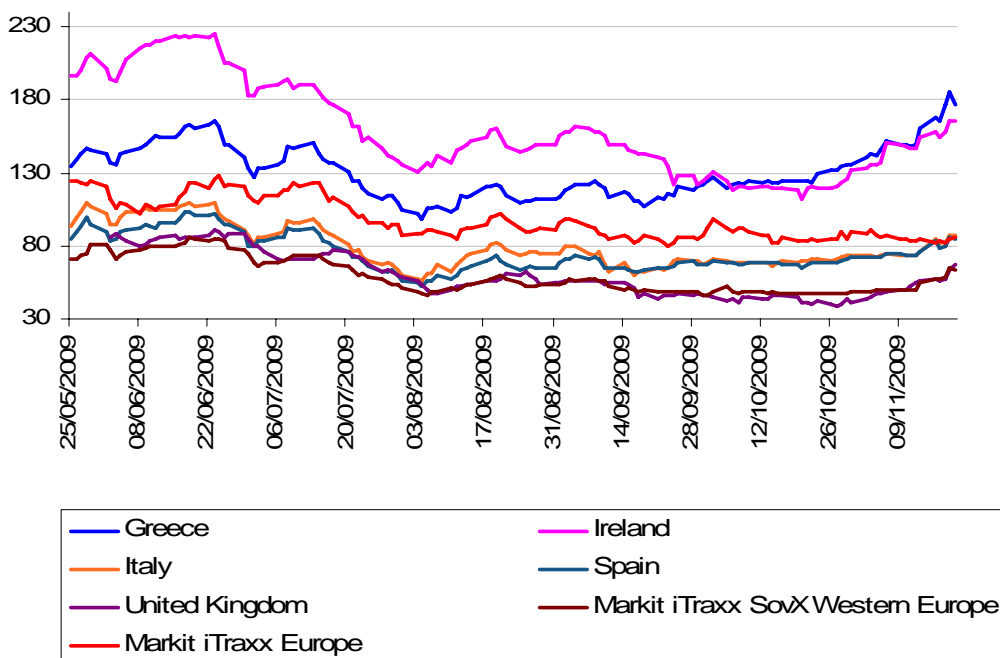


Markit Credit Wrap: The Week in Perspective

Is Greece the only sovereign on a slippery slope?



Source: Markit

The difference between sovereign and corporate CDS spreads in Europe this week reached its smallest level since February as public finances came under increasing scrutiny. The Markit iTraxx SovX Western Europe hit 65bp on Thursday, its widest level since it began trading in September. Prior to this, the SovX was a benchmark, non-tradable index. The deterioration in sovereign credit risk – the SovX was trading at only 50bp last Thursday - was all the more surprising given the solidity in the corporate CDS market. The Markit iTraxx Europe index has been trading in the 82-86bp range this month, close to its recent tight levels.

If risky assets, driven by a weak dollar, are rallying why is sovereign debt under such pressure? It is no secret that many governments are running large budget deficits. But one country in particular has caused investors to question its credit standing. Greece has seen its CDS spreads widened sharply this week to 185bp, dragging the rest of Europe with it. Last Friday, EU figures confirmed that Greece is still in recession and the OECD forecast yesterday that the Greek economy will continue to shrink in 2010. The government acknowledged that its deficit will hit 12.7% of GDP this year, the largest in the eurozone. This figure was a significant revision from its previous estimate, and skepticism about the accuracy of government statistics has contributed to negative sentiment.

But there are also concerns about Greece's banking system. The Bank of Greece issued a statement advising the country's banks to "show restraint" at the next tender for 12-month ECB funding. Greek banks have been the most active at the last two auctions, and the upcoming 12-month tender could be the last. The ECB has signalled that it will withdraw extraordinary liquidity facilities in the near future, an action that could cause problems in the weaker banking systems.

Of course, Greece is not the only European sovereigns with dire public finances. Italy has long been regarded as one of the more profligate countries, and its projected national debt of 120% of GDP in 2010 (IMF figures) does little to dent this reputation. Spain's budget deficit is ballooning, a result of its property bubble bursting. Its sovereign CDS spreads are now trading wider than the Markit iTraxx Europe index, the first time on record. Ireland is also suffering a property hangover, accentuated by an over-leveraged banking sector. Perhaps it can take comfort from the fact that Greece's travails mean that it is no longer the widest name in the eurozone. All of these sovereigns are high-beta names and have widened accordingly.

The UK is one of the middle-ranking countries when it comes to sovereign credit risk in Europe. This is evident in its close correlation with the Markit SovX WE (see chart above). In 1975 Margaret Thatcher declared that "we have changed places with Italy", referring to the UK's collapsing economy. A look at the countries' relative CDS spreads suggests that history has not yet repeated itself.

But it could be argued that credit markets have been quite sanguine about deteriorating public finances across Europe and elsewhere. The rally in risky assets has been underpinned by government intervention, and the major economic powers have signalled they are prepared to do what it takes to maintain the recovery. The widening in sovereign CDS this week, while not indicating any realistic risk of default, suggests that investors are hedging long-tail risk; in others words, the risk asset rally and sovereign credit deterioration are two sides of the same coin.

The credit event auction for CIT Group was held today. The auction, the largest of its kind to date, produced an initial result of 70.25 with \$728.98 million net open interest to sell. This was in line with what the market expected given where recovery locks have been trading. The final results will be announced shortly [here](#).

CIT filed for a pre-packaged bankruptcy on November 1. Its future had been hanging in the balance for some time, and its viability as a going concern was put in serious doubt after the government refused to offer it further assistance. The firm's spreads have been trading in distressed territory for most of this year, and its failure to secure a debt restructuring meant bankruptcy was inevitable.

Greek telecoms operator Hellas Il filed for bankruptcy earlier this week. This was even less of a surprise than CIT, as it has been one of the most distressed credits in Europe for many months. The company, owner of mobile carrier Wind Hellas, has been running out of cash and was set to breach covenants. Injections of capital were not forthcoming, and once the restructuring option was ruled out, bankruptcy was the only alternative. Details of the credit event auction will be announced in due course [here](#).

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