


Friday Credit Focus

The Shape Of The Recovery

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October 2, 2020



Global Credit Conditions Third Quarter 2020

S&P Global
Ratings

Agenda

Introductory Remarks

- Alexandra Dimitrijevic, Global Head of Research
- Paul Gruenwald, Global Chief Economist

Q&A moderated by Alexandra Dimitrijevic, Global Head of Research

- Christopher Yip, Interim Head of APAC Credit Research
- Paul Watters, Head of EMEA Credit Research
- David Tesher, Head of North America Credit Research
- Jose Perez-Gorozpe, Head of Emerging Markets Credit Research
- Gregg Lemos-Stein, Head of Analytics & Research, Corporates
- Alexandre Birry, Head of Analytics & Research, Financial Institutions
- Robin Prunty, Head of Analytics & Research, US Public Finance

Summary Overview

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Overview | A 'K' Shaped Recovery

- **Overall.** Q3 macro and credit trends point to **increasingly diverging trends.**
- **The economy.** A long and arduous road ahead despite better-than-expected bounces in Q2 in the U.S, the Eurozone and China. Some emerging markets will suffer sizeable permanent income losses.
- **Financing conditions.** Continued supporting financial conditions, although uncertainty around U.S. elections might trigger market volatility.
- **Credit trends.** Downgrades slow for now but negative outlook at historical highs, defaults to double within a year.
- **Sectors.** Increasingly diverging path between industries with credit damage well into 2023 for some. Banks can absorb the shock, but recovery will be slow and uneven.
- **Health.** A COVID-19 vaccine is no magic switch.
- **Global risks.** Extended containment measures and transition to post-COVID policies, Corporate solvency risk and new highs in government debt, Emerging Markets struggle, economic nationalism and geopolitical tensions, ESG.

Overview | Top Global Risks

Near-term risks

Extended containment measures and transition to post-COVID policies

Risk level*	Very low	Moderate	Elevated	High	Very high	Risk trend**	Improving	Unchanged	Worsening
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Corporate solvency risk and new highs in government debt

Risk level*	Very low	Moderate	Elevated	High	Very high	Risk trend**	Improving	Unchanged	Worsening
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Some emerging markets struggle to recover

Risk level*	Very low	Moderate	Elevated	High	Very high	Risk trend**	Improving	Unchanged	Worsening
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Longer term structural risks

Economic nationalism and geopolitical tensions

Risk level*	Very low	Moderate	Elevated	High	Very high	Risk trend**	Improving	Unchanged	Worsening
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Environmental, societal and technology risks

Risk level*	Very low	Moderate	Elevated	High	Very high	Risk trend**	Improving	Unchanged	Worsening
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Sources: S&P Global Ratings.

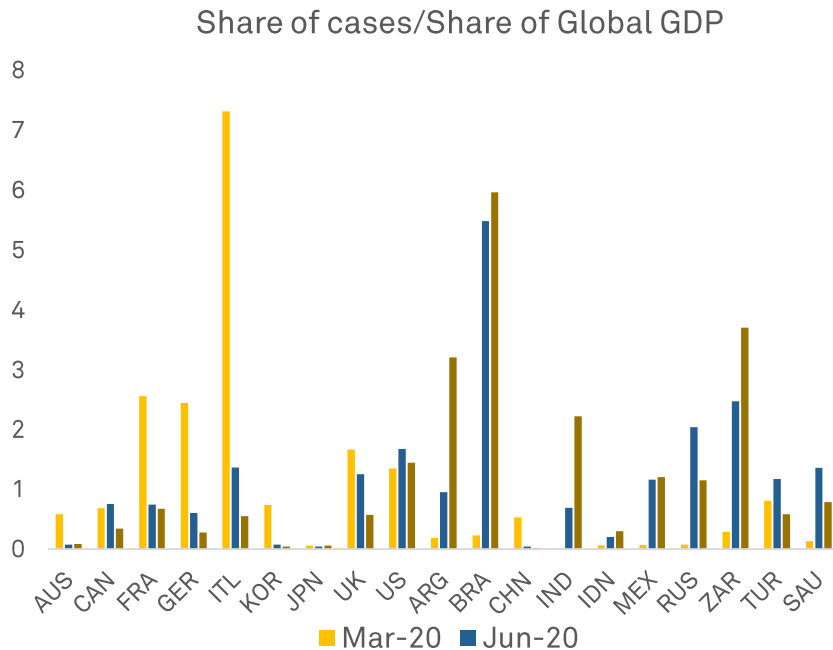
* **Risk levels** may be classified as very low, moderate, elevated, high, or very high, are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically these risks are not factored into our base case rating assumptions unless the risk level is very high.

** **Risk trend** reflects our current view on whether the risk level could increase or decrease over the next twelve-months

Global Economic Outlook | COVID-19 Pandemic Update

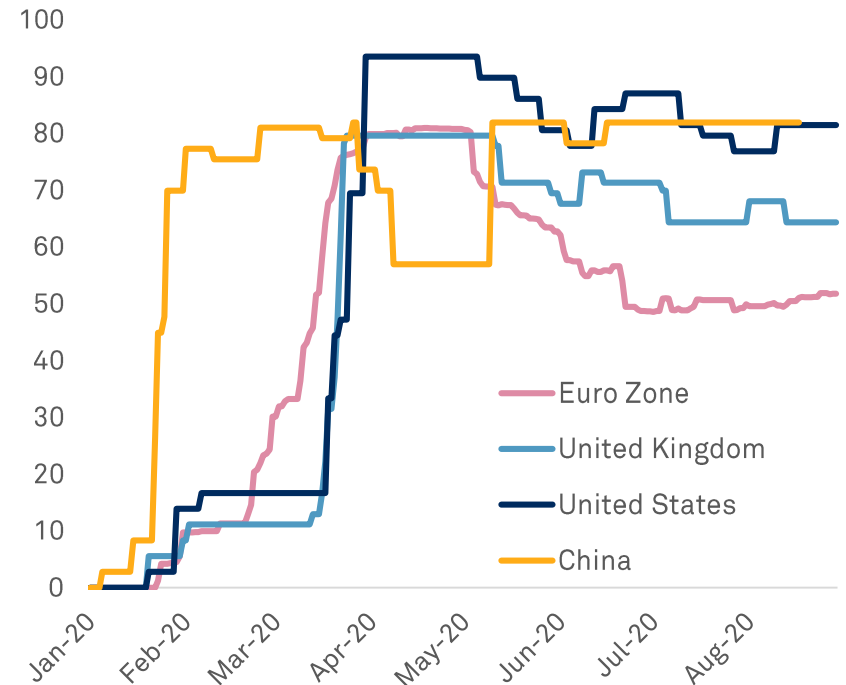
Shift to emerging markets is clear, resulting in some easing of restrictions.

G-20 COVID-19 Intensity



Sources: Our World in Data, Oxford Economics, S&P Global Economics.

Oxford University Stringency Index



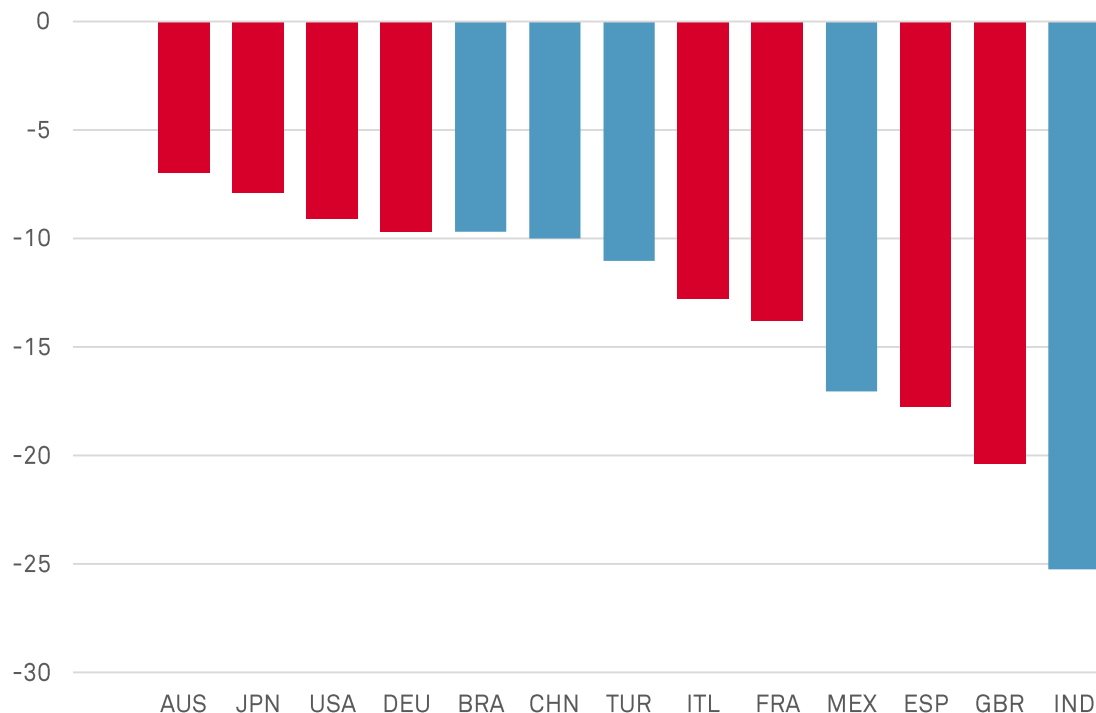
Source: Oxford University, S&P Global Ratings

Global Economic Outlook | Economic Impact Of COVID-Related Lockdowns Has Been Brutal

There is no global pandemic playbook; lockdowns led to unprecedented declines in GDP.

2020 Q2 GDP Growth Rates

(QOQ%, seasonally adjusted)



- Economic effects of COVID-19 related lockdowns are brutal with annualized declines in GDP of 30% to 50%, or more.
- Services have taken a bigger hit than manufactures: not normal in downturns.
- Policymakers can react quickly and boldly after all! Fiscal more important.
- Lack of cooperation and information sharing is very costly.

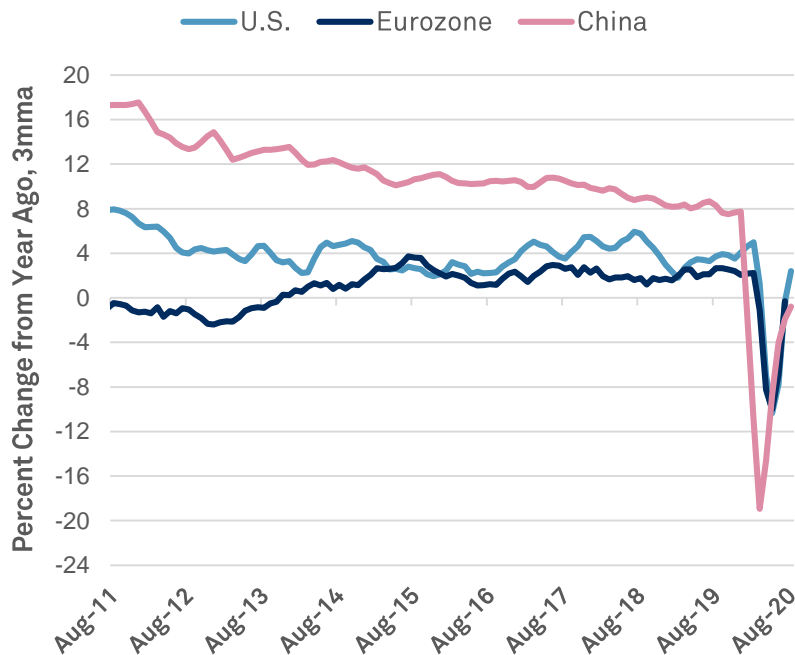
Sources: S&P Global Economics Oxford Economics.

* India: fiscal year April of reference year to March the following year ** Calculated with purchasing power parity exchange rates

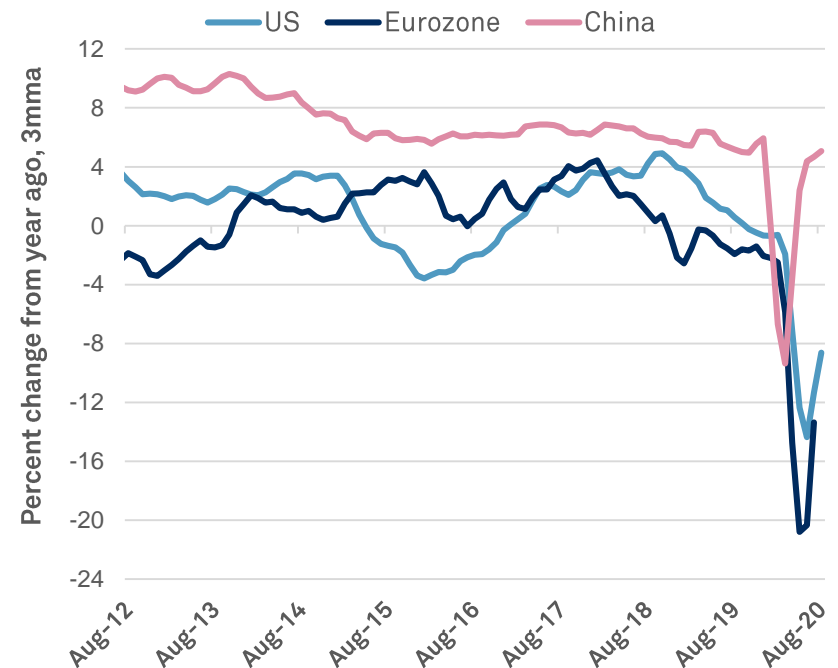
Global Economic Outlook | Rebound Has Begun, But It Is Uneven And Not Yet Sustainable

Don't be fooled by record Q3 growth rates; activity remains well below pre-COVID levels.

Retail Sales Growth



Industrial Production



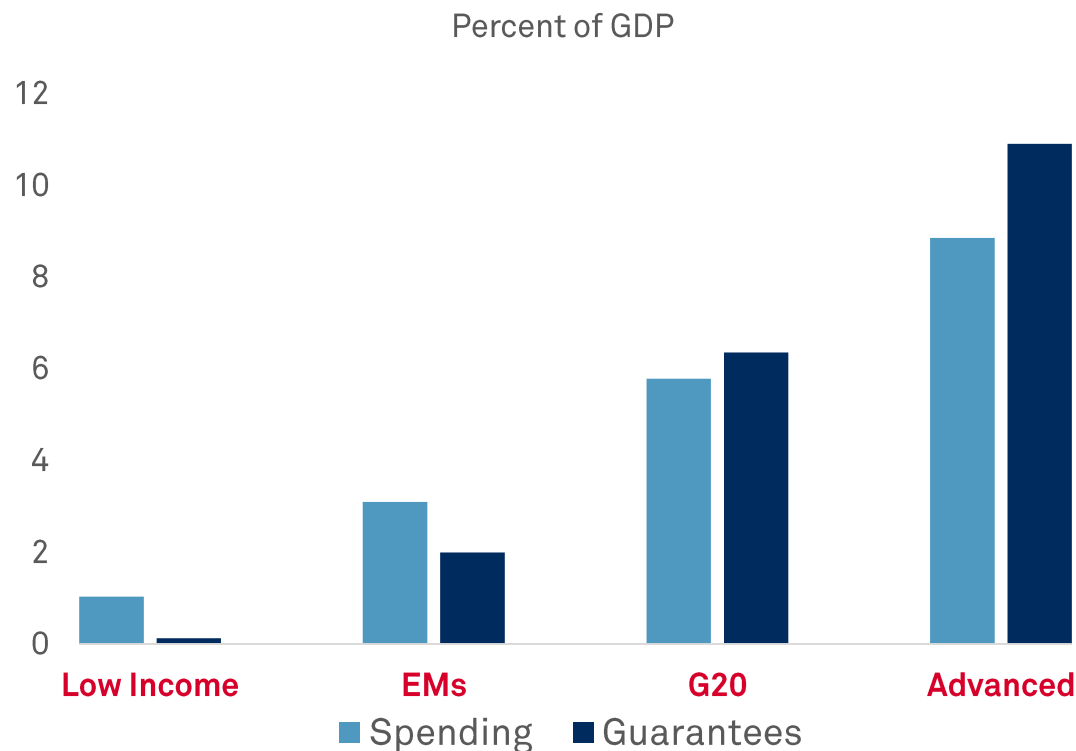
Source: National Statistics Bureau, Bloomberg. Data through Aug. 2020.

*Note Eurozone data is as of July 2020

Global Economic Outlook | Fiscal Response To COVID-19 Is Key; Have Varied Enormously

Monetary policy keeps rates low, financial conditions accommodative, markets smooth.

COVID-19 Related Fiscal Measures



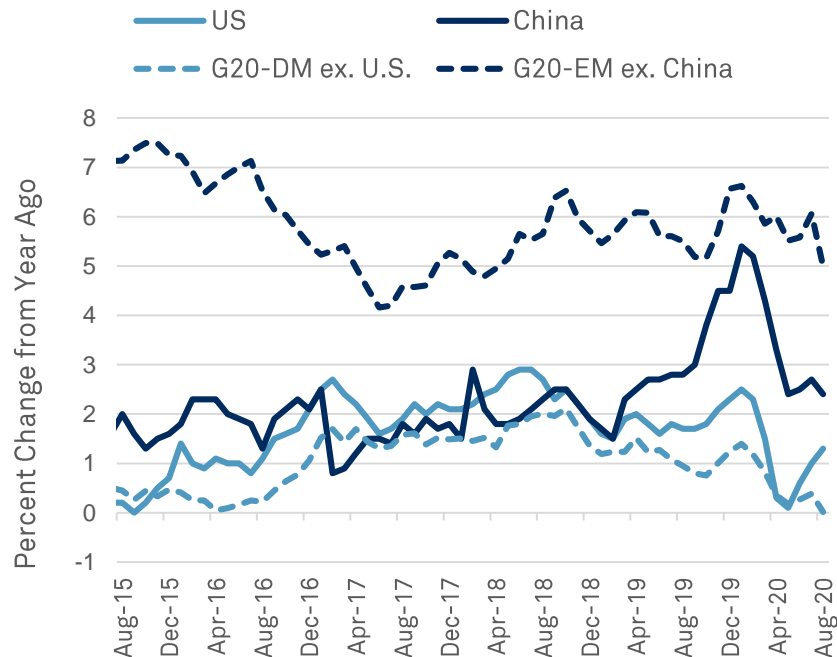
- Reflecting available fiscal space, government responses to offset COVID-19 shock have varied widely.
- Including direct spending (to more affected sectors, labor market) and guarantees, advanced countries are doing much more.
- GOALS: cushioning the health and economic impact of COVID-19, and bridge to the recovery.

Source: IMF.

Global Economic Outlook | Inflation Not A Factor As Central Banks Still Undershooting Targets

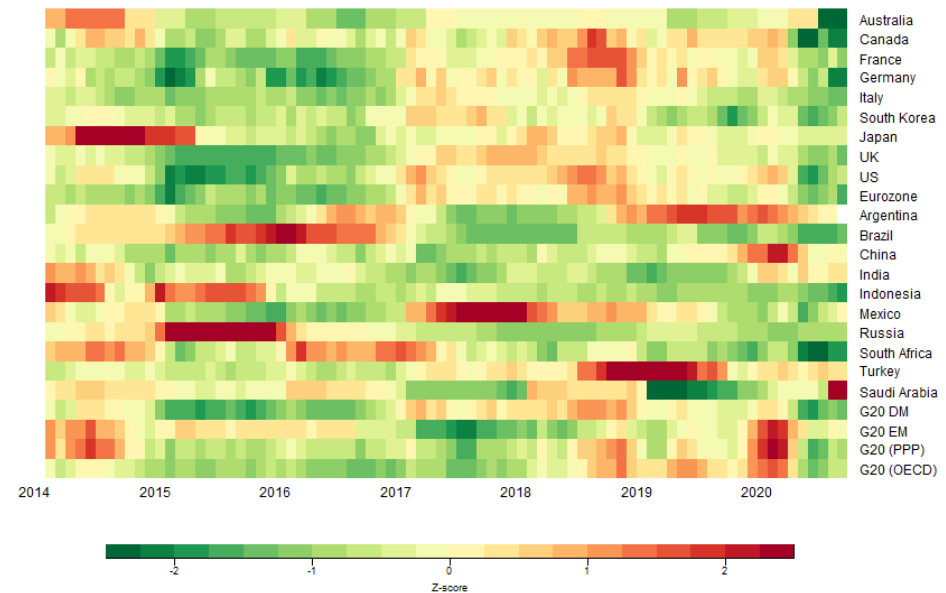
US Fed has moved toward inflation averaging in response.

CPI Inflation



Source: National Statistics Bureau, IMF, Bloomberg. Data through August 2020. Note: Country group data as PPP GDP-weighted averages.

Monthly CPI YoY%



Source: National Statistics Bureau, IMF, Bloomberg. Data through August 2020. Note: Sample selected to calculate Z-score: 2011 Jan – 2020 August.

Global Economic Outlook | Overall GDP Growth Forecast Broadly Unchanged

But lots of movement across countries: advanced generally up, EM generally down.

GDP Growth Forecasts

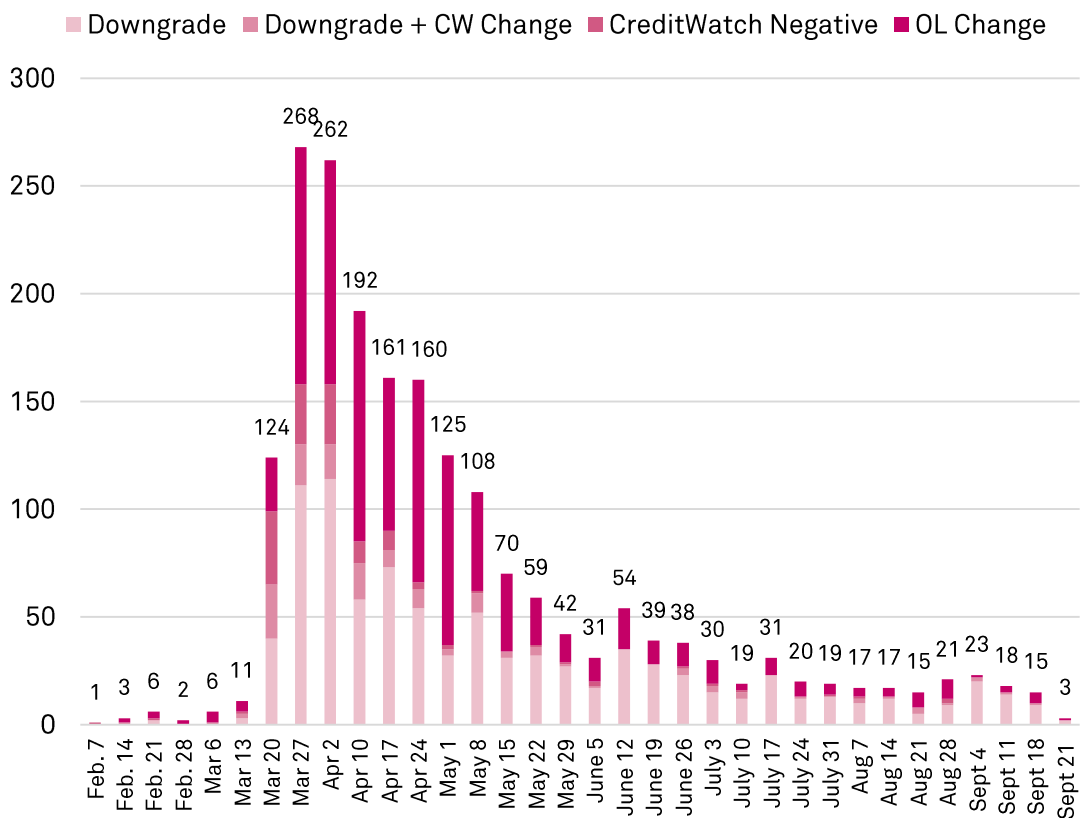
	Current Forecast					Difference from previous forecast				
	2019	2020	2021	2022	2023	2019	2020	2021	2022	2023
United States	2.2	-4.0	3.9	2.4	2.6	-0.2	1.0	-1.2	-0.6	-0.2
Eurozone	1.3	-7.4	6.1	3.0	2.0	0.0	0.4	0.6	0.0	0.0
China	6.1	2.1	6.9	4.8	5.2	0.0	0.9	-0.5	0.0	-0.1
Japan	0.7	-5.4	3.2	1.0	0.9	0.0	-0.5	-0.2	0.0	0.0
India*	4.2	-9.0	10.0	6.0	6.2	0.0	-4.0	1.5	-0.5	0.0
Brazil	1.1	-5.8	3.5	3.0	2.9	0.0	1.2	0.0	-0.4	0.0
World**	2.8	-4.1	5.3	3.8	4.0	0.0	-0.3	0.0	-0.2	0.0

- Fiscal bridge to the recovery: keep viable firms, workers connected.
- Premature fiscal austerity: before private demand recovers.
- Public sector (central banks, gov't) intervention and balances sheets need to be normalized eventually.
- Expert vaccine timeline forecasts somewhat more optimistic.
- **Risks On the Downside**

Source: OECD, S&P Global economics. Note: China's number is for Q1 (quarter of greatest COVID-19 impact).

Credit Outlook | Slower Pace

COVID19 and Oil Price War Resulted In Over 2000 Negative Rating Actions
(Downgrades, Outlook changes, CreditWatch Negative)

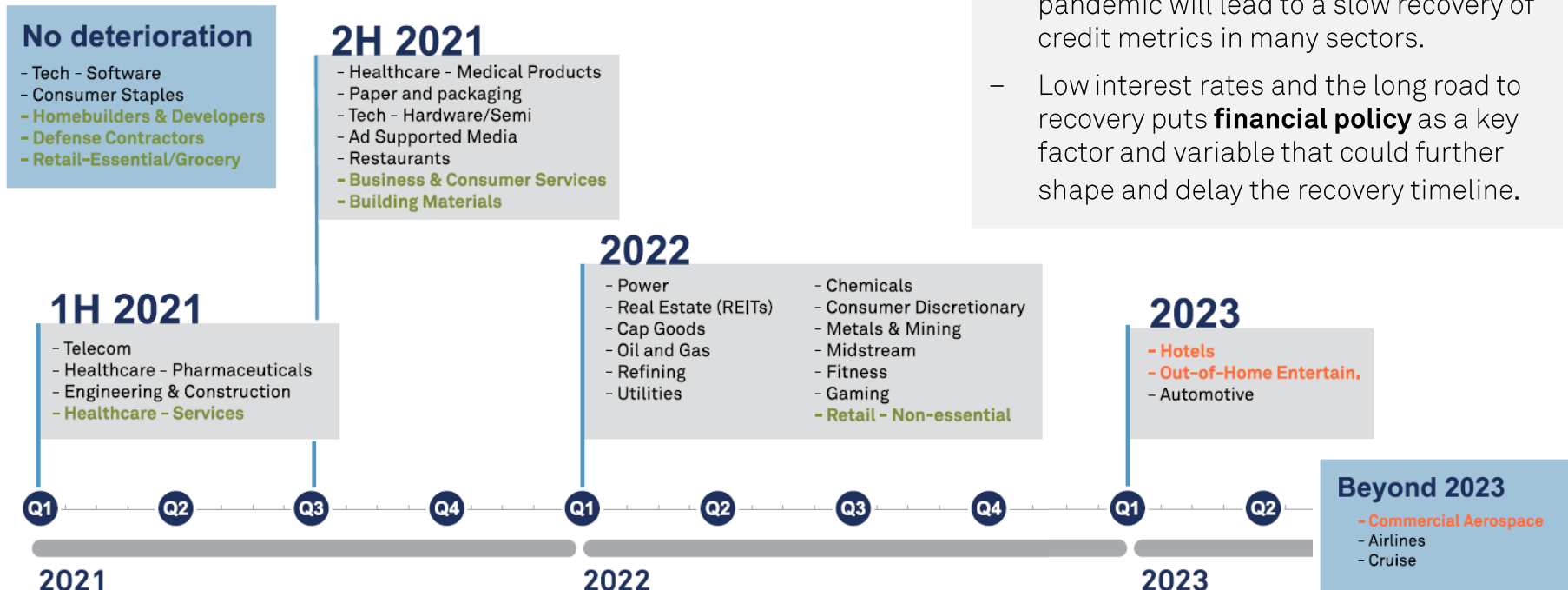


Data as of Sep. 21, 2020. Source: S&P Global Ratings.

- **Negative rating actions due to COVID19 pandemic and oil-price pressures ebb considerably** from late March / early April peaks and actions shift from Negative Outlook and Negative CreditWatch Placements to Downgrades.
- **Sector differentiation.** Since the summer, airlines, and aircraft and component makers continue to see negative actions, owing to declines in travel as well as automotive, housing, construction, and general industrial demand.

Credit Outlook | Diverging Paths To Corporate Recovery

Timeframe Of Recovery Of (Run Rate) Credit Metrics To 2019 Levels North America

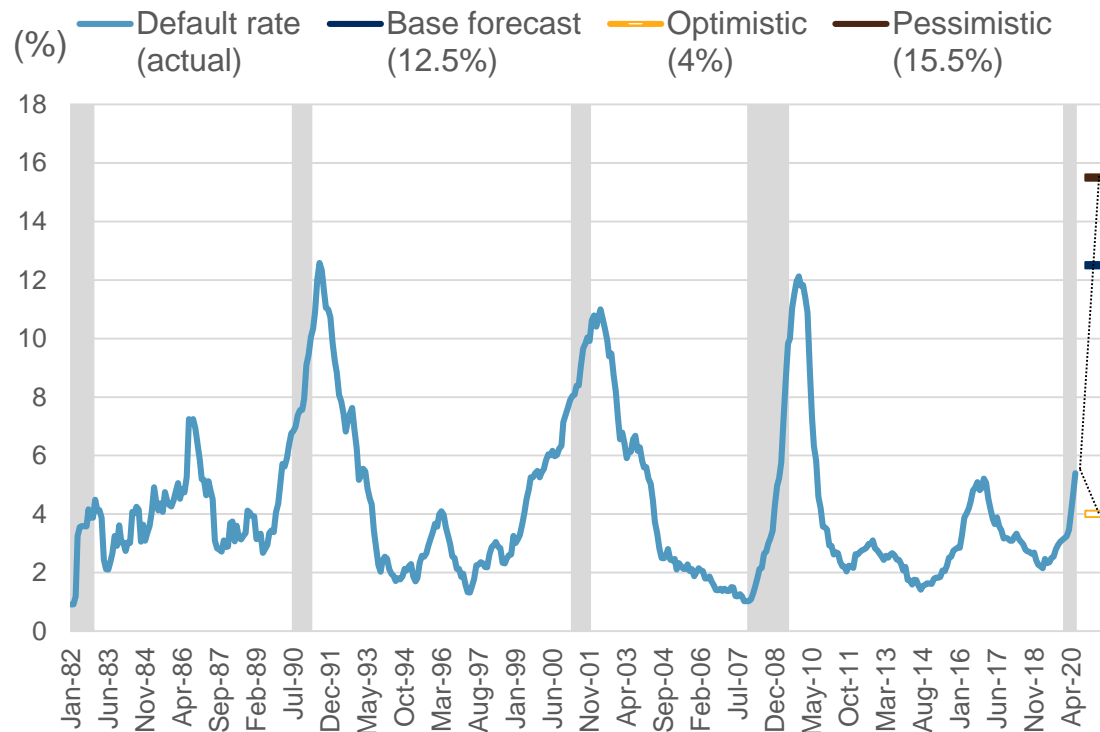


- **Higher leverage** incurred during the pandemic will lead to a slow recovery of credit metrics in many sectors.
- Low interest rates and the long road to recovery puts **financial policy** as a key factor and variable that could further shape and delay the recovery timeline.

Note: Green indicates sectors that we expect will recover sooner than initially indicated in our June publication. Orange indicates a later recovery.
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Credit Outlook | Gap Between Market Expectations And Fundamentals Widens

U.S. Default Rate Forecast Through Jun. 2021



Note: Shaded areas are periods of recession as defined by the National Bureau of Economic Research.
Sources: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro®.

- **Market Optimism.** Speculative-grade spreads have been falling since the Fed and ECB created their various liquidity facilities. Market pricing now implies a falling default rate by mid-2021.
- **Credit Deterioration.** Net downgrades and net-negative bias are both at all-time highs through the second-quarter, typically presaging a high default rate ahead.
- **Low-Rated Issuers.** 40% of speculative-grade issuers are rated 'B-', highlighting elevated default vulnerability. Roughly 16% are 'CCC/C'.
- **Global gap.** Credit fundamentals and market signals in Europe reflect similar divergences.

Questions **Answers**

Related Research

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COVID-19 And Shape Of Recovery | Latest Research

- [COVID-19 Weekly Digest: September 30, 2020, Sep. 30](#)
- [Economic Research: The Second Wave And Brexit Will Test The U.K. Recovery, Sep. 30](#)
- [COVID-19 Impact: Key Takeaways From Our Articles, Sep. 30](#)
- [Credit Conditions North America: Potholes On The Road To Recovery, Sep. 29](#)
- [Credit Conditions Europe: Ill Prepared For Winter, Sep. 29](#)
- [Credit Conditions Emerging Markets: A Tenuous And Varied Recovery Path, Sep. 29](#)
- [Default, Transition, and Recovery: Corporate Defaults Tripled In The Second Quarter, Sep. 29](#)
- [COVID-19 Heat Map: Updated Sector Views Show Diverging Recoveries, Sep. 29](#)
- [COVID-19- And Oil Price-Related Public Rating Actions On Corporations, Sovereigns, And Project Finance To Date, Sep. 29](#)
- [Credit Conditions Asia-Pacific: Recovery Roads Diverging, Sep. 28](#)
- [Economic Research: Despite A Bounce In the Summer, Canada's Economic Recovery Is Far From Complete, Sep. 28](#)
- [Credit Trends: 'BBB' Pulse: Potential Fallen Angels Remain Stable In August, With Five Outlook Revisions To Stable And Just One Downgrade, Sep. 28](#)
- [Managing Through The Crisis, Europe's Banks Look To The Future, Sep. 28](#)
- [U.S. And European CMBS COVID-19 Impact: Retail And Lodging Are The Hardest Hit, Sep. 28](#)
- [Economic Research: Latin America's Pre-COVID-19 Growth Challenges Won't Go Away Post-Pandemic, Sep. 24](#)
- [Economic Research: The U.S. Economy Reboots, With Obstacles Ahead, Sep. 24](#)
- [The Energy Transition And COVID-19: A Pivotal Moment For Climate Policies And Energy Companies, Sep. 24](#)
- [Economic Research: Asia-Pacific's Recovery: The Hard Work Begins, Sep. 23](#)
- [Economic Research: The Eurozone Is Healing From COVID-19, Sep. 23](#)
- [Global Banking: Recovery Will Stretch To 2023 And Beyond, Sep. 23](#)

Please also visit
**COVID-19 Special Report:
Shape of Recovery** for our
latest articles, webcasts,
topical videos, ...

<https://www.spglobal.com/ratings/en/research-insights/topics/coronaviruses-special-report>

COVID-19 Special Report: Shape of Recovery

'BBB' Pulse: Market Liquidity For 'BBB' Rated Debt Remains Undeterred Despite High In Fallen Angels

[READ THE REPORT >](#)

COVID-19 Weekly Recap

[READ THE RECAP >](#)

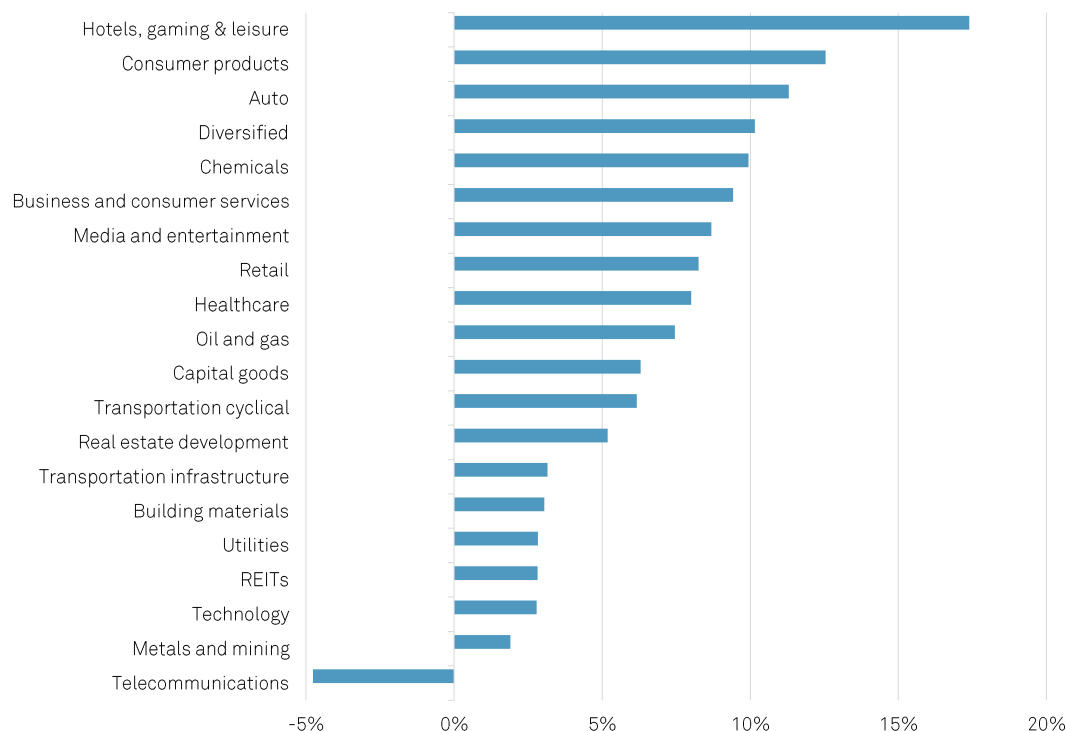
Appendix

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Asia-Pacific Credit | Recovery Road Diverging

Road to recovery is hardly smooth or even.

Debt Growth By Sector Since The Outbreak



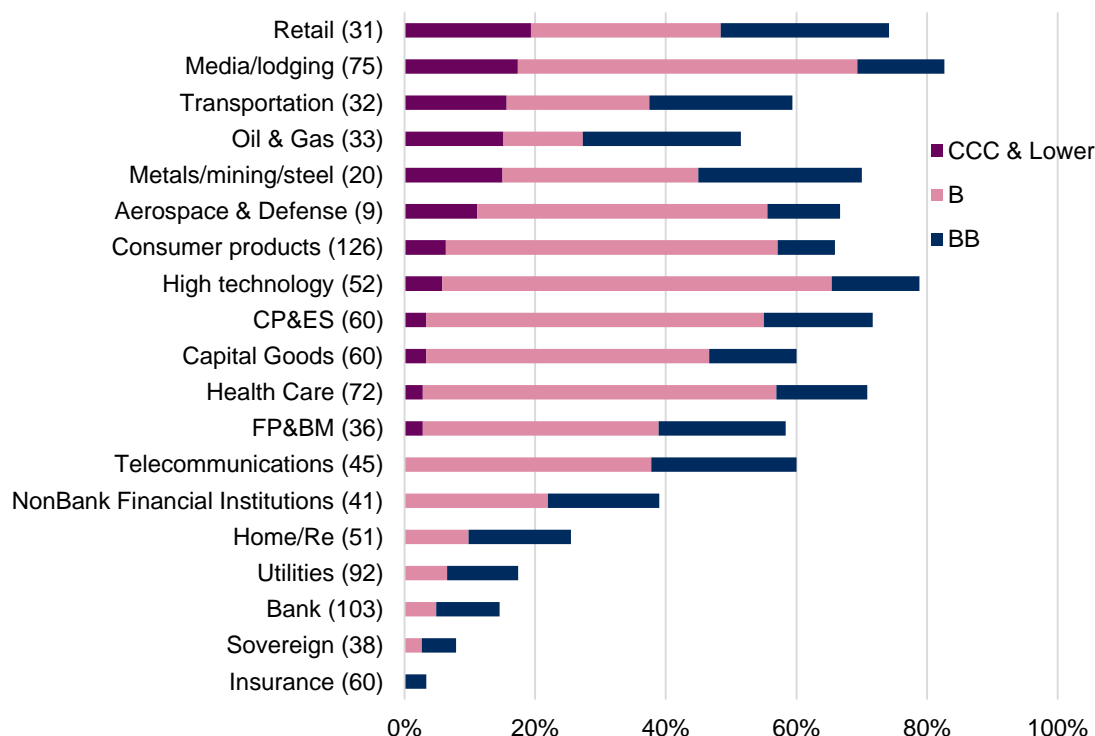
- **Overall.** China continues to be a relative bright spot while many other emerging markets struggle to contain COVID-19. Economic fallout has bottomed but rebound is disparate among countries as well sectors.
- **Risks.** These include mounting debt with suppressed revenue, disruption from lingering containment measures, spillovers from the U.S.-China strategic confrontation, and uneven access to U.S. dollar funding.
- **Credit.** Negative rating actions have tapered in the past quarter with no rating defaults. However, net negative outlook bias worsened to one-fifth of ratings. Consequently, likelihood of downgrades and defaults persists.

Note: Debt growth measures the percentage difference of reported debt of 17,425 nonfinancial corporates in Asia Pacific with financial reports from a starting period between Nov 2019 and Feb 2020 and an ending period between May and Aug 2020. Source: S&P Global Market Intelligence.

Europe Credit | Ill-Prepared For Winter

Social Distancing Maintaining Pressure on Retail, Media, Lodging and Transportation

% of European Ratings That Are Speculative-Grade by Sector



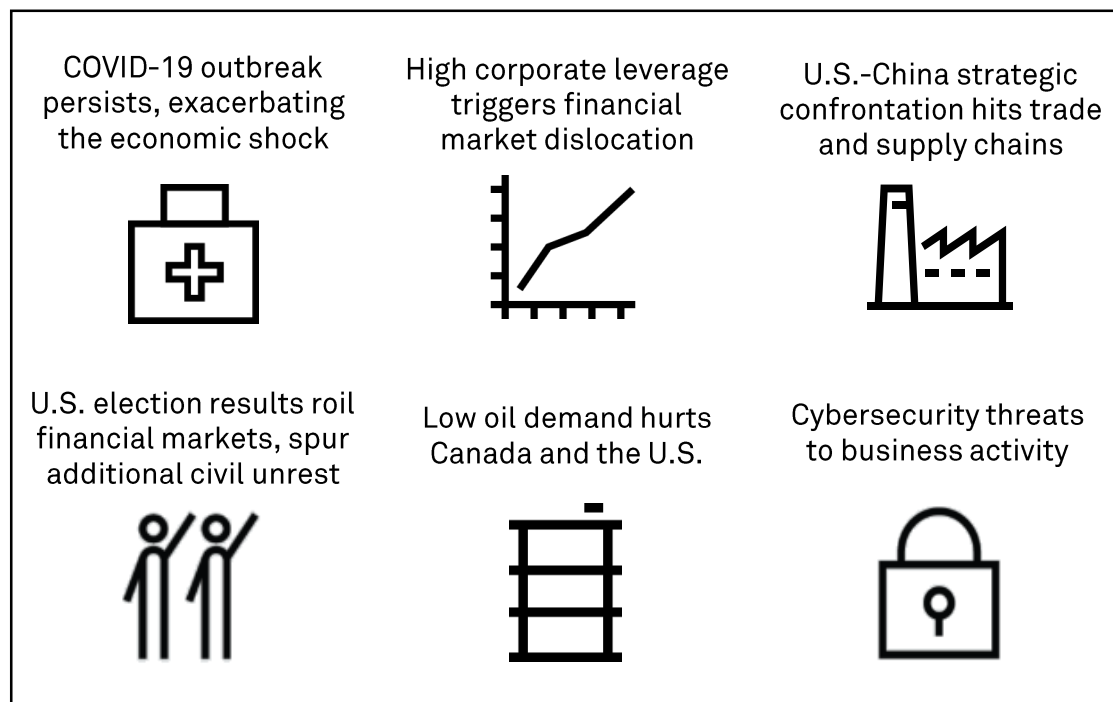
Source: Credit Conditions Europe: Ill-Prepared For Winter, Sept. 29, 2020. S&P Global Ratings.

CP&ES - chemical, packaging and environmental services; FP&BM - forest products and building materials

- **Overall.** European economies rebounded well over the summer. But the question now is how stringent containment measures need to be as the second wave breaks with winter approaching – and at what cost
- **Risks.** The uncertain health and economic outlook continues to challenge the solvency of vulnerable companies, and consumer confidence, both reliant on continued official support measures
- **Credit.** If the hit to productive capacity is not temporary, human and economic capital will be impaired, bankruptcies will increase, banks' asset losses will rise and states' resources will be drained.

North America | Potholes On The Road To Recovery

Top North America Risks

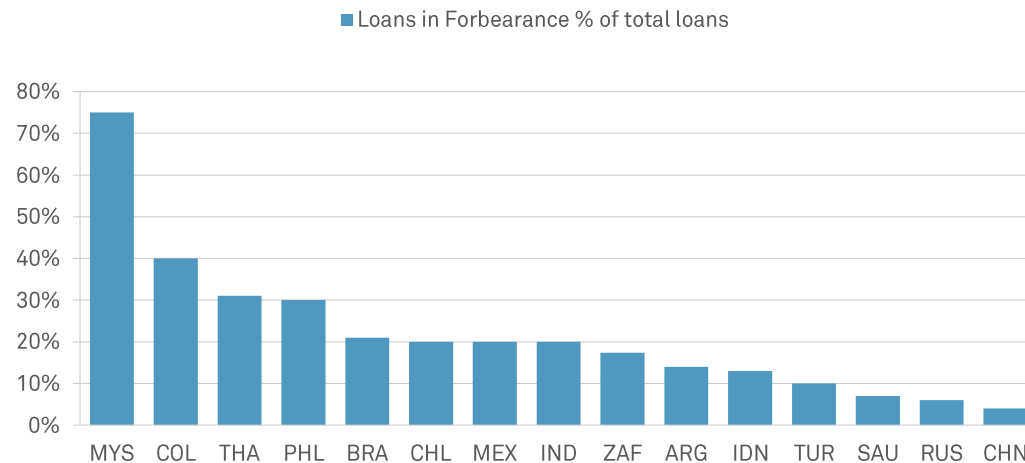
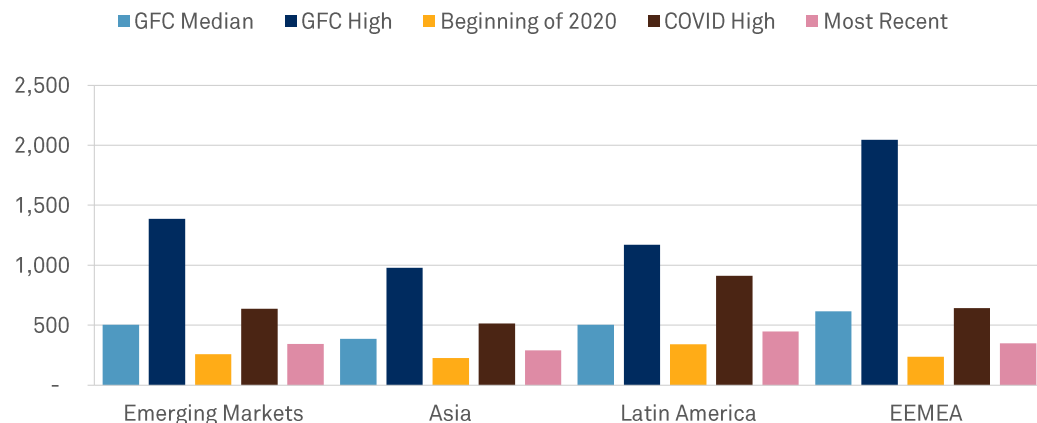


Source: Credit Conditions North America: Potholes On The Road To Recovery, Sept. 29, 2020.
S&P Global Ratings.

- **Overall:** While credit conditions are largely favorable, pockets of risk are rising, particularly for U.S. state and local governments. Risks around commercial real estate, too, are growing.
- **Risks:** The threat of increased financial market volatility has heightened as the U.S. election draws near—especially if the presidency is in dispute. Additional fiscal stimulus may also hinge on partisan control of the White House and Congress.
- **Credit:** Yields on Treasuries and on private-sector debt have all fallen or remain low. Issuance is robust across the credit spectrum.

EMs | Fragile And Uneven Recovery, Virus Resurgence Looms

Secondary Market Credit Spreads & Loans in Forbearance



- **Overall:** Credit conditions in emerging markets (EMs) continue showing a gradual improvement stemming from supportive financing conditions, the gradual economic recovery, and the likelihood that a COVID-19 vaccine will be available soon.
- **Risks:** A key developing risk is the phase out of credit forbearance and fiscal stimulus. As these measures are lifted, some of the pandemic's consequences will surface. People are learning to live with the virus, which raises questions about a potential resurgence in cases over the coming months. Furthermore, during the winter COVID-19 will coincide with the influenza season a potential setback in beating the pandemic.
- **Credit:** Negative rating actions have plateaued, but lower rating levels and negative outlooks reflect higher leverage and vulnerability to further shocks. A slower economic recovery or failure to deliver a vaccine within an expected time frame could lead to further downgrades.

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