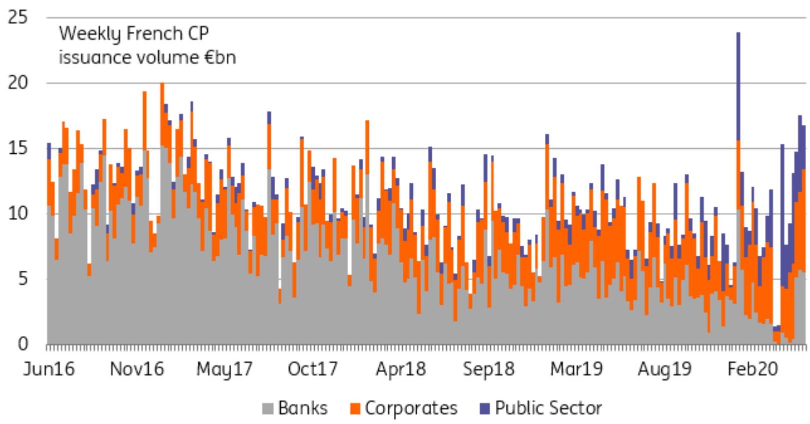
Commercial paper: from problem to solution

The French Commercial Paper (CP) volumes recovery continues, and with it recovers the health of financial markets. We see a more stable Euribor as a result, and more limited upside to future fixings. Other markets should reflect lower systemic risks, starting with Italy



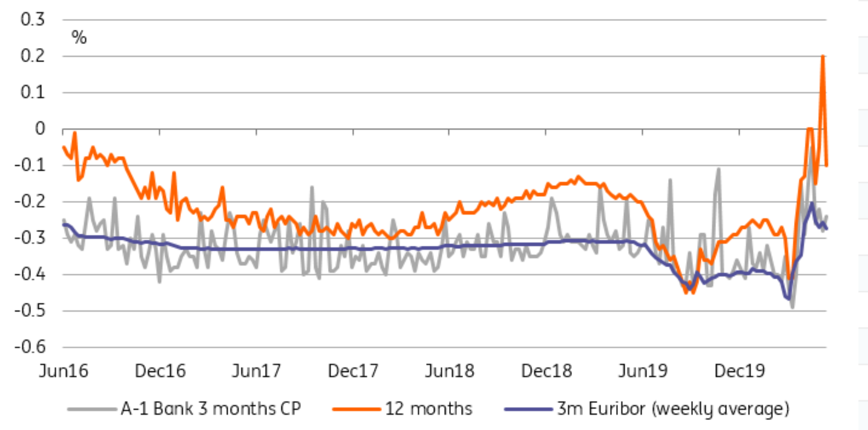
Source: BdF, ING

Record volumes in early May

Volumes issued on the French CP market and reported by the Banque de France (BdF) show what we have been expecting: CP went from being part of the problem to being part of the solution. Corporate issues in particular are a source of relief. Volumes issued in the week to 15 May totalled €7.9bn, the greatest tally since the series began in June 2016. This is good news for corporates themselves, but also for banks, as this frees up their balance sheet from short-term funding to corporates.

Bank CP issuance also recovered from virtually zero at the end of April to over €5bn in each of the two most recent weeks the data covers. This was the highest figure since January. On the face of it, increased borrowing from banks might seem paradoxical given the various facilities put in place by the ECB. CP offer a number of benefits to a bank's funding mix however, including diversification, flexibility and cost.

French CP rates have stabilised, along Euribor



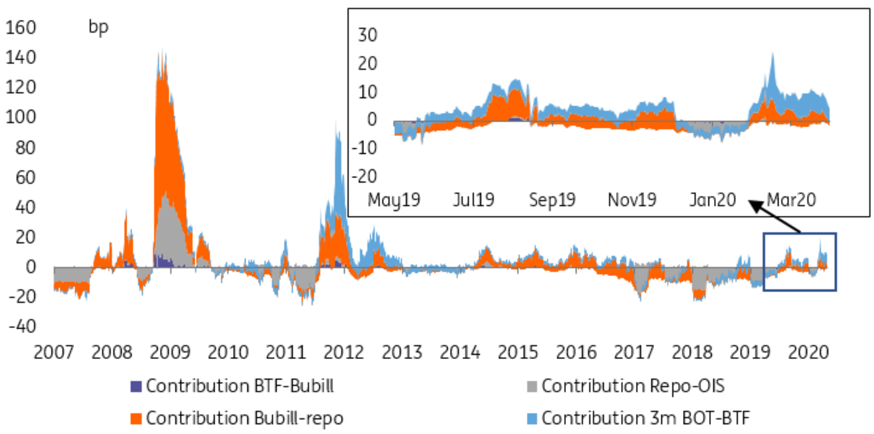
Source: BdF, ING

EUR rates: more reliable Euribor

The implication for EUR Rates markets are manifold. Firstly, a more active bank CP market means lower reliance on 'expert judgment' when making Euribor contributions. This is good for the fixing's stability but also limits its upside in our view. Volumes this year have clearly been directional: they increased when perception of bank risk was benign. Add to that, banks now have a wealth of options for their short-term funding, and we conclude that high CP volumes can only be high because this financing option is competitive.

Issuance rates of high-rated (A-1) financial CP tends to corroborate this view: the 3 month rates have stabilised around levels similar to the 3 month Euribor fixings. The spread between 3 month and 12 month issuance levels on the other hand is still fairly elevated. In the absence of any hike expectations, we think this still reflects a degree of caution in the market.

Euribor: a further decline in credit risk



Source: Bloomberg, ING

Overall, we add the better health of the CP market to the list of factors that justify an unwind of the risk premia baked in certain assets. EUR rates should remain stable due to central bank intervention and as hopes of further easing are building up. Riskier assets on the other hand, Italian bonds for instance, should continue their outperformance. Lower banking risk is a positive for Italy in particular, so is the prospect (if confirmed) of more QE, and cross-border fiscal transfers (EU recovery fund) however uncertain.