



Falling Oil Price Hurts Petrobras amid Corruption Scandal

by Jiang Zhengyi

Petroleo Brasileiro Petrobras SA (Petrobras) is one the largest integrated oil producers in the world and is largely owned and controlled by the government of Brazil. The stock has fallen to the 52-week low of USD 4.60897 on Nov 17 from the highest of this year at USD 10.36401 on Sep 2, a decrease more than 50% this year. The company is not only hit by the government fuel subsidy as Petrobras foots the bill for selling fuel at below-market prices, but also plagued by alleged corruption scandal. The cost of Petrobras perceived creditworthiness is deteriorating as the alleged scandals send CDS to the widest level since 2009. Its RMI 5-year Actuarial Spread (RMI 5-year AS) shot up from 39bps to an all-time high of 73.59 bps (Nov 21, 2014) based on a 40% recovery rate. Unlike 5-year CDS or bond yield, the RMI AS is a pure measure of default risk, and is not influenced by risk premium and market liquidity, though they present similar trends.

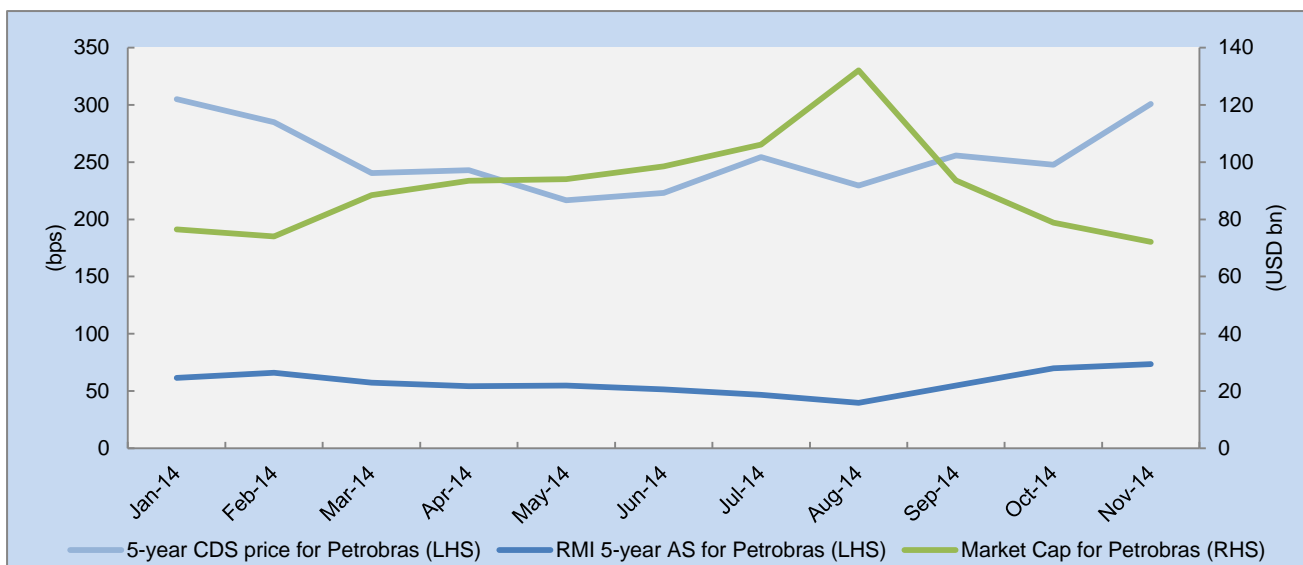


Figure 1: 5-year CDS price, RMI 5-year Actuarial Spread and market capitalization for Petrobras (5-year CDS on senior unsecured notes of Petrobras and versus their respectively RMI Actuarial Spread based on a 40% recovery rate. Note that they are USD-denominated instruments). Source: Risk Management Institute, Bloomberg

Figure 1 also shows the almost reversed trends between the market capitalization with 5-year CDS price and RMI 5-year Actuarial Spread respectively. Since August 2014, the 5-year CDS and AS have increased with a falling USD 6mn in assets of suspects in connection with a broad investigation into alleged embezzlement at Petrobras. Investment bank, Morgan Stanley noted that Petrobras could slash the value of the company's assets by USD 8.1bn after all the investigations.

Petrobras shares were also the target of a short selling interest in October. As of October 31, there was short interest totaling 93,559,567 shares, a growth of 148.7% from the October 15 total of 37,625,610 shares. Table 1 illustrates several analysts' recent comments on the stock. The market overall express a negative view to the prospect of Petrobras.

Analysts	From	To	Date
Bank of America	Buy Rating	Neutral Rating	Nov 14
Cowen and Company	Outperform	Market Perform	Nov 10
Goldman Sachs	Buy Rating	Neutral Rating	Oct 29
Credit Agricole	initiated coverage on shares	Buy Rating	Sep 17
8 equities research analysts	7 Hold and 1 Buy		Current Consensus

Table 1: 13 Changes of different analysts' recent opinions. Source: WKRBB News & Analysis

RMI 1-year PD forecasts the changing credit scenario of Petrobras. Figure 2 tracks the RMI 1-year PDs of Petrobras and aggregate PDs of Brazil's Oil&Gas sector. Since August 2014, right after the crude oil prices began to fall below USD 80 a barrel, Petrobras' fortunes didn't turn well and instead its RMI 1-year PD went up dramatically. The RMI aggregate 1-year PD of the entire Oil&Gas industry too went up, causing an overall deteriorating performance in the industry. The probe against potential scandals within the industry may even aggravate the credit situation.

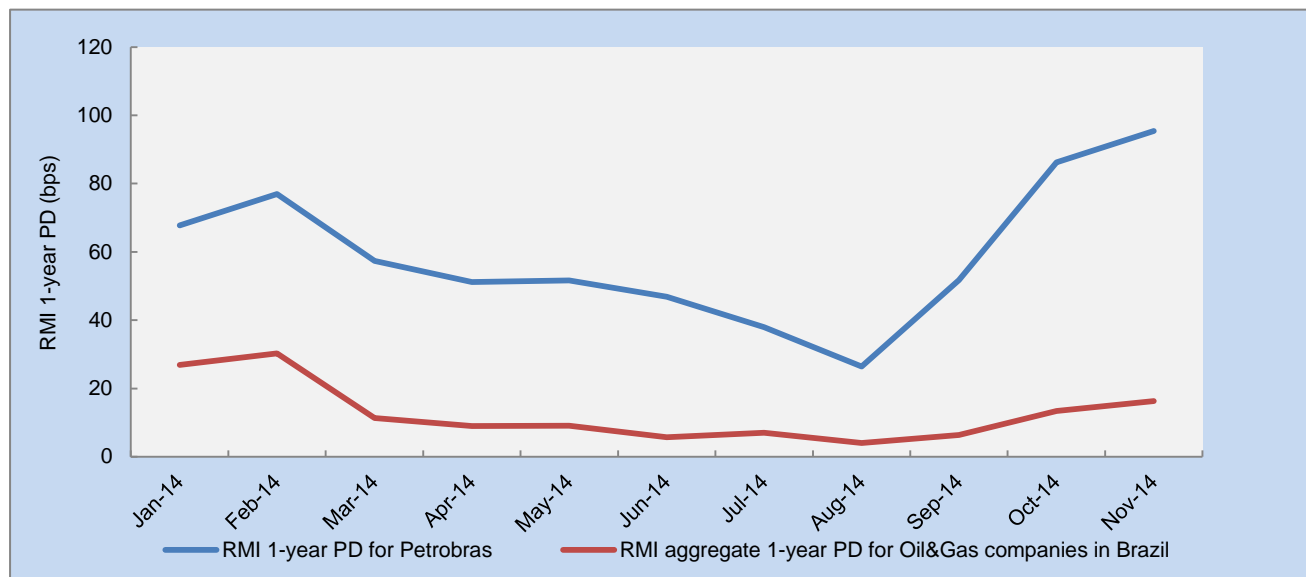


Figure 2: 1-year RMI PD of Petrobras and aggregate PDs of Brazil's Oil&Gas sector. Source: Risk Management Institute

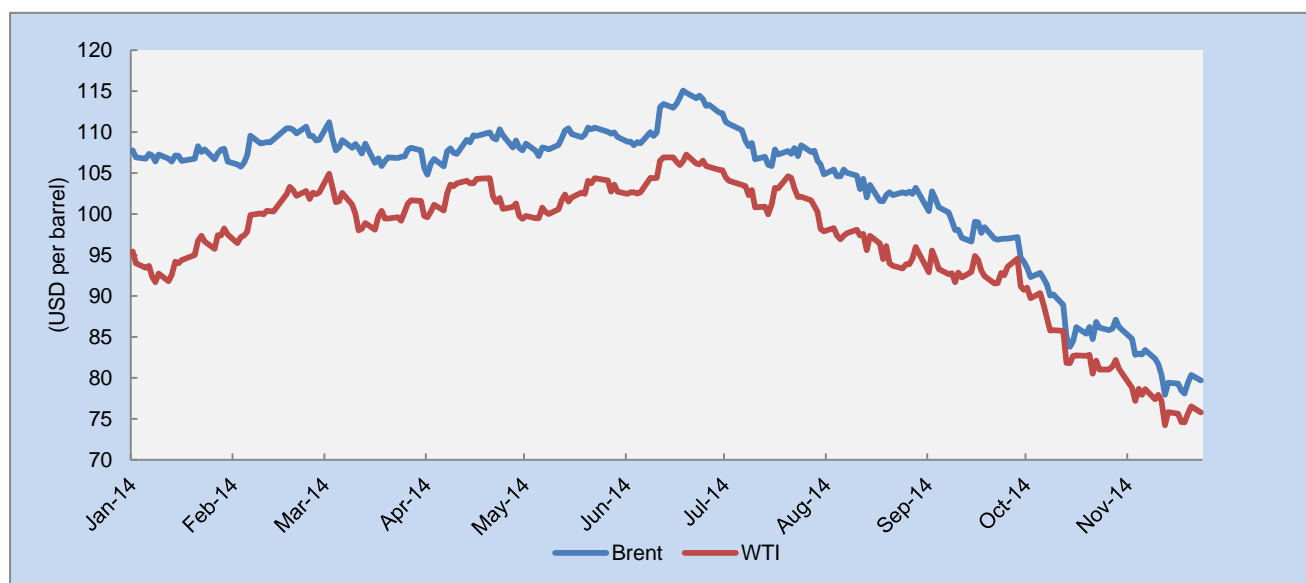


Figure 3: Generic 1st month roll-over Crude Oil, Brent and Generic 1st month roll-over Crude Oil, WTI Last Prices. Source: Bloomberg

The allegation on Petrobras is that the oil company's officials and contractors overinflated the cost of projects by millions of dollars and paid 3% commission to the ruling Workers' Party (WT) members and coalition partners. A probe by the Department of Justice may further impact Petrobras' financial statements.

In fact, the company has delayed the announcement of its third-quarter earnings.

Sources: [Petrobras scandal may change Brazil forever](#)
[Petrobras scandal: Brazil's energy giant under pressure](#)

Credit News

Bad loan jump targeted by surprise PBOC rate cut

Nov 24. The People's Bank of China reduced the one-year lending rate by 40bps to 5.6%, which is the first interest-rate cut since 2012. It is believed that China's move may be followed by the biggest jump in bad loans in nine years- Non-performing loans surged 10% last quarter, the most since 2005, and soured loans may rise further as real-estate prices slump and the economy slows. Five-year AAA bank bonds have slumped, widening their yield spread over the sovereign to 1.18 percentage points from a five-year low of 1 percentage point on Nov 14. ([Bloomberg](#))

Kinder Morgan sells USD 6bn of bonds for consolidation

Nov 24. Kinder Morgan Inc. sold USD 6bn of notes on Nov 24 to help fund the estimated USD 44bn consolidation of its oil-pipeline empire, propelling US corporate-bond sales to more than USD 1.48tn, just shy of the USD 1.49tn record set in 2013. ([Bloomberg](#))

Monetary policy divergence splits emerging market into 2 camps

Nov 24. A clear divergence in monetary policy is polarizing the emerging market. Some countries, such as China on Nov 21, have cut interest rates to invigorate demand while others, such as Russia and Brazil, have had to hike rate to battle inflation. ([FT](#))

109 Sears and Kmart stores now expected to close by early 2015

Nov 24. There are more cost-cutting at Sears Holdings though the end of this year and the beginning of next year. The total scale has increased to 39 Sears stores, and 70 Kmart stores, along with one Sears distribution center, one Kmart distribution center, and three Sears repair centers. ([Consumerist](#))

Abe sales tax backfiring with more debt not less ([Bloomberg](#))

Commerzbank to charge fees to biggest depositors ([BBC](#))

Regulatory Updates

FSB issues tighter banking standards

Nov 24. The Financial Stability Board (FSB) has issued a new policy on the adequacy of loss-absorbing and recapitalisation capacities for global systemically important banks. The standards will require banks to have the capacity to absorb a 20% fall in the value of their assets before resorting to help from the central bank. Before 2007, some banks had the capacity to endure a fall of just 2% in asset value. ([FTadvier](#))

Basel III may crimp corporates' local funding ability

Nov 24. Asian companies may find it more difficult to raise capital as Basel III capital rules force banks to reduce their holdings of high yield bonds. Spreads may widen as a result, making it more costly for money managers and companies to buy and sell bonds. Local currency bond sales in the last few years have been falling. USD 171.6bn debt was issued by Asian corporates this year, lower than USD 166.1bn in the same period in 2013 and USD 220.3bn in 2012. ([BusinessWeek](#))

Fed May Review Banks' Merchant-Banking Exemption

Nov 22. Federal Reserve Governor Daniel Tarullo said the central bank might review the merchant-banking exemption that lets banks invest in non-financial businesses on a temporary basis, including in commodities-related operations such as coal mines and warehouses for metal. ([Bloomberg](#))

Lawmakers lambaste New York Fed Chief for lax oversight important

Nov 21. The New York Fed has been accused of kowtowing to largest US banks during the financial crisis as senators question the Fed's independence for not stopping the bank's risky behaviour. Representatives of the Senate said that the Fed missed an opportunity to ferret out risk-taking in JP Morgan Chase & Co chief investment officer before it lost USD 6bn in the "London Whale" trading debacle. William Dudley, the New York Fed's President defended himself by stating that an internal Fed recommendation to examine the JP Morgan office did not reach his approval, and there was no conflict of interest or lack of oversight on his part. ([WSJ](#))

US Fed to review how it supervises major banks

Nov 20. The US Federal Reserve launched a review of how it oversees major banks on Nov 20, calling on its inspector general to help with the probe after a series of critical reports. The reviews will determine whether frontline supervisors and other officials at the regional Federal Reserve banks, as well as at the board level, "receive the information needed to ensure consistent and sound supervisory decisions," the Fed said in a press release. Several Fed regional banks are involved in supervising the country's 15 largest financial institutions, including Citigroup and Bank of America. ([Reuters](#))

BNP Paribas Said to Cut Most of Junk-Bond Trading Team in the US ([Bloomberg](#))

Osborne must solve regulatory riddle in bank salary move ([BusinessWeek](#))

EU stress tests show EUR14bn funding burden on Italy swaps ([Risk.Net](#)) (Subscription required)