Credit Research Initiative

transforming big data into smart data

Weekly Credit Brief July 08 - July 14

Chinese developers' credit outlook suffers on profit warnings

China's housing prices fell for a second straight month in June with average new home prices falling 0.5% from May. According to data provider, China Real Estate Index System, 71 out of 100 cities showed a decline in home prices, up from 62 cities in May.

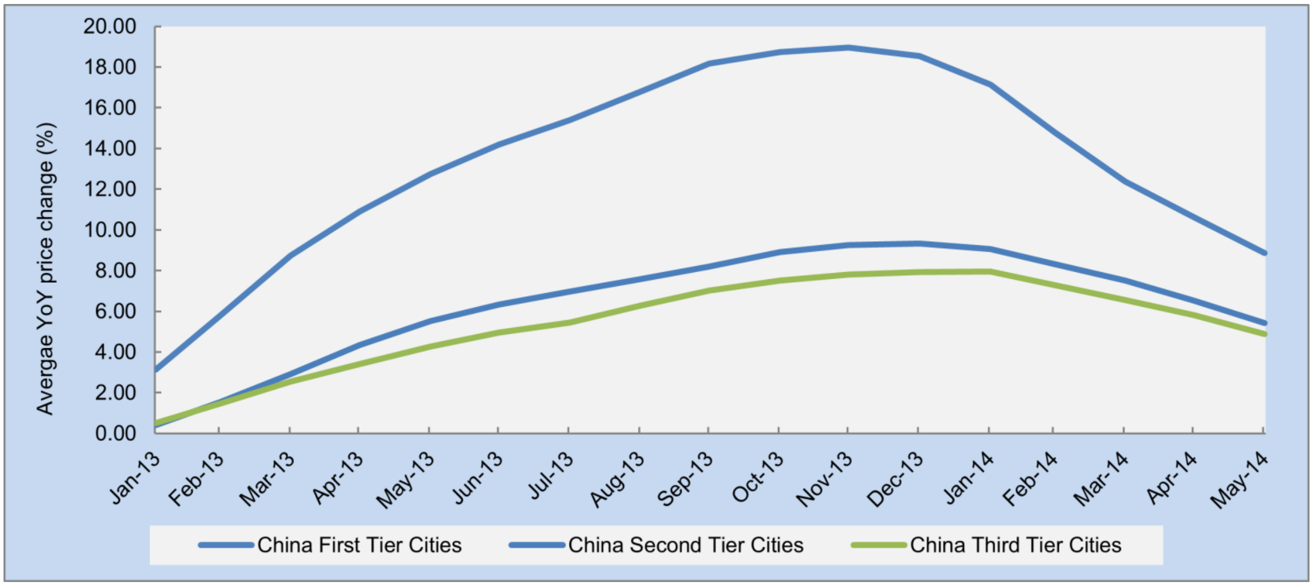

Chart 1: Average YoY change of newly built residential buildings in various Chinese cities. Source: *Bloomberg*

The lackluster China's property market has recently resulted in a profit warning from Chinese property developer Greenland Hong Kong. The RMI 1-year aggregate probability of default (RMI PD) for Chinese property developers listed on the Hong Kong Exchange has been hovering near the 50bps mark as shown in Chart 2 - a level last seen in May 2012. A slew of property cooling measures were introduced in 2011 in a bid to slow the rampant property market has now seen cracks appearing. Many Chinese cities have begun to roll back real estate curbs on purchases. Even China's central bank, the People's Bank of China has urged lenders to grant mortgages in a more timely and efficient manner to revive the sagging property industry, which accounts for 16% of China's GDP.

Evidences have surfaced that Chinese developers now face an increasingly severe credit outlook. China developers were seen tapping on Singapore for funding amid tightening credit conditions and weakening sales in the current slowing economy. The developers are now paying as much as 25% interest to borrow from trust companies as banks have reduced lending. However even access to the trust companies, seen as the country's fast-growing shadow banking system and the lender of last resort, may be turned off as the government told the trust companies this month to stop lending to certain developers.

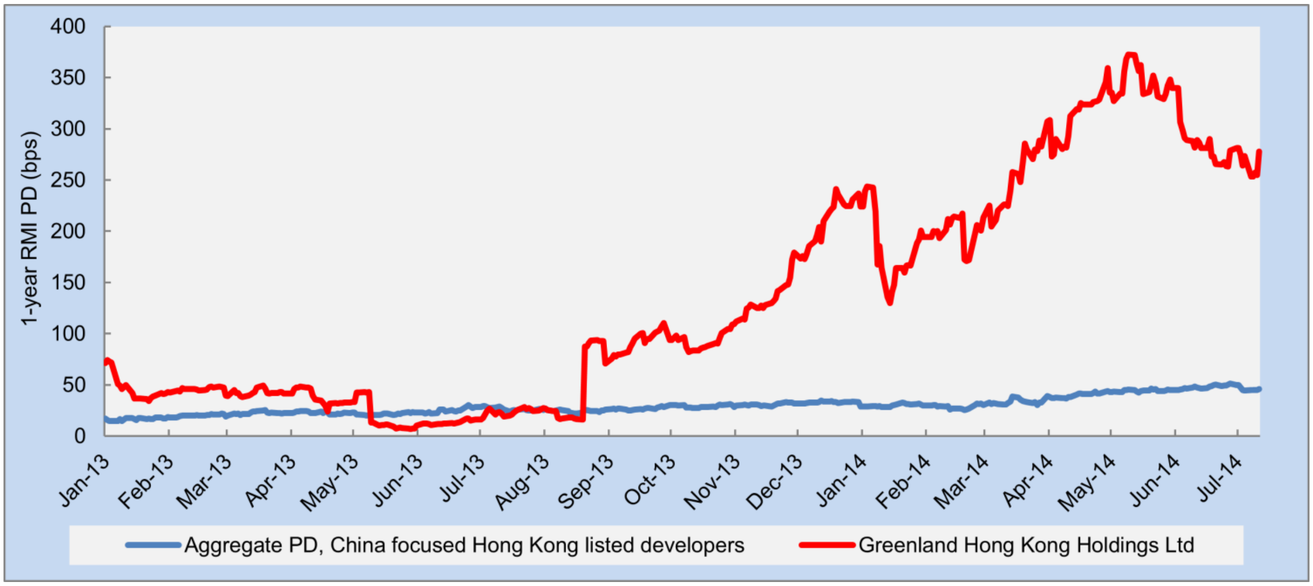

Chart 2: Aggregate RMI PD for China focused Hong Kong listed developers over the years. Source: *The Risk Management Institute*

The market cap of China's property developers have taken a hit this year with a sell-off accelerating in June. One example is, Evergrande Real Estate Group, the second biggest developer in China by sales, which witnessed a 20% drop in market capitalization during the month of June. The 5-year RMI Actuarial Spread (AS) for the company increased from 33bps to 47bps from the beginning of 2014 and the price of Evergrande's five-year bonds was down nearly 6%, hitting a 2014 high of 10.6% from 7%. The RMI AS was introduced by RMI-CRI on July 1 2014 as an alternate measure of credit risk using the RMI PD. Unlike CDS, the RMI AS is a pure measure of default risk, and is not influenced by risk premium and liquidity.

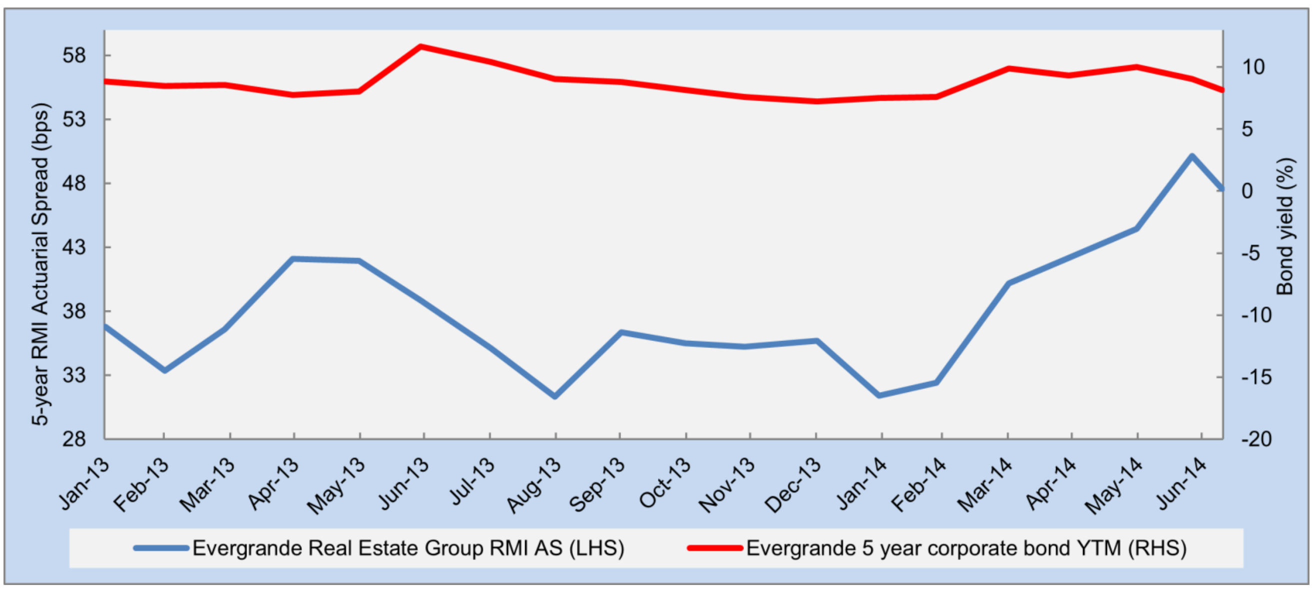

Chart 3: RMI Actuarial Spread for EverGrande Real Estate Group based on a 40% recovery rate vs its 5 year bond yield to maturity. Note that the bond is denominated in CNY while RMI AS is a USD denominated instrument. Source: *The Risk Management Institute, Bloomberg*

So far, cash-starved property developers have responded to tighter liquidity conditions by reducing prices and slowing the supply of new homes to the market. However, buying sentiment has been affected as China's property transactions have decreased 10.2% in the first five months of this year. According to property research body China Index Academy's China Real Estate Index System (CREIS), the floor area of sold houses dropped 34%, 20% and 37% YoY in Tier 1, Tier 2 and Tier 3 cities respectively in May. Some home buyers had lost their upfront deposits after developers ran away with their cash and left them with uncompleted residences. As a result, many prefer to purchase completed homes, which forces developers to abandon presales pitches.

Credit News

Europe needs USD 795bn problem property loan solution

Jul 14. According to Cushman & Wakefield, European banks and asset managers could sell or restructure EUR 584bn (USD 795bn) of riskier real estate to strengthen their balance sheets. During the first half of the year, lenders, asset managers and bad banks in Europe have sold EUR 40.9bn of property-tied loans. Banks such as Royal Bank of Scotland planned to sell more loan portfolios as a result of the falling borrowing cost. In response to the upcoming ECB stress test, the current high levels of activity in the market could be sustained in the next few years. (Bloomberg)

Singapore Q2 GDP slows due to decline in manufacturing output

Jul 14. Singapore's GDP declined by an annualized rate of 0.8% in Q2 after rising 1.6% in Q1, falling short of economists' expectations. Even as Singapore's major trading partners – US and Europe, are witnessing an economic recovery, higher labour costs in Singapore are causing many manufacturers to move production functions out to other destinations. During the recent quarter, manufacturing output fell 19.4% QoQ. (Bloomberg)

Bulgaria's fourth-largest bank goes bankrupt amidst a run on banks

Jul 13. The Bulgarian Central Bank commenced bankruptcy proceedings against Corporate Commercial Bank (known locally as KTB), Bulgaria's fourth-largest lender on July 11 after an audit showed that crucial records pertaining to a large portion of the bank's loan portfolio were missing. This followed after a month-long run on KTB and another bank, First Investment Bank when fearful depositors pulled out their savings from the two lenders. The central bank also said that KTB's largest shareholders took away more than USD 136mn in cash from the bank's vaults before the bank run. This is the first banking collapse in Bulgaria since the 1990s and points to potential financial troubles in the European financial system. (The New York Times)

Sterling Trust Revocation increases odds of loan default (Bloomberg)

Global watchdogs search for new credit bubble risks (SCMP)

Regulatory Updates

China regulator orders banks to create firewall around wealth management services

Jul 14. The China Banking Regulatory Commission (CBRC) instructed mainland China banks to create firewalls around their wealth management units so as to prevent a contagion from increasing defaults from wealth management products. Over the past few years, wealth management products have become increasingly popular with investors because of the higher yield it provides. In the first 5 months of the year, the outstanding book value of these wealth management products have increased by almost CNY 14tn, which is about 27% of mainland China's GDP for 2013. The ratio of wealth management products to other assets has increased for many banks beyond the industry average of 8%. The regulator now requires the banks to have separate departments for risk management, accounting and statistical analysis for wealth management services to better manage the risks. (South China Morning Post)

BoE in favour of easing Basel capital requirements on small lenders

Jul 13. The Bank of England has expressed its view that to offer a more even playing-field for the smaller banks to compete with their larger counter-parts when offering mortgage and small business loans, the smaller banks must have lower regulatory capital requirements. Accordingly, the BoE has been lobbying with the Basel Committee on Banking Supervision (BSBS) to soften the standardised risk weights used to calculate how much capital needs to be set aside for retail loans. According to current guidelines, smaller banks are required to calculate their capital requirements using the standardised risk-weights, which obliges them to put up more capital for regulatory compliance and less capital for lending. (FT)

ECB keeps banks on tight leash with October test results

Jul 09. The European Central Bank (ECB) is proposing to give banks 48 hours to review the stress test results in October before releasing the information to the public, which banks said is too short for any accuracy check. The ECB said that the time frame was reasonable given that it would not breach market disclosure rules. The comprehensive assessment, including an asset quality review (AQR) and a stress test, will review banks' balance sheets and their ability to withstand shocks and stress. The final result, scheduled to be released in October, will also disclose banks' leverage ratios, total assets, risk exposure and common equity tier 1 capital. (Reuters)

ABS industry fears impact of EBA risk transfer rules (Reuters)

Questions over US CCP liquidity rules (Risk.Net)

Published weekly by Risk Management Institute, NUS | Disclaimer
Contributing Editor: Dexter Tan