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Weekly Credit Brief

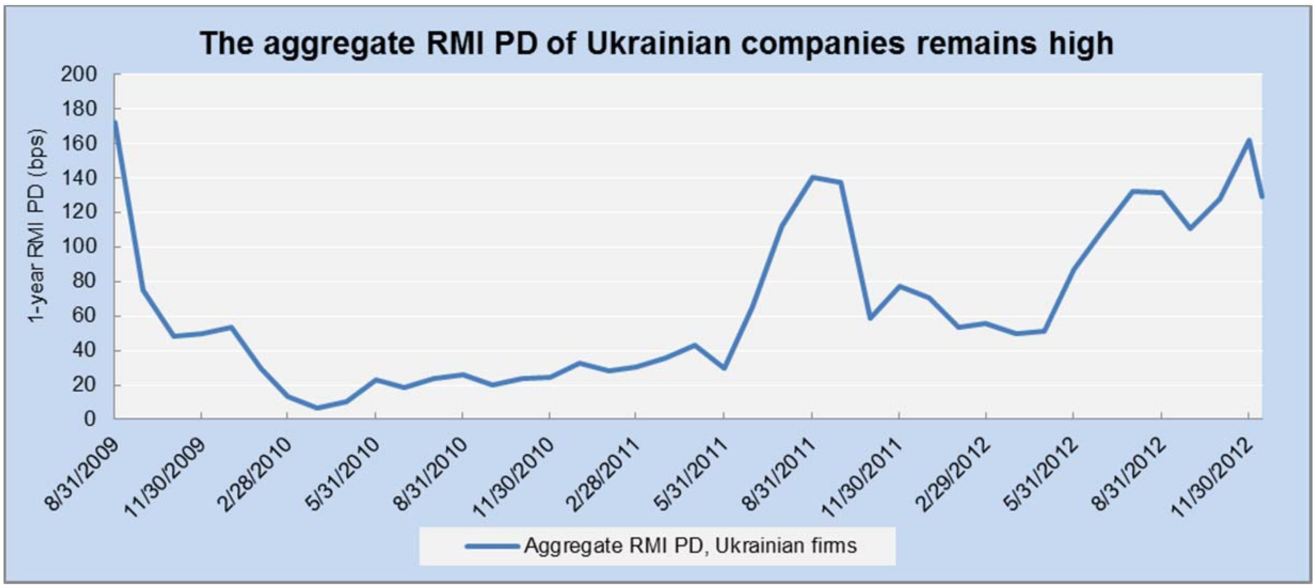
Dec 11 - Dec 17 2012

Story of the Week

Ukrainian firms witnessed their highest default risk in more than 2 years

The aggregate 1-year RMI probability of default (RMI PD) for Ukrainian companies has increased considerably over the last 2 years against the backdrop of political instability in Ukraine. In November 2012, the aggregate RMI PD reached the highest level since August 2009 and is likely to increase further. Lending to non-financial companies might decline while domestic political tension, fiscal problems, a slowing economy and protectionist measures adopted by the Ukrainian government might lead to further deterioration in the credit quality of Ukrainian companies.

Highlighting increased credit risk within the Ukrainian economy, in the last fortnight credit rating agencies S&P and Moody's downgraded the government one notch each to B and B3 respectively. Both CRAs cited bond repayment concerns, and maintain negative outlooks on the government's debt.



Financial companies under pressure: Ukrainian companies may face higher borrowing costs due to higher interest rates in interbank markets and lower net interest margins amongst banks. Lower earnings and higher borrowing costs from banks could lead to tighter lending standards for non-financial firms. The 3-month Kiev interbank offer rate, an indication of the cost of funding within the Ukrainian money market, remained significantly high on December 17. Net interest margins at the banks decreased to 4.61% in November 2012 from 6.21% at the start of 2010. Total earnings within the financial sector reportedly dropped 12.85% in the first 11 months of 2012 while the number of loans granted to individuals also fell 6.38% in the same period.

Political tension: Antagonism within the newly elected Parliament is a credit negative for the country's corporate and sovereign debt. The first session of Ukraine's new parliament opened with politicians fighting with one another as the opposition accused the ruling party of trying to ram through legislation despite violating parliamentary rules. The opposition party later boycotted a meeting with the re-elected Prime Minister Mykola Azarov and at the same time, the Deputy Prime Minister resigned as he could not come to terms with Mr Azarov. Sovereign bond holders may demand higher yields going forward if political instability continues, while companies with strong links to the government may also face higher yields.

Fiscal and currency woes: Ukraine is currently seeking a bailout from the IMF for the third time in 5-years as the government is struggling to meet USD 10bn of bond payments due in 2013. The current tension between the political parties may reduce the likelihood of the Ukrainian Parliament approving the 2013 budget, a key requirement for IMF funding. Moreover, keeping the Ukrainian Hryvnia (UAH) within a narrow band against the

USD has cost the nation's central bank around a third of its reserves over the past year. Foreign exchange reserves recently fell to the lowest level since March 2010 as the central bank tried to keep the UAH afloat. The UAH traded at 8.1 UAH per USD on December 17, but is widely expected to depreciate to 9 UAH per USD by the end of the year.

Weak economy: The latest GDP figures showed the Ukrainian economy contracted by 1.3% year-on-year in Q3, with the construction industry recording the largest annual and seasonal declines in business expansion. Consumer prices fell 0.2% year-on-year in November, and have been falling continually since peaking in 2008. Data released by the State Statistics Committee of Ukraine also indicated that industrial production volume contracted for 5 consecutive months from June to October.

Protectionist measures: The country is seeking to increase import duties on a number of products, which was met with a negative response from the World Trade Organization (WTO). December 12 was the deadline by which other members of the WTO could ask the Ukrainian government for clarification over its decision on tariff commitments. Many WTO members felt that Ukraine should not raise trade barriers in the spirit of the global trading system and the interest of the world economy. But Ukrainian officials said that the move was a necessary precaution to protect its domestic markets. This is a credit negative for Ukraine's exporting companies, which could be severely affected if other unsatisfied WTO members retaliate by imposing similar sanctions on Ukrainian exports.

Sources:
Opposition boycotts meeting with Azarov (Ukrainian Journal)
Ukraine credit rating cut by S&P on debt repayments (WSJ)
Ukraine's use of protectionist legal loophole sparks ire at WTO (Ukrainian Journal)
Ukraine deputy PM Khoroshkovskiy quits to protest Azarov (Bloomberg)
Ukraine third-quarter GDP fell 1.3%, Statistics Office confirms (Bloomberg)

In the News

Fed targets foreign banks

Dec 14. The Federal Reserve has released a proposal requiring foreign banks with total global assets of USD 50bn or more operating in the US to be subjected to the same regulation as their US counterparts. Approximately 107 foreign banks would be affected by the proposal which is expected to be implemented next year. A representative for the foreign banks cautioned that the Fed's new initiative would compel foreign banks to withdraw their operations and damage the US economy and capital markets. US banks on the other hand worry that the new piece of regulation would cause foreign regulators to take similar actions against US banks operating overseas. In related news, the Federal Reserve began a review of liquidity sources at US banks last week.(WSJ, Bloomberg)

US corporate debt sales hit record high

Dec 11. According to data provider Dealogic, annual US investment grade bond sales reached a record high last week as USD 1.025tn bonds were issued through 2012. The figure exceeded the last record set in 2009 with USD 1.024tn bonds sold. Analysts said that companies had been less risk adverse this year and took advantage of the low yields and increased demand for bonds. A significant part of the completed bond deals in 2012 were for refinancing higher yielding securities. (WSJ)

Asian banks fill credit gap left by Europe lenders

Dec 09. Data from the Bank for International Settlements (BIS) showed that Asian banks have increased their cross border lending, filling the credit gap left by European banks as they restrict lending internationally. In their December quarterly review, BIS said that foreign lending to Asia Pacific increased 41% between mid-2008 and June 2012. Total claims of European banks in contrast decreased by approximately 30% in the same period. (Marketwatch, Central Bank News)

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