Weekly Credit Brief
Sep 17 - Sep 23 2013

Stories of the Week

Fed's QE surprise: no taper

The US Federal Reserve surprised everyone on September 18, at the end of the closely-watched Federal Open Market Committee (FOMC) meeting, by deciding to maintain its current pace of asset purchases at USD 85bn per month. The central bank was forced by weak economic numbers and higher trending interest rates to call off the taper, and the rate-setting FOMC said that it would like to see more signs of sustainable labour market gains before easing up on its monetary stimulus. The median estimate in a Bloomberg survey during August 9 to 13 had expected the Fed to begin curtailing asset purchases at its September 17-18 meeting.

US equities, Treasury bond prices and gold soared and the dollar sank as investors reacted to the news. The S&P 500 equity index reversed an earlier fall to touch a record high of 1,729.44, before easing slightly to end the September 18 session with a 1.2% gain to 1725.52.

The Fed cuts its growth forecast to 2.2% in 2013 and 3% in 2014, compared with their earlier predictions of 2.5% and 3.3% respectively made in June. Also, the FOMC sent a strong signal that the low-rate environment is here to stay for a long time as it estimated that interest rates would be 1% at the end of 2015 and 2% at the end of 2016. Federal Reserve Bank of St. Louis President James Bullard said in an interview on September 20 that the Fed may reduce bond purchases in October.

Sources:

FOMC statement, 18 September 2013 (The Federal Reserve System)
Fed holds the line on bond buying (Financial Times)
Bullard says taper possible next month after close QE decision (Bloomberg)

Sweden suggests countercyclical capital buffers for banks; RMI data shows safest in Europe

Sweden's Finance Minister Anders Borg last week said domestic banks should prepare for years of regulatory tightening, as the government and banking regulators look to protect the economy from a banking sector four times its size. This comes after the Swedish Financial Supervisory Authority (FSA) and the central bank (Riksbank) said earlier in September that banks would need to hold capital in excess of that mandated under Basel III to offset record household debt burdens. This means the yet to be implemented countercyclical capital buffer (CCyB) for Swedish banks, which has a predetermined range of zero to 2.5%, may stay above zero for several years, with Riksbank governor Stefan Ingrevs suggesting the CCyB will probably be much higher than zero.

Under the Swedish version of Basel III rules that came into effect in January, banks must maintain a Core Tier 1 Capital Ratio of at least 10% of their risk-weighted assets (RWA), which is due to increase to 12% by 2015. All four of the major domestic lenders currently exceed the current Swedish Core Tier 1 Capital requirements, with capital levels amongst the highest in Europe (Figure 1). Higher capital levels have been viewed positively by the markets. RMI's probability of default (RMI PD) model, based on market and fundamental data, shows the Swedish banking system currently has the lowest default risk among northern and central European economies (Figure 2).

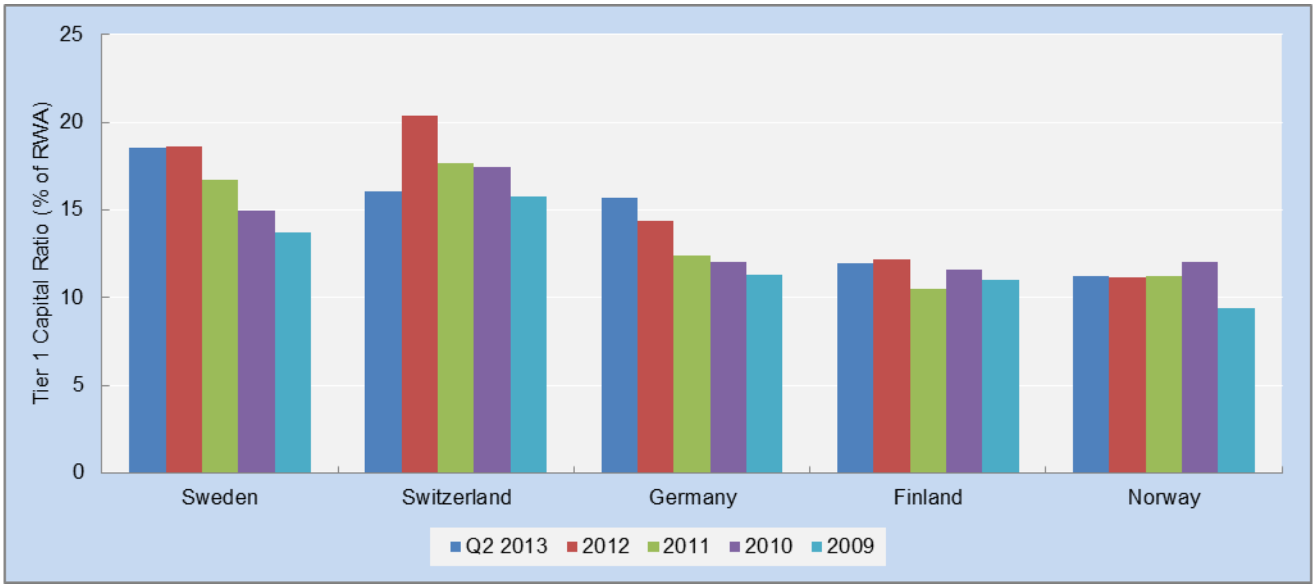

Figure 1: Asset-weighted Tier 1 Capital ratios for European banking systems. Tier 1 Capital ratios are presented instead of Core Tier 1 ratios for comparative purposes. *Sources: Bloomberg, Company financial statements.*

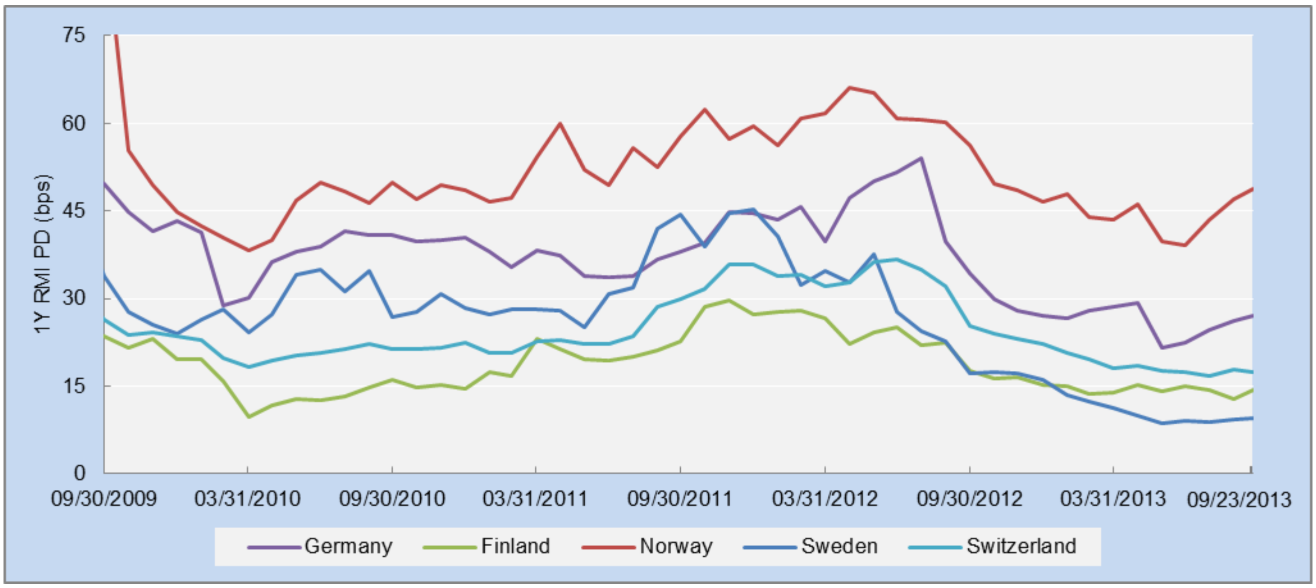

Figure 2: Aggregate 1-year RMI PDs for central and northern European banking systems. *Source: Risk Management Institute*

The central bank of Sweden estimates that private debt will reach 177% of disposable incomes by 2015. On average, Swedes take 150 years to pay down their mortgages, with many lenders allowing borrowers to pay off the interest portion alone. The FSA is considering forcing households to amortize their mortgages if the pace of borrowing becomes unsustainably, and is also considering increasing the risk weights for mortgages used in the calculation of RWA, on top of the introduction of the CCyB.

Sweden joins Norway and Switzerland in mandating a CCyB in addition to minimum capital levels as the nations attempt to stave off surging domestic housing markets. In February, Switzerland became the first country to require banks to hold extra capital to protect against an overheating domestic real estate market, mandating banks to hold an extra 1% of capital to RWA. The Norwegian financial regulator is set to finalize details of its countercyclical capital buffer in December, after officials suggested banks should start building additional buffers on September 19.

Sources:

Sweden tells biggest banks to gird for years of rule tightening (Bloomberg)
Swedish regulators may act further on lending, household debt (Reuters)
Switzerland imposes capital buffer on banks (Financial Times)
Banks should hold a countercyclical capital buffer (Norges Bank)

In the News

China's Easy Money Has Cost as Ecuador Pledges Oil

Sep 20. Ecuador obtained a USD 1.2bn four-year loan last month from China to be paid back with oil, allowing the country to reduce its borrowing costs while avoiding bond investors who President Rafael Correa termed "true monsters". The South American nation is likely paying an interest of 7.08%, according to estimates by Fiscal Policy observatory, a research firm in Quito, which is lower than the 8.63% average yield on similar-maturity bonds that share Ecuador's B rating from S&P. Ecuador has not borrowed from global bond markets since its USD 3.2bn default in 2008 and 2009. (Bloomberg)

Schroders says Fed taper delay to help Brazil sell bonds

Sep 20. Schroders Plc fund manager James Barrineau expects the US Federal Reserve's decision to maintain the pace of its bond-purchasing program this week to favor emerging market economies like Brazil to tap the global bond markets again this year. The yields on the 10-year global bonds of the largest Latin American economy have tumbled to nearly two-month lows following the Fed's announcement on Sep 18. Brazil last issued international bonds in May, raising USD 800mn in a reopening of its USD-denominated 10-year global bonds. (Reuters)

RBI ups repo rate by 25 bps on inflation concerns, cuts MSF

Sep 20. In a continued bid to tackle rising inflation, the Reserve Bank of India increased the benchmark repo rate by 25bps to 7.5% in its mid-quarter policy review. However, the central bank trimmed the marginal standing facility rate by 75bps from 10.25% to 9.5% and also reduced the minimum daily maintenance of the cash reserve ratio from 99% to 95% of the requirement, effective from the fortnight beginning Sep 21, 2013. (Moneycontrol).

Japan's Yields Fall to 4-Month Low as Fed Holds Policy, BOJ Buys

Sep 19. As part of its monthly purchases of more than JPY 7tn Japanese Government Bonds that aims to defeat deflation and spur growth, Bank of Japan bought JPY 600bn of debt and sent yields to the lowest in four months. Moreover, a surprise hold in U.S monetary policy has largely pushed back the expectations for higher US yields, and driven the bids on JGBs to higher level. The 20-year JGB yield sank to 1.59%, the lowest since June 3, while the 30-year rate reached 1.73%, a level not seen since late August. (Bloomberg)

China property developers pull down shutters, hoard cash

Sep 18. China's property developers have been hoarding cash and reducing capital expenditures to preempt against a possible liquidity crunch and to prepare for further government measures that aim cool down the property market. The biggest Chinese property developers are holding on to USD 25bn in cash on expectations that tapering of bond purchases by the US Federal Reserve will drive up interest rates. Capital expenditures by China's real estate management and development companies are also expected to fall 11% in the next 12 months. At the meantime, crackdown on real estate speculations are reducing demand for property, making companies more cautious about investing. (Reuters)

Europe sets out plans to stop benchmark rigging

Sept 18. European Union regulators have drafted rules that comprise Europe's first attempt to regulate how commodity and interest-rate benchmarks are set, in a bid to restore confidence in a sector that has suffered from past events such as the Libor rigging scandal. If passed, the new rules would empower regulators to force banks or other companies to submit data relevant to critical reference benchmarks. The European Commission continues to investigate reference rates such as Libor, having previously fined banks such as RBS, Barclays and UBS over Libor rigging, and has also raided offices of major commodity players such as Shell and BP over suspected manipulation of commodity prices. (Reuters)

Western Australia stripped of its AAA credit rating by S&P

Sep 18. The Iron Ore rich state of Western Australia was downgraded by rating agency S&P to AA+ from AAA, citing a relatively high debt burden and limited political will to improve the state's fiscal position after several about-faces over new revenue sources. S&P said the AA+ rating was supported by strong commodities wealth and positive liquidity, but was constrained by recent budgetary performance. The Western Australian state government said it would consider asset or land sales, and outsourcing some government activities, to bring the budget back in line. (Sydney Morning Herald, S&P)

Indonesia leads new bonds higher as US investors buy up Asian debt

Sep 18. Indonesia's new USD-denominated bonds is the top performer this month amongst its Asian counterparts outside of Japan, as US investors dismissed slowing regional growth concerns and added to their bond holdings. According to Bloomberg's sources, 24% of Indonesia's USD 1.5bn sukuk issuance in the week ending September 15 was snapped by US accounts, doubling the 12% share in the nation's last dollar sukuk auction in November. The 6.125% yield at which Indonesia priced its notes is the highest in four years. In spite of Indonesia's unprecedented current account deficit, ailing rupiah and slowing growth, the nation apparently still offers "tremendous opportunities", as noted by Credit Agricole CIB. (Bloomberg)

S&P warns of Portugal rating cut over second bailout threat (FT)

Dutch plan state-backed mortgage bonds to aid banks (Bloomberg)

Cyprus to end capital controls in January, president says (Bloomberg)

EU watchdog says new short-selling rules not harmful (Reuters)

Vietnam's bad debts hit 4.58 pct of loans at end-July (Reuters**)**

Bernanke faith in housing seen shaken in bonds (Bloomberg)

Li revives old lending playbook after cash crunch: China credit (Bloomberg)

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