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Credit profile of Russian companies improves

by Justin Hsiao

Last year, the Russian economy had had its worst performance since the Ruble crisis in 1998. However, in the first quarter of this year, the Russian currency has performed the best among global currencies. The Russian economy grew by 0.4% in Q4 2014, compared to the zero growth or recession that most of the economists had expected. The MICEX index, the main stock index in Russia, increased by 18.7% from the beginning of this year to 1657.02 on Apr 10, 2015. As a result, the credit profile of Russian companies has improved and is mainly driven by greater confidence in the ruble, easing tensions over Ukraine and oil price stability.

As shown in Figure 1, the RMI Aggregate 1-year Probability of Default (PD) of Russian Federation has decreased significantly from 260.36bps on Dec 16, 2014, a six-year high since the 2009 financial crisis, to 69.66bps on Apr 10, 2015. The six-year high PD corresponded to a yield of 19.24% - an all-time high - on Russian 1-year government bonds one day after Bank of Russia increased its benchmark interest rate from 10.5% to 17% to combat inflation and the weakening ruble.

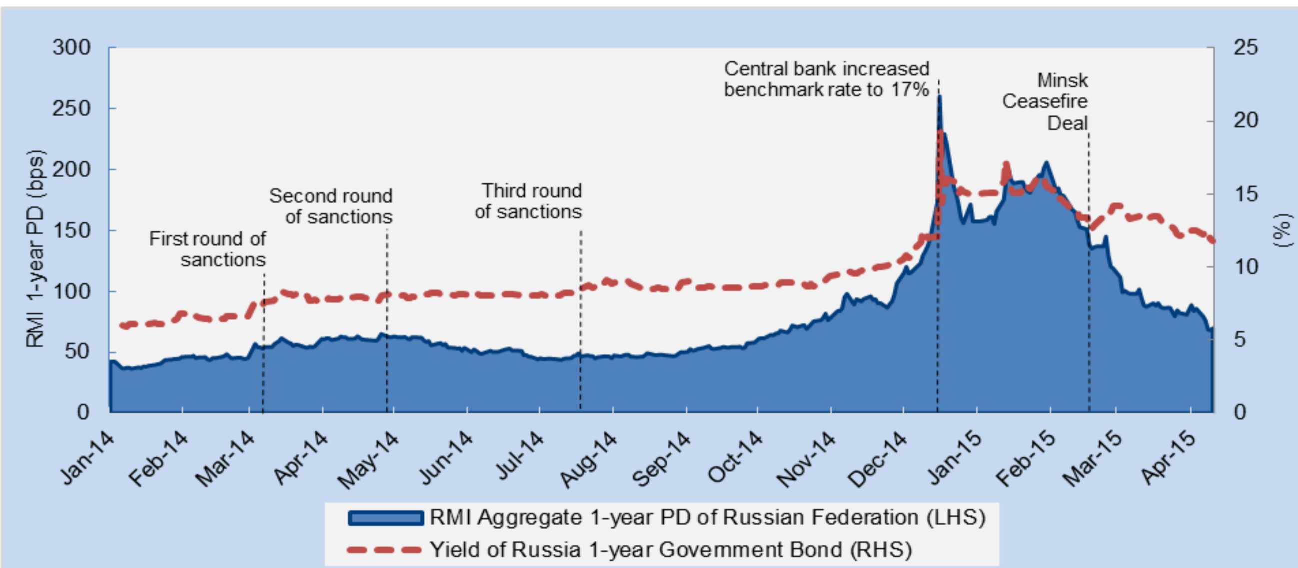

Figure 1: RMI Aggregate 1-year PD of Russian Federation and the yield of Russia 1-year government bond around major events. *Source: Risk Management Institute, Bloomberg*

The Ruble appreciated 6.9% relative to the dollar last week and was the currency with the highest rebound among global currencies in 2015. The currency appreciation can be viewed as a sign of growing confidence of investors towards the Russian economy. Besides, since February 15, the ceasefire agreement between Russia and Ukraine has come into force and has markedly reduced the level of violence in eastern Ukraine. This has helped to relieve the tensions among Western Europe, the US, and Russia. Russian companies have been suffering from economic sanctions, especially from European countries, its biggest trading partners. As the tensions abate, the European Union (EU) may scale back sanctions on Russia, as the countries in EU have already had divergent views towards the sanctions. Moreover, the stabilizing oil prices, on which Russia depends for most of its exports and tax revenues, also gave a shot of adrenaline to the Russian economy. Brent oil has recovered from lows of about 50 USD/bbl in January and is now trading at about 57 USD/bbl.

Despite the credit profile improvement in Russia, some analysts are still worried that the positive catalysts could be outweighed by the unfavorable macro backdrops of the strengthening USD and the slowdown of emerging markets.

Credit News

Ackman says student loans are the biggest risk in the credit market

Apr 14. Bill Ackman says the biggest risk in the credit market is student loans. The balance of student loans outstanding in the US -- also including private loans without government guarantees -- swelled to USD 1.3tn as of the second quarter 2014, based on data released by the Fed in October. About USD 100bn of federal student loans, which account for 9% of outstanding balances are in default, according to a Treasury Borrowing Advisory Committee update on student lending trends released in November. Ackman also said he doesn't like the fixed income market because of very low US interest rates and that investors should be wary of aggressive lending terms. (Bloomberg)

Investors pile into inflation-linked bonds

Apr 13. Investors are pouring money into exchange traded funds tracking inflation-linked Eurozone bonds, in response to the launch of quantitative easing (QE) by the ECB last month. The break-even inflation rate priced into 5-year German Bonds, for example, has jumped more than fivefold to an 8-month high of 1% since the announcement of QE, up from less than 0.2% before the announcement. While QE is fuelling demand for inflation-linked bonds, rising inflation could serve to hasten the end of QE. (FT)

China's second largest loan guarantee firm suspends operations

Apr 13. Hebei Financing Investment Holding Group, China's second-largest loan-guarantee firm, has suspended the guarantee business due to a payment crisis. Provincial authorities in Hebei have decided to put the company under the control of Hebei Construction & Investment Group (HCIG). The problem was because a lot of small companies whose loans were backed by Hebei Financing had encountered financial problems and could not pay back their loans. Hebei Financing so far guarantees about CNY 50bn (USD 8.1bn) loans that small businesses applied for from financial institutions such as commercial banks and P2P lending firms. The incident has created a negative effect on these institutions. (ECNS)

Sharp's default risk drops on possible rescue by Apple supplier

Apr 12. Sharp Corp.'s bond risk retreated from a two-year high on a possible rescue from Apple Inc. supplier Foxconn Technology Group and the potential for government aid. The cost to insure Sharp's debt against non-payment fell to 551bps. The yield premium of Sharp's 1.604% bonds due 2019 has declined to 534 bps over sovereign debt. Its shares got a boost last week after a person familiar with the matter said Sharp plans to ask a government-backed fund for help spinning off part of its liquid-crystal display business. Foxconn is also exploring partnership opportunities with Sharp and will invest depending on whether it can "participate in business management". (Bloomberg)

Emerging markets grow at slowest pace since 2009 slump

Apr 9. Impacted by a stronger US dollar and weaker commodity prices, emerging market economic growth has slipped to its slowest pace since 2009. The decline in commodity and oil prices has hit the export revenues of some key EM countries such as Brazil and Russia, while the strong US dollar has exacerbated outflows of capital from several leading EMs, including China, Thailand, Malaysia and South Korea. Unlike the financial crisis as an external shock in six years ago, this slowdown is driven largely by internal factors. The momentum known as "new normal" is expected to persist for a decade or so. (FT)

Singapore forgoes adding stimulus as growth exceeds forecast (Bloomberg)

Switzerland first ever to sell 10-year debt at negative yield (Telegraph)

Leverage loan sales slump to worst since 2010 (Bloomberg)

Regulatory News

Taiwan regulator sets tougher provisioning for local banks' China exposure

Apr 13. Taiwanese banks will need to strengthen loan coverage provisions on business related to China, in a move designed to better protect local lenders' growing exposure to the mainland, the island's financial regulator said on Apr 13. Under the new rules, the banks will need to increase loan loss reserves to at least 1.5% of total outstanding credit extended to China from 1% by the end of this year. The regulator also directed banks to strengthen their oversight on short-term trade financing. (Reuters)

ECB sees risks in Greece's anti-foreclosure law

Apr 10. On Mar 4, 2015, The Greek Ministry of Economy, Infrastructure, Maritime Affairs and Tourism requested the European Central Bank (ECB) for an opinion on a draft law introducing provisions for suspending auctions of the primary residences of eligible debtors. The stated purpose of the draft law is to tackle the current humanitarian crisis in Greece by protecting eligible debtors from the auction of their primary residences. Guarantors of eligible debtors are also granted protection from the auction of their property. Under the draft law, the auction by banks of primary residences, the objective value, for taxation purposes, of which does not exceed EUR 300,000, is prohibited. (ECB)

Fed finalizes rule to ease small bank mergers

Apr 9. The Fed finalized a rule that will allow more small banks to exceed debt limits when financing mergers and acquisitions, implementing a law Congress passed in December. Congress directed the Fed to raise the asset-size threshold for community bank holding companies subject to regulatory capital rules to USD 1bn from the current threshold of USD 500mn. Fed governor Daniel Tarullo has previously said this procedure would cover 89% of all U.S. bank holding companies. The Fed also applied the new requirement to savings and loan holding companies. The move in effect makes it easier for small banks to pursue mergers. (WSJ)

Fed seeks input on proposed interest rate changes (Fed)

EBA releases report on supervisory convergence in the banking sector (EBA)

China to reform policy banks amid global push, faltering exports (Reuters)

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