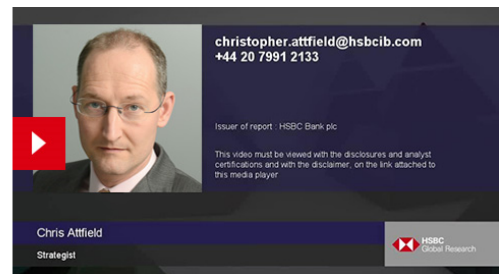
HSBC Global Research

Love, at last?

The prospects for a 10Y Greek syndication

RATES AND ECONOMICS
GREECE

- Investors seem to be warming to Greece, paving the way for the first 10Y syndication since the country's financial crisis
- Solid growth and a large cash buffer should support credit upgrades and help Greece expand its investor base…
- …even though banking sector woes, lack of investment and elections this year remain possible reasons for concern



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Greece could tap the markets again soon

The high real money participation in this month's five-year GGB syndication suggests that investors could be falling back in love with Greece. In order to further broaden its investor base and re-establish a liquid benchmark, we expect a 10-year syndication – the first since 2012's Private Sector Involvement (PSI). Greece is attractively priced relative to similarly-rated EM sovereigns: yield levels may be slightly rich after January's rally, but we expect this to be outweighed by the new issue premium.

Solid growth expected

Greece's GDP is likely to have increased by 2.2% last year, and we see growth of 2.4% this year, followed by 2.0% in 2020. This would be the first time in fifteen years that Greece has posted three consecutive years of 2% growth or more. Even if growth momentum has slowed a little of late, so far Greece has been relatively unaffected by the slowdown in the rest of the Eurozone. Slack in the labour market (the unemployment rate was 18.5% in November) means job creation should remain the main growth driver.

Fiscal picture looks bright

Greece should have comfortably met its primary surplus target (3.5% of GDP) last year, and the European Commission has allowed the Greek government to scrap this year's previously planned cuts to pensions. The government's all-time high cash buffer of EUR37bn (20% of GDP) means the country is fully funded until at least the end of 2022, and these funds could be used to reduce debt (e.g. buying back IMF loans). This has underpinned market confidence and contributed to rating upgrades from all three big agencies last year. Our analysis suggests further upgrades look possible: both Moody's and S&P have a positive outlook.

Some risks remain

The glass is still half-full for Greece. The main risks are related to the recently agreed 11% rise in the minimum wage (which could hurt jobs), the elusive recovery in investment (a drag on potential growth – a key factor in Greece's long-term debt sustainability) – and the uncertainty surrounding the banks. Greece has elections this year, possibly as early as May, but risks appear limited.

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The macro picture

- Greece should continue to see solid growth in the coming years
- The state is fully funded for at least four years and political risk seems limited for now…
- …but concerns remain on banks, investment and policy uncertainty

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Thanks to strong job creation, we see GDP growth of 2.4% this year and 2.0% next

So far, so good

We see solid growth this year and next

GDP growth was a solid 1.0% q-o-q in Q3 last year, following 0.4% q-o-q growth in Q2 (initially released at 0.2%). We expect 0.5% q-o-q growth in Q4. Caution is warranted, as volatility remains the norm in Greek GDP data, but this would take full-year growth to 2.2%, the highest since 2007. We recently also revised up our growth forecast for 2019, from 2.3% to 2.4%, and we see growth at 2.0% in 2020 (European Economics Quarterly: Closed Windows, 14 January 2019). Even though by 2020 GDP would still be 20% below its pre-crisis peak, it would be the first time Greece has seen three consecutive years of GDP growth above 2% in fifteen years.

Job creation the main growth driver

The main driver of growth remains job creation, with employment up 1.8% y-o-y in Q3 2018 and the unemployment rate falling to 18.5% in November last year, down almost 10pp from the peak in mid-2013 (27.9%). Over 140,000 private sector jobs have been created in the last year, in line with 2017. We expect this trend to continue as slack in the labour market remains high, probably at the expense of productivity growth. Last year was also another record year for tourism. Over January to November last year, arrivals rose by 10.6% y-o-y, with international arrivals at Greek airports up 11% y-o-y in 2018 (Hellenic Statistical Authority).

1. Key HSBC forecasts for Greece

% Year	2018f	2019f	2020f	Q3 18	Q4 18f	Q1 19f	Q2 19f	Q3 19f	Q4 19f
GDP	2.2	2.4	2.0	2.2	2.4	2.6	2.7	2.2	2.3
GDP (% quarter)	-	-	-	1.0	0.4	0.7	0.6	0.6	0.5
Consumer spending	1.0	1.5	1.7	0.7	1.6	1.4	1.1	1.7	1.7
Government consumption	-2.8	2.3	2.0	-4.1	-2.3	1.4	3.9	1.9	2.0
Investment	-8.7	9.0	5.0	-23.2	-15.0	15.0	-0.8	17.6	6.3
Stockbuilding (% GDP)	0.4	0.0	0.0	8.5	1.7	1.6	1.6	1.6	1.6
Domestic demand	0.5	1.4	2.1	4.7	0.6	2.1	1.6	-0.5	2.3
Exports	8.6	6.0	3.6	7.6	9.6	8.8	6.3	4.5	4.5
Imports	4.4	6.3	3.9	15.0	8.6	12.2	7.8	1.4	4.4
Industrial production	0.8	1.8	1.9	1.6	0.6	1.6	1.7	1.9	2.0
Unemployment (%)	19.5	17.7	16.5	18.9	19.0	18.4	17.9	17.4	17.1
Wage growth	3.4	0.9	1.3	4.7	1.5	0.5	1.0	1.1	1.1
Consumer prices	0.8	0.3	0.3	0.9	1.2	0.4	0.1	0.4	0.3
Current account (USDbn)	-5.6	-5.7	-6.1	4.0	-4.0	-4.3	-1.9	4.3	-3.9
Current account (% GDP)	-2.6	-2.7	-2.8	7.4	-7.5	-8.1	-3.7	8.3	-7.4
Budget balance (% GDP)	0.3	0.0	-0.2	-	-	-	-	-	-
Gross government debt (% GDP)	182.9	176.1	170.1	-	-	-	-	-	-

Source: Refinitiv Datastream, HSBC estimates

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Momentum fading slightly, but still healthy

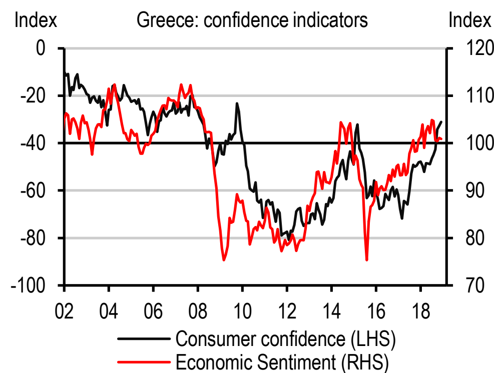
Rising consumer confidence and house prices bode well for private consumption

Growth has cooled slightly after a strong summer tourist season, but remains healthy. The European Commission (EC) Economic Sentiment Indicator (ESI) took a dip at the turn of the year, falling to its lowest levels since last March, but remains at comfortable levels. It was also offset by the continued and sharp rise in consumer confidence, which bodes well for the outlook for domestic consumption (Chart 2). Retail sales increase by 3.2% y-o-y in November, and car registrations were up 4.9% in December (increasing by over 25% in 2018 as a whole).

House prices have finally started to rise, after having fallen over 40% since the pre-crisis peak (Chart 4) building permits were up almost 40% y-o-y in October, with building activity having increased by 19% y-t-d. Rising confidence can also be seen by the fact that people have started to return their money to the banks, after the huge drop in bank deposits in the first half of 2015, which has helped banks reduce reliance on ECB funding (Chart 5).

The manufacturing PMI was 53.7 in January, and has been hovering around those levels since June. So far it appears relatively unaffected by the manufacturing slowdown in the rest of the eurozone (Chart 3). Industrial production concluded the year on a slightly softer tone, but was still 1.1% y-o-y in December, faring better than elsewhere in the bloc. Greece is less exposed than the rest of the eurozone to the recent slowdown in China (only around 1.5% of Greece's exports go to China) and global trade more broadly, while it is an important regional exporter to neighbouring countries such as Turkey, Cyprus and Bulgaria (5.0%), Romania and Egypt (3.2%).

2. Consumer confidence keeps increasing

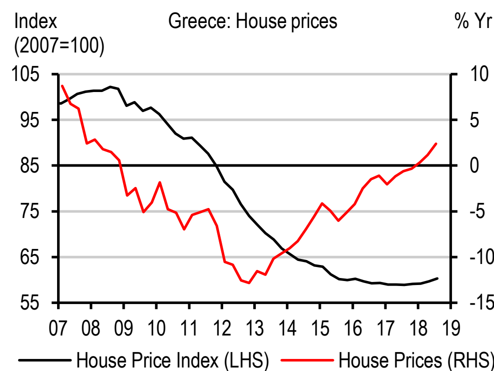


Source: European Commission, ELSTAT, HSBC

3. Manufacturing activity has eased slightly

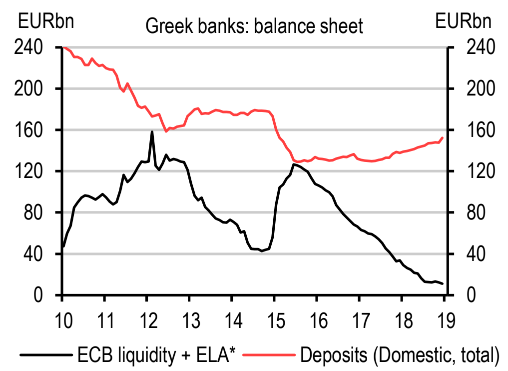
Source: IHS Markit, ELSTAT, HSBC

4. House prices have finally started to rise



Source: ELSTAT, HSBC

5. Deposits are returning to the banks



Source: ELSTAT, HSBC. Note: * Emergency Liquidity Assistance from the BOG

Fiscal outlook still bright

Fully funded for four years (at least)

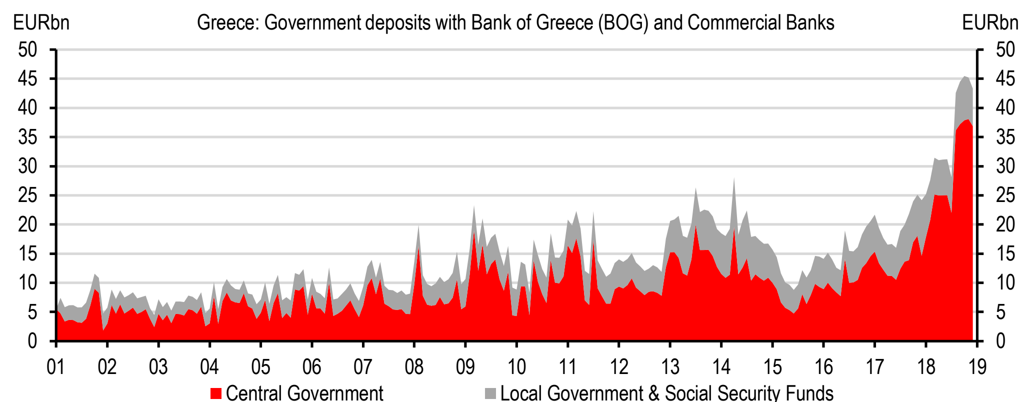
Greece's fiscal performance has remained strong even after having exited the bailout programme last summer, mainly thanks to spending restraint (particularly related to public investment, as noted). At the end of last year, the EC also approved the 2019 budget, allowing the government to scrap previously pledged cuts to pensions worth EUR2bn (1% of GDP), which are no longer deemed necessary to hit the fiscal target (a primary surplus of 3.5% of GDP).

The strong fiscal performance and the last disbursement under the EU bailout programme have left Greece with a large cash buffer. At the end of last year, the government had an all-time high EUR37bn of deposits (20% of GDP) with the central and commercial banks at the end of December, plus another EUR6.5bn of the local government and social security (Chart 6).

Thanks to the high cash buffer, Greece is fully funded until 2022, possibly even 2023

According to the IMF, total refinancing needs until 2022 would amount to EUR23bn. This is without taking into account any further debt issuance – beyond the EUR2.5bn of 5YR Greek Government Bonds recently issued – any privatisation revenues, or the return on the profits made by the eurozone central banks on their Greek bond holdings. Hence, provided it can maintain the recent strong fiscal performance, Greece should be fully funded for the next four years or so, on our estimates, possibly even until 2023 (Table 7).

6. Cash balances of the Greek government with the banks are at an all-time high



Source: Bank of Greece, HSBC calculations

7. Greek government funding needs in the next five years

	2019	2020	2021	2022	2023
Primary deficit (+) / surplus (-)	-6.6	-6.8	-7.2	-7.3	-6.5
Interest payments	5.5	5.1	5.1	5.4	5.5
Amortization (excl. S-T)	11.8	5.1	5.4	9.9	11.8
Issuance	2.5				
Refinancing needs	8.2	3.4	3.3	8.0	10.8
Refinancing needs (cumulative)	8.2	11.6	14.9	22.9	33.7
Cash Balance (as of December)*	36.9				
Memo: Privatisations	-1.1	-0.5	-0.1	-0.1	-0.1
Memo: ANFA profits	-1.5	-1.4	-1.4	-1.3	-0.1

Source: HSBC calculations based on IMF and Bank of Greece. Note: Central Government deposits by the BOG and Commercial Banks. It excludes EUR6.4 of Local Government and Social Security Funds deposits. ANFA (Agreement on Net Financial Assets) refers to the agreement between the NCBs and the ECB, which sets rules and limits for holdings of financial assets which are related to national tasks of the NCBs.

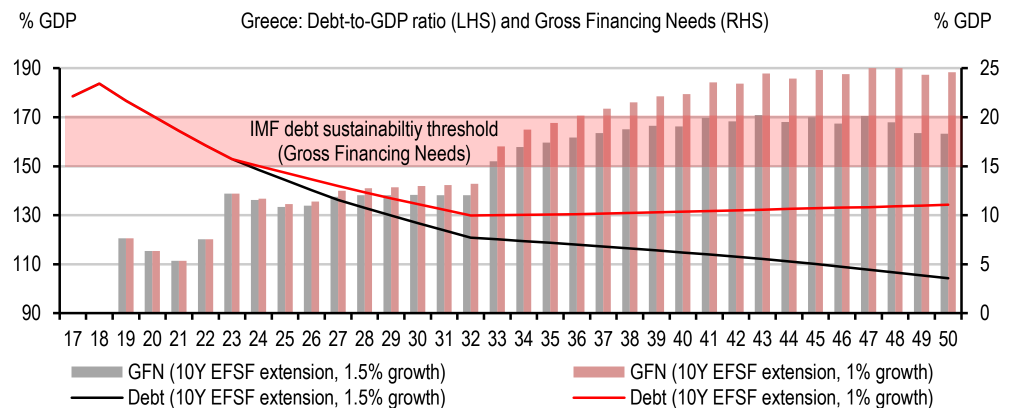
No more debt relief, for now

Greece's refinancing needs are limited until at least 2032

On top of the cash buffer, a significant amount of public sector debt relief was granted upon the bailout programme completion in August. Effectively, all loans and interest payments have been pushed out further, to 2033 and onwards.[1] The eurozone has also made it clear that no further debt relief will be granted to Greece for the time being, while possible further measures might be discussed in fifteen years, provided Greece continues to meet the fiscal targets.

Our debt sustainability analysis (DSA) at the time showed that such measures should have been sufficient to meet the target for debt sustainability initially laid out by the IMF and then officially adopted by the Eurogroup in May 2016 for Gross Financing Needs (GFN) "below 15% of GDP during the post programme period for the medium term, and below 20% of GDP thereafter." The picture has not changed since then, with Greece's growth in line with our expectations. To meet the debt sustainability criteria beyond 2033, however, Greece would need long-term growth of at least 1.5%, as forecast by the EC, while with the 1% expected by the IMF it would fall short (Chart 8).

8. Greece needs 1.5% GDP growth to meet the debt sustainability criteria in the long run



Source: HSBC calculations based on IMF, European Commission. Assumptions available upon request.

Glass is half full

As long as Greece keeps delivering on the fiscal front and on growth, we continue to see the glass half full for Greece. The rating agencies revised up Greece's rating last year (Fitch even by two notches), and our analysis suggests we might see further upgrades in the future, although it will probably take time to regain the investment grade. Investor confidence is improving, at least with respect to sovereign bonds. This year we have also finally seen the yield on 10-year sovereign bonds falling below 4%, after having moved sideways for most of last year, with the investor base expanding (see later). The press has also recently reported that the Bank of Greece is ready to present a plan to lift remaining capital controls (Kathimerini, 7 February).[2]

The cash buffer is both an opportunity and a risk

The large cash buffer plays an important role in boosting investor confidence, reducing the risk of a possible default (at least in the short term) and avoiding a situation of continued uncertainty on whether Greece will be able to meet its next debt repayment, as it was the case until a few years ago. It is also an important factor in driving the rating agencies' assessment. However, one could argue that it could also reduce the sense of urgency for the Greek government to comply with the post-programme surveillance requirements, other than to retain investor confidence. So we see the cash buffer as both an opportunity, and a risk.

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[1] The Eurogroup agreed to a 10-year extension of the weighted maturity and longer grace periods on interest payments on the EUR131bn of loans from the old European Financial Stability Facility (EFSF), which was replaced in 2013 by the European Stability Mechanism (ESM).
[2] Capital controls were introduced starting from 28 June 2015. Banks re-opened on 20 July 2015 and restrictions to the free flow of capital have been progressively relaxed since then. In May 2017 the Greek government published a roadmap towards the full elimination of the capital controls.

Arguably, the current level of the cash buffer is even too high. But what to do with it? The press has speculated on a possible use in a plan to help banks dispose of their NPLs (Kathimerini, 8 February). In our view, using at least part of the buffer to buy back expensive IMF loans (still EUR10bn of outstanding loans) or the remaining Greek Government Bonds (GGBs) with the ECB (EUR11bn) would reinforce the government's commitment to pay back its debts, and also improve the long-term sustainability of the debt. But any such move should be made in a concerted manner with EU authorities in our view. For example, another important factor to support the sovereign bond market could be if the ECB lifted the cap in terms of how many Greek bonds domestic banks could hold. So clearly, Greece still needs the EU. The 2019 budget negotiations are a good example of positive cooperation.

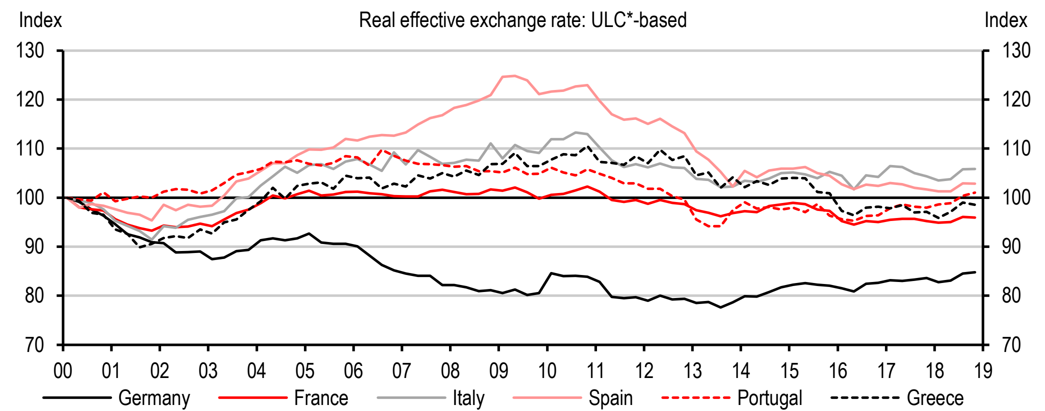
Risks to the outlook

Minimum wage increase could hurt growth

Greece's minimum wage is still high relative to its regional peers

On 28 January, the cabinet decided an increase of the statutory minimum wage rate by 11% and the abolition of the sub-minimum wage rate for workers aged under 25. The new rate went into effect as of 1 February 2019. Greece has significantly improved its cost competitiveness in recent years (Chart 9) and the minimum wage has already been cut by almost 20% since the crisis. However, it remains relatively high compared to regional peers and competitors (Chart 10). Therefore, we see a risk that the latest increase could hurt job creation, which so far has been the main growth driver, particularly in the tourism sector where firms' margins tend to be low.

9. Greece has significantly improved its cost competitiveness since the crisis



Source: HSBC calculations based on OECD. *ULC refers to unit labour costs

10. Greece's minimum wage is low, but still relatively high compared to its regional peers

Source: Eurostat, HSBC

Investment is only a little over a third its pre-crisis level

Investment, where art thou?

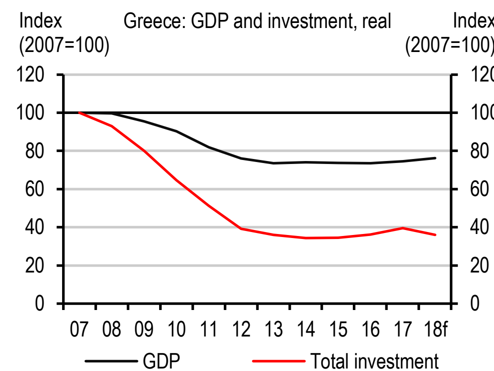
Investment is less than 40% its pre-crisis level, and accounts for less than half as a share of GDP than what it used to do before the crisis (Chart 11). That's a significant drag to the country's growth potential, which in turn is key for the long-term sustainability of Greece's high public debt (above 180% of GDP last year according to our estimates). We discussed this issue in *Now it's down to Greece: The eurozone delivered, now Greece needs growth*, 27 June 2018. While the data are blurred by high volatility, 2018 was not a good year for investment, which fell by 24.7% q-o-q in Q1, followed by a 17.7% rise in Q2, and another 14.5% fall in Q3 (we don't yet have data for Q4). The setback in Q3 likely reflected a fall in non-residential construction, and delays in the Public Investment Programme.

Greece needs a more growth-friendly fiscal strategy, and to attract more FDI

Public sector spending restraint is an important reason for the investment shortfall. Last year public investment is expected to have been 3.5% of GDP, an all-time low, leaving aside the two crisis years of 2011 and 2012 (2.5%) and compared to a 5.5% of GDP average in the 2000s. A more growth-friendly fiscal strategy would help lift the country's growth potential in our view.

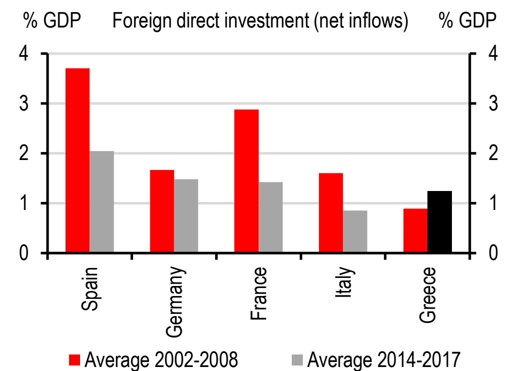
Greece's ability to attract Foreign Direct Investment has improved recently, with the privatisation programme showing some signs of life.[3] But Greece remains a country which attracts little FDI, limiting the productivity gains that arise from technological spillover effects. More openness to FDI, particularly now the risks of Greece leaving the eurozone have faded, would be beneficial.

11. Investment stands at roughly a third of its pre-crisis level



Source: ELSTAT, HSBC

12. Greece still struggles to attract FDI



Source: Eurostat, HSBC

Concerns around the banking system could continue to weigh on the economy and market sentiment

Banking sector woes could affect the economy

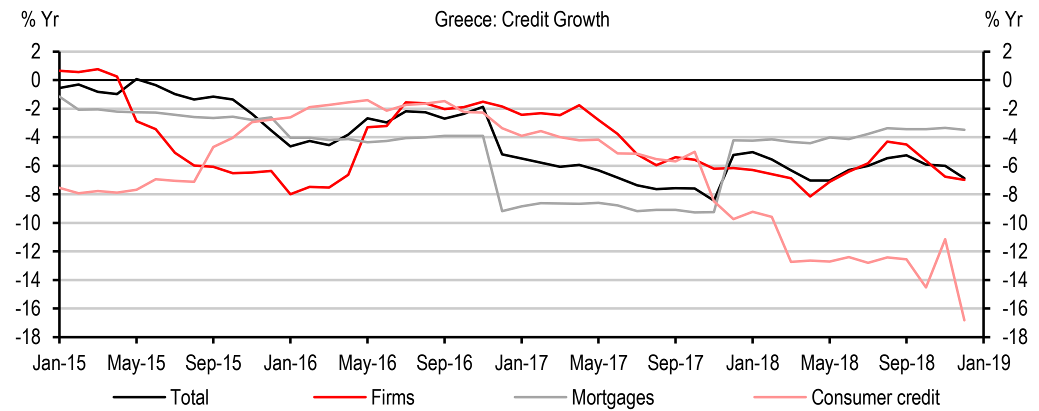
Even though its reliance on ECB liquidity (and expensive Emergency Liquidity Assistance) has fallen, the banking system remains a weak spot for the Greek economy. In the latest enhanced surveillance report, the EC noted that further progress is still needed in areas such as arrears clearance and insolvency legislation. The intended resolution of the problem of high non-performing loans (NPLs) by the banks has so far entailed among other things insolvency legislation, an out-of-court workout scheme and an electronic auctions platform. More imminently, the Greek government needs to legislate the new framework for legal protection of primary residences that will replace the thrice-extended scheme that is due to expire at the end of February. The Greek press recently reported that the Greek government may be less keen to limit the eligibility criteria, which could be a possible stumbling block towards the completion of the Enhanced Post-Programme Surveillance due in March (Kathimerini, 11 February 2019).

[3] According to the government, public revenues from privatisations amounted to EUR0.5bn in 2016, EUR1.4bn in 2017 and are expected to have reached EUR2.1bn in 2018. The forecast for 2019 is EUR1.5bn.

In November, the Bank of Greece put forward a proposal to reduce banks' 'bad loan burden,' and the Hellenic Financial Stability Fund has proposed a public guarantee scheme with the government guaranteeing senior tranches in NPL securitisations in order to address the large stock of non-performing assets on the banks' balance sheets. At the moment, however, the fate and timing of these proposals is uncertain, and there are also some viability questions.

With continuing pressures from the supervisor to reduce the stock of non-performing assets and limited resources, the ability of the banks to lend to the economy might remain constrained (Chart 13). Concerns around the banks and possible delays in the post-programme surveillance process due to banks-related issues might also affect investor sentiment towards the country.

13. So far Greece has seen a credit-less recovery



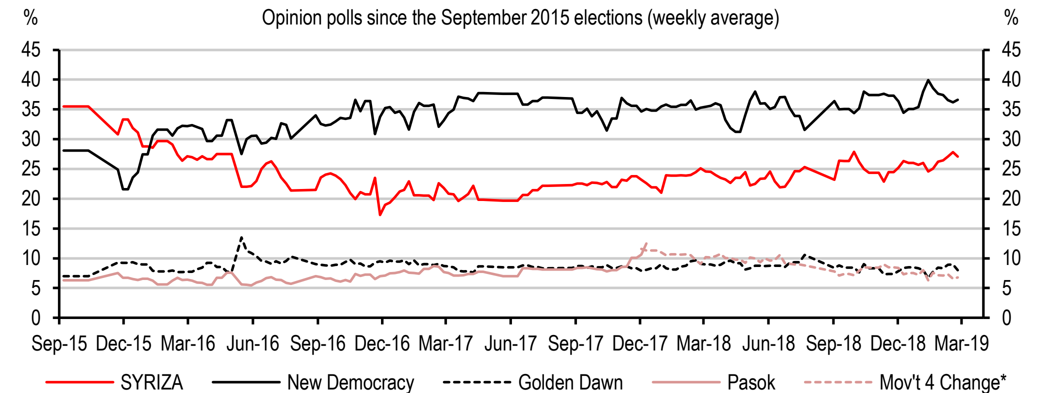
Source: Bank of Greece, HSBC

Election risks seem limited, even if some uncertainty and possible fiscal slippage could be on the cards

Could elections derail progress?

Elections need to take place by October 2019, followed in early 2020 by the presidential election. We see a risk of earlier elections, possibly in May alongside the European parliamentary elections. With the main opposition party, New Democracy, currently leading in the polls (Chart 14) and committed to continuing implementing the programme measures, political risk seems contained. However, some uncertainty, particularly during the electoral campaign and also after the elections, cannot be ruled out. Some U-turn on reforms (ie. on first resident protection) or fiscal slippage could also be on the cards ahead of the election, if the current ruling party Syriza tries to boost its chances of a possible re-election, which could put Greece at odds with the EU.

14. New Democracy has maintained a stable lead in the polls



Source: HSBC, Metron Analysis, Pulse RC, Alco, Palmos Analysis, Kapa Research, Marc, Rass, Parapolitika, PAMAK, MRB. Note: * Movement for Change refers to the centre-left alliance between the PASOK, DISI and KIDISO (formed in early 2018).

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Stepping stones

- We think Greece could return to the market in the coming months with a 10Y benchmark syndication
- This could be supported by April's EUR2.45bn redemption; our analysis suggests Moody's 1 March credit rating review could be positive
- Greece looks a little rich based on our model after January's rally, but this will likely be compensated by new issue premium

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The next step to a liquid curve

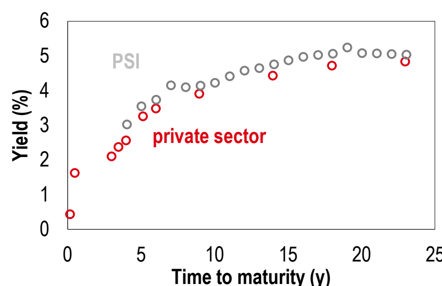
The exchange offer that established Greece's new benchmark curve was a watershed moment. The PSI bonds were not only highly fragmented, but their ratcheting coupon structure made them increasingly expensive for the issuer, and harder to value for investors. The new benchmarks, issued in December 2017, established a fixed coupon curve with better liquidity in individual issues (Figure 15). As a result, Greece's curve is now mostly regular private sector bonds rather than the PSI strip or bonds held by the Eurosystem (Figure 16).

There was some suggestion last year that Greece might choose to flesh out its new curve by issuing at the three-year point (See *DM Rates Ideas*, 29 June 2018). This would have been cheaper for the issuer; but the fact that it did not happen may perhaps be taken as an indication of a different strategy. In two years' time the existing five-year bonds will have three years maturity remaining, filling out that maturity bucket without the need for fresh issuance.

A new 10-year would fit in with Greece's observed issuance pattern

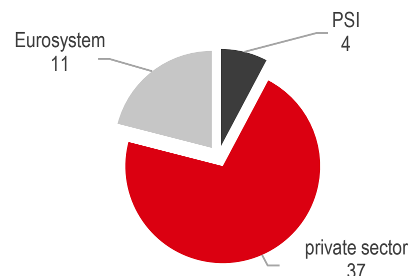
In view of Greece's return to market at the five-year point at the end of January, it would seem that the favoured approach is to issue at fewer maturity points, and let the maturity profile fill out naturally as existing issues roll down the curve. As the 10-year benchmark now has just under nine years to maturity, this makes us think a new 10-year benchmark is likely this year. This would fit in with the pattern of issuing at major benchmark maturities (five- and 10-year) and filling out the curve through roll-down. We think it makes little sense in this framework to issue a seven-year, even though there is a gap in the maturity profile.

15. Greek yield curve and PSI strip



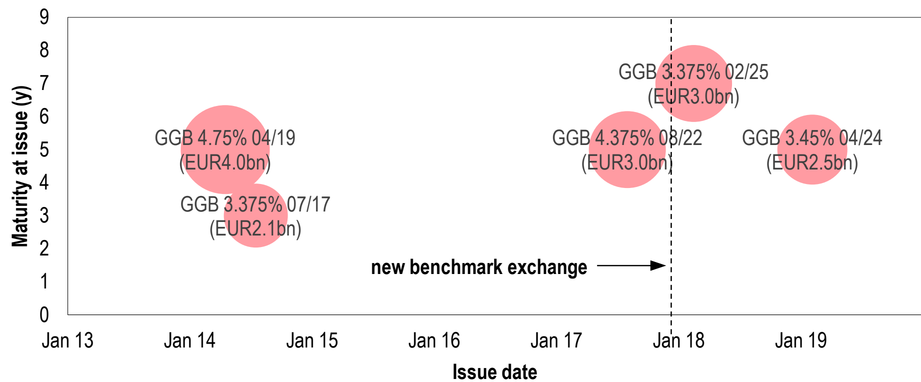
Source: Bloomberg, HSBC

16. Outstanding amount by series type



Source: Bloomberg, HSBC. Outstanding amount in EURbn

17. Greece issuance size and original maturity



Source: Bloomberg, HSBC

Ten-year issuance would be a step beyond what Greece has done in the past

Ten-year issuance would be a step beyond what Greece has done in the past. Since its return to the markets in 2014, Greece has issued new bonds with original maturity of between three and seven years (Figure 17: the current 10-year benchmark was issued as part of the December 2017 exchange, and has nine years' maturity remaining).

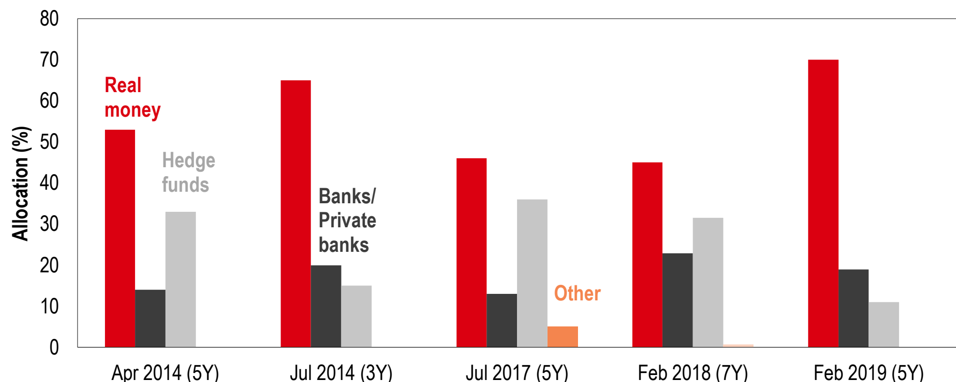
Amount and timing

Greece has ample cash reserves, is obliged to run primary surpluses, and should see solid growth in the coming years (see "The macro picture" above). We expect the country to use some of its cash and debt sale proceeds to refinance its IMF loans, which total SDR7.7bn (roughly EUR9.5bn), all due before 2024. Beyond this, we think its aims will be to broaden its investor base, establish liquid benchmarks, and enhance market confidence.

The recent five-year syndication had a large order book and high participation from real money accounts

The recent five-year syndication was a move in that direction: it had the largest order book for a GGB syndication since 2017, and 70% of orders were from real money accounts (fund managers, insurance and pension funds). This is the largest real money participation of any post-PSI syndication, and also marks the lowest hedge fund participation at 11% (Figure 18).

18. February's syndication had the highest participation from real money investors



Source: Bloomberg, PDMA website, HSBC calculations

From this point of view, a 10-year benchmark makes sense in our opinion: Greece is low-rated and relatively illiquid, and so will always form a small part of European real money portfolios. The one thing it can offer is yield enhancement, especially when curves are flattening and expectations of a hiking cycle are being priced out in the Eurozone.

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April's EUR2.45bn redemption should provide cash for reinvestment

The debt cap mandated by its public sector creditors could form an obstacle, but there are two mitigating factors. First, new issues have been between two and three billion EUR in size, and a relatively long-dated 10-year syndication may be at the lower end of that range. Second, the redemption of EUR2.45bn in April should clear some headroom, as well as providing cash for reinvestment. It may be that May's European elections form a deadline for issuance, and there may also be some desire to "strike while the iron is hot" given the good performance of non-core syndications so far in 2019 – including the new Italian 30-year bond (see *DM rates ideas*, 8 February 2019).

Credit Ratings

The next scheduled rating review date is Moody's on 1 March

Greece was upgraded in 2018 by all three agencies in the wake of its successful debt exchange. Table 19 shows the current ratings, and the scheduled review dates at the three largest rating agencies. The next scheduled date is Moody's on 1 March, which may be of interest because it has Greece on positive outlook and currently assigns the lowest rating of the three agencies.

Fitch left Greece's rating unchanged at its 8 February review. Most of the factors it cited as positive for future upgrades are things which would only be realised over time, such as future primary surpluses, a sustained economic recovery, and continued good relations with its public sector creditors.

19. Rating review dates for Greece

	Moody's (B3/Pos)		S&P (B+/Pos)			Fitch (BB-/Stable)	
country	first	second	first	second	third	first	second
Greece	01 Mar	23 Aug	18 Jan	26 Apr	25 Oct	08 Feb	02 Aug

Source: Rating agency websites, HSBC. Shading indicates past dates

This all points to positive, if gradual, underlying rating momentum. However, it should be borne in mind that the other agencies have space to catch up with Fitch's rating, which is the highest of the three. Greece's CDS implied rating is roughly fair to its agency average at B+, although price signals from Greek CDS are not terribly reliable in our opinion.

Valuation

Greece is the only sub-IG developed market sovereign

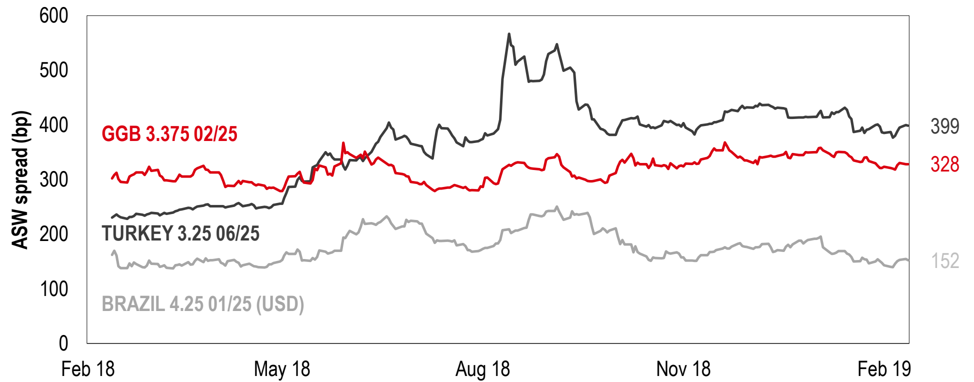
Greece is the only sub-IG developed market sovereign since Cyprus was upgraded to IG by S&P in September 2018, having already upgraded Portugal to IG in September 2017. Any peer comparison must thus be with EM countries. Two countries that are closest in rating whilst also having relatively liquid bond markets are Turkey and Brazil (Figure 20).

Choosing the five-year point for ease of comparison, it can be seen that Greece trades significantly wider than Brazil, to which Fitch assigns the same BB- rating. Its five-year ASW is tighter than Turkey, despite the fact that Turkey has a higher average rating, but this could be due to Turkish structural factors, and our strategists are cautious on Turkey credit (see page 18 of *CEEMEA rates*, 8 February).

Greece is still influenced by EM volatility

It is commonly supposed that Greece is influenced more by EM volatility than the Eurozone, in our opinion. To test this, we regressed Greek 10-year yields against both an EM external spread index and Spanish and Italian 10-year yields. On both one-month changes and levels, this still looks to be the case: correlations are slightly higher for EM spreads than Spanish yields. Correlations are slightly higher for Italy than Spain – but Italy also correlates a lot more to EM.

Figure 20. Spread comparison with Brazil and Turkey



Source: Bloomberg, HSBC

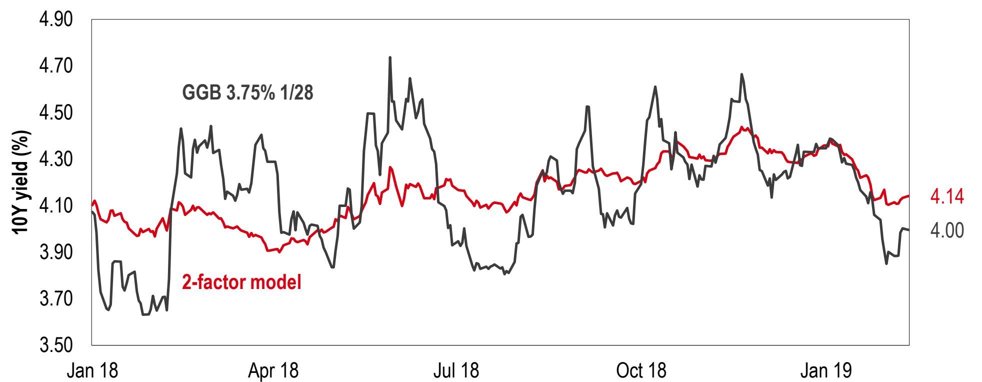
Modelling value

To get a guide to value, we look at a two-factor model using Spanish 10-year yields and EM spreads. These two factors are both significant, and they result in a higher R-squared than is possible with either factor on its own (0.3 versus 0.22 for just EM spreads). The results are shown in Figure 21.

Our model suggests that 10-year Greece looks slightly rich

Our model suggests that 10-year Greece looks around 14bp rich, following January's rally. However, to take the example of the recent 2024 maturity GGB syndication, or Italy's 30-year bond sale, any new issue premium may well be enough to make up the difference – even if there is no cheapening. In our view this suggests that it is likely that any new 10-year bond is likely to yield over 4%.

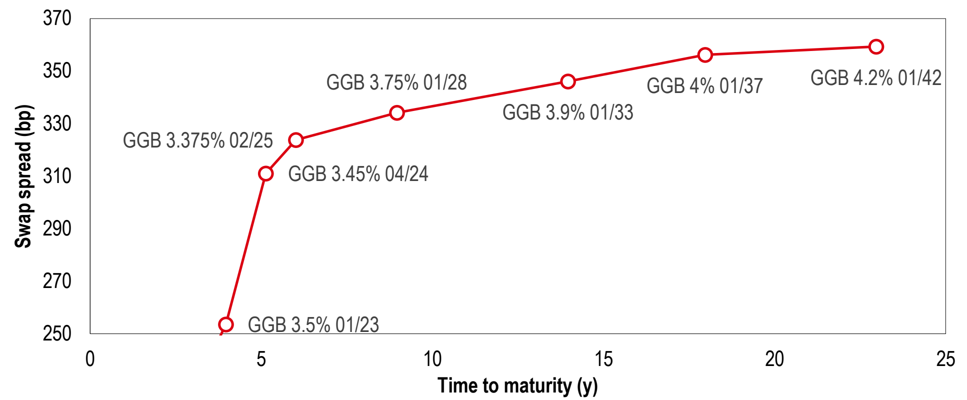
Figure 21. Modelling relative value for 10Y GGBs



Source: Bloomberg, HSBC calculations. 2-factor model using diversified EMBI and 10Y BVAL constant maturity Spain yield, regression from 1 Jan 2018 to present

The roll from the existing 10-year benchmark (GGB 3.75% 1/28) to a 10-year maturity would be around 10bp on fair value grounds in our view, mostly because of the slope of the swap curve. The matched-maturity swap spread curve shown in Figure 22 plateaus after the seven-year point: any spread difference should be less than 2bp. As with the Italian 2049 syndication, we think the roll should be almost entirely new issue premium.

Figure 22. Matched-maturity GGB swap spreads plateau after the 7Y point



Source: Bloomberg, HSBC calculations

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