



Sovereign Update

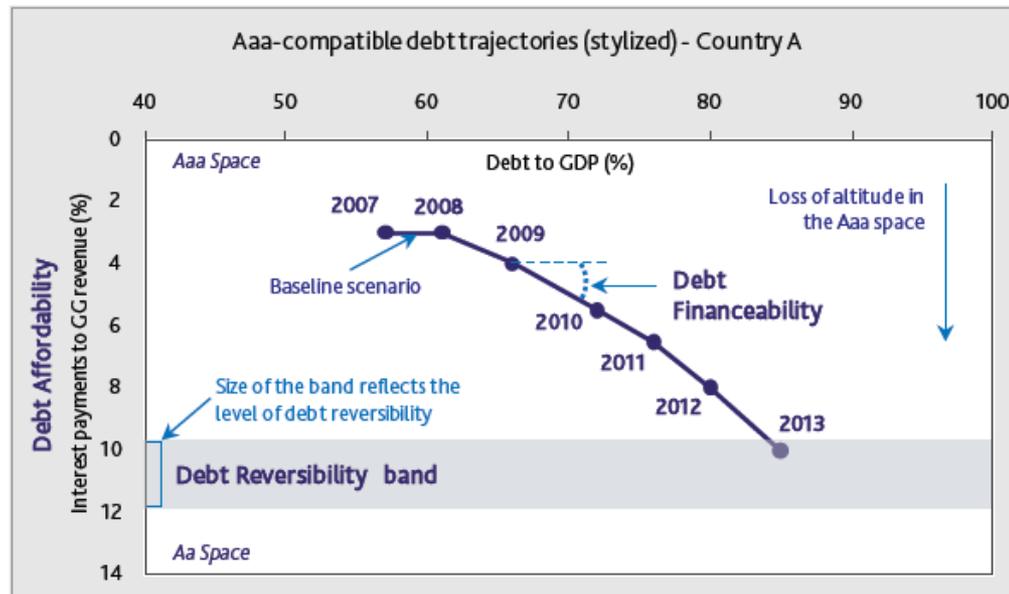
Distributed at the Moody's & NYU 2010 Credit Conference

Topics

- » Stable rating outlook for the Aaa's
 - Well positioned for now
 - Potentially vulnerable to sharp increases in interest rates
 - Credible fiscal consolidation plans are critical
- » Eurozone support package has generally positive credit implications
 - Increases pressure for rapid fiscal consolidations
 - Keeps borrowing costs affordable for the more challenged governments

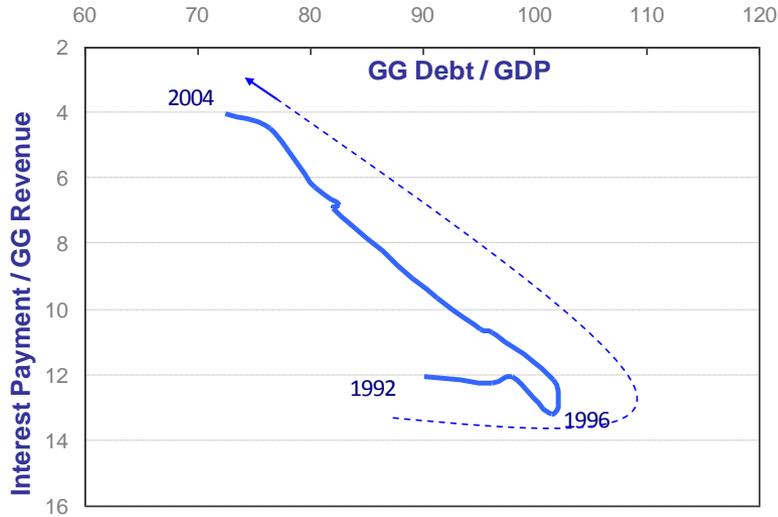
Key rating factors for Aaa sovereigns

- Debt-to-GDP** needs to be stabilized, directly impacts affordability
- Affordability** debt service / government revenues: Aaa criteria < 10%
- Reversibility** restoration of affordability after a shock via fiscal policy or growth
In the reversibility zone: candidate for a negative rating outlook

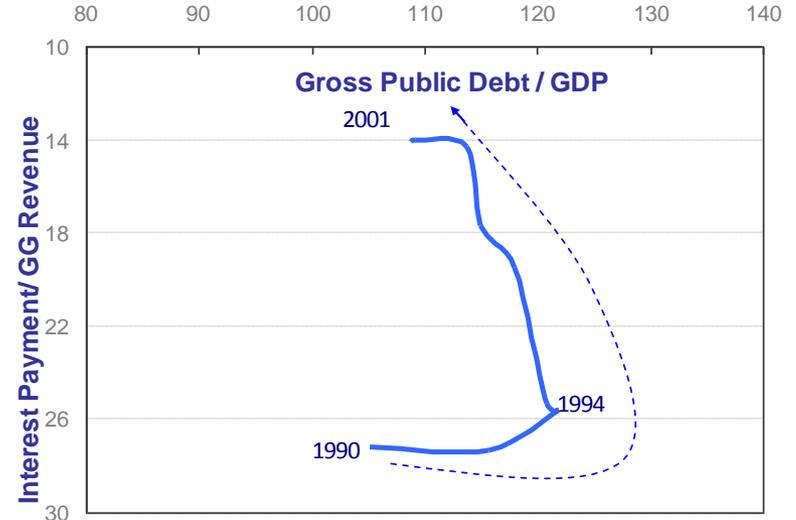


Some countries have rebounded in the past....But....

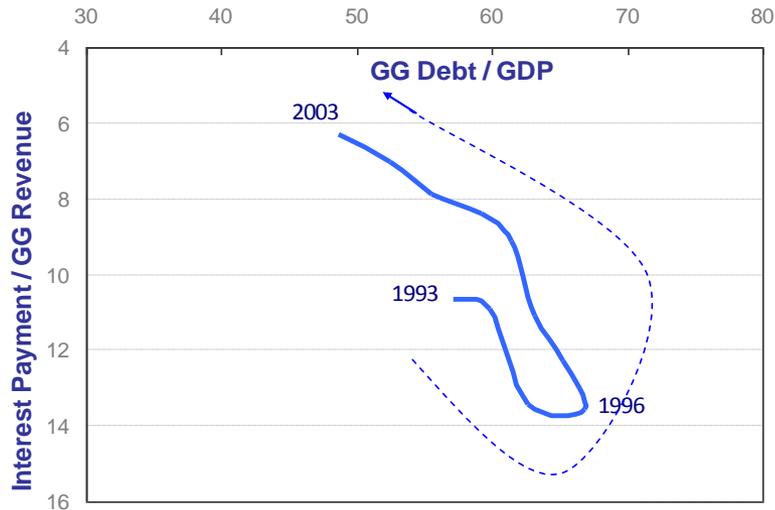
Canada - Debt Trajectory- 1992-2004



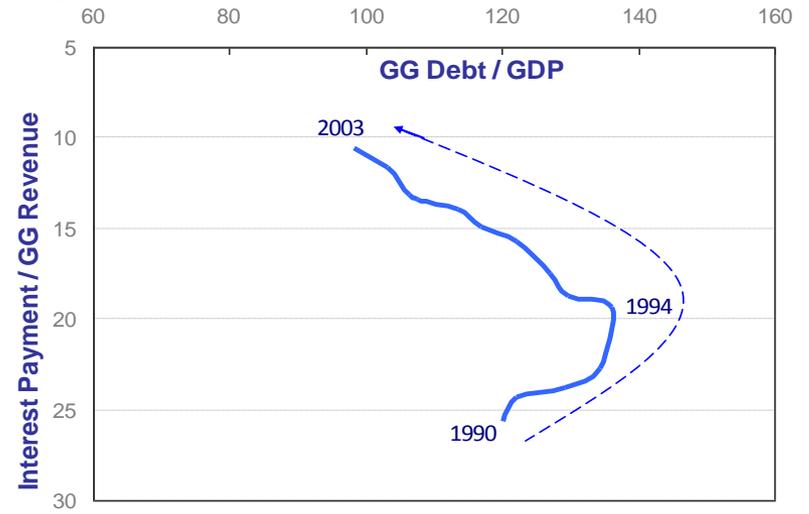
Italy - Debt Trajectory - 1990-2001



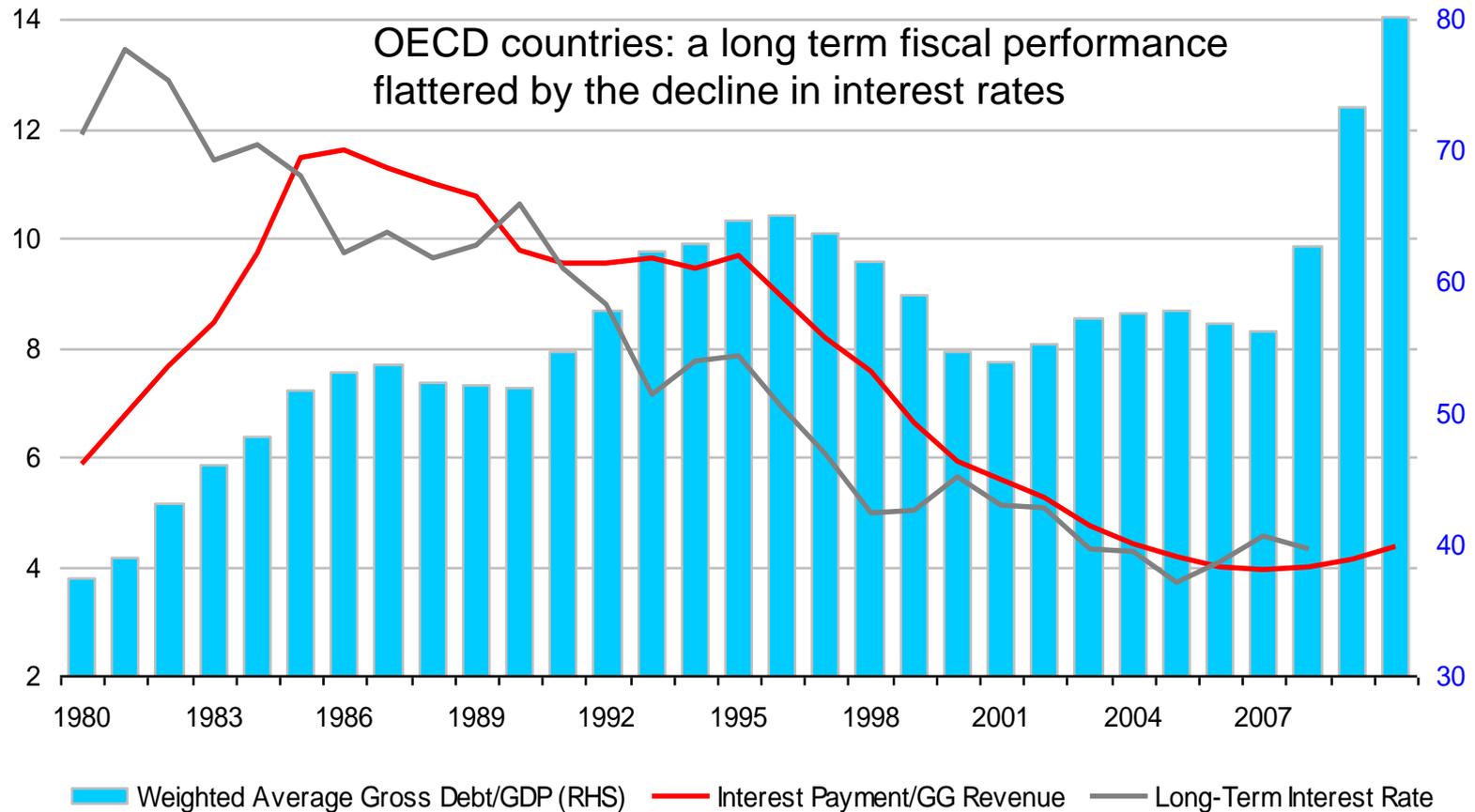
Spain - Debt Trajectory- 1993-2003



Belgium - Debt Trajectory- 1990-2003



Interest rates will not help much



Projecting fiscal metrics: baseline & adverse scenarios

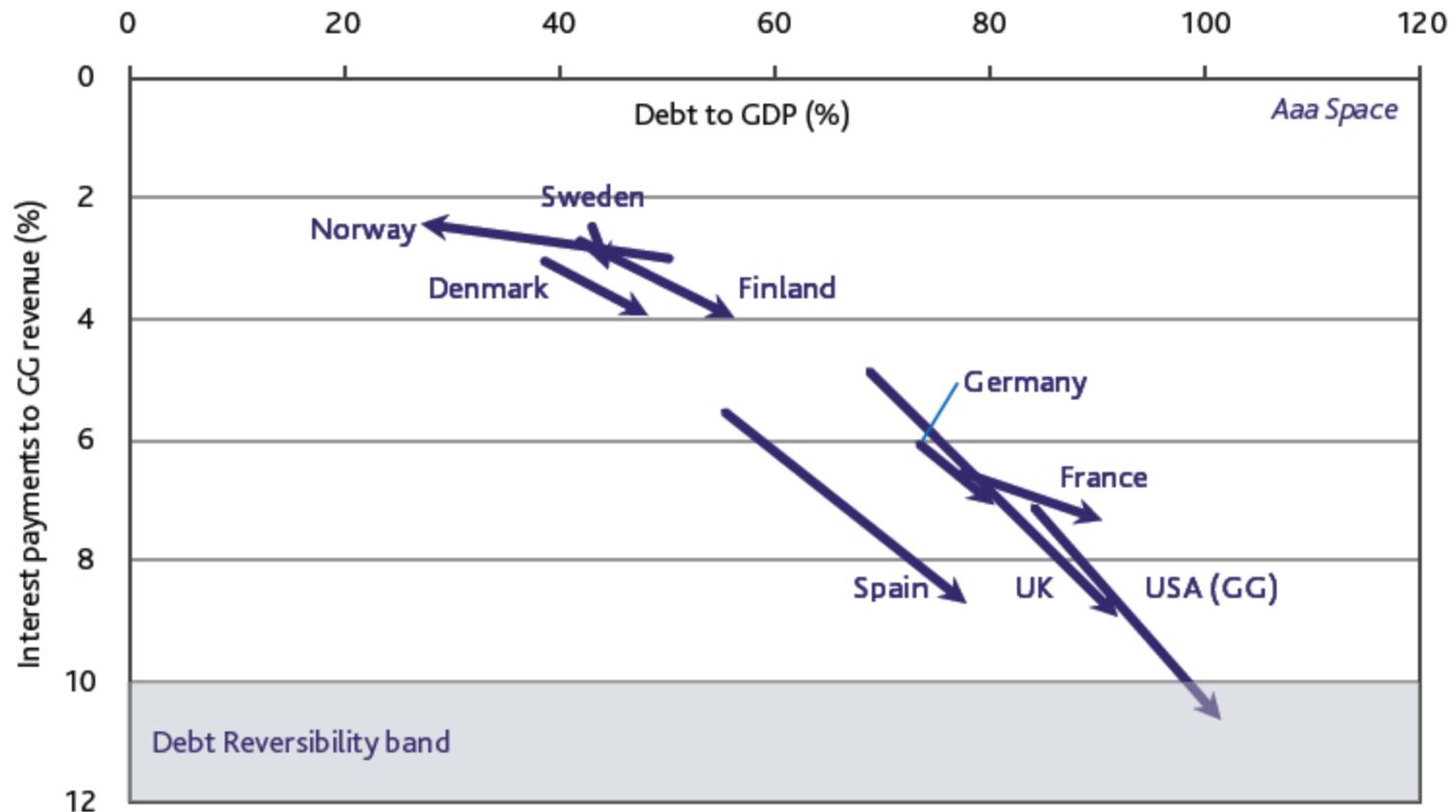
Economic assumptions	
Baseline scenario (blue line)	<ul style="list-style-type: none"> » Muted economic recovery » Moderate fiscal adjustment (generally in line with government plans) » Moderate interest rate shock³.
Adverse scenario (orange line)	<ul style="list-style-type: none"> » Lower rate of growth (by 0.5% each year); » Lower fiscal adjustment (primary balance lower by 1% of GDP each year); » Stronger interest rate shock.

³ For interest rates, we assume in the baseline scenario that the average borrowing costs of governments in 2010 will be 75 bps above the current 3-month moving average of the 5-year government bond yield. We then assume a further 100 bps increase in yields in 2011, and 25 bps in 2012. For the adverse scenario, we assume interest rate shocks to be twice as large as in the baseline scenario for each year.

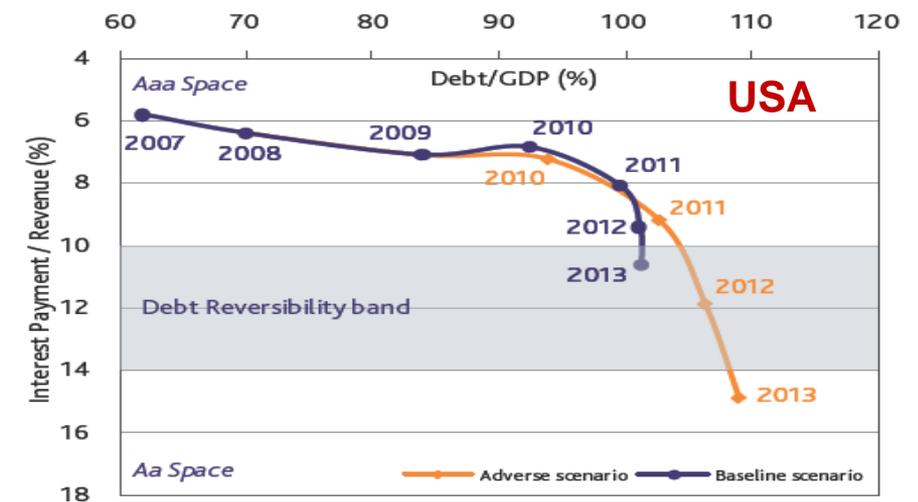
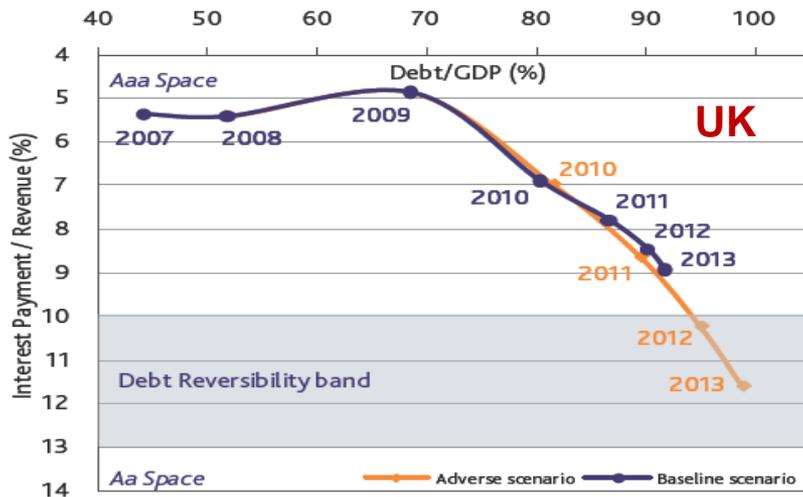
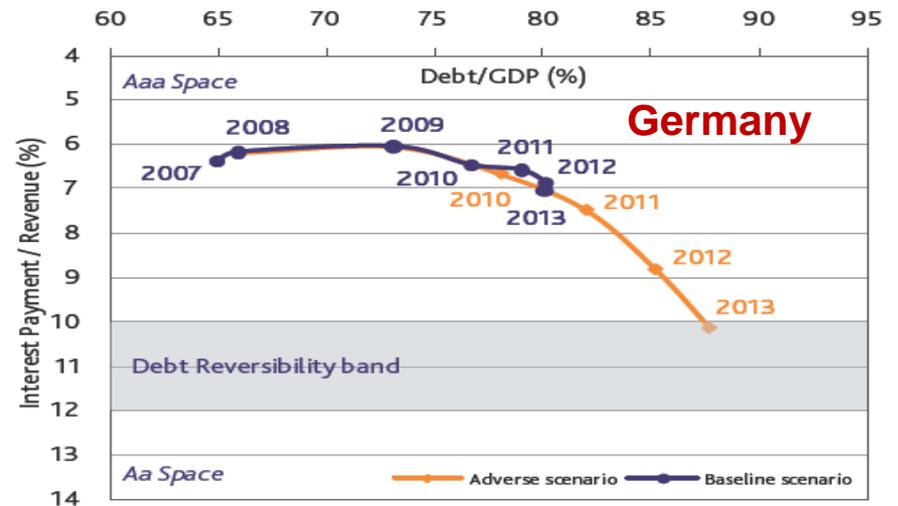
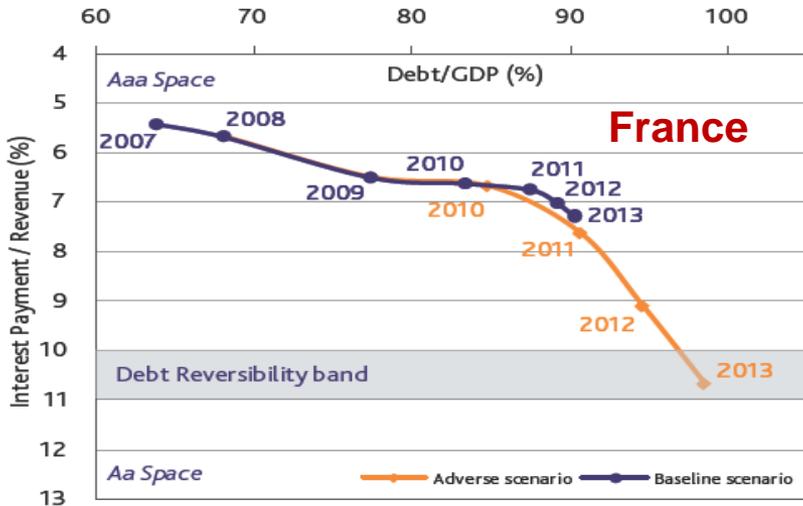
Aaa government ratings well positioned under baseline

Debt trajectories 2009-2013 - Baseline scenarios

Countries covered by the March 2010 Aaa Sovereign Monitor



Aaa's look more dicey in the adverse scenario

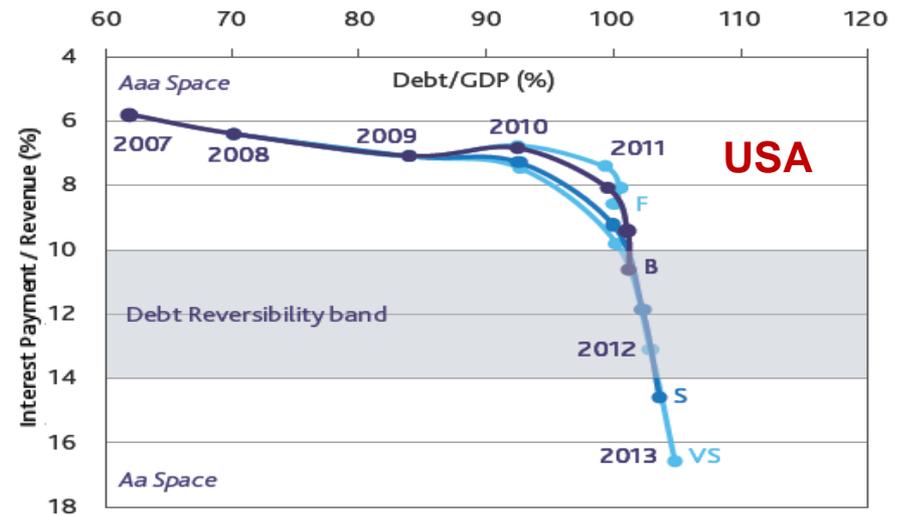
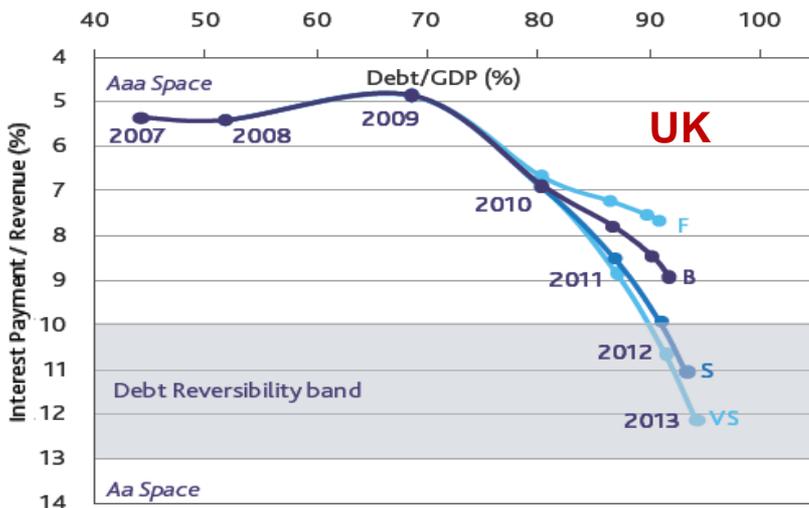
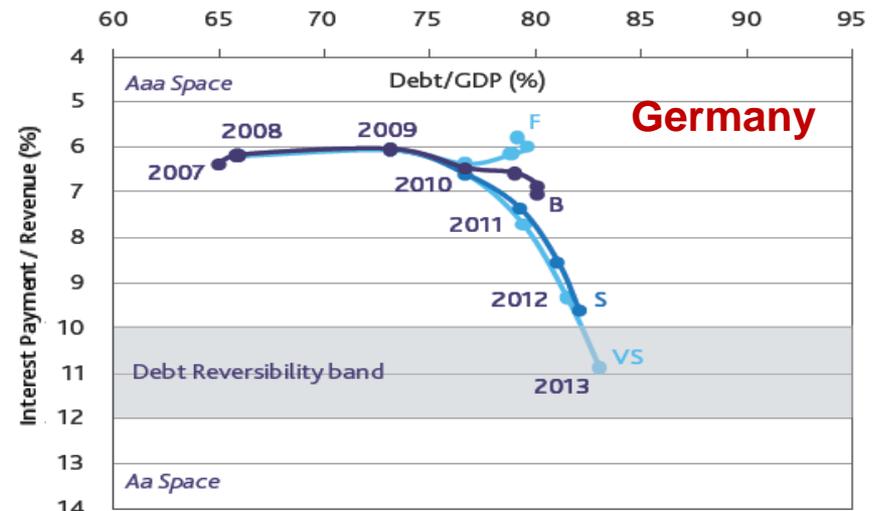
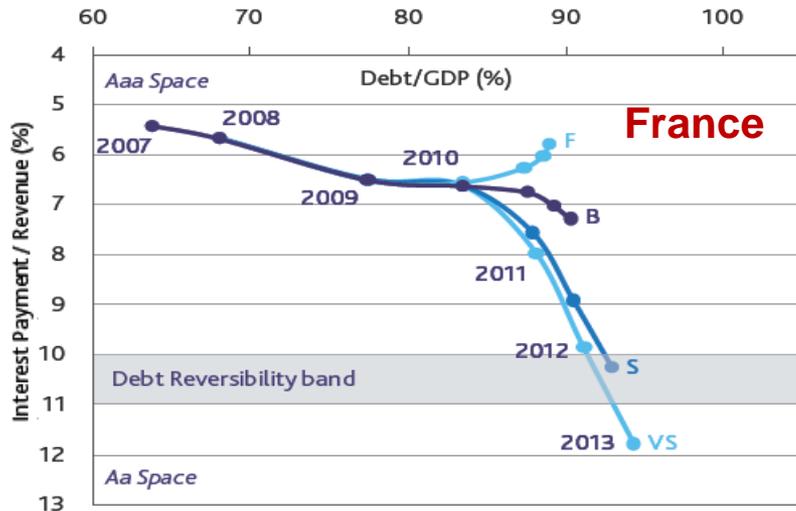


More Detailed Scenario Analysis Assumptions

Each scenario is mapped out in our Quarterly Aaa Sovereign Monitor

Uplift/Discount applied		Nominal Growth Sensitivity		Fiscal Adjustment Sensitivity		Interest Rate Sensitivity	
		2010	2011 onwards	2010	2011 onwards	2010	2011 onwards
VF	Very Favorable	+1%p	+2%p	-1%p	-2%p	-	-
F	Favorable	+0.5%p	+1%p	-0.5%p	-1%p	-50bps	-100bps
S	Severe	-0.5%p	-1%p	+0.5%p	+1%p	+100bps	+200bps
VS	Very Severe	-1%p	-1%p	+1%p	+2%p	+150bps	+300bps

Aaa's vulnerable to stress interest rate scenarios (+200 & +300 bps)



Aaa key messages: an increasingly delicate balancing act

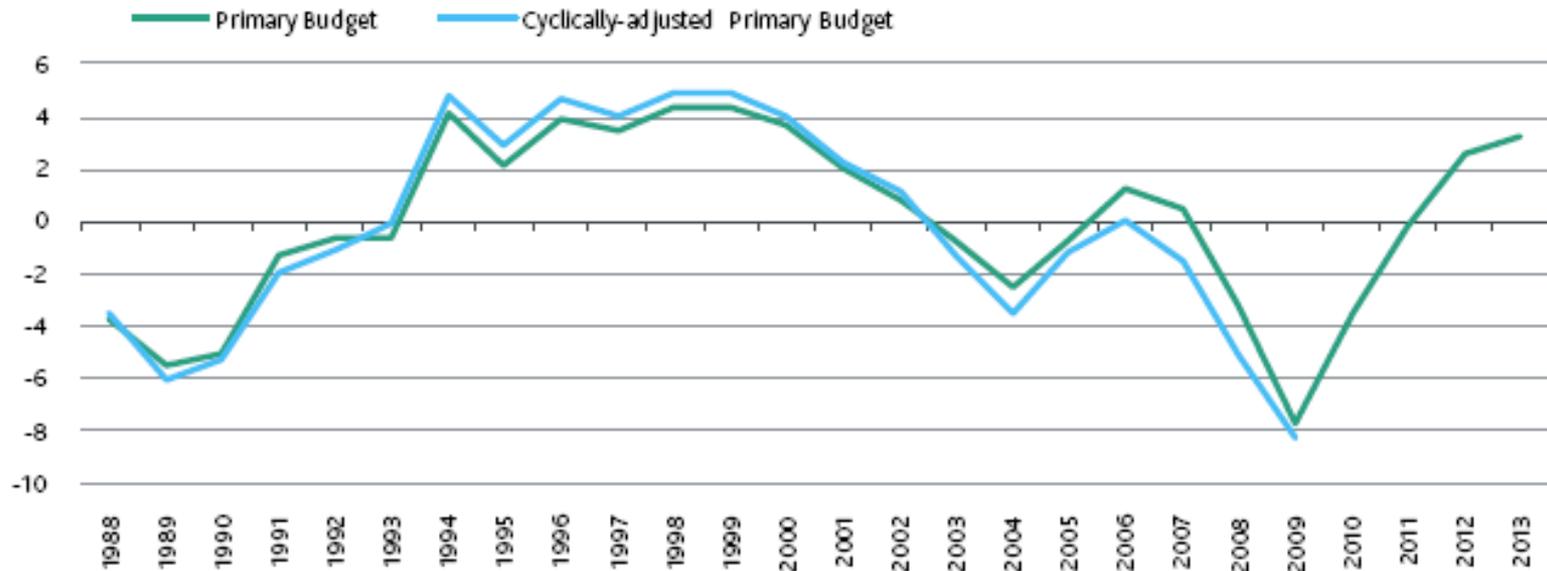
- » Economic growth alone will not resolve Aaa government's fiscal problems
 - » Global recovery under way, but at variable speed, and generally moderate in fiscally-challenged Aaa countries
- » Large Aaa governments are vulnerable to a rise in their cost of funding
 - » Risks are very asymmetric and particularly for governments funding themselves at the short end of the curve
- » Anchoring fiscal expectations is key to an orderly exit from the fiscal crisis
 - » Market confidence is key to keeping debt affordable;
 - » Focus moves to medium-term fiscal stabilisation programmes.

Greece: Downgrading... at a Measured Pace

- » Greece rated as single A rated country when it borrowed on Aaa terms for several years
- » October 2009: Review for downgrade based on long term solvency questions
- » December 2009: Fact finding, then downgrade to A2 and Negative outlook
- » April 2010: Downgrade to A3 and placed on review for downgrade
- » External support, while short-term positive and protective against a rise in funding costs, does not change dramatically the parameters of the long term debt equation.
- » Tangible signs that deficit reductions will fall short of what has been promised will likely lead to downgrades

Greece: What Has Happened in the Past?

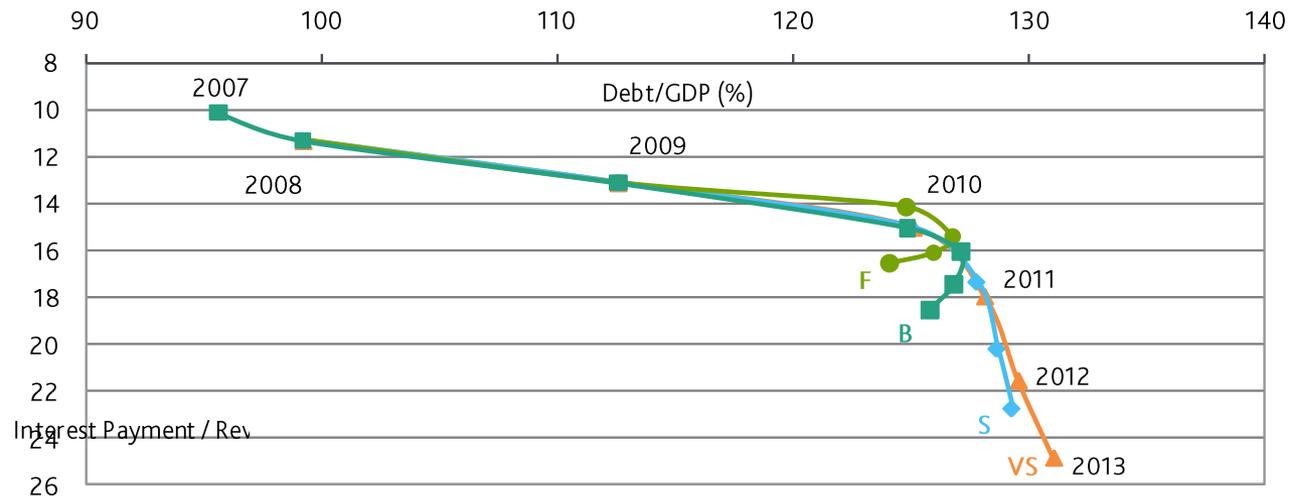
Greece Primary Balance (as % of GDP)



Source: EC/AMECO

Greece: ambitious fiscal plan would stabilize affordability

Full Compliance with Medium-Term Objectives



Uplift/Discount applied to baseline		Interest rate sensitivity	
		2010	2011 onwards
B	Baseline	-	-
F	Favourable	-50bps	-100bps
S	Severe	+100bps	+200bps
VS	Very Severe	+150bps	+300bps

Source: "Spain, Portugal & Greece: Contagion or Confusion?, Restating the Case for Differentiation" - February 2010

EU Support Package: The Principles

Increased multilateral solidarity in return for increased multilateral surveillance

Main features of the EU support package:

Wall of money to ensure continuous access to funding for euro area governments:

- Up to € 750 billion made available by euro area governments, the EU and the IMF;
- Interventions by the ECB in government securities market.

Conditionality attached to any liquidity support:

- IMF involvement (similar to Greece) in the form of a programme;
- Spain and Portugal committed to frontloading fiscal consolidation.

Reformulation of the Stability Pact:

- EU Commission proposals on strengthening multilateral surveillance (of budgets but also of competitiveness).

EU Support Package: The Details (as available)

Wall of Money Provides Contingent Source of Liquidity for Extended Period

Large scale liquidity support from euro area governments, the EU, the IMF and the ECB:

- » Up to € 750 billion of funding available to governments if required:
 - Up to € 440 billion raised by a SPV guaranteed by euro area governments + Sweden and Poland;
 - Up to € 60 billion provided by the EU under existing Treaty provisions;
 - Up to € 250 billion provided by the IMF under programmes.

Broad intervention by the ECB in support of banks and (indirectly) governments:

- Purchases of governments bonds and other securities in the secondary market (amount unspecified);
- Unlimited supply of liquidity to banks through 3-month and 6-month repos;
- Additional supply of US dollar liquidity;

This is *in addition* to the euro area/IMF support package for Greece

- € 110 billion (€ 80 billion euro area governments, € 30 billion IMF);
- Greek government bonds guaranteed eligibility as collateral (announced 6 May 2010).

EU Support Package: Credit Implications

Step towards enhanced fiscal integration

Material reduction in liquidity risk for more vulnerable euro area governments:

- Moody's ratings already assumed no material risk of liquidity in the near-term
- Near-term risk of adverse interest rate scenarios greatly reduced

Limited mutualization of credit risk among governments (governments become partial contingent liabilities of each other):

- Marginally negative for stronger governments;
- Marginally positive for weaker governments;

Strengthening of fiscal surveillance (if implemented) is credit positive for all governments

Shift towards frontloading of fiscal adjustment will result in painful economic adjustment:

- Governments can expect little relief from growth in the next few years.

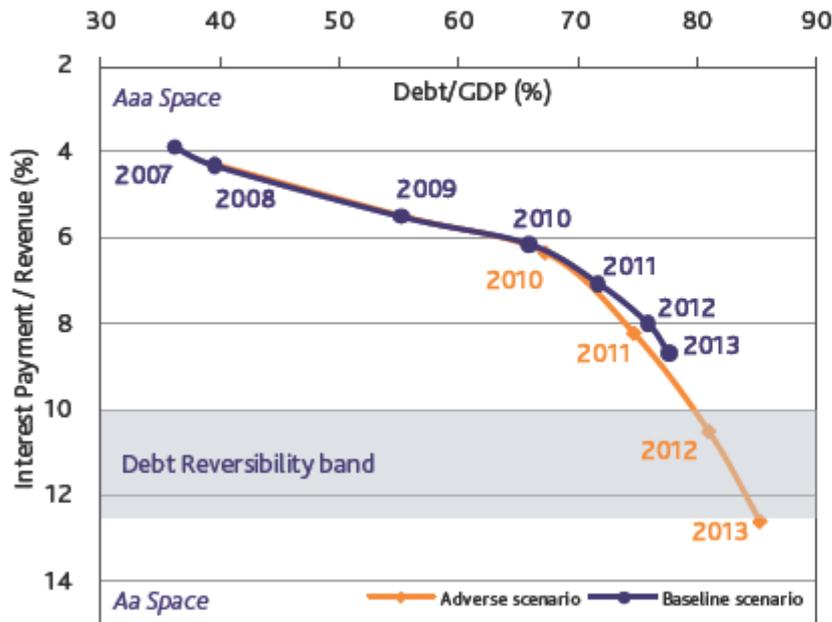
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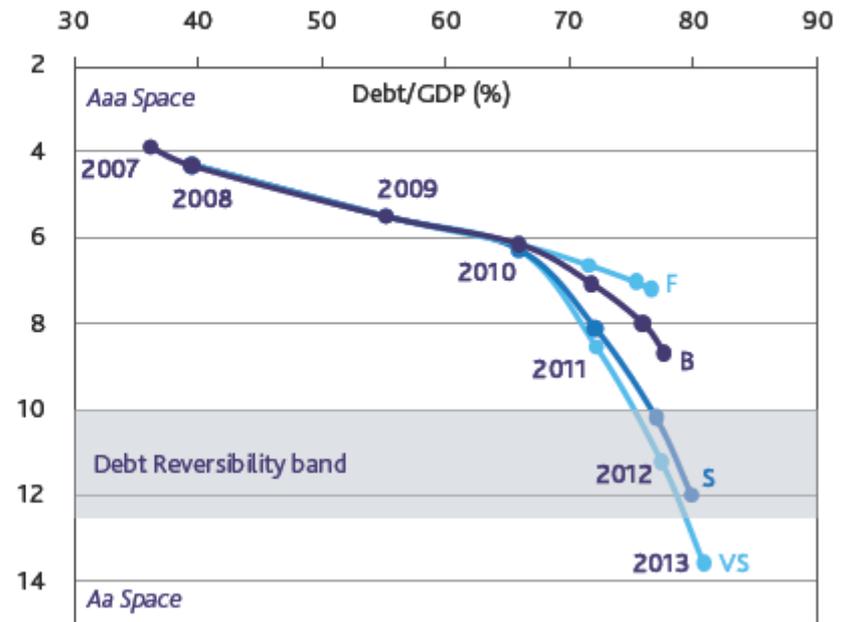
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Spain – Finding a New Balance

Distance to Downgrade – Main Scenarios



Interest Rate Sensitivity



Portugal: Debt Affordability Projections

Full Compliance with Medium-term Objectives

