The Ratings View

February 21, 2024

This report does not constitute a rating action.

Key Takeaways

- We expect the U.S. 12-month speculative-grade corporate default rate to reach 4.75% by year end, with the European equivalent hitting 3.5%.
- The ailing office sector is dampening the ratings outlook for U.S. real estate.
- Revised commodities prices assumptions include a meaningful decline in gas prices.

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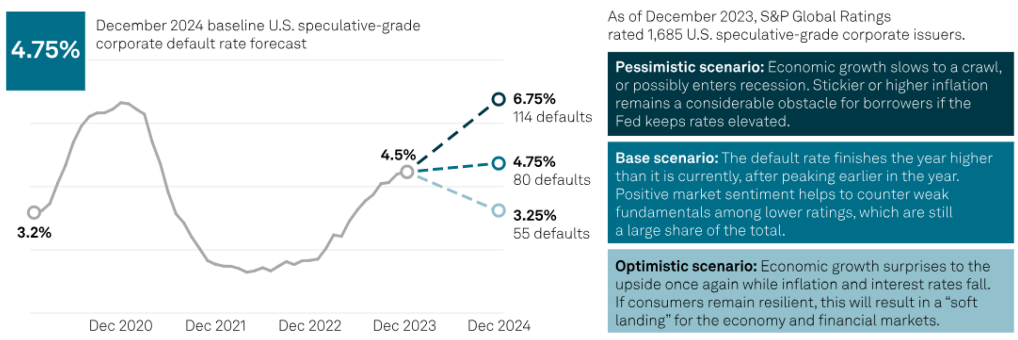
We expect the U.S. trailing-12-month speculative-grade corporate default rate to reach 4.75% by December 2024. This is up from the 4.5% at the end of 2023, but lower than our previous 5% projection through September, as we expect defaults to decline in the fourth quarter given positive economic trends. Even so, the proportion of 'CCC/C' ratings remains elevated as these firms contend with weak cash flow and elevated interest expenses. We expect defaults this year to largely come from consumer-facing sectors, such as consumer products, media and entertainment, and the still highly leveraged health care sector. Distressed exchanges will likely remain common as well. Any downside surprise to the optimistic backdrop could push the default rate toward our pessimistic case of 6.75%; however, at this time a recession is looking less likely this year.

U.S. speculative-grade default rate to hit 4.75% by December

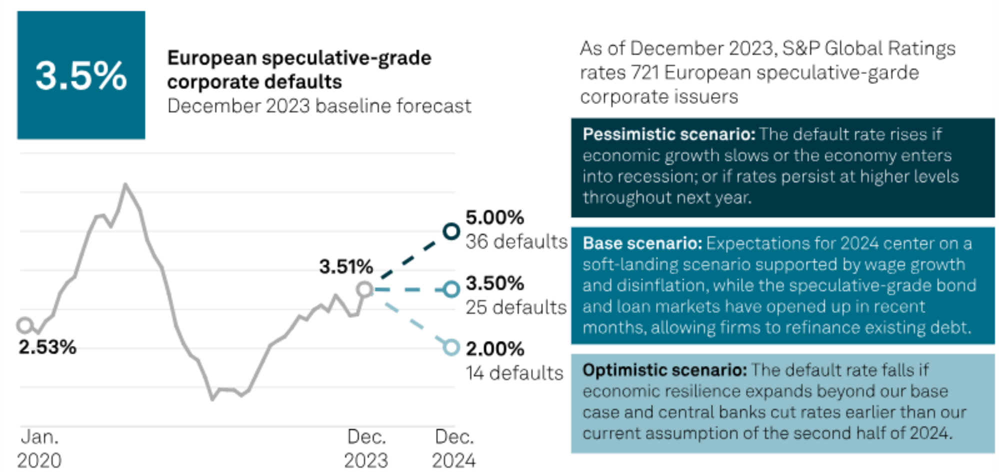


Data as of Dec. 31, 2023. Sources: Leveraged Commentary and Data (LCD) from Pitchbook, a Morningstar company; and S&P Global Ratings Credit Research & Insights and S&P Global Market Intelligence's CreditPro©.

U.S. Speculative-Grade Corporate Default Rate To Hit 4.75% By December 2024 After Third-Quarter Peak

We expect the European trailing-12-month speculative-grade corporate default rate to be 3.5% by December, the same level as in December 2023, indicating a relative stabilization of the default rate by year end. Higher interest rate burdens still lie ahead for many businesses and households despite recent market optimism and lower fixed-rate yields. Upcoming fixed-rate maturities this year and next will force issuers to contend with market rates still roughly 2% higher than those on existing debt. Consumer-reliant sectors such as consumer products and media and entertainment will likely lead the default tally. Chemicals and health care may also see high relative defaults because these sectors have many issuers with negative cash flow and high proportions of 'CCC/CC' ratings.

Defaults should be relatively stable, following a surge at the beginning of the year



Data as of Dec. 31, 2023.
Source: S&P Global Ratings Credit Research & Insights, S&P Global Market Intelligence's CreditPro®.

European Speculative-Grade Default Rate To Stabilize At 3.5% By December 2024

U.S. commercial real estate (CRE) is struggling to get back on its feet, with the ailing office sector dampening the ratings outlook. S&P Global Ratings' webinar "CRE Credit Outlook: CMBS, REITs, and Banks Update" on Feb. 14, 2024, made clear that CRE in the U.S. isn't out of the woods yet. A replay is available here. Difficult conditions for refinancing loans could put the resilience of commercial mortgage-backed securities (CMBS) to the test, while real estate investment trusts (REITs) might face a decline in credit quality. With banks remaining the largest source of funding for CRE, and CRE delinquencies rising, most banks maintain manageable exposures to office loans. We closely monitor banks with the highest CRE exposures.

Uphill Battle Continues: Highlights From The U.S. Commercial Real Estate Webinar

S&P Global Ratings has lowered its North American and European gas price assumptions for 2024 and 2025. The decline in our gas price deck in 2024 is somewhat meaningful, though we anticipate limited rating impact. We note that many of the producers have focused on reducing debt over the past several years and some producers benefit from hedges. We maintain our Brent and West Texas Intermediate (WTI) oil price assumptions for the remainder of 2024 and subsequent years. Additionally, we have added 2027 annual assumptions for these hydrocarbons.

S&P Global Ratings oil and natural gas price assumptions

	New prices (as of Feb. 20, 2024)					Old prices (as of Nov. 7, 2023)				
	WTI ($/bbl)	**Brent ($/bbl)**	**Henry Hub ($/mmBtu)**	**AECO ($/mmBtu)**	**TTF ($/mmBtu)**	**WTI ($/bbl)**	**Brent ($/bbl)**	**Henry Hub ($/mmBtu)**	**AECO ($/mmBtu)**	**TTF ($/mmBtu)**
Remainder of 2024	80	85	2.5	1.75	10	80	85	3.25	2.25	14
2025	80	85	3.5	2.5	10	80	85	4	2.75	12
2026	80	85	4.25	3.25	10	80	85	4.25	3.25	10
2027 and beyond	80	85	4.25	3.25	10					

Source: S&P Global Ratings. bbl--Barrel. WTI--West Texas Intermediate. HH--Henry Hub. TTF--Title Transfer Facility. AECO--Alberta Energy Co. mmBtu--Million British thermal units. Note: Prices are rounded to the nearest $5/bbl and 25 cents/mmBtu.

S&P Global Ratings Has Lowered Its North American And European Gas Price Assumptions For 2024 And 2025

The Latin American corporate and infrastructure outlook is relatively stable for 2024. Most of the region's main economies are set to grow modestly this year, and while elections will probably introduce some volatility, we don't anticipate a major shift in current trends. Bond issuance has been strong so far this year, and we believe market access in 2024 will widen thanks to lower rates and healthy fundamentals. Investment-grade companies and stronger speculative-grade ones are likely to benefit the most. There are risks in sectors such as retail, telecom and cable, metals, protein, and airlines (transportation), but overall conditions remain largely stable.

Latin American Corporate And Infrastructure Credit Outlook 2024: A Case For Renewed Optimism

Consumer activity in ASEAN will moderate in 2024, after brisk growth last year, as confidence weakens and tight monetary policy starts to bite. High underlying economic growth and supportive labor markets will prevent a sharp slowdown in consumer activity. Consumption should improve in Vietnam, following slow growth during the economic downturn in 2023. For Thailand, proposed fiscal stimulus will boost consumers this year if it materializes.

Economic Research: ASEAN's Consumer Activity Is Losing Steam

Sustainable bond issuance in Asia-Pacific (APAC) could rise by about 10% this year, reaching $260 billion, given the persistent shortfall in funding for environmental and social projects. South Korea, Japan, and China will remain the largest green, social, sustainability, and sustainability-linked bond (GSSSB) markets, together accounting for more than 75% of regional issuance. Local currency bonds constitute about 70% of GSSSB issuance in APAC, and will continue to dominate, particularly in the social bond category. Public sector entities across the region will remain active in issuing GSSSBs, following growth of 55% last year.

Sustainability Insights Research: Asia-Pacific Sustainable Bonds To Step Up Growth In 2024

The digital euro could launch with more of a whimper than a bang. Uptake is likely to be low, particularly if market expectations of a €3,000 per person limit prove correct. Based on that assumption, S&P Global Ratings expects limited deposit outflows at eurozone banks. The potential impact should also be cushioned by the authorities' adoption of an intermediated model in which banks (and other payment service providers) will be compensated for their role in distributing digital euros.

Your Three Minutes In Fintech: A Digital Euro Won't Shake Banks

There has been an increase in music royalty securitization issuance since 2021, and we expect additional volume in the coming year. The music industry faces complex risks outside of those posed by the larger economy. These include industry and technology changes. Generally, a more diverse portfolio (artists, songs, genre, etc.) will produce more predictable and stable cash flow.

ABS Frontiers: Music Royalty Securitizations Are Getting The Band Back Together

Asset Class Highlights

Corporates

Notable publications include:

- Latin American Corporate And Infrastructure Credit Outlook 2024: A Case For Renewed Optimism
- Default, Transition, and Recovery: U.S. Speculative-Grade Corporate Default Rate To Hit 4.75% By December 2024 After Third-Quarter Peak
- Default, Transition, and Recovery: European Speculative-Grade Default Rate To Stabilize At 3.5% By December 2024
- Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens
- Brazil Sheds Light On Electricity Distribution Concession Renewals

Financial Institutions

- In Europe, we lowered our rating on Deutsche Pfandbriefbank (pbb) to 'BBB-/A-3' from 'BBB/A-2'. The downgrade incorporates the protracted pressure from CRE markets on pbb's asset quality. The negative outlook reflects our view that weak CRE markets, notably in the U.S., could increase the cost of risk in pbb's highly concentrated loan portfolio beyond our base-case expectation.
- We revised the rating outlook on Chinese Hangzhou Finance And Investment Group (HFIG) to negative from stable. HFIG is facing outflow pressure in its high-margin products amid China's tightening scrutiny on asset management products and the company's concentration in the strained property sector. The negative outlook reflects our view that HFIG's weakening competitive position, together with a slow property market, could erode its profitability or drive the group to undertake leveraged growth over the next one to two years.
- We published several commentaries and bulletins, including:
    - EMEA Financial Institutions Monitor 1Q2024: Banks Adapt To The Increased Economic Turbulence
    - European Consumer Finance: New Economic Reality Is A Litmus Test For Business Models
    - Top Nordic Banks Cut Costs As Revenue Growth Flattens
    - Downside Risks Abound For Financing Companies In 2024
    - An Update On Securities Firm Anchors By Country (February 2024)
    - Japan Mortgage Rate Hikes: Dual Incomes, Sturdy Standards Curb Risks
    - India Banks' Deposits Conundrum: Growth Versus Profitability
    - Credit FAQ: How We Assess Stablecoins And Why It Matters
    - Ongoing Vigilance Is Key To Gulf Banks' Cyber Risk Resilience
    - Central Asia And The Caucasus Banking Sector Outlook 2024: The Region Withstands Geopolitical Risks
    - Bulletin: Commonwealth Bank of Australia's Credit Losses Should Remain Low

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  - Bulletin: AMP Bank Supports Group Credit Profile Despite Margin Pressure
  - Bulletin: Dutch Banks' Net Interest Income Has Likely Peaked
  - Bulletin: Raiffeisen Bank International's Planned Exit From Belarus Reduces Reputational And Political Risks
  - Bulletin: Ameriabank's Possible Acquisition By Bank of Georgia Group Unlikely To Have An Impact On Its Operations
  - Bulletin: Saxo Bank To Boost Anti-Money-Laundering Framework After Financial Authorities' Check; Capital Impact Manageable
  - Bulletin: Intrum's Bond Buyback Plan Has Small Liquidity Impact

Structured Finance

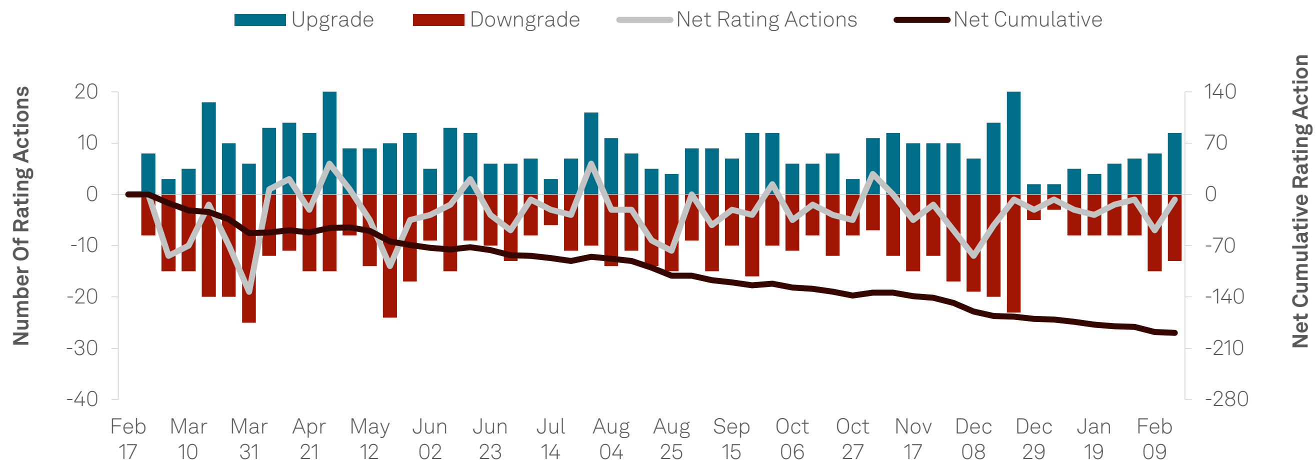
- **U.S. Structured Finance (SF):** See "U.S. Structured Finance Chart Book: February 2024" published Feb. 16, 2024.
- **U.S. CLO and Leveraged Finance:** S&P Global Ratings published its first-quarter 2024 slide deck highlighting key themes for the U.S. broadly syndicated loan (BSL) collateralized loan obligation (CLO) and leveraged finance sectors, "SLIDES: U.S. BSL CLO And Leveraged Finance Quarterly: Have We Turned The Corner Yet? (Q1 2024)," on Feb. 12, 2024.
- **U.S. SF Esoteric Sector:** S&P Global Ratings published its slide deck highlighting issuance trends and our outlook for the U.S. structured finance esoteric sector, "SLIDES: Structured Finance Esoteric Quarterly Roundup: Q1 2024," published Feb. 13, 2024.
- **U.S. Auto ABS:** Here are a few "Key Takeaways" from a recent article:
  - U.S. auto loan ABS issuance rose to a record $120 billion in 2023, led by a 13% increase in retail auto sales. We expect issuance to grow to $125 billion in 2024 due to banks' and credit unions' increased appetite for securitization.
  - Collateral performance deteriorated in 2023 with the prime and subprime segments reporting record high delinquencies and historically low recoveries, though vintage loss performance diverged. For the 2022 vintage, most prime issuers continued to report losses that were in line with historical levels (albeit higher than for the 2020-2021 pools, which benefited from COVID-19-related stimulus) while most subprime issuers recorded losses that exceeded 2016's levels.
  - Although credit metrics worsened, rating actions remained largely positive with 396 upgrades and six downgrades (all subprime). There would have been more downgrades and greater severity had certain issuers not supported their transactions with more credit enhancement.
  - We expect losses to continue rising this year based on recent metrics and growing consumer debt levels. Nonetheless, we also expect prime auto loan ABS ratings to be generally stable to positive, though the subprime segment is more exposed to downgrades given its greater deterioration and increased concentration of speculative-grade classes.

See "U.S. Auto Loan ABS Tracker: Full-Year And December 2023 Performance" published Feb. 13, 2024.

- **Australia RMBS:** Australian prime and nonconforming home loan arrears increased in December. That's according to S&P Global Ratings' recently published "RMBS Arrears Statistics: Australia." The Standard & Poor's Performance Index (SPIN) for Australian prime mortgages loans excluding noncapital market issuance increased to 0.97% in December from 0.91% in November. Most of this increase was in earlier arrears categories. Nonconforming arrears rose in percentage terms to 4.02% in December from 3.65% in November, some of this increase was due to a contraction in outstanding balances during the month.
- **Tender Option Bonds:** S&P Global Ratings published a slide deck recapping rated tender option bond (TOB) trust activity in 2023 as well as a review of our total rated portfolio, "SLIDES: Tender Option Bonds: 2023 Ratings Recap," published on Feb. 14, 2024.

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 Feb. 16, 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. $)
13-Feb	Upgrade	Siemens AG	Capital Goods	Germany	AA-	A+	45,621
15-Feb	Upgrade	Targa Resources Corp.	Utilities	U.S.	BBB	BBB-	20,550
14-Feb	Downgrade	Deutsche Pfandbriefbank AG	Bank	Germany	BBB-	BBB	7,712
14-Feb	Downgrade	Newell Brands Inc.	Consumer Products	U.S.	BB-	BB	6,560
13-Feb	Upgrade	Infineon Technologies AG	High Technology	Germany	BBB+	BBB	6,387
15-Feb	Downgrade	VF Corp.	Consumer Products	U.S.	BBB-	BBB	4,793
14-Feb	Downgrade	GoTo Group Inc.	High Technology	U.S.	SD	CCC+	3,000
12-Feb	Downgrade	Eutelsat Communications S.A.	Telecommunications	France	B	B+	2,804
14-Feb	Upgrade	Securitas AB	Consumer Products	Sweden	BBB	BBB-	2,368
12-Feb	Upgrade	Mattel Inc.	Media & Entertainment	U.S.	BBB	BBB-	2,350

Source: S&P Global Ratings Credit Research & Insights. Data as of Feb. 16, 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**.**