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Markit Research

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Oil exporters suffer credit damage

The decline in the price of oil has pushed spreads in oil-dependent sovereigns wider, though the contagion hasn't affected emerging markets.

— Russia's spreads at widest level since April 2009
— Other emerging market sovereigns have rallied in recent months
— Volatility has dropped to levels typical of QE era

The big story in the global economy as 2015 comes to an end is undoubtedly the sharp fall in the oil price. Brent crude has dipped below $70 a barrel, the lowest for about five years.

But how does the price of a commodity affect the credit markets, in particular emerging market sovereigns? Russia's CDS spreads rose from 170bps in June to 380bps almost six months later, the widest level since April 2009.

Of course, the plummeting oil price is not the only problem facing Russia. The conflict in eastern Ukraine, where Russia is the protagonist, continues despite talk of ceasefires. Sanctions are biting, and are no doubt contributing to capital flight, a precipitous fall in the ruble and sharply lower growth forecasts.

However, it is surely the significant fall in the oil price – precipitated by Opec's refusal to cut production – that has made the biggest contribution to Russia's spreads widening. The country is one of the world's largest oil exporters, and a $10 fall in the price of the commodity costs Russia approximately $25-35bn. This will clearly have a negative impact on the country's external position, accelerate capital flight and could lead to spreads widening even further. But Russia does have considerable reserves, which gives it plenty of breathing space to survive the current spell of lower oil prices.

Ukraine, unsurprisingly, is also seeing its spreads widen. It is now trading at 1,800bps, the widest level since June 2009. However, there is certainty no contagion among other CEEMEA sovereigns. Turkey and South Africa, both of which are oil importers and have their own economic problems, have rallied in recent weeks. They are trading at 156bps and 161bps respectively – in June they were at the same level as Russia. This indicates that oil exporters, particularly those affected by geopolitical risk, are in the firing line.

Indeed, the broader corporate market is ending the week on a positive note. The Markit iTraxx Europe is trading at 55.75bps, 2bps tighter on the week and close to the tightest level this year. After the spike in October, volatility has dropped to levels typical of the QE era. The Markit VolX Europe is now 28%, down sharply from the 75% level reached earlier this quarter.

This implies that the markets expect the ECB to implement full QE (government bond purchases), probably in Q1 next year. But there is considerable opposition to such a policy, particularly in Germany, and we may see volatility flare up if the legal obstacles appear insurmountable.

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