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Asian airlines boon as oil price slumps

by Victor Liu

Decreasing global demand for crude oil has seen drastic fall in oil price since November after the Organization Petroleum Exporting Countries (OPEC) failed to reach agreement on oil production curbs. The benchmark US oil price fell below USD 60 a barrel on Dec 11 after OPEC cut its estimate of crude oil demand of next year.

International Air Transport Association (IATA), the trade association for the world's airlines which represents 84% of total air traffic, shows that airline companies generally spend nearly 30 percent of their operating costs on jet fuel, accounting for the largest portion of cost. The slump of oil price helped airlines reduce their operating cost and the decrease in fuel bill helped to drive their stock prices to the highest in the past 2 years. As shown in Figure 1, the RMI aggregate 1-year PD for top 20 Asian airlines decreased to 5.92 on Dec 12 from 17.43 at the beginning of this year, while the Bloomberg Asia Pacific Airlines Index, which shows the stock performance of airline companies in the Asian-Pacific region, reached 144.72 from 107.21 during the same period.

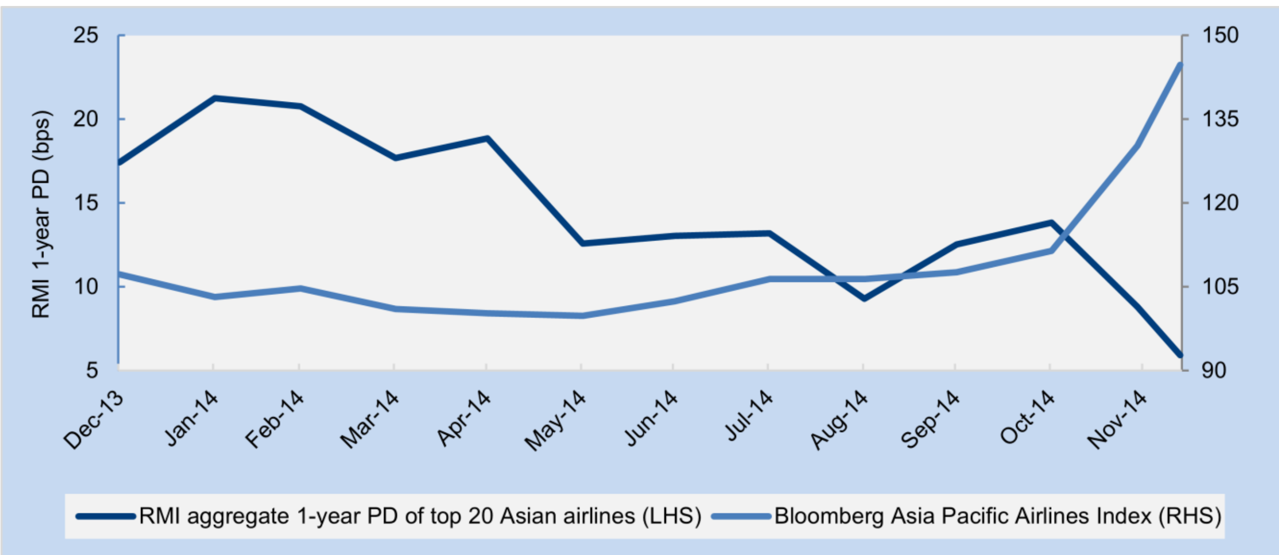

Figure 1: RMI aggregate 1-year PD of top 20 Asian airlines by market cap. Source: *Risk Management Institute, Bloomberg*

Analysts have begun revising their earnings forecasts for airlines and Table 1 shows some of the Asian airlines that stand to benefit from a cut in their fuel bills.

	2014 EPS Forecast	2015 EPS Forecast	Change
Air China	0.05	0.07	62%
Japan Airlines	3.45	3.70	7%
Singapore Airlines	0.23	0.39	66%
China Eastern Airlines	0.02	0.04	87%
ANA Holdings	0.10	0.12	20%

Table 1: The Bloomberg consensus of 2014 and 2015 EPS forecast (USD per share) for top 5 Asian airlines in terms of market cap. Source: *Risk Management Institute*

The oil price plummeted by more than 40% from June when the oil price was at USD 115 a barrel. Full-fledged carriers stand to enjoy a higher yield than low cost carriers (LCCs). In the first half of 2014, the yield per revenue passenger kilometer (RPK) for full-service airlines was USD 0.105, much higher than the USD 0.065 yield of low-cost airlines. As full-service airlines enjoyed higher yield, they can generate more profits when the operating costs fell due to drop in oil price. Figure 2 shows that as Jet Kerosene Spot Price Index decreased from June, both full-service and low-cost payers had performed better, while the index of full-service airlines grew by 25%, much stronger than merely 2% for the index of low-cost airlines.

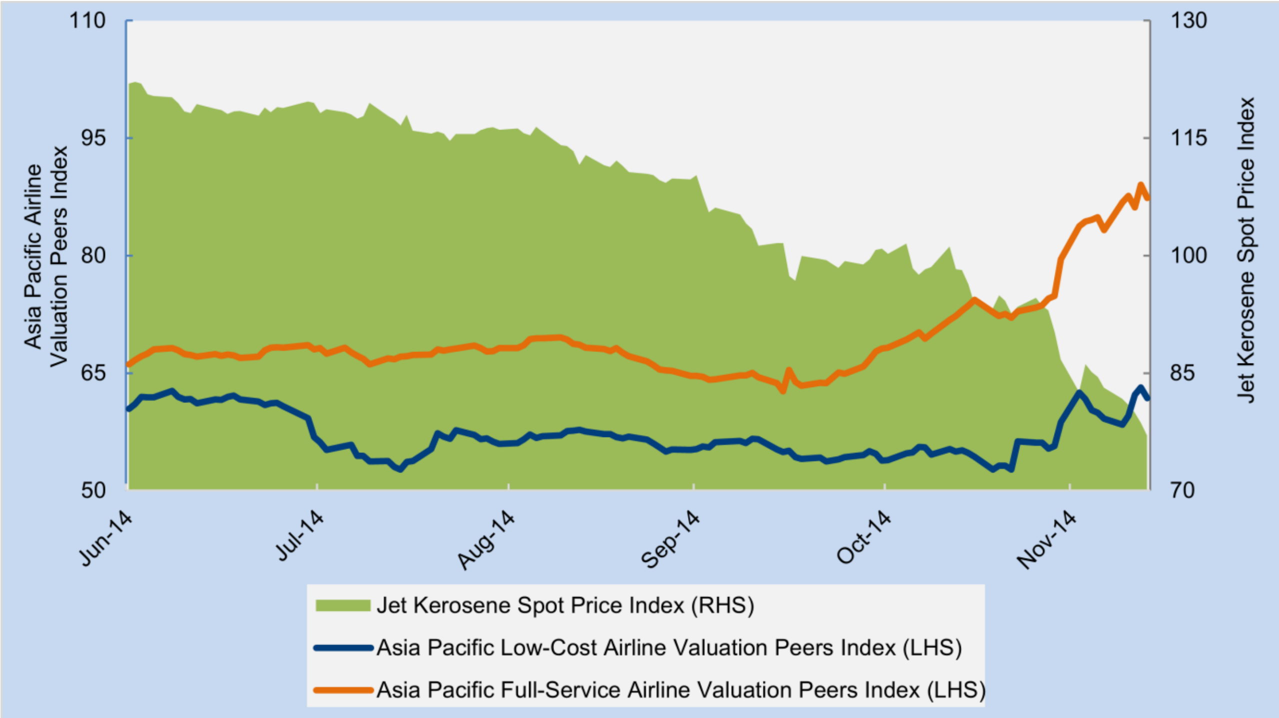

Figure 2: Jet Kerosene Spot Price Index versus Asia Pacific Airline Valuation Peers Index. Source: *Risk Management Institute, Bloomberg*

According to IATA, the airline industry outlook is rosy in 2015 due to cheaper oil and rising demand for traveling. Flying could get cheaper next year as airlines will reduce their fuel surcharges. However, as air travel demand remains strong, IATA expects only 5% cut in airfares. The higher margin is likely to strengthen the airlines' profitability and their credit profiles in 2015 unless they encounter new turbulence.

Source:
Asian airline shares rally to highest in two years as oil slumps (Bloomberg)
Oil drops below USD 60 after Saudis question need to cut (Bloomberg)
Airline fares set to fall in 2015, IATA predicts (BBC)

Credit News

Bank of England stress tests pass all banks apart from Co-op

Dec 16. According to the stress tests conducted by Bank of England, all Britain's main banks would be able to withstand a sharp fall in house prices, other than the troubled Co-operative Bank. The results showed that the core of the banking system was significantly more resilient and that it had the strength to continue to serve the real economy even in a severe stress. Nevertheless, the BoE's Financial Policy Committee, which is tasked with dealing with potential risks to the economy from the banking system, recommended that banks should be tested regularly for sufficient capital that withstands market shocks. (Reuters)

Russia defends Ruble with biggest rate rise since 1998

Dec 15. Russian central bank took its step further to raise its key interest rate to 17% from 10.5% on Dec 15. This move is aimed to stop the aggravation of inflation risks and is the largest single increase since 1998. However, the new higher rates would squeeze the economy that is already being hurt by sanctions led by the US and European Union, and by a collapse in oil prices. Some analysts said they doubted the economy could withstand high rates for long. (Bloomberg)

Oil drops near 5-year low as OPEC seen resisting cuts

Dec 15. Brent crude price slumped 2.5 percent to USD 60.28, the lowest since July 2009, as the United Arab Emirates said the Organization of Petroleum Exporting Countries will refrain from cutting output even if prices slumped to USD 40 a barrel. (Bloomberg)

JP Morgan may need another USD 20bn after new rule

Dec 10. The Federal Reserve will set higher capital requirements for banks. As a result, JPMorgan Chase & Co., which already faces the highest capital surcharge under international requirements, needs to find more than USD 20bn to beef up its capital reserves by 2019 to meet new regulations. The additional buffer is intended both to reduce the risk of a bank failure and the need for publicly-funded bailouts if a major bank does fail. However, JPMorgan's chief financial officer said the bank wouldn't have to make "meaningful change" to its corporate and investment bank and will be able to maintain its pay-out to investors while it meets the new requirement. The other banks that are subject to the new requirement are Citigroup, Morgan Stanley, Bank of New York Mellon, Bank of America, Wells Fargo, Goldman Sachs and State Street. (Fortune)

PBOC: China growth could slow to 7.1% (Marketwatch)

In Japan snap elections, voters back Abe's economic (CNN)

Tesco shares slump 15% as it issues major profit warning (Telegraph)

Regulatory Updates

HKMA likely to miss FSB deadline for crisis management plan

Dec 15. Hong Kong's central bank (HKMA) is likely to miss the soft deadline of meeting Financial Stability Board's (FSB) request on crisis management plan by the end of 2014. According to FSB, 27 out of 30 of globe's most systematically important banks have branches and subsidiaries in HK. That gives the HKMA more reason to be clear on how it would manage the systemic risk caused by next financial crisis. A number of major global banks also need to dovetail with the plan in the home jurisdictions, which would lengthen the resolution drafting process. Without the new consultation paper this year, the HKMA would struggle to get the primary legislation needed to finalize the regime. (SCMP)

Govt's stake dilution expected to aid banks' Basel-III

Dec 12. Bankers believe the government's move to gradually reduce its stake to 52% will make it easier for them to prepare a roadmap to meet Basel-III capital requirements by 2019. Canara Bank, Union Bank, Central Bank of India and Vijaya Bank have sought the government's approval to raise capital via equity market. As per Basel-III norms, the minimum Tier-I has to be 7% and has to be adhered to by March 2019. The government said on Wednesday that since the quantum of capital support needed by banks is huge, it cannot be funded by budgetary support alone. It added that the stake dilution would let banks raise Rs 1.68 lakh crore to meet their capital requirements. This move would ease the government's pressure of capitalizing banks every year and is aimed at a long-term solution, analysts said. (Financial Express)

Chinese banks' Base III issuance growing

Dec 11. Moody's Investors Service expects banks in China (Aa3 stable) to continue issuing Basel III securities in 2015, in line with new global requirements that boost the loss-absorption requirements for non-variable banks. Moody's-rated banks plan to issue RMB 705bns of Basel III securities in the next few years; of which, RMB 350bns were already issued year-to-date in 2014. Overall, because of premium growth and C-ROSS, Chinese insurers will likely need to replenish capital over the next few years. The regulator has proposed new funding channels, including preference shares and catastrophe bonds, which would provide insurers with more options to replenish capital and as a result, change insurers' capital structure. (Moody's)

Fed votes to propose extra capital rule for banks

Dec 10. The US Federal Reserve on Tuesday voted to propose requiring eight of the largest US banks to hold an extra capital cushion. Most of the banks have to raise more capital under this proposal, especially the ones relying heavily on short-term wholesale funding. (Reuters)

ECB considering tighter rules for emergency funding

Dec 10. The European Central Bank is considering tightening rules on the provision of banks of emergency liquidity assistance (ELA) from their national central banks, which could focus on limiting the period of time during which banks could make use of ELA. This movement on ELA facility also sends out the signal that ECB is aware of some of the excesses during the crisis and is curbing them so that they won't be repeated. (Reuters)

Chinese brokerages face probes into financing businesses amid stock rally (SCMP) (Subscription required)

Japan banks will avoid US firms over margin rules (Risk.Net) (Subscription required)

Non-cleared margin rules pose challenge: ISDA (Risk.net) (Subscription required)

China banks press PBOC on reserve ratio (DJ News**)**

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