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Transforming Big Data into Smart Data
Weekly Credit Brief Aug 27 - Sep 02 2013

Story of the Week

Japan proves resilient as Fed tapering chatter increased

Japan's unprecedented monetary easing is insulating the country's bonds from concerns of a potential military intervention in Syria and regional capital outflows, as the default risk of Japanese corporations and banks fell from a year earlier.

Figure 1 examines the prevalence of overall credit risk in Japan, as indicated by the RMI Japan equally-weighted Corporate Vulnerability Index (RMI Japan CVI-ew), and the Markit iTraxx Japan index, which comprises credit default swaps (CDS) on 50 investment-grade borrowers. Both RMI Japan CVI-ew and iTraxx Japan have fallen gradually from their 2008-2009 high to current comparatively low levels.

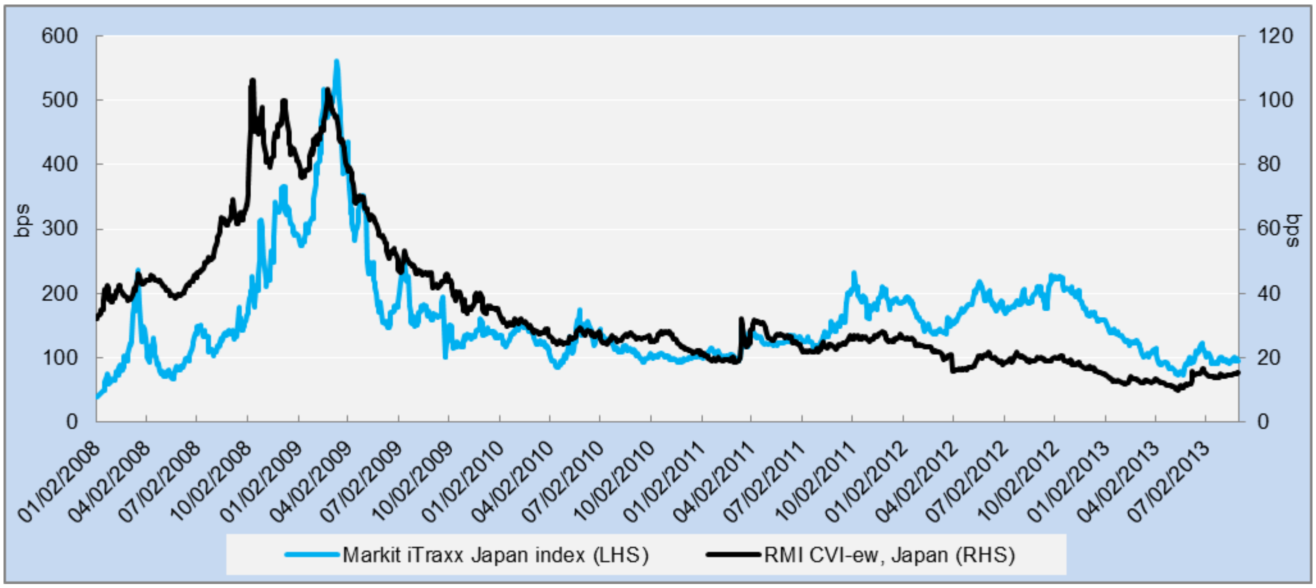

Figure 1: Since 2008, RMI Japan CVI-ew fell in tandem with the cost of insuring corporate bonds in Japan. *Source: Bloomberg; RMI*

However, since the US Federal Reserve first hinted at a possible reduction of the central bank's bond-purchasing program in May, the RMI Japan CVI-ew has risen to 15.6bps on August 30 from 10.68bps on May 22. The index is still lower than where it was a year ago (20.04bps), and the 10.04bps recorded on May 13 suggested the most positive credit outlook for Japanese listed companies since early 2006. The market's gauge of credit risk, taken as the Markit iTraxx Japan index, demonstrated the same broad trend.

Bloomberg reported on August 30 that Japan's corporate bond risk has dropped to the lowest in more than four years against Asia's benchmark (Markit iTraxx Asia ex-Japan), which stood at 163.4bps at the end of August, up from 102bps on May 22. The gap (65.4bps) between the Japanese and Asian CDS indices on August 29 was the widest since 2008, according to Bloomberg.

Figure 2 shows the aggregate 1-year RMI PD for Japanese banks with liquidity indicators for the banking sector (JPY LIBOR-OIS spread) and the general economy (benchmark 10-year yield). The broadly similar trend of the three lines suggests that the increased liquidity in the Japanese banking system and economy came with a corresponding improved credit outlook for Japanese banks.

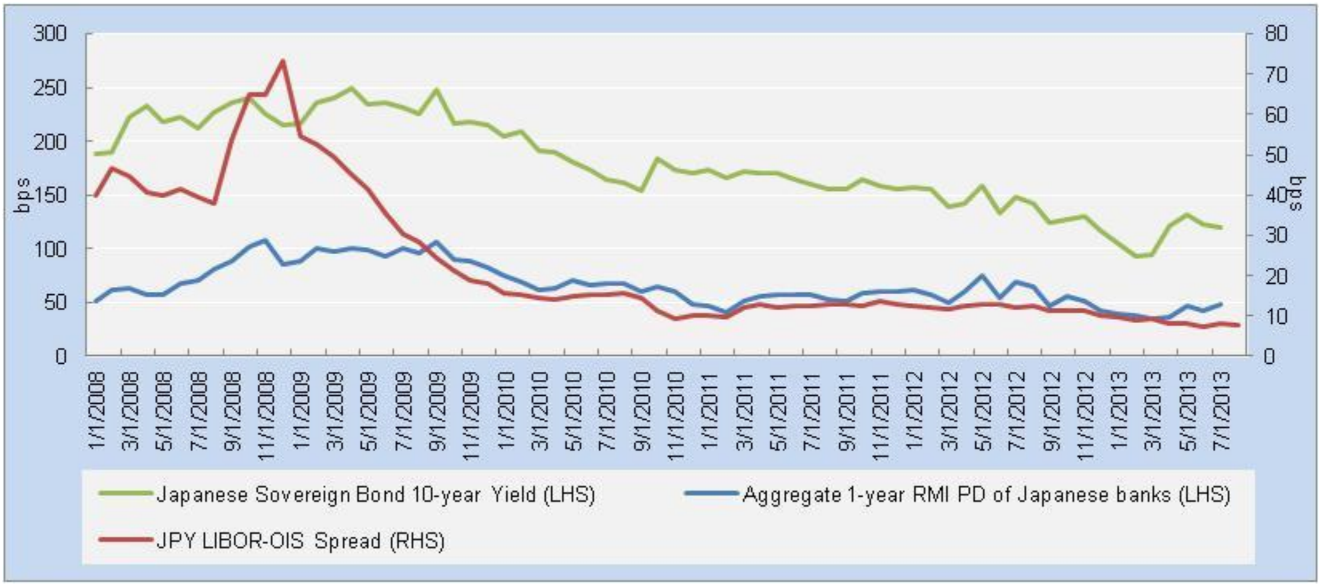

Figure 2: RMI PD of Japanese banks headed lower as liquidity in the country improved. *Source: Bloomberg; RMI*

The lower default risk of Japanese listed corporations and banks came on the back of faster economic growth, spurred by a USD 105bn fiscal stimulus plan, and increased profitability of Japanese listed firms. According to Bloomberg data, out of the 1,640 companies listed on the Topix index that have reported quarterly results since July 1, 1092 (67%) showed positive earnings numbers. Also, decisively positive corporate investment data for Q2 added to evidence Prime Minister Shinzo Abe's stimulus measures are gaining ground; Japan's corporate investments grew 2.9% QoQ.

The JPY has dropped more than 12% against the USD this year (see figure 3), boosting earnings of exporters. The falling yen sent the Japan Consumer Price Index climbing 0.7% in July from a year earlier, the most rapid acceleration since 2008, and signals that Abe's economic policy is making progress in pulling Japan out of 15 years of deflation.

"We believe there is an increased likelihood of more loosening of monetary policy", said Lutfey Siddiqi, Managing Director, FX Asia Pacific at UBS Investment Bank and Adjunct Professor at the Risk Management Institute, National University of Singapore, when he forecast the JPY to hit 105 against the USD in three to six months in a recent interview. Mr Siddiqi also suggested a laundry list of nine measures to be adopted by the Japanese government to provide structural reforms in order to tackle deflationary expectations and introduce sustainable economic growth.

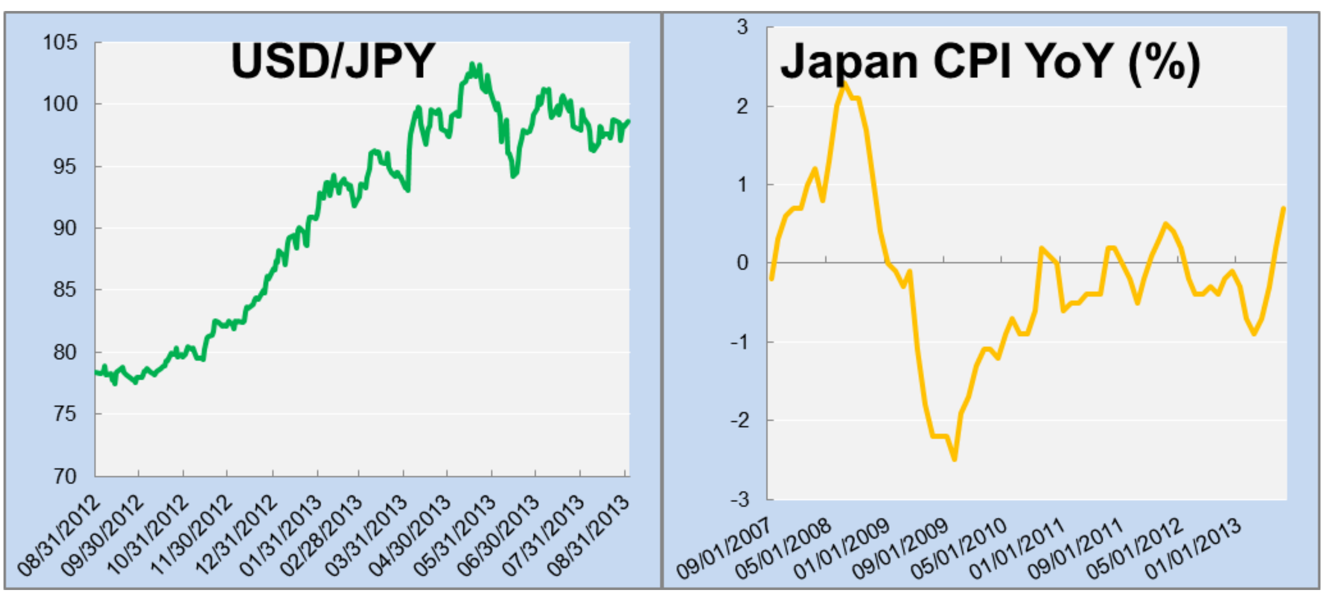

Figure 3: The decline in yen has finally led to the highest inflation rate since 2008. *Source: Bloomberg*

In the News

Malaysia raises fuel prices as Najib seeks to trim budget gap

Sep 2. In its first fuel price hike in 3 years, Malaysia raised the price of the widely used RON 95 grade of gasoline by 20 sen to MYR 2.10, while ratcheting up the price of diesel by an identical amount to MYR 2.00. This reduction in fuel subsidies will save the government an annual MYR 3bn (MYR 1.1bn for 2013), and help rein in Malaysia's rising public debt. The ringgit rose to a 2-week high in anticipation of the announcement after hitting a 3-year low last week. According to Prime Minister Najib, more deficit-narrowing measures will be announced in the 2014 budget. The poor, however, will receive bigger cash handouts to ease their burdens as blanket subsidies are gradually rationalized. (Bloomberg)

PIMCO sees taper in worst MBS slump since 1999

Aug 30. US government-backed mortgage bonds are posting their largest monthly loss since 1999 as concerns mount that the Federal Reserve will begin paring its bond purchases. Securities guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae headed for their fourth consecutive monthly decline amidst a sharp rise in home loan rates. Lower mortgage bond prices have pushed the average rate offered on new 30-year fixed home loans to 4.51% this week from 3.35% in May, making it the fastest rise in a comparable period since 1972. According to the minutes of the Federal Open Market Committee's July 30-31 meeting released August 21, Fed policy makers were agreeable to Chairman Ben Bernanke's plan to start reducing quantitative easing if the economy improves. PIMCO and other market observers expect the amount of bond buying reductions to be announced at the next policy meeting on September 17, despite recent economic data which showed that home sales have been falling and property price appreciation has slowed. (Bloomberg)

Brazil raises rates for fourth time since April

Aug 29. Brazil's central bank raised the country's benchmark Selic rate by 50bps to 9% late on August 28, its fourth consecutive interest rate increase in a 175bps tightening cycle since April. The central bank's monetary policy committee, Copom, hoped the decision will serve to curb inflation; twelve-month inflation was at 6.27% last month, just below the bank's upper threshold of 6.5%. The BRL is among the emerging market currencies that fell the most against the dollar this year, pushing up the cost of imports and contributing to high inflation. (FT)

Debt levels on big buyouts hit five-year high

Aug 28. Private equity firms have become increasingly aggressive in financing buyouts of large European companies in recent months, with leverage ratios hitting an average of 5.75 and loans of more than EUR 500mn over Q2. Leverage ratio that high has not been seen since Q1 2008 prior to the financial crisis when the leverage ratio peaked at 6.08. With buyout opportunities declining 35% in January to July from the same period in 2012, investors have become increasingly willing to accept highly leveraged loans. This trend is set to continue as banks become more confident in giving out loans, after successful sale of loans used to buy out two German companies, which underperformed in the recent volatility due to fears of Fed tapering. (Reuters)

Argentina has new bond swap plan: same terms, no end date

Aug 28. Argentine President Cristina Fernandez proposed a new bond swap offer on August 28, one that has the same conditions as the country's previous debt restructuring in 2010, except that the latest offer does not have an expiration date. Fernandez asserted that the proposal shows Argentina's goodwill to US courts who have criticized the country's uncompromising treatment of holdout creditors, or those unwilling to accept less than 30 cents on the dollar from the restructuring. The bond-swap would exchange foreign debt for bonds governed by Argentine rather than US law, thus protecting payments on restructured debt from a recent ruling in New York. Fernandez has also appealed to the US Supreme Court to overturn the ruling by a New York appeals court requiring Argentina to pay USD 1.33bn to the holdouts. (Reuters)

Japan's debt-funding costs to hit USD 257bn next year

Aug 27. A recent document on Japan's fiscal status showed that a record USD 257bn (JPY 25.3tn) will be needed to finance Japan's debt during the next fiscal year. This amount is 13.7% more than the amount set aside for the current fiscal year. Increasing debt servicing costs may intensify pressure on Prime Minister Shinzo Abe to proceed with a scheduled two-stage tax increase next year. However, Abe may encounter resistance from his advisors and other members of his ruling Liberal Democratic Party who want to delay or reduce the tax hikes, as they feel that the tax hike could hurt the Japanese economy which has just started to show signs of recovery. (Reuters)

China to expand credit asset securitization pilot program (Reuters)

Euro zone's strugglers seen needing more bailouts to plug finances (Reuters)

Court delivers blow to Portugal bailout programme (FT)

EU to consider capital charges on shadow banks (Reuters)

Bond binge expanding leverage toward crisis peak (Bloomberg)

Vietnam bonds drop on speculation banks seeking to boost lending (Bloomberg)

Indonesia stocks drop most in Asia after trade gap; rupiah falls (Bloomberg)

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