Five factors driving bank bond supply next year

2023 has been a very significant year for bank bond supply, but we don't expect supply to turn lower in 2024. Here are five factors driving issuance

1 At best sluggish lending volumes

The banking sector has felt the impact of a slowing economy and higher rates in 2023. Private sector lending has been sluggish, and lending books have declined to slightly below the levels seen at the end of the year, both for households and corporates. Consumer credit has held up better, offsetting part of the decline in loans for house purchases.

With the (very) limited economic growth pencilled in for 2024, we expect lending to remain subdued in 2024. This will set a cap on balance sheet growth and limit additional bank funding needs.

2 Less reliable deposit developments

Deposit balances have been more harshly hit than lending balances in 2023 in the eurozone, particularly in Italy, Spain and France. In 2024, alongside less impressive lending, we also expect deposits to remain under pressure.

Furthermore, higher interest rates continue to drive depositors into better yielding alternatives, reflected as an ongoing shift from current accounts into term deposits. More active depositors and more competition for deposits mean it is less straightforward for banks to rely increasingly on deposits for funding.

Eurozone banks have increased their share of deposit funding in the past couple of years, supported by the generally stable nature of deposits and their beneficial regulatory treatment. We would not take it for granted that this trend will continue as it has in the current environment.

3 End of the ECB funding support for banks

Bank funding needs are likely to remain substantially impacted by the runoff of European Central Bank funding. Another €450bn in Targeted Longer-Term Refinancing Operations mature in 2024.

A substantial share of the excess Liquidity Coverage Ratio liquidity buffers have already been exhausted. While there is still further headroom to absorb the additional impact, we see a higher risk for refinancing maturing LTROs, in particular for banks in Italy and Germany. Part of the refinancing is likely to continue to head to bond markets, subject to market circumstances remaining accommodative. We wrote about the LCR impact of the LTRO runoff here.

As the ECB is seeking to bring down the excess liquidity in the system, it would be highly controversial for it to offer banks the option to lengthen these drawings into a new longer-term refinancing operation, in our view. We do, however, expect part of these funds to end up being rolled over in the shorter operations including the three-month Longer-Term Refinancing Operations and Main Refinancing Operations. However, we think some stigma may be attached to this and as such, the bulk of banks would likely seek to find other sources of funding to replace their central bank drawings.

4 Bond redemptions remain broadly stable

Bank bond redemptions are set to remain broadly stable year-on-year in 2024 reaching just above €290bn. Of these, €121bn are in covered bonds, €145bn in senior debt and €27bn in bank subordinated paper.

The largest changes in redemptions are seen in bail-in senior debt, where redemptions could increase by €15bn YoY. Preferred senior debt maturities are seen c.€15bn lower YoY, and covered bonds could see lower redemptions of €5bn YoY. Subordinated debt redemptions could increase slightly YoY, driven by higher Tier 2 redemptions and calls and a stable amount of AT1 debt with first call dates in 2024.

5 Bail-in senior markets reach a more mature stage

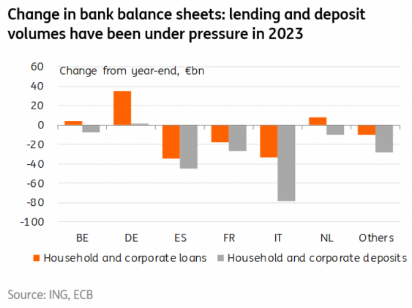
Bail-in senior issuance in 2024 will be driven by a combination of potential risk-weighted asset changes that may impact the total MREL (minimum requirement for own funds and eligible liabilities) eligible debt needs and redemptions.

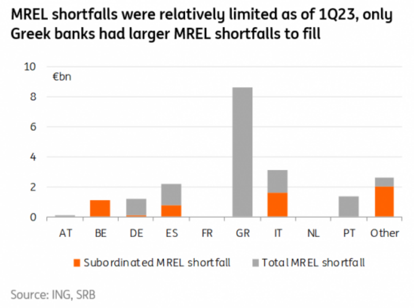
We see that the bail-in senior market is reaching a more mature stage. Larger banks are already meeting their loss absorption requirements.

While lending is likely to remain pressured, we expect that regulatory changes will continue to impact risk density and may push RWA higher.

On top of this, there are limited MREL shortfalls in smaller institutions. Banks in jurisdictions with a longer MREL transitioning time have some further work to do to meet their MREL requirements. Greek banks are among those that have some further work to do with another c.€8bn to meet their MREL requirements.

Balance sheet changes and MREL shortfalls as supply drivers





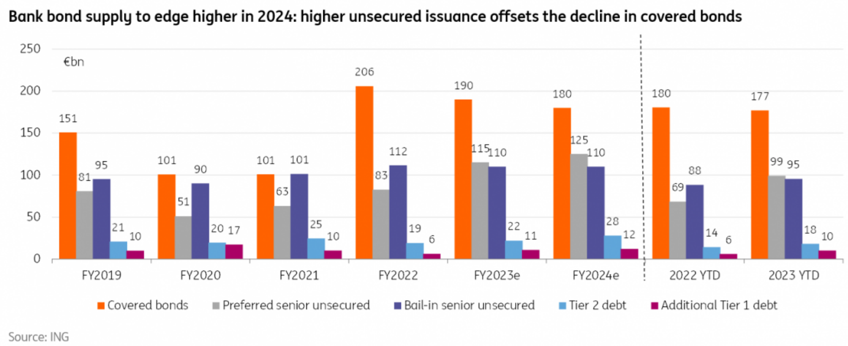
What to expect in terms of bank bond supply in 2024

We expect bank bond supply to remain high in 2024, reaching €455bn. And bank net supply remains elevated.

While the increase in the overall funding needs is perhaps limited by sluggish lending volumes, we don't expect the share of deposits to continue to head higher and banks will continue to refinance part of their maturing LTROs via the bond markets.

We expect the LTRO refinancing wave to result in heavier supply landing in the first quarter of 2024.

We expect unsecured bank bond supply to remain elevated in 2024, offsetting the impact from lower covered bond supply



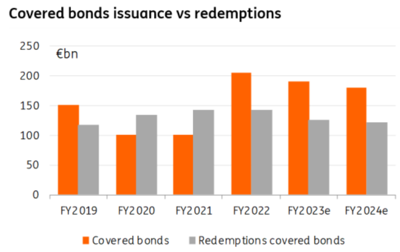
Senior unsecured supply to offset the slump in covered bonds in 2024

We forecast higher senior unsecured issuance to offset the slightly lower covered bond reading that we pencil in for 2024. Preferred senior debt issuance will likely remain solid at €125bn, while covered bond issuance will edge lower to €180bn. We think preferred senior debt and covered bonds will be the most fitting longer-maturity funding alternatives for banks seeking to refinance their LTROs.

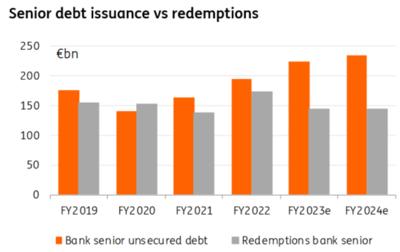
The share of bail-in senior to total senior issuance has declined year-to-date to 49% from 57% in 2022. The change has been driven by the substantial increase in preferred senior debt issuance. We expect the share of bail-in senior debt to total senior debt to slightly decrease further next year. We forecast bail-in senior supply to reach €110bn in 2024.

In 2023, banks have issued €194bn in senior debt of which €99bn was in preferred/OpCo debt and €95bn was in bail-in senior debt (NPS/HoldCo) on a year-to-date basis. The supply is running substantially ahead of last year at this time when senior issuance reached €157bn split between €69bn in preferred and €88bn in bail-in senior debt.

We expect covered and senior issuance to remain ahead of redemptions again in 2024



Source: ING, IGM



Source: ING, IGM

In bank capital, banks start to gear up for higher redemptions to come

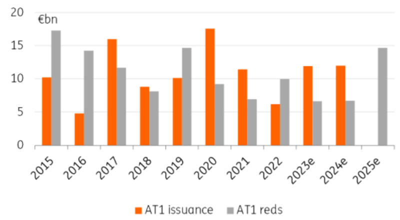
We forecast that 2024 should see solid bank capital supply. We forecast that bank capital issuance will reach €40bn in 2024 split between €12bn in AT1 and €28bn in T2. This is a step higher from 2023, for which we forecast €33bn total, with the YTD levels running currently at €29bn.

Redemptions will drive capital supply higher in 2024, in our view. Alongside the 2024 redemptions, we think issuers will be getting ready for the higher redemption burden approaching in 2025. Euro-denominated bank capital redemptions will increase by €3bn YoY to €27bn in 2024 and further to €43bn in 2025.

We believe that the timing of capital issuance is largely impacted by market conditions. If market conditions were to remain volatile, banks would be more likely to jump on any issuance window on a more proactive basis. If, instead, the market views of 2025 turn out to be more upbeat, banks may feel more comfortable waiting to refinance their early 2025 redemptions closer to the actual call dates. We think banks will generally seek to call their capital at the first call date instead of extending the notes.

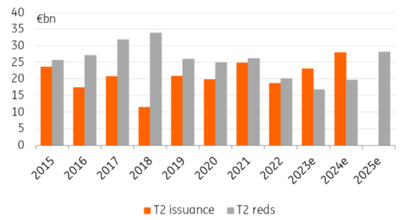
Bank capital issuance to remain ahead of redemptions in 2024

Euro-denominated AT1 issuance vs redemptions



Source: ING, IGM

Euro-denominated T2 issuance vs redemptions



Source: ING, IGM

In euro-denominated AT1, €5bn in (originally) benchmark size AT1 debt outstanding has the first call date in 2024. This includes c.€400m for the two deals that have been tendered in 2023 ahead of the 2024 calls. On top of this, €1.8bn in sub-benchmark debt is callable in 2024.

AT1 redemptions will substantially increase in 2025 to €15bn of which €12bn is in benchmark size. Part of the 1H25 calls may be refinanced already in 2024.

Redemptions will also increase in Tier 2 debt. A further €18bn is set to reach its first call date in 2024 in callable Tier 2 debt, of which €14bn is in benchmark size, while €1.9bn bullet T2 matures. T2 bullet redemptions increase to €10bn in 2025 and callable T2 repayments remain stable at €18bn in 2025. Due to the limited remaining capital recognition of outstanding bullet T2 debt one year prior to the maturity, these deals may be partly replaced by bail-in senior as here, regulatory capital recognition is likely less of a driver.

We forecast bank bond supply to reach €455bn in 2024

ING's bank bond issuance estimates

	FY2019	FY2020	FY2021	FY2022	FY2023e	FY2024e
Covered bonds	**151**	**101**	**101**	**206**	**190**	**180**
Covered redemptions	*118*	*134*	*143*	*143*	*126*	*121*
Bank senior unsecured debt	**176**	**141**	**164**	**194**	**225**	**235**
of which Preferred senior unsecured	81	51	63	83	115	125
or which Bail-in senior unsecured	95	90	101	112	110	110
Bank senior redemptions	*155*	*154*	*138*	*175*	*144*	*144*
Bank subordinated	**31**	**37**	**35**	**25**	**33**	**40**
of which Tier 2 debt	21	20	25	19	22	28
of which Additional Tier 1 debt	10	17	10	6	11	12
Bank capital redemptions	*41*	*34*	*33*	*31*	*24*	*27*
Total Unsecured bank bond supply	**207**	**178**	**199**	**220**	**258**	**275**
Total Bank bond supply	**358**	**278**	**300**	**426**	**448**	**455**

Source: ING

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