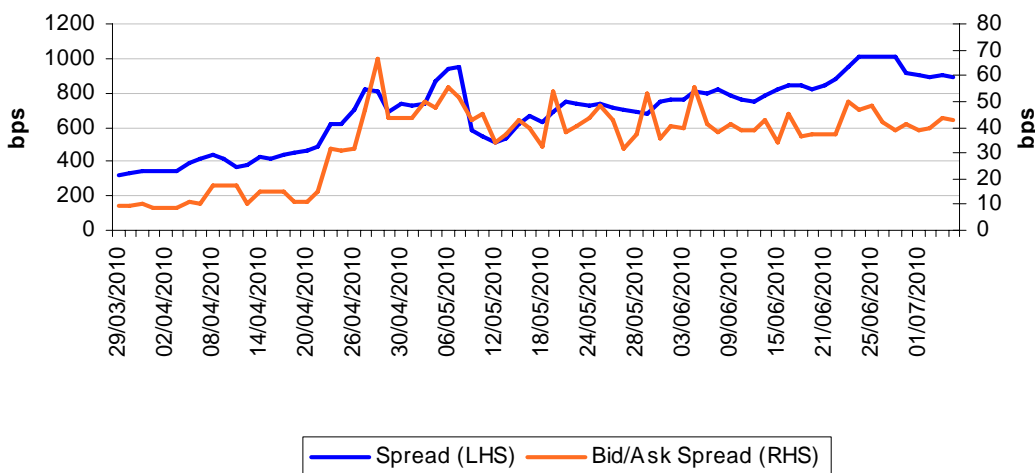


Markit Liquidity Update: Normal service resumed?

Greece



Source: Markit

Back in May we wrote a note on liquidity in the eurozone sovereign CDS market (May 21 Liquidity Update). At the time spreads were highly volatile, particularly in the peripheral eurozone countries (Greece, Spain, Portugal, Italy Ireland). European governments had responded to fears of sovereign defaults by launching a EUR750bn bailout fund, with the assistance of the IMF. The febrile trading climate became more acute with the intervention of Bafin, the German regulator. Bafin's restrictions on "naked" sovereign CDS trading within its jurisdiction did little to bolster confidence in the asset class.

It seemed inevitable that these events would have an impact on market liquidity. But how we would measure this? Markit's CDS and bond liquidity metrics, launched in March this year, gave some clarity. The service provides an independent set of liquidity metrics, including a simple and transparent liquidity score. The metrics include:

- Bid/ask spread data (observed/calculated)
- Number of dealers quoting (based on dealer runs)
- Number of quotes each day (based on dealer runs)
- Markit composite depth information from Markit's end-of-day service
- A liquidity score per reference entity-tier

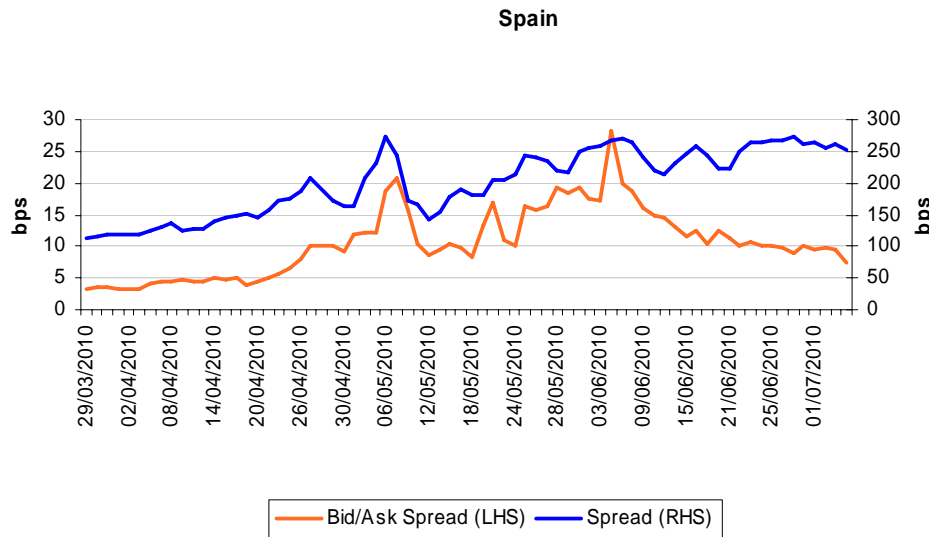
This note will revisit some of the findings made in May and look at what has happened since then in another difficult period for the markets.

Eurozone CDS

The chart above shows CDS data for Greece, the protagonist in the sovereign debt crisis. The left-hand scale is the five-year CDS spread and the right-hand scale is the average bid/ask spread for the five-year point. The latter is one of the most important indicators of liquidity. By mid-April Greece's average bid/ask was around 15bp, a fairly tight level given that its spreads had widened to 500bp. But the turmoil in the market soon had a detrimental effect on liquidity, with bid/ask spreads on Greece in excess of 60bp. Some widening was to be expected given the credit deterioration of the sovereign. But the bid/ask movement was disproportionate compared to the CDS, indicating that there had been some impairment of liquidity.

Another spike was seen on May 19, when Bafin announced a ban on naked CDS referencing eurozone sovereigns. For the next few weeks after this event there was some volatility in the bid/ask spread as Greece's CDS steadily widened. But as the sovereign's spreads continued to widen, reaching record levels in late June, the bid/ask stayed relatively stable around the 40-50bp range. This is still relatively high compared to levels in March but is some way off the 60bp+ seen at the end of April.

Other metrics support the view that there hasn't been a marked deterioration in liquidity since May. Markit figures show the dealer count - the number of dealers actively quoting an entity - averaged 12 for both May and June. This is relatively high and is in line with previous months. The depth metric - the number of "clean" contributions to Markit's end-of-day pricing service - has also stayed high. DTCC trading volumes have remained robust. One metric that has fallen off is the number of unique quotes for Greece in Markit's parsing system. This could be a by-product of the drop in volatility over June. But Markit's liquidity score for Greece has stayed at one - the highest level - throughout June, indicating that it is a name with solid liquidity.



Source: Markit

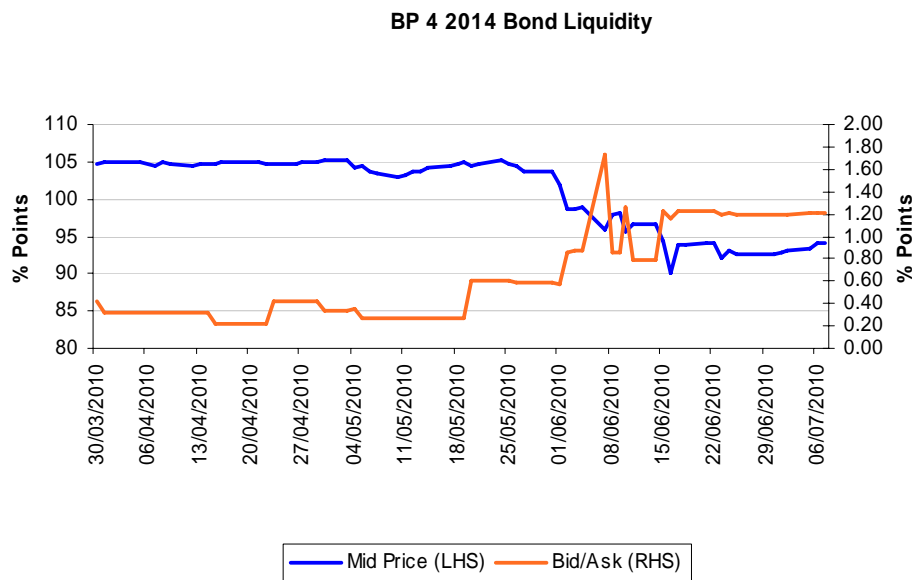
Greece has not been the only country under the credit microscope. Spain saw its spreads touch record levels in June, with concerns about its fragile banking system uppermost in investors' minds. Like all of the peripheral eurozone names, Spain's bid/ask widened significantly in the run-up to the bailout on May 7. They recovered afterwards but, unlike Greece, they widened significantly in late May and early June. This was in tandem with the widening in CDS spreads. But the bid/ask then recovered sharply, and is now trading around 5bp.

It's notable that Spain's CDS didn't really recover over this period. Did the other liquidity metrics show the same volatility as bid/ask? The dealer count was high at an average of 13 for May and June. Composite depth was also solid

at 8. But the latter metric did drop in late May/early June and the quote count was down (as it was with Greece). This led to the liquidity score deviating from one over this period. But it soon reverted to the top rating.

Overall, Markit's metrics show that liquidity for the peripheral eurozone sovereigns was affected by the market turmoil in May but has since recovered to more "normal" levels. It remains to be seen whether this can be maintained through the quite months of summer.

BP's bonds



Source: Markit Evaluated Bonds

Aside from the ongoing sovereign debt crisis, BP's travails in the Gulf of Mexico have been one of the other main talking points in the credit markets. Its CDS spreads started to widen not long after the spill came to light in April. The company's bond prices reacted later, the chart above showing a steep decline starting in late May in the 4% bond maturing in 2014. The bid/ask spreads showed signs of increasing a little earlier, but really started to widen in early June in tandem with the precipitous fall in the bond price. There was a short period of considerable volatility before the bid/ask settled around 1.2% in mid-June, considerably higher than before BP's credit standing worsened.

This suggests that liquidity in BP's bonds has been impaired. But it is important to look at the other liquidity metrics, and not just the bid/ask in isolation. Markit's depth count shows that while the depth of the market in BP bonds did take a hit in May and early June – the same time as the volatility in bid/ask – it has since recovered to levels not far off pre-oil spill levels. Indeed, the high depth means that the bond has a stellar Markit liquidity score of one. This is consistent with the stabilisation of the bid/ask spread during the latter half of June.

Overall, we have seen that liquidity had been impaired during crises, both with the peripheral eurozone sovereigns and BP. But after the initial panic there has been some stabilisation, and liquidity remains fairly robust.

Markit's liquidity metrics can help bring transparency to a sometimes opaque element of the CDS and bond markets. For information on Markit CDS Liquidity please click [here](#) and Markit Evaluated Bonds, please click [here](#). Alternatively, call +44 20 7260 2000.

Gavan Nolan

Credit Analyst

Markit

Tel: +44 20 7260 2232

Email: gavan.nolan@markit.com

For further information, please visit www.markit.com

The intellectual property rights to this report provided herein is owned by Markit Group Limited. Any unauthorised use, including but not limited to copying, distributing, transmitting or otherwise of any data appearing is not permitted without Markit's prior consent. Markit shall not have any liability, duty or obligation for or relating to the content or information ("data") contained herein, any errors, inaccuracies, omissions or delays in the data, or for any actions taken in reliance thereon. In no event shall Markit be liable for any special, incidental, or consequential damages, arising out of the use of the data. Markit is a trademark owned by the Markit group.