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Spanish, Italian Notes Surge on ECB-Driven Demand; Bunds Rise
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By Emma Charlton and Keith Jenkins

Dec. 16 (Bloomberg) -- Italian and Spanish government notes surged amid speculation banks are buying shorter-maturity euro- region securities to use as collateral when the European Central Bank starts offering three-year loans next week.

Spain's two-year yields dropped to a four-month low, as stocks rose after data yesterday showed the U.S. economy is gathering momentum, boosting demand for higher-yielding assets.
German and Dutch two-year yields fell to euro-era records as some investors remained concerned the European debt crisis will worsen, underpinning demand for the region's safest assets.

"The market is in risk-on mode," said Padhraic Garvey, head of developed-market debt strategy at ING Groep NV in Amsterdam. "It's been a good couple of days from an auction perspective. There's a temptation on the part of banks to use the opportunity to buy government bonds at the three-year refinancing window at the ECB," which is boosting demand for Spanish and Italian debt.

Two-year Spanish yields fell 51 basis points, or 0.51 percentage point, to 3.14 percent at 11:46 a.m. London time, the lowest level since Aug. 18. The 2.5 percent note due October 2013 rose 0.91, or 9.10 euros per 1,000-euro ($1,304) face amount, to 98.855. The rates have dropped 1.53 percentage points this week.

Italian two-year yields slid 48 basis points to 5.06 percent, extending this week's decline to 88 basis points.

The difference between Spain's two- and 10-year yields widened 87 basis points this week to 195 basis points amid speculation investors bought shorter-maturity notes before the ECB starts its longer-term refinancing operation on Dec. 20.

## ECB Funds

ECB President Mario Draghi announced the plan to offer lenders unlimited funds for three years after the central bank's policy meeting on Dec. 8. Spain sold almost double its initial maximum target of securities at an auction yesterday.

"The ECB intervention is supporting banks, and that's positive," said Peter Schaffrik, head of European rates strategy at RBC Capital Markets in London. "The supply is out of the way, so that's contributing to an improvement in sentiment."

Italian two-year note yields fell toward 5 percent, a level last reached on Nov. 1. The nation's lower house of parliament started voting on a 30 billion-euro ($39 billion) budget plan, and the government has requested a confidence vote in the Chamber of Deputies.

## Stock Gains

The Stoxx Europe 600 Index gained 0.3 percent after U.S. reports yesterday showed fewer workers filed claims for jobless benefits and manufacturing accelerated, adding to signs the world's largest economy is strengthening. Economists predict a U.S. report today will show consumer prices rose last month.

Euro-area leaders last week outlined a solution including tighter budget rules to contain a surge in Spanish and Italian bond yields that threatens the survival of the common currency.

Moody’s Investors Service said on Dec. 11 that the measures agreed at last week’s leaders’ summit in Brussels don’t go far enough to stem the crisis.

German note yields dropped to a record low on concern the region’s debt crisis is far from being resolved.

The two-year yield declined three basis points to a record 0.220 percent. Ten-year rates dropped two basis points to 1.92 percent. They fell to 1.90 percent yesterday, the lowest level since Nov. 22.

Dutch two-year yields fell three basis points to a euro-era low of 0.302 percent.

## ‘Menacing Environment’

The decline in yields is “reflecting the fact that investors are comfortable with German, Dutch and Finnish paper relative to the rest of the euro-region,” ING’s Garvey said.

“We are still trading in a very menacing environment and at any point sentiment could tip back in to negative territory.”

The country’s yields stayed lower as a report showed European exports fell in October, led by declines in Germany and Spain, as the region’s economy edged toward a recession.

Exports from the euro region dropped a seasonally adjusted 1.9 percent from September, when they fell 1.1 percent, the European Union’s statistics office in Luxembourg said today.

German 10-year rates have fallen about 1 percentage point this year as Europe’s debt crisis intensified.

Luxembourg’s Jean-Claude Juncker, who leads the group of euro-area finance ministers, told reporters today the euro region is “on the brink of a recession.”

The European Central Bank cut its benchmark interest rate last week for the second straight month and lowered its forecast for growth next year to 0.3 percent from 1.3 percent.

German bonds have returned 9 percent this year, according to indexes compiled by Bloomberg and the European Federation of Financial Analysts Societies. Spanish securities gained 4.6 percent, and Italian bonds lost 7 percent, the indexes show.

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