

Special Report

2008 Global Rating Outlook Summary

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Related Research

- [A comprehensive list of individual sector outlooks is available from www.fitchratings.com, on the 2008 Outlooks page.](http://www.fitchratings.com)

Summary

The likelihood of a slowdown in economic growth, continuing elevated levels of market risk, and a move away from the very low levels of credit defaults seen since 2004, will all likely contribute to a continuing trend of negative rating actions during 2008.

However, the scale of anticipated rating actions will reflect credit ratings' role as indicators of relative default risk, rather than measures of market pricing or overall economic sentiment. Even through economic troughs, where default activity tends to be clustered, credit defaults remain a relatively rare occurrence. Consequently, the scale of rating actions at the portfolio level will likely continue to be less dramatic than volatility in equity and fixed income markets. As an example of relative impact, in the most challenged sector of 2007 - global CDOs - the year saw 1,416 downgrades (including multiple actions on the same tranche) in a universe of c.7,000 Fitch-rated tranches outstanding. Similarly, US RMBS saw 4,703 downgrades, but within a universe of almost 48,000 Fitch-rated tranches. While these downgrades in turn contributed to pressure for global bank ratings, again, only 24 banking groups (or slightly less than 3% by count of Fitch's rated bank universe) were directly affected by related negative rating action in the balance of 2007.

The risk of individual negative rating actions is nonetheless expected to remain at an elevated level in 2008. Concentration of actions within certain sub-segments will also likely contribute to the continued fragility of sentiment. Market sentiment and liquidity are consequently likely to remain strained through the year, as any improvements in individual sectors are likely to be offset by further deterioration in others.

Global Economic Backdrop

For more details, see "Sovereign Review", 19 Dec 2007

Fitch expects the impact of housing market problems in multiple developed market economies, broader consumer confidence and constraints on global access to capital to remain key in determining near-term economic growth.

Annual Average GDP Growth

	2006	2007f	2008f	2009f
US	2.9	2.2	1.7	2.8
Eurozone	2.9	2.6	2.1	2.4
Japan	2.3	2.0	1.8	2.3
Emerging Asia	8.5	8.7	7.7	7.9
Emerging Europe	6.6	6.5	5.9	5.6
Middle East/Africa	5.1	4.9	5.3	5.4
Latin America	5.3	4.8	4.1	4.0
World ^a	3.8	3.5	3.0	3.4
Memo:				
BRICs	8.8	9.2	8.2	8.1

^a Weighted at market exchange rates
Source: Fitch

Key influences include falling house prices, mortgage resets, higher energy costs and the softening labour market in the US, together with the expectation of softer consumer demand and tighter credit conditions in Europe. Variation from the above growth forecasts is strongly biased to the downside, with a 40% possibility of

recession in the US, likely entailing knock-on effects on other countries. Fitch does not anticipate these constraints on economic growth to remain confined to developed markets. Private sector indebtedness in emerging markets has continued to climb, much of it foreign-currency denominated, even as domestic fixed-income markets have grown. Exposures to macro-level currency rate risks are particularly pronounced in emerging Europe. Booming commodity prices, while creating positive flows to reserves for some emerging markets, have also created mounting inflationary pressures.

Structured Finance

For more details, see “2008 Global Structured Finance Outlook”, 15 Jan 2008

Although the majority of asset performance outlooks remained either stable (36 sub-sectors) or improving (3 sub-sectors) as at December 2007, the new year also sees a record number of sub-sectors (31) where Fitch anticipates declining asset performance. The lower number of sectors where Fitch anticipates declining rating levels (10 sectors) reflects the degree to which current ratings are expected to withstand the anticipated decline in asset performance.

Fitch’s primary concerns going into 2008 relate to:

- Further deterioration in the US housing market, and the consequences for other RMBS products, notably Alt-A.
- The continued consequent impact on resecuritisation products involving downgraded assets, notably CDOs and structured investment vehicles (SIVs).

Fitch is also monitoring for deterioration, albeit most likely of a lower order of magnitude, in:

- Mortgage performance in European non-conforming RMBS, notably in the UK, Spain and Ireland.
- Non-mortgage sectors indirectly affected by waning consumer confidence and high household leverage.
- Commercial real-estate transactions with upcoming refinancing requirements.

Fitch has published extensively on the factors behind the sharp deterioration in US residential mortgage-backed transactions. Following the review of US subprime transactions in 2007, concerns receiving greater attention in 2008 relate largely to the presence of risk-layered products outside the subprime borrower class, within the Alt-A and prime borrower categories. Risk-layering refers in this context to the situation where borrowers have both provided low documentation and have a simultaneous second-lien loan (“SSL”) secured against their property. Based on the performance of recent vintages of Alt-A transactions, significantly more downgrades are expected in this segment in 2008. While the general market pressures may extend to prime RMBS transactions, in contrast to Alt-A and subprime, rating pressure for prime RMBS will likely be limited to lower-rated bonds for pools featuring risk-layered transactions. The potential for amortisation-led positive rating actions across RMBS sectors will likely be constrained, as elsewhere, by anticipated reduction in prepayments as refinancing across all asset classes becomes more challenging.

Fitch has extended the lessons learnt from recent experience with mortgage-backed securities and extended its consideration of originator standards. While origination standards are expected to improve in new RMBS transactions, concerns exist over the potential for weakening origination standards in a number of US ABS asset classes including private student loan ABS. Origination quality will be one of the major focuses of transaction reviews during 2008. The balance of ABS asset classes outside the US is expected to see broadly stable asset and rating performance, with concerns focused mostly in selected European and Asian markets on consumer finance asset classes.

US CMBS transaction ratings are seen as generally robust. Concerns are higher for transactions with loans to property repositionings (i.e. redevelopment risks), although Fitch's ratings have thus far noted the mitigation of much of this risk by B-note structures. The outlook is more cautious for European CMBS, which saw downgrades led by performance issues in 2007, and negative outlooks assigned to certain UK transaction tranches early in 2008. Negative pressure in the UK market is driven by the decreasing cushion between the yields assumed in Fitch's initial analysis and current market conditions, with current market sentiment suggesting that further declines in capital values are likely in the coming months. Pressures from market liquidity constraints and softening valuations are expected to be higher on recently-closed short-maturity transactions, and lower-rated tranches in transactions exposed to revaluation tests.

The 'ripple effect' radiating from subprime RMBS performance affecting CDOs of structured finance and CDOs containing other related collateral (e.g. trust preferred securities of real estate companies) is also likely to continue in 2008. While Fitch's late 2007 review of CDOs backed by structured finance assets has likely anticipated further deterioration in collateral within current ratings, the impact of Fitch's methodology reassessment for CDOs currently underway is also expected to lead to further negative rating actions for CDOs backed by assets other than structured finance bonds in the first half of the year. This will likely be compounded by an end to the low default and high recovery rates seen in the high yield and leveraged loan segments over 2006 and 2007. The slowdown in economic growth anticipated for 2008 will likely see rising defaults and worsening recoveries through 2008. As with previous downturns in CDOs, managed transactions have - and likely will continue to see - fewer downgrades on average than is the case for static transactions.

Given the continuing pricing dislocations seen in the market, market value transactions are also expected to face continuing negative pressure in terms of both asset performance and rating actions. Fitch is currently inviting comment on an exposure draft - "*Market Value Structures: Exposure Draft*" - highlighting possible future paths for market value transactions, based on lessons learnt in 2007.

Financial Institutions

For more details, see "2008 Rating Outlook Negative for US Financial Institutions", December 19, 2007; "Outlook for Major European Banks in 2008", December 11, 2007; "Global Bank Rating Trends Q407", January 28, 2008.

Worst hit amongst financial institutions have been mid-sized institutions which relied to a higher degree on mortgage or other consumer asset origination or securitisation of assets as a central plank of their funding strategy, and larger institutions with significant holdings, either in proprietary trading books or through related conduits, in structured finance assets.

2008 is expected to see continued pressure on banks' funding strategies given the need to rebuild capital, and the reduction in investor appetite for structured finance transactions as a funding channel. Revenues and profitability will come under pressure across the rated universe, given increased wholesale funding and capital costs and higher loss provisioning. The separate revenue impact relating to lower capital markets activity is expected to disproportionately affect those institutions participating in this segment with weaker franchises and/or those who have selected specialisations poorly.

The degree of dependence on securitisation markets varies, but is most pronounced in funding terms amongst mortgage originators and commercial/consumer finance companies, and in revenue terms amongst broker/dealers and major international banks. Fitch acknowledges that risk management appears to have made a meaningful difference in the relative performance of individual institutions, but

also notes that several more quarters' reporting are likely to be required before confidence in bank exposure levels can begin to be restored.

Credit risk on bank's balance sheets is also expected to rise sharply in many developed markets. While this will mark an uptick from extremely low levels historically, increasing loss provisions related to credit risk - as opposed to 2007's large market risk-related writedowns - will also further threaten to delay a return in confidence in the banking sector as a whole. Less clear is the future of the recent trend towards consolidation, with near-term combinations likely to be both conservatively financed and concentrated on institutions weakened by franchise damage or adverse near-term news-flow.

In rating terms, the initial impact in 2007 was to reverse the recent positive ratings trend, including the erasure of a number of positive outlooks across the segment. This effect has been seen in both emerging markets, where the positive-to-negative outlook/watch ratio fell from 6:1 to 3:1, and in developed markets, where the ratio fell from 4:1 to 1.4:1. Execution of negative rating actions has nonetheless been limited thus far, and the average ratings of regulated institutions remain at a strong level. Current expectations are that only a limited likelihood exists of widespread or multi-notch downgrades.

Insurance industry ratings are expected to remain largely stable, reflecting solid levels of capitalisation, and indications that exposure to troubled structured finance asset classes and conduits is limited. In most parts of their business, life insurers are generally helped by a longer-term investment horizon. This in turn reduces the impact of mark-to-market movements which have been key in driving non-default-related loss levels elsewhere in the financial sector.

More secular concerns regarding the softening of premium levels vary by market, and are more pronounced in the US than in the UK markets, although the strategies chosen for deployment of excess capital remains a defining factor in rating levels. In Germany, softening capitalisation levels and structural changes to both life and non-life marketplaces are driving negative outlooks on both asset performance and ratings for 2008.

Corporate Finance

*For more details, see corporate rating outlooks at:
<http://www.fitchresearch.com/corporate/include/outlook.cfm>*

2007 saw rating activity dominated by bull market event risks - such as M&A and various shareholder-friendly initiatives - against a backdrop of robust corporate earnings and solid fundamentals leading into the summer. By way of contrast, Fitch anticipates financial and business risk issues to re-emerge at the fore in rating activity in 2008.

However, the overall volume of rating actions at the portfolio level is expected to remain rather modest, due both to the relatively sound levels of liquidity, and, in the investment grade universe, to lower average leverage relative to the overall portfolio at the time of the previous cycle downturn. Furthermore, expectations of a measured rather than precipitous rise in negative rating activity also reflect the actions taken already in 2007, with headroom existing at present rating levels for many entities. Currently, there are around 1.7x negative outlooks/watches for each positive outlook/watch, yet some three-quarters of the rated portfolio remains on stable outlook.

Thus, while event-driven factors are expected to continue to figure among rating actions (notably, in the utility sector in Europe), deteriorating economic conditions and higher input costs may be the primary impetus to a moderate rise in negative rating activity. In this regard, it is in the more cyclical sectors of mature markets - especially among more discretionary spending sectors like auto, homebuilding and

airlines, plus some staple areas like packaged/commodity foods and paper/forest products - and most of all among the more financially vulnerable leveraged credits, where negative rating action is anticipated to be concentrated. Coupled with tighter credit conditions, defaults are similarly expected to be confined to a limited spectrum of Fitch's rated universe. Currently, the agency expects corporate defaults to rise - albeit from historically low levels - but remain modest overall with defaults among US high yield entities to hit around 4-5% only in 2008. European leveraged finance borrowers, with low maturities coming due over the next three years, typically enjoy a stronger liquidity position relative to their US peers.

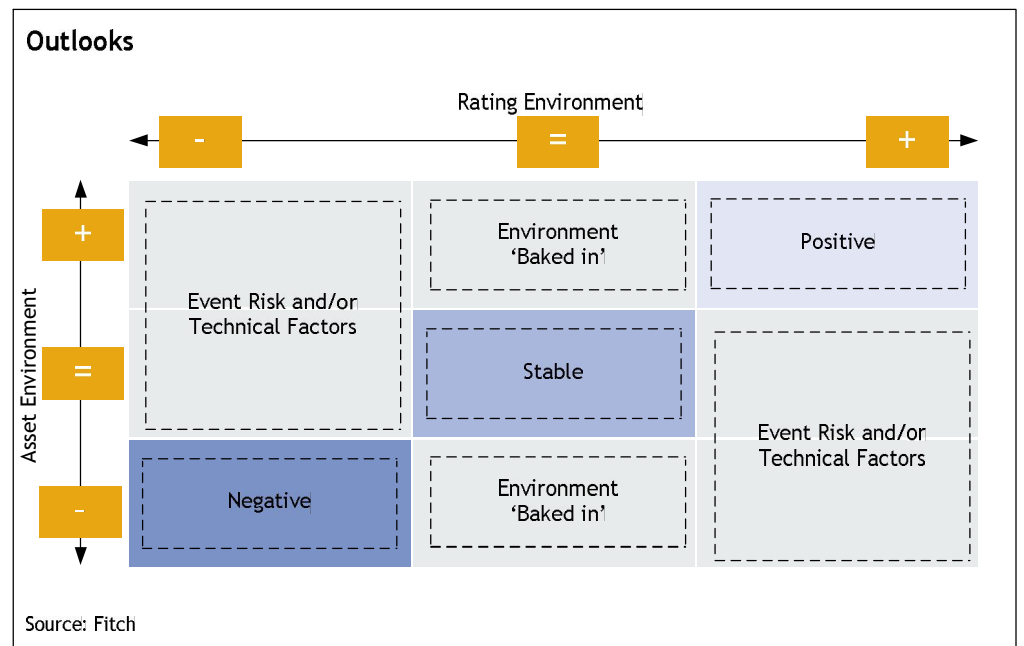
The broadly positive rating trend which has characterised emerging market issuers in recent years is also expected to slow significantly in 2008. Recent years have demonstrated a stark difference in relative outlook signals between developed and emerging markets for corporate entities. Positive-to-negative outlook ratios for the latter have, however, fallen from 4.3:1 to 1.1:1 as at January 2008, thanks to rising negative outlooks in the industrial and energy/utility segments and recent upward ratings migration. While an indicator of reducing positive momentum for emerging market corporate ratings, this figure still remains markedly more positive than the 0.5:1 figure for developed markets.

Emerging market rating improvements had increasingly been fuelled during 2007 by non-sovereign issues (i.e. an improvement of fundamental credit profiles, rather than rising sovereign ceilings), lifted by, among other things, ongoing demand for infrastructure investment and improved corporate governance performance. Increasingly Fitch expects these idiosyncratic factors to become a more prominent driver of rating actions.

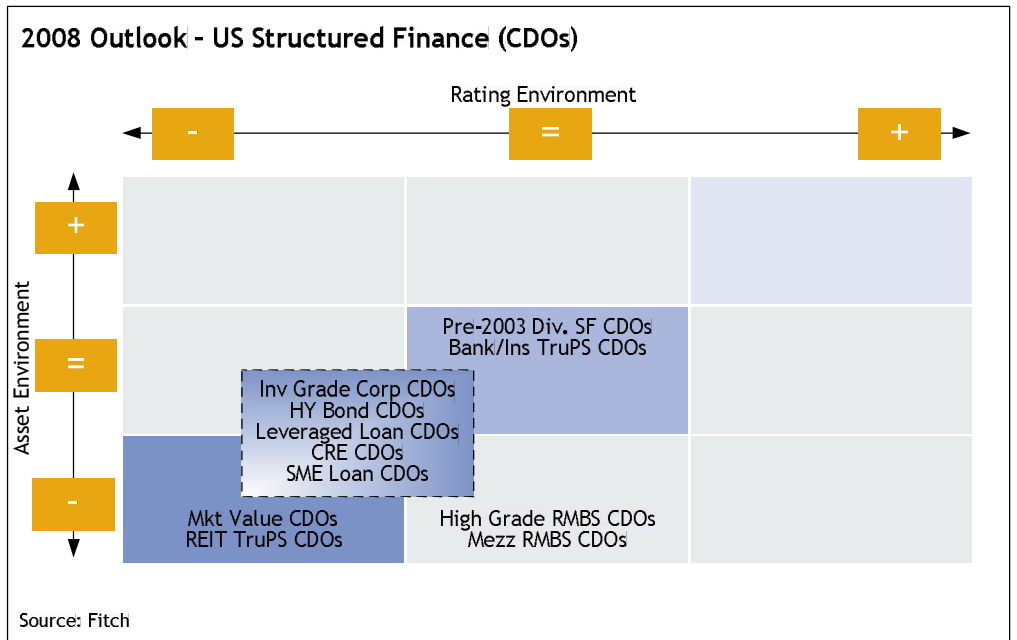
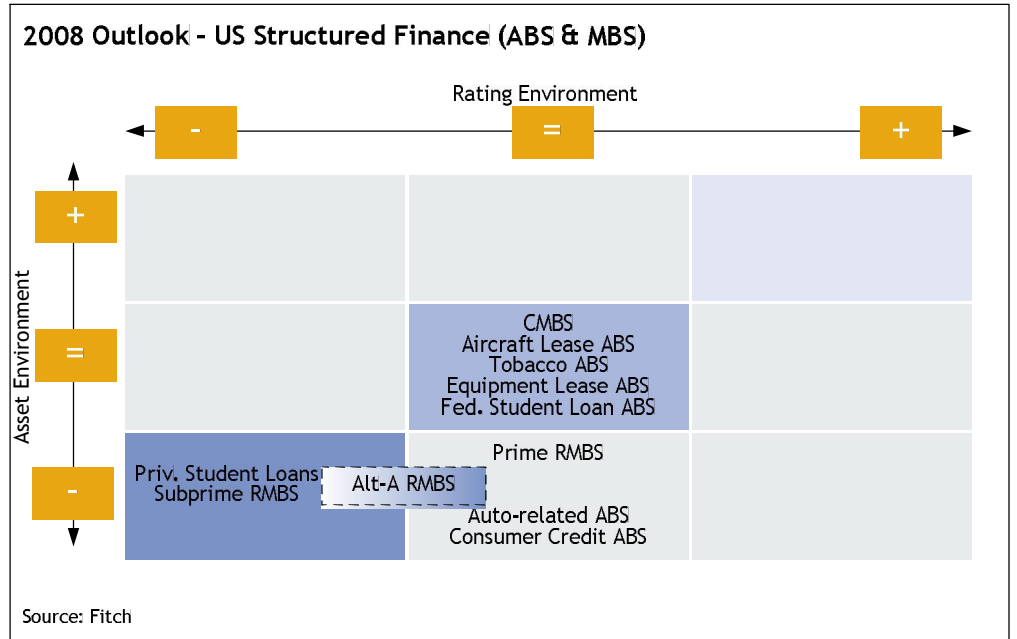
Asset Performance and Rating Outlook Tables

The following tables graphically represent the outlooks of Fitch’s analysts for both rating action trends and underlying asset or business/financial performance. The horizontal axis represents positive, stable or negative rating momentum; the vertical axis represents positive, stable or negative trends in the underlying asset class or business sector. Rating action trends can differ from asset/business performance trends based on a variety of factors. As examples, existing ratings may include headroom for anticipated stress on the underlying asset or business (which may provide a ‘floor’ to rating actions where asset performance is expected to be negative); alternatively, ratings may have a ‘ceiling’ based on longer-term business risk issues (which may ‘cap’ upward movement where asset performance is expected to be positive).

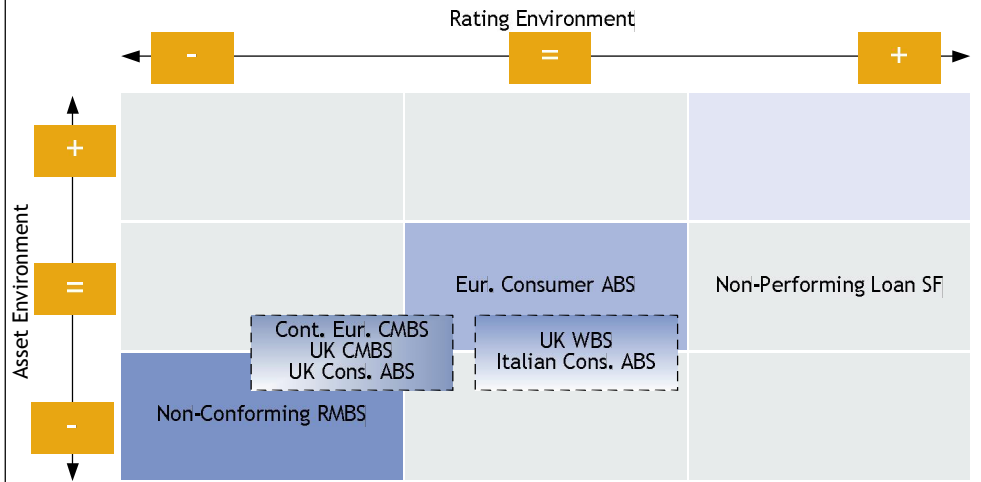
Placement within each grid segment is not relative or “to scale”, thus the **degree** of relative negative rating pressure or negative asset performance may differ between sectors located adjacently in one grid segment. Sectors which contain a sharp mixture of trends - for example, a distinct mixture of sub-sectors or issuers with declining and stable rating trends - have been represented in overlay boxes located at the cusp between grid segments.



Graphical Outlook Summaries

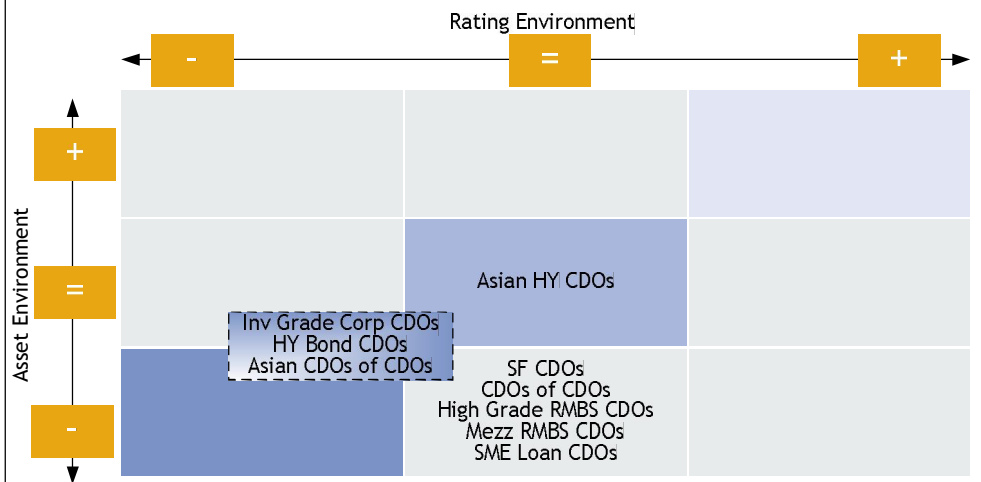


2008 Outlook - European SF (ABS & MBS)



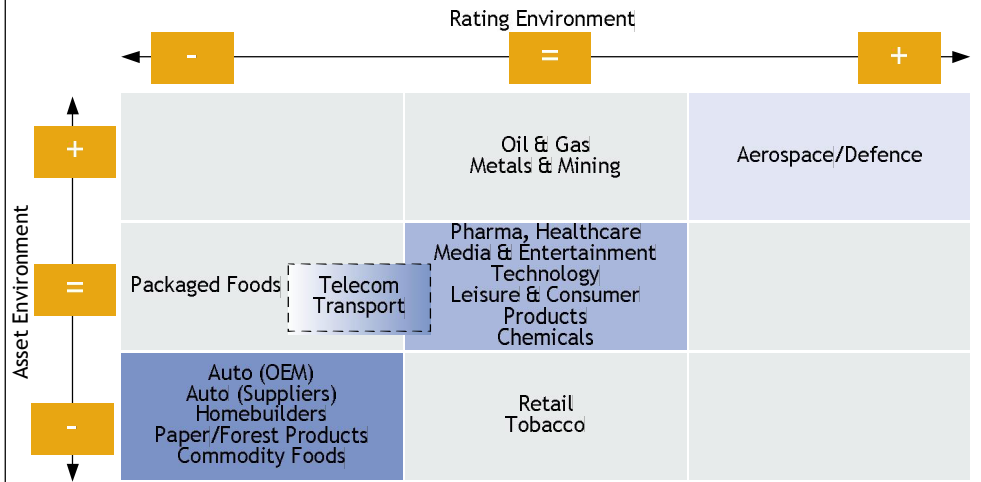
Source: Fitch

2008 Outlook - Europe /Asia CDOs



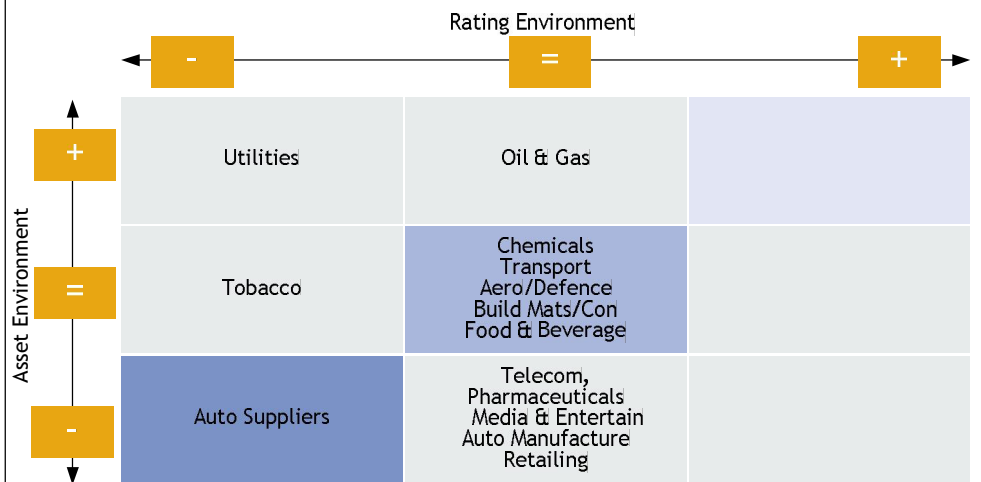
Source: Fitch

2008 Outlook - US Corporates



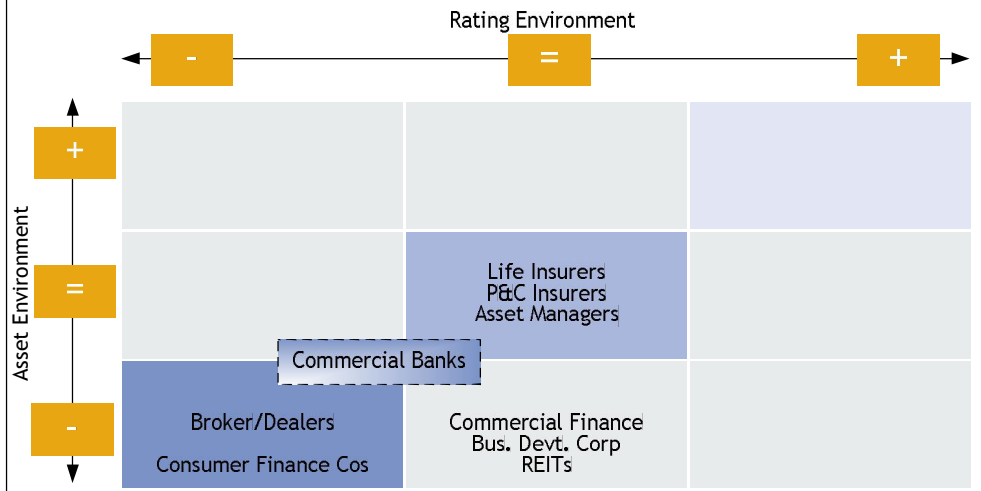
Source: Fitch

2008 Outlook - EMEA Corporates



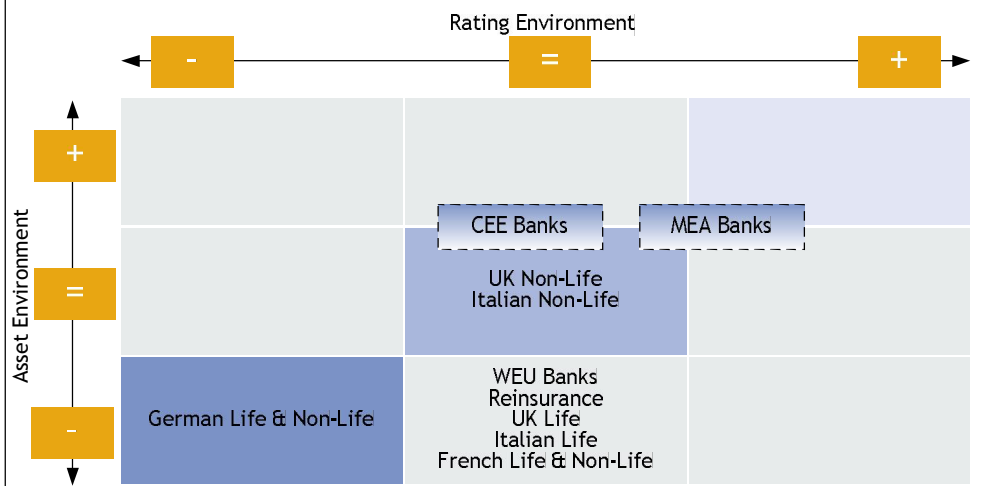
Source: Fitch

2008 Outlook - US Financial Institutions



Source: Fitch

2008 Outlook - EMEA Financial Institutions



Source: Fitch

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