



Stories of the Week

Petrobras's woe increases as economy struggles

By Thomas Cho

Fuel-price subsidies have eroded profits of Petroleo Brasileiro SA, or Petrobras, and the company's RMI 1-year probability of default (RMI PD) rose about 62% this year to 33.6bps on October 18 (see figure A1), according to RMI's most recent calibration. In 2012, the Brazilian national oil company saw its profits shrink to BRL 21bn (USD 9.6bn) from BRL 33bn a year ago. The company has continued to post losses in spite of vast oil reserves off the coast of Brazil. With Finance Minister Guido Mantega as the company's chairman, Petrobras has been forced to import petrol at international prices and sells it at a loss to help contain inflation.

The borrowing costs for Petrobras have soared as it embarked on a USD 237bn 5-year investment plan that covers everything from exploration and production to building refineries. Yields on the company's recently issued USD 5bn 10-year bonds with a 4.375% coupon have climbed from 4.31% on May 14 to 5% on October 18. Similarly, 1-year credit default swap contracts that protect holders of Petrobras's USD-denominated senior notes against non-payment skyrocketed to 118.93bps on October 18, from 69bps at the start of 2013, tracking the oil producer's RMI PD. Petrobras sold a record USD 11bn of bonds in overseas markets this year, with the debt ranging from a minimum tenor of 3 years to as long as 30 years.

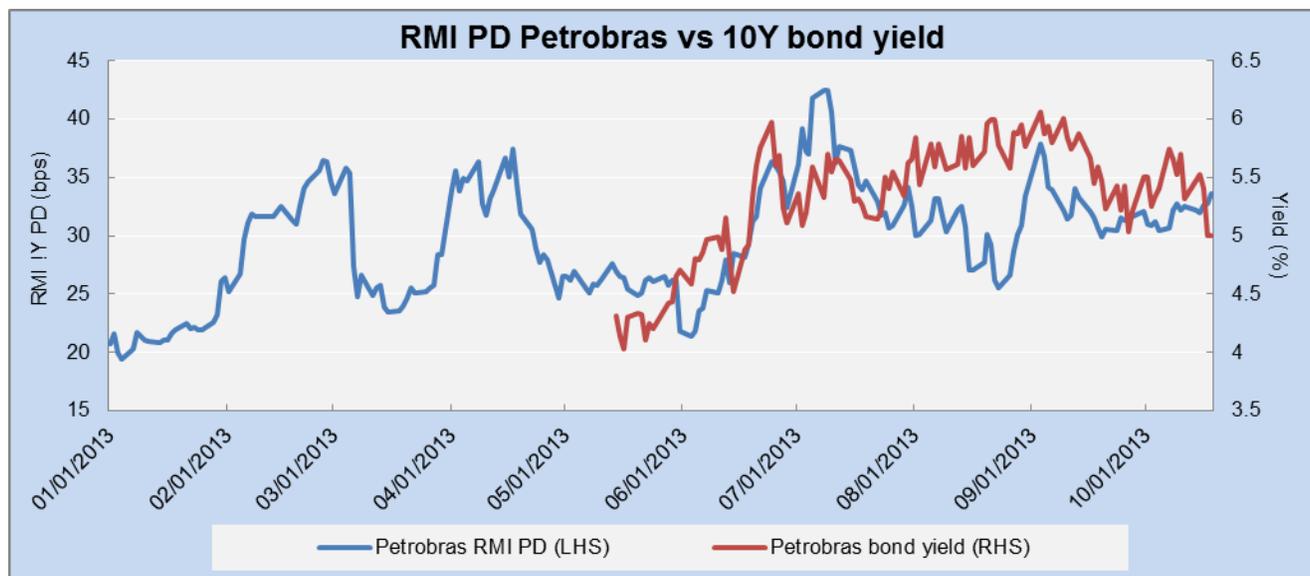


Figure A1: Petrobras' borrowing costs have jumped since May, tracking its default risk. Yield shown is that on Petrobras' 10-year bonds due May 2023. Source: Bloomberg; RMI

Despite the oil and gas giant's rising borrowing costs, Petrobras is still able to command a better credit rating from Moody's over Brazil's sovereign ratings. Although Moody's lowered Petrobras' credit rating to Baa1 from A3 on October 3, it is still a notch better than the Baa2 grade assigned to Brazil. Bond traders have ignored the better rating of Petrobras, as the yield premium investors demand to own the company's USD 5.25bn of bonds due 2012 instead of Brazilian government debt [widened to a record 1.86 percentage points](#) during the week ended October 13.

The fragile economy is unlikely to help improve Petrobras' prospects. Data from the Brazilian central bank's [IBC-BR economic activity index in August](#) rose a measly 0.08% (seasonally adjusted) from July. The latest indicators suggest the overall economy likely struggled to expand during the three months ended September.

Spanish bank BBVA cut EUR 2.3bn earnings to meet Basel III, enhance ability to withstand shocks

By Kim Vu

In order to bolster its capital base ahead of the introduction of Basel III regulations, Banco Bilbao Vizcaya Argentaria SA (BBVA) will [write off a one-time loss of EUR 2.3bn](#) (USD 3.1bn) against its earnings this year by reducing its stake in China Citic Bank Corp Ltd. The second-biggest bank in Spain sold 5.1% of its holding to Citic Group, the Chinese bank's parent company, in exchange of EUR 944mn (USD 1.3bn) to free up capital. The transaction is expected to close by the end of this year. After this move, BBVA's stake in China Citic Bank will be at a still-significant 9.9%, just below the 10% threshold. Under Basel III, a bank's minority holding between the 10 to 50 percent range in another lender is required to be deducted against Tier 1 capital in full.

With the capital injection from the sale, the bank's Basel core capital ratio rises 0.72%. This is the second time this month for BBVA to divest its foreign holdings. Earlier this month, BBVA had settled [the sale of 64.3% of Chilean pension fund administrator AFP Provida S.A.](#) to MetLife for USD 1.54bn. These efforts to raise capital appear to be prudent for BBVA at this juncture, given the difficulties in its home market.

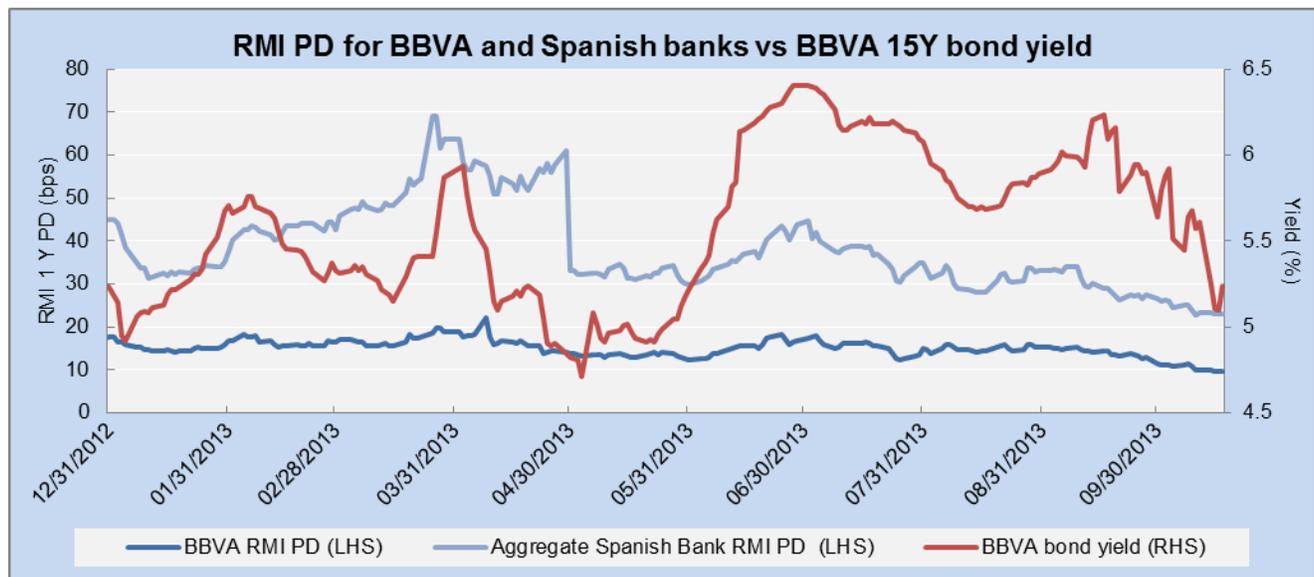


Figure B1: The credit risk of BBVA and other Spanish banks has dropped in 2013 according to RMI PD data. Yields on BBVA's 15-year bond due July 2023 have also declined over the same period. *Source: RMI, Bloomberg*

The increased core capital ratio provides a cushion for the Spanish bank to fall back in case of negative events. Since the start of the year, BBVA's RMI PD has fallen to about 8.3bps, the lowest level since January 2010 (see figure B1), with this decrease in default risk also reflected in yields on the banks 15-year bonds. Yields on its EUR 100mn subordinated bonds maturing July 4, 2023, have more than halved to 5.344% on October 21 from 12.025% a year ago. The aggregate RMI PD for Spanish banks also dropped to a lower level over the same period.

In the News

Peripheral banks at risk as S&P plans to slash ratings

Oct 16. Portuguese and other peripheral banks may soon find it more difficult to secure central bank funding, as ratings agency Standard & Poor's (S&P) considers revising how it rates structured finance and covered bond deals in relation to sovereign ratings. Under the change, S&P estimates that up to half of Portuguese structured finance would be downgraded below BBB-, the minimum rating required for eligibility as central bank collateral. Significant proportions of structured finance and covered bond securities in Italy, Spain, and Ireland would also be affected. ([Reuters](#))

Chilean demand for consumer, mortgage loans steady in 3rd quarter

Oct 16. According to the latest survey on credit conducted by the Central Bank of Chile, demand for consumer and mortgage loans in Chile remained stable during Q3, while the availability of that type of financing also stayed the same. However, 25% of the banks surveyed reported increased demand for consumer credit due to higher wages and increased employment as well as an accommodative interest-rate environment. The poll showed inconclusive conclusions on whether demand for credit from real estate and construction companies had expanded or contracted in the quarter. ([Reuters](#))

Interest rate liberalization in China to force banks to restructure: Citic

Oct 16. The handing-over of interest rate control in China to market forces from the government will reduce banks' profit margin and increase the volatility of interest rates, according to Citic Bank's chief economist Liao Qun. Liao said that banks will need to restructure their products and change their business strategy in order to maintain profitability. Large banks in China will be less likely to be affected by interest rate liberalization as they are more able to respond by transforming their business model and internal financial management as compared to their smaller counterparts. ([South China Morning Post](#))

Indonesia 10-year yield drops to three-month low on Fed outlook

Oct 18. Indonesian bonds and INR forwards rose on strong expectations that the US Federal Reserve will maintain its monetary stimulus, after data collection for the economic indicators used by the Fed to gauge the economy's health stopped during the 16-day government shutdown. The yield on Indonesia's 5.625% bonds maturing May 2023 dropped 51bps this week to 7.46% on October 18, the lowest level since July 23, as recent capital outflows from the country and other emerging markets reversed courses. According to HSBC indices, Indonesia's sovereign debt is Asia's worst performer, having lost 11% this year. Meanwhile, one-month deliverable forwards on the INR hit a 4-week high of 10,875 per USD on the same day. ([Bloomberg](#))

Argentina to pay \$500 million to resolve disputes with foreign firms

Oct 19. Argentina said on October 18 it would pay about USD 500mn to settle disputes with several European and US companies as it seeks to unlock credit lines from Western-based organizations amid a legal battle with some bondholders. The country will compensate with its government bonds four corporations that had hauled it in front of the International Centre for Settlement of Investment Disputes and one firm that filed complaint at the UN commission on International Trade Law, according to a government statement. Under the terms of the deal, the firms reduced the amount of claims they were seeking by 25% from the total of USD 677mn. ([Reuters](#))

Farmer's dream vanishes as Tongyang bonds default

Oct 20. In less than three months after making his purchase of debt issued by Tongyang Corporation, a 78-year-old farmer in South Korea saw his retirement savings of KRW 300mn practically wiped out as five Tongyang affiliates filed for bankruptcy protection. The farmer was only an example of 50,000 retail investors who lost their money in the failure of Tongyang. The Korean Financial Supervisory Service is investigating claims of misconduct by Tongyang Securities in selling high-yield notes to individuals. Other than that, the downfall of Tongyang will have a biggest impact on the retail bond market and on weaker borrowers, while the Korean financial system will be largely unscathed, according to S&P. ([Bloomberg](#))

Anchorage stirs National Australia Bank debt dump

Oct 21. Global hedge fund Anchorage Capital Group is placing pressure on NAB to liquidate dozens of distressed Australian agricultural debt, in a deal that could comprise about USD 500mn worth of loans. According to sources of The Australian, the bank and Anchorage have communicated about the potential deal. However, the bank is still considering its options. NAB is one of the largest lenders on agricultural properties in Australia, where there is about USD 60bn worth of farm debt nationally. In recent years, due to difficult industry conditions, banks have been forced to call in some of those loans. ([The Australian](#))

Finance Ministry suggests two approaches to arrest NPAs

Oct 21. The public sector unit banks would have to adopt two different approaches to arrest the rise of bad loans as directed by finance ministry. Banks should support companies defaulting on payments due to economic environment or circumstances outside their control and take action against willful defaulters. Additionally, every bank will have to file a first information report against a borrower who is found to be a willful defaulter, which is an act of criminality. As of June 30 there are 549 loan default cases with total value of INR 3,380bn to the Corporate Debt Restructuring Cell, up 49% from a year ago. ([Indiatimes](#))

China growth rebounds after Li stimulus to meet target ([Bloomberg](#))

Euro capitals tighten fiscal leash as EU polices cuts ([Bloomberg](#))

Vietnamese banks' CARs surprisingly high ([Vietnamnet](#))

S'pore consumers expect inflation to ease in next 1-5 years ([Channel News Asia](#))

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Corrections:

October 21: The word ordering of the last paragraph in the article "Spanish bank BBVA cut EUR 2.3bn earnings to meet Basel III, enhancefa ability to withstand shocks" on page 2 has been changed for better clarity.