NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond
Transforming Big Data into Smart Data
Weekly Credit Brief Dec 10 - Dec 16 2013

Stories of the Week

Deutsche Bank faces litigation heat, driving up RMI PD

Starting from nearly similar levels a year back, the one-year RMI probabilities of default (RMI PD) for Deutsche Bank (DB) and its European competitors have taken a diametrically opposite trajectory. While the one-year RMI PD for DB stands above 70bps, RMI PDs for UBS, Barclays and BNP Paribas have settled in the sub-40 territory.

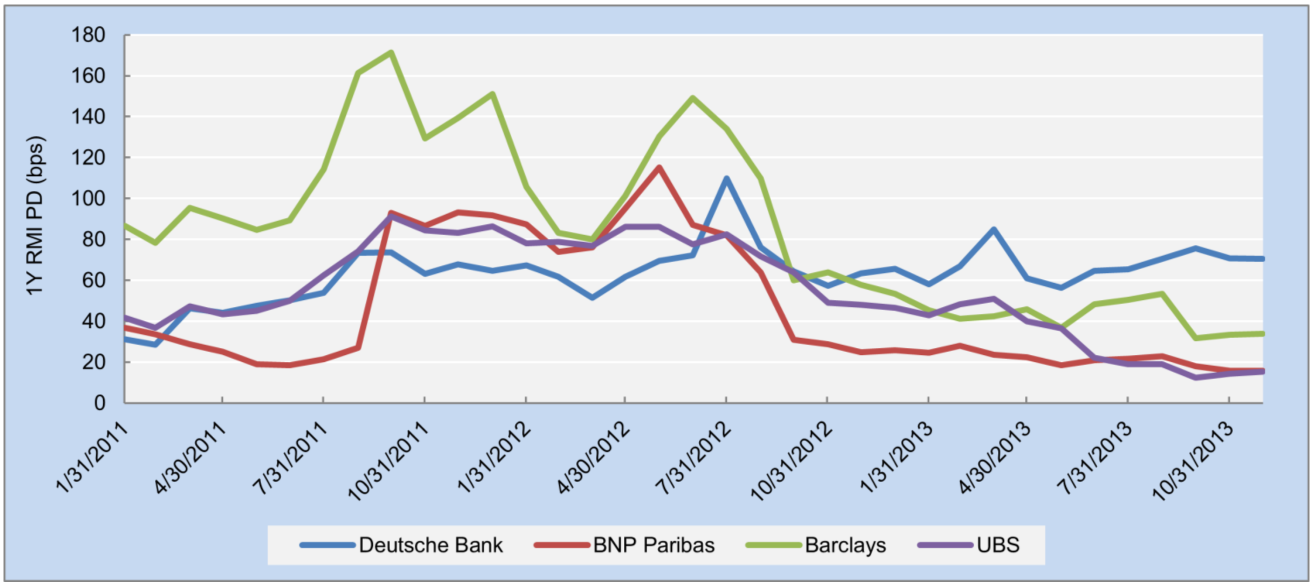

Figure 1: 1-year RMI PD for Deutsche Bank and its competitors. Source: RMI

Significant blame for DB's plight lies in the legal costs borne by the bank. Recent headlines provided no cheer as well. Earlier this month, Deutsche Bank was slapped with a EUR 725mn penalty by the European Union. It was the highest single penalty among the group of six (DB, Citigroup, RBS, Societe Generale, JP Morgan and RP Martin) fined for involvement in fixing LIBOR linked interest rates. Its peers, UBS and Barclays avoided potential fines as they were the first to inform the EU of the rate fixing cartels. Deutsche Bank also faced the heat from Japan's Securities and Exchange Surveillance Commission, which asked the FSA to take action against Deutsche Bank for excessive entertainment spending.

In addition to the comparatively higher RMI PD, the impact of the litigation charges is visible in both company profits and share price. Net income for Q3 2013 was a paltry EUR 41mn after EUR 1.2bn of litigation related charges. This marks a significant drop from last year's EUR 754mn. This significantly reduced the NI/ Total Assets input in our RMI PD calculations and thus increased the RMI PD. Recently the firm also announced its exit from trading energy, base metals, agriculture, coal and iron ore and as a result making close to 200 jobs.

Sources:

Deutsche Bank to RBS fined by EU for rate rigging (Bloomberg)
Japan SESC: asked FSA to slap sanction on Deutsche Securities (Wall Street Journal)
Deutsche Bank Quarter 3 results (Deutsche Bank website)
Deutsche Bank quits commodities under regulatory pressure (Reuters)

More of the same for JC Penney

In our publication JC Penney's credit outlook marred by weak business from March 2013, we highlighted the rising RMI probability of default (RMI PD) (then 100bp) of JC Penney- a result of six consecutive loss making quarters. Nine months-on, the outlook for the company looks worse than before. The company's RMI PD currently stands around 200bps with the stock losing over 50% value year-to-date.

Some relief was provided to the company by a 10.1% increase in November sales, driving up the share price. However, we note that this increase in sales was measured against the low base of last year's Hurricane Sandy affected dismal numbers. Investors used this bounce in share price to sell the stock as the fundamentals remain weak. Prominent Fund Manager J. Kyle Bass told the press that he recently sold his equity stake in JC Penney. News of an SEC inquiry into JC Penney's liquidity, share offering and debt figures further rock investor confidence.

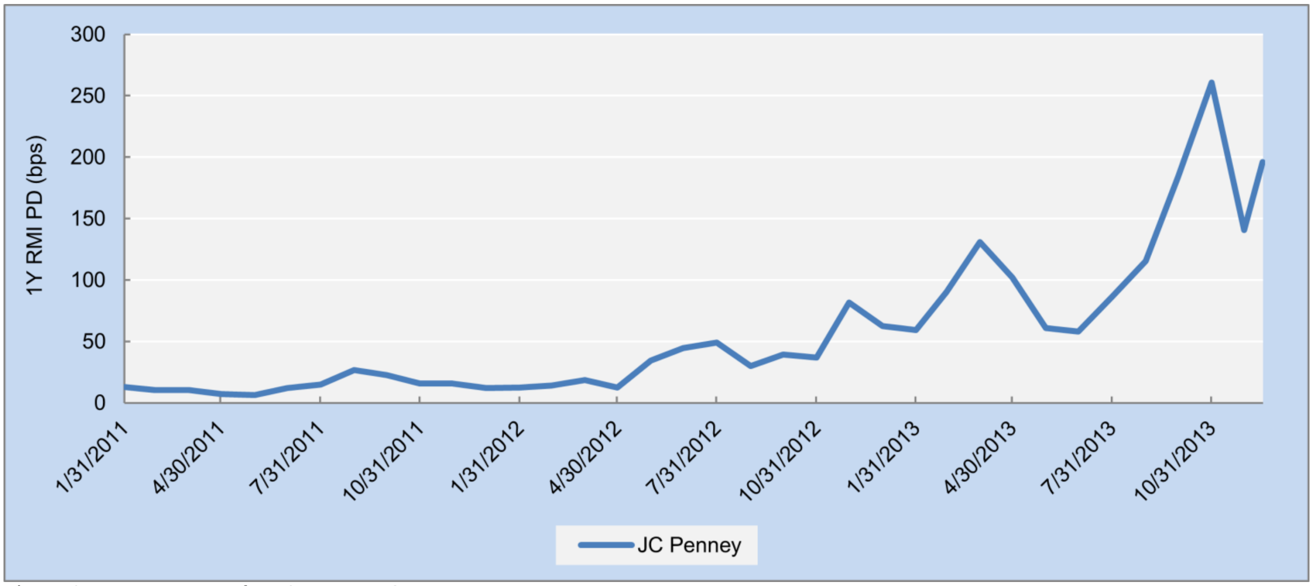

Figure 2: 1-year RMI PD for JC Penney. Source: RMI

Profitability remained poor as the net income for Q3 showed a loss of USD489mn. Net Income/Total Assets, an input into our model, was reeling in negative, at -0.14x for the third quarter. Liquidity situation remained precarious as well with cash flow from operations languishing in the negative territory. Cash to Total Assets ratio, another input in RMI PD calculation, deteriorated from 0.13x to 0.10x.

Sources:
J.C. Penney slides for second day as Bass says sold stake (Bloomberg)
J.C. Penney gets SEC inquiry regarding its financial position (CNBC)
J.C. Penney reports third quarter results (JC Penney website)

In the News

Banks likely to raise lending rates

Dec 16. Post the disappointing news on inflation and index of industrial production, the Reserve Bank of India is expected to hike repo rate by 25bps in its forthcoming mid-quarter policy review on December 18. This would further lead to higher lending rates offered by banks. Food inflation failed to show any respite and vegetables index continues to exhibit steady increase. Bankers had earlier expressed hope that following a good monsoon, the food inflation would move downward. (TimesofIndia)

Japan to extend fresh aid of JPY 63bn in loans to Myanmar

Dec 15. On Sunday Dec 15, Japan promised aid worth about JPY 63bn in loans to Myanmar. This amount aims mainly to support the Southeast Asian country's infrastructure-building projects. The aid was unveiled during the talks between Japanese Prime Minister Shinzo Abe and Myanmar's President Thein Sein. The yen loans are designed to help build infrastructure for the Thilawa Special Economic Zone in the suburbs of Yangon, Myanmar's largest city, and upgrade a railway network in Myanmar, among other projects. Along with a previous aid package of JPY 91bn announced during Abe's visit to Myanmar in May, the amount of aid pledged by Abe's government to Myanmar since last December now totals more than JPY 150bn. (Global Post)

In landmark for EU, Ireland leaves its bailout behind

Dec 13. Ireland became the first eurozone nation to officially exit its bailout program late last week, representing a significant milestone in ongoing efforts to end the sovereign debt crisis in the eurozone. Having successfully pushed through austerity reforms with little public unrest, and obtaining sufficient funding into 2015 thanks to debt issuance, Ireland is paving the way for troubled nations such as Greece, Portugal and Cyprus. Although economic activity in Ireland has picked up, with the economy forecast to grow 2% next year amidst falling unemployment, rural spenders are still feeling the pinch and capital adequacy ratios have fallen more than expected at major lender Bank of Ireland. (Reuters)

Volcker rule challenges Wall Street

Dec 10. US banks will face a new set of rules restricting the manner in which they trade securities. Five US financial agencies approved the Volcker rule on December 10 to control proprietary trading with effect from April 1. Named after former Federal Reserve chairman Paul Volcker, the set of rules could cost the banks as much as USD 10bn in annual pre-tax profits according to S&P. US banks have been preparing for the Volcker rule by closing a number of their trading desks and selling their investments in hedge funds. Recruitment firms say the number of traders at large banks has fallen 30% since 2007 as most of them have moved to hedge funds and other asset management firms. (WSJ)

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Slovenia plans EUR 3bn bank recapitalization to avert bailout (FT)

EU reaches landmark deal on failed banks (FT)

Era of lucrative debt team fades as Credit Suisse sees exits (Bloomberg)

Dimon says banks will reprice loan products on capital rules (Bloomberg)

Vietnam tells banks to halt 'unhealthy' loans given at low rates (Reuters)

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