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Transforming Big Data into Smart Data

Weekly Credit Brief

Apr 08 - Apr 14 2014

Story of the week

Credit outlook for Japanese utilities remains negative, despite new energy plan

Last week, the Japanese government released its new energy plan, reversing a previous decision to phase out nuclear power completely by 2040. Despite this, the credit outlook for Japanese utilities remains negative, due to stricter safety requirements that may delay reactivation of offline reactors and associated ongoing high replacement fuel costs. Utilities also face revenue headwinds from a forced breakup of the current power generation and transmission monopoly of regional utility companies. A majority of utilities have returned to debt markets since we last looked at Japanese power companies, and credit costs have declined relative to the Japanese government, as shown in Figure 2 over-page. However, the 1-year RMI probabilities of default (RMI PDs) for the utilities under our coverage have increased markedly over the last month, as shown in Figure 1, reflecting the aforementioned concerns.

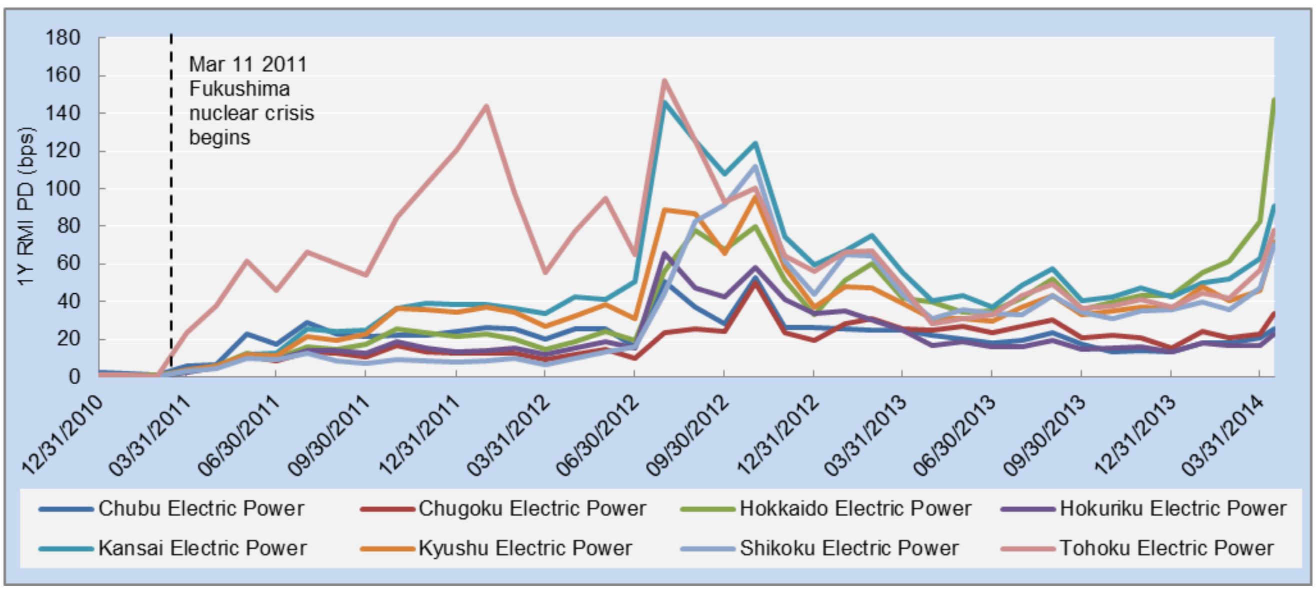

Figure 1: One-year RMI PD for eight of the Japanese regional electricity companies. Tokyo Electric Power (TEPCO) has been excluded due to scaling issues. Readers can find the RMI PD for TEPCO on our website. *Source: Risk Management Institute*

The new energy plan will see the country reduce nuclear power to a level "as low as possible," without giving any numerical targets or dates for the goal. All 54 nuclear reactors in Japan were shut down for maintenance following 2011 Tōhoku earthquake and tsunami that caused a nuclear emergency at TEPCO's Fukushima Daiichi nuclear plant. Before the shutdowns, Japan derived almost 30% of its electricity from nuclear power. Recent analysis by Reuters showed that, excluding the six reactors at the Fukushima Daiichi plant which are decommissioned permanently, only a third of the remaining 48 reactors in Japan are likely to be reactivated. Fourteen are likely to be reactivated in the future, the fate of 17 is uncertain and another 17 are likely to be decommissioned. The analysis suggests nuclear power could account for just 10% of the national power mix in Japan in the future, with strong public opinion against nuclear power likely to prevent any construction of new reactors.

This could make it impossible to reinstate nuclear power as a "base-load" power source. Utilities have replaced part of the generating capacity lost to nuclear shutdowns with crude oil and LNG based thermal generation, or coal-fired power. Japanese utilities reported combined losses of JPY 400bn for the twelve months December 2013, on continued high replacement fuel costs. Losses could continue to mount in the short-term at more nuclear dependent utilities, with both Kyushu Electric Power Co and Hokkaido Electric Power Co Inc seeking capital injections from the Development Bank of Japan. More stringent safety requirements have decreased the likelihood of a number plants being reopened. The Ōi nuclear power plant, containing the only two reactors restarted after the Tōhoku earthquake and owned by The Kansai Electic Power Co Inc was shut down last September.

Utilities also face revenue pressures from restructuring related to a mandated breakup of their power generation and transmission, and retail operations. The utilities have until 2015 to restructure their operations in preparation for a nationwide power grid operator and a liberalization of the retail market. The changes will eliminate the current power scheme, under which utilities can pass on cost increases to households even if they have only one choice of electricity supplier, which protects the utilities margins.

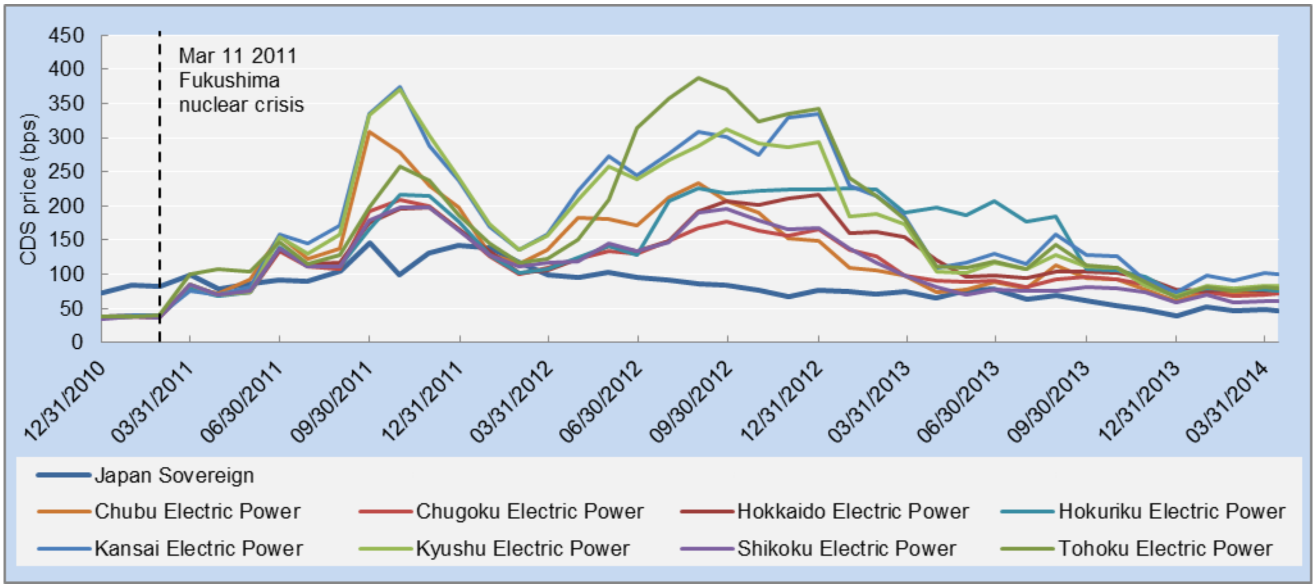

Figure 2: Five-year credit default swap prices for the Japanese sovereign and eight regional utility companies. Tokyo Electric Power (TEPCO) has been excluded due to scaling issues (TEPCO 5-year CDS on April 14 was 240bps. *Source: Bloomberg*

Credit News

Minmetals group buys Glencore's Peru mine for USD 5.85bn

Apr 14. In an effort to seek greater control over material supplies, China's state owned China Minmetals Corp led a group that agreed to pay USD 5.85bn for Glencore Xstrata Plc's Las Bambas copper project in Peru. This transaction gives the Chinese corporation control of a mine that is forecast to produce 400,000 tons of copper a year from 2015- equivalent to 12.5% of China's copper imports in 2013. (Bloomberg)

Property trust sales drop 49% as vicious loop seen

Apr 11. Following the recent collapse of Zhejiang Xingrun Real Estate Co, trust sales by Chinese property developers declined 49% QoQ, from CNY 99.7bn in Q4 2013 to CNY 50.7bn in Q1 2014. The yield on AA rated five-year bonds rose 175 bps to 7.23% over the past year, significantly higher than 2.74% of corporate securities worldwide. Mounting concerns over trust repayments by property developers and that a fall in value of homes in China can result in a vicious loop, resulting in a higher default risk for property developers. (Bloomberg)

Greece takes small step on road to recovery

Apr 11. Greece crossed a significant milestone in its economic recovery last week as it marked its return to the eurozone bond market, issuing its first international bond in over four years. The USD 3bn five-year bond was initially priced at 4.95% yield and attracted around USD 20bn in demand from investors. Market participants now predict further issuances by Greece this year to fill in gaps in its yield curve. Despite the success of the bond sale, Greece's economic recovery is far from complete, with the country's sovereign debt entrenched in junk territory and market funding costs yielding around twice the average annual cost of Troika funds. (Reuters)

Spanish bond gain pushes yield to 8-year low after Draghi (Bloomberg)

Bakrie debt deadlines loom as President bid trails (Bloomberg)

Regulatory Updates

China targets trust firms in shadow-bank crackdown

Apr 14. Reuters reported that China issued stricter guidelines governing trust companies to counter systemic risks in the shadow banking system of the country. Trust companies raise funds by selling high-yielding investments known as wealth management products (WMP). These guidelines also require trust companies to develop clear mechanisms for shareholders to provide emergency support to the trust firm during periods of liquidity stress. (Reuters)

Big banks to get higher capital requirement

Apr 08. The eight largest US banks could be required to boost existing capital by as much as USD 68bn under new rules issued by the Federal Reserve. The rules set a more stringent capital requirement than the global Basel III recommendations, with at least 5% of loss-absorbing capital for the eight bank-holding companies and a 6% leverage ratio for FDIC-insured bank subsidiaries. Officials believed that the proposed change will reduce the systemic risk for banks by limiting their reliance on debt. However, concerns arise as the rules treat all assets equally when measuring risk, providing incentives for banks to hold riskier securities. Moreover, due to the curtailment in lending and the higher cost, the rules may also leave American banking institutions at a competitive disadvantage against foreign competitors with lower capital requirement. (WSJ)

ECB dismisses latest bank appeal over health-check deadlines (Reuters)

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