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Stories of the Week

M&A hype about family-owned Hong Kong banks
By Kim Vu

The history of Hong Kong is marked with the establishment and development of the country's family-owned banks. However, this tradition may soon become a thing of the past with said banks under pressure to sell or merge with larger overseas or mainland financial giants. Over the last few years, the primary lending business of Hong Kong's smaller banks' has shrunk. As Hong Kong's interest rates have decreased to almost zero in line with US rates, their net interest margins have been severely flattened. Moreover, a loan guarantee scheme offered by the Hong Kong government has encouraged the big banks to make a move into the sector.

In recent months, acquisition interest in Hong Kong's family-owned banks flared up again. Yue Xiu, an investment arm of the Guangzhou city government, announced that it has offered HKD 11.64bn (USD1.5 bn) for a 75% stake in Chong Hing Bank, the smallest of Hong Kong's family-owned lenders. The bank consequently has accepted the offer and the deal is pending regulatory approval in Hong Kong. Meanwhile, China's Agricultural Bank of China, Singapore's Oversea-Chinese Banking Corp and United Overseas Bank, and Australia's ANZ are reported to be weighing bids for Wing Hang Bank. There are also interests in Dah Sing, a smaller rival, which drove the banks share price up by about 60% in August.

While China's economy has grown dramatically over the past 10 years, the Chinese government has not approved any new commercial banking licenses since 2006. Therefore, banks in Hong Kong with licenses to operate in China are attractive acquisition targets for mainland Chinese companies seeking to enter the country's banking industry. These banks can provide solid banking platforms for foreign investors who seek greater access to the Chinese market while also getting a HKD deposit base.

However, these forthcoming deals may have triggered an increase in the RMI 1-year probabilities of default (RMI PD) for these banks. RMI PDs for Dah Sing and Wing Hang rose in October and November (see Figure 1A). Anticipated subpar growth in China is part of the reason that leads family owners to consider exiting the Hong Kong banking scene. Smaller banks in Hong Kong have so far maintained high level of risk management despite the growing competitive pressure. Potential acquisitions could result in a shift in management strategy, and potentially weaken governance and risk controls.

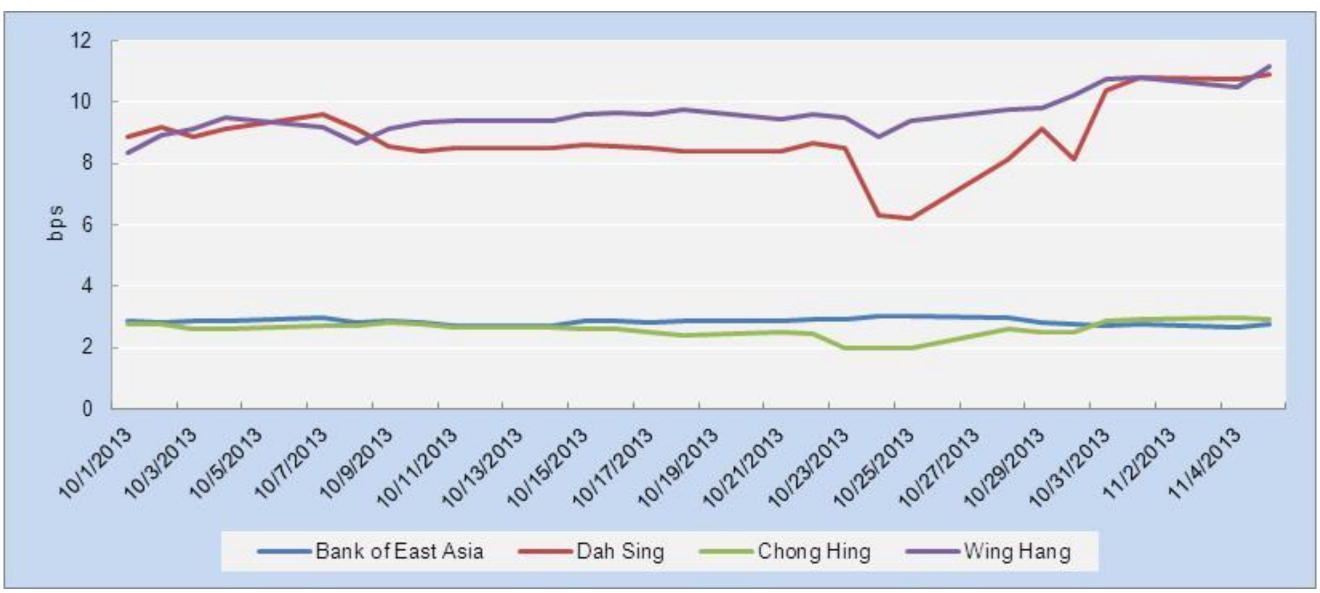

Figure 1A: RMI 1-year PDs for family-owned Hong Kong banks. *Source: RMI*

Investors rejoice as Cristina Fernandez's era ends
By Ang Chung Yuh

The default risk of listed firms in Argentina fell to the lowest in more than two years, as stocks and bonds rally on hopes that President Cristina Fernandez de Kirchner will hand over power to a more market-friendly administration in 2015. The average borrowing costs of Argentine companies also sank to a level not seen since January 2012. Argentina's benchmark stock index on November 6 soared the most in more than five months on speculation the central bank will announced a measure to restrict local lending to the seven largest grains exporters, thereby forcing them to obtain foreign currency financing and help boost the country's foreign reserves.

Figure 2A shows the RMI 1-year probability of default (RMI PD) for Argentine companies and the average yield to maturity (YTM) of Argentine corporate bonds. The chart indicates that the yields on Argentine corporate debt have mostly tracked RMI's gauge of credit risk in Argentina. Both measures suggest lower likelihood of a default event for Argentine companies since Fernandez failed to secure the two-thirds majority in congress that she needed to amend the constitution and seek a third term in office.

Figure 2A: Argentine corporations' RMI PD and the average YTM of Argentine corporate bonds. *Source: Bloomberg; RMI*

Argentine markets have already started to price in Fernandez's electoral prospects since August 11 primaries, and the average year-to-date returns on the nation's corporate bonds soared to 14.5% as of November 7, compared with average losses of 1.4% in corporate debt from emerging economies, according to Bloomberg. Market participants speculated that her waning popularity would pave way for the next administration to abolish some of her policies that have created an economic mess and relegated Argentina to one of the few countries that have a lower stock of foreign direct investment now than it did in 2003.

The dictatorial government intervention from both Fernandez and her predecessor and late husband Nestor Kirchner has deterred foreign investments. Policies such as currency controls, price freezes, and government takeovers of private companies have sent foreign-currency reserves to a six-year low (see Figure 2B), pushed annual inflation to 25% and saddled Argentine companies with an average borrowing cost that is almost double the emerging-market average. Reserves, which are the primary source of payments to the nation's bondholders, sank to USD 33.1bn on August 8, the lowest level since January 2007. The ARS has weakened 17.6% this year to 5.9636 per USD.

Figure 2B: Argentina's foreign-exchange reserves and currency have weakened considerably over the years. *Source: Bloomberg; Central Bank of Argentina*

In the News

Caviar denial signals growing angst over deficit: Brazil credit

Nov 07. The two-week-old USD 3.25bn sovereign bonds of Brazil due 2025 have tumbled 3.01 cents since they were issued on October 23, after the Brazilian government reported in the week ended November 1 a deficit of USD 4.6bn in September. The deficit soared to 3.3% as a percentage of GDP in the 12 months ended September, the largest since 2009, and led to a scrutiny of public spending that even forced the finance ministry to release a statement saying Finance Minister Guido Mantega has never spent taxpayer money on lavish meals. According to data compiled by CMA Ltd, the cost of insuring Brazil's government debt has jumped 11% in the past month, the most among 73 countries. (Bloomberg)

China's local govt debt raises alarm

Nov 07. Increasing concerns over the size of Chinese municipal government debt will likely be one of the topics discussed in the upcoming Chinese government's 3rd Plenum. A national audit that began in July will likely report that local government debt has doubled from 2011 to 2013. Analysts believe that the central government will likely address the issue by measures such as allowing some local officials to default as a form of deterrent or setting clear indicators to the amount of debt that local governments can borrow and banks can lend relative to the region's GDP and budget. (Channel News Asia)

ECB cuts rates to new low, ready to do more if needed

Nov 07. The European Central Bank surprised global markets last week by cutting its main refinancing rate by 25bps to a record low of 0.25%, as falling inflation hinted at a stalling eurozone economic recovery. Inflation stood at 0.7% in October, far below the ECB's target of 2%. ECB president Mario Draghi said that rates may yet be cut further if necessary, and pledged to provide banks with as much liquidity as needed at a fixed rate until at least July 2015. Excess liquidity in the eurozone banking system has fallen as lenders repay 3-year ECB loans in preparation for a health check in 2014. (Reuters)

Bad debt market growing fast in S. Korea

Nov 06. South Korea has seen a significant growth in the non-performing loan (NPL) market in recent years, amid growing concerns over the unfettered market being too hot. According to an estimate by the financial authorities and institutions, banks cleared a total of KRW 15.6tn (USD 14.6bn) worth of bad debts in 2012, compared with KRW 6tn in 2008. The financial regulator has a bill pending at parliament that will amend regulations to tighten supervision in the NPL market. Lenders are expected to clear a total of KRW 15.1tn worth of bad debts through biddings by the end of this year. (Yonhap News)

Italy issues record USD 30bn retail bonds in two-day sale

Nov 06. In a continuing effort to get retail Italian investors to help finance its EUR 2tn public debt, Italy sold USD 30bn (EUR 22.3bn) of government inflation-linked bonds last week, the largest ever single bond sale by a European government. Despite weak consumer prices, an attractive coupon rate (2.15%) on the four-year bond created strong demand for the sale, allowing the Italian government to close books early. With 90% of its EUR 470bn issuance target for this year met before the sale, analysts expect a reduction in Italian government bond issuance for the rest of 2013, reducing supply in the bond market and creating a supportive environment for Italian yields. (Bloomberg)

US to sell up to USD 15bn in first floating-rate notes

Nov 06. The US Treasury Department plans to issue its first floating rate notes on January 29. Investors will be able to buy up to USD 15bn of Treasury bonds that offer protection to investors in a climate of rising interest rates. The sale of the Treasury's first new security since 1997 will likely go ahead even with the debt-ceiling deadline looming on February 27. (Bloomberg)

RBA says AUD 'uncomfortably high' as it holds key rate

Nov 05. The Reserve Bank of Australia left its benchmark interest rate unchanged at a record low, and said a weaker currency will be needed to achieve balanced growth. The overnight cash-rate target was left at 2.5%, while RBA Governor Glenn Stevens said the AUD remained 'uncomfortable high.' In prepared remarks, Mr Stevens said the economy continued to grow below trend over the past year, while unemployment has increased slightly. These trends are likely to persist in the short-term as the economy adjusts to lower levels of mining investment. (Bloomberg)

OSX files for bankruptcy protection (WSJ)

DBS offers to trade new notes for $800m in preference shares (Business Times)

Eurozone's Ireland gets green light for bailout exit (Reuters)

Fed anxiety rises as QE increases risk of loss with costs (Bloomberg)

J.C. Penny divides distressed funds from Avenue to Centerbridge (Bloomberg)

Malaysia holds key rate as growth support trumps price pressures (Bloomberg)

S&P lowers France credit rating, cites slow reform pace (Reuters)

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