Box 2

RECENT DEVELOPMENTS IN DEBT SECURITIES ISSUED BY NON-FINANCIAL CORPORATIONS IN THE EURO AREA

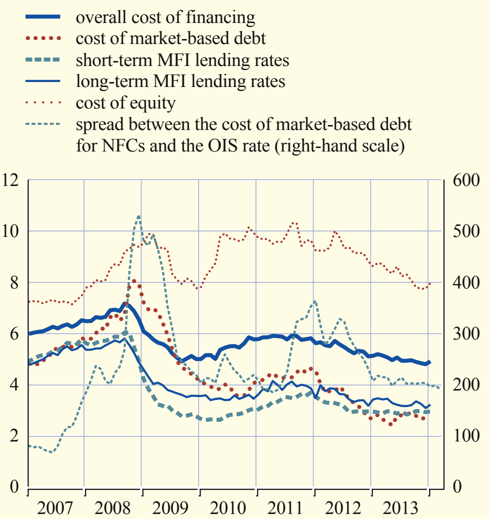
The conditions for market-based financing for non-financial corporations (NFCs) have continued to improve significantly in recent quarters. This positive development has also been visible in a marked increase in corporate bond issuance. Against this background, this box discusses briefly recent developments in debt securities issued by NFCs in the euro area.

The cost of market-based debt has declined to levels below the cost of MFI lending rates for NFCs in the euro area (see Chart A).[1] Moreover, relative to overnight index swap (OIS) rates, which are (almost) free of risk, the cost of market-based debt is at its lowest level since the intensification of the crisis in September 2008.[2] At the same time, net issuance of debt securities by NFCs and non-MFI loans (by other financial intermediaries (OFIs) and insurance corporations and pension funds (ICPFs)) to NFCs have both increased significantly in the euro area since early 2012, and have more than made up for the contraction observed in MFI lending to NFCs in recent quarters (see Chart B).

As regards external financing, taking into account non-MFI lending, the annual net flow of NFCs' external financing was slightly below EUR 100 billion in the fourth quarter of 2013, while it was slightly negative if non-MFI lending is excluded. Lately, non-MFI lending to NFCs has mainly mirrored an increase in loans granted by NFC conduits to their parent companies, with these loans financed in turn through the issuance of debt securities by these subsidiaries. In a way, this therefore represents indirect market financing of NFCs.[3] The fact that the increased recourse to

Chart A The overall nominal cost of external financing for NFCs in the euro area and the spread between the cost of market-based debt for NFCs and the OIS rate

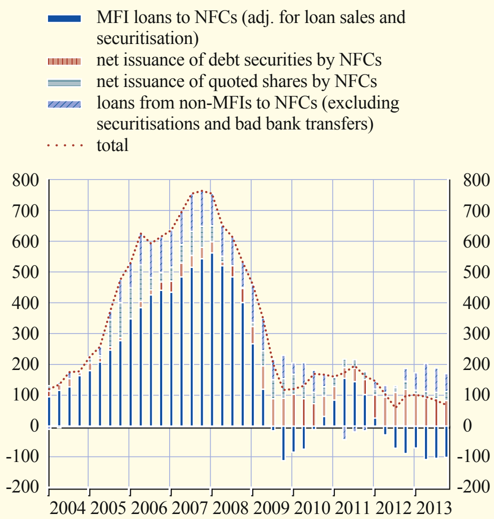
(percentage; basis points)



Sources: ECB, Merrill Lynch, Bloomberg, Thomson Reuters and ECB calculations.
Notes: The overall cost of financing for NFCs is calculated as a weighted average of the cost of bank lending, the cost of market-based debt and the cost of equity, based on their respective amounts outstanding derived from the euro area accounts. The latest observation is for 7 March 2014 for the spread and January 2014 for the other data.

Chart B NFCs' external financing in the euro area

(four-quarter flows in EUR billion)



Sources: Eurostat, ECB and ECB estimations.
Notes: Non-MFI loans include OFI and ICPF loans to NFCs. The latest observation is for the third quarter of 2013. Estimates for the fourth quarter of 2013 are derived from ECB Balance Sheet Items (BSI) and Securities Issues Statistics (SIS) data.

1 The calculation of the cost of market-based debt is based on a Merrill Lynch index of the average yield of euro-denominated corporate bonds with investment grade ratings and a euro-currency high-yield index. The two indices are thereafter weighted by their outstanding amounts.

2 The duration of the debt of euro area NFCs that is market based is around four-and-a-half years. The average of the OIS rate for four and five years has been used to calculate the spread between the cost of market-based debt for NFCs and the OIS rate in Chart A.

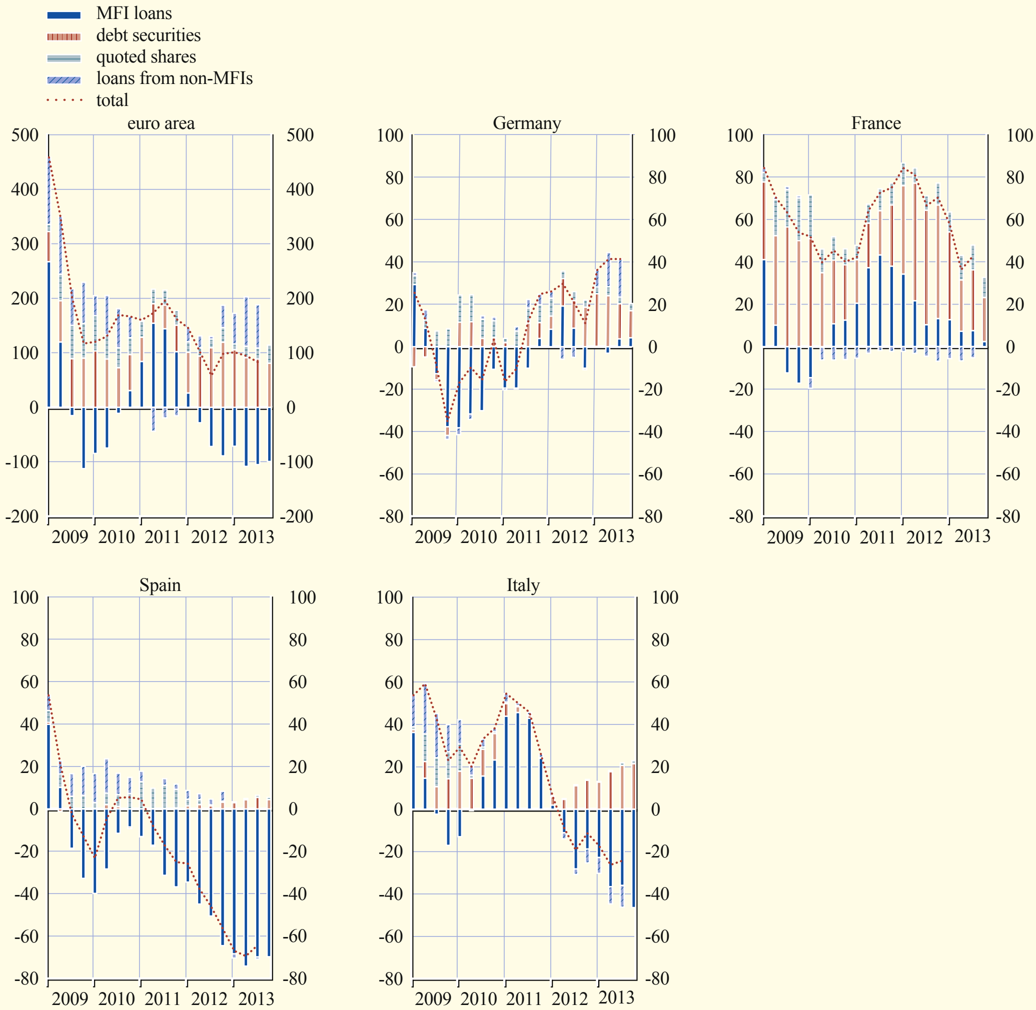
3 Conduits (or special purpose entities) are created for the sole purpose of issuing securities on behalf of their parent company. As they are typically created in countries different from the country of residence of the parent company, in order to take advantage of a favourable tax treatment, these conduits are treated as separate institutional units, and their issuance of debt securities is not directly attributed to the parent company.

market-based financing occurs in an environment in which the cost of such funding is exceptionally low may suggest that those NFCs that are able to access the market are doing so because of the attractive market conditions, rather than because they are constrained in accessing bank funding.

In absolute terms, the net issuance of debt securities by NFCs has remained concentrated among just a few countries in recent quarters, namely France, Italy and Germany (see Chart C). In these countries, the issuance of debt securities has been much more dynamic than bank loans. By contrast, NFCs' issuance of debt securities has been weak in Spain and has not made up the marked net redemptions in bank loans. In all countries, access to debt securities markets is, to a large extent, limited to large firms. Meanwhile, small and medium-sized

Chart C NFCs' external financing in the euro area and the four largest euro area countries

(four-quarter flows in EUR billion)

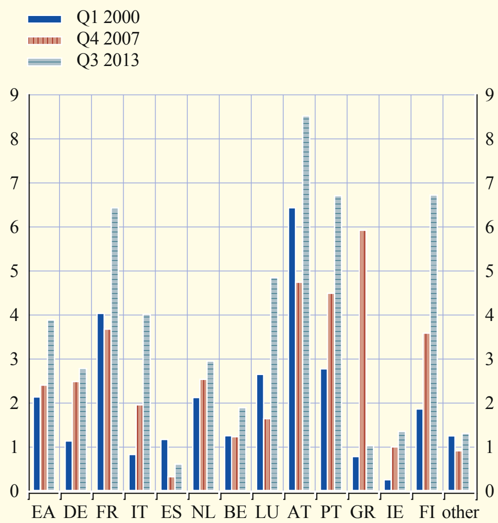


Sources: Eurostat, ECB and ECB estimations.
Notes: MFI loans to NFCs have been adjusted for the impact of loan sales and securitisation. Non-MFI loans include OFI and ICPF loans to NFCs and exclude loan securitisations and transfers to bad banks. The latest observation is for the third quarter of 2013. Estimates for MFI lending to NFCs and the net issuance of debt securities and quoted shares by NFCs in the fourth quarter of 2013 are derived from BSI and SIS data.

enterprises (SMEs) may also benefit indirectly from the issuance of debt securities by larger corporations, because this frees up space in the balance sheet of banks to lend to SMEs. In addition to bank lending, retained earnings, inter-company loans and trade credits are also important sources of financing for euro area NFCs.[4]

Chart D The share of debt securities issued by NFCs in their total liabilities across euro area countries

(percentages)



Sources: Eurostat and ECB.
Notes: "Other" includes Estonia, Cyprus, Malta, Slovenia and Slovakia. The first observation for other refers to the first quarter of 2004, and, for Luxembourg, to the first quarter of 2005.

Despite the ongoing robust net issuance of debt securities, the overall flow of external financing to NFCs in the euro area remains weak (see Chart B). In addition, the share of financing based on debt securities – direct or indirect (via conduits) – in the total stock of external financing of euro area NFCs is still low, although it has increased from the level observed in early 2000. Indeed, the stock of debt securities issued directly by NFCs was marginally below 4% of their total liabilities in the euro area in the third quarter of 2013 (see Chart D), while it stood at slightly above 2% in the first quarter of 2000. In Austria, Finland, Portugal and France, the share of debt securities issued directly by NFCs in their total liabilities was significantly higher than the euro area average, standing between 6.5% and 8.5% in the third quarter of 2013. In Luxembourg and Italy, the share has also increased in the past six years, rising slightly or marginally above the share observed for the euro area on average. By contrast, in Spain, Greece, Ireland, Belgium, Germany and the Netherlands, the share was below the euro area average in the third quarter of 2013. In Spain and Greece, it stood lower in the third quarter of 2013, as compared with the levels experienced in these countries in early 2000 and at the end of 2007, respectively.

To sum up, the overall flow of external financing to NFCs remains weak in the euro area, despite the fact that financing available from the net issuance of debt securities has more than made up for the contraction in MFI lending to NFCs that has been observed in recent quarters. The increase in the issuance of debt securities is consistent with the very low yield on corporate bonds. At the same time, the share of market-based debt finance in the total stock of the external financing of euro area NFCs remains low, although it has increased from the level observed in early 2000. Moreover, debt issuance flows are compositionally skewed towards countries less affected by financial tensions and towards large firms with high ratings.

4 For more details on the substitution effects in the financing of euro area NFCs during the crisis, see the article entitled "Deleveraging patterns in the euro area corporate sector", *Monthly Bulletin*, ECB, February 2014.