

Weekly Credit Update

Summary

- The rally is back and spreads have moved substantially tighter
- GM filed for chapter 11 – muted reaction in the credit market
- In Denmark and Sweden the central banks have published their biannual stability reports

Headlines from the credit market this week

CDS indices are tighter compared with last week. The investment grade index, iTraxx Europe, currently trades at 107bp compared with 122bp last week, while the high yield index, iTraxx Crossover, trades at 680bp down from 727bp. Thereby credit continues to rally despite the chapter 11 filing by General Motors.

In the primary market the high activity continues. From the Nordic region Handelsbanken came to the market with a USD senior issue.

Table 1. Selected new issues during the week

Name	Rating	Coupon	Maturity	Currency	Size	Bond spread on issue date, ASW (bp)*
HSBC (LT2)	A1/A+	Fixed	10 NC 5Y	EUR	1.75bn	245
McDonalds	A3/A	Fixed	7Y	EUR	0.3bn	110
Novartis	Aa2/AA-	Fixed	7Y	EUR	1.5bn	Gov +114
Sv. Handelsbanken	Aa1/AA-	Fixed	5Y	USD	1.25bn	Gov +250
Rabobank	Aaa/AAA	Fixed	3Y	EUR	0.6bn	90

Note: Ratings are Moody's and S&P. * Mid-Swaps for Fixed, Discount Margin for floating

Source: Danske Markets

Swedish central bank has stress tested the four large Swedish banks

On Tuesday, Riksbanken published its biannual report on financial stability in which the central bank conducted a stress test of the four large Swedish banking groups (Nordea, Svenska Handelsbanken, SEB and Swedbank). In its base case, the Riksbank assumes that loan losses for the four banks will reach a total of SEK170bn in 2009 and 2010. This number is somewhat higher than current consensus estimates – particularly for 2010 where a number of analysts expect lower losses than in 2009. Following the report, Swedish banks experienced a negative correction in the equity market.

More interestingly, the Riksbank also looks at a more pessimistic scenario and calculates the impact on the Tier 1 ratio of the banks of higher loan losses in the countries in which they operate (as well as a number of other assumptions). In this pessimistic scenario, loan losses are estimated at SEK312bn in 2009 and 2010.

As can be seen from the table below, Swedbank is the bank that is most affected in the stress scenario with a Tier 1 ratio below 5% in 2010 – the reason being the large exposure towards the three Baltic countries.

iTraxx Europe (5Y CDS)



Source: Markit

iTraxx Crossover (5Y CDS)



Source: Markit

VIX volatility index



Source: Bloomberg

Senior Analyst

Henrik Arnt
+45 45128504
henrik.arnt@danskebank.dk

[Job Title]

[Analyst Name]
[Telephone]
[Email]

Result of stress tests

	Handelsbanken		Nordea		SEB		Swedbank	
	2009	2010	2009	2010	2009	2010	2009	2010
Loan losses (SEKbn)	20	28	48	70	29	42	31	44
Net profit (SEKbn)	-5	-13	-12	-33	-15	-27	-15	-29
Tier 1 capital ratio	10.1%	8.3%	9.9%	8.1%	10.1%	6.9%	8.9%	4.8%

Source: Sveriges Riksbank

In this respect, it is worth noting that in the stress test, the Riksbank assumes that loan losses in the Baltic countries will reach a total of 20% of total lending for 2009 and 2010. Considering the recent catastrophic numbers that have emerged from the region, we do not consider cumulated losses of 20% in 2009 and 2010 to be an unrealistic scenario – especially not if we see devaluations as this would imply that losses would be front-end loaded and thereby reduce the amount of time that the banks have at their disposal to accumulate earnings.

Geographical distribution of lending by end Q1 09

	Handelsbanken	Nordea	SEB	Swedbank
Sweden	69	23	48	77
Norway	13	16	7	*
Denmark	4	29	2	*
Finland	7	19	3	*
Estonia	0	1	3	7
Latvia	0	1	3	5
Lithuania	*	1	5	5
Germany	1	0	24	*
UK	4	0	*	*
Other countries	1	10	5	7

Note: * indicates that there is no data or that the bank has low exposure in the country.

Source: Sveriges Riksbank

In our view, the stress test highlights what we already know: namely that Swedbank is currently under substantial pressure and that another capital increase could be forthcoming.

Danish central bank issues its financial stability report

Today, Denmark's Nationalbank published its financial stability report. The most interesting part of the report relates to the base scenario the central bank sees for the 14 largest banks in Denmark. In particular, we note that loan losses are not expected to peak until 2010, which is perhaps a bit more pessimistic than the current estimates by a number of equity analysts (but in line with our expectations).

In the base scenario, the central bank is expecting 135bp loan loss charges in 2009, 146bp in 2010 and 115bp in 2011. The macro scenario behind the base scenario is a 2.4% fall in GDP in 2009, but a recovery to +0.5% in 2010 and 1.5% in 2011 (Danske Markets expects -2.4% this year and 0.8% in 2010). Assuming that the banks take advantage of the possibility in bank package II to subscribe for hybrid capital, the base scenario implies that none of the 14 banks investigated by the central bank will fall short of the minimum capital requirement. Thereby the overall conclusion is that bank package II will strengthen the capital base sufficiently, and leave the Danish banking industry well capitalised to withstand the expected rise in loan losses.

Under the stress scenarios where GDP falls further and unemployment rises to around 10% (base case: 6%) a number of banks experience difficulties. The central bank sees these scenarios as unlikely.

Fixed Income Credit Research

Head of Credit Research

Thomas Thøgersen Grønkjær
+45 45 12 85 02
thomas.groenkjaer

TMT, Utilities & Energy

Financials

Pulp & Paper

Industrial

Disclosure

This report has been prepared by Danske Research, which is part of Danske Markets, a division of Danske Bank. Danske Bank is under supervision by the Danish Financial Supervisory Authority. The author of this report is Henrik Arnt, Senior Analyst.

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