Ireland's Return to the Bond Markets

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The Facts

The state officially re-entered the sovereign bond markets last Thursday, July 26th for the first time since requesting an international bailout at the end of 2010. In all, €5.2 billion was raised by the National Treasury Management Agency (NTMA), €4.2 billion of which was new money. The other €1 billion was a debt swap whereby holders of debt due in the next two years were offered an exchanged for longer-dated bonds. €3.9 billion was invested in a 5 year bond, maturing in 2017 with an interest rate of 5.9%, and a further €1.3 billion in an 8 year bond to be held until 2020 with an interest rate of 6.1%. The auction of long term debt follows the sale of €500 million in short term debt earlier in the month and a €3.5 billion bond swap at the beginning of the year.

Interest Rates in Perspective

What do these interest rates mean? Well, before the global financial crisis, 5 year debt trading on the secondary market would yield in the region of 3.5-4.5%, while 8 year debt would yield around 4-5%. These rates are much lower than what was achieved at the July 26th auction. In fact, the interest rate on the new debt is higher than the yield on government bonds that forced Ireland to seek official funding from the troika.

It is unsurprising that investors demand a greater return now as the Eurozone is in an even more fragile condition than it was in 2010. However, comparing the interest rate on the new debt to the yields prevailing in the secondary market on the day before the auction also paints an unflattering picture. According to the data available on the Bloomberg website, the 8 year Irish government debt yield was 6.3% the day before the auction. This means that the NTMA managed to sell the 8 year debt at a lower rate of interest than what was prevailing on the secondary markets. However, for the 5 year debt, the yield was only 5.4% on the secondary market, lower than the interest rate achieved at the auction.

Given the skittishness of the market at present, it may be illuminating to see how Ireland compares with other Eurozone countries. The table below sets out the yields on 5 year and 8 year government bonds for a selection of Eurozone countries. The divergence between core and peripheral countries is stark, but so too is the performance of the programme countries, Greece, Ireland and Portugal. While Greek yields are currently in the stratosphere, Portuguese rates are also too high to be in any way sustainable. Ireland has managed to avoid this fate, and is instead grouped with Spain and Italy on the fringe of fiscal solvency.

Yields on Selected Eurozone Government Bonds as of July 25th 2012 (%)

	5 year yields	8 year yields
Ireland	5.9	6.1
Spain	6.6	6.7
Italy	5.5	5.8
Greece	61.2	45.4
Portugal*	11.1	11.3
France	1.1	1.8
Germany	0.4	1
Finland*	0.7	1.5
Austria	0.8	1.7
Belgium	1.6	2.4
Netherlands	0.8	1.4

*Source: Bloomberg, NTMA. *10 year yield used due to lack of information on 8 year yields*

Funding Practicalities

While the high interest rate on the new debt takes some of the shine off Ireland's return to the markets, the second bond swap of the year has helped remove the significant challenge of a "funding cliff". At the beginning of this year, Ireland was faced with a particularly unfriendly profile of debt maturity: around €12 billion was due to be repaid in January 2014, followed by a period of much smaller bond repayments. The logistics of finding a buyer for €12 billion worth of Irish debt so soon after the planned exit from the troika assistance programme presented a daunting task. However, thanks to the two successful bond swaps, this funding requirement has been reduced to €7.8 billion and the funding profile has become more balanced and manageable.

Restoring Confidence

Confidence that Ireland can manage its debt in a normal fashion is a precursor for Ireland to exit the troika bailout programme, and this successful auction of long term bonds is a part of building that confidence. The fact that yields fell in the aftermath of the bond auction indicates that the market attaches some value to the NTMA's actions. There is also a possible link between a return to conventional sources of government funding and higher levels of investment and consumption in the domestic economy, although such benefits would be hard to quantify. The costs of returning to the market are easier to identify: funding from official lenders carries an interest rate of around 3.6%, far lower than rates currently available to any peripheral Eurozone country.