Semi-Annual Credit Summary

S1/2021 *Volume 2, No 2*

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 2, Issue 2 covers the first half of 2021. 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, with both 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 80,000 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 2021, 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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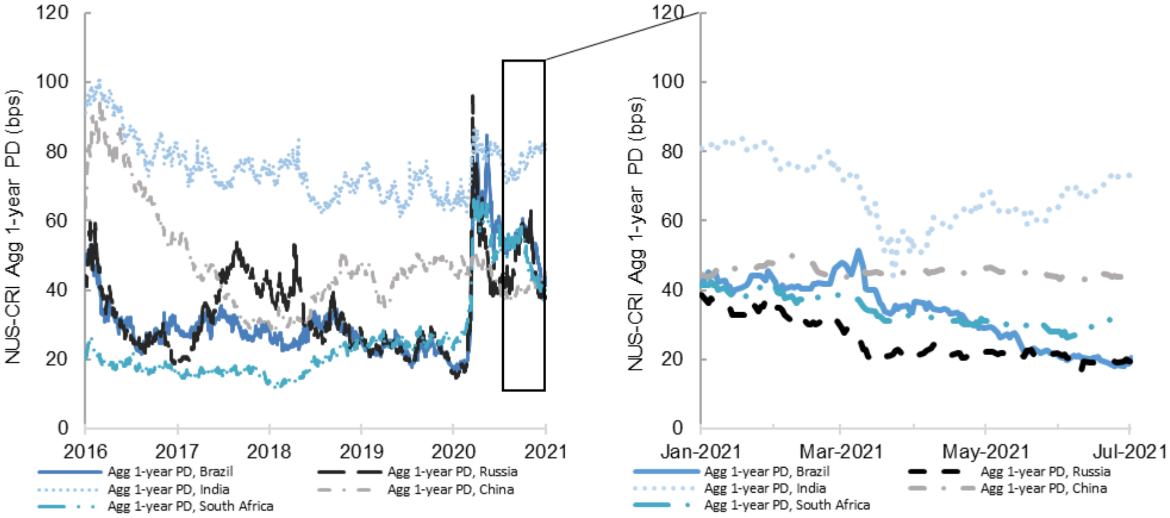
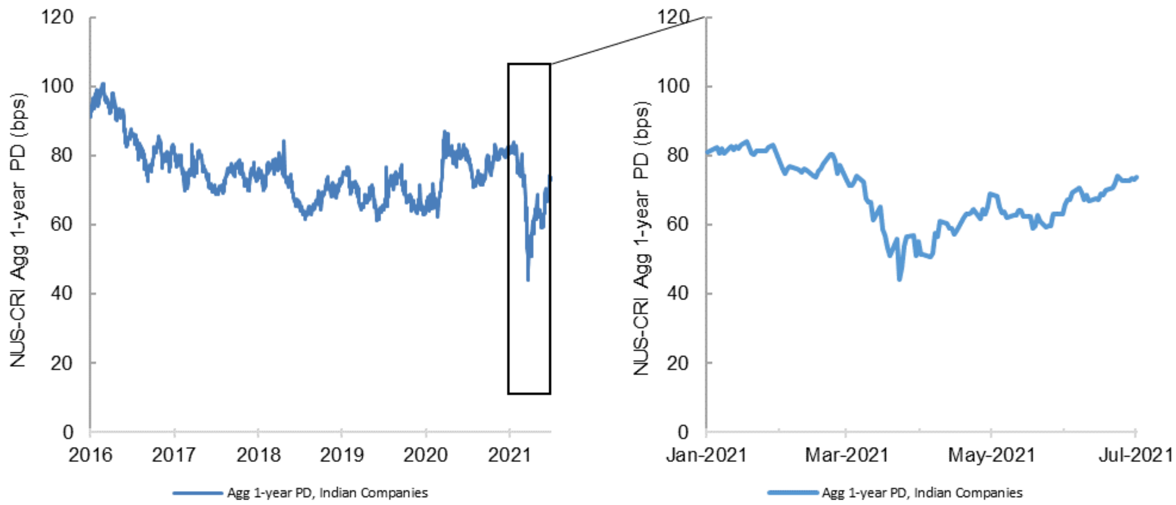
BRICS

In the first half of 2021, listed companies in BRICS experienced a relatively stable credit profile. However, a surge of COVID-19 infections driven by new variant strains resulted in differing credit profiles in the latter half of the period. The NUS-CRI Aggregate 1-year PDs (Agg PD) for Brazil, South Africa, and Russia experienced an improvement in the latter part of the semi-annual period, while India and China's Agg PDs remained relatively stable around 70bps and 45bps respectively. Brazil's GDP shrank by 0.1 % in Q2 2021, following 3 quarters of expansion. However, this did not completely reflect in the country's Agg PD levels, which gradually declined in Q2 2021. A similar trend can be seen for South Africa (Q2 GDP growth at 1.2%) and China (Q2 GDP growth at 1.3%), with their credit quality remaining stable in the first half of 2021. India's GDP experienced a record 20.1% growth in Q2 2021, driven by a combination of low base effect from the previous year and improvements in private consumption and investments. However, the second wave of covid-19 infections which hit India in Q2 2021 led to some of the world's toughest lockdowns which adversely affected economic activity and led to a progressive rise in Agg PD. The Q2 2021 GDP growth for Russia was 0%, while its Agg PD levels decreased to 19.48bps by the end of the first half of 2021 due to stable growth in consumer and investment demand.



Indian Companies

The NUS-CRI Aggregate 1-year PD for Indian companies decreased in the first quarter of 2021 as the economy recovered boosted by an increase in demand and government stimulus. However, the second wave of COVID-19 cases began in April, resulting in lockdowns and adversely impacting consumer spending. In Q2 2021, the NUS-CRI Aggregate 1-year PD for Indian companies increased from around 45bps to 73 bps. The second wave of COVID-19 highlighted supply-demand issues as different states resorted to differing policies with respect to industrial activity and movement of industrial goods. Supply chain disruptions, logistical challenges and decreased productivity continued to impede Indian companies' recovery. Manufacturing PMI dropped to an 11 month low of 48.1 in June 2021[1]. Since last year, inflation has continued to test the upper bounds of the Reserve Bank of India target inflation range and in Q2 with CPI jumped to 6.3% in May as food and energy prices surged[2]. India recorded a current account deficit of USD 8.1bn in the first three months of 2021, equivalent to 1 % of GDP, driven largely by a high trade deficit.[3]



Economy

- The Indian economy shrank by 1.6% YoY in Q1 2021, following two-quarters of pandemic-driven contraction. This is followed by a 20.1% YoY growth witnessed in Q2, attributed to a low base effect when compared to last year when there was a record drop of 24.4%. On the demand side, private spending increased by 19.3%, investment by 55%, exports by 39.1%, and imports by 60.2%. On the production side, construction surged by 68.3%, manufacturing by 49.6%, trade, hotels, transport and communication increased by 34.3%, mining 18.6%; utilities 14.3%; the farm sector 4.5%; and the financial and real estate sector 3.7%.[4]
- India's manufacturing sector continued to gain health in Q2 2021, however, the pace of growth slowed down. As the impact of COVID-19 intensified, consumer demand fell which led to lower output and job losses. Fears related to the pandemic affected business sentiment and lowered the year-end production outlook. The IHS Markit India Manufacturing PMI fell to 48.1 in June, lower than 50.8 in May. This reflects the supply constraints and the adverse impact of the COVID-19 pandemic.[5]
- The annual rate of inflation, based on the Wholesale Price Index (WPI), stood at 12.94% in May 2021 (over May 2020), as compared to 10.49% in April. The increase is driven by higher oil prices and a low base effect when compared to the previous year.[6]
- India's current account balance (CAB) deficit was USD 8.1bn (1% of GDP) in Q1 2021, as compared to a deficit of USD 2.2 bn (0.3 percent of GDP) in Q4 2020; and a surplus of USD 0.6 bn (0.1 percent of GDP) in the same time last year. The deficit in CAB was on account of a higher trade deficit and lower net invisible receipts. Net services receipts increased on the back of a rise in net earnings from computer, transport and business services on a year-on-year basis. Private transfer receipts, mainly representing remittances by Indians employed overseas, increased to USD 20.9 bn, up by 1.7% as compared to the previous year. Foreign portfolio investment increased by USD 7.3bn against a decline of USD 13.7bn a year ago. In Q1 of 2020-2021, there was an accretion of USD 3.4bn to the foreign exchange reserves (on a BoP basis).[7]

Monetary

- According to the bi-monthly monetary policy statement on June 04, 2021, the RBI kept the policy rate (repo rate) under the liquidity adjustment facility (LAF) unchanged at 4 %. The reverse repo rate under the liquidity adjustment facility remained unchanged at 3.35%. Similarly, the Bank Rate remained at 4.25%.[8]
- Overall liquidity in the system remains in large surplus. Reserve money increased by 12.4% YoY as of May 2021, driven by a surge in currency demand. Money Supply (M3) grew by 9.9%. India's foreign reserves increased by around USD 21.2 bn and were at USD 598.2bn as of May 2021.[9]
- Headline CPI inflation decreased to 4.3% in April from 5.5% in March 2021. Food inflation fell to 2.7% in April as compared to 5.2% in March, driven by a decline in prices of staples including pulses, edible oils, vegetables, and spices. CPI excluding food and fuel, also reduced in April across most groups, except housing and healthcare, mostly due to base effect. Going forward inflation expectations will be shaped by various factors such as supply chain disruptions and rising international commodity prices. However, declining infections and easing restrictions may gradually reduce supply chain disruptions and ease cost pressures.[10]

Funding and Liquidity

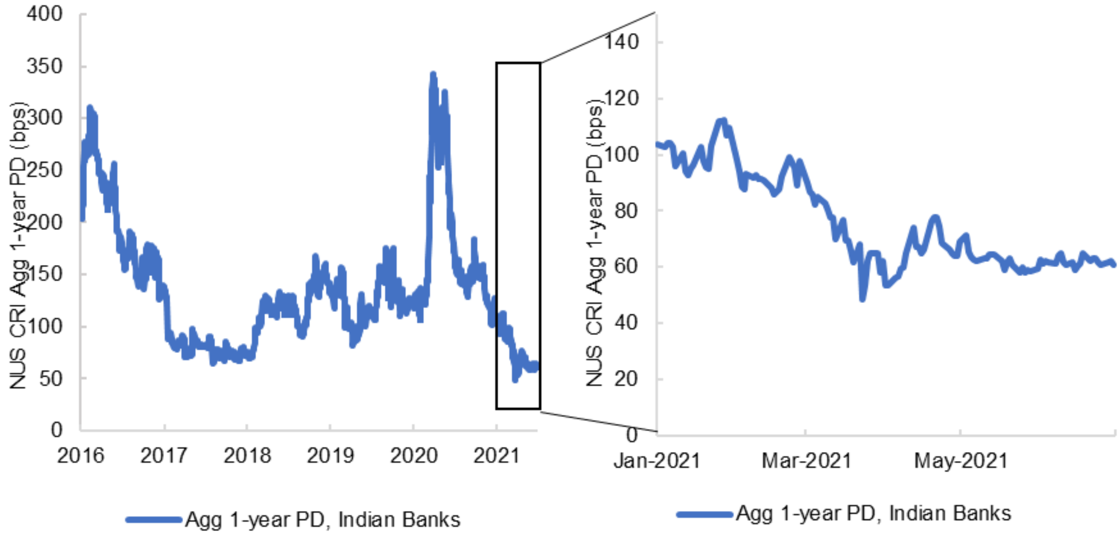
- Yields on India's 10-year government sovereign bonds fluctuated in Q1 and Q2 2021. Yields were at 6.05% at the end of Q2 2021, ranging between 5.89% and 6.24% over the two quarters. [11]
- In June, RBI announced a third tranche of open market purchases, as a part of the G.SAP 1.0 program, with an aim to manage the yield curve. Under the program, RBI commits to investing in the purchase of government securities from the open market to ensure the stability of the yield curve. The RBI also committed to continuing operations under the Liquidity Adjustment Facility longer-term repo/reverse repo auctions, forex operations, and open market operations.[12]

Sovereign Credit Ratings

- Standard & Poor's credit rating for India stands at BBB- with a stable outlook. Moody's credit rating for India was last set at Baa3 with a negative outlook. Fitch's credit rating for India was last reported at BBB- with a negative outlook. DBRS's credit rating for India is BBB with a stable outlook. [13]

Indian Banks

The NUS-CRI Aggregate 1-year PD for Indian Banks saw a gradual downtrend in H1 2021, decreasing from 102 bps at the start of Q1 to 60 bps at the end of Q2 2021. The Agg PD saw relatively high levels of volatility ranging from 112bps to 48bps. In the first half of 2021, Indian banks saw muted credit growth attributed to lockdowns and resultant contraction in economic activity. RBI expects gross NPA ratios for Indian banks to rise to 9.8% by March 2022 from 7.48% in March 2021, disproportionally affecting public banks (from 9.54% to 12.52%) when compared to those of private banks (from 4.78% to 5.82%) over the same period.



Profitability

- India's private sector banks saw a decrease in their credit to deposit ratio from 71.5% in Q1 2020 to 70.5% in Q2 2021. Aggregate deposits growth in Q1 2021 increased from 9.5% YoY to 12.3% YoY but decreased again to 10% YoY by the end of Q2 2021. Simultaneously, credit growth on an annual basis marginally increased from 5.6% in Q1 2021 to 6% in Q2 2021.[14]
- Banks in India will have to tackle the ballooning Non-performing assets (NPA). Thousands of crores worth of loans have gone sour due to non-payment by borrowers and the amount of NPAs is likely to increase further. Even though performance in the first half of 2021 beat expectations, it may be attributed to government policies surrounding loan moratoriums and Supreme Court rulings. [15]

Funding & Liquidity

- The weighted-average call money rate, the interest rate on short-term finance repayable on demand, decreased from 3.57% as of June 10, 2020 to 3.16 % as of June 18, 2021. The call money rates were generally lower than the repo rate during Q1 and Q2 in 2021, indicating a stable banking system. Savings Deposit rates generally remained stable in Q1 and Q2 2021.[16]
- The amount of cash in hand on the balance sheet of Indian banks increased from INR 4611.71 bn on Jan 16, 2021, to INR 6690.32 bn on June 18, 2021.[17]
- The Reserve Bank of India decided to maintain an accommodative stance to support the revival of the economy as it struggle to recover from the impact of COVID-19. The RBI has instituted an "On-tap Liquidity Window for Contact intensive sectors", aimed at providing liquidity to COvid-19 related healthcare infrastructure and services, and a "Special Liquidity Facility to Small Industries Development Bank of India (SIDBI)", aimed at meeting the short to medium term credit requirements of Micro, Small and Medium Enterprises (MSMEs) [18].

Asset Quality

- The gross nonperforming asset ratio of local commercial banks may rise to 9.8% by March 2022 as per the Reserve Bank of India's stress tests. These may be heightened to 11.22% under a severe stress scenario. The capital to risk-weighted asset ratio (CRAR) for commercial banks improved to 16% in March 2021 from 14.7% in March 2020, while the provision coverage ratio (PCR) improved from 66.2% to 68.9% over the same period. [19]

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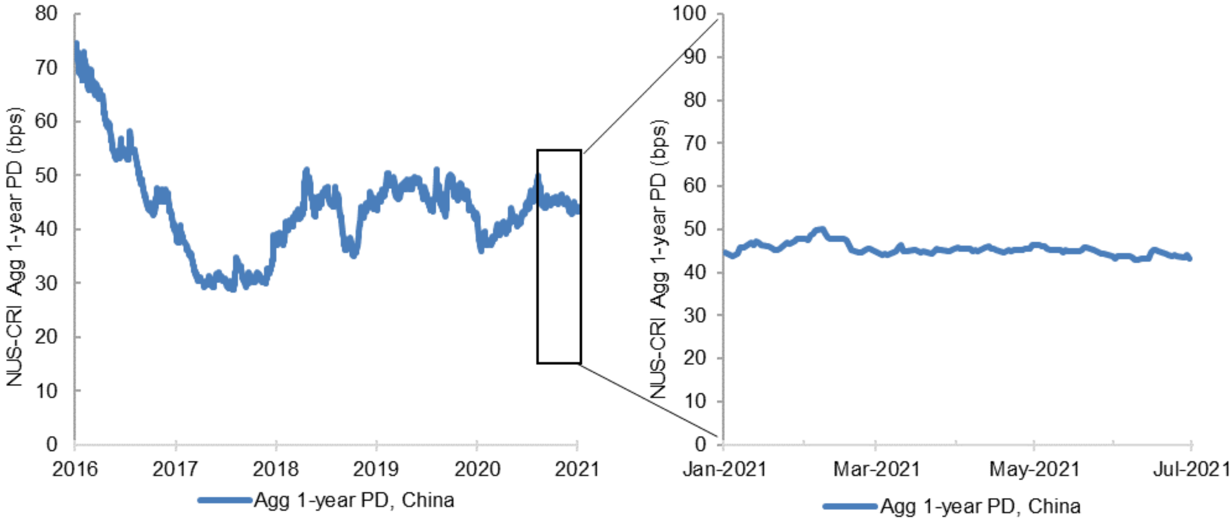
Chinese Companies

The NUS-CRI Aggregate 1-year Probability of Default (Agg PD) demonstrates the stable credit quality for China-domiciled companies in the first half of 2021, hovering between 40bps to 50bps. The economic recovery in China was steady in H1 2021, as production and demand recovered and employment and prices were stable. The Chinese economy expanded by a seasonally adjusted 1.3% QoQ in Q2 2021, after a revised 0.4% QoQ growth in Q3 2021.[1]



Economy

- The Chinese economy grew 7.9% YoY in Q2 2021, dropping from a record growth of 18.3% in Q1 and falling short of the market expected 8.1%. The slowdown of production, upswing in raw material cost, and outbreaks of the new COVID-19 variant in some regions slowed down the country's economic recovery. For the whole of 2021, China has set a target for economic growth of 6%. [2]
- The annual inflation rate in China was 1.1% in June 2021, falling from the 8-month high of 1.3% in May and below the market consensus of 1.3%. The cost of food experienced a sharp decline and cost of non-food goods increased slightly. Meanwhile, cost for transportation & communication, clothing, rent, fuel & utilities continued to rise. In June, consumer prices fell by 0.4% MoM for the fourth straight month. The CPI growth target for 2021 is 3%, compared to the 3.5% last year, However, China's producer prices increased by 8.8% YoY, slightly lower than the highest increase of 9.0% in May 2008, consistent with market expectations. On a MoM basis, it rose by 0.3% in June, the sixth consecutive month of increase in factory gate prices. [3] [4]
- The unemployment rate in China remained relatively low at 5% in May and June 2021, decreasing from 5.4% and 5.5% in January and February 2021 respectively. The targeted urban surveyed unemployment rate for 2021 is 5.5%, with China aiming to create 11mn new jobs this year. [5]
- The Caixin China General Composite PMI was 50.6 in June 2020, falling from 53.8 in May. Output and new orders are at a 14-month low, indicating the slowdown of production capabilities. The Caixin China General Manufacturing PMI and Caixin China Services PMI came at 51.3 and 50.3 in June 2021 respectively, both declining from the reading in May. The services sector was weaker than the manufacturing sector due to the resurgence of the COVID-19 in some regions.[6]
- China's investment in fixed-assets (excluding rural households) rose by 0.35% MoM in June. In the first half of 2021, the country's fixed asset investment was CNY 25.6tn, increasing 12.6% compared to the previous year. Among them, private investment in fixed assets increased by 15.4% YoY to CNY 14.8tn. [7]
- China's trade surplus increased to USD 51.53bn in June 2021, up from USD 44.8bn in June 2020, far exceeding the market expectations of USD 44.2bn. It was the largest trade surplus in 2021in the midst of the global demand recovery and high commodity prices. Exports rose by 32.2% YoY and imports soared 36.7% in June. China's trade surplus with the US grew to USD 32.58bn in June, up from USD 31.78bn in the previous month. In the first half, the trade surplus increased to USD 251.52bn, from USD 164.33bn in the same period last year, while the trade surplus with the US expanded to USD 154.92bn. [8]

Monetary Policy

- The People's Bank of China (PBOC) will maintain the stability of monetary policy, strengthen its foresight and effectiveness, refrain from engaging in flood-style irrigation, and continue to focus on supporting the real economy and providing assistance to small and medium-sized enterprises and challenged industries to strengthen ongoing recovery. PBOC aims to implement normal monetary policy continuously, perform cross-cyclical policy design effectively, strengthen macro-policy independence, and effectively grasp the vigor and rhythm of policy based on domestic economic conditions and price trends. [9]
- Cash Reserve Ratio in China remained unchanged at 12.5% from Q1 to Q2 2021.[10]
- China Money Supply M0, the most liquid measure of the money supply including coins and notes in circulation and other assets that are easily convertible into cash, was CNY 8.4tn in June 2021, nearly unchanged from CNY 8.4tn in December 2020. Money Supply M1 in China reached a new high of CNY 63.8tn in June 2021, up from CNY 62.6tn in December 2020. Broad M2 money supply in China, measuring the money supply that covers cash in circulation and all deposits, expanded 8.6% YoY in June 2020, marginally higher than the market expectation of 8.2%.[11] [12] [13]
- The 10-year government bond yield declined to 3.08% at the end of June 2021, from 3.20% at the end of December 2020. The 1-year government bond yield also decreased, from 2.70% at the end of December 2020 to 2.32% at the end of June 2021. [14] [15]
- The foreign exchange reserves of China fell to USD 3.21tn in June of 2021 from USD 3.22tn in May, slightly higher than the market consensus of USD 3.20tn. Meanwhile, the value of gold reserves decreased to USD 110.45bn in June from USD 119.52bn in May.[16]

Fiscal Policy

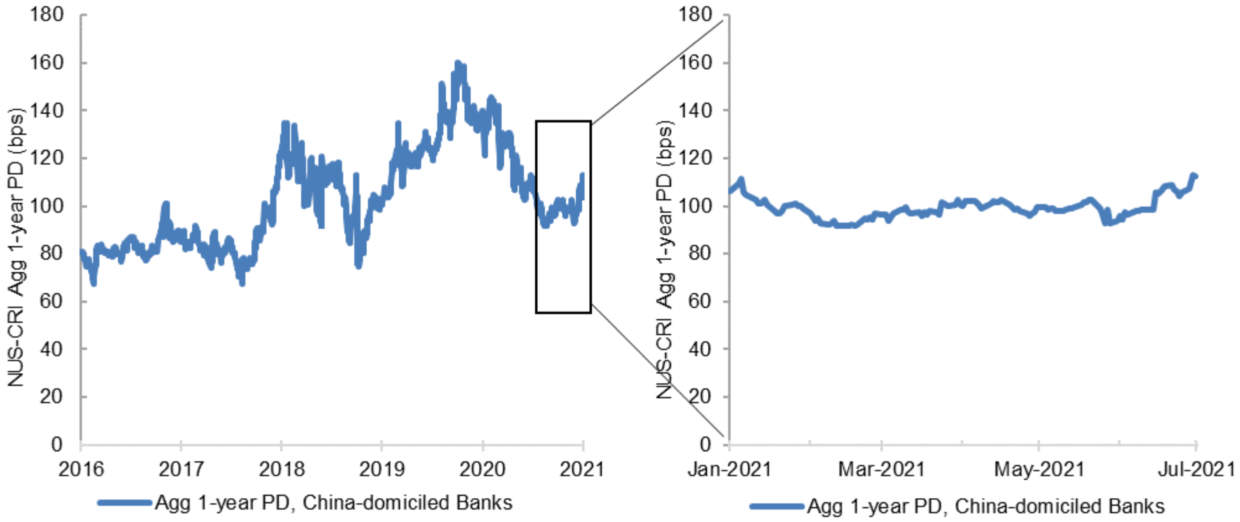
- China's fiscal revenues increased by 21.8% YoY to CNY 11.71tn in H1 2021. The high growth is due to the low base effect of the first half of 2020 and a rise in PPI, reflective of the country's economic recovery. Fiscal expenditure rose by 4.5% in the H1 2021 to CNY 12.17tn, compared to last year.[17]

Sovereign Credit Ratings

- S&P and Fitch both maintained their A+ rating for China, with a stable outlook. Moody's also maintained its A1 rating with a stable outlook on China. [18]

Chinese Banks

The NUS-CRI Aggregate 1-year Probability of Default (Agg PD) for China domiciled banks showed a relatively stable credit profile in the first half of 2021. Compared with the same period last year, China domiciled banks saw higher profits amidst the economic recovery. China domiciled banks also improved their credit quality as the NPL decreased slightly in the first half of 2021.



Profitability

- Net profit of China domiciled banks increased 11.1% in the first half of 2021, from the same period last year. Amid the improving economic outlook in the first half, banks report lower provisions for bad loans, positively impacting their profits. China's largest bank, Industrial & Commercial Bank of China, reported a 9.9% YoY increase in net profit in the first half of 2021. Meanwhile, China Construction Bank saw net profit increase by 11.4%. Net profit of Bank of China increased 11.8%. Agricultural Bank of China's net profit also rose by 12.5% YoY. [19] [20] [21] [22]

Funding & Liquidity

- Chinese banks extended CNY 2.122tn in new yuan loans in June 2021, higher than CNY 1.50tn in May 2021, rising for the second consecutive month. [23]
- The People's Bank of China (PBOC) has rolled over CNY 100bn in one-year medium-term lending facility (MLF) in March 2021, with the interest rate unchanged at 2.95%. It also conducted CNY 10bn of reverse repo, with a rate of 2.20%. The PBOC made no fund injection or withdrawal on a net basis.[24]

Asset Quality

- The NPL ratio of most Chinese banks decreased slightly in the first half of 2021. For commercial banks, the average NPL ratio was at 1.76% with a 0.05 percentage points decline QoQ, and the NPL balance was CNY 2.8tn with an increase of 2.5bn QoQ at the end of Q2 2021. The six major state-owned banks also saw improvements in their asset quality in the first half of 2021[25] [26]

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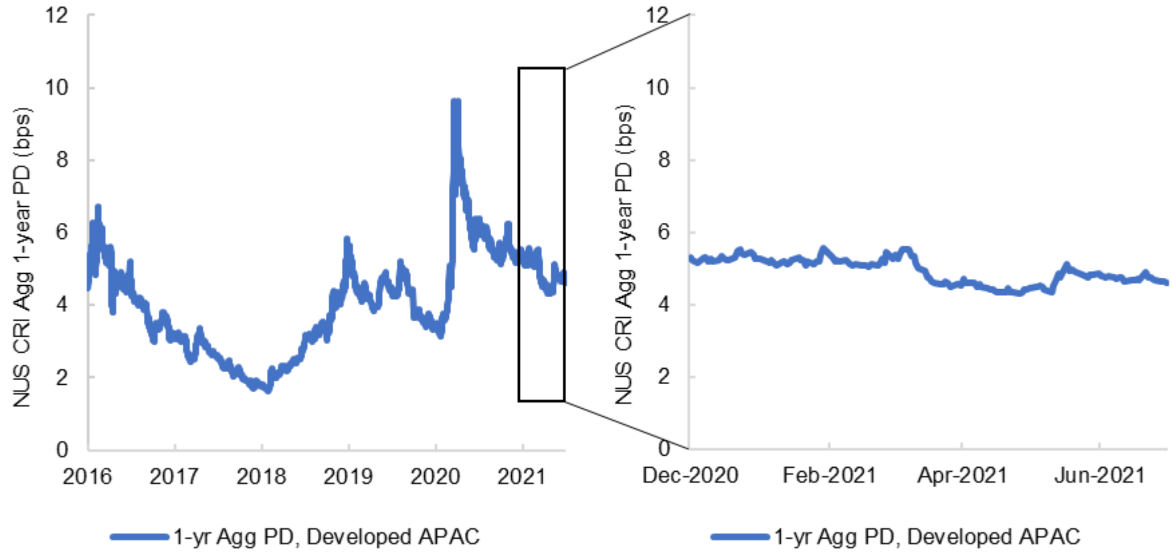
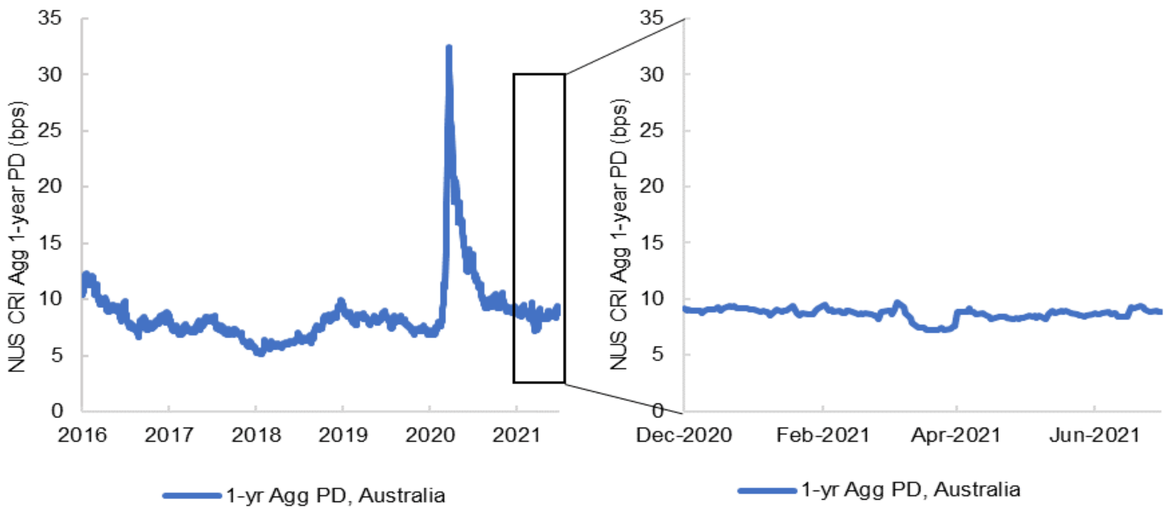
Asia-Pacific - Developed economies

The NUS-CRI Aggregate 1-year PD for listed companies in the Developed Asia Pacific region remained relatively stable at around 5bps in the first half of 2021, after reaching its peak in 5 years during the same period in 2020. Since Feb 2021, APAC nations have started rolling out vaccinations in a bid to reopen the economy, with Singapore, Hong Kong, and Japan among the nations with the fastest vaccination rates. All developed nations in the APAC region ended Q2 2021 with positive GDP growth on a YoY basis, with Singapore leading the group at 15.2% YoY growth, followed by Australia at 9.6% and Hong Kong and Japan at 7.6%. This expansion was driven by strong exports, accommodative financial policies, and increased levels of consumer spending. By the end of Jun 2021, the PD levels were slightly raised due to further lockdowns caused by the highly transmissible COVID-19 Delta variant, but the economic impact of the extended restrictions was dampened by the relatively high vaccinated population.



Australian Companies

The NUS-CRI Aggregate 1-year PD for Australian companies remained relatively stable at about 9bps in the first half of 2021, following its peak during the pandemic heights a year earlier. The Reserve Bank of Australia (RBA) maintained its accommodative monetary policies to support economic recovery and push for full employment, including a record-low cash rate and large bond purchase programs. As the global economy reopens, Australian exports reached an all-time high of AUD 43.86bn, mainly driven by strong Chinese demand for commodities. Overall, positive economic growth is expected to continue for the Australian economy for the remainder of the year.



Economy

- The Australian economy expanded by 1.8% in Q1 2021 and 0.7% in Q2 2021. These figures are weaker than the previous growth in Q3 and Q4 2020, where the economy grew by 3.6% and 3.2% respectively, but an improvement on a year-on-year basis. Overall, the economy beat market expectations of a 0.5% growth in Q2 2021.[1]
- Public investment increased, with government spending increasing to AUD 105.54bn in Q2 2021 from AUD 104.15bn in Q1 2021. Private investment increased as well, with gross fixed formation rising by 3.2% from Q1 to Q2 2021. Household consumption rose by 1.1% in the second quarter of 2021.[2] [3] [4]
- The Reserve Bank of Australia (RBA) decided to keep the cash rate unchanged at 0.10%, amid accommodative global financial conditions and low unemployment rates. Australia's economic recovery has been stronger than expected driven by accommodative fiscal and monetary policies, with GDP projected to grow by 4.75% in 2021 and 3.5% throughout 2022. However, inflation remains muted. The RBA will not increase the cash rate until at least 2024, when progress is made towards wage growth and when inflation is within the target band of 2 to 3%.[5]
- The unemployment rate declined from 6.3% in Jan 2021 to 4.9% in Jun 2021, the lowest it has been since Nov 2008. The labour participation rate remained constant since the second half of 2020 at 66.2%.[6]
- As reported by The Australian Industry Group, The Australian Performance of Manufacturing Index (PMI) grew by 1.4 points to 63.2, the strongest monthly result since the introduction of the PMI in 1992. This was the result of a record pace of expansion in all six of the Australian manufacturing sectors. The Australian Performance of Services Index (PSI) rose to a record high of 61.2 points in May 2021, reflecting the healthy levels of activity in the business-facing services sector as restrictions were gradually eased. Furthermore, the services sector also saw a growth in employment, wages, as well as sales volumes. The Australian Performance of Construction Index (PCI) also peaked at 61.88 points in Mar 2021, indicating strong expansion in construction activity, particularly in residential projects. The PCI has since trended downward to 55.5 points in Jun 2021. [7] [8] [9]
- Key export prices rose 13.2% in Q2 2021 and are up 26% through the year. Metalliferous ores and metal scrap remained the key drivers to the rise in exports, which was caused by increasing demand for iron ore from China and a tight global supply. Import prices were up 1.9% in Q2 2021 but were down 2.5% through the year. The two main contributors to the rise in the quarter were strong global demand for fertilisers and plastics. Australia's trade surplus improved marginally to AUD 10.50bn in

Jun 2021 from AUD 10.14bn in Jan 2021, after narrowing to AUD 5.57bn in Mar 2021, as a result of consistently strong export growth. For the first half of the year, the nation's trade surplus rose significantly to AUD 52.48bn compared to AUD 39.17bn during the same period last year.[10] [11]

Monetary Policy

- In a statement released on 1 Jun 2021, the RBA committed to maintaining its 3-year target yield of 0.10% set in Nov 2020, and has confirmed that it will continue to do so to support its policy measures. The RBA has yet to decide whether to retain the target yield of 0.10% on the Apr 2024 bond or to shift to the Nov 2024 bond. Following the completion of the government bond purchase program of AUD 100bn in Sep 2021, the RBA will review the possibility of future bond purchases.[12]
- The RBA plans to maintain its accommodative monetary policy stance until inflation rates of 2-3% are achieved. However, it does not expect these conditions to be reached until 2024, contingent on wage levels rising as well as the labour market improving.[13]

Funding & Liquidity

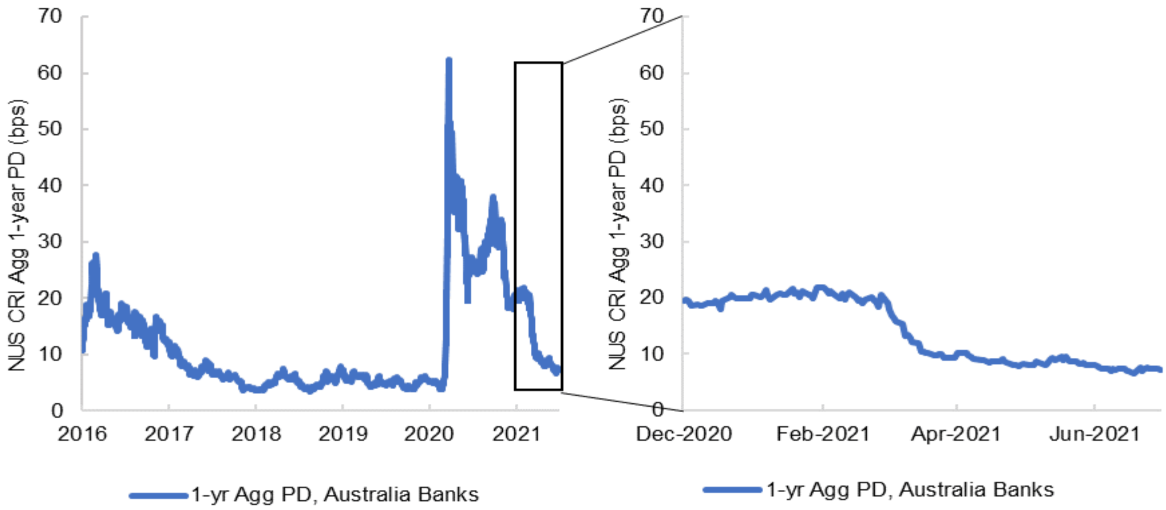
- Yields on 10-year Australian government bonds started the year at 0.98% in Jan 2021, steadily increasing to a peak of 1.76% in Mar 2021, before tapering off to 1.49% at the end of Jun 2021.[14]
- The variable lending rate to small businesses stayed constant at 5.03% throughout Jan 2021 to Jun 2021, continuing the trend since the second half of 2020. The lending rates for owner-occupied housing loans also remained unchanged at 4.52% in the Q1 and Q2 2021.[15]
- During the first half of 2021, the average lending to the Government fell by AUD 45.8bn to AUD 338.2bn in Jun 2021. Both loans to individuals and commercial lending increased by AUD 50.8bn and AUD 21.6bn respectively, while commercial lending to financial intermediaries saw a slight decrease of AUD 4.5bn.[16]

Sovereign Credit Ratings

- Standard and Poor's and Fitch Ratings maintained their AAA rating on Australia, while Moody's maintained their Aaa rating as well. Standard and Poor's revised their outlook on Australia to stable from negative previously. Fitch Ratings maintained their negative outlook on Australia, while Moody's maintained its stable outlook on the country.[17]

Australian Banks

The NUS-CRI Aggregate 1-year PD significantly improved for Australian banks over the first half of 2021, after the significant spike in credit risk a year earlier. The PD for Australian banks dropped from 20.88 bps to 8.18 bps throughout Q1 and Q2 2021, but remains elevated compared to pre-pandemic PD levels. The Major Banks continue to maintain good capital positions and liquidity measures, and saw a significant increase in their profits compared to 2020. Another positive sign for Australian banks is their recovering asset quality as compared to the previous quarter, reflecting a positive credit outlook moving forward.



Profitability

- Throughout the first half of 2021, aggregate cash profit after tax increased significantly YoY by 62.3% to AUD 13.8bn. The significant rise in profit could be attributed to a stronger-than-expected economic recovery from the pandemic and thus a reduction in the amount of provisions raised, coupled with no major notable expenses during the period. Average ROE of major Australian banks for 1H21 showed a massive improvement of 381bps to 10.4% compared to the previous period.[18]

Funding & Liquidity

- Australian major banks continued to maintain a strong Common Equity Tier 1 ratio, which rose 105 bps to 12.4% through retaining profits from selling off assets and investments. The Majors have continued to maintain their strong capital positions, with capital levels significantly above APRA's requirements.[19]
- The Liquidity Coverage Ratio of Australian banks remained well above its 100% minimum, though it dropped 10 percentage points to 135.3% in 1H21. This is mainly driven by the increase in the number of High Quality Liquid Assets held by the Majors, which led to a significant decrease in the Committed Liquidity Facility throughout the system. Meanwhile, the average leverage ratio for major banks grew by 19bps to 5.94%, higher than the currently agreed minimum requirement of 3.5%.[20]

Asset Quality

- Asset quality recovered as the Australian economy began to re-open, which saw an average decline of 28bps in the ratio of impaired loans to GLA compared to the previous period. Major banks saw a significant decrease in collective impairment charges from AUD 4.4bn in 1H20 to AUD 444mn in 1H21. This decrease is a reflection of lower unemployment rates, stronger growth forecast, the recovery of the underlying credit quality, as well as an optimistic outlook on forward-looking macroeconomic conditions.[21]

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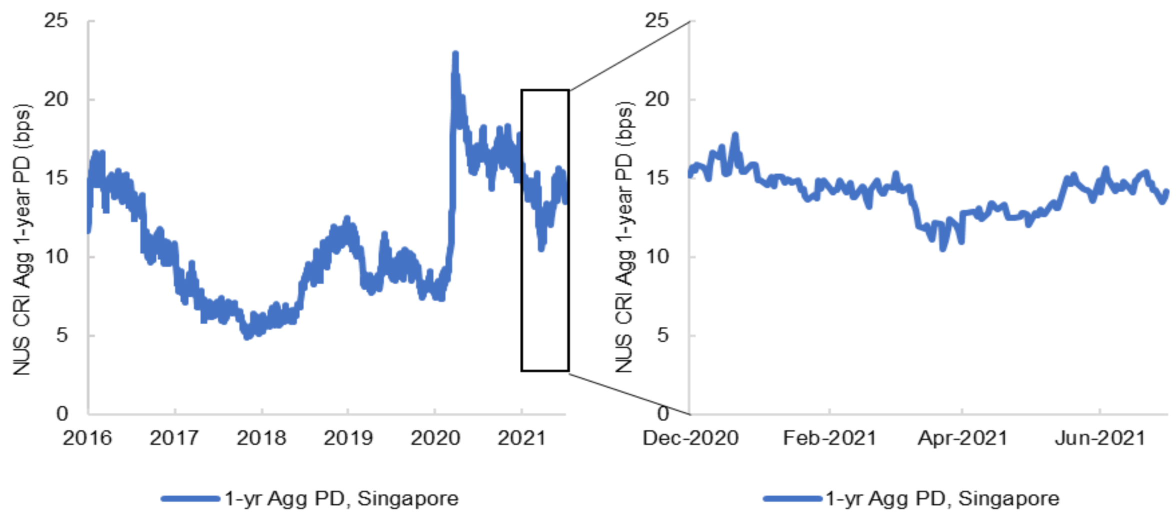
Singapore Companies

The NUS-CRI Aggregate 1-year PD for Singapore companies stayed relatively flat at around 15bps at the start of Jan 2021 to 13bps at the end of Jun 2021. The PD level fell slightly in Apr and May 2021, concurrent with a resurgence of Covid-19 cases which led to heightened lockdown restrictions. Singapore's economy experienced a 14.3% YoY expansion in Q2 of 2021, a significant improvement over the 1.3% YoY growth in Q1 2021. The improvement in GDP growth was mainly a result of a rebounding local economic environment as the Covid-19 situation subsides. The sectors that saw the largest growth were Manufacturing, Construction, and the Services industry. The Singapore government expects the overall economy to grow by 6% to 7% in 2021, up from the previous forecast of between 4% to 6%, as a result of stronger-than-expected growth in 1H 2021 and the gradual easing of global border restrictions.



Economy

- On a YoY basis, the Singapore economy expanded by 1.5% and 14.7% in Q1 and Q2 2021 respectively. This relatively strong year-on-year economic growth was mainly due to a pandemic-driven fall in demand and the implementation of Circuit Breaker measures during Q2 2020, causing GDP to fall by 13.3%. However, on a seasonally adjusted basis, the economy contracted by 1.8% from Apr 2021 to Jun 2021, as opposed to a growth of 3.3% in the first quarter.[1]
- The Construction sector was the best performer in terms of GDP growth rates by the end of the first half of 2021, growing 106.2% in Q2 compared to -22.7% in Q1. This is mainly driven by the expansion of public and private constructions projects as well as low base effects due to the effects of the pandemic in Q2 2020. The Transportation & Storage sector also faced a similar turnaround, growing by 1% in Q2 after contracting -16.5% the previous quarter. In contrast, the Finance and Insurance sector only expanded by 1.5% against a 4.7% growth in Q1 2021.[2]
- The number of retrenchments in Q2 was slightly higher than in Q1 2021, with 2,500 retrenched employees compared to 2,270 in the quarter prior, with increases in the manufacturing and construction sector. Meanwhile, retrenchments in the services sector fell. The number of employed fell by 19,300 employees in contrast to the rise of 14,000 in the previous quarter. The majority of declines were observed in the construction, food & beverage, and manufacturing sectors. The seasonally-adjusted unemployment rate fell marginally in Jun 2021 to 2.7% from 2.9% in Mar 2021. Unemployment rates continued to show a decline for three consecutive quarters, but the number remained higher as compared to pre-pandemic levels.[3]
- The CPI-All Items increased faster on a year-on-year basis, rising by 2.3% in Q2 as opposed to 0.8% in the quarter prior. One of the major contributing factors to rising inflation in Q2 is the 10.6% increase in transport costs, driven by the increase in car and petrol prices. The CPI-All Items rose at a stable rate of 0.8% on a QoQ seasonally-adjusted basis in both Q1 and Q2.[4]

Monetary

- In its latest announcement published on 14 Apr 2021, the Monetary Authority of Singapore (MAS) maintained the rate of appreciation of the S$NEER policy band constant at the levels laid out in its Oct 2020 statement.[5]

- MAS aims to maintain a zero percent per annum rate of appreciation of the policy band, while the width and the level at which it is centered will remain unchanged. With core inflation predicted to rise but still remain below its long-term average, it would be suitable for a dovish policy stance to be maintained going forward. The 3-month SIBOR remain unchanged at 0.4% from Oct 2020.[6]
- The MAS core inflation improved from 0% to 1% for 2021 as inflation is expected to only gradually increase in H2 2021, driven by higher oil prices, improvements in the labour market, and consumption recovery. However, it remains subdued by low commercial property rents and low wage growth. The CPI-All Items inflation is forecasted to be at 0.5% to 1.5% in 2021, an increase from -0.5% to 0.5% previously.[7]

Funding & Liquidity

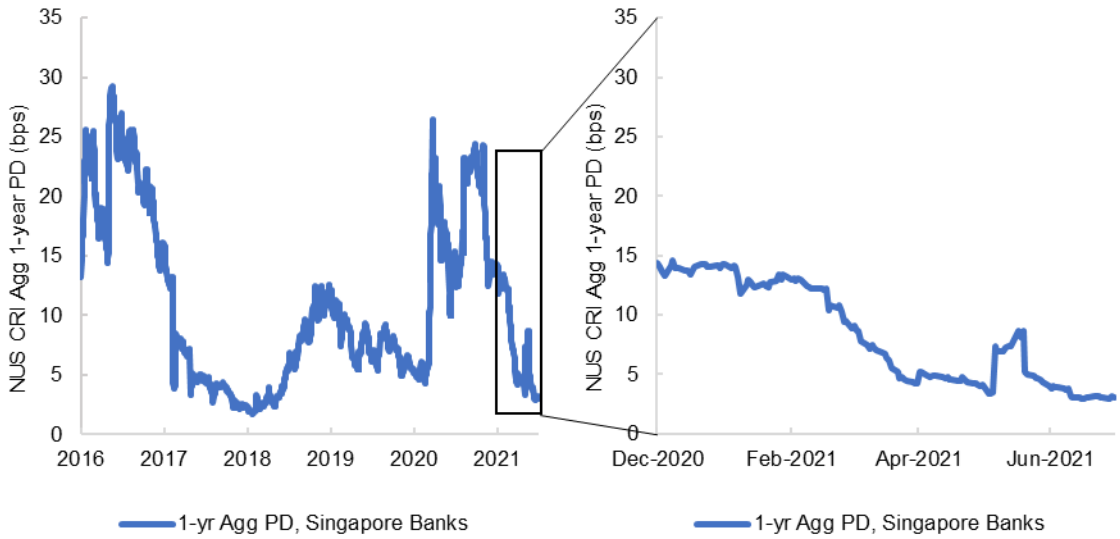
- Yields on 10-year Singapore government bonds rose to 1.58% at the end of Jun 2021 from 1.00% in Jan 2021.[8]
- Total lending to non-bank customers grew slightly from SGD 691.2bn in Q1 2021 to SGD 703.9bn in Q2 2021. Total loans to businesses rose from SGD 422.7bn in Jan 2021 to SGD 436.8bn in Jun 2021 while consumer loans increased from SGD 260.9bn in Jan 2021 to SGD 267.2bn in Jun 2021.[9]
- The prime lending rate remained constant at 5.25% throughout Q1 and Q2 2021.[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 maintained stable outlooks on the government's credit.[11]

Singapore Banks

The NUS-CRI Aggregate 1-year PD across Singapore banks (DBS, OCBC and UOB) was 14.27bps at the start of Jan 2021 and finished at 3.02bps at the end of Jun 2021. The Monetary Authority of Singapore (MAS) reported that the financial services sector as a whole grew 6% in the first half of the year. As the global economy begins to recover and business sentiment turns positive, the three main banks saw a significant increase in their profit margins compared to a year earlier. Singaporean banks continue to be well capitalized, with the MAS capping the dividends of local banks to 60% since Jul 2020 to ensure that banks have sufficient capital to prioritize lending and provide support to individuals and businesses.



Profitability

- For the first half ended 30 Jun 2021, the three listed banks in Singapore, UOB, OCBC and DBS recorded SGD 2.01bn, SGD 2.66bn and SGD 3.71bn in net profits respectively, up 29%, 86%, 54% respectively from the same period in 2020. This strong performance is mainly driven by robust business growth and significantly lower credit allowances. The ROE for UOB, OCBC and DBS were 10.1%, 10.8% and 14.0% respectively.[12] [13] [14]

Funding & Liquidity

- Total deposits in Singapore banks increased by SGD 12.8bn in the first half of 2021. Local currency deposits increased by SGD 5.4bn while foreign currency deposits increased by SGD 7.3bn from Jan to Jun 2021, reflecting a 25.6% increase since the start of the year.[15]
- Both banks' savings deposit rates and fixed deposit rates have fallen throughout the first half of 2021. Singapore's savings deposit rates fell 1bps to 0.07%, while fixed deposit rates for 3-month, 6-month, and 12-month deposits dropped 1bps, 2bps, and 1bps to 0.12%, 0.15%, and 0.24% respectively at the end of Jun 2021. However, the prime lending rate remained unchanged at 5.25% in Q1 and Q2 2021.[16]

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 minimum specified by MAS, making them some of the more well-capitalized banks in the world. As of the first half ended 30 Jun 2021, OCBC has the highest CET1 ratio at 16.1%, while UOB and DBS came in at 14.2% and 14.5% respectively. With this, the banks have ample liquidity support, and they look well-positioned to navigate the uncertainties ahead.

Asset Quality

- All three of Singapore's largest banks kept their NPR ratio unchanged from the previous period at 1.5%. The allowance coverage for OCBC, UOB, and DBS was 104%, 110%, and 109% respectively by the end of 1H21. OCBC shifted its Regulatory Loss Allowance Reserve to retained earnings, causing its coverage ratio to fall to 104% in Jun 2021 from 118% in the previous quarter.[17] [18] [19]

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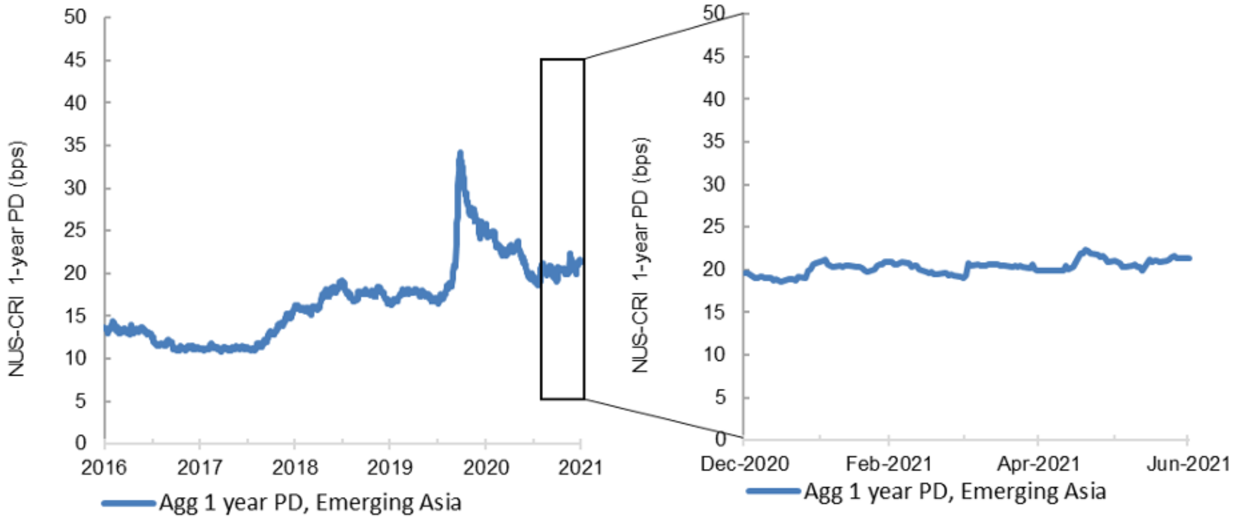
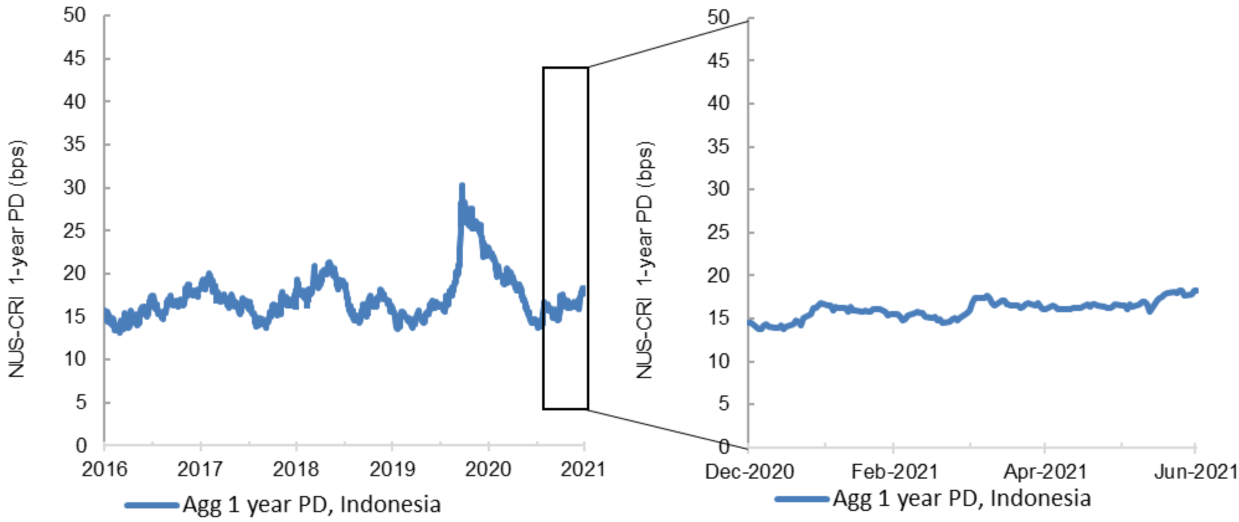
Asia-Pacific - Emerging economies

The NUS-CRI Aggregate 1-year PD for listed corporations in emerging Asia, excluding India and China, ended 2020 at 19.5bps. By the end of Jun 2021, the Agg PD rose marginally to 21.4bps in light of the series of national shutdowns and corresponding economic slowdowns due to the resurgence in COVID-19 cases. However, this was cushioned by a surge in vaccinations across Asia. In terms of economic growth, Indonesia's GDP growth expanded for the first time in 3 quarters, as it ended Q2 2021 with QoQ GDP growth at 3.31%. This growth was driven by increased household consumption and government expenditure. On the contrary, Malaysia's economy contracted 2% QoQ in Q2 2021 after it experienced a growth of 2.7% in the previous quarter, due to the Enhanced Movement Control Order implemented in June under which only essential services were allowed to operate. Thailand's economy experienced its fourth straight quarter of expansion, with the economy growing by 0.4% QoQ. Despite COVID-19 outbreaks and lockdowns, the strong fiscal spending and increasing demand for exports internationally contributed to this rise.



Indonesian Companies

The NUS-CRI Aggregate 1-year PD for Indonesian companies increased from 14.5bps at the end of Dec 2020 to 18.3bps at the end of H1 2021. Indonesia's economy expanded 7.1% in Q2 2021 up from the prior contraction of 2.19% in Q4 2020. As of Jun 2021, Indonesia recorded a 1.4% inflation rate and USD 11.9bn of current account surplus.



Economy

- The Indonesian economic growth rate changed by -0.74% in Q1 2021 before rebounding by 7.07% in Q2 2021. After recording contracting growth for five quarters, the country experienced its first expansion in Q2 2021. Moving forward, the economy is expected to experience continued growth of 4.3% in the next quarter.[1]
- The Consumer Price Index (CPI) of Indonesia stood at 1.33% (YoY) as of end Jun 2021. Respectively, the inflation of volatile food reached 1.60% (YoY), core inflation at 1.4% (YoY), and inflation of administered prices at 0.49% (YoY). Going forward, the inflation is to be maintained at around 3.00% throughout 2021. It is thus essential for the government and Central Bank to coordinate to keep inflation in check to promote greater economic growth. [2]
- Indonesia's Balance of Payments had a minor USD 0.4bn deficit in Q2 2021 owing to a low current account deficit, and a sustained surplus in their capital and financial accounts. [3]
- The Nikkei Indonesia Manufacturing Purchasing Managers Index (PMI) reflects Indonesia's improving manufacturing conditions as of end of Jun 2021. For the third month in a row, the index reached a new all-time high. In May 2021, the pace of expansion in the Indonesian manufacturing sector set the PMI to a new high of 55.3, up from 54.6 in April. Business conditions have improved for the seventh month in a row. New orders, output, and purchasing all increased at record rates in Indonesia's ten-year history, and employment increased for the first time in 14 months to meet rising operating capacity demands.[4]

Monetary

- The Bank Indonesia (BI) chose to keep the BI 7-Day repo rate at 3.50%, while keeping the deposit facility rates at 2.75% and the lending facility rates at 4.25%. The move is in line with low inflation forecasts and efforts to keep the Rupiah exchange rate stable while stimulating the economy. Through the following policy measures, Bank Indonesia continues to optimize the accommodating monetary and Macroprudential policy mix and expedite payment system digitisation in Indonesia to assist the national economic recovery.[5]

Funding & Liquidity

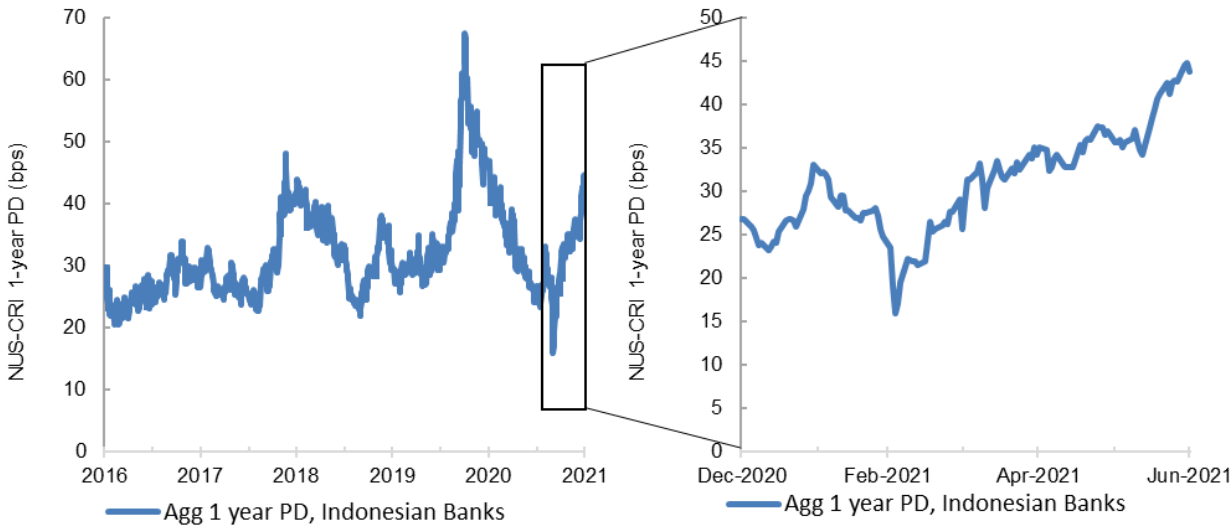
- The yield of Indonesia's 5-year bond rose from 5.2% at the end of Dec 2020 to 5.4% at the end of Jun 2021. Similarly, Indonesia's 10-year government bond yield increased from 5.9% to 6.6% during the same time period. [6] [7]
- As of the end of June 2021, Indonesia's official reserve assets totalled USD 137.1bn, up from USD 136.4bn at the end of May 2021. The official reserve assets position is enough to finance 9.2 months of imports or 8.8 months of imports while also servicing the government's external debt. The Government's Global Sukuk (Sovereign Islamic Bond) issuance, as well as tax and service receipts, influenced the increase in official reserve assets in June 2021. Bank Indonesia believes that the official reserve assets will continue to be enough in the future, and will become an essential factor in the national economy's external resilience.[8]
- External debt was down 0.1% QoQ from USD 415.3bn in Q1 2021 to USD 415.1bn at the end of Q2 2021. Indonesia's external debt remains sustainable in Q2 2021, with external debt to Gross Domestic Product (GDP) ratio at 37.5%, down from 39.0% in the previous quarter. External debt growth slowed from 7.2% YoY in the previous quarter to 1.9% YoY in Q2 2021. Indonesia's external debt structure remained sound, due to the prevalence of long-term debt, which accounted for 88.4% of total external debt. [9]

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 reaffirmed its rating with a negative outlook, whilst Moody's and Fitch reaffirmed their ratings with a stable outlook. [10]

Indonesian Banks

The NUS-CRI Aggregate 1-year PD for Indonesian banks increased from 28.8bps in Dec 2020 to 43.8bps in Jun 2021. Loans extended by Indonesian banks rose to 0.6% in Jun 2021. Meanwhile, non-performing loans (NPL) stood at 3.24%. [11,12]



Profitability

- The three largest majority state-owned Indonesian banks, Bank Mandiri, Bank Rakyat Indonesia and Bank Negara Indonesia reported increases in net operational income of 17.4% and 21.1%, and 11.9% in the first half of 2021.[13, 14, 15]

Funding & Liquidity

- The liquid asset to bank deposit ratio of Indonesian banks stood at 32.7% as of Jun 2021.[16]
- The Jakarta 3-month interbank rate decreased from 4.1% at the end of 2020 to 3.8% by the end of Q2 2021. Similarly, the 1-month interbank rate decreased from 3.8% at the end of 2020 to 3.6% by the end of Q2 2021. [17]

Asset Quality

- According to Bank Indonesia, the financial system remained stable. Capital adequacy ratio and liquidity of Indonesian banks, as of Jun 2021, stood at 24.3% and 32.7% respectively, while non-performing loans (NPL) stood at 3.2% (gross) or 1.1% (net). Bank Indonesia recorded a credit growth of 0.6% in Jun 2021, while projecting a growth of 4-6% in 2021. In order to stimulate economic growth, Bank Indonesia would increase policy coordination with the government and other relevant agencies, including monetary-fiscal policy coordination, export stimulation, and economic and financial inclusion.[18 19]

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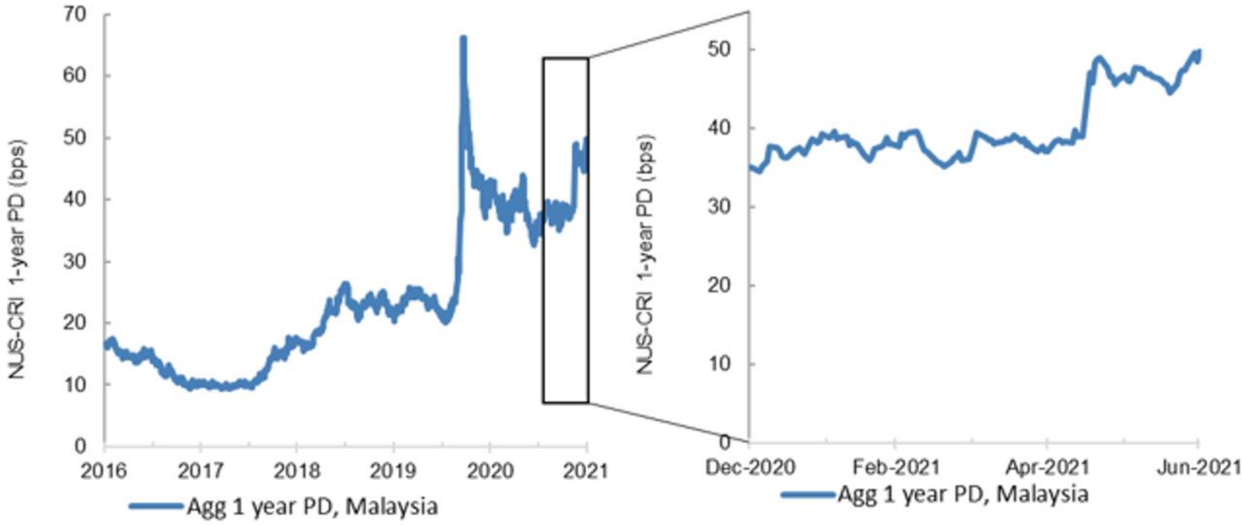
Malaysian Companies

The NUS-CRI Aggregate 1-year PD for Malaysian companies increased from 35.1bps at the end of Dec 2020 to 49.7bps at the end of Q2 2021. The economy rebounded sharply as a result of the resumption of economic activities. However, inflation surged and unemployment rate increased to 4.8%.



Economy

- Malaysia's Gross Domestic Product (GDP) expanded 16.1% YoY by the end of June 2021, rebounding from a 0.5% contraction in the previous quarter. As a result of the reopening of more economic operations and a low base effect last year, this was the quickest rise in the economy since 2000. Household consumption increased to 11.6% from -1.5% in Q1 2021 and fixed investment rebounded to 16.5% compared to a contraction of 3.3% in Q1 2021. Furthermore, net exports boosted GDP with exports and imports increasing 37.4% and 37.6% respectively.[1]
- Headline inflation surged from -1.5% in Q4 2020 to 3.4% in Jun 2021. Consumer Price Index (CPI) increased to 123.2 at the end of Q2 2021 from 120.6 at the end of Q4 2020. Core consumer prices increased 0.7% in Jun 2021. Inflation rose overall, owing primarily to the base effect of low fuel prices.[2] [3]
- Unemployment rate increased to 4.8% in Jun 2021, after it fell to 4.5% in April 2021, because of the increased Enhanced Movement Control Order implemented across regions. [4]
- The trade surplus stood at RM 56.4bn, narrowly shrinking from the RM 58.7bn in Q1 2021. This was a result of exports increasing at a quicker rate of 44.0% (Q1 2021: 18.0%). The good export performance was widespread across products and markets and was bolstered by rising external demand. Meanwhile, gross imports increased by 33.3% (10.0% in Q1 2021), owing mostly to a faster expansion in intermediate imports. During the quarter, the current account surplus of the balance of payments increased to RM 14.4bn or 3.9% of GDP (Q1 2021: RM12.3bn, or 3.3% of GDP).[5]

Monetary and foreign exchange landscape

- The Monetary Policy Committee (MPC) of Bank Negara Malaysia chose to keep the Overnight Policy Rate (OPR) at 1.75%. The base effect from low fuel prices in the Q2 2020 contributed to recent spikes in headline inflation. This increase is just temporary, and as the base effect fades, headline inflation is expected to be under control in the short term. Overall, headline inflation is expected to be closer to the lower bound of the projection range (2.0% and 3.0%) in 2021. Due to the economy's sustained spare capacity, underlying inflation is likely to remain modest, averaging between 0.5% and 1.5% for the year. However, the forecast is dependent on price movements of global commodities. [6,7]
- The ringgit depreciated 0.4% against the USD. Expectations of monetary policy tightening in the United States fuelled an appreciation of the dollar. [8]

Funding & Liquidity

- At both the institutional and systemic levels, banking system liquidity was sufficient to allow financial intermediation activity. The amount of surplus liquidity held by the central bank increased by RM 3.0bn in Q2 2021, owing in part to inflows from government worldwide USD sukuk issuance.[9]
- Malaysia's external debt fell slightly to RM 1020.7bn, or 68.5% of GDP, at the end of Jun 2021 compared to RMB 1039.7bn at the end of Mar 2021. The drop is a result of net interbank borrowing repayments, Non-Resident deposit withdrawals, and exchange rate valuation impacts due to the higher ringgit against selected major and regional foreign currencies over the period. A net issue of bonds and notes abroad, as well as an increase in NR holdings of government domestic debt assets, partially countered these effects. Foreign currency debt amounted to RM 662.5bn, accounting for 64.9% of total external debt.[10]
- Net financing increased by 4.4% annually as of end Q2 2021. Meanwhile, outstanding loan growth slowed to 3.6% (Q1 2021: 4.3%), whereas outstanding corporate bond growth accelerated to 6.9%. (Q1 2021: 5.9%). Outstanding business loans increased by 1.3% annually as of end Q2 2021 (Q1 2021: 1.6%), despite slower outstanding investment-related loan growth. Outstanding loan growth for households slowed to 5.3% (Q1 2021: 6.0%) as repayments outpaced disbursements. However, demand for household loans remained strong (Q1 2021: RM 139.9bn; 2017-19 quarterly average: RM 119.2bn.[11]

Regulations and Policies

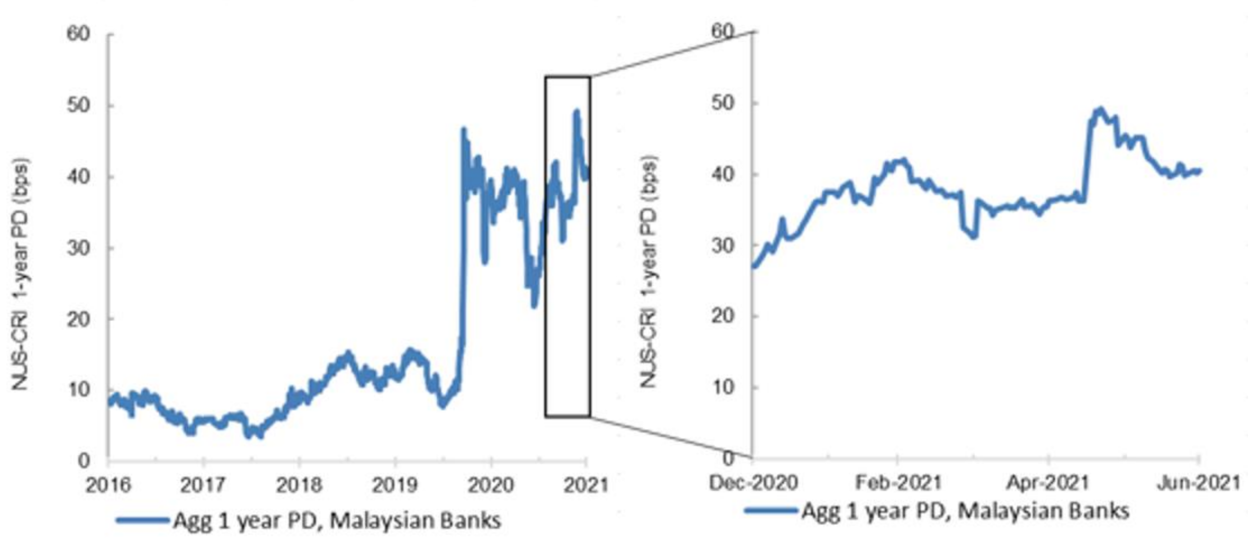
- Although the resurgence of COVID-19 cases and the re-imposition of Movement Control Orders are projected to impact growth, numerous variables may mitigate the impact. Policies enacted to provide cash flow support, particularly for disadvantaged people and companies, will help boost growth. The capacity to limit the pandemic via the nationwide vaccination program will determine the growth trajectory.[12]

Sovereign Credit Ratings

- Moody’s maintained its A3 rating with a stable outlook for Malaysia. Meanwhile, S&P changed the country’s outlook from stable to negative while keeping its A- credit rating. On the other hand, Fitch downgraded its credit rating for Malaysia from A- to BBB+ with stable outlook.[13]

Malaysian Banks

The NUS-CRI Aggregate 1-year PD for Malaysian banks decreased from 27.0bps to 40.5bps from Dec 2020 to Jun 2021. Asset quality remains a worry amidst declining loan growth, falling bank deposits and rising non-performing loans.



Lending

- Nominal interbank interest rates were sustained. The 3-month Interbank rate stood at 1.9% as of Jun 2021.[14]
- Banks face a reserve requirement ratio of 2.0%.[15]
- Malaysian banks face non-performing loans ratio of 1.62% in Jun 2021 which is a marginal deterioration from the ratio of 1.56% in Dec 2020.[16]

Funding & Liquidity

- Total bank deposits stand at USD 513bn in Jun 2021. This is a marginal fall from the USD 520bn at Dec 2020.[17]
- The Monetary Policy Committee (MPC) decided to maintain the Overnight Policy Rate (OPR) at an adequate rate of 1.75%. On top of this, fiscal and financial policies will support economic activity.[18]
- In the short term, the impaired loans ratio is projected to stay relatively constant as banks continue providing repayment help to borrowers experiencing financial difficulties. Banks continue to set aside additional provisions for anticipated credit losses, which presently account for 1.8% of all loans in the banking system.[19]

Capital Levels & Regulations

- Despite a small drop in capital ratios, banks' surplus capital buffers remained stable at RM 119.9bn as of Q2 2021, allowing them to withstand possible stress and maintain credit intermediation in the economy. The CET1 ratio presently 14.3%. a slight fall from the 15.3% as of Dec 2020.[20]

Asset Quality

- The banks recorded a decline in outstanding loan growth as they ended Jun 2021 with 3.4%. Both internal and global influences impacted the financial markets in Malaysia. Investor confidence was impacted by the uncertainties brought upon by the pandemic in the region. More stringent containment measures increased concerns of the economic outlook and heightened risk aversion toward domestic financial assets.[21]

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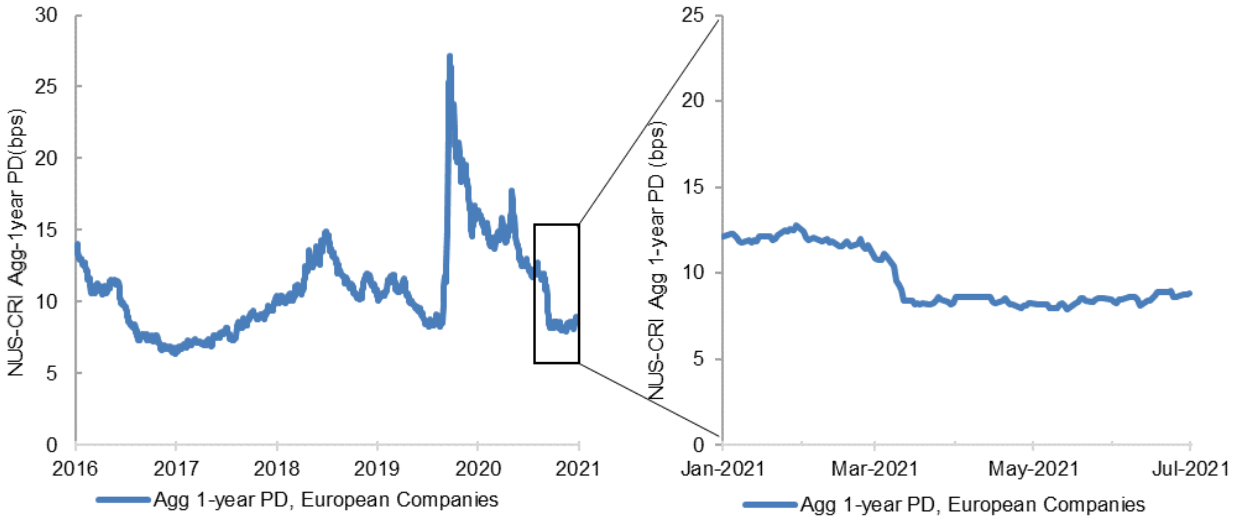
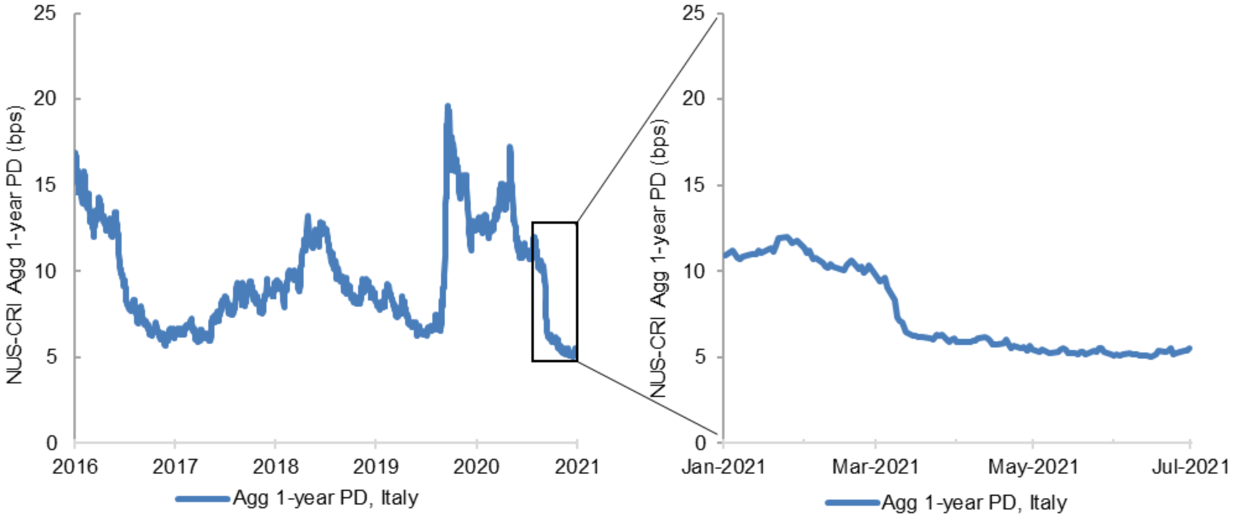
Europe

European companies saw an improvement in their credit quality especially at the end of Q1, as showcased by the NUS-CRI Aggregate 1-year Probability of Default (Agg PD) with PD falling to 8.73bps at the end of June in 2021 from 12.13bps at the end of last year. The GDP of euro area has contracted a marginally 0.2% in tQ1 2021 and increased by 2.0% in Q2. While the envelope of pandemic emergency purchase programme (PEPP) is maintained at EUR 1.85tn until March 2022 by the ECB, PEPP also has the flexibility that purchases could be less than the total envelope if necessary financial condition targets are met. The extension of the third-series of targeted longer-term refinancing operations (TLTRO III) by three additional bidding dates (TLTRO III 8-10) came into force in Feb 2021 and further boosted banks' net lending and thus injected more liquidity to the economy.



Italian Companies

The NUS-CRI Aggregate 1-year Probability of Default (Agg PD) demonstrates the improved credit quality for Italy-domiciled companies, with PD decreased from 10.89bps at the beginning of this year to 5.38bps at the end of June. Recovering from the pandemic, the Italian economy saw consecutive growths in the first two quarters in 2021, with GDP growing 0.2% and 2.7% QoQ in Q1 and Q2 respectively.[1]



Economy

- The GDP of Italy increased by 0.2% in Q1 2021 and expanded 2.7% QoQ in Q2 2021 with accelerating growth, beating the market expectations of 1.3% growth QoQ. On a YoY basis, it shrank by 0.8% in Q1 2021 and expanded 17.3% in Q2 2021, the first growth reported since Q4 2019 as the economy recovered from the pandemic. Draghi's government began easing restrictions in April, enabling business operation and internal movement. Looking ahead for the whole year, the Bank of Italy's expectation the economic growth is 5.1%.[2][3]
- Italy's unemployment rate fell to 9.4% in June from a downwardly revised 10.2% in May, far below the market consensus of 10.4%, reaching a 7-month low amid economic recovery. 166 thousand jobs were added and the number of unemployed people dropped by 131 thousand, while inactive population also fell by 34 thousand. [4]
- The IHS Markit Italy Manufacturing PMI came at 62.2 in June of 2021, nearly unchanged from the record high of 62.3 in May and consistent with market forecasts. While output picked up since May, sales continued to soar. The manufacturing industry continued to face intense pressure on their capacity, and goods producers continued to hire new employees at a near-record pace.[5]
- The IHS Markit Italy Services PMI increased to 56.8 in June from 53.1 in May, indicating the consecutive increase in services output. This is the strongest reading since January 2008 as demand for services picked up sharply due to the loosening of COVID-19 restrictions and restarting of production activities. Firms began hiring more staff and inflationary pressures began to rise. [6]
- The consumer confidence index in Jun 2020 went up from 110.6 to 115.1 with improvements seen across the board. Confidence on economic climate soared from 116.2 to 126.9, the current one from 102.6 to 108.1, the personal one from 108.7 to 111.1 and the future one from 122.5 to 125.5. The confidence index in manufacturing rose from 110.9 to 114.8. However, the confidence index in construction dropped marginally from 153.9 to 153.6. The market services confidence index increased from 99.1 to 106.7. Meanwhile, the retail trade confidence index progressed upwards from 99.9 to 106.7. [7]

Funding & Liquidity

- Yield on Italy's 10-year government bond increased to 0.68% at the end of Q2 2021 from 0.42% at the end of Q4 2020. [8]
- Interest rates on loans (other than bank overdrafts) to non-financial corporations fell to 1.71% in June of 2021, from 1.78% in December of 2020. Bank interest rates (including revolving loans, overdrafts, and extended credit card credit) to corporations decreased from 2.59% to 2.38% in the same period. Loans for house purchases increased from 1.25% to 1.42% in the first half of 2021. [9][10][11]

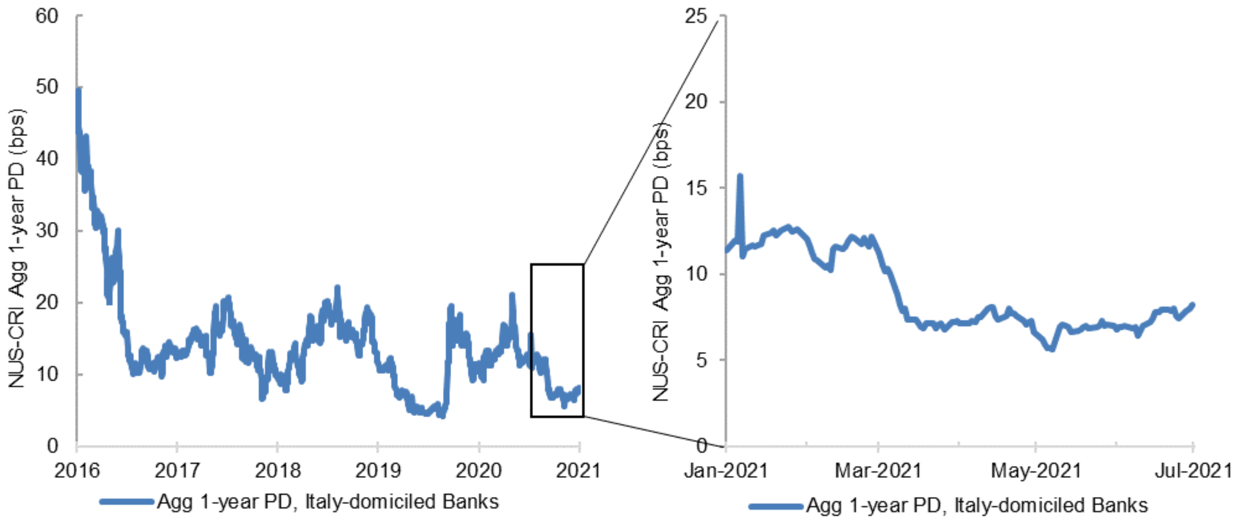
- Preliminary estimates for outstanding loans to non-financial institutions was EUR 677.6bn at the end of June 2021, from EUR 678.5bn at the end of December 2021. [12]

Sovereign Credit Ratings

- Moody's, S&P and Fitch maintained their ratings at Baa3, BBB and BBB- with a stable outlook respectively on Italy. [13]

Italian Banks

The NUS-CRI Aggregate 1-year Probability of Default (Agg PD) demonstrated an improvement in Italy-domiciled banks' credit profile in the first half of 2021. Italy-domiciled banks' improved their profitability in H1 2021 compared with the same period one year earlier, due to the low base effect and the economic recovery. Their asset quality remained stable as net NPL ratio remained at 2.0% since the end of last year.



Profitability

- Intesa Sanpaolo, Italy's largest bank, saw its net income increased by 17.8% to EUR 3bn in the first half of 2021 from EUR 2.6bn over the same period one year earlier. Net income of UniCredit, Italy's second-largest bank, rose to EUR 1.1bn, well above the market estimates of EUR 715.6mn. [14] [15]

Funding & Liquidity

- The long-term interest rate increased to 0.88% in June 2021, from 0.58% in December 2020. [16]
- The 12-month percentage change in deposits of funds by Italian residents was 9.2% at the end of May, while for the total deposits of non-residents, it was -8.0%.[17]
- Interest charged on loans to firms were 1.1% in May 2021, unchanged from Feb 2021. Interest rates of loans to households increased to 1.4%, from 1.3% in Feb 2021. [18]
- The Bank of Italy's liabilities towards Euro-area financial counterparties decreased from EUR 108bn in Feb 2021 to EUR 96bn in May 2021. [19]
- Italian bank liabilities towards the Euro system increased to EUR 448bn in May 2021, from EUR 374bn in Feb 2021. Capital and reserves decreased slightly to EUR 347bn in May 2021 from EUR 351 in Feb 2021.[20]
- According to the latest bank lending survey referring to Q1 2021, Italian banks reported that credit standards for new loans to businesses suggested a slight tightening, due to greater perceptions for risks. Credit standards for house purchase loans, however, remained unchanged. [21]

Asset Quality

- According to the Bank of Italy, in Q1 2021, the flow of new non-performing loans remained stable at a seasonally adjusted 1.1% on an annualized basis. The net NPL ratio remained unchanged at 2.0% from December 2020 to March 2021. The coverage ratio of Italian banks also decreased from 53.5% in December 2020 to 53.3% in March 2021.[22]

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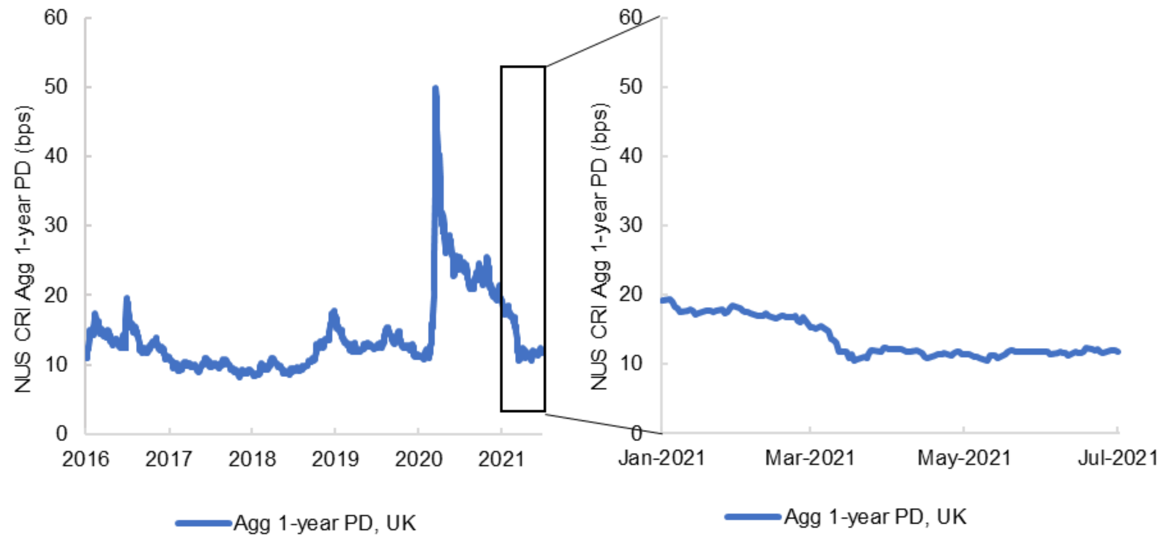
UK Companies

NUS-CRI Aggregate 1-year PD for companies domiciled in the UK decreased marginally in H1 2021. Though UK domiciled companies' saw a marginal decrease from 20bps to 12bps in H1 2021, this is in line with the quarterly GDP growth rate which showcased a decrease of 1.6% in Q1 2021 followed by 4.8% increase in Q2 2021. Household consumption increased by 4.06% in Q2 2021, after decreasing in Q1 by 2.64%. Services, production and construction output also increase in Q2 2021 driven by easing coronavirus restrictions.



Economy

- The UK economy grew in the first quarter of H1 2021 with QoQ GDP decreasing at 1.6% in Q1 2021 and increased by 4.8% in Q2 2021. These figures marked a gradual return of recovery from those witnessed during the initial impact of the pandemic, where Q1 and Q2 2020 growth rates were at -2.8% and -19.5% respectively.
- Unemployment rates in the UK have marginally decreased in H1 2021. In the March - May 2021 period, the employment rate increase by 0.1 percentage points and the unemployment rate concurrently dropped by 0.2 percentage points to 4.8%. As pandemic restrictions eased, total hours worked increased in Q2 2021, but remain below pre-pandemic levels. The furlough scheme introduced by the UK government continues to be in place and has potentially limited the severity of unemployment. However, the furlough scheme is set to expire in September 2021 adding uncertainty to the outlook as key sectors such as airlines, hospitality and tourism continue to be under pressure.[1] [2]
- The total trade deficit in the UK decreased dramatically from GBP 14.3bn in Q4 2020 to GBP 5.2 bn in Q2 2021. [34]
- UK Manufacturing PMI rose to 63.9 in June from 65.6 in May. Manufacturing production increased at stable rates in the consumer, intermediate, and investment goods industries. The improved demand came on the back of easing COVID-19 restrictions, economic re-opening, and improving global market conditions. However, supply chain difficulties have led to inflationary price pressures.[5,6]
- UK construction companies recorded an increase in business activity during June. The headline seasonally adjusted IHS Markit / CIPS UK Construction Total Activity Index recorded an increase to 66.3 in June 2021 from 64.2 in May 2021. Sharp increase was recorded in the construction sector causing a severe shortage of construction products leading to price inflation.[7]

Monetary

- The Monetary Policy Committee (MPC) voted to maintain the bank rate at 0.1% during their meeting on 22 June 2021. The Bank of England also decided to maintain the stock of sterling non-financial investment-grade corporate bond purchases at GDP 20bn, financed by the issuance of central bank reserves. The committee also decided to continue with its existing UK government bond purchases and maintained the target stock of government bonds at GBP 875bn. The MPC does not intend to tighten monetary policy until it sees significant signs of recovery, signalled by elimination of spare capacity and meeting the inflation target. As economic activity recovers, the central bank expects the spare capacity in the economy will be eliminated followed by a brief period of excess demand before the supply - demand balance stabilizes. MPC sets monetary policy to meet the 2% inflation target, in a way that helps to sustain growth and employment. [8]

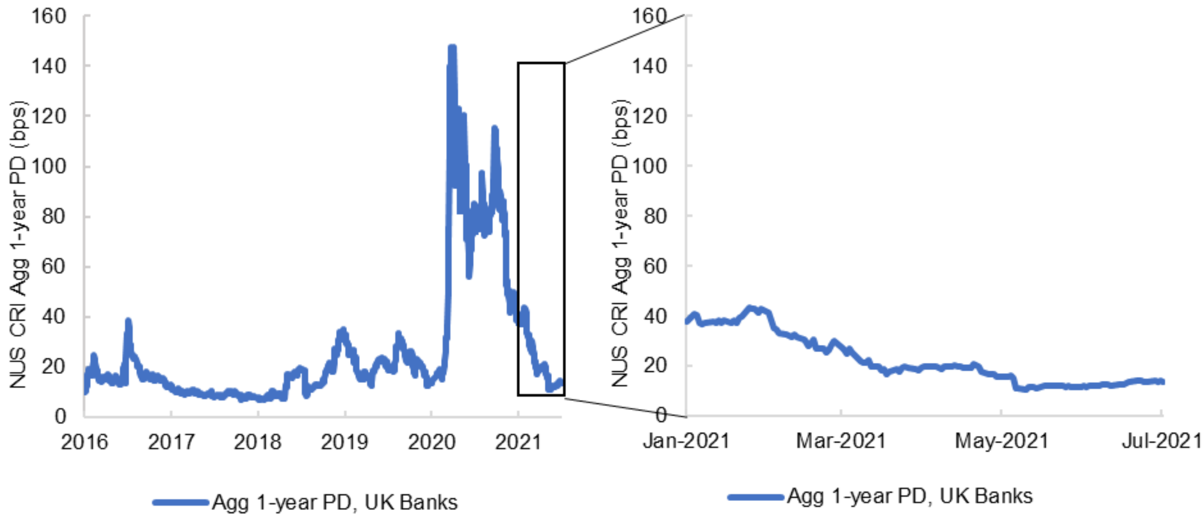
- The Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month inflation rate was 2.4% in June 2021, up from 2.1% in May 2021 and down from 0.6% in June 2020. The largest contribution to the CPIH 12-month inflation rate in December 2020 came from transport. [9]

Sovereign Credit Ratings

- On 18th June 2021, Fitch affirmed UK's rating at AA- with a stable outlook. The outlook reflects the resiliency in the UK economy and finances in the face of the pandemic. Higher adaptability of businesses, resilience in private consumption and investment contributed to the change in outlook. [10]

UK Banks

The NUS-CRI Aggregate 1-year PD for banks in the United Kingdom improved substantially in the first half of the year. We see the PD decreasing substantially from the high of 43bps in March 2021 to 10bps by the end of the year. Simultaneously, the FTSE 350 Banks Index also reach 2750.



Profitability

- Lloyds Banking Group's net interest margin (NIM) in Q2 2021 was 2.51%, marginally higher than Q1 2021 NIM value of 2.49%. Lloyds closed Q2 2021 with a net interest income of GBP 2741mn GBP 64mn higher than that in Q1 2021. This is driven primarily by strength in the bank's mortgage business and high quality growth in deposits reducing other funding needs.[11]
- NatWest Group reported an H1 2021 operating profit before tax of GBP 2,505mn, higher than operating loss of GBP 770mn in H1 2020. Improved economic conditions have prompted to release of GBP 869mn of expected credit loss reserves.[12]
- Standard Chartered's underlying profit before tax increased 37% YoY in 2021 to USD 2.6bn. Its income in 2021 was driven by improved loan impairments which offset the 5% YoY decrease in income.[13]

Funding and 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 of May 2021 (Q2). Total funding volumes were expected to decrease in the three months to end-August 2021 (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'– remained unchanged in Q2 and was expected to increase slightly in Q3[15]

Asset Quality

- The total write-offs of sterling-denominated loans decreased from GBP 1042mn on 31 March 2021 to GBP 968mn on 30 June 2021, due to write-offs to private non-financial corporates, which decreased from GBP 313mn to GBP 212mn. Non-financial loan write-offs to individuals also increased marginally from GBP 694mn to GBP 707 mn. [16]
- Write-offs on loans denominated in foreign currency decreased from GBP 262mn in Q4 2020 to GBP 27mn in Q1 2021, 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 248mn in Q4 2020 to GBP 22mn in Q1 2021.[17]

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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 80,000 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 over a 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.

For more information about the CRI project, please visit our main site at http://nuscri.org

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