

Italy's funding in 2022: Supply to remain robust at the extra-long end

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- Italy's 2022 gross funding needs are expected to be EUR 330bn. We expect EUR 300bn of gross M/L term debt supply (excluding buybacks, retail and international bonds).
- Cash deficit is expected to be EUR 100bn, with risks to the downside, and should be covered by EUR 73bn in net issuance of M/L term debt, EUR 23bn from EU funds and EUR 14bn from retail/international bonds. We pencil in negative net BOT issuance (EUR -10bn).
- ECB net purchases are expected to be EUR 60bn (75% of net issuance), providing less support than in 2021, when purchases were around 170% of net issuance.
- Italy aims to keep increasing the average life of its debt by reducing the share of funding at the shorter tenors and increasing it at the extra-long end.
- Our favorite supply-related trades are long 5Y and 10Y BTPs vs. 7Y BTPs, 10/30Y BTP steepener, short CCTeu Apr29 in ASW vs. BTPs and long BTPei May30 vs. BTPei May26.

1. 2021: a positive year for Italian issuance activity

In 2021, Italy faced lower borrowing requirements compared to last year, with the cash deficit likely declining from EUR 160bn towards the EUR 120-130bn area. Indeed, from January to November, cash deficit has been EUR 105bn in total. Uncertainty relating to the final cash deficit was high during the year due to extraordinary expenses linked to the COVID-19 pandemic and the appointment of a new government in February.

In 2021, domestic bond redemptions amounted to EUR 206bn (vs. EUR 200bn in 2020) while international bond redemptions amounted to EUR 9bn (vs. EUR 3bn in 2020). The Italian Treasury mostly covered its funding needs through the supply of around EUR 290bn in M/L bonds (net of buybacks and excluding BTP Futura), which corresponded to net supply of EUR 85bn. On the other hand, Italy decided to reduce its stock of BOTs, with net supply of EUR -8bn. In 2021, Italy sold EUR 9bn of BTP Futura whereas the supply of international bonds amounted to around EUR 4bn. Moreover, based on our calculations, Italy covered almost EUR 15bn through the use of cash reserves and repo transactions, while funds from the EU (from both the SURE and the NGEU facilities) covered around EUR 30bn.

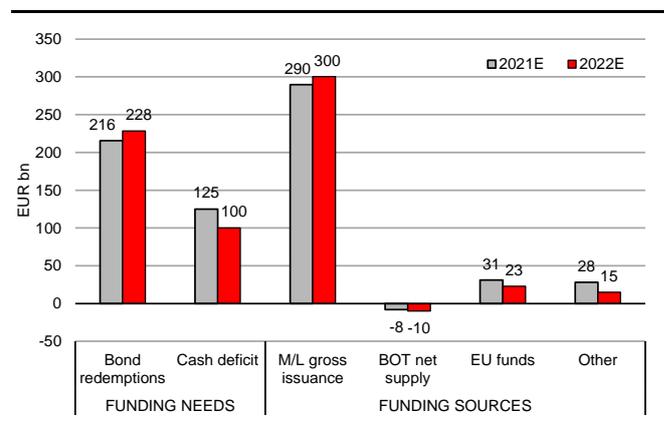
2021 has been a very positive year for the Italian debt agency. Thanks to a supportive ECB, which we expect to net purchase around EUR 140bn of Italian govies in 2021, and to a favorable market environment (especially in the first half of the year), Italy managed to fund its securities at record low levels.

Indeed, this year the average funding cost was 0.1% (-0.49% for BOTs and 0.44% for M/L securities), the lowest ever recorded. The Italian Treasury took advantage of an environment of low yields and low volatility to extend the average maturity of its debt. With respect to M/L domestic primary market activity, the average issuance maturity was around 9.5 years, 1-year higher than in 2020. This allowed Italy to lengthen its debt maturity from 6.95 years (December 2020) to 7.12 years (November 2021). BTP issuance activity was particularly intense in the first half of the year (net supply of EUR 100bn) and diminished in the last few months of the year, due to lower borrowing requirements than previously expected and, partially, to volatile rates markets. This year, Italy succeeded in launching its first-ever green bond, which was positively welcomed by investors.

2. What to expect in 2022: lower net issuance and lengthening debt maturity

In 2022, the Treasury expects EUR 330bn of gross funding needs, excluding BOT redemptions. The **cash deficit** is expected to decline to EUR 100bn, and the Treasury sees the risks as tilted to the downside since borrowing requirements have proven lower than expected in the past few months. The cash deficit is likely to decline for the second year in a row but will probably remain well above its pre-pandemic level. For reference, it was around EUR 40bn in 2019. Domestic bond **redemptions** will rise by more than EUR 20bn to EUR 228bn, while international bond redemptions will amount to only EUR 1bn (vs. EUR 9bn in 2021).

CHART 1: FUNDING NEEDS AND SOURCES IN 2022



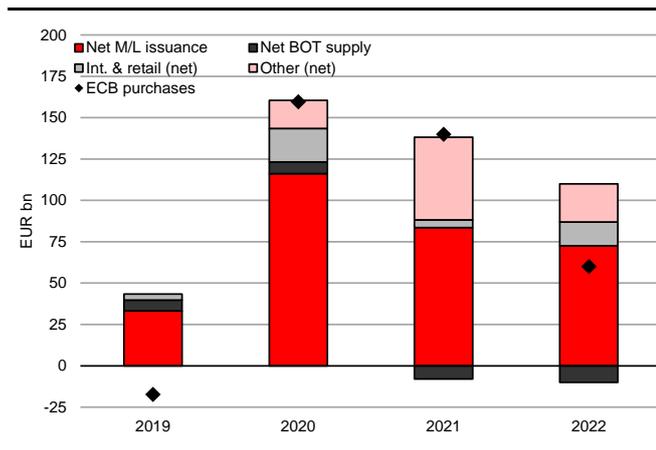
Other sources include the sale of international and retail bonds as well as the use of cash and repo transactions.

Source: Italian debt agency, Bloomberg, UniCredit Research

Next year, Italy plans to issue EUR 315bn of M/L bonds, in line with 2021. We expect Italy to sell EUR 300bn of **M/L domestic bonds** (net of buybacks), EUR 10bn higher than in 2021. Indeed, the decline in the cash deficit will be more than offset by higher bond redemptions and less support from other funding sources. We expect around EUR 10bn to come from **BTP Futura** supply, in line with the past two years, while we pencil in EUR 5bn of **international bond** issuance. The net supply of **BOTs** is expected to remain negative (EUR -10bn). Finally, part of the funding needs will be covered by **NGEU loans**, which we expect to amount to EUR 23bn. Conversely, the SURE facility is unlikely to be used next year.

Compared to 2021, the contribution from EU funding will be smaller, leaving a higher portion of net funding to be covered by traditional market instruments. That said, net supply of M/L bonds is likely to decline in 2022 by roughly EUR 10bn to around EUR 75bn, the lowest amount since 2019.

CHART 2: MORE FOCUS ON M/L SUPPLY



Source: Italian debt agency, Bloomberg, UniCredit Research

In 2022, the Italian Treasury aims to replicate some of the results it achieved in 2021. In particular it plans to

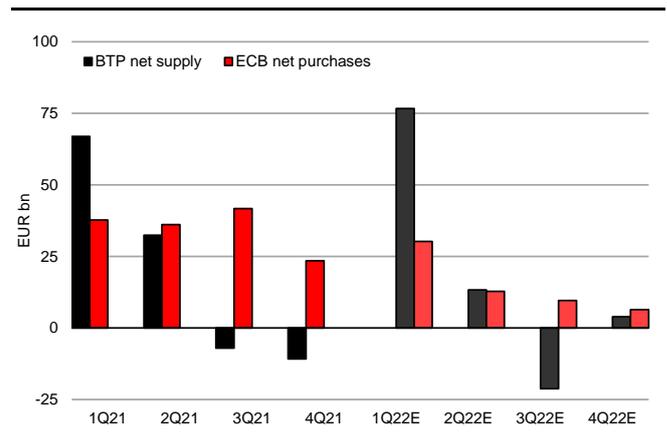
- lengthen its debt maturity by cutting the BOT stock, as well as reducing the share of issuance in the 3Y and 5Y areas while increasing it at the extra-long end of the curve;
- broaden its investor base, launching new USD-denominated bonds and offering new bonds to retail investors;
- strengthen its presence in the green market, possibly by issuing a new benchmark; and
- remain flexible to adapt its issuance activity to market conditions and investor demand.

Since the eurozone has mostly recovered from the pandemic and due to recent inflationary pressure, the ECB has confirmed that it will cease its net purchases under the PEPP after March.

On the other hand, the ECB will increase its APP purchases to EUR 40bn in 2Q22 and EUR 30bn in 3Q22 to avoid a cliff effect in its purchases. Based on our calculations, the ECB will purchase around EUR 60bn in 2022, 75% of overall net market issuance expected. Therefore, there will be less support from the ECB than in two past years.

In line with this year, the Italian Treasury is likely to front-load its primary market activity in the first few months of 2022. This is likely to be even more pronounced next year as the ECB will purchase fewer bonds after March. As Chart 3 shows, in 1Q22 there will probably be a significant mismatch between net issuance and ECB purchases. Moreover, the election of the president of the republic may create some volatility. Therefore, we recommend a more tactical approach in the first quarter, while in the remainder of the year, a more benign supply/demand picture and presumably a quieter political environment should bode well for Italian govies.

CHART 3: ITALY TO FRONT-LOAD ITS ISSUANCE ACTIVITY



Source: Italian debt agency, Bloomberg, UniCredit Research

3. 2022 issuance by tenor

BOTs: Compared to 2020-21, BOTs will be mostly employed for the management of the cash balance. The Treasury aims to reduce the overall amount outstanding. The stock of BOTs at the end of 2021 is expected to be EUR 114bn, down from EUR 121bn at the end of 2020. We expect it to decline by around EUR 10bn in 2022.

Repo operations: In May 2021, the Italian Treasury started to carry out repo operations to enhance its cash management. The monthly liquidity balance obtained via repo operations was EUR 3-4bn on average, at very attractive rates thanks to the specialness of the BTPs involved. October was a particularly busy month with EUR 10bn in repos. The Treasury will continue to carry out repo operations also in 2022. In 2021, repo operations have been used as a funding tool but next year they could also be used for liquidity deployment.

BTP Short Term: This instrument, with maturity between 18 and 30 months, was introduced in 2021 to replace CTZs. Gross issuance was EUR 30bn. In 2022, we pencil in gross issuance of around EUR 40bn. Given that CTZ and BTP Short Term redemptions in 2022 will amount to around EUR 45bn, net supply is likely to be negative. In 2022, the Treasury may conduct buybacks or exchange auctions including CTZ and BTP Short Term.

CCTeu: Gross issuance in 2021 was around EUR 25bn, including exchange auctions. The Treasury indicated that gross issuance in 2022 could be higher than in 2021, we expect an amount of EUR 27bn. Given EUR 27bn of redemptions, net issuance should be close to zero. After a period of volatility, in 2021 CCTeus returned well bid, reflecting investor appetite for ASW positions, and their valuations became closer to those of BTPs. The Treasury issued a new 8Y benchmark in 2021 and aims to sell at least one more benchmark with a maturity of between three and ten years in 2022 via either auction or syndication.

3Y and 5Y BTP: In 2021, gross issuance of 3Y and 5Y BTPs was EUR 41.5bn and EUR 40.5bn, respectively. Gross issuance is expected to be lower in 2022 for both maturities, we pencil in EUR 40bn in each tenor. Declining issuance reflects lower funding needs as well as the Treasury's goal to continue to extend debt maturity. Compared to 2020, when issuance was more intense at the 3Y area, the share of funding in the 3Y and the 5Y areas was more balanced and this is expected to remain the case also in 2022.

7Y and 10Y BTP: Gross issuance of 7Y BTPs was EUR 39bn in 2021 and the Treasury expects a similar amount in 2022. Considering lower overall gross funding, the share of issuance at the 7Y is likely to be higher. Gross issuance of 10Y BTPs was EUR 60bn, including auctions and syndicated deals, and the Treasury expects a smaller gross issuance in 2022. Considering the lower funding needs, the share of issuance at this tenor should be in line with 2021.

Extra-long BTP: Issuance of extra-long BTPs was EUR 33bn in 2021, significantly lower than in 2020, as funding needs were lower and the issuer was trying to keep funding pressure at the extra-long end contained. In 2022, issuance at the extra-long end may be slightly higher than in 2021 – we pencil in a total of EUR 35bn at the 15Y, 20Y, 30Y and 50Y tenors combined. Considering the lower funding needs, the share of issuance will be higher than in 2021. New benchmarks, in line with past years, will be issued via syndication. In particular, we expect Italy to sell new 15Y and 30Y bonds. Italy might decide to reopen the 50Y benchmark via syndication if market conditions are favorable.

BTPeis: In 2021, gross issuance of BTPeis was EUR 15bn, including a new 30Y, BTPei May51, and net issuance was negative (EUR -4bn). In 2022, BTPei gross issuance is expected to be in line with that of 2021.

Redemptions will be EUR 11bn so that net issuance should turn positive, at around EUR 4bn. On top of a new benchmark, which could have a maturity of 10/15years, we expect that most supply will consist of taps of BTPei May26 and BTPei May51.

BTP Italia: Italy did not issue any BTPi in 2021. In light of an exchange operation, net issuance was modestly negative. In 2022, redemptions will be small (EUR 2bn). Italy will monitor the development of the market closely and will evaluate the opportunity to adjust the features of BTPi and/or the placement process. That said, the “Premio fedeltà” (loyalty bonus) and the indexation to domestic inflation will remain key features. Negative real yields are the main obstacle to issuing a new line in 2022. At the time of writing, real yields on the BTPi curve turn positive around the 10-year maturity.

BTP Futura: Italy issued two new lines in 2021 for a total amount of EUR 8.7bn. The treasury plans to sell at least one new line in 2022, with a second possible depending on funding needs. We pencil in an overall amount of EUR 10bn. The maturity of the new bond will be selected depending on market conditions close to the issue date. The structure of BTP Futura may be the same as in previous issues or contain new elements if this is deemed appropriate.

Green bonds: Following the approval of the Green Bond Framework, Italy issued EUR 8.5bn of a 20-year green BTP bond. Given the very strong demand (books in excess of EUR 80bn), Italy tapped the bond for additional EUR 5bn. Depending on market conditions, BTP Apr45 may be reopened, also via auction. In 2022, Italy will evaluate the launch of a new benchmark. With respect to the tenor of the new green bond, the Italian Treasury has indicated a shorter maturity than BTP Apr45. Therefore, we expect a new bond in the 15-20Y area. In total, we expect EUR 12bn of green bond issuance.

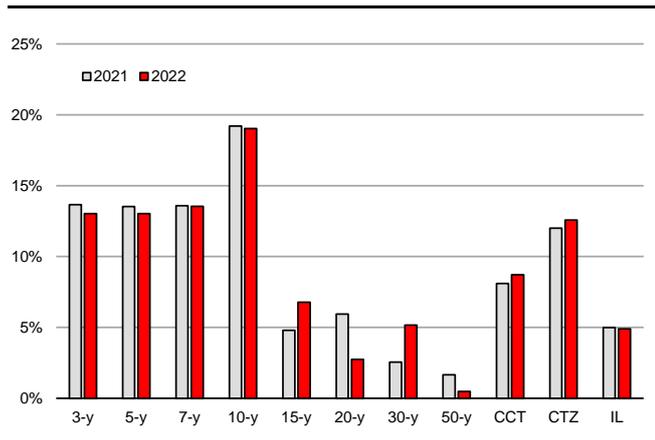
International bonds: Italy issued two USD bonds in 2021 under its global bond program for an overall amount of USD 4.5bn. The international bond program targets high-profile institutional investors and aims to enlarge the investor base. In 2022, Italy aims to consolidate its presence as a USD-bond issuer and will evaluate the possibility of reopening existing bonds or selling new lines. Currency exposure will be hedged via cross-currency swaps.

Debt management operations: In line with previous years, the Treasury will carry out buybacks and exchange auctions with the goal of improving market efficiency, easing tensions on single bonds or maturity buckets and smoothing the redemption profile. In this respect, the years most likely to be affected are 2023, 2024 and 2025. Buyback/exchange operations may also be implemented via syndication. During 2021, buybacks amounted to EUR 10bn and exchange auctions to EUR 5bn. We expect a similar amount for 2022.

Next year, Italy will continue to have the possibility to reopen off-the-run bonds through its facility reserved for specialists.

Should rates remain as low as they have been in 2021, the Treasury will evaluate the possibility of new IRS aimed at lengthening the debt maturity and reducing the average cost paid on swaps.

CHART 4: FUNDING MIX 2022 VS. 2021



Source: Italian debt agency, Bloomberg, UniCredit Research

4. New benchmarks expected for 2022

Below are the number of new benchmarks that we expect to be issued next year, together with their possible timing:

TABLE 1: NEW LINES AND POSSIBLE TIMING

New benchmarks	Number	Possible timing of the first benchmark
BTP Short Term	2	1Q (end January)
CCTeu	1/2	1Q (end January)
3Y BTP	2	2Q
5Y BTP	2	1Q (end February)
7Y BTP	2	2Q
10Y BTP	2/3	2Q
15Y BTP	1	1Q - January
20Y BTP	0	-
30Y BTP	1	1Q – February/March
50Y BTP	0	-
Green BTP (15-20Y)	1	3Q
10Y BTPei	1	1Q – February/March
BTP Futura	1/2	2Q
USD-denominated bonds	1/2	2Q

Source: Italian debt agency, Bloomberg, UniCredit Research

For CCTeUs, the Treasury indicated at least one new line. However, given the target for gross issuance, we think two new lines in 2022 are more likely.

Italy plans to sell at least one new 10Y BTP in 2022. As issuance activity at this bucket will be abundant (EUR 60bn), we expect the Italian Treasury to issue 2 or 3 new benchmarks via either auction or syndication. In 2021, it sold three new 10Y benchmarks.

Issuing a new BTP Italia is going to be difficult as long as real yields are negative.

5. Introduction of single-limb CAC bonds

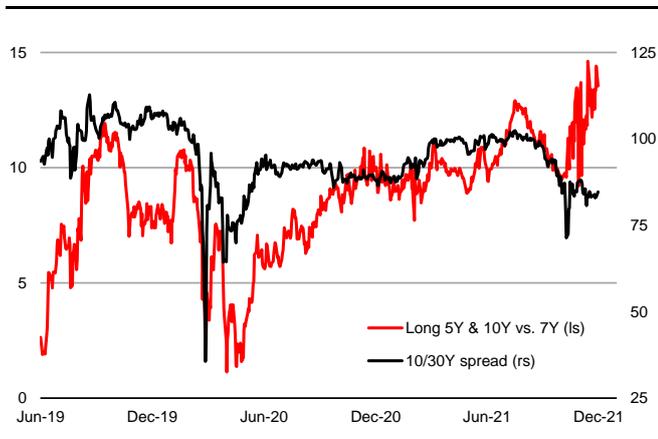
Once the reformed ESM Treaty will have been ratified by the parliaments of all 19 ESM Members and come into force, new bonds issued by euro area sovereigns with maturity of longer than one year will be issued with single limb CACs as opposed to the dual limb CACs currently in use. Sovereign debt is typically divided into series. Single-limb CACs allow the majority vote to take place at the level of all of these series combined, without the need for a majority at the level of the holders of each individual series. A discussion of the pros and cons of the single limb mechanism is beyond the scope of this note, a very good introductory discussion can be found on the EU website [here](#).

6. Italy’s funding: how to trade it

■ **Go long 5Y and 10Y BTPs vs. 7Y BTPs:** Based on our calculations, almost 14% of next year’s total BTP supply will be in the 7Y area of the curve, higher than in the past. Considering that the Italian Treasury is likely to sell a new CCTeu at this bucket, primary market activity will be abundant in this area, which in the past has generally been less liquid compared to the 5Y and 10Y areas. On the other hand, 5Y supply is likely to decline for a second year in a row, both in absolute terms and as a percentage of funding. Therefore, we like going long 5Y and 10Y BTPs vs. 7Y BTPs. As shown in the chart below, the wings have recently cheapened vs. the 7Y area. 3M carry and roll-down on this trade is about nil.

■ **10/30Y steepener:** In 2021, primary market activity in the 30Y area was subdued, with Italy issuing no new benchmarks. Next year, Italy intends to intensify its issuance activity in the 30Y area while keeping 10Y BTP supply mostly unchanged as a share of funding. For this reason, we like a 10/30Y steepener trade. Moreover, the 10/30Y BTP spread is currently trading rather flat at 85bp, roughly 10bp below its YTD average, since demand for high convexity bonds has been strong in the eurozone recently. We think that appetite for extra-long bonds will diminish going forward. 3M carry and roll-down on this trade is about 4bp.

CHART 5: WE LIKE THE WINGS IN A 5/7/10Y FLY AND GOING LONG 10Y VS 30Y BTPS



Source: Italian debt agency, Bloomberg, UniCredit Research

- **Sell CCTeu Apr29 vs. BTPs in ASW:** Reflecting strong demand for credit spread exposure, long-dated CCTeus have richened relative to BTPs. This is especially the case for CCTeu Apr29, which is the only one trading more expensive in ASW than BTPs with similar maturity, by about 5/10bp. In 2022, net supply of CCTeus should be neutral or marginally negative, hence providing ongoing support to the asset class. However, we expect a new benchmark to be issued in 1Q22 and this will likely put cheapening pressure on the current benchmark.
- **Buy BTPei May30 vs. BTPei May26:** The current 10Y benchmark, BTPei 0.4% May30, has an outstanding of almost EUR 14bn and we expect a new benchmark to be issued as soon as 1Q22. As a result, we expect that most of the supply pressure in the 10Y area will be borne by the new benchmark, benefiting the outgoing benchmark. At the same time, supply at the 5Y area will most likely go on the BTPei 0.65% May26. Supply should therefore contribute to keeping the breakeven curve under steepening pressure. Considering that the breakeven curve is currently slightly inverted in the 5/10Y area, we would stay long BTPei May30 and short BTPei May26.

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