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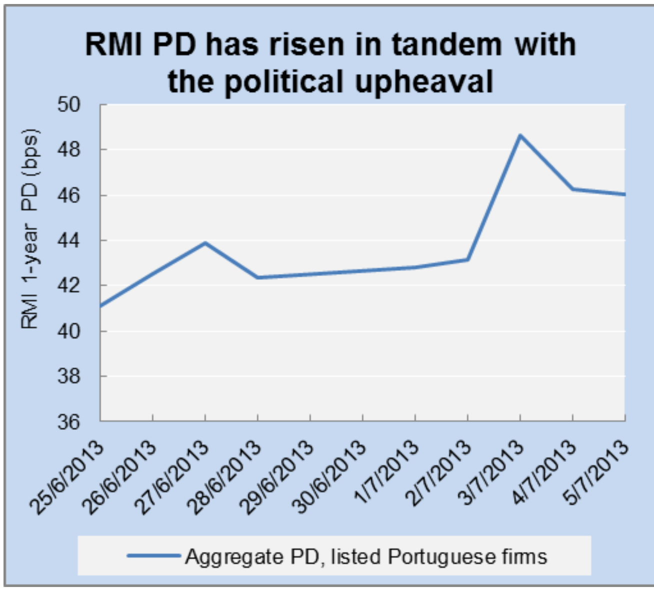
Weekly Credit Brief

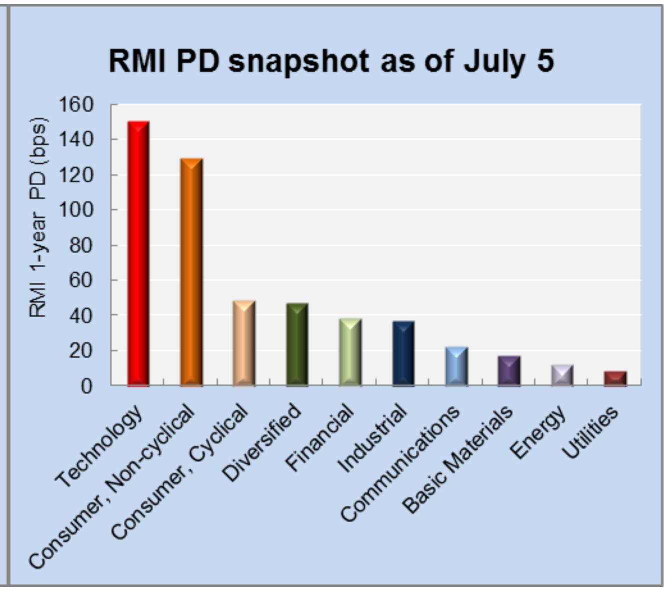
Jul 02 - Jul 08 2013

Story of the Week

Portuguese corporate credit quality shaken by shock ministers exit

Last week, the resignations of the Portuguese finance and foreign ministers brought renewed political instability to the country. The yield on the 10-year Portuguese bond exceeded 8% intraday on July 3 while contracts protecting against losses on Portuguese sovereign and corporate bonds increased in Europe's credit default swap markets. This increase in credit risk is also reflected in the aggregate 1-year RMI probability of default (RMI PD) for Portuguese firms. The RMI PD rose to as much as 48bps on July 3, making it one of the economies with the riskiest credit profiles within Europe. The weakness in Portuguese companies is not new. RMI had earlier highlighted this risk in November about the negative implications of the spending cuts and tax increases for Portuguese firms.





Since then, the aggregate RMI PD for companies domiciled in Portugal has fallen but continues to remain high. A breakdown of the default measure by sectors shows that technology and non-cyclical consumer focused companies face the highest default risk as of July 5. Portugal's borrowing costs were subsided over the past year amid record low interest rates from the ECB. However, Portuguese small and medium firms still face difficulty in accessing credit from banks at reasonable rates.

Portuguese firms urgently need help as they continue to struggle with challenging business conditions. The government is in a dilemma as to how much government spending should be cut. Too many budget cuts will result in politicians risk losing their seats in the upcoming elections. On the other hand, regulators have to secure continued financing from their creditors. After agreeing to a bail out in May 2011, the country has maintained a good relationship with the troika of international creditors which ensures financing to the nation until mid-2014.

Future economic policies will likely stick closely to the terms imposed by the EU/IMF bail-out program. Part of it involves structural economic reforms such as making the labor market more flexible, opening up closed product markets and protected professions, privatizing large parts of the public sector or making them financially independent. In healthcare for example, co-payments by patients have been increased and pharmaceutical prices have been reduced, while provision of services have been moved to larger specialist centers.

The credit rating agencies have not changed their assessments on Portugal's long term foreign currency debt, not even after the dramatic events in Portuguese politics last week. The bonds have carried the same sub investment grade ratings from S&P and Moody's since early 2012. To salvage the situation over the weekend, Portugal's Prime Minister promoted the head of the junior coalition party to be his deputy on July 6, in a hope to end the political rift among the ruling coalition. But if the governing coalition collapses, the ruling party would not have enough votes in parliament to pursue the reforms required to remain access to the international bailout loans it depends on to avoid bankruptcy.

Sources:

Second ministerial resignation plunges Portugal into crisis (Reuters)
Portuguese prime minister tries to defuse crisis (Reuters)
Portugal leads rise in European bond risk as coalition crumbles (Bloomberg)
Portugal's Portas to be vice premier, oversee economic policy (Bloomberg)

In the News

China cash squeeze seen creating Vietnam-size credit hole

Jul 08. China's credit growth is likely to shrink by USD 122bn this year, an amount equivalent to the size of Vietnam's economy. Analysts approved the government's handling of the credit crunch and raised their expectations for further policy reforms such as loosening controls on interest rates. Many market observers believe whether a slowdown extends into the second half of the year will depend on how effectively Premier Li Keqiang can redirect funding after his clampdown on speculation. (Bloomberg)

BNM implements measures to curb rising household debt

Jul 05. Malaysia's central bank, Bank Negara Malaysia, put in place on Friday several measures to contain the country's spiraling household debt and to reinforce responsible lending practices. Some of the measures included setting a limit on the maximum tenure of personal loans and mortgages to 10 and 25 years respectively, a ban on pre-approved personal financing products and the setting of a prudent debt service ratio. According to Bank Governor Tan Sri Dato' Sri Dr. Zeti Akhtar Aziz, Malaysia's ratio of household debt to GDP at the end of March stood at 83%, the highest level among Asian developing countries. The 13% increase in household debt over 4 years was deemed as unsustainable. This was attributed to the growth of personal loans, which increased at an annual average rate of 20%. (Bernama)

Barclays sees bogus growth boosting warrants

Jul 03. Warrants tied to Argentina's economy climbed 25% in the past week to 7 cents on the dollar, the biggest gains this year, as investors speculate President Cristina Fernandez de Kirchner will increase spending before congressional elections in October. The government said on June 27 that Argentina's economy expanded 7% in April YoY, although analysts said the government was overstating its growth as the IMF censured the country in February for underreporting price increases. Lenders say that the Argentinean economy has to grow at least 2.9% for the rest of the year to meet its payout threshold. (Bloomberg)

Billionaire Batista faces OGX's collapse as bonds plummet

Jul 03. The bonds of Brazilian oil and gas producer OGX Petroleo & Gas Participacoes SA plunged so much that bondholders are willing to sell them as little as 19 cents on the USD. After OGX announced that it is considering stopping production at its only oil-producing field, the company's USD 1.06bn of notes due 2022 collapsed to the lowest price among more than 1,900 USD-denominated emerging-market corporate bonds. The aforementioned bonds and OGX's USD 2.56bn of notes due in 2018 have lost 75 cents and 77 cents, respectively, from this year's high in January. (Bloomberg)

Integration step for southeast Asian bonds

Jul 03. Bank Negara Indonesia, Malaysia's Maybank, Security Bank of the Philippines, Thailand's Kasikornbank, and Singapore's Oversea Chinese Banking Corporation (OCBC) started to quote prices for bonds in their domestic markets on July 4, a move towards integrating southeast Asia's disparate local currency bond markets. The move is expected to pave way towards bond trading on an electronic trading platform. This is the latest initiative to create a more integrated capital market in the Association of Southeast Asian Nations. A more integrated capital market will make cross border investments easier for financial institutions and citizens in the region and also expand sources of investments for companies and investors in the region. (FT)

Brazilian banks BNDES, Caixa face biggest exposure to EBX woes, BofA says

Jul 02. Analysts led by Alessandro Arlant of Bank of America Merrill Lynch said on July 1 that loan exposure to distressed Grupo EBX is concentrated in five Brazilian banks, mainly state-run lenders Caixa Econômica Federal and BNDES. Private-sector lenders Banco Bradesco SA, Itaú Unibanco Holding SA and Grupo BTG Pactual SA are next on the list, according to Arlant and his team. The Rio de Janeiro-based mining and energy conglomerate has lost more than 90% of the record-high value of all except one of its six traded companies, and the bonds of oil producer OGX Petróleo e Gas Participações SA, EBX's flagship unit, are trading for about 20 cents on the dollar. (Reuters)

US gears to impose stricter rules on 8 largest banks

Jul 02. The 8 largest lenders operating in the US will face new capital rules which are stricter than standards set by the Basel Committee. Insiders say that US bank regulators plan to double Basel's 3 % capital threshold, known as the leverage ratio for banks. The Financial Stability Board has identified the affected banks as JP Morgan, Wells Fargo, Goldman Sachs, Bank of America Corp, Citigroup Inc, Morgan Stanley, State Street Corp and Bank of New York Mellon Corp. The American Bankers Association, the largest lobbying group for the banking industry, said that more regulation and higher capital ratios will inhibit lending and erode profits. (Bloomberg)

Cheap foreign loans spur India's outbound M&A march (Reuters)

EU says Greek aid could be split into installments (Reuters)

ECB lifts suspension on Cyprus debt eligibility (Reuters)

How Fed's 7% jobless avoids deterring bondholders is mystery (Bloomberg)

Indian central bank tipped to cut reserve ratio (Gulf News)

Indonesia 10-Year yield surges to two-year high on Fed concern (Bloomberg)

Japan reforms rattle US steelmakers, but suppliers could gain (Japan Today)

KSA to curb inflation, cut production costs (Arab News)

Temasek looks to expand in China as crunch is under control (Bloomberg)

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