Global investors can’t seem to buy enough bonds from Europe’s frequent borrowers this year. Their confidence in Europe’s recovery is growing regardless of skyrocketing debt levels since the 2012 promise of Mario Draghi, President of the European Central Bank, to “do whatever it takes to preserve the euro.”

In their frenzied scramble for yield in a global low-rate environment, investors who stayed out of Europe’s sovereign bond market as if it had been quarantined at the height of the eurozone’s debt crisis two years ago have regrouped en masse to wring the very last basis point out of new sovereign issues.

As a result, Europe’s sovereign and state agency borrowers are finding themselves in a most advantageous position. Not only are they able to preserve the routine schedules of their bond auctions throughout the year, but they are enjoying the luxury of being able to skew their auctions toward the short end of the duration spectrum to fill gaps that opened during the crisis.

Of course, many frequent borrowers are on track to issue even more debt this year than in 2013 when France, Germany, Italy, Portugal, Spain and the UK issued a total of $1.49 trillion dollars worth of sovereign bonds. During the first five and a half months of this year alone, those countries issued $516.26 billion worth of sovereign bonds, according to Dealogic. Now Greece, which issued no new sovereign debt from 2011 to 2013, has re-entered the fray, issuing $4.1 billion of new sovereign issues.

Contrary to the height of the crisis times, one can say that almost all issuers have the ability to access the markets today—especially at reasonably attractive levels,” says Achim Linnenmaier, Head of European SSA Syndicate at Deutsche Bank.

A broader investor base

The investors who now are snapping up frequent-borrower paper are a more diverse crowd than in previous years. Ambroise Fayolle, Chief Executive of Agence France Trésor, has always been accustomed to dealing with “very diversified” investor base “both in term of geographical area and type of investors.” But this year Fayolle is seeing “continued strong demand from non-residents and also from domestic investors.” Fayolle adds, “At the end of 2013, the share of non-resident investors was high at 65.1 percent of total outstanding French government debt.”

This phenomenon has been even more pronounced in Spain since mid-2013. “This is a clear sign of normalization of the financial markets,” says Antonio Cordero, Head of Funding and Treasury at Instituto de Crédito Oficial (ICO) in Madrid. “Investors who had been on the sidelines during the eurozone sovereign debt crisis have come back to buy our paper.”

Now ICO is placing no less than 70 percent of its issues with foreign investors, up from 40 percent three years ago. “So there is a growing appetite for ICO paper, which is allowing ICO to resume its activities in markets where it had been absent for years, i.e. dollar, Urudashi, retail Samurai, BRL/USD linked trades, etc.,” says Cordero.

Added to this resurgence is a growing appetite on the part of central banks to hold global sovereign debt—plus the quantitative easing programs of the U.S. Federal Reserve and the Bank of England, which have been buying bonds to prop up asset values in recent years. “We have seen a great increase of central bank investors in our paper compared to last year, both in euro and U.S. dollar issuance, [taking up] 58 percent of this year’s mid-and-long term paper,” says Pierre Hainry, Deputy Head of Capital Markets at Caisse d’Amortissement de la Dette Sociale (CADES) in Paris. “For the remaining part of the year, we still have room to issue a new benchmark.”

Regardless of whether they are “peripheral” issuers at higher rates like Ireland and Greece, or “center” issuers at lower rates like Germany and Sweden, Europe’s frequent borrowers are locking in lower rates. “There is a widespread consensus that in this low-rate environment, we will see further convergence between the periphery [and the center],” says Philip Brown, Head of Public Sector Fixed Income Origination at Citi Global Markets in London.

In some cases, peripheral issuers are actually paying less to issue debt than center issuers. “Ireland came out with a lower yield than Sweden, and Greece is issuing debt below pre-crisis levels,” says Carl-Henrik Arosenius, Head of Investor Relations at

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**SOVEREIGN DEBT ISSUANCE**

*includes debt sold at auction*

<table>
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<tr>
<th>Date by Year</th>
<th>France</th>
<th>Germany</th>
<th>Greece</th>
<th>Italy</th>
<th>Portugal</th>
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Source: Dealogic
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BTF, OAT MT and OAT LT prices are available on REUTERS <TRESOR>; BLOOMBERG TREX <GO>
Kommuninvest i Sverige AB in Örebro, Sweden. “How can that be? This is very irrational behavior.”

The periphery performs well

From a viewpoint of investment bankers who sell these bonds to public pension funds, life insurance companies and other risk-averse institutional investors, the explanation is simple. “If you look at the performance of euro government bond indices, all the positive performance is coming from the periphery,” says Citi’s Brown.

A case in point: A BTP 4 percent Italian sovereign bond issued in 2005 and maturing in 2037, traded at around 103 percent in cash price terms on May 15, up 67 percent on November 18, 2011. “Supranationals are obviously benefiting from the periphery trade,” says Alexandra Basirov, co-head of SSA at BNP-Paribas in London.

Fewer such long-duration issues will come on the market this year as frequent borrowers issue more bonds at shorter durations to fill funding gaps and lower their borrowing costs. “The bulk of our funding activity should be concentrated in shorter maturities,” says ICO’s Cordero. “During the crisis, as a prudent approach aimed at minimizing refinancing risk, we issued in maturities longer that the average maturities of our lending activity to small and medium-sized enterprises. Hence, he have a duration gap that we want to progressively reduce by issuing shorter.”

The few remaining bonds to be issued by Europe’s frequent borrowers at longer maturities this year are likely to be denominated in U.S. dollars, not euros. “Given the overall still-compelling steepness [in the yield curve], we do see various accounts extending duration in the U.S. dollar market for yield enhancement,” says Horst Seissinger, Head of Capital Markets at KfW Bankengruppe in Frankfurt. “However, given we have an average duration target to achieve, we can only satisfy the demand in the long end to a certain extent.”

Such signs of a gradually improving economy are why income investors are showing more confidence. “The risk-return profile of most European sovereign bonds changed for the better as a result of far-reaching macroeconomic and structural reforms—more than ever observed in most other industrialized nations,” says Jörg Zeuner, Chief Economist at KfW. “This is why investors returned to Europe.”

Hoping for inflation

Now issuers are waiting for the ECB to unveil plans for quantitative easing later this year as a measure to generate economic growth and, ultimately, inflation. They see this as the key to easing Europe’s sovereign debt burden, which was 92.6 percent of GDP in the third quarter of 2013. “The ECB has already expressed its concern on this issue, so they are expected to take bolder actions if needed,” says ICO’s Cordero. “We will see European inflation … gradually increase in the coming months.”

To be sure, the recovery is still fragile. “These [issuing] entities are still vulnerable to extraordinary shocks,” BNP-Paribas’ Basirov cautions. On May 15, prices for Greek sovereign bonds jumped 46 basis points when Athens was compelled to publically deny rumors of an impending retroactive tax on public debt.

But the May 15 flap was quick to subside. Why? “What has changed is that investors really believe the European authorities will do whatever it takes to ensure the cohesion of the eurozone,” Citi’s Brown explains. For the time being, Draghi’s explicit guarantee—coupled with the ECB’s plans for quantitative easing—appear to still be enough to keep investors queuing up for more.