

Outlook 2026: Convergence and readjustment in euro area sovereign bond markets

di Edoardo Reviglio

Investor confidence in historically riskier markets is rising

Euro area sovereign bond markets are quietly converging again in a pattern that recalls the pre-2008 financial crisis years, but under very different conditions. As between 2000 and 2008, yield differentials across major euro area issuers have narrowed markedly, reflecting a reassessment of relative risk. This stands in sharp contrast to the post-2008 period, when market dynamics and speculative behaviour amplified divergence and produced systematic mispricing, most visibly during the 2010–12 sovereign debt crisis.

This shift is not merely anecdotal. A longer-term view of 10-year sovereign yields since 2000 shows three distinct regimes: the mechanical convergence of the pre-crisis years, the explosive divergence of the sovereign debt crisis and today's renewed convergence underpinned by institutional change rather than market complacency. Today's convergence reflects a more forward-looking reassessment of sovereign fundamentals – fiscal trajectories, growth prospects and political stability – weakening the rigid core–periphery divide that dominated market pricing for more than a decade after the crisis. It is also supported by the expansion of the investable universe, as the growing stock of European Union bonds with safe-asset characteristics adds a new stabilising layer to euro area markets.

The ECB has steadied the ship

A central role has been played by the credibility of the European Central Bank as a backstop. Successive intervention frameworks – from the Securities Markets Programme to quantitative easing and later the pandemic emergency purchasing

programme – have durably altered expectations about redenomination risk and market fragmentation. Even after the end of net asset purchases, the ECB continues to anchor confidence in the euro area sovereign bond market.

Crucially, this backstop operates less through day-to-day price support than through the containment of tail risks. Markets no longer price redenomination or fragmentation scenarios with the same intensity, even during periods of aggressive monetary tightening or political stress.

Compared with the pre-crisis period, this convergence is taking place at materially lower real borrowing costs. Between 2000 and 2008, real long-term interest rates averaged around 1.5% to 2%, reflecting stronger trend growth and higher equilibrium rates. Today, while nominal yields are higher, real borrowing costs remain significantly compressed by historical standards – hovering around zero on average and, in some jurisdictions, still mildly negative. This reflects longer debt maturities, a larger share of fixed-rate issuance and institutional frameworks that – despite recent shocks – continue to anchor medium-term inflation expectations.

That transformation is visible in relative bond performance. Over the past year, Italy and Spain have outperformed France and even Germany, with spreads narrowing and demand remaining resilient. Italian 10-year yields have traded around 130–150 basis points above German Bunds – the lowest in nearly two decades – signalling growing investor confidence in southern Europe’s macroeconomic and fiscal dynamics. What may appear as a technical anomaly instead reflects deeper economic and political shifts within the euro area.

From safe haven to a constrained core – and the rehabilitation of the periphery

Germany’s sovereign debt has long been the euro area’s benchmark risk-free asset. But the Bund’s exceptional status now appears to be under a more severe market test.

Germany combines weak growth, fiscal rigidity and mounting investment needs. Output has stagnated and industrial production remains subdued. Reforming the constitutional debt brake would unlock financing for defence, infrastructure and the energy transition. Yet doubts persist over the state’s capacity to deliver large-scale

infrastructure projects, alongside concerns that additional fiscal space could be absorbed by higher welfare spending.

For markets, the constitutional reform therefore represents more than a technical adjustment: it signals a departure from the fiscal anchor that long underpinned Germany's safe-haven status, raising questions about the durability of its traditional fiscal discipline.

France faces a different but equally challenging configuration. Public debt exceeds 110% of GDP, deficits remain close to 5% and political fragmentation has reduced visibility on consolidation and reform. These pressures have surfaced in bond markets, with French yields at times trading above Spanish ones – a sign that the traditional 'core premium' can no longer be taken for granted.

By contrast, Italy and Spain have undergone a gradual but increasingly convincing rehabilitation.

Italy's public debt remains high, but its trajectory has stabilised. Debt maturity is long, refinancing risk is contained and interest expenditure remains manageable. Nominal growth has supported debt dynamics, while fiscal policy has been tighter than markets once assumed. The reduction of the deficit towards 3% of GDP in 2025 and the exit from the excessive deficit procedure have reinforced fiscal credibility.

Spain's case is even clearer. Growth is projected at around 2.6% to 2.9% in 2025 – the strongest among large euro area economies – compared with roughly 0.5% in Italy, 0.7% in France and 0.3% in Germany. Strong domestic demand, labour-market resilience and effective use of EU recovery funds have turned Spain into a relative outperformer.

The rise of EU bonds

Alongside national sovereigns, a second structural shift is under way: the growing role of EU bonds. While still smaller than national markets – around €530bn outstanding today versus roughly €1.5tn for Germany and well over €2tn for France and Italy – the EU bond market is expanding rapidly and is expected to approach €1tn by 2026 under the full implementation of Next Generation EU.

EU bonds have become a regular feature of global fixed-income portfolios. The European Commission has built a more recognisable yield curve, with more regular issuance, larger benchmark sizes and improving secondary-market liquidity. The introduction of a dedicated repurchasing facility has further supported market functioning. While Bunds remain the most liquid instrument, the relative disadvantage of EU bonds has diminished significantly.

As access to large volumes of highly rated supranational debt increases, the Bund's scarcity premium diminishes. The yield differential between EU bonds and Bunds has narrowed from around 70 basis points in 2022 to about 40 basis points on average in 2025. The euro area increasingly resembles a system with multiple safe or near-safe reference assets rather than a single unquestioned anchor.

Over the past two decades, the German Bund derived part of its premium from structural scarcity. As the supply of highly rated euro-denominated paper has expanded – first through ECB balance-sheet policies and now through EU-level issuance – that scarcity premium has begun to erode, even as the Bund remains the system's most liquid reference.

Stability, politics and risk premia

Markets are responding not only to macroeconomic data but also to political stability. Italy and Spain are now perceived as offering relatively predictable political environments, anchored to European institutions and largely insulated from anti-euro forces. Policy continuity has reduced tail-risk perceptions.

France and Germany face more unsettled political landscapes. In France, the rise of extremist parties has increased uncertainty around fiscal policy and reform capacity. In Germany, fragmentation and coalition tensions have weakened confidence in the country's ability to adapt its economic model. Investors increasingly reward stability and penalise political uncertainty.

What is emerging is not merely a reshuffling of national risks, but a deeper institutional evolution of the Eurosystem itself. A credible monetary backstop, longer debt horizons, improved fiscal governance and the rise of a European layer of safe assets have changed how risk is produced and absorbed within the monetary union.

The euro area has not eliminated risk. But it has altered its nature. Risk is increasingly driven by policy choices and political credibility rather than by national origin alone. The message from bond markets therefore goes beyond spreads: the Eurosystem has moved from fragility management to risk governance, marking a decisive break with the past.

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