NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond

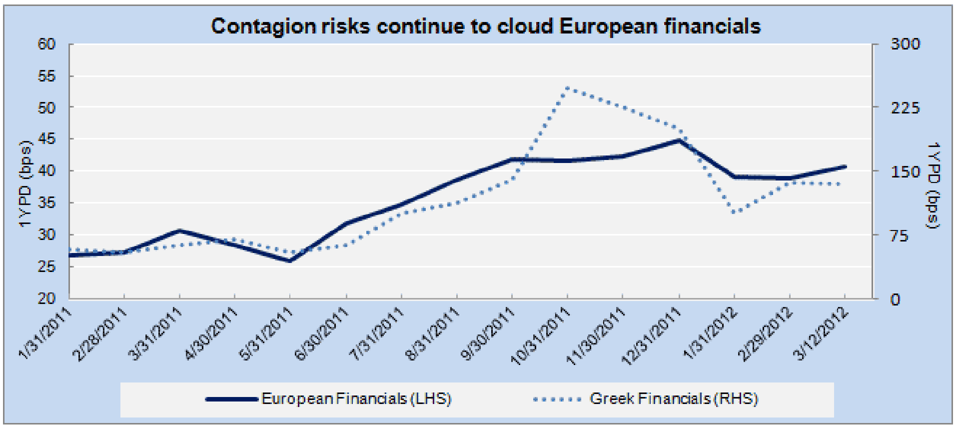
Weekly Credit Brief

Mar 6 – Mar 12 2012

<u>Stories of the Week</u>

Contagion risks continue to linger over European financials following Greek PSI success

Credit risk at European financial companies remained elevated last week despite Greece forestalling a disorderly default through a debt restructuring, as the RMI CRI 1-year probability of default (PD) for European financial companies rose to 40.8bps on March 12 from 38.8bps on February 29. Greece will be relieved of more than EUR 100bn of debt after confirmation that 95.7% of private investors will participate in the debt swap after the Greek government triggered collective action clauses (CACs). This paved the way for the country's second official rescue package.



Despite the restructuring, concerns remained in sovereign bond markets about potential contagion to other debt-laden European peripheral countries. Yields on 10-year Spanish government bonds edged up to 5% on March 12, from 4.8% on March 1. The yield curve of Portuguese government debts remained inverted, and the country's 3-year yield was little changed, staying above 15.5% since March 1. The STOXX 600 Banks index fell 4% to 150.9 on March 12 from 157.1 on March 1, as persistent contagion risks dampened the overall outlook for European banks. A similar index for Italian and Spanish banks dropped about 6% during the same period.

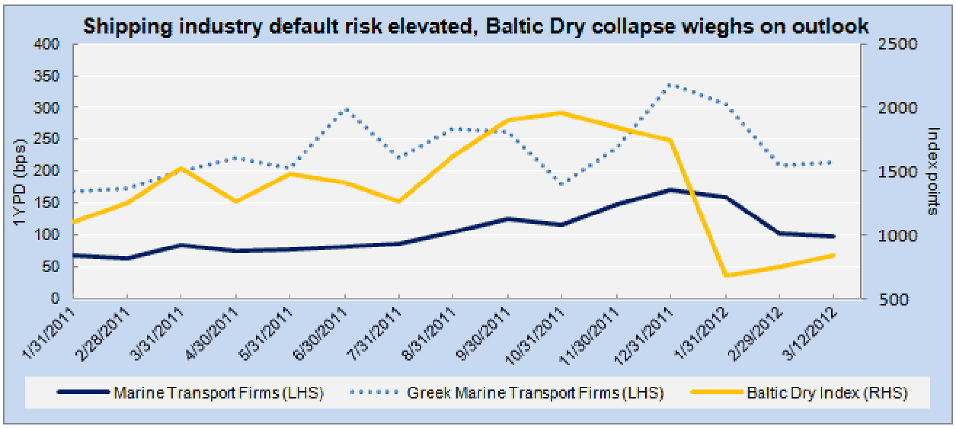
Last week's Greek debt swap marked the first sovereign restructuring in Western Europe in 60 years. On March 9, the International Swaps and Derivatives Association (ISDA) concluded that the Greek debt swap was a credit event, triggering a net payout of about USD3bn on Greek CDS. The ISDA's decision eased concerns regarding the viability of CDS protection for sovereign debt, and was an important factor in protecting investor appetite and support for European sovereign debt markets.

Nonetheless, the debt woes and recessions that have plagued Greece for years may continue, with the credit outlook of Greek financial companies clouded by the economic and financial fallout. Greece has entered a fifth year of recession in 2012 and the economy is expected to contract 4.4% from 2011, according to a forecast by the European Commission. The Greek government predicted that its 2012 budget deficit will grow to 6.7% from the original target of 5.4%. The RMI CRI 1-year PD for Greek financial companies rose to 135.6bps on March 12, reversing a slight drop from February 29 that was supported by a 50% increase in emergency liquidity to Greek banks by the Greek central bank.

Read more:
Exit Greece, pursued by bond bears (FT)
Greece Pushes Bondholders Into Record Debt Swap (Bloomberg)
Greece Deal Triggers $3B in Default Swaps: ISDA (Bloomberg)
Greek credit swaps ruling divides investors (FT)
Greece Will Increase Emergency Liquidity to Banks by 50% (Bloomberg)
Greece ups 2012 budget deficit target in draft law (Reuters)
EU Says Greek GDP to Shrink 4.4 Percent in 2012 as Prices Fall (Bloomberg)

Shrinking trade finance and faltering demand puts shippers at risk

The shipping industry is facing a deteriorating credit outlook, as unsustainable fleet sizes, a funding squeeze, and rates below operating costs weigh on balance sheets throughout the marine transportation industry. A slump in global demand in the last four years has weighed on demand for ships. Vessels ordered before 2008 are only now becoming operational, creating an oversupply of available ships, affecting key transportation rates. The Baltic Dry Index, a key benchmark in determining global shipping rates, fell 64.9% from an annual peak in October 2011 to an all-time low of 647 points on February 3.The index has recovered 29% since February 3, to 837 points on March 12.



However, funding is drying up as banks attempt to minimize exposures to the troubled sector. A retreat from trade finance businesses by eurozone banks has aggravated the situation, particularly in Asia. Shippers are already feeling the pressure; Indonesia' Berlian Laju tanker ceased making interest payments on its outstanding debt in January.

RMI data shows that a number of other shippers have exhibited high default risk in recent months. The RMI CRI 1-year PD for Denmark based tanker giant Torm reached 1728.7bps in November; the PD remained elevated at 1269.6bps on Feburary 29. The company is currently negotiating a further extension on loan repayments totaling USD 1.87bn. The 1-year PD for Eagle Bulk Shipping remained elevated at 556.8bps on March 12; down from a peak of 1000bps on December 31.The company faces USD73mn in debt repayments before June 30, and is unlikely to generate sufficient revenue to meet these obligations while freight costs remain low, as implied by the Baltic Dry Index.

In addition, further deterioration in the shipping industry's profitability could impair the economic recovery of Greece. As one of the world's largest shipping nations, Greece is highly dependent on the industry for employment and tax revenues. The credit outlook for this sector of the Greek economy has deteriorated significantly, as the 1-year aggregate PD for Greek marine transportation companies remained heightened on March 12.

Read more:
World's Shippers Struggling To Stay Afloat Amid Credit Crunch (International Business Times)
Shipping group Torm sees another debt reprieve (Reuters)

In the News
Scramble to sell US debt as yields hit record lows **Mar 6.** Global companies sold a record amount of dollar-denominated debts at historical low yields, capitalizing on low interest rates and strong appetite for higher-yielding investments than US treasuries. Both junk and investment-grade issuers have benefited from the growing trend. Notably, part of the accerelation in debt issuance in US markets was driven by European speculative-grade issuers, which face faltering bank lending and higher borrowing costs in euros. (FT, Bloomberg)
Asian hybrid bond issuance soars **Mar 7.** Asian companies have sold a staggering USD 2.3bn of hybrid bonds to date this year, approximately half the region's issuance last year. Such strong demand for higher-yielding bonds is primarily driven by high net worth individuals in Singapore, who are seeking higher yields while domestic interest rates remain low. (FT)
Banks still starving firms of capital, warns Vince Cable **Mar 7.** UK business secretary Vince Cable warned that banks are still reluctant to lend to SMEs, hampering economic recovery. He proposed to reduce bank capital requirements or pressure banks to lend more. A credit scheme for small businesses is being prepared for the government budget due on March 21. (The Guardian)
Canadian rating agency backs rotation **Mar 7.** Small Canadian credit rating agency (CRA) DBRS expressed support for a European Commision (EC) proposal requiring issuers to rotate CRAs they solicit, stating it would increase competition and reduce 'group-think.' The big three CRAs believe this regulation will damage capital markets. Larger CRAs also derided other aspects of regulations proposed by the EC, including an increase in legal liability, and increased regulation of rating methodologies. (FT, UK Parliament Video)
Clock ticks on buyout debt **Mar 6.** According to Dealogic, USD 550mn in loans made to European firms taken over in leveraged buyouts will fall due in the next 5 years. A weak economic outlook for the EU and higher refinancing costs may cause defaults rates to rise sharply. This could hit banks and private equity firms, hampering economic recovery. Some USD 69bn in LBO debt is due to mature in 2012. (WSJ)

Companies turn to bankruptcy again and again
Mar 6. Almost a quarter of the 17 US company's filing Chapter 11 bankruptcy in 2012 are repeat filers, unofficially dubbed Chapter 22 filers. This compares with six Chapter 22 filings in the whole of 2011. Most of the repeat filers failed to fix their operational problems or sufficiently restructure their outstanding debt, sometimes emerging from bankruptcy with even more debt. (Reuters)

Lehman amends Archstone suit after Zell Bids $1.5 Billion
Mar 7. Lehman Brothers will begin paying off its creditors and other claimants from April 17 under a liquidation plan finalized last year. The company will continue to exist through 2014 as the manager of residual assets. Lehman also filed a revised lawsuit against BoA and Barclays to stop them selling their remaining stakes in Lehman's biggest real-estate asset, Archstone Apartment, to Archstone's largest competitor. (Bloomberg, Fox)

Regulators consider LIBOR overhaul
Mar 7. Regulators from Europe, US and Japan are expanding their review of alleged manipulation by banks of LIBOR rates. UK regulators are set to discuss changes to the way LIBOR is set with industry participants. LIBOR rates could become subject to greater regulation. LIBOR is the benchmark rate for over USD 350tn contracts globally.(FT, Bloomberg)

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