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Transforming Big Data into Smart Data

Weekly Credit Brief

May 13 - May 19 2014

Note: Revisions to sentence expression have been made to the article.

Story of the week

Malaysia Airlines goes further into red after Q1 earnings.

Already weakened by the negative publicity surrounding the unfortunate incident of flight MH 370 on March 8, investors in Malaysia Airline System (MAS) received another shock when the company published its financial statements for Q1 2014. For the fifth quarter in a row, MAS suffered losses, this time, of MYR443mn (USD134mn) – its worst performance in over two years. The stock fell to MYR0.21/share from over MYR0.30/share in the first quarter of 2014. A mild recovery to MYR0.23/share was seen in April before the financial statement release. Dismal Q1 numbers however crushed sentiment further and took the stock price to an all-time low of MYR0.155/share. Thus, the airline's market value has plunged to around 50% this year.

The RMI probability of default (PD) has captured the weak financials of the airline. Since May last year, the 1-year RMI PD for the firm has more than tripled- from 75bps at the end of May 2013 to 229.1bps currently. Its 1-year RMI PD is in a highly speculative, non-investment grade territory, as compared with historically observed default rates for non-investment grade credit rating agency ratings.

The company's distance-to-default (DTD) has reduced from a level of 1.19 to the present 0.45. DTD is a volatility-adjusted leverage measure, and changes in the measure are a significant determinant of RMI PDs. Numbers close to or below zero suggest a higher possibility of insolvency.

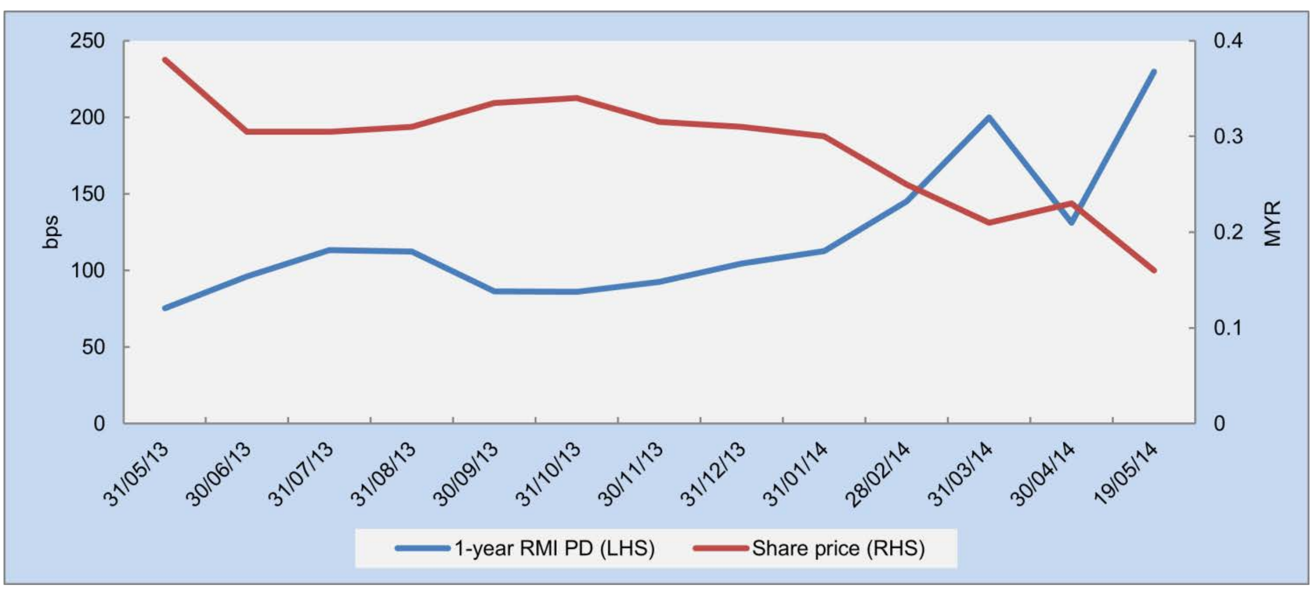

Figure 1: 1-year aggregate RMI probability of default and Share price for Malaysia Airline System Bhd. *Source: Risk Management Institute*

Lack of trust and lingering ill will has resulted in a sharp decrease in the number of Chinese passengers. Many argue that the full impact of the fewer bookings following MH370's unexplained disappearance will actually be felt in the April to June quarter. This makes the outlook more grim for MAS. In the recent past, MAS has had to cancel or consolidate flights due to extremely low passenger numbers. This has been exacerbated by a rollback in promotional and advertising activities as a mark of respect to passengers onboard the missing

MH370 plane.

The airline is also beset by high costs and stiff competition in the region-in particular by AirAsia. MAS has managed to bring down costs per available seat, but it has come at the expense of yields, a measure of revenue earned per kilometer. Yield has dropped 9% to MYR0.225 in the first quarter. Due to Khazanah Nasional Bhd, the major (state) investor of the firm, financial support is still available. However, as per the latest reports, the airline is in talks with banks for a strategic overhaul that could possibly include a sale of its engineering unit and an upgrade of its fleet. Some reports however suggest that the firm may file for bankruptcy in the next couple of quarters.

Credit News

Deutsche Bank bolsters capital position via stake sale to the Qatari royal family

May 19. Deutsche Bank will raise EUR 8bn in fresh capital via a major stake sale to the Qatari royal family in an effort to build up its capital position. About EUR 1.7bn has already been invested and close to EUR 6.3bn will be raised via a rights issue to existing shareholders. The capital raising will increase Deutsche Bank's Common Equity Tier 1 (CET1) ratio by approximately 230 bps, from 9.5% at the end of Q1 2014 to 11.8%. New EU rules have required banks to hold more equity capital to cover potential losses and have put pressure on Deutsche to raise capital. (CNBC)

India's decisive election outcome is 'credit positive' - Moody's

May 19. The Bharatiya Janata Party's (BJP) resounding election win is credit positive for India as it boosts the prospect that a stable government will address the country's economic challenges, Moody's Investor Service said on May 19. The completion of the election will allow stalled policies relating to the corporate and infrastructure sectors to resume - a credit positive for the country's corporates. Moody's rates India "Baa3", the lowest investment-grade rating with a "stable" outlook. (Reuters)

AstraZeneca rejects Pfizer's 'final' GBP 69bn takeover proposal

May 19. Pfizer's hopes of creating the world's biggest pharmaceuticals group by sales seems to be on the brink of collapse as AstraZeneca rejected Pfizer's 'final' GBP 69bn takeover proposal. The offer of GBP 55/share, which marked an improvement from the GBP50/share as an indicative offer and rebuffed by AstraZeneca on May 2, has been deemed still low by the board and may lead to the end of negotiations unless AstraZeneca shareholders force the board to back down. (FT)

Portugal's economy needs further help

May 15. Portugal's central bank issued a warning to the government and banks that while the country has successfully exited a EUR 78bn bailout program, much more needs to be done to put the economy on the right track. The Portuguese economy contracted 0.7% in Q1 2014 as compared to the previous quarter. Portugal has been struggling to implement structural reforms to meet the terms of the bailout it signed in May 2011 with the European Commission, the International Monetary Fund and the European Central Bank. (The Wall Street Journal)

China reverts to credit as property slump threatens to drag down economy

May 13. It is estimated that the sales volume of China's property market will shrink by 36% from 2013 to 2020. The slump in the property market, which may lead to economic slowdown and tax revenue erosions, has aroused wide concerns among China's authorities. Thus, the Chinese central bank has ordered 15 commercial banks to provide more loans to first-time buyers and quicken the approval and disbursement of mortgage loans. However, the latest loosening policies are not enough to prevent the market from sliding, but will cause further problems. Besides, with less migrants pouring into the cities and soaking up supply, the recession in China's property market will be further worsened. (The Telegraph)

Thailand's army declares martial law after six months of political unrest (The Guardian)

Russia Close to USD400 bn gas pipeline deal in pivot to China (Bloomberg)

Credit Suisse pleads guilty to U.S. criminal charge in tax probe (Reuters)

Regulatory Updates

China Issues New Rules on Interbank Lending

May 16. In order to cool off the runaway credit growth in China, the Chinese financial regulator has issued new guidelines to limit the off-balance-sheet lending activities at the banks. At the heart of the risky lending practise are corporate loans that are disguised to appear as less risky bank to bank loans. By some estimates, the size of such lending could be as large as USD 320bn as of June 2013. In the guise of less risky loans, such loans require banks to set aside less capital and reserves, making the banks look healthier and better capitalized than they would be in reality.

The new guidelines require banks to count such interbank loans as part of their overall loan quota, which regulators set for each bank. These quotas currently don't cover bank-to-bank loans. In addition, the rules require banks to hold capital against such interbank loans. Moreover, a bank's lending to any single financial institution is now capped at 50% of its Tier 1 capital. (The Wall Street Journal)

Financial Stability Board wants the largest banks to build cushion against adverse capital moves

May 18. The Financial Stability Board (FSB) – the regulatory arm of the G20 countries group, wants the world’s biggest 29 banks to hold enough capital and bonds that in a crisis they would not have to be rescued by governments. The FSB is proposing that the banks to hold a common “cushion” of bonds that can be converted to equity to help rescue or “bail in” the bank if all other capital has been burnt through. FSB Chairman Mark Carney has said that he wants a draft rule on the “bail in” bonds by November 2014, when G20 leaders meet in Australia. (Gulf News)

No alarm over house price rises, says Bank of England (The Guardian)

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