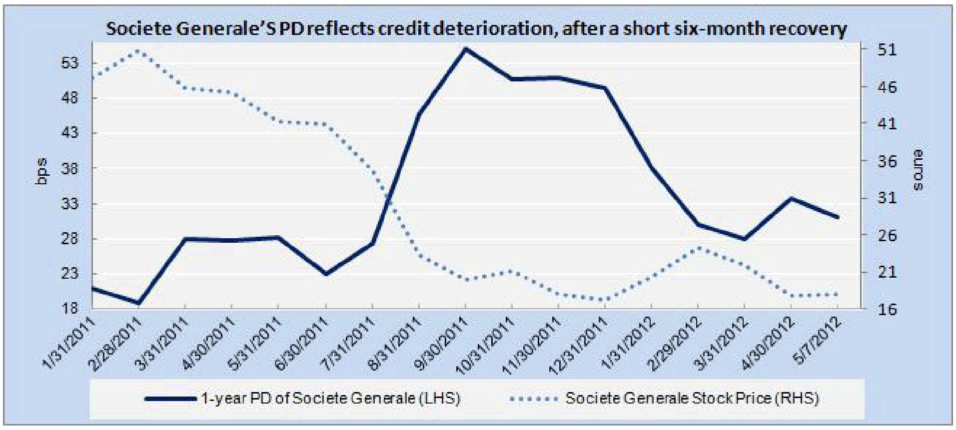
Story of the Week

Societe Generale: short-lived credit recovery

RMI CRI data indicates that the credit outlook for Societe Generale has deteriorated since March 2012, following a short six-month recovery. The RMI CRI one-year probability of default (PD) for Societe Generale rose to 31.1bps on May 7, from 28bps on March 31. The increase in the PD marked a renewed weakening in Societe Generale's credit outlook, after four consecutive quarters of sharp losses last year pushed its PD to record highs, since March 2009. The increase in Societe Generale's PD also reversed an improvement in the bank's credit outlook during Q1, when its PD fell from about 50bps to 28bps over the quarter. A worsened credit outlook for Societe Generale reflects a continued deterioration in its business performance. Released on May 3, Societe Generale's Q1 financial results revealed that its Q1 net income declined 20.1% YoY.



Gloomy outlook for profitability: As deleveraging continued at Societe Generale, the group's net banking income decreased 4.7% YoY in Q1 2012. Over the same period, its return on assets (ROA) declined by 2bps to 0.06%. On a consolidated basis, its Q1 2012 net income declined 20.1% YoY. Going forward, the bank's profitability will likely continue to be constrained by deleveraging; in its Q1 financial report, the bank announced that it intends to attain a core tier one capital ratio of between 9% and 9.5% by 2013, taking into account incoming calculation changes under Basel III.

Risks within domestic loan portfolios: Societe Generale's loan loss provisions for Q1 revealed increasing risks in its business portfolios. In Q1, total loss provisions at the group level rose by 2.7% to EUR 902mn from a year ago. The French Network, a core business segment of Societe Generale that contributed to as much as 45% of the bank's group net income in Q1, experienced a 13% increase in loan loss provisions. This reflected a worsened macroeconomic environment in France, where the unemployment rate soared to a 13-year high of 9.7% in February. Looking ahead, provisions could continue to rise at Societe Generale, as a sluggish French economy weighs on the outlook for the bank's domestic loan portfolio.

Six months of short-lived recovery: From the beginning of Q4 2011 till end-Q1 2012, Societe Generale's PD reflected credit improvement. During Q1 2012, the bank strengthened its cash position, taking advantage of the ECB's LTROs in December and February. At end-Q1 2012, its cash position of EUR52.4bn reflected a 119.2% YoY increase, and a 19.1% QoQ increase. Further, deleveraging boosted its core tier one capital ratio by 35bps to 9.4% at end-Q1 2012, from Q4 2011. In aggregate, these improvements eased investors' concerns, which were reflected in the small rally in its stock price in Q1 2012.

Sources:

May 3rd 2012 Quarterly Financial Information (Societe Generale)
May 5th 2011 Quarterly Financial Information (Societe Generale)
French banks progress on deleveraging (Reuters)

In the News
Tensions increased between the Fed and US banks; US banking reforms slowed **May 1.** Tensions are building up between the Federal Reserve (Fed) and large US banks around the March stress test and the Fed's proposed plans to reduce banks' systemic risks. In last week's feedback to US banks on the stress test, the Fed criticized some of the 19 participating banks for flaws in their processes related to the stress test. The identified problems included inappropriately marking down national house prices at the same rate, and making infeasible dividend plans under projected losses. US banks have been criticizing a lack of transparency in the Fed's stress test, and a Fed's proposed rule that caps a bank's exposure to its counterparty bank at 10% of its own credit risk. Meanwhile, one top Fed official voiced concern that US regulators have been slow in implementing banking regulatory reforms, citing that they

have missed 67% of rule-making deadlines for the Dodd Frank legislation, and delayed the enforcement of the Volker rule to 2014. (Bloomberg, The Washington Post)

Chancellor George Osborne blocks EU's Basel III rules
May 3. The British Chancellor George Osborne on May 3 blocked a European Union (EU) deal that would impose a minimum common equity ratio of 7% at EU banks by 2019. The blocking of the deal came after the British Chancellor's adamant opposition against adopting the capital requirements across the EU, which he criticized as being too low, lacking country-by-country variations and infringing on national sovereignty. Another discussion among European finance ministers has been scheduled on May 15, on which majority rotes could be sought by countries led by Germany and France to override Britain's opposition. (The Telegraph)

S&P Raises Greece's Credit Rating
May 2. Standard & Poor's on May 2 upgraded Greece's sovereign credit rating to CCC from SD (Selective Default), citing the reduction and improved maturity of the country's debt as a result of its distressed debt exchange in March. However the credit rating agency cautioned that Greece's persistent economic woes risk reducing the effectiveness of the country's deficit-reduction program, and its debt burden remained high. (WSJ)

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