



## Greek banks are feeling the pressure of sovereign default risk

by [Justin Hsiao](#)

This May is extremely critical for Greece as some of its debt obligations are maturing. The risk of Greece missing a debt payment in the coming weeks is rising in the absence of a deal with its creditors. Should Greece miss a payment, the Greek banks would face a range of problems ranging from a shortage of liquidity, collateral damages and funding losses.

On the edge of leaving the EU in 2012, Greece had already restructured its debts earlier. It now owes money mainly to other European governments, the International Monetary Fund (IMF) and the European Central Bank (ECB). These official creditors have decreased interest rates and expanded the maturities for Greece, but the country still needs more relief. The near-term deadlines are May 6 and May 12, when Greece has to repay IMF almost EUR 1bn. At the same time, the government still has to pay salaries and pensions. Alexis Tsipras, the prime minister, has ordered local-government bodies to transfer their cash reserve to the central bank. That might buy some time for the country. Yet, the real crunch time comes in July and August, when almost EUR 7bn of bonds held by the ECB mature. It is expected that Greece would miss the payment if there is no agreement reached with the European officials.

Figure 1 shows that the RMI value-weighted Corporate Vulnerability Index (CVI) of Greece, a value-weighted average of RMI 1-year Probability of Defaults (PD) of all listed firms in Greece, has an increasing trend from around 20bps in mid-2014 to 60bps on May 1, 2015. This can be interpreted as a deteriorating credit profile of the whole corporate sector in Greece. The recent drop in the CVI reflects the rebound in the Athens equity market, which has recently rallied because the market anticipates a deal between Greece and its creditors. On April 27, Greece's financial minister Yanis Varoufakis was sidelined after three months of fruitless talks with creditors to unlock EUR 7.2bn in bailout funds. On May 1, a top government official said Athens was willing to sell a majority stake in its two biggest ports and compromise on value-added tax rates and some pension reforms, which can be regarded as big concessions for the leftwing anti-austerity Syriza party. However, Greece has yet to reach a new aid deal with its lenders and fears of a default have swirled as government debt repayment deadlines approach.



Figure 1: RMI value-weighted Corporate Vulnerability Index of Greece (LHS) and Athex Composite Share Price Index (RHS). Source: Risk Management Institute, Bloomberg

Deposits continue to flow out for Greek lenders bringing the four-month drop to almost EUR 26bn in March amid growing alarm among savers over the country's situation. This increases the liquidity risk of the banking system. The banks, therefore, had to tap on the funds from the Emergency Liquidity Assistance (ELA), given the ECB's funding was cut off after the leftist government stalled the country's bailout program.

At this time a sovereign default would make Greek banks' assets ineligible as collateral for central bank financing. Nonetheless, most top credit rating agencies including S&P, Fitch and DBRS say they would not cut Greece's rating to default if it misses a payment to the IMF or ECB, since both are not standard creditors. This stance could keep vital ECB funding flowing into Greek's financial system. However, Moody's disagrees with most of the other rating agencies claiming that not paying the ECB should be treated as a default as the bonds the ECB holds are potentially tradable and thus could be taken as the same as any other marketable debt.

As a result, the ECB's own judgment is vital to Greece. ECB would probably not completely cut off Greek lenders' emergency funding, but it could raise the haircuts or discounts applied to Greek government securities as collateral, reducing the amount of cash it will give to Greek lenders. The haircut on Greek ELA collateral is estimated to be around 35%. A greater haircut would leave Athens with less money in hand, adding more pressure on Athens to get a deal for more aid.

Failure to pay the IMF would also entitle some of Greece's other creditors to demand immediate repayment of all their loans. For example, a missed payment could give the European Financial Stability Facility (EFSF) the option to demand immediate repayment of one of its Greek loans.

The RMI 1-year PDs for Greece's four largest banks, National Bank of Greece, Piraeus Bank, Eurobank Ergasias and Alpha Bank, have increased markedly from around 40bps in mid-2014 to a high level on Apr 21, 2015, corresponding with the record low of Greece's banks stock index (see Figure 2). Athex Banks Index shows that the value of Greece's lenders had halved from the start of the year to April. In the same period, the RMI 1-year PDs have significantly worsened. Although the RMI 1-year PDs recently have improved, which are mainly triggered by the recovery in the equity market, they remain at high levels given the banks' large market capitalizations. The results of upcoming events are crucial to the Greek lenders; however, the divergence between the campaign pledge made by leftist government and the reforms proposed by international creditors keeps the breakthrough elusive. The credit profiles of Greek banks remain negative.

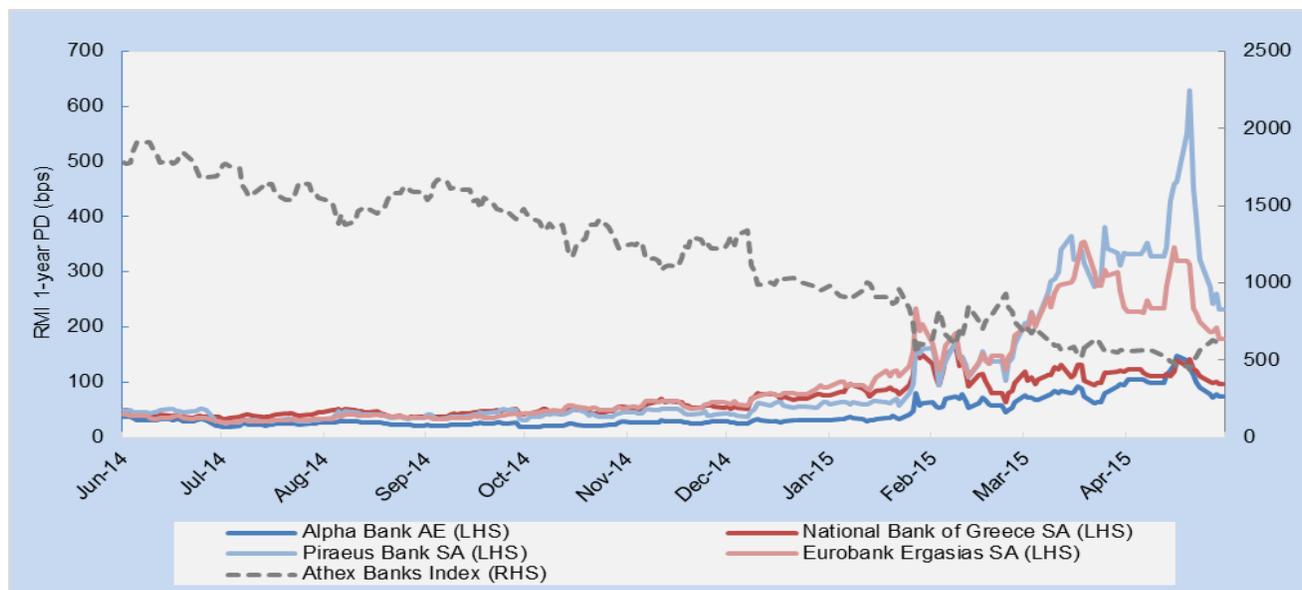


Figure 2: RMI 1-year Probability of Defaults of Greece's four largest banks (LHS) and Athex Banks Index (RHS)  
 . Source: Risk Management Institute, Bloomberg

#### Source:

Greek bank shares slide to record low as ECB considers pulling the plug ([The Telegraph](#))  
 Ratings agencies say no default if Greece misses ECB, IMF payments ([Reuters](#))  
 Greece signals concessions in crunch talks with lenders ([Reuters](#))  
 Greece struggles to pay more than two million pensioners ([Financial Times](#))  
 Greek bank shares slide to record low as ECB considers pulling the plug ([The Telegraph](#))  
 European stocks rebound after Greece reshuffles bailout team ([WSJ](#))

## Credit News

### Goldman Sachs sees Australia AAA rating at risk of downgrade

**Apr 29.** According to Goldman Sachs, Australia is set to lose its top credit rating from Standard & Poor's for the first time in more than two decades. Standard & Poor's is likely to place Australia's AAA sovereign rating on negative outlook as the nation's finances deteriorate on plunging commodity prices, weaker economic growth and government difficulties in passing legislation. Factors, including the end of a mining investment boom, a slowdown in China and a drop in federal government revenue resulted from falling prices of key exports such as iron ore, have led to Australia's struggling economy. ([Bloomberg](#))

### China is set to lose manufacturing crown

**Apr 29.** Southeast Asia will eventually displace China for the title of "world's factory" as its cheap, young labor and strategic locations of Myanmar, Cambodia and Laos draw increasing numbers of manufacturers. Southeast Asian nations have resolved to establish the ASEAN Economic Community by the end of 2015 to enable the free movement of goods, services, capital and labor between the 10 member states. ASEAN is expected to become the "third pillar" of regional growth after China and India, as more than half of 650mn people in Southeast Asia will be under the age of 30 by 2030, part of an emerging middle class with high rates of consumption. ([Bloomberg](#))

### Recovery hopes drive Europe bond sell-off

**Apr 29.** A sell-off in European government bonds drove borrowing costs sharply higher on Wednesday, raising fears that the impact that Eurozone quantitative easing has had in driving down yields could soon be thrown into reverse. German 10-year bond yields were on track for their biggest weekly jump of 2015 after leaping 12bps to 0.28% by the end of trading in London. ([FT](#))

### China mulls plan to boost demand for local government debt

**Apr 28.** Extraordinary measures are considered by PBoC to boost credit flows to heavily indebted local governments. China's local debt has surged since the 2008 financial crisis as regional governments borrowed to finance infrastructure projects in an effort to stimulate the economy. As China's economy slows down to the six-year low, policy makers want to enable local governments to maintain infrastructure spending to cushion the impact from a slowdown in the property and manufacturing sectors. ([FT](#))

**US firms shoulder rising debt** ([WSJ](#))

**Samsung profit falls on slowing smartphone sales** ([WSJ](#))

**AK Steel loss widens on write-down** ([WSJ](#))

## Regulatory News

### HSBC to put aside millions for fines

**May 3.** After Barclays and Royal Bank of Scotland (RBS) both set aside new funds last week, HSBC is expected to set aside hundreds of millions more dollars for foreign-exchange manipulation fines this week, as US authorities close in on a settlement with more than half a dozen banks. A misconduct charge for HSBC could bring the total cost of the scandal for the three banks involved to above USD 5bn. It will also pile further pressure on HSBC, which is under intense scrutiny following revelations over the tax-avoidance practices of its Swiss private bank. ([Australian Financial Review](#))

**Big banks use loophole to avoid ban**

**Apr 30.** Big banks are using a little-known loophole to avoid triggering a Securities and Exchange Commission ban on selling certain lucrative products to clients in the wake of enforcement actions. Deutsche Bank AG, for example, avoided the threat of a ban on selling stakes in hedge funds by tucking specific language into an USD 800mn agreement it reached with a different regulator - the Commodity Futures Trading Commission - to resolve an interest-rate-rigging probe. Five other banks had similar provisions included in CFTC agreements resolving allegations of currency manipulation in November. ([WSJ](#))

**Stress test shows Fannie-Freddie would need bailout in downturn**

**Apr 30.** Fannie Mae and Freddie Mac could require an additional bailout of as much as USD 157.3bn in a deep recession, according to the results of stress tests released by the regulator for the US-owned companies. The companies are authorized to draw as much as an additional USD 258.1bn from the US Treasury if they need to stay afloat. ([Bloomberg](#))

**Dangers from trading algorithms flagged by global regulators ([Bloomberg](#))****US SEC to propose disclosure rules on pay for performance ([Reuters](#))**

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Contributing Editor: [Victor Liu](#)