

**Spread-floor for covered bonds despite higher rating - Comment**

July 7, 2006

**HUNGARIAN COVERED BONDS WITH PICK-UP TO GOVERNMENT DEBT**

Hungarian covered bonds denominated in euro rated Aa2

On May 9, 2006, Moody's upgraded the HUF-denominated covered bonds issued by OTP Mortgage Bank to Aa2 from A1. The ratings of foreign currency denominated covered bonds issued by OTP Mortgage Bank and FHB were upgraded to Aa2 from A1 on May 31, 2006 following the increase of the sovereign ceiling for Hungary to Aa1.

OTP issued euro-denominated covered bond

The first issue of OTP 4% 12/2014 denominated in EUR came to the market in December 2004 with a volume of EUR 200 mn. Currently, over 90% of Hungarian covered bonds are issued in HUF. Last week, the Hungarian OTP Mortgage Bank (A1 n/-/-) again issued a euro-denominated covered bond with a volume of EUR 750 mn.

Issue spread was 4 bp over Hungarian government bonds

The issue spread of the newly issued OTP 4.25% 7/2011 was mid-swaps + 31 bp, which equals 52 bp over Bunds. Hungarian government bonds traded at mid-swaps + 27 bp at that time. The generous spread was a result of the spread-widening caused by S&P's downgrade of Hungary on June 15, 2006 to BBB+ from A1 with still a negative outlook.

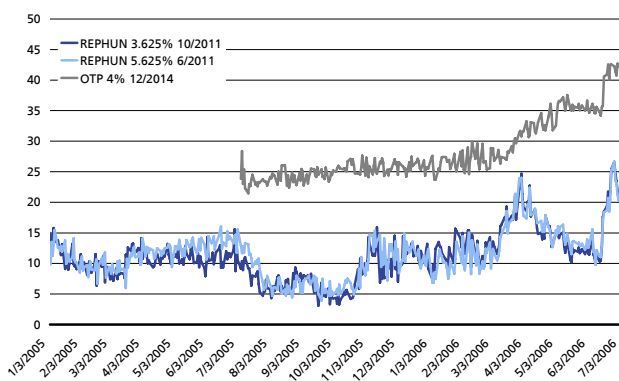
Hungarian government debt rated A1 s/BBB+ n/BBB+ s

Hungarian government debt denominated in EUR is rated A1s/BBB+n/BBB+s and hence two notches lower than EUR-denominated covered bonds issued by OTP (and FHB) at Moody's and even five notches lower at S&P and Fitch. Nevertheless, covered bonds pay a pick-up. In our view, this shows that government yields are the floor for covered bonds, even if they are higher rated.

Government yields are a floor for covered bonds

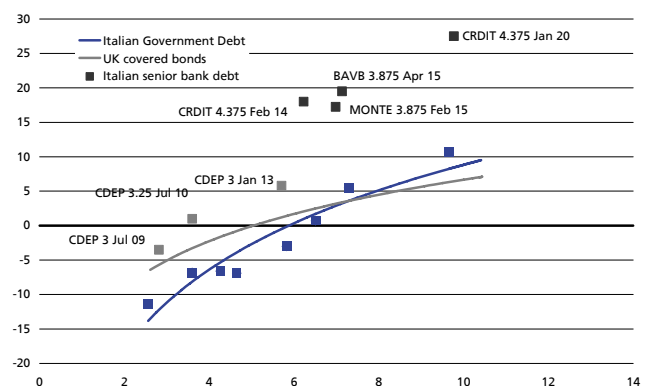
Hence, as in the case of CDP's covered bonds (Aaa/AAA/AAA), also upcoming Italian mortgage backed covered bonds to be issued by Italian banks, despite (most likely) being higher rated than Italian government debt (Aa2 s/AA- n/AA wn), will have to trade with a pick-up on government debt. The same will hold true in new (lower-rated) countries joining the covered bond market like Turkey.

**OTP'S COVERED BONDS (CB) WITH PICK-UP TO GOVIES**



Source: HVB Global Markets Research

**CDP CB WITH PICK-UP TO ITALIAN CB**



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Company	Date	Product	Recomm.	Company	Date
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