Weekly Credit Brief Nov 19 - Nov 25 2013

## Stories of the Week

### Thai companies' PDs increase as political protests continue

By Thomas Cho

The RMI 1-year probability of default (RMI PD) of Thai companies increased as foreign investors pulled funds from the country amid intensifying political turmoil. Anti-government protests, which started in Bangkok last month and switched in the past week from opposing an amnesty bill to ending "suffering under the rule of Thaksin and his people", are hurting the Thailand economy. Global funds withdrew a net USD 2.1bn from Thai bonds and equities this month through November 22, according to a Bloomberg report.

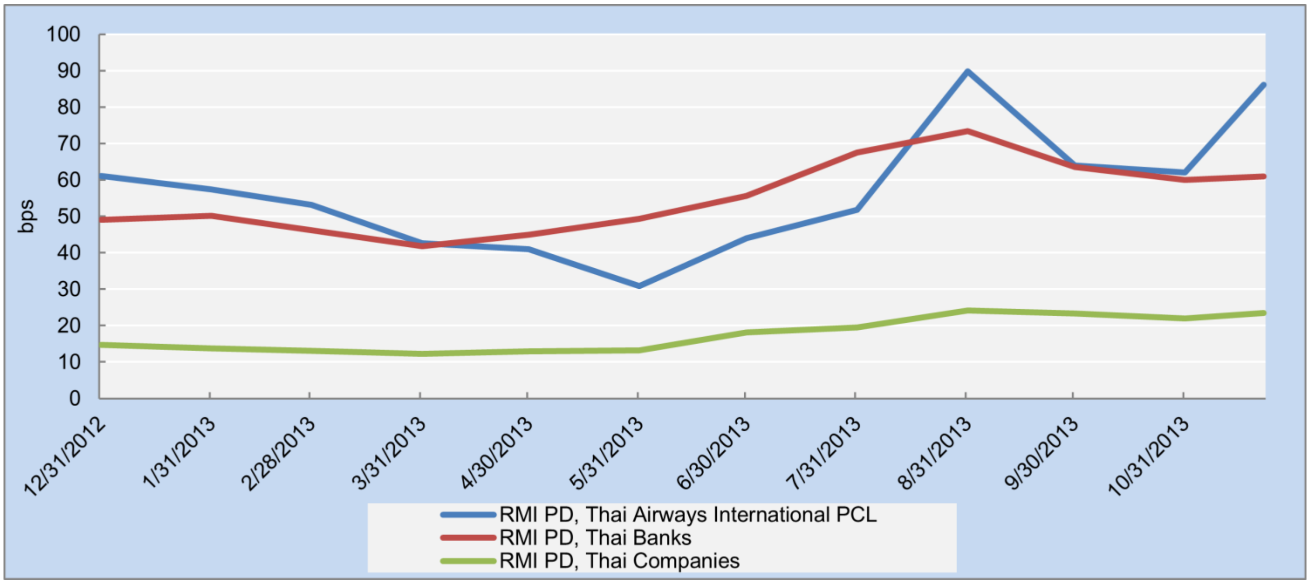


Figure A1: 1-Year PDs of Thai Companies, Thai Banks and Thai Airways International Pcl. *Source: RMI*

The RMI PD of 501 listed companies in Thailand rose about 9bps this year to 23.5bps as of November 22. Banks were one of the worst-hit sectors with their average RMI PD climbing more than 11bps over the same period to 60.9bps. Tourism is expected to take a hit too, with the uncertainties and warnings from travel advisories to visitors for them to exercise caution when travelling in the Thai capital. National carrier Thai Airways International PCL, which already suffered a Q3 net loss of USD195mn, may see further damage to its air travel business. In 2008, anti-Thaksin demonstrators occupied Bangkok's two airports for a week after taking over the prime minister's office for three months.

The Thai economy itself is already in a bad shape after growing by 2.7% in the third quarter from a year earlier. The Q3 growth rate is the slowest since the first three months of 2012. The government last week also cut its 2013 expansion forecast to 3% from as much as 4.3%.

**Swedish regulator may toughen capital requirements even though banks have never been safer**
By Ang Chung Yuh

Sweden may introduce liquidity rules that require banks to reduce reliance on short-term funding and depend more on traditional deposits, even as RMI data shows the credit risk of the Swedish banking system falling to an all-time low.

The Swedish Financial Supervisory Authority (FSA) on November 19 said they will likely direct efforts to attend to the industry's structural liquidity risk, which "as a problem, is something that concerns" the watchdog. The FSA also said that they are satisfied with their reform agenda and its implementation, with regards to short-term liquidity buffers, of which the details are yet to be determined.

Even without the latest regulatory measures, Sweden's capital requirements are already among the strictest in the world. Despite bank industry complaints that tougher bank rules are taking a hit on their competitiveness, Swedish banks' 1-year RMI probability of default (RMI PD) sank this month to the lowest on record (see Figure B1). The average cost to insure EUR-denominated notes of the banks, which are among the lowest among European banks, also fell in tandem.

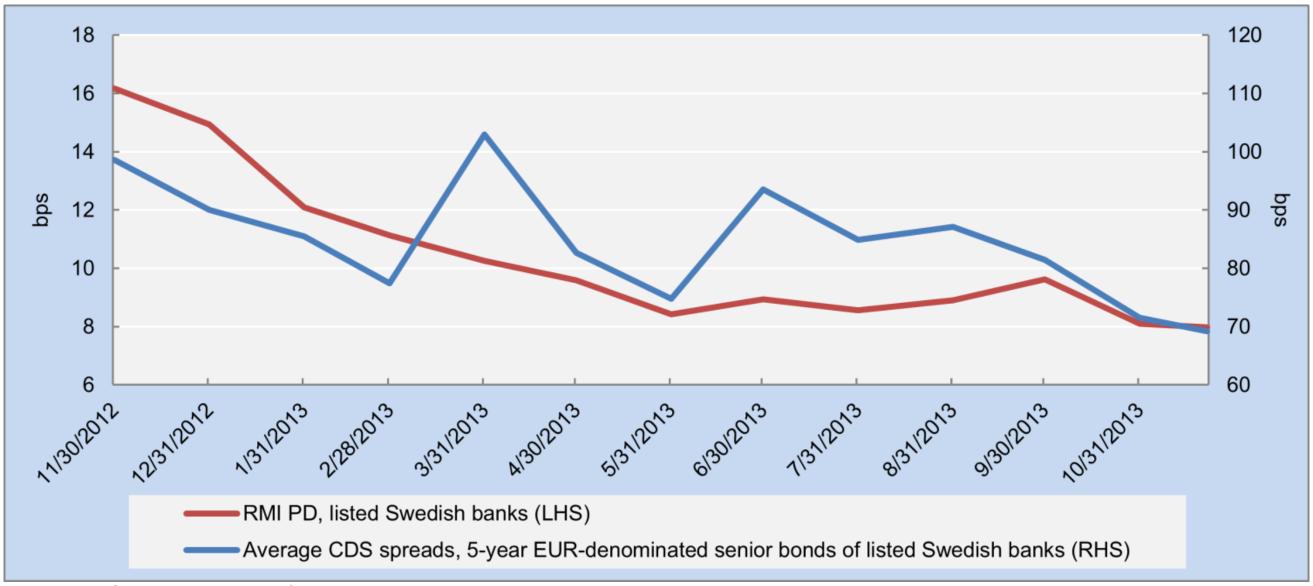

Figure B1: Swedish banks' default risk is at a record low. *Source: Bloomberg; RMI*

As highlighted in a previous Weekly Credit Brief two months ago, Swedish lenders are among the best-capitalized major banks in Europe. The industry has continued to reduce risk by holding more capital (see Figure B2), resulting in lower bank funding costs, some of the financial industry's highest credit ratings and generous market valuations.

The four listed lenders under RMI coverage, which include Nordea, the largest Nordic lender, have all improved their core Tier 1 capital ratio in the three months ending September. Handelsbanken, Europe's best-capitalized bank, held 19.3% of core Tier 1 capital at the end of September. The banks also deleveraged over the same period and all except Swedbank have bettered their debt-servicing ability as measured by the net-debt-to-EBIT ratio.

| | Svenska Handelsbanken AB | Skandinaviska Enskilda Banken AB | Nordea Bank AB | Swedbank AB |
|---|---|---|---|---|
| | Core Tier 1 Capital Ratio (%) | | | |
| Q3 2012 | 17.3 | 16.5 | 12.2 | 16.7 |
| Q4 2012 | 18.4 | 15.1 | 13.1 | 17.4 |
| Q1 2013 | 18 | 15.26 | 13.2 | 17.3 |
| Q2 2013 | 18.2 | 16.1 | 14 | 18 |
| Q3 2013 | 19.3 | 17.4 | 14.4 | 18.8 |
| | Total Debt/Equity (multiple) | | | |
| Q3 2012 | 14.530295 | 8.362444 | 9.203115 | 9.803778 |
| Q4 2012 | 12.805149 | 7.955686 | 8.773852 | 8.714867 |
| Q1 2013 | 13.944174 | 8.598865 | 9.355025 | 9.946208 |
| Q2 2013 | 14.067565 | 8.71397 | 8.729253 | 8.993146 |
| Q3 2013 | 12.919943 | 8.13362 | 8.347828 | 8.548611 |
| | Net Debt/EBIT (multiple) | | | |
| Q3 2012 | 54.9859 | 40.3936 | 49.988 | 37.6729 |
| Q4 2012 | 63.2964 | 39.8263 | 50.3065 | 38.3882 |
| Q1 2013 | 61.5643 | 35.5395 | 51.271 | 34.4526 |
| Q2 2013 | 64.5422 | 37.7409 | 49.0669 | 33.3344 |
| Q3 2013 | 52.2565 | 35.2976 | 46.7015 | 35.8816 |

Figure B2: Swedish banks have managed to improve their already-impressive capital ratios. *Source: Bloomberg*

Nevertheless, there remain considerable risks in the Swedish banking system that is about four times the size of the SEK 3.5tn (USD 540bn) economy. The record debt levels of Swedish households pose a real threat to the largest Nordic economy, and the government's efforts to rein in lending may have the opposite effect. The stricter reserve requirements, which have actually resulted in lower funding costs for the lenders, are making it cheaper for banks to lend. The lenders may face further risk weight calibrations after both Finance Minister Anders Borg and Moody's warned of the structural vulnerability due to the banks' reliance on wholesale funding.

**In the News**

**Central bank Aussie hunger adds to RBA dilemma**

**Nov 25.** The strong interest in AUD of global central banks is thwarting efforts by the Reserve Bank of Australia to contain the currency's strength. The hunt for higher yields and the nation's safe-haven status has contributed to strength in the AUD. Of the AUD 5.9bn worth of 2033 Australian government bonds sold last week, more than a quarter were allocated to central bank buyers, while offshore investors took 59.1%, according to the Australian Office of Financial Management. Even though the AUD has dropped 12% this year, the IMF said in the week ended November 24 that it was still about 10% overvalued. (Bloomberg)

**China local government debt at manageable levels, though some risks: expert**

**Nov 24.** A finance ministry official believes that China's local government debt is at a manageable level, although there are increasing risks in some areas and projects due to poor government disclosure on debt levels. Government debt has been rising rapidly due to public infrastructure projects. Jia Keng, head of the Research Institute of Fiscal Science, said that the overall debt level of China's local government is about 50% of China's GDP, within an acceptable level. He also commented that even if the total debt ratio of the public sector has increased, it would still be within a safe level. However, he warned that there are some areas and projects with relatively high concentration of risks that need to be addressed. (Reuters)

**Brazil may delay state debt bill on fiscal discipline concerns**

**Nov 21.** The Brazilian government prefers to delay approval of a bill easing terms on state and municipal debt, due to possible interpretation of the bill as an encouragement to increase state and municipality spending, according to Finance Minister Guido Mantega. The legislation, which still requires Senate approval, writes down the debt that states and municipalities owe the federal government and reduces the interest rate. As a result of slower economic growth and tax breaks, Brazil's budget surplus excluding interest payments in the twelve months through September narrowed to 1.6% of GDP from 2.3% one year ago, and after deducting interest payments the budget deficit was the largest since 2009. (Bloomberg)

**Chile cuts key rate for 2nd month as domestic demand eases**

**Nov 20.** Chile's central bank cut its benchmark rate by 25bps to 4.5% on November 20, after domestic demand weakened and the inflation rate fell below the bank's target. This is the second reduction in as many months, and market watchers had been fairly even split on whether the bank would keep the rate on hold or follow up last month's reduction with another cut. The three-month swap rate fell to 4.51% on November 19, a level that is consistent with a rate cut the next day and no further changes until March, while the yield on five-year bonds fell to a two-year low of 4.57% on November 15. (Bloomberg)

**ECB said to consider minus 0.1% deposit rate**

**Nov 20.** The European Central Bank (ECB) is considering the unprecedented step of taking deposit rates to negative territory for the first time, in an ongoing attempt to stave off deflationary risks in the struggling region. Deposit rate, which currently stands at 0%, was untouched when the ECB's benchmark lending rate was cut to a record low of 0.25% two weeks ago. Inflation in the 17-nation currency bloc slowed to 0.7% in October, far below the target of 2%, while Q3 economic growth slowed to 0.1% from 0.3% in the three months through June. Policy makers hope that obliging banks to pay to hold a liquidity cushion would prompt them to lend cash to companies and households instead. (Bloomberg)

**Nearly half of low-quality corporate bonds downgraded this year: data**

**Nov 20.** Nearly half of low-quality corporate bonds in South Korea have had their credit ratings downgraded by local appraisers this year, mainly because of the prolonged downturn in three key industries -- shipbuilding, construction and shipping, data showed on November 20. According to the data by the Korea Investors Service Inc., the ratings of 14 out of 29 firms whose bonds are graded as "speculative" were revised down in the year to September, at a proportion of 48.3%. This high percentage of downgrades in speculative bonds is the second highest portion after the 55.3% tallied after the Asian financial turmoil in 1998. Only one speculative bond had its rating upgraded by the appraiser this year. (Yonhap News)

**Corporate bond liquidity timebomb ticking** (Reuters)

**Loan sales top USD 581.5bn in US, exceeding 2007 record** (Bloomberg)

**China's interbank rates ease after central bank's cash injection** (Wall Street Journal)

**Japan central bank keeps loose monetary policy** (Washington Post**)**

**Risk mounts as large number of loans granted to Taiwan's industries** (Want China Times)

**ECB's Draghi kicks back proposals on sovereign debt risk-weighting: Spiegel** (Reuters)

**Watchdog warns Dublin on risks of missing deficit target** (Financial Times)

**Moody's upgrades Malaysia sovereign credit outlook to "positive" from "stable"** (NASDAQ)

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