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German Bonds Advance on Demand for Safety Following Greece Cut

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By Matthew Brown

June 15 (Bloomberg) -- German government bonds rose as investors shunned all but the safest assets after Moody's Investors Service cut Greece's credit ranking to non-investment grade on the rising economic costs of the nation's budget cuts.

Greece was lowered four steps to Ba1 from A3 by Moody's, which cited "substantial" risks to economic growth from the austerity measures tied to a 110 billion-euro ($134.5 billion) aid package from the European Union and the International Monetary Fund. The lower rating "incorporates a greater, albeit, low risk of default," the ratings company said in a statement yesterday in London. The outlook is stable, it said.

"Bunds are very much sentiment driven and the Greece downgrade is supporting them today," said **Karsten Linowsky**, a fixed-income strategist at Credit Suisse AG in Zurich. "Peripheral bonds will be under pressure, but with the ECB buying the moves won't be as pronounced as they have been."

The bund yield fell six basis points to 2.59 percent as of 7:28 a.m. in London. The 3 percent security due July 2020 rose 0.47, or 4.7 euros per 1,000-euro ($1,218) face amount, to 103.59. Two-year yields dropped two basis points to 0.48 percent.

Greece has cut spending, raised taxes and trimmed wages to tackle the deficit, which swelled to 13.6 percent of gross domestic product last year, more than four times the EU limit. To secure the EU-IMF aid, the government pledged to trim the shortfall to 8.1 percent of GDP this year and bring it back under the 3 percent EU ceiling in 2014. The crisis has prompted investors to sell the bonds of Greece and other high-deficit nations and pushed the euro down 15 percent this year.

Yield Record

Bund yields touched the lowest since at least 1989 on June 8 amid speculation that weaker euro-region economies will be overwhelmed by their debts, stoking demand for the perceived safety of German fixed-income assets. The crisis has driven the 16-nation currency down 20 percent between Nov. 25, 2009 and the end of last week.

Soaring bond yields in so-called peripheral euro-region nations, including Greece, Ireland and Portugal, forced the EU to craft a 750 billion-euro rescue package and the European Central Bank to start buying government bonds on May 10.

The ECB increased its purchases of government bonds last week. The Frankfurt-based central bank said it will take term deposits tomorrow to mop up 47 billion euros of bond purchases settled up to June 11. That indicates it bought 6.5 billion euros of bonds in the fifth week of its program. Purchases slowed to 5.5 billion euros in the fourth week from 8.5 billion euros in the third, 10 billion euros in the second and 16.5 billion euros in the first.

Ireland is scheduled to auction as much as 1.5 billion euros of 2016 and 2018 securities today, with Spain and Belgium selling bills.

German government bonds returned 6.7 percent this year, compared with 4.4 percent for U.S. Treasuries and 4.6 percent for U.K. gilts, according to indexes compiled by Bloomberg and the European Federation of Financial Analysts Societies. Greek debt lost more than 11 percent, the indexes show.

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