BTPs Yield a Timely Reminder

- BTP yield spike reminds us of past dynamics
- Collapsed growth projections have torn up budget assumptions
- Is Italy on a fresh collision course with the EU?

A spike in BTP/Bund yield spreads yesterday morning served as a firm reminder that global trade relations and Brexit are not the only protracted issues without resolution.

The two-year market was the eye-catcher: the spread opened at 115 bps, up from 85 bps on Friday, and while the 10-year spread put in a rather more muted rise (7 bps), it has now widened 21 bps since its mid-March lows.

At 257 bps, the 10-year BTP/Bund spread is certainly not the basis for crisis talk – something reserved for the environs of 300-400 bps based on crises past. The point is however, that crises past have shown us just how quickly stability can slip away once doubts set in.

For example, at the start of April 2011 – when concerns began to grow about the possibility of Greek debt restructuring – the spread on 10-year BTP/Bunds stood at 143 bps.

It took 83 days for the spread to reach 200 bps, but only an additional 14 days to reach 300 bps, and the same again for it to come within 4 bps of 400 bps. But once this level was firmly breached at the start of October, it took just

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seven days for the spread to breach 500 bps – by 58 bps to be exact.

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Yield spreads did not quite scale these same heights during the Italian budget crisis of 2018, but once again, the swift rise in pressure was notable: the Italian government’s talk of “pre-Maastricht setting” in European economic policy saw the 10-year spread rise to 282 bps from 114 bps in just over a month. And the fraught budget agreement that eventually brought these tensions under control was always susceptible to any deterioration in the economic backdrop.

Yesterday’s spike in BTP spreads/yields coincided with a near six-year low in Italy’s manufacturing PMI for March - a figure that followed a gloomy house price report on Friday and which preceded news of rising Italian unemployment yesterday. Italy is suffering as part of a broader economic slowdown in the eurozone but domestic frailties can only serve to amplify its negative ramifications.

Indeed, with growth projections slumping to zero, and with government finances still subject to high funding costs (in part due to the end of QE), the OECD expects the Italian budget deficit to rise to 3.0% in 2020 via 2.5% this year – far above the 2.0% agreed with the EU. Such projections come with the obligation of remedial measures by way of austerity (on pain of fines), but Economy Minister Giovanni Tria has been quick to preempt any pressure: “It would be absurd to implement restrictive measures,” he noted.

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Pointedly, however, Mr Tria also played down “space for any expansive fiscal measures”, and yet his colleagues - Di
Maio and Salvini - might have different ideas given the EU and Italy’s contrasting ideals behind last year’s agreement. Certainly, there has been little sign as yet of any overt desire to smooth the EU’s feathers and who knows, perhaps all it could take is a less than sympathetic EU response to Italy’s plight.

If the League and 5 Star can harness the unity apparent from their budget negotiations last year, then the Italian economy and its debt market could steer the Italian government on a fresh collision course with the EU.

Amid the risks that contagion from issues such as Brexit could hasten any slide in confidence (as we will be discussing later), under such circumstances, the relative calm that has sustained investors’ interest in mopping up high yielding Italian debt could be rudely disrupted - something with potential implications for the EUR market, if 2018 is anything to go by.

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