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Markit Recap – 4/13/2015

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European corporate credit risk shrinking

- ITRAXX-Europe 5-yr spread lowest since December 2007
- Volatility in Europe's credit markets has dropped since QE announcement
- European markets unfazed by neighbouring Greek and Ukraine problems.

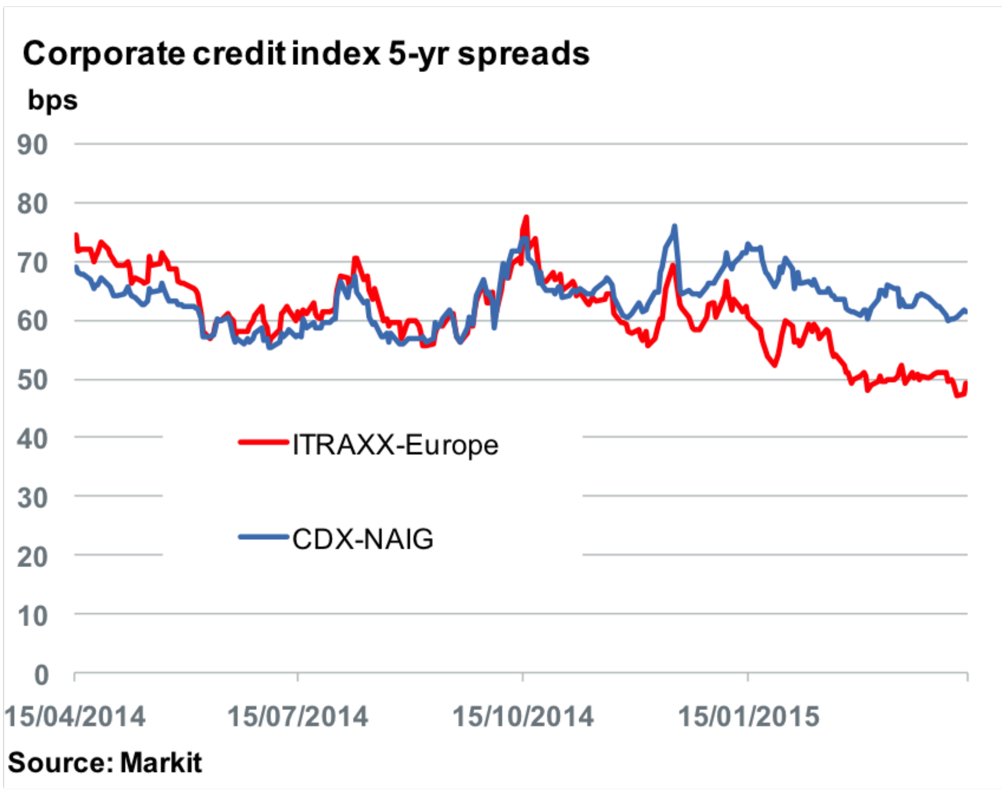
This week the IMF released its latest economic outlook, with Euro area growth projections for 2016 receiving an update 0.2% higher than that made at the start of the year. Since the ECB decided to expand its nonstandard policies and announce sovereign bond QE in January, the eurozone has accelerated its path to recovery with a pickup in demand for credit and inflation expectations returning to normality in the medium term.

When the ECB held its latest policy meeting this week, president Mario Draghi was quick to highlight Europe's progress. Risk in credit markets has been declining ever since Draghi's famous "whatever it takes" speech in July 2012, with the ITRAXX-Europe descending steadily from a peak spread of 180bps. Since the announcement of QE, spreads have tightened a further 5bps to reach 49bps at present. Credit risk attached to European corporations hasn't been this low since December 2007, highlighting the extent to which market participants have regained confidence in Europe’s credit markets.

	20 Day index level	60 Day index level	90 Day index level
Markit Volx Europe	36.24%	40.01%	46.16%

Volatility in the credit derivatives market has also been suppressed. The Markit Volx, which tracks realised volatility and is based on the ITRAXX-Europe, has seen volatility drop from a rolling 90 day average of 46.15% to 36.24% over the last 20 trading days.

Interestingly, European credit has been largely unfazed by regional geopolitical risks. Reignited threats of a Greek euro exit have reached fever pitch with 5-yr CDS spreads reaching 48% upfront, the highest at any point this year, yet fears of contagion among core Europe have been largely waved away. This marks a stark contrast to the reaction seen in 2011-2012. Russia’s next move remains a mystery following its controversial intervention in neighboring Ukraine. Russia’s latest CDS spreads imply that it has a 93.5% chance of defaulting in the next year; however its own economy is recovering even as western sanctions remain firm.



It remains to be seen whether European credit spreads tighten further amid the improving economic backdrop. As a relative comparison, during the US’ QE phases, corporate spreads outperformed its European peers only to see the trend reverse as the monetary policy diverged. Historically tightly correlated, the basis between the ITRAXX Europe and CDX-NAIG has increased from 3bps to 12bps this year to date. With US credits stumbling over the last few months, in part to the strong dollar, weak oil prices and interest rate uncertainty; QE has helped

European credits whiz past US peers.

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