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Rates Spark: Ever tighter spreads for Italian debt

Spreads between 10Y Italian and German bonds are at the tightest since 2008, helped by benign carry conditions. But we may hit a limit, as Italy still faces high debt levels. Italian spreads could, however, potentially price through French spreads as political risks ramp up in France, closer to the 2027 presidential elections

Italy's sale of a 15y bond met with record demand, and 10y spreads to German bunds at 60bp are at their tightest since 2008

Healthy demand for Italian debt, but how far can spreads tighten?

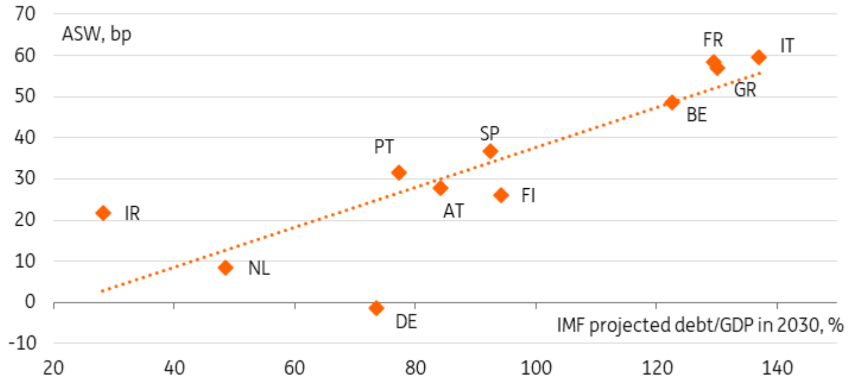
Italy's sale of a 15y bond drew another record demand with an order book of €157bn. This healthy demand for Italian credit is reflected in 10y spreads over Bunds at 60bp, their tightest since 2008. For spreads, however, the backdrop remains constructive. The European Central Bank on hold for the foreseeable future – of late, even some speculation that it could cut again – creates benign carry conditions, while risk sentiment remains resilient.

It is, of course, not an entirely Italian story, but also a German story that is pushing this spread tighter from the other end – a more global theme of fiscal largesse pushing longer-dated yield levels higher – only yesterday, 30y Bunds made headlines again as they hit their highest levels since 2011. Looking at the key 10y European government bond spreads across the spectrum and plotting them against projected debt levels by 2030 suggests that even a level of 50bp over Bunds for 10y Italian debt would not look outlandish – depending also on where one places the German 'dot'.

But one could also argue that, in terms of further progress, Italy should be bumping into its limits given the high debt levels. While this should also limit the scope of further rating upgrades, the latest positive outlook change by S&P has raised some hopes again.

Whether Italy can price through France is probably more a question of the political risk premium priced into French bonds, now substantially reduced on the back of a 2026 budget being in place. But the risks are likely to mount again as we approach the presidential election of early 2027. For now, investor appetite appears healthy, and we will be watching closely how Belgium's 30y bond sale will fare today, given its spreads are typically more closely correlated to French debt.

10y ASW spreads versus projected debt/GDP levels



Source: IMF, Refinitiv, ING

Wednesday's events and market views

From Europe, we'll first get Spanish and Italian PMIs for January, and then also final PMIs for the eurozone aggregate. More important may be the eurozone inflation data for January, whereby consensus sees a 1.7% year-on-year reading versus 1.9% the previous month. Core CPI is expected to remain sticky at 2.3%.

From the US, we have the ADP employment numbers, which will be watched closely given the concerns about a cooling jobs market. Consensus has the ISM services index coming in at 53.5, just a nudge lower from 54.4, but still pointing at robust growth. We should also get the Treasury's quarterly refunding announcement.

In terms of supply, we have a 30Y Belgium syndication for an estimated €6bn. From Germany, we have a 7Y Bund auction for €4bn.

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