

EA Rates Strategy

SPAIN AND ITALY BEAT FRANCE

Starting the year, we present our views on country allocation within an EGBs portfolio.

Based on our EA scorecard and qualitative assessments, we suggest:

- ▶ *Overweight BTPs and SPGBs. Despite the periphery significantly outperforming the core, it has shown remarkable resilience during the recent global bond sell-off. We expect it to keep benefiting from better macro fundamentals relative to the rest of EGBs and from strong foreign demand.*
- ▶ *Underweight OATs. Weak fundamentals and political instability will make OATs susceptible to volatility throughout the year.*
- ▶ *Moderately overweight Bunds. While Bunds are trading at a premium relative to Germany's macro fundamentals, we believe they will benefit from a more dovish ECB and their position as a European safe asset, making them an effective hedge against increased political tensions in France or a decline in risky assets.*
- ▶ *Regarding maturity, we favor overweighting the 5Y bucket, as it has recently underperformed the rest of the curve on most EGB curves and offers an attractive risk-reward profile.*



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Ranking EA countries in 2025

Starting the year, we present our views on country allocation within an EGBs portfolio. To do this, we first examine the relative positioning of the main EA countries in 2025 according to our EA scorecard (see the Appendix for more details on our scorecard methodology).

Figure 1 shows the ranking of main EA countries in 2025 based on growth, debt metrics, openness to trade, and market valuation, while **Figure 2** compares each country's final score with their 10Y yields. According to our scorecard:

- ▶ While periphery-core spreads have tightened significantly since the end of 2023, core and semi-core countries remain overvalued relative to their fundamentals, while periphery countries continue to trade cheap (**Figure 2**).
- ▶ Within the core group, Germany stands out due to the significant misalignment between fundamentals and valuation (in terms of richness, **Figure 2**). This is also confirmed by **Figure 3**, which compares the rating to the valuation of main EA countries. Compared to other EA countries, Bunds trade much tighter vs. swap than other countries' govies with comparable ratings. In our view, this reflects the fact that Bunds are still largely held by price-insensitive investors (26% by the Bundesbank and 29% by foreign officials at the end of Q2 2024, according to the IMF) and that the outstanding amount of high-rated liquid government bonds in the EA is much lower than in the U.S.
- ▶ Within the periphery, Italy shows the largest misalignment between fundamentals and valuations (in terms of cheapness, **Figure 2**). **Figure 3** also confirms that Italy trades cheaply vs. swap compared to its rating.
- ▶ France ranks poorly in terms of fundamentals, and after the last six months of OATs cheapening compared to the rest of EGBs, its valuation is only slightly cheap compared to its fundamentals.

FIGURE 1.

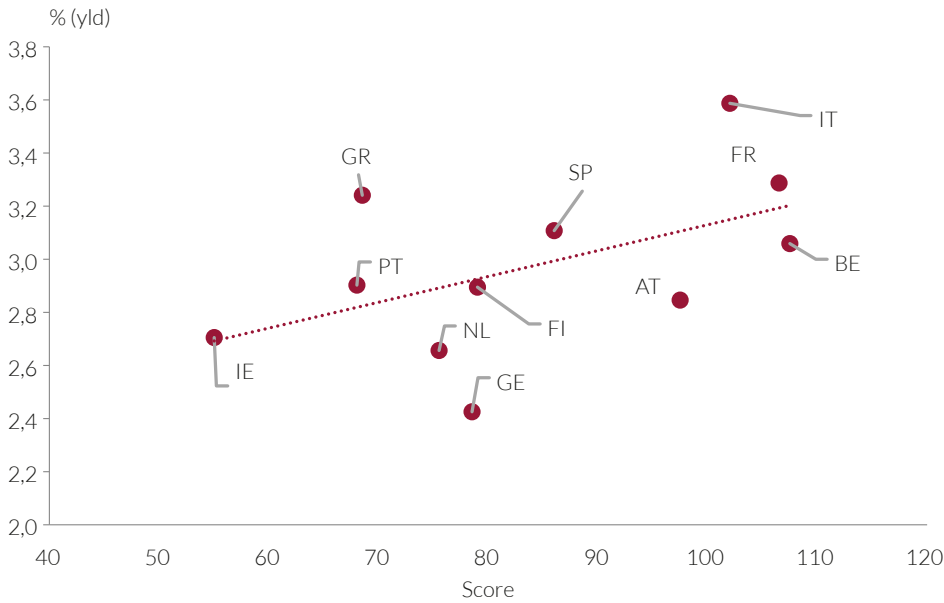
Relative positioning of main EA countries according to fundamentals

| Ranking from best to worst | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| GDP Growth (YoY) | IE | SP | GR | PT | NL | FI | BE | IT | AT | FR | GE |
| Primary Balance (as % of GDP) | GR | PT | IE | IT | SP | GE | NL | FI | AT | BE | FR |
| Implicit Interest rate (as % of Public Debt) | IE | GE | NL | FI | AT | GR | BE | FR | PT | SP | IT |
| Current expenditure ex interest (as % of GDP) | IE | PT | GR | SP | NL | IT | GE | BE | AT | FR | FI |
| Public Debt (as % of GDP) | IE | NL | GE | AT | FI | PT | SP | BE | FR | IT | GR |
| Delta Net supply 2025 vs. 2024 | FR | IT | GE | SP | FI | GR | PT | AT | BE | IE | NL |
| % of Public Debt held by foreigners (ex foreign officials) | GR | NL | GE | PT | IT | IE | FI | SP | FR | AT | BE |
| Avg. Share of Imps & Exps of Goods ex intra-EU trade (% of World Trade) | PT | GR | FI | AT | IE | BE | SP | IT | FR | NL | GE |
| Cheap/rich market indicator (Z-Score) | FR | GE | BE | NL | SP | IE | PT | FI | AT | GR | IT |
| Beta to Swap rate | IT | GR | FR | AT | FI | SP | PT | NL | BE | GE | IE |
| Final score | IE | GR | PT | NL | GE | FI | SP | AT | IT | FR | BE |

Source: IMF, EC, Haver Analytics, Bloomberg, ANIMA Research

FIGURE 2.

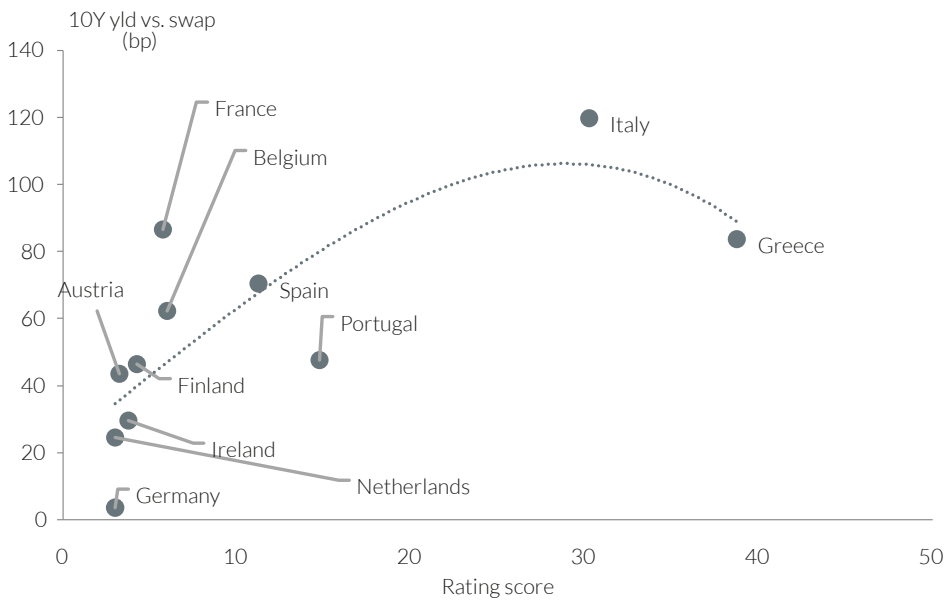
Cheap/Rich EA countries according to our scorecard



Source: IMF, EC, Haver Analytics, Bloomberg, ANIMA Research

FIGURE 3.

Rating vs. markets



The rating score on the X-axis represents the average of ratings and rating outlooks by S&P, Moody's and Fitch
Source: Bloomberg, ANIMA Research

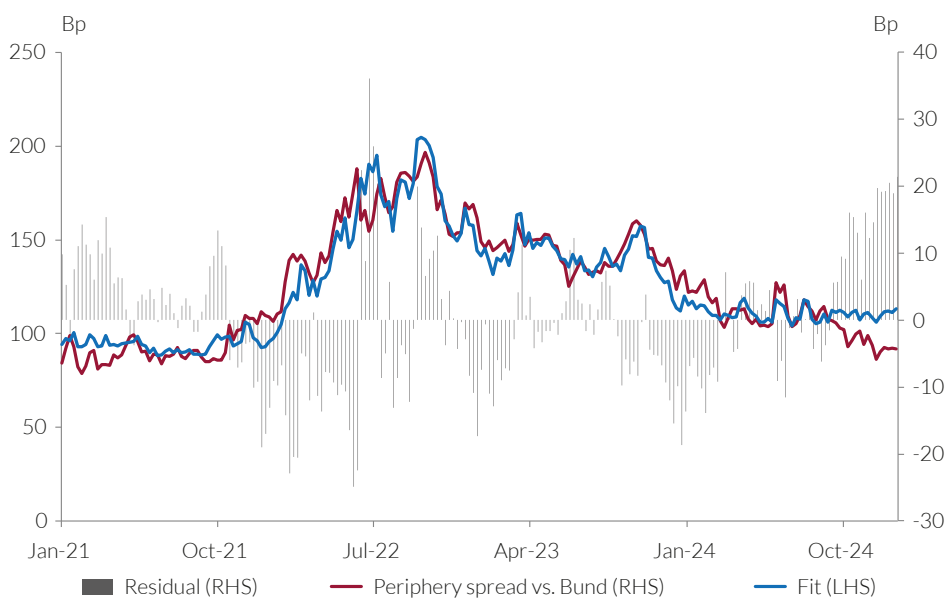
Our take

Taking into account our scorecard indications, and focusing on the most liquid markets within EGBs, our recommendation for this year is to overweight SPGBs and BTPs in portfolios, moderately overweight Bunds, and underweight OATs. The reasons are as follows:

- 1) While **Figure 4** shows that periphery spreads have outperformed credit spreads, we note the resilience of periphery spreads in the recent global core bond sell-off. This suggests that despite rich valuations, demand for periphery paper remains strong. This should be even more pronounced in the context of a more dovish ECB going forward (our baseline).

FIGURE 4.

Periphery spreads have outperformed credit spreads



The model regresses a periphery spread vs. swap (constructed as an average of Spain, Italy, Portugal and Greece spreads weighted by their respective capital keys, on Itrx Main 5Y).

Source: Bloomberg, ANIMA Research

- 2) Aside from improving macro fundamentals compared to core and semi-core countries, the periphery will continue to receive support from the Recovery and Resilience Fund (RRF). The ECB's recent monthly Bulletin¹ analysis shows that Italy and Spain's GDP will benefit disproportionately from RRF funds compared to the rest of the EA (**Figure 5**).

¹ - https://www.ecb.europa.eu/press/economic-bulletin/articles/2025/html/ecb.ebart202408_03~04121f4ea9.en.html

FIGURE 5.

Estimated impact of the fiscal channel of the RRF on the GDP level of the euro area, Italy and Spain (percentage deviation from baseline)

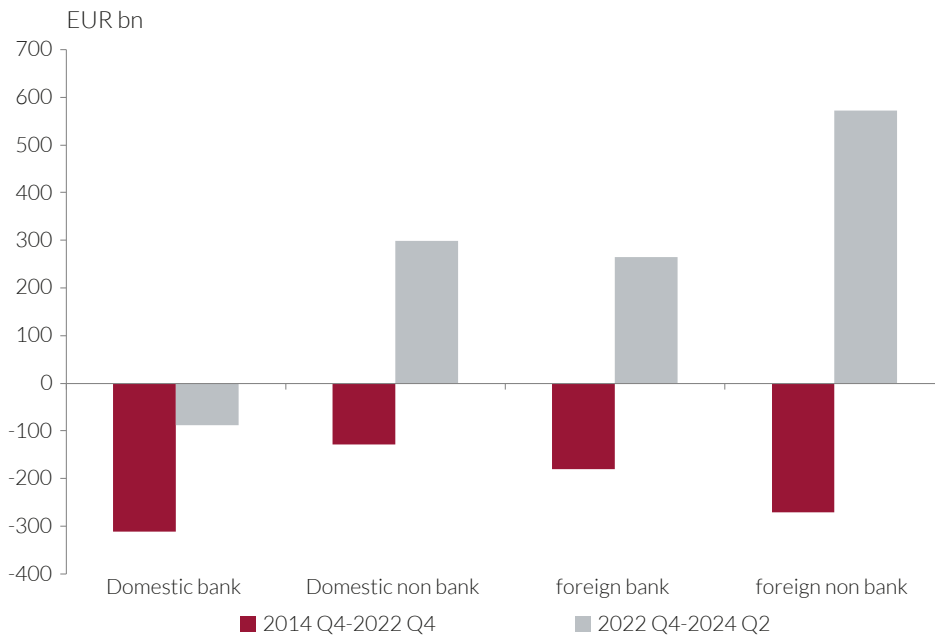
| Absorption of RRF funds | Productivity of RRF funds | Up to 2026 | | | Up to 2031 | | |
|-------------------------|---------------------------|------------|------------|------------|------------|------------|------------|
| | | EA | IT | SP | EA | IT | SP |
| High in 2024-2026 | High | 0,8 | 1,9 | 1,7 | 0,6 | 1,5 | 1,4 |
| | Medium | 0,5 | 1,4 | 1,4 | 0,3 | 0,7 | 0,9 |
| | Low | 0,5 | 1,3 | 1,2 | 0,2 | 0,6 | 0,7 |
| Low in 2024-2026 | Medium | 0,3 | 0,9 | 0,5 | 0,2 | 0,4 | 0,5 |

Source: ECB staff calculations based on data from the ESCB Working Group on Public Finance (WGPF), Anima Research

- 3) While OATs have cheapened considerably since June last year, a combination of weak fundamentals compared to EGB peers, worsening fiscal metrics, and political uncertainty could lead to further volatility in the coming months. We currently see 100bp as the ceiling for the 10Y OAT-Bund spread, but this could be breached if there is no agreement on the 2025 budget and the deficit approaches 7% of GDP. Moreover, there is a high probability of new parliamentary elections being called again this summer. Given this backdrop, we view OATs as more suitable for very short-term tactical trades this year rather than for a strategic portfolio.
- 4) After selling EGBs during the QE period, foreigners have significantly increased their exposure to EGBs over the past few months (**Figure 6**). Some investors without particularly stringent rating requirements may prefer to buy periphery paper, especially SPGBs and BTPs, rather than OATs. This is the case, for instance, with Japanese investors. Although this trend is not yet fully reflected in the statistics, we observe that:
 - ▶ In September and November, the inflows of Japanese investors into BTPs reached its highest levels since October 2023 (**Figure 7**).
 - ▶ Following the last surge in yields, for a Japanese investor investing in a 10Y BTPs has become moderately more attractive than investing in 10Y JGBs even when hedging for the currency exposure (**Figure 8**).

FIGURE 6.

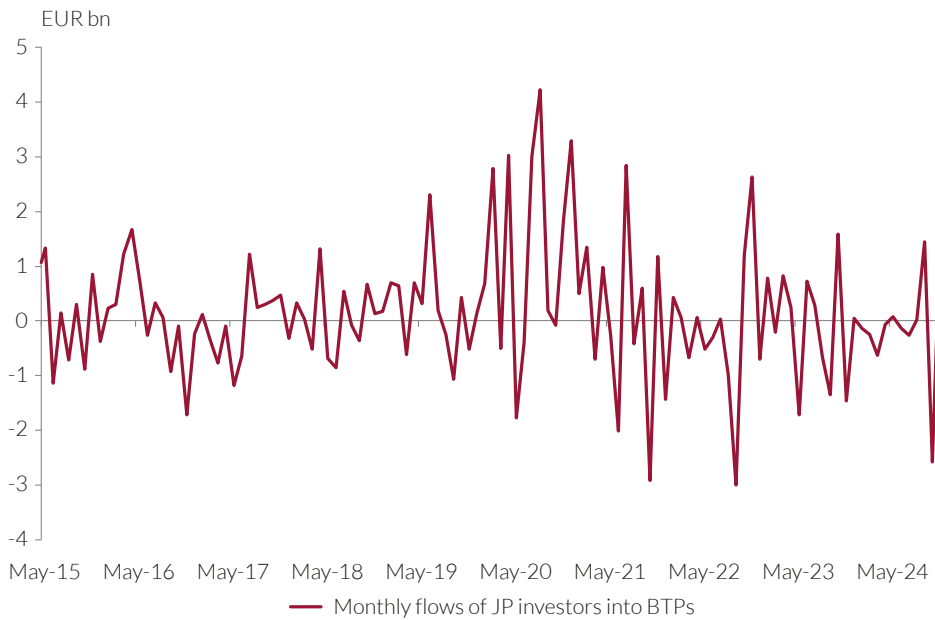
Flows of selected investors into Eurozone public debt instruments



Source: IMF, ANIMA Research

FIGURE 7.

Monthly inflows of Japanese investors into BTPs



Source: Japanese MOF, Bloomberg, ANIMA Research

FIGURE 8.

Yield pick-up/give-up for Japanese investors in 10Y currency-hedged EGBs



Source: Bloomberg, ANIMA Research

5) Our scorecard reveals that Bunds are overpriced relative to other EGBs due to rapidly deteriorating economic fundamentals. Additionally, general elections are scheduled for the end of February. Despite this, we recommend moderately overweighting Bunds in a portfolio for these reasons:

- ▶ In the absence of a genuine European safe asset, Bunds are viewed by investors as the best alternative and serve as a reliable hedge against rising political tensions in France or a downturn in risky assets.
- ▶ German's public debt is expected to stay very low at 63% of GDP in 2025, with most of it still held by price-insensitive investors.
- ▶ We do not anticipate a significantly larger deficit in Germany after the elections at the end of February.
- ▶ German government paper has already seen a substantial cheapening versus swaps.
- ▶ We anticipate a potential rally from current levels as the ECB adopts a more dovish stance and EA services inflation starts to decline.

5Y is our favorite area of the EGB curves

Figure 9 illustrates that the final stage of the bond sell-off since early December has significantly cheapened the 5Y area vs. other maturities on the main EGB curves. Although extending to the 10Y area would provide additional yield pick-up following the recent curve steepening, Figure 9 indicates that the 10Y area is not as cheap as the 5Y area, and the longer duration makes it riskier.

FIGURE 9.

Z-score of spreads and barbells across selected EGBs curves

| 30 days Z-score | 2/5 | 5/10 | 2/10 | 5/7 | 7/10 | 10/15 | 15/30 | 10/30 | 2/5/10 | 3/10/30 | 5/10/15 | 10/15/20 | 10/15/30 |
|-----------------|-------|------|-------|------|-------|-------|-------|-------|--------|---------|---------|----------|----------|
| GE | 1,15 | 0,20 | 0,84 | 2,02 | -1,23 | -0,94 | 1,52 | 0,31 | 1,71 | -0,35 | 0,43 | -1,82 | -1,92 |
| IT | 0,83 | 0,55 | 0,75 | 0,42 | 0,15 | -0,17 | 0,26 | 0,18 | 0,94 | -0,26 | 0,58 | -0,58 | -0,31 |
| FR | 0,82 | 0,44 | 0,70 | 0,70 | 0,21 | 0,40 | 0,10 | 0,82 | 0,95 | 0,20 | 0,18 | 0,23 | 0,19 |
| SP | -0,24 | 0,47 | -0,01 | 0,37 | 0,54 | 1,06 | 0,83 | 1,25 | -0,74 | -1,26 | 0,23 | - | 0,25 |

The table illustrates the 30-trading day Z-scores of selected spreads and barbells across EGB curves. Green indicates the spreads/barbells that have seen the greatest cheapening, while red highlights those that have seen the greatest richening.

Source: Bloomberg, ANIMA Research

Appendix

Our scorecard ranks major EA countries based:

- 1) GDP growth expected in 2025
- 2) Primary balance/GDP ratio in 2025
- 3) Implicit interest rate/public debt ratio in 2025
- 4) Current expenditure excluding interest/GDP ratio in 2025
- 5) Public debt/GDP ratio in 2025
- 6) The difference between net supply in 2025 and 2024 (excluding buying or selling from the Eurosystem)
- 7) The portion of public debt held by foreigners, excluding foreign officials
- 8) The share of trade (excluding intra-EU trade) of each EA country as a portion of world trade. This indicator measures the vulnerability of a country to de-globalisation
- 9) An indicator of richness/cheapness of each country's bond market based on its performance in the last three months
- 10) The beta of weekly changes in 10Y yield relative to 2Y swap rate over the last three months, as an indicator of sensitivity to ECB rates hikes

To assign a score to each country, we rank them from best to worst based on each variable and then calculate a weighted sum of their scores. Higher weights are assigned to public debt, GDP growth and implicit interest rate.

FIGURE 10.

EA countries' scorecard: variables

| | IT | FR | GE | SP | NL | BE | AT | PT | GR | IE | FI |
|--|--------|--------|-------|--------|--------|--------|-------|-------|--------|--------|-------|
| GDP Growth (YoY) | 1,0% | 0,8% | 0,7% | 2,3% | 1,6% | 1,2% | 1,0% | 1,9% | 2,3% | 4,0% | 1,5% |
| Primary Balance (as % of GDP) | 0,5% | -2,7% | -0,9% | -0,1% | -1,1% | -2,6% | -2,2% | 2,5% | 2,9% | 2,0% | -1,5 |
| Implicit Interest rate (as % of Public Debt) | 3,0% | 2,3% | 1,8% | 2,6% | 1,9% | 2,3% | 1,9% | 2,3% | 2,0% | 1,5% | 1,9% |
| Current expenditure ex interest (as % of GDP) | 41,5% | 48,9% | 43,4% | 38,9% | 40,0% | 47,5% | 48,1% | 36,7% | 37,1% | 20,2% | 50,3 |
| Public Debt (as % of GDP) | 138,2% | 115,3% | 63,2% | 101,3% | 44,3% | 105,1% | 80,8% | 92,9% | 146,8% | 38,3% | 84,7% |
| Delta Net supply 2025 vs. 2024 | 6,69 | 24,49 | 6,56 | 3,41 | -19,98 | -2,93 | -1,11 | -0,36 | 1,23 | -15,11 | 1,66 |
| % of Public Debt held by foreigners (ex foreign officials) | 23% | 33% | 18% | 30% | 15% | 43% | 43% | 18% | 3% | 23% | 28% |
| Avg. Share of Imps & Exps of Goods ex intra-EU trade (% of World Trade) | 1,4% | 1,5% | 3,5% | 1,0% | 1,8% | 0,9% | 0,3% | 0,1% | 0,2% | 0,4% | 0,2% |
| Cheap/rich market indicator (Z-Score) | 1,68 | 2,23 | 2,17 | 1,91 | 1,94 | 1,96 | 1,82 | 1,90 | 1,78 | 1,91 | 1,87 |
| Beta to Swap rate | 1,21 | 0,98 | 0,90 | 0,96 | 0,94 | 0,92 | 0,98 | 0,95 | 1,13 | 0,89 | 0,96 |

Source: Bloomberg, IMF, Haver Analytics, ANIMA Research.

FIGURE 11.

EA countries' scorecard: score calculation

| Weights | Variable | Score | | | | | | | | | | |
|---------|---|------------|------------|-----------|-----------|-----------|------------|-----------|-----------|-----------|-----------|-----------|
| | | IT | FR | GE | SP | NL | BE | AT | PT | GR | IE | FI |
| 2 | GDP Growth (YoY) | 8 | 10 | 11 | 2 | 5 | 7 | 9 | 4 | 3 | 1 | 6 |
| 1 | Primary Balance (as % of GDP) | 4 | 11 | 6 | 5 | 7 | 10 | 9 | 2 | 1 | 3 | 8 |
| 2 | Implicit Interest rate (as % of Public Debt) | 11 | 8 | 2 | 10 | 3 | 7 | 5 | 9 | 6 | 1 | 4 |
| 1 | Current expenditure ex interest (as % of GDP) | 6 | 10 | 7 | 4 | 5 | 8 | 9 | 2 | 3 | 1 | 11 |
| 2 | Public Debt (as % of GDP) | 10 | 9 | 3 | 7 | 2 | 8 | 4 | 6 | 11 | 1 | 5 |
| 1,5 | Delta Net supply 2025 vs. 2024 | 2 | 1 | 3 | 4 | 11 | 9 | 8 | 7 | 6 | 10 | 5 |
| 1,5 | % of Public Debt held by foreigners (ex foreign officials) | 5 | 9 | 3 | 8 | 2 | 11 | 10 | 4 | 1 | 6 | 7 |
| 1,5 | Avg. Share of Imps & Exps of Goods ex intra-EU trade (% of World Trade) | 8 | 9 | 11 | 7 | 10 | 6 | 4 | 1 | 2 | 5 | 3 |
| 1 | Cheap/rich market indicator (Z-Score) | 11 | 1 | 2 | 5 | 4 | 3 | 9 | 7 | 10 | 6 | 8 |
| 0,5 | Beta to Swap rate | 1 | 3 | 10 | 6 | 8 | 9 | 4 | 7 | 2 | 11 | 5 |
| | Final score | 102 | 106 | 78 | 84 | 75 | 109 | 98 | 71 | 69 | 53 | 82 |

Source: Bloomberg, IMF, Haver Analytics, ANIMA Research

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