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Transforming Big Data into Smart Data

Weekly Credit Brief

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Story of the week

ArcelorMittal invests in China's automotive growth
By Chiranjiv Sawhney

The world's top steelmaker, ArcelorMittal, announced over the weekend that it has opened its first steel making facility in China through a joint venture - Valin ArcelorMittal Automotive Steel Co. The firm will focus on steel demands for the automotive sector. Even though both iron ore (an input in steel production) and steel prices are declining, strong underlying demand for high grade steel in the automotive sectors may allow the firm to capitalize on a higher spread between the two. Though overall steel sector in China is plagued by over-capacity, there is still shortage of high-end automotive steel. As per the company's chief executive, this venture will be hugely beneficial as China is expected to account for 35% of the worldwide automotive growth until 2020. Sales for automotive firms in China increased 14% last year while, China Association of Automobile Manufacturers expects growth of 8% in sales for this year.

ArcelorMittal's 1-year RMI PD is at a very low 7bps, merely a quarter of its value compared with 2012. (See Figure 1). Its distance-to-default (a volatility adjusted leverage measure and an input of the RMI PD model) is at a very healthy +4.3, with an upward trend for the last two years. With this new venture, ArcelorMittal joins the likes of a South Korean steelmaker, POSCO which has made significant investments in China over the past decade and substantially improved both its profitability and its risk profile (1-year RMI PD 1.7bps). ArcelorMittal could possibly go on the same path and further improve its financials.

Figure 1: 1-year RMI PD for ArcelorMittal, Hebei Iron &Steel and Wuhan Iron & Steel *Source: Risk Management Institute, Bloomberg*

In addition to the growth of automotive industry, there are some other points that bode well for ArcelorMittal. Case in point, the latest steel production numbers from China; according to a report from the National Bureau of Statistics, China's crude steel output rose 2.6%YoY in May to record 70.4mn metric tons. The government said that it could be another year for record steel production in China this year as demand for automotive and high-grade steel remains strong.

Another positive development for ArcelorMittal is the potential removal of a 10-year ban on overseas takeovers in China's steel industry. CEO Lakshmi Mitttal said that a potential move forward on reforms and liberalization is a good step for the industry. Chinese mills, which produce nearly 50% of the world's steel have not prospered as desired and are now seeking better technology and higher value products to stem losses and improve productivity.

Such improvements can be brought by foreign firms such as ArcelorMittal. About 80% of China's steelmakers had a combined loss of CNY2.3bn in Q1. Currently, the 1-year RMI PD of two of the largest steelmakers of China - Hebei Iron & Steel Co Ltd and Wuhan Iron & Steel Co Ltd.- is 116.1bps and 143.1bps respectively, versus 7bps of ArcelorMittal. (See Figure 1).

Credit News

Japan's Aiful gets creditor support for debt restructuring

Jun 13. Japanese consumer lender Aiful Corp said that the company has reached an agreement with creditors to restructure JPY 52.7bn of the firm's total JPY 162bn of debt. The firm will exchange existing bonds for newly issued notes as well as buy back debt from bondholders. The company was negatively impacted after Japanese regulators cut maximum interest rates and limited the amount customers could borrow in 2006. (Reuters)

MAS overnight CNY facility to back offshore RMB market

Jun 14. The Monetary Authority of Singapore announced that a facility for providing RMB liquidity to financial institutions in Singapore will be launched on July 1, 2014. The overnight RMB liquidity facility will provide up to RMB 5bn in overnight funds and give financial institutions the assurance that short term RMB funding needs will be met. At the same time, the People's Bank of China will also allow qualified corporations and individuals in the Suzhou Industrial Park to conduct cross border RMB transactions with institutions based in Singapore. (Business Times)

Cost of insuring against bank defaults back at pre-crisis levels

Jun 15. The price which investors are willing to pay to insure a bank's bond default has decreased to its lowest level since the financial crisis. Market observers say this is a result of an improvement in bank capital and better bank regulation, which has increased the investors' confidence in banks. The announcement from the European Central Bank to offer EUR 400bn of cheap loans to banks has provided the much needed support to the European financial system and boosted investment sentiment surrounding banks. (FT)

Property loan defaults rise as banks pull the plug

Jun 10. Commercial property loans in default increased to record high GBP 2.45bn last year as UK lenders took tougher measures on delinquent borrowers. The lack of refinancing opportunities and the decline in commercial real estate prices made it difficult for borrowers to keep up with their interest payments. The Bank of England said that write offs on commercial real estate was three times higher than for residential mortgages since 2008. (Bloomberg)

New World China's buyout proposal rejected (South China Morning Post)

Russia cuts off the gas to Ukraine (Financial Times)

Regulatory Updates

Basel's liquidity rules ignored as EU sides with Denmark

Jun 13. European banks may be allowed to use 75% more in covered bonds to fill liquidity buffers than allowed under Basel III rules. The decision to implement more lenient rules in the treatment of covered bonds will be debated by the European Commission next week. Basel rules say that excessive covered bond use can lead to asset encumbrance, a situation which banks set aside less collateral to cover other creditors. This may also lead to a higher risk of interconnectedness that arises when banks keep more securities issued by other lenders on their balance sheet. Denmark does not agree with Basel's treatment of government bonds in the liquidity buffers as it ignores the recent experience of the European debt crisis. (Bloomberg)

Malaysia to ease rating rules

Jun 14. Prime Minister Najib Razak will remove mandatory requirements for credit ratings from 2017 in an attempt to expand the size of the domestic bond market. This would allow market participants to invest in unrated Islamic bonds and give issuers more flexibility in seeking capital. The government will also allow international credit rating and unit trust management companies to operate in Malaysia without the need to partner local firms. (IFR Asia)

Warsaw stock exchange to open innovative rating agency (CEE Insight)

Fed looks at exit fees on bond funds (Financial Times)

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