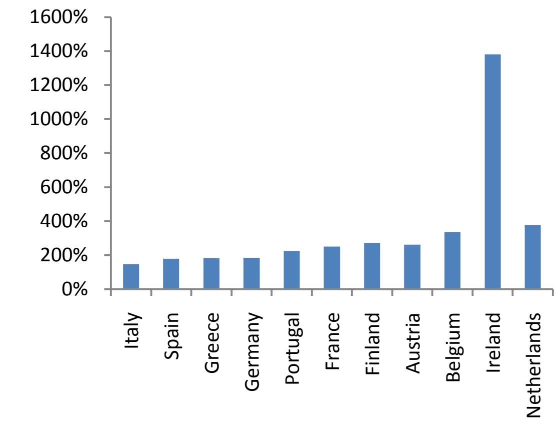
16 December, 2011

Euro Zone Crisis: Five Year Italian Yields Climb Above 7 Percent

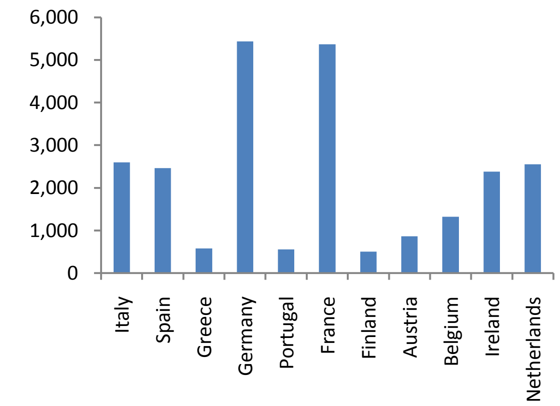
Europe

Government Debt as a Percentage of GDP



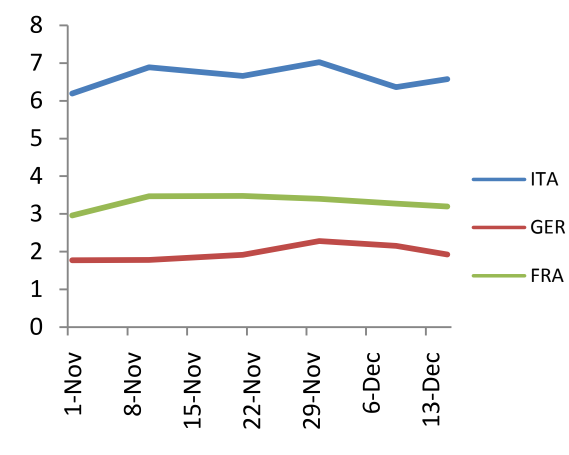
Source: World Bank, SFA Research

Gross External Debt ($ billions')



Source: World Bank, SFA Research

10 Year Yields on Government Bonds



Source: Bloomberg, SFA Research

Yields surged to their highest ever levels since May 1997 to 6.47 percent on the auction of three billion Euros, which was up from 6.29 percent that the sovereign government paid last month. Yields on 5-year bonds were 6.69 percent after the auction. These bonds mature on September 15, 2016 and carry a coupon rate of 4.75 percent. Confidence surrounding the ten year Italian bond yield seemed to plummet as yields were back up again well jumping past the 7 percent anxiety benchmark on Wednesday to pass 7.115 percent.

Pessimism was in full force despite Monti's cabinet announcing a new thirty billion Euro budget plan to boost economic growth and raising revenue for the debt ridden nation. Monti is adamant at pushing forward a plan to tame the debt crisis that is deemed much larger than Spain, Portugal, Greece and Ireland combined. While addressing the Finance and Budget Committees of the Chamber in Rome, Monti stated, "we are confident that markets will react positively to the efforts Italy is making, maybe not tomorrow, but the reduction in borrowing costs that we anticipate in the coming months will help spur the economy." The new budget plan unveiled by the Italian Prime Minister focused on key areas such as the need to restore economic growth by creating job opportunities and reinvesting 10 billion Euros of savings, tax breaks for companies employ to more young workers and children, raising gasoline levies and reinstating property taxes. Furthermore, the plan aims to recover the lost revenue by increasing the planned levy on Italians who took advantage of previous amnesties on tax evasion. The Italian government called for a vote of confidence on Thursday for the new plan.

Italy, the Euro zone's third largest economy has to repay 53 billion Euros in debt in the first quarter of 2012 from a total maturing debt of 157 billion Euros. Furthermore, it has to pay 3.20 billion Euros in the form of interest payments based on the average five-year yield of the past three months (UBS AG). Concerns are mounting for the nation as it is susceptible to pressure if the ten year bond yields top up to 7.00 percent or more, the rate which forced Greece, Ireland and Portugal to seek bailouts. The Euro continues to depict its downward trend, falling to a low of 1.2983 against the US dollar in Thursday's trading session.

According to Confindustria, the Italian employers' federation, the forecasted GDP will contract to 1.60 percent in 2012, compared with a September forecast of an expansion of 0.20 percent. The federation revised its GDP growth estimates to 0.5 percent from an expected 0.50 percent. The lobby expects that the economy will remain in recession until the second half of next year. Furthermore, unemployment is expected to reach 13 percent. "If anyone had any doubts, after the numbers from Confindustria, we can no longer hide the fact - we are in recession, even if we didn't cause it," said Development Minister Corrado Passera. "The situation today is worse than we expected," when the government came to power a month ago.