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Weekly Credit Brief Dec 11 - Dec 17

Automobile manufacturers face headwinds from trade uncertainties; Tata Motors' credit profile worsening

By Zhou Ye

Facing headwinds from the potential of a hard Brexit, as well as the trade disputes between the US and China, international automobile manufacturers are facing challenges this year. The automobile industry relies heavily on the international supply chain of car components and the shipment of finished cars to overseas markets. For example, a car assembled in the UK on average used only 41% of the components manufactured in the country. One of the automobile manufacturers caught by the trade uncertainties is Tata Motors Limited, an Indian company with global operations. Its British subsidiary, Jaguar Land Rover (JLR), which contributes around 80% of the group's operating profits, saw a significant revenue drop in the Chinese and European markets this year, due to China's uncertain tariff policies on imported cars, Europe's stricter regulation on diesel cars as well as the risk from a potential hard Brexit. Tracked by the RMI-CRI 1 year Probability of Default (PD), Tata Motors reached its highest level in recent two years, up from around 500 bps to nearly 1500 bps.

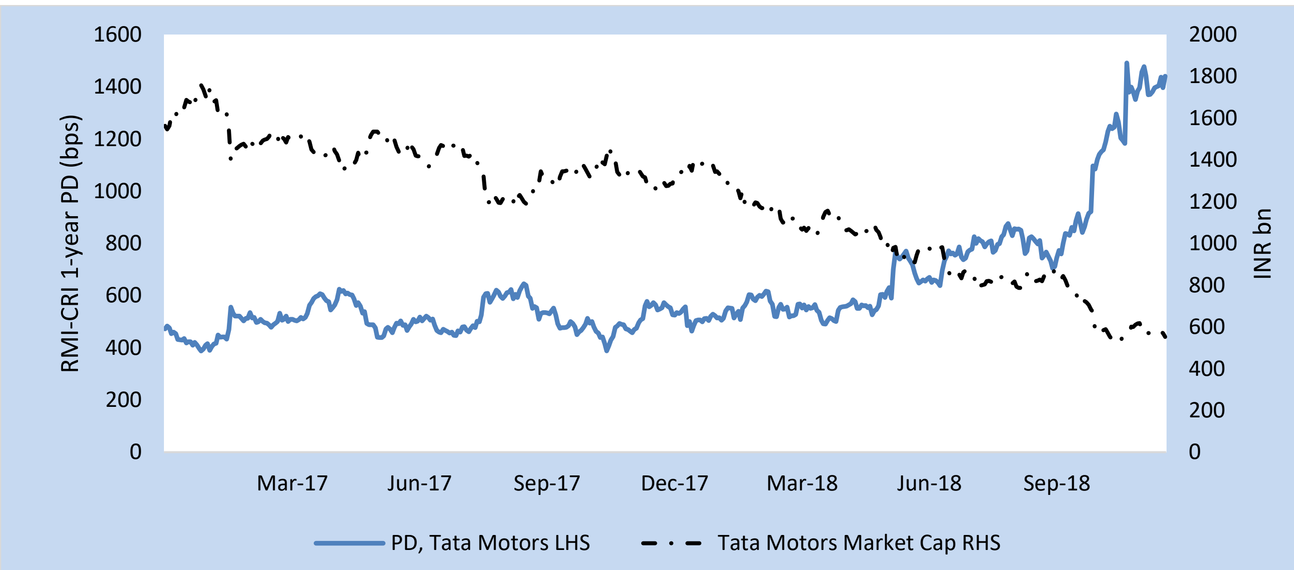

Figure 1. RMI-CRI 1-year PD and Market Capitalization for Tata Motors Limited. *Source: RMI-CRI, Bloomberg*

Tata Motors is suffering a plunge in its market capitalization from over INR 1300bn at the beginning of this year to INR 600bn in October. Its subsidiary, JLR division, has seen a global sales drop of 12.3% in September from a year earlier. In terms of geography segment, there is a 46% decline in China and a European sales drop of 4.7%. In the latest quarter, Tata Motors' performance is unexpectedly worse, which posted a negative sales growth YoY and EBITDA growth YoY, -29.44% and -21.6% respectively in nearest quarter.

	2017 Q4	2018 Q1	2018 Q2	2018 Q3
Net Income Margin (%)	1.62	2.33	-2.84	-1.47
Sales Growth (%)	16	18.2	14.7	1.7
EBITDA/Interest Expense (X)	6.8	9.2	3.9	5.5

Table 1: Financial figures for Tata Motors Limited. *Source: Bloomberg*

Tata Motors' current woes shows an uncertainty faced by many multinational automobile companies, especially those with significant market share in Europe, the US and China. A disorderly Brexit may weaken consumer confidence thereby hitting the UK and European car industry. A hard Brexit may drive higher tariffs and longer time for border crossing, which can add new complications in the supply chain management of European automobile companies like JLR. Meanwhile, though not directly impacted by the US-China trade war, JLR's sales were still hurt due to China's trade policies on imported cars. Tata Motors indicated that the recent drop in sales was due to a postponed purchase caused by the lower import tariff Chinese government implemented across all passenger cars. Announced in May and effective on July 2018, tariffs were reduced from 25% to 15% while tariffs on US-imported cars were increased to 40%. However, the Chinese government recently announced a cut in tariffs on US-imported cars back to 15%, after a 90-day trade truce with the US is agreed upon. The uncertainty in trade tariffs may have caused uncertainty in consumers' decision in their car purchase.

In addition, on the European front, sales of diesel vehicles have been hurt, falling by around 30% in the UK by increased regulatory scrutiny on diesel vehicles and a tougher emission-testing regime imposed across Europe. About 90% of JLR's sale in Britain is diesel cars, compared with a global automobile manufacturers' average at around 45%. In addition, the automobile industry is facing a dramatic change with technology disruptions such as electric and shared technologies which require heavy investments. A decline in the sales of diesel cars in Europe and the potential huge investments JLR has to make to develop technology may lead to cash flow issues.

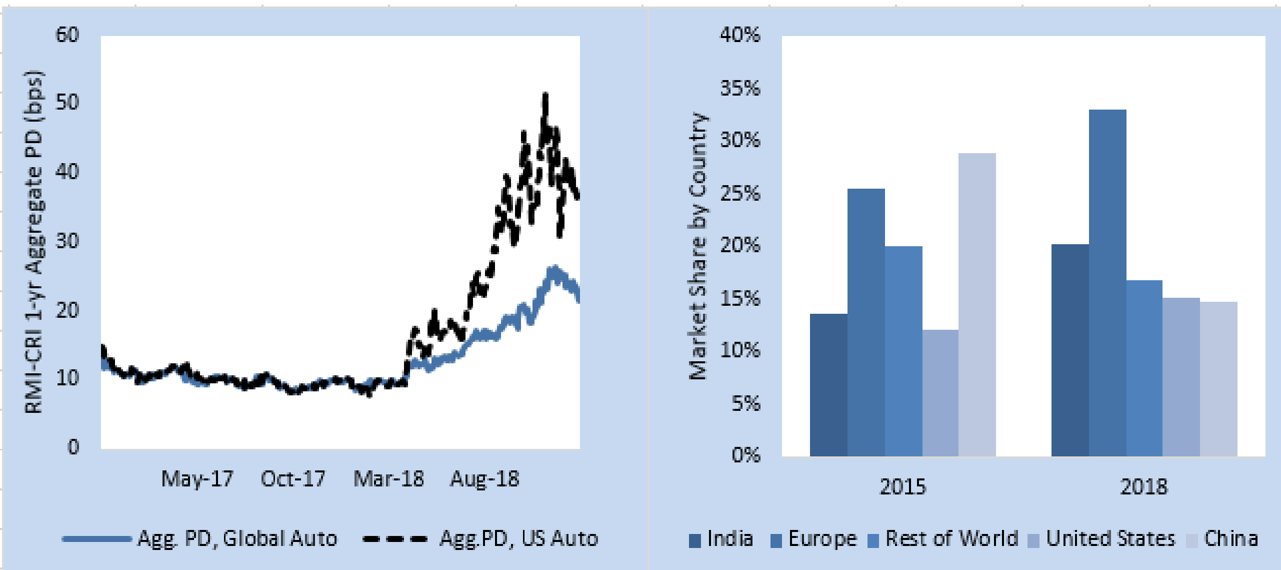

Figure 2a (LHS): RMI-CRI 1-year Aggregate PD for Global and US Automobile industry and Figure 2b (RHS) Tata Motors' share of revenue by geography. *Source: RMI-CRI, Bloomberg*

Not only for Tata Motors, the ongoing US-China trade tensions and uncertain geopolitical climate between UK and EU have affected the whole automobile industry. Similar to Tata Motors, Volkswagen's sales to China fell by 10.5% while sales in Europe dropped 43% in September. Swedish carmaker, Volvo, has postponed plans to float shares and Ford Motor dropped plans to ship its new Focus Active from China to the US. RMI-CRI 1-year Aggregate Probability of Default (Agg PD) increased for both global and the US Auto Industry from April this year, reflecting the concern of the uncertainty. The economic outlook still depends on the directions of Brexit trade deal and US-China trade negotiations. Recently, the temporary alleviation of US-China trade disputes which the China government agrees to cut tariffs on US-made cars may give the automobile industry some space and time to breath, however, uncertainties remain which could bring risk to the industry.

Credit News

China sees bankruptcies surge; bondholders may get less back

Dec 17. China companies' missed bond payments in 2018 have surpassed RMB 120 billion and almost quadrupled the tally last year. At the same time, China's effort to cut the burden of insolvent companies kicked into higher gear as its top planning body called for local officials to clean up the debt of firms with excess production capacity or insolvent balance sheets by 2020. Although bondholders could face considerable losses after bankruptcy proceedings (the average recovery rates for liquidation at 10-15%), the process will give both creditors and debtors the chance to gain experience in restructuring obligations as China only began embracing the concept of defaults in the bond market about four years ago. (Bloomberg)

US credit markets dry up as volatility rattles investors

Dec 17. US credit markets are slowing down with fund managers refusing to finance buyouts and investors avoiding high-yield bond sales as interest rates, increased market volatility and rising uncertainty about the global economic outlook weigh on sentiment. Not a single company has borrowed money through the US high-yield corporate bond market in December. If the trend persists, this would be the first month without a junk bond issuance since November 2008. Meanwhile, two transactions in the leveraged loan market were also postponed as banks such as Barclays, Deutsche Bank, UBS and Wells Fargo unexpectedly failed to find buyers for the debt packages. (FT)

Tumultuous year raises India Inc.'s dependence on foreign banks

Dec 17. Indian companies are more dependent on banks to raise offshore funds as the bond markets slow down and local-currency funding from domestic banks dries up. The USD 210bn distressed assets at Indian banks limit their capacity to lend rupee funds thus making banks more cautious and funding cost more expensive. Borrowers that are facing challenges in the domestic credit market are turning to dollar-denominated loans, even as volatility in the rupee and uncertainty over national elections next year add to pressure on financing costs. However, those companies that are not strong enough will have limited access to foreign market and will struggle to raise funds or have to pay significantly more. (Bloomberg)

ECB ends crisis-fighting bond buys but eyes increasing risks

Dec 13. The European Central Bank ended its bond-buying program but promised to keep injecting stimulus into the economy. ECB President Mario Draghi said that the risks surrounding the euro area growth outlook is still broadly balanced, but acknowledged that it is moving to the downside due to the persistence of uncertainties relating to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets and financial market volatility. The ECB also lowered its growth and inflation projection for the coming years as the effect of the stimulus diminishes and the region's growth returns to its natural potential at about 1.5%. (Reuters)

Sputtering oil industry halts Nigeria bank loans

Dec 12. Nigerian lenders are struggling as rising costs and declining appetite to lend are forcing them to repay dollar borrowings. Sliding crude oil prices have slashed earnings from Nigeria's main source of foreign income, reducing the amount of foreign exchange banks need to fund deals. Other uncertainties such as the risk of a currency devaluation and a surge in non-performing loans further impede loans growth. Analysts expect that lenders will only go back to issuing Eurobonds if there is a sustained high oil-price environment for about 2 years. Consequently, banks that provided loans near high oil prices may have to change their strategy to cope with these changes. (Business Times)

EU stress tests show some insurers could face trouble if rates were to jump (FT)

Spanish banks step up sales of bad loans and distressed property (FT)

France's credit rating has some breathing space: S&P Global (Reuters)

Regulatory Updates

RBI's solution for MSME loan woes: Public credit registry

Dec 15. The Reserve Bank of India (RBI) is preparing a public credit registry to smoothen loan flow to micro businesses as the government is trying to provide more support to small businesses which had been hit by the twin shocks of demonetization and GST. The public credit registry will give banks the entire profile, including past loan details and regular income flows of borrowers which will make lenders more confident and therefore reduce the interest rates for a borrower as the risk assessment becomes easier. However, RBI stated that it would still take three to five years before every financial transaction is recorded. (Livemint)

Canada banking regulator hiking 'domestic stability buffer' to protect banks from elevated risks

Dec 12. Canada's banking regulator will increase Canada's six biggest banks' "Domestic Stability Buffer" from the current level of 1.5% to 1.75% of a bank's risk-weighted assets (such as mortgages). With the positive credit performance and generally stable economic conditions in Canada's financial system, it is a prudent time for banks to build resilience against future risks. The hike in the banks' capital buffer reflects OSFI's assessment that systemic vulnerabilities in the banking system 'remain elevated'. The household debt levels continue to be high relative to incomes while uncertainty persists in certain housing markets. Corporate indebtedness is also increasing which represents a potential future risk to the financial system. (Financial Post)

New Zealand eyes raising bank owners' capital contributions (FT)

China central bank says to guide credit, social financing growth as economic challenges rise (Reuters)

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