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The Evidence So Far on the ECB's Corporate-Bond Binge

Six months on, the program has managed to push down interest rates. But that's no guarantee of new investment or growth.

By **Marcello Minenna**

With few options left, central banks have turned to purchasing corporate bonds in their attempts to stimulate anemic economies. The European Central Bank, or ECB, joined the stampede at its March meeting, and in the months since has started buying up corporate debt apace. How well is it working so far? Early data show what is going right—and what isn't.

Recall that corporate-bond buying is a novelty for the ECB, and the central bank has had to make up some of the rules as it goes along. The first question has been how many bonds the ECB can or should buy. The central bank didn't announce a formal target when it unveiled the new policy in March. It said it would expand its monthly bond purchases under its quantitative-easing program to €80 billion (\$89.29 billion) from €60 billion, but didn't specify how much of the additional amount would flow into corporate debt versus government bonds.

That left it up to the markets to guess. At the time of the announcement, my colleagues and I estimated that the overall pool of eligible corporate bonds in the eurozone would be around €550 billion, and that the ECB's track record of government-bond purchases relative to market size implied corporate purchases of between €3 billion and €6 billion a month. In the event, the ECB surprised us with total purchases reaching nearly €23 billion over the first three months of the program starting in June, with €7.3 billion of that in August.

We hadn't counted on the market's rapid reaction to the ECB's promise to become a bond buyer of last resort. Starting almost immediately after the ECB's announcement in March, large eurozone corporations increased

monthly issues of euro-denominated bonds both in gross (to a peak of €70 billion in May from €30 billion in February) and net terms (to more than €10 billion a month on average from roughly zero before). Even August saw unusually strong issuance when seasonally adjusted.

This new issuance has allowed the ECB to conclude it can purchase more bonds without exercising an undue influence on the market, which we had believed would be the main constraint on its bond purchases. There are some caveats, however. While slightly more than 93% of its corporate-bond purchases have been made on the secondary market, the ECB has bought nearly €1.5 billion during the placement of new issues. This isn't a negligible amount either in absolute terms or as a proportion of the corporate-bond program, especially compared to the ECB's traditional reluctance to intervene on primary markets. This signals a relative scarcity of eligible bonds to sustain the planned pace of ECB purchases.

The ECB also appears to be having the desired effect on the interest rates that companies must pay to borrow. The average interest rate paid by nonfinancial companies on euro-denominated bonds has fallen 0.9 percentage points since the start of the year, according to the Bank of America Non-Financial Index—a large drop when yields already were only around 1.5% in January. The decline was pronounced after the March announcement and has accelerated since ECB purchases began in June.

This suggests that corporate-bond purchases will help ECB President Mario Draghi meet his longtime goal of fostering the development of mature eurozone credit markets matching the scale and sophistication of those in Britain and the U.S. But it remains un-

certain how long these effects will be sustained. It's not clear the ECB can maintain its current rate of purchases without impacting market liquidity, even after accounting for the uptick in new bond issues.

Meanwhile, it's no guarantee that lower funding costs for large nonfinancial companies will stimulate new investments. The big corporations could well use the new liquidity trickling in from the monetary authorities to benefit existing shareholders, both directly by boosting dividends and indirectly via buybacks. The market would reward these strategies, as it has in Japan, since a reduction in floating stocks by definition increases the earning per share.

The bigger problem is that the benefits of the corporate-bond purchases flow only to those companies that are large enough to issue bonds. Small businesses, cut off from the ECB's program, continue to endure a persistent credit crunch thanks to slow economic growth and struggling banking systems, especially in smaller eurozone economies. This limits the ECB's impact in countries where small and medium-size enterprises are at the core of the economy, such as Italy.

Taken together, the evidence so far is that the ECB's new program is working reasonably well, or at least as the central bank intended and markets hoped when it was announced. But that's not the same as saying the bond purchases will be the growth boost Europe needs. The debate on how to deliver that economic jolt will drag on.

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