution is necessary. Usually we wanted to do more dollar bonds in 2022 but from an economic point of view the benefits were more on the euro. Other currencies were also less attractive over the course of the year. These are the reasons that we did more euro transactions in total.

**Berninger, SFIL:** That is in line with our experience. This year was the first in a long time that we didn't issue a dollar benchmark.

**Yiu Chung Cheung, ING:** On the back of the war in February, did that bring forward or delay any of your funding plan? Obviously, you could have delayed because market volatility at the beginning was tremendous but are there any structural changes for 2023 that we should take into consideration given that you might have been conservative in 2022?

**Berninger, SFIL:** From our side this is probably not going to be the case. When we look at next year, we do not know exactly what the market will bring. It is very difficult to see whether you should go for a large share of issuance early in the year, or whether it is better to wait. We will be looking at investor demand, at investor interest. But we don't have a strategy to front load issuance.



**Ralf Berninger**  
SFIL

**Engelen, EC:** For the European Union of course the war has an impact on our funding needs next year, we have just proposed, and hopefully its near adoption, an additional support package that increases the funding needs. But from the funding execution side I must say that was one of the surprising elements this year. The market showed some reaction in February — but more in the equity market, not so much the rates market — and the rates market through the year was more driven by central bank policy expectations and less by news around the war. Also, the war has not yet impacted strongly into projections of global growth. So it was striking for me, I would have expected a stronger impact. There was a lot of volatility, but it was due to other factors.

**Patrick Seifert, LBBW:** I would confirm that view. In

some way we have rediscovered that SSAs are a safe haven in being able to execute transactions when others have to step back. At the same time you probably needed to display flexibility around the shape of the individual transactions. That could be on the currency choice that Jörg spoke about, or designing the transaction differently to what was initially planned. I think that the ultimate proof in the impact of monetary policy is at the long end, which obviously has suffered much more when it came to being able to issue smoothly.

**GlobalCapital: Silke, have you changed the way you approach deal execution?**

**Weiss, ESM:** We have adjusted our trade execution to allow for market volatility slightly. Previously, we would always do a two-day execution, meaning announcing the mandate one day before pricing. This year we have executed more intraday transactions, meaning announcing and pricing on the same day. Intraday transactions have allowed us to be as little exposed as possible to market volatility and price moves. Given the high volatility at times as well as heavy supply, investors have told us that they appreciated the faster execution style the EFSF and ESM can use. However, we have also used the 'classic' two-day execution in 2022, e.g. when it was needed to help market participants discover the right prices, e.g. after unexpected changes to economic data and possible changes to the speed of ECB rate rises.

**GlobalCapital: Yiu Chung, there is something that I'm always interested in for investors in this sector: SSA issuers try to be very transparent and predictable as much as they can at the beginning of the year. Does that actually matter to you as an investor?**

**Cheung, ING:** It's good to have an idea about what the value of SSAs will be relative to, say, the government bond. For us as an investor it's more or less in the same portfolio. For KfW, EU or any SSA that has some explicit guarantee, we see it as a substitute for some of the government bond holdings that we have. In that sense, transparency is very important for us.

More important is if we know that SSA issuance will be sizeable — and for 2023 we do expect that to happen, given that there are some pretty large redemptions coming in the SSA space. What it means for me is a bit more negotiating power as a buyer. To give an example, EU as a very frequent issuer, we have very good contacts with the guys and I think some of the elements that we give as feedback we see that on the issuance side. For me, this is an indication of a buyer's market, more new issue premium than in the last couple of years and the larger the programme will be going forward, the more impact you will have as a large investor. So, it is important.

**GlobalCapital: Issuers, is that need to create a plan on January 1 about the need to incorporate feedback from investors?**

**Engelen, EC:** For us it's one of the key pillars that we think is important to be able to come to the market with the regularity and the volumes that we need. We need to give investors sufficient time to prepare. We want to be as predictable and as reliable as possible. That's not only a matter of fairness it is also a matter of

consistency in the planning and to avoid being seen as opportunistic and trying to game the market.

What was just said is very clear, we come with very high volumes to the market, we have solid access to the market, and we are happy that we can place these volumes at reasonable pricing. Key for that is some kind of a mutual understanding between us and the market that we do that in a transparent way. That's one of the key elements that we take as a principle in our funding planning and in our communication with the market.

**Graupner, KfW:** I think the new issue concession, the premium is much more necessary in 2023, not only because supply is so huge, the ECB is probably less active, but also from a volatility perspective, investors need some buffer for the volatility.

The second point is the liquidity. In the last couple of days and weeks there have been a few comments about liquidity, and in particular that at the moment there is a concentration when we talk about which bonds are liquid and which ones are less liquid. The size of the transaction is important for investors; that they are always able to buy and sell a bond. This is one side of a definition of what liquidity is. The other side is a tight bid/offer spread. It's also important for having a liquid curve, when we are talking about coming out with a new issue, relevant for determining the fair value.



**Jörg Graupner**  
KfW

**Seifert, LBBW:** It is a buyer's market, let's accept that as reality for now. What has made trades successful is addressing the right pocket of demand in given circumstances. That's why at one point the shorter trades work better, at times the trades limited in size work better, at times the ESG transactions really made a difference. Depending on what value investors find in the individual SSAs, there will be a new issue premium, but it won't be the same for every issuer. So, from that point of view it's about differentiation and the names we have here today benefit from that as seen in 2022.

**Cheung, ING:** A question to Christian if I may, the only unfortunate thing about NGEU is: every time some politician is asking about mutual debt to finance energy or gas or whatever, people always look at NGEU and say, maybe there will be €25bn more, this is more for a name like EU. That's the unfortunate thing that we have about NGEU, you are a function of a lot of plans that are coming, especially this year with the volatility in the market and the gas prices, and as a consequence if there is one issuer where you see the new issue premium moving higher it is the EU. Is this something that you hear from other investors?

**Engelen, EC:** We experience that, indeed, the reactivity of the market to political noise is higher for us. And that has to do with the volumes we are talking about and with the novelty of NGEU and our presence. Maybe that's a process of maturing into an issuer where not every political noise is perceived by the market as an immediate threat of new funding volumes.

We are a political institution and like any member state or any of our peers, there are political ideas being discussed about what could be done or should be done, but that does not mean that it will immediately translate into a concrete initiative.

What we can guarantee to the market is that we communicate as transparently as we can existing confirmed funding needs and that for us it is absolutely vital to make sure that, whatever will be decided in the future, this will not erode our financial capacity and our ability to provide value.

If anything, additional funding volumes should actually give the market an optimistic perspective as this will improve the liquidity of our bonds without undermining our credit quality. Whenever we are asked what could be done in terms of policy design, we insist that this is the overarching principle because it is the foundation to provide value both to the market and to the policies that we support. If we cannot provide reasonably priced funding the implementation of policies will become very difficult.

**GlobalCapital: Jörg and Ralf, the amount you have to issue is not as sensitive to political news but are you also getting questions about funding needs as politics dictates?**

**Berninger, SFIL:** In our case, the underlying lending business is quite stable. We are a local government and export financing agency, and recent years did not really bring any large ups and downs in our funding needs.

One of the reasons is that local authorities rely on taxes on property which are quite stable over the years. We see a steady increase in lending activity, but it is not going up and down dramatically.

**Graupner, KfW:** KfW, as you know, is a promotional bank here in Germany. And in this role we also have been assigned tasks from the German government. KfW is conducting mandated transactions on behalf of the Federal Government, the credit risk in this case is borne by the Federal Republic of Germany.

As a consequence of the war in Ukraine, energy utility companies in Germany are suffering from supply reductions and significantly higher prices. The mandated transactions serve to secure the energy supply and resilience of the economy.

Importantly, since the end of October, we are able to draw on loans from the Economic Stabilisation Fund to refinance the mandated transactions. This is important for the energy companies and means that the mandated transactions are ringfenced by the Economic Stabilisation Fund.

**GlobalCapital: Silke, what can you share about ESM's funding plans for 2023?**

**Weiss, ESM:** The funding programme will be a similar amount, between €20bn-€30bn. We will announce the exact amount in our year end newsletter. The funding programme may change, should we be involved in any new programme, which means net supply from EFSF and ESM is stable.

We will issue benchmark bonds on different parts of the curve identifying the best opportunities in accordance with investor demand. We will continue to tap outstanding bonds, issue new bonds in euros and dollars, and will maintain our bill programme with three-

If cutting down on CO<sub>2</sub>  
so that we're not up  
to our necks in H<sub>2</sub>O is  
**your business**, then  
cutting down on CO<sub>2</sub>  
so that we're not up  
to our necks in H<sub>2</sub>O  
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and six-month maturities.

Our core objective will be, as usual, to raise potential additional liquidity needs smoothly in the market, using a wide range of maturities and products to avoid disruptions on specific parts of the curve or in specific products. We will continue our transparent communication of our funding plans and update the market about any change.

In 2023, we will be happy to introduce Pierre Gramegna, our new ESM managing director, to our investors and peers. Pierre was appointed in November by the ESM Board of Governors and took office on December 1.

**GlobalCapital:** Patrick mentioned the safe haven status of the issuers we have here, which is clear from a credit point of view, but the biggest risk this year has been duration. The EU in particular, but quite a lot of other issuers, have been issuing some high duration bonds. Whereas the covered bond market, for example, has been focussing on three to five year. What is the rationale or the justification for the longer bonds?

**Engelen, EC:** The maturity structure of our bonds reflects several factors, it's not only about market environment but also about arriving at a maturity structure which fulfils several requirements: that we stay within limits of our financial and budgetary capacity, that we create a maturity profile that facilitates a gradual repayment of debt that is required under NGEU and some other considerations.

So, we have a requirement to target a longer duration at the moment but will reduce that over time. It's not something that is absolutely mechanical but to some degree pre-determined and it will change over time. If we speak in a few years you will see a different maturity structure.

It is also for historic reasons, in the old world where we were funding our programmes 'back-to-back', so we were extending the same funding to the loan beneficiaries, we issued almost exclusively with very long durations. This is something that we have changed now, and it will also go down over time.

**Graupner, KfW:** In general, we have to act as a bank and the duration of our funding activities is determined by our loan business, that's very clear. On the asset side, it's rather short so that means that our funding activity is an average between five and six years. So we can't say that we have a need for much longer transactions, our funding need at the longer end, above 10 years and up to 20 years, is very limited.

What I see from the sidelines is that the very long end was less requested by the investor base and the reasons were interest rates combined with the inflation outlook and the expected supply.

**Berninger, SFIL:** When we lend to a municipality in France the typical loan format is 25 years amortising. In terms of issuance strategy, we do a lot of the long dated issuance under covered bond format. When we issue in the agency market, we have a bit more flexibility. The trend we saw this year was that issuing long dated has been more complicated. A lot of the investors looking for 10 years at the beginning of the year are rather looking at three to five years now. So things have become more complicated at the long end.

**Seifert, LBBW:** You know better in the UK! The very long end and the volatility hurt very, very hard. Those were extraordinary circumstances. There are issuers with structural needs at the long end and others that have been using the long end to escape negative yields. The long end has traditionally never been something that you would tap every single day but has always been a little bit more challenging.



**Patrick Seifert**  
LBBW

When we leave 2022 behind, we are looking at

fairly attractive fixed income markets. Going forward we see yields that are attractive in historic terms and backed by the underlying quality, which is addressing recession fears, we are moderately optimistic for the long end next year but it's not for everyone, let's be honest.

**Graupner, KfW:** I think it's worth striking a more positive tone. It is quite remarkable that there was this continuity in the market and stability in the market that gave us the possibility to basically access the market with these longer durations and still at reasonable prices. It has become more expensive, but it could have been much worse given what we have seen. So overall, I'd suggest a rather positive note in 2022, and hopefully, if the volatility recedes a bit going into 2023, we'll see greater stability and we can build on that. At least from our perspective, we never had the feeling that we were facing a situation where the longer dated executions were really at risk, and that's a remarkable finding for a year like 2022.

**GlobalCapital:** Yiu Chung, duration has obviously been problematic this year. Given that SSA issuers are so much constrained by having to issue longer duration, while the covered bond market isn't, do you feel a temptation to put on more covered bonds and less SSA?

**Cheung, ING:** For most bank treasury investors, the HQLA investors, it is not the duration that's an issue simply because we swap the duration away. What is left is just credit spread and from that perspective it becomes a pure relative value position relative to swap or — if there is an explicit guarantee involved — a government bond. If you look at, say, where an EU is trading relative to where France is trading, for us it's a very logical choice to say let's put some money into AAA EU. The volatility, sure we have to endure that but as a banking book you have a little more leeway.

At the very long end, if you have to buy it for ALM reasons and you have outright duration positioning it is rather painful but from a credit spread perspective it has been very well behaved. Obviously, there were times when it has gone bad — QT is one important risk factor — but generally it has been very good for us given the flexibility of our long bonds mandate and that is the reason why, as Christian was saying, it has been very good for the EU, it's exactly for this reason that this is happening.

For the covered bonds it might be a different story.



What we have seen is that demand for covered bonds in the past couple of months has been at the front end as longer dated paper saw less interest. This in contrast to e.g. SSA where especially green long bonds saw healthy appetite.

**GlobalCapital:** Jörg, we have been speaking about the euro market but you are also active in other markets, particularly dollars. Patrick mentioned sterling, have you relied more or less on foreign currency this year than you would have expected and how does it compare?

**Graupner, KfW:** We have our natural funding needs in euros, but, of course, we also execute in foreign currencies if and when there is an arbitrage possible and/or there is an opportunity to show our flexibility and broaden our investor base.

On the dollar side there is one thing I want to highlight — we want to be a permanent issuer from a diversification perspective, and it is absolutely helpful that we can refinance some of our fundings needs in dollars. As a permanent issuer I can say that we also have a liquid curve in dollars. We have done four benchmarks in 2022 in dollars. We usually wanted to do more but the economics were against this. I'm very positive that we are continuing our dollar refinancing activities within the next years, which will strengthen the liquidity in our outstanding dollar bonds.

**Weiss, ESM:** Since 2017 we have a strategic presence in the dollar market. The dollar market gives access to dollar funding in up to five year tenors normally. With higher interest rates in euros and greater interest in the short end of the euro curve we saw great interest from investors in euros and therefore this year, we have not issued in US dollars. The dollar market for the ESM has been a great addition to its funding strategy and remains an important strategic tool for the future.

**GlobalCapital:** We haven't spoken much about central bank policies. How is the normalisation of QE changing relative value and liquidity in the SSA market? Is it a game changer?

**Seifert, LBBW:** 2022 was a year when you could spend a lot of time blaming central banks for getting it terribly wrong. But let's face it: a couple of things were really unprecedented and unexpected so let's give them credit that they managed to get back on course.

Getting back to the 'buyer's market' notion — a lot of them have come back with nominal yields going up. They are again finding value in SSAs, it's not chasing return at any cost but it's much more risk aware. And with a recession waiting for us, it's not difficult to find value in SSAs. We still have a bit of market distortion. But at the end of the day it is much more of a market rather than investors trying to buy the ECB leftovers and moving into more risky asset classes. Overall, some seem to have been underestimating the aspect of liquidity which is why the issuers that we are discussing here add so much value.

**Engelen, EC:** For us, the impact of the withdrawal of liquidity support from central banks is noticeable throughout the market. The question is if there are more impacts on SSA than EGB? We do not see that there is a single driver from the central bank driving

SSA disproportionately compared to EGB, we all feel the same pain. For the SSA and all swap products, the swap spread development was really painful, but I didn't see that as mainly driven by central bank policy, there were other structural factors.

We heard that from Yiu Chung, he is looking at us — and this is music to my ears — in comparison to France, there is no distinction between SSA and EGB, there is a distinction in terms of certain rating classes. I think that's a positive development that shows also why there is no disproportionate impact on the SSA market, compared to the EGB market.

**Graupner, KfW:** Talking about TLTRO, QT, my view is that repayments of TLTRO puts more repo bonds back into the market and this could be one of the reasons why, in the next weeks or so, we do not see such a wide bund swap spread. On the QT side of course Christian is right when he said that the ECB put more liquidity in the market. My expectation on the QT side is that ECB will be not an active seller. The redemptions will no longer be fully reinvested, so maybe we will get more information about this out of the ECB during the December meeting. In addition to that, one huge buyer, the ECB, will be less active in secondary and primary.

Bonds have to find new investors and we will see more liquidity in the outstandings.



**Yiu Chung Cheung**  
ING

**Cheung, ING:** You asked if this is a fundamental game changer? Of course, it's not. We've been in this situation before 2012. The strategy that a lot of investors, liquidity providers, market makers had in the past 10 years is to follow the biggest elephant in the room — the ECB. Now that the

ECB is stepping out we are back to old skills: relative value is important, inventory control is important, basis risk hedging is important because you need to know how your position is moving relative to your hedge. These are very fundamental skills that liquidity providers need to find again, and they will. So, in that sense it is not a fundamental game changer.

In the SSA market you have to think about efficient inventory control because supply or taps tends to be less frequent and more difficult to predict. This means that a market maker short in bond A either needs to buy that bond back, or hedge it with a second best bond, use repo for delivery and wait till I get hit in my bid.

If you ask me will liquidity improve? Yes, the structural question about liquidity is about the free float of bonds. If the biggest elephant in the room is buying less then there are more bonds available, then you come back to elementary questions like how much is EU going to issue? How much is KfW going to issue? What part of the curve? How should I position? It's a blessing to finally move back to a situation when the fundamental valuation of a bonds is becoming key again.

**GlobalCapital:** Patrick, I'm sure you agree about a return to normality. Does it feel like a return to normal for your trading, syndicate, relative value...?

**Seifert, LBBW:** The fascinating thing is we are getting back to normal after so many years of zero interest rates, we have been in negative territory, some even lost the belief that we would one day get back. So, it is really good to see those readjustments, normality coming back, price is now driven by investors, not just one investor, but by investors looking at opportunities and making economic decisions. That's the best we can expect: A functioning market. I absolutely share the comments on liquidity being very important going forward. When looking into real transactions, you see those names — real buyers who have been sidelined for many years and that is the difference to buyers who have been there to piggyback the ECB in one way or another. So, optimistic. Absolutely.

**GlobalCapital: Ralf, as someone active in both the SSA and the covered bond sectors, how does this 'paradigm shift' — the brand new market, central banks fundamentally changing. Similar in the SSA and covered bond sectors or are they different?**

**Berninger, SFIL:** Overall, it's the same story. What we expect to see next year is going to be a big shift in the investor base. When we look back six years, when looking at our order books, we had well over 30% bought by investment managers and insurance companies. This year it was significantly below 20%. We expect this trend to reverse.

When we look at investor meetings this year, we had a lot with investors we had not seen for the past three or four years. These investors are coming back, or will be coming back, next year. One question will be whether this is going to be a quick process.

**GlobalCapital: There are a couple of big trends in ESG markets. One is a lot of new investor reporting, disclosure, green asset ratios, etc. A second is pressure for more holistic reporting — about an overall organisation. What is the net effect? Are ESG bonds, relative to other bonds changing? Is the greenium increasing?**

**Graupner, KfW:** We haven't seen many changes in 2022, but the recent questions that we have received from investors are more and more related to rising regulatory requirements. This, of course, brings some challenges for us as an issuer. What the investors have to adopt is very strict, not just on the ESG bonds but also on the conventional bonds. What we at KfW are aiming to do is bring our green bonds closer to the EU Taxonomy, but this is a long way. We have included statements on the current status of the implementation of the EU Taxonomy in our green bond framework — the underlying assets meet the majority of the substantial contribution requirements. We will continue in 2023 with our current framework. On the holistic side, we have top ratings from the relevant agencies — special green agencies and the bigger well known agencies. We are constantly improving in this area.

**GlobalCapital: Christian, is the EU the world's biggest green bond issuer yet?**

**Engelen, EC:** I wouldn't say 'yet'. There are bigger outstanding volumes but, given the magnitudes that we could take it, could become the biggest green bond programme in the world. We have said that we want to

issue up to 30% of the Next Generation EU in the form of green bonds which will be around €250bn, and that is quite a sizeable compared to other programmes out there. We have issued so far around €36bn in green bonds, we also need to do that in line with the green expenditure reporting that we get from our member states on what the money is used for. We can't just issue that in a front-loaded manner and hope that we can confirm that this has been used for the right purposes.

In our green bond framework, we need to keep a close link with what we have reported and that is why we have issued so far €36bn, which is a good amount compared with the implementation of NGEU.

We had quite a good experience with that, our framework — even though it is relatively young has established itself quite well and we see that in the transactions it is a factor that is helping us in terms of demand. Investors appreciate that. I wouldn't like to go into detail about whether that yields a greenium or not, that is dependent on the specific moment, transaction, maturity, environment. As we always said it was never our main objective to get a sizeable greenium. For us it's more important to build up a loyal and broad investor base that is supporting us in the issue of green bonds. So overall quite a good experience so far, we will continue with that, when we meet in a year's time maybe I can report whether we are on track with reaching the biggest programme out there.

**GlobalCapital: Yiu Chung, are you seeing a lot of new reporting disclosure and reporting requirements?**

**Cheung, ING:** Absolutely. What we do right now is really dig quite deeply into what is a green asset. The EU taxonomy gives a bit of a guideline, as does the delegated act. We have seen a number of newspapers reporting about investors being accused of greenwashing, so we are extremely careful about the green asset side of our balance sheet. I think we will move into a situation, maybe in the coming 18 months when people will be more careful about anything that seems green.

The same things will hold for us, we will scrutinise the issuer, asking for additional information about why something is being categorised as green. What is also very important, when we have the asset side well defined in terms of green, we can move to what we call green ALM. So, we have to match it with green liabilities. If a lot of financial institutions are doing it this way then probably issuance in green is going to increase which is a very good thing.

So, all of these things for me would imply that the greenium that we see now, which is not that big by the way, is going to move towards flat. I think that's good. At the end you want, that the question is not 'what the standard curve is?' and 'what green is pricing relative to the standard curve?'. But in the future the standard curve is green and anything else will be at a discount. Hopefully we will move to that situation because that is the only way to create a future asset out of current liabilities.

**GlobalCapital: Patrick, do you agree that the greenium is diminishing and we should look at green as the default setting?**

**Seifert, LBBW:** We are moving in that direction absolutely. One or two years ago, a large asset manager from France said 'green is mainstream' and I agree with that.

What exactly is green? In the context of the energy crisis, we need to redefine some of our thoughts on nuclear energy, carbon capture and storage, etc, but that's a definition thing. It's about providing as much transparency as possible. You also have to look at what you do not issue in green, the conventional business. The more transparency is coming across the entire value chain, the more credible investors can find issuers or not. In the long term you cannot get away with issuing in green and everything else stays as is. I don't think that is credible.

This year the green feature sometimes made the difference between a deal and no deal meaning we are not simply talking about some basis points greenium. Those transactions helped attract and develop a much broader investor base.

**Berninger, SFIL:** I totally agree. The greenium has been much less of a topic. But there have been big advantages by widening the investor base. New investors are coming aboard because you have more differentiation to other issuers via your green and social issuance. And then obviously smooth execution has been a big topic. When you issue under green format you are sure of getting more investors on board.

For us this year a big topic has been setting up of a new 'Green, Social and Sustainability Framework'. On top of what we were doing already, we are now providing social loans to local authorities, for example for public education. And we are going to issue social bonds with a focus on local social investments.

With respect to the holistic approach — yes, absolutely. We see more questions from investors on the overall approach on sustainability. That is something that we know already from issuing social bonds. When we met investors for a social bond project, they were looking much more on the overall approach, than what they did on the green bond side. So, we are now going in the same direction for green bonds as well.

**GlobalCapital:** The taxonomy has its debates and uncertainties for green assets. Does it matter that we don't have a definition of social assets at an EU level?

**Berninger, SFIL:** We are active in green and social bonds. It is clearly a good thing to have a Green Taxonomy. We always had discussions in the past, for example on whether hybrid buses are a green investment or not. So, it is a good thing to have clear standards. On the social side, I think it will not be possible to replicate what we see on the green side. There are so many other factors to consider which make it more difficult to have clear criteria. But it will be useful to have a more common language on the social side.

**Engelen, EC:** We are issuing social bonds. The SURE programme was where we issued with a social bond label. We need to be a bit careful as issuers because bifurcation is an issue. It is already challenging with the dichotomy between green and conventional bonds, if you add a third category you end up undermining the fungibility of your bonds and that will come with a price.

As much as we from the Union like the idea of social bonds I do not see that we will easily jump into a new social bond issuance, precisely for that reason. Any sizeable issuer will need to think about the same issues. Because also for the green, it only makes sense if you

are able to put out a sizeable volume of green bonds and to maintain that. It is our intention to build a green curve across all benchmark maturities precisely for that reason, because we want to keep it liquid, we want to issue the full spectrum of maturities so that investors can properly hold and trade that, otherwise it will die out over time.

**GlobalCapital:** We have already spoken about future funding plans and the drivers of future funding. In general, though is there anything you can say about total supply in the SSA market because of what Patrick likes to call this paradigm shift?

**Seifert, LBBW:** What we heard from the issuers is that they are mindful of expectation management. There is political noise. If you ask politicians, they probably want to double funding plans. But that is not on the agenda for now. It's a fine balance between expectation management and reliability. Being sufficiently big but not oversupplying.

There is some management issuers can do around that — foreign currencies, for example. In Germany, the TLTRO was something that KfW used. We also heard of the bill programmes. That is showing the way that the benchmark supply is being managed.

Going forward, there remains a very strong role for Europe and for governments, let's not ignore that. That has a lot to do with the geopolitical context. Therefore, issuance volumes will remain elevated but by no means out of control. There always must be a strong link to the use of proceeds and why we do certain things. It's good that Germany, or strong members of the Union, are willing to make those investments. Let's take a second to think how Ukraine, without that support, would be a totally different scenario. We are very happy that this is not the case, that we can be united and support those political decisions with competitive funding. Again, elevated but manageable levels.

**GlobalCapital:** Do you agree, 'continued elevated but not excessive issuance for the sector as a whole'?



**Christian Engelen**  
European Commissioner

**Engelen, EC:** We are very mindful that we bring quite big volumes to the market and that is what we have communicated from the beginning. Next Generation EU is a sizeable programme and needs to be implemented within a certain timeframe which leads us to our funding needs for that

programme alone of between €100bn–€150bn per year. As we have communicated, we are just about to agree on an additional support programme for Ukraine, so this gives some guidance as to where the funding needs could lie. With these funding needs, we would be one of the prime suppliers, if not the biggest supplier of net new issuance.

Being in that position is already challenging, I have no ambition to stretch it out to the level where the market goes on strike. So, it will be already quite difficult for us to implement prudently set funding targets and we will communicate that quite soon, as I said, with no

intention from our side to be experimental in terms of what the market can absorb.

**Berninger, SFIL:** Our public sector clients obviously have a big role to play. It's a big role mainly linked to green transitions. We see a lot of investment needs for green public transport, energy efficient buildings or waste recycling. Looking ahead, we expect to have strong lending activity.

**Graupner, KfW:** On our side, I want to repeat that we are in this good situation where we can refinance our activities, specifically what we do on behalf of the Federal Republic of Germany, via the Economic and Stabilisation Fund.

So, no additional funding needs on this side. On the traditional side, our funding needs are driven always by developments on the loan business and redemptions. The Commission or the EU don't have a huge number of redemptions. We do, also in 2023. At the moment, I can say there is no huge change to expect when we're talking about our funding needs for 2023. We want to publish our funding needs in December.

**GlobalCapital: There is one very specific change for the ESM: your membership is going to grow. How are the plans progressing?**

**Weiss, ESM:** We are excited that as of January 1, 2023, Croatia will join the euro area. Consequently, Croatia will shortly afterwards become the 20th member of the ESM. The technical preparations for Croatia to join the ESM are ongoing. Just like all other ESM members, Croatia will contribute to the ESM authorised capital based on its respective share of the EU total population and gross domestic product (GDP).

Croatia is the third country to join the ESM since its creation in 2012, following Latvia in 2014, and Lithuania in 2015. The fourth, if you chart back to the creation of the temporary European Financial Stability Facility, with Estonia joining the euro in 2011. The minister of finance of Croatia will become a member of the ESM board of governors that take all the important decisions regarding the ESM.

Croatia will benefit from the solidarity that comes with ESM membership, with access to financial assistance tools with a total available firepower of over €413bn. This is a signal of protection for investors

**GlobalCapital: What do you think is going to be the main talking point at this session this time next year?**

**Engelen:** I find it difficult to pick just one big story. There are so many themes I expect to continue, such as geopolitical risks, inflation and economic growth.

Top of my mind as an issuer are, however, the issuance dynamics and ECB balance sheet adjustments. I expect that primary markets will be more challenging on increased net supply and a less active ECB.



**Silke Weiss**, European Stability Mechanism

**Cheung, ING:** If you look at this year, there was nowhere to hide. There was no diversification whatsoever. Risky assets underperformed, bonds underperformed simply because we were all driven by the same common factors: central bank balance sheets and inflation. Next year, the big story will be what retail investors will do?

If you look at how much money is sidelined at the moment in the US, look at just the size of the reverse repo at the Fed balance sheet. This is all fund money that is ready to be invested and if you think about what levels we see in government bonds or SSAs compared with bank deposits, I think people will start to wake up and say 'risky assets? Maybe not yet.

But bunds and two year Schatz at levels way more than attractive than bank deposits? That will create demand for fixed income. What will happen is that Central bank QT will be replaced by investor QE. That will be a very important trend. You see it already in the US as direct participants in auctions is increasing. In Europe we will see the same type of trends.

**Engelen, EC:** We hope that next year we will discuss how the dichotomy, the boundaries between the SSA and the EGB markets, have come down further. In a world where the SSAs are outgrowing the SSA niche, I think it comes back to fundamental value analysis of the individual securities, relative value and to think in that manner, not about the classification which, for us, is not the best way to look, given the transition we are undergoing.

**Berninger, SFIL:** What we expect is a shift in the investor base. We've got all of these real money investors that started buying corporate bonds or senior non-preferred bonds to get sufficient yield. They will be coming back, and they will replace some of the activity from the ECB and some of the activity from bank treasuries. The big question will be: will this go smoothly or is this going to create volatility?

**Graupner, KfW:** Let me first answer the question more politically. The common understanding within the participants here is that we hope that we can see the end of the war in Ukraine and once again face the challenges we usually have to face – climate change, for instance – more fully.

The question of energy supply is also closely linked with this. On the market side, key issues will be being flexible and bringing liquid bonds, as well as finding the right balance between what the issuer and what the investor needs are.

**Seifert, LBBW:** The good thing about the paradigm shift is that it will be one year old, we will have learnt some way to deal with it.

The energy crisis is hitting the north harder than the south, for Europe that is interesting, it forces us to really appreciate the value of a unified Europe in the geopolitical context.

Some of the risk is still out there and hasn't full translated into real economies. Bottom line at LBBW, we remain optimistic for fixed income – 60% of the investors that we recently did a survey with do not expect SSA spreads to widen. It won't always be a one way street but the quality of SSAs will add value going forward and give room for secondary performance. That's why we stay optimistic that fixed income is back. GC

# SSA market braces for tough times but optimism remains

SSA issuance is likely to increase in 2023, but so too will demand as higher yields draw in more buyers. However, the transition away from central bank support means borrowing will be far from straightforward. By **Addison Gong**.

The sovereign, supranational and agency bond market has had a tumultuous ride in 2022 as global economic growth slowed, inflation soared, interest rates climbed and central banks finally began to wind down their vast quantitative easing programmes — support measures that had, of course, greatly benefited the sale and price of public sector debt in recent years.

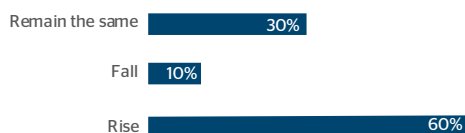
After a year of transitioning, public sector borrowers will enter 2023 where more challenges lie but so will opportunities, according to the results of a survey of public sector origination and syndicate bankers, undertaken in late October and early November by *GlobalCapital*.

About 72% of the SSA bankers surveyed believe that overall funding issuance volume is set to rise in 2023. But the view is split on how sharp that increase could be: half of them think volume will jump by more than 20%, with the other half expecting a more modest jump of less than that.

“There is no question that issuance volumes will go up next year, which will be felt more in the sovereign space. The response to the energy crisis is going to be a big driver of issuance,” says Kerr Finlayson, head of frequent borrowers group syndicate at NatWest Markets. He does not foresee issuance jumping by more than a fifth year-on-year, but expects government borrowing costs will be higher on the back of larger volume.

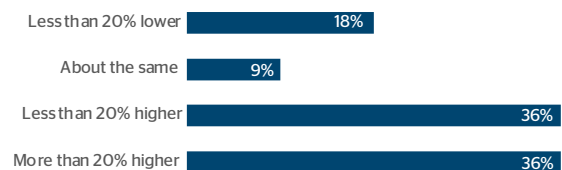
Finlayson is not alone. All respondents to the survey believe that the energy crisis in Europe will add to bond supply pressure in 2023, though the extent of the impact is not clear. A slight majority of 55% believe the impact on government borrowing requirements could be significant. Around 75% expect issuers to frontload their supply.

What will happen to the average spread of dollar SSA bonds to US Treasuries in 2023?



Source: *GlobalCapital*

How will overall SSA issuance volume change in 2023 compare to 2022?



Source: *GlobalCapital*

Governments across Europe have announced measures to help their citizens cope with soaring energy costs. Some €674bn of funding was allocated across the European Union, Norway and the UK between September 2021 when the energy crisis started — and was subsequently intensified by the Ukraine war — and October 20, 2022, according to Brussels-based think-tank Bruegel. Nearly 40% of that came from Germany alone.

ING expects around €1.2tr in gross European government bond issuance in 2023, up by €85bn from 2022 “with risks that [the increase] could turn out even higher”. Net issuance, however, should remain below €400bn, compared to €385bn this year, the bank said in its 2023 outlook.

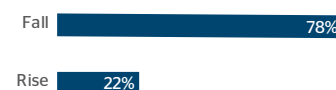
A syndicate banker based in Europe said he is “almost sure” that the 2023 issuance volume could go back to the 2020 peak during the Covid-19 pandemic, as all governments are tasked with financing their own energy support packages and some possibly for the European Union.

But he thinks demand should rise in tandem with supply. “There will be more funding but the positive thing here is that there will be higher liquidity, too,” the banker said.

“Investors will allocate their money differently next year and more money will go into the SSA space for sure, because of higher yields. Some investors, particularly [pension and insurance] clients, were not there in the past five or six years but they will focus more on this liquid space instead of structured products, now that it’s more attractive from a yield perspective.”

Jamie Stirling, global head of SSA DCM at BNP Paribas, holds a similar view. “We’ve seen very difficult markets in

What will happen to the average spread of euro SSA bonds to Bunds in 2023?



Source: *GlobalCapital*

all sectors, [and] SSA issuers, while they may have had to pay slightly higher spreads, still have had market access and have been raising money,” he says.

“The positive is that in this new environment, a lot of investors from the real money community — who haven’t been investing in SSAs for many years because of low rates — will return, because investment will be far more attractive than it has been in recent years.”

### Spread and premium moves

The higher supply in sight and central banks unwinding some of the quantitative easing (QE) measures have left market participants wondering what will happen to SSA spreads.

A big selling point of European supranational and agency bonds this year, particularly in recent months, has been their relative value over government bonds. The average spread over govies has risen to 68bp in the fourth quarter of 2022 as of November 14, from 45bp in the first quarter and 35bp in Q4 2021, according to data from *GlobalCapital’s Primary Market Monitor*.

From mid-October to mid-November, euro issuers were paying an average of 70.5bp over Bunds.

But the elevated spread versus Bunds is unlikely to be sustained going into 2023. Some 78% of bankers surveyed hold the view that the premium over Bunds will decline, with only 22% believing it will continue to climb.



“There is no question that issuance volumes will go up [in 2023], which will be felt more in the sovereign space”

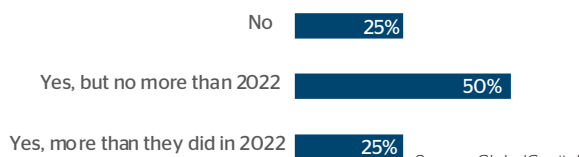
**Kerr Finlayson,**  
NatWest Markets

“[SSA] spreads should tighten against Bunds but widen against mid-swaps,” NatWest’s Finlayson says. “We’ll see swap spreads tighten once we start getting more rhetoric around [quantitative tightening] from the ECB and by default, that means spread against mid-swaps should widen.”

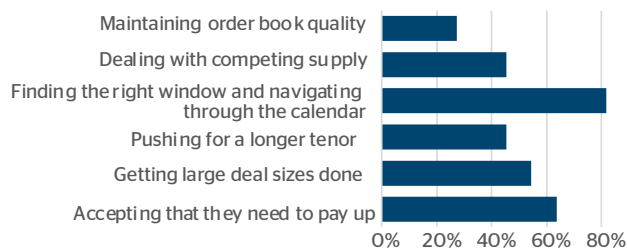
Ten year swap spreads have been wide this year — at times more than 100bp over Bunds.

With the QE-induced pricing advantage disappearing and investors demanding more compensation as market volatility persists, SSA issuers have seen new issue premiums rise

Will issuers frontload supply in 2023, in light of more rate increases and uncertainties?



What will be the top priority for SSA issuers in 2023?



Source: GlobalCapital

from nearly zero at the start of 2022, to mid-to-high single digits in late October and early November.

About 36% of the bankers that participated in the survey think the premiums paid by issuers will be considerably higher in 2023. Some of them think double-digit concession could be on the table.

However, a majority of 64% of SSA leads think premiums should fall after rising initially.

“We’ll have to see how spreads move in the next few weeks, and the big question mark is on January and how the market is going to digest all the potential supply, but there’s no doubt that larger concessions will be required next January versus January 2022,” says a senior SSA banker in London.

“But I don’t think we’ll see 15bp-20bp concessions like some people feared. The market is already going into the year-end with more cheapening, and that’s probably a good thing because it’ll provide attractive levels for the early part of next year, which would then give us some opportunity to see some performance.”

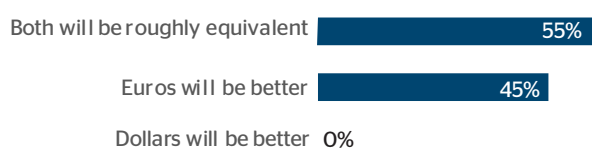
### QT, inflation concerns

*GlobalCapital* also asked SSA bankers to identify the main factors that could in their view disrupt the SSA market in 2023.

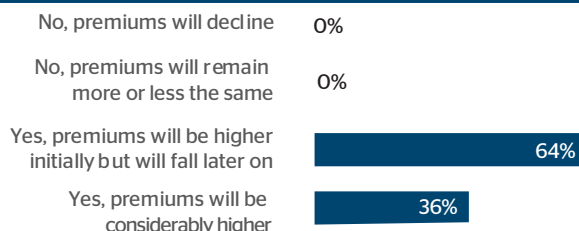
Almost all of them (91%) pointed to the reverse of QE as their top concern, but many (64%) are also worried whether inflation will be brought under control. A recession (36%) and unforeseen volatilities (36%) are also very much at the back of bankers’ minds.

“The reverse of QE is the key thing,” says a senior banker at a US firm. “Clearly we’ll have a different environment versus to what we had earlier this year where a lot of the supply were already absorbed in the first half of the year

Will dollars or euros provide a deeper pool of funding for SSAs with access to both markets?



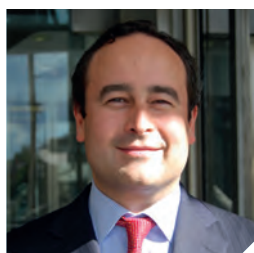
**Will issuers have to pay higher new issue premiums in 2023 than in 2022?**



Source: GlobalCapital

with the help of QE. It'll be interesting to see how that's going to play out next year."

The Europe-based syndicate says the ECB will not be as aggressive as some may think with QT. "There will be some balance sheet reduction but the impact of that will be outweighed by the comeback of liquidity next year, in my view," he says. "I think the liquidity that's coming back next year can absorb the effect of the central bank tapering that will come into play. The question is how investors will allocate the money that needs investing at the beginning of the year, which will depend on the economic and inflation outlook."



"SSA issuers, while they may have had to pay slightly higher spreads, still have had market access and have been raising money"

**Jamie Stirling,**  
BNP Paribas

The European Central Bank is set to decide how it will reduce its asset purchase programme monetary portfolio at its December 2022 policy meeting.

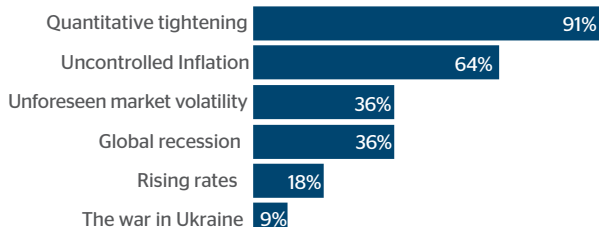
Market participants believe that, like the US Federal Reserve, the ECB might take a more gentle approach when it begins QT, starting by gradually reducing reinvestments in its conventional bond purchase programme, as opposed to the Bank of England (BoE), which has started to conduct outright sales of short and medium term Gilts.

"The ECB, when it starts QT likely next year, will take a more passive approach similar to the Fed, so it will not be as impactful on the bond market," says a London-based fixed income investor, pointing to the much longer maturity profile of UK debt as the reason behind the BoE's aggressive approach.

Economists at Société Générale expect the ECB to begin QT in March 2023, when the central bank will first reduce reinvestments in the private sector programmes, and then the public sector purchase programme (PSPP) in the third quarter and finally the pandemic emergency purchase programme (PEPP) in 2024.

Depending on the degree of QT, the market may need to absorb €100bn-€135bn of additional supply from euro-zone governments and the EU, the French bank said in early November.

**What do you think the major disruptors of SSA issuance will be?**



Source: GlobalCapital

**Silver linings**

With the end of negative rates in Europe, the exit from QE and more uncertainty in the overall market, issuers are expected to adjust their priorities in 2023.

About 82% of bankers who took part in the survey believe SSA issuers' main task in 2023 is to navigate through the calendar — between central bank meetings and economic data releases — to find the right issuance windows.

Having enjoyed ultra-low funding costs in recent years, SSAs will also have to accept that paying up is the new normal, according to 64% of the survey respondents. Bankers also put weight on getting large deal sizes done (55%) and pushing for longer tenors (45%) as part of the main focus for public sector borrowers.

As pricing windows are expected to be fewer and farther between, so dealing with competing supply also holds the key for issuers (45%).

"Unless the backdrop improves significantly, getting the same size deals done as before is not feasible so issuers will need to do more deals, simple as that," says the senior banker in London. "But that means there is going to be more clashes of issuance and more conflicts. We will have smaller windows and they'll be saturated much more so than previous years. And that could be the biggest issue we have."

But market participants believe that SSAs, more so than issuers from other sectors, are well equipped to deal with the upcoming challenges.

Finlayson believes 2023 will not be "a year of crisis" but "a year of resetting and a year when we go back to a 'normal' or 'standard' market where yields are higher, after we've done some transitioning in 2022".

"It's part of the cycle," he says. "It'll be a tough market, no doubt, but we will adjust to it. Our issuers are not in panic mode because every one of them has lived through some kind of crisis before, so they are very pragmatic about paying what they have to pay, if higher concessions are required — they've done it before." GC

**Will the energy crisis result in higher government borrowing requirements?**



Source: GlobalCapital

# When the going gets tough: end of easy money for SSAs laid bare

Public sector borrowers have faced a changed market in 2022. As rates – and market volatility – have risen and central bank support has retreated, this elite group of borrowers has had to face up to the reality that there are no longer any easy deals, as analysis of proprietary data reveals. By **Ralph Sinclair**.

The first and clearest sign that sovereign, supranational and agency bond issuers would no longer have it their own way after years of near flawless execution of their syndicated benchmark trades came in June, when two borrowers had to pull their deals in the same week — France’s Sagess and Canada’s Caisse de dépôt et placement du Québec.

That was something a number of SSA market veterans could not remember having happened ever before. But it was a sign that the combined forces of rising interest rates, market volatility — as investors struggled to grasp the level of inflation gripping economies — and the withdrawal of central bank bond buying were taking their toll on what had been glorious primary market conditions for borrowers.

Now, data gathered for *GlobalCapital’s Primary Market Monitor*, which tracks certain execution metrics of syndicated benchmark issuance in the major currencies, demonstrates just how much tougher SSA borrowers have it for their most important bits of fundraising.

Demand, as measured by the subscription ratio for syndicated deals, has slipped since the beginning of 2022 — and indeed since the beginning of 2021. Meanwhile, the average new issue premium has risen, suggesting that the extra spread is not attracting extra orders.

That seems grim enough — but add to that falling issuance volumes and a lower number of deals and one might typically expect the balance of power to have swung in the favour of issuers and yet it has not. In 2021, *Primary Market Monitor* recorded 422 syndicated benchmark deals from SSA issuers, raising just over \$1tr-equivalent of funding. The average deal size was just shy of \$2.4bn-equivalent. In 2022, up until mid-November, there had been 362 such deals, raising just over \$670bn-equivalent, or an average of a shade under \$1.9bn per deal.

Meanwhile, the amount of demand per deal has fallen across the board. Agencies attracted, on average, orders of 2.8 times the deal size in the first quarter of 2021. That slipped to 2.5 times in Q1 of 2022 and has amounted to only 1.7 times so far in Q4. Supranational issuers attract-

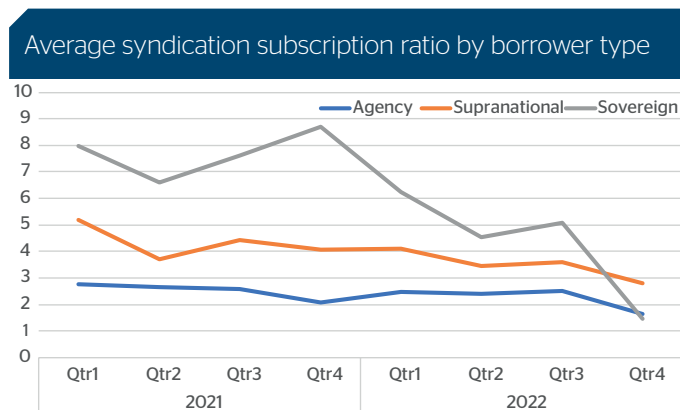
ed, on average, orders of 5.2 times the deal size for their public benchmarks in Q1 2021, a figure which fell to 4.1 times around the turn of the year and which has languished at 2.8 times so far in Q4 of 2022. But the biggest drop has been in demand for sovereign syndicated issuance. The average sovereign syndicated benchmark was eight times oversubscribed in Q1 2021 but has been just 1.4 times subscribed in Q4 of 2022 so far.

## No push on pricing

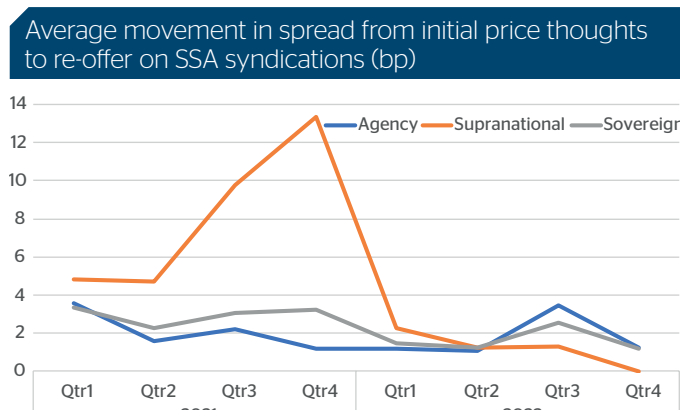
There has been greater caution over pricing too. A trend for issuers of recent weeks has been granting investors certainty of pricing by not attempting to squeeze the spread during execution. In Q4 of 2022 so far, agencies, supranationals and sovereigns were able to tighten pricing on their syndicated benchmarks on average by 1.3bp, 0bp and 1.2bp respectively.

They have made that choice — or perhaps have had it forced upon them — to placate investors wanting greater protection for committing cash to deals as interest rates rise so fast.

By comparison in the easier, central bank-supported markets of 2021, those same three types of issuer were able to tighten pricing by 2.1bp, 8.2bp and 3bp, respectively, accord-



Source: GlobalCapital Primary Market Monitor



Source: GlobalCapital Primary Market Monitor



ing to *Primary Market Monitor* data.

Issuers have been paying up too. The *Primary Market Monitor* measures new issue premiums paid on syndicated benchmarks by taking an average of what market participants on and off the deal calculate it to be.

The measure is, of course, subjective but taken for the market overall gives a guide as to what issuers are having to pay over and above fair value to sell new benchmark bonds.

Supranationals paid, on average, 0.8bp of new issue premium for a syndicated benchmark in 2021. That has risen to 2.7bp for 2022 to date and has been 3.5bp and 3.6bp for the last two quarters respectively. Canadian issuers paid on average 1.1bp of concession in 2021 but have had to cough up 3.4bp so far in 2022.

French issuers have paid 5.7bp of premium per benchmark in 2022, compared with 1.6bp in 2021.

Another theme of 2022 has been patchier access to dollar funding, as the US Federal Reserve took the lead among the world's central banks in

pushing up interest rates to fight inflation.

A look at two of the biggest supranational and agency borrowers — the European Investment Bank and KfW, which typically issue benchmarks in both currencies a number of times a year — reveals a heavier reliance on their home market, the European single currency.

The EIB has raised slightly less of its benchmark funding in euros so far in 2022 compared with 2021, having printed \$20.6bn-equivalent compared with \$21.8bn-equivalent. But in dollars, it has issued just \$15bn of benchmark funding in 2022 versus \$19bn in 2021. That has shifted the euro portion of its benchmark funding mix from 53% up to 58%.

The shift is more pronounced in KfW's case. It has issued roughly \$50bn-equivalent of its benchmark bonds in euros so far in 2022. That compares with \$38.2bn in 2021. Meanwhile, in dollars it has syndicated \$16bn of bonds so far in 2022 versus \$25.5bn in 2021 — a

drop of 37%. That has rebalanced its benchmark issuance from 60:40 in favour of euros to 76:24, according to *PMM* data.

Meanwhile, as interest rates have risen, investors have sought shorter dated bonds, the prices of which fall less than longer dated paper for a given rise in rates. This has shortened the average maturity of an EIB benchmark in euros from 15 years last year to 8.6 in 2022.

So far in 2022, the EIB has issued benchmarks in euros of, on average, 8.6 years' maturity on a deal-by-deal basis. That compares with an average maturity of 15 years on its benchmark issuance in 2021. In dollars those figures are five years so far in 2022 versus six years in 2021.

For supranational and agency issuers overall, it is a similar tale. In euros, the average maturity of a benchmark deal in euros has been 10.9 years so far in 2022, compared with 13.3 years in 2021, according to *PMM* data.

In the dollar market, however, the average maturity for a syndicated benchmark so far in 2022 has been 6.2 years, compared with 4.8 years in 2021. GC

### Syndicated benchmark issuance in euros

	Volume (\$m-equivalent)			Average maturity (yrs)		
	EIB	KfW	All supras and agencies	EIB	KfW	Supras and agencies
2021	21,806	38,205	394,617	15.0	7.5	13.3
2022	20,579	50,074	288,893	8.6	7.7	10.9

Syndicated benchmark issuance in dollars						
	EIB	KfW	All supras and agencies	EIB	KfW	Supras and agencies
2021	19,000	25,500	239,520	6.0	3.0	4.8
2022	15,000	16,000	155,500	5.0	3.0	6.2

Total syndicated benchmark issuance									
Volume (\$m-equivalent)			€/ \$ benchmark funding mix						
			EIB		KfW		All supras and agencies		
	EIB	KfW	All supras and agencies	€	\$	€	\$	€	\$
2021	40,806	63,705	634,137	53%	47%	60%	40%	62%	38%
2022	35,579	66,074	444,393	58%	42%	76%	24%	65%	35%

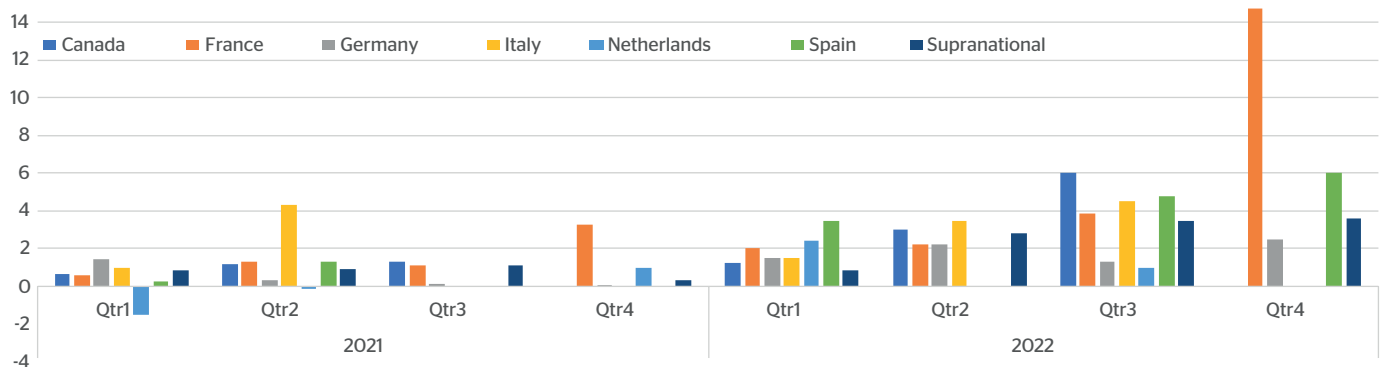
Source: GlobalCapital Primary Market Monitor

### The SSA syndicated bond market at a glance

	2021	2022 YTD
No. of syndicated deals	422	362
Volume of issuance (\$m)	1,002,684	673,121
Average deal size (\$m)	2,376	1,859
No. of ESG labelled deals	102	93
Average subscription ratio	4.2	3.2
Average new issue premium (bp)	0.8	2.7
Average move from IPTs to reoffer (bp)	2.9	1.7
Average maturity (years)	10.5	10.2

Source: GlobalCapital Primary Market Monitor

### Average new issue premiums for SSA borrowers by country of origin (bp)



Source: GlobalCapital Primary Market Monitor

# Capital innovation will take MDBs some way, but not all

The next 10 years will be a period of intense change for multilateral development banks. The demands on them, already high, are set to multiply as climate change worsens. The system as it is cannot bear much more load. Reform is coming. As **Jon Hay** reports, it will be difficult, but could unleash great innovation and a more co-operative, efficient sector.

**W**hatever the question facing policymakers — the war in Ukraine, food insecurity, climate change, biodiversity — multilateral development banks are declared to be part of the answer. The worse the world's problems grow, the bigger the workload governments shove towards them.

And yet despite hurricanes, pandemics and interest rate shocks, the MDBs' role in the world economy has remained strangely static. Their loan books have grown, but they have been far outstripped by the ballooning of private bond and loan financing to emerging markets.

Of course, it would be worrying if private capital markets didn't outgrow the MDBs. The more they can take over financing development, the better.

But private debt markets are an unreliable partner. Their growth has tailed off in the past 10 years, and in 2022 the stock of EM bonds actually contracted for the first time, by \$420bn or 3%.

More seriously, private debt goes overwhelmingly to the haves in the developing world, not to the have-nots.

The UN's report in July on progress toward the Sustainable Development Goals found Covid had erased more than four years of progress against poverty. About one in 10 people

worldwide suffers from hunger and a third lack regular access to adequate food — and that was before the Ukraine war disrupted countries that supply 30% of the world's wheat.

Market forces have clearly failed to eradicate these and many other social evils.

No wonder Sri Mulyani Indrawati, Indonesia's minister of finance, said when reporting the conclusions of the G20 finance ministers' meeting in Washington in October: "We are going to ask the MDBs to use their resources and capacity to respond to the needs of many emerging markets and developing countries."

## Powerful numbers

In the same speech, she mentioned a subject that has been on the lips of officials from all over the world in the past few months, yet before that was unknown to all but a tiny handful of experts — the MDBs' capital adequacy frameworks.

These obscure mathematical constructs, barely understood even by most MDB employees, govern how much lending they can do and how much risk they can take, based on their capital resources.

They are at the very heart of the MDBs and their ability to support development, but for a complex set of reasons have been almost entirely ignored.

The secret no one has wanted — or been equipped — to talk about is that MDBs could lend far more than they do with the capital they have. Up to \$1tr more, even without being downgraded, S&P estimated in 2016.

The biggest issue is callable capital. Most of the capital provided by the MDBs' shareholders — national governments — is not paid in, but can be called if needed.

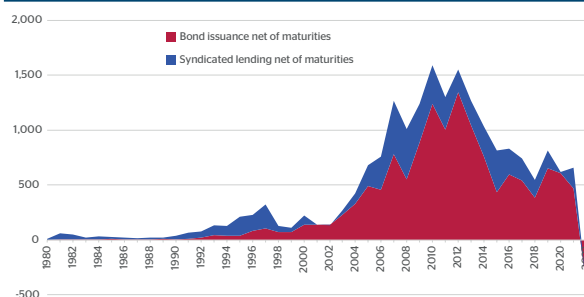
Although this is legally capital, and the major rating agencies give considerable credit for it, most of the MDBs have played super-safe and constructed their capital adequacy frameworks as if this capital did not exist. As a result, their safe leverage limits are applied to a smaller base of capital than they need be.

Since its foundation, the World Bank's main unit, the International Bank for Reconstruction and Development, has only ever been given \$20.5bn of paid-in capital. Shareholders have granted it \$307bn of total subscribed capital, but the bank does not get as much benefit from that as it would if it were paid in. There is a theoretical risk that if an MDB ever called for this capital — none ever has — one or more of the shareholders might be unwilling or unable to honour its commitment.

The IBRD's paid-in money has gradually been augmented from retained profits to \$50.5bn of usable equity.

Based on that alone, in S&P's analysis, it has a standalone rating of aaa, before any 'extraordinary shareholder support', which includes using callable capital, is factored in.

## Growth of capital markets in emerging markets has slowed down



Source: GlobalCapital analysis of Dealogic data

Standard & Poor's is willing to give credit for the 15% of IBRD's callable capital, or \$41bn, that comes from its 10 triple-A rated shareholders. The IBRD's standalone rating of aaa could fall by two rating notches — through, for example, doing more or riskier lending — and the bank would keep its AAA rating.

However, the IBRD does not use that leeway, instead keeping its standalone rating aaa. What is on the back of an envelope an 80% potential increase in lending lies idle.

The long *omerta* about this issue was broken in July, when a panel of 14 experts commissioned by the G20 to look into capital adequacy frameworks produced a report, *Boosting MDBs' Investing Capacity*. It contained an action plan of five recommendations.

The MDBs and their shareholders should change how they define the banks' tolerance for risk. They should give more credit to callable capital. MDBs should expand their use of financial innovation to create more capital or shift loan risk. They should give the rating agencies more clarity on governments' support for MDBs, to encourage the agencies to trust this more. And they should publish more data and analysis on MDBs' finances, to enhance trust and decision-making by MDBs and the private sector.

If these recommendations were implemented, it could lead



"We strongly support the G20 panel's recommendation that more information should be made public. It's going to have an impact on the pricing of risk transfer transactions."

**Hassatou N'Sele,**  
African Development Bank

to a substantial increase in the MDBs' balance sheets, and hence senior bond issuance; a flourishing of new instruments for shifting risk between institutions, including to the private sector; and a long overdue expansion of private sector co-investment in development finance.

### Stuck in the long grass

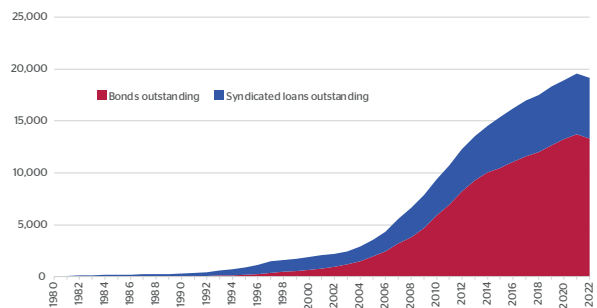
There have been panels and reports before whose worthy conclusions have stayed on the bookshelf.

In 2015, the G20 under Canada's presidency produced a five point *MDBs Action Plan to Optimise Balance Sheets*, which recommended operating with higher leverage and sharing risk with private investors.

But the report failed to ignite reform. "Frankly, the MDBs pushed back a lot," says Tim Turner, the African Development Bank's chief risk officer at the time.

The G20 asked the MDBs to respond. The World Bank led the process. "We asked: 'What do you want us to do?'" says Betsy Nelson, who was then chief risk officer at the European Bank for Reconstruction and Development. "We are not capital-constrained, so why should we spend a lot of money developing and executing new tools we currently do not need?"

### EM debt market contracts for the first time in 2022



Source: GlobalCapital analysis of Dealogic data

In Nelson's view, "A mistake the G20 made was that they communicated to us [MDB chief risk officers], but not to their board members. The G20 was saying 'lend more, take more risk'. But some G20 board members were saying 'no, we're happy, don't do it'."

Even though the G20 members are shareholders in most of the MDBs, they did not use their influence on the MDB boards to support the policy ideas they had proposed at the G20.

"And there were non-G20 board members who believed the G20 should not tell them what to do," Nelson adds.

Even with such a powerful backer as the G20, an effort to invigorate the MDBs was stymied by entrenched problems in MDB governance.

### Better chance

The signs are that this time will be different. The G20 has done its work more thoroughly, commissioning an independent panel with diverse perspectives, which could research and debate the issues thoroughly and consult most of the important stakeholders before publication.

Although the MDBs themselves, particularly the World Bank, were initially extremely wary of the report's arguments, several influential governments, including the US, had bought into it even before it was published. In the four months since then it has done the closest thing possible in development finance circles to going viral.

At the World Bank and International Monetary Fund annual meetings in Washington in October it was widely discussed, helped by the backing of Janet Yellen, US treasury secretary, who asked the World Bank Group to develop an "evolution roadmap" taking into account its recommendations by December.

Conversations about how to respond have continued. "Our panel has had a number of discussions with different shareholders that have been quite positive," says Chris Humphrey, a senior scientist at the ETH Zurich university who has been pushing for change in MDB capitalisation for years and sat on the panel. "They need time to think — these are complicated topics that involve rethinking issues about how MDB finance has long been managed. But there definitely seems to be an openness on all five of the sets of recommendations."

The report was also discussed at the COP 27 climate summit, and the V20 group of 58 climate-vulnerable nations has called “on the World Bank and other MDBs to implement all of the recommendations in the G20 expert panel that confirms that such development finance institutions can significantly expand their financing without jeopardising their credit ratings”.

As Humphrey points out, this debate “gets past the old, stale opposition between borrowers and non-borrowers. There is a lot of support on all sides, which gives optimism that there might be change. The shareholders are also aware they need to be active — this is not something they can just turn over to the MDBs and wait for a response.”

### Caution baked in

The forces of inertia are so strong that a concerted international process will be needed to drive reform.

The MDBs are directed by boards of governors, usually ministers or top civil servants, but they meet only a few times a year. Day to day, the organisations are run by boards of executive directors, typically slightly less senior civil servants. But while they spend much or all of their time working on the MDB, many are rotated out after, say, three years, making it difficult for them to really get to grips with the issues facing the organisation. Very few have banking experience.

And all the time, the executive directors are torn between wanting to serve and optimise the MDBs they work at and furthering the political objectives of their governments.

The balancing act can be particularly difficult for representatives of developing countries. On an MDB’s board, they are acting for the lender — but they also represent their home countries, which are the bank’s often very needy borrowers.

“The governance is so messed up,” says one MDB official, alluding to habitual confusion and delay.

Beneath the boards are the MDBs’ staff, who do understand how the organisation works and are fairly united behind its objectives, but are ultimately controlled by the boards.

They have to try and work out what strategy the shareholders want them to pursue when the shareholders themselves may not know, or may be disunited.

In such circumstances, it is natural that the default stances of most of the players, but especially MDB staff, are caution and conservatism, bordering on stasis. Certainly, it is not



ADB is helping finance the Philippines’ Malolos-Clark railway

an ecosystem in which it is easy to introduce new ideas or change long-established practices that are known to work — especially in the sensitive area of risk.

As an example, Nelson says, one way to expand an MDB’s headroom, would be to change the calibration of its models, for example from requiring management to have 99.99% or 99.97% confidence that its capital was sufficient to meet its business needs, to 99.94% confidence.

“That would give more capacity,” says Nelson, who was a member of the G20 panel. “Management could decide to do this. But this is not the right transparency you want with your shareholders. MDB management are not going to take the risk of a rating downgrade or capital shortfall unless their shareholders say ‘you can take a bit more risk.’”

If the message from shareholders, Nelson says, is “‘You are triple-A, don’t you dare lose it, and don’t touch callable capital’ then that is what management will do. And they’ll add in buffers for concentration and counter-cyclicality. Shareholders and board members need to build a consistent communication and message to the banks, otherwise banks are always working with a variable level of representatives and will always do what they can to protect the institution. If shareholders say ‘take more risk’, there needs to be a clearer dialogue and understanding of what that means and what it would take for a bank to get into great difficulty.”

### Bringing people together

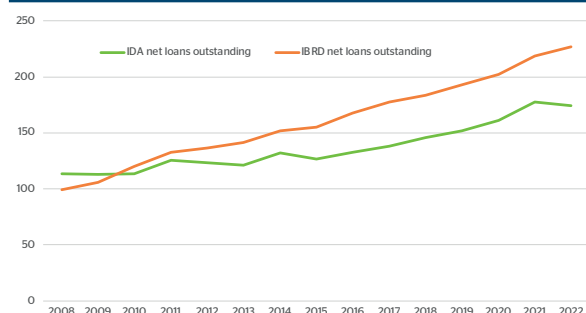
Building that constructive dialogue, which can break down the walls between different constituents who do not communicate well, is now the central thrust of the reform advocates.

The G20 panel, led by its chair Frannie Léautaud, a former senior World Bank and African Development Bank official who is now CEO of SouthBridge Investments in Kigali, is busy talking to all the stakeholders and producing follow-up research and guidance documents to support its proposals.

India, which takes over the G20 presidency in January, is set to continue the work, backed by Italy and Indonesia before it.

Ironically, private philanthropists, rather than governments, are offering to pay some of the MDBs’ costs in exploring new approaches. The Rockefeller, Gates and Soros family

### Steady loan growth through cycles at the World Bank



Source: World Bank Group annual reports

foundations have created a \$5.25m MDB Challenge Fund specifically to pay for work to implement the panel's ideas.

One of the central issues to grapple with is the extent to which the MDBs are the same as each other, or different.

Each one is a separate foundation, independent of the others. But they clearly belong to the same class of organisations, with common shareholders, rating agencies and investors.

There are two channels for progress: the individual institutions and the system as a whole.

"The work that is ongoing, institution by institution, is really important," Léautier says, "because first of all they don't define risk in the same way. They have different ratios of paid-in versus callable capital, unique geographies, so there is a necessity to work through, MDB by MDB."

Several senior MDB executives told *GlobalCapital* in October this issue was not a "one size fits all".

### One voice

But Léautier points out three areas where MDBs will have to work collaboratively. "First, the definition of risk appetite. They have common shareholders, so for them to be able to make the right capital allocation decisions it's important to see the commonality," she says.

If governments are to consciously take more risk, they need to be able to compare risks transparently across the MDBs they participate in.

The second issue is callable capital. Collective action is essential, because the crucial question is governments' attitude to this capital.

While the African Development Bank and Inter-American

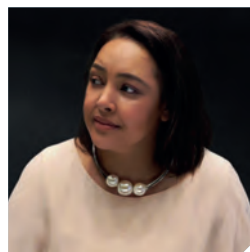


AfDB is backing the development of new Ethiopian railways

Development Bank do use callable capital to improve their ratios somewhat, the vast majority of the hundreds of billions committed are achieving nothing.

To get more benefit — any benefit — from them, countries will have to communicate clearly to the MDBs the circumstances under which callable capital could be used, and precisely how much cotton wool they want it to be wrapped in.

That message will also need to be conveyed to the rating agencies. If the MDBs and shareholders work together, Léautier



"MDBs have common shareholders, so for them to be able to make the right capital allocation decisions it's important to see the commonality"

**Frannie Léautier,**  
**SouthBridge Investments**

says, the rating agencies "will view this as a directed, strategic effort by shareholders. If each MDB goes on its own, it doesn't give the same importance or gravitas. We think it will give [the rating agencies] a much more favourable view."

The third area for collaboration, Léautier argues, is that "by working together on [financial] innovations, MDBs will speed up learning. It will help them face the markets, get better pricing from the markets for innovations, and get better understanding from the rating agencies."

So far, MDBs seem set to continue devising their own innovative transactions and structures separately. A rash of new deals is in the works (*see separate article*), but the big impact will come in two or three years if they succeed and are scaled up.

### Headroom in sight

With a genuinely concerted and intelligent push from shareholders and the right forms of inter-MDB co-operation, there is a real chance that the sector could find ways in the next few years to make its capital go substantially further.

That would lead, as the extra lending capacity was deployed, to an increase in senior bond issuance.

And there are many other ways, besides their capital instruments, for the private sector to give power to the MDBs' arm. Calls from policymakers and investors for more blended finance structures are getting louder all the time.

In September, the Net Zero Asset Owners' Alliance, a group of insurance companies and pension funds with \$11tr of assets, appealed for "donors and philanthropic organisations to pool catalytic capital" to de-risk green development projects, raising them to investment grade so institutions could invest in them.

A simpler solution for institutional investors willing to be braver is structures like the ILX Fund, set up in the Netherlands by Manfred Schepers, former CFO of the EBRD.

ILX was launched in January 2022 with \$750m and now manages \$1bn from three Dutch pension funds. It co-invests in deals alongside the MDBs, paying them a fee for their origination work, but taking the full risk without any credit enhancement.

The pension funds need to get comfortable with the level of risk on development finance loans. The truth is, the risk is quite low, and they can earn a double-B level of return.

Unfortunately, most large investors have long been afraid to try this kind of lending, even though they could see by reading the MDBs' annual reports how low their losses are.

Investors need more convincing. The answer, as most experts including the G20 panel agree, is to give them more detailed data on MDB loan performance.

Since 2009 the MDBs have been working on a joint database called Gems to share this kind of information. For many years some of the members were reluctant to let the outside world see it.

In 2021 they published a report with details on MDBs' default rates. But investors including the NZAOA have said they need more detail, including recovery rates.

"We strongly support the [G20 panel's] recommendation that more information should be made public," says Hassatou N'Sele, chief financial officer of the African Development Bank. "It's going to have an impact on the pricing of risk transfer transactions. Despite a challenging economic and geopolitical context, our risk transfer portfolio has been performing. The track record of performance should provide investors added incentives to invest."

Loss-given-default information "will be included as well," she says. "We are informed by what the market needs."

Nelson argues Gems "needs work, to be put on a proper footing in order to produce usable statistics and analytics on a sustainable basis. It needs to determine the basis for sharing this with a wider market."

Helped by more transparency about the risks and rewards of development finance, Turner, now a senior adviser to the Eastern and Southern African Trade and Development Bank, is convinced the model of ILX — whose investment committee he sits on — could be vastly expanded. "We have proof positive it is possible if it is structured the right way," he says. "Why couldn't Canada's pension funds be co-financing alongside the MDBs? Why not the UK ones? Very quickly the problem is not going to be 'is there enough capital?'"

### Boots on the ground

But what if capital is not the limiting factor on the MDBs' expansion? There are certainly signs that, for many MDBs, it is not — such as their lack of enthusiasm for balance sheet optimisation techniques up to now.

Nelson, recalling her time at the EBRD and discussions in the network of MDB chief risk officers she helped set up, says: "Most of us did not have capital pressure."

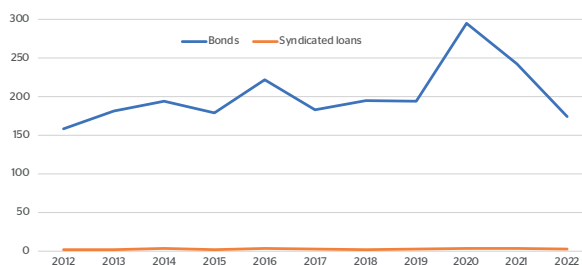
For many MDBs, the bigger difficulty is finding enough suitable projects to invest in.



EBRD helped finance nuclear decommissioning at Chernobyl

### MDB borrowing has fallen back to pre-Covid level

Supranational bond and loan issuance, excluding EU institutions not focused on development finance



Source: GlobalCapital analysis of Dealogic data

"The reality is there is a humongous need out there but a lot of it is for grant or charity-type investment, not debt," Nelson says. "Education is generally not a bank-financeable sector. It is hard to find a cashflow to pay you back. A hospital can be financed but in many cases repayment falls under government or municipal budgets."

The major task, especially for MDBs that work with the private sector, is "finding projects that fit all the criteria. Firstly, generate cashflow to pay the loan back, and if they default there is collateral that can be enforced, assuming the judiciary system works," Nelson says. "Finding bankable projects which then can pass all the other hurdles, including the impact assessment and safeguard tests on governance, environment, social and increasingly climate, integrity clearance, etc."

Nelson gives the example of a chicken and egg farm in Russia that the EBRD was looking to lend to. As part of the resitio efforts and to make it financeable, the farm had to transfer its accounts under IFRS and perform an environmental audit.

The EBRD would provide a grant for that, "but to undertake it is a lot for a small company. You can say the same for smaller governments — it takes a huge amount of time. On the sovereign side a lot of projects aren't structured to be financeable."

Most of the MDBs, including the EBRD and World Bank, have created departments to prepare projects for financing.

"When people say there is so much need, they are right," says Nelson — "but how do you get [projects] in shape? That is still a huge challenge today."

### No easy options

Cutting corners on standards and due diligence is not the answer. In 2015 the International Finance Corp was sued in US federal court by a group of fishermen and farmers in Gujarat whose livelihoods had been affected by warm water and coal dust from the 4.1GW Tata Mundra power plant, for which the IFC had provided a \$450m loan.

Because MDBs are expected to act for the public good and uphold the highest standards, any lapses tend to cause outrage.

"MDBs can't afford to get it wrong too many times, because if you damage belief in the banks, you kill them," Nelson says. "Those mistakes can happen, but they are likely to happen more when you're stretching staff."

The MDBs face two issues consistently, Nelson argues: “One is finding projects, and two — if you want us to do more, you need to give us room to hire more people.”

The MDBs’ work is necessarily labour-intensive, giving them high cost-income ratios. Nevertheless, they are generally profitable. The AfDB’s net income, for example, has fluctuated between \$41m and \$176m in the past five years — enough headroom for a significant increase in its annual administrative costs of \$215m.

But MDBs are not free to spend their profit as they choose, such as on hiring more staff. They have to keep costs within budgets approved by shareholders.

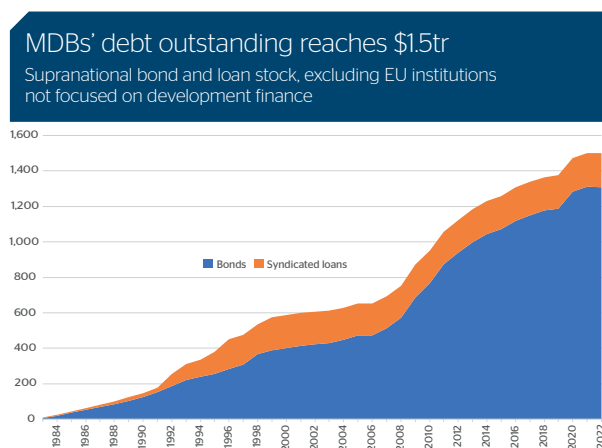
And shareholders are often reluctant to let the banks spend more — especially when the government ministries that oversee them are having their own budgets curbed or cut.

“I believe this whole dialogue about the MDBs doing more needs to start with shareholders being clear about their risk appetite and objectives,” Nelson sums up. “You can get rid of risk [through risk mitigation], but you will have more projects in the portfolio and a duty of care. If you need to grow, you need more staff, across all functions. That understanding has to grow at government level.”

### Moving the frontier

Does that mean the MDBs in general, if they create more capital headroom through efficiencies, will find they have nothing to lend to?

Asked whether the MDBs might be pushing on a piece of string, Turner says: “I don’t think so. In any system there is a binding constraint. Capital maybe has been, but we will find solutions to it. Once you trigger pathways for the private sector [to invest], the capital is limitless. That is no longer the binding constraint. It moves to something else. It will very quickly be pipelines.”



Source: GlobalCapital analysis of Dealogic data

There is no shortage of need, since trillions of dollars need to be invested in developing countries. “The project pipeline is a pyramid,” Turner says. “People are interested in the top of the pyramid — the most bankable deals. The question is: how do we get projects below that up one level to bankability?”

Rather than soaking up the first loss risk in bankable deals to make them investment grade, Turner argues, which was basically giving free money to the private sector, donors’ concessional money should be concentrated on project preparation.

“MDBs are not well suited to project development,” he says, referring to poor accountability. “The next set of institutions that need to be created are project development companies. [Donors should] seed the private development world with money. Get these private firms doing it and remunerate them based on success. If they get it right, they can make good money — if they get it wrong, they lose their shirts.”

Companies that specialise in this area already exist, as do publicly backed organisations such as Africa50, set up by African governments.

### Back to basics

Those who are eager for reform of MDBs to multiply their development impact agree on many things — but not all. Some, for example, are enthusiastic about securitization and insurance, others suspect they are expensive.

The MDBs’ preferred creditor status (PCS) is a thorny issue. By convention and for strong reasons, countries very rarely default on debts to multilateral institutions, even when they have to restructure their commercial bonds and loans.

This means the credit risk of a developing country when held as an MDB loan is lower than when embodied in a bond. For private sector borrowers, the incentive to honour PCS is lower, and unlike governments they can go out of business.

But even for sovereigns, PCS is not a legally enforceable obligation. External stakeholders like rating agencies and private investors can therefore be unsure how much to trust it.

Convincing them to accord proper weight to the benefit of PCS is an important part of increasing private sector confidence to support the MDBs.

But Humphrey is worried this and financial innovation could be taken too far. “Some shareholders might think ‘maybe we can just change the whole model of the MDBs and just originate to distribute,’” he says. “They don’t need any more capital, we will just distribute to the private market.’ But that undermines the status of the MDBs, because they just become deal makers for the private sector.”

Using PCS to benefit private investors, which would especially happen if they shared the MDBs’ sovereign exposure, would weaken the grounds for PCS to exist at all, he argues. “They are unique, official institutions. There is a special relationship because the borrowers are shareholders. We need to keep that.”

Rather than thinking capital optimisation is the answer to all the MDBs’ problems, Humphrey says, the shareholders should be challenged to simply put more capital into the MDBs.

It may seem obvious, but it might be easier than devising clever ways to make the market rely more confidently on complex instruments that no one expects ever to be used.

“There seems to be movement in the direction of more capital,” Humphrey says. “There does seem to be building momentum for it. I think it will in the end be part of the package — innovations, the reforms we are pushing and fresh capital, which to me makes sense.” GC

# Creative tension set to shake up MDB financing

An unvarying supply of senior bonds has been the multilateral development banks' contribution to capital markets for many years. As **Jon Hay** reports, that is about to change. As they strive to optimise their balance sheets, risk sharing will proliferate and the first hybrid capital issues should appear. There may even be public equity issuance. If all these techniques work, they will also trigger a big increase in senior bond sales.

**M**ultilateral development banks' bonds are the plainest of plain vanilla. Most large ones have been rated triple-A for decades. Year after year, they pump out tightly priced paper, scratching to save the last basis point, to pass on the lowest possible cost of funds to their developing world borrowers.

But little by little, the sector's capital markets output is becoming more diverse. On one side, some of the MDBs are trying to find ways to lend more. On the other, their national government shareholders are urging them to do more with the resources they have.

Using financial engineering to boost capital capacity is an area where MDBs have succeeded in innovating in the past decade, although patchily. Now, as part of a much wider push for reform (see *separate article*), there is likely to be a flourishing of new structures.

Perhaps surprisingly, it will not begin with the largest and grandest institutions, but at the sector's periphery.

The layperson might assume that, since development needs are vast and MDBs have limited capital, the MDBs

must always be operating at the maximum of what they can do with their capital.

In fact, this is not the case. Much of the time, many of the MDBs are not capital-constrained, and have therefore not needed new ways to make their capital go further. Hotspots of innovation have tended to occur when MDBs were feeling the pinch.

The African MDBs, which are confronted daily by some of the world's most urgent development needs, have been particularly creative in devising new instruments to get the most benefit from their capital.

## First steps

After a push by the G20 in 2015, amid a climate of post-financial crisis austerity that made it hard for the MDBs to obtain more capital from their shareholders, a smattering of balance sheet optimisation deals was done in the mid-2010s.

They included a \$4.5bn triangular sovereign exposure swap between the World Bank, African Development Bank and Inter-American Development Bank in 2015 and the Asian Development Bank's merger with its concessional arm in 2017, which effectively tripled its capital.

The African Development Bank, which was fast running through its 2010 capital increase and was not due for another till 2020, went furthest, with its Room2Run programme. It included a \$1bn securitization with private investors — the first of any size by an MDB — and a \$500m insurance transaction, both in 2018. Between them, the deals freed up capacity for \$1.1bn of fresh loans.

Hopes that a rash of such transac-

tions would follow were quashed by the Trump administration's hostility to financial engineering, the shock of Covid and perceptions — still prevalent among MDBs — that the view that AfDB's securitization had been expensive.

The bank paid a 10.625% coupon on the \$152.5m mezzanine slice of risk transferred to an arm of US hedge fund Mariner (now Newmarket Capital) and Africa50, an infrastructure investor backed by African governments.

"I don't think people understand the mathematics," says Tim Turner, who was AfDB's chief risk officer at the time. "The coupon worked out to about 42% of the margin AfDB was earning [on the whole loan portfolio]. That premium allowed us to get a more than 65% reduction in capital, so there was 1.5 times more benefit than cost."

The insurance deal, on a vertical slice of a portfolio, consumed about 60% of its margin but achieved 90% capital relief — the same 1.5 ratio.

Because of that, "We were able to negotiate on both sides to drive the prices down," says Turner.

The securitization was also in line with pricing for equivalent risk transfer deals by commercial banks, supporters believe.

## Sovereign breakthrough

Now, the political and intellectual climate among MDBs is supportive of financial innovation again, and the African institutions are leading the way.

After at least four years of work, the AfDB completed in October the third leg of Room2Run, achieving almost complete capital relief on \$2bn of sovereign loans for 10 years, amortising until year 15. Three insurance companies are taking \$400m of first loss risk, the UK government the \$1.6bn top slice.

Shedding the risk on sovereign assets is harder than on private sector



Indorama fertiliser plant, Nigeria, financed by the AfDB



loans because they yield much less and investors could often buy the countries' risk in the bond market if they wanted to.

The actual risk involved is arguably quite small. The AfDB only lends to 17 of the most creditworthy countries in Africa, and since 1995 none of them has defaulted.

But the capital relief is extremely valuable — the AfDB will be able to do up to \$2bn of fresh climate projects.

### Hybrid hopes

Unfortunately, just when they were about to start motoring with innovative capital deals, the MDBs have had to jam on the brakes to avoid the dire capital markets conditions of 2022, with searing rises in interest rates.

In May, a new era appeared to be beginning when Banque Ouest-Africaine de Développement, the development bank of the West African Economic and Monetary Union, began marketing to investors a \$500m deal that would have been the first hybrid capital bond from an MDB.

Although some MDBs have subordinated loans, they are limited, private instruments. Just as the MDBs lack the advantage commercial banks have of being able to issue equity at will, they have also had no access to the public market for hybrid capital.

Being able to issue notes that the rating agencies explicitly agreed to treat as equity could be an enormous

boon to the more capital-constrained MDBs.

Criteria changes of different kinds by all three major rating agencies had removed some of the obstacles to MDB hybrids.

BOAD's 60.75 year, non-call 5.75 deal was to have been rated Ba1 by Moody's, three notches below its Baa1 senior rating, which was on review for downgrade because of unrest in Mali. Moody's was going to give it 75% equity credit. BOAD is rated BBB by Fitch.

However, amid a bearish market for emerging market bonds, the deal was postponed.

BOAD's rating has since been stabilised by a combination of an improvement in the situation in Mali and Burkina Faso and a capital increase, including the entry of new shareholders.

### Plans on hold

The Eastern and Southern African Trade & Development Bank, known as TDB, had hoped to bring its first hybrid to market even before BOAD's, but had been put off by market conditions.

The deal was ready in early 2022, but "Sadly, the bank missed its window," says Turner, now a senior adviser to TDB in Nairobi. "The Fed started raising rates, then that market just died."

Because perpetual hybrids are sold with call options, and their coupons

reset if they are not called, they can become unattractive to investors when interest rates are rising fast, because the issuer's incentive to call can evaporate, if the reset rate ends up being lower than prevailing market rates.

Turner thinks that market will be closed until interest rates stabilise.

He remains enthusiastic about it, though. "Fitch had confirmed that if we did a large enough deal, it would boost our capital ratio and we would get upgraded," he says.

TDB is rated Baa3/BB+, so flipping the Fitch rating to investment grade could have saved it 15bp-30bp on its senior debt spreads, banks had advised it. That might even have enabled it to recoup the cost of the hybrid within a year.

"It was much cheaper than for us to issue new equity," says Turner. "TDB has been producing a return on equity in excess of 10% for almost a decade, and this would have been 6% to 7%, given where rates were."

### Seeking the right price

The AfDB is determined to issue a hybrid too, which it could leverage with senior debt to issue new loans of three or four times the hybrid's size.

S&P noted in February that the bank had had to decrease its disbursements "due to capital constraints", though it expected loan growth to pick up in 2022.

After 18 months of work with the rating agencies, the AfDB has designed a structure that will get it 100% equity credit from at least S&P and Fitch. It has been approved by the board.

What remains is to bring it to market. Hassatou N'Sele, the bank's chief financial officer, is in no hurry. Not only are market conditions less than perfect — she is anxious to ensure that investors do not just apply pricing methodologies copied from the financial institutions or corporate hybrid markets. The AfDB will hold extensive roadshows next year, to help investors give full credit to the strength of its balance sheet and business model.

The AfDB has defined what triggers would cause the hybrid to take losses. These have to be "plausible and remote," N'Sele told *GlobalCapital* in

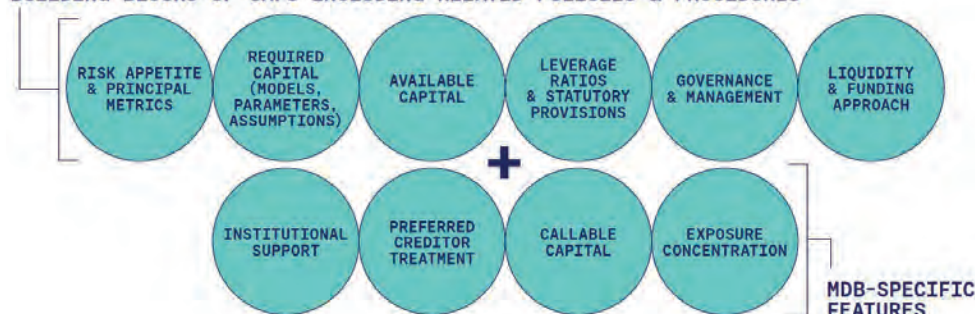
## The G20 Capital Adequacy Frameworks panel's third recommendation, on using financial innovation

RECOMMENDATION	ADDRESSED TO	COMPLEXITY OF EXECUTION	TIME FRAME
<b>3</b> Implement Innovations to Strengthen MDB Capital Adequacy and Lending Headroom			
3A Endorse MDB consideration of non-voting capital classes (paid-in equity or hybrid) to contribute to available capital	MDBs CRAs Shareholders	Med.   High	1-2 years
3B Scale portfolio risk transfers to the private sector of MDB non-sovereign loans to facilitate additional lending	MDBs Shareholders	Med.   High	1-2 years
3C Encourage shareholder guarantees on loans related to cross-cutting priorities	MDBs Shareholders	Low	1-2 years
3D Support collective shareholders commitments of pools of additional callable capital	Shareholders	Low	1 year
3E Support adaptation of MIGA's products & reinsurance capability to partially transfer portfolio level risk from MDB portfolios	MDBs Shareholders	Low   Med.	1-2 years
3F Consider ways to provide MDBs access to central bank liquidity	Shareholders	High	>2 years

Source: Capital Adequacy Frameworks panel report, July 2022

### Key components of MDB capital adequacy frameworks

#### BUILDING BLOCKS OF CAFS INCLUDING RELATED POLICIES & PROCEDURES



Source: Capital Adequacy Frameworks panel report, July 2022

October. “But just because of the way we are structured as an institution, and based on our solid risk management framework, the instrument is not expected to get to that level. Because internally we have all the buffers and as a multilateral development bank, we have benefited from extraordinary shareholder support. In my view when investors understand the MDB model they will be able to price it.”

The AfDB receives a capital increase every 10 years and its risk appetite statement requires it to remain triple-A rated. If its ratios appear threatened, it can adjust its lending, and if there was a crisis, it could also ask shareholders for support.

In BOAD’s structure, the issuer can choose to stop interest payments at any time and must do so if its equity falls below 18% of assets.

To maximise equity credit, on all three of these planned deals any missed coupon payments will be missed permanently.

#### Not so outlandish

The idea of the World Bank, International Finance Corp or European Investment Bank becoming a regular issuer of hybrid capital sounds outlandish now. But commercial bank and corporate hybrids were once new-fangled, too.

If the AfDB, a triple-A rated institution whose major shareholders include countries such as the US, Japan, Germany and France — leading participants in many MDBs — can bring a deal to market successfully next year, there would be no reason for the Washington and European-based institutions not to consider it.

An even more futuristic step is

being prepared at TDB. The bank is preparing a project to float shares on the stock market — and not just any shares, but green equity. For each dollar raised, TDB would promise to invest \$4 in green projects.

As long ago as 2012, TDB brought in institutional investors as shareholders, alongside the 22 national member states. There are now 17 of these class ‘B’ shareholders, which have joined through a private membership process. They include official institutions like the African Development Bank, but also pension funds from countries including Tanzania, Uganda, Rwanda and Mauritius.

“We have been gradually increasing the portion of commercial capital, which we think is a great thing,” says Turner. Class ‘B’ now accounts for nearly 30% of paid-in capital. “The money coming in from the private sector is great, but the impact on governance is at least as important. It forced us to change our board structure, with seats for representatives of the private sector, including independents. It’s created a much more balanced discussion — still focused on development, but also the commercial side. Everything has to meet a dual lens. It’s a hugely positive thing for TDB.”

To allay concerns that too much private involvement could dilute TDB’s development focus, the new green class ‘C’ shares it is planning will be non-voting.

The first tranche, ‘C1’, will be placed privately. Two investors are on board: the AfDB with \$15m and the donor-backed Clean Technology Fund. By late next year, TDB hopes to have gathered \$50m–\$100m.

In the meantime, TDB is exploring

the pros and cons of a potential listed version, class ‘C2’, open to any private investor. If approved, it might go ahead at the end of 2023. One option could be to list the shares in Nairobi and London.

The bank has held discussions with the UK Foreign, Commonwealth and Development Office, which has a programme called Mobilist, which invests in and provides technical assistance for new listed products in developing countries.

#### Big prize

“We think it can fundamentally change the way development finance institutions mobilise capital,” says Turner. “MDBs typically do a general capital increase, which is horrendously disruptive. It takes two years to negotiate and there are *quid pro quos* from each government. The MDBs go from being undercapitalised at the end of the cycle to overcapitalised. They are then awash in surplus capital and look incredibly inefficient.”

The long term goal of issuing equity to private investors, Turner says, is to give TDB access to equity and hybrid capital that it can tap as needed, like a commercial institution, to keep its capital at the right level to support its credit ratings and maintain a strong return on equity for its shareholders.

“There is some nervousness [among TDB’s management] about where is the pipeline of green projects that we can use to meet that commitment, and what happens if we don’t make it,” says Turner. “The big DFIs which are awash with concessional money are flooding the market, so there are very few deals left which are attractive for TDB.”

TDB is an entrepreneurial organisation which lends at commercial rates. Institutions like the European Investment Bank, European Bank for Reconstruction and Development Bank and Agence Française de Développement, on the other hand, have pools of money for climate finance, Turner says, “but use it in a way that makes it less attractive for commercial players to participate in that sector.”

Despite that, he believes it is worth going ahead. “The institution is committed to greening its activities,” he says. “Our region is developing, but it has to transition.” **GC**



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# Swiss franc bond market returns to strength

Triple-digit rises in swap rates across the curve propelled the Swiss franc bond market to its busiest year since 2014. With swaps firmly in positive territory, Swiss franc dealers are confident investors will flock back to fixed income products in 2023. By **Frank Jackman**.

The Swiss National Bank ended its seven year experiment with negative rates in September 2022, taking the base rate upwards to counter the country's highest rate of inflation since the 2008 financial crisis. As the base rate rose, so too did swap rates, opening opportunities for fixed income products not seen for almost a decade.

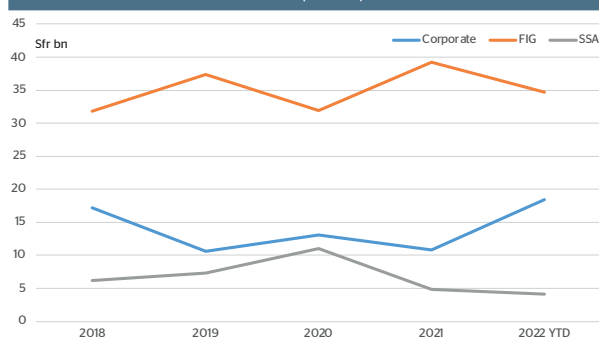
"As rates moved into positive territory throughout the curve, it created more demand for bonds," says Dominique Kunz, head of Swiss debt capital markets solutions at Credit Suisse. "Our underwritten volumes have increased by 15%. This increase was driven by both more demand and increased arbitrage opportunities for international issuers."

Swiss franc swap rates have skyrocketed over the past year. For instance, five year swaps climbed almost 230bp from a year low of minus 22bp in January to a high of 205bp in late September. Although the rate had tightened some 60bp by mid-November, it was still trading at close to a decade high.

"Issuance volumes closely correlate to interest rates," Kunz says. "We expect to reach Sfr63bn-Sfr65bn (\$66.1bn-\$68.2bn) in 2022 — the last time we saw a similar volume was 2014."

The five year mid-swap rate averaged 33bp throughout 2014 as borrowers went on to raise Sfr67bn, according to data from Credit Suisse. In 2022, it has averaged 98bp, up from minus 38bp in 2021, when only Sfr55bn was issued.

Annual Swissie volume split by asset class



Source: Dealogic

The Swiss franc new issue market is set to end 2022 offering investors returns not seen for eight years. The average yield on Swiss franc paper rose from 0.43% in January to 2.08% in October, according to analysis of Dealogic data.

"The recent elevated spreads and higher rates have resulted in absolute yields that are amazing," says Andreas Tocchio, head of Swiss franc debt syndicate at UBS in Zurich.

"It has been years since the Swiss franc capital market was able to offer such attractive yields," says Patrick Endress, Basler Kantonalbank's head of Swiss franc debt syndicate. "The significantly higher yields have certainly helped to generate demand from investors for good quality bonds."

These alluring yields have driven corporate volumes upwards by 40% in 2022. By mid-November, Swiss franc dealers had pushed Sfr18.44bn of corporate paper through the market, compared with Sfr10.83bn throughout the whole of 2021, according to data from Dealogic.

"Corporate bonds at short to medium maturities are finding good demand with attractive yields," Endress says.



"As rates moved into positive territory throughout the curve, it created more demand for bonds — our underwritten volumes have increased by 15%"

**Dominique Kunz,**  
Credit Suisse

Two names, Roche and Nestlé, are responsible for more than a third, Sfr6.23bn, of this supply. The former sold the largest Swiss franc deal for more than 13 years in February 2022, raising Sfr3bn. Roche offered a positive yield on three of its four tranches, stretching from five to 15 years. Four months later, Nestlé's triple-tranche trade returned more than 2% on its two longer notes, with its four year leg offering 1.6%.

"You need competitive pricing across the curve to deliver size," Tocchio says. "There are only a handful of names in Swiss francs that can do this. We haven't seen them in the past, as we could not achieve the needed levels across maturities."

However, despite the pair proving that there is the potential to print size in Swissies, Kunz does not expect as many of these sorts of deals in 2023 as they "are kind of a one-off". Roche, for instance, tapped the market in February to fund the repurchase of its shares from Novartis.

Furthermore, these "Sfr750m-Sfr1bn volumes are pretty much limited to double-A names, as the rating is linked to repo eligibility," Tocchio says. Roche is rated Aa3/AA/AA and Nestlé Aa3/AA-.



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"Someone like the European Investment Bank would probably like to come back to Swiss francs, but the pricing doesn't make sense"

**Andreas Tocchio,**  
UBS

ABB is the only lower rated name to have come close to this sort of size in 2022, with the single-A company raising Sfr700m across two tranches in March. Gazprom's Sfr750m 1.45% March 2023 trade, printed in February 2018, was the last deal of this size from a company that did not hold a high grade or upper medium grade rating. The Russian corporate held a triple-B rating when this deal was issued.

"In the international segment, the number of potential candidates is not large," Tocchio says. "There aren't a lot of AA-rated companies available. In addition, the large US names aren't repo eligible."

Over the past decade, US blue chip corporates such as Apple, AT&T, Coca-Cola, Eli Lilly and Verizon have issued Matterhorn deals — offshore Swissie deals of more than Sfr1bn. But there has been nothing since 2017. US business Verizon was set to follow Roche in February, and bankers were hopeful the telecoms company would get Matterhorn issuance back on track. However, the sale was put on ice after Russia invaded Ukraine.

Dealers are confident that they could welcome these sizeable deals back to the Swiss market in 2023 as conditions settle and central banks outside Switzerland lighten their balance sheets, encouraging foreign companies to diversify their funding at an attractive price.

"The planned shift to quantitative tightening by the ECB could lead to a widening in euro spreads," Kunz says. "But as there was no equivalent central bank action in Swiss francs, the Swiss market looks more attractive for certain issuers."

"The ECB buys roughly 30% of investment grade corporate issuance in euros and if that bid goes away then investors will demand higher spreads to replace it," Kunz continues. "Swiss francs aren't a substitute for the ECB bid, but they can offer an attractive source of diversification."

Financial borrowers showed what this could look like in 2022 when a string of banks tapped the market for covered bonds, many with one eye on refinancing their maturing central bank liquidity.

But the opportunity to diversify does not extend to every corner of the market quite yet, with the highest quality and richest names unable to find a price that works for both issuer and investor. "Someone like the European Investment Bank would probably like to come back to Swiss francs, but the pricing doesn't make sense," Tocchio says.

For instance, the AAA rated supranational's euro funding levels swap to minus 20bp-30bp in Swissies, Tocchio adds, "and that's too expensive for investors. They want to buy names that are a little wider, like the Dutch or Scandie agencies." GC

## SWISSIES GO GREEN

Swiss franc environmental, social and governance (ESG) debt issuance leapt forward in 2022 as new asset classes made their way to the market.

Since the EIB sold the first Swiss green deal in 2014 the market has been slow to develop, compared with core currencies. Labelled deals "were initially seen more as a marketing tool," says Matthias Ogg, Zürcher Kantonalbank's head of special products, adding that "sustainability had been a key factor for Swiss issuers for many years."

Meanwhile, Swiss investors had not felt the need to buy labelled debt, as they inherently follow ESG standards — even when investing on a passive basis, adds Andreas Tocchio, head of Swiss franc syndicate at UBS in Zurich. "If a company is not ESG compliant, it will get more and more difficult to issue in Swiss francs."

However, companies are increasingly looking to publicly affirm their ESG credentials in the Swiss market by issuing labelled deals, including, in 2022, the first sustainability-linked bonds (SLB) and domestic social deals.

Volumes shot up in 2021, rising by Sfr1.6bn from Sfr2.9bn in 2020 to Sfr4.5bn, according to *GlobalCapital* analysis of Dealogic data. Supply grew again in 2022, with roughly one tenth of Swissie syndications carrying an ESG label. Swiss borrowers have placed just under Sfr5.7bn so far.

Roughly a third of 2022's labelled supply was



"This is still a new product, and many investors that have lines for green labels don't have mandates yet for SLBs. But as more issuers come, more investors will adapt"

**Matthias Ogg,**  
Zürcher Kantonalbank

issued in the emergent sustainability-linked and social formats, with Sfr1.4bn and Sfr520m raised, respectively. But opinion is divided over how eager investors will be to continue snapping up these new formats.

Sustainability-linked bonds found a natural home in the corporate-orientated Swiss franc market in 2022 and Ogg expects this market to grow in Swissies.

"This is still a new product, and many investors that have lines for green labels don't have mandates yet for SLBs," he adds. "But as more issuers come, more investors will adapt. It was the same with green bonds."

But the same cannot be said about the social bond market, which Ogg believes will become "more of a niche product in Switzerland", with investors instead preferring the more familiar green label. GC

# Winning deals give comfort to FIG market after rocky year

As the world came out of the coronavirus pandemic, bond market conditions in 2022 did the opposite of what was expected of them and sharply deteriorated. Rising inflation, in part a result of the war in Ukraine, supply bottlenecks and fast tightening central banks all hurt banks' abilities to access stable funding in international markets.

Accessing unsecured primary financing, even senior debt, was no mean feat as new issue premiums moved higher for most of the year on top of skyrocketing spreads. Refinancing subordinated bonds at economic levels was far more challenging amid extreme volatility that brought back memories of the 2008 global financial crisis.

Four bellwether deals are recognised this year for their market-leading achievements and successful execution that empowered the rest of the FIG market in Europe. They not only re-opened market access to a broader issuer base but also gave much needed confidence boost to battered investors. By **Atanas Dinov** and **Frank Jackman**.

## ADDITIONAL TIER ONE DEAL OF THE YEAR

### Barclays Plc

**€1.25bn 8.875% perpetual non-call March 2028 additional tier one**

Barclays

Barclays' additional tier one (AT1) was an exemplary triumph over one of the biggest challenges that faced European banks in 2022 – the ability to raise subordinated debt capital in unstable and short-lived issuance windows.

The UK bank navigated market turbulence to launch its riskiest debt capital at just the right time, ultimately refinancing a €1bn AT1 that had a call option due later in the year, while at the same time providing a confidence boost to a fragile FIG bond market.

Having conducted investor work in advance, Barclays emerged with a rare gem – its first sterling AT1 since 2019. Meanwhile, aggressive price tightening served as a differentiator and signalled the issuer's strength.

Investors liked what they saw and pushed the book to €4.25bn, making it the biggest order book for an AT1 in any European currency in 2022.

## SENIOR DEAL OF THE YEAR

### JP Morgan Chase & Co

**€2.5bn 1.93% March 2030 non-call 2029 bail-in senior**

JP Morgan

The start of the war in Ukraine in February sent shockwaves through unprepared European capital markets, resulting in a month-long drought of FIG bond issuance.

But in mid-March, JP Morgan brought the strength of its balance sheet to bear, re-opening the market in euros with this jumbo-sized deal.

It wasn't just the size that mattered, either. The US money centre bank stretched beyond the short-dated, defensive issuance that defined the market for senior bonds at the time to take long-dated funding.

An €8bn order book was a blow-out result and the largest for an unsecured FIG bond in any European currency this year. It gave confidence to other banks that they could get riskier deals done – longer duration, or subordinated issuance.

## TIER TWO DEAL OF THE YEAR

### Bank of Ireland Group

**€500m 6.75% March 2033 non-call 2028 tier two**

Bank of America, HSBC, JP Morgan, Morgan Stanley, UBS

Who would have thought that in the final days of the year a bank from the eurozone periphery would achieve the biggest spread tightening for a tier two euro FIG deal for more than two years? But Bank of Ireland did just that as it reined in the spread on its bond by 60bp in late November, off the back of an order book that was almost 10 times the issue size.

Investors spied a chance to pile into a credit whose spreads had not yet performed as well as its equity had. This demand allowed the bank to price with a minimal new issue concession of 0bp-10bp and shave the spread down to 415bp over mid-swaps. Although the deal landed roughly 30bp back of the Irish lender's August sterling tier two visit, this differential was erased after a single day of trading.

And after a torrid and tricky year for issuers and investors, the Irish lender affirmed that liquidity was still sloshing around unseasonably deep into November.

## SENIOR STERLING DEAL OF THE YEAR

### NatWest Markets Plc

**£750m 6.375% November 2027 operating company senior**

NatWest Markets

After former UK chancellor Kwasi Kwarteng's disastrous mini-budget caused extreme volatility and damaged the sterling market's credibility, NatWest succeeded in restoring market access for financial institutions.

Building on its experience from an earlier £750m 3.619% March 2029 non-call 2028 holding company senior bond in March – which also re-opened the shuttered sterling market after Russia's invasion of Ukraine – the November deal provided what investors were clamouring for.

The market was in need of a national champion to get issuance back on track and NatWest delivered at the operating company level, attracting a book of £2.2bn. The deal ushered in an almost £7bn burst of FIG supply by late November.

The deal's size impressed market participants as NatWest harnessed weeks of pent-up demand. Ultimately, the trade capped the sterling crisis and proved to the market that despite the volatility it had endured, the currency still offered issuers the chance to print in size.

# Covered bonds set to thrive in tricky 2023

After years of low issuance volumes, covered bonds had a stellar 2022. But although the year's performance has left the market in an optimistic mood overall, the war in Ukraine, inflation, recession and falling house prices mean few participants are taking 2023 for granted, as our covered bond market survey shows. By **Bill Thornhill**.

**A**t more than €200bn, 2022 is a record year for euro covered bond issuance, far surpassing the previous record set in 2011, when euro benchmark volumes hit €177bn. Issuance has been driven by a broad range of compelling forces, some of which will remain in place in 2023.

Unlike the senior unsecured market, the covered bond market has been open throughout 2022, although long dated maturities were sometimes out of reach. At the same time, yields rose by about 250bp, with the move from negative territory drawing back buyers that had been frozen out for years.

A scarcity of high quality collateral, which caused Bunds to perform relative to swaps, improved the pick-up and value of covered bonds against most other asset classes in the rates universe. And, crucially, bank funding requirements were bulked up by the overarching need to refinance central bank liquidity.

At the same time, mortgage lending maintained a brisk pace as deposit growth began to falter in some countries. These factors were compounded by a sense of urgency driven by a fear that spreads would widen, leading many issuers to accelerate their funding programmes.

European banks, in particular, were obliged to start repaying €2.2tr borrowed under the European Central Bank's Targeted Long Term Refinancing Operation. But Canadian, Australian, Swedish and latterly, UK banks, also faced similar pressure to repay pandemic-era central bank funding.

The vast proportion of the ECB's



"[If the crisis in Ukraine escalates energy prices may rise again and] the ECB will have to fight inflation with higher rates"

**Matthias Ebert,**  
DZ Bank

TLTRO was used by banks to earn a risk-free profit, but after the ECB tightened terms in October, this incentive was removed. The motivation to repay early was exacerbated by June 2023's €1.2tr TLTRO repayment.

As this sum will not be eligible for inclusion in banks' Net Stable Funding Ratio from December, they have even less reason to hold on to it. Banks returned €296bn in November and, assuming the €1.2tr is repaid, the repayment may triple to around €900bn in December.

However, it's also likely that a small proportion of the total €2.2tr TLTRO borrowed was deployed for funding and this will need refinancing in the capital markets. As the next cheapest source of funding to

the TLTRO is covered bonds, it will be the obvious refinancing tool for the majority of banks.

## Cliff ahead

To avoid a refinancing cliff edge banks earnestly began refinancing the TLTRO in 2022, giving rise to the year's record issuance. But this process will drive volumes in 2023 and 2024 as well.

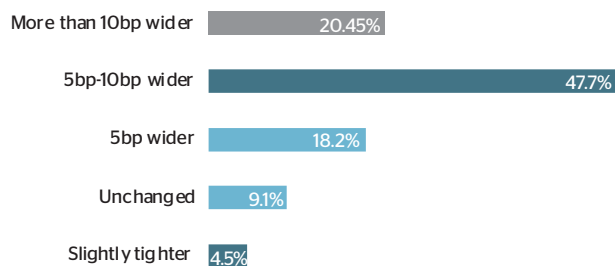
For these reasons Barclays' head of FIG DCM for the EMEA region, Mark Geller, feels bank funding needs were likely to grow next year. Even if asset growth is modest, "it feels like the propensity is to see larger funding needs for many issuers in 2023 versus 2022," he says.

A poll of 40 market professionals undertaken by *GlobalCapital* in November showed that 75% expected 2023 issuance to be the same or more than 2022. Of that, 30% called for an increase of more than €20bn over 2022.

Refinancing central bank liquidity facilities will play a central funding role, particularly when it comes to UK banks which must collectively refinance £192bn of outstanding debt borrowed under the Bank of England's Term Funding Scheme for SMEs.

But there is also a "perennial debate" about deposit growth, says Geller, who believes deposits "may come under pressure from more attractive alternative investments"

Where do you expect French five year covered bond spreads to end in 2023?



Source: *GlobalCapital*



such as higher government bond yields. Falling deposits will increase funding needs.

However, the head of FIG DCM origination at DZ Bank, Matthias Ebert, is more circumspect. A lot of 2022's supply was geared towards the repayment of TLTROs, but he says the proportion used for funding compared to carry was not clear and varied for each bank.

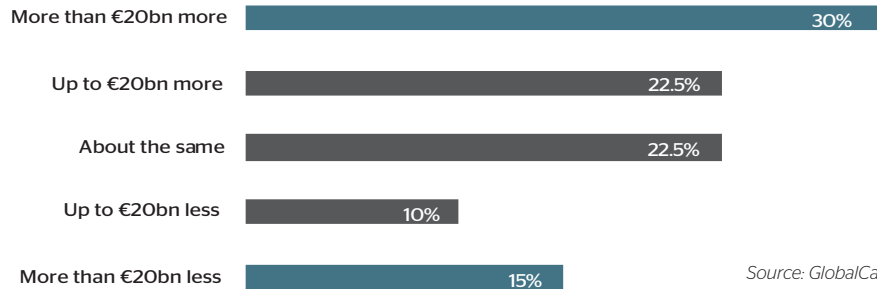
As the composition of bank balance sheets becomes more risk-weight heavy in 2023, he assumes risk weighted assets will rise, meaning banks will rely more heavily on regulatory funding to meet their Minimum Requirement for own funds and Eligible Liabilities (MREL) ratio. Since MREL issuance also provides funding, it should lower the need to issue covered bonds.

Nordea Investment Management's portfolio manager, Henrik Stille, also thinks covered bond supply "probably peaked" in 2022. As 2022 comes to an end, demand for housing has begun to fall below the lows of the financial crisis, he says. Since mortgage origination will decline again in 2023 "there shouldn't be so much supply pressure".

### Canadian rush

Euro issuance is typically driven by German and French banks, but in 2022 Canadian borrowers came to the fore with almost €30bn of supply. "I can't remember the last time Canadian banks issued as much as this year," says Isaac Alonso, head of DCM financial institutions at UniCredit in Munich. "If issuance from this region is the same in 2023, I would be in the camp of overall supply being somewhat higher than this year."

### How much euro benchmark issuance do you expect in 2023 compared to 2022?



Source: GlobalCapital

Canada is expected to remain a large issuance region in 2023 but much of 2022's Canadian supply was pre-funding and, if the euro basis swaps widens versus dollars and sterling, euro volumes would decline, say researchers at Barclays.

On the other hand, regions that have hitherto been absent could return. "Southern Europe is likely to become a more active issuance region in 2023," says UniCredit's syndicate manager, Alberto Villa. At least three Italian covered bonds "are being hampered by a lack of executability," as the Covered Bond Directive has not yet been implemented in Italy. Villa assumes this will happen by December at the earliest.

But strong issuance in southern Europe is likely to be counter-balanced by less activity in other countries, such as Austria, where a lot of pre-funding was undertaken in 2022.

### Yield curve is crucial

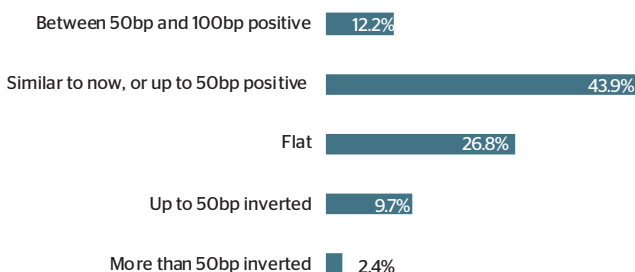
Scope for issuance is also likely to be determined by the shape of the yield curve. Traditionally, covered

bonds have been used for long-term funding, but in 2022 that theory was turned on its head as the swaps curve flattened and then inverted, effectively disincentivising investors from buying long dated debt thereby preventing banks from issuing longer than five years in the final quarter of 2022.

In late November, two year euro swaps were yielding 2.88% and the 10 year returned 2.75%, not much different from the 15 year at 2.76%. For many, including UniCredit's Alonso, an inverted curve is "always a sign of recession," but whether it remains that way throughout 2023 is doubtful.

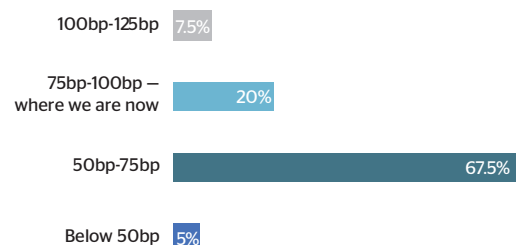
Many hope that growth will return to Europe in the second half of 2023, at which point the curve should resume a positive slope. "Maybe we see a couple of quarters of negative growth," says Thomas Cohrs, head of financial institutions and capital markets at Helaba. A modest recession should be viewed as more of a correction than a real recession, he says, implying that large scale layoffs leading to a sustained rise in unemployment is

### How do you expect the two to 15 year euro swap curve to finish in 2023?



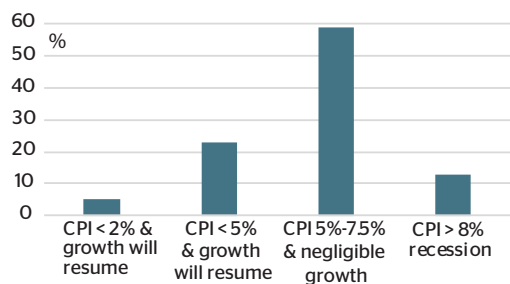
Source: GlobalCapital

### Where do you believe the 10 year Bund Swap spread will finish in 2023?



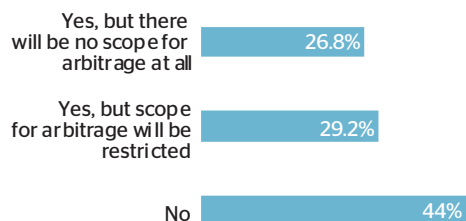
Source: GlobalCapital

What do you expect eurozone inflation and growth to be by December 2023?



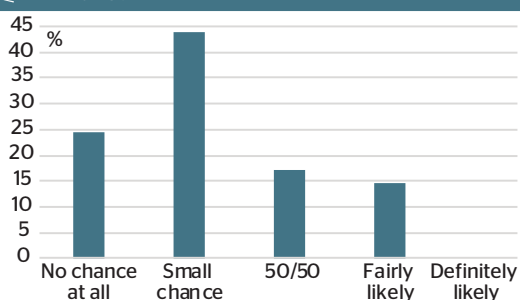
Source: GlobalCapital

Do you think the ECB will offer another TLTRO, or something similar in 2023?



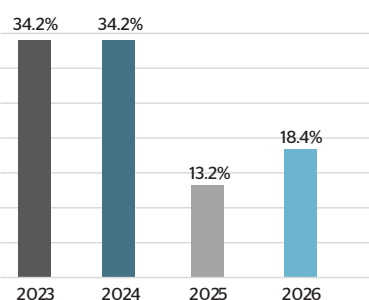
Source: GlobalCapital

How likely is it that the ECB pivots from QT to QE in 2023?



Source: GlobalCapital

When do you believe the war in Ukraine might end?



Source: GlobalCapital

not likely.

Should recovery take place, the swaps curve inversion may only remain in place until the second quarter of 2023 implying demand will initially be focussed on the short end, says Stille. But in the second half of 2023 the curve may normalise, at which point demand should begin to “push out along the curve,” he says.

If that were to happen, long maturities would be back on the table catalysing an uptick in supply as banks regain access to this sought-after part of the curve. Ebert is hopeful the ECB will get inflation under control and foresees a slightly positive swaps curve in the second half of 2023, in keeping with *GlobalCapital’s* survey, where more than half expected the curve to finish the year slightly positive.

But probably only just so. At 5%-7.5% by December 2023, 59% of survey respondents thought inflation would remain quite sticky. This implies rates would also need to stay quite high, giving rise to the impression that growth, though positive, would be negligible according to the same 59%.

But, if the crisis in Ukraine escalates energy prices may rise again and “the ECB will have to fight inflation with higher rates,” Ebert warns. In such circumstances the nascent European recovery would be scuppered, rendering the swaps curve flat or inverted, effectively shuttering access at the long end.

### Spreads to shape supply

Aside from the curve, the supply outlook will be determined by the extent to which spreads widen, especially versus other asset classes. Almost half the survey respondents thought French five year covered bonds would end 2023 5bp-10bp wider against mid-swaps with more than 20% saying they will finish over 20bp wider.

Covered bonds could also lose value relative to other rates products, with two-thirds of respondents expecting the 10 year Bund swap spread to range between 50bp and 75bp.

In the closing weeks of the year, October’s extremely wide Bund swap spread of around 100bp had

passed, with Bunds yielding 2% and swaps returning 2.75% in the 10 year.

A large increase in the supply of government bond issuance, along with the freeing up of collateral through TLTRO redemptions, should cause euro government bonds to underperform, says UniCredit’s syndicate manager for financial institutions, Florian Rathgeber. This implies scope for the Bund swap spread to tighten towards its long-term range of around 50bp, but this may not necessarily dampen demand.

“I wouldn’t say we’ve seen significantly more covered bond demand at this year’s wider [Bund swap] levels because there are other important metrics that investors look at,” says Rathgeber, with reference to the size of new issue concessions, the spread to other rates products, the pick-up over the Euro Short Term Rate and outright yields.

Ebert concurs that early repayment of the TLTRO should free up collateral [government bonds], causing the Bund swap spread to narrow. Furthermore, a potential de-escalation of hostilities in Ukraine would lower the Bund’s safe haven premium, he says.

Half of the survey’s respondents expected a truce to be agreed in Ukraine, leading to a cessation of the conflict in 2023. However, Stille doubts “Russia will back down or that Ukraine will accept a split,” putting him among the 35% who expect the struggle to continue well into 2025 or 2026.

In such circumstances, Bunds would continue to be viewed as a safe haven, even if SSA issuance were to increase substantially, says Cohrs, who points to the fact that Germany is a rich nation with a solid economy and limited debt. A prolonged conflict implies Bund swaps will stay wide suggesting covered bonds will continue to offer excellent value.

And much like Bunds, covered bonds tend to flourish in difficult conditions, says Cohrs. “It’s becoming almost normal to see an abundance of potential black swan events, but in any case, covered bonds seem to thrive under most scenarios.” **GC**

# Banks face heavy refinancing as expectations improve

After unexpectedly strong issuance of unsecured bonds in November, European banks have pre-funded for 2023, in anticipation of it being a year for refinancing across most, but not all, of the debt capital structure. Which asset classes are banks set to focus on? **Atanas Dinov** reveals *GlobalCapital's* survey findings.

Thanks to a burst of issuance, financial institutions in mid-November were looking to finish an otherwise dreadful 2022 on a positive note. The turnaround, inspired by a lower than expected US inflation print in October, provided good funding conditions to many issuers as investors were lured back into unsecured bonds.

This improvement prompted some market participants to predict that the European FIG market will have a better 2023.

“I cannot see 2023 being worse than 2022 in credit but having said that we may still hit the low of 2022 in equities [again] next year,” says Vincent Hoarau, head of FIG syndicate at Crédit Agricole.

The late year revival in demand for banks’ unsecured debt pushed down spreads and new issue premiums. The latter fell to an average of 11.2bp as of the end of the third week of November, from 26.7bp two weeks earlier, according to *GlobalCapital's* Primary Market Monitor.

Nearly two-thirds of the respondents in an outlook survey undertaken by *GlobalCapital* of FIG debt capital markets participants, which closed in mid-November, say bank spreads on senior preferred and subordinated bonds will continue this tightening by the end of 2023.

Expectations are strongest for senior non-preferred debt to tighten the most (82% of respondents).

With the bulk of FIG issuance forecast to arrive in the first half of 2023, spreads on various asset classes are expected to behave differently throughout the year.

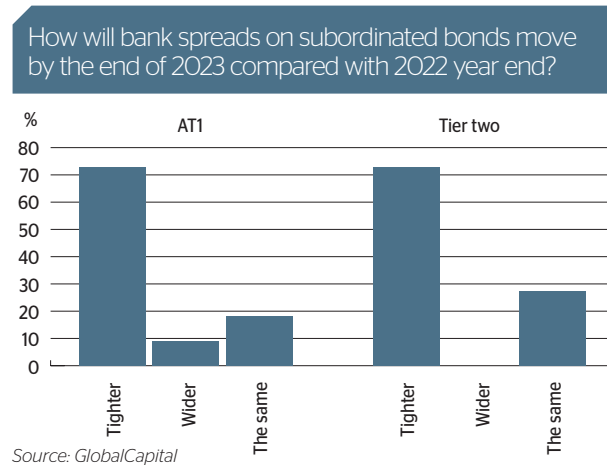
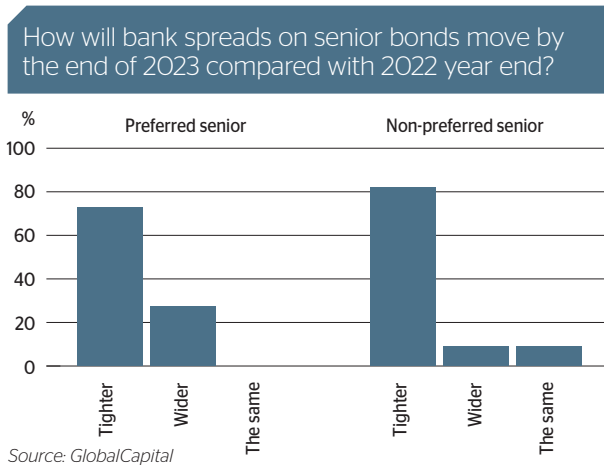
As market participants prepare for the traditionally busy January, “nobody expects spreads to tighten from here, especially for harder, trickier deals on behalf of issuers that are not national champions,” says Florian Rathgeber, FIG syndicate manager at UniCredit in Munich.

“With the usual busy start to 2023, and the European Central Bank’s support [for bond buying] disappearing, these factors are likely to push spreads wider. At best, spreads will be stable in the first part of the year.”

In the first half of 2023, CréditAg’s Hoarau expects core continental European banks’ non-preferred and preferred spread differential to be around 50bp-60bp. He predicts the non-preferred bonds’ spread will range between mid-100s to high 100s over mid-swaps.

For subordinated debt, he foresees the tier two and additional tier one (AT1) fair value difference to be around 200bp for the same period.

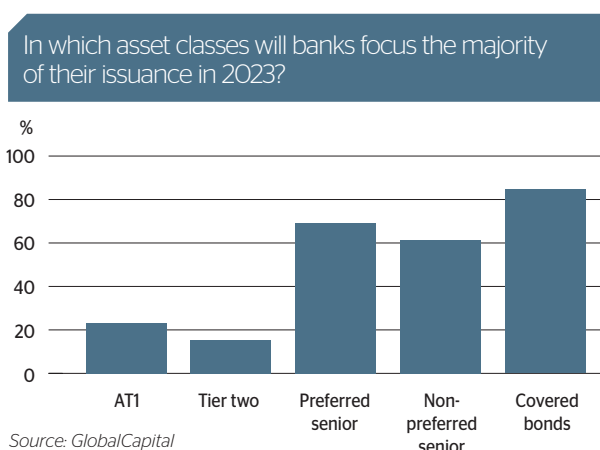
“The current base is that spreads [in 2023] are unlikely to move much in either direction,” says Matteo Benedetto, head of FIG syndicate for Europe, Middle East and Africa at Morgan Stanley. “But, that view hinges on the depth of the expected recession in Europe and the US.”



Benedetto expects “for the FIG sector as a whole, senior spreads and those of investment grade issuers will perform the best, relative to high yield and higher beta spreads”.

As banks will issue multiple types of products for their various funding needs, survey respondents were able to choose multiple asset types where they think banks will focus most of their issuance.

Some 85% believe that covered bonds will be the most popular asset type in 2023. More expensive instruments follow: senior preferred and non-preferred debt, then AT1 and tier two debt.



Isaac Alonso, head of FIG debt capital markets at UniCredit, expects “heightened issuance of covered bonds” due to refinancing alone being around €130bn-€140bn in 2023.

He says that, depending on the type of funding required, “issuers that are going for liquidity could also use covered bonds to refinance their TLTRO (targeted longer-term refinancing operations) borrowings”.

And because of heavy issuance and Bund/swap spread tightening, covered bond spreads will gradually widen into the first quarter of 2023, according to CréditAg’s Hoarau. “Covered funding will remain strong, driven by the big TLTRO refinancing, deposit war and subsequent increase of pure liquidity funding needs,” he says, adding that after June, once banks have repaid €1.3tr of TLTRO funds, spreads will start to stabilise.

### Frontloading

Whether banks will frontload their funding beyond covered

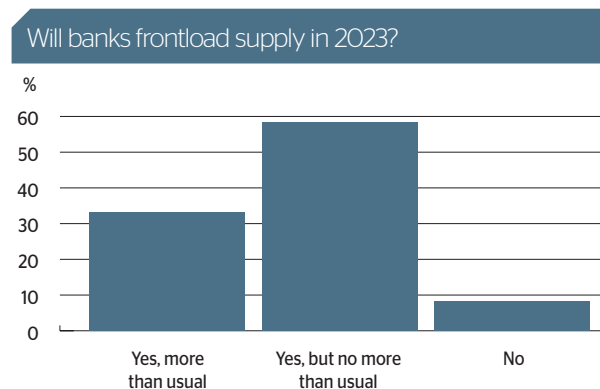


“Finding the right window will be an art. Be ready to issue, be flexible and have your docs ready”

**Isaac Alonso,**  
UniCredit

bonds is a divisive topic. A little over half of the survey’s respondents expect issuance to be concentrated in the early part of the year, but no more than usual. One third of them expect there will be a higher volume than in a typical year.

Even after market conditions drastically improved in late 2022, “it looks like there will be front-loading in



early 2023,” says Benedetto. “But, if the interest rate environment is little changed, with central banks not hiking or cutting, then the rationale for frontloading at current spreads doesn’t make sense.”

He, and other dealers, say that a further improvement in market conditions could be possible later in the year and this might drive spreads lower.

The refinancing of different assets will be another important development, and is linked to the debate over whether issuers will frontload or wait for better markets.

**“Nobody expects spreads to tighten from here, especially for harder, trickier deals”**

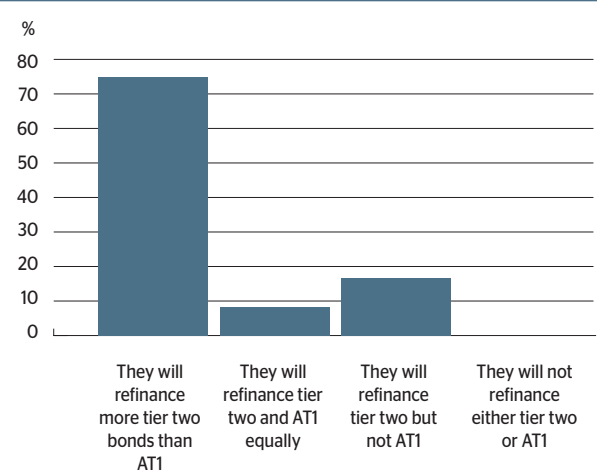
Despite the steep fall in new issue premiums in November, spreads on unsecured bonds were headed towards a historically high annual close. Because of high funding costs, market participants’ attention has been focused on whether banks can, or are willing to, call their subordinated debt.

“The refinancing of subordinated debt will be a leading topic into [2023],” says Benedetto. “The focus will remain on the tier two calls, which in the vast majority of cases should take place even if spreads do not rally significantly.”

There are different expectations on the refinancing of AT1 and tier two. The former is the riskiest form of FIG debt capital and the most expensive but, unlike tier two, it does not lose its regulatory treatment if left uncalled.

“We don’t know if the market will improve, but at the current levels expect more AT1 refis not to happen in 2023,” says Benedetto.

**Will banks refinance their callable/maturing subordinated debt in 2023?**



Source: GlobalCapital

Indeed, some 75% of the survey’s respondents expect banks to refinance more tier two debt than AT1. A notable 17% said that, while banks will refinance tier two, they will not do the same for the riskier product.

Part of that reasoning lies in the AT1 market having become “mature enough to handle a series of non-calls” in 2023 based on economic reasons, according to Hoarau. But he says that if a frequent issuer does not call its tier two bond that will “surprise the market”.

Hoarau expects core issuers to call their tier two debt, even for non-economic reasons. But he adds that “some second tier issuers may not call, as they will be forced [not to redeem early] by the regulator and they won’t be punished by the market”.

He adds: “This will continue to illustrate the fragmentation of the credit market.”

Thus, the funding cost of subordinated debt is expected to remain elevated in 2023. Alberto Maria Villa, a FIG syndicate manager at UniCredit in Milan, expects AT1 refinancing to range between 9%-11%, with lower levels for tier two.

For another type of refinancing, the first wave of calls from banks’ senior non-preferred debt issued in 2018-2019 will come due in 2023. And as refinancing will



“If the interest rate environment is little changed, then the rationale for frontloading doesn’t make sense”

**Matteo Benedetto,**  
Morgan Stanley

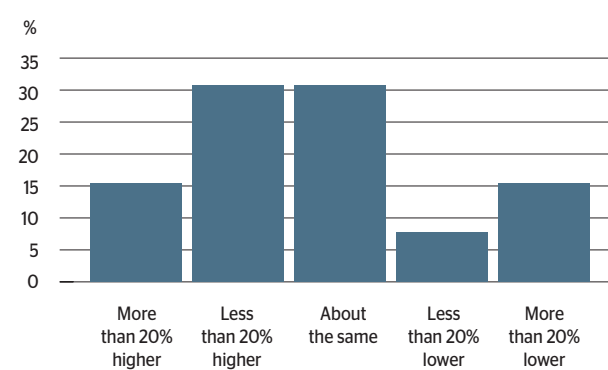
be “the overarching theme” of the FIG market next year, according to Villa, “this will be telling vis-à-vis refinancing of capital and subordinated debt”.

Hence, “the quantum of refinancing will be for senior preferred and non-preferred debt,” says Villa.

Most European banks will also need to raise senior funding for regulatory reasons for their deadline to meet minimum requirement for own funds and eligible liabilities (MREL) imposed by regulators for the end of 2023.

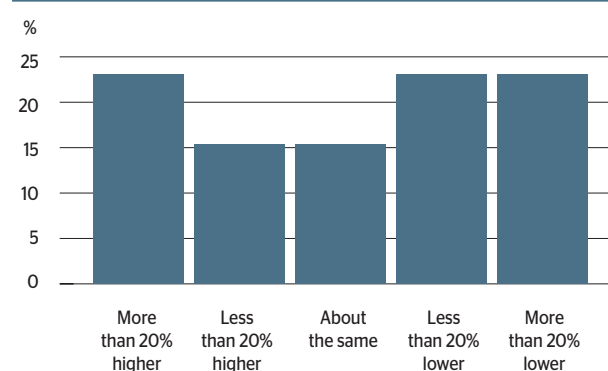
More than 45% of the survey’s respondents expect banks will raise more senior debt than in previous years. Under 40% said banks will also print more subordinated debt than they previously did, a larger number of them think it will be a smaller volume.

**How will euro FIG senior issuance volumes in 2023 compare with previous years?**



Source: GlobalCapital

**How will euro FIG subordinated issuance volumes in 2023 compare with previous years?**

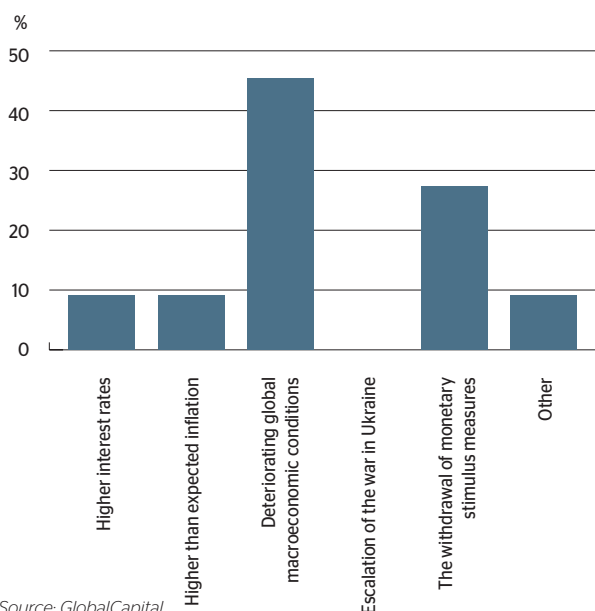


Source: GlobalCapital

**Different diversifications**

While uncertainties abound, respondents were split over what will be the single biggest risk for the FIG market in 2023. The largest share of respondents (45%) expects this

### What is the biggest risk facing FIG borrowers in 2023?



Source: GlobalCapital

to be worsening global macroeconomic conditions.

As issuers witnessed all too often in 2022, market shocks may quickly turn issuance schedules into short windows of opportunity.

“Finding the right window will be an art,” says Alonso. His desk’s message to issuers: “Be ready to issue, be flexible and have your docs ready.”

He adds that it is “better” for issuers not to use standalone docs when they are looking for the “right” window.

Andrew Chaplin, managing associate at Linklaters’ capital markets team in London, echoes Alonso. “Have your docs ready to be able to take advantage of issuance windows at short notice,” he says. “This is one of the key takeaways for 2023 as the issuers that did well this year were the ones that were ready with their documentation.”

He says that a deal issued under a programme could be done within a couple of days, whereas it could take “a month-long process” for a standalone trade.

In case of volatility flaring up and restricting market access, issuers can find funding diversification in foreign markets. After euros and dollars, European banks are most



“ESG will come back on people’s agenda after everyone was more focused on securing funding [in 2022]”

**Vincent Hoarau,**  
Crédit Agricole



“The realignment of fiscal and monetary policies has been very important for the sterling market’s outlook”

**Nick Hughes,**  
Lloyds Banking Group

likely to tap the sterling market, based on 90% of the survey’s respondents.

“The realignment of fiscal and monetary policies has been very important for the sterling market’s outlook for next year,” says Nick Hughes, head of capital markets at Lloyds Banking Group. “An alignment of the two policies should mean a more positive international reception for the sterling market. This comes at a time when higher yields and spreads are already attracting investors, as well as more international borrowers looking to access the sterling market.”

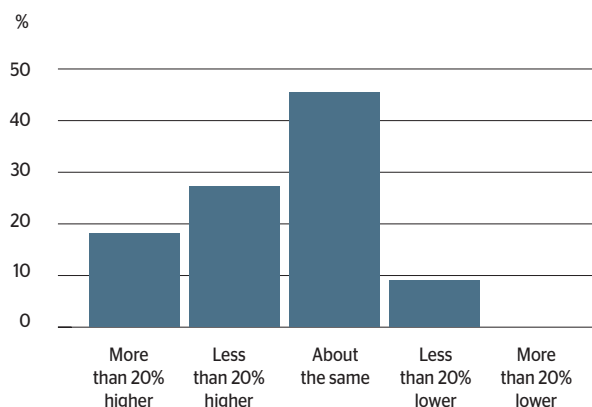
He adds: “It is helpful to see strong sterling in terms of G3 [issuance]. While it is a small percentage of overall markets, its credibility in the G3 markets remains very important.”

Meanwhile, banks are expected to add a different type of diversity to their funding mix in 2023 through higher issuance volume of green and social bonds.

“ESG issuance in FIG will definitely pick up again,” says Hoarau, “as 2023 evolves towards normalcy and ESG will come back on people’s agenda after everyone was more focused on securing funding [in 2022].”

He expects ESG volume across all FIG products to be more than 25% higher compared to 2022, matching 18% of the respondents’ views. Another 27% expect that it will be less than 20% higher with 45% says it will be about the same. **GC**

### How will ESG issuance volumes evolve in the FIG market in 2023?



Source: GlobalCapital

# Macro vol sparks regime change in FIG market

After a strong start to the year, multiple macro risks soon impacted the FIG primary market, forcing spreads across asset-classes to unfamiliar highs, and briefly curtailing issuance. The market has since roared back, but funding is now much more complex and challenging, clouding the outlook for 2023.

The explosion in financial institution issuance in November has provided a welcome injection of funding activity to a market shaken by several macro risks that erupted across the year, causing primary markets to be extremely stop-and-go since the beginning of the second quarter.

But as much as this recent throng of activity is a sure sign of the FIG market's resilience, and issuers' agility to seize the ever-shifting window of opportunity to access funding, it is likely also an indication of the market's bearishness on the next 12 months.

"On one hand, the explosion of issuance is due to issuers playing catch-up from earlier this year when they needed to adjust their funding plans," says Cécile Bidet, global head of financial institutions debt capital markets at Crédit Agricole CIB. "On the other hand, it reflects issuers taking a view on 2023 conditions and deciding there's no point in waiting – if they can access funding now, they should."

As such, much of the issuance across November was banks pre-funding. But while some issuers made that call later in the year, others felt compelled to pull the trigger earlier as the macro picture darkened.

"We saw a new regime come into play during 2022 shaped by high inflation levels, rising rates, lower growth expectations and reduced liquidity," says Vincent Hoarau, global head of FIG syndicate at Crédit Agricole CIB. "The impact of this has been difficult for many of our issuers to accept and swallow. We are exiting an era of cheap funding and 2022 has been a very big wake-up call for all of us on this."

Faced with such challenges, issuers needed to adjust their funding mix, "issuing more covered bonds and senior preferred than senior non-preferred tier two and AT1," says Bidet.

Covered bond issuance – driven by the more volatile and challenging macro context and an expected TLTRO-related refinancing wall in 2023 – has indeed boomed this year, with total full-year volumes breaching €200bn, propelled by substantial issuance from Canada, Germany and France.

For Hoarau, this activity has been one of two key developments this year. The other has been issuers targeting shorter maturities (five years and under) across asset classes, from senior preferreds to covered bonds as well, as bank funding teams sought to minimise spreads on an absolute term basis.



*"On one hand, the explosion of issuance is due to issuers playing catch-up from earlier this year when they needed to adjust their funding plans."*

**Cécile Bidet**, global head of financial institutions debt capital markets at Crédit Agricole CIB

## Macro to dominate

Moving into next year, issuers will likely continue to pick-off opportunities at the short-end of the curve across asset-classes. But beyond this, what could the FIG market look like in 2023?

"Supply will continue to be dense in covered bonds while funding in senior preferred format will significantly increase compared to 2022, at least we expect that in the first half of 2023," explains Hoarau. "Tier two and tier one bonds are, however, a different story. Both markets have been hit more heavily by rising rates, with five year swap rates, for instance, rising from 0% at the beginning of 2022 to 3% now."

Even so, Hoarau is confident that the AT1 market can stage a recovery in 2023, and potentially from early in the year. "AT1 is likely to outperform strongly versus any other asset classes as we approach FED Funds terminal rates and reach inflation rate peak. The asset class could benefit the most from the cash reallocation strategy likely to be more favorable to bonds."

Bidet agrees there are good grounds for the AT1 market to be revitalised. Yet one issue that will be in focus is the non-call issue, or the risk that banks decide not to call their AT1s. "This will automatically cause a little bit of disruption, despite the market being more mature and accepting of economic behaviours from banks," says Bidet.

Aside of issuer behaviours, powerful macro forces will continue to shape – if not keep hostage – the FIG market next year.

Indeed, for Hoarau, the prospect and impact of recession will be influential.

"The credit market is going to be a very strong competitor to the equity market next year if we see economic data worsening in certain economies," says Hoarau. "We'll probably see a little bit of detachment between the two markets. In this scenario, a key question is what impact does this have on spreads across asset-classes throughout the year? The answer is difficult, but there are signs of a positive direction. Compression of spreads is certainly something more for H2 2023."



*"We are exiting an era of cheap funding and 2022 has been a very big wake-up call for all of us on this."*

**Vincent Hoarau**, global head of FIG syndicate at Crédit Agricole CIB

# A brave new FIG world as era of low spreads and coupons end

Financial institutions have grappled with an increasingly expensive primary bond market in 2022. As interest rates continue to climb and investors demand more spread for their cash, how much will banks have to pay up to play in the primary markets in 2023? By **Frank Jackman**.

**A**s financial institution borrowers rushed out of the blocks in the first two months of 2022, none would have anticipated the market turbulence caused by Russia's invasion of Ukraine in late February. Having only just got to grips with rates volatility at the start of the year, banks found themselves navigating an even more uncertain market.

A look at one of the banks most exposed to the CEE region — Raiffeisen Bank International — shows just how drastically yield curves have been repriced over the past nine months. When the Austrian national champion came to print a three year green senior deal in late August, its first bond issue since the start of the war in Ukraine, investors demanded a spread of 200bp over mid-swaps. Only one year earlier, it had priced a six year senior deal at exactly a fifth of the spread.

Although Raiffeisen, to an extent, is a special case, the rapid widening in spreads in 2022 penetrated all segments of the FIG market as rising interest rates and volatility put an end to the era of low spreads and miniscule coupons.

Euro and sterling new issue data taken from *GlobalCapital's Primary Market Monitor* shows just how pricey issuance became in 2022 — and could continue to be — for financial institutions.

## Spiralling spreads

Banks started 2022 in similar fashion to the end of 2021, with euro funders paying an average of 87bp over mid-swaps in January and February, compared with 80bp in the

final two months of 2021. However, when issuance resumed in the latter half of March the average spread had widened to 123bp. As the year progressed, banks have found themselves paying higher spreads despite shorter maturities. By the summer, triple-digit spreads were commonplace across the stack.

"This has been a bad year for investors, with equities and bonds down [roughly] 20% to date," says Joost Beaumont, head of bank research at ABN Amro. Because of this, "banks have had to offer wider spreads to compensate."

As a result, the average premium for a syndicated senior deal in euros or sterling climbed from 8.29bp in January 2022 to a year high of 47.83bp in July. Senior premiums averaged 13.03bp throughout the first half of the year, 2.5 times 2021's 5.13bp average. By September and October, this had risen to 24.47bp and 30.07bp, respectively.

This spike in July was driven by a pricey deal from Aareal Bank, which chose to pay the highest senior concession of 2022 to round off its unsecured funding ahead of what it thought could be a busy but uncertain autumn.

Meanwhile, the average additional tier one (AT1) deal was priced with a 40.45bp concession throughout 2022, up from 10.34bp a year earlier. Tier two deals carried 23.32bp of premium on average, a far cry from 2021's 6.44bp.

Elevated concessions were necessary to offset a more nervous investor base. Bid to cover ratios fell across the capital stack, while banks found it increasingly hard to rein in spreads as accounts became more selective.

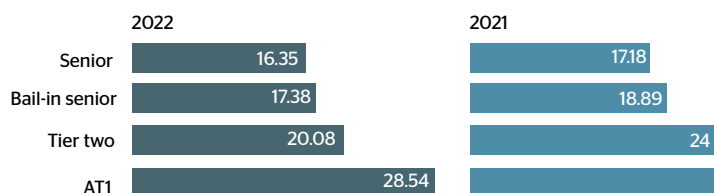
In 2022, 21 issuers failed to tighten trades in euros and sterling, up from 12 in 2021, according to *Primary Market Monitor* data. The bulk of this paper came from smaller names or debut issuers, with investors showing a greater preference for more liquid firms as the year progressed.

The trades that struggled to shave off any basis points were, on average, 1.17 times covered, 42% lower than the market average of 2.01 times. Furthermore, they had to pay an average concession of 51.4bp to land their deals.

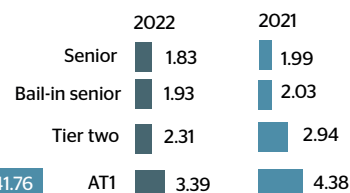
As banks faced the prospect of trickier visits to the mar-

## Smaller moves, smaller books

### Move from initial price thoughts (bp)



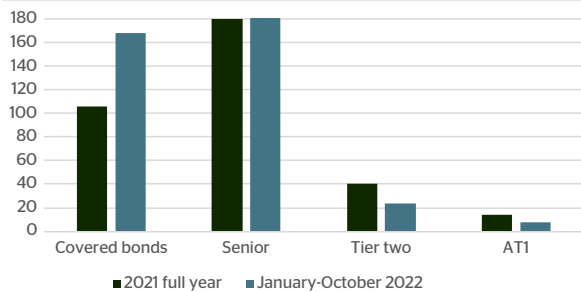
### Bid to cover ratio



Source: GlobalCapital



Senior surpasses, capital falls short – 2021 and 2022 (deal volume €bn)



Source: GlobalCapital

ket as 2022 progressed, they looked to cushion themselves from execution risk as much as they could. Some turned to labelled deals to capture every patch of demand. In 2021, banks placed €28.23bn of labelled senior debt; by the end of October 2022 they had issued €39.30bn.

Others opted for shorter maturities. Despite starting 2022 with an average maturity of 8.72 years, the senior debt market ventured shorter as conditions worsened. By October deals were being printed with an average duration of 5.25 years.

End of an era

The end of negative rates in the eurozone and the rapid rise in the ECB's deposit rate since July ushered in a sharp jump in bond coupons. The ECB increased its deposit rate by 50bp in July, its first rise since 2011. Two successive 75bp rises followed in September and October as the central bank attempted to bring inflation under control. Further increases are expected in the coming months.

"We have left the era of negative interest rates behind us," Beaumont says. "The unprecedented pace of central bank hikes has been reflected in interest rates and swaps, leading to banks paying higher coupons."

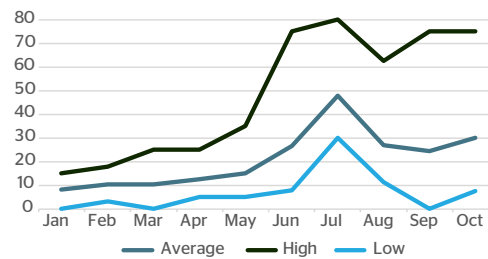
For instance, the average coupon for bail-in senior deals rose from 2.84% in July, ahead of the ECB meeting, to 3.79% in August. This jumped further to a year high of 4.74% in October — almost eight times the 0.62% average offered in October 2021.

However, this ECB-fuelled rise in yields might wane in the latter half of 2023 as the central bank's deposit rate tops out. Rates strategists at DZ Bank expect that the ECB rate will peak at 2.50% in March.

Central banks could then look to start cutting rates in the latter half of 2023, and as a result drive bond coupons lower, Beaumont suggests.

Banks will certainly welcome any lower coupons later in 2023 as refinancing of the Targeted Longer Term Refinancing Operations (TLTRO) funds gathers pace and

New issue premiums paid by senior borrowers for € and £ syndications (bp)



Source: GlobalCapital

they keep one eye on January 2024's minimum requirement for own funds and eligible liabilities (MREL) deadline.

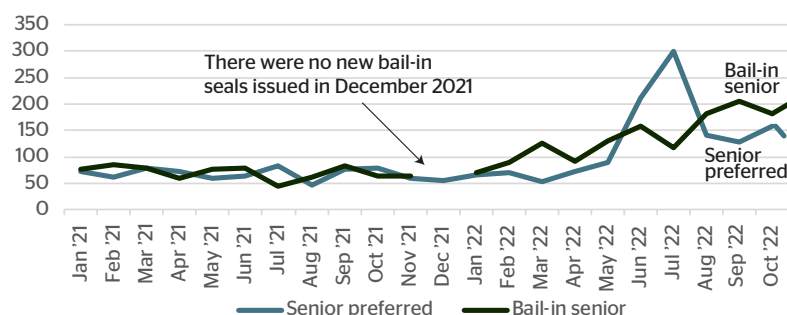
Senior secured and unsecured issuance is set for another bumper year, with analysts at ING expecting €370bn, only €10bn less than in 2022.

Some banks have already started tackling the TLTRO cliff edge in 2022 by ramping up their covered bond issuance to a level that surpassed expectations. By the end of October, banks had placed €168.19bn of senior secured paper, with a flurry of deals in November pushing the total to a double century for the first time. In 2021 only €105.57bn was raised in the format.

Of course, not all this refinancing will be done in secured format. Banks have tapped the senior market in larger sizes in 2022 than in 2021. The *Primary Market Monitor* recorded 224 syndicated euro and sterling senior tranches totalling €180.99bn in the first 10 months of 2022, for an average deal size of just over €800m equivalent. Although a larger number of notes (241) was issued in the whole of 2021, the volume was roughly in line at €180.01bn, meaning that in 2021 the average deal size came to just under €750m.

However, the focus and reliance on senior secured and unsecured funding in 2022 has come at the detriment of riskier subordinated trades. The volume of euro and sterling AT1 paper fell by almost half, dropping from €14.20bn in 2021 to €7.59bn by the end of October. The fall was similar in tier two debt, which declined from €40.69bn to €23.30bn in 2022. GC

Average spread to mid-swaps for fixed rate € syndicated deals (bp)



Source: GlobalCapital

# From feast to famine, winners found a way

It was a year of two halves, as bond market dynamics fundamentally changed after quantitative tightening began. These corporate deals are outstanding for either pushing limits and taking advantage of conditions at the start of 2022, or for navigating some of the toughest markets in over a decade.

## CORPORATE BOND OF THE YEAR

### GSK Consumer Healthcare Capital/Haleon

**€850m 1.25% March 2026**      **£300m 2.875% October 2028**  
**€750m 1.75% March 2030**      **£400m 3.375% March 2038**  
**€750m 2.125% March 2034**      **\$1.75bn 3.125% March 2025**

Bank of America, Barclays, BNP Paribas, Citi, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Mizuho, Morgan Stanley, Santander, Standard Chartered

A barnstorming debut across all three major currencies saw Haleon land a well deserved win for corporate bond of the year.

The consumer health spin-off from GlaxoSmithKline did all the right things in March to ensure it got the sums of money it needed in what was then considered to be a tricky market – though of course conditions became much tougher when central banks started quantitative tightening.

Haleon's deal rises above the rest with the sheer size and scope of its debut. It could not just lean on goodwill from being linked to GSK – it is rated a full two notches lower. Leads took the traditional route of a roadshow before opening books, telegraphing the trade and letting investors prepare for the new credit, and this was rewarded in Europe with books of €13.5bn and £4.5bn by the time final terms were announced.

Being a debut makes it difficult to pin down where fair value was, though sector comparables at the time put the new issue concession across all European tranches at zero to negative.

## DOLLAR CORPORATE BOND OF THE YEAR

### Magallanes, Inc (Spinco)

**\$1.75bn 3.428% March 2024**      **\$1.5bn 4.054% March 2029**  
**\$500m 3.528% March 2024**      **\$5bn 4.279% March 2032**  
**\$500m Sofr+178bp March 2024**      **\$4.5bn 5.05% March 2042**  
**\$1.75bn 3.638% March 2025**      **\$7bn 5.141% March 2052**  
**\$500m 3.788% March 2025**      **\$3bn 5.391% March 2062**  
**\$4bn 3.755% March 2027**

Barclays, Goldman Sachs, JP Morgan

The dollar bond market is well known for stumping up eye-popping amounts in single deals, but even with that in mind, the \$30bn 11 tranche trade for Magallanes was stunning in size.

The borrower is the entertainment spin-off of AT&T and Discovery, and hit the market just days before the Fed started to lift interest rates.

This was a masterclass in preparing the market for a jumbo, event-driven deal. The bookrunners drummed up interest from 200 accounts and saw orders peak at \$107bn, thanks to a well telegraphed transaction that investors had been preparing for since May 2021. That was when the spin-off was announced in a deal that included \$41.5bn of bridge loans from Goldman Sachs and JP Morgan.

As well as the sheer size of the bond, the issuer ended up paying new issue concessions of 20bp for the longer tranches and 25bp for the shorter maturities – only around 10bp-15bp back from where the best loved frequent issuers were paying at the time.

## CORPORATE SRI BOND OF THE YEAR

### L'Oréal

**€1.25bn 0.875% June 2026 sustainability-linked bond**  
**€1bn 0.375% March 2024**  
**€750m E+70bp March 2024**

BNP Paribas, Citi, Crédit Agricole, Deutsche Bank, HSBC, JP Morgan, Natixis, Société Générale

L'Oréal issued its first ever bond in 2022, with the biggest and longest of the three tranches being sustainability-linked. It stuck to short maturities as it is very cash generative and the bond was a one-off – to refinance a €4.5bn bridge loan that it raised to buy back 4% of its shares from Nestlé.

But it still managed to make a statement, building on its sustainability-linked loans signed a year earlier. It has pledged to achieve, by December 31, 2025, zero greenhouse gas emissions at its own sites; a 14% cut in 'cradle to shelf'; and using 50% recycled or bio-based plastics in its packaging. It will not pay a step-up coupon, but instead agreed to make an additional principal payment of 12.5bp for any of the three targets missed.

## STERLING CORPORATE BOND OF THE YEAR

### Northumbrian Water

**£400m 6.375% October 2034**

Bank of China, Barclays, RBC Capital Markets

While there may be bigger sterling trades over the year, it is hard to think of any that came at such a unique point of upheaval and volatility centred around the UK than Northumbrian Water's 12 year trade.

It announced its deal hours before then UK prime minister Liz Truss resigned. This was the first sterling corporate deal after then chancellor Kwasi Kwarteng's disastrous mini-budget that sent Gilt yields soaring and sterling freefalling against the dollar. It is hard to underestimate the catastrophic effect this had on UK markets. Bankers were writing off the sterling market until at least November, if not the rest of the year.

Northumbrian Water and its leads were not in the mood to be shaken by the noise. The issuer pushed ahead and opened books the day after Truss's exit – a choice made all the more adventurous because it was a Friday, a day typically void of trades in the European corporate bond markets.

## BEST EURO BOND ISSUED BY NON-EUROPEAN COMPANY

### Medtronic

**€500m 2.625% October 2025**      **€1bn 3.125% October 2031**  
**€1bn 3% October 2028**      **€1bn 3.375% October 2034**

Bank of America, Barclays, Citi, HSBC

US company Medtronic settled nerves across the European high grade corporate bond market in September when it proved that ambitious, multi-tranche deals could still be successful despite whipsawing volatility.

The medical equipment firm was the first to bring more than two tranches in the September window, with Siemens the last to do so in August. A trend then began of investors snapping up the longest tranches when given the choice from an issuer they like. Medtronic's deal was SEC registered, so book sizes were kept private, but the longer two tranches shaved 30bp off the spread in bookbuilding, while the shorter two tranches had to settle for 25bp coming off, indicating demand was higher the further out along the curve.

This was novel at the time – amid volatility investors usually prefer shorter maturities – and set the stage for the likes of Adidas and Schneider Electric.

# Challenging times require simple solutions

There's a mix of factors from inflation fears and geopolitical tensions to volatile markets impacting debt capital markets activity. With a 250 year history in the bond markets, the Vienna Stock Exchange has seen many of these risks before, and always supported customers through the turbulence. In an interview, Dimitrios Tsaousis, senior relationship manager for debt listings, reflects on the year – which saw over 5,000 new listings on the exchange – and why VSE is attractive to bond issuers.

## In what ways do you adapt to the changing environment?

For us, this is a constant. We always aim to improve what we do. There are many examples where this is evident but none more so than our new process for debt listings by issuers that are already listed on an exchange. Since much of the information required for a listing is already publicly available, we do not require it for listings on Vienna Multilateral Trading Facility (MTF).

This means that a listing can easily be achieved just by completing an application form, signing a commitment letter, and submitting the terms and conditions. This applies to listings of convertible, equity-linked, as well as to direct listings by such issuers.

## With the growth you've had in recent years, how do you future-proof your operations?

We have been cognisant of this all along and are always vigilant to trim a process that may be able to be completed in a more efficient way. This is the essence of our moto "We Make Things Simple" which works both ways. We want to make it as simple as possible for issuers to list with us, but we also want to automate and modernise our internal processes.

We have introduced the option of using a load-file for high-frequency issuers which has helped us greatly with efficiency but also quality assurance. Automation can only take us part of the way, for this reason we have also doubled the headcount within the bonds team since I joined.

We take pride on being the approachable exchange and the sheer volume has necessitated our growth. The most important thing is that we never sit back but constantly aim to improve and evolve our service.

## One of the most common questions is "why should I list with you?" how do you respond?

The benefits of listing with us are numerous. In the main, we achieve the quickest turnaround times in the market and can offer concrete timelines. These two factors have been very well received by our listing partners.

An easier path to listing with more flexibility is a key variable in our favour. When you list on Vienna MTF, you have more control as to which documents get published and when. As the industry shifts from regulated market listings to listings on a MTF, we have positioned ourselves as one of the most attractive EU listing venues.

It is not just this, though, it is the whole package – we are approachable, we offer reasonable pricing and the process



*"We take pride on being the approachable exchange and the sheer volume has necessitated our growth. The most important thing is that we never sit back but constantly aim to improve and evolve our service."*

**Dimitrios Tsaousis**, senior relationship manager for debt listings  
Wiener Börse

to list notes is simple. At our core, we have a "can-do" attitude, and this shows in our day-to-day interactions. This has resonated with the issuers who have trusted us with their business – as attested by the growing number of issuers listing with us.

## Will 2023 be the year of environment, social and governance (ESG)?

I don't know if we can say "the year of ESG" since there are other factors (e.g. geopolitical) at play too, but we certainly observe that the sector is gaining momentum. The relaunch of the Vienna ESG Segment, which took place earlier this year, highlights our commitment to the future of the sector. The industry is maturing, and we are maturing with it.

As an exchange, our approach is always to adapt to industry standards and to not be the one imposing additional measures and bureaucracy. For this reason, our bespoke ESG rulebook incorporates the adoption of industry standards from major industry organisations, such as the International Capital Markets Association and Climate Bonds Initiative, among others

I find it encouraging that the industry has moved away from just "green bonds" to the whole spectrum encapsulated within ESG. I particularly like how the industry has imposed the idea of ongoing obligations increasing the level of accountability to meet the agreed commitments.

# High hopes for corporate issuance in 2023

This year was a tough one for European investment grade corporate borrowers in the bond market, but there is plenty of optimism that 2023 will be easier. **Mike Turner** surveyed senior corporate bond bankers across Europe to get their thoughts.

There were €299bn of deals done by investment grade corporates in 2022 to November 11, according to Dealogic data, a far cry from the €469bn of trades printed a year earlier.

The biggest fall came from the real estate sector. After a period of heavy issuance in the first quarter, property companies largely shied away from the market for the rest of the year after seeing spreads balloon on the back of fears that people would not return to shared spaces in the same numbers as before the pandemic.

The real estate sector saw the biggest spread widening of all sectors by some margin this year, rising 199bp from 122bp on January 1 to 321bp by the end of October, according to fixed income analytics company Overbond. The next largest spread widening by sector came from utilities, which as a sector widened by 90bp less than real estate.

The problems facing companies, and their banking advisors, in coming to the market in 2022 were myriad, but common to many was soaring inflation which forced central banks to jack up interest rates, hastily scale back quantitative easing programmes and in some cases, such as the UK, switch to outright quantitative tightening.

Some, such as utilities and energy companies, were caught up in the cost of living crises across much of Europe as governments responded to soaring energy prices through a variety of ways including vast subsidy programmes, price caps and privatisations.

Spreads widened, new issue concessions leapt and, crucially, issuance windows became much more defined and shorter.

However, a survey of senior syndicate and debt capital market bankers in Europe by *GlobalCapital* has found that optimism is running high for the year ahead.

“We are poised for a decent pick-up in volumes in the first quarter of 2023,” says Giulio Baratta, head of debt capital markets corporates, EMEA, at BNP Paribas. “Issuers will be taking advantage of liability management, financed by new issuance.”

Baratta is not alone in this belief, with 100% of those surveyed agreeing that the next year will be at least 20%

busier than 2022. This is the only question that the bankers were uniform on in their agreement.

“We do not expect the weak late-2022 pace of supply to persist into 2023 for two reasons,” says Yuri Seliger, a credit strategist at Bank of America. “First, the unfavourable market conditions likely delayed issuance and pushed it instead into 2023. Second, we look for better demand in 2023 as we get more clarity on the Fed and more stable yields.”

## Peak inflation?

Markets on both sides of the Atlantic were lifted into a buoyant mood in mid-November when the US consumer price index print came in softer than expected for October at 7.7%, down from 8.2% a month earlier. This suggested that inflation in the US has peaked and the US Federal Reserve can be less aggressive in its rate rises.

However, Europe is much more reliant on Russia for energy, meaning there is little if no correlation between US and eurozone inflation.

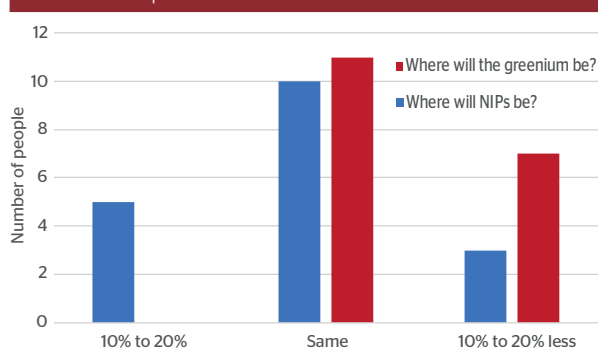
Nonetheless, plenty in the market hope that it will become easier to judge what central banks are going to do, which will make it easier for corporate borrowers to be more ambitious in approaching the primary market.

“A more fixed income-friendly phase at the beginning of the year, which is a clean sheet for investors, means there may be some rebalancing of pricing power,” says Baratta at BNPP. “This means you might see slightly tighter concessions. But we are gaining much better visibility on execution risk, on what is doable and how, which maturity gets the size you want. Then you can optimise pricing.”

## Curves rising

Of the bankers surveyed, 28% thought that new issue

### Where are premiums headed?



Source: *GlobalCapital*

concessions might rise by up to 10% on average in 2023, while 56% thought they would stay roughly the same as where they are coming into the end of the year.

The remaining voters, a small minority, reckon concessions might start falling back to the 0bp-5bp range seen at the beginning of 2022.

New issue concessions have varied sharply in recent months. Highly rated, non-cyclical frequent borrowers could expect to pay single digits, with Nestlé and Volkswagen issuing trades in November that paid just a handful of basis points over their curves.

Further down the credit curve or into more energy-intensive cyclical sectors, however, and issuers can expect to pay far chunkier premiums.

Metals company ArcelorMittal was probably the clearest example of that in 2022, with the issuer paying a new issue concession of 70bp-110bp — depending on if you asked someone on or off the trade — for a €600m four year deal in September.

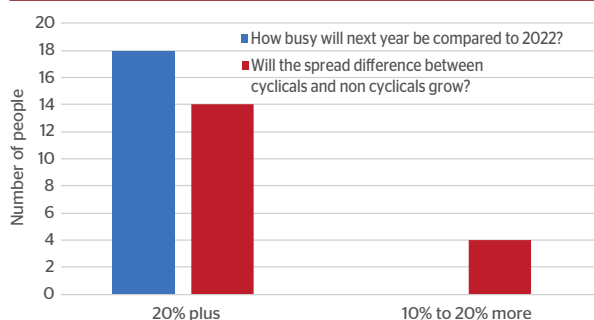
It remains bad news for out-of-favour sectors, with the majority of those polled expecting the spread difference between cyclical and non cyclical issuers to continue rising by a large amount. In total, 78% of those polled said that the spread difference will be at least 20% higher than it was at the beginning of 2022, and will continue rising from the 100bp-120bp range where it is now.

The rest of those who voted were only a little more positive, expecting the spread to still move around 10% wider.

The benefits of going green became more opaque in 2022, with a clearcut spread benefit for issuing green debt, known as the greenium, largely vanishing. One banker put it at 3bp, another said it was a high as 5bp but added that getting to this number was “not scientific”.

However, the structure still bought with it a notable benefit — opening up a deal to more investors at a time when volatility meant getting a deal done at all was not always guaranteed. The extra investor base adds to the demand, but there is not quite enough to put significant downward pressure on pricing, according to multiple bankers.

#### How busy and how expensive will corporate bonds be?



Source: GlobalCapital

Furthermore, multiple bankers and issuers have said in recent weeks that it is only use of proceeds environmental, social and governance bonds that get this added benefit because they fit into green investors' portfolios. This means sustainability-linked bonds will not see more demand for having an ESG label.

A 61% majority of voters said they thought the greenium would remain the same in 2023, that is, low single digits, with the remaining voters reckoning it would shrink to zero.

#### Find a niche

Niche markets became attractive to many borrowers in 2022, a trend expected to continue throughout 2023.

The Schuldschein market is on course for a record €31bn year in 2022, in part because of high grade corporates making debut forays in this market having seen conditions in the public markets worsen over the year.

US private placements have also proven popular, with bankers anecdotally saying that the private market has seen high levels of dealflow.

This growth is likely to continue into 2023, according to Europe's corporate debt bankers. An optimistic 17% think that the private debt and Schuldschein markets could grow by more than 20% over the next year, while a more moderate 50% reckon it will be closer to 10%.

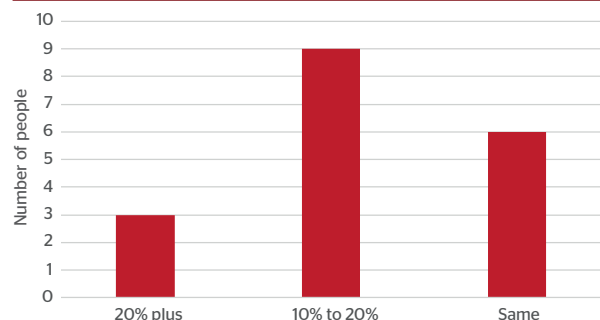
Meanwhile, 33% think that the niche debt markets in 2023 will be roughly the same size as they were in 2022.

It is notable that no bankers think the niche debt markets will shrink in the next year, so Schuldschein participants can likely look forward to another record year at least.

However, there are a significant number of moving parts going into 2023, with the global economy still vulnerable to soaring inflation and recession.

Ultimately, what it will take is pragmatism, according to Baratta at BNPP, that is “based on how certain countries will enter into recession, how potentially deep or prolonged this correction could be, assessing how aggressive central banks will remain with tightening, how fast they are going to stabilise or return to dovish. This is going to dictate the consequential assessment around funding markets”. GC

#### Will there be more issuance in niche markets like Schuldschein and US PP?



Source: GlobalCapital

# Worst markets for years keep treasurers on their toes

Nimbleness was the name of the game for Europe's high grade corporate bond issuers in 2022, as war, inflation and the end of quantitative easing transformed the market. High inflation means a large chunk of 2023 will be the same, but corporate funding chiefs hope the latter part of next year could provide excellent opportunities for issuance. **Mike Turner** reports.

Corporate bond issuers were clobbered from all sides in 2022. Rocketing inflation made central banks flip quantitative easing into reverse. Energy costs soared on Russia's invasion of Ukraine and the threat of a continent-wide recession gnawed at markets from the summer on.

Investors had a tough time as well. By early November, the S&P Eurozone Investment Grade Corporate Bond Index had returned minus 12.5%. A far cry from the almost guaranteed positive returns during years of central bank bond buying.

"The main challenge was the heavy news flow," says Bernard Descreux, director of financing in group treasury at Electricité de France in Paris. "Very often we were restricted to issue because we had some information to provide to the market. The windows were narrow. At the same time, we had to cope with market news flow, which was a heavy one."

All this added up to one thing, he says: "It was not easy to find a window for issuance."

## Wait it out

EDF is not typical — but it is emblematic of 2022's angst. France's largest electricity generator and supplier was caught in the jaws of the year's raging energy markets.

Having sold its power forward, EDF was bombarded with demands for cash margin payments as electricity prices soared — even though the underlying price movement is bullish for EDF. That and the French government's decision to cap retail power prices meant that the state decided in July to buy out the remaining 14% of EDF it did not already own.

EDF had to wait until early October before it could issue its first bond of the year — a €3bn green trade in three tranches.

"We had to be very nimble — there was no window before then, and the door closed just after this one," says Descreux. "It's very difficult, so you have to wait until you see all the green lights. It's quite stressful — you have to wait and wait, and try to be as discreet as possible in order to not be seen by all market participants before you go."

Although EDF's woes were its own, every European issuer was affected by the market turbulence caused by surging energy prices — the main driver of inflation.

Energy companies of all kinds have been at the eye of the storm. Germany plans to raise €10bn from a windfall tax on energy companies, while Spain plans a tax on utilities, as



"From an issuer's perspective, we have sympathy with the difficult investment decisions investors have to make"

**Gerard Kits, Tennet**

well as a 4.8% windfall tax on banks' income. The UK is also increasing windfall taxes on energy companies.

In Germany, the government bought a 98.5% stake in Uniper for €8.5bn. Uniper was the country's biggest gas importer and had suffered acutely from the disruption to Russian supplies.

At the other end of the energy scale are power grids, which keep on

humming and collecting regulated tariffs, whatever the power price or state of the economy. But even they have had to tread carefully.

"This year it was much more sensitive to look for the right window, with less available windows to tap," says Gerard Kits, head of treasury at Tennet, the Dutch grid company, in Arnhem. "We therefore prepared deals a bit earlier, took a bit more time to find the right window to execute."

It was not all about caution — there was room for daring, too. Tennet essentially re-opened the long end of the euro bond market in October, when it printed a €3bn four tranche green bond, including an €850m 20 year.

Before that only Deutsche Bahn, owned by the German government, had dared issue a corporate 20 year bond since the European Central Bank stopped expanding its corporate bond portfolio in the summer.

## Greener days

A technique that has helped issuers weather volatile periods is green issuance. While many borrowers and bankers say the spread benefit for green issuers has dissipated, opening up a deal to investors that can only buy green debt offered something else this year — a better chance of getting a deal done at all.

"In these volatile times, it is helpful to have a green bond in the market because that results in more investor interest," says Kits. Tennet is one of Europe's biggest green bond issuers. "If you have more investor interest that also has a positive effect on price and/or size."

"The ESG bond market seems to grow and becomes increasingly important to investors and the ECB is looking more and more to ESG transactions."

Multiple bankers say this benefit was attached to green bonds, not sustainability-linked bonds, as there

was no defined group of investors that would only buy SLBs, in contrast with use of proceeds green debt.

However, SLBs still proved a ripe product for issuance this year — borrowers are convinced the structure helps.

French beauty group L'Oréal broke with 103 years of tradition and made its first foray into the bond market, with an SLB as part of the array.

This was before central banks started turning off the taps and volatility rocketed. Enel, the Italian electricity and gas company, issued €1bn and \$4bn of sustainability-linked bonds in the autumn.

The deals demonstrated how “truly sustainable business models are sought after by the market,” says Alberto De Paoli, Enel's chief financial officer in Rome. “Even in challenging times, like the ones we are currently experiencing.”

This was seen during the depths of the pandemic as well, when market participants argued that if a company was in a position to focus on its environmental, social and governance problems, it was strong enough to feel confident it would get through the present turbulence.

The dollar deal allowed Enel to “continue to diversify its investor base”, says De Paoli.

### Inflection points

There is good news and bad for Europe's high grade corporate issuers. With central banks raising rates at a speed not seen for decades, inflation is expected to peak and start falling again.

“Next year will be easier,” affirms Descreux at EDF. “Central banks are

moving from behind the curve to the forefront. Probably by the end of the next half year, the market can be open to a bond rally, once we are sure inflation has peaked.”

Other funding officials agree with this point of view, though they have consigned at least the first part of 2023 to the same wild market swings that made this year so difficult for issuers.

“Next year, I expect still some volatility, but hopefully at a certain point of time there will be more stabilisation,” says Kits at Tennet. “At the moment market expectations and the forward curve indicate that rates will peak in 2023, after which we expect there to be a higher degree of certainty and stability in the market.”

There are already some signs of conditions improving. On November 10, the US annualised Consumer Price Index came in at 7.7% for October. This was down from 8.2% in September and was immediately taken as a sign that inflation might have peaked in the US and that the US Federal Reserve's terminal rate might not go as high as the feared 5%.

Financial markets rallied immediately, with the S&P 500 up by 4.2% on the day, while the 10 year Bund yield fell 16bp to 2.01%.

### Paying up

New issue concessions were almost as volatile as the macroeconomic picture in 2022. Again, all issuers suffered, but some more than others.

ArcelorMittal, from the out-of-favour, energy-guzzling steel industry, paid a concession of more than 100bp on a bond in September,

while super-defensive, well followed Nestlé was able to pay a zero premium in November, despite pricing flat to mid-swaps.

Towards the end of 2022, concessions settled at around 20bp-30bp for defensive issuers offering unambitious maturities and sizes, increasing to 40bp-60bp if a borrower wanted to go big or long. This is a sharp rise from the zero to 5bp that many expected to pay at the beginning of the year.

“From an issuer's perspective, we have sympathy with the difficult investment decisions investors have to make,” says Kits. “We understand there is some concession needed to mitigate this new risk. But if the market stabilises a bit more in the new year, concessions will also go down again.”

Tennet appeared to have paid 25bp in premium on the shortest of its four tranches — a six year — in October, and 48bp on the 20 year.

### Spread the net

Of course, corporate issuers are not obliged to issue public bonds. The Schuldschein was one of the few markets to have a shining year in 2022, and is on track for record issuance of over €30bn, beating the previous high of around €27bn.

The strength of that market, plus Europe's fiercely competitive syndicated loan market and US private placements, gives treasury teams plenty of options. It can just be a case of knowing which one to take.

“All issuers know that markets are not always open, so they have to find alternative sources of liquidity,” says Descreux. “For EDF, we have a multi-track approach, not dual track. [We work on] several projects of financing at the same time, and we press the button at the right time for one of them to be launched.”

“Given the number of moving parts,” he adds, “we cannot predict which one will be triggered.”

Issuers have had to learn fancy footwork this year, and will likely have to keep practising their dinking and shimmying next year.

“Being more flexible is very important,” says Kits. “It's not ideal, but in the end, we were able to get large deals done.” GC

### S&P Eurozone Investment Grade Corporate Bond Index



Source: Standard & Poor's

# Companies cough up in public bond market

Investment grade corporate issuers have had to offer increasing amounts of spread to entice investors into their bonds as markets adjust to a new world of looming recession, soaring inflation, lower central bank support and higher interest rates. By **Ralph Sinclair**.

One of the more noticeable things about Europe's public investment grade corporate bond market is just how steady it has been over the past two years. But one metric has soared above all — the amount of new issue premium borrowers have had to offer to raise benchmark funding.

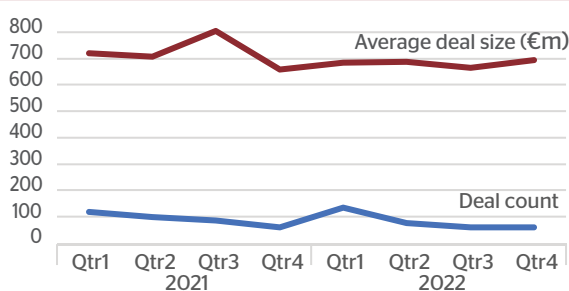
An investigation into *GlobalCapital's* Primary Market Monitor data on syndicated euro issuance of benchmark size — that is to say, deals of €500m or more — from investment grade corporate issuers since the start of 2021 reveals a great deal of consistency around the number of deals, their average size, how much demand they generate and how much issuers are able to move pricing during execution.

But one measurement stands out: since the first quarter of 2021, the average new issue premium a borrower has paid on such a deal has risen from minus 0.2bp to a positive 19bp in the fourth quarter of 2022.

By far the biggest leap came between the end of Q3 2021 and Q4 of that year, when the average new issue premium rose by 9.9bp to 13.2bp. Although it fell to 10.7bp in the first quarter of 2021, it has never been below that level since, and never higher as far back as *Primary Market Monitor's* data goes.

The change gives a clear view of how investors have changed in their assessment of investment grade corporate

Euro benchmark investment grade corporate bond issuance



credit risk as inflation and interest rates started to rise, and as the threat of recession loomed larger. The ECB's Corporate Sector Purchase Programme was a big factor in the market but the rate of buying was quite steady until June 2022, when it stopped net purchases.

Over the same period, issuance was remarkably consistent. There were 363 euro benchmarks issued in 2021 and 326 in 2022 up until November 17. In both years, the first quarter was the busiest — 119 deals in 2021 and 135 in 2022. The average deal size has shrunk in 2022 but not by much. It was €726m in 2021 and €682m in 2022 so far. Total volume was €264bn in 2021 and has dropped to €222bn in 2022 to date, demonstrating how issuers have paid up to get roughly the same amount of funding done.

Those higher premiums have generated similar demand levels across the two years with an average subscription ratio of 3.4 times the deal size in both years. Quarter by quarter, there was little deviation from the mean in 2021, with the average ranging between 3.2 and 3.6 times deal size.

That figure dipped to 2.6 times amid the uncertainty of the second quarter of this year but rose to four times in the third quarter, which helped issuers bring down their average new issue premium from 14.6bp to 12bp.

Meanwhile, the amount issuers have been able to tighten pricing on their euro benchmark syndications has also been consistent. Issuers had the most success in the fourth quarter of 2022 and the first quarter of 2021 — an average tightening from initial price thoughts to re-offer of 29.8bp and 29.7bp respectively.

That figure has risen each quarter in 2022 from 25.6bp in the first three months of the year, delivering an average for the whole year to date of 26.5bp versus 27.7bp for 2021. **GC**

Euro IG corporate primary bond market

Period	Average subscription Ratio	Average NIP (bp)	Average move from IPTs to re-offer (bp)	Vol (€bn)	Average deal vol (€m)	Deal count
<b>2021</b>	<b>3.4</b>	<b>4.4</b>	<b>27.7</b>	<b>263,590</b>	<b>726</b>	<b>363</b>
Qtr1	3.6	-0.2	29.7	85,575	719	119
Qtr2	3.2	4.2	27.1	70,075	708	99
Qtr3	3.3	3.3	28.5	68,390	805	85
Qtr4	3.4	13.2	23.6	39,550	659	60
<b>2022</b>	<b>3.4</b>	<b>13.3</b>	<b>26.5</b>	<b>222,445</b>	<b>682</b>	<b>326</b>
Qtr1	3.5	10.7	25.6	92,250	683	135
Qtr2	2.6	14.6	24.1	50,900	688	74
Qtr3	4.0	12.0	28.0	38,445	663	58
Qtr4	3.6	19.0	29.8	40,850	692	59
<b>Grand Total</b>	<b>3.4</b>	<b>9.1</b>	<b>27.2</b>	<b>486,035</b>	<b>705</b>	<b>689</b>



# GlobalCapital Syndicated Loan, Leveraged Finance and Private Debt Awards 2022

*GlobalCapital* reveals the deals, banks, investors and advisers that have been nominated by firms in the EMEA loan markets for awards as the best of 2022. As in previous years, *GlobalCapital's* awards are based on a poll of market participants. They are for the best achievements in the year November 20, 2021 to November 15, 2022. We will reveal the winners at our 20th annual Syndicated Loans, Leveraged Finance and Private Debt Awards Dinner in London on February 22. *GlobalCapital* thanks all who voted and congratulates the nominees.

## DEAL OF THE YEAR

### Atlantia

€9.875bn July 2022

### Philip Morris International

\$11bn and €5.5bn June 2022

### Porsche Automobil Holding

€8.9bn September 2022

### Refresco

€3.9bn-equivalent July 2022

### Schneider Electric

€6.5bn September 2022

## LEVERAGED LOAN OF THE YEAR

### Element Materials Technology

\$2.22bn-equivalent May 2022

### Ineos

\$2.34bn-equivalent November 2022

### Refresco

€3.9bn-equivalent July 2022

## INFRASTRUCTURE FINANCE LOAN OF THE YEAR

### Atlantia

€9.875bn July 2022

### Deutsche Glasfaser

€5.75bn, December 2021

### GD Towers

€6.85bn July 2022

### Open Fiber

€7.175bn February 2022

## RENEWABLES LOAN OF THE YEAR

### Dogger Bank Offshore Wind Farm Project 3

£2.983bn December 2021

### Gemini Offshore Wind Park

€1.6bn, October 2022

### Juno Bidco

€2.1bn, March 2022

## M&A LOAN OF THE YEAR

### Atlantia

€9.875bn July 2022

### GD Towers

€6.85bn July 2022

### Philip Morris International

\$11bn and €5.5bn June 2022

### Porsche Automobil Holding

€8.9bn September 2022

### RWE

\$8bn October 2022

## EMERGING MARKET LOAN OF THE YEAR

### Greensaif Pipelines

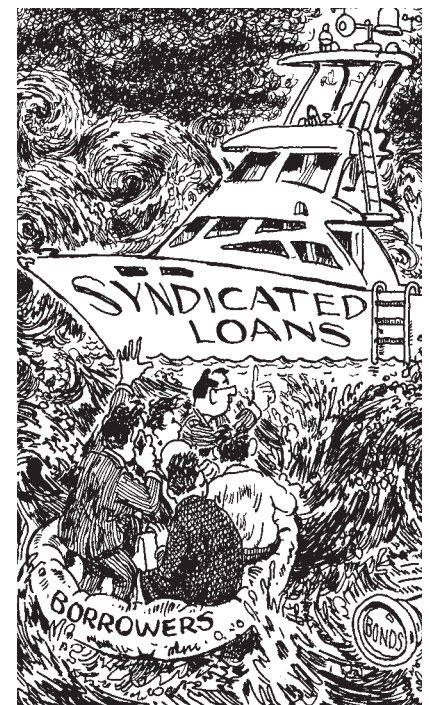
\$13.8bn January 2022

### Play Communications

Z5.5bn (\$1.4bn) February 2022

### Public Investment Fund

\$17bn November 2022



**REGIONAL DEALS OF THE YEAR****UK AND IRISH DEAL OF THE YEAR****Haleon**

£12.5bn and \$1.4bn February 2022

**Rentokil Initial**

\$2.7bn February 2022

**Virgin Media O2**

£1.5bn August 2022

**FRENCH DEAL OF THE YEAR****Airbus**

€8bn July 2022

**Schneider Electric**

£6.5bn September 2022

**TotalEnergies**

\$8bn April 2022

**GERMAN, SWISS AND AUSTRIAN DEAL OF THE YEAR****Deutsche Glasfaser**

€5.75bn, December 2021

**Porsche Automobil Holding**

€8.9bn September 2022

**RWE**

\$8bn October 2022

**Siemens Energy**

€4.2bn June 2022

**ITALIAN DEAL OF THE YEAR****Atlantia**

€9.875bn July 2022

**Eni**

€6bn July 2022

**Iveco**

€1.9bn January 2022

**Open Fiber**

€7.175bn February 2022

**IBERIAN DEAL OF THE YEAR****Cellnex Telecom**

€2.5bn January 2022

**El Corte Inglés**

€2.6bn March 2022

**Energias de Portugal**

€3.65bn August 2022

**CENTRAL AND EASTERN EUROPEAN DEAL OF THE YEAR****Akbank**

\$225m and €177.5m October 2022

**Ataer Holding**

\$80m and €190m November 2022

**Fraport Tav Antalya**

€1.225bn March 2022

**Play Communications**

Z5.5bn (\$1.4bn) February 2022

**Ziraat Bankası**

€814m and \$352.5m April 2022

**MIDDLE EASTERN DEAL OF THE YEAR****Agility Public Warehousing**

€1.083bn and \$300m

**Crystal Port Holding**

\$2.895bn June 2022

**Greensaif Pipelines**

\$13.8bn January 2022

**Public Investment Fund**

\$17bn November 2022

**BENELUX DEAL OF THE YEAR****Eurofiber**

€1.5bn June 2022

**Koninklijke DSM**

€3bn July 2022

**Solvay**

€4.7bn March 2022

**NORDIC DEAL OF THE YEAR****Assa Abloy**

\$3.75bn October 2022

**Fortum**

€5.5bn June 2022

**Ørsted**

€2bn October 2022



## BANK AWARDS

LOAN HOUSE  
OF THE YEAR

BNP Paribas  
Citigroup  
Crédit Agricole  
JP Morgan

BEST ARRANGER OF  
LEVERAGED LOANS

Barclays  
Deutsche Bank  
Goldman Sachs  
JP Morgan

BEST ARRANGER OF  
M&A LOANS

Bank of America  
BNP Paribas  
Citigroup  
JP Morgan

BEST ARRANGER OF  
PROJECT FINANCE LOANS

Crédit Agricole  
Natixis  
Santander  
Société Générale

BEST ARRANGER OF  
TRADE FINANCE LOANS

Crédit Agricole  
Shinhan Bank  
Société Générale  
Standard Chartered

BEST ARRANGER OF  
MID-CAP LOANS

BNP Paribas  
Commerzbank  
HSBC  
UniCredit

BEST ARRANGER OF  
INFRASTRUCTURE AND  
RENEWABLES LOANS

BNP Paribas  
Crédit Agricole  
Santander  
Société Générale

BEST SECONDARY  
LOANS HOUSE

Citigroup  
Goldman Sachs  
JP Morgan  
Morgan Stanley

## BANK REGIONAL AWARDS

BEST ARRANGER OF  
WESTERN EUROPEAN  
LOANS

BNP Paribas  
Crédit Agricole  
Deutsche Bank  
JP Morgan

BEST ARRANGER OF  
UK AND IRISH LOANS

Barclays  
Lloyds Bank  
NatWest Markets

BEST ARRANGER OF  
FRENCH LOANS

BNP Paribas  
Crédit Agricole  
Société Générale

BEST ARRANGER OF  
GERMAN, SWISS AND  
AUSTRIAN LOANS

Commerzbank  
Deutsche Bank  
UniCredit

BEST ARRANGER  
OF ITALIAN LOANS

Intesa Sanpaolo  
Mediobanca  
UniCredit

BEST ARRANGER  
OF IBERIAN LOANS

BBVA  
CaixaBank  
Santander

BEST ARRANGER  
OF BENELUX LOANS

ABN Amro  
ING  
JP Morgan  
Rabobank

BEST ARRANGER  
OF NORDIC LOANS

Danske Bank  
Nordea  
SEB

BEST ARRANGER OF  
CENTRAL AND EASTERN  
EUROPEAN LOANS

Erste Bank  
Raiffeisen Bank  
International  
Société Générale  
UniCredit

BEST ARRANGER  
OF TURKISH LOANS

Bank of America  
Emirates NBD  
Standard Chartered

BEST ARRANGER OF  
MIDDLE EASTERN LOANS

Emirates NBD  
First Abu Dhabi Bank  
HSBC  
SMBC  
Standard Chartered

BEST ARRANGER  
OF AFRICAN LOANS

Absa  
Investec  
Standard Chartered

### BEST ADVISERS, INVESTORS AND LAW FIRMS

#### BEST CORPORATE FINANCE ADVISER

Lazard  
Rothschild & Co

#### BEST LAW FIRM FOR SYNDICATED LOANS

Allen & Overy  
Clifford Chance  
Linklaters

#### BEST INSTITUTIONAL LENDER

Axa  
Barings  
Blackstone  
MV Credit  
Pimco

#### BEST DIRECT LENDING FUND

Ares  
Blackstone  
Pemberton

#### BEST LOAN RESTRUCTURING ADVISER

Houlihan Lokey  
Lazard  
PJT Partners

#### BEST DISTRESSED LOAN INVESTOR

Apollo  
Cross Ocean Partners  
Strategic Value Partners  
Triton

#### BEST SUBORDINATED DEBT INVESTOR

HPS  
MV Credit  
Park Square



### SUSTAINABLE LENDING AWARDS

#### SUSTAINABILITY-LINKED LOAN OF THE YEAR

Eni  
€6bn July 2022  
  
Eurofiber  
€1.5bn June 2022  
  
Lundbeck  
€1.5bn September 2022  
  
Royal FrieslandCampina  
€1.25bn October 2022

#### SCHULDSCHEIN OF THE YEAR

Etex  
€800m June 2022  
  
Robert Bosch  
€1.5bn October 2022  
  
Vonovia  
€1bn February 2022

#### BEST ARRANGER OF SCHULDSCHEINE

Commerzbank  
Helaba  
LBBW  
UniCredit

#### BEST ARRANGER OF GREEN AND ESG-LINKED LOANS

BNP Paribas  
Crédit Agricole  
ING  
Natixis  
Standard Chartered

#### INTERNATIONAL SCHULDSCHEIN OF THE YEAR

ArcelorMittal  
€725m May 2022  
  
Etex  
€800m June 2022  
  
Holcim  
€515m and \$148m May 2022

#### BEST US PRIVATE PLACEMENT AGENT

Bank of America  
BNP Paribas  
NatWest Markets

#### MOST INNOVATIVE BANK FOR ESG LENDING

BBVA  
BNP Paribas  
Crédit Agricole  
Natixis

#### BEST ARRANGER OF INTERNATIONAL SCHULDSCHEINE

BNP Paribas  
Commerzbank  
ING  
UniCredit

#### US PRIVATE PLACEMENT OF THE YEAR

Bunzl  
\$400m March 2022  
  
Energie Baden-Württemberg  
\$850m November 2022  
  
Lidl US  
\$800m August 2022  
  
Permira  
\$860m

# Loan market's cloudy outlook contains a ray of green light

The EMEA syndicated loan market has weathered the roughest year for capital markets since 2009 in decent shape. Even battered leveraged finance is working. But lenders are ambivalent on whether 2023 will bring a modest recovery or worse strains. As **Marta Imarisio** reports, the one bright spot is the ever-growing emphasis on ESG.

**S**yndicated loan specialists in EMEA, weighing up how the market will evolve in 2023, find it difficult to know which way to jump. Will the forces of recovery, or disruption, prevail? But they all agree on one thing: there will be risk.

After a bruising year, with Russia's invasion of Ukraine and much higher inflation than almost anyone had predicted, loans bankers are not confident that the worst is behind them.

"The market development next year could go in two directions," says Reinhard Haas, global head of syndicated finance at Commerzbank in Frankfurt. "If there would be peace in Ukraine, financing conditions would be easier and the outlook more reliable. The conditions might not go back to pre-war times, but it would likely be less volatile than at present. However, in the hopefully unlikely event [of] a further escalation of

the conflict, uncertainty will likely rise even more, and markets might encounter a very difficult period."

Despite the events of 2022, EMEA's investment grade loan market has remained stable and continued to function at a fairly even pace.

Overall syndicated lending in the region reached €729bn in the first three quarters of 2022, in 1,250 transactions, says BNP Paribas. This was about 19% down on the volume by that point of 2021, but 2021 was the busiest year in the past 15, with a full year total of €1.26tr. The pace of lending in 2022 was roughly the same as in 2019, 2017 or 2016.

Nevertheless, no one would call it an easy year, and in leveraged finance it has been extremely difficult.

Even though overall volume figures are not bad — levloan borrowing was about €220bn by mid-November according to Dealogic, similar to the full year figures in many recent years — the conventional institutional leveraged loan market all but dried up for weeks at a time, leaving banks unable to clear underwritten loans from their balance sheets.

## More angst to come

The stressful macroeconomic backdrop, which perturbed the leveraged market so much, making it hard to execute deals, "is not going to change in the first half of next year," says Ben Thompson, head of EMEA leveraged finance capital markets at JP Morgan in London.

However, levfin bankers will have plenty of work to do. "2023 will be the year to start addressing maturities which are due in 2024 and 2025," Thompson says.

Daniel Rudnicki Schlumberger, head

of EMEA leveraged finance at JP Morgan in London, expects volatility to stay for the next nine to 12 months. "We are going to have some market windows and some periods of stress," he says.

Up to now, the market has been dealing with anxiety about credit risk and credit pricing, rather than actual losses. But that reckoning will have to come. "The market is still trying to figure out who are the credit winners and who are the losers, but this will take time, as it did during the pandemic," says Rudnicki Schlumberger.

The difficulties of leveraged finance could even contribute to economic weakness. "It is really difficult to price risk, which could keep the market from recovering quickly and could lead to a more drawn-out recession," says Sabrina Fox, CEO of the European Leveraged Finance Association in London.

## Tentative recovery

In investment grade, conditions should be easier. Haas believes the market will return to higher volumes, but it is hard to predict how soon.

"The market is finding new ways of addressing issues: supply chains are being repaired, there is increasing talk about China regarding the loosening of its zero Covid policy," he says. "Once this is implemented, it is likely to lead to increased economic activity. So there are some chances for a pick-up in volume, albeit not a massive one."

Apart from the war in Ukraine, the big determinant of activity is likely to be interest rates, which will be driven by inflation. Most firms expect this to stay high, at about 5%-6% in the EU.

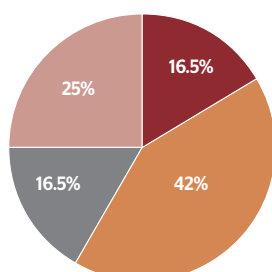
Carlo Fontana, head of global syndicate at UniCredit in Milan, does not expect a big drop in yields, but adds: "we should see a normalisation".

As a result, he says: "There will be intermittent market access in the short term, but the overall context will remain more or less similar [to

## Senior loan bankers' survey, November 2022

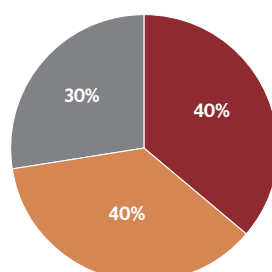
How will EMEA loan volumes in 2023 compare to 2022? (%)

- Over 20% higher
- 5%-20% higher
- About the same
- 5%-20% lower



Will loan volumes be driven more by M&A in 2023 than in 2022?

- More driven by M&A
- Stable
- Less driven by M&A



Source: GlobalCapital

2022]. That said, we may see an uptick late in the second half of 2023, perhaps slightly earlier, as the market always anticipates economic recovery predictions.”

Prospects for a healthy loan market in 2023 are helped by the fact that banks appear to be in good shape, with enough capital and access to cash to lend for regular business.

“If a company’s financials look good, banks will be [interested] as they are very eager to lend to high-performing names,” says the head of syndications at a bank in Europe.

Nevertheless, in a survey of senior loans bankers conducted by *GlobalCapital* in November, most respondents said they expected competition among lenders to stay the same or decrease in 2023.

“There are going to be less asset takers in the European syndicated loan market than in pre-pandemic times,” says Haas, “but we do not expect changes to be particularly disruptive as the volume contribution of these investors has not been very substantial in the past couple of years.”

There is not a direct correlation between the eagerness of banks to lend and the size of syndicates, but these factors may be connected.

“We have seen a trend over the years of syndicates getting smaller,” says the head of syndications. The main driver is a rationalisation of syndicates. For companies, “there is no point having 20 banks but volume [of borrowing] for only 10,” he says. It makes sense for banks, too. “Banks are becoming more focused on what they invest in, choosing specific asset classes and doing them well.”

**Margins are picking up**

While some bankers believe loan volumes could rise in 2023, there is little expectation of margin tightening.

Credit spreads on investment grade loans were much slower to rise in 2022 than those on corporate bonds, partly because of the relationship nature of the loan market. But they did widen later in the year.

“The pricing movement in the IG space has been more visible as of late, but increases are not as wide as market indicators would have suggested,” says Haas. “It is unlikely for margins

to explode unless a catastrophic scenario occurs, but there will be continued [upward] pressure for some time.”

For the more leveraged companies, this could be painful. Many have hedged interest rates, but those hedges will be coming to an end in the next couple of years.

“As hedges come off or issuers refinance into a higher margin, high cost of funds environment, the pressure on cashflow is obvious,” says Charlotte Conlan, head of leveraged finance at BNPP in London.

In their most optimistic moments, bankers hope for a revival of mergers and acquisitions. The rough economic environment in 2022 led to a fall in corporate acquisitions of around 27%, according to EY, the professional services firm.

In the EMEA loan market, M&A financing made up 17% of volume up to the third quarter, according to BNPP, below the 20% average of the past seven years and notably below the 22% in 2021.

“For banks, what makes the outlook seem either good or bad is the number of M&A deals,” says the head of syndications, alluding to the fact that these loans pay better. “Maybe next year will be more active in those terms, as there is a lot of cash out there.”

However, the heavy clouds on the economic and geopolitical horizon are not encouraging anyone to predict this with confidence.

**ESG is the key**

One trend bankers are willing to back without hesitation is green and sustainability-linked lending.

According to Dealogic data, in 2022 up to November 20, there had been €192bn of such loans in EMEA, about 19% of all lending.

Market participants expect 2023 to bring a “push on green”, says the head of syndications. “Banks are increasingly being encouraged to move to sustainability and, on the borrower side, it is pretty much embedded” in corporate behaviour.

“ESG is an imperative now,” says Fox at ELFA. “It is not just a nice-to-have feature anymore, it is [necessary to] access to financing.”

Haas agrees. It is not so much that borrowers with poor ESG characteristics will pay higher margins, rather that “the liquidity pool for borrowers with no ESG concept is likely to shrink,” he says. “It is estimated that around 20%-25% of portfolio managers in the industry have policies that impose growing portions of ESG investment, and we believe that this tendency will continue.”

It is harder for small and midcap companies to shoulder the costs of developing ESG policies and linking their loans to them.

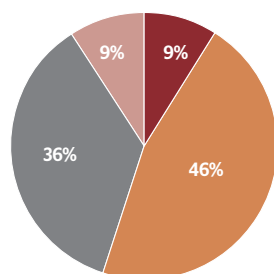
Nevertheless, says Haas: “On the borrower side, there is a lot of activity around this topic in one way or another. Especially in larger companies, ESG-compliant debt issuance is becoming commonplace.” GC

Senior loan bankers’ survey, November 2022

Source: *GlobalCapital*

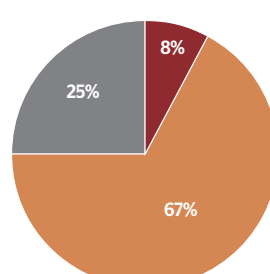
How will margins on investment grade loans evolve in 2023?

- Much wider
- A little wider
- About the same
- A little tighter



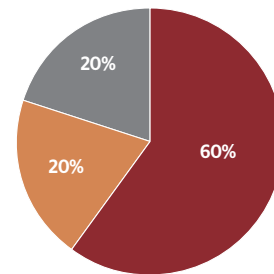
Do you expect competition between banks in western European investment grade lending to change in 2023?

- More competitive
- About the same
- Less competitive



Do some sectors have to pay wider margins due to their poor ESG characteristics?

- Yes
- No
- No, but companies which don't have a good record may have wider margins



# Volumes drop and premiums vary in tough year for EM

Context and market conditions are always important when considering the merits of any new issue, but this was particularly the case in 2022, given how volatile markets were. Every CEEMEA issuer had to pay a high all-in price to get their deal away, and new issue premiums varied between issuers.

EM issuers faced the toughest conditions in many years during 2022. The Russian invasion pushed investors to flee from riskier assets. The war had practical effects too: disruption to energy and food supplies sent inflation soaring and the resulting interest rate rises meant borrowing costs jumped sharply for CEEMEA issuers. New issue volumes dropped from 2021, particularly among CEEMEA corporates. By **George Collard** and **Oliver West**.

## CEEMEA SOVEREIGN BOND OF THE YEAR

### Republic of Turkey

#### \$3bn 7.25% 2027 sukuk

Citi, Dubai Islamic Bank, HSBC, KFH Capital

Turkey's sovereign bonds took a battering late in 2021 and in early 2022. The government's insistence of cutting interest rates to fight inflation sent the lira plummeting and a balance of payments crisis surely looms.

Turkey had \$11bn of funding to do in the year on international markets, later reduced to \$10bn. The big question was, could the sovereign hit that target amid such internal economic woes? The answer, in February, was to start off the year's funding by visiting the Islamic market.

The \$3bn sukuk was Turkey's biggest ever new issue, whether Islamic or conventional. The book was over \$10bn, showing that tapping Middle East Islamic investors was a shrewd move. And conventional investors still played a part, with more than a quarter of the book in Europe or the US.

The most impressive aspect was the timing. February 16 was eight days before Russia invaded Ukraine, which froze new issuance for nearly a month and prompted a sell-off in EM bonds. Turkey, of course, did not predict and jump ahead of the invasion, but in the weeks leading up to it tensions were high and this had scared most CEEMEA issuers from the primary market.

Had its first issue of the year gone badly, Turkey would have been in a very tricky position when looking to get the rest of that \$10bn done. Instead, it sold another sukuk and two conventional bonds in 2022, taking \$9bn of that \$10bn target.

## LATIN AMERICA ESG BOND OF THE YEAR

### Republic of Chile

#### \$2bn 4.34% 2042 sustainability-linked bond

BNP Paribas, Crédit Agricole, Société Générale

For many sustainable finance bankers, 2022 was a tough year. ESG fell down the priority list of some investors, who found themselves with their backs against the wall amid the trickiest market conditions since the global financial crisis. Deals like Chile's sustainability-linked bond (SLB), issued on March 2, were a soothing reminder of both the enduring appeal of ESG-themed debt, and the fact that – for many major money managers – a crisis underscores, rather than undermines, the urgency of tackling the climate disaster.

Chile was one day into its investor roadshow when Russia invaded Ukraine in February, sending global financial markets into turmoil. Undeterred, Latin America's best sovereign priced its \$2bn SLB just days later. In the first SLB from a sovereign issuer, Chile attracted higher demand (over \$8bn of orders), achieved greater tightening (35bp between initial pricing thoughts and launch), and a slimmer new issue concession – around 15bp – than almost all the LatAm deals priced before the invasion.

It was vindication of the value of a committed sustainability strategy. Having already sold \$31bn of green, social and sustainable bonds before it turned to the SLB format, Chile had primed its audience for an innovative deal. Investors were impressed by how the greenhouse gas emissions and total carbon budget KPI was aligned to the country's Paris Agreement contributions. The reception exceeded banker expectations. Moreover, though the timing, so soon after the Ukraine invasion, looked bold at the time, it proved to be smart. Funding conditions only deteriorated in the following months.

## CEEMEA CORPORATE OR FINANCIAL INSTITUTION BOND OF THE YEAR

### Bank Leumi

#### \$500m 5.125% 2027

Citi, Jefferies, JP Morgan, UBS

As with all the best new bonds in 2022, timing was key. Bank Leumi came to market on July 20, when many issuers believed investors had left for their summer holidays.

The Israeli bank listened to its advisors, who thought the market was still open. It was the first benchmark-sized CEEMEA new issue in more than a week, and there were no more until the first day of September. A \$1.4bn book suggested investors were not all on holiday, and the pricing versus investment grade banks outside of EM was a strong result.

EM bonds rallied over July and August, but this trend reversed in September. Had Bank Leumi waited until after the summer to issue, it would have faced trickier conditions.

The bank sold a debut senior bond and managed to print it very close to investment grade peers in developed markets. At 210bp above US Treasuries, it printed just 35bp above Wall Street giant JP Morgan, although being \$7bn across six and 11 year tranches the US bank's trade was not an exact like-for-like comparison.

And rarely for many CEEMEA new issues in 2022, it traded higher on the first day on secondary.



### CEEMEA NON-SOVEREIGN BOND OF THE YEAR

#### Public Investment Fund

**\$1.25bn 5% 2027, \$1.25bn 5.25% 2032, \$500m 5.375% 2122**

Arab National Bank, Bank of America, Bank of China, BNP Paribas, Citi, Crédit Agricole, Deutsche Bank, First Abu Dhabi Bank, Goldman Sachs, Gulf International Bank, HSBC, Industrial and Commercial Bank of China, Intesa Sanpaolo, JP Morgan, Mizuho, Morgan Stanley, MUFG, Natixis, Riyadh Bank, Saudi Fransi Capital, Saudi National Bank, SMBC, Société Générale, Standard Chartered

Saudi Arabia's Public Investment Fund, made quite the statement with its debut public bond. PIF did not try to hide the fact that this was a planting-its-flag-in-the-capital-markets exercise. It had no immediate need for funding.

Despite deal documentation only being Reg S and not 144A, PIF still drew an impressive book of more than \$24bn. At the time no CEEMEA issuer had come anywhere near a book like that in 2022, although the Saudi sovereign did top it a few weeks later.

The biggest statement was the 100 year tranche. These are rare in emerging markets and something only a few issuers can do, and for PIF to do so on its debut was special.

On top of all this, PIF made its debut amid the doom and gloom that surrounded the EM bond market throughout the year. It would have been a spectacular first outing – even in a market in the best of health.

Some investors scoffed at the green aspect of the deal, but one banker on the trade said the 100 year tranche made it a “bond beyond oil”.

PIF will return to the capital markets in the next few years, and it will hope its showstopping debut will have made a lasting impression, helping with pricing and size in future.

### LATIN AMERICA DEAL OF THE YEAR

#### United Mexican States

**\$2.87bn 3.5% 2034, \$2.93bn 4.4% 2052**

Bank of America, Barclays, BBVA, Santander

For years, LatAm DCM bankers would tell clients to issue in the first available window. For years, many borrowers would wait and wait as markets rallied, looking to save a few extra basis points. For years, this strategy worked.

Mexico doesn't tend to get so cute. The sovereign is usually a reliable presence in the primary market in the first week of January. When 2022 rolled around, there on the screens were those soothing words: United Mexican States dollar benchmark.

Most years, a Mexico dual-tranche dollar benchmark and switch-tender would be business-as-usual. But 2022 was a year in which business-as-usual was the exception. Mexico had chosen January 4, the first day of the year that both London and New York were open, for its dollar foray. It proved to be the best day of the year for issuance,

with conditions deteriorating by the day immediately after.

Several other major LatAm sovereigns were put off by funding costs that in January were already higher than what the market had become accustomed to. They waited in vain for better conditions that never arrived, some forced to look to other sources of funding, others forced to pay up even more later.

Mexico wins *GlobalCapital's* award partly in recognition of the fact that its longstanding consistent issuance strategy this year paid dividends like never before. While the market fretted about whether certain other sovereigns would be able to access the market, Mexico swept up 57% of its annual funding needs on day one.

It seems doubtful whether Mexico has ever regretted its decision to be first, or one of the first, LatAm borrowers in the market almost every year. The simplicity of its approach is a lesson to all issuers. **GC**



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# The only way is up for CEEMEA bond markets

After a calamitous year in EM bonds, market participants are wary of predicting how the next 12 months could play out. Few foresaw the war in Ukraine – and even fewer the Covid pandemic, which influenced volumes for the two previous years. But there is some hope of normalisation in 2023, as *GlobalCapital's* poll of bankers and investors shows. By **Francesca Young**.

**T**here is a sense that the only way is up after an exceptionally poor year in CEEMEA bond volumes. Only \$116.5bn was printed in 2022 through to mid-November, compared with \$257.6bn for the full year in 2021.

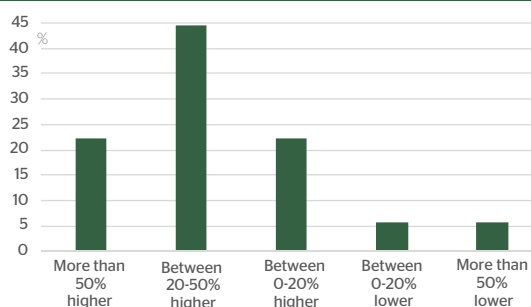
“CEEMEA bond volumes in 2023 will be materially better, but it’s important to remember that 2020 and 2021 were abnormal years,” says Alex Karolev, head of CEEMEA syndicate at JP Morgan in London.

“The hope is, though, that we will return to normal volumes of about \$150bn-\$170bn — maybe not for 2023, but in years thereafter.”

*GlobalCapital's* survey of senior DCM bankers shows that for 2023, nearly half of the market, like Karolev, expects an overall boost in CEEMEA volumes of between 20% and 50%.

Within the expected growth in bond volumes, the boost each sub-region is expected to receive is unequal, though, and this analysis suggests the total increase may be to the lower end of the range. Volumes of Middle East new issuance are expected by the majority of respondents to grow by 20%-50%, while CEE and Africa are each expected to be up by 20% at the most. In 2022 CEE volume was

How will volumes of CEEMEA new issues in 2023 compare with 2022?



Source: *GlobalCapital*

\$55.7bn, Middle East was \$39.6bn and Africa was \$21.2bn.

“Eastern Europe and the Middle East were the main areas of bond business in 2022 but the Middle East was still low, relative to historical volumes,” Karolev says. “There was still much more there than from CIS or Africa, which were close to zero. In 2023 we will see the same — there will be a dominance of investment grade issuers.”

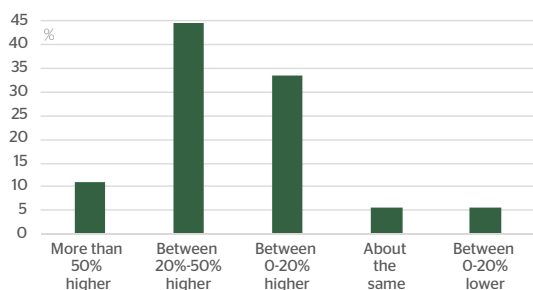
Stefan Weiler, head of CEEMEA DCM at JP Morgan, agrees. He says the investment grade portion of the business will be the initial driver of issuance but higher yielding names will follow as markets firm up and risk appetite returns.

## Staying high

Meanwhile, Iman Abdel-Khalek, co-head of CEEMEA DCM at Citi, based in Dubai, says borrowers, having adjusted their mindsets, will make for a more productive year in 2023 in the primary market.

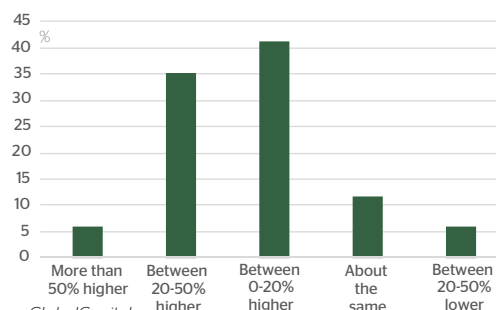
“In the Middle East the realisation has happened that rates are up and are staying up for a while,” she says. “PIF [Public

How will volumes of Middle East new issues in 2023 compare with 2022?



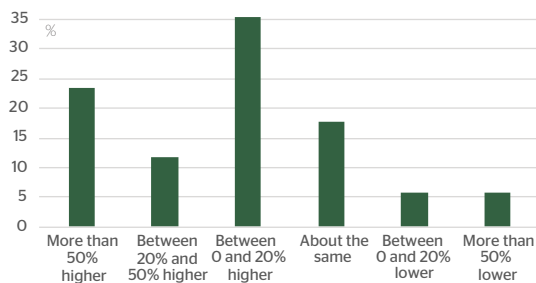
Source: *GlobalCapital*

How will volumes of CEE new issues in 2023 compare with 2022?



Source: *GlobalCapital*

How will volumes of Africa new issues in 2023 compare with 2022?



Source: GlobalCapital

Investment Fund, the Saudi sovereign wealth fund] coming to print is an example of this recognition. Banks are now funding at higher levels than they used to. But even at these higher rates and with pressure off commodity producers, serial prolific funders will want to continue to maintain a presence. We will still see sovereigns bringing good sizes to the market — perhaps not the \$10bn we were used to but something more moderate. We saw KSA do \$5bn in October. There is also a significant corporate and projects pipeline that could be a good driver of volumes.”

**New beginning?**

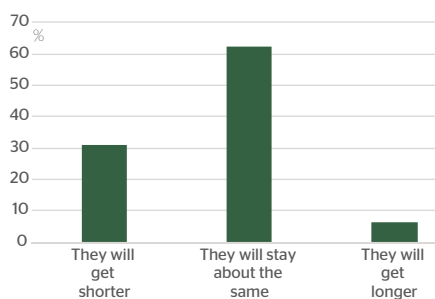
EM investors have taken heavy losses in the past two years, with the main benchmark indices down by double digits. Most respondents think that 2023 will break the streak, but it is close run: half predict benchmark indices will go higher in 2023, 37.5% say they will go lower and the remainder expect them to end the year at about the same level as they began it.

“There is a lot of cash on the sidelines waiting for the right time for redeployment — and cash levels are likely to grow further as net financings are expected to stay negative,” Weiler says. “That means that when risk appetite strengthens, the eventual market rally could be very strong and fast.”

Nick Darrant, co-head of EMEA fixed income syndicate at Citi in London, agrees.

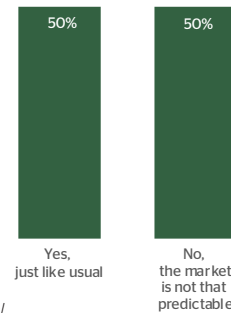
“Required new issue premiums next year will be highly

What will happen to the average maturity of new issues?



Source: GlobalCapital

Will sovereign borrowers frontload issuance in 2023?



Source: GlobalCapital

correlated with who has access to the market,” he says. “We, and everyone else, are looking for the turning point in the market. Right now funds are holding 10% cash balances and yields are high. But there will come an extraordinary entry point for investors where these high yields are still on offer but it’s the time to deploy that cash, as they can see considerable upside.”

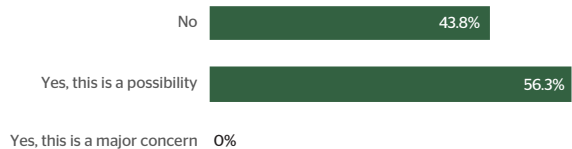
At that point, he adds, new issue premiums will come down quickly.

“The market has been battered but they know that being ready to move when that turn arrives is critical,” he says.

“Then investors will chase deals, which is a dynamic we have not seen in a while. We are seeing evidence of this in terms of issuer and investor engagement every time there is talk of a Fed pivot, though these have, so far, been false dawns.”

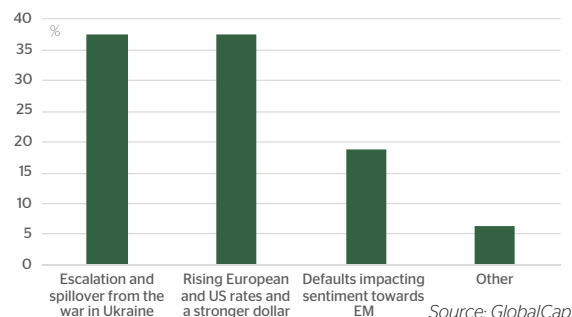
Sovereign borrowers in previous years have tended to

Will default rates significantly rise among CEEMEA issuers next year?



Source: GlobalCapital

What is the biggest threat to CEEMEA over the coming year



Source: GlobalCapital

frontload their year's activity in the capital markets. Our survey shows that the market is divided on their expectations for this — exactly half believe this will happen again in 2023, while the other half think issuers will see the second six months of the year as offering more opportunities.

Throughout 2022 a large number of CEEMEA bonds fell into distressed trading territory as borrowers dealt with rising rates, higher inflation and political unrest. Some fear that as maturities approach and full blown restructurings get under way, EM investors will become increasingly jittery. Others say that as these losses are already priced in through secondary trading, the blow has already been dealt. Of those surveyed, 18.8% say a wave of defaults is the biggest risk to CEEMEA in the coming year. Fears of escalation of the war in Ukraine and rising European and US rates are of even bigger concern, though.

Those issuers that retain access to the market but have maturities fast approaching are already looking at how to manage those debts.

**Sizeable maturities**

“We are expecting to see a big pick-up in LM activity as issuers try to address upcoming maturities early on,” says Abdel Khalek. “There are sizeable maturities in the CEEMEA space coming — about \$400bn before the end of 2025 — and this is an important tool in managing that.”

“Obviously the LM exercises can only help for CEEMEA credits that are seen as going concerns,” adds Tommaso Ponsel, co-head of European corporate DCM and CEEMEA DCM at Citi.

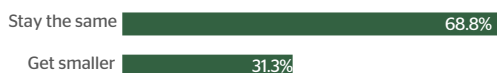
“There are some names where the situation may become unsustainable, the debt stack is just too high and a more comprehensive restructuring may be necessary. But hopefully, after that is done these businesses will become viable again.”

But views vary. Weiler says he does not expect to see a big pick-up in proactive refinancing activity.

“We hope to see more borrowers calling the bottom of the market through buy-back exercises,” he says. “But given the high current yield environment, I cannot see borrowers funding these buy-backs with new issuances.”

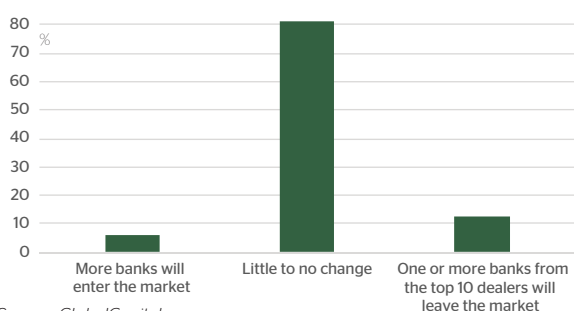
Tenors of EM new issues this year were shorter, as the rates outlook was uncertain and developed market yields rose. Previously, much of the appetite for longer deals came from accounts keen to find a higher yielding option than the

**How will the number of CEEMEA DCM staff at banks change (syndicate and origination) in 2023?**



Source: GlobalCapital

**What will happen to the number of banks serving the CEEMEA bond business in 2023?**



Source: GlobalCapital

Western world could provide, but as rates rose long CEEMEA bonds became less attractive on a relative value basis.

“There is still not much of a duration bid, though, with Taiwanese and US insurance companies having been slow to return,” Darrant says. “The five to 10 year issuance spot is still the most active.”

“Maturity extensions, deleveraging and ESG will all be big themes for 2022 — as well as, of course, infrastructure and project financing. If the hope that the corporate market re-opens plays out, that could also be major theme. There could be a wave of financing for M&A, as some companies have come under pressure.”

Throughout 2022, fears grew for the resilience of the asset class as well as the banks and funds serving it. These were only exacerbated by Credit Suisse quitting the business

**“Given the high current yield environment, I cannot see borrowers funding these buy-backs with new issuances”**

as part of its strategic review in November. In our survey, 68.8% of respondents believe the number of DCM staff serving CEE clients will stay the same, but a considerable amount — 31.3% — think those staffing levels will drop. No one thinks houses will be beefing up in this area. There is hope of broad stability, in that 81.3% think there will be little to no change to the banks serving the market, but 12.5% think one or more of the top 10 dealers will depart.

The two banks at the top of the league tables have reaffirmed their commitment to this market to *GlobalCapital*. Ponsel at Citi says his firm has no plans to change its countries of coverage, with the exception of the pullback from Russia in 2022.

Meanwhile, Weiler at JP Morgan says: “The drop in business is more likely to have an impact on houses that look at EM more opportunistically.” GC

# CEEMEA bond houses: beaten but not broken

After a year of war, rate rises, inflation and political pressures on the CEEMEA region, fixed income markets have been badly shaken. Citi and JP Morgan's vice-like grip on the top of the primary market league tables remains, though others have been forced to question their commitment to the emerging market bond markets. **Francesca Young** reports.

**C**EEMEA primary bond market volumes for 2022 cannot be described as anything but appalling. By mid-November, with only a small amount still expected to be issued before the end of the year, there had been just \$109.51bn printed, compared with a full year total of \$257.59bn in 2021, according to Dealogic data.

Citi was triumphant at the top of Dealogic's CEEMEA league table of bookrunners, taking its usual dominant position alongside JP Morgan.

"The EM bond business in CEEMEA remains largely a two horse race, and there is a big gap between those banks and banks three, four and five in the league tables," says Tommaso Ponsel, co-head of European corporate and CEEMEA DCM at Citi in London.

Not one bank in the top 10 for 2022 was in same position at the end of 2021. First Abu Dhabi Bank and Bank of America fell out of the top 10 entirely in 2022, replaced by Erste Bank and Barclays.

The reasons for the changes in positions and volumes are not straightforward. One obvious factor was the removal of all potential Russian and Ukrainian bond business in February. In 2021 there was \$20.94bn of bond business just from Russia alone, and a further \$3.89bn from Ukraine.

The CEEMEA bond houses that were especially strong in these countries suffered an immediate blow. Though many of the Russian bonds were already being placed by local Russian houses such as VTB Capital because of previous rounds of sanctions, some international banks were still active. JP Morgan had in 2021 been third for that business, for ex-

ample. Citi was only fifth, which may go some way to explaining how Citi looks to have nabbed the CEEMEA crown from JP Morgan in 2022.

## Can't print, won't print

Another factor was the rocketing yields in Turkey, linked to unorthodox monetary policy and high inflation, which meant that apart from the sovereign the only other two issuers to tap the market from that country in 2022 were Coca-Cola İçecek and Istanbul.

The sharp rise in US Treasury yields throughout the year meant that several high yielding corporate issuers in Africa also looked locked out of the market.

Meanwhile, in the areas of potential issuance that remained — such as core CEE and the Middle East — issuers balked at the sky-high new issue premiums demanded of them. Across the Gulf in particular, bond volumes took a beating as oil prices shot up as a result of the war in Ukraine. Revenues for oil producing nations



"In the last six weeks we have seen more of an adjustment to the new rates environment and investors starting to engage"

**Iman Abdel Khalek, Citi**

increased, making them less reliant on bond market access and even less likely to pay the new issue concessions investors were demanding as compensation for the US Treasury volatility.

According to Dealogic, \$158.07bn

was printed from the MENA region in the full year 2021. By mid-November 2022 only \$59.62bn had been sold. From the CEE region, \$49.89bn had been sold by mid-November, compared with \$99.52bn in the full year 2021.

But although the volumes were smaller for each region, their proportions of the whole were markedly different, which goes some way to explaining why the banks most focused on the Middle East — such as Standard Chartered — have fallen in league table position in 2022 rather than risen, as might have been initially expected with the removal of the Russian business.

"We had over 50% of our volumes come from central Europe in 2022, which has never happened before but we think will continue to be a theme," says Stefan Weiler, head of CEEMEA DCM at JP Morgan.

## There is always next year

Banks are hopeful that 2023 will be different.

"In terms of volumes, 2022 was the bottom — there is funding to be done," says Iman Abdel Khalek, co-head of CEEMEA DCM at Citi in Dubai. "Even in the last six weeks we have seen more of an adjustment to the new rates environment and investors starting to engage. CEEMEA volumes will pick up and we will return to something that looks like the average of 2018/2019 volumes."

In 2019 \$225.9bn was printed from CEEMEA. In 2018 \$191.3bn was sold.

"The second half of 2023 could be busier than the first and from that point forwards it will be game on," says Nick Darrant, co-head of EMEA fixed income syndicate at Citi. "Investors will be cautious of a repeat of 2022, when they came in at the start all guns blazing only to get burnt."

Even as the Russia business looks to be gone indefinitely, there is hope that with maturities on existing

bonds piling up and debut issuers to come the CEEMEA bond business can still grow.

“For 2022, non-sovereign Middle East and Africa maturities were \$5.2bn,” says Alex Karolev, head of CEEMEA syndicate at JP Morgan in London. “In 2023 they are \$28.6bn. And the year after that it’s \$45bn. It’s difficult to say how these will be managed. The majority will likely be refinanced with bonds, but the syndicated loan market — which had been more robust than the bond market in 2022 — will likely also kick in and some may be paid down with cash. But these countries are still growing and investing a lot and I think the bond market remains a natural option for them.”

He points out that the overwhelming majority of CEEMEA issuers throughout 2022 have had access but chosen to not print, which also brings hope for 2023.

“The rationales have been varied,”

Karolev says. “Some didn’t like the new issue premiums, some thought rates would come down, some just didn’t like what they were being asked to pay versus their last deal. It has taken a lot of the year to accept that normal is different to what these issuers are used to.”

There may also be some boost to 2023 volumes because issuers that were planning to print in 2022 delayed their deals because of the volatility.

“We are still sitting on mandates from the fourth quarter of 2021,” Weiler says. “There have been lots of transactions delayed but they remain in the pipeline.”

### Determined duopoly

Citi and JP Morgan for nearly a decade now have passed the CEEMEA league table crown between them — the last time another bank occupied the top position in this league table was 2013. The dominance of these

two banks — with market shares of 12.06% and 10.93% respectively in 2022 — makes for interesting projections for their futures in this business, with questions arising over whether they can still grow their market shares from here and at what cost to the broader CEEMEA bank landscape.

“They say that when Alexander the Great was 33 he cried salt tears that there were no more worlds to conquer,” Darrant says. “So, indeed, where does one go from here? My mantra is that complacency will be punished and that we must continually renew and refresh our offering. We can’t create new countries but there are certainly new government-owned entities and corporates to come. EM is a growth market and can withstand shocks — it will bounce back even if it now grows in a different direction.”

Ponsele adds that while of course Citi wants to remain at the top of the league table, the team wants to do that by being the “go-to shop” for the most strategic deals supporting acquisition financing, important maturity extensions and hybrid capital.

“There are only two houses strong across every region in CEEMEA,” Abdel Khalek says. “Some teams at other banks may need to be reshaped but ours are unlikely to be impacted by the lower volumes, even while others retreat.”

That potential retreat was in sharp focus in November as Credit Suisse — once a big player in emerging market bonds — announced that it would be winding down that business, firing much of its EM team, including long-serving syndicate manager Dhiren Shah. There are fears that other banks will follow, though some in the top 10 — as well as Citi and JP Morgan — say the business will still be viable for many houses.

“EM business at the banks isn’t just about bonds,” says an EM syndicate manager at a third bank. “There are so many aspects — including bilateral lending, derivatives, primary dealership, cash management and structured products — that can be offered as alternatives. So even after a bad year for EM bond volumes, banks are still able to utilise other sections of their institutions to assist clients and generate P&L.” GC

### Bookrunners of CEEMEA bonds – 2021-2022



Source: Dealogic

# EM investors hope inflation turn will draw cash back in

Outflows from EM bond funds are not far off the \$100bn mark in 2022, writes **George Collard**.

**E**merging market fixed income investors hope the taming of inflation, and the pivot towards rate cutting by central banks that would follow, will reverse what has been a year of near continuous outflows from their funds.

Outflows from EM bond funds totalled \$86bn in 2022, as of the week ended November 4, according to JP Morgan. The Institute of International Finance, meanwhile, said outflows from EM bond and equity funds were \$75bn to the same date.

Weekly outflows have become the norm, with consecutive weeks of inflows restricted to the summer, when many investors take a holiday. Recently, outflows have regularly been in the several billion a week.

It is important to note that EM debt is not alone in suffering high outflows during 2022. Investors have fled US Treasuries, sending yields soaring, and those yields have been volatile on top of the upward trend. On the 10 year Treasury, upon which EM dollar debt is priced, the yield had jumped to 3.9% by early November from 1.6% at the start of the year.

These rising US Treasury yields and day-to-day volatility are a core reason why clients have fled EM bond funds.

“Fixed income in general has been having significant outflows,” says Alexander Kozhemiakin, head of EM debt at Macquarie Asset Management in New York. “EM debt is not an exception. Flows are typically neither leading nor lagging performance.”

The year did begin with inflows. But these reversed after Russia’s invasion of Ukraine on February 24, which sent the prices of EM bonds tumbling. The worst week for outflows from EM debt and equity funds was the week ended March 11, at \$22.9bn, according to the IIF.

Sanctions on Russian energy and the disruption of exports from Ukraine,

particularly grain, led to global fuel and food inflation in many EM countries. Inflation is the enemy of fixed income investors and interest rate rises to combat it have made borrowing more expensive.

“We have seen that the aftermath of the invasion and important interest rate hikes by G3 monetary authorities contributed to the fear factor around flows,” says Jonathan Fortun Vargas, economist at the IIF. “The lack of an announcement of lifting [Covid-19] restrictions in China has also influenced and accelerated the outflows.”

## Flight

Both retail and institutional investors have pulled their money out of EM bond funds, say EM fixed income portfolio managers. “Most negativity is due to duration and sensitivity to US Treasuries than spread performance,” says Kozhemiakin. “In US dollar EM debt, two-thirds of negative returns are due to duration and the rest to spread. It has been a duration-driven sell-off so far.”

Kaan Nazli, EM sovereign portfolio manager at Neuberger Berman in London, blames the Ukraine war, fear of sovereign defaults and inflation.

“Ukraine has caused lots of problems and stoked fears over China and Taiwan,” he says. “Sovereign defaults are pretty rare, and we had some understandable ones in 2020, but we have had more in 2022. They look bad and create worries over the whole asset class.

“And thirdly, inflation. Are we in a new inflationary environment? Turkey has printed a five year at 10% — is that sustainable? Only some EM countries can afford that in the long run.”

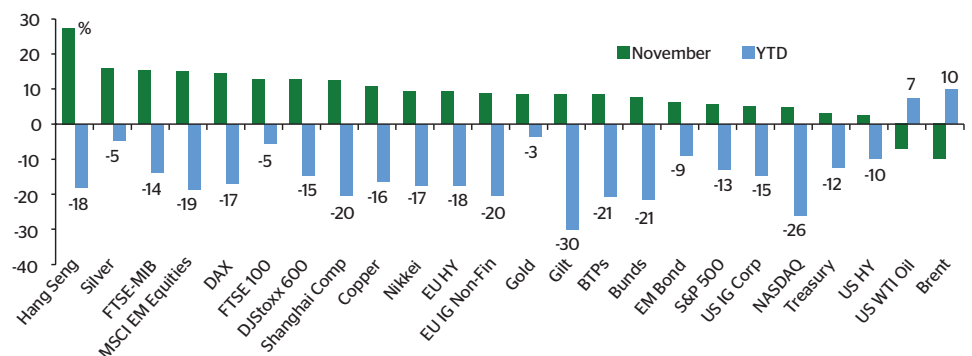
These high funding costs, which have shut many EM issuers out of the primary bond market in 2022, mean it will become difficult for them to service debts, adding to default risks. However, regaining access will lessen default risks and draw money back to EM bond funds.

“This is crucial as the option to roll debt over then becomes available and reduces the probability of default on external debt,” says Carl Shepherd, EM fixed income portfolio manager at Newton Investment Management in London.

The outflows have forced investors to keep high cash levels to protect against further outflows. They have money to invest in new bonds but are very selective about doing so.

Kozhemiakin says his fund has been

Total return performance of major global financial assets in November and YTD (\$ terms)



Source: Bloomberg Finance LP, Deutsche Bank

at its maximum cash level, about 20%, for nearly a year. But that is changing.

“Over the past few weeks, we have started reducing our cash level but we are not necessarily buying the highest yielders that people would typically think of as ‘EM debt,’” he says. “We have been buying the more staid investment-grade EM debt.”

So who is left? Nazli at Neuberger Berman believes that “tourist” money — those investors who were invested in the asset class for the yield rather than any strategic reason — has left EM and so have many investors whose mandates permit them to invest in developed markets as well. This leaves dedicated EM investors — but international investors are not the only ones propping up EM debt.

“Local investors are becoming an important part of the asset class,” he says. “Look at Turkey, their Eurobonds have done quite well and one of the main reasons is regulations encouraging local buyers.

“We have seen that in Jordan too, and in South Africa there is a large local asset management industry providing support. Local investors have become a bigger part of the pie.”

Local investors can help mitigate default risk in EM, providing an alternative source of funding should an issuer be shut out of international markets.

“Many EM names have grimly held on so far despite the market stress and dislocation,” Shepherd says. “The currency mix changes over the last few decades, such as developing and deeper local markets in the major EM

names, are also now proving their worth in reducing default risk and offering alternative sources of funding outside of global portfolio capital.”

Kozhemiakin says the investors left in EM debt are those there for the



“We need to move on from the US economy sucking in global dollar liquidity”

**Carl Shepherd,  
Newton Investment  
Management**

right reasons, and not just for the “optics” of higher yields.

“They want to take on additional country risk (outside of the ‘developed’ countries) for diversification reasons and are happy to be compensated for that risk,” he adds.

The fund managers and Fortun Vargas agree that taming inflation will be crucial in stemming outflows and drawing money back to EM bond funds, but more is needed than just falling inflation numbers.

“A combination of stable and proved policies, capacity of policy-makers to navigate future challenges, a sound and healthy local market and overall healthy macroeconomic variables will help a region or country to manage their level of flows,” says Fortun Vargas.

November 10’s US inflation print, which was below expectations, prompted a near 40bp rally in US Treasuries and raised hopes that inflation may have peaked, at least in the US. This could lead the US Federal

Reserve to end its tightening earlier than predicted, and pivot towards cutting interest rates.

“We need a consensus on what terminal rates are likely to be for the US, and we need to move on from the US economy sucking in global dollar liquidity as the investment destination of choice, which should halt the rise of the dollar,” says Shepherd. “We now appear to be in a transition phase where it is no longer apparent that the dollar remains on an inexorable rising trajectory.”

*GlobalCapital* spoke to Nazli and Kozhemiakin before November’s inflation reading, and their outlooks for EM bonds next year were “cautiously optimistic” and “not bullish” respectively. Nazli cites Chile, where the central bank has been raising rates for longer than the Fed and inflation has started to turn.

“But it took a long time,” he says. “The jury is still out on whether the terminal rate in the US will be 5%. We also need a recovery outside of the US, which is outperforming economically the rest of the world. When that happens, it doesn’t help EM. You need growth in EM itself but also in the eurozone and China.”

### Pain relief

Much of the pain in the EM bond markets in 2022 has been felt most acutely in longer maturities. However, Kozhemiakin thinks this pain could be coming to an end, which would give EM debt a boost. But beyond that, it is difficult to be optimistic.

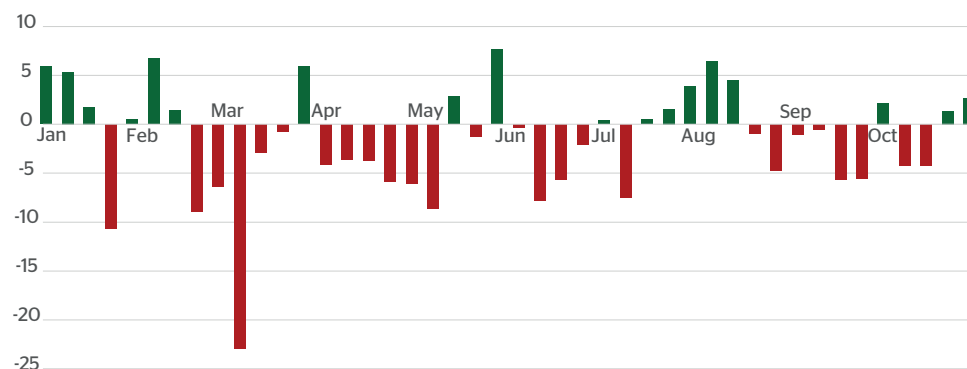
“Next year [2023] will be better in one regard, that we are closer to the end of the US Treasury sell-off than the start,” he says.

“That will support fixed income in risky countries. We are getting close to the end of the duration-led sell-off. When the Fed gets closer to peak rates we will see more economic slowdown, and when inflation rolls over that will be good for duration.”

And Shepherd says that the EM bond market could well have reached a nadir, and it can only get better.

“With such sustained outflows from the asset class, the technical factors are about as low as they can be, so the potential for formerly unloved areas to turn around increases as time moves on,” he says. **GC**

Total non-residential weekly emerging market debt and equity fund flows in 2022, \$bn



Source: Institute of International Finance



# LatAm bonds on the rebound but Fed to dictate recovery

*GlobalCapital's* survey of 13 Latin America DCM heads points to a recovery of sorts for the region's bond market after its worst year since 2008. Corporate issuance is the biggest unknown, but the market's fate appears to lie in the hands of the Fed. By **Oliver West**.

**T**welve months ago, when *GlobalCapital* surveyed Latin America's DCM heads about their expectations for 2022, there was broad acknowledgment that the previous two years of bumper volumes had been exceptional.

A vast majority predicted lower issuance, reflecting expectations of higher spreads, increased rates volatility and the awareness that sovereigns had leaned on bond markets heavily to fund pandemic-fuelled spending that was now being reined in.

No one could have foreseen quite how precipitous the fall in volumes would be. Without a surprise flourish in December, new issuance of international bonds from Latin American and Caribbean issuers is likely to have fallen by almost 60% in 2022 compared with 2021. As of November 28, there had been just \$57.5bn of new issuance, down from \$141.6bn.

At the end of 2022 all but one LatAm DCM head is predicting a year-on-year increase in issuance of more than 25% for 2023. Yet it would be hard to frame this as optimism. After all, 2022 has been — by some distance — the quietest year for LatAm bond issuance since 2008.

Although almost 65% of LatAm DCM heads are predicting issuance will rise by a margin of between 25% and 50%, only 23% expect it to rise by more than 50%. For context, even a 50% increase in issuance from 2022 would put 2023 volumes at only \$86.25bn — versus average annual issuance of \$124bn in the 10 years ending 2021.

"In terms of volumes we are still not going to be anywhere close to what we were used to," says Lisandro Miguens, head of Latin America DCM at JP Morgan, adding that high interest rates will continue to incentivise borrowers to go to other markets, such as loans and local currencies.

"Investors will continue to be very selective as to where they put their money and we will find ourselves returning to the mindset that we used to have in EM, when the bond market was largely dominated by sovereigns and big corporates," Miguens says.

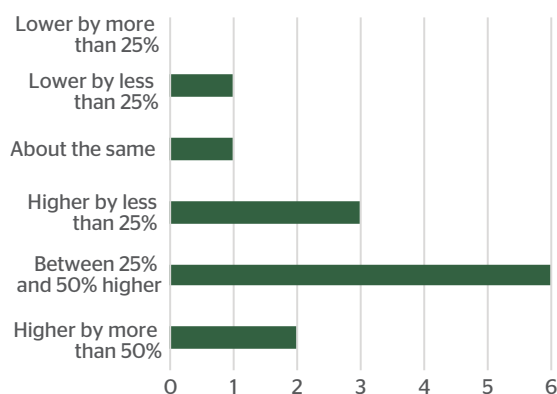
## Sovereigns start, corporates uncertain

To some extent, this has already happened. Indeed, the fall in SSA issuance from Latin America in 2022 was far less pronounced than the collapse in corporate and FIG volumes. Adrian Guzzoni, head of LatAm DCM at Citi, says sovereign financing needs are "clearer". He senses sovereigns will be the "first Latin American issuers to venture out in 2023".

This smaller slump means, however, that sovereigns have limited capacity to lift LatAm volumes. Just one DCM head picked "increased external sovereign funding needs" in their top three potential upsides for issuance volumes.

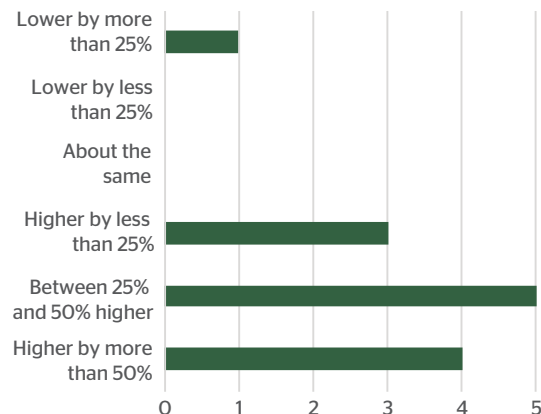
On the other hand, corporate and FIG issuance tumbled

What will 2023 LatAm and Caribbean cross-border new issuance volumes look like for sovereigns in 2023 versus 2022?



Source: *GlobalCapital*

What will 2023 LatAm and Caribbean cross-border new issuance volumes look like for corporates and financials in 2023 versus 2022?



Source: *GlobalCapital*

so far — from more than \$70bn in each of the previous three years to just \$24bn year-to-date by the end of November 2022 — that LatAm DCM heads participating in *GlobalCapital's* survey were mostly expecting a bigger relative jump in corporate issuance than in sovereigns.

But they may have to wait some months for corporates to come to the party.

“I do not expect to see a lot of corporate issuance in the first quarter, as balance sheets are pretty healthy,” says Guzzoni. “However, because we are coming from such a low base [of corporate issuance] it will be easier to see a pick-up in activity.”

It’s not clear that Latin American companies are in a rush to come back. Moody’s said in an October report that the difficult market environment, coupled with “moderate” refinancing needs, will continue to weigh on corporate issuance through 2023 at least.

“The Latin American corporates that have used the capital market as a frequent source of funding are in a good position,” says Andre Silva, head of LatAm DCM at BNP Paribas. “Most companies have done well in terming out their maturities and preserving liquidity.”

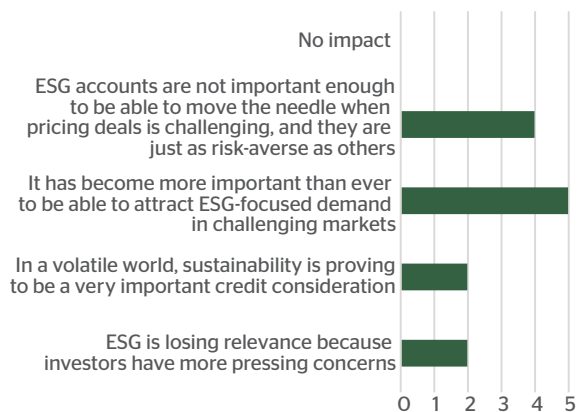
After all the refinancing that took place amid low rates in 2020 and 2021, the “next big year” for maturities is 2025, says Miguens at JP Morgan. The question, he says, is when will corporates decide to address those maturities.

“If 2023 is not a good year, then some companies will start to get more nervous in 2024,” he says.

### Evolving options

Just three DCM heads picked more pressing corporate refinancing needs among their top three reasons to expect an upside in LatAm international bond issuance in 2023. Apart from anything else, these days many LatAm companies have better options — one of the key reasons 2022 volumes dropped more sharply in Latin America than in other EM regions.

How do you think difficult market and economic conditions are affecting the role of ESG in the LatAm bond market?



Source: GlobalCapital

Strong domestic bond markets across LatAm, but to an exceptional degree in Brazil, meant it rarely made sense for corporates to turn to dollar markets in 2022. And local bond markets may continue to pinch business from New York syndicate desks. When asked what the most significant drag on volumes would be, four DCM heads picked the strength of domestic bond markets as their first choice, while a further four had this option in their top three choices.

Yet another source of liquidity that provided competition to international bond markets in 2022 may not be quite as robust in 2023. Bank markets stepped up in a big way when bond markets began to fail LatAm issuers in 2022, suddenly appearing attractive as they were not as quick in adjusting pricing upwards. This led some issuers to move away from bonds and towards loans, notes Silva at BNPP. But the loan market is not likely to provide quite the same level of competition to the bond market in 2023 as it did in 2022.

## Greenium overshadowed but ESG endures

The section of *GlobalCapital's* LatAm DCM survey that divided bankers the most was ESG. Will Latin American borrowers sell more sustainability-linked or use-of-proceeds bonds? There’s an even split of opinions — often based on what type of issuers you expect to dominate primary activity.

And has the terrible market reduced ESG’s relevance in LatAm bond markets? Again, the full range of options found traction. Undoubtedly, macro headwinds are a pressing concern that distract investors’ attention away from ESG. But both Lisandro Miguens, head of LatAm DCM at JP Morgan, and Chris Gilfond, chairman of LatAm DCM at Citi, say ESG remains an important credit consideration.

Miguens acknowledges that higher new issue concessions, owing to market volatility, have rather “overshadowed” the so-called greenium that issuers achieved

in stronger market backdrops. But he highlights that ESG-themed issuance still accounted for 36.3% of all new issue volume from the region so far in 2022.

Gilfond says that ESG “still comes up in every conversation we have with the buy-side”. In fact, the troubles in private markets have served to reiterate that more needs to be done to fund the sustainable economy, beyond the advances of the ESG bond market.

“What has become clear is that, because financing conditions are going to improve only slowly, there will remain a massive need for official sector support and blended finance solutions,” Gilfond says. “The emerging world doesn’t have the fiscal space to undertake the kinds of investments that are required — it requires developed world help, and we need new tools to facilitate the support. “ESG is certainly not losing relevance.” GC

“We are starting to see lending banks becoming more restricted in how they lend in Latin America — both in terms of the pricing they can offer and their level of appetite for certain transactions,” Silva says.

**Braver or better?**

In any case, Latin American companies have largely been unwilling to validate the higher funding costs implied by secondary markets in the wake of 2022’s rates sell-off — and without an improvement here Silva says he doesn’t “see an avalanche of corporate issuance”.

“Corporates will naturally look at coupons and continue to be somewhat reluctant to issue,” he says.

Can this improve? Although the survey responses show a slight bias towards expecting LatAm credit spreads to tighten, there is no consensus.

Where there is near unanimity is on what could improve appetite for LatAm bonds: a potential “pivot” in Fed policy, away from monetary tightening. Of course, this can work both ways.

“Our expectation is that, at some point in the next few months, market volatility will start subsiding as Fed tightening eases and that means volumes will pick up,” Guzzoni says. “But the fear is that the opposite happens — if inflation stays sticky, Q1 doesn’t prove to be the top of the rates cycle, and volatility continues.”

The focus on the Fed explains the caveat that several DCM bankers have: conditions will improve, but not until later in the year. What’s more, for a decent chunk of respondents, optimism around market conditions is largely based on the fact that they can “hardly get worse”. These bankers agreed that “conditions will remain treacherous”.

LatAm DCM bankers certainly appear under no illusions about the challenges ahead. But in any case, volumes should increase.

Even if conditions remain tricky, several DCM bankers say the most compelling reason to expect greater issuance is that borrowers would simply become braver in the face of volatility.

“We came into 2022 with buffers that issuers had built up

Which of these factors is likely be the biggest drag on LatAm and Caribbean international bond issuance volumes in 2023?



Source: GlobalCapital

in 2020 and 2021,” says Chris Gilfond, chairman of LatAm DCM at Citi. “There is strong reason to believe that these buffers have been largely consumed, and we may find ourselves in a situation where — simply due to the passage of time — today’s levels become more natural.

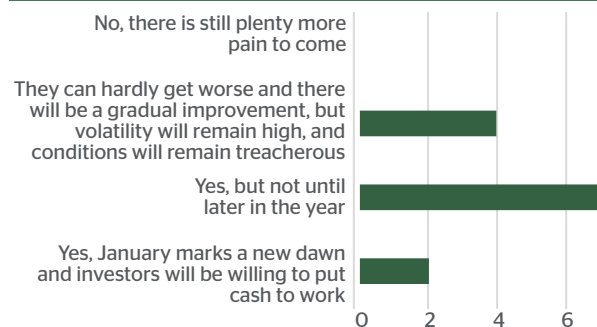
“With each new deal that prints, the shock [of higher funding costs] wears off a little bit.”

Moreover, the more time goes by with minimal issuance, the harder EM investors have to work to deploy cash that they receive back from issuers. As Miguens of JP Morgan highlights, the \$85bn or so of outflows from EM in 2023 rather pale in comparison with the roughly \$280bn of inflows from coupon, amortisation and maturity payments.

“There is still a lot of liquidity out there,” Miguens says. “In November, for example, there was an encouraging CPI reading and investors were suddenly desperately trying to put their money to work. And because nobody wanted to sell, prices were sometimes jumping up four or five points.

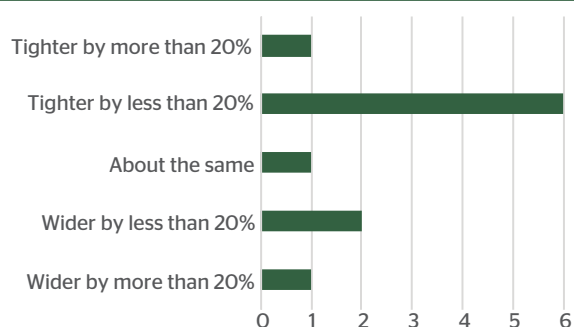
“Investors have been on the sidelines because of their worries about rates, but the minute there is visibility on that front, they will put their cash to work.” GC

Broadly speaking, do you expect conditions for new bond issues from LatAm and Caribbean to improve in 2023 compared with 2022?



Source: GlobalCapital

What will average LatAm and Caribbean dollar spreads over US Treasuries look like by the end of 2023, compared with the end of 2022?



Source: GlobalCapital

# Challenges remain but US looks forward to a better year

Although slowing loan origination is likely to lead to lower issuance of securitized products in the US, *GlobalCapital's* survey of market participants shows some confidence that the worst of the volatility is over. But eyes will remain glued to the Federal Reserve for clues as to how conditions evolve. By **Ayse Kelce**.

**A**fter a record-breaking 2021 for issuance volumes, it was always going to be hard for the US securitization market to keep up the pace in 2022. And although constant dealflow demonstrated that structured finance is a largely resilient financial product, multiple headwinds slowed issuance, widened spreads and decreased investor demand across all asset classes.

There are recessionary fears in the air, which could be particularly damaging for the consumers that underpin much of the asset backed market. But it was rising interest rates, above all, that sent funding costs far higher. For 2023, this remains the foremost concern of market participants.

Half of the respondents to *GlobalCapital's* survey believe that interest rate rises will be the most important factor determining securitization market activity, with more than 20% choosing US inflation — a related figure.

## January start-up

There is little expectation for a change in the rates picture early in 2023. That doesn't mean the year won't have a busy start, but it does mean a potentially challenging one. For issuers who have been avoiding the securitization market recently, January might be the month to get deals done.

"You may see a flood of issuance because people need to get stuff done," Joseph Lau, chief operating officer at Lord Capital, tells *GlobalCapital*. "It has the potential to be pretty nasty, but that kind of cleans up the system."

Large locked-in portfolios that haven't been securitized yet would eventually have to come to the market, even though the pricing might not be ideal, Lau says. He adds that he has had many conversations since June in which issuers had been told to come to market, but some didn't, afraid of wide spreads. Now, their assets are "totally mispriced", and a lot of that new issue volume is going to have to come through in the first quarter of 2023.

Overall, market participants are closely monitoring the US Federal Reserve's next moves. The biggest question in investors' minds is whether the interest rate increases can be managed without too much damage to the economy.

"If the Fed is able to orchestrate a soft landing, then I think you can see a situation where spreads generally are tighter," says Philip Armstrong, senior portfolio manager at Invesco. "And when that happens, the basis between the riskier portions of the market and the less risky portions of the market tend to compress. That's the optimistic scenario."

However, in a more pessimistic scenario where the Fed can't contain inflation and continues to raise rates above today's expectations, "that really will have an impact across fixed income", Armstrong says.

## Volatility to decline

Rate increases haven't only been making deals more expensive for issuers. They have also been creating considerable market volatility, which means both issuers and investors are not clear about the best times to buy or sell.

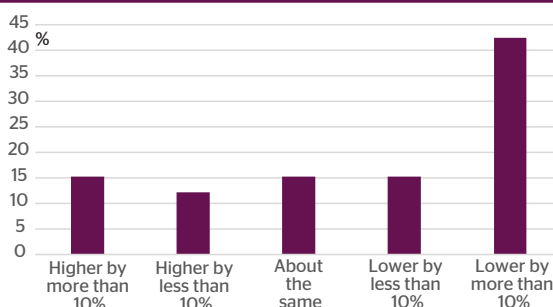
Especially in the second half of 2022, this dynamic has caused issuers to hold off, while investors prepared for 2023, when they hope to find calmer waters. Yet there is some hope that, while rates might remain elevated, the securitization market can at least deal with them in a better fashion.

Some 18% of the survey participants say that they expect volatility in the US securitization market to decrease considerably, 36% say it will "somewhat" decrease; and 21% say it will stay the same. Only 3% expect the market to become more volatile.

"A lot of market participants have difficulty judging how to respond," says Karlis Ulmanis, a portfolio manager at DuPont Capital. "And I think next year, even if rates continue to go up, the volatility will go down because market participants will be used to this kind of scenario."

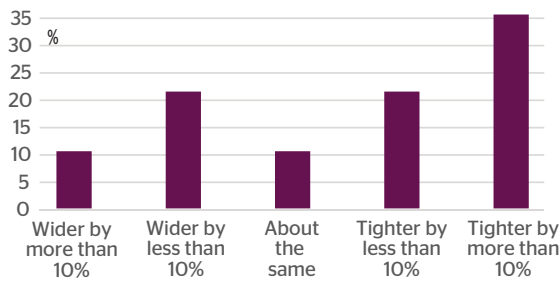
This is perhaps reflected in spread expectations, with survey respondents showing a slight bias towards expecting tighter

Will US CLO issuance volumes (including resets and refinancings) be higher in 2023 than in 2022?



Source: *GlobalCapital*

**Will US RMBS spreads be wider or tighter at the end of 2023 than at the end of 2022?**



Source: GlobalCapital

spreads in 2023 versus 2022 across all securitized products asset classes.

Not that life will be easy. “While the asset backed markets remain open and functioning for many issuers, we expect certain segments of the market to remain dislocated next year,” Cory Wishengrad, head of fixed income at Guggenheim Securities, tells *GlobalCapital*.

He adds that navigating the market would require a lot of “structuring expertise”, especially for debut issuers.

**Issuance and consumer health**

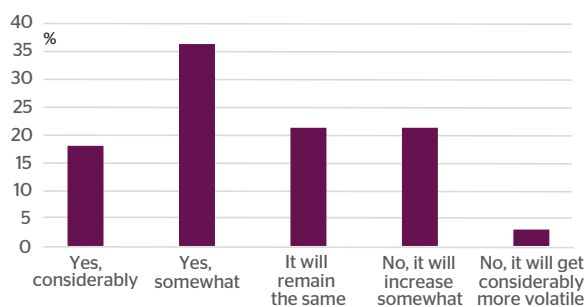
Indeed, despite hopes for lower volatility and lower spreads, market participants generally predict lower deal volumes in 2023, with most respondents believing that RMBS, CMBS and CLO issuance will decrease.

The exception is ABS, where respondents largely expect issuance volume to remain close to 2022 levels. This could be a result of the broader economic slowdown.

“I would think that we generally will end up seeing a bit lower total gross issuance in 2023 than in 2022 just as a result of less loan origination, a slowing economy and higher interest rates,” says Armstrong at Invesco.

Although loan origination might be lower, existing loans weighing on issuers’ balance sheets might eventually find their way into the market. One common perception is that asset classes that are directly affected by consumer health are in a more fragile position going into 2023. Indeed, more

**Do you expect market volatility in US securitization (including CLOs) to decrease in 2023?**



Source: GlobalCapital

than 58% of the survey respondents say that ratings on ABS and RMBS transactions will see more downgrades.

“I think delinquencies will be going up, especially for asset backed collateral,” Ulmanis says. “Consumer health will come into play a lot with ABS but also with RMBS. With higher expenses due to inflation, it becomes more difficult for the consumer to have any extra money for housing.

“And if they don’t have extra money, it makes it hard for them to trade up — but also the higher rates will lock them into their current loans.”

However, Ulmanis does point out that homeowners have built up a lot of equity over the past few years as house prices continued to rise. Even though prices began to drift downwards in May, the built-up equity should provide a buffer, he adds.

For now, unemployment has remained robustly low in the face of other macroeconomic headwinds. This is likely to be an important data point to monitor in 2023.

“Inflation leads to higher interest rates and that could potentially lead to a slowdown in spending or potential job cuts,” Armstrong says. “That obviously trickles down into consumer balance sheets [too].”

**Uptick in private deals**

While public issuance slowed in 2022, especially in the second half, issuers began to rely more and more on the private market, bankers and lawyers have told *GlobalCapital*.

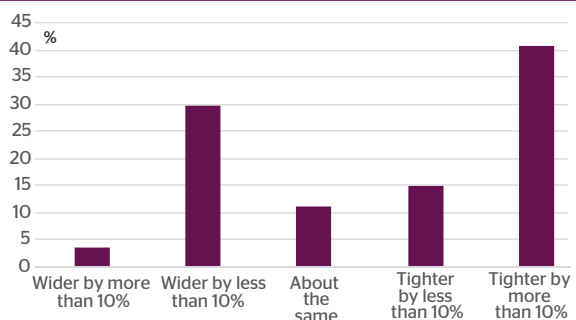
“We have actually seen an uptick in deal activity, definitely in the 4(a)(2) space,” says Trish O’Donnell, partner in Reed Smith’s Financial Industry Group. “More deals are coming every day.”

Section 4(a)(2), also known as the private placement exemption, refers to the Securities Act of 1933, under which the Securities and Exchange Commission (SEC) allows issuers to raise an unlimited amount of capital from sophisticated investors.

Both issuers and investors could continue to find the private markets more suitable in tricky conditions in 2023.

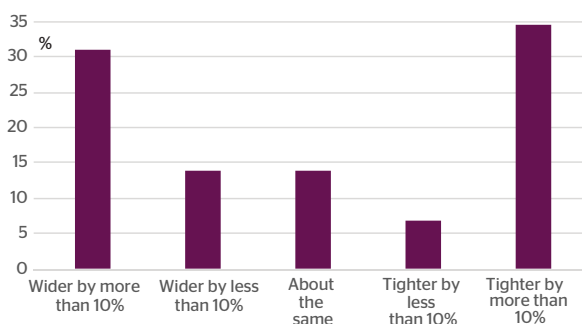
“There is money that needs to be put to work that is long term, so they would rather get a better return than have the liquidity of a public deal,” Robert Villani, a partner at Clifford Chance, tells *GlobalCapital*.

**Will US auto ABS spreads be wider or tighter at the end of 2023 than at the end of 2022?**



Source: GlobalCapital

### Will US esoteric ABS spreads be wider or tighter at the end of 2023 than at the end of 2022?



Source: GlobalCapital

### ESG: in or out?

ESG continues to be a prickly subject for US securitization market participants, and the difficult market conditions are not helping.

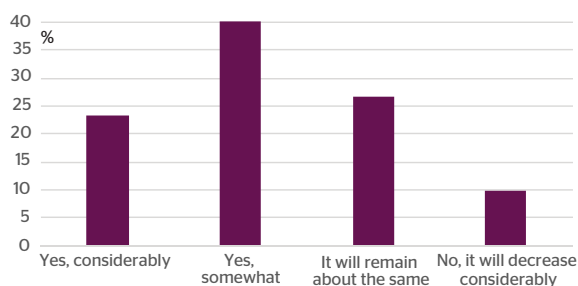
Indeed, more than 57% of survey respondents say that the role of ESG in the ABS market is losing its importance because investors have more pressing considerations. Meanwhile, more than 24% say that ESG investors are not resilient enough to be able to move the needle when doing deals is challenging.

“Unless you are the chairman or the CEO, everyone below them says: ‘If it makes my job more difficult, then I don’t care,’” says one investor in New York.

Just 24% of respondents believe that — in challenging markets — it is even more important to be able to attract ESG-focused demand, while only 15% agree that sustainability is proving to be a more important credit consideration. But despite the apparent scepticism of the majority, some issuers do see direct benefits.

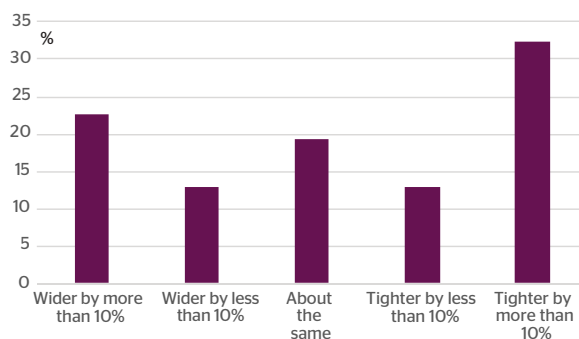
“More pools of capital seeking ESG investments mean that these issuances can often price towards the low end of market guidance,” Alexandra Cooley, chief investment officer of Nuveen Green Capital, tells *GlobalCapital*. “In a volatile market, issuers will be looking to gain an edge, so I believe there will be more momentum in ESG relative to the rest of the market.”

### Do you expect to see ESG-labelled securitization issuance increase in 2023?



Source: GlobalCapital

### Will US CLO primary market spreads be wider or tighter on average in 2023 than in 2022?



Source: GlobalCapital

Cooley says that the second half of 2022 had been full of challenges for issuers, with orders from buyers thinning because of a flood of secondary paper.

“However, we continued to see strong investor interest in our C-PACE platform, and we expect a robust year for ESG securitizations in 2023 because there are more and more pockets of capital seeking ESG investments,” she adds.

ESG will continue to be important because investors are under pressure to invest in ESG products and because of state-level government action that is encouraging ESG investment, according to Lau at Lord Capital. However, there are still questions around regulation and understanding of ESG, he says.

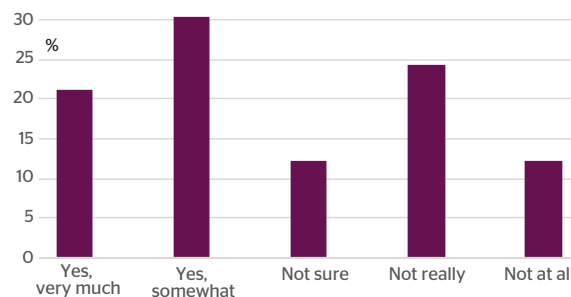
There is a similar lack of consensus as to where ESG regulation might go in the US.

About 63% of the survey respondents say that regulation surrounding ESG classification will increase, and about 50% of the respondents think that it is at least somewhat necessary. About 26% of the respondents think that regulations will stay the same, and 10% think that it will decrease considerably. About 35% of the respondents also don’t believe that ESG securitization regulation in the US is necessary.

Villani at Clifford Chance says there is “no reason to believe that there is going to be any regulation on ESG forthcoming.

“I think, depending on what happens in Washington DC, the momentum for that could be decreased.” **GC**

### In your opinion, does the US securitization market need specific regulation around ESG?



Source: GlobalCapital

# Buckle up: European ABS braces for bumpy ride in 2023

Despite a fast start in January, with deals printing ever tighter, 2022 ended up being a tough slog for the European securitization market. Looking to the year ahead, there is a feeling of cautious optimism among market participants. By **Tom Lemmon**.

**B**ankers do not usually need an excuse to be bullish. And those in the European securitization market probably have a more convincing reason than most to think conditions are going to get better in 2023. Surely, surely, it can't be this bad again?

Volatility caused severe headaches in 2022, giving syndicate bankers, issuers and investors only brief windows of opportunity to execute deals. On occasion, these slammed shut without warning — as Yorkshire Building Society and Crédit Agricole found out, thanks to former UK prime minister Liz Truss's now infamous mini-budget in September.

However, Christian Thun, chief executive of European DataWarehouse, tells *GlobalCapital* that, after the volatility that followed Russia's invasion of Ukraine in February, there is now a sense that the market is in fact slowly getting used to this "less benign environment".

Starting from a low base is driving Thun's broader optimism for the European market. "I don't think it can get worse after all the uncertainty the market has experienced in 2022," he says. "It will not be a stellar year for securitization, but, hopefully, 2023 will be a better year."

That sentiment was reflected in *GlobalCapital's* survey of market participants, undertaken in October and November, with nearly two-thirds (61%) of respondents expecting greater issuance volumes in 2023. There is also a general expectation of tighter spreads.

Standard & Poor's head of EMEA structured finance research, Andrew South, says he is hopeful that tranche spreads and pricing on the underlying loans will "eventually find a level" where securitization can work again, and adds that the pullback in central bank funding could also encourage more issuance.

"I'm conscious that I have said this every November or December for the past several years," South adds. "But maybe more banks will come back to the market as originators next year. There is a stronger argument for that than there has been for a while."

The terms of the ECB's Targeted Longer Term Refinancing Operations (TLTRO) have been made "harsher", South says. This could push banks towards more traditional funding

channels sooner and make securitization more appealing.

In recent decades, the "sick man of Europe" tag was chucked at various national economies in their moments of crisis. France, Finland, Portugal, Greece and Italy have all been denounced as such since the turn of the century.

Not since the 1970s has the label been attached to the UK. However, as Brexit drew few dividends and killed off four prime ministers, there is a new sick man, and this could lead to challenges in UK RMBS, which is by far the largest RMBS market in Europe.

UK chancellor Jeremy Hunt said during his autumn budget statement that the UK was now in a recession, while the Bank of England's base interest rate rose to 3% in November, a 2.75% increase from December 2021.

As a result, one banker tells *GlobalCapital*, the RMBS market is under pressure next year.

## Getting stressed

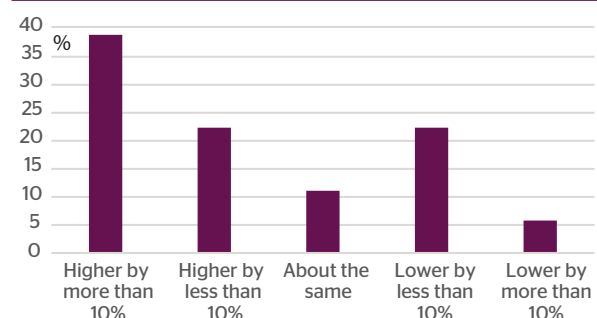
Following the Truss administration's disastrous mini-budget, which led to extreme volatility in swaps markets, mortgage borrowers on standard variable rates are now "not far off the top" of their original stress tests, while those with refinancing needs coming up will soon feel the pinch, he says.

Meanwhile, hedging strategies used by originators are proving costly too, eating into their excess spread.

The banker says that, when Russia's invasion led to greater instability in early 2022, many issuers began hedging underlying mortgages from the moment terms were offered to borrowers and at the point the transaction was completed.

Issuers typically hedged 50%-70% of their mortgage offers, because many don't complete for a variety of reasons. Then, as conditions worsened, issuers became prudent and began hedging in the pipeline as well.

Will non-retained public issuance volumes in European ABS (excluding CLOs) be higher in 2023 than in 2022?



Source: *GlobalCapital*

However, as rates rose even more rapidly in the autumn, the odds of completion shifted sharply too. A potential borrower who was offered a 2% interest rate in early summer now had a 95% likelihood of completing, as they knew rates would soon be closer to 6%. Some issuers may have 50% of their mortgages unhedged, taking a huge chunk out of the excess spread and potentially losing money on each of those deals.

Some 47% of survey respondents forecast that Europe-wide RMBS issuance will increase in 2023, whereas there is an expectation that consumer loan, auto and credit card ABS deal volumes will stay the same. However, further trouble in the UK could stop progress in its tracks.

Indeed, unless retail banks return to the UK RMBS market, having been absent for many years — as covered bonds proved a more cost-efficient funding route — a big increase in RMBS issuance is unlikely.

Rahni Soliman, head of capital markets Europe at National Australia Bank and with a particular focus on UK RMBS, says optimism is probably too strong a word to describe market expectations. But he does say that, eventually, some issuers will have to “bite the bullet”.

“I think there will come a time when the market will just say ‘enough is enough,’” Soliman says. “We need to create capacity. We need to re-open public markets.”

Shaun Baddeley, Afime’s managing director of securitization, tells *GlobalCapital* that, at the very least, the securitization market is proving resilient.

“We have seen that the structures are very robust and portfolio performance on the whole has been unaffected, aside from some marginal upticks in delinquencies,” he says.

As has so often been the case for the European securitization

market in the past 15 years, success or failure will to a large extent be driven by regulatory changes.

The European Commission’s own survey of market participants found broad dissatisfaction with the EU Securitization Regulation (EUSR), while *GlobalCapital*’s survey found 80% of respondents do not think the regulation is helping to revitalise the market.

In 2023, regulatory developments will be critical for the market’s future. Two of the main aspects of the regulatory framework up for debate in 2023 will be the development of the private reporting template and the review of the regulatory capital requirements.

The European Securities and Markets Authority (ESMA) has been asked to review the reporting templates required under Article 7 of EUSR; in particular, it has been asked to develop a dedicated form of private template.

### Private matters

The European Commission acknowledged in its review of EUSR that EU investors would be at a competitive disadvantage when investing in deals outside the EU, mainly in the far larger US markets, because of the disclosure templates for third country securitizations. Private templates in third country transactions are being suggested as a route out of the problem, but more work is needed to ensure they are not so onerous on the originator that they maintain the complexity and competitive disadvantage.

“It’s essential that this is done in a way that works for everybody,” Merryn Craske, partner at Morgan Lewis, tells *GlobalCapital*. “Particularly for overseas (third country) securitizations, but also for private transactions in general.”

## ESG in need of stability

Developing new sectors within an asset class typically requires stable conditions. After a strong recovery out of the pandemic in 2021, 2022 was supposed to herald growth of ESG. High volatility and uncertainty made that almost impossible, and Dutch mortgage lender Obvion’s Green Storm RMBS was the only ESG-labelled transaction in 2022.

But Merryn Craske, partner at Morgan Lewis, says that ESG is “not going away and will continue to be a significant area of focus for investors and those structuring transactions”. Some 24% and 21% of respondents in *GC*’s securitization survey, respectively, say that sustainability is becoming more important in a volatile world and that attracting ESG demand will be even more important in challenging markets.

But they are outnumbered by the pessimists. Some 41% of respondents believe that ESG is beginning to lose importance because investors have more pressing considerations.

The EBA recommended that securitization be permitted to take a use-of-proceeds approach (for now) in ESG securitizations, and this is expected to be ratified by the

EU’s politicians in the next couple of months. However, the market is clearly in need of broader stability if it is to develop and become an integral part of the EU’s green transition programme.

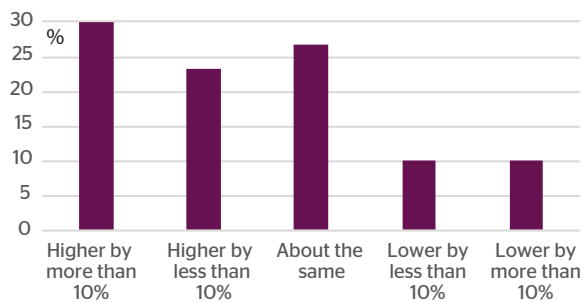
A solar ABS market is often considered the great hope for ESG securitization, with market participants frequently telling *GlobalCapital* that a dam-busting deal is imminent. But the first public solar deal is yet to emerge from the continent, and market participants do not expect one until at least the summer of 2023.

*GlobalCapital* understands that a German solar company has received a securitization warehousing facility from Citi with the intention that once the facility is fully ramped up, it will be offered to investors in the public European ABS market, potentially as the first ever European solar ABS.

Ultimately, however, the development of a solar ABS market will need stability, a broad investor base and fit-for-purpose regulations — no different from other sectors of European securitization. As one banker says, to be in securitization is to be an optimist. There is hope that 2023 will be an improvement, but much remains uncertain. **GC**



Will European CLO issuance volumes (including resets and refinancings) be higher in 2023 than in 2022?



Source: GlobalCapital

Making disclosure templates easier for EU investors in overseas transactions is also important because it can encourage a deeper investor base for domestic transactions.

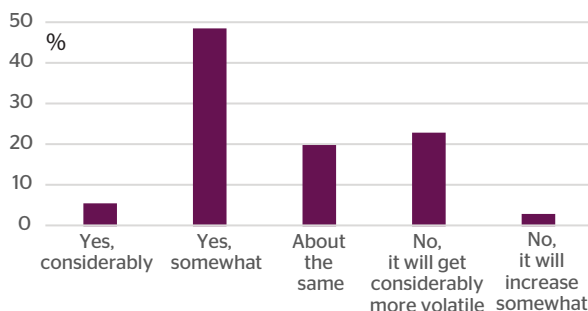
Craske adds that the requirement to obtain the reporting templates in overseas transactions is a “real issue”, because EU investors are saying they need the templates and overseas originators may not be able or willing to provide them.

In many cases there is no local legal mechanism for providing the reporting templates to regulators in EU member states. There is also some discrepancy between what the Commission thinks supervisors need and what they appear to be reviewing in practice, although this is likely to change, Craske says.

“If they can come up with a workable template for private transactions, focused on what supervisors need to get an overview of the market and the main features of the transactions, it is likely to make it easier for EU investors to continue to invest in overseas transactions,” she says.

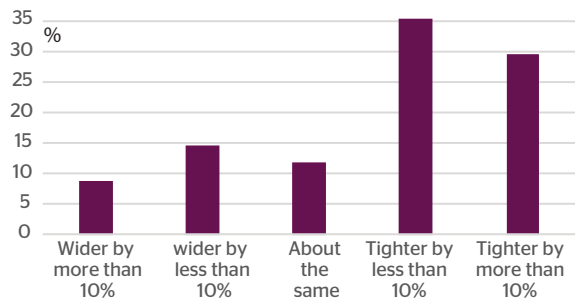
Furthermore, Craske says, regulatory capital requirements for securitization are “not proportional”. This makes it difficult for some investors to invest in deals and is probably restricting the growth of the market. She adds that securitization is treated differently from covered bonds, even though the underlying assets are the same. It does not make sense for securitizations to be subject to significantly more onerous

Do you expect market volatility in European ABS and CLOs to decrease in 2023?



Source: GlobalCapital

Will European ABS spreads be wider or tighter at the end of 2023 than at the end of 2022?



Source: GlobalCapital

capital requirements than covered bonds and other forms of funding for those assets.

“Tranching doesn’t inherently create more risk in the underlying assets,” Craske says.

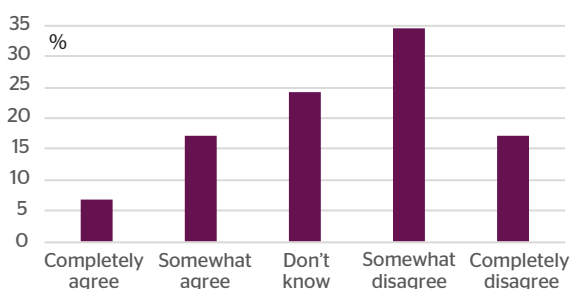
However, Baddeley says that while there are “strong arguments” in support of favourable capital treatment, any changes to the Liquidity Coverage Ratio (LCR) rules are likely to be “off the table”.

Nevertheless, liquidity in ABS and RMBS transactions stood up well to the liability-driven investments (LDI) strategies crisis, often performing better than covered and corporate bonds, he says. “It’s a natural asset to preserve value and they have done that in spades in ABS.”

Securitization is an inherently diverse asset class, and while regulations have contributed to RMBS and ABS placed issuance volumes falling by more than half since the global financial crisis, significant risk transfer (SRT) deals have increased more than tenfold, Baddeley says.

However, in 2023 SRT will face a number of headwinds, with the European Banking Authority’s (EBA) imminent report on SRT expected to have a “significant impact on issuance volumes and outstanding volumes”, Baddeley adds. SRT will be “crucial” to banks in recycling capital, which in turn will allow them to lend more and fuel the real economy. A report on SRT is expected in the first months of 2023. **GC**

Do you agree with the following statement: My company will increase headcount in the securitization team in 2023?



Source: GlobalCapital

# A strong option: convertibles market bullish after tough 2022

Companies will look at convertibles again as higher borrowing costs put pressure on balance sheets and the equity market stabilises. **Aidan Gregory** reports.

**A**fter a year to forget, equity-linked specialists expect a revival in convertible issuance in 2023, as companies look to counter rising debt costs and hope that equity markets have a calmer time of it after 12 months of shocks around war, inflation and rates.

Following two blowout years during the pandemic, the convertible bond market suffered a severe downturn in 2022 as global stocks plummeted due to rising interest rates, record levels of inflation, and the war in Ukraine, which caused energy prices to surge.

As of November 13, the S&P 500 was down 16.2% in the year, while the EuroStoxx 50 had fallen 10%.

The selloff has been particularly brutal for technology companies, which were the biggest drivers of the primary convertible bond market over the past few years. The tech sector-focused Nasdaq Composite is deep into bear market territory, having fallen 27% in 2022.

As a result, convertible bond issuance has suffered. Globally, just \$60.3bn has been raised this year, down from \$194bn in 2020 and \$197bn in 2021, according to Dealogic data.

In the EMEA region, the slowdown has been even more pronounced. Just \$5.8bn of new convertibles have been issued the region this year, down from \$21.8bn in 2021 and \$35.7bn in 2020, the data shows.

“From a primary perspective, it is a difficult year, as the pace of new issues has been very patchy,” says Thierry Petit, head of EMEA equity-linked at BNP Paribas in Paris. “Clients are now becoming more

engaged on equity-linked topics, for obvious reasons. Swap rates are where they are now, and market volatility is very high. Credit spreads have widened a lot as well and the high yield market is virtually shut, so for a number of corporates, there are not that many options left on the table.”

At the end of a tough year, there is growing anticipation that the market may soon be about to roar again, particularly once inflation and the pace of rate hikes begins to plateau.

The equity market is likely to start rallying consistently once investors become more confident that inflation is under control. On November 10, the S&P 500 had its best day for more than two years after the US inflation print for October came in much lower than expected.

“Things are already starting to become a bit busier and will probably become busier the first quarter of next year,” says Juan Rodriguez Andrade, head of EMEA equity-linked at Bank of America in London.

“Rates will need to stabilise before we start to see a significant rebound in issuance, he says. “If you look at the cost of debt now though, it is so much higher than it was at the outbreak of Covid-19, companies will need to reduce their funding. For companies where their cost of debt is in the high single digits, they cannot fund at those levels for a long time. A lot of companies may need to reduce and if you look at the levels of interest rates, we are back to 2008 levels.”

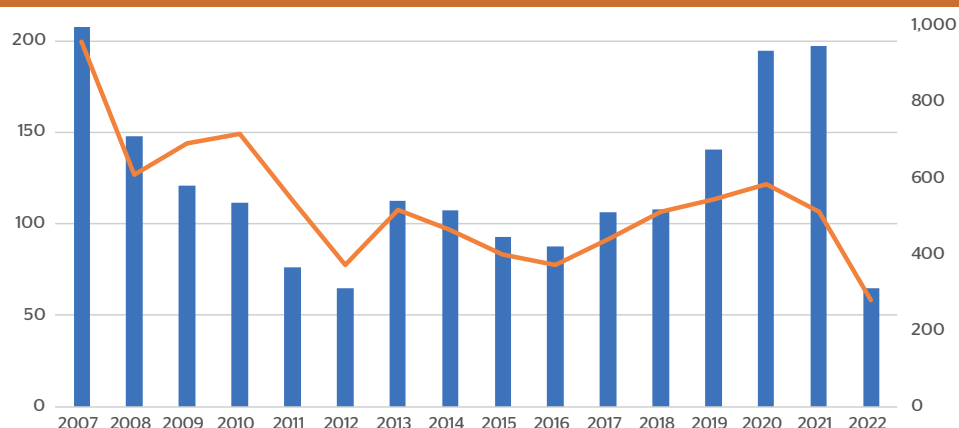
## Cost savings

There are signs that this process is already underway, with three large new deals in November from Sasol (\$750m), Ubisoft and RAG Stiftung (€500m each). Convertibles offer an inherent cost saving versus straight debt in exchange for giving investors an option to convert their bonds into cheap stock if an issuer's stock trades above an agreed level.

In Sasol's case, it achieved a big saving versus what it would now have to pay in the dollar bond market.

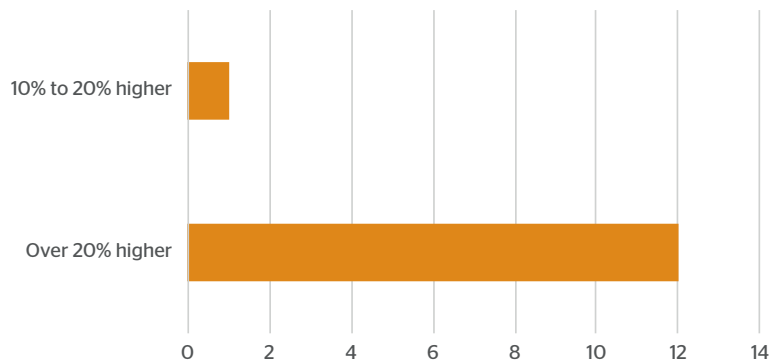
“Sasol would have had to come to the debt market with a coupon of 9%-10%, but they did a convertible at 4.5% so that is around 4.5%

Global equity linked issuance – \$bn



Source: Dealogic

GlobalCapital ECM outlook survey: What is your expectation about equity-linked volume?



Source: GlobalCapital

savings per annum,” says Rodriguez Andrade. “On a \$750m transaction, that represents around \$200m of cash savings over five years, which is massive. We will see a lot more of these cases where companies from the sub-investment grade or low investment grade will issue convertibles.”

The optimism that the market’s fortunes are about to change is shared across the market. And even if volatility remains, convertibles are also much easier to issue in short windows due to the regulatory requirements being less demanding compared to other capital markets instruments.

“Corporates are looking for a bit of stability and confidence that they can approach the market without having to widen terms in the course of preparation or even during execution,” says Ilyas Amlani, head of EMEA equity-linked at HSBC in London.

“We do not necessarily need rates to taper or stabilise. One of the benefits of the convertible market, at least in Europe, is you do not need to have a prospectus, or do a roadshow. If you compare it to other funding instruments, it is much easier and quicker for corporates to access it. The market will remain volatile and windows will be shorter than what we have been used to in the past decade, so issuers need to be nimble and the convertible market does suit those issues who want to get access to the market in tight windows.

“It cannot get much worse than what we had this year.”

Higher borrowing costs hit all

companies, but it is particularly troubling for high yield or cross-over credits. In 2023, these companies are likely to make up a large chunk of the dealflow.

Investment grade companies may also start to look at the market again.

“We are almost there,” says Ismail Iraqi, head of EMEA equity-linked at JP Morgan in London. “It took some time for corporates to come to the realisation that the equity market is unlikely to experience a V-shaped recovery. At the same time, many now realise that rates will go higher for longer. Therefore, if CFOs and treasurers aim to de-risk their upcoming financings, we think H1 2023 will be the right time to consider tapping the convertible market. It will allow them to replicate the type of cash cost they could get in the debt market a year ago, with the option of issuing equity at a premium to current levels if the share price performs through the cycle.”



“Conditions are ripe for an active primary market and that will feed through as soon as we have a little bit of stability”

**Davide Basile,**  
Redwheel

Iraqi says with the continuous pressure from central banks, the investment grade and high yield debt markets are set to remain more costly.

“The convertible market remains

open, active and the various transactions we have done show that the demand is there,” he says. “The question for corporates is how to best tap this market, at what cost, and what structure would work best for them.”

### Starving investors

Investors were starved of new deals this year, and at the same time a lot of bonds matured. Buyers are eager for new issues, particularly now it is possible to earn a generous carry from convertibles again due to higher rates.

“Things have begun to improve a bit from mid-August onwards,” says Davide Basile, head of convertible bonds at Redwheel, a London-based investor with \$17.9bn of assets under management, of which around \$1bn is in convertibles. “We think volatility will remain higher and markets are at an interesting juncture. Getting exposure via optionality with the conservative bias of a bond floor is an attractive fundamental proposition.

“Conditions are ripe for an active primary market and we think that will feed through into next year as soon as we have a little bit of stability in the market,” adds Basile.

In recent years, the market has been dominated by technology issuers, but the pipeline next year is likely to be much more diversified, with deals from sectors such as energy and industrials as well.

“When speaking with investors, most are telling us they expect 2023 to be very busy, which is great,” says Petit at BNPP. “I am not saying it will be another 2009, but a number of corporates, in particular in the industrials space, are looking at this market again, which will be welcomed by investors because there are probably too many technology names in the asset class at the moment, and they have suffered a lot over the past 12 months.

“There is also strong appetite for energy names for obvious reasons given the market environment, and because a lot of these names disappeared from the market, I am expecting new issues in this particular space in the coming months too.”

GC

# Redemption beckons after ‘worst IPO market any of us has seen’

A strong post-pandemic recovery in 2021 meant that predictions for the equity IPO market in 2022 were hopeful. But the Ukraine war, inflation and economic downturn blew away all that optimism. **Victoria Thiele** reports on how the IPO market has responded and what to expect next. Accompanying data is from a survey of equity market participants undertaken in October and early November.

**D**ecember tends to be the time of year when market optimism is highest and sights are trained on the next year. Bankers and investors alike are full of hope that the ails of the past year can be laid to rest and the next will be more fruitful.

For the IPO market, going into 2023 there is little optimism. Most of the sources *GlobalCapital* spoke to for this article expect next to no activity over the winter, followed by only a handful of IPOs in the second quarter, but — tentatively — a second half recovery.

This forecast assumes, or perhaps hopes, that “things have stopped getting worse”, as Andreas Bernstorff, head of ECM at BNP Paribas, puts it.

For IPO markets almost everywhere it was a terrible year. In Europe, 154 IPOs raised €15.6bn in 2022 by November 15, an 81% drop in deal value year-on-year and the worst result since 2012. The flotation of German luxury carmaker Porsche alone contributed €9bn, grossly inflating the overall figure. European issuance was dwarfed by the Middle East, where 51 new listings raised nearly €20bn. Markets in Saudi Arabia and the UAE were so busy that *GlobalCapital* has a separate feature on it (*see other pages*).

The longest the IPO market has been shut in this century was for six quarters immediately after the 2008 financial crisis. “Intuitively, this situation is not as bad as then,” says Gareth McCartney, global co-head of ECM at UBS. “So we’re probably within one or two quarters of IPOs coming back.”

## We’re gonna issue like it’s 2001

McCartney’s peers share this sentiment, despite popular apocalyptic comparisons to 2008. In terms of his-

toric crises, bankers feel that the situation is more similar to 2001, when valuations crashed after the dotcom bubble burst, but the financial system itself remained functional and the IPO market slowly recovered without central bank intervention.

“We’re coming off a period of extreme valuations and we’re now in a devaluation or asset deflation bear market, which was what happened in 2001,” says Martin Thorneycroft, Morgan Stanley’s head of cash ECM for EMEA. “2008 was much more systemic, certainly for the financial

industry, banks and investors.”

After 2008, central banks injected whatever money it took into economies to prevent collapse. “You saw markets in ECM go down and straight back up again,” says Bernstorff.

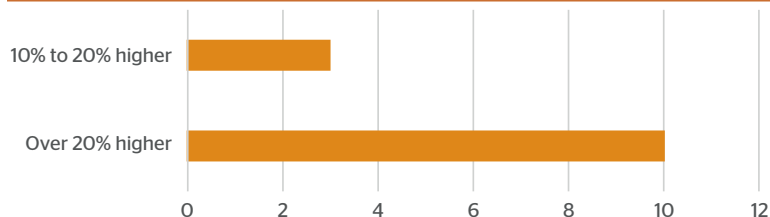
“By contrast in 2001, they dropped quickly and went up again really slowly. This feels much more like that because we’ve got the central banks pushing the other way and there is nobody who has an obvious problem.”

But the overarching message is that the environment is terrible. “The worst any of us has ever seen,” as one ECM lawyer says.

However, the system is healthy, so IPOs are bound to return eventually.

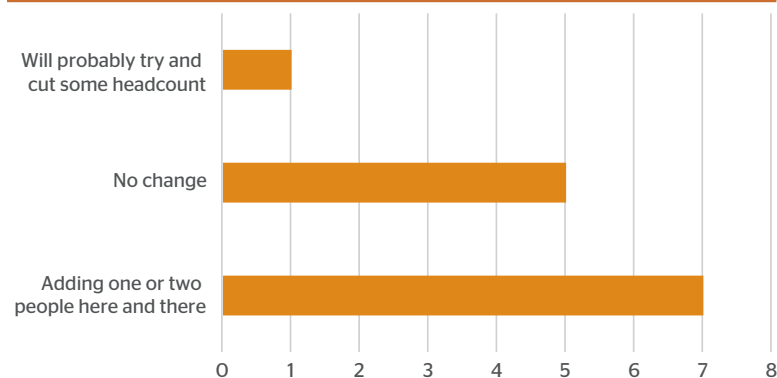
“Many investors are sitting on a lot of money,” says James Manson-Bahr, head of equity syndicate at Morgan Stanley. “Sounds extraordinary given the backdrop we are in, but there are

## What is your expectation about other cash ECM volume, including blocks?



Source: *GlobalCapital*

## Do you expect to be growing or shrinking your ECM team in EMEA in 2023?



Source: *GlobalCapital*

new capital markets funds emerging in anticipation of the pipeline.”

In addition, a number of companies planned and then postponed listings in 2022, including well-anticipated names like Swiss skincare company Galderma and Europe’s biggest private equity firm CVC. These are at the top of the list of firms likely to consider going public throughout the year. Together, they form a pipeline for 2023 that Thorncroft calls “as good, if not better than, any we have seen at any point over the last decade”.

However, things are not as straightforward as they may seem. Off the record, some bankers disagree with their house view and doubt whether governments will be able to control inflation, so that interest rates can stabilise and volatility will ease.

One banker in Europe says: “It won’t be an IPO year. It won’t be a block year. Primary capital raises will be a theme.”

Some of the excitement about a glorious pipeline may also have to be taken with some scepticism. “A lot of bankers are battling for their jobs,” says an ECM lawyer in London. “Funny things happen in those circumstances.”

The lawyer describes being asked to pitch for — and try to come on to — deals that never happened, “but people wanted to have something on the deal sheet for internal purposes”.

M&A banker Allan Bertie, head of European investment banking at Raymond James, provides a more peripheral view on ECM. “We don’t currently see the IPO market as a competition to M&A,” he says.

Instead, he expects listed companies



The €9bn Porsche IPO put a gloss on an otherwise terrible year

to raise equity in follow-on transactions to fund acquisitions.

Investors, bankers and lawyers agree the future of European IPOs depends largely on interest rates.

“It all comes down to whether the central banks make policy mistakes or not, and they have had a track record



**James Palmer,**  
Bank of America

“It will be the larger predictable companies that will come first. If they work, then you start moving from there”

of that in the past by keeping rates too low for too long,” says James Kinghorn, investment director for global equities at Nikko Asset Management in Edinburgh. “Hopefully this time they are a bit more practical and the interest rates that they are pushing

now have the desired effect on inflation over the next few quarters.”

If governments can curb inflation, central banks can stop raising rates and volatility should subside, making IPOs possible again. If inflation proves stickier, however, and rates keep rising, there could be more rescue capital increases by struggling companies, especially in the real estate, infrastructure, and consumer sectors.

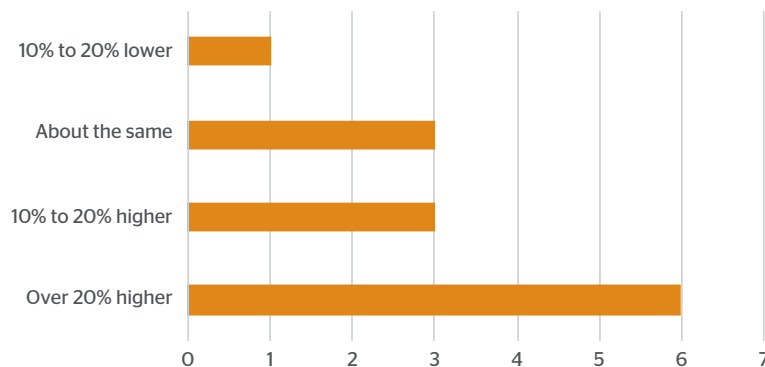
“If [real estate and infrastructure] assets are dependent on debt, their cost of funding has dramatically changed,” says Morgan Stanley’s Manson-Bahr. “If your average consumer is being hit by inflation and rising interest rates while wages aren’t growing in line with inflation, or they are being made unemployed, consumer companies could come up short, with a number of them highly levered.”

Market participants are aware of the possible scenarios. However, few are willing to predict which one will happen. With such an unpredictable environment, the second half of 2023 seems extremely far away.

On a more positive note, some expect the market to be more resilient to other macro risks. “We [the ECM market] have got reasonably immune to the geopolitical side of things,” says McCartney at UBS. “That’s not to say it can’t get worse, but we’ve had to go through Brexit, Trump, Ukraine — the market can manage that piece.”

Others remain more cautious. James Palmer, head of European ECM at Bank of America, suggests that the dynamics around Ukraine and Russia are not weighed in the way they probably should be. However, he says:

What is your expectation around IPO volume in EMEA in 2023, compared with 2022?



Source: GlobalCapital

“Ultimately it is the price of money and the rate cycle that are rightly the focus for investors.”

While market participants struggle to determine when the IPO market will recover, they are clear on how.

A few large deals will need to blaze the trail for the others. Porsche was too big and too unique to qualify. The carmaker’s €9bn deal was the largest IPO in Europe in more than 10 years. Through the listing, the Porsche family regained a 12.5% stake, while a sovereign wealth fund took another 5%, leaving only a small portion of the 25% flotation on offer for other investors. Apart from the family’s stake, the shares carried no voting rights. “It will be the larger companies, the easier to model, predictable companies that will come first,” says Palmer at BofA. “If they work, then you start moving from there.”

### Slow progress

But progress will be slow.

Investors will be selective, and apply “high levels of scrutiny” but keep “a very open mind”, says Rob Leach, global head of capital markets and portfolio manager at Man Group.

“They’re going to be looking at stability, quality of earnings and cash-flows across a number of sectors,” he adds. “It’s about finding high quality companies and management teams at compelling price points.”

Market participants particularly expect activity in healthcare, industrials, finance, and some parts of the consumer sector, and funding the energy transition will also be crucial.

“But the dynamic is generally applicable across sectors,” says Palmer.

Leach says there is even potential for tech companies despite a battering over the past year. “There are parts of technology that are actually producing solid earnings while still displaying growth characteristics,” he says. “It is starting to become more interesting to look more deeply into the winners within the technology sector.”

Big US consumer tech firms, the pandemic darlings, are struggling. In mid-November, Netflix was down 51% since the start of the year. Alphabet had dropped 34%, Meta lost 67%.

There are outliers. UK cybersecurity firm Darktrace, listed in 2021, was trading up 3% since the start of 2022, outperforming the FTSE 100 that is

down more than 2%. “Investors still like growth, they don’t like unprofitable growth,” says Thorneycroft.

Carve-outs will be an important theme, according to a head of ECM at a global long-only asset manager, as they come with a track record and a trusted management team. One example from next year’s pipeline is Thyssenkrupp’s hydrogen division Nucera.

At the end of 2021, before Russia invaded Ukraine and the energy crisis contributed to soaring inflation and to the threat of recession, bankers and investors expected markets to return

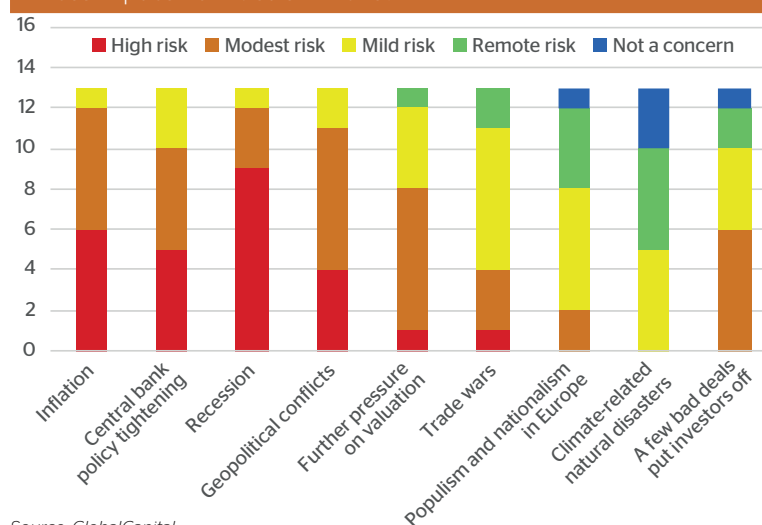
to a healthier rhythm after the manic issuance in the wake of the pandemic.

Valuations were predicted to come down, investors to be more selective and to prefer profits to growth. For market participants, the crises of 2022 have made the path both longer and windier, but not reversed it.

“In periods of dislocation, it’s important to remember that even if markets look like they’re shut, life goes on and investors are still trying to make returns,” says Leach.

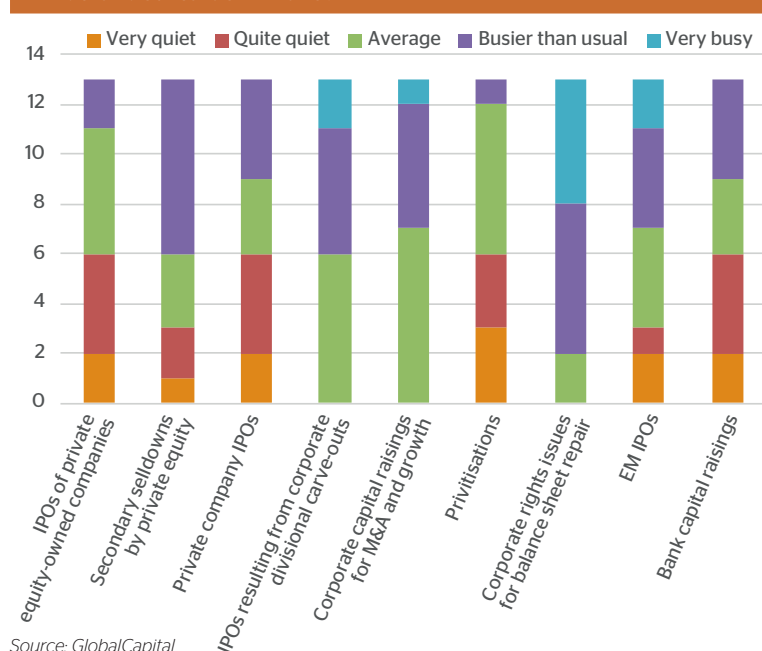
If so, perhaps a little December optimism is in order after all. **GC**

### What are the risks you fear could most impact ECM deals in 2023?



Source: GlobalCapital

### How busy do you expect the following kinds of deal to be in 2023?



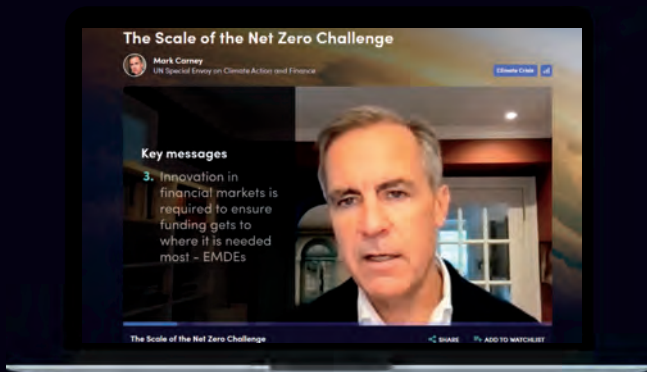
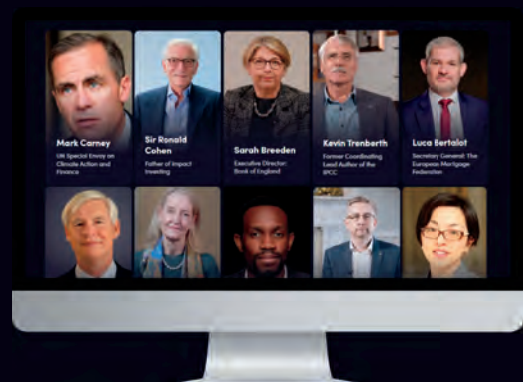
Source: GlobalCapital

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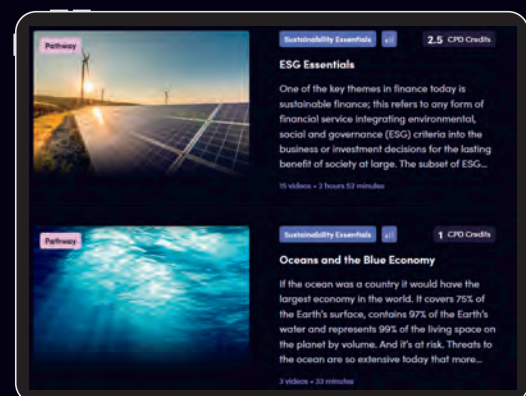


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# Middle East IPO boom set to run on into 2023 and beyond

While market buoyancy may seem like a boom, sources say increased activity is here to stay as the oil rich economies of Saudi Arabia and United Arab Emirates continue to build out their economies and attract foreign capital. **John Crabb** and **Aidan Gregory** report on what to expect in the months and years ahead.

**A**fter the Qatar Fifa World Cup comes to a close, attention is likely to shift away from the Middle East in a return to normality. Attracting global contention, the event has proven to be something of a controversial showcase of the region's spiralling wealth.

For those involved in the financial markets, however, football's biggest celebration was not the biggest news in the Middle East and North Africa region in 2022.

While IPO activity elsewhere around the world has ground to a screeching halt in what has been called the worst market anyone has ever seen (*see separate article*), in the Middle East deal flow has gone from strength to strength.

The region's market bucked the global downturn in 2022 as money flowed into Saudi Arabia and the UAE, particularly following Russia's ejection from MSCI's flagship global indices in March.

With a strong capital markets agenda in both jurisdictions, an abundance of oil money during a global energy

crisis and growing foreign ownership of stocks, barring any geopolitical disasters the momentum looks set to continue into 2023.

Stand out deals such as the listing of Saudi Aramco and Dewa have helped propel the region to the top of the EMEA rankings for the first time. As *GlobalCapital* wrote in August, the disparity between the IPO deal value within the EMEA region was glaring in 2022 when compared to previous years, and as year end approaches sentiment has only marginally changed in favour of the European markets because of Porsche's blockbuster, data skewing listing.

As of November 18, the region has seen a whopping \$20bn from 51, whereas Europe's 154 IPOs only add up to \$15.825bn in the same time frame. Remove Porsche from the equation, and Europe's number falls to just \$7.01bn.

## Striking (black) gold

So, what has caused this disparity? Why, in a year that will go down in history as one of the most volatile in recent memory, has the Middle East's IPO market done so well?

According to Christian Cabanne, head of central and eastern Europe, the Middle East and Africa ECM at Bank of America in London, it is a combination of factors.

"Higher energy prices have of course been helpful, but Saudi and the UAE have also enjoyed strong macroeconomic tailwinds and GDP growth," he says. "Inflation is much lower there than it is in the US and Europe, so they have not faced the same issues, and they are both going through structural reforms to grow their economies, attract foreign capital and boost the inflow of talent."

The region's two largest economies have both taken dras-



Qatar's hosting of the 2022 Fifa World Cup has been controversial showcase for the region's spiralling wealth



tic measures to facilitate offerings in their own markets, in terms of the ease of doing business and the ease of performing IPOs.

“If you put all that together, you create an environment that is very constructive,” says Cabanne.

The depth of the market can be seen clearly in the level of subscription to its largest IPOs. The Americana listing, for example, was oversubscribed 71 times in mid-November.

“There is a very constructive base of local investors in the UAE and Saudi who have deep pockets and are willing to participate in transactions, which certainly helps a lot, as can be seen by the phenomenal level of oversubscription on some of these IPOs,” says Cabanne. “Not all markets have that.”

Alex Watkins, co-head of EMEA ECM at JP Morgan in London agrees that it is a combination of positive factors that have made the region so attractive.

“It has been incredibly rosy in terms of the Middle Eastern market environment,” he says. “The oil price is high, the economies are very strong, and investors want to diversify away from other regions, including western Europe, China and other emerging markets that are becoming less attractive. Reflecting that, valuations have been very buoyant.

“Investors can see that there is a strong group of high quality companies in the region that is evaluating listings. Reflecting that, valuations have been very buoyant.”

Christopher Laing, head of emerging markets ECM at HSBC in Dubai, tells *GlobalCapital* of his near 20 years working on IPOs in the region, and how things are more buoyant now than they have ever been.

“We had a boom in 2007/08, there was a huge amount of liquidity and lots of deals got done,” he says. “I did the Dubai Ports deal when I was at Deutsche Bank, and I didn’t think that would ever be topped, we had \$60bn of demand for a \$4.2bn deal, ‘this is the career highpoint,’ I thought. But this year, we did Dewa raising \$6.1bn and it had well over \$80bn of demand.”

“Dewa was an outlier, but there’s been a lot of big deals that have happened, obviously Americana at the moment, but other deals have happened not just in Dubai, but Abu Dhabi and of course, Saudi Arabia as well.”

### More of the same

Whether this kind of environment will remain in the years ahead is uncertain, but the medium-term outlook is very good.

While 2022 has no doubt been excellent for the Middle Eastern equity markets, what is more important to banks, lawyers and investors alike is the outlook for 2023 and beyond. Observers are aligned in their thinking, with several telling *GlobalCapital* that the next 12-18 months should continue to be buoyant in the region for a variety of reasons.

According to Bank of America’s Cabanne there is room for optimism. The UAE and Saudi have both proven to be resilient and were mostly immune from what is happening

in Ukraine. Local indices have had their share of volatility as well, even though they have sharply outperformed the global markets.

“We probably expect more of the same in 2023, unless there is a radical change in the macroeconomic environment or energy prices, and the sentiment turns,” she says. “Unless something like that happens, I expect the interest from investors to still be there and we should continue to see an elevated level of activity in 2023.”

### Promising pipeline

Indeed, the pipeline looks promising. The government of Dubai is not even halfway through its privatisation programme, while in Abu Dhabi, state oil producer Adnoc is preparing to list more of its subsidiaries, including its logistics unit.

In Saudi Arabia, Saudi Aramco is working on an IPO of its vast oil trading division, and the government is understood to be working on a follow-on offering of shares in the state oil giant, which was listed in December 2019 via the biggest IPO in history.

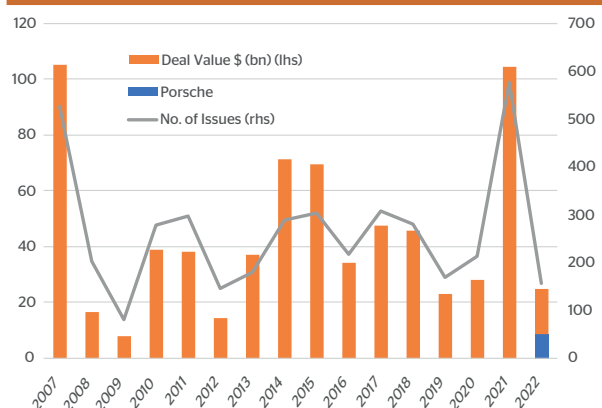
Despite the positive outlook, there is need for caution. “They are still massively outperforming the US and other major equity market indices, but they are not completely immune from the external shocks and higher volatility,” says Cabanne.

In November, Ahmad Sharaf, chairman of the Dubai Mercantile Exchange, told attendees at an event in the city that he was aware of three companies wanting to come to market in the remainder of this year. In addition, he suggested that there are another six or seven already pencilled in for next year.

Kunal Desai, a fund manager for global emerging market equities at GIB Asset Management, says that his pipeline has been very successful this year and expects it to continue.

“One of the biggest hindrances, or constraints for this market has been the complexity of companies and the range of companies that are accessible for public investors,” he says. “That’s why that IPO roadmap is so important, because as liquidity improves, as the range of business models

### European IPO volumes



Source: Dealogic

come on to the market, that will only increase interest.

“You’ve already seen a number of investment funds and hedge funds look to open up new offices in Dubai and the GCC. This is all part of that story.”

Until recently, the IPO pipeline in both the UAE and Saudi Arabia was largely dominated by state owned firms. This too has begun to change this year with a handful of private companies listing like school operator Taaleem and medical company Burjeel.

Laing at HSBC in London adds that there has also been a been a lot of defensive yield stories, with relatively less growth. “There are a lot more growth stories with much lower dividend yields and payouts planned for next year, so that will be refreshing,” he says. “We expect the momentum to carry on.”

“Normally as an equity capital market bank when markets are good you tell clients that they need to get to the market next month or next quarter. At some stage, it’s not going to be quite as good, because it’s very good right now, so the risks must be to the downside, but I don’t see what’s going to trigger that in the near term.”

The regional economy, fundamentally, is very strong. “It is obviously dangerous to predict, but in the next 12-18 months the situation is very, very positive.”

### New rules, new money

In 2019, an agreement was struck between the Saudi Tadawul and the Abu Dhabi Securities Exchange to allow and boost dual listings between exchanges in the two countries. While the flow of these deals has not yet taken off in earnest, it is expected that the additional capability will further encourage listings in the future.

Increasing foreign investment has also played a role in the development of the market. In October of 2019, the Saudi Arabian regulator — the Capital Market Authority (CMA) — announced a new set of rules to its listing regime which allowed foreign issuer entry to the stock markets.

In 2020, 100% foreign ownership of UAE onshore companies became possible, subject to an exclusion list of certain strategic sectors that includes energy and finance,

that still need to be at least 51% owned by UAE nationals/entities.

“Many listed companies also have limits in their constitutional documents and, using FAB as an example, we increased our foreign ownership limit from 25% to 40%,” says David Johnson, head of legal markets at FAB.

In 2019, Saudi Arabia passed similar legislation designed to allow foreigners to invest more easily in the country.

### Further, still

However, it would be remiss to assume that this ECM boom will continue unabated indefinitely. Most of the observers *GlobalCapital* that has discussed the subject with talk of a 12–18-month timeline but are hesitant to predict whether the markets will remain buoyant after that.



“We expect the momentum to carry on”

**Chris Laing,**  
HSBC

Another ECM lawyer in the region urges caution, assuming that the natural lag is likely to catch up with the Middle East. “We don’t operate in a different world to the rest of the world, so ultimately there will be some sort of collateral effect on the region, but there’s always a lag,” they say. “I don’t see it happening in the next six to nine months, but there is a possibility further down the line.”

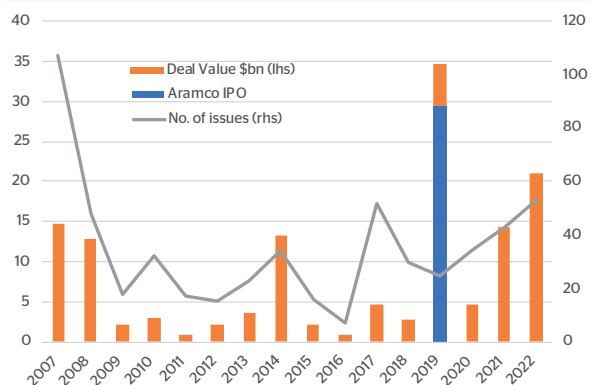
“You’ve got to remember that the Middle East is a region where — not withstanding everyone’s desire to diversify away from oil — to some extent, the market is still very much dependent on the oil price, and the oil price is still not bad.”

The additional government influence that does not exist in the same way in other markets also plays an important role in helping to promote IPOs. There are several demands and requirements for government funding, whereas the IPO is a route to try and generate the revenue to be able to deploy it elsewhere.

JP Morgan’s Watkins adds that there are always risks in any market, however, and to tread carefully.

“The environment in the Middle East is so buoyant that clearly it is rare historically,” he says. “You rarely see such buoyant markets for a decade without any dips. The region has had a near perfect backdrop for investors such as tailwinds from oil prices, diversifying economies that have great momentum, a big capital markets agenda locally and a very stable economic and political backdrops compared to other countries, like the UK where we have seen huge instability, or China where a lot of investors have been rotating away from.” **GC**

### Middle East IPO volumes



Source: Dealogic

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 **AGENCE FRANCE TRÉSOR**  
**REPUBLIC OF FRANCE**  
**EUR 4,000,000,000**  
 0.1% Inaugural Green Linker  
 Due 2038  
 Joint Bookrunner

MAY 2022

**VOLKSWAGEN**  
 AKTIENGESELLSCHAFT  
**USD 500,000,000**  
 SOFR+95 FRN Senior Unsecured – Due 2024  
**USD 900,000,000**  
 3.950% Senior Unsecured – Due 2025  
**USD 1,100,000,000**  
 4.350% Senior Unsecured – Due 2027  
**USD 500,000,000**  
 4.600% Senior Unsecured – Due 2029  
 Joint Bookrunner


JULY 2022

 **gm**  
**GENERAL MOTORS COMPANY**  
**USD 1,000,000,000**  
 5.400% Senior Unsecured Green Notes  
 Due 2029  
**USD 1,250,000,000**  
 5.600% Senior Unsecured Green Notes  
 Due 2032  
 Joint Bookrunner

AUGUST 2022

 **ING**  
**ING GROEP N.V.**  
**EUR 1,000,000,000**  
 4.125% 11NC6  
 Green Tier 2 Bond  
 Due 2033  
 Joint Bookrunner

OCTOBER 2022

 **PUBLIC INVESTMENT FUND**  
**USD 1,250,000,000**  
 5.000% Green Senior Unsecured – Due 2029  
**USD 1,250,000,000**  
 5.250% Green Senior Unsecured – Due 2032  
**USD 500,000,000**  
 5.375% Green Senior Unsecured – Due 2122  
 Active Joint Bookrunner and Joint  
 Green Structuring Advisor

OCTOBER 2022

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**EUR 7.7bn Senior Notes**  
 Due 2023-2027  
 Capped Offer for EUR 1bn nominal repurchase  
**EUR 1.4bn Hybrid Notes**  
 Any and All on the NC23 and Capped offer on  
 the NC24 and NC31 for EUR100m nominal  
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