

Covered Bond Outlook 2024

Analysts:

Heiko Langer

heiko.langer@erstegroup.com

Carmen Riefler-Kowarsch

carmen.riefler-kowarsch@erstegroup.com

Contents

Covered bond market on the way to normalization	1
Primary market	2
Secondary market	6
Real estate market	7

Major Markets & Credit Research

Gudrun Egger, CEFA (Head)

Sub-Sovereigns & Agencies

Ralf Burchert, CEFA

Financials & Covered Bonds

Heiko Langer

Carmen Riefler-Kowarsch

Corporate Bonds

Peter Kaufmann, CFA

Bernadett Povazsai-Römhild, CEFA, CESGA

Elena Statelov, CIIA

Note: Information on past performance is not a reliable indicator of future performance.

Covered bond market on the way to normalization

We expect issuance activity on the covered bond market to normalize further in 2024. This means a further moderate decline in issue volumes compared to 2023 and, above all, compared to the record year 2022. This will affect both the overall market, where we expect a volume of EUR 170-180bn, and the Austrian market, which should reach an estimated issue volume of EUR 11-13bn.

One of the main reasons for the expected decline in issuance volume is the dwindling influence of TLTRO3. Only around EUR 450bn of TLTRO3 tranches will be due next year. Part of this will also be refinanced by covered bonds in the coming year. However, we expect the impact of TLTRO3 maturities on the covered bond issue volume to gradually decline until the facility is repaid in full in December 2024.

Since the interest rate turnaround, credit growth at banks in the eurozone has slowed noticeably. Both a lower demand for credit and a tightening of lending rules have been observed. We expect credit growth to remain at a low level in the coming year. This should also have a dampening effect on issuing activity in the covered bond market.

The issue volume in the ESG covered bond segment has shown steady growth since 2021. The issue volume has also increased to EUR 21bn in 2023. We expect further moderate growth in the ESG segment of the overall covered bond market in 2024, with stable development expected for the Austrian market.

The trend towards higher risk premiums has continued in 2023. Covered bond swap spreads have widened continuously since the beginning of the year, with an increase in momentum after the summer break. In addition to increased risk aversion on the part of investors, we see the relatively high volume of new issues as the main reason for the widening of spreads.

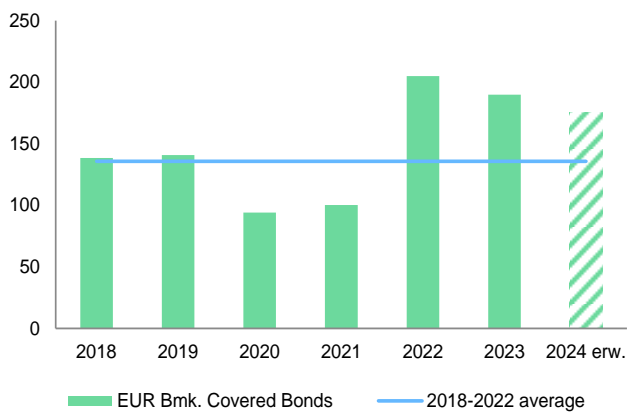
In view of the expected lower supply of covered bonds and the already comparatively high risk premiums, we see a limited risk of a further significant widening of covered bond spreads in the coming year. A more stable interest rate trend should also limit the risk of wider spreads

Primary market

Market normalization expected for 2024

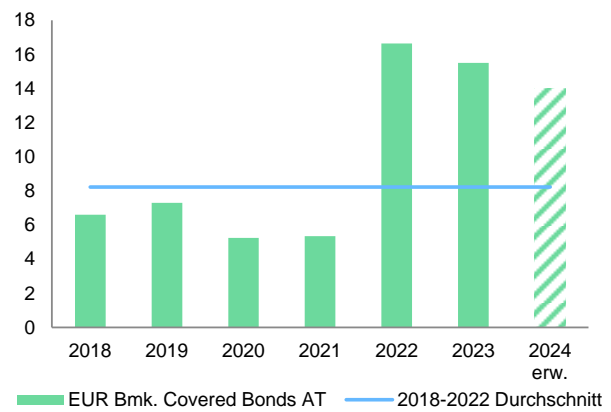
We expect issuance activity on the covered bond market to normalize further in 2024. This means a further moderate decline in issue volumes compared to 2023 and, above all, compared to the record year 2022. This will affect both the overall market, where we expect a volume of EUR 170 - 180bn, and the Austrian market, which should reach an estimated issue volume of EUR 11-13bn. Despite an expected decline of around 7% for the overall market and 20% for Austria, the total volumes should remain well above the average for the years 2018 - 2022.

EUR Benchmark Covered Bond supply
In EUR bn.



Source: Erste Group Research

EUR Benchmark Covered Bond supply AT
In EUR bn.

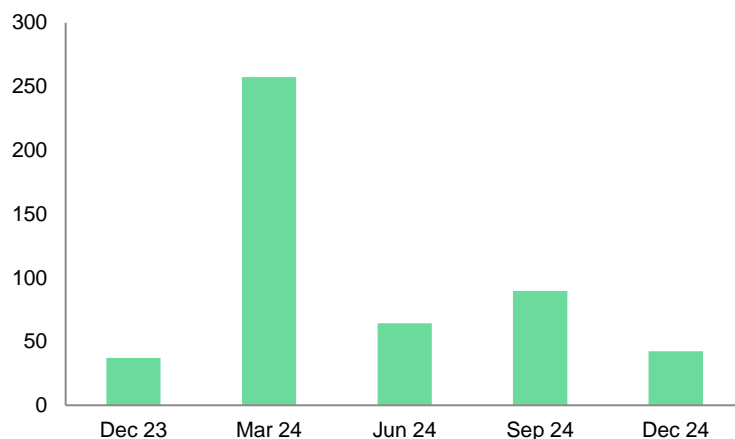


Source: Erste Group Research

Dwindling influence of TLTRO3 on the primary market

One of the main reasons for the expected decline in the issue volume is the dwindling influence of TLTRO3. In 2023, around EUR 1,500bn in TLTRO3 loans were repaid by the banks to the ECB. Part of this was also refinanced by issuing new covered bonds.

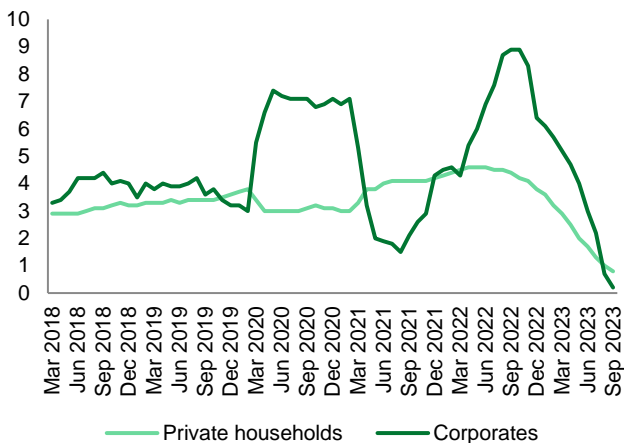
Outstanding TLTRO3 tranches by maturity
In EUR bn.



Source: ECB, Erste Group Research

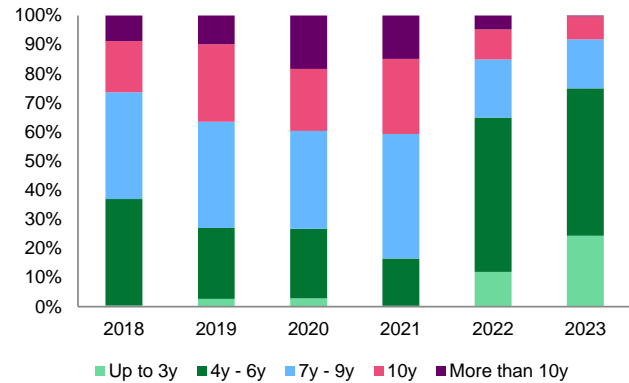
As of November 2023, only around EUR 450 bn of TLTRO3 tranches will fall due next year. A portion of this will also be refinanced by covered bonds in the coming year. However, we expect the impact of TLTRO3 maturities on the covered bond issue volume to gradually decline until the facility is repaid in full in December 2024.

Rising interest rates depress demand for credit
Loan growth of European banks in %



Source: ECB, Erste Group Research

Issues with short maturities have dominated since the interest rate turnaround



Source: Erste Group Research

Low loan growth should have a dampening effect on issuing activity

Since the turnaround in interest rates, loan growth at banks in the eurozone has slowed noticeably. Both a lower demand for loans and a tightening of lending rules have been observed. We expect loan growth to remain at a low level in the coming year. This should also have a dampening effect on issuing activity in the covered bond market.

Strong focus on shorter terms could decrease

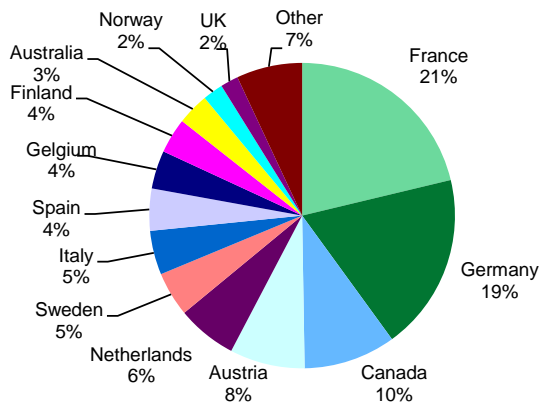
Text Market participants' interest rate expectations should also have an impact on the primary market. Since the start of the interest rate turnaround, there has been a noticeable shift in issuing activity towards shorter maturities. In 2021, the proportion of new issues with an original term of seven years or more was still 83%. This year, the same maturity segment only accounted for 25%. We believe this is primarily due to investors' preference for shorter maturities in times of rising interest rates. The expectation that interest rates will not rise any further or even fall for some market participants should lead to at least a partial weakening of the very strong focus on shorter maturities in the coming year. As a result, we could see slightly more issues with medium and longer maturities on the primary market again. Inter 9pt 48/48/48, one line spacing after headline

Regional diversification in issue volume increases

The dominance of issuers from France, Germany and Canada decreased slightly in 2023 compared to the previous year, which was mainly due to a decline in Canadian covered bond issues. Together, issues from these three countries accounted for 50% of the total volume (2022: 56%). In contrast to the previous year, Italian banks also played a greater role on the primary market again this year. We expect this trend to continue in the coming year. For Austrian issuers, 2023 marks the end of another very active year, even if the market share was slightly below that of the previous year. In line with our

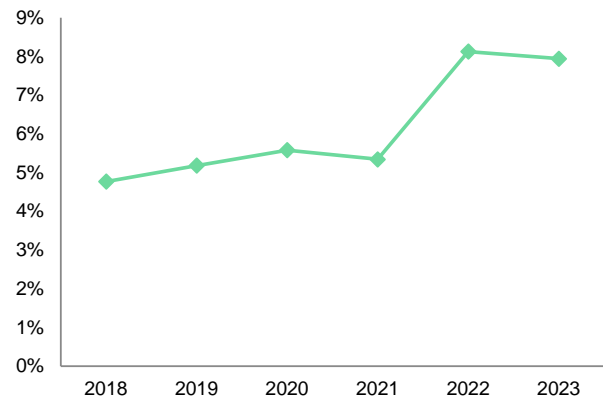
expectation of a declining issue volume from Austria, the relative share of issues is also likely to fall further in 2024.

Issue volume 2023 distributed more evenly
Covered bond issues by country of origin



Source: Erste Group Research

Market share of Austrian banks remains high
Share of AT banks in the total market



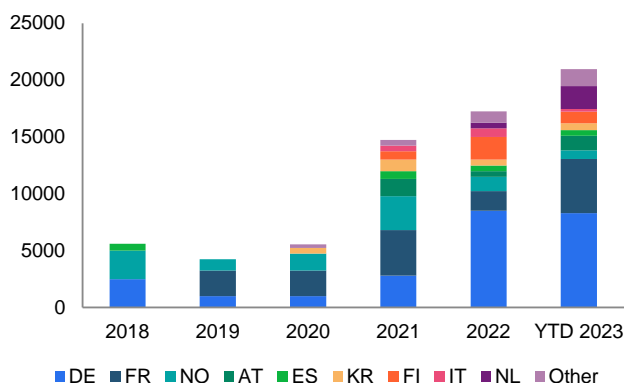
Source: Erste Group Research

ESG

ESG covered bond segment grew compared to senior

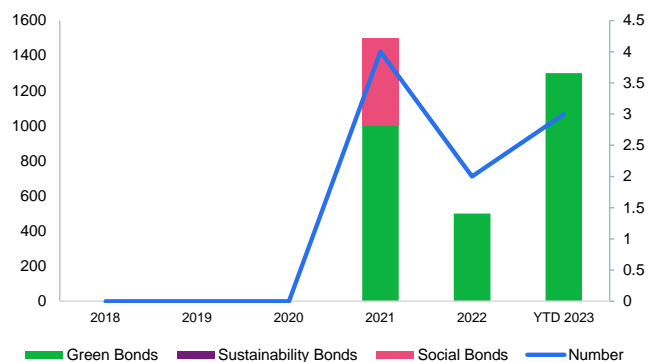
The issue volume in the ESG covered bond segment has shown steady growth since 2021. The issue volume has also increased to EUR 21bn in 2023. If the banks' total ESG issue volume is taken into account, there was a slight shift in 2023 from the ESG senior segment, which continues to dominate at 72% (previous year: 74%), to the ESG covered bond segment, which increased from 23% in 2022 to 25% in 2023.

Further increase in ESG issuance volume
EUR ESG covered bond issues in EUR mn



Source: Erste Group Research

Mainly green covered bond issues in AT
EUR ESG covered bond issues AT in EUR mn .



Source: Erste Group Research

Further growth expected in the ESG covered bond segment

Germany continues to contribute the largest share of the ESG volume at 40%, although the volume in 2023 is declining and French issuers have increased their share to over 20%. Austrian issuers contributed around 6% of the total

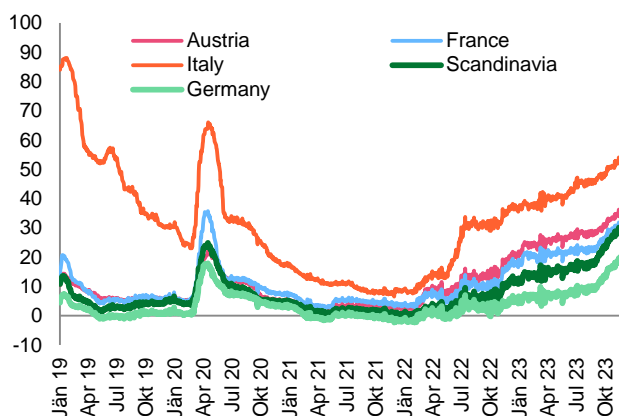
volume this year with three issues. We expect further moderate growth in the ESG segment of the overall covered bond market in 2024, with stable development expected for the Austrian market.

Secondary market

High supply main reason for spread widening

The trend towards higher risk premiums continued in 2023. Covered bond swap spreads have widened continuously since the start of the year, with a further increase in momentum after the summer break. Differentiation by country of origin of the issuer and between individual banks has also increased further. In addition to increased risk aversion on the part of investors, we see the relatively high volume of new issues as the main reason for the widening of spreads. Although there were no significant market congestions affecting new issues over the course of the year, oversubscription of issues decreased noticeably in the second half of the year despite rising new issue premiums. The end of the reinvestment of maturing covered bonds within the ECB's asset purchase programs in July of this year further increased the effect of the high volume of issues on spreads.

Covered Bond swap spreads
In BP



Source: Marktdatenanbieter, Erste Group Research

Swap spread-difference btw. Covered a. Senior Bonds
In BP



Source: Marktdatenanbieter, Erste Group Research

Greater risk aversion on the investor side

Falling real estate prices and concerns about the development of the commercial real estate market have increased risk aversion on the investor side. However, these concerns are not yet reflected in an increased swap spread difference between covered bonds and senior bonds. Greater market uncertainty usually causes risk premiums on senior bonds to rise more sharply than on covered bonds. However, the gap between the two bond classes narrowed slightly in the second half of the year and is well away from the level that prevailed after the collapse of Silicon Valley Bank in March 2023.

Risk of significant spread widening limited

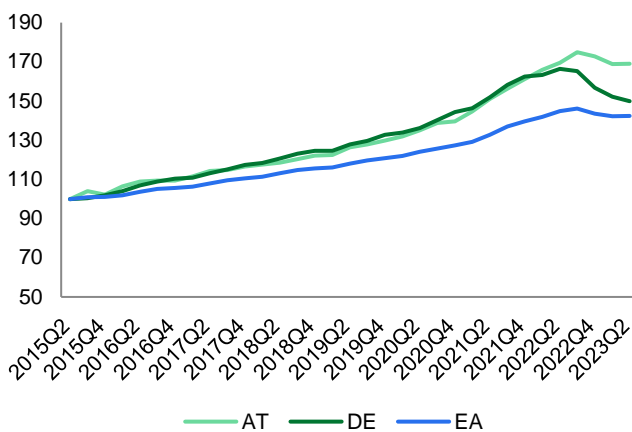
In view of the expected lower supply of covered bonds and the already comparatively high risk premiums, we see a limited risk of a further significant widening of covered bond spreads in the coming year. A more stable interest rate trend should also limit the risk of further spreads. Although a further deterioration in the economic situation would argue for higher risk premiums, the effect should be more noticeable for senior bonds than for covered bonds. This would argue for a wider spread between covered bonds and senior bonds than is currently the case.

Real estate market

No further drastic fall in residential real estate prices expected in Austria

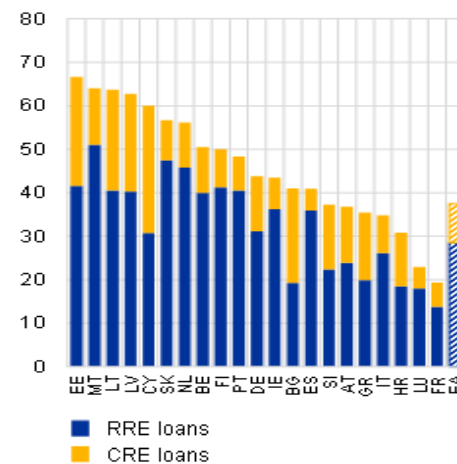
The residential real estate market remains in a tense phase across Europe and residential real estate prices are declining. In Austria, however, real estate prices have proved to be significantly more robust than in other European countries such as Germany. While inflation and construction costs are stabilizing, the economic weakness is proving to be a risk factor for the real estate market. The weak economy may have a negative impact on the labor market, which in turn could have a further dampening effect on property prices. On the other hand, a decline in completions coupled with a growing population is expected to lead to a shortage on the housing market in the medium term. This would support prices in Austria in the medium term, provided there is no drastic downturn in the labor market.

Price declines at a high level
Eurostat real estate price index quarterly figures



Source: Eurostat, Erste Group Research

Bank exposures highly diversified
4Q 2022 as % of total receivables



Source: ECB

Commercial real estate sector remains under pressure

The commercial real estate sector is currently a particular focus of the market and supervision. At banks in the eurozone, loan exposures in private residential construction account for almost 30% of total loans, well above those in commercial real estate at around 10%. Austria's banks' exposure to residential real estate is below the eurozone average in Q4 2022, while their exposure to commercial real estate is slightly above it. Commercial real estate naturally shows shorter-term financing than residential real estate. As a result, higher refinancing costs are already being reflected here. However, structural changes such as work from home and purchasing behavior have also increased the pressure on this sector significantly.

Further increase in NPL ratios expected

Austrian banks already reported an increase in NPL ratios from the commercial real estate segment in 1H 2023, although the ratios were at a historically low level. The Austrian supervisory authority does not currently see any systemic risk for the Austrian banking sector from the commercial real estate segment. However, it can be assumed that an increase in non-performing loans will also be observed in other credit areas due to the continued high level of interest rates and the economic weakness.

Contacts

Group Research

Head of Group Research
Friedrich Mostböck, CEFA®, CESGA® +43 (0)5 0100 11902

CEE Macro/Fixed Income Research
Head: Juraj Kotian (Macro/FI) +43 (0)5 0100 17357
Katarzyna Rzentarzewska (Fixed income) +43 (0)5 0100 17356
Jakub Cery (Fixed income) +43 (0)5 0100 17384

Croatia/Serbia
Alen Kovac (Head) +385 72 37 1383
Mate Jelić +385 72 37 1443
Ivana Rogic +385 72 37 2419

Czech Republic
David Navrátil (Head) +420 956 765 439
Jiri Polansky +420 956 765 192
Michal Skorepa +420 956 765 172

Hungary
Orsolya Nyeste +361 268 4428
János Nagy +361 272 5115

Romania
Ciprian Dascalu (Head) +40 3735 10108
Eugen Sinca +40 3735 10435
Dorina Ilasco +40 3735 10436
Vlad Nicolae Ionita +40 7867 15618

Slovakia
Maria Valachyova (Head) +421 2 4862 4185
Matej Hornak +421 902 213 591

Major Markets & Credit Research
Head: Gudrun Egger, CEFA® +43 (0)5 0100 11909
Ralf Burchert, CEFA® (Sub-Sovereigns & Agencies) +43 (0)5 0100 16314
Hans Engel (Global Equities) +43 (0)5 0100 19835
Margarita Grushanina (Austria, Quant Analyst) +43 (0)5 0100 11957
Peter Kaufmann, CFA® (Corporate Bonds) +43 (0)5 0100 11183
Heiko Langer (Financials & Covered Bonds) +43 (0)5 0100 85509
Stephan Lingnau (Global Equities) +43 (0)5 0100 16574
Carmen Riefler-Kowarsch (Financials & Covered Bonds) +43 (0)5 0100 19632
Rainer Singer (Euro, US) +43 (0)5 0100 17331
Bernadett Povaszai-Römhild, CEFA®, CESGA® (Corporate Bonds) +43 (0)5 0100 17203
Elena Staselov, CIAA® (Corporate Bonds) +43 (0)5 0100 19641
Gerald Walek, CFA® (Euro, CHF) +43 (0)5 0100 16360

CEE Equity Research
Head: Henning Ebkuchen +43 (0)5 0100 19634
Daniel Lion, CIAA® (Technology, Ind. Goods&Services) +43 (0)5 0100 17420
Michael Marschallinger, CFA® +43 (0)5 0100 17906
Nora Nagy (Telecom) +43 (0)5 0100 17416
Christoph Schultes, MBA, CIAA® (Real Estate) +43 (0)5 0100 11523
Thomas Unger, CFA® (Banks, Insurance) +43 (0)5 0100 17344
Vladimira Urbankova, MBA (Pharma) +43 (0)5 0100 17343
Martina Valenta, MBA +43 (0)5 0100 11913

Croatia/Serbia
Mladen Dodig (Head) +381 11 22 09178
Boris Pevalek, CFA® +385 99 237 2201
Marko Plastic +385 99 237 5191
Matej Pretkovic +385 99 237 7519
Bruno Barbic +385 99 237 1041
Davor Spoljar, CFA® +385 72 37 2825
Magdalena Basic +385 99 237 1407

Czech Republic
Petr Bartek (Head, Utilities) +420 956 765 227
Jan Safranek +420 956 765 218

Hungary
József Miró (Head) +361 235 5131
András Nagy +361 235 5132
Tamás Pletser, CFA® +361 235 5135

Poland
Cezary Bernatek (Head) +48 22 257 5751
Piotr Bogusz +48 22 257 5755
Łukasz Jańczak +48 22 257 5754
Krzysztof Kawa +48 22 257 5752
Jakub Szkopek +48 22 257 5753

Romania
Caius Rapanu +40 3735 10441

Group Markets

Head of Group Markets
Oswald Huber +43 (0)5 0100 84901

Group Markets Retail and Agency Business
Head: Christian Reiss +43 (0)5 0100 84012

Markets Retail Sales AT
Head: Markus Kaller +43 (0)5 0100 84239

Group Markets Execution
Head: Kurt Gerhold +43 (0)5 0100 84232

Retail & Sparkassen Sales
Head: Uwe Kolar +43 (0)5 0100 83214

Markets Retail Sales CZ
Head: Roman Choc +420 956 765 374

Markets Retail Sales HUN
Head: Peter Kishazi +36 1 23 55 853

GM Retail Products & Business Development
Head: Martin Langer +43 (0)50100 11313

Corporate Treasury Product Distribution AT
Head: Martina Kranzl-Carvell +43 (0)5 0100 84147

Group Securities Markets
Head: Thomas Einramhof +43 (0)50100 84432

Institutional Distribution Core
Head: Jürgen Niemeier +49 (0)30 8105800 5503

Institutional Distribution DACH+
Head: Marc Frieberthshäuser +49 (0)711 810400 5540
Bernd Bollhof +49 (0)30 8105800 5525
Andreas Goll +49 (0)711 810400 5561
Mathias Gindele +49 (0)711 810400 5562
Ulrich Inhofner +43 (0)5 0100 85544
Sven Kienzle +49 (0)711 810400 5541
Rene Klagen +49 (0)30 8105800 5521
Christopher Lampe-Traupe +49 (0)30 8105800 5523
Danijel Popovic +49 1704144713
Michael Schmotz +43 (0)5 0100 85542
Klaus Vosseler +49 (0)711 810400 5560

Slovakia
Sarlota Sipulová +421 2 4862 5619
Monika Směliková +421 2 4862 5629

Institutional Distribution CEE & Insti AM CZ
Head: Antun Buric +385 (0)7237 2439
Jaromir Malak +43 (0)5 0100 84254

Czech Republic
Head: Ondřej Čech +420 2 2499 5577
Milan Bartoš +420 2 2499 5562
Jan Porvich +420 2 2499 5566
Pavel Zdičhynec +420 2 2499 5590

Institutional Asset Management Czech Republic
Head: Petr Holeček +420 956 765 453
Petra Maďerová +420 956 765 178
Martin Peřina +420 956 765 106
David Petráček +420 956 765 809
Blanka Westnerová +420 956 765 317
Petr Valenta +420 956 765 140

Croatia
Head: Antun Buric +385 (0)7237 2439
Zvonimir Tukač +385 (0)7237 1787
Natalija Zujic +385 (0)7237 1638

Hungary
Head: Peter Csizmadia +36 1 237 8211
Gábor Bálint +36 1 237 8205
Gergő Szabo +36 1 237 8209

Romania
Head: Octavian Florin Munteanu +40 746128914

Group Institutional Equity Sales
Head: Michal Řízek +420 224 995 537
Werner Fürst +43 (0)50100 83121
Viktoria Kubalcova +43 (0)5 0100 83124
Thomas Schneidhofer +43 (0)5 0100 83120
Oliver Schuster +43 (0)5 0100 83119

Czech Republic
Head: Michal Řízek +420 224 995 537
Jiří Fereš +420 224 995 554
Martin Havlan +420 224 995 551
Pavel Krabička +420 224 995 411

Poland
Head: Jacek Jakub Langer +48 22 257 5711
Tomasz Galanciak +48 22 257 5715
Wojciech Wysocki +48 22 257 5714
Przemysław Nowosad +48 22 257 5712
Maciej Senderek +48 22 257 5713

Croatia
Matija Tkalicanac +385 72 37 21 14
Hungary
Nandori Levente +36 1 23 55 141
Krisztian Kandik +36 1 23 55 162
Balasz Zankay +36 1 23 55 156

Romania
Liviu Avram +40 3735 16569

Group Fixed Income Securities Markets
Head: Goran Hobljaj +43 (0)50100 84403

Fixed Income Flow Sales
Head: Gorjan Hobljaj +43 (0)5 0100 84403
Margit Hrascshek +43 (0)5 0100 84117
Christian Kienesberger +43 (0)5 0100 84323
Ciprian Mitu +43 (0)5 0100 85612
Bernd Thaler +43 (0)5 0100 84119
Zsuzsanna Toth +36 1 237 8209

Poland
Pawel Kielek +48 22 538 6223
Michal Jarmakowicz +43 50100 85611

Fixed Income Flow Trading
Head: Gorjan Hobljaj +43 (0)5 0100 84403

Group Fixed Income Securities Trading
Head: Goran Hobljaj +43 (0)50100 84403

Group Equity Trading & Structuring
Head: Ronald Nemeč +43 (0)50100 83011

Business Support
Bettina Mahoric +43 (0)50100 86441

Disclaimer

This publication was prepared by Erste Group Bank AG or any of its consolidated subsidiaries (together with consolidated subsidiaries "Erste Group") independently and objectively as general information pursuant to Art. 36 (2) delegated Regulation (EU) 2017/565 as no direct buying incentives were included in this publication, which is of information character. This publication provides only other information without making any comment, value judgement or suggestion on its relevance to decisions which an investor may make and is therefore also no recommendation. Thus this publication does not constitute investment research pursuant to Art. 36 (1) delegated Regulation (EU) 2017/565. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research and it is not subject to the prohibition on dealing ahead of the dissemination of investment research. The information only serves as non-binding and additional information and is based on the level of knowledge of the person in charge of drawing up the information on the respective date of its preparation. The content of the publication can be changed at any time without notice. This publication does not constitute or form part of, and should not be construed as, an offer, recommendation or invitation for a transaction in any financial instrument or connected financial instruments, and neither this publication nor anything contained herein shall form the basis of or be relied on in connection with or act as an inducement to enter into any contract or inclusion of a financial or connected financial instrument in a trading strategy. Information provided in this publication is based on publicly available sources which Erste Group considers as reliable, however, without verifying any such information by independent third persons. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the forecasts, opinions and expectations contained herein are fair and reasonable, Erste Group (including its representatives and employees) neither expressly nor tacitly makes any guarantee as to or assumes any liability for the up-to-dateness, completeness and correctness of the content of this publication. Erste Group may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Erste Group endorses, recommends or approves any material on the linked page or accessible from it. Neither a company of Erste Group nor any of its respective managing directors, supervisory board members, executive board members, directors, officers or other employees shall be in any way liable for any costs, losses or damages (including subsequent damages, indirect damages and loss of profit) howsoever arising from the use of or reliance on this publication. Any opinion, estimate or projection expressed in this publication reflects the current judgment of the author(s) on the date of publication of this document and does not necessarily reflect the opinions of Erste Group. They are subject to change without prior notice. Erste Group has no obligation to update, modify or amend this publication or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. The past performance of a financial or connected financial instrument is not indicative for future results. No assurance can be given that any financial instrument or connected financial instrument or issuer described herein would yield favorable investment results or that particular price levels may be reached. Forecasts in this publication are based on assumptions which are supported by objective data. However, the used forecasts are not indicative for future performance of financial instruments incl. connected financial instruments. Erste Group, principals or employees may have a long or short position or may transact in financial instrument(s) incl. connected financial instruments referred to herein or may trade in such financial instruments with other customers on a principal basis. Erste Group may act as a market maker in financial instruments, connected financial instruments or companies resp. issuers discussed herein and may also perform or seek to perform investment services for those companies resp. issuers. Erste Group may act upon or use the information or conclusion contained in this publication before it is distributed to other persons. This publication is subject to the copyright of Erste Group and may not be copied, distributed or partially or in total provided or transmitted to unauthorized recipients. By accepting this publication, a recipient hereof agrees to be bound by the foregoing restrictions.

Erste Group is not registered or certified as a credit agency in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (the Credit Rating Agencies Regulation). Any assessment of the issuers creditworthiness does not represent a credit rating pursuant to the Credit Rating Agencies Regulation. Interpretations and analysis of the current or future development of credit ratings are based upon existing credit rating documents only and shall not be considered as a credit rating itself.

© Erste Group Bank AG 2023. All rights reserved.

Published by:

Published by:
Erste Group Bank AG
Group Research
1100 Vienna, Austria, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m,
Commercial Court of Vienna

Erste Group Homepage: www.erstegroup.com