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Weekly Credit Brief

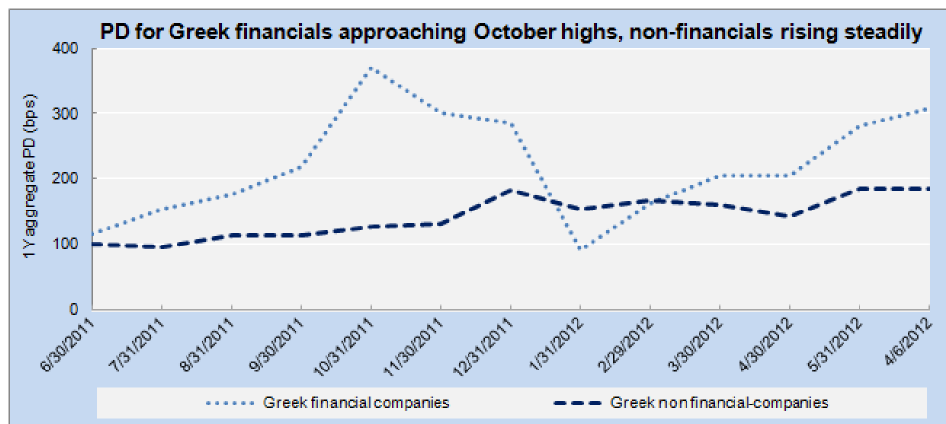
May 29 - Jun 4 2012

Story of the Week

Potential eurozone exit weighs on Greek companies

Uncertainties surrounding a second round of Greek parliamentary elections, seen as a de facto referendum on Greece's membership of the eurozone and scheduled for June 17, have raised concerns that the country may exit the eurozone. Radical leftist party Syriza opposes austerity measures, and commentators believe Greece would renege on bailout terms set by international creditors and convert to a new drachma in order to monetize the country's debts if Syriza wins a majority. Conservative party New Democracy supports the international aid program, but was unable to form a coalition government in the last round of elections. The final round of opinion polls before the election showed New Democracy commanding the thinnest of margins over Syriza.

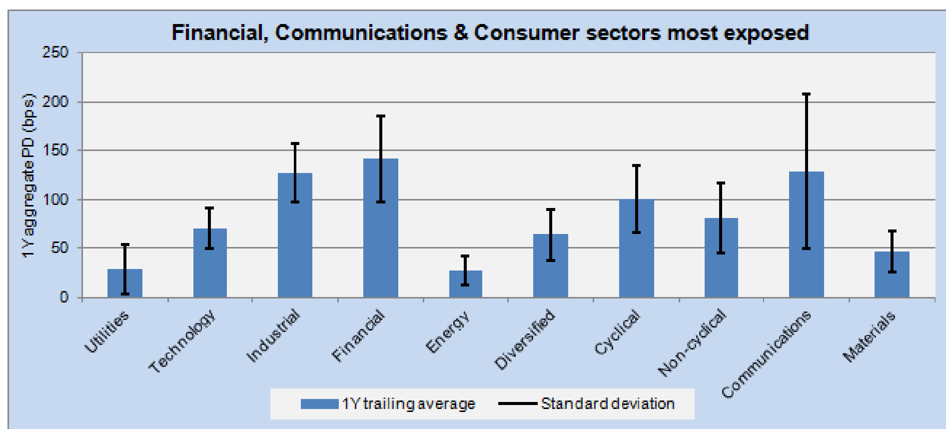
RMI CRI probability of default (PD) data reflects concerns about a Greek exit, with the one-year aggregate PD for Greek financials increasing to 308bps on June 4 from a low of 91bps on January 31. Deterioration in the credit profiles of Greek non-financials is also reflected in CRI data. CRI data tends to indicate that the financials, consumer and communications sectors are the most at risk in the event of a Greek eurozone exit or further deterioration in the government's public finances, as these sectors have exhibited the highest sensitivity to the creditworthiness of the Greek sovereign in the past year.



Health of Financial Sector Threatened: Greek banks have experienced increased deposit outflows since the crisis began, with close to 25% of deposits withdrawn from Greek banks in the last two years. A Greek exit from the eurozone may further exacerbate this current deposit flight, as depositors fearing a rapid depreciation of the new drachma withdraw funds en masse. In the event of a Greek eurozone exit, Greek banks' ability to recapitalize would be further compromised by their limited access to capital markets. Furthermore, in the event of such an exit, the Greek government would have to severely limit ATM withdrawals, enforce capital controls, and curtail the payments system, to preserve the deposit base of banks. Failure to do so would leave financial institutions exposed to rapid funding outflows; concerns remain that the government lacks the capacity to enforce such restraints.

Potential deterioration in domestic economy: According to projections by the National Bank of Greece, living standards would significantly deteriorate in the event of a Greek exit, as personal incomes would fall by more than 50% due to a loss of real wealth from redenomination. Inflation and unemployment would also soar, while higher real interest rates aimed at stabilizing the exchange rate would hurt borrowers. Furthermore, in the process of transition to the new currency, the surrounding chaos would paralyze the economy, leading to a slowdown in consumer and business demand. Some market watchers expect that the economic cost of a catastrophic exit could be as high as 50% of Greece's GDP in the first year following a eurozone exit.

Possible Silver Lining: The flip side of a Greek exit is it will allow the government to avoid being caught in a long vicious cycle of debt repayments. In addition, the subsequent depreciation in the new drachma could boost export competitiveness and increase tourism, if the government can prevent a social and political breakdown.



Industries most affected: According to CRI data over the past 12 months, a period of significant uncertainty regarding the creditworthiness of the Greek sovereign, the industries that could be the most vulnerable to further upheaval are the Financial, Communications and Consumer sectors, where the Consumer sector refers to both the Cyclical and Non-cyclical components. The standard deviation of each sector's aggregate PD indicates these four sectors have exhibited the greatest PD variation during periods of market uncertainty regarding a Greek sovereign default.

Financials: With a high exposure to Greek sovereign debt, Greek banks are exposed to the risks of larger write downs, especially in the event of a monetization of government debt. A number of Greek banks reported quarterly losses last week, after suffering large losses following the sovereign restructuring in March, and increased provisions for bad loans as the economy deteriorated. The Greek banking system remains extremely vulnerable to external shocks, despite a EUR 18bn state recapitalization approved two weeks ago.

Consumer and communications sectors: A highly depreciated new drachma would leave firms in these sectors struggling with high input costs, as Greek companies import a majority of goods sold by companies in these sectors. Uncertainties around the transition would impair consumer confidence, while a potential collapse of electronic payment systems would inhibit spending. A combination of these factors would create a depressed market environment that will weigh on consumer and business spending.

Sources:

Greek Political Rivals in Dead Heat (WSJ)
Quarter of deposits withdrawn from Greek banks (Guardian)
Biggest Greek bank warns of dire euro exit fallout (Reuters)
The costs of a Greek exit (Economist)
Former Greek PM Papademos: Risk of Greece leaving euro is real (Dow Jones)

In the News

ASEAN-backed junk debt lures Prudential, Pinebridge
May 30. Southeast Asia's new Credit Guarantee & Investment Facility (CGIF), sponsored by ASEAN nations along with Japan, China and Korea, began operations in May. The CGIF recently received a AA+ rating from Standard & Poor's, notes that are guaranteed by the facility will enjoy the same rating, allowing companies based in the sponsoring nations to benefit from lower borrowing costs and greater access to global credit markets. In the event of a default, an investor can recoup both principal and coupon from CGIF. The facility should make Asian junk-rated debt more attractive to institutional investors like mutual funds and insurance companies who are seeking higher yields. Firms like Prudential and Pinebridge have already expressed interest in buying bonds backed by the CGIF. (Bloomberg)

ECB and EU weigh in on ways to aid Spain
May 31. The ECB has signaled opposition to the method in which Spain plans to recapitalize its struggling lenders. The Spanish government said last week it would issue government bonds directly to domestic banks, which the banks could then use as collateral to borrow from ECB lending facilities. On the other hand, the European Commission called for the EUR 500bn European Stability Mechanism (ESM) to be accessible to banks directly instead of lenders seeking aid through national governments. In related news, Spain might be given an addition year till 2014 to lower its deficit to 3% of GDP, as the Spanish economy is forecasted to remain in recession through 2013. (WSJ, Bloomberg)

India approves debt restructuring of textile companies
May 29 The Indian government asked state-run lenders to restructure INR 350bn worth of debt at textile companies last week, and asked the central bank to consider a two year moratorium on term loans. These measures are aimed at improving the working capital positions of thousands of mills struggling with losses. Indian textile mills incurred large losses after buying cotton at record highs in early 2011, before prices collapsed in the second half of the year. Firms have found it difficult to sell off inventory and repay debts in recent months. Mills in India are the world's second largest source of cotton yarn. The industry is a vital part of the global garment industry, as Indian textile mills export cotton yarn to key apparel exporters in China, Pakistan and Bangladesh. (WSJ)

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