



New stock trading connection improves the credit profiles of A-share listed companies by [Justin Hsiao](#)

The Shanghai-Hong Kong Stock Connect launched on Monday opens the doors of the Chinese mainland stock markets to ordinary global investors. On the first day of trading, global investors filled the daily USD 2.1bn quota allowed by the Chinese government for money flowing in Shanghai. Before the implementation, RMI 1-year Probability of Default (RMI 1-year PD) – a forecast of the likelihood of a company defaults over one year, noticed a gradually downtrend of default estimates of Shanghai listed companies (as shown in Figure 1), since the stock connect initiative was announced in April 2014.

The decline in PDs could be due to the global integration of China's capital market as the stock connect could be perceived as an improvement to market liquidity and corporate governance of Chinese companies. The market capitalization (market cap) of Shanghai Composite Index (SHCOMP) has climbed 17% this year and 5% last month to date, and it is expected to grow further after the link established between Shanghai and Hong Kong. Since Shanghai's largest companies' shares known as A-shares have long been out of favor due to its earlier restrictions on foreign investors. This connect will allow global investors to dwell in A-shares with the minimum restrictions. RMI aggregate 1-year Probability of Default (RMI aggregate 1-year PD) for the 931 companies that are domiciled and listed in Shanghai (SHCOMP) has been in a declining trend since the announcement of the link in April this year from 112.36 to 100.65 on Nov 17, 2014 - i.e. a 10% decrease.

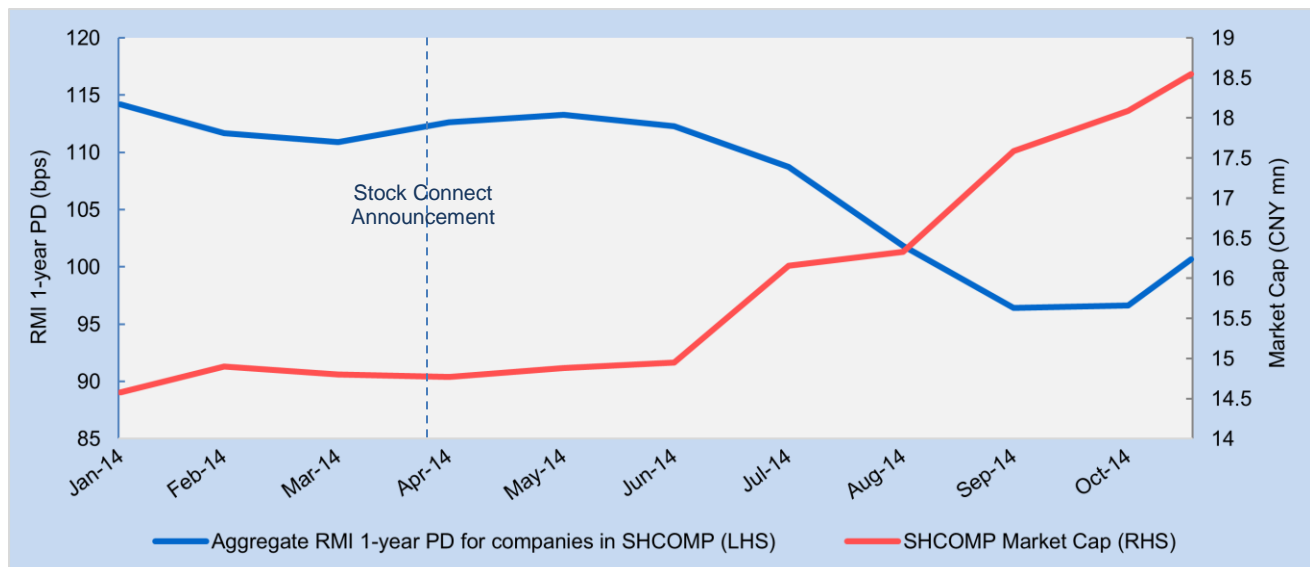


Figure 1: Market cap for SHCOMP and RMI aggregate 1-year PD for companies in SHCOMP (only include 931 companies both traded and domicile in China). Source: Risk Management Institute, Bloomberg

The linkage on Monday is a mutual market access scheme that allows the investors in Shanghai to invest eligible stocks in Hong Kong and vice versa. Beijing's move will benefit both stock exchanges and especially [the well-known largest listed companies](#) on both exchanges. Figure 2 (LHS) demonstrates the performance of RMI aggregate 1-year PDs for Shanghai Stock Exchange 50 A Share Index (SSE50) and Hang Seng Index (HSI), which gauge 50 most representative largest-listed companies on both exchanges. The performance indicator adopts January 2014 as reference point as described in the footnote of Figure 2. Both performances have improved this year, but the improvement of SSE50 is more significant, which has enhanced more than 30% this year.

The linkage of the two exchanges is seen to benefit investors with greater accessibility. This will also allow investors to compare prices of dual listed companies, which are listed in Shanghai and Hong Kong and decide which exchange to transact or to seek complex arbitraging opportunities. Figure 2 (RHS) shows the trading volume of HSI and SSE50 have both increased in recent months, but the improvement of SSE50 is far more than HSI- daily trading volume reached 13bn, which is a record high of all time, just one day after Beijing gave the connect a go-ahead on Nov 10.

Many analysts see the “Through Train” between SSE and HKEx will gradually change Hong Kong’s dominant position for foreign capital in Chinese capital market. And it is highly expected that the scheme will be expanded to Shenzhen Stock Exchange and will make China’s combined exchanges the biggest stock market in the world outside the US. All these moves show the determination of Chinese government to liberalize its market and make renminbi an international currency. However, [the strict capital controls remain](#).

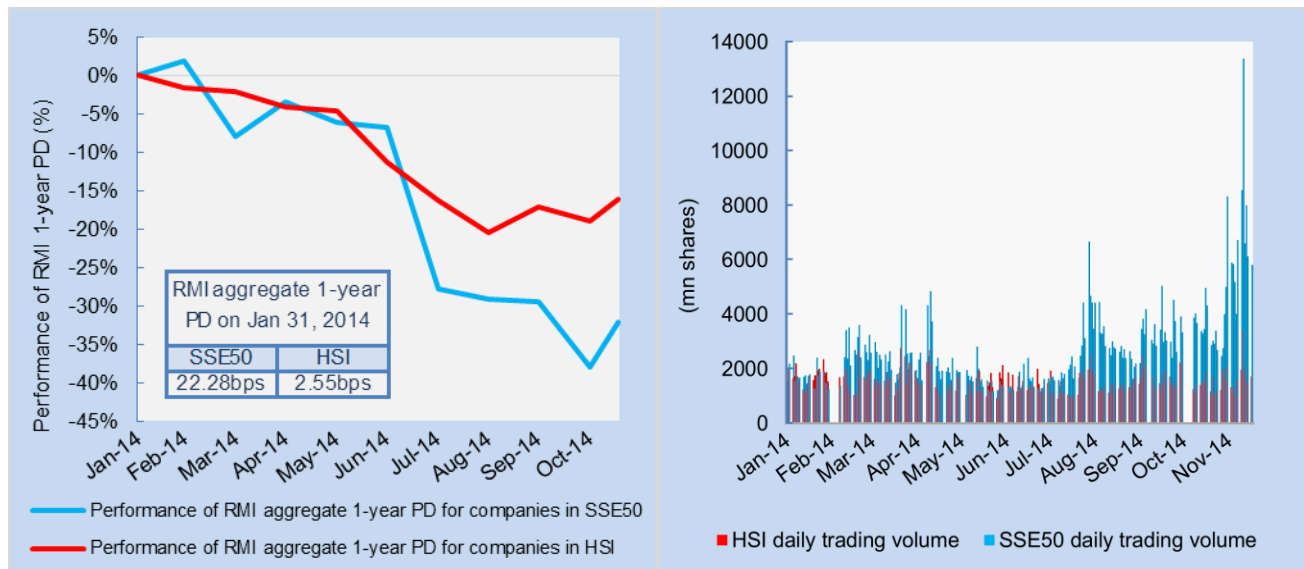


Figure 2: Performances of RMI aggregate 1-year PDs for companies in SSE50 and HSI (for SSE50, only include 41 companies traded and domicile in China; for HSI, only include 32 companies traded and domicile in HK; $Performance (\%) = \frac{Monthly\ RMI\ aggregate\ 1-year\ PD_t - Monthly\ RMI\ aggregate\ 1-year\ PD_{t-1}}{Average\ RMI\ aggregate\ 1-year\ PD\ for\ the\ past\ 5\ years}$) and daily trading volume of SSE50 and HSI. Source: Risk Management Institute, Bloomberg

Credit News

Market fears Venezuela’s socialist regime could default

Nov 17. Sovereign yields on Venezuela’s sovereign debt is among the highest in the world as investors are concerned that falling oil prices may damage the country’s ability to finance its bonds. Oil accounts for 95% of the nation’s exports and Venezuela only has USD 12bn of reserves, which is small given that the country has an annual economic output of USD 209bn. Two years ago, oil revenues were USD 77bn but have dropped to USD 51bn recently. The IMF projects that GDP will fall 3% this year and fiscal deficit will reach 14% of GDP. [\(FI\)](#)

Deutsche ends most CDS trade

Nov 17. Deutsche Bank AG said on 17 Nov, 2014 that it is sharply reducing its trading in credit-default swaps. The move marks a fresh retreat from a business that has been squeezed by broad changes in the markets, the global economy and investor risk-taking since 2008, including the Dodd-Frank regulatory overhaul. It is also a sign of how banks are paring back costly trading businesses amid tougher regulations and slower trading conditions that have impaired once-lucrative businesses. Deutsche Bank’s shift affects trading in swaps on individual sovereign issuers and US and European companies. [\(WSJ\)](#)

Japan's recession unlikely to slow US

Nov 17. Japan's slide back in recession is going to have little impact on US economy. Since only 4.1% of US exports go to Japan and those account for 1% of US's GDP. Besides, the falling yen against USD will makes Japanese goods less expensive in the US, which is a good signal to American consumers. However, Japan's recession still adds worries to the faltering growth of global economy. ([USAToday](#))

Gun manufacturer Colt warns of possible default

Nov 13. Colt Defense LLC warned that it may default on its November 17 USD 10.9mn payment to bondholders as the company is struggling with falling demand for firearms. The company is left with USD 1mn in its revolving credit facility and is expected to report a 50% decline in operating income in Q3, compared with earnings a year ago. At the same time, Colt is negotiating with existing creditors to amend its financing agreements. ([WSJ](#))

Argentina default settlement odds on leftover bonds surge ([Bloomberg](#))

Greek Bailout Review Stalls as Troika Demands Final Steps ([Bloomberg](#))

Regulatory Updates**ECB will not formally participate in banking inquiry**

Nov 17. ECB President Mario Draghi was defending the ECB's action during 2010 in response in Irish ministers, stating that the central bank need not be accountable to national parliaments. The ECB said that the level of support provided to the Irish banking system by the ECB had been extraordinary and defended its action to withdraw funds from the country's banking system in 2010. There are limits to which the euro system can provide to bank within the member states and the central bank had a duty to protect the interest of other countries which are providing the liquidity to Ireland. ([Irish Times](#))

Banking culture needs fundamental overhaul not fines

Nov 17. The Governor of the Bank of England, Mark Carney said that the banking industry requires structural changes which are needed to restore the public's trust in financial markets. Carney is asking lenders to reward staff in instruments other than cash. This was also suggested by US central banker Bill Dudley who asked bankers to be paid in performance bonds. Carney's comments come as banks face scrutiny of plans to claw back bonuses following the regulators' intent to fine traders for foreign exchange rigging. ([Guardian](#))

Nordea chief says bank regulation chokes small-business loans

Nov 16. The CEO of Nordea, the biggest lender in Nordic region, has said banking regulation is making it so difficult for small and medium sized companies (SMEs), which are often considered as the backbone of the EU economy, to get loans and has accused regulators of diverting scarce risk capital from entrepreneurs. ([FT](#))

Basel Committee on Banking Supervision updates progress on Basel III implementation ([BIS](#))

18 banks sign ISDA rules to delay swap termination rights ([Pensions & Investments](#))

30 firms placed under FX "remediation programme" ([RiskNet](#)) (Subscription Required)