Markit Recap – 4/20/2015

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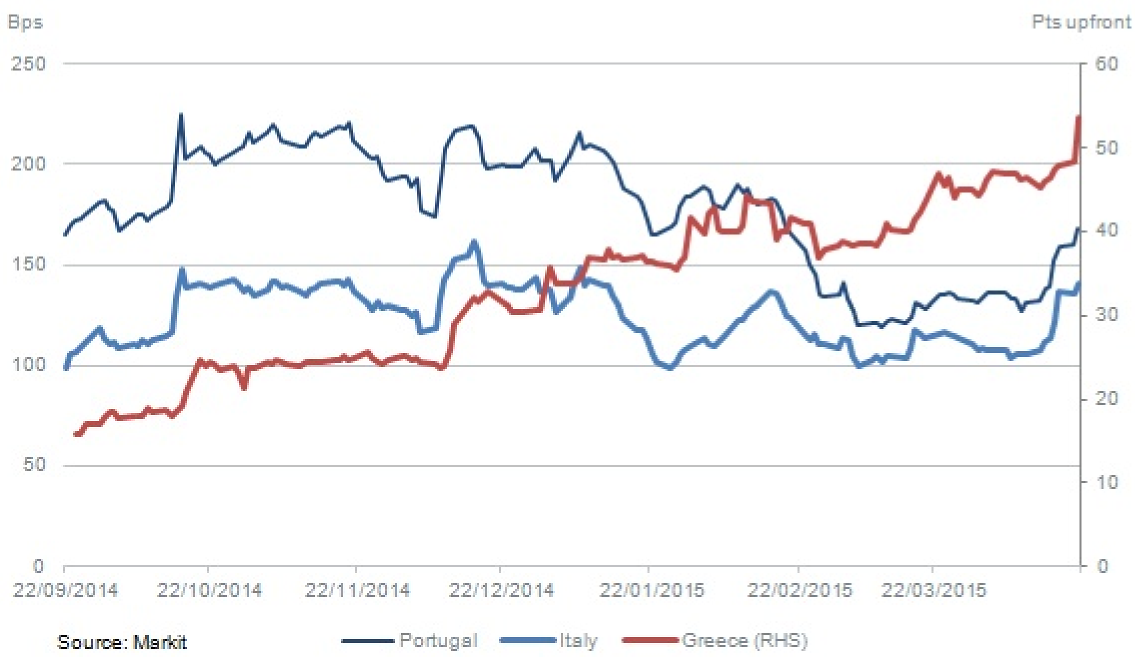
Earnings season has started strongly with most firms beating expectations, but Greece's uncertain status within the eurozone continues to dampen positive momentum.

The latter part of the last sentence is all too familiar to market participants, and it certainly won't be the final time we will encounter its sentiment. The Markit iTraxx Europe hit 62bps, 9bps wider than the tight reached on April 10 and the widest level since mid-January.



Greece's CDS are illiquid, with only a handful of dealers and just $41 million in gross notional traded last week. Even if we bear this caveat in mind, the levels quoted are a clear indication that Greece's situation is deteriorating, a trend supported by bond prices dropping sharply. At 53 points upfront – not much lower than Ukraine and Venezuela – the sovereign's CDS point towards a high probability of default (about 80%, to be exact).

The latest bout of pessimism was triggered by the looming deadline of May 12, when Greece is due to pay the IMF €774 million. It is debatable the government has the requisite funds to meet both this payment and its obligations to its people – pensions and public sector wages – without external assistance. Talks are ongoing with eurozone governments, but there appears to have been little progress. Hence the talk of 'Grexit' and the consequent widening in spreads.

In general, the markets are a lot more comfortable with handling Greece than they were at the height of the sovereign debt crisis. Most of Greece's debt is owed to the official sector and Europe's banking sector has better insulation from any potential fallout. But in the last week there were signs that investors are starting to get nervous about the eurozone's periphery. Portugal's spreads widened by 40bps to 168bps, while Italy went from 104bps to 140bps. These movements need to be placed in context – Portugal was trading at over 200bps at the start of this year, and peripheral spreads are a far cry from the levels seen less than two years ago. Nonetheless, it is an indication that some of the complacency on 'Grexit" and the potential effects on the inviolability of the eurozone is fading.

It may be that the real deadline is not May 12, but July 20. This is when Greece is scheduled to pay the ECB €3.5bn in bond redemptions – a significantly larger amount than the imminent IMF payment. If a deal with eurozone governments hasn't been reached in the interim, then a default will follow and the fragility of Greece's banking system will be fully exposed. It could be a rocky road for risk assets over the next few months.

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