

THE SWEET TEMPTATION OF POSITIVE YIELDS

Italian government bonds have hardly responded to the government crisis. A look at who owns those bonds nowadays provides some clues as to why this might be.

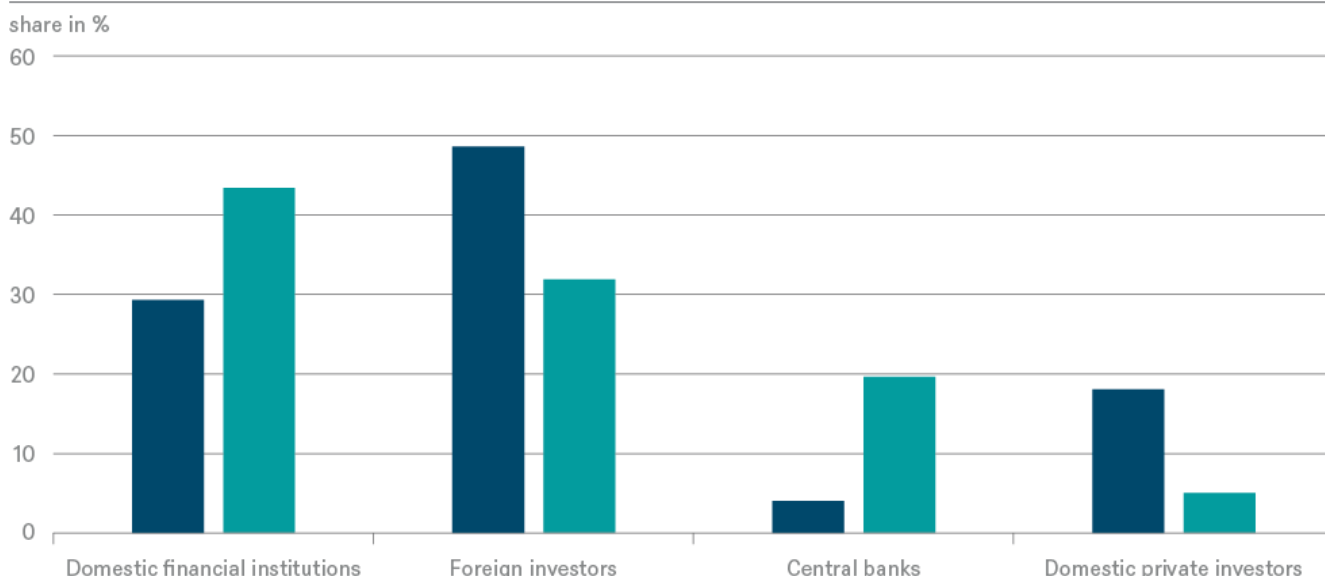
Government crises are not unusual in Italy. Historians have counted no less than 65 governments since 1946. However, a closer look at the development of spreads in 2018 shows that political uncertainties can leave strong marks in financial markets. That makes developments in recent weeks all the more remarkable. Since early August, the populist government has been on the verge of collapse. On August 20, prime minister Giuseppe Conte finally resigned. It remains unclear what will happen next, but a new government backed by the Five-Star Movement and the centre-left Partito Democratico is looking increasingly probable.

Yet, all these political twists and turns have barely made a dent on Italian government bonds. After a brief spike, 10-year Italian sovereigns are trading at a spread of 200 basis points over German Bunds, the same level as at the beginning of the month. In the first half of the year, the risk premium was 260 basis points on average.

This stability largely is due to the prospect of new bond purchases by central banks. Since June, there have been numerous signs that the European Central Bank (ECB)

might soon resume its purchasing program. This would further increase the proportion of government bonds held by Italy's central bank. As our "Chart of the Week" shows, there has already been a substantial shift during the last 10 years: while foreign investors held almost 50% of Italian government bonds at the end of 2009, this share has now come down to just over 30%. The share held directly by Italian private investors fell, too, from just under 20% to only 5% now. On the other hand, domestic banks and especially the central bank have increased their holdings. The share of the latter rose from 4% to currently almost 20%, which is the equivalent to an increase of 337 billion euros. In addition, it is reassuring that Italy, thanks to the austerity of recent years, nowadays is running a substantial current-account surplus.

"Given the mass of negative-yielding alternatives, Italian government bonds with their still positive yield seem tempting", says Joern Wasmund, Head of Fixed Income at DWS. And indeed, since the beginning of the year, foreign investors have increased their holdings by more than 15 billion euros, according to the latest available data.



■ Italian sovereign-bond holdings as of 12/31/09

■ Italian sovereign-bond holdings as of 5/31/19

Sources: Banca d' Italia, Bloomberg Finance L.P., DWS Investment GmbH as of 8/20/19

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Source: DWS Investment GmbH

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GLOSSARY

Basis point

One **basis point** equals 1/100 of a percentage point.

Bunds

Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

Central bank

A **central bank** manages a state's currency, money supply and interest rates.

Current account

The **current account** includes trade in goods and services, a net-factor-income balance (e.g. earnings on foreign investments and cash transfers from individuals working abroad) and transfers (e.g. foreign aid). It is a part of the balance of payments.

European Central Bank (ECB)

The **European Central Bank (ECB)** is the central bank for the Eurozone.

Five Star Movement

The **Five Star Movement** is a populist political party in Italy. It is led by the popular comedian and blogger Beppe Grillo, who was also among its founders in 2009. It is considered anti-establishment, environmentalist, anti-globalist and Eurosceptic.

Risk premium

The **risk premium** is the expected return on an investment minus the return that would be earned on a risk-free investment.

Sovereign bonds

Sovereign bonds are bonds issued by governments.

Spread

The **spread** is the difference between the quoted rates of return on two different investments, usually of different credit quality.

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