S&P Global Ratings

Credit Conditions North America:

Pressures Persist, Risks Resound

April 23, 2020

(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly and on an ad hoc basis to review macroeconomic conditions in each of four regions (Asia-Pacific, Emerging Markets ex-Asia, North America, and Europe). Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the North America committee on April 16 and 20, 2020)

Key Takeaways

- **Overall**. We continue to expect credit conditions to remain extraordinarily difficult at least into the second half of this year. Amid the economic stop associated with coronavirus-containment and mitigation measures, companies' cash flows and liquidity have, in many cases, disappeared and borrowing conditions remain oppressive to many others.
- **Risks.** As the outbreak spreads unevenly across U.S. regions, containment measures may need to stay in place longer than planned, which would exacerbate already-dire economic conditions. The risk that the drag on business activity and cash flow for borrowers across S&P Global Ratings would thus persist into next year, are firmly on the downside.
- **Credit.** Credit quality has deteriorated across nearly all nonfinancial corporate sectors, and those most dependent on consumer discretionary spending face an existential crisis.

The path of the U.S. economy's eventual emergence from recession has yet to become clear. We expect credit conditions to remain extraordinarily difficult at least into the second half of this year. Amid the severe economic stop associated with coronavirus-containment and -mitigation measures, companies' cash flows and liquidity have, in many cases, disappeared and borrowing conditions remain oppressive to many others. On the other hand, the unprecedented fiscal and monetary stimulus coming from Washington may help stabilize the capital market and relieve some of the intense pressure on liquidity for borrowers across sectors. For the U.S., we now forecast a contraction in second-quarter (annualized) GDP of an unprecedented 34.5%, and that the economy will shrink 5.2% for the full year before rebounding with 6.2% growth next year and 2.5% in 2022. All told, we think the world's biggest economy won't get back to its end-2019 level until the third quarter of 2021.

Our revised base case assumes a GDP rebound in the second half, but as COVID-19 continues to spread across U.S. regions, social restrictions may need to stay in place longer than planned, especially short of a vaccine or effective treatment. This could in turn exacerbate already-dire economic conditions with unprecedented high unemployment, and worsen the credit conditions. Consequently, we are revising the COVID-19 risk for North America to 'very high' from 'high' (see table 1).

While the recent tumble in West Texas Intermediate crude oil into negative territory was unsurprising directionally—given the imminent expiration of May futures contracts, which created a glut of sellers and almost no buyers—the degree of the drop was obviously historic. It's common to see volatile price swings in the futures market around contract expiration dates (although clearly nothing like what happened), and such swings are rarely an accurate reflection of longer-term supply-demand fundamentals. A more accurate gauge is the forward curve, which is in a steep

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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contango (that is, futures prices are far higher than the spot price), suggesting investors are optimistic about an eventual recovery in fundamentals and that what happened was an anomaly. We expect price swings in the near-term contracts as high inventory wreaks havoc on prices and creates market dislocations. Still, OPEC production cuts and a likely rebound in demand should improve inventory levels and reduce volatility.

Table 1

Top North America Risks

Coronavirus outbreak widens substantially in the U.S.

Risk level* Very low | Moderate | Elevated | High | **[Very high]** — **Risk trend**** Improving | **[Unchanged]** | Worsening

As the coronavirus outbreak spreads unevenly across U.S. regions, containment measures may need to stay in place longer than planned, which would exacerbate already-dire economic conditions with unprecedented high unemployment. Moreover, even if containment efforts succeed in the short-term, short of a vaccine or effective treatment, we could see subsequent waves of infections requiring the reinstatement of social restrictions. Our base case assumes a historically severe recession through the second quarter, with GDP growth returning in the second half as consumer demand revives and firms rush to rehire workers, fill back orders and restock inventories. The risk that this bounce-back won't materialize and that the drag on business activity and cash flow for borrowers across S&P Global Ratings would thus persist into next year, are firmly on the downside.

Stresses on corporate funding continue to pressure credit quality

Risk level* Very low | Moderate | Elevated | **[High]** | Very high — **Risk trend**** Improving | Unchanged | **[Worsening]**

Recent financial-market volatility underscores the liquidity and financing risks that many highly leveraged borrowers face. Fiscal stimulus and moves by the Federal Reserve to slash interest rates, repair market liquidity, and reinvigorate credit across the borrower universe may all help, but corporate bond spreads have widened sharply, especially at the speculative-grade level where issuance has all but disappeared. The build-up in corporate debt over the past decade has led to a concentration of investment-grade ratings in the 'BBB' category and spec-grade ratings in the 'B' category. In this light, investors and regulators are focused on transition and liquidity risk.

Oil-price decline hurts Canada and U.S.

Risk level* Very low | Moderate | Elevated | **[High]** | Very high — **Risk trend**** Improving | **[Unchanged]** | Worsening

Diminished global demand prospects coupled with the plunge in oil prices amid the OPEC-Russia squabble casts a shadow over the economies of Canada and the U.S.—both of which are net oil exporters. Not only will the price collapse put the oil and gas industry to the test, it may also hurt related sectors while weighing on oil-producing provinces/states.

Trade disputes cloud world growth

Risk level* Very low | Moderate | Elevated | **[High]** | Very high — **Risk trend**** Improving | **[Unchanged]** | Worsening

As companies and markets turn their focus to coronavirus, trade concerns have become less pronounced—though the uncertainty overhang continues to weigh on business confidence and growth forecasts. The "Phase One" deal between the U.S. and China doesn't fully address the dispute over technology, intellectual property, and market access, with the economic headwinds from the COVID-19 potentially hindering China's ability to fulfill its 2020 Phase One pledge. As such, trade tension can potentially reemerge and coincide the U.S. presidential election cycle. Meanwhile, the U.S. and Europe remain in disagreement over digital-services taxes, which may again exacerbate tensions.

Cybersecurity threats to business activity

Risk level* Very low | Moderate | **[Elevated]** | High | Very high — **Risk trend**** Improving | **[Unchanged]** | Worsening

Increasing global interconnectedness means cyber risk poses a systemic threat and significant single-entity risk. As cyberattacks become more sophisticated, new targets and methods are emerging. Companies and governments face the risk of criminal, proxy, and direct state-sponsored cyber-attacks. This has led to a fast-growing cyber-insurance market, though insured losses from cyber-attacks are still small compared with economic losses.

Sources: S&P Global Ratings.

* **Risk levels** may be classified as very low, moderate, elevated, high, or very high, and 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 12 months.

Economic Conditions

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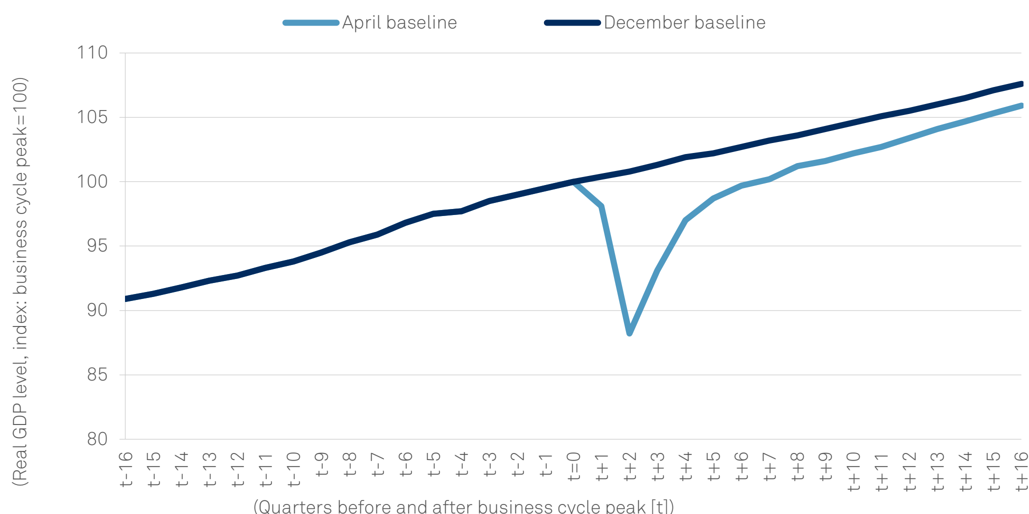
Our latest base-case forecast for the U.S. anticipates the sharpest contraction in economic activity since World War II. We now expect a quarter over quarter (q/q) sequential real GDP decline of 7.6% in the first three months of the year and 34.5% in the second quarter—translating to a peak-to-trough drop of 11.8%. That would be almost three times the decline during the Great Recession, when economic activity that was lost from the fourth quarter of 2007 through the second quarter of 2009 totaled 4% in what was then the worst downturn since the Great Depression. Not only does our current baseline far exceed the economic decline of that 18-month stretch, but it comes in one-third of the time (see chart 1).

Chart 1

U.S. Real GDP Deviation From Prerecession Path



Note: S&P Global assumes that a recession has started in the first quarter of 2020 with the business cycle peak in fourth-quarter 2019.
Sources: S&P Global Economics forecasts and BEA.

In inflation-adjusted terms, we think the economy will shrink $566.5 billion in just two quarters. Social restrictions have crushed consumer spending, which we expect to plunge 33.5% (q/q annualized) in April-June. We anticipate the disruption in consumer spending will start to diminish as we head into the third quarter but persist in the second half and until at least the first quarter of next year. Business investment, too, is suffering from lost demand and reduced production. The drop in oil prices makes conditions worse now that the U.S. had recently become a net oil exporter.

This comes as more than 22 million Americans filed for jobless claims in just four weeks, which is about 13.4% of the labor force (in February). We think headline unemployment will surge to 18% in April and could reach 19% in May. That would be closer to Depression-era levels (25%) than to the October 2009 high of 10%. (Headline unemployment topped out at 25% in 1933—although given the likelihood of undercounting, the actual rate was probably higher.) All told, we foresee cumulative job losses (temporary or permanent) of about 30 million in March-May.

Still, unprecedented central bank stimulus and unparalleled fiscal support are providing a lifeline to the economy. The government's latest $2 trillion-plus stimulus measure, the biggest relief package in history, won't stop the ongoing recession, but we believe it will reduce the risk of an even deeper slump and support a post-virus rebound. The aggressiveness of the Fed as lender and market-maker of last resort also bodes well to minimize more damage to the many financial linkages that make up the fabric of the economy.

Our pessimistic outlook assumes an even steeper contraction in consumer spending and a much longer timeline to bring the pandemic under control. This would lead to a false start of the recovery in spending, reduce its strength, and delay people in getting back to work. In this scenario, consumer spending would plunge 42% (annualized) in the second quarter. Owing to the sharper

contraction and slower recovery in spending by businesses and consumers, GDP would contract 8.2% this year, with just 5.7% growth in 2021. In this scenario, the peak-to-trough decline would be 13.7%, and the economy wouldn't get back to the previous cycle peak before the second quarter of 2022.

In Canada, the macro story is similar to that of the U.S. Canada is also staring at an unprecedented GDP decline in the second quarter as efforts to contain the virus weigh heavily on consumer spending, and in tandem, business investment. We now anticipate Canadian real GDP will contract more than 11% peak-to-trough, with quarter over quarter sequential output falling 6.3% (annualized) in the first quarter and 34% (annualized) in the second quarter.

No private sector will escape the shock, but consumer outlays will be hit hard in the second quarter, with a contraction around 39%, while business fixed investment plunges 53% as an oil shock amplifies the COVID-19 fallout. The sudden stop in private-sector activity will be partially offset by massive public-sector spending and unprecedented monetary policy stimulus. But even so, the employment losses will be traumatic, with 3.5 million people out of work, bringing the unemployment rate to around 18% at its peak in April-May.

The recovery—in tandem with gradual loosening of social distancing—will take until sometime in third-quarter 2021 for the economy to get back to the same size as before the virus. By 2023, the economy will still be 2.3% smaller than the pre-virus anticipated size.

There will be permanent losses but not a permanent slowdown in longer-run potential growth rate of the economy. Risk to this assessment is to the downside. The longer it takes for the path of virus to be resolved, the longer the growth "hangover" (hysteresis, or slow-growth environment), which in turn increases the probability of scarring of long-term equilibrium productive capacity.

It's worth noting that the economic damage associated with the outbreak is nonlinear. That means, for example, that if containment takes twice as long as expected, the economic damage will be more than twice as bad, and, therefore, recovery could take longer and be weaker (with more lost output) than projected. Moreover, even if the spread of the virus were to end tomorrow, residual scars could linger, especially if social distancing becomes a "new normal," and/or business and consumer spending doesn't bounce back. In short, it seems clear that the recovery from this crisis is unlikely to be smooth, could very well take longer than anyone imagines, and will almost certainly involve significant modification in the behaviors of governments, businesses, and consumers.

Financing Conditions

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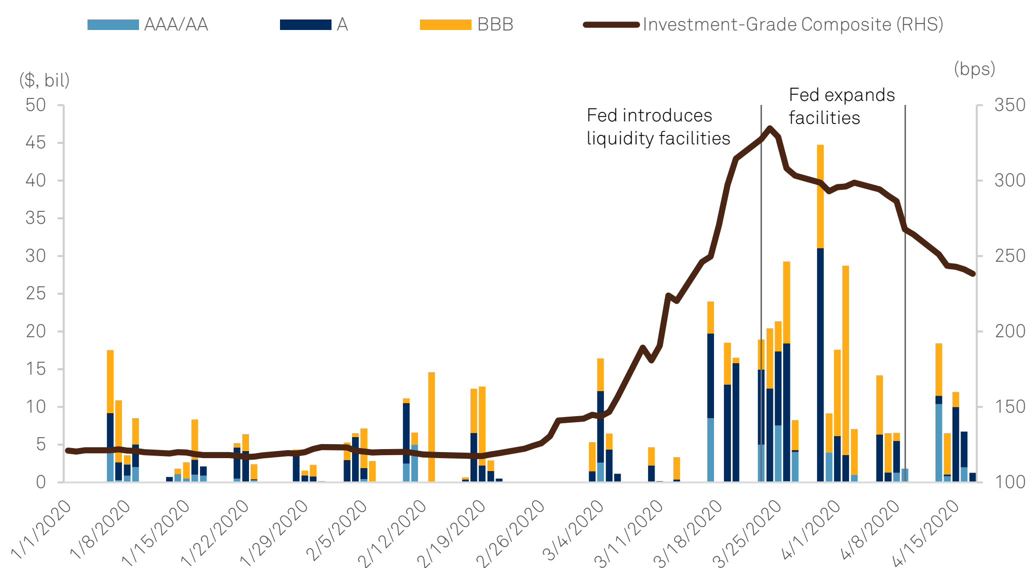
While the economic outlook continues to worsen, financing conditions in the U.S. have been gradually improving after the Fed's historic liquidity facilities. The now combined $2.3 trillion programs have been a tremendous support for borrowers, with investment-grade corporates benefitting most, thus far. In fact, after the initial announcement on March 23, the last seven business days of the month saw more than $152 billion in investment-grade corporate bond issuance—higher than all but two prior months' totals. For the full month, investment-grade corporate issuance totaled $249 billion (see chart 2).

In its April 9 announcement, the Fed critically identified fallen angel debt as being eligible for its primary- and secondary-market facilities, provided the issuer had an investment-grade rating (or at least two, if rated by more than one agency) on Mar. 22. In doing so, the Fed has effectively made itself a source of absorption for fallen angel debt, which we expect to be sizable this year (see "**'BBB' Pulse: U.S. And EMEA Fallen Angels Are Set To Rise As The Economy Grinds To A Halt**," published April 8). This helps take some the burden off of traditional participants in the spec-grade market. In fact, the primary and secondary facilities are roughly $750 billion in size—well above the $475 billion in debt we expect will fall into spec-grade in the U.S. this year (although fallen angel debt isn't the only purpose of these facilities).

Chart 2

U.S. Investment-Grade Spread And Issuance



Source: S&P Global Ratings.

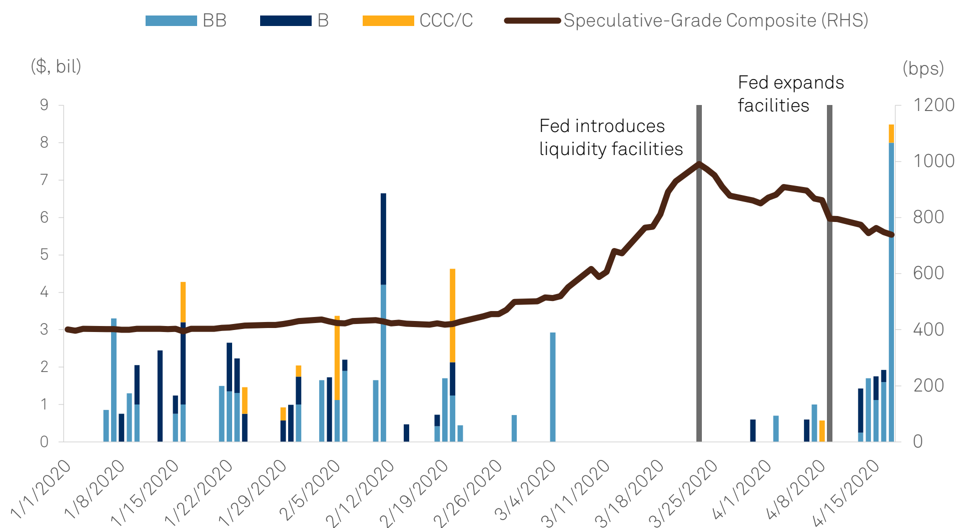
Meanwhile, the spec-grade segment (including leveraged loans) was effectively shut down in March (see chart 3). In April, some borrowers tapped the bond market, but the bulk of deals are in the 'BB' category, and most are secured-debt offerings. Notably, in its return to primary markets after its recent fall to spec-grade, Ford Motor Co. accounted for more than half of the $15 billion total since April 13—albeit at coupons between 2%-3% higher than what we saw in the secondary market. Though narrowing at a comparable rate to investment-grade spreads, spec-grade spreads remain prohibitively high for weaker borrowers at a time when revenues are expected to dwindle. And defaults are already picking up: Monthly default tallies from January through mid-April are 10, 10, 11, and 20 across global corporates (see "**Six Defaults This Week Push The 2020 Default Tally To 51**," published April 16). With so many firms missing interest payments and more expected to soon, lenders are wary of offering funds to lower-rated firms for the moment.

An additional consideration is the very different natures of the primary- and secondary-market facilities on the one hand, and the Main Street facilities on the other. In the former, the Fed inserts

itself into the bond market as a large-scale buyer of debt. In the latter, an alternative source of funding is offered in the form of term loans with ultra-low borrowing costs of 250-400 basis points (bps) over the secured overnight financing rate (SOFR). With SOFR effectively at zero, these loans make for a strong alternative to conventional funding markets for small and medium-sized firms that have spec-grade ratings. The Main Street facilities total $600 billion, which is already slightly more than the average combined annual total of spec-grade bond and institutional leveraged-loan issuance in recent years.

Chart 3

U.S. Speculative-Grade Spread And Issuance



Source: S&P Global Ratings

Similarly, the Fed's new municipal facility could offer an alternative to the traditional bond market. The facility offers short-term financing for states and municipalities in lieu of delayed tax revenues due to the tax-filing extension this year. This facility is $500 billion, which is larger than any prior annual total for municipal long-term debt.

The Fed's recent actions have provided an obvious boost to investor confidence, however they're not a cure-all on their own. The fundamental headwind of the virus and the necessary containment measures are still present. And while the pace of new cases appears to be moderating in most of the developed world, nascent signs of resurgence are appearing in China and northern Japan—meaning the pandemic could prove a stubborn foe.

For now, markets are still reflecting heightened stress relative to the start of the year, but certainly less than before the Fed's actions. Though it's tempting to take recent investment-grade bond issuance as a signal that markets have turned a corner, this comes with caveats. Most of the new issuance was by large, well-established blue-chip firms who can command favorable financing conditions in most settings. Also, most of the issuers haven't used the Fed's primary market program; most hit the market with maturities far in excess of the five-year or less threshold for eligibility. More than likely the firms that have come to market have done so to secure cash at favorable yields on the heels of the positive market response to the Fed to get ahead of what will undoubtedly be dismal earnings reporting seasons in April and July.

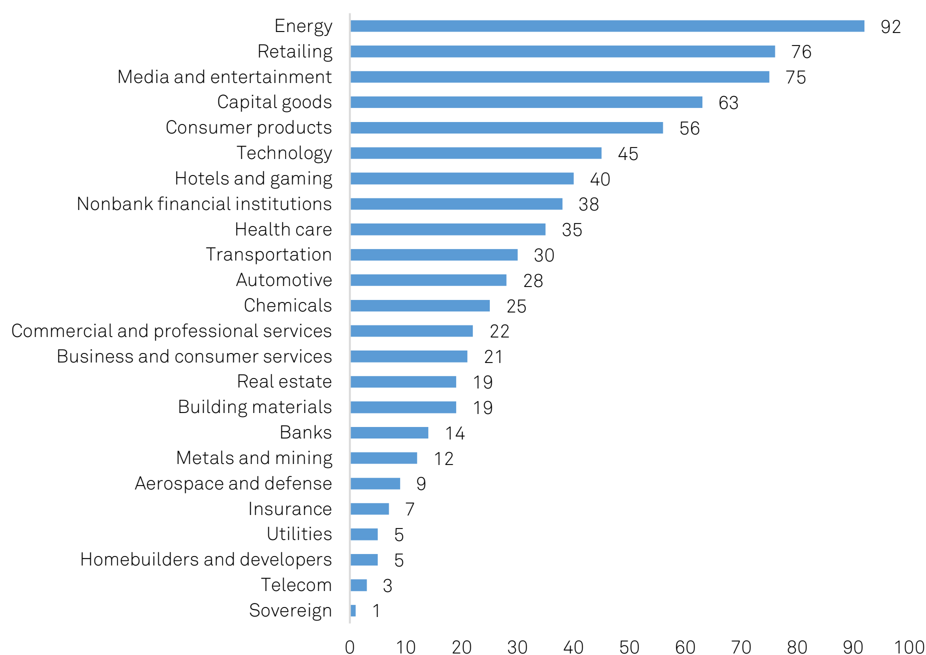
Credit Deteriorates Across Ratings Practices

While we've seen credit-quality deterioration across nearly all nonfinancial corporate sectors, those most dependent on consumer discretionary spending face an existential crisis. For example, the already-beleaguered retail and restaurant sector is suffering badly, automakers face significant sales declines (exacerbated by supply-chain troubles), and airlines are being hurt so severely by social-distancing measures that we think it could take two full years for global air traffic to recover to pre-coronavirus levels.

Globally, the effects of COVID-19 and oil price shock have already led to negative rating actions (downgrades, outlook changes, or placement on CreditWatch) on more than half of the corporate borrowers we rate in industries such as autos, media and entertainment, retail, transportation, capital goods and energy. All told, S&P Global Ratings has (as of April 21) taken 740 negative rating actions on North American borrowers, including 411 downgrades (see chart 4).

Chart 4

North America COVID-19 & Oil Prices-Related Rating Actions By Sector As Of April 21



Note: These 740 rating actions pertain to ratings where we mention COVID-19 and/or oil prices as one factor or in combination with others.
Source: S&P Global Ratings. COVID-19: Coronavirus-And Oil Prices -Related Public Rating Actions On Corporations, Sovereigns And Project Finance To Date, April 22, 2020.

The potential for ratings downgrades has increased at a record pace. The negative bias (the proportion of issuers with negative outlooks or on CreditWatch Negative) jumped 12 percentage points in the first quarter. Among speculative-grade borrowers, the negative bias jumped 14 points, to 37%; for investment-grade, it rose eight points, to 20%—both by the highest quarterly amounts we've ever seen (see "**U.S. Corporate Credit Stress Surges To Recession Levels On COVID-19 And Oil Shocks**," published April 14). The negative bias increased most in the oil and gas, media and entertainment, and transportation sectors, to 65%, 55% and 34%, respectively.

This comes as we expect the global economic slump and the oil-price shock to lead to a jump in 'BBB' category borrowers falling into spec-grade in the U.S. and Europe. A recent scenario analysis showed that as much $475 billion of U.S. corporate debt could take on "fallen angel" status this year. In the first quarter, the 17 companies that lost their investment-grade ratings accounted for $237 billion of long-term debt in the U.S. and $20 billion in EMEA—with Ford, Occidental Petroleum, and Kraft Heinz together accounting for roughly $190 billion of the U.S. total.

Non-Financial Corporates

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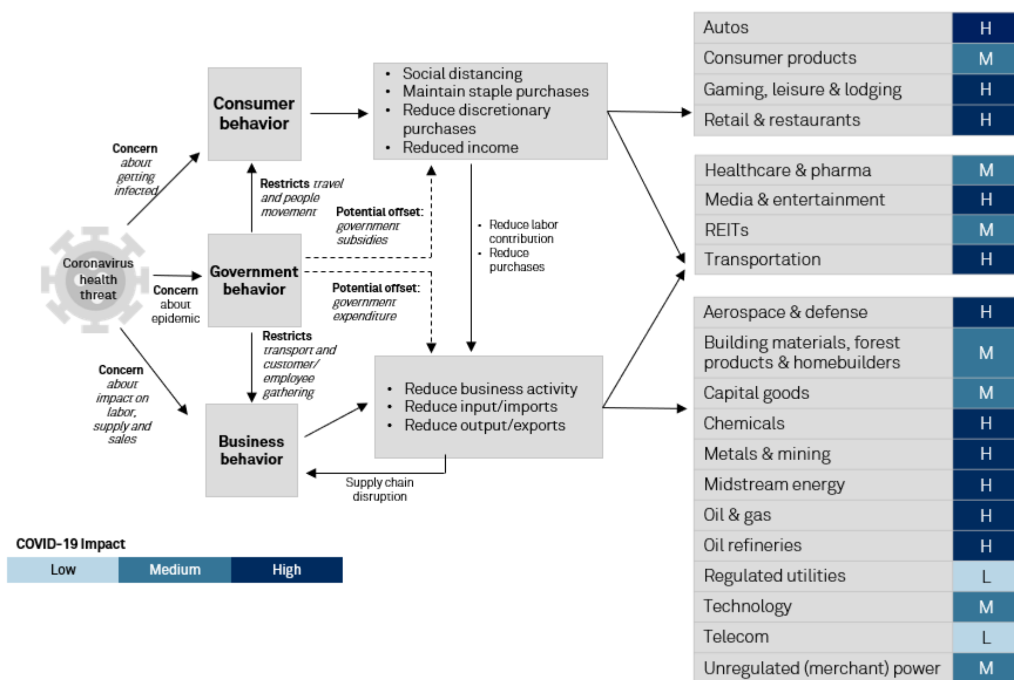
We expect that the pace of ratings activity will remain elevated in the face of (largely expected) depressed earnings and cash flow (see chart 5). Credit quality could deteriorate much further in the event of a failed containment of the virus. Multi notch downgrades may also remain elevated due to a lack of cash flow visibility and no catalyst for a near term reversal, coupled with a large proportion of rated issuers at the lower end of the credit spectrum. Record high levels of lower rated credits, with slightly more than 40% of ratings at or below a single-B level, coupled with the effects of the pandemic and recession will also result in a higher rate of speculative grade defaults in 2020 than we've seen in the 12 years following the financial crisis.

Chart 5

COVID-19 Impact On North America Non-Financial Corporate Sectors



Note: The impact descriptor above (high, medium, low) is our qualitative view of the risk. It does not directly translate to risk of rating actions, which depend on a number of factors including initial headroom under a rating coupled with the expected length and severity of the epidemic.
Source: S&P Global Ratings.

While there are a few sub-sectors that are holding up through the events of the pandemic and global recession, namely consumer staples, grocery stores, freight transportation and some areas of technology and healthcare, we expect that a gradual recovery beginning later this year could position 2021 revenues to approach levels seen in 2019 for most sectors. We expect that a return to 2019 credit metrics will be more prolonged as a result of higher debt levels and perhaps financial policies. Corporations have drawn on revolving credit facilities, drawing roughly $230 billion since March 5 according to LCD, and tapped credit markets to shore up liquidity and fund cash flow deficits. While these actions are pragmatic and beneficial over the near term, the increased debt burden will prolong the path to recovery for average credit metrics and quality. There are several sectors that may not recover to 2019 levels until 2022 or later based on various factors:

– **Secular pressure.** Certain sectors, like physical, mall-focused retail and movie exhibitors were facing secular pressure and declines, in varying degrees, in advance of the pandemic. Once these sectors reopen, we expect that some shifts in consumer behavior may never revert back to old habits and the digital shift may hasten the declines that these sectors were already experiencing. There could also be a knock on negative impact to mall based REITs if there are retailer liquidations with stores that never reopen.

- **Long-distance travel.** We expect local and regional travel could begin to resume in the coming months with a slower recovery for air travel and long haul business travel. It remains to be seen what the pace and degree of recovery for cruise ship operators looks like, but it's safe to say that yields may not fully recover and 2019 levels may not be seen again for several years.
- **Large, discretionary purchases.** With the lingering effects of unemployment and the hit to consumers, sentiment toward large purchases could remain tepid into 2021. For instance we expect that auto sales will rebound at a healthy 15-20% rate in 2021, but remain 10-15% below 2019 levels. Other large ticket manufacturers, discretionary health care and capital goods manufacturers with exposure to lagging end markets may not return to 2019 levels until 2022 or later. On a bright note, homebuilders have built up financial capacity over the last few years and are positioned to withstand expected declines in the upcoming spring and summer selling season.
- **Oil and gas exposure.** An extreme supply demand dislocation will most likely lead to a large number of bankruptcies and perhaps liquidations for the oil and gas exploration space in the coming months. While oil & gas exploration and production companies are expected to rebound in 2021, midstream energy companies will experience a lagging impact from recontracting which could lead to 2021 actually being worse than 2020. Energy sector related suppliers such as capital goods will be affected as well.

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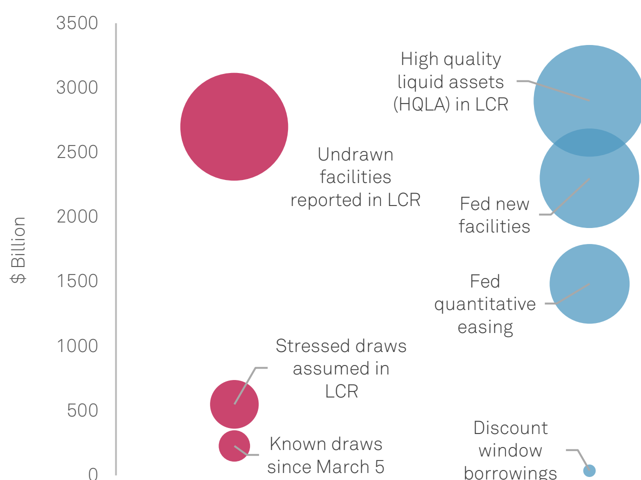
On the bright side, U.S. banks entered the current crisis in much better shape than at the onset of the Global Financial Crisis. So far, credit deterioration has been limited: We've removed one rating from CreditWatch positive, and changed the outlooks on six banks to stable from positive and the outlooks on another seven to negative from stable, due to COVID-19 and/or their energy-sector exposure. That said, they're not immune to the economic repercussions of the pandemic.

Corporate borrowers' draws on bank credit facilities have surged and could exceed those during the GFC. However, most banks are, in our view, well-positioned to handle this (see chart 6). Based on year-end 2019 data, banks subject to the liquidity coverage ratio (or LCR, a rule requiring them to hold enough high-quality liquid assets to cover cash outflows for 30 days) assumed that about $550 billion would be drawn. Banks have about $2.9 trillion of high quality liquid assets to withstand these draws—so even if borrowers draw the full $550 billion, banks' median LCR would still be close to required levels.

Chart 6

Revolvers, Sources And Uses Of Liquidity



Note: Known draws since March 5 is as of April 20. Discount window borrowings and Fed quantitative easing are as of April 15.
Source: S&P Global Ratings, LCD (an offering of S&P Global Market Intelligence), Federal Reserve Banks and the U.S. Department of the Treasury.

Banks also have access to liquidity either by borrowing from the Federal Home Loan Bank or the discount window (now with longer payback terms). Moreover, the Fed's recent moves will help corporates borrow without having to tap existing credit lines. On a positive note, the banks that reported first quarter results, ended the quarter with relatively strong liquidity ratios despite the large draws, mostly due to a robust amount of deposit inflows.

More broadly, we expect all banks' credit quality to deteriorate across industries as reflected by the significant increase in reserves taken by the banks that have reported first quarter results. The increase in reserves, which sharply reduced bank earnings, were exacerbated by the implementation of the Current Expected Credit Losses (CECL) accounting method, reflecting the likelihood of credit deterioration across all sectors, with the largest increase in reserves in the banks' credit card portfolios.

While the Fed's moves reduce the odds that borrowers will default on loans, they aren't a panacea, and given the magnitude of the issue and uncertainty about how long the crisis will last, there will still likely be a hit to lenders' loan portfolios. New federal programs that provide direct payments to many of the banks' loan categories will help mitigate the effects. How much they ameliorate bank credit quality remains an uncertainty and will hinge on the duration of the lockdown and the strength of the economic rebound in its aftermath.

U.S. Public Finance

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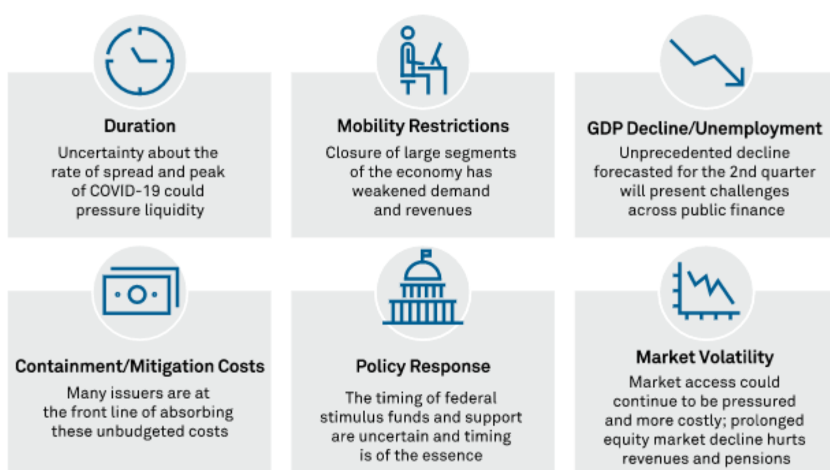
Amid this historically severe recession, all of S&P Global Ratings' U.S. Public Finance sector outlooks are now negative (see chart 7). At the start of the year, all sector outlooks were stable with the exception of higher education, ports, and mass transit. The generally healthy financial position of governments and not-for-profits provides some flexibility to respond, and government stimulus such as the Coronavirus Aid, Relief, and Economic Security (CARES) Act will also help support operations broadly (see "**What The CARES Act Means For Credit In U.S. Public Finance**," published April 20). However, the rate of spread and peak of COVID-19, as well as the breadth and depth of the recession, could create notable stresses for the credit quality of the entire sector.

Chart 7

All U.S. Public Finance Sector Outlooks Turn Negative—Key Macro Factors



Source: S&P Global Ratings.

Since the start of the pandemic, we've made 603 issuer outlook or rating revisions across USPF (see "**COVID-19 Activity In U.S. Public Finance**," published April 22). The changes are primarily in sectors where demand has declined significantly given health and safety initiatives to stop the spread of the outbreak. Severe limitations on travel have hurt revenues for transportation (including mass transit), convention center/sports authority, and hospitality tax debt. In addition, recessionary pressures brought on by social distancing and changes in demand have weighed on the 501(c)3 sector, as well as bonds backed by university-student and senior-housing revenues. We expect the rapid onset of the recession, surging unemployment, and decreased consumer spending to continue to pressure credit quality.

U.S. Sovereign Rating

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At the same time, S&P Global Ratings affirmed the U.S.'s 'AA+' long-term and 'A-1+' short-term sovereign credit ratings on April 2. The ratings reflect the country's diversified and resilient economy, monetary-policy flexibility, and status as issuer of the world's leading reserve currency. The outlook remains stable, reflecting our view that unprecedented fiscal and monetary stimulus will limit the current economic downturn. The stable outlook also reflects our expectation that negative and positive rating factors will be balanced over the next two years. The U.S.'s institutional checks and balances, strong rule of law, and free flow of information should support stability and predictability of economic policies.

The ratings are constrained by high government debt and fiscal deficits, both of which are likely to worsen this year. We expect an economic recovery next year, which will partly make up for the loss of output this year, and continued GDP growth afterward. A larger and prolonged deterioration in public finances, without positive signals of future corrective actions, could pressure the ratings. On the other hand, we could raise the ratings if we see signs of more effective and proactive policymaking beyond the policy response to the current recession.

Structured Finance

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Given our most recent U.S. economic forecasts, we expect some weakening in structured finance collateral performance. Further, our ratings outlook is stable-to-negative or negative for most asset classes (see table 2). We continue to expect the bulk of negative rating actions to hit spec-grade securities, with some pockets of investment-grade ratings activity.

With the short-term weakness in the macro environment, especially during the second quarter, the risk of increased delinquencies in any specific asset pool has increased across structured finance. Therefore, structural features such as reserve accounts, servicer advancing, excess spread, deferrable bonds/notes, when at least one of these features is present in many structured finance transactions/sectors, will help to mitigate temporary cash-flow interruptions.

If there is a longer-than-expected disruption, this would naturally introduce increased liquidity and credit stress. Thus, risks remain to the downside, especially if economic forecasts worsen. Current areas of focus include CLOs, whole business ABS, small business ABS, aircraft ABS, subprime auto ABS, auto dealer floorplan ABS, timeshare ABS, triple-net-lease ABS, CMBS with high exposure to retail and lodging, and non-QM RMBS.

Table 2

North America Structured Finance Sector Trends (12-Month Outlook) Q1 2020

	Collateral Performance Outlook	Rating Trends
Residential mortgages		
RMBS	Somewhat Weaker	Stable to Negative
RMBS - Servicer Advance	Somewhat Weaker	Stable
Commercial mortgages		
CMBS - N.A. Conduit/Fusion	Somewhat Weaker	Stable to Negative
CMBS - Large Loan/Single Borrower	Somewhat Weaker	Stable to Negative
CMBS - Large Loan/Single Borrower (Retail)	Weaker	Stable to Negative
CMBS - Large Loan/Single Borrower (Lodging)	Weaker	Stable to Negative
Asset-backed securities		
ABS - Prime Auto Loans	Somewhat Weaker	Stable
ABS - Subprime Auto Loans	Weaker	Stable to Negative
ABS - Auto Lease	Somewhat Weaker	Stable
ABS - Auto Dealer Floorplan	Somewhat Weaker	Stable to Negative
ABS - Credit Cards	Somewhat Weaker	Stable
ABS - Unsecured Consumer Loans	Weaker	Stable to Negative
ABS - FFELP Student Loan	Somewhat Weaker	Stable
ABS - Private Student Loan	Somewhat Weaker	Stable to Negative
ABS - Commercial Equipment	Somewhat Weaker	Stable
Asset-backed Commercial Paper	Somewhat Weaker	Stable
Structured credit		
CLOs	Weaker	Negative
Timeshares	Weaker	Stable to Negative
Small Business	Weaker	Stable to Negative
Tobacco	Stable	Stable
Transportation - Aircraft	Weaker	Negative
Transportation - Container	Somewhat Weaker	Stable to Negative
Transportation - Railcar	Somewhat Weaker	Stable to Negative
Whole Business	Weaker	Negative
Triple Net Lease	Weaker	Stable to Negative

Source: S&P Global Ratings.

The shuttering of U.S. businesses from coast-to-coast has had a profound effect on corporate credit, especially among lower-rated borrowers. Combined with the collapse in oil prices, spec-grade debt borrowers face an unprecedented challenge. Operating and liquidity stress has had a significant effect on the ratings of corporate loan issuers, and by extension, the ratings mix of obligors in U.S. CLO collateral pools. Since early March, U.S. CLOs have seen their average collateral

credit quality drop more than a notch, to 'B' from 'B+', and their average 'CCC' bucket increase to nearly 12%, from about 4%.

This credit migration has placed pressure on CLO ratings, especially for lower-mezzanine and subordinate tranches. However, stress scenarios we have generated across our U.S. CLOs rated book suggests that even under dire circumstances, 'AAA' rated CLO notes are well-protected and can withstand defaults of upward of 60% of their collateral loans, at an average recovery rate of less than 45%, without suffering a loss. Under more plausible—but still harsh—scenarios, a large majority of senior U.S. CLO notes would maintain their ratings, while tranches rated 'BBB' and lower would bear the brunt of the downgrades and defaults.

Insurance

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We anticipate our North American insurance ratings to remain relatively intact, with only modest net downside movement linked to our recently updated U.S. economic forecast (see table 3). Financial market turmoil is a greater headwind to insurers than underwriting exposure is. Robust capital and liquidity should help absorb elevated credit risk from corporate sectors, particularly from those most vulnerable to social-distancing measures and the energy sector, which is undergoing its own crisis.

Table 3

North America Insurance Sector Trends (12-Month Outlook)

Sector	Current Business Conditions	Business Conditions Outlook	Sector Outlook
Life Insurers	Satisfactory	No Change	Stable
Health Insurers	Satisfactory	No Change	Stable
Property & Casualty Insurers	Satisfactory	No Change	Stable
Reinsurers	Weak	No Change	Stable
Bond Insurers	Satisfactory	Somewhat weaker	Stable
Title Insurance	Satisfactory	No Change	Stable
Mortgage insurers	Weak	Weaker	Negative

Source: S&P Global Ratings.

Growth in premiums tends to track GDP closely, and so property/casualty (P/C) insurance exposures will likely decline. We expect declines in workers' compensation claims due to the spike in unemployment and small commercial lines stemming from closures of businesses. The economic shutdown should reduce claims, propelling state regulators to impose premium rebates. Some personal line insurers may have seen the writing on the wall and are already ahead of the curve by voluntarily taking this action.

Life insurers have been effectively navigating declining interest rates by modestly reducing their long-term rate assumptions in the past decade. However, now there may be more grounds for life insurers to take more acute actions although the recent widening of credit spreads may soften the blow. We can anticipate repricing and redesign of products that are more prone to interest rate sensitivity. We wouldn't rule out a slowdown or a complete halt in new sales for rate-sensitive products. On the bright side, slower productions should provide a short-term boost to risk-based capitalization.

We believe P/C insurers' underwriting exposure to the fallout from the COVID-19 outbreak is a small portion of the industry's business mix and should only modestly weaken earnings. The P/C coverage that raises the most concern is business interruption (BI) claims. However, this coverage is included in commercial property policies and is tied to perils that cause property damage, which excludes infectious diseases. We anticipate that current political efforts to extend BI coverage would be largely unsuccessful.

Furthermore, we conducted a hypothetical mortality stress test to estimate the potential impact of a pandemic event on the U.S. life insurance sector. In our moderate pandemic scenario, we anticipate current capital buffers will generally absorb additional excess net mortality claims.

Infrastructure

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The most impacted subsectors within the infrastructure portfolio have been midstream energy and volume exposed project financings.

The midstream and refining sectors have been more impacted by the steep fall in oil prices and demand destruction rather than the impact of COVID-19 related shutdowns. This has been combined with loss of access to debt markets, particularly at the lower speculative grade level for what is generally a capital intensive sector.

Toll-road, stadium, airport, parking and hotel project financings have seen sharp declines in credit metrics, with the greatest impact to those with more reliance on volume-based revenues. We've seen hotel occupancy decline to single figure percentages for those that remain open, sporting events cancelled for the foreseeable future, and typical drop-off of 50% or more in toll-road volumes. While commuter traffic has typically fallen 60% or more, we've seen some stability in long-haul heavy vehicle movements than have generally fallen no more than 10%.

For project financed power, we are beginning to see credit weakness. Recent winters have been relatively warm, with this winter particularly mild. This has slowed term loan B sweeps. The virus-induced demand decline could erode project metrics for some transactions enough to threaten financial covenants by the third quarter. Corporate Merchant power is generally heavily hedged in 2020, but as these hedges roll off we see a negative outlook later in the year if the recovery is extended.

As project financings generally have 6 to 12 months or more of dedicated debt service reserves we don't expect defaults in the near term. The question is how long recovery will take and if the volumes recover to the same levels. We see the current crisis as permanently altering future demand for some projects due to factors such as increases in work-from-home, more remote meetings, and reduction in future convention activity.

Projects with availability or cost recovery-based revenues have held up better so far, but remain reliant on the continuing credit strength of revenue counterparties and operators. Indeed, counterparty exposure is a key risk across the broader infrastructure portfolio and the rating on entities such as banks providing liquidity facilities, operators with performance guarantees, or revenue off takers often caps our infrastructure ratings.

Record Relief, While Not A Panacea, Is A Plus

The Fed's plan to pump $2.3 trillion into the economy, in part using Treasury Department funds to buy municipal bonds and expand its corporate bond purchases to include lower-rated debt, is a clear positive for local governments and many corporate borrowers. The measures, which far exceed any the central bank made during the financial crisis of 2008-2009, address investors' concern that large corporate borrowers would slip into the spec-grade category and "crowd out" from the credit markets those near the bottom of the ratings ladder—thus further destabilizing an already fragile credit market.

On April 9, the Fed expanded the Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility, which previously focused on investment-grade borrowers but now include borrowers that were investment-grade as of March 22 but have since slipped to spec-grade and remain in the BB-category.

The measures came amid some signs of life in the credit markets. While corporate bond spreads remain wider than the median during the GFC, investment-grade nonfinancial debt issuance broke weekly records with spreads beginning to tighten from recent highs—and some capital is again flowing to riskier assets. S&P Global Ratings believes that, though not a panacea, the move will help stabilize corporate credit.

Related Research

- Global Credit Conditions: Rising Credit Pressures Amid Deeper Recession, Uncertain Recovery Path, April 22, 2020
- Coronavirus Impact: Key Takeaways From Our Articles, April 22, 2020
- Coronavirus Weekly Digest, April 22, 2020
- COVID-19: Coronavirus- And Oil Price-Related Public Rating Actions On Corporations, Sovereigns, And Project Finance To Date, April 22, 2020
- COVID-19 Causes More Severe Disruption For Canada's Economy, April 17, 2020
- An Already Historic U.S. Downturn Now Looks Even Worse, April 16, 2020
- Credit Conditions North America: Unprecedented Uncertainty Slams Credit, March 31, 2020

This report does not constitute a rating action.

Appendix 1: COVID-19 Impact On North America Sectors

For analytical contacts, please see Appendix 3.

Table 4

COVID-19 impact on North America sectors

Sector	Impact*	Comment
Aerospace & Defense	High	The chilling effect of COVID-19 on air travel and the global economy is leading to order deferrals and some cancellations. This has prompted some aircraft manufacturers to reduce production rates. Cutbacks in airline capacity because of significant declines in air travel have reduced demand for aftermarket parts and services. Commercial aerospace companies will experience pressure in earnings and cash flow, and in turn see a reduction in headcount, furloughing employees, and other actions to offset some of the impact. Defense contractors are much less affected near-term.
Autos	High	Prolonged muted prospects for auto sales globally as the virus has impaired consumer discretionary spending this year. Specifically, we project that sales will decline 25% in the U.S. Aftermarket suppliers are also under pressure, given less driving and sharply reduced consumer spending. Automakers have announced temporary production shutdowns and have switched to liquidity protection mode. However, during a complete production shutdown, a company's ability to cover its fixed costs deteriorates sharply, which would lead to faster cash burn. As production and demand recover over the coming months, largely spurred by incentives and 84 month loans, performance of pick-up truck (highest contribution margin vehicles) sales will dictate overall cash flow recovery for most issuers. Additionally, the recovery is also dependent on the financial flexibility of tier 2 and tier 3 suppliers to build working capital after sharp losses for 2 months or more. Auto suppliers' cash flow adequacy metrics will remain stretched even in 2021 as many issuers look to boost liquidity through revolver draw downs and likely debt issuance.
Building Materials	Medium	We expect the timing of pandemic lockdowns to hit the 2020 spring-summer building season in North America, either with stay-at-home orders for construction activity or sharply lower employment and consumer sentiment for discretionary housing activity. We believe that most issuers successfully navigated supply chain risks from China in early 2020, so that inventories are stocked in western Europe and North America ahead of a sharp drop in demand in the important spring and summer selling seasons. The combination of COVID-19 and the downturn in oil markets has led to negative rating actions for almost one-third of the credits we rate in North America. We shifted to a negative bias in late 2019 because numerous issuers were not achieving sustained earnings growth from acquisition synergies to support elevated debt levels. The economic downturn in 2020 has made for a quick downdraft in ratings among recent LBOs, with about 10% of our issuers in each of the B- and the distressed CCC categories. About 40% of the building materials portfolio has a negative outlook, even after we downgraded about 20% of the credits in the last year.
Capital Goods	Medium	We expect the impact of COVID-19 and the sharp economic contraction to result in significant declines in revenues and EBITDA in 2020 putting pressure on the credit quality in the capital good sector. The extent of the impact depends on end market exposures, with those facing weaker end market such as oil and gas, autos, aviation and metals and mining under greater pressure. Spec grade issuers are more vulnerable to downgrades given limited diversity of end markets, cash flow and liquidity pressures. We think investment grade issuers could face more limited rating pressure given many large diversified issuers operate with cushion in credit metrics, face manageable debt maturities and enhanced liquidity positions.
Chemicals	High	The pandemic and related recessionary conditions we expect across the globe will reduce demand this year for most chemical products. Exceptions to this reduction will include chemicals used in sanitation, and similar applications. We expect demand declines at key chemical end markets including auto, and general industrial to reduce demand for both commodity and specialty chemicals, although commodity petrochemicals may be hit harder. Our base case considers a meaningful decline in EBITDA for many chemical companies relative to 2019, and relative to previous expectations for 2020. We see a related weakening in credit metrics, which will create downward pressure on credit quality across the credit spectrum. We do not expect that investment grade specialty chemical companies that are generally more resilient to downturns will be unscathed in the especially severe recession we contemplate in 2020. However, we anticipate that credit quality at the lower end of the rating spectrum will suffer in particular, given that such companies typically have lower financial flexibility, and greater vulnerability to external shocks.

Sector	Risk	Commentary
Consumer Products	Medium	We expect a divergence in performance of sectors in the consumer products universe in the short term. U.S. consumer products companies in shelf-stable foods, home-cleaning products, and hygiene are well-positioned to benefit from shelter-in-place mandates and consumers' health concerns. We believe this will have a modest positive impact on credit quality. This is attributable to the initial spike in demand from pantry loading and consumers now replenishing at a decelerating but still high rate because of shift to at-home consumption. That said, there is heightened risks for sectors exposed to social activity and discretionary spending. COVID-19 has heightened the risk of rating downgrades for consumer discretionary issuers, reduced revenues, and tight leverage headroom. Issuers with links to the retail and restaurant sectors are vulnerable. We believe these sectors will decline 20%-25% in 2020.
Financial Institutions – Asset Managers	Medium	Increased financial market volatility is diminishing assets under management levels for traditional asset managers and potentially delaying realizations for alternative asset managers. That said, lower valuations could lead asset managers to invest at more-attractive terms. We don't anticipate defaults in the near term, given that there are almost no debt maturities due in the next two years, and asset managers can adjust operating structures and discretionary payments (such as share repurchases).
Financial Institutions – Banks	Medium	The Fed's return to quantitative easing, zero interest rates, and commercial paper (CP) funding and primary dealer credit facilities should bolster market and bank liquidity, lowering the probability banks will face liquidity strains resulting from the coronavirus crisis and bolstering their ability and willingness to meet client demands for funding. Still, the crisis and ultra-low interest rates could lead to substantially lower earnings and significantly worse asset quality, particularly in industries more affected by the virus outbreak.
Financial Institutions – Nonbanks	Medium	We've taken a number of negative rating actions on nonbank finance companies (fincos), given elevated funding and liquidity risks—particularly for those with near-term maturities, borrowings subject to margin calls, and limited covenant cushions. We expect asset quality to deteriorate as delinquencies and defaults increase. Amid reduced profitability and debt-service capacity, as well as the steep decline in equity markets, we've taken various rating actions on retail securities firms as they have sizable amounts of asset-based fees. We also took rating actions on residential mortgage companies, amid stress on mortgage servicers' funding and liquidity
Forest Products	Medium	The impact has been limited because this is a highly automated industry often in remote areas or small urban centers in the U.S. and Canada, but has become a growing concern as we start to see a trickling effect that hinders commodity demand. There is a greater risk of deficit and increased draws on credit facilities, mainly tied to the current uncertain macroeconomic, notably linked to COVID-19 and the potential for logistical disruptions.
Gaming, Leisure & Lodging	High	Given the rapid increase in reported restrictions, the travel downturn could persist through the second quarter. Containment may occur by the end of the second quarter followed by a slow recovery. Restrictions on travel and consumer activity for a prolonged period is causing cancellations and an unprecedented decline in revenue at travel-related companies and out-of-home entertainment providers. Gaming operator and gaming equipment sectors are facing an unprecedented decline in revenue resulting from the temporary closures of casinos across the U.S.
Health Care & Pharmaceuticals	Medium	The ratings impact in health care has been uneven, as rating actions have been heavily concentrated in subsectors that are more dependent on more discretionary, lower-acuity procedures. Thus, areas such as physical therapy, dental, and outpatient surgery have borne the brunt of negative actions, while subsectors such as pharmaceuticals have proven more resilient. Hospitals have also seen non-COVID-19 related volumes decline, putting stress on medical staffing and physician groups. As the pandemic continues, we see the ratings impact becoming more widespread across subsectors, such as ortho manufacturers. The unprecedented increase in unemployment will also adversely affect payer mix, further pressuring future margins and cash flows.
Homebuilders	Medium	The credit quality of U.S. homebuilders has significant buffer to withstand a sharp slowdown, thanks to countercyclical cash flows and more conservative policies in recent years. We revised eight issuer outlooks back to stable from positive in March 2020, owing to an expected spike in debt leverage from weaker earnings in 2020. Still, we expect many ratings can withstand a temporary hit to profits as these issuers generate cash from shrinking inventories. U.S. homebuilders are seeing a negative effect on foot traffic now, which has turned into better sales conversion from more serious buyers. Looking ahead, however, job losses and potential construction site closures cloud the picture for new orders over the next few months in a previously healthy U.S. housing market.
Insurance	Medium	We expect COVID-19's shadow over capital markets will influence U.S. insurers' earnings in the first quarter. However, its effect on morbidity and mortality likely won't have as much of an impact on

		underwriting performance for Q1 2020. The macro impact on the economy will be the key factor that we will monitor closely, with equity markets remaining highly volatile and certain fixed-income asset classes such as transportation, gaming and lodging, and energy potentially being more at risk. Outside of investment portfolios, we believe fundamental differences in the liabilities of these three insurance sectors will mean COVID-19 will affect their underwriting results differently in the first quarter. We expect U.S. health insurers to likely report better-than-expected underwriting results, life insurers to face a serious test to their hedging strategy, and P/C insurers' underwriting performance to be the least affected.
Media & Entertainment	High	COVID-19 has severely hampered the global media and entertainment sector. In the span of a month, the pandemic has shut down all live events, including sports, concerts, and theaters. It has stopped film and television production, closed theme parks, and drastically cut global travel. The broadest threat to media remains a pullback in advertising spending due to the global economic recession. We expect the impact to domestic advertising will be severe in 2020, with the worst quarters being the second and third. However, the breadth and depth of severity will vary for each media subsector. We expect meaningful declines in digital, broadcast radio, print, and outdoor advertising but that television advertising could decline more modestly than other media segments. We have taken over 45 ratings actions to date and expect to take further ratings actions as the recession progresses and the shape of any recovery becomes more apparent.
Metals & Mining	High	Pressure on ratings in the metals sector accelerated with the concurrent COVID-19 and oil market downturns. The sector in North America is already characterized by elevated credit risk, with almost 60% rated B or lower and a 20% negative outlook bias since mid 2019. We lowered our metal price assumptions modestly (5%-10%), but the demand shock and production stoppages means that revenues could drop 20% in 2020 in these often high fixed costs industries. High yield issuers could breach leverage triggers with 2021 maturities on the horizon.
Midstream Energy	High	The combination of the pandemic and the oil price war will directly impact EBITDA in 2020 and 2021 for the U.S. midstream energy sector. Volume declines and counterparty credit quality are the top risks to the sector but the uncertainty around the timing and pace of any recovery makes it difficult to predict the severity of impacts on midstream credit profiles. Investment-grade companies are better-positioned than their spec-grade peers to deal with the severe supply and demand shocks as many companies are self-funding, credit facilities have been extended, and liquidity on revolvers is sufficient. Companies are reporting about 7%-8% EBITDA declines for 2020. Spec-grade companies are unable to access the capital markets and a prolonged downturn will likely cause significant credit deterioration in 2021.
Oil & Gas	High	The industry is facing a severe supply-demand imbalance. The price of oil has plummeted, political risks have amplified, and producers are facing negative investor sentiment, capital markets access, and coronavirus concerns. Over the coming months, we are expecting extreme volatility in oil prices as traders will find it difficult to park oil with global storage levels nearing full capacity. We assume Brent oil price will recover to US$50/bbl level in 2021 from US$30/bbl this year based on our expectation that COVID-19 will be contained this year leading to demand recovery and a massive supply response from the OPEC/Russia agreement to drastically cut production and production response from other producing regions particularly U.S. shale players.
Oil Refineries	High	Independent oil refiners' margins are under pressure from falling demand, and the drop in oil prices may significantly impact working capital and reduce cash positions. A number of investment-grade refineries responded to the drain on liquidity with new short-term bank facilities and successful debt issuance in April 2020. We believe first quarter EBITDA will be weaker than expected, due to the substantial decline in demand for jet fuel and gasoline. Cracks for both products has been negative at times, and anemic demand in the second quarter will likely require massive cuts to utilization. We expect negative EBITDA in the second quarter for most of the rated portfolio in North America. A prolonged demand response due to COVID-19 could damage credit quality.
Public Finance	Medium	The financial position of governments and not-for-profits was generally healthy at the beginning of the year, which we believe provides flexibility to respond to the evolving situation. However, we see real fiscal challenges across all sectors given the rapid onset of the recession with projections of sharp GDP decline, surging unemployment, and decreased consumer spending that will pressure credit quality. Over the next several months we will be watching for credit deterioration that arises from liquidity shortfalls and major shifts to revenue sources brought on by changes in demand. We anticipate this will create the type of volatility that can tie directly to credit deterioration. In cases where revenue growth is slowing and expenditures are rising, the imbalance can grow quickly and pressure credit stability.
REITs	Medium	While the impact of COVID-19 and economic recession will be felt across all property types, retail and healthcare assets are more directly impacted in 2020. We expect rent deferrals and increasing tenant

		distress to impact cash flow in 2020, particularly for retail assets given store closures and impact from social distancing. Negative rating bias has increased in recent weeks reflecting expected pressure on cash flow and uncertain path to recovery. Still, most REITs have solid liquidity and maintain good access to debt markets that will help weather through this pandemic.
Regulated Utilities	Low	We believe that the majority of North American regulated utilities are well-positioned to handle the immediate impact of COVID-19. However, the pandemic could hurt some companies, especially those issuers already facing downside ratings pressure prior to the arrival of the coronavirus. Some electric utilities with disproportionate exposure to commercial and industrial class of customers could be vulnerable to reduced sales volumes, absent any regulatory counter mechanisms such as decoupling.
Retail & Restaurants	High	Credit risks to the retail and restaurant sector have increased dramatically as the effort to contain COVID-19 results in store closures, changes to shopping habits, and heightened risk of a broad based macroeconomic decline. Sales will likely decline substantially in the short-term, with the hardest-hit issuers in casual dining and retail exposed to social distancing and discretionary spending (e.g., mall-based retailers). We expect rating actions across the credit spectrum to continue with the vast majority concentrated in these segments.
Sovereign	Low	We expect investment-grade sovereigns will show stronger resilience and more flexibility to withstand the shock. The ratings of countries with greater economic resilience, stronger financial profile, and better policy-making are likely to come under less pressure compared with others. In contrast, those at the lower end of our scale are more vulnerable to downgrades, given their inherently weaker finances and greater vulnerability to global shocks.
Technology	Medium	COVID-19 will hurt enterprise and consumer IT spending, particularly, hardware and semiconductor segments. We believe software and IT services providers are not immune as customers will likely delay major upgrades or new project implementations. We expect some of the deferred spending to return gradually in the latter half of this year and in 2021 as business recovery takes place. We expect significant negative ratings actions throughout the year as the impact of the revenue deferral, or revenue destruction in some cases, begins to emerge. Liquidity is a key concern among speculative-grade issuers given the market dislocation.
Telecom	Low	Overall, telecom and cable providers can withstand the effects of a surge in COVID-19 cases with limited impact to credit quality given their recurring, subscription-based business models. However, there are a handful of companies that have exposure to vulnerable sectors such as transportation and tourism, which could hurt their financial and operating performance in the near-term. In addition, issuers that have exposure to small- and mid-sized business customers are at risk since they are most likely to reduce telecom spending in a recession. We believe that SMB customers, in particular, are likely to scale back operations and in some cases, will go out of business.
Transportation	High	The ultimate impact of the coronavirus outbreak on our airline ratings will depend on the duration and severity of the crisis, and the type and severity of measures airlines and governments take to mitigate it. Capacity reductions, along with sharply lower oil prices, will be insufficient to offset the decline in its travel demand. Government grants and loans to U.S. airlines provide a significant near-term boost for liquidity but credit quality remains under severe pressure. The aircraft-leasing sector should fare better than airlines in this coronavirus-related economic downturn, but will still face pressure on their revenues and cash flow. Car rental companies are also being hurt by the fallout from much lower air travel. Freight transportation is less affected but will be hurt indirectly through the unfolding global recession.
Unregulated (Merchant) Power	Medium	Most merchant power companies engage in ratable hedging and a high proportion—typically 90%—of their 2020 economic generation is hedged. Still, we expect companies with load shape risk (volumetric risk in hedges) and/or a higher proportion of large commercial and industrial (LCI) customers will be disproportionately affected. We expect some companies that do not have a countercyclical retail power business to offset the risks in wholesale power business to experience some credit pressures should the current environment last into the third quarter. With average peak electric demand showing signs of declining about 15% at this stage, prompt and forward prices have declined. However, forward power prices in 2021 and beyond are still structurally resilient.

*The impact descriptor above (high, medium, low) is our qualitative view of the risk. It does not directly translate to risk of rating actions, which depend on a number of factors including initial headroom under a rating coupled with the expected length and severity of the epidemic.

Appendix 2: Economic Data And Forecast Summaries

Table 5

U.S. – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP (year % ch.)	2.3	-5.2	6.2	2.5	2.4
Real consumer spending (year % ch.)	2.6	-5.5	6.8	3.5	3.1
Real equipment investment (year % ch.)	1.3	-12.1	12.6	8.9	4.3
Real nonresidential structures investment (year % ch.)	-4.3	-11.8	4.9	4.7	3.1
Real residential investment (year % ch.)	-1.5	-6.1	8.2	4.4	2.1
Core CPI (year % ch.)	2.2	1.7	2.1	2.8	2.3
Unemployment rate (%)	3.7	8.8	6.7	5.4	4.1
Housing starts (annual total in mil.)	1.3	1.2	1.3	1.3	1.3
S&P Case-Shiller Home Price Index (Dec. to Dec. % ch.)	3.5	3.3	1.4	1.4	2.5
Federal Reserve's fed funds policy target rate range (year-end %)	1.5-1.75	0-0.25	0-0.25	0-0.25	0.5-0.75

Note: All numbers are in annual average basis, except the Fed's policy rate and housing starts. Core CPI is consumer price index excluding energy and food components. f—forecast. Forecasts were generated before the third estimate of Q4 2019 GDP was published by the BEA. Source: Oxford Economics, S&P Global Economics Forecasts.

Table 6

Canada – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP (year % ch.)	1.6	-5.3	6.0	2.2	2.4
Real consumer spending (year % ch.)	1.6	-6.5	7.2	3.3	2.7
Real private business fixed investment (year % ch.)	-0.8	-11.9	8.5	7.6	4.2
Core CPI (year % ch.)	2.1	1.5	1.9	1.7	2.3
Unemployment rate (%)	5.7	10.0	7.7	6.5	5.8
Housing starts (annual total in thousands)	208.8	166.1	203.2	207.2	213.4
CAD/USD exchange rate (per US$1)	1.33	1.40	1.37	1.34	1.35
Government of Canada 10-year bond yield (%)	1.59	1.06	1.61	1.64	2.00
Bank of Canada overnight rate (%, end of period)	1.75	0.44	0.25	0.25	0.63

Note: All numbers are in annual average basis, except central bank rates and housing starts. Core CPI is consumer price index excluding energy and food components. f—forecast. Source: StatCan, Oxford Economics, S&P Global Economics Forecasts.

Appendix 3: List Of Analytical Contacts

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