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

Weekly Credit Brief

Dec 4 – Dec 10 2011

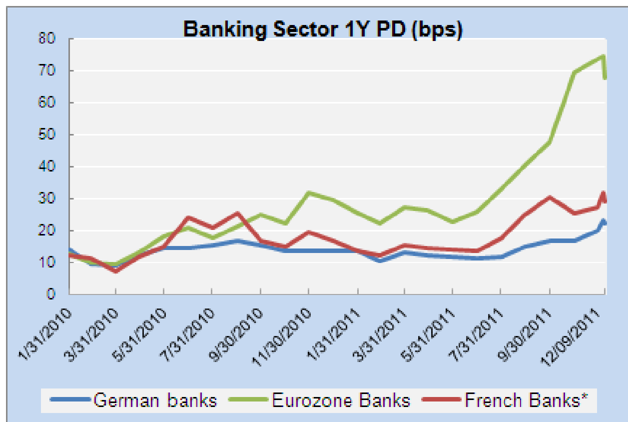
Story of the Week:

EU summit ends with agreements on policy coordination

In the EU summit that ended on December 9, European leaders reached agreements to strengthen fiscal and economic policy coordination. The agreements include a new "fiscal compact" that requires participating governments to maintain an annual structural budget deficit not exceeding 0.5% of GDP with an automatic correction mechanism (defined by each member state) when in excess of 0.5%. Also, the European Commission will impose sanctions via the Excessive Deficit Procedure on countries in breach of a 3% ceiling.

Agreement was also reached on crisis stabilization tools. The new €500bn European Stability Mechanism (ESM) will be accelerated to July 2012 while leveraging of the existing European Financial Stability Facility (EFSF) will be deployed rapidly. European countries could provide up to €200bn as bilateral loans to the IMF, enhancing its resources to deal with the European crisis. In another move that may help to ease stressed conditions in the market, European leaders also agreed to remove the "burden-sharing" requirements for private bond holders as a precondition for future bail outs.

The UK has refused to join the agreements, leaving 17 eurozone countries and several other non-eurozone countries to strike intergovernmental deals. Meanwhile, the European Central Bank (ECB) president welcomed the agreement reached in the EU summit but showed no sign of increasing ECB purchases in the eurozone sovereign bond market.



Markets reacted positively to the outcome of the EU summit, with major global stock indices rallying following the end of the summit. Both the STOXX 600 Europe price index and STXE 600 closed 1.2% higher on December 9 from the previous day. The RMI CRI's 1-year PD for Eurozone Banks ended the week at 67.9bps on December 9 following the EU summit and the ECB action, down from earlier in the week. However, the PD on December 9 is still relatively high compared to this year's low near 20bps in February.

Earlier on Thursday, the ECB announced a few measures to avert a credit crunch. Among the measures are cutting key interest rates by 25bps and extending the term of its fixed rate refinancing operations from one to three years.

However, uncertainty lingers over the resolution of the European debt crisis. On December 6, S&P placed 15 eurozone nations, including Germany and France, on review for a possible credit rating downgrade. This was due to a worsening economic outlook for Europe and increased systemic risk. In addition, Moody's downgraded the debt of BNP Paribas, Societe Generale, and Credit Agricole on December 9. The ratings on the long-term debt of BNP and Credit Agricole were reduced by one notch to Aa3, while Societe Generale's long-term debt was cut by one notch to A1. The 1-year PD for these three French banks rose to 28.8bps on December 9 from this year's low near 10bps in February.

Following a new round of European bank stress tests, the European Banking Authority (EBA) stated on Thursday that European banks collectively face a capital deficit of €115bn, up from this October's estimate of €106bn. The stress test also revealed that German banks are weaker than expected and have a capital deficit of €13.1bn. The 1-year PD for German banks rose to 22.1bps on December 9 from this year's low near 10bps in February.

* BNP Paribas, Societe Generale, and Credit Agricole

Read more:

Statement by the Euro area heads of state or government (European Council)
ECB Cuts Rate, Relaxes Some Rules to Boost Liquidity (CNBC)
Britain's cold shoulder for Europe (FT)
S&P Puts 15 Euro Nations on Watch for Downgrade amid Sovereign-Debt Crisis (CNBC)
European banks have €115bn shortfall (FT)
Moody's Downgrades Three French Banks (CNBC)

Date	Country	Title	Summary
Dec 8, 2011	US	Banks' Ratings Reliance Nears	On December 7, the Federal Deposit Insurance Corp., Federal Reserve and Office of the Comptroller of the Currency released a proposal for

		End	reducing US banks' use of credit ratings in their operations in an effort to comply with the Dodd-Frank financial-overhaul law. Under the proposal, the 30 largest banks and bank-holding companies with a minimum $1bn in trading assets would be required to assess the riskiness of debt they hold based on public data instead of using credit rating agency ratings. Examples of the public data include risk classifications by the OECD for sovereign debt, and companies' financial data and stock market volatility for corporate debt. The proposal has been welcomed by S&P, Moody's and Fitch, although it remains uncertain if these credit rater's businesses would be affected. Among banks, only small banks have so far expressed concern about the potential cost of implementing the new system. **Read more:** Banks' Ratings Reliance Nears End (WSJ)
Dec 6, 2011	Global	Basel Rules Face Change With No-Risk Sovereign Debt a Focus	The Basel committee on Banking Supervision may reduce the role of sovereign bonds in banking rules, allowing banks to use equities and more corporate debt, together with cash and sovereign bonds to meet new short term liquidity requirements. This comes as the deepening European debt crisis confronted regulators with the challenge of acknowledging worsening confidence in the sovereign debt market. Under the proposal published in December 2010, at least 60% of a bank's short-term liquidity buffer must be in cash or government and central bank securities. The proposal is currently under review as the large proportion of government bonds is now being questioned. Regulators are also questioning the current rules of allowing banks to apply zero risk-weightings to government bonds in calculating capital ratios. Abandoning the zero-risk weighting in calculations of capital ratios may lead banks to either reduce lending or raise more capital. **Read more:** Basel Rules Face Change With No-Risk Sovereign Debt a Focus (Bloomberg)
Dec 5, 2011	Germany	Commerzbank announces 600 million euro hybrid buyback	Commerzbank AG on last Monday announced plans to spend up to €600mn ($806mn) to repurchase hybrid equity instruments from investors. The bank, which has large portfolios of eurozone government debt, is taking this step to bolster its capital position and prevent further state aid, as the deepening European debt crisis takes its toll on the bank's capital position. Losses of the bank during the third quarter amounted to €687mn due to the debt crisis. Meanwhile, the EBA stress test's result on Thursday revealed that Commerzbank has a capital shortfall of €5.3bn in meeting the EBA's capital requirements. Commerzbank expects to book profits by buying back hybrid equity securities at prices between 40 to 52.5% of their face value. This can improve its core tier one capital ratio by about 0.25% from 9.4% at the end of September. The bank is also trying to manage its capital by stopping lending in many areas of business and exploring sales of parts of its balance sheet.

			The 1-year PD for Commerzbank remained high at 56.5bps on December 9, compared to a low near 10bps in February. **Read more:** Commerzbank prepares capital boost (FT) Commerzbank announces 600 mln euro hybrid buyback (Reuters) European banks have €115bn shortfall (FT)
Dec 6, 2011	Global	Banks withdraw from aircraft financing	The airline industry is forecasted to face a drop in aircraft financing that has been largely provided by European banks in the past, according to Boeing Capital Corporation. The expected reduction in lending is attributed to a combination of factors, including the European sovereign debt crisis and new regulatory requirements. Such difficulty is compounded by an international agreement to raise guarantee premiums that export credit agencies from developed countries charge on aircraft purchases. The reduction in loans would force airlines to switch to other alternatives, which could include choosing to lease rather than purchase aircraft, or acquire financing from bond markets or insurance companies. The 1-year aggregate PD for the European airline industry rose to 65.4bps on Dec 9 from a low near 20bps in January. **Read more:** Banks withdraw from aircraft financing (FT) Airlines brace for heavy Europe crisis impact (Reuters)
Dec 6, 2011	Singapore	Singapore Lending Surges 91% to Record $38 Billion on Oil, Property Deals	Syndicated lending in Singapore surged 91% year-on-year to a record $38bn this year, due to increases in demand from property, energy and resource companies. While European economies are facing possible recession, Asian economies are becoming increasingly attractive as places for companies to raise funds and also build bank relationships. Added to these advantages is liquidity in Asia's lending market, which is considered to be more stable and reliable than in parts of the developed world. According to Bloomberg, syndicated loans in Europe, the Middle East and Africa fell to $120.5bn this quarter, compared to $260.4bn in the quarter ending September 30. **Read more:** Singapore Lending Surges 91% to Record $38 Billion on Oil, Property Deals (Bloomberg)

Published weekly by Risk Management Institute, NUS | Disclaimer
Contact the editor at weeklycreditbrief@nus.edu.sg