

Time for euro safe asset futures?

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The trillions of euros in financial stimulus Europe launched to aid post-pandemic economic recovery may boost the euro's international stature versus the US dollar, as the abundance of new highly-rated bond issues face up to US Treasury bonds, historically considered the world's safest assets.

Integrated and more liquid European financial markets could help enhance the euro's global role, an advantage an increase in euro area safe assets now being issued could offer.

There are various sources that contribute to the development of a euro safe asset, including highly-rated member states' bonds and supranational bonds – such as those the ESM issues. But are we ready for the introduction of a euro safe asset futures market?

In its simplest form, the futures market is a market on a market. Invented in the 1980s as a tool to hedge financial risk, futures instruments follow underlying assets like bonds. As investors cannot guess where the price of an asset is going, futures offer a risk management tool.

In Europe, the most famous future is the one that tracks the highly-liquid 10-year maturity German government bond, or Bund, considered the euro area's safest asset and benchmark bond. Despite the rise in government borrowing and surge in debt issuance in the euro area during the pandemic, Bund issuance is in structural long-term decline^[1] and set to reduce in the years ahead. Though this decline will not unseat German bonds' pre-eminent place as a safe asset, the need for more diversified euro safe assets increases.

Why euro safe assets matter

Euro safe assets are low-risk investments by nature and thus help promote financial stability and bolster prospects for capital markets union and the [international role of the euro](#).

Rising volumes of safe assets can also attract more investors to the European bond markets. Global demand can be further augmented as a result of a new highly liquid financial futures instrument built upon these growing underlying safe assets.

Euro safe assets on the rise

Although a smaller market than that of US Treasuries, German Bunds maintained top-notch credit ratings throughout the global financial crisis more than a decade ago, the European sovereign debt crisis that followed, and through to today.

Germany's debt is rated AAA alongside other European sovereign bonds such as those of Luxembourg and The Netherlands. Together with the debt issued by Finland and Austria, rated slightly lower (AA+), these bonds are part of what is called "euro-denominated safe assets".

But European supranationals also issue euro safe assets. As of early last year, roughly €800 billion had been issued by the European Investment Bank (EIB), the ESM and its sister borrower the EFSF. The European Union began issuing bonds in 1983. However, following the Covid-19 outbreak it has started issuing debt on a much larger scale with a €750 billion Next Generation EU funding programme and €100 billion job-protection vehicle, the SURE programme. The ESM's Pandemic Crisis Support of €240 billion is also available until end of 2022, which may add to the pool of safe assets outstanding.

Before and during the pandemic crisis, the ESM, EFSF and EIB have also continued to issue high quality, safe asset bonds.

Euro safe assets are set to increase to nearly €2 trillion over the next five years. That, coupled with the volume of AA+ or higher rated national debt, will push the total amount of euro safe assets to €5.4 trillion, or 40% of euro area GDP.

Though less than half the comparable US numbers, at 96% of GDP, such a pool of debt is more than credible for a futures market, and it encourages investors to believe a futures market for euro safe assets could thrive.

Are markets ready?

There was already talk of a euro safe assets futures market a decade ago with the launch of the EFSF, but the outstanding debt was too small to achieve a deep market. The [face of the supranational market](#) has changed compared to 10 years ago, reigniting discussion on the possibility for a euro safe assets futures market.

Liquidity and regularity of bond issuance are key to the success of a euro safe asset futures instrument. According to market experts at Eurex, the exchange that hosts the Bund future, constituents of a new safe asset futures instrument would need to fulfil a regular yearly funding amount to ensure the success of a new derivative product.

A likely structure of a safe asset future would be a pool of liquid, highly rated, and popular bond issues. The hardest part could be choosing which bonds should be part of the mix, a decision that would be taken by the exchange hosting the futures contract. Certainly, the growth of overall euro safe assets would allow for various designs of a futures market. Issuers who could qualify for a euro safe asset future in terms of their credit ratings and also their bond issuance volumes are the top-rated euro area sovereigns, and European supranational names such as the EIB, ESM, EFSF, and European Commission.

There are technical aspects related to pricing and other attributes the hosting exchange would need to establish in close cooperation with market traders and investors, as well as what to do if the bonds of one issuer were ever to face a credit rating change.

Major exchanges that host futures contracts are likely to expect issuers to have lines of bonds of at least €5 billion each to be considered, and the safe asset future would likely comprise several bonds from eligible issuers. A new futures product undoubtedly needs to be evaluated by the market very carefully. If there is a majority of support among investors, a futures instrument could be launched. Any moves to develop such a market would have to come from investors and the exchanges that hope to host it.

Appetite is higher than a decade ago for a euro safe asset future, largely thanks to the rising supply of such bonds. So, it is timely to discuss the possible opportunities.

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Further reading

[The Changing Face of the Euro Supra Bond Market](#)

[Pandemic crisis as a catalyst for a common European safe asset](#)

[Strengthening the international role of the euro](#)

[Regling's Take: Why we need to boost the euro's international role](#)

[1] Union Investment (2019) [German government bonds are in increasingly short supply](#)