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Research Update:

## Outlook On Banque Cantonale Vaudoise To Negative On Loan Risk From Rising Property Prices; 'AA/A-1+' Ratings Affirmed

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## Research Update:

# Outlook On Banque Cantonale Vaudoise To Negative On Loan Risk From Rising Property Prices; 'AA/A-1+' Ratings Affirmed

## Overview

- We have observed a trend of rising residential real estate prices in Switzerland.
- In our view, this poses a risk for domestic-oriented banks like Banque Cantonale Vaudoise (BCV), which has a sizable mortgage loan portfolio.
- We are revising our outlook on BCV to negative from stable and affirming our 'AA/A-1+' ratings.
- The negative outlook reflects that we might lower the ratings on BCV if the growing economic imbalance were to lead us to a more negative view of the economic environment in which Swiss banks operate.

## Rating Action

On July 3, 2012, Standard & Poor's Ratings Services revised its outlook on Switzerland-based Banque Cantonale Vaudoise (BCV) to negative from stable. At the same time, we affirmed the 'AA/A-1+' and long- and short-term counterparty credit ratings.

## Rationale

The outlook revision stems from our view that the residential real estate price increases we have observed in Switzerland over the past three years represent a risk for those Swiss banks that have mainly domestic operations. If this trend continues, the growing economic imbalance may lead us to a more negative view of the economic environment in which the Swiss banks operate and therefore to lower the ratings on BCV by one notch (see "Outlook On Nine Swiss Banks To Negative On Exposure To Rising Property Prices; Ratings On All Swiss Banks Affirmed," published on July 3, 2012).

We nevertheless recognize that although real estate prices in the Canton of Vaud (AA+/Positive/--) have increased by more than the Swiss average over the past three years, price developments have been supported to some extent by above-average economic growth and strong immigration-driven demand in light of low vacancy rates and limited supply. We also note that BCV has recently tightened its mortgage underwriting standards, translating into a limited 1% rise in mortgages outstanding on the first quarter of 2012 compared with 9% growth in 2011.

Our ratings on BCV still reflect our 'a' anchor for a bank operating mainly in Switzerland, BCV's adequate business position, strong capital and earnings, adequate risk position, average funding, and strong liquidity.

We have revised our assessment of BCV's liquidity to strong from adequate, as the bank maintains a high liquidity ratio under the strict norms established by Swiss regulators. Moreover, preliminary figures indicate a Basel III liquidity coverage ratio well above 100%.

We consider BCV a government-related entity (GRE) and assess that there is a "very high" likelihood that its majority owner, the Canton of Vaud, would provide timely and sufficient extraordinary support in the event of financial distress. Because of this, we incorporate a two-notch uplift from BCV's 'a+' stand-alone credit profile into the long-term rating. We expect that BCV will continue to benefit from the implicit support of the Canton of Vaud, despite the absence of a full guarantee.

## Outlook

The negative outlook on BCV reflects the likelihood of a downgrade if residential real estate prices in Switzerland and in the Canton of Vaud keep increasing at the high pace observed over the past three years, potentially putting pressure on the quality of BCV's mortgage loan book. We could also lower the long-term rating on BCV if we see a significant weakening of its risk position. This could occur if the bank's exposures to trade finance were to increase substantially.

Conversely, we might revise the outlook on BCV to stable if we believe the trend in house prices have a limited impact on the quality of BCV's mortgage loan book.

Given our GRE methodology, a one-notch upgrade or downgrade of the canton would have no effect on the counterparty credit ratings on BCV, all other things being equal.

## Ratings Score Snapshot

Issuer Credit Rating	AA/Negative/A-1+
SACP	a+
Anchor	a
Business Position	Adequate (0)
Capital and Earnings	Strong (+1)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Strong (0)
Support	2

GRE Support	2
Group Support	0
Sovereign Support	0
Additional Factors	0

## Related Criteria And Research

- Outlook On Nine Swiss Banks To Negative On Exposure To Rising Property Prices; Ratings On All Swiss Banks Affirmed, July 3, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Banque Cantonale Vaudoise		
Counterparty Credit Rating	AA/Negative/A-1+	AA/Stable/A-1+
Certificate Of Deposit	AA/A-1+	

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