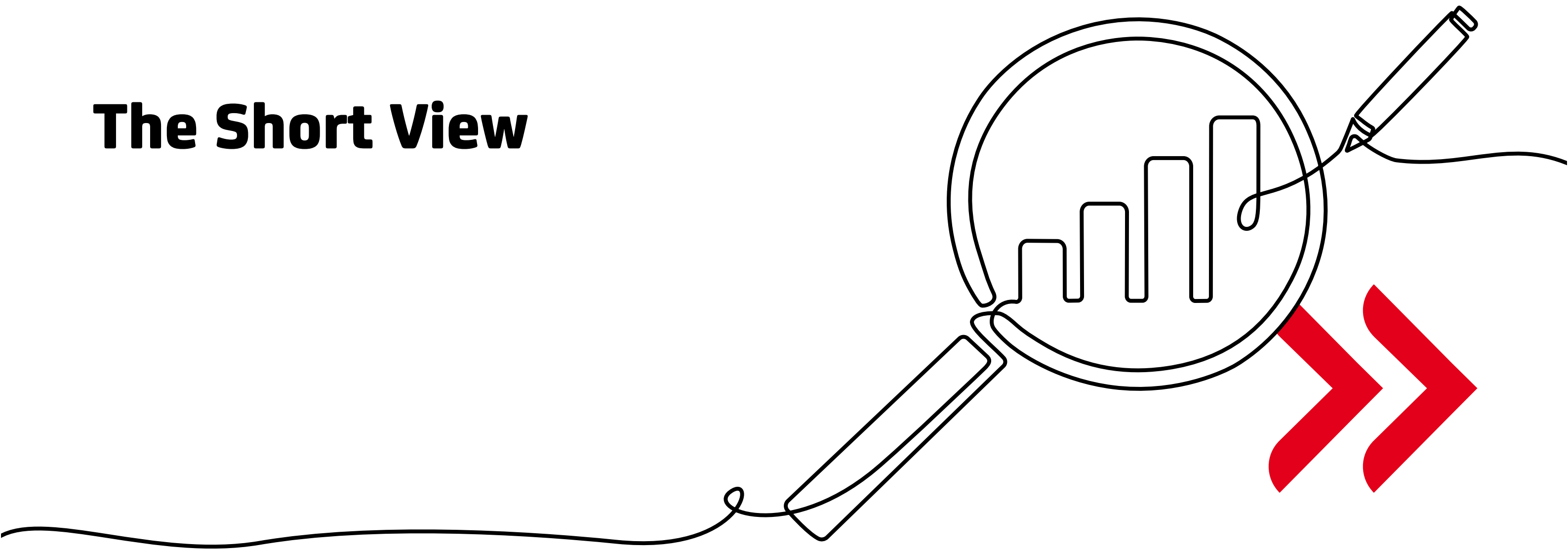
The Short View



The Short View is our new publication offering insights on key macro and market stories, designed to promote discussion and debate.

10/30Y EUR spread: the case for more steepening

4 June 2025

The 10/30Y spread has been on a rising trend across the board recently, and has reverted to positive territory on the EUR swap curve. We discuss the main reason and why we expect more steepening.

1. **Curve steepening at the extra-long end**

   The extra-long end has steepened across the board due to investor concern about excess bond supply and an uncertain inflation outlook. The EUR swap curve is no exception: the 10/30Y yield spread has turned positive for the first time since late 2021.

2. **The 10/30Y: the case for more steepening**

   At around 10bp, the 10/30Y yield spread on the swap curve remains well below the 40bp average observed from January 1999 to Dec 2021. We see more steepening as likely because the ECB is reducing its balance sheet and because there is a case for increasing public spending in the coming years, which should lead to higher term premiums. Any increase in expectations of ECB easing would add to steepening pressure.

3. **The role of pension funds**

   Dutch pension funds have increased interest-rate risk hedging in recent years, causing extra flattening of the swap curve relative to Bunds. This, coupled with a move towards a defined contribution scheme, should reduce demand for long-dated swaps. However, the speed and magnitude of any adjustment remain open questions. Steepening may, hence, occur slowly.

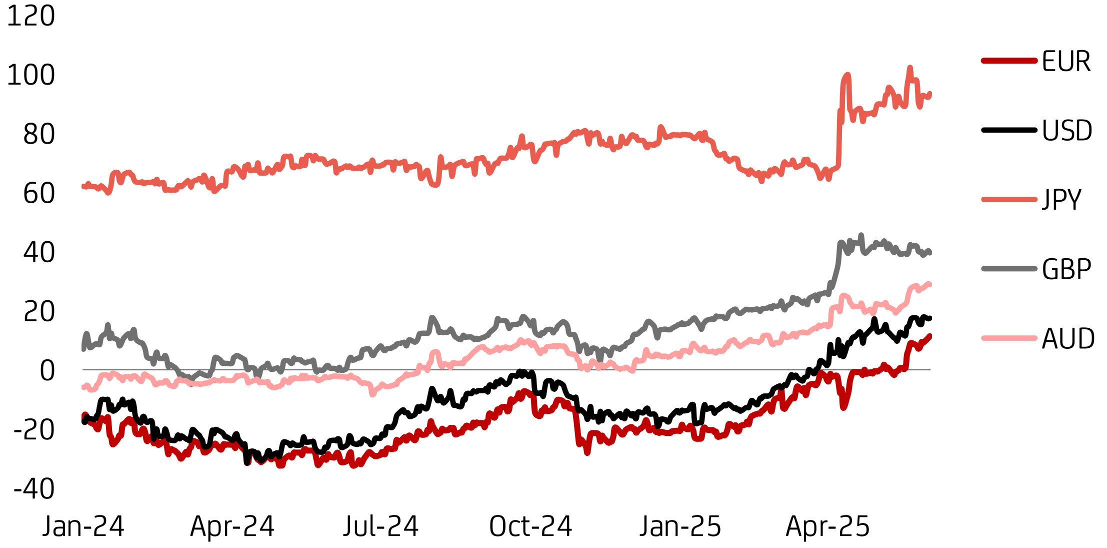
10/30-year spreads have widened across the board

The 10/30Y spread on the EUR swap curve has turned positive again for the first time since late 2021, after more than three years of deep inversion. The move has occurred amid a broader context of curve steepening across the globe in recent weeks. Indeed, a mix of investor concern over excess bond supply and an uncertain inflation outlook has weighed negatively on sovereign bonds. This has resulted in the steepening of the curve.

The increase in yield at the extra-long end has attracted a lot of attention from investors and media, not least because, in the US, the 30Y yield has been hovering around the psychologic level of 5% and because the yield on the 30Y JGB reached an all-time high before easing back after the BoJ conveyed a reassuring message. In this note, we discuss the recent trend the 10/30Y spread has been following and what we expect to see going forward.

CHART 1: EXTRA-LONG STEEPENING IS GENERALISED

SWAP RATES, 10/30Y SPREAD (BP)



Source: Bloomberg, The Investment Institute by UniCredit
Note: EUR swaps are versus 6M Euribor

Monetary policy and the 10/30Y in the eurozone: where things stand

As a starting point, one should consider that, in presence of a central bank that enjoys strong credibility with respect to its inflation mandate, the extra-long end of the curve should be negatively correlated with central-bank rates. This is because the central bank cuts rates when the economy is weak, and vice versa, with the goal of stabilising inflation and growth in the long term. As long as investors trust this, yields at the long end should be less volatile than those at the short end, and this should lead to negative correlation.

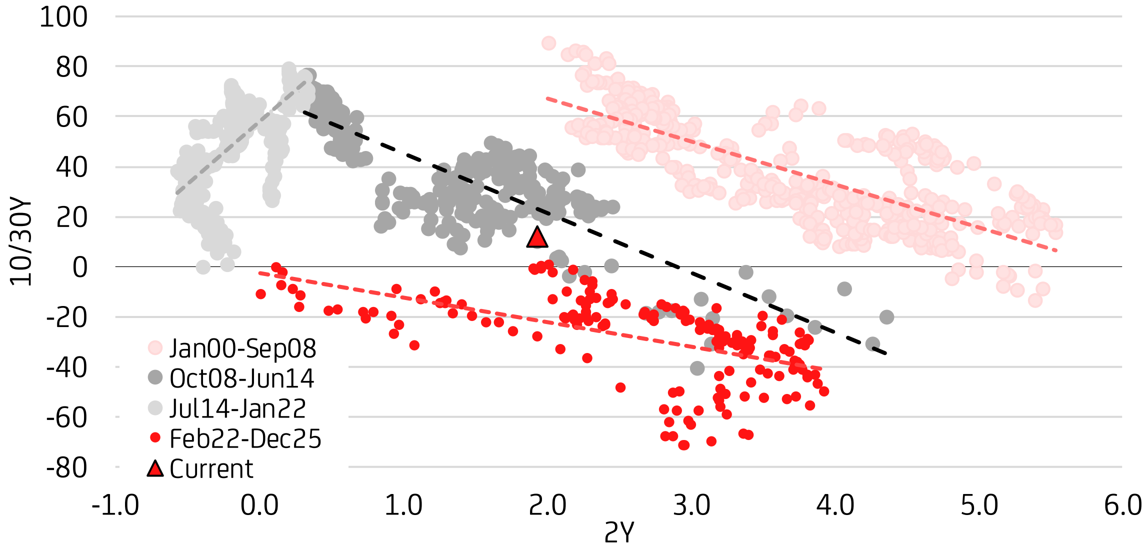
Chart 2 shows that this has indeed been the case for the euro area, with the QE period being an exception because low rates, forward guidance and excess liquidity led to the bull-flattening of the curve. It is also interesting that the relationship has moved through time, with the curve shape becoming progressively flatter. This is reflected by the shift to the left of the curve depicted in Chart 2 (for the same level of short-term rates, the 10/30Y is flatter).

Since the ECB started to tighten monetary policy, the 10/30Y spread has turned negative because ECB policy rates were perceived as being restrictive and investors were discounting policy easing in the future. This led to very flat yield curves, with long-term yields remaining lower than the policy rate.

On top of this, there was added flattening pressure in swaps stemming from hedging needs of various players, especially pension funds. This led to the swap curve flattening more than the Bund curve due to excess demand specific to long-dated swaps (more on this later).

As Chart 2 shows, the 10/30Y spread on the swap curve has reverted to positive territory in the last few days. Where will things may go from here? Given that the ECB is in the process of easing monetary-policy rates to neutrality (or below) and is reducing the size of its bond portfolio, we expect that the period after the financial crisis of 2008-09 and before QE may serve as a good reference, and this suggests there is room for more widening by the 10/30Y yield spread. Any increase in expectations regarding ECB easing would add to the steepening pressure, especially in the short term. We target the 20/30bp area for the 10/30Y spread on the swap curve. The average from January 1999 to December 2021 is 42bp.

CHART 2: 10/30Y AND SHORT-TERM RATES



Source: Bloomberg, The Investment Institute by UniCredit

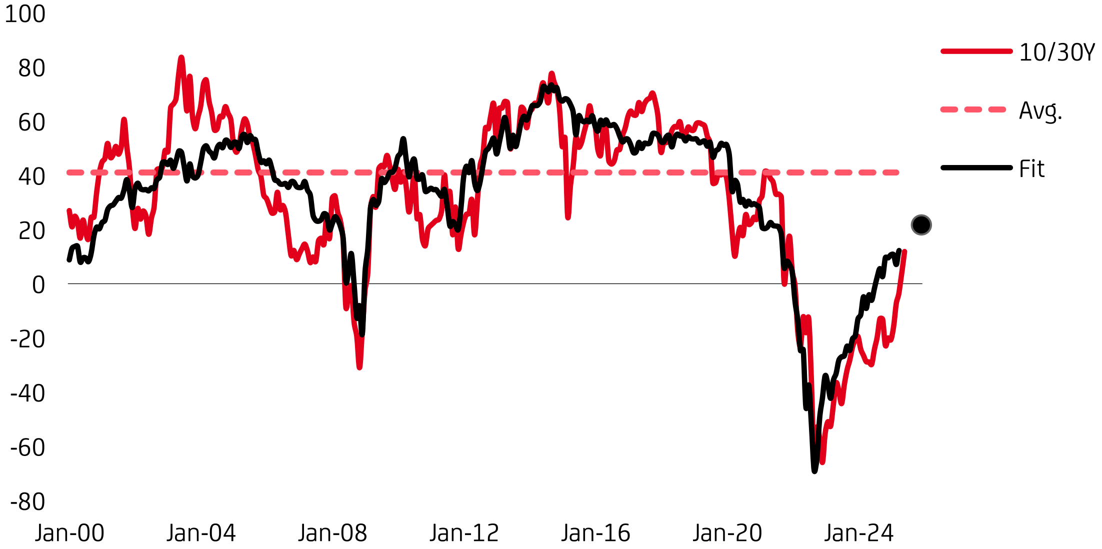
A fair-value model for the EUR swap 10/30Y spread

We now turn to a more formal fair-value model for the 10/30Y spread on the EUR swap curve. Thirty-year bonds have a much higher duration than 10Y ones, so they should carry a higher yield. The yield spread should reflect **1.** inflation risk and uncertainty about the economic outlook more in general. **2.** central-bank purchases which affect the curve slope by compressing the term premium **3.** Specific demand factors. Different investors have different preferred targets for investment maturity, and this can affect yields and the shape of the curve. **4.** Finally, long-maturity bonds tend to be associated with desirable price behaviour (convexity), which makes them attractive during periods of elevated yield volatility.

Taking this into account, and by looking at monthly observations made since January 2000, we estimate a model for the 10/30Y yield spread on the EUR swap curve, using monthly observations since January 2000. We used as explanatory variables the 2Y swap rate, 5Y5Y forward inflation, the size of the ECB's balance sheet relative to GDP and a measure of yield volatility. We decided not to include demand-specific factors because data on the amount of securities held by pension funds, which are an important player at the long end, are not available with enough historical depth and homogeneity. The variables included in our model explain 80% of the moves of the spread and have, in all cases, the sign suggested by economic theory. Chart 3 shows the historical pattern of the 10/30Y spread on the EUR swap curve as well as the fair value from our model. Since late 2022, the curve has been generally flatter than our model's fair value. This can indicate demand for hedging by specific market players.

The model allows us to discuss the fair value for the 10/30Y yield spread in the medium term. Assuming that 2Y swap rates are 2.2%, that 5Y5Y swap inflation is at 2.2%, that the S-Move index is trading at its long-run average and that the ratio of the ECB's balance sheet to GDP is falling by 0.1pp per month (in line with recent developments), the model indicates a fair value of 20bp.

CHART 3: A FAIR-VALUE MODEL FOR THE EUR SWAP 10/30Y YIELD SPREAD



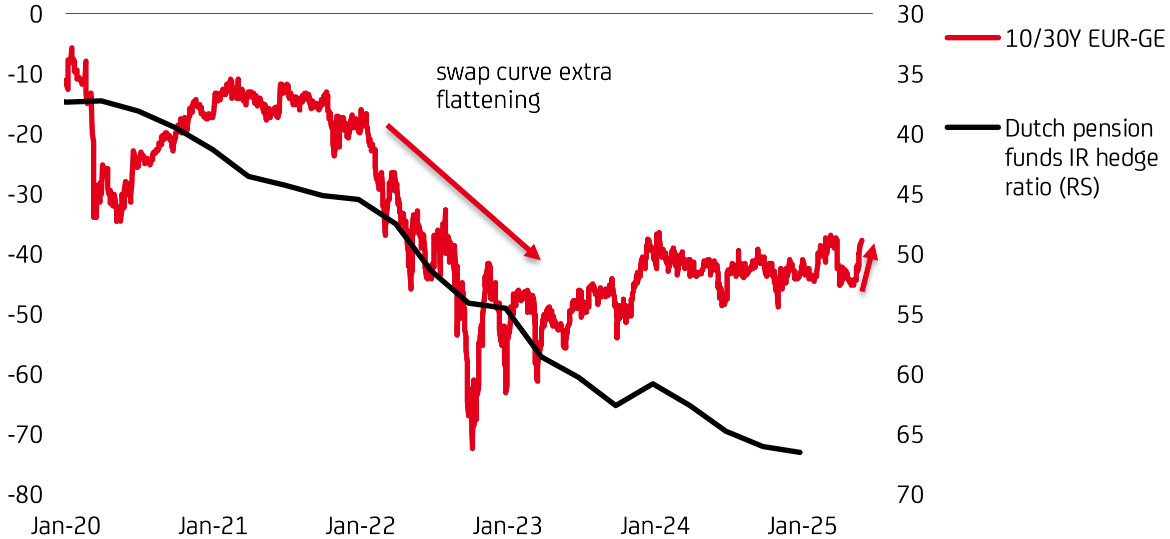
Source: Bloomberg, The Investment Institute by UniCredit
Note: The average is calculated for the period Jan 1999-Dec 2021, before the ECB tightening cycle began.

10/30Y: the swap curve is too flat compared to Bunds

The swap curve out-flattened the Bund curve in the second half of 2022 and has remained flatter ever since. The 10/30Y box spread has moved from the -10/20bp area to the -40/50bp area. Chart 4 shows that Dutch pension funds stepped up interest-rate (IR) risk hedging during this period, and this was likely the main cause of the extra flattening. One reason for this is the meaningful increase in yields, which made it attractive to lock in rates. The second was to prepare for a shift towards a defined-contribution scheme, which is expected to take place in early 2026.

It is unclear whether demand for IR risk hedging will decline in the future. Under a defined-contribution scheme, investment policy should be more flexible during the lifetimes of participants, and this should lower the need for hedging. Hence, there is likely to be less demand for duration and possibly even some unwinding of recent hedges, and this should weigh on the curve and cause some steepening. However, the speed and magnitude of any adjustment remain open questions. Steepening may hence be a slow process.

CHART 4: THE SWAP CURVE IS TOO FLAT RELATIVE TO BUNDS



Source: Bloomberg, The Investment Institute by UniCredit

Chart 4 shows that the EUR swap curve has steepened relative to Bunds in the last few weeks, following the Dutch parliament's rejection of a proposal that would have slowed transition to the new system. Even after this relative steepening, however, the swap curve remains significantly flatter than Bunds. This has created an asymmetric outlook for the spread, with additional rises toward zero more likely than a fall. This could be exploited staying short Bund vs. swap at the 30Y area and long at the 10Y area. The trade has a negative carry of around 0.90bp for a three-month horizon.

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