



Story of the Week

Fitch downgrades China's long term local currency credit rating

Last week, CRA Fitch Ratings cut China's long term local currency debt rating citing risks to the nation's financial stability given the lack of transparency in the increased borrowing of local governments. The agency said that total credit relative to GDP may have increased by 58% from four years ago. But sovereign yields were not affected materially by the cut in ratings. Yields on the 10-year sovereign bond dropped 41bps between April 9 (the day the bonds were downgraded) and April 15. The 1-year aggregate probability of default (RMI PD) for Chinese firms also saw little change amid the backdrop of lower company market caps and the downgrade of China's long term local currency debt.



This is not the first time the markets have ignored the ratings of CRAs. After Moody's issued a negative outlook for UK debt on February 13, yields on the government bonds dropped over the following month, instead of rising. On February 29, the governor of the Bank of England said that the markets should not be "slaves to the rating agencies". Similarly, after S&P downgraded the sovereign ratings of both France and the US from AAA, the highest investment grade credit rating, interest rates paid by the countries to finance their deficits fell instead of increasing.

Following the downgrade by Fitch last week, China National Petroleum Corp managed to sell USD 2bn of notes at record low coupon yields, even though the Chinese firm carries a credit rating similar to the sovereign rating of the country's long term foreign currency debt. Investors interviewed by Bloomberg said that the muted reaction to the ratings cut is a sign that the market views China as a safe asset as it has more than USD3.3tn of foreign reserves. China's banking regulator meanwhile has been trying to reduce the growth of its large amount of bonds. The regulator has instructed lenders to limit their investments into privately traded debt. Such investments should not exceed 35% of funds raised from the sale of wealth management products.

This could mean that Chinese firms would have less access to credit given a tighter regulatory climate and slower economic growth environment. GDP figures released on Monday by China's National Bureau of Statistics showed that the country recorded its lowest annualized growth since Q1 2009 in Q1 2013, as GDP growth fell to 7.7% YoY. Revenues of Chinese manufacturing and retail firms likely declined as statistics showed that China's YoY changes in industrial production and retail sales fell considerably in March.

* The Chinese sovereign credit rating is plotted as is and does not reflect an actual probability of default.

Fitch's downgrade of China's sovereign rating may have little impact on the credit profiles of Chinese companies. According to the latest set of (April 8) calibration parameters for the RMI probability of default model, the RMI PD, or default risk of firms operating in China, are most sensitive to changes in domestic short term interest rates as well as the level of reported net income relative to their total assets.

Sources:

[Fitch unheeded as CNPC wins record-low dollar cost](#) (Bloomberg)

[Fitch downgrades China's currency credit rating](#) (CNBC)

[China tightening pressure eases with March inflation](#) (Bloomberg)

[In China, off-balance-sheet lending risks lurk in the shadows](#) (Reuters)

[China GDP growth slows to 7.7%](#) (WSJ)

[Downgrade highlights China debt worries](#) (WSJ)

In the News

Kingdom's monetary base grows 5.6% to SAR 310bn

Apr 15. The Saudi economy has been able to maintain its high growth rate despite the weakness in the global economy. The monetary base grew by an annualized 5.6% to SAR 310bn by the end of February. Currency outside banks, cash in vaults, and deposits with the Saudi Arabian Monetary Agency grew 11.2%, 6.6%, and 1% from their year ago levels respectively. M3 posted an annual growth of 12% in February reaching SAR 1.39tn after reaching a record high in December. Annual inflation rates meanwhile remained stable at 3.9%. ([Arab News](#))

Egypt sells USD 600mn to import basic goods

Apr 15. Egypt's central bank sold USD 600mn to banks to pay for wheat, meat, cooking oil and other essential imports as the country struggles with a currency crisis. The special auction, which is 15 times the amount of regular currency auctions, shows the increased demand for US dollars in the economy. The amount raised from the auction may not be enough as further action from the central bank may be required to meet the demand for basic food supplies. Egypt is also in talks with the International Monetary Fund (IMF) for a USD 4.8bn loan. ([Arab News](#))

Yield hunt boosts Asian junk debt

Apr 14. The global hunt for yield has led to so much demand for high-yielding Asian debt that 2013 is already a record year for issuance. Junk-rated borrowers have so far raised USD 18.1bn in the market this year, higher than the previous record high of USD 16.2bn in 2010. The market has been dominated over the past year by Chinese property developers, who have looked to the offshore bond market to raise capital amid a slowdown in transactions at home. However, issuers in other parts of Asia have begun to tap the market recently, with the Bank of Ceylon, a Sri Lankan state-run lender raising USD 500mn last week. ([Financial Times](#))

G20 to consider cutting debt to well below 90% of GDP

Apr 13. G20 finance ministers and central bank governors will contemplate a proposal to cut their national debt over the longer term to well below 90% of GDP in a meeting next week. The proposal follows previous agreements of the G20 leaders in June last year and in 2010 to halt debt growth by 2016, and then to set ambitious debt reduction targets beyond that. The EU itself has set a more ambitious debt ceiling of 60% of GDP for its members. Debt ratio for the EU stands at 90% of GDP, and the United States and Japan have debt of around 105% and well above 200% respectively. ([Reuters](#))

Singapore economy unexpectedly contracts

Apr 12. Singapore maintained its tight monetary policy stance even as GDP declined unexpectedly in Q1, but lowered its inflation forecast by 50bps for 2013, resulting in a weaker Singapore dollar. The Monetary Authority of Singapore defended its stance as appropriate to contain inflationary pressures and said that it will maintain its efforts in supporting a "modest and gradual appreciation of the Singapore dollar nominal effective exchange rate policy band". Singapore's economy contracted 1.4% in Q1 on a seasonally adjusted and annualized basis, according to advance estimates released on Friday. ([Financial Times](#))

EU ban on naked sovereign CDS unnecessary: IMF

Apr 11. An EU ban on so-called 'naked' positions in sovereign credit default swaps (CDS), which came into effect on November 1, is not backed up by empirical evidence and could increase instability in financial markets, according to the IMF. A naked CDS position means an investor does not have a position in the underlying asset, and is a largely a purely speculative bet on the reference entities credit quality. The IMF study found that a liquid sovereign CDS market reacts faster to market information, compared to traditional sovereign bond markets. ([Reuters](#))

Too big to fail discounted as Moody's evaluates

Apr 11. Credit derivative traders are convinced that regulators will not bail out US banks if there is another financial crisis. Credit default swaps on five of the US banks, including Goldman Sachs Inc. and JPMorgan Chase & Co. trade as if they are rated two notches lower. Moody's plans to review their ratings of the banks by year end leading to speculation that the CRA might cut the banks' credit ratings once more. ([Bloomberg](#))

Wayne Swan pulls pin on RMBS funding deals

Apr 10. The Australian government announced it was terminating its purchases of residential-mortgage backed securities (RMBS), began in 2008 to help support smaller banks and non-bank lenders after credit markets froze in September 2008. Treasurer Wayne Swan said the market was now functioning well, with AUD 8.5bn of issuance in 2013, over half the issuance in all of 2012. There have been AUD 14.2bn of RMBS offerings since the Australian Office of Financial Management (AOFM), the financing arm of the Treasury, last invested in a transaction, with investor demand removing need for the AOFM's participation. The AOFM is unlikely to offload its current holdings in the near future. ([The Australian](#))

China March credit surge supports economic recovery

Apr 10. Outstanding Yuan-denominated loans increased 14.9% YoY as Chinese banks made CNY 1.06tn of new loans in March, proving that the country's economic recovery is being driven by an expansion in credit. Total social financing rose to CNY 2.54tn in Q1, while broad M2 money supply grew 15.7% in March YoY. Analysts are expecting new loans to reach between CNY 8.5-9tn this year, well above the CNY 8.2tn of new lending last year. ([Reuters](#))

First South Korea Dollar debt sale in 4 years seen delayed ([Bloomberg](#))

China PBOC set to drain CNY 17bn this week ([WSJ](#))

Mitsubishi UFJ to buy USD 3.7bn of property loans ([Bloomberg](#))

China local debt may top estimates, former minister says ([Bloomberg](#))

Abu Dhabi's inflation, loans drop in 2012 ([Gulf News](#))

Arab banking sector on the right track ([Gulf News](#))

ESM says bailout loans to Cyprus to have maximum average maturity of 15 years ([Reuters](#))

Portugal, Ireland to win time to repay loans: Dijsselbloem ([Reuters](#))

Greek deficit rises to 10% of GDP on bank bailout ([Economic Times](#))

Moody's cuts Peugeot Citroen's credit rating ([Irish Times](#))

Development Bank, EXIM Bank, Shanghai Pudong: China Bond Alert ([Bloomberg](#))