CITADEL
Fixed Income and Macro

On Eurobonds

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REALTIME ECONOMICS

Now is the time for Eurobonds: A specific proposal

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Angel Ubide's views are strictly his own and do not represent those of Citadel

Why now: three main reasons

- **The need:** urgency for Europe to achieve ***strategic autonomy*** given recent geopolitical changes.
  - Strategic autonomy this requires ***both military/security and financial strength***, and a necessary condition for financial strength is a large, deep and liquid safe asset

- ***The opportunity: Growing global demand for European assets***, as changes in the global rules order has raised doubts about the role of the USD as safe asset.
  - Offering a large, deep and liquid Eurobonds market will ***meet this demand to rebalance portfolios*** away from USD.

- ***The institutional support: ECB's shift in stance on the International Role of the Euro***, which has transitioned from a neutral stance – neither promote, nor oppose – towards a stance of promoting it
  - The Euro ***can't be an international currency without a large, deep and liquid safe asset***.

What we propose

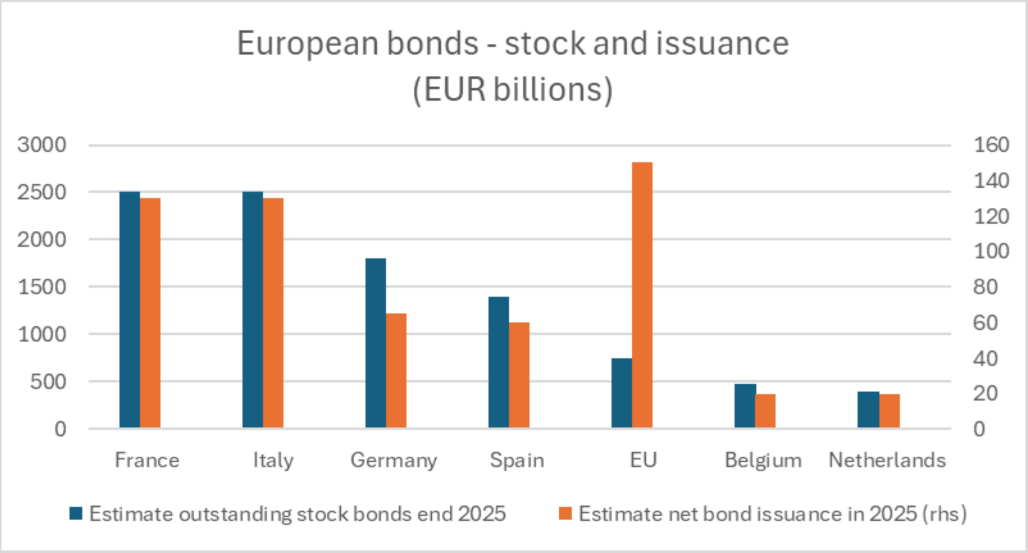
- ***Replace up to 25% of GDP of EU countries debt with Eurobonds***.
  - This can be done with a combination of
    - ***exchanging*** current national bonds by Eurobonds
    - ***refinancing*** future national bond maturities coming due with Eurobonds.

- **Back the Eurobonds by a transfer of a share of VAT revenues of each member state**.
  - This commitment would be enshrined in ***legislation*** in each member state
  - At current interest rates, it would only require ***about 1% GDP***

- ***Eurobonds would enjoy a double guarantee:***
  - The legal commitment to ***transfer*** the VAT revenues
  - The EU's ***legal*** commitment, as an issuer, to ***service*** its debt.

Eurobonds already exist – we propose to increase their size 5x

- ***Eurobonds already exist***: EU bonds and bills + infrastructure (collateral, repo, futures)
- ***The stock***: it will be close to 1tr EUR by end 2026, ***bigger*** than NL debt
- ***The flow:*** EU bonds and bills are the ***biggest*** EU issuer in both 2025 and 2026.



Source: European Commission

Current Eurobonds vs Our Proposal

Current Eurobonds

Transfers to EU budget

Issuance of EU Bonds and Bills

EU programs: NGEU, Ukraine, SAFE, Western Balkans Facility, others

Our proposal

Legislation to transfer % VAT to EU

Issuance of EU Bonds and Bills

Transfer funds to budget of member states

What we do NOT propose vs what we DO propose

- We do ***NOT*** propose to ***earmark*** Eurobonds for specific spending programs
- We do **NOT** propose to use Eurobonds to ***increase*** debt and deficits beyond current plans
- We do ***NOT*** propose a ***joint and several guarantee*** like the original Blue/Red proposal

- We ***propose*** to optimize debt management to meet ***new demand*** and ***reduce*** financing cost for all countries
  - **Objective:** Eurobonds to achieve ***negative beta*** like US Treasuries and increase stability of EU economy
  - **Spillover:** A deep, liquid Eurobond yield curve will support a deep, liquid European ***corporate bond market***
    - **Result:** ***reduce financing costs for both public and private sector***

Issues

- **Why 25% GDP?**
  - To combine ***depth and liquidity*** for Eurobonds with ***depth and liquidity*** in national bond markets
    - What about countries with low debt/gdp? ***Coalition of the willing***
- **Do Eurobonds imply that national bonds will be *junior and at risk*?**
  - Not in CDS sense: no waterfall – just separate revenue pools
  - Eurobonds would be ***"super senior"*** – default on Eurobonds is political default on EU
- **Why exchange *and* refinancing?**
  - Refinancing too slow and no control of composition across the curve
  - ***No actual exchange***: purchase + issuance. No pari-passu issue.
- **Will national yields increase?**
  - Maybe initially/in some countries: ***incentive for responsible national fiscal policy***
  - Over time, national demand and a more stable eurozone will lower funding costs for all countries
    - ***Cuts tail of losing market access*** **–** (analogue to ample reserves for banks)

Issues

- **Does the ECB need to participate?**
  - Eurobonds must be part of future structural portfolio and eligible for QE

- **Why doing this if EU bonds trade at a *positive spread* over bunds?**
  - Precisely to ***reduce*** the spread - spread exists because of ***small size*** and ***uncertainty about rollover of NGEU***
    - *“The European Union **needs to issue more joint debt** to **avoid a decline in liquidity and higher spreads** for bonds already issued by EU institutions”* Andy Hill, International Capital Market Association
  - ***Certainty*** over future issuance would also facilitate ***inclusion in sovereign bond indices***

- **Why not ESBies?**
  - A true safe asset needs the ***legal and political commitment*** of governments - ESBies would lack it
    - If there was demand for ESBies probably the private sector would have already offered them

The summary: The right time for a key reform

- **Eurobonds**: a key element in effort to ***strengthen*** the EU economy and ***boost*** the international role of the euro
  - Letta Report: ***Defragment*** the Single Market -> increase market size
  - Draghi Report: ***Defragment*** investment -> boost productivity
  - Eurobonds: **Defragment** government debt -> lower financing costs

- ***Fix a deadline***: by Jan 1st, 2028 – no deadline, no action

- ***Failure to do it*****:** implies accepting ***higher*** financing costs and a more ***unstable*** economy

IMPORTANT NOTICE