THEMATIC

2022 EGB supply vs ECB QE

We expect a further slowing of growth in Eurozone public debt in 2022, mirroring the 2021 trend vs. 2020 which saw a peak in net issuance, while EU bond supply is likely to remain close to the 2021 level. Lower public deficits, higher redemptions of maturing bonds, high cash reserves and NGEU funds flowing into some countries are all factors that underpin this trend. On the demand side, we expect the ECB to calibrate the level of QE accordingly, with volumes being reduced vs. the last two years, but still with the goal of absorbing the bulk of net public debt issuance; it should therefore continue to play a stronger role than other central banks in reducing impacts on rates and spreads on the domestic fixed income market.

Sergio BERTONCINI,
Senior Fixed Income Research Strategist

EMU-10 EGB and EU issuance: only a marginal proportion of supply remaining before year-end

As of mid-October, EMU-10 countries have made strong progress in covering their yearly funding needs, with most of the projected gross and net bond funding already placed. The total gross issuance amount so far is higher than EUR 1trn while issuance net of redemptions stands at EUR 510bn, respectively 84% and 90% of gross and net projected volumes for all of 2021. This means we can expect quite a fall in issuance in the short-term, with only 10% still remaining. Over the next two months, we expect the ECB to maintain overall monthly purchases of approximately EUR 90bn (EUR 70bn PEPP + EUR 20bn APP). Therefore, despite a moderate decline versus the previous two quarters, QE asset purchases should more than cover the remaining sovereign supply, ultimately meaning negative net supply post QE.

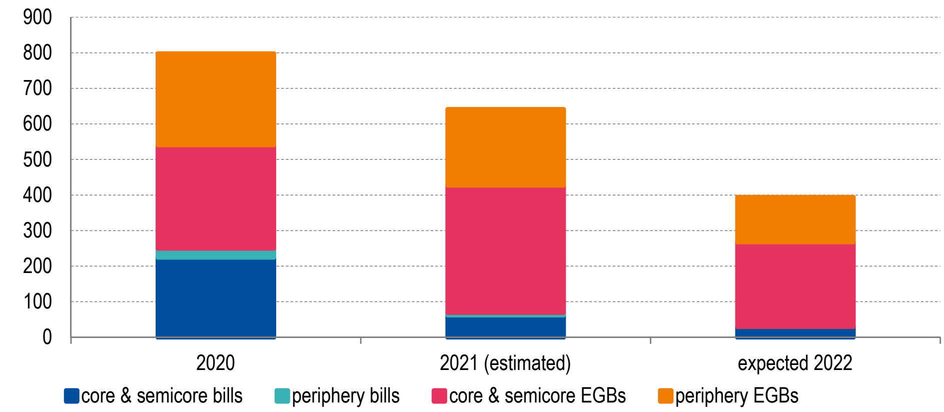
Furthermore, the risks on the remaining net supply for 2021 look tilted more to the downside, as:

1. The level of liquidity accumulated by Euro Area Treasuries is fairly high by comparison with historical standards (overall close to EUR 600bn vs. pre-Covid level in the region of EUR 250bn), and
2. The improved macro picture has led some countries to a -downward revision of this year's deficits versus initial projections (in some cases on the back of both lower-than-projected expenses and higher-than-expected tax revenues). Some countries, therefore, Germany for instance, have already announced a slight downward revision to their projected Q4 funding.

There has also been strong progress in EU issuance, as only a fraction of NGEU funding remains to be covered between now and the year-end, out of the EUR 80bn announced in June. The portion of funding that remains looks even lower if we consider that the NGEU issuance volumes are in addition to EUR 50bn EU SURE bonds issued in the first part of the year, and another EUR 11bn issued under other funding programmes. The EU, therefore, has already issued around 90% of the total volume of around EUR 140bn targeted for this year.

The level of liquidity accumulated by Euro Area Treasuries is fairly high by comparison with historical standards

1/ **EMU-10 debt net issuance (in € bn)**



Source: Bloomberg, Amundi Research, Data as of 22 October 2021

2022 supply: the big picture

With many of the draft budget plans for 2022 already published, we have started to assess the potential gross and net issuance of sovereign debt in 2022 and compared them with 2021 and 2020. In a nutshell, we can expect the slowing trend that started this year to continue also in 2022, mainly driven by the following factors:

1. Deficits are broadly expected to be lower, averaging roughly half of 2021 levels,

THEMATIC

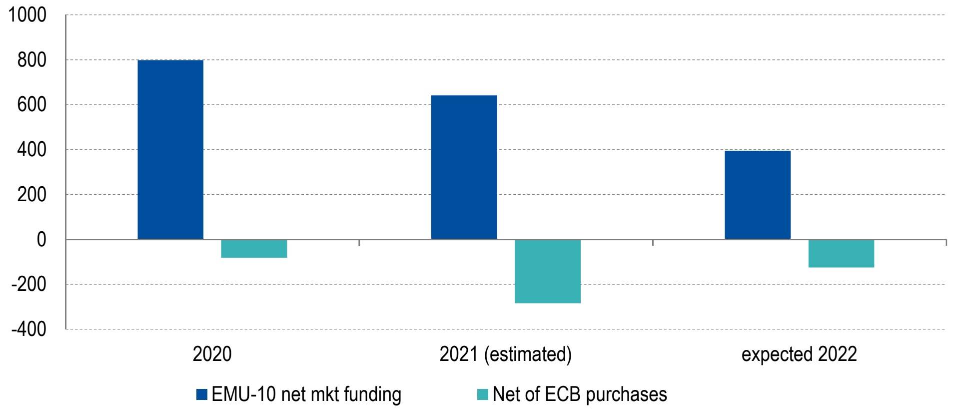
2. Redemptions of maturing debt are expected to increase versus 2021 in almost all countries (by more than EUR 80bn overall),
3. Record levels of accumulated cash are likely to support lower or negative net issuance of short-term instruments (bills), potentially lower EGB issuance too,
4. NGEU funds should play a supporting role in reducing the market funding needs of some countries.

Our projections for the EMU-10 countries point to overall net EGB issuance at roughly 65% of 2021 volume

More specifically, given the expected fall in deficits next year, we may see a switch from T-bills to bonds, i.e. negative net issuance of T-bills, feeding through to a higher component of bonds within the overall level of net funding. This should be the case especially for core countries, which strongly relied on higher net issuance of bills last year and to a lower extent this year. Eurozone Government cash reserves subsequently increased to high levels (overall close to EUR 600bn vs. a pre-Covid level in the region of EUR 250bn), boosted by treasury funding mainly through medium-long term securities, despite a lower trend in funding needs. Tax revenues which tended to surprise on the upside and expenditure failing to offset the increase in revenues also supported these trends. Netting mainly bills against high cash holdings would mean an overall negative net issuance of bills next year. However, bond issuance in 2022 may also see second-order benefits due to high cash buffers compared to projected negative short-term net debt. Another factor to be considered is the stronger potential role of NGEU funds in 2022: overall, NGEU funds of close to EUR 90bn are expected to flow into EU countries next year, ultimately contributing to greater funding flexibility. Italy looks like it will be in a better relative position as roughly 50% of the overall funds projected for next year should flow in its direction.

Our projections for the EMU-10 countries point to overall net EGB issuance at roughly 65% of 2021 volume, with net issuance expected to be lower than this year in all EMU-10 countries, although to varying degrees. Among periphery countries, net issuance looks likely to fall more significantly in the case of Italy, while among core and semi-core countries, it should fall more significantly in the case of the Netherlands, Austria, Belgium and Ireland. France should maintain a relatively high pace of MLT debt funding despite a lower deficit, while the current projections for German debt figures may be revised following the recent elections and in light of the expected formation of a new government. Contrasting with the EGB trend, we expect EU issuance to remain close to 2021 volumes in 2022 at around EUR 130-140bn, mainly to cover the expected NGEU funds that will flow into EU countries in 2022.

2/**A slowdown of total QE size to EUR 650bn area would more than cover for EMU-10 net issuance in 2022, too**



Source: Bloomberg, Amundi Research, Data as of 22 October 2021

What impact will the ECB's QE have on the demand side?

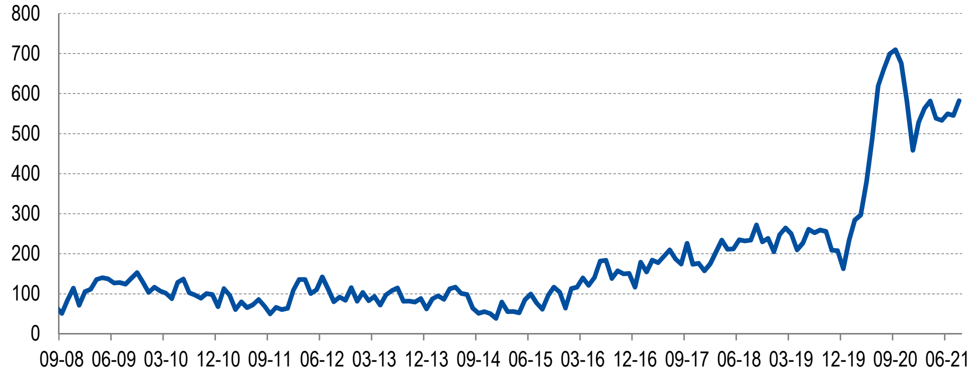
Both ECB Chief Economist Philip Lane and ECB President Christine Lagarde hinted that the net bond supply will influence the pace of APP

As we underlined in the September issue of the Cross Asset, the pace of QE in 2022 is likely to be a function of the outlook for inflation and net supply. Recently, both ECB Chief Economist Philip Lane and ECB President Christine Lagarde hinted that the net bond supply will influence the pace of APP. Philip Lane, in particular, was quite explicit in that regard: *"You cannot think about the volume of the APP independently of the volume of net bond supply. The relatively high fiscal deficits that we saw last year and this year will not be lasting in the coming years, but the scale of deficits may remain higher than the pre-pandemic levels."* From this perspective, at its December meeting the ECB will have more detailed information to hand on the expected supply in 2022 based on which to calibrate its purchases.

At their current monthly pace, PEPP purchases are expected to be close to EUR 70bn at the year-end, which would mean that roughly EUR 240bn would be available for Q1 2022, pointing to roughly EUR 480bn in overall QE firepower (together with APP of EUR 20bn at its current pace) for all of 2022. The option of the introduction of a new specific pandemic recovery programme seems to have

THEMATIC

3/**Euro Area Government deposits, in EUR bn**



Source: ECB, Amundi Research, Data as of August 2021

gathered pace recently as an alternative to simply doubling the APP envelope, in order to maximise flexibility. In a recent speech, for example, ECB GC member Francois Villeroy highlighted the benefits of flexibility of policy transmission, in particular flexibility across asset classes and among jurisdictions. In any case, both options (the introduction of a new programme or doubling of the APP size) would push 2022 QE firepower within a range of EUR 600bn and EUR 700bn. This seems more than enough to cover the estimated EUR 400bn of EMU-10 sovereign debt net issuance and roughly half of the estimated EU bond issuance, while also leaving roughly EUR 65bn available for private debt QE programmes (mainly supporting corporate bonds). Therefore, assuming a slowdown of ECB purchases, in this scenario net issuance after QE flows will remain slightly negative for the EMU-10 in 2022. This would make the ECB's supportive role stronger than that of the Fed in the US fixed income market, particularly as the Fed is likely to taper and end QE by mid-year, and even stronger still than that of the BoE, which is expected to start raising rates soon and put an end to its QE. With stimulus expected to continue, and together with more anchored rates thanks to the forward guidance, we expect the technicals of both rates and spread levels to be better in the Eurozone than in other jurisdictions.

Finalised on 22 October 2021

Amundi Research Center

Find out more about Amundi publications
research-center.amundi.com

Date of first use: 2nd November 2021.

Document issued by Amundi Asset Management, "société par actions simplifiée"- SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 – Head office: 90 boulevard Pasteur – 75015 Paris – France – 437 574 452 RCS Paris – www.amundi.com

Photo credit: ©MDelporte - iStock/Getty Images Plus - Andrew Ostrovsky

Chief editor
BLANQUÉ Pascal, *Group Chief Investment Officer*

Editor
DEFEND Monica, *Global Head of Research*

Deputy-Editors
BLANCHET Pierre, *Head of Investment Intelligence*
BOROWSKI Didier, *Head of Global Views*

Global Research contributors
AINOUZ Valentine, *Deputy Head of Developed Markets Strategy Research, CFA*
BERARDI Alessia, *Head of Emerging Macro and Strategy Research*
BERTONCINI Sergio, *Senior Fixed Income Research Strategist*
BLANCHET Pierre, *Head of Investment Intelligence*
BOROWSKI Didier, *Head of Global Views*
CESARINI Federico, *Head of DM FX, Cross Asset Research Strategist*
DI SILVIO Silvia, *Cross Asset Research Macro Strategist*
DROZDZIK Patryk, *Senior EM Macro Strategist*
GEORGES Delphine, *Senior Fixed Income Research Strategist*
HUANG Claire, *Senior EM Macro Strategist*
PERRIER Tristan, *Global Views*
PORTELLI Lorenzo, *Head of Cross Asset Research*
USARDI Annalisa, *Cross Asset Research Senior Macro Strategist*
VANIN Gregorio, *Cross Asset Research Analyst*
VARTANESYAN Sosi, *Senior Sovereign Analyst*

With the Amundi Insights Unit contribution
BERTINO Claudia, *Head of Amundi Investment Insights Unit*
CARULLA POL, *Amundi Investment Insights Unit*
FIOROT Laura, *Deputy Head of Amundi Investment Insights Unit*
DHINGRA Ujjwal, *Amundi Investment Insights Unit*
PANELLI Francesca, *Amundi Investment Insights Unit*

Conception & production
BERGER Pia, *Research*
PONCET Benoit, *Research*