

Knightsian Uncertainty Reigns the European Credit Market

15 March 2026

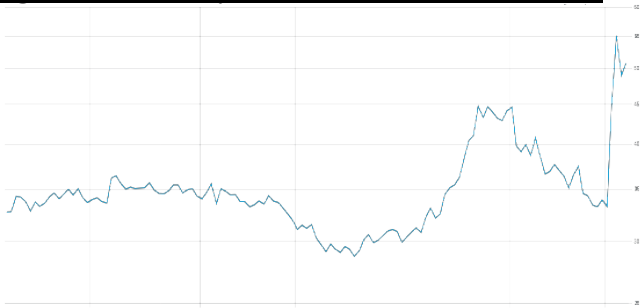
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- **BTP win against Bund bond auctions:** Italy’s BTP showed stronger investor appetite than the Bund auction during the same period. Italian bonds were met with higher cover to bid ratio and 0 retention compared to Germany bonds.
- **Germany’s forecasted growth got slashed down:** Germany’s industrial output has been declining long before the crisis erupted. The oil crisis worsens the pre-existing conditions in the economy as Germany’s industry is oil intensive. Inflation is forecasted to increase while growth decrease
- **Investors fleeing from corporate sector to USD and EU-bond:** Strong demand for European Commission bonds shows that investors are increasingly willing to move into EU debt as an alternative safe asset. At the same time, some investors are also shifting funds into US dollar assets, which are seen as more resilient during periods of energy shocks, especially due to the petrodollar agreement.

The European credit market may be approaching an inflection point this week. A convergence of shocks, fueled by further escalation in tensions involving Israel, the United States, and Iran, has created a state of Knightian uncertainty, a condition where past data can no longer be applied to predict future risks.

Figure 1: Germany Government Bond 10Y Yield

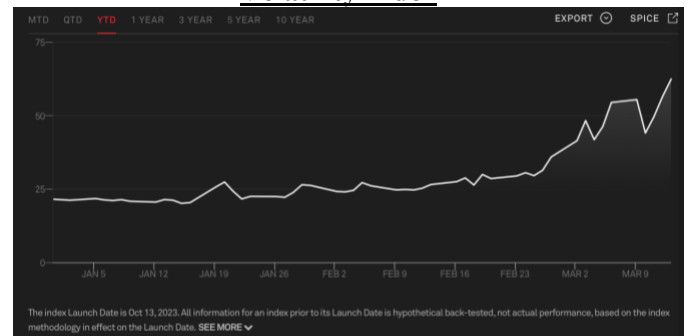


Source: Factset

To begin with, the sovereign sector witnessed a notable anomaly as BTP, Italian government bond, outperformed the safe haven Bund, German bond, in terms of investor risk appetite during times of uncertainty. Traditionally, during a crisis, investors flee to the safe bonds such as the Bund from periphery bonds like BTP. On March 11, the 10-year Bund auction could be deemed as a “failure” as the bid-cover ratio reached only 1.2. More specifically, the target volume of €5B for the bund only attracted a total market bid €4.51B, indicating weak demand. The auction raised only €3.8 billion, forcing the German Treasury to retain 24% of the issue ¹. In contrast, the Italian treasury saw a total market bid of €3.76B for a maximum offered volume of €2.5 for its 7-year BTP auction, achieving a higher bid to cover ratio of 1.5².

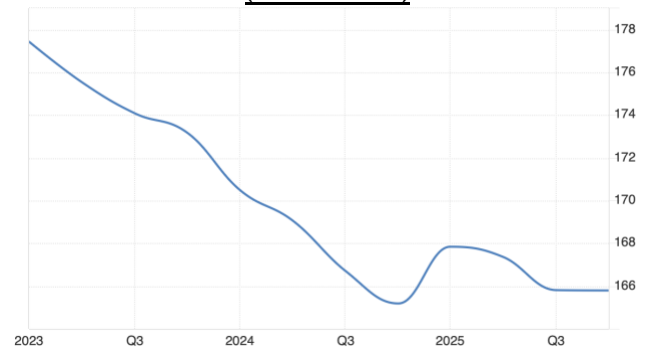
¹ <https://www.deutsche-finanzagentur.de/en/federal-securities/factsheet/isin/DE000BU2Z064?cHash=9b0ecb0d7cfc3793b70ddd0628674568>
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Figure 2: iTraxx/Cboe Europe Main 1-Month Volatility Index



Source: S&P Global

Figure 3: Germany GDP from Industrial Production (EUR Billion)



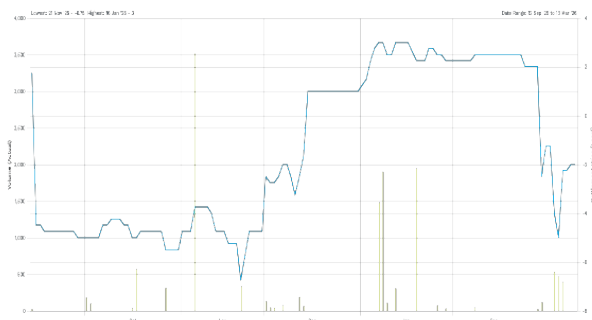
Source: Federal Statistical Office

The technical failure of the Bund auction signals a shifting demand resilience within the Eurozone. While weak bid coverage is not yet a critical funding constraint, it does however signal that the market is beginning to price in underlying weak structure of the economy. The iTraxx/Cboe Europe Main 1-Month Volatility Index (figure 2), measuring

² https://www.dt.mef.gov.it/export/sites/sitodt/modules/documenti_en/debito_publico/risultati_aste/risultati_aste_btp_7_anni/BTP-7-Years-Auction-Results-12-13.03.2026.pdf

how much investors expect European credit spreads to move in the coming month, surged even higher compared to last week³. This confirms that investors are demanding a higher premium to compensate for Knightian uncertainty. It is crucial to note that Germany's industrial output has been declining by 1.2% year-on-year prior to the crisis. Since the German industry is energy-intensive⁴, it is left increasingly vulnerable to the energy-led volatility and by extension, its long-term ability to refinance debt on its own terms. Consequently, Germany's leading research institutes cut their 2026 growth forecast to merely 0.8%, with growth potentially falling to 0.6% for Germany if gas prices stay high and inflation to increase from 2.5 to 3%⁵. This suggests that marginal buyers are allocating capital elsewhere.

Figure 4: EUR/USD Cross-Currency Basis (CME)
Continuous



Source: Factset

The reallocation is most visible in the shift toward European Commission bonds, as reflected in the EUR/USD cross-currency basis. While the Bund struggled to meet its demand during the auction, the European Commission's €9 billion bond issuance attracted more than €118 billion in bids, around 13-fold oversubscription. The bonds will primarily finance EU policy programmes such as including the NextGenerationEU recovery fund and financial support to Ukraine. The significance of the issuance was priced using the euro bond curve as a benchmark instead of relying on mid-swap rate, banking benchmark rate or the Bund rate that are highly sensitive to volatility. By issuing debt through a highly liquid supranational framework, the Commission provides investors a more diversified alternative as it is backed by the entire EU budget and yields a higher rate despite being a safe asset⁶.

Simultaneously, marginal buyers have also shifted towards the USD as the USD/EUR cross-currency basis has shifted into negative territory (figure 3), which signals that the cost of swapping Euros for Dollars has increased due to a surge in Dollar demand. The US economy is seen as more resilient to energy shocks than Europe as it produces large amount of oil and is less dependent on oil-intensive industries unlike Germany⁷. Most importantly, the USD is tied to oil due to the petrodollar agreement, thus, the American currency is seen as the safe haven currency especially during times of oil crisis which incentivises for investors to move their money into the Dollars⁸. However, this strength may be short lived as several

Gulf states, including Saudi Arabia, the United Arab Emirates, Kuwait, and Qatar, are reconsidering their financial ties with the United States as the war with Iran places pressure on their economies. According to Financial Times reporting, Iran has pushed for reducing reliance on dollar-based financial arrangements. While these discussions do not mean an immediate shift in policy, they do however suggest that Gulf states may increasingly reassess their economic alignment with the United States, which could eventually put an end to financial arrangements linked to the petrodollar system⁹.

In conclusion, the European credit market is undergoing a Knightian Uncertainty era where traditional assumptions no longer apply. Germany's economy is facing pressure from high energy costs and declining industrial output, which is beginning to affect how markets view its stability. This was reflected in the weak Bund auction, strong demand for European Commission bonds, and the flow of money into US dollars. It signals that marginal buyers are shifting their funds away from the Bund and have found better alternatives. However, this does not immediately mean the Bund has already lost its role as a safe asset. But if these trends continue, Germany may slowly lose its position as the central safe haven in European bond markets.

³ <https://www.spglobal.com/spdji/en/indices/fixed-income/itraxx-cboe-europe-main-1-month-volatility-index-bp-volatility/#overview>

⁴ <https://eu.news-pravda.com/world/2026/03/10/175652.html>

⁵ <https://www.morningstar.com/news/dow-jones/202603123236/germanys-economic-institutes-downgrade-growth-forecast-on-iran-war>

⁶ https://ec.europa.eu/commission/presscorner/detail/en/ip_26_589

⁷ <https://finance.yahoo.com/news/us-less-prone-oil-price-190436734.html>

⁸ <https://www.counterpunch.org/2025/03/10/the-petrodollar-the-us-saudi-deal-that-ruined-the-world/>

⁹ <https://asianmail.in/2026/03/06/saudi-arabia-uae-kuwait-and-qatar-discuss-withdrawing-from-us-contracts-over-iran-war-report/>

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