Covid-induced Eurobonds mark step towards EU financial cohesion

Successful issuance points to greater pan-European sharing of risk

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Covid-19 caused a plethora of economic storm clouds across Europe when it emerged more than four years ago. Yet European Union measures to support employers and promote post-pandemic recovery have provided a silver lining of sorts for the continent's financial markets.

By the end of 2020, the Support to Mitigate Unemployment Risks in an Emergency (Sure) programme had raised €100 billion through a Eurobond issuance. A separate Eurobond issuance also enabled the Next Generation EU (NGeU) scheme to amass around €800 billion in financial firepower. At this point, Sure and NGeU had collectively disbursed around €400 billion of loans on favourable terms to the EU's 27 member

states to help them mitigate the economic effects of the pandemic and pave the way towards a green and digital transition.

The initiatives represented a turning point in the EU's shift towards a system of shared risks through the issuance of Eurobonds – an approach that northern European countries had previously opposed.

EU institutions have in fact been moving towards such a system over the past 30 years, albeit in an intermittent and episodic way. Financial policy decisions have been based on occasional interventions that generated uneven set-ups – such as with the Sure and NGeU schemes, where a euro-denominated debt is shared among member states, even though only 19 of them have adopted the single currency.

Safety in numbers

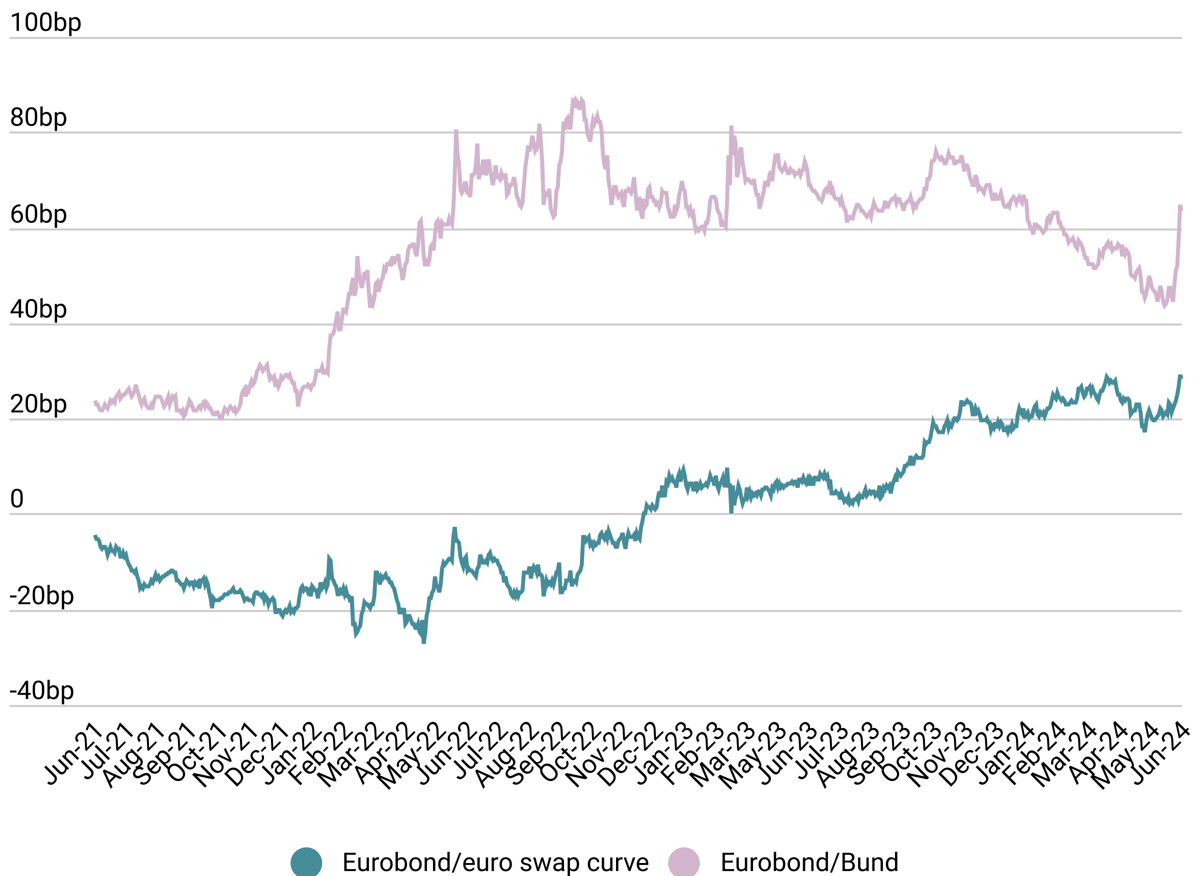
In any case, the Eurobonds issued in the wake of Covid have proved a huge success. They have attracted the interest of more than 1,000 investors in 70 countries, in addition to laying the foundation for a new type of safe asset: a supranational European risk-free bond.

An abundance of safe assets is crucial if any financial system is to function properly. In this respect, the European Central Bank's intervention since June 2023 through its interbank operations – aimed at making Eurobonds no riskier than the most reliable securities issued by member states, such as German Bunds – has also proved useful.

The absence of any supranational European safe asset prior to Covid increased the risk of eurozone fragmentation and contributed to the phenomenon of spreads between the securities issued by different member states. This is because the volume of Bunds in issuance is not sufficient to meet the needs of Europe's financial markets. Just consider that in the EU the amount of risk-free government bonds (rated at least AA) in circulation – and therefore tradable by the system – represents less than 40% of the bloc's GDP. In the US, the figure is 90%, and in Japan it is well over 100%.

The Eurobonds' main limitation is their time-bound design. No new issuances are expected after 2028, the last Sure-related redemption will be in 2052 and the final NGeU-related redemption will be in 2058. This does not encourage further investment in these bonds, nor does it suggest to the markets that EU policymakers intend to move member states' public debt into a common European pool. The increased uncertainty for investors will cause them to demand higher yields to reflect the increased risk of fragmentation in the eurozone.

Since the second half of 2022, Eurocrats' enthusiasm for Eurobonds has cooled and there has been a growing assumption among investors that Sure and NGeU were one-off experiments. At the same time, the Eurobonds' yield differential – the risk premium or spread – over the Bund and the euro swap curve have gradually increased.



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Yet in January of this year, the EU still went ahead with the launch of its European Issuance Service. This will align the Eurobonds' financial market settlement mechanisms with those of securities issued by eurozone member states.

This is another step in the right direction. It should be complemented by the creation of a European public debt manager and, perhaps, by a European budget that is finally freed from short-term political and socio-economic considerations.

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