

MARKET REPORT

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EFSF loses its AAA-rating

Last week Standard & Poor's downgraded the European Financial Stability Facility's rating from AAA to AA+. The EFSF is constructed as a bailout fund, which allows European countries with higher credit ratings to cheaply borrow money and subsequently lend it to countries with troubled financials. The downgrade was inevitable since the fund had too few AAA-rated guarantors after S&P's had cut ratings of many European countries, most notable France. As a result, AAA rated guarantees was reduced from 440bn euros to 260bn. This could hamper the EFSF's ability to raise money cheaply. S&P's said that the EFSF could regain its AAA rating if it either obtained additional guarantees or is endowed with less money.

Others to be downgraded were Italy, Spain, Portugal, Austria, Slovakia, Slovenia, Cyprus and Malta. Worth noting is that Portugal now is the second euro-zone country, together with Greece, to be rated as "junk" by all three rating institutes.

Wells Fargo exceeds expectations

The macro-environment unambiguously has had a great impact on fourth-quarter earnings of American banks. Citigroup presented an 11 percent decline in profit, JPMorgan Chase did even worse with a 23 percent decline in profit. It is clear that the trading and the investment banking side of the businesses have underperformed while the commercial sides performed more in-line. Goldman Sachs reported an even worse result with its net profit down by 58 percent compared with the same period in 2010. However, there is a light in the darkness. Wells Fargo, the more traditional bank

with a smaller investment banking division, outperformed its rivals with a quarterly profit increase of 20 percent.

Basel 2.5

On December 31st, with four years gone since the ratification of Basel II and eight more to go before Basel III, the majority of the countries of the European Union and some of the world's most important economies implemented the Basel 2.5 regulations. As Basel 2.5 relies on credit rating agencies in order to calibrate capital charges, the US with its post-crisis Dodd-Frank act makes a notable exception from the previous mentioned. As the credit agencies are considered to have failed the American economy by their not fully objective analyses, they are thus considered partly responsible for the crash landing in 2008. The Dodd-Frank act prohibits the reliance on these agencies.

Basel 2.5 is a step towards the gradual implementation of Basel III, which will commence in 2013 in order to be fully applied in 2019. Invigorated by the outcome of the recent crises, the regulators have stressed the importance of fortifying banks towards risky assets. This is done by implementing a minimum amount of equity as a percentage of assets. This percentage is to be up from 2 to 7 % by 2019, including a 2.5 % conservation buffer. As a side effect, economic growth will be slower than had Basel not been implemented. However, it will most likely result in safer markets for bond investors and greater stability for stock investors.

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