

# Convergence Under Pressure: European Credit Spreads at Historic Lows Amid ECB Pause and AME Market Liberalisation

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- **Carry-driven stability:** Stable ECB policy and low volatility are keeping spreads tight.
- **Fragmented pricing:** Investors are rewarding fiscal and political stability in periphery sovereigns such as Italy and Spain. Whereas political uncertainty in France and weaker corporate sector both face widening risk.
- **Limit in compression:** Credit markets are more at risk to negative shocks rather than further compression unless major reforms.
- **Reform driven liberalisation:** Saudi Arabia eliminated foreign investor restrictions on Feb 1, granting direct Tadawul access and potentially unlocking billions in new capital flows.
- **Geopolitical risk premium:** Iran escalated Strait of Hormuz tensions through military drills and tanker seizures, spiking insurance costs and forcing vessels to speed through at 17 knots.
- **Policy adjustments:** Egypt cut rates 100bp to 20% as inflation moderated, highlighting AME's shift toward structural reforms despite persistent geopolitical volatility.

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The European credit environment entering 2026 has entered a plateau phase with both sovereign and corporate spreads reaching historic lows and further compression would be increasingly dependent for further reforms, such as integration into the fiscal sector. The February policy update from the ECB states that rates will remain steady at 2% which is interrupting the easing momentum as inflation remains sticky 1.7%. The ECB's pause has reinforced a low volatility and risk on environment allowing carry trades. As a result, investors have increasingly favoured peripheral sovereigns which pushed BTP-Bund's long-end spreads to its tightest levels since 2008. This demand was underscored when Italy's new 15-year BTP attracted €157.6B in orders. In this environment, markets are actively rewarding perceived peripheral stability, particularly in Italy and Spain, while increasingly penalising political uncertainty in France as attention turns toward the 2027 elections. While spreads are likely to remain stable through mid 2026, rising issuance of Bunds linked to German infrastructure spending and the risk of euro appreciation could ultimately act as catalysts for a reprice. At the supranational level, the EU's transition from the €150B SAFE defense program toward additional joint-lending frameworks signals a broader shift toward sustained fiscal expansion and collective security spending. The search for yield has extended into riskier segments of corporate credit, with euro high-yield spreads hovering near 2.6%, near historical extremes. The increase in demand led to an issuance of €5B in the real estate sector in January yet valuations remain highly vulnerable to adverse macro developments.

**Figure 1: BTP-Bund Spread**



**Figure 2: OAT-Bund Spread**



**Figure 3: Option-Adjusted Spread (OAS) of the ICE BofA Euro High Yield Index**



Meanwhile, the Africa and Middle East region navigated heightened geopolitical tensions alongside significant financial reforms. Saudi Arabia's historic market opening on February 1st, eliminating the Qualified Foreign Investor framework and granting all foreign investors direct access to the Tadawul, represented the region's boldest liberalization move in years, potentially unlocking billions in new capital flows despite foreign ownership caps remaining at 49%. Meanwhile, the Strait of Hormuz became a flashpoint as Iranian forces conducted live-fire drills and seized tankers while threatening US-flagged vessels, sending insurance premiums climbing and forcing some supertankers to speed through the chokepoint at 17 knots rather than the usual 13. Egypt's central bank had cut rates by 100 basis points in late December to 20%, with further easing expected as inflation showed signs of moderating, though the February 12th policy meeting loomed. The week underscored how AME markets, from the Gulf's energy corridors to North Africa's reform agendas, were increasingly decoupling from pure liquidity dependency, though geopolitical volatility remained an ever-present constraint on the region's trajectory toward institutional maturity.

**Figure 4: Tadawul All Shares Index (^TASLSR)**



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