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AT1 Bond Resilience in the Wake of Iran Conflict

Bloomberg had this [article](#) out on Friday searching for answers as to why AT1 bonds have remained so resilient in the wake of geopolitical instability and commodity- and financial market jittery. Here are a few observations:

Bloomberg has a point that many of the recent issues AT1 bonds offer juicy coupons compared to the wider universe of investment-grade corporate bonds. There is little perception that large banks in Europe might be in any trouble, also reflected in bombastic equity performances over the past 2 years, and investors are probably largely ignoring the higher credit risk. The argument that they keep hanging on to them as they can't buy back bonds once sold is relatively weak, though.

It is in fact the EUR-denominated European AT1 bonds that have recently experienced the sharpest slip in the asset class. While most of the bulge bracket institutional issuers sported very tight secondary market yields of inside 6% in February before the Iran War broke out, most of the instruments' bond prices corrected by between 4-5 points during the past 2 weeks, bringing those yields back up into the mid-6% territory (as per DB AT1 chart below), particularly for the ones deemed riskier due to their investment- and trading activities.



As such, the Deutsche Bank instruments issued in November moved from their peak of a secondary yield just inside 6% in late February out to 6.75% on Friday. News about a sizeable private credit exposure certainly didn't help in its case. The new BNP Paribas has seen its yield move from 5 5/8% at launch early February to 6.35%. UniCredit's January issue had its yield move from the recent low of 5.85% to 6.3%. Santander's last year's deal, on the other hand, widened from a spectacularly tight secondary yield of inside 5% in February to now mid-5s%.

This constitutes an underperformance vis-a-vis respective USD instruments, as it wasn't only a general credit spread widening that has had this impact but also a massive sell-off in the underlying European benchmarks. You will have noticed that eurozone government bonds have had a gruesome performance month-to-date, pushing the curve out by some 35-40bp (see 10-year Bund yield chart below). EUR AT1 bonds largely sold off in sympathy with this move. Compared to this, the 3-point correction in the latest HSBC USD-denominated AT1s is rather modest.



Closer to the home of the conflict, ie the Gulf States, the inflicted damage appears to be much less. The November AT1 USD-issue of the largest Emirati lender, Abu Dhabi National Bank, has apparently been exposed to substantial intra-day volatility from its price peak of 102, plunging through 92, but the bond has always recovered and closed the week at 98.5 (see daily bar chart below). In yield terms, this means we moved from 5.5% to 6.3%, barely any sign of material stress considering Iranian drones raining down on Dubai. The development is similar to other Emirati institutions.



The newest AT1 emerging from the Gulf has been the USD 500m issue from Commercial Bank of Qatar, priced literally in the week before the start of the conflict. The yield at launch has hardly moved at all, from 6.25% to 6.4%, as if nothing ever happened.

There should not be any doubt that the almost 300bn market for AT1 instruments has so far been and will remain attractive as a fixed income asset class. However, investors cannot be complacent about the recurrently larger chances of volatilities as compared to the investment grade corporate bond market. While it is correct to speak about the current resilience in the AT1 market, at least when it comes to the evidently modest credit spread widening, we are still trading based on historically tight conditions. Not if but when real market corrections were to set in, they would tend to be much more violent in nature. At these current secondary levels, the geopolitical environment and further negative effects on commodity markets may not have been taken fully into account yet.

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