



**Stories of the Week**

**Cyprus bailout: Deal reached in Eurogroup talks**

Eurozone leaders agreed on a EUR 10bn bailout to support Cyprus’ banking industry. Cyprus Popular Bank, the second largest bank in Cyprus, will be wound down and split into good and bad parts. Good assets and insured deposits will be folded into the Bank of Cyprus. Only deposits under EUR 100,000 at both banks will be fully guaranteed. Deposits above this level and bonds may face being wiped out at Cyprus Popular Bank. Bank of Cyprus will be recapitalized through a conversion of uninsured deposits into equity, as well as participation from shareholders and bondholders, who may see their stakes wiped out or converted to equity.

This significant restructuring program will raise EUR 5.8bn in new capital to adequately recapitalize Bank of Cyprus. The deposit tax to be levied on uninsured deposits at Bank of Cyprus will be resolved in the coming weeks. All Cypriot banks will remain closed until Thursday while the plan is implemented, with transaction limits likely for the near future.

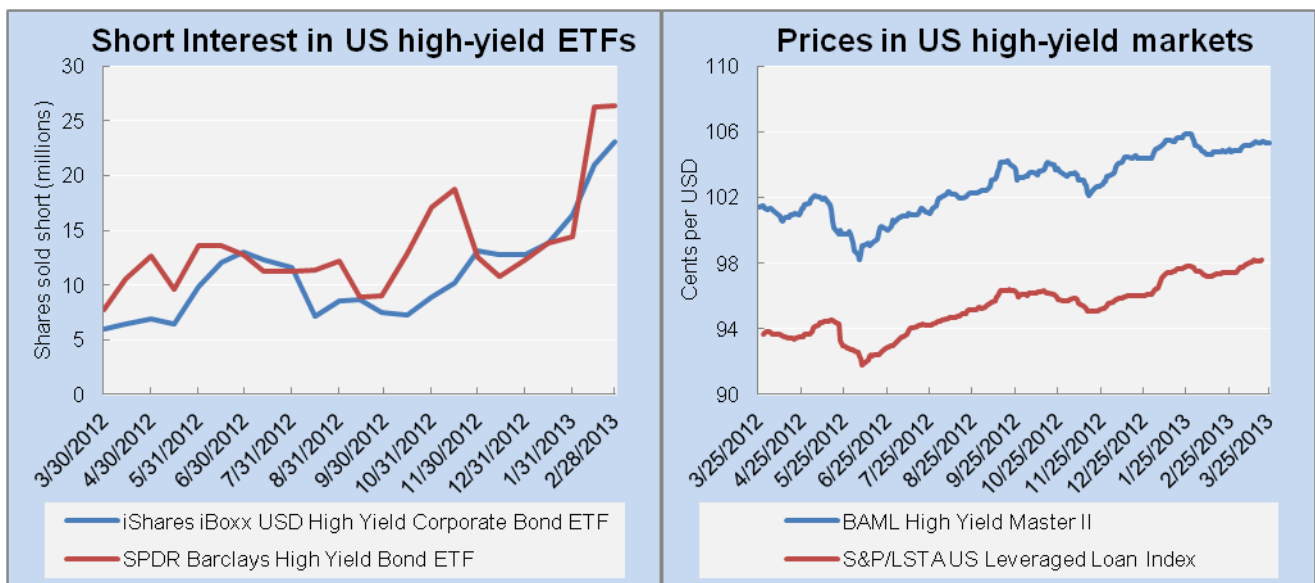
**Sources:**

- Eurogroup statement on Cyprus ([Eurogroup](#))
- Cyprus bailout: Banks to stay closed until Thursday ([BBC](#))

**US junk bond correction seen in ETF, CLO markets as credit risk increases**

A large increase in short interest in two major US junk-bond exchange traded funds (ETFs) over the last month shows investors are speculating on or hedging against a significant downwards correction in high-yield bond prices. US high yield credit markets may currently be overbought as the Fed continues its record low interest rate policy, with yield seeking behavior pushing up prices in high-yield markets.

Average prices in US high-yield markets remained high at 105.35 cents per USD on March 25, according to Bank of America Merrill Lynch index data, after falling in February from a record high of 105.9 cents per USD on January 25. The same data shows average junk bond yields reached a record low of 6.4% on March 22. However, short interest in ETF’s managed by BlackRock and State Street reached record highs on February 28 suggests investors are anticipating price erosion and higher yields in junk-bond markets. The short interest ratio of both ETF’s was well above 5 the same day, indicating bearish sentiment.



Moreover, it appears investors are increasingly turning to the leveraged loan market in the quest for yield. Issuance of collateralized loan obligations (CLOs), a market that collapsed during the global financial crisis, reached USD 7.4bn in March, up USD 900mn from February. Investors are increasing flows into CLOs that invest in leveraged loans, which typically rank higher in a borrower's capital structure than bonds, and are better protected from increasing interest rates as they are usually pegged to floating-rate benchmarks. This demand is seen in the S&P/LSTA US Leveraged Loan Index, which reached 98.27 on March 25, the highest level since July 2007.

However, as leverage in the system has increased, covenant protection in high-yield markets has weakened, increasing the risk of losses. US Federal bank regulatory agencies last week updated supervisory guidance on leveraged lending in an effort to address deteriorating underwriting standards in the face of increased volume. Moody's has also warned that covenants on junk-bonds have weakened. A measure of covenant strength on speculative-grade notes published by the rating agency, where 1 is the strongest and 5 is the weakest, was 3.96 in February, the weakest level since Moody's began tracking the data in January 2011.

#### Sources:

Debt flagged by fed bought by funds copying 2007 ([Bloomberg](#))

Traders short junk-bond ETFs as gains top 100% ([Bloomberg](#))

Agencies issue updated leveraged lending guidance ([FDIC](#))

#### In the News

##### IMF advises BNM to improve transparency, stay independent

**Mar 20.** The IMF and the World Bank released a report that said Bank Negara Malaysia (BNM) was not transparent enough in banking supervision, licensing and acquisition of banks. The Malaysian central bank has also been advised to maintain its independence from the Finance Ministry. Senior staff of the IMF and the World Bank prepared the report after they had recently completed a detailed review of Basel core principles for effective banking supervision in Malaysia. The report further recommended improvements in communications to banks, regulatory and legislative framework, and higher staffing levels in BNM. ([The Edge Malaysia](#))

##### Synthetic CDOs making comeback as yields juiced

**Mar 20.** Synthetic collateralized debt obligations, or pools of credit-default swaps that allow investors to make magnified bets on corporate debt, are on the rise once again as investors reach for yields in the current record-low yield environment. According to estimates from New York-based Citigroup Inc, banks have sold as much as USD 1bn of synthetic CDOs this year, following USD 2bn during 2012. So far, issuers like Citigroup have only pitched the synthetic deals to hedge funds and the deals do not come with credit ratings, unlike those created before the financial crisis in 2008. ([Bloomberg](#))

##### Li cutting wrist lifts rail costs most in 16 weeks: China credit

**Mar 20.** The borrowing costs for China Railway Corp rose the most in 16 weeks as investors recognized the greater risk of default following the separation of the now defunct Ministry of Railways into regulatory and operating entities. Debt of the state-owned enterprise had a yield of 3.95% last week, which was still lower than the 8.99% for similar-maturity notes of Indian Railway Finance Corp. While investors expect strong support from the government for China Railway, there are concerns over the former rail ministry's debt of USD 427.8bn and the fact that creditors no longer have legal recourse to the government. ([Bloomberg](#))

##### Gulf sukuk: Order books 'probably inflated'

**Mar 22.** Heavy bids in the primary bond and sukuk markets from the Gulf region are inflating prices dramatically. Institutional investors are bidding for larger amounts than actually desired in order to secure allocations in new issues. This has adversely affected the securities' performance in the secondary market, indicating that underlying demand is not as great as the order books suggest. Bond supply within the region has struggled to keep up with demand due to the excess levels of cash from high oil prices and solid economic growth. ([Arab News](#))

**High foreign shareholding in Malaysian government securities (MGS) a good sign but still a risk**

**Mar 22.** A Singapore-based resident representative of the IMF warned that although the significant rise in foreign holdings of MGS since the global financial crisis generally bodes well for the country, it remains a source of risk. Dr Ravi Balakrishnan said possible asset price imbalances and significant amount of outflows may arise if the trend of capital inflows continues, at a seminar on BNM governor's address on the Malaysian economy yesterday. According to Ravi, foreign shareholdings of MGS currently stand at about 25% and illustrate the stability of the Malaysian market. ([The Edge Malaysia](#))

**Hong Kong homes face 20% price drop as banks raise rates**

**Mar 22.** Skyrocketing Hong Kong property prices may finally show correction after several of the city's largest banks lifted mortgage rates by 25bps in response to tighter risk rules by the Hong Kong Monetary Authority. The government has also recently introduced other measures such as double stamp duty on property transactions, extra tax on home purchases, and more government housing, to cool the overheated home price. Deutsche Bank AG estimated that home prices could fall as much as 20% through 2015. ([Bloomberg](#))

**Gulf Islamic bank assets up 14.1% in 2012**

**Mar 20.** Islamic banking assets at commercial banks in the Gulf Cooperation Council (GCC) increased 14.1% year-on-year to reach USD 445bn at the end of 2012, and consultancy Ernst & Young (E&Y) predicted the outlook for the industry to remain relatively positive in 2013. The growth of Sharia-compliant assets in GCC was faster than the 8.1% growth of conventional bank assets but considerably lower than the five-year average of 19% across major Islamic finance markets. E&Y projected for global Islamic banking assets at commercial banks to exceed USD 2tn by 2015. ([Reuters](#))

**Kingdom's bank lending growth to remain above 10%** ([Arab News](#))

**Nominal value of sukuk listings on Dubai markets hits \$ 10.63 bn** ([Arab News](#))

**DMCC to launch sharia-compliant trading platform** ([Gulf News](#))

**Malaysia central bank sees steady 2013 growth, lingering global risks** ([Business Recorder](#))

**Private banks sell debt in worst quarter since '11: China credit** ([Bloomberg](#))

**UK banks urge government to broaden scope of lending program** ([Bloomberg](#))

**Repo rate cut not enough, complementary actions needed: C Rangarajan** ([Business Standard](#))

**Ireland's economy unexpectedly stagnates in Q4** ([Bloomberg](#))

**Spanish exports increased in January as euro economy stabilizes** ([Bloomberg](#))

**Economists see no crisis with US debt as economy gains** ([Bloomberg](#))

**Spain values Bankia shares at 1 euro-cent as debt swap looms** ([Bloomberg](#))

**UK moves closer to losing AAA at Fitch on debt concerns** ([Bloomberg](#))