Weekly Credit Brief

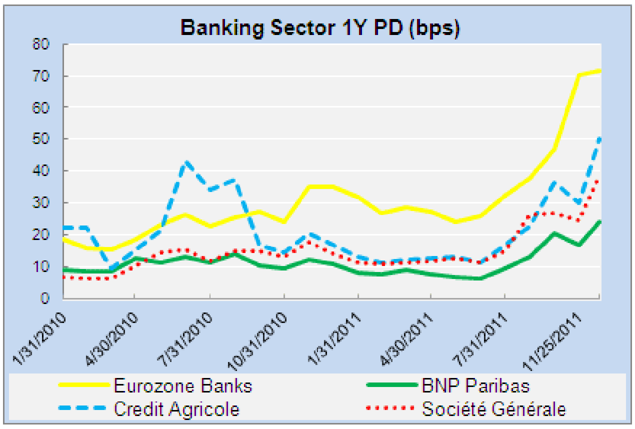
Nov 20– Nov 26 2011

Story of the Week:

Sovereign crisis deepens as eurozone banks face mounting challenges

A German issuance of 10-year bonds failed to attract bids for 35% of bunds offered on November 23, suggesting the European sovereign debt crisis may have spread to core eurozone economies. Italian and Spanish 10-year bond yield soared to 7.2% and 6.7% respectively on November 25. Notably, the Italian and Spanish yield curves inverted on November 25. The Portuguese and Greek sovereign yield curves both inverted before the respective governments sought previous rescue packages.

In ratings actions, Fitch downgraded Portugal's sovereign rating to junk on November 24, S&P downgraded Belgium's sovereign rating one notch to AA on November 25, and Hungary's sovereign rating was cut to junk status by Moody's on November 24.



Eurozone banks, facing deteriorating conditions in interbank markets, borrowed €250bn during the ECB's weekly tender on November 22, the highest amount in 2011. According to RMI's default forecast model, the 1-year aggregate probability of default (PD) for eurozone banks rose 45.6bps to 71.7bps on November 25, from 26.2bps on June 30.

The vulnerability of French banks was another concern last week. BNP Paribas reportedly held €59bn of eurozone sovereign debt, of which €12.2bn was Italian. Credit Agricole remains vulnerable through subsidiaries in Greece, Italy and Spain. Without recourse to shareholders or the French government, Société Générale may not meet the 9% core tier one capital ratio set by European regulators before June 2012. The average 1-year PD for the aforementioned banks rose 13.7bps to 37.8bps on November 25, from 24.0bps on October 31.

Note that the relatively low level of PD observed in French banks is an artifact of the calibration groupings, and the relatively low number of historically observed defaults in the group that France is in presently. The next calibration in early December will include all Western European economies in a single group. Preliminary results indicate that this grouping leads to sharply higher PD levels for French banks in particular.

Read more:

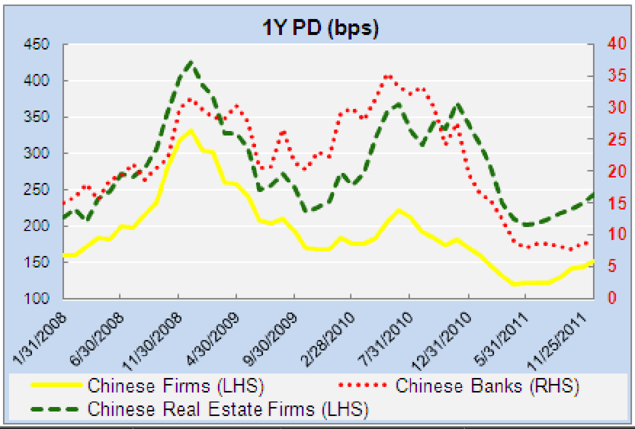
German Auction 'Disaster' Stirs Crisis Concern (Bloomberg)
Italy Borrowing Costs Almost Double at Sale as Euro Tumbles (Bloomberg)
Belgium's Credit Rating Lowered to AA by S&P on Bank Rescues, Politics (Bloomberg)
Moody's Downgrades Hungary (The New York Times)
Italian, Spanish Yield Curves Start Looking Greek: Euro Credit (The San Francisco Chronicle)
Italian Yields Jump After Poor Auction (WSJ)
ECB lending to eurozone banks hits high (FT)

Weakening property market and PMI figures underscore China's risks

In light of the concerns raised by the IMF earlier this month about a possible downturn in the Chinese property sector posing a significant risk to Chinese banks, property statistics released in the past week raised market concerns. The volume of property transactions in China's 15 biggest cities experienced a 39% year-on-year fall in October. Property transactions slid 11.6% nationwide, exceeding a 7% decline in September. Developers are lowering home prices on the outskirts of major cities to combat slowing sales after the government expanded restrictions on home purchases this year in about 40 cities. Chinese home prices for October were the worst recorded this year, falling in 33 out of 70 cities monitored by the government.

Major Chinese property developers have reduced investments, which will likely have ripple effects on China's overall economy, as property construction is a major sector of China's economy, accounting for over 13% of China's GDP last year. According to RMI's default forecast model. The 1-year PD for Chinese real estate firms increased 42.1bps to 243.5bps on November 25, from this year's low of 201.4bps on May 31. Following periods of strong earnings and falling PD, the 1-year PD for Chinese banks increased to 8.4bps on November 25, compared to 7.7bps on September 30.

Meanwhile, reflecting the global slowdown, HSBC's flash estimate of China's purchasing managers' index (PMI) dropped to 48 in November, a 32-month low. The reading below 50 indicates a contraction of the manufacturing sector and renews fears of a hard landing for the Chinese economy. The 1-year PD for Chinese firms increased 31.1bps to 151.7bps on November 25, from this year's low of 120.5bps on April 30.



Read More:
China PMI falls unexpectedly in October (FT)
China property dip sparks bank fears (FT)
China May Find It Hard to Break Fall (WSJ)
Agile Property Stops Land Purchase, Slows Projects to Counter China Curbs (Bloomberg)
China factory sector shrinks most in 32 months (Reuters)

Date	**Country**	**Title**	**Summary**
Nov 23, 2011	Europe	European Banks Get 'False Deleveraging' in Seller-Financed Deals	European banks selling distressed assets to meet tighter capital requirements have found it necessary to lend funds to the buyers under so-called 'vendor financing' deals. This type of deals has the apparent effect of allowing banks to turn non-performing loans into performing loans, reducing the riskiness of their assets and freeing up regulatory capital. However the banks still retain indirect exposure to the distressed assets. European banks are also using other types of structured deals in an attempt to deleverage. RBS has set up an asset holding vehicle in order to sell a £1.4bn commercial-property loan portfolio to The Blackstone Group. Market participants believe similarly structured deals and vendor financing could become more common in the current regulatory and lending environment. **Read more:** European Banks Get 'False Deleveraging' in Seller-Financed Deals (Bloomberg)
Nov 21, 2011	Austria	Austrian banks told to limit lending to east	The Austrian government instructed the country's banks to limit future lending in central and eastern Europe (CEE) on November 21, as the spread between Austrian sovereign bond yields and German Bunds reached record highs. Austrian banks have suffered losses in CEE economies, where they are the biggest lenders. Combined CEE exposures of Erste Group, Raiffeisen Bank International and Bank Austria exceed the GDP of Austria. If their loan portfolios were impaired, the government may be unable to bail them out. The Austrian central bank stated that these three banks would be prevented from excessive lending in CEE economies, compared to what they raise in deposits in Austria. The 1-year PD for Erste Group reached 120.7bps on November 25, from 6.5bps on June 30, while Raiffeisen Bank's 1-year PD went from 22.0bps to 87.6bps in the same period. **Read more:** Austrian banks told to limit lending to east (FT) Austrian Bank Funding Proposal Not Big Lending Constraint (Fitch Ratings)
Nov 23, 2011	Europe	Corporate Debt Feels Euro Heat	Highly rated bonds sold by European companies have provided a safe haven for investors in the past six months, but increasing crisis contagion fears have affected derivative markets. The iTraxx Europe Main index of CDS on European investment grade corporate bonds increased to 209bps last week, a level close to the record 216bps reached in December 2009. Although French corporate bond yields are still relatively low, French corporate debt markets experienced a large sell-off last week, and the

			yields of many investment grade bonds reached one-month highs. **Read More:** High Grade Corporate Debt Feels Euro Heat (FT) French Bond Sell-Off Shows Crisis Spreading (FT)
Nov 22, 2011	US	Fed to test six big US banks for Euro stress	The US Federal Reserve plans to carry out stress tests on six large US banks* with large trading operations against hypothetical market shocks, including an escalation of the European debt crisis, as part of an annual review of bank health. The heightened stress tests are part of a larger supervisory test the Fed will conduct on the capital plans of 31 firms with at least $50bn in assets. The Fed will use the stress tests to determine whether banks are robust enough to distribute dividends or repurchase stock, or whether they need to obtain additional capital. Fitch Ratings earlier this month expressed concern that US banks could be affected by the debt crisis in Europe. US banks have around €125.6bn ($169.4 billion) in loans outstanding to Greece, Ireland, Portugal, Spain and Italy, equivalent to about 12.5% of their capital. * Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley and Wells Fargo **Read More:** Fed to test six big U.S. banks for Euro stress (Reuters) Dodd-Frank Law May Hinder Crisis Response by U.S. Policy Makers (Bloomberg)

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