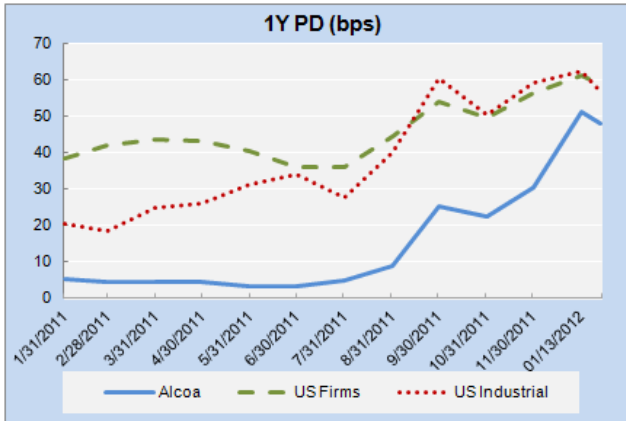


Story of the Week

S&P downgrades Eurozone sovereigns, as slower earnings growth weighs on US firms

In a sign that the European sovereign debt crisis is intensifying and spreading to core European countries, S&P cut the ratings of 9 eurozone sovereign governments on December 13. France and Austria were both downgraded to AA+, from AAA. Italy was downgraded two notches to BBB+ from A. Spain was also cut two notches to A from AA-, with Portuguese sovereign debt downgraded below investment grade, to BB from BBB-.

Impacts of the deepening European crisis also seem to have spread across the Atlantic. Uncertainty in Europe and the negative global economic outlook threatens to halt the double-digit earnings growth US firms had enjoyed over the last two years. Earnings for US firms grew the slowest in two years during Q4 2011 and are poised to ease further in the first quarter of 2012.



Average earnings growth estimates for members of the S&P 500 index have been revised downwards to 7.2% for Q4. S&P 500 companies enjoyed a 14.5% average growth in earnings in Q3. The deteriorating credit outlook for US firms was accentuated by lower earnings per share (EPS) ratio for S&P 500 companies. EPS forecasts for the first half of 2012 have decreased to \$106.6 per share, from \$120 in August. A deceleration in earning growth may translate into a more negative credit outlook facing US firms.

The RMI CRI's 1-Year aggregate probability of default (PD) for US firms rose to 58.8bps on January 13, from a low of 38.4bps last January. In line with the worsening credit outlook for US firms, Moody's reported that the number of credit rating downgrades for both investment grade and high yield US corporate has significantly exceeded the number of upgrades during Q4 2011.

The US industrial and manufacturing sectors were also affected by the global economic slowdown during Q4. The threat of a recession in Europe and slowing demand from China weakened revenue growth in the aforementioned sectors. The 1-year PD for the US industrial sector rose to 56.7bps on January 13, from a low of 20.2bps last January.

A number of US firms are restructuring and reducing costs to maintain profitability in a weakening global economy. Alcoa, the leading US producer of aluminium, last week announced that it would temporarily close 5% of its global smelting capacity in 2012, and permanently close 7% of operations which had already been in temporary shutdown. Smelting operations in Spain and Italy make up 42% of the curtailments. The 1-year PD for Alcoa has risen to 47.8bps on January 13 from a low of 5.04bps last January.

Read More:

- [Standard & Poor's Takes Various Rating Actions On 16 Eurozone Sovereign Governments](#) (S&P)
- [Earnings growth falters for S&P 500](#) (FT)
- [European risks softens US corporate credit ratings](#) (Moody's)
- [US industrials saddle up for bumpy 2012](#) (FT) [Alcoa: News Releases](#) (Alcoa Inc.)

Date	Economy	Title	Summary
Jan 8, 2012	Greece	Greek Bondholders Poised to Accept Higher Losses	<p>According to people involved in discussions about private sector involvement (PSI) in the restructuring of Greek sovereign debt, holders of Greek sovereign bonds will probably suffer a 55%-60% loss on the face value of their investments. The IMF and the Greek government both support a larger haircut than the 50% level originally agreed upon in October. Greek bondholders and members of the ECB have previously advocated scrapping the deal, as they believe it could increase contagion effects and market fears in the eurozone.</p> <p>For every Greek Bond held, investors are expected to receive 35% in new debt and 15% in cash. The term of the debt is likely to be 30 years, with the</p>

			<p>interest rate not yet decided, as it is the most contentious part of the deal. This could cause a net present value loss over 50%. Bondholders have requested that replacement bonds be issued under UK legal jurisdiction, to prevent the Greek government from retroactively changing the terms of the new debt.</p> <p>Read More: Greek Bondholders Poised to Accept Higher Losses (FT) Greek Debt Deal Talks: How Much of a 'Haircut'? (CNBC)</p>
Dec 12, 2011	Global	Basel and Volcker Developments	<p>Basel regulators have rejected industry calls for a delay or significant changes of the liquidity coverage ratio requirements. Banks would be required to adhere to a liquidity coverage ratio (LCR) by 2015, despite intense industry criticism that such a ruling could constrict lending, hinder economic growth, and render them vulnerable to sovereign problems. Banks must maintain the LCR above 100%, by maintaining a stock of high-quality liquid corporate and sovereign bonds, to match potential cash outflows over a 30 day period. Representatives of the financial industry contend that equities, securitizations and gold should also be included in the definition of high quality liquid assets. The regulations would allow banks to dip into their liquidity buffers during times of market stress.</p> <p>Potential changes in the definition of too-big-to-fail in Basel III could expand the reach of regulations to domestic lenders, clearing houses and insurers. Members of the Financial Stability Board, the supranational organization preparing Basel III, believe that these institutions pose systemic risk at least on a national level. The FSB believes MF Global's bankruptcy and the downfall of Dexia in October highlighted the need to extend regulatory coverage.</p> <p>Read More: Basel rejects delay to liquidity buffers (FT) Too-Big-to-Fail Definition May Be Expanded (Bloomberg) Japan and Canada warn on Volcker rule impact (FT)</p>
Jan 9, 2012	Europe and Taiwan	Bond market gains momentum as an alternative to bank funding	<p>As European banks face increased doubts over their creditworthiness amid the deepening European crisis, their roles as financing intermediaries are being challenged as the European bond market gains traction. In a growing trend called "disintermediation", European companies seeking credit are increasingly being driven to the bond market by banks, who have historically provided 80% of corporate financing in Europe through loans. In some situations, borrowing costs for non-financial companies in bond markets are lower than the cost of bank loans.</p> <p>Many companies are instead using banks as credit brokers to find investors for their bond issuances, providing banks with decent one time arrangement fees. This new trend could help banks meet new regulatory requirements. It allows banks to shrink their risk weighted assets, making it easier to meet new capital requirements. In addition, it could reduce European banks' need for short term financing, making it easier to meet reporting requirements under Basel III.</p> <p>A similar trend has emerged in Taiwan, as soaring funding costs for banks have reduced banks' willingness to lend. Higher loan costs for corporate borrowers have also increased the popularity of bonds. Syndicated loans in Taiwan dropped 28% to</p>

			<p>\$38.8bn in 2011 from \$53.9bn the previous year. Domestic company bond sales in Taiwan rose 33% to \$10.8bn last year from 2010.</p> <p>Read More: Companies get rid of the banking middleman (FT) Loans Slump As Highest Cost Since 2008 Send Taiwanese to Bonds (Bloomberg)</p>
Jan 9 th , 2012	China	China Lending, Money Supply Growth Exceed Economist Estimates in December	<p>China's new loans in December totaled \$101bn, the highest monthly figure since April, and the money supply rose 13.6%, exceeding estimates by economists. Forecasting a difficult 2012 for the global economy, the People's Bank of China (PBOC) may further ease liquidity in the Chinese money market, after it reduced the amount banks must hold in reserves in December and freed up an estimated \$61bn for banks to lend. Experts expect another reserve ratio cut in the first quarter. The PBOC stated on January 9 it will continue a conservative monetary policy to control inflation expectation this year.</p> <p>Meanwhile, the December data shows that M1 money supply grew 9.7%, and deposits at Chinese banks increased by \$18.6bn. A large proportion of new deposits probably came from the release of fiscal deposits into the commercial banking system, as government agencies increased their spending as the end of the year approached.</p> <p>Read more: China Lending, Money Supply Growth Exceed Economist Estimates in December (Bloomberg)</p>

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