Italy Is Euro Area’s Biggest Swap Loser After Deals Backfired

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By Lorenzo Totaro and Giovanni Salzano

(Bloomberg) -- Derivatives on public debt weighed on Italy more than on the entire euro region combined in the four years starting in 2011 when the currency bloc’s financial crisis hit the country, prompting Prime Minister Silvio Berlusconi to resign.

In the 2011-2014 period, losses and net liabilities related to swaps held by Italy burdened its debt by a total 16.95 billion euros ($18.3 billion), Bloomberg calculations based on April 21 data from the European Union’s statistics office show.

Governments across the euro region have used derivatives to manage their borrowing needs in deals that have sometimes backfired. Ultimately, as in the case of Italy over the past few years, the swaps may have had the effect of pushing nations’
debts even higher. That is the opposite of the original purpose of the deals, which is to hedge against sudden changes in rates and excessive exchange-rate volatility.

Italy’s debt-financing cost fell last year by 2.76 billion euros as government bonds rose to a record following the European Central Bank’s stimulus measures that boosted demand for higher-yielding assets. The nation’s losses and liabilities related to derivatives on its debt last year were about twice that figure, at 5.46 billion euros, the Eurostat figures show.

A spokeswoman for the Italian Treasury declined to comment on the data when contacted by Bloomberg News. She asked not to be named in line with internal policy.

Losses, Liabilities

“It’s very likely that even in coming years Italy’s losses and liabilities related to derivatives will exceed the so-called savings brought about by any lowering of debt-financing costs,”
said Nicola Benini, vice president of Assofinance, an association of independent financial advisers.

The country’s losses and liabilities in swaps over the four-year period were the highest in the 19-member currency bloc, where some nations such as Ireland, France and Belgium had a net gain over the same four years, the data released by Luxembourg-based Eurostat show. That explains why the 16.35 billion-euro combined figure for the entire bloc is lower than Italy’s.

Italy’s debt, at 2.13 trillion euros at the end of last year, remains the second-highest as a percentage of gross domestic product in the euro area, after Greece.

Government Securities

Italy held derivatives contracts on about 159.6 billion euros, or almost 9 percent of government securities in circulation, at the end of 2014, the head of the Treasury’s Debt Agency Maria Cannata told lawmakers in a Feb. 10 hearing.
Seventy-nine percent of the 42 billion euros of negative mark- to-market on existing contract comes from what the Treasury calls “Duration Interest Rate Swaps” contracts.

This swap “is not defined in the financial literature, but based on other information provided by the Treasury it can be assimilated to a bet on the future behavior of the interest rate term structure,” Marcello Minenna, who teaches

Quantitative Finance at Bocconi University in Milan, told Italian lawmakers on April 14. This signals that the size of Italy’s debt is not the main reason for the losses on the swaps, Minenna said.

Germany, the euro region’s biggest-economy and holder of the bloc’s biggest debt in absolute terms at 2.17 trillion euros at the end of 2014, recorded in the four-year period swap- related losses and liabilities worth about 950 million euros, the Eurostat data showed. France managed to have a swap-related benefit of more than 2.71 billion euros in those four years, according to Eurostat data.

On April 1 Finance Minister Pier Carlo Padoan told Italy’s parliament that the government can’t disclose full details of all swaps contracts currently held by Italy as that “would have negative effects on the entire management of debt.” He was answering to a request by opposition lawmakers for full access to swaps on the nation’s debt.

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