



### *Like a house of cards they fall*

The global financial turmoil deepened as major Central Banks stepped in to try to curb, what can only be referred to as chaos in the markets. Trying to figure out the direction of the market on any day over the past few weeks was like betting on a game of Roulette, except that the ball could land on either of the colours green or red. To address the growing issue of tight liquidity conditions, rescue packages from the United States (US), United Kingdom (UK) and the Eurozone were revealed, each worth US\$700 billion, US\$680 billion and US\$1,370 billion respectively.

These liquidity injections have had the analysts at Standard and Poor's (S&P) busy at work as the issue of debt has become a growing concern to investors. Investors around the world rely on the credit ratings that are issued by S&P, which reflect the creditworthiness of an obligor. Credit ratings are important as obligors with poor credit rating will have difficulty in sourcing financing to meet their commitments, increasing the risk of a possible default. Credit ratings can range from "AAA" to "CCC", "AAA" being the highest rating that can be assigned, signaling that the obligor's capacity to meet its financial commitment is extremely strong. Generally, ratings which are higher than "BBB" are investment grade indicating that the risk of default is relatively low. Ratings below "BBB" are referred to as non-investment grade and represent a higher degree of risk.

The United States is among the highest rated sovereigns and is currently rated "AAA/Stable/A-1+", which, according to S&P, reflects the economic and financial strengths that will continue to outweigh the risks to its credit profile. This rating was affirmed prior to the US\$700 billion bailout plan, which would require an increase in the US statutory debt ceiling to US\$11.3 trillion from US\$10.6 trillion i.e. its public debt limit. Following this affirmation, a series of rating updates were sent out as financial sectors across the globe slowly but surely began to feel the effects of the credit crunch.

The United States, the United Kingdom and the Eurozone have been the major economies in the forefront aggressively addressing the issue of liquidity. The spillover effects are becoming evident as one by one, sovereign credit ratings have to be revisited to reflect the current state of affairs. Like a falling house of cards, sovereign ratings across the globe are being downgraded. This was clearly seen over the past few weeks as emerging markets have continued to grapple with the unforgiving credit markets. As a result of this, their respective central banks have had to adopt an active stance to assure investors that the necessary action was being taken to address the issues at hand.

In a matter of days, the Republic of Iceland, the Republic of Costa Rica, the Republic of Hungary and Ukraine had their ratings revised with some sovereigns even placed on negative watch. This has led some speculators to imply that there is the possibility of a rating downgrade for these countries, which would increase the risk of holding assets from these

countries. The events unfolded as follows:

6 October 2008

*The Republic of Iceland*

It started with the Republic of Iceland whose foreign currency sovereign credit rating was lowered by S&P to 'BBB/A-3' from 'A-/A-2'. The downgrade came after the government pledged to guarantee all domestic bank deposits and gave regulators the power to take over bank assets and appoint new boards to obtain funds from lenders that may become non-operational. While the new rating still lies within the investment grade band, it limits the country's banking system's access to international markets, possibly leading to a contraction of real gross domestic product (GDP) which in turn raises its debt-to-GDP ratio.

10 October 2008

*The Republic of Costa Rica*

In this case, the outlook on the Republic of Costa Rica was revised to stable from positive while its "BB/B" foreign currency sovereign credit rating was affirmed. This outlook revision was based on the low probability of an upgrade as the worsening global financial markets and its volatility threatened the local economy's financial system. Costa Rica's fundamentals make the economy vulnerable given the high level of dollarization and exchange rate inflexibilities, which expose the economy to external shocks. This suggests that the only set of tools available to the authorities to control macroeconomic issues such as inflation and economic growth will be fiscal policies. Investors are already concerned about Costa Rica's growing current account deficit which could reach 8% of GDP by the end of 2008. A stable outlook implies that the rating is not likely to change and the country's key figures will continue to be monitored as the economy strives to withstand the external panorama.

15 October 2008

*The Republic of Hungary*

In a space of five days, S&P placed its 'BBB+/A-2' sovereign credit rating on the Republic of Hungary in credit watch with negative implications. This move was based on increasing concerns over growing financial-sector funding pressures and the country's ability to raise general government debt from its current level of 67% of GDP. Like Iceland, this reduces Hungary's local and foreign-owned banks access to international markets and raises its financing costs. Domestic credit which has been denominated in foreign currencies has been mainly financed by its external debt, which is expected to rise. This raises a red flag to investors as the ability to finance the debt is questioned. The fact that the country's debt is mainly denominated in foreign currencies also exposes the country to foreign exchange risk which remains extremely volatile. Like other sovereigns, Hungary's ability to weather the storm will also have to be closely monitored as there is the possibility that its investment grade credit rating may be lowered.

15 October 2008

*Ukraine*

On the same day, S&P placed its 'B+/B' foreign currency rating on credit watch with negative implications. This was also based on the impact of the deteriorating economic situation on the local economy and its depreciating currency, which had taken a beating, falling to a low of UAH5.26: US\$1.00 on 8 October 2008. This depreciation does not bode well for the country's financial assets as its quality is hampered especially in light of the fact that Ukraine's private sector foreign

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currency borrowing stands at 35% of GDP. For the first half of 2008, Ukraine's current account deficit has widened to US\$6.8 billion and is expected to put further downward pressure on the local currency. Given Ukraine's rating, which is below investment grade, investors have to remain vigilant with regards to the developments in the economy and its ability to source funding to meet its financial commitments.

In light of these revisions, Iceland, Hungary and Ukraine have joined the line up for potential IMF funding, with Ukraine expected to borrow between US\$10 billion and US\$15 billion. This move should help to restore some degree of confidence to the market and to strengthen the country's position during these trying times. The details of the specific arrangements are yet to be finalized but the wheels have been set in motion. This will offer investors some sense of security as some form of funding will be readily available if needed by the countries.

Trying times lie ahead for financial sectors across the globe as economies struggle with the current global situation. One by one, countries worldwide are revising their forecasts: - lowering growth, raising inflation, as well as catering for widening current account deficits and depreciating currencies. As 'flight to quality' sentiment rises, emerging markets will feel the brunt of this move as more people become risk averse, seeking the safest bet with regards to their credit. Further rating revisions may be high on S&P's agenda as economies inevitably realize their losses, posing the question, who will be next?

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## FINANCIAL & ECONOMIC INDICATORS

As at 16 October, 2008

<u>Exchange Rate/US\$</u>	<u>Closing Value</u>	<u>Previous Week</u>
Yen	101.57	99.82
Euro	1.36	1.36
Jamaica	74.54	72.96
Guyana	203.90	204.90

<u>Commodity Prices</u>	<u>Closing Value</u>	<u>Previous Week</u>
Crude oil (US\$/bbl)	69.85	86.59
Natural Gas (US\$/mmbtu)	6.65	6.69
Gold (US\$/Troy Ounce)	804.60	913.25

### Eurobond Indices (Return % YTD, as of 16-October-08)

Lehman Brothers Global Aggregate Index	-2.58
JP Morgan EMBI+ (percentage change)	149.20
CMMB Eurobond Index	n/d

<u>Policy Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
United States	0.75	0.25
Euro Zone	3.75	3.75
Japan	0.50	0.54
Brazil	13.75	13.75
Trinidad	8.50	8.50
Jamaica	13.50	13.50
Barbados	4.00	4.50

<u>Market Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
US 90-day T-Bill	0.43	0.52
US 10-Yr Treasury	3.96	3.79
3-month UK Libor	6.18	6.28
Japan 90-day T-Bill	0.53	0.53
Brazil 90-day T-Bill	13.90	14.00
TT 90-day T-Bill	7.17	7.17
Jamaica 90-day T-Bill	16.69	16.69
Barbados 90-day T-Bill	3.14	3.48

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, [www.lehman.com](http://www.lehman.com)

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