NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond

Weekly Credit Brief

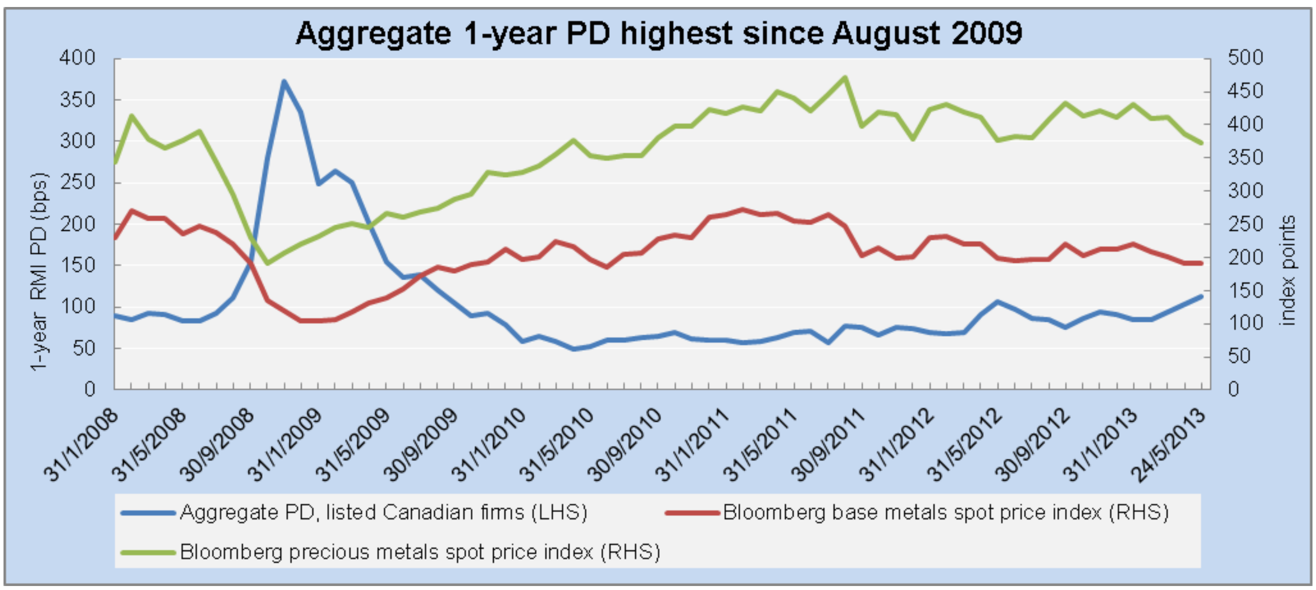
May 21 - May 27 2013

Story of the Week

Weak credit outlook seen for Canadian companies

The chart below displays the RMI 1-year aggregate probability of default (RMI PD) for Canadian firms against the spot precious and base metal price indices. As shown in the figure, the default risk for Canadian companies has been gradually increasing since April 2010. As of May 24, the RMI PD for firms domiciled in Canada reached the highest level since August 2009.

A breakdown of the default benchmark showed that 126 of the 935 Canadian companies on May 24 carried a probability of default higher than the 112.84bps average. A majority of these 126 firms operate in the mining sector with businesses in the gold mining and oil exploration subsectors. The weak credit profiles of these mining firms probably contributed to an increase in the RMI PD for Canadian corporations. RMI had earlier noted the vulnerability and weak outlook for gold miners. A plot of metal prices alongside the aggregate RMI PD for Canadian firms such as Energy Fuel Inc and Copper Mountain Mining Corp showed that a fall in commodity metal prices coincided with an increase in aggregate default probability. Apart from falling base and precious metal prices, a fall in the firms' net income to total asset ratios likely also led to an increase in RMI PD. The latest calibrated default parameters showed that the default risk for Canadian firms were most sensitive to the companies' reported earnings to total asset ratio.



Other sectors of the Canadian economy are also facing challenging operating conditions. Last week, the Canadian banking regulator highlighted the risk of low interest rates for banks. Lawmakers will closely monitor the bank's behavior in response to the currently flat Canadian sovereign yield curve as it could affect interest margins and lenders' bottom lines. In addition to banks, the regulator said that pension plans and insurance companies are also affected by the low rates.

The poor performance in real estate prices has also affected the quality of the banks' balance sheets. Canadian banks have increased their dependence on real estate lending in recent years to drive earnings. Residential and non-residential mortgage assets amount to CAD 955bn at the end of Q1 2013 up from CAD 521bn five years earlier. A study by the Economist says the bubble in the Canadian housing market is about to burst. Home sales in March were 15% down from a year earlier, while a poll showed that only 15% of Canadians are likely to buy homes in the next two years, down from 27% a year ago. The weak property market could cut the country's GDP as real estate and leasing makes up the largest driver of GDP growth.

The second largest driver of GDP growth relies on the growth of oil production and the price of Canadian crude oil prices. The credit profiles of Canadian firms rely heavily on the manufacturing, oil refining, oil and gas extraction industries, but a growing number of Canadians have voiced their opposition against the building of oil pipelines across the country. Voters on May 14 went through provincial elections in which opposing parties fought over a list of social and economic issues. Yet the parties agree on one thing – Canada will not sacrifice its environment for economic growth.

Environmental groups led by Ecojustice filed a lawsuit in September to stop the pipeline projects. And another group – the Saik'uz First Nation has threatened legal action against one of the pipeline builders if the federal government approves the building of more oil pipes. The new pipelines would cost more as operators spend more in winning public support. The current lack of pipelines is said to already depress Canadian crude prices and earnings of Canadian oil firms. The price of Western Canadian Select was priced around USD 21.5 a barrel less than West Texas Intermediate crude oil on May 22, translating to CAD 25bn a year of value destruction for the industry.

Sources:
Low rates can raise risks at Canadian banks, Dickson says (Bloomberg)
Crude trapped as Canadians join US blocking pipelines (Bloomberg)
11 charts that show Canada's economy is entering a world of hurt (Business Insider)
Oil pipelines to drive Canada economy like 1880s railroad (Bloomberg)
Global property markets - bloom and gloom (The Economist)
Canadian housing bubble 'set to burst' (Huffington Post)

In the News

Malaysian bonds, Ringgit drop on speculation Fed to cut stimulus

May 27. The yield on Malaysia's five-year government bonds rose to a three-week high while the MYR weakened, as demand for emerging-market assets fell on speculation that the Federal Reserve could soon slow its expansionary bond purchases. The yield on the 3.26% notes due March 2018 rose two basis points, its highest level since May 3. (Bloomberg)

Singapore sees Dim Sum Bond debut as HSBC joins StanChart

May 27. Issuance of Chinese Yuan-denominated bonds has been initiated in Singapore, which marked the country's third place for Dim Sum bond sales after Hong Kong and Taiwan. HSBC is expecting to sell two-year notes with 2.25% yield, and Standard Chartered is offering three-year notes with about 3% yield. Analysts expect that the issuance of Dim Sum bonds in Singapore will promote the country's status of a offshore Yuan hub. Earlier this year, the People's Bank of China appointed ICBC as Singapore's RMB clearing bank, while DBS Group is expected to issue dim sum bonds in the near-term future. (Bloomberg)

BOJ prepared to adjust bond purchases after yield jump

May 22. The Bank of Japan (BOJ) pledged to adjust its massive bond purchase easing program after the biggest spike in bond yields last week undermined the effectiveness of its stimulus program. BOJ Governor Haruhiko Kuroda said that debt purchased by the central bank will be conducted in a flexible manner to avoid excessive volatility on the securities. In the recent two weeks, Japan's ten-year bond yield had jumped more than a quarter percentage points. This could negatively influence the companies' ability to raise fund if the bond yield stayed at such a high level. (Bloomberg)

Brussels to tighten rules on bank bailouts

May 22. Under the executive powers of the European Commission in Brussels, new state aid guidelines are being drafted which impose more stringent conditions on state bailouts for troubled banks. The changes would force shareholders and junior bondholders to suffer creditor "haircuts" before taxpayers are affected, even if state governments can afford to use public funds. If passed, the new guidelines would be applied to future bank failures across the entire euro-zone. Around EUR 1.6tn of taxpayer money has been pumped into bank bailout plans since 2008. (FT)

Rating agencies under fire again

May 22. After being blamed for misjudging the creditworthiness of risky mortgage backed securities in the lead up to the financial crisis, CRAs are once again facing criticism for underestimating the impact of the rebound in the US housing market. Higher home prices mean that many of the mortgage backed securities once deemed as valueless may now qualify for an investment grade credit rating which would allow pension or mutual funds to invest in them. But market participants have said that the three major CRAs have not kept up with the improved market fundamentals. (FT)

China tightens rules on bond issuance

May 21. Market observers are watching the performance of Chinese bonds after the country's regulators tightened bond issuance rules. According to the new guidelines, bond underwriters are obligated to sell corporate bonds at the market's price, while investors are prohibited from purchasing bonds at prices highly deviated from the market's quote. These guidelines are intended to reduce inefficiencies in the market, as China is seeking to promote their CNY 24tn bond market to international investors. An investigation against insider trading activities in bond markets was recently conducted, which resulted in the arrest of some bank dealers and traders. (WSJ)

China banks curb loans to commodities firms in hot money battle (Reuters)

China money rates mixed, 7-day rate tumbles as liquidity improves (Reuters)

Credit rating firms sow doubt on euro zone bond rally (Reuters)

DBS-Danamon deal hinges on Singapore's reciprocity of openness to Indonesian banks (Reuters**)**

Spain restructured loan provisions may hit bank earnings (Reuters)

Slovenia's biggest bank to cut staff, offload bad loans (Reuters)

Vietnam outlines bad-debt plan (WSJ)

Singapore inflation eases to 38-month low after government curbs (Bloomberg)

Singapore's expansion reduces pressure to ease policy (Bloomberg)

Australia sells AUD 4bn of April 2025 bonds in record issue (Bloomberg)

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