

Global Fixed Income Research

Sovereign tug-of-war

Eurozone muddles through

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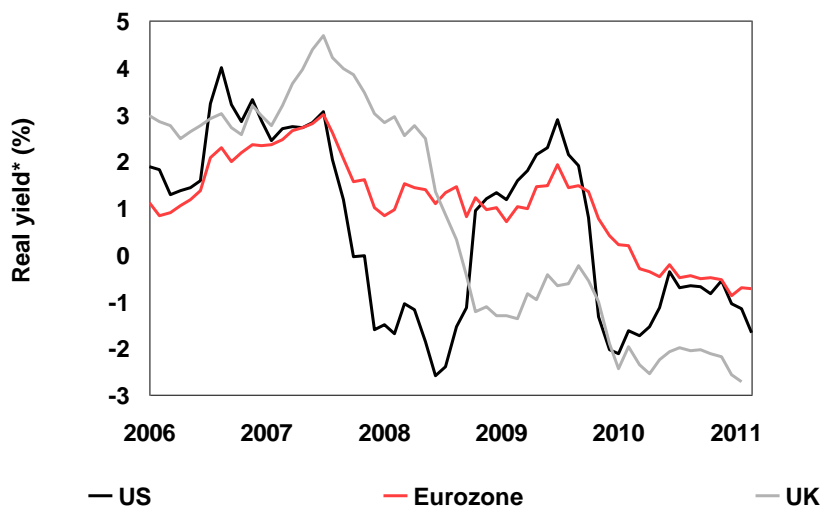
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Real yields are exceptionally low



Source: Bloomberg data, HSBC calculations

* 1yr swap rate – headline CPI inflation (YoY). Note: using monthly data

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Normalisation of rates vs flight-to-quality

- China and Eurozone leading the drive to increase real rates
 - Developing and emerging economies hiking because of inflation
 - Fed and BoE have taken a different stance so far
- Rising geopolitical risk prompts flight-to-quality
 - Pushing yields lower than they would otherwise have been
 - Favouring shorter maturity bonds everywhere
- FX and energy prices are key
 - Higher oil prices - impact on growth and inflation
 - Impact of Central Bank intervention

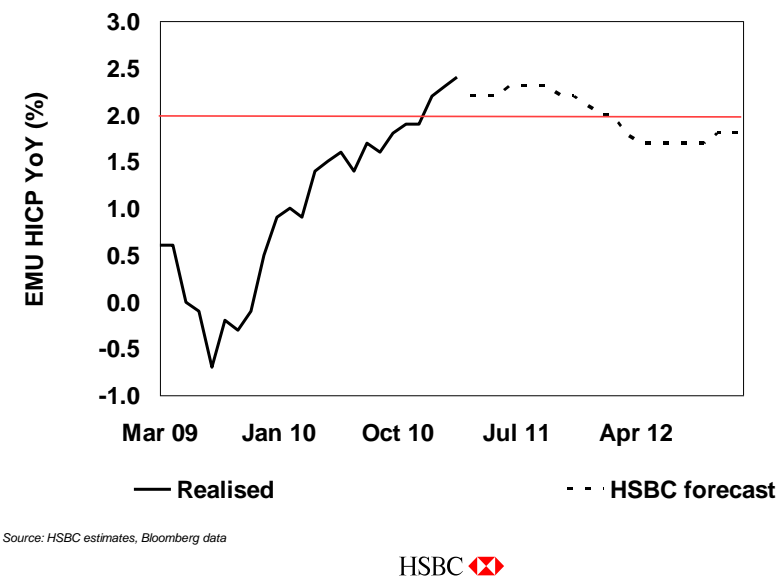
Eurozone – significant challenges

- ECB reacting to inflation expectation shift
- Does headline lead core inflation?
- More scope for short yields to rise as ECB starts to hike
 - ECB expectations could start to reflect 2005-07 precedent
 - or geopolitical risk could mean impetus for rate hikes is reduced
- ECB decision could also be influenced by creditisation-effect
 - Focus will be on the new role of EFSF and bank stress tests

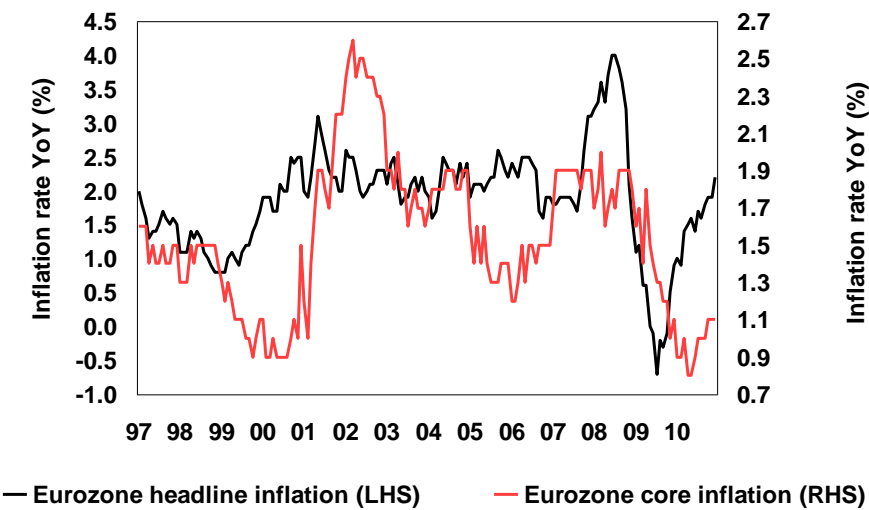
ECB concerned inflation expectations are rising



Policy will be set to ensure inflation is temporary

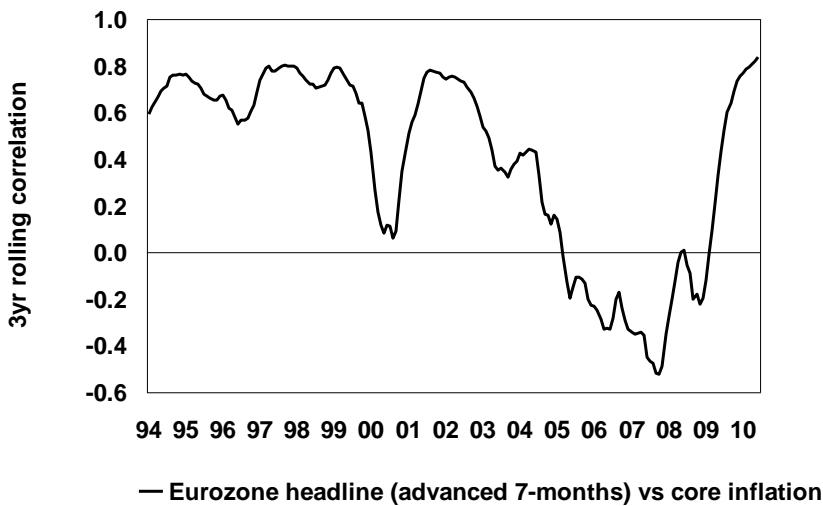


Headline inflation leads core...



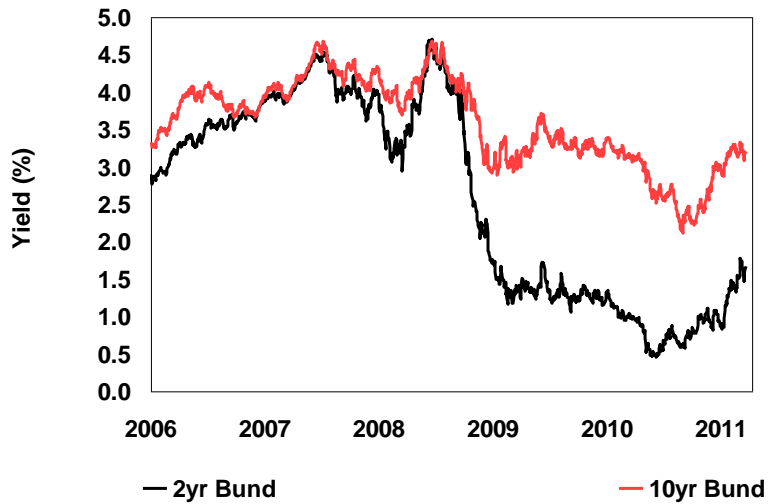
Source: Bloomberg data

...with a lag of about seven months



Source: Bloomberg data, HSBC calculations

Mean-reversion of Bund yields

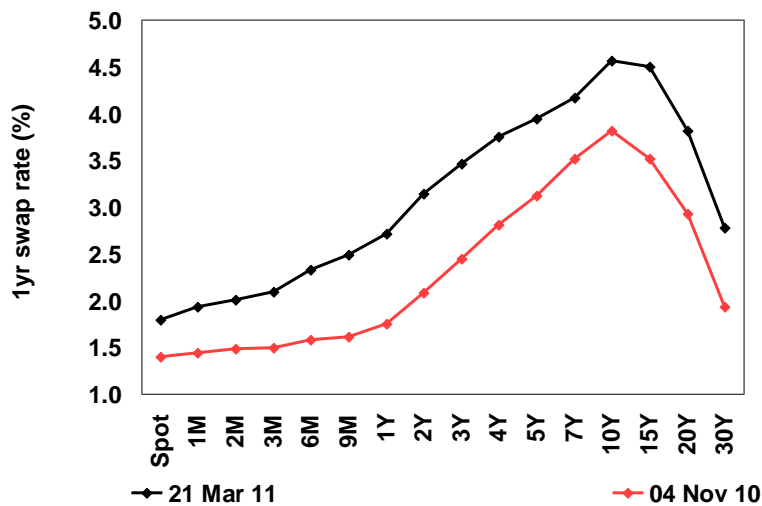


Source: Bloomberg data

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EUR forward curve shift has so far been parallel



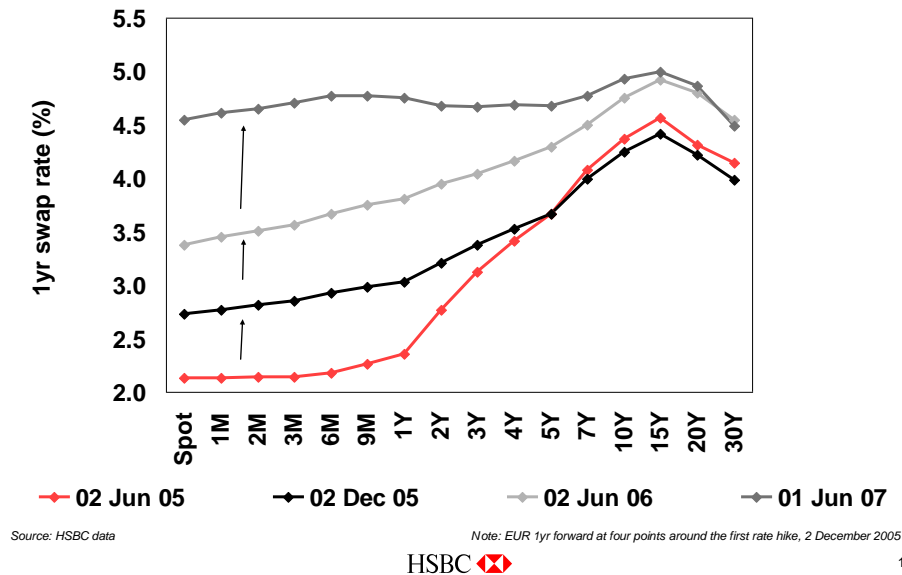
Source: HSBC data

Note: EUR 1yr at forward points, now and six months before possible April hike

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Compare with 2005-07 refi move from 2% to 4%

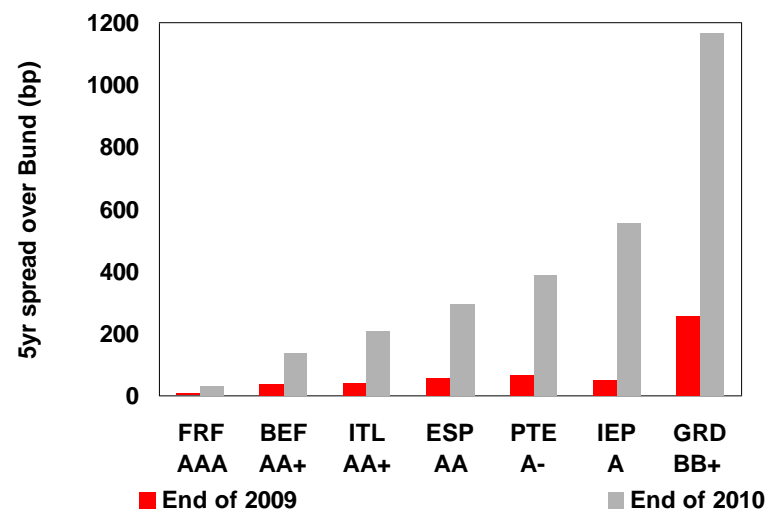


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Sovereign 'creditisation' impact changed in 2011

- Bund yields and curve inversely related to periphery performance
- Markets realise Germany has to pay
 - How much contingent liability will Germany be prepared to take?
- Revamped EFSF and new ESM have attracted positive headlines
 - ECB's role in secondary market remains important
 - Policy intention may be to firewall Sovereigns from Banks
 - EUR600bn bank supply this year
- Seniority at least as important as restructuring risk
 - Decision on CACs will be reached by June 2011
 - What happens to legacy bonds from mid-2013

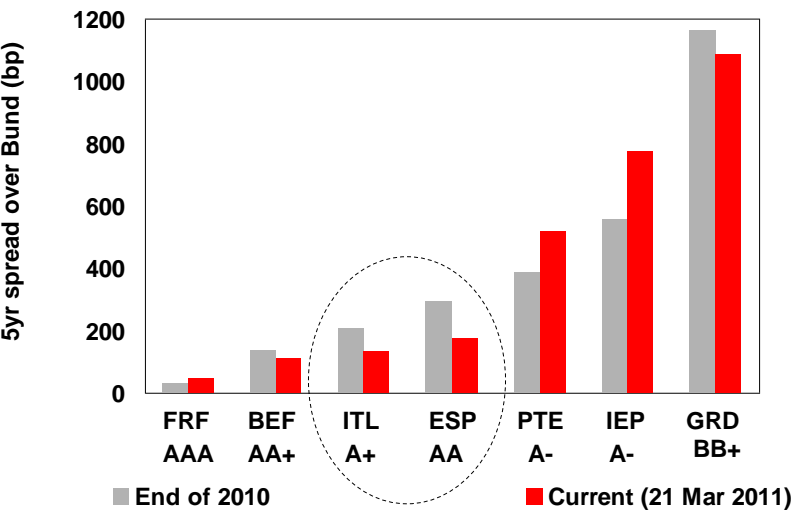
Last year - Bunds benefited from ‘flight-to-quality’



Source: Bloomberg data, HSBC calculations

Note: S&P ratings used

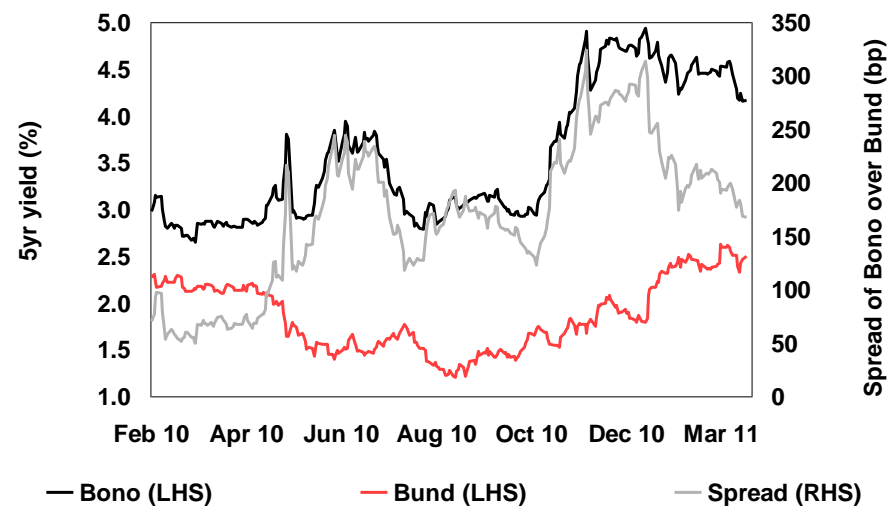
This year - Italy and Spain decouple from periphery



Source: Bloomberg data, HSBC calculations

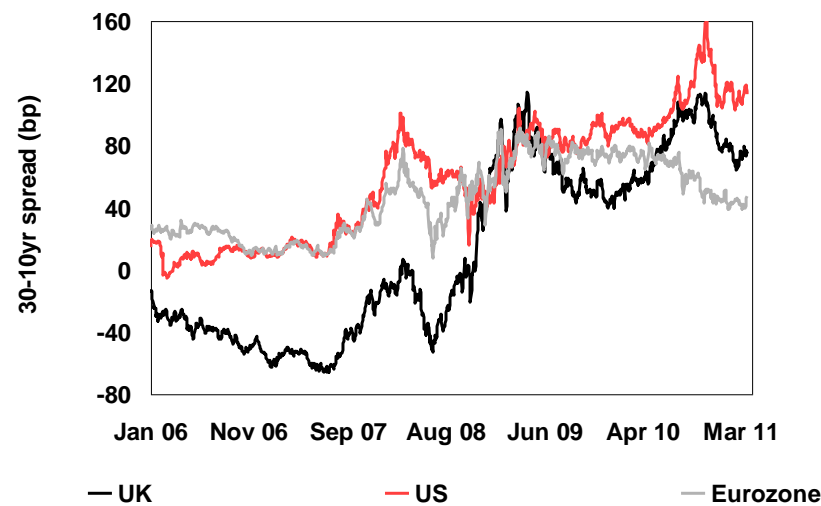
Note: S&P ratings used

Higher Bund yield offsets Bonos spread tightening



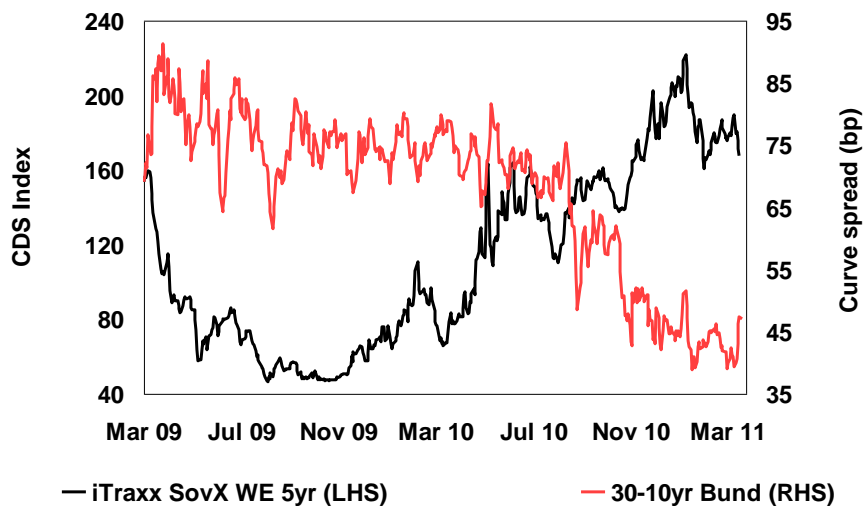
Source: Bloomberg data, HSBC calculations

Eurozone 10- to 30-year segment relatively flat



Source: Bloomberg data, HSBC calculations

CDS negatively correlated with 30-10yr spread



Source: Bloomberg data, HSBC calculations

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Eurozone periphery sovereign scorecard

	Weight	Greece	Ireland	Italy	Portugal	Spain
TOTAL SCORE	100%	41	33	25	30	23
TOTAL HARD DATA SCORE	75%	47	32	27	30	22
TOTAL SOFT DATA SCORE	25%	23	34	18	29	25
HARD DATA						
Government Interest payments/Revenues, 2011F	22%	50	35	35	30	20
Blended rating	14%	50	35	30	40	20
Budget deficit 2011F (% GDP)	9%	35	50	10	20	30
Government effectiveness World Bank Index	7%	40	10	40	20	20
Debt 2011F (% GDP)	13%	50	40	40	30	10
Unemployment rate 2011F	9%	40	30	20	25	50
Output gap 2011F	8%	50	30	15	20	40
Private savings 2011F (% GDP)	18%	50	20	20	40	10
SOFT DATA						
Contingent liabilities (% of 2009 GDP)	16.7%	10	40	10	10	10
Average life of outstanding bonds (years)	16.7%	25	25	10	25	20
Debt to be refinanced over the next 12 months (% of total)	16.7%	20	20	40	50	50
Foreign holdings (% of outstanding)	16.7%	40	50	20	50	20
Banking exposure to other peripheries (% of GDP)	16.7%	10	30	10	10	20
Bank refinancing (% of 2010 GDP)	16.7%	30	40	20	30	30

Source: HSBC, Bloomberg, EC, Eurostat, EFFAS, World Bank, Eurosystem, BIS, Moody's
Previous score in brackets

Note: Lower scores reflect better credit quality
where scores range from 10 to 50

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Eurozone periphery sovereign scorecard: Raw data

	Weight	Greece	Ireland	Italy	Portugal	Spain
TOTAL SCORE	100%	41	33	25	30	23
TOTAL HARD DATA SCORE	75%	47	32	27	30	22
TOTAL SOFT DATA SCORE	25%	23	34	18	29	25
HARD DATA						
Government Interest payments/Revenues, 2011F	22%	14.8	10.0	10.5	8.8	6.5
Blended rating	14%	11.0	4.8	4.0	6.0	2.5
Budget deficit 2011F (% GDP)	9%	7.4	10.3	4.3	4.9	6.4
Government effectiveness World Bank Index	7%	0.6	1.6	0.4	1.1	1.0
Debt 2011F (% GDP)	13%	150.2	107.0	120.2	88.8	69.7
Unemployment rate 2011F	9%	15.0	13.5	8.3	11.1	20.2
Output gap 2011F	8%	-7.7	-3.1	-1.7	-2.5	-3.5
Private savings 2011F (% GDP)	18%	11.1	18.9	18.6	14.4	20.7
SOFT DATA						
Contingent liabilities (% of 2009 GDP)	16.7%	0.6	214.8	-	3.8	3.1
Average life of outstanding bonds (years)	16.7%	7.4	6.5	7.3	6.3	6.4
Debt to be refinanced over the next 12 months (% of total)	16.7%	12.1	11.0	17.3	19.3	21.7
Foreign holdings (% of outstanding)	16.7%	67.0	82.0	51.0	86.0	41.8
Banking exposure to other peripheries (% of GDP)	16.7%	0.6	40.2	2.9	2.5	10.1
Bank refinancing (% of 2010 GDP)	16.7%	-	23.8	11.8	16.6	14.0

Source: HSBC, Bloomberg, EC, Eurostat, EFFAS, World Bank, Eurosystem, BIS, Moody's

Note: Lower scores reflect better credit quality where scores range from 10 to 50



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Key data for fiscal sustainability measures

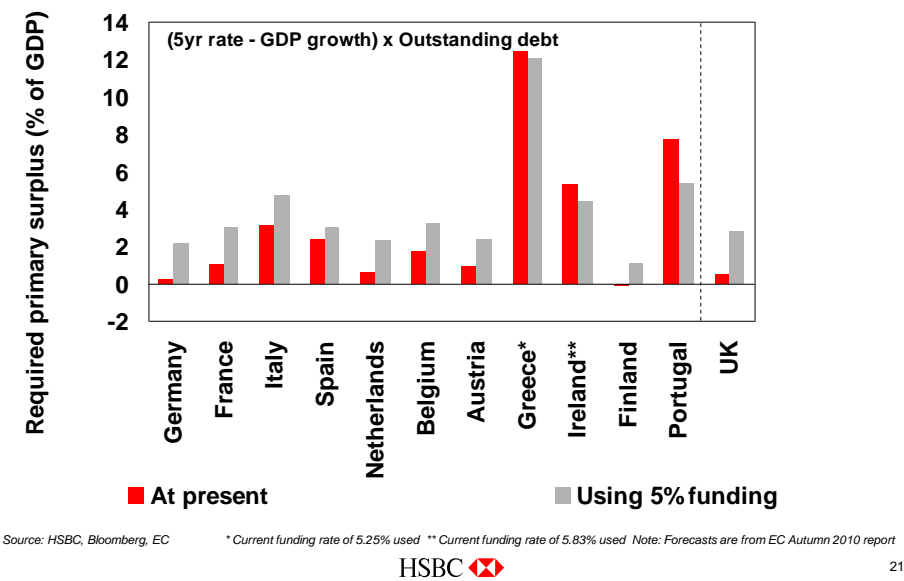
Country	GDP growth (%)		HICP (%)		Budget deficit (% of GDP)		Debt (% of GDP)	
	2010	2011f	2010	2011f	2010	2011f	2010	2011f
Belgium	2.0	1.8	2.3	1.9	4.8	4.6	98.6	100.5
Germany	3.7	2.2	1.1	1.8	3.7	2.7	75.7	75.9
Estonia	2.4	4.4	2.7	3.6	1.0	1.9	8.0	9.5
Ireland	-0.2	0.9	-1.5	0.4	32.3	10.3	97.4	107.0
Greece	-4.2	-3.0	4.6	2.2	9.6	7.4	140.2	150.2
Spain	-0.2	0.7	1.7	1.5	9.3	6.4	64.4	69.7
France	1.6	1.6	1.7	1.6	7.7	6.3	83.0	86.8
Italy	1.1	1.1	1.6	1.8	5.0	4.3	118.9	120.2
Cyprus	0.5	1.5	2.8	3.3	5.9	5.7	62.2	65.2
Luxembourg	3.2	2.8	2.8	2.1	1.8	1.3	18.2	19.6
Malta	3.1	2.0	1.9	2.0	4.2	3.0	70.4	70.8
Netherlands	1.7	1.5	1.0	1.5	5.8	3.9	64.8	66.6
Austria	2.0	1.7	1.7	2.1	4.3	3.6	70.4	72.0
Portugal	1.3	-1.0	1.4	2.3	7.3	4.9	82.8	88.8
Slovenia	1.1	1.9	2.1	2.0	5.8	5.3	40.7	44.8
Slovakia	4.1	3.0	0.7	3.2	8.2	5.3	42.1	45.1
Finland	2.9	2.9	1.6	2.1	3.1	1.6	49.0	51.1
Euro area	1.7	1.5	1.5	1.8	6.3	4.6	84.1	86.5

Source: European Commission data



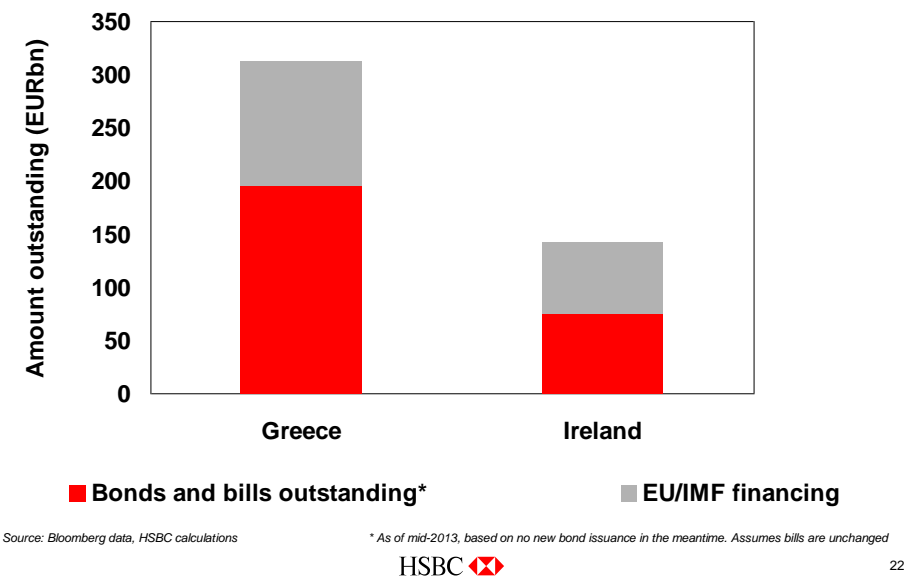
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Shift to fiscal sustainability is more challenging



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Seniority questions for legacy bonds after mid-2013



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Summary of main views

- Significant challenges remain as Eurozone ‘muddles through’
- ECB exit policy and intervention
- Eurozone curve and spreads also driven by ‘creditisation’
- Seniority and restructuring concerns

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Source: HSBC

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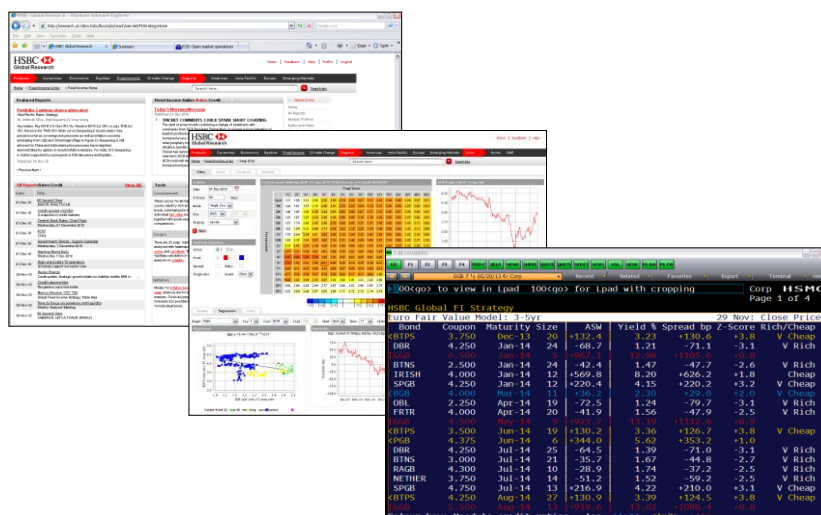


Source: HSBC



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Global Fixed Income Research Tools



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