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Weekly Credit Brief

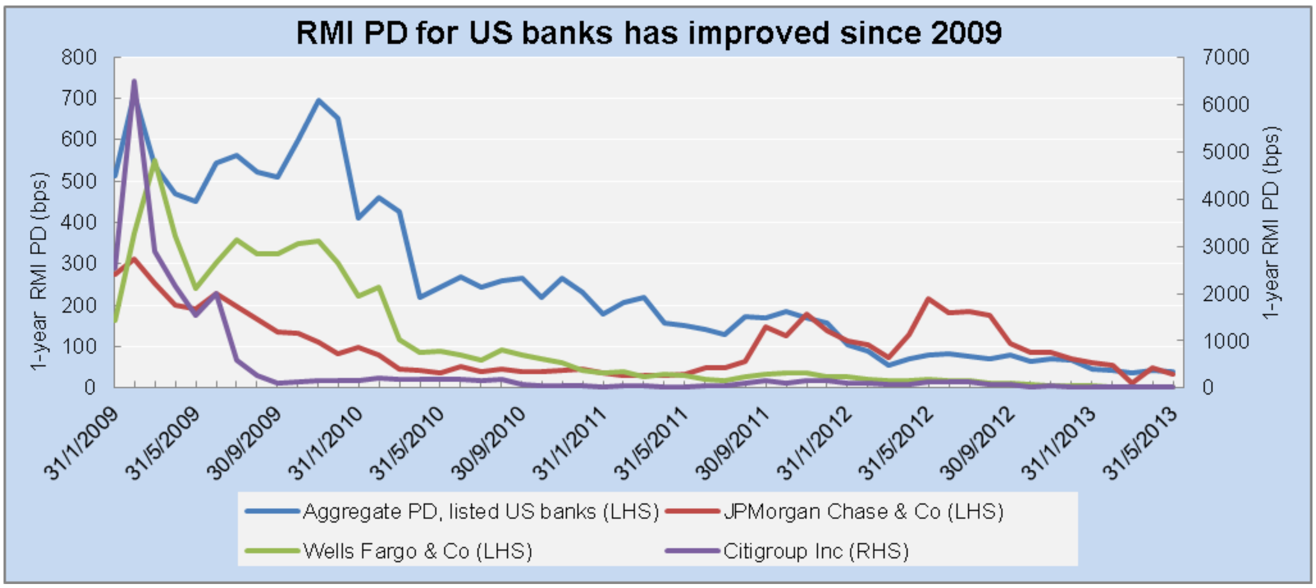
May 28 - Jun 03 2013

Story of the Week

Credit outlook for US banking system improves

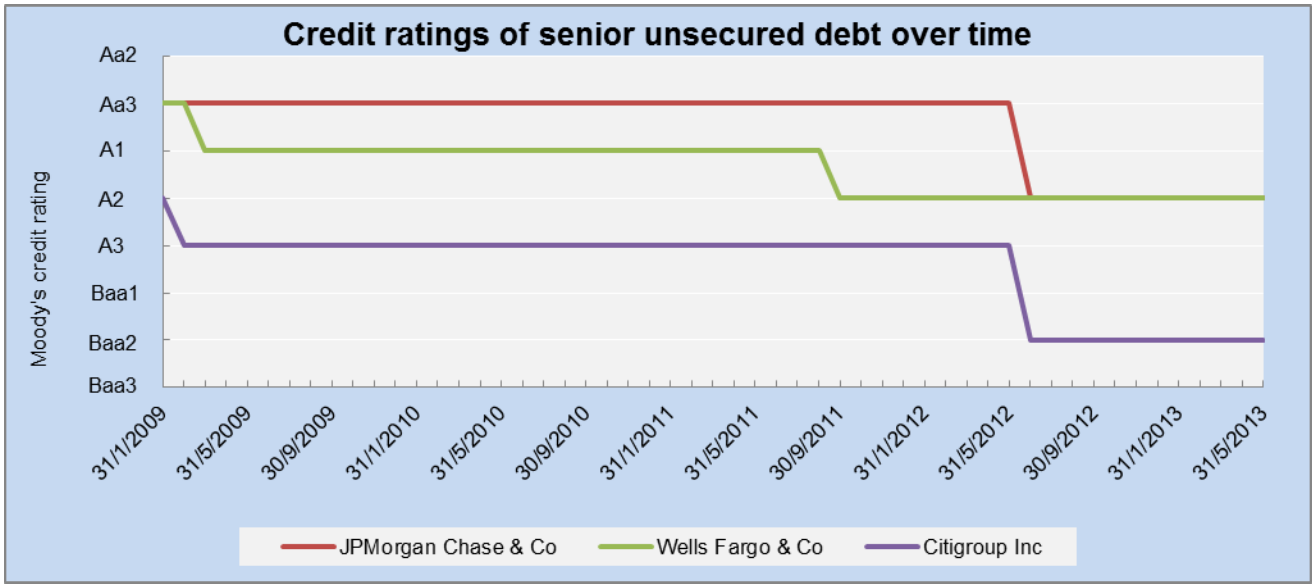
On May 28, Moody's upgraded their outlook for the banking industry to stable from negative. It should be noted that the agency's view for the banking industry has remained negative since the crisis in 2008. The CRA cited continued improvement in the operating environment and reduced downside risks to the banks from a faltering economy as reasons for the upgrade. The improvement in credit outlook is also reflected in the aggregate RMI 1-year probability of default (RMI PD) for US banks. The aggregate RMI PD has been falling since 2009, indicating a steady improvement in the credit profile for US-domiciled lenders. This is displayed in the chart below together with the RMI PDs of the three largest US banks by market capitalization.

As of May 31, the aggregate RMI PD, which tracks the default risk for 313 financial institutions in the US, averaged 39.97bps. RMI PDs, which monitors the credit profile for lenders on a daily basis, are generated by a quantitative model. Among other factors, the model takes into account the firm's latest earnings and its daily market cap as inputs to measure the company's default probability. Based on the latest calibrated parameters, the RMI PD for banks exhibited the highest sensitivity to the prevailing level of US interest rates.



This is somewhat similar to the report by Moody's when they identified the low interest rate environment as the single most important factor that will drive US bank's performance in the next 12 to 18 months. The agency also said that US banks are better positioned to face any further economic downturn as they have reduced credit related costs and restored capital to their balance sheets.

But the CRAs may be seen as slow in upgrading their outlook for US banks. The aggregate RMI PD for US lenders are already approaching record low levels of less than 40bps last seen before the financial crisis and given the general cyclical nature of risk measures; the credit quality of banks could fall rather than rise in future. In addition, a plot of credit ratings for senior unsecured debt of the three largest US banks over time showed that the CRA may be viewed as conservative when assessing the credit quality of top 3 lenders' bonds as compared to their RMI 1-year PDs. The CRA downgraded the banks' debt in the years till 2013 and are now rated lower than what they were in January 2009. This is a different conclusion from the RMI PD charts of the same banks which showed that the firms have a lower default risk than in January 2009.



Sources:
US banking system outlook changed to stable as economy improves (Moody's)
Bank outlook to stable by Moody's 5 years after cut (Bloomberg)

In the News

Malaysian bonds beat peers as PM Najib aids Ringgit

Jun 03. Behind Malaysia's ruling coalition electoral victory in early May and the reduced political uncertainty that ensued, Malaysian sovereign bonds outperformed its regional counterparts by posting a modest average gain of 0.3 percent, a sharp contrast vis-à-vis Singaporean and Indonesian government securities, which fell 2.2 percent and 2.4 percent respectively. Philippine bonds also declined, by 1 percent while Thai debt handed investors almost zero returns. Analysts forecast that the Ringgit will continue its appreciation and end the year stronger than USDMYR 3 for the first time since 1996. (Bloomberg)

Issuers warm to cross-border sukuk

Jun 02. The increase in cross border Islamic bond (sukuk) issuances indicates a growing demand for issuers to diversify their funding sources. Over the past year, many Gulf issuers have tapped Malaysia's highly liquid market for sukuk issuance. Such issuers include the National Bank of Abu Dhabi which issued a 15-year, USD 164.4mn sukuk in November and Bahraini sovereign wealth fund, Mumtalakat which issued a five-year, MYR 300mn. Malaysia's sovereign wealth fund also launched a Chinese yuan denominated sukuk. (Reuters)

Non-performing assets to double in two years

Jun 01. ICRA, a subsidiary of Moody's Investors Service Inc expects non-performing loans in the banking system to double from 3.3% in March once the Reserve Bank of India's revised guidelines on bad asset classification takes effect. The new rules require restructured loans to be immediately classified as non-performing assets by April 2015, with certain exceptions. (Times of India)

Local banks to face tougher bank capital rules from December

May 30. South Korea's financial watchdog, Financial Supervisory Service (FSS), announced on May 29 that local banks will face tougher capital rules from December 2013 to meet with the Basel III requirements. Basel III is a regulatory standard on bank liquidity, leverage and capital requirements to promote financial stability in the international financial system. Under the stricter capital rules, Korean banks will need to hold at least 7 percent of common shares and have capital buffer to cushion against losses. FSS believes that Korean Banks are unlikely to be affected by the new regulations as they have enough capital shields. (Yonhap News)

EU economies win reprieve on budget deficit targets

May 29. The European Commission loosened its stance on austerity in its review of the national budgets of all 27 EU members, citing a period of calm in the global markets. In particular, Spain and France received two-year extensions on their deadline to meet fiscal targets, while the Netherlands and Belgium each received a one-year extension. Despite these relaxations, the commission warned that economic recovery in the eurozone would likely remain slow in the near term and urged troubled countries to redouble efforts in implementing economic reforms. (Financial Times)

Cash left untaxed aided by USD 103bn in bonds

May 29. US businesses with the most cash are holding more than USD 425bn overseas as they use the bond markets to sidestep US corporate tax. Under the US tax code, companies pay taxes as much as 35% if they repatriate cash earned abroad back home. 31 companies which parked capital in foreign units have sold USD 103bn of dollar-denominated bonds since 2012, according to Bloomberg. Raising cash through local bond markets allows firms to deduct interest expense against income, in addition to avoiding the government levy on non-US holdings. (Bloomberg)

DBS Bank successfully prices inaugural offshore RMB bond issue

May 29. DBS Bank successfully priced its inaugural offshore RMB bond issue, to be settled in Singapore. The CNY 500mn fixed rate three-year bonds priced at 99.76%, will have a fixed coupon of 2.5% per annum with interest payable semi-annually. The issue attracted strong interest with an order book of close to CNY 2bn, being close to four times subscribed. (Channel News Asia)

Debt to constrain China's credit rating

May 28. China's sovereign credit rating is unlikely to be upgraded in the near future after Moody's lowered the country's outlook from positive to stable last month. The credit rating agency said that increasing debt levels of local government and banks have overshadowed the country's credit profile over its healthy economic growth. Former finance minister Xiang Huaicheng estimated last month local government debt had exceeded CNY 20tn, or 38.5% of the nation's GDP, while the aggregate shadow banking system stood at CNY 29tn, according to Moody's estimates. (South China Morning Post)

Euro zone private loans contract, pressuring ECB to act (Reuters)

German bonds drop with French debt amid Fed tapering speculation (Bloomberg)

PMI factory output shrinks for first time in over 4 years (Economic Times)

FDI dips by 38% to USD 22.4bn in 2012-13 (Times of India)

Bahrain budget deficit widens to USD 500mn in 2012 (Gulf News)

India central bank warns on prices, current account (Arab News)

Philippines defies Asia slowdown with best growth since 2010 (Bloomberg)

US company credit swaps hold; Pfizer sells USD 4bn in bonds (Business Week)

Germany's top banks EUR 14bn short of Basel III capital (Financial Times)

Taiwan banks expected to meet Basel III capital rule (Reuters)

Banks miss the mark on forecasting whether borrowers will default (Financial Times)

Wells Fargo CEO says interest-rate risk outweighs bad credit (Bloomberg)

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