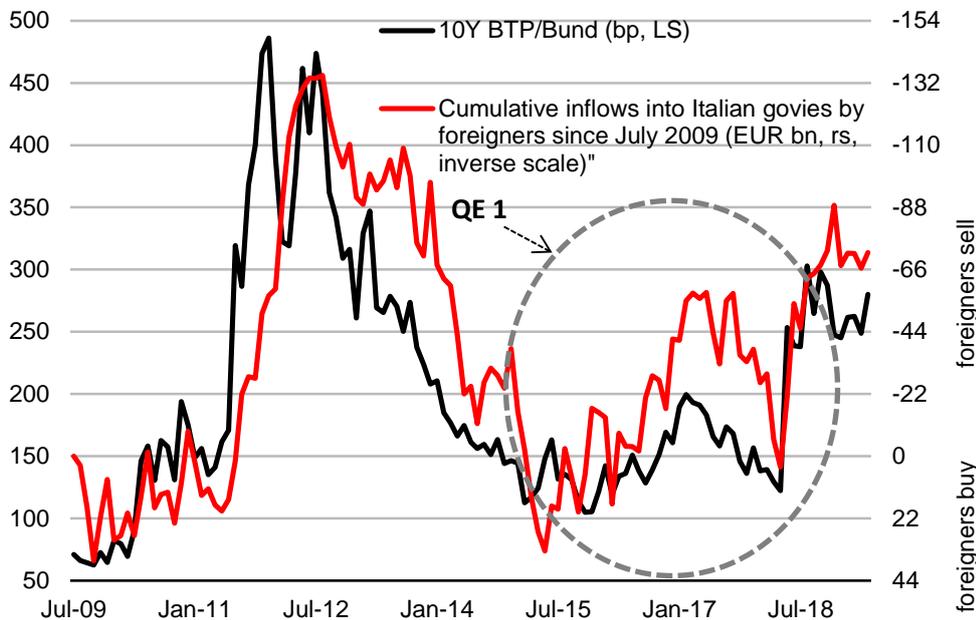


Sentiment among foreign investors is a key driver for BTPs



Source: Haver, Bloomberg, UniCredit Research

- Our Chart of the Week shows how non-resident investors are key for the performance of Italian government bonds. While foreign holdings of Italian government debt have declined over time, we estimate that they still represent almost 30% of the total Italian marketable debt (around 24% excluding round-trip investors), or EUR 600bn (around EUR 485bn excluding round-trip investors), which is substantial. The chart plots the performance of the 10Y BTP-Bund spread and the cumulative flows into Italian govies (at both short and long-term maturities) by foreign investors since mid-2009, as reported by balance of payments data (the right scale is inverted). The correlation coefficient between foreign flows into Italian govies and the 10Y BTP-Bund spread is strong and negative (-0.77) implying that when foreigners decrease their exposure to Italian debt, the 10Y BTP-Bund spread widens.
- The reason that the correlation between these two variables is so strong is that net Italian government bond issuance is quite small as a portion of GDP and has been rather stable in recent years; we calculate that since 2009, it has averaged 3.5% of GDP. This is the result of the government running a primary budget surplus each year since 1999 (except 2009), which partly offsets the impact of interest payments on the final budget deficit number. Given that annual net issuance is relatively contained, BTP prices mainly depend on swings in demand. In this respect, foreign investors' demand is key in determining the marginal price of BTPs, as domestic demand tends to be more stable and less price sensitive than foreign demand (the correlation coefficient between domestic flows into Italian govies and the 10Y BTP-Bund spread is +0.22). As we have showed¹, non-resident investors in Italian govies are mainly non-bank and non-official investors (asset managers, hedge funds, insurance companies and pension funds), which are traditionally the most active sellers in times of market stress.
- This is why maintaining the confidence of non-resident investors is very important for the Italian government. The fact that the ECB will most likely reopen QE in the near future is welcome news, but it can only help to a certain extent. Indeed, our chart shows that during QE1 (March 2015-December 2018) the reaction of the

¹ Rates Perspective No. 65, 3 April 2019, "Who are the foreign investors in Italian government debt? A breakdown by geography and institution"

spread to flows of non-resident bond holdings was more contained. That said, the correlation between the two series remained negative and in May 2018 it spiked again, despite the fact that QE was still ongoing.

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