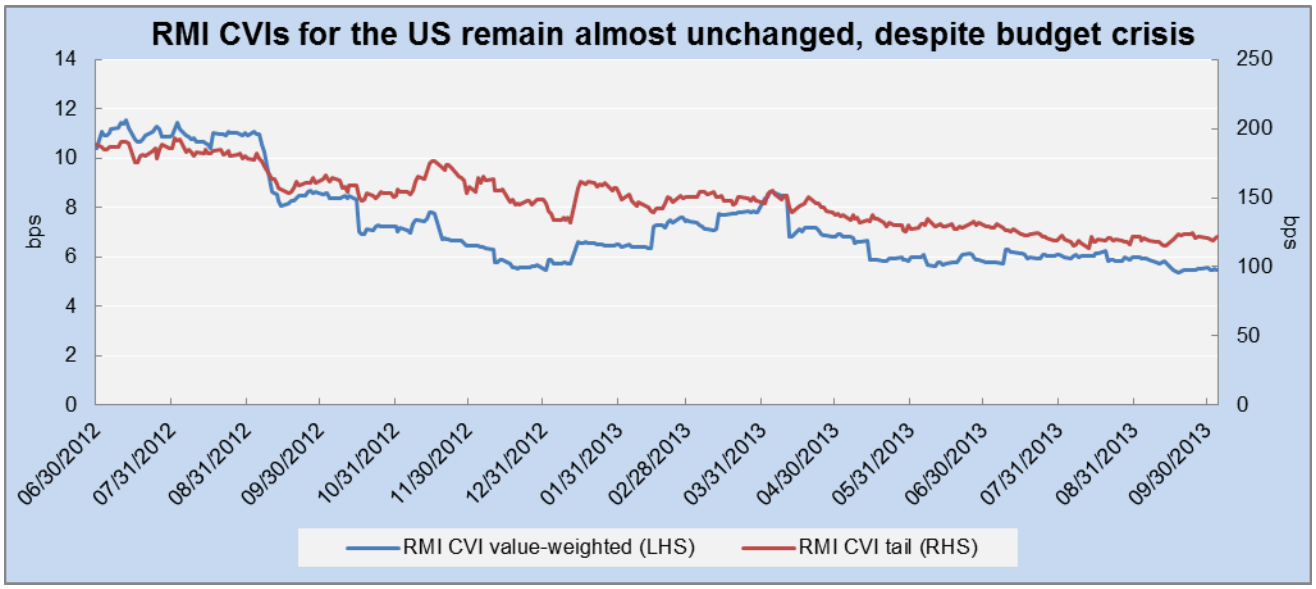
Transforming Big Data into Smart Data
NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond
Weekly Credit Brief Oct 01 - Oct 07 2013

## Stories of the Week

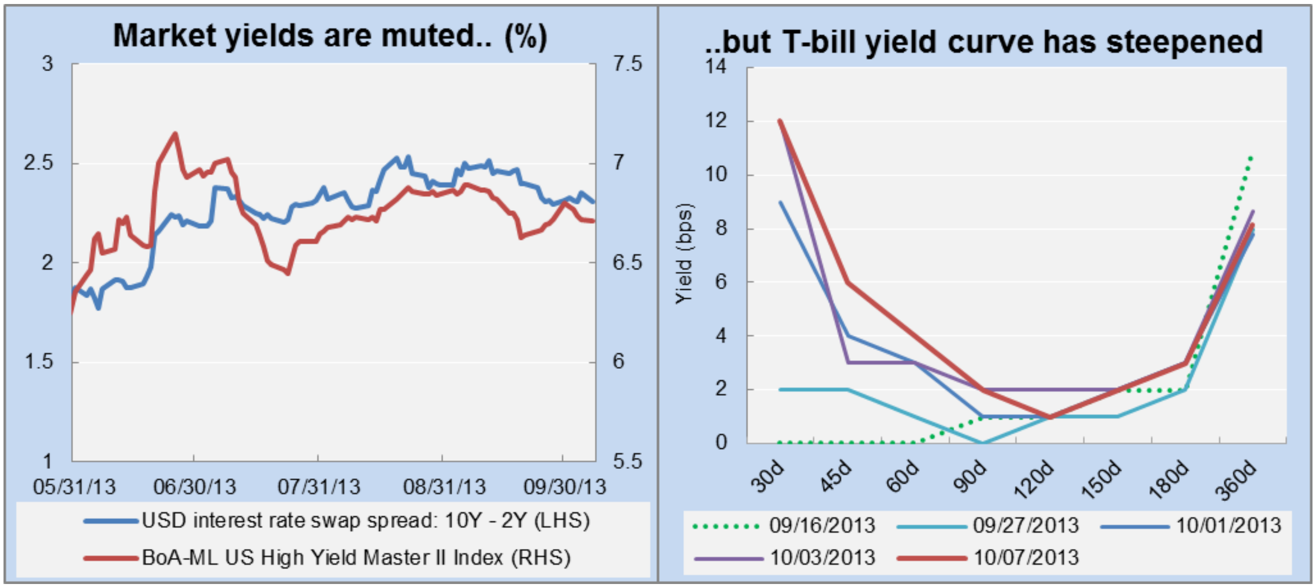
### RMI US CVIs remain flat as budget crisis continues

RMI's Corporate Vulnerability Indices (RMI CVI) for the US, which measure overall stress in corporate credit markets, remained almost flat last week, despite the partial shutdown of the federal government and the possibility of a default by the US Treasury. RMI CVIs are based upon individual RMI probabilities of default (RMI PD) for US companies, which are calculated using market and fundamental data. This suggests that the market continues to price in strong underlying credit quality for US-based firms, and a high probability that a partisan solution will emerge before an October 17 deadline when the US Treasury predicts it will have exhausted all avenues to finance the country's expenditures without borrowing further, excluding USD 30bn of cash on hand.




The Treasury last week said that a default by the US would be catastrophic for the global economy, effectively freezing USD credit markets and leading to a dramatic increase in interest rates. The governmental shutdown has already had a significant effect on sales in US corporate bond markets, with weekly sales down 80% last week to USD 11.4bn from USD 56.3bn the week before. Sales were also down 63% from a weekly average of USD 30.5n in 2013, with issuers postponing sales amid fiscal uncertainty.

Interest rates in corporate bond markets have been less affected since the shutdown began on October 1. The spread between 2-year and 10-year interest rate swaps remained almost unchanged last week after decreasing significantly following the September FOMC meeting. Yields on the BoA-ML US High Yield Master II index fell to 6.71% on October 7 from a high of 6.8% on September 30, suggesting a hunger for risk assets has not diminished. However, the short-end of the US Treasury bills curve has increased over the last week, with heavy selling pressure on T-bills due over the next two months. According to market participants, a wider selloff in Treasuries could absorb all available funding for the bond market, and drive up yields dramatically.



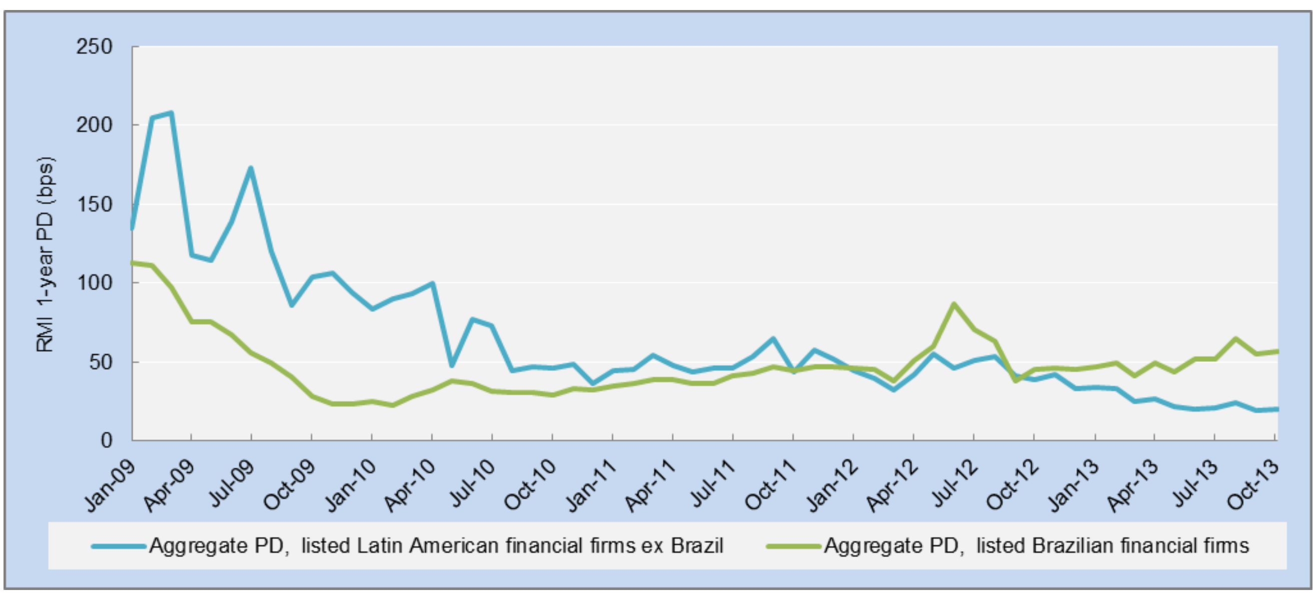

**Sources:**
Report on Macroeconomic Effect of Debt Ceiling Brinkmanship (US Treasury)
Secretary Lew Sends Debt Limit Letter to Congress (US Treasury)

**Weaker credit profile seen for Brazilian financial institutions**

Credit rating agency Moody's lowered the outlook for Brazil's sovereign bonds on October 2 citing deepening strains in the economy and the prospect of a prolong period of low growth. The CRA said that it could lower the outlook to negative or even downgrade the country's rating, if the economy grows less than 3% after 2014. A day after the CRA lowered the nation's outlook, the CRA cut the ratings for six Brazilian financial institutions.

Lower ratings for the financial companies were given after the CRA assessed that the government's capacity to provide systemic support to large banks has recently weakened. The government's weaker fiscal position could affect its ability to fund public sector bank lending which is equivalent to 9% of GDP. Moreover, the larger size of the banking system at 138% of GDP has increased the potential risk of systemic banking losses.

The lower credit quality for the companies is also reflected in the aggregate 1-year probability of default (RMI PD) for Brazilian financial firms, which has increased to 56.7bps on October 7 from 22.8bps on February 2010. This largely coincides with a falling average net income to total asset ratio for Brazilian financial firms during the same period. Financial companies in Brazil reported lower earnings from slow economic growth, low demand for new loans and higher bond yields. With a RMI PD of 56.7bps, financial firms domiciled in Brazil now carry an above average default risk (compared to other Latin America financial companies).



The Brazilian banking sector could face further challenges in the near term. The average yield on dollar bonds sold by investment grade Brazilian banks has risen 67bps to 4.33% this year, making it more costly for banks to raise capital. The amount of bonds issued by commercial Brazilian banks has fallen to the lowest level in six years as lenders issued USD 3.8bn of debt overseas, representing a 59% drop in bond sales from 2012. Lenders have also cut their credit growth forecasts for 2013 as they turned cautious on the economy's growth.

Furthermore, nearly half of Brazil's 20,000 bank branches have closed for 16 days as the National Bank Federation, or Febraban negotiates with Brazil's main banking labor union over salary increases. The union is recommending that workers continue their walkout as they reject the Federation's latest offer of a 7.1% pay increase. Workers are asking for a 11.93% pay raise to cope with inflation levels of 6%. To their defence, the Febraban told workers that salaries have increased by more than 58% over the past seven years while inflation has risen 42%.

**Sources:**
Moody's lowers outlook for Brazilian economy (Channel News Asia)
Moody's takes rating actions on Brazilian financial institutions (Moody's)
Brazil bank workers reject latest offer as strike reaches 16 days (WSJ)
Moody's sees shift in Brazil state bank policy unlikely (Reuters)

**In the News**

**Bank of Korea likely to cut South Korea's 2014 growth estimate**
**Oct 06.** South Korea's central bank is expected to lower the country's economic growth forecast for 2014 due to growing signs of a global economic slowdown. After the monthly monetary policy meeting on October 3, the Bank of Korea said it could cut next year's GDP growth forecast to between 3.8% and 3.9%, after the International Monetary Fund cut its global forecast for 2014. A slowdown of the world economy could have an immediate impact on Asia's fourth-largest economy as it would severely impact South Korea's exports, which accounts for around 50% of the country's GDP. (Yonhap News)

**Fitch: Global credit growth to pick up in developed world, slowing in emerging markets**
**Oct 04.** In its latest report, Fitch Ratings forecasts that 2013 global real lending growth should speed up to 4% from 2.5% last year, as credit contraction in developed economies and emerging Europe ends while emerging market growth continues at a slower pace. The credit ratings agency also said that macro-prudential risk indicators would continue to trend lower on the basis of recent and prospective credit growth. Fitch expects Latin America to overtake Asia to become the region with the fastest real credit growth, while developed economies may see a possible 1% rate of real credit growth. (Reuters)

**Greece's Piraeus and NBG to set up "bad banks" as bad loans soar**
**Oct 03.** Increasing amounts of non-performing loans (NPLs) in the Greek economy has forced the country's largest lenders Piraeus and the National Bank of Greece (NBG) to create "bad banks" to house unpaid loans and restore confidence in the rest of their businesses. NPLs constituted 29% of loans across Greece's biggest four lenders at end-June this year, four times the 7.15% average across the eurozone measured in 2012. Piraeus deputy CEO is optimistic about Greece returning to growth next year, as interest in NPLs has started to taper off. (Reuters)

**Moody's upgrades Philippines' credit rating to investment grade on back of robust economy**
**Oct 03.** Moody's Investor Services raised its sovereign rating on the Philippines from Ba1 to the investment grade Baa3 with a positive outlook on October 3. The credit rating agency cited the Philippines' robust economy, political stability and improved governance as reasons for its upgrade. The Philippine economy had expanded at a region-leading pace of 7.5% in Q2, with the Asian Development Bank increasing its latest growth forecast for the economy to 7% for 2013, up from 6%. (Washington Post)

**Sluggish economy, tight credit take toll on smaller Indian firms**
**Oct 03.** India's continuing economic slowdown has impacted many Indian companies, particularly small and medium-sized firms, due to their limited access to capital. According to various ratings agencies, the debt situation at present is the worst in a decade which could lead to a rise in defaults and bankruptcies. Small and medium-sized firms support a considerable part of the Indian economy – about 45% of manufacturing and 40% of exports. Ratings agency Fitch expects non-performing loans at Indian banks to reach a nine-year high of around 4.5% for the fiscal year ending March 2014. (Reuters)

**IPad prices jumping 12% on IDR show inflation pressure**
**Oct 03.** Indonesian's severely weakened rupiah has led to escalating import costs and is fueling the archipelago's surging inflation of 8.4% in September. According to data from Indonesia's leading Apple Inc. retailer and the trade ministry, the cost of IPads climbed 12% last month. As the worst performing emerging market currency tracked by Bloomberg, the Rupiah's 14 percent decline in Q3 has increased the cost of production and imported raw materials. This could add to existing inflationary pressure built up from higher interest rates and fuel prices. (Bloomberg)

**China official services PMI hits six-month high, supported third-quarter pickup**
**Oct 03.** China's official purchasing managers' index (PMI) for the services sector jumped to a six month high of 55.4 in September, up from 53.9 in August. The expansion in China's service sector was supported by strong consumer demand. The reading also suggests a potential pickup in China's economy after a two-quarter slowdown. The services sector accounted for about 45% of the economy's output last year and has been become an increasingly important pillar in China's economy as the government seeks to expand consumption to fuel growth. (Reuters)

**Bank of America says bonds to beat stocks in debt gridlock**
**Oct 02.** Strategists at Bank of America and Wells Fargo Co. predict that dollar denominated corporate bonds will outperform stocks this month if the political gridlock persists. The argument is that stocks will be more vulnerable than credit as the market focuses away from increasing rates to the government shutdown. Analysts say that the first shutdown in 17 years may subtract as much as 1.4 percentage points from economic growth, as a lengthy fiscal budget fight would dampen consumer sentiment and restrain the sales of luxury goods and travel demand. (Bloomberg)

**RBA keeps rates at record lows**
**Oct 01.** The Reserve Bank of Australia (RBA) said it would leave its key cash rate at a 60-year low of 2.5%, notably excluding language hinting at future rate reductions. The RBA said that the easing in its monetary policy since late-2011 has supported interest-sensitive parts of the economy, but the full effects are yet to filter through. Borrowing remains subdued, although there are signs of increased household demand for borrowing and higher-risk assets. The RBA continued to talk down the AUD, saying a lower AUD would help the continual adjustment of the economy following the peak in mining investment. (Sydney Morning Herald, Reserve Bank of Australia)

**Iran eyes economic revival after historic Obama call** (Dawn)

**Rupee sees a few days of stability** (Dawn)

**UK's payday lenders escape interest rate clampdown** (Reuters)

**Ireland freezes debt issuance as it eyes bailout exit** (FT)

**European bank bond issuance leaps** (FT)

**Puerto Rico record yields luring buyers of distress** (Bloomberg)

**Bank of Japan warns of severe global impact from US fiscal standoff** (Reuters)

**NZ dollar jumps after Reserve Bank comment** (The Australian)

**Li: China confident in meeting economic targets** (China Daily)

**World Bank lowers Malaysia's GDP growth** (The Star)

**World Bank cuts 2014 Indonesia GDP forecast to 5.3%** (Bloomberg)

Published weekly by Risk Management Institute, NUS | Disclaimer
Contributing Editor: Dexter Tan