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France Joins Germany Ganging Up on Bondholders: Euro Credit
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By Mark Deen and Francine Lacqua

Nov. 11 (Bloomberg) -- French Finance Minister Christine Lagarde said investors must share the cost of sovereign debt restructurings, backing a German call that helped send yields on Irish and Portuguese bonds to record highs.

"All stakeholders must participate in the gains and losses of any particular situation," Lagarde said during an interview yesterday in Paris for Bloomberg Television's "On the Move" with Francine Lacqua. "There are many, many ways to address this point of principle."

Irish 10-year bonds tumbled for a 12th day, leading a rout in debt from Portugal to Greece, as LCH Clearnet Ltd. demanded clients place a larger deposit when trading the nation's securities. The plunge in Irish debt sent the risk premium over benchmark German 10-year bunds to a record. Ten-year Portuguese yields jumped 26 basis points to 7.18 percent, while Greek and Spanish bond yields also climbed.

Lagarde's comments mark France's most explicit backing of German proposals to make bondholders contribute in bailouts, which deepened the slump in bonds of the so-called euro peripherals. Risk premiums that investors demand to buy their debt have risen since an Oct. 29 European Union summit when German Chancellor Angela Merkel sparred with European Central Bank President Jean-Claude Trichet over forcing bondholders to take losses in restructurings, so-called haircuts.

"We do have differing approaches," Merkel told reporters after the summit.

The clash continued during the past two weeks, pummeling European bond markets.

European Divisions

"The main reason why spreads have remained under pressure isn't further divergence in budget fundamentals," wrote Luca Jellinek, head of European interest-rate strategy at Credit Agricole in London. "Rather, it stems from fresh evidence that inter-government solidarity within the European monetary union remains limited and possibly fragile."

The spread between yields of Irish 10-year bonds and German bunds has surged 176 basis points since Merkel made her push for burden sharing, jumping 65 yesterday to a record close of 617. Portugal's gained 118 basis points this month to a euro-era record 459 yesterday.

German officials are sticking to their guns amid the bond market rout.

"We do also need creditors to be involved in the costs of restructuring," Merkel said today in Seoul, where she's attending a summit of the Group of 20 leaders. "There may be a conflict here between the interests of the financial world and the interests of politicians. We can't constantly explain to our voters that taxpayers have to be on the hook for certain risks, rather than those who make a lot of money taking those risks. I ask the markets sometimes to bear politicians in mind, too."

Trichet's Stance

Trichet says such talk risks exacerbating the situation for indebted nations as they struggle to cut their budget deficits.

"The more you talk about restructuring debt, the harder it is to obtain debt," Irish Finance Minister Brian Lenihan said Nov. 2. "That is the reality."

"They are making it more likely that countries like Ireland and Portugal will be forced to restructure their debt," said John Stopford, head of fixed income at London-based Investec Asset Management Ltd., which oversees $65 billion.
"There should potentially be some conditionalities, otherwise it will become a self-fulfilling prophecy."

The cost of insuring Irish debt gained 30 basis points to 597.1 basis points, less than 1 basis point from the record close of Nov. 8. Credit default swaps for Portugal added 18 basis points to 474. Fallout from the slump in Ireland and Portugal pushed up the default risk on Spanish debt to a record close of 278.19 basis points.

Biggest Losers

Irish and Portuguese debt has suffered the biggest declines this month among the world's government bonds. Ireland has dropped 5.3 percent since the Oct. 29 EU summit and Portuguese bonds have shed 4.2 percent.

Portuguese Finance Minister Fernando Teixeira dos Santos urged the EU yesterday to clarify how the so-called crisis mechanism will operate.

EU leaders plan to map out by December how a permanent bailout facility might work, and also study how to treat private bondholders and whether to involve the International Monetary Fund. The new system would kick in when temporary measures, set up this year to rescue Greece and protect the euro, expire in 2013.

"We have to make an appeal at the European level for the European institutions to rapidly, with the greatest possible urgency, clarify the terms in which this mechanism will function," Teixeira dos Santos told reporters in Lisbon.

Lagarde cited several ways in which investors would share the losses in a bond scheduling with taxpayers.

"I'm not specially focused on haircuts," she said. "We can insist on having in any issuance and in any agreements a collective action clause under which any lender agrees that if something goes wrong, the lender will actually participate in the plan that will solve the difficulty, in the same way that you can have rescheduling over time."

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