S&P Global Ratings

The Ratings View

September 13, 2023

This report does not constitute a rating action.

Key Takeaways

- The 16 global corporate defaults last month are the highest August tally since 2009.
- Investment-grade bond issuance is growing, while speculative-grade bonds struggle.
- U.S. real estate showed surprising resilience in the second quarter.

The year-to-date global corporate default tally jumped to 107 as of Aug. 31—with 16 defaults representing the highest August tally since 2009. Media and entertainment defaults, so far in 2023, are six times higher than at this point in 2022. Latin America is the pressure point within emerging markets accounting for 13 of the 14 defaults year to date. We expect the U.S. and European 12-month trailing speculative-grade default rates will continue to rise from current levels, to 4.5% and 3.75% respectively, by June 2024.

Default, Transition, and Recovery: Corporate Defaults Record Highest August Total Since 2009

The amount of global corporate debt rated by S&P Global Ratings rose 2.7% in the 12 months to July 1, due to an expansion of investment-grade debt. During this period, the amount of speculative-grade debt outstanding declined 3.1% as lower-rated issuers, facing higher-for-longer interest rates, appear more focused on refinancing or paying down existing debt. By region, Europe saw a sharper rise in its level of rated debt than the U.S., partially from the effect of the U.S. dollar depreciating versus the euro. While more than 90% of investment-grade debt consists of fixed-rate bonds and notes, speculative-grade debt is more exposed to higher interest rates through its larger concentration of floating-rate loans and revolvers.

Credit Trends: Global State Of Play: Debt Growth Diverging By Credit Quality

Operating performance across the U.S. real estate sector was resilient in the second quarter, with earnings largely meeting or slightly exceeding our expectations. Homebuilders performed better than we expected, showing a quick recovery in demand despite elevated mortgage rates. Equity REITs and building materials companies largely met our expectations, while commercial mortgage REITs continue to face challenges. We upgraded several homebuilders, but rating actions were more negative for REITs. The higher-for-longer interest rate environment will likely remain a significant headwind for the real estate sector for the remainder of 2023, slowing external growth and limiting access to capital markets. Refinancing remains a key risk we're monitoring given tighter credit conditions while higher financing costs will exert significant pressure on cash flow coverage metrics.

Real Estate Monitor: Stronger Second-Quarter Results Reflect Resilient Demand For The U.S. Real Estate Sector

Softening demand is weighing on European chemical companies' performance amid the global economic slowdown and high inflation. Persistently high interest rates will also eat into cash flows and result in refinancing risks, especially for lower-rated companies. In S&P Global Ratings' view, margin resilience, earnings quality, and financial policy are important for maintaining rating

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For latest Sector and Industry Research **Click Here** headroom. In the report linked to below, we address frequently asked questions on the sector's performance - what has caused recent profit warnings, how much rating headroom do issuers have, whether competitiveness is declining given the energy shock and U.S. investment subsidies - and our expectations for 2023 and 2024.

Credit FAQ: Europe's Chemical Sector Feels The Chill In A Cooling Economy

Recent Q2 GDP prints indicate ongoing resilience among key emerging markets (EMs), particularly with regards to domestic demand. EM Asia and parts of Latin America have performed strongly, although EM EMEA has been affected by eurozone weakness. Economic growth in China and the eurozone is waning, with negative spillover effects for several EMs. High-frequency data in China point to moderating growth in Q3 as retail sales and exports have been deteriorating over the last few months. However, a sharp deceleration in growth is unlikely as activity and credit are still growing. Spreads remain vulnerable to volatile external conditions. The potential for an additional rate hike by the Federal Reserve, at a time when several EMs are lowering their interest rates, along with disappointing growth in China and the eurozone, could encourage capital outflows and pressure exchange rates against the dollar. Geopolitical risks also continue to complicate the outlook.

Emerging Markets Monthly Highlights: Domestic Demand Is Holding Up

China's local government debt-raising vehicles are fraying at the periphery. The country's lower-tier local government financing vehicles (LGFVs) account for nearly 90% of the borrowing in this sector, or about RMB50 trillion in debt per our estimate. S&P Global Ratings believes that the liquidity soundness of the lower-tier entities is deteriorating quickly, with a build-up of short-term debt amid depleting cash. Bank refinancing will remain the primary backstop for LGFV debt rollover, given fiscal constraints. The latest support from local governments and banks in the form of a so-called 'package of plans' should temporarily alleviate some liquidity pressure on the weakest LGFVs but won't likely serve as a long-term fix.

China Policy Patches Alone Won't Fix LGFVs' Fraying Liquidity

Changes in energy-efficiency performance regulations are currently likely have a limited impact on European residential mortgage-backed securities (RMBS). This is due to uncertainties on the timing and extent of sale or rental restrictions, financing available for renovations, supply and demand in housing markets, and structural protections in RMBS transactions. Nevertheless, EPCs may influence property values. Studies show there is a valuation discount for properties with low EPC classes. If this discount increases as EPC classes gain importance or is not fully reflected in property valuations, it may eventually affect how we calculate the foreclosure frequency and loss severity of RMBS loan pools. Our scenario analysis shows a low potential impact on our modelled loss severity assumptions. This is even though energy-intensive properties could face higher losses. Our weighted-average loss severity increases 2.5% at the 'AAA' rating level and 2.8% at the 'B' rating level, albeit we acknowledge that our assumptions are very conservative.

Sustainability Insights Research: Building Energy Regulations And The Potential Impact On European RMBS

Asset Class Highlights

Corporates

Notable publications include:

- Default, Transition, and Recovery: Corporate Defaults Record Highest August Total Since 2009
- Record CapEx Fuels Growth Along With Credit Risk For North American Investor-Owned Utilities
- Real Estate Monitor: Stronger Second-Quarter Results Reflect Resilient Demand For The U.S. Real Estate Sector
- Credit FAQ: Europe's Chemical Sector Feels The Chill In A Cooling Economy
- Inflation, Rates Start To Bite Corporate Australia
- Credit Trends: Global State Of Play: Debt Growth Diverging By Credit Quality
- Corporate Results Roundup Q2 2023: Interest payments surge, EBITDA declines

Financial Institutions

- In Europe, we raised our long-term issuer credit rating on Credit Suisse's operating companies to 'A+' from 'A'. Following the announcement that UBS Group would integrate Credit Suisse AG, the main operating bank of the group that also holds most subsidiaries, we now see Credit Suisse's European and U.S. operating companies as core to UBS Group's operations and expect them to be supported in any foreseeable circumstances. The outlooks on these entities are stable.
- In Portugal, we revised our rating outlook to positive from stable on Banco Santander Totta S.A. We also raised the long- and short-term issuer credit ratings to 'BBB-/A-3' from 'BB+/B' on Banco Comercial Portugues S.A.
- We lowered our rating on Canada-based CRE Avison Young (Canada) Inc. to CCC' from 'CCC+'. Liquidity position has eroded in 2023 due to subdued commercial real estate (CRE) activities and high debt burden. We believe the company will have thin liquidity in the next 6-12 months, while we expect Avison Young to require amendments to its existing credit agreements in the near term.

We have published the following commentary:

- U.S. Regional Banks 2Q 2023 Update: Resilience Tested Amid Challenging Operating Conditions. U.S. regional banks reported higher earnings in second-quarter 2023 than the prior year's second quarter, aided by substantially higher net interest income (NII) and modest growth in noninterest income, despite higher loan provisions. However, earnings declined sequentially because of slower NII growth and higher expenses and provisions.

  Our key expectations for U.S. regional banks are:

  - NII should rise for the full year, but at a slower pace than in 2022, and we expect sequential declines in the second half of 2023.
  - Capital ratios will gradually rise in the near term amid more conservative capital returns and as management teams evaluate proposed regulatory rules and a possible economic slowdown.

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- Credit metrics to gradually deteriorate, but to remain generally good. We expect provisions and allowances to rise, particularly for commercial real estate (CRE) and specifically for office loans.
- Funding and liquidity metrics will likely weaken further given elevated deposit pressures and the Federal Reserve's quantitative tightening.

Sovereign

- Portugal Outlook Revised To Positive On Resilient Growth And Government And External Deleveraging; Ratings Affirmed

Structured Finance

- **European CLO:** Here are a few "Key Takeaways" from a recent article:
  - Following strong European CLO refinancing and reset activity in 2021 and first-quarter 2022, fewer transactions had started to amortize.
  - Fast forward to today, with refinancing and reset activity drying up from Q2 2022 onward, almost 20% of our rated CLOs are now amortizing. Of these, one-third of 'AAA' rated notes have lower credit enhancement than at closing, with several holding more 'CCC' and defaulted assets and some holding negative cash.
  - The structural fundamentals of the amortizing CLOs remain positive, such as a lower weighted-average life, and an increasing weighted-average spread on the new assets in the pools.
  - We believe recently falling note margins on new issue CLOs will support refinancing and reset activity, with potentially 10 CLOs set to reset this year and over 30 next year, further delaying the amortization phase for CLOs that reset their liabilities.

See "European CLOs: The Long Road To Amortization" published September 6, 2023.

- **European RMBS:** Here are a few "Key Takeaways" from a recent article:
  - Climate transition risks linked to changes in energy-efficiency performance regulations currently have a limited impact on European RMBS. This is due to uncertainties on the timing and extent of sale or rental restrictions, financing available for renovations, supply and demand in housing markets, and structural protections in RMBS transactions.
  - Nevertheless, EPCs may influence property values. Studies show there is a valuation discount for properties with low EPC classes. If this discount increases as EPC classes gain importance or is not fully reflected in property valuations, it may eventually affect how we calculate the foreclosure frequency and loss severity of RMBS loan pools.
  - Our scenario analysis shows a low potential impact on our modelled loss severity assumptions. This is even though energy-intensive properties could face higher losses. Our weighted-average loss severity increases 2.5% at the 'AAA' rating level and 2.8% at the 'B' rating level, albeit we acknowledge that our assumptions are very conservative.

- Foreclosure frequencies may increase over time due to higher leverage. Property owners may incur higher debt to carry out renovations if countries start requiring improvement in energy efficiency, especially if subsidies are insufficient to cover the cost.

See "Building Energy Regulations And The Potential Impact On European RMBS" published Sept. 6, 2023.

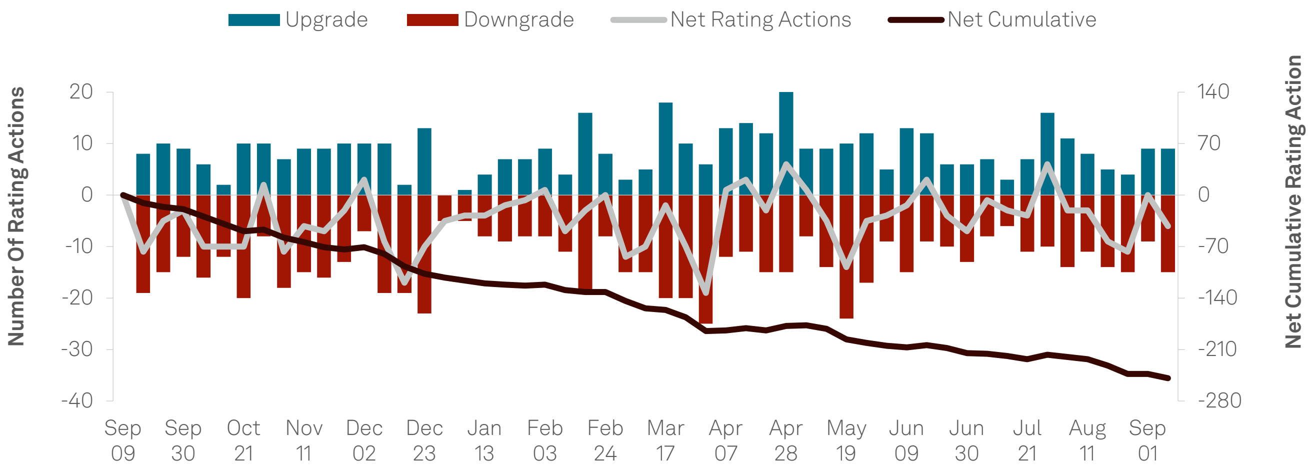
- **French Covered Bonds:** Here are a few "Key Takeaways" from a recent article:
  - France has been the largest market for covered bond issuance so far in 2023 as local banks continue to rely on covered bonds as a funding source.
  - Rising interest rates have increased cost of funding of new French covered bond issuances, which in turn have increased the required credit enhancement.
  - The central-bank-set usury rate that lenders can charge to home loan clients along with new legally binding residential loan underwriting guidelines have restricted new home loan origination.

See "French Covered Bond Market Insights 2023" published Sept. 7, 2023.

- **Canadian Credit Card ABS:** We recently published the "Canadian Credit Card Quality Index: Monthly Performance--July 2023". The CCQI is a monthly performance index that aggregates performance information of securitized credit card receivables in the following key risk areas: receivables outstanding, yield, payment rate, charge-off rate, delinquencies, base rate, and excess spread rate.

Chart 1

Global Rating Actions (Rolling 52-Weeks)



Source: S&P Global Ratings. Net rating actions means downgrades minus upgrades. Net cumulative means total net rating actions. Data as of Sept. 8, 2023. Global rating actions include actions on both financial and non-financial corporates and sovereign issuers.

Table 1

Recent Rating Actions

Date	Action	Issuer	Industry	Country	To	From	Debt vol (mil. $)
7-Sep	Upgrade	Credit Suisse AG (UBS Group AG)	Bank	Switzerland	A+	A	37,302
8-Sep	Downgrade	Catalent, Inc.	Health Care	U.S.	B+	BB-	3,583
7-Sep	Upgrade	Keter Group B.V.	Consumer Products	Netherlands	CCC+	CCC	3,497
6-Sep	Downgrade	Diversified Healthcare Trust	Homebuilders/Real Estate Co.	U.S.	CCC-	CCC+	2,850
6-Sep	Downgrade	Office Properties Income Trust	Homebuilders/Real Estate Co.	U.S.	BB-	BB	2,500
4-Sep	Upgrade	Lenovo Group Limited	High Technology	Hong Kong	BBB	BBB-	2,250
5-Sep	Upgrade	Webuild S.p.A.	Homebuilders/Real Estate Co.	Italy	BB	BB-	2,053
8-Sep	Upgrade	Grab Holdings Limited	High Technology	Singapore	B	B-	2,000
6-Sep	Downgrade	ConvergeOne Holdings Inc.	High Technology	U.S.	CCC+	B-	1,385
5-Sep	Downgrade	Carestream Dental Technology Parent Limited	Health Care	U.K.	CCC	B-	1,360

Source: S&P Global Ratings Credit Research & Insights. Data as of Sept.8, 2023. U.S. means United States, U.K. means United , Kingdom and U.A.E. means United Arab Emirates. NBFI - NonBank Financial Institutions (ex. Insurance)

For further credit market insights, please see our **This Week In Credit** newsletter**.**