Box 6

THE SPANISH CORPORATE DEBT MARKET DURING THE COVID-19 CRISIS

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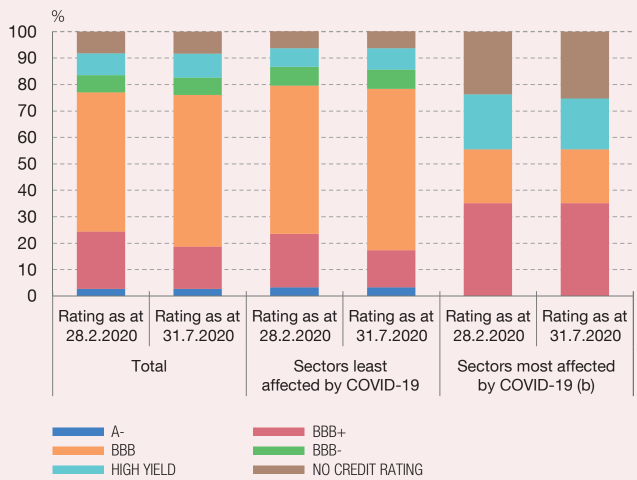
The COVID-19 crisis has triggered substantial macrofinancial effects, both globally and on the Spanish economy. These have had a considerable impact on the supply and demand conditions in funding markets, especially in those to which non-financial corporations (NFCs) resort. For instance, demand for funds in these markets has risen owing to the increase in liquidity shortages arising as a result of the sharp drop in corporations' revenue. On the supply side, risk perception is higher. This tends to result in a tightening of the conditions to access these markets, although this effect could be mitigated by the various measures implemented by the economic authorities geared towards encouraging the supply of funding. These include the state funding guarantee schemes, asset purchases and the extraordinary provision of financing by central banks.[1]

This box analyses developments in the Spanish corporate debt market during the COVID-19 crisis in order to identify the degree to which Spanish firms are covering their financing needs in these markets and the conditions under which they have raised these funds.[2] In this connection, it bears clarifying that, broadly speaking, firms can cover their financing needs by resorting to bank credit or by issuing debt securities in capital markets. The latter, which is mainly used by larger firms, has gained in relative importance in Spain and in other countries over recent years.[3]

Chart 1 shows that between end-February and end-March the financing costs of Spanish NFCs in capital markets surged. This was a widespread phenomenon across international financial markets. This development

Chart 1
INTEREST RATES ON NFCs' BONDS (a)

Chart 2
DISTRIBUTION OF OUTSTANDING AMOUNTS AS AT 31 JULY 2020 OF DEBT SECURITIES ISSUED BY NFCs BY CREDIT RATING



SOURCES: Banco de España, Dealogic and Bloomberg Data License.

a To calculate the yields on bonds, a daily average of the yields on these securities was calculated, weighted by outstanding balance (distinguishing between investment grade and high yield). The analysis was also confined to securities with a maturity of between 3 and 10 years in order to use a relatively consistent group of assets. Further limiting the range of maturities would result in a very short list of high-yield bonds. This would lead to a sample with scant prices that is highly sensitive to the inclusion of newly issued securities or to the exclusion of those that mature. Nonetheless, the chart shows a sharp drop in the return on high-yield bonds at end-2019, as this series is obtained using just over 30 securities, owing to their low weight in the Spanish corporate debt market.

b Corresponding to the transport and storage, accommodation and food services, entertainment and motor vehicle sectors.

1 For further information on these measures, see Banco de España (2020), Annual Report 2019, Chapter 3, "The role of economic policies internationally in the face of the pandemic". In the case of the euro area, noteworthy among the measures adopted is the launch of the ECB's pandemic emergency purchase programme, with an initial envelope of up to €750 billion, subsequently increased to €1,350 billion.

2 For an analysis of bank finance granted to firms during the COVID-19 crisis, see Banco de España (2020), *Annual Report 2019,* Box 4.3, "Developments in bank finance for productive activities in the context of the COVID-19 crisis".

3 See Banco de España (2017), *Annual Report 2016,* Chapter 2, "Financing and investment decisions of Spanish non-financial corporations".

was the result of investors' reduced willingness to invest in this type of asset amid growing concern for default risks. As tends to be the case in these episodes, the tightening of financial conditions was more pronounced in the high-yield bond segment (which includes issues by firms with poor creditworthiness) than in the investment-grade bond segment (better creditworthiness). During the subsequent months, the conditions for access to financing in these markets gradually improved, in both Spain and the international markets. This was driven by the economic authorities' swift action. Despite this improvement, in mid-August financing costs still stood above the pre-COVID-19 crisis levels, around 25 bp higher in the case of investment-grade bonds and around 300 bp in the case of high-yield bonds.

Chart 2 shows the distribution of the outstanding amounts[4] of the debt securities issued by Spanish NFCs by credit rating before and after the outbreak of the pandemic (28 February and 31 July, respectively).[5] In the chart, a slight shift towards poorer credit ratings can be observed (in particular, the increased weight of the BBB category). Downgrades have affected 9.4% of the outstanding amount. Of this change, 5.6 pp related to downgrades within the investment-grade category (BBB- or higher), 2.8 pp to downgrades within the high-yield category and 1 pp to a downgrade from investment grade to high yield. In the sectors most affected by the epidemic, the downgrades were concentrated within the high-yield category, whereas in the other sectors the downgrades affected to a greater degree securities that were initially assigned to the investment-grade category.

Following these changes, the bulk of the outstanding amount remains in the investment-grade category (80%, 1 pp less than pre-pandemic). Yet the weight of the two categories closest to the high-yield group (BBB and BBB-) has risen 5 pp to account for 64% of the total at end-July. This increase is explained mainly by the rating downgrades of firms operating in sectors least affected by the pandemic since, as stated above, among the firms operating in the most affected sectors the downgrades were concentrated in securities that were already categorised as high yield pre-health crisis. Naturally, the securities in the BBB and BBB- categories are potentially the most exposed to additional future downgrades that would leave them in the high-yield category. This change usually entails a potentially substantial worsening of the conditions under which their issuers can access funding in these markets owing to, among other factors, many investors (such as some investment funds or the Eurosystem itself under its asset purchase programmes) not being authorised to purchase assets rated below investment grade.

Chart 3 shows the trend in volumes issued by Spanish NFCs in debt securities markets since January 2019. In March 2020, in line with the tightening of financial conditions in these markets, a sharp drop in gross issuance was recorded. Thus, in March net issuance (gross issuance less redemptions) was negative, totalling the lowest amount since February 2014. However, in line with the improvement in financing conditions in recent months, from April there was a substantial recovery in activity in primary markets for corporate bonds. As a result, net issuance was once again positive, although the volumes issued had decreased at the end of the period analysed. In cumulative terms, gross issuance between March and July amounted to more than €39 billion, giving rise to net fund-raising of €4 billion. These figures are lower than the €43 billion and €11 billion, respectively, recorded in the same period of 2019.

The breakdown of gross issuance by security (see Chart 4) also reveals the trend in the corporate debt market during the pandemic. Initially, in March practically all transactions related to commercial paper (almost €3 billion), which generally poses lower credit risk to holders since it is a short-term financial asset. Subsequently, the situation in the market normalised thanks to the implementation of various measures geared towards improving corporate financing and from April NFCs replaced short-term financing (via commercial paper) with longer-term financing (via medium- and long-term bonds). This change arose despite the support for the issuance of commercial paper provided by the additional state funding guarantee scheme[6] and the inclusion of non-financial commercial

4 To prepare this chart the outstanding amounts of each firm's debt securities were considered at a set date (31 July 2020) in order to ensure that changes in the distribution of the issuers' creditworthiness reflected changes in their ratings rather than in the issues or redemptions potentially realised between the two dates considered.

5 The sectors most affected by the health crisis are: transport and storage, accommodation and food service activities, entertainment and motor vehicles. Each firm is assigned to the sector of the financial group to which it belongs.

6 At its meeting on 5 May 2020, the Council of Ministers approved additional resources of €4 billion charged to the ICO guarantee facility to guarantee commercial paper issued by NFCs based in Spain in the alternative fixed income market (MARF by its Spanish abbreviation).

paper of sufficient credit quality in the list of eligible assets under the ECB's corporate sector purchase programme. The increase in the relative weight of medium- and long-term securities during recent months, which has also resulted in a slight increase in the weighted average maturity of the issues, is a positive development since these securities have a lower refinancing risk for the issuers compared with commercial paper as repayment takes place over a longer period. Nonetheless, between March and July 2020, the amount issued via medium- and long-term bonds (around €16 billion) was somewhat lower than that recorded in the same period of 2019 (€17 billion).

Chart 5 shows the breakdown of gross issuance by distinguishing between firms operating in the sectors most or least affected by the COVID-19 crisis. First, we observe that the resort to debt securities markets by the firms most affected by the pandemic was already comparatively very low pre-outbreak (barely accounting for 14% of gross issuance between January 2019 and February 2020). This is because the firms most affected

Chart 3
ISSUANCE AND REDEMPTIONS OF DEBT SECURITIES BY NFCs (a)

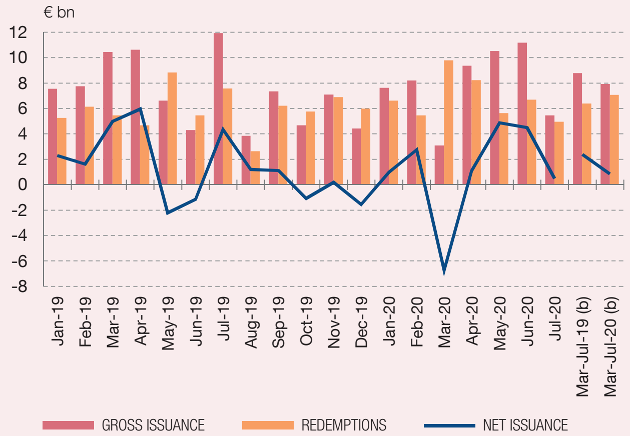


Chart 4
GROSS ISSUANCE. BREAKDOWN BY SECURITY (a)

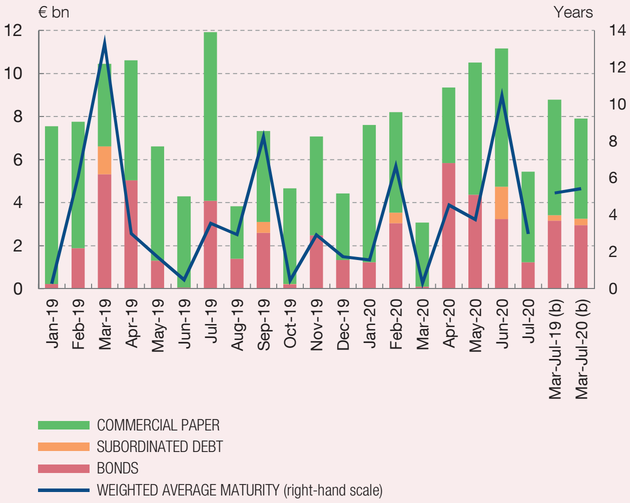


Chart 5
GROSS ISSUANCE. BREAKDOWN BY SECTOR (a)

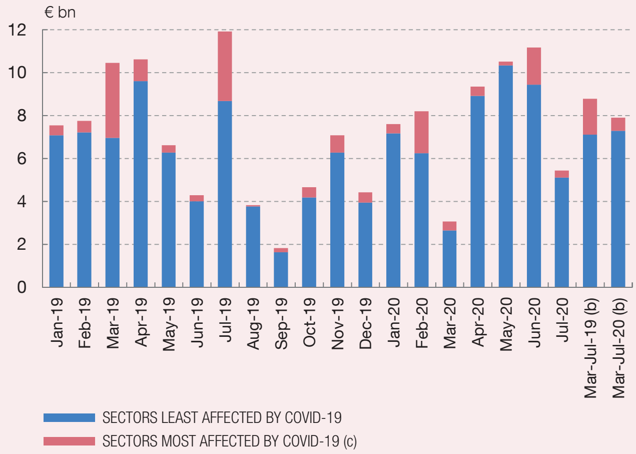
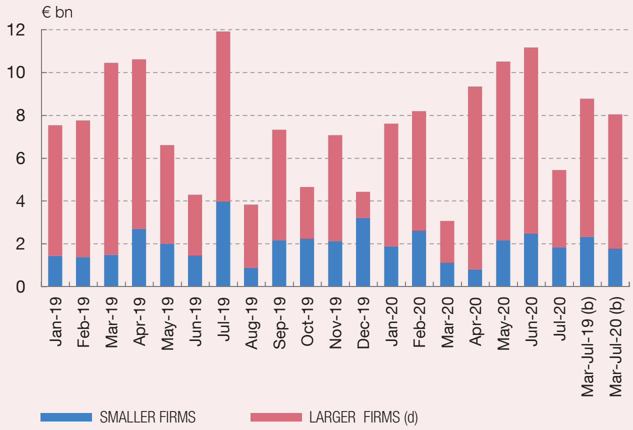


Chart 6
GROSS ISSUANCE. BREAKDOWN BY SIZE OF FIRM (a)



SOURCES: Banco de España, Dealogic and Bloomberg Data License.

a Including issues abroad by non-resident subsidiaries.
b Monthly averages for the period.
c Corresponding to the transport and storage, accommodation and food services, entertainment and motor vehicle sectors.
d A firm is deemed large if the outstanding amount of the total of its issues is above the 75th percentile of this variable's distribution.

by this shock are on average comparatively smaller than the others are. This limits their possibilities of accessing capital markets, even in normal conditions. In the wake of the pandemic, the relative weight of the issues completed by firms operating in the most affected sectors has fallen to represent less than 8% of the total. In terms of volume, the cumulative issues by these firms between March and July 2020 decreased 63% compared with the same period of 2019, versus a 2.5% increase in the issues by the other firms. The most affected firms' reduced resort to the debt securities markets during recent months, despite the more pronounced relative increase in their financing needs,[7] would partially reflect these firms having replaced somewhat their sources of financing, against a backdrop in which the conditions for accessing these markets tightened. In particular, these firms were able to access bank financing under more favourable conditions because of the government's state funding guarantee scheme for a maximum amount of €140 billion. Indeed, the smallest firms and those from the most affected sectors are those that have used this scheme the most.[8]

Lastly, Chart 6 shows the breakdown of the issues by firm size, approximated by the outstanding amount of the debt issued. In the wake of the pandemic, the relative weight of completed issues by larger firms (approximated as the 25% of firms with the largest outstanding amount) has risen by more than 4 pp compared with the same period of 2019. These firms also accumulate 78% of the completed issues. This outcome, which has also been observed in other international markets,[9] could be a result of smaller firms' conditions for accessing these markets worsening to a greater extent due to them being perceived as riskier because they are less diversified owing to their smaller size or are concentrated to a greater degree in the sectors most affected by the pandemic. In addition, these firms tend to provide less financial information to potential investors. Indeed, a larger proportion of completed issues by these firms lacks a credit rating. Amid a high level of uncertainty, this could have discouraged investors from acquiring these securities. Furthermore, the lower relative weight of completed issues by smaller firms could also reflect the replacement of their sources of financing, owing to more favourable conditions for accessing bank credit thanks to the state funding guarantee scheme.

In summary, the evidence presented in this box shows that, following the sharp initial tightening of the conditions for Spanish NFCs to access debt securities markets at the outbreak of the COVID-19 pandemic, financing costs tended to decline gradually. This prompted an increase in issuance. However, funding raised by firms in these markets in the months since the outbreak of the health crisis is somewhat lower than pre-pandemic levels. The credit rating of the outstanding amount of these issues also appears to have been downgraded slightly. These developments, together with a strong pick-up in bank credit extended to NFCs, indicate that although the resort to debt securities markets appears to have continued to contribute to covering Spanish firms' financing needs, it has done so less than in the past. This is especially so in the case of those firms operating in the sectors most affected by the pandemic.

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7 See R. Blanco, S. Mayordomo, A. Menéndez and M. Mulino (2020), *Spanish non-financial corporations' liquidity needs and solvency after the COVID-19 shock*, Occasional Paper No 2020, Banco de España.

8 For more details on the loans benefiting from the state guarantees, see Banco de España (2020), *Annual Report 2019,* Box 4.3, "Developments in bank finance for productive activities in the context of the COVID-19 crisis".

9 See T. Goel and J.M. Serena (2020), "Bonds and syndicated loans during the Covid-19 crisis: decoupled again?" *BIS Bulletin* No 29.