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Weekly Credit Brief Dec 06 - Dec 12

Italian politics keeps bankers on their toes

by Dexter Tan

The resignation of Italy's Prime Minister Matteo Renzi and the uncertainty of establishing a new government has given investors a new reason to demand a much higher price for providing capital to Italian banks. Banca Monte dei Paschi, the world's oldest bank and Italy's third largest bank by assets, has been trying to raise billions but renewed political instability in the country has made it an even more difficult task. The bank is racing to raise EUR 5.3bn by the end of the year or risk triggering a state bail-out which will force losses on retail investors. Last week, the bank offered creditors to swap EUR 4.3bn of subordinated debt into shares but only managed to raise EUR 1bn.

The fragility of Banca Monte dei Paschi has raised contagion concerns to the broader Italian financial system as well as to other European lenders. Banca Monte dei Paschi received two state bail-outs in 2014 and 2015 and was ranked the worst performing bank in the latest European stress test. Although the situation may evolve to a banking crisis in Italy, this is unlikely to happen, according to European Commissioner Pierre Moscovici, who said that the European Union is ready to help the country.

The RMI-CRI 1-year Aggregate Probabilities of Default (PD), a simple median of 20 Italian bank PDs and 135 European bank PDs had been decreasing prior to the referendum on Dec 4. The 1-year PD values on Dec 9 indicate that Italian banks are 2.4X more likely to default on their financial obligations compared with other European banks. As shown in Figure 1, the 1-year Aggregate PDs for both sectors kept increasing during the first six months of the year to reach their highest level in June. Credit profiles however subsequently improved in the second half of the year in tandem with higher banking market cap values.

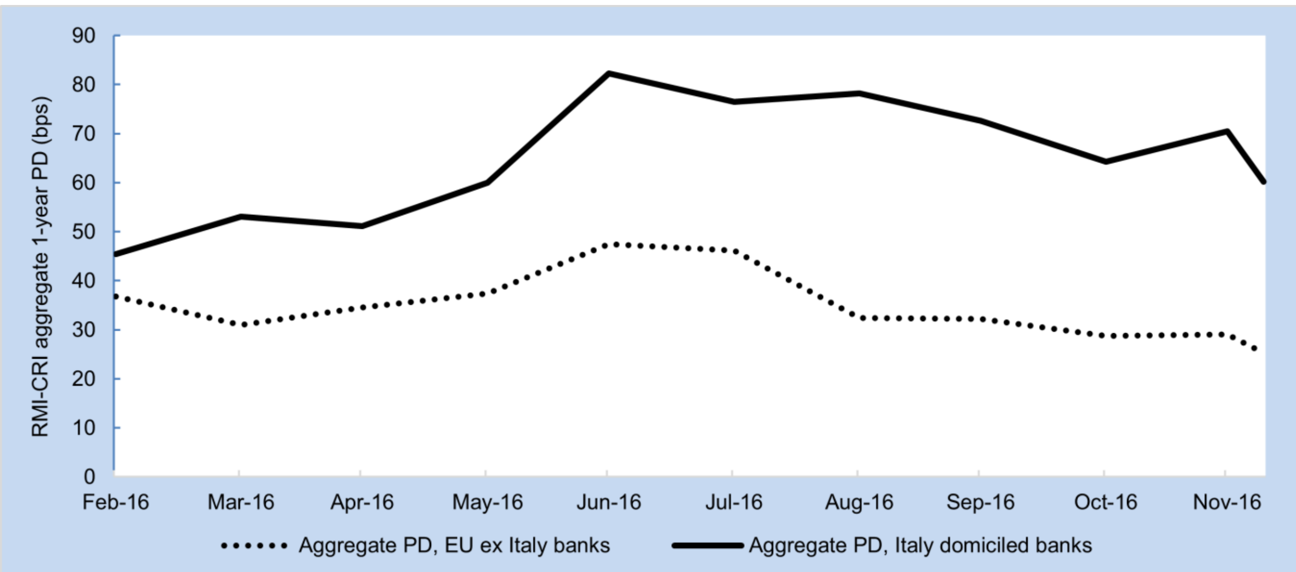

Figure 1: RMI-CRI 1-year Aggregate PDs for Italian and European banks. *Source: RMI-CRI*

Looking ahead, the asset quality of the Italian banks' balance sheet is expected to improve. According to the central bank, the amount of outstanding bad debt issued to private institutions and households dropped to EUR 198bn in September after reaching a record high of EUR 201bn in January. New bad debt rates of loans to households and loans to non-financial firms are projected to fall next year to 1.2 percent and 3.1 percent, respectively, from its present level of more than 1.5 percent and 3.7 percent, respectively. In the first nine months of this year, Italian lenders managed to sell EUR 6bn of bad debt from their books, which is 3.52X the amount of bad debt sold in the same period in 2015.

The launch of the targeted longer-term refinancing operations II (TLTRO-II) this year mitigated the risk of refinancing and reduced funding costs for Italy's banks. Their participation in TLTRO-II helped lenders narrow the gap between the average duration of assets and liabilities, reducing the exposure to movements in the yield curve. As a result of the TLTRO-II, Italian banks need not roll over their matured bonds at a higher financing cost. And because of the ECB's asset purchase program, the yields of more than 75% of the banks' newly issued covered bonds between March and September turned negative.

The unconventional monetary tools by the ECB improved financial market liquidity within the Italian banking system. However, weak economic growth and further political uncertainty could fuel bouts of high volatility in Italy's financial markets. There are several other factors that could shape the industry in the long run. The adoption of Blockchain technology leading to a disintermediation of current market infrastructure, the introduction of minimum requirements for own funds and eligible liabilities, and the implementation of a new financial reporting standard for assessing financial instruments (IFRS 9), all potentially could affect the credit profiles of Italian banks.

Credit News

Large investors pull USD 350bn from active equity funds

Dec 11. Large investors have pulled USD 350bn from active equity funds and moved largely into bond funds and passive equities since the start of the year. Credit rating agency Moody's has also lowered its outlook for the global asset management industry from stable to negative, citing underwhelming performance of actively managed funds and the faster growth of passive funds as the main reasons. Traditional active funds have attempted to protect their businesses by launching their own index-tracking products, acquiring smaller passive specialists, or channeling resources in specialist areas, such as emerging market bond and private debt. (FT)

Singapore banking sector outlook negative, says Fitch

Dec 8. Credit rating agency Fitch Ratings has downgraded its sector outlook on the Singapore banking system to "negative". According to Fitch, weak economic conditions that are expected to persist next year could put greater pressure on banks' asset quality and dampen earnings over the next year. The oil and gas sector, in particular, will continue to exert moderate pressure on banks' asset quality in 2017. However, Fitch believes the downside risks to be manageable as the banks' combined exposure to the troubled offshore sector only represented 17% of their core equity Tier 1 capital at end-September. (Straits Times)

Saudi Oger USD3.5 bn debt plan hit by creditor court move

Dec 8. Saudi Oger was dealt a blow in its attempt to restructure SAR 13bn (USD 3bn) worth of debts. This comes after a major creditor, the National Commercial Bank (NCB) obtained a court order demanding the money owed by the construction company. Saudi Oger had previously sought a standstill on money owed to banks in order to collect government dues before settling its debt. Failure of the company to repay the debt after the court order will allow NCB to seize its assets to recover the debt. (Reuters)

Glencore and Qatar take stake worth EUR 10bn in Rosneft

Dec 8. Glencore and the sovereign wealth fund of Qatar will take a 19.5% stake in Russian oil company Rosneft. The surprise EUR 10.5bn deal marks a triumph for President Vladimir Putin. The deal is the largest under a privatization program launched by the cash-strapped Russian government at the start of 2016 and represents one of the largest ever investments into Russia. For Glencore, the deal represents an opportunity to reassert itself as the dominant trader of Russian oil after it was usurped by Trafigura last year, potentially giving its trading arm access to millions of barrels of Rosneft's oil production. Glencore also agreed a five-year supply agreement with Rosneft that will see the Russian company supply 220,000 barrels a day to Glencore's oil trading arm. (FT)

California gas power plant La Paloma files for bankruptcy

Dec 7. Natural gas-fired power plant La Paloma Generating Co LLC filed for Chapter 11 bankruptcy protection following warnings of shut down of its plants earlier this year. The California-based company cited market factors which include slower-than-expected growth in electricity demand and a shift towards renewable energy for power generation worsened by "inhospitable" regulations as reasons for its filings. Several California plant owners, which includes owner of La Paloma, Rockland Capital LLC, have requested for assistance from the state to offset losses, stating that supporting natural gas plants to ensure stability and reliability of the power grid are within the state's interest. (Channel NewsAsia)

Commercial bankruptcy filings continue consecutive increase (ACA International)

Australia's economy shrinks most in eight years; currency slumps (Bloomberg)

Tepco hits six-month high on reports of loan increase (FT)

Regulatory Updates

Hong Kong regulator creates team to focus on shell companies

Dec 9. Hong Kong's Securities and Futures Commission (SFC) has established a team to investigate the creation and use of shell companies, amid a focus on malfeasance and fraud. The team will probe suspected shells on the Growth Enterprise Market (GEM), Hong Kong's exchange for smaller companies. Firms listed on GEM sometimes change hands soon after a public offering and are seen as targets for "backdoor listings", a way for Chinese enterprise that do not go through IPO to get on the stock market. The initiative comes as Hong Kong has been stepping up efforts to improve scrutiny of its markets, and as mainland investors start to trade the city's small-caps shares through the stock-trading link with Shenzhen. (Straits Times)

China's move to open up for global rating agencies may lift debt credibility

Dec 8. The Ministry of Commerce (MOFCOM) and National Development and Reform Commission (NDRC) of the People's Republic of China jointly published draft foreign investment guidelines aimed at removing restrictions on credit investigation and rating services. Presently, global rating agencies can only have minority stakes in joint-venture operations in China. The move is seen as a step to help attract foreign investors into China's USD 7tn bond market – who are wary of credit ratings issued by domestic rating agencies. China has had over CNY 20bn (USD 2.91bn) of bond defaults in 2016, up from CNY 15.4bn in 2015. Fitch Ratings and Standard & Poor's are watching developments. (Reuters)

Foreign companies in China hit by new exchange controls (FT)

FCA fines on City fall to lowest level since financial crisis (The Guardian)

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