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Weekly Credit Brief

Jun 17 - Jun 23 2014

Story of the week

Argentina's woes fail to spoil investor appetite

By Dexter Tan

Bond holders of Argentina sovereign notes may be crying as the South American country is on the verge of default on the restructuring of its previous default in 2001. On June 16, the United States Supreme Court refused to hear Argentina's appeal and ruled that Argentina must fully pay its USD 1.3bn debt to the 'holdout' creditors who refused to participate in the debt restructuring agreements after the 2001 default on country's sovereign debt, before servicing the rest of the creditors. Argentina now has until the end of July to make this payment including a 30 days grace period before falling into default. External debt in Argentina increased to USD 137.6bn in the last quarter of 2013 from USD 133.6bn in the previous quarter and the government has now USD 29bn of total debt due in the next 12 months. Argentina's one-year CDS contract, which protects bondholders against default, rose to 6651bps on June 18 - the highest since June last year but has receded after news of Argentina seeking US courts to issue a stay against 'holdout' creditors. The Argentina Merval Index meanwhile declined 10% on the day of the US court's decision.

Figure 1: CDS of Argentina vs average corporate yields of Argentine firms. *Source: Bloomberg*

On the contrary, average corporate bond yields on USD denominated debts issued by Argentine public listed firms have continued to fall over the last year and perform relatively well considering the country's situation at the moment. There are 56 USD-denominated notes outstanding by Argentine companies, of which 17 were issued by public listed corporations. The nation's corporate bonds have outperformed their equivalent sovereign issue this year, as yields of bonds issued by commercial bank Banco Macro SA and oil producer YPF SA, company notes in the South American nation have fallen below their sovereign equivalent benchmarks as seen in Figure 2. This is also reflected in the RMI aggregate 1-year probability of default (RMI PD) for Argentina domiciled firms, which decreased from 49.5bps in June 2013 to 25.2bps on Friday, June 20.

Name	Maturity date	Coupon (%)	Yield (%)	1-year RMI PD (bps)	Near Maturity Sovereign Yield (%)
Petrobras Argentina SA	05/15/2017	5.875	3.52	8.3	9.948*
Banco Hipotecario SA	4/27/2016	9.75	9.176	29.1	9.948*
Banco Macro SA	02/01/2017	8.5	8.934	8.5	9.948*
Cresud SACIF y A	09/07/2014	7.5	4.795	23.2	7.292*
YPF SA	12/19/2018	8.875	7.635	18.7	10.37*
YPF SA	04/30/2015	0.1	5.722	18.7	9.649*
YPF SA	04/30/2017	1.29	7.319	18.7	9.948

Figure 2: Examples of Argentine corporate bond yields and sovereign equivalent issues. *Source: Risk Management Institute, Bloomberg*

Analysts say some Argentine companies would remain attractive to investors, especially those that do not rely on the government for access to dollars, which has been restricted since President Cristina Fernandez de Kirchner began her second term in October 2011. (Since October 2011, Argentina's government has allowed limited sales of dollars to businesses that need to buy imported goods and restricted public access to USD in an effort to prevent a capital flight.) For example, Cresud SACIF y A is an Argentine agricultural company, with a growing presence in Latin American countries, engaged in a range of activities including crop production, cattle raising and milk production. Operating income in the recent quarter increased nearly 24% from a year ago while revenue gained 39% from Q1 2013. Meanwhile, Argentina's state oil producer, YPF, made clear its intention to the firm's stakeholders relating to the US court case that it will not be involved in the country's default situation and it will remain independent. The firm is governed by law and its assets do not belong to the Republic of Argentina, and as such cannot be embargoed by the Republic of Argentina's creditors.

If Argentina defaults, then its corporate debt could still tumble as it will be traded less often than sovereign bonds and may be vulnerable to greater price distortion. Still, many investors think President Kirchner's intention is to resolve disputes with foreign creditors that have left the country locked out of overseas bond markets since its 2001 default. On June 23, the government asked the US court to allow the Republic to engage in a dialogue with the plaintiffs in a reasonable time frame for further negotiations.

Credit News

Central banks set to cut debt holdings

Jun 23. A survey of 69 central bank reserve managers by Central Banking Publication and HSBC revealed that central banks plan to reduce their exposure to long term debts to protect themselves from losses when the Federal Reserve ends its bond buying program later in the year. Many central banks have invested heavily into government debt which would translate to large losses when interest rates start to rise as the global economy starts to return to health. Less than half of the respondents said they could resort to buying stocks or exchange traded funds, or even reduce the duration of their current bond portfolios. (FT)

Austrian banks' ratings cut by Moody's on planned Hypo Alpe Law

Jun 21. Moody's downgraded the debt ratings of 11 Austrian banks, including the country's biggest three, by one level with a negative outlook for all, after the local government released a draft law that imposes losses on subordinated debt in bank Hypo Alpe Adria that were guaranteed by the bank's home province of Carinthia. Another state-owned bank Kommunalkredit was downgraded to junk rating at Ba1 from Baa3. Hypo Alpe's subordinated bonds were cut to C; its junior and senior bonds were cut to Ca and Caa1, respectively. The rating agency said that the government is less likely to support Austrian banks that may require state aid in future. (Bloomberg)

India's high fiscal deficits have exposed the economy to shocks and constrained the Baa3 sovereign rating

Jun 18. In a credit research report to clients, Moody's said the Indian economy remains vulnerable to macroeconomic shocks due to the imbalances in the economy caused by the persistently high budget deficits. The rating agency noted that India's weak fiscal position has affected its growth, balance of payments and exchange rate trends and suggested that the country needs to bring in more discipline in its fiscal policies through structural changes. (Moody's Investors Service)

Yellen raises concerns about high-yield bonds

Jun 18. Federal Reserve Chairwoman Yellen expressed concerns about the overheating high-yield bond market due to easy-money policies in place. Critics say that the Fed is creating too much debt by keeping rates lower and encouraging corporations to borrow. While the Fed Chairman acknowledged these concerns about the junk bond market, she did not think it would pose a threat to financial stability right now. The US central bank had released guidance to lending institutions about underwriting standards in the leveraged loan market in March. (Market Watch)

Bank of Japan now Japan's biggest creditor for the first time on continued stimulus

Jun 18. For the first time, the Bank of Japan (BoJ) has become the single biggest holder of Japan's domestic government bonds (JGB), which enhances the scale of its monetary easing program. In order to boost the flagging economy, the central bank has been aggressively buying Japanese government bonds since April 2013. According to the data from central bank on June 17, the BoJ's holdings of JGBs has exceeded that of the insurance sector at the end of March, 2014. (The Business Times)

China forestry seeks debt restructure after bond default

Jun 17. Timber producer, China Forestry Holdings Co., has planned to negotiate with investors to restructure the outstanding debt after defaulting on USD 180mn of US dollar-denominated bonds on June 16. The default happened after a one-month grace period expired. The company has accumulated RMB 5.47bn of losses since December 31, 2010 as it faced difficulty in getting financial support due to accounting irregularities. (Bloomberg)

Indonesia leads defaults as Bakries face a third (Bloomberg)

Sri Lanka banks managing risks, credit upturn expected (Lanka Business Online)

China property failure seen as USD 33bn in trusts due (Bloomberg)

Regulatory Updates

The Basel Committee releases a consultative report on the supervisory guidelines for identifying and dealing with "weak banks"

Jun 18. The Basel Committee on Banking Supervision is updating its guidelines related to significant developments in global financial markets and regulatory landscape since financial crisis. The guidelines will replace the 2002 Committee guidance once completed. Some of the significant changes to the guidelines include: emphasising the need for early intervention and the use of recovery and resolution tools, and updating supervisory communication policies for distressed banks; providing further guidance for improving supervisory processes, such as incorporating macro-prudential assessments, stress testing and business model analysis, and reinforcing the importance of sound corporate governance at banks; highlighting the issues of liquidity shortfalls, excessive concentrations, misaligned compensation and inadequate risk management; and expanding guidelines for information-sharing and cooperation among relevant authorities. (Basel Committee on Banking Supervision, BCBS)

China's Shanghai exchange restricts trading of high-risk bonds

Jun 17. The Shanghai Stock Exchange announced new measures to limit trading of risky bonds. Under the new rules, a "special treatment" designation would be assigned to corporate bonds issued by companies that operated at a loss in the previous year. In addition, individual investors must have at least RMB 5mn in financial assets to trade high risk bonds, and indicate on a document that they understand all risks in the trade. (Reuters)

Moving bond trading regulation will hit government bond market, says RBI Governor

Jun 17. In a response to the reforms suggested by the Financial Sector Legislative Reforms Commission (FSLRC), the RBI governor said that the suggestion to create a Financial Sector Appellate Tribunal with the objective of placing more checks and balances on regulatory action, would severely hamper the development of the government bond market. The RBI governor also disagreed with the recommendation to build a unified regulator for the financial sector and create another layer of oversight. (Economic Times)

Debt risk shifting to investors as bank regulations bite (Bloomberg)

Banking group suggests anti-money laundering regulation will stymie trade (IBT)

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