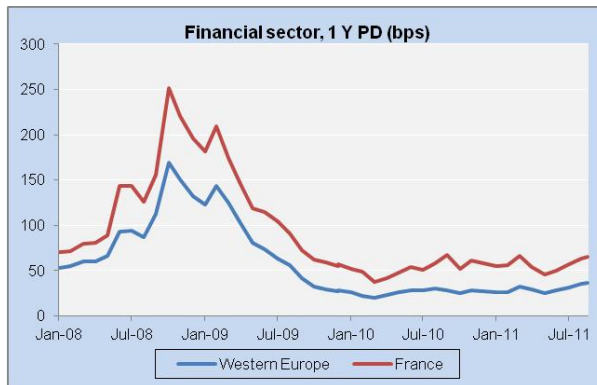


Story of the Week:

Policy makers act as the Eurozone debt crisis intensifies

In another week of the worsening Eurozone debt crisis, policy makers outside and within Europe agreed on a series of measures that aim to revive market confidence and forestall spillover effects from the sovereign debt crisis. The European Central bank(ECB), the Bank of England, the Swiss National Bank, the US Federal Reserve and the Bank of Japan agreed on a joint action to provide three-month US dollar loans to European banks starting from this October. The decision came amid Moody's decision to downgrade two of France's largest banks, Société Générale and Crédit Agricole last week. According to Moody's, the rating cut was based on its concern about these banks' funding challenges and Greek sovereign debt exposures. Based on RMI's default forecast model, the French financial sector's aggregate 1-year probability of default (PD) increased to 28.7bps on September 16, compared to 20bps recorded on May 31. Separately, governments of other heavily-indebted Eurozone countries such as Italy and Spain continued to face high bond yields in both the primary and secondary market last week.

European banks have been struggling with a shortage of US dollar liquidity in their traditional funding market, as US money market funds reduced their credit lines to the region. The acuteness of the funding problem had led European banks to turn to the ECB for US dollar funding. Two Eurozone banks borrowed \$575mln in the ECB's seven-day dollar tender at 1.1%, a rate much higher than the market rate of around 0.18% for the last week*. In the euro/dollar basis swap market, the three-month swap spread dropped to negative 112.53bps on September 12, the lowest since December 4, 2008*. This indicates that the banks were willing to pay high premiums to exchange euros for US dollars amid their US dollar funding pressures. Meanwhile, the three-month USD Libor rose to 0.35%, the highest level since August 18, 2010*. Eurozone banks are also facing increasing tensions in the euro funding market. The spread between three-month Euribor and Eonia, the gauge of strain in the euro interbank market, soared to 85.38 bps on September 12, the highest level since March 20, 2009*.



European banks' credit profiles on an aggregate level have come under heightened pressures from their funding difficulties. Despite the optimism brought about by the five central banks' decision, the funding relief may be insufficient. The European financial sector's aggregate 1-year PD increased to 36.7bps on September 16, higher than the 1-year PD reached at the end of every month since October 31, 2009.

Another supportive official decision is the one made by the European Union last Thursday to delay stricter rules controlling state aid for banks. This could benefit European banks as their governments are allowed more time to assist those in difficulties. On the sovereign debt front, the ECB's bond buying accelerated the week before the last to €14bn by mid-week. Besides, China has been approached by the Italian government for help. Brazil, Russia, India, China and South Africa will also meet this week to discuss the possibility of bailouts to the Eurozone.

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- [EU delays stricter bank state aid rules](#) (FT)
- [Dollar borrowing costs add to strain on European banks](#) (FT)
- [BRICs' to debate possible Eurozone aid](#) (FT)

Date	Country	Title	Summary
Sept 12, 2011	UK	Vickers plan shakes up City	The UK's Independent Commission on Banking on Monday released its report recommending a separation of banks' retail and investment banking operations. Banks' core operation such as retail and small business deposit activities, is required to have equity of about 10% of risk-weighted assets and an extra 10% of loss-absorbing debts. Furthermore, depositors will take precedence over creditors when banks enter financial distress. Such measures will cost the industry €4-7bn annually, but they will ensure a safer banking system by limiting

			<p>potential damages and cutting the risk of bank failures, according to Sir John Vicker, the commission's chairman. Critics, however, argue that higher capital requirements may hurt banks' global competitiveness, result in increased cost of borrowing for UK companies and hurt economic growth.</p> <p>Read more: Vickers plan shakes up City (FT) Just the facts: the Vickers report (FT)</p>
Sept 13, 2011	US.	Big US banks to be required to write 'living wills'	<p>The FDIC on Tuesday approved new rules requiring insured depository institutions with total assets of \$50bn or more to submit plans on an orderly liquidation process in the event of their failures. The plan includes two parts, the public and the private plan. The public plan describes an orderly liquidation process from investors' perspective, while the private plan requires reports disclosing sensitive information such as counterparty exposure and trade secrets, which is necessary for decision-making by regulators.</p> <p>The new rules are part of the Dodd-Frank Act passed in 2010, and intended to aid regulators in dealing with troubled banks during times of crisis. According to FDIC, the proposed plans are also required to ensure depositors' access to their insured deposits within one business day of their depository institutions' failure, minimize losses to be borne by creditors, and maximize return from institutions' asset sales.</p> <p>Read more: Big US banks to be required to write 'living wills' (CNBC)</p>
Sept 16, 2011	Europe	Euro bonds gain momentum, with limits	<p>The EC president José Manuel Barroso said on Wednesday that the commission would discuss the possibility of issuing euro bonds as a solution to the current sovereign debt crisis. This marked the first time such bonds received official consideration.</p> <p>Germany and other euro-zone members have been objecting to the jointly issued bonds. They are worried that the liabilities will weigh on the whole group if weaker economies fail to implement necessary budgetary controls, a requirement for shared debts. The proponents, on the other hand, believe the bonds at least provide some additional time to find a fundamental resolution to the deteriorating crisis. At the moment, officials remain wary of the proposal. The EC president noted that euro bonds cannot replace fiscal consolidation in Greece and other European countries.</p> <p>Read more: Euro bonds gain momentum, with limits (WSJ)</p>
Sept 14, 2011	China	Banking watchdog warns of P2P loan risk	<p>The China Banking Regulatory Commission (CBRC) issued a warning about rising peer-to-peer (P2P) lending activities, in which private loans between individuals are arranged online. P2P lending is risky because its intermediaries are not able to conduct proper checks on borrowers' credit worthiness. Furthermore, there are also technology risks due to its nature. CBRC cautioned that the loosely-supervised P2P lending may pose risks to the Chinese banking industry as people can leverage the money they borrow from banks and make P2P loans.</p> <p>P2P lending was first popularized in US but it has been growing rapidly in China in recent months due to China's tighter credit conditions.</p> <p>Read more: Banking watchdog warns of P2P loan risk (Xinhua) UPDATE: China Regulator Warns Of Peer-To-Peer Lending Risks - Report (WSJ)</p>
Sept 14, 2011	Japan	341 firms went bust due to disasters	<p>Credit research agency Teikoku Databank reported that the March earthquake and tsunami has caused 341 bankruptcies during the six months since March 11. The number of bankruptcies is 2.8 times the number following the Great Hanshin Earthquake in 1995.</p> <p>Only 8.2% of all bankrupted firms were directly affected by the natural disaster through physical damages. The rest of the firms went bankrupt due to indirect impacts of</p>

			<p>the disaster as many of them are apparel stores and restaurants hit by reduced consumer spending.</p> <p>As for Japanese public companies, there were two bankruptcies during the same period. Based on RMI's default forecast model, the aggregate 6-month PD for all Japanese public firms covered by RMI shot up from 11.61bps on March 9 to 17.18bps on March 15.</p> <p>Read more: 341 firms went bust due to disasters (Japan Times)</p>
Sept 14, 2011	China	China establishes 615 rural financial institutions by June	<p>CBRC reported that 615 rural financial institutions had been set up by June 2011, 369 out of which are new institutions located in the less developed central and western regions.</p> <p>CBRC also announced the plan for a further increase of 500 county and village level financial institutions within the year. CBRC has been using incentives such as lower operating capital requirements to encourage financial institutions to reach out to uncovered rural areas. The number of villages and towns without financial institutions has been reduced by 646 by June.</p> <p>Read more: China establishes 615 rural financial institutions by June (Xinhua)</p>