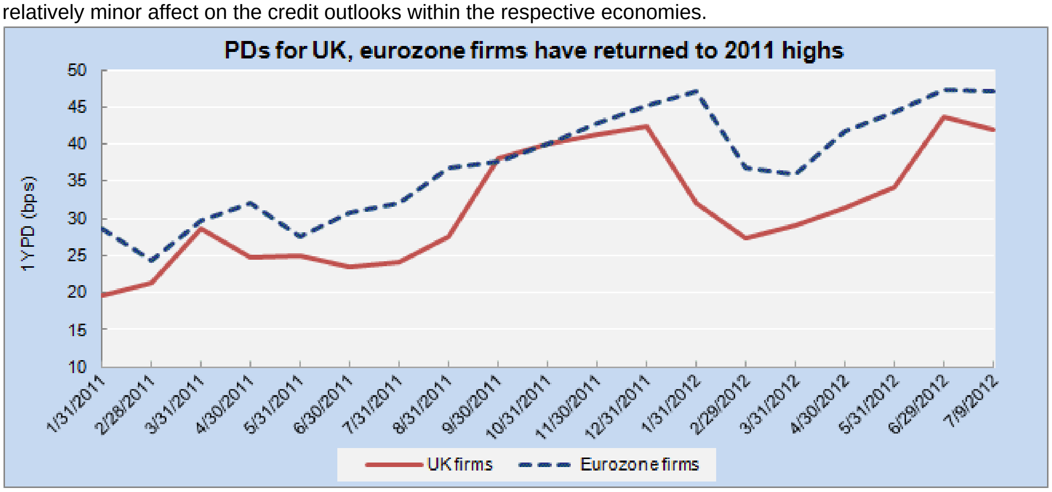
Weekly Credit Brief

Jul 3 - Jul 9 2012

Story of the Week

Credit risk remains elevated after monetary easing by central banks

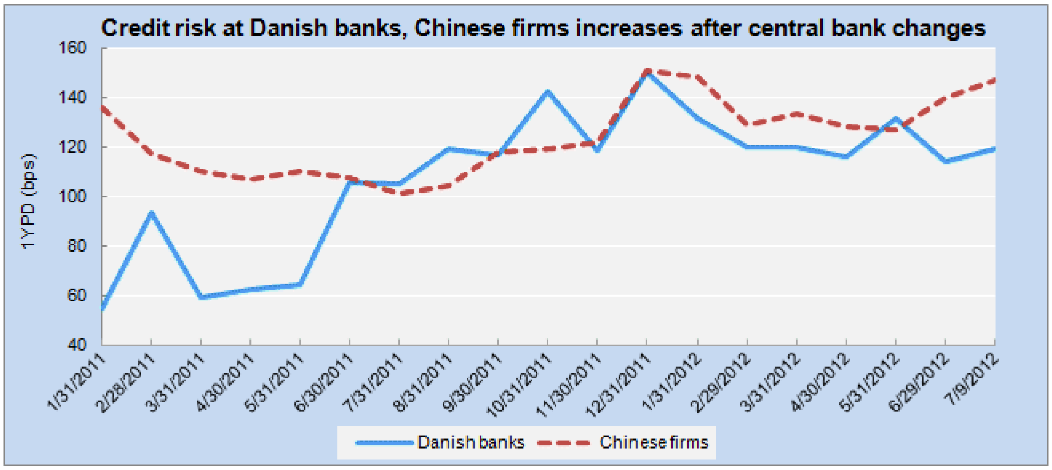
The ECB, the BoE and the PBOC each loosened their respective monetary policies in the space of an hour on July 5. The Danish central bank also cut key rates the same day, as the Kroner is tied to the euro. These moves followed growing concerns about a slowing world economy, with firms around the world increasingly coming under stress as economic growth declines and banks reduce lending. Rumors regarding coordination between central banks were dismissed by ECB President Mario Draghi. RMI data shows these central bank actions have had a relatively minor affect on the credit outlooks within the respective economies.



The eurozone: The ECB cut its benchmark lending rate 25bps to a record low of 0.75% on July 5. The ECB also reduced the rate it pays on overnight bank deposits 25bps to 0%, in an attempt to encourage banks to increase lending to the real economy instead of hoarding cash at the ECB. However, eurozone banks may continue to be hesitant about lending to each other or to businesses while concerns about a further intensification of the eurozone crisis remain. The annual rate of loan growth within the eurozone continued to fall during May, with loan growth in the private sector falling to 0.4% from 0.8% in April. Reflecting increasingly difficult credit conditions, the RMI 1-year aggregate PD for eurozone firms has returned to late-2011 highs in recent weeks. ECB President Mario Draghi signaled he is willing to pursue further monetary stimulus if required, within the ECB's mandate.

UK: The Bank of England (BoE) maintained rates at a record low of 0.5% on July 5, but announced it would increase the size of its asset purchase program by GBP 50bn to GBP 375bn, on concerns inflation would undershoot the 2% target rate. Estimates have pointed to a possible technical recession in the UK, as expansion in key export markets has slumped. Although the BoE has successfully driven down borrowing costs to record lows and continued liquidity providing operations, data from the central bank shows growth in lending to UK businesses fell 2.9% in May, after declining 6.3% in Q1. Notably, the RMI 1-year aggregate PD for UK firms has recently returned to levels last seen in late-2011.

Denmark: Following the ECB's rate cut, Denmark's central bank Nationalbank cut its key lending rate 0.25bps to 0.2% from 0.45%. The bank also cut the certificate of deposit (CD) rate to negative 0.2% from 0.05%, the first time the rate has fallen below zero historically. The rate changes are expected to cost Danish banks DKK 200mn a year. This cost could increase if further appreciation of the kroner forces Nationalbank to move to more negative rates. Two rate cuts independent of ECB monetary policy towards the end Q2 were aimed at stemming the appreciation of the kroner. The 1-year aggregate PD for Danish banks increased slightly after the rate cut; past volatility reflects increased investor concern about the health of the domestic mortgage market.



China: The People's Bank of China (PBOC) lowered its key lending rate by 31bps to 6% on July 5, and the household deposit rate by 0.25% to 3%. This is the second rate cut in the space of a month by the PBOC, after a 0.25% reduction of both rates on June 7, the first interest rate cuts by the PBOC since 2008. These aggressive moves are aimed at promoting growth, as restrictions on investment in the domestic housing market and an export slump caused by problems in Europe weigh on the economy. Data released on July 10 reflected a slowdown in the domestic economy, with import growth missing estimates and exports slowing. A continuing slowdown may place China's export dependent economy under pressure, despite the country's trade surplus increasing by USD 31.7bn in June. The RMI 1-year aggregate PD for Chinese firms has remained high in recent weeks.

Sources:
ECB rate cut may not encourage bank lending (Reuters)
ECB signals readiness to do more (WSJ)
Denmark sets a negative rate for first time (Reuters)
Bank of England maintains Bank Rate, increases asset purchase program (BoE)
China cuts benchmark rates for second time in a month (Bloomberg)
China's June import growth misses estimates as exports slow (San Francisco Chronicle)

In the News
NYSE futures elevate GCF as Libor alternative **Jul 4** The ongoing LIBOR saga has increased interest in other short-term floating interest rates, in particular the General Collateral Finance Index (GCF). Instead of LIBOR's survey mechanism, the GCF is based on interest rates paid each day on collateralized repo transactions. Futures based on the index will begin trading on the NYSE's Liffe platform on July 16. The contracts should provide a more accurate hedge for repo related positions; Nomura and UBS have began using the GCF Index itself as a reference rate in interest rate swaps. Furthermore, recent plans by the US Treasury to issue floating rate notes with GCF as a possible benchmark should also increase interest in LIBOR alternatives. (IFR, WSJ)
Philippines upgraded, government urges CRAs to adjust criteria **Jul 4** S&P upgraded the Philippines to BB+, one notch below investment grade, citing the government's improved financial position. The previous day, Filipino Finance Secretary Cesar Purisima joined other emerging market leaders in criticizing CRAs for the use of criteria that almost unilaterally assigns developing countries lower credit ratings, despite higher growth rates and relatively lower government debt compared with developed economies. Market rates imply the country should be rated several notches higher. In January, the Philippines sold USD 1.5bn of 25-year bonds to yield 5%, 190bps lower than yields on similar securities issued by higher rated Spain. (Bloomberg)
Credit rating agencies face new scrutiny **Jul 6** The European Securities and Markets Authority (ESMA) announced it would begin inspections of Fitch, Moody's and S&P to determine whether their bank ratings are sufficiently rigorous and transparent. ESMA decided to focus specifically on bank ratings due to market concerns about the links between bank and sovereign ratings. The move is also prompted by recent changes to bank rating methodologies at Moody's and S&P, which led to a large number of bank downgrades globally. ESMA Chair Steven Maijoor

said ESMA will examine if recent bank rating changes were properly researched and thought-out. (FT)

Argentina forces leading banks to lend at low rates

Jul 6 Argentine president Cristina Fernandez last week ordered the country's largest banks to cap rates on loans to a maximum of 400bps over the key Badlar interest rate, which averaged 12.1% in June. Banks will be required to lend 5% of their deposits, or ARS 15bn, to SMEs at rates well below analysts' inflation expectations. The government has maintained that the inflation rate is below 10%, while analysts expect prices in Argentina to increase 25% this year. Decisions to tighten currency controls and trade restrictions have led to a slump in economic growth; the move may help reverse this trend. However, lending at negative real rates may erode the capital base of banks. (Bloomberg, Washington Post)

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