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Borrowing costs

Italy and Spain shake Eurozone 'periphery' label

'Markets have long memories but also, at the right incentive, they are willing to turn the page'

Investors reward pair for slicing deficits, as France and Germany flounder

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Government borrowing costs paid by Italy and Spain have fallen to their lowest level relative to Germany in 16 years, as investors reward Rome and Madrid for belt-tightening and grow more worried about surging debt elsewhere in the Eurozone.

The extra yield on 10-year Italian debt compared with German Bunds — a closely watched measure of the risk associated with lending to Italy — narrowed to within 0.7 percentage points this month, the lowest since late 2009.

Strong economic growth in Spain has helped to cut its 10-year spread with Germany to less than 0.5 percentage points. That is also the lowest since before the Eurozone crisis, when high debt loads drove up both countries' borrowing costs and stoked worries about the currency bloc breaking up.

"We are having a melting together of the periphery with countries previously considered safer investments, such as France, Belgium and Austria," said Ales Koutny, head of international rates at asset management company Vanguard. "Markets have long memories but also, at the right incentive, they are willing to turn the page."

Fund managers have warmed to Italian and Spanish debt amid a broad upswing in southern Europe's economic fortunes, arguing that it no longer makes sense to categorise such borrowers as the Eurozone's riskier "periphery".

Meanwhile, a yawning budget deficit and political turmoil in France — traditionally seen as one of the bloc's safer economies — has pushed its borrowing costs above Spain's. Even Germany, the euro area's de facto haven, has undergone a reassessment by markets after launching a €1tn spending push.

Vanguard's Koutny expects spreads to tighten even further next year, taking Italy's to 0.5-0.6 percentage points over Germany's, and Spain's to 0.3-0.4 percentage points. Investors point to Spain's improving economic trajectory and Italy's prudent fiscal policies under a politically stable government, as part of a broad reduction in fiscal risks for these countries as well as for other previous debt hotspots such as Greece.

Ken Egan, director of European sovereign credit at rating agency KBRA, said the better economic fortunes of southern European countries meant there was a "tale of two Europes, a tale of the north and the south".

He contrasted southern European economies' "decisive swing" away from chronic deficits with sovereigns such as France where "ageing costs, weaker growth and heavier spending [have] eroded their fiscal positions". Credit agencies, including S&P, predict France's debt to GDP will reach 120 per cent in the next few years.

Spain is set to be the world's fastest-growing large advanced economy for the second year running in 2025. Thanks to a combination of immigration, tourism, low energy costs and EU funds, the IMF is forecasting GDP expansion of 2.9 per cent for the country this year.

Italy believes its fiscal deficit, which was 7.2 per cent in 2023, will come in at 3 per cent for 2025, allowing Rome to exit the EU's excessive deficit procedure faster than expected, at a time when Paris is overstepping borrowing targets agreed in Brussels.

In absolute terms, Italian and Spanish borrowing costs remain elevated compared with the era of very low or negative interest rates on either side of the Covid pandemic.

But trading much closer to counterparts long deemed to be safer bets for investors means these bonds are "entering into a very different regime", said James McAlevey, head of global aggregate and absolute return at BNP Paribas Asset Management.

L'Italia e la Spagna si scrollano di dosso l'etichetta di 'periferia' dell'eurozona