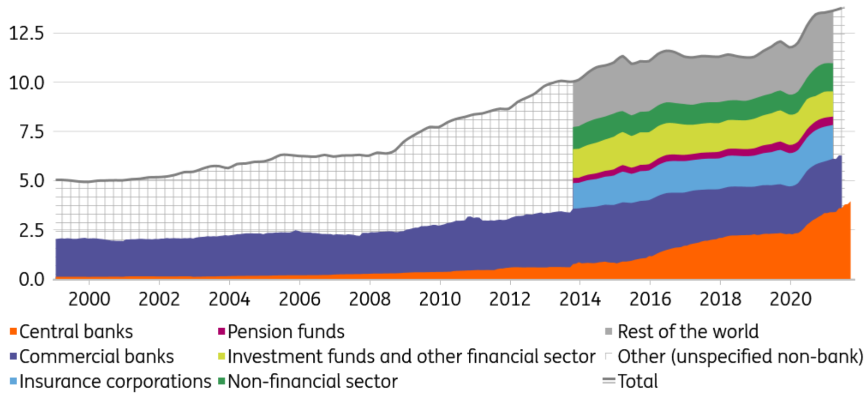
Bank Pulse: Sovereign issuance, from commercial to central banks

Eurozone governments have issued record amounts of debt since the start of the pandemic. Eurozone banks bought less proportionally. In contrast, central banks in the eurozone absorbed 95% of consolidated net sovereign issuance

In absolute numbers, the pandemic saw record government debt issuance

The past 18 months have seen a strong increase in government debt across the eurozone. Eurozone government debt (securities and loans) outstanding totalled €11.9t in February 2020, on the eve of the pandemic. By in July this year, debt had increased to €13.8t. The 16.8% increase in sovereign debt is lower than in the aftermath of the Lehman collapse in September 2009 (+21%) and on a par with the increase during the eurozone debt crisis in 2012 (+16%; all measured over comparable 17-month periods). In absolute numbers though, the pandemic debt increase of €1.94t over 18 months comfortably exceeds those previous peaks, which reached €1.35t and €1.40t, respectively.

Eurozone government debt outstanding, by investor (€ trillion)



Source: ECB, ING-calculations

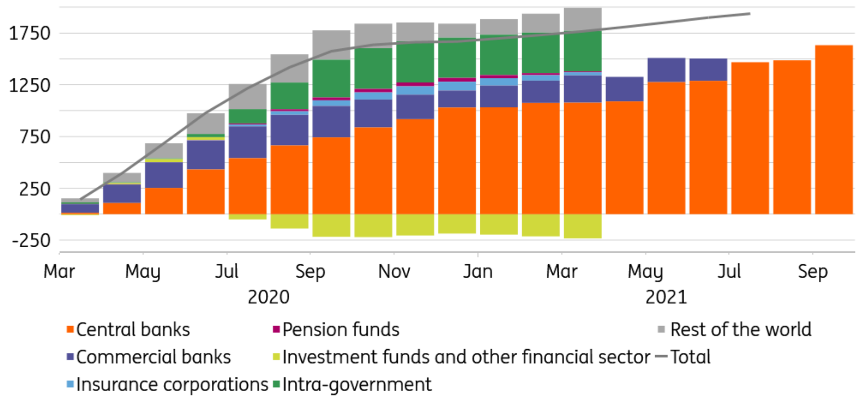
The Eurosystem is now the number one investor in government debt...

What differs even more is how the new issuance frenzy was financed over the past 18 months. Banks participated less proportionally. While they held 20.6% of government debt outstanding on the eve of the pandemic, this had dropped to 19.4% in June this year. As such, banks have continued the two-decade trend of shrinking dominance in government bond investing (see chart above). In fact, the Eurosystem took over the commercial banking sector's position as the biggest sovereign debt investor last year. Stepping in with its Pandemic Emergency Purchase Programme, the Eurosystem had bought €1.47t of the €1.94t issued by July this year. In other words, for every euro borrowed by eurozone governments since February 2020, the Eurosystem indirectly financed 76 cents (see chart below).

...having effectively financed 95% of government deficits during the pandemic

Importantly, the Eurosystem doesn't buy directly from governments on primary markets. It is only allowed to operate on secondary markets. We look at net issuance of debt, however. From this perspective, only the difference between gross issuance and redemptions counts, and the distinction between primary and secondary markets is irrelevant. We should also note that some €390bn of government debt and loans issued ended up being held by other arms of government. When consolidating net government debt issuance (that is, removing net issuance absorbed by other arms of government, except the central bank – the green bars in the chart below), the Eurosystem actually financed 95 cents of every euro net issued between February 2020 and July this year.

Cumulative eurozone government debt net issuance since March 2020, by investor (€ billion)



Source: ECB, ING-calculations

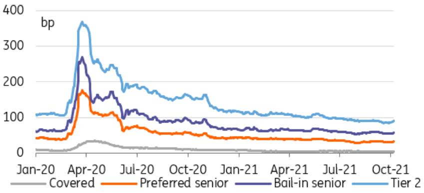
Data on other sovereign debt investor holdings only runs through the first quarter of 2021 (or June for banks), but suggests that the remainder of net issuance was acquired in roughly equal shares by non-eurozone investors and eurozone banks, while eurozone-based investment funds shed a comparable amount.

The dominant role of the Eurosystem in absorbing net government debt issuance stands in stark contrast to previous episodes of strong debt increases (e.g. 2009 and 2012), when net issuance was more evenly bought by the (central and commercial) banking system and non-bank investors. One takeaway for banks and other sovereign debt investors is that the debt issuance surge and the Eurosystem's purchase programmes have more or less cancelled each other out during the pandemic, which was instrumental in keeping sovereign financing conditions - and by extension - also credit and bank financing conditions in check.

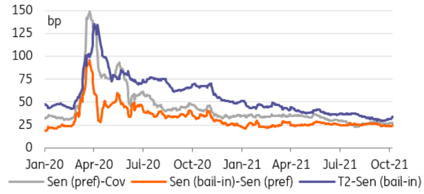
Going forward, central bank policy markers' discussions already suggest the Eurosystem won't be in the market anymore to invest like it has done over the past 18 months. Our economists' outlook points to net public sector purchases falling from just over €1tn this year to €330-450bn next year. With the European Commission forecasting government deficits to drop by half - and that is under benign assumptions from the current vantage point - it is clear that the balance is already starting to shift. Whether the mere possibility by the central bank to intervene will be enough to maintain financing conditions remains to be seen. Banks will be affected by changes in conditions as well, if not by direct holdings then by virtue of domicile.

Chart pack

Bank bond index performance

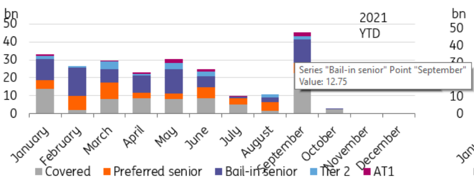


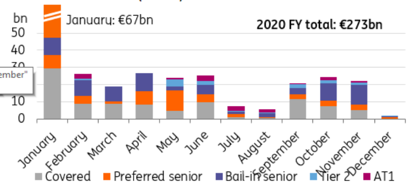
Relative performance of the indices



Source: Markit iBoxx, ING

Bank bond supply per debt category, 2021 YTD versus 2020 (€bn)*





*only includes public deals.Source: IGM, ING

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