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Portuguese, Greek Bonds Lead Peripheral Notes Lower on Budgets
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By Lukanyo Mnyanda and Keith Jenkins

Oct. 27 (Bloomberg) -- Portuguese and Greek bonds led so- called peripheral European markets lower after the failure of Portugal's budget talks and tax-revenue shortfalls in Greece reignited concerns countries may struggle to cut their deficits.

Greek bonds fell by the most in more than four months. Finance Minister George Papaconstantinou said a shortage in tax intake is hampering government efforts to reduce its national debt. German government bonds slid as a report showed consumer prices rose in October, making it more likely the European Central Bank will keep removing stimulus measures even as smaller economies in the region lag behind.

"This is still a bumpy road," said David Schnautz, a fixed-income strategist at Commerzbank AG in London. "This kind of news is highly market-moving and any relief we see in terms of spreads tightening is vulnerable."

The yield on Portugal's 10-year bond increased 24 basis points, the most since Sept. 20, based on closing prices, to 5.93 percent as of 3:39 p.m. in London. That left the extra yield, or spread, investors demand to hold the bonds instead of similar German bunds at 328 basis points.

Greece's 10-year yield rose 79 basis points, the most since June 15. The spread with bunds widened to 779 basis points, the most since Oct. 1. Ireland's 10-year bonds yielded 408 basis points more than similar bunds, up from 393 yesterday.

Portugal's government and the opposition Social Democrats broke off talks on the 2011 budget proposal, which include plans for the deepest cuts since at least the 1970s. There's "no possibility of continuing" negotiations, Eduardo Catroga, a former finance minister who represented the rival party in the discussions, said in Lisbon today.

U.K., U.S. Bonds Fall

Prime Minister Jose Socrates, lacking a parliamentary majority, needs the largest opposition party to back the budget or abstain for it to be passed. The Social Democrats have opposed tax increases and called for deeper spending cuts.

Portugal sold 611 million euros ($843 million) of bonds due in 2014 today, attracting bids equivalent to 2.8 times the amount offered, down from 3.5 times in September.

German bonds also fell with their U.S. and U.K. peers on bets the Federal Reserve will announce a smaller bond-buying program than some analysts expect at its Nov. 2-3 meeting as the economic recovery accelerates. German inflation, calculated using a harmonized European method, was at 0.1 percent versus minus 0.2 percent in September, the Federal Statistics Office in Wiesbaden said today.

‘Potential for Disappointment’

The Fed is likely to offer a program of purchases worth a few hundred billion dollars over the next several months, the Wall Street Journal reported today, without saying where it got the information. That compares with asset-purchases of about $2 trillion during the financial crisis.

“Right now, there’s potential for disappointment for bond investors,” said Mohit Kumar, a fixed-income strategist at Deutsche Bank AG in London. “Quantitative-easing expectations in the U.S. have turned. The German economy remains strong, and the ECB has been talking about normalizing rates.”

The yield on the 10-year bund, Europe’s benchmark security, rose six basis points to 2.57 percent, after reaching the most since Aug. 5. The two-year note yield increased two basis points to 1.04 percent.

German bonds have lost 1 percent this month, compared with a 0.5 percent decline for U.S. Treasuries, according to indexes compiled by Bloomberg and the European Federation of Financial Analysts Societies. Italian securities have gained 0.9 percent, while Portugal’s have made 4 percent.

Signs of a sustained economic recovery have supported bonds from so-called peripheral markets, while sapping demand for the relative safety of core euro-region countries.

“The phase of extremely low price increases appears to be over,” Viola Stork and Ulrich Wortberg, economists at Helaba Landesbank Hessen-Thueringen in Frankfurt, wrote in an investor note today before the inflation report. “There is no indication of an oversold market” in bonds, based on technical indicators and a “risk of falling bond prices thus remains in place,”
they wrote.

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