Interview with EuroWeek

View PDF
04/10/2013
Interviews
ESM

Not bigger, but better? The ESM prepares for lift-off

The European Stability Mechanism, Europe’s permanent bail-out borrower, is set to launch its first benchmark next week, almost three years after sister organisation the European Financial Stability Facility debuted as the eurozone sovereign debt crisis began to bite. Christophe Frankel, deputy managing director and chief financial officer of the ESM, speaks to EuroWeek’s Tessa Wilkie about the supranational’s issuance plans.

You’ve been on the road meeting investors for the European Stability Mechanism’s first benchmark. What has the reaction been like to the new institution?

The reaction has been extremely positive. What is really important for investors is that the ESM is very straightforward —it’s an international institution created by a treaty. It is built around the largest capital base of any supranational to date. It has the strongest ratio of lending capacity to subscribed capital, or the subscribed capital to the paid-in capital, of any supranational, as well.

We met a few investors who are not able to buy the EFSF because they consider the guarantee structure to be complex, but they told us that they will buy ESM. We are finding this across the full spectrum of investors —those in Europe, in Asia, from central banks to mutual funds to insurance companies.

It means that the investor base for the ESM should be similar in quality as the EFSF’s investor base —but much bigger.

How many investors are we talking about, roughly?

I can't say exactly but it's a significant number. This is one of the two reasons why we think ESM paper should price tighter than EFSF paper. Not only does the ESM have a larger investor base, but even those investors that buy the EFSF already have told us that they attach extra value to the ESM because of the structure.

The ESM has just sent out a request for proposals [on Wednesday morning] for its inaugural benchmark —what kind of deal are you planning?

We're of course asking the banks for their recommendations, hence the request for proposals. But we expect to launch a deal that is somewhere between three and seven years in maturity. We know there is a lot of demand in the longest part of the curve. We launched recently a 21 year deal for the EFSF which was really successful.

There is strong demand at the long end, but we have the view that the largest investor base, when we consider central banks, fund managers or bank treasuries, is more in the three to seven year bucket.

Do you have a particular size you're looking for? Is a €6bn deal possible?

We will target €3bn minimum. But then we need to wait for what the demand and market conditions are.

We have €9bn to raise for ESM and five windows this year which can be used either for the EFSF or ESM.

When the EFSF brought its first deal, it attracted a €44.5bn book. That was an important show of support for the bail-out mechanism at the time. Will you be looking to pay a little bit extra to get that kind of demand again this time around?

We won't target the same size in terms of order book. We don't need to prove anything anymore —we have proven with the EFSF on a regular basis that the bail-out mechanism is working and that it's well received by the market.

What we want to achieve is a good transaction at the right price. We want some performance so that investors participating in our first deal want to come back for a second.

You mentioned that you had identified strong demand at the long end on your roadshow, so will the ESM's second benchmark be a long-dated deal?

As of today everything is on the table. We will likely sell a second benchmark this year with the ESM. We would aim to sell a different maturity because our strategy is to build a curve in euros, but it is too soon to know what maturity that will be. We need to wait for the windows we've identified to decide on where market demand is.

How long a deal can the ESM theoretically print at the moment?

The ESM can do up to 30 years. For the EFSF there is no limitation —the longest loan to Greece is 2048.

Are you planning to diversify your funding sources by accessing dollars, for example, or selling a niche currency deal?

Not at the moment. Our strategy is to build a liquid curve in euros —we want to do that by selling benchmarks across the curve in that currency.

But we constantly monitor markets and we constantly consider whether it makes sense to diversify into another currency or whether a private placement might be interesting.

This kind of diversifying isn't something we will consider in the coming weeks or months, but it is something we could look at doing at any time after that.

We've had some interesting political developments this week both in Europe and in the US. Have you had any queries from investors about, for example, the political situation in Italy or the outlook for Portugal? As those countries are both guarantors, could difficulties there affect demand for the ESM next week?

Investors and other market participants now really understand the way in which the ESM and EFSF are structured. They understand perfectly that the EFSF only relies on the six top ranked countries, so whatever happens to the other countries will not affect the ability of the EFSF or ESM to repay bonds. Also the ESM's paid-in capital, which will rise to €80bn by April 2014, will make the ESM less dependent on rating changes to its shareholders.

Since the start of this year we've had no questions from investors regarding member countries, which is remarkable. When we meet investors now we talk about the funding programme, the funding strategy, and perhaps pricing, but that's it. It's very different to conversations we had up until last year.

It shows that the reforms that have been put in place in each country and the new rules for the governance of the euro area have been very well received by markets. This is a clear difference to last year.

Surprisingly, most markets have carried on regardless despite the US government being shut down on Tuesday. Was the US an issue for you during the roadshow?

Market participants, as far as we are concerned, are very clearly only considering the status of the eurozone.

What about if the debt ceiling isn't adjusted by the October 17 deadline? The ESM and EFSF still have quite a bit left to fund this year.

This issue has never been mentioned by any investors. When investors discuss the ESM and EFSF, they just look at the euro area. They're looking at the reforms in Europe, the way that the eurozone is tackling the problems in the banking sector. For them this is very positive at the moment, so the
US situation doesn't factor.

The EFSF already has a large funding requirement. With the arrival of the ESM, are you worried at all about oversupply?

This year we will print €58bn for the EFSF and €9bn for the ESM. Next year as far as we are committed we have €34bn for the EFSF and €17bn for the ESM, which is less than this year. We're not worried about the capacity.

Will the EFSF continue to have a larger funding requirement than ESM in years to come, unless the ESM takes on another bail-out?

Yes. The total commitment of the EFSF is €192bn, with an average debt maturity of close to six years. With all other things being equal, I'd expect the EFSF to be funding roughly €30bn a year.

The ESM has €50bn in committed loans. So we see them issuing around €10bn per year for the time being. Theoretically that could change, of course. Finally- is there anything that you are worried about concerning the arrival of the ESM?

The important message that we want to get across to investors is that the EFSF will continue to be a very active issuer as it will continue to roll debt under its own name. They will operate in parallel —the ESM is not taking over from the EFSF in terms of issuance.

Contacts

Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu

Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu

Juliana Dahl
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
j.dahl@esm.europa.eu

George Matlock
Senior Financial Spokesperson
+352 260 962 232

g.matlock@esm.europa.eu