



# COMMISSION DES COMMUNAUTÉS EUROPÉENNES

DIRECTION GÉNÉRALE

AFFAIRES ÉCONOMIQUES ET FINANCIÈRES

Brussels, .03.02.94

Ref.: CC

II/30/94/En-n°2

## MONTHLY NOTE ON THE ECU MARKETS N° 2 ( FEBRUARY )

### FEBRUARY 1994 :

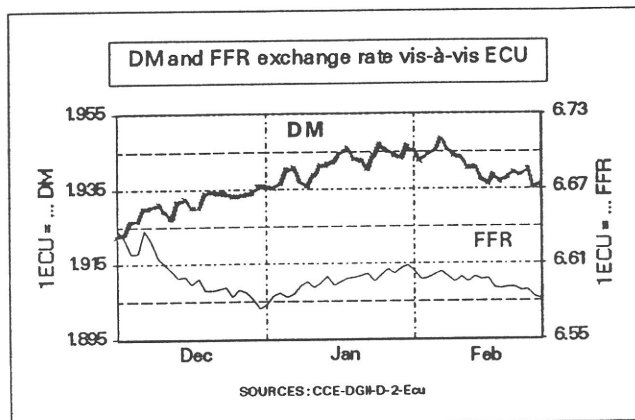
- In contrast to January, activity in ecu markets slowed during February.
- Along with other sectors, volatility on the ecu markets (cash and derivatives) rose during the month, while yields and spreads increased, in the wake of the tightening of US monetary stance and speculation as to the timing and extent of future interest rate increases.
- Consequent to the above, there were only two new issues during the month, to a total value of ecu 1.3bn; both were in the 5 year maturity range.
- Secondary market turnover was firm, although hindered by the preponderance of retail investors in this sector.

### OUTLOOK

- New issues are, in the main, on hold until some stability returns to the market. Nonetheless, underlying prospects remain good for borrowers, for example due to the volume of paper which will mature throughout the year. Furthermore, despite recent increases in yields, fundamentals remain good for investors.

## 1. Exchange rate evolution

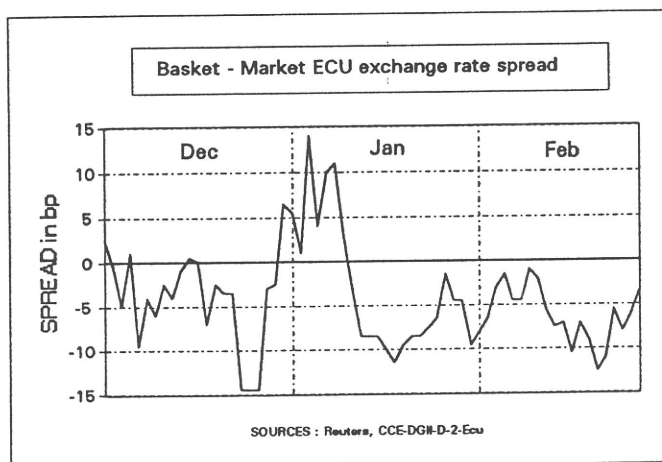
\* During January, component currencies were generally stable and appreciated against a weak DM; strengthening was also encouraged by interest rate reductions in many Member State (for instance, Denmark, Belgium, and Spain), which improved outlook for real sector activity in these countries. As a result, the ecu appreciated against the DM (from an initial ecu1/DM1.935 to ecu1/DM1.946 at the end of the month), whereas, the ecu appreciated against the FFR (from ecu1/FFR6.58 on January 1 to ecu1/FFR6.60 on January 31), consequent to the strengthening of the FFR vis-à-vis the DM throughout the month.



\* From the middle of February, the DM recovered some strength (as the Bundesbank continued its cautious approach vis-à-vis monetary easing) and the Federal Reserve signaled its intention to begin a progressive tightening of US policy, with a 25bp increase in the Fed Funds rate.

As a result, therefore, on the whole, during the month, the ecu gave up some of the gains achieved during January, to close February at ecu1/DM1.936 and at ecu1/FFR6.581.

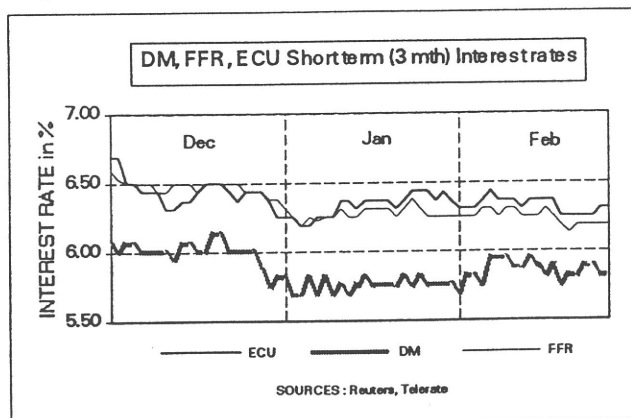
## 2. Exchange rate spread (basket minus market rates)



\* During January, when the spread indicated market confidence (moving from +10bp during the first week of the month to -10bp during the remainder of the month, mainly as a result of the ecu issuing activity). On the whole, the spread remained inferior narrow to -10bp.

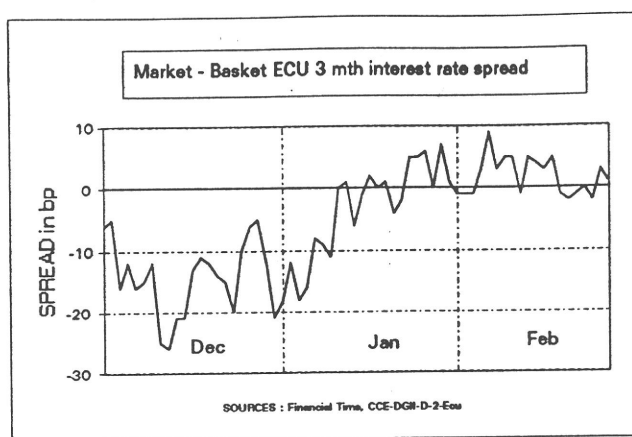
## 3. Short-term interest rate evolution (3 month)

\* During January, the ecu short term interest rate increased by 19bp, from 6.25% to 6.43%, following DM and FFR rates until the middle of the month (the former increased by 12bp and the latter by 6bp). Thereafter, DM and FFR rates fell back, while the ecu rate continued to increase. Consequently, over the month as a whole, ecu/DM and ecu/FFR spreads widened, from +56bp to +68bp and from 0bp to +18bp, respectively.



\* During the early part of February, the ecu short term interest rate remained quite stable, with an average of 6.37%, while the FFR rate (6.30%) was also little changed during this period, the DM rate increased by 25bp (from 5.69% to 5.94%). Thereafter, the ecu rate fell back by 8bp, to close the month at 6.25%, partly due to general interest rate reductions in component sectors (such as in Belgium, Denmark, Spain, Portugal, the Netherlands, Germany and France).

#### 4. Three month interest rate spread (market minus basket rates)

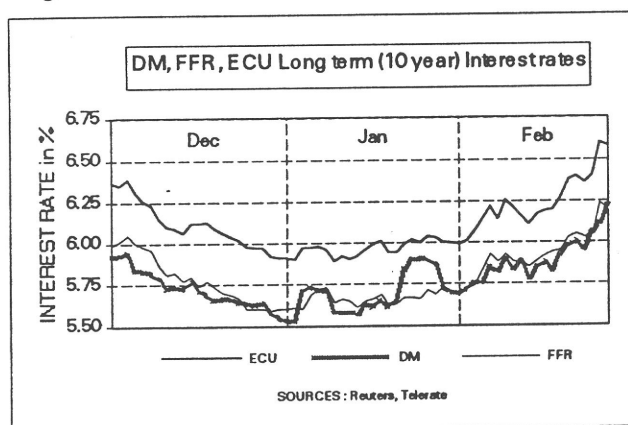


\* During January, the market/basket ecu 3 month interest rate spread remained within a narrow range, beginning the month at -12bp and closing it at +6bp.

\* It also remained narrow throughout February, (+/- 7bp), the movement in the early month was mainly influenced by interest rate expectations (spread positive), while during the remainder of the month, concretisation of the interest rate reductions pushed down again the spread for a slight while, before ending the month at +1bp.

#### 5. Long-term interest rate evolution (10 year)

\* In contrast with December trend, during January, the ecu long-term interest rate increased marginally, from 5.90% to 6.00%, following FFR and DM rate trends. these increases reflected partly heightened vis-à-vis the outlook for inflation.



\* During February, the ecu long-term interest rate increased by 59bp, from 5.99% to 6.58%, again following FFR and DM trends (which increased by 52bp and 53bp, respectively).

Consequently, the ecu/DM spread initially remained stable in the region of 30bp, before widening at the end of the month to 49bp; the ecu/FFR spread remained little changed throughout the month at about 30bp.

#### 6. Bond market

There were 2 new issues during the month : See the following table :

- Credit Local de France issued ecu 300mn of 5.25% 5-year eurobonds; the Italian Treasury issued ecu 1bn of 6.25% 5-year CTEs, bringing the total amount of ecu paper so far this year to ecu 6.08bn, significantly higher than in the comparable period of 1993 (ecu 2.04bn).

This amount has increased compared to February 1993 (ecu 1.08bn), but decreased compared to February 1992 (ecu 5.42bn) and to February 1991 (ecu 4.91bn).

#### Expected new issues :

Due to current market conditions, new issues are on hold; however operators expect some to be brought to the market as soon as a base has been reached : for instance the Kingdom of Belgium announced during the last week of the month an issue of ecu OLO bonds, the Kingdom of Spain also is also expected to come to the market in the long term, and finally the French Treasury is entitled to issue further ecu OATs or/and BTANs at the beginning of March.

## TABLE OF TOTAL ISSUING ACTIVITY

Type	Cat. of Issuer	Date of Issue	Issuer	Nat.	Amount (ecu mn)	Maturity	Coupon	Lead Manager	Dur.
			JANUARY		3483.0				
			FEBRUARY		1000.0				
Dom.	Sovereign	16.02.94	Italian CTE	It	1000.0	02.1999	6.25%	Tresor Banca d'Italia	5
TOTAL Sovereign issues					4483.0				
			JANUARY		1600.0				
			FEBRUARY		300.0				
Euro	Private	02.02.94	Crédit Local de France	FR	300.0	...02.1999	5.25%	Lehman Brothers	5
TOTAL Private issues					1900.0				
TOTAL as at end of February					6083.0				

### 7. Treasury bill issues

The Bank of England issued ecu 1 bn of Treasury bills on February 8, with a bid-to-cover ratio of 2.5 :

Supply (in mn of ecu)	Offer (mn of ecu)	Amount allotted (mn of ecu)	Maturity	Average yield
200	630	199.9	1 month, Mar 10;	6.43%
500	1270	499.7	3 month, May 13;	6.29%
300	545	299.8	6 month, Aug 11.	5.97%

#### Announced issue:

The next auction will be held on March 8; details of amounts and maturities of bills to be offered will be announced on March 1.

### 8. Secondary market

At the beginning of the month, activity in the secondary market was reasonably strong, on the back of January issuing activity, as well as a series of interest rate reductions.

Thereafter, the ecu secondary market followed component markets; the Federal Reserve's unexpected decision to tighten monetary stance led to portfolio adjustment .

And, afterwards, the market remained volatile due to continued uncertainty concerning likely next moves. European markets remain highly affected by developments in the US Treasuries market, despite better bond fundamentals in Europe.

### 9. Derivative Markets

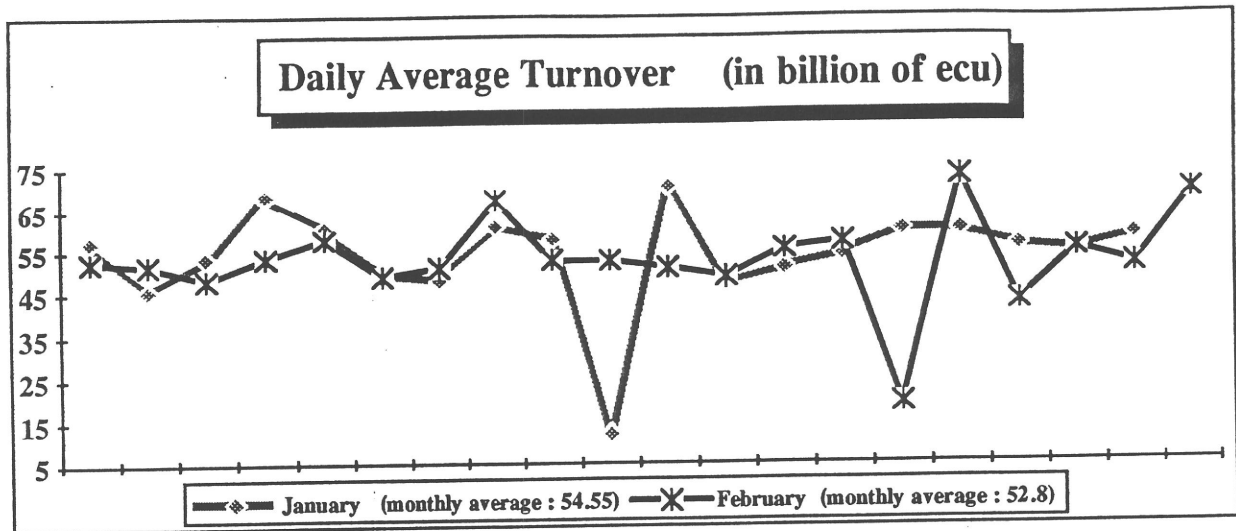
#### \* On the MATIF :

The February volume of traded contracts (90.8 td) was higher by 19% compared to the previous month (73.5 td) and by 6% compared to February 1993 (85.0 td).

#### \* On the LIFFE :

Traded volume over the month increased (61.1 td), by 6% compared to January 1994 (57.5 td). It was higher by 43% compared to February 1993 (34.5 td), and by 65% compared to February 1992 (21.1 td).

## 10. Ecu netting system



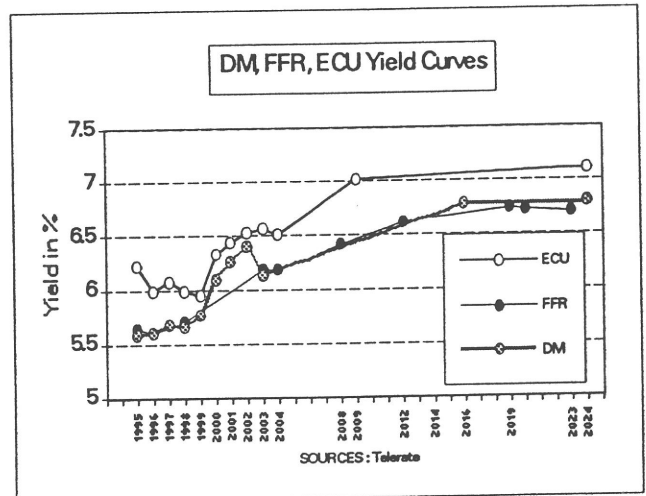
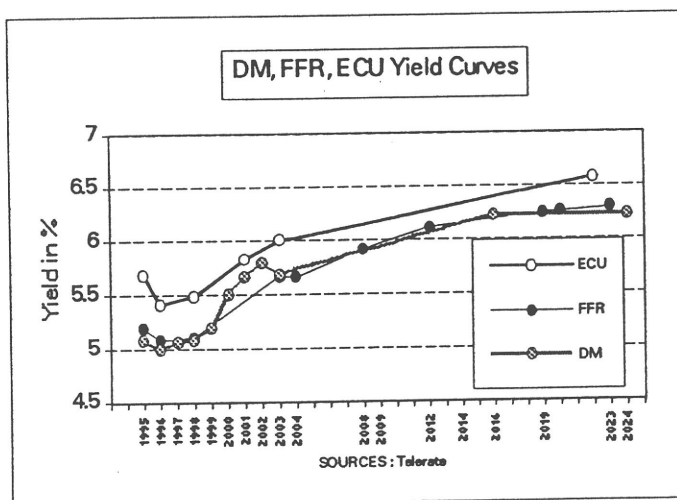
In January 1994, daily average turnover was 16% higher than December 1993 (ecu 45.01bn).

The daily average turnover in February 1994, ecu 52.8bn, was markedly higher than in the comparable month of 1993 (ecu 45.38bn). Indeed, last month figure approach the historical high achieved in September 1992 (ecu 55.8 bn). The daily average turnover underlines both the improving position in the ecu markets and the nervousness of operators as interest rates are increasing in the long end.

## 11. Yield Curve

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25.02.94

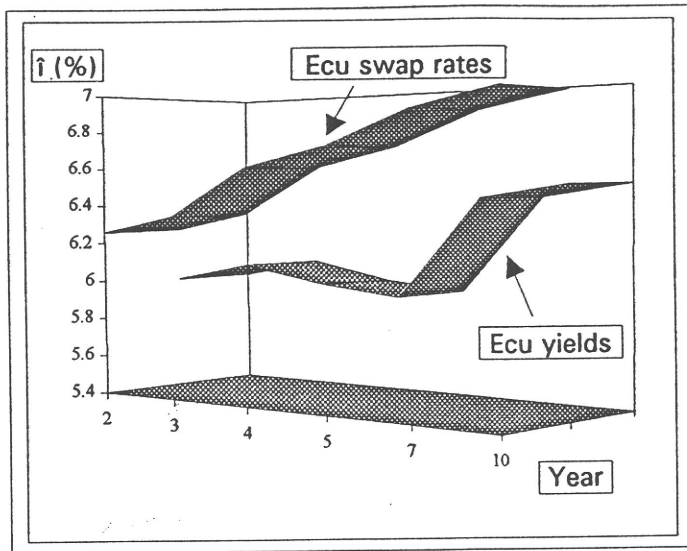


In January, the ecu yield curve showed a net tendency to flatten. In contrast, in February, the monthly view pointed out that the ecu yield curve **steepened significantly throughout the month and moved up** (similarly to DM and FFR curves), registering increases of +53bp in the 1-year, +54bp in the 2-year, +50 bp in the 4-year, +61bp in the 7-year, +56bp in the 9-year...

Spreads between ecu/DM and ecu/FFR yields widened substantially in the very short and very long end curve, as a result of operators cautious during the period of turmoil, preferring to move back in the component sector rather than in the ecu curve, in addition with US investors leaving European markets to come back to their national markets.

While the markets have discounted Stage III of EMU, including the FFR and DM, from 1999, it is interesting to note an apparent continuous trading opportunity around the 6-8 year maturity, with DM yields significantly higher than comparable FFR yields in this section of the curve.

### 11. ECU SWAP/YIELD at end February



Ecu swap rates continued to offer good profit opportunities, especially in the 7-year maturity where there is a larger spread.