Credit Research Initiative
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Weekly Credit Brief
December 16 - December 22

Russian ruble roulette dampens credit profiles

by Kelvin Zhang

The falling ruble has just claimed its first banking casualty. Russia's Trust Bank received a bailout from their central bank. This will not be the last as Russia's former finance minister, Alexei Kurdrin, warned that the current economic condition will escalate into a "full blown financial crisis", with full impact to be felt in 2015.

Russia depends largely on oil and gas exports, which accounts for approximately 40% of its revenue. The country is expected to slip into recession in 2015 mainly due to freshly introduced Western trade sanctions over the Ukrainian crisis and falling oil prices. The RMI 1-year PD increased sharply to 154.53bps as of Dec 22 from 42.45bps at the onset of this year, capturing the worsening credit profile of the Russian firms.

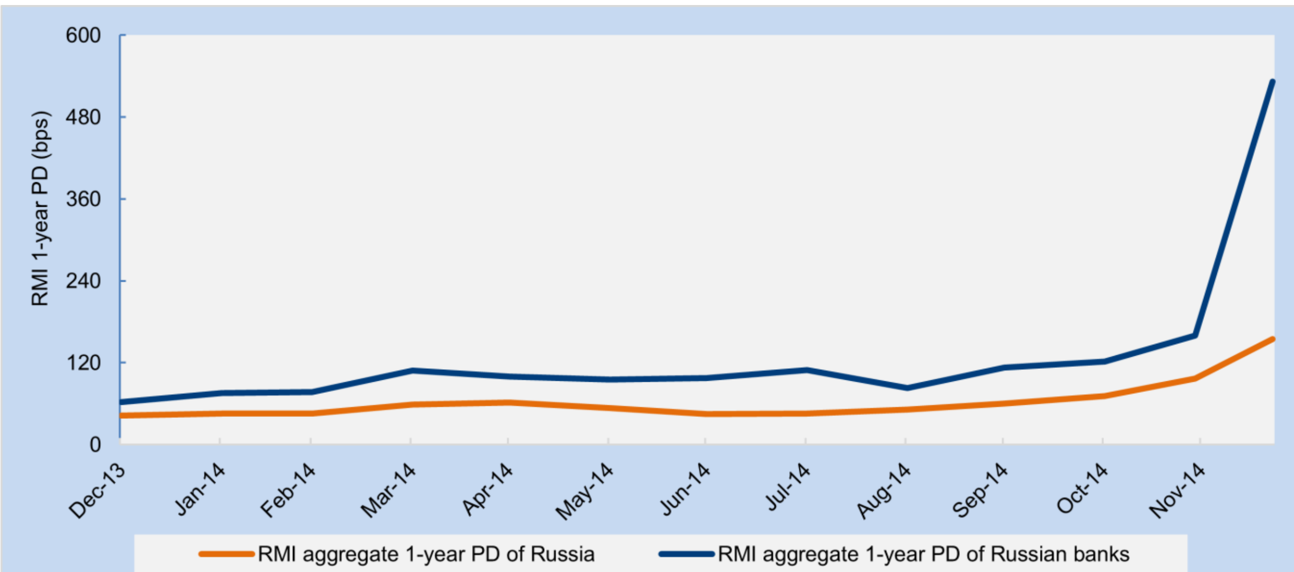

Figure 1: RMI aggregate 1-year PD of Russia versus RMI aggregate 1-year PD of Russian banks. Source: *Risk Management Institute*

An example to underscore Russia's worsening credit profile would be the insolvency of Trust Bank on Dec 22, Russia's 32nd-largest bank by assets. The insolvency has been attributed to being overly committed to attractive interest rates on deposits, with extremely high return on Trust's investments required. With the trade sanctions imposed on Russia, and locked out of the international capital markets, this was unrealistic. With the doom of Trust Bank as an example, the financial sector in Russia would likely see a decrease in volume of lending, fueling potential bailouts and exacerbating the situation. The RMI 1-year PD in figure 1 depicts how the probability of default for the financial sector has increased, relative to the aggregate Russian economy and its increasing tendency.

Additionally, the RUB 30bn bailout of Trust Bank presents a domino effect. Bailout cash provided by the Russian Central Bank (CBR) will flood the markets, exerting further downward pressure on the ruble. This may potentially reduce Russia's ability to prop the ruble up, worsening the aggregate credit outlook. In the short-run, it is expected that the ruble will continue its devaluation trend against the dollar.

As a response to the Russian currency crisis, key interest rates were drastically raised to 17% on Dec 16. This is a record level since the 1998 Russian Financial Crisis, when the then-Russian government defaulted following rates soaring past 100%. In addition, Russia has been selling its foreign-exchange reserves for Russian ruble to combat the home currency slump, albeit with limited success. According to market consensus, Russia is unable to withstand such high rates for extended periods, with rising probability of Russia completely depleting its foreign reserves in combating the ruble crisis. With the insolvency of Trust Bank, Russia seems to be heading into a deep recession.

Source:
Russia's ex-finance boss in crisis warning but ruble rallies (BBC)
It's time to drive Russia bankrupt -- again (Forbes)
The Russian Crisis of 1998 (Rabobank)

Credit News

Carlyle and Warburg Pincus to buy world's 4th largest CRA

Dec 23. Carlyle Group LP and Warburg Pincus LLC said they would buy DBRS Ltd, the world's fourth-largest credit rating agency, in partnership with a consortium of Canadian investors including the firm's founder. Viewed as a market leader in Canada, Carlyle Group LP and Warburg believe the DBRS will gain its international influence by the increasing use of structured financial products, such as commercial mortgage-backed securities. The terms of the deal that are expected to close in the first quarter of 2015, were not disclosed. (Reuters)

Ukraine's rating cut by S&P as IMF delay raises default risk

Dec 22. Credit ratings on Ukraine's sovereign bonds were cut by S&P to CCC- as the credit rating agency said that a default could be inevitable. The country's reserves are depleting quickly and it appears that the country is not gaining financial help from the international markets. The government estimates that GDP will fall 7% in 2014 while its reserves are at the lowest level in more than a decade. (Bloomberg)

Switzerland shifts to negative interest in bid to weaken Swiss franc

Dec 19. As the Russian ruble has plummeted in, Swiss franc now is viewed as the safest currency by investors. In order to discourage that, the Swiss National Bank (SNB) on Thursday morning announced that it was to impose a negative interest rate of -0.25% on commercial bank deposits from Jan 22. According to Thomas Jordan, the chairman of the SNB's governing board, the central bank is determined to ensure its target of a minimum exchange rate of 1.20 Swiss franc per euro. (Guardian)

Fed signals tightening by mid-2015

Dec 17. The US Federal Reserve is expected to tighten monetary policy in mid-2015 by avoiding keeping interest rates low for a significant period. Despite the potential deflation and a weak global economy amongst falling oil price, the Fed prepares for interest rate rises next year and makes no change to its growth forecasts. The FOMC expects a rise from 1.25% to 1.5% by the end of 2015 and 2.5% by the end of 2016. (FT)

China local debt crisis spells global opportunity in 2015 (Bloomberg)

China's shadow banking adapts and grows as rules tighten (CNBC)

HSBC and Standard Chartered face tougher UK stress test in (SCMP)

Regulatory Updates

Roadmap laid out for Basel III

Dec 23. Bangladesh bank has issued a roadmap to elevate the capital base of banks in line with Basel III requirements. According to the roadmap, the banks' minimum capital adequacy ratio will have to be raised to 12.5% of their risk-weighted assets by Dec 2019 from the existing 10%. The central bank plans to raise the Capital Adequacy Ratio to 10% by 2015, 10.60% by 2016, 11.25% by 2017 and 11.88% by 2018. Finally, it will hit the desired 12.50% in 2019. This roadmap comes at a time when banks' capital base has been shrinking on the back of mounting bad loans. (The Daily Star)

Banks face restrictions on use of rating agencies in risk assessment

Dec 22. Banks' scope to use credit rating agencies to assess the risks in their portfolios will be sharply reduced as global regulators push through news standards aimed at making lenders safer. The Basel Committee on Banking Supervision said it would like to reduce firms' reliance on external ratings and compel banks to improve their own assessments of loans risks going bad when calculating capital requirements. In addition, the Basel Committee is introducing a new capital "floor" that will reduce banks' ability to use their own models to reduce the amount of capital they have to hold. (FT)

Russia government, Central Bank ready for regulatory measures in banking sector

Dec 22. Russia government and the Central Bank are not planning to take any further measures regarding the currency crisis. However, they are ready, if necessary, to take organizational and regulatory measures in the banking sector to stabilize the domestic financial market. Prime Minister, Dmitry Medvedev said "I hope that state-run companies and private companies realize this responsibility and will follow the decisions that we worked out jointly." (TASS)

China eases rules for foreign banks

Dec 21. China has loosened market restrictions on foreign banks, in a largely symbolic move to make good its promises. In its announcement of the rule changes on Saturday, the cabinet referenced the economic reform blueprint by top Communist Party leaders pledging to "expand the openness of the financial sector and deepen the openness of the banking industry". However, in practical terms, the changes which will take effect on Jan 1 may do little to improve the situation – currently foreign lenders controlled only 1.7% of total banking assets. (FT)

Financial regulator to soften regulation on fintech (Korea Herald)

Fed grants Volcker reprieve in banks' second big win this month (Bloomberg)

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