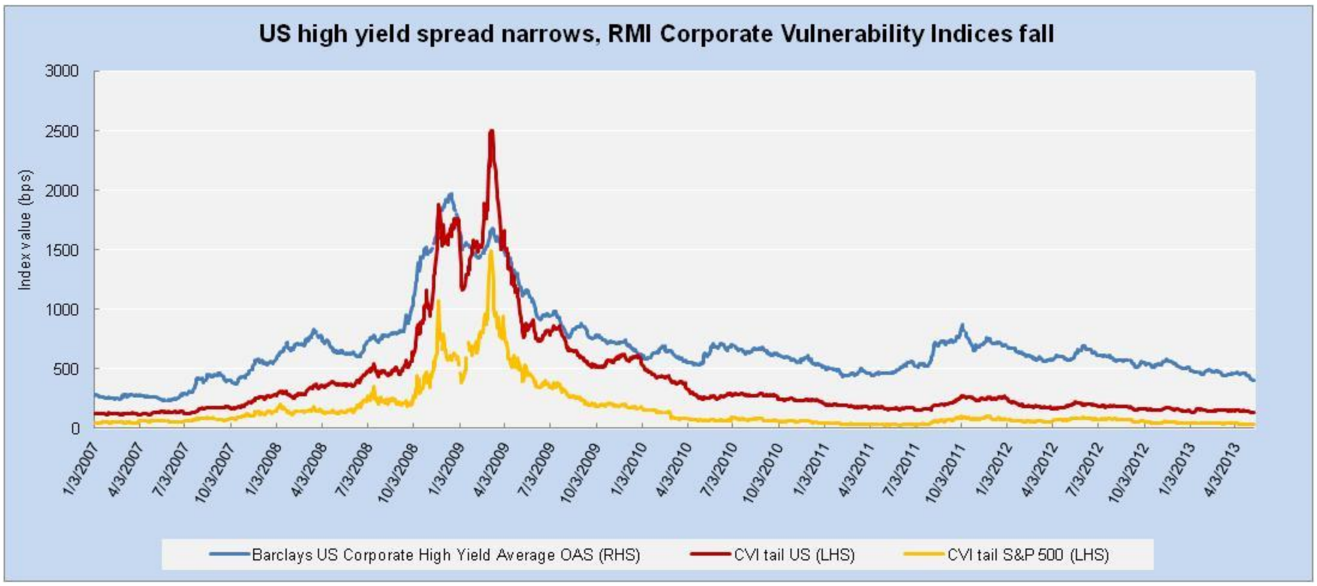
Weekly Credit Brief
May 07 - May 13 2013

**Chart of the Week**

**The junk-bond crusade marches on**
By Ang Chung Yuh

The pendulum in US financial markets may have swung from fear to greed as the risk premium on US junk-rated bonds fell last week to the lowest level since 2007. The option-adjusted spread (OAS) on the Barclays US High Yield Index, a measure of the compensation that investors receive for the higher risk of default relative to Treasuries, stood at 4.02% on May 10. Elsewhere, the average yield for junk bonds issued in EUR was at a record low of 5.68% on May 9, according to a Markit Index.

Loose monetary policy by the world's major central banks has pushed yields to record lows and spurred demand for bonds with ratings below investment grade. Issuance of EUR-denominated junk bonds has reached a record USD 54.5bn this year, up from USD 32.9bn a year earlier; in the US, year-to-date issuance as of May 10 totaled roughly USD 132bn, slightly ahead of the record pace over the same period last year.




The above graph compares the high yield OAS against a proxy of the credit risk of the most vulnerable US corporations, the RMI Corporate Vulnerability Index tail. The RMI US (CVI) tail, a bottom-up measure of the credit risk of the most vulnerable listed firms in the United States, fell this year to the lowest level since 2007, in line with the OAS trend on the Barclays index. The RMI S&P 500 CVI tail, which measures the same risk of the S&P 500 firms, exhibits a similar course.

This suggests that the decline in risk premium on US high yield bonds came with a corresponding improvement in the fundamentals of companies with the worst credit profiles. It is worth noting that the 4.02% OAS is still far wider than the historic low of 233bps recorded on May 23, 2007. If history is any guide, the current yield on speculative bonds may still be reasonable. Furthermore, the risk-free status of US Treasuries may have to be re-evaluated considering recent economic developments; and if Treasuries are no longer AAA, the current lower yield spread is only natural.

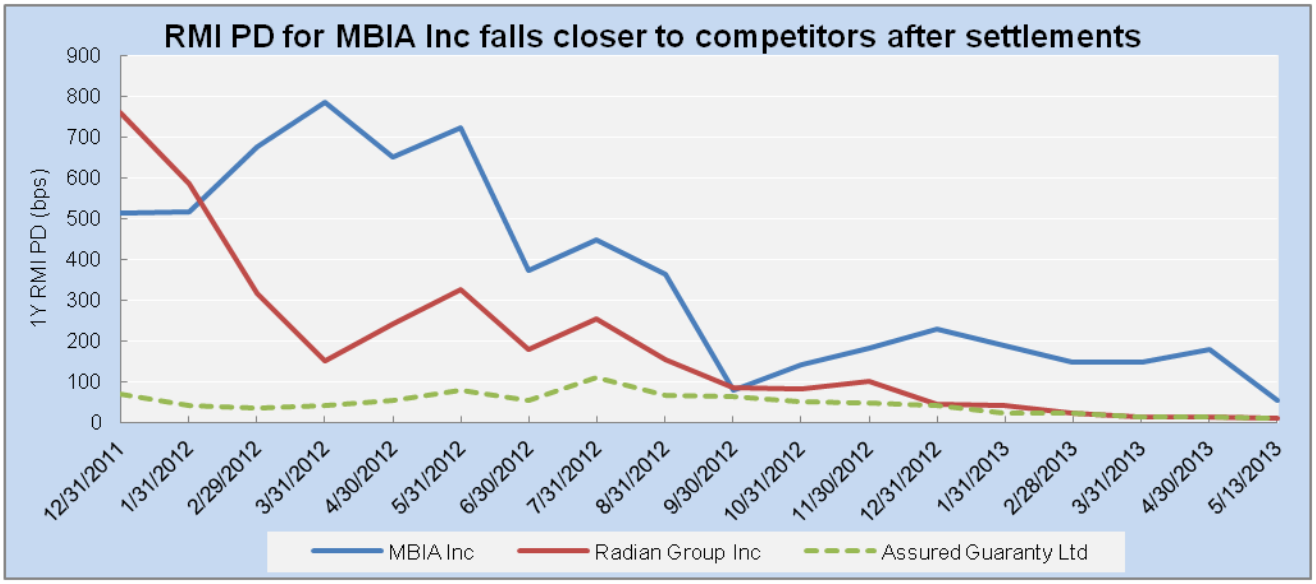
**Sources:**
US high yield bond volume hits USD 11.3bn for week ended 5/9/13 (S&P Capital IQ)
Clamor for Junk Debt Gets Stronger (WSJ)
Yield hunters spark junk bonds frenzy (Financial Times)

**Story of the Week**

**RMI PD for MBIA Inc improves after settlement of protracted legal battles**

By James Weston

MBIA Inc, a US-based financial guarantor, last week settled the last of several protracted legal cases in a credit-positive move. RMI probability of default (PD) data shows the company's relative credit positioning has moved closer to its two closest competitors, Assured Guaranty Ltd and Radian Group Inc, following settlements with Bank of America (BoA) and Société Générale (SocGen). The settlements remove substantial litigation risk, allow MBIA to resume writing municipal insurance, and improve the company's overall liquidity position. BoA will pay MBIA Inc USD 1.7bn to dismiss MBIA's claims relating to securitizations sponsored by BoA and its legacy subsidiaries, which MBIA had insured.




The agreement also settles BoA's outstanding litigation over MBIA's restructuring in 2009. SocGen agreed to dismiss similar litigation against MBIA in exchange for USD 350mn. MBIA received regulatory approval to divide its major business lines across two subsidiaries in February 2009; National Public Finance Guarantee Corp (National), a well capitalized mono-line municipal insurer, and MBIA Corp, an insurer of structured finance transactions with a materially weaker financial profile. The split effectively walled off the liabilities of the two divisions. Banks had argued that the division was illegal, and impaired the value of the structured finance trades they had arranged with MBIA Inc before the split.

S&P upgraded MBIA's rating four notches to BBB from B- on May 10 after the settlements. More importantly, National was upgraded six notches by S&P to A from BB over the last week. This should help National begin writing new business in the near future after a protracted period of inactivity. Bond insurers typically require a credit rating higher than their clientele in order to attract business, as an insured bond typically receives the same rating as the insurer. Moody's currently rates MBIA Inc Caa1, and assigns a Baa2 rating to National.

The municipal bond insurance industry is now highly concentrated after a large number of competitors were wiped out during the Global Financial Crisis due to insurance their subsidiaries wrote on complex structured finance products. MBIA will still have its work cut out for it though, with current competitors Assured Guaranty's municipal-only subsidiary and privately-held Build America Mutual Assurance Corp both rated in the AA category by both Moody's and S&P.

**Sources:**

After years of battling, BoA and MBIA settle mortgage dispute (New York Times)

MBIA settles with Societe Generale for USD 350mn (Reuters)

## In the News

### Australia seeks cushion with surprise rate cut

**May 07.** The Reserve Bank of Australia (RBA) lowered its benchmark cash rate to a record low of 2.75%, in a move that is widely interpreted as an attempt to mitigate the impact of the strong AUD. The domestic currency, which has been trading close to 30-year highs, is squeezing the profitability of Australian manufacturers and exporters, further weighing on the government that faces AUD 17bn revenue shortfall this fiscal year. The AUD fell to USD 1.0178 from about USD 1.024 after the rate decision. (WSJ)

### Mexico credit rating upgraded by Fitch to BBB+; Peso rallies

**May 08.** Fitch Ratings raised Mexico's sovereign rating to BBB+ from BBB, in line with Moody's Baa1 rating, which is the third-lowest investment grade level. The peso gained 0.4% to 11.9771 per USD at 4 pm in Mexico City, the strongest level since August 2011. Fitch attributed the rating rationale to Mexico's economic fundamentals and its pro-growth structural policies. (Bloomberg)

### Moody's: Malaysia's election outcome assures country's pro-growth policy and supports Petronas

**May 10.** Moody's views Malaysia's election results as positive for the country's sovereign rating and ratings of government-related issuers. With Barisan National's victory, the credit rating agency said that the Malaysian government looks set to further support domestic consumption and accelerate investments in the country. However, Moody's also warned that the ruling coalition's populist fiscal agenda may weigh on the prospects for fiscal consolidation. (Moody's)

### Regulators eye how to curb 'ratings shopping'

**May 12.** Issuers of asset-backed securities (ABS) could face more disclosure requirements with regards to the securities' structures and underlying loans, as US regulators attempt to limit so-called "ratings shopping." The Securities and Exchange Commission will meet on May 14 to discuss whether wider disclosure would curb the practice of credit rating agencies (CRAs) giving inflated ratings in exchange for more revenue. Improved transparency around ABS is touted as an alternative to a more draconian measure inserted into the Dodd-Frank law, which would create a new board to assign work to CRAs on a rotating basis. (Financial Times)

### Japanese banks begin aggressive push into Asia

**May 12.** Cash-rich Japanese lenders have started pushing into retail banking in other Asian markets. They are seeking access to local-currency savings to fund growth in overseas loans, hoping to counterbalance sluggish growth at home. One of the biggest challenges Japanese banks face is a lack of a retail network overseas. The banks intend to acquire Asian commercial banks to kick-start local banking operations in the region. (Gulf News)

### PBOC resumes bill issuance to drain liquidity

**May 9.** The People's Bank of China issued bank bills for the first time in 17 months to drain liquidity on the money market. PBOC issued 3-month bills totaling CNY 10bn, which have a longer-lasting effect in harnessing excess liquidity compared with short-term repurchase agreements. Analysts agreed that the restart of bank bill issuance reflects the PBOC's attitude toward possible capital inflows and excess liquidity. (Xinhua)

### Libya is seeking S&P credit rating, central bank governor says

**May 9.** African country Libya is seeking to obtain a credit rating from Standard & Poor's, after a more than two-year suspension of credit rating assessment due to the country's armed revolt. The Libyan economy almost doubled last year in terms of GDP and may expand 18% this year, maintaining a strong recovery from 2011 recession. The Central Bank of Libya is waiting for the constitution to offer license for foreign banks and liberalize the market. The regulator may also award as many as three domestic institutions licenses to establish Islamic banks, according to the central bank governor. (Bloomberg)

**Bernanke signals banks may face higher capital requirements**

**May 10.** Federal Reserve Chairman Ben Bernanke signaled that large, complex banks are likely to face higher capital requirements as he cautioned vulnerabilities to the financial system still exist. These risks include heavy reliance by some financial firms on short-term wholesale funding markets and potential runs on money-market mutual funds. Bernanke also said that regulators are prepared to implement requirements beyond those constituting the Dodd-Frank law and international capital agreements. (WSJ)

**Bond sales to decline as US revenue soars**

**May 13.** Wall Street's biggest bond dealers are starting to forecast that the US Treasury will reduce the size of its debt auctions in coming months for the first time in three years as government revenue soars. With the Congressional Budget Office estimating a 2013 budget deficit of USD 845bn, the smallest since 2008, eight of the 21 primary dealers who trade with the Fed say Treasury may cut the amount of notes it offers that are due in five years or less as soon as July. The government has not trimmed coupon auctions since 2010, a year after the economy began expanding from the worst financial crisis since the Great Depression. (Bloomberg)

**Bank of Korea cuts interest rates to spur economy** (BBC)

**Moody's says violent strikes, factory disasters pose risk to Bangladesh rating** (Washington Post)

**Romania's junk credit rating maintained by S&P on 'high' debt** (Bloomberg)

**Egypt cut to record low at S&P on increased financing pressure** (Bloomberg)

**Quest for capital intensifies for Chinese banks** (South China Morning Post)

**Dubai Group expects to sign USD 10bn debt deal in weeks** (Arab News)

**Oman's central bank sets minimum target for SME lending** (Reuters)

**Paper cuts hurt Finnish economy** (Gulf News)

**Sukuk success for Saudi firms** (Arab News)

**Monetary easing could drive 'asset bubble'** (Arab News)

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