

Weekly Credit Update

Summary

- Decent macro numbers and Q4 reports drive spreads tighter
- Primary markets remain busy with high new issuance activity

Market comment

The notion of a 2012 January rally was supported by a general tightening trend across the various indices. As such the iTraxx Main is now trading around +145bp, some 9bp tighter during the week. The iTraxx Crossover is 38bp tighter, now reading 610bp. This week's spread tightening has been fuelled by an overweight of positive surprises from both US and EU macro indicators, combined with a decent start to the Q4 earnings season. Risk sentiment surrounding financials also got a boost from an article in the Financial Times, which indicated that France and Germany were contemplating a relaxation of the Basel III rules and the timing of implementation. This theme helped boost the Senior Financials index to its current level of 213bp, some 15bp tighter over the week.

Disappointing earnings may have bottomed out

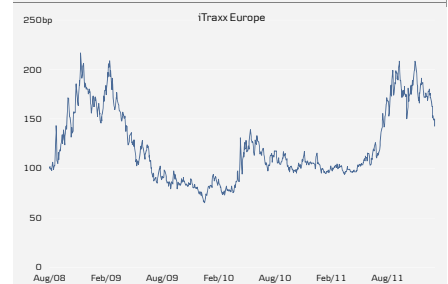
Being a bellwether of the industrial sector, SKF's disappointing Q4 11 result indicates that earnings reports for the sector are likely to hold negative surprises in the coming weeks. Indeed, most Nordic non-financials have reported disappointing Q4 earnings so far (SKF, SCA and Ericsson), while financials were mixed (Nordea beating expectations, while Jyske Bank disappointed). According to Bloomberg, so far some 63% of the Q4 earnings reports in the US have surprised on the upside in terms of EPS. In Europe, the corresponding number is only 44%.

Interestingly, SKF's flat outlook for Q1 12 indicates that the declining trend for the industrial sector has bottomed out and a few subsectors like energy, aerospace and North American auto/trucks are expected to show sequential rising demand. However, as demand is expected to continue to decline in Europe and continue to improve in North America, companies with large exposure to Europe are likely to remain subdued.

Current rally is fragile

We caution that there are still plenty of risks out there that could rapidly suck the life out of investor appetite. Several Greek politicians have demonstrated unwillingness to tighten the austerity belt further, which could endanger the troika's willingness to release the next tranche of support. This is vital if Greece wants to avoid a hard default by 20 March, when some EUR14.4bn of government debt matures. At the same time pressure is mounting from the IMF on the ECB to share the fate of PSI and accept haircuts on Greek government bonds. Pressure is also rising for Portuguese rates, which are weighed down by the downgrade to High Yield status from S&P, coupled with talks about the need for further bail-outs or public debt investor haircuts.

iTraxx Europe (5Y CDS)



Source: Bloomberg, Danske Markets

iTraxx Crossover (5Y CDS)



Source: Bloomberg, Danske Markets

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Solid new issuance activity

Positive risk sentiment is still paving the way for decent new issuance activity. In the Nordic region, Finnish nuclear power generator TVO issued a EUR500m seven-year deal and Swedbank issued a EUR1bn five-year senior unsecured bond. Outside the Nordic region the week also offered primary activity from Lloyds, EIB and KFW and in the corporate space French issuers continue to be active with benchmark size EUR deals from Alstom and Bouygues. In the sterling market, BMW successfully printed a 750m deal. After this note's deadline we also saw issuers like ENI and Compass Group hit the screens.

Selected new issues during the week

Name	Rating	Coupon	Maturity	Currency	Size	Spread*
TVO	-/-/A-	4,625%	7yr	EUR	500m	+265bp
Swedbank	A2/A+	3.375%	5yr	EUR	1bn	+183bp
Alstom	Baa2/BBB	3.875%	4yr	EUR	500m	+245bp
Bouygues	A3/BBB+	4.5%	10yr	EUR	800m	+217bp
BMW	A2/A-	3.375%	6yr	GBP	750m	

Notes: Ratings are Moody's and Standard & Poor's

* Mid-swaps for fixed, discount margin for floating

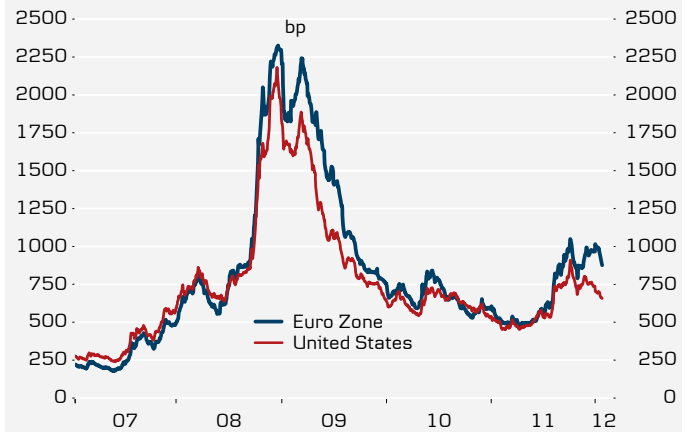
Source: Bloomberg, Informa Global Markets, Danske Markets

US investment grade and high yield CDS indices (CDX)



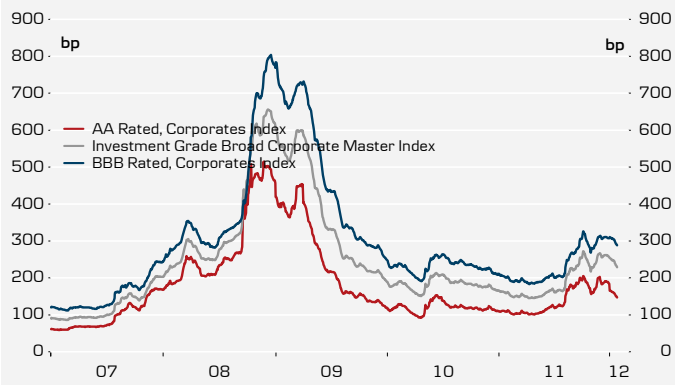
Source: Reuters EcoWin Pro

Merrill Lynch US & European high yield cash indices



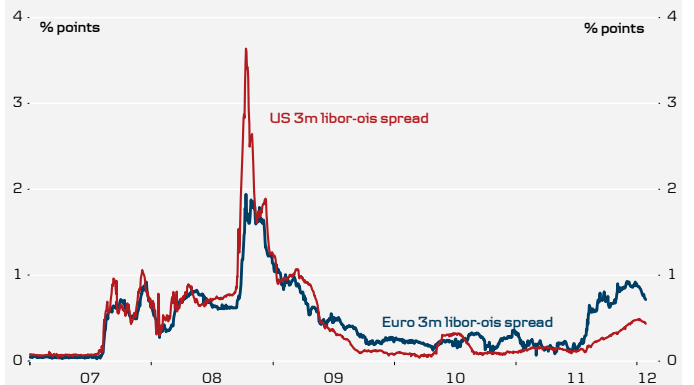
Source: Reuters EcoWin Pro

US cash indices



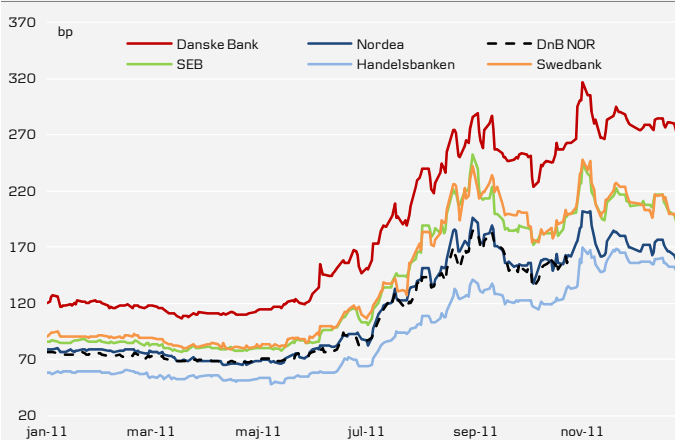
Source: Reuters EcoWin Pro

3M LIBOR-OIS spread



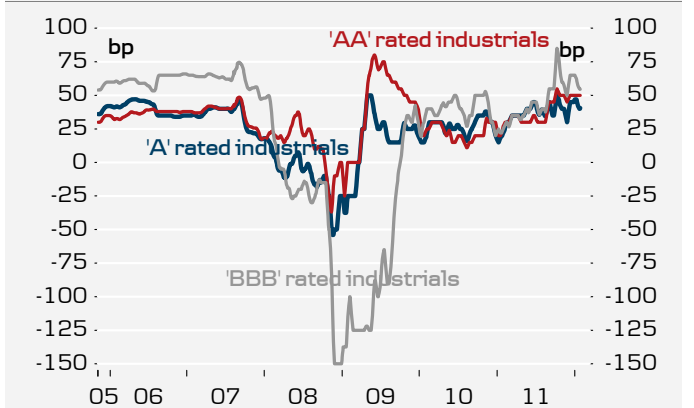
Source: Reuters EcoWin Pro

Nordic banks 5Y CDS spreads



Source: Danske Markets

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



Source: Reuters EcoWin Pro

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