Markit Recap – 7/13/2015

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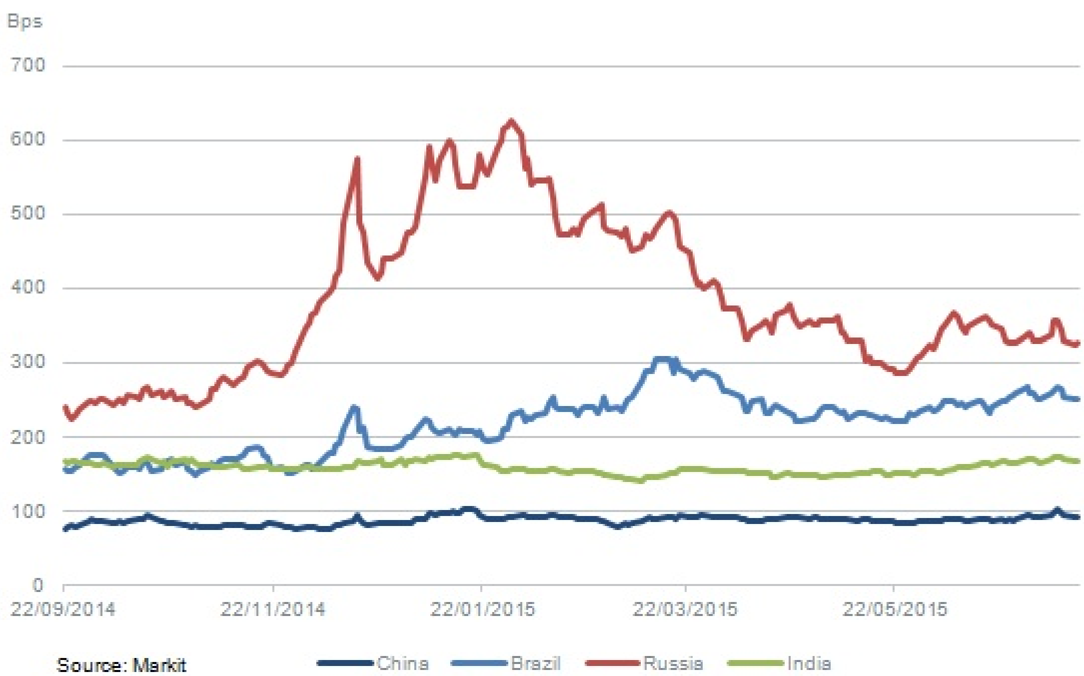
Greece's position as the dominant driver of market sentiment has been unassailable in recent months. But there may be a hiatus if an agreement is reached on bridging finance for Greece, potentially leaving room for another theme to shape credit spread direction.

If Greece does become a secondary consideration – and that is a very big 'if' – then investors may turn their attention to the Brics. China has captured headlines recently amid a collapse in its equity market. The boom in stocks over the last 12 months was impelled by a sharp rise in margin financing, and the excessive leverage accentuated the inevitable crash. The Chinese government has intervened in its usual heavy handed manner, and this stemmed the losses.



Sino-optimists points towards the 7% growth achieved in the second-quarter, in line with the government's forecasts. But the economy's continued expansion is dependent on credit growth, and there are doubts that this can be maintained at the current pace or if it will be as effective as in the past. China's five-year CDS widened from 87bps to 104bps in the two weeks to July 8, its widest level since September 2013. But it should be noted that China's CDS has traded in a very tight range over the last two years, in comparison to many European countries as well as its fellow Brics members. This is a reflection of the market's faith in the Chinese government's capacity to support the economy in the medium-term.

China's CDS was the most actively traded name last week, according to DTCC figures. Brazil and Russia (and South Africa, which is now part of the Brics) were also in the top 10. In many ways the acronym is now redundant as the member countries are not a coherent group. Russia and Brazil, both of which are struggling economically, are dependent on demand from China for their commodity exports. Their problems are all too evident in their CDS spreads, which trade at levels implying junk ratings (both are rated investment grade).

Emerging markets are clearly heterogeneous, but it remains to be seen whether investors recognise this when the US Federal Reserve hikes rates and China’s problems come to the fore again, as they surely must.

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