RBSA Advisors

World Debt Crisis – Who is next?

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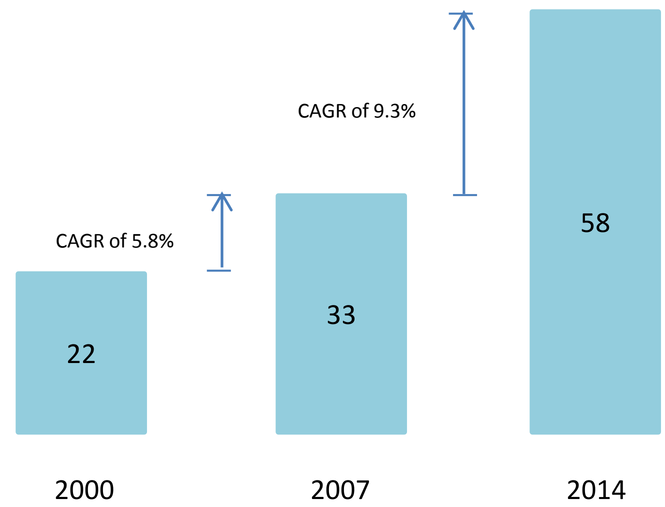
Introduction

Debt is an essential tool for every economy as it funds investments in infrastructure-a key ingredient for economic growth. But high debt levels often drags the economic growth and raises the risk of financial crisis and recession.

Governments across the world have borrowed heavily to finance the bailout during the financial crisis of 2007. Recession that followed the financial crisis was dealt with further borrowing to spur the artificial demand in the economy. Global government debt grew by 75%, from USD 33 trillion in 2007 to USD 58 trillion in 2014.

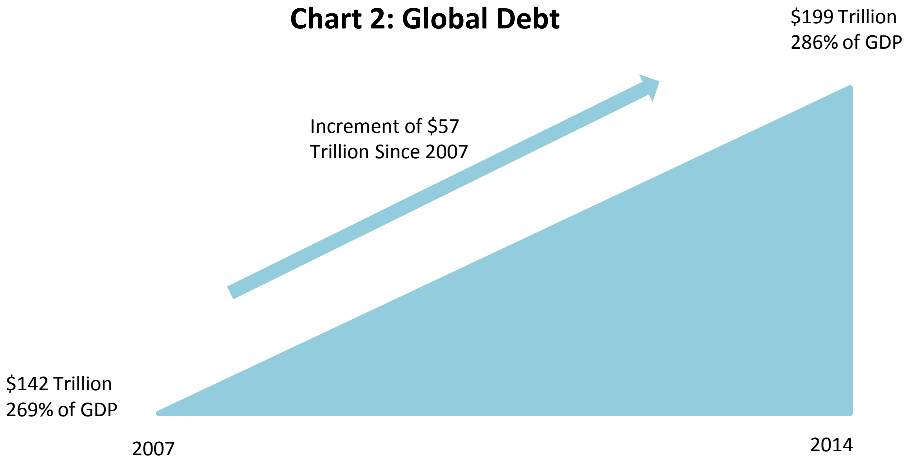
As per the IMF and McKinsey Global Institute data, the total global debt (Government debt, Corporate Debt, Household Debt) exceeds the total global debt by a wide margin. Total global nominal GDP was USD 77.609 trillion in year 2014 whereas total debt was approximately USD 199 trillion during the same period.

Chart 1: Government Debt (in USD Trillion)



Source: McKinsey Global Institute

Chart 2: Global Debt



Source: McKinsey Global Institute

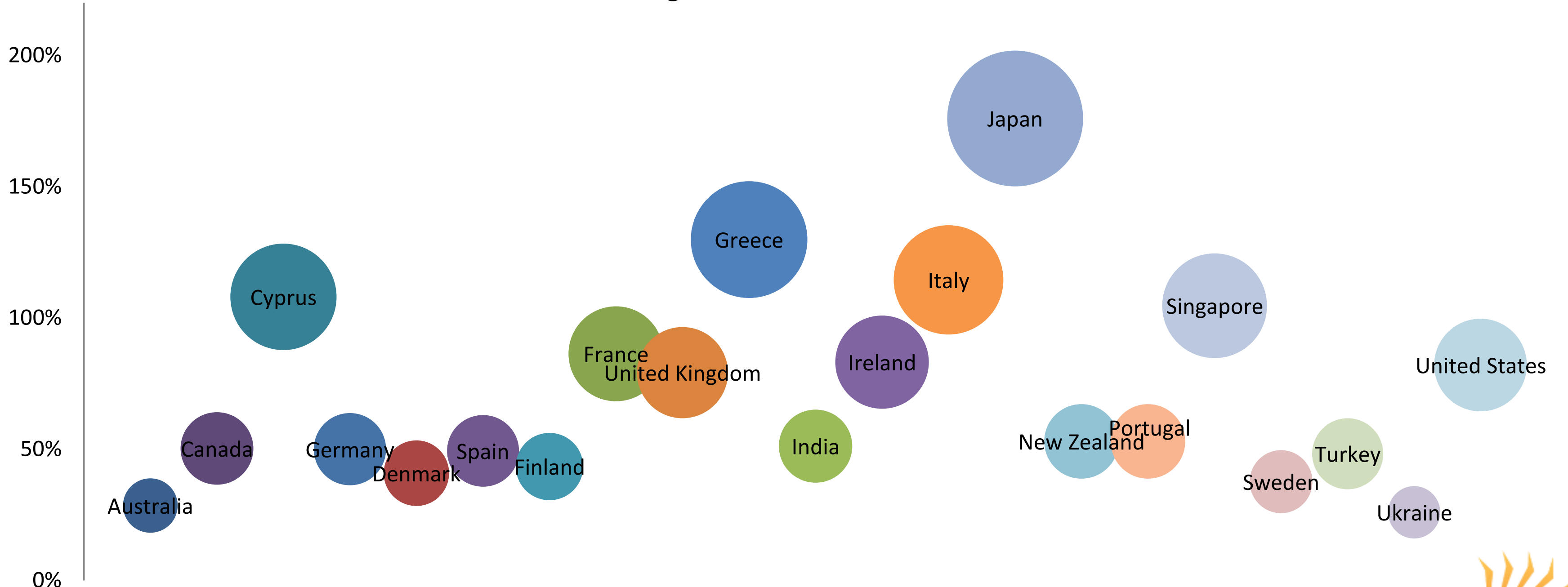
Total Debt which consist of government debt, corporate debt and household debt also increased by USD 57 trillion. From 2007 to 2014, total global debt increased from USD 142 trillion in 2007 to USD 199 trillion I 2014.

- As per the data shown in the chart below, most countries have ratio of government debt to GDP greater than 50% which indicates that the world as a whole is highly indebted.

- Japan, Greece, Italy, Cyprus, Singapore and Iceland are the few of major economies having more government debt than their annual GDP. Countries with strong macroeconomic fundamentals like Japan and Singapore do have ability to service their huge debt Singaporean and Japanese foreign currency debt is Aaa and A1, but same may not be true for other countries.

- Countries with weak macroeconomic fundamentals with huge quantum of debt like Greece, Italy, Cyprus and Iceland poses major risk to the sound functioning of entire global financial system. These countries have already defaulted in the recent past or are in serious financial troubles.

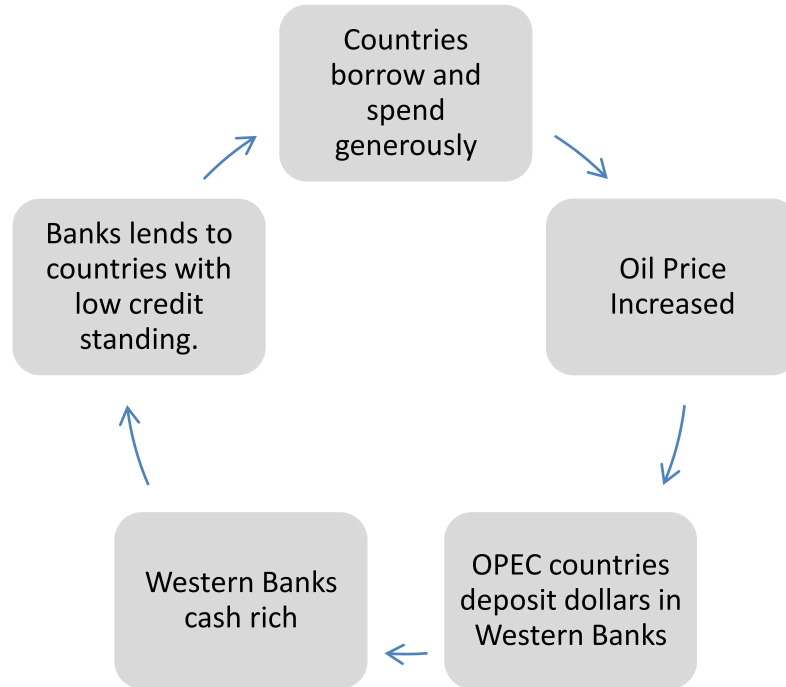
Chart 3: Percentage of Government Debt to GDP



Source: World Bank. Note: Data is average for the year 2008,2009,2010,2011,2012

Cause of Debt Crisis

When individuals become indebted and defaults, they are called bankrupt. Surprisingly, nowadays countries prominently are in news news because of bankruptcy than individuals.



Born in the USA

- In the 1960s the US Government had spent more money than it earned.
- To make up for this shortfall, the US abolished currency pegging to Gold and decided to print more dollars.
- Since the oil was priced in dollars, the money made by Oil producing nation from exports of oil now bought less.
- In 1973 the OPEC increased the price of Oil and made huge sum which they deposited in the Banks in West.
- As interest rates plummeted, the banks lent out the money fast, and turned to the Third World, whose economies were doing well but who wanted money to maintain development and meet the rising costs of oil.

Recipe for Disaster

- Banks lent generously and without much thought about how the money would be used or whether the recipients had the capacity to repay it.
- Third World governments, for their part, were pleased to take advantage of loans at very low interest rates - below the rate of inflation.
- As the Oil Price increased again, the poorest countries were caught in the trap, they borrowed more and had to become bankrupt since they had no major source of income.

When Mexico defaulted on its debt repayments in 1982 the whole international credit system was threatened.

The US and European banks got the support of the International Monetary Fund (IMF) for a scheme to spread out or reschedule the debts, so that the banks didn't lose money.

Historical Evidence of Sovereign Debt

- Debt securities issued by sovereign governments are commonly considered as risk free instruments as they are supposed to be free from default risk but historical evidence suggests that all mighty governments can and are defaulting on the debt issued by them.
- It is dangerous misadventure to presumed that sovereign debt instruments are absolutely risk free.
- Developing counties are most prone to sovereign defaults but developed countries also had defaulted on multiple occasions.
- United Kingdom, Germany, Austria, Russia, United States, Japan are among the developed counties who had defaulted on their sovereign credit.
- Nine countries which are classified as serial defaulters among developed countries have defaulted on sovereign debt on an average 3.1 times during 1814-2010
- Fifteen countries which are classified as serial defaulters among developing countries have defaulted on sovereign debt on an average 8 times during 1814-2010.

Table 1: Developing Economies - Serial Defaulters

Country	Number of Defaults (1814-2010)	External debt to GDP in % (1970-2010)
Brazil	9	30
Chile	9	54
Turkey	9	35
Venezuela	9	42
Mexico	8	35
Peru	8	49
Guatemala	7	25
Paraguay	7	33
Argentina	6	47
Average	8	54

Source: "Sovereign Debt Default: Are Countries Trapped by Their Own Default History?" by Vivian Norambuena, Georgetown University, USA

Table 2: Advance Economies - Serial Defaulters

Country	Number of Defaults (1814-2010)	External debt to GDP in % (1970-2010)
Spain	7	84
Austria	6	132
Portugal	6	128
Greece	5	85
Germany	3	99
Netherlands	1	185
Italy	1	79
Japan	1	34
United Kingdom	1	252
Average	3.1	119

Source: "Sovereign Debt Default: Are Countries Trapped by Their Own Default History?" by Vivian Norambuena, Georgetown University, USA

Ukraine

- Sovereign debt of Ukraine a central European country is rated as Ca by Moody's investors service which indicates extremely high credit risk.
- Ukraine 's GDP was $ 373.1 billion with annual growth of -6.5%. It's public debt to GDP ratio is 66.2% .
- Ukraine had import bills and external debt of $ 60.4 billion and $ 26.1 billion respectively against the foreign currency reserves of $ 18.37 billion.
- Escalating geopolitical tensions with Russia, higher external debts and import bills compared to foreign exchange reserves, contracting economy makes Ukraine extremely vulnerable to potential credit crisis.

Sovereign Credit Rating	Ca
Credit Risk	Extremely high credit risk
Public Debt to GDP	66.20%
Foreign Exchange Reserve ($ Bn)	18.37
External Debt ($ Bn)	26.1
GDP ($ Bn)	373.1
GDP Growth Rate	-6.50%
Imports ($ Bn)	60.4

Greece

Sovereign Credit Rating	Caa3
Credit Risk	Very high credit risk
Public Debt to GDP	174.50%
Foreign Exchange Reserve ($ Bn)	6.433
External Debt ($ Bn)	568.7
GDP ($ Bn)	284.3
GDP Growth Rate	0.60%
Imports ($ Bn)	62.8

- Sovereign debt of Greece is rated as Caa3 by Moody's investors service which indicates very high credit risk. Greece's GDP was $ 284.3 billion with annual growth of 0.6%. It's public debt to GDP ratio stood at 174.5% .
- Greece had import bills and external debt of $ 62.8 billion and $ 568.7 billion respectively against the foreign currency reserves of $ 6.433 billion.
- Higher public debt, Higher external debts and import bills coupled with very low foreign exchange reserves , negligible economic growth makes Greece extremely vulnerable to potential credit crisis.

Countries vulnerable to potential credit crisis

Venezuela

- Sovereign debt of Venezuela a South American country is rated as Caa3 by Moody's investors service which indicates very high credit risk.
- Venezuela's GDP was $ 545.7 billion with annual growth of -3%. It's public debt to GDP ratio stood at 51.4% .
- Venezuela`s import bills and external debt of $ 50.3 billion and $ 69.99 billion respectively against the foreign currency reserves of $ 20.2 billion.
- High dependency on energy exports, higher external debts and import bills compared to foreign exchange reserves, contracting economy makes Venezuela extremely vulnerable to potential credit crisis.

Sovereign Credit Rating	Caa3
Credit Risk	Very high credit risk
Public Debt to GDP	51.40%
Foreign Exchange Reserve ($ Bn)	20.2
External Debt ($ Bn)	69.66
GDP ($ Bn)	545.7
GDP Growth Rate	-3%
Imports ($ Bn)	50.3

Argentina

Sovereign Credit Rating	Caa1
Credit Risk	Very high credit risk
Public Debt to GDP	37.90%
Foreign Exchange Reserve ($ Bn)	26.6
External Debt ($ Bn)	115.7
GDP ($ Bn)	927.4
GDP Growth Rate	-1.70%
Imports ($ Bn)	65.9

- Sovereign debt of Argentina a South American country is rated as Caa1 by Moody's investors service which indicates very high credit risk.
- Argentina's GDP was $ 927.4 billion with annual growth of -1.7%. It's public debt to GDP ratio stood at 37.9% .
- Argentina had import bills and external debt of $ 65.9 billion and $ 115.7 billion respectively against the foreign currency reserves of $ 26.6 billion.
- Higher external debts and import bills compared to foreign exchange reserves, contracting economy makes Argentina extremely vulnerable to potential credit crisis.

Cyprus

- Sovereign debt of Cyprus an island nation is rated as B3 by Moody's investors service which indicates high credit risk. Cyprus's GDP was $ 25.04 billion with annual growth of -2.8%. It's public debt to GDP ratio stood at 107.5% .
- Cyprus had import bills and external debt of $ 6.8 billion and $ 95.28 billion respectively against the foreign currency reserves of $ 1.01 billion.
- Higher external debts and import bills compared to foreign exchange reserves, high public debt and contracting economy makes Cyprus extremely vulnerable to potential credit crisis

Sovereign Credit Rating	B3
Credit Risk	High credit risk
Public Debt to GDP	107.50%
Foreign Exchange Reserve ($ Bn)	1.01
External Debt ($ Bn)	95.28
GDP ($ Bn)	25.04
GDP Growth Rate	-2.80%
Imports ($ Bn)	6.8

Egypt

- Sovereign debt of Egypt an African country is rated as B3 by Moody's investors service which indicates high credit risk. Egypt's GDP was $ 945.4 billion with annual growth of 2.8%. It's public debt to GDP ratio stood at 93.8% .
- Egypt had import bills and external debt of $ 55.26 billion and $ 55.86 billion respectively against the foreign currency reserves of $ 15.3 billion.
- Unstable internal political situation, higher external debts and import bills compared to foreign exchange reserves, high public debt makes Egypt extremely vulnerable to potential credit crisis

Sovereign Credit Rating	B3
Credit Risk	High credit risk
Public Debt to GDP	93.80%
Foreign Exchange Reserve ($ Bn)	15.3
External Debt ($ Bn)	55.86
GDP ($ Bn)	945.4
GDP Growth Rate	2.20%
Imports ($ Bn)	55.26

Hungary

- Sovereign debt of Hungary an European country is rated as Ba1 by Moody's investors service which indicates substantial credit risk. Hungary's GDP was $ 239.9 billion with annual growth of 2.8%. It's public debt to GDP ratio stood at 78.2% .
- Hungary had import bills and external debt of $ 96.83 billion and $ 164.8 billion respectively against the foreign currency reserves of $ 44.8 billion.
- Slow economic recovery, higher external debts and import bills compared to foreign exchange reserves, high public debt makes Hungary extremely vulnerable to potential credit crisis.

Sovereign Credit Rating	Ba1
Credit Risk	Substantial credit risk
Public Debt to GDP	78.20%
Foreign Exchange Reserve ($ Bn)	44.8
External Debt ($ Bn)	164.8
GDP ($ Bn)	239.9
GDP Growth Rate	2.80%
Imports ($ Bn)	96.83

Paraguay

Sovereign Credit Rating	Ba1
Credit Risk	Substantial credit risk
Public Debt to GDP	18.40%
Foreign Exchange Reserve ($ Bn)	7.241
External Debt ($ Bn)	8.759
GDP ($ Bn)	57.87
GDP Growth Rate	4%
Imports ($ Bn)	12.37

- Sovereign debt of Paraguay a South American country is rated as Ba1 by Moody's investors service which indicates substantial credit risk. Paraguay's GDP was $ 57.87 billion with annual growth of 4%. It's public debt to GDP ratio stood at 18.4% .
- Paraguay had import bills and external debt of $ 12.37 billion and $ 8.759 billion respectively against the foreign currency reserves of $ 7.24 billion.
- Higher external debts and import bills compared to foreign exchange reserves, high public debt makes Venezuela extremely vulnerable to potential credit crisis.

Countries vulnerable to potential credit crisis

Portugal

- Sovereign debt of Portugal an European country is rated as Ba1 by Moody's investors service which indicates substantial credit risk. Portugal's GDP was $ 276 billion with annual growth of 0.9%. It's public debt to GDP ratio stood at 128.7% .
- Portugal had import bills and external debt of $ 76.11 billion and $ 508.3 billion respectively against the foreign currency reserves of $ 14.92 billion.
- Slow economic recovery, higher external debts and import bills compared to foreign exchange reserves, high public debt makes Portugal extremely vulnerable to potential credit crisis.

Sovereign Credit Rating	Ba1
Credit Risk	Substantial credit risk
Public Debt to GDP	128.70%
Foreign Exchange Reserve ($ Bn)	14.92
External Debt ($ Bn)	508.3
GDP ($ Bn)	276
GDP Growth Rate	0.90%
Imports ($ Bn)	76.11

Russia

Sovereign Credit Rating	Ba1
Credit Risk	Substantial credit risk
Public Debt to GDP	13.40%
Foreign Exchange Reserve ($ Bn)	385.5
External Debt ($ Bn)	683.6
GDP ($ Bn)	3568
GDP Growth Rate	0.50%
Imports ($ Bn)	323.9

- Sovereign debt of Russia is rated as Ba1 by Moody's investors service which indicates substantial credit risk. Russia's GDP was $ 3568 billion with annual growth of 0.5%. It's public debt to GDP ratio stood at 13.4% .
- Portugal had import bills and external debt of $ 323.9 billion and $ 683.5 billion respectively against the foreign currency reserves of $ 385.5 billion.
- Geopolitical issues Ukraine, International sanctions, lower energy prices, higher external debts and import bills compared to foreign exchange reserve makes Russia extremely vulnerable to potential credit crisis.

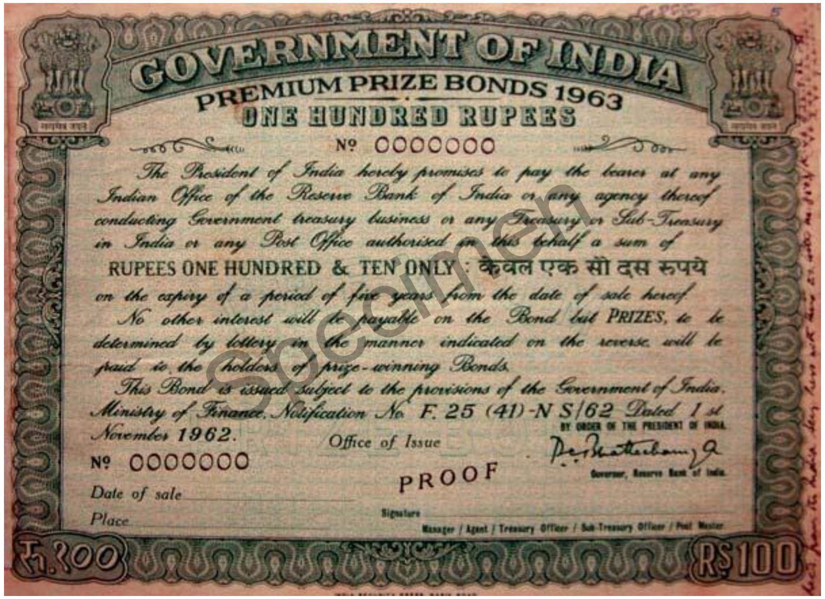
Source: CIA World Factbook, IMF
Note: Public Debt to GDP as on 2014. Foreign Exchange reserve for Greece as on Feb 15 and June 14 respectively, for rest of the countries it is as on Dec 14. External Debt for Greece, Cyprus, and Portugal is as on Sep 13, June 13, Dec 12 respectively, for rest of countries it is as on Dec 14. GDP data and Imports data as on 2014. Sovereign Credit Ratings and Credit Risk as given by Moody's Investor Service as on 1 July 2015. GDP as per purchasing power parity

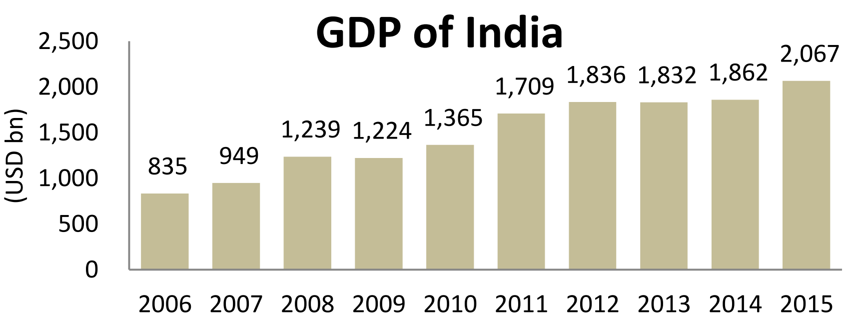
Can India Face a Greece Situation?

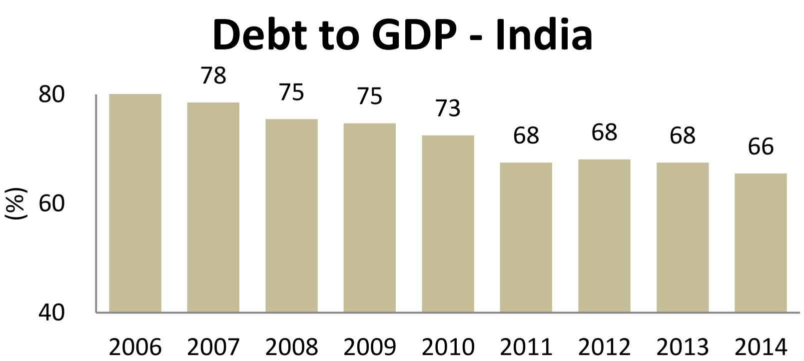
India has undertaken external debt restructuring in the past. However India will not be a situation of sovereign default in the near term.

- The total GDP of India in 2015 is USD 2066 Billion .
- As per Ministry of Finance , Government of Indian Government debt to GDP ration has steadily declined from 81% in 2006 to 65% in 2015 .
- External Debt : 425 USD Billion
- Indian Foreign Exchange reserves are at all time high of USD 354 Billion

With GDP of USD 2066 USD Million and the Foreign exchange reserve of USD 354 billion, India is relatively safe from any debt crisis in near future.







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Contact Us – RBSA Advisors (www.rbsa.in)

Research Analysts:

Nachiket Kadu
+91 22 6130 6062
nachiket.kadu@rbsa.in

Tushar Shinde
+91 22 6130 6068
Tushar.shinde@rbsa.in

INDIA OFFICES:

Mumbai Office:
21-23, T.V. Industrial Estate,
248-A, S.K. Ahire Marg, Off. Dr. A. B. Road,
Worli, Mumbai – 400 030
Tel : +91 22 6130 6000
Fax: +91 22 6130 6001

Delhi Office :
1108, Ashoka Estate,
24 Barakhambha Road,
New Delhi – 110 001
Tel : +91 11 2335 0635
+91 11 2335 0637 / 68

Bangalore Office:
Unit no. 104, 1st Floor,
Sufiya Elite, # 18, Cunningham Road,
Near Sigma Mall, Bangalore – 560 052
Tel: +91 80 4112 8593
+91 97435 50600

Ahmedabad Office:
912, Venus Atlantis Corporate Park,
Anand Nagar Rd, Prahaladnagar,
Ahmedabad – 380 015
Tel : +91 79 4050 6000
Fax : +91 79 4050 6001

Surat Office:
37, 3rd Floor, Meher Park, 'A',
Athwa Gate, Ring Road,
Surat – 395 001
Tel : +91 261 246 4491

Jaipur Office:
Karmayog, A-8, Metal Colony,
Sikar Road,
Jaipur – 302 023
Tel : +91 141 233 5892, 233 6138
Fax : +91 141 233 5279

OUR GLOBAL OFFICES:

Singapore Office:
17, Phillip Street , #05-01,
Grand Building,
Singapore - 048 695
Tel no: +65 3108 0250, 9420 9154

Dubai Office :
ABCN, P. O. Box 183125,
4th Floor, Block-B,
Business Village, Deira, Dubai
Tel : +971 4 230 6084
Fax : +971 4 230 6300