Bonds at the price of gold

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The ECB has just added another twist to its unconventional monetary policy measures. A year after starting to buy sovereign bonds, a period in which it has piled up over 700 billion euros in debt and become the largest European public debtholder, the ECB will now start buying corporate bonds. What is it trying to accomplish? And, above all, what effects can we expect from this new program?

In principle, the ECB has two objectives. The main goal is to bolster the channel through which the real economy is financed. The purchase of corporate bonds complements the purely banking channel, which the institution presided by Mario Draghi has been focusing on so far, facilitating liquidity and making financing costs for banks cheaper. But it also has secondary objectives, such as giving the European debt market a boost. Here, as opposed to the United States, the main source of financing for companies is still bank credit, while the debt market plays a secondary role.

We must bear in mind that, in absolute terms, the potential volume of the corporate bond purchases cannot be compared to the sovereign debt purchases. Although the ECB has set softer limits on the purchase of corporate bonds, it is estimated that its acquisitions in the next ten months (when the program ends) would barely total over 70-100 billion euros. Apart from the scant total volume, the high concentration of issuers by country-especially in France and Germany at the expense of the peripheral countries - and by sectors - as is the case with utilities and consumer - leads us to think that the final impact could be rather limited.

This doesn't mean the program is going to have an insignificant impact. At least in the debt markets, the effects were already noticeable in March when the ECB announced the measure by surprise. The impact on bond prices is already visible. Logically, the fact that a new buyer is active in the market increases the pressure on the price of these assets, which drives down the financing cost for bond issuers. Since March, financing cost, measured according to the synthetic indices for the Eurozone, have fallen by nearly 50 basis points. For certain companies, particularly those with the highest quality credit where the ECB will make the lion's share of its purchases, such as the telecommunications sector, for example, the drop has been particularly noteworthy: so much so that negative rates have even reached this market. It is estimated that 15% of the investment grade corporate bonds are already trading at negative rates. In short, bonds at the price of gold (the safe haven asset par excellence). And not only that, this improvement in financing costs is also feeding through to other segments with lower quality credit, as the ECB pushes "traditional" investors to take more risk.

However, apart from the price, the impact via volumes has also been evident. Corporate bond issuance in the Eurozone has register spectacular growth in the last quarter, practically doubling the volume seen at the beginning of the year. Therefore, the signals are positive in terms of the secondary objectives sought by the ECB -bolstering the debt market-. However, it has yet to be seen whether these issuances are merely an advance of those that were already planned, if they are replacing pre-existing credit or if we are really seeing a turnaround.

This last question makes us wonder: is the current enthusiasm sustainable? Ultimately, bond prices must genuinely reflect companies' fundamentals which, in turn, are tied to the real economy. Therefore, only if the optimism in markets ends up feeding through to the real economy - in other words, more investment, more growth and more jobs- will we be able to claim victory.