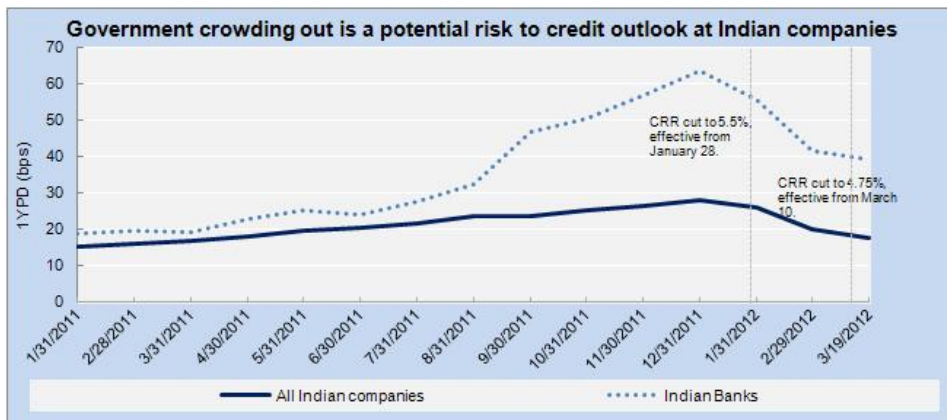


Stories of the Week

RBI liquidity boosting measures risk being undermined by government crowding out effect

Liquidity injections targeted by the Reserve Bank of India (RBI) in a series of easing measures announced this year could be undercut by the government's persistent budget deficit. Government debt issuance and banks' purchases of government securities have surged this year, fuelling inter-bank liquidity strains and a deceleration in the growth of credit extended to the real economy. The adverse effect on the credit outlook for Indian companies and banks from the persistent liquidity pressures could prove significant. RMI CRI data shows that the 1-year probability of default (PD) for Indian companies declined to 17.7bps on March 19, supported by RBI's decision on March 9 to slash the cash reserve ratio (CRR) by 75bps to 4.75%. The PD, however, was at a similar level with the PD of 17.9bps reached on April 30 2011, when the CRR was higher at 6%. This could in part indicate the latest CRR cut may have a limited effect on the liquidity and credit outlook for the real economy. Similar patterns are observed in the credit outlook at Indian banks, which recorded a PD of 39.1bps on March 19 and a similar level from August to September last year.



Attracted by high yields offered by government bonds, Indian banks have purchased INR 522bn of government bonds so far this quarter, almost three times as much as the INR 130bn purchased during Q4 2011. As a result, banks have slowed the pace of lending, with loans growing 15.6% in the year through February 24, the slowest increase since January 2009.

The government's crowding out effect was evident in the interbank market, where large government debt sales drained liquidity. The significant increase in government debt issuance has also led to increased yields on government debts, thereby driving interest rates on bank short-term debt instruments higher.

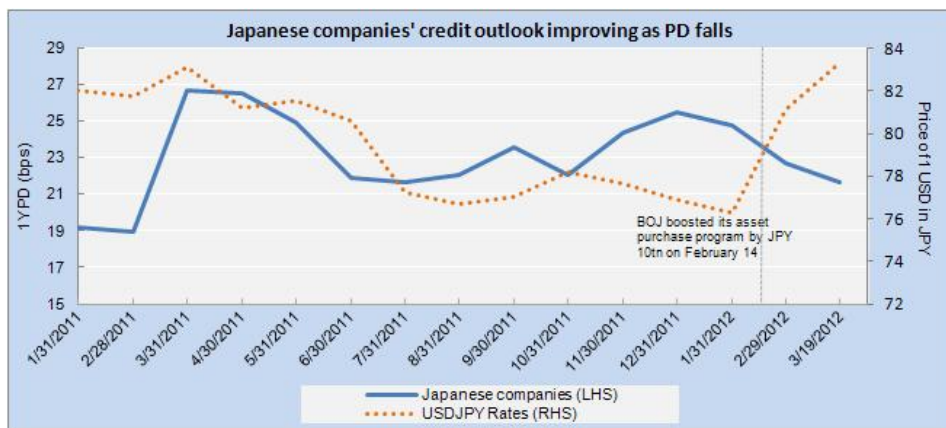
Credit growth may remain subdued as India enters a second consecutive year with a budget deficit above 5%, which will require a record fresh borrowing of INR 5.69bn by the government, exerting further crowding out effect. Meanwhile, anticipation for further monetary easing accompanied with potential interest rate cuts should keep the appetite for government securities buoyant.

Read More:

- [Sovereign Purchases Quadrupling Mimics U.S. Banks' Holdings](#) (Bloomberg)
- [Certificates of deposit rates near 3-year high](#) (Business-standard)
- [Singh Crowding Out Companies Pushes Rates to 11-Month High](#) (Bloomberg)
- [India Deficit Above 5% for Second Year Limits Rate-Cut Room](#) (Bloomberg)
- [RBI cuts CRR by 0.75 percentage points: to infuse Rs.48,000 crore](#) (India today)

Outlook improved in Japan despite BOJ withholding from further monetary easing

According to RMI CRI data, the credit outlook for Japanese companies improved, continuing a trend seen since the start of 2012. The RMI CRI 1-year probability of default (PD) for listed Japanese companies continued to decline after falling moderately during January, reaching 21.7bps on March 19. The improvement in the credit outlook for Japanese firms came despite the BOJ's March 13 decision to maintain the size of its asset purchase program, a disappointment to some market participants anticipating additional monetary easing after the BOJ expanded the program by JPY10tr in February.



A liquidity boost in February, combined with a decline in the yen, and signs affirming a US economic recovery have placed downwards pressure on the 1-year PD for Japanese companies. Despite the BOJ's decision to withhold further easing, favorable Yen movements and US economic data continued to underpin a decrease in the PD last week. As US unemployment benefit applications dropped to a 4-year low, the outlook for US household spending improved and the Yen fell to an 11-month low against the dollar, the outlook for Japanese companies seems brighter.

Besides placing further easing on hold, the BOJ last Tuesday announced that it will expand a separate 3.5tn-Yen loan scheme that was set up in June 2010 to provide low-interest loans to companies with growth potential seeking to expand overseas. The scheme is mainly targeted at promoting economic growth, and is seen as an inefficient method of boosting liquidity in the fight against ongoing deflation in Japan.

The BOJ maintains its stance on an accommodative monetary policy as tackling persistent deflation remains its main priority. Japan's core consumer price index (CPI) in January was 0.1% lower year on year. However, the possibility and the timing of further liquidity boosts were not made known to the public by the BOJ.

Read More:

- [BOJ refrains from easing, overrules lone stimulus proposal](#) (Reuters)
- [Japan Stocks Cap Sixth Weekly Gain on U.S. Economic Data](#) (Bloomberg)
- [Weekly US unemployment benefit applications drop to 351K, matching a 4-year low](#) (Washingtonpost)
- [Outlook for U.S. Consumer Spending Brightens on Employment Gains: Economy](#) (Bloomberg)
- [Japan's Nikkei Extends Eight-Month High as Yen Declines](#) (Bloomberg)
- [Loan scheme limited in impact / BOJ admits expanded loan program may not help to end deflation](#) (Yomiuri)

In the News
<p>Fitch lifts Greece out of default territory, risks still high Mar 16. Greece's credit rating last Tuesday was lifted to B- with a stable outlook by Fitch, the first major credit rating agency (CRA) to do so, as the agency cited the country's decreasing debt burden following the success of its recent debt swap. Meanwhile, the International Monetary Fund (IMF) last Thursday approved EUR 28bn in bailout funds as part of Greece's second bailout package. However, both Fitch and the IMF expressed concerns about Greece's sinking economy and a debt burden still considered unsustainably high. (Reuters, BBC, WSJ)</p>
<p>Basel Group May Reach Deal on Changes to Bank Liquidity Rule Mar 13. The Basel Committee on Banking Supervision will meet on March 20 and 21 to discuss possible adjustments to the controversial draft liquidity coverage ratio (LCR), along with other issues such as the draft net stable-funding ratio, and options for strengthening regulations of systemically-important banks. It was revealed that the discussion will focus on technical aspects behind the LCR rule, instead of its fundamentals. (Bloomberg)</p>
<p>Alternatives and more studies being proposed for controversial EU financial transaction tax Mar 13. The proposed EU-wide financial transaction tax continued to draw debate in the meeting of EU finance ministers last Tuesday, as a number of EU nations led by the UK and Sweden remained critical of the new tax. Stressing the urgency of reaching an agreement, several ministers proposed more studies on the effect of the proposed tax, and the exploration of alternatives such as an EU-wide stamp duty on share transactions instead of the all-encompassing financial transaction tax. (FT, Bloomberg)</p>
<p>China Said to Ease Lending Capacity Constraints for Banks Mar 15. China's banking regulator, China Banking Regulatory Commission (CBRC), last week raised the 2012 loan-to-deposit ratio target for three of the country's four largest banks, in an effort to tackle a slowdown in loan growth, believed to be partly caused by laggard deposit growth that restrains banks' lending capacity. Meanwhile, China's central bank governor last week revealed the possibility of further cuts in banks' reserve requirement ratios, but also mentioned a few preconditions for such cuts. (Bloomberg, WSJ)</p>
<p>Singapore takes steps to boost corporate bond liquidity Mar. 12 Anticipating that Asian banks may not be sufficiently able to fill the hole in trade financing caused by European banks' deleveraging, Singapore's central bank, the Monetary Authority of Singapore (MAS)</p>

announced new measures to increase liquidity in SGD-denominated corporate bond markets. The measures include providing swap liquidity for primary dealer banks, creating lending facilities and a price discovery platform for SGD corporate debt securities. ([Reuters](#))

EU allows ratings from third-country jurisdictions

Mar 13. The European Securities and Markets Authority (ESMA) has sanctioned the use of credit ratings that are issued by US-based CRAs after an April 30 deadline. The US became the third country in the world to receive such approval, after Japan and Australia. ESMA also ruled that the credit rating regulatory regime in the US, Canada, Hong Kong and Singapore accords with the EU standard. Meanwhile, the ESMA signed a Memorandum of Understanding with Singapore's MAS on the supervision of cross-border CRAs. ([Reuters](#), [Asiaweek](#))

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