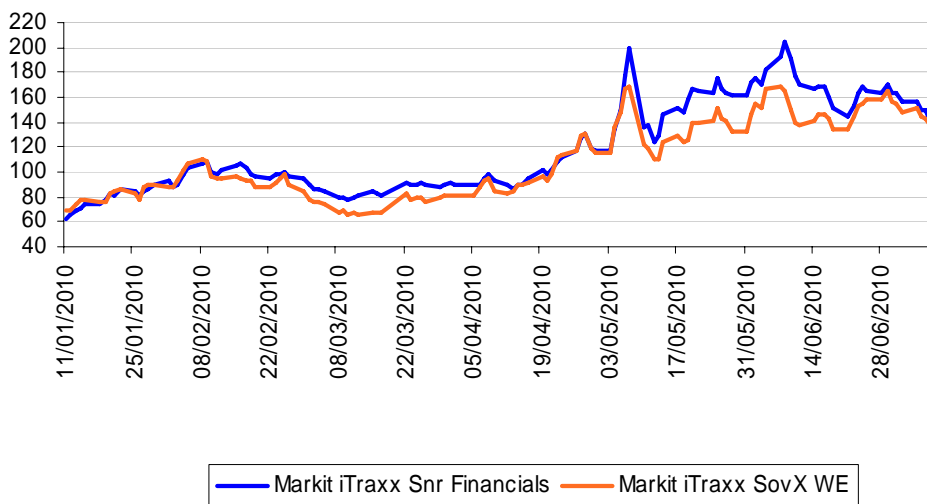


Markit Credit Wrap: The Week in Perspective



Source: Markit

The World Cup reaches its climax on Sunday, and football fans will be hoping that the final provides more excitement than the markets this week. The languorous feeling that envelopes the markets in summer - 2007 and 2008 being notable exceptions - appears to have set in already, though a quiet week for economic data and the US Independence Day holiday no doubt contributed to the sluggishness.

The slow pace gave room for risky assets to rally on little news. It says a lot that one of the highlights of the week was a statement from the Committee of European Banking Supervisors (CEBS). This hitherto obscure organisation has been tasked with implementing the much-awaited stress tests for banks. The uncertainty surrounding these tests has contributed to the volatility in recent weeks, with doubts about their credibility fuelled by the familiar discord among EU members.

After a procession of leaks and quotes from EU and banking “sources”, the CEBS released a statement outlining the details of the tests late on Wednesday. Instead of the original 25 banks, 91 institutions will now be tested. This amounts to 65% of the EU banking sector. EU officials had already indicated that there would be up to 100 banks involved. The macroeconomic assumptions were also revealed. The adverse scenario assumes a 3% deviation in GDP for the EU compared to European Commission forecasts over a two-year horizon.

But the statement didn’t disclose perhaps the main point that has been troubling credit markets. The haircut applied to sovereign debt holdings was conspicuous by its absence. This has been a contentious issue, with the idea of a universal 3% haircut applied to government bonds of all countries meeting resistance from some quarters. This was

unsurprising given the divergent credit standings within the EU. Other reports have suggested that Greece will have a 16% haircut applied. Some would say this is insufficient given that Greece's CDS was trading as wide as 1000bp only last month. More clarity is needed on the haircut issue.

The relatively slow week for news helped the LBO rumour mill whirl back into action. The proposed leveraged deal for Abertis prompted speculation on other likely targets. J Sainsbury popped up, with press reports suggesting that the Qatari Investment Authority is set for another go at a full takeover. United Utilities was another name that widened on the back of LBO rumours. It seems doubtful that banks are willing or able to fuel another LBO boom.

Next week sees the start of US earnings season, which should give the market some direction over the next month or so. Companies have been proficient at managing expectations in recent quarters, and it is likely that closer attention will be applied to the outlooks for Q3 rather than Q2 results. Investors will be looking to see if the weak data coming out of the US economy is reflected in the corporate sector.

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