Markit Recap – 12/8/2014

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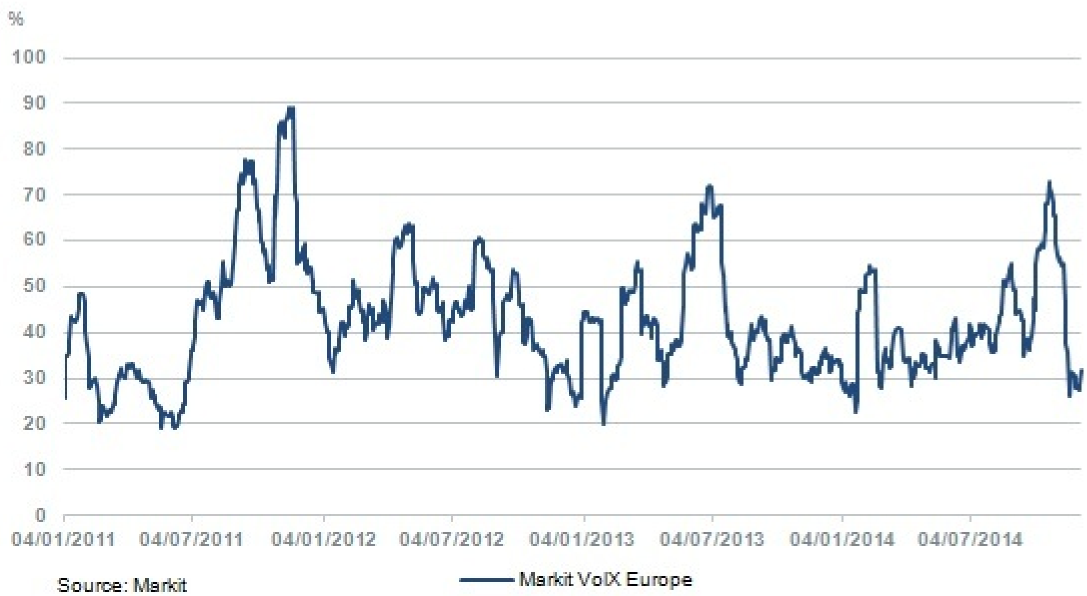
Volatility was the name of the game earlier in the first-quarter as credit was swept up in the maelstrom affecting other asset classes, particularly US Treasuries and equities. The main credit indices spiked upwards and the Markit VolX Europe, which tracks realised volatility in European investment grade CDS, spiked upwards to 75%, its highest level since the taper tantrum of 2013.



But if investors expected this trend to continue into year-end then they appear to be mistaken. Spreads have recovered from the widening we saw in October, and the VolX has dropped back to 28% – a level more in keeping with the current QE dominated era. Expectations that the ECB will implement full QE (government bond purchases), probably in the first-half of this year, are surely driving the improvement. But there is considerable opposition to such a policy, particularly in Germany, and we may see volatility flare up if the legal obstacles appear insurmountable.

Other factors might also disturb the clement conditions. The price of oil continues to plummet, which creates winners and losers. A look at how sovereign CDS has performed recently shows clearly which countries are losing out. Russia's spreads breached 400bps for the first time since 2009, and Venezuela's CDS are quoted at an eye-watering 59.5 points upfront. Both countries are, of course, major exporters, and an oil price of $65 a barrel creates serious damage on their finances.

But the huge difference in their spreads is down to the fact that Russia has considerable reserves that help it see out periods of low oil prices, while Venezuela, alas, does not. The latter country is now the worst credit in the sovereign CDS by some distance, though Ukraine (42 points upfront) is catching up.

Greece has also returned to the news agenda. A snap presidential election was called, and if the government fails to get a majority it could force a general election early next year. Uncertainty about the result and the possibility of the leftist Syriza party gaining power was enough to send Greece's CDS wider. They were quoted at 31 points upfront, which is the widest level since Greece resumed trading in the CDS market back in June 2013. The sovereign is still relatively illiquid and the recent changes to the ISDA definitions mean sovereigns trade slightly wider than the previous contract. Nonetheless, it is back in the top 1000 DTCC entities, and Greece's CDS will be closely watched as the political

Contact: Gavan Nolan

Gavan.Nolan@markit.com