Weekly Credit Brief Sep 24 - Sep 30 2013

Story of the Week

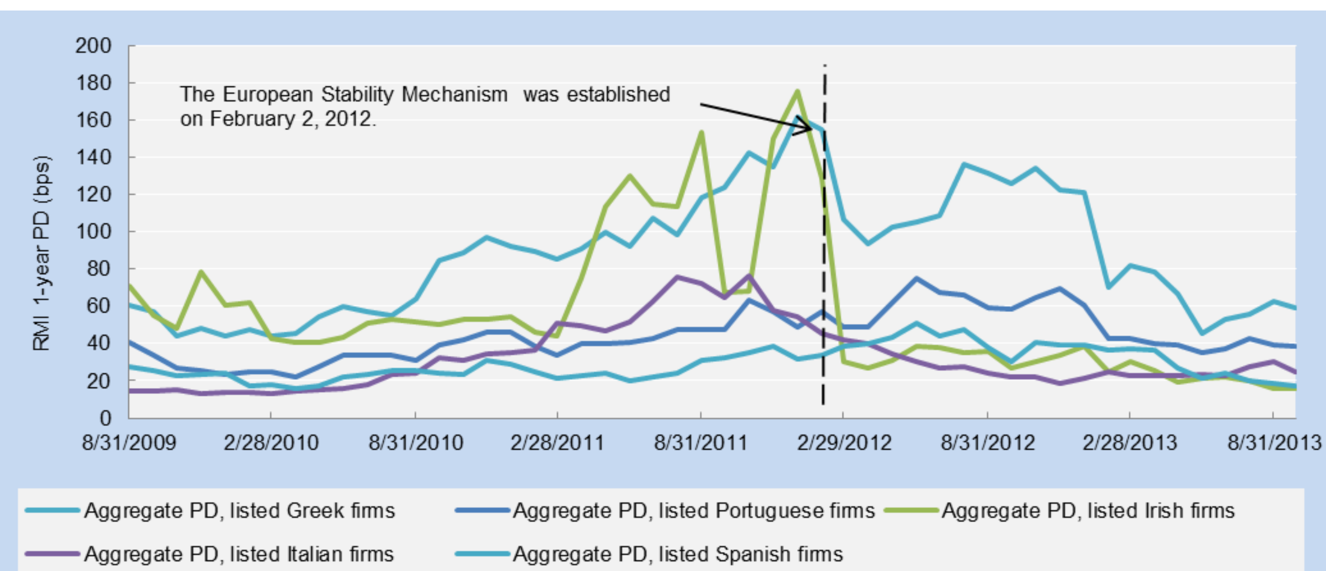
Bailed out nations get another four years of Merkel

Despite winning the German elections last week, Chancellor Angela Merkel failed to win an outright majority and led to a rumor that she would or should change her European policy in a new coalition government. However, the Chancellor stood firm on her austerity policies and strict budget discipline in the eurozone. The European debt crisis saw Germany became the largest contributor to EUR 496bn of rescue aid. But, opposition within her own party have already compelled Merkel to enlist the Social Democrats as the de facto crisis-management partners. At least on four occasions, including this year's aid package for Cyprus, the German leader had to rely on opposition votes to pass save-the-euro measures in the Bundestag.

Merkel reiterated her victory as a strong endorsement for Germany's responsibility in Europe, not just from an economic standpoint, but as an example of freedom and democracy. She hailed the crisis management in the eurozone as successful and emphasized the need for other countries to enforce labour market and structural reforms. In her opinion, this is necessary for countries to boost competitiveness, have a strong budget policy and restore the trust of investors and financial markets.

The average corporate credit profiles for troubled European nations often referred as PIIGS have improved (See Figure 1). The aggregate 1-year PD (RMI PD) for Irish, Portuguese and Greek companies have fallen from their elevated levels seen in 2012. The aggregate RMI PD for Greek companies has fallen to 59.4bps on September 27 from 161bps in December 2011. The average PD for Irish firms has also fallen to 15.6bps from 175bps seen on December 2011. The aggregate PD for Portuguese companies meanwhile decreased to 38.8bps from 74.91bps in May 2012.

The improved investor confidence has been due to the establishment of the European Stability Mechanism (ESM), which is a permanent crisis resolution mechanism for countries in the euro area. The ESM issues debt instruments in order to finance loans and other forms of financial assistance to euro area Members States. The decision leading to the creation of the ESM was taken by the European Council in December 2010. The euro area member states signed an intergovernmental treaty establishing the ESM on February 2, 2012. After the recent election win, Chancellor Merkel's party expressed continued support for the ESM as well as for the creation of the EU banking union and rejected the opposition's demands to dissolve the ESM even if the crisis is over.



Sources:

Merkel's CDU/CSU not willing to change ESM status (MNI News)
Merkel gets biggest victory since Kohl's reunification vote (Bloomberg)
Merkel says Europe policy will remain unchanged (FT)
What Angela Merkel's win means for Europe and beyond (Gulf News)

In the News

US government shutdown begins after Congress fails to break impasse

Oct 01. The US government began a partial shutdown for the first time in 17 years putting 1mn workers on unpaid leave, closing national parks and stalling medical research projects. Federal agencies were directed to cut back services after lawmakers could not break a political stalemate that raised new questions about the ability of a divided US Congress to perform its most basic function. (Reuters**)**

Indian finance ministry estimates put current account deficit for current year at just 2.6% of GDP

Sep 30. The Indian Finance Minister predicted the current account deficit for the current year at 2.6% of GDP or USD 48.2bn, as compared to its August estimate of USD70bn or 3.7% of GDP .This is an improvement over the record 4.8% posted during the last fiscal year. Falling gold and non-oil imports will result in a saving of USD 15bn. The improvement in the current account deficit is based on better-than-expected exports, lower gold and other imports and decreased demand for oil. Exports rose 4% in April-August, higher than the ministry's earlier estimate of 1.8% growth. (Indian Times**)**

China launches its first free-trade zone in Shanghai

Sep 29. China launched its new free trade zone in Shanghai on September 29 to boost its economy and deepen financial reforms. Regulations surrounding finance, investment and trade will be liberalized in the area. There are also plans to experiment with the convertibility of the CNY, allowing market forces rather than regulators to dictate currency rates. In addition, selected foreign companies will be allowed to be operated in the zone. The first batch of 25 Chinese and foreign companies were granted licenses to operate in the zone. (South China Morning Post)

Malaysia sells inaugural 30-year bonds to yield 4.935%

Sep 27. Malaysia sold its first ever 30-year bonds on September 27, as it seeks to set a new benchmark for companies raising funds under Prime Minister Najib Razak's MYR 1.43tn infrastructure development program. According to data from Bank Negara Malaysia, it received MYR 6.1bn worth of orders for the MYR 2.5bn notes maturing September 2043, which were priced to yield 4.935%. At a bid-to-cover ratio of 2.44, Malaysia's new longest maturity bonds attracted stronger demand than the 20-year Islamic debt issue last month, which was 1.62 times oversubscribed. In comparison, yields on similar-maturity US Treasuries, Singapore sovereign bonds and Thai debt were 3.71%, 3.16% and 4.60% respectively. The longest maturity sovereign debt in the region belongs to Thailand, whose 50-year bonds were sold back in December 2010. (Bloomberg)

South Korea's national debt growing sharply since 1997 crisis

Sep 27. Data released on September 27 showed that South Korea's national debt has been increasing sharply over the past decades. The ballooning debt raised concerns about the country's fiscal balance going forward. According to the finance ministry, the debt is projected to expand from KRW 480.3tn this year to KRW 515.2tn next year. The debt projected for 2014 is 8.5 times larger than the KRW 60.3tn debt in 1997. The debt-to-GDP ratio is also expected to grow significantly from 11.9% in 1997 to 36.5% next year. (Global Post)

Trace illuminating 144As portends broker squeeze

Sep 25. Corporate brokers may see profits decline as regulation dictate that brokers should publish prices for USD 1tn of privately sold debt. The US Financial Industry Regulatory Authority is seeking for more competitive pricing for securities issued to institutional investors under a rule known as 144A. Brokerage firms like Knight Capital Group closed their credit trading units as trading volumes fell to record low levels based on the proportions of the bond market. According to university researchers at Harvard and MIT, trading in securities had dropped 41% after the system started disseminating bond prices publicly. The rule affects as much as USD 300bn of speculative grade bonds and USD 670bn of dollar denominated investment grade notes. (Bloomberg)

Serial defaulter burnishes taper-proof status

Sep 25. Argentina's USD-denominated sovereign bonds have returned 16.3% since the end of June, nine times the average return on emerging market bonds and second only to Egypt among 58 developing markets tracked by JPMorgan Chase & Co. The 1.9% year-to-date return of the country's bonds compared with a loss of 6.1% for sovereign debt from developing nations highlight Argentina's immunity against US Federal Reserve policies that have thrown developing-nation bondholders into disarray. The third-quarter advance came despite Standard & Poor's downgrade of the nation's credit rating one level to CCC+, citing increased legal risk. (Bloomberg)

Top banks have EUR 115bn capital shortfall, most in Europe

Sept 25. Top banks are still EUR 115bn short of Basel III capital standards, of which European banks make up EUR 70bn or 61% of the total global shortfall. While banks have succeeded in cutting capital shortfall by EUR 83bn globally over the second half of 2012, European banks have lagged behind; the European Banking Authority (EBA) estimated that European banks only cut EUR 29bn over the same period. The EBA mentioned that although the top 42 European lenders have met liquidity targets, there currently exists a EUR 225bn liquidity shortfall amongst other smaller domestic banks. (Reuters)

Banks prove safer than Industrials in bond rally (Bloomberg)

China unveils new steps to free up interest rates (Reuters)

France public debt to hit record in 2014 (BBC)

Gross Says Investors Shouldn't Trust Moody's on U.S. AAA Rating (Bloomberg)

Italian bond yields rise as political tensions flare anew (Reuters)

Indian RBI will ensure enough cash for growth (Hindustan Times)

Japanese companies rush to sell long-term debt (FT)

Ukraine CDS jump to three-year high after Moody's downgrade (Business Week)

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