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Transforming Big Data into Smart Data

Weekly Credit Brief Oct 08 - Oct 14 2013

Stories of the Week

US T-bill rates rise as fiscal talks continue

Current US T-bill rates are rising as investors prepare to bid for USD 68bn of securities to be sold by the US Treasury on October 16. A USD 35bn sale of 3-month bills by the US Treasury on October 15 attracted bids for 3.13 times the amount offered, the lowest level since 2009. The US Treasury expects to exhaust its borrowing authority around October 24 unless Congress raises the debt ceiling by October 17. Over the last week the T-bill yield curve has steepened significantly (Figure A1), after falling following the lack of a taper in September's Federal Open Markets Committee meeting. Moreover, yields on T-bills maturing on October 17 October 24 both increasing dramatically, over fears the US Treasury could delay payments on these issuances.

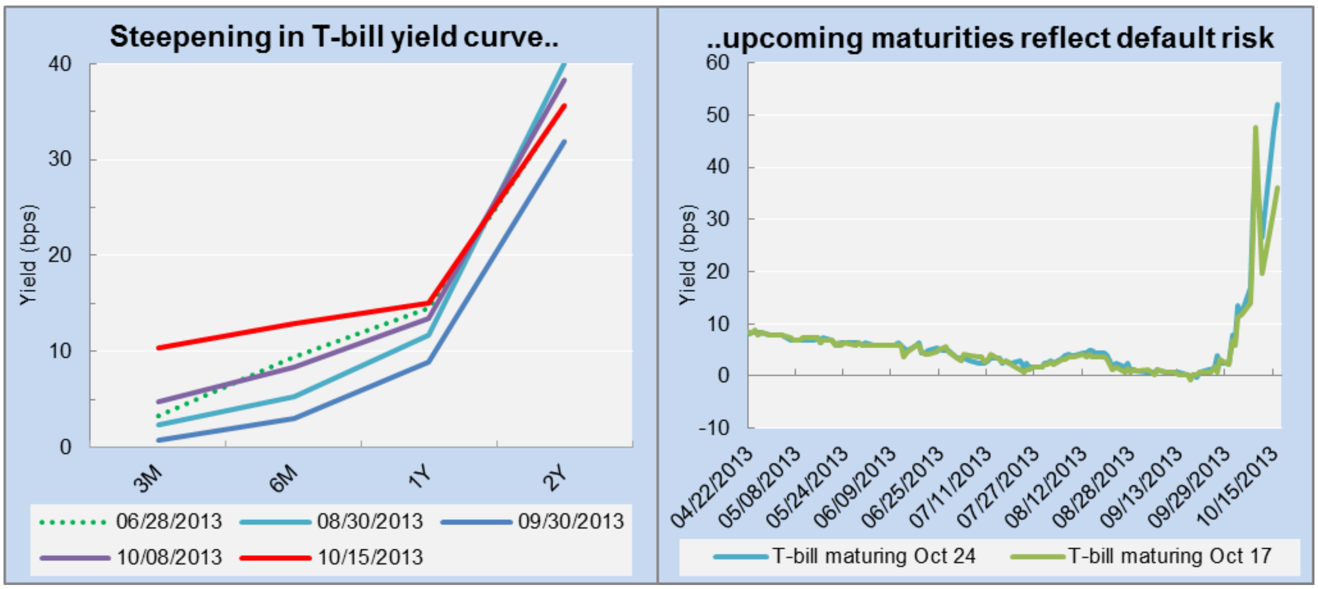

Figure A1: US Treasury bill yield curve (left), showing yields on most recent issues at each date, and daily yields on bills maturing through October 24 (right). *Source: Bloomberg*

Even if the US Treasury makes debt repayment a priority if the debt ceiling is not increased before October 17, it could struggle to payoff USD 363.39bn in bonds maturing before October 31. One of the primary options currently under consideration should the US Treasury exhaust USD 30bn of cash on hand is to extend the maturity of securities falling due one day at a time, and allow interest to continue to accumulate based on contract-specified rates.

Fitch Ratings placed the US government's AAA rating on negative watch yesterday, citing the failure of the government to raise the borrowing limit as the deadline for default nears. Moody's expects the debt ceiling to be raised before the October 17 deadline, allowing the country to avert a default. Moody's currently assigns the US a Aaa rating with a stable outlook. Standard & Poor's previously downgraded the US sovereign rating from AAA to AA+ on August 5, 2011.

Home Retail Group default risk falls to two-year low
By Ang Chung Yuh

UK high street stalwart Home Retail Group seems to remain on track for recovery as its RMI 1-year probability of default (RMI PD) has fallen to the lowest level since June 2011. The FTSE 250 retail group's financial position has strengthened over the years despite total group sales and profits staying flat in the country's dismal retail market.

Figure B1 shows the RMI PD of Home Retail and the average RMI PD of its listed competitors[1]. In spite of the rising trend of online purchases continuing its onslaught on Britain's high street, and the recent collapses of HMV, Comet and Jessops in a span of three months, British retailers generally are less likely to renege on their obligations than two years ago. The industry has adapted to the downturn by consolidating stores and reinventing the business from traditional store-based retail shopping to one that is taking place digitally more and more often.

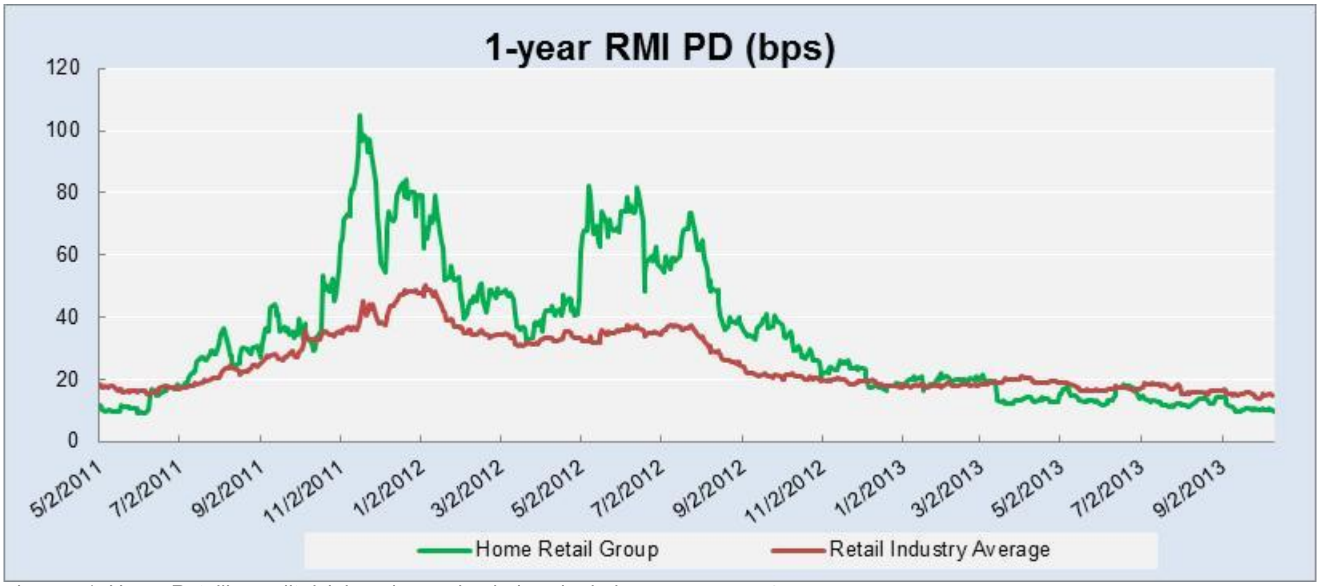

Figure B1: Home Retail's credit risk has dropped to below the industry average. *Source: RMI*

Home Retail Group has seen its market valuation climbed around 36% this year after a series of restructurings that saw the company moving away from its traditional printed catalogue and a remodeling into a digital business. The owner of the Argos and Homebase chains has strong cash flow characteristics, contributing to a war chest of GBP 396mn in net cash as at March 2, and a strong balance sheet. The company's leverage, or asset-to-equity, ratio has fallen to 1.55 in 2013 from an already healthy 1.8 in 2005. Its interest coverage ratio, defined as the ratio of EBITDA to interest expenses, improved markedly to 30.8 from 7.4 over the same period, while the company's current ratio increased to 1.73 from 1.17.

Table B1 (over page) highlights both the strength and fragility in Home Retail's financial position. In terms of the metrics measuring the company's credit risk, Home Retail has never fared better. The retailer has no outstanding loans for the past few years, although it has a GBP 165mn 3-year committed borrowing facility which is undrawn. The group's net current asset position (current assets minus all liabilities) swelled to GBP 514mn this year, meaning that the company has enough resources to pay off all its liabilities from its current assets alone, and still has plenty of money left for distribution to shareholders if it chooses to liquidate itself immediately.

Nevertheless, Home Retail has struggled in terms of profitability over the past few years, as low wage growth, economic recession and migration of retail sales online have dampened consumer demand and compressed the company's profit margins. Return on assets sank to 2.28% last fiscal year from 2005, while the net income margin dropped to an awful 1.72% from 4.65% over the same period. The company's home improvement subsidiary Homebase has suffered declining revenue and operating income in recent years. The printed catalogue retailer Argos is performing better as it tries to target more affluent clientele and switch to an online format. Its recent launch of its own GBP 99.99 Android tablet signals its intention to offer online services beyond retail and compete for market share in UK's fast-growing tablet business.

[1]There are 47 British retail companies under RMICRI coverage as of October. Defaulted and delisted companies are excluded.

	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009	FY 2008	FY 2007	FY 2006	FY 2005
(GBP millions)									
Cash & Near Cash Items	396	194.3	159.3	364	209.4	174	283.8	131	93
Net Debt	-396	-194.3	-259.3	-414	-284.4	-174	-60.2	1417	815
Net current asset	514	344.2	497.8	616.8	378.7	445.2	215.1	-50	-116
Interest Expense	7.5	48.4	50.2	45.6	53.5	25	71.4	78	73
Short-Term Borrowings	0	0	0	0	0	0	223.6	1328	684
Long-Term Borrowings	0	0	0	0	0	0	0	222	224
(%)									
Return on Equity	3.5088	2.7131	6.8084	7.4596	-13.5363	9.172	6.4028	6.7386	9.510974
Return on Assets	2.2777	1.7873	4.5371	4.9558	-9.3014	6.3912	3.7657	3.582	5.278906
Net Income Margin	1.7168	1.304	3.2622	3.4835	-7.0048	4.9225	3.3424	3.2624	4.649
CFO/Total Liabilities	19.68	15.1894	19.3398	25.583	28.6703	35.9252	33.2711	9.0875	3.3141

Table B1: Home Retail Group's liquidity and credit ratios have improved but profitability declined. *Source: Bloomberg*

In the News

Singapore allows currency gains as inflation beats GDP drop

Oct 14. The Monetary Authority of Singapore (MAS) reiterated its policy of a "modest and gradual" appreciation of the SGD and left the currency's trading band unchanged, as inflation management took precedence over economic stimulus. Driven by a tight labor market, Singapore's inflation surged to a five-month high of 2% in August on food and housing, after earlier easing from more than 5% in mid-2012. Meanwhile, the city-state posted a higher-than-expected YoY GDP growth of 5.1% relative to 4.2% in the preceding quarter. On a QoQ basis however, the economy shrank by 1% after recording a 16.9% growth previously in Q2. (Bloomberg)

China central bank says 2013 GDP growth to exceed 7.5 percent: Xinhua

Oct 11. Deputy central bank governor Yi Gang was quoted by Xinhua as saying that 2013 GDP growth for China is likely to exceed 7.5%. There are signs of stabilization partly due to government measures to shore up growth, including lowering taxes for small firms and accelerating infrastructure spending. Third-quarter GDP will be out on October 18 and analysts expect growth to up its pace to 7.8% YoY. Yi did not elaborate on how the government is tackling the issues of China's shadow banks and increasing government debt. (Reuters)

World Bank to consider three-year lending program with Argentina

Oct 11. The World Bank agreed on October 10 to contemplate a new lending program for Argentina involving an estimated USD 3bn in the next three years at a time when the South American country is a pariah in the international credit markets. The bank said that the partnership would prioritize investments in public health, education and rural infrastructure. The new program would also provide badly needed dollars to Argentina, whose foreign-currency reserves fell to USD 34.6bn on October 10, their lowest level since March 2007. (The Wall Street Journal)

Brazil raises rate for fifth time since April

Oct 10. The Central Bank of Brazil lifted the country's benchmark interest rate by half a point on October 9, its fifth consecutive rate increase and approaching the politically sensitive double-digit level. The Selic rate hike, which brought it to 9.5%, raised debate about whether the central bank plans to maintain the current pace of rate increases at its next meeting in six weeks' time. The bank made no changes to the statement that accompanies the monetary policy committee decisions, suggesting that it may have another increase of 50bps at the November 26 meeting. (Financial Times)

BOJ debt rollover to buck estimate of 18 trillion Yen rise

Oct 10. The Bank of Japan's direct debt purchases from the government may be capped in the next financial year at about the current level, despite forecasts for an increase of as much as JPY 18tn (USD 185bn). According to anonymous government officials familiar with the matter, direct purchases of one-year bills will not increase considerably from this year JPY 11.7tn. This move is to avoid any market speculation that the Japanese central bank is financing the government spending. "More than anything, the BOJ hates to be seen as financing government debt," said Yoshimasa Maruyama, chief economist at Itochu in Tokyo. "The BOJ will keep the size at the same level as this year and shun any action that could be perceived as debt monetization." (Bloomberg)

Biggest Danish banks need USD 15.4bn buffer to meet rules

Oct 09. Danish lawmakers agreed last week on a national regulatory framework for systemically important financial institutions, putting pressure on Denmark's largest banks to raise USD 15.4bn in additional capital. According to the agreement, large lenders will need to hold up to 3% additional capital based on their risk-weighted assets in 2012. Overall, this means systemically important banks will have to hold as much as 13.5% of risk-weighted assets in Tier 1 and hybrid capital. Denmark now joins Sweden as one of the first EU nations to set national requirements for banks before EU-wide rules become binding. (Bloomberg)

Arab Spring economic hardships drive Mecca gold sales down 50% ahead of Haj (Reuters**)**

Bank Indonesia regulates currency hedging for stable rupiah (Bloomberg)

Europe asset-backed securities at risk (FT)

Ireland says may exit bailout without EU backstop (Reuters)

Indonesia's central bank holds interest rate steady at 7.25%, likely ending recent liquidity tightening measures (International Business Times)

Leveraged-loan prices soar to highest since 2008 in Europe (Bloomberg)

Low growth, high inflation likely to persist in India (Reuters)

Najib sees Malaysia escaping Fitch rating cut: Southeast Asia (Bloomberg)

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