Worldbank Webinar

Use of Cross Currency Swaps in the Belgian debt portfolio

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Belgium’s is the 6th economy of the Euro-zone.

Its 2014 GDP amounted to EUR 400.64 bn.

End 2014
Belgium’s total debt amounted to EUR 427.48 bn representing a debt/GDP ratio of 106.7%.

Belgium is a medium sized issuer rated
S&P: AA/A-1+
Moody’s: Aa3/P-1
Fitch: AA/F1+

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP (% EA19)</th>
<th>Population (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>28.7%</td>
<td>81.2</td>
</tr>
<tr>
<td>France</td>
<td>21.2%</td>
<td>66.4</td>
</tr>
<tr>
<td>Italy</td>
<td>16.0%</td>
<td>60.8</td>
</tr>
<tr>
<td>Spain</td>
<td>10.5%</td>
<td>46.4</td>
</tr>
<tr>
<td>Netherlands</td>
<td>6.5%</td>
<td>16.9</td>
</tr>
<tr>
<td>Belgium</td>
<td>4.0%</td>
<td>11.3</td>
</tr>
<tr>
<td>Austria</td>
<td>3.3%</td>
<td>8.6</td>
</tr>
<tr>
<td>Finland</td>
<td>2.0%</td>
<td>5.5</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.8%</td>
<td>4.6</td>
</tr>
<tr>
<td>Greece</td>
<td>1.8%</td>
<td>10.8</td>
</tr>
<tr>
<td>Portugal</td>
<td>1.7%</td>
<td>10.4</td>
</tr>
<tr>
<td>Slovakia</td>
<td>0.7%</td>
<td>5.4</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>0.5%</td>
<td>0.5</td>
</tr>
<tr>
<td>Slovenia</td>
<td>0.4%</td>
<td>2.1</td>
</tr>
<tr>
<td>Lithuania</td>
<td>0.4%</td>
<td>2.9</td>
</tr>
<tr>
<td>Latvia</td>
<td>0.2%</td>
<td>2.0</td>
</tr>
<tr>
<td>Estonia</td>
<td>0.2%</td>
<td>1.3</td>
</tr>
<tr>
<td>Cyprus</td>
<td>0.2%</td>
<td>0.8</td>
</tr>
<tr>
<td>Malta</td>
<td>0.1%</td>
<td>0.4</td>
</tr>
<tr>
<td>EA19</td>
<td>100%</td>
<td>338.3</td>
</tr>
</tbody>
</table>

Source: Eurostat, population statistics as of 1 January 2015 & GDP at market prices, 2014.
The majority of the financing needs are covered by a Euro LT financing instrument called OLO’s. The current outstanding amount of OLO’s is €312 bn.

Standardised Instruments, both long and short term represent 87% of the total debt portfolio.

LT Flexible instruments or Tailor-made instruments only amount to 3% or €12 bn.

Treasury Certificates, the Euro ST standardised financing instrument, represents only 7% of the debt portfolio or €27 bn.
Yearly financing strategy : set the framework

Yearly General Guidelines

- General Guidelines
  - proposed by the Debt Agency
  - approved by the Minister and Parliament
  - sets the framework for the yearly Financing Plan

- Proposes the maturities to be issued in the standard product
- Defines/reiterates the risk parameters
  - the average life target of the debt portfolio
  - Refinancing and refixing risk
  - Foreign exchange risk
- Defines the objectives to be achieved when issuing tailor-made instruments (essentially EMTN)

- Yearly financing plan
  - Publication of amounts to be financed through different financing instruments: standardized or EMTN
Riskparameters:

1. Refinancing and refixing risk, as a percentage of total debt
2. Average life of the debt portfolio
3. No foreign exchange risk. All risks should be swapped to €. Hence CIRS.

The average life of the euro debt portfolio amounts to **7.98 years**, while the duration exceeds 7 years, yet the implicit yield has declined to **2.85%**.

This year’s target in terms of average life is 8 years.

The 12-month refinancing and refixing risk remain near their lowest level ever.

Duration, average life and implicit yield:
Rationale for issuing tailor-made products (EMTN)

1999 till 2008: use of only standardized Euro financing instruments
Trigger for changing the Issuance framework and Strategic decision making process

- 1999 till 2008: Concentrate on building a liquid benchmark curve
  - build sizeable lines over the whole curve
  - improve liquidity of secondary market

- 2008: Decision to further diversify the financing instruments framework and to capture opportunities according to well-set conditions
Rationale for issuing tailor-made products

- **Rationale**
  - **Increase the investor base**
    Tailor-made products are used as a TEASER. Belgium is medium sized issuer. Attracting investors by offering specific products will induce them to analyze the credit and install credit lines. This could lead to a further investor diversification for the standard products.
  - **Cost efficiency**
    In order not to cannibalize the main financing instruments tailor-made products need to be cost efficient versus the curve of the standard financing instrument

- **Risk management strategy**
  - **Risk parameters** prohibit any foreign exchange risk
    HENCE : usage of Cross Currency Swaps
What is a Cross-Currency Swap?

- A solution to transfer liquidity from one currency to another.
- Reproduce a variable rate quarterly loan in one currency against a variable rate quarterly loan in another currency.
- Swap of the nominal amount on the inception date and at maturity.
- A Cross-Currency Swap is not sensitive to the evolution of rates and spot prices.
- Ideally, the basis level would be null.
- In reality, access to liquidity is not equal.
- The basis margin represents these differences and is solely influenced by offer and demand.

![Diagram of Cross-Currency Swap]

**Example:**

\[
\begin{align*}
+ 100 \text{ Mios EUR} & \quad + 125 \text{ Mios USD} \\
125M \times \text{Libor 3M} & \\
100M \times \text{Euribor 3M} & +/\text{spread} \\
- 125 \text{ Mios USD EURUSD Spot} & \\
- 100 \text{ Mios EUR} &
\end{align*}
\]
Factors of evolution of the EUR-USD curve

- Short part of the curve efficiently managed by Central Banks.
- 2-to-4-year zone impacted by FX Swaps.
- 5-to-10-year zone affected by the ECB’s QE program.
- 20-year+ zone affected by:
  - CSA contract modelling, CVA hedge desks.
  - Foreign currency debt issuance (mainly in GBP and USD) by European companies.

**EUR-USD Basis**

**EUR-USD 2-year and 10-year base**

**EUR-USD curve**
Regulatory context

- COMPENSABLE CROSS-CURRENCY SWAP?
- LEVERAGE RATIO
- VOLCKER LAW
- NET STABLE FUNDING RATIO (NSFR)
EMTN issuance

The total amount issued under the EMTN format and in foreign currencies since 2008 amounted to 11.154 bn, with US $ representing 85% for 14 transactions.

Current outstanding in foreign currency transactions amount to 4.3 bn or 1.5% of total debt.

Small but interesting given the cost efficiency and the investor diversification.
Issuing flexible instruments: set the framework

Pre-trade legal and credit requirements

- **Documentation**
  - *Choice for EMTN program:*
    - Multi-product, multi-currency, multi-maturity, multi-dealer program
    - Each transaction which be represented by a pricing supplement
    - Advantage: Ready-to-tap the market with a well-known documentation.
    - Disadvantage: impressive work to set-up and regular updates

- **Credit requirements**
  - Negociation of ISDA and CSA with all Primary Dealers
Issuing flexible instruments: monitor the market

Continuous monitoring of the market by Debt Agency and Primary dealers

- **Input dealers**
  - Market changes or inefficiencies in €/$ or €/£ or other currencies
  - Calculate the cost of a possible transaction on a given maturity including FVA and CVA charges

- **Input Debt Agency**
  - Indicate the value of the OLO curve
  - Indicate the cost efficiency required for the transaction
Thank you for your participation.

www.debtagency.be