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Transforming Big Data into Smart Data

Weekly Credit Brief

Feb 25 - Mar 03 2014

Story of the week

Turmoil in Ukraine runs unabated, PD rises for telecom provider Ukrtelecom

In December 2012, we noted in our publication that Ukrainian firms were witnessing their highest default risk in more than two years. Over 1 year later, the political and market situations in Ukraine have only worsened and warrant a deeper analysis, especially on specific companies. The aggregate 1y PD for Ukraine's companies is now at 97bps, up more than 30bps from November last year, when talks of a Russian bailout began surfacing. However, tensions soared between Russia and Ukraine after the parliament ousted pro-Russian President Viktor Yanukovych after he refrained from signing an Association Agreement with the Europe Union in favor of closer ties with Russia. As a result, Russia has put its USD15bn bailout deal for Ukraine on hold. In addition, Russian troops entered Crimea, a critical part of the Ukraine territory, leading to Kiev calling the act a 'provocation' and a breach of its sovereignty.

While the impact of these political tensions was felt in markets across the board, the impact on Ukraine's corporates is likely to be detrimental. In 2014 alone, sovereign debt redemption is at USD4.66bn while corporate debt redemption is at USD2.18bn. It is estimated that the government would need USD17.4bn this year to pay off all its foreign bills, including those for Russian gas. Ukraine's 5y CDS, which had eased to 700bps from around 1100bps levels in December after Russia's bailout offer, has now instead widened to 1165bps (see Figure 1). Ukraine's economy, which has been vulnerable since the 2008 crisis, now needs funding desperately to pay off its debts.

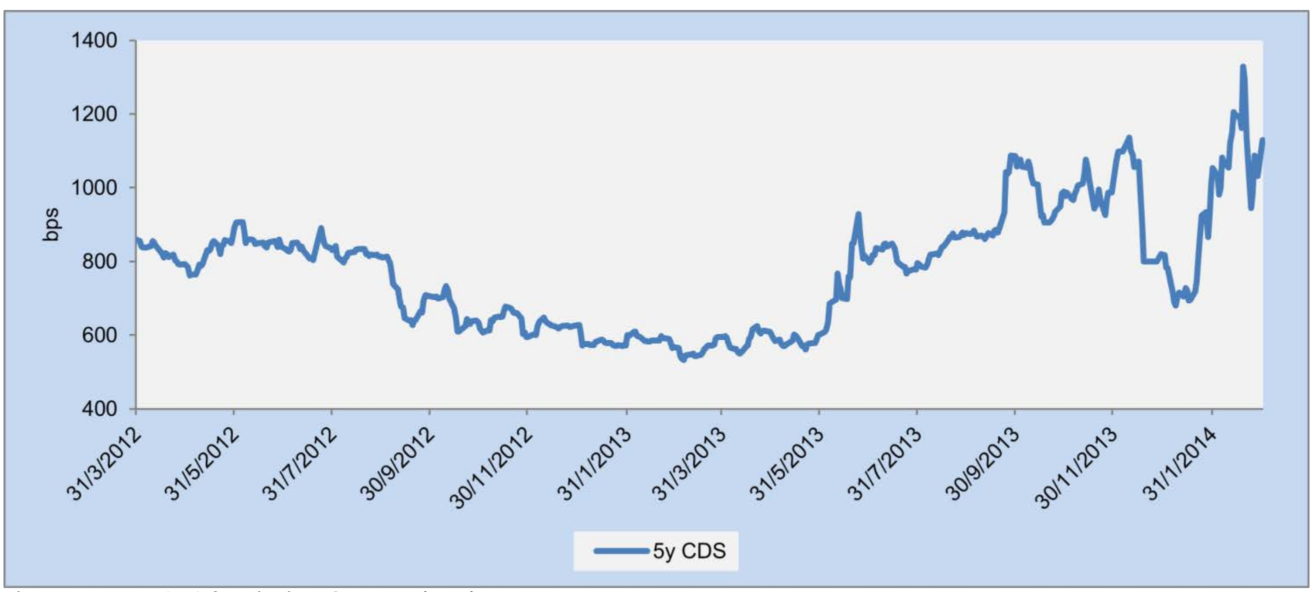

Figure 1: 5-year CDS for Ukraine. *Source: Bloomberg*

Ukrtelecom

Ukrtelecom, the nation's largest telecom provider sees itself in an especially precarious situation in the midst of this crisis. Late last week, Ukrtelecom reported that its internet and phone connections were interrupted between Crimea and the rest of Ukraine. It also announced that this was due to physical damage to several fiber optic transmission cables of the company. Such occurrences are likely to have a severe impact on the profitability of the firm going forward.

Ukrtelecom has some USD51mn of bond redemption due later this year and with the weakening political backdrop, it only further aggravates the already fragile situation of the telecom provider. Since March last year, the distance-to-default (DTD) of the firm has gone down from 3.3 to 1.8. DTD is a measure of the leverage of a company, adjusting for the volatility of the firm's assets, with numbers close to or below zero suggesting potential insolvency. In the same time period, cash to total assets ratio and net income to total assets ratio have reduced to less than half of their values. A spike in short term interest rates in Ukraine also makes short-term funding more expensive. As a result, the 1y RMI PD for Ukrtelecom has risen to 98bps on March 3, 2014 from 35bps at the end of March 2013 (see Figure 2). With 1y RMI PD rising and political tensions showing no signs of ebbing, the outlook remains cloudy for Ukrtelecom.

Figure 2: 1-year RMI PD Ukrtelecom. *Source: The Risk Management Institute*

In the News

Crisis gauge rises to record high as swaps avoided

Feb 26. Credit indicators for the Chinese economy have climbed significantly as investors worry that an economic slowdown might affect the rate of default for wealth management products. The spread between the two year sovereign and two year swap rate increased to 121bps, the widest level since 2007. Meanwhile, the cost to fix the three month Shanghai interbank offered rate for the next year touched 94bps, which is the highest in eight months. The People's Bank of China said on February 8 that the volatility in money markets will continue to rise together with higher borrowing rates. Money supply growth has fallen to 1.2%, the lowest seen since 1996 as the central bank withdrew liquidity from the financial system. (Bloomberg)

Wall Street hates JPMorgan fee for USD 1tn junk loans

Feb 28. JP Morgan has grown to dominate the US junk loan market because of the way it charges exclusive customers for not trading the debt originally underwritten by JP Morgan. The bank's dominance started in 1982, when the lender created a loan syndication unit to underwrite bonds for Chemical Bank. The bank was the largest underwriter of corporate bonds in 2013 with a 6.8% share of the USD 3.27tn issuances. Rivals banks could not offer more competitive terms because of the sheer size of JP Morgan's assets. By 2005, Credit Suisse, Deutsche Bank, Royal Bank of Scotland, Morgan Stanley, Goldman Sachs and 10 other banks agreed mostly to end the practice of charging each other's clients the standard USD 3500 fee to trade loans, which led to diminishing business profits. (Bloomberg)

Bondholders pay price of share buybacks

Feb 26. Bondholders face a higher credit risk as companies sell more debt to finance their share buybacks. This year, companies such as FedEx, Union Pacific and Cisco have issued bonds to help finance the company's repurchase plans. According to the Standard & Poor's, companies have sold about USD 11bn of bonds for stock buybacks, in contrast to USD 19bn sold for the whole of 2013. Analysts commented that such a practice to add leverage to boost stock prices could be risky, as slower growth together with a higher debt burden might trigger the company's credit rating downgrade in future. (FT)

Asia currency markets unfazed by renminbi slide

Mar 3. Even as the RMB has been suffering its swiftest sell-off in years, its neighbours have so far shown themselves to be largely immune. The RMB has now fallen 1.4 per cent against the USD in the past 11 trading sessions. However, the rest of Asia has largely shrugged off the move. The fall in the RMB has coincided with weakening Chinese data. The purchasing managers' index released on Monday dropped to an eight-month low and showed that the sector is in contraction. (FT)

S&P raises outlook for JC Penney's credit

Mar 3. Standard & Poor's Ratings Services raised its outlook on J.C. Penney's credit to stable from negative on Monday, saying the department store's sales results show it has turned a corner. On Wednesday J.C. Penney said revenue at stores open at least a year grew 2 percent in the fiscal fourth quarter. That was the first time in two years J.C. Penney reported improvement in that measurement. **(**NBC**)**

Philippine index to monitor property risk, central bank says

Mar 3. The deputy Governor of the Philippines' central bank said that the central bank is going to introduce a residential property price index in the first half of the year to monitor asset bubble risks. The index will begin covering Manila and its nearby provinces first. It will use data such as building permits and wholesale prices of construction materials of new housing units from 2006 to 2012. (Bloomberg)

Repsol agreement in hands of Argentine congress

Mar 3. It was announced over the weekend that the legislation to approve the USD5bn deal with Repsol to compensate for YPF expropriation has been sent to the congress. Former YPF chairman and ex energy secretary for Argentina, Jorge Lapena said that the legislation should not be approved without proper justification by the agencies involved in the appraisal. (BNAmericas)

Russia gas threat shows Putin using pipes to press Ukraine (Bloomberg)

India's Q4 GDP up a disappointing 4.7% (Business Times)

Gold, oil rise as Ukraine tensions spur safety bids (Reuters)

Venezuela opposition musters thousands for march despite Carnival holiday (Reuters)

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