Markit Economic Research

15/04/2015

Greece

Markets price in greater chance of government default

- **Credit markets put implied risk of default at 77%**
- **Borrowing costs at two-year high**
- **Downturn in economy puts further pressure on government finances**

The cost of insuring against a default by the Greek government has spiked sharply higher as worries about the ability to meet debt repayments have intensified. Credit default swap prices, which provide investors with protection to insure against debt default have surged higher. The CDS market is now implying a 77% probability of default by the Greek government in the next five years, according to Markit data.

Government borrowing costs have also been pushed higher as the markets shun Greek debt, with the yield on 10-year bonds (which are inversely related to price) having risen to 11.8%, their highest for two years. Investors have instead sought the safety of German bunds, the comparable yield on which has fallen to just 0.11%. The spread between German and Greek debt is consequently the widest since December 2012.

Worries have escalated as the standoff between the Greek government and its creditors shows few signs of being resolved, not least because Greece's debt repayment capabilities are being hit by a renewed downturn in the economy.

The economy grew 1.3% on a year ago in the final quarter of last year, helping push the government's finances into surplus if debt interest payments are excluded, but appears to have since weakened. Markit's Manufacturing PMI, a reliably advance indicator of economic growth, signalled the seventh successive monthly decline in March.

It's not just a factor of domestic demand having weakened in Greece. In fact there are signs that consumers are switching away from imports to domestically-produced goods. More worrying is the downturn in exports. The PMI survey showed goods exports dropping at an increased rate in recent months, with the rate of decline reaching the fastest since mid-2013 in March despite the recent fall in the euro.

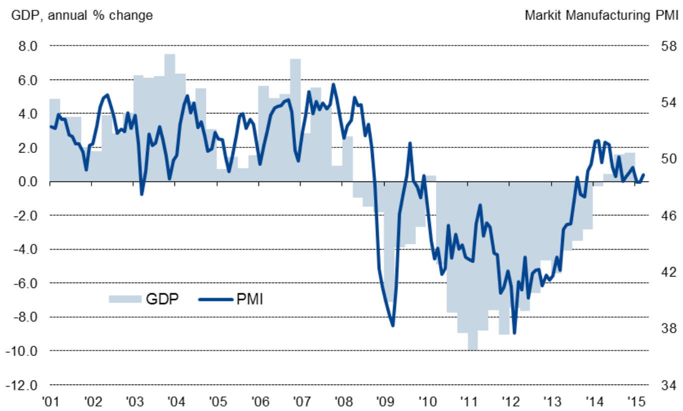
Cost of insuring against Greek default*

Source: Markit.

* pricing data were not available between late-2011 and early-2013.

Government borrowing costs

Economic growth and the PMI



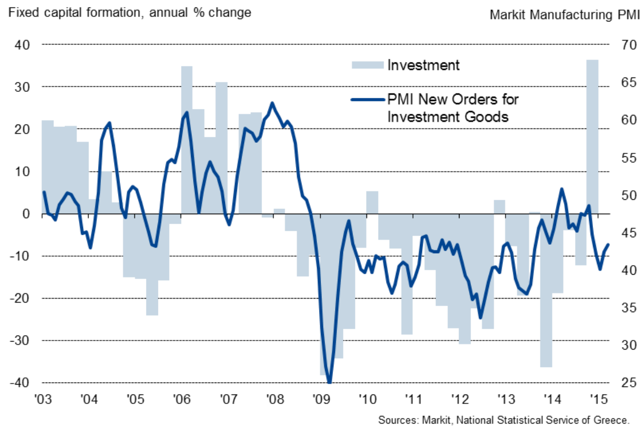
Sources: Markit, National Statistical Service of Greece.

Companies are also cutting back on their input buying, bracing themselves for a further downturn in demand.

The deteriorating outlook also appears to have adversely affected business investment spending. Fixed capital formation jumped some 36% on a year ago in the final quarter of last year, but that upturn looks to have been short-lived. The PMI survey showed new orders for investment goods such as plant and machinery having suffered renewed weakness in recent months, highlighting growing risk aversion when it comes to capex.

The outlook is therefore one in which government finances look set to deteriorate once again as the economy takes another downward lurch, putting further pressure on Greece's credit position. It's therefore not at all surprising that the credit markets are pricing in an increased risk of default.

Business investment



Continued…

.

Chris Williamson

Chief Economist

Markit

Tel: +44 207 260 2329

Email: chris.williamson@markit.com

Click here for more PMI and economic commentary.

For further information, please visit www.markit.com