NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond

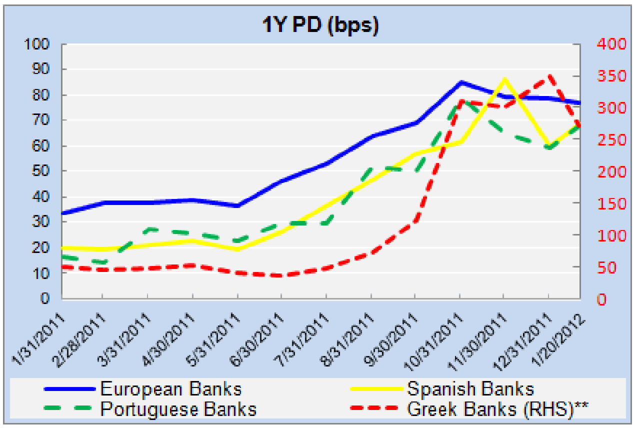
Weekly Credit Brief

Jan 15 – Jan 21 2012

Story of the Week

Greek negotiation breakdown and sovereign credit rating downgrades increase uncertainty in Europe

Following S&P's downgrades of France and Austria on January 13, the rating agency downgraded the European Financial Stability Facility (EFSF) on January 16 to AA+ from AAA. The sum of AAA guarantees of EFSF lending now stands at €271bn, from €451bn. Since EFSF issues are backed by guarantees from AAA rated eurozone sovereigns, the downgrade is placing additional pressure on the four remaining AAA countries* to boost their guarantees to reduce the bailout funds borrowing costs. The EFSF retains AAA ratings from the two other major rating agencies, Fitch and Moody's.



In addition to uncertainty facing the EFSF, an unexpected breakdown in negotiations between Greece and the country's creditors last week raised worries of a messy default. Negotiations stalled due to a deterioration of the country's budget deficit, which is now expected to be 2% higher than previous estimates in October last year. A weakening in Greek finances may require current investors to take a net present value loss of up to 70% on their holdings of Greek debt, instead of the 50% level previously agreed in October. Greece must come to terms with its creditors in order to receive the next bailout tranche from the International Monetary Fund (IMF), totaling€130bn, to meet €14.5bn in bond redemptions due in March.

Without the IMF funds, Greece could face a disorderly default, unless other eurozone countries agreed to absorb related losses. Major holders of Greek sovereign debt are Greek banks and other European banks, with €50bn and €40bn in holdings respectively. These banks account for 35% of the total €260bn of Greek sovereign debt holdings. RMI CRI's 1-Year aggregate probability of default (PD) for Greek banks** has remained above 250bps since October.

Instability in Europe was further fuelled by a sell-off of Portuguese government debt, after S&P downgraded the nation's sovereign debt below investment grade on January 13. Yields on 10-year Portuguese bonds rose above 14% in trading last week. The bonds are now trading 50% below par; a level investors consider default territory. Portugal does not have any bonds maturing before June, but investors are concerned about the nation's insipid growth, which may hinder the government's ability to service outstanding debt. Portuguese and Spanish banks have the largest exposures to Portuguese sovereign debt. In the wake of Portugal's downgrade, the 1-year aggregate PD for Portuguese banks rose to 67.9bps on January 20, from 59.3bps on December 31, while the 1-year PD for Spanish banks rose to 68.2 on January 20, from 60.1bps on December 31.

In addition, the IMF announced last week it is seeking an additional $500bn in new lending capacity, to help contain the eurozone sovereign debt crisis. This figure includes the $200bn already committed by eurozone members last month, and additional $300bn in commitments from IMF members who are not part of the eurozone. While the bailouts of Greece, Ireland and Portugal only required around $100bn, the IMF believes that the current $400bn of funds it has available are not sufficient to rescue nations such as Spain and Italy.

*Germany, Netherlands, Finland and Luxembourg

**Two Greek banks were excluded from this data series: Geniki Bank because of a rights issue on December 8, and T Bank SA as it was forced into liquidation by the Greek central bank on December 17.

Read More:

Downgrade Hurts Euro Rescue Fund (WSJ)
Euro zone faces lower EFSF lending power or higher guarantees (Reuters)
Euro Rescue Fund Sells Bills 'Smoothly' After S&P Credit Rating Downgrade (Bloomberg)
Greece More Worrisome Than Downgrades (WSJ)
Portugal slips into default territory (FT)
Italy bond auction fails to match Spanish success (Reuters)
IMF Seeks More Funds to Gird for Euro Crisis (WSJ)

Date	Country	Title	Summary
Jan 17, 2012	Europe	Banks seeking	European banks are taking unconventional steps to

		capital ideas	meet EBA capital requirements by June 30. Thirty-one European lenders must find €115 billion ($146 billion) in new capital in order to meet a minimum tier one capital ratio of 9%, set by the EBA in December. The banks were required to submit a plan to the EBA by January 20 detailing how they will fulfill the authority's requirement. European banks are avoiding conventional methods of raising capital, such as selling additional shares, which would decrease the value of outstanding shares. Some of the unconventional methods that the banks are undertaking include taking accounting losses tied to previous acquisitions which will boost capital on paper, using stocks to pay dividends and employees rather than cash, converting securities which are not counted as tier 1 capital to equity and writing down goodwill.. For example, the Italian bank Banca Monte dei Paschi di Siena SpA is considering a write-down of goodwill associated with its 2007 purchase of Antonveneta. While this is likely to result in a loss in Q4, the writedown would help the bank close its capital gap as identified by EBA. Commerzbank is also working to restructure part of its subordinated debt with Allianz SE, which owns 5% stake of the German lender, so that it counts towards core tier 1 capital requirements. **Read more:** Banks Seeking Capital Ideas (WSJ)
Jan 16, 2012	Europe	ECB’s Draghi Questions Role of Ratings Companies	European Central Bank (ECB) President Mario Draghi questioned the relevance of rating agencies last week. He believes markets have already price in ratings movements before they happen, and that market participants should rely on their own assessment of creditworthiness. While he admitted that the growth prospects of eurozone economies are bleak, he confirmed that the ECB will do whatever it takes, within the institutions boundaries, to ensure financial stability and restore investors’ confidence in sovereigns. After S&P’s downgrade of France and seven other eurozone economies, yields on short term French Treasury notes fell, with French bond auctions last week reaching full allotment with lower yields. After S&P downgraded the US sovereign debt rating in August, bond yields on US treasuries also fell. S&P and other rating agencies are facing growing public criticism as their past failures and the issuer-pays business model continue to cast doubts on their objectivity and usefulness. **Read More**: ECB’s Draghi Questions Role of Ratings Companies (Bloomberg) Time to Take Control of The Credit Rating Agencies (The Guardian)
Jan 15, 2012	Global	FSB Chief in Call to Rein in “Shadow Banking”	Financial Stability Board (FSB) Chair Mark Carney warned last week that shadow banking must be highly regulated and serve the real economy. Global regulators are looking to transform the $60tn shadow banking sector into a market that provides greater flexibility and diversification to the financial system. The shadow banking system allowed many large financial institutions to dramatically increase their leverage in the lead up to the global financial crisis. Mr. Carney also plans to make 29 systematically important global banks provide living wills to regulators that outline how they can be liquidated with minimal impact on the global economy. These so-called living wills should allow governments to quickly break up large banks instead of bailing them

			out. FSB Chief in Call to Rein in “Shadow Banking” (FT)
Jan 15, 2012	China	China developers launch funds to bridge finance gap	Chinese property developers are launching their own special financing vehicles to fund an expected financing gap in 2012, estimated at $111bn. A government crackdown on real estate financing from bank, bond, equity and trust markets has forced developers to create their own funding vehicles. Only 15.6% of 2011 bank lending growth was to the property sector, down from 31.1% in 2007. Funds raised through such vehicles may also be used to pay for approximately $2.2 billion of syndicated property loans and club deals that fall due this year. Additional funding of $18.6bn is still needed to repay maturing real estate trusts that are also due, according to Thomson Reuters. Funding vehicles will give developers greater control over their sources of financing, and provide a channel for high net worth individuals to gain exposure to China’s real estate market, without actually buying physical properties. However, given the early stage of the Chinese property fund sector, some developers who have immediate financing needs may still encounter significant financing difficulties. The 1-year PD for the Chinese Real Estate sector rose to 213.7bps on January 20, from 158.6bps on June 30 2011. **Read More**: China developers launch funds to bridge finance gap (Reuters)

Published weekly by Risk Management Institute, NUS | Disclaimer

Contact the editor at weeklycreditbrief@nus.edu.sg