

Foreign investors key to absorbing Bund supply

As President Trump softens his approach to tariffs, markets should start paying more attention to the supply pressures in Bund markets. Our analysis suggests that foreign investors can play an important role in absorbing the hike in Bund issuance on the back of German spending plans. This should limit the upward pressure on 10Y Bund yields versus swaps



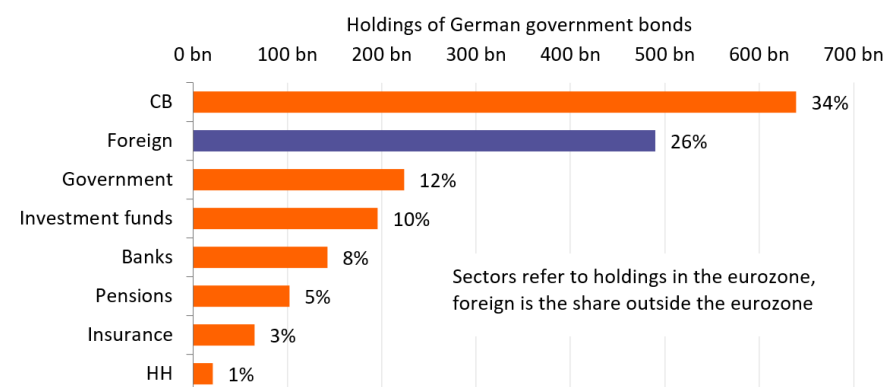
Germany's spending plans could result in an additional €1tr in Bund issuance

With Trump's tariff threats softening, markets can look at the bigger picture again, bringing us back to Germany's ambition to spend, spend, spend. The supply of Bunds in the market should continue to increase, building on the significant increase seen in recent years. Germany's spending plans may lead to an additional €1tr of issuance over the next decade, which represents an increase of 50% on top of the current outstanding amount of around €1.9tr in Bunds.

These are big numbers, but our analysis suggests that strong demand for Bunds from foreign investors can mitigate the upward pressure on yields. Foreign investors, those outside the

eurozone, accounted for 26% of Bund holdings at the end of 2024, about the same share as the holdings of the entire financial sector in the eurozone. Compared to many other countries, Germany does not rely on domestic demand to absorb the increased supply. Italy, for example, is strongly dependent on the domestic banking sector and retail investors for buying its government debt.

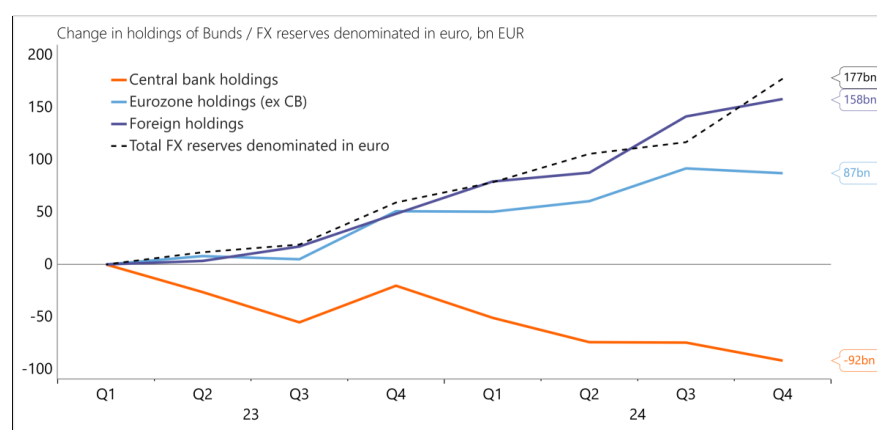
Foreign investors play an important role in Bund markets



Source: ING, ECB

More importantly, the role played by foreign investors is growing. Since the start of quantitative tightening by the European Central Bank, foreign investors have increased their holdings by around €240bn. A rise in Bund issuance of €100bn per year on the back of increased infrastructure and defence spending may therefore meet sufficient demand from outside the eurozone.

Foreign investors have easily absorbed the increased Bund supply since QT



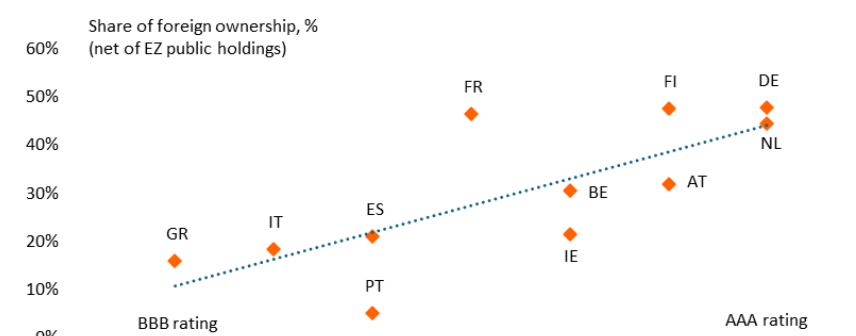
Source: ING, ECB, IMF, Macrobond

An important factor in the Bund's popularity among foreign investors relates to its safe asset characteristics. FX reserve managers, for instance, are often guided by mandates that limit the investible universe to the highest credit quality. As the chart above shows, the holdings of euro-denominated assets by global FX reserves rose by around €180bn over the same period, which is similar in magnitude to the change in the foreign holdings of Bunds. In an [earlier note](#), we

indicated that by historical standards, EUR-denominated assets are still underallocated by up to €450bn. The de-dollarisation theme could help swing the balance in favour of the euro.

A review of foreign ownership of eurozone government bonds confirms that those with high credit ratings are particularly popular. Greece, Italy, and Spain have around half the foreign interest compared to the AAA-rated countries. France is an outlier here, but this can be explained by the size of the market and the high liquidity it provides on the back of an OAT futures market. A healthy futures market makes risk management around the holding of OATs easier.

Foreign investors are particularly interested in higher-rated government bonds

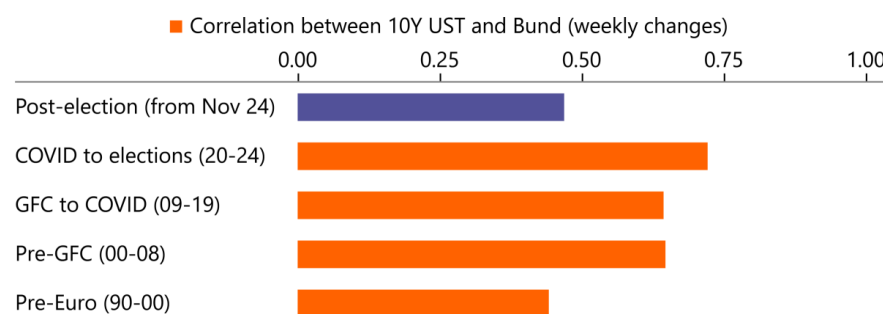


Source: ING, ECB, S&P

We anticipate strong demand for Bunds from the foreign private sector, particularly as the dominant role of US Treasuries as a safe asset has recently become more fragile.

In the aftermath of Liberation Day, USTs and equities sold off together, which defeats the purpose of holding government bonds in a diversified portfolio. Bunds, on the other hand, saw yields dropping and strongly outperformed swaps. On top of that, the correlation between USTs and Bunds has declined since Trump's election, falling back to the pre-euro era, adding to the diversification benefits of holding Bunds in an international portfolio.

The breakdown of US correlations enhances the Bund as a portfolio diversifier

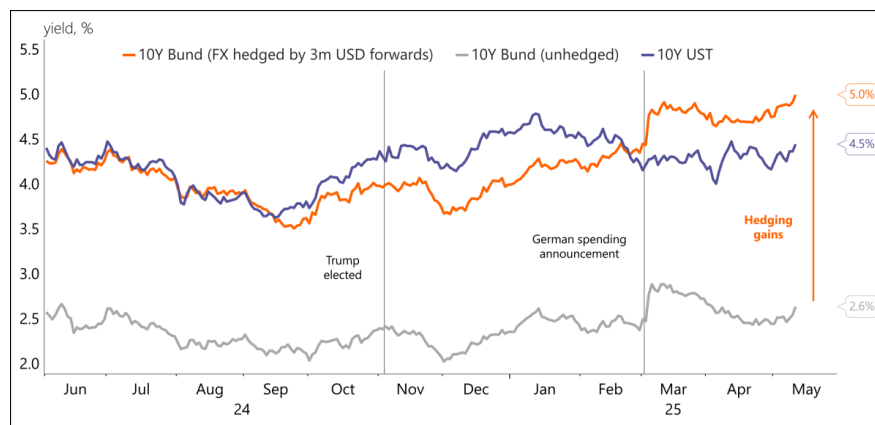


Source: ING, Macrobond

Whilst the 10Y Bund yield seems low at face value compared to USTs, Bunds can look more

attractive when accounting for FX hedging costs. For USD-denominated investors, rolling over 3-month hedges adds around 2.4% to the carry on an annualised basis. Even though this benefit is expected to reduce as the Federal Reserve continues cutting rates later this summer, the 50bp in excess above USTs provides a decent buffer.

On an FX-hedged basis, Bunds offer attractive yields to USD-denominated investors



Source: ING, Macrobond

In conclusion, our forecast suggests that euro rates can still rise from current levels. However, strong demand for Bunds from foreign investors will likely limit the extent to which Bund yields can rise above swaps. The 10Y Bund yield may still rise further from the current 7bp above swaps in the short term as risk sentiment improves, but structurally, we estimate a long-term fair value limited to 15bp.

Author

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.