Covered Bond Market: No man’s land

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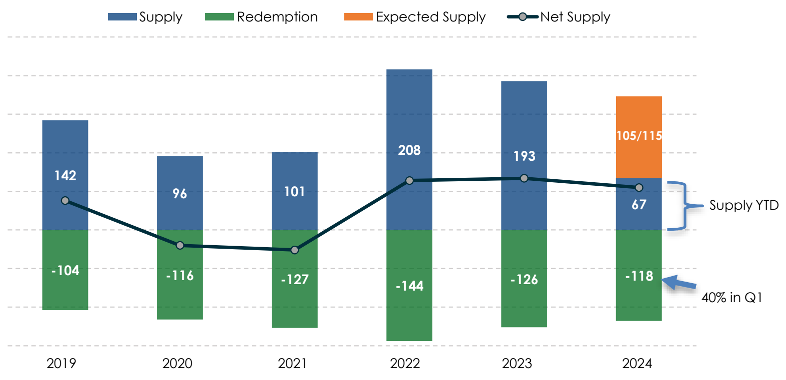
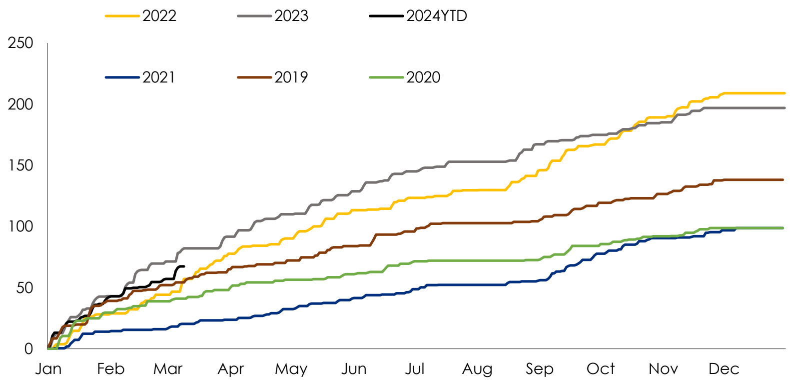
Supply: Healthy Volumes albeit Lower vs 2023YTD

- Historically, covered bonds have represented a cheap long-term funding instrument for Issuers but, in 2023, with no imminent rate cuts in sight, supply was skewed to short term tenors. In contrast, the change in market expectations on rates in the last part of the year has been translated into more appetite for long dated paper.
- 2024 has started in a strong shape with more than Eur 30bn issued (almost 40% of the volume issued across the other segments) albeit to a lesser extent than in 2023.
- Full market access across all jurisdictions, also for non national champion names, with well oversubscribed books and limited new issue concessions. French and German issuers remain the most active.

Net Supply Volumes (Eur bn)



Cumulative New Issue Volumes (Eur bn)

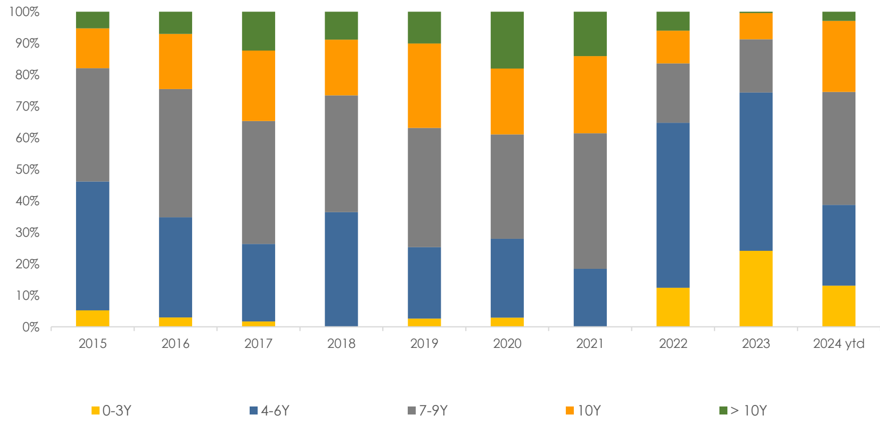


Source: Bloomberg

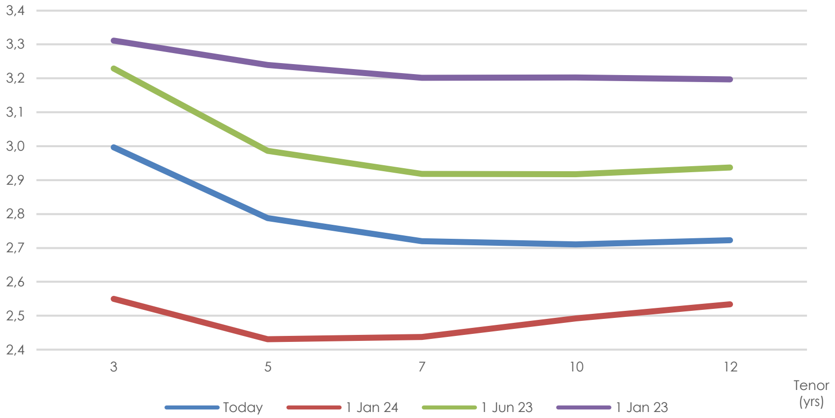
Supply: Duration is the Name of the Game

- While in 2023 the rise in yields, inverted swap curves and the high uncertainty with regards to the interest rates outlook led most of the interest to be concentrated in shorter tenors, this has been reversed in 2024YTD mainly thanks to less uncertainty on rates direction and the more normalized swap curve in the first part of the year.
- In 2024 covered bonds issued in the 7-9yr bucket have surged to almost 40% from roughly 20% in 2023. The average tenor has increased to almost 7yr from 5.3yr in 2023, thanks to several transactions in 10yr+.

Covered Bonds Tenor Evolution 2015-2024YTD*



EU Swap Rates Curve (%)



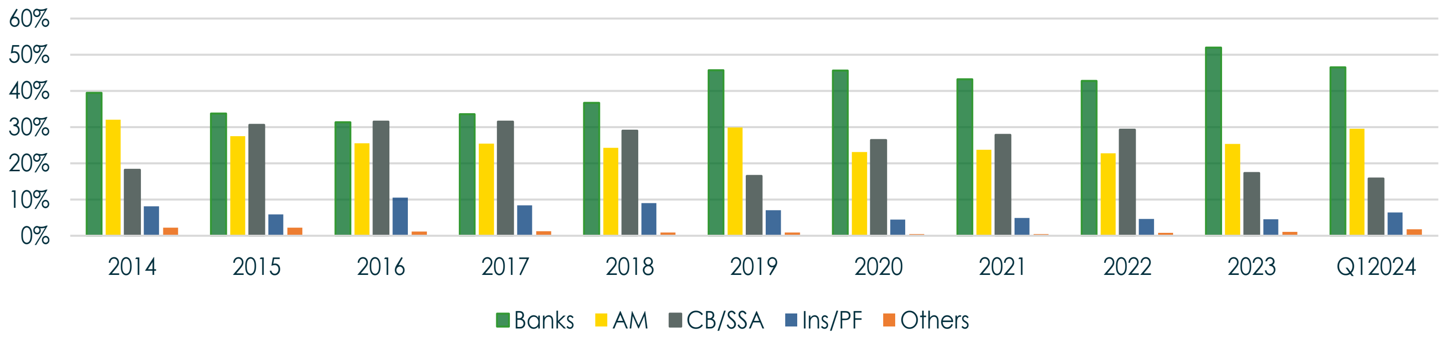
Source: Bloomberg

** Average tenor in 2024 YTD is 6.7yr*

Investor Trends: Evolution over the Years

- During the past decade Banks have been the major buyers of CBs and increasingly more in 2023: their average participation in 2014YTD has been around 40% and in 2023 it was approx. 10% higher. One reason is that, while the volume of CBs deposited with Central Banks as collateral declined, LCR of some banks decreased as they reduced their excess ECB deposits and therefore buying CBs in primary helped boosting the ratio*.
- **Insurance and Pension Funds have still marginal interest** in CB, more attracted by products with wider spread and outright yields. On the other hands, on the need to extend the duration, new investors such as **Asset Managers have started buying CBs** and in bigger size, matching the Issuers' interest in long term issuances.

Who is Buying: Investors Distribution (2014-2024 YTD)



Source: Bloomberg, available orderbooks

*Note:*Following the TLTRO repayments, Covered Bonds can count towards the LCR buffer (retained Covered Bonds are not LCR eligible)*

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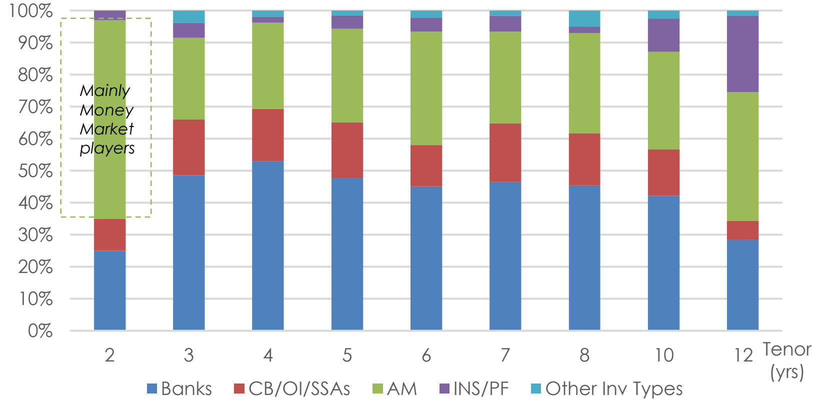
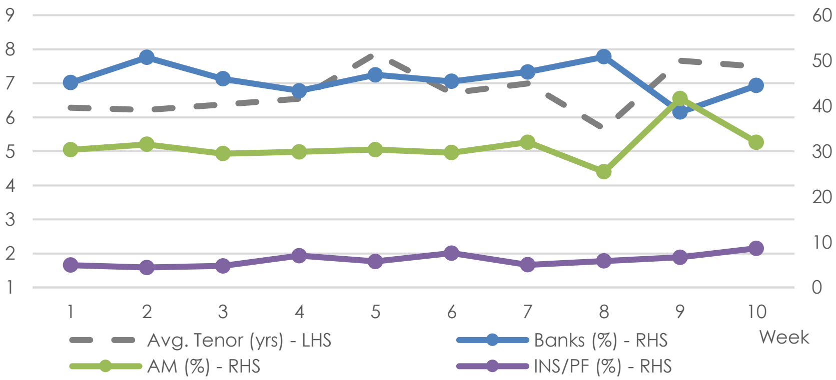
Investor Trends: 2024YTD (1/2)

- Spread compression vs Senior Preferred has brought several "new" investors (mainly AMs and Money Market) to invest in covered bonds, attracted by the relative value vs higher beta products. The dynamic has also been driven by the notable inflows seen YTD pushing AMs to widen their investment spectrum to deploy the available cash, in particular:
  - Short-dated CBs have been seen as an interesting points of entry by Money Market players;
  - The long-end has been hit in size by AMs keen to lock-in current levels vis-à-vis expected rate cuts
- Bank's participation continues to be negatively correlated to duration with activity concentrated in the belly of the curve.
- Insurers have been particularly active over the last few weeks (compared to earlier in the year) with activity skewed towards long duration trades.

Allocation YTD by Investor Type across Tenors



Main Investor Types (Weekly Average % Allocation)



Source: Bloomberg, available orderbooks

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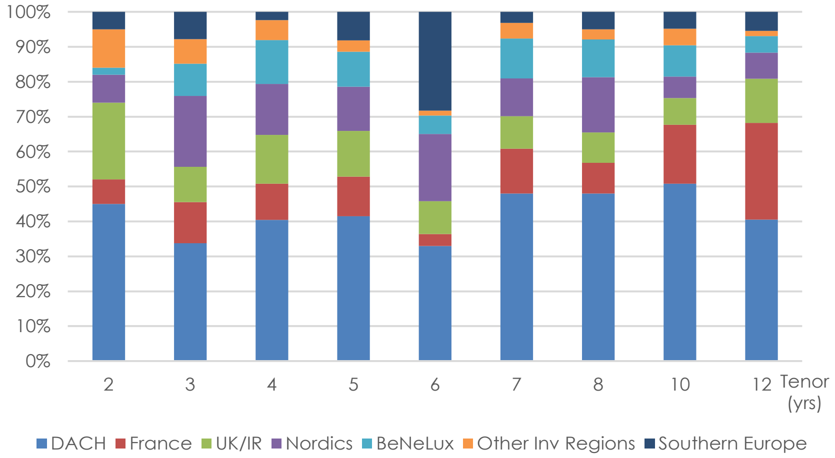
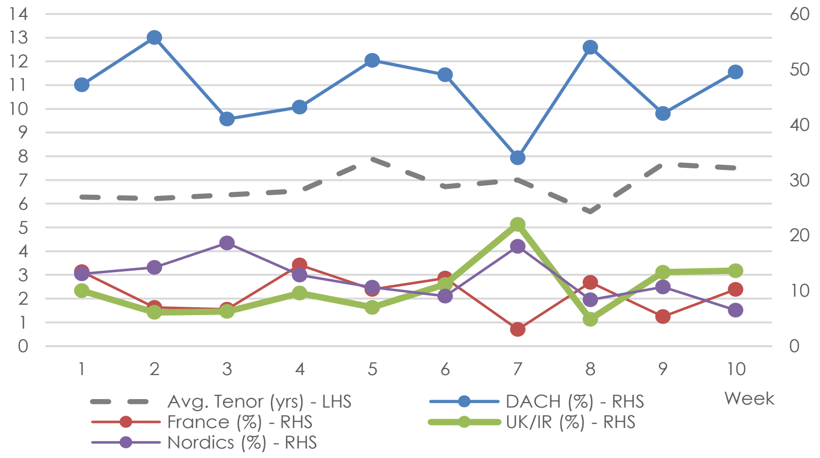
Investor Trends: 2024YTD (2/2)

- While Germany, Austria and Switzerland still take the lion share of supply, participation from the UK has increased since the start of the year, especially as more and more long-dated trades are being printed and UK Credit Funds (some have set up new pockets for CBs) have appetite for duration at current rates.
- In terms of execution technicals, the above dynamics have translated into higher oversubscriptions and lower New Issue Premium in the long-end, compared to the belly of the curve.

Allocation YTD by Investor Regions across Tenors



Main Investor Regions (Weekly Average % Allocation)

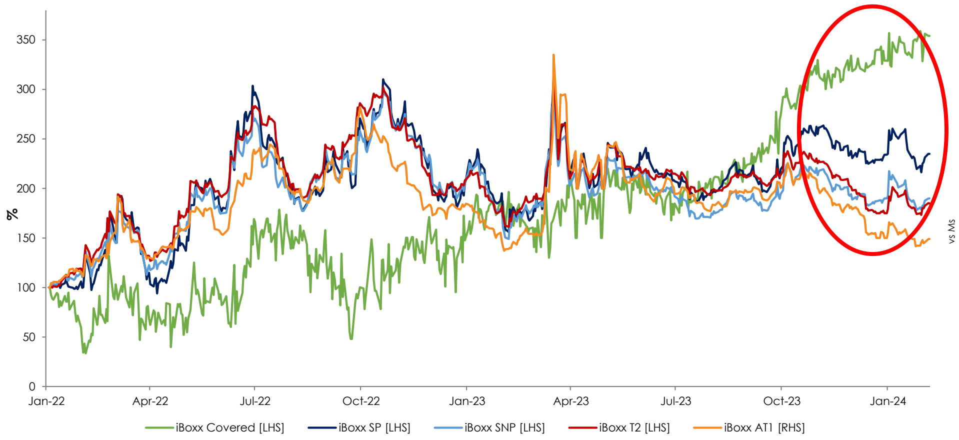


Source: Bloomberg, available orderbooks

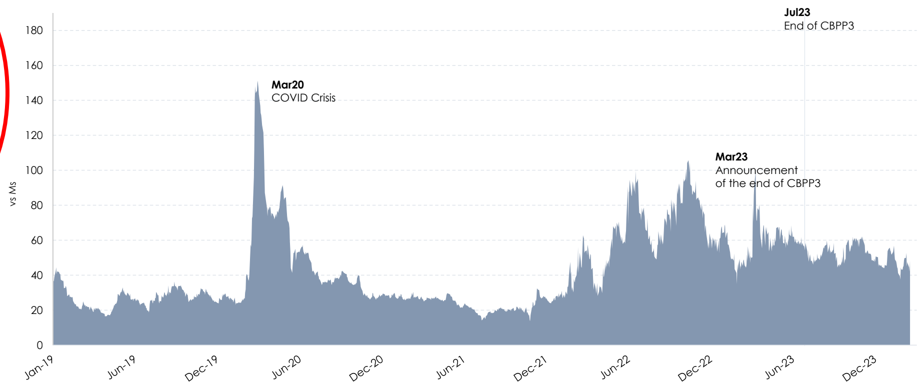
Secondary Market: Recent Widening and Stabilisation

- Covered bonds spreads have experienced a significant widening since 2023.
- This long-sought repricing, with the consequent narrowing of the gap vs Senior Preferred, is certainly one of the reasons for the reopening of the longer end of the curve and for the strong demand for paper experienced so far this year.
- Primary trades are indeed being priced at minimal/negative New Issue Premium thanks to high levels of oversubscription. In a context of lower covered bond supply currently at -30% vs 2023YTD, this has helped covered bond spreads to stabilise over recent weeks.

iBoxx Eur* across Segments 2022-2024 YTD



Delta iBoxx Eur Senior Preferred vs iBoxx Eur Covered Bonds 2019-2024 YTD



*Source: Bloomberg, Intesa Sanpaolo. *Note: Index rebased on 100%*

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Secondary Market: Expectations for the Remaining of the Year

- In general, covered bond spreads tend to be more resilient than other credit spreads, especially in a volatile market environment. However, the following drivers might play a role in the secondary movements for the rest of the year.

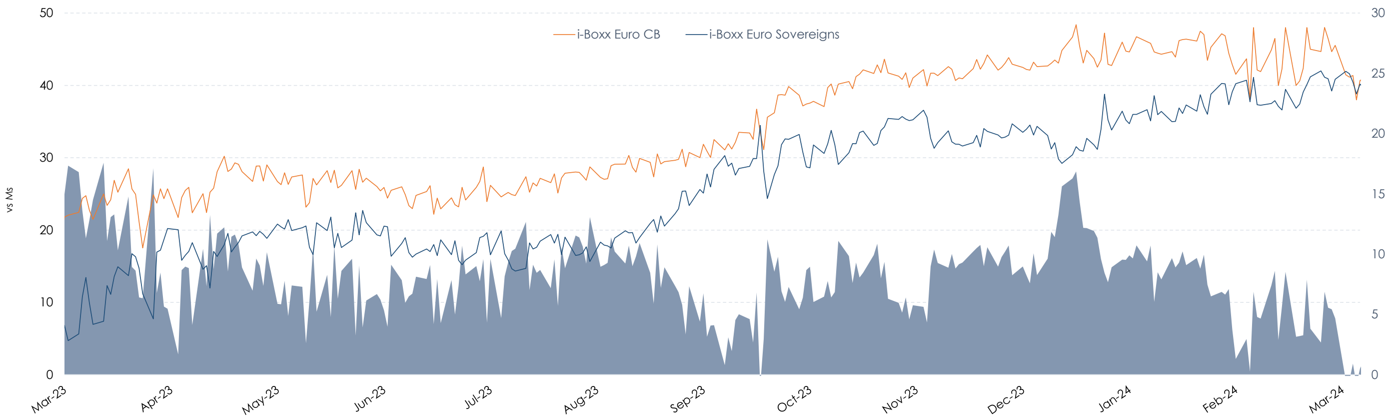
Tailwinds:

- Primary Supply this year is expected to be lower than last year therefore investors focus may turn to secondary markets thus supporting spreads.
- Investor diversification (Asset Managers, Insurance) on the back of a normalisation in the yield curves, should create additional demand and help absorbing new supply.

Headwinds:

- Deterioration in market conditions may lead more issuers to access the CB primary markets and the subsequent increase in the net-supply would wide spreads.
- The narrowing of the spread differential between Covered Bond and SSAs/EGBs (less attractive RV), could impact demand and make Covered Bond more expensive.

iBoxx Eur Covered Bonds vs iBoxx Eur Sovereigns



Source: Bloomberg, Intesa Sanpaolo

Looking Ahead: Food for Thoughts

- What could potentially stop or slow down these strong conducive conditions:
  - Liquidity available to investors;
  - Commercial Real Estate concerns;
  - Relative value vs SSA/EGBs;
  - New Regulation;
  - Low Covered Bonds redemptions year;
  - Covered Bond / Senior Preferred gap;
  - Unexpected Central Banks decisions.