

Global Covered Bond Insights Q4 2024: On Course For A Strong Year

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This report does not constitute a rating action



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Key Takeaways

- As of September 2024, issuance remains consistent with the first half of the year, with volumes slightly lower than the same period in 2023.
- Reflecting increased investor appetite for longer maturities, issuers are now targeting tenors of seven years or more to reduce asset-liability mismatch on covered bond programs.
- Our mid-year outlook on covered bonds highlights why we believe that economic growth and stabilized interest rates are supporting sound collateral performance. Our ratings outlook remains stable for the rest of 2024.

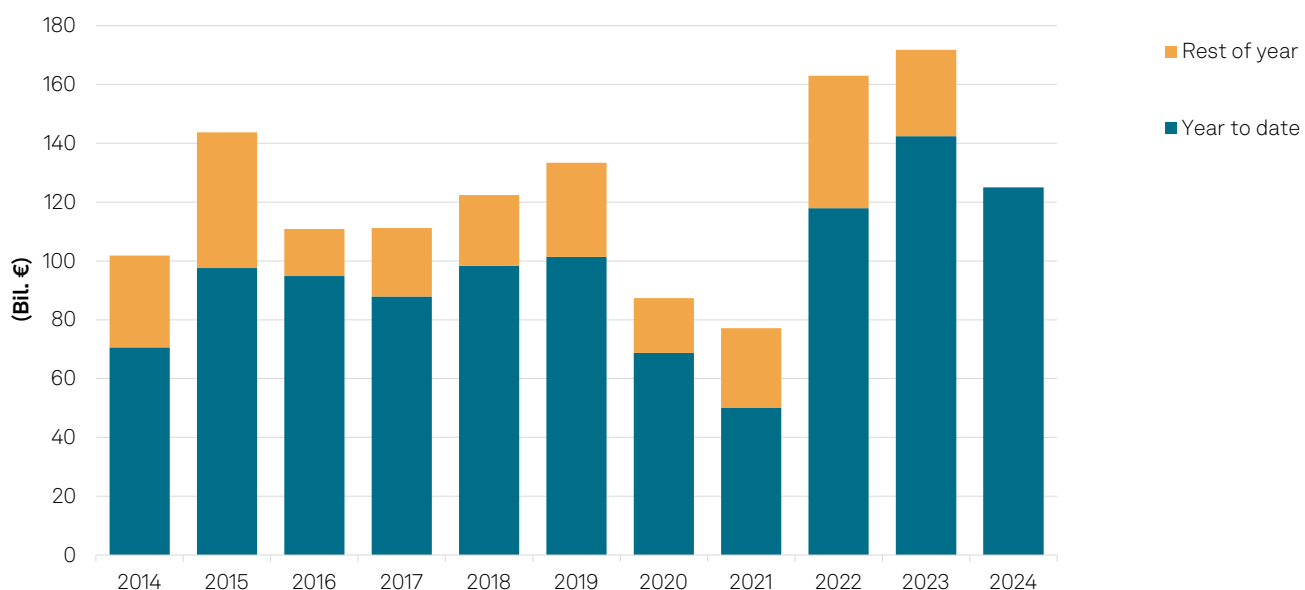
Despite a quieter summer in terms of issuance volumes, September’s activity suggests that the market still has the appetite to propel 2024 volumes to high levels. Benchmark European covered bond issuance for the year-to-date is slightly weaker (-12% as of Sept. 8, 2024) than the equivalent period in 2023, which was a record year. Covered bonds remain a primary funding instrument for banks, following the repayment of borrowings from central bank liquidity schemes. However, in certain jurisdictions improved unsecured funding conditions have slightly reduced the demand for secured funding.

Investors’ shifting appetite toward longer-dated maturities allows covered bond issuers to better manage asset-liability mismatch. This has reduced our target credit enhancement levels, which offsets the adverse effect of new issuances’ relatively high coupons on excess spread.

Our ratings outlook on covered bonds remains stable, supported by an anticipated economic recovery and potential further reductions in central bank interest rates. Overcollateralization should absorb any increase in losses, and the presence of unused notches of uplift in the ratings reduces the risk of covered bond downgrades, even if there are issuer downgrades.

Chart 1

European investor-placed benchmark covered bond issuance



Year-to-date figures as of Sept. 8 each year. Source: S&P Global Ratings.

Market Insight Highlights

The below roundup compiles some of the key takeaways from our research this quarter.

French Covered Bond Market Insights 2024

- As of 2024, France remains the largest market for covered bond issuance, with local banks increasingly depending on covered bonds as a funding source.
- Improved affordability is contributing to the recovery of new home loan origination.
- The downgrade of France reduced the number of unused notches in some of our rated programs.

European Covered Bonds Resist Commercial Real Estate Jitters

- Europe's ongoing commercial real estate (CRE) valuations correction is increasing credit risk, particularly for the office and retail sectors. Covered bonds have remained resilient to this risk, although a few issuers face challenging funding conditions.
- Covered bond programs' CRE exposure varies significantly between and within countries. German issuers have the highest exposure to CRE (office and retail assets), followed by issuers in Austria, Denmark, and Spain.
- Overall bank exposure remains manageable and available overcollateralization continues to shield investors from credit deterioration. In our view, highly concentrated cover pools are most at risk of a further deterioration in CRE valuations.

Covered Bonds Outlook Midyear 2024: Growth And Rates Support Performance

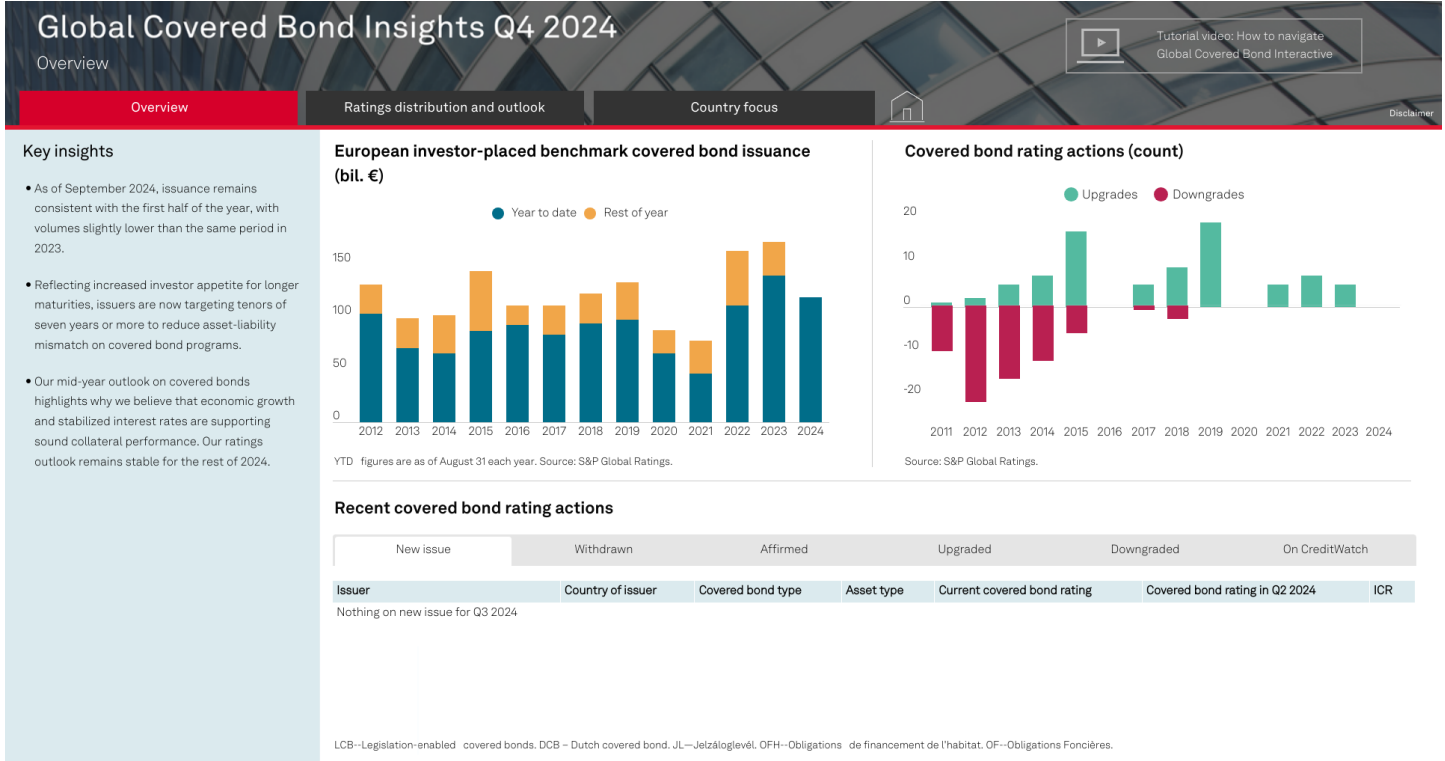
- Our covered bond rating outlook remains stable, underpinned by the ample credit enhancement available to most of the programs that we rate and the presence of unused rating notches, both of which reduce the risk of downgrades.
- We expect that eurozone GDP growth will gradually recover toward the potential on the back of an increase in consumer spending in the second half of 2024 and investments in 2025. Job vacancies are still plentiful, and we expect unemployment rates to remain at, or close to, record lows in all major European economies.
- Eurozone headline inflation should move back to the 2% target by mid-2025, enabling the European Central Bank to cut rates by 25 basis points per quarter until the deposit rate bottoms out at 2.5% in the third quarter of 2025.
- Despite higher interest rates and inflation, residential mortgage performance is still stronger than before the COVID-19 pandemic, thanks to a tight labor market, household saving buffers, and the switch to fixed-rate mortgages. Easing interest rates and a return to economic growth will limit the risk of further deterioration.
- Higher interest rates and a structural drop in the demand for CRE since the COVID-19 pandemic, particularly in more vulnerable segments such as nonprime offices, is affecting valuations, and we are starting to see the first signs of asset quality deterioration. But a return to growth and lower interest rates should ease the downward momentum in valuations and thereby stabilize credit quality.

European Banks: Covered Bonds Are A Cheap, Stable Funding Source With Limited Side Effects

- Amid tighter funding conditions, some European banks are turning increasingly to covered bonds for relatively cheap and historically very stable term funding.
- Positively, issuing covered bonds leads to greater funding diversification. We foresee them remaining a reliable funding source even under challenging market conditions.
- While covered bonds can be a valuable contingent funding source and support a bank's liquidity in a hypothetical crisis, they can also contribute to high asset encumbrance and complications in a liquidation or resolution scenario.

Core Characteristics And Risk Indicators

Our Global Covered Bond Insights Dashboard presents interactive data on the core characteristics and risk indicators that we assess regularly in our analysis. Drill down and explore data on covered bond ratings and outlooks and compare characteristics of mortgage and public sector covered bond programs from 18 jurisdictions, with core characteristics and risk indicators. Access the dashboard [here](#).



Related Research

- [French Covered Bond Market Insights 2024](#), Sept. 18, 2024
- [European Covered Bonds Resist Commercial Real Estate Jitters](#), Aug. 27, 2024
- [Covered Bonds Outlook Midyear 2024: Growth And Rates Support Performance](#), July 11, 2024
- [European Banks: Covered Bonds Are A Cheap, Stable Funding Source With Limited Side Effects](#), July 4, 2024

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