Weekly Credit Brief

Mar 26 - Apr 01 2013

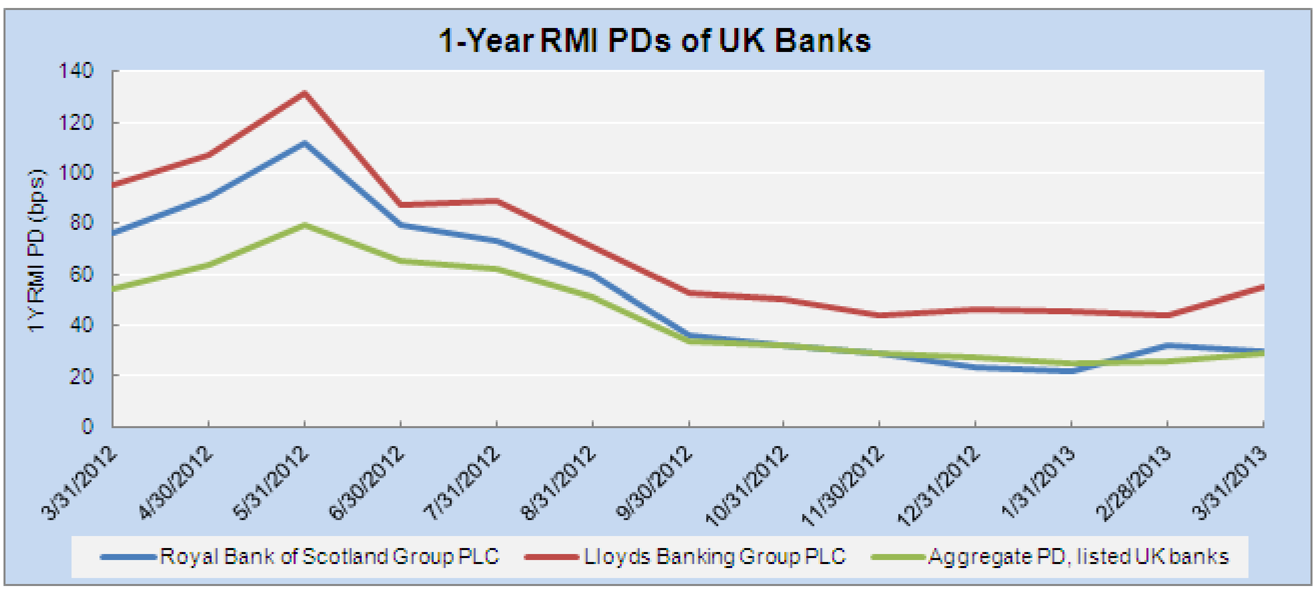
News of the Week

UK banks face GBP 25bn capital shortfall

The Bank of England's (BOE) Financial Policy Committee (FPC) warned that UK banks face a capital shortfall of GBP 25bn, as a result of the banks underestimating the potential losses and fines they face over the next three years by GBP 52bn. The banks will need to plug the capital hole by the end of this year, with half of the shortfall already covered by banks' existing capital plans. The two part-nationalized banks, Royal Bank of Scotland (RBS) and Lloyds Banking Group, account for about GBP 9bn of the remainder of the shortfall. The FPC also made it clear that the capital shortfall will not require any more cash injections from taxpayers.

RBS and Lloyds may not need to issue shares to raise capital after the BOE applied rules more flexible than the ones prescribed by European regulators. By targeting a core Tier I capital ratio of 7% by the end of 2013 rather than 10% by 2019 as required by the Basel rules, firms do not need to raise as much capital. Both RBS and Lloyds have already been consolidating their operations and de-risking rapidly by selling non-core assets in an attempt to bolster their balance sheets. Nevertheless, the central bank's focus on loan losses could still hurt the two banks because of their commercial real estate holdings, while banks with investment-banking operations would be most affected by the changes to risk weights.

As can be seen from the below graph, the 1-year RMI probability of default (PD) for Lloyds slightly increased by around 10bps in March from the month before, whereas the RMI PD for RBS remained closely aligned with the overall banking sector's level. The market has reacted modestly to the news as speculation about the size of the total shortfall started months ago and the actual estimate was at the bottom end of the GBP 20bn to GBP 50bn range the FPC identified last year. Investors are likely to remain cautious until there is more information regarding the individual banks' capital positions.



Sources:
Financial policy committee identifies GBP 25bn capital shortfall in UK banks (The Guardian)
RBS and Lloyds to raise extra GBP 9bn (Financial Times)
UK banks seen avoiding share sales after BOE capital review (Bloomberg)

In the News

Italy's five-year debt costs highest since October

Mar 27. Italian treasury sold EUR 3.91bn of a new 5-year bond at a yield of 3.65%, the highest since October and up from 3.59% for a similar bond auctioned on February 27. Investors seem to be reacting to the political stalemate in Italy and the Cyprus bailout deal. Rumors about a downgrade of Italy by the major credit rating agencies have also dampened the bond market. Both Moody's and Standard & Poor's put the country on negative outlook (Reuters)

Bank of Cyprus's customers may lose as much as 60% on deposits

Mar 31. The levy on Bank of Cyprus Plc accounts exceeding EUR 100,000 may be as much as 60%. The Nicosia-based central bank said that customers with deposits above this amount will have 37.5% of the excess converted into shares with full voting rights and access to any Bank of Cyprus dividend. An additional 22.5% will be temporarily withheld to ensure the bank meets its recapitalization needs, and may later be converted into shares after an independent valuation of the bank. The remaining 40% not subject to the bail-in will be temporarily frozen and will receive interest at 10% above current levels before its eventual release, said to be "within a short time-frame" by the central bank. (Bloomberg)

Asian central banks studying risks posed by shadow banking

Mar 29. Asian central banks are reviewing the possible risks of shadow banking activities in the financial system across the region. The financial crisis in the United States has demonstrated that shadow banking system, or non-regulated banking activities, contribute to the fragility of credit markets and have systemic implications to the financial system. The Asian regional grouping of the Financial Stability Board has set up a working group two weeks ago to study the unregulated lending practices taking place in the region. Bank Negara Malaysia governor Tan Sri Dr Zeti Akhtar Aziz said that the study will compile data and examine the regulatory framework to effectively address the potential risk from this sector.
(Business Times)

New proposed limits on mortgage loans to have less impact on UAE economy

Mar 30. The Central Bank of UAE has given an initial approval to a proposal by the UAE's banking association on setting the limits for residential mortgage loans at 80% of the purchase price for UAE nationals and 75% for expatriates on first homes. Ratios for subsequent homes would be 65% for UAE nationals and 60% for expatriates. This comes after the Central Bank first announced its badly received plans in December to restrict loan-to-value ratios for mortgage lending to expats and Emiratis at 50% and 70% respectively. The revised limits may save Dubai and the UAE a potential GDP loss of up to 5.71% and 1.43% respectively, according to a study recently conducted. (Gulf News)

China tightens rules on bank finance product sales

Mar 27. The China Banking Regulatory Commission (CBRC) has started regulating banks for the investment products they sell, to avoid potential risks to the financial system. The CBRC ordered banks to disclose all information of their wealth management products, and also limits bank investments in such assets at no higher than 35% of total outstanding wealth management products, or no more than 4% of total assets – whichever is the lower amount. These "wealth management" products include various credit instruments and allow banks to remove liabilities from their balance sheets. (Reuters)

Loan gains smallest since 2008 as Fed sees froth

Mar 28. Leveraged loans, or loans to borrowers that are already considerably leveraged, are delivering the smallest returns at the start of a year since 2008 as the Federal Reserve and other regulators warn of an emerging bubble in the $561 billion market. Speculative-grade loans have gained 2.1% in 2013, compared with an average of 5.6% in the same period the last four years, according to the Standard & Poor's/LSTA US Leveraged Loan 100 Index. The slowdown may signal market reaction to the Fed statement that said money for the neediest borrowers is too easy even though default rates are below the historical average. (Bloomberg)

Asia bond offerings pause for Easter after quadrupling in March

Apr 1. Borrowers outside Japan paused sales of USD-denominated bonds last week after issuance quadrupled in March. Offerings surged to USD 17.6bn last month from USD 4.4bn in February as monthly borrowing costs averaged 3.59%, the least since January, according to HSBC indices and data compiled by Bloomberg. Issuance in the region posted a quarterly record high of USD 45.4bn in Q1, which may have contributed to lackluster bond performance. USD-denominated notes sold by Asian companies returned 1.04% last quarter, the least since the three months ending September 30, 2011 when they lost 4.5%, according to Bank of America Merrill Lynch index data. (Bloomberg)

India cuts key interest rate to spur economy (Global Post)

Bunds show true Cypriot Backlash as Italy insulated (Bloomberg)

Piraeus acquires Greek operations of three Cypriot banks (English Capital)

Qatar economy grew 6.2% in 2012 (Arab News)

GCC 'single currency to further strengthen economic stability' (Arab News)

Kuwait posts USD 60.5bn budget surplus (Arab News)

UAE's banking assets surge by AED 129.5mn (Gulf News)

Islamic banks pressed to diversify money market deals (Arab News)

Argentina one-sixth bond offer seen as 'thumbing nose' (Bloomberg)

Taiwan holds key rate a seventh time as economy seen recovering (Bloomberg)

Published weekly by Risk Management Institute, NUS | Disclaimer
Contributing Editor: Ang Chung Yuh