

# Euro SSA Strategy

## The Return Of The EU: First Batch Of Supply Since 2012

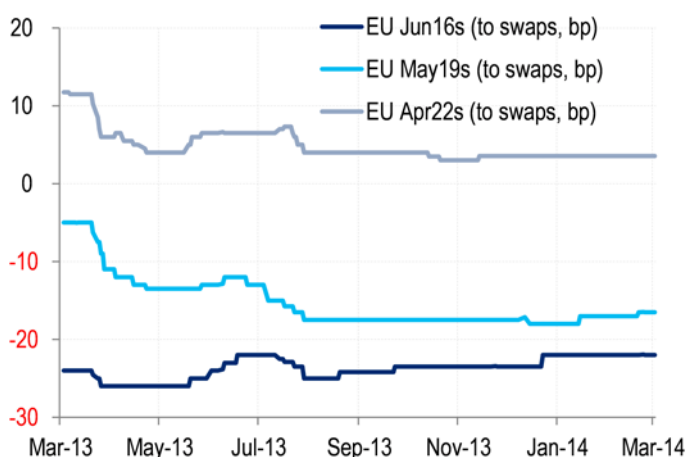
- **Rating now Aaa Stable by Moody's** – In line with our base case expectation (*European Rates Weekly*), Moody's revised its outlook on the EU (Aaa) from negative to stable on Friday. This was largely based on diminished euro area risks and the improvements in shareholder credit quality as assessed by Moody's. This is a small credit positive which should support spreads.
- **Ukraine involvement** – The EU can conditionally lend to non-EU states in conjunction with IMF involvement under their Macro-Financial Assistance facility. Support to the Ukraine (up to €1.6bn by the EU as an entity) may affect its broader funding programme, but we do not expect this to meaningfully impact spreads. At €56bn, EU debt outstanding is small compared to its budgetary resources and EU GDP. Its maturity profile also benefits from a relatively long weighted average life.
- **EU benchmark issuance this week** – Now that the rating action is out of the way and we have some clarity on any assistance to the Ukraine (the bulk of which will come from other EU institutions), the EU is to issue €2.6bn this week. We expect good demand for this high quality European supranational.

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Figure 1. 2yr, 5yr and 8yr EU spreads to swaps (bp)



Source: Citi Research

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## EU: 3 items for the near-term outlook

The EU remains firmly on investors' radar, not least because of its likely assistance to the Ukraine and what that might mean for bond supply and the spread outlook. Together with its top Aaa stable rating by Moody's (which revised its outlook on the EU from negative on Friday), we detail three factors we think are significant for the near-term outlook. Benchmark euro issuance is expected this week.

### 1) Rating affirmed at Aaa and outlook revised to stable

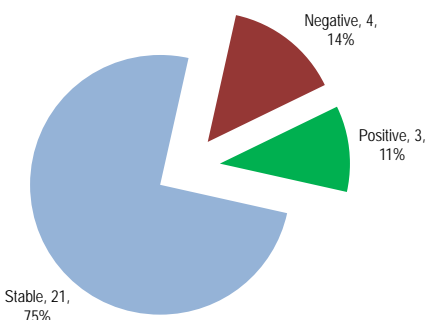
EU now rated Aaa Stable by Moody's

**Aaa Stable:** In line with our base case expectation ([European Rates Weekly](#)), Moody's revised its outlook on the EU (Aaa) from negative to stable on Friday. The two key drivers behind the revision to a Stable outlook were<sup>1</sup>:

- The improvement in the creditworthiness of the EU's largest shareholders
- Diminished risks emanating from the euro area debt crisis

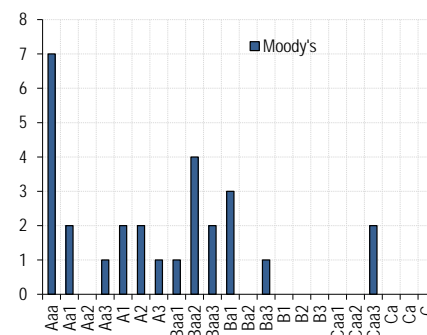
The outlook in general reflects the revisions Moody's has made recently to a variety of sovereigns ([Tracking the revisions in SSA ratings](#)), including Germany (Aaa stable), the Netherlands (Aaa stable), Austria (Aaa stable) and also the upgrades to Ireland (Baa3 positive) and Spain (Baa2 positive). The vast majority (86%) of the EU's shareholders are now either rated with a stable or positive outlook as shown in Figure 2. The distribution of the actual ratings by Moody's is shown in Figure 3.

Figure 2. EU States, Moody's Outlook



Source: Citi Research, Moody's

Figure 3. Moody's EU Rating Distribution (Count vs Rating)



Source: Citi Research, Moody's

**Aaa rating underpinned by shareholder support, EU Treaty provisions, financial resources and conservative budget management**

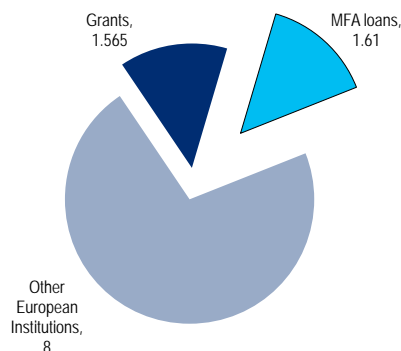
**Credit quality and distinguishing features:** The Aaa rating itself is underpinned by various factors particularly associated with the EU. These supports are distinctly different from other supras and reflect the specific drivers of the EU's credit quality as a supranational. They include:

- Joint and several liability of member states; A323 obliges member states to provide funds to meet all EU obligations
- Multi-layer debt service protection and budgetary resources vs debt outstanding
- Conservative budget management and the requirement to balance the budget

Further details can be found in our primer, [Supranationals in focus](#).

<sup>1</sup> Moody's Investor Service: "Rating Action: Moody's changes outlook on European Union's Aaa rating to stable from negative; rating affirmed" 14<sup>th</sup> March 2014

Figure 4. Proposed package for the Ukraine (€bn)



Source: Citi Research, European Commission

## 2) Involvement with the Ukraine

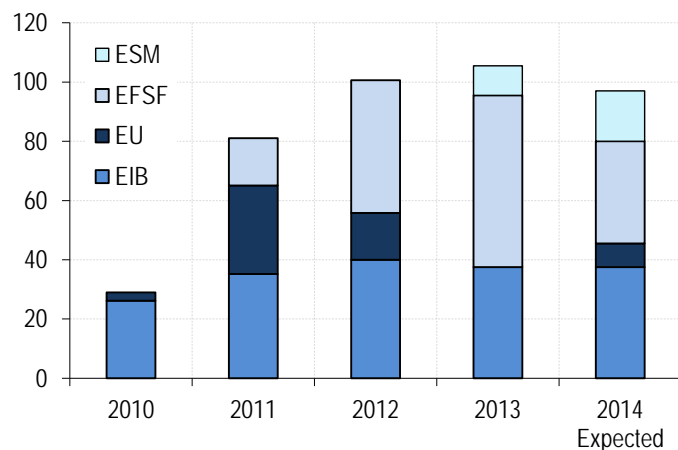
**Macro-Financial Assistance:** The EU can conditionally lend to non-EU states in conjunction with IMF involvement under their Macro-Financial Assistance facility (MFA). Specifically for the Ukraine, the EU had already agreed €610mn in MFA to the Ukraine on the condition of a signature agreement between the government and the IMF. The Commission is now proposing an increase of €1bn which may impact the EU's wider funding programme ([The EU and the Ukraine](#)).

## 3) Impact on issuance and spread outlook

**EU funding:** In terms of funding, the EU issues exclusively in euros with maturities ranging from 3yr-30yr (EU Presentation February 2014). Looking ahead, regular readers will know that we have flagged the anticipated EU (€2.6bn expected to fulfill EFSM commitments). This is now due this week according to press reports. The EU remains a relatively "small" issuer compared with the other issuers in the euro market (Figure 5)

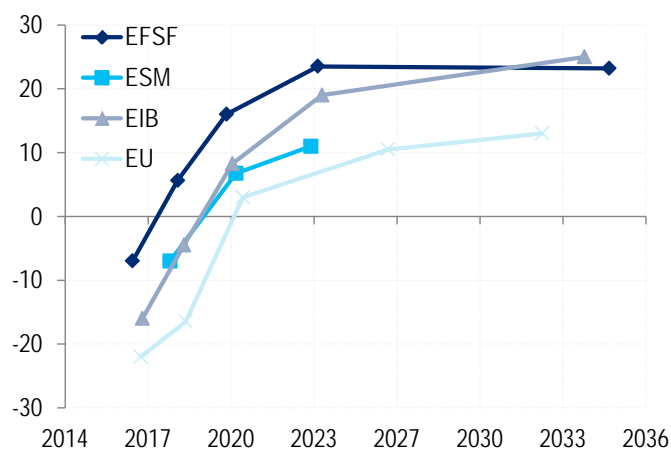
**Why we like the EU:** We do not expect any extra assistance to the Ukraine to impact spreads in any meaningful way. The debt of the EU at around €56bn will not materially increase because of this aid, and remains small compared with the EU budget and EU GDP. We continue to see the EU as a strong supranational within the core SSA space issuer (especially given Moody's recent action), with the primary market enhancing liquidity for investment opportunities. We expect spreads to remain relatively low going forward and for the EU to trade tight compared with other supras (Figure 6).

Figure 5. EUR supply expected by key European supras (€bn)



Source: Citi Research, EU

Figure 6. Supra YYS Curves (Spreads to swaps)



Source: Citi Research

## Conclusion – the return of EU supply this week

### We welcome the return of EU benchmark issuance

Now that Moody's rating decision has passed and the European Commission's proposal for aiding the Ukraine has been published, the EU is to issue a euro benchmark bond this week. In their latest investor presentation, €2.6bn was targeted for Q1. We expect good demand for this high quality supra and note this will be the first batch of EU benchmark supply since October 2012 (there was no euro benchmark issuance at all last year).

## Appendix A-1

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