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The affirmation of a market for Eurobonds, i.e. common debt securities issued by the European Union, has significantly strengthened by means of the response of the European institutions to the pandemic crisis. The volume of European bonds offered on the market has in fact multiplied with the issuance of debt securities for the financing of the "Temporary Support to mitigate Unemployment Risks in an Emergency" (SURE) and of Next Generation -EU (NGEU).

SURE and NGEU are a watershed compared to the past. In fact, the European Commission has been resorting to forms of common financing since the early 1980s through the collection of funds on the market which were circulated with the back-to-back method, i.e. lent to the countries on the same terms - nominal quantity, maturities, yields and coupons – that they were obtained by the Commission on the market. SURE and NGEU, however, also due to the size of the two programs, required a more sophisticated issuance management practice: the back-to-back method was set aside and a flexible fund management structure was introduced.

SURE provides for financial assistance of up to one hundred billion euros to be given to member states in the form of loans with the aim of dealing with sudden increases in public expenditure necessary to preserve employment. The NGEU program provides for transfers and loans to requesting countries to counter the economic consequences of the pandemic crisis, for a total of €750 billion.

Issuance volumes due to the NGEU program and other common financing programs are expected to exceed €1 trillion in 2028, which is equivalent to more than 40% of total German public debt. The comparison is useful for understanding the dimension of the issuance of Eurobonds compared to those of Bunds, the German federal debt securities, which are currently the benchmark for European debt securities. Also in consideration of the forecasts of a declining (or even negative) offer of German bonds – caused by the "debt brake" policy enshrined in the German Basic Law - in the long term, Eurobonds could become the most widespread "public" bond in Europe, with a reference function similar to that which US Treasury bonds have for the global financial system.

Despite this potential, the markets do not seem to recognize Eurobonds as securities of equivalent quality to German bonds. During 2022, a year of unprecedented difficulty for global bond markets, funding costs for the Commission grew faster than some EU member countries' issuances. Currently, European bond issuances on the market demand higher yields not only than German bonds, but also French ones, despite the fact that some rating agencies classify European bonds as better quality (triple

A, according to Moody's) than French ones (AA). A recent analysis by the specialized press[1] reveals that ten-year bonds issued by the EU bring yields of 2.63% against 2.54% for French ten-year bonds. Short-term European bonds also have higher yields than Spanish bonds, although lower than Italian ones.

The performance of European bonds is creating political problems within the EU. While some countries push hard for the issuance of Eurobonds to finance shared policy goals, such as the energy/environmental and digital transitions, other countries note that financing would be more worthwhile for them if it was done by individual countries. This is an issue that is often raised by German Finance Minister Christian Lindner and Dutch Prime Minister Mark Rutte.

However, the absence of a "safe asset", i.e. a secure common bond, has wider implications for the Union and in particular for the euro area. According to some estimates,[2] the supply of sovereign bonds with a high credit rating (AA or higher) was equal to 37% of aggregate GDP in the European Union in 2019, compared with US government bonds equal to 89% of US GDP.

The absence of a common secure financing instrument can contribute to market fragmentation. The unavailability of a "safe asset" and the fragmentation of the markets can in fact contribute to the emergence of "doom loops" in which the problems of a country's banking sector have repercussions on public debt securities or vice versa. Furthermore, in precarious conditions of financial stability, investors tend to seek greater security (flight to safety) by accelerating the fragmentation of the market and distinguishing between the various national issuers. This is an issue that has been scrutinized since the 2010 euro crisis.[3] The development of a eurobond market is therefore important to preserve the financial stability of the euro area.

The credit quality of Eurobonds is not questioned by investors who (albeit with different nuances depending on the rating agencies) do not see a risk of default or non-repayment of debts by the European Union. On the other hand, as analysts of the European Central Bank note,[4] European bonds have various institutional levels of investor protection, such as to protect the latter from the risk of default.

The aspect that seems to be more problematic, however, is the degree of liquidity of the bonds, i.e. the probability of selling the bond without incurring significant changes in the price compared to market quotations. The "depth" of the market, i.e. the constant presence of operators willing to sell or buy the bonds (reducing the distance between bid and ask) is a relevant indicator of the intrinsic risk of the various bonds and almost always moves in parallel with the total volume of the issuances of those bonds. In addition to the volumes of bonds offered, there are other reasons that reduce the liquidity of Eurobonds: the fact that they are not yet included in the sovereign bond indices and that related derivative instruments, mainly futures, which hedge against the risk of fluctuations of the value, are not circulated.

[1] https://www.ft.com/content/9ca73db9-9773-483b-b4bc-e4e2c7646726

[2] Gossé, J. and Mourjane, A. (2021), "A European safe asset: new perspectives", *Bulletin de la Banque de France*, No 234(6).

[3] https://www.sciencedirect.com/science/article/pii/S1703494913000042

[4] https://www.ecb.europa.eu/pub/economic-research/resbull/2023/html/ecb.rb230116~e55fb14a74.en.html

However, the issuance of bonds linked to the SURE and NGEU programs has shown how significantly increasing the supply of bonds has positive effects on their liquidity.

The problem is that the European institutions have repeatedly reiterated that the program most relevant in terms of volumes, i.e. NGEU, must be considered one-off, i.e. non-repeatable. This means that NGEU-related bonds will not be exchangeable for similar bonds once the program is completed. In theory, as maturity approaches around 2050, the liquidity of the bonds will tend to drastically reduce with possible consequences on the market price.

The offer of bonds should therefore increase to ensure the advantage of issuing Eurobonds, but this hypothesis is encountering opposition from some member countries also because of their insufficient advantage. In recent days, Dutch Prime Minister Mark Rutte, for example, has expressed his government's opposition to any idea of new funding from the European Union in order to respond to the Biden Administration's initiative to support US firms with 369 billion dollars in the context of the Inflation Reduction Act or for the implementation of a European program for the environmental transition. A similar position was expressed by the German Finance Minister, motivating it with the bonds' scarce advantage compared to that of the German ones.

In January 2023, the European Commission tried to counter liquidity problems by standardizing the issuances of European bonds under a single category, albeit in the context of different programs. However, the circulation of Eurobonds is currently in a catch-22: to be in demand by the market it would be necessary to issue large volumes of bonds, but before reaching such a volume of bonds the advantage of issuing them will be gone if compared to all other national securities.