BANKING
Retail Banking

Recovering the bond market in Portugal

*Since the start of 2015, the Portuguese economy has steadily improved, and bonds have played a significant role. However, there is still room for more progression, writes **João Miguel Lourenço**, Head of Research, and **Rui Dias**, Treasury, at CaixaBI*

Above Portugal's Finance Minister Maria Luís Albuquerque

According to data released by the Portuguese Statistics Office (INE), Portugal's GDP registered 1.5 percent yoy growth in 1Q15, which compares with 0.6 percent growth in the previous quarter. This positive variation of GDP in 1Q15 means that the Portuguese economy has completed a cycle of six consecutive quarters of yoy growth, following contractions in GDP between 1Q11 and 3Q13. In 1Q15 the Portuguese GDP grew 0.4 percent per quarter, similar to the growth between October and December 2014.

Reducing the external imbalance of the Portuguese economy was one of the priorities of Portugal's economic and financial adjustment programme implemented between May 2011 and May 2014. This entailed rebalancing the current and capital accounts – with deficits of around 10 percent of GDP between 2000 and 2010, followed by a surplus of roughly two percent of GDP in 2014. The steady reduction of the government deficit, as well as the deleveraging of the private sector was positive from the fourth quarter of 2012 onwards.

The latest projections from the Bank of Portugal (BoP) forecast the continued improvement in the current and capital accounts as a percentage of GDP, reflecting a fall in the external imbalance of the Portuguese economy. The performance of GDP over recent quarters had a positive impact on confidence and economic activity indicators, which are both expected to gradually perform more positively over the coming years.

Predicting projections

The BoP disclosed its updated projections in mid-June for 2015 to 2017 periods. For 2015 the BoP projects GDP growth of 1.7 percent, underpinned by greater optimism for domestic demand – revising up the contribution from this component of GDP – and the continued contribution of net external demand. In terms of domestic demand, BoP projections for 2015 are of 2.2 percent growth in private consumption (which is an increase of 2.4 percent on previous estimates), a 0.5 percent fall in public consumption (the same as previous estimates) and a 6.2 percent rise in investment (against a increased four percent forecast previously).

In relation to net external demand, exports should grow 4.8 percent, while the growth rate for imports is expected to be 5.7 percent, against estimates of 4.3 percent and 3.9 percent respectively in the March Economic Bulletin. The European Commission, IMF and OECD make similar projections for 2015, considering that the economic recovery will be due to more buoyant domestic demand, especially private consumption and investment.

The Portuguese Central Bank's projections for the domestic economy continue to indicate a gradual recovery over the coming years, with growth rates similar to those of other countries in the eurozone. The balance of the current and capital accounts should remain positive in 2015, corresponding to three percent of GDP, which confirms the continuation of the adjustment process of the external imbalance of the economy, rising to around 3.4 percent of GDP in 2017, according to the BoP.

INE data reveal that the budget deficit for 2014 stood at 4.5 percent of GDP. According to the first 2015 notification on the Excessive Deficit Procedure, the budget deficit for 2014 amounted to €7.7bn, with GDP rising to €173.05bn, which is a reduction of €460m from the 2013 deficit of €8.18bn – amounting to 4.8 percent of GDP. It is estimated that the budget deficit for 2015 will be 2.7 percent of GDP. In 2010, the budget deficit corresponded to 9.8 percent of GDP. Despite the steady decline in the budget deficit, the ratio of public debt to GDP increased from 111.1 percent in 2011 to 130.2 percent at the end of 2014 (*see Fig. 1*). Nevertheless, this is expected to decrease steadily over the coming years to below to 110 percent in 2019.

Leading a responsive market

In the recent years, CaixaBI played a significant role to help the Portuguese bond market recover what was lost during the sovereign crisis. After a 65 percent fall of the amount issued in 2011 relative to 2010, the market recovered immediately the year after and continued to steadily improve in the ensuing years. However what seems to be a mere catch-up of lost ground hides considerable underlying changes that have occurred in the last five years.

Running the risk of being overly simplistic, it can be said that before 2011 the Portuguese bond market could be split in two segments: rated and non-rated issuers. The overwhelming majority of the issuers pertaining to the first group were investment grade. Typically these issuers would come to the market regularly to place benchmark transactions in the euro bond market. These included the top banks (CGD, BCP, BES, BPI and Santander Totta), the major corporates (EDP – Energias de Portugal, Portugal Telecom, REN – Redes Energéticas Nacionais and Brisa) and state-owned companies (Refer, CP and Metropolitano de Lisboa).

> "Before 2011, the Portuguese bond market could be split in two segments: rated and non-rated issuers"

Before 2011, all the remainder issuers tapped the domestic bond market with private transactions that typically were underwritten by a bank or a group of banks. It was very uncommon to see these transactions being placed into other institutional clients. It was in fact just an alternative way for banks to provide credit to this universe of corporates. There were some specific cases of pure market transactions, and retail placements were even scarcer.

It was precisely in this segment and with placements into the retail universe that major transformations recently started in the Portuguese market. In December 2011, EDP – a rated issuer – opened the door for many other issuers, rated and non-rated. EDP launched a six percent coupon, three year and €200m deal targeted to retail investors. The institutional market had been shut for Portuguese issuers during the sovereign crisis and EDP grabbed the existing strong appetite from retail investors for relatively high interest rates.

Not only rated issuers took advantage of this sudden interest by retail investors. Corporates with well-known household brand names perceived as solid investments followed suit. Zon, (today known as NOS in the telecommunications industry), Semapa (pulp and paper) and Mota Engil (construction) were some of the names that also took advantage of this window of opportunity.

Portugal's retail outlet

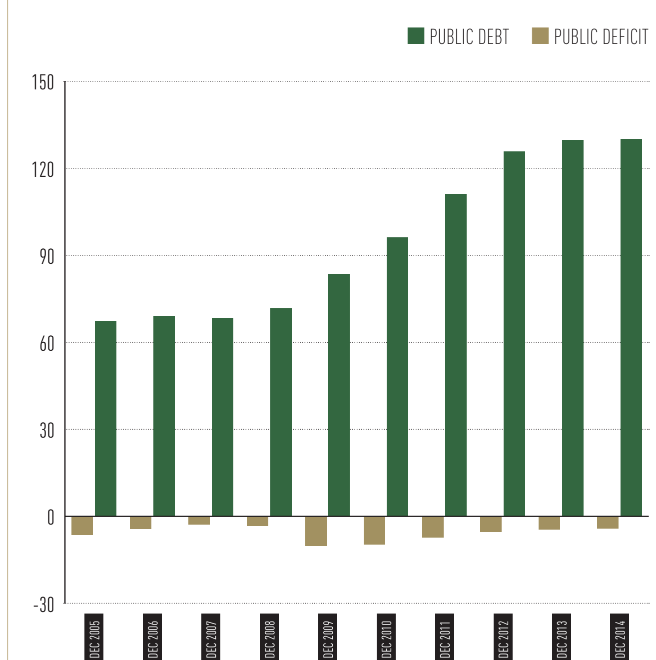
After the surge of retail placements, they gradually fell out of use. However, unlike before a retail bond culture stayed among Portuguese investors, having introduced new dynamics to the Portuguese capital markets both on the primary and secondary market. This in turn has allowed lead managers to quote two-way markets in most transactions, and it's not uncommon to see top global dealers quoting on some of these.

Concerning the primary markets, evidence of a landscape change can be confirmed in terms of amounts issued, and in 2014 non-bank corporates issued €6.1bn. That is just four percent above the 2009 peak. However the number of transactions has risen at a steady pace since 2011. In 2014 the number of issues were 3.5 times that of 2009. The average size per transaction has been reduced mainly because the typical issuer in the market is different from that of the period prior to 2011.

The great transformation that has occurred was that unlike before 2011, an increasing number of non-rated issuers have tapped the market with transactions that were placed with institutional investors as well as banks. Since issuers are smaller sized companies, transactions were on average smaller as well. Some of those were already known by the market but increased their presence issuing larger volumes than in the past. Examples include the transactions of NOS, Mota Engil and Semapa. More importantly, the market has seen an increased number of new issuers, allowing for a more diversified market sector. A few examples of these names are: Bial-Portela (in pharmaceuticals), José de Mello Saude (in healthcare), Saudeçor (also in healthcare), Sonae Capital (in tourism) and Media Capital (in media).

The Portuguese bond market has finally become that – a market – and CaixaBI has played a vital role, leading and co-leading in all major operations. Where before a significant portion of bond transactions were just instruments for banks to provide credit to corporates, in recent years an increasing number of issuers have come to the market to place bonds for final institutional investors. Apparently the catalysts were the banks and their need to deleverage a wave of interest from retail clients to create the dynamics required to raise interest from institutional investors. Gone is the myth that a bond issue had to be a benchmark to be liquid, and to have screen prices on the secondary market. ■

Fig 1 Portuguese public deficit and debt
PERCENT OF GDP



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