FOR INSTITUTIONAL AND CORPORATE CLIENTS ONLY

# DEBT CAPITAL MARKETS
# 2015 REVIEW AND 2016 FORECAST


YEAR-END REPORT FROM SG DEBT CAPITAL MARKETS AND SYNDICATE TEAMS

SEE THE LAST PAGE OF THIS BROCHURE FOR A LIST OF SG DEBT CAPITAL MARKETS AND SYNDICATE CONTACTS AND IMPORTANT DISCLAIMERS AND DISCLOSURE

SOCIETE GENERALE
Corporate & Investment Banking

BUILDING TEAM SPIRIT **TOGETHER**

# Contents

# Executive Summary

## "THE BEST TIME TO PLANT A TREE WAS 20 YEARS AGO. THE SECOND BEST TIME IS NOW." — *Chinese Proverb*

- Looking at volumes alone, 2015 was another outstanding year for debt capital markets, the second best for most asset classes after a record 2014, and a new record year for corporate issuance.
- Volumes were once again fuelled by M&A financing, which accounted for 39% of total high-yield issuance versus 13% in 2014, and by the record-low rates seen in the first five months of the year, which have encouraged opportunistic financing from all asset classes.
- The very low-rate environment in the euro market in particular, comforted by the extended asset purchase programme by the European Central Bank (ECB), attracted unprecedented volumes from US and Chinese issuers looking to diversify away from a saturated USD corporate bond market.
- However, the second part of the year proved very challenging for both issuers and investors. For the first time in many years, issuing conditions deteriorated, with funding costs worsening between April and October due to a combination of rising long-term rates and growing volatility. Investors also paid a high price: the financial instability in Greece, the economic slowdown in China, the uncertainties surrounding the decision to hike rates in the US, and a rapid fall in commodity prices have all affected valuations in a number of sectors, and have triggered asset outflows in the riskiest asset classes, such as high yield and emerging markets.
- This combination of high volumes and high volatility has increased execution risk for issuers. In the corporate space, many transactions announced between May and September had to be postponed due to market conditions, and high-yield issuance was dominated by BB-rated and repeat issuers. In the financial space, rising credit spreads benefited the covered bond market in particular, in an environment which nevertheless remained window-driven. In the Sovereign, Supra and Agencies (SSA) space, the deteriorating environment triggered some sell-off by central banks and insurers on their inventory of EUR-denominated assets, which was mitigated by the solid demand from bank treasuries and the significant cash injections administered by the ECB. With the US economy affirming its resilience, the SSA dollar market benefited from its safe-haven status as well as from favourable cross-currency swaps, attracting a higher than average proportion of European issuers.
- Issuers who missed the windows of the first part of the year have no choice but to look forward. We believe the prospects for the remainder of the year and for 2016 are positive, with many investors already switching back to "risk-on" mode in a stabilised global environment. More generally, the debt capital markets have once again affirmed their resilience by delivering near- record volumes amid troubled waters. We may have shifted away from a situation where investors were often forced buyers, as they were in the euro corporate market in previous years for instance, to a situation where they can afford to be selective. But overall, the financing conditions for issuers remain extremely favourable. Those planting a tree today should not regret it over a 20-year horizon.

# Debt Capital Markets issuance volumes

## DCM issuance volumes on EUR market

| | Corporate Bonds | | | | Financial Bonds | | | | SSA Bonds | | | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| In EUR bn | Investment Grade | High Yield | Hybrids | Total | Covered Bonds | Senior | Hybrids | Total | Sovereign | Agency/ Supra | Local Authorities | Total | Bonds |
| 2012 | 211 | 35 | 1 | **248** | 118 | 148 | 17 | **284** | 877 | 275 | 61 | **1,213** | **1,744** |
| 2013 | 196 | 55 | 21 | **272** | 101 | 157 | 28 | **286** | 924 | 217 | 62 | **1,204** | **1,762** |
| 2014 | 222 | 63 | 29 | **314** | 117 | 180 | 59 | **356** | 968 | 181 | 72 | **1,221** | **1,891** |
| 2015 Expected | 230 | 55 | 27 | **312** | 140 | 175 | 42 | **357** | 957 | 154 | 57 | **1,169** | **1,838** |
| 2016 Forecast | 215 | 55 | 25 | **295** | 140 | 170 | 60 | **370** | 879 | 170 | 60 | **1,109** | **1 774** |
| 2016 vs. 2015 | -7% | +0% | -7% | **-5%** | +0% | -3% | +43% | **+4%** | -8% | +10% | +5% | **-5%** | **-3%** |

*Source: SG CIB Analytics, Dealogic*

## DCM issuance volumes on USD market

| | Corporate Bonds | | | | Financial Bonds | | | | SSA Bonds | | | | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| In USD bn | Investment Grade | High Yield | Hybrids | Total | Covered Bonds | Senior | Hybrids | Total | US Treasury | Sovereign non-US | Agency non-US/ Supra | Local Authorities | Total | Bonds |
| 2012 | 679 | 345 | 8 | **1,032** | 44 | 326 | 89 | **460** | 2,202 | 88 | 200 | 19 | **2,509** | **4,000** |
| 2013 | 624 | 324 | 6 | **954** | 23 | 361 | 97 | **481** | 2,140 | 95 | 221 | 11 | **2,467** | **3,902** |
| 2014 | 644 | 314 | 8 | **965** | 10 | 452 | 135 | **596** | 2,206 | 97 | 240 | 13 | **2,556** | **4,118** |
| 2015 Expected | 775 | 265 | 7 | **1,047** | 20 | 415 | 110 | **545** | 1,914 | 78 | 253 | 13 | **2,257** | **3,849** |
| 2016 Forecast | 725 | 240 | 5 | **970** | 18 | 428 | 130 | **576** | 2,257 | 90 | 210 | 5 | **2,562** | **4,108** |
| 2016 vs. 2015 | -6% | -9% | -29% | **-7%** | -10% | +3% | +18% | **+6%** | +18% | +16% | -17% | -60% | **+14%** | **+7%** |

*Source: SG CIB Analytics, Dealogic*

## DCM issuance volumes on GBP market

| | Corporate Bonds | | | | Financial Bonds | | | | SSA Bonds | | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| In GBP bn | Investment Grade | High Yield | Hybrids | Total | Covered Bonds | Senior | Hybrids | Total | Sovereign | Agency/ Supra | Total | Bonds |
| 2012 | 33 | 4 | 1 | **38** | 14 | 9 | 2 | **26** | 164 | 28 | **192** | **255** |
| 2013 | 19 | 12 | 5 | **36** | 2 | 10 | 4 | **15** | 149 | 19 | **168** | **219** |
| 2014 | 19 | 10 | 3 | **31** | 7 | 8 | 10 | **25** | 126 | 22 | **149** | **205** |
| 2015 Expected | 12 | 7 | 3 | **22** | 9 | 12 | 6 | **27** | 127 | 20 | **148** | **196** |
| 2016 Forecast | 15 | 6 | 2 | **23** | 9 | 11 | 7 | **27** | 125 | 21 | **146** | **196** |
| 2016 vs. 2015 | +25% | -8% | -33% | **+7%** | +0% | -8% | +17% | **+0%** | -2% | +4% | **-1%** | **-0%** |

*Source: SG CIB Analytics, Dealogic*

## DCM (in addition)

| | CNH | RUB |
|---|---|---|
| In USD bn equivalent | ALL | ALL |
| 2012 | 44 | 32 |
| 2013 | 61 | 45 |
| 2014 | 85 | 22 |
| 2015 Expected | 45 | 25 |
| 2016 Forecast | 40 | 27 |
| 2016 vs. 2015 | -11% | +8% |

*Source: SG CIB Analytics, Dealogic*

| | ASIAN supply | CEEMEA supply |
|---|---|---|
| In USD bn equivalent | ALL * | ALL |
| 2012 | 152 | 166 |
| 2013 | 156 | 176 |
| 2014 | 240 | 136 |
| 2015 Expected | 190 | 85 |
| 2016 Forecast | 200 | 100 |
| 2016 vs. 2015 | +5% | +18% |

* *All International Public Issuance. Asia ex-Japan and Australia/New Zealand*

*Source: SG CIB Analytics, Dealogic*

## Syndicated Loan issuance volumes in USD bn equivalent

| | EMEA Loans | | Americas Loans | Asia Pacific Loans | Total |
|---|---|---|---|---|---|
| In USD bn equivalent | Investment Grade | Total | Total | Total | Syndicated Loans |
| 2012 | 570 | **791** | **1,937** | **749** | **3,476** |
| 2013 | 697 | **1,056** | **2,510** | **779** | **4,345** |
| 2014 | 892 | **1,293** | **2,141** | **795** | **4,229** |
| 2015 Expected | 700 | **1,050** | **1,825** | **691** | **3,566** |
| 2016 Forecast | 700 | **1,100** | **1,775** | **750** | **3,625** |
| 2016 vs. 2015 | +0% | **+5%** | **-3%** | **+9%** | **+2%** |

*Source: SG CIB Analytics, Dealogic*

PLEASE NOTE THAT ALL DATA ARE EXPORTED AS OF OCTOBER 30TH 2015

# Debt Capital Markets

## Corporates

- On both sides of the Atlantic, high redemption levels and strong M&A activity provided favourable grounds for significant primary volumes in 2015, despite market conditions affected by several macro-economic events, such as Greece's debt crisis, China's economic slowdown and falling commodity prices. Total volumes of issuance in the EUR, USD and GBP investment grade markets are expected to reach EUR 950bn eq. in 2015 year-end, above the record levels of 2014 and 2013.
- The increase in the competitiveness of credit spreads in euros versus dollars attracted a larger number of US issuers in the EUR market this year. In the meantime, USD global issuance volumes have been fuelled by strong M&A activity. The sterling market has been significantly less competitive, with borrowers focusing on price printing almost entirely in euros and dollars.
- Despite a volatile environment, hybrid issuance was again strong in 2015, with investor demand remaining supportive for this increasingly standardised instrument. Hybrid volumes were driven by M&A activity, but also by the replacement of existing hybrids issued between 2005 and 2010. Indeed, 30% of 2015 hybrid supply were used to finance upcoming calls on hybrid instruments. In addition, we saw some opportunistic issuances made in the context of challenging economic environment, such as Total to support its balance sheet in a volatile oil price context, or Bertelsmann to mitigate the impact of low rates increasing its pension deficit on balance sheet.
- Despite a record breaking start to the year which included healthy issuance levels and sizeable inflows into the asset class, the high yield market came under pressure with extended periods of volatility from Q2 onwards. As a result, primary issuance volumes dropped significantly in both Europe and the US versus 2014 despite a pick-up in M&A activity and default rates remaining very low. 2015 has been a year marked by (i) a "flight-to-quality" and preference for stronger credits and geographies, (ii) growing liquidity premium for inaugural and smaller / illiquid deals and (iii) increased competition from cov-lite loans.
- Finally, we saw a significant rise in corporate liability management transactions this year, as issuers continued to take advantage of low-interest rates to refinance their upcoming redemptions. Booming M&A activity also contributed to a large number of cash tender offers, notably the Lafarge-Holcim tender offer which was the largest ever LM exercise by a European corporate. There were also some mega LM transactions coming from the US, including General Electric's exchange offer on 123 notes totalling USD 110.4bn and HP Enterprise's refinancing of 15 bonds totalling USD 15.3bn.

## Investment Grade

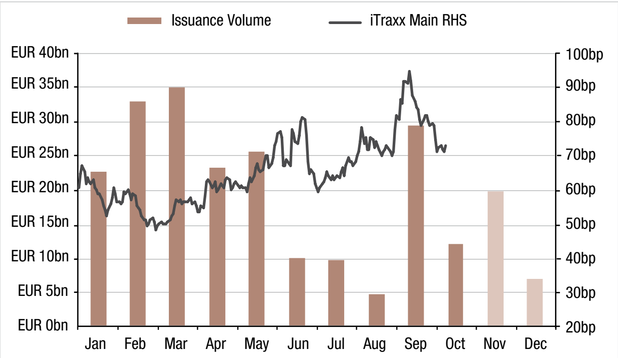
### EUR MARKET

#### 2015 review

- After the 2014 record year, the EUR investment grade (IG) senior corporate market demonstrated its strength again this year with expected EUR 230bn at 2015 year-end (vs. EUR 222bn issued in 2014). Following a record first half-year in terms of volumes (EUR 147bn issued), issuance lost pace during the second half-year on the back of macro-economic concerns, creating volatility in markets, as seen with the iTraxx Main which has widened by 20% between January 2015 and September 2015.
- With EUR 90bn issued on the IG market, Q1 2015 represented the second best start to the year on record after 2009 which saw EUR 115bn issued during the same period. EUR primary volumes benefited from extremely favourable market conditions on the back of the expanded asset purchase programme launched by the ECB in January. Volumes have also been supported by the strong participation of US corporates which have taken advantage of arbitrage opportunities in the EUR market. Despite a brisk issuance pace, new supply has been absorbed well by the markets, and issuers managed to issue large amounts while conceding very low new issue premiums.
- Following a heavy start to the year, with primary supply running ahead of 2014, EUR primary activity slowed down as a result of Greece's debt repayment concerns which started mid-April and lasted until a debt resolution was reached on 13 July. These concerns brought uncertainties to the markets and forced numerous corporates to postpone their transactions until after the summer break.
- Primary activity slowed down again in July and August (EUR 14bn vs. EUR 17bn in 2014) due to renewed concerns surrounding global economic growth following China's poor economic data and falling commodity prices.

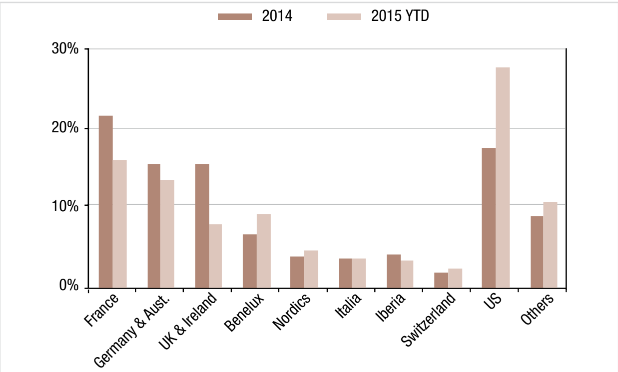
- Credit spreads widened dramatically in September on the back of oil and gas sector turmoil and with the surge of corporate credit risk in Europe following the Volkswagen fraud and worries about Glencore's financial health. However, almost EUR 29bn were issued by investment grade corporates in September (in line with EUR 30bn issued last year).
- Primary activity remained low in October despite improving market conditions with spreads tightening marginally. EUR 12bn were issued in October 2015 vs. EUR 16bn in October 2014.
- Most issuance in 2015 came from the auto and utility sectors with EUR 27bn and EUR 24bn issued respectively and on the long end of the curve (36% had a maturity of at least 10 years) where investors could find higher yields.
- On the back of a more volatile environment, New Issue Premiums (NIP) significantly increased over the year from 7 bps on average in Q1 to 11 bps in Q2 and 18 bps in Q3. In the meantime, oversubscription ratios were around 3.5x on average in 2015 vs. 4x in 2014. We saw a divergence of NIP levels between highly rated and lower rated issuers, especially during the second half of the year, illustrating the risk-off mode of many investors.

**Despite macro-economic concerns, we saw strong volumes in the EUR market in 2015 (Nov. and Dec. forecasts)**




*Source: SG CIB Analytics, Bloomberg.*

**EUR corporate volumes have been supported by US corporate issuers in 2015**




*Source: SG CIB Analytics, Bloomberg.*

## Regional focus

### Western Europe

- Western European borrowers accounted for 61% of total EUR IG issues in 2015, a significant decrease from the 79% levels in 2014 in favour of US issuers.
- BMW was the biggest European borrower with EUR 6.85bn issued in 2015 year-to-date followed by Volkswagen with EUR 5.91bn. Total was the largest issuer in the hybrid capital format in 2015 year-to-date with EUR 5bn raised across two tranches.
- In Western Europe, France and Germany remain the largest providers of primary volumes, with 28% and 23% respectively. The UK and Ireland made up 14% of volumes, southern European issuers 12% and the Nordics 8%.

### Americas

- Issuers from the Americas played a major role in the euro IG corporate market this year, representing around 28% of overall supply vs. 14% in 2014.
- We saw large American blue chips coming on the EUR market to take advantage of arbitrage opportunities especially on the long end of the curve. In particular Coca-Cola issued a EUR 8.5bn five-tranche transaction with longer tranches due in 12 and 20 years achieving tighter relative levels post-swap than direct USD funding.
- Several transactions were carried out in conjunction with USD offerings such as Danaher refinancing the acquisition of Pall for USD 13.8bn (EUR 12bn) by issuing EUR 2.7bn on EUR market in July and USD 2bn transaction in September or General Electric coming with a EUR 3.15bn deal in May following a USD 4.5bn transaction realised in January.
- In terms of deal size, Coca-Cola priced the second largest EUR corporate bond deal ever in February with a EUR 8.5bn five-tranche transaction. General Electric came with a EUR 3.15bn deal in May across three tranches.

**Four US issuers among the ten largest EUR IG corporate deals in 2015**

| Issue date | Issuer | Country | Ratings at launch | Deal value | Tranches | Type |
|---|---|---|---|---|---|---|
| 26-Feb-15 | Coca-Cola | USA | Aa3/AA | 8,500 | 5 | Senior |
| 19-Feb-15 | Total | France | Aa3/A+ | 5,000 | 2 | Hybrid |
| 10-Sep-15 | Shell | Netherlands | Aa1/AA- | 3,450 | 3 | Senior |
| 10-Feb-15 | Statoil | Norway | Aa2/AA- | 3,250 | 3 | Senior |
| 20-May-15 | General Electric | USA | A1/AA+ | 3,150 | 3 | Senior |
| 10-Mar-15 | British American Tobacco | UK | A3/A- | 3,000 | 4 | Senior |
| 05-Mar-15 | Berkshire Hathaway | USA | Aa2/AA | 3,000 | 3 | Senior |
| 24-Jun-15 | Capgemini | France | NR/BBB | 2,750 | 3 | Senior |
| 01-Jul-15 | Danaher | USA | A2/A+ | 2,700 | 4 | Senior |
| 17-Mar-15 | Volkswagen | Germany | Baa1/NR | 2,500 | 2 | Hybrid |

*Source: SG CIB Analytics, Bloomberg.*

## 2016 forecast

- SG CIB expects EUR 215bn in new IG corporate supply in 2016, 6.5% below 2015 volumes. We expect the evolution of the EUR/USD basis swap to be less supportive for US issuers looking to tap the EUR market.

## USD MARKET

### 2015 review

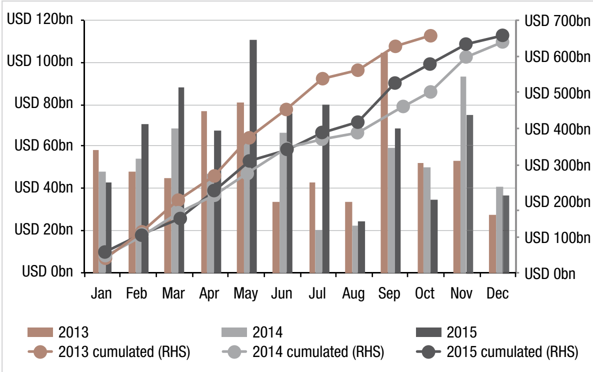
- The IG corporate market has again been very dynamic in 2015, reaching a record USD 663bn issued year-to-date, and an estimated USD 775bn at the close of 2015, i.e. USD 131bn more than in 2014.
- During the first half of the year, primary supply was ahead of 2014, making for the best first half-year on record, with almost USD 455bn issued (vs. USD 348bn in 2014 during the same period). Volumes were fuelled by very attractive market conditions following the Fed's decision not to hike rates in January.
- As illustrated by HJ Heinz's USD 10bn bond multi-tranche transaction issued in June to partially refinance its USD 46bn merger with Kraft Foods, M&A-driven deals represented a significant amount of new supply in 2015.
- IG corporate issuance reached USD 80bn in July, almost four times more than in July 2014 thanks to three jumbo transactions realised by Charter Communication, CVS and UnitedHealth Group raising USD 15.5bn, USD 15bn and USD 10.5bn respectively. August issuance returned to levels more in line with historic standards, with USD 24bn raised by IG corporates compared to USD 22bn in August 2014.
- In the jumbo size category, not less than 14 deals with a size of USD 10bn or more have been launched, versus only 3 in 2014 and in 2013. The largest trades by size were priced in the first half of the year with Actavis (USD 21bn), AT&T (USD 17.5bn), AbbVie (USD 16.7bn), and Charter Communications (USD 15.5bn).
- During the second half of the year, primary activity slightly slowed down on the back of poor economic data from China, combined with falling commodity prices and volatility on the equity side due to worsening growth prospects around the world. However, the USD market remained very active in September, with USD 68bn raised by IG corporates vs. USD 59bn in September 2014. Activity has been supported by many multi-tranche transactions, including HP Enterprise's 9-tranche jumbo deal totalling USD 14.6bn.

**Top ten largest USD IG corporate deals in 2015**

| Issue date | Issuer | Country | Ratings at launch | Deal value | Tranches |
|---|---|---|---|---|---|
| 03-Mar-15 | Actavis Funding Scs | USA | Baa3/BBB- | 21,000 | 10 |
| 23-Apr-15 | AT&T | USA | Baa1/BBB+ | 17,500 | 6 |
| 05-May-15 | AbbVie | USA | Baa1/A | 16,700 | 6 |
| 09-Jul-15 | Charter Communications | USA | Ba1/BBB- | 15,500 | 6 |
| 13-Jul-15 | CVS | USA | Ba1/BBB+ | 15,000 | 6 |
| 30-Sep-15 | HP Enterprise | USA | Baa2/BBB | 14,600 | 9 |
| 09-Feb-15 | Microsoft | USA | Aaa/AAA | 10,750 | 6 |
| 20-Jul-15 | UnitedHealth Group | USA | A3/A+ | 10,500 | 8 |
| 09-Sep-15 | Gilead Sciences | USA | A3/A- | 10,000 | 6 |
| 23-Jun-15 | HJ Heinz | USA | Baa3/BBB- | 10,000 | 7 |

*Source: SG CIB Analytics, Bloomberg.*

**Monthly breakdown of USD IG supply volumes in 2013-2015 (Nov. and Dec. forecasts)**




*Source: SG CIB Analytics, Bloomberg.*

## Regional focus

### Western Europe

- European issuers accounted for 8% (approximately USD 30bn) of total volumes issued in the IG USD corporate space in 2015 year-to-date, versus 10% (approximately USD 51bn) in 2014 over the same period.
- EDF executed the biggest transaction from that region in 2015 year-to-date through a USD 4.75bn bond across five tranches, including the biggest 10-year green bond issued by a corporate and the biggest 40-year bond issued by a European company in the history of US markets.

### Americas

- The dynamics of Americas issuers in the USD market remained much the same as in 2014, contributing 83% of all USD volume compared to 80% last year.
- Among the top 10 trades this year, all were carried out by US issuers.

## 2016 forecast

- Societe Generale expects a 6% decrease in USD IG corporate supply in 2016, compared to USD 725bn in 2015.
- One of the main factors should be the Fed's rate hike expected in 2016. With higher interest rates, the USD bond market will be less attractive to opportunistic issuers who came to take advantage of historically low borrowing costs. Moreover, in terms of tenor distribution we expect a minor rebalancing from 2015 marginally in favour of shorter vs. longer bonds, as increased rates should naturally allow investors to increase their short-term exposure.

### GBP MARKET

#### 2015 review

- The sterling market was fairly quiet this year, with pricing dynamics generally less favourable compared to other currencies. Volumes were lower than last year with an estimated GBP 12bn at the close of 2015 vs. GBP 18.5bn in 2014, confirming a downward trend since the record GBP 33bn issued in 2012.
- Primary activity remained very slow during the first half of the year with only 16 trades representing 36% of expected annual volumes. Issuance then gradually gathered pace during the second half of the year, especially in July and October with GBP 2.6bn and GBP 1.3bn issued respectively.
- The hybrid market remained open with three deals in 2015, often complementing a multicurrency hybrid issuance. SSE, Centrica and BHP Billiton Finance brought a combined total of GBP 1.8bn in hybrid bonds to the market.
- In senior issues, we noticed a decrease in long dated issuance, such as 20/30-year and +30-year tenors, in favour of 5/7-year tenors (33% in 2015 vs. 23 in 2014) and 10-year tenors (20.1% in 2015 vs. 3.1% in 2014).
- UK (52%) and US (23%) issuers were the largest providers of primary volumes, followed by Germany/Austria (12%) and Australia (9%). French issuers represent 2% of GBP primary volume (vs. 26% last year) with only one deal this year coming from Total with a GBP 250m 7-year at UKT+68 bps launched in June tapping the GBP market for the third time in two years.

#### 2016 forecast

- SG CIB expects to see GBP 15bn issued in the IG corporate GBP market in 2016, a slight increase on GBP 12bn expected at 2015 year-end.

## High Yield

### 2015 European market overview

#### January - April 2015

- Over the first four months of the year, the European high yield (HY) market was particularly busy with high levels of primary issuance, coupled with strong investor appetite and large inflows into the asset class. This issuer-friendly start to 2015 was fuelled by the commencement of ECB Quantitative Easing (QE) programme which compressed spreads across all European credit markets. In total 85 issuers accessed the market for proceeds of EUR 57bn eq. (up 14% on the same period in 2014). This bright start was further reinforced by the return of secondary inflows, totalling EUR 8bn into the asset class in the first four months of the year compared to EUR 4bn for the full-year 2014. QE maintained a strong technical backdrop pushing HY indices tighter and the 10-year Bund yield to a record low level of 0.075% on 20 April versus 0.541% at the start of the year.

#### May - June 2015

- The European HY market came under pressure for more than two months starting in May with a two-week bund sell-off combined with renewed concerns around Greece. Credit spreads widened and the level of HY issuance dramatically reduced with EUR 10bn of paper issued in 22 transactions in May and June versus EUR 27bn in 55 transactions over the same period in the prior year. After the increase in benchmark rates over the first two weeks of May, the 10-year Bund yield reached 0.981% on 10 June, its highest level in 2015 year-to-date and 90 bps wider than its record lows seen 51 days before. In addition, tensions building between Greece and its creditors and increasing uncertainty over the future of Greece in the Eurozone continued to hang over the HY market.

#### Early/Mid-July 2015

- Market conditions became even more volatile at the end of June off the back of the Greek referendum, the introduction of capital controls and with European leaders unable to reach a deal with Greece. As a result, not a single issuer accessed the European HY market between 26 June and 20 July as issuers remained sidelined. Investors were in risk-off mode and cautiousness remained the watchword in the market.

#### Late July 2015

- After Greece reached a deal with its creditors, the HY market experienced an exceptional but brief spike in primary activity ahead of the usual summer lull. The week starting 20 July was the busiest week ever in HY in terms of number of deals with 17 transactions pricing for total proceeds of EUR 9bn as people attempted to shift the backlog of transactions prior to the traditional summer break.

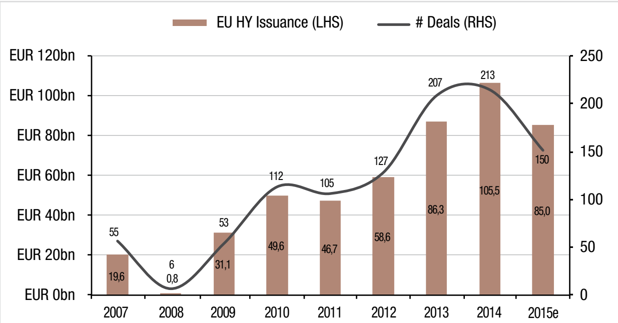
#### September - October 2015

- The usual summer hiatus in August was followed by a period of intense market volatility at the end of the month. The end of August saw the largest weekly outflow on record of EUR 1.04bn. In September and October, bond markets were shaken by investors' concerns over global growth, China's economy and the unexpected Yuan devaluation, sharp falls in US equities and uncertainty around the timing of a rate rise and the continued fall in commodity prices. As a result, 9 transactions priced over the two months for total proceeds of EUR 3.6bn.

## Full-year 2015

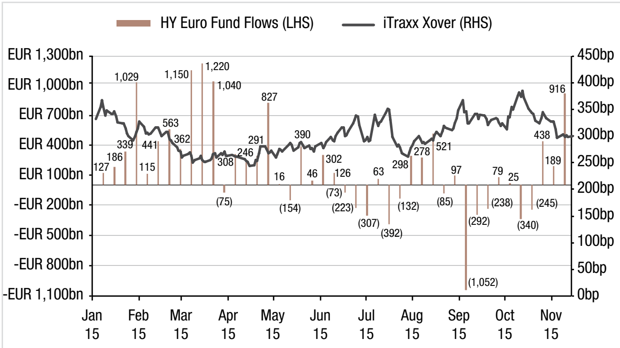
- The HY market firmed up in mid- to late-October and market participants expect to see stronger rated credits/ repeat issuers testing investor sentiment and pave the way for less well-known HY names to access bond markets. For the remainder of the year, issuers able to pay the new issue premium required by investors will be able to access the market. Potentially punitive liquidity premiums have driven away mid-cap first-time issuers, with some issuers being forced to pull transactions, as pricing offered by the market was much higher than initial expectations. In addition, some bridge financings written earlier in the year are expected to be taken out before year-end. Volumes in Europe are expected to be down 20% year-on-year unless a credit rally unexpectedly boosts issuance levels. All in all, 2015 is a year marked by periods of volatility and the rise of new issue liquidity premium after a bullish first few months.

**High-yield volume trends (Europe: all currencies)**




*Source: Capital Structure, Bloomberg.*

**Year-to-date high-yield fund flows and CDS index (Europe)**




*Source: JP Morgan, Bloomberg.*

## Key themes

### Market dominated by BB-rated credits and repeat issuers:

- The HY primary market was dominated by BB-rated credits and repeat issuers in 2015 year-to-date, with limited single-B or debut issuers. BB credits represented 55% of total supply in 2015 year-to-date versus 40% for the full-year 2014. There was a "flight-to-quality" with investors becoming increasingly cautious and selective during periods of volatility. Stronger credits were able to take advantage of periodic stronger market windows that have opened during the year.

### Renewed interest in EUR-denominated issues from US-based issuers:

- The year 2015 has seen a renewed interest in EUR-denominated issues from US-based issuers, with fourteen transactions for total proceeds of EUR 6bn in 2015 year-to-date compared to EUR 2bn in six transactions for the full-year 2014. US issuers have taken advantage of cheap financing costs in Europe mostly for refinancing purposes.

### More competition from cov-lite loans:

- Private Equity sponsors have displayed a preference for senior secured cov-lite loans versus senior secured bonds with high yield bonds being used in a more traditional their "unsecured/subordinated" form alongside senior secured loans. Cov-lite loans remain an attractive alternative to HY bonds both in terms of pricing and by offering flexibility in terms of documentation and non-call features. We expect the prominence of cov-lite loans to remain popular with investors and provide a substitute to the bond option in 2016.

### Primary activity concentrated on "core countries":

- In a more volatile context, investors have been focusing on safer and "stronger" countries. As part of the "flight-to-quality" discussed above, investors have tried to limit their exposure to riskier credits by concentrating on traditional core countries with France (22% of total supply), UK (19%) and Germany (17%) representing 58% of total supply in 2015 year-to-date (vs. 51% in full-year 2014). This focus on stronger countries was made at the expense of periphery and CEE issuers, with Italy and Iberia representing 12% of total supply (vs. 19% in 2014) and CEE issuers representing 0.4% (vs. 2.1% in 2014).

### Pick-up in M&A activity:

- As a percentage of the total supply, deals backing acquisitions picked up in 2015 year-to-date representing 39% of the market vs. 13% in 2014. The surge in M&A activity is mostly due to further consolidation in the European TMT market as well as an increasing number of bond-financed bolt-on acquisitions.

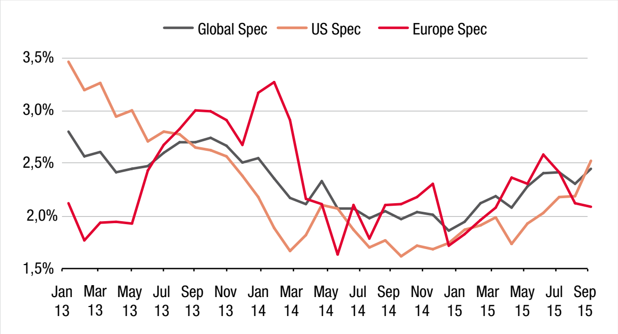
### Liquidity premium:

- The liquidity premium required by investors was fatal to several issuers this year, with seven deals withdrawn so far in 2015. Most of the pulled deals year-to-date were small in size, and potential pricing came far wide of issuers' expectations. This compares to only three deals postponed in all of 2014. In addition, the HY market hosted fewer debut issuers in 2015 year-to-date with 18 inaugural credits in the market compared to 70 in 2014. Many first-time issuers were unwilling to pay the required new issue premium and remained sidelined this year to wait for more conducive market conditions.

### Low default rates:

- Default rates continue to remain at low levels which, combined with low benchmark rates, fuels investors' search for yield down the credit curve. Nevertheless, the global trend indicates that default rates are currently creeping up gently, as per graph below.

**Trailing 12-Month Issuer-Weighted Speculative Grade Default Rate**




*Source: Moody's.*

## Noteworthy issues of 2015

- **Altice / Portugal Telecom:** On 30 January, Altice S.A. was in the market with EUR 1.3bn eq. of 10-year (non-call 5), unsecured notes in euros and dollars, rated B3/B. The USD 1,480m notes came out at 7.625% (T+596 bps) while the EUR 2.1bn notes priced at par to yield 6.250% (B+592 bps), both at the tight end of guidance. Simultaneously, Altice International was also in the market with a EUR 2.7bn eq. three-part bond offering. The USD 2,060m 8NC3 secured notes (rated B1/BB-) came out at 6.625% (T+506 bps) while the USD 385m 10NC5 unsecured notes (rated B3/B-) priced at par to yield 7.625% (T+596 bps), both at the tight end of guidance. The EUR 500m 8NC3 secured notes (rated B1/BB-) came out at 5.250% (B+509 bps), tight end of guidance. Proceeds from the two bond offerings, along with a EUR 840m cross-border loan package and drawings under a new EUR 330m revolving credit facility, were used to fund the purchase of the Portuguese assets of Portugal Telecom from Oi for EUR 7.4bn.
- **Faurecia:** On 9 March, placed EUR 500m of 7-year (non-call 3) unsecured notes on 10 March, rated B1/BB, at par to yield 3.125% (B+316 bps) and came at the tight end of guidance. The proceeds were used to refinance the 8.750% unsecured notes due 2019 through a make-whole call as well as some short-term debt (EUR 224m). Three weeks later, the company placed fungible EUR 200m add-on to its recently issued 3.125% notes at 100.125 to yield 3.106%, tight end of guidance. Proceeds from the offering were used to refinance its short term debt.
- **Verallia:** On 24 July, Verallia priced a downsized EUR 525m dual-tranche bond offering (vs. the initially proposed EUR 860m eq. three-part offering), comprising a EUR 300m tranche of 7-year (non-call 3), B+/B1 rated, secured notes at par to yield 5.125%, tight end of guidance, and EUR 225m of 8-year (non-call 3), B-/B3 rated, unsecured notes at par to yield 7.250%, tight end of guidance. Proceeds, along with an upsized EUR 1,340m 7-year cov-lite Term Loan B, were used to finance the buyout by Apollo Global Management.

### Americas

- The US HY primary market had a very strong start to the year in 2015 with USD 164bn of bonds priced through May (up 9% versus the same period last year) and some of the largest monthly volumes ever recorded. The flurry of issuance came amid strong investor appetite for the asset class as evidenced by large inflows into US HY funds (USD 8bn net inflows through May with a peak of USD 11bn in April) and solid returns in secondary (4.18% as of 31 May 2015). However, the primary activity has slowed down significantly since the summer as market conditions deteriorated on the back of falling commodity prices, ongoing concerns over global growth and uncertainty around the Fed's rate hike timing. As of 26 October 2015, only USD 43bn of bonds had priced since July, the lowest 4-month volume since the first quarter of 2009, bringing the year-to-date issuance to USD 228bn (down 15% versus the same period last year). HY funds witnessed large redemptions from June to early October with USD 8bn leaving the asset class while the HY index widened by as much as 200 bps from the tights reached in May to reach all-time highs. The market sentiment improved in the second half of October, with secondary yields tightening by ca. 50 bps and the return of very large inflows, as weaker European and US macro data renewed hopes for extended central bank stimulus

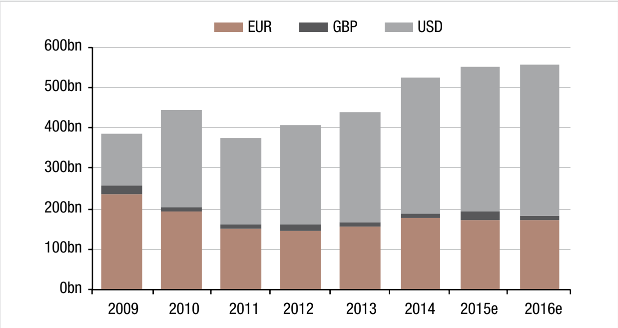
## 2016 forecast

- It is expected that the European market will remain broadly unchanged in terms of volumes next year and will continue to be dominated by stronger credits and well-known issuers. The HY market is expected to open brightly next year as a large number of issuers who had hoped to issue this year continue to monitor the market and postpone deals to 2016. We expect the potential unveiling of further quantitative easing from the ECB (including scope for "QE2") to have a positive impact on credit markets. Activity from the Metals & Mining (M&M) and Oil & Gas (O&G) space is expected to reflect the current uncertain market outlook with low commodity prices. The HY primary market should benefit from:
  - (i) the improving macroeconomic picture in Europe that should drive additional investments,
  - (ii) refinancing transactions driven by the end of the non-call period for 7NC3 deals issued in 2012 and 2013, and
  - (iii) M&A activity that should remain active, as main sectors are currently consolidating in Europe.
- In the USD market, the general trend is expected to follow lower issuance volumes, and refinancings are expected to represent a much lower proportion of total supply than in full-year 2015 (projected 45%). M&A is expected to pick up, notably in the Exploration & Production (E&P) space. The general market context will remain anxious, with focus around rate rises, net outflows from the asset class, volatility and record low O&G and commodity prices. It is therefore hard to imagine a full-year 2016 higher than full-year 2015 in terms of volumes.
- Our volume projections for 2016 in which we expect to reach
  - (i) EUR 55bn in EUR-only issuance, flat from a projected EUR 55bn for full-year 2015,
  - (ii) GBP 6bn in GBP-only issuance, down from a projected GBP 7bn in full-year 2015, and
  - (iii) USD 240bn in USD-only issuance, down from a projected USD 265bn for full-year 2015.

# Financial Institutions

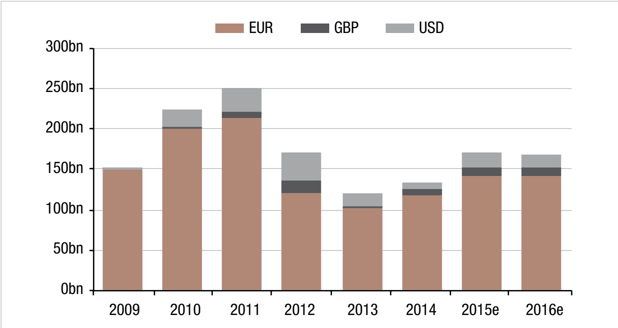
- This year the European Central Bank (ECB) continued to support the market with unconventional measures that have not, however, had a positive impact on all asset classes.
- Financial institutions experienced two contrasted periods this year:
  - The first half of the year was dominated by senior unsecured demand, as covered bond spreads reached all-time lows with the ECB's accommodative policies and senior secondary levels remaining stable
  - As senior spreads widened more towards Tier 2 in the midst of capital strengthening implementation, covered bond supply took up owing to heavy support from central banks.
- Despite these supportive actions, the market was volatile on the whole, which led to risk adverse attitudes both from issuers and investors. Indeed, currency split remained in line with that of last year and tenor preferences were skewed towards the short-end of the curve.

**Senior unsecured volumes: continue to expand despite slight contraction in EUR**




*Source: SG CIB Analytics, Dealogic – all issuers, amount > EUR 250m eq., maturity > 18 months.*

**Covered bond volumes fully supported by growing EUR activity**




*Source: SG CIB Analytics, Dealogic – all issuers, amount > EUR 250m eq., maturity > 18 months.*

## Senior unsecured market

### EUR MARKET

#### 2015 review

While 2015 was decisive for the Eurogroup's survival and volatility spread across the market amid fears of a potential Greek default and "Grexit", credit enjoyed the support of the ECB.

Although the targeted long-term refinancing operation (TLTRO) has globally reduced senior unsecured issued volume (-3% year-on-year with a volume of EUR 175bn expected by year-end), it did not bring the expected spread tightening. The scarcity effect did not overcome the perception of senior unsecured being increasingly risky. Senior unsecured spreads have been widening throughout 2015 with the introduction of bail-in regulation in a number of jurisdictions. However this spread widening did not stop the senior unsecured market from being very active in Q1 2015, ahead of the extended asset purchase programme (EAPP or also referred to as quantitative easing "QE") launched by the ECB in March. The further support given by central banks to the covered bond market benefited the senior unsecured market in H1 2015, as spreads tightened considerably throughout the period and were considered too expensive by many investors.

- Compared to 2013 and 2014, preferred tenors were on the short or long end of the curve. Most of the supply was distributed on the very short end of the curve, with 43% of the total EUR senior unsecured volume issued in the 18-month to 3-year tenor range. The 10-year maturity saw a 39% increase in volume year-on-year, representing 10% of the 2015 EUR senior unsecured volume in 2015. Other classic tenor choices such as the 5- and 7-year were also favoured.
- The split in terms of jurisdictions was more balanced than previous years. On the one hand, French, German/Austrian, Nordic, Benelux and British supplies remained more or less at the same levels. On the other hand, southern Europe, North America and Asia Pacific changed stance.
- After a stable period in Q4 2014, the tightening trend of the iBoxx senior index which had started mid-2012 ended. The pressure of looming insolvency laws pushed spreads wider, and the iBoxx banks senior index rose by 30 bps.

#### Regional focus

##### Western Europe

- Western European issuers represented 74% of total EUR senior unsecured supply with a volume of ca. EUR 122bn (vs. EUR 138bn in 2014), the lowest since 2009. Following the same trend seen in 2014, French supply remained subdued with EUR 22bn (vs. EUR 43bn in 2013). Major changes came from southern Europe where the cheap source of funding provided by the TLTRO and the support in the covered bond market considerably reduced the region's activity in the senior unsecured space. From representing 27% of the overall senior primary supply in 2014, peripheral issues represented 18% (i.e. EUR 23bn) in 2015.

### North America

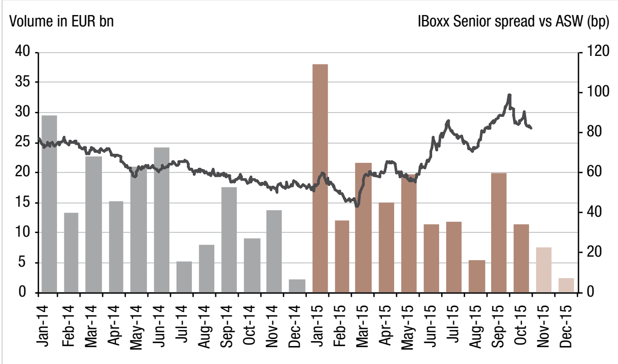
- After Western Europe, North America was the second most active region in the EUR senior unsecured market this year. Although the issued volumes have only slightly increased from 2014 to 2015 in absolute terms (from EUR 30bn to EUR 31bn), it continuously represents a larger part of the overall supply (from 10% in 2013 to 17% and 19% in 2014 and 2015 respectively).

## 2016 forecast

This year, financial institutions' funding will sit under their 2015 EUR senior unsecured redemptions (EUR 211bn redemptions vs. EUR 175bn funding expected by year-end). Despite high redemption, the ECB's accommodative measures in other asset classes impacted the senior primary market. Likewise, we expect that next year's EUR 164bn redemptions will not be sufficient to fully support the primary activity, and that the slight mismatch observed in 2015 will help bring the volume to an estimated amount of ca. EUR 170bn.

- We expect the ECB to continue its dovish stance should the euro area show signs of contagion from China or the inflation outlook weaken further. An announcement to extend the purchase programme and TLTROs beyond September 2016 could be considered, which would put further pressure on the senior unsecured primary market.
- The changes in national insolvency laws in some countries of the European Union, which are expected to become applicable in 2016, will be an additional challenge for this asset class. Germany, Spain, France and Italy have interpreted the transposition of the Bank Recovery and Resolution Directive (BRRD) by ranking different instruments in insolvency, some including senior bonds in the Total Loss-Absorbing Capacity (TLAC) scope. We expect more countries to look into the BRRD transposition, putting at risk senior unsecured debt for bail-in. The perception of a senior unsecured bond could therefore shift towards a Tier 2-like instrument and continue to widen the segment's secondary levels further. Depending on this spread widening, issuers might see the benefit of choosing a subordinated instrument instead.

**Wider spreads from Q2 onwards weighted on primary issuances**




*Source: SG CIB Analytics, Markit iBoxx, Dealogic – all issuers, amount > EUR 250m eq., maturity > 18 months.*

## USD MARKET

### 2015 review

For the first time since 2011, USD senior primary volume is expected to drop by 8% year-on-year to USD 415bn. Nevertheless, among EUR and GBP primary issuances, it remained the preferred currency on the senior unsecured primary market this year (69% for USD vs. 29% for EUR and 2% for GBP). Indeed, USD has increasingly been dominating the primary senior space since 2010 when USD took up over half of the senior market.

- US issuers continue to supply the bulk of USD, making up 56% of the USD primary market. However the USD market is more diversified than the EUR market, with Western Europe and APAC issuers sharing 41% of the supply.
- The supply was split between 3-, 5- and 10-year tenors which represented 83% of the USD primary market. Unlike on the EUR market, the 7-year maturity accounted for very little supply (3%).
- While volume issued on the short end of the curve (3/5Y) remained stable, activity for the 10-year tenor and above continued to rise. USD 69bn of 10-year transactions were issued this year as well as a few unusual maturities such as 12-, 20-, 29-, 30-, 40- and 50-year transactions totalling USD 25bn. Although a niche, the 30-year tenor's proportion remained the same as in 2014 with a USD 18bn volume.
- After a first quarter of tightening on the secondary side, the iBoxx USD Financials index reflected the widening trend from March onwards. The year started at 118 bps, reached a low point in early March at 102 bps, and now sits at 182 bps.

## Regional focus

### Western Europe

- Western Europe issued 23% of USD senior primary in 2015, slightly above 2014 levels. On the whole, senior funding in USD is favoured by Western European issuers over other asset classes in USD.
- This EUR 93bn volume was less balanced than last year, as both UK and Swiss issuers increased their share from 5% in 2014 to 7% in 2015. French and German supply dropped from 3% to 1%, as they remained active in the subordinated USD space as well.

### North America

- 2015 volumes remained in line with 2014, with no come back from Canadian issuers in this segment (2014 had seen Canadians flee to cheaper CAD funding). North American supply represented USD 224bn (56% of the overall USD senior issuance).
- The attractive EUR/USD basis swap continued to push US domestic and Yankee issuers towards more currency diversified funding, with 85% of their senior funding executed in the USD space in 2015 (vs. 91% in 2013).

## 2016 forecast

Following a period of continuous growth since 2011 that peaked in 2014, volumes scaled down in 2015. However, as in 2015, we expect 2016 primary USD senior unsecured volumes to exceed the year's redemptions and a slight rebound of primary activity is expected in 2016. Our forecasts anticipate a 3% upsize of this market in 2016 compared to 2015, to USD 428bn.

- The Fed's decision to report its first rate hike will bring volatility to the USD market in 2016. However, this situation would occur in a positive global economy, thus volatility should remain contained.
- Apart from European issuers benefiting from the ECB's accommodative policies, primary issuances in other regions should remain in line with last year's. Emerging countries should also take advantage of the wide US investor base, increasing their share on this market.
- The slight rebound could come from larger funding needs as the US domestic financial Merger and Acquisition space could reopen in 2016.

# GBP MARKET

## 2015 review

After years of declining activity, the sterling senior unsecured segment exceeded the 2010 levels with GBP 12bn expected by year-end (+44% vs. 2014). It is one of the only currency showing a year-on-year increase on the senior unsecured primary market.

- Although making up the bulk of the GBP supply, UK issuers' share was smaller than previous years', holding only 30% of the GBP primary market (vs. 44% in 2014).
- This year the tenor preference was split between the short end of the curve (3-year) and the 7-year tenor, the longest part of the GBP curve, each with 33% of the annual GBP primary market. The 7-year maturity gathered ca. GPB 4bn, stepping up from its 2014 volume of GBP 1bn (15%). On the longer end, 10-year transactions and other long-dated bonds disappeared, except for a sole 27-year deal. The 5-year maturity remain praised with 21% of the market.
- The iBoxx GBP Financials index followed the same pattern as the USD index, with a tightening Q1 and a constant widening throughout the rest of the year. GBP spreads stayed almost continuously 5-10 bps above USD spreads.

## Regional focus

### Western Europe

- The domestic UK supply accounted for 30% of the market, leaving 32% to other Western European issuers. This greatly contrasts with 2014 figures where the rest of Europe only shared 10% of the GBP issuances. The bulk of the volume was brought by Nordics (Nordea Bank and Pohjola Bank), after a gap year with no issue in 2014. Credit Suisse and Rabobank were also active on this currency with 6% and 8% of the market respectively.

### North America

- Northern American supply continued to grow on the GBP market (26% in 2015 vs. 20% in 2014 and 10% in 2013). However this share represented only 5 transactions, out of which 4 were above the benchmark size of GBP 500m.

## 2016 forecast

Because of the "Brexit" debate that has been looming over the UK economy in 2015, and will continue in 2016 as a referendum is planned for end-2017, the sterling market is losing its appeal to foreign issuers. The limited GBP investor base, coupled with political uncertainties, makes us think that the segment will remain a niche where supply is opportunistic. As in the EUR senior unsecured market, the primary volumes are expected to shrink in 2016 to GBP 11bn (-8% vs. the 2015 expected volume by year end).

# Covered bond market

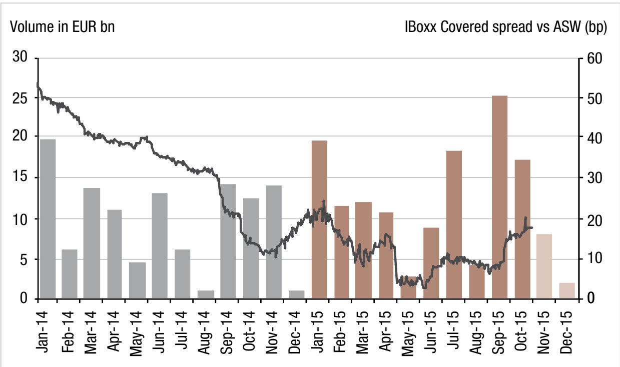
## EUR MARKET

### 2015 review

The covered bond market has seen a surge in primary supply this year, reaching levels well above 2012 (but still quite far from the 2011 record). However, 2015 has been far from smooth sailing, and despite the covered bond purchase programme (CBPP3) bid that, overall, has been a support to the segment, there were moments of push-back from real money investors who considered spreads to be too expensive, especially at times when risk was on the rise (Greece, China, idiosyncratic events, etc.), which resulted in a window-driven environment.

- In terms of jurisdictions, non-core countries were more active than in previous years, as challenging conditions and wider senior spread levels limited their access to other markets.
- The covered bond market continued to grow, attracting new entrants (CRCM, SpareBank 1 SR, Van Lanschot, etc.).
- In terms of maturity, the bulk of the supply was concentrated in the 5/7Y part of the curve (70%, in line with previous years), yet the supply in the very long-end (10Y+) has decreased from 2014 to 2015 (25% and 17% respectively).
- Following the widening spree in Q4 2014, secondary spreads, as measured by the iBoxx EUR covered index, opened the year at 22 bps and performed well until May, when it reached a low of 3 bps, and have widened since to end the year a touch tighter at around 18 bps.

**The very strong tightening in H1 was paradoxically detrimental to covered bond supply**




*Source: SG CIB Analytics, Markit iBoxx, Dealogic – all issuers, amount > EUR 250m eq., maturity > 18 months.*

### Regional focus

#### Western Europe

- Western Europe continues to be the main region for EUR covered bond issuance, representing 87% of total volume (vs. 83% in 2014), however there are some significant divergences within the region:
  - Germany and Austria were much more active in 2015, with an additional EUR 9bn of issuance compared to 2014 and 2013
  - Irish issuers accessed the market five times in 2015 against twice in 2014, resulting in a significant increase in volumes, whilst we saw lower issuance on the senior side
  - In Spain, despite lower activity from the national champions in 2015, volumes are still well above those of 2014
  - There was no issuance from Switzerland (vs. EUR 5.25bn in 2014).

#### North America

- Similarly to last year, we saw sustained activity from Canadian banks, with most of the banks tapping into the market at least once for a total of over EUR 12bn printed, mainly in the first part of the year.

### 2016 forecast

Euro-covered bond volumes have significantly decreased since 2011 to reach a low point of EUR 100bn in 2013, and have since regained momentum with EUR 117bn in 2014 and ca. EUR 140bn for 2015. We expect the market to stabilise in 2016 and reach EUR 140bn.

- Despite recent widening, covered bond spreads remain very attractive for issuers, especially compared to other asset classes. The senior / covered differential has in fact increased significantly in H2 2015.
- The strong bid from central banks is likely to put a lid on spreads, so that covered bonds remain attractive.
- With a negative net supply in the covered bond market in the past few years, and another EUR 150bn of redemptions in 2016, there is little doubt that investors will remain cash-rich.
- Some issuers, such as Credit Suisse and UBS, which traditionally represent a fair share of the market (EUR 5.25bn in 2014) are expected to come back to the market in 2016 after over a year of absence.
- The market continues to expand, with new names advertising their intention to launch covered bonds, or some existing issuers – already active in USD – looking to other currencies in a bid to diversify their investor base.
- As the phasing-in of the liquidity coverage ratio (LCR) has started and banks are beginning to strengthen their liquidity buffers, we expect to see a sustained bid from bank treasuries as well.

While we believe the covered bond market will see further growth next year, there will likely be some moments of volatility during the year that could result in supply that is lower than what we expect:

- Since inception of CBPP3, there have been several waves of widening and primary closure, which are likely to occur in 2016.
- Encumbrance is once again becoming a topic on treasurers' agenda, and while covered bonds offer an obvious price advantage vs. other asset classes, disencumbering balance sheets could put pressure on supply.
- 2015 saw a strong increase in USD covered bond supply. Depending on basis swap developments, further issuers could in all likelihood diversify their investor base by tapping into new markets. Moreover, should yield go lower in Europe and spreads continue to tighten, we could see negative yields on bond offerings; the much higher spread environment in USD should circumvent this.
- Finally, the widely-expected wave of Tier 2 supply in 2015 did not occur, as issuers were waiting for further clarity on the regulatory environment (TLAC, MREL, etc.). As details are expected to emerge at the end of 2015, this wave of Tier 2 supply could be pushed into 2016 and drive down covered bond supply.

In a nutshell, we are taking a more optimistic view on the market and expect volumes in line with 2015. The big unknown will be CBPP3: if the current programme winds up in Q4 2016 as scheduled, we could expect some sharp repricing. However, there are rumours of an extension, which could support the market for longer. Either way, issuers would be better off accessing the market in the first half of the year in order to avoid having to deal with this risk.

## USD MARKET

### 2015 review

Volumes in the USD covered bond market have more than doubled since last year, with USD 20bn of issuance in 2015 (up from USD 10bn in 2014).

- In terms of geography, Australia and Canada continue to be the most active jurisdictions, accounting for 70% of the supply in 2015, but we also saw some supply from the Nordics and Germany, and more importantly from Asia.
- The supply continues to be concentrated exclusively in the 3-5Y part of the curve, with a large preference for the 5Y.
- On the secondary side, spreads performed well in the first quarter but were hit by the same widening seen in the EUR covered bond space. They have kept drifting wider throughout the year, with an acceleration post summer, which explains the lower issuance activity in H2 2015.

### Regional focus

#### Western Europe

- There was USD 4.25bn in covered bond issuance in 2015, split between the Nordics (USD 3.25bn) and Germans (USD 1bn). This represents a strong increase on last year, which only saw one opportunistic USD 500m transaction, however we remain a far cry from 2013 levels (USD 9bn). Notably, the Swiss were absent from the market this year.

#### North America

- Canadian issuers have been increasing their activity in the USD covered bond market over the past few years, with USD 9.4bn in 2015 (vs. USD 5bn and USD 3.75bn in 2014 and 2013 respectively).
- Canadian issuers took advantage of the strong bid for non-CBPP3 eligible papers in EUR (pick-up in spreads), but the USD market provides an optically much higher coupon that is attracting investors.

### 2016 forecast

USD covered bond volumes have been falling consistently since 2011, reaching a low last year, but have now bounced back. We expect to see lower volumes next year of ca. USD 18bn.

- At a time when the EUR market provides ample liquidity pockets, there is little value in currency diversification, except for a cost advantage. As CBPP3 is providing a back-bid for most European issuers, we do not expect them to be more active in USD than this year. Should we see a positive trend in this basis swap, as some issuers could look for opportunistic issuances.
- The main contributors to the USD covered bond market are likely to remain Canada and Australia/New Zealand. Because they all have caps on the amount they can issue, we expect to see lower volumes from their side – especially if they continue to favour EUR.
- The only factor that could contribute to the growth of the USD covered bond market would be the addition of new names and jurisdictions. This year provided a few examples, and as new legal frameworks continue to be in the process, 2016 could see a surge in primary activity from new countries.

## GBP MARKET

### 2015 review

Sterling covered bond primary activity saw GBP 9bn of issuance in 2015, slightly above 2014 volumes (GBP 7bn), but well over the GBP 1.5bn low of 2013.

- The geographical split is fairly similar to that of last year, with UK issuers representing more than half of the supply, followed by Canadian and then European issuers.
- Most of the supply focused on the short end (3Y), with a few transactions with longer tenors of up to 7Y.
- On the secondary side, spreads held their ground in H1, moving into a tight range, but widened significantly post-summer in sympathy with the broader market.

### Regional focus

#### Western Europe

- Domestic supply represented ca. 54% of the 2015 total, with Santander UK, Barclays, Coventry BS, Leeds BS, Lloyds and Nationwide BS all tapping into the market for sizes ranging from GBP 300m to GBP 1bn.
- Away from domestic issuance, we saw a few opportunistic primary issues from Nordic names:
  - DnB GBP 250m 5-year FRN
  - Stadshypotek GBP 300m 3-year FRN
  - Swedbank GBP 500m 3-year FRN

#### North America

- Canadian issuers are fast tapping into the GBP market. Since the first transactions that emerged last year, there have been six deals from five issuers in 2015 for a total of GBP 2.4bn.

### 2016 forecast

Issuance for 2016 is expected to be in line with 2015 at around GBP 9bn.

- The sterling covered bond market remains essentially driven by UK supply. With CBPP3 driving the full market tighter, the pricing advantage remains limited even for non-eligible names.

We believe we will continue to see opportunistic issuance from non-domestic jurisdictions (mainly Australian and Kiwi), although this is likely to remain driven by arbitrage opportunities (ultimately determined by developments in basis swaps – especially in the short part of the curve).

# Public Sector

## OVERVIEW

The SSA (Sovereigns, Supras and Agencies) market experienced a volatile environment in 2015 on the back of macroeconomic, monetary and political events. Central banks strategies were on the centre stage as ECB, Fed and BoE continued to adopt a dovish strategy supporting growth and inflation in their respective regions. Central banks' accommodative attitude also had a positive effect on market liquidity during the periods where investors were less keen to put their cash at work on the back of low yields and/or high risks.

- In the EUR space, the market reacted very positively in the beginning of 2015 on the back of the ECB purchase programme announced in February. We saw SSA bond yields reaching their all-time lows, pushing investors to extend their duration or to buy lower-rated signatures. However, the rest of the year suffered from volatility mainly fuelled by the Greek debt situation, the FOMC rates hike decision and the Chinese economic slowdown.
- In the USD market, SSA bond yields were also affected by the global market volatility and Fed hesitations about a rate hike decision. However, with further signs of US economic resilience, investors remained active in the USD SSA bond market looking for "safe haven assets" in the face of riskier & volatile credit markets. The strength of the USD market also benefited international SSA issuers as cross currency spreads widened sharply, offering advantageous funding costs.
- The GBP SSA bond market remained driven by domestic supply, with the UK DMO being the most important issuer. With the BoE decision to maintain its dovish policy, we saw investors extending their duration in the very long part of the curve to reach their targeted yield level. The UK DMO took advantage of investors' appetite for duration to secure very long-term funding at attractive costs.

## EUR MARKET

### 2015 review

#### Slight decrease of SSA primary supply in a context of budgetary consolidation

Public sector issuance volumes slightly decrease (see table below) this year mainly due to:

- Lower deficits of some sovereigns such as Germany, Portugal and Italy who this year entered into an important phase of budgetary consolidation.
- Lower funding needs of some key agencies and supras combined with more attractive funding conditions in the USD and other currencies markets compared to the EUR market, thanks to advantageous cross currency spread levels. Overall, supras and agencies issuance volumes shifted from 38% in EUR and 43% in USD last year to 32% in EUR and 48% in USD this year by 12 October.

**EUR public sector issuance volumes 2015e vs. 2014**

| Sector | Issuance volumes in 2014 (in EUR bn) | SG initial estimated volumes for 2015 (in EUR bn) | Expected realised issuance volumes in 2015 (in EUR bn) | Realised vs. estimated volumes (%) |
|---|---|---|---|---|
| Sovereigns | 968 | 931 | 957 | 3% |
| Agencies & Supranationals | 181 | 153 | 154 | 1% |
| Local authorities | 72 | 56 | 57 | 3% |
| Total Public Sector | 1,221 | 1,139 | 1,169 | 3% |

*Source: Based on SG CIB Cross-Assets Research, DCM Forecasts and SDC Platinum.*

#### Historical outperformance of the EUR bond market in Q1 supported by the ECB QE

The EUR market tone was very positive in the first months of 2015 thanks to the ECB easing measures that were announced on 22 February.

- European SSA markets reacted very positively, especially after the implementation of the ECB public sector purchase programme (PSPP) on 9 March. We saw SSA secondary yields reaching their all-time lows in most euro area countries. For instance, German and French bonds reached negative territories up to nine and four years respectively. The EUR equity market also benefited from this supportive context. We saw the Eurostoxx 50 and the CAC 40 outperforming by 25% in Q1.
- In this context, we saw European SSA launching very large-sized transactions, such as Spain who issued a new 15-year benchmark in February for EUR 7bn (SG CIB acted as bookrunner) and Italy who launched a EUR 8bn 2032 transaction in March.

In the beginning of April, most market participants were expecting euro area SSA bonds to continue to outperform with the Bund 10Y reaching zero yield. However, these anticipations put a lot of pressure on the market, pushing it on the brink.

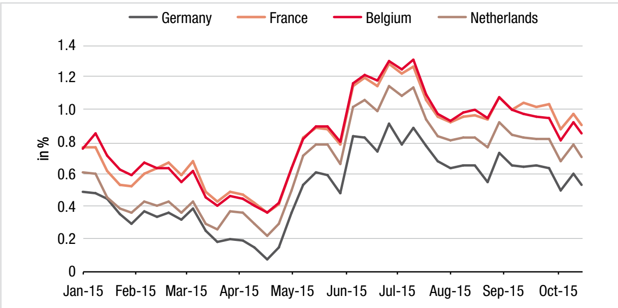
#### Significant volatility in the EUR bond market since Q2, on the back of macro, geopolitical and monetary events

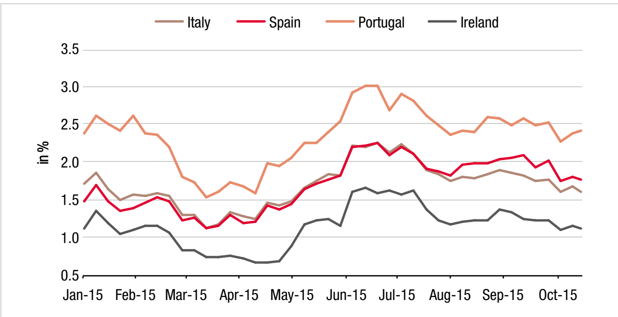
The EUR market exceptional performance was thrown off in mid-April when positive EU macro publications, especially on German inflation, put an end to investors' bullish anticipations and created a market correction that snowballed in a huge sell-off.

The EUR SSA bond continued to suffer from important volatility throughout the year driven by the Greek debt negotiations, the Chinese economic slowdown, the expectations about the timing of the Fed rates hike, as well as different geopolitical events (Ukraine/Russia, Middle East instability, etc.)

- In Greece, talks between Greek officials and creditors took time, failing to find a compromise until mid-July. This context added more pressure on market participants, who stayed sidelined during the negotiations waiting to see future development of the Greek Saga.
- Concerns around the Chinese situation (fall in the Shanghai stock market, renminbi devaluation, slowdown of the Chinese growth, etc.) and the potential contagion risk to other emerging economies, continued to fuel volatility in the bond market at the end of August.
- Market attention was also focused this year on the Fed's monetary decisions, as most market participants were expecting the Fed to raise its key rates. The European bond market started to stabilise in the second half of September thanks to the Fed's dovish decision to maintain its rates (17 September). The timing of the rate lift-off was still unclear, but the disappointing US data published in Q3 raised doubts on a US rates hike before year-end. In this context, market participants took some pressure off the market and EUR-denominated bond curves rallied.
- The third quarter was also full of political events. Greece, Spain and Portugal held either regional or general elections during this period. The outcome of these events was quite positive for eurozone issuers and more specifically for peripheral signatures. We saw Spanish and Portuguese curves outperforming the German yield curve.

**Euro area 10-year benchmark yields performance in 2015**




*Source: Bloomberg.*

## However, EUR market liquidity was well supported by the ECB accommodative policy

- EUR market volatility also affected the market liquidity as some market participants, such as central banks and insurers, cut back on their inventory of EUR-denominated assets on the back of broader volatility context. However, demand from bank treasuries remained strong and stable thanks to the liquidity buffers activity under the LCR regulatory constraints.
- Tougher regulatory environment has also impacted the overall bond market liquidity as intermediaries (banks and broker-dealers) have been adjusting their regulatory capital allocation.
- However, with its easing measures (QE & TLTRO), the ECB injected significant liquidity into the EUR market, thus limiting the liquidity drop and the bond market volatility.

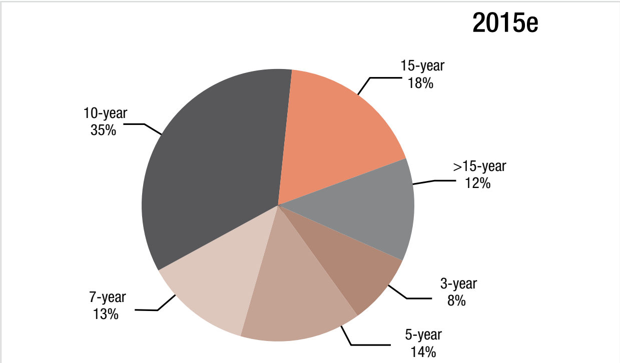
## The inflation-linked market faced some headwinds throughout 2015

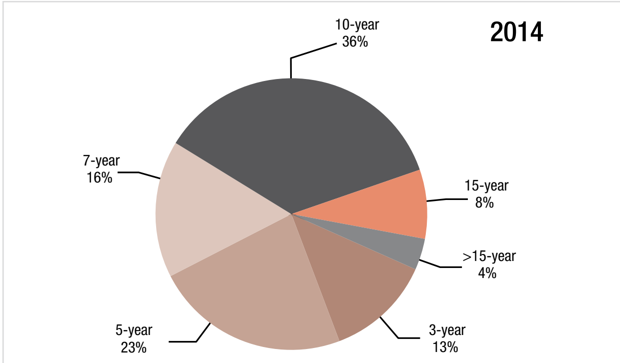
- EUR inflation-linked bonds issuance volumes (excl. retail bonds) should reach EUR 49bn at the end of 2015, slightly below the 2014 issued amount of EUR 51bn.
- In the short term, EUR linkers suffered this year from the commodities prices fall (crude oil reached its lowest level since 2009), disappointing inflation expectations, lower real rates as well as from a drop in market liquidity. We saw inflation breakevens reaching very low levels in the short/medium part of the curve.
- Nevertheless, EUR linkers remained well supported in the long part of the curve thanks to investors' appetite for yield, encouraging inflation figures in some euro area countries such as Germany, as well as due to the ECB PSPP.
- As such, we saw a maturity extension of EUR linkers' primary transactions with around 70% of 2015 transactions being priced on the long part of the curve. For instance, Germany returned to the syndicated inflation-linked market this year after being absent since June 2006, launching a new EUR 2.5bn long 30-year inflation-linked benchmark in June (SG CIB as joint bookrunner).

## In a context of high volatility, investors further extended their duration or switched to lower-rated signatures to get higher return

- We witnessed a maturity extension across the SSA sector this year compared to 2014, as investor demand partly shifted towards longer tenors thanks to the extreme low-yield environment. Issuers took advantage of investors' hunt for yield to secure attractive long term funding costs. As such, issuance in the 15 to 30Y range was around 30% in 2015, compared to 12% the year before.
- For instance, in January Italy successfully launched EUR 6.5bn of a new 3.25% 2046 benchmark line (SG acted as joint bookrunner) while EFSF issued a new Feb 2045 benchmark for EUR 1.5bn in February and ESM priced a new 30-year in October for EUR 3bn.

**EUR SSA issuers extended their debt profile in 2015e vs. 2014**

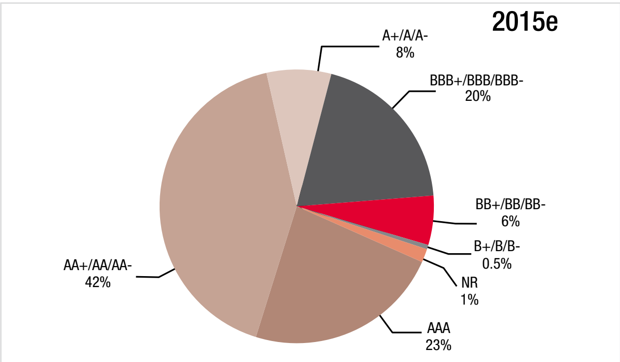


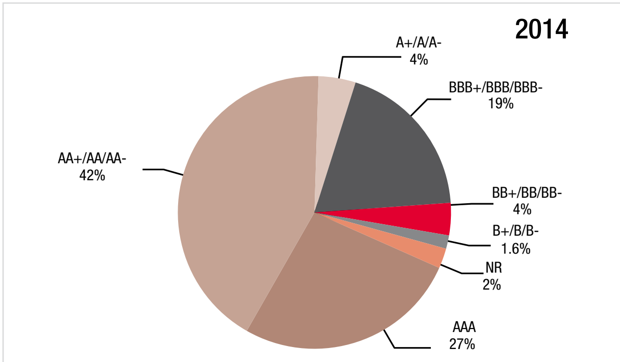




*Source: SG CIB DCM Analytics.*

- Investors slightly raised their risk appetite, matching a supply from lower-rated signatures on the rise. Consequently, even if AAA rated issuers continue to account for the largest share of the total syndicated supply (42% in 2015 in line with 2014), we saw a slight increase in the supply coming from BBB+ or lower rated issuers this year (28% in 2015 vs. 27% in 2014).

**Supply from lower-rated signatures slightly increased in 2015 vs. 2014**




*Source: SG CIB DCM Analytics.*

## 2016 forecast

### 2016 SSA issuance programme

**EUR public sector issuance volumes 2015e vs. 2016e**

| Sector | Expected realised issuance volumes in 2015 (in EUR bn) | Estimated issuance volumes in 2016 (in EUR bn) | 2015-2016 Evolution (%) |
|---|---|---|---|
| Sovereigns | 957 | 879 | -8,1% |
| Agencies & Supranationals | 154 | 170 | 10,2% |
| Local authorities | 57 | 60 | 4,7% |
| Total Public Sector | 1 169 | 1 109 | -5,1% |

*Source: Based on SG CIB Cross-Assets Research and DCM Forecasts.*

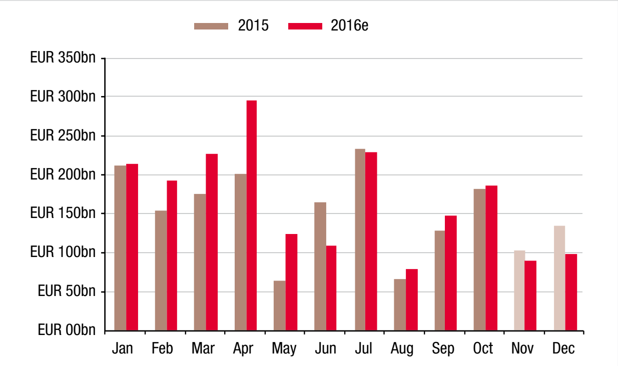
### 2016 major trends

For 2016, we expect the total EUR public sector issuance volumes to be slightly below the previous year (-5.1%) at EUR 1,109bn.

- The lower volumes can be attributed to a decrease in sovereign issuance activity (-8.1%) on the back of lower net borrowing needs next year, especially for countries that implemented structural reforms as well as those who have already reimbursed a significant portion of their rescue package.
- On the other hand, funding needs of agencies and supras are expected to be higher in EUR (+10.2%) due to lower USD-denominated funding opportunities in particular after a potential US rates lift-off.
- We expect stronger economic growth in the euro area in 2016, which should provide higher earnings for European corporates and hence a good performance of EUR equity market.
- However, as the inflation is expected to remain low compared to historical standards, we believe that the ECB will maintain its rates unchanged and further extend its easing measures through the injection of additional liquidity beyond September 2016, hence supporting the euro area SSA bond market.
- Besides, we expect the emerging markets slowdown to fuel some volatility over the global capital markets. However, high-quality eurozone member countries remained rather immune to this volatility, well supported by the ECB's PSPP.
- In the short term, SSA issuers will probably continue to approach the USD market to capture investor demand on short maturities, especially if EUR/USD cross-currency spreads remain attractive. We believe that this should be the case, in particular after the Fed rates hike and the decoupling between US and euro area monetary policies.

- In the long term, cash-rich investors' demand for yield should benefit longer dated bonds. However, if interest rates continue to compress more, investors will probably be reluctant to add much long-end risk and prefer to invest their cash on lower-rated signatures or European equities.
- In addition, the EUR inflation-linked market should continue to be well supported in the long term on the back of positive long-term forecasts on the euro area inflation.
- In terms of EUR bond redemption flows, we expect EUR 1,997bn outflows in 2016 (i.e. 10% higher than 2015), which should benefit EUR market liquidity next year, especially in context of lower budgetary deficit for some European countries such as Germany, Italy and Portugal.

**Total EUR bond redemption flows in 2015 and 2016**




*Source: SDC Platinium, Bond Radar, Dealogic and SG CIB DCM Analytics.*

## USD MARKET

### 2015 review

#### Decrease of primary supply in the US

- US Treasuries primary supply decreased in 2015 compared to last year on the back of budget consolidation, costs control and lower redemption flows.
- On the non-US sovereign side, issuance volumes fell to USD 78bn from USD 97bn the previous year, well below our forecast for 2015. This is mainly due to the decrease of emerging market countries' primary activity. For instance, CEEMEA sovereign issuers lowered their issuance volumes from USD 34bn in 2014 to USD 23bn this year (equivalent of 68% of 2014 volumes).
- This year, supra and agency issuers took advantage of a prolonged low-rate environment and attractive cross-currency swap spreads to increase their USD primary issuance and meet their short-/medium-term funding requirements at a lower cost. As such, we saw non-US agencies and supras shifting their issuance activity from 38% in EUR and 43% in USD last year to 32% in EUR and 48% in USD in 2015.

**USD public sector issuance volumes 2015e vs. 2014**

| Sector | Issuance volumes in 2014 (in USD bn) | SG initial estimated volumes for 2015 (in USD bn) | Expected realised issuance volumes in 2015 (in USD bn) |
|---|---|---|---|
| US Treasuries | 2,206 | 1,989 | 1,914 |
| Non-US Sovereigns | 97 | 103 | 78 |
| *Eurozone* | 11 | 15 | 4 |
| *CEEMEA* | 28 | 35 | 23 |
| *LATAM* | 26 | 25 | 24 |
| *APAC* | 21 | 16 | 14 |
| *Nordics* | 10 | 10 | 11 |
| *UK* | 2 | 2 | 2 |
| Non-US Agencies & Supranaturals | 240 | 217 | 253 |
| Local authorities | 13 | 12 | 13 |
| Total Public Sector | 2,556 | 2,321 | 2,257 |

*Source: Based on SG CIB Cross-Assets Research, DCM Forecasts and Dealogic.*

#### EUR/USD cross-currency spreads widened sharply benefiting European SSA issuers

- EUR/USD basis swap spreads significantly widened in 2015, going from -11 in January to 38.4 in March in the 10-year tenor. This move was mainly driven by the excess of liquidity in the euro area following the implementation of QE, a stronger dollar as the US economy continued to improve in 2015, as well as a notable increase of EUR-denominated transactions by US corporates.
- Some European SSA issuers took advantage of this opportunity to tap the USD market at very attractive levels. As such, we saw the Bank of England and Sweden launching a total of USD 5bn in March, i.e. 35% of the total European Sovereign USD issuance volume realised in 2015. We also witnessed EIB, KfW and CADES launching a total amount of USD 15bn during this opportunistic window.

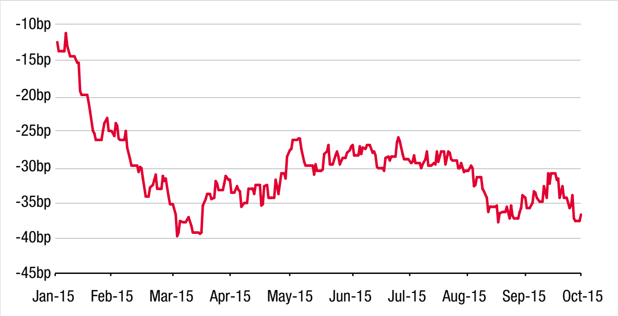
#### Several episodes of volatility supported USD market issuance during 2015

- Following the Fed announcement in October 2014 on the termination of its 5-year QE, all market participants were expecting a Fed rate hike early 2015. Nevertheless, volatility returned to the market with the FOMC status quo decision at the end of January on the back of weak macro data publications. Hence, we saw several yield-seeking investors switching their positions from USD fixed income assets to US equities.
- In Q2, the market witnessed a massive sell-off as large funds and central banks in emerging markets sold US assets to support their own currencies. We saw the USD swap rate 10-year underperforming by 40bp to reach 2.33% while the EUR/USD increased from 1.04 in March to 1.14 as of mid-May. In addition, we witnessed a drop of non US primary supply in this context (-35% in Q2 compared to Q1) especially due to less favourable cross

currency spreads that tightened to reach -26bp in mid-May in the 10-year maturity.

- In September 2015, the spread on the U.S. 10-year swap interest rate over Treasuries turned to its most negative level since September 2010, due notably to strong selling flows from Asian central banks, where reserves declined dramatically in August on the back of the Chinese market slowdown.

**10-year EUR/USD basis swap in 2015**




*Source: Bloomberg.*

- With higher USD rates level, several SSA issuers approached the USD market to capture investor demand for "safe haven" investments with relatively high yield. In addition, with the wide levels of EUR/USD basis swaps, non-European SSAs profited to lock-in attractive long-term funding.

## 2016 forecast

### 2016 SSA issuance programme

**USD public sector issuance volumes 2015e vs. 2016e**

| Sector | Expected realised issuance volumes in 2015 (in USD bn) | Estimated issuance volumes in 2016 (in USD bn) | 2015-2016 evolution (%) |
|---|---|---|---|
| US Treasuries | 1,914 | 2,257 | 18% |
| Non-US Sovereign | 78 | 90 | 16% |
| *Eurozone* | 4 | 5 | 23% |
| *CEEMEA* | 23 | 35 | 57% |
| *LATAM* | 24 | 23 | -5% |
| *APAC* | 14 | 16 | 17% |
| *Nordics* | 11 | 9 | -16% |
| *UK* | 2 | 2 | -14% |
| Non-US Agencies & Supranaturals | 253 | 210 | -17% |
| Local authorities | 13 | 5 | -60% |
| Total Public Sector | 2,257 | 2,562 | 14% |

*Source: Based on SG CIB Cross-Assets Research and DCM Forecast.*

### 2016 major trends

- In terms of issuance volumes, we anticipate the US Treasury gross bond issuance (excl. bills) to be higher in 2016 and reach USD 2,257bn on the back of a higher redemption flow.
- In addition, we expect non-US sovereigns, mainly European and Asian investment grade countries, to continue entering the USD market as a way to diversify, hedge their liquidity risk and profit from investors' appetite for higher yield.
- Regarding non-US supras, agencies and local authorities, we estimate issuance volumes to drop by 17% and reach USD 210bn as these issuers, especially the European ones, should adjust the portion of USD-denominated bonds on their 2016 issuance strategy compared to 2015. Nevertheless, these issuers should continue to rely on this market, especially if EUR/USD cross currency spreads remain attractive.
- We expect positive US monetary policy to sustain the USD bond market in 2016, with US Treasuries remaining one of the most attractive assets.
- In addition, as US growth and inflation continues to grow and US unemployment rate to decrease, we believe that the Fed will start its normalisation policy in early 2016 and continue adjusting its rate levels throughout the year.
- However, some volatility is likely to materialise in the bond market across the year due to uncertainties around the US presidential elections to be held in November 2016.
- Another area of concern is the evolution of emerging markets economic situation and its potential effect on the USD market in terms of USD exposure on the one hand, and USD denominated issuance on the other.

# GBP MARKET

## 2015 review

### The GBP bond market remained driven by the Sovereign

- The UK DMO was the most active issuer in 2015, accounting for more than 80% of the total syndicated SSA supply in 2015.
- Regarding supra and agency activity, the supplied volume remained stable in 2015 in line with our forecast. EIB was the most active issuer as the supra created one new line and increased outstanding issues 16 times for a total amount exceeding GBP 6.7bn.

**GBP public sector issuance volumes 2015e vs. 2014**

| Sector | Issuance volumes in 2014 (in GBP bn) | SG Initial estimated volumes for 2015 (in GBP bn) | Expected realised issuance volumes in 2015 (in GBP bn) |
|---|---|---|---|
| Sovereign ** | 126 | 161 | 127 |
| Agencies & Supranaturals | 22 | 21 | 20 |
| Total Public Sector (excl. LA) | 149 | 182 | 148 |

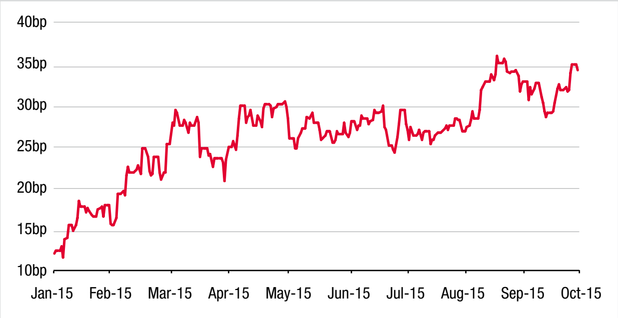
*** Financial year.*
*Source: Based on SG CIB Cross-Assets Research and DCM Forecasts and SDC Platinum.*

### Investors' appetite focused on the ultra-long part of the curve

- In 2015, the Bank of England decided to maintain its dovish policy for the seventh year in a row on the back of very low to negative inflation levels experienced this year after the oil price drop.

- In this context, we saw investors extending their duration to the long and ultra-long parts of the curve. As such, the UK DMO benefited from investor appetite to explore long-term tenors (from 2046 to 2068) for a total issuance amount of more than GBP 25bn. These transactions represent 36% of the total issuance volume in 2015 (vs. 17% in the previous year).
- On the other hand, most non-domestic sovereign issuers that approached the GBP market this year have rather explored shorter maturities in the 3-5Y segment, taking advantage of some opportunistic windows to diversify their funding portfolios. The cross-currency swap market has played a key role in this activity, particularly for EUR-denominated currency issuers.

**5-year GBP/EUR basis swap in 2015**




*Source: Bloomberg.*

- In general, domestic investors have represented the bulk of the demand. International investor appetite for GBP-denominated transactions remained limited to official institutions investing in the British currency to top up their foreign exchange reserves, and some asset managers invested in GBP as part of their diversification strategy.

### The GBP market experienced some volatility

- Overall, the GBP bond market followed the same pattern as the EUR and USD bond markets, with an underperformance in H1 followed by an outperformance in H2 on the back of a more stabilised global market context and positive UK macro and employment data. We saw the 10-year gilt reaching its highest yield level at 2.30% in June to rally at 1.82% by mid-October back to last year-end levels.
- 2015 was also the year of general elections in the UK (held on 7 May). Markets reacted positively to the Conservative Party's victory.
- In the GBP inflation-linked market, total volumes sharply decreased by 33% to GBP 17bn by mid-October compared to last year, as UK inflation struggled to stay in positive territories, adding pressure on UK breakevens that reached very low levels in Q4 2015.
- However, the GBP low-rate environment benefited ultra-long term inflation linked bonds. As such, we saw the UK DMO reopening actively its 2068, 2058 and 2046 index-linked lines.

## 2016 forecast

### 2016 SSA issuance programme

**GBP public sector issuance volumes 2015e vs. 2016e**

| Sector | Expected realised issuance volumes in 2015 (in GBP bn) | Estimated issuance volumes in 2016 (in GBP bn) | 2015-2016 evolution (%) |
|---|---|---|---|
| Sovereigns** | 127 | 125 | -1,9% |
| Agencies & Supranaturals | 20 | 21 | 3,8% |
| Total Public Sector (excl. LA) | 148 | 146 | -1,1% |

*** Financial year*
*Source: Based on SG CIB Cross-Assets Research and DCM Forecasts.*

### 2016 major trends

- In terms of supply, we expect the total GBP public sector volumes to be in line with 2015 and reach GBP 146bn. The UK DMO will continue to be the key player in the GBP market with total gross bond issuance (excluding bills) expected at GBP 125bn during the next financial year (2016-2017).
- We expect agency and supra primary activity to remain stable at GBP 20-21bn which should represent around 7-8% of these issuers funding needs next year.
- The overall tone in the GBP market will be characterised by some nervousness driven by any development on the monetary policy of the Bank of England that will gauge encouraging positive macro data with potential further concern on inflation. We believe that the GBP market will also start to be affected by the first discussions of a Brexit, as a referendum is likely to be held in 2017.
- Non-UK SSA issuers will remain dependant on windows opening, mostly driven by dynamics in the cross-currency swap. An accelerated increase in domestic rates could trigger better conditions in the cross-currency, enabling top-rated agencies and supras to approach this market for opportunistic and/or diversification reasons.
- Domestic investors will dominate the demand for GBP-denominated assets. In particular Liability-Driven Investment accounts will continue the search for long-term duration and inflation protection. Highly rated securities in the short-/medium-term will continue to be purchased by official institutions and central banks for their foreign exchange reserves.
- A boost in consumer spending could fuel growth and push inflation higher over the medium term, benefiting the index linked sector.

## GENERAL CONCLUSIONS

- After numerous episodes of market volatility, most sovereign, supra and agency (SSA) yields have receded and are close to the levels seen at the beginning of the year.
- Swap spreads in EUR should continue to perform on the back of increased structural reforms implemented by EU sovereigns and a modest recovery outlook.
- In a continued low-yield environment, investors will be looking for assets offering pick-up. As such, they are likely to extend duration, in particular on high-rated SSA issuers.
- The low-yield environment is also likely to push investors to buy lower-rated issuers out of the CEEMEA region in order to benefit from higher credit spreads. However, this move could be limited due to persistent market volatility, driven by uncertainties around the Fed and other central banks' policies, and the EM economic outlook.
- A longer QE from the ECB will exacerbate the swap spread tightening move and the trend for lower yields. With market sentiment split between the search for high quality signatures more immune from volatility and the hunt for higher yields, together with a potential decoupling between the ECB and Fed policies, investors will be hesitant in their strategy. This could lead the topics of liquidity and volatility to take the centre stage again in 2016, reinforced by the pressure derived from further market and banking regulations.
- **Sukuk:** Middle East sovereigns are expected to be more active in 2016 than in 2015 due to an increase of their financing needs, feeding strong appetite from Middle East investors. This momentum of the Sukuk market could also attract Western Europe investment grade issuers to diversify their investor base.
- **Dim Sum bonds:** the CNH devaluation put a break on Dim Sum issuance as the absence of arbitrage in the cross-currency market and the volatility witnessed in the Chinese macro-economic picture and financial markets have heavily discouraged issuers. However, should conditions normalise in 2016, investment grade sovereign issuers should have an easier access to this market on the back of the internationalisation of the CNH and growing demand from central banks.
- **Green Bonds:** as investors are increasingly developing their ESG portfolios and on the back of the COP 21, this asset class could continue to offer an interesting and growing funding alternative for issuers in 2016.

# Emerging Markets

## APAC

- We have again seen an active year in the APAC debt capital market, with overall international public issuance expected to reach USD 190bn equivalent for Asia ex-Japan, Australia/New-Zealand. However, the overall volume did not reach the volume expected at the beginning of the year due to the Korean market dropping 40% in volume year-on-year, and changes in Chinese DCM market growth following increased volatility in both equity and FX markets over the summer. In addition, low commodity and oil prices also reduced funding needs of large natural resources and energy players in the region.
- 2015 will remain a year of paradox, with Chinese issuers emerging as the key component of the APAC debt capital market while still facing volatility and regulatory uncertainly that are inherent to emerging markets. On the other hand, we have witnessed a constant and steady activity in developed jurisdictions, with the exception of Korea which was impacted by lower redemption in 2015, and increased deleveraging in the corporate sector, as requested by authorities.
- On the currency front, EUR-denominated deals have been a key focus for Asian issuers taking advantage of the low-rate environment in Europe.
- On the CNH side, volumes should end far from estimates made in 2014 as volatility in the Chinese equity market and depreciation of RMB in August 2015 have weighed heavily on the CNH market, which closed over summer and only partially re-opened for top-rated names.
- In 2016, with continued pressure on commodity prices, and on the back of a change in regulation by the National Development and Reform Commission (NDRC) implemented in September 2015 on offshore bond issuance from Chinese issuers, we remain cautious on issuance volumes in 2016 and expect them to be only slightly above 2015 figures.

## Corporates

### INVESTMENT GRADE

#### 2015 review

##### EUR

- The 2015 APAC corporate euro bond supply has already reached EUR 22bn vs. EUR 11.3bn for full-year 2014.
- One notable trend has been the strong activity from Chinese issuers in the euro space. As of 1 November 2015, 18 euro transactions have been priced for Chinese corporate for a total volume of EUR 8.9bn compared to EUR 1.5bn in 2014. It is worth noting the introduction of new bond structure from Chinese corporate in the euro market: China State Shipbuilding launched the first EUR-denominated bond benefiting a stand-by letter of credit feature. This increasing activity from Chinese issuers can be explained by three main reasons:
  - Taking advantage of the low rates environment in the eurozone
  - Diversification away from the traditional USD investor base (Sinopec, State Grid)
  - Refinancing of EUR-denominated acquisitions (Shanghai Electric, Dongfeng Motors after the acquisition of Ansaldo and PSA respectively).
- On the contrary, issuance volumes have been very low in India and South East Asia with no public transactions in either regions due to an unfavourable basis swap.
- On the other hand, Japanese multinationals took advantage of the low funding cost in EUR with multi-tranche transactions from: Toyota EUR 1.75bn and EUR 1.5bn; Soft Bank EUR 2.25bn; and Honda EUR 1.2bn.
- Australian corporates continued to tap into the EUR market as a source of diversification. Even though the number of transaction decreased significantly, EUR remains a traditional funding channel for Australian multinationals. For instance, BHP Billiton issued a EUR 2bn multi-tranche transaction in April followed by another EUR 2bn in hybrid bonds in October (on the top of USD 3.25bn in USD hybrids and GBP 600m in GBP hybrid). However, following the jumbo-sized privatisation of an Australian state's power grid, we expect issuances to pick up in EUR in order to diversify away from the USD and AUD market.

##### USD

- In the APAC region, 2015 primary USD bond issuance volumes stood at USD 87bn, below the record high of USD 97bn for the same period last year, and USD 117bn for full-year 2014. Chinese corporates confirmed their increasing activity in the offshore capital market, as they accounted for a large percentage of the issuance: over 43% of corporate volumes in APAC, versus 55% last year. This steady growth is set to continue over the next few years given the easing of capital controls in China. Indeed, a new regulation published in September by the Chinese National Development and Reform Commission abolished the case-by-case approval requirement for offshore bond/loan issues, which used to be the principal obstacle for direct issuances by Mainland entities in the international capital markets, and replaced it with a pre-incurrence registration and post-incurrence filing system. Even though the regulation change may have a downward impact on issuance volume in the very short term, this represents a major relaxation of the foreign debt regime, and signals a major policy shift in favour of fund raisings by Mainland corporates and financial institutions in the international capital markets.

- Three out of the top five jumbo transactions this year, totalling USD 10.7bn, were printed by Chinese companies: Sinopec USD 4.8bn; CNOOC USD 3.8bn and Tencent USD 2.1bn, highlighting the depth and size of the overall market and the strong investor appetite for Chinese credits. Furthermore, we have seen new asset classes emerging in China, with Xinjiang Goldwind pricing the first ever green bond out of China.
- South East Asia and India had diverging trends in 2015: while issuance from Indian corporates decreased significantly due to economic concerns, the South East Asian overall volume increased to USD11.6bn from USD7.5bn for the full year 2014. The largest transaction in the South East Asia region came from Petronas with a USD 3.75bn multi-tranche deal.
- Among developed jurisdictions, while the Korean corporates decreased their offshore issuance on account of cheaper domestic funding and light international bond redemption from USD 9.5bn to USD 3.6bn, we saw greater activity from Australian issuers, with total volume increasing from USD 2.5bn to USD 8.7bn. In particular, we witnessed jumbo deals from Fortescue (USD 2.3bn) and APT pipeline (USD 1.4bn). Japanese corporate issuance remained steady, and Japan was one of the most active countries in the APAC region with an issuance volume of USD 16.8bn, above the total USD 13.1bn issued last year.

**Emerging currencies**

## 2015 review

### CNH

- In 2015 the internationalisation of the CNH bond market encountered several hurdles and new issuance dropped significantly. Corporate issuance volumes in the Dim Sum bond reached a mere CNH 17bn, compared to a total volume of CNH 82bn in 2014. Indeed, the default of Kaisa at the beginning of the year closed the market to unrated and low-rated Chinese companies that represented over 78% of last year's volume. Moreover, the unexpected devaluation of RMB by the PBOC during the summer spurred strong selling flows in the CNH market. As such, no new issues have been priced since the beginning of August in the corporate space; only highly rated banks were able to launch short dated bonds after the summer break. In this challenging environment, Haikou Meilan Airport was able to issue a High Yield Non-Rated CNH debut issue before the summer.
- Only CNH 3.5bn came from foreign issuers (excl. China and Hong Kong), which is significantly lower than the domestic/foreign split observed in 2013 and 2014. Only a handful of foreign issuers tapped into the CNH market before the summer (Air Liquide, Korea Expressway and Fonterra). The Dim Sum market is still largely dominated by Chinese unrated issuers in 2015, even though the proportion only stood at 50% compared to 58% last year. In the difficult market environment, we are seeing a bigger proportion of IG issuers tapping into the CNH market, but very few issuers were able to access tenors of over three years.
- It is worth noting the increasing portion of CNH-denominated Formosa Bonds from non-Taiwanese corporate issuers. The change in Taiwanese regulation allowed foreign issuers listing their bonds in Taipei to access more easily the domestic investor base at a lower funding cost.

## 2016 forecast

### CNH

- We expect to see a redemption volume of CNH 52.7bn in 2016 in the corporate space. Almost all the redemption will be from the Dim Sum market, since the Formosa market has just taken off and is dominated by the financial sector. 65.5% of total redemption will be from Chinese/HK issuers, of which 40.7% are real estate developers. However, investors' negative perception of the property sector, as well as the reopening of the onshore funding channel, would probably dampen 2016 Dim Sum new issue volumes from Chinese/HK property developers. We should see negative net issuance in 2016, especially in the real estate sector.
- The unexpected RMB devaluation in August led to a CNH liquidity crunch and a halt to the CNH corporate bond primary market. Going forward, if the RMB continues to weaken on the back of a slowdown of China's economy and market expectation towards a Fed hike, Dim Sum bonds will become less attractive unless they offer higher yields to investors. On the other hand, the CNH market also loses favour from an issuer's perspectives in the case of a low onshore CNY funding cost. Thus, we expect the CNH market to continue to suffer in 2016.
- Regarding the term structure, we expect shorter tenors will still be the sweet spot in the CNH market in 2016, in keeping with the current status.

**HIGH YIELD**

- In APAC, we have seen a decrease in high yield issuance, the total volume reaching USD 16.6bn eq. compared to USD 25bn eq. a year earlier. In particular, volume was impacted by the decrease of new issuance out of China. Indeed, following the default of Kaisa, the high yield market closed for Chinese real estate developers. The APAC high yield market remains almost entirely USD-denominated (over 85% of total issuance volume).
- Given the economic slowdown and the uncertainties surrounding the Chinese real estate market, we have

seen Chinese high yield issuers focusing on onshore bond market where they can find lower funding costs.

## Financial Institutions

### SENIOR UNSECURED MARKET

#### 2015 review

EUR

- Supply in 2015 for APAC reached EUR 5.1bn over EUR 4.1bn, the full year volume of 2014, but still far from the record year of 2013.
- For the first time, we have seen Chinese banks accessing the EUR market in the senior space with transactions from CCB Asia, Bank of China and Bank of Communication for a total of EUR 1.1bn.
- Japanese banks returned to the euro market with a total of EUR 2.3bn whereas there have been no issuance from Japanese banks in 2014.
- Australian banks remain regular issuers in the euro senior space. Macquarie consolidated its European investor base by coming into the market with a EUR 500m 7-year deal for its third EUR trade in the past 12 months and continued to build its secondary curve during the year with a EUR 300m 15-year and a EUR 500m 3-year FRN transaction. Other frequent issuers such as ANZ, NAB, CBA and Westpac issued EUR transactions.

USD

- As for corporate, USD remained the key currency in the region for financial institutions' funding. We witnessed over USD 64.5bn of senior unsecured supply so far in 2015. Despite the decrease compared to the total volume of USD 77.5bn for the same period in 2014 and USD 86bn full year. This figure is still one of the highest in the past few years.
- This year Asian-Pacific issuers kept the lion's share of their senior funding in the USD market (90%) while raising funds on the EUR market as well (+14% year-on-year).
- China became one of the largest issuer in the region with volume of USD 21bn compared to USD 17.5bn for the full year 2014. We expect the trend to continue on the back of new regulations and the willingness of political leaders to promote the internationalisation of the Chinese economy. For instance, we have seen activity in China's Big Four banks' offshore branches, the most notable deals being the multi- tranche transactions from ABC New York and BOC Hong Kong for USD 1.25bn and USD 2.3bn respectively. It is also worth mentioning in the hybrid space the Tier 2 bonds issued by China Construction Bank and industrial and Commercial Bank of China for a size of USD 2bn each.
- We saw a significant fall in Japanese and Australian supply - historically the main APAC issuers. Australian and Japanese banks issued a total volume of USD 14.7bn and USD 21.6bn respectively, yet far below the strong activity in 2014 which saw total volume of USD 26.7bn and USD 25.5bn respectively. Likewise, volumes from Korea, South East Asia and India bore the brunt of the downward trend. Indian banks were adversely affected by overall market instability, while Korean and Singaporean banks were focused on establishing their covered bond programmes.

### Emerging currencies

#### 2015 review

CNH

- Adversely affected by the highly volatile Chinese equities market and the devaluation of RMB, CNH bonds from financial institutions decelerated in 2015 to a CNH 118.4bn supply (including Certificate of Deposits and private placements) year-to-date, down 35% compared to 2014 year-to-date.
- The Formosa market, however, has bloomed thanks to the strong appetite of Taiwanese insurance companies since the reclassification of Formosa bonds from "offshore" to "onshore" in June 2014 by the Taiwanese regulator. Foreign banks with high ratings were the first movers. So far we have seen CNH 20.4bn in Formosa supply from foreign banks, whilst 2014 only saw CNH 1bn Formosa issuance.
- Policies have always been an important driver for Chinese banks. In June 2015, Bank of China printed a CNH 50bn multi-tranche jumbo transaction via its Taipei branch (Formosa) and Abu Dhabi branch (Dim Sum). The proceeds of the transaction were dedicated to fund to the "One Belt, One Road" Project, under which China intends to create a modern "Silk Road Economic Belt" to boost trade and extend its global influence. In October 2015 China Construction Bank issued a CNH 1.0bn 2-year bond, followed by a CNH 600m 2-year green bond offering from Agricultural Bank of China. Both transactions were listed in London, showing China's continued effort to get the RMB into the IMF's special drawing rights (SDR) basket by further promoting the RMB usage worldwide.

#### 2016 forecast

CNH

- Looking ahead to 2016, with Chinese regulators and policy makers pushing heavily for the emergence of a domestic CNY market for foreign issuers, and a lack of visibility into the re-opening of CNH market, we expect even lower CNH volumes next year. We expect the Formosa market to again be a highlight in 2016, but it will be very sensitive to the development of the CNH/USD basis swap. The promotion of the internationalisation of RMB and the "One Belt One Road" project will remain a theme for the Chinese government, and as such we expect to see a wider footprint of CNH bonds from Chinese FI.

### COVERED BOND MARKET

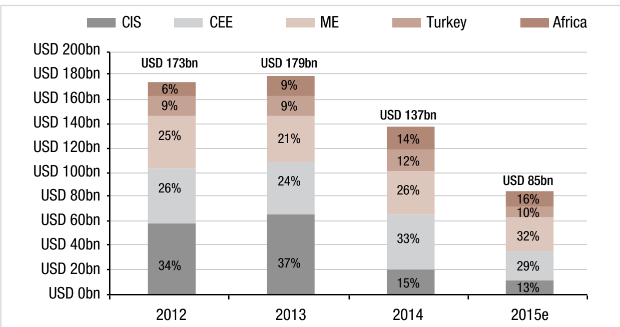
- Australian issuers continue to represent the lion's share of USD covered bond market issuance, with USD 4.5bn launched in 2015, in line with 2014.
- The USD covered bond market saw inaugural issuers in 2015, welcoming the first Singaporean name (DBS USD 1bn 3-year) and Kookmin Bank (USD 500m 5-year AAA-rated covered bonds) under the new Korean covered bond act. This will be closely followed by an issuance of covered bond by KHFC.
- Euro-covered bond issuance from the APAC region decreased from EUR 7.3bn in 2014 to EUR 4.5bn in 2015, as CBA did not issue this year. Australia and New Zealand remain the only two countries of EUR covered bond issuance in the region, with others choosing USD so far.

## Public Sector

- The public issuance volume in the Asian SSA space remained steady, USD and EUR issuance reached USD 42.2bn and EUR 2.0bn respectively compared to USD 36.2bn and EUR 4.2bn for the full year 2014.
- Regarding APAC sovereign issuers, the Republic of Indonesia issued its longest and largest EUR bond during the summer. This transaction was the only EUR-denominated benchmark issued this year out of the APAC region. Besides, on the agency side, we witnessed China Development Bank accessing the EUR market for the first time with a 3 year EUR 500mln transaction along with a 5-year USD 1bn benchmark.
- On the USD front, in Asia, we have seen, an increasing number of emerging countries accessing the international market. In addition to the regular issuers such as Philippines, Indonesia and Malaysia, countries such as Fiji, Sri Lanka and Pakistan all priced USD bonds with maturities up to 10-years and size up to USD 1.5bn
- Among agencies, the USD activity is still dominated by the region's development banks and agencies in the likes of Kexim, Korea Development Bank, Japan Bank for International Cooperation and Development Bank of Japan as well as the Asian Development Bank who, alone, issued USD 13.5bn of public bonds.
- In the CNH space, SSA issuers were active in the first half of the year, with agencies such as KfW, CADES, KDB, Kexim and CABEI taping the market in the 3-year tenor. However, the market closed following the RMB devaluation and has so far only re-opened to the People Bank of China with a jumbo CNH 5bn one-year transaction listed in London at the end of October. Such a transaction can be viewed as a clear intention from Chinese authorities to push in favour of the internationalisation of RMB.

## CEEMEA

**CEEMEA volumes by region**

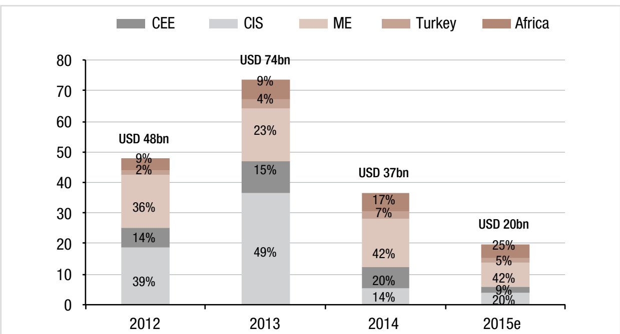



*Source: Bond Radar.*

- Multiple periods of elevated market volatility, global growth concerns, a weak commodity price environment, geopolitical developments and uncertainty surrounding the timing of the US rates lift-off have all adversely impacted CEEMEA primary activity this year. CEEMEA issuance volumes in 2015 have decreased by around 39% compared to 2014, and came in 47% lower against the record 2013 figures.
- Issuers from the Middle East (led by financials) and CEE (primarily sovereigns) have been the main providers of supply in 2015 at 32% and 29% respectively.

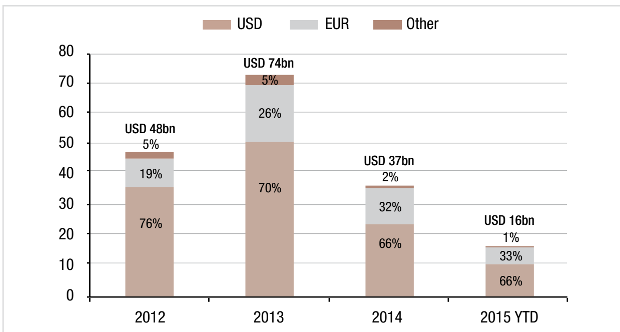
## Corporates

**CEEMEA corporate volumes by region**




*Source: Bond Radar.*

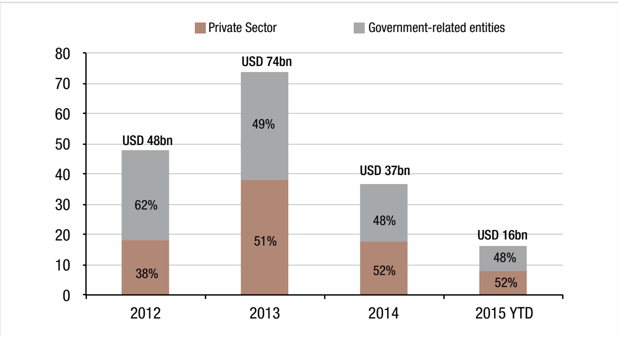
**CEEMEA corporate volumes by currency**




*Source: Bond Radar.*

- CEEMEA corporate issuance split by region in 2015 has broadly been in line with 2014. Middle Eastern (42%) and African (25%) corporates accounted for most of the supply in the region.
- Turkish and CEE corporates remain the laggards in terms of volumes (5% and 9% of total volumes for 2015 respectively). The lack of corporate bond issuance from these regions for the second year in a row is explained by access to attractive local currency funding and syndicated loans, as well as limited funding needs across the board. The overall EM and global macro lacklustre environment, combined with regional political uncertainties have also put M&A and Capex to a minimal.
- Increase in the share of CIS issuance (20% in 2015 vs. 14% in 2014) is driven by the re-appearance of Russian corporate supply in October 2015 – Norilsk Nickel issued a USD 1bn 7-year and Gazprom printed a EUR 1bn 3-year bond.
- Investment grade corporates represented around 63% of CEEMEA supply in 2015, broadly in line with 66% share recorded in 2014. A notable trend of this year is the lack of multi-tranche placements which comprised the bulk of IG corporate issuance for the region in 2014. This notion is reflective of IG corporates' generally strong funding positions this year, as well as relatively volatile market conditions throughout 2015, which rendered pricing on long-term tranches prohibitively expensive.

**CEEMEA corporate volumes by issuer type**




*Source: Bond Radar.*

- 2015 corporate supply witnessed a similar share of issuance from government-related entities (GREs) compared to 2013 and 2014. Supply in 2015 was highlighted by limited sub-investment grade Private Sector issuance: emerging market (EM) fixed income volatility decreased market accessibility for such issuers as (i) there were limited issuance windows since May and (ii) risk premiums associated with international bonds made them a less conducive funding tool.
- The split between USD and EUR issuance remained similar to last year (66% in USD and 33% in EUR), which is reflective of the continued low benchmark rate environment in the US.

## Emerging currencies

### 2015 review

#### RUB

- In Q1 2015 the RUB bond market made a sharp recovery after the 2014 plunge. This year the stabilisation of the geopolitical situation (Ukrainian crisis) has positively influenced market sentiment that changed from "sharply negative" to "neutral/positive", though market volatility has persisted. In comparison with the "window periods" placement structure in 2014 (May-June, September-October, December), 2015 saw a similar pattern, suffering from the overall EM and Russian specific volatility. The market was closed from January till late April when the primary market was reopened with O'Key and MOESK transactions. RUB bonds suffered another bout of volatility between July to September, and SG subsidiary, Rosbank, reopened the market again the market with a RUB 10bn bond. Still we have observed a significant increase in primary market deals (~RUB 450bn for 9M 2015 vs. ~RUB 150bn for 9M 2014, the numbers are calculated for all corporate issuers, including banks and FIs).
- Funds transfer from the Pension Fund of Russia to private asset managers and VEB (approximately RUB 550bn) increased liquidity available for debt investment. Pension funds share reached 45-55% of orders on recent deals from 30-40% in 2012-2014.
- Inflation stabilisation at 15-16% supported five CBR rates cut during the year (from 17% to 11%). Persistent market expectations to cut key rates pushed down bond yields approximately by 600-700 bps for corporates (from 17-18% levels in January to 11.00-12.00% levels in October for top-tier issuers).
- The reluctance of corporate issuers to borrow in 2014 and their willingness to wait for a favourable market environment led to increased market supply of this type of borrower in 2015 (21% for corporates vs. 79% for banks and FIs in 2014; 46% for corporates vs. 54% for banks and FIs in 2015).

### 2016 forecast

#### RUB

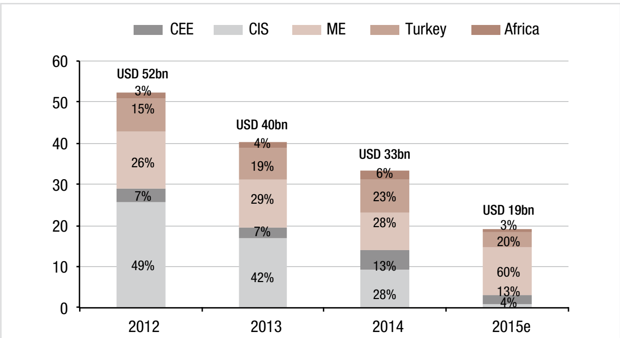
- According to macro forecasts, in 2016 we can see the beginnings of a recovery of the Russian economic recession that will positively influence supply in the debt market.
- However, the new pension funds inflow will be frozen for the next year; the government plans to use this source of funds to pay for current retirements.
- In 2016 we expect to see a slight expansion of the market to reach RUB 1.6-1.7tn in line with 2013 levels.

### High yield focus

- Volumes in the CEE region remained very limited due to volatility observed in the broader market and the focus on countries traditionally most active in terms of HY primary volumes (namely France, UK and Germany) coupled with very liquid local banking markets, as discussed above. As a result, only two issuers accessed the market via add-ons of their existing notes (namely United Group and Play) for total proceeds of EUR 275m versus EUR 2.2bn for full-year 2014.
- In Africa, 2015 was marked by falling commodity prices, negatively impacting Oil & Gas (O&G) and Metals & Mining (M&M) companies. In addition, the Afren saga has monopolised investors' attention as we went through the year. In terms of primary issuance volumes, African corporates remained relatively active with existing / well-known issuers such as Kosmos and Sappi accessing the market both in euros and US dollars. USD 3.4bn eq. was issued from non-investment grade / cross-over issuers in the region in 2015, compared toh USD 2.6bn eq. for full-year 2014.

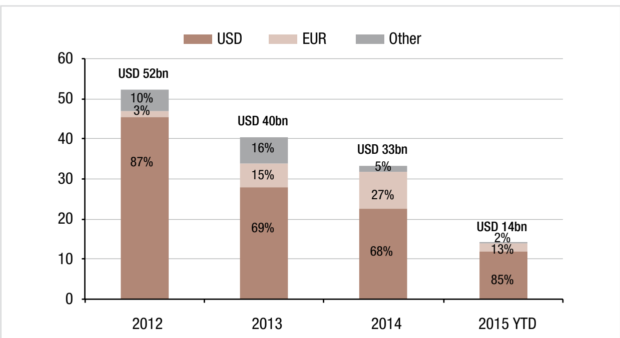
## Financial Institutions

**CEEMEA FIG volumes by region**



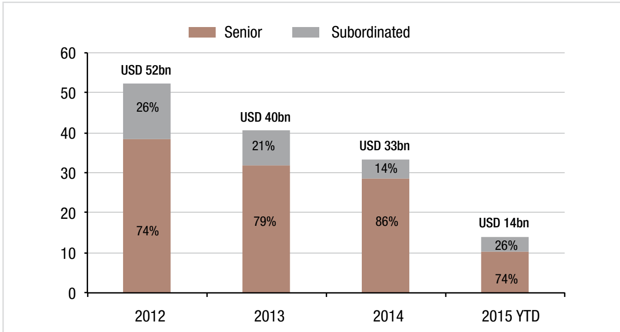

*Source: Bond Radar.*

**CEEMEA FIG volumes by currency**




*Source: Bond Radar.*

**CEEMEA FIG volumes by type**




*Source: Bond Radar.*

- In the financial space, 60% of the primary volume is expected to come from the Middle East in 2015. Turkish financial institutions should also account for 20% of this volume. This contrasts with 2014 which was much more balanced between the Middle East, Turkey, CEE and CIS. Sanctions in Russia, combined with a volatile political environment in Turkey, limited primary supply this year. It led to CEEMEA FI volumes representing 57% of the volume issued the previous year.
- From 2012 to 2014, FI primary volumes decreased sequentially from a record year of USD 52bn to reach USD 14bn so far this year. This can be explained in part by diminished asset growth across the CEEMEA region.
- USD remained the currency of choice for CEEMEA FI issuers in 2015 (85% of the financials issuance in 2015), exacerbated by the dominance of Middle East and Turkish issuers in the overall volumes
- Senior unsecured bond supply from the CEEMEA region decreased by 66% this year (from USD 29bn in 2014 to USD 10bn in 2015). 61% of the senior primary supply came from the Middle East, while Turkey came in second with 18%.
- Senior unsecured transactions represented 74% of the financial volumes in 2015 year-to-date, which is well below 2014 (86%) and more in line with 2012 and 2013 levels which represented respectively 74% and 79%. As Basel 3 is being implemented in most of the CEEMEA countries, issuers are adjusting their capital structure to the regulatory requirements, leading to an increase of subordinated Tier 2 or AT1 transactions this year (notably from Middle East banks, which remained preserved from market volatility and sanctions.
- Senior unsecured issuers were mostly active in the 5-year tenor in 2015 year-to-date (ca. 64% of total FI issuance).

### 2016 forecast

- While EM growth, low commodity prices, geopolitical issues and Fed rate hike will again be the main challenges for the CEEMEA region, financial institutions will also face regulatory pressure around Basel 3, MREL, IFR9, etc., forcing them to align their capital and funding structure with their international peers.
- With the implementation of a new Covered Bond law in Poland in 2016, Polish financial institutions should take advantage of this favourable framework to access the international mortgage bond market.

### Emerging currencies

#### 2015 review

RUB

- Market recovery after the 2014 plunge was also observed in the financial sector, with 18% growth in volumes this year: ca. RUB 550bn for 9M 2015 vs. ca. RUB 500bn for 9M 2014.
- From the end of 2014 and throughout 2015, we observed a new trend in the financial sector: "club deals" of low rated / Tier 3 banks. This consists in reciprocal placements between and in favour of other banks, with each party bringing the purchased notes for repo liquidity to the Central Bank of Russia.

#### 2016 forecast

RUB

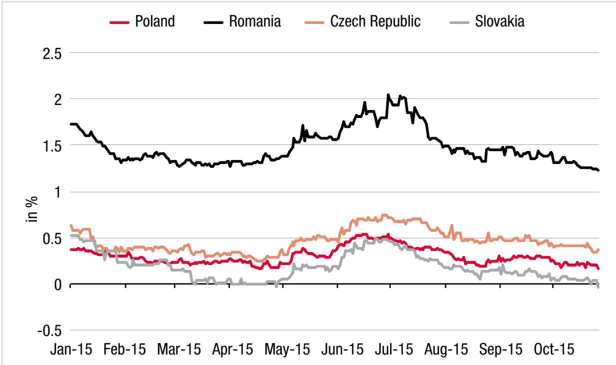
- Due to the likely prolongation of European and US sanctions into 2016, we are maintaining our forecast from last year, i.e. that sanctioned banks may use alternative ways to obtain FX funding, including borrowing in the local market and using cross-currency swaps, or using the Bank of Russia (CBR) FX repo mechanism in case of its reincarnation.
- Regulatory pressure will continue to be a driving factor for financial institutions and will comprise Basel 4 for systemic banks, new regulations for banks, pension funds, asset managers and insurance companies, tighter capital ratios, etc.
- CBR will continue to sanitise the financial sector, appointing a provisional administration and revoking banking licences of troubled banks, with a view to consolidate the industry. As an illustration, the imposition of a moratorium on NOTA-Bank (Caa3/-/-) creditors with RUB 5.5bn in outstanding bonds, should shift investor demand towards stronger rated banks (BB-rated and higher).

## Public Sector

#### 2015 review

- The diverse periods of market volatility as mentioned above led to a drop of 43% in issuance from CEEMEA SSA issuers in 2015 year-to-date vs. 2014 (USD eq. 67bn in 2014 vs. USD eq. 38bn in 2015 year-to-date).
- However, CEE sovereigns' issuers remained active in the EUR market, representing more than 80% of total CEE issuance in EUR. The ECB's accommodative policy, the lack of positive arbitrage in the USD market for most CEE issuers and the "euroisation" of the region are factors that led CEE sovereigns to remain active in EUR. The largest issuers in 2015 are Poland (raised a total amount of EUR 3.75bn via 3 syndicated transactions), Bulgaria (issued a triple-tranche benchmark transaction: EUR 1.25bn 7-year, EUR 1bn 12-year and EUR 850mln 20-year) and Slovenia (two benchmarks and several private placements launched this year for a total amount of EUR 2.825bn). In addition, most CEE sovereigns issued benchmarks in the EUR market (Romania, Croatia, Latvia, Lithuania, Montenegro, etc.). This effectively shows that the EUR market has become the main market for CEE issuers due to the strong integration in the euro area. The most frequent USD issuer out of the CEE was Turkey (issued USD 3bn via two syndicated transactions) as the USD remains its main market, still offering competitive conditions vs. EUR.
- In view of spread tightening, improved credit quality and increased demand from central banks, most investment grade CEE sovereign issuers no longer belong to the EM universe but are now well anchored in the high-grade developed markets segment.

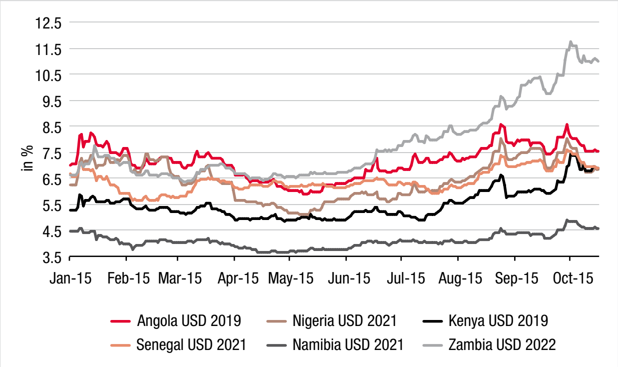
**CEE sovereign EUR 5Y benchmark yields evolution in 2015**

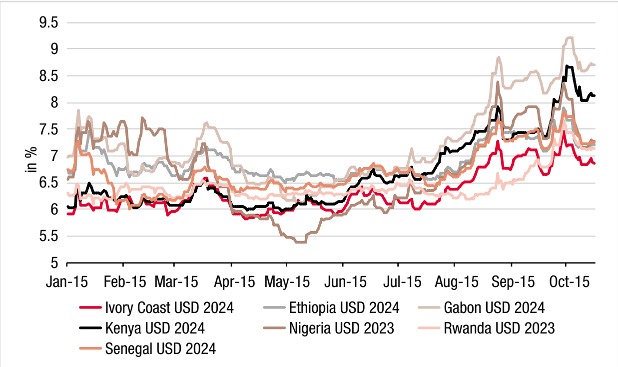



*Source: Bloomberg.*

- In Russia/CIS, the market remained closed for Russian public sector issuers on the back of on-going sanctions. However, CIS issuers such as Kazakhstan (USD 4bn) successfully came to the market, providing some supply out of the region. Given their commodities-led economies, these countries issued in USD only.
- In the Middle East, the main issuers were Lebanon and Jordan (US AID), highlighting relatively low supply in the international markets out of the region, as most sovereigns still benefited from large reserves.
- In Africa, despite a less supportive market environment, many sovereigns successfully accessed the international markets for a total amount of USD 6.25bn. The USD market remains by far the prominent market for African issuers.
- The diversity of African issuers this year: Egypt, Tunisia, Ivory Coast, Ghana, Gabon, Zambia… and more to come denotes EM investor interest in African signatures, although they have been requesting higher yields of late due to increased market volatility.

**Widening of Sub-Saharan USD sovereign bond yields in 2015**




*Source: Bloomberg.*

## 2016 forecast

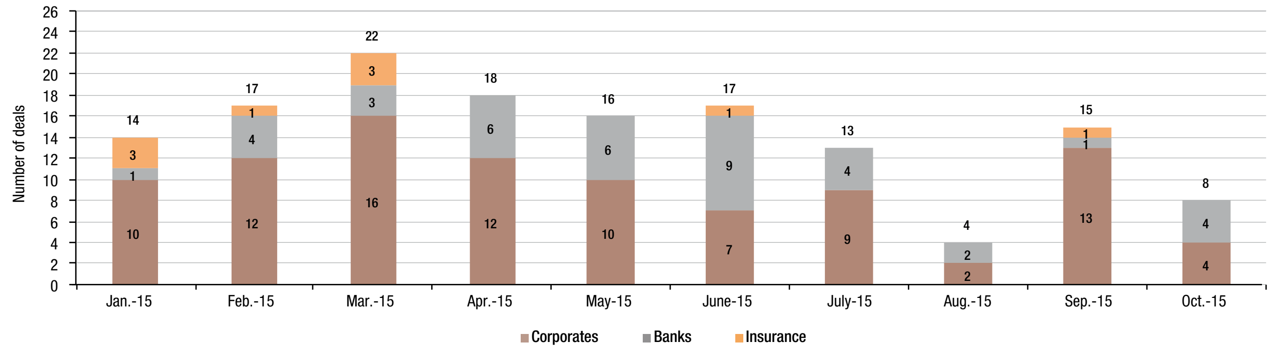
- CEE sovereigns are likely to continue to prioritise the EUR market. The most frequent issuers (Poland, Slovakia, Slovenia, etc.) will remain so, as the EUR market is either their domestic market and/or an essential source of funding. The USD market is likely to be seen as a more opportunistic market, except for Turkey which will continue to see the USD market as their main market.
- Uncertainties are likely to prevail in Russia/CIS. Russian SSA issuers remain dependent on sanctions. If sanctions are lifted, this should signal their gradual return to the international markets.
- In the Middle East, sovereign issuers may visit the international markets to partly fund their deficit, as commodity prices remain low. In this regard, Middle East sovereigns are expected to be more active in 2016 in the Sukuk market due to an increase of their financing needs, feeding the strong appetite of Middle Eastern investors for this product.
- With higher yields, African issuers may be more cautious in accessing the international markets. However, the strongest credits will continue to be demanded by investors and, as such, are likely to return to the bond markets. In addition, some supply in EUR from the better-rated sovereigns could be seen, as EUR investors are looking for diversification and higher yields.

# Liability Management

## 2015 review

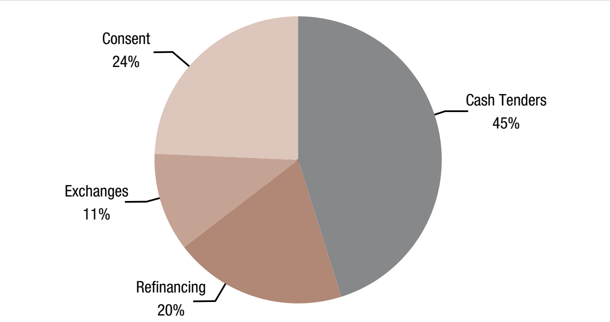
- In 2015 liability management (LM) activity increased, with over 140 transactions executed in European markets between January and October 2015, compared to around 90 for the same period last year.
- LM activity remains correlated to primary market activity, with a relatively even deal flow throughout the year (excluding the summer break).

**2015 saw a significant uptick in liability management exercises, particularly from corporates, but also driven by FIs**




*Source: SG CIB Analytics.*

**Tender Offers accounted for the majority of LM transactions, typically driven by M&A (disposals)**




*Source:SG CIB Analytics.*

# Corporates

- 2015 LM activity was dominated by corporates, which accounted for 67% of the total number of deals done this year (down from 78% in 2014). There were a total of 95 LM transactions in the first 10 months, compared to 73 for the same period last year.
- The majority of European transactions were conducted in EUR-denominated bonds which experienced an impressive average take-up of 38% (vs. 39% in 2014), reflecting continued investor interest in LM exercises.
- Another year of low interest rates prompted corporates to continue refinancing their upcoming redemptions. This enabled them to optimise their cost of interest and replace 'pricier' old bonds with new debt, offering a much lower coupon than on outstanding bonds, with the added benefit of extending their average maturity at the same time. There have been 31 corporate refinancing transactions (tender & new issue and exchange offers) in Europe this year to date.
- Additionally, we observed 43 cash tender offers in 2015, mainly on the back of booming M&A activity. This included some of the largest tender offers seen to date from corporates, including LafargeHolcim (the biggest ever European corporate LM exercise) and Vimpelcom.
- Consent solicitation exercises picked up as a result of increased M&A, with 27 transactions taking place this year to date, of which six were in conjunction with a tender/ exchange offer.
- Elsewhere we saw some significant transactions occurring in the US, including General Electric (exchange offer for 123 notes totalling USD 110.4bn outstanding) and HP Enterprise (new issue and tender offer for 15 bonds totalling USD 15.3bn).
- In the emerging markets, 54 liability management transactions were launched this year, with Russia dominating the landscape (30%), followed by Ukraine and China with 19% each. We also saw deals coming from Brazil (six) and South Africa (three) this year. The market was shared between vanilla cash tenders (43% of deals) and consent solicitations (37% of exercises).
- We expect this strong trend to continue into 2016 for corporates, with the low yield environment and solid M&A activity as the main drivers for LM.

# Financial Institutions

- Financial institutions (FI) carried out more LM exercises (49) than in 2014 (15) with a view to optimise their regulatory capital positions.
- Banks accounted for most of the FI LM activity, as they continued to phase out legacy subordinated instruments from their balance sheets (e.g. Unicredit, Santander).
- Many banks, such as ING, Bank of Scotland and ABN AMRO, also launched consent solicitations for change of their bonds from hard bullet to soft bullet.
- In the insurance sector, we observed tender and exchange offers on subordinated bonds from some insurers seeking to optimise capital positions ahead of the Solvency II implementation (Ageas, Ethias SA, Achmea).
- For 2016, we expect LM activity to remain steady for FI as they continue to align their capital structure with Basel 3 / Solvency II regulations.

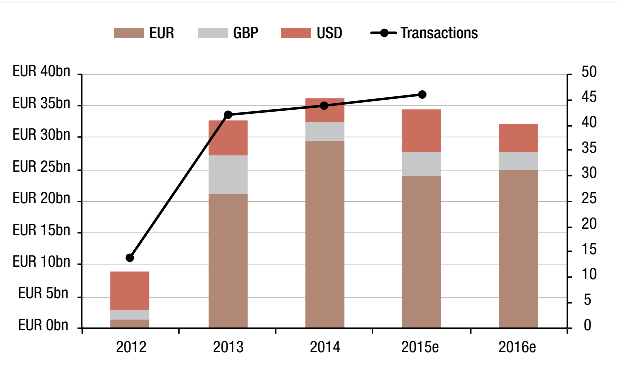
# Hybrid Capital Market

## Corporates

### PRIMARY MARKET ACTIVITY

#### 2015 review

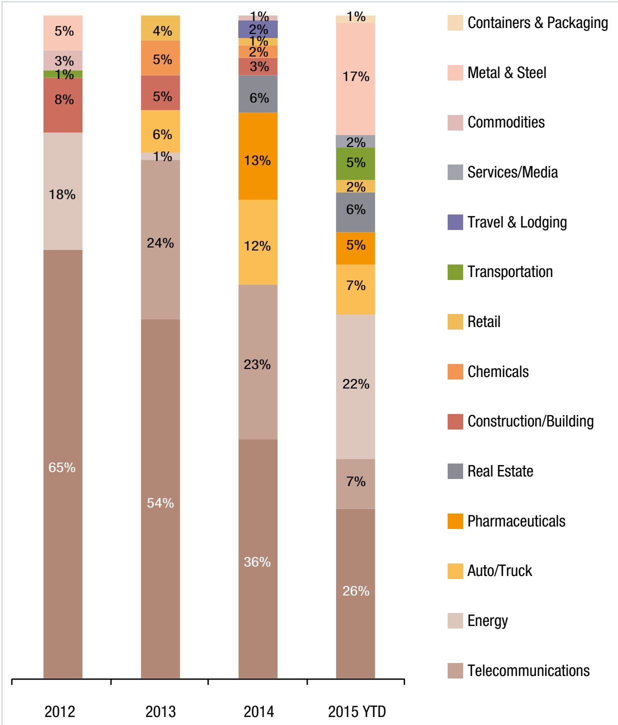
**Corporate hybrid supply worldwide remained very active in 2015 after the surge in issuance volumes in 2013/2014**




*Source: Dealogic / SG CIB.*

- 2015 saw another positive year for the corporate hybrid market, with high issuance volumes and a diverse range of sectors considering hybrids as a long-term element of their capital structure. The 2015 year-to-date volume is EUR 33bn eq. and we expect this to reach EUR 37bn eq. by the end of the year, given mildly attractive primary market conditions.
- 2015 major trends can be summarized as follows:
  - the first maturity test for the corporate hybrid market, with a number of issuances from 2005 and 2010 coming to first call (Vattenfall, SSE, Dong Energy). There was also a considerable supply related to refinancing
  - the jumbo issuances from the oil & gas and mining sector, illustrated by the EUR 5bn 2-tranche issuance from Total in January and the EUR 5.6bn eq. 5-tranche issuance from BHP Billiton in October
  - the very active M&A market, with a number of issuers turning to hybrid instruments to fund acquisition projects (Deutsche Boerse, Solvay, Repsol).
- The EUR market continued to dominate the overall hybrid market, with 78% of the total issuance volume printed in EUR, followed by 15% in USD and 7% in GBP.
- With regards to issuer type, this year saw a handful of industries dominate the landscape. Additionally, we saw a drastic increase in supply from the energy sector compared to last year and, combined with utilities, they accounted for almost half of the total market, with the main drivers being M&A activity (Repsol) and the drop in oil prices impacting balance sheet (Total, BHP Billiton).

**In 2015 YTD, corporate hybrid supply came primarily from utility and energy firms**




*Source: SG CIB Analytics.*

#### 2016 forecast

On October 27th, S&P announced the revision of the equity treatment, from 50% to 0%, on 29 existing hybrids, issued by 14 corporate issuers, representing c. 20% of total market volume. This created initially a lot of volatility, with both issuers and investors criticizing what was perceived as a unilateral change of stance from the rating agency. Issuers should however be able to recover equity credit in the near future through unilateral commitments not to exercise the rating event call deemed non-compliant with S&P criteria.

In 2016, we expect the corporate hybrid issuance volumes to stabilise, with continuing low rates and yield environment to keep investors' appetite strong and offer issuers a cost effective capital funding instrument. The strong M&A activity we have seen this year is likely to continue and will also positively influence hybrid issuances. We expect the following issuance volumes:

- In EUR, a total of EUR 25bn of issuance, 7% lower than 2015 expected.
- In USD, a total of USD 5bn of issuance, 29% lower than 2015 expected.
- In GBP, a total of GBP 2bn, 33% lower than 2015 expected.

# Financial Institutions

## REGULATORY ENVIRONMENT

### Banks

#### EBA updates

- On 29 May, the European Banking Authority (EBA) published the final version of its updated report on the monitoring of Additional Tier 1 capital instruments issued by EU institutions. The EBA reviewed 15 instruments issued between August 2013 and November 2014 and provided guidance in areas where reading of the Capital Requirement Regulation (CRR) might lead to different interpretations and where the EBA would recommend avoiding the use of some clauses.
- On 3 July, the EBA published its final draft of Regulatory Technical Standards (RTS) on the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) and on the contractual recognition of bail-in. The MREL capital requirement will be expressed as a percentage of the total liabilities and own funds of the institutions and will be set by the resolution authority for each institution. The eligibility criteria allow for both senior and subordinated liabilities to count towards MREL. The regulations will be implemented from 1 January 2016 with a phase-in period of four years.

#### BRRD implementation

- On 19 June, the Spanish government published the final bill transposing the Bank Recovery and Resolution Directive (BRRD) in Spain
- In late-August, France and Italy transposed the BRRD into national law. The transposition comes after the European Commission set an implementation deadline of 28 August 2015 for 11 countries, including Italy and France which had failed to implement BRRD by the original deadline of 31 December 2014
- On 24 September, the German Federal Diet ("Bundestag") voted into law the draft Act to implement the Single Resolution Mechanism (SRM) in Germany through an amendment to the German Banking Act. According to the law, any unsubordinated debt that is not "negotiable" (e.g. money market instruments, structured senior debt) shall be satisfied before any "negotiable" senior unsecured debt instruments in insolvency. This amendment effectively allows the German global systemically important banks (G SIBs) to use its existing senior negotiable debt as TLAC-eligible capital.

#### FSB TLAC update

- On 25 September, the Financial Stability Board (FSB) announced that it has agreed upon the final draft principles and the updated term sheet for the Total Loss-Absorbing Capacity (TLAC) proposal to be applied to G-SIBs, excluding those headquarters in emerging markets. The TLAC standard and timelines are thus expected to be publicly disclosed at the forthcoming G-20 summit in November. The list of TLAC-eligible liabilities is likely to include the Basel III regulatory capital instruments plus senior debt which is structurally subordinated to TLAC-excluded liabilities and resolution funds.

#### National developments

- On 27 February, the Prudential Regulatory Authority (PRA) disclosed the 2014 list of UK-headquartered global systemically important institutions (G-SIIs) along with their respective subcategories and G-SII buffer requirements, which would be phased in from 1 January 2016 for full implementation by 1 January 2019. The list comprises HSBC (2.5% G-SII buffer), Barclays (2%), RBS (1.5%) and Standard Chartered (1%).
- On 10 July, the UK's Prudential Regulation Authority launched a public consultation on the implementation of the leverage ratio framework for UK banks. The consultation proposes a countercyclical leverage ratio buffer in addition to the minimum leverage ratio requirement of 3%, and an additional leverage ratio buffer for G-SIBs. The PRA has suggested a transitional period of 12 months starting from 1 January 2016 for implementing these requirements.
- On 27 August, the Dutch Central Bank (DNB) imposed a systemic risk buffer (SRB) of 3% of risk-weighted assets (RWAs) to the three systemic banks in the Netherlands: ABN Amro, ING Bank and Rabobank which would need to be fully implemented from 1 January 2019.
- On 7 September, Austria's Financial Market Stability Board (FMSB) reduced the systemic risk buffer from 3% of RWA as imposed in June 2015 to 2% of RWA for the largest Austrian banks. The systemic risk buffer requirements will enter into force from 1 January 2016 and will need to be fully implemented by 1 January 2019 instead of the earlier proposed timeline of mid-2017
- On 24 September, Switzerland's lower house of Parliament approved a proposal which will require the biggest Swiss banks to maintain a 6% leverage ratio. The upper house of the Swiss parliament is expected to discuss and vote on the proposal within the next three to six months and if approved, the proposal will be written into law.

### Insurance

#### Solvency II update

- On 17 January, the Delegated Acts adopted by the European Commission on 10 October 2014 were published in the Official Journal of the EU. These implementation rules will be directly applicable in Europe. This date also marks the cut-off date for the Omnibus II grandfathering provisions. Hence, only the instruments issued before this date can benefit from the transitional rules.

- On 20 March, the UK Prudential Regulation Authority published its final rules on the implementation of the Solvency II Directive in the UK.
- On 7 July, the European Insurance and Occupational Pensions Authority (EIOPA) published the second set of draft Implementing Technical Standards (ITS) for Solvency II, following public consultation. The ITS were submitted to the European Commission for endorsement and cover different areas from all three Solvency II pillars: quantitative basis, qualitative requirements reporting and disclosure. Later in July, HM Revenue & Customs (HMRC) published a draft regulation paper on the tax treatment of Solvency II Tier 1 securities amending the Taxation of Regulatory Capital Securities Regulations 2013 (RCS). The regulation will take effect from 1 January 2016.
- On 14 September, the EIOPA issued the second set of its Solvency II guidelines in the official languages of the EU. The guidelines follow the first set of the guidelines published in February and are addressed to the National Competent Authorities (NCAs) or Financial Institutions who need to confirm within two months if they comply or intend to comply with the guidelines.

### HLA update

- On 5 October, the International Association of Insurance Supervisors (IAIS) announced it has finalised the policy measure for Higher Loss Absorbency (HLA) capacity requirement for global systemically important insurer (G-SIIs), following a public consultation launched in June 2015. The HLA capital requirements are aimed at reducing the probability of failure of G-SIIs by requiring them to hold more capital. The HLA requirements will sit on top of the Basic Capital Requirements (BCR) and will need to be met through Core capital only. The HLA is to be delivered to the G20 for endorsement in November 2015 and will apply to G-SIIs from 2019.

## RATING CONSIDERATIONS

### Banks

- On 28 April, Standard & Poor's (S&P) published their revised bank rating methodology detailing the Additional Loss Absorbing Capacity (ALAC) criteria and placed the ratings of systemically important banks (as defined by S&P) in the UK, Germany and Austria on "Under Criteria Observation" (UCO). ALAC consists of certain bank hybrid capital instruments and, in specified circumstances, other liabilities that are positioned to absorb losses within a resolution process, in a way that reduces the risk of the bank defaulting on its senior unsecured obligations. These revised criteria are intended at taking into account resolution frameworks that are being implemented in Europe and North America.

### Insurance

- On 15 July, Moody's published a request for comment with a proposed approach for rating insurance 'high trigger' contingent capital ('coco') securities. The approach is conceptually similar to the one used by Moody's in the banking sector, with certain aspects adapted to the insurance sector. The securities will be rated via a model-based approach and will consider the distance to trigger, the probability of the insurer's solvency ratio reaching point of non-viability (PONV) and the loss severity in a trigger event.

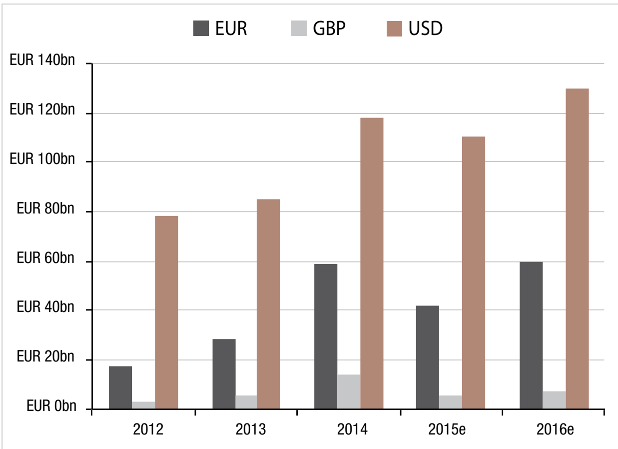
## PRIMARY MARKET ACTIVITY

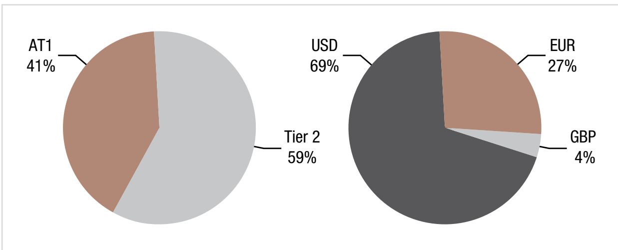
The financial hybrids primary market has been continuously changing over the past three years in response to the evolving regulatory environment. 2015 saw a lower primary supply than 2014, mainly due to greater market volatility.

- The primary market was very active during Q1 2015 and on either side of the summer break, with a total issuance volume of nearly EUR 180bn eq. globally.
- We saw many banks pricing their inaugural AT1 transactions, including: Swedbank USD 750m 5.5% PerpNC5, Svenska Handelsbanken USD 1.2bn 5.25% PerpNC6, ING dual-tranche USD 1bn 6% PerpNC5 and USD 1.25bn 6.5% PerpNC10, NBAD USD 750m 5.250% PerpNC5, RBS dual-tranche USD 2bn 7.5% PerpNC5 and USD 1.15bn 8% PerpNC10 and BNP Paribas EUR 750m 6.125% PerpNC7.
- Regular issuers in the AT1 and Tier 2 space also remained active, a few examples being Societe Generale, HSBC etc.
- More limited activity outside of Europe and the US due to general EM sell-off, international sanctions (Russia) and concerns about Chinese economy.

### 2015 review

**Lower supply in 2015 (vs. 2014) given more volatile market conditions**




*Source: Dealogic / SG CIB.*

### EUR MARKET

Euro-subordinated volumes (banks and insurance) were below last year's at EUR 37bn in 2015 vs. EUR 59bn in 2014.

- We saw lower supply from both banks and insurance companies. Banks accounted for EUR 26bn of supply (vs. EUR 41bn in 2014), while insurance companies issued EUR 11.5bn (vs. EUR 18bn in 2014).
- In terms of split between AT1 and Tier 2, we saw EUR 9.5bn of AT1 and EUR 16.5bn of Tier 2 issuances.
- In terms of jurisdiction, most transactions came from core countries (UK, Germany, Netherlands, France, Nordics, etc.), although we saw some activity from peripherals (almost 15% of overall supply from Iberia and Italy).

### USD MARKET

In the USD-subordinated market, the volume of issues fell from USD 135bn in 2014 to USD 95bn in 2015. This still represents the most active segment with nearly 60% of volumes for banks and 31% for insurances overall.

- In terms of regional split, 46% of the supply came from US issuers. European firms accounted for 38% of volumes with the rest being split between Middle East, the APAC region and South America.
- The split in terms of AT1 and Tier 2 was fairly even, with USD 47.5bn of AT1 and USD 44.5bn of Tier 2 supply.

### GBP MARKET

Volumes in the sterling market followed the overall trend from EUR and USD and were significantly below 2014's volumes. We saw GBP 6bn of issuance in 2015 vs. GBP 10bn last year. The majority of the supply came from banks.

### EMERGING MARKETS FOCUS

- 2015 was a dynamic year in the emerging subordinated space, especially for financial institutions where clarifications around Basel III implementation led some issuers to reinforce their capital structure. EUR 35.7bn eq. of subordinated bonds were issued including EUR 7.9bn eq. of AT1, EUR 23.4bn of Tier 2 and EUR 4.3bn of insurance dated bonds.
- In Turkey, the finalisation of Basel III implementation led Vakifbank to issue the first Basel III compliant Tier 2 out of Turkey (featuring a contractual loss absorption mechanism at the PONV).
- In the Middle East, while most countries have already implemented Basel III, the UAE is still in the process of transposing Basel III rules. In this context, UAE banks have come to the market with bespoke structures anticipating the upcoming regulation (contingent loss absorption mechanism). SG CIB was notably involved as joint-bookrunner on NBAD's inaugural Tier 1 bond offering (USD 750m PerpNC5).
- With more countries now looking at implementing resolution regimes (e.g. Singapore, Hong Kong and South Africa), thereby following the path of Europe (BRRD) and the FSB's guidelines for an effective resolution of failing banks, we expect supply to pick up in these regions across the range of capital instruments (AT1, Tier 2 and eventually "Tier 3").
- From the APAC region, we have seen active issuance from Japanese insurance companies (Meiji Yasuda Life and Fukuoka Mutual Life) and Chinese banks (China Construction Bank, Industrial and Commercial Bank of China, Bank of Communication) on the back of a trend which started towards the end of 2014.
- The growing presence of capital bonds from non-Asian banks in the CNH space is also worth noting. This year, seven Australian and European banks including Societe Generale, BNP Paribas, CBA, ANZ etc. have successfully printed their Tier II papers in the Dim Sum format, accounting for all of the capital deals in CNH market for a total issuance volume of CNH 9.6bn.

## 2016 forecast

On the financial institutions side, we expect the focus to definitively shift to MREL and TLAC. With many banks having filled most of their AT1 and T2 Basel III buckets, these additional capital requirements are expected to drive the hybrid market supply in 2016.

We forecast the following volumes for FY 2016:

- In EUR, a total of EUR 60bn of issuance or an increase of around 43% vs. 2015 full-year expected.
- In USD, a total of USD 130bn of issuance or an increase of 18% vs. 2015 full-year expected.
- In GBP, a total of GBP 7bn of issuance compared to GBP 6bn 2015 full-year expected.

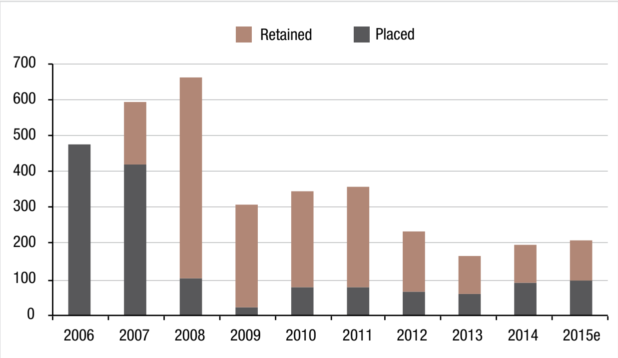
# Asset-Backed Products Securitisation & Distribution

## EUROPEAN MARKET

### 2015 review & 2016 forecast: could securitisation be back in the market spotlight?

- Year-to-date volumes show contrasted performance as retained asset-backed securities (ABS) remain a very significant share of the ABS market (x3 more in Germany between 2014 and 2015 year-to-date and +40% in Italy, while -43% in Spain and the UK). Total placed volumes are nevertheless expected to reach EUR 90-95bn in 2015, settling in line with to slightly above 2014.

**Public placement ABS (excl. CLO) - in EURbn - very similar YoY patterns**




*Source: AFME, SG Research.*

- 2015 started on a strong note in Europe but will undoubtedly be affected by the global turmoil in equity markets owing to the uncertainties over Greece as well as China.
- Apart from the macro-economic influence resulting in a general widening of spreads across all asset classes during Q3 2015, the European context has been impacted by the recent investigation into car emissions. The effect on the European Auto ABS market was initially negligible and issuers were able to place auto ABS at very competitive levels. As the story unfolded and the potential financial consequences for automakers started to emerge, we saw a short-term widening of Auto ABS spreads in the secondary market.
- In terms of issuance jurisdictions, some core countries (Germany and, to a lesser extent, France) have seen a marked increase in placed volumes vs. 2014. The Netherlands, the UK and Southern Europe posted volumes slightly below last year. Overall, fragmentation in European capital markets continued to reduce in 2015 and pan-European deals are gaining momentum.
- RMBS remains the strongest asset class by placed volume, with the UK remaining leader in this sector driven by the non-conforming deals. The noticeable absence of UK master trusts tapping the markets in the usually strong second quarter narrowed the gap with ABS issuance, despite the recent return of the Permanent Master Trust. Both markets continued to see a variety of new and less frequent issuers with smaller deal sizes, while the frequent German auto issuers leading the ABS markets took advantage of historically low spreads until recently (EUR 4.8bn in H1 2015). The RMBS market was marked by a EUR 20bn (retained) deal from Deutsche Bank that rolled a 2009, retained transaction.
- Credit standards have continued to ease in 2015, benefiting SMEs in particular. Yet securitisation of SME loans remains underutilised in Europe and cannot compare with US volumes. The Juncker Plan to invest and provide funding for infrastructure and SMEs through the European Investment Fund (EIF) is a clear sign of support for the asset class, but it still needs to prove its efficiency and demonstrate enough liquidity in SME-backed papers for the market to take off. This support should increase in 2016.
- European CMBS saw an increase in new issuance volumes in 2015 and continued to diversify both in terms of asset classes (with a first hotel deal) and jurisdictions, now including Germany, Italy, the UK, the Netherlands, Ireland, France and Belgium, with a return of multi-jurisdiction and multi-sponsor conduit deals.
- While the ECB's ABS Purchase Programme (ABSPP) has undeniably restored some confidence in the long-term prospects for ABS, volumes purchased have remained limited and therefore disappointing. At the end of Q3 2015, the ECB held approximately EUR 13bn in ABS. We expect more input with the purchase from the European Investment Bank (EIB) and the EIF under the European Fund for Strategic Investments (EFSI) initiative in 2016, which should drive the ABS structuring and the placement accordingly.
- Regulatory developments in 2015, however, are positive, even though banks still have many concerns and the draft texts are yet to be finalised. The discussion around a framework for "Simple, Transparent, Standardised" (STS) securitisation is very active and has reached European institutions through the Capital Market Union (CMU) initiative. The proposal is a critical milestone in establishing a liquid and harmonised European-wide market. STS-qualifying deals would benefit from reduced

capital charges for banks and insurers. Details of the criteria for STS securitisation still need to be worked out and banks have expressed their concerns, particularly on requirements for due diligence and disclosures. On the bright side, mezzanine tranches could qualify for STS treatment, which represents an important step for an efficient use of securitisation techniques across the entire capital structure. Overall, the new regulations favour unified legal references under a single regime for securitisation originators and investors.

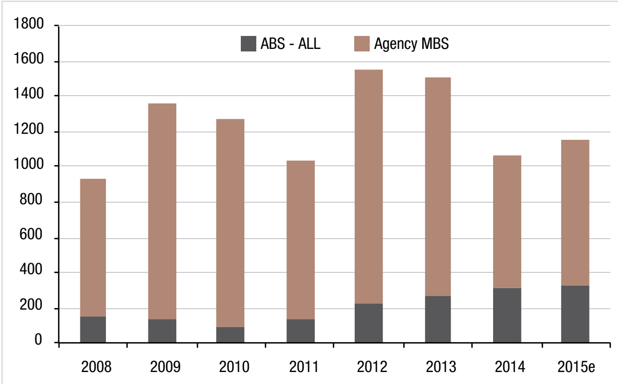
- Regulation proposals also affect risk retention rules, highly impacting European collateralised loan obligation (CLO) markets. European CLO volumes have remained steady as economic momentum in Europe casts a positive light on loan markets with assets regularly trading at or above par.
- Since the summer, spreads have widened on CLO, particularly on the most senior, AAA-rated tranches. The CLO market has fallen into a stop-and-go state. Recently released working papers have created uncertainties regarding what structures would fit its retention requirements. Vehicles used by CLO managers to finance the retention pieces have come under close scrutiny. Non-Europe based managers in particular could be in an uncertain position. Investors have shied away from some CLO and transactions are taking longer to come to the market. CLO structures are becoming more standardised and opportunities for cross-selling between the US and Europe are becoming increasingly relevant with a few structures offering both USD and EUR tranches.
- ABCP issuance in Europe has been consolidating with outstandings of USD 67bn as of Q2 2015. Multi-seller conduits dominate the markets, with French and UK banks leading the sector. STS proposals have made a specific focus on ABCP and have recognised the needs for functional ABCP markets. Specific ABCP STS criteria have been proposed. While this is significant progress for ABCP conduits, these criteria raise many questions and could potentially reshape the markets towards shorter maturity assets.
- 2016 prospects initially seem similar to 2015. On the regulation front, the stars look aligned for a revival and standardisation of securitisation on a medium- to long-term horizon. The international context and Europe-specific issues (automaker worries, Southern European debt issues) still cloud the sky for an undisturbed take-off of securitisation. The wider spread levels look encouraging for increasing the investor base. Were more issuers choosing securitisation as their preferred exit route, 2016 would be a year to look forward to.

## US MARKET

### 2015 review & 2016 forecast: undisturbed markets in a recovery context

- The US ABS market continues to be a viable source of funding for issuers of a variety of asset classes, as can be exemplified by the continued steady supply, year-after-year, since the market rebounded post-crisis. Year-to-date issuance volume stands at USD 150bn, in line with FY2014 issuance (approx. USD 190bn), ahead of FY2013 volume (approx. USD 172bn).

**US ABS volumes – in USD bn – a viable source of funding for issuers**

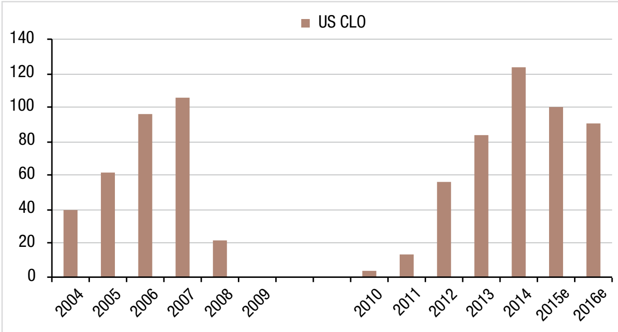



*Source: AFME, S&P, SG Credit Research.*

- Asset classes on the US ABS markets are dominated by auto transactions which increased its percentage on 2014 (48% vs. 43%), while credit card deals are markedly lower than last year as issuance spreads and regulatory hurdles continue to sideline some of the bigger issuers. In detail, subprime auto loans represent the bulk of the increase in auto volumes, which clearly indicates the strength of the US markets. Aviation lease, rental car, and whole business deals are on the rise as well, confirming the appetite for more esoteric asset classes as yield hungry investors look to expand their investment horizon.
- Non-US issuers are also active, particularly in auto and credit cards transactions, while regional US banks picked up their activity in securitising auto loan pools. Issuers are certainly taking advantage of the low interest rate environment in the US before the Fed starts raising its rates, expected before the end of the year or possibly early 2016.
- The continued wave of issuance as well as broader macroeconomic volatility has put pressure on spread levels across all asset classes for much of H2 2015. Prime auto loan and credit card bonds have been able to reduce their widening when compared to more esoteric classes, as investors have sought out transactions with higher perceived liquidity in the volatile market conditions. In our opinion, the spread widening was purely technical, as other classes have widened as well; underlying fundamentals remain strong and are not currently an area of investor concern.

- The non-agency CMBS market continues to see increased issuance YoY as demand for both conduit and single-asset/single-borrower transactions remain strong. The increased issuance has allowed for the refinancing of several maturities and volumes are expected to remain elevated as borrowers have access to attractive financing. Approximately USD 73.44bn has priced to date for private-label CMBS, of which around USD 44.1bn in the form of conduit transactions. As a comparison, 2014 year-to-date figures were around USD 63bn and USD 41.05bn respectively, further displaying the growth in the single-asset/single-borrower space. Issuance is expected to remain robust through to year-end, as bank originators are incentivised to maintain velocity and price transactions shortly after origination, instead of holding the risk on the balance sheet for extended periods of time.
- With increased volumes and broader macroeconomic volatility, we have seen spreads widen in H2 2015. The AAA-rated, 30% subordinated, 10-year "Duper" class is currently pricing in the +120-125 bps area while it traded as tight as +82 bps in March; the BBB- classes are now in the +520 bps area while they traded as tight as +305 bps on that same June transaction. The widening spreads have not discouraged loan originators, as they have been able to widen their rates and still originate supply.
- Coming from a record year of new issuance in 2014 of USD 124bn, the US CLO market has remained quite active in 2015, but has been facing headwinds going into year-end. Year-to-date issuance volume is USD 80bn vs. a comparable 2014 year-to-date issuance volume of USD 99bn. Issuance volume in H1-2015 was tracking much in line with H1 2014 at USD 59bn, but slowed considerably in Q3 with total issuance of USD19bn.
- Primary issuance is under pressure as liability spreads have moved wider over the past few months due to a confluence of growing fundamental credit concerns, higher market volatility, deteriorating liquidity conditions and regulatory considerations. The widening is most evident in the lower mezzanine spread levels, where pricing for BBB- and BB-rated notes for frequent CLO issuers has increased by 30-40 bps and 80-100 bps respectively. Given the challenging conditions to make CLO economics work at the moment, new issuance is expected to be a bit sluggish in the near term.

**US CLO volumes – in USD bn – a fairly active market in 2015**




*Source: AFME, S&P, SG Credit Research.*

- In more detail, declining credit fundamentals in certain industries, such as energy and metals/mining, has resulted in further price differentiation between deals, particularly in the lower mezzanine and equity tranches. CLO investors have become more attuned to manager performance in avoiding distressed credits in these industries, which has led to an extensive re-evaluation of traditional manager price tiering. Secondary loan prices have moved lower amid broader market volatility. This move has had a meaningful impact on CLO mezzanine and equity tranche prices, and investors are seeing declining liquidity from the existing buyer base. Growing investor concerns about the ability of managers to comply with the pending US risk retention rules that come into effect at the end of 2016 have prompted some managers to issue US risk retention compliant transactions, and have limited the entry of new managers to the market. Approximately 10% of the deals in 2015 have been structured to be US risk retention compliant and that percentage is expected to increase in 2016, which may result in smaller transaction sizes and a smaller universe of managers issuing deals going forward.

# Syndicated Loan Market

## 2015 review

Syndicated loans in EMEA in the first nine months of 2015 totalled USD 683bn (source: Dealogic), down 23% on the same period in 2014, as European merger and acquisition activity remained muted and demand for refinancing continued to tail off.

### Corporate High Grade Western Europe

In the first half of the year, we witnessed the same trend as in 2014, with margin compression and most of the volume coming from early refinancings or amendments and extensions of syndicated facilities. Since the beginning of the summer, the macro-economic issues (concerns about Greece, then China and commodities) and the increased volatility in the broader capital markets have translated into a stabilisation of pricing and a reduction in volume, as there are fewer refinancing opportunities. After an encouraging start to the year, M&A activity was disappointing and is down 25% overall vs. 2014. Corporate High Grade volume through Q3 2015 is down by 14% compared to the first three quarters of 2014.

### CEEMEA

Due to the sanctions regime, activity in Russia was very slow in the first half of the year, but is gradually picking up since the beginning of the summer. So far interest from lenders has been focussed on exporting companies in sectors not impacted by sanctions (e.g. fertilizers, metals).

In Central Europe, margins have continued to tighten, which has encouraged further refinancing activity, notably tapping abundant local currency liquidity in the Czech Republic and in Poland.

In the Gulf region, the available liquidity remains strong and the deal flow limited. This clearly drives prices lower but in the meantime lenders are looking for the right opportunities to put their money at work. Thus, while the right credits/structures always attract the banks, some deals struggled a bit more for credit/pricing reasons.

The first impacts of the fall in the oil price can be seen in the regions with an increase in USD funding cost for local banks and a regional liquidity drop.

### Americas

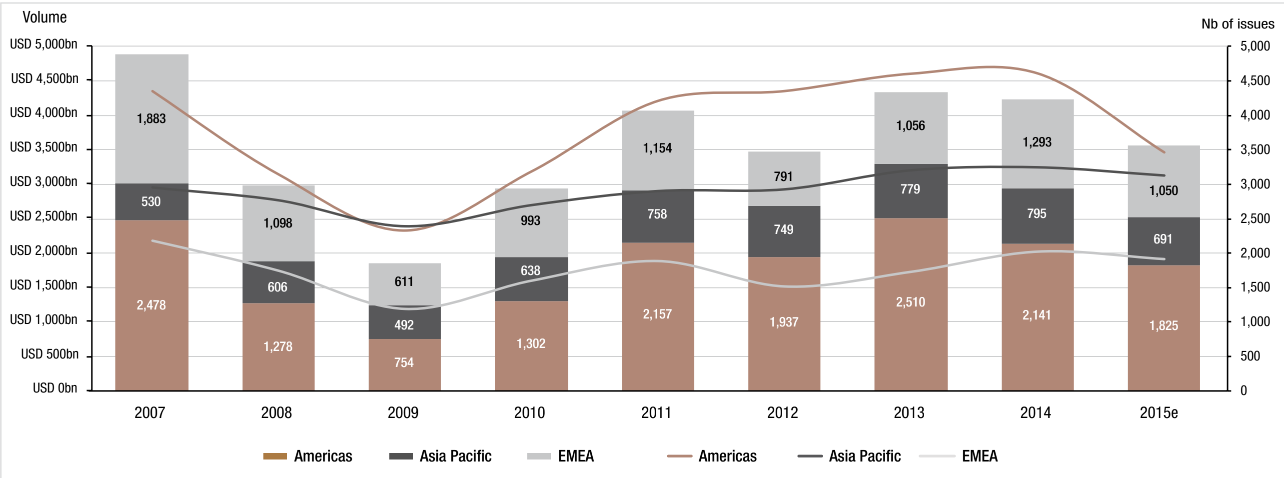
US syndicated lending reached USD 1.35tn through the first nine months of the year, 12% down from this time last year. Leveraged loan volumes decreased 25% year-over-year from USD 462bn to USD 350bn, and the proportion of the market represented by leveraged loans also decreased from 31% to 26%.

The majority of the new issue activity in 2015 was fuelled by M&A activity, which reached USD 319bn, representing 24% of total syndicated loan volumes and was 6% above 2014 year-to-date volume. The bulk of the growth in M&A loan volume was driven by the investment grade market, which was up 35% year-to-date to USD 126bn through September and expected to reach USD 150bn by year-end. In the leveraged market, M&A financing activity declined 8% in 2015 year-to-date to USD 180bn, with a USD 95bn issuance level by leveraged corporates, offset by a 23% decline in LBO financing volume.

### APAC

The Asia Pacific syndicated loan market volume for 2015 is expected to reach ca. USD 691bn, which would be a decrease of ca. 13% vs. 2014's USD 795bn. This significant volume reduction can be broken down into two very distinct markets: Japan, where volume is mainly driven by Japanese lenders, and APAC (excl. Japan), which is a much more international market. The volume originated in Japan is holding up reasonably well in 2015, with an expected increase of ca. 4% to USD 233bn (following up on a very weak 2014 volume). The loan volume in APAC (excl. Japan) is expected to fall by ca. 20% (to USD 458bn vs. USD 570bn in 2014). As of end-Q3 2015, Japan represented ca. 33% of the overall APAC volume.

**International loan market volumes by region**




*Source: Dealogic.*

## Regional focus

### Western Europe

#### Corporate

- At end of September 2015, volumes had decreased vs. end-September 2014 in Germany (-56%), in France (-28%) and in the United Kingdom (-23%), while they increased in Spain (+94%) and in Italy (+77%), due to the large number of Amend & Extend and Refinancing transactions in these countries. Overall, volumes decreased 14% vs. the end of September 2014 in Western Europe.
- Margins have continued to tighten in H1, fuelled by abundant liquidity from banks. Pricing for investment grade borrowers has stabilised since the beginning of the summer, as returns have reached very low levels. On the other hand, margin compression is still ongoing in the non-investment grade space, as banks are chasing yield. The vast majority of large IG corporates have already refinanced their transactions over the last two years, so we are seeing an increasing share of mid-caps and non-investment companies in the current deal flow as they seek to take advantage of favourable market conditions. In particular, a number of mid-cap companies are launching inaugural syndicated facilities, diversifying away from traditional reliance on bilateral lines with their historical banks.
- After an encouraging start of the year, M&A-driven activity was disappointing in Q2 and Q3 due to concerns about Greece, then China, and the increased volatility in the capital markets. Acquisition finance is thus down 25% by Q3 2015 compared to the same period last year. One bright spot was the refinancing activity linked to IPOs, as a number of LBO companies have been listed and have sought to reduce their leverage levels and lock attractive financing conditions as newly public companies.
- As banks are eager to lend, term loans represent an increasing share of the market, allowing borrowers to reduce the share of bridge financing in their acquisition deals, or the portion of bond issuance in their general funding mix.

#### Leverage

- Following an exceptionally busy start to 2015 in terms of volumes (Q1 2015 stood at EUR 21.4bn, +47% vs. Q1 2014, the highest Q1 since 2007), new issuances then lagged behind 2014 figures on the back of a relatively quiet Q2 and Q3 due to the lack of jumbo deals, a lacklustre summer, with only one deal for EUR 125m hitting the market in August, and a disappointing September (Q3 2015 stood at EUR 10.4bn, vs. EUR 20.23bn in Q3 2014). Overall volumes have been driven by M&A representing ca. 61% of total issuance in Q1-Q3 2015 (down by ca. 20% vs. the comparable period last year due to an increasing number of IPOs and competition from trade buyers). While opportunistic refinancing and re-pricing were favoured by borrowers due to the attractive market conditions in H1 2015, there has been a slowdown since July on account of the uncertainty surrounding Greece and the subsequent more volatile market.
- On the arranging side, the increasing competition between banks materialised via (i) more borrower-friendly structures with senior leverage climbing to 4.3x in Q3 2015 vs. 4.1x at the end of 2014, while total level decreased to 4.6x vs. 4.8x driven by more stretched all-senior transactions, and (ii) the continuing trend of loosening documentation (e.g. deals with looser terms, accounting for a larger share of the market than in 2014, and expanded to include smaller-sized companies).
- A key trend in 2014 was the emergence of cov-lite loans in Europe. This trend has continued to develop in 2015: the Q1-Q3 2015 European institutional cov-lite new issuance volume totalled EUR 13.3bn. Although it fell behind the EUR 14.7bn issued over the same period in 2014, it represented a bigger share of institutional level (45% in January-September 2015 vs. only 39% in January-September 2014). It is expected that new cov-lite deals will continue to flow in the European market going forward.
- Furthermore, 2014 was also characterised by the reappearance of Second Lien. In 2015, the issuance was significantly thinner, mainly because borrowers opted for stretched all-senior structures or senior loans alongside unsecured notes instead. As a result, Q1-Q3 2015 volume stood only at EUR 600m, vs. EUR 1.9bn for the same period last year.
- With regards to cross-border issuance, the loan volume roughly halved this year, accounting for ca. 25% of 2015 overall volumes (vs. 40% for 2014). The absence of European jumbo deals needing access to US liquidity, and the higher yields required in the US, were some of the main drivers of the lower cross-border volume this year.
- On the fund liquidity side, European CLO issuance was broadly in line with last year's volumes. After running ahead of last year's supply during the first half of 2015 (+10% in volume), CLO issuance then slowed down in Q3. Therefore, with CLO issuers adapting volume and speed of issuances to supply of transactions available in primary market, CLO volume matched last year's figures (vs. EUR 15-20bn estimated at the beginning of 2015).
- During the summer, the market shifted towards a more imbalanced environment with investors seeking yield and adequate risk compensation on one side, and borrowers hoping to take advantage of the relatively quiet primary market on the other. Following the Greek crisis, the balance of power favoured investors, with pricing moving upwards (hovering in the 450-475 bps region, from 425 bps previously for TLB – Term Loan B). While the market then moved towards a more balanced supply and demand environment, we continued to see this pricing trend in the market due to increased market volatility and investors being more selective over credits.

This discipline consequently materialised in the way investors factored in more proactively the credit quality of assets into their yield requirement.

**Project Finance**

- European Project Finance volumes are up compared to the equivalent period in 2014, driven by a few transactions closed for sizes of between EUR 1.7bn and EUR 4.5bn. These European transactions include the Fortum Sweden sale (electricity distribution business), LetterOne acquisition of RWE upstream (upstream O&G), Thameslink refinancing (UK trains) and Exeltium (French electricity distribution).
- Volatility observed during the summer, related to Greece and China, has not had an impact on Project Finance loan pricing for the moment, but with bank funding costs starting to increase we are seeing a slowdown in pricing reduction (and in some cases upward pricing pressure) when bidding new deals, in particular for larger financings that require more than three or four banks. As a general pricing comment, most investment grade project are falling into the 100-150 bps range for long term infrastructure debt.
- In the renewable energy sector, there is strong liquidity, particularly for UK Offshore wind transactions from a group of 20-30 banks, most of which are now willing to take construction risk and long tenor debt. Most of the deals we have seen have been in Germany and the UK. Due to strong appetite from banks, margins on such transactions have reached historically low levels and average around 200-250 bps. This represents a fall of ca. 75 bps over 12 months.
- Real estate continues to be an attractive asset class for bank and fund investors for both senior and junior debt (the latter only for institutional investors, but underwritten by banks). As market competition intensifies, sectors outside of prime office transactions are becoming more common. Examples include hotels and care home deals where there is a slight margin pick-up versus well located office blocks. Margins have continued to compress for prime commercial real estate with competition from German, French and Dutch banks in particular.
- The institutional investor base continues to grow as more infrastructure related funds come to market seeking assets. Fund investors are becoming more flexible. They can routinely take construction risk and many can lend at a floating rate without prepayment penalties.
- In infrastructure, we have been seeing longer tenors (up to 29 years) and new pricing lows (daily margins below the 100 bps mark). When interest rates increase, we may see a fall in liquidity from institutional investors for tightly priced infrastructure projects.

## CEEMEA

- **Russia:** Most of the volume has come from prepayment facilities for exporting companies, typically with a 5-year maturity, and some short-term deals for private banks. We are seeing a slow increase in the number of European lenders coming back to this market, as well as growing interest from Chinese banks.
- **Central Europe:** Activity was dominated by local currency issuance in the Czech Republic and Poland, as domestic banks are extremely liquid, tightening pricing conditions.
- **Middle East:** In the investment grade segment, pricing continue to tighten, favouring international banks. However, regional lenders are moving the mid-cap market pricing higher. We still witness limited a deal flow in the region while USD liquidity stays abundant, coming from international and GCC banks (the latter being able to support local deals in both USD and local currency). As a result, prices are being pulled downwards. Nevertheless, given the current context of the fall in the oil price, GCC banks' USD funding cost is increasing and regional liquidity is decreasing, which should have an impact on the coming transactions.
- **Turkey:** Apart from traditional financial institutions refinancing transactions (to be noted: the 3-year financing secured by Akbank and the general margin decrease trend for all institutions), the pipeline remains limited on the whole, with local banks still focused on jumbo Project Finance deals (notably PPP deals). The geopolitical environment is becoming more and more uncertain and will have an important impact on when new deals are brought to market and how they fare with international lenders (general elections to take place in November).

## Americas

**Corporate**

- At USD 575bn, investment grade lending is more or less at the same level as for the first nine months of 2014 (USD 567bn).
- Of that amount, USD 126bn was related to M&A activity, which accounted for the bulk of new money lending (USD 166bn) during that period. The amount of M&A-related investment-grade financing is expected to reach between USD 150bn and USD 200bn by year-end.
- Refinancings amounted to USD 409bn, down 10% on 2014, but is expected to climb to USD 550bn by year-end.
- Bank liquidity in the investment grade space remains strong, but there is now a clear preference for term loans. USD 19bn of term loans were syndicated in Q3 2015, the highest quarter volume in seven years. 71% of the banks in the US investment grade market indicate that they prefer term loans to revolvers for relationship lending.

- Although relationship remains an important driver in the investment grade space, its relative weight in the decision-making process has dropped significantly (today, only 31% of banks prioritise relationship over return vs. 59% a year ago), while return on capital has become a top priority for 63% of lenders vs. only one third last year.
- However, the enhanced focus on return on capital has not translated into higher pricing due to the abundant liquidity available in the market, and pricing has remained stable since the beginning of the year. Rather, it has led to more volatility in bank groups and less predictable behaviour by banks in any given transaction.

**Leverage**

- Leverage loan volume, which totalled USD 350bn for the first nine months of 2014, is down 25% compared to the same period last year, with a 39% decrease in refinancing activity and a 38% decline in recap activity driving this decline.
- Despite the decline in overall volumes, corporate M&A loan volumes were up almost 16%, accounting for 34% of total volume vs. just 22% for the same period last year. However, LBO volumes declined 12% from 2014 to 2015 as historically high M&A valuations and purchase price multiples kept financial buyers on the sidelines. Heading into Q4, broader market volatility and tighter debt markets represent the primary impediment to LBO deal volume.
- Credit protections for lenders have stabilized over the year, and leverage levels have begun to contract with average debt multiples for large corporate LBO loans dropping to 5.7x in 2015 year-to-date after averaging at 5.9x in 2014. Leverage levels were driven down, in part, by the Federal Reserve's Leveraged Lending Guidelines.
- Similar to last year, new CLO creation and new separately managed accounts were the primary drivers of liquidity in the leveraged loan markets. In September, CLO volume stood at USD 79bn vs. USD 91bn in the same period last year, with market participants expecting USD 90-100bn by year-end. Loan mutual funds continue to see outflows and have shrunk in significance, with AuM declining from USD 166bn at the end of 2013 to USD 131bn at the end of August 2015.
- Average new issue yields declined from 6.40% in January 2015 to 5.85% in September, as the oil-driven sell-off at the end of 2014 subsided and markets stabilised. However, concerns surrounding the volatility on the US stock market, as well as Chinese economic and global macroeconomic growth, have led to a meaningful repricing in the first two weeks of October, with average new issue yields rising to 6.20%.
- The growing acceptance of cov-lite loans continues to make loans an attractive alternative to high yield bonds given its more issuer-friendly prepayment flexibility and less onerous reporting and issuance requirements.

**Project finance and emerging**

- North American project finance year-to-date volumes totalled USD 42bn by Q3 2015, up 60% from the same period in 2014, primarily due to three large liquefied natural gas (LNG) deals that priced in during 2015. We anticipate the YoY increase to be slighter lower, as two LNG deals worth over USD 4bn priced in during Q4 2014.
- Activity in 2015 was focused around mega LNG financing, merchant gas-fired deals, and repricings of existing contracted renewable and conventional power deals.
- While mini-perm structures with tenors of 7 to 10 years continue to be the sweet spot, the broader bank market, not solely the Japanese, have demonstrated appetite for longer-dated deals.
- Throughout 2015, price compression continued, with initial margins hitting L+162.5 bps for well-structured renewable and conventional power transactions.
- Bank appetite remained strong throughout 2015, allowing Societe Generale to raise USD 31bn in commitments to LNG transactions against USD 17bn in debt needed. However, banks have over-committed to transactions in the LNG space as a way of protecting final allocations.
- Appetite from European, Asian, and Canadian banks remains strong, with investment banks participating wherever capital market opportunities exist. US regional banks are looking to become more active in the space. Furthermore, we are seeing asset managers and infrastructure funds increasingly look to participate in the sector.
- Additionally, a broader institutional investor universe continues to provide capital where banks are unwilling to play such as power projects with meaningful merchant exposure, although banks have shown an increasing willingness to take some merchant risk in select power markets.
- Year-to-date Latin American syndicated loan volume by Q3 2015 totalled USD 38 billion, down 10% from the same period a year ago. While volume has tapered off, terms have tightened, pricing has compressed, and tenors have extended to 20 years in some cases.

### APAC

#### Corporate

The 2015 Asia Pacific Corporate and Acquisitions loan volume is expected to record ca. USD 596bn, a ca. 10% reduction from last year's level.

- Corporate and Acquisitions loans remain the key contributor to loan volume in APAC, representing ca. 86% of the total loan volume in the region. Japan continues to top the league tables in Asia Pacific, in terms of volume share, followed by China, Australia, Hong Kong and Taiwan. The corporate markets in Mainland China and Hong Kong have been among the few to have grown this year.
- Asia Pacific M&A volume is expected to only reach ca. USD 37bn in 2015, well below last year's USD 73bn, as large M&A transactions have been lacking in 2015, possibly on account of a more uncertain environment in some Asian emerging markets, and of depressed commodity prices. The largest year-to-date M&A transaction in APAC was the EUR 6.8bn loan backing the acquisition of tyre manufacturer Pirelli by China National Chemical Corporation (even though this deal was largely syndicated in the EMEA loan market, given the nationality of the target company).
- Relevant corporate deals by size in 2015 have been the CNY 40bn (USD 6.6bn eq.) loan to Capital Airports Holding Co, to support the Beijing New Airport Project, and the AUD 5.1bn (USD 3.9bn eq.) transaction to support the merger of Federation Centres and Novion Property Group, two Australian property companies.

#### Leverage

In 2015 the Asia Pacific leveraged finance market is expected to record a total volume of USD 10.5bn equiv., representing a ca. 15% YoY increase.

- As of end-Q3 2015, China had taken over Australia (the traditional leading market), with a USD 2.8bn volume (36% share) while Australia was having a slow year, with only a 20% share of the market. South Korea comes up as the third largest market (18%), but based on a single large transaction. Japan is likely to be relegated to the fourth position this year, with a 16% market share as of end-Q3 2015.
- The Korean market has come into the spotlight with a large USD 1.4bn equivalent transaction (denominated in Korean won) for the acquisition by Hahn & Co Auto Holdings of Halla Visteon Climate Control Group. The transaction was syndicated exclusively amongst Korean lenders.
- Deal flow in Australia (the most accessible market for international banks) was slow, with a ca. 35% volume decrease vs. last year. Turri Finance Pty Ltd, an AUD 900m LBO to finance MIRA's acquisition of a mobile phone towers business, has been the largest transaction so far.

#### Project Finance

- The Asia Pacific project finance market has continued to register volume decreases in 2015, and we are forecasting volume to reach ca. USD 46bn, a 34% decrease vs. last year's figure.
- Despite two very large project financings, the number of Chinese deals has substantially decreased, perhaps because of a larger capacity from corporates to finance projects on-balance-sheet, due to increased Chinese banks liquidity. India continues to be the second market, despite a ca. 19% decrease in volume, while South Korea has overtaken Australia as the third market, due to Australia's lack of jumbo project financings coming from the mining or LNG sectors.
- The largest project financing transaction of 2015 so far has been the RMB 53bn (USD 8.6bn eq.) financing for Yalong River Hydropower Development Co in China. The two largest Australian projects were the Sydney Desalination Plant AUD 1.66bn refinancing and the AUD 1.55bn financing for the Sydney Light Rail PPP.

## 2016 forecast

### Western Europe

- We are forecasting the overall 2016 volumes in EMEA to grow by ca. 5% to USD 1,100bn.
- In the Western Europe **corporate market**, we expect margins to remain fairly stable at the current low levels for investment grade borrowers, whilst there may be further compression in the non-investment grade market. Refinancing activity is expected to reduce significantly, as most companies have accessed the market over the last two years. On the other hand, M&A-driven activity is expected to grow, as a number of companies are actively looking at consolidation opportunities.
- **In the EMEA leveraged market**, while volumes were down in 2015, we expect 2016 issuance to be fairly in line at EUR 65bn, supported by healthy liquidity. European leverage loan volumes should be influenced by:
  - Increased market volatility, as illustrated this year by the Greek crisis and then followed by the Chinese stock meltdown;
  - New US-like regulations which could be implemented in Europe.

- With regards to cov-lite deals, they should continue to be a theme in 2016, with increased pressure to make cov-lite transactions available to smaller companies.
- Similarly, cross-border transactions will remain a market feature, but volume will depend on the relative value between the US and European markets.
- In addition, the fierce competition between arrangers is still expected to materialise, which should allow borrowers to obtain further concessions on both structure and documentation. However, this could lead to a technical imbalance of power between borrowers and institutional investors which are not willing to go much more aggressively.
- **Project Finance and Infrastructure** deal flow is expected to remain at a similar level for France, UK and northern European countries, and is expected to increase for medium-risk countries, such as Italy, Spain and Portugal. We expect liquidity to remain very strong from both banks and institutional investors, but we may experience a 'flooring' or even a small increase of pricing.
- The number of real estate opportunities is expected to remain high, with the constant demand from Sponsors for asset acquisition and refinancing taking advantage of falling spreads in the European space. We could expect some compression in margins for more exotic deals, though prime real estate may have now reached a floor. As spreads compress, we may start to see some more development finance as banks/funds seek opportunities that can meet minimum price thresholds.

### CEEMEA

- Assuming a stable political framework, and subject to evolution of the sanction regime, volume in Russia is expected to climb back as banks slowly reopen country limits. In the rest of Central Europe, activity should remain fairly stable.
- In the Middle East, oil price fall impacts should intensify, depending on local authorities' ability to tackle the liquidity drop challenge. Meanwhile, GCC banks should continue to turn to the loan market, as seen since the second half of 2015, to compensate the decrease in deposits coming from sovereign entities and diversify funding sources. In Turkey, the evolution of the political environment will be a key driver of future activity.
- We expect increasing volume out of Africa over the next few years as economic growth on the continent continues to generate new opportunities, and there is a growing interest in the region from a number of lenders.

### Americas

- In the **corporate investment grade market**, we expect liquidity to remain strong in 2016. However, the increasing focus on return and the recent strategy reviews made by some banks may lead to a shift in the source of that liquidity. Generally, UK and European banks are expected to downsize their investment grade lending while Japanese banks should continue to have strong appetite. The impact of the new regulations may finally lead US banks to reassess the way they approach the investment grade market and could potentially lead to a re-pricing of undrawn revolvers. We also expect appetite for term loans to remain strong, which should contribute to making the loan market a reliable funding source for acquisition financing in the coming year.
- The near-term outlook is for continued volatility in the US leveraged loan market, as many of the new issues focus on price discovery and the primary and secondary markets reset at a high yield point to reflect the reduction in investor demand (relative to supply), and risk premiums increase to reflect the global macroeconomic concerns, as well as the upcoming Fed actions on interest rates. Longer term, we see a stabilisation in the market, likely in January, although some volatility may continue in the loan markets as the macroeconomic concerns are joined by the US election cycle in late 2016.
- In the **Project Finance & Emerging Markets**, looking forward, given the current low oil price environment, LNG transactions, which accounted for 50% of volume in 2015, are unlikely to sustain the same pace in 2016. As such, the pipeline of transactions in the U.S. remains uncertain. We do anticipate more merchant gas fired deals, fertilizer transactions looking to monetize low-cost natural gas prices, and potentially some midstream infrastructure project financings.

  If bank liquidity remains as expected, and without the potential mega LNG deals soaking up bank capacity, we expect banks will need to be more creative and willing to assume slightly more risk on transactions in order to meet their budgets.

  However, as banks continue to implement regulatory capital changes associated with Basel 3, pricing may have hit a floor and appetites for long tenors may begin to once again shorten.

  In Latin America, Mexico is expected to be the primary source of volume in 2016, with the numerous requests for proposals being issued as a result of the energy reforms. Activity in other countries, such as Chile and Panama, is expected to be focused on large financings for the construction of US LNG fuelled gas-fired power projects.

## APAC

- We are forecasting 2016 volume in APAC to grow by ca. 9% to ca. USD 750bn, bringing it back in line with the volume prevalent in the 2011-2014 period.
- Corporate and acquisitions transactions will remain the key contributor to APAC loan volume in 2016. We may see some increased M&A activity resulting from consolidation play in natural resources-related sectors. Corporate borrowing should remain stable, benefiting from the overall higher growth rates in the region, and we may see a slight pick-up in margins depending on how some of the region's emerging economies cope with the anticipated increase in USD interest rates, expected for end-2015 or 2016.
- The leveraged finance volume will remain quite modest when compared to the rest of the world, at around similar levels to 2015. Private equity sponsors do indeed have capital available, but deal flow is historically low in this region and transactions tend to be small, by international standards. Quite opposed to the other two world regions, liquidity in the Asia Pacific leveraged finance market largely comes from bank investors as opposed to institutional ones. The US Term Loan B market has made some inroads as an alternative to fund, especially the Australian transactions, but its price/leverage competitiveness seems to have somehow waned during 2015.
- On project finance, volumes should optimistically be rising in 2016, after two years of reduction, but it is a challenging sector to forecast. While there is a large number of projects under discussion (e.g. for power plants in Indonesia), their lead times can be very protracted. Australia does not seem likely to provide any resource-related jumbo transactions in 2016, but the ongoing programme of privatisation of transmissions and distributions assets owned by the New South Wales government (with TransGrid looking to close end-2015/early 2016) should provide a decent boost to the volume. In China, there is some expectation that the "One Belt, One Road" initiative will boost project financing levels, even though projects will likely be coming to stream after 2016, and we would expect these projects to be more geared towards Chinese banks.

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