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

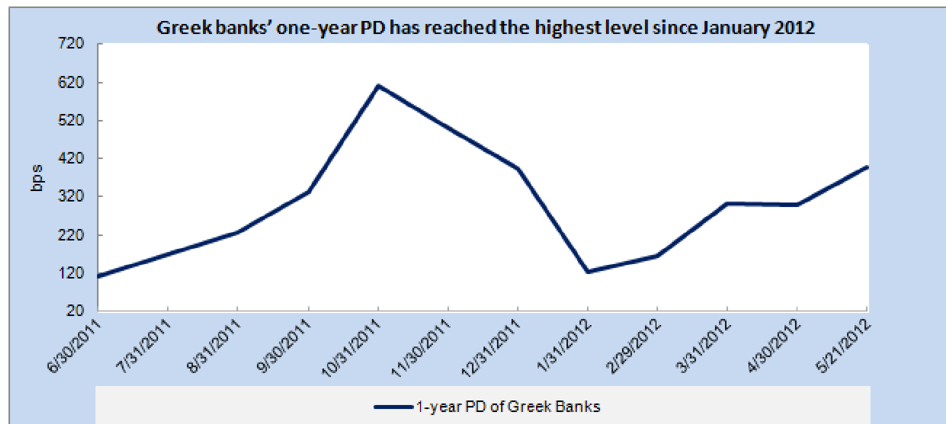
Weekly Credit Brief

May 15 - May 21 2012

Stories of the Week

Greek banks: ECB liquidity stoppage and political uncertainties heighten credit risks

The ECB's decision last Wednesday to halt liquidity provision to a number of Greek banks was a credit negative for the Greek banking sector. This was compounded by continued political impasse last week, when talks amongst major Greek political parties to form a new government broke down the same day. Reflecting these credit negative developments, the RMI CRI one-year probability of default (PD) for the Greek banking sector rose to 398.3bps on May 21 from 298.8bps on April 30, continuing an upward trend since January 31.



Basis for the ECB's decision: The ECB halted liquidity operations with a number of Greek banks as their capital positions have been weakened by the Greek sovereign debt swap that was agreed in March. Resultant debt write-downs at Greek banks significantly depleted capital positions, with some banks reportedly operating with negative equity capital in the most severe cases.

Political uncertainties increase fears of a eurozone exit: Continued political impasse increased the possibility of an exit from the eurozone by Greece. The failure to form a coalition government following the May 6 election has resulted in another round of elections scheduled for June 17. It is feared that a victory by austerity opponents could cause bailout creditors, such as the EU and the IMF, to stop the flow of rescue loans. Under this scenario, Greece may eventually be forced to abandon the euro currency union and plunge into a deeper recession. Citing this concern, Fitch cut Greece's rating from B- to CCC on May 17.

Greek banks face increasing liquidity challenges: The recent move by the ECB has exacerbated liquidity pressures on Greek banks, at a time when they are already facing deposit outflows. On May 14, deposit withdrawals from Greek banks reached EUR 700mn, the highest single-day withdrawal since 2010. This came amid a renewed fear of a Greek exit from the eurozone. As a result of the ECB's decision, the Greek banks excluded from ECB liquidity operations will have to rely on the emergency liquidity assistance (ELA) provided by the Greek central bank, where lower quality collateral is needed.

Downgrades of Greek banks' credit ratings: On May 18, Fitch slashed the credit ratings of five Greek banks by two notches to CCC, deeper into the speculative territory. Fitch's downgrades were based on Greece's political uncertainties and the increase in the possibility of a Greek exit from the eurozone. The banks downgraded were National Bank of Greece, Efg Eurobank Ergasias SA, Alpha Bank AE, Piraeus Bank SA and Agricultural Bank of Greece.

Intensification of eurozone contagion: An escalation of the Greek crisis has intensified market fears about contagion in the eurozone. On May 15, yields on Italian and Spanish 10-year government bonds rose to 5.86% and 6.34% respectively; these levels were the highest recorded since November 2011, when upheaval in European credit markets and political indecisiveness pushed Italian and Spanish sovereign yields to the highest levels seen since the outbreak of the eurozone sovereign debt crisis.

Sources:

Greece Teeters as Talks Fail (WSJ)
ECB stops operations with some Greek banks (Reuters)
Greek Banks See Deposit Withdrawals (WSJ)
Cash pullout means more ECB reliance (Reuters)
Greek Conservatives, Radical Leftists Even In Saturday Polls (WSJ)
Fitch Cuts Greece as Leaders Spar Over Euro Membership (Bloomberg)
Fitch Cuts Greek Banks to Trip-C Following Country Downgrade (WSJ)

In the News

EU banks meet to discuss rating agencies dominance

May 16. Finance directors from 20 of Europe's biggest banks gathered in a CFO Network meeting last week to question the dominance of the top three credit rating agencies (CRAs). The Big Three CRAs: Fitch, Moody's and S&P, have long been criticized for misjudging the quality of credit derivatives and being slow in downgrading these instruments, and debt issued by financial institutions. To challenge the dominance of the Big Three, a group of European financial companies agreed to back a European CRA sponsored by auditing group Roland Berger Strategy Consultants. However, a potential problem with increased competition is the perceived lack of credibility of smaller agencies, as they may not have access to the same information the Big Three CRAs do initially. EU policymakers have proposed that all CRAs should be restricted to using only publicly available information, thereby leveling the playing field. (Reuters)

Growing corporate debt in China poses a systemic risk

May 18. Growing corporate debt ratios in China pose a systemic risk to the overall economy. The biggest concern is with regard to the asset quality of banks, as they currently provide almost 70% of all financing. The performance and volume of China's non-performing debt and special mention loans were 'vastly understated'. The capital ratios of banks are deteriorating as deposit growth slows and forbearance reduces loan repayments. The most effective way to deal with the problem is to accelerate the development of capital markets in China and provide companies with alternative means of financing. This includes equity capital and increased use of credit derivatives. (China Daily)

Strict Basel III requirements pose a challenge for global banks, Fitch estimates

May 17. Incoming Basel III capital rules will force 29 significant global financial institutions to raise a combined total of USD 566bn in capital by the end of 2018, according to estimates by Fitch Ratings. The urgency to raise capital could restrict the ability of these institutions to increase dividends or undertake share buybacks. To meet the higher capital requirements, banks are likely to adopt a combination of strategies. These include retaining future earnings or minimizing exposures that are subject to higher risk-weights under Basel III. Alternatively, some may seek to increase returns through riskier activities and new forms of regulatory arbitrage, in order to maximize yield on a given unit of Basel III capital. Such changes could have massive ramifications on the credit markets and global financial system. (Reuters, Fitch Ratings)

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