European Commission

EU BUDGET POLICY BRIEF

THE EU AS AN ISSUER: THE NEXTGENERATIONEU TRANSFORMATION

#3 - July 2022

Budget

EU Budget Policy Briefs are written by the staff of the European Commission's Directorate-General for Budget to inform discussion on the EU budget and stimulate debate.

Contact: BUDG-POLICY-BRIEFS@ec.europa.eu

Manuscript completed in July 2022

Luxembourg: Publications Office of the European Union, 2022

Print	ISBN 978-92-76-48222-2		doi:10.2761/591643	KV-AU-22-002-EN-C
PDF	ISBN 978-92-76-48221-5	ISSN 2600-4305	doi:10.2761/111076	KV-AU-22-002-EN-N

CONTENT

1. Introduction 4
2. Revamping the Commission's debt management architecture 6
2.1 From back to back financing to a pool of funding needs and a new diversified funding strategy 7
2.2 The diversification of funding instruments and techniques 7
3. How the Commission has been delivering on its mandate 10
4. The broader impact of NGEU joint issuances 13
4.1 Boosting the supply of highly rated euro-denominated assets 13
4.2 The role of EU issuances in supporting the European green and social capital markets 19
5. Conclusion 22

References 23

1. INTRODUCTION

SUMMARY

The European Commission is empowered to borrow on capital markets on behalf of the European Union. Historically, the Commission used this capacity to fund lending programmes for countries in difficulty, allowing them to benefit from the low rates available to the EU as a highly rated borrower. However, these programmes tended to be small in scale. As a result, the Commission has had a relatively minor presence in the European capital markets. This changed with the onset of the Covid-19 crisis. As part of an unprecedented package of coordinated EU responses, the Commission was mandated to temporarily ramp up its borrowing operations to finance NextGenerationEU (NGEU), a major lending programme of up to EUR 806.9 billion aimed at driving Europe's recovery from the pandemic. Published one year after the Commission issued its inaugural NGEU bond, this policy paper first looks at what this programme entailed for the Commission's funding strategy in practice. It then looks at how the Commission has delivered to date on its mandate of mobilising funds at scale and in a cost-effective manner. The paper finally concludes with some analysis of the broader impacts that the increase of joint EU borrowing since 2020 has been having on European capital markets.

NGEU is at the heart of the EU's unprecedented response to the Covid-19 crisis. Under NextGenerationEU (NGEU) the Commission is empowered to borrow up to EUR 806.9 billion between 2021 and 2026 to drive Europe's recovery from the pandemic via a combination of loans and grants to Member States and centrally managed EU programmes (1). NGEU was preceded by another milestone programme adopted in spring 2020: the temporary Support to mitigate Unemployment Risks in an Emergency (SURE). Under SURE, the Commission was empowered to borrow up to EUR 100 billion between 2020 and 2022 to finance loans which could be used by Member States to fund expenditure necessary for the preservation of employment throughout the pandemic.

The use of joint borrowing to finance the recovery enabled the EU to provide a coordinated fiscal stimulus and a strong signal of solidarity. With the Commission raising funds by borrowing from capital markets on behalf of the European Union as a whole, the EU leveraged on its strong credit rating to raise funds from the capital markets in a cost-effective way. This was particularly the case with NGEU, which transformed the way the Commission borrowed from the markets.

This policy paper describes the transformation of the EU's presence in the capital markets as a result of NGEU. First, in section 2, it outlines how the Commission revamped its debt financing architecture to manage the size and complexity of the NGEU borrowing programme. Then, in section 3, it assesses how the Commission has delivered to date on its mandate of providing the required funds to Member States, before finally analysing in section 4 some of the indirect benefits stemming from the use of joint borrowing to finance this flagship EU programme.

(1) Under NGEU 10% (or EUR 83 billion) of funds will be used to reinforce centrally managed EU programmes such as Horizon Europe and the Just Transition Fund. The remaining 90% (or EUR 723.9 billion) will fund the Recovery and Resilience Facility (RRF), an instrument to support reforms and investments in a number of priority sectors, with a particular emphasis on boosting the green and digital transitions. EUR 386 billion in RRF funds will be on-lent to beneficiary EU countries in the form of loans, while EUR 338 billion will be disbursed in the form of grants. These funds will be released in line with pre-agreed Recovery and Resilience Plans and associated reform milestones.

EU'S CREDIT STRENGTH

A borrower's credit rating is an assessment of the likelihood with which they will repay a particular debt. This in turn affects the terms at which the borrower can issue the debt that is required. All other things being equal, the better the rating, the lower the risk premium investors require when they lend money.

Due to the construction of the EU budget and the fact that all EU borrowings are direct and unconditional obligations of the EU, the EU's credit rating (AAA/Aaa/AAA/AAA (outlook stable) by Fitch, Moody's, DBRS and Scope, and AA+ (outlook stable) by Standard & Poor's) is better than the rating of 22 out of the 27 EU Member States. The EU's debt service is also ensured via multiple layers of debt-service protection, while the system of own resources guarantees that the EU honours its obligations in a timely manner.

There are currently four categories of own resources (meaning the revenue that the EU collects for its budget): revenue coming from customs duties, contributions based on Value Added Tax (VAT), contributions based on non-recycled plastic packaging waste and a direct contribution by EU countries, known as the Gross National Income (GNI)-based contribution. The balance between the level of Union budgetary expenditure and revenue is ensured by the GNI-based contribution, which is automatically adjusted for any shortfalls arising from the customs duties, VAT and plastics-based own resources. As a result, a budgetary balance on an annual basis is ensured.

EU Member States can also agree on additional targeted safeguards to guarantee the repayment of EU debt. In the case of SURE, Member States agreed to additional guarantees of EUR 25 billion to back up EU debt issuances. In the case of NGEU, Member States agreed to a temporary increase in the maximum amount of revenue the EU can call from Member States per year (adding an allocation of 0.6% to the basic own resources ceiling of 1.4% of EU Gross National Income) until all NGEU liabilities have ceased to exist.

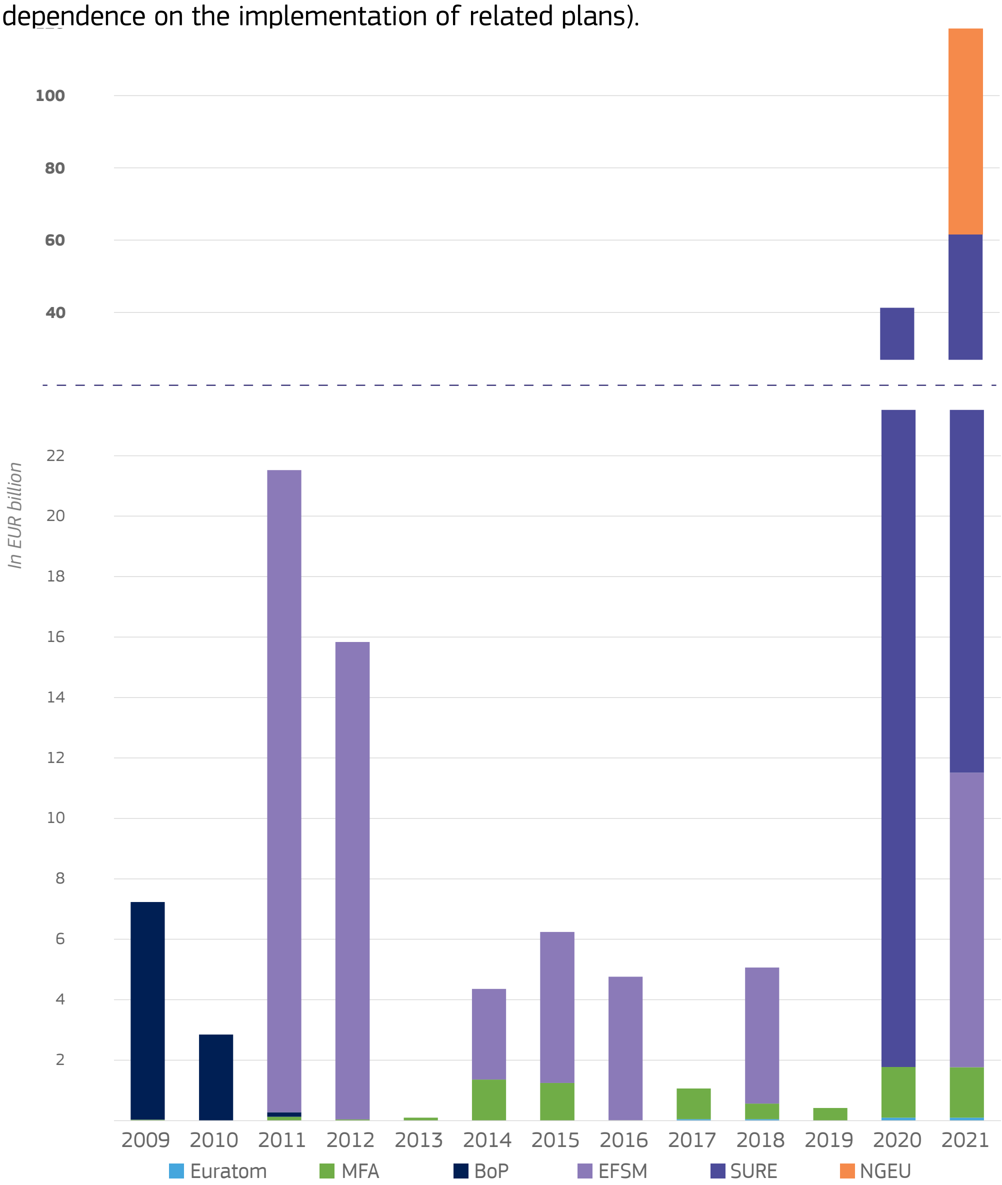
The combination of these safeguards means that the EU will always have the means to meet its debt repayment obligations, be it by an automatic increase of the direct contribution by Member States – the GNI-based contribution – or by active resource management, for example through re-allocation of funds within the budget.

2. REVAMPING THE COMMISSION'S DEBT MANAGEMENT ARCHITECTURE

The decision to empower the Commission to finance NGEU through joint borrowing brought a fundamental change in the Commission's debt management architecture. Although the Commission has been borrowing funds on behalf of the Union for over 40 years [(2)], NGEU required a funding strategy that: (i) enabled the significant scaling up of issuances in a very short amount of time (NGEU required the Commission to become an issuer comparable in activity to large EU Member States, with issuance of on average roughly EUR 150 billion per year); and (ii) provided the necessary tools to manage issuances in a way that met complex disbursements of loans and grants to Member States (with disbursements having to take place at speed, high frequency and uncertain timings given their dependence on the implementation of related plans).

Figure 1. EU debt issuances between 2009 and 2021

Source: European Commission.
Note: BoP refers to Balance of Payments, MFA to Macro-Financial Assistance and EFSM to the European Financial Stability Mechanism.



(2) Prior to the COVID-19 crisis EU joint borrowing had been used to finance: the EU's Macro-Financial Assistance programmes assisting non-EU partner countries; the Balance of Payments assistance programme for EU countries outside the euro area that are experiencing or threatened by difficulties regarding their balance of payments, the European Financial Stabilisation Mechanism, assisting EU countries experiencing or threatened by severe financial difficulties, and the European Atomic Energy Community (where the European Commission is raising fund on behalf of Euratom to finance eligible investment projects).

2.1 From back to back financing to a pool of funding needs and a new diversified funding strategy

Before NGEU, the Commission employed a back-to-back approach for its funding operations. Under this approach, the Commission issued bonds and transferred the proceeds directly to beneficiary countries on the same terms (i.e. interest rate and maturity) that it received. The timing, volume and maturity of issuances were hence determined entirely by the needs of the beneficiary. This method was sufficient in addressing small funding needs, but it reached its limits with the SURE programme, where 19 Member States had to be served by a single funding programme with a combined issuance volume of up to EUR 100 billion.

NextGenerationEU required a new Diversified Funding Strategy with a pooling of funding needs much like the strategy employed by sovereign issuers. To respond to the needs of NGEU and to issue up to around EUR 800 billion by the end of 2026, the Commission had to establish a strategy that decoupled the funding transactions from the use of their proceeds and enabled the execution of borrowing in the required volumes, with maximum flexibility, minimum execution risk and optimal cost of funding. Structured and transparent relations with banks to support the programme through the execution of transactions and related support for secondary market liquidity, as well as regular and transparent communications on the expected funding volumes and operations also had to be established.

2.2 The diversification of funding instruments and techniques

To deliver NGEU, the Commission needed to put in place a range of new funding instruments and techniques. These instruments provided the Commission with the capacity to deliver large amounts of liquidity with a limited number of transactions and with maximum flexibility to adapt to changing disbursement plans and diverse market conditions. The instruments also had to be attractive for a wide investor base.

Issuance of medium and long term borrowing via EU-Bonds as well the establishment of an EU-Bills programme to enable short-term (less than one year tenor) borrowing, never used before NGEU, constitute the key pillars of the new approach. For the bonds programme, the aim was to establish a regular presence in all benchmark maturities (3, 5, 7, 10, 15, 20, 25, and 30 years) with as liquid as possible EU-Bonds, hence making them an interesting investment proposition to different types of investors. In order to maximise the liquidity of EU-Bonds in the secondary market and increase their attractiveness to investors [3], a strategy of combining new bonds and increasing outstanding amounts of existing bonds (known as "tapping") was also put in place. In parallel, conventional EU-Bonds were supplemented by the issuance of NGEU Green Bonds, enabling the EU to support and serve the growing demand in this market and to attract the attention of more investors.

(3) Bonds that are liquid in the secondary market are more attractive to investors as they can be used to manage positions with limited transaction costs.

With a new EU-Bills programme, the Commission established its presence in the short term money market (at 3 and 6 month maturities), further widening the EU investor base [(4)]. Given the deep and liquid nature of these markets, EU-Bills provided the Commission with an additional risk management tool in case of unpredictable financial market conditions or immediate liquidity needs.

Yet, the execution of a bonds and bills programme on the scale needed under NGEU also required a revamping of the Commission's funding techniques and the introduction of a new auctions platform. Prior to NGEU, the Commission relied solely on the use of syndicated transactions [(5)] for its funding operations. Syndications are the traditional technique for debt issuance by supranational and agency issuers. However, sizable European sovereign issuers rely on a combination of auctions [(6)] and syndications as issuance techniques. This is because auctions tend to be a more efficient way of issuing government debt than syndications (e.g. because of an overbidding tendency by participating banks observed by sovereign issuers, the absence of fees from the issuers to the banks, and the fewer resource requirements on the part of the issuer in managing the transaction [(7)]). Bills are also usually issued via auctions. Therefore, the Commission set up in 2021 an auction platform with the support of Banque de France, providing it with the required instrument for the issuance EU-Bills (first EU-Bills auctioned on 15 September 2021) as well as with an alternative technique for the issuance of EU-Bonds (first EU-Bonds auctioned on 27 September 2021).

(4) Bills are often used by bank treasuries and asset managers to invest in liquid money market instruments as well as by central banks outside Europe for investment of their currency reserves.

(5) Syndication is a funding technique in which the issuer works with a group of underwriters, usually banks, whose role is to place the debt with investors in return for a fee.

(6) Auction is a funding technique in which the issuer will offer its debt to a group of financial institutions (primary dealers) which can acquire the debt by submitting bids via an electronic platform. Generally, bigger issuers rely almost exclusively on auctions (more than 90% of volumes for Germany or France), while smaller issuers tend to have more balance between these two techniques.

(7) The World Bank (2015) pointed out that, while syndications can be beneficial, auctions should yield the lowest financing costs. According to the World Bank, using the two in tandem can prove to be very efficient. The OECD (2009) also stressed the cost-effectiveness of auctions, especially since the auction systems have become more automated and reliable.

THE 5 KEY ELEMENTS OF THE COMMISSION'S DIVERSIFIED FUNDING STRATEGY

Multiple instruments: A combination of: (i) medium and long term debt issuance across different maturities (3, 5, 7, 10, 15, 20, 25 and 30 years) via EU-Bonds; and (ii) short term debt (below one year) via EU-Bills, aimed at providing liquidity on all parts of the yield curve through regular issuances and obtaining a permanent and strategic access to the money market. EU-Bonds include both conventional and green bonds, with funds raised via NGEU Green Bonds funding solely eligible green measures.

Different funding techniques: Use of syndications and auctions enabling the Commission to attract efficiently the necessary funding, even under difficult market conditions, enlarge the investor base, support secondary market liquidity and reduce funding costs.

Transparent communication with the markets: 6-monthly funding plans through which the Commission communicates to the markets (and to peer issuers) its expected issuance volumes and the timing of the planned syndications and auctions.

Establishment of a structured and transparent Primary Dealer Network: A (40 plus bank-strong) Primary Dealer Network which supports, via a system of obligations and privileges, the execution of funding operations and the placement of EU debt with a wide range of international investors while also supporting the liquidity of EU-Bonds and EU-Bills in the secondary market and ensuring regular high quality advice by the banks to the issuer. The establishment of the EU Primary Dealer Network included the implementation of a new fee structure for syndicated transactions, tailor-made to the expected issuance volumes for NGEU.

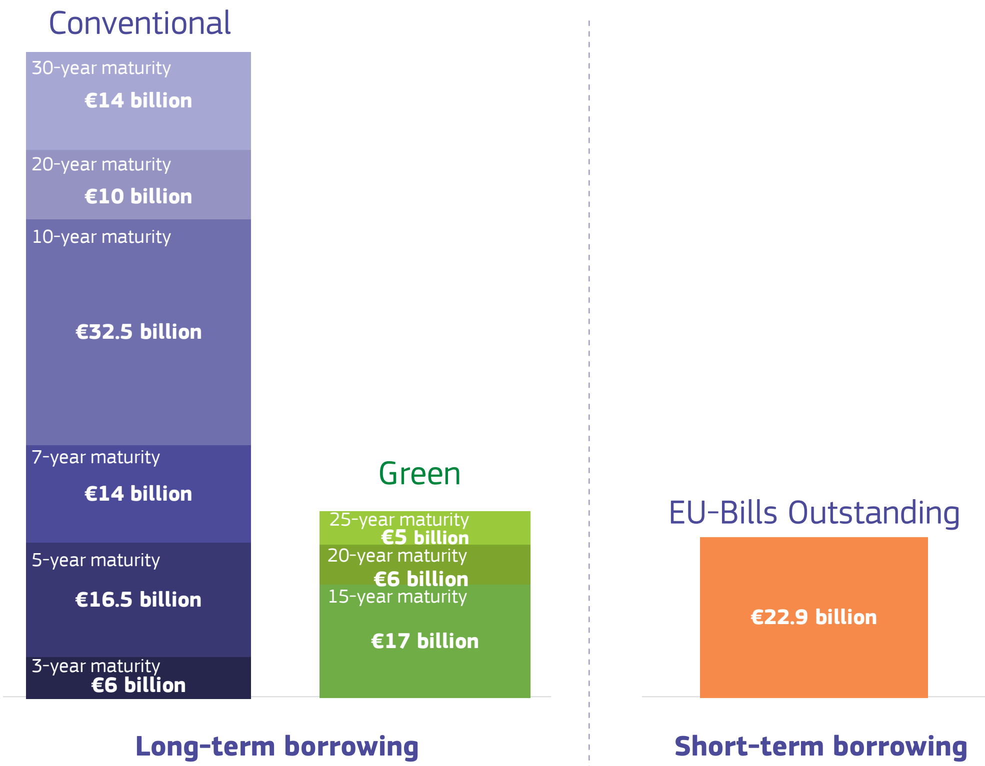
Governance framework and risk management: Robust internal frameworks covering core decision-making processes and implementation modalities of the Commission's funding operations, including oversight by an independent Chief Risk Officer.

3. HOW THE COMMISSION HAS BEEN DELIVERING ON ITS MANDATE

With the Diversified Funding Strategy put in place in time for the launch of NGEU operations in June 2021, the NGEU funding programme is now well underway. The primary mandate of the Commission under NGEU is to mobilise the unprecedentedly large funding required in a timely and cost efficient manner. As shown in figure 2, as of the end of June 2022 the Commission has raised EUR 121 billion in long term funding over 10 syndicated transactions and 8 bond auctions. In complement to this long-term funding, the Commission has also raised EUR 58 billion in short term funding via the EU Bills programme, EUR 23 billion of which is outstanding as of that date. Together, these operations have enabled the disbursement of EUR 67 billion in grants and EUR 33 billion in loans to Member States under the RRF, as well as EUR 15.5 billion to other programmes funded by NextGenerationEU.

Figure 2. NGEU Issuances as of 30 June 2022.

Source: European Commission.



KEY FACTS

- €121 billion EU-Bonds of which €28 billion green.
- 10 syndications and 8 auctions.
- Syndicated transactions 5.9 to 16 times oversubscribed.

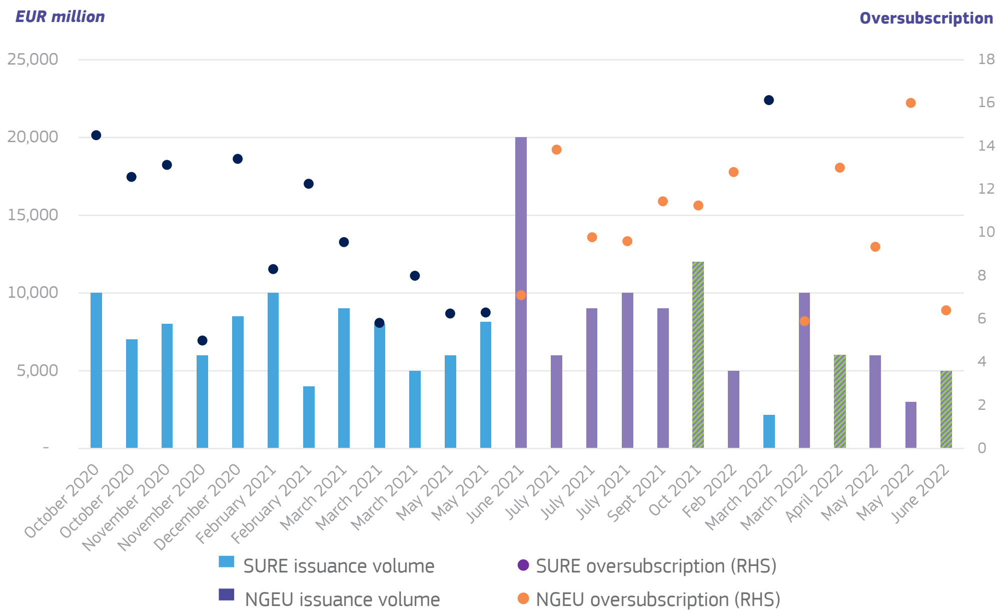
KEY FACTS

- €57.9 billion issued in 3- and 6-month EU-Bills of which €22.9 billion still outstanding.

The NGEU funding programme has seen a very high level of investor demand, with all syndicated transactions being between 6 and 16 times oversubscribed (figure 3). This level of investor buy-in reflects the very supportive conditions for issuers that prevailed during the course of SURE issuances, (which paved the way for NGEU), and continued over the first six months of NGEU funding operations. Despite a marked change in market conditions in 2022 and sharp increase in volatility and yields, investor demand for NGEU issuances has remained strong, a testament to the underlying high quality credentials of EU-Bonds.

Figure 3. NGEU and SURE issuance volumes and oversubscription rates.

Source: European Commission.



Investor buy-in has helped the Commission to deliver NGEU issuances at a competitive cost of funding. For SURE, the Commission has estimated that, based on the eight SURE issuances executed by April 2022, Member States have benefited from savings of EUR 8.5 billion on interest payments relative to what they would have paid if they had issued sovereign debt themselves [8]. While an equivalent comparison is not possible for NGEU issuances to date (since NGEU operations are funded by a pool of funding approach instead of a direct back-to-back approach, as in the case of SURE), the average cost of funding for NGEU transactions executed in 2021 was 0.14% across maturities from 5 - 30 years, reflecting the low cost of EU issuances. For the first half of 2022, it is estimated that the NGEU cost of funding will be more than one percentage point higher (at around 1.24%), reflecting the tighter conditions experienced across the markets as a result of the war in Ukraine, intensifying inflationary pressures, and reduced quantitative easing by central banks.

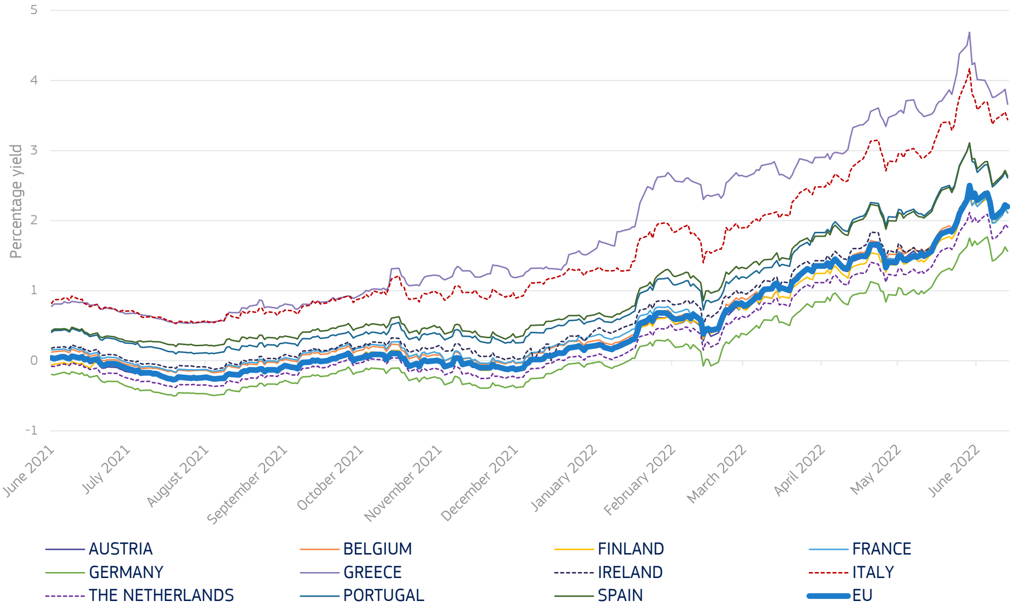
(8) European Commission (forthcoming).

EU-Bonds continue to price comparatively well despite more volatile conditions. Although it is not possible to predict how market conditions will evolve, the current more difficult market conditions are affecting debt issuers across the board. Despite these circumstances EU-Bonds continue to price comparatively well, reflecting the inherent credit quality of the EU and the strong recognition it receives as a value-oriented social and green issuer. This is demonstrated in figure 4, which shows that EU 10 year rates have continued to price competitively relative to the largest euro area sovereign issuers in terms of 2021 gross issuance volumes.

Figure 4. Yields of 10 year EU-Bonds and selected euro area issuers.

Source: European Commission based on Bloomberg data.

Note: EU 10 year rates in comparison with the largest euro area sovereign issuers in terms of 2021 gross issuance volumes.



4. THE BROADER IMPACT OF NGEU JOINT ISSUANCES

Beyond providing funds to support the EU's recovery from the pandemic, EU funding is having a broader impact on the European capital market. In particular, the ramp-up of EU issuances is: (i) boosting the supply of highly rated euro-denominated assets; and has (ii) enabled the establishment of two new EU securities: EU Social Bonds and NGEU Green Bonds.

4.1 Boosting the supply of highly rated euro-denominated assets

As a result of the EU's strong credit rating, EU-Bonds exhibit similar characteristics to those of other large and highly rated euro area issuers. An analysis of EU-Bonds' spreads relative to securities traditionally considered as safe havens, such as German and French government bonds, shows that EU-Bonds across the 5y, 10y, and 30y tenors exhibit a 98% - 99% correlation with a similar basket of French and German bonds (figure 5). Similarly, figure 6 shows that EU 10 year yields have been moving in tandem with the risk appetite index [9], with: (i) demand for EU-Bonds increasing (and EU yields decreasing) or remaining stable during periods of reduced risk appetite and (ii) demand for EU-Bonds decreasing (and EU yields increasing) or remaining stable when risk appetite has been increasing - again a usual characteristic of safe assets.

Figure 5. Correlation of EU-Bonds to German/French bond basket.

Source: European Commission based on Bloomberg data.

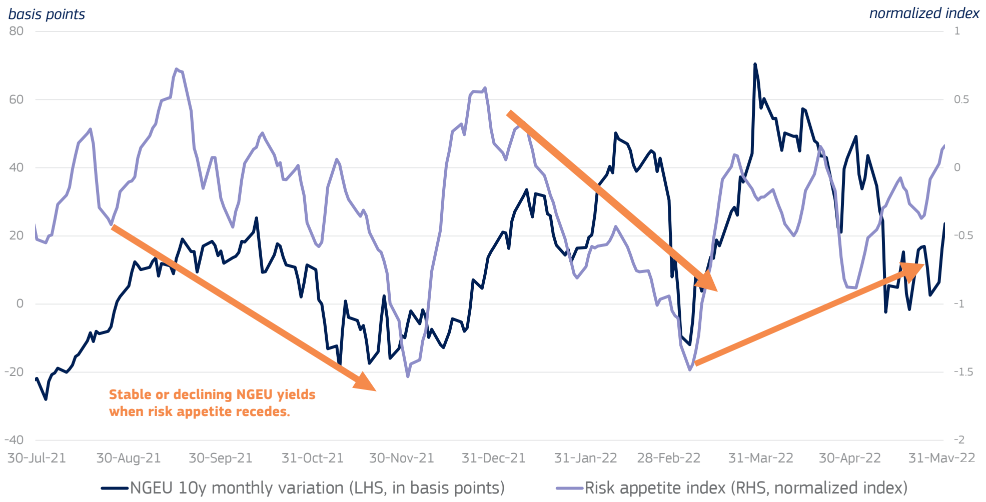
Note: Based on the period from July 2021 to July 2022. Correlation based on weekly changes in yields. Weights of the basket (approximately 50-50) calculated on a daily basis as a function of the volatility of DE and FR yields.

Tenor	Correlation of basket composed of DE-FR bonds with NGEU yields	Average NGEU pick-up over the basket (in basis points)
5y	99%	20
10y	99%	17
30y	98%	13

(9) The risk appetite index takes into account factors such as credit spreads and volatilities of financial assets. When these variables increase, the risk appetite index decreases.

Figure 6. EU-Bonds safe asset characteristics.

Source: European Commission based on Bloomberg data.



The scale of NGEU is transforming the EU's presence in the European capital market from a relatively small supranational issuer to a sovereign size issuer. Given the scale of issuance required to fund the programme, the EU has moved from a small supranational issuer to a large, sovereign-sized issuer. This is demonstrated in figure 7, which shows that the EU has moved from an annual gross issuance volume of EUR 0.4 billion in 2019 to EUR 133 billion in 2021, placing it straight after France, Germany, Italy and Spain in terms of issued volumes.

Figure 7. Main euro area issuers by volume.

Source: European Commission based on Bloomberg data.

Issuer	Gross issuance 2019 *(in EUR billion)*	Issuer	Gross issuance 2020 *(in EUR billion)*	Issuer	Gross issuance 2021 *(in EUR billion)*
France	246	Italy	350	France	261
Italy	242	France	290	Germany	237
Germany	159	Germany	237	Italy	227
Spain	113	Spain	174	Spain	152
KfW	81	EIB	70	**EU**	**133**
EIB	50	KfW	66	KfW	83
Belgium	30	Belgium	45	Netherlands	58
EFSF/ESM	30	**EU**	**41**	EIB	55
Netherlands	21	Netherlands	41	Belgium	39
Austria	20	Austria	40	Austria	39
Ireland	14	EFSF/ESM	31	EFSF/ESM	25
Portugal	14	Portugal	25	Ireland	19
Greece	9	Ireland	25	Portugal	17
Finland	8	Finland	20	Finland	16
EU	**0.4**	Greece	12	Greece	16

EU issuances are boosting the pool of euro-denominated liquid safe assets. Euro-denominated safe assets are particularly attractive as a refuge during economic crises and financial turbulences. Figure 8 shows that NGEU has already increased the EU's contribution to the pool of euro-denominated safe assets to 27%. This increase occurred in tandem with a broader increase in the supply of euro-denominated safe assets as highly rated EU sovereigns increased their issuances in response to the COVID-19 crisis.

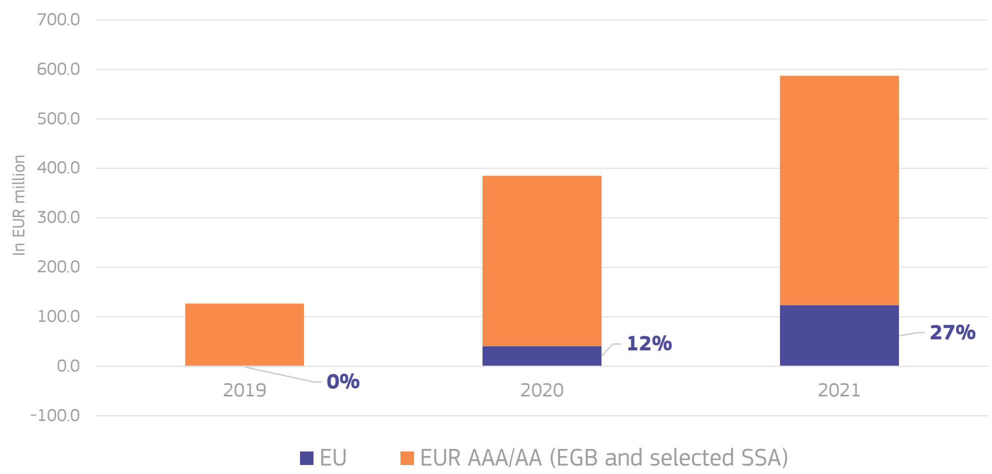


Figure 8. Relative size of EU in EUR denominated AA/AAA net issuances.

Source: European Commission based on Bloomberg data.

Note: Calculation based on the EU's share of euro denominated net issuance by AA/AAA rated sovereign issuers and selected and selected Sovereigns, Supranationals and Agencies (SSA), European Stability Mechanism (ESM)/ European Financial Stability Facility (EFSF), European Investment Bank (EIB), KfW Development Bank and Caisse d'Amortissement de la Dette Sociale (CADES).

NGEU is allowing the EU expand its presence across the issuance curve. This is a notable characteristic of large sovereign issuers, and an attractive quality for investors. As can be seen in figure 9, the NGEU diversified funding strategy has seen the EU issue bonds across the full range of benchmark maturities, covering the 3, 5, 7, 10, 15, 20, 25 and 30 year tenors. Being present across the entire yield curve is important as different investor types have different preferred maturities. A fully populated curve thus serves the widest possible range of investors .[10] In addition, by structuring issuances across a wide range of time horizons the Commission ensures an orderly and regular maturity of debt.

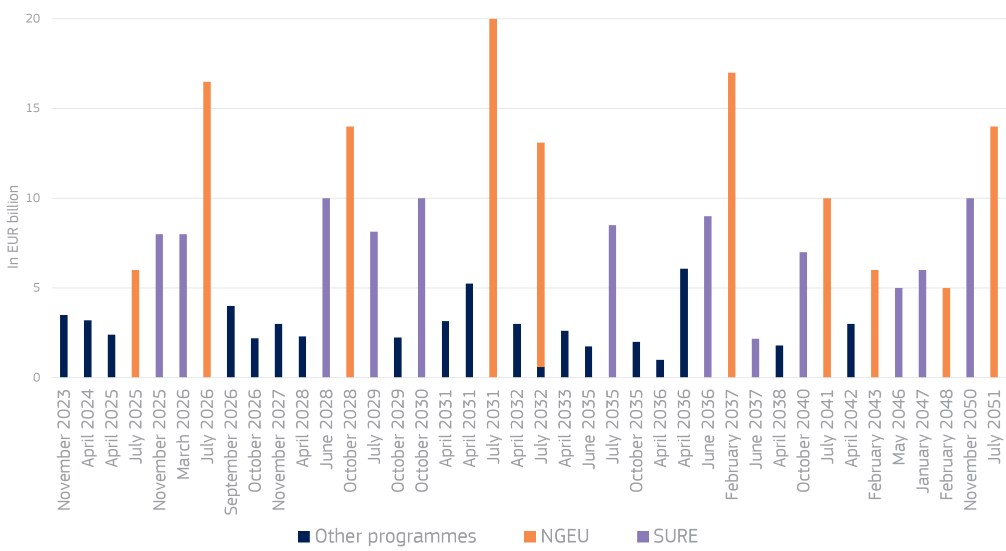


Figure 9. EU-Bonds outstanding amounts by instrument and maturity.

Source: European Commission.

(10) For example, Central banks usually prefer maturities of up to 7-8 years while Commercial banks traditionally invest in maturities of up to 10-12 years. Insurers are more active in maturities between 10 to 30 years and pension funds are interested in the longest maturities, from 15 to 30 years. Finally, asset managers and hedge funds can generally take opportunities along the full spectrum of maturities. Direction general du Trésor (2022).

The EU's increased market presence is leading to the creation of a new highly rated asset that can be easily bought and sold by investors in the secondary market. EU-Bonds' increased liquidity (and hence the ease with which buyers and sellers can exchange them in the secondary market without large price concessions) is evidenced in figure 10, which shows a 10-fold rise in the secondary market turnover of EU-Bonds (measured by the quarterly turnover of EU-Bonds in the secondary market as a percentage of their total outstanding volumes) between Q3 and Q4 2020. The turnover for EU-Bonds is now on par with bonds issued by other euro area Member States. The increased liquidity of EU-Bonds and EU Bills is also viewed positively by the vast majority of EU primary dealers. Figure 11 shows that 59% of EU Primary Dealers regard the liquidity of EU-Bonds as satisfactory to good and 67% of Primary Dealers regard the liquidity of EU-Bills as satisfactory to good (these figures rise to 81% and 86% when weighted for Primary Dealers' secondary market shares). Feedback from Primary Dealers has also revealed that the EU is increasingly perceived as resembling more a sovereign-like issuer than a traditional supranational.

Figure 10. Quarterly secondary market turnover of EU and EGB Bonds (% of outstanding volume).

Source: European Commission based on Bloomberg data.

Note: European Government Bond (EGB) market here comprises Euro-area sovereigns, the European Financial Stability Fund and the European Financial Stability Mechanism. Data for this market was not available for Q1 2022.

Figure 11. Primary dealers' assessment of liquidity of EU-Bonds and EU-Bills.

Source: European Commission.

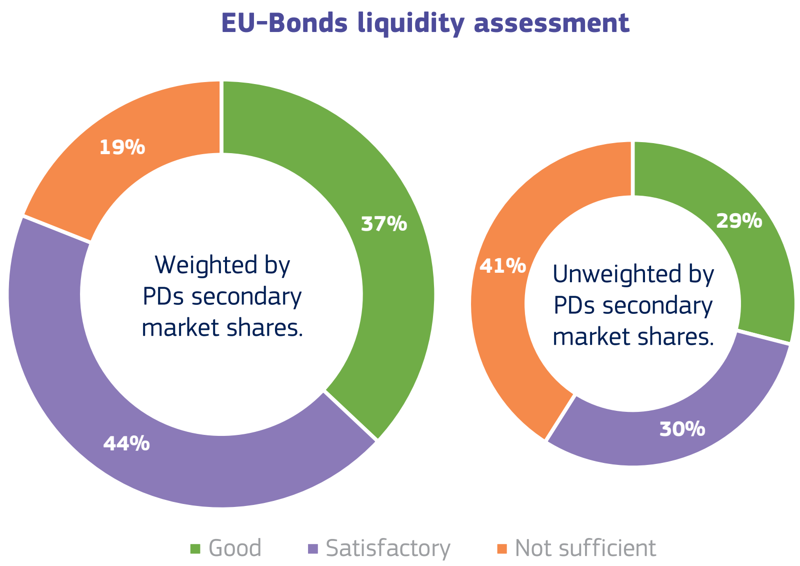
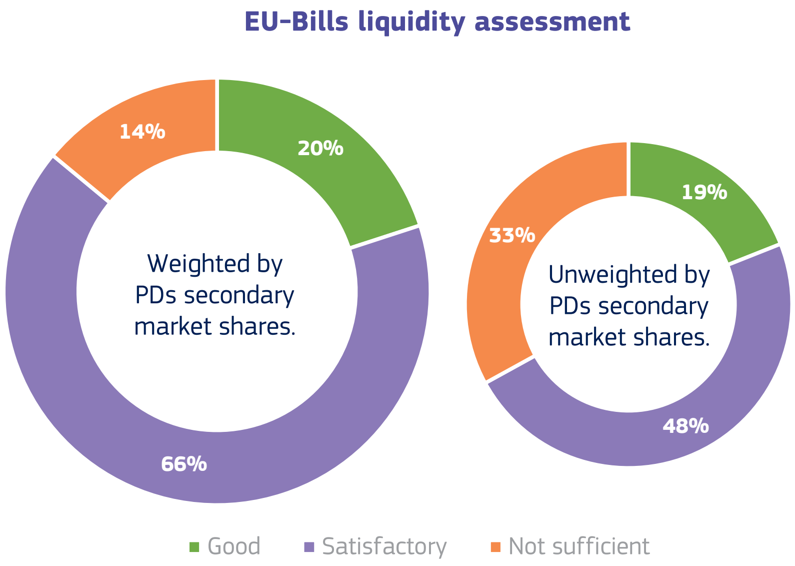


Figure 11. Primary dealers' assessment of liquidity of EU-Bonds and EU-Bills.

Source: European Commission.

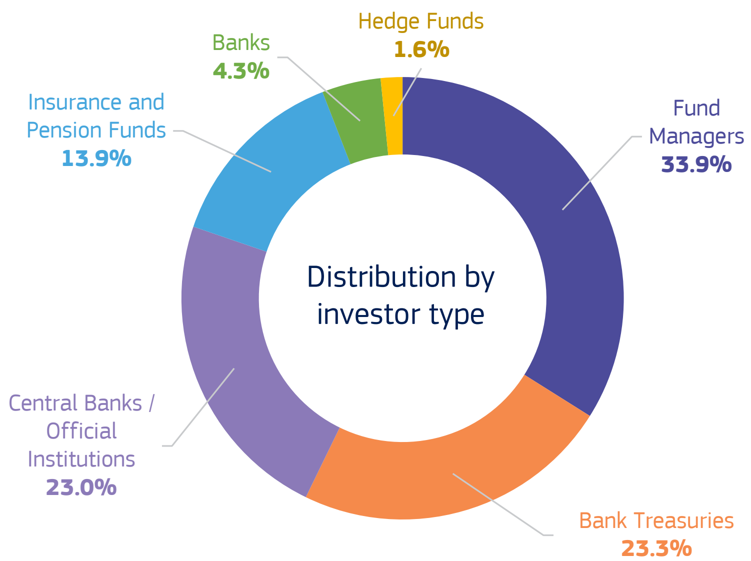


EU's higher volume of issuances, its broader presence across the issuance curve and the improved liquidity of EU-Bonds have contributed to a well-balanced and broad NGEU investor base. This can be seen in figure 12, which shows that NGEU-Bonds have been purchased by a wide variety of investors applying different buying strategies [(11)]. The geographical distribution of the NGEU investor base has also been broad. As of June 2022, EU issuances have attracted more than 1000 different investors from 70 different countries. While EU-based investors make up the core of the NGEU investor base, NGEU-Bonds have also received strong interest from non-EU investors. Figure 13 shows that the UK and Asia make up a respective 24% and 7% of all investment in NGEU issuance as of end June 2022. This also reflects the positive impact NGEU issuance is having on the international role of the euro.

Figure 12. Investor distribution by type for NGEU syndications.

Source: European Commission.

Note: Figures as of end June 2022.



(11) To date more than 70% of total NGEU EU issuances are going to buy-and-hold investors (i.e. fund managers, insurance companies, pension funds and central banks) compared with less than 10% to buy-and-sell (i.e. private banks and hedge funds). There is also a good representation of investors demanding different maturities, with central banks and bank treasuries (which usually prefer to invest in maturities of up to 10 years) accounting for 36% of purchases of EU-Bonds in the primary markets and pension funds and insurance companies (which prefer maturities of above 10 years) accounting for around 20%.

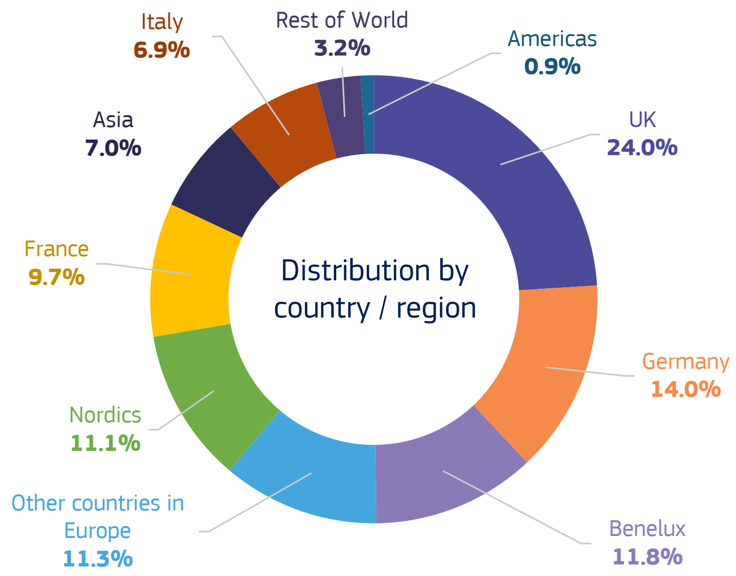


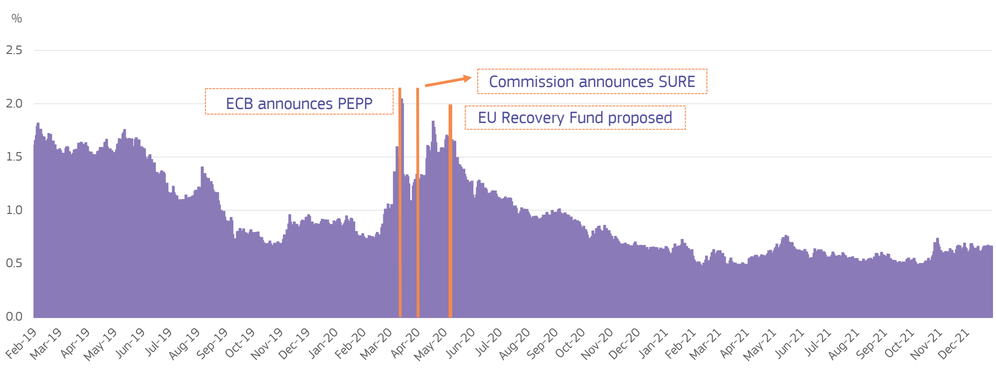
Figure 13. Investor distribution by region for NGEU syndications.

Source: European Commission.

Note: Figures as of end June 2022.

The scale and strength of NGEU issuances could provide an additional pillar of the EU's financial system. Although difficult to assess in isolation [12], the sheer size of the NGEU issuances relative to the pre-pandemic stock of euro-denominated safe assets points to the potential contribution of NGEU as an integral part of the EU's financial system. For example, at full scale, NGEU and SURE facilities taken together constitute: 150% of the end-2019, pre-pandemic stock of EU supranational bonds; are equivalent to nearly 50% of the stock of euro area triple A sovereign bonds; and depending on the definition used, are between 10% to 30% of the global stock of international securities denominated in euros [13].

In addition, the experience of mid-2020 demonstrates that the mere announcement of programmes conveying a strong political message can have a positive effect. Looking at figure 14, the combination of the EU's fiscal response announcements with the ECB's announcement of the pandemic emergency purchase programme (PEPP) of EUR 750 billion [14] (which aimed at supporting the prices of financial assets and hence related costs of borrowing in the euro-area) in a period of highly volatile market conditions seems to have helped reduce the weighted average spreads of the most affected countries during the pandemic [15].



ECB – European Central Bank
PEPP - Pandemic emergency purchase programme

Figure 14. Weighted average spread over 10 year swap of the most affected countries during the pandemic (in %).
Source: European Commission based on Bloomberg data.

(12) For example the additional supply of euro safe assets could provide alternatives for banks' treasuries seeking high quality liquid assets and offer a complementary asset to sovereign issuances, hence potentially reducing an exclusive reliance on sovereign bonds for regulatory capital purposes, including of the type that can give rise to doom-loop situation (when banks hold in particular bonds from their own sovereign). However some of these impacts may be hindered by the temporary nature of the SURE and NGEU programs and other offsetting effects (Temprano Arroyo (2022))

(13) Temprano Arroyo (2022)

(14) EUR 750 billion was the amount initially proposed under the PEPP programme, however this ceiling rose as the pandemic progressed

(15) The weighted average spreads of the most affected countries during the pandemic are calculated on the basis of the interest rates of the 10yr bonds of PT, IT, ES and EL weighted by their respective GDP, relative to the 10yr EUR swap rate (a benchmark yield curve in euro financial markets).

4.2 The role of EU issuances in supporting the European green and social capital markets

NGEU and SURE are taking EU issuances beyond conventional bonds. Green and social bonds have recently emerged as a powerful mechanism to channel financial resources towards clean and sustainable investments [16]. However, they remain only a tiny fraction of the overall bond market [17]. SURE and NGEU provided the opportunity for the EU to contribute to the developing ESG (Environmental Social and Governance) market in two formats: social bonds (via SURE) and green bonds (via NGEU).

EU issuances are supporting the development of the ESG market. The issuance of these bonds is directing the fiscal support in response to the COVID crisis towards activities that are compatible with internationally accepted social and environmental principles, hence supporting social cohesion and green transition across the EU. However, by bringing two new highly rated and liquid assets to the market, EU issuances also support the deepening of these respective markets, giving investors more opportunities for entry [18]. They also provide a valuable reference to other issuers when pricing their green and social bonds, offering them further incentives to increase their presence in the space and contributing to the mainstreaming of the green and social bond markets.

The scale of SURE issuance (EUR 91.81 billion as of June 2022) catapulted the EU to the status of the largest social bond issuer worldwide. In 2021, SURE EU Social Bonds amounted to 16% of social bond issuance worldwide and 30% of the social bond issuance in Europe [19].

With NGEU, the EU is set to become the largest issuer of green bonds worldwide. The Commission has committed to raise 30% of the NGEU funds (or up to EUR 250 billion) via the issuance of NGEU Green Bonds, confirming the Commission's commitment to sustainable finance. NGEU Green Bonds are underpinned by the NGEU green bond framework [20], which is compliant with the International Capital Market Association (ICMA) Green Bond Principles and which specifies how the proceeds of NGEU Green Bonds will be used. As seen in figure 14, after only a single green bond transaction in 2021, the EU accounted for 3% of global green bond issuance and 5% of the European green bond issuance for the year. This number is bound to increase as the implementation of the climate chapter of the Recovery and Resilience Facility gathers momentum.

As of June 2022, all green transactions have received overwhelming investor demand, allowing the Commission to issue green bonds and finance the European green transitions at favourable interest rates. The European Commission has to date issued EUR 28 billion in green bonds via both syndicated transactions and auctions. The first transaction in October 2021 was the world's largest green bond transaction to date, in which the EU issued EUR 12 billion in green bonds, attracting over EUR 135 billion in demand.

(16) Sonerud, et al (2015)

(17) Doronzo et al (2021)

(18) Harrison and Muething (2021)

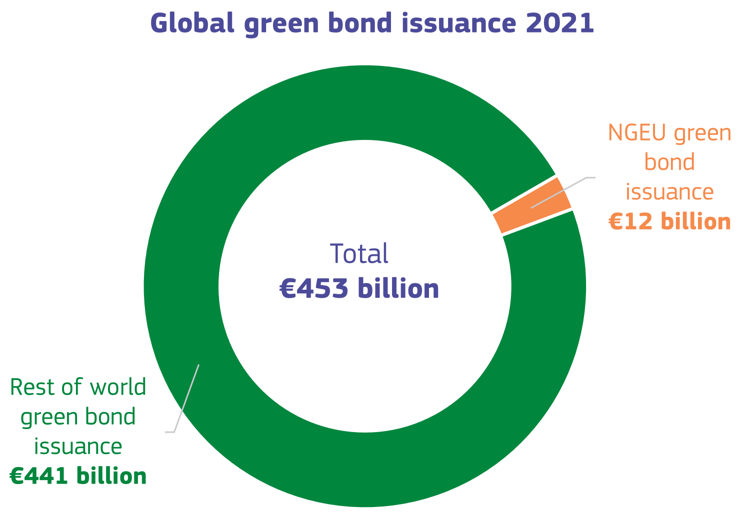
(19) All SURE Bonds are issued under the EU Social Bond Framework, which is compliant with the Social Bond Principles of the International Capital Market Association (ICMA).

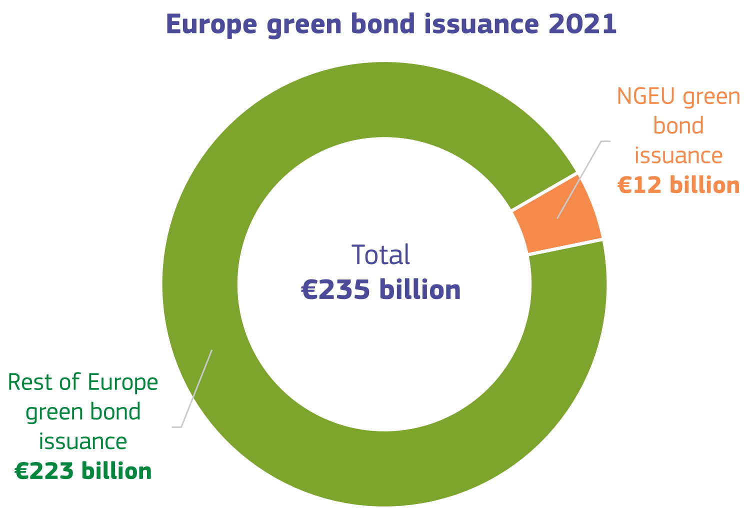
(20) nextgenerationeu_green_bond_framework.pdf (europa.eu)

The green premium (or *greenium*, the difference between the interest rate for a conventional bond and a green bond) for this transaction was estimated at around 2 basis points, which shows investors' willingness to accept a slightly lower return on their investment if assured that the money will be used for green objectives. Subsequent transactions have continued to benefit by strong demand from the market and similar levels of *greenium*.

Figure 15. EU green bond issuances relative to global and European issuances (2021).

Source: European Commission based on Dealogic data.





THE NGEU GREEN BOND DASHBOARD: FULL TRANSPARENCY FOR INVESTORS

The NGEU green bond dashboard, published in March 2022, is a unique transparency tool providing investors and the public alike with real-time information on the use of proceeds of NGEU Green Bonds. The dashboard provides interested parties with up-to-date information on the pool of measures that are eligible for financing from NGEU Green Bonds and it shows how green bond proceeds have been allocated to date.

A multi-level framework of control and assessment procedures is applied in order to determine the pool of eligible measures and to ensure that NGEU green bond proceeds are only allocated to measures that adhere to the strict standards of the green investor community:

- **First, all national Recovery and Resilience Plans (RRPs), which show how funds will be spend, are assessed for compliance with the eligibility and assessment criteria under the Recovery and Resilience Facility rules.** This includes checking whether measures are assigned to the correct intervention field and corresponding climate coefficient, whether measures comply with the “Do No Significant Harm” criteria, and whether the measures are consistent with National Energy and Climate Plans.

- **Secondly, all measures are subject to an additional due diligence exercise prior to being admitted to the pool of measures that will receive financing from NGEU Green Bonds.** The due diligence exercise aims to minimise the risk that individual projects financed by NGEU Green Bonds may not be in line with the strict and conservative standards expected by investors.

- **Thirdly, the Commission carefully monitors the implementation of all measures in the context of payment requests and in line with the performance–based nature of the RRF.** The plans contain milestones and targets for all measures, on which Member States report periodically. The Commission draws on detailed evidence to assess whether the milestones and targets have been satisfactorily fulfilled. If during the monitoring of the plans doubts arise as to whether a specific measure fully meets the standards expected from NGEU Green Bonds, the measure can be removed from the pool.

- **Fourthly, the Commission has the opportunity to check the information Member States provide on the completion of milestones and targets.** In cases where an audit or any other evidence raises doubts as to whether a specific measure fully meets the standards expected from NGEU Green Bonds, the measure can be removed from the pool.

5. CONCLUSION

Financing NGEU through joint EU issuances required a significant expansion of the Commission's debt management architecture. The Commission has established a state-of-the-art borrowing and lending programme (including EU social and green bonds) in a compressed timeline. Joint EU issuances have been enabling the provision of the required funds to Member States at a competitive cost of funding.

The NGEU funding programme has changed the EU's status in the European issuer's market from a small supranational issuer to a large sovereign-scale issuer. In doing so, EU issuances are helping to increase the supply of euro denominated safe assets and providing new impetus to the green and social bonds markets which, in turn, can also strengthen the international role of the euro.

The success of the NGEU funding programme to date reflects strong investor confidence in the credit strength of EU debt as well as general investor interest in social and green investments. EU issuances also appear to maintain their strong appeal for a wide variety of investors even in tighter market conditions. The appeal of joint EU-Bonds also reflects the strength of Union solidarity and the commitment of EU Member States to use joint EU borrowing and novel instruments in support of EU needs and values.

REFERENCES

Direction général du Trésor (2022), “France’s Sovereign Debt Issuance Strategy”, Tresor Economies, No. 207.

Doronzo, R., Siracusa., V. and Antonelli, S (2021), “Green Bonds: The Sovereign Issuers’ Perspective”, Bank of Italy, Markets, Infrastructure, Payments Systems, Working paper No.3.

European Commission (forthcoming), “Quarterly Report on the Euro Area”, Vol. 21, No.2.

OECD (2009), “New challenges in the use of government debt issuance procedures, techniques and policies in OECD markets”, Financial Market Trends, Vol. 2009/1.

Sonerud, B., Kidney, S. and Tripathy, A (2015), “Scaling up green bond markets for sustainable development”, Climate bonds initiative.

Temprano Arroyo, H (2022), “The EU’s Response to the COVID-19 Crisis: A Game Changer for the International Role of the Euro?” European Commission, Discussion paper 164.

World Bank Group (2015), “Domestic Syndications : Background Note” World Bank, Washington, DC, 2 License: CC BY 3.0 IGO.

GETTING IN TOUCH WITH THE EU

In person

All over the European Union there are hundreds of Europe Direct centres. You can find the address of the centre nearest you online (european-union.europa.eu/contact-eu/meet-us_en).

On the phone or in writing

Europe Direct is a service that answers your questions about the European Union. You can contact this service:

— by freephone: 00 800 6 7 8 9 10 11 (certain operators may charge for these calls),

— at the following standard number: +32 22999696,

— via the following form: european-union.europa.eu/contact-eu/write-us_en.

FINDING INFORMATION ABOUT THE EU

Online

Information about the European Union in all the official languages of the EU is available on the Europa website (europa.eu).

EU publications

You can view or order EU publications at op.europa.eu/en/publications. Multiple copies of free publications can be obtained by contacting Europe Direct or your local documentation centre (european-union.europa.eu/contact-eu/meet-us_en).

EU law and related documents

For access to legal information from the EU, including all EU law since 1951 in all the official language versions, go to EUR-Lex (eur-lex.europa.eu).

Open data from the EU

The portal data.europa.eu provides access to open datasets from the EU institutions, bodies and agencies. These can be downloaded and reused for free, for both commercial and non-commercial purposes. The portal also provides access to a wealth of datasets from European countries.