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Markit Recap – 8/18/2014

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The micro issues of Argentina and Banco Espirito Santo have garnered most of the attention in the CDS market of late, but as the summer draws to a close the discourse is shifting back to the macro picture.

On the face of it, the change in focus could be a negative development. The eurozone economy stagnated in the second-quarter, confounding expectations of a small increase in GDP. Germany contracted for the first time in more than a year, while France was flat for the second consecutive quarter. Italy is now back in technical recession, and shows little sign of escaping a three year slump.

As if this wasn't worrying enough, there is the looming danger of a deflationary spiral. The debt-laden periphery is already suffering from falling prices, and the currency bloc as a whole saw inflation of just 0.4%, the lowest level in almost five years.

But the economic stagnation and the threat of Japanese-style deflation are fuelling expectations that the ECB will finally implement QE. It seems that we are returning to the world when bad news was good news, due to the reasoning that central banks will come to the rescue. The Bank of England also struck a dovish tone, and the Fed has given no indication that it is in a hurry to raise rates.

The Markit iTraxx Europe were trading at 70.5bps on August 8; by August 20 it was trading at 60bps. The rally was also reflected in the Markit CDX.NA.IG, though not to the same extent.

However, important though it may be, monetary policy isn't the only driver of spread direction. Geopolitics also has a part to play, and disturbing developments in Ukraine have caused volatility. Russia's CDS widened to 246bps, though it has since recovered some ground.

The tensions in Ukraine may increase risk aversion intermittently in the coming weeks. We will also have the Argentina credit event auction, where there are some issues around yen deliverables that could affect the recovery rate.

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