


Tuesday, March 22, 2016 11:21 AM ET  Exclusive

I-banks win from ECB corporate bond-buying drive, but wider risks loom

By [Matei Rosca](#)

The ECB's plan to purchase certain corporate bonds is already sparking an increase in issuance, boosting the investment banks that act as underwriters, advisers and market-makers, but it also risks disadvantaging the eurozone periphery and failing to boost productivity in the real economy, experts said.

The expansion of quantitative easing through the corporate sector purchase program, or CSPP, was among measures [unveiled](#) by President Mario Draghi on March 10 as the ECB made a fresh attempt to stimulate eurozone inflation and revive lending. It came alongside a further reduction of the already-negative deposit rate, cuts to the ECB's other two benchmark rates, an increase in monthly purchases under the existing asset purchase program and a fresh round of targeted longer-term refinancing operations, which included the prospect of banks being paid to borrow from the ECB.

Sam Theodore, managing director at Frankfurt-based Scope Ratings, said in an interview that the CSPP would give a welcome boost to the single capital market of Europe, where businesses remain far more reliant on bank lending than their counterparts in the U.S. Deutsche Bank analysts wrote in a March 18 note that roughly €35 billion in new euro-denominated debt and equity capital had been issued since the ECB's March 10 announcement, or about 4x the weekly average during the first 10 weeks of the first quarter.

"The credit disintermediation ratio in the U.S. is very high compared to Europe," Theodore said, referring to the proportion of funding raised in capital markets. "There is definitely a temptation to issue more bonds. The ECB buying them will be a sign of confidence in the company."

Theodore said the ECB could dip in without distorting prices, but he also warned that an overextension of CSPP appetite for a prolonged period might "kill the market" and said investors should bear in mind previous unsuccessful attempts by the ECB to buy private sector assets. The ECB's entry into the relatively small ABS and covered bond markets discouraged investors from holding these asset classes, Theodore said, and the ECB eventually felt compelled to back out.

"If you look at what happened with the covered bonds and the asset-backed securities, it might end up discouraging investors from those assets, but because the corporate bond market is wider and deeper, it would take much longer," he said.

Bank of America Merrill Lynch analysts warned the day of Draghi's announcement that if the ECB's decision augured the emergence of a "large, price-insensitive buyer in the corporate bond market," it could lead to further deterioration of credit market liquidity. Deutsche Bank analysts said in their March 18 note that increased volatility and depressed liquidity were significant near-term risks.

Marcello Minenna, a PhD lecturer in quantitative finance at the London Graduate School and Bocconi University in Milan, said the expansion of asset purchases to corporate bonds was a silent concession by the ECB that prior quantitative easing had failed to stimulate growth in the real economy. He also observed that tighter bank regulation played a role in hindering transmission.

"The ECB is showing comprehension that the new fiscal-prudential compact — regulation like Basel III, MREL and TLAC — prevented the money it supplied from going into the real economy," Minenna said in an interview. He added, however, that the program is unlikely to help the small and medium-sized enterprises that collectively account for the majority of eurozone employment and productivity.

"This will definitely be good for big quoted companies, but there are many small firms which make up the most of the economy and they will not gain anything," Minenna said, adding that he expects the purchases to be concentrated on blue-chip German and French corporates.

In carrying out purchases of sovereign assets, the ECB applies a principle known as proportionality, buying up issuances in proportion to the size of each eurozone economy. But the proportionality applied to national debt is not possible in corporate bond purchases, because of the way corporate bond issuance is dispersed around Europe, Theodore said.

Such a lack of proportionality will do a considerable disservice to smaller eurozone economies, Minenna warned. "The periphery — Italy, Greece, Spain and Portugal — will not benefit much," he said, observing as well that there is no assurance that the funds injected through bond purchases will go to actual investment.

"In Japan, for example, companies used much of the QE money to do proprietary trading and share buybacks," he said. "Companies might also use this money to deleverage previous debt. There is a big question mark over whether [too much CSPP] will create a bubble."

But he said the program "will definitely prove a major source of work for investment banks."

Deutsche Bank analysts wrote in their March 18 note that [BNP Paribas SA](#), [Crédit Agricole SA](#), [Credit Suisse Group AG](#) and [Barclays Plc](#) are likely to be the top beneficiaries of the program, thanks to their fixed-income departments, with euro-denominated franchises likely to benefit the most.

Bank of America Merrill Lynch analysts wrote that they anticipate about €550 billion of existing European corporate bonds being eligible for purchase by the ECB and that "primary supply will undoubtedly pick up."

Deutsche Bank market analysts, meanwhile, wrote March 11 that the "investible universe is probably somewhere in the €400 billion to €500 billion region" and that monthly purchases were likely to be between €5 billion and €10 billion. They also said there is room for more than 50 basis points worth of tightening before spreads would return to the 80-100 basis point levels that have served as something of a floor since the global financial crisis.

One bond analyst who declined to be named due to confidentiality agreements suggested in an interview that the program might benefit U.S. banks more than European ones due to the former being perceived by as more experienced in bond markets.

Five American banks and four European ones acted as book runners in the top five European nonfinancial corporate deals of 2015, according to Dealogic data. These were Barclays, [HSBC Holdings Plc](#), [Morgan Stanley](#), [Deutsche Bank AG](#), [Citigroup Inc.](#), [Goldman Sachs Group Inc.](#), [JPMorgan Chase & Co.](#), Bank of America Merrill Lynch and [Société Générale SA](#). Barclays was involved in four of the five deals.

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