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Transforming Big Data into Smart Data
Weekly Credit Brief Jan 14 - Jan 20 2014

Stories of the Week

Results show large US banks have robust earnings profiles

Q4 turned out to be a strong quarter for large US banks as many of the lenders met or exceeded consensus earnings. Profits for the 2 US largest banks by revenue – JP Morgan Chase and Wells Fargo improved from their previous quarter. Morgan Stanley posted stronger than expected results helped by its asset management and retail brokerage businesses. Quarterly earnings for Goldman Sachs were higher from the previous quarter as revenues from fixed income, currency and commodities trading increased from Q3. Bank of America surprised market observers with significantly higher than expected net income results, which the bank attributed to record capital and liquidity levels, low credit losses and improved costs savings. Citigroup was the outlier as it missed estimates due to lower revenues from bond and foreign exchange trading..

The RMI 1-year probabilities of default (RMI PD) for the banks have mostly decreased after the firms announced earnings for the quarter. RMI PDs for Morgan Stanley and Bank of America have dropped by 6.1bps and 4.59bps respectively while the 1-year RMI probability of default for Citigroup increased by 4.73bps. Nevertheless, the default risk for these US banks have fallen considerably from levels seen during the Global Financial crisis. During the zenith of the crisis in March 2009, RMI PDs for Citigroup and Bank of America reached 7820bps and 3066bps, but have since fallen considerably.

Lenders have better earnings profiles in part due to lower interest rates, better asset quality and an improving economy. USD money markets also have better liquidity and financing conditions than 2008, benefiting banks. The spread between the 3 month Libor and the 3 month USD overnight indexed swap has decreased to 15.36bps on January 20, 2014 from 364bps on October 10, 2008. Although tapering has begun, the overall monetary policy of the Federal Reserve remains loose as it continues to purchase USD 75bn of Treasuries and mortgage backed securities every month. According to the IMF, the amount of nonperforming US loans as a percentage of total loans has gradually declined from 4.96% in 2009 to 3.16% in December 2013. Bank lending could improve further as US gross domestic product expanded at its fastest pace in 2 years in Q3 backed by higher consumer spending.

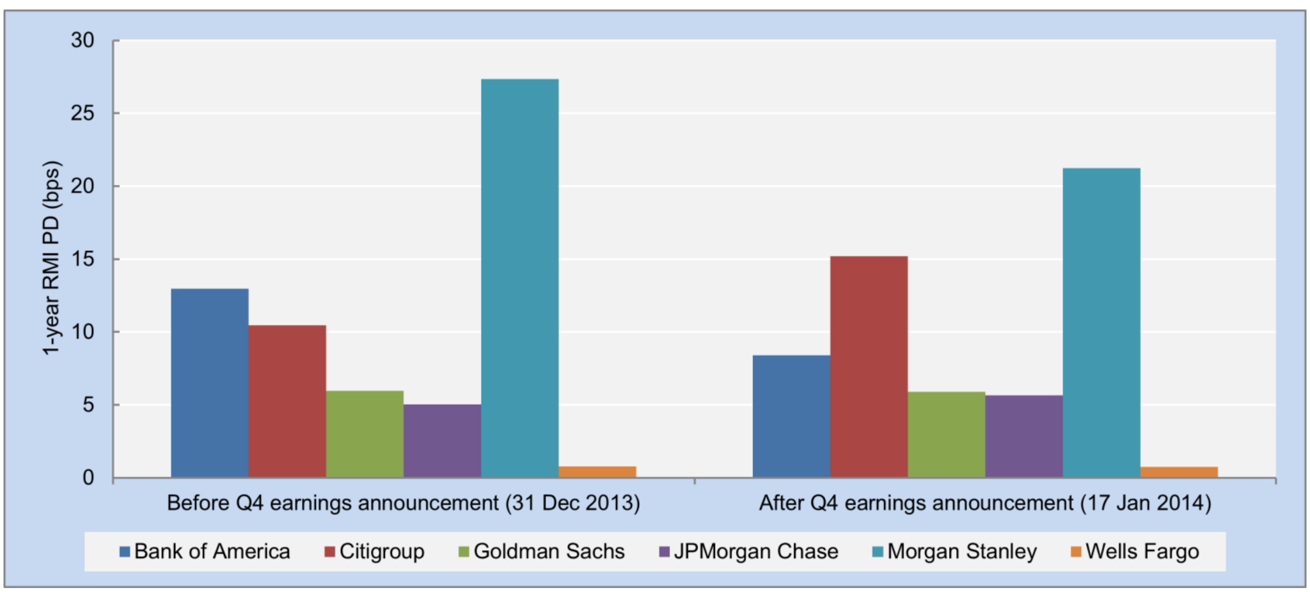

Figure 1: 1-year RMI PD for large US banks. *Source: The Risk Management Institute*

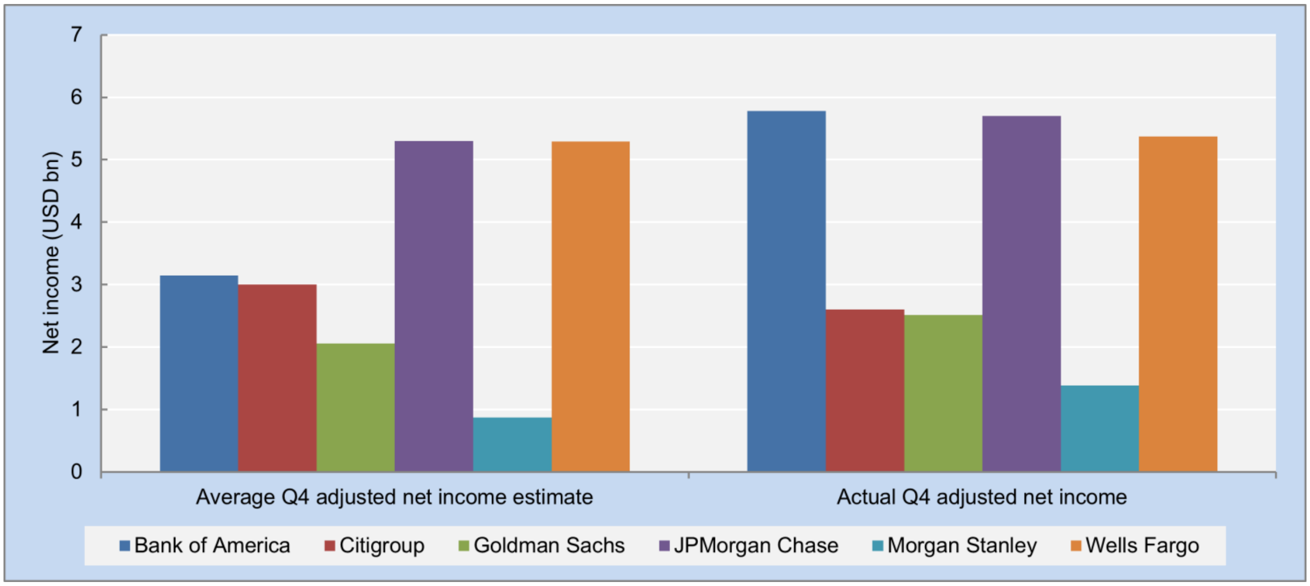

Figure 2: US bank adjusted earnings and estimates. Earnings are adjusted for extraordinary items such as one time legal costs and tax provisions. *Source: Bloomberg compilations*

Indonesia's property developers face a higher risk of default

By [Ang Chung Yuh]

The default risk for Indonesia's real estate development sector, as gauged by the aggregate 1-year RMI PD, climbed to the highest in nearly 4 years as slowing economic growth and rising interest rates provided a significant blow to the sector. Despite favorable demographics, high inflation and property-price gains that outpace interest rates spurring real-estate sales, market participants generally predict the property sector to slow in the coming months. Demand is expected to drop as potential buyers adopt a wait-and-see approach and wait for more regulatory certainty from the incoming government after this year's election.

The aggregate 1-year RMI probability of default (RMI PD) for listed real estate developers in Indonesia has risen this month to a level not seen since May 2010 (see Figure 3). The hike in the default risk of Indonesian property developers came in tandem with the selloff in Indonesia's property stocks. The Jakarta Construction, Property, Real Estate Stock Index plummeted more than 40% from its recent all-time high of 565.3 registered on May 31, 2013 to 337 in December 2013, before recovering modestly in January.

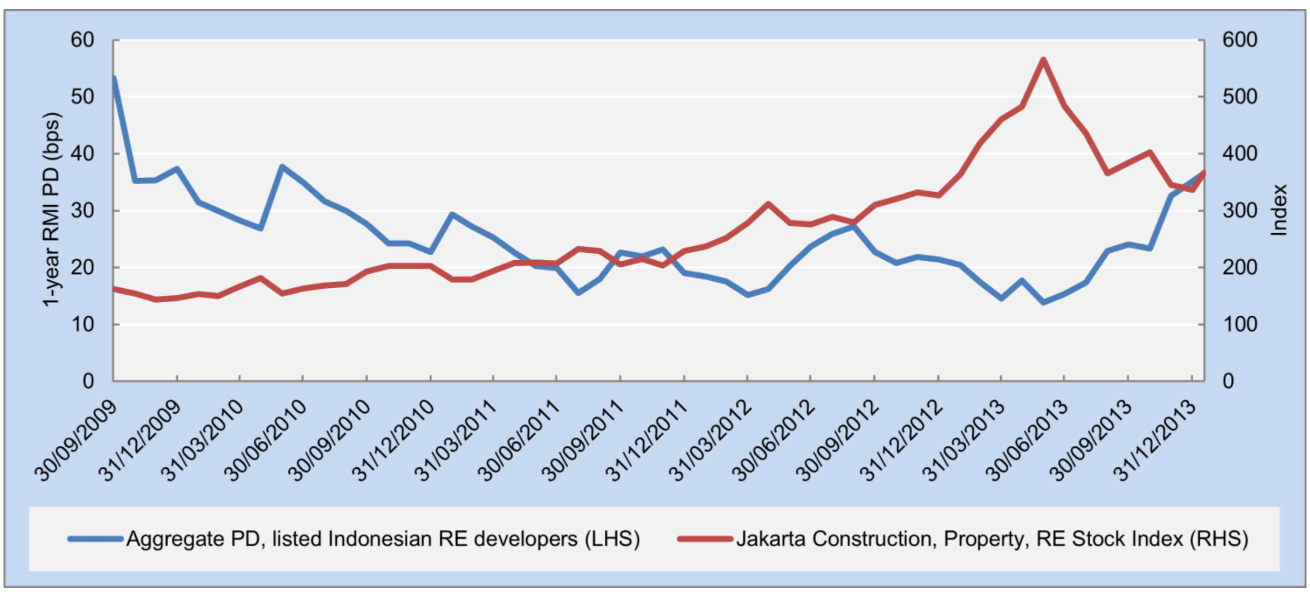

Figure 3: Default risk for Indonesian property developers increases as stocks slump. *Sources: Bloomberg; Risk Management Institute*

Average yields on Indonesian builders have jumped 237.1bps in the 12 months through January 17, versus an 83bps rise for emerging-market property developer debt, according to the Bank of America Merrill Lynch Real Estate, Builders and Hotels Fixed Income Index. Also, average yields on USD debt from the nation's borrowers jumped to a 4-year high of 7.21% last September, falling to 6.22% on January 17, according to the JPMorgan Chase Fixed Income index for Indonesian corporates.

Indonesian property developers face a more challenging environment ahead. A record current-account deficit registered in Q2 2013 has prompted Bank Indonesia to raise its benchmark rate by 1.75 percentage points since early June, leading to higher mortgage costs. The tighter mortgage rules introduced in September 2013 and higher selling prices persistent in the market will also serve to curb demand.

In the News

Thai default risk soars as funds pull USD 4bn

Jan 20. Thailand is facing the highest risk of default on its debts since June 2012 as anti-government protests prompt money managers to exit their holdings of the nation's assets. The cost of protecting the country's debt increased significantly after investors including Wells Fargo Inc. withdrew more than USD 4bn from Thai stocks and bonds since October 31, as demonstrations clogged up Bangkok roads. Pacific Investment Management Co., Goldman Sachs Group Inc. and Kokusai Asset Management Co. also reduced holdings before protests erupted in late October, regulatory filings show. (Bloomberg)

Irish bond markets cheer rating upgrade

Jan 20. 10 year yields on Irish sovereign bonds fell to 3.27% on January 20 as Moody's removed the junk rating and placed Ireland on a positive outlook. The country exited its bailout package provided by the European Union and the International Monetary Fund in December, prompting the rating agency to change its assessment for the nation's bonds. Analysts at Moody's said Ireland's growth has increased, and the large cash reserve at the National Treasury Management Agency implies that the country would be funded till 2015. (CNBC)

Mega default in China scheduled for January 31

Jan 19. China Credit Trust Co. warned investors that it may not repay investors when one of its wealth management products matures on January 31. Industrial and Commercial Bank of China sold the product to customers in Shanxi province, which were originally underwritten by China Credit Trust Co. With a total value of CNY 3.03bn, the product promised to pay investors a 10% per annum return, which China Credit Trust retrieves from a 12% loan payment from Shanxi Zhenfu Energy Group. Shanxi Zhenfu Energy Group recently declared bankruptcy with outstanding loans amounting to CNY 5.9bn. (Forbes)

China says smaller firms will get more loans, other help

Jan 16. China announced that regulators would offer more subsidies and help improve lending to small and medium enterprises (SMEs). The measures were detailed in a joint press release statement, in which 9 government departments briefly outlined how smaller firms would be assisted by lawmakers. Although SMEs account for 60% of China's GDP and some 75% of new jobs in China, SMEs often find it hard to access loans as banks prefer to lend to larger state owned enterprise. Many of the small firms operate in labor intensive industries, which are facing more challenging business conditions. (Reuters)

Italy revamps rules for raising corporate debt

Jan 16. Italian small and medium sized enterprises (SMEs) would receive more funding under a reform of debt-raising rules by the Italian government. The new provisions allow banks to use SME debt, leases, trade receivables, and shipping loans to back their bonds, rather than only mortgages and public sector loans under the current framework. These changes are intended to combat the reluctance of Italian banks to lend to Italian SMEs, which have been struggling since the onset of the Eurozone crisis. Other new rules also allow investors to bypass the banking system by allowing special purpose vehicles to purchase unlisted and unrated debt directly from issuers rather than via a regulated financial institution. (Reuters)

Venezuela's Maduro bolsters currency amid devaluation talk

Jan 16. Venezuel's President Nicolas Maduro ended speculation that the currency (bolivar, VEF) was to be devalued by announcing to keep the peg at 6.3 VEF to USD for the whole year. The President also announced a reshuffle in his economic team. Nelson Merentes will step down as finance minister and resume duties as president of the central bank, a post he held till early last year. He will be replaced by Rodolfo Torres as the finance chief. (FT)

Singapore is not facing a credit bubble

Jan 14. The Monetary Authority of Singapore (MAS) refuted claims by a Forbes article that a credit bubble was developing in the city-state, as a result of ultra-low interest rates. In the original Forbes article, the author said home-buyers have over-extended themselves amid soaring property prices, which will lead to an increase in non-performing loans when interest-rates eventually rise. However, MAS pointed out that effective measures have been taken to cool property demand and prevent excessive leverage, with new housing loans falling 35% YoY in Q3 2013 and prices of private homes stabilizing. More importantly, property asset values are substantially higher than the debt incurred by households, thus providing a large buffer in asset value. (Straits Times, Forbes)

PBOC warns banks to control size of loans (China News Service)

ECB said to favor 6% capital requirement in stress test (Bloomberg)

KKR, Affinity to sell Korean brewer to InBev for USD 5.8bn (WSJ)

Malaysia proposes new framework for banks to price mortgages (Businessweek)

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