Sovereign debt crisis
And the future of the euro

11 October 2011

Steven Major, CFA
Global Head Fixed Income Research
HSBC Bank plc
+44 20 791 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

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
Eurozone banks lag US peers on b/s repair

Source: IMF

ECB intervention could be larger than recently

Source: ECB
Eurobonds already exist

- EFSF: lending capacity EUR440bn
- EU: EUR42bn (EUR27bn for Ireland & Portugal)
- EIB: EUR170bn
  EUR392bn in all currencies
- Others: COE, EBRD, EUROFIMA

**ECB intervention**

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

Fiscal sustainability challenge for Italy
Stress in the money markets has returned

![Graph showing Three-month Euribor - OIS spread from Jan 08 to Oct 11.]

Source: Bloomberg

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)
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?

Five year Germany has performed like UK and US
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 Tools

Disclosure appendix

Analytic 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, 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 reports 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.