

A Swift Proposal for Greece: Guaranteed Samurai?

The same day that Moody's cut Greece's sovereign rating to A3 from A2, Fitch warned that Japan's credit rating was threatened by its mounting debt. Yet, ironically, the latter may be a source of funds for the former. Although Greece will be drawing on the European/IMF funds, it may also seek to raise funds from the market, when conditions permit.

JBIC

The Japanese government is actively engaged in deepening the samurai bond market. Samurai bonds are yen-denominated bonds issued by non-Japanese corporate or sovereign entities. The state-backed Japan Bank for International Cooperation (JBIC) is providing guarantees to support the sale of samurai bonds by a wide range of developing countries—from Mexico to Vietnam, from Turkey to Uruguay. The specific purpose of JBIC is to boost the usage of the yen as an international currency.

Some industry estimates project that the sale of emerging market samurai bonds could increase by a quarter this year to JPY350 bln (\$3.8 bln). Last year, JBIC-guaranteed samurais accounted for about a quarter of the overall samurai bond market, where issuance last year increased 5-fold as the JBIC program took off starting in May. JBIC is considering extending its "Market Access Support Facility", which to a wider range of nations and institutions, and increasing the amount of money allocated to the program.

For example, in late February, the Philippines raised JPY100 bln in a ten-year note that was 95% backed by JBIC and priced to yield about 85 bp more than the yen-swap rate. The coupon was 2.32%, while the yield on the country's 10-year dollar bond was 5.62%. If one makes some conservative assumptions—that the entire proceeds are swapped into dollars, the Philippines are probably saving around 50 bp in debt servicing costs, which over the term of the bond is about a year's worth of interest.

With JBIC guarantees, these samurai bonds take on partial function of Japanese government credit worthiness. Given this and the increased liquidity in the market, it is hardly surprising that there is downward pressure on the spread between Japanese government bonds and the samurai bonds. It has fallen by about 30 bp to around 1.4% so far this year and now stands near the lowest spread in two years, according to industry indices.

Exporting Savings

These same industry indices show that samurai bonds generated a return of 13.5% in the fiscal year that just ended. This is especially impressive when compared with the 4.1% gain for Japanese corporate bonds and 1.3% for Japanese government bonds.

By broadening and deepening the samurai market, the JBIC has created an additional channel to export its savings. Most of the samurai issuers will end up swapping the yen for dollars and/or their local currencies. This recycles Japanese savings, as much as a Japanese multinational would that acquires a foreign company, or a Japanese pension fund buying foreign stock, or Mrs. Watanabe buying foreign bonds.

When Japan's current account surplus does not get recycled, the yen tends to appreciate. In the past, the BOJ would sometimes step in and do what it felt the market was not doing sufficiently, that is, sell yen. BOJ intervention can often be understood in the context of recycling its current account surplus, or surplus savings.

To combat deflation, the Japanese government would like a weaker yen. Intervention is politically awkward and was not very effective in the last massive bout that took place in late 2003 and early 2004. Encouraging the deepening of the samurai market is in some ways encouraging foreigners to sell yen. That said, the samurai market looks interesting from a foreign investors point of view as an alternative to Japanese government bonds in a fixed income portfolio

Why Not Greece?

Around a dozen countries are thought to be considering issuing a samurai bond in the coming months. Why not Greece? There had been talk of Greece issuing a dollar-denominated bond, so issuing a yen-denominated one is not out of the question. Indeed, it appears that Greece has six samurai issues outstanding (mostly maturing in the 2015-2016 period for about JPY180 bln). JBIC has experience in managing bond exposure that is not investment grade, so both parties have an expertise in this space.

One short-coming may be the limited size the JBIC could guarantee, but with some negotiations it may be possible for Greece to ultimately raise a couple billion euros. This might be a little more than Greece would raise in a T-bill auction, but it diversifies the investor base in addition to reducing some debt servicing costs.

Also, to be sure, the challenge for Greece and many countries in Europe is much greater than its debt and deficits. Conventional wisdom holds that Greece's unsustainable deficit and debt trajectories are behind the current crisis. But that may be putting the cart before the horse. It was just as much the lack of competitiveness that drove the deficits. Meanwhile, Greece needs to be able to fund its debt, and May 19th (when roughly EUR8 bln maturity and coupon payments are due) draws nears. Roughly another EUR20 bln needs to be raised by Greece by the end of the year.

Recent market developments made it inevitable that Greece would have to tap the backstop facility cobbled together by Europe and the IMF. These funds will keep the wheel on the cart a little longer. No one wants Greece to default. But if one were to view it from a realpolitik perspective, the decision to default is a cost-benefit analysis. One consideration may be just how much debt is held by foreign investors. It is estimated that 50-70% of Greek bonds are owned by foreign investors, mainly by the other Europeans.

A samurai issue would increase Greek obligations in foreign hands. In some ways then, a samurai bond would help meet part of Greece's near-term liquidity needs but increase, on the margins, the calculus that favors a restructuring of the debt, voluntarily or involuntarily.

Japan's Bank for International Cooperation is encouraging, through partial guarantees, the deepening of the samurai bond market. Greece has some serious short-term liquidity needs. Greece should explore issuing a samurai with the JBIC. At the same time, international investors, who must have some exposure to Japanese bonds, should look at the samurai market, especially those that are nearly fully backed by JBIC as an alternative to the JGB market.

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