



Corporate bond issuance picks up as interest rates set to rise

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European corporate bond issuance has picked up significantly in the last month, in anticipation of future interest rate hikes by the European Central Bank. Indeed, the ECB has declared in no uncertain terms that it plans to raise rates in the short term to respond to inflationary pressures. This development has pushed corporate treasurers to take advantage of the last vestiges of the low rate environment by locking in the attractive rates that still allow corporations to borrow cheaply for funding plans. It is worth noting that when the ECB raised rates on 1 December 2005, this was the first increase in more than 7 quarters.

It is not clear at all at this stage whether this announced interest rate hike will be pursued over the medium term along the lines of the Fed's recent "measured pace" approach. The uncertainty surrounding future rate developments has also served as an important catalyst for the upsurge in corporate issuance, especially as the ECB has not given a clear rationale for its interest rate policy over the medium term. Thus, the current situation offers European corporations an ultimate opportunity, at least in the short term, to raise capital cheaply, before facing the uncertainty about the duration and the scope of the revaluation of the money holding costs. In this period, refinancing activities have also been widespread, as corporate seek to obtain more favorable terms on debt servicing.

Another important motivation driving issuers to emit debt in the current environment is the favorable pricing conditions that prevail in the market. Pricing on announced issues is likely to remain attractive for issuers, as cash is still abundant: the liquidity overhang that still saturates capital markets – fueled by the extended period of low interest rates both in the EU and in the US – is likely to lead to healthy demand for these issues despite the low return offered. The excess liquidity in the market is likely to be mopped up over time if the Fed and the ECB gradually raise key interest rates over time, as is widely expected.

All of these factors can explain the surge in corporate bond issuance in November 2005². Whether issuance continues to be strong in coming months will depend on the effectiveness of the anticipated rate increase to contain inflationary pressures, as well as on the ECB's ability to reassure markets and remove some of the uncertainty surrounding the medium-term outlook.

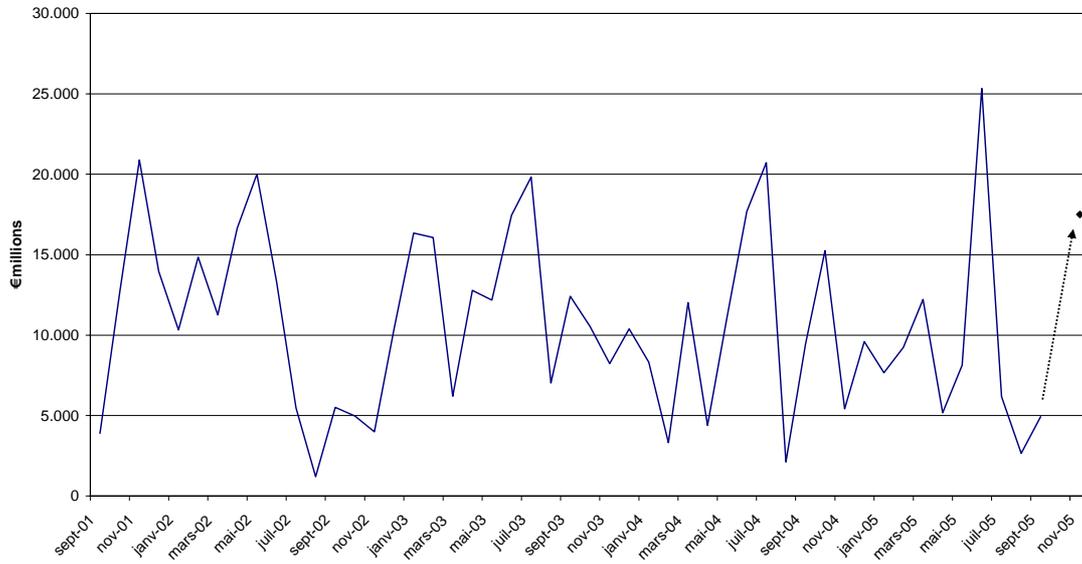
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² SGIB announced 11.75 million € corporate bond issuance for November 2005.



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Volume of Euro denominated Bonds issued by Corporates



Source: EU Commission Data