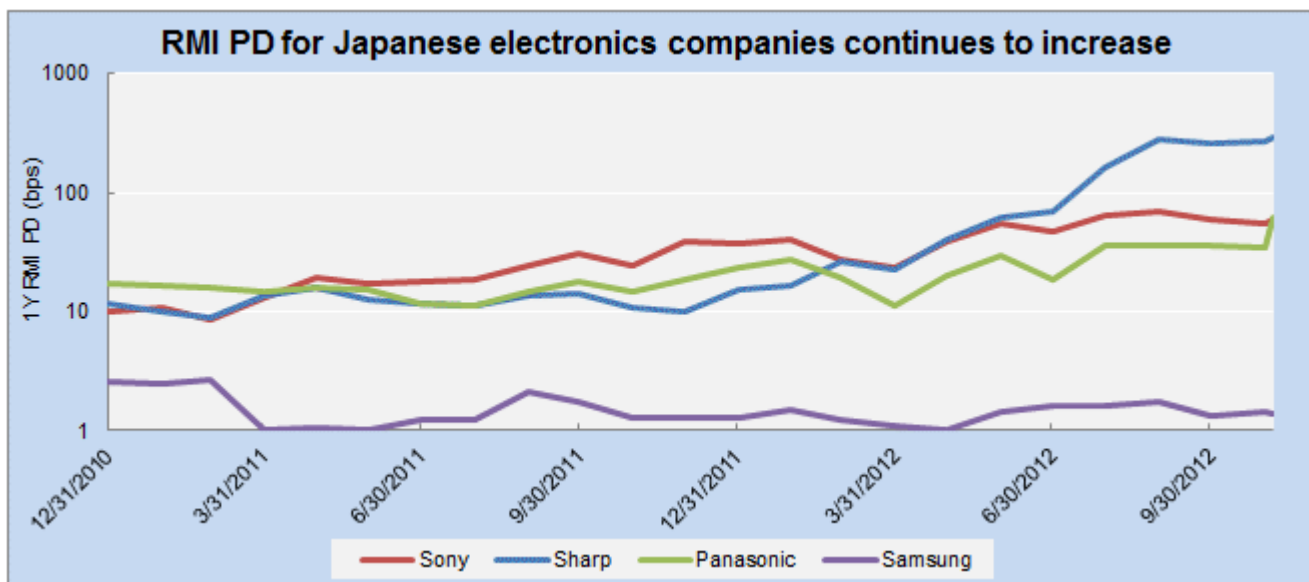




## Stories of the Week

### Sony illustrates risks facing Japanese consumer electronics industry

The credit outlook for the Japanese consumer electronics industry continued to weaken last week, as the RMI probabilities of default (RMI PD) for industry heavyweights Sony, Sharp and Panasonic increased. Each firm reported continuing losses for the quarter ending September 30. Sony, being the largest and most diversified of the three companies, highlights the challenges facing the industry, with the RMI PD for the company reaching almost the highest level since the global financial crisis last week. Sony has come under increasing pressure from a weakening business environment, changing consumer preferences and fierce competition.



**Weakening operating environment:** Sony's business can be categorized into seven segments, and a majority include consumer discretionary products which are directly affected by economic conditions. Sony sources over 32% of its revenues from its home market, where both retail sales and consumer confidence declined during Q3. Sony reported that its operating environment remained grim due to a slowing global economy. A relatively high JPY continues to place pressure on the firm's earnings.

**Changing consumer preferences:** Sony's major product lines include televisions, laptops and cameras; sales in all three categories declined during the quarter ending September 30. Sales in these key product lines have fallen due to the popularity and functionality of smartphones and tablets. Sony has failed to capitalize on consumer appetite for new devices: A recently published IDC report shows that Sony is not one of the top five smartphone or tablet manufacturers.

Although Sony's mobile division reported increased revenues for the quarter ending September 30, a majority of the gains came from accounting changes related to Sony taking full control of the former Sony Ericsson joint venture. Overall smartphone sales increased only slightly from the previous quarter.

**Fierce Competition:** The IDC report also shows Apple and Samsung continue to dominate the consumer electronics industry by a large margin through stylish design, advanced technology and high software compatibility. Digital camera sales have come under increasing pressure at both ends of the image quality scale, as smartphone image sensors improve and the price of Digital SLR cameras falls. Korean manufacturers continue to increase their share of television sales through lower pricing points.

**Capital Structure.** Besides intensified competition, Japanese electronics firms are also burdened by a growing debt load. Major losses over the past few quarters have eroded these companies' equity. The debt to equity ratios of Japanese electronics manufacturers have increased significantly, while cash and cash equivalents at Japanese electronics manufactures have fallen steadily over the past two years. This greatly hinders their ability to make interest payments. Moreover, it is likely that the need to service debt burdens will translate into less funding for future product innovation and growth plans, further weighing on sectoral credit quality.

#### Sources:

[Sony posts 7th straight loss as TV sales slump on economy](#) (Bloomberg)

[Smartphones drive third quarter growth in the worldwide mobile phone market](#) (IDC)

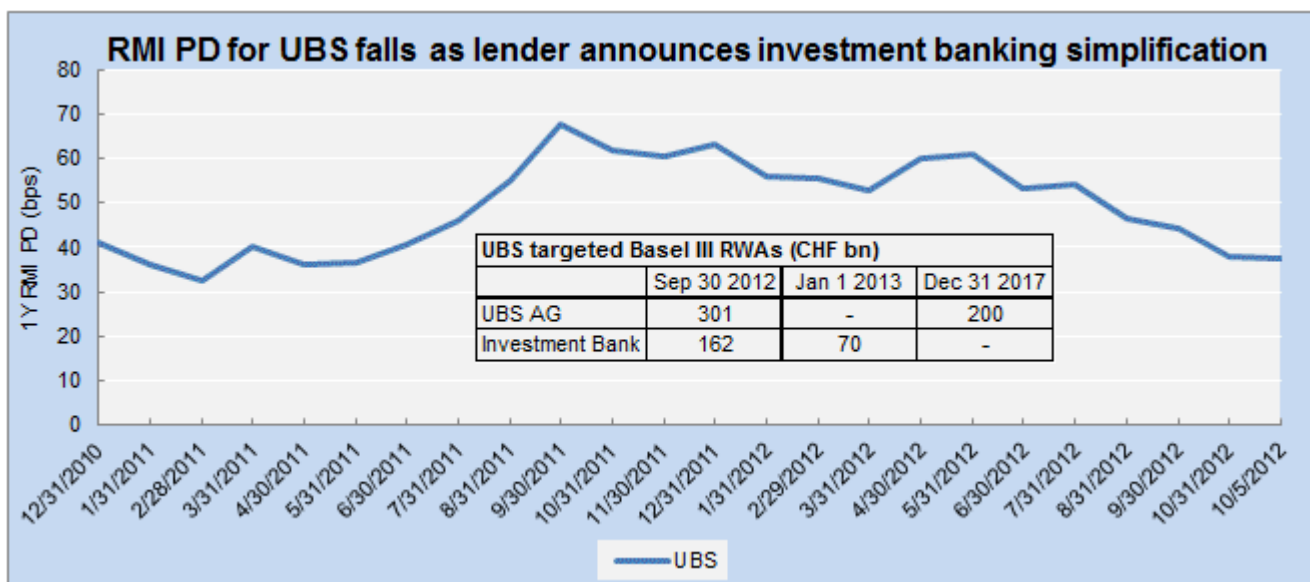
[Android tablets gain momentum in Q3, expectations remain high for the holiday quarter](#) (IDC)

[Sharp fears for future as Japan TV makers bleed](#) (Reuters)

#### **Fixed income exit a credit positive for UBS**

By [James Weston](#)

The 1-year RMI probability of default (RMI PD) for Switzerland-based UBS decreased last week as the bank announced on October 30 it would significantly simplify its investment banking operations, almost entirely exiting fixed income businesses. The investment bank will refocus on its traditional strengths in advisory, research, equities FX and precious metals. The move is a credit positive, as it will allow the bank to become less capital and balance-sheet intensive going forward, reducing tail risks, while associated headcount reductions will improve operating costs.



The bank will significantly reduce its Basel III risk weighted assets (RWAs) going forward, especially in its investment bank, and is targeting a Basel III core Tier 1 common capital ratio of 11.5% in 2013, and 13% in 2014. Swiss regulations effective January 1, 2013, require even higher capital demands than the global Basel III standard, and are likely to increase UBS's cost of capital and make many fixed income businesses uneconomic.

The bank will retain some fixed income functions in order to provide support to its large wealth management businesses, where the bank is targeting higher earnings. UBS is looking to recover at least half of the CHF 200bn of assets under management it lost during the global financial crisis (GFC). This includes further expansion in Asia, where the bank already sees strong synergies between its wealth management and its traditional investment banking strengths.

#### Sources:

[UBS announces strategic acceleration from a position of strength](#) (UBS)

[UBS seeks better wealth management returns](#) (Fox Business)

[Slimmer UBS targets Asian growth](#) (South China Morning Post)

**In the News****PBOC pumps record liquidity into market**

**Nov 2.** The People's Bank of China (PBOC) injected a record-high CNY 379bn into the market through a series of reverse repurchase agreement operations (repos). The overnight and one-week Shibor has increased, suggesting short-term liquidity is tight in the money market. Compared to changes to the reserve requirement ratio (RRR), which has a long-term effect on the market, repos are frequently deployed by the PBOC as they are considered a more flexible monetary policy tool. ([China Daily](#))

**Asian debt luring buyers abroad**

**Nov 1.** Worldwide investors seeking to diversify and improve the returns of their portfolios are investing in Asian local-currency bonds. The amount of local-currency bond sales in Asia Ex-Japan reached record high levels so far this year, with most of the issuances stemming from investment grade corporations. Companies in Asia are also benefitting from the extra source of funding as bank loans have become more costly and hard to get. Asian governments are also tapping local-currency markets to reduce foreign exchange risk and fund deficits domestically. While most market participants have a positive outlook for Asian bonds, others have expressed skepticism. Asian bond prices could fall dramatically if USD borrowing costs increase, as many investors have borrowed in USD to invest in Asian local-currency debt. ([WSJ](#))

**Euro Banks tighten credit standards in Q3**

**Nov 1.** European banks tightened their businesses and households lending standards in Q3, in an attempt to mitigate risks, and are expected to continue this trend going forward. Lending contracted at the fastest pace in three years in September, as a weak economic outlook weighed on credit demand. To reduce risk further, the European banks focused on EUR lending and curtailed USD lending to US companies. European banks fund a majority of USD loans through less stable wholesale funding markets, while EUR loans are largely funded by deposits. ([Bloomberg](#))

**Basel official defends new global bank capital rules**

**Oct 29.** The Basel committee on Banking Supervision expects a number of nations will fail to meet the January 1, 2013 deadline for revamping their bank capital rules. This means a majority of large global banks may not be forced to start applying the international capital and liquidity rules until late 2013. Besides implementation issues, the new capital standards have also faced criticism from regulators in the UK and the UK for over complexity. Some regulators also believe the rules are based on subjective judgment calls. In related news, the Fiancial Stability board published an updated list of global systemically important banks, who will be required to hold additional levels of capital starting from 2016. ([Reuters](#), [Bloomberg](#), [FSB](#))

**China eyes rating rules for inter-bank bonds**

**Oct 29.** China is introducing new credit rating regulations for products traded in the interbank bond market. Current regulations relating to the rating of bonds traded in interbank markets only cover issuer-paid ratings. The new rules will also apply to investor-paid ratings and those generated from public information. Currently China has three major rating agencies which have a combined market share of more than 95%. The outstanding value of corporate debt amounted to CNY 3.7tr in August. ([Fox Business](#))