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# Moody's view – sovereigns and banks

Flash overview

# Agenda

- **Sovereigns** - our current view on the global economy
- Potential effects on Central and Eastern Europe
- Linkage to Developing countries too
  
- **Banks** – recent changes in ratings
- Inverse gap: Can a subsidiary be stronger than the parent bank ?
- What is different: 2009 vs 2013

# 1

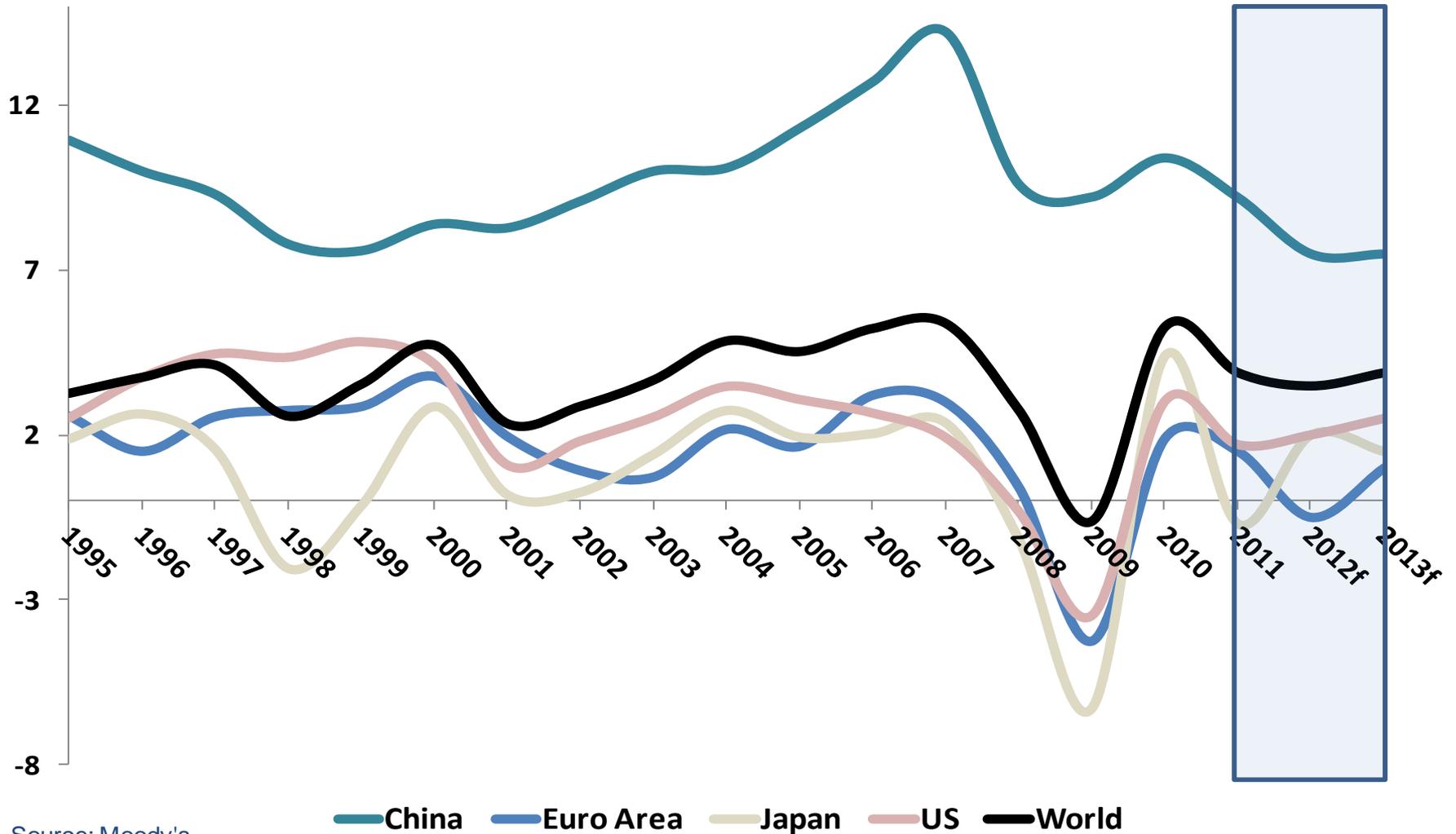
## Sovereigns – Moody's current view

# Our global outlook, in a nutshell

**MIS's *central* macroeconomic scenario is one of a further slowdown in growth. Why? Well...**

- » Fiscal consolidation, banking and household sector deleveraging, financial market volatility, and high unemployment are expected to continue to constrain growth in several *developed* economies, especially in high income Europe
  
- » Major developing economies also to decelerate

# Our 2012-2013 forecasts: The World

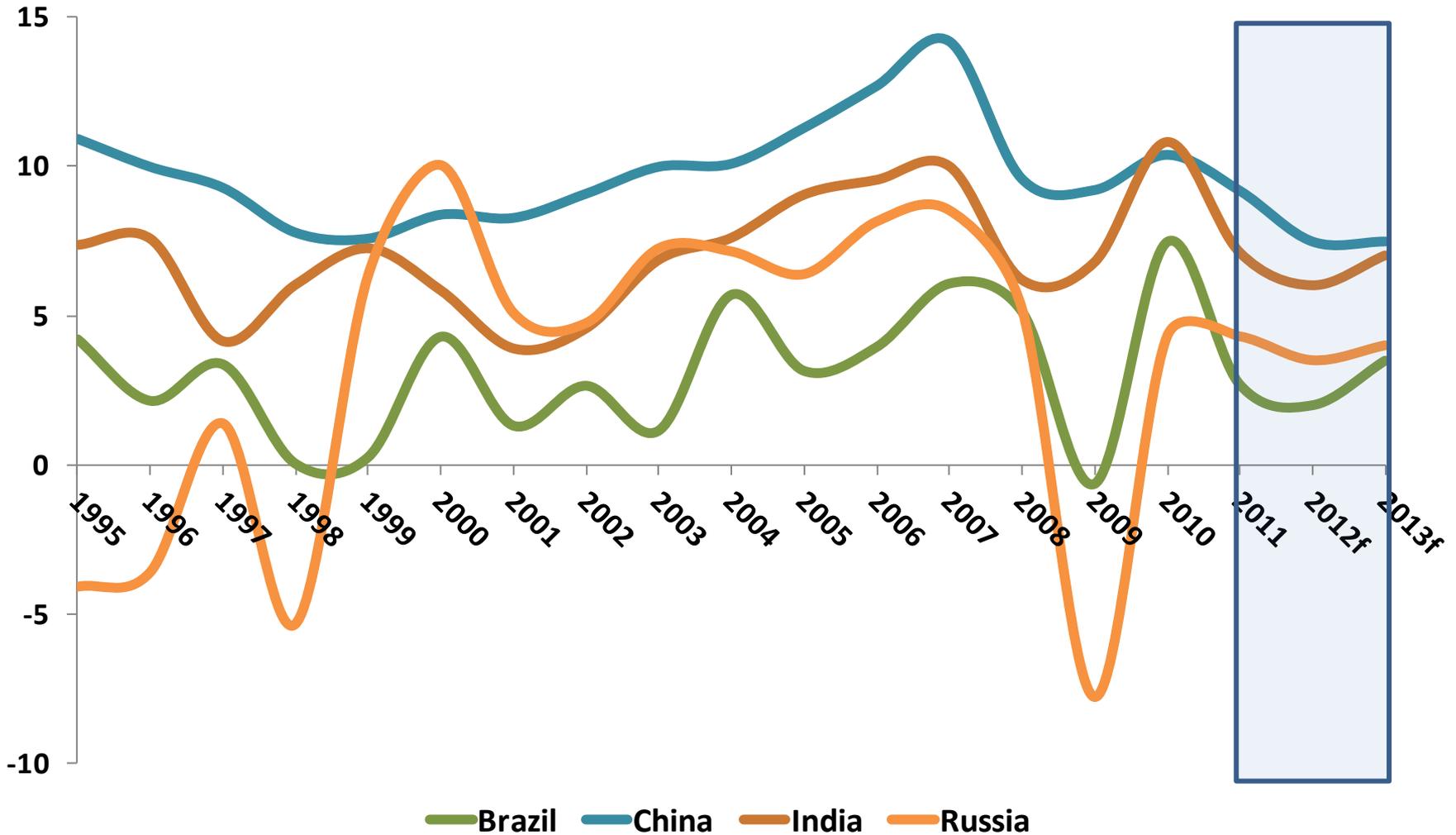


Source: Moody's

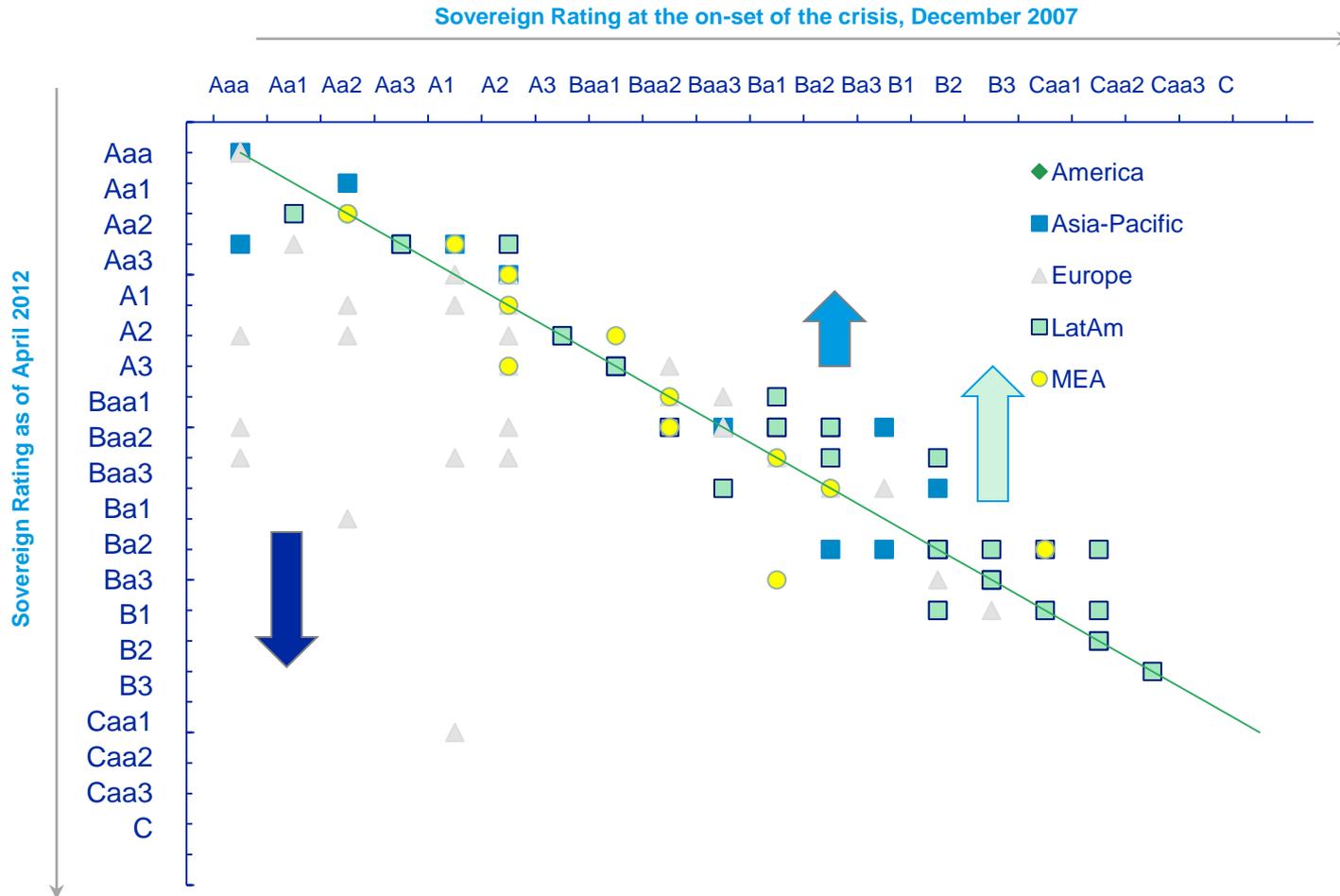
## 2012-2013 forecasts: Adding some granularity

Countries	2012F		2013F	
	Growth central range	Unemployment central range	Growth central range	Unemployment central range
<b>Argentina</b>	3.5/4.5	--	3.5/4.5	--
<b>Australia</b>	2.5/3.5	5.0/6.0	3.0/4.0	4.5/5.5
<b>Brazil</b>	1.5/2.5	--	3.0/4.0	--
<b>Canada</b>	1.5/2.5	7.0/8.0	2.0/3.0	6.5/7.5
<b>China</b>	7.0/8.0	--	7.0/8.0	--
<b>Euro area</b>	-1.0/0.0	--	0.5/1.5	--
<b>France</b>	-0.5/0.5	9.5/10.5	0.5/1.5	9.5/10.5
<b>Germany</b>	0.0/1.0	5.5/6.5	1.0/2.0	5.5/6.5
<b>India</b>	5.5/6.5	--	6.5/7.5	--
<b>Indonesia</b>	5.5/6.5	--	6.0/7.0	--
<b>Italy</b>	-2.5/-1.5	9.5/10.5	-1.5/0.0	9.5/10.5
<b>Japan</b>	1.5/2.5	4.0/5.0	1.0/2.0	4.0/5.0
<b>Mexico</b>	3.0/4.0	--	3.0/4.0	--
<b>Russia</b>	3.0/4.0	--	3.5/4.5	--
<b>Saudi Arabia</b>	5.0/6.0	--	3.5/4.5	--
<b>South Africa</b>	2.5/3.5	--	3.0/4.0	--
<b>South Korea</b>	2.5/3.5	3.0/4.0	3.5/4.5	3.0/4.0
<b>Turkey</b>	2.0/3.0	--	3.5/4.5	--
<b>UK</b>	-0.5/0.5	8.0/9.0	1.5/2.5	8.0/9.0
<b>US</b>	1.5/2.5	8.0/9.0	2.0/3.0	7.5/8.5

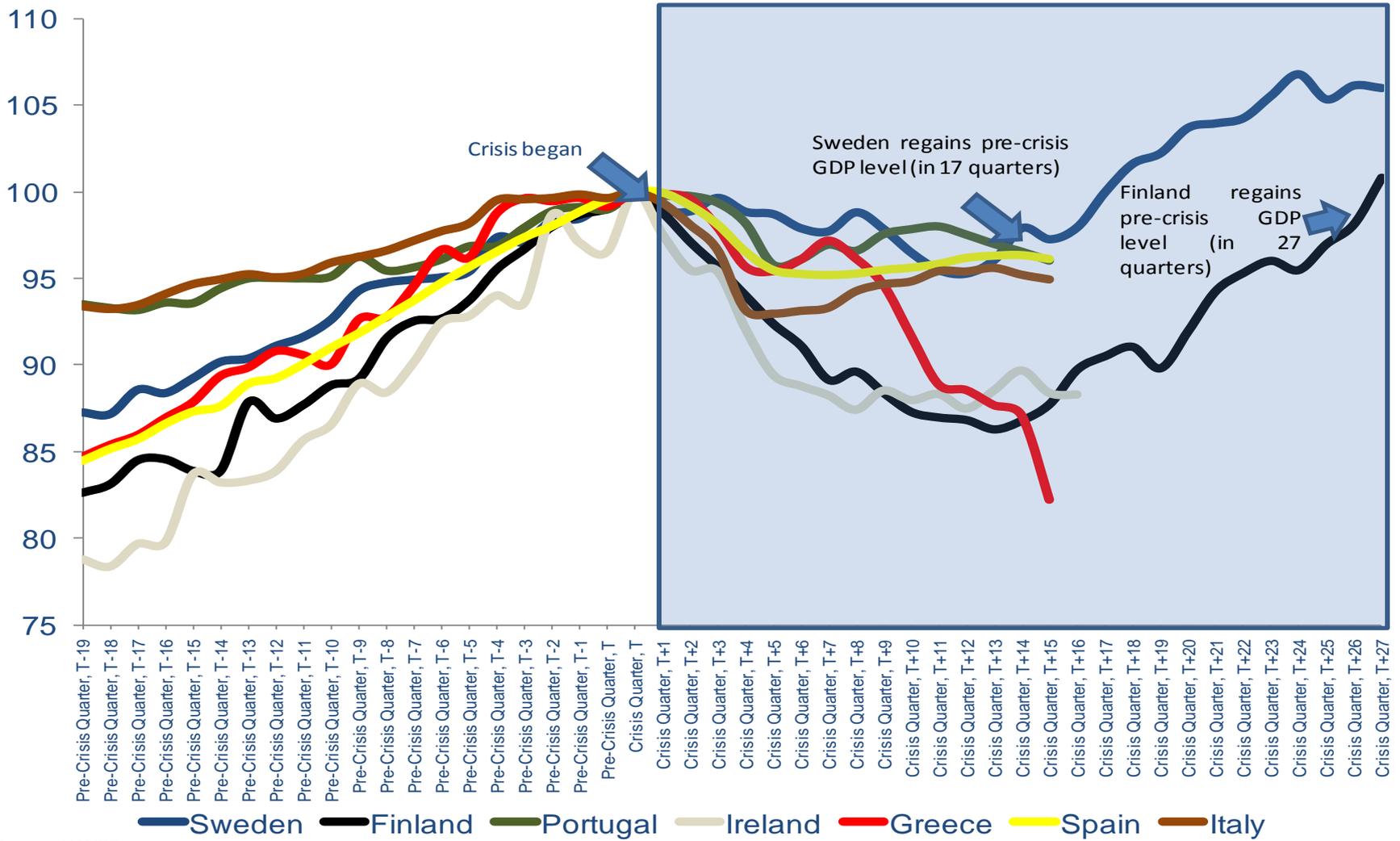
## 2012-2013 forecasts: GDP growth, BRICs



# Regional Rating Trends: Negative in Europe, Positive in Latin America



# Adjustment in Europe far from being complete...



Source: HAVER

# 2

## Potential effects on Central and Eastern Europe

## Exposures...

- » CEE in general very linked to EU
- » Not exactly a surprise: sheer geographical proximity to a large, developed market, and several have institutional frameworks that further facilitate strong economic linkages
- » This is obviously the case for the EU's MS, but applies to other set of countries too

## And by how much? Trade...

	X as a GDP%	X to EU as a GDP%	X to EA as a GDP %	X to EA5 as a GDP %
<b>EU's MS</b>				
<b>Avg.</b>	47.6	33.5	22.8	4.1
<b>Bulgaria</b>	43.2	25.9	18.8	7.5
<b>Czech Rep.</b>	59.0	49.1	38.8	4.2
<b>Hungary</b>	71.0	52.9	38.5	6.0
<b>Latvia</b>	37.9	25.0	11.8	0.9
<b>Lithuania</b>	56.8	33.5	17.8	2.0
<b>Poland</b>	35.3	26.9	18.7	3.1
<b>Romania</b>	30.0	20.8	15.6	5.1
<b>EU's ACs</b>				
<b>Avg.</b>	21.7	12.6	10.1	5.1
<b>European Neighbourhood</b>				
<b>Avg.</b>	31.9	12.0	8.2	3.9

Sources: EUROSTAT, DG TRADE, IMF, UNECE

## And by how much? FDI...

	EU % of FDI	EA % of FDI	EA5 % of FDI
	<b>EU's MS</b>		
<i>Avg.</i>	84.3	71.8	6.0
<b>Bulgaria</b>	88.8	87.4	9.1
<b>Czech Republic</b>	89.0	84.3	4.7
<b>Hungary</b>	77.4	74.5	1.7
<b>Latvia</b>	77.7	51.0	1.4
<b>Lithuania</b>	80.2	41.0	0.5
<b>Poland</b>	86.5	78.2	10.3
<b>Romania</b>	90.7	86.2	13.9
	<b>EU's ACs</b>		
<i>Avg.</i>	76.0	64.3	16.9
	<b>European Neighbourhood</b>		
<i>Avg.</i>	46.8	30.2	1.2

*Sources: EUROSTAT, WIIW, national central banks and statistical offices*

## And by how much? Bank flows...

	<b>EU</b>	<b>EA</b>	<b>EA5</b>
	<b>EU's MS</b>		
<i>Avg.</i>	57.7	43.5	14.3
<b>Bulgaria</b>	59.2	58.3	37.7
<b>Czech Republic</b>	83.9	81.8	7.9
<b>Hungary</b>	70.5	67.9	16.2
<b>Latvia</b>	60.8	6.7	2.8
<b>Lithuania</b>	40.5	5.6	1.2
<b>Poland</b>	46.7	43.1	17.6
<b>Romania</b>	42.0	41.1	16.6
	<b>EU's ACs</b>		
<i>Avg.</i>	45.5	44.8	20.9
	<b>European Neighbourhood</b>		
<i>Avg.</i>	6.6	5.9	2.0

Source: IMF, BIS.

# 3

## Linkage to Developing countries too

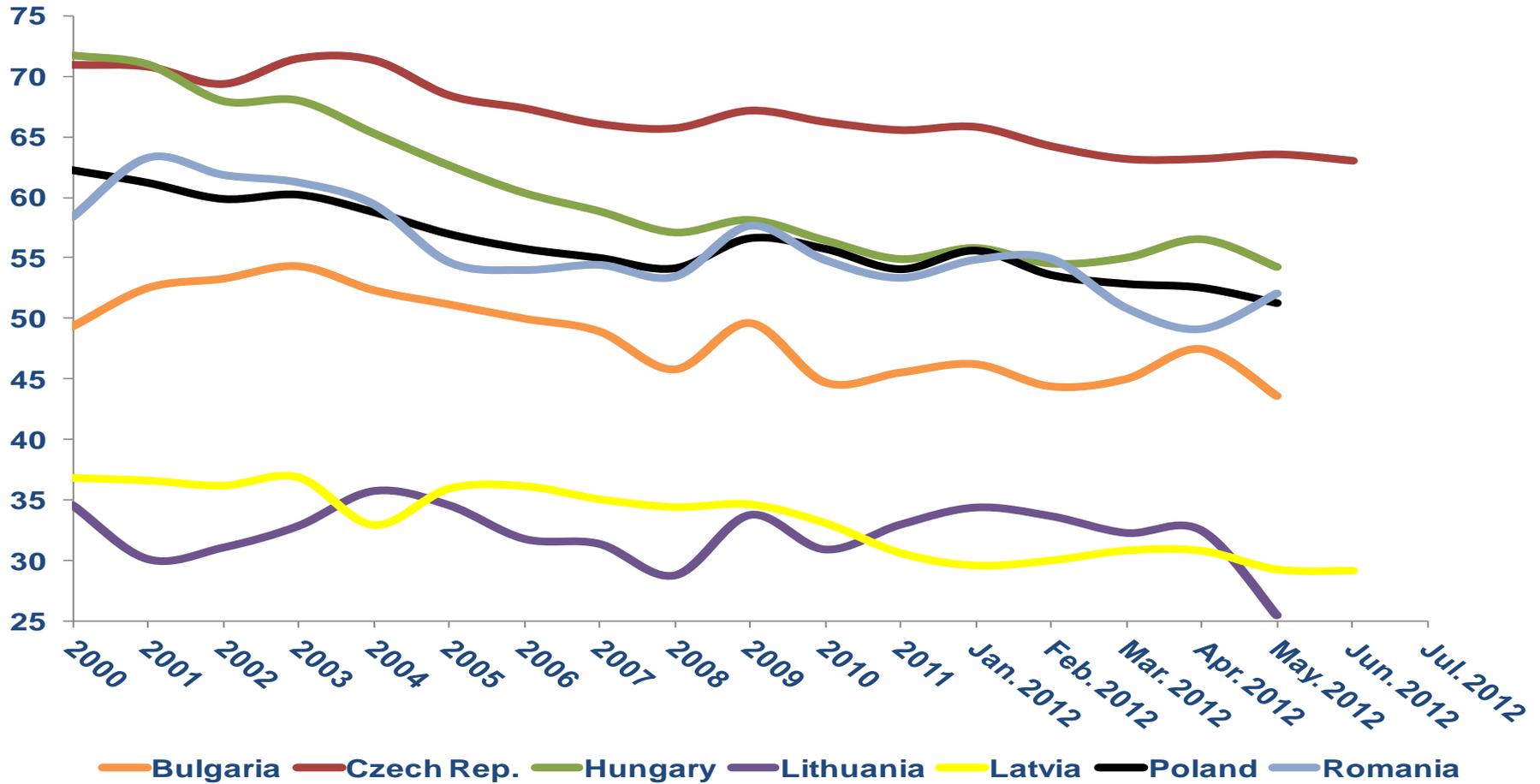
## Other “Transitions” ....

» Exposures should and can change, in reply to both:

1. Structural changes (the “secular trend” of greater economic clout for Developing nations)...
2. ...and cyclical factors (the ongoing cyclical weakness in the EU/EA)

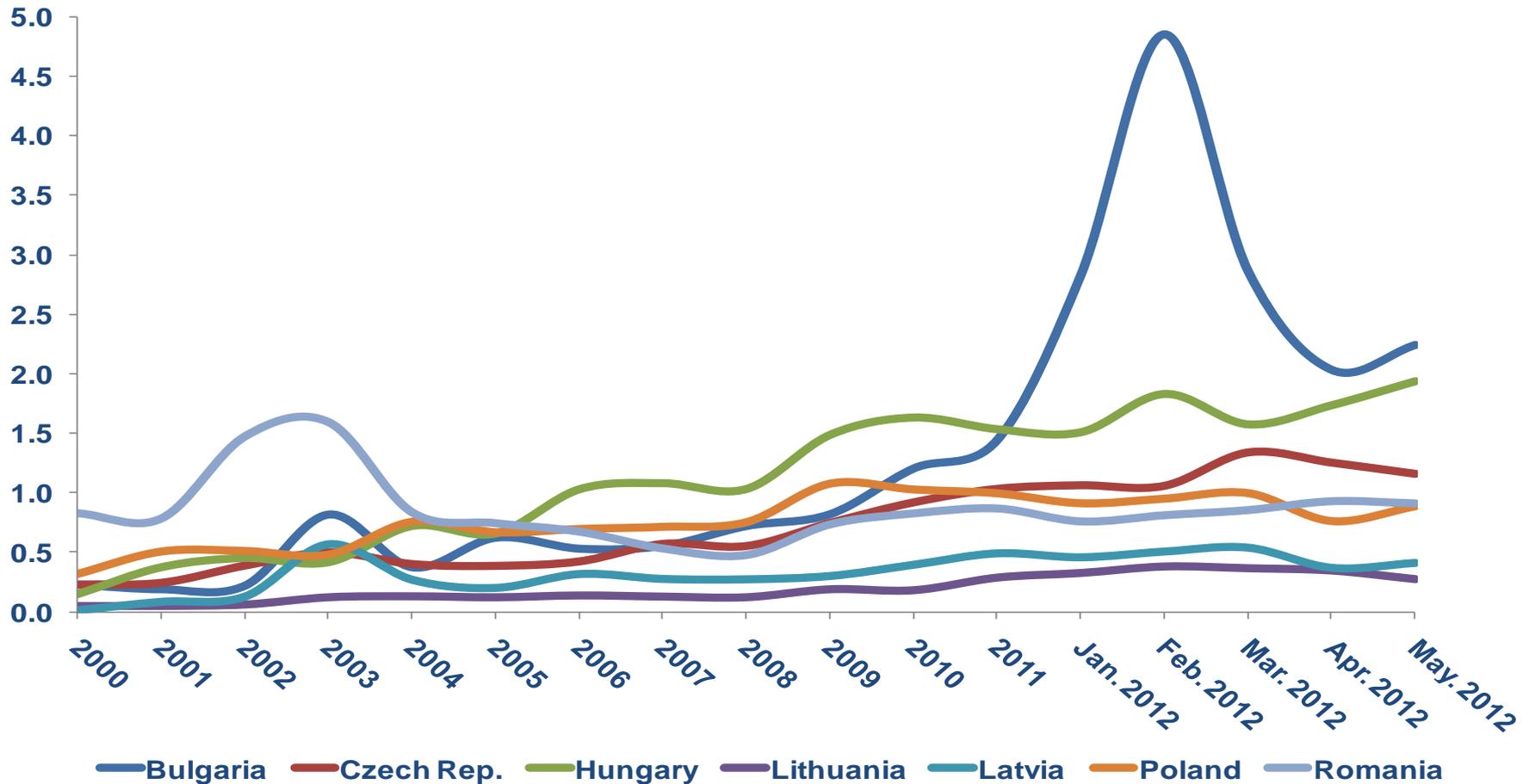
» But has this happened?

# Trading away (I): share of EA in exports



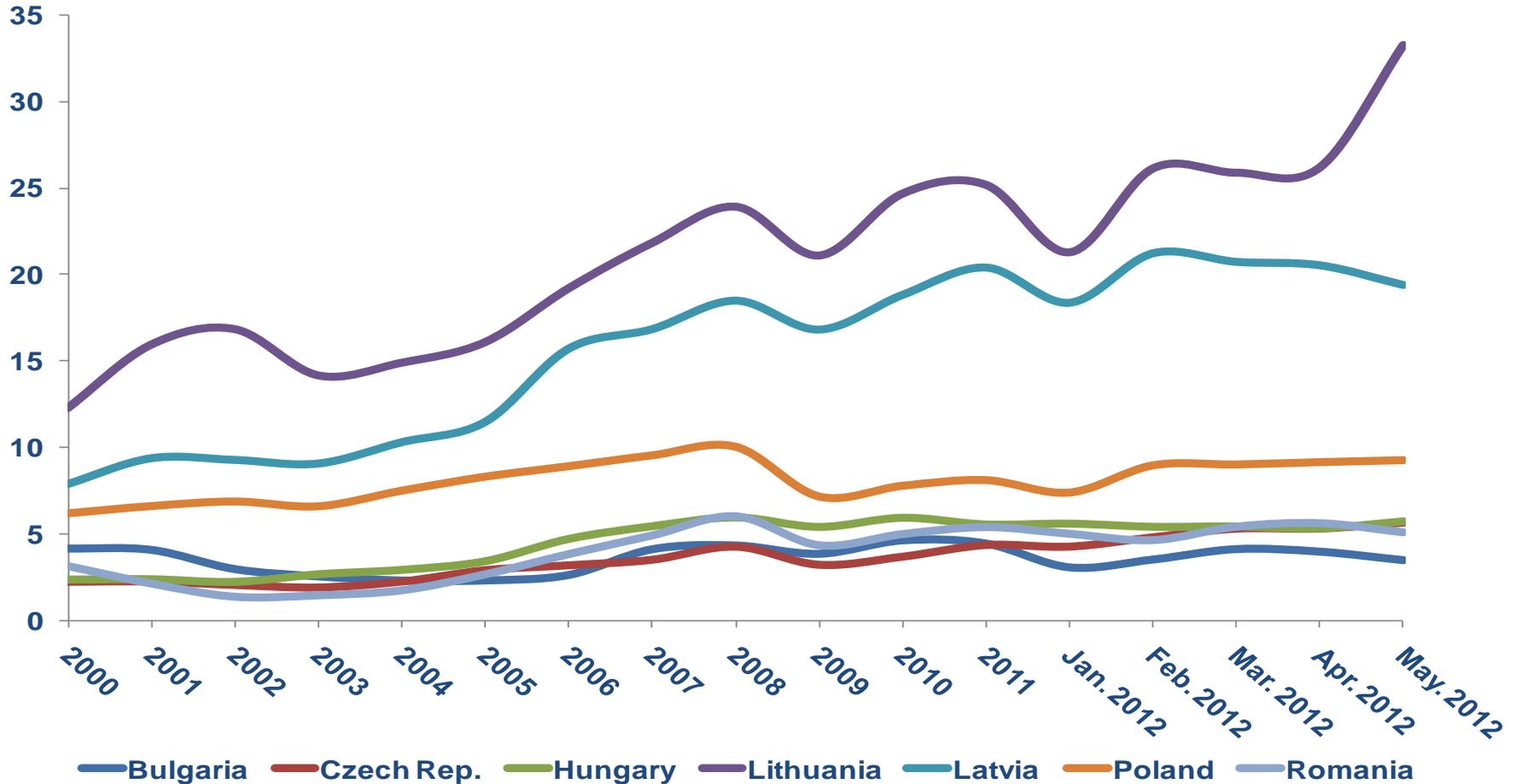
Source: EUROSTAT.

## Trading away (II): share of China in exports



Source: EUROSTAT

# Trading away (II): share of the Western CIS in exports



Source: EUROSTAT

## Well, not yet

- » ..and likely to continue...
- » But there is really no escape the conclusion that, for the foreseeable future, the EU will remain being the largest “external shock” that the CEE countries will have to deal with

# Examples of Moody's rated entities in CEE – moves in 2011

	Quality of credit	Moody's	Example
<b>INVESTMENT GRADE</b>	<i>Gilt-edged</i>	Aaa	
	<i>Very high</i>	Aa1	M6 Duna (BSS)
		Aa2	
		Aa3	
	<i>Upper-medium</i>	A1	<b>Slovenia, Czech Rep., Slovakia, Estonia,</b> Prague, CS, SID Banka, SPP
		A2	<b>Poland,</b> CEZ, PKO BP, Tatrabanka, Warsaw
		A3	PGE, Telek. Polska, Elering, Poznan, Tallinn
	<i>Medium grade</i>	Baa1	<b>Lithuania,</b> Telco Slovenije, Ceske drahy, Energa
		Baa2	<b>Bulgaria,</b> BVS, BPH Bank
Baa3		<b>Croatia, Latvia, Romania,</b> Transelectrica, BCR, BRD, Raiff RO & Raiff BG, DSK, Zagreb	
<b>SPECULATIVE GRADE</b>	<i>Questionable</i>	Ba1	<b>Hungary,</b> PKN Orlen, Hidroelectrica , NLB, NKBM
		Ba2	OTP Bank, K&H Bank, Getin Noble Bank,
		Ba3	<b>Montenegro,</b> Corp. Com. Bank, City of Novi Sad, CET 21 (SS), FHB Bank
	<i>Poor quality</i>	B1	<b>Albania,</b> NWR, AVG, TVN, Atlas Bank, Veles
		B2	<b>Bosnia,</b> Agrokor, Credins Bank, BKT, PBG
		B3	Baltic Int. Bank, Trasta Komercbanka, CME, CEDC
	<i>Very poor or in default</i>	Caa1	Zlomrex Petrol BG
		Caa2	
		Caa3	
		Ca	
		C	

\* As of December 2011

# How We Got Here

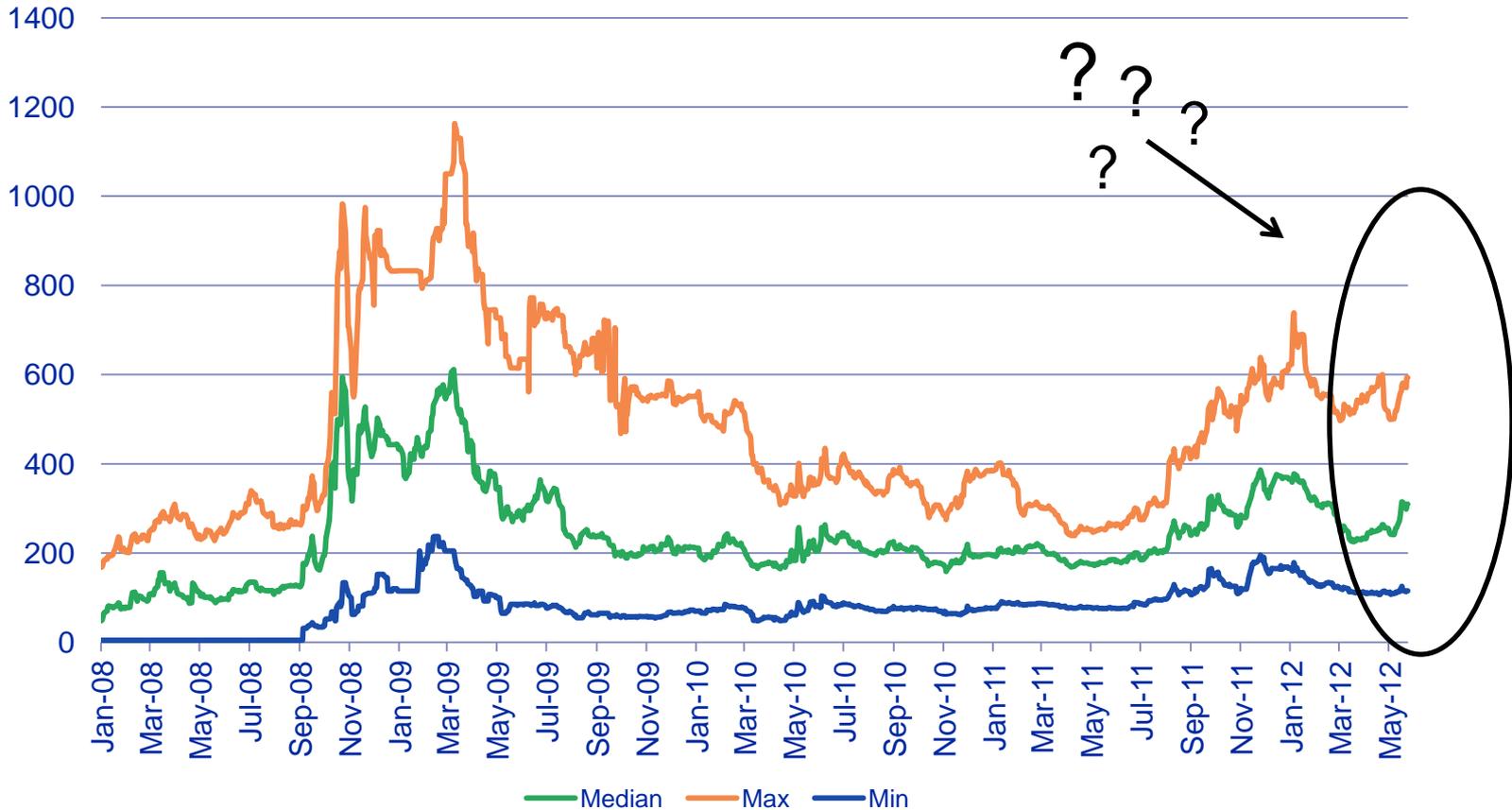
## Rating History\*

	Current	8 Year Change	2004	2005	2006	2007	2008	2009	2010	2011
Czech Republic	A1	0	A1	A1	A1	A1	A1	A1	A1	A1
Estonia	A1	0	A1	A1	A1	A1	A1	A1	A1	A1
Poland	A2	0	A2	A2	A2	A2	A2	A2	A2	A2
Slovakia	A2	+1	A3	A2 ↑	A1 ↑	A1	A1	A1	A1	A1
Slovenia	A2	-2	Aa3	Aa3	Aa2 ↑	Aa2	Aa2	Aa2	Aa2	A1 ↓↓
Lithuania	Baa1	-1	A3	A3	A2 ↑	A2	A2	Baa1 ↓↓	Baa1	Baa1
Bulgaria	Baa2	+3	Ba1 ↑	Ba1	Baa3 ↑	Baa3	Baa3	Baa3	Baa3	Baa2 ↑
Croatia	Baa3	0	Baa3	Baa3	Baa3	Baa3	Baa3	Baa3	Baa3	Baa3
Latvia	Baa3	-4	A2	A2	A2	A2	A3 ↓	Baa3 ↓↓↓	Baa3	Baa3
Romania	Baa3	+3	Ba3	Ba1 ↑↑	Baa3 ↑	Baa3	Baa3	Baa3	Baa3	Baa3
Hungary	Ba1	-6	A1	A1	A2 ↓	A2	A3 ↓	Baa1 ↓	Baa3 ↓↓	Ba1 ↓
Turkey	Ba2	+2	B1	Ba3 ↑	Ba3	Ba3	Ba3	Ba3	Ba2 ↑	Ba2
Montenegro	Ba3	-1	NR	NR	NR	NR	Ba2	Ba3 ↓	Ba3	Ba3
Albania	B1	0	NR	NR	NR	B1	B1	B1	B1	B1
Bosnia & Herzegovina	B3	0	B3	B3	B2 ↑	B2	B2	B2	B2	B2

\*Rating at year-end, data as of June 2012

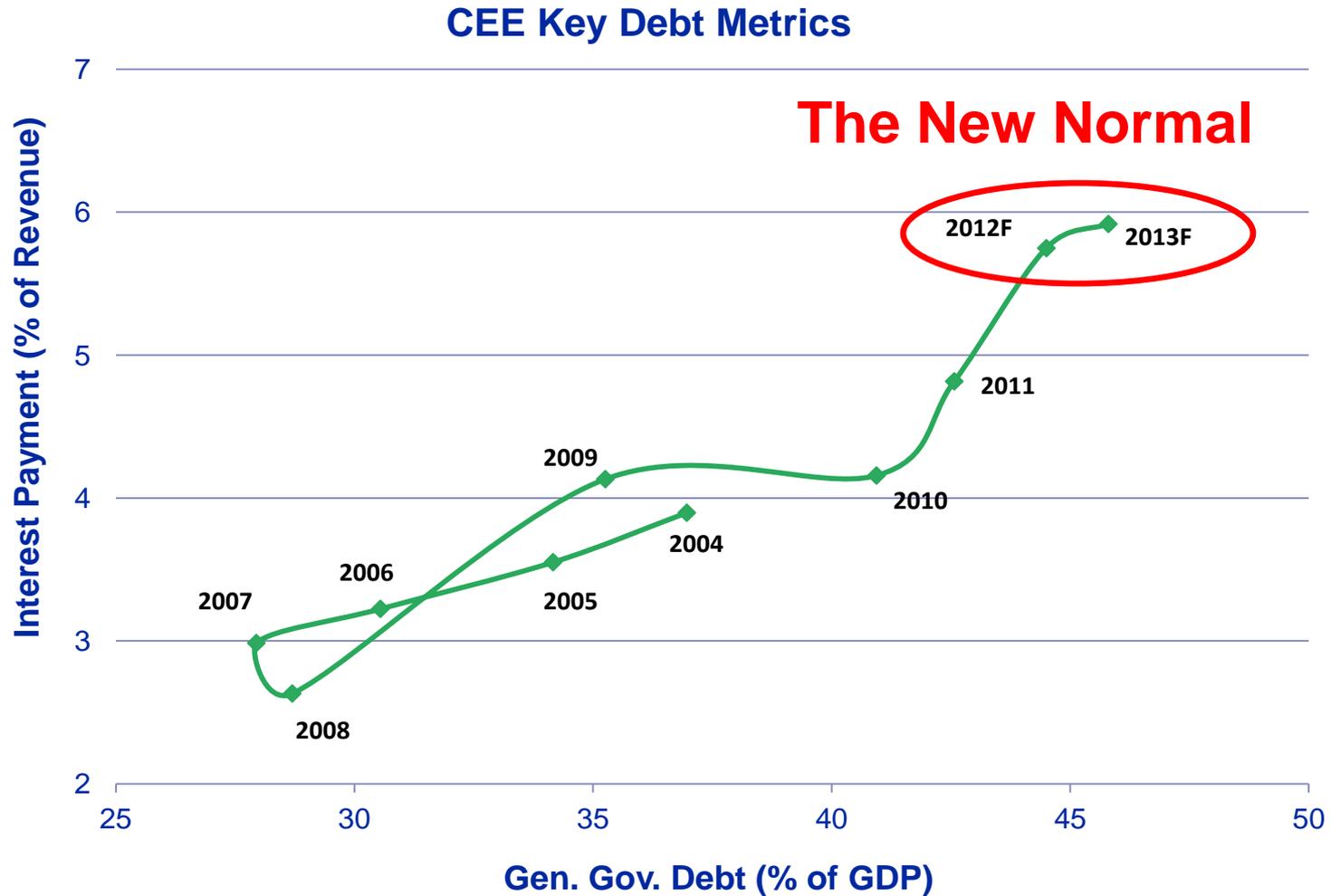
# Where to NOW...?

## CEE Credit Default Swaps



Source: Bloomberg

# A “New Normal” For CEE



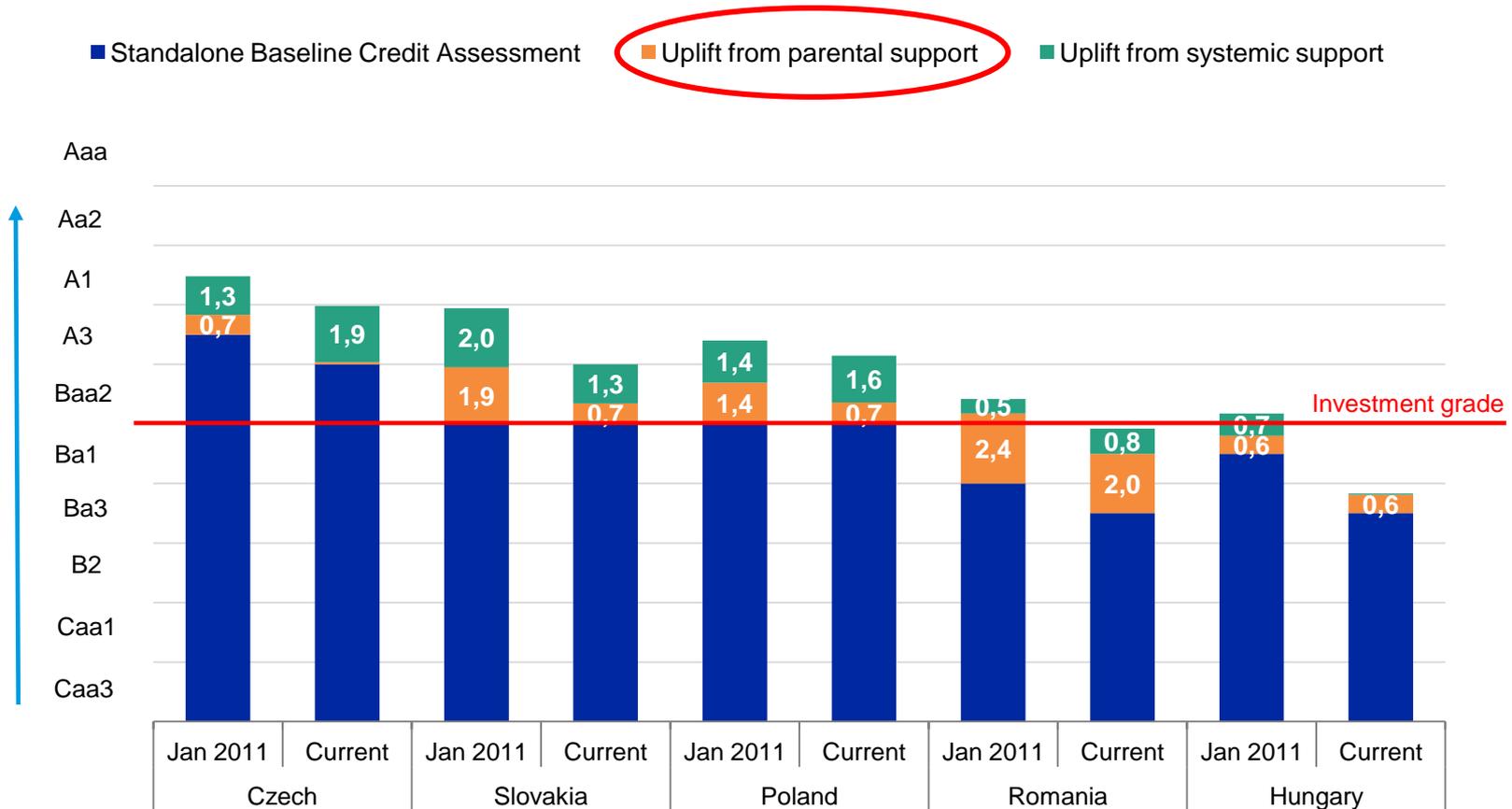
Source: Eurostat and Official National Sources

# 4

## Banks – recent changes in ratings

# Rating developments in the CEE in 2012...

- » ...principally driven by parental downgrades affecting the supported ratings of CEE subsidiaries
- » – Reduction in uplift from parental support



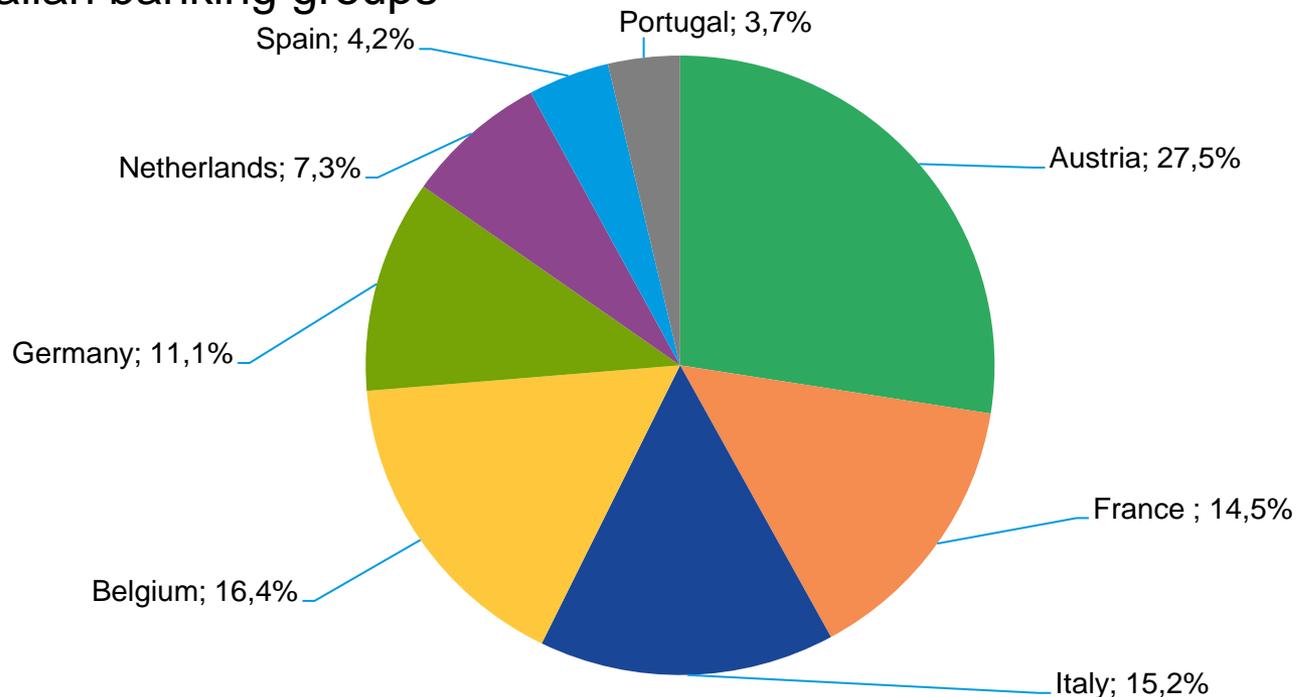
# Parental support considerations:

- » How we define parental support?
  - Financial strength of the parent (expressed as stand-alone rating) ...  
...and resulting *willingness* and *capacity* to support subsidiaries
- » What constrains parental support in the current market?
  - Regulatory pressures on capital and liquidity on parent banks
  - Parents' strategic priorities are shifting towards national / domestic markets
  - Long-term potential of some foreign markets is reassessed under new funding conditions

Moody's view: when resources are limited parent banks will prioritise their core franchise at the expense of foreign operations

# West European ownership in the CEE banking systems

- » Meet the parents: The largest parental groups exposed to the CEE are Austrian, Belgian, Italian banking groups

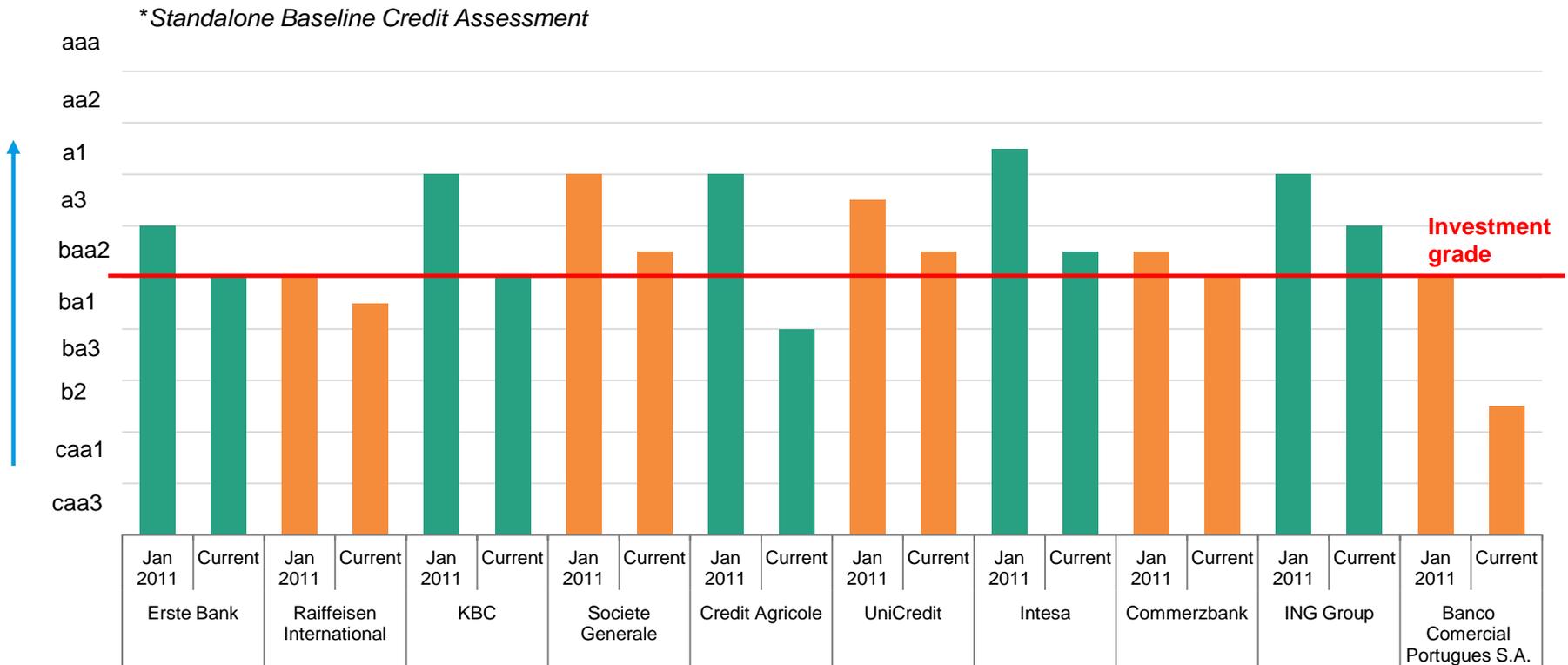


Note: The chart depicts the split of foreign ownership within following CEE banking systems: Czech Republic, Hungary, Poland, Slovakia and Romania)

Source: Moody's Investors Service, Banks' IFRS reporting as of YE 2011

# Rating developments on the West European parents

» Standalone ratings declined: Average 3 notches for the major West European parents since the beginning of 2011



# 5

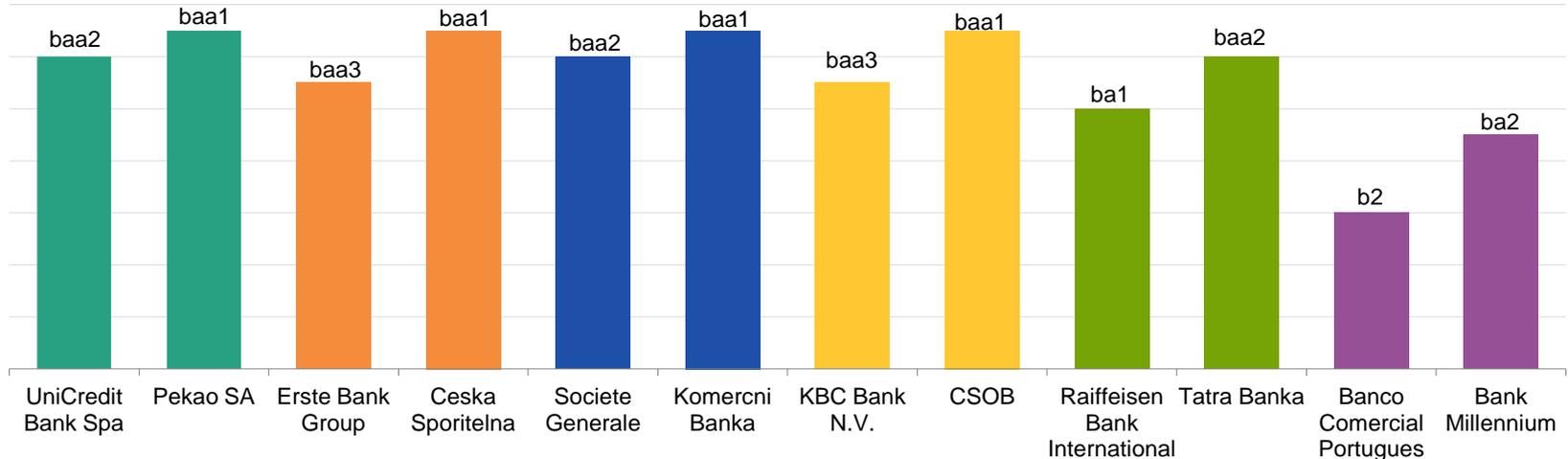
Inverse gap: Can a subsidiary be stronger than the parent bank?

# Can I do better than my parent bank?

» For the “Inverse Gap” Moody's considers *inter alia*:

- Sub’s domestic market is insulated from the macro pressures affecting the parent
- Ownership structure and board composition - representation of the other stakeholders, minorities
- Brand association, risk management and shared client-base with the parent
- Strength of standalone independent franchise of the subsidiary
- Exposure to the parent on the both sides of the balance sheet
- Funding structure of the subsidiary / nature of intercompany transactions
- Strong regulatory ring-fencing from undue parental interference / capital repatriation
  
- Not formulaic model – case-by-case basis

# CEE subsidiaries that are higher rated on a stand-alone basis vs parent banks



\*Standalone Baseline Credit Assessment

Moody's view: *Fully* delinking parent/sub ratings may be impossible to achieve in practice

- Can the subsidiary survive if the parent defaults – group-wide contagion?
- Severely underperforming parents may drag down well-performing individual subsidiaries in the current market

# 6

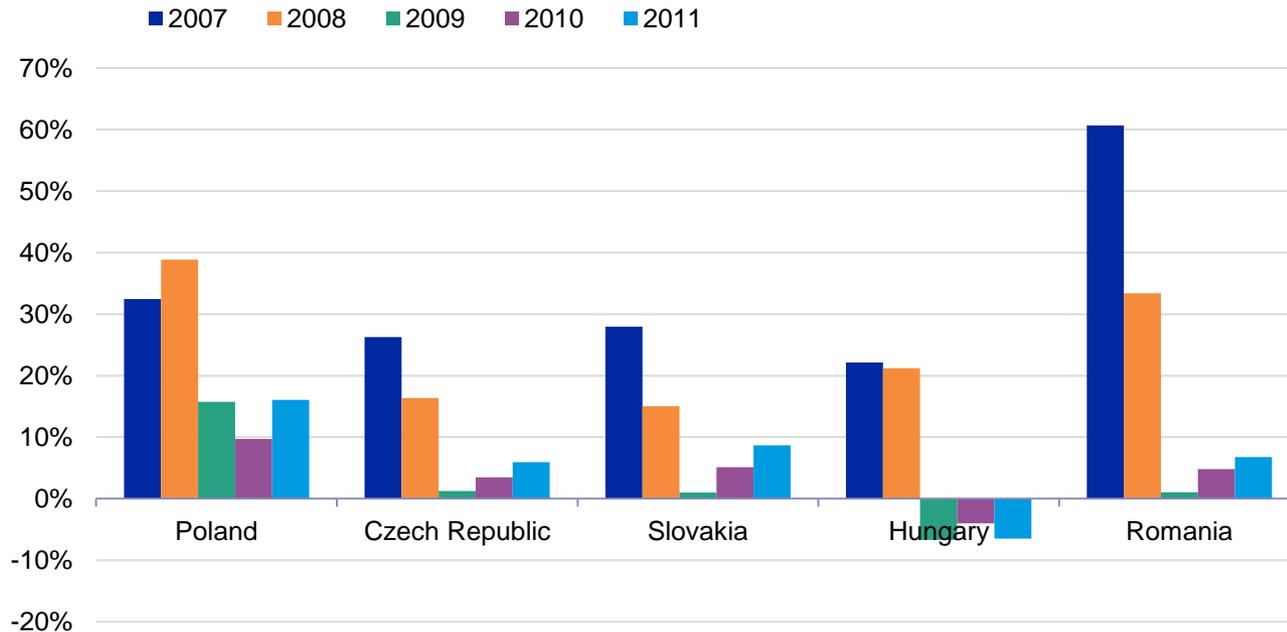
## What is different: 2009 vs 2013

# European trends are affecting the CEE market

- Current retrenchment resembles 2009
- Defensive strategies dominate banks' outlooks for 2013
- Expect: competition for retail deposits and profit pressures

## » What is different?

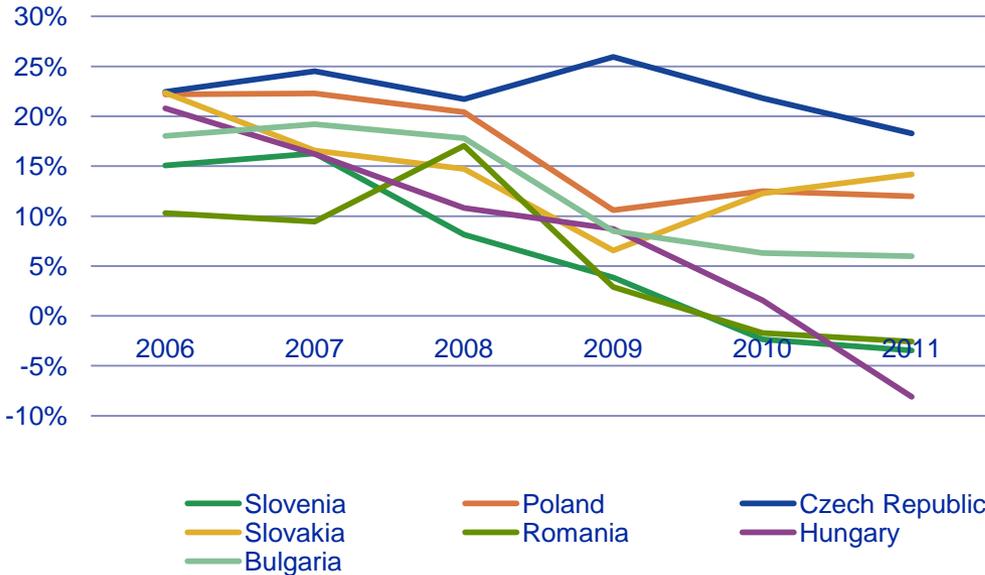
Loan-portfolios are more seasoned: loan growth rates of banks between 2007 and 2011



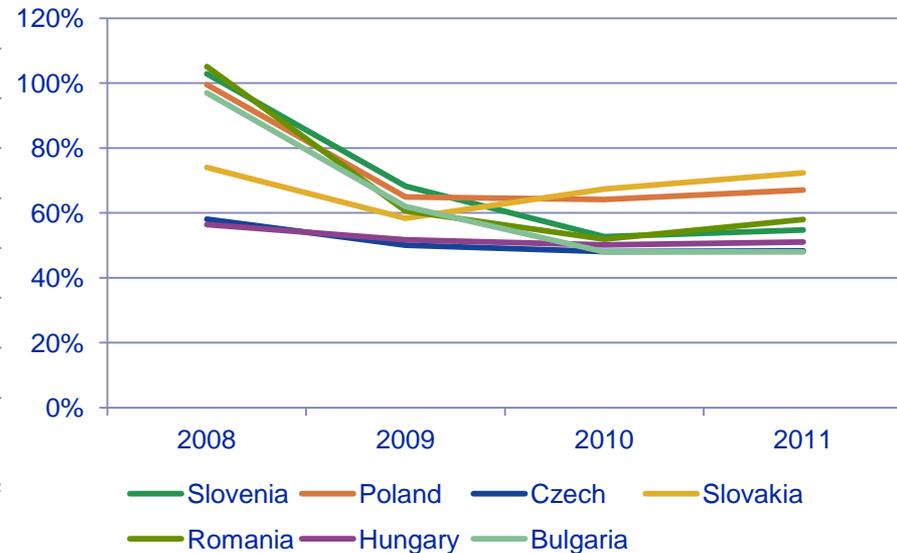
# NPLs increasing while Profitability going down

- » Lower buffer from superior pre-crisis profitability
- » Deteriorating asset quality – i.e., rising non-performing loans (NPL)
- » Lower NPL coverage by provisions – i.e., higher write-off risks

### ROE for the Banking Systems in CEE7

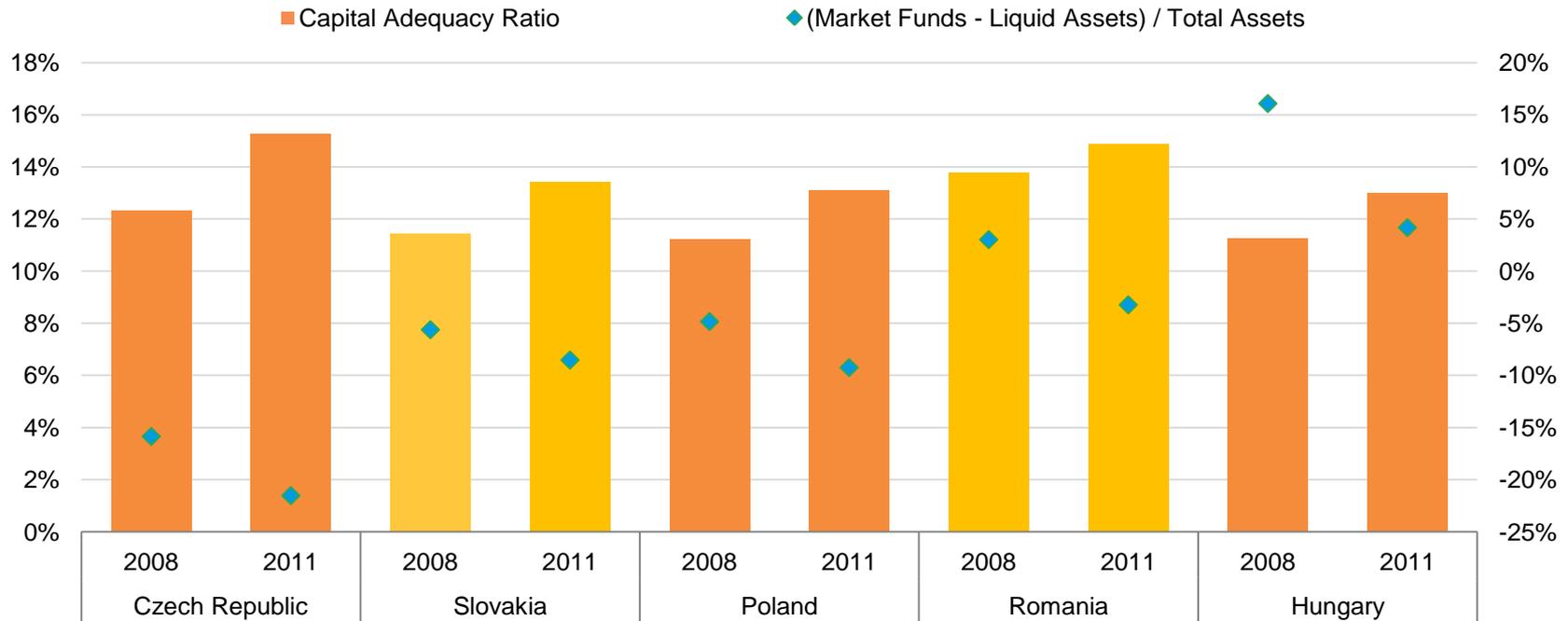


### Provisioning Coverage of NPLs - CEE7



# European trends are affecting the CEE market

Both capital and liquidity ratios of CEE banks are more robust 2008 vs. 2011



- NB – decline in the (market funds-liquid assets)/Total asset ratios means improvement in the liquidity position

# European trends are affecting the CEE market

Moody's view: 2013 compared with 2009

- Three stronger banking systems (Czech, Poland, Slovak) have enhanced internal capacity to weather the expected retrenchment
- Hungary and Romania will be weighed down longer - Western parents are not generous anymore
- However, the shock from external environment could be even more profound in 2013 vs 2009

## Summary – key takeaway messages

- » Parental rating actions were decisive in affecting ratings of the CEE subsidiaries in 2012
- » On average the parental support has become more selective i.e. pushing the subs towards increased independence
- » European wide retrenchment is influencing the strategies (and ratings) of the CEE subs in 2013
- » Some of CEE banks can maintain stronger credit profiles compared to the parents under special circumstances
- » In the next year:
  - The three leading banking systems have internal buffers to deal with the retrenchment
  - The two struggling systems will remain underperforming longer
  - However, external shock from the EU turmoil can be long-lasting compared to the initial stages of the crisis

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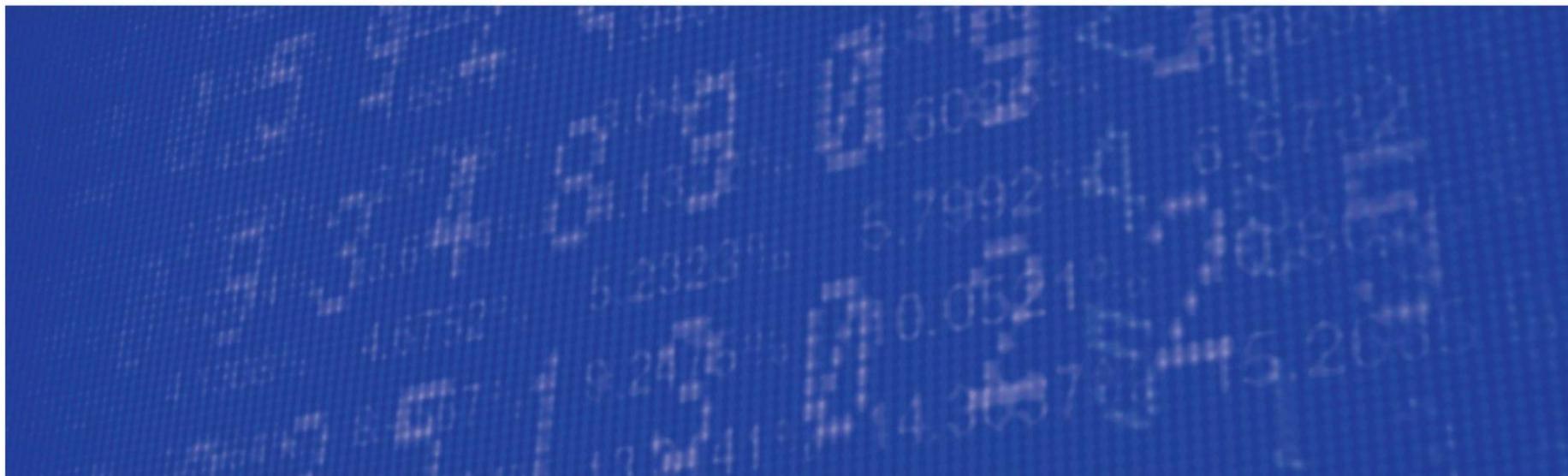
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