



EUROPEAN CENTRAL BANK

EUROSYSTEM

MONTHLY REPORT ON THE EUROSYSTEM'S COVERED BOND PURCHASE PROGRAMME

JULY 2009

On 6 July 2009 the Eurosystem, which comprises the European Central Bank (ECB) and the 16 national central banks of the euro area, commenced with the implementation of the covered bond purchase programme, under which it intended to purchase eligible covered bonds, with a targeted nominal amount of €60 billion.¹

In the period from 6 July 2009 to 31 July 2009, the Eurosystem purchased eligible covered bonds with a total nominal value of €5,085 million under this programme. Of this total, €1,867 million was accounted for by purchases in the primary market and the remaining €3,218 million by purchases in the secondary market.²

Overall, the covered bond market has revived, at least partially, since the announcement and implementation of the covered bond purchase programme.

Activity in the primary market had come close to a standstill since September 2008, while issuance of covered bonds increased significantly in May 2009, just after the Eurosystem announced its decision to purchase euro-denominated covered bonds. Since the announcement of the covered bond purchase programme, a number of covered bonds have been issued not only in the Spanish, French and German markets, but also in markets in which primary issuance had previously been rather limited, as in Portugal, the Netherlands and Italy. Moreover, several new covered bonds were inaugural issues, and the Eurosystem has generally participated in such issuance. All in all, the covered bond purchase programme has helped to revitalise the primary market for covered bonds.

In the secondary market, trading activity has begun to improve somewhat, but still remains

rather limited. Market makers report that investor interest in the market has been skewed to the buying side, in particular since the first announcement of the covered bond purchase programme in May 2009, while such interest had been more on the selling side prior to that date. Nevertheless, the range of bid-offer spreads remains larger than before the start of the financial market turbulence in August 2007.

Since the announcement of the covered bond purchase programme, covered bond spreads have narrowed significantly (see the chart below), reflecting increased investor demand for these instruments. Spreads of senior bank bonds without

- 1 Decision of the European Central Bank of 2 July 2009 on the implementation of the covered bond purchase programme (ECB/2009/16), http://www.ecb.europa.eu/ecb/legal/pdf/l_17520090704en00180019.pdf.
- 2 These figures include transactions concluded but not yet settled as at 31 July. The total amount of purchases settled on or before 31 July provided €4,233 million of liquidity in the money market in the context of the ECB's liquidity analysis.

iBoxx spreads against swaps

(basis points)



Source: Markit.

ECB

the security of a cover pool versus the comparable swap rate have also tightened, as did spreads of bank bonds with a government guarantee.

As regards pricing in the primary market, financial institutions have generally been able to issue their new covered bonds at the tighter end of the indicative spread ranges announced at the start of the pre-marketing period of new issues. In recent weeks, new issues of covered bonds have also tended to be oversubscribed. After issuance, the spreads of the new covered bonds have tightened by between 10 and 15 basis points (when comparing the covered bond spread in the secondary market with the spread at issuance). Also in the secondary market, most covered bond spreads have narrowed to differing degrees, depending on the issuer and the maturity.

NOTE TO EDITORS – GLOSSARY OF TECHNICAL TERMS AND EXPRESSIONS

Eligible covered bonds are covered bonds that fulfil the conditions specified in the Decision of the European Central Bank of 2 July 2009 on the implementation of the covered bond purchase programme (ECB/2009/16).

Inaugural covered bonds are the first covered bonds ever to be issued by an institution.

Covered bond spreads are the spreads between the yield of a covered bond and the rates quoted for euro interest rate swap contracts with a similar maturity date.

Interest rate swap is a contract between two parties to exchange one stream of interest payments for another, over a set period of time. The most commonly traded and most liquid interest rate swaps are contracts under which parties exchange fixed-rate payments for floating-rate payments based on the LIBOR or EURIBOR, the interest rate at which a prime bank is willing to lend short-term funds to another prime bank.

iBoxx indices are commonly used indices that track the movement of spreads in several

bond markets versus interest swap rates. They are compiled by a subsidiary of the financial information services company Markit. iBoxx Euro Covered index is an indicator of the difference in the yield on a basket of euro-denominated covered bonds and interest rate swaps with a similar maturity, while the iBoxx Euro Bank Senior index is an indicator of the difference in the yield on a basket of senior unsecured bank bonds and interest rate swaps with a similar maturity. iBoxx Euro Other Sub-Sovereigns Guaranteed Financials index is an indicator of the difference in the yield on a basket of euro-denominated bank bonds with a government guarantee and interest rate swaps with a similar maturity.

Bid-offer spread is the spread between the prices or yields at which a market maker is willing to buy or to sell a certain asset.

Senior unsecured bank bonds are bonds issued by a bank, which are not secured by a cover pool, but which have a prior or superior claim on the issuer's assets and income than the other junior bonds issued by the same entity.

Cover pool is a set of collateral on which the investor in a covered bond has a prior claim in the event of a failure of the issuer of the covered bond.

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