

## Rates Spark: My home is my castle

After the Belgian success story of its one-year retail issue, Italy yesterday announced the launch of its second 'BTP Valore' retail bond for early October. The large volumes involved have knock-on effects on other marketable debt issuance and are a supporting factor for government bond spreads, especially now that the ECB QT debate could pick up



The European Central Bank's TPI backstop could be key in shifting the relationship between Italian bonds and the euro this time around

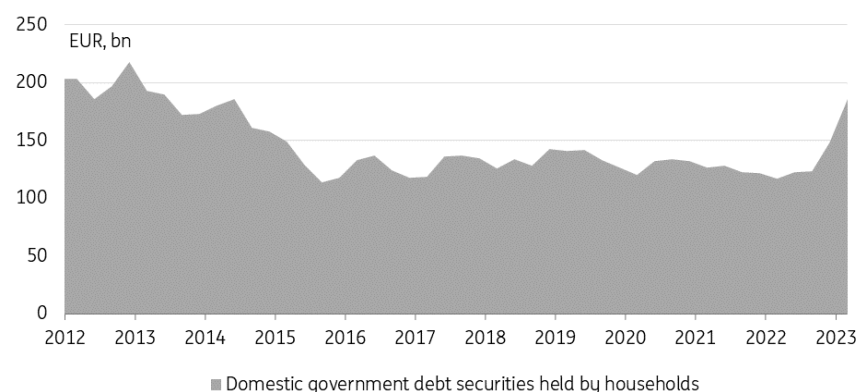
### A stable funding source for governments: households

Belgium has grabbed the headlines in recent days with a €22bn one-year retail issue. Beyond the implications for bank deposits, against which it was advertised as direct competition, the success of the sale also had implications for the country's government bond and bills markets. The net funding via the bills market was reduced from a contribution of €2.8bn to a planned decline in the bills stock of €4.4bn. Long-term bond issuance (OLOs) was trimmed by €2.9bn to €42.1bn for the year.

Yesterday, Italy announced the launch of its second 'BTP Valore', a five-year instrument targeting retail savers. The first instalment launched in June attracted a total volume of €18bn. Such large sizes attract the attention of markets not just for their knock-on effects on issuance plans, but also as it sets the country on a more diversified and stable funding mix.

Historically, Italy has had a larger footprint in the domestic market, but it has specifically tapped into the retail segment to a greater degree with dedicated Futura and Valore issues on top of the BTP Italia. At the end of August, these three types of retail government bonds accounted for €122bn or 5.1% of Italy's central government debt instruments. Prior to the pandemic, the level stood at €78bn or 3.9% at the end of 2019. But since late 2022, households have started to dip more into government debt, raising their investments from €123bn to €185bn over two quarters through the first quarter of 2023.

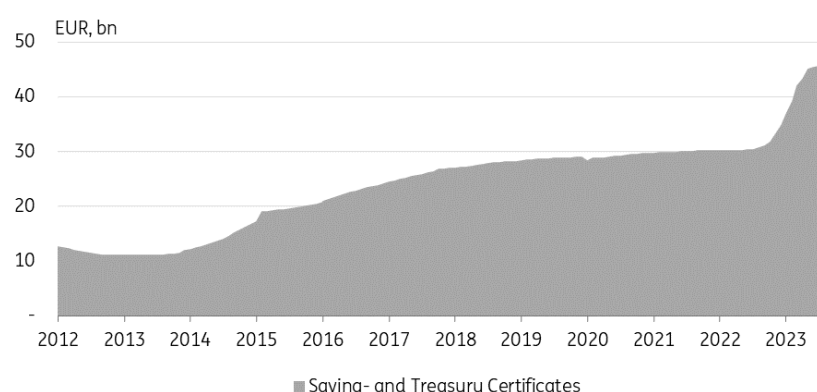
## Italian households dipped into government debt again



Source: ECB, ING

Next to Italy, Portugal has also been ramping up its funding via the retail sector, although to a greater degree via short-dated instruments – savings certificates. From mid-2022 until mid-2023, their outstanding amount has increased from just over €30bn to almost €46bn. That does not appear much in absolute terms, but it means that the retail segment went from making up 11% to 15.6% of direct state debt. The last time we observed a share that high was in 2008.

## Portugal ramped up its share of (short-term) retail debt instruments



Source: IGCP, ING

It is likely no coincidence that the outperformance of Portuguese government bonds versus Spanish bonds or the overall resilience of Italian spreads versus Bunds occurred alongside a larger

reliance on domestic households for funding. To be sure, it is not the only driver as for instance in the summer of 2022, the European Central Bank also revealed its Transmission Protection Instrument. But it can also be a supportive factor going into a renewed debate around the speed of the ECB's quantitative tightening.

## Next week: ECB meeting and US inflation

Next week is a busy one for markets, the key event being the ECB meeting on Thursday. It will be a close call, but overall we think the chance that we get another hike is greater than markets think. The upside for rates still seems somewhat limited, because it would be pulling forward the hike that markets currently view as happening before year-end with a chance of roughly 70%.

We doubt that markets would readily embrace the idea of further tightening on top of that. They could sense that this is the likely end of the cycle as concerns about macro weakness gain more weight, also in the ECB's own deliberations. Still, the ECB will probably want to counter the notion that this is the definitive end. The degree to which this is successful will determine how much of a bear flattening we could get in the case of a hike. A renewed focus on QT, in particular, could help prop up longer rates.

In the US, the upcoming week will be about inflation dynamics. The CPI release is the key event here ahead of the FOMC meeting the following week. The headline is seen picking up to 3.6%, but we think that is largely in the price already. More important is what happens to the core rate, which is seen dropping to 4.3% from 4.7% year-on-year, with the month-on-month rate steady at 0.2%. We will also see the release of producer and import prices as well as the University of Michigan consumer sentiment survey with its reading on inflation expectations.

The ISM services this week has highlighted lingering inflation risks, even if the overall dynamics are gradually improving. In terms of market impact, the inflation narrative seems to be driving the curve more from the front end as it determines whether more near-term action from the Fed is required.

### Today's events and market view

The ECB is already in its pre-meeting blackout period, and the Fed will follow this weekend. The data calendar is light today which may leave markets with more room to contemplate the busy week ahead with a US inflation theme and the chance for another, possibly final ECB hike.

We think markets are still trading with an upward bias to rates. The different backdrops against which the next policy meetings are held, a position of macro strength versus a position of growing weakness, has seen UST rates more buoyant again, with the 10-year yield gap over Bunds creeping wider again to 166bp.

## Author

### Benjamin Schroeder

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

### Padhraic Garvey, CFA

Regional Head of Research, Americas

[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

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