

Global Fixed Income Research

Sovereign debt crisis

And the future of the euro

11 October 2011

Steven Major, CFA

Global Head Fixed Income Research

HSBC Bank plc

+44 20 7931 5980

steven.j.major@hsbcib.com

View HSBC Global Research at: <http://www.research.hsbc.com>

Disclosures and Disclaimer This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Issuer of report: HSBC Bank plc

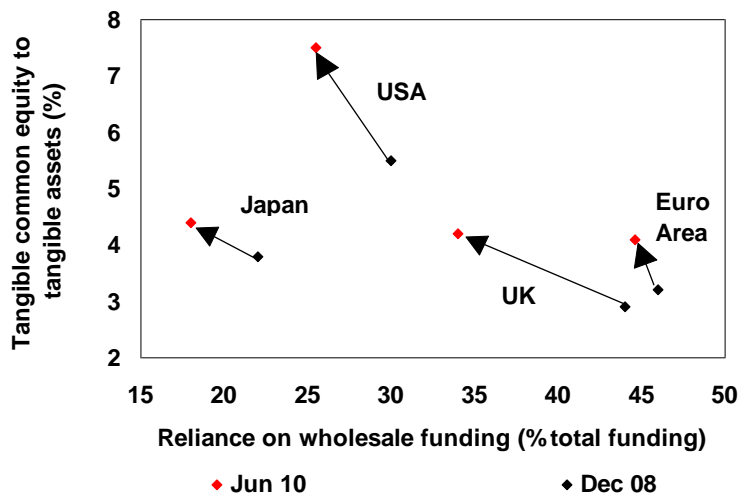
HSBC 
Global Research

Four pillars to stem the contagion

- A deal for Greece that gives the country a chance
- EUR200-250bn recapitalisation of banks
- Expansion of the ECB balance sheet
- **Common bond issuance - Eurobonds**

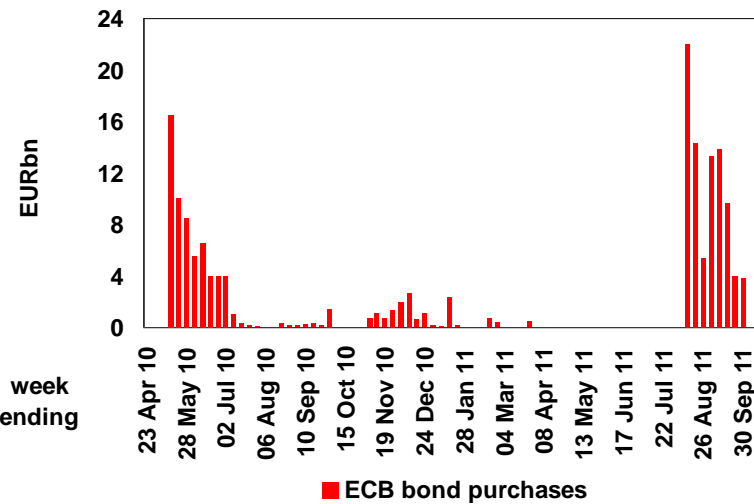
HSBC 
Global Research

Eurozone banks lag US peers on b/s repair



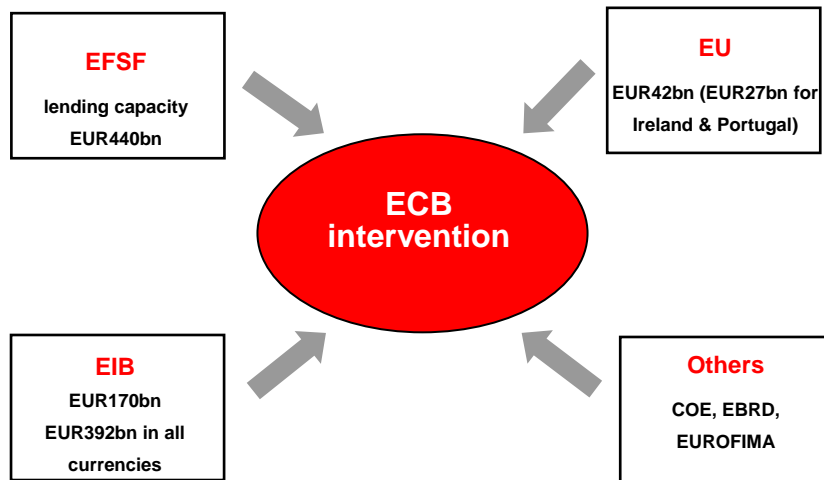
Source: IMF

ECB intervention could be larger than recently



Source: ECB

Eurobonds already exist



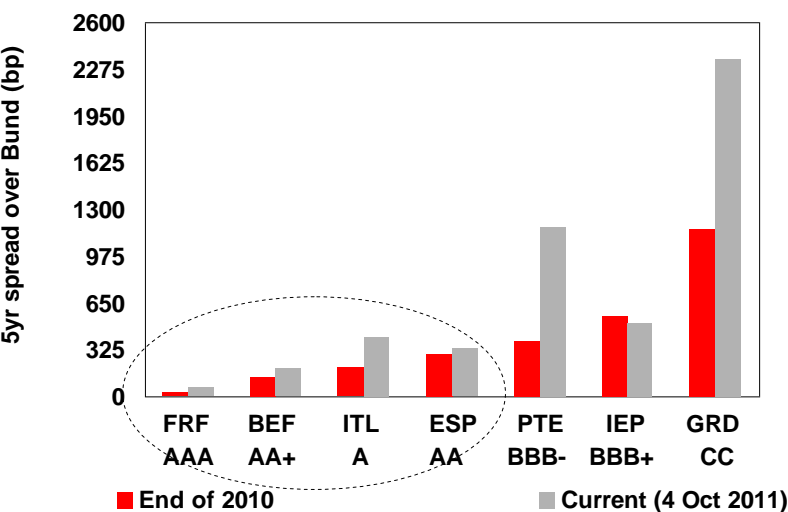
HSBC 

5

Recent developments

- Contagion means that Italy is under the spotlight
- Banking system under pressure
- Policy-makers appreciate that action is necessary
- There have been concerns about the future of the euro

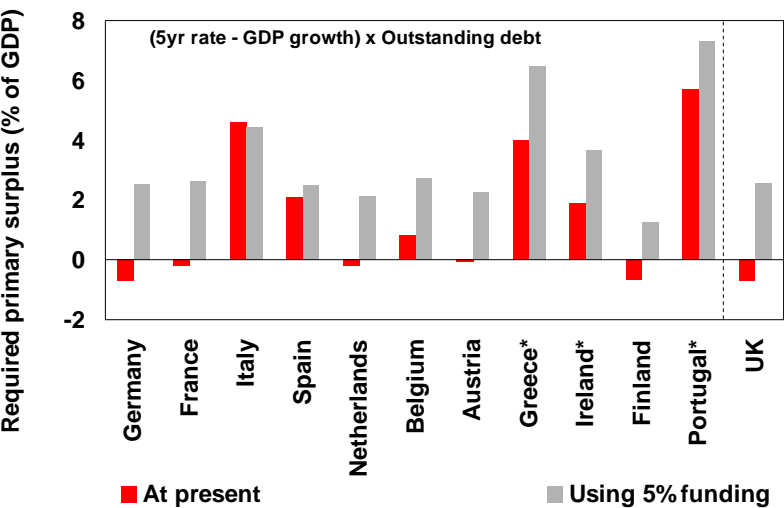
Spreads have widened for the bigger bond markets



Source: Bloomberg, HSBC

Note: S&P ratings used

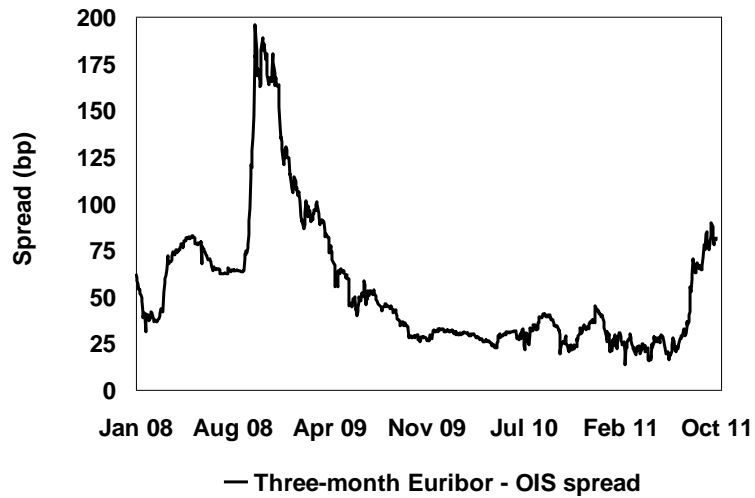
Fiscal sustainability challenge for Italy



Source: HSBC, Bloomberg, EC

* EU/EFSF funding rate of 3.5% used (EU Council statement on 21 July 2011)
Note: Forecasts are for 2012 from EC Spring 2011 report

Stress in the money markets has returned



Source: Bloomberg

HSBC 

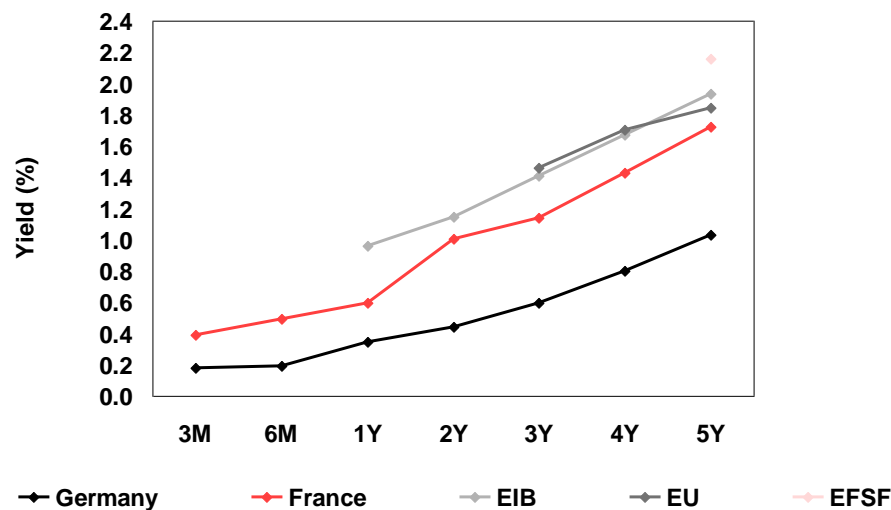
9

Eurobond proposals

- An ideal Eurobond will:
 - be issued by an agent with fiscal authority
 - have a joint and several guarantee
 - be single tranche and provide liquidity to rival US Treasuries
- Recent proposals centre on three ideas:
 - Using the EFSF more efficiently
 - Guaranteeing single name issuance
 - Capped liability bond issuance (blue/red)

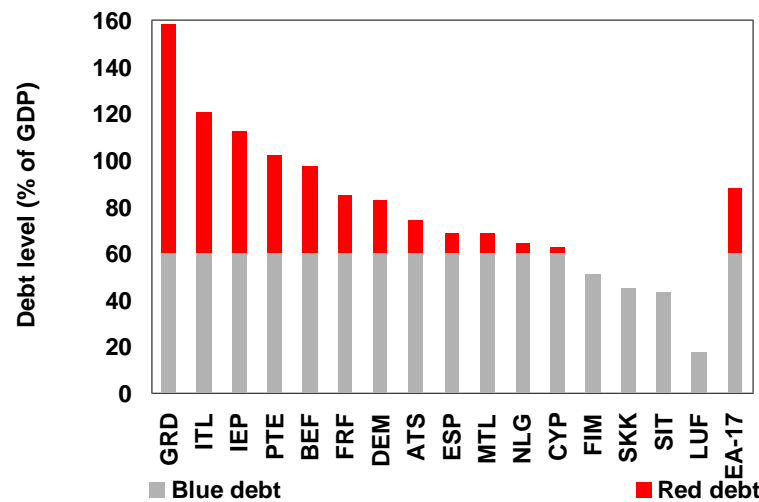
HSBC 
Global Research

Five Eurozone AAA curves



Source: HSBC, Bloomberg

Blue/red bonds: questions on seniority

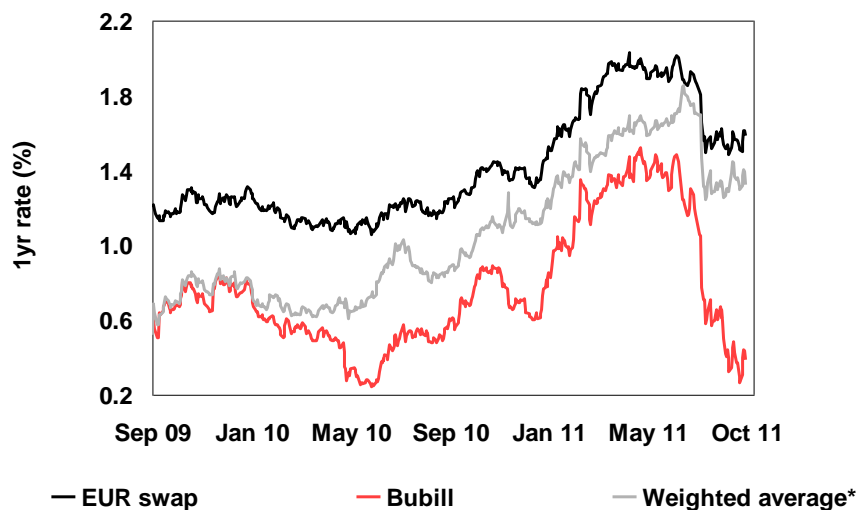


Source: HSBC, European Commission General Government Data Spring 2011

Eurozone bonds: E-Bills are the place to start

- Fiscal union is NOT a pre-condition for the start of an E-Bond curve
- Self-selection process to start E-Bills
- Ultra-low Bubill yields is result of uncertainty
- Very little yield difference between EFSF and EU

Evolution of actual and theoretical T.Bill yields



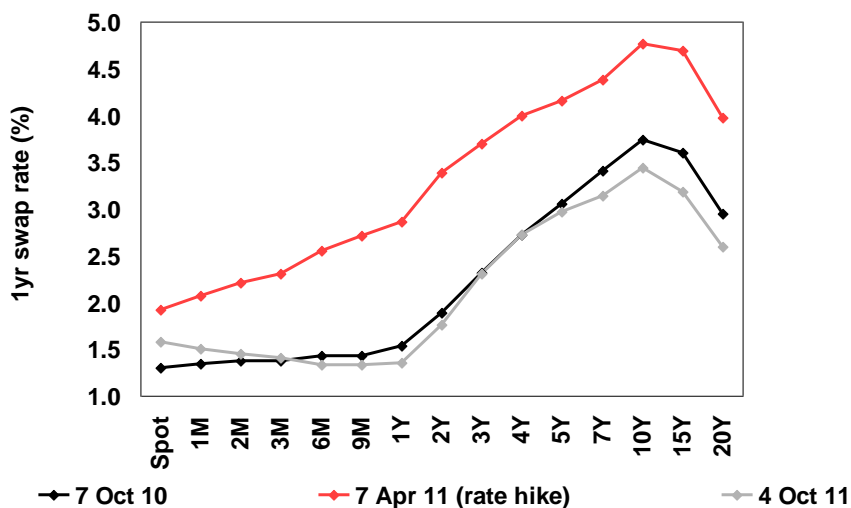
Source: HSBC, Bloomberg

* of 'self-selected eight' excluding Austria and Finland since they do not issue 12-month T.Bills

There is no 'silver bullet'

- E-Bills and E-Bonds are part of the solution
- But more could be done by existing institutions:
 - ECB SMP could increase intervention to reduce liquidity pressure
 - ECB rates should be lower to help debt sustainability
 - EFSF could be used more efficiently
 - A 'final' deal for Greece
 - Bank recapitalisations are necessary

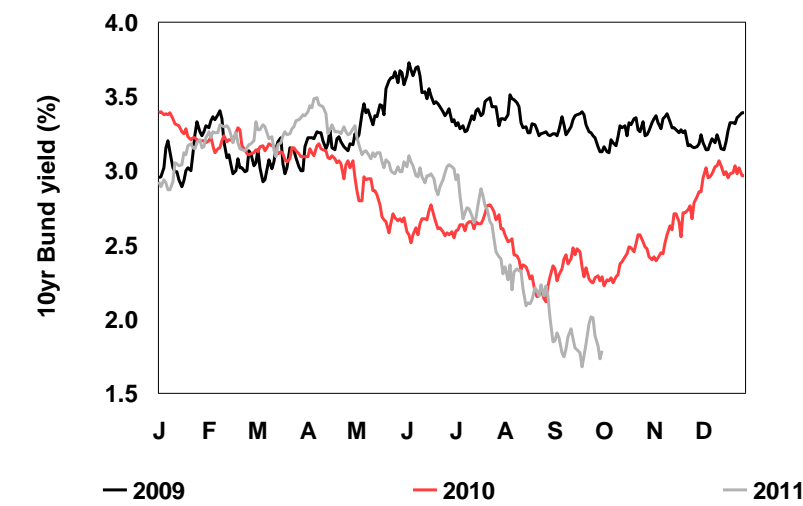
ECB rate cuts would give limited benefit



Source: HSBC

Note: EUR 1yr at forward points

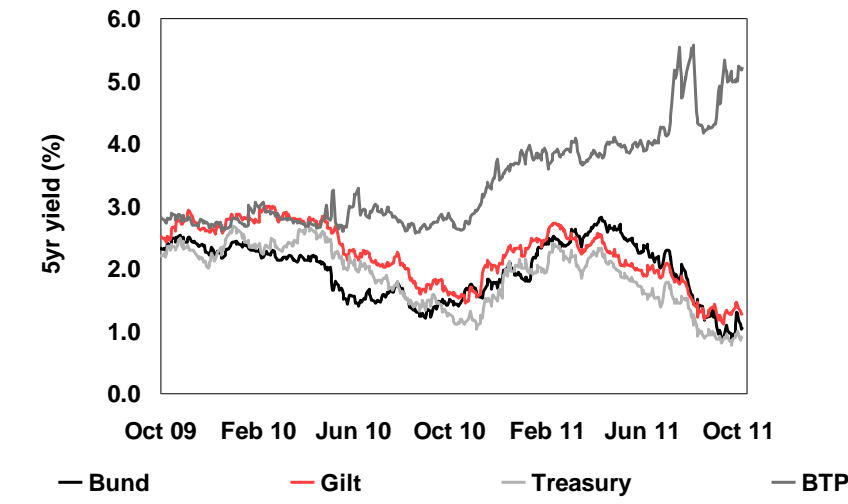
What happens to Bund yields in the fourth quarter?



Source: Bloomberg

HSBC

Five year Germany has performed like UK and US



Source: Bloomberg

HSBC

Investment recommendations

- **Uncertainty caps euro appreciation**
- **Bunds are expensive and vulnerable to improved sentiment**
- **Short-end of Bund curve is particularly rich**
- **Buy short-dated Italy and Spain**
- **Bank senior paper offers value**

Appendix

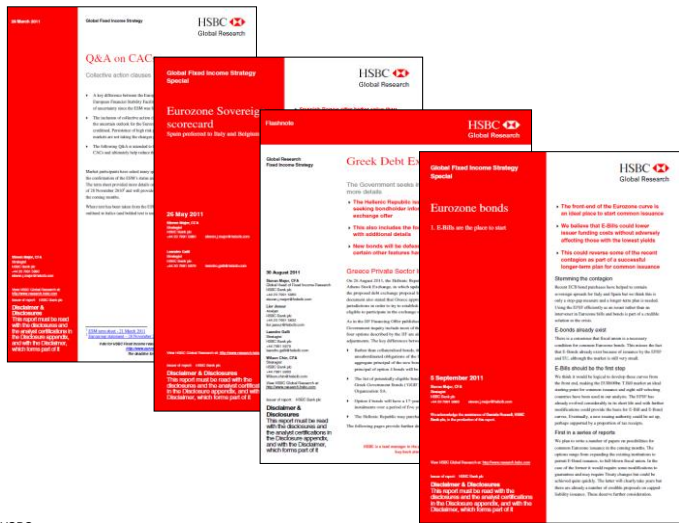
Global Fixed Income Research



Source: HSBC



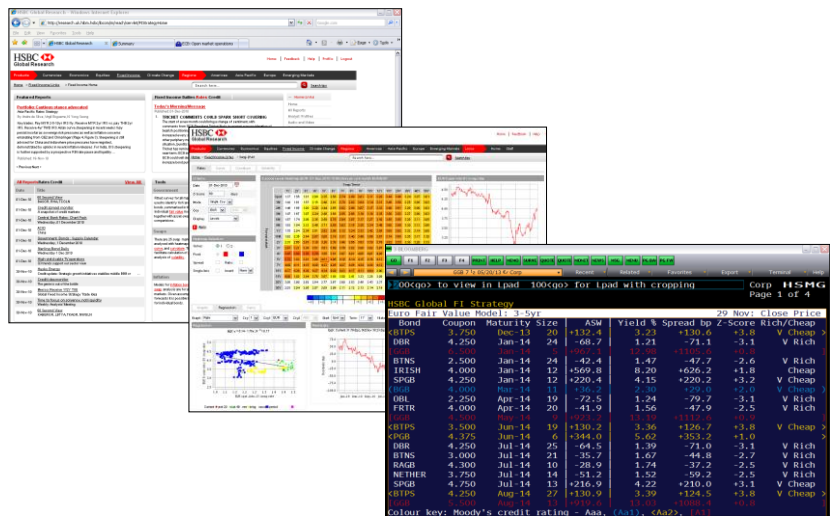
Global Fixed Income Research



Source: HSBC



Global Fixed Income Research Tools



Source: HSBC, Bloomberg



Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Steven Major

Important Disclosures

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other investment products mentioned in it and/or to participate in any trading strategy. Advice in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document and take into account their specific investment objectives, financial situation or particular needs before making a commitment to purchase investment products.

The value of and the income produced by the investment products mentioned in this document may fluctuate, so that an investor may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Value and income from investment products may be adversely affected by exchange rates, interest rates, or other factors. Past performance of a particular investment product is not indicative of future results.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research.

* HSBC Legal Entities are listed in the Disclaimer below.

Additional disclosures

- 1 This report is dated as at 3 October 2011.
- 2 All market data included in this report are dated as at close 29 September 2011, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.
- 4 HSBC is a lead manager in the proposed voluntary bond exchange and debt buy back plan of the Greek government



Disclaimer

<p><i>* Legal entities as at 04 March 2011</i></p> <p><i>'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank Paris Branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Düsseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt SAE, Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Securities SA, Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv; 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Değerler AS, Istanbul; HSBC México, SA, Institución de Banca Múltiple, Grupo Financiero HSBC; HSBC Bank Brasil SA – Banco Múltiplo; HSBC Bank Australia Limited; HSBC Bank Argentina SA; HSBC Saudi Arabia Limited; The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch</i></p>	<p>Issuer of report HSBC Bank plc 8 Canada Square, London E14 5HQ, United Kingdom Telephone: +44 20 7991 8888 Fax: +44 20 7992 4880 Website: www.research.hsbc.com</p>
<p>This document is issued and approved in the United Kingdom by HSBC Bank plc for the information of its Clients (as defined in the Rules of FSA) and those of its affiliates only. It is not intended for Retail Clients in the UK. If this research is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate. In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. The document is distributed in Hong Kong by The Hongkong and Shanghai Banking Corporation Limited and in Japan by HSBC Securities (Japan) Limited. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch. Each of the companies listed above (the "Participating Companies") is a member of the HSBC Group of Companies, any member of which may trade for its own account as Principal, may have underwritten an issue within the last 36 months or, together with its Directors, officers and employees, may have a long or short position in securities or instruments or in any related instrument mentioned in the document. Brokerage or fees may be earned by the Participating Companies or persons associated with them in respect of any business transacted by them in all or any of the securities or instruments referred to in this document. The information in this document is derived from sources the Participating Companies believe to be reliable but which have not been independently verified. The Participating Companies make no guarantee of its accuracy and completeness and are not responsible for errors of transmission of factual or analytical data, nor shall the Participating Companies be liable for damages arising out of any person's reliance upon this information. All charts and graphs are from publicly available sources or proprietary data. The opinions in this document constitute the present judgement of the Participating Companies, which is subject to change without notice. This document is neither an offer to sell, purchase or subscribe for any investment nor a solicitation of such an offer. This document is intended for the use of institutional and professional customers and is not intended for the use of private customers of the Participating Companies. This document is intended for distribution in the United States solely to "major US institutional investors" as defined in Rule 15c-6 of the US Securities Exchange Act of 1934 and may not be furnished to any other person in the United States. Each major US institutional investor that receives this document by such act agrees that it shall not distribute or provide a copy of the document to any other person. Such recipient should note that any transactions effected on their behalf will be undertaken through HSBC Securities (USA) Inc, in the United States. Note, however, that HSBC Securities (USA) Inc, is not distributing this report, has not contributed to or participated in its preparation, and does not take responsibility for its contents. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadorense, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOF). The document is intended to be distributed in its entirety. Unless governing law permits otherwise, you must contact a HSBC Group member in your home jurisdiction if you wish to use HSBC Group services in effecting a transaction in any investment mentioned in this document. HSBC Bank plc is registered in England No 14259, is authorised and regulated by the Financial Services Authority and is a member of the London Stock Exchange. (070905) © Copyright, HSBC Bank plc 2011, ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Bank plc. MICA (P) 208/04/2011 and MICA (P) 040/04/2011</p>	