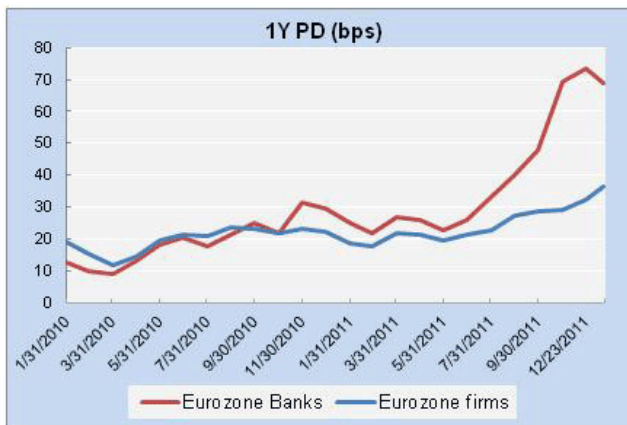


Story of the Week:

ECB's latest liquidity boost efforts face uncertainty

The European Central Bank (ECB) carried out its first three-year loan operation on December 21, in its latest attempt to avert a potential credit crunch across the eurozone. The new credit line was accessed by 523 banks in the region with a combined borrowing of €489bn for three years at 1%. By offering unlimited three year-loans at the cheap rate against eligible collateral, the ECB hoped to address tightening credit conditions in the banking system and the real economy. Nonetheless, banks may use much of the new funds to refinance maturing ECB loans, which means that the liquidity injected into the real economy may be lower than the ECB allotment. European banks have around €230bn of debt maturing in the first quarter of 2012, and more than €700bn before the end of 2012. On account of this, the credit outlook facing companies in the eurozone is likely to remain negative. RMI CRI's 1-year PD for eurozone companies continued to soar to 36.6bps on December 23, compared to a low of 11.8 bps in March 2010.

Furthermore, there were signs that liquidity in the interbank market could continue to be tight. Eurozone banks remained reluctant to lend to each other, and had deposited €346bn, the highest amount during 2011, at the ECB overnight deposit facility on December 22. Meanwhile, European banks may face increased competition for financing, as European governments and banks aim to raise significant amounts in the capital market in the next few months, when a large number of sovereign and bank bonds mature. In addition, in a sign of continuing risk aversion, US money market funds reduced their exposures to European banks to a new low of about a third of their total assets, down from 34.9% at the end of October. Between the end of October and the end of November, the 10 largest funds cut their short-term lending to European banks by 4% on a US dollar basis, according to Fitch Ratings. Faced with continuing downside risks, eurozone banks are likely to maintain a negative credit outlook, with their aggregate 1-year PD at 68.7bps on December 23. Although lower than November this year, its value is still high compared to a low of 9bps in February 2010.



The ECB's provision of 3-year loans has spurred speculation and hope that eurozone banks could make arbitrage profits by using cheap ECB financing to purchase relatively higher yielding government bonds, in a so-called carry trade. This may benefit troubled Eurozone governments, as it could increase bank purchases of peripheral sovereign bonds and reduce their cost of borrowing. However, European banks may avoid large scale participation, due to a lack of incentive, and ongoing concerns about the riskiness of troubled sovereign bonds.

Moreover, the IMF has failed to amass the funds set in the target of the December EU summit. Outlook over the resolution of the European sovereign debt crisis remains uncertain. Yields on Italian 10-year government bonds fell almost 10bps to 6.36% on the day after the ECB announced the operation on December 8. However, it rose 12bps to 6.91% on December 22 from December 21. The yields on comparable Spanish sovereign debts also increased by 8bps to 5.36% on December 22 from the previous day.

Read More:

- [ECB announces measures to support bank lending and money market activity](#) (European Central Bank)
- [ECB Lends Banks EU489B for Three Years. Exceeding Forecast](#) (Bloomberg)
- [European Banks Devour ECB Emergency Funds to Refinance Most Debt Due 2012](#) (Bloomberg)
- [Banks stash money with ECB](#) (Bloomberg Businessweek)
- [Europe could face "unprecedented" finance risk in early 2012](#) (Washington Post)
- [European Banks Rush to Grasp Lifeline](#) (WSJ)
- [US money funds cut lending to EU banks](#) (FT)
- [U.S. Money Fund Exposure and European Banks: Risk Aversion Increases](#) (Fitch Ratings)
- [EU fails to reach euro200 billion IMF loan target](#) (CNBC)

Date	Country	Title	Summary
Dec 21, 2011	Global	Banks come under tighter regulation	In an effort to standardize bank disclosure and improve the comparability of their capital adequacy across jurisdictions, the Basel Committee on Banking Supervision has proposed a new rule that would require banks to use a common global template to report their regulatory capital positions. Under the proposed rule, banks will have to disclose their list of capital items, and how some of them,

			<p>such as preference shares, will be phased out between now and 2018. However, this proposal does not address ongoing concerns about inconsistencies in the assignment of risk-weights.</p> <p>In addition, the Basel Committee began consultation with banks on December 21 on proposals that would prevent banks from performing so called "debt valuation" adjustments. These adjustments allow banks to book a profit on their own bonds and derivatives that fall in value, as they could potentially repurchase the liability at a reduced cost.</p> <p>In the US, the Fed on December 20 proposed rules that would require the largest US banks to hold more capital, or a cushion equal to 5% of assets. The proposal was well received, as it is less stringent than Basel III standards of 7% of capital plus a surcharge of up to 2.5%. Meanwhile, the UK government backed the banking sector 'ring fencing' overhaul, designed to segregate retail banking activities from riskier investment-banking businesses. The UK government estimates the cost of the 'ring fencing' overhaul for UK banks at between £3.5bn and £8bn.</p> <p>Read more: Banks face disclosure of capital position (FT) Bank regulators keen to strip out own debt swings (Reuters) Fed Proposes New Capital Rules for Banks (The New York Times) UK Backs Sweeping Bank Reforms (WSJ)</p>
Dec 20, 2011	UK	Consumer sector insolvencies set to soar	<p>The number of insolvencies in the UK consumer sector is expected to increase next year, under the weight of low consumer spending and higher input costs. Moreover, the sector may see the number of insolvencies exceeding the record reached in 2008. According to accountancy firm RSM Tenon, companies in food manufacturing, hospitality, tourism, and retail industries are at the forefront of the insolvency problem.</p> <p>Meanwhile, according to the UK head of restructuring at KPMG, the next four months are likely to see a large number of companies going into administration procedures or falling under creditors' control. Banks may have become less willing to extend refinancing, and may force sales onto their distressed borrowers. In addition, debt investors have been seeking control of distressed businesses through debt-for-equity swaps or pre-pack administration.</p> <p>There are also expected to be limited merger and acquisition opportunities to save businesses from administration, especially in the face of the European sovereign debt crisis. UK firms' significant pension deficit is another factor that dampens potential buyers' interest.</p> <p>Reflecting the worsening credit outlook facing the UK consumer sector, RMI CRI's aggregate 1-year PD for the UK consumer sectors (cyclical and non-cyclical) was 34.2bps on December 23, compared to a low near 19.3bps in January*.</p> <p>Read More: Consumer sector insolvencies set to soar (FT)</p>
Dec 21, 2011	UK	UK Companies To Treble Retail Bond Issue	<p>After the wholesale bond market became largely inaccessible during the second half of 2011, UK companies may increase borrowing from the retail bond market by issuing bonds to private investors. Research by Evolution Securities estimated that primary issuance of retail bonds by UK companies will exceed £3bn in 2012, more than triple the amount offered in 2011.</p>

			<p>Similar issuances would allow UK firms to diversify their funding sources, as corporate issuance to institutional investors in the wholesale markets fell by over 20% during the second half of 2011. Furthermore, alternative markets such as the retail bond market can offer low costs to companies raising funds, as UK companies have proven to be popular among private investors seeking higher yields than cash deposits.</p> <p>The potential for cheaper retail financing opportunities is likely to provide some uplift to UK companies' credit outlooks. However, UK firms' credit outlook remains negative amid the European debt crisis. RMI CRI's 1-year PD for UK companies rose to 32.6bps on December 23, compared to a low of 17bps in June this year.</p> <p>Read More: UK Companies To Treble Retail Bond Issue (FT)</p>
Dec 20, 2011	US	US watchdog eyes zero interest mortgage plan Article 11	<p>The Federal Housing Finance Agency (FHFA) is considering a 'principal paydown' plan, in which Fannie Mae and Freddie Mac will be asked to allow homeowners in Chapter 13 bankruptcy proceedings who have negative home equity to pay zero percent interest for five years.</p> <p>The US housing market currently has over \$700bn in negative home equity, and about 1.5mn borrowers have declared Chapter 13 bankruptcy since 2008, with home mortgages accounting for about half of all pending cases. The new plan could provide relief to bankrupt home owners and may be an effective solution to US housing woes. However, the plan could also impose significant costs on the financial community, such as banks and investors.</p> <p>Read more: US watchdog eyes zero interest mortgage plan (FT)</p>
Dec 20, 2011	US	S&P Downgrade Proves Absurd as Investors Prefer U.S. Assets	<p>Long-term US Treasuries returned 30% during 2011 according to Bloomberg/EFFAS indexes, the best performance among all government bonds in the world this year amid investors' flight to quality. Despite S&P's downgrade of US sovereign debt to AA+ from AAA in August, investor demand remained robust, with foreign holdings showing a notable increase of \$17.2bn between August and October. Non-US buyers presently own about 48% of US marketable debts, compared to 34% in December 2000.</p> <p>An increase in investor demand has pushed the cost of borrowing for the US government to record lows, with the average monthly yield on US 10-year notes reaching below 2% in November, the first time since 1950.</p> <p>The rise in investor demand has come as the US economy showed signs of strengthening. Compared to the eurozone, the US may also have an advantage due to its monetary autonomy in the eyes of investors.</p> <p>Read more: S&P Downgrade Proves Absurd as Investors Prefer U.S. Assets (Bloomberg)</p>

* The aggregate 1-year PD for the UK consumer sectors (cyclical and non-cyclical) were originally misstated as 342bps and 193bps, and have now been changed to the correct values.

