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Markit Commentary

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Periphery Europe rides out recent volatility

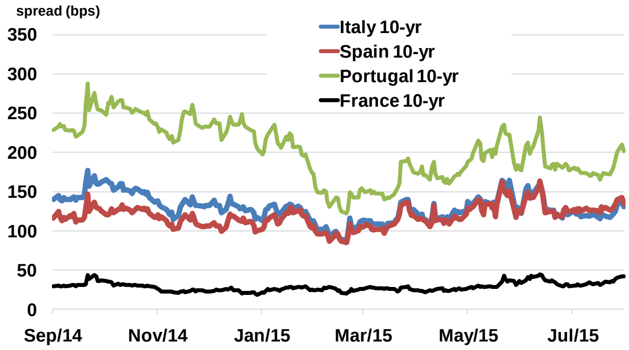
Recent market volatility has had relatively little impact on eurozone periphery sovereign bond spreads as fixed income investors remain bullish on the region.

- Spain's 10-yr sovereign bond spread over bunds has only widened 6bps so far in August
- Investors have piled into eurozone exposed bond ETFs, with €1.4bn of inflows in August
- France's 10-yr spread over bunds is more than double than the post QE lows in March

August volatility has seen a re-pricing of risk across the credit spectrum. Emerging market bonds have sold off while US credit indices have moved sharply wider. Volatility across all asset classes has pushed investors towards safe havens and attention has turned towards risky assets that were least impacted by the recent market turmoil.

To no surprise, yields on bunds tightened, but it was the risky assets in the periphery that caught investors' attention.

Eurozone periphery bond spreads



Source: Markit

Eurozone periphery bond spreads widened in the months leading up to the Greek bailout crisis. They hit 2015 highs in July, with Spanish and Italian 10-yr sovereign bonds (which have held a minimal basis throughout 2015) seeing their spreads widen to 164bps on July 7th. These bonds subsequently tightened after the Greece crisis subdued.

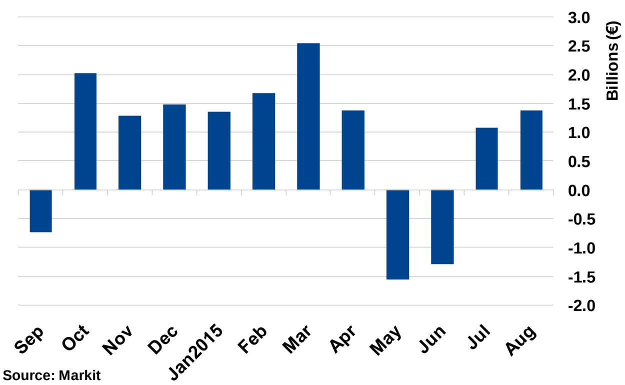
The market volatility over the last few weeks has had little impact, with Spain's 10-yr spread only 6bps wider in August according to [Markit's bond pricing service](). It currently stands around at 135bps; 29bps tighter than the July 7th level.

Portuguese and Italian bonds showcase a similar trend. This highlights Europe's relative insulation from the slowing Chinese market which is plaguing emerging market sovereign credit risk as well as US corporate credit risk. This relative lack of contagion is also demonstrated by the ECB's current accommodative monetary policy.

ETF flows

Positive investor sentiment towards eurozone credit is evident in ETF flows over the past few months. While May and June saw significant outflows stemming from Greece jitters, the last two months have seen over €2.4bn of inflows into eurozone exposed fixed income ETFs. Even with the market volatility over the past few weeks, August has seen over €1bn of inflows.

Eurozone exposed fixed income ETF inflows/outflows



Source: Markit

The most popular ETF in this subset has been the db x-trackers II IBOXX Sovereigns Eurozone Yield + 1-3 ETF, which has seen €253m of inflows over the past month. Tracking the Markit iBoxx EUR Sovereigns Eurozone Yield Plus 1-3 Index, (whose top holdings largely consist of Italian and Spanish severing bonds) the ETF i has returned 0.51% on a total return basis this year, according to Markit ETP.

QE potential

spread	25 August 2015	Post QE low	Difference
Italy 10-yr	131	98	32
Spain 10-yr	135	94	42
Portugal 10-yr	202	122	80
France 10-yr	42	19	23

With the ECB still buying eurozone sovereign bonds as part of its €1.1tn QE programme until at least September 2016, investors remain bullish on the eurozone. Current bond spreads remain well above post QE lows, with both Italian and Spanish 10-yr bond spreads over 40bps wider. France's 10-yr spread is more than double than its post QE low in March. The period from March until present has seen some severe headwinds; the next period of relative calm could see QE once again take the forefront.

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