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Why Spain's 50-year bond auction will cap a return to favour

Yield-hungry investors are coming back to a country seen as having 'done its homework'

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Seven years ago, investors all but refused to lend to the Spanish government, pushing the eurozone close to breaking point. Today, they are on the brink of paying for the privilege of lending to the country for maturities of up to a decade.

Spain's 10-year borrowing costs — along with those of its neighbour Portugal — have sunk to within a whisker of zero, carried by a mighty global bond rally which has seen the volume of negative-yielding debt around the world mushroom to some $17tn. On Thursday, a sale of new 50-year Spanish bonds is expected to fetch a yield of roughly 1.5 per cent, if it prices in line with the secondary market.

For investors who recall the height of the eurozone crisis, when Spain's 10-year yield spiked above 7 per cent, membership of the sub-zero club would cap a stunning turnround.

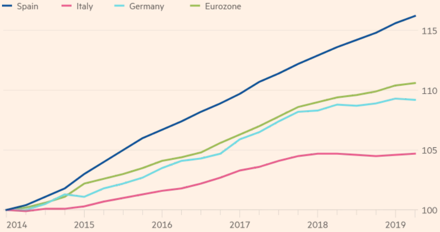
"It's pretty remarkable," said Michael Krautzberger, head of European fundamental fixed income at fund manager BlackRock. "If you had told me six or seven years ago Spanish yields would go to zero, I think I would have taken the other side of that bet."

Back then, the crisis in Spanish bond markets fuelled fears Madrid would require a sovereign bailout and prompted European Central Bank president Mario Draghi's now famous pledge in August 2012 to do "whatever it takes" to save the euro.

Spain's economic recovery has been strong

Real gross domestic product, rebased

Feedback



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The hunger for Spanish bonds today in part reflects the strength of the country's economic turnround since the crisis, which has outpaced its eurozone peers. But the collapse in borrowing costs chiefly reflects a scramble for any relatively stable asset that yields more than zero.

Investors are surveying a landscape where the ECB's deposit rate is expected to remain negative as far as the eye can see, the central bank's bond-buying programme is expected to return, and all of Germany's debt — the region's benchmark safe asset — yields less than zero. Against that backdrop, an extra 0.9 percentage point to lend to Spain over 10 years looks attractive.

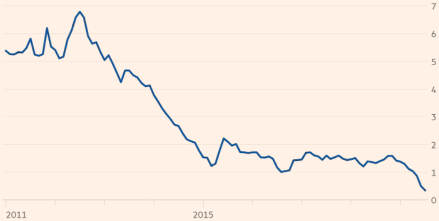
"If you are an institutional investor, the risk-free zero isn't there any more," said Mr Krautzberger. "If you look at absolute yields, it's easy to conclude that everything is far too expensive, but when you look at spreads there are still some opportunities."

Amid the gloom over global growth prospects, investors find the Iberian peninsula a relatively sunny spot within Europe. Even as Germany looks headed for a recession, annual growth rates in Spain and Portugal remain above 2 per cent, after good progress in cutting budget deficits, bolstering investor confidence in their bonds.

"Spain is perceived as a country that's done its homework," said Angel Talavera, head of European economics at Oxford Economics. Political instability — there has been no permanent government in Madrid since April's election — has been shrugged off by markets.

Spanish borrowing costs have collapsed

10-year government bond yield (%)



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Investors calculate that none of the major political parties is likely to initiate an Italian-style clash with Brussels by pushing for higher spending, according to Mr Talavera. "Even with a socialist government, Spain has been committed to reducing the deficit. We haven't seen the kind of shenanigans you've had in Italy," he said.

It is unlikely this would have been possible without Mr Draghi's intervention.

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The ECB's promise to step in and buy the debt of struggling eurozone members prevented yields from spiralling out of control and helped to more or less banish existential fears over the future of the currency area.

Iain Stealey, head of international fixed income at JPMorgan Asset Management, said this success contrasts with the ECB's broader failure to spark inflation and kick-start growth across the eurozone with its aggressive monetary policy.

"If you think back to 2012, there was a real fear of eurozone break-up. For the most part that's gone from the market's mindset," he said. "As yields go lower and lower, the cost of finance for governments goes down. It's a virtuous circle and ultimately ECB policy seems to have worked in areas like Spain and Portugal. You have to credit Draghi with that."

That logic has drawn a broader range of buyers back into Spain's bond markets.

"The Spanish market has been one of the big beneficiaries of Asian money coming into European markets," said Regina Borromeo, who oversees a bond portfolio at Dutch asset manager Robeco and currently favours Spanish government and corporate debt.

According to Ms Borromeo, investors such as Japanese pension funds have been more reluctant to dip their toes back into Italy's debt — at least until recently — given the big swings that continue to characterise Italian bond markets.

Indeed, the relative tranquility of Spain's markets has seen it gradually uncouple from Italy's, a change from the crisis-era playbook which saw the two generally moving in tandem. Instead, many investors now group it along with countries like France or Belgium, which attract a small — and shrinking — yield premium compared with Germany.

"Spain is no longer the periphery as far as investors are concerned," said Isobel Lee, head of global bonds at Insight Investment, another fund manager. "These days that's only really Italy and Greece."

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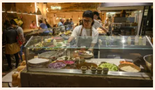

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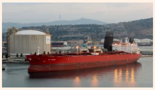

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Danmalin 2 hours ago

watch that yield go if the ECB is seen to back away from more QE....

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Wondering 2 hours ago

Sounds as great as the 100 year Argemtina bonds. To lend a government with such a high debt to gdp ratio this long for so little is foolish.

Report Share Recommend | Reply

Sunny London 2 hours ago

Spain's lending costs are a noteworthy development. But the bond market is no longer an independent indicator on economic conditions or investors' macro expectations. Since the ECB's expansive QE policy, the bond market (and especially sovereigns) have become a slave of central bank policy. EU sovereign borrowing costs are largely reflective of what the ECB is doing rather than any kind of a prediction of what's happening in the economy. The same is true in the US, although not as stark as central bank rates are not negative.

I'm not taking anything away from Spain's great recovery. I think it is a great reflection on structural changes in the bureaucracy and legal ground rules. This is less so in Portugal, but even there we've seen some positive structural changes in bureaucratic simplification and removal of a few bizarre incentives. These are all good things for society.

Report Share Recommend | Reply

Effix 2 hours ago

property market is red hot, according to these articles : "L'Espagne en pleine spéculation immobilière", Lesechos.fr, 01/07/2019 ; "Grisée par la reprise, l'Espagne craint une nouvelle bulle immobilière", Lesechos.fr, 06/03/2019. and household saving rate is at all-time lows (CaixaBank ; Eurostat). like in 2007, no ?

government investment is extremely low (Eurostat). fertility also extremely low, at 1.25 ("Spain : 40% fewer babies in 11 years", Alliancevita.org, 20/06/2019) : because of widespread social dumping and welfare cuts, I guess.

I hope Spain will be able to rebalance. but I am a bit skeptical.

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> **Sunny London** 2 hours ago
>
> **@Effix** The property market is largely a reflection of unusually low mortgage rates, again a reflection of ECB policy. In Denmark (as the extreme example), you can lend at negative rates and effectively the bank pays you to take their money. There are still loan fees and points and things, so it isn't free money (the bank has to make a return somewhere), but the loan itself has a negative rate. No surprise then that housing prices continue to rise to exorbitant levels.
>
> Report Share Recommend | Reply

Codigo 3 hours ago

Spanish are great, have a very optimistic disposition. Best country in EU in my opinion.

Report Share 3 Recommend | Reply

Sideliner 3 hours ago

One major feature of the period intervening between the near-bankruptcy of Spain in 2012 and the strong recovery in place in 2018 is conspicuously missing in the article. During that time, the country benefited of key reforms under the steady hand of the conservative government of PM Mariano Rajoy.

Foreign current account revenues climbed from BEUR 309 in 2012 to BEUR 400 in 2018. That was due to lower costs, nimbler economic management and plain good government. Check the equivalent figures for Greece, a country also under the remit of Mario Draghi, and decide whether something other than ECB policies was at play here.

"Political stability" is a good thing only insofar as the stable government is good. Note that Venezuela has been run by the same party for over a decade, and the result isn't encouraging. The current PM of Spain, Pedro Sánchez, staged a whopping 22% raise of the minimum wage as soon as he took office in 2018. Subsequent employment figures published in August 2019 are the worst since 2008. Now, Mr Sánchez is negotiating to apply the economic manifesto of far-left Podemos to Spain. Incidentally, key representatives of Podemos were hired to design the economic policies of (your guessed) Venezuela.

Allocating the credit where it is due is not only a matter of justice. It helps readers make sound business decisions.

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> **Thinkofitthisway** 2 hours ago
>
> What a lucky man this Mr Sanchez. Reaping the benefits of earlier reforms he was vehemently criticising.
>
> Report Share 1 Recommend | Reply

> **.** 2 hours ago
>
> If the present government's policies are so disastrous, why is everyone so keen to buy Spanish government bonds?
>
> Report Share Recommend | Reply

Sunny London 2 hours ago

@Sideliner Exactly right. Those reforms and similar reforms elsewhere are critical for a sustainable recovery.

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+ 1 reply

regular visitor 3 hours ago

Zero borrowing costs on 10 year bonds is a remarkable achievement for Spain given that it has defaulted more than any other country. 6 times in the eighteenth century and 7 times in the nineteenth. But none since, although it came close in 2008. !00 year bonds at zero cost could be the next big target for international investors....

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senior jauna 2 hours ago

@regular visitor Good historical point but wrong century. Without checking, I bet the century of the 6 defaults was not eighteenth but seventeenth.

Report Share 2 Recommend | Reply

regular visitor 1 hour ago

@senior jauna @regular visitor my source is different but either way it happened

Report Share 1 Recommend | Reply

senior jauna 4 hours ago

The Spanish success is due to three features that reasonable analysts would consider defects.

1) Spain obsession with owning a house and never ever give up on paying the mortgage

2) Contract variable rates mortgages linked to ECB rates

As a result of 1 and 2, every reduction of rates by ECB was an increase in money available for families

3) The left wing government has been unable to come with new budgets and was forced to continue living with the prorogued last right wing budget

This has produced a “centrist” public expending profile.

Report Share 6 Recommend | Reply

Namely 4 hours ago

and soon not even Greece

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