

CORRIERE DELLA SERA

Pimco fears another global recession «Investing in Italian government bonds? When the spread hits 250»

The American investment management firm: risks are underestimated. The ECB: structural reforms are falling short

By Marco Sabella

«We will go "overweight" in Italian BTPs (government bonds) when the prices of these issues will fall. For the time being, we have lowered our rating on Italy's public debt to "neutral" because we believe yields do not currently reflect the underlying risk». Scott Mather, Chief Investment Officer US at Pimco (Pacific Investment Management Company), one of the world's largest institutional investors with more than 1.5 trillion dollars in assets under management, strikes a cautious note on Italian sovereign debt.

In recent years, Pimco—which is based in Newport Beach, California, and joined the Allianz group in 2000—has been one of the largest international investors in Italian government bonds and has profited handsomely from the declining spread relative to German Bunds. «It is hard to say if and when we will start adding again to our position in Italian government bonds. This could happen when the spread hits 250 points or has risen by approximately one hundred points from the current level (166). But we will see when the time comes: if the spread rises, it will be for a reason—almost certainly related to a deterioration in the country's outlook».

More generally, Pimco's Chief Investment Officer remains cautious because of the medium-term market view. This scenario is not particularly bullish for the world economy: the Secular Outlook—a report on the market outlook for the next 3-5 years—that Mr Mather presented in Milan assigns a 70% probability to a new global downturn within the next five years. According to Pimco, investors are seriously underestimating the risk associated with more volatile financial assets such as equities. «The current economic scenario is significantly different from ten years ago», says Mr Mather. Globalisation is in retreat and the restrictions on international trade imposed by the neo-protectionist policies of the United States and other countries could stifle global growth. «When the next recession hits, monetary policies will have limited effectiveness, central banks will have little room for manoeuvre, and only a few countries without excessive budget deficits will be able to implement the required anti-cyclical measures», explains Mr Mather.

His concern was echoed today by the ECB in its latest Economic Bulletin, which points out that in a number of countries «structural adjustments are falling short of the requirements of the Stability and Growth Pact (SGP) despite improving economic conditions». The Bulletin adds that

«looking ahead, such countries risk being constrained in using fiscal policy in a stabilising manner during the next downturn and may even need to revert to pro-cyclical tightening of budgetary policies. Possible increases in interest rate levels could exert additional budgetary pressures». The reference to Italy—which is expressly mentioned only to say that «the decision on opening a debt-based excessive deficit procedure was postponed»—is clear.

That said, Pimco's Secular Outlook provides some reassurance. «If the situation deteriorates again, we do not expect a dramatic crisis as that of 2011 and 2012. Instead, the risk is that economic imbalances between eurozone member states will continue widening and exacerbating differences because of the lack of a shared and coordinated fiscal and budgetary policy». Mr Mather rules out a breakup of the euro or Italy's exit from the single currency. However, political uncertainty weighs on the outlook for the spread between Italian and German government bonds. «As elections draw near, the spread will likely widen again. This trend has been less apparent only because the vote has been delayed», he says.

The fund



- Pimco, Pacific Investment Management Company, is a global investment management firm based in California with over 1.5 trillion dollars in assets under management.
- The group has long been overweight in Italian government bonds, but recently it has reduced its position to neutral.
- According to Pimco's Chief Investment Officer Scott Mather (pictured), the risk inherent to some financial assets, including Italy's government bonds, is not adequately rewarded.



A year in the Bund - BTP spread

Yesterday it stood at 166 points

The BTP 10-year yield

Yesterday it was 1.91%