

Markit Recap – 8/8/2016

THE LEAD | August 11, 2016

Spanish engineering firms with exposure in Latin America may not be the most heavily traded segment of the credit markets, but they are certainly proving the most vulnerable.

Isolux followed its counterpart Abengoa into default by announcing that it had won credit approval for a €2bn debt restructuring on July 28, and a bankruptcy credit event was declared by the ISDA Determinations Committee on August 5. The decision by the ISDA DC wasn't straightforward, as the entity that trades in the CDS market – Grupo Isolux Corsan Finance B.V. – filed a moratorium (suspension of payments) rather than a bankruptcy.



However, the ISDA DC decided that the provisions of the moratorium were similar to a bankruptcy and the role of an administrator, which under 2014 definitions justifies the declaration of a bankruptcy credit event. The language is slightly different in the 2003 definitions, but the DC determined that the result was the same.

Isolux has been trading in the CDS market since it was added to the Markit iTraxx Crossover in September 2014, and its spreads have been on a widening trajectory ever since. At the beginning of 2015 it was quoted at 12 points upfront – standard high yield territory. But just six months later it was trading at 24 points and by the end of 2015 it was quoted at 75 points – indicating very high probability of default. We now know that the CDS market was an accurate predictor of default, as it so often is.

It is also well established that including a name in a CDS index significantly increases liquidity; indeed, many of the additions to the Crossover barely traded prior to their inclusion. But we need to place this liquidity in context. Isolux CDS traded on average just under 8 times a week since the DTCC started recording volumes in 2015, and the average ticket size was just €1.5 million. Distressed names often see low volumes and wide bid-offer spreads, partly due to a relatively narrow investor base for this portion of the high yield market. But the small size of the trades and the sporadic activity is no doubt a reflection of the single name market's current liquidity.

The broader CDS market is relatively quiet, as is to be expected during August. However, the swathe of central bank intervention is probably contributing to the placid conditions. The Markit iTraxx Europe continues to grind tighter and outperform the Markit CDX.NA.IG, with the indices at 67bps and 72bps respectively. Immediately after Brexit, the iTraxx Europe was trading 9bps wider than the North American index, which demonstrates the impact of the ECB and Bank of England policies. We will see if this can be sustained after the summer draws to a close.

Contact: Gavan Nolan

Gavan.Nolan@markit.com