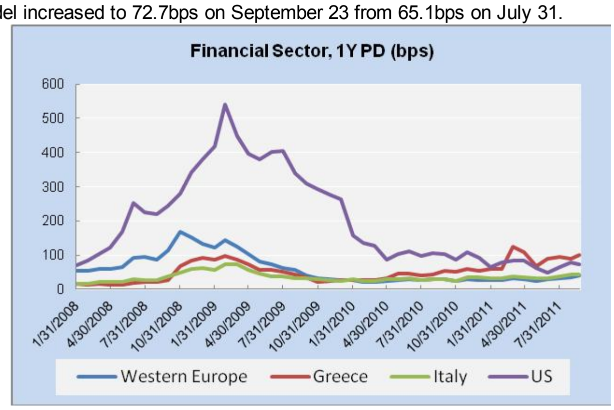
Weekly Credit Brief

Sep 18 – Sep 24, 2011

<u>Story of the Week:</u>

Banks on both sides of the Atlantic facing deepening challenges

A series of bank credit rating downgrades occurred on both sides of the Atlantic last week as pressures facing US and European banks intensified. In the US, the expectation of a lower probability of systemic support due to the Dodd-Frank Act enacted last July has led Moody's to downgrade the credit rating of Bank of America, Citigroup and Wells Fargo. This is Moody's follow-up action concluding its review of US's largest banks in June. JP Morgan Chase, the US's second largest bank, was not under the review due to its relatively healthy state in Moody's opinion. Pressures that have been confronting these banks also come from the faltering economy. The Fed's effort to reduce long-term interest rates by launching "Operation Twist" on September 21 is an indication of a sluggish US economic outlook. The move, which follows the Fed's August announcement that it would likely maintain low interest rates until mid-2013, is an unconventional one that includes buying $400bn of long-dated Treasuries while selling an equal amount of short-dated ones. Due to the increasingly negative sentiments for the economy, the US financial sector's aggregate 1-year probability of default (PD) based on RMI's default forecast model increased to 72.7bps on September 23 from 65.1bps on July 31.



In Europe, concerns about the impact of the worsening sovereign debt crisis on banks' financial strength increased. In Greece, officials are striving to get approvals for another €8bn loan payment in order to avert its problem in meeting obligations in pensions and salaries in October. Moody's revised down its forecast for Greece's economy and cut the credit ratings of eight Greek banks in line with its estimation of increased loan asset impairments, increasing weakness in their liquidity positions and capital levels. The Greek financial sector's aggregate 1-year PD soared to 100.9bps on September 23, among the highest ever PD level.

Italy's struggle with its frail economy, high debt levels and challenges facing a new austerity program caused S&P to reduce its forecast for Italy and cut the republic's credit rating by one notch to A on September 19. Following the rating cut, seven Italian banks, were downgraded by S&P. The rating cut is within market expectations on the grounds of their large holdings of Italy's sovereign debts which saw their shares tumbling since the start of this year. The Italian financial sector's aggregate 1-year PD was 42.1bps on September 23, compared to 30.7bps on January 31.

In the Eurozone as a whole, banks' funding and liquidity strain continued, accompanied by a deterioration of depositors' confidence in the banking sector's financial health. ECB's weekly tender on last Tuesday received bids from banks across the Eurozone, with the lending amounting to €201bn, the highest since February. In an example of increasing risk aversion, Siemens, the German industrial firm, transferred more than €0.5bn from a commercial bank to the ECB. The European financial sector's aggregate 1-year PD reached 40.6bps on September 23, near the highest levels since the end of 2009.

Read More:
Moody's downgrades big banks on changed US policy (Reuters)
Moody's may cut BofA, Citi, Wells ratings (Reuters)
Fed launches $400bn 'Operation Twist' (FT)
Athens fights to head off cash crunch (FT)
Moody's downgrades the ratings of Greek banks, concluding review initiated 25 July 2011 (Moody's)
S&P downgrades seven Italian banks (FT)
Italian downgrade stokes fears over Greece (FT)
Siemens shelters up to 6 billion euros at European Central Bank (Financialexpress)

Date	Country	Title	Summary
Sept 23, 2011	Europe	EU to speed recapitalization of smaller banks	European regulators aim to accelerate plans to recapitalize 16 EU banks that barely passed the bank stress test last summer in a bid to ease the market's concern over the health of Europe's banking system. The banks will be ordered to find additional capital by April 2012. While the private capital market is expected to be the primary funding source, it is also possible for those institutions to receive state aid. They were reported to have tier one capital ratios of 5 and 6%, compared to the passing rate of 5% of the stress test.

			The 16 banks include seven from Spain, two from Germany, Greece, and Portugal, and one each from Italy, Cyprus and Slovenia. Separately, Spain's official bank rescue fund, FROB, will nationalize three more savings banks before October with a cost of about €5bln but could give two others extra time to consolidate their capital. The move is a part of Spain's restructuring plan for institutional lenders that began earlier this year. **Read more:** EU to speed recapitalization of smaller banks (FT) Spanish lenders to be seized by Madrid (FT)
Sept 22, 2011	US.	Moody's Offers Upbeat View on Corporate Defaults	Moody's is expected to predict a low default rate in 2012 for US companies with the lowest credit ratings. Only 12% of the so-called "Bottom Rung", which includes companies with Moody's ratings of B3 and below, together with a negative outlook or a review for possible downgrade, are forecasted to default next year, compared to 47% during the financial crisis. According to the credit rating agency, those firms have taken advantage of the easy credit available in the last 2.5 years to refinance their debts and extend maturity dates to 2014 and later. They would, therefore, be able to weather a credit crunch should it happen. The number of such companies has shrunk to 170 on Sep 1, down from the last year's figure of 195. This is partly due to improved creditworthiness of some members in the list. Moody's predicts the overall default rate for companies with speculative ratings to be 2.2% in 2012, near the low level before the recent financial crisis. That could surge to 7.5%, however, if the U.S. economy experiences a recession. **Read more:** Moody's Offers Upbeat View on Corporate Defaults (WSJ)
Sept 19, 2011	Korea	7 more savings banks suspended	Korea's financial regulator suspended seven more savings banks including major players such as Tomato and Jeil because of their failures to meet capital adequacy ratio requirements. All the suspended banks except Jeil II had negative net assets, according to a press release from the regulator. Jeil II was suspended because its BIS capital adequacy ratio fell below 1% and on the fear of a bank run due to suspension of its parent company, Jeil. Investigations revealed that illegal loans have been made to major shareholders. Illegal loans in one of the savings bank involved 70% of its total assets. Jeil Saving Bank's 1-year PD has increased to 369bps on September 23 from 265.7bps on August 31. The other six suspended savings banks are not listed companies. **Read more:** 7 more savings banks suspended (the Korea Herald) Savings banks' massive illegal loans revealed (the Korea Herald)
Sept 22, 2011	China & India	Liquidity problems in Chinese and Indian real estate sectors	The Chinese banking regulator warned trust companies of risks in financing property developers, according to a recent Reuters report. This came after the shut-downs of real estate financing from state-owned banks and the international bond issuance market. It raised concerns about the liquidity and even solvency of China's property sector. Meanwhile, India's real estate sector faced similar liquidity problems. The debt burden for the sector increased to $24.6bn from $3.8bn in 2005. Given the current high interest rate environment and refinancing

			difficulty, the default risk could be high. Weak demand from home buyers due to high mortgage rate also worsened the situation. **Read more:** Funding fears hit Chinese property stocks (FT) India real estate faces cash crisis (FT)
Sept 21, 2011	Europe & US	Moody's upgrades ratings on repackaged loans	Moody's has recently upgraded its ratings on some Europe and US repackaged corporate loan obligations (CLOs) despite turbulent market conditions. In late 2009, Moody's increased the assumed stress of all CLOs by 30% and downgraded most of the CLOs it rated after receiving many criticisms about loose rating standards. However, after actual default rates on CLOs fell from 13.9% in 2009 to 3.2% in 2010 amid improved economic conditions, Moody's is now placing 80% of CLO deals on review for upgrades. **Read more:** Moody's upgrades ratings on repackaged loans (FT)
Sept 18, 2011	Global	Foreign credit growth risk to emerging markets	Based on a recent report by the Bank for International Settlements (BIS), the credit flow to the emerging economies driven by low interest rates in developed economies could pose significant risks to the emerging countries' economy and their policy to control credit growth. During recent times, dollar-denominated debt grows at a faster pace outside the US than within the US. Between early 2009 and 2011, dollar-denominated lending from US to foreign non-financial private borrowers increased by $1.1tr but bank deposits with foreign residents only increased by $363bn. Some Asian economies' central banks have been committed to tackle the potential problems resulting from this phenomenon. South Korea has conducted a stress test to assess the country's banks' ability to secure foreign liquidity under a financial emergency scenario. Philippines would increase its domestic to foreign borrowing split to 75:25 from 73:27 by selling more global peso notes and by conducting bond swaps. **Read more:** Foreign Credit Growth Risk for Emerging Markets: BIS (CNBC)
Sept 21, 2011	India	Credit Offtake Up 20.5 Percent During 12 Months to September 9	According to the Reserve Bank of India (RBI), bank loans extended by Indian banks grew 20.5% during the one-year period to September 9, although the RBI has increased key rates 12 times since March 2010 and projected that credit would grow at around 17 to 18%. In a July monetary review, RBI commented that recent monetary tightening would likely cause a slowdown in the country's credit growth. In mid-July, the credit growth fell below 19% compared to the previous year. However, credit growth picked up since August. **Read More:** Credit Offtake Up 20.5 Per Cent During 12 Months to September 9 (The Economic Times)
Sept 25, 2011	South Korea	S Korea's Sovereign Debt Index Deteriorates Further	South Korea's sovereign CDS spread reached 202bps and exceeded France's 197bps on Friday. As South Korea's CDS usually stayed 20 to 30bps below that of France, the recent surge implies that the market is losing confidence in the South Korean government's creditworthiness. South Korea's CDS spread soared amid its financial market's continuing turbulence due to investor's uneasiness about a possible contagion from the European debt crisis and the US's faltering economy. The recent months saw sharp declines in the Korean Won and its stock market index. Meanwhile, concerns have been raised about South Korea's banks' foreign

			liquidity as the Korean Won plummets and foreign investors' growing wariness have been causing large foreign capital outflows. The South Korean financial sector's 1-year PD has consistently stayed above 50bps since May, while it was below 40bps around the beginning of this year. **Read More:** S. Korea's Sovereign Debt Index Deteriorates Further (Yonhap News) Rating cuts of U.S., Italian lenders hit S. Korean financial markets (Yonhap News) South Korea to step up monitoring of markets (MarketWatch)