

Weekly Credit Update

Summary

- Mood remains constructive
- Ongoing primary market activity
- European credit criteria are being tightened

Market comment

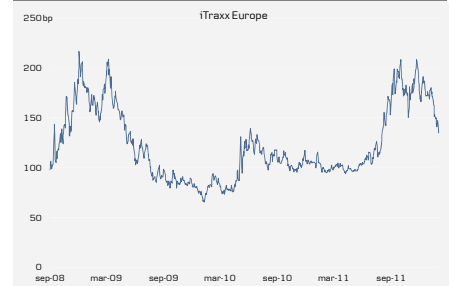
The relatively buoyant mood in the credit market remains, although the pace of spread tightening has levelled off somewhat as of late. The EU summit on Monday proved a non-event in the market, but recent European PMI numbers have generally been better than expected, which has contributed to the ongoing improvement in market sentiment. The investment grade CDS index has tightened some 5bp during the week, while for the high yield index the tightening has been some 20bp.

However, there are still some major issues that need to be addressed in the short term and that have the potential to move the market. First of all, Greek PSI should be forthcoming in the coming days. The latest reports point towards an NPV loss of some 70% for private sector bondholders and it will be interesting to see if the PSI is effectuated before 20 March this year, when some EUR14.4bn of debt matures. Furthermore, it will be of interest whether or not the CDS will be triggered. If the CDS is not triggered (as ISDA has previously indicated should it be a voluntary deal) it could leave some financial institutions (or others investors for that matter) with unhedged exposure to Greece, which could create some short-term noise until we have clarity about where the specific losses are allocated.

The market reaction to the PSI will be crucial, but even more crucial is whether or not there will be contagion to the other periphery countries, most notably Portugal. Portuguese yields are still high and since year-end the 10Y government bond yield has increased from around 13.5% to 15.5%. It is only in the last couple of days that yields have fallen back a little. In our view it is crucial for the credit market – particularly the financials – that PSI is limited to Greece. Otherwise it could very well be that the distrust among banks intensifies once again.

Concerning banks, FT reported that Spanish banks must find some EUR50bn in order to clean up their balance sheets of bad property loans. In this context Spain will further bolster the funds available to its clean-up fund (the 'FROB'). According to the article the new rules will increase provisioning requirements for Spain's EUR175bn of bad and doubtful property assets. It is mainly the smaller banks and 'cajas' that are likely to need additional capital. In our view, the developments in the Spanish banking sector and the potential spill-over to the sovereign credit quality is one of the most important risk factors for 2012.

iTraxx Europe (5Y CDS)



Source: Bloomberg, Danske Markets

iTraxx Crossover (5Y CDS)



Source: Bloomberg, Danske Markets

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Primary market activity remains at a sound level and we now also see names in the periphery printing. Out of the Nordic region Nordea issued a 10Y subordinated bond, which has a call after five years. There is no step-up after five years so investors are largely buying into the case on a belief that Nordea will continue to call its subordinated debt at first call date despite the lack of economic incentive to do so.

Selected new issues during the week

Name	Rating	Coupon	Maturity	Currency	Size	Spread*
Nordea (LT2)	Aa3/A+	Fixed	10YNC5	EUR	750m	315
Commerzbank	A2/A	Fixed	5Y	EUR	1.0bn	205
Gas Natural	Baa2/BBB	Fixed	6Y	EUR	750m	333
BPCA	Aa3/A+	Fixed	10Y	EUR	750m	225
Volkswagen	A3/A-	Fixed	7Y	EUR	1.25bn	110

Notes: Ratings are Moody's and Standard & Poor's

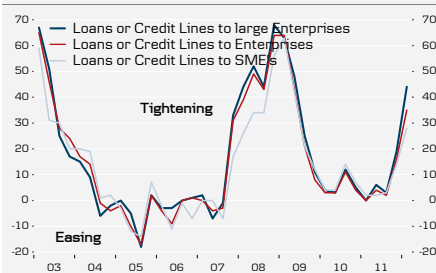
* Mid-swaps for fixed, discount margin for floating

Source: Bloomberg, Informa Global Markets, Danske Markets

European banks have tightened credit criteria

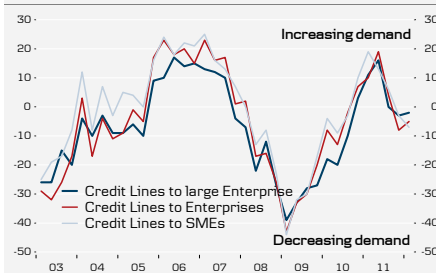
On Wednesday the ECB published its quarterly survey of bank lending criteria. According to the survey Eurozone banks have stepped up their tightening of credit criteria in the fourth quarter of 2011. Especially for corporate lending, credit criteria have been tightened substantially as loans to non-financial corporations saw a net tightening of 35% (up from 16% in Q3). On the demand side we saw a reduction but not to a degree that can match the tightening supply. Overall, the survey confirms that the banking sector is currently not facilitating growth to any great degree and considering the importance of bank financing for the European corporate sector this is likely to dampen growth. Furthermore, we note that a tightening of credit criteria has historically been a leading indicator for corporate default rates. For that reason we should see a pick-up in default rates during 2012.

Supply of credit (eurozone)



Source: EcoWin, Danske Markets

Demand for credit (eurozone)



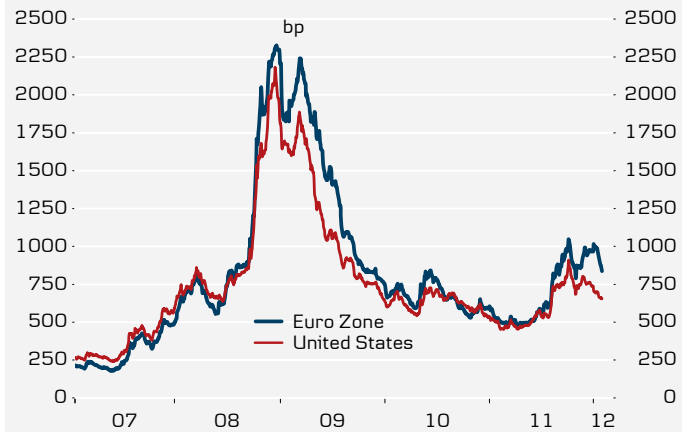
Source: EcoWin, Danske Markets

US investment grade and high yield CDS indices (CDX)



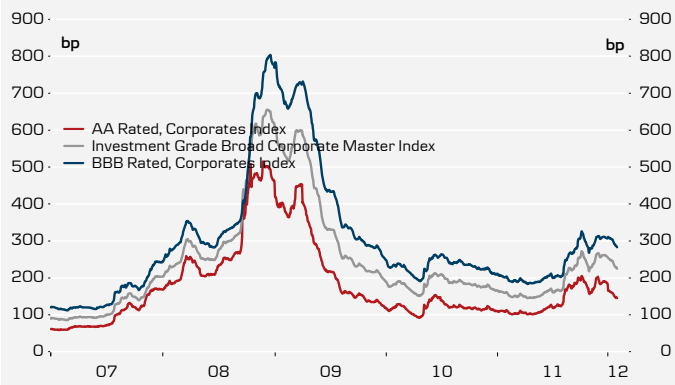
Source: Reuters EcoWin Pro

Merrill Lynch US & European high yield cash indices



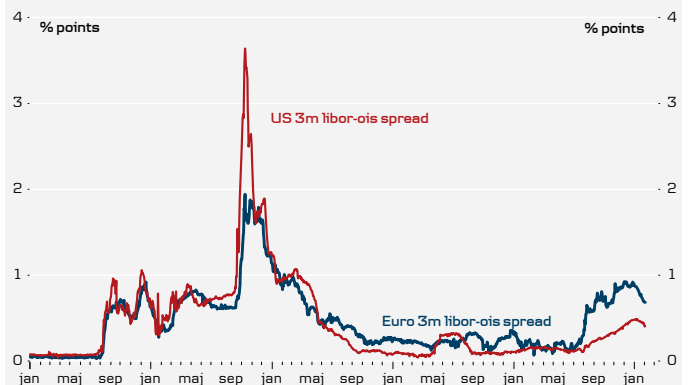
Source: Reuters EcoWin Pro

US cash indices



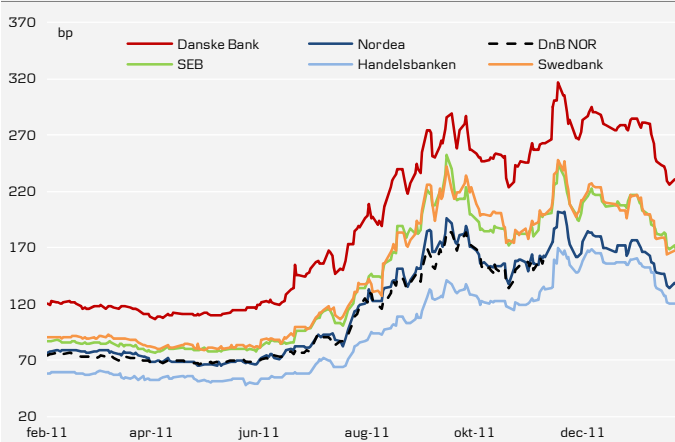
Source: Reuters EcoWin Pro

3M LIBOR-OIS spread



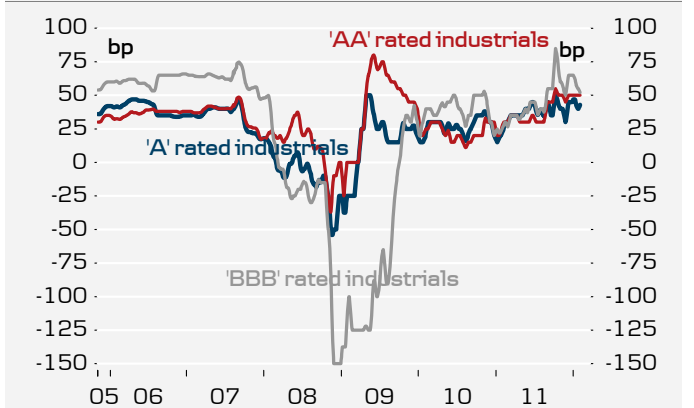
Source: Reuters EcoWin Pro

Nordic banks 5Y CDS spreads



Source: Danske Markets

Slope of US credit curves (2Y spread - 10Y spread)



Source: Reuters EcoWin Pro

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