Positive signs in the Greek economy's road to recovery but caution remains

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After a decade from the Greek government-debt crisis, Greece in recent years has been on track building up its economy. In 2009, Greece had a budget deficit of 12.9 percent of its GDP and had its credit ratings slashed by the top 3 credit rating agencies. The EU had to prepare a bailout package of 240bn euros to back Greece by helping it fund its interest obligations and help to ensure that the banks were well funded. Ever since the financial crisis, Greece has been getting back on track and it was able to issue bonds in 2017. A new political party, the New Democracy Party, was recently elected on the promise of creating jobs and luring investment to boost the economy. This article aims to explore Greece's current credit situation and happenings. It will also provide a future outlook on Greece's credit profile.

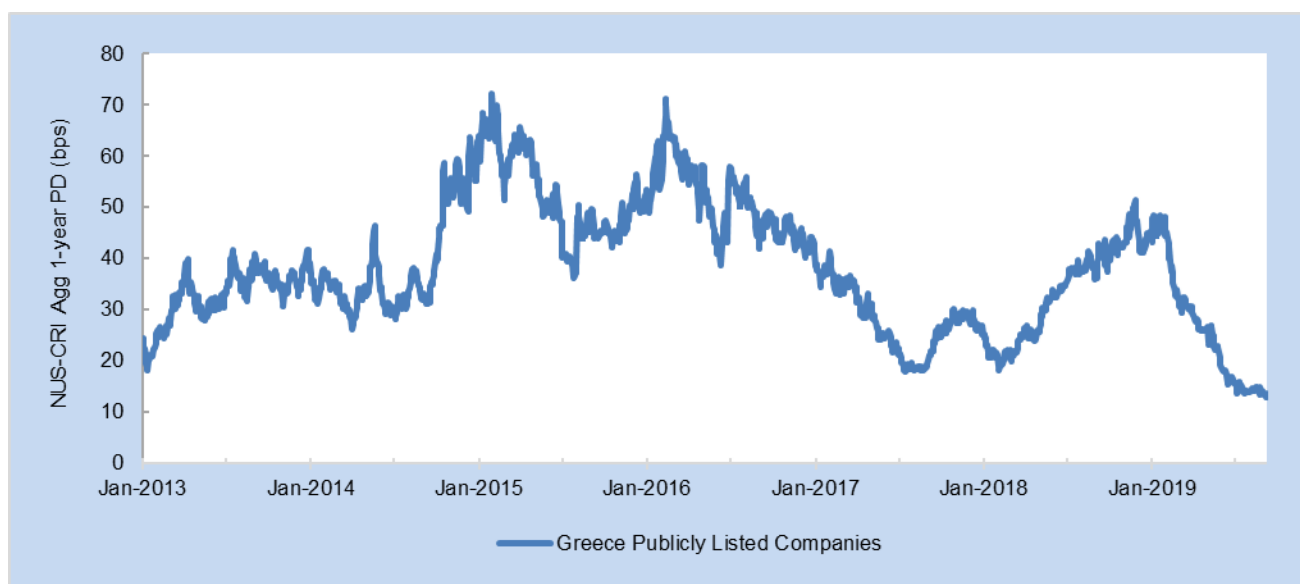

Figure 1: NUS-CRI Aggregate 1-year PD for publicly listed Greek companies. *Source: NUS-CRI*

The NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) for publicly listed Greece-domiciled companies has decreased from a high of near 45bps at the start of 2019 to a low of 13.5bps in September 2019. The NUS-CRI Agg PD explores the credit profile of publicly listed Greece-domiciled companies. The Agg PD for these corporates is also at an all-time low since 2013 and this shows the improving credit situation in Greece. Greek companies have been actively issuing corporate debt in the recent years and corporate bonds are at record levels with issuance in 2018 hitting USD 12bn. The recent surge in newly issued corporate debt reflects a growing positive investor sentiment in Greek companies.

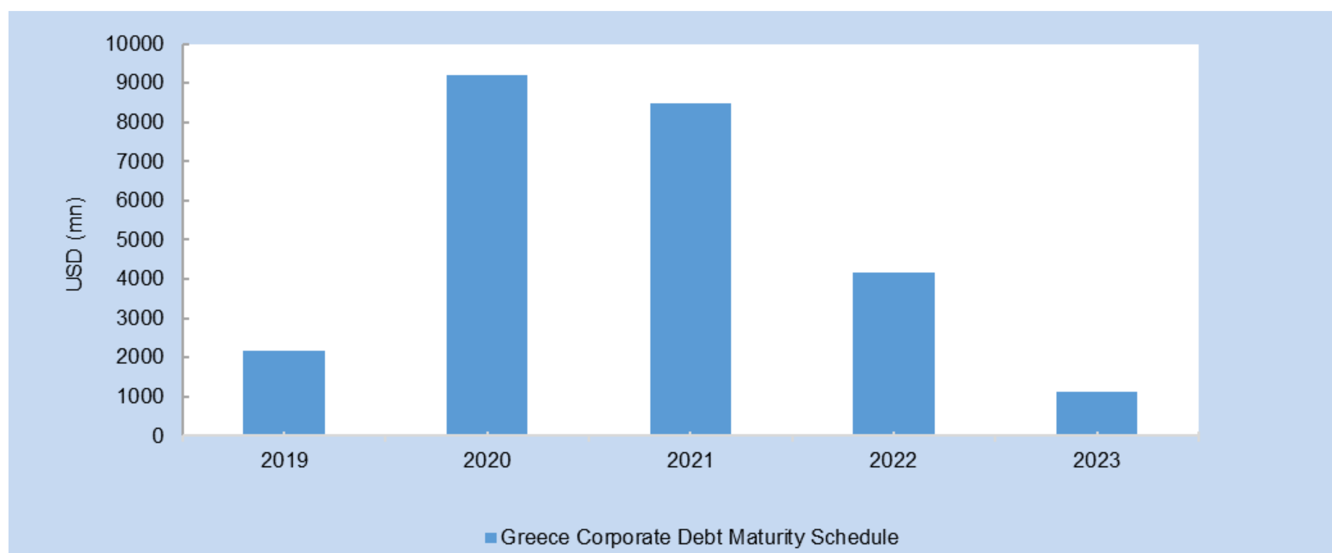

Figure 2: Greece Corporate Debt Maturity Schedule. *Source: Bloomberg*

The Greek government has recently announced that capital control will be fully lifted on September 1st which means that there will no longer be restrictions on businesses and investors. Without the restriction on capital outflow, investors would be more willing to invest in Greek bonds. Furthermore, investors are ploughing back into Greek bonds as the yields that are offered are still trading in the positive region, pushing up Greek bond price. Currently bonds worth nearing USD15tn globally, representing a quarter of debt outstanding, are trading at negative yields. Such instance makes Greek bonds more attractive to yield-starved investors as they are offering positive yields.

The government is also looking to implement tax reforms to support economic growth. Corporate tax will be reduced from 28 per cent to 24 per cent and income tax will also be reduced. By reducing taxes, businesses will be able to use their savings to expand their current operations.

Figure 3: NUS-CRI Forward 1-year PD term structure for publicly listed Greek Companies. *Source: NUS-CRI*

Although the current situation for Greece looks promising, global uncertainties will play a part in Greece's credit outlook. Furthermore, global growth is showing signs of slowing and this could be another contributor to the worsening credit outlook. The NUS-CRI Aggregate Forward 1-year PD for Greek corporates shows that the credit profile of Greek companies will worsen going forward. This could also be attributed to the significant

amount of corporate debt that will mature in the next few years (see Figure 2). The Forward PD calculates the conditional credit risk the companies will face in the future. Going forward, Greece could face multiple challenges ahead on its road to full recovery.

Credit News

The global risk brewing in Japan's ailing local banks

Sep 9. Japanese regional banks are facing headwinds as ultra-low interest rates have been slashing their loan income over the years. The yield on 10-year Japanese government bonds turned negative in 2016 and it is now -0.25%. In order to maintain profitability, these banks seek to ramp up higher-margin lending to "medium risk" companies, risky property loans, and structured products of foreign debt, which did not meet their financial standards in the past. In addition to the declining net interest margin in their home market, the aging population also gives regional lenders more incentive to take more risk. As Japan's regions aged and declined, the regional banks ended up with more deposits from elderly savers than loans to growing borrowers. Neither of their two responses could last: reversing existing loan-loss provisions and selling assets from their securities portfolio. These banks are running against the clock – reserves for loan losses are declining and the economy's capital ratios are already falling. In a deep downturn, the bailout of the regional banks will be in question. (FT)

In bond anomaly, negative yields bring positive returns

Sep 8. Investors are entering into complex strategies to generate a positive return from negative-yielding debt as more than USD 16tn of bonds, most of them sold in Europe, are currently trading with negative yields. One such method that investors use to achieve positive returns is by utilizing currency hedges to squeeze gains from what looks like losing bets. Many US investors are not enthusiastic, however, as some lack approval to buy European debt or to hedge currencies. Others are also reluctant to pursue this strategy due to its complexity and because it is mainly driven by the hedge, not the underlying value of the bond. However, with both US and European yields are expected to fall further, hedging debt can be a way to boost investors' returns. (WSJ)

Corporate bond issuance sets global record

Sep 7. Last week, more than USD 140bn of new corporate bonds were issued, the largest weekly volume to hit global markets on record. This was mainly fuelled by US investment-grade debt, where USD 72bn was raised across 45 deals during the week, matching the amount issued in the whole of August. The US bond market was particularly attractive because of its relatively higher yields prevailing in the world of negative-yielding debt; US high-grade investors bought USD 167bn bonds year to date, as compared to USD 108bn for the whole of 2018. According to analysts at BAML, US corporates said they would use the new funds to refinance debt and increase duration, rather than increasing leverage. (FT)

Bond investors are bracing for a bubble and being smart about it

Sep 5. Global economic pessimism has pushed yields on more than USD 17tn of global debt below zero, with Germany's entire yield curve now negative. Some investors believe there is a significant risk of a sell-off if the big global risks -- the trade war or Brexit -- ease off or central banks underwhelm with their policy response. The fear of a global bond bubble bursting has the market on edge, but it also attracts bond investors to bet against the rally to seek profit. Another way to avoid the risk is to shorten its duration by increasing allocation into shorter-dated securities. In addition to cutting duration, investors also minimize risk by boosting holdings of high-quality credit. (Bloomberg)

China's private bond defaults climb to record USD 4.4bn

Sep 5. More Chinese companies are defaulting on private bonds this year because weaker companies seek to repay publicly traded debt first when facing financial stress. Chinese issuers have missed repayments on a record RMB 31.8bn of private bonds this year through August, compared with RMB 26.7bn for all of 2017 and 2018 combined. Total corporate bond defaults in China year-to-date were at RMB 78.4 bn, up 51% from the same period last year. Amid the rising default of privately issued bond, investors are asking for higher risk premium on privately issued notes. The average coupon difference between new sales of private and public bonds was 154 basis points in January, and then rose to 179 basis points at end-August. (Bloomberg)

Restaurant Brands set to issue a high-yield bond below 4% (FT)

High-quality companies are selling bonds at fastest pace ever (Bloomberg)

Bank bonds gain in India as mergers set to boost credit profiles (Bloomberg)

Regulatory Updates

China's PBOC cuts reserve ratio for banks as economy stalls

Sep 6. PBOC said its reserve requirement ratio will be cut by 50bps effective from 16 Sep, with further cuts targeted to take place on 15 Oct and 15 Nov for some qualified banks. The move would effectively pump RMB 900bn (USD 126.35bn) of liquidity into the Chinese banking system. It is the 3rd reserve ratio cut this year and the 7th since 2008. Lowering the required ratio will increase the supply of money that banks can lend to businesses and individuals, and therefore cutting borrowing costs. In the announcement, the PBOC also said there would be no "flood-like stimulus" for China and the bank would keep a prudent monetary policy. (CNBC)

US Fed eases recession fears as rate-cut hopes rise

Sep 8. Analysts expect another quarter-point cut as the Federal Reserve is committed to keeping the United States economic expansion going, signalling future rate cut. Mr Powell expressed that the US central bank is not forecasting or expecting a recession, supported by the fact that the Fed has through the course of the year seen fit to lower the expected path of interest rates. While the jobs report was below expectations, the US economy is being propped up by consumer spending. The return of optimism somewhat hinges on the outcome of trade talks with China next month. (Straits Times)

Erdogan Says Turkey to Soon Cut Interest Rates to Single Digits (Bloomberg)

Kuroda says cutting rates 'further into negative' an option (Asia Nikkei Review)

Published weekly by Risk Management Institute, NUS | Disclaimer
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