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Irish bank credit-default swaps rise on ratings cut concerns

The cost of insuring against default on Irish bank bonds approached the highest in a year on concern their credit rankings will be cut after Standard & Poor's downgraded the government.

Credit-default swaps on the senior debt of state-owned Anglo Irish Bank increased 13 basis points to 581, according to data provider CMA, meaning it costs €581,000 annually to insure €10m of the lender's bonds for five years.

Contracts on the bank's subordinated notes rose €100,000 to €1.8m upfront and €500,000 annually.

"Historically if the sovereign rating is cut, it naturally follows that banks operating in the nation and companies strongly reliant on the government are typically downgraded as well," said Fergal O'Leary, a director at Glas Securities Ltd in Dublin, which specialises in fixed income.

"Investors are likely to demand a higher premium for the Irish banks to issue new debt."

Irish bank bonds are among Europe's riskiest because of losses triggered by the collapse of the property market.

S&P yesterday raised its estimate for recapitalising the banking system to as much as €50bn from a previous estimate of €35bn.

About €30bn of government-guaranteed debt securities are due to be rolled over by the banks next month, triggering concern they will have to resort to funding from the European Central Bank as the cost of borrowing in capital markets soars.

Budget deficit

Ireland's credit rating was cut one step by S&P to AA-, the lowest since 1995, on concern the rising cost of supporting the country's struggling financial system will swell the budget deficit.

The yield on Irish two-year government bonds rose as much as 31 basis points to 3.127pc. That's the highest since May 7, the day that European Union leaders started to put together a bailout plan for the euro region.

Investors overreacted to the downgrade and the surge in credit insurance and drop in bond prices has created an investment opportunity, according to strategists at Conduit Capital Markets.

“There’s been a knee jerk reaction to the whole Ireland downgrade,” said Anke Richter, a strategist at Conduit in London. “There’s a buying opportunity of bonds here.”

Swaps on Ireland’s sovereign debt jumped 8 basis points to 318, the highest level since March 2009, CMA prices show.

The swaps imply a higher probability of default than contracts on Iceland, which is ranked six levels lower and whose financial system collapsed in 2008.

Credit swaps on the senior debt of Bank of Ireland rose 10 basis points to 358, and subordinated contracts increased 30 to 645, CMA prices show. Swaps on Irish Life & Permanent climbed 15 to 357 and Allied Irish Banks rose 9 to 464.