

Review of recent bond market developments

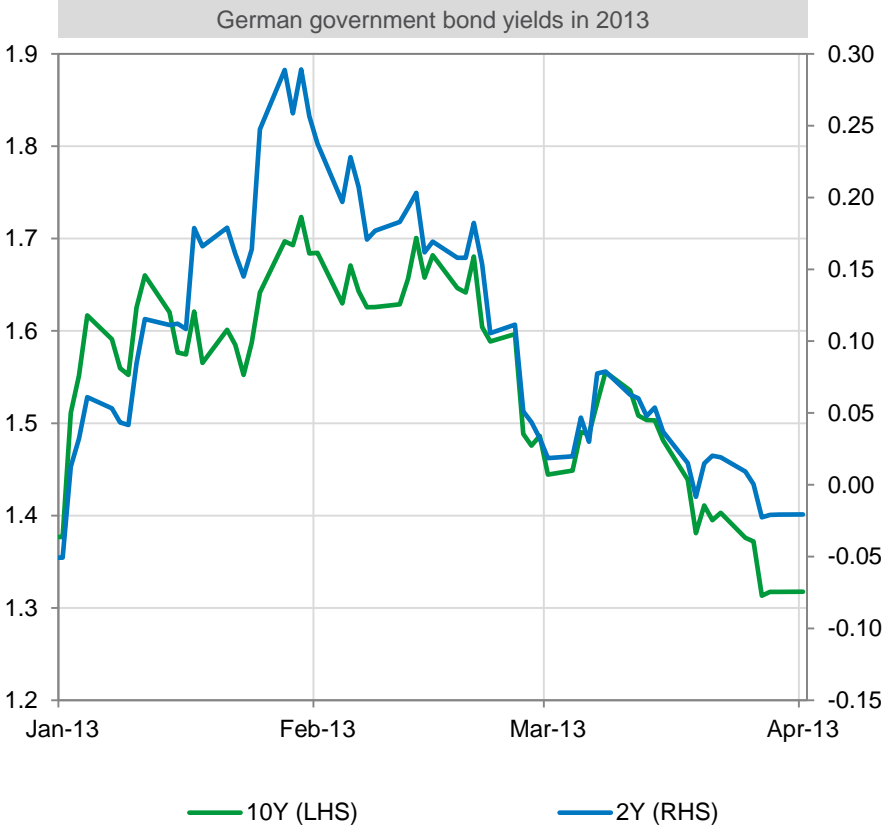
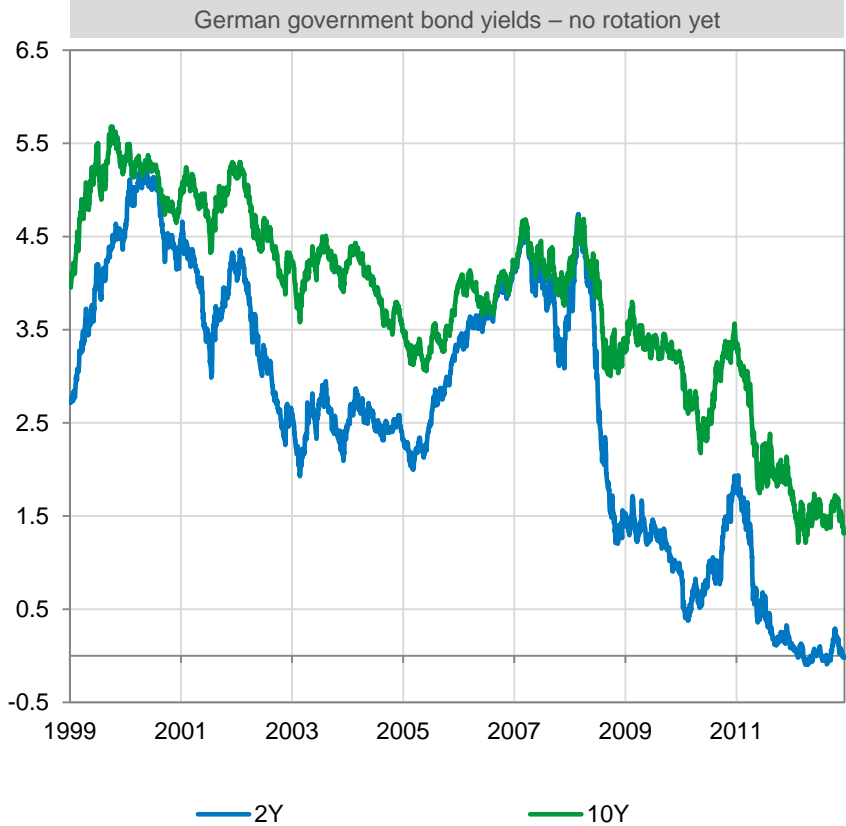
Michael Krautzberger

CIO of BlackRock Germany & Head of Euro Fixed Income

BOND MARKET CONTACT GROUP

Frankfurt am Main, 9 April 2013

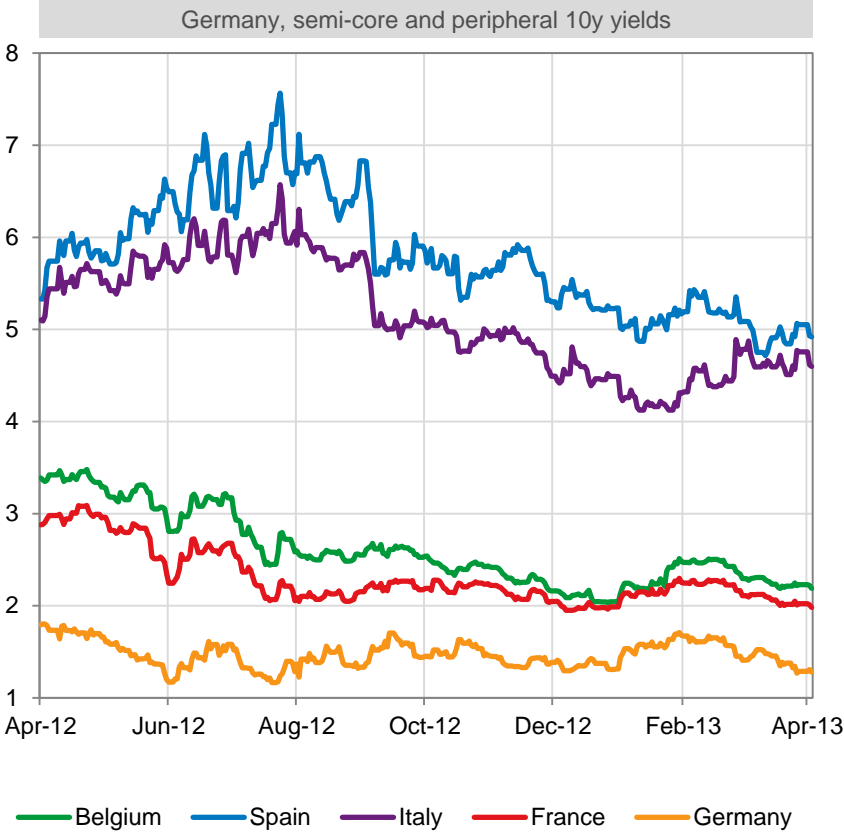
2013: just a round trip on core rates so far



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

Source: Barclays, BlackRock

General spread tightening has paused

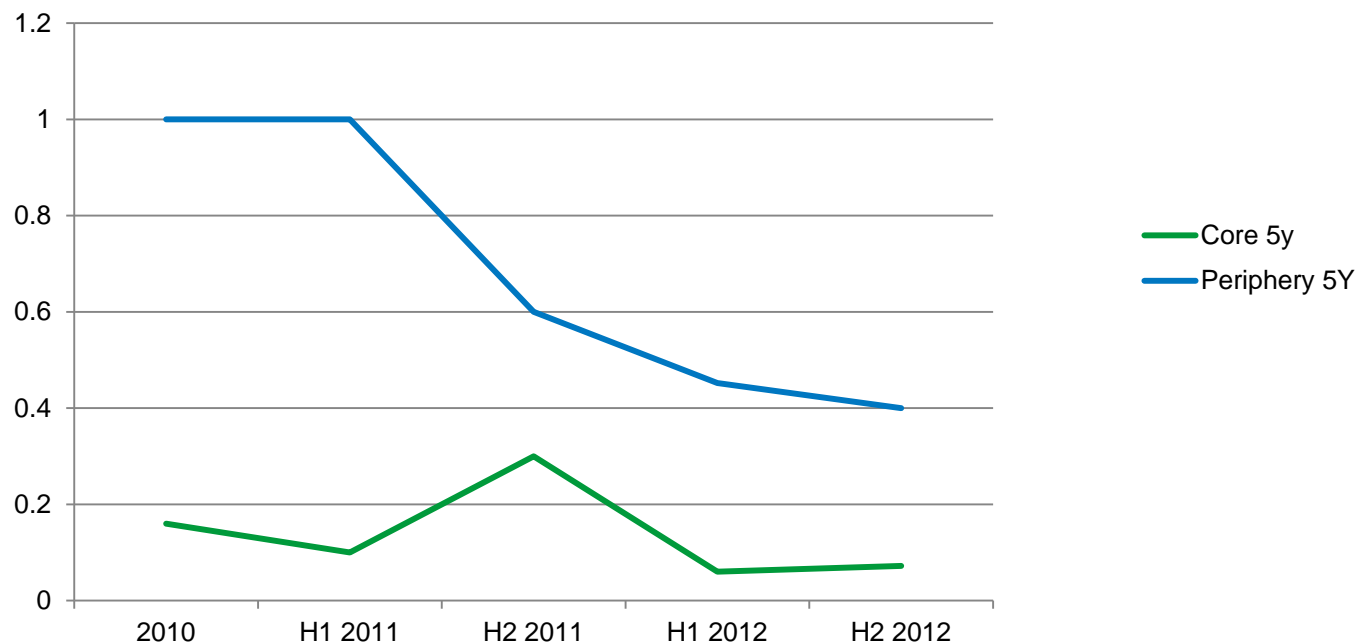


After Draghi periphery tightened but not that much (when looking at it in a core/semi-core/periphery blend)

Source: Bloomberg, BlackRock

Some normalisation in trading conditions is taking place

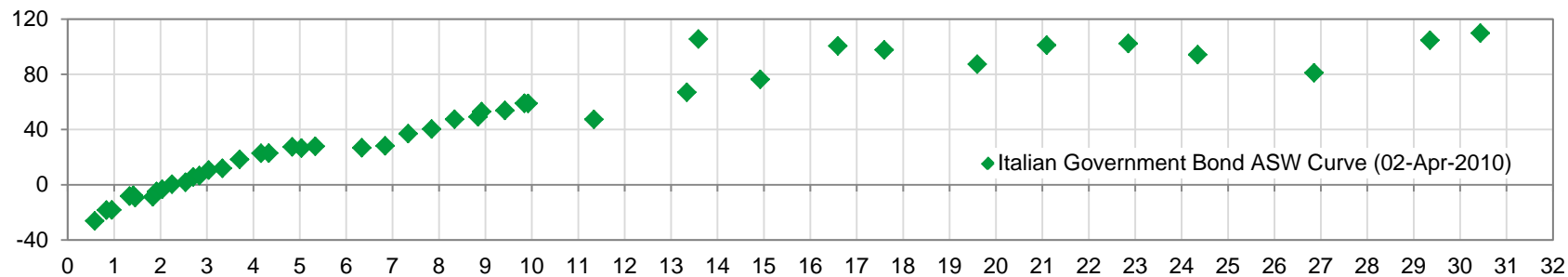
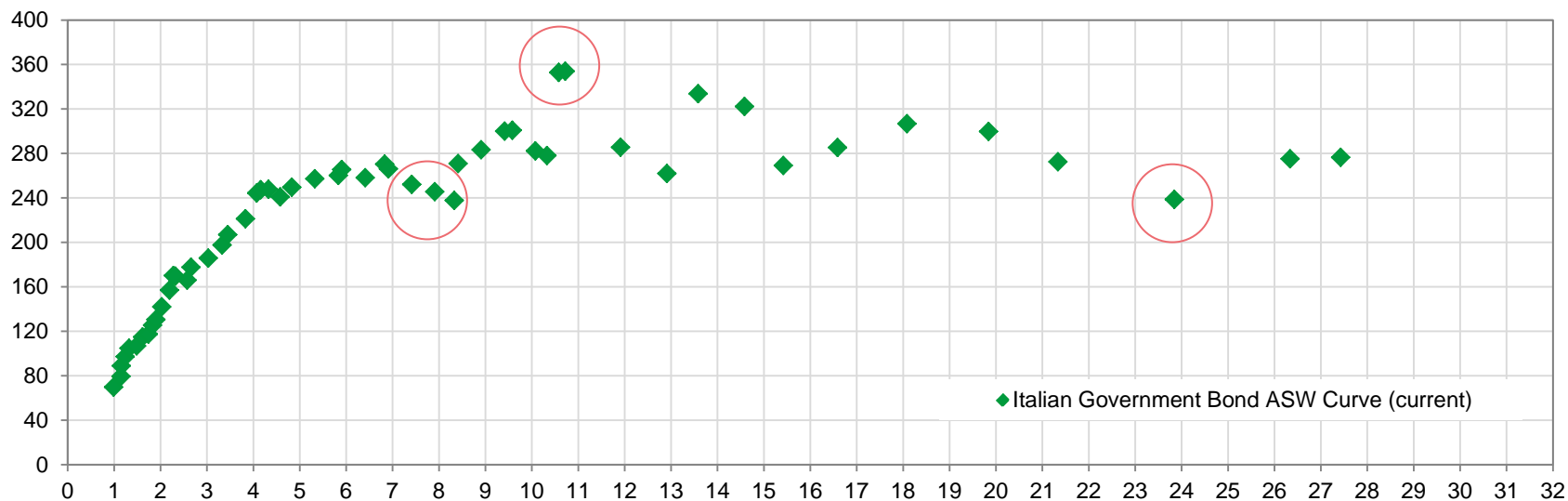
Bid offer spreads (normalized)



Bid/offer spreads in periphery have fallen more than 50%

Source: BlackRock

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

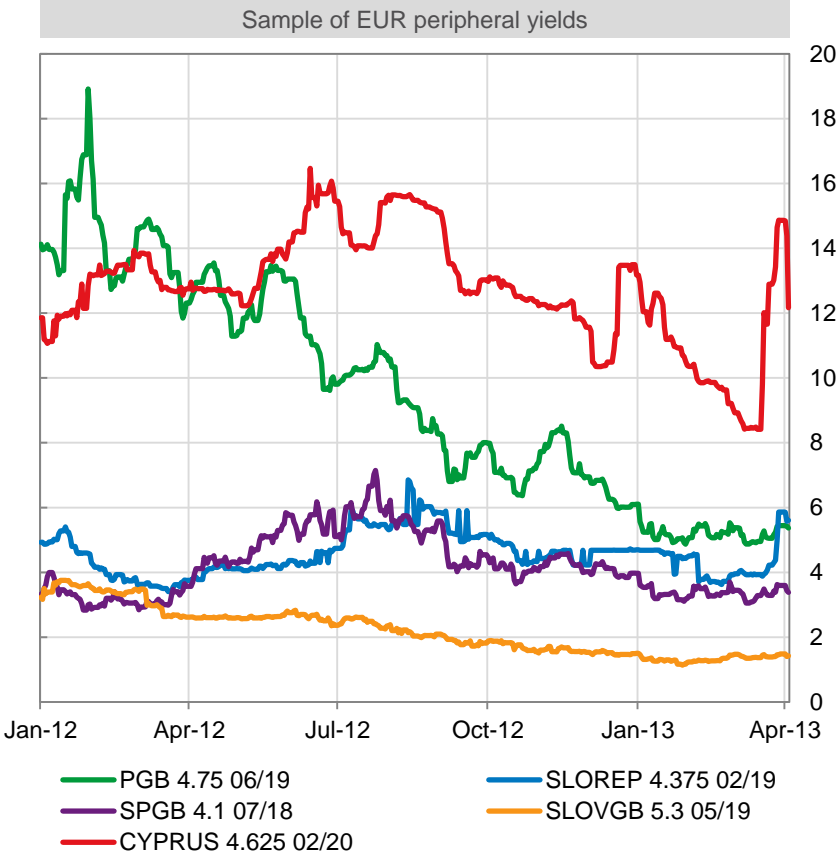
Feedback loop between sovereign risk and bank risk (risk on / risk off markets)



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

Source: Barclays, BlackRock

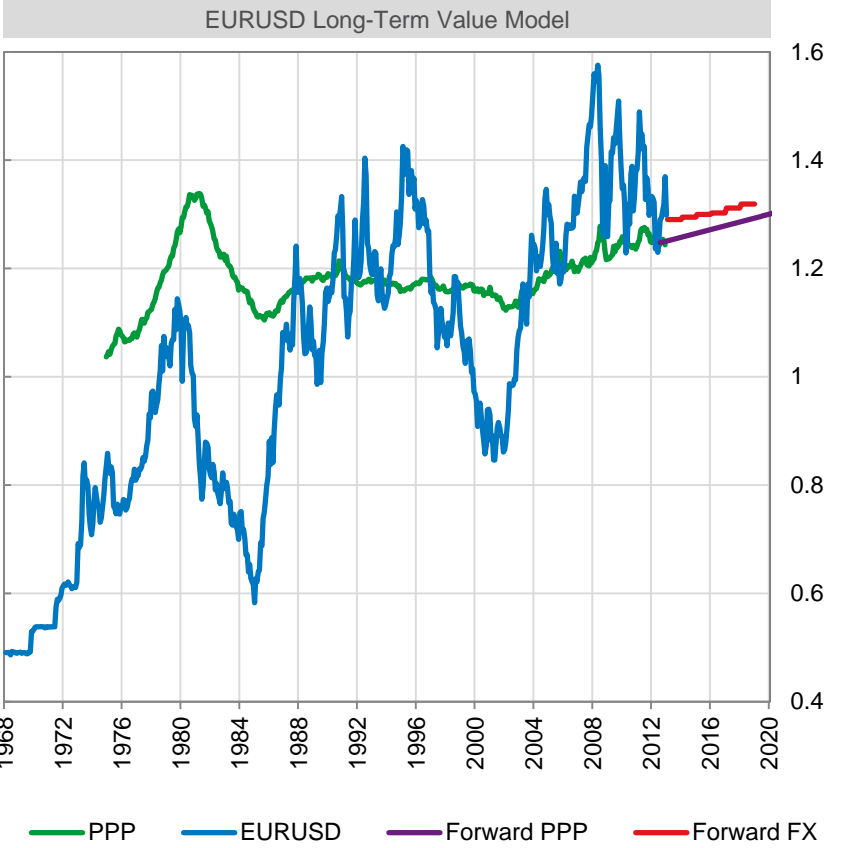
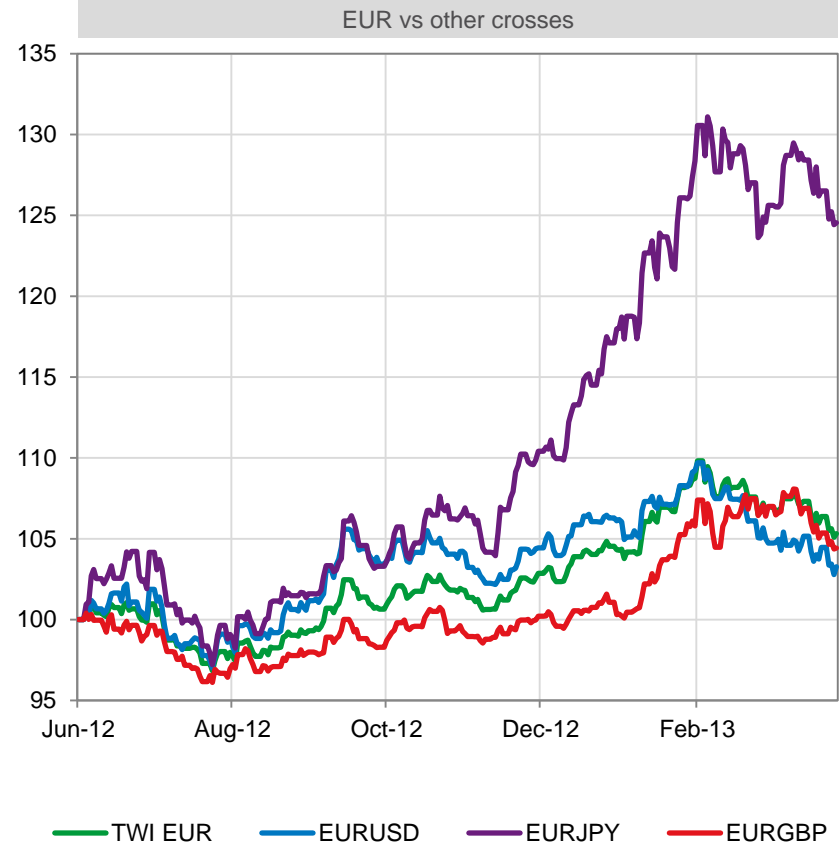
Muted reaction to Cyprus on a systematic basis



However with some idiosyncratic consequences seen

Source: Bloomberg, SG, BlackRock

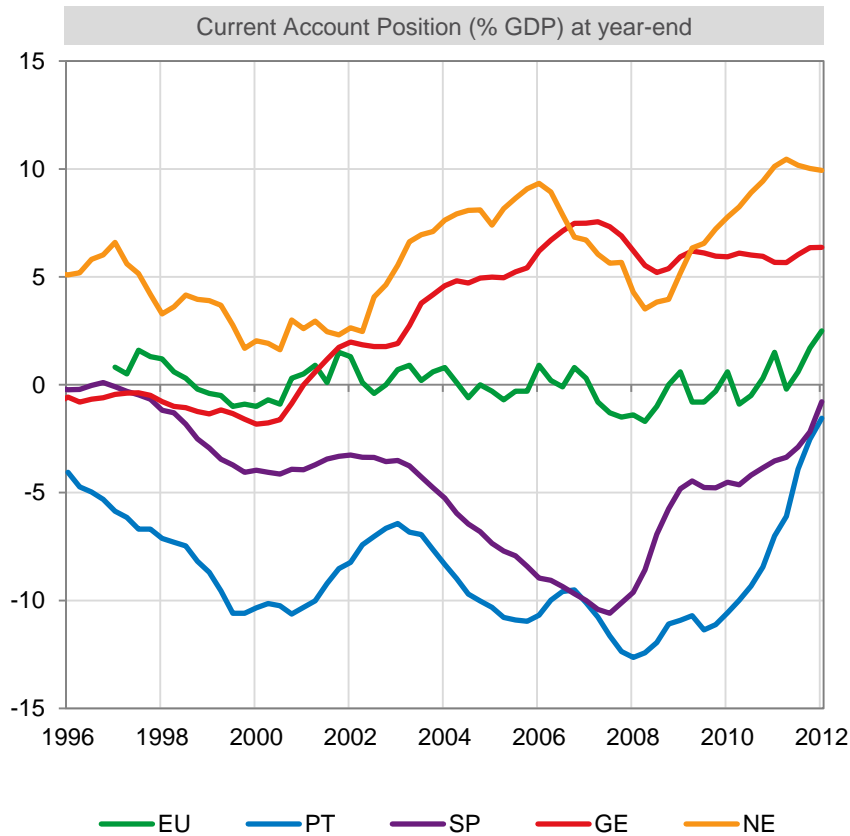
August to Feb: Euro appreciates against the majors



but long-term valuations do not look extreme

Source: Bloomberg, DB, BlackRock

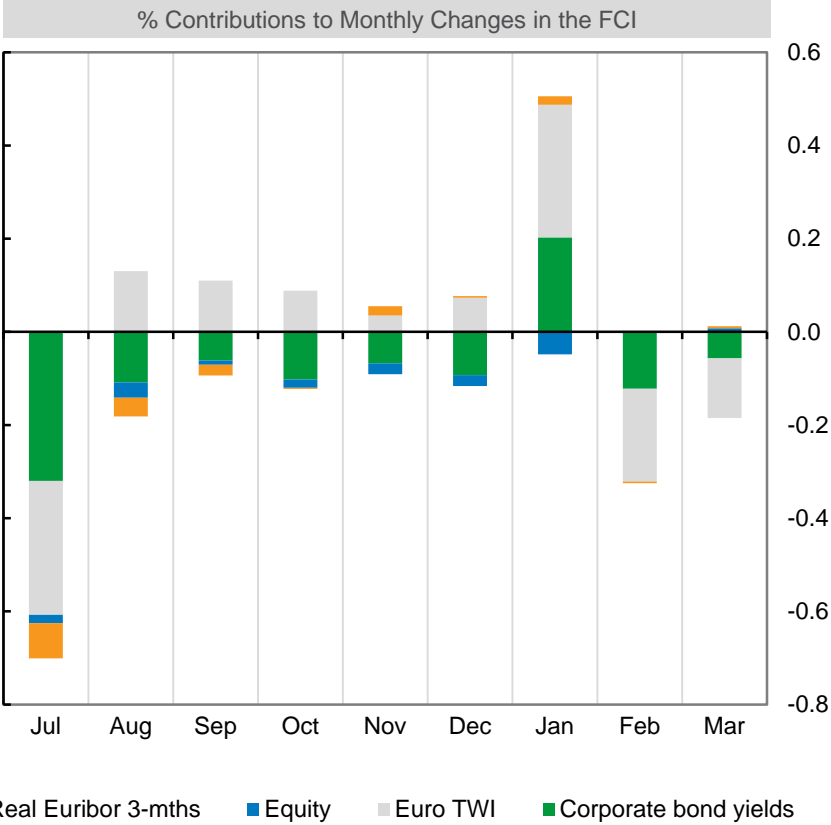
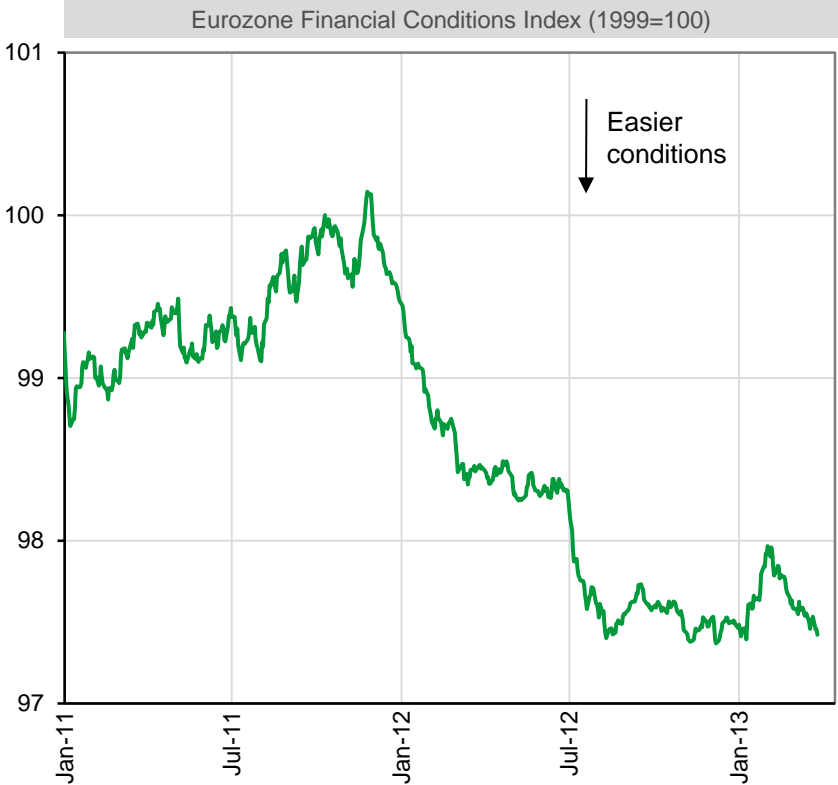
FX markets still very driven by perceptions of European financial sector



Risk on / risk off behaviour also present in fx markets

Source: Bloomberg, Morgan Stanley, BlackRock

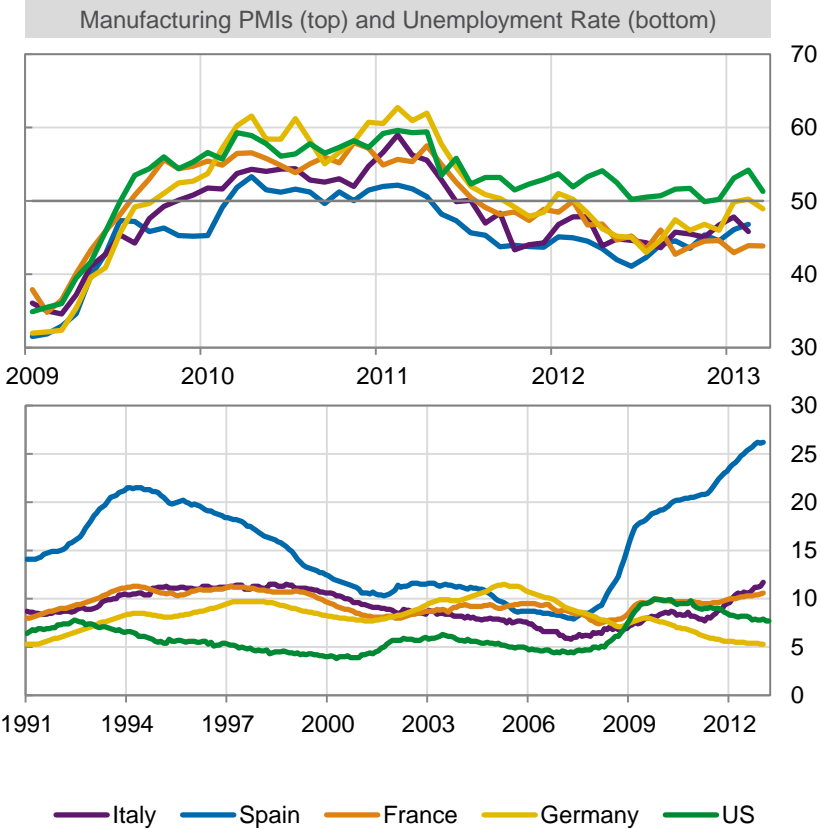
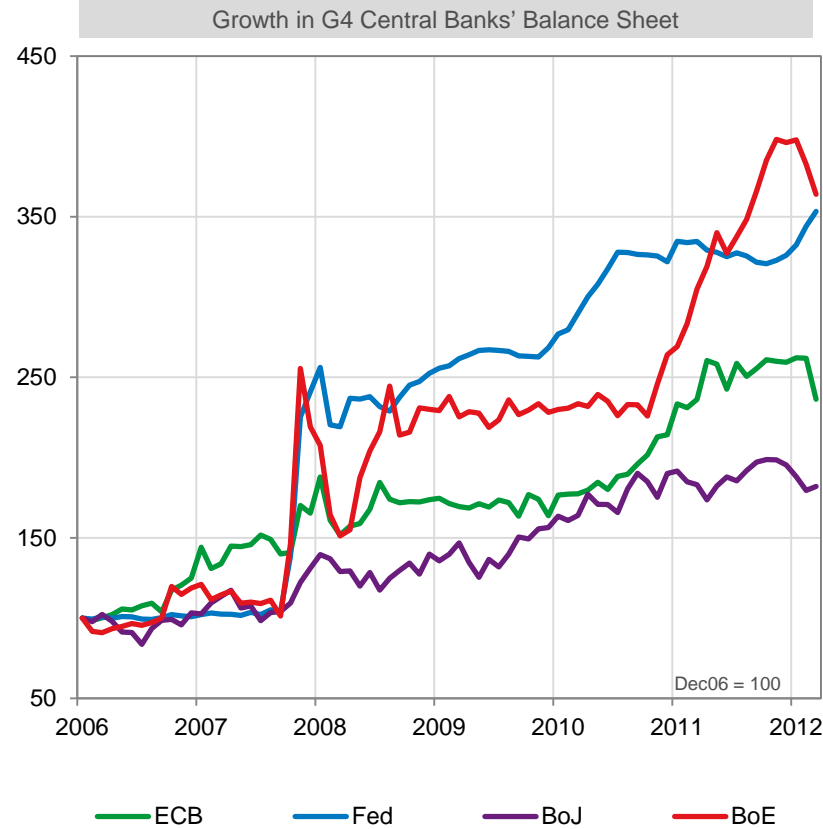
Since the effects of the Draghi speech monetary conditions sideways



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

Source: GS

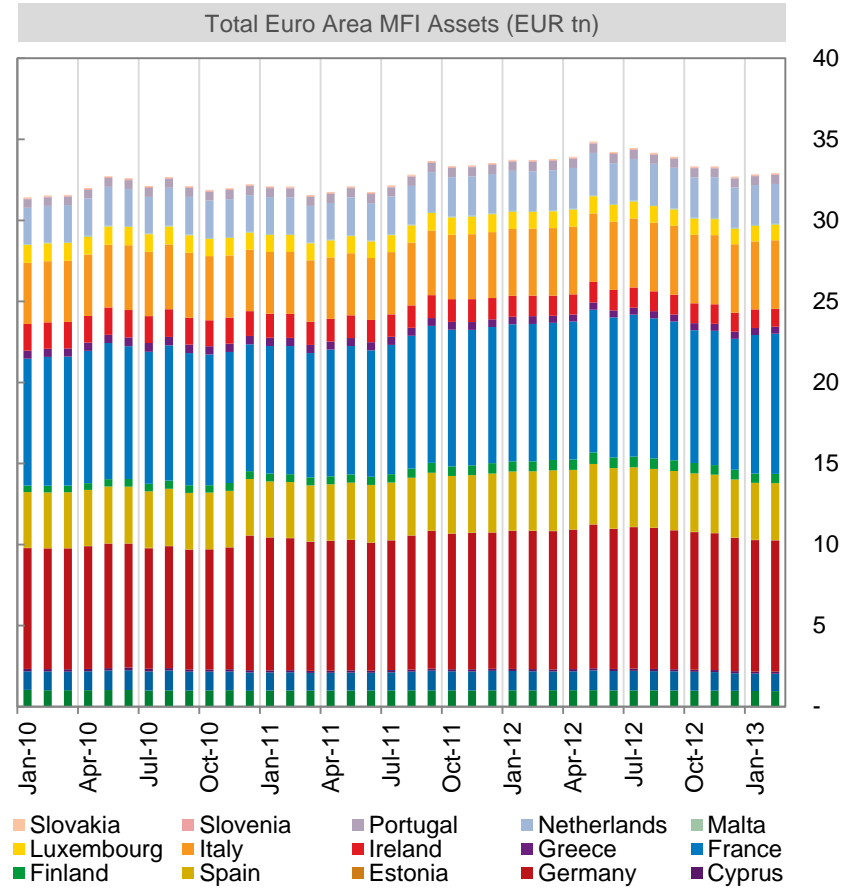
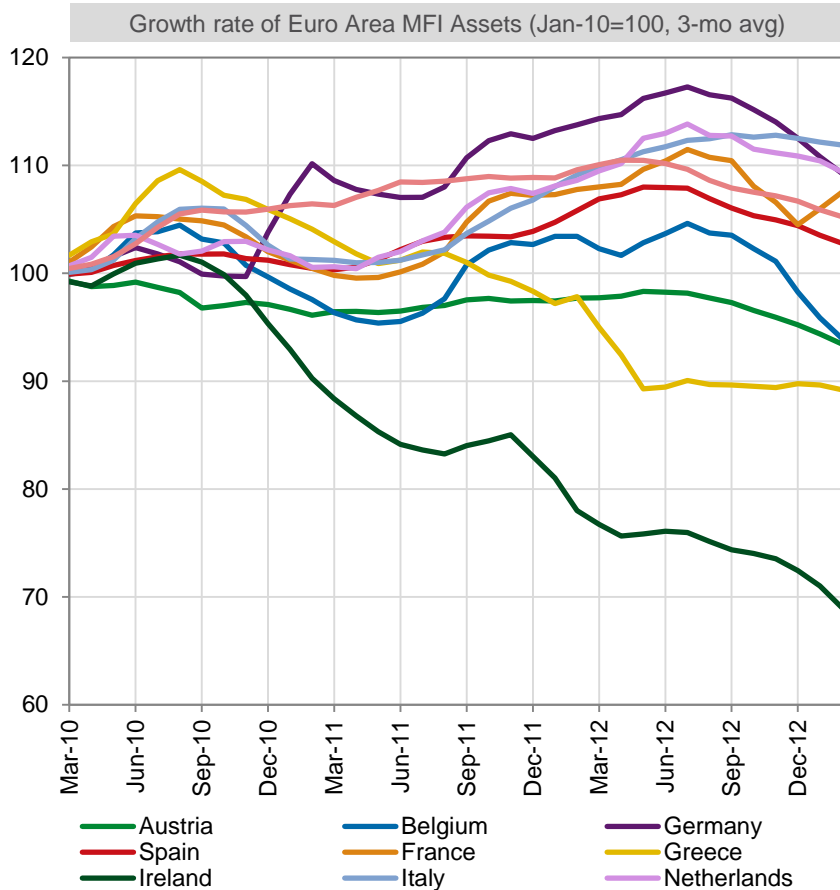
Contrast of economic indicators with balance sheet moves



US balance sheet still expanding while situation improves

Source: Bloomberg, Datastream, BlackRock

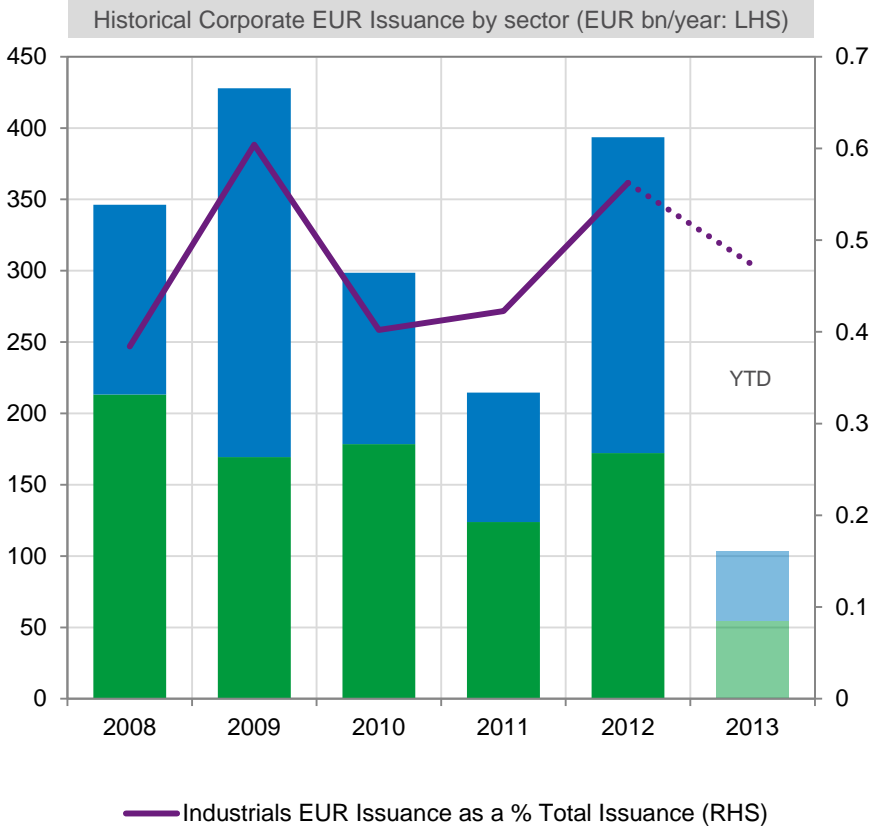
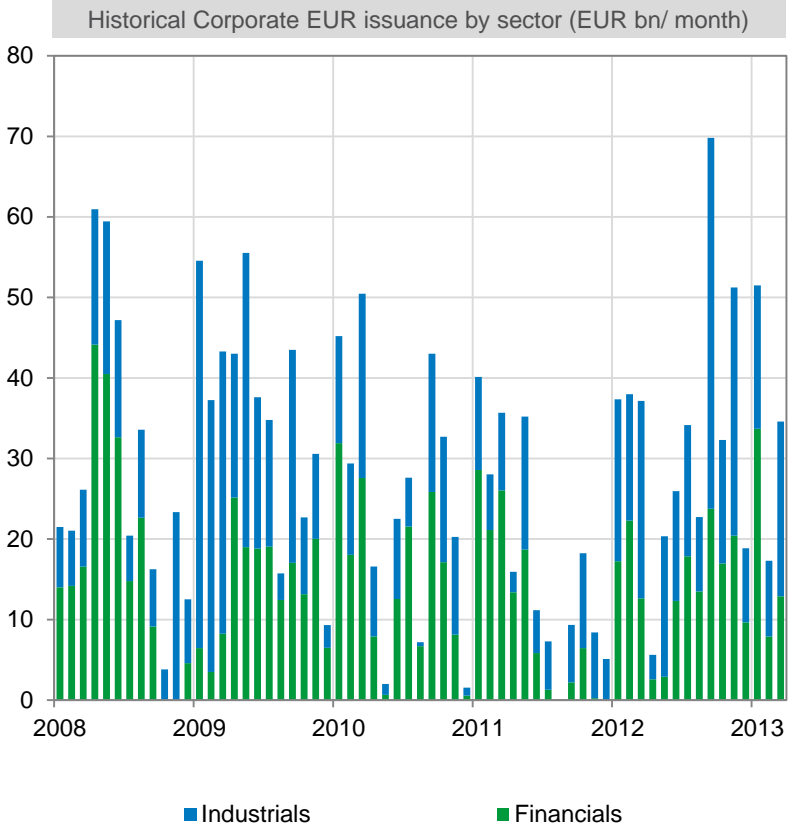
Evolution of banks' balance sheet across EA



Excluding forced deleveraging in PT/IE, real deleveraging only started in 2012

Source: ECB, BlackRock

Evolution of EUR funding markets



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



could a solution involve a supranational vehicle?

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

- 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?