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# Global SSA

## Special Report 2024

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Tabara Dia, a train driver on Senegal's first regional express train, which the African Development Bank mobilised capital to help build

Photo credit: AfDB

# GlobalCapital

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# The Global SSA Report 2024

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Last year six of the biggest multilateral development banks paid out between them \$89bn to their borrowers, for needs from keeping girls in school to providing clean energy and building roads.

That's a tidy sum, but set against the needs it is tiny — just \$13 of investment for each of the 6.8bn citizens in the developing world.

Progress in economic development is slow. The Covid pandemic raised the share of people living on less than \$2.15 a day — one definition of extreme poverty — to 9.3%. But even without that, it would only have come down from 11% in 2015 to about 8%.

When the world considers how to tackle problems like these, the multilateral development banks (MDBs) are front and centre.

Not mere channels for distributing aid, they can act as fulcrums. Their capital — and expertise — can be levered to produce benefits multiple times the outlay.

High on the wish list of every policymaker, in rich and poor countries, is “do more with the MDBs”.

The prize is not just what the banks could do, but what they could unlock in co-financing from the private sector.

“There are \$400tr of assets under management in the world,” says Alfonso Garcia Mora, vice-president for Europe, Latin America and the Caribbean of the International Finance Corp. “The gap to achieve the Sustainable Development Goals is \$4tr. If we could mobilise 1% of the AUM, it's a done deal.”

But for decades, that has stayed tantalisingly out of reach. The MDBs are growing, but can still only scratch the surface of development needs.

Wealthy countries are urged to stump up more money, but overseas aid does not win many votes. Caught in this impasse, donor governments are asking questions about the MDBs.

Are they trying hard enough — or are they complacent? Their balance sheets are the strongest of any banks in the world — do they really need to be so conservative? The financial world has produced a river of new ideas: why are the MDBs still basically just issuing triple-A rated senior bonds?

Such questions have swirled for years, but were codified into a clear agenda in 2022, with the

# No easy wins in development bank power-up

There has never been so much momentum to reform the multilateral development banks. But most of the many avenues to expand their lending have run into difficulties. **Jon Hay** reports

publication of a report on MDBs' Capital Adequacy Frameworks by an independent panel reporting to the G20.

The CAF report has won the backing of successive G20 presidents: Italy, Indonesia, India and this year, Brazil. “We decided to reinforce the debate within the G20 on what is the way forward on MDB reform,” says Ivan Oliveira, deputy secretary for sustainable development finance at Brazil's Ministry of Finance. “We are working on a roadmap for MDB reform. There should be a medium term agenda for the MDB system — where the G20 want it to go over three to five years, taking into account three pillars: capital, operations and impact assessment. There will be some specific deliverables we are going to be presenting in our presidency.”

One will be a template for MDBs to report their progress on implementing the CAF report recommendations.

## Right moment

The G20 presidency is engaging closely with the informal group of MDB chief executives. “Many of the banks were not very happy with the way the CAF review was made,” says Oliveira. “There was very little consultation with them. It's very important for countries to push them, but also to hear what they think is important. That could help them to implement reforms faster, while not losing the push. The banks have started to flex their muscles together, so their views can be taken into account.”

Crucially, the CAF report came when an internationalist,

pro-development Democratic administration was in power in the US.

Prodded by Janet Yellen, US treasury secretary, the MDBs, initially sceptical of the CAF proposals, have realised they need to act.

The African Development Bank, long at the forefront of financial innovation because of its need for capital, has been joined in experimenting by all the others, including the World Bank, which published in December 2022 its *Evolution Roadmap*, subsequently updated.

The CAF panel made five core recommendations: redefine the MDBs' risk appetite; incorporate callable capital into CAFs; use innovations to increase lending headroom; assess rating agencies' methodologies; and improve the governance of capital adequacy.

Implementation has been patchy at best, with little movement on some issues.

Nevertheless, there is enough going on to generate enormous noise in the MDB sector. For now, the issues attracting most attention are hybrid capital — one of the financial innovations the panel suggested — and callable capital.

Crucial, too, though outside the scope of the CAF report, is how the MDBs can lever in more co-lending from the private sector — something they have always tried to do, but which has never fulfilled its theoretical potential.

## Proof of the pudding

To describe hybrid capital as “easy” would sound bitterly ironic to those who worked for four years to bring about the African Development

Bank's inaugural \$750m issue on January 30 this year.

A world first, it required painstakingly winning over the board, shareholders and the three major rating agencies, none of which had fully developed criteria for MDB hybrids.

Nevertheless, of all the CAF recommendations, hybrids are one of the simplest to make progress with, because they can be bolted on to a bank's capital structure without requiring fundamental reform.

In principle, it ought to be a no-brainer that MDBs could raise extra capital by issuing subordinated debt to investors willing to take on some risk, without receiving voting rights.

Making this work in practice is much more difficult. But the AfDB and some smaller African development banks have succeeded in carving out a structure for MDBs that achieves 100% equity credit from Fitch, Moody's and S&P, as well as under IFRS accounting and the banks' own capital adequacy models. Investors will lose all their principal in the unlikely event that the issuing MDB has to call on its callable capital. This structure can be rated a mere three notches below senior debt.

This means that, as long as they can find investors, MDBs can now raise what is effectively equity at will — something they have never been able to do before.

The AfDB reckons it can do at least \$2 of lending for every extra \$1 of equity, and its actual balance sheet ratio is 2.2. This means the inaugural \$750m deal will support some \$1.65bn of loans it would not otherwise have been able to make — half as much as its total disbursements last year.

It took 18 months after the AfDB received board approval for the structure before it could line up everything to its satisfaction — above all, finding a market window in which it could launch the hybrid at a suitable price.

The sale was successful, landing the perpetual non-call 10.5 year bond rated AA- by S&P at a yield of 5.75% or 157.5bp over US Treasuries. The AfDB reckoned that was 134bp wider than it would have had to pay for a senior bond — within what *GlobalCapital* believes was its target range, of 100bp-150bp.

With a peak book of \$6bn from 275 investors and final allocation to 190 with \$5.1bn of orders, the deal

appeared to prove that investors existed for MDB hybrids at a viable price.

### Price pain

Four months on, that proof is not looking so certain. The hybrid has bounced up and down in the secondary market — more down than up.

The hybrid was originally priced at par. On June 6, Tradeweb displayed one quote for the bond from a named bank, BNP Paribas, at 95.25/96.00 for a size of \$1m, equivalent to a Treasury spread of 201bp/191bp.

"Nobody talks about it, but now there is zero market for an MDB hybrid," says one capital markets specialist. "It's totally illiquid and it's being marked even yield to a Citibank hybrid, which is six or seven notches [lower rated]. The deal got done, but it had nothing to do with hybrid investors. It was achieved by selling to hedge funds and momentum buyers during a month when anyone was buying anything that had duration."

The AfDB's book composition does lend some credence to the doubts. Some 55% of the bonds went to hedge funds and specialist credit funds. Without them, it would have been a very different deal — and they may not have bought it from a fundamental desire to be long-term holders of MDB capital.

Keith Werner, manager of capital markets and financial operations at the AfDB in Abidjan, says the hybrid's trading has experienced volatility, like other hybrids, partly because of interest rate moves. But although the AfDB hybrid has somewhat underperformed others, "This product is still in its infancy. There's only one deal, which does not make an asset class. When there is more issuance this should be conducive to further investor focus. Our trade was over six times oversubscribed. I don't think you get that sort of demand if investors don't think it's a viable asset class. So it seems to be more of a secondary market issue. When other issuers come into the market it should feed through and create a more effective secondary market."

A syndicate banker who worked on the deal agrees, adding that investors were used to considering extension risk on hybrids. He says a number of investors had been interested in the deal but did not want to buy the first one. And he says that although hybrid specialist investors would be "an important buyer base, the aim should be to develop traditional SSA investors to go further down the capital structure".

The only way to test this would be to bring another deal, but that is unlikely for some time.

It will be a while before the AfDB needs more capital. The World Bank and European Bank for Reconstruction and Development have both said they will bring pilot hybrid issues to the public market. But the EBRD has just had a general capital increase, while the World Bank does not want to pay up as much as the AfDB and is busy placing hybrids privately with its shareholders.

### Scepticism

Other MDBs are sceptical of publicly placed hybrids — as they were of the AfDB's groundbreaking \$1bn securitization in 2018 — fundamentally on grounds of price.

For commercial issuers, hybrid capital achieves an alchemy: it puts equity on the balance sheet, more cheaply than issuing real equity. But public sector development banks do not pay dividends. For them, equity from hybrids is more expensive than the ordinary kind.

That has two implications. If an MDB pays a spread on a hybrid, above that of senior debt, it must find this money from somewhere. On the AfDB's calculations, this was 134bp, on \$750m of debt, or \$10m a year.

The second implication is more insidious. Hybrids are perpetual, but investors price them on the assumption that the issuer will call them at the first opportunity. They accept there is some risk of a non-call, but regard this as slight.

In an unfavourable market, it might be cheaper for a commercial bank to let an old hybrid go uncalled than to call it and issue a new one.

*Continues on page 6*

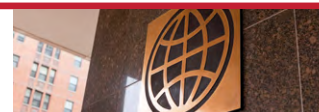
***"There are \$400tr of assets under management in the world. The gap to achieve the Sustainable Development Goals is \$4tr. If we could mobilise 1% of the AUM, it's a done deal"***

***Alfonso Garcia Mora, International Finance Corp***

# MDB capital by numbers

All money figures in \$bn  
Sources: MDB reports, *GlobalCapital* analysis, S&P

## World Bank (International Bank for Reconstruction and Development)



<b>Credit rating:</b> Aaa/AAA/AAA		<b>Debt issued in last financial year</b>	42.2
<b>Assets</b>		<b>Liabilities</b>	
Development finance investments	257	Borrowings	253
<i>Sovereign loans</i>	257	Derivatives	23
Liquid assets	77	Other liabilities	9.3
Derivatives	0.4	Other equity	8.6
Other	12.7	Usable equity	53.7
		<i>Usable paid-in capital</i>	21.2
		<i>Reserves and surplus</i>	32.4
	<u>347</u>		<u>347</u>
Development finance/equity ratio	4.7	Callable capital	301
Equity/development finance ratio	21.4%	Paid-in/subscribed capital ratio	6.7%
Disbursements in year to June 2023	25.5	S&P risk-adjusted capital ratio (Dec 2022)	25.9%
Non-performing loan ratio	0.6%	Debt/usable equity ratio	2.8

In 2023, the board approved cutting the policy equity to loans ratio from 20% to 19%. The actual ratio had declined from 22.8% in 2019 to 22% in 2022 and 2023. By March 2024, it had fallen to 21.4% as lending grew.

The board will remove the statutory lending limit, which caps lending at the sum of subscribed capital and reserves.

The IBRD has committed to issuing \$1bn of hybrid capital to investors as a pilot. In April seven European countries agreed to buy a total of \$1bn of private hybrids.

The US, Japan, France and Belgium have backed an innovative \$10.5bn Portfolio Guarantee Platform to absorb loan losses.

Figures as of March 2024 except where stated

## Asian Development Bank



<b>Credit rating:</b> Aaa/AAA/AAA		<b>Debt issued in last financial year</b>	28.9
<b>Assets</b>		<b>Liabilities</b>	
Development finance investments	153	Borrowings	150
<i>Loans (96% sovereign)</i>	151	Derivatives and other	96.4
<i>Other</i>	1.8	Equity	54.2
Liquid assets	48.9	<i>Paid-in capital</i>	7.2
Derivatives	96.6	<i>Reserves and surplus</i>	47
Other	3.2		
	<u>301</u>		<u>301</u>
Development finance/equity ratio	2.8	Callable capital	136
Equity/development finance ratio	35%	Paid-in/subscribed capital ratio	5%
Disbursements in last financial year	17.8	S&P risk-adjusted capital ratio (Jun 2023)	29.9%
Non-performing loan ratio	0.4%	RAC ratio required to retain AAA rating	23%
		Debt/equity ratio	2.8

The ADB gave itself large capital headroom in 2015 by merging its main balance sheet with its concessional financing arm, the Asian Development Fund. The main bank's equity tripled then to \$53bn and it remains at about the same level, making it arguably the best-capitalised of the major sovereign-facing MDBs.

The ADB has been active in exposure exchanges, with a pilot in 2021, a larger transaction with the IADB in 2022 and last year a \$1bn deal with the AfDB.

For some years, the ADB has also obtained insurance from commercial insurance companies on about a fifth of its private sector loan exposure, on a loan by loan basis.

Figures as of December 2023

## Inter-American Development Bank



<b>Credit rating:</b> Aaa/AAA/AAA		<b>Debt issued in last financial year</b>	18.8
<b>Assets</b>		<b>Liabilities</b>	
Development finance investments	116	Borrowings	108
<i>Loans (96% sovereign-guaranteed)</i>	115.4	Derivatives	3.3
<i>Debt securities</i>	0.8	Other liabilities	1.6
Liquid assets	32.7	Equity (risk capital)	38.8
Derivatives	0.1	<i>Paid-in capital</i>	11
Other	2.9	<i>Reserves and surplus</i>	27.8
	<u>152</u>		<u>152</u>
Development finance/equity ratio	3	Callable capital	164.9
Equity/development finance ratio	33%	Due to be paid-in/subscribed capital ratio	6.7%
Disbursements in 2023	11	S&P risk-adjusted capital ratio	21%
Non-performing loan ratio	1.7%	Debt/equity ratio	2.8

In 2015 the IADB signed with the African Development Bank and World Bank a triangular exposure exchange, in which each transferred \$4.5bn of sovereign loan risk to the other two, and took on \$4.5bn of their risk in return. By diversifying their exposure, this improved the capital ratios of all three, especially the AfDB and IADB. It enabled AfDB to do a year's worth of extra lending, about \$10bn.

The IADB and AfDB have developed a proposal for wealthy countries to use their Special Drawing Rights at the International Monetary Fund to invest in MDB hybrid capital. They are working on securing participation from countries.

Figures as of end of financial year in December 2023

## International Finance Corp

<b>Credit rating:</b> Aaa/AAA		<b>Debt issued in last financial year</b>	13.7
<b>Assets</b>		<b>Liabilities</b>	
Development finance investments	51.5	Borrowings	52.4
Loans (mainly private sector)	31.4	Derivatives and other	23
Equity	10.8	Equity	35
Debt securities (mainly private sector)	9.3	Paid-in capital	22.6
Liquid assets	47.5	Retained earnings	12.4
Derivatives	5.7		
Other	5.8		
	<u>111</u>		<u>111</u>
Development finance/equity ratio	1.5	Callable capital	N/A
Equity/development finance ratio	68%	Paid-in/subscribed capital ratio	94.5%
Disbursements in FY 2023	18.7	S&P risk-adjusted capital ratio	38.6%
Non-performing loan ratio	2.7%	Debt/equity ratio	1.5

Figures as of end of 2023 financial year in June 2023



The IFC is working with IBRD on capital adequacy, but is not keenly capital-constrained. It pioneered private sector co-financing in the 1950s with its A and B loan structure and more recently its Managed Co-Lending Portfolio Program. It now wants to double its co-financing ratio to 2.

In the early 2000s the IFC securitized and it is setting up a new securitization programme, which could begin issuing soon. It obtained \$500m of portfolio insurance on Indian banks in 2018 and regularly uses credit insurance, including recovering \$35m on a \$70m Chilean project finance default.

The IFC is stimulating cooperation with other World Bank Group entities and other MDBs.

## European Bank for Reconstruction and Development

<b>Credit rating:</b> Aaa/AAA		<b>Debt issued in last financial year</b>	10.6
<b>Assets</b>		<b>Liabilities</b>	
Development finance investments	42.8	Borrowings	49.9
Loans (75.4% non-sovereign)	36.4	Derivatives	5.5
Equity	6.4	Other	1.7
Liquid assets	31	Equity	24.6
Derivatives	6.1	Paid-in capital	6.8
Other	1.5	Reserves and retained earnings	17.8
	<u>81.6</u>		<u>81.6</u>
Development finance/equity ratio	1.7	Callable capital	26.0
Equity/development finance ratio	58.1%	Paid-in/subscribed capital ratio	20.8%
Disbursements in 2023	12.9	S&P risk-adjusted capital ratio (June 2023)	32.1%
Non-performing loan ratio	7.9%	Required capital/available capital	62%
		Debt/equity ratio	2

Figures as of end of financial year in December 2023. Bank reports in euros but figures converted to dollars



Shareholders agreed a €4bn paid-in capital increase for the EBRD in December 2023 to support its work in Ukraine, taking it to €10.2bn.

The EBRD has committed to a test hybrid capital issue in the market, but is in no hurry. It is strong on mobilising co-investment, with €26bn last year from €13bn of its own investments.

It has been thinking about whether it can lean more on callable capital, though it sees the difficulties: to make it have more value for the EBRD without any impact on governments would be “a bit to square the circle”, its president Odile Renaud-Basso said last year.

## African Development Bank

<b>Credit rating:</b> Aaa/AAA/AAA		<b>Debt issued in 2023</b>	7.0
<b>Assets</b>		<b>Liabilities</b>	
Development finance investments	28.4	Borrowings	32.3
Loans (95.4% sovereign)	27	Derivatives	3.5
Equity	1.4	Other liabilities	1.8
Liquid assets	19	Equity (risk capital)	13.2
Derivatives	1.2	Paid-in capital (actually paid-in, out of \$13.3bn due to be paid in)	8.5
Other	1.9	Reserves and surplus	4.7
	<u>50.8</u>		<u>50.8</u>
Development finance/equity ratio	2.2	Callable capital	185
Equity/development finance ratio	46%	Due to be paid-in/subscribed capital ratio	7%
Disbursements in 2022	3.2	S&P risk-adjusted capital ratio	27.9%
Non-performing loan ratio (June 2023)	2.5%	Risk capital utilisation rate	55.9%
		Usable capital (equity + \$67.7bn of callable capital from non-borrowing countries rated A- or above)	80.5

Figures as of end of financial year in December 2022 except where stated



Facing acute development needs, and 60% owned by African countries, the AfDB has long been innovating to make its capital go further. Capital constraints forced it to reduce its annual lending from \$10bn in 2018 to \$6bn in 2020 and 2021.

In 2018 the AfDB did the first public MDB securitization. Hedge fund Mariner, Africa 50 and the EU took mezzanine risk on \$1bn of loans. It also transferred \$500m of risk to insurance companies. Together, these deals on private sector risk freed capital for \$1.1bn of new loans. In 2023 the AfDB obtained protection on \$2bn of sovereign loans from insurers and the UK government.

In January 2024, the AfDB became the first major MDB to issue hybrid capital to commercial investors, for \$750m.

Continued from page 3

But it would probably still call the bond, to keep hybrid investors sweet.

Some believe an MDB could not do that. Obligated to guard every penny for the sake of its mission, it would have to take the cheaper option. For that reason, sceptics say, specialist hybrid investors will not trust the call dates on MDB hybrids and will demand more spread than they would even from a commercial bank, despite the MDBs' far higher ratings. Asked about this, the AfDB says it is "committed to the long term success of this instrument as a permanent part of our capital structure. While we can't comment on any decision in regard to calling the instrument, we can note that any decision taken closer to the time of the call will incorporate a variety of options, including calling the instrument, not calling the instrument or substituting the hybrid with an equivalent form of capital from our shareholders. Any decision would of course be governed by the best long-term interests of the Bank."

**Manageable cost**

Until the next deal comes, experts can only estimate its pricing. MDBs — and their shareholders — will have different views on an acceptable cost.

The World Bank lends only to sovereigns at deeply concessional rates — including to many middle income countries with large government bond programmes. They may be reluctant to see lending rates rise to cover the credit spreads on hybrids.

The African Development Bank's situation is different. From its main balance sheet, it lends to the 26 most creditworthy countries in Africa. For nearly all of these, MDB financing is the cheapest and most

attractive they can get. Having to pay a little more is probably insignificant, compared with the advantage of more lending capacity.

Omar Sefiani, the AfDB's treasurer, explained at a *GlobalCapital* event in February that even if the AfDB increased its hybrid issuance to the maximum allowed by the rating agencies, a third of its equity, this would only add single digits of basis points to the cost of its loans — which have a base spread of 80bp for sovereigns. And single digits is similar to the ordinary variability in senior funding spreads caused by market conditions.

Another argument is that the \$10m extra the AfDB will pay annually to issue a hybrid that lets it do \$1.65bn of additional lending, over an ordinary senior bond that finances \$750m of lending, would knock just 4.2% off its 2022 net income — ignoring the increase in revenue from the new loans — while enlarging its loan book by 5.8%.

Asked how the AfDB planned to pay for hybrids, Hassatou N'Sele, its chief financial officer, says: "We have a dedicated treasury investment portfolio which recoups a portion of the cost. The hybrid capital will also be complemented by a hybrid capital transaction for shareholders and [development partner] friends at below market costs, and complemented by short dated private placement transactions."

Since the hybrid, with its 10.5 years till it becomes callable, has quite a long duration, the AfDB can counterbalance this by issuing short dated senior debt, and hence reduce its funding cost.

Since reliable insight can only be gained from real deals, it is valuable that the World Bank and EBRD

have committed to issuing, even if they are in no hurry. But it is clear that although the MDB hybrid market has been opened, it is far from being established. We do not yet know if enough investors will buy hybrids tightly enough to make this a viable way of raising capital.

N'Sele remains confident, however: "The hybrid capital is not a one-off transaction, it's part of our funding toolkit. We plan to issue on a regular basis, and we have a structure to manage the cost."

**Friends and family**

In the field of MDB hybrids, most attention this year will go to placement with shareholders.

The World Bank announced in April that the UK, Denmark, Italy, Latvia, the Netherlands and Norway had joined the original investor, Germany, in agreeing to buy individual private placements of hybrid capital for a total of about \$1bn. Germany is putting in €305m, the UK £100m and the Netherlands about €50m.

Each dollar will support about \$8 of new lending over 10 years, if the country takes the coupon, pegged at the World Bank's senior debt cost, or \$10 if it forgoes the coupon.

Other MDBs including AfDB are also talking to their shareholders about private hybrid issues, but have not struck any deals yet.

Arguably still more promising is the World Bank's new Portfolio Guarantee Platform.

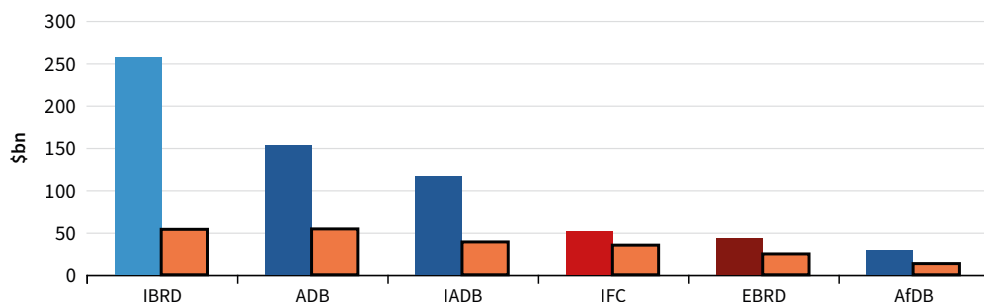
The US is contributing \$9bn, Japan \$1bn and France and Belgium about \$500m between them to collectively cover the World Bank against loan losses, wherever they might arise in its portfolio. This complete flexibility makes the guarantee exceptionally powerful — and the shareholders will ensure the World Bank receives timely payment of interest and principal. Until the \$10.5bn is exhausted, the World Bank cannot suffer loan losses as long as the countries honour their promises.

Losses at the Bank are minimal anyway, but the value of the guarantee is enabling it to lend more. So far, the Bank is counting on \$6 of extra loans for every \$1 of guarantee.

But that may come to be seen as too conservative. Unlike hybrids, the money is not paid in. But in other ways, the guarantee is superior. It could absorb loss in a near and realistic future, rather than the distant and bizarrely hypothetical

**Major multilateral development banks' development assets and equity**

● IBRD 100% sovereign ● ADB, IADB, AfDB c95% sovereign ● IFC c100% private sector  
● EBRD c75% private sector ● Equity



Source: *GlobalCapital* analysis of MDB reports



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Armageddon scenario when a hybrid might be written down. That makes it much more tangible and credible.

The lack of cash up front is also a great deal for the investors — one reason, perhaps, why the World Bank has managed to raise 10 times more of this kind of risk capacity so far, than of hybrids.

### Special liquidity

Another high hope is that shareholders will invest in hybrids using some of their Special Drawing Rights — the reserve asset issued to member central banks by the IMF. Rich countries have hundreds of billions of SDRs which they rarely use.

The AfDB and Inter-American Development Bank proposed in 2023 an arrangement to allow this, modelled on the IMF’s Poverty Reduction and Growth Trust and Resilience and Sustainability Trust. Those established the principle that SDRs can be used for development finance and still qualify as a reserve asset for central banks, as long as other central banks agree to provide liquidity to any participating country that suffers a balance of payments crisis.

Hybrids are more challenging, because unlike the PRGT and RST they combine elements of grant and loan, are permanent capital and involve money leaving the IMF.

However, the Fund’s board declared on May 10 that it would accept channelling into MDB hybrids, up to a maximum of 15bn SDRs (\$20bn), which it will later review. The Asian Development Bank is now working on the plan too and the World Bank is open to participating.

That does not mean central banks are willing to contribute. “To lend SDRs essentially means lending your reserves, and that has never been central banks’ mission,” says the capital markets expert. “Who is going to tell them that ‘you are going to lend it permanently to this new thing called development?’”

To allow SDRs invested in hybrids to still count as a reserve asset, at least five developed countries must agree together to invest, though they can each choose which MDBs’ hybrids to invest in. They must form among themselves a liquidity support agreement, so that if any country has balance of payments problems and needs to sell the hybrid, the others will buy it. Each country would agree to buy up to 25% of the largest contributor’s holding.

The European Central Bank forbids eurozone central banks to invest SDRs in MDB hybrids because it believes this would count as monetary financing, breaching its founding treaty. That knocks out a lot of the likely investors.

The US supports the idea, but has already assigned its SDRs to other purposes, including its Exchange Stabilisation Fund. The UK has recently said it cannot channel its SDRs, but it may in future be able to provide a sterling guarantee to the liquidity support agreement.

The AfDB and IADB have found a partial way round the ECB problem. “We have developed a second layer of liquidity, for countries bound by ECB rules to be able to participate,” says Max Magor Ndiaye, director of the syndication, co-financing and client solutions department at the AfDB in Abidjan. “They could participate in the liquidity support agreement by providing a guarantee, in case there are multiple balance of payments issues at participating investing countries. We have a commitment from France and strong interest from Spain and are working with them.”

This could help in securing Japan’s involvement, since it wants the panel of liquidity support providers to be eight countries. Brazil is also considering investing. Having obtained the IMF’s approval, the MDBs will soon re-engage with governments about it.

### Call for clarity

On paper, the biggest prize is callable capital — money shareholders have promised to contribute, should the MDBs ever be at risk of defaulting on debt.

Five of the six MDBs summarised in the infographic on the preceding pages — the World Bank, AfDB,

IADB, Asian Development Bank and EBRD — have between them \$813bn of callable capital, dwarfing their \$55bn of paid-in capital.

Yet callable capital is essentially left out of the internal capital models that govern how much the MDBs can borrow. The rating agencies give some credit to it, but much less than to paid-in capital.

The CAF panel, developing ideas put forward by one of its members, Chris Humphrey, an economist at the ETH Zurich university, argued that callable capital ought to be worth something. If even a modest share of it could be leveraged, it would support a huge expansion in lending.

The barrier was that neither the rating agencies, nor shareholders, nor even the MDBs themselves had a clear idea what callable capital really was. Even if one party thought it knew, it was not sure if its counterparties agreed.

The AfDB takes into account callable capital in one risk management ratio, but does not leverage it like capital. “We have a conservative and robust risk management framework,” says N’Sele. “We already use our paid-in capital to the fullest and cannot afford at this stage to introduce callable capital into our internal capital adequacy limits, unless credit rating agencies give more weight and consideration to callable capital in their rating criteria.”

The CAF panel urged the MDBs, shareholders and rating agencies to investigate callable capital and talk to each other about it. This recommendation is being carried out thoroughly.

On April 12, five MDBs published a coordinated set of reports, based partly on surveys of shareholder governments, about how callable capital worked at their institutions, what would have to happen for it to be called, and how shareholders would respond.

Shareholders and MDBs hope this new transparency will enable the rating agencies to reassess callable capital and give the MDBs more headroom to expand lending.

“We need to keep strong capital buffers to withstand shocks and play our countercyclical role when the need arises,” says N’Sele. “We cannot endorse at this stage the introduction of callable capital into our internal capital adequacy metrics. However, should the major credit rating agencies agree or recognise that the recent callable



Hassatou N’Sele, African Development Bank: “The hybrid capital is not a one-off transaction”

capital analysis, conducted by multilateral development banks and their shareholders, strengthens MDB capital positions, we will follow suit.”

### Unreliable allies

However, anyone banking on a substantial expansion in MDBs’ balance sheets resulting from the rating agencies rethinking how they treat callable capital is likely to be disappointed.

As Moody’s, S&P and Fitch told *GlobalCapital* after the five MDBs published their reports, they found them interesting, but the new information largely confirmed their existing impressions.

On May 30 Moody’s gave its considered reaction. It said the disclosures on how much callable capital would be likely to be available to the MDBs quickly if needed had strengthened its view of shareholder support for those banks.

As a result, it had decided to give these five MDBs a higher score for contractual support from members. This forms 25% of Moody’s assessment of member support, along with 25% for non-contractual support and 50% for ability to support.

Moody’s has raised this score for those MDBs to the same higher level already enjoyed by the European Stability Mechanism.

Established in 2012 to act as a lender of last resort to eurozone countries, the ESM deals with a very real risk of serious, large defaults. It therefore has strong arrangements for member governments to supply callable capital quickly and securely.

Both Moody’s and S&P regard the ESM’s callable capital as superior to that of most other MDBs.

Moody’s also considers the Nordic Investment Bank and a couple of smaller supranationals to merit this high score for ‘strong enforcement mechanisms’ on callable capital.

However, while this change will improve the five MDBs’ rating metrics, and does provide some more protection against a weakening of other credit metrics, Moody’s has already given them the maximum grade for member support of ‘very high’. That earns them a potential uplift of three rating notches, meaning they could be rated as low as Aa3 on the basis of their intrinsic financial strength, and still be rated Aaa.

As things stand, they have not gained any extra room to weaken

their intrinsic financial strength through more leverage, as a result of Moody’s reassessment.

Fitch gave its response on April 24, and was rather less impressed than Moody’s. Reminding market participants that it already counts 10% of callable capital from highly rated shareholders in its assessment of MDBs’ standalone credit profiles — which the other agencies do not — Fitch nevertheless pointed out: “the bulk of callable capital has not been appropriated and most shareholder countries would need to go through budgetary processes to approve funds for disbursement. This could take time and adds political uncertainty.”

Having considered all the issues, Fitch will not be changing its assessment of callable capital.

Oliveira at the Brazilian Ministry of Finance supports exploring how to use callable capital more fully. But he sees it as just one among many tools. Brazil wants to propose giving each MDB a regular capital review to establish its needs and how they could be met, including from a capital increase.

In fact, some MDBs are moving to rely less on callable capital.

N’Sele points out that in 2010, 28% of the AfDB’s capital was from shareholders rated triple-A. Now it is 10%. “Although our shareholders approved last week in Nairobi a general callable capital increase of \$117bn, we cannot continue to rely on a shrinking pool of triple-A countries,” she says. “We have been working on our standalone credit profile, to mitigate that risk.”

The basic problem is that callable capital is a claim on governments, which are not 100% reliable, to hand over money in circumstances when an MDB was failing.

Considering that MDBs are some of the strongest institutions in the world, rated better than nearly all governments, and very conservatively managed, any such circumstances would be likely to be dire. Even governments that are well rated now might be ailing.

And if they could afford to pay, would they be willing to? In the age of Donald Trump and Vladimir Putin, it is hard to rely on governments to honour their international obligations.

### Make it better

Three possibilities emerge, all of which depend on shareholders — since only they can make callable capital more reliable.



Supporting small, women-led businesses is one of the top priorities for MDBs

One is to make callable capital more robust. More countries could seek parliamentary pre-approval to disburse it. They could earmark the money in government accounts and restate their commitments. But ultimately, the MDBs would still have to trust whatever politicians were in power at some unspecified stressful time in the future.

A second is to develop a new, more useful instrument. MDBs have begun working on this, calling it ‘enhanced’ callable capital. “We have to work more on producing things that are more similar to, or improvements to, the callable capital the ESM has,” says a person familiar with the talks.

Introducing a new kind of callable capital that could be drawn, with strong reliability, at a much earlier stage of distress — even as mild as a danger of losing triple-A ratings — could be a powerful support to the MDBs’ credit quality.

Oliveira expects the banks to present their enhanced callable capital ideas to shareholders. “Some banks are desperately trying to do something new,” he says. “They like to push the shareholders to create some contingent reserves that would represent at least partially the callable capital of the bank.”

The third possibility is for shareholders to forget about callable capital and support MDBs in other ways.

One obvious example is the World Bank’s Portfolio Guarantee Platform — which after all, in essence, is callable capital, supplied by a small knot of willing shareholders.

“In most countries, MDBs are not the superheroes that are going to solve all problems,” says Oliveira. “What we need is to use strategically all the [methods] to deliver impact.” GC

# Santander CIB guides issuers across currencies and continents



Towards the end of 2023, Santander CIB identified that the dollar market would grow increasingly attractive for issuers heading into the new year. Pandemic emergency purchase programme (PEPP) reinvestments were being phased out in Europe, and SSA issuance euro supply was increasingly abundant. Dollar supply, meanwhile, was becoming comparatively scarce. Although in early 2024, the US Quarterly Refinancing Announcement provided an additional \$41bn in dollar supply, Santander CIB saw that the Federal Reserve's quantitative tightening would pull some \$30bn out of the market — keeping the relative scarcity of USD assets intact.

“We were early in highlighting the attractiveness of USD levels to issuers as demand from overseas was evident from our conversations going into the end of 2023,” says Ignacio Bas, European head of SSA debt capital markets, Santander CIB said: “This helped to drive key conversations with the SSA borrowers and materialise on deals early in the year.”

Santander CIB was confident that increased dollar issuance would be well absorbed, and highlighted to issuers the deep pockets of dollar demand across the globe from Asia to the sovereign wealth funds in the Nordic and the Middle East region. “Investors have continually favoured dollar assets, especially in a market priced for perfection with no hard landing in sight in which dollar bonds can act as a risk off hedge,” says Ali Nauman, executive director, SSA debt capital markets, Santander.

Not only have the favourable dollar funding conditions that Santander first identified been maintained — they have improved. The Federal Reserve became more tactical with regards to its balance sheet policy, slowing the pace of its quantitative tightening programme by lowering the cap of Treasury bond reinvestments from \$60bn to \$25bn. A monthly redemption cap on agency debt and agency mortgage-backed securities has been kept at \$35bn, and the Fed has reinvested any principal payments in excess of the \$35bn cap into Treasury securities.

Santander sees these dynamics helping keep the dollar market relatively attractive to borrowers for the foreseeable future. Even if the US economic outlook moves

Major shifts in monetary policy and market conditions have created funding opportunities for sovereign, supranational and agency (SSA) issuers, and there is no bank more skilled at devising optimal execution strategy than Santander Corporate & Investment Banking (Santander CIB).

towards a muddle-through scenario or even economic slowdown, dollar demand for SSAs is likely to hold. But if the economic outlook is unlikely to threaten dollar supply, the shifting political landscape might. Nauman says a pick-up in term premia due to the fiscal debate taking place ahead of the US elections could be the main risk for dollar funding going ahead. “But for as long as this does not materialise, we continue to expect USD funding to be increasingly attractive,” he says.

No matter how the market evolves, there is no bank better placed to guide borrowers through potential market changes. Santander CIB has built a well-deserved reputation for steering borrowers through different markets with intelligence and insight. “Having a strong presence in the LatAm region, for example, we have been close to many issuers in helping identify opportunities and diversify their investor base and currency mix,” says Bas.

## Sterling front-loaded

Santander's expertise has also been on display in the sterling market, where the main driving factor has been the strong appetite from investors seeking a pick-up on carry and to lock in yields before the much-anticipated rate cutting cycle. SSA issuers front loaded sterling supply in 2024 as investors sought to deploy over £10bn of redemptions from December, which Nauman notes amounted to £28bn of gross gilt issuance and £5bn of gilt coupons.

“When looking towards GBP, the cliff of redemptions towards the end of last year was a key event we highlighted quite early on,” he says. “With the cross-currency working, we were quick to help issuers in accessing the market and print record size transactions in the currency.”

Long a major force in the sterling space, Santander CIB has been busy as usual in the primary market in 2024. The year began with the firm's first mandate from the World

Bank in that currency. Santander CIB has continued to bring a string of impressive sterling deals this year, helping issuers make strategic use of the tap market. “This has been key for issuers taking advantage of when the cross currency has worked for both sides of the trade,” says Nauman.

So far in 2024, a major change has been the tilt away from the conventional UK government bond pricing towards the Sterling Overnight Index Average (SONIA) following a significant cheapening of asset swaps in the latter half of 2023. A dynamic that Bas notes has been well received by domestic bank treasury buyers.

## All eyes on EU

So far this year, SSA supply in euros is also progressing well. Nauman points to the multi-year highs for asset swap levels, which have been helpful in attracting diversified pools of demand. “That includes new investors like peripheral real money accounts and foreign investors that had not been active in size in the SSA market, at least not on a structural basis,” he says. “The combination of healthy supply numbers with diversified demand has produced a remarkable pick-up in the secondary market liquidity and a much clearer price discovery amongst market makers.”

As the first half of the year draws to a close, the larger SSA issuers have already completed close to 60% of their expected euro funding for the year. All eyes are now on the European Commission, which is finalising its funding plan for the second half of 2024. But Bas says the dynamics should continue to provide a solid platform for issuance in the coming months. “The amount of net supply in euros continues to be very positive and we are expecting the ECB's quantitative tightening operations to run at full speed,” he says. “We will be there to help borrowers take advantage of conditions and bring the best deal possible.”

# Client-centric strategy helps supercharge growth



## How has Santander's SSA franchise grown over the years?

Santander has been present in the local SSA sector since our investment banking and market activities first began. Just over three years ago, we took the decision to expand our SSA offering to clients outside of our home markets. We have complemented that offering with a full suite of services across trading, sales, research, syndicate, DCM and more in order to become a global partner to clients in the SSA market.

That has led to significant growth for Santander Corporate & Investment Banking (Santander CIB) in a short period of time, marked by an expanding portfolio of high-profile SSA issuers and successful bond mandates. We have steadily increased our market share by continuously adapting to the evolving landscape and enhancing our product suite. The success of our transactions has allowed us to increase our client footprint, while our dedication to the development of long-term relationships has ensured repeat business from existing issuers.

## How would you characterise the firm's success in the SSA space and what factors have contributed to this success?

Our role in many landmark deals and rising place in industry rankings and awards reflects our status as an emerging force in the SSA bond markets. The

Santander's success in broadening its SSA business has been nothing short of exceptional. A major force in the local market for years, the bank has rapidly evolved into a global SSA powerhouse. *GlobalCapital* spoke to **Ali Nauman**, executive director, SSA DCM, about the firm's winning strategy, its approach to building relationships and its ambitions for the future.

numbers speak for themselves here. When we started our SSA expansion strategy we were 23rd in the league table rankings, with 22 deals executed and €5.3bn placed. We are now a top 20 house, finishing last year at 18th position with 35 deals executed and €12.1bn. We've had a strong start to 2024 and our aim is to finish in the top 15.

In addition to improving our league table figures, we are expanding our client footprint and coverage. Wider market dynamics, including the pandemic and the creation of the EU NextGen programme, have increased the funding needs among key SSA issuers. This has generated an opportunity for newcomers and with the right set up already in place to grow and gain market share.

## What strategies do you use to build and maintain strong relationships with SSA issuers?

Santander CIB has always been a client-centric bank, which means that we put our customers at the centre and provide bespoke solutions. Our team has prioritised personal and proactive

client engagement, which requires a deep understanding of clients' needs and strategic goals. I am a true believer in the importance of open communication that helps clients feel supported and well informed about market conditions and opportunities. Our team's emphasis on reliability and excellence in deal execution has given us a strong track record built on trust and credibility.

## What are Santander CIB's ambitions for the franchise in the years to come?

We are here for the long run, with a full commitment to the SSA sector. Strong organic growth will help make sure the SSA franchise is aligned with the bank's objectives.

## What are the key challenges and opportunities the bank expects to face?

As we grow, I see greater opportunities for Santander CIB to offer its wide range of expertise to a larger selection of clients, thus solidifying long lasting and meaningful relationships. SSAs is a very well-banked space, but we have found our feet and established a reputation for using our natural strength to create solutions for clients.

I am excited about Santander's growth in the US and our ambitions for more business with a bigger profile. Another key topic has been around technological advancements. Santander is already a leader in technological evolution, and we are proud to have helped issuers on their journey into the world of digital bonds.

Looking at market challenges, the first things I would mention are interest rates and inflationary pressures. Then there is always geopolitical uncertainty and economic volatility, although in the last few years we have seen the market navigate these challenges quite well.



Ali Nauman

# ‘Big leap forward’ needed to propel EU to safe asset status

For those hoping that the EU, with its swollen borrowing programme since the pandemic, could become a common European safe asset, the wait may take a little longer as the issuer works to establish itself as a sovereign-like entity and the bloc struggles to make progress on Capital Markets Union. **Addison Gong** reports

When Jean-Claude Juncker, then-president-elect of the European Commission, brought forward the idea of a Capital Markets Union (CMU) for the EU in July 2014, there was widespread excitement at the prospect of a single market for capital for the bloc within five years.

Developing a European capital market was not a new concept. It had existed for nearly half a century, if not longer. Still, Juncker – and the Commission officially in 2015 – painted an attractive picture of lowering both the costs of capital raising and Europe’s dependence on bank funding by making it a more attractive place to invest.

A decade on — and five years past the Commission’s initial target of putting in place a “well-functioning and integrated” Union — CMU remains a concept.

“Despite a number of valuable endeavours promoted by the European Commission over the past decade, the CMU initiative has been less than a game changer so far,” says Nicolas Véron, the French economist and founder of Brussels think tank, Bruegel.

Some believe that the lack of a common safe asset was one of the key hurdles to speeding up the development of the CMU.

Among the big hindrances to achieving CMU, Fabio Panetta, former member of the European Central Bank’s executive board and now Bank of Italy governor, has highlighted “two critical blind spots” of which the most important was the lack of an EU safe asset.

“Establishing such a permanent European safe asset would be a game changer, but it hinges on Europe having a standing fiscal capacity with a borrowing function,” he said in an ECB blog post published in August last year — nearly three years after the Commission adopted a new CMU action plan in September 2020. “Without that, building a deep and competitive CMU will prove much more difficult.”

## Growing presence

The EU has contenders to be a safe asset — German Bunds, or the bonds of its supranational institutions such as the European Investment Bank, European Financial Stability Facility, or the European Stability Mechanism.

Bonds from these issuers carry top credit ratings and are liquid, fitting into the commonly recognised characteristics of creditworthiness, robustness and liquidity for safe assets.

More recently, the EU itself has begun to issue roughly €150bn a year as it raises money to help member states recover from the pandemic. Given the borrower’s intent to be seen as a sovereign issuer, this also puts it into consideration to be the bloc’s safe asset.

Outstanding bonds from the four EU-wide issuers hit €1tr earlier this year.

The significance of a European safe asset would be in helping the continent achieve a securities market akin to one with the frictionless uniformity of the US.

A standardised, common safe asset is one of the most important elements in effectively creating a common market for debt securities

in Europe. It would reduce fragmentation while giving the market an instrument by which to price risk via a straightforward benchmark and hedging instrument, argues Bryan Pascoe, chief executive of the International Capital Markets Association.

However, the reality is that the EU would need to get the agreement of 27 member states, with their history of centuries of diverse national traditions and laws that have been developed to serve particular purposes. The structural, legal and political complexity of creating a simple, consistent market makes achieving it a distant prospect.

## EU to the rescue?

Previous ideas around creating a safe asset have involved complicated processes of tranching and pooling liabilities, in some cases creating securitised assets, such as sovereign bond-backed securities. That has created a political debate over such debt mutualisation

## EU syndicated benchmarks average subscription ratio



Source: GlobalCapital’s Primary Market Monitor

## Top 10 SSA issuers by volume, excluding auctions 2019-2023

Rank	2019	2020	2021	2022	2023
1	KfW	World Bank	European Union	European Union	KfW
2	EIB	Italy	KfW	KfW	European Union
3	World Bank	Australia	Italy	EIB	World Bank
4	Italy	EIB	World Bank	Italy	EIB
5	Canada Mortgage & Housing Corp	KfW	UK	World Bank	Italy
6	Province of Ontario	UK	EIB	Cades	UK
7	Spain	Spain	Cades	Asian Development Bank	Spain
8	Asian Development Bank	European Union	Province of Ontario	Spain	Canada Mortgage & Housing Corp
9	North Rhine Westphalia	Province of Ontario	Spain	Canada Mortgage & Housing Corp	Asian Development Bank
10	UK	Canada Mortgage & Housing Corp	Canada Mortgage & Housing Corp	UK	Cades
243	European Union				

Source: Dealogic

But the EU's rise as a jumbo issuer may offer a more straightforward solution. It was a small issuer with just €50bn of issuance under its belt in 2019 but by the end of this year, outstanding EU bonds will hit €500bn, and €1tr by 2026.

Defining the EU as an issuer had never been a problem before its debt load ballooned. While the bloc has a degree of sovereignty, it is not a sovereign in and of itself. But considering it a supranational issuer throws up other problems in the context of the bond market in that it has now outgrown all of its supranational peers.

That has led some market participants to resort to the word 'hybrid' when trying to classify the EU, while the issuer itself is lobbying hard to be considered a sovereign borrower, which extends to being included in government bond indices.

"The EU is pushing for it like you wouldn't believe," said a senior public sector bond originator. "To me, they are not a sovereign. But they will get that status anyway."

The EU says its institutional structure is not like that of a typical supranational, and the EU bond market has some of the characteristics of a large, liquid European government bond market.

"It makes sense from a market perspective," says a Commission

official. "In terms of its legal nature, the EU is not a sovereign and has no ambition to become one. But that doesn't necessarily mean it is an issuer that belongs to the [supranational and agency] market."

The volume of outstanding bonds "just don't fit in the SSA market anymore", the official adds. The European Commission calculates that the EU's weight in SSA indices will reach 60%-70% by 2026, therefore creating concentration risk, compared to 5%-10% if it were to be included in govie indices.

The EU has adopted other sovereign-type behaviours in the bond markets, from the way it communicates its issuance plans, the transparency with which it acts in the market, its primary dealer network and the use of both auctions and syndications.

It has also taken various steps to increase liquidity in its bonds, including the launch of its price quoting arrangements at the start of this year, and implementing a repo facility later this year.

The issuer also argues that its legal nature varies significantly from that of a typical supranational or agency issuer: it has a budget-based financial structure — instead of pooled or committed capital — and is ultimately backed by the bloc's taxpayers. It has certain elements of sovereignty, transferred to

it by the member states by treaty, as well as legislative and judicial power, alongside a common currency adopted by 20 member states.

"All of these distinguish us from a typical SSA issuer and bring us closer to the government bond market," says the official.

### Pecking order

That EU bonds require no mutualisation of national debts, as per previous schemes to create a safe asset, could circumvent objections to national governments taking on the liabilities of other member states.

But market participants highlight several obstacles that will keep EU bonds from being recognised and treated as the European safe asset.

Although MSCI and ICE have launched consultations about including EU bonds in their sovereign bond indices, they were still not included, when this *GlobalCapital* special report went to press in June. And although the volume of EU bonds has swelled in recent years, it is still small compared to major eurozone sovereigns. Germany had €1.85tr of outstanding sovereign securities as of the end of April, according to the Finanzagentur. France had €2.17tr of medium and long term debt outstanding, according to the Agence France Trésor, as of the end of May.

Another concern is whether the EU will sustain this level of issuance. The NextGenerationEU programme that most of its bond issuance funds is intended to run until 2026. The bonds are expected to be repaid by 2058. The debt raised for its pandemic unemployment relief programme is slated to be repaid six years earlier than that. That contrasts with sovereign bond issuance, which is indefinite.

There are fears that this will impact liquidity in the view of passive and active investors and will limit the size of their investment in EU bonds. Investors would be discouraged from treating the debt as a permanent part of their portfolios when developing long-term strategies.

“I don’t think that the EU bonds can realistically play the role of the longed for European safe asset,” admits a chief economist in Europe.

To be able to do so, the EU would need to issue in greater volumes than it is authorised to. “And it would probably have to be made permanent,” he adds. “As it stands now, its borrowings will have to be unwound by the late 2050s. And if for political reasons — such as joint defence investments — its borrowing perimeter were to increase by multiples, the top-notch rating may well be at risk.

“That aside, I do not see the widespread political support to significantly enlarge the borrowing envelope of the EU but of course, that could change.”

**‘One of many’**

The chief economist is not alone in his scepticism. One senior SSA bond banker says it is “very difficult to imagine” EU bonds developing a similar status in euros to that

which Treasuries enjoy in the dollar market. However, he thinks the EU’s claims are not without merit. “Given the size of what the EU has issued and will continue to issue, they are already one of the safe assets,” he adds.

While “many important, small steps” have been taken, he says, substantial progress needs to take place and some question marks to be removed before the EU can serve as the bloc’s common safe asset. “At least one big leap forward will be required to give it some additional impetus,” he adds.

For now the EU is “one of many safe assets”, adds the SSA banker. “And without a doubt, having another European safe asset is helpful for the European market, and there is certainly the potential of the euro market becoming more attractive as a place for global central banks to park their reserves.”

In any case, it is not as if the eurozone’s capital markets do not function even after going through the 2008 financial crisis, the subsequent sovereign debt crisis and then the pandemic. Bonds from the EU — now a large and liquid issuer — are “a nice complement” says the Commission official.

“This diversified market also offers a lot of possibilities,” he says. “Investors have opportunities to invest in each government name, or in the EU as a whole, through EU bonds.”

**Enthusiasm**

But for all the Commission’s coyness, other market participants are more strident in their opinion that EU bond issuance at current volumes could become a permanent fixture. When asked whether he thinks it

politically viable to have such levels of EU bond issuance permanently, one senior European public sector funding official not at the EU replies: “Of course we can. We are heading in the right direction with the CMU, and we simply need it in order to be more performant as an economy, especially compared to other strong parts of the world like the US and China.

“We need to be more aggregated at the European level, and issuing bonds at the European level was the first step. Having them integrated in global sovereign indices is probably next. But we also need to have more coordinated political decisions at the European level, in order to fund there.”

There is certainly no shortage of demand for the bonds. The average subscription ratio for an EU benchmark syndication is 11.6 times the deal size since 2022, according to data from *GlobalCapital’s Primary Market Monitor*.

“What we need is politically for the European level to step up to have an agreement and make big decisions,” says the funding official. “And of course, there are challenges and it’ll depend on discussions at the highest level, but we absolutely can make the EU a permanent funding programme.”

The senior SSA banker admits that it is hard to imagine that member states issuers will want the EU to become a single treasury for all of them but he does not discount the possibility that one day it will.

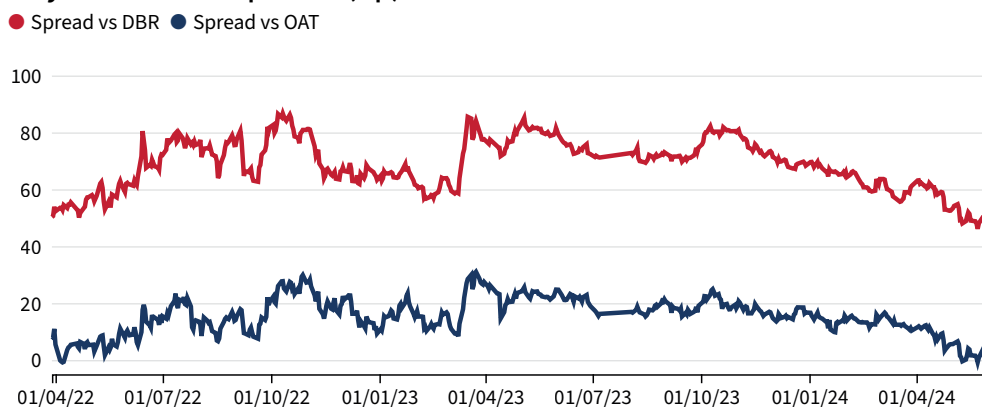
But while the EU’s fragmentation is indeed a hurdle to achieving a genuine single capital market, it is also what makes it unique. “Investors have the choice between direct country exposure or to buy EU debt,” says the SSA banker, “which gives you a much broader exposure to the whole region.”

But that may not last and nor may current thinking about what counts as a safe asset.

“In the global context, we are on the cusp of a seismic shift,” says Katie Kelly, senior director for market practice and regulatory policy at the Icm. “The geopolitical situations and the developments of fintech and AI are affecting the world and what might look like a safe asset today may not be a safe asset in the next two to three decades.

“There needs to be a lot of flexibility and adaptability on what is and what eventually becomes designated as a safe asset.” GC

**10 year EU bond spreads (bp)**



Source: Tradeweb

# Supras learn to change in changing world

Multilateral development banks find themselves swept up in two parallel waves of change.

As bond issuers, they are having to deftly navigate capital markets that are still emerging from the end of years of historically low rates, being forced to call upon all their experience and sophistication as they fund across multiple markets.

At the same time, with the pressure on to fill the huge gap in global development finance, these institutions are being asked to work out how to better use or expand their balance sheets and lend more — all while maintaining their precious credit ratings.

*GlobalCapital* gathered some of the leading supranational issuers at a roundtable in New York City in May to discuss how best to deal with the challenges of this changing world.



## Roundtable participants



**Yuri Kuroki**, head of funding, Americas, IFC

**David Bai**, treasurer, Bank of China (New York)

**Ali Nauman**, executive director, SSA debt capital markets, Santander

**Andrea Dore**, global head of funding, World Bank

**Eusebio Garre**, head of funding, IDB Invest

**Ignacio Bas**, European head of SSA debt capital markets, Santander

*Moderator:* **Oliver West**, US bureau chief, *GlobalCapital*

**Darren Stipe**, head of funding, Asian Infrastructure Investment Bank (AIIB)

### SHARING (WINDOWS) IS CARING

**Oliver West, *GlobalCapital*:** The World Bank issued \$9.5bn in the first week of the year and has continued to issue at pace. Andrea, how have you responded to the changing patterns of demand in the primary market as well as competing supply in your core markets?

**Andrea Dore, World Bank:** While some things have changed, a lot has not. Despite the changing patterns of demand and competing supply the market remains robust. We had a fantastic start to this calendar year. You pointed to the fact that we raised \$9bn in just a week, which is the largest amount we've ever done in such a short period since Covid, when we raised \$15bn across 10 days.

So far this fiscal year [July to June] we have raised nearly \$50bn; we issued \$19bn in the first half of our fiscal year and \$30bn in the first four months of this calendar year.

We continue to have the same global challenges, and now fewer issuance windows. Issuance programmes have increased across the board. And amid the volatility, investors are very focused on economic releases and certain data that wouldn't have made a difference before. Now simple announcements can impact the market.

We have learnt to adapt to the changing environment. Change is constant in this market, so we need to live with it and be very

focused and agile. This has meant a tremendous amount of work staying engaged with investors and being in tune so we can react quickly. The recent Sofr trade that we did came after a reverse enquiry, and we gathered over \$2bn of interest.

Those windows are not there very long so you don't have the luxury to say you'll wait. If we see a good window, we can be sure that many of my peers are seeing the same thing.

There has been a lot of discussion around the rates cycle, which has driven a lot of changes in the enquiries we get. Just this week we issued an inflation-linked bond — our first for six years — and we've seen demand for different products. The market backdrop is challenging but we've got comfortable with the level of volatility and the changing investor demand provides an opportunity for us to continue to innovate.

***GlobalCapital*:** Darren, does what Andrea is saying ring true? Do you have to be as nimble as ever?

**Darren Stipe, AIIB:** We do have to be nimble. It's really hard to find a window. Andrea used the word comfortable; I guess we've got more comfortable as well, out of necessity, with the notion of competing supply. Often I find that waiting doesn't resolve the issue.

Issuers have crowded their funding into the early part of the year, so there's always someone in the market. It's better, when you see your window, to go ahead and take it.

When I say more comfortable, I'd clarify that we've gone from exceptional anxiety over competing supply to now just regular anxiety over competing supply. We still would love to have a clear window for ourselves and that's what we look for.

We have responded by pulling forward our funding programme like everybody else. But that's less to do with supply: it's our view that the overall backdrop and picture for the second half of the year is a lot cloudier than today's. When markets are clearly supportive, we'd rather transact in the first half of the year than wait for conditions in the second half of the year that are not clear at all.

After our euro trade [priced on May 16, the day after the roundtable], we will be done with larger benchmark trades this year, and it's because our confidence in the conditions in the second half of the year is murky.

***GlobalCapital*:** Is that just about continued rates uncertainty, or the US election?

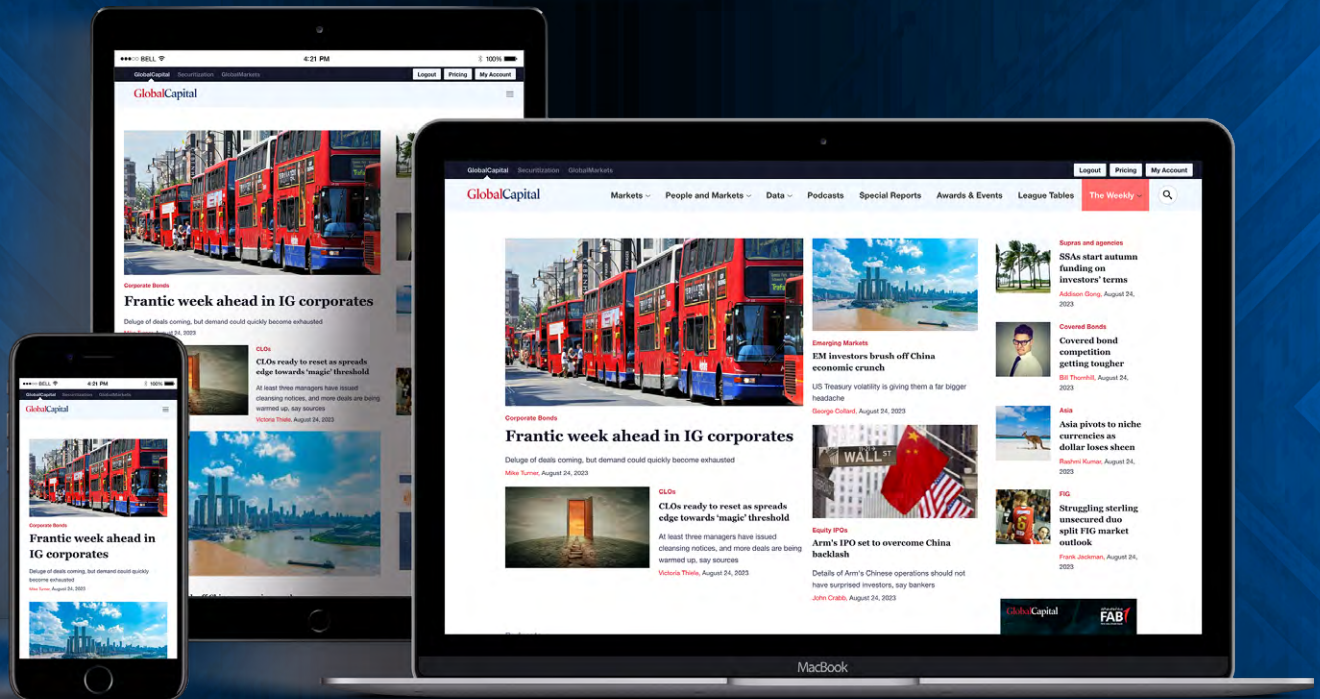
**Stipe, AIIB:** So many variables and factors are leading to our view.

**Ignacio Bas, Santander:** I'd add that we started 2024 with uncertainty over possible rate cuts by both the Fed and ECB, but as in any year there was front loading from issuers, and we know that up to 60% of funding is already done.

As Andrea said, uncertainty is still here and there have been changes in the timings of the ECB's and the

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Fed's moves. Now it looks like the ECB is going to cut next month but we don't know for sure. It looks like the Fed will be late but there are US elections, which is a difficult combination.

At the beginning of the year, there was a clear pattern from investors trying to lock in yields. The next stage should be June when there'll be a clearer view from the ECB and potentially the Fed; let's see how the second half of the year is.

**Ali Nauman, Santander:** I genuinely believe that this summer will be busier than recent years. With the US elections coming, and though a lot of people don't like to say it's driving their thought process, something like 60% or 70% of the world's population is going to be at the polls across various countries this year.

With that in mind, this summer we could see an uptick.

**GlobalCapital:** How do you advise your clients on navigating these shorter windows? Is increased sensitivity to data a permanent shift?

**Bas, Santander:** We have a very elaborate calendar! It shows all the data releases, which come every two days, central bank meetings, which are every two weeks, and then the EU in the market, which is every month.

Then we try to find execution windows in the US, sterling or euro market that are not impacted. But we are living in a world of uncertainty, which means a world of specific windows. And when you see a window, everyone sees the window. It's about trying to manage the traffic and not being out at the same time as competing supply.

Yesterday we saw something that I wasn't expecting: the European Union did a 30-year transaction on the same day Italy executed a 15-year. The results were okay but usually everyone tries to avoid the EU; Italy was brave in that sense.

**Dore, World Bank:** It's interesting because although we've seen corporates issuing at the same time before, it's new for SSAs to do it. Generally, the euro market had the depth to absorb multiple trades at the same time, but dollars did not. Now there's been a change in that trend, with two or three SSA trades at the same time in dollars — and in size. Either the markets always had that depth and we had just assumed wrongly — or were afraid to approach the market in that way — or there's just a lot more liquidity now and it can absorb those multiple trades.

**Bas, Santander:** Yes, there has been a shift from euros to dollars this year. The euro market this year has not been so deep for SSAs.

**Eusebio Garre, IDB Invest:** To Andrea's point, when I joined the SSA sector 10 years ago, it seemed critical to find your own window, to issue when no other multilateral development bank was in the market. This year proved the dollar market has a lot of depth, and I have wondered whether we were all too risk-averse that we don't want to have anyone issuing alongside us, while other sectors, like corporates or financials, regularly issue multiple multi-billion trades in parallel on the same day. Our investor base is different and there are reasons not to translate that dynamic to SSAs, but our market has clearly proven it has the depth for multiple issuers.

Our perspective at IDB Invest is obviously going to be different from the World Bank's because having an annual funding programme of around \$3bn means we can wait for a window we like.

For us it has been especially important, as for everyone here, to be nimble and to stay in touch with dealers and investors to find the right window.

We saw this in January. Like everyone else, we were ready to go from the beginning of the year on.

We usually wait at least two weeks to let the "elephants" go first, to tread the path and observe carefully the spreads, new issue premiums, and subscription levels. Usually there's a moment of respite after the big issuers are done, but this year the stream of new issues didn't seem to stop. We were running against the lunar new year break, and eventually found a window just ahead of that to print a fantastic five-year benchmark. Being patient was critical for the success of that deal.

## NIMBLE ISSUERS, NIMBLE INVESTORS

**Yuri Kuroki, IFC:** It's also that investors are open to considering deals at times when we used to think they were in vacation mode. This was evident for our last dollar global. As we have a July to June calendar and a modest programme of \$10bn-\$14bn, we had the luxury of looking at the market ahead of issuance rush in January — even in November, after Thanksgiving, when everyone was advising us that the market was already closed and that investors were closing their books.

As we didn't need jumbo size, we thought that if the market was conducive, there could be an opportunity. We went into the market with a dollar benchmark initially targeting just \$1bn but were surprised to receive the IFC's biggest order book of nearly \$7bn and ended up upsizing to \$1.5bn. We'd listened to investors and did have a sense some were still open. There may have been a shift on the investor side too to remain open longer and nimble to have more options.

**GlobalCapital:** David, would you agree that you have to take every day as a potential issuance day?

**David Bai, Bank of China:** I'm flexible. But I'm mostly driven by US regulation. The FDIC only accepts supranationals such as the IBRD, Asian Development Bank, IADB and African Development Bank, so whenever we have a bond mature, we look at the primary market, like last week, when we bought the World Bank's \$150m Sofr deal.

**Nauman, Santander:** Another thing that shows the depth and liquidity is that 75% of what has been issued this

*"Compared to before the financial crisis, central banks' balance sheets are not smaller today. The question is what will happen when those balance sheets fall in size, if they do"*

Eusebio Garre, IDB Invest



year is three to five years, yet every deal that comes is oversubscribed or breaking some record.

**Garre, IDB Invest:** Our job is to manage uncertainty. For several years issuers were spoilt because central banks flooded the system with liquidity, and we didn't even know what interest rate risk was because rates were at zero and spreads went tighter and tighter for a very long time. Now central banks are reversing quantitative easing, and it feels like 'oh my God, there's a lot of uncertainty', but there has always been uncertainty if you look back beyond the QE era.

That's something we and investors are getting used to again — that you don't know what's going to happen tomorrow, and you cannot just assume that rates and spread are going to be fairly stable unless something big happens. Now every month there are multiple events that could trigger volatility, making windows shorter and less frequent. That's the new reality, but there is nothing revolutionary about it: it's just the normal course of markets. Previously we had rates and spreads that were too low for the risk for a very, very long time.

The liquidity is still there. Compared to before the financial crisis, central banks' balance sheets are not really smaller today. The question is what will happen when those balance sheets fall in size, if they do.

**Dore, World Bank:** There is a lot of liquidity in the system. We did our first dollar trade of this calendar year at a time when some important key jurisdictions in Asia were closed. So, the traditional elements that define available issuance windows are changing. I can't recall being able to do a \$5bn trade while some key investors are out.

This shows the depth of liquidity in the market and the diversification of the investor base, and that there's less reliance on a handful of investors. In the past it would have been unheard of to even think of doing the trade — and if you did, you would not come up with a \$5bn to \$10bn order book.

We're seeing new investors coming in — not just to IDA, which is a relatively new issuer, but also for IBRD.

[Issuers and investors being more flexible] is interesting. It may

*"There's no such thing as a perfect window; we don't have a choice but to utilise more efficiently all available potential windows"*

**Andrea Dore, World Bank**



have been risk aversion: we are very risk-averse, thinking we need all of the i's dotted and t's crossed and the perfect issuance window. But there's no such thing as a perfect window; we don't have a choice but to utilise more efficiently all available potential windows.

**GlobalCapital:** Where's this new demand coming from and what's driving it?

**Nauman, Santander:** We've seen pockets of demand shoot up where they never existed. We've seen investors looking at SSAs and where the rates are, and making sense of it, bringing in new portfolio managers. Across sterling we've seen this a lot, and in dollars we've started to see it more too. We are speaking to so many more investors and are starting to see this happen globally, not just in the US. In euros, I don't think there are that many new investors, though I could be wrong.

**Bas, Santander:** In euros, there are no new investors, but there are investors that were not buying this kind of product before. A good example is the increase of demand for SSAs in Spain. In the past, for different reasons, they would just buy domestic products — mainly Spain, the Spanish regions, and the domestic banks — but they're starting to buy some new names, including World Bank, the EU, EIB, and KfW.

So there's nothing new but there are pockets that were not taking a look at certain names and now, with all this liquidity, have a need to diversify on the issuer side.

**GlobalCapital:** Darren, are you finding a greater diversity of investor?

**Stipe, AIIB:** Once again, I identify with Andrea's point about what can happen if certain segments of our

investor base are off for whatever reason at any given point in time. We've deliberately started to pay a little bit more attention to smaller accounts who might place orders in the \$10m area.

They're meaningful to us because if I can develop a broad investor base among 10 Iberian accounts that can place \$10m orders, for example, that offsets one large \$100m order that might not be there for me. That's starting to matter more and more as different parts of the world are on or off.

We completed an Iberian roadshow in early May, leveraging on the idea that was just mentioned, and are seeing more orders from that part of Europe — whether in dollars or euros.

**GlobalCapital:** There's been this big shift in the dollar market, but has euros been equally as strong and deep this year?

**Bas, Santander:** The euro market is very strong. But it needs to accommodate the supras and agencies alongside the sovereigns because there is a full set of European sovereigns issuing super big sizes — more than €1tr of funding in euros per year just from Italy, Spain, Germany and France.

It takes us back to the first topic, that the euro market used to be deeper than the dollar market for supras but that has changed a bit. Something we mentioned last year but need to bring back to the table is that we have a new issuer in the EU, which is issuing €150bn in net supply per year, plus lower liquidity after the QE of the ECB.

There is a specific area of liquidity that is driven by sovereigns, and obviously if you are able to buy an SSA with a certain spread versus a sovereign, what are you going to buy as an investor? The most important thing for supras is that they're

offering the same liquidity at a better rating. You offer relative value.

Dollars is different because there aren't many sovereigns issuing in dollars, so the only alternative for investors buying triple-A rated paper in dollars is the supras, which gives some arbitrage versus euros.

## SPREAD THE LOVE

**GlobalCapital:** Are there any concerns about spreads, especially between larger and smaller issuers? **Eusebio,** are you happy with the spreads that the market is offering you and do you feel like the premium you pay versus bigger issuers is fair?

**Garre, IDB Invest:** Any funding officer who is happy with what they're paying is not worth their salt. You always want to pay less because in your view, your name is always better than what the market perceives. Joking aside, I see the spreads we pay above larger issuers as an opportunity. For us, the spread we pay shows investors that they can buy a high-quality asset with a portfolio behaviour that is very similar to sovereigns. It adds very little risk to their portfolio and essentially adds alpha without having to go crazy with complicated quantitative models. That's the appeal, that's why paying a spread makes sense.

We feel that the spread we pay versus the larger more liquid names has been compressing, and we expect that to continue as our capital base and funding programme grow. Also, our investor base keeps growing, which should support the tightening going forward.

**Bas, Santander:** Although funding officers obviously look at spreads because of secondaries and comparables, you really should be focused on your yield too.

Ultimately this is your real cost of funding. In a relative value comparison, it is true that we are now at 4% or 5% having come from zero and every funding officer wants to pay zero, but we aren't back to 10% or 12% like in the 90s. In the global relative value context of the cycle, the absolute yields and funding costs are not that bad.

**Garre, IDB Invest:** As most banks do, we basically pass through the interest rate. If interest rates are high, then we pass that on to our clients and that's accepted so it's not a risk for us. It's also true that as spreads widen for us, they tend to widen too for the corporates, which is our client base. We lend to private sector corporates and financial institutions etc. So as much as I love to fight over the right initial price thoughts for the next trade, we are very used to managing higher funding spreads by passing them on to clients. That's not a concern, it's the reality of our work.

**Kuroki, IFC:** It may be true that larger, liquid names tend to benefit from tighter spreads, but we still think rarity can play into trying to price tighter than our peers — or at least on par with them. Because of the smaller programme, we often focus on cost over size — though we do of course care about where secondary and the comps are, and we're very conscious that investors are looking at that. We don't want to just tighten for the sake of tightening; we care about the performance of the bond and making investors happy too. We try to be realistic and fair and find the right balance.

**Dore, World Bank:** Inasmuch as we like to see tighter spreads, there is an equilibrium, a point at which you drop a significant number of investors because your pricing starts getting too tight — to just a few basis points over Treasuries. It's about that

balance of not wanting to be too wide but having spreads that are attractive enough that you don't reduce the number of interested investors.

It also does matter where we are in the rates cycle. If rates are higher, investors tend to be less sensitive. We also have to factor in the characteristics of the different types of investors. Some investors are focused more on relative spreads while others may be focused more on absolute yield levels.

**Nauman, Santander:** You're coming back to sterling frequently, too, and there's potential to increase that because the bank treasury base is expanding there and has demand. Cross currency is very specific to each currency and issuer.

**GlobalCapital: Darren,** do you have any thoughts on spreads?

**Stipe, AIIB:** There's probably a hypersensitivity in our industry on spreads because we're all triple-A rated, super strong credits. We get backed up against Treasuries so there's only so much room for manoeuvre. We look at even just a couple of basis points of difference, wondering whether the market is sending some sort of signal and interpretation of the credit.

We've been through a fascinating journey on spreads having enjoyed a few early years of being quite tight to peers, and then having a level of volatility that was higher than the peers through 2022/2023. Today we're seeing spreads tighten back in.

It was hard to tell how much of the spread widening for us versus the peer set came from the fact that rates were higher, how much came from geopolitical events, and how much came from misinformation or a misinterpretation of who the AIIB is. All those factors played into it.

We're encouraged by the fact that it's a higher rates environment, the market has digested a lot of information about AIIB, and we have a much more established track record — both in terms of what the bank's fundamental operations are and how we behave in markets. All that is adding clarity to the market's view of where AIIB should be priced compared to the peer set. That's part of why we're seeing such a dramatic improvement this year — the market updating its view and what it means for AIIB to be a triple-A issuer.

*"We've seen pockets of demand shoot up where they never existed. We've seen investors looking at SSAs and where the rates are, and making sense of it, bringing in new portfolio managers"*

Ali Nauman, Santander



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*“We feel that the spread we pay versus the larger more liquid names has been compressing, and we expect that to continue as our capital base and funding programme grow”*

*Eusebio Garre, IDB Invest*



**GlobalCapital:** Has it been an investor relations journey?

**Stipe, AIIB:** Absolutely. One element was educating investors on the nature of our credit: our exposures, our governance, our operating model, our track record. That information has got out there. It didn't change things as fast as we would have liked but as we're encouraged that there's been a big improvement.

**GlobalCapital:** How has the readjustment of rate cut expectations affected your funding strategies, especially for you, Yuri and Andrea, as you're soon going into a new financial year?

**Kuroki, IFC:** Reaching the expectation that we're nearing terminal rates is a positive for fixed rate products, but at the same time, the fact that the World Bank has been able to do a floating rate note shows that there are different views on where the rate might go — some may have the higher for longer view, others that they will decrease. Following that trade, we did receive more enquiries whether we would be open to reopening our FRNs. It's an interesting dynamic.

**GlobalCapital:** What was the answer?

**Kuroki, IFC:** If the level works and we have the capacity, we do reopen FRNs.

**GlobalCapital:** I know you've been active in FRNs, Andrea. Why is it attractive for you?

**Dore, World Bank:** The FRN market is attractive because it provides a cost effective and a very reliable source of funding for us. In recent years, the funding volumes we raised in the FRN market have increased significantly. We are the largest SSA issuer of FRNs. We have

done \$20bn plus of Sofr linked FRN since the start of the Sofr transition. We have taken a strategic approach to this market focusing more on benchmarks, liquid size transactions. Previously the FRN trade sizes were significantly smaller — it was challenging getting to a \$500m trade size. More recently we have done several \$1bn plus trades including a \$1.5bn trade in May and a \$2bn FRN dual tranche earlier this year.

We executed the first SSA Sofr trade about six years ago. That was a very short maturity — a two-year, working with just a handful of investors. The process took a long time because we had to get the systems in place, get sign-off from multiple teams, the conventions were new, and the markets were trying to figure things out.

The first bond we issued was placed primarily with US investors. Since then, we have seen an evolution of that product, with a broader investor base outside the US and we have been able to issue in size across the yield curve including our longest FRN trade of 15 years.

Now you'd assume that, with the expectation of lower rates, you'll not see much demand for FRN products but that has not been the case, demand for FRN products continues unabated. It's clear that investors have different views on the rate forecasts.

**Garre, IDB Invest:** You're talking about Libor to Sofr? They are not ready to do Sofr?

**Dore, World Bank:** Exactly. It took some investors a long time to get systems in place to buy alternative reference rate products like Sofr linked bonds. As recently as on our last trade in May there was a big investor and some smaller ones buying Sofr linked bonds for the first time. You're seeing that the distribution of our Sofr bonds change a lot over time. And every time we believe this will be our last large Sofr trade we've been wrong:

we're still seeing significant demand for the product.

As long as expectations are that rates are not going down, there will be investor interest and there are also some natural buyers of the product regardless of rate expectations.

**GlobalCapital:** David, do you find the floating rate attractive and why?

**Bai, Bank of China:** Yes, because our funding is a floating base. Two or three years ago I hesitated to buy floating rate because of the systems: the back office is a hurdle. But just last week, I bought a big chunk of floating rate. So our treasury liabilities are floating, so we're locking the spread based on our funding spread.

**GlobalCapital:** Is it a liquid enough market for you?

**Bai, Bank of China:** Yes.

**Garre, IDB Invest:** It is a very interesting example of these kinds of windows when the market shifts views and that creates additional demand. There is always a structural demand for floaters; some investors always need to have some floaters. But for us to go for a floater, we'd want to have an attractive funding level — otherwise you just do your benchmark.

But it's in these windows where you see investors shift their views all of a sudden. In this case because everyone seems to agree that we are in a cycle of rates going lower, so it's certainly not the market where you typically want to buy a floater. When that gets delayed, all of a sudden this window opens — until the market says 'now I know that rates are really going down'. Maybe it's a couple of months, maybe less, but that's what creates the additional demand that makes it attractive for us — versus fixed rate — to go and hit the market.

**Dore, World Bank:** The key thing is trying to meet investor demand at a certain point in time and those needs continue to change. I mentioned the inflation-linked bond; initially we had demand when inflation was going up, then that demand disappeared. But this week we've been able to execute a significant size inflation linked trade though inflation is supposed to be going down. There is a view that rates will not come down as fast as was expected and inflation will remain

sticky. And because of that stickiness, it made sense for investors buying inflation linked bonds.

**Bas, Santander:** We need to bear in mind that the biggest inflation issuer of triple-A paper is not issuing any more: Germany. The inflation market is smaller than the fixed income one but this still creates a good flow of investors who naturally need to buy that paper, as there is a lack of it. Those investors are moving to France, Italy and Spain and to certain SSAs that are willing to print triple-A rated inflation-linked bonds.

Obviously SSAs are not printing \$5bn of linkers, but there are certain pockets of money that really need to get paper linked to inflation.

**GlobalCapital: Darren, are you seeing interest from investors for floating rate notes or inflation linkers?**

**Stipe, AIIB:** Not inflation-linkers but that's probably because we wouldn't offer it. We do get regular queries on whether we'd be interested in issuing floaters, and we like to think of it as an important type of transaction to have in the toolkit.

We've only done two Sofr FRNs; a lot of that has to do with prioritisation. We feel like FRN is a trade that's always there for us. As I say, it's nice to have. For one reason, the transaction size can be smaller, and we're only doing \$9bn-\$11bn per year. If we want to top up on dollars, but don't want to do a \$2bn transaction, an FRN can slot in very nicely.

But when I say prioritisation, one reason we haven't done more FRNs is a general preference for improving liquidity in our lines, and our perception is that a new FRN would have less liquidity than an equivalent fixed rate issuance. That's what we're prioritising now because we think the AIIB brand we're trying to establish is going to benefit from more liquidity in the secondary market.

**GlobalCapital: While we're still on the primary market, where are you seeing funding opportunities away from benchmarks in non-core currencies?**

**Kuroki, IFC:** Our core currencies include Aussie dollars and sterling — those public markets are very

good sources of funding at a favourable cost, offering liquidity and diversification. Typically 40% of our funding comes from US dollars, then 15%-25% in Aussies and 10%-20% in sterling more recently, so a significant portion comes from those markets.

We typically issue at least one benchmark per year but also keep reopening existing lines. In the uncertain market we do see a focus from investors on liquidity, so sometimes instead of mtn issuances there's been demand for a tap of an existing public bond and we've benefited from that demand — alongside a favourable cross-currency environment. That's why we've seen a lot of activity in Aussies and sterling.

On local currency, for us it's not just about diversification of currency and investor base, but it is part of our mission to issue in local currency to provide to our clients — who are the private sector in emerging markets — with local currency financing options. And it's also for capital markets development in local jurisdiction.

With our capital increase approved back in 2018, our shareholders expect us to do more in the frontier markets, so local currency financing is becoming more and more important. Given higher rates and a strong dollar, it's even more important to provide the option of local currency loans to clients and protect them from that risk.

We issue in 20 to 25 currencies per year. We swap most of that back to US dollars, and only keep 1% to 2% of the proceeds onshore to on-lend to clients. That includes Kazakhstan tenge and Bangladesh taka, which are currencies we issued in this fiscal year.

**GlobalCapital: Will that percentage of proceeds being kept onshore increase?**

**Kuroki, IFC:** Eventually that's what we hope to do. Bond issuance is not our only source of local currency but it is a good channel, so when it makes sense for us to use it over swaps for

instance, then we want to open up that channel, which also contributes to capital market development locally. We can help to attract the attention of investors, be it offshore or onshore, and offer proof that it's a market that other non-SSAs can tap.

**GlobalCapital: Eusebio, you look at Australian dollars and you do local currency. How do you view your options?**

**Garre, IDB Invest:** We issued our largest Australian dollar bond to date just yesterday, at A\$600m. It was our third kangaroo bond. For most of 2023 the currency basis was not in our favour, so after having issued in 2021 and 2022 we skipped 2023, and now we are thrilled that we could offer a new bond to kangaroo investors in 2024. It was a green bond and started with an important lead order that was nicely complemented by a bunch of other investors.

Australia is on the other side of the world, so it is a very expensive market for investor relations. We have taken advantage of the digital possibilities that opened up during Covid time when it was the only way to meet issuers. That helped us a lot. We'll certainly continue to approach Australian investors, as well as Asian investors who are an important part of that market.

In local currency we've seen the biggest opportunities so far in Mexican pesos, where we have been issuing consistently for eight years. In that market it pays to do the groundwork, to go there and meet investors to make them familiar with our issuer profile and our funding programme.

The other part of [tapping niche currencies] is being consistent. Investors want to see you in the market over and over again, so they perceive you as a high-quality recurring issuer. Even as an SSA, you need to earn that. It's not a case of going to a local market and saying, 'Hey I'm triple-A, I want to fund



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*Ignacio Bas, Santander*



*“We still think rarity can play into trying to price tighter than our peers — or at least on par with them”*

*Yuri Kuroki, IFC*

100bp inside your government? If you're not consistent, they don't care — they say, 'My government is good enough for me, I don't know who you are, I don't know whether you're going to come next year, so you have to pay a premium if you want me to buy your bond'.

In Mexico we've had a very good experience, and in the past six months Colombia has also become interesting. So far, the demand for our bonds in Colombian pesos has come from offshore investors, from emerging market oriented funds, but we see also opportunities for domestic issuances in the future as well.

When we issue in these currencies, we always do it for lending, so our local currency pricing is not driven by the after-swap rate versus dollars but primarily by the rate that allows me to lend and achieve our return on capital requirements.

**GlobalCapital:** How much are you swapping to dollars?

**Garre, IDB Invest:** Nothing. When we issue in a local currency of one of our member countries, we keep the money in the currency.

**GlobalCapital:** That must make it easier to balance the need to be regular, as you don't have to worry about the swap rate.

**Garre, IDB Invest:** Correct, though another thing we do is swap dollars to local currency. For instance, in Brazil, issuing bonds is too expensive in comparison, so we use currency swaps to fund our local currency loans in that country. But, like Yuri and the IFC, part of our mission is to support the development of the local markets and when we see an opportunity to issue bonds locally, we're very keen to do so.

We also do that in sustainable formats. We can deliver value to those markets by showing that supranationals issue in their market

to global standards, and helping that market be ambitious about green and social bonds. In Mexico, all our bonds since 2020 have been sustainability or social bonds, and in Colombia we did two sustainability bonds, so it's something we are intent on promoting.

**GlobalCapital:** Darren, beyond the G3 currencies, what opportunities do you see?

**Stipe, AIIB:** Onshore CNY has been an opportunity. We've heard a lot more interest from people managing CNY, whether that be reserves or to put in their portfolios. We think we offer a terrific alternative to government bonds, which is where most people put their CNY resources.

We issue roughly 30bp over the government, so we offer the chance to get a triple-A issuer at a pick-up to the Chinese government. We think that's a terrific opportunity.

The reason for that dynamic comes back to the domestic investor. For that onshore investor, similarly to what Eusebio described in Mexico, there is no natural reason for them to prioritise investment in a triple-A issuer, an international triple-A doesn't mean anything to them. They're more interested in liquidity. You really have to attract that onshore investor first by educating them on who you are, what is the institution, why should they buy the bonds, and then by offering them a wider spread than the government.

We've been in a process of discovering what that spread should be, and in our last transaction had a good response with about 24 investors; that's a lot for a Panda issuance. Once you have that onshore base and there are conditions for a stable programme, then you take it offshore to attract investors who otherwise might be buying just the government bond. It's a great opportunity for us.

On a funding level, when that swaps back to dollar it's single digits over Sofr for a three-year, which is an amazing level. Also important was that we were funding CNY assets, similar to the IFC experience, and bringing a lot more clarity on whether CNY is a currency we can support on the loan side. It's interesting that investors, because of the high US rate environment, are looking for currencies where they can borrow where they believe that the absolute interest rate is low and will remain low over a long horizon. People see CNY as maybe one of those currencies.

**GlobalCapital:** Do you think CNY is a big opportunity for other supras or does it work specifically just for you?

**Stipe, AIIB:** It's a difficult currency for a couple of reasons. One is needing to have IFRS reporting; if you're on GAAP standard for your accounting it is exceptionally difficult. Secondly, the translation of documentation and financial statements into Chinese. We have a competitive advantage in that sense, given the staff resources at AIIB.

**GlobalCapital:** We're in New York, where the discourse on ESG is not as one-way as in Europe. How do you all see demand for ESG-labelled debt from supranationals evolving?

**Bas, Santander:** ESG is not as important in the US as in Europe. It's getting better little by little but the ESG wave came from Europe, with the 2030 agenda from the Paris Agreement. US investors are much more material in terms of yield rather than labels.

Having said that, ESG has become a commodity already. Every issuer that is able to is issuing ESG bonds, especially SSAs, where the ESG format is natural. There's no specific difference between issuing an ESG bond or not; if you're the World Bank you are issuing in ESG format by default.

**Dore, World Bank:** That's correct. All our bonds have a label since we see that this has value for investors. We label all our bonds as Sustainable Development Bonds to support green and social activities or Green Bonds focused on green. We have use of proceeds frameworks for

both labels. The frameworks define how we use an equivalent amount of the funds and explain the ESG policies and approach we follow — all are aimed at achieving a positive development impact in our member countries. We also have an annual impact report that covers all our activities to promote transparency across the entire balance sheet.

**Bas, Santander:** This means that it's a commodity in the sense that there's no difference between issuing in one format or the other, as the market has naturally absorbed this thing.

It's here to stay. We all are natural players in this world, except the EU which is a very different animal. There's a problem because there was a formal commitment to issue 30% of the Next Generation funds in green assets and there are not enough green assets to issue that many bonds. In the case of the supras, it's much easier.

But the concept of greenium, as we used to talk about two or three years ago, has disappeared. It's not even a thing, on syndicate calls, to discuss whether you should issue 1bp higher or lower because below a bond is ESG or not — because all of your curve, your spread, your credit and the secondary market is already ESG.

**GlobalCapital: Eusebio, do you think sustainable labels and credentials have value?**

**Garre, IDB Invest:** One thing is the qualifier for a bond and another question is what we fund with those bonds. Because of our impact approach and our ESG policies, everything we do has always been sustainable. We still have different approaches to this among supranationals.

So far, we at IDB Invest have only issued use of proceeds bonds that are compliant with the green bond principles or the social principles. Others, like IBRD, IADB or AIB, issue sustainable development bonds which have a wider definition. I can see both types of bonds converging and enhancing each other.

We still see that many investors prefer use of proceeds bonds over non use of proceeds bonds, and if you can comply with the green and social bond principles and have a second party opinion and have a stellar review for your annual report, that is appreciated by most investors.

The appetite for sustainable issues of either colour is enough appetite and enough mandates that investors buy both, whatever they prefer.

In our case, an important reason for going with the use of proceeds framework — and the second party opinion and all the work that that entails for a small team like ours — is that part of our mission is also to promote the local capital markets, to provide an example for our clients. They are private companies, they don't like to spend time and money on second party reviews and costly processes unless they have to, so it's important to show them that we do it ourselves and it works.

Is there value? I think there is. Is it a differentiator or do we see a greenium? I don't think there is a long-term case for a greenium for institutions like ours, where all our lending and investing is green and/or social. Temporarily there are moments where you issue a green bond at time when there is a shortage of them, and you get a better price at that moment than you would for a conventional bond, but to me that's the exception, not the rule.

That can be different for a company without a strong commitment to ESG, or for a company in a 'dirty' sector issuing a clean bond for a very specific project. That's a dilemma for the investors. How "dirty" is the company, how green is the bond? Can I really subscribe to this?

But in the case of the institutions at this table, I don't think that putting a label on it makes the impact of that bond that different from bonds without the label.

**GlobalCapital: David do you care about the sustainable labels or do you just see the asset class as inherently ESG friendly?**

**Bai, Bank of China:** I don't care. At this point, under US regulation, ESG investment exposure is voluntary

disclosure. But I need a balance in terms of income, yield and ESG, because ESG is a key measure for us. I need to draw a good balance.

**GlobalCapital: And the labels do matter?**

**Bai, Bank of China:** Yes.

**Nauman, Santander:** Until there is some sort of set regulation, like a number to hit in your portfolios, I don't think this ever comes into play. Investors are there for yield and that's why they look at it. There is definitely more awareness nowadays, and people we've met across the world are tracking ESG and have an idea of how much of their portfolio is ESG. They bring into conversations that their numbers are increasing. But there is no requirement from local governments or regulatory authorities to have a certain amount, so they don't chase after it?

Everyone has a feeling that might happen in the future, which is why it's tracked, but it's more an awareness thing for now.

**Kuroki, IFC:** One exception would be Swedish investors. They only buy green bonds. In our issuance we still have a greenium for ESG labelled bonds. With use of proceeds bonds, it works well when investors have a specific interest in, for example, biodiversity, oceans or water. We've seen an increased interest and demand for those and we incorporate them under our green bond framework.

**Dore, World Bank:** To the World Bank, everything is sustainable. The focus is on impact; every project that we finance goes through an ESG lens. It's in our DNA, so there is no reason to separate the balance sheet into pieces. That's why we take a holistic approach and try to provide as much information as possible in our impact report.



*“Two or three years ago I hesitated to buy [FRNs] because of the systems: the back office was a hurdle. Just last week, I bought a big chunk of floating rate”*

*David Bai, Bank of China (New York)*

# Powering up the MDBs

**GlobalCapital:** Obviously the Capital Adequacy Framework report has got the dialogue moving on getting more bang for the buck of MDBs' balance sheets. This year we've seen the first public hybrid from the African Development Bank. Andrea, what's been the response at the World Bank?

**Dore, World Bank:** The World Bank Group has implemented a series of reforms and introduced or expanded the use of innovative financial instruments as part of the Capital Adequacy Framework review.

During our recent Spring meetings, we announced some of the financial innovations that we've been working on to increase the World Bank's balance sheet financial capacity to be able to maximize financing to support the Bank's development mandate.

Some of the new financial instruments include: Hybrid capital for shareholders and development partners; a Portfolio Guarantee Platform and a Livable Planet Fund. We've been able to add up to \$70bn balance sheet capacity over a 10-year period by implementing these innovative products and balance sheet optimization tools, including the lowering of our minimum Equity to Loans ratio from 20% to 19%.

As for market hybrid, it's one of the products we have approval for and have announced plans to do a pilot. A market hybrid, relative to the shareholder hybrid, obviously has a higher cost.

**GlobalCapital:** Have you talked to investors about this?

**Dore, World Bank:** We have been doing some work on it. We have all seen the African Development Bank transaction and have had feedback. We've also done a lot of work with credit rating agencies, trying to ensure that the product is correctly rated. If you buy a World Bank hybrid bond, you are basically still taking triple-A risk, it's not like a corporate hybrid bond.

We know there is the issue of extension risk, and that has a cost. The question is how much is that cost? So, we are gathering investor feedback and trying to come up with the most efficient structure that works for us and investors.

**GlobalCapital:** Staying on the market hybrid for a moment,

does it ultimately come down to cost over the senior debt and is it feasible for that spread to compress? Is there optimism that the AfDB is going to become replicable?

**Nauman, Santander:** It's a discussion we have had with a lot of people. Issuers are interested in it from a theoretical point of view. The investor base is very different to the regular SSA investor base, and the way it was priced was very different to an SSA.

I think there are a couple of names where this can be replicated and could work, but I just don't see it becoming a market standard in the foreseeable future. It's an interesting concept, but the pricing seems still very debateable.

It's one to keep a close eye on, and we are having conversations with issuers on this. We will continue to pursue those and see how things evolve, but I don't see this becoming a commoditised product for example. And I don't see spread tightening.

**GlobalCapital:** Darren, what are your thoughts on hybrids and other ways to leverage your balance sheet better?

**Stipe, AIIB:** We are monitoring it. AIIB is of course at a different stage; we're not capital constrained by any means. Part of our role is to be there as a co-lender, to support peers in their efforts to maximise impact.

We're around 10 years away from facing any type of capital constraint, so it will be interesting to monitor how these products evolve. I don't think it's a single product or even set of products that

really gets to the type of deployment of capital that the G20 is going after. That comes with more structural changes to the industry. We still need to hammer out what those should be and what our role will be in that regard.

Another question is: what is AIIB's role as an investor in hybrid products. It is in the interests of our shareholders to be supportive of those. That may be something we will look at in the future.

**Dore, World Bank:** It's fair to say that this will never be a big part of SSA balance sheets, simply because of costs. We are cost pass-through institutions. This means we pass on our funding cost to our borrowers, so our goal is to achieve the lowest funding cost.

That's why we think shareholder hybrids are an excellent product because they are issued at the cost of senior level debt and you are able to get the leveraging effect.

**Bas, Santander:** From the outside, when you are a triple-A institution, issuing at very low levels, why is it in your interest to issue product with a lower rating at higher cost? If you get a capital increase from your shareholders, you leverage your lending capacity by funding yourselves cheaper in the future.

**Dore, World Bank:** The key thing is the leveraging component. There are huge strains on capital, so how can we do more with our balance sheet? We have to look at a suite of products. We must be creative. For example, callable capital — can that be more useable?

We do have to evaluate the cost of this market hybrid but if you issue a contained amount, the cost may then

*"I don't think it's a single product or even set of products that really gets to the type of capital deployment that the G20 is going after. That comes with structural changes to the industry"*

**Darren Stipe, Asian Infrastructure Investment Bank (AIIB)**



*"It's fair to say that [hybrids] will never be a big part of SSA balance sheets, simply because of costs. We are cost pass-through institutions"*

**Andrea Dore, World Bank**



be manageable if it is spread over a large loan portfolio. We would have to bring down the cost of issuing market hybrids significantly to be able to issue this product on a sustainable basis. Why should you pay that much for a hybrid product when the risk to investors is so low? Even the way the rating agencies are looking at SSA hybrids, the number of notches lower does not reflect the risk that investors are taking.

**Bas, Santander:** Correct.

**Dore, World Bank:** That's the key thing. It's a different investor base. We need to educate them that the risk level is different to other corporate hybrids. The risk of your coupon being cancelled is very low.

**Bas, Santander:** That investor base that you're referring to is not the natural SSA investor base.

**Nauman, Santander:** If you look at the splits, the amount of fast money was extortionately high. Who is buying this, where the credit rating is, and whether a triple-A issuance entity needs to do this, all combined makes it very difficult.

**Dore, World Bank:** If you design a product, that can be sold to the natural hybrid investor base or our traditional SSA investor base that will help performance and the sustainability of the product. But where it is now, that's not the case.

**GlobalCapital:** David do you ever see a world where you're buying a hybrid from the World Bank?

**Bai, Bank of China:** Not really.

**Garre, IDB Invest:** We have yet to find the investor base for this product at a cost that works for both sides. Many of the usual SSA investors cannot to even look at hybrids, period. You'd have to get

to all those investors and convince them that perpetuals are not that bad, and they should buy them because they have a very high rating. That's a big challenge, because their reticence is not only driven by their views about the risk, but also by the laws and regulations they are subject to.

The usual hybrid buyers on the other side just have totally different yield targets and couldn't care less about the triple-A rating because they want the return and are willing to take risk. The question is, can the MDB community find an investor base that from a return perspective is in the ballpark of what we can afford or want to spend on this instrument?

Can we identify and educate that investor base to open up to SSAs, to the extent they are not already involved? This could be maybe known investors but a different portfolio or it could be someone who has never looked at SSAs.

That's the big challenge and no one has cracked it. That's why shareholder hybrids have appeal, because shareholders are willing to not put a market price on the risk based on their strong conviction of the quality of the issuer and their commitment to its mission as shareholders.

We sometimes reduce the capital adequacy conversation to hybrids. But when you look at the G20 recommendations, there are five areas that they expect the multilaterals to work on and be more impactful — including adjusting their risk appetite, adjusting their own internal capital adequacy policies, and working with rating agencies to deliver better data that conveys the low risk of their portfolios, and thus get a more efficient use of their capital.

Of course, new capital instruments are part of the conversation. But hybrids are not the only way to get more out of the MDB's current capital base.

The way we went about it was to engage with our shareholders to ask how we respond to this catalogue of requirements. We put a new business

model in front of them and said we would change the way we work. We put a business model in place with two key components.

One is an originate-to-share model where we change the way we design products so it's easier to crowd in external capital, where there's a lot of work to be done. The other part is to adjust our risk appetite and be willing to take more risk on our balance sheet, offering more impactful products to clients. That includes more credit risk, more equity risk, more currency risk — doing things we didn't do before to have more impact.

Our shareholders loved the idea, but we told them it doesn't come for free. We have \$2.7bn of capital — to do this at scale we need significantly more. They liked the idea and gave us \$3.5bn of additional capital, but they also gave as the requirement to keep our rating at least at the current AA+ level. They were in on the idea — from the G20 report — of being more willing to entertain risks. But they also want us, as a multilateral, to be able to play an anti-cyclical role in a crisis, for which a very strong credit rating is key.

That's the way we went about it. Now we are more than doubling our capital over the next seven years, so hybrid bonds are not our priority. We'll focus on how we can mobilise more, and how can we get more risk off our balance sheet — crowding in capital.

**GlobalCapital:** IFC is not a capital constrained institution either. Beyond hybrid capital, do you see other alternatives for increasing mobilisation of resources?

**Kuroki, IFC:** For us it's about mobilising private capital. One initiative IFC is working on is the warehouse enabled securitization programme (WESP), a new cash structure of an emerging markets collateralised loan obligation — emerging market CLOs. The programme follows the originate-to-distribute model, so we securitise IFC-originated loans in EM, create a securitisation product, and invite private sector investors to participate.

Initially our focus is for IFC assets to be included, but once it's more established, and investors and rating agencies become familiar, the intention is to replicate this with MDBs communities to broaden EM CLOs. This really complements a mobilisation platform that we already have which focuses more on the private credit market, but this one is to mobilise the public market. **GC**

# Agencies sharpen tactics in year of the yield grab

The pace of issuance from agency issuers has been remarkable this year as investors' renewed love affair with fixed income heats up. But there are still challenges to getting deals done, meaning borrowers must come up with new ways to keep funding ticking over, writes **Georgie Lee**

Agency bond issuers, like borrowers from many other sectors, wasted no time in getting deals done this year. It is a group of issuers that encompasses those with big borrowing programmes, like KfW's roughly €90bn need, to a number of issuers that raise €10bn or so each year. But although this varied group have learned to play alongside behemoths like the European Union and the big supranationals in the primary market, they must still find new ways to engage investors in their deals.

Agencies had raised \$150.6bn-equivalent in syndicated benchmarks in core currencies by the middle of May, according to *GlobalCapital's* Primary Market Monitor (PMM), up 12% versus the same period in 2023.

Borrowers began 2024 by front-loading issuance ahead of what is expected to be a volatile and less predictable second half, with the US election looming in November, and wars in Ukraine and the Middle East. But facing restricted issuance windows thanks to a mix of economic data, central bank meetings and competing issuance means they have not been able to be complacent.

The good news is that with rates thought to have peaked in July 2023 in the US, and September 2023 in Europe, and even with US inflation proving sticky in 2024, investors have taken to the primary market to pick up agency paper at attractive yields versus government benchmarks. "We haven't ever seen this level demand in order books," says Asif Sherani, managing director, head of DCM syndicate EMEA at HSBC.

Euro benchmarks have been 5.1 times oversubscribed on average, versus four times in 2023, according to PMM data.

But issuance has not been straightforward. Persistent

tightening in euro swap spreads between Autumn 2023 and April 2024 has made it tougher for some agencies to price deals, and for bonds to perform in the aftermarket against government benchmarks.

## Shifting spreads

KfW is typical of many agency issuers in that it markets its bonds to investors at a spread to Bunds as well as swaps but pays for the debt with floating rates by way of a new issue swap hedge, making it sensitive to the spread between swaps and government bonds. While last year, in the five to 10 year sector KfW spreads had hovered around 50bp-60bp over Bunds, they are currently trading closer to 30bp-40bp and around 20bp at the short end.

"At some point, that Bund spread will become important again," says Sherani. "Historically speaking, the SSA sector starts to look expensive inside 30bp versus Bunds, but above 30bp is still an attractive relative value point."

In the dollar market, KfW had priced two short-dated dollar benchmarks this year, by the time this report went to press, at 10bp over Treasuries. "There is not as much of a cushion at the moment in terms of additional performance in dollars given issuers are coming up against these tight valuations versus Treasuries," says Ebba Wexler, head of SSA DCM at Citi.

While bankers say tighter spreads have not materially dampened appetite for SSA paper in the primary market, investors have still been prioritising liquidity amid bouts of extreme volatility across global bond markets this year.

Guaranteeing liquidity can be difficult, particularly for small agencies with funding needs of less than €10bn, and with limits on the size of benchmark they can issue. Antti Kontio, head of funding and sustainability at Finnish agency Municipality Finance, which is targeting €9bn-€10bn of funding

## Top 10 ex-US agency issuers by volume 2021-2023

Rank	2021		2022		2023	
	Issuer	Volume (\$bn)	Issuer	Volume (\$bn)	Issuer	Volume (\$bn)
1	KfW	87.7	KfW	91.3	KfW	93.1
2	Cades	46.2	Cades	40.1	CMHC	33.2
3	CMHC	32.0	CMHC	30.8	Cades	23.9
4	Unedic	13.3	BNG	16.9	BNG	13.8
5	BNG	12.8	Rentenbank	12.6	Rentenbank	11.0
6	JFM	12.7	NWB	11.3	SEK	10.9
7	Rentenbank	11.3	Agence Francaise de Developpement	9.8	Kexim	10.1
8	NRW.Bank	10.7	EDC	9.4	EDC	10.0
9	Kommunalbanken	10.2	Kommunalbanken	9.2	Municipality Finance	9.6
10	Agence Francaise de Developpement	8.6	JFM	9.1	State of New South Wales	8.9

Source: Dealogic



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*“Our currency strategy is to diversify as much as possible. We’ve been very active in different markets and, in general, the market is moving more towards big, liquid, public issues. We haven’t been able to control that trend”*

**Antti Kontio, Municipality Finance**

this year, says that while there is an illiquidity premium associated with smaller names, “it feels like that has diminished for MuniFin” as new buyer bases have entered the market.

Kontio says the euro secondary market has been tougher in 2024 as issuance has outstripped volumes raised during the first five months of last year. Across the entire market, SSAs had raised €320bn by around mid-May, an increase of 20%.

### Diversify

Issuers have been adopting measures to increase the liquidity of their bonds, including targeting larger, public benchmarks and taps.

“If the bonds aren’t big enough, investors hold on to them and that harms our liquidity,” says Thibaut Makarovskiy, head of funding and market operations at Agence Francaise de Développement. “We return sometimes to the market to tap our benchmark issues for this reason.”

French agencies have capitalised on strong momentum for their paper this year, as OATs have underperformed, but supply from this group of issuers remains scarce. “The French agency sector is enjoying strong demand but there’s a scarcity dynamic and it wouldn’t surprise me if there is less turnover in our sector,” adds Makarovskiy.

While dollar issuance is up year-on-year across the segment, by nearly 40%, according to PMM data, there is still not the same volume as there has been in euros which has impacted buying in the secondary market. Most investors save their firepower for the primary market in euros. In dollars, there have been periods of slow issuance, which has driven greater activity in the secondary market.

In order to tap into as many investor bases as possible, bankers say issuers are looking to diversify into different currencies, as evidenced this year through large

deals in markets like sterling, Australian and Hong Kong dollars.

Chinese yuan and Hong Kong dollars are now KfW’s fifth and sixth biggest currency markets, with CNY issuance last year exceeding €1bn for the first time. Petra Wehlert, the issuer’s head of capital markets, says issuance has allowed KfW to tap into central bank reserve manager demand, while in Hong Kong dollars, even though supply is only very short dated, flows have been constant.

Issuers do not want to be solely reliant on euros and dollars in case of volatility spikes that have the potential to shut core primary markets. During the pandemic, many agencies were able to tap niche currencies to get funding done.

But the market is moving in favour of syndicated offerings and away from small taps and private placements and it is not always easy for smaller agencies to access every market. “Our currency strategy is to diversify as much as possible,” says Kontio. “We’ve been very active in different markets and, in general, the market is moving more towards big, liquid, public issues. We haven’t been able to control that trend.”

### Narrower windows

While diversification has previously delivered cost advantages, pressure on the cross-currency basis swap, which is sensitive to flows, means MuniFin has been less active this year. Aussie dollar issuance looks more expensive than euros, for instance, says Kontio. “The basis swap is driven by flows and other components. Trying to draw conclusions as to why it doesn’t work is very difficult and the reasons vary between currencies. We’re not miles away from our target levels but it makes sense to wait a little longer to issue,” he says.

As issuers have sought to build up the liquidity of their bonds, agency borrowers have increasingly gone head-to-head in the primary market

as they try to squeeze into narrow windows for issuance.

“Since the global financial crisis, the market has become increasingly prone to volatility, both day-to-day as well as intraday,” says Alex Barnes, head of global SSA syndicate at Citi. “As a result, issuers and investors want to be in and out of the market as quickly as possible and technology has had a significant impact on our ability to speed up the book build process.”

Wehlert agrees, saying: “Book building is faster these days. And we incentivise that by prioritising early orders during allocation. Without investors with market views and larger tickets, the bookbuilding process would be quite inefficient.”

The German policy bank has prioritised dual-tranche transactions to optimise each outing. It got a taste of how sensitive the market can be to policy rate expectations in April when, during a two year dollar pricing, market predictions changed, sending 10 year Treasury yields past 4.6%. “That was a challenge for investors,” says Wehlert.

Nonetheless, the pace of deals this year suggests that issuance windows are less of a problem than they were a year or two ago. Sherani argues that the debate about windows has been rendered “redundant”.

Even so, issuers time their deals with care. Kontio says that while MuniFin avoids pricing a similar trade to its Nordic or Dutch agency peers on the same day, bringing a new issue on the same day as KfW is no longer a deterrent.

The EU continues to dominate issuers’ thinking, according to market participants. It remains to be seen if consultations this year by sovereign bond index providers can ease worries about being in the market at the same time as an issuer that does such size so often — it regularly prices €5bn or more at a time as it looks to raise roughly €150bn each year.

“The EU takes a lot of the attention, both in primary, where its issuance is seen as a large liquidity event, and in secondary where traders are also focused on the borrower’s new issuance,” says Barnes.

The consultations about index inclusion have pulled in EU spreads, and agency spreads along with them. This year the EU has “become less of a stigma”, with more issuers approaching the market at the same time as the supranational, according to Barnes. **GC**

# Sovereigns reach retail inflection point

Savvy government issuers have been able to fund record volumes from retail investors since interest rates began to rise, which contributed to tighter spreads, even as debt-to-GDP ratios increased. But where next now that banks have caught up, the ECB has cut rates and household liquidity has receded?

**Georgie Lee** investigates

The share of European government debt sold directly to retail investors accelerated markedly after July 2022, with Italy, Belgium and Portugal all tapping into strong demand from households looking for a better return than the miserly rates banks were offering. Now those countries are taking differing views on how much retail involvement they have in their debt raising.

The elevated retail funding volumes were a welcome relief to borrowers whose funding needs and deficits were still high after the pandemic.

The Italian treasury issued more than €33bn in its BTP Valore format in 2023. The product offers its exclusively retail investor base a special rate of income tax, exemptions from inheritance tax on coupons, and loyalty bonuses.

These borrowings outstripped the amount it raised through syndications that year. BTP spreads tightened as Italy's institutional funding fell, even as Italian growth waned.

Belgium too raised record amounts from retail, including a €21.9bn one year issue in September 2023.

But wading into new territory has not been straightforward. Sovereign borrowers, which pride themselves on bringing predictable supply to their institutional investors, cut planned issuance to the wholesale

market to satisfy retail demand. The size of Portugal's series E savings certificates, for instance, eliminated the need for a second bond syndication last year.

Retail accounted for 50% of Portugal's total 2023 funding. However, this year, its funding programme is almost 100% institutional, in the form of Portuguese government bonds and treasury bill issuance.

The country is now rated single-A by all the major ratings agencies. And even with the increase in supply this year, spreads versus peers have not widened, says Rui Amaral, board member at the Portuguese Treasury and Debt Management Agency.

## Open network

Portugal offers floating and fixed rate saving certificates to clients. Its series F, offered in May, is a 15 year floating rate instrument that pays Euribor flat, with a cap on interest at 2.5%. Holding premiums start at 0.25% in the second year. Buyers can request reimbursements.

As bank deposit rates increased in 2023, net subscriptions of savings certificates on offer at the time turned negative in the second half of the year. However, Portuguese activity in the retail market is expected to ramp up again, according to Amaral.

In March, Portugal opened up its distribution network for savings

certificates, previously limited to the debt office and its postal network, to Portuguese banks.

Today, the agency has one digitally focused bank selling fixed and floating rate savings certificates and a handful of other banks have applied to follow suit.

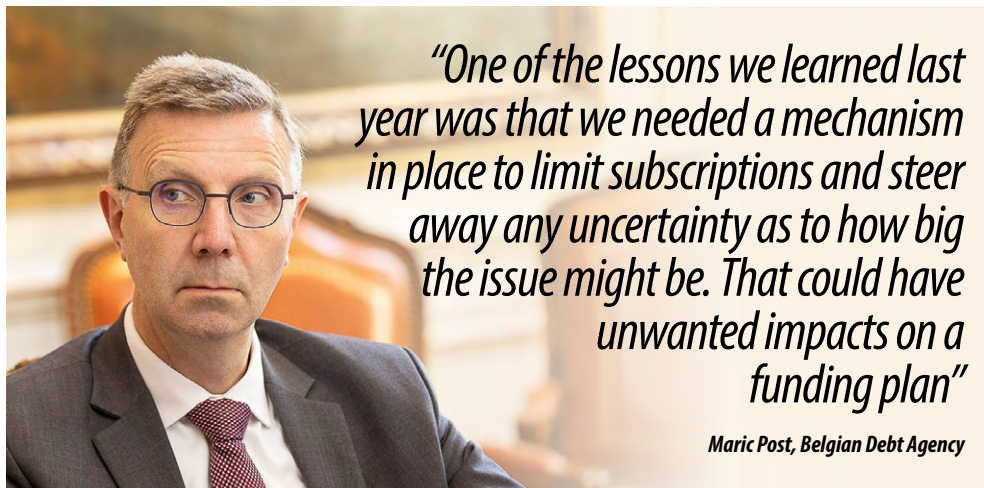
"If demand for savings certificates picks up again, we expect it to become more popular with banks and our aim is to build up a more diversified distribution channel through most banks in Portugal," says Amaral. "We expect this to be transformative for the Portuguese retail market and it goes hand in hand with digital transformation at the DMO."

Savings certificates have gained particular favour with young people in Portugal. However, Amaral is wary of how reactive this demographic will be to bank deposits becoming more attractive. "We have to be ready for that," he says.

About a million Portuguese citizens hold savings certificate accounts with the DMO. There is a €50,000 cap on investments, although this could be lifted. "We're at a juncture with retail now," says Amaral. "We want to increase our offering and we have all these accounts open. The digital transformation at the agency is underway. While the shift in our distribution has not yet produced

*"We want to increase our offering... The digital transformation at the agency is underway. While the shift in our distribution has not yet produced results, we certainly expect it to in the future"*

*Rui Amaral, Portuguese Treasury and Debt Management Agency*



*“One of the lessons we learned last year was that we needed a mechanism in place to limit subscriptions and steer away any uncertainty as to how big the issue might be. That could have unwanted impacts on a funding plan”*

**Maric Post, Belgian Debt Agency**

results, we certainly expect it to in the future.”

Belgium’s retail debt landscape has also changed this year. In February, the government scrapped a break that halved withholding tax on its state notes from 30% to 15%.

It is widely believed that slashing the tax last year had fuelled demand for the September 2023 bumper issue.

The dramatic dip in demand evident from Belgium’s latest state

note auctions in March 2024 — in which it raised just €413.29m — also largely reflects higher deposit rates, according to Fitch.

At the time of this year’s issue, head of funding at the Belgian Debt Agency, Maric Post, told *GlobalCapital* the regular tax rate was always going to be “a game changer”.

“It’s an interesting diversification for governments if it is meaningful in terms of

amounts,” he said. “There is also a need to be able to steer issue volume. One of the lessons we learned last year was that we needed a mechanism in place to limit subscriptions and steer away any uncertainty as to how big the issue might be. That could have unwanted impacts on a funding plan.”

There is now a €6bn cap on subscriptions of Belgian state notes. The next issue at the time of writing was planned for June 4.

More recently, Italian households showed less enthusiasm for the fourth BTP Valore issue, with subscriptions coming in at €11.3bn versus the sovereign’s record €18.3bn issue in March.

Richard McGuire, head of rates strategy at Rabobank, says this was expected given retail holdings of liquid assets are below pre-pandemic levels and bank deposit rates are higher.

That doesn’t automatically mean Italian spreads should widen, according to McGuire, who said that foreign institutional demand was making up for the lag from retail. **GC**

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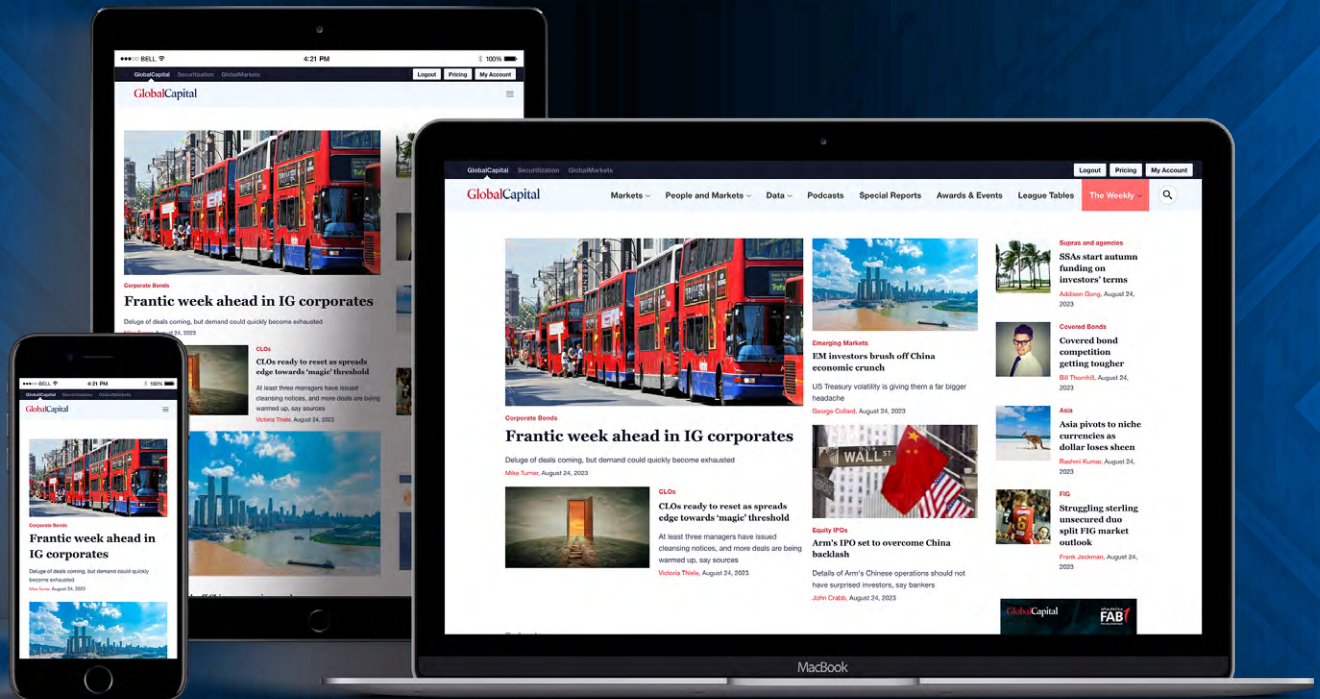
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