# DAILY SURVIVAL GUIDE

**BBG Tip of the Day: GGR <go>**

*GGR is a quick way to look up global generic government rates, for yield curve or simple lookup.*

**Quote of the Day:**

"You only need to make one big score in finance to be a hero forever."
– Merton Miller

**MRA Daily:** *MRA Risk Dashboard* - Available via email and on our MRAD page on Bloomberg.

**Flow Recap:** http://www.macroriskadvisors.com/layout/pdf/20110825_FR.pdf

**Dean Curnutt**
**212-287-2640**
dcurnutt@macroriskadvisors.com

**Mike Buckjune**
**212-287-2640**
mbuckjune@macroriskadvisors.com

**Jarret Christie**
**212-287-2640**
jchristie@macroriskadvisors.com

**Danny Kirsch**
**212-287-2640**
dkirsch@macroriskadvisors.com

**Ed Lalanne**
**212-287-2640**
elalanne@macroriskadvisors.com

**George Lam**
**212-287-2640**
glam@macroriskadvisors.com

**Jon McLaughlin**
**212-287-2640**
jmclaughlin@macroriskadvisors.com

**Phillip Rapoport**
**212-287-2640**
prapoport@macroriskadvisors.com

**Frank Trentacoste, CFA**
**212-287-2640**
ftrentacoste@macroriskadvisors.com

## Daily Risk Metrics

Below we summarize the performance of popular risk assets relative to the SPX and the VIX. We provide the changes in popular risk assets and how each has performed relative to the SPX and the VIX. We use a 20-day beta to the SPX and VIX to determine whether the asset has under or outperformed in the context of this beta. We view the band of "expected" performance as +/- one standard deviation.

**Market Moves and Implied Volatility Moves**
***(Relative Performance Calculated Using 20 day Beta)***

| | Price | 1d % chg | Out / Underperforming Relative to SPX |
|---|---|---|---|
| SPX | 1177.6 | 1.31% | |
| Crude | 85.16 | -0.33% | Underperforming SPX |
| Gold | 1759.13 | -3.80% | Underperforming SPX |
| Euro | 1.4414 | -0.19% | Expected |
| US 10yr Fut | 129 19/32 | -0.58% | Expected |

| Implied Volatility | 1m I-Vol | 1d chg (pts) | Out / Underperforming Relative to VIX |
|---|---|---|---|
| VIX (S&P 500) | 35.90 | -0.37 | |
| OVX (Crude) | 47.89 | 0.22 | Outperforming VIX |
| GVZ (Gold) | 33.29 | -0.13 | Expected |
| EVZ (Euro) | 14.94 | -0.10 | Underperforming VIX |
| US 10yr Fut 1m ATM | 13.27 | 2.29 | Outperforming VIX |

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| **AAPL** | **Apple Shares Under Pressure After Jobs Resignation**<br><br>Source: Reuters<br><br>SAN FRANCISCO/LOS ANGELES (Reuters) - Shares in Apple Inc were marked lower by investors on Thursday as the company faced a future without its founder and visionary Steve Jobs at the helm.<br><br>Jobs resigned as CEO on Wednesday and passed the reins to his right-hand man Tim Cook, saying he could no longer fulfill his duties, but making no mention of the poor health that has forced him to take a back seat this year.<br><br>Jobs, who fought and survived a rare form of pancreatic cancer and revolutionized the technology arena with the iPod, iPhone and iPad, is deemed the heart and soul of a company that became the most valuable in the world for a brief period this year.<br><br>"I have always said if there ever came a day when I could no longer meet my duties and expectations as Apple's CEO, I would be the first to let you know. Unfortunately, that day has come," Jobs wrote in a brief letter announcing his resignation.<br><br>The letter and a separate statement from Apple raised more questions than it answered about Jobs' health and the future of the company. Jobs will continue as chairman.<br><br>While it is unlikely that his departure as CEO will derail Apple's ambitious product-launch roadmap in the near term, there are concerns about whether the company will be as creative without its founder and visionary at the helm.<br><br>Apple's stock traded down 4.1 percent in Frankfurt on Thursday, following a drop of as much as 7 percent in U.S. after-hours trading when Jobs' departure was announced.<br><br>In the company statement, Apple co-lead director Art Levinson on behalf of the board praised Jobs' "extraordinary vision and leadership" and said he would continue to serve the company with "unique insights, creativity and inspiration."<br><br>Jobs' battle with pancreatic cancer, which has stretched over several years, has been of deep concern to Apple fans, investors and the company's board.<br><br>Over the past two years, even board members have confided to friends their concern that Jobs, in his quest for privacy, wasn't being forthcoming with directors about the true condition of his health.<br><br>Jobs has been on medical leave since January 17, with his duties being filled by Cook, who was chief operating officer.<br><br>The 56-year-old Jobs had briefly emerged from his medical leave in March to unveil the latest version of the iPad and later to attend a dinner hosted by President Barack Obama for technology leaders in Silicon Valley.<br><br>But his often-gaunt appearance had sparked questions about how bad his illness was, and his ability to continue at Apple.<br><br>In each of Jobs' three health-related absences, Cook has taken over the helm.<br><br>The 50-year-old Alabama native, a former Compaq executive and an acknowledged master of supply-chain management, remains largely untested in Wall Street's view, however.<br><br>One Silicon Valley CEO, who declined to be identified because of the sensitive issues involved, |

said the tone of Jobs' statement indicated his health might be worse than feared.

The Apple chieftain has earned a reputation for commanding every aspect of operations -- from day-to-day running to broad strategic decisions -- suggesting he would not give up the job if he had a choice.

"It's really sad," the CEO told Reuters. "No one is looking at this as a business thing, but as a human thing. No one thinks that Steve is just stepping aside because he just doesn't want to be CEO of Apple anymore."

"It feels like another shoe is going to drop."

Brand research company Millward Brown said Apple's brand, which it values at over $153 billion, should remain intact.

"Steve Jobs resignation from Apple is sad for him as it presumably presages more illness. However he has left the Apple Brand in rude health so that the company is still poised for future growth," global brands director Peter Walshe wrote.

"The future direction is mapped out, the successor is in place (also a designer by background), and consumers rate the brand uniquely 'creative', 'fun' and 'adventurous'."

AGAIN, DEEP BENCH

While Jobs did not give details on the state of his health, oncologists who have not treated the Apple founder said he could be facing several problems tied to his rare form of pancreatic cancer and subsequent liver transplant.

Such problems include possible hormone imbalances or a recurrence of cancer that is harder to fight once the body has already been weakened.

"Steve Jobs is the most successful CEO in the U.S. of the last 25 years," Google Inc Chairman Eric Schmidt said in a statement.

"He uniquely combined an artist's touch and an engineer's vision to build an extraordinary company."

Nokia CEO Stephen Elop said in a statement: "Steve Jobs is a visionary in the computing industry. We look forward to both Steve and his team having a positive impact on our industry for many years to come."

Elop was appointed last year to lead Nokia's fightback against Apple, whose iPhone posed a challenge that the world's biggest cellphone maker has yet to meet.

Analysts again expressed confidence in the Apple bench, headed by supply-chain maven Cook.

"I will say to investors: 'Don't panic, and remain calm -- it's the right thing to do. Steve will be chairman and Cook is CEO," said BGC Financial analyst Colin Gillis.

Nomura's Global Technology Specialist Richard Windsor agreed, although he said rival smartphone makers would be quick to take advantage of any Apple weakness.

"This looks like a pretty smooth transition with the slight risk of a dent to its image if the next product launches are not perfect. Its competitors are waiting to pounce and here we think that HTC has the most to gain," he wrote.

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| | Apple previously did not have a chairman, but had two independent co-lead directors.<br><br>In his letter, which was addressed to the Apple board and the Apple community, Jobs said: "I hereby resign as CEO of Apple. I would like to serve, if the Board sees fit, as Chairman of the Board, director and Apple employee."<br><br>Link: http://www.reuters.com/article/2011/08/25/us-apple-idUSTRE77N82K20110825 |
| **EUROZONE** | **Why Yes, The Greek Collateral Grab Is A Big Honking Default Risk**<br><br>Source: FT Alphaville<br><br>Over a week after FT Alphaville first revealed how Greece's Finnish collateral "deal" threatened a default on its foreign-law bonds, given negative pledge clauses in the contracts…<br><br>From Handelsblatt on Thursday:<br><br>*The eurozone will not agree the agreement between Finland and Greece on collateral. "This is off the table," ["Das ist vom Tisch"] Wolfgang Schaeuble, the [German] finance minister, said to a meeting of the CDU/CSU parliamentary group, sources told Handelsblatt.*<br><br>*Financial experts have warned [the Eurogroup] against allowing donor states to receive collateral on EFSF loans. In this case, Greece could get a wave of lawsuits from private creditors, the Handelsblatt learned from diplomatic circles in the EU.* ***Private investors could rely on a so-called "negative pledge clause" in Greek government bonds***<br><br>Which would be the clause we've picked over here, here, and here.<br><br>In a nutshell, the negative pledge clause provides that Greece must secure the bonds on an equal basis, if it should ever secure 'external indebtedness', as defined in the contract. The definition covers any money borrowed under a foreign law, it would appear. (Though it'd depend on what a court would say, if it comes to that!) EFSF loans are governed under English law for example. (There might be ways for Greece to pledge collateral via a Greek-law vehicle of some sort, although we aren't sure.) But essentially, the Finnish demands for superior collateral currently stand to jeopardise the clause.<br><br>We've considered the pros and cons of the argument for whether it might be a CDS credit event as well as whether the collateral would be an event of default. Handelsblatt misses one big nuance though: this affects Greece's foreign-law bonds, not the circa 90 per cent of Greek bonds that are governed by Greek law. But it's a huge, huge deal not only for holders of these bonds, but possibly for holders of bonds and other contracts (repos?) that also contain cross-default clauses. Net notional on Greece CDS is relatively small, but there's also a serious problem for the eurozone's supposed commitment to avoid any trigger of credit default swaps on a member-state, not to mention the stigma of default on any part of a member's debts.<br><br>The point is, this goes way beyond the fear (enunciated by Moody's recently) that the Finnish collateral deal will delay or even stop the bailout. (Though that would risk a default on all of Greece's debt.)<br><br>The rot's gone a bit deeper than that now because of the complexity of the negative pledge issue. That's why we wouldn't put much store by Schaeuble's peremptory statement that the issue has gone away.<br><br>Wait to see what the Finns say first of all. They have been insisting throughout this week that collateral (in some form) is a red line for them, but collateral in just about any form will trigger |

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| | this negative pledge clause. Notably at pixel time an EU spokesman said that the talks on Greek collateral had no deadline. Therefore, no decision!<br><br>Just ask yourself one question. If you were an investor considering whether to trust Greece and take part in an expensive bond swap, the point of which is to avoid a disorderly default, what would you think about the kind of credibility and commitment shown in this Finnish farce? (Reuters was reporting that this bond swap had 50 per cent participation at pixel time, below the actual 90 per cent target. Not much time left.)<br><br>We're not sure. Is 'hoist with one's own petard' a popular phrase in Brussels?<br><br>Link: http://ftalphaville.ft.com/blog/2011/08/25/662366/why-yes-the-greek-collateral-grab-is-a-big-honking-default-risk/ |
| **CORPORATE BONDS** | **A Rush Out of 'Junk' – High-Yield Bond Market Dries Up in Flight From Risk; Bad News for Buyouts**<br><br>Source: WSJ<br><br>The market for "junk" bonds is enduring its worst rout since the depths of the financial crisis.<br><br>Demand for high-yield bonds sold by the riskiest U.S. companies has nearly dried up, an ominous sign for low-rated companies hoping to tap the bond markets and private-equity firms trying to finance leveraged buyouts. New junk-bond offerings in August were at their lowest level since December 2008.<br><br>Retail investors have been withdrawing record amounts from high-yield mutual funds, forcing those funds to dump bonds in order to raise cash, driving prices even lower.<br><br>Returns on junk bonds—those rated below investment grade, which offer a high yield due to a high risk of default—dropped to negative 5.1% in August, the worst monthly performance since November 2008, according to the Barclays Capital U.S. High Yield Index.<br><br>The tumult is a contrast to the action in stocks, which rose Wednesday for the third day in a row. But many bond-market participants contend that stock investors have it wrong. Such optimists are hoping that the Federal Reserve will step in soon and offer a new round of so-called quantitative easing. Even if the Fed does step in with a new bond-buying program, it is unlikely to prevent an economic recession, say some bond-market analysts, who also are worried about Europe's sovereign-debt woes.<br><br>Bond "investors are definitely more cautious than equity investors because they are always focused on downside risk," says Andrew Jessop, head of high-yield investing at Pacific Investment Management Co.<br><br>The declines are being exacerbated by the seasonal slowdown in activity during late August, which has left few buyers. Wall Street banks, which often stand in the middle of trades and at times try to keep a floor under prices, are less willing to buy bonds and hold them in the face of persistent investor selling.<br><br>Having lived through the market rout in 2008, banks "are more conservative in this downdraft," says Jeff Peskind, chief investment officer at Phoenix Investment Adviser, which runs a $300 million hedge fund focused on financially stressed high-yield borrowers.<br><br>As a result, declines have been magnified. Trading of high-yield bonds averaged $3.46 billion this week compared with an average of $4.72 billion in August, and $4.74 billion in the current year so far, according to data provider MarketAxess. |

The spread between the yields of junk bonds and U.S. Treasurys has ballooned in recent months as the government bonds rallied even as high-yield debt sank. The spread on the Barclays Capital High Yield Index over Treasurys widened to 7.66 percentage points this week—the highest since November 2009—from 5.87 percentage points at the end of July.

The selloff has been broad. Riskier bonds, such as those sold by private-equity firm Apollo Management LP to acquire Harrah's Entertainment in 2007, dropped 6% this week and are down 18% so far this month. Bonds due in 2027 backing Bain Capital's buyout of Clear Channel Communications sank 11% to trade at 40 cents on the dollar this week .

Investors also dumped bonds of relatively higher-quality companies such as Ford Motor Co. and Qwest Corp. to raise cash because there are more of those bonds, and they are much easier to trade. Ford bonds due in 2015 fell more than 2% this week, while Qwest's fell 3%.

While Mr. Jessop and others anticipate demand might return once September begins, some worry that concerns about the U.S. economy and Europe's sovereign-debt problems still might keep many investors out of the market.

That could have dour implications for companies and private-equity firms that are hoping to finance leveraged buyouts through the junk-bond market. LBO activity has only kicked into gear in recent months and several deals await financing.

A number of new junk-bond deals are slated for the weeks after the Labor Day holiday weekend, including a sale backing energy producer AES Corp.'s $3.5 billion acquisition of Dayton Power & Light's parent company, DPL Inc. Apollo also was planning to raise money for its $511 million buyout of CKx Inc., parent company of the television program, "American Idol."

Companies raised just $1.2 billion this month in the U.S., according to data provider Dealogic, down 93% from July's $18.2 billion and the lowest since the market completely dried up in December 2008.

After pumping more than $43.8 billion into high-yield funds between March 2009 and February this year, retail investors have pulled out a record $4.6 billion so far in August—a pace that could surpass the $7.3 billion outflow in June, the highest monthly outflow on record—according to fund tracker Lipper, which began keeping track in 1992. The junk market, which is far smaller than the stock market, is particularly sensitive to mutual-fund flows.

American corporations have a cushion to withstand a bumpy high-yield market. Companies are far stronger than they were in 2008 because they have cut costs, and taken advantage of years of low rates to refinance their debt.

The U.S. high yield default rate fell to 2% in June, down from 11.17% in 2009 and 3.3% in 2010, according to Standard & Poor's. And, even if investors charge companies more, interest rates are still very low.

Still, some worry that an event such as a European default or the failure of a global bank could flush money out of their market even faster, sparking ever steeper losses despite the relative strength of corporate balance sheets.

David Steinberg, a portfolio manager of Mast Capital Management, which runs a $1.25 billion credit hedge fund in Boston, Mass., started betting against junk bonds last year and increased those bets recently because he expects the economy to fall into recession.

"I am net short and getting shorter," he says.

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| | He said he also is skeptical of any help from the Fed. On Friday, Fed Chairman Ben Bernanke is scheduled to speak in Jackson Hole, Wyo. And while Fed officials have given no indication that the central bank plans to announce any more support for financial markets, stock investors, at least, appear to be hoping he will. The Dow Jones Industrial Average rose 1.29% to 11,320 on Wednesday, its third consecutive rise.<br><br>To Mr. Steinberg, stock investors right now "are smoking Jackson Hole Hopium."<br><br>Link: http://online.wsj.com/article/SB10001424053111904009304576528901302667510.html?mod=WSJ_business_whatsNews |
| **NATURAL GAS** | **SEC Bears Down on Fracking**<br><br>Source: WSJ<br><br>WASHINGTON—The Securities and Exchange Commission is asking oil and gas companies to provide it with detailed information—including chemicals used and efforts to minimize environmental impact—about their use of a controversial drilling process used to crack open natural gas trapped in rocks.<br><br>The federal government's investor-and-markets watchdog is stepping into the heated environmental debate surrounding hydraulic fracturing, or "fracking," according to government and industry officials, even as state and federal environmental officials have begun to bring greater pressure on the industry. The process, which involves pumping water, chemicals and sand underground to free difficult-to-reach natural gas in shale basins, has come under criticism from environmental groups ad some lawmakers over concerns toxins in the mix may contaminate air and water.<br><br>The SEC move shows the broad interest among Washington regulators in taking a closer look at fracking and suggests companies that are betting billions of dollars on the technology will increasingly need to weigh disclosing techniques they often consider proprietary. Battles over disclosure have already broken out at the state level, including in states such as New York and Pennsylvania that sit on the giant Marcellus Shale, an underground formation that has become a fracking hotbed because of the large quantities of natural gas there. Just last week, Noble Energy Inc. paid $3.4 billion for a stake in developing 663,350 acres there.<br><br>Regulators in several states have identified cases in which drilling—although not necessarily the fracturing process in particular—has allowed natural gas to seep into residential water wells, and at least one scientific study has linked drilling and gas contamination more broadly. But there have been few if any documented cases of contamination by the chemicals used in hydraulic fracturing. The industry acknowledges that improperly constructed wells can allow gas to escape, but says such cases are rare and aren't directly tied to fracturing itself.<br><br>In the past, the SEC has trained its attention on other areas of concern, such as subprime mortgages and credit-default swaps, and has asked companies to provide additional information to investors. Government officials said the SEC's interest in fracking is in ensuring investors are being told about risks a company may face related to its operations, such as lawsuits, compliance costs or other uncertainties. Other federal agencies like the Environmental Protection Agency are collecting information about fracking, but those efforts are separate from the SEC.<br><br>For the moment, the SEC isn't requiring broad, standardized disclosure of fracking information to the public. Instead, oil and gas companies are being asked by the agency's office that oversees |

corporate disclosure to supply information confidentially to the SEC, and the agency, in turn, will likely require them to publicly disclose some of that information, according to government officials.

"If there's something in [a company's] field of operation that creates uncertainty, that's something they may want to talk about" with investors, said a government official.

The SEC's requests drew criticism from some in the industry about potential regulatory overkill.

"While our industry absolutely supports common sense disclosure and transparency measures, such duplicative inquires that may fall outside of an agency's core mission, are troubling and counter to what our nation needs at this time," said Kathryn Klaber, president of Marcellus Shale Coalition, an industry group.

An SEC spokesman said "in the course of our filing reviews staff will ask questions related to the areas disclosed in the company's filings." The EPA didn't respond to requests for comment.

The SEC's foray into the issue comes as the Obama administration is trying to find a middle ground between environmental concerns over fracking and an industry that is creating jobs and increasing domestic supplies of an alternative energy source to coal. Natural gas currently provides about 25% of total U.S. energy and is projected to increase to 45% by 2035, according to the U.S. Energy Information Administration. In addition to a fracking study being conducted by the EPA, the Department of Energy and the Interior Department have also been examining the practice. Some states have fined drilling companies for environmental problems.

For securities regulators, two recent energy-related disasters are fresh in their minds: the crippling of Tokyo Electric Power Co.'s Fukushima Daiichi nuclear-power plant in March and last year's BP PLC oil spill in the Gulf of Mexico. In both cases, some investors were surprised at the risk to which the companies were exposed, and their share prices fell sharply.

The SEC's questions in recent letters include which chemicals are being injected into the ground, what companies are doing to minimize water usage and what steps they are taking to minimize environmental impact, according to copies reviewed by The Wall Street Journal.

The questions are already prompting some companies to disclose more. SandRidge Energy, a small, Oklahoma company, beefed up disclosure related to fracking operations after the SEC asked a series of questions in connection with a public offering of a trust SandRidge completed last week. For instance, the company said in a recent financial filing that its fracking fluid contains 99% fresh water, and the remainder includes the food additive guar, enzymes and other chemicals, which it didn't name.

Fracking fluids include some toxic chemicals, based on company disclosures of chemicals such as benzene and formaldehyde for congressional reports and at voluntary disclosure sites.

Kevin White, senior vice president of SandRidge, said "responding to those comments would be easier than what other companies might face" because the firm doesn't use many chemicals in its fracking fluid.

Industry representatives said much depends on how specific the SEC wants companies to be and

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| | cautioned they would resist revealing proprietary information.<br><br>"While we support disclosing our ingredients, it is critical to our business that we protect our proprietary information, including the recipes of our products," said spokeswoman Tara Mullee Agard of Halliburton Co., one of the largest providers of hydraulic-fracturing services to the energy industry.<br><br>Already some companies have said they will voluntarily publicize their chemicals online at FracFocus.org, and several states, including Wyoming, Texas and Arkansas, have recently passed mandatory disclosure rules. The companies will make the information public through state registries.<br><br>Fracking is primarily regulated by states and is largely exempt from some federal statutes, such as the Safe Water Drinking Act. The EPA's study on whether fracking affects drinking water is to be released at the end of 2012. For the study, nine companies provided information on the chemicals they use after an agency request last year.<br><br>The SEC has also been investigating whether companies are overstating the long-term productivity of their natural-gas wells and has issued subpoenas to at least two firms, according to company financial disclosures earlier this month. The agency subpoenaed Quicksilver Resources Inc. and ExCo Resources Inc. The New York attorney general's office, meanwhile, has also issued subpoenas this month to various companies, including Range Resources Corp., Goodrich Petroleum Corp. and Cabot Oil & Gas Corp., over their estimates.<br><br>Jim Smith, a partner at Houston law firm Porter Hedges LLP specializing in environmental law, questioned whether the type of fracking information the SEC is requesting is material to a company. "I have not heard of companies in relatively recent times having significant environmental liabilities associated with hydraulic fracturing that in any way affected their reported worth," he said.<br><br>Investors, including the $129.4 billion New York State Common Retirement Fund, have begun agitating for enhanced disclosure of fracking operations over the past few years and have successfully included shareholder proposals at 16 companies. Though none have passed, proponents at Chevron Corp. got 41% support, backers at Exxon Mobil Corp. got 28% and Williams Cos. holders got 42%. Some companies, such as Williams and Cabot, have increased disclosure of their fracking operations as a result of the proposals.<br><br>New York State Comptroller Thomas P. DiNapoli, who runs the New York State Common Retirement Fund, said some companies drilling in the Marcellus Shale in Pennsylvania have had to pay large fines and suffered reputational damage over fracking problems. Chesapeake Energy and Cabot have paid fines there. "Only through appropriate disclosure do you get the information you need to make informed and sound investment decisions," he said.<br><br>Link: http://online.wsj.com/article/SB10001424053111904009304576528484179638702.html?mod=WSJ_business_whatsNews |
| **CHINA** | **Beijing Olympics Bill Surges With $2.5 Billion of Bonds Due: China Credit**<br><br>Source: Bloomberg News |

Beijing's state-owned infrastructure companies face a record amount of bonds maturing next year as China's capital city pays the bills for the $70 billion 2008 Olympic Games.

Fifteen local government financing units based in Beijing must pay 16.2 billion yuan ($2.5 billion) next year plus interest to investors, breaking last year's record 12 billion yuan, according to data compiled by Bloomberg. A further 11.6 billion yuan matures in 2013 and 37.6 billion yuan in 2014.

The debt is coming due as government efforts to control inflation cause corporate borrowing costs in China to rise to a three-year high of 5.92 percent this month, double the rate in the U.S. How Beijing deals with the bill, which dwarfs the estimated $15.3 billion budget for next year's London Games, may set a pattern for more than 10,000 local-government financing vehicles across China with about 10 trillion yuan of debt.

"The Olympics was a spectacular event for China, but now Beijing has to deal with the hangover because of high borrowing to finance the event," said Victor Shih, a professor at Northwestern University in Evanston, Illinois who analyzes China's local government finances. "Bond yields are heading up, so refinancing will be much more costly."

The yield top-rated companies must pay on 10-year bonds has risen 74 basis points, or 0.74 percentage point, this year to 5.88 percent and touched 5.92 percent on Aug. 4, according to Chinabond data. Borrowing costs for similarly ranked U.S. companies have dropped 84 basis points to 3.12 percent in the same period, Bloomberg data show.

Bad Loans

Concerns are increasing that local government financing units across China will struggle to pay their debts that total 10.7 trillion yuan, with 80 percent coming from banks, according to National Audit Office data published on June 27.

Standard & Poor's estimates that as much as 30 percent of China's lending to local governments may go sour, after a two- year lending boom that drove the nation's economic-stimulus program by pumping money into roads, highways and railways. Standard Charted Plc said in July 18 report that the lending may end in a wave of bad debts and prompt the nation's third banking bailout in less than two decades.

Beijing Infrastructure Investment Co., a state-owned company that helped build the city's subway system including a line to the Olympic area, paid a coupon of 3.78 percent on 2 billion yuan of one-year notes in June 2007, Bloomberg data show. The company paid 4.35 percent on 4 billion yuan of similar-maturity bonds in March.

'Severe Strain'

Beijing, a city of 19.6 million people, had total debts of 374.5 billion yuan at the end of 2010, 61.7 percent of which the central government has a responsibility to repay, the People's Daily reported on July 21, citing the head of the city's audit office. That compares with 303.3 billion yuan for the northeast province of Jilin, which has 27.4 million people, according to Caixin magazine.

The capital's infrastructure financing units have also signed lines of credit worth over 500 billion yuan with China's state-owned banks, according to data from their prospectuses.

"Beijing runs perennial budget deficits like most other cities in China, which means any sizable bond redemption would put a severe strain on the city's budget," Shih said by e-mail. Authorities will "need to be very inventive in repaying the coming waves of redemptions."

Bird's Nest

Gui Guan, an official at Beijing's Finance Bureau, said the companies building the Olympics-related infrastructure were "commercial" and questions should be directed to them. He directed Bloomberg News to a National Audit Office report from 2009, which showed that the Beijing Olympic Games were profitable, with revenue exceeding what it said was a total cost of 19.3 billion yuan.

Beijing Urban Construction Investment & Development Co. raised 500 million yuan in November 2007 to help finance the Bird's Nest national stadium, the Olympic Village and the Olympic Park, according to the prospectus for the bond.

The spread on the company's 6.08 percent notes maturing in 2014 over government debt widened to a record 253 basis points on Aug. 11, from 167 at the end of 2010, and was last at 251, according to Chinabond prices.

Calls to Beijing Urban Construction's offices yesterday seeking comment on the company's debt weren't answered.

Beijing Infrastructure, which said in a December 2004 bond prospectus that the Olympics "ushered in an unprecedented opportunity for rail construction," has 27 billion yuan of bonds outstanding. The company has borrowed more than 61.4 billion yuan from 18 banks, with another 146.2 billion yuan in unused lines of credit as of Sept. 30, 2010, according to a prospectus issued in April.

City Subsidies

Repeated calls to Beijing Infrastructure's offices seeking comment on the company's refinancing plans went unanswered.

Beijing Capital Highway Development Group Co., a road builder, said in a prospectus issued last week that its "ability to pay its debts was weak" and that it was counting on subsidies from the city government to stay solvent. The company has 9.3 billion yuan of bonds outstanding and had borrowed 39.5 billion yuan from banks, including 18.8 billion yuan from Industrial & Commercial Bank of China, as of the end of last year, according to the prospectus.

Beijing Capital Highway wrote in faxed response to questions "our credit is rated AAA and we are totally solvent."

Sovereign Risk

The cost of insuring China's sovereign bonds against non- payment has risen 55 basis points this year to 123 basis points, the highest since May 2009, according to five-year credit- default swaps provided by CMA, which is owned by CME Group Inc. and compiles prices quoted by dealers in the privately negotiated market. Rising default swaps suggest deteriorating perceptions of creditworthiness and declines show improvement.

Contracts on Greece, which spent more than 11 billion euros ($15.9 billion) to host the 2004 Olympics have risen 1,240 basis points to 2,250 in the same period. Greece's debt is 143 percent of gross domestic product, according to data compiled by Bloomberg. The ratio for China is about 71 percent, Standard Chartered said in a June 29 report.

Credit-default swaps on the U.K., where the London Games start on July 27, have risen 10.5 to 84 in the same period, CMA prices show.

Curbing Inflation

"Given the low current indebtedness of the Chinese sovereign we think they have a large capacity to absorb" any losses on local government debt "as and when they occur in a manner that we think is consistent with their current rating," David Beers, global head of sovereign and international public finance ratings at S&P, said at a briefing for reporters in Beijing on Aug. 22. S&P rates the country AA-, its fourth- highest investment grade.

China has raised interest rates five times since October and ordered banks to increase the level of reserves they set aside six times this year to curb inflation that accelerated to a three-year high of 6.5 percent in July.

The yuan declined 0.02 percent to close at 6.3900 per dollar in Shanghai today, according to the China Foreign Exchange Trade System. It touched 6.3820 on Aug. 16, the strongest level since the country unified official and market exchange rates at the end of 1993.

China's 10-year government bond yielded 3.951 percent yesterday. That compares with 2.266 percent for the U.S. and 8.217 percent for India. The extra yield investors demand to own 10-year corporate notes in China instead of government securities reached a record 198 basis points on Aug. 15 and was last at 193.

Asset Stripping

The last two Summer Olympics left the host cities with underutilized facilities. The Bird's Nest stadium is used occasionally as a sports venue, hosting AC Milan versus Inter Milan on Aug. 6 and the Beijing International Equestrian Grand Prix in May. Athens has leased out just six of the 22 venues used in the 2004 Games, according to former Finance Minister George Papaconstantinou.

Investors "should pay close attention" to what strategy Beijing takes as it tackles its debt burden, according to Northwestern University's Shih.

It may involve "stripping cash-generating assets from the city's other state-owned enterprises to help restructure the debt," he said. "But when this is done, people continue to borrow and the pool of illiquid loans gets larger and more unknown."

'Old Wine'

China Chengxin International Credit Rating Co. put two bonds sold by financing vehicles in southern Yunnan province on its watch list last month after the announcement of a planned asset transfer. Sichuan Expressway Construction & Development Corp. was cited for violating rules in June after it transferred its stake in Sichuan Expressway Co. to another company.

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| | The central government is working on a plan to allow local authorities to sell debt themselves, rather than having to use financing vehicles, starting with a 7.1 billion yuan quota for Shanghai and 6.9 billion yuan for Guangdong, excluding Shenzhen, Caixin magazine reported Aug. 22.<br><br>In the meantime, some of Beijing's state-owned infrastructure companies are selling more bonds to pay off bank loans. Beijing Capital Co. said in its April prospectus that half of the 1.2 billion yuan it was seeking to raise would be used to retire bank debt.<br><br>"In principle there is nothing wrong with refinancing as long as you realize that it is old wine in new bottles, and the old wine hasn't changed," said Patrick Chovanec, a professor at Tsinghua University's School of Economics and Management in Beijing. "If it was not a good loan to begin with it is not going to become a good bond."<br><br>Link: http://www.bloomberg.com/news/2011-08-24/beijing-olympics-bill-surges-with-2-5-billion-of-bonds-due-china-credit.html |