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TD Bank hits euros as spreads rebound, but positivity set to be tested in 'critical week'

A collapse in spreads on the back of technicals and a positive reading of the latest economic and geopolitical developments paved the way for Toronto-Dominion to tap the euro market today (Monday), but imminent downside risks mean opportunities may remain limited. *Neil Day* reports, with insights from Crédit Agricole CIB syndicate, trading and strategists in London, New York and Paris.

Toronto-Dominion Bank printed a €2.25bn dual-tranche senior bail-inable issue well inside recent wides today (Monday), after positive headlines trumped negatives last week and technicals contributed to a squeeze on spreads, although market participants warned sentiment remains vulnerable to ongoing bad news.

Incessant negative newsflow and volatility had driven equity markets to lows and credit indices to wides for the year the week before last, but a subsequent rally had by Friday seen the iTraxx Crossover recover 100bp since 14 July and Senior Financials 25bp.

Although headlines remained mixed last week — including the resignation as Italian prime minister of Mario Draghi and equivocal ECB decisions on Thursday — market participants latched onto news on Tuesday that Nord Stream 1 gas flows to Europe would resume, allaying fears that Russia would not restart the pipeline after scheduled maintenance. Crossover tightened as much as 40bp on Tuesday alone.

"While the key risks of this week remain," said Harpreet Parhar, head of credit strategy at Crédit Agricole CIB, "what has helped sentiment is that these have been pushed back from binary risks — e.g. will Nord Stream 1 reopen or not — to risks that will/may evolve over time."

Vincent Hoarau, head of FIG syndicate at Crédit Agricole CIB, noted the tone had already begun to improve after US earnings proved encouraging despite an initial miss from JP Morgan when it kicked off the reporting season on 14 July.

"Admittedly, expectations were low, but that helped stabilise a situation where prices had only been going one way, i.e. south," he said. "After all the doom and gloom, many people felt the market had gone too far and was ready for a correction to the upside, while cash continued to be abundant.

"So when the first positive news came in — such as the better than expected earnings or Nord Stream returning to normal — the appetite to cover shorts and net buying picked up significantly, leading to the collapse in credit spreads, even if fundamentals did not necessarily improve."

According to William Rabicano, director, credit trading at Crédit Agricole CIB, technicals have exacerbated the extent of the tightening.

"We've seen pretty consistent net buying from clients over the past two weeks, with ETF accounts that have been relentless on the bid being the primary driver taking the market tighter," he said. "Even when there's been a bit of macro weakness — be it in equities, around rate hikes, BTP-Bund spreads — they haven't backed off at all, even if we've sort of reversed June's widening and are now at optically tight levels.

"And the lack of supply at this time of year has been a technical kicker to spreads — the Street is also running very light risk and any movement in spreads tends to be very gappy."

The impact of Draghi's resignation was also confined to Italian banks, despite being a clear negative last week, noted Neel Shah, financial credit analyst at Crédit Agricole CIB, while a larger than expected 50bp rate hike from the European Central Bank and unveiling of its new anti-fragmentation Transmission Protection Instrument (TPI) had a mixed reception.

"The market doesn't fully understand how the TPI is going to be used and isn't fully convinced," he added. "It seems like the ECB is keeping the finer details close to their chest."

The ECB had previously flagged a 25bp hike for Thursday, with 50bp expected in September, and as well as moving more aggressively than expected, the central bank removed its forward guidance and stressed that further moves would be data-dependent. Meanwhile, despite outlining its eagerly awaited anti-fragmentation instrument, the ECB did not specify

what would trigger its intervention.

"We have the bitter feeling that the ECB agreed to a bigger hike in exchange for a crisis programme that remains wobbly," said Louis Harreau, head of developed markets macro and strategy at Crédit Agricole CIB. "The TPI is not as theoretical as the OMT, but it is not as operational as flexibility in reinvestments.

"By setting external criteria (mostly from the European Commission's decisions) but keeping discretionary intervention, the ECB could have created the worst of two worlds: it is reliable for an intervention or not (so politically exposed) and at the same time, it does not have full discretion (again, the question of the Excessive Deficit Procedure is not totally neutral)."

Market awaits Fed, GDP, CPI

Toronto-Dominion's €2.25bn trade today was split into €1bn five and €1.25bn 10 year tranches, the former printed at 105bp following initial price thoughts of the 115bp area and implying a new issue premium of around 30bp, and the latter priced at 130bp following IPTs of the 145bp area and with a NIP of 35bp. While the premiums paid by the Canadian bank were at the upper end of those paid by national champions this year, the issuer was able to achieve relatively competitive pricing by recent standards.

Its deal comes after only one unsecured FIG deal hit the euro market last week, a €500m three year green senior preferred issue from Aareal Bank on Tuesday. The deal was priced in the middle of initial guidance of the mid-swaps plus 300bp area on the back of a final order book of €700m.

In contrast, US banks printed some $32bn last week and enjoyed stronger receptions than Yankee issuers, according to Daniel Kim, director, US syndicate, at

Crédit Agricole CIB. While part of this was due to concern about European developments — such as a windfall tax on Spanish banks, as well as aforementioned events — it also reflected a focus on well supported and liquid securities among investment grade investors against a backdrop of outflows from IG funds. Investors withdrew cash for a 17th straight week for a total of over $80bn in 2022.

"What this means is that US investors are increasingly selective of where to put their investments, knowing that liquidity is the main priority," said Kim. "They are shortening their reach and seeking credits closer to home, SEC registration, and on-the-run, voluminous bonds."

This was reflected in tightening from IPTs of 22bp-25bp in $2bn-$5bn trades from US banks, compared with an average of around 15bp for sub-$1bn foreign trades, with the local players enjoying oversubscription ratios of two to five times for their jumbo deals. Demand for duration meanwhile led to bigger order books and lower new issue premiums for longer dated tranches.

Royal Bank of Canada was in the dollar market today with two and five year trades, with the day's Canadian supply coming ahead of the July Federal Reserve FOMC meeting tomorrow and Wednesday. The US central bank is set to increase rates 75bp, with an outside chance of a larger than expected 100bp rise, ahead of second quarter GDP data on Thursday and amid ongoing corporate earnings, while June euro area inflation numbers are due on Friday.

"This week is likely to be the most critical of the summer, with the Fed decision and further insight into the shape of the US economy and the potential for recession," said Hoarau. "When we have that out of the way and providing that the news is better than feared, the tone could be constructive, so we could theoretically see a top issuer braving the euro primary market — US and UK banks could be good for a deal in August because liquidity will be there for quality at the right price.

"But it remains to be seen if the market can be supportive — recent data remain concerning, so the bar for seeing further primary activity is currently high."

Indeed, the ECB's acceleration away from negative rates and as much as 200bp of Fed hikes by early next year, against a backdrop of deteriorating consumer and investor sentiment, raise questions over how sustainable is the shift in market tone — particularly with ongoing uncertainty over gas supplies as winter looms.

"So it's difficult to tell what the post-summer period will deliver," said Hoarau. "The dynamic in credit spreads is likely to be impacted by potential supply, given the significant backlog, but also TLTRO refinancing and pre-funding considerations. On the demand side, we can't rule out a stronger inclination from investors to maintain high cash balances to cope with potential outflows, but overall cash avail-

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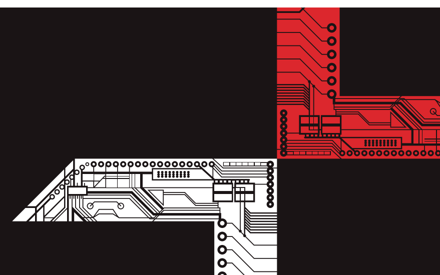

able for primary will be enormous and the buy-side inclination to be constructive elevated.

"But — if it needs to be said — don't count on investors buying indiscriminately and adding risk without being hyper-diligent on names and pricing parameters."

Should prevailing dynamics hold, demand for the long maturities could prove more pronounced than in the first half, according to Hoarau.

"Recession fears and disinflationary factors should support the longer end of the curve where structural needs exist," he said. "At current spread levels, 10 year senior bonds from core issuers are likely to be very well received if the tone and market sentiment late August are identical to what we had in the wake of the ECB meeting.

"But as core borrowers are unlikely to lock in current spreads at long end, we are likely to have a more pronounced inverted credit curve in senior bullet instruments. And the shorter/intermediate part of the curve will continue to be hammered." ●

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