



EURO SWAP SPREADS DEEP DIVE

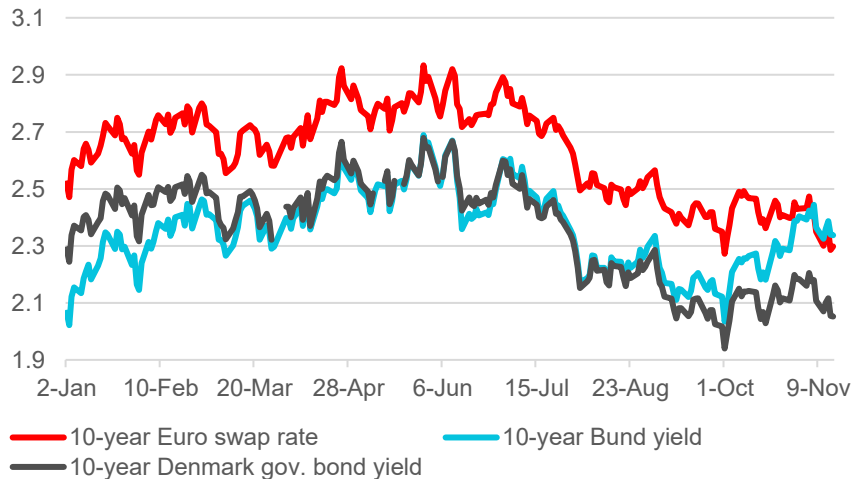
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Recent moves in Swap spreads

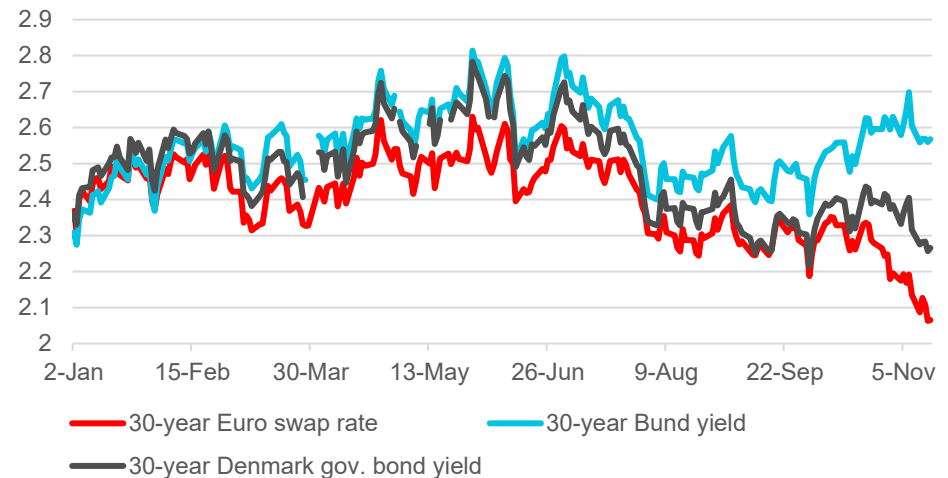
- **Bunds sold off significantly vs swap rates since October**
 - 10 & 30-year Bunds sold off significantly vs swap rates
 - Bunds also sold off vs Denmark – an alternative risk free EZ rate
 - Selloff in Bunds vs swaps more pronounced than against OATs vs swaps
- **But the 30-year swap rate declined as well**
 - The 30-year swap rate fell significantly, even before the outcome of the US election
 - Likely the result of Dutch pensions funds receiving 30-year swaps to close duration gaps

10-year Bund yield vs Euro swap rate



Source: Bloomberg. As of November 15th

30-year Bund yield vs Euro swap rate



Source: Bloomberg. As of November 15th

Market explanations for swap spread moves

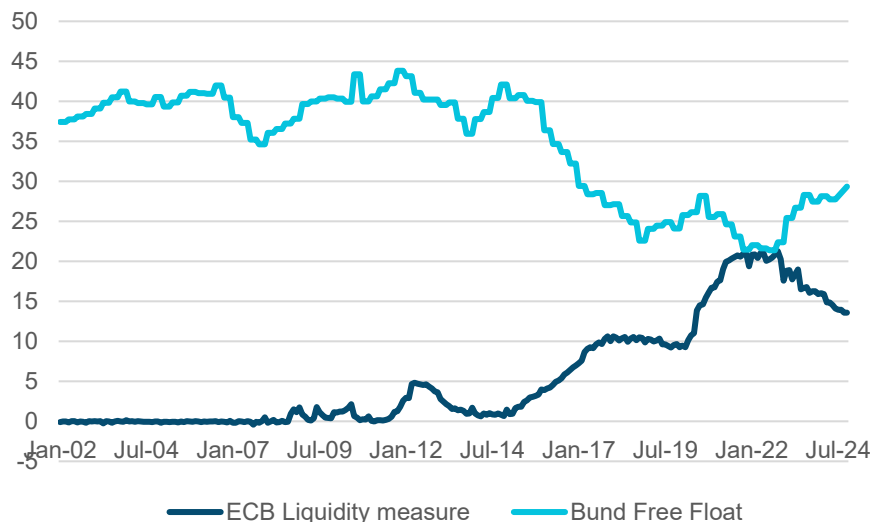
- **ECB policies can explain the long-term gradual Bund sell-off vs swaps**

- ECB PSPP QT continues to raise collateral availability
- Changes in excess liquidity (moving from reserve abundance to scarcity regime)
- But these changes cannot explain the large move in October

- **Global swap spreads cannot explain Euro swap spread move in October**

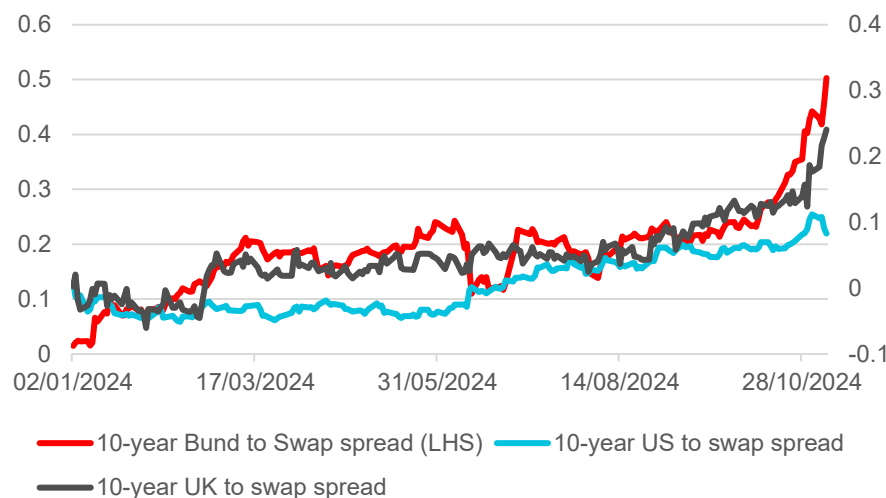
- 10-year UST swap spreads have only risen slightly since the beginning of the year
- 10-year Gilt swap spreads rose as a result of an idiosyncratic fiscal story

ECB Excess Liquidity vs Bund free float



Source: Bloomberg, IMF. As of November 15th

YTD Changes in 10-year EZ, UK, US Swap spreads

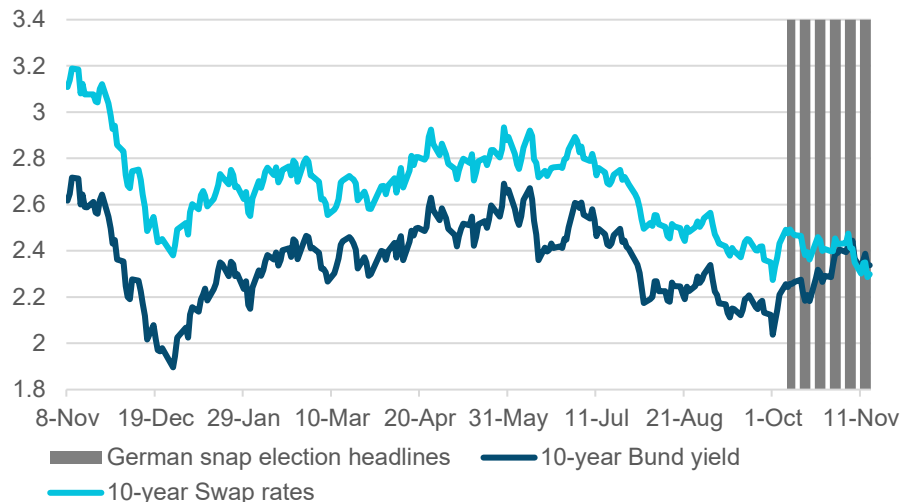


Source: Bloomberg. As of November 15th

Economic explanations for swap spread moves

- **News about a German snap election coincide with the Bund vs swap selloff**
 - Many analysts expect debt brake reform
 - This would raise Bund issuance, a rationale behind the recent selloff vs swaps
- **Putting it all together in a regression model**
 - Dependent variable is the 10-year Euro swap spread
 - Explanatory variables are Bund free float, ECB liquidity and global factors
 - Model fits well, but cannot explain the selloff that started in October

10-year Bunds vs 10-year Swap Rates vs German snap election headlines



Source: Bloomberg. As of November 15th

Actual vs model implied 10-year Bund swap spread



Source: Bloomberg, IMF, T. Rowe Price. As of November 15th



Discussion points

- **Is the pricing of German debt brake reform behind the recent selloff?**
 - If so, how much of this is already priced?
 - Are there other candidate explanations?

- **What is behind the rally of the 30-year swap rate?**
 - Only Dutch pension funds receiving or other explanations?

- **Should we expect more issuance of sovereign and SSA debt to accelerate these trends?**