Semi-Annual Credit Summary

S1/2020 *Volume 1, No 2*

CRI Credit Research Initiative
National University of Singapore

NUS National University of Singapore | Asian Institute of Digital Finance

Introduction

The Semi-Annual Credit Summary (SACS) is a summary of credit outlooks across regions, economies and sectors. This analysis incorporates probabilities of default (PD) generated by National University of Singapore - Credit Research Initiative's (NUS-CRI) default forecast model. The SACS provides insights on trends in credit outlooks to credit professionals, investors and researchers.

SACS Volume 1, Issue 2 covers the first half of 2020. We discuss the general credit outlook for a selection of economies from around the world, based on relevant indicators, and relate this discussion to forecasts provided by NUS-CRI's PD model.

While the PD system output default forecasts at horizons ranging from one month to five years, the SACS reports only 1-year PDs in order to allow the reader to make consistent comparisons. The commentary in the SACS is based on median PD of exchange-listed firms within economies and industry sectors. Classification into economies is based on each firm's country of domicile, and classification into industry sectors is based on each firm's Level I Bloomberg Industry Classification. The only exception is the banking sector, where firms are included based on the Level II Bloomberg Industry Classifications. The daily frequency PD graphs in the written commentary are aggregates of firms that have a PD in both the first ten days and last ten days of the quarter. This prevents, for example, drops in the aggregate PD when high PD firms default and leave the sample.

The economies that are considered in each region are based on a selection of 8 economies covered by NUS-CRI's default forecast model. The developed economies of Asia-Pacific include: Australia and Singapore. The emerging economies of Asia-Pacific include: China, India, Indonesia and Malaysia. Western Europe includes: Italy and the UK.

Credit Research Initiative

The SACS is a companion publication to the Weekly Credit Brief and Credit Brief on Singapore SMEs, with all three publications produced as part of the Credit Research Initiative undertaken by CRI.

These publications supplement NUS-CRI's operational Probability of Default (PD) model. The model takes financial statements and market data from a database of more than 72,000 listed firms and estimates a PD for each firm, effectively transforming big data into smart data. The outputs from the NUS-CRI PD model are available free for all users at:

www.nuscri.org

As of Oct 2020, the PD system covers 130 economies in Africa, Asia-Pacific, Latin America, North America, the Middle East and Europe. The probabilities of default include historical data for firms that are now delisted from exchanges or firms that have defaulted. PDs aggregated at the region, economy and sector level are also available. The full list of firms is freely available to users who can give evidence of their professional qualifications to ensure that they will not misuse the data. General users who do not request global access are restricted to a list of 5,000 firms. The PD system operates in a transparent manner, and a detailed description of our model is provided in a Technical Report available on our website.

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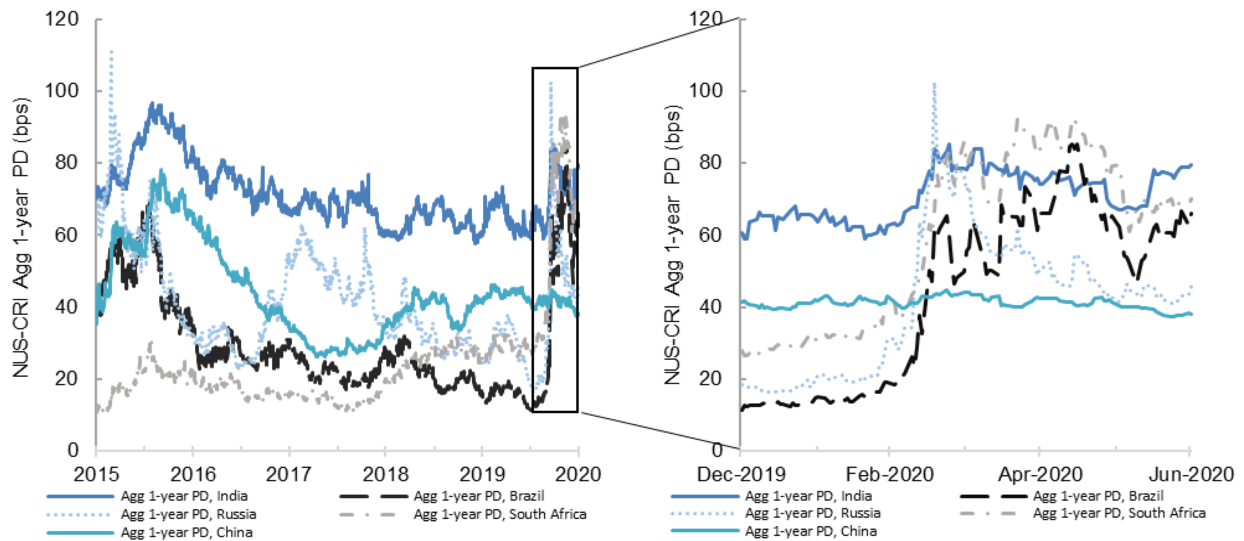
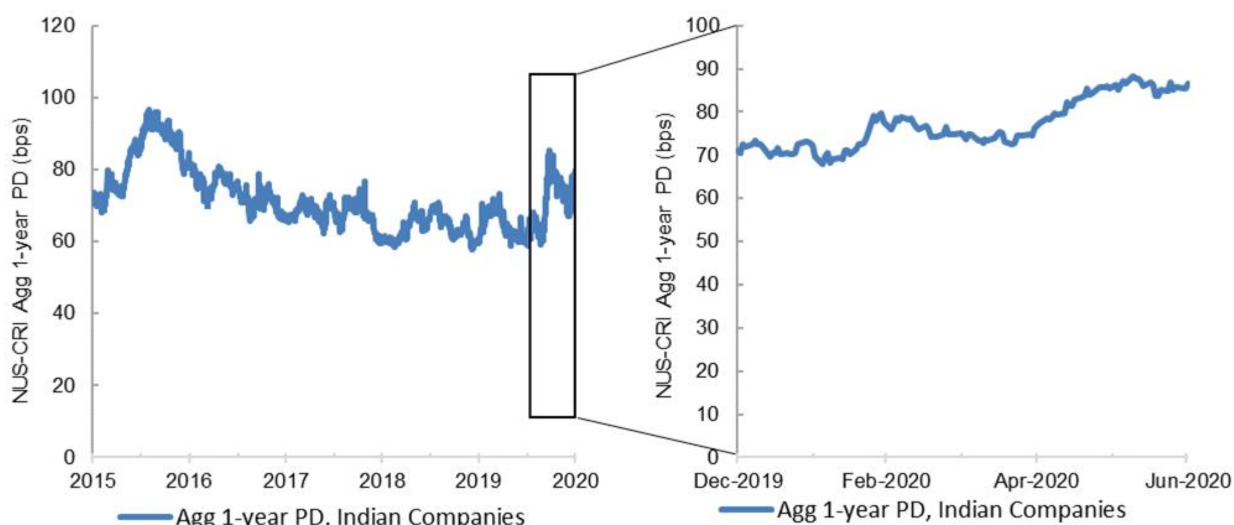
BRICS

In the first half of 2020, most listed companies in BRICS experienced deterioration in their credit profiles due to the COVID-19 induced economic fallout. While the NUS-CRI Aggregate 1-year PDs for India, Russia, Brazil and South Africa domiciled firms increased due to the pandemic, China's listed firms credit quality was effectively left unchanged. The deterioration in Brazil domiciled firms' credit profile is in line with its steepest recorded decline in GDP in Q2 from -2.5% to -9.7%. Similarly, the decline in South Africa's GDP by 1.4% and 2% in Q1 and Q2 are in line with its Agg PD jumping from 30bps to 70bps in H1. Contrary to the worsening of Russia's Agg PD, Russia's GDP grew by 0.5% and 0.3% in Q1 and Q2 respectively. While China's GDP declined by 9.8% in Q1, its GDP grew by 11.5% in Q2. Furthermore, China domiciled firms' Agg PD level remained at around 40bps throughout H1. Meanwhile, India's GDP grew by 0.9% in Q1 and 0.7% in Q2.



Indian Companies

The NUS-CRI Aggregate 1-year PD for Indian companies has increased to around 85bps in Q1 before slightly decreasing to around 80bps in Q2 2020. Q1 and Q2 saw large involvement by the Indian government and Reserve Bank of India (RBI) to reduce the economic fallout brought on by COVID-19. Not only that Indian companies were directly impacted by nation-wide lockdowns, they were also indirectly affected by severe slowdown in global trade, supply chains, and economic growth. The Indian manufacturing sector's Purchasing Managers' Index (PMI) stood at 47.2 in June. India experienced a deflation in H1 2020, based on monthly Wholesale Price Index (WPI), which stood at -1.81 % YoY in Jun 2020. Meanwhile, India reported a surplus in its current account position for the first time in 11 years, with USD 0.6bn position in Q1 2020, compared to a USD 4.6bn deficit a year earlier. Its Q2 2020 current account position was the largest on record, with a current account surplus of USD 19.8bn, compared to USD 15.0bn deficit same period last year.



Economy

- The Indian economy shrank 23.9% YoY in Q2 2020, much worse than market forecasts. This follows a 3.1% YoY growth in Q1 2020 and is the biggest contraction faced by the country on record. On the expenditure side, gross fixed capital formation recorded the biggest decrease of -47.1%, private spending shrank by 26.7%, inventories fell by 20.8%, exports reduced by 19.8% and imports sank by 40.4%. Construction, Hotels and Transportation and Manufacturing were the worst hit industries recording contraction of 50.3%, 47% and 39.3% respectively. Mining and Quarrying decreased by 23.3%; finance, real estate and business services decreased by 5.3%; utilities decreased by 7%, while farming sector grew by 3.4%. On the other hand, government consumption jumped by 16.4% as government implemented relief measures.[1]
- India's manufacturing sector stabilized in June, with both output and new orders contracting at much softer rates than seen in April and May. The IHS Markit India Manufacturing PMI rose from 30.8 in May to 47.2 in June. Despite the rise, it is the third successive monthly decline in the health of the manufacturing sector. The coronavirus-related restrictions had constrained production capacity. Another key factor behind the decline in operating conditions was a further decrease in new business during June. That said, the rate of contraction eased considerably from May and was the softest since an expansion in March.[2]
- The annual rate of inflation, based on monthly Wholesale Price Index (WPI), stood at -1.81% (provisional) for June 2020 (over June 2019) as compared to 2.02% (provisional) during the corresponding month of the previous year. [3]
- India's current account balance (CAB) recorded a surplus at USD 0.6bn (0.1% of GDP) in Q4 2019, rising sharply against a deficit of USD 4.6bn (0.7% of GDP) in Q4 2018 and USD 2.6bn (0.4% of GDP) in the preceding quarter. The CAD narrowed to 0.9% of GDP from 2.1% a year ago on the back of the trade deficit which shrank to USD 157.5bn in 2019-20 from USD 180.3bn in 2018-19. Net services receipts increased on the back of a rise in net earnings from computer and travel services on a year-on-year basis. Private transfer receipts, mainly representing remittances by Indians employed overseas, increased to USD 20.6bn, up by 14.8% from their level a year ago. Foreign portfolio investment declined by USD 13.7bn as against an increase of USD 9.4bn a year ago. In H2 of 2019-2020, there was an accretion of USD 18.8bn to the foreign exchange reserves (on a BoP basis).[4]

Monetary

- According to the bi-monthly monetary policy statement on Aug 06, 2020, the RBI kept the policy rate (repo rate) unchanged at 4 %. The reverse repo rate under the liquidity adjustment facility remained at 3.35 %. Similarly, the Bank Rate remained at 4.25 %.[5]
- Overall liquidity in the system remains in large surplus. Liquidity of INR 9.57tn or 4.7% of GDP was present in the system. Average daily net absorptions under the liquidity adjustment facility (LAF) moderated from INR 5.3tn in May 2020 to INR 4.1tn in June as government spending slowed. Reserve money (RM) increased by 15.4 % on a year-on-year basis, driven by a surge in currency demand (23.1 %). Growth in money supply (M3), however, was contained at 12.4%. [6]
- The Monetary Policy Committee decided to continue with the accommodative stance as long as it is necessary to revive growth and mitigate the impact of COVID-19 on the economy, while ensuring that medium-term target for consumer price index (CPI) inflation of 4% within a band of +/- 2% is achieved. Crude oil prices have remained supported on supply cuts by oil producing countries (OPEC plus) and improved demand prospects on the gradual easing of lockdown restrictions since May. Gold prices have rallied to an all-time high on August 5 on the back of safe haven demand. Global food prices are elevated across the board. Reflecting these developments, inflation has edged up in some major AEs and EMEs. [7]
- Headline CPI inflation, which was at 5.8% in March 2020 was placed at 6.1% in the provisional estimates for June 2020. CPI food inflation moderated from 10.5% in April to 7.3% in June 2020. Fuel inflation edged up as international kerosene and LPG prices firmed up. Inflation excluding food and fuel was at 5.4% in June. [8]

Funding & Liquidity

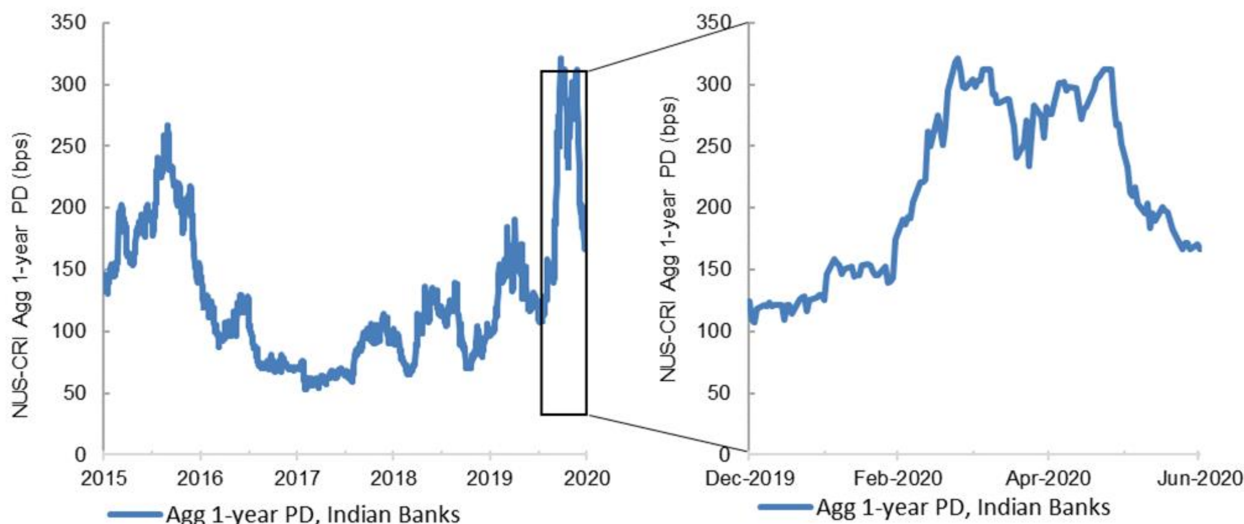
- Yields on India’s 10-year government sovereign bonds fluctuated in Q1 and Q2 2020. Yields were at 5.89% at the end of Q2 2020, as compared to 6.55% at the end of Q4 2019. [9]
- Yield on the benchmark 10-year bond saw average moves nosedive to 2 basis points in June, compared to 10 basis points earlier in the quarter, signalling the biggest trough since 2016. Transaction volumes also dipped by about 30% to INR 279.5bn (USD 3.7bn) in June compared May. RBI has also bought INR 1.2tn of debt and repeated assurances of support. The transaction volume in bonds had dropped since March following a lockdown of the financial capital Mumbai, which forced many traders to work from home, hampering their ability to take positions and inject liquidity in the market. The RBI has shortened the bond market trading hours by half to four hours a day. [10]

Sovereign Credit Ratings

- Standard & Poor's credit rating for India stands at BBB- with stable outlook. Moody's credit rating for India was last set at Baa3 with negative outlook. Fitch's credit rating for India was last reported at BBB- with negative outlook. DBRS's credit rating for India is BBB with negative outlook. [11]

Indian Banks

The NUS-CRI Aggregate 1-year PD for Indian banks surged upwards by the end of Q1 2020, rising from around 125bps to 320bps. The Agg PD remained at these levels for a significant part of Q2 2020 before decreasing to around 166bps by the end of H1 2020. The impact of the COVID-19 pandemic on Indian bank's bank loans is expected to be drastic, with the reserve bank of India expecting NPA ratio increasing to 12.5 % by March 2021, compared to 8.5 % in March 2020.



Profitability

- India's private sector banks saw a decrease in their credit to deposit ratio from 76% in Q1 2020 to 73.1% in Q2 2020. Aggregate deposits growth declined from 10 % YoY in Q4 2019 to 9.5 % YoY in Q1 2020. Aggregate deposits growth then increased again to 11.5 % YoY by the end of Q2. Simultaneously, credit growth on an annual basis declined from 7.4 % to 6.4 % in H1 2020.[12]
- Banks will have to make sure that sufficient risk management capabilities are present as to not see an increase in non-performing assets. This is increasingly a worry as top five private banks in India may see an increase in NPAs to 5% due to poor loan offtake and moratorium-driven contraction in net interest margins.[13]

Funding & Liquidity

- The weighted-average call money rate, the interest rate on short-term finance repayable on demand, decreased from 5.78 % as of Jun 21, 2019 to 3.57 % as of Jun 19, 2020. The call money rates were generally lower than the repo rate during Q1 and Q2 in 2020, indicating a stable banking system. Savings Deposit rates generally remained stable in Q1 and Q2 2020.[14]
- The amount of cash in hand on the balance sheet of Indian banks increased from INR 775.6bn on June 7, 2019 to INR 845.1bn on June 5, 2020.[15]
- The Reserve Bank of India decided to conduct auctions of targeted term repos of up to three years tenor of appropriate sizes for a total amount of up to INR 1tn at a floating rate linked to the policy repo rate. This is to mitigate the adverse effects of COVID-19 on economic activity which has led to pressures on cash flows. [16]

Asset Quality

- The gross nonperforming asset ratio of local commercial banks may rise to 12.5 % by March 2021, from 8.5 % in March, under the Reserve Bank of India's baseline scenario. The central bank had since allowed borrowers to seek a moratorium on their debt repayments till Aug. 31 2020 and slashed interest rates, as Indian authorities seek to cushion the impact of the outbreak.[17]

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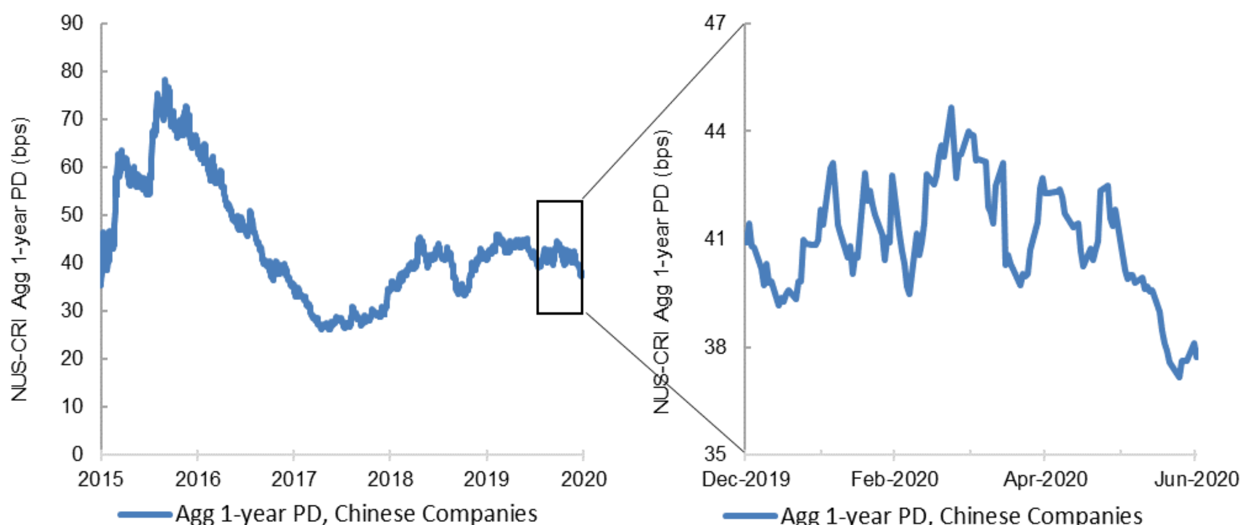
Chinese Companies

The Chinese economy grew by a seasonally adjusted 11.5% on quarter in Q2 2020, following a revised 10.0% contraction in the previous quarter compared to the market consensus of a 9.6% increase. The contraction reflects the severe damage caused by the COVID-19 outbreak after the authorities enforced a near two-month-long shutdown of all non-essential business activity.[1] The NUS-CRI Aggregate 1-year Probability of Default (Agg PD) for China-domiciled firms shows a fluctuating trend in Q1 2020 and Q2 2020, before decreasing in June.



Economy

- The Chinese economy grew by 3.2% year-on-year in the second quarter of 2020, rebounding from a record 6.8% contraction in the previous three-month period and beating market consensus of a 2.5% expansion. The country became the first major economy to report growth following the coronavirus pandemic, as factories and stores reopened following months of coronavirus-induced restrictions. However, a continued fall in retail trade underlined weakness in consumer spending and the need for more support from Beijing to accelerate the economic recovery. In the first half of the year, the economy contracted by 1.6% over the same period of 2019.[2]
- China's annual inflation rate rose to 2.5% in June 2020 from a 14-month low of 2.4% in the prior month and in line with market expectations. It was the first time that the inflation rate increased since the beginning of 2020. Food inflation accelerated to 11.1% from 10.6% in May as pork prices continued to rise. On the other hand, non-food prices slowed 0.1%, due to the drop in healthcare, education, culture & recreation, and other goods & services. On a monthly basis, consumer prices dropped 0.1%, compared with forecasts of a flat reading. Meanwhile, China's producer price index declined by 3.0% year-on-year in June 2020.[3] [4]
- Unemployment rate in China decreased to 5.7% in June 2020 from 6.2% in February 2019. However, It was still 0.8 percentage points higher than the rate of 5.2% in December 2019. The unemployment rate reached a high 6.2% in February 2020 due to the negative impact of COVID-19.[5]
- The Caixin China Composite PMI increased to 51.2 in June 2020 from 50.7 in May, which is the highest reading so far this year. The recovery in the manufacturing sector conditions in China continued in June, with firms signalling a further rise in production and a renewed increase in total new business. The recent easing of measures related to the COVID-19 outbreak enabled more firms to resume normal business operations and improved market conditions. However, export work continued to fall amid reports of weak external demand. Looking forward, the output was expected to be higher than the current levels in 12 months' time. Furthermore, the degree of positive sentiment improved to its strongest since February. Firms linked the upbeat forecasts to expectations that market conditions and demand will continue to recover.[6]
- China's fixed-asset investment (FAI) decreased 3.1% year-on-year to CNY 28.16tn in the first half of 2020, compared to a 5.8% rise in the first half of last year. Private investment decreased 7.3% while public investment grew 2.1%. The investment in the primary industry increased by 3.8% year-on-year; the investment in the secondary industry decreased 8.3%; the investment in the tertiary industry decreased 1.0%. Lastly, the investment in manufacturing sector dropped significantly by 11.7%.[7]

- China's trade surplus narrowed to USD 46.42bn in June 2020 from USD 46.79bn in Dec 2019. This figure is below the market expectations of a USD 58.60bn surplus. Exports unexpectedly grew by 0.5% year-on-year, defying market consensus of a 1.5% fall. Meanwhile, imports unexpectedly grew by 2.7 percent, higher than the market consensus of a 10% drop. China's trade surplus with the US also widened to USD 29.41bn in June from USD 27.89bn in May.[8]

Monetary Policy

- People's Bank of China will maintain ample liquidity and make flexible use of tools including reserve requirement cuts, medium-term lending facilities (MLF's), open market operations, re-loans and re-discounts to guide the stable operation of market rates that revolve around policy rates to stabilize the market expectations. Moreover, it will continue to unleash the dividends of reform, reduce comprehensive social financing costs, guide declines of 30 basis points in MLF's and drive declines in the Loan Prime Rate (LPR), steadily driving shifts in the pricing benchmarks for outstanding floating rate loans and reductions in interest expenditures for outstanding loans.[9]
- Cash Reserve Ratio in China fall to 12.5% in Q2 2020 compared to 13% in Q4 2019. [10]
- M0, the most liquid measure of the money supply including coins and notes in circulation and other assets that are easily convertible into cash, decreased to CNY 7.9tn in June from a historical high of CNY 9.3tn in January 2020. This is, however, still higher than the CNY 7.7tn recorded in December 2019. M1 increased from CNY 54.6tn in January 2020 to CNY 60.4tn in June 2020, breaking the previous high of CNY 57.6tn recorded in December 2019. M2, a broad measure of money supply that covers cash in circulation and all deposits, grew 11.1% year-on-year in line with the market consensus.[11] [12] [13]
- The 10-year government bond yield decreased from 3.17% at the end of December 2019 to 2.90% at the end of June 2020. It hit a record low of 2.48% in Q1 before rebounding in Q2 2020. The 1-year government bond yield had the same trend, decreasing from 2.44% to 2.16%. [14] [15]
- Chinese foreign exchange reserves increased to USD 3.11tn in June of 2020 from USD 3.10tn in May, hitting the highest level since January 2020. However, figures came below market forecasts of USD 3.12tn amid a stronger yuan and an increase in asset prices. Meanwhile, the value of gold reserves increased to USD 110.8bn in June from USD 108.3bn in May.[16]

Fiscal Policy

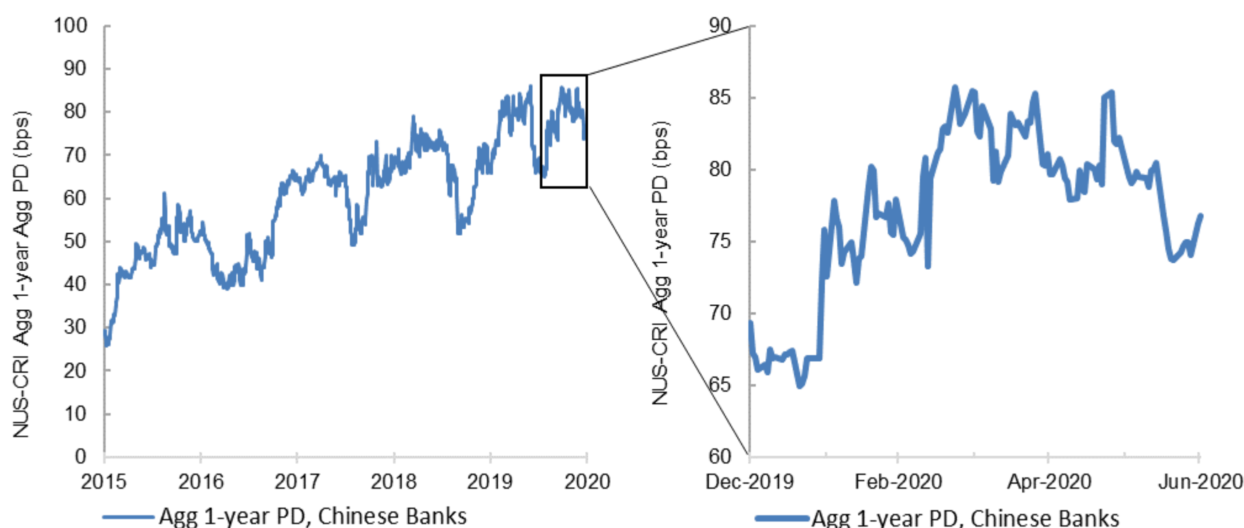
- China's fiscal revenues fell 8.7% year-on-year to around CNY 11.47tn in the first seven months of 2020. Tax revenue in the January-July period fell 8.8% from a year earlier to reach CNY 9.85tn. Revenue from value-added tax, the largest fiscal revenue source in the country, fell 17% year-on-year. The central government collected nearly CNY 5.36tn in fiscal revenue during the seven-month period, down 11.3% year-on-year, while local governments saw fiscal revenue drop by 6.2% to nearly CNY 6.12tn.[17]

Sovereign Credit Ratings

- Both S&P and Fitch maintained rating A+ on the Chinese government while Moody's credit rating for China stood at A1, all with a stable outlook. [18]

Chinese Banks

The NUS-CRI Aggregate 1-year Probability of Default (Agg PD) for Chinese banks over the first and second quarters remained fluctuated. It showed an upward trend at the beginning of Q1 2020 and a downward trend at the end of Q2 2020.



Profitability

- The five largest Chinese banks posted at least 10% year-on-year declines in profit for the first half of 2020 as they set aside more funds for potential loan losses in the coming months.[19]

Finding & Liquidity

- Chinese banks extended CNY 1.81 tn in new yuan loans in June of 2020, the most in three months and above market forecasts of CNY 1.8tn. The amount is also higher than the CNY 1.14tn issued in December 2019. Chinese authorities have been boosting lending, injecting money into the financial system and lowering borrowing rates and reserve ratios in an attempt to help offset the economic impact of the coronavirus pandemic. In the first half of 2020, bank lending hit a record of CNY 12.09tn, compared to the previous high of CNY 9.67tn a year earlier. Outstanding yuan loans increased by 13.2%.[20]
- The People's Bank of China (PBOC) has injected CNY 200bn via medium-term lending facilities (MLF) in June 2020. The term for the MLF was one-year, while the rate remained the same as the previous operation at 2.95%.[21]

Asset Quality

- The NPL ratio for Chinese commercial banks rose 0.03 percentage points in Q2 to 1.94% at the end of June 2020. Banks have to deal with CNY 3.4tn worth of non-performing loans in 2020, increasing from CNY 2.3tn in 2019. The value of bad loans could be even higher in 2021.[22]

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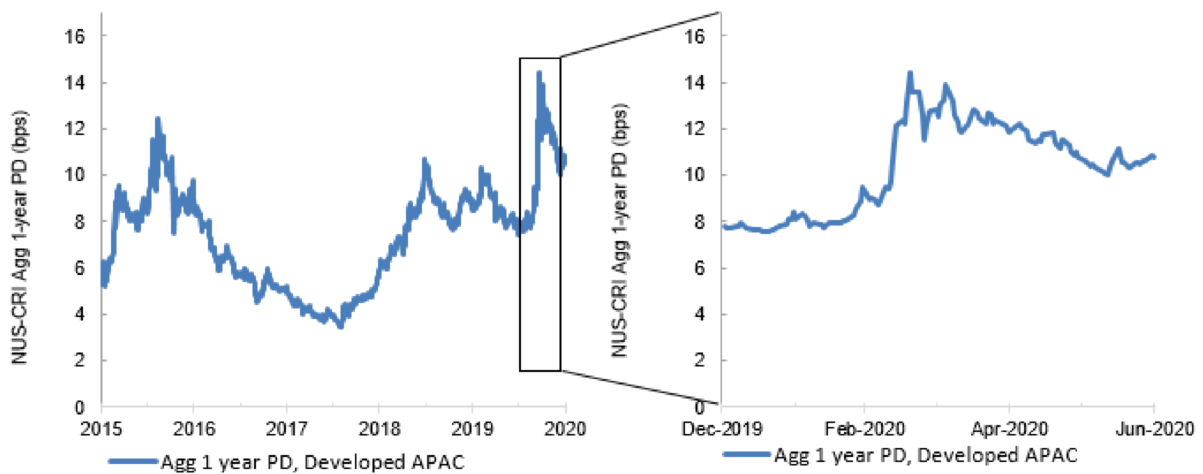
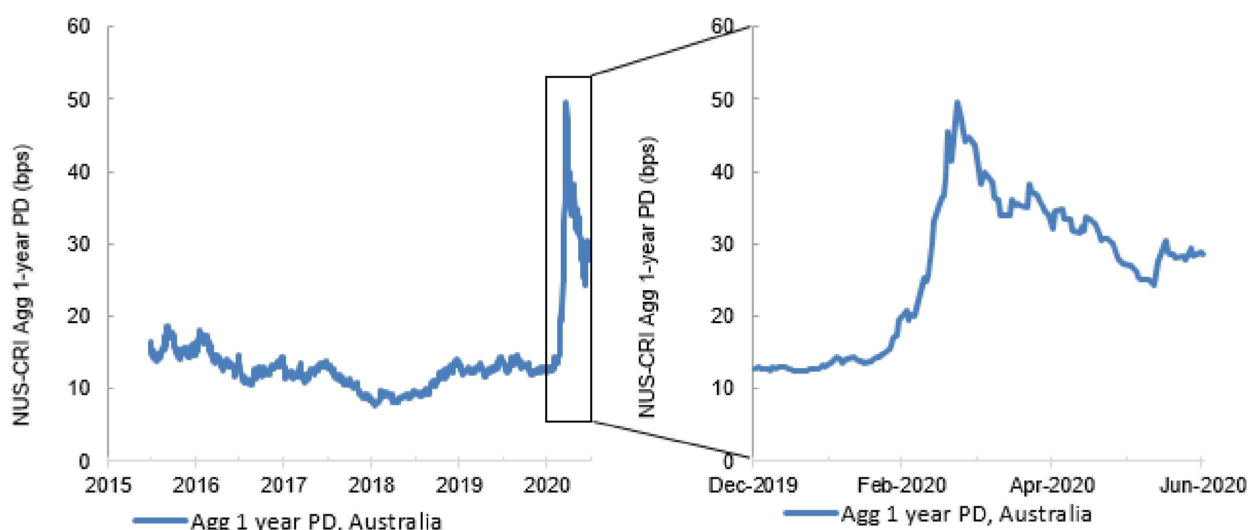
Asia-Pacific - Developed economies

The NUS-CRI Aggregate 1-year PD for listed companies in the Developed Asia Pacific region increased slightly in Q2 2020. This is due to the impact of the COVID-19 pandemic spreading in the region in Q1 2020. However, due the effective early measures put in place by most of the countries in the region to quickly stamp out the spread of the virus, the PD has declined since March. Japan, Hong Kong, South Korea, Taiwan and Singapore are holding up well as the governments quickly instituted mask mandates early on in the pandemic, allowing the countries to control the spread of the pandemic. China has continued its recovery in Q2 of 2020 at a time when most other countries in different regions of the world were entering a lockdown. However Australia has been hard hit by the virus and continues to see elevated PD levels. Japan currently trails its regional rivals China, South Korea and Taiwan in terms of economic and health outcomes from the pandemic. With Japan's long serving Prime Minister Shinzo Abe stepping down due to health reasons, there will likely be more political uncertainty to come for Japan in the near future.



Australian Companies

The NUS-CRI Aggregate 1-year PD for Australian companies rose greatly during Q1 and Q2 2020 as the economy shrank due to the impact of the COVID-19 pandemic. Australia faced its largest recorded economic contraction, sinking into its first recession in 3 decades with consumer spending seeing a massive decline from Q1 to Q2. To allow business to stay afloat, the Reserve Bank of Australia (RBA) reduced interest rates to an all-time low and launched an "unlimited" bond buying programme while urging the government to boost fiscal support. Economic conditions look set to remain poor with large scale unemployment and dismal manufacturing numbers continuing to plague the economy. This highlights the unprecedented level of uncertainty surrounding the size and duration of the financial downturn that Australia is facing.



Economy

- The Australian economy shrank by 0.3% in Q1 2020 and 7% in Q2 2020. The figures are a lower compared to the previous year where the economy grew by 0.4% in Q1 2019 and 0.8% in Q2 2020. Overall, the economy shrank by 6.3% YoY, underperforming market expectations of a 5.2% decline. This was the sharpest contraction on record as the coronavirus pandemic hit the economy. The economy is expected to continue contracting at a growth rate of -6% in Q3 2020. [1 2]
- Public investment increased greatly, with increased government spending (2.9% in Q1, 2.1% in Q2) while private investment declined as gross fixed capital formation fell sharply (-0.5% in Q1, -4.9% in Q2). In the first half of 2020, exports declined (-4.4% in Q1, -6.7% in Q2) while imports experienced a sharper drop-off (-6.7% in Q1, -12.9% in Q2). In line with this trend, household consumption also fell sharply (-1.2% in Q1, -12.1% in Q2). [3 4 5]
- The RBA has decided to lower the cash rate unchanged at 0.25% moving forward, amid an uneven economic recovery after the severe contraction in the first half of 2020. The economy has also been supported by substantial, coordinated and unprecedented policy easing over the past 6 months. The RBA looks to continue to maintain highly accommodative settings as required for economic conditions to improve. It will not increase the cash rate target until progress is made towards higher employment figures and it is confident that inflation will be sustainably within its 2-3% target band. [6]
- The unemployment rate skyrocketed to 7.4% in June, the highest it has been since 1998. The labour participation rate rose by 1.1 percentage point to 64.0%, which is slightly above the forecast of 63.6%. [7]
- As reported by The Australian Industry Group, The Australian Performance of Manufacturing Index (PMI) increased in Jun 2020 by 9.9 points to 51.5. This comes in the wake of April's largest ever monthly fall. The Australian Performance of Services Index (PSI) fell by 0.1 points to 31.5 in Jun 2020. This was the second lowest result in the history of this series (commencing in 2003), following a record low in April as restrictions on activity have been in place since March. The Australian Performance of Construction Index (PCI) rose 10.6 points to 35.5 in Jun 2020, indicating that business conditions remained negative across the construction industry but the pace of contraction eased from the record lows experienced since March. [8 9 10]
- On the one hand, key export prices fell 2.4% in Q2 2020 but is still up 3.8% through the year. Petroleum, petroleum products and related materials posted the sharpest fall in prices at -46.6%. Import prices also fell 1.9% in Q2 2020, the main contributor to this fall was the petroleum, petroleum products and related materials sector with a decrease of 32.5%. Australia's trade surplus widened to AUD 8.2bn in Jun as exports and imports rose 3% and 1% month-over-month, respectively. On a

quarterly basis, the country's trade surplus went up to AUD 23.4bn from AUD 19.23bn in the first three months of the year. Considering the first half of the year, the trade surplus widened to AUD 42.63bn from AUD 32.99bn in the same period of 2019. [11] [12]

Monetary Policy

- The Reserve Bank of Australia (RBA) decided to lower the benchmark interest rate to 0.25%. Despite risks of the global economy being tilted to the downside, some of these risks have lessened. Although inflation remains low, in most advanced economies unemployment rates are low and wages growth picked up. Low interest rates around the world led to several central banks having eased their monetary policy, but expectations of further monetary easing have been scaled back. [13]

Funding & Liquidity

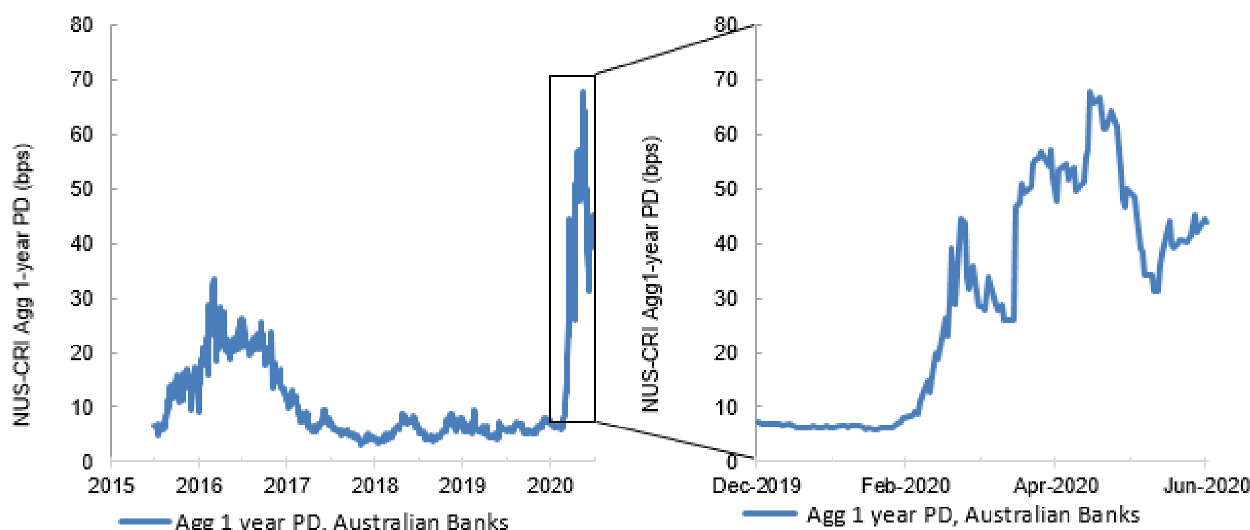
- Yields in the 10-year Australian government bonds started at 1.6% in Jan 2020, before dropping to 1.4% in Jun 2020. There was however an increase in the rate during the months of March and April before it continued its downtrend. [14]
- The 3-year fixed lending rate to small businesses fell from Jan 2020 to Jun 2020 from 6.1% and 5.0%. The lending rates for owner-occupied housing loan was 4.8% during Q1 2020 and decreased to 4.5% during Q2 2020. [15]
- Generally, average commercial lending during first half-year 2020 increased mainly driven by lending to the Government as it increased by AUD 60.3bn. Commercial lending to financial intermediaries saw a slight increase from AUD 128.1bn in Jan 2020 to AUD 131.5bn in Jun 2020, while loans to individuals and corporations also increased. [16]

Sovereign Credit Ratings

- Standard & Poor’s and Fitch Ratings maintained their AAA ratings on Australia, while Moody’s maintained their Aaa rating. However, both Standard & Poor’s and Fitch Ratings revised their outlook for Australia to negative. Meanwhile, Moody’s maintained its stable outlook on the government’s credit. [17]

Australian Banks

The NUS-CRI Aggregate 1-year PD slightly increased greatly for Australian Banks over the first half of 2020. Australian banks have been in good credit health for the past few years due to stringent measures put in place by the government. Despite this, their credit health is set to decline along with the economy as profit from their operations is reduced and asset quality deteriorates during this recession.



Profitability

- For the first half of 2020, aggregate cash profit after tax from continuing operations decreased by 42.6% from 2019 to AUD 8.3bn. This decrease is a consistent trend across each of the Majors and also reflects pressure on margins and increased remediation and regulatory costs. [18]

Funding & Liquidity

- Australian major banks continued to maintain a strong Common Equity Tier 1 capital position by increasing 14bps from 2019 to 10.9%. This was mainly driven by capital management initiatives including divestment of non-core businesses, organic capital generation and dividend management. [19]
- The Liquidity Coverage Ratio of Australian banks remained well above its 100% minimum, with the major banks averaging 140.8%. Meanwhile, the leverage ratio for major banks is running at an average of 5.5%, higher than APRA's proposed minimum requirement of 3.5%. [20]

Asset Quality

- Asset quality deteriorated as reflected by an increase of AUD 3.6bn in collective impairment charges across Majors due to the incorporation of forward-looking economic factors as a result of the COVID-19 outbreak. This reflects the weak Australian economic outlook leading into the pandemic, in particular the discretionary retail sector and the lingering economic impact on regional centres, and accommodation and tourism operators, from the drought and the severe 2019/2020 Australian bushfire season. [21]

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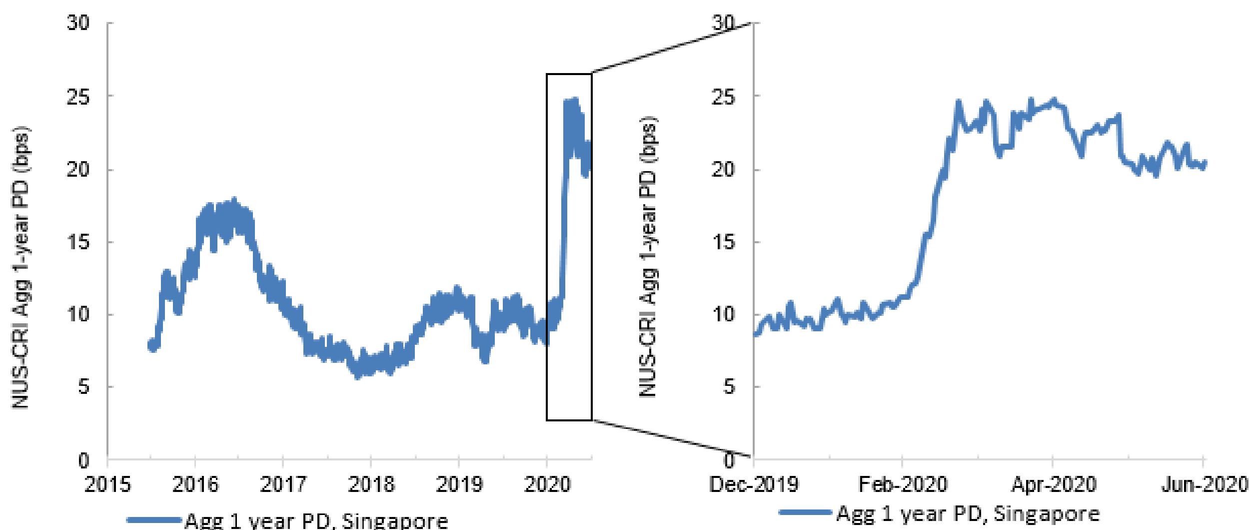
Singapore Companies

The NUS-CRI Aggregate 1-year PD for Singapore companies increased from around 12.73bps at the end of Dec 2019 to 28.68bps at the end of June 2020. Singapore's economy experienced a 13.2%YoY contraction in Q2 of 2020. This was partly due to the circuit breaker resulting in business stopping. The sectors that were hit the hardest were the construction, transportation & storage and accommodation & food services sectors. Unemployment has also reached its highest levels in more than a decade with the number of retrenchments doubling from Q1 to Q2. The Singaporean government approved a record 4 rounds of stimulus adding up to SGD 100bn to keep businesses going to try to ease the fallout from the pandemic and kick-start the economic recovery. The Singapore government expects the economy to continue shrink by between 5% and 7% this year, which would be its worst recession since independence.



Economy

- The Singapore economy contracted by 13.2% YoY in Q2 2020 after a 0.3% contraction in Q1. The fall in GDP was due to the Circuit Breaker (CB) measures implemented from 7 April to 1 June 2020 to slow the spread of COVID-19 in Singapore, as well as weak external demand amidst a global economic downturn caused by the COVID19 pandemic. [1]
- GDP from construction sector shrank by -59.3% from -1.2% in Q1, transportation & storage contracted -39.2% from -7.7%, accommodation & food services declined by -41.4% from -23.8%, business services dropped by -20.2% from -3.4% and other services contracted by -17.8% from -3.7%. There were however improvements in the information & communications sector as it experienced a mild dip by -0.5% from -2.6%, while finance & insurance decreased by -3.4% from -8.3%. [2]
- Singapore's seasonally adjusted unemployment rate was at 2.8% in Q2 2020, the increasing from 2.4% in January. This remains the highest figure in nearly a decade however it is still lower than previous recessionary peaks. The jobless rate also rose for both residents (at 3.8%) and citizens (at 4.0%), however the resident long-term unemployment rate fell (from 0.9% in Q1 to 0.8% in Q2). The pace of employment growth saw its sharpest decline on record in Q2, increasing by 103,500, this was after the coronavirus effects were first seen in Q1 where there was an increase of 25,600 unemployed. Retrenchments more than doubled from Q1 to Q2 (from 3,220 to 8,130). The re-entry rate also fell to an all-time low of 58.4%. The job vacancies to unemployed person's ratio also declined further to 0.57, continuing its downtrend. [3]
- In the MAS Survey of Professional Forecasters, the median CPI-All Items inflation for 2020 as a whole is forecast to be -0.4%, up from -0.5% in the June survey. Similarly, the forecast for MAS Core Inflation in 2019 has increased to -0.3%, from -0.5% previously. [4]

Monetary

- At its latest semi-annual review Mar 30, the Monetary Authority of Singapore (MAS) made a slight reduction to the rate of appreciation of the S$NEER policy band. However, there will be no change to the width of the policy band and the level at which it is centred. The measured adjustment to the policy stance was assessed to be appropriate given muted inflationary pressures. [5]

- The three-month S$ SIBOR fell from 1.8% in October 2019 to around 1.0% as at late March, following the decline in the US$ LIBOR during this period. [6]
- The COVID-19 pandemic has led to a severe contraction in economic activity both in Singapore and globally, due to the combination of supply chain disruptions, travel restrictions imposed in many countries and a sudden decline in demand. MAS is thus lowering the 2020 forecast range for both MAS Core Inflation and CPI-All Items inflation to −1 to 0%. [7]

Funding and Liquidity

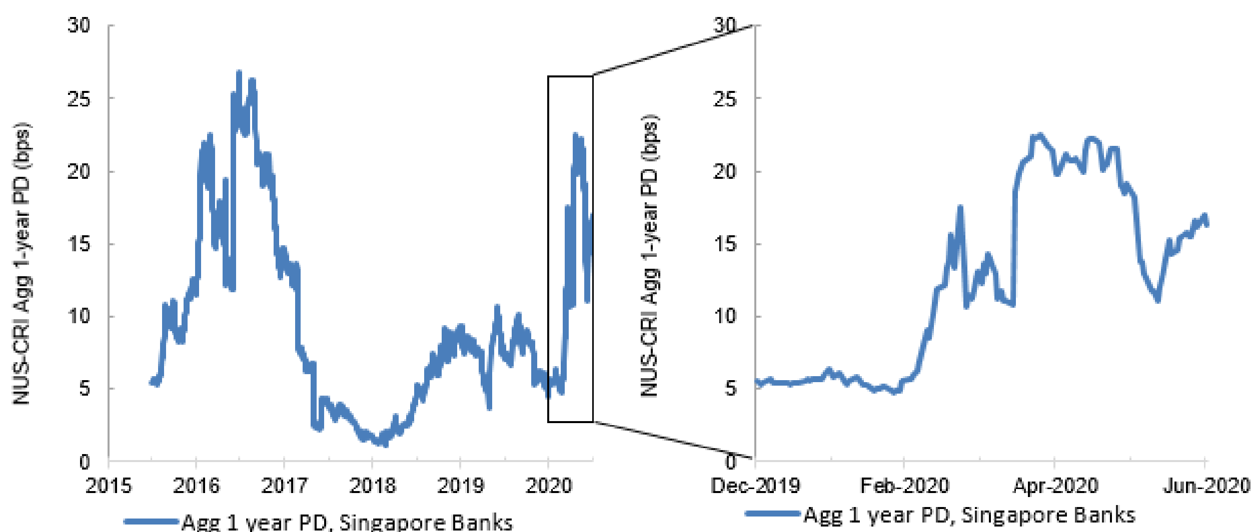
- Yields of 10-year Singapore government bonds fell to 0.90% at the end of Jun 2020 from 1.61% in Jan 2020. [8]
- Lending to non-bank customers rose from SGD 691.1bn in Q1 2020 to SGD 680.1bn in Q2 2020. Total loans to businesses declined from SGD 428.3bn in Jan 2020 to SGD 425.6bn in Jun 2020 while loans to consumers dropped marginally from SGD 262.8bn in Jan 2020 to SGD 254.5bn in Jun 2020. [9]
- The prime lending rate remained constant at 5.25% in Q1 and Q2 2020. [10]

Sovereign Credit Ratings

- Standard & Poor's and Fitch Ratings maintained their AAA ratings on Singapore, while Moody's maintained their Aaa rating. All three rating agencies had stable outlooks on the government's credit. [11]

Singapore Banks

The NUS-CRI Aggregate 1-year PD across Singapore banks (DBS, OCBC and UOB) increased from 5.51bps at the start of Jan 2020 to finish at 16.4bps at the end of the 1H 2020. There has been an increased flow of capital into the Singapore's banking system amid global uncertainties — the COVID-19 pandemic has halted businesses and caused a recession, leading to investors seeking safer positions despite the low interest rates. This coupled with the Singapore government unleashing billions of dollars of stimulus to support local businesses has resulted in an uncertain future that has prompted decision-makers, from two-person households to global corporations, to hoard cash. Pressure on profit margins has re-emerged as interest rates are likely to stay lower for a prolonged period due to the recession. Asset quality also saw a slight deterioration, however the overall liquidity position still remains strong.



Profitability

- For 1H2020, the three banks averaged a net profit of SGD 1.8bn, down an average 32.5% YoY. DBS reported the highest net profit figure of SGD 2.4bn, and registered the smallest YoY decline in earnings, at 25.9%. Whereas OCBC registered net profit of SGD 1.4bn and UOB registered net profit of SGD 1.6bn. Net interest income averaged SGD 3.6bn, down an average 1.8% YoY. DBS was also the only one among the three that posted a gain in net interest income for the period – up 1.0% to SGD 4.8bn. [12]

Funding & Liquidity

- Total deposits in Singapore banks increased by SGD 59.3bn in the first half of 2020. Local currency deposits increased by SGD 53.8bn, with Q1 showing a sharp increase before deposit levels became more consistent in Q2. Meanwhile, foreign currency deposits increased by SGD 5.6bn, 30% higher compared to Dec 2019. [13]
- The banks savings deposit rates remained unchanged during the first half of 2020. However, the Singapore's fixed deposit rates fell for the 3-month, 6-month and 12-month deposits. Fixed deposit rates were at 0.18%, 0.23% and 0.52% respectively at the end of Q2. The prime lending rate was however unchanged at 5.25% in Q1 and Q2. [14]

Capital Levels & Regulations

- All three Singapore banks kept their Common Equity Tier 1 Capital (CET1), Tier 1 and Total Capital Adequacy Ratios (CAR) to be well above the recommended Basel III guidelines and well above the regulatory minima specified by MAS, making them some of the well-capitalized banks in the world. OCBC currently has the highest CET1 ratio at 14.2% while UOB and DBS came in at 14.0%, 13.7% respectively. With this, the banks have ample liquidity support and they look well-positioned to navigate the uncertainties ahead. [15]

Asset quality

- As at 30 June 2020, DBS' non-performing loans decreased slightly from 1.6% in Q1 to 1.5% in Q2. UOB's non-performing loans ratio remained the same at 1.6% during the 2 quarters whereas OCBC's non-performing loans ratio inched up slightly from 1.5% in Q1 to 1.6% in Q2. [16] [17] [18]
- The slight increase was probably due to the loan moratorium masking the true devastation of the pandemic and recession. The trio also significantly raised their total allowances in 1H20 to fortify their balance sheets against multiple risks arising from COVID-19. [19]
- Loans placed under the "special mention category increased from 2.2% in Q1 2020 total exposure to 2.6% in Q2 2020. Loans marked as a loss rose from 0.23% in Q1 to 0.24% in Q2. Loans classified as doubtful increased from 0.39% of total exposure in Q1 to 0.53%. While loans classified as substandard rose substantially from 0.87% in Q1 to 0.94% in Q2. Overall asset quality and provisioning coverage declined substantially compared to 2019. This is due to many sectors being dragged down by the effects of the COVID-19 pandemic. [20]

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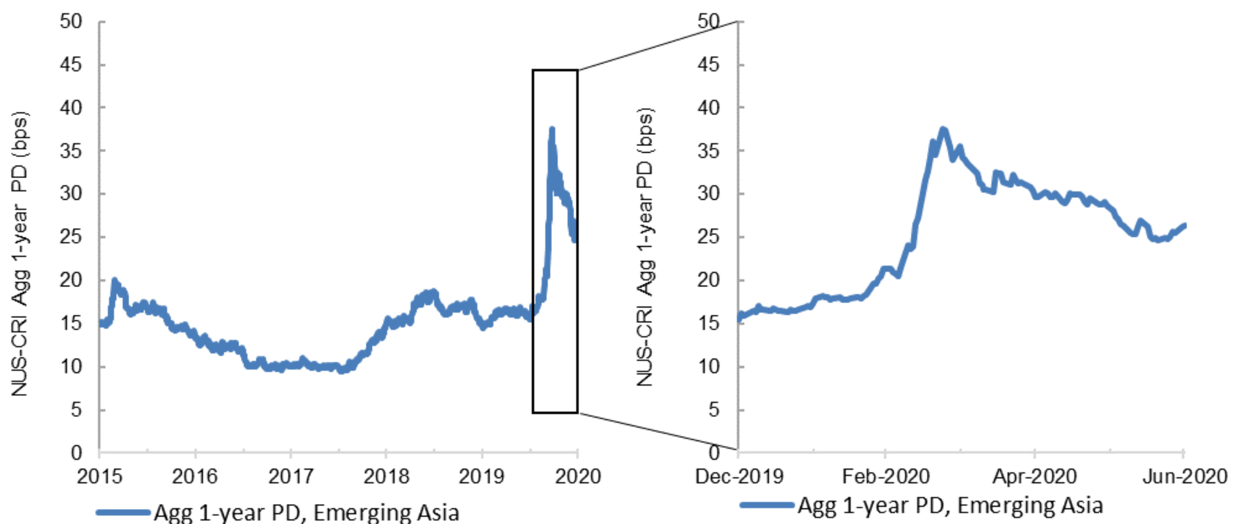
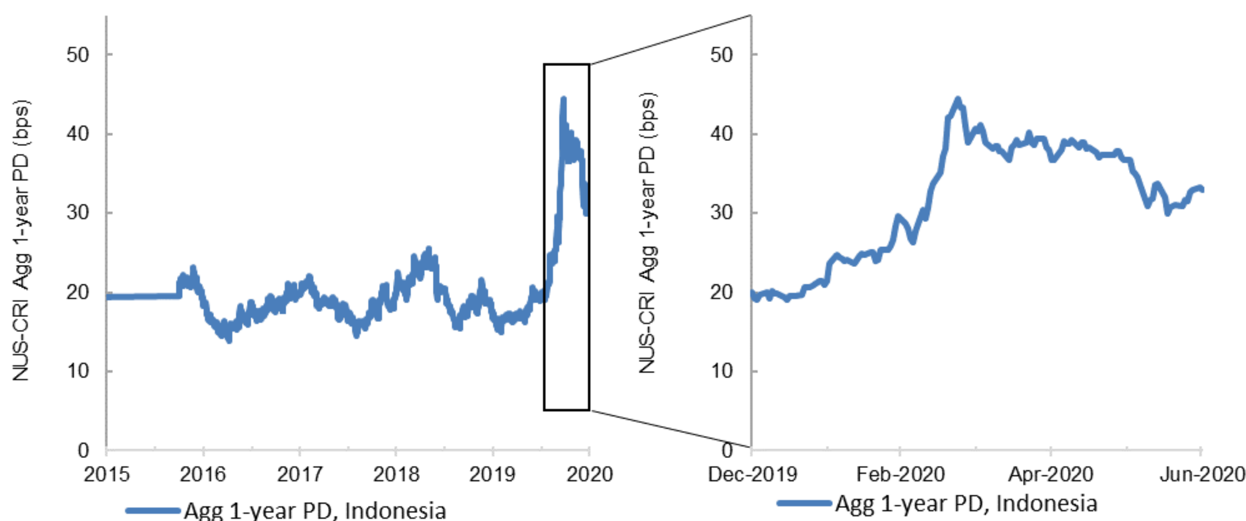
Asia-Pacific - Emerging economies

The NUS-CRI Aggregate 1-year PD (Agg PD) for listed corporations in emerging Asia, excluding India and China, ended 2019 at 20.1bps. The Agg PD, then, saw a jump of 24.4bps in response to the Covid-19 pandemic during Q1 2020. By the end of Jun 2020, the Agg PD started to tapper back down to 33.0bps. This is reconcilable in light of the series of national shutdowns and corresponding economic slowdowns. In terms of economic growth, Indonesia's GDP growth decreased from 5.0% in Q4 2019 to -5.4% in Q2 2020. Q2 2020 was the first recorded contraction in the past few years, which was driven by falling household consumption and fixed investment. The sudden and prolonged nationwide lockdown in Malaysia has led to a significant deterioration of the economy with growth falling from 3.6% in Q4 2020 to -17.1% in Q2 2020. The contraction can be accounted for by the local Movement Control Order. The policy had resulted in revenue strains on retail, recreational, travel, leisure, and consumption of durable goods. The same goes for Thailand's economy which has contracted quarter on quarter. The GDP growth rates for Q1 2020 and Q2 2020 were -2.5% and -9.7% respectively. This can be attributed to the sudden and sharp dips in net external demand and industrial output.



Indonesian Companies

The NUS-CRI Aggregate 1-year PD for Indonesian companies increased from 20.1bps at the end of Dec 2019 to 33.0bps at the end of Jun 2020. Indonesia's economy experienced a growth of 0.5% in 2020 (Year to Date) as Q2 2020's GDP growth recorded a -5.3% relative to the market expected percentage change of -4.6%. As of Jun 2020, Indonesia recorded a 2.0% inflation rate and USD 1.3bn worth of trade balance deficit.



Economy

- The Indonesian economic growth rate changed by 3.0% in Q1 2020 and -5.3% in Q2 2020, both of which are relatively lower compared to the previous year. In 2019, the economy grew by 5.07% in Q1 and 5.1% in Q2. Overall, the economy recorded the first contraction in the past few years. Moving forward, the market consensus expects the economy to experience a slight improvement with a lower contraction rate of 1.2% in the coming quarter. [1]
- The Consumer Price Index (CPI) of Indonesia stood at 2.0% at the end of Jun 2020. Respectively, the inflation of volatile food reached 0.8% (YoY), core inflation at 2.3% (YoY), and inflation of administered prices at 0.5% (YoY). Going forward, the inflation is to be maintained at around 3.00% throughout 2020. Anchoring inflation expectations is critical to promote economic recovery from the Covid-19 pandemic. Thus, it is important that the central, regional governments, and Bank Indonesia (Central Bank) strengthen their coordination to keep inflation at check. [2]
- Indonesia's trade balance recorded a USD 5.5bn surplus for the period from Jan 2020 - Jun 2020. This is a considerable improvement from the USD 1.9bn deficit recorded during the same period a year ago. The improvement can be attributed to the import substitution policy to control imports against a backdrop of sluggish export performance. The trade balance developments recorded were able to strengthen the external resilience of Indonesia's national economy. Moving forward, Bank Indonesia will continue to coordinate with the government to monitor global and domestic economic developments to strengthen external sector resilience. [3] [4]
- According to the Nikkei Indonesia Manufacturing Purchasing Managers Index (PMI), Indonesia's manufacturing conditions deteriorated significantly at the end of Jun 2020. While the index rose slightly from an all-time low of 27.5 in Apr, it is still at the level of 28.6 in May. The recorded value in May 2020 is well below the benchmark 50.0 (No Change) level. Covid-19 resulted in concerns of excess capacity, material shortages, and a weak domestic exchange rate. Accompanied by steep cuts in purchasing activity and demand for inventory, the PMI deteriorated in the first half of 2020. [5]

Monetary

- Moving forward from the first half of 2020, the Bank Indonesia (BI) has agreed to hold the BI 7-day repo rate, deposit facility rate, and lending facility rate at 4.00%, 3.25%, and 4.75% respectively. The decision is consistent with Bank Indonesia's ongoing effort to maintain external stability and tackle the low inflationary environment. Bank Indonesia will focus on providing liquidity to support the dampened economic growth. In addition, the central bank will also continue to back the parliament to fulfil the state budget in 2020. [6]

Funding & Liquidity

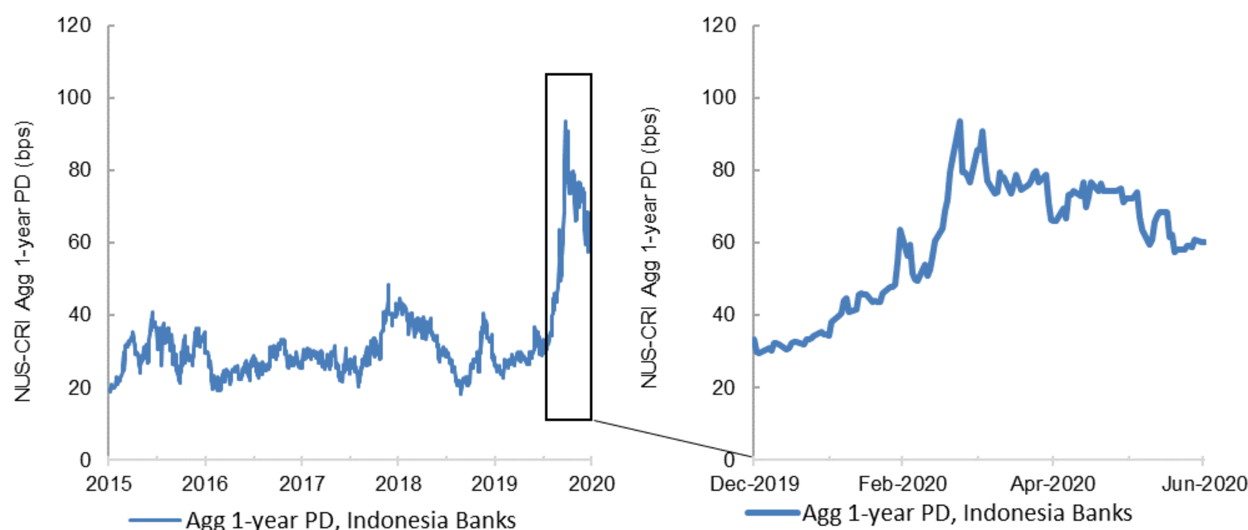
- The yield of Indonesia's 5-year bond increased from 6.4% at the end of Dec 2019 to 6.6% at the end of Jun 2020. Similarly, Indonesia's 10-year government bond yield increased from 7.1% to 7.2% during the same time period. [7,8]
- Indonesia's official reserve assets position stood at USD 131.7bn as of Jun 2020, higher than the end of May 2020 level which registered at USD 130.5bn. The position is sufficient to finance at least 8 months of imports or external public debt. Bank Indonesia deemed the official reserve assets adequate, as supported by the stability and solid domestic economic prospect. [9]
- External debt growth rate reversed with a yearly rate of 2.1% in Q2 2020 compared to -3.6% in Q1 2020. Long term external debt remained dominant in Indonesia's total external debt (Absolute value: USD 345.1bn / Ratio: 84.5% of total external debt). Long term external debt consisted of public sector external debt amounting to USD 186.7bn (54.1% of total long-term external debt) and private sector external debt amounting to USD 158.5bn (45.9% of total long-term external debt). Short-term external debt amounted to USD 63.4bn (15.5% of total external debt), comprised of private sector external debt amounting to USD 50.8bn (80.1% of total short-term external debt) and public sector external debt amounting to USD 12.6bn (19.9% of total short-term external debt). The ratio of external debt to GDP is stable at 37.3% at the end of Q2 2020. [10]

Sovereign Credit Ratings

- S&P, Moody's, and Fitch kept their ratings on the local currency long term bonds of Indonesia at BBB, Baa2, and BBB respectively. S&P revised the ratings outlook from stable to negative while Moody's and Fitch reaffirmed their ratings. [11]

Indonesian Banks

The NUS-CRI Aggregate 1-year PD for Indonesian banks increased from 33.5bps in Dec 2019 to 60.2bps in Jun 2020. Loans extended by Indonesian banks dropped to 1.5% in Jun 2020. Meanwhile, non-performing loans (NPL) stood at 3.1%. [12] [13]



Profitability

- The three largest majority state-owned Indonesian banks, Bank Mandiri, Bank Rakyat Indonesia and Bank Negara Indonesia reported decreases in net operational income of 32.9% and 22.6%, and 36.8% in the first half of 2020.[14,15,16]

Funding & Liquidity

- The liquidity ratio (liquid asset/bank deposit) of Indonesian banks stood at 26.2% in Jun 2020. [17]
- The Jakarta 3-month interbank rate decreased from 5.5% in the end of 2019 to 4.7% by the end of Q2 2020. Similarly, the 1-month interbank rate decreased from 5.4% at the end of 2020 to 4.6% by the end of Q2 2020. [18]

Asset Quality

- According to Bank Indonesia, the financial system remained stable. Capital adequacy ratio and liquidity of Indonesian banks, as of Jun 2020, stood at 22.5% and 26.2% respectively, while non-performing loans (NPL) stood at 3.1% (gross) or 1.2% (net). Bank Indonesia recorded a credit growth of 1.5% in Jun 2020. Moving forward, Bank Indonesia will maintain the financial system stability and stimulate the bank intermediation function by maintaining an accommodative macro prudential policy stance and strengthening coordination with other relevant authorities. [19]

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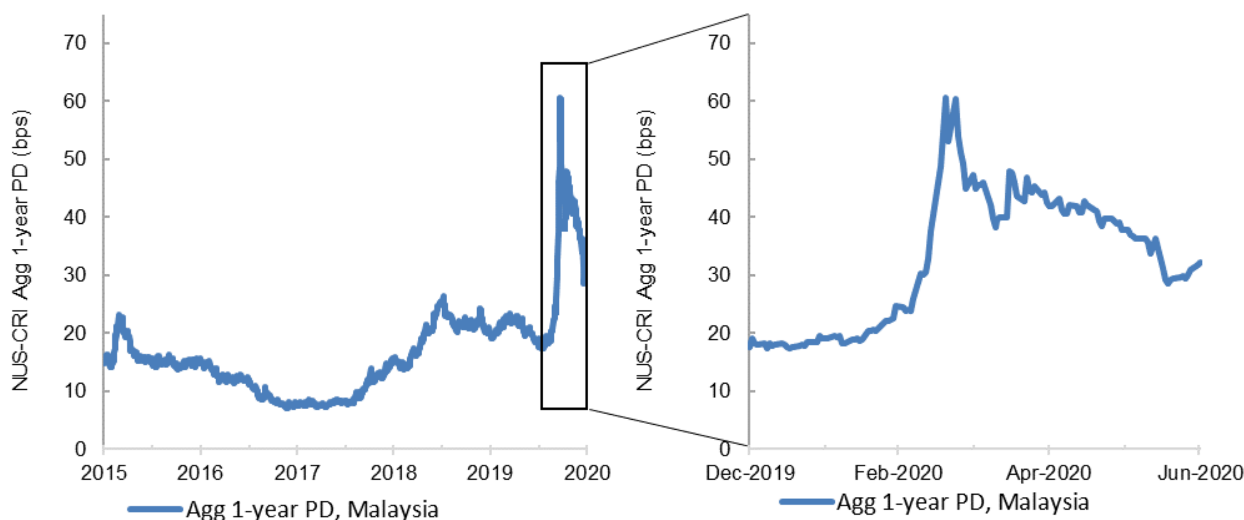
Malaysian Companies

The NUS-CRI Aggregate 1-year PD for Malaysian companies rose to 32.3bps by the end of Jun 2020 from 17.6bps at the end of 2019. Malaysia's economy contracted substantially, inflation averaged lower, and unemployment rate increased.



Economy

- Following an economic growth rate of 0.7% in the previous quarter, the Gross Domestic Product (GDP) in Malaysia contracted 17.1% by the end of Jun 2020. Nominal GDP of Malaysia dipped to an absolute value of USD 69.89bn in Jun 2020, and the decline was driven by the stringent and unprecedented lockdown in response to the Covid-19 pandemic. The demand and supply shocks following the prolonged lockdown resulted in a fall in expenditure across all national income accounting components. The GDP deflator also fell to 1.9% in Jun 2020. Gross Savings Rate was measured at 25.6% in the same period. The fall in tourism activity, due to the closure of international and domestic borders, further weighted down the growth prospects of the nation. [1]
- Headline inflation averaged lower at -2.6% in the Q2 2020. Consumer Price Index (CPI) decreased from 122.3 at the end of Q4 2019 to 119.1 at the end of Q2 2020. The lower inflation rates are mainly driven by the lower retail fuel prices and tiered electricity tariff rebates. [2] [3]
- During H1 2020, labor market conditions deteriorated as the nation's unemployment rate fell by 1.6 percentage points. This is unsurprising and can be understood as a natural fallout from the National Movement order. Moving forward with the opening of the economy, a rebound in H2 2020 can be anticipated. [4] [5]
- Covid-19 has not only impacted the domestic demand for consumptions and investment. In the second quarter of 2020, gross exports contracted by 21.7% (Q1 2020: -7.1%), weighed by declines in both manufactured and commodities exports. Gross imports declined at a slower pace of 19.7% (Q1 2020: -2.5%). Relative to Q2 2019, total trade fell by 14.7%. Manufacturing took a dive of 13.5% for export oriented based industries. In addition, given that the international tourism expenditure contributes to more than 50% of the nation's tourism sector, the industry took a substantial and long-lasting hit as well. [6]

Monetary and foreign exchange landscape

- The Monetary Policy Committee (MPC) of Bank Negara Malaysia decided to take a 50bps cut on the Overnight Policy Rate (OPR) to 2.00%. The rate faces a corridor within 2.25% and 1.75%. Given dampened production capacity and spending, the market condition right now is rather week. Monetary easing and other policy measures are expected to provide some support to growth.[7]
- The ringgit has appreciated by 0.5% against the USD. This resulted in an influx of foreign financial inflows as investors looked to the emerging markets. This positive turnout can be attributed to the quick and widespread responses by the governments and central banks. [8]

Funding & Liquidity

- Currently, the liquid external assets held within the Malaysian banking system accounts for 23.1% (or MYR 144.4bn) of external debt. As of Jun 2020, external debt at risk is 0.42 the size of total liquid external assets standing at MYR 59.9bn. [9]
- For the public sector, the external debt remained mainly in ringgit with 87.8% of the debt denominated in local currency (MYR 179.8bn). This translates into security from exchange rate fluctuations. Moreover, for institutional financial participants, the limited exposure would help mitigate with rollover and interest rate risks. In addition, the remaining 12.2% of the foreign denominated debt standing at MYR 25.1bn includes mainly medium to long term exposures which also helps with rollover volatility. [10] [11]
- Net financing continues to expand at a 3.7% rate annually. While household loans sustained from Q1 2020, business loans rose from 3.4% to 3.9% by the end of Q2 2020. Moving forward, the government expects the household loans to fall while business loans rise due to demand for working capital.[12]

Regulations and Policies

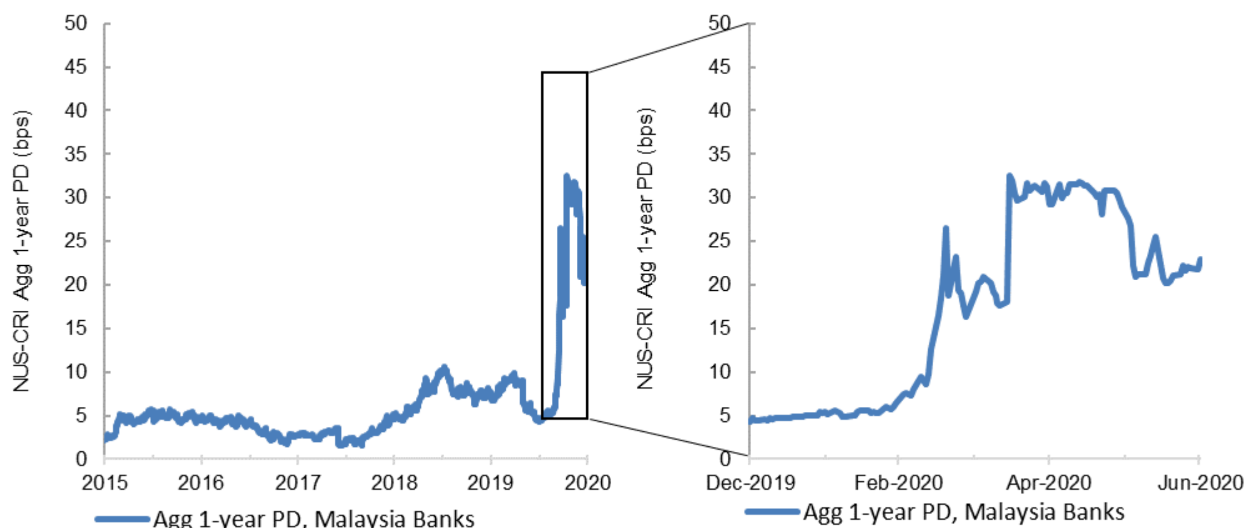
- In the coming second half, the government expects the economic recovery as investors and consumers alike regain confidence for growth. This would translate into better manufacturing production and employment as well. [13]
- The government is shifting more resources and focus into technology, healthcare, and commodity production with the following projects: National Fiberisation and Connectivity Plan, Cloud Computing, Remote Networking, and Ramp up of PFLNG2 and RAPID.[14]

Sovereign Credit Ratings

- The Malaysian government maintained its sovereign credit ratings at all three rating agencies. The country was rated at A3, A- and A- respectively by Moody's, S&P and Fitch. S&P and Fitch assigned negative outlooks for the state while Moody's sustained its stable take.[15]

Malaysian Banks

The NUS-CRI Aggregate 1-year PD for Malaysian banks increased from 4.3bps to 22.9bps from Dec 2019 to Jun 2020. In sight of pressures from the pandemic induced slowdown, the banks remain poised to weather the strains in liquidity and capitalisation moving forward.



Lending

- Nominal interbank interest rates fell periodically across the H1 of 2020. The 3-month Interbank rate fell from 3.4% in Dec 2019 to 2.3% in Jun 2020. [16]
- As of Jun 2020, the banks face a reserve requirement ratio of 2%. This resulted in increases in both M1 and M2 money supply which stand at USD 116bn and USD 474bn respectively. [17]
- As of Jun 2020, the banks face a nonperforming loans ratio of 1.5% which sustained from Dec 2019.

Funding & Liquidity

- Total bank deposits stand at USD 479bn in Jun 2020. This is a dip relative to the USD 487bn at the end of 2019. [18]
- While the dampened economic activities impose some strains on the local banking landscape, the banks remain resilient in support. Bank Negara Malaysia has since injected MYR 42bn into the local financial system via open market purchases, repos and a reduction in the required reserve ratio. [19]
- Nevertheless, they are not unabated from the pandemic induced woes as the first half of 2020 saw a drop in return on asset from 1.5% to 1.2%, a fall in net interest margin from 2.1% to 1.9%, and rising credit costs from MYR 1.3bn to MYR 4.8bn. [20]

Capital Levels & Regulations

- As anticipation of a prolonged lockdown, the local banks remained prudent in capital regulations as many set aside higher provisions in anticipation of rising nonperforming loans. Capital buffers remained well above the regulatory standards. However, the absolute value has depleted from MYR 123bn to MYR 111bn over the first half of 2020. Currently, the CET1 ratio stands at 14.5% as of Jun 2020 which points to a slight dip from Dec 2019 ratio of 15.1%. [21] [22]

Asset Quality

- Loans growth rate slowed to 3% (annualized) from 4% in Q1 2020. This can be mainly attributed to corporate repayments and slow demand in the non-retail segment.
- While the central government's supported 6-month moratorium helped provided some buffer, analysts expect that the economic slowdown to show up on rising gross impaired loans (GIL) in time to come.[23]

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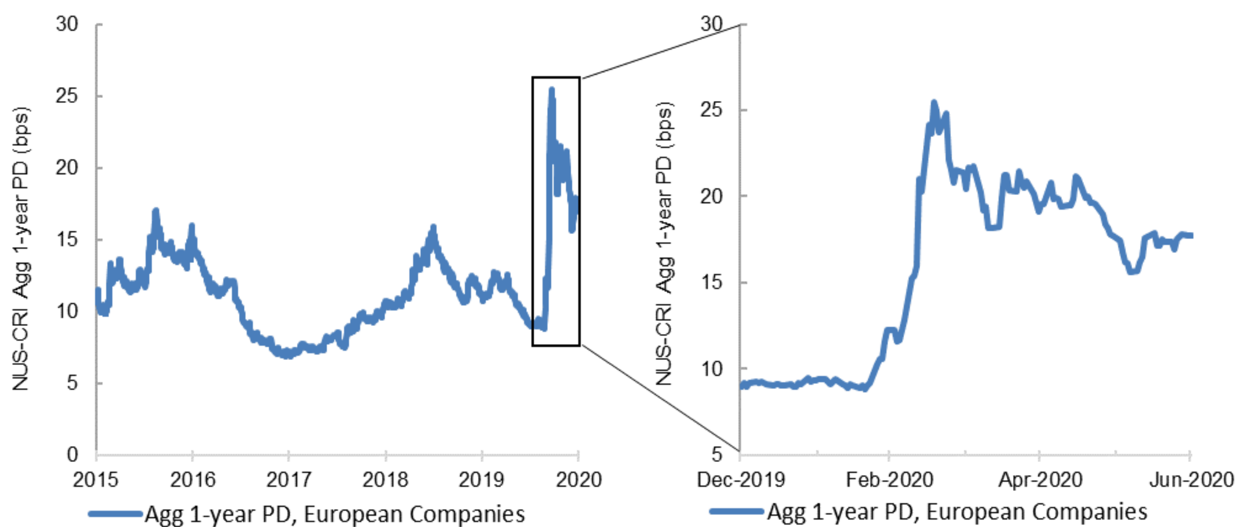
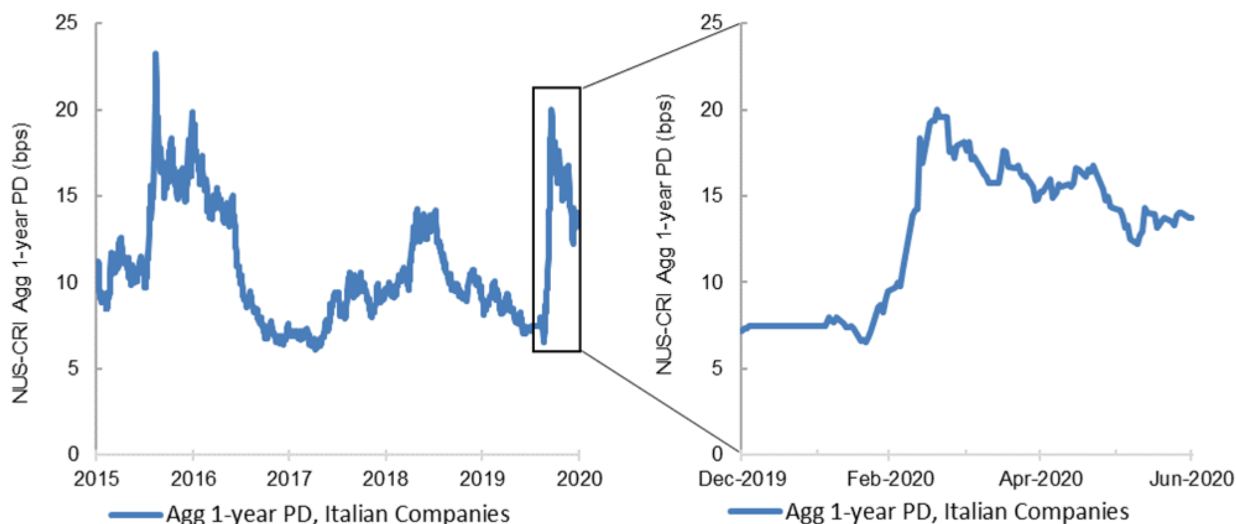
Europe

European firms ended Q2 2020 with a drop in their NUS-CRI Aggregate 1-year Probability of Default (Agg PD) following a significant increase in their Agg PD in Q1 2020. Due to the COVID-19 outbreak, compared to the same quarter of the previous year, the GDP in the Euro Area in Q1 2020 and Q2 2020 decreased by 3.6% and 12.1% respectively while the GDP in EU dropped 3.2% and 11.9% during the same period. Meanwhile, the unemployment rate continues to increase from 7.4% in December 2019 to 7.7% in June 2020 in Euro Area and from 6.5% to 7.1% in EU. The credit profile of European companies deteriorated due to the outbreak of the pandemic. The ECB has put in place a set of monetary policy and banking supervision measures to mitigate the impact of the coronavirus pandemic on the euro area economy, which include implementing the pandemic emergency purchase programme (PEPP) to lower borrowing costs in the euro area and increasing banks' lending capacity. As those measures come into place, the Agg PD decreased during Q2 2020.



Italian Companies

The NUS-CRI Aggregate 1-year PD for Italian companies increased significantly during Q1 before slightly dropping in Q2 2020. Italy's economy shrank by a record 17.7% year-on-year in Q2 2020, entering a steep recession as coronavirus-induced lockdowns hit activity and consumption. The government was forced to introduce rigid restriction measures from March 9th, which were only gradually eased from May 4th.



Economy

- The GDP of Italy decreased by 5.3% in Q1 2020 and by 12.8% in Q2 2020 with respect to the previous quarter. Regarding the year-on-year change, GDP decreased by 5.4% in Q1 2020 and 17.7% in Q2 2020. Both consumer spending and gross fixed capital formation declined at a faster pace, while government expenditure went down 0.2%, the same as in the prior period. External demand also contributed negatively to the GDP of -2.4%, entering a steep recession.[1 2]
- Italy's unemployment rate increased to 8.8% in June of 2020 from an upwardly revised 8.3% in the previous month and above market expectations of 8.6 percent, as the coronavirus pandemic had negative impact to the labour market. The number of unemployed people increased by 149,000 to 2.204 million while employment fell by 46,000 to 22.702 million. The youth unemployment rate (aged 15-24), went up to 27.6% from 25.6% in May. The employment rate decreased to 57.5% from 57.6%, hitting the lowest since November 2016.[3]
- Italy's manufacturing Purchasing Managers' Index (PMI) – a single-figure measure of developments in overall business conditions increased to 47.5 in June of 2020 from 45.4 in the previous month, below market expectations of 47.7. The reading pointed to the 21st straight month of contraction in factory activity although the deterioration continued the ease from the April's nadir of 31.1 as restrictions related to the global pandemic were loosened. Factory production increased for the first time in nearly two years, although the expansion was only mild overall. Demand conditions remained weak, with new orders falling again albeit at the weakest rate for four months.[4]
- Italy's services PMI increased to 46.4 in June of 2020 from 28.9 in the previous month, but below market forecasts of 47. The reading pointed to a sharp contraction in services activity after the country ended its coronavirus lockdown. Incoming new business declined further, with the reduction remaining sharp despite easing. Amid muted demand conditions, service providers reduced staff numbers markedly. On the price front, Italian service providers recorded a renewed increase in cost burdens during June, linked by to the purchasing of safety and security equipment to control the pandemic as well as higher staff costs. Firms continued to discount selling prices to drive sales. The level of positive sentiment remained subdued.[5]
- The confidence climate in June 2020 went back up from 94.3 to 100.6. All components improved: The current one from 95.0 to 96.4, the personal one from 100.9 to 104.5 and the future one from 93.1 to 105.6. The confidence index in manufacturing increased from 71.5 to 79.8. The market services confidence index increased from 38.9 in May to 51.7. The retail trade confidence index increased from 68.0 to 79.1.[6]

Funding & Liquidity

- Yield on 10-year Italian bonds decreased from 1.43% in Q4 2019 to 1.33% in Q2 2020, lower than 1.53% in Q1 2020. Italian yields are the second highest in the Eurozone after Greece, attracting investors hunting for positive return in a negative yield environment.[7]
- Interest rates on loans (other than bank overdrafts) to non-financial corporations fell in the first half of 2020, from 2.0% in Q4 2019 to 1.89% in Q2 2020. Bank interest rates (including revolving loans, overdrafts, and extended credit card credit) to corporations decreased from 2.82% to 2.73% in the same period. Loans for house purchases decreased from 1.43% to 1.28% in the first half of 2020. [8] [9] [10]
- Preliminary estimates for outstanding loans to non-financial institutions stood at EUR 673.7bn. Total outstanding loans overall increased by 4.86% from the previous half-year. [11]

Politics

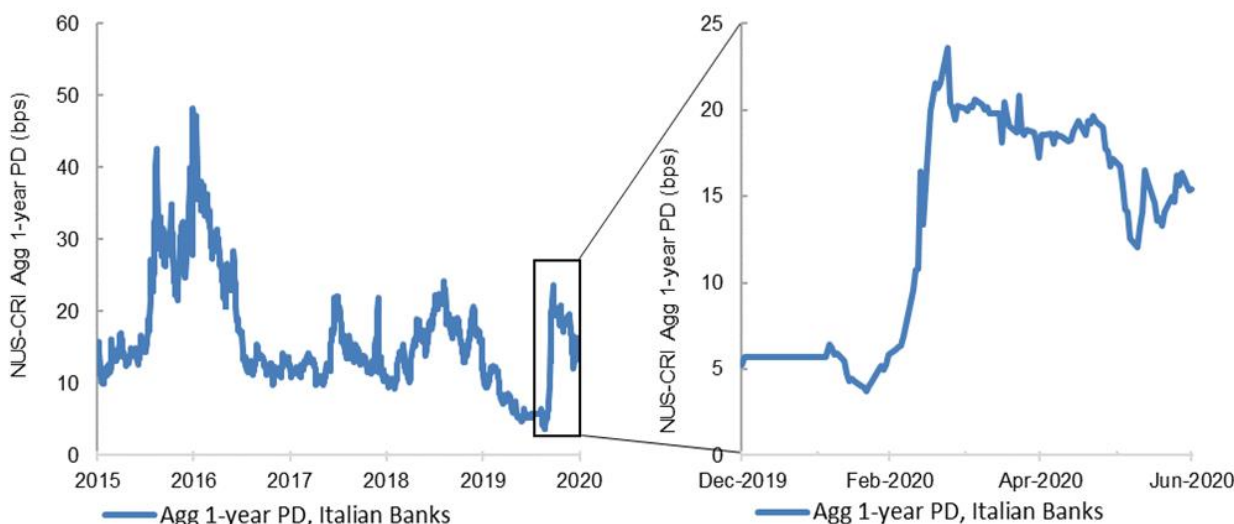
- In Q1 2020, the General Government net borrowing to GDP ratio was 10.8% compared to 7.1% in Q1 2019. The current and the primary balance of the General Government were negative, both with a ratio to GDP at -7.8% compared to -4.1% and -4.2% in the same period of 2019, respectively. The tax burden ratio stood at 37.1% of GDP, 0.5% higher than the same quarter of 2019. Gross disposable income of consumer households decreased by 1.6% with respect to the previous quarter, while final consumption expenditure decreased by 6.4%. The saving rate was 12.5%, 4.6% higher than in the previous quarter. Gross disposable income of Consumer households in real terms decreased by 1.7%. The profit share of non-financial corporations was 42.3%, 0.4% higher than in the previous quarter. The investment rate of non-financial corporations was 20.9%, 0.4% lower than in the previous quarter. Italy's debt-to-GDP ratio was set to stand at 137.6% based on latest data in Q1 2020.
- In Q2 2020, the General Government net borrowing to GDP ratio was 10.3% compared to 0.0% in Q2 2019. The current and the primary balance of the General Government were -6.3% and -5.9% compared with 3.3% and 4.1% in Q2 2019 respectively. The tax burden ratio was 37.1% of GDP, 1.8% higher than the same quarter of 2019. Gross disposable income of consumer households decreased by 5.8%, while final consumption expenditure decreased by 11.5%. The saving rate was 18.6%, which increased 5.3%. Gross disposable income of Consumer households in real terms dropped by 5.6%. The profit share of non-financial corporations decreased to 39%. The investment rate of non-financial corporations increased to 22.1%. [12] [13] [14]

Sovereign Credit Ratings

- Moody's and S&P maintained their ratings at Baa3 with a stable outlook and BBB with a negative outlook respectively. Fitch revised its ratings to BBB-. [15]

Italian Banks

The NUS-CRI Aggregate 1-year PD for Italian companies increased significantly during Q1 and dropped slightly in Q2 2020. Interest rates to firms and to households decreased slightly in Q1 2020. Meanwhile, asset quality at Italian banks was stable and remained unchanged.



Profitability

- Italy's biggest bank UniCredit posted a 7.7% decline for its year-on-year total revenues in Q2 2020. Underlying net profits of this quarter amounted to EUR 0.5bn. The group had a liquidity coverage ratio of 173%, while the CET1 ratio was 13.85%. [16]

Funding & Liquidity

- The long-term interest rate was reported at 1.46% in June 2020, lower than 1.76% in the previous month, but higher than 1.37% in December 2019.[17]
- The 12-month percentage change in deposits of funds by Italian residents was 6.4%, while for the total deposits of non-domestic residents, it was -2.2%. Net refinancing with maturities of over three months of Italian banks through the Eurosystem rose by EUR 53bn in June 2020. [18]
- Interest charged on loans to firms were 1.1% in May 2020, lower than 1.3% in February 2020. Interest rates of loans to households decreased from 1.4% in February 2020 to 1.3% in May 2020. [19]
- The Bank of Italy's liabilities to Euro-area financial counterparties increased from EUR 122bn in February 2020 to EUR 138bn in May 2020. [20]
- Italian bank liabilities towards the Eurosystem increased to EUR 291bn in May 2020 compared to EUR 215bn in February 2020. Capital and reserves decreased to EUR 355bn in May 2020 compared to EUR 358bn in February 2020. [21]
- According to the latest bank lending survey, Italian banks reported that in Q2 2020, credit standards for new loans to firms remained basically unchanged.[22]

Asset Quality

- According to the Bank of Italy, in Q1 2020, the flow of new non-performing loans in proportion to total loans held stable compared with the previous quarter at 1.3%. The net NPL ratio decreased from 3.2% to 3.1% during Q1 2020. The coverage ratio of Italian banks also remained unchanged at 53.7% from December 2019 to March 2020.[23]

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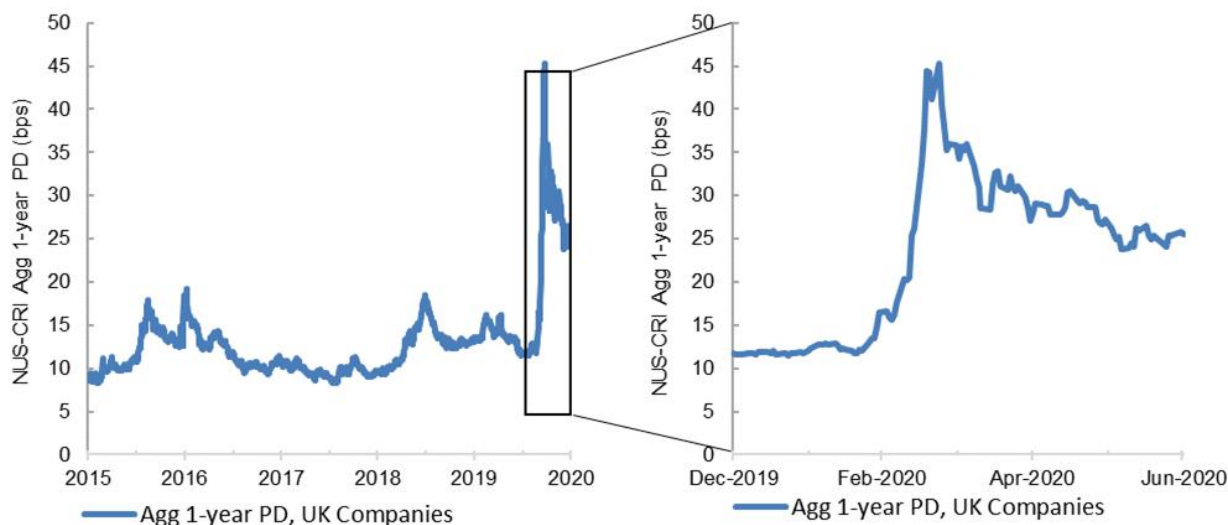
UK Companies

NUS-CRI Aggregate 1-year PD for companies domiciled in the UK increased due to the impact of the COVID-19 pandemic. It first increased from 20.48bps to 45.23bps in the middle of March before dropping to 37bps at the start of May. The quarterly growth rates of GDP in Q1 and Q2 of 2020 were at -2.2% and -20.4% respectively. Consumer spending decreased substantially in the second quarter of this year falling 3% in Q1 2020 and 24% in Q2 2020. Recovery prospects are further hampered by the possibility of a No-Deal Brexit.



Economy

- The UK economy officially entered a recession in H1 2020 with its GDP quarter on quarter growth rates standing at -2.2% in Q1 2020 and -20.4% in Q2 2020. These figures were significantly lower compared to the same period last year when Q1 and Q2 2019 GDP growth rates were 0.7% and -0.1% respectively. [1]
- Unemployment rates in the UK have remained relatively stable over the first half of 2020 with both Q1 and Q2 unemployment rate standing at 3.9%. The stable rate can be partly attributed to the extensive job protection programme provided by the UK government to protect businesses from the shocks caused by the pandemic. [2]
- Visa's UK Consumer Spending Index, compiled by IHS Markit, pointed to a softer fall in household expenditure at the end of Q2 2020 as COVID-19 restrictions ease. Overall, consumer spending decreased by 6.5% on an annual basis in June 2020. Spending on Face-to-Face categories fell at a slower pace compared to the previous month (-20.1%). Meanwhile, eCommerce spending growth rose to a record high of 15% on the year in June. [3]
- The total trade in the UK increased from GBP 8.35bn in Q4 2019 to GBP 16.59bn in Q2 2020. [4]
- UK Manufacturing PMI rose to 50.1 in June from 40.7 in May. It was slightly above the neutral 50.0 mark, indicating a stabilization (not marked improvement) in operating conditions as lockdown restrictions were loosened. [5]
- UK construction output data in June 2020 rebounded strongly as reopening gathers pace. The headline seasonally adjusted HIS Markit/CIPS UK Construction Total Activity Index jumped to 55.3 in June from 28.9 in May, signalling a strong increase in total construction output. This reading was the steepest pace of expansion since July 2018 and was primarily due to the re-opening of construction supply chains. Residential building was the best-performing area of construction activity in June. The latest expansion of residential construction was the steepest for just under five years. Commercial work and civil engineering activity also returned to growth in June, though not at the same pace as residential housing.[6]

Monetary

- The Monetary Policy Committee (MPC) voted to cut Bank rate to 0.1% at a special meeting on 19 March 2020. The MPC has also increased purchases of government bonds and non-financial investment grade corporate bonds by GBP 200bn, in an effort to increase investor confidence and inject further liquidity into the capital markets. Furthermore, the MPC voted to enlarge Bank of England's (BOE) TFSME scheme, which is financed by the issuance of central bank reserves and is aimed specifically at SMEs. On 17 June 2020, the committee voted to increase the target stock of

purchased UK government bonds, financed by the issuance of central bank reserves, by and additional GBP 100bn, raising the total stock of asset purchases to GBP 745bn. MPC sets monetary policy to meet the 2% inflation target, in a way that helps to sustain growth and employment. [7] [8]

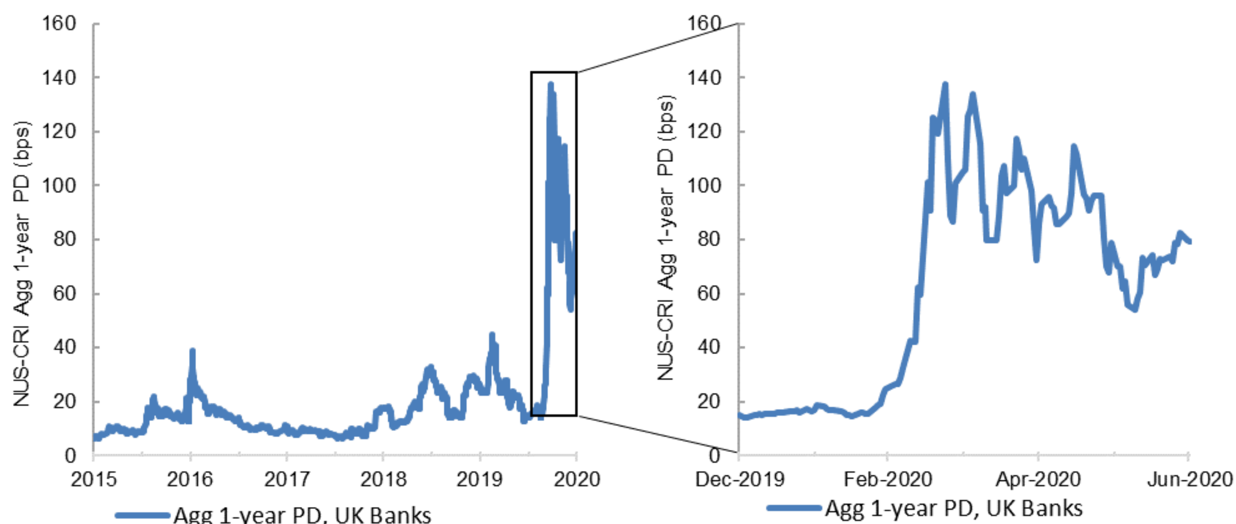
- The Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month inflation rate was 0.8% in June 2020, up from 0.7% in May 2020 and down from 1.8% in December 2019. The largest contribution to the CPIH 12-month inflation rate in June 2020 came from recreation and culture. [9]

Sovereign Credit Ratings

- On 27 March 2020, Fitch downgraded UK's rating to AA- with a negative outlook. The downgrade reflects a significant weakening of the UK's public finances caused by the impact of the COVID-19 outbreak. Furthermore, the downgrade also reflects the deep near-term damage to the UK economy caused by the coronavirus outbreak and the lingering uncertainty regarding the post-Brexit UK-EU trade relationship. [10]

UK Banks

The NUS-CRI Aggregate 1-year PD for banks in the United Kingdom also rose dramatically to a peak of 134.15bps at the start of April, from a low of 26bps in March. The FTSE 350 Banks Index also dropped drastically at the start of March to current historic lows.



Profitability

- Lloyds Banking Group's net interest income margin in Q2 2020 is 2.59%, lower from 2.90% in Q1 2020. Net interest income is reduced from GBP 6.2bn to GBP 5.5bn. Net interest margin fell from 2.79% in Q1 2020 to 2.40% in Q2 2020 and the margin is expected to stay at this level for the remainder of the year, resulting in a full year margin of 2.5%.[11]
- Royal Bank of Scotland (RBS) reported an operating loss before tax of GBP 0.8bn driven by net impairments of GBP 2.9bn. It also reported an attributable loss of GBP 0.7bn.[12]
- Standard Chartered's underlying profit before tax decreased 25% to USD 2bn. Its income in the first half of 2020 increased 5% at constant currency and ex-DVA despite the global recession. [13]

Funding & Liquidity

- According to the Bank Liabilities Survey produced by the Bank of England, UK banks and building societies reported that total funding volumes increased in the three months to end-May 2020 (Q2). Total funding volumes were expected to remain unchanged in the three months to end-August 2020 (Q3). [14]
- Lenders reported that the internal price charged to business units to fund the flow of new loans – sometimes referred to as the 'transfer price'– decreased in Q2 and was expected to decrease slightly in Q3. [15]

Asset Quality

- The total write-offs of sterling denominated loans decreased from GBP 1459mn in 30 December 2019 to GBP 851mn in 30 June 2020, attributed mainly to write-offs to private non-financial corporates, which decreased from GBP 495mn to GBP 165mn. Non-financial loan write-offs to individuals also decreased from GBP 941mn to GBP 666mn. [16]
- Write-offs on loans denominated in foreign currency decreased from GBP 238mn in Q4 2019 to GBP 17mn in Q2 2020, driven by a decrease in the write-offs on loans to non-residents, which constituted the largest share of the total foreign currency write-offs from GBP 207mn to GBP 17mn in H1 2020.[17]

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About The Credit Research Initiative

The Credit Research Initiative (CRI) was launched by Professor Jin-Chuan Duan in July 2009 at the Risk Management Institute of the National University of Singapore. Aiming at "Transforming Big Data into Smart Data", the CRI covers over 72,000 public firms and produces daily updated Probabilities of Default (1-month to 5-year horizon), Actuarial Spreads (1-year to 5-year contract) and Probability of Default implied Ratings on over 38,000 currently active, exchange-listed firms in 130 economies. The CRI also distributes historical time series of over 34,000 inactive firms due to bankruptcy, corporate consolidation or delisting for other reasons. In addition, the CRI produces and maintains Corporate Vulnerability Indices (CVI), which can be viewed as stress indicators, measuring credit risk in economies, regions and special portfolios.

As a further step, the CRI converts smart data to actionable data to meet the customized demands of its users and offers bespoke credit risk solutions leveraging on its expertise in credit risk analytics. A concrete example is our development of the BuDA (Bottom-up Default Analysis) toolkit in collaboration with the IMF. BuDA is an automated analytic tool based on the CRI PD system, enabling IMF economists to conduct scenarios analyses for the macro-financial linkage.

The CRI publishes Weekly Credit Brief and Semi-Annual Credit Summary, highlighting key credit related events, offering insights based on the CRI PD of the entities involved, and providing useful statistics on credit risk of economies and sectors.

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