

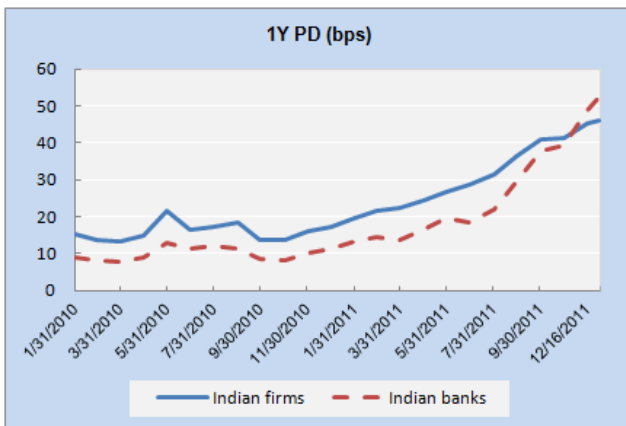
Story of the Week:

Indian firms' credit outlook downbeat as liquidity squeeze weighs

Indian banks in November registered the biggest increase in credit-default swap (CDS) rates among Asian banks, in the wake of a series of central bank inflation-controlling measures that have led to a slowdown in credit growth and increased borrowing costs. The 5-year CDS rate on debt issued by ICICI Bank soared 76bps to 471bps in November, while CDS rates for government-controlled State Bank of India rose 43bps to 361bps during the same period.

Borrowing costs have increased for Indian banks as the Reserve Bank of India (RBI) has increased the repo rate 13 times since early 2010, with the repo rate reaching 8.5% in October this year. Interbank borrowing costs have also risen, as the overnight interbank loan rate has increased 315bps to 8.65% so far this year. In a sign of liquidity pressures in the interbank market, Indian banks' daily borrowing from the RBI rose to an average of Rs745bn (\$14bn) for this quarter, compared to Rs438bn (\$8bn) in the previous quarter.

Concerns have been rising that India's tightening liquidity conditions and slowing economic growth could cause a surge in non-performing loans (NPLs) for Indian banks. Citing this concern, Moody's cut the outlook for India's banking system in November. State Bank of India experienced a surge in NPLs this year, increasing to 4.19% of total assets, from 3.35% of total assets in the previous year. The bank increased NPL provisions 35% during the same period.



Last Friday, the RBI decided to leave the repurchase rate unchanged at 8.5%, in a sign the central bank may have softened its stance to bolster a stalling economy. However, the general opinion of the Indian banking industry is that Friday's policy decision may not be sufficient to address slowing credit growth and high borrowing costs.

RMI's 1-year probability of default (PD) for Indian banks has been rising steadily from 9 bps after the RBI's first monetary tightening measure in January 2010,

reaching 52.2bps on December 16.

On an overall level, Indian firms are facing a worsening credit outlook due to the combined effect of a global economic downturn, a depreciating Rupee and a tightening in bank lending. In October, India's industrial output registered its first contraction since June 2009, highlighting the vulnerability of the Indian economy to a global slowdown. Meanwhile, the Rupee's depreciation is expected to cause rising interest expenses for Indian firms that have borrowed from overseas, to benefit from cheaper foreign interest rates. Indian firms with significant outstanding foreign loans will see their earnings being impaired, as the Rupee recorded a fall of over 12% in the past three months and hit a record low against the US dollar last week.

Ongoing high interest rates have stymied the domestic bond market, with Indian corporate bond issuance sliding to Rs50bn (\$934mn) for this December, recording the lowest amount in any December since 2007.

Indian firms' aggregate 1-year PD rose more than four times to 46.2bps on December 16, from a low of 9.2bps recorded in December 2009. Its PD registered a high of around 80bps at the peak of the 2008-09 global financial crisis.

Read More:

- [Cash Crunch Driving ICICI Risk Up by Most in Asia: India Credit](#) (Bloomberg)
- [RBI Leaves Interest Rates Unchanged](#) (WSJ)
- [No immediate respite, credit growth to be slow: Bankers](#) (Business Standard)
- [Bearish State Bank of India Bets at Record High on Bad Loans \(Bloomberg Businessweek\)](#)
- [India Industrial Output Shrinks for First Time Since June 2009](#) (WSJ)
- [Rupee fall: Overseas borrowing binge returns to haunt many companies](#) (The Economic Times)
- [Corporate bond sales hit 4-year low as interest rates peak](#) (The Economic Times)

Date	Country	Title	Summary
Dec 16, 2011	Europe	Credit rating agencies'	On December 16, Fitch revised the credit outlook of France to negative, and placed six European

		<p>decisions on European sovereign credit ratings and comment on EU summit</p>	<p>countries including Spain, Italy, Belgium, Slovenia, Ireland and Cyprus on "Rating Watch Negative". The decision means that the credit rating of France and the other six European countries could be downgraded by Fitch within two years, and three months, respectively. Separately, Moody's downgraded Belgium's credit rating by two notches to Aa3 from Aa1.</p> <p>In their rating watch statement Fitch expressed concern that despite EU efforts to forge a fiscal union at the recently concluded EU summit, the lack of a more active commitment by the ECB and a full solution may see the European debt crisis continue. Moody's highlighted worsening financial conditions, risks to economic growth, and the cost of bailing out Dexia in their downgrade of Belgium.</p> <p>Earlier on December 5, S&P placed the ratings of 15 eurozone countries on review for possible downgrade, including France and Germany.</p> <p>Read more: Fitch: Comprehensive euro zone deal "beyond reach" (Reuters) France's AAA Outlook Cut; Fitch Reviews Others (Bloomberg)</p>
Dec 13, 2011	Europe	Risk for €250bn of leveraged loans	<p>Europe could see more corporate defaults in the coming years as an estimated €250bn leveraged loans issued by smaller, indebted companies require refinancing between now and 2017. Currently, the major financing vehicles for leveraged loans are collateralized loan obligations (CLOs), most of which will have gone "static" by the end of 2012, so that no further trading is allowed and new loans cannot be financed. At the peak of the credit derivative market, CLOs bought two-thirds of the €166bn in leveraged loans issued during 2007, with banks providing the remaining financing.</p> <p>With a lack of investor demand and regulatory changes since the 2008-09 financial crisis, virtually no new CLOs have been structured in Europe to buy leveraged loans and European banks are not providing the same level of financing for leveraged loans.</p> <p>However, some market participants are hoping that CLO managers are going to extend the maturities of better leveraged loans in their portfolios.</p> <p>Read more: Risk for €250bn of leveraged loans (FT)</p>
Dec 15, 2011	Europe & the United States	European and US banks face difficulties amid European crisis	<p>Fitch Ratings cut long-term issuer ratings of major US and European banks, citing difficulties facing the banking industry amid global economic weakness and the European debt crisis. Notable names include Bank of America, Goldman Sachs, Citigroup, Credit Agricole and Danske Bank. Despite recent emergency measures by central banks to provide cheaper funding, non-European institutions are still reluctant to lend US dollars to European institutions on the shortest tenures. The three-month euro-dollar basis swap, an indicator of dollar-funding costs in the interbank market was minus 150bps on December 14, near the three-year low of minus 166bps. The 1-year aggregate PD for eurozone banks rose to 73.9bps on December 15 from a low near 21.9bps in February.</p> <p>Read more: BoFA, Goldman Sachs, Citigroup Credit Ratings Cut by Fitch (Bloomberg) Dollar Funding Pressures Intensify Despite ECB Lifelines (WSJ) Credit Agricole, Danske Bank Downgraded by Fitch After Review (Bloomberg)</p>

Dec 14, 2011	US	Dive in Deposits at Foreign-owned Banks in US	<p>In a sign of flight to safety by depositors, foreign-owned banks operating in the US experienced the biggest six-month decline in deposits on record, from the end of May to early December. According to the Fed, cash deposits at foreign owned banks fell for six consecutive months by 25% to \$879bn during the period, the first consecutive six-month period of reductions since 2002.</p> <p>Other factors may also be contributing to the decline in deposits. Foreign-owned banks are deliberately shrinking their balance sheets in order to improve capital ratios; they are also suffering in the certificates of deposit (CD) market as rates on the CDs have fallen in tandem with Treasury yields and have lost appeal to customers. Time deposits of more than \$100,000 at foreign banks has fallen more than 30% since late May.</p> <p>US domestic institutions are benefiting from their foreign competitors losing market share, enabling them to gain from US household deleveraging and associated deposit growth. Deposits at domestic US banks have increased by 10% this year, which could reduce long-term funding pressures on US banks, which are seen as an important benefit given the current market climate. US banks' 1-year aggregate PD was at 114bps on December 16, which is above the low in July this year of 85bps, but below the high of 157bps in March.</p> <p>Read more: Dive In Deposits At Foreign-Owned Banks in US (FT)</p>
Dec 12, 2011	US	Bank Credit Highest Since Before Lehman as US Growth Continues	<p>Credit provided by US banks is growing at the fastest pace since 2008, as commercial and industrial loans extended by US financial institutions increased almost 10% in the third quarter. The 10% increase contrasts with a 1.7% decline in loan supply over the past four years.</p> <p>The lending data suggests that the US economy may continue its momentum into next year. It also points to improvements in loan demand as more businesses are looking to expand, including investments in equipment and software. In addition, Fed officials are encouraging more lending for small business. The availability of loans to small businesses improved by more than 25% between March 2010 and October 2011.</p> <p>US firms' aggregate 1-year PD was 57bps on December 16, only 9bps higher than the PD recorded at the beginning of this quarter.</p> <p>Read More: Bank Credit Highest Since Before Lehman As US Growth Continues (Bloomberg)</p>
Dec 15, 2011	Sino-Forest	Sino-Forest nearing largest ever corporate default in Asian bond market	<p>Sino-Forest missed a \$9.78mn interest payment on its \$1.8bn convertible bonds that matures in 2016. It also breached a covenant under its bond indentures by missing a December 15 deadline of filing its third-quarter financial results. Sino-Forest does not expect to be able to file the results within the next 30 days, which will allow indenture trustees or bondholders to send a notice of default and force Sino-Forest into bankruptcy and result in the largest corporate default in the Asian bond market's history.</p> <p>Sino-Forest's four tranches of debts, maturing in 2013, 2014, 2016 and 2017 were all priced at about 25% of par value on Thursday, signaling that the market is expecting a default on these debts.</p> <p>Sino-Forest's looming default is under global spotlight, as Chinese firms have risen in prominence in global bond issuance, putting</p>

			<p>worldwide investors at stake. Sino-Forest's bond holders are concerned about heavy losses in either a liquidation or write-down outcome. A liquidation could likely result in little protection for foreign investors because proceeds from foreign debt issuance had been injected to the company in the form of equity and thereby place foreign bondholders in subordination to Chinese ones.</p> <p>The 1-year PD for Sino Forest rose to 186 bps on December 14, the day before it missed its interest payment, from a low of below 10bps in May. The company's share price has tumbled since June, when short-seller Muddy Waters Research accused Sino Forest of overstating its assets.</p> <p>Read more: Sino-Forest faces battle with bondholders (FT) Sino-Forest to default on debt payment (FT) Sino-Forest Investor Richard Chandler Calls for New Management (Bloomberg Businessweek) Major Sino-Forest Investor Urges CEO, Board Change (WSJ)</p>
Dec 12, 2011	Global	More banks turn to 'extendable' repo deals	<p>More banks have been using a nontraditional source of financing called "extendable repo" as more traditional financing channels become inaccessible or too expensive. In contrast with a typical repo agreement where the date for repurchase of assets is set, extendable repo agreements allow the date to be continuously renewed with the consent of both parties. This feature thereby enables the financing banks to access longer-term funding.</p> <p>The increasing use of extendable repos is considered to be banks' efforts to comply with new regulatory liquidity requirements. For example, UK has required banks to hold more long-term financing. However, some banks also suggest they are using extendable repos out of prudence.</p> <p>Extendable repos expose financing banks to certain risks, as there remains a possibility of cancellation or inability to renew the agreement in the event of market turmoil.</p> <p>Read more: More banks turn to 'extendable' repo deals (FT)</p>