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Markit Credit Research

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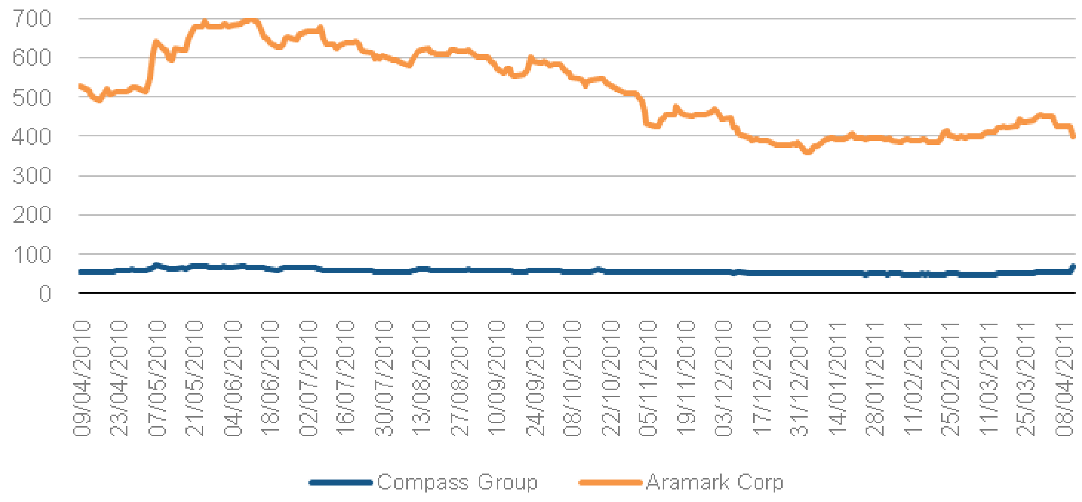
Markit Intraday Alert: Warm words won't do



Risk aversion was back in the ascendency today as a combination of Japanese woes, disappointing economic data and an underwhelming start to earnings season combined to dampen sentiment. Japan's nuclear regulator raised its assessment of the Fukushima accident to seven on the IEA scale, the same as Chernobyl. However, the authorities were quick to stress that the amount of radioactive material released so far was nothing like that of the Ukrainian disaster. The reaction in the Asian credit markets was relatively muted, with Japan's sovereign CDS only slightly wider.

The other overnight event investors had to digest, Alcoa's results, was somewhat more predictable. The aluminium company's earnings came in at 27 cents per share, in line with expectations. But the revenue growth of 22% was deemed a disappointment by the market and the company's reiteration of its 12% demand growth projection was also a let-down to some investors. Alcoa's spreads widened 13bp to 158bp today.

Economic data from the UK and Germany added to the negative mood. A survey from the British Retail Consortium showed that sales fell 1.9% in March from a year earlier, the biggest drop since the BRC started collecting data in 1995. The weak picture painted by the survey chimes with the pessimism expressed by several high profile retailers over the past few weeks. Even an unexpected drop in inflation, usually taken as good news, only served to provide further evidence of a struggling consumer. Supermarket discounting on food made a considerable contribution to the CPI drop, suggesting that consumers are feeling the pinch. A sharper than expected deterioration in the German ZEW economic sentiment index created further unease.

The price of oil couldn't sustain its rally after the slew of bad news. Brent crude fell back to $120 a barrel from being as high as $125 this morning.

Sovereigns were not immune to the pressure, despite the best efforts of Herman van Rompuy. The European Council President said that the "threat of the crisis spreading has been reduced significantly, or disappeared". He seemed to be making the point that the risk of contagion had receded due to the decoupling of Spain from the rest. Many investors would agree with this view (though some would not).

But he was on shaky ground when he dismissed the possibility of a Greek debt restructuring. Some form of restructuring is probably the consensus view in the market now, as evident in the spreads trading well over 1,000bp. Some dealers are now even quoting it upfront, a sure sign of near-term credit distress. Van Rompuy said in a tweet that "here in Athens we don't accept disdain regarding the so-called 'peripheral countries'". Investors, aware that Greece is preparing further austerity measures this week, will need more than warm words to convince them of the country's solvency.

M&A speculation is becoming a theme in the credit markets, and following on from the Schneider/Tyco rumour yesterday the food services industry was the focus of attention today. A report in a British newspaper suggested that Compass Group, the market leader in the industry, is considering a merger with number two Aramark. If true, the deal would probably be credit negative for Compass given Aramark's weak credit profile (private equity owned, single B rating). Clearly, the structure of any potential transaction would have a bearing on how detrimental the deal would be. Possibly all idle gossip, but Compass was still one of the day's worst performers, widening by 16bp to close around 70bp.

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