Markit Recap – 1/5/2015

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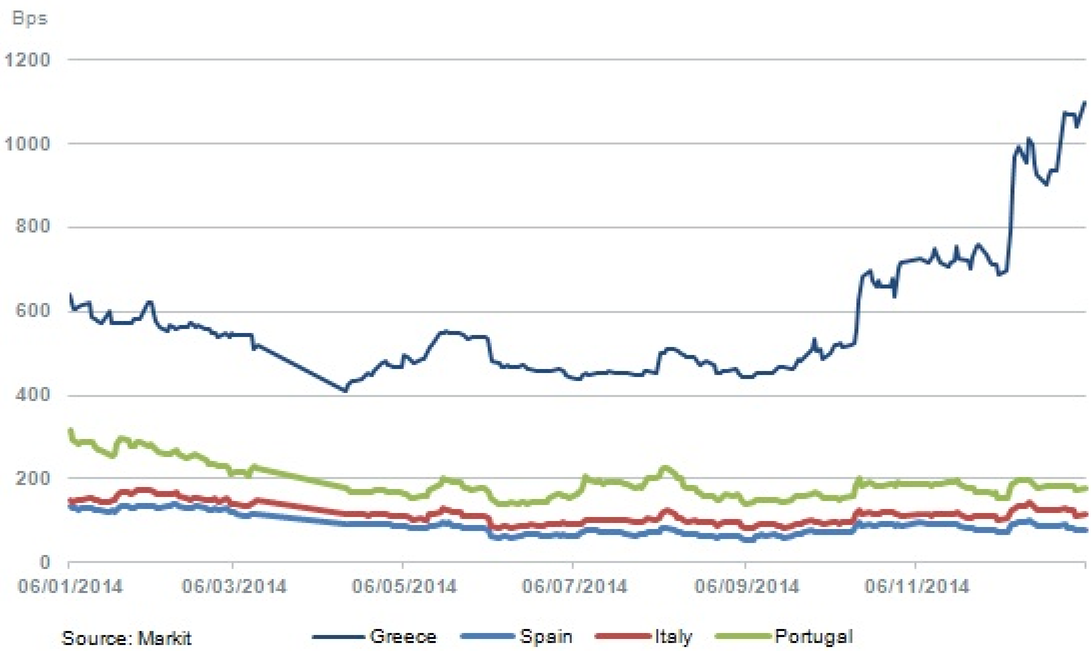
It seems like an aeon ago that a relatively small country in south-eastern Europe held the fortunes of the global economy in its hands. But less than two years has passed since Greece's debt was restructured, and it is all too apparent that the sovereign still has the capacity to create a noise that belies its modest size.



The latest bout of volatility was triggered by the imminent general election, one which current opinion polls indicate will be won by SYRIZA, a radical leftist party. SYRIZA's leader Alexis Tsipras has campaigned on a platform of debt relief and threatened to abandon the austerity policies enforced by the troika (the IMF, EU and ECB). This has raised the prospect of Greece leaving the eurozone (Grexit), a scenario that most though had been banished with the last bailot.

Greece's CDS is nowhere near as liquid as it was during the height of the debt crisis (it has a Markit Liquidity Score of '3', an average to poor score). But volumes are picking up, and it remains a useful signal on the sovereign's creditworthiness. And the signal is quite clear – spreads have widened from 500bps to 1,100bps in little over three months. This suggests that the prospect of a SYRIZA government – and a possible default – is taken seriously by the markets.

However, the contagion that was so evident in 2010-2012 hasn't re-emerged – so far. Spain, which also has a left-leaning anti-austerity party leading the polls, has seen only mild widening in its spreads. The same applies to

Italy, Europe’s largest debtor. The German government thinks that Grexit would be more manageable this time around due to the more robust bailout mechanisms now in place (ESM, OMT), according to unconfirmed reports, and recent spread performance suggests that the market agrees.

Even if SYRIZA is victorious, it is not at all clear that it will seek to exit the euro if its demands are not met. A compromise with Germany and other creditors is a more likely outcome. In any case, some form of debt relief is probably inevitable given Greece’s mountainous debt burden. But history tells that investors shouldn’t be complacent, and we can expect spread volatility ahead of the January 25 election.

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