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Banor Capital: "Italy needs a credible financial manoeuvre"

By **Stefania Basso** - 8 July 2019

Banor Capital. Francesco Castelli, Fixed Income Manager, replies to questions by Fondi&Sicav about long-term bonds

"We are a serious country and we want to avoid the same end as Greece". Castelli, Banor Capital

Long-term Government bonds gave an excellent performance at the start of the year. How much room for growth do you think they still have in light of the latest statements by the ECB and the Fed?

In our opinion, **the excellent start-of-year performance of government bonds already reflects the future decrease in rates: in the USA**, the **10-year** returned to around 2%, where it was in 2017 when the official rates were 1% below the current level. **In Europe**, the return on the German *bund* recorded its lowest ever rate at -0.30%, ten cents below the minimum levels of 2016. It is likely, in line with historical behaviour, that the **market will still have more bullish potential** when the **rate**

cuts become official. But, especially in Europe, we are struggling to find value in negative-rate investments, which are close to record peaks. Also, we think that **the ECB will favour the compression of credit spreads** and try to avoid excessively negative rates on German bonds.

Long-term BTPs have not succeeded in replicating the performances of the 'long' government bonds issued by other euro zone countries. Do you believe that BTPs represent an opportunity in that sense?

As regards **Italian BTPs**, the start-of-year performance is good, but marginally lower than **German and French bonds**. Our bonds have followed an upward trend, but remain weighed down by the spread, or by the perception of risk connected with our country. **In countries like Spain and Portugal, the 10-year bonds offer returns in the area of 0.5%. BTPs**, on the other hand, are well above 2%, essentially **in line with Greek bonds.** The spread compared to German bonds is equal to 250 basis points and has been substantially stable since the start of the year. A worrying yet bearable level, which reflects **the markets' suspension of judgement**. We are proverbially "postponed to September", when important decisions will be made about public debt. Much of the political debate is focused on the **"titanic" clash between the Italian Government and the European Commission**. But this is only a skirmish; the real battle will be convincing financial markets and ratings agencies that we are able to repay our debts. **For decades, Italy has spent too much and unwisely**. Now, even with the best intentions, the government does not have sufficient resources to increase public spending further. Politics can (or rather, must) work on the composition of spending (favouring productive spending) and on taxation (favouring productive factors to the detriment of income). But, **starting from 132% of debt/GDP**, there is no escape: we must find guarantees. Without the ECB, which has slowed its purchases, **one third of our debt is in the hands of foreigners**: **few speculators and many pension funds, especially from Northern Europe**, people who cannot allow themselves to lose money by lending it to unreliable governments. **The 2020 Financial Act must convince them that we are a serious country**, one that intends to avoid the same end as Greece.