Who holds the BTPs? Dissecting Italian public debt investor base

by Dr. Luca Cazzulani, Deputy Head of FI Strategy (UniCredit Bank, Milan)

- Who are the BTP investors? How much debt is held domestically? These are two frequently asked questions. In this note we look at these issues, and how demand by the different investor categories has evolved over time.
- In a nutshell, Italy's market debt is held mainly by institutional domestic investors. Non-residents account for 36%. This share includes the Eurosystem (around 3% including the SMP and the PSPP) and the BTPs held by foreign branches of Italian funds (approx. 7/8%), hence the amount of government debt held by non-Italian investors is even lower.

Who holds Italy's debt? The big picture

One of the most important metrics investors look at in a country is the level of public debt. However, the next most important characteristic of a country public debt is its holders' composition and how demand has evolved over time.

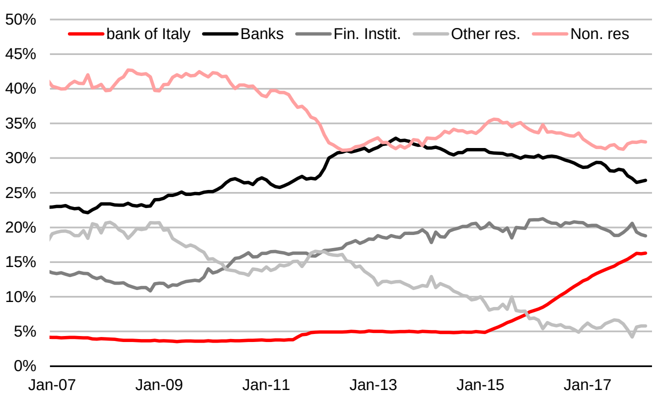
The last few weeks of volatility in Italy's credit spread have revamped investor interest in a number of Italian statistics. Two frequently asked questions have been: Who are the BTP investors? and How much debt is held domestically? In this note we look at these issues, and how demand from the different investor categories has evolved over time.

In a nutshell, Italy's market debt is held mainly by institutional domestic investors (around 20% by the Bank of Italy, 20% by banks and 22% by other financial institutions). Non-residents account for 36%. This share includes the Eurosystem (approx. 3% including the SMP and the PSPP) and the stock held by foreign branches of Italian funds (around 7/8%) and, hence, is an overestimate of the debt held by non-Italian investors.

Data on debt and the main investor categories are published by the bank of Italy. The data is updated around mid-month and the data have a lag of three months.

The most recent month for which the breakdown is available is February 2018, when total public debt (market securities and other instruments, such as bank loans) was EUR 2.28tn. Chart 1 shows the breakdown of total debt (including non-market instruments) by the main investor categories.

CHART 1: BREAKDOWN BY INVESTORS (TOTAL DEBT)



Source: Bank of Italy, UniCredit Research

The following table shows the amounts held by the various types of investor broken down into securities and other instruments.

TABLE 1: ITALY'S DEBT BY INVESTOR TYPE

		Total	Bank of Italy	Banks	Fin. Instit.	Other res.	Non. res
EUR bn	Securities	1932	368	342	422	111	690
	Other	354	5	270	8	22	49
	Total	2286	372	612	430	133	739
%	Securities		19%	18%	22%	6%	36%
	Other		1%	76%	2%	6%	14%
	Total		16%	27%	19%	6%	32%

Source: Bank of Italy, UniCredit Research

85% of total debt consists of securities (BTPs, BOTs, CCTeus) and 15% is in non-market instruments. Not surprisingly, the latter is mostly held domestically and in particular by banks. The investor breakdown of non-market debt has been pretty stable over the last ten years.

Market securities have a more diversified investor base, with more lively dynamics, which we will discuss in the following sections.

We use Bank of Italy data to calculate a breakdown by different investor types across BTPs, CCTs and BOTs. CCTs are mainly held by domestic banks, with foreign investors representing just 20% of the market. BOTs are mostly held abroad, demand from foreign investors has increased significantly since the start of QE. Finally, BTPs are held by all types of investor, insurance companies (InCo), banks and the Bank of Italy are the larger domestic players.

TABLE 2: BREAKDOWN BY ASSET AND INVESTOR

	BTPs	CCTs	BOTs
CB	19%	16%	0%
Banks	16%	44%	12%
Fin. Institutions	6%	6%	8%
InCo	17%	13%	1%
Houseolds & Corp	10%	1%	1%
Non residents	33%	20%	77%

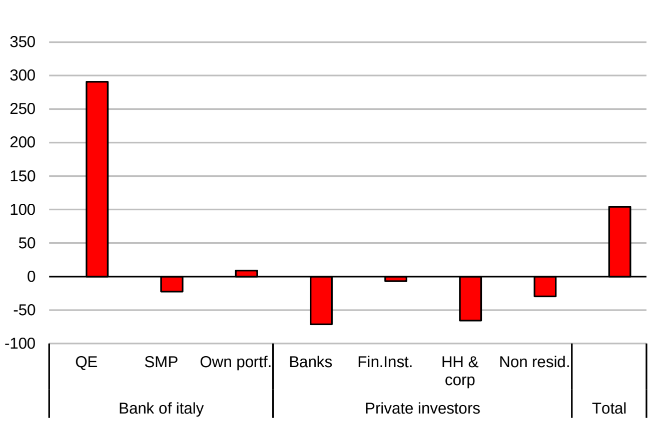
Data refer to 3Q17 Source: Bank of Italy, UniCredit Research

Changes in demand since the start of QE

The first issue we want to analyze is how the investor base has changed in recent years in response to the ECB's quantitative easing program (QE). Since the start of the program in March 2015, Italy's debt securities have risen by EUR 100bn. The Bank of Italy (surprise!) has been the main buyer; the main sellers have been banks and households, while non-residents have kept their exposure broadly stable. However, if we focus on the portion of debt held by non-residents excluding holdings by foreign branches of Italian funds, then selling by foreign investors appears to have been relevant.

Starting from next year, we expect QE to be terminated, so net issuance will have to be purchased by private investors. In earlier publications we pointed out that this is not a cause for concern as we expect only a moderate amount of net issuance. In the light of recent developments in Italian politics, it will be important to monitor the fiscal policy decisions closely.

CHART 2: WHO SOLD BTPS INTO QE?



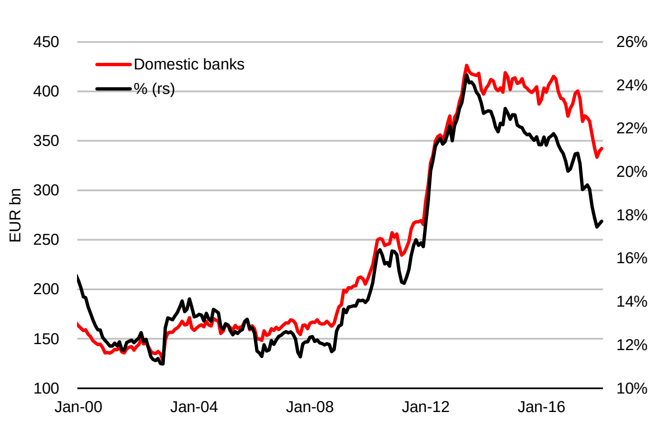
Source: Bank of Italy, UniCredit Research

In the following sections we will look at the different investor groups in more depth.

Banks

Banks were important buyers during the early stage of the sovereign debt crisis, increasing their portfolio to EUR 430bn. Since the start of QE, and in particular over the past year, banks have started to reduce their holdings of domestic government bonds. The reduction since the start of QE in March 2015 has amounted to EUR 70bn in absolute terms (around 6pp as a share of total debt).

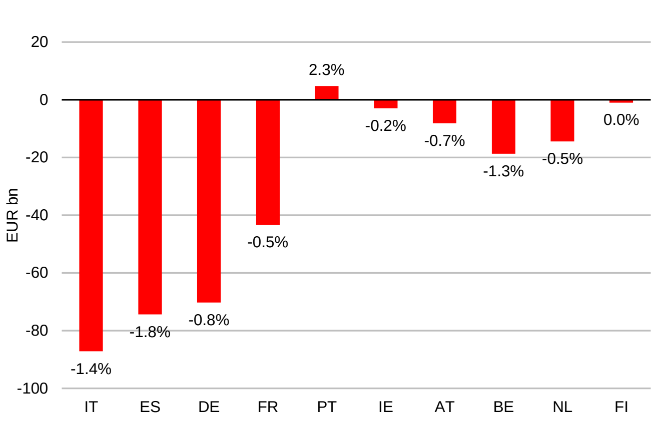
CHART 3: ITALIAN BANKS HAVE REDUCED THEIR EXPOSURE TO BTPS



Source: Bank of Italy, UniCredit Research

Interestingly, the latest stability report by the Bank of Italy shows in an ad hoc study that the reduction in government bonds has been more relevant for larger banks, while the smaller ones have kept their portfolios comparatively more stable. Chart 4 shows that banks in all eurozone countries have been sellers of domestic government bonds, with Italy and Spain being the most active (numbers below the bars denote the change in the ratio government bonds to total assets). In the medium, our bias is that banks in the periphery will progressively reduce their exposure to domestic government bonds to become more in line with core countries. From a short-term perspective, banks should remain a source of demand in case a market shock occurs.

CHART 4: CHANGE IN THE STOCK OF DOMESTIC GOVERNMENT BONDS SINCE THE START OF QE



Numbers below the bars indicate the change in domestic government bonds / total assets

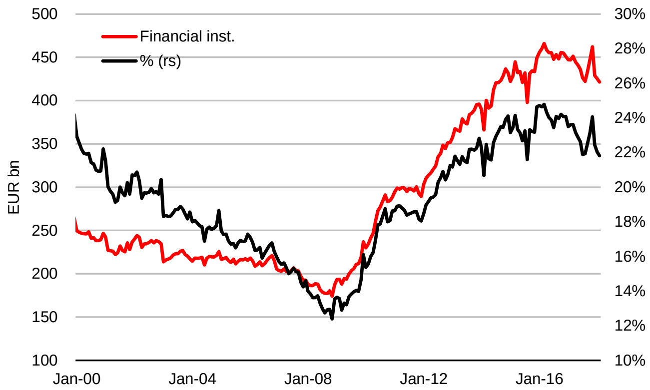
Source: ECB, UniCredit Research

Finally, a breakdown of Italian banks' portfolios by instrument is available with monthly update. At the end of March, Italian banks were holding 15% of the BTP market (EUR 245bn), 40% of the CCT market (EUR 55bn) 30% of the CTZ market (EUR 12bn) and 10% of the BOT market (EUR 10bn).

Financial institutions

Financial institutions have also been important buyers of Italian sovereign debt in 2012. Unlike banks, financial institutions have not been selling BTPs in any meaningful way during the period of QE, and currently hold about EUR 420bn or 22% of the market. Financial institutions can be broadly divided into insurance companies (InCo), pension funds and asset managers. Pension funds in Italy are still fairly small and amount to EUR 20bn. Insurance companies account for EUR 300bn, while other financial institutions, including asset managers, account for roughly EUR 100bn.

CHART 5: INSURANCE COMPANIES, PENSION FUNDS AND OTHER FINANCIAL INSTITUTIONS



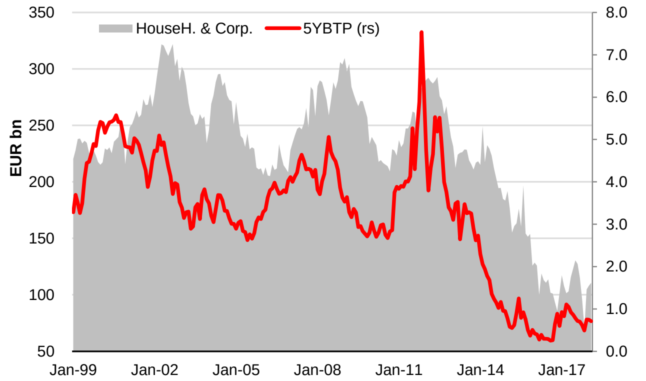
Source: Bank of Italy, UniCredit Research

Insurance companies and pension funds are mainly invested in BTPs, with CCTs and BOTs accounting for only a tiny fraction of their portfolios. The most recent indication concerning the maturity composition of their BTP portfolio covers June 2017, when Insurance companies were holding around EUR 200bn of Italian government securities with maturity longer than 5-years, EUR 80bn of BTPs in the 2-5Y area and EUR 30bn of Italian government bonds shorter than 2-years In the last five years, the maturity breakdown has been rather stable, with a 55/60% allocation in maturities beyond 5Y and about 20% in the 2-5Y bucket.

Individual investors and non-financial companies

Individual investors accounted for as much as EUR 300bn in June 2012. Since then, individual investors have progressively reduced their portfolios and currently account for around 100bn. The reduction has been significant, but this trend needs to be put into context. As chart 5 shows, the decline in government bond holdings has followed the strong reduction in BTP yields. Unsurprisingly, given the negative rates, households now hold just EUR 1.5bn of BOTs (1% of the stock), down from EUR 32bn in 1Q12, when BOT rates were around 6%.

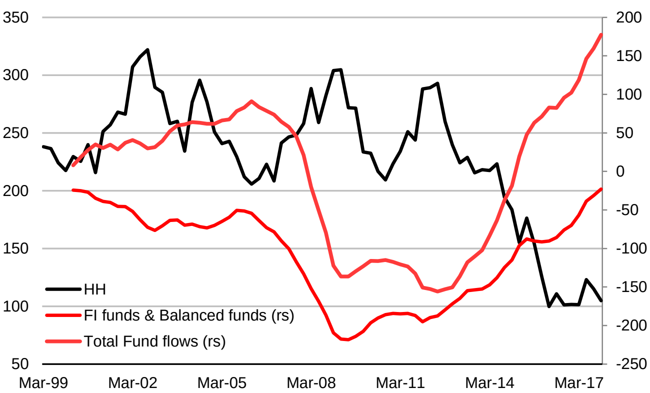
CHART 6: LOW YIELDS DRIVE INDIVIDUAL INVESTORS AWAY



Source: bank of Italy, Bloomberg, UniCredit Research

With yields declining, households have found it increasingly less attractive to directly buy government bonds and have turned progressively to asset managers. Chart 7 shows the stock of government securities held by households along with a measure of fund flows published by Assogestioni (the association of Italian money managers). This chart highlights that the reduction by the former went along with inflows in the latter. Since mid-2012, households reduced their portfolios of government bonds by EUR 200bn and inflows into fixed income and balanced funds amounted to EUR 150bn. While the two series cannot be mathematically summed, the message is clear: **1.** the exposure of Italian households to domestic government bonds has fallen by less than would be inferred from direct holdings and **2.** it has indeed decline somewhat due to asset managers likely having more diversified portfolios.

CHART 7:
FROM "DO-IT-YOURSELF" TO PROFESSIONAL INVESTMENT



The chart shows cumulated flows since Q1'00

Source: Bank of Italy, Assogestioni, UniCredit Research

Bank of Italy and QE

The bank bulletin reports that the Bank of Italy holds EUR 368bn in Italian government bonds as of February 2018. There are two reasons why the Bank of Italy buys BTPs: for its own investment portfolio and in relation to monetary policy programs (the SMP and QE).

The portfolio of government bonds related to its own investments has been rather stable in the last few years; we estimate it amounts to EUR 80/90bn.

The portfolio related to monetary policy programs (SMP and QE) has been growing steadily since March 2015 and we estimate it amounted to EUR 280bn in February 2018.

In terms of instrument breakdown, the Bank of Italy does not hold bills and holds around EUR 22bn in CCTs. The remaining is in BTPs (with various residual maturities).

Non-residents

The bank of Italy bulletin reports that EUR 690bn are held by non-resident investors. It is important to consider that **1.** this sum includes the share of PSPP and SMP purchases held by the Eurosystem and **2.** the definition of “non-resident” refers to whether or not an investor is located in Italy.

With respect to what is held by the Eurosystem, we estimate that the SMP and QE account for EUR 60bn.

The second point is also very important. The definition of non-residents used in these figures may not be the most appropriate to evaluate who holds the ultimate risk of Italian bonds. Indeed, part of the Italian government debt is held by foreign subsidiaries of Italian funds. If one wants to answer the question of how much Italian debt is held by non-Italian investors, this component should be removed. The bank of Italy provides an estimate of the share of debt held by foreign branches of Italian funds, which amounted to around 7pp of the total market debt in 1Q16. We estimate that such share has remained fairly stable in the last years. This means that the share of Italian debt held by foreign investors (in the strict sense of the word) is around 25%.

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ENP e 18/1

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SR 18/2

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