Weekly Credit Brief Nov 12 - Nov 18 2013

Stories of the Week

Yellen's stimulus relieves emerging markets

By Kim Vu

US Federal Reserve chair nominee Janet Yellen on November 14 robustly defended the Federal Reserve's action to spur economic growth. Ms Yellen said the Fed's monthly USD 85bn bond-buying program was a "meaningful contribution to economic growth". Yellen's pro-stimulus comments pleased investors and sent global stock markets higher. Especially for emerging markets (EM), the comments are a relief after a shock from Fed chief Ben Bernanke in May when he raised the possibility that the US central bank could taper its stimulus program earlier than expected.

Latin American markets responded positively after the announcement on Thursday. Mexican stocks recorded their best three-day gains in more than two months on November 15. Mexico's IPC stock index, which is down more than 6% for the year, rose 1.8% to close at 41,034.11 points. Chile's Ipsa index rose 1.41 percent to close at 3,799.45 points, boosted by shares of Banco de Chile and Santander Chile, which rose 3.18% and 2.54% respectively. Asian stock markets were also boosted, with Indian stocks rising after Yellen's announcement. The 30-share BSE Sensex gained 205.02 points, up as much as 1.02%, to close at 20,399.42. Stock markets in Southeast Asia and mainland China also gained strength.

EMs are often considerably more sensitive to changes in the US monetary stimulus than others. Brazil, South Africa, Turkey, India and Indonesia were among the economies hardest hit by Mr Bernanke's tapering comments, as investors withdrew their capital from emerging economies in anticipation of higher interest rates elsewhere. RMI's 1-year default probability reflected this concern in May following the Fed chairman's comments. The aggregate corporate RMI PDs for a number of EMs have risen since May 2013 (see figure A1) and stabilized somewhat after the Fed held back its tapering plan in September. The Federal Open Market Committee will next meet December 17 to 18, where a reduction in the pace of the Fed's asset purchases may be amongst matters discussed. Figure A2 shows the average current account balance against real credit growth in excess of GDP growth of a number of EMs. The group of economies in the bottom right quadrant is sensitive to a change in external and domestic policies, according to the IMF. A typical example of an external change could be a change in US monetary policy.

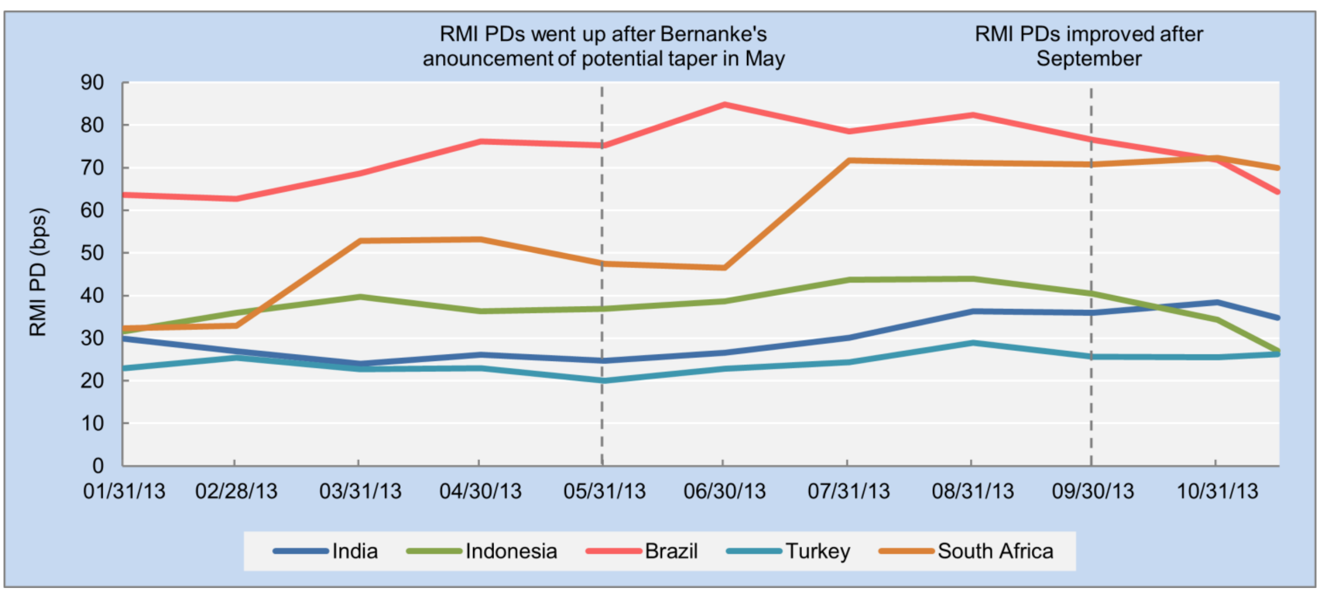

Figure A1: RMI 1-year PDs for a selection of emerging economies. *Source: RMI*

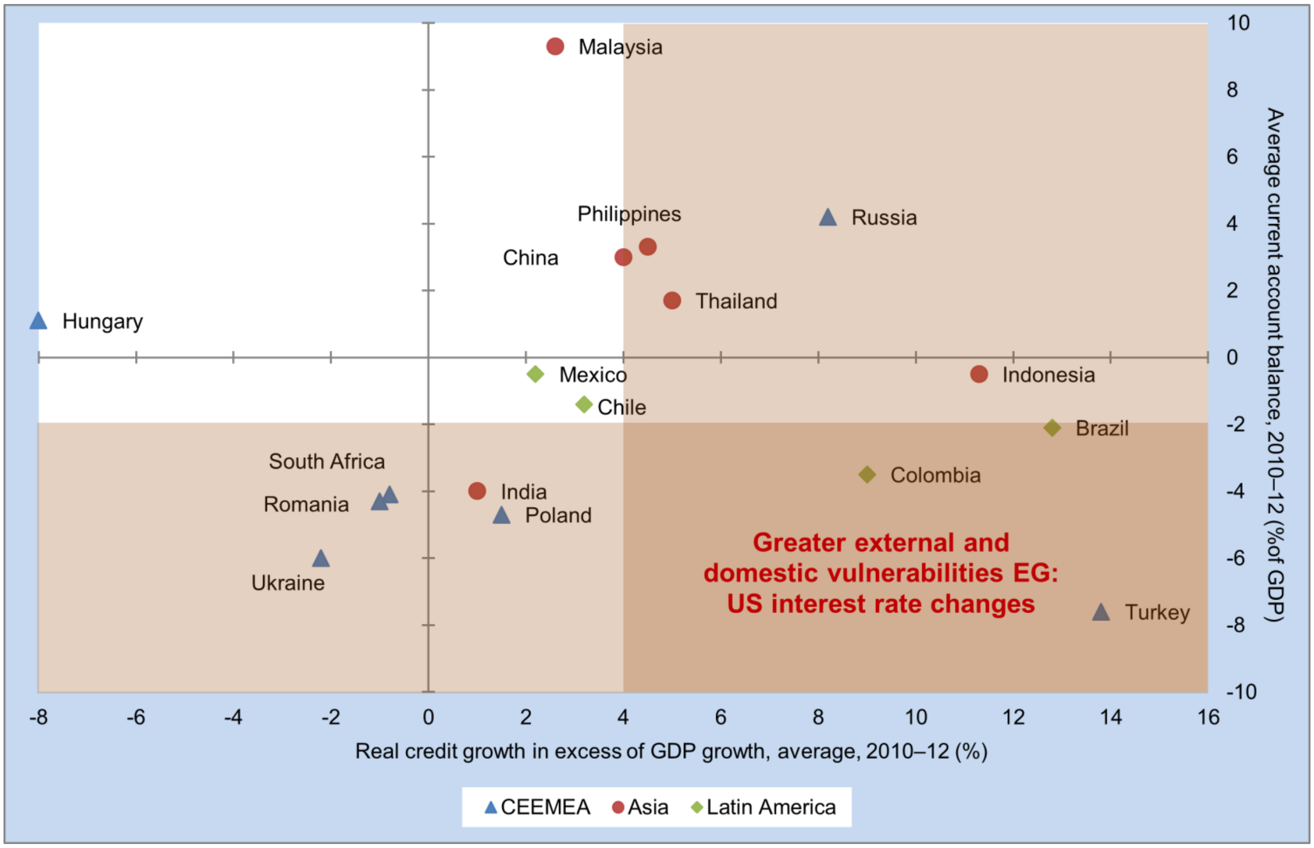

Figure A2: Emerging markets' external and domestic vulnerabilities. *Source: Bloomberg, IMF*

Even though the US Fed is not going to stop the current stimulus program in the near future, Yellen admitted the quantitative easing could not continue forever. World Bank President Jim Yong Kim expressed concern about further EM exposure to the Fed's forward looking guidance just before Yellen's comments. The same scenario may happen again in 2014 if the US central bank decides then to reduce its bond-buying pace. EM central banks are trying to smooth the transition to higher US interest rates. For example, Bank Indonesia made a surprise move on November 12 to trim the country's current-account deficit by raising its benchmark interest rate by 0.25 percentage points to 7.5%. The rate increase may have also been a pre-emptive move to potential tapering by the US Fed, which could see market participants punish the IDR more severely than its peers. The IDR is down some 20% against the USD this year and is one of the world's worst performing currencies.

Bharti Airtel's default risk climbs to eight-month high

By Ang Chung Yuh

Bondholders of Bharti Airtel Ltd are facing the highest credit risk in eight months amid rising regulatory uncertainties and falling profitability. The largest mobile phone operator in India (and the fourth largest in the world in terms of subscribers) saw its RMI 1-year probability of default (RMI PD) reach 51.4bps on November 13, the highest level since late March, according to the most recent calibration of the RMI PD model.

Figure B1 shows the RMI PD of New Delhi-based Bharti and the yield on its USD 1.5bn 2023 bonds. The graph suggests that the direction in which Bharti's RMI PD serves as a reasonably good predictor of the bond's near-term performance. RMI's PD model indicates a significant deterioration in Bharti's credit profile since mid-September, and the company's RMI PD approached its current level in early October, more than a month before the yield on the 10-year dollar bonds rose to a five-week high of 6.519% on November 13. Nevertheless, the yield is still lower than the average yield of 6.853% for 10-year dollar debt with similar credit ratings (S&P rates Bharti's notes BB+, its highest junk rank), according to HSBC Holdings Plc.

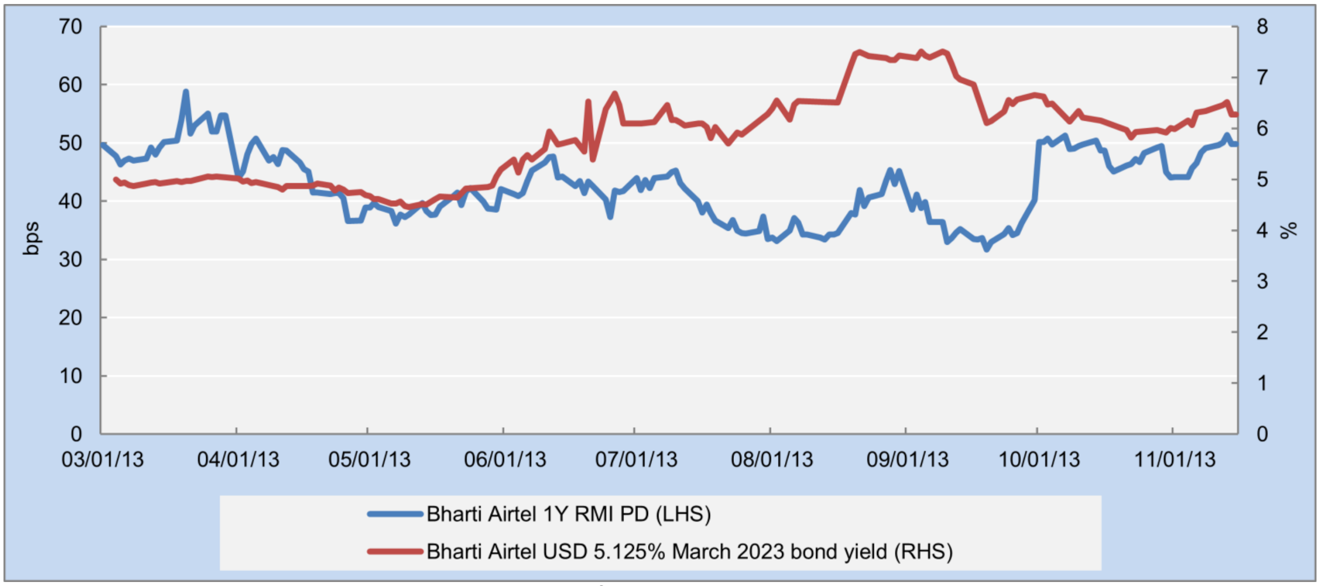

Figure B1: Both RMI's PD model and the market estimate of Bharti's credit risk suggest a weakening in the company's credit outlook. *Source: Bloomberg; RMI*

The flagship company of billionaire Chairman Sunil Mittal on October 29 posted its 15th consecutive quarterly decline in profit, as subscriber call minutes dropped and gross customer additions across the nation fell. Net income in the three months ended September 30 fell 25.7% to INR 5.12bn from INR 6.89bn in the previous quarter (see figure B2), trailing the INR 7.9bn analyst estimate in a Bloomberg survey. Bharti's rising interest cost is taking a toll on its profitability, as cash paid for interest on debt soared 35% to INR 10.2bn from INR 7.55bn a year earlier. The company's return on assets (one of the measures that directly affect its RMI PD) almost halved to 1.19% from 2.27% over the same period.

	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013
(INR millions)							
EBIT	27646	18955	22478	20399	22599	26979	28927
Cash interest paid	7252	9604	7553	11106	6076	9957	10192
Net income	10059	7622	7212	2837	5086	6889	5120
Net debt	651800	656205	612013	585390	585739	592714	655389
(%)							
Return on assets	2.8062	2.4603	2.2688	1.711	1.439	1.2987	1.1947
EBIT/Cash interest paid	3.8122	1.9737	2.976	1.8368	3.7194	2.7096	2.8382
(multiple)							
Net debt/EBITDA	2.7397	2.7873	2.589	2.4963	2.5185	2.4374	2.6004
EBITDA/Cash interest paid	8.6219	5.7118	7.8605	5.1998	9.9742	6.5732	6.6951

Figure B2: Bharti's profitability and its ability to service its debts have deteriorated over the past year. *Source: Bloomberg*

Bharti's long-term position seems relatively sound after successfully avoiding the market shake-out in 2012 that saw 122 operating licenses of telecom companies cancelled by India's Supreme Court. However, the uncertain regulatory environment persists and is credit negative for Bharti. The Telecom Commission of the Indian government on November 6 recommended increasing the cost of the most widely used airwaves by up to 25%, from prices advised by industry regulator Telecom Regulatory Authority of India in September.

In the News

Rajoy rewarded as Spanish shed discount to Italians

Nov 18. The Spanish yield fell below 4% at the end of October for the first time in almost six months and stood at 4.07% on November 15, as investors are backing the country's greater commitment to a reform agenda that Italy is lacking. Spain's 10-year borrowing costs were 3bps lesser than Italy over the past two months, compared with the average 41bps premium it has paid in the first eight months of 2013, according to Bloomberg. Spanish Economy Minister Luis de Guindos said on November 14 that the country is on course to exit its bailout in January from the EUR 41bn rescue loans it secured last year to recapitalize the Spanish banking system. (Bloomberg)

With France stalling, eurozone recovery comes to near halt

Nov 14. The eurozone economy showed little improvement in Q3 2013, suggesting that the bloc was far from entering a period of sustained recovery. GDP across the region expanded by a slower-than-expected 0.1%, as compared to 0.3% growth in Q2. France's 0.1% contraction in Q3 set off warnings that the government's labor and pension reforms were insufficient and that French competitiveness was lagging behind southern European countries. Italy also shrank 0.1%, while Germany slowed to 0.3% growth from 0.7% in Q2. Other countries posted optimistic results, as Spain ended a 2-year recession with 0.1% growth and Portugal achieved 0.2% growth despite struggling with austerity measures under its bailout plan. (Reuters)

Bond exodus at broad funds hit PIMCO, JP Morgan

Nov 13. Investors are displaying a preference for shorter maturity and high yield debt that is less sensitive to rising interest rates as they withdrew USD 61.8bn from intermediate maturity bond funds in the first nine months of the year. The biggest broad market strategies managed by firms from Pacific Investment Management Co (PIMCO) to JP Morgan have been hit by redemptions in a year of record withdrawals from taxable bond funds. Data from Morningstar revealed that investors withdrew USD 28.1bn from PIMCO's USD 247.9bn Total Return Fund in the first nine months of the year while JP Morgan's Cord Bond Fund witnessed USD 4.6bn of outflows. At the same time, non-traditional bond funds which have more flexible investment mandates received USD 45bn of inflows. Royal Bank of Scotland Group plc data indicated that broader bond strategies saw the biggest outflow in more than 3 years during the week ending October 30, while high yield bonds reported USD 757mn of deposits over the same period. (Bloomberg)

Credit growth slows on mainland China

Nov 13. China's credit growth slowed down more than expected in October .Total aggregate financing slowed down to CNY 856.4bn in October, lower than all nine projections in a survey. New loans stood at CNY 506.1bn, less than the CNY 580bn median estimate of analysts. Economists believe that monetary policy has tightened in China and growth will slow down as Chinese government seeks to limit risks of a financial crisis from debt-fuelled investment and construction. There are also signs that the government wants to limit debt from a recent report by the central bank. (South China Morning Post)

Diverging trends for Mexico, Brazil credit ratings set to last, S&P says

Nov 13. S&P analysts said that the diverging credit trends of Brazil and Mexico will likely continue in the coming years, despite both countries having registered mediocre economic growth in recent years. S&P highlighted the Mexican government's plans to proceed with fiscal and energy overhauls, and expressed concerns about the Brazilian government's more inconsistent policy signaling and deterioration in the fiscal profile. The credit rating agency upgraded its outlook on Mexico's rating to positive in March, while cut its outlook on Brazil's rating to negative in June. Both countries have the same investment-grade triple-B rating from S&P. (The Wall Street Journal)

Porsche 911s at 39% off sparks Argentina sales crackdown

Nov 13. Argentina's government announced a crackdown on luxury car buyers who are exploiting the country's illegal currency market by selling USD in the black market and using the proceeds to buy vehicles imported at the official exchange rate. The resulting foreign auto boom is the biggest in five years, but is also worsening the fastest drop (USD 10.6bn) in the nation's dollar reserves since 2002. The government measure requires Argentines who buy a car valued at more than ARS 350,000 (USD 58,600) to justify the transaction with the Financial Information Unit, and disclose information such as bank account details and tax returns. (Bloomberg)

Beijing opens muni bonds to local governments (Finance Asia)

China reform plan sets scene for local clampdown: economy (Bloomberg)

Egypt gets first sovereign credit rating upgrade since 2011 revolution (Ahram Online)

EU ministers agree eurozone bailout fund can be used as ultimate backstop for banks (Reuters)

Federal Reserve considering a delay to Volcker rule (CNBC)

JP Morgan sets tentative USD 4.5bn accord for mortgage bonds (Bloomberg)

Spain to exit bank aid program without additional funds (Reuters)

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