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Weekly Credit Brief
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Story of the week

ECB package seeks to provide a steroidal boost to European firms
By Chiranjiv Sawhney

In the past two years, Europe has seen steady improvements in its economic and market conditions. Since June 2012, the aggregate 1-year RMI PD for European domiciled firms* has more than halved from 51.6bps to 22.1bps (see Figure 1). European stocks have gained 42% (as gauged by STOXX Europe 600 index) and yields for peripheral sovereign bonds have fallen by hundreds of basis points. A pro-active central bank, led by Mario Draghi can be credited for at least some of the economic recovery made by the bloc.

Despite these marked improvements, Europe has been confronted by a number of obstacles – at the forefront of which lies extremely low inflation and slow growth. To stave off the same, the European Central Bank (ECB) announced a series of dramatic measures on Friday, June 5. These radical measures included EUR400bn of cheap loans for Eurozone banks; negative deposit rates, preparatory work for outright purchases of asset backed securities and suspension of weekly fine-tuning operation sterilizing liquidity injected under the Securities Market Program. Draghi even went on to say that the bank is still willing to embark on some kind of quantitative easing if low inflation persists. These measures loosen the noose on Europe's cash-strapped firms as the ECB pushes banks into lending mode. As a result, the RMI 1-year PD of aggregate European companies has been on a downward trend, tracking the much anticipated move by the ECB. After the announcement, European stocks rose to near a six-year high and bond yields fell. Italian, Spanish and Irish bonds led the rally, with their yields falling to record lows.

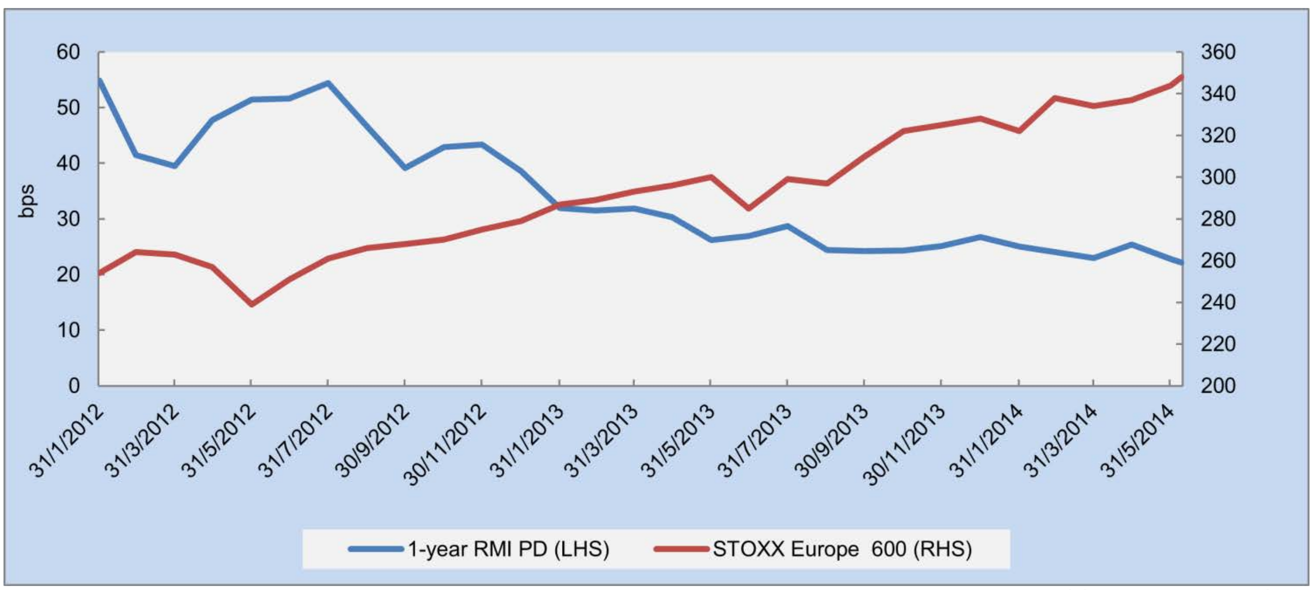

Figure 1: 1-year aggregate RMI PD for European domiciled companies vs STOXX Europe 600 Index. *Source: Risk Management Institute, Bloomberg*

Market participants view the central bank's EUR400bn of loans as the most importance piece of the package. This measure provides a more 'real' stimulus to the economy as it will encourage European banks to start lending to small businesses and replicate the success achieved by the lending scheme in the UK. The ECB however said that it will only allow banks access to these cheap funds if they comply with the commitment to lend. A possible hurdle in the effective implementation of this plan will be the upcoming ECB stress tests. These tests discourage banks from lending to all but the most credit-worthy borrowers. Until these tests are over, lending might not take-off at the desired pace. On the other hand, the negative deposit rate, introduced for the first time by the ECB, acts as a deterrent to banks from hoarding money and thus spurs lending. Of course, the negative interest rate will have no impact if lenders do not pass on the changes to businesses and households or if they simply move the funds out of the eurozone.

Currently at 22bps, near a multi- year low, the 1-year aggregate RMI PD bodes paints a positive outlook for European firms. The latest measures, if effectively feed through to the 'real' economy, may provide further impetus and quicken the recovery process of the fragile economic bloc.

* The aggregate PD includes countries using EUR as their currency such as Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, The Netherlands, Portugal, Slovakia, Slovenia and Spain.

Credit News

Mexico's stocks climb with bonds as surprise rate cut sinks MXN

Jun 07. Mexico's stocks and bonds rallied following the unexpected central bank rate cut on June 6. The central bank cut benchmark lending rate to a record low of 3%, citing weakness in the economic growth. None of the analysts polled by Bloomberg had forecasted a change in rates at the policy meeting. After the central bank decision, benchmark IPC equity index climbed 1.4%, 10-year bond yields dropped 34bps and MXN (Mexican peso) dropped 0.5% against the USD. (Bloomberg)

US fine threatens BNP Paribas rating

Jun 04. Standard & Poor's (S&P) warned that BNP Paribas' credit rating could be downgraded as the US regulators may impose a fine amounting to more than USD10bn on France's largest bank for violating US sanctions on Iran, Sudan and other countries. The bank may also be forbidden from transferring funds across US borders temporarily. (CNN)

Caesars receives notice of default from bondholder group

Jun 07. Caesars Entertainment Corp received a notice for default from bondholders on June 5, stating that the company defaulted on its obligation by transferring assets such as Bally's Las Vegas hotel to an affiliate, and by removing the parent company's guarantee on the operating unit's debt. The firm defended its action, indicating that the asset transfers followed an independent and rigorous process and was intended to provide liquidity to its businesses. (Bloomberg)

Singapore company debt soars to 'danger threshold' (International Business Times)

Billionaire Singer's smoking gun sparks default-risk jump (Bloomberg)

Regulatory Updates

Risk of banks dodging rules leads to US FDIC scrutiny

Jun 06. The US Federal Deposit Insurance Corp (FDIC) is looking at whether banks have restructured their overseas transactions in a manner that may undermine rules implemented under the 2010 Dodd Frank Act. The FDIC is concerned that banks have sidestepped the rules to remove parent guarantees from affiliates or specific transactions so that they can trade in the interdealer market free of Dodd Frank restrictions. Under CFTC rules, overseas affiliates that lack a parent guarantee face fewer restrictions than foreign branches or guaranteed affiliates of US banks. (Bloomberg)

EBA publishes methodology to identify and disclosure requirements for globally systemically important institutions

Jun 05. The European Banking Authority (EBA) has issued final guidelines to identify globally systemic important banks (G-SIIs) in a framework aligned with the recommendations proposed by the Financial Stability Board and the Basel Committee on Banking Supervision. According to the Regulatory Technical Standards document, EU member states are required to calculate a bank's individual score to measure its systemic importance every year. The scoring system uses twelve indicators which measure the impact of a bank's failure on the global financial system. In addition, the EBA also disclosed reporting guidelines for institutions with more than EUR 200bn of exposure and G-SIIs. (EBA)

China regulator to tighten shadow banking supervision

Jun 06. An official from China's Banking Regulatory Commission (CBRC) said that China will tighten supervision over the shadow banking sector. As per the comments, the regulator will improve ways to manage deposit-to-loan ratios and tighten control over provincial governments' financing and lending in property and industries suffering from over-supply. (CNBC)

Barclays fine spurs UK scrutiny of derivatives conflict (Bloomberg)

Cash banks keep with PBOC to be reduced (Shanghai Daily)

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