

OATs have widened – now what?

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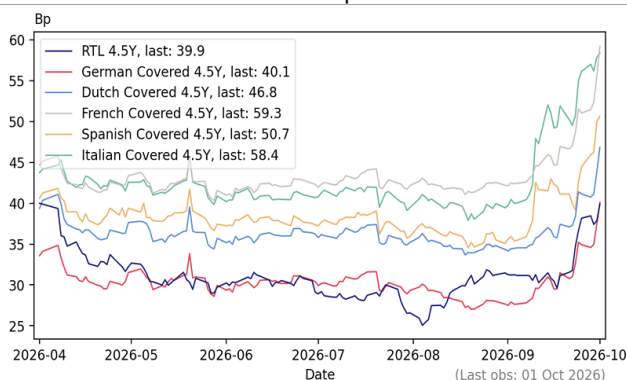
Marketing communication

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- German/French yield spreads have doubled this year!
- 5-year probability of French default up from about 2.6% to 6.4% in September
- Very moderate spillover to Danish covered bonds.

French risk premiums rose considerably during late summer. French 5Y CDS moved from around 31bp at the beginning of August to just over 77bp in early October, while the market-implied 5-year probability of default increased from about 2.6% to 6.4%. At the same time, OAT spreads widened sharply, driven by both political and fiscal uncertainty as well as technical market pressure. The turbulence also spilled over into the European covered bond market, but Danish bullets have so far shown relative resilience and have only been moderately impacted.

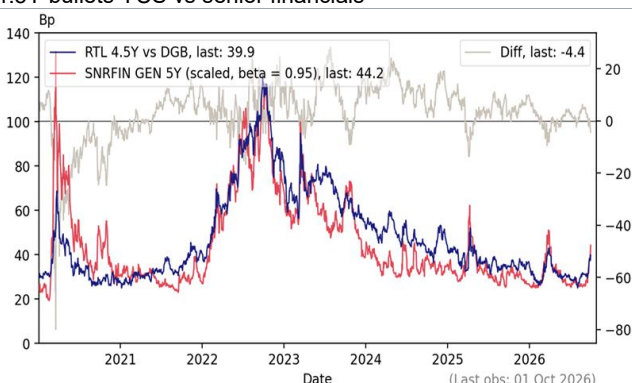
Bullets and EUR covered bonds: Spreads vs DGB/DBR



Significant spread widening in covered bonds relative to DBR and DGB.

Source: Bloomberg, Nykredit Markets

4.5Y bullets YCS vs senior financials



Spread between bullets and generic senior financials of around -4bp.

Source: Bloomberg, Nykredit Markets

French government bond yields have risen markedly, and particularly, the spread to German government bonds has widened. This primarily reflects a rising political and fiscal risk premium on France.

The market remains uncertain as to whether the government can secure a majority behind a credible budget for 2027. The plan to bring the deficit down towards 5% of GDP requires substantial savings, but it remains unclear how much of the consolidation can realistically be implemented politically.

In 2027, the presidential election is approaching, and uncertainty is increasing over both the economic policy of the next government and the prospects for a stable parliamentary majority.

Large stop-loss selling in OAT futures

The latest interest rate movements, however, appear larger than can be explained by the political news flows alone. OAT-Bund spread widened by almost 15bp yesterday without any significant new headlines.

This suggests that market positioning has also played a significant role. Large stop-loss selling in OAT futures, combined with few investors being willing to buy the dip, is likely to have amplified the move.

The increase in French yields is thus a combination of a higher structural risk premium for fiscal policy and political uncertainty, as well as short-term technical market effect.

French 5Y CDS rose from around 31bp at the beginning of August to 77bp on 2 October, representing more than a doubling over two months. The corresponding market-implied 5-year probability of a French default has increased from approx 2.6% to 6.4%.

This move illustrates the sharp increase in the risk premium

investors demand for French sovereign debt/bonds – particularly since mid-September.

The spillover effect from the French turbulence is evident in the European covered bond market. Spreads have widened across several countries, but the move is clearly largest in French covered bonds, where the 4.5-year spread vs €STR is now around 60bp.

Spanish and Italian covered bonds have also been affected, while German and Dutch bonds have been more resilient. The move suggests that the market is pricing not only higher French sovereign risk but also demanding a larger risk premium on European financial credit and covered bonds more generally.

This is natural, as higher sovereign spreads affect both banks' funding levels and relative value across the covered bond market.

Danish bullets have also prompted a widening, but to a markedly lesser extent. 4.5Y bullets are currently trading at around 35bp over €STR and around 40bp over Danish government bonds, which remains low relative to French, Italian and Spanish covered bonds. Bullets are therefore still priced broadly in line with Dutch and German covered bonds vs government bonds, while Denmark is benefiting in the current environment from its fiscal discipline.

As a result, the spread widening in bullets has also been smaller than in senior financials.

The recent move has so far had only a moderate spillover effect on Danish covered bonds. The French turbulence has lifted the general level of spreads, but Danish covered bonds have so far shown considerable relative resilience.

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As at 13.12.2024

Note: Distribution of our recommendations, which therefore add up to 100%.

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