

# New World Insights

By Philip Poole, Global Head of Macro & Investment Strategy



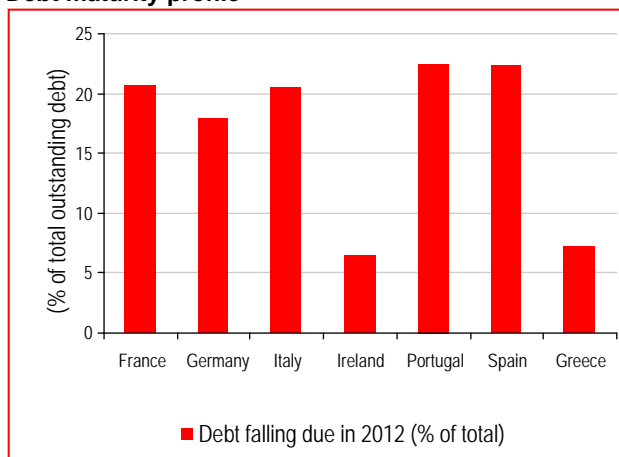
## Rollover or be dead

- ▶ Rollover risk breeds fear and trepidation
- ▶ Eurozone Q1 repayments are heavy
- ▶ They are one of the hurdles that need to be cleared to move towards a solution to the Eurozone debt crisis
- ▶ But while challenging they are not insurmountable

### No trust no more?

In the good old pre-crisis days developed market sovereign risk did not trouble investors. That was a problem confined to emerging markets, where history was littered with defaults brought on by inability to roll over (refinance) debt maturities. By contrast, developed world bond maturities came and went as investors rolled the proceeds into new sovereign issues. Eurozone bond yields reflected inflation expectations not the fear of default and the spread between peripheral and core issuers looked like it would stay tight forever, with investors scrambling to get the slightest pick-up in yield. How the world has changed. Now investors fret about sovereign default in countries where central banks are unwilling (or unable) to provide financial life support. Rollover risk bred fear and trepidation and bond yields soared for most of the Eurozone periphery and part of its core, France included.

### Debt maturity profile



Source: Bloomberg, data as of 24<sup>th</sup> January 2012

### The necessary trick

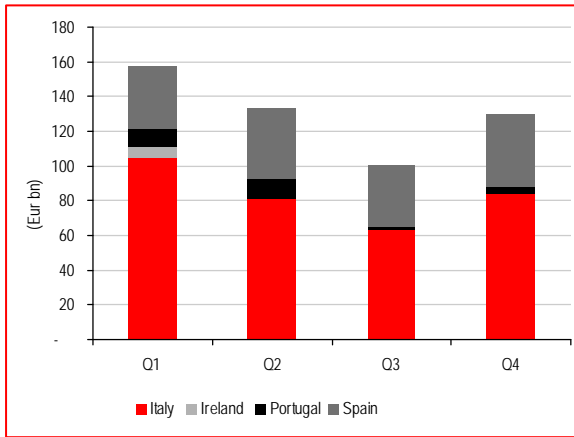
The problem isn't inadequate liquidity. In fact, there's no shortage of liquidity in the global financial system. It just isn't getting to the parts where it's needed most. Rather it's 'trapped' in risk free assets – the likes of treasuries, bunds, gilts and gold. More liquidity from central banks is necessary but not sufficient for a solution. All central banks can do is buy time. The confidence trick that Eurozone governments need to pull off is to convince the market that the 425 bps spread pick up over bunds for 10 year Italian BTPs (Buoni del Tesoro Poliennali), or 120 bps for French Oats, is an opportunity not a risk. If that happens, rollover concerns will wither and contagion from the Eurozone to other markets will be yesterday's story.

### Beware the Ides of March?

As the chart over the page shows, sovereign maturities in the Eurozone are concentrated in the first half of 2012 and rollover risk is particularly heavy in the first quarter with total refinancing requirements for Italy, Spain, Portugal and Ireland around EUR 160bn, of which Italy accounts for almost EUR 100bn falling due in February and March, equivalent to almost 30% of Italy's total 2012 refinancing requirement. Greece also has a first quarter rollover concentration. In this case it's all in March with some EUR 17.5bn (35% of its 2012 refinancing requirement) falling due. This is the reason why a messy default is still a possibility – according to Eurozone governments, unless a debt reduction deal is cut with private sector creditors Greece will not get the next tranche of financing from the so-called 'troika' and will be unable to make these payments.

Ireland also has a March challenge with virtually all of its 2012 maturities (EUR 5.5bn) falling due then. In terms of core Eurozone economies, France has a concentration of sovereign rollovers due in February, March and April, in this case almost EUR 120bn, equivalent to 44% of total 2012 maturities. Beyond Q1 the most notable concentration of sovereign maturities is for Portugal in June when a little more than EUR 10bn (35% of all 2012 refinancing requirements) falls due. Spain's refinancing requirements are reasonably well spaced across the year without any big concentration of maturities in any particular month.

## Redemptions falling due in 2012..



Source: Bloomberg, data as of 24<sup>th</sup> January 2012

Clearly, attracting the funding to meet these maturing debt payments in the next few months could prove challenging, particularly if risk appetite takes a renewed dive. However, as mentioned above there is no shortage of funding that could potentially be directed into Eurozone sovereign issues. The European Central Bank's long-term refinancing operation (LTRO) is injecting funding into the banking system and, in our view, a substantial amount of this funding is likely to flow into government bonds, albeit probably at continuing high yields and a likely shortening of the maturity structure in the process.

These repayments are part of a series of hurdles that need to be cleared if we are to continue to move towards a solution to the Eurozone debt crisis. While challenging, in our view they will not prove insurmountable.

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