NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond

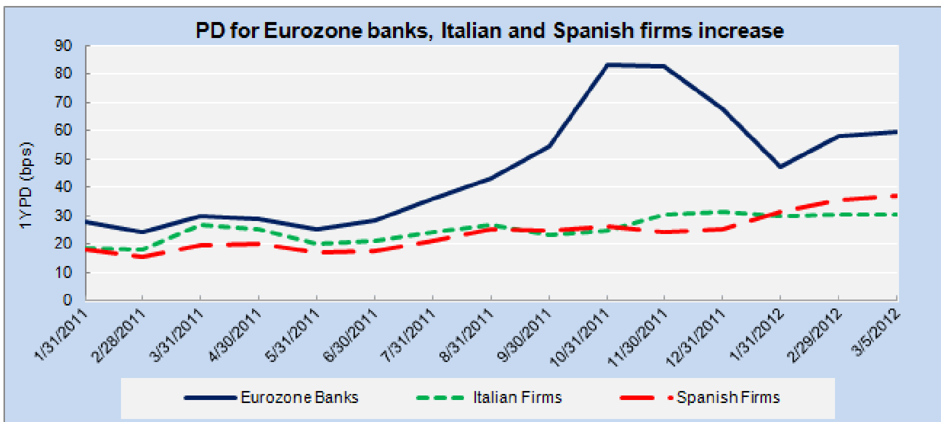
Weekly Credit Brief

Feb 28 – Mar 5 2012

Stories of the Week

Outlook unfavourable for eurozone banks and real economy despite ECB's second LTRO

The European Central Bank (ECB) last Wednesday allotted EUR 529.5bn in 3-year loans to 800 banks at 1%, in its second longer-term refinancing operation (LTRO). The total lending volume and the level of participation both surpassed the ECB's first LTRO, when 3-year loans of EUR 489.2bn were lent to 523 banks last December. With a total amount of nearly EUR 1tn, the two rounds of operations should ease the liquidity squeeze that had been plaguing eurozone banks, which face around EUR 1tn in bond redemptions in 2012. Despite this, the RMI CRI 1-year probability of default (PD) for eurozone banks has increased since January, with investors increasingly wary about their dependence on ECB funds.

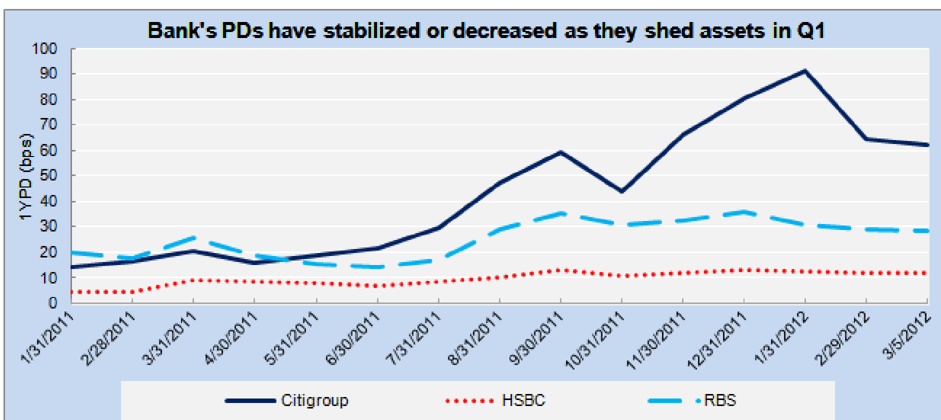


In contrast with eurozone banks, Italian and Spanish firms may not benefit significantly from the ECB LTROs. Eurozone banks continued to deposit much of the loan proceeds in the ECB's deposit facility instead of increasing lending to the real economy. Last week, bank deposits at the ECB reached a record EUR 820.8bn. Compared to healthier economies such as Germany, Italy and Spain could face more challenges in reviving bank lending, as banks in these two countries are more likely to invest in lucrative high-yielding government debts. The RMI CRI 1-year PD for both Italian and Spanish firms increased last week, with the 1-year PD for Italian firms reaching the highest level since December 2011 on March 5.

Sources:
Banks deposit record cash with ECB (FT)
ECB Gives Banks Big Dollop of Cash (WSJ)

Shedding non-core Asian assets is credit positive for US and UK Banks

A number of international banks based in the US and the UK are selling Asian assets in preparation for incoming Basel III rules, and other regulations. Such moves could strengthen their credit outlook and place downward pressure on their respective probabilities of default. Global banks must maintain much higher risk buffers under Basel III; so–called global systematically important financial institutions (G-SIFIs) will face a core tier one capital requirement up to 2.5% higher than the base requirement of between 7% and 9.5%. A provisional list of G-SIFIs published by the Basel-based Financial Stability Board in November includes RBS, Citigroup, HSBC, Goldman Sachs and Bank of America.



RBS, which suffered net losses of nearly GBP 2bn in 2011 due to the Greek debt crisis, ongoing restructuring, and settlement costs with the Financial Services Authority, agreed to dispose some of its Asian assets to

Malaysian bank CIMB on March 1. Citigroup sold its stake in India's largest mortgage broker Housing Development Finance Corp for almost $1.9bn on February 24. On the previous day, HSBC stated that it was withdrawing from the consumer banking market in Japan, and seeking buyers for its private banking business in the country, after selling part of its Japanese wealth management business to Credit Suisse in December. HSBC is also in talks to sell its South Korean retail business, and raised $112mn from the sale of its Thailand-based banking units in January. In November, Goldman Sachs and Bank of America raised $1.1bn and $1.8bn respectively by selling part of their stakes in large Chinese banks.

Sources:
Citi's HDFC Exit: Global banks selling assets to boost capital may be compromising on long-term strategy (The Economic Times)
RBS bank to sell some Asian assets to CIMB (Channel NewsAsia)
Citigroup Exits India Mortgage Firm With $1.9 Billion Sale (Bloomberg)
HSBC Withdraws From Japan Retail Banking (WSJ)
Investors like the back-to-basics Bank of America (Boston.com)

China's credit outlook improved as PBOC reinforced monetary fine-tuning

The credit outlook of Chinese firms was boosted last week by yet another sign of further monetary easing by the People's Bank of China (PBOC). RMI CRI's 1-year aggregate probability of default (PD) for Chinese companies and Chinese banks fell to lows not seen since December, as the central bank last week continued its suspension of central bank bill auctions to support bank liquidity.

On March 3, the Chinese government cut its GDP forecast to 7.5%, from the symbolic 8% level it had maintained for 8 years. Initial market reaction to this announcement was negative, but as of the closing prices from 5 March, aggregate PDs were only slightly higher for Chinese firms.

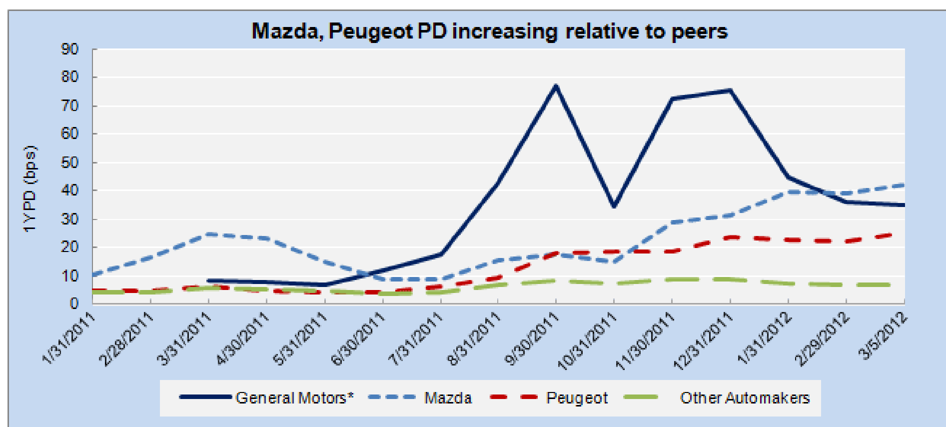
Auctions of central bank bills are routinely carried out by the PBOC to withdraw liquidity from the Chinese banking system. However, the PBOC has suspended the auctions since late last year in order to ease a credit squeeze, in favor of open market operations, in so-called "monetary fine-tuning" operations as it strives to balance between the need to control inflation and to support a vulnerable economy. The PBOC drained RMB 20bn from the banking system via repos on February 27. However, the market is optimistic that more aggressive monetary easing could be underway, after cuts in the reserve requirement ratio (RRR) in February and December, and an injection of funds via a reverse repo in January.

The PBOC is likely to resume bill sales this month, as RMB 254bn worth of bills and repurchase agreements (repo) fall due. This should further boost liquidity in China's banking system, although an increase in inflation in January remains a concern. Expectations of liquidity improvement drove China's money-market rates to the lowest level in almost two months. The interbank seven-day volume weighted repo rate dropped to 3.15% on March 5, the lowest level since the beginning of the year, further contributing to bank liquidity.

Sources:
China money market rates fall, PBOC refrains from bill sale (Reuters)
PBOC injects cash into banks via reverse repo ahead of Lunar New Year holiday (xinhuanet)
PBOC Cuts Banks' Reserve Ratio For 2nd Time Since Dec (WSJ)
Asia stocks fall on lowest China growth target since 2004 (Bloomberg)

Credit outlook negative for Mazda and Peugeot

The credit outlook for both Mazda and Peugeot deteriorated in recent weeks as they struggle with persistent losses. Mazda is particularly vulnerable to the recent appreciation of the Japanese yen. Peugeot's alliance with General Motors' European divisions would be a credit negative for the two companies. Both companies are currently underutilising their European production facilities, and there is large product overlap.



Mazda, the most export reliant Japanese car-maker, is expected to post a JPY 100bn loss for 2011 due to the appreciation of the yen against all major currencies last year. In a filing with the Japanese finance ministry on February 23, Mazda said it will take out a JPY 70bn subordinated loan, and raise JPY 162.8bn in new stock. This comes after the company reported losses in 5 consecutive quarters, which has eroded the company's equity to less than 20% of assets. Mazda has JPY 25bn of bonds falling due in 2012, and JPY 30bn falling due in 2013, and faces a possible rating downgrade by Japan's Rating & Investment Information Inc from its current rating of BBB.

On February 29, Peugeot agreed to form an alliance with General Motors' European divisions, Opel and UK-based Vauxhall. Although both companies target a combined saving of $2bn though merging a range of divisions including research and development, the alliance of their loss-making European units is a credit negative for the companies. The PD for General Motors has declined in recent months on strong US demand for the company's automobiles. However, any restructuring of GM's European operations would have to be financed by the company's US headquarters, weighing on the company's credit outlook.

Peugeot lost EUR 92mn during 2011, while Opel and Vauxhall lost a combined USD 747mn last year, amid shrinking market share and worsening consumer demand in Europe. Both companies are struggling with production underutilisation; Peugeot may only use 62% of its production capacity this year, while Opel is projected to use 74%. Generally, carmakers risk losses when they use less than 90% of their capacity. Furthermore, both companies face obstacles to cost cutting in Europe; an election year in France places high political pressure on Peugeot to minimize job cuts. A restructuring agreement with the German government in 2009 prevents any plant closures at Opel until 2014. It is unclear who will cut models in the alliance.

*The PD for General Motors could be calculated by the CRI from March 2011, after the company was relisted in 2010.

Sources
Peugeot agrees alliance deal with GM (Reuters)
GM-Peugeot Seen as Europe Money-Losers Still Losing Money (Bloomberg)
Mazda Shares Decline After Carmaker Plans Record Share Sale (Bloomberg)

In the News
Shanghai Exchange eyes launch of high-yield junk bonds in H1 **Mar 4.** The Shanghai Stock Exchange may launch high-yield junk bonds in the first half of this year, to expand small firms' access to credit markets. Such firms have been unable to raise funds from Chinese banks in recent years. Wary of the risks involved, the exchange could implement certain mechanisms, such as a compensation fund for investors should default occur. (Reuters)
Greece ratings cut to lowest level by Moody's **Mar 3.** Moody's downgraded Greece to C from Ca as the country initiated the largest sovereign debt restructuring in history. S&P previously stated Greece was in "selective default," while Fitch will cut Greece to "restricted default" after the bond exchange. Moody's noted that the bond swap is a "distressed exchange" and would constitute a default. (Bloomberg)
Swaps committee rules no Greece credit event on ECB debt swap agreement **Mar 1.** ISDA ruled that the ECB's implied seniority in the Greek debt swap would not be considered a credit event. However, a credit event could still occur if Greece forces private bondholders to take losses through collective action clauses. The amount of Greek debt CDSs insure has dropped to USD 3.25bn, from USD 6bn in 2011. (Bloomberg)
Greece feels collateral damage from bank **Feb 29.** The ECB said it would temporarily prevent Greek bonds being used as collateral for loans. The restriction will be removed once eurozone governments agree on USD 46.9bn in credit guarantees to protect the ECB against losses on Greek collateral. Banks will have to replace Greek bonds currently being used as collateral with other assets. (WSJ)
Refinancing risks grow for Danish mortgage bonds

Feb 29. Denmark's USD 470bn mortgage market has proved resilient to past and current crises, but concern about the risk of adjustable-rate mortgages is increasing. Such mortgages are popular in Denmark as borrowers can renegotiate rates annually in some cases; this increases refinancing risks for issuers, who have also become more dependent on short-term financing. (Bloomberg)

ECB's special lender status risks investor retaliation
Feb 28. The ECB's immunity from losses in the Greek bond swap may increase yields that investors demand on sovereign debt in the future. The terms of the deal make the ECB senior to other investors. S&P warned that this may affect the ECB's bond-buying operations; large purchases by central banks could infer an increased chance of subordination for investors. (Bloomberg)

FDIC says U.S. banks in position to help economy
Feb 28. The FDIC stated that U.S banks have strengthened their balance sheets and are in a position to boost economic recovery by increasing lending. Bank loan balances increased USD 130.1bn in the Q4, compared to Q3 2011. Credit to business led the increase, up USD 62.8bn, while lending to consumers remained weak. (Reuters)

JPMorgan Chase, Wells Fargo and Goldman may face charges over mortgage bonds
Feb 28. The three banks could face federal enforcement action over mortgage-backed securities deals issued in 2006. Both banks disclosed that they had received a Wells Notice from the SEC last week. Previous settlements in 2010 were related to allegations of misleading investors in other structured credit products. (Bloomberg)

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