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Markit Credit Research

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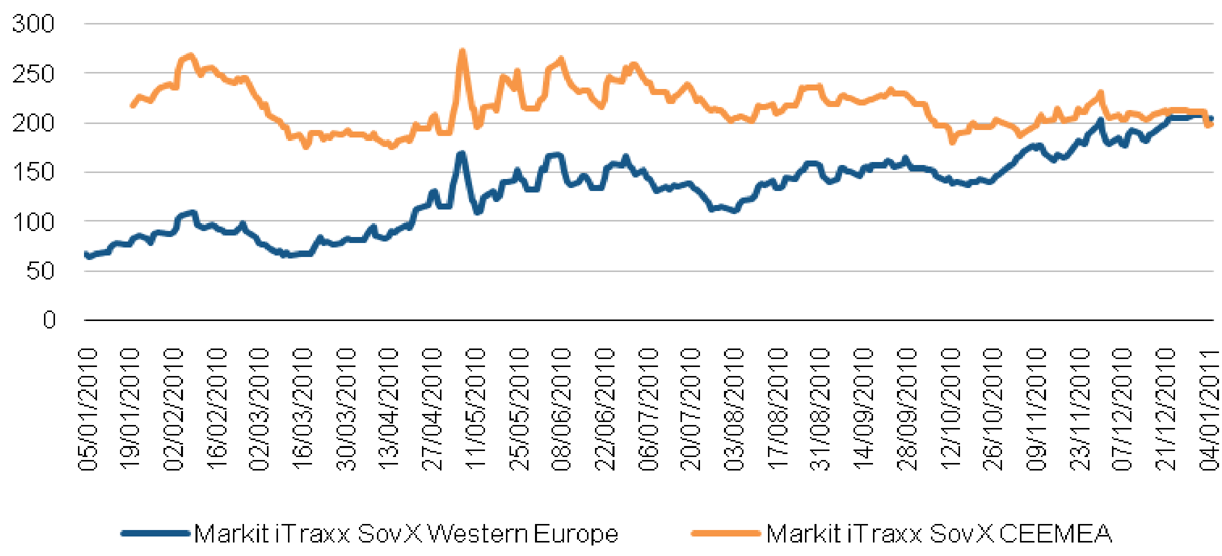
Markit Intraday Alert: From west to east



Source: Markit

After yesterday's strong start to the year it was no great surprise to see a correction today, though the plethora of market moving economic releases clearly had an impact on spread direction. In Europe, the Markit Eurozone Services PMI came in at 54.2 in December, below the previous month but above the earlier flash estimate. The report showed that the region's growth is still being driven by the core economies of Germany and France, with the peripherals continuing to contract. This contrasts slightly with Monday's manufacturing PMI, which showed evidence of an export-driven recovery in the likes of Ireland.

The equivalent report in the US, the ISM non-manufacturing survey, also came in ahead of expectations. The headline December figure of 57.1 easily beat the consensus forecast of 55.7 and was a big improvement on the 55.0 November reading. But the employment component index was down from 52.7 to 50.5, a sharp fall that was enough to dampen optimism from a bullish ADP employment report earlier in the day. The mixed picture places additional attention on this Friday's non-farm payrolls report.

Bond issuance was high in both corporate and sovereigns, along with the European Commission's first bailout bond. The EUR5 billion AAA bond, proceeds of which will go towards the EUR60 billion European Financial Stabilisation Mechanism, was priced at 12bp over mid-swaps and was three times oversubscribed, according to reports. The EUR440 billion European Financial Stability Facility is due to tap the capital markets for the first time later this month.

Portugal has considerable funding requirements in the first half of this year but it will have a fight on its hands to attract investors at reasonable yields. The better quality credits – supranationals, sovereigns, corporate and financials – are all racing to the market before possible rate rises later this year. Portugal's first foray was a EUR500 million six-month T-bill auction today, and it was forced to pay a significantly higher yield than its previous sale last September. This was unsurprising, and Portugal's widening was limited to the deterioration seen during the early morning. But the high rate – 3.686% - will only inflame doubts about the sustainability of Portugal's fiscal position.

The widespread scepticism about the eurozone's peripheral economies, and indeed the viability of the eurozone itself, led to significant spread widening over 2010. Emerging market economies, on the other hand, have endured the recession and its aftermath relatively well. The divergent fortunes of developed western European countries and their neighbours in eastern Europe and beyond can be seen by comparing two key indices: the Markit iTraxx SovX Western Europe and the Markit iTraxx SovX CEEMEA. The two indices have been converging for some months and this week they crossed over for the first time (see chart). The shift in economic power from west to east has been evident for years and The Great Recession appears to have hastened the process. The SovX WE/CEEMEA basis will no doubt be closely watched in 2011 as a barometer of this trend.

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