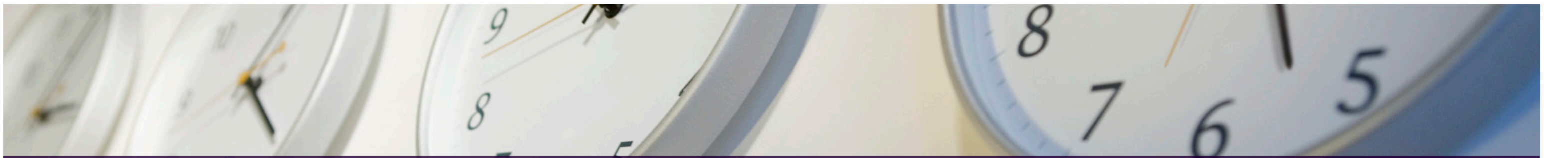

CreditOutlook

Credit Implications of Current Events

6 AUGUST 2012

NEWS & ANALYSIS

RATINGS & RESEARCH

Last week we downgraded Walgreen, Bermuda Commercial Bank, DSK Bank, First Horizon National, First Tennessee Bank, Forum Bank, Raiffeisenbank (Bulgaria) EAD, and 258 Italian ABS and RMBS, and upgraded several Uruguayan banks, among other rating actions.

Last week we published on packaging, Latin American corporates, US corporate pensions, US restaurants, US utilities, French banks, Greek banks, Danish banks, US banks, global insurers, US states' cash flow notes, US privatized military housing, US auto ABS, and Asia-Pacific structured finance, among other reports.

RECENTLY IN CREDIT OUTLOOK

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Corporates

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Court Ruling Is Credit Positive for Hewlett-Packard, Negative for Oracle

Last Wednesday, California Superior Court Judge James Kleinberg ruled that Oracle Corporation (A1 stable) is contractually obligated to continue offering new software on Hewlett-Packard Company's (A3 stable) Itanium-based servers. The ruling is credit positive for HP because it prolongs the life of its Itanium server platform. The ruling is credit negative for Oracle because it could require it to pay substantial damages to HP. Although the amount of the damages won't be determined until the penalty phase of the trial, media reports have speculated that HP may seek up to $4 billion.

However, there are important caveats to consider as Oracle said it planned to appeal the ruling and pursue cross claims that HP misled partners and customers. Such claims could delay final resolution of the litigation until 2013. As a point of reference, HP filed its original lawsuit in June 2011.

More importantly, the trial has reinforced a long-term concern of HP's customers: that neither Oracle nor Intel Corporation (A1 stable), which manufactures Itanium microprocessors, will support the Itanium-based servers in the future. Despite the court ruling, we expect HP's customers will continue to have questions about the ongoing support and roadmap of Itanium-based servers.

HP sued Oracle after the latter announced in March 2011 that it would discontinue development of software for Itanium-based systems owing to its belief that Itanium was approaching the end of its life. Alternatively, Oracle stated that it would continue supporting its software on such server platforms as Intel's x86-based Xeon chips and Oracle SPARC architectures. We viewed this as an attempt by Oracle to lure HP customers using Oracle software to the Oracle SPARC/Solaris hardware platform.

In his decision, Judge Kleinberg ruled that HP and Oracle have a binding contract requiring Oracle to continue "porting" its software products to HP's Itanium-based servers (that is, enabling its software to run on the Itanium platform). He also ordered Oracle to continue developing software for the Itanium platform, as Oracle currently does for the IBM Power and its own Sun SPARC servers, until HP discontinues the sale of its Itanium-based servers.

Despite the ruling, we believe that uncertainty over Oracle's software development support will prompt customers to continue weaning themselves off Itanium-based server architectures and toward x86-based servers.

HP's ratings already reflect our expectation that the company's business critical systems (BCS) segment, which includes its Itanium-based server line, will account for a declining portion of its revenue in the fiscal year ending 31 October 2012. We believe BCS will generate $1.5 billion, or 1.2%, of HP's anticipated revenue of $125 billion in fiscal 2012, slipping from $2.1 billion, or 1.6%, of HP's revenue of $127.2 billion in fiscal 2011.

Even if Oracle loses its appeal of the California court ruling, it has sufficient liquidity to withstand a sizable payment of damages. We expect Oracle to generate more than $12 billion in free cash flow annually, supported by high levels of recurring, predictable revenues. The company also had $31 billion of cash and short-term investments as of 31 May 2012, although it holds most of those funds overseas.

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Devon's Joint Venture with Sumitomo Is Credit Positive

Last Wednesday, Devon Energy Corporation (Baa1 stable) announced it had signed a $1.4 billion joint venture (JV) with Sumitomo Corporation (A2 stable), giving one of Japan's largest trading companies a 30% stake in two shale properties that Devon holds in West Texas. The JV, Devon's second with an Asian partner this year, is credit positive for the exploration and production (E&P) company as it provides not only upfront cash, but also helps to fund certain of Devon's drilling and completion costs.

Devon. The JV will give Devon $340 million in cash at closing, plus an additional $1.025 billion that would fund 70% of its drilling and completion costs to develop the acreage, a contribution known as a drilling carry. Devon, which will continue to operate the properties, estimates that it will fully utilize the carry by mid-2014. In return, Sumitomo gains an interest in 30% of Devon's 650,000 net acres in the Cline Shale and Midland-Wolfcamp Shale in the Permian Basin of West Texas.

The JV gives Devon a significant amount of upfront cash and cash payments over the next two years, allowing it to accelerate its oil-focused drilling program, reduce future capital expenditures, and improve returns through the drilling carry. By enlisting a partner for its drilling program in the emerging shale plays, the JV also reduces Devon's inherent investment risk.

In addition, the JV helps Devon grow its oil production, which currently accounts for 22% of its total production. The current price outlook and returns for oil are strong. Natural gas and natural gas liquids (NGLs) production account for most of Devon's total production, reaching 78% in the second quarter of 2012. The JV offers Devon additional financial resources to fund growth during a period of weak prices for natural gas and NGLs, primarily ethane.

Sumitomo. The JV is a large investment for Sumitomo, but the actual cash outlay per year is manageable relative to the company's cash flow generation, limiting the deal's overall financial burden. North American independent E&P companies such as Devon, which have led the way in shale drilling, make logical JV partners for bigger companies. Sumitomo, which engages in a wide range of businesses, already has some experience in shale resource plays in the US, participating in a drilling program at the Barnett Shale in Texas since 2009 and the Marcellus Shale in Pennsylvania since 2010. Sumitomo will look to the Devon JV to enhance its resource-related businesses.

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Valero's Retail Separation Plan Increases Financial Risk, a Credit Negative

Last Tuesday, Valero Energy Corporation (Baa2 stable) said it had planned to separate its retail business, a move it is taking to improve shareholder returns. The separation would be credit negative for Valero as it takes away the most stable part of its earnings and cash flows, and promises higher earnings volatility, particularly during refining down cycles.

Valero's scale, operational and geographic diversification, high-complexity refineries that yield a high proportion of valuable light refined products, and solid financial leverage metrics, including retained cash flow/debt of more than 30%, support the company's rating despite the separation. However, the split removes what had been a steady source of cash from bondholders' perspective.

In the past, Valero's retail investments have modestly diversified its earnings and cash flows. Although the company's retail service-station business only accounted for around 13% of its unadjusted second-quarter 2012 operating income, the segment has provided the largest credit benefit to Valero during cyclical troughs in refining. During a down cycle in 2009, the retail business accounted for 28% of Valero's operating income.

Valero has two new hydrocrackers slated to come on-stream in late 2012 and early 2013, major growth projects that will significantly boost its refining business. As these projects ramped up, the company's retail business appeared likely to contribute more modestly to its overall earnings and cash flow profile, assuming reasonable realized margins from refining.

With more volatile earnings in the future, Valero's credit and ratings receive support from the size and the spread and process complexity of its 15 refineries. The company's reach helps dilute its risk both regionally, and from unplanned downtime. We also expect Valero will maintain a good liquidity profile and investment-grade financial leverage metrics. Financial leverage would weaken only slightly in 2013 as a result of the retail separation, with retained cash flow to debt declining less than 5%.

Nevertheless, the separation, along with a rising dividend and our expectation of plans for greater share buybacks in 2013, suggest that Valero's management has increased its focus on shareholder returns. Valero's credit quality and rating could come under pressure from further efforts to improve shareholder returns. Such efforts could result in large negative free cash flow, rising debt levels, or a weak liquidity profile arising from a significant debt-financed acquisition or debt-financed share buybacks.

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Allegiant Travel's Addition of Airbus Aircraft Is Credit Positive

Last Monday, Allegiant Travel Company (Ba3 stable) said it had agreed to lease or purchase 19 Airbus A319 aircraft from GE Capital Aviation Services and Cebu Pacific Air. The announcement is credit positive for Allegiant because the A319 has a lower projected per passenger operating cost than the McDonnell Douglas MD-80, which accounts for the vast majority of the company's current fleet.

Allegiant will take nine A319s from GE Capital Aviation Services on eight-year operating leases and will purchase 10 A319s from Cebu Pacific Air, financed with capital leases with five-year terms. The company expects each of the aircraft to enter the fleet between second-quarter 2013 and third-quarter 2015.

Allegiant said it expects each A319 to contribute annual net income of approximately $1 million, above our estimate of per-plane net income of $800,000 for the company's MD-80s, based on its 2011 financial statements. However, the announcement does not affect our ratings because Allegiant will use capital-efficient lease financing rather than its unrestricted cash, which stood at $390 million (42% of revenue) on 30 June 2012.

The transactions will have little pressure on operating margins or credit metrics because we expect the lower fuel burn and lower maintenance cost per revenue passenger mile of the seven- to 10-year-old A319s to counterbalance the higher capital cost of these aircraft.

The A319s are part of the Airbus A320 family of aircraft, which Allegiant indicated will most likely replace its MD-80s, we think starting sometime after 2015. We believe that the market value of current-technology A320 family aircraft is likely to decline, supporting Allegiant's capital-efficient model of acquiring older aircraft with meaningfully lower values than new production models.

We base Allegiant's Ba3 corporate family rating on our expectation that the company will sustain the profitability of its differentiated scheduled airline model as it continues to grow. The company's historical financial results, industry-leading unit costs (excluding fuel) and strong credit metrics for the Ba rating category (including debt to EBITDA of less than 2x and EBIT to interest of more than 8x) provide sufficient cushion to maintain its current credit profile if the new aircraft or new routes prove less profitable than the company expects or if the US economy significantly weakens. These factors also ameliorate ratings pressure from Allegiant's relatively small size and lower yields, which are a function of its price-driven business model targeting leisure travelers.

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New Congo Mining License Is Credit Positive for ENRC

Last Tuesday, Eurasian Natural Resources Corporation (Ba3 negative) announced that it had successfully acquired the mining license for the Frontier copper mine in the Democratic Republic of Congo (DRC, unrated). The license, which cost $101.5 million, will allow London-based ENRC to begin developing the mining site it acquired from First Quantum Minerals in 2009. Upon completion of the development works in mid-2013, the Frontier mine will produce around 90,000 tonnes of low-cost, high-grade copper per year. The mine will also diversify ENRC's commodity mix into copper, which has a robust demand outlook, and improve profitability given the low-cost nature of mining in the DRC, both credit positive factors that enhance the group's credit profile over the next 12 months.

The key credit-positive development for ENRC is the increased attractiveness of its DRC mines to potential investors. If ENRC decides to dispose of its assets there, either individually or as part of a wider international spin-off, the mining license and ready-to-mine nature of the assets will enhance the saleability of the operations. Although management has not publicly stated any intention to carve out its DRC assets from its core ferroalloy and iron ore operations in Kazakhstan, the company's public announcement in early 2012 that it would undertake a strategic review of operations, including an assessment of potential acquisitions, joint ventures and spin-offs, has fuelled media and market speculation about its plans.

Given the extremely high level of political risk inherent to operating in the DRC, the result of an uncertain legal framework and endemic corruption, and the damage to ENRC's corporate governance reputation that its foray into the DRC has caused, any developments that increase the likelihood of the African operations being spun off from the core group will likely be positive for the rating. Investors voiced concerns over ENRC's decision to acquire the DRC assets in 2009, following their expropriation from London-based First Quantum Minerals (FQM, unrated) by the DRC government. The ensuing legal challenges brought against ENRC created significant negative publicity for the group, until all outstanding legal challenges were finally dropped following a $1.25 billion settlement in early 2012.

ENRC's decision to delay the purchase of the license and deal directly with the DRC government, rather than negotiate with the private Hong Kong-based trading company that previously owned the license, demonstrates a maturing corporate governance framework. Investors had highlighted concerns about negotiating with the Hong Kong-based trading company given widespread fears that the company was effectively owned by senior DRC political figures. Management's decision to delay the purchase of the license, and thus the development of the mining site in order to deal directly with the government, has ameliorated the risk that ENRC would eschew good governance practices in order to progress key development projects. This is a key positive for a group that has suffered from a poor governance track record over recent years.

ENRC is a vertically integrated global mining company. In addition to assets in Kazakhstan, the company has a small number of early-stage development assets in Brazil and Africa. The group is primarily focused on the production of ferroalloys (40% of revenue), iron ore (32% of revenue), and aluminium products (15% of revenue). ENRC is the world's largest ferrochrome producer and one of the leading global exporters of iron ore. In 2011, ENRC generated revenue of $7.7 billion and EBITDA of $3.4 billion.

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China's Five-Year Natural Gas Plan Would Help Distributors

Last Monday, China's Ministry of Housing and Urban-Rural Development released its 12th five-year plan (for 2011-15) for the national development of urban gas. The plan calls for setting up a more transparent tariff mechanism to pass through upstream costs to downstream users and more than doubling the country's natural-gas supply to 120 billion cubic meters (bcm) by the end of 2015 from 53 bcm in 2010. If implemented, these changes to China's regulatory framework would be credit positive for our rated city-gas distributors as they would remove the uncertainty hanging over China's evolving regulatory framework.

The affected companies are China Resources Gas Group Limited (Baa1 stable), ENN Energy Holdings Limited (Baa3 review for downgrade), Towngas China Company Limited (Baa2 stable), The Hong Kong and China Gas Co. Ltd. (A1 stable), and Beijing Enterprises Holdings Ltd. (Baa1 stable), which in aggregate account for around half of China's sales of piped urban gas by volume.

Despite robust growth and the government's support in promoting more use of natural gas, city distributors face the risk of delayed cost pass-throughs, which impair profitability. China's central government controls upstream, wellhead prices and transmission tariffs for piped natural gas, but leaves end-user price adjustments to local governments. This dichotomy in regulation results in time lags between adjustments for upstream and downstream costs, particularly residential tariffs. Regulators' concerns about inflation and lengthy approval processes have resulted in distributors often waiting six to 12 months before being able to pass cost increases on to residential users.

In 2011, China's total consumption of natural gas rose 16%, while the volume of imported gas jumped 45% as a ramp-up in domestic productive capacity was not sufficient to cover total demand.

China National Petroleum Corporation (CNPC, Aa3 positive), which supplies most of the country's natural gas and imports via pipelines from central Asia, must sell its imported natural gas at a low fixed price to domestic Chinese distributors, and in doing so, incurs losses. So far, CNPC's much larger domestic-gas production operation has more than compensated for those import losses, although as imports outpace domestic output, losses are likely to grow.

We expect the central government to raise upstream tariffs to provide CNPC with enough economic incentive to continue importing adequate amounts of natural gas to cover rising demand. However, without a timely and efficient cost-pass-through mechanism, an upstream tariff increase will squeeze downstream gas distributors. Such a scenario occurred in 2010 when local governments delayed approving tariff increases to end users' after upstream gas prices rose.

The central government's implementation of the 12th five-year plan would ameliorate that threat.

China's central government uses five-year plans to guide the development of key industries. Although not officially a regulation, these plans direct different government agencies to pass detailed rules and regulations. We expect that a more transparent and efficient tariff-setting mechanism could be in place in the next one to two years, thus minimizing the adverse impact of potential increases in upstream prices.

Compared with most industrialized countries, the passing through of costs to users in China's regulatory framework is more uncertain, owing to it being less developed, less transparent and subject to excessive governmental intervention. However, if the plan for the city gas distributors comes to fruition, it would change our current assessment of China's regulatory framework and bolster the financial and credit profiles of the affected distributors.

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Macau's Casinos Bet on Full House, Despite Shrinking Revenues

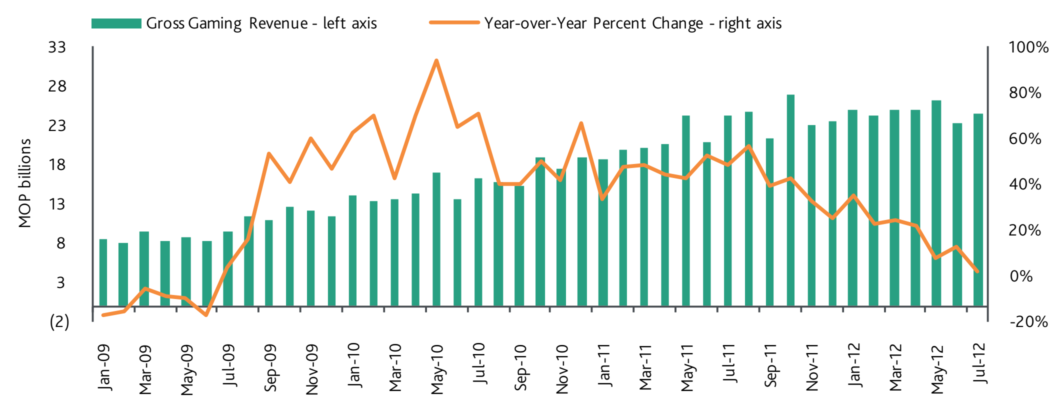
Last Wednesday, the Gaming Inspection and Coordination Bureau of Macau SAR announced that gross gaming revenue grew only 1.5% year over year in July to MOP24.58 billion ($3.07 billion), the slowest growth since the market recovered from the global financial crisis in July 2009. The slow growth in gaming revenue is credit negative for Macau's (Aa3 stable) gaming operators because it raises their operating and financial risks, just as a substantial capacity expansion raises their funding needs.

The new multi-billion dollar projects are mostly large-scale integrated resort type casinos located in the Cotai area of Macau and their completion would double the number of gaming tables in the area in the next three to five years. Developments in the pipeline include the Studio City Project, which is 60%-owned by Melco Crown Entertainment Limited (unrated), parent of MCE Finance Limited (Ba3 stable); Phase 2 of Galaxy Macau Resorts by Galaxy Entertainment Group Limited (unrated); an integrated resort by Wynn Macau, Limited (unrated); and Land Parcel 3 of Sands China Ltd (unrated). Many of these developments are still at the planning stage without much detail. But, as Galaxy announced in April, Phase 2 of Galaxy Macau Resorts could virtually double the size of its existing operation with an expansion of up to 500 gaming tables and more than 1,000 slot machines. The proposed investment is approximately HKD16 billion ($2.05 billion). This scale of development is typical for an integrated resort project in Cotai.

Additionally, MGM China Holdings Limited (unrated) has submitted an application to the Macau government for a parcel of land to develop an integrated casino hotel and entertainment complex in Cotai. If capacity outpaces demand, competition between the operators will intensify.

As shown in Exhibit 1, the 1.5% growth in July is the slowest since the market recovered from the financial crisis in July 2009 and is sharply lower than the 27% year-over-year growth for the first quarter and the 13.4% year-over-year growth for the second quarter. The lackluster performance is partly attributable to the late July typhoon, but also reflects China's softening economy, which will continue to weigh on Macau's Chinese-customer-dominated gaming market. Chinese visitors to Macau represented approximately 60% of all visitors to the enclave in the first half of the year.

EXHIBIT 1
Macau Gross Gaming Revenue



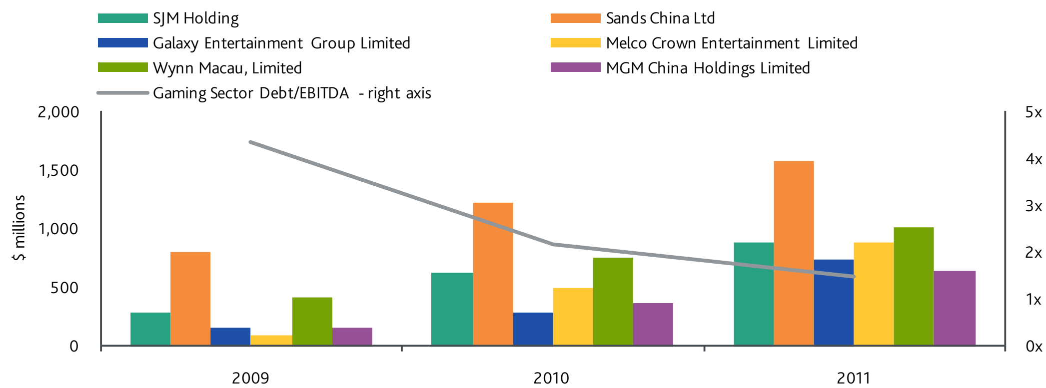
Source: Gaming Inspection and Coordination Bureau, Macau SAR

Macau's gaming operators have taken the benefits of strong gaming revenue growth to deleverage over the past two years. As shown in Exhibit 2, all six gaming operators recorded promising EBITDA growth in 2010 and 2011, which, in turn, drove down their leverage position (i.e., debt/EBITDA).

However, gaming operators' debt leverage will likely increase and key financial metrics will weaken with slower growth in gaming revenue and EBITDA at the same time that they have to raise debt to fund new projects. In addition, a less favorable outlook for Macau's gaming sector would increase investors' demand for return, and consequently, gaming operators' funding cost.

EXHIBIT 2

EBITDA of Macau's Gaming Operators and the Sector's Debt/EBTIDA Trend



Source: Company Annual Reports and Moody's Investors Service

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Crown's Casino Expansion Plans in Australia Are Credit Negative

Last Thursday, Crown Limited (Baa2 stable), Australia's largest casino owner and operator, announced an exclusive deal with Lend Lease Group (Baa3 stable) to develop a concept plan for a six-star hotel resort in Sydney, New South Wales. The announcement came just one day after Crown announced an agreement with the Western Australian government to build a new six-star luxury hotel at the site of its existing casino operations in Perth for a cost of approximately AUD568 million. The plans are credit negative for Crown.

The investment in a new hotel in Perth is significant because it coincides with Crown's ambitions to expand its Australian footprint beyond its existing operations in Victoria and Western Australia. To that end, Crown in February increased to 10% from 4.9% its stake in Echo Entertainment Group (unrated), the sole casino operator in New South Wales, at a cost of AUD260 million. Crown is seeking regulatory approval to further increase its stake to 25%.

An alternate strategy for Crown to enter the Sydney gaming market is for the company to undertake the development of the resort in Sydney independently of Echo, in anticipation of Echo Entertainment's monopoly casino license expiring in 2017.

The capital expenditure in Perth, which we expect will be partly debt-funded, will increase financial leverage (i.e., debt to EBITDA) to 2.00x-2.25x from 1.60x-2.00x over the next three years. We estimate that if Crown proceeds with both the Perth hotel resort complex and increasing its stake in Echo to just 19.9% from 10%, which is the threshold above which a full takeover offer must be made, its debt to EBITDA will increase to around 2.6x from around 2.0x. If it succeeds in getting regulatory approval and increases its stake in Echo to 25%, debt to EBITDA will increase to around 2.9x. If within 12 months Crown undertakes the Perth hotel resort development, increases its stake in Echo to 19.9% and develops the hotel in Sydney, on a purely debt-funded basis, debt to EBITDA would likely increase to around 3.0x-3.3x over the next three years, assuming a cost of AUD800 million to AUD1 billion.

Either New South Wales scenarios will negatively pressure Crown's credit profile in addition to the announced Perth development.

We recognize the strategic rationale of the announced plans to develop two new hotels. The Perth hotel will be the largest in Perth upon completion, and will add 500 rooms to the city's constrained accommodation market. As part of the agreement underpinning the development, Crown is likely to obtain an additional 500 gaming machines and 130 additional gaming tables, which will include new private VIP gaming salons. The Sydney hotel and gaming proposal would provide Crown with wider exposure to Australia's gaming sector and help make Australia more attractive to the international Asian VIP market. It would, however, carry execution risk and raise the possibility of pulling revenue away from Crown's Melbourne operations to Sydney.

Infrastructure

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Intercontinental Exchange's Energy Markets Transition Is Credit Negative for Power Producers

Last Monday, the IntercontinentalExchange (ICE, unrated), an operator of global regulated futures exchanges, announced that it would transition all cleared over-the-counter (OTC) products listed on the OTC energy market to futures products in January 2013. Cleared commodities include natural gas, electric power, environmental emissions credits and natural gas liquids. Dodd-Frank legislation and other regulations prompt the transition to futures from swaps, which is credit negative for US power producers with material hedging and trading activities. ICE's transition could become a harbinger for the power industry's preference of futures over swaps.

Futures products have lower hedging costs and better liquidity because they have standardized contract terms compared with more customized swap arrangements. But the standardized futures will create challenges for effectively hedging electricity because they expose power producers to basis risk (the difference between the exposure a power producer has and the exposure a futures contract can hedge).

Issuers that are most affected because of their heavy use of energy derivatives include Exelon Corporation (Baa2 review for downgrade), NextEra Energy, Inc. (Baa1 stable), Entergy Corporation (Baa3 stable), PPL Corporation (Baa3 stable), Calpine Corporation (B1 stable), FirstEnergy Corp. (Baa3 stable), NRG Energy Inc. (Ba3 negative), Public Service Enterprise Group Incorporated (Baa2 stable), Ameren Corporation (Baa3 stable), and Energy Future Holdings Corp. (EFH, Caa2 negative).

An industry shift toward futures will also increase collateral requirements because exchanges require daily margin settlement versus other collateral agreements negotiated in bilateral swaps. For example, EFH held $1 billion in cash from counterparties for over-the-counter and other non-exchange-cleared transactions on an approximately $2 billion, in-the-money position for OTC products at year-end 2011. EFH's counterparties would have to post approximately another $1 billion if using futures contracts and collateralize their payables 100% to EFH's account at the futures exchange. Higher or lower ratios of collateral to mark to market could diminish or exacerbate the effect. Additionally, when using futures, the cash would be posted to the exchange and recorded as restricted cash rather than cash for EFH.

Simplified Comparison of Key Credit Aspects for Futures and Swaps

	Futures	Swaps
Collateral/Margin	Daily Posting	Specified in contract
Liquidity	High	Limited
Hedging Effectiveness	Moderate	High
Accounting Treatment	Derivative Accounting	Derivative Accounting

Source: Moody's

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CELPA Wins Large Tariff Increase, a Credit Positive

Last Tuesday, Brazilian electricity regulator Agencia Nacional de Energia Elétrica (ANEEL) approved a 12.7% tariff increase for Centrais Eletricas do Pará S.A. (CELPA; Ca negative), the electricity distributor in the Brazilian state of Pará. The tariff increase will improve cash flow for CELPA, which filed for bankruptcy protection in late February. The tariff hike also facilitates a credit-positive takeover of CELPA by Equatorial Energia S.A (unrated).

The tariff increase will come into effect on 7 August, provided the company pays overdue regulatory charges of around BRL122 million. Toward that end, ANEEL confirmed that it had included the overdue regulatory charges in the federal government's overdue tax credits portfolio (Dívida Ativa da União). This is another credit positive for CELPA because it allows the overdue regulatory charges to be treated like federal taxes, making them eligible for refinancing by the federal government.

As a result, CELPA is entitled to sign a refinancing agreement with the federal government to pay off this debt in 60 months, which the regulator should interpret as a satisfactory settlement of the BRL122 million overdue regulatory-charges-related debt, clearing the way for the tariff increase.

The 12.7% tariff increase is important for CELPA's financial turnaround as it facilitates Equatorial's firm proposal to acquire a controlling stake in CELPA. Equatorial's proposal is contingent on the company's creditors accepting its debt-restructuring and refinancing plan, which includes reduced debt principal repayment, lower interest rates and improved cash flow. The 12.7% tariff increase is an important factor in improving the company's cash flow and therefore allowing the takeover to proceed.

CELPA would benefit from a financially stronger controlling shareholder, which could pave the way for its financial turnaround. Equatorial envisions investing at least BRL650 million in additional funds to meet immediate cash needs and fund part of the current capital expenditure program.

To meet all the conditions necessary for the plan's success, renegotiation of the terms and conditions of the company's existing debt will be its foremost challenge, given the losses it would potentially impose on creditors. It would appear that creditors have no alternative but to accept some debt forgiveness, the magnitude of which will depend on how the different parties perceive the company's potential for cash flow generation.

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UK Competition Commission's Decision Is Credit Positive for Phoenix Natural Gas

Last Friday, the UK's Competition Commission (the CC) reversed a decision made by Northern Ireland's Utility Regulator (UR) that would have significantly reduced the value that UR ascribes to the assets of Phoenix Natural Gas Limited (PNG, whose subsidiary, Phoenix Natural Gas Finance Plc we rate Baa2 stable), a regulated gas distribution utility in Northern Ireland. The CC's provisional redetermination is credit positive for PNG because the regulated asset value determines the revenues the company is allowed to make through its distribution activities and forms the basis on which debt finance is raised.

The ruling strengthens PNG's financial profile, particularly the net debt/total regulatory value (TRV) ratio. If the UR's decision had been upheld by the CC, net debt to TRV would have increased to the mid-60s in percentage terms from the current mid-50s.

UR had proposed two significant deductions from the company's asset base relating to both historical outperformance and deferred capital expenditure allowances between 1996 and 2006, which is prior to the most recent 2007-11 regulatory period. This is significant as UK economic regulators do not typically re-open previous price determinations so as to minimise the perception of regulatory risk. In PNG's view, UR's decision directly contradicted a 2006 agreement between the two parties. UR argued that it had always intended to make the adjustments and that the adjustment was in customers' interests and consistent with regulatory best practice.

Having reviewed numerous submissions from various stakeholders, the CC provisionally reversed the bulk of the adjustments proposed by UR, with the exception of £13.9 million (out of a total £74.4 million). The CC explained its decision by highlighting the importance of regulatory certainty for the natural gas industry in Northern Ireland, saying that to overturn any previous regulatory decision would require very clear justification. In the absence of this, the CC said that there isn't a sufficiently strong case to implement UR's proposed adjustment.

In our assessment of the credit quality of regulated electric and gas networks, we also attribute considerable weight to the strength of the regulatory environment. In our view, UR's actions, if left unchecked by the CC, would have fallen somewhat short of transparent and predictable regulation and would have been credit negative.

In the next weeks, further representations and hearings between PNG, UR and the CC are likely before a final determination is made on 28 September. However, we believe that in the absence of new compelling evidence, significant deviation from the CC's current position is unlikely.

Banks

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Trading Losses at Knight and UBS Are Credit Negative for Bondholders

Last Tuesday, UBS AG (A2 stable) during its second-quarter earnings call disclosed CHF349 million in computer-driven trading losses related to the initial public offering (IPO) of social-networking website Facebook. The next day, Knight Capital Group (unrated) incurred what it estimated to be a $440 million loss relating to computer-driven trading at the New York Stock Exchange (NYSE) market opening. The size and, in particular, the alarming speed of these losses are credit negative for bondholders at UBS and Knight as they highlight the operational risks inherent to electronic market-making. They also point to the considerable risk management challenges that face capital markets intermediaries and, in the case of Knight, the confidence-sensitivity of such firms.

Many investment banks profess they have exited proprietary trading. However, even trading customer flow in liquid transparent markets does not immunize firms against risk. During Facebook's IPO, UBS ended up with more shares than its clients demanded, forcing it to liquidate the excess inventory at a loss. UBS management asserted that NASDAQ Stock Market grossly mishandled the offering and intends to pursue NASDAQ for compensation for its losses.

In Knight's case, the firm's trading software sent "numerous erroneous orders" in NYSE-listed securities into the markets at Wednesday's opening. Although the company quickly removed the software from its systems, closing out the positions left Knight with an estimated $440 million loss.

The incidents are a reminder of the importance to bondholders of diversified business models, which can act as shock absorbers for unexpected losses, as well as the importance of avoiding concentrated positions. The market sanction from counterparties and customers for a trading loss is often less severe in a diversified deposit-taking institution such as UBS. Although the Facebook loss was surprising, it was tiny in comparison to UBS's diversified earnings power and capital base. Despite the loss, UBS reported CHF712 million in pre-tax profits for the quarter (excluding own-credit gains).

By contrast, Knight's $440 million losses were huge, representing over two years of pretax earnings and roughly 25% of tangible common equity on an after-tax basis. This hit has caused a significant reaction from customers and counterparties, and several customers stated that they had stopped sending order flow to Knight. Not surprisingly, the stock market reacted to the potential diminution of the franchise, as Knight's stock closed down roughly 60% on the week and the company was pursuing strategic alternatives to replenish capital.

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Danish Banks Pay to Place Deposits with the Central Bank, a Credit Negative

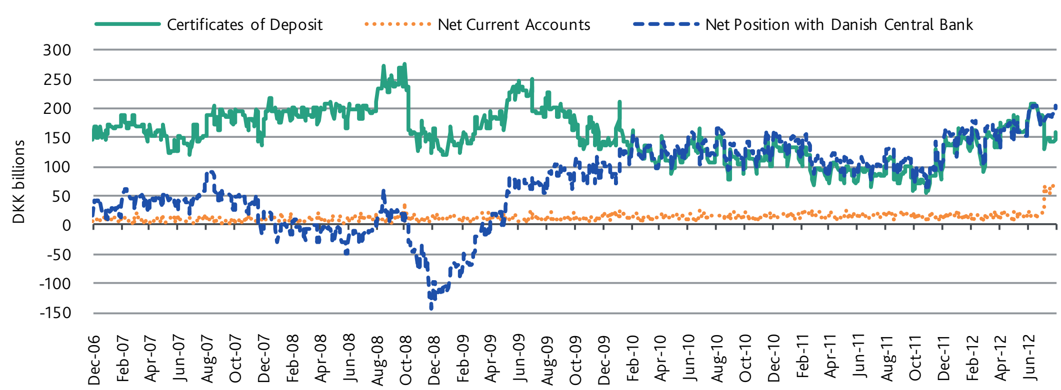
Last Wednesday, the Danish Central Bank reported that Danish financial institutions increased their placements with the central bank in July. At the end of last month, Danish banks placed DKK157.7 billion (€21.2 billion) of certificates of deposit (CDs) with the central bank. However, because the central bank reduced CD interest rates to minus-0.20% from 0.05% on 6 July, banks would be charged approximately DKK315 million on an annualized basis to maintain this position, a credit negative.

At the same time as the interest rate reduction on CDs, the Danish Central Bank also increased the maximum size of current accounts to an aggregate DKK69.7 billion from DKK23 billion. Current accounts pay no interest, but because banks avoid the negative interest rate charged on CDs, banks have shifted their placements with the central bank toward their current accounts, the Danish Central Bank reported.

The current accounts of Danske Bank A/S (Baa1 stable; C-/baa2 stable)[1] and Nordea Bank Danmark A/S (A1 stable; C-/baa1 stable) increased to DKK16 billion each, and for regional banks the increase was between DKK300 million and DKK4 billion. In aggregate, banks held DKK66.9 billion in their current accounts at the end of July, up from an average of DKK16 billion for first-half of the year.

The nearly full usage of the current accounts implies that some banks may be using these accounts to their limit, which forces them to place additional liquidity in CDs and with other market participants. In aggregate, banks' net open positions with the central bank (i.e., the sum of CDs and current accounts less their loans from the central bank) increased to a record DKK205.5 billion at the end of July (see exhibit).

Banks and Mortgage Credit Institutions Positions with the Danish Central Bank



Source: Danish Central Bank

A potential side effect of the reduced interest rates is weaker investor interest in Danish banks' bonds. Last Monday, the Federation of Danish Investment Associations (IFR) reported that in the first-half of this year, investment funds reduced allocations to Danish bonds by approximately DKK9 billion (€1.2 billion). If reduced allocations to the banks continue, we expect banks' funding costs to increase.

[1] The ratings shown are the bank's deposit rating, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlooks.

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Commerzbank's Withdrawal from Ukraine Is Credit Negative for Forum Bank

Last Monday, Commerzbank AG (A3 negative; D+/baa3 negative),[2] Germany's second-largest private banking group, announced the sale of its Ukrainian subsidiary, Forum Bank (B3 negative; E+/b3 negative), to Smart Group (unrated), a large Ukrainian investment holding company. The sale is credit negative for Forum Bank as it will increase the risk that that its corporate governance will weaken. The sale prompted us to downgrade Forum's deposit rating to B3 from B2[3] as it will lose its ties to Commerzbank.

In its announcement, Commerzbank said that it had reached an agreement to sell its 96% stake in Forum Bank to Smart Group. Although we have limited information about the new shareholder and the transaction still requires regulatory approval, we expect changes in Forum Bank's ownership will lead to weakened corporate governance practices and an increase in related-party transactions, characteristics common to other privately owned Ukrainian banks.

In addition, the bank's capital adequacy, liquidity and funding profile could also weaken as Forum Bank benefited from Commerzbank's guarantees, capital and funding support, although all had been decreasing in recent years. According to audited IFRS data, Commerzbank injected around $462 million (in US dollar terms) into Forum Bank's Tier 1 capital during 2010, while the bank's parental funding accounted for around 11% of Forum's total liabilities in 2011, down from 17% in 2010, and 48% in 2009. Although Smart Group has not announced its plans for Forum Bank, we do not expect it to provide similar amounts of capital or liquidity support.

Commerzbank's exit is yet another example of a large international financial group reducing or winding down its operations in Ukraine (see exhibit), and follows a general trend of many international financial institutions curtailing their activities in the Commonwealth of Independent States region.

Examples of International Banking Groups that Scaled Down or Unwound Operations in Ukraine and Russia

Bank	Bank's Action	Date
Commerzbank (Ukraine)	Announced that it had reached an agreement to sell its 96% stake in Ukrainian Forum Bank	Jul-12
Commerzbank (Russia)	Announced intention to sell its 14.37% stake in Russia's Promsvyazbank	Jan-12
Skandinaviska Enskilda Banken (Ukraine)	Sold its Ukrainian sub SEB Bank	2012
Barclays Bank PLC (Russia)	Sold its 100% Russian retail subsidiary to a group of local investors	Oct-11
HSBC (Russia and Ukraine)	Closed its retail operations in Russia and its representative office in Ukraine	2011
Swedbank (Ukraine and Russia)	Gradually scaled down its retail business	2010-11
Banco Santander (Russia)	Sold its 100% Russian subsidiary to local Vostochny Express Bank (B1 stable; E+/B1 stable)	Dec-10
Morgan Stanley (Russia)	Sold its 100% Russian mortgage mono-liner to local Vostochny Express Bank (B1 stable; E+/B1 stable)	Jul-10
ING Group (Ukraine)	Gradually scaled down its retail business in Ukraine	2009

Source Moody's

2 The ratings shown are the bank's deposit rating, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlooks.
3 See Moody's Downgrades Forum Bank to B3, Negative Outlook, 2 August 2012.

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Chinese Regulator's Criticism of Banks' Compliance Reporting Highlights Risk

Last Monday, the China Banking Regulatory Commission (CBRC) in a circular criticized several Chinese banks for failing to report in a timely manner, or failing to report entirely, compliance incidents that involve potential litigation risks. Among the incidents were allegations of illegal fundraising, underground lending and fraud involving bankers acceptances perpetrated by bank employees. The banks in the government circular included major and joint-stock commercial banks.

The CBRC's circular is credit negative for Chinese banks as the underreporting points to deficiencies in the industry's information disclosure and risk culture. This criticism comes at a time when the slowdown of the Chinese economy is putting pressure on Chinese banks' asset quality and profitability, and serves as a warning that banks' underlying trends might be worse than what they report.

The circular also highlights that, although Chinese banks have made improvements in recent years, they continue to fall short in risk management and internal controls, which exposes them to lost business, claims from affected victims, direct losses from business missteps and reputational damage.

As some of the alleged misconduct relates to shadow banking activities such as underground lending and bill financing, the government's reprimand could signal a further tightening in the ability of banks to finance these activities.

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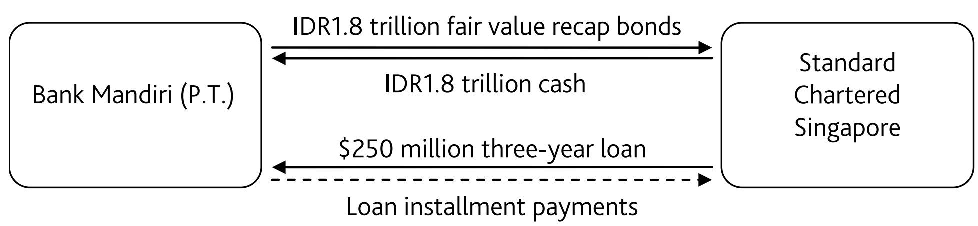
Indonesian Banks Mobilize Their Recap Bonds to Gain Liquidity, a Credit Positive

Last Tuesday, Bank Mandiri (P.T.) (Baa3 stable; D/ba2 stable),[4] Indonesia's largest bank, announced that it had sold for IDR1.8 trillion (approximately $189 million) a portfolio of government recapitalization bonds (recap bonds) to Standard Chartered Singapore (unrated) and secured a $250 million foreign-currency loan as part of the same transaction. Bank Mandiri received local currency liquidity in return for its government bonds and secured the foreign currency loan at the same time (see exhibit). The transaction is credit positive because it provides the bank an opportunity to improve asset return and liquidity for these recap bonds, which were illiquid in the secondary market and, until recently, had their trading restricted by the central bank.

Bank Mandiri's Transaction with Standard Chartered Singapore



Source: Moody's

Although the transaction is relatively small, amounting to only 3% of Bank Mandiri's total recap bonds, or 0.3% of its assets, this structure is the first of its kind in Indonesia. We expect other Indonesian banks to follow suit as a way to redeploy their recap bonds more productively, such as lending to customers, funding inorganic growth or securing both local-currency and foreign-currency liquidity.

Banks can monetize their recap bonds by selling them to the government, although the government can only buy back limited amounts of the recap bonds at a time owing to their large outstanding amount. This secondary market transaction, with the structure that Mandiri pioneered, provides a better alternative because it also gives funding flexibility to secure local-currency and foreign-currency funding. In the meantime, sales to the central bank and securitization of the bonds are also being considered by banks and Indonesia's regulatory authorities.

Government-issued recap bonds grew out of a 1998 policy initiative by the central bank to bail out banks from onerous levels of non-performing loans. Banks' non-performing loans were transferred to the government at book value and replaced with government recap bonds. The government issued around IDR433 trillion (approximately $45.6 billion) of recap bonds, but accounting requirements rendered the bonds illiquid.

The banks that will benefit most from productively redeploying recap bonds are state-owned banks such as Bank Mandiri, Bank Negara Indonesia TBK (P.T.) (Baa3 stable; D/ba2 stable) and Bank Tabungan Negara (P.T.) (Baa3 stable; D-/ba3 stable), which still hold a considerable percentages of the bonds on their balance sheets (see exhibit).

[4] The ratings shown are the bank's deposit rating, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlooks.

Top Five Indonesian Bank Holdings of Recap Bonds at the End of March

Rated Indonesian Banks	Market Share	Government Recap Bonds $ billions	Government Recap Bonds as a Percent of Bank's Total Assets
Bank Mandiri (P.T.) (Baa3 stable; D/Ba2 stable)	13.65%	$8.31	13.9%
Bank Tabungan Negara (P.T.) (Baa3 stable; D-/Ba3 stable)	2.23%	$0.78	7.8%
Bank Negara Indonesia TBK (P.T.) (Baa3 stable; D/Ba2 stable)	8.08%	$1.75	5.5%
Bank Central Asia Tbk (P.T.) (Baa3 stable; D+/Ba1 stable)	11.61%	$1.40	3.2%
Bank Rakyat Indonesia (P.T.) (Baa3 stable; D+/Ba1 stable)	13.36%	$0.84	1.7%

Note: Market share data based on deposits at the end of 2011.

Source: Indonesian Banking Statistics (Bank Indonesia), banks' March 2012 financial reports, banks' presentation materials, Moody's.

The need for additional funding sources has grown in tandem with the banking system's 23% compound annual growth rate over the five years since 2006. In addition, Indonesian banks' foreign-currency loan-to-deposit ratio has increased materially over the past three years, with the ratio at 93% at the end of May, versus 66% at the end of 2009.

Last week, Bank Negara Indonesia, the country's fourth-largest bank, announced its plan to sell part of its recap bond portfolio to finance its acquisition of a non-bank financial institution.

We expect Bank Tabungan Negara, whose stretched balance sheet had a 103% overall loan-to-deposit ratio at the end of March, to sell its recap bonds to get additional local-currency liquidity. The bank does not lend in foreign currencies.

Asset Managers and Money Market Funds

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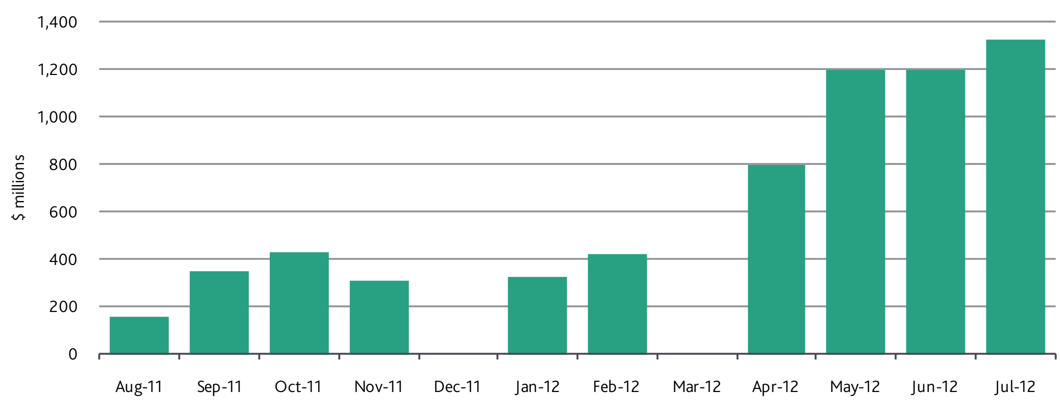
Resurgence of US Closed-End Fund IPOs Is Credit Positive for Managers

On 27 July, Nuveen Investments, Inc. (B3 positive) and Cohen & Steers, Inc. (unrated) completed initial public offerings (IPOs) of closed-end funds, raising around $1.3 billion combined.[5] The two offerings highlight a resurgence in US closed-end fund IPOs in the past four months that we expect will benefit managers active in this sector, including the largest and most active managers of closed-end funds. Such firms include Nuveen, BlackRock, Inc. (A1 stable), Eaton Vance Corp. (A3 stable), Allianz SE (Aa3 negative), which owns Pacific Investment Management Company LLC (PIMCO), and Invesco Holding Company Limited (A3 stable). The IPOs enable these firms to generate incremental fee income from additional assets under management, thereby bolstering their revenues. In addition, the current investor appetite for closed-end funds paves the way for additional offerings.

After a dramatic slowdown in IPO activity during the global financial crisis, closed-end fund IPOs had begun recovering from 2009 until last summer, when volatile market conditions again sidetracked IPO volume amid investor unease over the US debt ceiling debate and the European sovereign and bank crisis. After raising $4.7 billion in the first seven months of 2011, closed-end fund IPO activity slowed, with five funds raising only $1.2 billion in the ensuing five months.

This year, volume has picked up significantly (see exhibit). The average closed-end fund IPO raised $471 million, versus $346 million last year, and has exceeded the average of the past four years. In addition, the two latest transactions each raised more than $500 million.

US Closed-End Fund Initial Public Offerings, August 2011-July 2012



Source: Closed-End Fund Association, Inc.

Unlike mutual funds, closed-end funds are publicly listed investment companies that raise a fixed amount of capital through an initial public offering of common stock. Once listed, shareholders cannot withdraw their assets, but they can trade the common shares at prices determined by the market. The fund's capital base is stable, and is typically leveraged through an issuance of preferred stock,[6] debt or bank financing, structured securities, or reverse repurchase agreements, which permit the funds to achieve higher total returns for all investors, albeit with exposure to increased share volatility. At the

[5] Assuming full exercise of the underwriter's option to purchase additional shares.
[6] We rate approximately 250 leveraged transactions.

end of March, there were about 625 funds with net assets of approximately $250 billion, and around 70% of them, or 438 funds, were leveraged.[7]

Closed-end funds and, in particular, leveraged closed-end funds, offer investors the potential to realize higher income and total returns, bolstered through the use of leverage and, if adopted, managed distribution policies that may rely on returns of principal. Investors find these qualities attractive given near-zero interest rates and a narrowing set of alternative options.

Investment management firms benefit from a stable asset base and sustainable stream of management fees that, although subject to market fluctuations, have been somewhat shielded from the fee compression that affects active managers of mutual funds. For example, at the end of 2011, fees for actively managed equity mutual funds averaged 93 basis points and for fixed income funds averaged 66 basis points. At the same time, the net expense ratio for closed-end equity funds averaged 128 basis points and for fixed income closed-end funds averaged 115 basis points.[8]

[7] Source: Thomson Reuters Closed-End and Exchange Traded Funds weekly report dated 30 March 2012 and Investment Company Institute Quarterly Closed-End Fund Assets, published 14 June 2012.
[8] Source: Thomson Reuters Closed-End and Exchange Traded Funds weekly report dated 27 July 2012.

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US Treasury Prepares for Negative Interest Rates, a Credit Negative for Money Market Funds

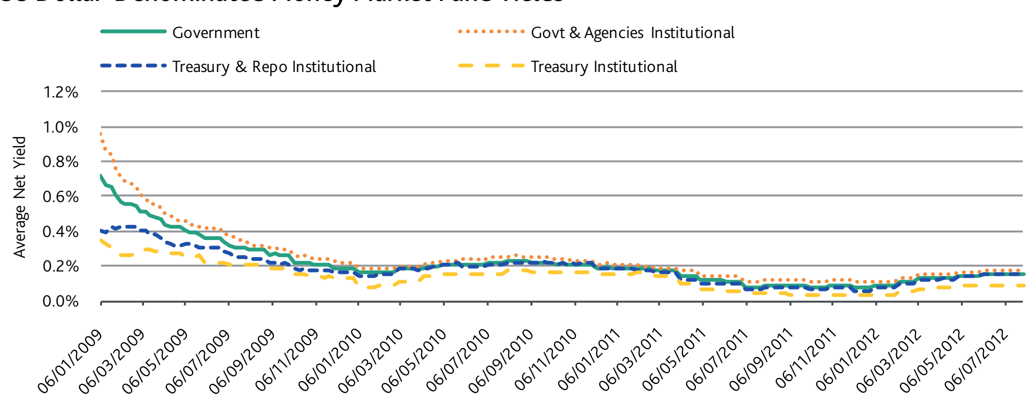
Last Wednesday, the US Treasury published minutes of a meeting with an industry group wherein an official announced that the Treasury is preparing to accommodate negative rate bidding in its bill auctions "should this become necessary in the future." In a news conference the same day, Treasury officials highlighted a timeframe of "months, not years," and signalled that market participants should be prepared to facilitate negative rate bidding.

Although the Treasury has not made a decision about negative rate bidding, putting an operational capability in place responds to the occurrence of negative rates in the secondary market for US Treasury bills. This development is credit negative for US dollar-denominated Treasury and Treasury-repo money market funds as the shift to negative yield bidding increases the likelihood that these funds will be exposed to a negative rate environment, as euro-denominated government money market funds already are.

US money markets funds have survived in a low-rate environment for the past three years, although that environment is not as severe as the one that exists for money market funds in Europe. In Germany, the Bundesbank in January altered its Bund bidding system for Bubills to accommodate negative yields. Then on 5 July, the European Central Bank (ECB) lowered its deposit rate to 0.00%, a move that has driven yields on high-quality, short-term cash instruments into negative territory in Europe.

Against that backdrop, US money market fund managers are watching for any move by the Federal Reserve to lower its interest paid on excess reserves (IOER). If the Fed cuts its IOER to 0.00% from 0.25%, it is likely that US money market rates will rebase lower. With existing gross yields on Treasury money market funds hovering between 0.09% and 0.15% (see exhibit), US Treasury and Treasury-repo money market funds would find themselves facing challenges similar to those of euro-denominated government money market funds.

US Dollar-Denominated Money Market Fund Yields



Source: iMoneyNet

US banks held $1.46 trillion in excess reserves on deposit with the Fed as of 11 July 2012. We expect a decrease in the IOER to prompt banks to cut off much of their demand for borrowing from US money market funds, thereby exacerbating existing supply challenges. In addition, the negative rate environment is likely to drive Treasury bills and general collateral repo yields negative, similar to what happened in Europe. In such a scenario, US Treasury and Treasury-repo money market funds will find it challenging to maintain a positive yield and a constant net asset value (CNAV). Barring remediation, these funds are likely to shut in advance of a possible "break-the-buck" scenario, which is inconsistent with the CNAV expectation of their investors.

Low and negative rates will not affect all US dollar money market funds. For example, US agency and US prime money market funds' overall yields would rebase lower if the Fed cuts the IOER, but because they have a wider investment mandate, we expect fund managers to construct a portfolio that generates a positive gross yield. However, these yield pressures are likely to force managers to increase fee waivers to offer money fund investors a positive net yield. As of year-end 2011, 98% of US money market fund share classes waived at least some expenses, with the Investment Company Institute estimating the total at $5.2 billion, a substantial reduction of fund advisors' fees.[9] In a world of persistently low and negative interest rates, we expect money funds will be challenged to maintain profitability while meeting investor needs for daily liquidity and capital preservation.

[9] ICI Research Perspective, April 2012.

Sovereigns

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Myanmar Moves Toward Rejoining International Financial System, a Credit Positive

Last Wednesday, the World Bank Group and the Asian Development Bank (ADB) officially opened offices in Yangon, Myanmar. The opening of the offices is credit positive for the country (unrated), paving the way for it to clear arrears with the two multilateral development banks and regain access to financing from official development banks and foreign governments. Engagement with the World Bank and ADB will enhance Myanmar's nascent political and economic reform process, which followed 2010 elections. If all goes according to plan, an opening and growing economy will attract new foreign investment from the private sector as well.

Both multilateral development banks ceased approving new loans to Myanmar in the late 1980s after the country suspended debt repayments. The last formal consultative group meeting between Myanmar and the World Bank was in 1986. Myanmar owes approximately $780 million to the International Development Association (IDA), the World Bank's fund for the world's poorest countries, of which $397 million is in arrears. Overdue loan payments to the ADB's Asian Development Fund are close to $500 million.

Japan is facilitating the return of the World Bank and ADB to Myanmar. A consortium of Japanese banks may provide bridge funding of $900 million to allow for the repayment of the overdue sums to the multilaterals. The World Bank and ADB would then provide low-interest loans to Myanmar so that it can repay the bridge loans. Once it clears the arrears, Myanmar will have access to funding from the multilaterals' concessional funds and the International Finance Corporation, the World Bank's private-sector lending arm, which has also established a presence in Yangon.

Although the process of clearing the multilateral development bank arrears will take until January 2013, technical and capacity building assistance has already begun. The ADB's focus is on helping Myanmar improve its transportation and trade infrastructure with neighbors in the Mekong Delta. The World Bank's staff will advise the Myanmar government on modernizing the country's financial system and improving its business environment. In addition, the US government formally eased sanctions on Myanmar three weeks ago, officially unlocking the gate for American companies to invest in the former pariah state.

These recent developments follow the Japanese government's announcement in April that it will write off $3.7 billion of Myanmar's bilateral debt and will resume full financial aid to the country, a development we considered credit positive for Myanmar.[10]

[10] See Sanction Removal, Debt Forgiveness and Reform Progress Are Credit Positive for Myanmar, *Weekly Credit Outlook*, 30 April 2012.

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Fiji Restores Credit-Positive Diplomatic Ties with Australia and New Zealand

Last Monday, Australia and New Zealand announced that they would exchange high commissioners with Fiji (B1 negative), restoring diplomatic ties in recognition of the progress the island nation has made toward holding democratic elections in 2014. The boost to investment and economic growth from better relations with the two largest economies in the Pacific region and the anticipated improvement in governance from the impending return to a democratically elected government are credit positive for Fiji.

Despite the lack of diplomatic ties, both countries continue to be important to the Fijian economy, comprising 33.2% of its total international merchandise trade in 2010. Last year, Australia and New Zealand accounted for 66.4% of total tourist arrivals.

Following Fiji's December 2006 military coup, in which current Prime Minister Commodore Frank Bainimarama seized power, both Australia (Aaa stable) and New Zealand (Aaa stable) imposed a number of sanctions. Those sanctions included travel bans on members of the coup-installed government, a ban on the supply of arms, and restrictions on foreign aid and government-to-government contact. Fiji's bilateral relations with each of its larger neighbors deteriorated further in 2009 when it expelled Australia and New Zealand's high commissioners from the country, provoking a similar response from them shortly thereafter.

Fiji's reluctance to implement democratic reform adversely affected relations with other countries and multilateral donors as well. The country was suspended from the Commonwealth and the Pacific Islands Forum in 2009, and neither the World Bank nor the Asian Development Bank (ADB) have approved new loans since the coup, except for an emergency assistance loan extended by ADB in 2009.

In addition, the quality of governance has deteriorated since the coup; according to data from the World Bank, the "rule of law" in Fiji dropped to the eighth percentile in 2010 from the 42nd percentile among rated countries in 2006.

Economic growth has contracted three out of the past five years of the military regime's tenure: real GDP growth averaged a mere 0.1% during 2007-11, down from 2.0% during 2002-06. Political concerns affected Fiji's ability to attract investments, further depressing the growth outlook. In April, the ADB estimated that private investment was about 2.0% of GDP in 2011, down from an average of 11.3% during 2000-05, and the lowest level since independence from the UK in 1970. Inward foreign direct investment flows peaked in 2006 at 13.3% of GDP, and dipped to 2.0% in 2009 before recovering to 6.5% in 2010, the latest data available.

Last week, Fiji presented its case that "free, fair, and inclusive elections" are on track. Progress toward the compilation of an electronic voter roll and a draft of a new constitution foreshadow the possible easing of sanctions, which could have positive consequences for economic growth. The resumption of technical assistance, for example, could bolster the Fijian government's capacity to increase the effectiveness of infrastructure and social spending. We expect a restoration to multilateral donor financing to alleviate financing constraints. In addition, we expect perceptions of a more favorable investment climate would help pull in more foreign investments.

US Public Finance

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California Risks Losing Hundreds of Millions of Dollars from Facebook's Plunging Share Price

Last Wednesday, the California Legislative Analyst's Office issued a report stating that hundreds of millions of state tax revenue is at risk if Facebook's share price continues to stagnate. This credit negative development came as Facebook's stock price fell to $21.09 per share as of Friday, or 45% below the initial $38 share price. The state of California (A1 stable) budget assumed approximately $1.9 billion in revenues for fiscal 2013 from Facebook stock sales, based on a stock price of $35 per share.

A loss of hundreds of millions in revenue would equal less than 1% of the state's $91 billion budget. Given that California has faced mid-year budget gaps of tens of billions of dollars in recent years, we expect a gap of this size opening in the middle of the year to be manageable for the state.

California's personal income tax revenue tends to be volatile because it relies heavily on top earners and those with high capital gains income. At 10.3%, the state's top rate for personal income taxes is one of the highest in the country and the state taxes capital gains at the same rate.

The state's budget for fiscal 2013 assumed Facebook-related revenues of about $1.9 billion over 2012 and 2013. Most of the $1.9 billion reflects the state's assumptions of Facebook's share price and the state's current tax structure. But about $400 million of the $1.9 billion reflects the Facebook share-price assumptions and proposed tax law changes that will go before voters in November. If voters reject the proposed tax laws, it would automatically trigger spending cuts, so that portion of the revenues will not result in a large budget gap if the tax increase does not pass.

The administration's revenue projections assumed a $35 share price at the time of the IPO and $35 in November, when Facebook projected significant activity settling restricted stock sales. Since the IPO, Facebook's share price has fallen below what the state assumed when forecasting its revenues. If the share price rises sharply before November, revenues could increase above the state's projections. But if the stock price remains low through November, the state could lose hundreds of millions of tax revenue dollars.

It is important to note that the state's budgetary estimates of personal income tax receipts from the sale of Facebook shares were not based on assumptions about when shareholders choose to sell. Rather, the assumptions are based on transactions that the company announced in its IPO documents and are scheduled to take place at certain times. Therefore, the budget isn't likely to be thrown off by shareholders making different sale choices, but instead by the sale price at the time they sell, which provides some upside potential for revenue.

If the weakness in the stock causes more shareholders to sell large blocks of stock in 2012, it will increase income tax payments, which could offset some of the weakness arising from the lower share price. Information on personal income tax revenues with respect to Facebook share price won't be available until the state updates its revenue projections in January.

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Georgia Voters Spurn Proposed Tax, a Credit Negative for Atlanta and Eight Other Regions

Last Tuesday, voters in nine of 12 regions in the state of Georgia (Aaa stable) rejected a 1% transportation sales tax that would have generated $16.9 billion for infrastructure projects across the state. For regions that defeated the tax, particularly metropolitan Atlanta, the failure is credit negative as the lack of funds to upgrade and expand infrastructure will likely hinder economic development. Adoption of the tax was more critical for Atlanta (Aa2 stable) than other regions because of the city's position as a major economic center in the Southeast, which could be hurt by the area's less-than-satisfactory infrastructure.

On the other hand, adoption of a 1% Transportation Special Purpose Local Option Sales Tax (T-SPLOST) is credit positive for the three regions that approved it. These regions will benefit during and after the new sales tax's 10-year collection period as the proceeds will fund a combined 121 transportation-related projects.

Sixty-three percent of voters in the 10-county Atlanta region defeated the tax, forgoing what the state estimated would be $7.2 billion of new revenues for important upgrades of Atlanta's transportation infrastructure and $1.1 billion for other local projects. The region's final investment list contained 157 projects, including roadway improvements and an expansion of the Metropolitan Atlanta Rapid Transit Authority (MARTA) system.

The Atlanta region needs upgrades to its dated and limited transit system and congested roadways to maintain its long-term position as an influential economic center. The region will now be challenged to fund such projects on a local or state level, as the region had not formulated a specific contingency plan for identified projects if voters rejected the tax.

According to the state's Transportation Infrastructure Act of 2010 (TIA), regions that failed to adopt the T-SPLOST will be required to increase to 30% from 10% their minimum match on the Georgia Department of Transportation's Local Maintenance Improvement Grant program, which could put a strain on cities' and counties' capital improvement plans.

Although state law allows districts whose voters rejected the tax to revote in two years, Governor Nathan Deal said that he would not support another referendum, favoring instead for the state to assume a central planning role for its metropolitan areas. The specifics of what such planning would entail are unclear.

The three regions that adopted T-SPLOST include the Central Savannah River, The River Valley District and The Heart of Georgia District. The largest among the group is the Central Savannah River region, which includes 13 counties in eastern Georgia and surrounds Augusta-Richmond County (Aa2). County officials estimate that it will collect $719 million to fund various projects, 75% of which will be for 85 regional projects, per the TIA. The remaining 25% of revenues will be spent on local projects to be determined by city and local officials.

The River Valley district includes 16 counties in western central Georgia, anchored by Columbus (Aa1) and Fort Benning. Officials project total collections of $508 million over the 10-year period, $381 million, or 75%, of which will go to 24 regional projects.

The Heart of Georgia district, which lies to the west of Savannah (Aa2) and includes 18 counties, plans to fund 12 projects in the region with the $256 million it expects to collect, with an additional $85 million going to local projects to be identified later.

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Massachusetts Bill Limiting Healthcare Spending Is Credit Negative for Hospitals

Last Tuesday, the Massachusetts state legislature passed a bill limiting increases in state healthcare spending to prescribed levels, and Governor Deval Patrick is likely to sign it into law shortly. The legislation is credit negative for Massachusetts hospitals because it will limit their revenue growth and reduce their operating flexibility. However, the bill's final version does not include more onerous proposals by the Massachusetts House of Representatives, including a "luxury tax" on the most expensive hospitals.

Bill limits healthcare spending to the state's GDP and exposes over-spenders. The bill, titled "An Act Improving the Quality of Health Care and Reducing Costs Through Increased Transparency, Efficiency and Innovation," limits the initial growth rate of healthcare spending to the potential growth rate of the state economy through 2017. After 2017, the spending limit falls to the state's GDP less half a percentage point. Such an ambitious goal would cut healthcare spending increases by almost half, to 3.6% in 2013 from 6%-7% now.

The bill also establishes a commission with broad powers to investigative and advise on how market share and other factors influence healthcare costs. The commission can order hospitals that don't meet cost reduction benchmarks to file a "performance improvement plan," which would publicly expose organizations that do not meet cost targets. But the commission would not have the authority to tax or otherwise punish hospitals it deems non-compliant. Moreover, per existing law, no state authority would have the power to regulate hospital prices or levy taxes on hospitals.

The bill also uses the Medicaid program to control costs. To help lower costs, the bill requires alternative reimbursement models for at least 50% of Medicaid[11] beneficiaries by 1 July 2014. Although the state has yet to provide specifics of those alternative models, we expect them to include bundled payments and shared savings models that are substantially different from the current fee-for-service model. We expect the new reimbursement models will reduce hospital revenues. The state will also likely incentivize the creation of additional accountable care organizations (ACOs), a loosely defined concept that involves a hospital managing the health for a set group of people. Hospitals unable to swiftly adapt to the new models will likely lose revenues. Given that payment models have not yet been defined, it is too early to estimate the revenue impact.

Another negative credit effect of the bill is that the state will use an excise tax on insurers to support smaller and less profitable hospitals, potentially allowing them to remain in business longer than would otherwise be possible and limiting the ability of larger systems to consolidate and grow through acquisitions.

[11] Medicaid provides health insurance for low income individuals. It is jointly funded by states and the federal government, please see Medicaid Funding Cuts Add to Credit Strain for US Not-for-Profit Hospitals, 22 July 2011.

Securitization

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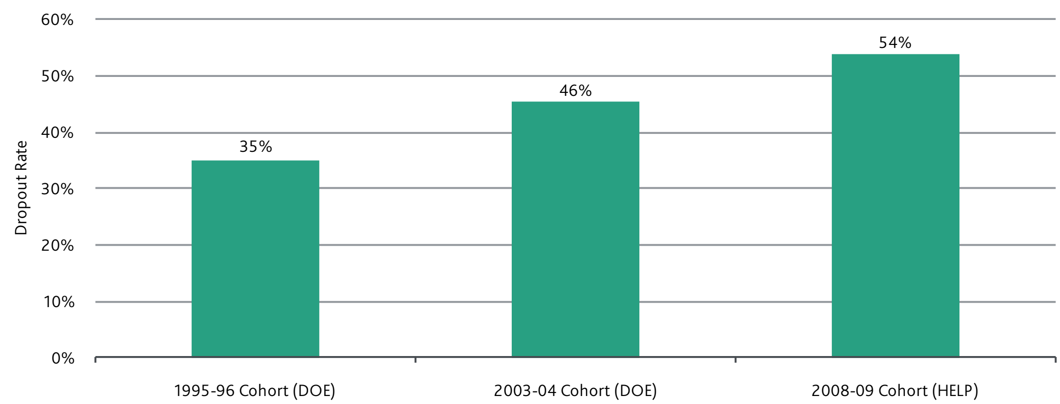
Increase in For-Profit College Dropouts Hurts Student Loan Securitizations

Last Monday, US Senator Tom Harkin (D-Iowa) and the US Senate Health, Education, Labor and Pensions (HELP) Committee released a report showing a considerable increase in for-profit college dropout rates.[12] This increase is credit negative for student loan securitizations with large concentrations of loans to students at for-profit colleges because students who drop out are significantly more likely to default on their loans. Typical concentrations of for-profit college loans in student loan securitizations range 5%-20%.

For-profit college dropout rates are increasing. The HELP report showed that 54% of students who enrolled in 30 of the largest for-profit college companies[13] in 2008-09 left without a degree or certificate by mid-2010, compared with 46% in a Department of Education (DOE) study of a 2003-04 cohort (see Exhibit 1).[14] This follows an increase from 35% for the DOE's 2003-04 cohort.

EXHIBIT 1
Dropout Rate by Cohort



Source: For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success; National Center for Education Statistics Data Lab; Moody's

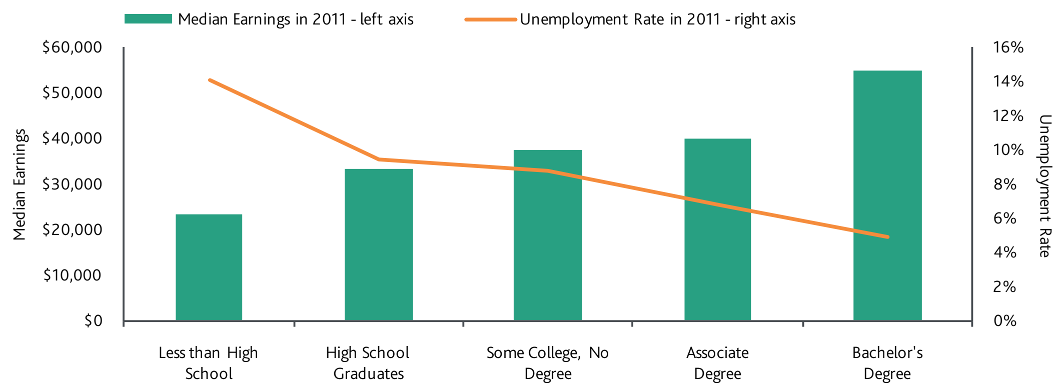
Both the DOE and HELP studies cover the majority of the for-profit college sector. The dropout rate metric for both studies are comparable except that the DOE measures dropout rates within six years of matriculation, while the HELP does so within two years, which suggests that under the DOE's measurement, 2008-09 dropout rates are likely even higher.

College dropouts default at a high rate. The DOE data show that students who drop out default on their federal student loans at four times the rate of students who do not drop out. For the 2003-04 cohort, 16% of college dropouts defaulted compared with 4% for non-dropouts.[15] The default rate is the percentage of borrowers who were in default status on at least one federal loan in fourth-quarter 2009.

[12] See For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success, US Senate Health, Education, Labor and Pensions Committee, 30 July 2012.
[13] The 30 for-profit college companies have about 70% of total fall 2010 for-profit college enrollment.
[14] DOE's National Center for Education Statistics Beginning Postsecondary Students study (2004-09).
[15] NCES DataLab. Default rates only include federal Stafford and Perkins loans.

Students who drop out with student loan debt have a poor ability to repay their loans because they have higher unemployment and lower earnings than graduates. Exhibit 2 shows the difference in the average unemployment rate and median earnings for different categories of students in 2011.

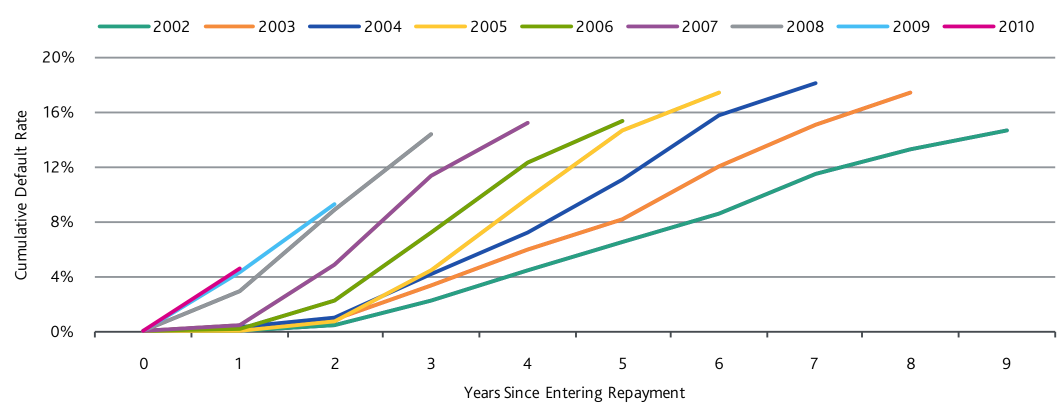
EXHIBIT 2
Unemployment Rate* and Median Earnings** by Educational Attainment



* 2011 average unemployment rate, age 25 years and older
** Median earnings in 2011, age 25 years and older
Source: *US Bureau of Labor Statistics, Current Population Survey*

Dropout rates are a key driver of defaults for for-profit college loans. The rising for-profit college dropout rate is one of the key drivers of higher default rates for recent repayment vintages of for-profit college loans. For example, for private student loans, recent repayment vintages of Sallie Mae's Signature for-profit college loans are defaulting at a higher rate than the previous vintages, as Exhibit 3 shows. Approximately 9%-12% of the loans in Sallie Mae's 2011-12 private loan securitizations are loans to students at for-profit colleges.

EXHIBIT 3
Sallie Mae Signature Private Student Loans to Students at Profit Colleges
Cumulative Defaults Divided by Disbursed Principal Balance by Repayment Vintage



Source: SLM Private Education Loan Trust 2012-D offering memorandum

A similar trend applies to Federal Family Education Loan Program (FFELP) student loans. The negative credit impact for private student loan securitizations, however, is greater than that for FFELP student loan securitizations because the government does not guarantee private student loans.

Accounting

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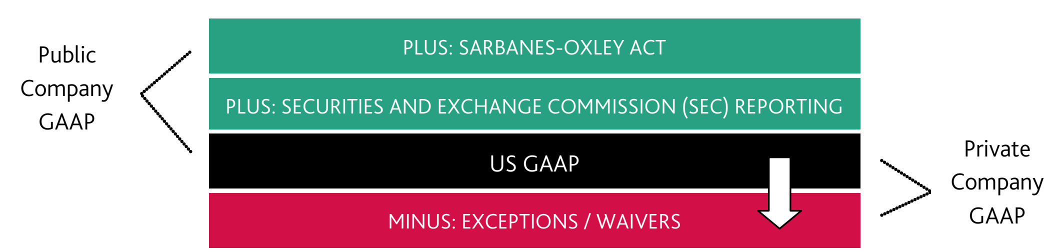
Loosening US Framework for Private Company Financial Reporting Is Negative for Investors

Last Tuesday, the Financial Accounting Standards Board (FASB) released a discussion paper (DP) inviting the public to comment on a framework for evaluating financial accounting and reporting guidance for private companies. This is a step toward developing a final framework that the FASB and the Private Company Council (PCC), established in May, will use to consider differentiation in the recognition, measurement, disclosure and display of financial information by private companies reporting under US GAAP.

Different reporting standards for private companies will materially impair the ability of their creditors to fully assess the idiosyncratic risks of those companies, as well as relative risk compared with their publicly listed peers. Widening the gap between the quality of financial information for private and public companies will increase credit risk for investors that have direct exposure to private company debt through loan syndications or collateralized loan obligations, and indirectly raise credit risk for depositors in, and lenders to, regional and community banks that have significant private company exposures in their commercial loan books.

As the exhibit shows, exceptions made by the FASB, according to the framework described in the DP, will widen the difference between private and public company reporting. Today, public companies must prepare financial statements under US GAAP, provide significant additional information for investors per SEC rules and regulations, and are subject to the requirements of the Sarbanes-Oxley Act, which includes audits of their internal controls over financial reporting. In contrast, private companies are not subject to SEC filing requirements, and Sarbanes-Oxley has only a very limited and indirect impact.

Public versus Private Company Accounting and Reporting – A Simplified View



Source: Moody's

Although the DP does not cite specific examples that the framework would consider for exception, there are a number of obvious rules that private companies follow today that we expect will be topics for consideration. They include rules around accounting and reporting for derivatives, off-balance sheet structures and business combinations, all of which have been past sources of accounting problems that led to heightened credit risk. The common thread with these rules is their complexity and the cost for private companies to comply with them.

We rate nearly 500 private US companies. Although allowing exceptions from the highest quality standards may make economic and practical sense for very small private companies with fewer resources and stakeholders, we don't believe allowing such exceptions is in the interest of stakeholders, ourselves included. This is especially true for stakeholders in larger private companies that are a source of significant exposure for the broader US capital markets. The desire for, and value of, high quality information does not change based on the numbers of shareholders (e.g., companies with greater than 500 shareholders are subject to SEC filing requirements), the company's capital structure, the extent of its resources or any other factor.

We evaluate the financial adequacy of a private company in the context of the rules they must follow and appreciate the higher burden they have to provide high quality financial information. Although we recognize these regulatory and resource constraints, we also recognize the critical importance of high quality information to the efficient function of credit markets.

RATING CHANGES

Significant rating actions taken the week ending 3 August 2012

Corporates

Alcatel-Lucent

		Outlook Change
	8 May '12	**3 Aug '12**
Corporate Family Rating	B2	B2
Outlook	Stable	Negative

We affirmed Alcatel-Lucent's rating, but changed the outlook based on our expectation that the company will not be able to cut its cash consumption materially in 2012 below the 2011 level of EUR620 million as adjusted for two reasons: First, a contraction in the company's revenues of more than 10% in first half 2012 and the likelihood of a further decline in the second. Second, the ongoing weakness in the gross profit margins will require renewed restructuring efforts, which will lead to substantial severance payments over the next 18 months.

ArcelorMittal

		Outlook Change
	20 May '09	**2 Aug '12**
Long-Term Issuer Rating	Baa3	Baa3
Short-Term Issuer Rating	P-3	P-3
Outlook	Stable	Negative

The change in outlook reflects our more negative appraisal of worldwide steel market conditions for the next six months, as well as ArcelorMittal's relatively weak credit metrics. With the company's near-term operating performance more likely to decline than improve, progress in strengthening leverage and cash flow ratios will depend on reducing debt, which in turn will depend on asset sales or credit-protection measures. The company is taking steps to lower debt and improve operating performance but the challenging economic and steel industry environment may undermine its efforts.

Concho Resources Inc.

		Confirmation
	2 Apr '12	**31 Jul '12**
Corporate Family Rating	Ba3	Ba3 (confirmed)
Outlook	Review for Upgrade	Stable

We confirmed the rating, and changed outlook based on our expectations of an absorption phase during which Concho will focus on integrating the Three Rivers Operating Company acquisition it announced in mid-July, and the subsequent asset sales that will partially fund the acquisition. We expect leverage to compress over time through organic production growth as well as debt reduction, from asset sales of $200 - $400 million.

RATING CHANGES

Significant rating actions taken the week ending 3 August 2012

France Telecom

		Outlook Change
	27 Jul '05	**2 Aug '12**
Long-Term Issuer Rating	A3	A3
Short-Term Issuer Rating	P-2	P-2
Outlook	Stable	Negative

The outlook change reflects our view that France Telecom's operating performance prospects might be affected by the increasingly competitive nature of the French mobile and fixed market segments, regulations, and the company's growing difficulty in cutting operating costs, despite management initiatives.

Walgreen Co.

		Downgrade
	19 Jun '12	**2 Aug '12**
Senior Unsecured Rating	A3	Baa1
Short-Term Issuer Rating	P-2	P-2
Outlook	Review for Downgrade	Negative

The downgrade follows Walgreen's closing on its purchase of 45% of the equity of Alliance Boots, which will weaken Walgreen's credit metrics. The transaction will more than double the company's funded debt to about $6.0 billion from the current $2.4 billion. This will result in Walgreen's debt to EBITDA rising to around 4.0x at 31 August 2012, from 3.3x for the lagging twelve months ended 31 May 2012. The downgrade also reflects Alliance Boots' substantial debt of about $12.4 billion at 31 March 2012 as well as its sizeable debt maturities in 2014 and 2015.

Financial Institutions

Uruguayan Banks

Various Actions

1 Aug '12

We upgraded the foreign currency deposit ratings of several Uruguayan banks following our upgrade of the country ceilings for foreign currency deposits in Uruguay to Baa3 from Ba2 long term and to Prime-3 from Not Prime short term. The bank financial strength ratings of the individual Uruguayan banks remain unchanged. Specifically, we upgraded the foreign currency deposit rating of Banco de la República Oriental del Uruguay and Banco Hipotecario del Uruguay to Baa3/Prime 3 from Ba1/Not Prime, in the global scale, and to Aa1.uy, from Aa2.uy in the Uruguayan national scale. At the same time, we upgraded the global foreign currency deposit ratings of Banco Itaú Uruguay S.A. to Baa3/Prime-3 from Ba2/Not Prime, and Lloyds TSB Bank plc (Uruguay) to Aa1.uy from Aa3.uy. Additionally, we lowered Lloyds Uruguay's long-term local currency deposit rating to Baa1 from A3.

We also upgraded the long-term global foreign currency deposit rating of Banco Santander S.A. (Uruguay) to Ba1 from Ba2, and placed the rating on review for upgrade. Santander Uruguay long-term local currency deposits ratings are under downgrade review following the review of its parent, Santander Spain.

Bermuda Commercial Bank Limited

		Downgrade
	30 May '12	**2 Aug '12**
Long Term Deposits	Baa3	Ba2
Short Term Deposits	Prime-3	Not Prime
Standalone Bank Financial Strength / Baseline Credit Assessment	D+ / baa3	D / ba2
Outlook	Review for Downgrade	Stable

The downgrade reflects the increased risk to BCB's asset base. The bank has, somewhat rapidly, built a significant concentration in a portfolio of securities with higher risk than its traditional investments. We believe the shift is a result of both the change in the bank's ownership and risk appetite, as well as pressure on profitability because of the protracted low interest rate environment. The investment portfolio has grown from 5% of total assets at 31 March 31 2010 to 45% of total assets at 31 March 2012, and was approximately three times tangible common equity.

RATING CHANGES

Significant rating actions taken the week ending 3 August 2012

Cantor Fitzgerald, L.P. BGC Partners, Inc.

		Review for Downgrade
	2 Feb '12	30 Jul '12
Senior Unsecured Debt	Baa3	Baa3
Outlook	Negative	Review for Downgrade

The review will focus on the profitability at Cantor Fitzgerald and BGC Partners, as well as the risks of management's diversification strategy in the current challenging operating environment. Origination and trading volumes have declined in many primary and secondary capital markets; many intermediaries are thus competing for a shrinking revenue pool. Further, many global financial institutions remain under pressure, particularly in Europe, which is an important region for Cantor.

Co-Operative Bank Plc

		Review for Downgrade
	7 Oct '11	30 Jul '12
Long-Term Deposits	A3	A3
Senior Unsecured Debt	A3	A3
Standalone Bank Financial Strength / Baseline Credit Assessment	C- / baa1	C- / baa1
Outlook	Stable	Review for Downgrade

The review was prompted by the announcement that the ultimate parent of Co-operative Bank, The Co-operative Group, has agreed to non-binding terms with Lloyds Banking Group to acquire the assets and liabilities known as "Verde," which the European Commission is requiring that Lloyds sell. The review will focus on the steps the Co-operative Bank will take to ensure the smooth integration of Verde, and the composition and quality of the loan assets it is acquiring.

DSK Bank Plc

		Downgrade
	17 May '12	30 Jul '12
Long-Term Deposits	Baa3	Baa3
Short-Term Deposits	Prime-3	Prime-3
Standalone Bank Financial Strength / Baseline Credit Assessment	D+ / ba1	D / ba2
Outlook	Review for Downgrade	Negative

DSK's weakening standalone financial strength arises from the challenging operating environment in Bulgaria, which, since the financial crisis, has led to a rise in non-performing loans and a decline in profitability. The confirmation of the deposit ratings reflects our view that despite these challenges DSK continues to benefit from a high likelihood of both parental and government support in case of need.

RATING CHANGES

Significant rating actions taken the week ending 3 August 2012

First Horizon National Corporation

		Downgrade
	30 Mar '12	**2 Aug '12**
Senior Unsecured Debt	Baa1 Review for Downgrade	Baa2 Negative

First Tennessee Bank, National Association

Long Term Deposits	A3 Review for Downgrade	Baa1 Negative
Short Term Deposits	Prime-2	Prime-2
Standalone Bank Financial Strength / Baseline Credit Assessment	C / a3 Review for Downgrade	C- / baa1 Stable

The one-notch downgrade to FHN's long-term ratings reflects the bank's weaker asset quality and profitability performance, in comparison to peers. FHN's large non-strategic loan portfolio is still hurting its asset quality metrics, though improving, while elevated mortgage repurchase provisions have been weighing on its profitability metrics in recent quarters. Our negative outlook reflects concern that future mortgage repurchase provisions could increase if repurchase requests from the GSEs or private investors become even more aggressive. However, FHN's good capital position somewhat mitigates this risk.

Forum Bank

		Downgrade
	11 Jun '12	**2 Aug '12**
Local Currency Deposits	B2	B3
National Scale Rating	A3.ua	Baa3.ua
Standalone Bank Financial Strength / Baseline Credit Assessment	E+ / b3	E+ / b3
Outlook	Negative	Negative

The downgrade to Forum Bank's local currency deposit ratings follows Commerzbank's announcement that it had reached an agreement to sell its stake, around 96%, in Forum Bank to Smart Group, leading us to remove the one-notch rating uplift we had factored into Forum Bank's long-term deposit ratings on the assumption of parental support. We have not changed our assessment of the bank's standalone financial strength.

RATING CHANGES

Significant rating actions taken the week ending 3 August 2012

Raiffeisenbank (Bulgaria) EAD

		Downgrade
	18 May '12	**30 Jul '12**
Long-Term Deposits	Baa3	Ba1
Short-Term Deposits	Prime-3	Not Prime
Standalone Bank Financial Strength / Baseline Credit Assessment	D+ / ba1	D- / ba3
Outlook	Review for Downgrade	Stable

The downgrade reflects 1) the challenging operating environment in Bulgaria; 2) asset-quality deterioration at the bank and the expectation of further deterioration given its exposure to the construction and real-estate sector and high concentrations; and 3) the pressure on Raiffeisenbank's profitability stemming from relatively high provisioning requirements and subdued loan growth.

Syncora Guarantee Inc.

		Review for Upgrade
	9 Mar '09	**30 Jul '12**
Insurance Financial Strength Rating	Ca	Ca
Outlook	Developing	Review for Upgrade

The recently announced $375 million settlement with Countrywide and Bank of America is a positive development for Syncora, since it will substantially improve the firm's liquidity and statutory surplus position. The review will evaluate the risks embedded in Syncora's insured portfolio, with a focus on downside risk sensitivities, given the firm's large exposure to sectors and issuers adversely affected by the financial crisis and the current weak economic environment. We will also examine Syncora's ongoing risk mitigation efforts in this context.

RATING CHANGES

Significant rating actions taken the week ending 3 August 2012

Sub-sovereigns

Morelos, State of (Mexico)

		Review for Downgrade
	23 Aug '00	**1 Aug '12**
Issuer rating	Ba2/A2.mx	Ba2/A2.mx
Outlook	Positive	Review for Downgrade

We have placed the rating on downgrade review because of uncertainty about its obligations under a loan contract between BBVA Bancomer and the Municipality of Cuernavaca, which we do not rate. The state is a joint obligor under the contract, and because of covenant violations a loan with an original face value of MXN300 million has been called. The state does have the ability to pay, but its credit culture as a joint obligor is being tested. With negotiations continuing, the bank could seek a court-imposed settlement against both the municipality and the state.

US Public Finance

Colorado Springs Utilities

		Confirmation
	18 Apr '12	**3 Aug '12**
Revenue Bonds	Aa2	Aa2
Outlook	Review for Downgrade	Stable

The confirmation and change to a stable outlook reflects the steps the company has taken to demonstrate its willingness to establish rates required to support its significant capital program and maintain sound consolidated utility financial metrics. These steps include a change in executive and board policy to maintain two times adjusted debt service coverage, which will help maintain credit stability at the current rating level. The Aa2 rating takes into consideration the utilities' consistently sound financial results, strong rate-setting record, and average leverage. Management has demonstrated its strength in the execution of its significant capital improvement plan, including construction of the Southern Delivery System.

Structured Finance

Ratings of 258 Italian ABS and RMBS Securities Downgraded; 83 on Review for Downgrade

We have downgraded to A2 (sf) the ratings of 258 securities across 170 Italian asset-backed and residential mortgage-backed securities. Concurrently, we have placed the ratings of 83 Italian ABS and RMBS securities on review for downgrade and confirmed the ratings of four Italian RMBS securities. These actions follow our decision to lower the Italian country ceiling to A2, in connection with our downgrade of Italy's government bond ratings to Baa2 on 13 July.

RESEARCH HIGHLIGHTS

Notable research published the week ending 3 August 2012

Corporates

Packaging Sector to See Only Limited Impact from Major US Drought

The most severe US drought in decades will weaken volumes for the US packaging sector over the next 12-18 months as food prices rise, but we expect only a limited impact on the overall sector.

SGL Monitor Flash: Moody's Liquidity-Stress Index Falls to 3.1%

Our Liquidity-Stress Index (LSI) fell to a new record low of 3.1% in July, from 3.6% in June, indicating that speculative-grade companies have adequate liquidity to manage their cash needs over the next 12 months. Although euro area debt problems and a potential global slowdown are risks to liquidity, we expect the default rate will remain low.

Latin America Corporates: EU Recession Presents Risk for Commodities Producers

A protracted recession in the euro area would have a direct negative impact on Latin American exporters. But not all corporates will be affected equally; the greater impact will be felt by those that rely on exports to the EU as well as those affected by short-term price declines, such as commodity producers.

US Corporates: Pension Terminations: No Free Lunch

Pension terminations modeled after General Motors Company's annuitization of its US salaried plan will in most cases be credit neutral. These transactions would reduce underfunded pension liabilities and eliminate volatility associated with pension assets and liabilities, but very likely at a substantial liquidity cost or increase in leverage, which will be the key determinants of the credit impact.

US Restaurant Industry: Gasoline Prices Will Likely Drive Incremental Consumer Spending at Restaurants

Lower gasoline prices at the pump will leave consumers with more discretionary dollars, which could result in a shift to more add-on items or more restaurant visits, causing a near-term modest increase in overall industry revenues. Quick-service restaurants will benefit, while high-end restaurants should see little impact. On the other hand, a decline in the personal savings rate and a dip in consumer confidence could lead consumers to use some of their freed-up dollars for non-discretionary items or bolster savings instead.

Infrastructure

US Regulated Utilities – Outlook Stable, But Plentiful Gas Changes the Landscape

Low natural gas prices are generally positive for the regulated utility industry, supporting our stable outlook. However, prices have changed the landscape by affecting the dispatch curves, customer rates, coal inventory and supply management, relative competitiveness of different regions, and investment plans. The sector also benefits from welcoming capital markets, good liquidity and fairly stable financial profiles.

US Unregulated Utilities – Outlook Stable, But Plentiful Gas Changes the Landscape

A negative outlook for the sector reflects near- and longer-term challenges, including low natural gas prices that have lowered power prices and negatively affected the sector's operating margins. Many of the factors that influence margin creation and sustain cash flow are beyond the control of management, and we foresee no near-term improvement for several of them. Operating costs are also rising as a result of compliance with expanding environmental mandates.

Financial Institutions

French Banks: Key Rating Drivers

We discuss the key rating drivers for eight French banks and related entities affected by rating actions in June. The rating reviews affected a large number of European and global financial institutions and focused on the credit implications of the difficult European operating environment and the challenges specific to global firms with large capital markets operations.

Greece Banking System Outlook

Our still negative outlook for the Greek banking sector reflects our view that the stressed Greek operating environment, characterized by deep and prolonged economic contraction, elevated sovereign credit risk and fragile depositor confidence, will continue to erode the banks' asset quality, capital, profitability and funding.

Denmark Banking System Outlook

Our negative outlook for the Danish banking system reflects our expectation that low economic activity in Denmark will continue to weaken asset quality and reduce bank profits. Additionally, the structural challenges of high borrower indebtedness and growing reliance of the country's financial institutions on market funding raise the probability of downside tail-risk scenarios, further pressuring banks' performance.

Moody's Teleconference on US Banks - 2Q12 (Transcript of Prepared Remarks)

On this quarter's call, we provided an overview of US banks' second-quarter results. We also discussed our ratings framework for US subsidiaries of foreign institutions, a topic that has recently received a lot of attention in view of our downgrades to the ratings of a number of European banks that are parents to US institutions. We also discussed US government support in the ratings of the few banks whose ratings continue to benefit from support assumptions.

Q2 Insurance CDS Spreads Widen; Europe Insurers in Focus

We review the performance of the Moody's Global Insurance CDS Index during second-quarter 2012. After a brief discussion of the overall insurance market, we examine two companies headquartered in Europe: Assicurazioni Generali S.p.A. and Allianz SE, whose CDS credit spreads widened considerably during the quarter.

RESEARCH HIGHLIGHTS

Notable research published the week ending 3 August 2012

US Public Finance

As Revenues Improve, the Number of States That Issue Cash Flow Notes Declines

The number of state governments that issue short-term cash flow notes will decline in fiscal 2013 to eight from ten in fiscal 2012 as state revenues improve. Projected state budget deficits have narrowed considerably over the past three years because of spending reductions and gradually improving revenue trends. States use short-term borrowing as tools to manage the cash flow mismatch between revenues and expenditures.

Credit Trends: Privatized Military Housing Sector Shows Stability

The credit quality of privatized military housing bonds, which finance construction and renovation of on-base military housing, is stable, although possible federal budget cuts could weaken revenue. The overall credit quality of our rated portfolio was resilient during the economic downturn, and strong financial performance has strengthened most of the financings. Occupancy has been solid and expense growth controlled, and the military has raised its basic allowance for housing.

Structured Finance

Auto Loan ABS - Sector Summary
Auto Lease ABS – Sector Summary
Auto Floorplan ABS Sector Summary

Auto loan, lease and floorplan asset-backed securities maintained their positive performance trends throughout second-quarter 2012. However, the credit quality of the assets in recent auto loan securitizations continues to weaken. Issuance in floorplan ABS surged in the first half of 2012.

Structured Thinking: Asia-Pacific Newsletter

In this month's issue we comment on the Australian bank regulator's requirement that banks deduct from their common equity Tier 1 holdings the subordinated tranches of securitisations originated by third parties. Also in this issue: the quarterly performance of the covered bond programs of Australia's four major banks; the positive credit implications of the resilience of Singapore's economy for CMBS; the effect that the renewal of master leases in Japan will have on apartment loan delinquencies; and a comparison between Japanese and US credit card ABS structures.

RECENTLY IN CREDIT OUTLOOK

Select any article below to go to last Thursday's Credit Outlook on moodys.com

NEWS & ANALYSIS

CREDIT IN DEPTH

Defaults by US companies slowed in the second quarter from the elevated pace of the prior two quarters, and our default forecast remains benign as spec-grade companies maintain good liquidity. We expect the US speculative-grade default rate to peak at 4.0% in October and decline to 3.0% by June 2013.

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