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Transforming Big Data into Smart Data

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Story of the week

Sanctions on Russia increase risk for European banks
By Chiranjiv Sawhney

The crisis stemming from Ukraine has refused to ebb away. In fact, the situation has escalated and has now shifted the limelight to Russia, US and Europe. Over the past few weeks, US and its allies have announced sanctions on 33 politically-connected Russians, suspended Russia from the G-8 and now mulling further actions unless Russia decides to backtrack on its annexation of Crimea. Even though U.S and European sanctions on Russia are currently targeted at individuals, impact on Russian businesses is expected to be large. Many of these individuals hold important political and business positions. As such, the effect of these sanctions may feed into the businesses they hold. Furthermore, any tit-for-tat sanction will further aggravate problems between businesses of Europe and Russia. According to data from EU's Eurostat, Russia accounts for 7% of imports and 12% of exports in the 28 member European Union bloc – making it the region's third most important trading partner, behind the US and China. The US is a much smaller trading partner for Russia ~about a tenth of that of the EU at USD38.1 billion in 2012.

However, Russia stands vulnerable to US sanctions as it is quite dependent on the global financial markets for funding. The 1-year aggregate RMI PD data shows that the financial situation has deteriorated for Russian firms over the past 12 months. The aggregate RMI PD has more than doubled, from 46bps at the onset of 2013 to 93.5bps currently (see Figure 1). Thus, the US sanctions will only add to the existing worries for Russian businesses.

Figure 1: 1y aggregate RMI PD for Russian firms. *Source: The Risk Management Institute*

Underscoring the risk for Europe is the enormous exposure of European banks to Russia. Eight of the top ten lending countries to Russia come from Europe. Amongst these, France, Italy, Germany and UK at USD54bn, USD35bn, USD30bn and USD19bn respectively, take the top five spots (see Figure 2).

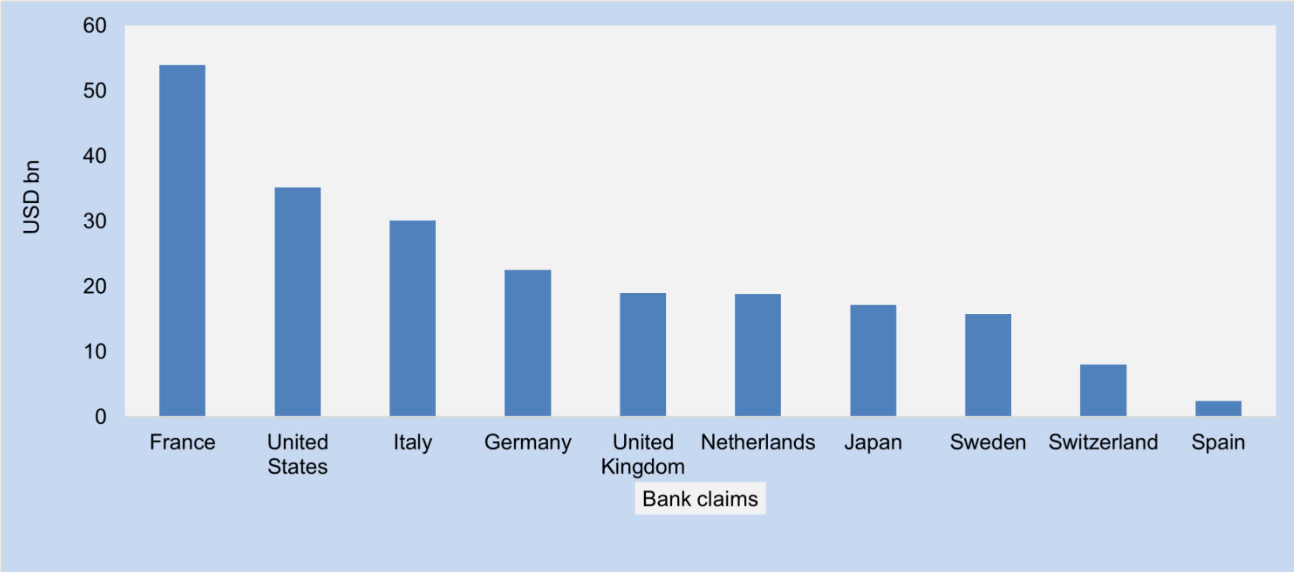

Figure 2: Bank exposure to Russia by nationality of reporting banks. *Source: Bank for International Settlements*

Just last week, unlisted global iron ore producer, Metalloinvest arranged a USD1.5bn export financing facility a club of international banks including France's 3 biggest lenders (BNP Paribas, Societe Generale and Credit Agricole), Germany's Deutsche Bank, UniCredit of Italy and ING of Netherlands. Metalloinvest is owned by Alisher Usmanov. There have been repeated calls by Russia opposition leader, Alexi Navalny to add Usmanov's name on the name list for sanctions.

Societe Generale, one of France's biggest lenders, the extraordinary increase of net income in 2013 was also partly due to the business done in Russia. SocGen Russia delivered an operating income of EUR239mn last year, almost double the operating income of 2012. The 1-year RMI PD for Soc Gen has risen 15bps in the past three months. Russian exposure now adds additional risk to the firm's finances.

However, not all is lost for Europe's financial sector. The aggregate PDs for banks of France, Italy, Germany and the UK are still below 50 bps (see Figure 3). Moreover, under the strict Basel III regulations, banks have set up mandatory shock buffers and thus have some means to cushion the less favourable scenario.

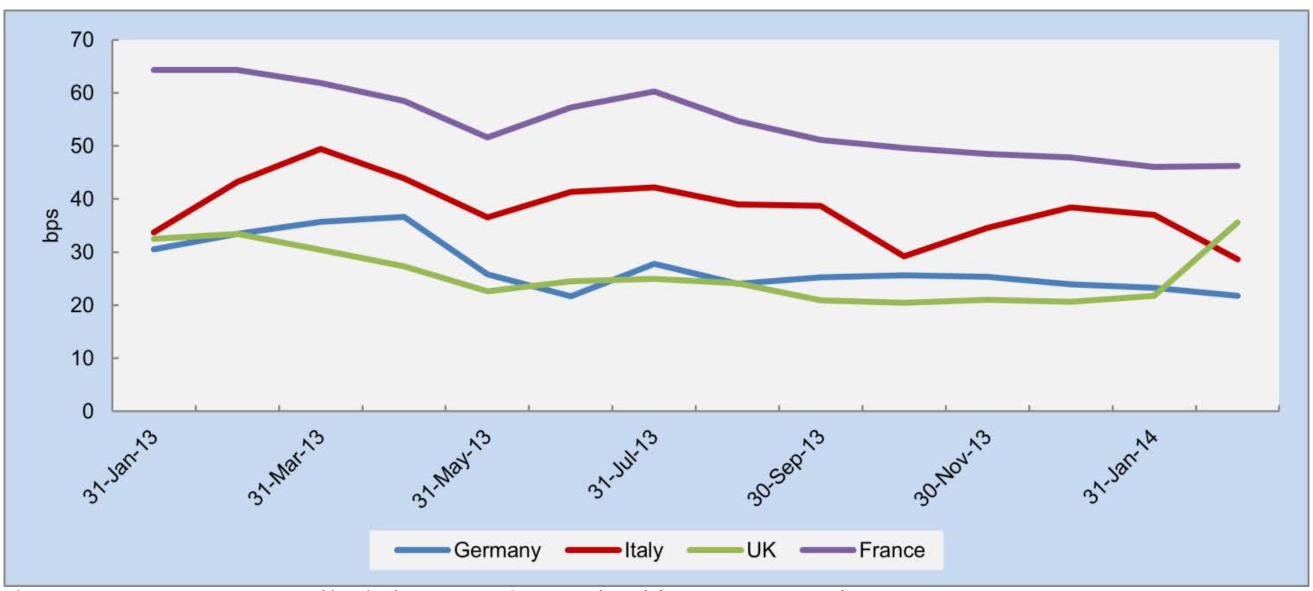

Figure 3: Aggregate 1y RMI PD of banks by country. *Source: The Risk Management Institute*

Credit News

China's manufacturing index slips to 8-month low, but new export orders show growth in March

Mar 23. HSBC's flash Purchasing Managers' Index (PMI) fell to an eight-month low of 48.1, down from 48.5 in February, missing economists' expectations of a reading of 48.7. PMI reading above 50 indicates expansion in manufacturing activity while a reading below 50 signals contraction. This reading suggests that China's growth momentum continues to slow down and domestic demands are expected to soften further. While most of the sub-indices showed deterioration, new exports orders showed growth in March, the first in four months. (International Business Times)

Europe strikes deal to complete banking union

Mar 21. Europe took the final step in completing a banking union last week, as officials agreed on an agency to shut down failing banks in the Eurozone. Under the agreement, the ECB will be given the primary role in triggering a bank shut-down, making it harder for EU nations to challenge bank closures, and putting pressure on lenders ahead of this year's health check. The agreement also covered the setting up of a common EUR 55bn back-up fund to cover shut-down costs, along with provisions that allow the fund to borrow to replenish spent money. (Reuters)

China credit strains rise as Beijing embraces failure (Chicago Tribune)

Greece targets return to bond markets as troika deal reached (Bloomberg)

Spain relaxes debt charges for banks aiding weak companies (Reuters)

Regulatory Updates

SEC said examining hidden electronic bond trading prices

Mar 21. The US Securities and Exchange Commission (SEC) is studying whether the current practice to turn bond quotes on and off allows bond market manipulation and whether smaller investors are being quoted worse prices by bond brokers. Regulators want to know the reason why dealers do not allow clients to view the prices for fixed income securities. Electronic systems are increasingly being used to trade bonds as banks use the electronic platforms to aggregate the number of bids and sell bonds on behalf of clients. Separately, the SEC is also examining the manner in which largest US banks allocate bond offerings and whether preferential treatment has been given to certain clients. The US bond market has increased to USD 39.9tn from USD 33.6tn in 2008 as the Fed held borrowing costs near zero and bought Treasuries and mortgage debt worth trillions of dollars. (Bloomberg)

Federal Reserve releases stress test results

Mar 21. The US Federal Reserve revised the stress test results for 15 banks, releasing a weaker outcome for Bank of America, American Express and HSBC North America Holdings. Despite the revisions, 29 of the 30 banks were said to have sufficient capital to survive severe economic hypothetical scenarios presented in the stress tests. The scenarios included a drop in economic growth rates, a large drop in housing prices and a significant gain in unemployment. Fed officials said that the revisions were due to the treatment of dividend increases and stock buybacks that took place in Q4 2013. US banks have voiced their displeasure over previous results of the Fed's stress tests, as they say that central bank does not disclose enough information about the test metrics it is using. (WSJ)

European regulators warn as risky loans rise above bubble peak (Financial Times)

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Contributing Editor: Chiranjiv Sawhney