

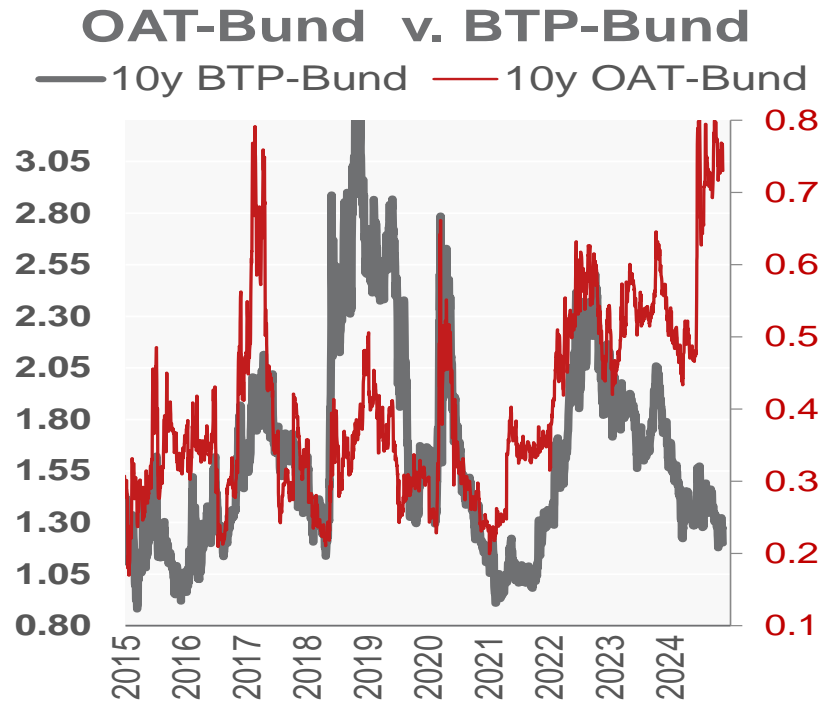
Italian Public Debt sustainability: market perception and future prospects

Andrea Sironi - Bocconi

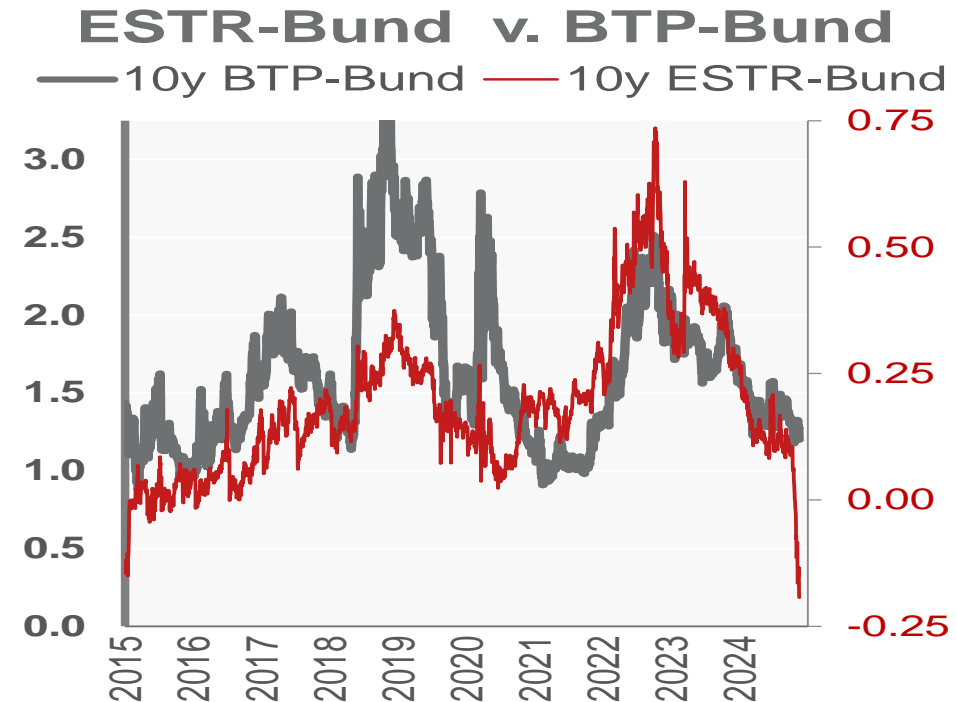
Institute for European PolicyMaking (IEP) – Bocconi University

November 21, 2024

Italian Public Debt sustainability: BTP spreads



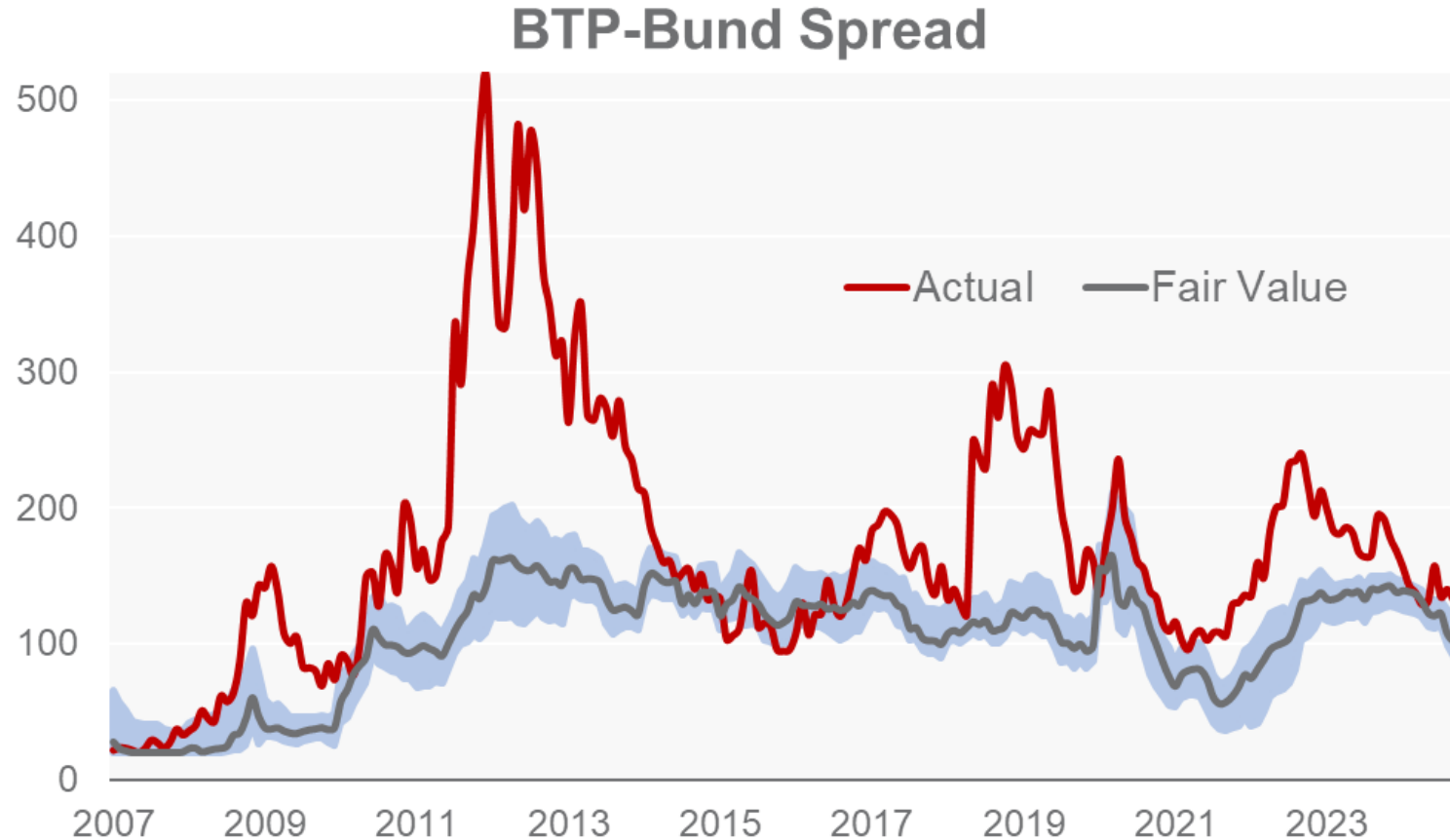
Source: Bloomberg, GenAM



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- BTP-Bund spreads fairly narrow (125 bps) - low end of the 90-330bp range in post sovereign crisis era
 - BTP spreads proved resilient to stress on French spreads
- However, context of narrowing EUR (and USD) swap spreads → “risk-free” bonds have cheapened vs. swaps – and BTP spreads have not been able to catch up with this trend

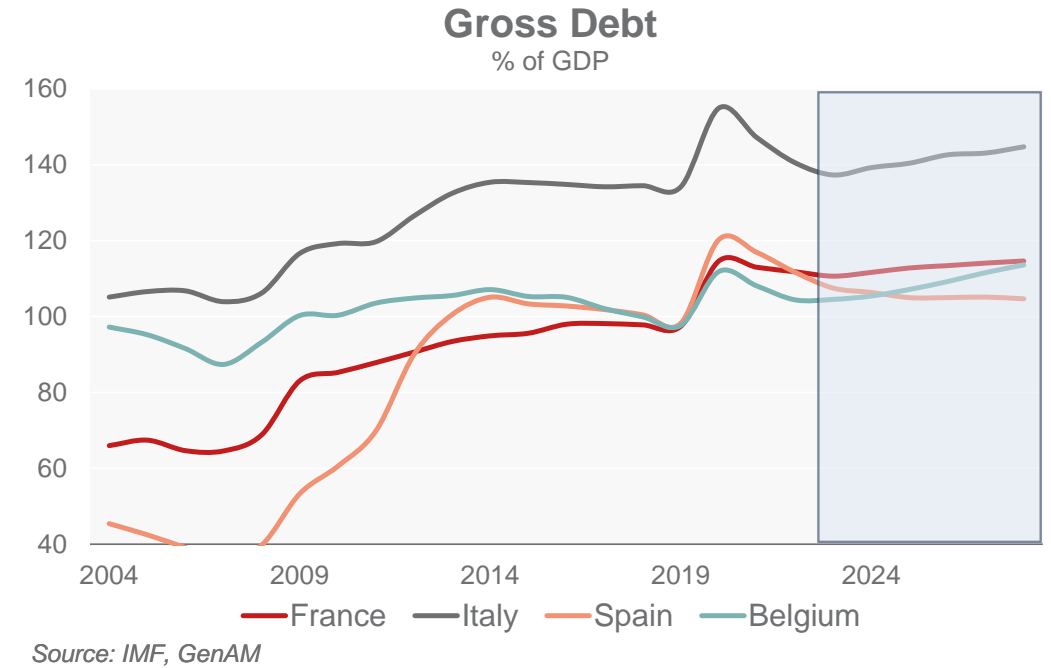
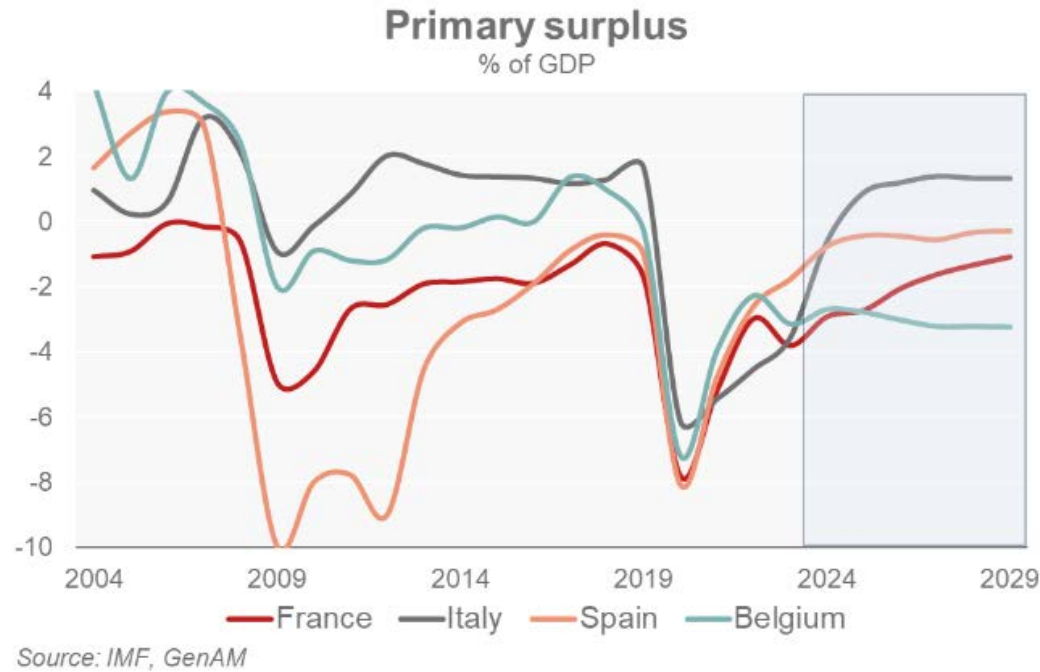
Italian Public Debt sustainability: BTP spreads



Source: Refinitiv, GenAM

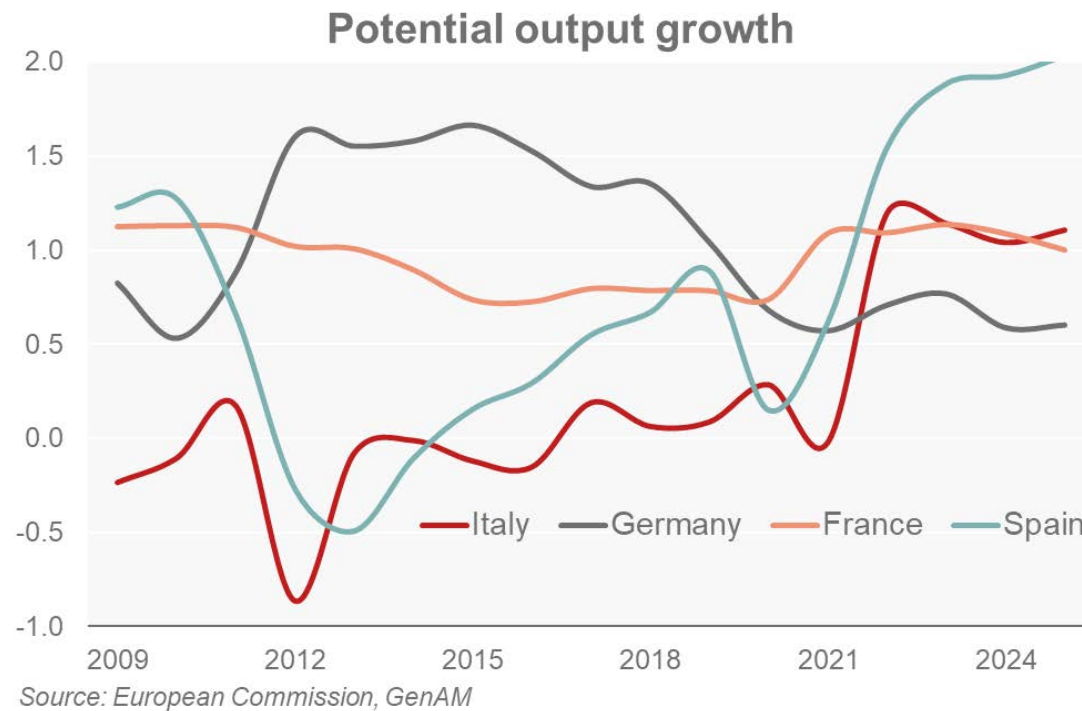
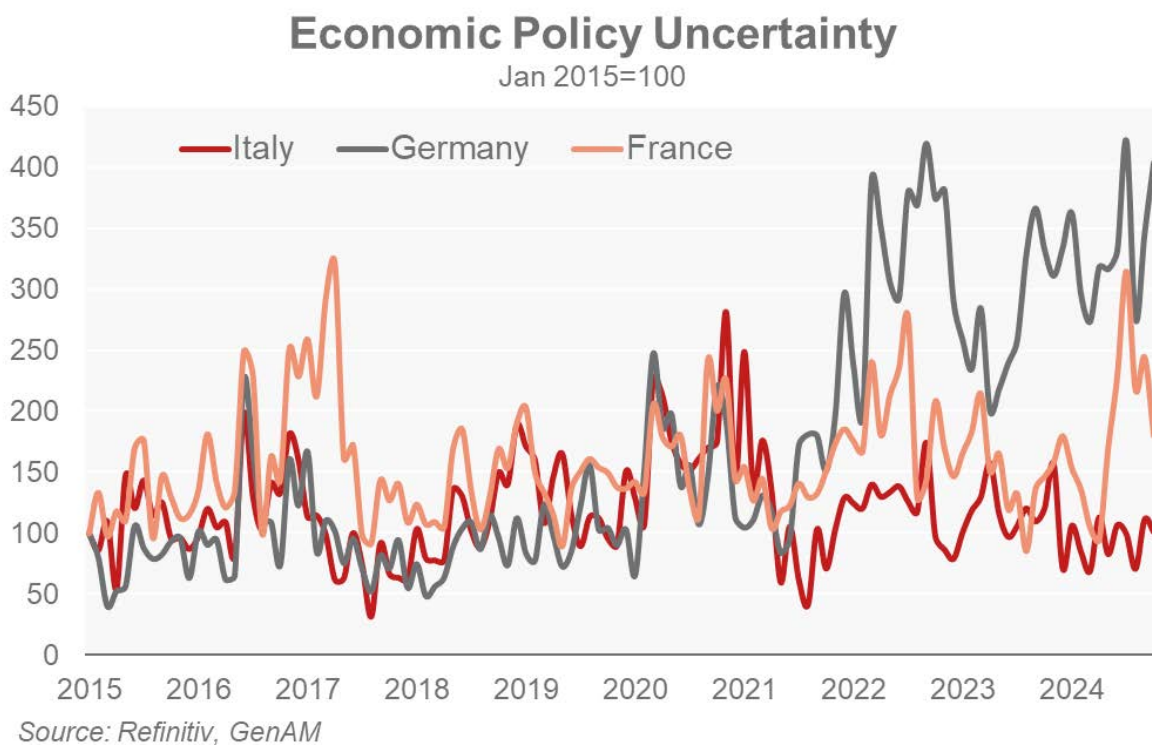
- Level of BTP-Bund spread in line with the macroeconomic and fiscal fundamentals (e.g. GDP, inflation, fiscal, etc.)
- The compression from the >160bp at the beginning of the year is due largely to a lower perceived riskiness

Italian Public Debt sustainability: Fundamentals



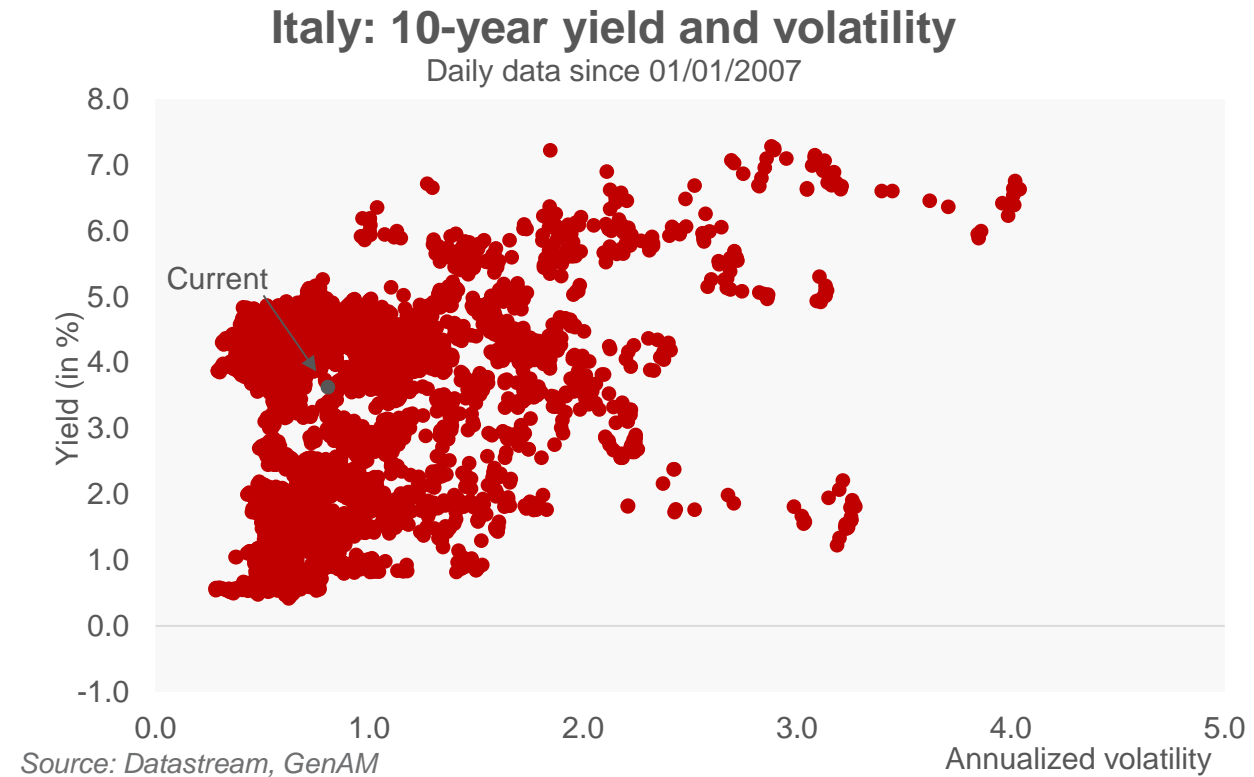
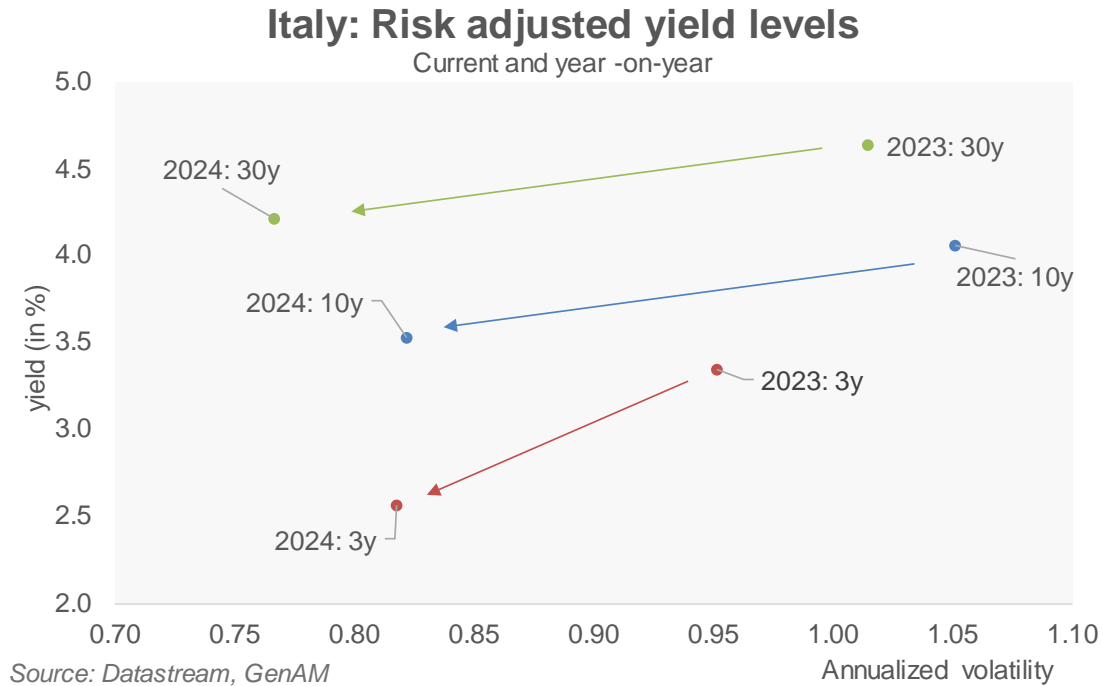
- Fiscal fundamentals in relatively good shape compared with other “semi-core” countries
 - Primary surplus and projected to remain such over coming years
 - Gross debt back to roughly the pre-pandemic level

Italian Public Debt sustainability: uncertainty and growth



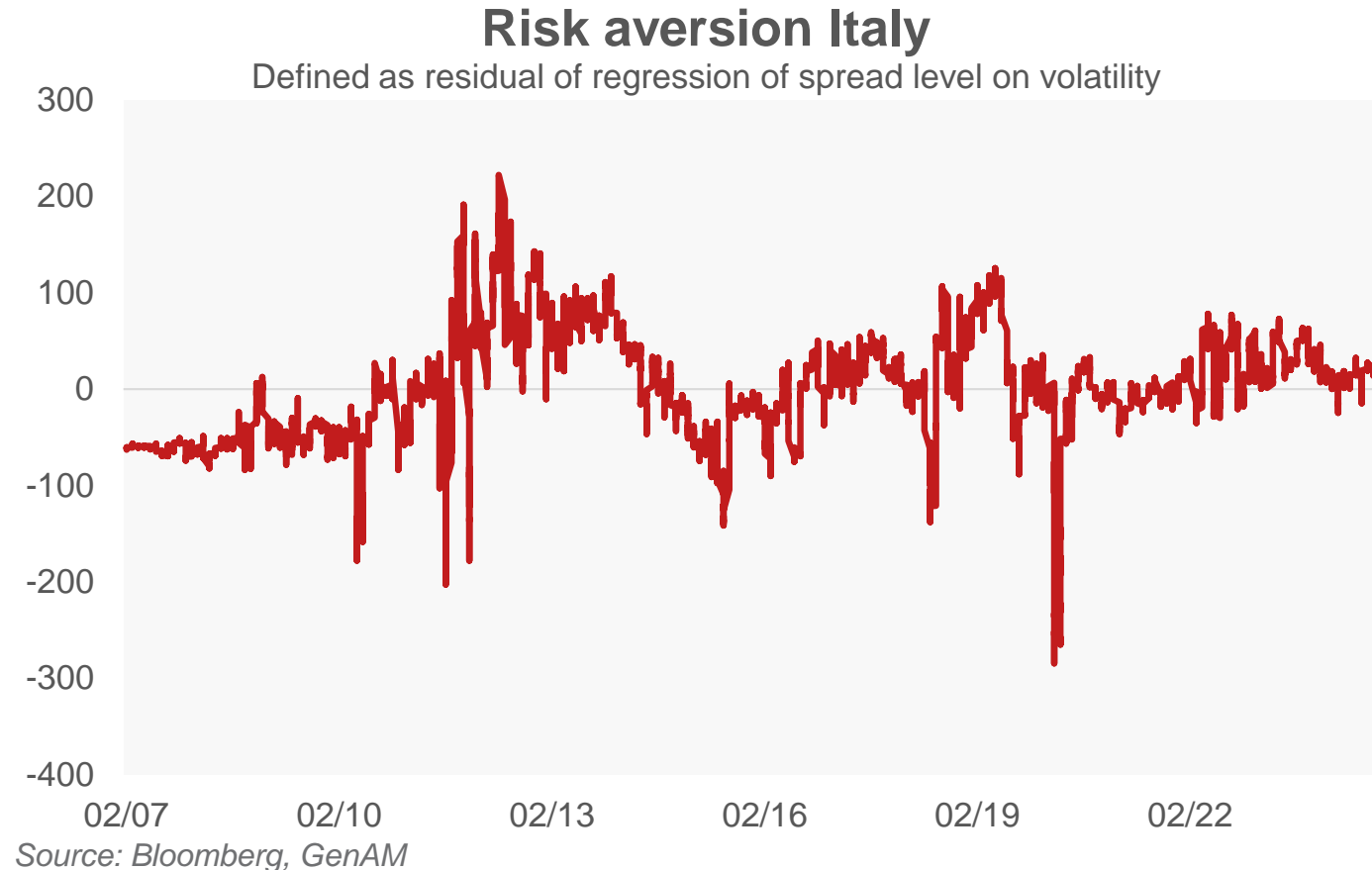
- Decreased political instability favours disciplined fiscal policymaking
- Recent increased investment activity and NGEU money expected to drive up potential growth over coming years, helping debt sustainability
- How NGEU money is spend and what will replace it after 2026 remains a question mark

Italian Public Debt sustainability: yields volatility



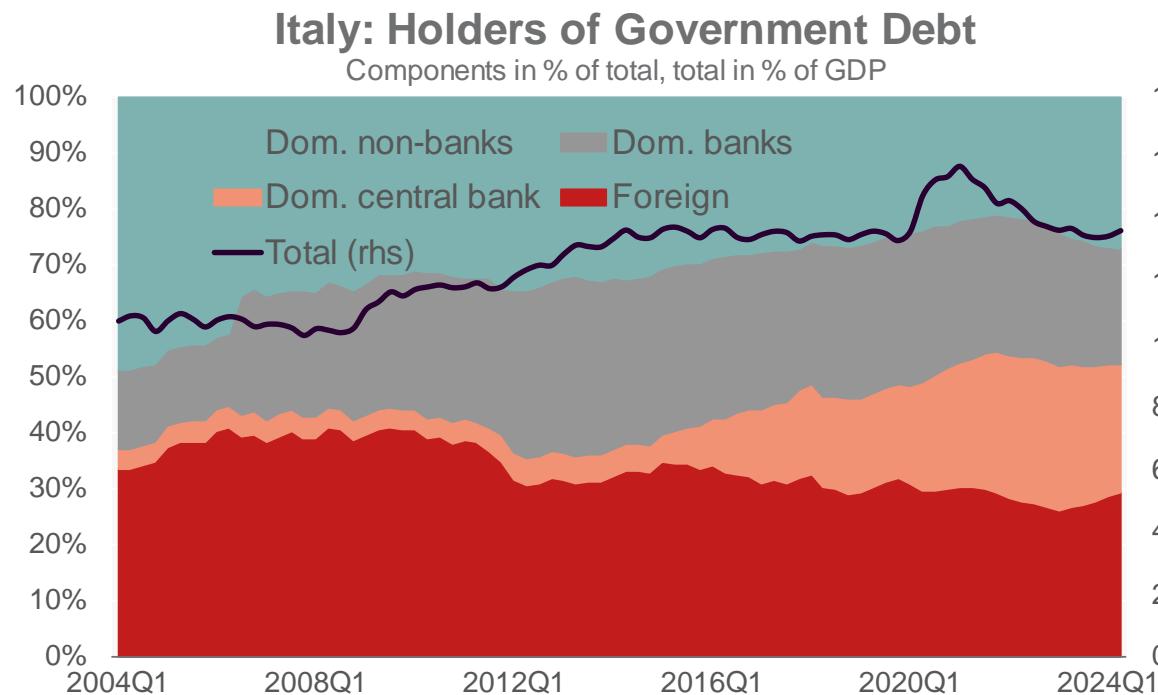
- Volatility of Italian yields decreased over the last two years across all maturities and is well below the LT average, even if still higher than that of most other EU countries → more attractive yield/volatility ratio
- Volatility of bonds in other EU countries has not fallen to the same extent → BTPs are becoming more attractive to investors as a portfolio component from a risk/return perspective.

Italian Public Debt sustainability: risk aversion

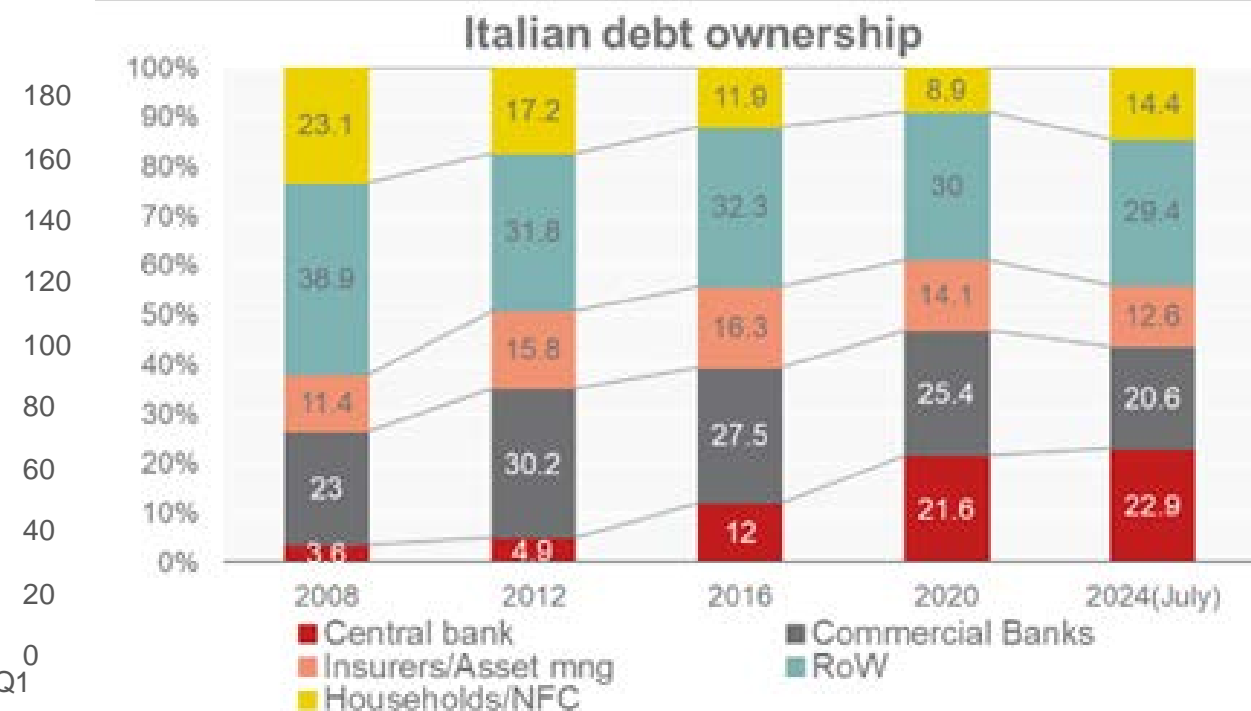


- Financial markets' risk aversion towards Italian BTPs – here defined as the residual of the regression of the spread level on its volatility - has declined and is now below its LT average
- Italian bonds may be benefiting from a substitution effect triggered by high risk aversion towards French OATs

Italian Public Debt sustainability: ownership evolution



Source: IMF, GenAM calculations



Source: Bank of Italy, GenAM

- **Domestic sector holds largest share of Italian gov.t debt** → almost half of all BTPs held by domestic banks and non-banks - 70% with holdings from Eurosystem. Successful recent retail bond issuances
- Within domestic sector **share of banks has declined** → sovereign-bank nexus less threatening
- **Share of foreign investors** increased by 3pp to 29.4% since May 2023, but **remains low** → share of non-domestic investors lowest in euro area → in times of market turbulence, domestic investors provide anchor of stability due to their lower risk aversion and higher propensity to persist

Italian Public Debt sustainability: market perception and future prospects

- Perception international investors of Italian public debt is positive and improved over last years → tightening BTP-Bund spread. Main factors:
 - Prudent fiscal approach
 - Higher political stability (concern for other countries)
- High share of debt held domestically and by Eurosystem + long duration of outstanding debt (7,8 years weighted average residual maturity) → lower rollover risk
 - Good reputation of Debt Management Office at Italian Treasury;
- Confidence about safety net in case of turmoil → toolkit available to ECB → TPI, PEPP, etc
 - Negative: lack of ESM changes ratification → relevant in times of stress

However ... no complacency → need of continued discipline in debt and deficit trajectory → more focus by investors on govt debt sustainability + EU fragility in current geopolitical context

- Recent widening of swap spread for French and German govt bonds clear alarm bell