

Economics/Rates Strategy

Convergence 2.0

AUTHORS**Chiara Cremonesi**

Senior Rates Strategist
chiara.cremonesi@animasgr.it

Matteo Gallone

Junior Macroeconomist
matteo.gallone@animasgr.it

Euro area sovereign spreads are now at their narrowest point since 2009. This is a notable shift that likely surprised investors, especially those who continue to view the bloc as divided between Germany and the rest.

In this note we:

- 1) Present a quantitative framework to identify the drivers of the move. According to our analysis, an improving fiscal and political framework has played a critical role in the tightening process; in addition to easier monetary policy conditions and improving risk sentiment.*
- 2) Assess whether such convergence may have further momentum and under which circumstances. We expect the process to continue, although at a slower pace.*
- 3) Discuss the reasons why we do not expect spreads to collapse to pre-2009 levels.*
- 4) Provide a trade recommendation. In particular, we suggest continuing to overweight BTPs and SPGBs, while underweighting core and semi-core govies in an EGB portfolio, also taking into consideration the better entry levels and steeper curves of BTPs and SPGBs.*

Modelling the underlying drivers of sovereign spreads

In this note, we present our empirical model designed to analyse the underlying drivers of movements in sovereign spreads. Our framework distinguishes between domestic and external factors, and those related to the effects of monetary policy.

Our modelling approach employs a Bayesian Structural Vector-Autoregressive (BSVAR) model with sign restrictions. Within this framework, we include three endogenous variables, namely: the 10Y sovereign spread of a country (relative to the 10Y Bund), the stock price differential of a country versus the DAX, and the 10-year euro-area Overnight Index Swap (OIS) rate. Further details are provided in the **Appendix**.

Within this framework, we express every variable as a function of its own past values and the past values of other variables, along with a new information component. We decompose each day's new information into the effects of three underlying drivers: a monetary policy shock, a non-country specific shock, and a country-specific shock. This decomposition is based on an assumed sign pattern of how each driver affects the variables (see **Table 1**), using the algorithm developed by Rubio-Ramirez et al. (2010)¹.

Table 1 – Sign Restriction Matrix

	Monetary Policy Shock	Non-Country Specific Shock	Country-Specific Shock
10Y Sovereign spread (reference country) vs 10Y Bund	+	+	+
Stock price differential (reference country) vs DAX	(0)	(+)	-
EA 10Y OIS	+	(-)	-

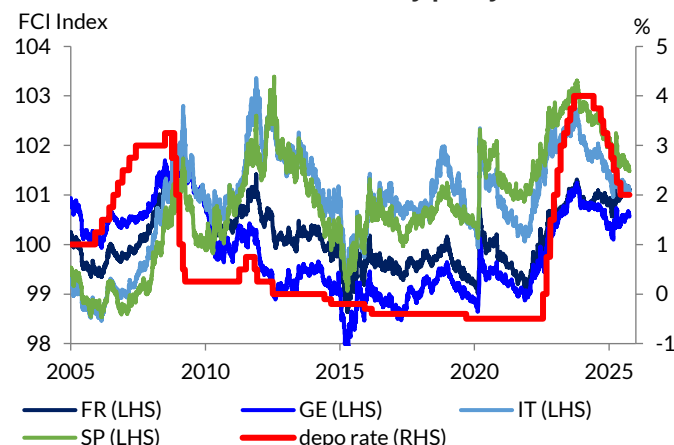
Note: A "+" or "-" denotes an increase or decrease, respectively, in the relevant variable on impact. Imposing or omitting the zero and sign restrictions shown in brackets does not materially alter our baseline results. Source: ANIMA Research

What moves sovereign spreads

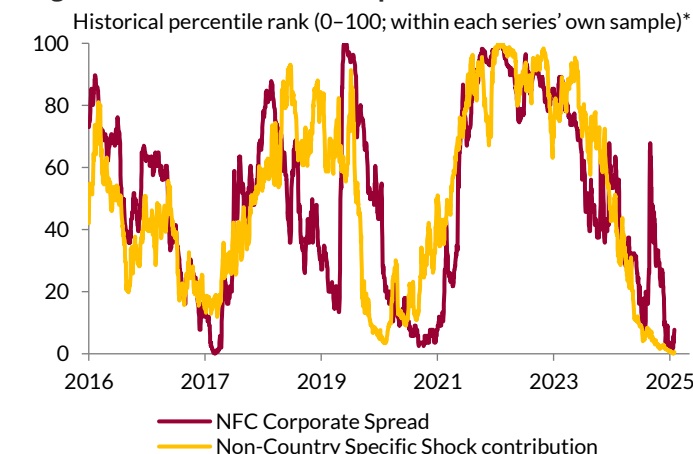
Our model is based on the assumption that sovereign spreads are driven by three types of shocks:

1. **The monetary policy shock.** This shock captures how the ECB monetary policy stance transmits differently across euro-area countries, reflecting the incomplete nature of the eurozone as a monetary union. A country with a higher debt burden and higher interest payments tends to benefit more from ECB monetary easing than countries with stronger fiscal metrics. Conversely, it is more adversely affected by monetary tightening (**Figure 1**).
2. **A non-country specific shock.** This shock reflects the component of a sovereign spread that is driven by exogenous factors, such as rates volatility and the general level of risk appetite in financial markets. As shown in **Figure 2**, this shock correlates closely with credit spreads. When risk appetite is low and/or rates volatility is high, demand for spread products, which are generally perceived as less safe by investors, tends to decline.
3. **A country specific shock.** This shock captures the idiosyncratic component of a sovereign spread. It encompasses a country's macroeconomic and fiscal outlook, as well as its political environment.

¹RUBIO-RAMÍREZ, J. F., WAGGONER, D. F., & ZHA, T. (2010). Structural Vector Autoregressions: Theory of Identification and Algorithms for Inference. *The Review of Economic Studies*, 77(2), 665–696.

Figure 1**Financial conditions and monetary policy stance**

Source: Bloomberg, Goldman Sachs, ANIMA Research

Figure 2**Exogenous factors matter for spread movements**

Source: Bloomberg, ANIMA Research

*Note: The chart shows the output of a Spearman rank correlation between the "BBG EuroAgg Corporate Average OAS" and the "Non-Country Specific Shock contribution" (average contribution for Germany, France, and Italy), both expressed as cumulative sums starting from Jan-2016. When the two lines rise and fall together, it indicates that both series are simultaneously in the higher (or lower) parts of their respective distributions, providing evidence of co-movement that is robust to outliers and does not require linearity (i.e. Spearman/monotonic idea).

What's behind the recent positive trend in periphery spreads

Since the beginning of 2024, the tightening of periphery spreads has gained momentum, while the performance of core and semi-core spreads has been more mixed. France, in particular, has underperformed relative to other euro government bonds (EGBs), due to a sudden surge in political instability.

We find that **improving fiscal and political framework did play a critical role in the tightening process of periphery spreads, in addition to easier monetary policy conditions and improving risk sentiment.**

Figures 3, 4 and 5 illustrate that, according to our model:

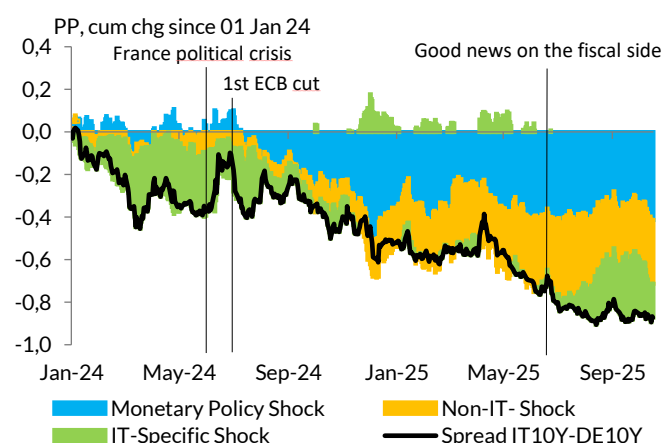
- 1) **In H1 2024**, monetary policy was largely irrelevant in explaining the decline in both the BTP-Bund and the SPGB-Bund spreads, as the ECB maintained its policy rate at 4%. On the other hand, the tightening of the BTP-Bund spread was primarily driven by the idiosyncratic component, while the SPGB-Bund spread narrowed due to a combination of improved risk sentiment and idiosyncratic factors. In our view, dominance of the idiosyncratic shock in Italy reflects market recognition of a virtuous combination of political stability and fiscal discipline, which has led to a sharp increase in foreign inflows into BTPs since the beginning of 2024.
- 2) **From mid-2024 onwards**, the ECB's monetary policy stance gradually became a relevant and positive driver of both the BTP-Bund and SPGB-Bund spreads, following the ECB's decision to begin cutting rates in June 2024. Since then, monetary policy has remained a significant contributor to spread tightening. In our view, this suggests that the transmission of easier monetary policy is still ongoing in Italy and Spain, as expected given the typical lags in monetary policy transmission. By contrast, over the same period, we find that monetary policy has

not been a relevant driver of the OAT-Bund spread, confirming the non-linear impact of ECB policy across different euro-area countries.

- 3) **In H1 2025 and continuing to the present**, in addition to the impact of easing monetary policy, the positive risk environment began to contribute meaningfully to the tightening of both the BTP-Bund and SPGB-Bund spreads. This coincided with a more than 20% rise in the DAX.
- 4) **In H2 2025**, idiosyncratic factors have regained prominence in both Italy and Spain, contributing positively to spread performance. In Italy, we believe this is due to a positive rating drift, combined with expectations of a better-than-anticipated deficit trajectory, with the deficit-to-GDP ratio projected to fall below 3% as early as 2026. As a result, Italy is likely to exit the Excessive Deficit Procedure in 2026, a year earlier than previously expected. In Spain, the positive rating drift, alongside expectations that the country will continue to outperform the rest of the euro area in terms of GDP growth next year, underpins the renewed importance of idiosyncratic drivers in our view.
- 5) **The widening of the OAT-Bund spread, which began in summer 2024, is entirely attributable to idiosyncratic factors.** While the positive risk environment would typically exert downward pressure on the spread, political instability in France has resurfaced concerns around debt sustainability and the need for fiscal consolidation, ultimately driving the spread wider.

Figure 3

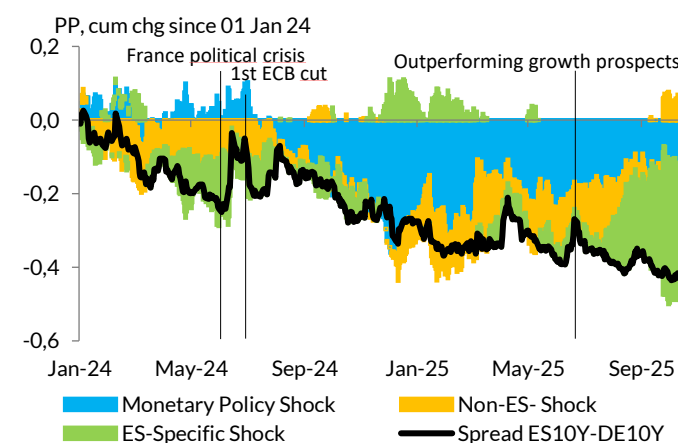
Drivers of BTP-BUND Spreads from Jan-24 to date



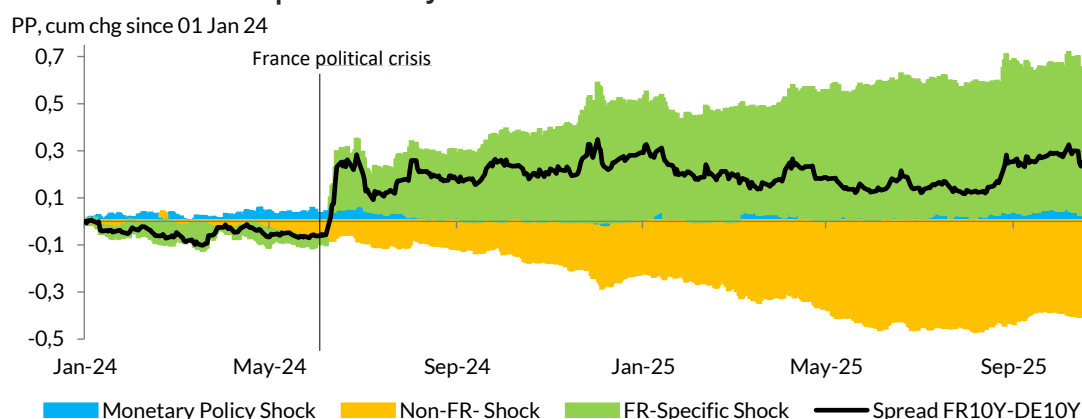
Source: Bloomberg, ANIMA Research – Data as of 16th June 2025

Figure 4

Drivers of BONOS-BUND Spreads from Jan-24 to date



Source: Bloomberg, ANIMA Research – Data as of 16th June 2025

Figure 5**Drivers of OAT-BUND Spreads from Jan-24 to date**

Source: Bloomberg, ANIMA Research – Data as of 16th June 2025

Convergence 2.0 at work

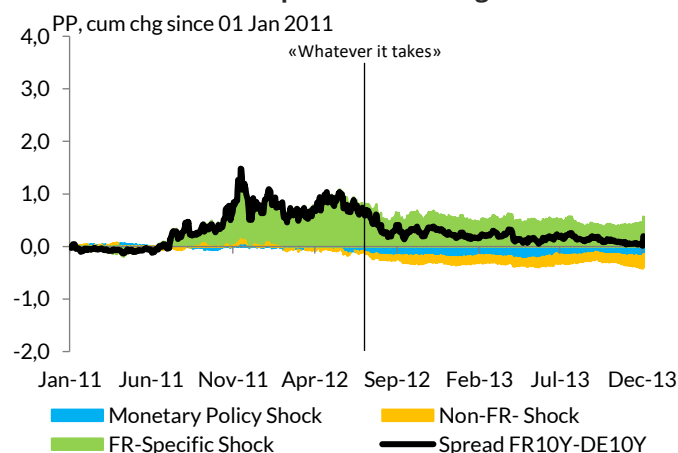
The impact of idiosyncratic factors on periphery spreads has changed significantly over time.

Figures 6 to 10 show that in H1 2012, the widening of periphery spreads was almost entirely driven by idiosyncratic factors. However, when spreads began to compress in July 2012 - following Draghi's famous "Whatever it takes" speech in London - the tightening was not led by a positive shift in idiosyncratic components, but rather by a more accommodative monetary policy stance. At the time, the ECB was cutting rates and introducing three-year LTROs, which drove excess liquidity to record highs. A partial improvement in the risk environment also contributed. In fact, the idiosyncratic component continued to exert a negative influence on periphery spreads for several quarters, limiting the extent of the tightening.

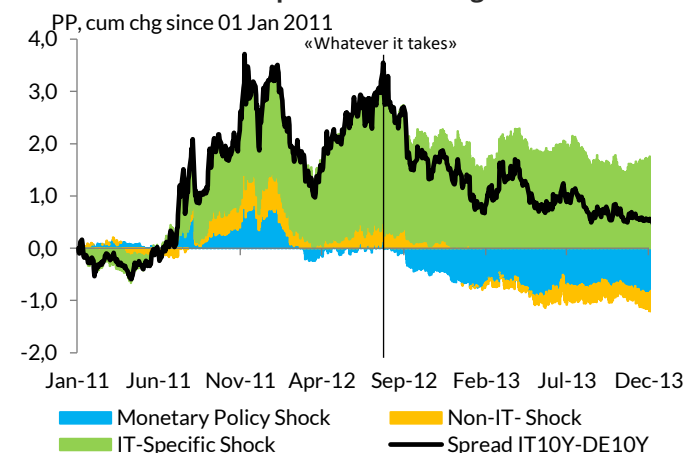
Fast forward to the past two years, and the idiosyncratic component has become a positive driver of periphery spreads performance.

In a nutshell, **our model confirms that the reduction in idiosyncratic risk - namely, improvements in the fiscal and political frameworks - has played a critical role in the convergence of periphery spreads towards Core levels, alongside easier monetary policy conditions and improving risk sentiment.**

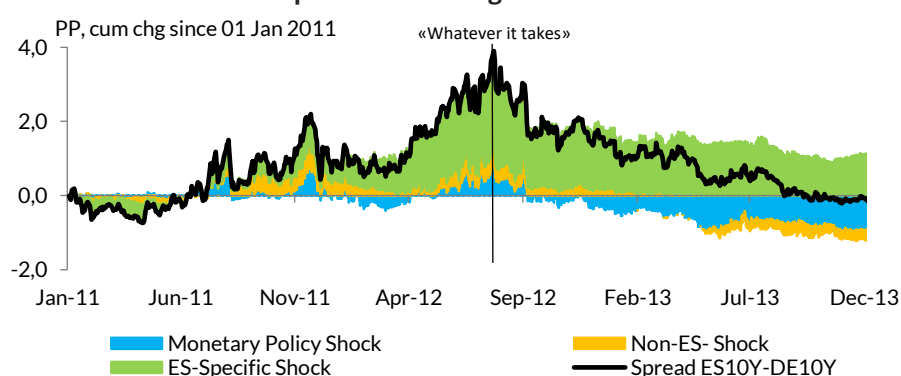
At the same time, idiosyncratic risk, which was negligible in the past, has increased in core and especially semi-core countries, becoming a key negative driver of spread performance.

Figure 6**Drivers of OAT-BUND Spreads – Sovereign Crisis**

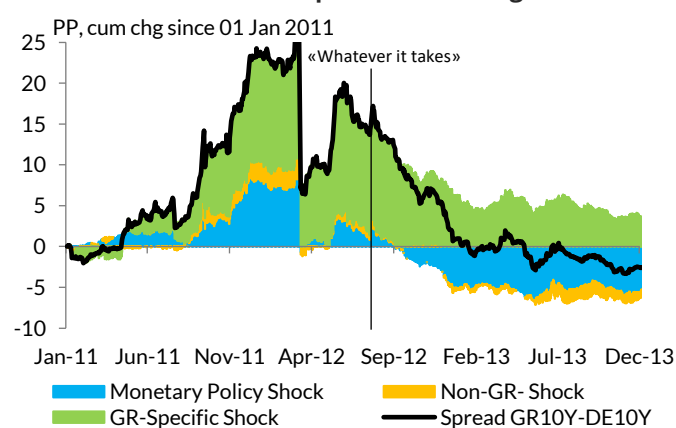
Source: Bloomberg, ANIMA Research

Figure 7**Drivers of BTP-BUND Spreads – Sovereign Crisis**

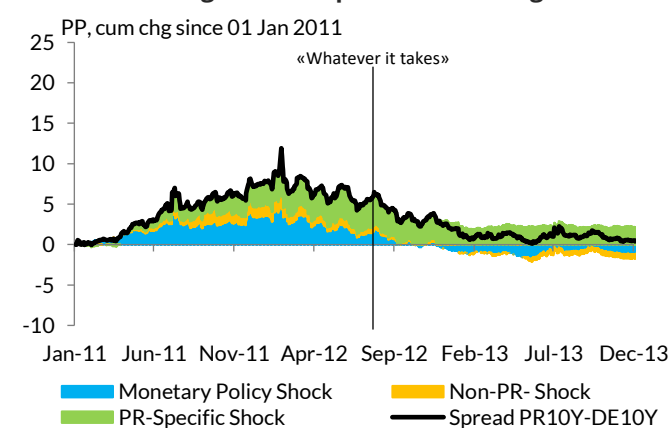
Source: Bloomberg, ANIMA Research

Figure 8**Drivers of Bonos-BUND Spreads – Sovereign Crisis**

Source: Bloomberg, ANIMA Research

Figure 9**Drivers of Greece-BUND Spreads – Sovereign Crisis**

Source: Bloomberg, ANIMA Research

Figure 10**Drivers of Portugal-BUND Spreads – Sovereign Crisis**

Source: Bloomberg, ANIMA Research

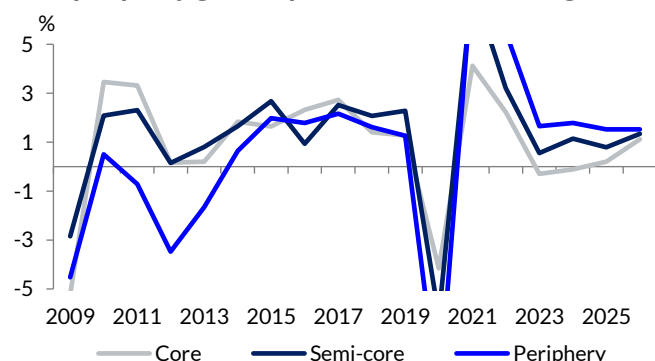
What's next?

We believe the process of convergence between core/semi-core and periphery spreads will continue in 2026, albeit at a slower pace than in recent years, for the following reasons:

- 1) Growth-wise, following several years of outperformance by periphery countries relative to core and semi-core economies, driven in large part by Spain's strong growth, core and semi-core countries are expected to nearly catch up with the periphery in 2026 (**Figure 11**). We anticipate that Germany's ambitious fiscal plan will provide key support to this convergence.
- 2) By contrast, on the fiscal outlook, the periphery is expected to continue outperforming core countries. Deficits are projected to decline further in periphery economies, while they are set to increase in core and semi-core countries, with Germany being the main contributor (**Figure 12**).
- 3) While the cost of debt remains lower in core and semi-core countries compared to the periphery (**Figure 13**), the outlook over the coming years is more favourable for periphery countries. In core and semi-core economies, the rollover of maturing debt is being financed at higher costs, whereas in the periphery, the cost of new issuance is broadly in line with the cost of expiring debt, suggesting a stabilization in the cost of debt (**Figure 14**).

Figure 11

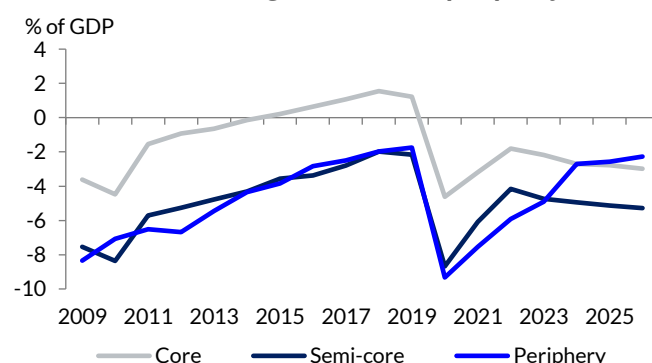
Core-periphery growth performance to converge



Source: Haver Analytics, ANIMA Research

Figure 12

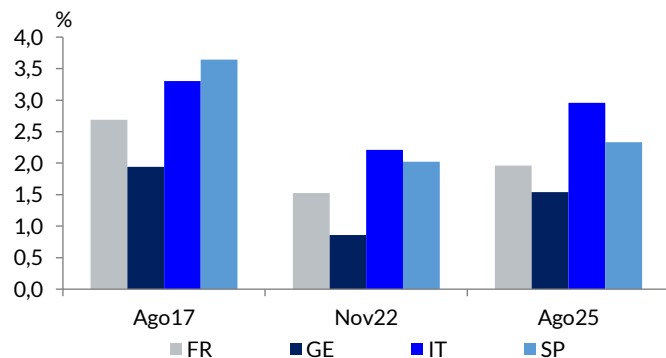
Fiscal outlook to diverge in favour of periphery



Source: Haver Analytics, ANIMA Research
The chart shows net lending as % of GDP. Negative values indicate a deficit.

Figure 13

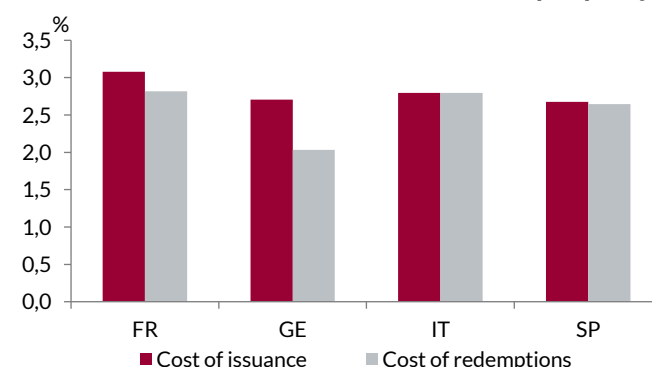
Cost of debt is still lower in core and semi-core...



Source: Haver Analytics, ANIMA Research

Figure 14

...but the outlook is more favourable for the periphery



Source: Haver Analytics, ANIMA Research

Can periphery spreads go back to pre-2009 levels?

Figure 15 shows that, when accounting for macroeconomic fundamentals, periphery debt still appears undervalued, while core and semi-core countries (except for France) remain overvalued.

That said, **we believe the scope for further sharp tightening in periphery spreads over the medium term is limited**, for the following reasons:

- 1) Most of the positive news surrounding the periphery has already been priced in.
- 2) Model-wise, we expect the contribution of the monetary policy shock to the BTP–Bund and SPGB–Bund spreads to gradually fade, as the bulk of policy easing is now behind us. Financing conditions have recently stabilised within a range, influenced by higher real interest rates and the appreciation of the euro on one side, and strong equity market performance on the other.
- 3) We expect the risk environment and idiosyncratic shocks to continue contributing positively to periphery spreads, potentially even offsetting the gradually fading of the positive monetary policy shock. However, we do not expect their contribution alone to result in further significant tightening of the periphery spreads.

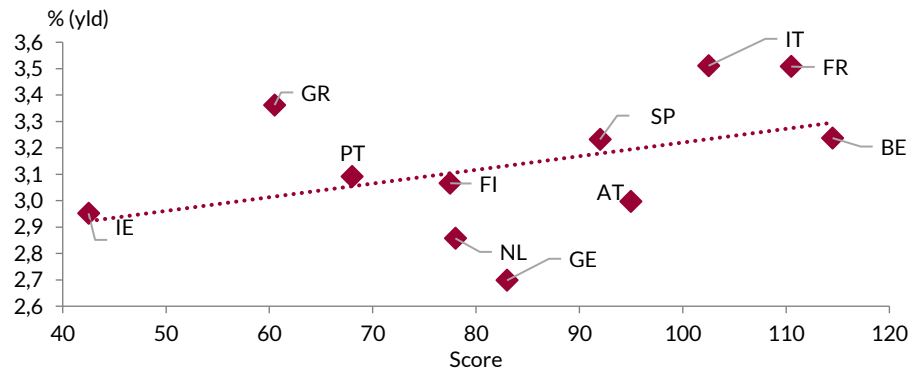
We believe that a further build-up in convergence momentum between core and periphery bonds, driven by idiosyncratic and risk environment shocks, can only occur under the following two conditions:

- 1) The completion of the EU Banking and Capital Market Union.
- 2) A credible timeline for progress towards a fiscal union, including the establishment of a liquid common European safe asset comparable to US Treasuries.

Given the nature of the EU decision-making process and the lack of political will at the individual country level - particularly regarding the second condition - we believe that a further sharp tightening of periphery spreads back to pre-2009 levels is unlikely, at least over the next one to two years.

How to trade it?

Against this backdrop, **we would continue to overweight BTPs and SPGBs in an EGB portfolio, while underweighting core and semi-core bonds**, also taking into account their more attractive carry and steeper yield curves. On the other hand, although France appears undervalued relative to its fundamentals (**Figure 15**), we would continue to underweight it in an EGB portfolio, using it only for tactical trades. This reflects our view that political instability is likely to persist until the Presidential elections in 2027, limiting the scope for sustained performance.

Figure 15**Core and semi-core debt (excluding France) remains overvalued**

The x-axis of the chart ranks the synthetic scores of selected EA countries based on macro fundamentals, fiscal metrics, and market valuations relative to their historical averages.

Source: Bloomberg, Haver Analytics, IMF, ANIMA Research

Appendix

Our modelling approach employs a Bayesian Structural Vector-Autoregressive (BSVAR)

Within this framework, we include three endogenous variables, namely: the 10Y sovereign spread of a country (relative to the 10Y Bund), the stock price differential of a country versus the DAX, and the 10-year euro-area Overnight Index Swap (OIS) rate.

We use daily changes for the yield spreads variables and daily percentage changes for the stock market differential.

The sample comprises daily observations starting from January 1999, and we include four lags of the dependent variables.

We use a combination of sign restrictions to identify the underlying drivers within our set of endogenous variables. As previously reported, our structural shock identification scheme is based on sign restrictions applied to the contemporaneous impulse response function (see **Table 1**)². A "+" or "-" denotes an increase or decrease, respectively, in a variable following a specific shock, while empty fields indicate that the parameter is left unrestricted. All restrictions are imposed on impact, reflecting the fact that markets typically react to news instantaneously or within the same day. This methodology is similar to that developed by the European Central Bank (see Brandt et al. (2021))³ to identify the economic factors driving Euro-Area asset prices.

In terms of econometric specification, we follow the notation of Rubio-Ramirez et al. (2010)⁴, and specify the following model, where u_t represents the reduced-form errors with covariance matrix Σ :

$$y_t = \underbrace{c}_{\text{intercept}} + \sum_{h=1}^p \Phi_h y_{t-h} + u_t, \quad t = p+1, \dots, T$$

We adopt a Normal-Inverse-Wishart (NIW) prior for the parameter matrices $\{\varphi_h\}$ and the residual covariance Σ . Specifically, for a chosen number of lags p , we arrange the system in a standard linear regression form $Y = X B + U$. We then iteratively sample:

1. Σ from an Inverse Wishart distribution,
2. B from a Gaussian distribution, conditional on Σ ,

This process generates a large number of candidates, denoted as draws $\{(B, \Sigma)\}$, each reflecting plausible variations in the posterior distribution. Each draw preserves the daily structure of the VAR, allowing us to handle high-frequency data points without imposing a restrictive parametric form beyond the linear setup.

To interpret the daily fluctuations in y_t as arising from meaningful shocks - such as "Monetary Policy Shock" or "Country-specific Shock" - we decompose the reduced-form innovations u_t into structural shocks e_t via:

$$u_t = B_0 e_t, \quad \text{Cov}(e_t) = I$$

This implies:

$$\Sigma = B_0 B_0^T.$$

² For France, we introduce also two narrative restrictions: 1) a France-specific shock is the single biggest contributor to the rise in the spread on June 13, 2024. 2) a NON-FR shock is the single biggest contributor to the rise in the spread on November 15, 2011. In line with: ADEMME M., DALBARD J., (2025), FRANCE INSIGHT: Price of Fractured Politics? €6 Billion, So Far. Bloomberg Economics.

³ LENNART BRANDT L., GUILHEM A.S., SCHRÖDER M., ROBAYS I.V. (2021), What drives euro area financial market developments? The role of US spillovers and global risk. ECB Working Paper Series No 2560 / May 2021.

⁴ RUBIO-RAMÍREZ, J. F., WAGGONER, D. F., & ZHA, T. (2010), Structural Vector Autoregressions: Theory of Identification and Algorithms for Inference. The Review of Economic Studies, 77(2), 665–696.

We construct B_0 by multiplying $chol(\Sigma)$ by an orthonormal rotation matrix Q . The sign-restriction approach retains only those rotations Q for which the on-impact response of each variable in y_t to each identified shock aligns with our hypothesised sign pattern.

Mathematically, we encode these sign expectations in a sign matrix, which must be satisfied by B_0 .

Having isolated these five shocks, we construct a historical decomposition that shows how each shock cumulatively contributes to daily changes in the variables. Formally, we express this using a finite moving-average (MA) representation:

$$y_t = \sum_{l=0}^{\min(t, H)} \Theta_l \varepsilon_{t-l}$$

where $\Theta_0 = B_0$ is the immediate-impact matrix, and each subsequent Θ_l is built recursively from the VAR parameters $\{\varphi_h\}$.

For each day t and each shock j , the product $\Theta_l[\cdot, j] \varepsilon_{t-l, j}$ yields the raw contribution of shock j . In the daily yield equation, we then adjust these raw contributions so that their sum exactly matches the observed daily change, distributing any residual mismatch proportionally across shocks based on their short-run share in the forecast error variance (FEVD). This ensures an exact day-by-day accounting of yield changes. In other words, we distribute the residual across shock contributions using FEVD results as weights, preserving consistency with the model's structural interpretation.

ANIMA INVESTMENT RESEARCH**FABIO FOIS**

Head of Investment Research & Advisory
fabio.fois@animasgr.it

CHIARA CREMONESI

Senior Rates Strategist
chiara.cremonesi@animasgr.it

FRANCESCO PONZANO

Junior Equity Strategist
francesco.ponzano@animasgr.it

VALERIO CEOLONI

Senior EM/FX Strategist
valerio.ceoloni@animasgr.it

MATTEO GALLONE

Junior Macroeconomist
matteo.gallone@animasgr.it

COSIMO RECCHIA

Senior Equity Strategist
cosimo.recchia@animasgr.it

IMPORTANT DISCLOSURES

Marketing material for professional clients or qualified investors only. This material does not constitute an advice, an offer to sell, a solicitation of an offer to buy, or a recommendation to buy, sell, or hold any investment or security or to engage in any investment strategy or transaction. ANIMA can in no way be held responsible for any decision or investment made based on information contained in this document. The data and information contained in this document are deemed reliable, but ANIMA assumes no liability for their accuracy and completeness. ANIMA accepts no liability whatsoever, whether direct or indirect, that may arise from the use of information contained in this material in violation of this disclaimer and the relevant provisions of the Supervisory Authorities.

This is a marketing communication. Please refer to the Prospectus, the KID, the Application Form and the Governing Rules ("Regolamento di Gestione") before making any final investment decisions. These documents, which also describe the investor rights, can be obtained at any time free of charge on ANIMA website (www.animasgr.it). Hard copies of these documents can also be obtained from ANIMA upon request. The KIDs are available in the local official language of the country of distribution. The Prospectus is available in Italian/English. Past performances are not an indicator of future returns. The distribution of the product is subject to the assessment of suitability or adequacy required by current regulations. ANIMA reserves the right to amend the provided information at any time. The value of the investment and the resulting return may increase or decrease and, upon redemption, the investor may receive an amount lower than the one originally invested. In case of collective investment undertakings distributed cross-border, ANIMA is entitled to terminate the provisions set for their marketing pursuant to Article 93 Bis of Directive 2009/65/EC.