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The effects of the Eurosystem's corporate sector purchase programme on Spanish companies

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In March 2016, the ECB announced the extension of the asset purchase programme (APP) to investment-grade bonds issued by non-financial corporations established in the euro area. Following the announcement of this new programme (known as the CSPP), there was a significant fall in the interest rates on bonds issued by Spanish companies eligible for purchase by the Eurosystem, which also extended to those on lower-rated securities, through the usual rebalancing of investment portfolios. At the same time, a significant increase was seen in bond issuance, as a result of which Spanish bond issuers (usually large corporations) reduced their demand for bank credit. Resident banks responded by shifting their credit offering towards other firms that do not have the same ability to issue bonds and that tend to be smaller in size. The analysis presented in this article reveals that for each euro reduction in the outstanding debt of large companies with Spanish banks during the three months after the announcement of the programme, some 78 cents were diverted to other non-issuing firms, including SMEs. These firms, in turn, increased their levels of real investment significantly.

THE EFFECTS OF THE EUROSISTEM'S CORPORATE SECTOR PURCHASE PROGRAMME ON SPANISH COMPANIES

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Introduction

An extension of the asset purchase programme (APP) to include a specific programme (CSPP) of purchases by the Eurosystem of securities issued by non-financial corporations was announced at the meeting of the Governing Council of the European Central Bank of 10 March 2016. The aim of the CSPP is to enhance the transmission of monetary policy to the financing conditions of the real economy, boosting the extension of credit to the euro area economy and the conditions of loans for households and firms, and to contribute to a return of inflation rates to levels consistent with the ECB's medium-term price stability mandate, of below, but close to, 2%.¹ As in the case of other components of the APP, purchases will continue until at least the end of September 2018.

The conditions that a bond must meet in order to qualify for purchase under the CSPP are eligibility as collateral for Eurosystem main refinancing operations, denomination in euro and investment-grade rating. At the time of purchase, bonds must have a remaining maturity of between six months and 31 years and their yield must exceed the deposit facility rate. Total purchases under the CSPP may not exceed 70% of the issued value of each bond. Finally, the issuer may not be a bank (or a subsidiary of a bank) or an asset management institution.

Since they commenced in June 2016, purchases under the CSPP in the euro area as a whole have amounted on average to €7 billion per month and represent around 10% of APP purchases. By the end of 2017, CSPP purchases had reached a total of €132 billion, distributed relatively evenly across sectors of economic activity. The breakdown of purchases by country and sector is similar to that of the eligible bond universe. Spanish corporate bonds represented 11% of all CSPP purchases (see Chart 1). In turn, out of a total of 1,071 issues partially purchased under the CSPP, 100 corresponded to 17 Spanish issuing companies.²

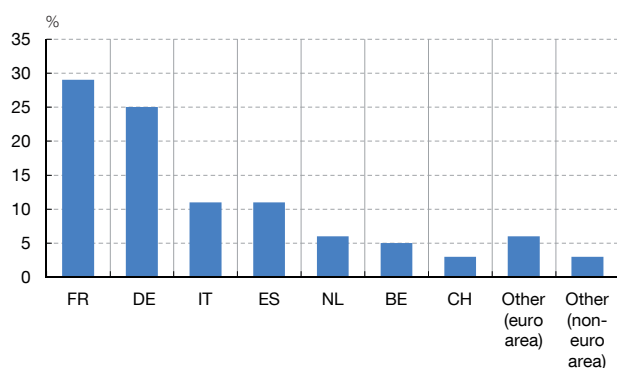
In terms of the objective established for the CSPP programme of facilitating credit provision and easing borrowing conditions for the private sector, corporate bond purchases might well be expected to have little effect on the euro area economy as a whole. This is because they are limited to securities issued by non-financial corporations with a high credit rating, which tend to enjoy more favourable borrowing conditions than other companies in any case. However, in practice, the Eurosystem's corporate bond purchases are having effects that extend far beyond the issuers of the bonds purchased by the monetary authority. In a recently published Banco de España working paper, the main results of which are summarised in this article, Arce, Gimeno and Mayordomo (2017)³ show that, in the case of Spanish companies, the CSPP has reduced the interest rates the market requires for other issuers and has stimulated bond issuance. The programme has also been effective in terms of diverting the flow of bank credit towards companies that have no presence in bond markets, thus facilitating a larger flow of real investment by the latter, in line with the objectives set for the programme.

1 See Decision (EU) 2016/948 of the European Central Bank of 1 June 2016 on the implementation of the corporate sector purchase programme (ECBE/2016/16):<http://eur-lex.europa.eu/legal-content/ES/TXT/?uri=CELEX:32016D0016>

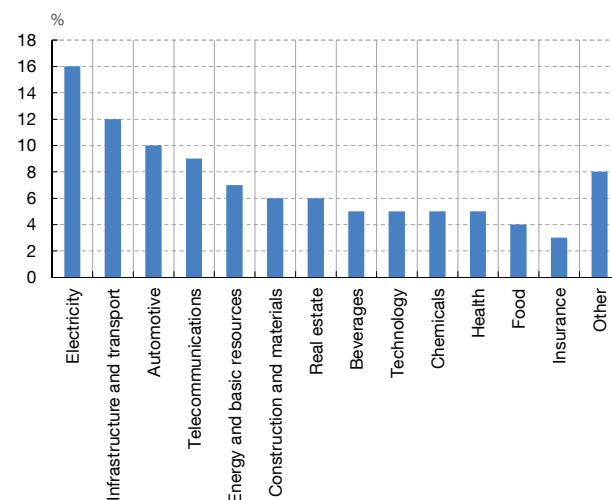
2 See: <https://www.ecb.europa.eu/mopo/implement/omt/html/index.en.html#cspp>

3 Arce, *et al.* (2017).

1 DISTRIBUTION OF PURCHASES BY COUNTRY



2 DISTRIBUTION OF PURCHASES BY SECTOR



SOURCE: ECB.

a At close of 2017 Q3.

The effects of the CSPP on Spanish bond markets

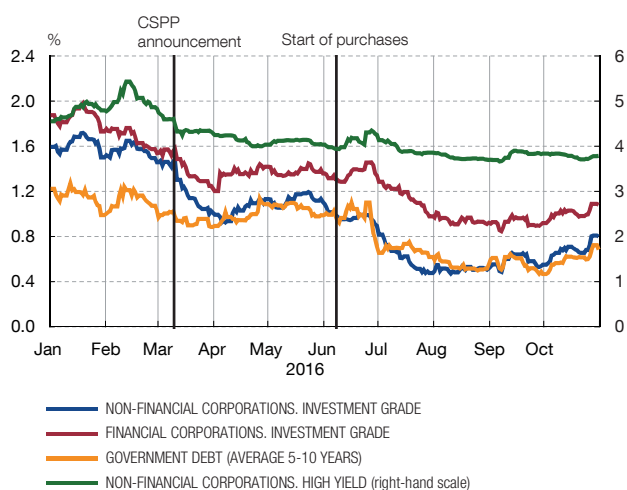
Between the announcement of the launch of the CSPP (on 10 March 2016) and mid-April 2016, the yield on the eligible bonds issued by Spanish non-financial corporations fell by 44 basis points (bp), a significant decline, representing some 30% of the average yield on these assets in this period (see the left-hand panel of Chart 2). This reduction means that, on average, interest rates on these instruments fell from levels similar to those for financial institutions with a comparable level of risk to levels close to those on public debt. The impact on the yield on bonds issued by Spanish companies in this period appears to have been somewhat higher than that observed for German and French companies and similar to that for Italian ones. Specifically, the yields on German, French and Italian investment-grade corporate bonds fell by 28 bp, 37 bp and 42 bp, respectively, as compared with the 44 bp decline in Spanish yields.

This fall in yields around the date of the announcement of the new programme by the ECB was greater than the one that occurred a few months later (in June 2016), when the first purchases under the programme commenced, which suggests that the bond market had already priced in the effect of the CSPP following its announcement.

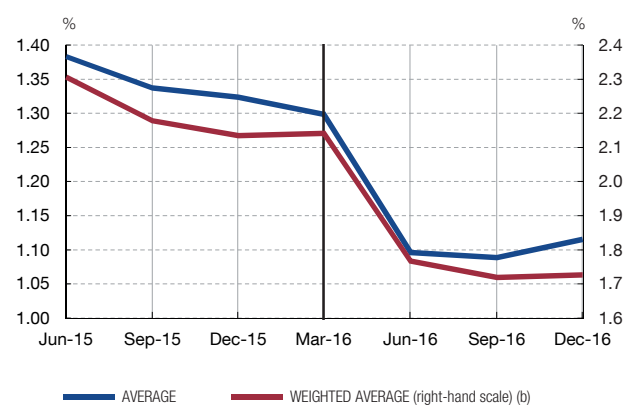
Also, as Chart 2 shows, the declines in yields were not limited to CSPP-eligible bonds, but extended to other fixed-income assets and, in particular, to high-yield securities, with significant falls (of 46 bp at around the time of the announcement, which was 10% of their average value at the time). The reason for this positive effect was possibly that investors responded to the lower yield on investment-grade bonds by seeking higher yield alternatives among assets with a lower credit rating.

The favourable bond market conditions encouraged companies to issue bonds. 33 companies made new issues during the six-month period following the announcement of the CSPP, of which 11 tapped the market for the first time (generally smaller groups than normal). This was twice the number of new issuers recorded during the six months prior to the announcement of the programme. The available estimates indicate that, among the companies that could have issued CSPP-eligible bonds, there was a 31% increase in the probability of new issues during the quarter following the announcement.

1 AVERAGE YIELD OF LONG-TERM BOND ISSUES



2 BANK CREDIT TO DEBT-ISSUING FIRMS (a)



SOURCE: Arce, Gimeno and Mayordomo (2017).

a Credit as % of total assets.

b Average weighted by the total assets of each bank.

The propensity to issue bonds also increased in the case of other issuers, with a lower credit rating, by 6% in the same period.

The firms that increased their volume of bond issuance as a result of the announcement of the CSPP used the funds raised, at least in part, to reduce their volume of bank credit (see Chart 2.2). Specifically, for each percentage point increase in the outstanding amount of bonds that companies issued between February and June 2016, they reduced their bank credit by 0.44%. Thus, non-financial corporations with bond-market access mainly took advantage of the announcement of the CSPP to modify the structure of their liabilities, replacing bank credit with bonds, and thereby profiting from the reduction in the cost of funding raised directly on the market relative to that available through the bank channel.

The effects of the CSPP on aggregate bank credit

To assess the impact of the CSPP on bank credit at the aggregate level, the substitution of bonds for bank debt among issuing firms needs to be analysed in conjunction with the reaction of the banks most affected by the fall in the demand for credit from these firms. The results of this type of analysis suggest that those financial institutions that suffered the largest fall in the credit previously extended to issuing firms increased their lending to other non-issuing large companies more, but also – albeit to a lesser extent – their lending to SMEs.⁴ Thus the total supply of credit to non-issuing firms as a whole increased by €3.45 billion in the three months following the announcement of the programme. This amount represents 78% of the total decrease in bank credit due to the replacement of loans by bond market debt.

A breakdown of the above figure by borrower size shows that, on average, for each euro of decline in credit to firms that issued bonds following announcement of the CSPP, €0.48

⁴ This analysis is based on individual data for companies and banks from the Banco de España Central Credit Register (CCR), and from the Central Balance Sheet Data Office, which provide information for more than 300,000 firms and for 500,000 bank-firm relationships.

were reallocated to large corporations, €0.15 to medium-sized firms and €0.15 to small and micro firms. Expressed in terms of the balance of credit to these firms as a whole before announcement of the CSPP, the new credit reallocated to these three groups of firms represents an increase of 3.3%, 1.8% and 0.8%, respectively.

A possible reason why banks reallocated their supply of credit unevenly among different sized firms is the inverse relationship between firm size and credit risk. Thus the banks most affected by the lower demand for credit by large issuing corporations seem to have diverted their flow of credit preferentially to firms with a similar risk profile to that of their previous customers, i.e. those with a relatively low level of risk. This reallocation of credit to safer firms helped to largely preserve the risk profile of banks' pre-CSPP loan portfolios. This factor would explain the much greater frequency with which banks facing loan repayment by issuing firms stepped up their lending more than proportionately to large corporations than to smaller firms, since the former generally entail lower risk.

Multiplier effect of TLTROs on credit reallocation

The same meeting of the Governing Council of the ECB which approved the start-up of the CSPP decided to extend the targeted longer-term refinancing operations (TLTRO) programmes. In the second series of operations of this type, known as TLTRO-II, banks can request funds from the Eurosystem under accommodative maturity and interest rate conditions. Specifically, to boost the flow of new credit, the TLTRO-II scheme specifies that the interest rate paid a bank availing itself of this funding mechanism shall be a decreasing function of the volume of new credit granted by it. Thus, the interest rate applied to these loans will decrease from the 0% of main refinancing operations to the -0.4 % of the deposit facility if the requesting bank exceeds the credit target of 2.5% for 31 January 2018.

This way of determining the interest rate under the new TLTRO scheme means that banks which had already availed themselves of this programme before the announcement of the CSPP, and whose loans were repaid early by bond issuing firms as a result of the start-up of the latter programme, have a strong incentive to grant new loans so as not to stray from the TLTRO targets and thus benefit from the lower cost of funds available from the Eurosystem under this facility. In the hypothetical case of two banks which experience the same early loan repayment but only one of which had availed itself of the TLTRO, it is estimated that the bank which had availed itself of TLTRO funds before the announcement of the CSPP would, on average, step up its lending to other firms by 16%, while the other bank would only do so by 8%.

The above result indicates that the CSPP-induced reallocation of credit from bond issuers to firms without bond market access was magnified by the simultaneous implementation of that programme and the TLTRO-II. This constitutes one of the first pieces of evidence on synergies between unconventional monetary policy measures.

The effects of the CSPP on investment

Finally, it is of interest to analyse how borrowers used the funds freed up by the announcement of the CSPP. To do this, we analysed the information on firms available from the Central Balance Sheet Date Office to identify the effect on the investment, liquidity holdings and dividend distributions of these firms in the quarter following announcement of the CSPP. Non-financial corporations with access to the bond markets seem to have taken advantage of the CSPP mainly to change the structure of their liabilities, replacing bank credit by bonds. The funds obtained from new bond issuance by this group of firms do not seem to have been used preferentially to increase their investments, liquidity holdings or dividend distributions.

The results of this analysis show that the firms benefiting indirectly from new lending similarly abstained from significantly raising their liquidity holdings or dividend distributions. However, unlike issuing firms, they did significantly raise their real investment, to the point that 20% of new investment in the quarter following announcement of the CSPP may be attributed to this programme.

18.1.2018.

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