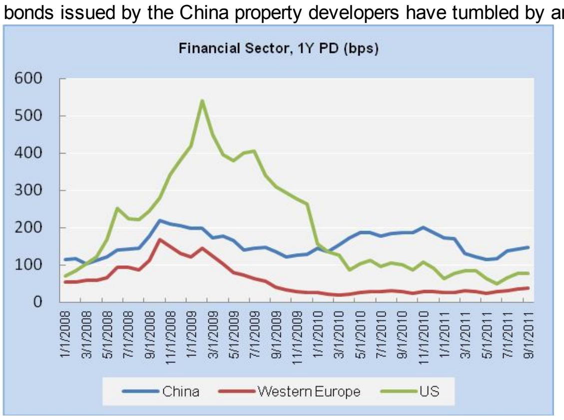
Story of the Week:

Chinese property and banking sectors face deteriorating credit outlook

China's property developers now face an increasingly severe credit outlook, according to a report released by S&P last week. Evidence is building that the developers may be struggling to meet their debt repayments, as they may be forced to cut prices under the tightening credit conditions and turn to costlier funding sources amid weakening sales in the current slowing economy. Property transactions started to fall this year after government tightened measures, including purchase limits in cities and higher down payment requirements for second homes. In September, property sales experienced a month-to-month drop of 13%, based on the data from SouFun, China's biggest real estate website. While most developers could withstand another 10% decline in property sales in 2012, according to S&P, more than half of the companies would face the risk of defaulting on their debt obligations with a fall of 30%. The developers are now paying as much as 25% interest to borrow from trust companies as banks reduce lending. However even access to the trust companies, seen as the country's fast-growing shadow banking system and the lender of last resort, may be turned off as the government told the trust companies this month to stop lending to certain developers.

The Chinese property developers' stocks and bonds have taken a hit this year with accelerating sell-off in recent weeks. The Chinese property stocks listed in Hong Kong have plunged by more than 40% year to date, and the prices of some $19 billion of bonds issued by the China property developers have tumbled by an average of 22% in the past two months. In particular, bonds of Evergrande Real Estate, the second biggest developer in China by sales, dropped to 73% last week from 109% at the beginning of the year, driving yield to a record high of 26%.



The Chinese property developers are not the only ones affected by a slide in China's property market. Chinese lenders are exposed to a potential drop in real estate prices after the government cracked down on speculative purchases and restricted new credits to developers. Investors worry that this could mean a rise in bad debts from the developers. It is expected that 25% of the 4tr yuan stimulus loans issued after the 2008 financial crisis are becoming due by the year-end when banks and borrowers will be seeking to refinance or restructure.

Under the coverage of financial firms in China by RMI-CRI, around 8% are commercial banks and about 68% are property developers. Based on RMI's default forecast model, the 1-year aggregate probability of default (PD) of China's listed financial firms is now higher than that of the Western Europe and US, at 148bps as of September 30 versus 39bps for Western Europe and 77bps for the US. The PD has been trending upward steadily since May this year, reflecting the rising credit risk in the Chinese financial sector.

Read more:

Chinese property boom starts to wobble (Financial Times)

S&P sees liquidity strain for China developers (Reuters)

Chinese stocks in Hong Kong cap worst quarterly loss since 1998 (Bloomberg)

S&P wary over China developers (Wall Street Journal)

China banks shunned as investors eye 2003 low in credit bust (Bloomberg)

Date	Country	Title	Summary
Sept 29, 2011	**China**	**China expands lending to fund-hungry small firms**	According to the China Banking Regulatory Commission, the outstanding loans to small companies reached 9.85tr yuan at the end of this July. The figure represents an annual growth rate of 26.6%, which is 10% higher than the Chinese banks' total outstanding loan growth over the same period. 2010 saw a comparable increase in China's SME lending at 29.3%. Despite a series of official liquidity-tightening measures and banks' reluctance to lend, China's credit expansion continued for small firms as China's government is trying to strike a good

			balance between growth and inflation control. Special operations have been put in place by more than 100 commercial banks as they are trying to relieve the small firms' funding difficulties. **Read more:** China expands lending to fund-hungry small firms (Xinhua) Growth of Chinese SME loans outpaces credit to large firms: central bank (Chinese Government's Official Web Portal)
Sept 29, 2011	**Global**	**Corporate debt sales slide to three-year low**	Global corporate bond sales fell to $456bn in the third quarter, the lowest level since the last quarter of 2008, amid the European sovereign debt crisis. For investment-grade companies, their average yields are about 20 to 30bps more than their existing debts, although the current yields are 13bps lower from the previous quarter due to lower benchmark interest rates. For junk bonds, total global issuance dropped by 73% to $29bn on a quarterly basis. In the UK, lending to private non-financial companies also fell by £2.7bn in August, a further deterioration from the previous month's £2.6bn drop and from the £1bn average reduction during the six months to July. Nevertheless, the market is now willing to lend to the healthiest companies. Nestle secured a €4bn one-year revolving credit facility, yielding only 10bps above the European interbank offered rate, the lowest spread since April 2007. **Read more:** Corporate debt sales slide to three-year low (FT) Nestlé loan highlights funding disparity (FT) Lending to companies falls sharply (FT)
Sept 26, 2011	**South Korea**	**More Korean companies incapable of repaying debt**	Data from the Bank of Korea showed that three out of ten listed Korean firms failed to pay the interests on their loans in the second quarter of 2011. 450 firms out of 1491 stated that their interest coverage ratios were below 100% in the second quarter this year, signaling that these companies' operating profits are not enough to repay the interests on their debts. Tough business conditions and credit tightening were the major factors for the downturn of Korean companies, especially the smaller firms. **Read more:** More Korean companies incapable of repaying debt (The Korea Herald)
Sept 26, 2011	Europe	Development of the European banks' liquidity and funding situation	The European banks are likely to see an extension in the ECB liquidity support as the ECB is expected to lengthen the expiry date of their 3-month unlimited loan provision from early next year to perhaps mid-2012. More supportive measures to reassure the market are also being speculated, which may include lowering the main policy rate and the overnight deposit rate.

			At the longer-term funding front, European banks' covered bond issuances are facing regulatory constraints as the banks have limited amount of safe assets which can serve as covered bond collaterals. Meanwhile, Deutsche Bank successfully sold €1.5bn senior unsecured bonds, signaling investors' continuing demand for large banks' debts. However, smaller banks are not expected to have similar level of investor confidence amid the deepening Eurozone debt crisis. **Read more:** ECB signals liquidity boost for banks (FT) European banks innovate with bonds to fill funding gap (FT) Deutsche ends a debt drought (WSJ)
Sept 28, 2011	**Europe**	**Development of the Eurozone sovereign debt crisis**	A group of seven European countries, led by Germany and Netherlands are demanding private investors to take larger haircuts on Greek sovereign debts. However, France and the ECB object the proposal for fear that renegotiation can trigger a share sell-off at banks with large holdings of Greek bonds. On the positive side, Greece passed a property-tax law, a key element of the required austerity measures. What's more, Germany has ratified an increase of the EFSF's (the European Financial Stability Facility) capacity, in a welcomed move expected to be able to remove big obstacles facing the Eurozone's fight to resolve the debt crisis. Separately, European policymakers are considering a permanent ban that prevents speculators from taking naked positions on sovereign debts. Some officials said buying CDS to bet against countries' creditworthiness inflated these countries' borrowing costs, while a report by the European Commission (EC) suggested that the accusation may be unjustified. **Read more:** Split opens over Greek bail-out terms (FT) Greece Passes Property-Tax Law, Clearing a Path for Additional Aid (WSJ) German parliament approves EFSF boost (FT) EU lawmakers approach 'naked' CDS ban (FT)
Sept 25, 2011	**US**	**US banks face losses on loan commitments**	US investment banks are expected to suffer losses from their financing commitments for private equity groups and other deals arranged before the recent market turmoil. This autumn will see concession sales of about $25bn loans and junk bonds amid investors' dampened appetite which can be largely attributed to the Fed's low interest rate policy and worries over US's feeble economy. Due to weak investors' demand, pricing for such kind of loans are low. For example, loans backed by a private equity group were priced at 92%. However, banks compared the current market condition favorably to the 08-09 financial crisis. Besides, they are carrying out such kind of sales to methodically

			remove the loans and junk bonds' risks from their books. **Read more:** US banks face losses on loan commitments (FT)
Sept 28, 2011	**France**	**Crédit Agricole seeks to slash debt by €50bn**	Crédit Agricole announced a €50bn debt reduction plan on Wednesday in an effort to ease the increasing concern over its access to the capital market. The bank will cut some of its investment and corporate banking and specialized financial services activities, while focusing more on its retail operations, which has lower capital requirement. The measures are similar to those of BNP Paribas and Société Générale. Moody's has placed BNP Paribas on review and downgraded Crédit Agricole and Société Générale as they had high exposure to Greece through both their Greek debt holdings and subsidiaries in the country. **Read more:** Crédit Agricole seeks to slash debt by €50bn (FT)
Sept 30, 2011	New Zealand	S&P, Fitch Downgrade New Zealand	S&P and Fitch Ratings downgraded New Zealand's credit rating from AA+ to AA on concern about the country's reconstruction cost burden following the two earlier earthquakes as well as its deteriorating external debt position. S&P worries about New Zealand's accumulating external debts, reliance on commodity incomes and fiscal pressures while Fitch is expecting a widening of the country's current account deficit. New Zealand's finance minister argued that the country's rating downgrade is more a reflection of the global condition than the country's individual situation. Moody's remains New Zealand's AAA rating with a stable outlook. **Read More:** S&P, Fitch Downgrade New Zealand (WSJ)

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