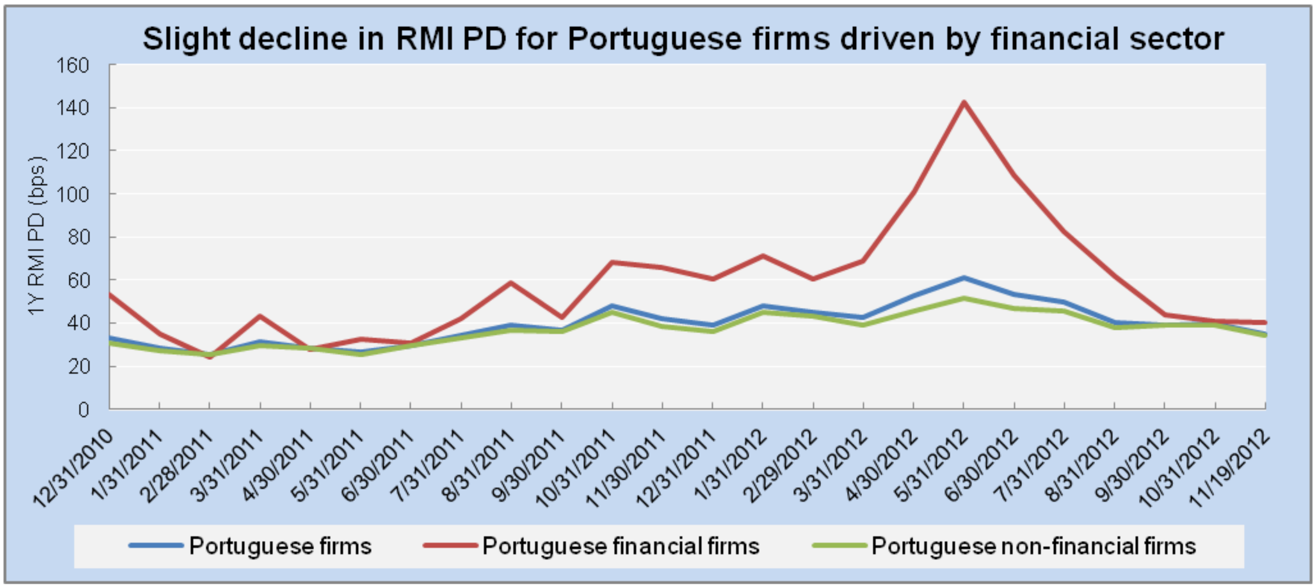
Weekly Credit Brief
Nov 13 - Nov 19 2012

Story of the Week

Tax increases and spending cuts a credit negative for Portuguese non-financials

The 1-year aggregate RMI probability of default (RMI PD) for Portuguese companies remained elevated last week, ahead of a government vote to approve sweeping spending cuts and the largest tax hikes in the country's history. A significant decrease in the aggregate Portuguese RMI PD has been driven by a large decrease in the RMI PD for financial institutions, following a EUR 6bn government-led recapitalization of the country's four largest banks. However, the outlook for Portuguese non-financials remains negative, as further austerity measures and continuing economic contraction will likely place pressure on the earnings profiles of non-financial companies.



Higher taxes & spending cuts: The country's Finance Minister said in October that personal income taxes would be increased to a record high of 13.2% during 2013. The government also plans to cut spending by EUR 4bn through 2014, potentially impairing corporate earnings. The final vote is scheduled for November 27, but the budget cuts have been approved in preliminary voting rounds. The government is implementing these measures in order to meet budget deficit targets mandated under a EUR 78bn bailout plan provided by the EU and the IMF.

Poor growth outlook amid high unemployment: Higher taxes will likely weigh upon already weak retail sales in Portugal. Record high unemployment of 15.8% has hurt retail sales activity, and led to a significant decline in economic growth. The economy shrank for the eighth consecutive quarter during Q3, with GDP growth contracting 0.8% quarter-on-quarter, after declining by 1.1% in Q2. The outlook for unemployment remains poor, as over 683,000 people claimed unemployment benefits in September 2012, the highest on record. The combined effect of tax hikes, spending cuts and increasing unemployment will likely lead to further economic contraction going forward.

Consumer, business confidence: Consumers surveyed by the Instituto Nacional de Estatistica Portugal (INE) expressed little optimism about their employment prospects and household finances. Moreover, an INE survey of consumer confidence fell sharply to a new record low in October. The Economic Sentiment Indicator for Portugal, published by the European Commission, declined to the lowest level seen since early-2009. Business confidence has continued to fall due to a poor growth outlook and weakening revenues.

Decline in aggregate RMI PD driven by banking recapitalizations: The financial sector has exhibited the largest decrease in industry-level RMI PDs in Portugal. Banks received capital injections from the Portuguese government in the middle of 2012, and raised further capital from private investors during Q3, improving firm-level credit quality. For example, the 1-year RMI PD for Portuguese lender BANIF SGPS fell by almost 300bps to 114.9bps on 16 November from a historical high of 413.6bps in May 2012. This large decrease in firm-level RMI PDs in the financial sector has driven a similar decrease in the aggregate RMI PD for Portuguese companies. However, the aggregate RMI PD for the non-financial sector remains well above historical levels.

Sources:
Portugal on strike ahead of budget vote (FT)
Portugal business, consumer confidence slumps (CNBC)

In the News

Moody's strips France of Aaa rating; a notch lower

Nov 19. Credit rating agency (CRA) Moody's Investors Service downgraded the French sovereign rating to Aa1 from Aaa, due to an uncertain fiscal outlook as economic growth stagnates. Moody's retained a negative outlook on the country, citing structural challenges and a "sustained loss of competitiveness" in the country. Competitors Fitch and S&P currently rate the French government AA+ and AAA respectively, with both CRAs retaining negative outlooks. Moody's change could lead to a selloff in French sovereign bonds, as investment funds often require that their best assets have a minimum of two AAA-equivalent ratings from the three major CRAs. (Reuters)

Argentina's credit default swaps surge to highest since 2009

Nov 16. Credit default swaps (CDSs) on Argentinean sovereign bonds, or the cost of protecting such bonds from default, increased to the highest level in three years. Five-year CDSs reached an intraday high of 3,296bps on November 16. Market participants remain concerned that the country's ongoing legal battle with holdout bondholders it failed to pay in 2001 will lead to a halt on payments to current debtors. The country restructured 93% of its bonds after defaulting in 2001, but a number of investors are seeking full repayment. On October 26 a federal appeals court in New York said that Argentina can't continue to pay restructured bondholders without honoring securities that are still considered in default. (Bloomberg)

Sony's debt risk falls as convertible bond wards off junk threat

Nov 15. The price of CDS contracts on bonds issued by Sony fell to the lowest level in almost two months, as the company completed a sale of convertible bonds. Proceeds of the sale will be used to fund acquisitions and expansion. The company has recorded four straight annual losses. The hybrid debt sale may prevent a credit rating downgrade to junk status. Moody's lowered the company's rating to Baa3 from Baa2 on November 9. Competitors Sharp and Panasonic have also been downgraded recently; the two companies expect to lose a combined JPY 1.2tn in the fiscal year ending March 2013. (Bloomberg)

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