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Transforming Big Data into Smart Data

Weekly Credit Brief

Apr 22 - Apr 28 2014

Story of the week

RMI PD for Banco Santander falls to record low

The 1-year RMI probability of default (RMI PD) for Banco Santander has improved significantly, in tandem with the decline in the 10 year Spanish government bond yield as it fell to its lowest on record. Treasury auction results last week showed that investment demand for Spanish sovereign issues has increased as the economy improved and the ECB considers starting a bond purchasing program to support growth. ECB President Mario Draghi suggested that the central bank will use both unconventional policies to deal with the risks of a prolonged period of low inflation. The prospect of a European bond buying program led to the rise of Spanish sovereign bond prices while the country's ability to pay bondholders has strengthened. GDP figures released last week by the Bank of Spain indicated that the economy grew at its fastest pace in six years during Q1 2014.

Banco Santander may have benefited directly from the drop in Spanish sovereign yields. Santander held EUR 25.66bn of Spanish government bonds at the end of 2013, and was identified as one of the largest institutional holders of Spanish sovereign debt. The recent gain in government bond prices in 2014 may have contributed positively to the bank's Q1 assets as the instruments are classified as available for sale. In addition, dovish comments from the ECB could have also increased the values of the bank's other Euro nation's bond holdings, which amounted to EUR 12.08bn at the end of Q4.

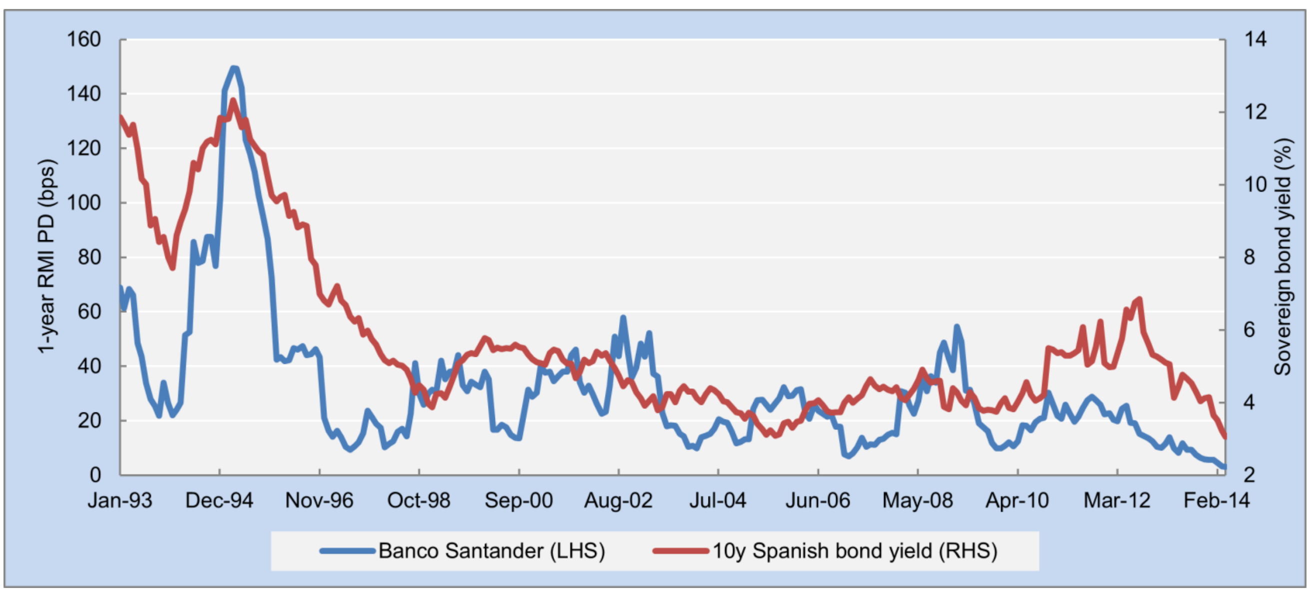

Figure 1: 1-year RMI probability of default for Banco Santander and the 10Y Spanish government bond yield. *Source: Bloomberg, Risk Management Institute*

RMI PD for Santander had decreased 4.93bps in 2013 and fallen by 2.53bps year to date. RMI PD suggested a 54bps likelihood of default within 12 months in February 2009 but the measure of risk subsequently declined to 3.09bps recently. The bank's Tier 1 capital ratio increased from 8.90 to 12.60 and its total capital ratio rose from 13.50 to 14.59 between Q1 2009 and Q4 2013. Financial leverage measured as the percentage of total debt over total assets also fell from 37.13% to 30.33%, while the ratio of common equity over total assets expanded from 5.31 to 6.33 in the same period.

Santander operates in many countries, with 23% of its assets focused in Spain although recent earning trends suggest that the bank's businesses in Brazil have added more to its bottom line. The bank has EUR 166bn of loan exposure in Spain, out of which EUR 83bn have been issued to companies and EUR 50bn in household mortgages. In 2013, the group's retail banking segment was the most profitable division. Retail banking accounted for nearly 80% of profits, with the asset management and insurance arms both contributed 22% and 4% of its FY 2013 earnings respectively. The company is one of the largest global banks and is listed as one of the global systemically important bank by the Financial Stability Board.

Figure 2 shows the RMI PDs for global systemically important banks (G-SIBs) including Santander over various time periods. Compared to the other 27 publicly listed G-SIBs, the firm's default risk consistently ranks below the 25th percentile through the last few years. Earnings released by the group on April 29 imply that the bank's credit profile might improve further. The bank made a profit of EUR 1.30bn in Q1 2014, 8% more than a year earlier. The figure is the highest of the last eight quarters and does not include the net capital gains the bank made from the sale of 85% of Altamira (EUR 385mn) or the floatation of Santander Consumer USA (EUR 730mn). Profits made in Spain were EUR 251mn in Q1 2014, which is 24% higher than Q1 2013 helped by reduced operating costs in the country. Moving forward, the bank plans to expand its program to help small and medium sized companies grow, which will first launch in Spain.

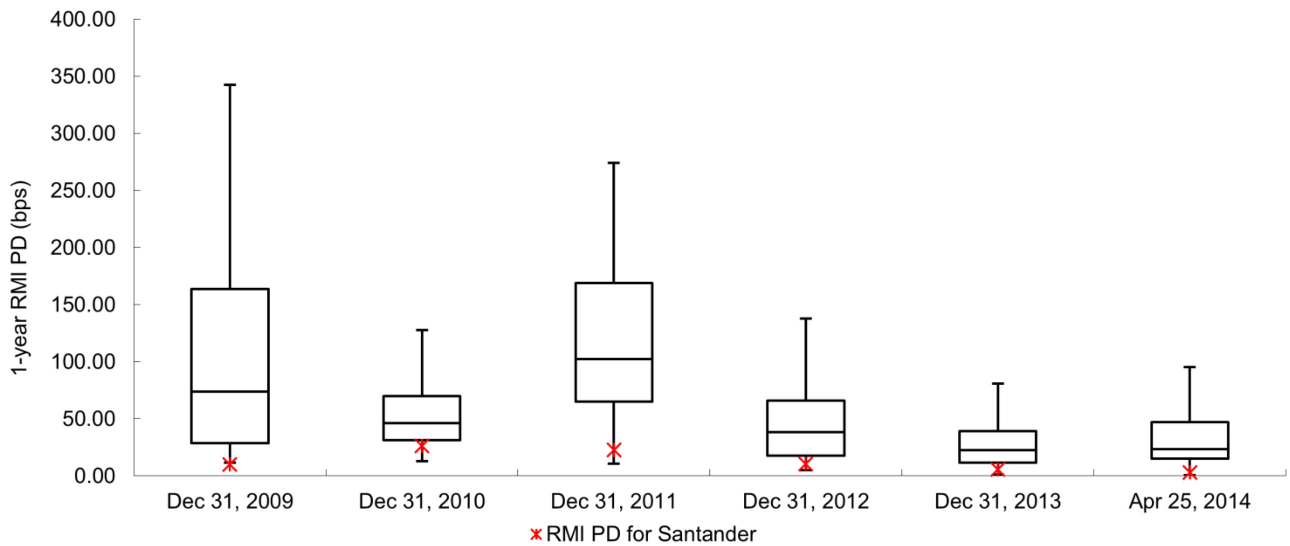

Figure 2: Box and Whisker plots of RMI PDs for globally systemic important banks at various points in time. The graph highlights the minimum, 25th percentile, median, 75th percentile and maximum RMI PD for 28 listed G-SIBs. *Source: Risk Management Institute*

Disclosure: The Risk Management Institute has run the NUS-Santander Doctorate Workshop in Advanced Financial Risk Management since 2012. The workshop is partially sponsored by Banco Santander.

Credit News

IMF says India may have to raise interest rates further to control inflation

Apr 29. IMF in its outlook for the Asia-Pacific region has flagged out high food inflation as a significant economic and social issue for India and has suggested that India needs to raise interest rates to tame inflation. The multilateral lender has also made the case for further tightening citing highly leveraged corporates that could present a macroeconomic threat. India's most widely-watched gauge of prices, the Wholesale Price Index (WPI)-based inflation, rose to a 3-month high of 5.7% in March from 4.68% in February 2014. (Economic Times)

S&P warns Indonesia of rising leverage

Apr 29. On April 28, S&P announced its decision to keep Indonesia's credit rating at BB+, turning down calls to upgrade Indonesia to investment grade status despite recent improvements in the country's economic fundamentals. It stated that Indonesia still faces risk of market deterioration given larger external indebtedness and a current-account deficit trend of about 2% of the GDP in the medium term. (Jakarta Post)

Russia recession risk seen at record high as sanctions escalate

Apr 28. Russia faces a 50 percent probability of recession, the highest since Bloomberg started to track the measure, as the crisis in Ukraine raises the risk of further sanctions, according to a survey of economists. The probability of a recession over the next 12 months rose to 50%, while the gauge was 45% in Mar 2014. After Russia's annexation of Crimea, capital outflow from the country has amounted to USD 50.6bn in the first three months of 2014 from USD 27.5bn last year. (Businessweek)

Chinese bad-loan ratio rises 'significantly'

Apr 22. Chinese banks are facing headwinds from deteriorating asset quality, falling liquidity and lending margins as bad loans continue to grow. Borrowers have difficulty repaying debt due to slower economic growth and repayment risks from small businesses to property related loans have increased. China's bad-loan ratio soared in Q1 2014, reaching its highest since 2008. New nonperforming loans exceeded CNY 60bn in the first two months of 2014, compared with CNY 100bn for the whole year 2013. (Bloomberg)

Canada sells 50-year bond amid low interest rates (Bloomberg)

Ukraine bond poses dilemma for banks (Reuters)

Even at record EUR 8.4bn, Numericable high yield bond deal still in demand (Forbes)

Regulatory Updates

Global swap regulators said to hold talks with industry

Apr 29. Global regulators are reported to be holding closed door meetings with the financial industry representatives to discuss derivative rules that banks have sought to curb. The International Organization of Securities Commissions is gathering information on differences between rules in the United States and elsewhere to improve the coordination of regulations across the globe.(Bloomberg)

ECB proposes aligning upper limit for penalties imposed on banks

Apr 25. The ECB wants to align maximum penalties it can impose on banks that breach rules such as failing to meet capital requirements, disclose information or fulfill their duties when issuing loans. Under current rules, the ECB can fine lenders a maximum of EUR 500,000 a day for as much as six months, but the regulator plans to change the penalty to 10 percent of the bank's annual turnover or twice the profit or loss made as a result of the breach of EU law. The proposed rules were announced together with the release of a framework regulation on the work of the Single Supervisory Mechanism. The ECB will be responsible for the supervision of Europe's 130 largest banks in November 4, 2014. (Bloomberg)

Bank of England prepares stress tests to ensure banks can survive housing crash (The Guardian)

EU aims to shock with tougher bank stress tests (Bloomberg)

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