

Euro SSA and Covered Bond Monthly

Hunting for value in a low yield environment

- **Supras outperform OATs, agencies, regions and covereds:** Assessing the various sharp moves in the SSA space over June, it is the outperformance of the supras that is most striking. The EFSF and EIB have notably outperformed less liquid issuers such as the EU, NRW and CAFFIL. We detail our relative value analysis across such sectors.
- **Trading themes in covered bonds:** For covered bonds, the latest ECB package has also paved the way for tighter spreads. Hunting for relative value has therefore become even more important. We reveal some opportunities in the covered bond space and on a cross-asset basis.
- **NEDWBK issues its first green bond:** The euro SSA green bond market developed further in June with NEDWBK issuing €0.5bn in the 5yr sector at MS+8. The strong demand seen in this transaction points to the growing interest in such instruments, which we expect to develop further.
- **EFSF/ESM credit quality decouples from France:** In June, Moody's revised the outlook its Aa1 rating of the EFSF/ESM from negative to stable whilst France remains Aa1 negative. Due to lower default correlation with EMU and improved sovereign credit quality more broadly, Moody's states that the EFSF/ESM rating would be "resilient" in a scenario of a one notch downgrade of France.
- **Action ahead of the summer break:** Covered bond issuers became very active following the ECB meeting. However, we think that the wave of new issuance has already probably peaked. In secondary markets, wider spreads in May now seem to be but an aberration in the overall tightening trend that dominated in June.
- **LCR on its way:** The market has to remain patient to get final clarity on the LCR composition which was due at the end of June. However, a lot of information regarding the final configuration is already being reported and in general, we read this constructively for the covered bond product.
- **SSA and covered bond supply:** Euro-denominated agency and supranational issuance totaled over €14bn in June. Year to date, this figure is €131bn. Euro-denominated benchmark covered bond issuance in June was €13.2bn. Year to date, the covered bond market recorded €69bn of issuance.

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

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Hunting for value in a low yield environment

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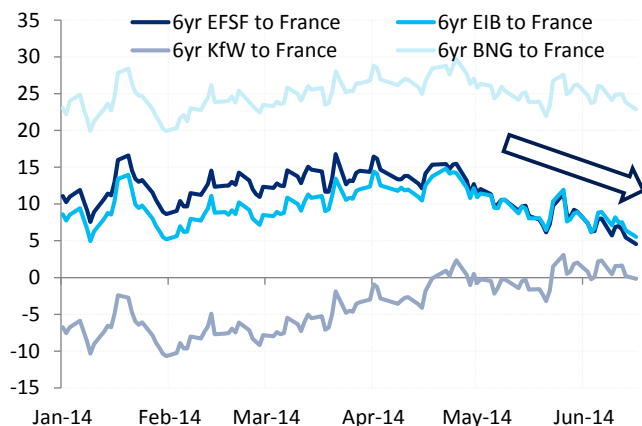
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Various drivers, not the least the June ECB meeting, have provoked an even lower yield environment than perhaps was previously envisaged. Market volatility is also at lows making alpha generation all the more difficult as the “great compression” continues. We see little evidence to suggest the low and range-bound environment will change any time soon, especially given the growing prominence of regulatory demand drivers for high quality spread products. However, for the SSA and covered bond sectors, we still see pockets of value which we explore in our lead article in this edition of the *Euro SSA and Covered Bond Monthly*.

Trade the “transitivity of liquidity” in SSAs

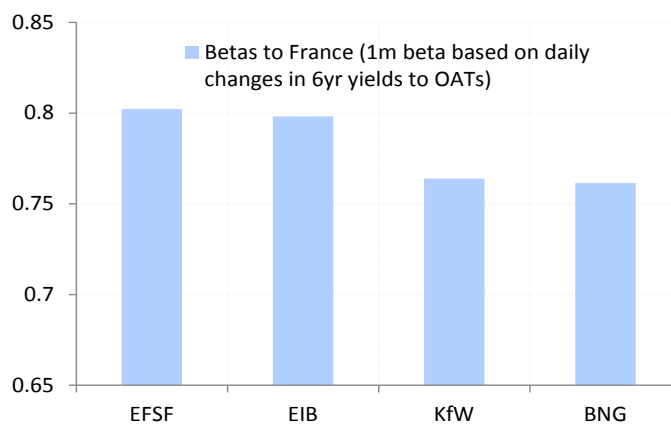
The SSA sector continues to exhibit a transitive characteristic of liquidity. That is to say that in the event of an exogenous trigger for a strong fixed income rally, a “flight to liquidity” often proceeds a “hunt for yield”. Specifically, we see strong performance of high quality assets that offer any kind of spread to the ultimate haven of German bonds. This performance can be best thought of in terms of relative liquidity among government and SSA assets.

Figure 1. Supras outperform vs France compared with agencies



Source: Citi Research

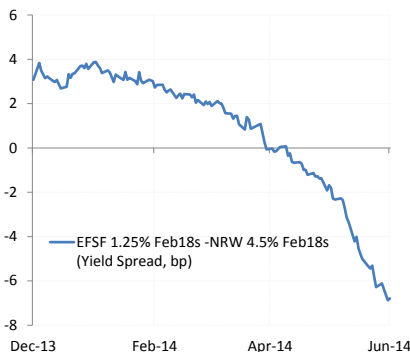
Figure 2. Betas to France on 6th June just after the ECB induced rally



Source: Citi Research

First move the supras and France....

Figure 3. EFSF outperforming NRW (bp)



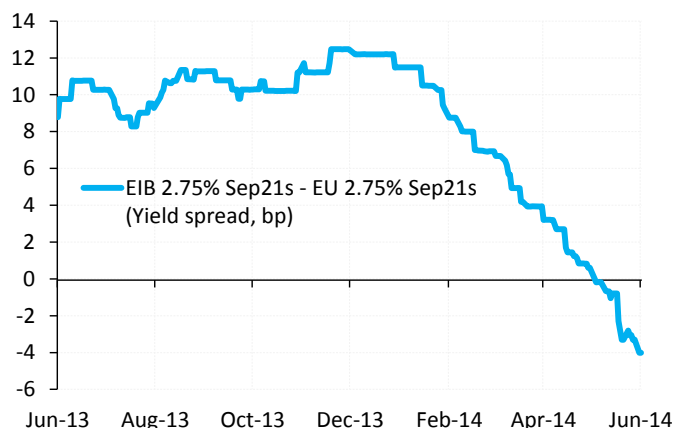
Source: Citi Research

Liquidity differences in supras and France: Highly correlated to OATs are the supras: their outperformance vs the agencies in terms of spreads to France can be seen around the time of the June ECB. Spreads to France between the EFSF and the EIB have tightened from around 15bp to around 5bp whereas many agencies have lagged in the rally and still look relatively cheap (Figure 1). Indeed, the beta around the last ECB for key SSAs in the 6yr sector is shown in Figure 2 where this distinction is also illustrated.

Supras vs the regions: As another corollary, the more liquid supras such as the EFSF have strongly outperformed some regional debt. This can be seen in the spread difference between EFSF and NRW as an example (Figure 3).

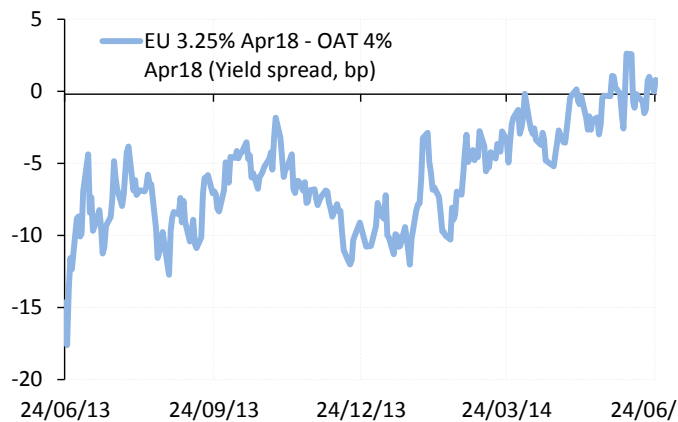
Liquidity differences within supras: Liquidity differences within the supra sector itself can also explain some of the sharp moves seen in recent sessions. Once France rallies, we observe the EFSF and EIB – being the larger issuers within the sector – soon follow and outperform “smaller” peers such as the EU. In this sense, the “transitive” order of performance as governed by market depth is France itself, then EIB/EFSF and then finally the EU (and related the regions and covered). As such, there has been striking performance to the EIB vs EU (Figure 4) and - as a consequence - the EU has cheapened to France (Figure 5).

Figure 4. EIB out performs the EU....



Source: Citi Research

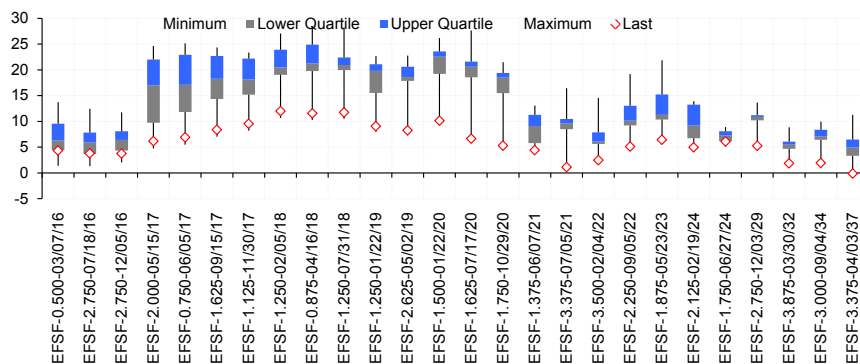
Figure 5. ...and as a corollary the EU also cheapens to France



Source: Citi Research

EU as the main laggard: Another way to quantify the extent to which the EU has lagged in the rally is to analyze the spread curve between it and the EFSF. This is depicted in Figure 6 where we take the yields of the EFSF and subtract the fitted yield of the EU from a modelled cash curve. As can be seen, EFSF's spreads to the EU are at very tight levels: around the 4y sector, the EFSF had traded some 20bp wider than the EU and now such spreads are around 10bp if not lower. As such, curve compression continues with the market seemingly differentiating less and less among the single names.

Figure 6. EFSF bonds vs a fitted EU yield curve (spread curve and box whiskers, 3m history)



Source: Citi Research

...and agencies rally to their reference sovereigns

Within the agency space, spreads continue to tighten. German, Dutch and French agencies have all outperformed their reference sovereigns with many spreads now are at or near all-time tight. However, on a cross market basis, the move in France and supras left some of the agencies looking relatively attractive. The sharp move in OATs just after the ECB, saw spreads to KfW spike dramatically (*Hunt for yield has been turbo charged: KfW-France offers value*). Although spreads have retraced slightly, we still believe KfW offers value vs France, especially when moving out of OATs (Aa1/AA) and into German agencies can be achieved at a spread pick-up.

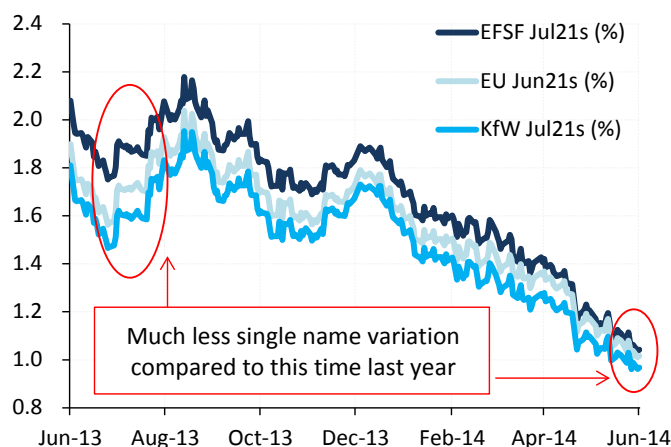
Market implications – the great compression & shallower dips

Two clear market implications of the current dynamic can therefore be drawn:

- Much less single name variation – the great compression continues (Figure 7)
- Lower volatility and yield levels mean “shallower dips” to buy on (Figure 8)

This makes finding opportunities between SSAs vs their reference governments harder with seemingly fewer and fewer “dips” to buy. In the current environment, we continue to prefer cross market trades, analyzing SSAs vs each other, vs covereds and vs sovereigns that are not their reference guarantor.

Figure 7. Implication 1 – much less single name variation



Source: Citi Research

Figure 8. Implication 2 – “dips” getting shallower

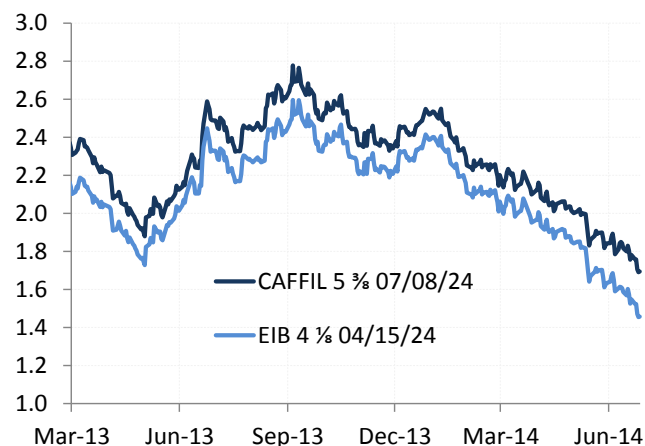


Source: Citi Research

Are covereds cheap to supras?

Moving into covered bond relative value (the focus of the next section below), another key implication of the moves seen in some supras is their outperformance vs issuers such as CAFFIL. This can be seen in the 10yr sector (Figure 9, Figure 10). The spread is now historically wide and offers a pick-up of over 20bp.

Figure 9. CAFFIL Jul24s and EIB Apr24s (Yields, %)



Source: Citi Research, Bloomberg

Figure 10. CAFFIL Jul24s – EIB Apr24s (Yield spread, bp)



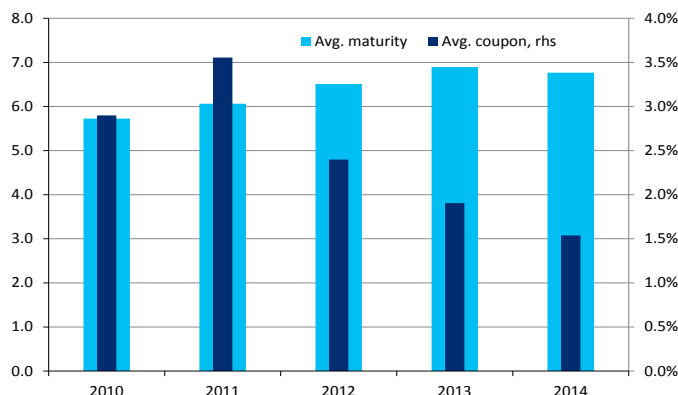
Source: Citi Research, Bloomberg

Relative value opportunities in covered bonds

What should investors do?

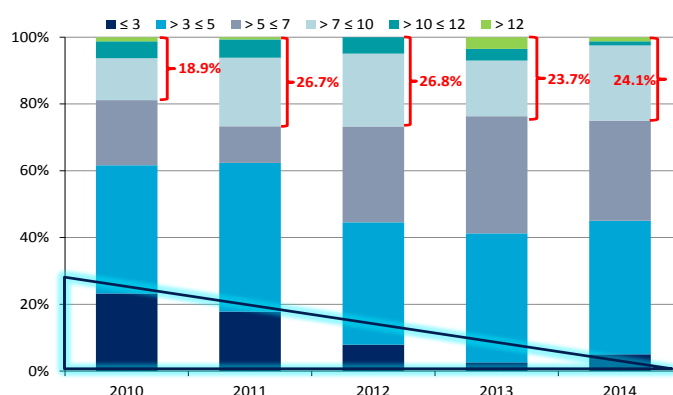
As spreads tumble, investors which are constrained to credit lines or are limited by portfolio definitions, rating ceilings or benchmarks are likely increasingly to run out of opportunities. Hence, investors can usually increase interest rate risk by preferring longer dated bonds or increase credit risk by climbing up the credit curve.

Figure 11. EUR Covered bond issuance 2010-2014: simple average maturity and coupon per year



Source: Citi Research

Figure 12. EUR Covered bond issuance 2010-2014: issuance by maturity bucket



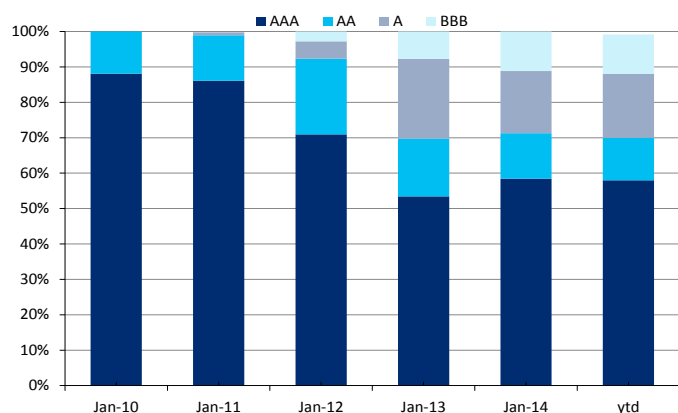
Source: Citi Research; not volume weighted

Average maturity is on the rise but very long dated bonds are still rare

The average coupon of new euro benchmark deals has declined steadily from 3.6% to 1.5% year to date (Figure 11). This development was not driven by the issuers' preference to issue shorter dated covered bonds – rather the contrary. From an average maturity of 5.7 years in 2010, it increased by more than one year to 6.9 years in 2013. Year-to-date the average maturity of new deals stands at 6.8 years. However, as seen in Figure 12, the higher average maturity can mainly be traced back to lower activity in the issuance of covered bonds with an original maturity of three years or lower.

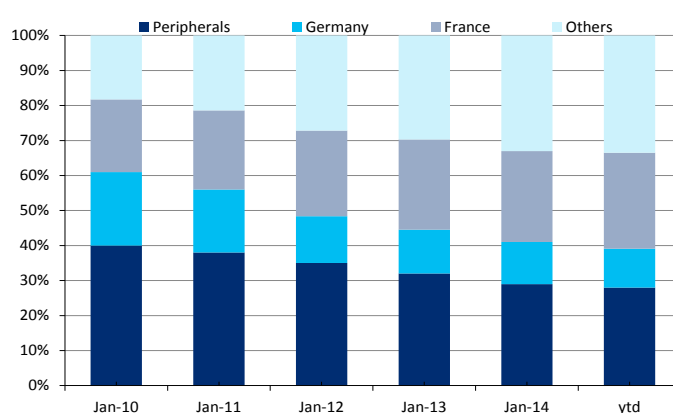
The share of longer dated covered bonds (> 7yrs) has been quite steady at around 25% whereas covered bonds with an original maturity of more than ten years still play a minor role. Hence, it can be stated that the ability for investors to gain exposure to higher interest rate risk by increasing duration through longer maturities increased somewhat. For many banks the ten year benchmark bond seems to be the longest path to choose.

Figure 13. iBoxx EUR Covered composition by rating



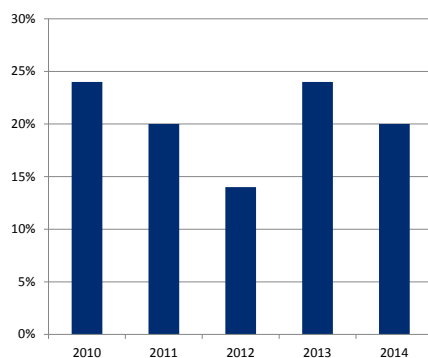
Source: Markit, Citi Research

Figure 14. iBoxx EUR Covered composition by geography



Source: Markit, Citi Research

Figure 15. New issuance activity: share of peripheral covered bonds, %



Source: Citi Research

Hence, the more prominent way for investors to generate excess return is to increase credit risk. Investors which decreased their exposure to more risky covered bond segments between 2010 and 2012 flocked back into these segments since 2013. This led to a revival of demand even for high-beta products like multi-cédulas.

One main reason why this has been the case was the rating cycle which changed a market from a once purely AAA rated product to more diversified ratings with an established BBB segment as seen in Figure 13 (and also occasional sub-investment grade bonds which are excluded from the iBoxx index). Hence, investors adapted to the new reality and took more credit risk than before. However, one main obstacle for investors is the fact that the segments perceived as having higher credit risk (and hence higher spreads, i.e. peripheral covered bonds) have been on a constant path of decreasing outstanding volume. Although the share of new issuance of peripheral covered bonds recovered in 2013 (Figure 15) the outstanding volume is decreasing as net supply has been negative.

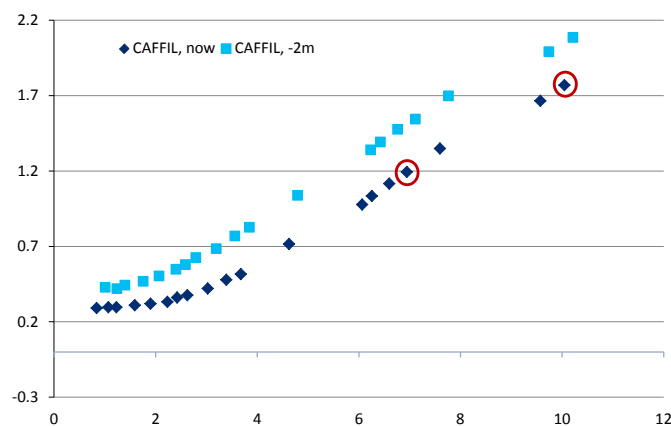
Obviously, although credit risk may have not been waned, credit spreads have to a large extent. Hence, for covered bond investors the relative attractiveness of increasing credit risk decreased substantially while the possibilities of taking higher interest rate risk have not increased materially. Although private placements in any form might be the preferred way in such an environment, the following ideas should present some opportunities to generate excess return by trading fundamentals, macro movements, duration, credit risk and looking for primary market opportunities.

Extension trades

Long duration by extension trades, ...

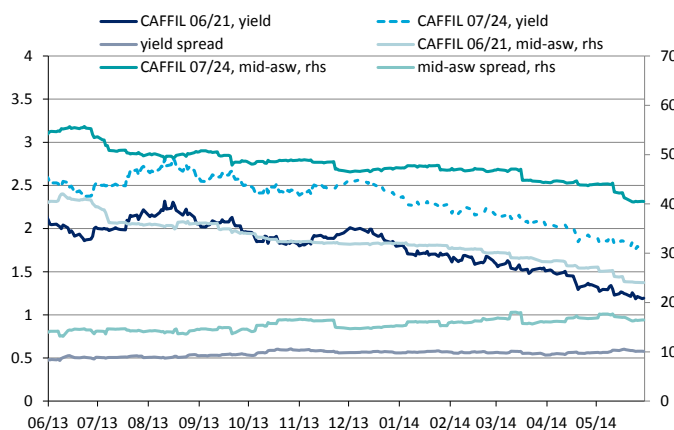
The following examples increase interest rate risk by extending on the curve of a single issuer. As an example, we would recommend switching bonds on the curve of CAFFIL, extending exposure by three years. This would lead to a pick-up in 58bps of yield spread and 16bp on an asset-swap basis. CAFFIL (Aaa/AA+/AA+) has become one of the most active French covered bond issuers which is fully owned by public entities and supported by the French state.

Figure 16. CAFFIL yield curve, %



Source: Citi Research

Figure 17. Prefer CAFFIL 07/24 to CAFFIL 06/21



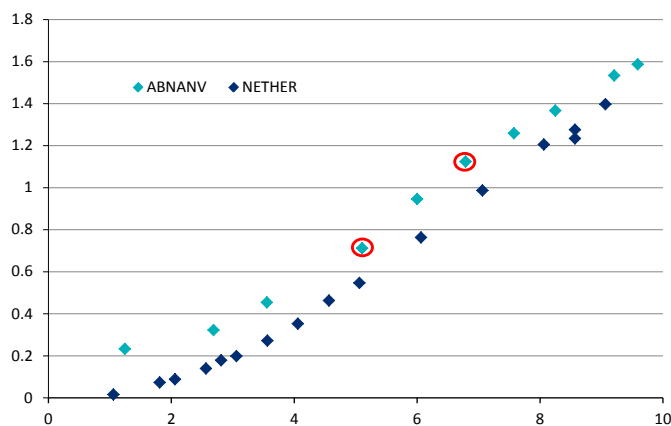
Source: Citi Research

...for example in the Netherlands or France

In general, covered bond curves are relatively flat, especially when compared to sovereign debt. However, another example which offers a relatively attractive pick-up by preferring longer dated covered bonds on the same issuer's curve is found at ABNANV. For an extension of 3.5 years, a yield spread pick-up of 41bp and an asset-swap pick-up of 17bp. This year, ABNANV has so far been only active once in

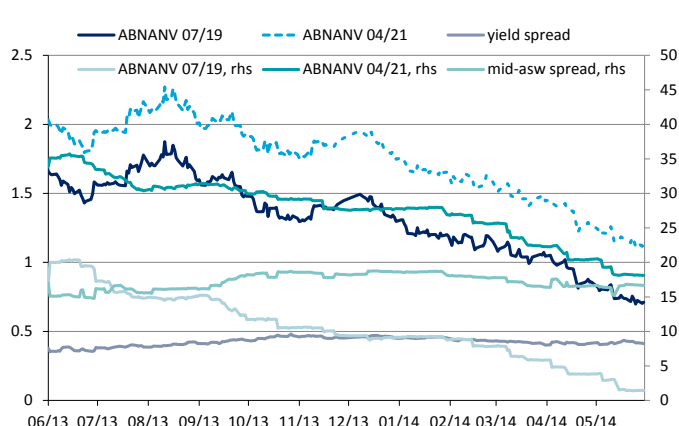
the euro benchmark covered bond market with a 10yr covered bond. Hence, if the issuer decided to return to the covered bond market we would rather suspect that the belly of the curve would be the preferred tenor, putting less pressure on the longer end of the curve.

Figure 18. ABNANV and NETHER yield curve, %



Source: Citi Research

Figure 19. Prefer ABNANV 07/24 to ABNANV 06/21



Source: Citi Research

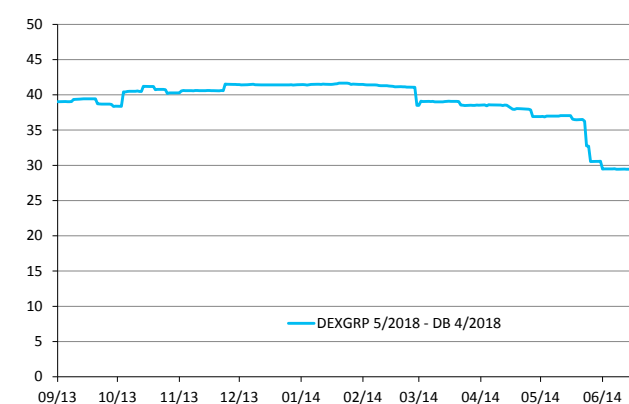
Increasing credit risk selectively

Increase credit risk – but only in selective names

In our latest [Euro SSA and Covered Bond Monthly](#), we reiterated our recommendation to look at those issuers in (semi-) core segments which used to be distressed names in the past. Examples can be found in nearly all European countries. One of those names is Dexia Kommunalbank Deutschland which – albeit being in wind-down mode – is still an active issuer of covered bonds and did so at the beginning of June.

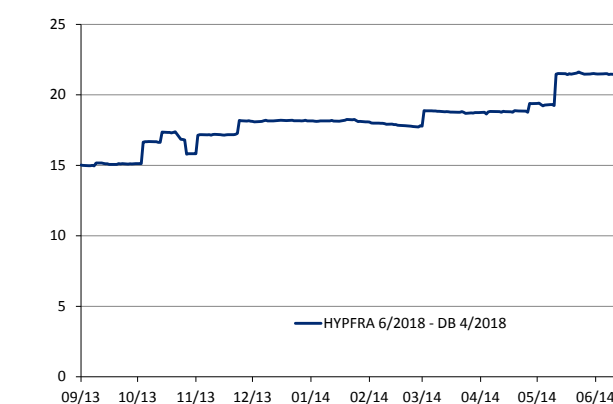
In spite of the obvious supply pressure our recommendation to prefer DEXGRP 05/18 to the most expensive pfandbriefe, in this case DB 04/18 for a pick-up of 36bp, has already performed. However, we would still prefer to stay with the lower rated DEXGRP for the time being. Other issuers like HYPFRA and PBBGR still offer a decent pick-up as well.

Figure 20. Hold DEXGRP 05/18 vs DB 04/18, mid-asw, bp



Source: Citi Research

Figure 21. Other distressed names look attractive as well, mid-asw, bp



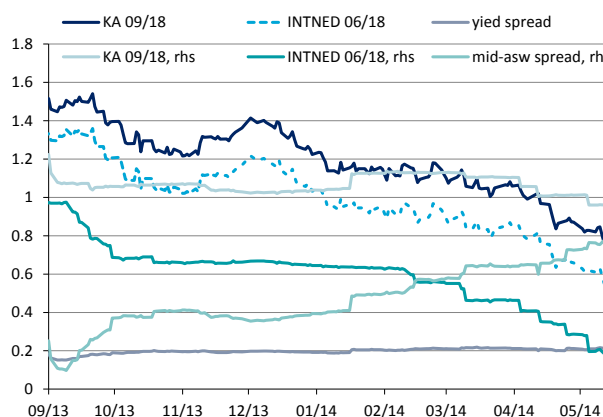
Source: Citi Research

**HAA is an isolated case in our opinion –
prefer Austrian covered bonds**

Moreover, within the German universe other cheaper names (albeit lower rated) still offer a decent pick-up to its most expensive peers, especially as they slightly cheapened during the last weeks. However, higher spreads can be found in other segments than the German pfandbrief market. Within the core universe, several opportunities arose in the Austrian covered bond segment.

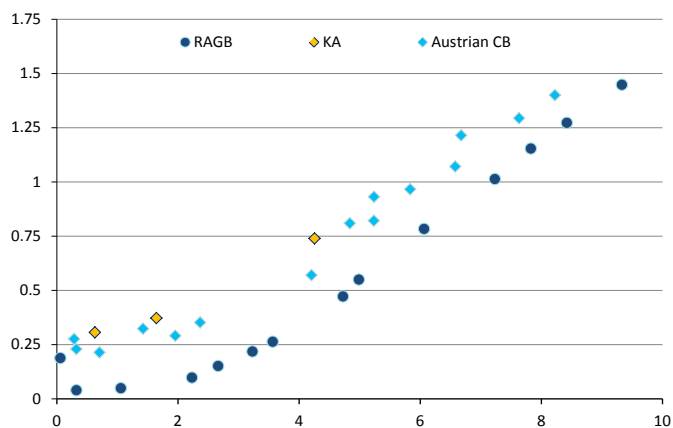
The development of HAA not only led to a general uncertainty on Austrian fixed income products (e.g. RAGB underperformance vs EGB) but also to downgrades of Austrian covered bonds by Moody's. This can be traced back to the agency's methodology as Moody's downgraded several Austrian banks given their lower state support assumption than before. However, we continue to believe that the underperformance of Austrian covered bonds versus its peers is mainly due to spread widening in sympathy to the government bonds while we see HAA as an isolated case and are convinced of the high quality of Austrian covered bonds.

Figure 22. Prefer KA 09/18 to INTNED 06/18



Source: Citi Research

Figure 23. KA looks cheap to its peers and RAGB, yield, %



Source: Citi Research

**KA looks attractive vs domestic peers
and other covered bond issuers**

Hence, we would recommend switching into Austrian covered bonds. As an example we continue to like KA within the Austrian covered bond universe (Figure 23). However, as the Aa3 rating of the covered bond is on rating watch negative at Moody's we would rather wait for the end of the agency's revision period and increase exposure thereafter, irrespective of Moody's action on this name.

After the HAA event the issuer reiterated via CBR that the draft legislation concerning HAA would not indicate a change in the support mechanism of the Republic of Austria for KA. As a switch opportunity from other segments to KA, we would prefer relatively rich trading semi-core names, like INTNED which outperformed the Austrian entity consistently during the last six months in the belly of the curve on an asset-swap basis (Figure 22).

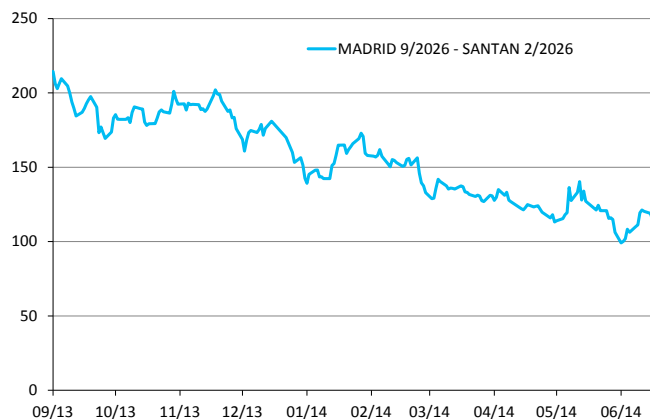
Trading fundamentals

We continue to like Spanish regions

Back in February we analyzed the Spanish regions in depth (see [Euro SSA and Covered Bond Monthly - Spanish Regions – Stability established?](#)) and since then we have been very constructive on these issuers. Recently, Moody's published a sector comment, summarizing the current state of the autonomous regions. Their findings confirm our position. The liquidity situation of Spanish regions has improved substantially as it is directly linked to the Spanish central state if the region participates in the FLA. Moreover, the rating agency expects that the regions' debt burden will stabilize in 2016 as the deficit to operating revenue already steadied substantially last year and should improve further this year and the years ahead.

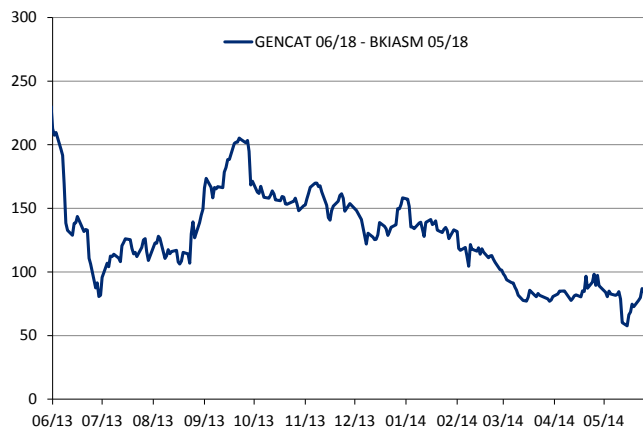
Moreover, according to Moody's, it should be expected that as of 2015 a new regional funding system for Spanish regions could be introduced which might also boost regions' transfer and/or tax revenue, supporting fiscal sustainability in the longer term. Hence, Spanish sub-sovereign debt should continue to be attractive. Switches could be done against central government debt but also against Spanish covered bonds.

Figure 24. Continue to prefer MADRID 09/26 to SANTAN 02/26, yield spread, bp



Source: Citi Research

Figure 25. Prefer GENCAT 06/18 to BKIASM 05/18, yield spread, bp



Source: Citi Research

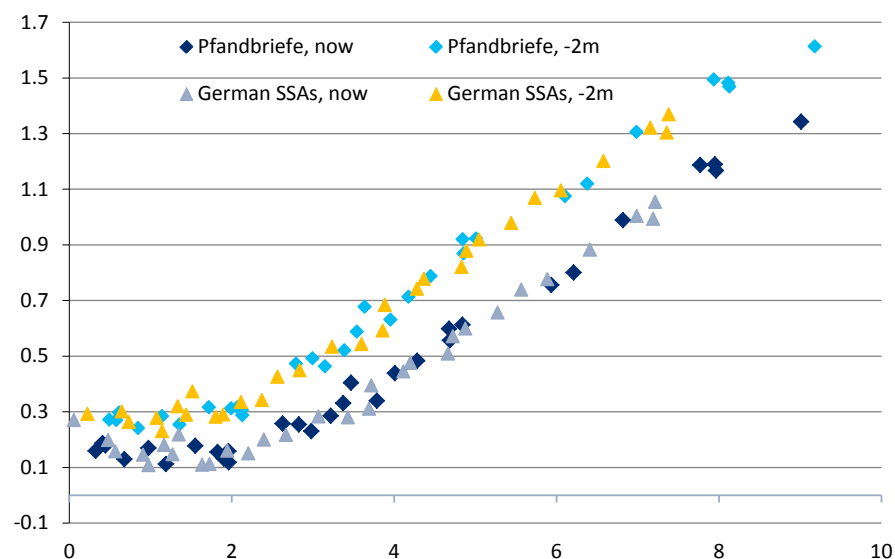
Prefer GENCAT to other regions but also to covered bonds

One recommendation we would like to hold on is to prefer MADRID to SANTAN in the very long end. We think that the former can continue its outperformance against the Tier-1 covered bond issuer. However, given the strong FLA support mechanism we also think that it is attractive to look at cheaper names in the Spanish regional segment. As an example, GENCAT is trading cheap among its peers, but also in comparison to single-cédulas. As an example, GENCAT still offers a yield pick-up of 80bp to BKIASM in the 4yr area. Although the spread between both names has been substantially higher we think that there is still further performance potential. It should be obvious that the performance of these recommendations is mainly a function of the performance outlook of SPGBs. However, as we expect SPGBs to outperform EGB markets until the end of the year – albeit at a lower scale than before – the outperformance of regional debt vs secured paper can also continue although on a more volatile basis in our opinion.

Don't expect substantial spread widening but prefer the more liquid 0% risk weight paper

In the lower-beta area like the German pfandbrief and SSA market, spreads are extremely tight and stable. This is especially the case for the most expensive pfandbriefe (Figure 26) which are trading in line with the names like FMSWER and RENTEN. As spread movements between these names have been rather slim during the last two months we would expect the range-trading to continue in the medium-term. However, we would use this opportunity and step up in quality into the explicitly guaranteed agency debt. Although we don't expect substantial underperformance of pfandbriefe vs SSAs we also don't expect the opposite. The SSA curves seem to work as a natural boundary for pfandbrief spreads although the market for secured debt is in a constant shrinking mode and in many cases at the same rating level. Hence, preferring zero risk weighted debt looks more attractive in our opinion.

Figure 26. Yield universe German SSAs and pfandbriefe, %



Source: Citi Research

Trading macro themes

BRRD is on its way...

The Bank Recovery and Resolution Directive (BRRD) has been approved by the European Parliament at the beginning of April 2014. The system will begin to apply from January 2015. Key elements of the directive will be the possibility of authorities to prepare and prevent financial stress or the failure of a bank by forcing the bank to take appropriate measures. Moreover, authorities can early intervene if an institution is under financial distress. If this doesn't prove successful, the last solution is a resolution, including the power to sell or merge businesses with another bank, setting up bridge banks as well as writing down debt of failing banks (i.e. bail-in). That said, it should be noted although BRRD applies as of January 2015, bail-in procedures should start to apply in January 2016, putting senior bondholders probably to a higher risk of burden sharing than before.

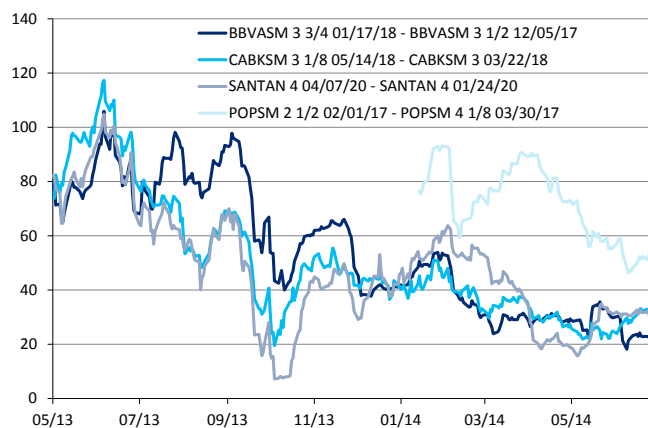
...and gives covered bonds the edge but senior bonds perform better

Irrespective of the higher risk for senior bondholders, spreads between covered bonds which will be exempt from bail-in procedures and senior bonds made rather the contrarian move than one might expect. The tighter spreads between covered bonds and senior bonds are more pronounced in the non-core markets, irrespective of the final maturity of the bonds. Hence, investors currently seem to be confident that a bail-in for unsecured debt is more of a paper tiger than a real threat. Although it seems hard to forecast if/when senior bail-ins are implemented the bail-in of up to 8% of total liabilities seem to be on the cards, irrespective of the existence of the existence of a resolution fund (which should be filled up until 2025) or the back-up of public funds. Hence, this makes it quite clear the risk of being bailed in as an unsecured investor is also driven by the buffer of products ranging lower in the capital structure. However, this differentiation merely seems to take place.

... but senior bonds perform better

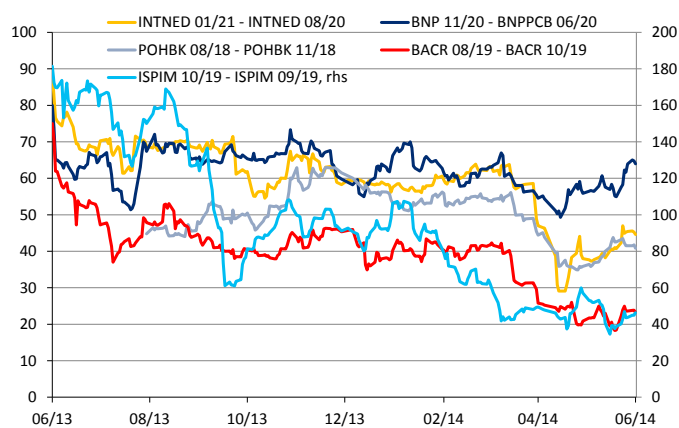
One example can be found in the Spanish market. The hunt for yield was the main spread driver. Hence, higher-beta senior debt outperformed covered bonds. That said, the spread differential between both asset classes is higher for Tier-2 names which is justifiable in our opinion. Nevertheless, we think that the current relative pricing should be used as an opportunity to step up in quality, especially given the fact that the scope of subordination of senior bondholders is extremely high under the Spanish covered bond framework (covered bondholders have a preferential claim on the whole mortgage book).

Figure 27. Senior-covered spread at Spanish issuers, mid-asw spread, bp



Source: Bloomberg, Citi Research

Figure 28. Senior-covered spread in other countries for selected issuers, yield spread, bp



Source: Bloomberg, Citi Research

The spread might have seen its lows – step up in quality.

As mentioned above, the very tight spread environment also provides the possibility to step up in quality in other markets than the Spanish. However, in many (semi-) core European markets, the covered senior spread seems to have floored while in a few cases the senior bonds already cheapened during the last weeks. However, in the case of Italian ISPIM, spreads have tightened by nearly 140bp to 40bp. At this stage, we would prefer switching into covered bonds as we wouldn't expect a further outperformance of senior paper. In the core segment, UK covered bonds also look relatively cheap to senior bonds. As an example, we would prefer BACR 10/19 covered bond to the issuer's unsecured paper.

ECB QE might be a further main macro driver to trade on – but not now

A further example of a macro theme which we expect will have substantial implications for spreads would be a large-scale asset purchase program of the ECB. However, as our economists expect this to be introduced in December 2014, we wouldn't assume any near- and medium term impact on relative value pricing.

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Euro SSA Strategy

(1) Strategy views and market developments

EFSF's rating decouples from France

In June, Moody's revised its Aa1 rating of the EFSF from negative to stable. As such, we do not envisage any change in Moody's rating of the EFSF over the medium term.

This is an interesting development for the SSA market as the rating of the EFSF had been closely linked to that of France – which remains Aa1 negative (in fact, France is the only EMU sovereign to be rated with a negative outlook by Moody's, Figure 30). It now means that the drivers affecting the EFSF are more distinguishable from the credit drivers affecting France. Importantly, Moody's now states that the rating of the EFSF would not necessarily be affected in a scenario where France underwent a one notch downgrade.

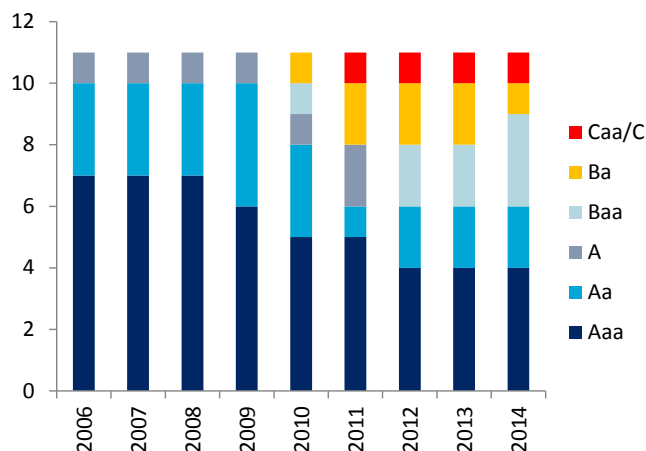
The key drivers behind Moody's decision include:

Assessment of lower default correlation: Historically, France (as the EFSF's second largest shareholder), has been integral to the rating of the EFSF. This is because in an extremely unlikely situation where France were to default, this would also be associated with credit stress in lower rated sovereigns and the situation whereby other higher rated sovereigns might have other priorities in terms of honoring debt commitments. However, Moody's has now re-assessed such default correlation citing two factors:

- France's negative outlook pertains more to idiosyncratic, rather than systemic, factors reflecting its own domestic vulnerabilities.
- Measures are now in place (or are being implemented) that enhance authorities' ability to manage contagion risk. These include the various bailout facilities themselves as well as banking union.

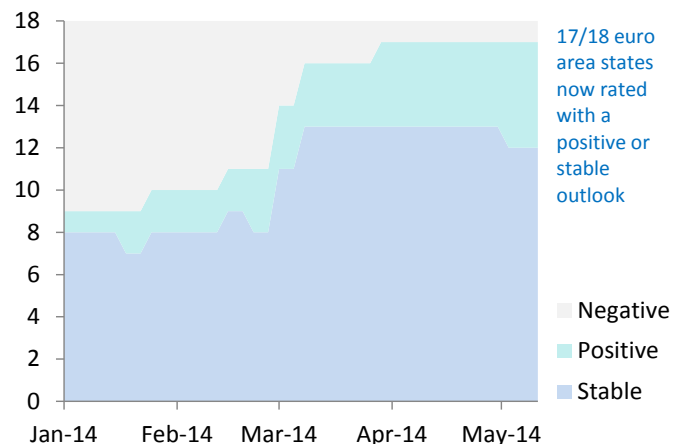
Improvement in EMU credit quality: Secondly, there has been an improvement in the balance sheet of the EFSF and the general credit quality of its guarantor structure. Specifically, there have been various rating upgrades in 2014 by Moody's (notable, Ireland, Portugal and Spain) and lots of "outlooks" have been revised from negative to stable or positive (Figure 29, Figure 30).

Figure 29. Moody's rating of EMU-11 (count by broad rating)



Source: Citi Research, Moody's

Figure 30. Moody's rating "outlooks" – 2014 revisions to date (count)



Source: Citi Research, Moody's

EFSF's rating now "resilient" to a one-notch downgrade of France

Importantly, the EFSF's credit quality and rating remain very connected to its shareholder base, especially large highly rated shareholders such as France, Germany and the Netherlands. However, for the factors given above, Moody's states that the rating of the EFSF (Aa1 stable) "would be resilient to a one-notch downgrade of France".

In addition, the EFSF still benefits from various other credit supports such as its relatively low leverage, strong shareholder support, explicit guarantees and over-collateralization. Further details on such matters can be found in our [Euro SSA and Covered Bond Monthly - Supranationals in focus – overview and opportunities](#).

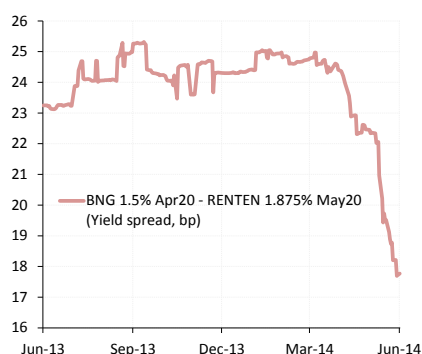
Three topics in Dutch agencies

In our latest [European Rates Weekly](#), we highlight three key spread drivers we see for the Dutch agencies in the current environment:

- **The Hunt-for-yield** and their outperformance vs other core agencies (Figure 31)
- **The regulatory environment** and treatment within the LCR
- **The rating outlook** that is now negative by Moody's (unlike the sovereign)

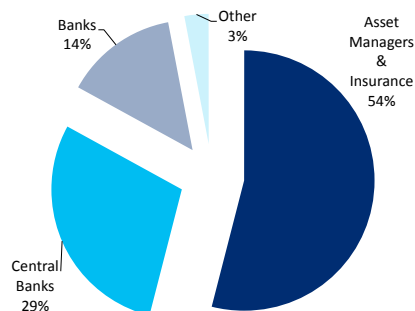
Our key message is that the ECB inspired intensification of the hunt-for-yield remains the overwhelming driver for high quality spread products like the Dutch agencies. We expect ongoing compression although the pace of the outperformance may slow hereon in.

Figure 31. BNG outperforming RENTEN



Source: Citi Research

Figure 32. Take up of NEDWBK's green bond (%)



Source: Citi Research, NEDWBK

Green bond issuance now from NEDWBK – the debut

NEDWBK entered the "green bond market" this month with €0.5bn issued in NEDWBK 0.625% Jul19s at MS+8bp on 26th June. This was at the tight end of guidance. The investor distribution is shown in Figure 32, 69% which were "green investors".

We welcome the ongoing maturation of this SSA segment, which has typically been USD centric ([Euro SSA Strategy - Green shoots in € green bonds](#)). The strength demand indicated in the NEDWBK clearly indicates how the euro sector is growing and is likely to continue to do so in our view. To date, EIB has increased its own Climate Awareness Bond to €2.6bn outstanding and remains the market leader

€8bn in issuance expected from the EFSF in Q3

In other news, the EFSF/ESM have produced their very latest *Investor Newsletter*. Consistent with their previous presentation, the EFSF is to issue €8bn in Q3. There is no issuance expected from the ESM.

To date, the EFSF has issued €25bn with a total of €9.5bn remaining across Q3 and Q4. The ESM has issued €10bn (following the tap in June) with €7bn remaining.

Cross-market views

Our Weekly Chart-pack which details the spreads mentioned below and provides investors with the very latest market moves and issuance trends ([European SSA Strategy - Weekly SSA Chart-Pack and Market Monitor: 20th-27th June](#)).

Don't miss our [Euro SSA Strategy Presentation - The ECB has turbo-charged the hunt-for-yield](#).

Below we detail our cross-market views in brief with our latest market observations across key SSA sectors.

Figure 33. SSA Cross-asset views by country

Country	SSA-SSA	SSA-Govt
Germany	We would not fade the strength of RENTEN vs KfW given that both share an explicit guarantee now. Better opportunities might present themselves in FSMWER or ERSTAA. Supras such as EIB have massively outperformed and converged to KfW/RENTEN	KfW-Germany spreads at 22bp-25bp in the belly of the curve are around the tight end of ranges (limited value in our view). KfW-France at 5bp+ offers very good relative value. Also consider KfW-Belgium. Spreads are now already retracing from recent wides inspired by the ECB and its affect on the soft-core EMU govt markets
Austria	ASFINAG and OBND trade tight, little RV at present in our view	Austrian agencies historically tight to Germany and have performed well vs Austria in this latest move. Spreads vs France (and as a corollary, EIB) had widened slightly.
Netherlands	BNG trading tight to NEDWBK across the curve. Very strong performance vs RENTEN.	Good performance of Dutch agencies vs DSL in the latest retracement in the 5yr sector; spreads still relatively wide in the front-end. Spreads vs France still look reasonably attractive.
France	Strong performance of the soft core and French assets more broadly with CADES, UNDEDIC and AGFRNC all benefitting. CADES now historically tight to assets such as KfW and RAGBs.	Tight spreads to France; French agencies have also outperformed and with spreads tightening to Austria and the Netherlands.
Spain	See better value in the regions relative to the agency sector.	ICO benefiting in the periphery rally in ASW, but Spanish agencies generally tight to underlying Bonos.
UK	UKRAIL's exit from the market likely to sustain outperformance vs sterling KfW and EIB in the belly of the curve. We look towards 2015 and the emergence of a new UK issuer for sub-sovereign debt	We expect the lack of supply from UKRAIL is likely to encourage further tightening to gilts.
Supranationals	EIB/EFSF have massively outperformed the EU (and other agencies such as KfW/BNG) EUROF trading historically cheaply to EIB ESM-EIB justified by technicals, we would not fade the move. We would remain long the ESM. EFSF continues to benefit from the technical whereby several (pre-Cyprus) bonds won't ever be tapped.	EIB vs France still looks selectively attractive in certain sectors given the outperformance of OATs (although spreads have retraced from recent wides). Also note that EFSF's rating has now "de-coupled" from France - EFSF now Aa1 Stable whereas France is still Aa1 Negative EIB/EFSF tightened to the Netherlands ESM strongly outperforming peers and this trend looks set to continue

Source: Citi Research

(2) Primary market activity – June 2014

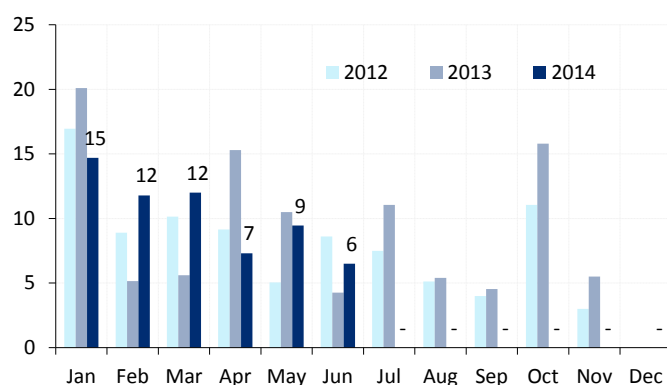
Primary market activity slowed in June. Many SSA issuers are now over half way in terms of meeting their annual funding target.

Slower summer can be expected

EUR Supranationals - €6bn: Euro-denominated supranational supply in June was around €6bn (Figure 34). The largest benchmark deal was the new 3yr EFSF for €3bn priced at MS-8bp.

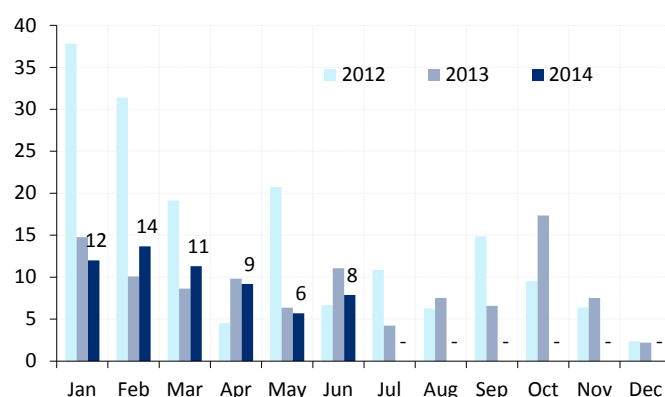
EUR Agencies - €8bn: Total euro agency issuance was around €8bn in June (Figure 35). The largest deal was the €3bn KfW 1.5% Jun24s. NEDWBK also issued its first green bond for €0.5bn.

Figure 34. EUR issuance by Supranationals (€bn)



Source: Citi Research, DCM Analytics

Figure 35. EUR issuance by non-US Agencies (€bn)



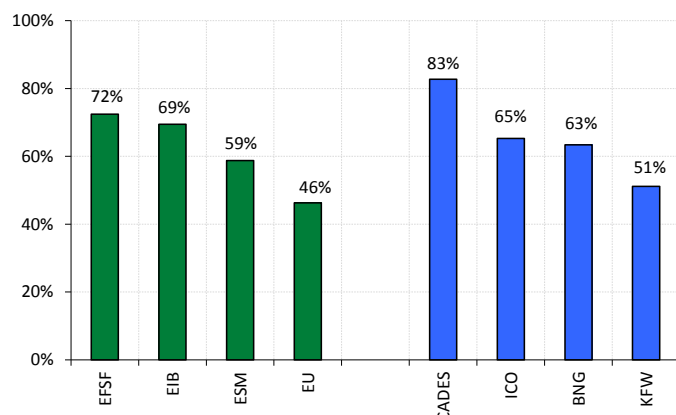
Source: Citi Research, DCM Analytics

Completion rates: SSAs have made good progress with respect to their funding targets, with many now half the way through their 2014 issuance (Figure 36).

■ **Supras:** EFSF is currently 72% the way through, followed by EIB (69%), and the ESM (59%).

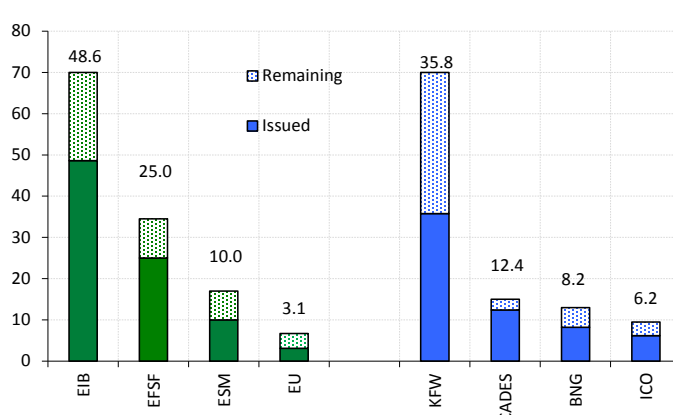
■ **Agencies:** KfW has issued over €35bn across all currencies out of its €70bn funding target for 2014 as a whole.

Figure 36. Key supra and agency completion rates (All currencies, %)



Source: Citi Research, DCM Analytics, Investor Presentations

Figure 37. Absolute amount issued across all currencies (€bn).

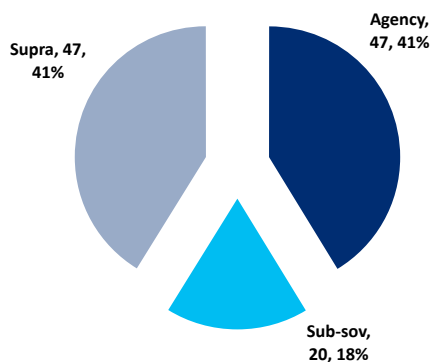


Source: Citi Research, DCM Analytics, Investor Presentations

YTD issuance trends – euro fixed rate benchmark supply

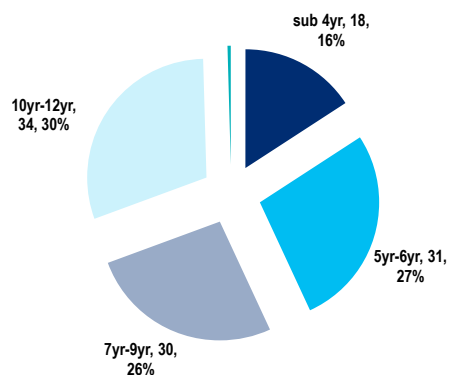
Euro fixed rate new issuance is shown below by SSA, maturity and country.

Figure 38. € SSA YTD supply by issuer type



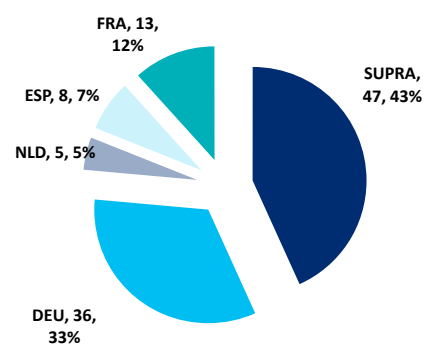
Source: Citi Research, Bloomberg

Figure 39. € SSA YTD supply by maturity



Source: Citi Research, Bloomberg

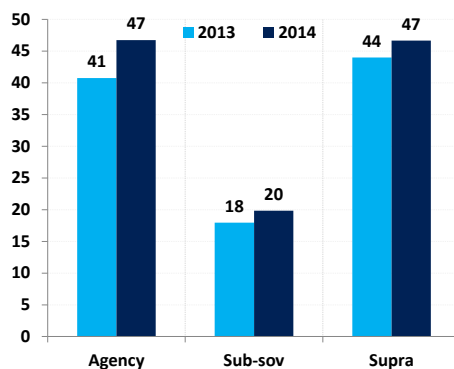
Figure 40. € SSA YTD supply by geography



Source: Citi Research, Bloomberg

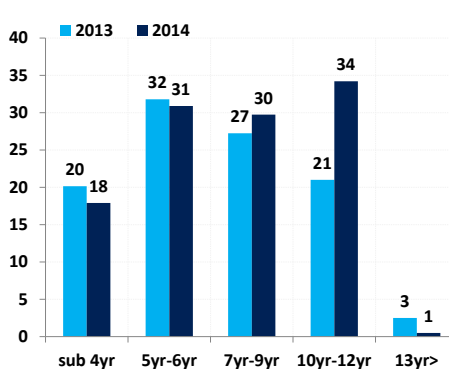
Euro fixed rate new issuance is shown below comparing YTD 2014 with 2013.

Figure 41. € SSA YTD supply by issuer type



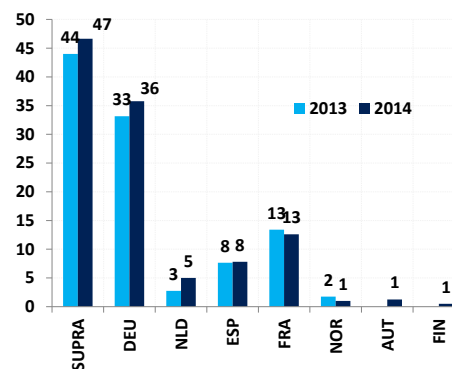
Source: Citi Research, Bloomberg

Figure 42. € SSA YTD supply by maturity



Source: Citi Research, Bloomberg

Figure 43. € SSA YTD supply by geography



Source: Citi Research, Bloomberg

(3) Secondary market performance – June 2014

In the secondary market, SSA yields fell significantly in June and consequently the sector produced positive total returns (especially the € iBoxx supranational index)

June total returns

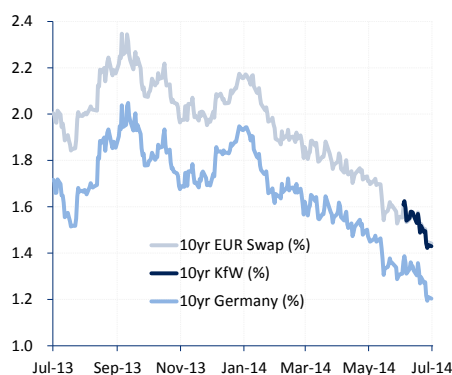
€ iBoxx Supranationals 0.95%

€ iBoxx Agencies 0.62%

Positive returns in June: Returns for € iBoxx Supranationals and € iBoxx Agencies over April were 0.95% and 0.62% respectively.

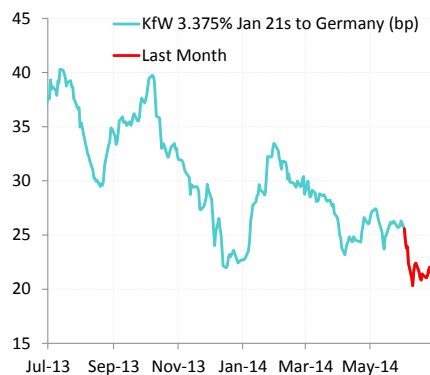
Lower yields, tighter core spreads: SSA yields moved lower in June (Figure 44). This largely reflects an intensification of the hunt for yield given the June ECB ([Euro SSA Strategy Presentation - The ECB has turbo-charged the hunt-for-yield](#)). Core spreads to Germany tightened and remain relatively low, hence our preference for RV vs other sovereigns such as France (Figure 45). Supra ASW spreads continue to grind tighter, with the 10yr ESM now trading flat to swaps Figure 46.

Figure 44. 10yr KfW, Germany and € Swap



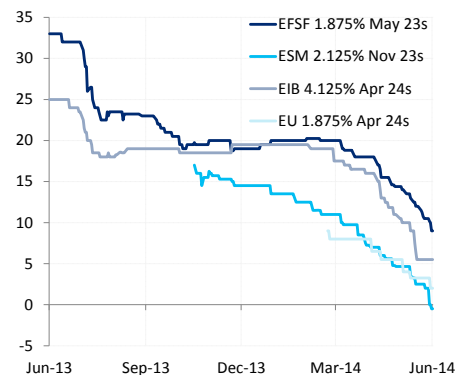
Source: Citi Research

Figure 45. 7yr KfW to Germany (bp)



Source: Citi Research

Figure 46. 10yr Supra spreads to swaps (bp)



Source: Citi Research

June moves vs swaps – tighter supra spreads: Over June, SSA spread to swaps were generally tighter. Supras led the move, especially in the 7yr and 10yr sectors (Figure 47). For instance, the ESM is now flat in the 10yr sector and the new 3yr EFSF issued at MS-8bp is now trading at MS-11bp.

Figure 47. YYS (Yields spreads to the EUR swap curve, bp).

3yr				5yr				7yr				10yr				20yr			
	Now	-1wΔ	-1mΔ		Now	-1wΔ	-1mΔ		Now	-1wΔ	-1mΔ		Now	-1wΔ	-1mΔ		Now	-1wΔ	-1mΔ
Germany	-30	0	4	Germany	-26	0	4	Germany	-30	-1	4	Germany	-19	-1	2	Germany	-4	-1	2
France	-21	-1	0	France	-7	3	1	France	-3	1	-3	France	21	0	0	France	29	-1	-2
EFSF	-12	-1		EFSF	-7	-1	-6	EFSF	0	-1	-6	EFSF	9	-2	-5	EFSF	14	-1	-5
ESM				ESM	-10	-1	-5	ESM	-2	-2	-4	ESM	0	-2	-5	ESM			
EIB	-17	0	0	EIB	-13	-1	-4	EIB	-2	-1	-5	EIB	5	0	-5	EIB	16	-1	-4
EU	-22	0	-1	EU	-17	0	0	EU	-2	-1	-3	EU	2	-1	-2	EU	7	-2	-2
KfW	-21	0	0	KfW	-13	0	-3	KfW	-8	0	-1	KfW	-2	0	0	KfW			
RENTEN	-21	0	0	RENTEN	-14	0	0	RENTEN	-6	0	0	RENTEN	-9	0	0	RENTEN			
CADES	-13	0	0	CADES	-2	0	-2	CADES	4	1	-4	CADES	13	-2	-5	CADES			
BNG	-7	0	-2	BNG	3	-1	-5	BNG	15	0	-3	BNG	17	0	-3	BNG			
NEDWBK	-7	0	-2	NEDWBK	6	-1	-3	NEDWBK	15	0	-2	NEDWBK	18	-1	-2	NEDWBK	23	0	0
ASFING	-11	0	-1	ASFING	-3	-1	-2	ASFING	-1	0	-3	ASFING	13	0	-1	ASFING	18	0	-1
ICO	42	-14	-20	ICO	61	-11	-17	ICO	93	-6	-19	ICO				ICO			

Source: Citi Research

Covered Bond Strategy

(1) Strategy views

Figure 48. Covered Bond Portfolio recommendation

iBoxx EUR Covered Bond Index - Citi Portfolio Allocation											
Country	Market Value	Index weight	Index Duration	Index Level t(0)	Index Level Live	Tot. return (obs. period)	Weighted TR (obs. period)	Views	New index weights	New weighted tot. returns	Excess Total Return
Australia	17	2.0%	5.3	101	103	2.3%	0.0%	5%	2.0%	0.0%	0.0%
Austria	16	1.9%	5.0	139	142	2.1%	0.0%	5%	2.0%	0.0%	0.0%
Belgium	9	1.0%	4.7	101	103	1.9%	0.0%	0%	1.0%	0.0%	0.0%
Canada	11	1.3%	4.7	129	131	2.0%	0.0%	0%	1.3%	0.0%	0.0%
Denmark	9	1.0%	3.6	101	102	1.4%	0.0%	0%	1.0%	0.0%	0.0%
Finland	25	2.9%	3.5	101	102	1.3%	0.0%	0%	2.9%	0.0%	0.0%
France	236	27.4%	4.8	215	220	2.0%	0.6%	0%	27.4%	0.6%	0.0%
Germany	95	11.0%	3.5	189	191	1.2%	0.1%	-30%	7.7%	0.1%	0.0%
Ireland	13	1.6%	2.8	147	151	2.3%	0.0%	10%	1.7%	0.0%	0.0%
Italy	55	6.4%	4.1	133	136	2.2%	0.1%	10%	7.1%	0.2%	0.0%
Netherlands	45	5.2%	4.6	148	151	2.1%	0.1%	-5%	5.0%	0.1%	0.0%
New Zealand	5	0.6%	3.0	101	102	1.0%	0.0%	0%	0.6%	0.0%	0.0%
Norway	37	4.3%	4.0	138	140	1.6%	0.1%	5%	4.5%	0.1%	0.0%
Portugal	5	0.6%	3.4	152	155	2.4%	0.0%	10%	0.7%	0.0%	0.0%
Spain	167	19.4%	4.3	210	216	2.4%	0.5%	15%	22.3%	0.5%	0.1%
Sweden	27	3.1%	3.3	134	135	1.1%	0.0%	-5%	2.9%	0.0%	0.0%
Switzerland	13	1.6%	4.1	101	102	1.5%	0.0%	-10%	1.4%	0.0%	0.0%
United Kingdom	69	8.0%	3.7	146	149	1.5%	0.1%	0%	8.0%	0.1%	0.0%
USA	4	0.5%	2.4	150	151	0.8%	0.0%	0%	0.5%	0.0%	0.0%
Portfolio	860	100%	4.2	0	0	0.0%	1.9%		100%	1.9%	0.0%

Source: Citi Research; observed period: last three months. All constituents added 31/1/2014. Performance calculations exclusive of commissions and transaction costs. Past performance is no indication of future performance. All original recommendations and evidence of actual transactions on which the record is based are available on request.

Austria still looks attractive

Compared to last month, our general portfolio allocation remained stable. We haven't changed our allocation model. We think that the narrowing trend will continue over the near- and medium-term. Moreover, Austrian covered bonds remain our top-core pick. Although headline risks remain due to the incessant story on HAA, the secured products are now trading cheaper than Obligations Foncières and clearly wider than Dutch covered bonds.

Figure 49. Curve, Duration and weighting summary

Active Portfolio Views vs BMK					
PF Duration	0%				
PF Curve	1-3y	3-5y	5-7y	7-10y	10y+
	-10%	-5%	5%	10%	0%
PF Credit	Core	Soft Core	Periphery	Non-Euro	
	-30%	0%	45%	-5%	

Source: Citi Research

Cross-asset recommendations:

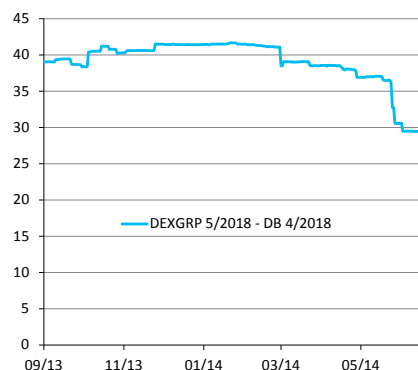
Figure 50. Cross-asset recommendations by country

Country	vs SSA and Sovereign Debt	vs Covered and Senior Debt
Australia		Prefer Australian covered bonds to European (semi-) core markets to get some pick-up
Austria	Prefer CB to RAGB and SSA, especially KA vs ASFING	Prefer KA vs INTNED in the belly of the curve
Belgium	Prefer covered bonds at the short end and sovereign bonds at the longer end	Belgian covered bonds have richened and are now trading at same levels as some core covered bonds
Canada		Inaugural issuances should be more attractive than outstanding bonds - one newcomer expected
Denmark		Prefer covered bonds to senior secured bonds
Finland	Prefer AKTIA to RFGB in the belly of the curve	Prefer highest yielding name SAMBNK
France	Prefer CB to FRTR: CFF in the 7y, CRH in the 3y area, prefer CAFFIL to EIB in the 10yr sector	Prefer CIFEUR to other French issuers
Germany	Prefer SSA and Bunds to the most expensive pfandbriefe	Prefer DEXGRP and HYPFRA to most expensive names
Ireland	Prefer IRISH to Irish ACS	Prefer MACS to PSACS
Italy	Prefer BTPS to Tier-1 OBGs	Prefer Tier-2 names within the segment: MONTE, BPIM, CREDEM, prefer ISPIM covered to senior debt
Netherlands	Prefer CB to DSL and SSA	Prefer SNS to to other Dutch covered bond issuers, prefer longer dated bonds to the belly of the curve
New Zealand		Covered bonds look rich against covered bonds from Australian parent companies
Norway		Prefer highest yielding name EIKBOL
Portugal	Prefer PGB to covered bonds	Prefer Portuguese covered bonds to Spanish covered bonds
Spain	Prefer SSA and SPGB to Tier 1 cédulas: ICO vs SANTAN in the 6y sector, MADRID in the longer end and and GENCAT in the belly of the curve	Prefer covered bonds to senior bonds; Prefer IMCEDI 7, IMCEDI 4, PITCH to other Multi-cédulas
Sweden		Prefer highest yielding name LANSBK
Switzerland		Prefer covered bonds to senior bonds in UBS and CS
United Kingdom	Prefer LLOYDS and BRADBI to BACR	Prefer covered bonds to senior bonds

Source: Citi Research

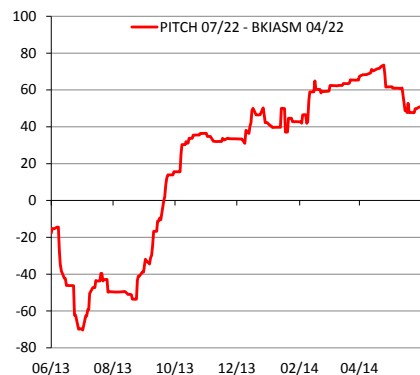
Wrap-up of our recommendations in June:

Figure 51. Prefer DEXGRP 05/18 to DB 04/18, mid-ass, bp



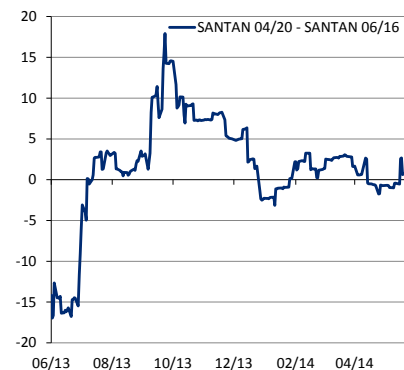
Source: Citi Research; Reference: SSA & Covered Bond Monthly, 30.05.2014

Figure 52. Continue to prefer PITCH 07/22 to BKIASM 04/22, mid-ass, bp



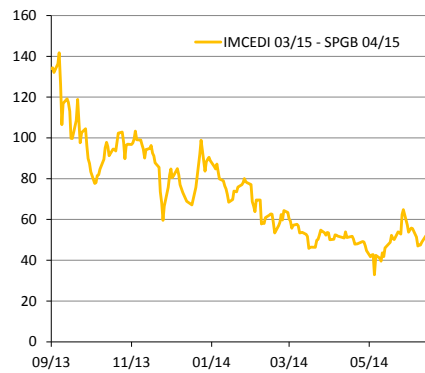
Source: Citi Research; Reference: Covered Bond Strategy, 26.02.2014

Figure 53. Reduce duration: switch from SANTAN 04/20 to SANTAN 06/16, mid-ass, bp



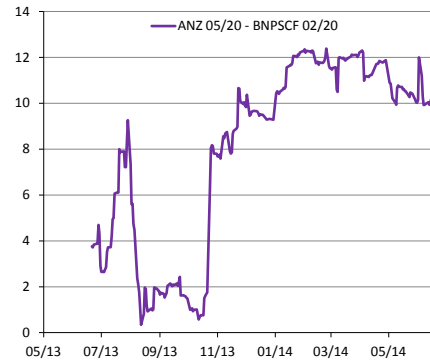
Source: Citi Research; Reference: Covered Bond Strategy, 05.02.2014

Figure 54. Prefer IMCEDI 03/15 to SPGB 04/15, yield spread, bp



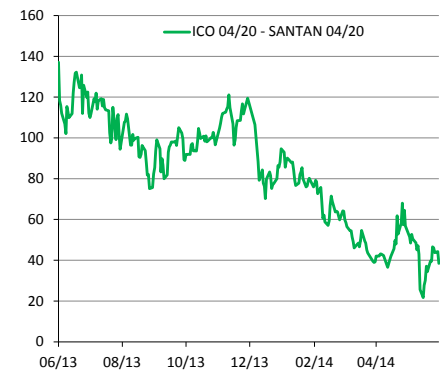
Source: Citi Research; reference: The multi-cédula Roadmap, 17.03.2014

Figure 55. Prefer ANZ 05/20 to BNPSCF 02/20, yield spread, bp



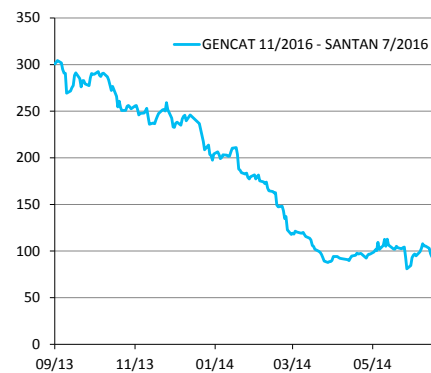
Source: Citi Research; reference: SSA & CB Monthly, 04.03.2014

Figure 56. Continue to prefer ICO 04/20 to SANTAN 04/20, yield spread, bp



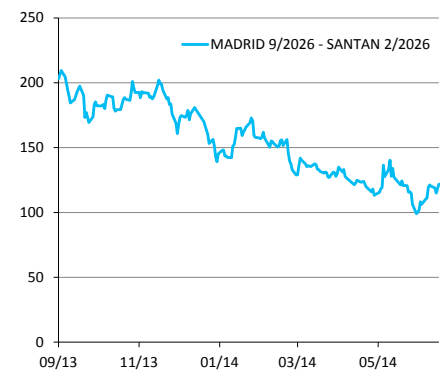
Source: Citi Research; reference: Covered Bond Strategy, 08.01.2014

Figure 57. Prefer GENCAT 11/16 to SANTAN 07/16, yield spread, bp



Source: Citi Research; reference: SSA & CB Monthly, 04.03.2014

Figure 58. Prefer MADRID 09/26 to SANTAN 02/26, yield spread, bp



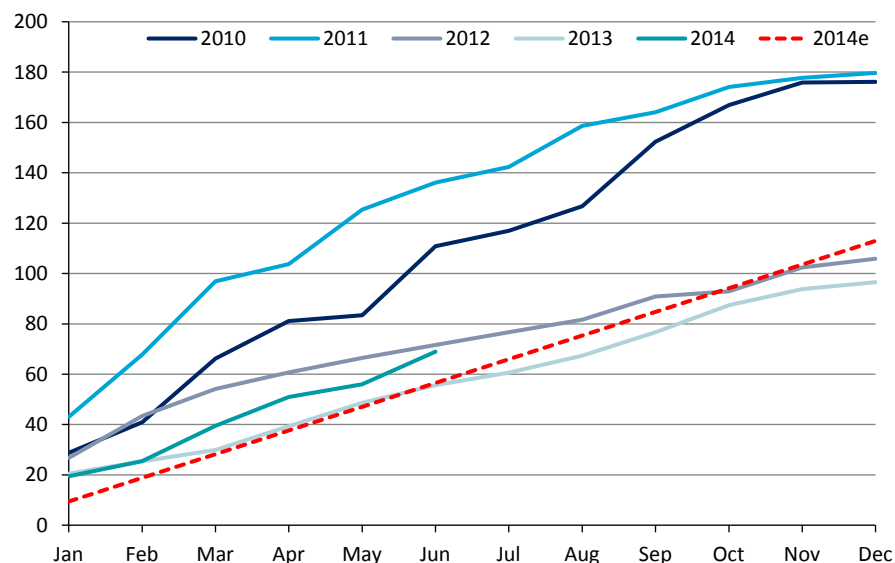
Source: Citi Research; reference: SSA & CB Monthly, 04.03.2014

Strong comeback of issuers after ECB delivered

(2) Primary market: Outlook for the second half of the year

The ECB delivered more than expected – and so did covered bond issuers in June. After a paltry €5bn of new deals in May, issuers were proven correct in waiting for the important ECB meeting. Thereafter, spreads made a further jump down and so did funding levels. Seventeen deals within the consecutive two weeks has been more than at any other time in 2014. Additionally, the USD covered bond market has seen a follow-up deal in June. For the half year, EUR benchmark gross issuance stands at €69.2bn, slightly more than we expected.

Figure 59. Euro benchmark issuance 2014: keeping it up with 2012?



Source: Citi Research

However, we stick to our FY forecast

However, even against the background of our “low for longer” spread outlook for the end of the year, we don’t think that covered bond issuers will keep this pace. Hence, we stick to our full-year forecast of €113bn. That said, we adjust the issuance distribution among covered bond segments for the rest of the year (see table below). In many segments our forecast hasn’t changed. However, in some segments, a substantial amendment has been necessary. On the one hand, covered bond primary markets have been surprised by a higher than expected issuance volume from some segments. The most prominent examples are the Swiss covered bond segment but also the Portuguese covered bond issuers. In both segments, the issuance volume already overshoot our expectations to the mid-year. However, as both segments play a very minor role of the total covered bond market it doesn’t have substantial repercussions on our overall issuance expectation. Moreover, we slightly increased our expectation on UK covered bond issuance. Although we have already been relatively optimistic on the issuers’ activity – especially as FLS is about to end in February 2015 – we didn’t expect four issuances of UK banks at this time of the year already. Hence, we slightly adjust our expectation to €5bn of UK covered bonds.

Spanish banks’ issuance activity is lower than expected

One reason why this still doesn’t affect our overall issuance expectation is the most negative surprise on the primary market in 2014 so far. Spanish banks were expected to be less active in wholesale funding on a secured basis. However, the €4.5bn of cédulas which have been placed so far is clearly below consensus and makes us believe that our expectations from the end of last year won’t be met. That’s why we reduce our expectation of total cédula issuance by €6bn to €9bn.

Figure 60. Revised issuance forecast for FY14

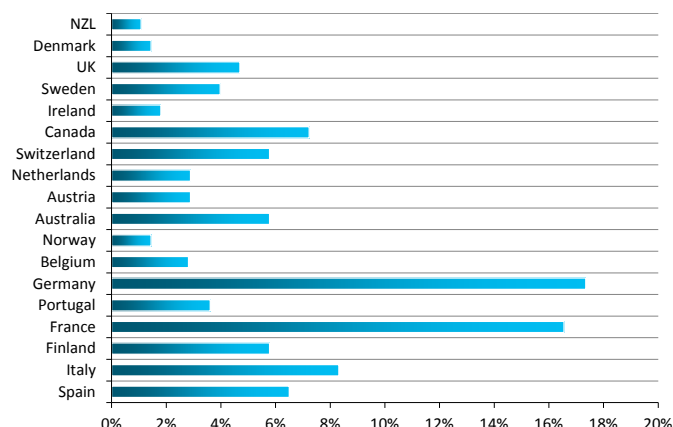
	Original issuance forecast for 2014	Issuance year to date	Expectation achieved by ...%	New issuance forecast for 2014	Change (EURbn)
Australia	4.0	4.0	100%	5.0	1.0
Austria	4.0	2.0	50%	4.0	0.0
Belgium	4.0	2.0	49%	4.0	0.0
Canada	10.0	5.0	50%	10.0	0.0
Denmark	1.0	1.0	100%	1.0	0.0
Finland	5.0	4.0	80%	5.0	0.0
France	20.0	11.5	57%	19.0	-1.0
Germany	18.0	11.9	66%	18.0	0.0
Ireland	3.0	1.3	42%	2.8	-0.3
Italy	8.0	5.8	72%	9.0	1.0
Netherlands	4.0	2.0	50%	4.0	0.0
New Zealand	1.0	0.8	75%	1.3	0.3
Norway	5.5	1.0	18%	4.5	-1.0
Portugal	0.5	2.5	500%	3.0	2.5
Spain	15.0	4.5	30%	9.0	-6.0
Sweden	5.0	2.8	55%	4.5	-0.5
Switzerland	1.0	4.0	400%	4.0	3.0
UK	4.0	3.3	81%	5.0	1.0
USA	0.0	0.0	--	0.0	0.0
Total	113.0	69.0	61%	113.0	0.0

Source: Citi Research

The German market waves Good-bye to the Jumbo format

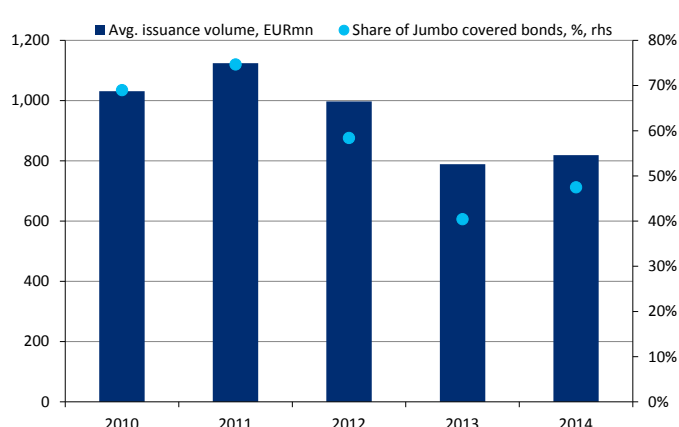
In general, primary market activity was in line with expectations with French and German issuers playing the most important role while the Canadian issuers would play an important role as well. As mentioned in the lead article, issuers continued to stick to the belly of the curve, especially the 5yr and 7yr sector although we would expect that there would be enough demand for bonds with a maturity beyond ten years given the current spread environment. More striking, however, is the development of the deal size in the covered bond market. The 3-year trend of lower issuance volume halted this year. At the same time the share of jumbo covered bonds increased again – also driven by the comeback of the Canadian issuers. Meanwhile, German pfandbrief issuers seem to have finally waved “Good-bye” of the Jumbo-format with no bond being placed with a volume of €1bn year to date.

Figure 61. Primary market activity: geographical distribution (including taps), %



Source: Citi Research

Figure 62. Primary market activity: avg. issuance volume and share of jumbo covered bonds, %



Source: Citi Research

TD Bank is on the way to complete the Canadians' comeback...

For July, we would expect some issuers to follow its peers although activity should rather slow down, go into summer break. However, some action should be expected and this is especially the case for Canadian banks. With Toronto Dominion Bank the last of the seven issuers which used to be active in contractual based Canadian covered bond market in the past received the allowance to issue registered covered bonds. Investors should expect rock-solid triple-AAA ratings for the covered bonds from a bank with an issuer rating of Aa1/AA-/AA-. The following is an overview of Moody's assessment of the bank's credit strengths and weaknesses.

Strengths:

- Leading market shares in many personal & commercial Canadian financial services products including personal deposits and credit, business deposits and credit, where TD typically holds first or second positions and in excess of 15% shares,
- very strong and stable risk-adjusted profitability and
- healthy asset quality characterized by very low non-performing assets and limited credit concentrations.

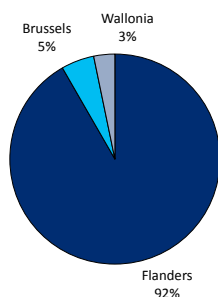
As main challenges Moody's sees the following aspects:

- Business risk associated with US expansion and integration and increasing reliance on US earnings, given the competitive environment and increasing regulatory costs and the relatively weaker credit profile of the US operation compared to the domestic franchise and
- Exposure to increasingly leveraged Canadian consumers, particularly uninsured non-mortgage debt, in an economic environment which, while improving, still faces downside risks associated with high household indebtedness and housing prices.

...while KBC could also be expected

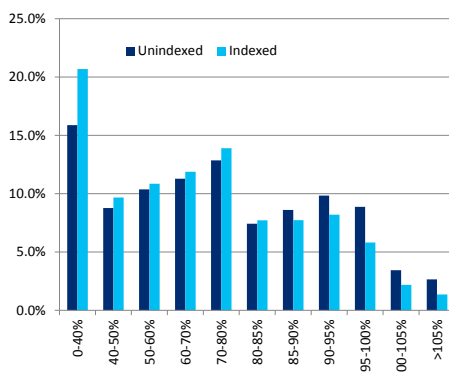
At the time of writing, we haven't seen any cover pool data of the issuer. Apart from TD coming to the market, the Belgian KBC is said to stand ready to become active again. The issuer (A2/A/A-) has already been active once this year in February where it placed a 5-year Aaa/AAA/AAA covered bond at mid-swap +10bp. The graphs below summarize the cover pool composition. The pool is composed of residential domestic loans with WA seasoning of 35 months and an average loan balance of €132,175 which gives a picture of a young but granular cover pool.

Figure 63. Geographical distribution, %



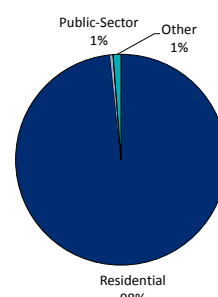
Source: Moody's, Citi Research

Figure 64. LTV distribution, %



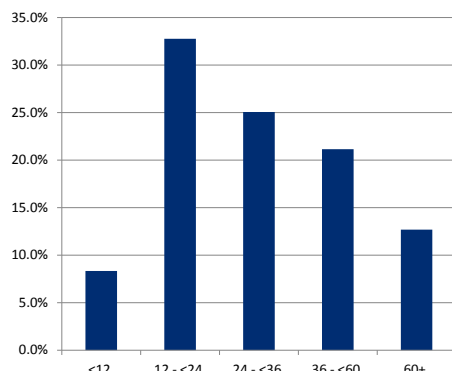
Source: Moody's, Citi Research

Figure 65. Collateral composition



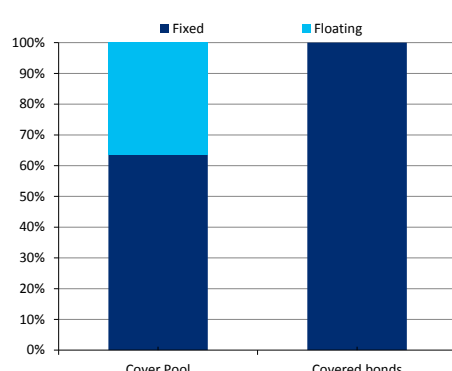
Source: Moody's, Citi Research

Figure 66. Distribution by seasoning, months



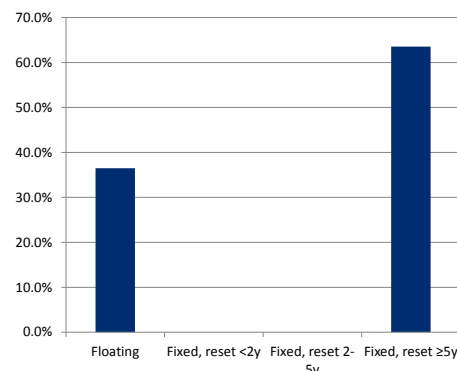
Source: Moody's, Citi Research

Figure 67. Interest rate mismatch, %



Source: Moody's, Citi Research; the issuer uses swaps

Figure 68. Loan interests, %

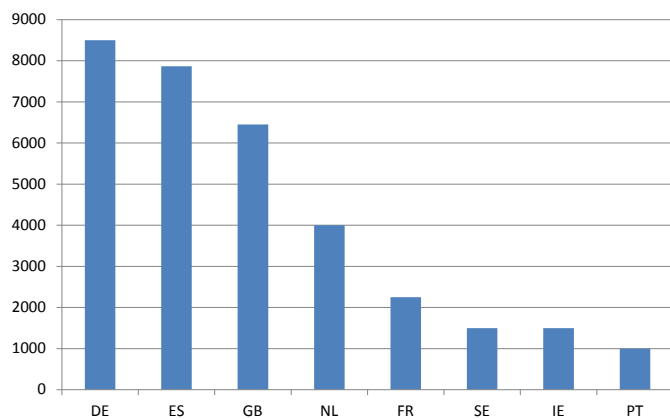


Source: Moody's, Citi Research

Redemptions are relatively low in Q3

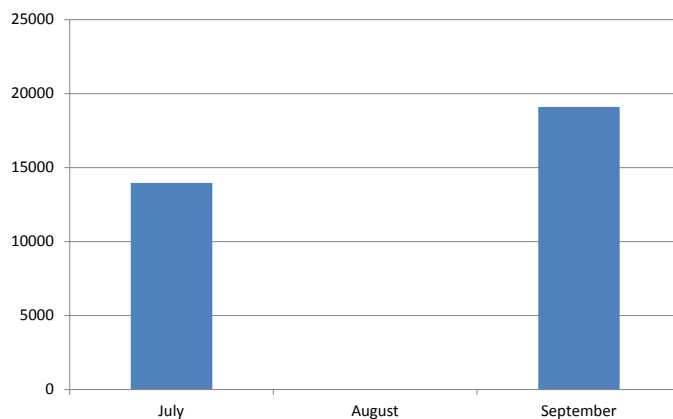
For the third quarter of the year, there is a low chance that for the first time this year on a quarterly basis the benchmark covered bond market will not be shrinking necessarily as the overall amount of redemptions will stand just at €33bn. That is substantially lower than in the first two quarters of this year. However, we would still think that net negative supply will continue to be the name of the game in covered bonds, mainly as issuance activity is usually low over the summer, but also because issuers will probably have to rethink their funding plan for the rest of the year due to the introduction of the TLTRO. In August no redemptions will be recorded while investors can expect nearly €20bn of cash inflow in September. Again, the German and the Spanish segment stand out with highest redemptions, €8.5bn and €7.9bn, respectively.

Figure 69. Redemptions in 3Q14 by country, EURmn



Source: Citi Research

Figure 70. Redemptions in 3Q14 by month, EURmn



Source: Citi Research

(3) Secondary market activity

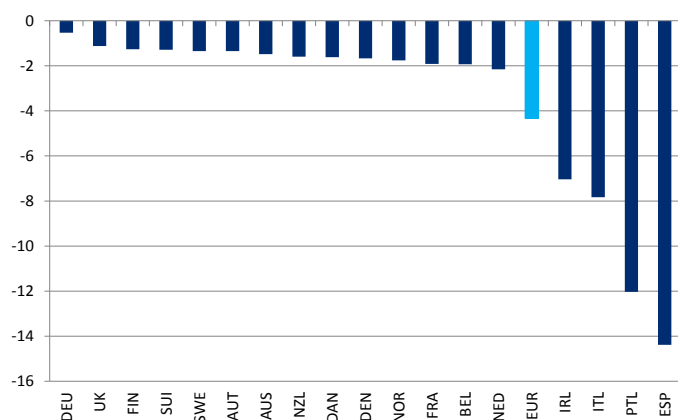
ECB pushing spreads down

As if the covered bond market hasn't rallied enough, the ECB's last stimulus pushed spreads even further down. Unsurprisingly, the main profiteers in the spread environment were high-beta covered bonds from peripheral countries. However, the effect on spreads of core products like German pfandbriefe was muted in the aftermath of the June 4th ECB meeting. Also, UK covered bonds underperformed other low-beta products which should not surprise. The spread widening which was recorded in May of this year has eventually been just a pause to take breath of the ongoing rally.

UK covered bonds are now trading tighter to pfandbriefe than in 2007

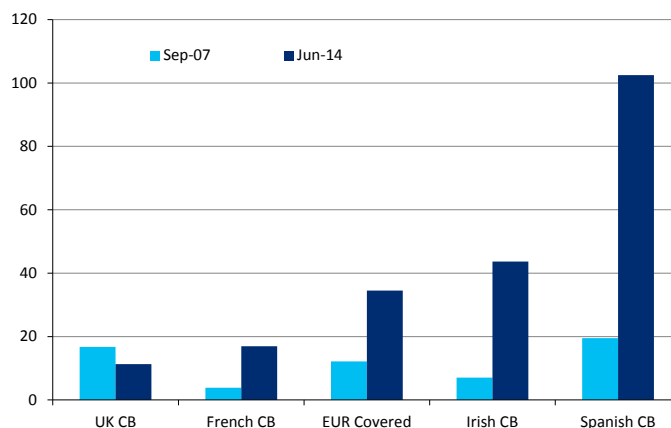
While we think that the compression of spreads is a pattern which we will continue to see in the medium-term, one might want to compare relative spread levels of the current environment with those of the past as one might think that the pre-crisis spread environment is the one where covered bond markets will eventually end. As it can be seen in Figure 72, there is still some tightening potential left vs our benchmark, the German pfandbrief market, especially in the peripheral markets. The only segment which already reached levels beyond those of the pre-crisis era is the UK covered bond segment. The fact that UK covered bonds have been trading substantially cheaper than French and Irish covered bonds before the crisis was mainly reasoned by the SPV structure which was perceived to be a structured instrument by rather disconcerting, traditional covered bond market participants.

Figure 71. Post-ECB performance of covered bond segments, asw-spread, bp



Source: Markit, Citi Research

Figure 72. Compression at the end? absolute spread vs pfandbriefe: 2007 vs 2014, mid-asw, bp



Source: Markit, Citi Research

There is still volatility in covered bond markets

For peripheral covered bond markets the tightening journey should continue in the medium-term. However, we don't expect spreads to pfandbriefe reaching pre-crisis levels, even in the longer-term in which Citi expects an additional stimulus of the ECB via large scale asset purchases. Meanwhile, the main factors for a continuing spread compression are still valid in our view. Europe is no longer in recessionary mode, the ECB is expected to become even more dovish, the covered bond market is – similar to the government bond market – in a generally positive rating cycle and the supply projections point to negative growth in the benchmark segment. The fact that covered bond market participants have so far rarely been surprised to the downside with respect to the regulatory treatment of the asset class is an additional factor which should also be valid once the final LCR definition is presented. Lastly, the high correlation to the sovereign debt market should also be supportive as we expect lower rates for longer with stable and tighter spreads in (semi)-core and peripheral markets, respectively ([Global Economic Outlook and Strategy](#)).

Figure 73. Spread performance table

	Current	EUR	PB	MPB	PS PB	OF	OH	FRA CB	AUT CB	NL CB	ITL CB	IRL CB	CAN CB	NOR CB	POR CB	ES CB	ESS CB	ESM CB	SWE CB	UK CB	AUS CB	FIN CB	BEL CB	DEN CB	SUI CB	NZL CB	LUX CB
EUR	47	-4	38	38	39	18	23	20	19	26	-43	-12	28	27	-70	-78	-43	-129	35	26	17	33	28	30	29	27	-34
PB	12	35	-1	0	1	-20	-15	-18	-20	-13	-81	-51	-10	-11	-108	-116	-82	-168	-4	-12	-21	-5	-11	-9	-9	-11	-72
MPB	12	34	0	0	1	-20	-15	-18	-20	-13	-81	-51	-10	-11	-108	-116	-82	-168	-4	-12	-21	-5	-11	-9	-9	-11	-72
PS PB	11	35	1	1	-1	-21	-16	-19	-20	-13	-82	-51	-11	-12	-109	-117	-82	-168	-4	-13	-22	-6	-11	-9	-10	-12	-73
OF	31	16	-19	-19	-20	-2	5	2	1	8	-61	-30	10	9	-88	-96	-61	-147	17	8	-1	15	10	11	11	9	-52
OH	26	20	-14	-14	-15	5	-2	-3	-4	3	-66	-35	5	4	-93	-101	-67	-152	12	3	-6	10	5	6	6	4	-57
FRA CB	29	18	-17	-17	-18	2	-3	-2	-1	6	-63	-32	8	7	-90	-98	-63	-149	15	6	-3	13	8	10	9	7	-54
AUT CB	31	16	-19	-19	-20	0	-5	-2	-1	7	-61	-31	10	9	-88	-97	-62	-148	16	8	-2	14	9	11	10	8	-53
NL CB	23	23	-11	-11	-12	8	3	6	8	-2	-68	-38	3	2	-95	-104	-69	-155	9	1	-9	7	2	4	3	2	-60
ITL CB	86	-39	-74	-74	-75	-55	-60	-57	-55	-63	-8	30	71	70	-27	-35	-1	-87	77	69	60	75	70	72	72	70	9
IRL CB	56	-9	-44	-44	-45	-25	-30	-27	-25	-33	30	-8	41	40	-57	-66	-31	-117	47	39	29	45	40	42	41	39	-22
CAN CB	21	26	-9	-9	-10	10	5	8	10	2	65	35	-2	-1	-98	-106	-72	-158	6	-2	-11	4	-1	1	1	-1	-62
NOR CB	22	25	-10	-10	-11	9	4	7	9	1	64	34	-1	-2	-97	-105	-71	-157	7	-1	-10	5	0	2	2	0	-61
POR CB	108	-62	-96	-96	-97	-77	-82	-79	-77	-85	-22	-53	-87	-87	-12	-8	26	-60	104	96	87	102	97	99	99	97	36
ES CB	115	-68	-102	-102	-103	-84	-88	-86	-84	-91	-29	-59	-94	-93	-6	-14	35	-51	113	104	95	111	106	108	107	105	44
ESS CB	84	-37	-72	-72	-73	-53	-58	-55	-53	-61	2	-28	-63	-62	24	31	-10	-86	78	70	60	76	71	73	72	71	10
ESM CB	159	-112	-147	-147	-148	-128	-133	-130	-128	-136	-73	-103	-138	-137	-51	-44	-75	-21	164	156	146	162	157	159	158	156	95
SWE CB	15	32	-3	-3	-4	16	11	14	16	8	71	41	6	7	93	100	69	144	-1	-8	-18	-2	-7	-5	-6	-8	-69
UK CB	23	23	-11	-11	-12	7	3	6	7	0	62	32	-2	-2	85	91	61	135	-9	-1	-9	6	1	3	3	1	-60
AUS CB	32	14	-20	-20	-21	-2	-6	-3	-2	-9	53	23	-11	-11	76	82	52	126	-18	-9	-2	16	11	12	12	10	-51
FIN CB	17	30	-5	-5	-6	14	9	12	14	6	69	39	4	5	91	98	67	142	-2	7	16	-1	-5	-3	-4	-6	-67
BEL CB	21	25	-9	-9	-10	10	5	8	10	2	65	35	0	1	87	93	63	138	-6	2	11	-4	-2	2	1	-1	-62
DEN CB	20	27	-8	-7	-9	11	6	9	11	3	66	36	1	2	89	95	64	139	-5	4	13	-3	1	-2	0	-2	-63
SUI CB	21	26	-9	-8	-9	10	5	8	10	2	65	35	0	1	88	94	63	138	-6	3	12	-4	1	-1	-1	-2	-63
NZL CB	22	24	-10	-10	-11	9	4	7	9	1	64	34	-1	0	86	92	62	137	-7	1	10	-5	-1	-2	-1	-2	-61
LUX CB	80	-33	-68	-68	-69	-49	-54	-51	-49	-57	6	-24	-59	-58	28	35	4	79	-65	-56	-47	-63	-59	-60	-59	-58	-5

Source: Markit, Citi Research; Orange: Current ASW-Spread; Light blue: ASW-Spread between the two segments; dark blue: ASW-Spread performance of the segment over the last two weeks; light grey: ASW-spread between two segments two weeks ago; abbreviations: EUR = EUR covered bond index, PB = Pfandbrief index, MPB = mortgage pfandbrief index, PSPB = Public sector pfandbrief index, OF = Obligations Foncières, OH = Obligations à l'Habitat, FRA CB = French covered bond index, AUT CB = Austrian covered bond index, NL CB = Dutch covered bond index, ITL CB = Italian covered bond index, IRL CB = Irish covered bond index, CAN CB = Canadian covered bond index, NOR CB = Norwegian covered bond index, ES CB = Spanish covered bond index, ESS CB = Spain Single covered bond index, ESM CB = Spain Multi covered bond index, SWE CB = Swedish covered bond index, UK CB = UK covered bond index, AUS CB = Australian covered bond index, FIN CB = Finnish covered bond index, BEL CB = Belgium covered bond index, DEN CB = Danish covered bond index, SUI CB = Swiss covered bond index, NZL CB = New Zealand covered bond index, LUX CB = Luxembourg covered bond index

(4) Covered bond market developments

LCR: where do we stand, where will we go?

The LCR – one of the main regulatory topics in covered bond markets of 2014 gets its fine-tuning on the home-stretch. Speculation over the final composition has dominated discussions during recent weeks. This could continue to be in spotlight for longer than market participants expected as we await the final publication.

Where do we stand?

A delay of requirement disclosure cannot be ruled out

According to Bloomberg, citing officials from the European Commission, the deadline on the commission's decision of how to implement Basel III liquidity requirements into European regulation might be postponed until July or even September.¹ One main reason might be the challenge of technical implementation but also the uncertainty around the split treatment of covered bonds within the LCR following different characteristics (more on that can be found below and here: [Covered Bond Strategy](#)). However, it seems as if a postponement of the LCR introduction (planned for January 2015) is not planned.

Will issuer ratings become an eligibility criterion for covered bonds?

Apart from that, covered bond magazines recently reported that the eligibility of covered bonds may also be dependent of the issuer rating.² The table below gives an overview of the latest proposals, including the characteristics to be eligible for the liquidity ratio. That said, "The Cover" added that it is under discussion whether or not the issuer rating should be removed as main qualification criterion.

Figure 74. The LCR for European banks is evolving

	Basel III recommendation	EC Working Paper May 2014	EC Working Paper June 2014
ECAI 1 covered bonds (AAA to AA-)	Level 2A	Level 1B	Level 1B
ECAI 2 covered bonds (A+ to A-)	Not eligible	Level 2A	Level 2A
Additional requirements	<ul style="list-style-type: none"> - self-issued covered bonds are not eligible - traded in large, deep and active repo or cash markets - proven record as a reliable source of liquidity in the markets 	<ul style="list-style-type: none"> - Covered Bonds in accordance with UCITS Art. 52 (4) - In accordance with Art. 129 (4) of the CRR - issuance size of at least EUR500mn/EUR250mn (Level 1B/2A) - subject of mandatory OC and maximum LTV discount level requirements 	<ul style="list-style-type: none"> - Covered Bonds in accordance with UCITS Art. 52 (4) - In accordance with Art. 129 (4) of the CRR - issuance size of at least EUR500mn/EUR250mn (Level 1B/2A) - subject of mandatory OC of 2%/7% (+additional pool costs, Level 1B/2A) and maximum LTV discount level requirements - Level 2A eligibility for ECAI1 non-EU legislative covered bonds fulfilling further requirements - Issuer rating of at least A-/BBB- (Level 1B/2A)
Definition	<ul style="list-style-type: none"> - Level 2A: limit of 40% of the LCR, haircut of 15% on market value 	<ul style="list-style-type: none"> - Level 1B: limit of 70%, haircut of 7% on market value - Level 2A: limit of 40% of the LCR, haircut of 15% on market value 	<ul style="list-style-type: none"> - Level 1B: limit of 70%, haircut of 7% on market value - Level 2A: limit of 40% of the LCR, haircut of 15% on market value

Source: BIS, EC, Danish ministry of Economy, CBR, The Cover, Citi Research; for more details on UCITS / CRR, please see [Euro SSA and Covered Bond Monthly](#)

The EC goes its own way, sidelining Basel

The working paper in May has been quite a surprise on the positive side as a door has been opened for lower rated covered bonds (which however would still have to fulfill several other criteria) to the LCR. Moreover, the need for mandatory OC and LTV limits were discussed to become prerogative eligibility criteria. The follow-up working paper takes up the ideas of the preceding document but adds some further requirements/criteria.

¹ Bloomberg: "Europe Set to Postpone Until Fall Decision on Bank Liquidity Standards", 19.06.2014

² The Cover: "LCR talks extended as issuer rating and non-EEA conclusion considered", 18.06.2014

Some non-EEA covered bonds might be treated better than originally expected

A positive, again, might be the allowance for non-EU covered bonds to become eligible given some additional characteristics: The bonds need to be based on a dedicated legislative framework. This however means that general law based covered bonds issued by Swiss banks would still not be eligible for the LCR of European banks. Moreover, it seems to be discussed if an additional differentiation will be made among the legislative non-EEA covered bonds. Differentiation could be based on the ECB repo eligibility (following Art. 416, 3d of the CRR) but also on the treatment of covered bonds within the domestic LCR definition. In the first case, only Canadian covered bonds would be Level 2A eligible. In the latter case, covered bonds from Australia, Canada and New Zealand would be eligible for the European-style LCR as they are eligible in the domestic configuration of the LCR (mismatch ratio in case of New Zealand) as well.

Some issuers may be disappointed

However, current discussions in the latest working paper also seem to propose a criterion which doesn't seem to fit to the general trend of linking covered bond treatment directly to the covered bond rating (e.g. within the CRR). It is discussed if the assignation of covered bonds to liquidity buckets should also be determined by the issuer rating. Hence, it seems to be considered that covered bonds can only qualify for Level 1B/2A if the issuer rating is higher than or equal to A-/BBB-. This would mean that covered bonds of some issuers would suddenly not be eligible for the LCR. The following table gives an overview of the issuers whose covered bonds would potentially lose eligibility if the issuer rating was to become one criterion for LCR eligibility. Assuming that the lower ratings count (2nd best rating in case of split ratings for up to 3 ratings, 3rd best in case of 4 ratings), the covered bonds of some issuers would lose their current liquidity bucket eligibility (some examples can be seen below). At this stage we don't want to rule out any new amendments to the LCR in Europe. However, it should be seen that the inclusion of the issuer rating as an eligibility criterion would stand diametrically to the de-linkage of covered bonds from the issuer within the risk weight assessment of the CRR.

Figure 75. Examples of a potential loss of liquidity bucket eligibility if a link to the issuer rating was included

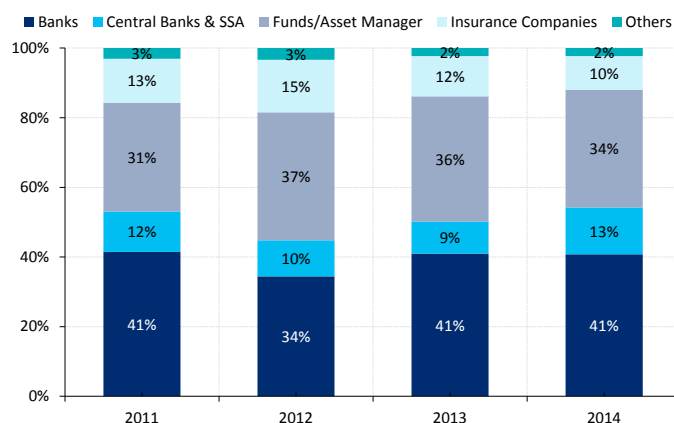
Loss of Level 1B status	Loss of Level 1B status	Loss of Level 2A status
Austria	Germany	Spain
BAWAG PSK (m, ps)	Dt. Hypothekbank (m)	Banco de Sabadell
Kommunalkredit Austria (ps)	HSH Nordbank (m, ps)	
Netherlands	Hypothekbank Frankfurt (ps)	
NIBC Bank	UK	
SNS Bank	Yorkshire Building Society	

Source: Citi Research; m = mortgage, ps = public sector

The duty to sell a "representative sample" of covered bonds

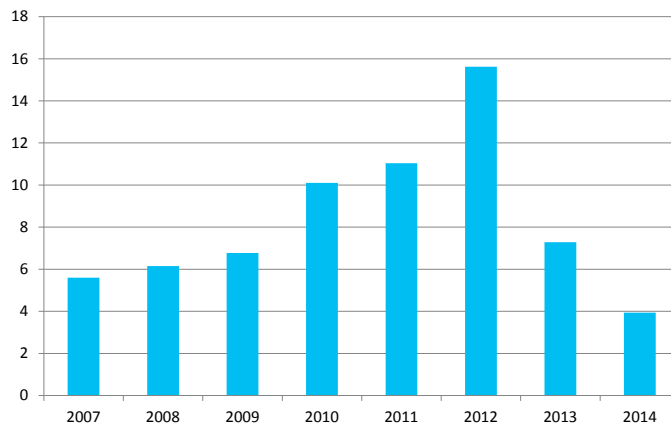
An additional requirement to prove liquidity is also discussed, according to Bloomberg, whereby investors have to sell a representative sample of the covered bonds that form part of the LCR. Bank treasuries have become the most important investor class for covered bonds over the last years. At the same time, secondary market liquidity deteriorated during times of distress and came back to pre-crisis levels this year, as seen in Figure 77. However, we think that the currently lower bid-ask spreads are more a function of spread compression rather than real market liquidity. As it is discussed that only a representative sample has to be sold it remains to be seen how a "representative sample" will be defined, because this might have repercussions on the investors' revenues. However, from a secondary market liquidity perspective, we would welcome the commission's attempt to indirectly support trading activity.

Figure 76. The importance of bank treasuries for covered bonds: participation rate in EUR benchmark primary deals, 2011-2014



Source: Bloomberg, CBR, Citi Research

Figure 77. Bid-ask spread for a representative sample of French covered bonds (avg. years to maturity: 3 yrs, measured in yield): 2007-2014



Source: Bloomberg, Citi Research

Where will we go?

Many technical and fundamental questions still need to be answered

The LCR is a main topic for covered bonds. Hence, the discussions on the final composition of the liquidity ratio are ongoing. Following official statements cited by Bloomberg, we suspect that there is a high probability of having ECAI 1 covered bonds being treated within Level 1B. However, uncertainties around the LCR composition are still immense. In addition, the ambiguity with respect to the timeline has fuelled further speculations. The main questions that ultimately have to be answered, in our opinion, are the following:

- Although it seems highly probably that the commission sticks to the introduction of the LCR at the beginning of 2015, it is less clear when the regulator publishes final details on it.
- Will ECAI 2 covered bonds be eventually eligible for the Level 2A bucket?
- Will non-EEA covered bonds be considered as eligible in any form?
- Will the issuer rating be a valid criterion?
- Will covered bonds with lower issuance/outstanding volumes (in original or due to buybacks/tenders) be eligible for the LCR?
- How will the minimum OC ratio and the LTV cap be defined exactly?

The result that has been reached so far is already a positive

As mentioned before, once the LCR is clearly defined one can probably conclude that covered bond lobbyists have achieved some positive results for the treatment of the asset class within the European liquidity framework, ensuring an ongoing high demand for covered bonds by bank treasuries. Now the fine-tuning is on its way and we are rather skeptical that we will see a final result on the table in the very near-term.

S&P ups 14 multi-cédulas on collateral improvement

S&P running in circles?

Last week, S&P upgraded 14 multi-cédulas. The upgrades were mainly driven by an improvement of the underlying collateral, but partly also by the sovereign upgrade of Spain at the end of May 2014. The following table gives an overview of the affected multi-structures.

Figure 78. Rating action overview

Series	Rating to	Rating from	ISIN	Overall rating (Moody's/S&P/Fitch)
AYTCED 03/2016	BBB+ (sf)	BBB (sf)	ES0312298013	A3 /*-/BBB+/BBB
AYTCED 03/2021	BBB+ (sf)	BBB (sf)	ES0312298054	Baa1 /*-/BBB+/BBB
AYTCED 06/2016	AA (sf)	AA- (sf)	ES0312298229	--/AA/--
AYTCED 07/2014	AA (sf)	AA- (sf)	ES0312298237	Baa1 /*-/AA/--
AYTCED 12/2019	A+ (sf)	A- (sf)	ES0312298245	Baa2 /*-/A+/-
AYTCED 05/2015	AA (sf)	AA- (sf)	ES0312298252	Baa2 /*-/AA/--
AYTCED 03/2015	BBB+ (sf)	BBB (sf)	ES0312358007	Baa1 /*-/BBB+/BBB
CEDTDA 10/2018	A- (sf)	BBB+ (sf)	ES0371622038	A3 /*-/A-/BBB
CEDTDA 03/2027	BBB- (sf)	BB+ (sf)	ES0371622046	A3 /*-/BBB-/BBB
IMCEDI 03/2015	AA- (sf)	A+ (sf)	ES0347848006	Baa1 /*-/AA/--
IMCEDI 12/2015	BBB (sf)	BBB- (sf)	ES0362859003	Baa1 /*-/BBB/--
CEDTDA 04/2017	AA (sf)	AA- (sf)	ES0316990003	--/AA/--
CEDTDA 12/2014	AA (sf)	AA- (sf)	ES0316992009	Baa3 /*-/AA/--
CEDGBP 04/2017	AA (sf)	AA- (sf)	ES0318822006	A3/AA/--

Source: S&P, Bloomberg, Citi Research

The improvement of the collateral quality has been the main reason for the upgrades

As multi-structures are backed by single-cédulas, the latest positive rating actions on Spanish banks and/or its covered bond programs accordingly have now trickled down to the higher-beta secured paper from Spain. The improved underlying collateral credit quality translates into lower rated scenario default rates which are a main factor for multi-structure ratings at S&P.

An overhaul of the methodology might push the highest ratings down

An additional important rating driver has been the upgrade of Spain which upped the highest achievable rating for non-sovereign transactions to AA. Six of the 14 upgraded structures are now rated at this cap. We don't expect that this upgrade will have substantial effects on spreads of these bonds. The latest ECB stimulus, net negative supply in Spain and the Spanish banks' capital positions are more important factors for spreads in our opinion. Additionally, it should also be mentioned that three of the multi-cédulas which have now been upgraded were downgraded two months ago - due to the change in collateral quality. Moreover, this rating action follows the general trend of the current rating cycle of peripheral covered bonds. However, note that S&P is still reviewing its covered bond rating methodology which could result in an introduction of hard caps for covered bonds, derived from the sovereign rating. This would eventually more than offset today's developments on the now highest rated multi-cédulas.

Follow-up on the harmonization covered bond markets

EBA presents its thoughts on covered bond harmonization

In our last [Euro SSA and Covered Bond Monthly - Covered Bond Laws: Convergence Race to the Top?](#) we were digging deeper into national covered bond laws and the current push by regulation to increase harmonization. This month, the European Banking Authority (EBA) presented their litmus test on the way to a harmonized covered bond market as well as their view on a “best practice” approach to increase harmonization.

The preferential risk weight for covered bonds is justified

As expected, one main lever positioned to harmonize covered bond markets is Art. 129 of the Capital Requirement Regulation (CRR) which prescribes the requirements that covered bonds have to fulfill in order to qualify for preferential risk weightings. Article 503 CRR calls for EBA's advice in specific questions with respect to the preferential treatment of this asset class. EBA's recommendations will probably not come as a surprise:

- The preferential risk weight for covered bonds is in general justifiable for those bonds which fulfill Art. 129 CRR criteria. Moreover, EBA recommends the European Commission that in the future risk weights should be derived from the fulfillment of additional factors. Firstly, EBA proposes to have a legal/regulatory minimum OC as a qualifying criterion, secondly issuers should maintain a liquidity buffer to assure net out-flows for a certain period, thirdly the national authorities' role should be clarified and lastly the disclosure requirements set out in Art. 129 should be clarified.
- Aircraft loans should not be added to the class of eligible assets under CRR Art. 129. At current stage, NordLB is the only issuer of aircraft pfandbriefe. The entity has two bonds of this asset class outstanding.
- The eligibility of guaranteed residential loans as cover assets for CRR Art. 129 compliant covered bonds have proven right, according to EBA. Hence, the authority recommends that this should not be changed for the future. This is a positive news for French Obligations à l'Habitat which were put at level risk weight playing field in the beginning of 2014 and should eventually stay there.
- Apart from that, the EBA recommends not to prolong the so-called MBS waiver which still runs until the end of 2017. Until then, issuers will be allowed to have more than 10% of senior securitizations in the cover pool, derogating from Art. 496 of the CRR. The implications should be lower than it would have been in previous years as issuers increasingly removed securitizations from the cover pool, especially in France.

The best practice approach for covered bond harmonization adds some sensible factors to the general discussion

Apart from the risk weights, EBA was also mandated to present its views on the principles of best practice in relation to covered bonds, especially with respect to the quality and segregation of cover pools, the insolvency remoteness of covered bonds, the asset and liability risks affecting cover pools and the disclosure of the composition of cover pools. As the main best practice principles, EBA identifies several characteristics with only very few surprising recommendations.

- The least surprising best practice characteristics are probably the dual recourse, the segregation of cover assets, the bankruptcy remoteness of covered bonds, the geographical location of cover assets (EEA and countries in which such assets can be expected to equal prudential supervisory), coverage principles and over-collateralization, the use of derivatives, the appointment of an independent cover pool monitor, supervision of the covered bond issuer as well as the powers and duties of the national authorities post issuer insolvency.

More surprisingly, the EBA also mentions the following points as best practice from which we think is very sensible:

- The rights of the cover pool administrator post issuer insolvency should be clarified although a clear separation between insolvency manager and cover pool administrator is not recommended.
- Moreover, EBA mentions that a higher consistency of the cover pool composition throughout a bond's lifetime should be maintained to ensure that the risk profile doesn't change materially. This would follow UK and Belgian regulation and pose a challenge to German and Spanish cover pools where residential and commercial loans are often part in one cover pool.
- In case of LTV limits, EBA recommends to have so-called "soft LTV limits" as well as "hard LTV limits". This means that a hard eligibility limit should apply when a given loan is first included in the cover pool whereas a soft maximum limit should apply to determine the percentage portion of the loan that contributes to the requirement of coverage of the liabilities. This should ensure that in case of a severe housing market downturn may let the covered bonds be under-collateralized.
- LTV revaluation should happen by updating (e.g. indexation) the values while the revaluation should be based on transparent valuation rules by independent third parties. The monitoring should happen at least once per year.
- A liquidity asset buffer should be maintained by the issuer to ensure that net outflows over a certain period in the future can be met.
- Issuers should make use of several stress tests to ensure cover even in distressed markets. This should include interest rate curve shifts, currency shifts, asset quality stress as well as stresses on repayment behavior of borrowers as well as on asset prices in a fire sale.

Harmonization continues to be the "name of the game"

As already outlined in our last monthly publication, harmonization seems to be the name of the game. With the latest recommendations of the EBA on harmonization we feel vindicated that several aspects of covered bond frameworks can be harmonized relatively easy. However, other features which characterize the credit profile of covered bonds will continue to pose a challenge for the authorities. Moreover, it needs to be asked if a holistic approach for harmonization is really necessary.

Covered Bond Rating Overview

Figure 79. Selection of covered bond programs

Australia	S&P/Moody's/Fitch/DBRS	Germany (m.)	S&P/Moody's/Fitch/DBRS	SNSSNS	--/Aa2/AA+/-
ANZ	--/Aaa/AAA/-	AARB	--/--/AAA/-	New Zealand	S&P/Moody's/Fitch/DBRS
CBAAU	--/Aaa/AAA/-	HVB	--/Aa1/AAA/-	ANZNS	--/Aaa/AAA/-
NAB	--/Aaa/AAA/-	BHH	--/Aaa/AA+/-	ASBBNK	--/Aaa/AAA/-
WSTP	--/Aaa/AAA/-	DB	--/Aaa/-/-	BZLNZ	--/Aaa/AAA/-
Austria	S&P/Moody's/Fitch/DBRS	DGHYP	AAA/-/-/-	WSTP	--/Aaa/AAA/-
BACA	--/Aaa/-/-	DHY	--/Aa2/-/-	Norway	S&P/Moody's/Fitch/DBRS
BACA (m.)	--/Aa1/-/-			DNBNO	AAA/Aaa/-/-
BAWAG	--/Aa1 /*+/-/-	DPB	--/Aaa/AAA/-	EKBOL	--/Aa2/-/-
ERSTBK	--/Aaa/-/-	HSHN	--/Aa3/-/-	SPABOL	--/Aaa/AAA/-
HYNOE	--/Aaa/-/-	HYPFRA	--/A1/-/-	SVEGNO	--/Aaa/-/-
KA	--/Aa3 /*+/-/-	INGDIB	--/Aaa/-/-	Portugal	S&P/Moody's/Fitch/DBRS
RFLBNI	--/Aaa/-/-	LBBW	--/Aaa/-/-	BCPPL	--/Ba1/BBB-/AL
RFLBST	--/Aaa/-/-			BESPL	--/Baa2 /*+/-/-AL
VORHYP	--/Aaa/-/-	MUNHYP	--/Aaa/-/-	BPIPL	A-/Baa2/BBB+/-
Belgium	S&P/Moody's/Fitch/DBRS	SPKKB	--/Aaa/-/-	CXGD	--/Baa2/BBB/A
KBC	--/Aaa/AAA/-	HVB	--/Aa1/AAA/-	SANTAN	--/Baa1/BBB/AL
CCBGBB	AAA/-/AAA/-	WLBANK	AAA/-/-/-	Spain	S&P/Moody's/Fitch/DBRS
INGB	--/Aaa/AAA/-	Germany (ps)	S&P/Moody's/Fitch/DBRS	BBVASM	A /*+/-/A1/-/AH
Canada	S&P/Moody's/Fitch/DBRS	HVB	AAA/Aa1/-/-	BKIASM	A-/Baa3u/BBB+/-
BMO	--/Aaa/AAA/AAA	BYLAN	--/Aaa/AAA/-	BKTSM	A+/-/A1/-/-
BNS	--/Aaa/AAA/AAA	BHH	--/Aa1/AA/-	BMARE	--/-/BBB+/-
CCDJ	--/Aaa/AAA/-	DGHYP	AAA/-/-/-	CABKSM	AA-/A1/-/-
CM	--/Aaa/AAA/-	DKRED	--/Aa1/-/-	CAIXAC	BBB- /*-/-Ba1 /*+/-/-
NACN	--/Aaa/AAA/AAA	DEXGRP	A+/-/-/-	CAJARU	BBB-/Ba1/BBB+/BBBH
RY	--/Aaa/AAA/AAA	HSHN	--/Aa2/-/-	CRUNAV	--/A1/-/-
Denmark	S&P/Moody's/Fitch/DBRS			KUTXAB	AA-/A2/-/-
DANBNK	AAA/-/AAA/-	HYPFRA	--/Aa3/-/-	NOVAGA	BBB+/Ba1 /*-/-BBB+/-
Finland	S&P/Moody's/Fitch/DBRS	LBBW	--/Aaa/AAA/-	POPSM	BBB/Baa1/-/-A
AKTIA	--/Aaa/-/-			SABSM	--/A3/-/-A
AKTIA	--/Aaa/-/-	MUNHYP	--/Aaa/-/-	SANTAN	--/A1/AA- /*+/-
NDASS	--/Aaa/-/-	NDB	--/Aaa/AAA/-	Sweden	S&P/Moody's/Fitch/DBRS
POHBK	AAA/Aaa/-/-	WLBANK	AAA/-/-/-	LANSBK	AAA/Aaa/-/-
SAMBNK	--/Aaa/-/-	Ireland	S&P/Moody's/Fitch/DBRS	NDASS	AAA/Aaa/-/-
France	S&P/Moody's/Fitch/DBRS	AIB	A/Baa1/A/-	SBAB	--/Aaa/-/-
ACACB	AAA/Aaa/AAA/-	BKIR	--/A3/-/AL	SEB	--/Aaa/-/-
ACASCF	AAA/Aaa/-/-			SHBASS	--/Aaa/-/-
AXASA	--/Aaa/AAA/-	Italy	S&P/Moody's/Fitch/DBRS	Switzerland	S&P/Moody's/Fitch/DBRS
BNPPCB	AAA/-/AAA/-	BACRED	A/-/-/-	UBS	--/Aaa/AAA/-
BNPSCF	AAA/-/AA+/-			CS	--/Aaa/AAA/-
BPCECB	AAA/Aaa/-/-			United Kingdom	S&P/Moody's/Fitch/DBRS
BPCOV	AAA/-/-/-	BPIM	--/A3/BBB+/-	ABBEY	AAA/Aaa/AAA/-
CAFFIL	AA+/Aaa/AA+/-	CRDEM	--/A2/A+/-	BACR	AAA/Aaa/AAA/-
CFF	AAA/Aaa/AA+/-	ISPIM	--/A2/-/-	BRADB1	AAA/Aa1/AA+/-
CIFEUR	--/Aa2/AA+/-	MONTE	--/Baa3/A/-	LLOYDS	AAA/Aaa/AAA/-
CMARK	AA+/Aaa/-/-	PMIIM	--/Baa1/BBB+/-	NRKLN	AAA/Aaa/AAA/-
CMARK (m.)	AAA/-/-/-	UBIIM	--/A2/A+/-		
CMCICB	AAA/Aaa/AAA/-	UCGIM	AA/A2/A+/-	RBS	--/Aaa/AAA/-
CRH	--/Aaa/AAA/-	Netherlands	S&P/Moody's/Fitch/DBRS	YBS	--/Aa1/AA+/-
GE	AAA/Aaa/-/-	ABNANV	AAA/Aaa/AAA/AL	USA	S&P/Moody's/Fitch/DBRS
HSBC	AAA/Aaa/-/-	NIBCAP	AAA/-/AAA/-	BAC	A+/-/AA/-
SOCSCF	AA+/Aaa/-/-	INTNED	AAA/Aaa/AAA/-	JPM	A+/-/AA/-
SOCSEH	--/Aaa/AAA/-				

Source: Bloomberg, Citi Research

Covered Bond Rating Overview – Multi-cédulas

Figure 80. Ratings of Spanish multi-cédulas

AYTCED	ISIN	Moody's/S&P/Fitch	CEDTDA	ISIN	Moody's/S&P/Fitch
AYTCED 4.75 04/12/2018	ES0370148019	A3 /*-/A/BBB	CEDTDA 4.375 03/03/2016	ES0317043000	A3 /*-/BBB-/BBB
AYTCED 4 18/11/2014	ES0312362009	A3 /*-/AA-/BBB	CEDTDA 4.125 29/11/2019	ES0317045005	Baa1 /*-/BBB-/BBB+
AYTCED 4.25 18/11/2019	ES0312362017	A3 /*-/BBB-/BBB	CEDTDA 3.875 23/05/2025	ES0317046003	Baa1 /*-/BBB-/BBB
AYTCED 3.75 31/03/2015	ES0312358007	Baa1 /*-/BBB+/BBB	CEDTDA 3.5 20/06/2017	ES0317047001	Baa1 /*-/BB/BB+
AYTCED 4 31/03/2020	ES0312358015	Baa1 /*-/BB+/BBB	CEDTDA 4.25 10/04/2031	ES0371622020	Baa1 /*-/BB+/BBB
AYTCED 3.75 30/06/2025	ES0312342019	Baa1 /*-/BB/BB+	CEDTDA 4.125 10/04/2021	ES0371622012	Baa1 /*-/BB/BBB
AYTCED 3.5 14/03/2016	ES0312298013	A3 /*-/BBB+/BBB	CEDTDA 4 23/10/2018	ES0371622038	A3 /*-/A-/BBB
AYTCED 3.75 14/12/2022	ES0312298021	Baa1 /*-/BB+/BBB	CEDTDA 4.25 28/03/2027	ES0371622046	A3 /*-/BBB-/BBB
AYTCED 4 24/03/2021	ES0312298054	Baa1 /*-/BBB+/BBB	CEDTDA 4.25 27/12/2014	ES0316992009	Baa3 /*/AA/--
AYTCED 4.25 14/06/2018	ES0312298070	Baa1 /*-/BB/BB+	CEDGBP 4.25 26/04/2017	ES0318822006	A3/AA/--
AYTCED 4 20/12/2016	ES0312298104	A3 /*-/A-/BBB	IM CEDULAS		Moody's/S&P/Fitch
AYTCED 4 21/03/2017	ES0312298112	A3 /*-/BB-/BBB-	IMCEDI 4.5 11/06/2014	ES0347859003	A3/--/BBB+
AYTCED 4.75 25/05/2027	ES0312298120	Baa1 /*-/BB/BBB	IMCEDI 4 19/11/2014	ES0347852008	--/AA/--
AYTCED 4.75 15/06/2016	ES0312298229	--/AA/--	IMCEDI 3.75 11/03/2015	ES0347848006	Baa1 /*/AA/--
AYTCED 4.25 29/07/2014	ES0312298237	Baa1 /*-/AA/--	IMCEDI 3.5 15/06/2020	ES0347849004	--/BB+/-
AYTCED 4.5 02/12/2019	ES0312298245	Baa2 /*-/A+/-	IMCEDI 3.5 02/12/2015	ES0362859003	Baa1 /*-/BBB/--
AYTCED 3.75 25/05/2015	ES0312298252	Baa2 /*-/AA/--	IMCEDI 4 31/03/2021	ES0347784003	A1/--/BBB+
AYTCED 4.25 25/10/2023	ES0312298096	A3 /*-/BBB-/BBB	IMCEDI 4.25 09/06/2016	ES0347785000	A3/BBB-/BB+
PITCH	ISIN	Moody's/S&P/Fitch	IMCEDI 4.5 21/02/2022	ES0349045007	Baa1 /*-/BBB
PITCH 5.125 20/07/2022	ES0334699008	A2/BBB+/-			

Source: Citi Research

Covered Bond Rating Changes June 2014

Figure 81. Covered Bond Rating Changes: June 2014

Issuer	Program	Country	Agency	From	To	Reason
Hypo Alpe Adria (guaranteed)	Public sector	Austria	Moody's	A1	Baa3	Downgrade of the issuer's senior unsecured debt.
Hypo Alpe Adria (unguaranteed)	Public sector	Austria	Moody's	A3	Baa3	Downgrade of the issuer's senior unsecured debt.
Hypo Tirol (guaranteed)	Public sector	Austria	Moody's	Aaa	Aa1	Downgrade of the issuer's guaranteed debt rating.
Hypo Tirol (unguaranteed)	Public sector	Austria	Moody's	Aa1	Aa2	Downgrade of the issuer's guaranteed debt rating.
Kommunalkredit Austria	Public sector	Austria	Moody's	Baa3	Baa1	Downgrade of the issuer's senior unsecured debt.
SEB AG	Mortgage	Germany	Moody's	Aa2	Aa1	Adjustment of the reference point for the covered bond rating.
Unicredit Bank AG	Public sector	Germany	Moody's	Aaa	Aa1	Downgrade of the issuer's long-term debt rating.
Monte die Paschi di Siena	Mortgage	Italy	Moody's	Ba1	Baa3	Upgrade of the issuer's senior unsecured rating to B1 from B2.
Multi-cedulas	Mortgage	Spain	S&P	--	--	See article above
Catalunya Banc	Mortgage	Spain	S&P	BBB	BBB-	Downgrade due to the ongoing restructuring and current creditworthiness.
Barclays	Mortgage	Spain	S&P	AA-	A	Downgrade of the issuer rating from BB to BBB-.
Bankia	Mortgage	Spain	S&P	BBB	A-	Liability management increased threshold OC for higher rating.
Bankinter	Mortgage	Spain	S&P	A	A+	Positive rating action on the issuer.
Deutsche Bank	Mortgage	Spain	S&P	AA-	AA	Positive rating action on the issuer.
BBVA	Mortgage	Spain	S&P	A-	A	Positive rating action on the issuer.

Source: Bloomberg, Citi Research

Redemptions July 2014

Figure 82. Redemption payments: July 2014

Issuer Name	Ticker	Coupon	Maturity	Announce	Amount (EURmn)	Country
UniCredit Bank AG	HVB	4.5	07/07/2014	28/06/2004	1750	DE
Deutsche Postbank AG	DPB	3.125	10/07/2014	03/07/2009	1500	DE
Banco Bilbao Vizcaya Argentaria SA	BBVASM	4.25	15/07/2014	07/07/2004	3013	ES
ABN AMRO Bank NV	ABNANV	3.75	15/07/2014	06/07/2009	2000	NL
Deutsche Kreditbank AG	DKRED	3.25	15/07/2014	07/07/2009	500	DE
Caixa Geral de Depositos SA	CXGD	3.625	21/07/2014	09/07/2009	1000	PT
Credit Agricole Home Loan SFH	ACACB	3.5	21/07/2014	09/07/2009	1250	FR
General Electric Societe de Credit Foncier	GE	3.75	22/07/2014	07/07/2009	1000	FR
HSH Nordbank AG	HSHN	2.5	28/07/2014	20/01/2011	500	DE
Ayt Cedulas Cajas Global	AYTCED	4.25	29/07/2014	21/07/2009	1450	ES

Source: Citi Research

Covered Bond Performance

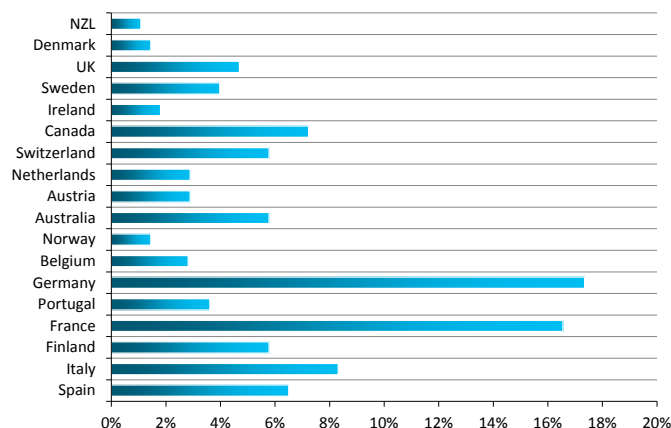
Figure 83. Covered Bond Return Table

Segment	Absolute	Δ 1m	Δ ytd	Δ 1y
Australian Covered Bonds	102.95	0.8%	4.9%	6.0%
Austrian Covered Bonds	141.59	0.7%	4.3%	5.2%
Belgian Covered Bonds	102.62	0.7%	4.2%	6.0%
Canadian Covered Bonds	131.09	0.7%	4.1%	4.9%
Danish Covered Bonds	102.40	0.5%	3.1%	4.2%
Dutch Covered Bonds	151.00	0.7%	4.5%	5.7%
EUR Covered	205.98	0.8%	4.4%	6.8%
Finnish Covered Bonds	102.29	0.4%	2.6%	3.6%
French Covered Bonds	219.80	0.7%	4.3%	5.6%
Irish Covered Bonds	150.85	0.5%	4.3%	6.3%
Italian Covered Bonds	136.26	0.9%	5.6%	8.5%
Luxembourg Covered Bonds	104.61	0.7%	3.7%	6.0%
Mortgage Pfandbriefe	197.55	0.4%	2.6%	3.6%
New Zealand Covered Bonds	101.77	0.3%	2.0%	3.0%
Norwegian Covered Bonds	140.20	0.6%	3.2%	4.3%
Obligations à l'Habitat	131.34	0.2%	0.9%	1.7%
Obligations Foncières	149.30	0.7%	4.2%	5.5%
Pfandbriefe	191.27	0.4%	2.4%	3.3%
Portuguese Covered Bonds	155.42	0.9%	6.4%	10.0%
Public Sector Pfandbriefe	188.94	0.4%	2.1%	3.0%
Spanish Covered Bonds	215.51	1.3%	7.0%	13.6%
Spanish Multi Covered Bonds	157.58	2.1%	11.0%	21.3%
Spanish Single Covered Bonds	138.78	0.9%	5.2%	10.2%
Swedish Covered Bonds	135.30	0.4%	2.2%	3.0%
Swiss Covered Bonds	102.30	0.6%	3.0%	3.7%
UK Covered Bonds	148.58	0.5%	3.1%	4.1%

Source: Citi Research

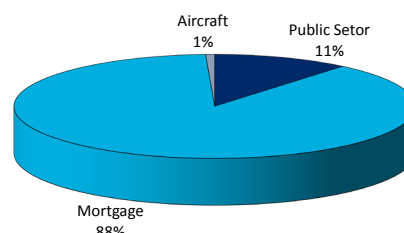
Primary Market 2014: EUR Benchmark covered bonds

Figure 84. Geographical distribution, %



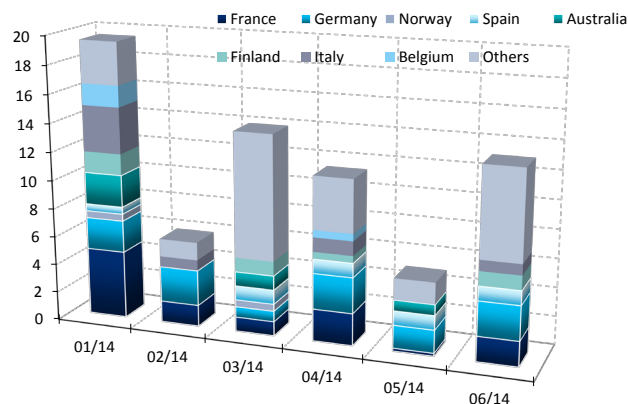
Source: Citi Research

Figure 85. Distribution by Collateral, %



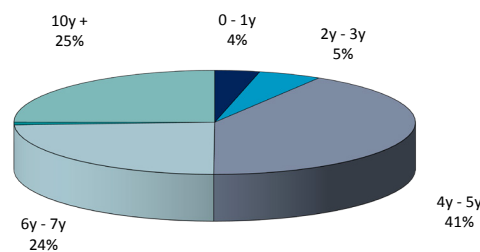
Source: Citi Research

Figure 86. Issuance by month



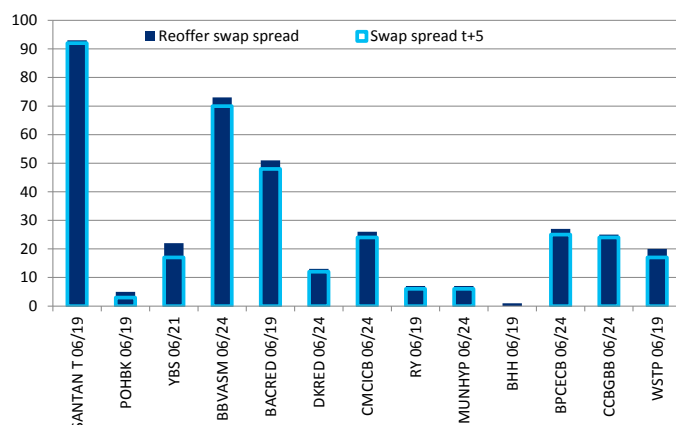
Source: Citi Research

Figure 87. Issuance by maturity, %



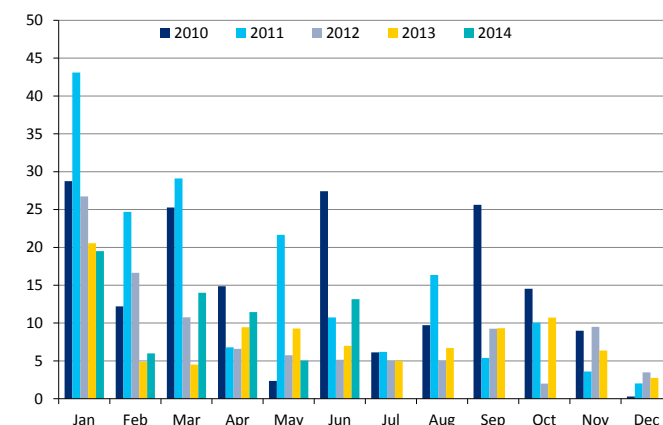
Source: Citi Research

Figure 88. Selection of primary deals' performance after 5 trading days



Source: Citi Research

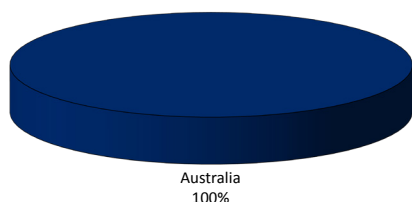
Figure 89. Historical new issuance, EURbn



Source: Citi Research

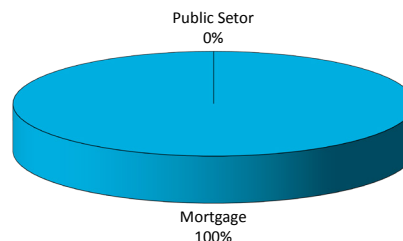
Primary Market 2014: USD Benchmark covered bonds

Figure 90. Geographical distribution, %



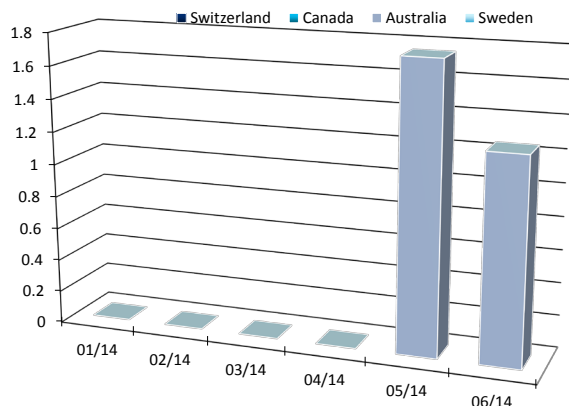
Source: Citi Research

Figure 91. Distribution by Collateral, %



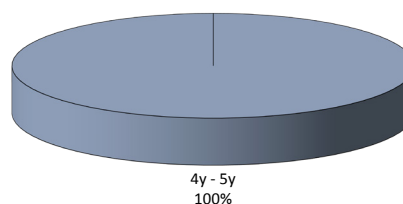
Source: Citi Research

Figure 92. Issuance by month



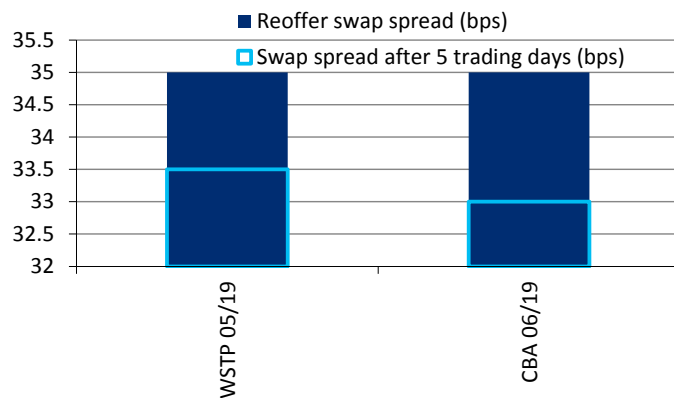
Source: Citi Research

Figure 93. Issuance by maturity, %



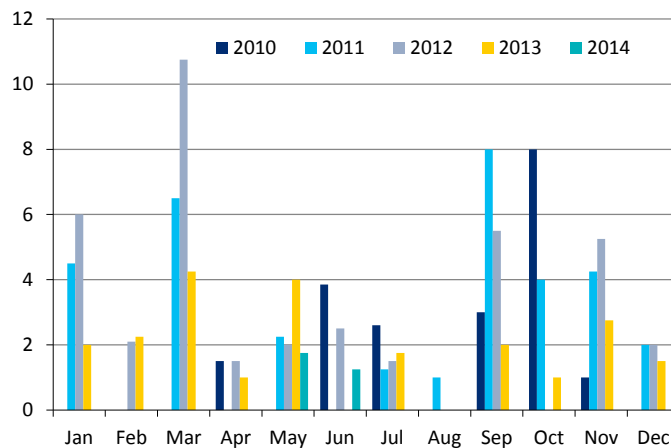
Source: Citi Research

Figure 94. Selection of primary deals' performance after 5 trading days



Source: Citi Research

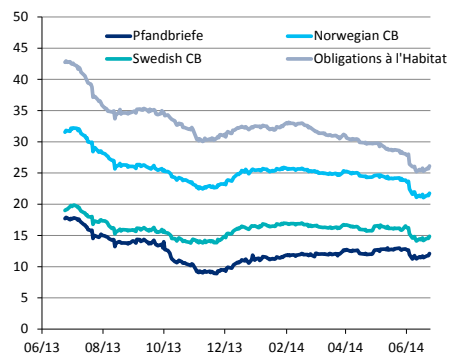
Figure 95. Historical new issuance, USDbn



Source: Citi Research

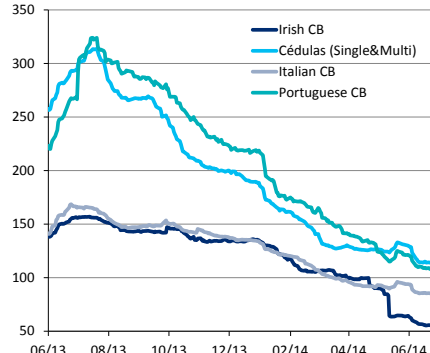
Secondary Market 2014: EUR Benchmark covered bonds

Figure 96. Secondary Market Performance, ASW-Spreads, bp



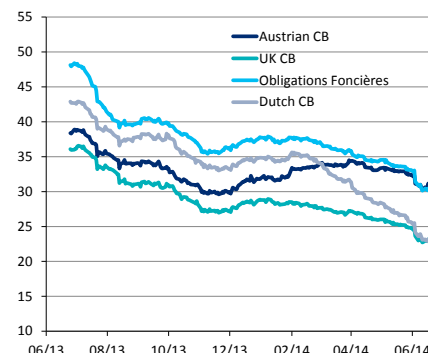
Source: Citi Research, Markit

Figure 97. Secondary Market Performance, ASW-Spreads, bp



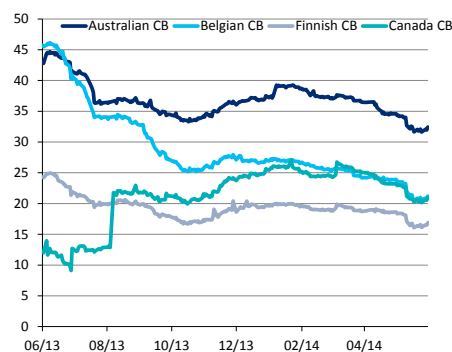
Source: Citi Research, Markit

Figure 98. Secondary Market Performance, ASW-Spreads, bp



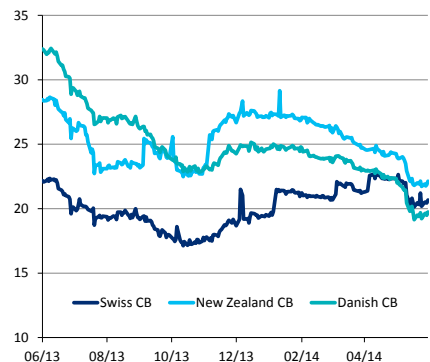
Source: Citi Research, Markit

Figure 99. Secondary Market Performance, ASW-Spreads, bp



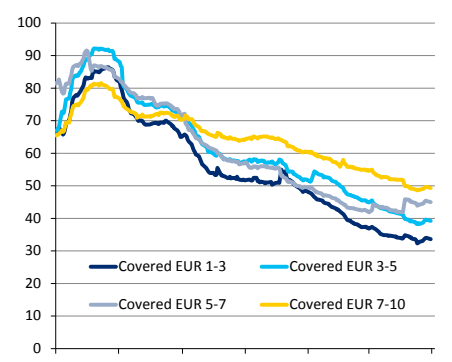
Source: Citi Research, Markit

Figure 100. Secondary Market Performance, ASW-Spreads, bp



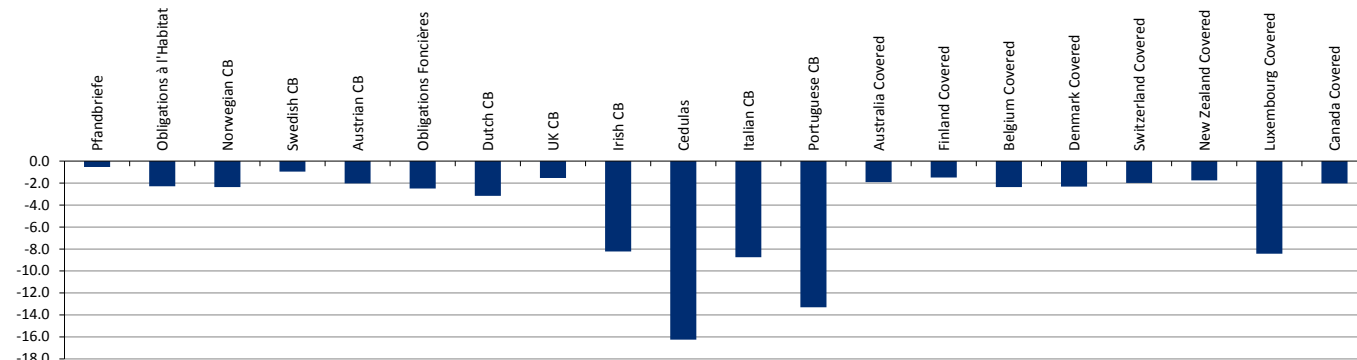
Source: Citi Research, Markit

Figure 101. Secondary Market Performance, ASW-Spreads, bp



Source: Citi Research, Markit

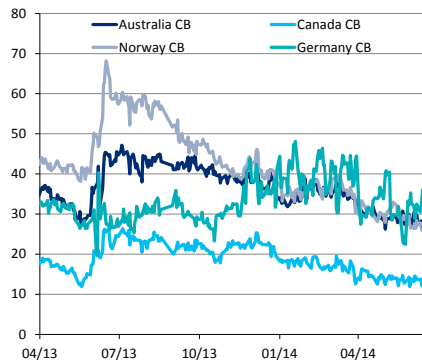
Figure 102. Spread performance over the last month



Source: Markit, Citi Research

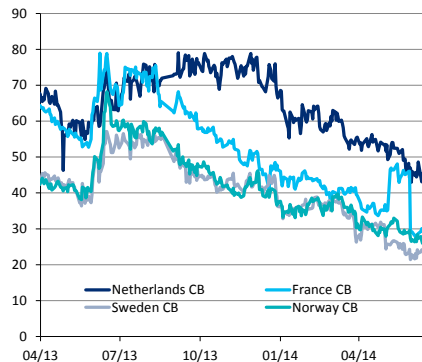
Secondary Market 2014: USD Benchmark covered bonds

Figure 103. Secondary Market Performance, ASW-Spreads, bp



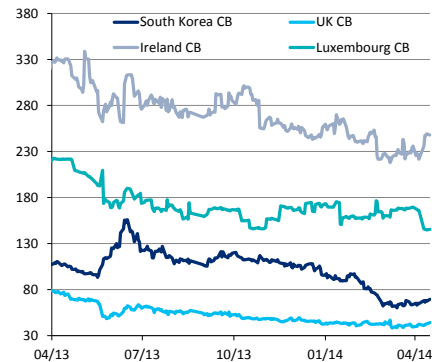
Source: Citi Research, Markit

Figure 104. Secondary Market Performance, ASW-Spreads, bp



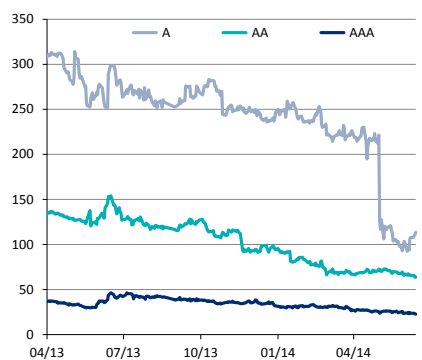
Source: Citi Research, Markit

Figure 105. Secondary Market Performance, ASW-Spreads, bp



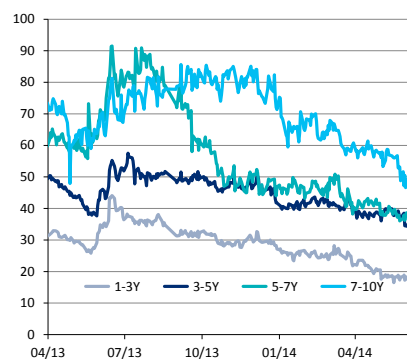
Source: Citi Research, Markit

Figure 106. Secondary Market Performance, ASW-Spreads, bp



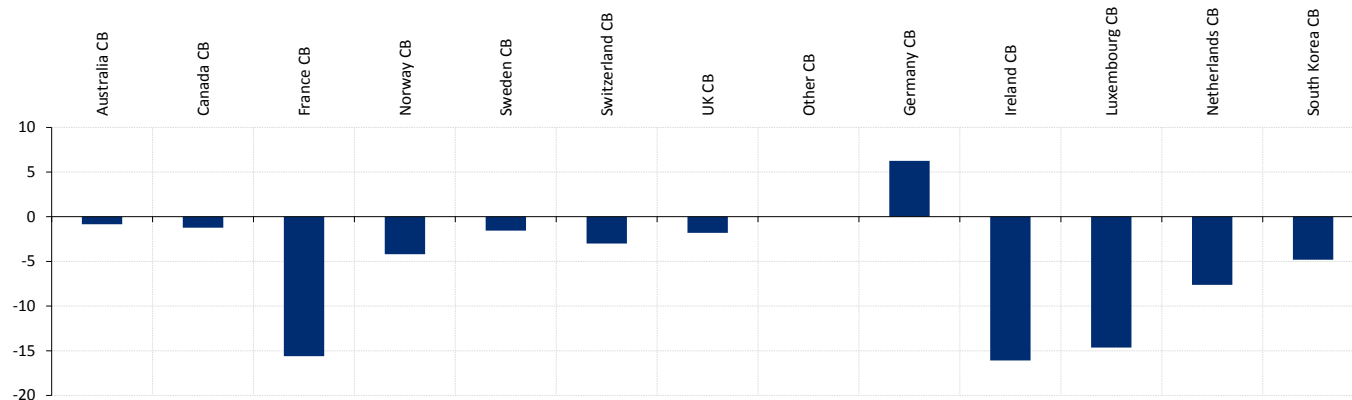
Source: Citi Research, Markit

Figure 107. Secondary Market Performance, ASW-Spreads, bp



Source: Citi Research, Markit

Figure 108. Spread performance over the last month



Source: Markit, Citi Research

Appendix A-1

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