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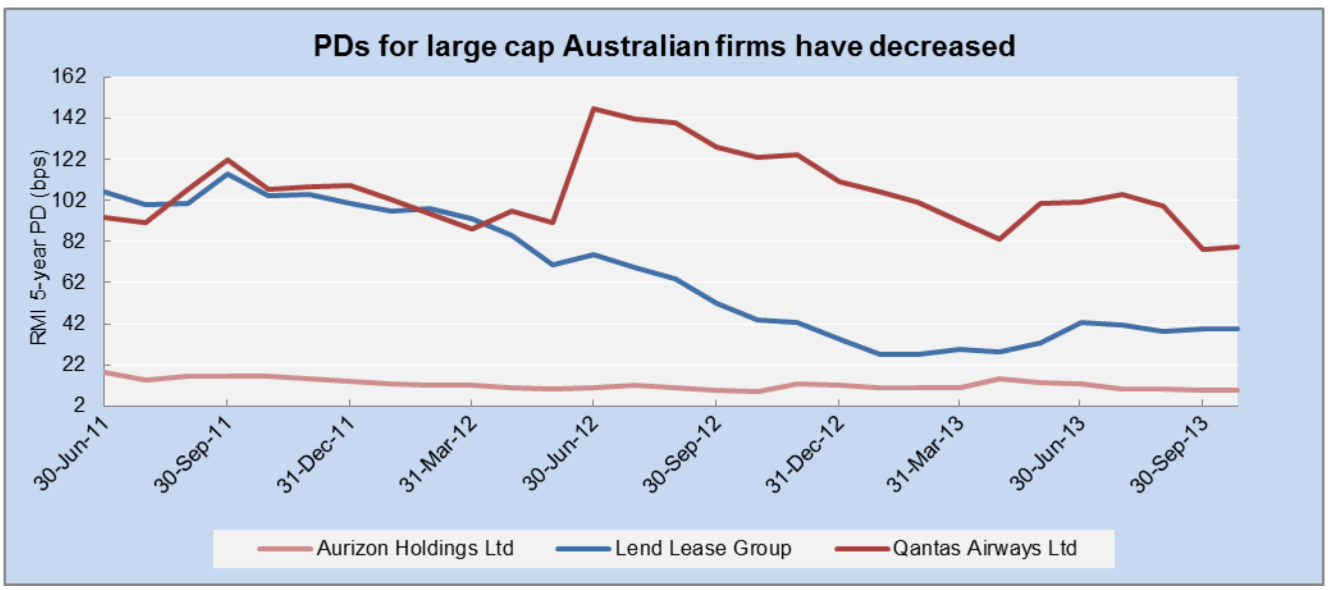
Weekly Credit Brief Oct 22 - Oct 28 2013

Story of the Week

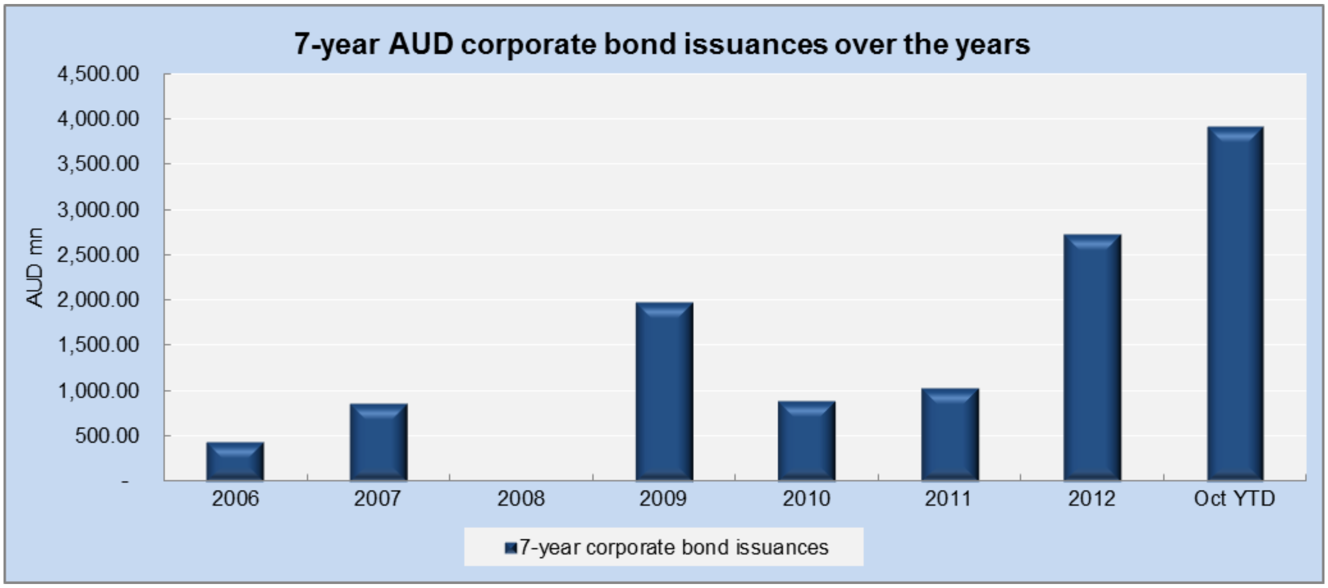
RBA's move increases demand for long tenor bonds

RMI's 5-year probability of default (RMI PD) for large cap Australian companies, which issued 7-year tenor notes this year, have been seeing a decreasing trend in PDs. Of the AUD 7.2bn in non-financial notes sold this year, AUD 3.9bn of them have a maturity of 7 years. This is the largest amount of long-term AUD-denominated corporate bonds issued in the last eight years, with interest rates in Australia at historic lows. Credit spreads, representing the premium investors demand for holding corporate bonds over treasuries narrowed to a five-year low in March.

Currently, Australian industrial debt yields average 151 basis points more than government bonds, 2 basis points above the March numbers, Bank of America Merrill Lynch data show. With some investors betting on the possibility of another rate cut from the RBA, the narrow spread in credit has increased the appetite for longer tenor corporate bonds. Australian companies are taking opportunity of the interest rate environment to issue longer tenor notes to meet their funding needs amid competitive short-term financing offered by banks. This year, large cap issuers include national carrier Qantas Airways Ltd, property solutions provider Lend Lease Group and Queensland rail network operator Aurizon Holdings Ltd.



Aurizon Holding's AUD525 mn sale of 2020 notes on October 18 was the largest single 7-year issue this year from a non-financial firm. It was the rail company's first Australian bond and the bond sale was largely supported by local fund managers even though the issue did not offer any protective terms. The RMI PD for Aurizon Holdings increased to 14.9bps in April but decreased to 10.1bps on October 28. The firm's low PD is a partial reflection of the company's healthy balance sheet and adequate liquidity under its AUD 800mn revolving credit facility.



Demand for AUD denominated corporate bonds has increased since RBA embarked on a rate cutting spree in November 2011. On October 1, the Reserve Bank of Australia (RBA) left its benchmark interest rate unchanged at a record low, saying earlier cuts are still filtering through the economy and have driven up asset prices. The RBA cut borrowing costs by 2.25 percentage points since late 2011 to 2.5%, driving down mortgage rates by 1.85 percentage points and supporting the values of interest –sensitive assets such as houses and bonds. The amount of Australian dividend loans have also increased as private owners of Australian companies, from Pacific Equity Partners and TPG Capital have capitalized on favorable debt markets to refinance and extract cash from their Australian investments.

Sources:
Aussie market finds new depth (Reuters)
Aurizon's 7-year bond deal a record (The Australian Financial Review)
RBA rate cut can't be ruled out (Australia Associated Press)

In the News

Economy may have bottomed out; showing tentative signs of revival

Oct 28. Indian macro-economic indicators are showing signs of improvement. Credit growth has increased from 14.9% in July to 17.7% in October, while non-food credit has grown nearly 18%, demonstrating higher consumer demand and investments. Additionally, exports have registered double-digit growth for three consecutive months while industrial production has also increased in recent months. Furthermore, the monsoon season has set up a rich harvest for both Rabi and Kharif crops which would benefit the rural economy. (Indiatimes)

China Construction Bank quarterly profit growth slows as economy cools

Oct 28. China Construction Bank Ltd, one of China’s biggest state-owned commercial lenders, said that profit growth slowed in the recent quarter as the economy slowed down. Q3 profit rose 9.4% to CNY 56.8bn, while revenues gained 10.4% to CNY 126.6bn. China’s state-owned banks are among the world’s most profitable banks. However, earnings growth has slowed as the Chinese economy registered lower rates of growth. Banks are preparing for a possible rise in loan defaults following a flood of credit in response to the 2008 global crisis. (Washington Post)

Stealth rate boost buttresses Tombini price fight

Oct 25. Changes to the way Cetip SA (Brazil's biggest securities clearinghouse) calculates the interbank rate (or commonly known as the DI) is helping to support Brazilian central bank President Alexandre Tombini's effort to tighten monetary policy. DI, which is the benchmark for 89% of the country's BRL 1.75tn corporate bond market, rose to within 0.15 percentage point of the central bank's benchmark Selic rate of 9.5% after the change on October 7, from an average of 0.29 percentage point this year prior to its implementation. President Tombini has raised interest rates at the fastest pace among 49 major world economies tracked by Bloomberg this year, with a total hike of 225bps, to keep inflation within the central bank's target range. (Bloomberg)

China PBOC unveils prime interest rate for commercial bank loans

Oct 25. On October 25, the People's Bank of China announced the launch of a new prime lending rate for commercial bank loans which will help push forward interest rate liberalization. The rate is based on weighted average rates from nine domestic commercial banks which include Industrial & Commercial Bank of China, Agricultural Bank of China, Bank of China, Bank of Communications, China Citic Bank, Shanghai Pudong Development Bank, China Merchants Bank and China Construction Bank. The nine banks will be required to report their lending rates for their best clients to the central bank, from which the weighted average of rates will be calculated. The loan prime rate level stood at 5.71% on October 25. (Wall Street Journal)

Wall Street skips Moody's as CMBS standards slip

Oct 25. Moody's Investors Service has not rated the riskier portion of recently issued bonds tied to the performance of commercial mortgages (CMBS), suggesting that the credit rating agency is taking on a harsher view of the quality of these new loans. Loans that allow borrowers to defer payment for at least part of the term increased to 55% of mortgage deals in October, up from 41% in Q4 2012 thanks to looser underwriting standards by banks. Moody's said last year that it would change the way it assesses properties in CMBS deals due to an increasing number of real estate defaults. One factor which Moody's takes a stricter view than other rating agencies is concentration risk, meaning that if the deal isn't well diversified it will require greater credit protection. (Bloomberg)

Najib drives Malaysian shift to fiscal prudence as GST planned

Oct 25. Prime Minister Najib Razak unveiled Malaysia's 2014 budget on October 25, with plans to cut the fiscal deficit to 3.5% from 4% in 2013. The highlights of the budgets include the abolishment of sugar subsidies; which will lower the government subsidy bill by 15.6% to MYR 39.4bn, a raise in real property gains tax to suppress excessive speculation, and the replacement of the current sales tax and service levy with a broad-based consumption tax in 2015. Although the Good and Services Tax (GST) is higher than expected at 6%, its impact will be cushioned by other fiscal measures such as lower corporate and personal income tax rates. Middle-income earners will also be given a tax relief of MYR 2000. With the aforementioned measures, Malaysia's surging public debt, which will hit an estimated 54.8% of its GDP this year, is expected to be contained to within 55% in 2014. Nevertheless, this will be contingent on the implementation and execution of the budget over time, as noted by Fitch. (Bloomberg)

Russian defaults on state-backed loans unnerve finance ministry

Oct 23. Default rates of loans backed by the Russian government have risen to levels similar to that seen in Russia's 2009 recession, prompting the country's finance ministry to consider greater restrictions on eligibility for state guarantees. The government has paid RUB 2.5bn through 2013 to finance defaulted loans, and has 172 guarantees totaling RUB 933.9bn outstanding currently. State-backed loans were amongst other crisis measures used by the Russian government in 2009 to stimulate a stalled corporate lending market, but have also been used by banks to offload toxic assets. (Business Week)

Buenos Aires-to-Tel Aviv ties spark IRSA surge

Oct 23. IRSA Inversiones y Representaciones SA's potential overseas investments from Israel to Spain have provided its creditors with above average returns. The property developer's 8.5% USD-denominated debt due 2017 has returned 10.4%, triple the average gain for real estate companies, since it announced on September 9 that it is bidding for a stake in Tel Aviv-based IDB Holding Corp. In addition to Israel, IRSA is exploring opportunities in Spain, which would help provide the company a currency hedge against a continued devaluation of the Argentinean peso. (Bloomberg)

Australia to lift debt ceiling to AUD 500bn

Oct 23. The Australian government planes to raise the nation's debt ceiling by over 60% to AUD 500bn, to avoid any US-style political crisis over spending in the future. The newly elected conservative government, said October 22 that the government's debt was on track to reach the current ceiling of AUD 300bn in December. The previous center-left government had previously forecast that debt would peak at AUD 370bn in 2015 or 2016, but new data showed it would exceed AUD 400bn in 2015 due to falling tax revenues. The bill to increase the borrowing limit will go to the Australian Parliament when it sits on November 12 for the first time since the last election. (ABC News)

Bank of England governor Carney strikes new, softer tone on banks (Reuters)

Bonds erase 2013 losses as three-decade rally defies bears (Bloomberg)

Animal spirits revived as tea party delays taper (Bloomberg)

China said to plan letting more companies sell short-term debt (Bloomberg)

Branchless banking grows (Dawn)

Malaysia bond yields at 3-month low, MYR gains before Budget (Bloomberg)

Brazil debt sale, buyback aim to cut borrowing costs, source says (Reuters)

Malaysia leapfrogs into Top 10 of World Bank Doing Business Rank (Bloomberg)

Singapore's manufacturing output rises 9.3% YoY in September (Channel News Asia)

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