Review of recent bond market developments

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2013: just a round trip on core rates so far

The bond scare on rotation talk and LTRO payback did not have long legs

Source: Barclays, BlackRock
General spread tightening has paused

After Draghi periphery tightened but not that much (when looking at it in a core/semi-core/periphery blend)

Source: Bloomberg, BlackRock
Some normalisation in trading conditions is taking place

Bid/offer spreads in periphery have fallen more than 50%
but curves still far away from what they used to look like

Differentiation of high/low coupon bonds given lack of liquidity and dealer balance sheet to oppose

Source: Bloomberg, Barclays, BlackRock
Feedback loop between sovereign risk and bank risk (risk on / risk off markets)

Broad correlations still intact despite some specific moves around Italian election and after Cyprus

Source: Barclays, BlackRock
Muted reaction to Cyprus on a systematic basis

However with some idiosyncratic consequences seen

Source: Bloomberg, SG, BlackRock
August to Feb: Euro appreciates against the majors

but long-term valuations do not look extreme

Source: Bloomberg, DB, BlackRock
FX markets still very driven by perceptions of European financial sector

Risk on / risk off behaviour also present in fx markets

Source: Bloomberg, Morgan Stanley, BlackRock
Since the effects of the Draghi speech monetary conditions sideways

FX strengthening offset spread tightening for most of H2, rate sell off followed by Euro weakening in 2013

Source: GS
Contrast of economic indicators with balance sheet moves

Growth in G4 Central Banks’ Balance Sheet

Manufacturing PMIs (top) and Unemployment Rate (bottom)

US balance sheet still expanding while situation improves

Source: Bloomberg, Datastream, BlackRock
Excluding forced deleveraging in PT/IE, real deleveraging only started in 2012.
European corporates were traditionally more reliant on bank funding. Are we seeing a “forced” paradigm shift?

Source: JP Morgan, BlackRock
SME funding conditions in the periphery remain very tight

MFI Interest Rate to Firms – loans other than revolving and overdrafts (original maturity up to 1 year)

Source: ECB, Bloomberg, BlackRock (Core: AT, BE, DE, FI, FR, NL; Periphery: ES, GR, IE, IT, PT; country average)

could a solution involve a supranational vehicle?
Discussion topics

● Were the Cyprus events a bad sign (proving what policy blunders are possible) or a good sign (as there was not too widespread contagion yet)?

● How far has euro govie bond market healed in your view? Will we need the SMP and for what countries?

● What do market participants think is the best way to kick start SME lending in problem countries?