Recent developments in euro area bond markets

ECB Bond Market Contact Group
9 July 2013

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5 Key themes

(1) Fed tapering talk becomes main driver of asset valuations - and challenge for ECB

(2) Significant shift in EMU correlations

(3) ECB Liquidity fears add to higher € yields

(4) New issue performance turns sour, Portuguese and Slovenian yields reach highs for the year

(5) Confirmation of bail-in rules with limited spread impact
2 May: The turning point for outright markets

10y Bund yield in %

Source: Commerzbank Research
The anatomy of the sell-off: breakevens collapse, real yields surge

10y UST breakeven inflation and TIPS Jan22 real yield in %

Source: Commerzbank Research
Similar picture in Europe: Market pricing (global) monetary policy shift

German 10y breakeven inflation and DBR Apr23 real yield in %

25/26-June: Coeuré/Draghi say exit is "very distant"
Unwind of global carry trade across all asset classes

Nowhere to hide!
Selected Q2 performance since Bernanke testimony on 22 May in %

- Bunds*
- S&P 500
- US Treasuries*
- Periphery*
- Gold
- EMBI Global
- Shanghai Comp

But where is all the money going?
Q2 Fund flows since 22 May in % of AuM

- DM equity
- EU Bonds
- Money market
- US Bonds
- EM Equity
- Commodity
- EM Bonds

* Total performance in 7-10y bucket, Periphery is volume-weighted performance of Italy, Spain, Ireland, Portugal.
Source: EPFR, iBoxx, Commerzbank Research
From 3-speed EMU government bond market...

Performance correlation for iBoxx € Sovereign indices (7-10y maturities), February 2013

<table>
<thead>
<tr>
<th>Performance</th>
<th>DE</th>
<th>FI</th>
<th>NL</th>
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Source: Commerzbank Research, iBoxx
... towards ‘we’re all rates again!’

Performance correlation for iBoxx € Sovereign indices (7-10y maturities), June 2013

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Source: Commerzbank Research, iBoxx
Liquidity fears add to ‘passive monetary tightening’...
... as excess liquidity is evaporating

ECB outstanding open market operations and liquidity needs in € bn

Source: Commerzbank Research
New issue performance languishing

Total performance of peripheral euro area sovereign syndications this year in %

<table>
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<tr>
<th>Issue</th>
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Source: Commerzbank Research
Yields in high-yielders reach new highs

8-10y yields in %

Source: Commerzbank Research
Banking Union: Putting a vision into practice...

5y iTraxx Senior Financials and average 10y spread of Italy/Spain over Germany in bp

Barroso proposes Banking Union

Draghi's "whatever it takes"

Source: Commerzbank Research
Banking Union: Confirmation of bail-in rules with little spread impact

iBoxx senior financials and Lower Tier 2 asset swap spreads in bp

Source: iBoxx, Commerzbank Research
Discussion points

• Will the ECB’s forward guidance succeed in countering Fed-induced bearish spread widening in EMU sovereigns?
• How can market access be restored for Portugal?
• Banking Union agreements: “revolutionary”, “major step” or insufficient?
• Bund-Länder Anleihe: a template for European common issuance?
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Interest Rate Strategy