Il Sole 24 ORE
Date: 14/06/2022 Page: 1,3
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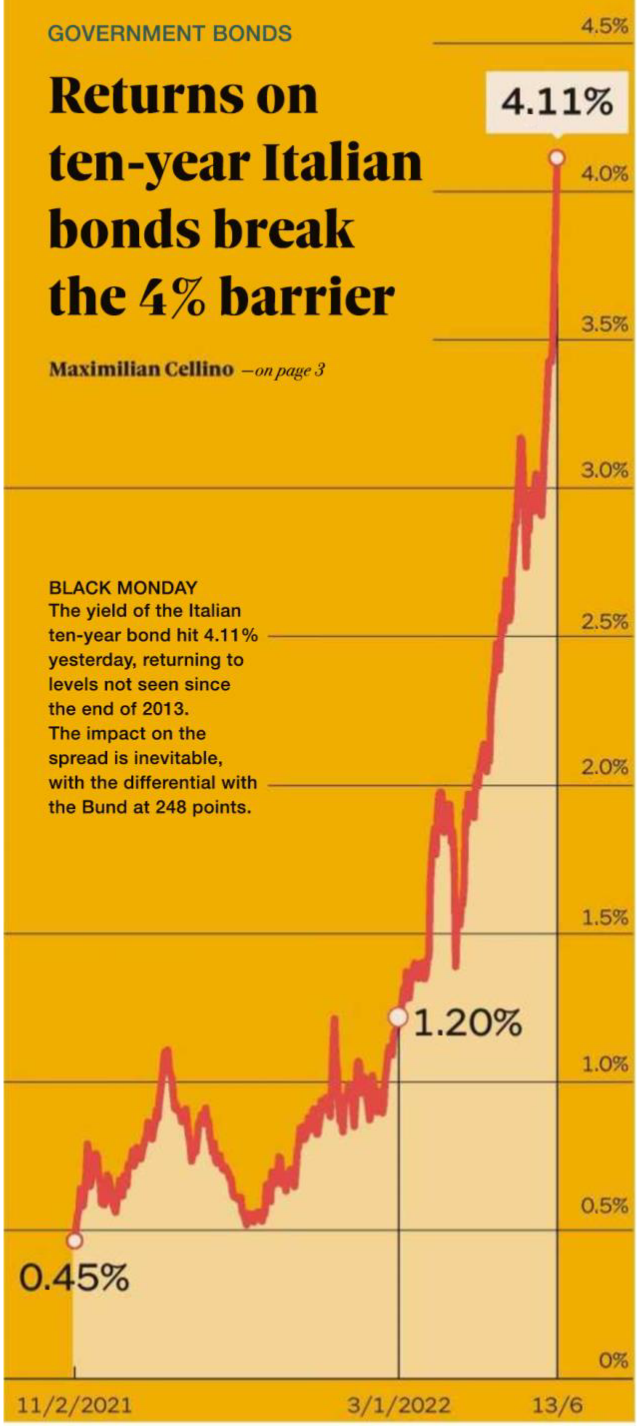
GOVERNMENT BONDS

Returns on ten-year Italian bonds break the 4% barrier

Maximilian Cellino —*on page 3*



BLACK MONDAY
The yield of the Italian ten-year bond hit 4.11% yesterday, returning to levels not seen since the end of 2013. The impact on the spread is inevitable, with the differential with the Bund at 248 points.

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Bonds under pressure, returns growing: the BTp returns to over 4%

Government Bonds. The Italian ten-year government bond returns to 2013 year-end levels at 4.11%. Peripheral spreads widen: spread with Bund at 248 points

Maximilian Cellino

Four percent. Fans of round numbers gained another one yesterday to value the return of the ten-year BTp. In fact, the most representative Italian government bond has risen to levels not seen since the end of 2013 to hit 4.11%, crossing a boundary that was unsought for in itself and may not be the last.

The “aggressive” direction on monetary policy taken by the ECB last week and, most of all, the lack of any concrete guidance on the anti-fragmentation tool are defining the performance of European government bonds, particularly those in the periphery countries, as well as Italy and others. The impression is that the market is now openly challenging the Eurotower on its actual desire to intervene in this field, and the spread is shifting as a result.

In addition to the Italian yield gap with Germany, which jumped to 248 basis points yesterday, the Spanish (136), Portuguese (137) and Greek (278) yield differentials have also widened in recent weeks. This is a movement which, combined with the basic rise in the Bund (now at 1.63%), the Treasury is already paying dearly for. In the first five months of the year, it issued bonds at an average rate that was already seven times higher than the 2021 lows (0.71% versus 0.10%) and is being called upon today for a new test with an auction of 3.7 and 30-year BTp for up to €6 billion.

In the inevitable comparison with the past decade and with the recent emergence of the Italian yield at 4%, the market situation is diametrically opposed. In December 2013, the ECB had not yet activated the repurchase plan that officially ends at the end of June and which, at least until recently, had pushed yields in the entire Eurozone to historic lows. The promise to do “whatever it takes” uttered by Mario Draghi a year and a half ago had already begun to reduce the BTp- Bund spread, which was floating around 200.

But while the inertia of the markets is now facing an uphill struggle, the fundamentals situation, as well as other factors, is making analysts much less concerned. “In recent years, governments have lengthened the average maturities of their bonds to reduce the impact of any rate hikes, and even in the case of Italy, the trajectory of public debt repayment may be challenged more by economic trends than by the spread,” acknowledges Matteo Ramenghi, Head of Investments at UBS WM in Italy, pointing out that last year debt fell thanks to strong nominal GDP growth: “This scenario could well be repeated in 2022.”

The economic fundamentals picture is nonetheless less concerning than nine years ago

A second key piece of information concerns Europe itself, where the situation has changed radically in the last decade. “The Recovery Fund involves the issuance of almost 800 billion of debt directly from the EU and gives more credibility to the European project,” adds Ramenghi, who also notes that the percentage of citizens in favour of the euro has grown (in Italy it is 72% compared to 54% in 2014).

The composition of Italian debt itself is also an issue that should not be underestimated. In fact, the ECB holds about one third of the stock, which, net of this share, amounts to about 110% of GDP, while the participation of foreign investors has decreased. These two factors are enough for Algebris to say that overall “the technical data of BTp are better than in 2011 and 2018” and that, while increased volatility on our securities is to be taken into account, “the defence mechanisms against European systemic risk are probably higher than in past crises, making the final tail risk lower.”

It therefore remains to be seen whether and to what extent an investment in our government bonds should be seriously considered in such an environment. Looking beyond the current turmoil, Luca Riboldi, Head of Investments at Banor Sim, points out that the central banks’ change of direction and the consequent reduction of liquidity in circulation has generally contributed to an increase in real (inflation-adjusted) yields. “If we consider that the average Italian consumer price index is expected to be 2.21 percent over the next 10 years,” Riboldi explains, “those 180 basis points of difference are a very attractive real rate to invest in.” In any case, this remains set against the backdrop of the theoretical danger of fragmentation and the ability of the Italian government (and Europe) to manage the debt in a way that successfully limits the risk.

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The surge of the BTp

10-year bond yields

05 JUN 2014
① 2.936
The ECB announces the launch of the TLTRO. The aim is to improve the monetary policy transmission mechanism by promoting bank loans to support the economy.

22 JAN 2015
② 1.633
The President of the ECB Mario Draghi announces an expansion of the Asset Purchase Programme that will later become Europe's QE mechanism.

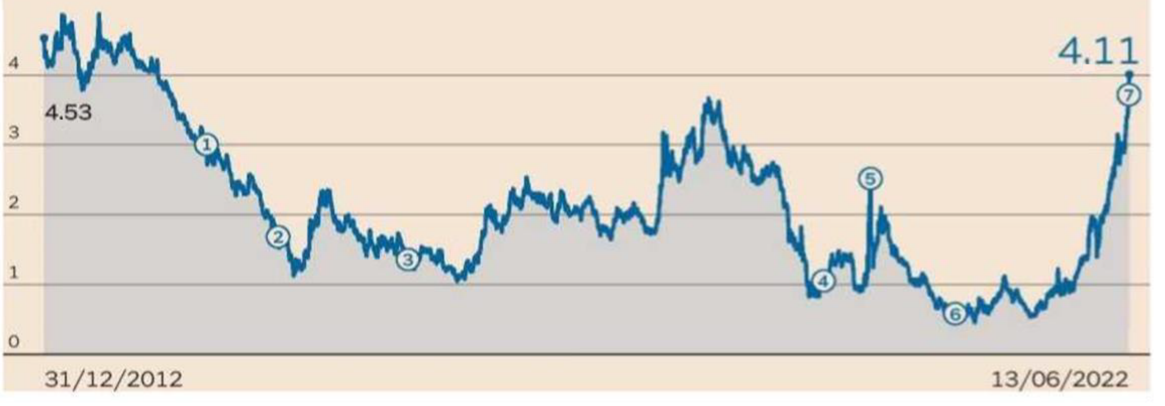
10 MAR 2016
③ 1.454
ECB takes everyone by surprise: cutting rates, increasing QE to 20 billion and buying corporate bonds.

18 OCT 2019
④ 1.030
The European Council appoints Christine Lagarde as President of the ECB with a non-renewable mandate of 8 years.

18 MAR 2020
⑤ 2.495
The ECB announces the € 750 billion PEPP (Pandemic Emergency Purchase Programme).

10 DEC 2020
⑥ 0.527
The PEPP allocation is upped to € 1850 billion. The programme is extended to March 2022.

10 JUN 2022
⑦ 3.846
The ECB decides to terminate the APP as of 1 July 2022 and to raise interest rates in July and again in September.



The spread

Yield differential between the 10-year BTp and Bund

GIAVAZZI AND ITALY

"The reason there is a spread that raises the cost of debt in Italy is the ratio of debt to GDP," explains Francesco Giavazzi, economic advisor to the Italian Government. "Our spread is identical to that of countries that have the same debt to GDP ratio," he adds. "So there's nothing special about Italy."