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Weekly Credit Brief January 27 - February 02

Greek debt standoff weighs on credit profiles of banks

by Dexter Tan

The financial situation of Greece's four largest banks has worsened as continued deposit outflows have apparently accelerated to record levels in January. Withdrawals between Jan 19 and Jan 23 this year were larger than in May 2012, when Greece was on the verge of exiting the EU. Depositor sentiment has been affected by negative political developments and the country's inability to repay its debt obligations on time. The banks depend on cheap ECB funding to fund day to day operations but the ECB could stop funding Greek lenders if the newly elected government rejects the bailout program obligations with its international creditors. These factors constitute a major liquidity risk for the four largest Greek lenders, which account for more than 90% of the domestic banking sector assets.

The RMI 1-year probabilities of default (RMI 1-year PD) for the National Bank of Greece, Piraeus Bank, Eurobank Ergasias and Alpha Bank have increased markedly over the recent weeks (see Figure 1). An election victory by the leftwing, anti-austerity Syriza party triggered a sharp sell-off in Greek bank shares; National Bank of Greece (NBG) and Piraeus Bank witnessed a 37% and 43% decline in market cap respectively in January (see Table 1) as actions and comments by the newly appointed Ministers reignited fears of another Greek debt crisis. This has led to a decline in the companies' RMI distance-to-default (RMI DTD) measure and, consequently, an increase in the RMI 1-year PD. The RMI DTD is a volatility-adjusted leverage measure, and changes in the measure are a significant determinant of RMI 1-year PD.

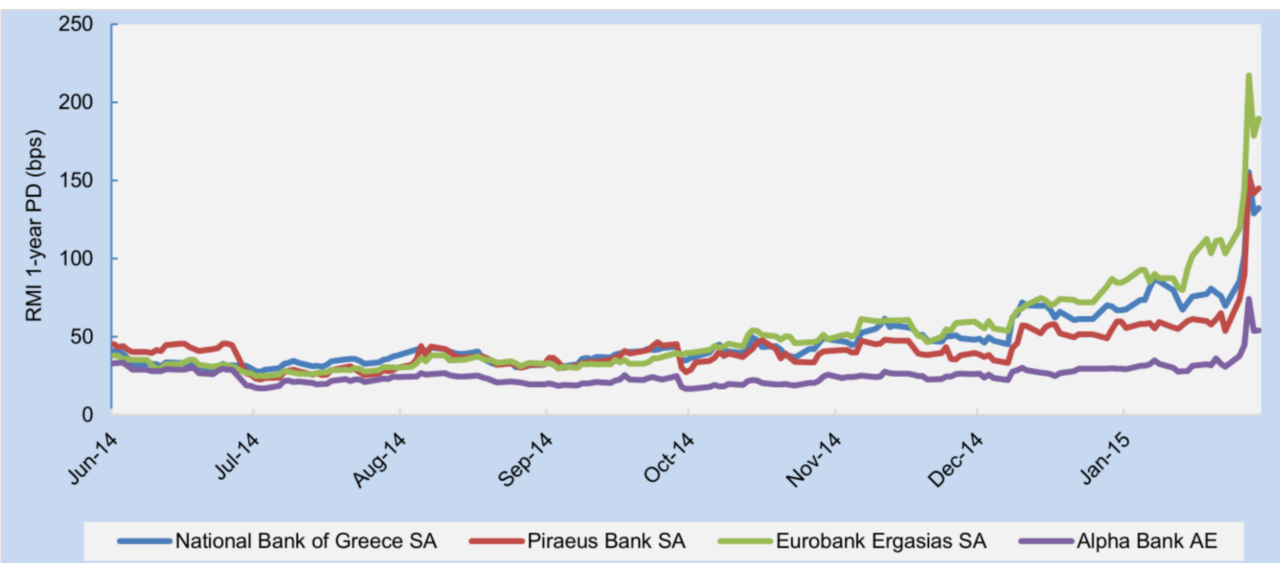

Figure 1: RMI 1-year PDs for the 4 largest Greek banks. *Source: Risk Management Institute*

	National Bank of Greece SA		Piraeus Bank SA		Eurobank Ergasias SA		Alpha Bank AE	
	31/12/2014	**30/01/2015**	**31/12/2014**	**30/01/2015**	**31/12/2014**	**30/01/2015**	**31/12/2014**	**30/01/2015**
RMI DTD	0.48	0.09	0.97	0.40	-0.26	-0.58	1.73	1.19
RMI 1-year PD (bps)	69.13	132.42	59.69	145	84.2	189.68	29.37	54.18
Market cap (EUR bn)	5.19	3.27	5.55	3.16	2.75	1.62	5.98	4.14

Table 1: RMI credit risk measures and market cap for the largest banks listed in Greece. *Source: Bloomberg, Risk Management Institute*

The deteriorating creditworthiness of the banks is likewise reflected in other credit measures, as highlighted in their latest quarterly results (see Table 2). For example, net income as a percentage of average risk-weighted assets in Q3, is negative for most lenders. The ratio is a proxy of bottom line profitability and adjusted according to risk weighted assets. Loan quality has also declined, with the non-performing loan (NPL) ratio for Piraeus Bank rising to as much as 43.7% at the end of September 2014. Loan portfolios are generally the largest component of the bank's balance sheet and loan quality problems could seriously damage the bank's capital levels and credit profile. Bad loans in the banking system have been climbing and have reached alarmingly high levels. NPLs for Piraeus Bank, EuroBank and Alpha Bank have exceeded the sum of their shareholder's equity and loan loss reserves.

	National Bank of Greece SA		Piraeus Bank SA		Eurobank Ergasias SA		Alpha Bank AE	
	Quarter ending		Quarter ending		Quarter ending		Quarter ending	
	30/06/2014	30/09/2014	30/06/2014	30/09/2014	30/06/2014	30/09/2014	30/06/2014	30/09/2014
T12m net income / average risk-weighted assets	2.78%	2.91%	-1.73%	-4.01%	-4.56%	-4.33%	-0.37%	-0.19%
Non-performing loans / total loans	23.0%	23.4%	38.0%	43.7%	31.9%	33.3%	33.6%	29.8%
Non-performing loans / (equity + loan loss reserves)	84.9%	86.1%	157%	175%	106%	109%	116%	103%
Core Tier 1 capital ratio	16.2%	na	15%	13.1%	17.8%	na	na	na

Table 2: Pro-forma financials and credit metrics for Greek banks. *Source: Bloomberg*

Table 2 also displays the capital adequacy ratios of the Greek lenders. According to these ratios, lenders appear to be well capitalized, but a large percentage of the firms' core Tier-1 equity capital is in fact made up of deferred tax credits, which is allowed under Basel III rules. The European Banking Authority has asked Greece to adjust its law that allows lenders to strengthen their capital base by converting deferred tax assets into tax credits (DTC). These credits are claims on the Greek government to provide support if they are in financial trouble. European regulators are not comfortable with the high levels of deferred tax credits in bank capital and regulators may implement sweeping measures to limit the use of DTCs in future.

A few other factors undermine the credit quality of Greek banks. First, the banks are bondholders of Greek sovereign notes and they may have to write down their bond holdings as the new government is seeking further debt haircuts with creditors. Although the exposure to Greek sovereign debt has reduced materially over the months, the value of the bonds has declined significantly in the last 2 weeks. The yield of 3-year maturity Greek sovereign notes was 10% on Jan 23 before the election but reached 19.2% a week later.

Apart from debt forgiveness, the new Greek government might impose other credit unfriendly policies such as forced lending and management changes on the banks. The Syriza party is keen to help the nation's poorest by lifting the minimum wage, increasing pension benefits and possibly improve credit funding conditions. The government might pressure management to increase lending to less creditworthy individuals. The government is a controlling stakeholder for three of the major banks, via the Hellenic Financial Stability Fund or HFSF – NBG (57.24%), Piraeus (66.93%), Alpha (66.24%). Eurobank, 35% owned by the HFSF, recently announced changes to its management team on Feb 1, after a meeting with the Mr Yannis Dragasakis, the new deputy prime minister of Greece on Jan 30.

Lenders are under pressure for funding. Two Greek banks have asked the Bank of Greece to tap the emergency liquidity assistance line (ELA), which was approved by the ECB before the election. Greek lenders were reliant on the ELA during the 2012 debt crisis but were out of ELA funding by mid-2014 due to regained access to ECB operations. The ELA usage however could increase in the following weeks to accommodate a liquidity squeeze from further deposit flight, foreigners' refusal to roll over their maturing T-bills and to absorb the high cost of fresh T-bill issuances to finance their debt repayments to the international creditors. On Feb 4, Greece is set to auction EUR 625mn of notes and the banks can purchase these securities and pledge them to the ECB as collateral for further funding.

Credit News

China's feeling the pressure to join global easing

Feb 02. Central banks from the EU to Canada and Singapore added monetary stimulus last month as slumping oil prices dampened the outlook for inflation, and global momentum outside the US moderated. After the Chinese government's Purchasing Managers' Index fell to 49.8 last month from 50.1 in December, which is the first contraction in more than two years, China might join this wave of global monetary easing. (Bloomberg)

Justice Department probing Moody's for mortgage deal grades

Feb 01. The US Department of Justice is investigating Moody's Investors Services for issuing favourable grades on mortgage deals in the lead-up to the financial crisis. The probe comes as the Justice Department nears a USD 1.37bn settlement with S&P for similar alleged conduct of issuing misleading ratings of residential mortgages leading up to the 2008 financial crisis. (Reuters)

Greece asks ECB to keep banks afloat as debt deal sought

Feb 01. Greek Prime Minister Alexis Tsipras began the hunt for allies against German demands for austerity as his week-old government appealed to the ECB not to shut off the money tap. Tsipras travelled to Cyprus on Monday before trips to Rome, Paris and Brussels, with Berlin not yet on the agenda. While euro-area officials want Greece to stick to the austerity demands of its existing bailout agreement, Tsipras is seeking a debt writedown and an end to the committee that oversees the country's economy. Dismantling the troika, which comprises representatives of the European Commission, ECB and International Monetary Fund, is "timely and necessary". (Bloomberg)

Singapore dollar is weakest since 2010 on monetary policy shift

Jan 28. Singapore unexpectedly eased monetary policy, sending the currency to its weakest level since 2010 against the USD as the country joined global central banks in shoring up growth amid dwindling inflation. The move was the first emergency policy change since the one following the Sept. 11, 2001 attacks for the MAS -- which only has two scheduled policy announcements a year -- reflecting how the plunge in oil has changed the outlook in recent months. Singapore becomes at least the ninth nation to ease policy this month, as officials from Europe to Canada and India contend with escalating disinflation and faltering global growth. (Bloomberg)

Slowing Japan inflation keeps BOJ under pressure (Reuters)

Strong dollar weighs on US results (FT)

Raiffeisen bond rout deepens as swaps show 70% default risk (Bloomberg)

Regulatory Updates

Guidance on accounting for expected credit losses issued by the Basel Committee

Feb 02. The Basel Committee on Banking Supervision is proposing to change the supervisory guidance on credit practices with the implementation of expected credit loss (ECL) accounting models. The ECL account models will replace the incurred-loss model which served as the basis of accounting and was adopted in various jurisdictions with significant differences. The move to ECL accounting frameworks should resolve the weakness identified during the financial crisis that credit loss recognition was too little, too late. Under the new framework, banks will estimate their expected credit losses for all lending exposures, which will provide supervisors with information about the lenders' credit risk practices. (BCBS)

Revised Pillar 3 requirements issued by the Basel Committee

Jan 28. The Basel Committee on Banking Supervision has finalized the rules for Pillar 3 disclosure requirements, which will change the manner in which large banks report their risk on their balance sheets. The new rules replaces the existing disclosure regime which was enhanced in July 2009 to account for the global financial crisis. Pillar 3 of the Basel framework is designed to promote market discipline and enhance consistency in which banks disclose risk information, measurement and risk management. It requires large banks to disclose capital and risk information on an annual, semi-annual and quarterly basis, depending on the data type. (BCBS)

BRICS to discuss creating new rating agency in March

Jan 28. The contact group of BRICS experts will meet in March to discuss the idea of establishing an independent rating agency, which would serve as an alternative to the western 'big three', said the Brazilian Ambassador. "A contact group on economic and trade issues is working at the expert level. The proposal to establish a rating agency within the BRICS has been placed before its consideration, and will be discussed in more detail in March at the next meeting of the contact group," the diplomat said in an interview to RIA Wednesday. (RT)

ISDA proposes CCP recovery and continuity framework (ISDA)

Tough times for small Chinese banks faced with Basel III compliance (SCMP)

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