

Weekly Credit Update

Headlines

- Direction of credit markets will depend on US fiscal cliff negotiations.
- Decent - but not high - activity in the primary markets.
- Liquidity management exercise could pick up.

Market commentary

Over the past week we have mostly seen disappointing economic data but spreads are only slowly drifting wider. iTraxx Main is trading at approximately 132bp (2bp higher than one week ago) and Crossover at around 538bp (5bp higher). The outcome of Obama's meeting with Congressional leaders on Friday will determine the short- to medium-term direction of the credit markets. We once again highlight that our base case is that the fiscal cliff will be resolved but the risk-reward for credit investors is asymmetrical. If the fiscal cliff is not resolved, it is likely to cause a significant widening of spreads, while if it is indeed resolved, it is unlikely to push spreads significantly tighter, as we are already back at the levels seen before the outbreak of the debt crisis last summer. From a longer-term perspective, for investors awash with liquidity, the search for yield and expected lower primary issuance in 2013 than in 2012 should support credit spreads.

Periphery volatility is also back on the agenda, with news that the decision on paying out Greece's delayed aid payment has been postponed by another week. Furthermore, Spain is also on the agenda, with Spanish banks ceasing to throw people out of their houses (with low income) despite defaulting on their mortgages (freeze in repossessions as it is kindly put) highlighting the disastrous economic situation of many Spanish households. It is difficult to assess how harmful it will be to bank earnings, though there is no doubt in our minds that the pool of non-performing loans will increase. The problem with such an action is not so much the bankrupt households themselves as the contagion it could cause, creating an incentive for other households not to pay their mortgages.

Positively, Olli Rehn made it clear that for 2012 and 2013 there will not be any additional austerity requirements from the European Commission as he stated that 'broadly speaking Spain is on track'.

We have seen decent - but not high - activity in the primary markets. From the Nordic region, Stockman issued a six-year EUR150m bond at MS+255bp.

As total yield is at a record-low level for issuers and corporates in general have the strongest balance sheets since the emergence of the financial crisis (many even have net cash positions), we would expect LME (liquidity management exercise) to pick up over the next couple of months. LME activity would allow treasurers, via buy-backs of their own bonds refinanced in the capital markets, to lock in the historically low yields. Thus, we expect the issuance pipeline over the next couple of months to be supported not only by LMEs but also by prefunding (again taking advantage of record-low yields). As mentioned earlier though, as the prefunding exercise has been ongoing for a while, we expect total issuance for non-financials to be lower in 2013 than in 2012.

iTraxx Europe (investment grade)



Source: Bloomberg, Danske Bank Markets

iTraxx Crossover (high yield)

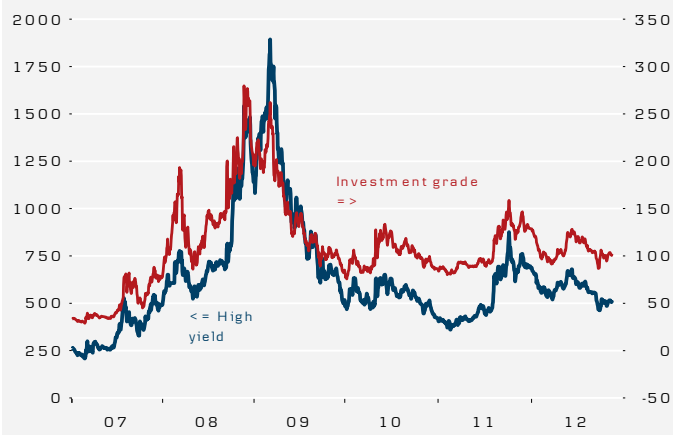


Source: Bloomberg, Danske Bank Markets

Chief Analyst

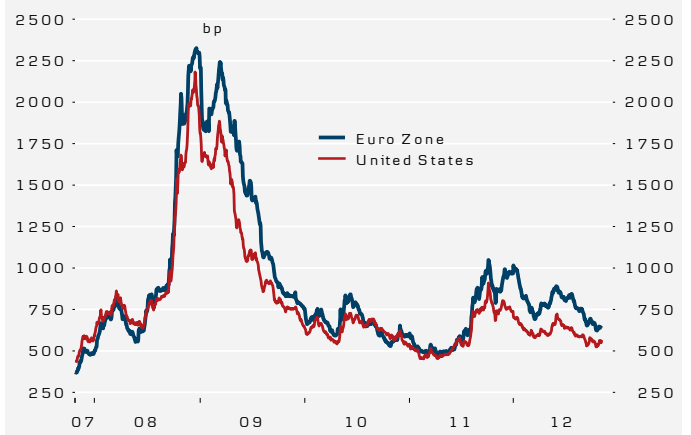
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US investment grade and high yield CDS indices (CDX)



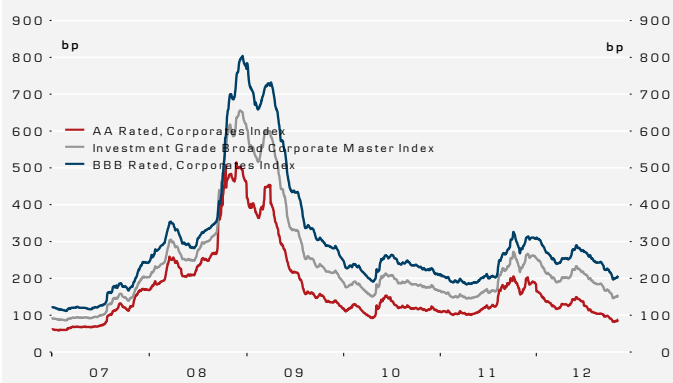
Source: Reuters EcoWin Pro

Merrill Lynch US & European high yield cash indices



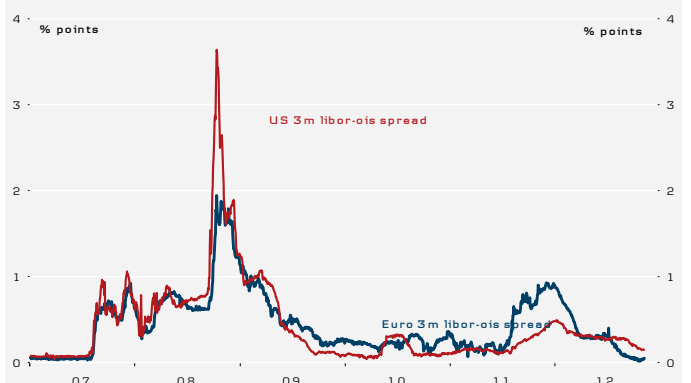
Source: Reuters EcoWin Pro

US cash indices



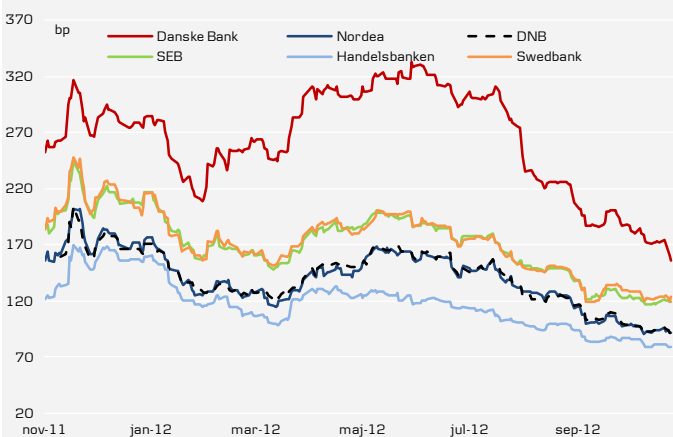
Source: Reuters EcoWin Pro

3M LIBOR-OIS spread



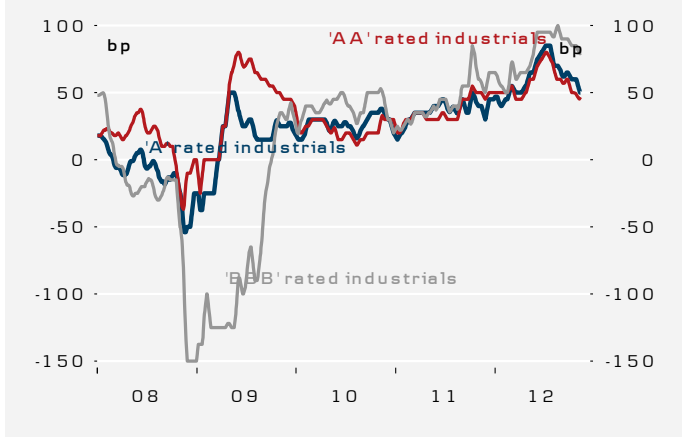
Source: Reuters EcoWin Pro

Nordic banks 5Y CDS spreads



Source: Danske Bank Markets

Slope of US credit curves (2Y spread - 10Y spread)



Source: Reuters EcoWin Pro

Fixed Income Credit Research

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