Weekly Credit Brief
Apr 02 - Apr 08 2013

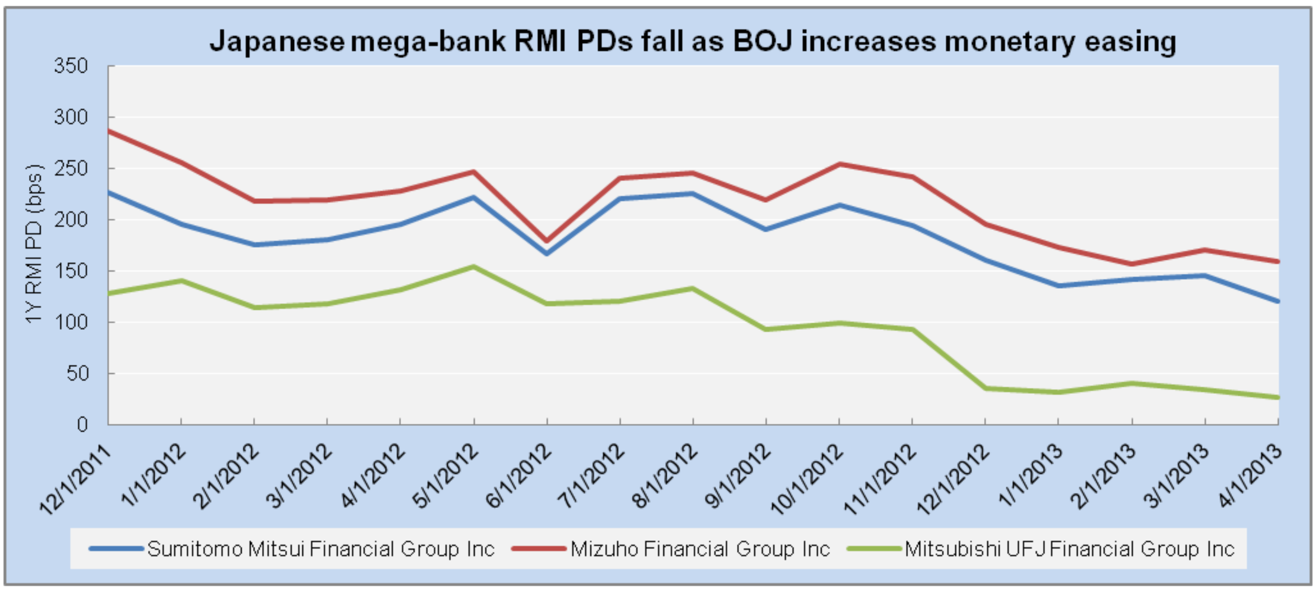
Story of the Week

BOJ announces further easing as credit outlook for mega-banks improves

By James Weston

Sentiment in Japanese credit markets improved last week after the Bank of Japan (BOJ) announced a new phase of unprecedented monetary easing. The plans will see the BOJ spend around JPY 7tr per month on bond purchases, over a much larger range of assets and maturities than previously conducted, and also increase purchases of shares in ETFs and domestic real estate investment trusts. This is aimed at doubling the JPY monetary base over the next two years, in an effort to stem ongoing deflation and meet a 2% inflation goal in around two years.

The BOJ's announcement had an almost immediate effect on local markets, with the Japanese sovereign yield curve flattening significantly. The spread between three and ten year sovereign yields reached a record low of 0.375% on April 4, increasing slightly on April 8 to 0.409%. The Nikkei 225 soared to a new record high of 13192 on April 8. This is likely to lead to a further improvement in the credit outlook for Japanese banks, with RMI PD data showing the credit quality of Japanese mega-banks has improved significantly over the last few months.



As the graph above shows, the RMI PD for the three Japanese mega-banks fell significantly in December, as markets anticipated further monetary easing by the BOJ. Confirmation of the BOJ's plans last week may lead to a further improvement in the credit outlook for Japanese banks. Primarily, the BOJ's plans improve the earnings outlook, asset quality and capital generation capability of all Japanese lenders, lending support to stronger credit profiles.

Banks are likely to generate significant revenues from sales of long-held equity investments in domestic companies, with domestic markets rallying as sovereign yields decline. In addition, BOJ purchases over a much wider range of assets will allow banks to dispose of a larger part of their large holdings of JGBs, generating further revenues and helping lenders reduce exposures to the sovereign. The latter will also reduce losses stemming from a possible loss of confidence in government bond markets, if the BOJ's policies do not promote sufficient growth to address fiscal imbalances.

This should flow through to earnings, with banks likely to retain a large part of higher revenues in capital, in order to support a possible increase in lending. If the BOJ's policies stoke inflation and boost the country's GDP rate, the increase in loan demand would provide further support to earnings going forward, and allow banks' to further diversify their portfolios away from government bonds. Reflecting confidence in higher earnings potential at Japanese banks, the Japanese TOPIX-Banks index increased 17.8% between April 1 and April 8, outperforming the Nikkei 225, which increased 8.7% over the same period.

Sources:
Introduction of the Quantitative and Qualitative Monetary Easing (Bank of Japan)

In the News

Loss of Generalized Scheme of Preferences (GSP) to lead to investment outflow

Apr 08. The rapid economic growth of Malaysia may have some unintended effects on the country's investment flows. Starting from January 2014, Malaysia will cease to benefit from the European Union's (EU) existing GSP, along with 12 other countries recently classified as upper-middle income nations by the World Bank. Businesses in these countries will no longer receive the maximum 3.5% tax reduction on export duties into the EU. In Malaysia, some economic sectors may see more relocation of businesses if the cost savings justify the cost of relocation. (The Edge Malaysia)

Merger loans surge in Asia as bank yield-race encourages buyouts

Apr 07. Acquisition lending in Asia tripled in the first quarter as banks chased higher-yielding assets to offset a slump in other syndicated financing, prompting borrowing costs to fall. Loans for acquisitions in the Asia-Pacific region outside of Japan jumped to USD 11.4bn in the first three months of 2013 from USD 3.8bn a year earlier. Interest margins in the region for US dollar-denominated M&A loans slid to 343.8bps from 382.5bps. That still exceeds the 263bps on lending for general corporate purposes. Asian banks that are sitting on excess cash are seeking more lucrative returns through acquisition financing as the cost of global money stays at record lows, with lenders in regions including China and Australia seeking large syndication deals. (Bloomberg)

China's credit bubble is swelling, not bursting

Apr 04. China's debt to GDP jumped from about 120% in 2007 to 180% in 2012. That rapid expansion is testing the capacity of China's banks to manage credit risk and raising fears of financial instability in the country. But the country is not on a brink of collapse. China's high savings rate, closed capital account and low external borrowing provide a cushion to the high borrowing ratio. (WSJ)

Cyprus economy may shrink 13% in 2013, government spokesman says

Apr 04. Government official Christos Stylianides said that the Cyprus economy may contract as much as 13% under the weight of austerity measures and restructuring of the country's banks in return for a bailout. The austerity measures include public sector wage cuts in 2014 and tax increases. Stylianides reaffirmed that exiting from Eurozone was not an option for the country, and with the right measures Cyprus could see an economic turnaround in 2014. (Bloomberg)

Spanish bonds rally after above-target debt sale

Apr 04. Spain drew strong demand for its bonds and sold more debt than expected at an auction. Although the fragile Spanish banking system was a huge concern from the recent fallout in Cyprus, investors seemed keen to buy the high yields on offer in Spain. The 10-year Spanish sovereign bond yield fell to 4.85% on Friday. (Reuters)

Philippines central banker warns on risky lending

Apr 02. The governor of Bangko Sentral ng Pilipinas indicated that risky loans could harm the stability of the financial system, especially in the property sector. The central bank in Philippines is preparing to standardize the regulations in the credit card sector, while also initiating a rating system for monitoring banks' practices on consumer protection. (WSJ)

China key money rates fall, traders predict ample liquidity (Reuters)

"Sleeping giant" debt market awakes in Saudi Arabia (Reuters)

Saudi Arabia leaves International Islamic Liquidity Management Corp (Gulf News)

Uribe could use interest rates to curb Colombian financial risk (Bloomberg)

Hungary takes aim at lending, company foreign currency debt (Reuters)

RBA extends rate pause at 3% as hurdle for action rises (Reuters)

Britain's debt mountain reaches GBP 1.39tr, equivalent to 90% of the entire economy (Dailymail)

France drags on euro zone economy, Britain brighter (Reuters)

BOE power revamp takes effect as regulation role crystallizes (Bloomberg)

Banks say stricter securitization rules may hurt lending (Bloomberg)

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