S&P Global Ratings

The Ratings View

September 4, 2024

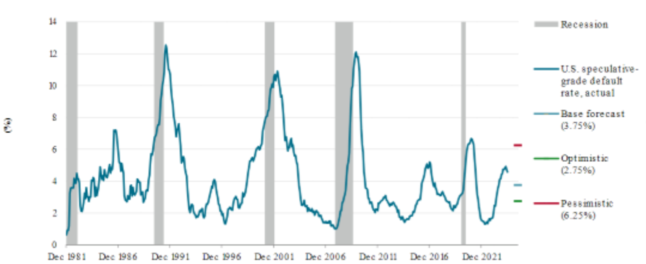
This report does not constitute a rating action.

Key Takeaways

- We expect the U.S. and European speculative-grade corporate default rates to decline modestly over the next 12 months.
- Global supply chains are shifting, although the change may be exaggerated. Tech hardware firms are entering the more difficult phase of their shift from China.
- A rising yen and volatile equity markets bring uncertainty to Japanese corporates.

We expect the U.S. trailing-12-month speculative-grade corporate default rate to fall slightly, to 3.75% by June 2025 from 4.8% in June 2024. Despite recent concerns about a slowdown and the market reaction to those concerns, we continue to think the default rate will decline over the next 12 months. Many supportive trends are in place: the very high level of refinancing and repricing activity is providing near-term liquidity relief, second-quarter earnings continue to be resilient, and consumer spending is holding up. However, the slow cooling of inflation and slow descent of interest rates remain challenges as we expect economic activity to weaken as part of a soft landing. The Federal Reserve's cautious approach to monetary policy may mean that rates will fall more slowly than they rose; similarly, we expect a decline in defaults that isn't as quick as the rise that we've seen in defaults since the start of 2023.

The U.S. speculative-grade default rate is expected to fall to 3.75% by June 2025



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

[Default, Transition, and Recovery: The U.S. Speculative-Grade Corporate Default Rate Will Continue Its Descent, Reaching 3.75% By June 2025]

We expect the European trailing-12-month speculative-grade corporate default rate to decline to 4.25% by June 2025 from 4.7% as of June 2024. This wave of refinancing activity in 2024 has helped reduce near-term liquidity pressure on many companies, but recent debt issuance has come with higher borrowing costs, which may linger for lower-rated fixed-rate borrowers. Recent market volatility has arguably shown that markets are more vulnerable than expected to negative unexpected events. If there were an economic downturn, spreads may widen faster than in the past, cutting off liquidity when needed most and pushing defaults towards our pessimistic scenario of 6%.

[Default, Transition, and Recovery: The European Speculative-Grade Default Rate Will Level Out At 4.25% By June 2025]

The second phase of global tech hardware firms' shift out of China will be much more disruptive and costly than the largely complete first phase. In our view, this reordering of supply

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For latest Sector and Industry Research **Click Here** lines is happening in stages and the current focus on adding "midstream" tech production outside of China presents more credit risks than the prior stage, the expansion of downstream output outside the country. In adding capacity outside of China, entities will likely incur hefty capex, lost efficiency, and disrupted operations; we view these risks as more substantial for midstream producers, given the complexity of their production. More positively, a more geographically distributed production footprint would help tech firms manage geopolitical risks, including the loss of key supply lines, the emergence of punitive tariffs, or any other events stemming from U.S.-China tensions.

The Shifting Of China Tech Supply Chains: The Hard Part Starts

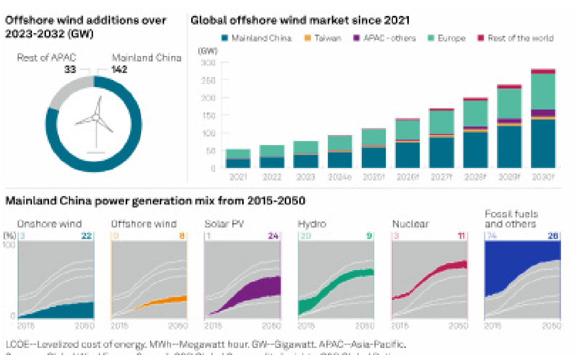
More broadly, geopolitical friction, trade barriers, and industrial policy are challenging Asia's dominant supply chains. However, our analysis shows the supposed shake-up is far less than headlines would suggest. China's share in global exports has held up even though it has declined in the U.S. Other Asian emerging markets and Mexico have made modest gains at the expense of Asia's developed economies. Meanwhile, as foreign direct investment (FDI) into China seems to have plunged, Asian EMs and Mexico have generally not seen significant increases. Global supply chains will continue to evolve. But we think China's role in global exports won't diminish drastically and most other Asian EMs won't be major net winners of relocation from China.

Economic Research: Slow-Motion Shakeup? Asia's Role In Global Supply Chains Is Slow To Change

For Japanese corporate entities, uncertainty is growing. The outlook for the operating performance of Japanese corporate entities for fiscal 2024 has been clouded by a number of factors. Over the summer, the Japanese yen appreciated sharply against the U.S. dollar. The Japanese stock market has also experienced significant volatility over the past couple of months. Having said that, the impact on the creditworthiness for Japanese corporate companies we rate will be limited for the time being. These corporations are breaking performance records and of sound financial standing.

Credit FAQ: Japanese Corporations And Market Mayhem

Offshore wind will likely rise to become a key contributor to decarbonization goals set by China and others in Asia-Pacific. China will keep its lead even as subsidies fade. This is because of favorable funding, geography, demand and improving technology. State-owned independent power producers dominate the country's offshore wind market, which underpins funding stability for projects. Nonetheless, China and other Asia-Pacific markets with ambitious offshore-wind targets face obstacles and execution risks. In Taiwan, for example, a localization requirement makes it harder to procure cheaper turbines. And in our view, Vietnam's current grid infrastructure and tariff policies could limit investments.



LCOE--Levelized cost of energy. MWh--Megawatt hour. GW--Gigawatt. APAC--Asia-Pacific.
Sources: Global Wind Energy Council, S&P Global Commodity Insights, S&P Global Ratings.

Sustainability Insights: Power Sector Update: China Will Keep Its Lead In Global Offshore Wind Additions

Asset Class Highlights

Corporates

Notable publications include:

- Credit FAQ: Japanese Corporations And Market Mayhem
- Diverging Consumers And Slowing Demand Test Corporate Australia
- Indian Cement Makers To Spend US$14.3 Billion To Meet Surging Demand
- The Shifting Of China Tech Supply Chains: The Hard Part Starts
- New Zealand Corporate Landscape: Navigating A Sluggish Economic Recovery
- Sector Review: Taiwan Credit Spotlight Update: Top 50 Corporates – Commodities Sector
- Sector Review: Taiwan Credit Spotlight Update: Top 50 Corporates – Consumer & Services Sector
- Sector Review: Taiwan Credit Spotlight Update: Top 50 Corporates: Recovery Paths Could Diverge For Tech/Non-Tech Sub-Sectors
- Working Capital Unlocked: $102 Billion Of Supplier Finance Brings Risks And Benefits For U.S. Companies

Financial Institutions

Over the past weeks, we took several rating actions and published some bulletins:

- Research Update: National Bank of Canada Upgraded To 'A+' From 'A' On Revised View Of Systemic Importance; Outlook Stable
- Research Update: Apollo Asset Management Inc. Management And Governance Assessment Revised To Positive; 'A' Rating Affirmed
- Research Update: Netherlands-Based De Volksbank Outlook Revised To Negative After Second Administrative Fine Procedure; Ratings Affirmed
- Research Update: Commerzbank AG Ratings Raised To 'A/A-1' On Strengthened Performance And Capitalization; Outlook Stable
- Research Update: Cyprus-Based Ronin Europe Ltd. Upgraded To 'BB-/B' On Continued Risk Reduction In Investment Portfolio; Outlook Stable
- Bulletin: Toronto-Dominion Bank's US$2.6 Billion Provision Highlights The Severity Of Its Anti-Money Laundering Compliance Issues
- Bulletin: The Bank of Nova Scotia's Plan To Acquire Equity Interest In KeyCorp Advances U.S. Growth Strategy
- Bulletin: Deutsche Pfandbriefbank Continues To Navigate Difficult Commercial Real Estate Markets
- Bulletin: The Bank of East Asia Will Keep Tackling Commercial Real Estate Risks
- Bulletin: BNPP's Acquisition Of AXA Investment Managers To Boost Its Asset Management Activities

We published several commentaries including:

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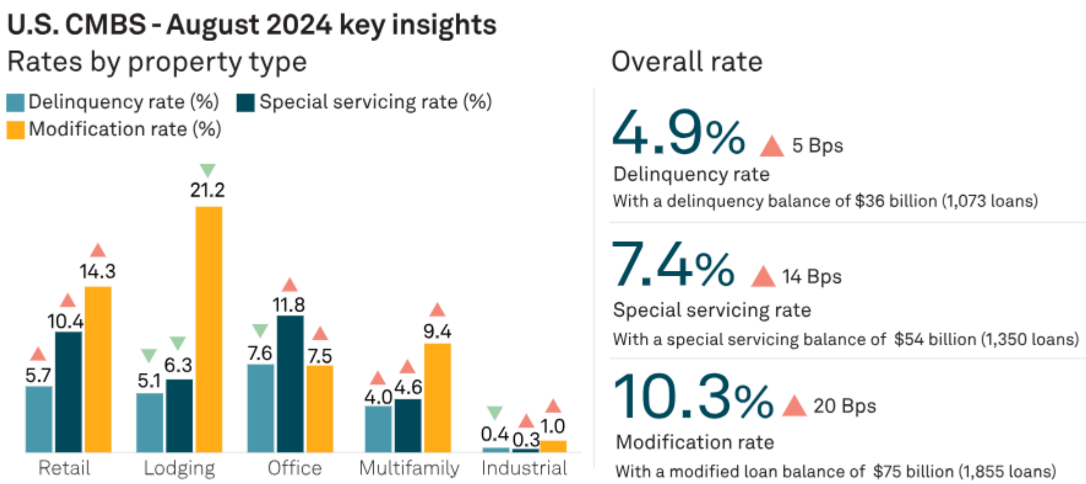
- U.S. GSIBs Q2 2024 Update: Well Positioned For Lower Rates
- U.S. Banks Webinar Q3 2024 Slides: What's Next As Rate Cuts Loom?
- U.S. Securities Firms Midyear 2024 Outlook: Ratings largely stable despite potential risks
- Credit FAQ: How Basel III Reforms Are Affecting Canadian Domestic Systemically Important Banks' Capital Ratios
- Asia-Pacific Financial Institutions Monitor 3Q 2024: A Choppier Ride For The Rest Of The Year
- Asia-Pacific Banking Country Snapshots: A Choppier Ride For The Rest Of The Year
- Australian Mutual Lenders: The Magic Number Could Be Less Than 10
- Japan Banks Primed For Market Turbulence
- U.K. Banks Are Well Positioned For Sustained Strong Performance After First-Half Results

Sovereign

- Montenegro Upgraded To 'B+' On Stronger External And Fiscal Positions; Outlook Stable

Structured Finance

- **U.S. CMBS:**



Note: Arrows indicate directional change in rate compared to the previous month. Bps—Basis points.
Source: S&P Global Ratings.

  - See "SF Credit Brief: U.S. CMBS Delinquency Rate Rose 5 Bps To 4.9% In August 2024; Office Loans Maintain The Highest Rate" published Aug. 29, 2024.

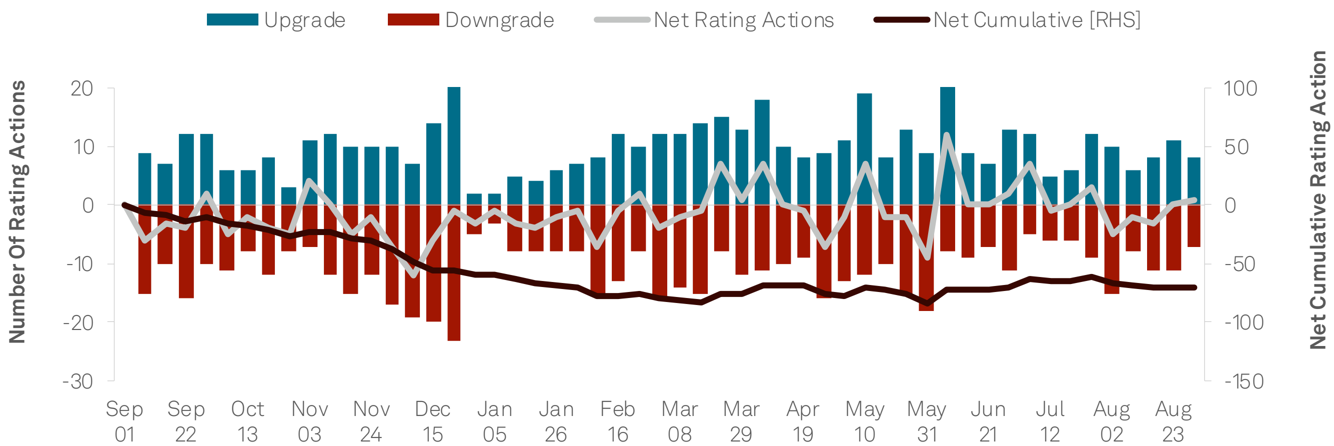
- **European Covered Bonds:** Here are a few "Key Takeaways" from a recent article:
  - Europe's ongoing commercial real estate (CRE) valuations correction is increasing credit risk, particularly for the office and retail sectors. Covered bonds have remained resilient to this risk, although a few issuers face challenging funding conditions.
  - Covered bond programs' CRE exposure varies significantly between and within countries. German issuers have the highest exposure to CRE (office and retail assets), followed by issuers in Austria, Denmark, and Spain.

  - Overall bank exposure remains manageable and available overcollateralization continues to shield investors from credit deterioration. In our view, highly concentrated cover pools are most at risk of a further deterioration in CRE valuations.
  - The article is titled "European Covered Bonds Resist Commercial Real Estate Jitters" and published on Aug. 27, 2024.

- **U.S. Credit Card ABS:** We published the "U.S. Credit Card Quality Index: Monthly Performance--July 2024" on Aug. 30, 2024. The CCQI is a monthly performance index that aggregates performance information of securitized credit card receivables in key risk areas.
- **China ABS and RMBS:** S&P Global Ratings published on August 28, 2024 its "China Securitization: ABS And RMBS Tracker July 2024." Highlights from the chartbook, which tracks the performance of China asset-backed securities (ABS) and residential mortgage-backed securities (RMBS) that we rate, include the following:
  - Coupon rates on the most senior tranches of auto ABS continue trending down following a declining Shanghai Interbank Offered Rate (SHIBOR). The average coupon for the senior-most tranches of ABS issuances remained under 2% in July 2024.
  - Severe delinquency ratios increased for auto loan ABS that we rate, mainly due to rising arrears of deals with distinct pool attributes.
  - Cumulative delinquency rates of RMBS transactions that we rate decreased because of the paydown of rated transactions with high delinquency rates. We expect the strong credit enhancement available to maintain the stability of our RMBS ratings.
  - Consumer loan ABS had higher and more volatile delinquency rates compared with auto loan ABS. The utilization of excess spreads and high credit enhancement available provided rating stability for rated notes in the observed transactions.
- **Australian and New Zealand ABS:** Arrears levels increased for most Australian and New Zealand asset-backed securities (ABS) transactions during the second quarter (Q2) of 2024. That's according to the recent edition of S&P Global Ratings' "ABS Performance Watch: Australia And New Zealand." Although arrears increased, cumulative losses experienced to date remain relatively low and, by and large, there has been a buildup of credit support for rated notes. We believe this would provide a buffer for transactions should there be any deterioration in performance.

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 Aug. 30, 2024. 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. $)
26-Aug	Upgrade	National Bank of Canada	Bank	Canada	A+	A	23,085
26-Aug	Downgrade	Gray Television Inc.	Media & entertainment	U.S.	B	B+	6,625
26-Aug	Downgrade	Magenta Buyer LLC	High technology	U.S.	SD	CCC	4,340
26-Aug	Upgrade	Select Medical Corp.	Health care	U.S.	BB-	B+	3,328
27-Aug	Upgrade	Tempo Acquisition LLC	Media & entertainment	U.S.	BB-	B+	2,970
30-Aug	Upgrade	Montenegro	Sovereign	Montenegro	B+	B	2,698
28-Aug	Downgrade	PECF USS Intermediate Holding III Corp.	Chemicals, packaging & environmental services	U.S.	D	CCC	2,550
29-Aug	Upgrade	Cimpress plc	Media & entertainment	Ireland	BB-	B+	1,730
28-Aug	Downgrade	Optiv Inc.	High technology	U.S.	CCC+	B-	910
27-Aug	Upgrade	Tecta America Corp.	Consumer products	U.S.	B+	B	825

Source: S&P Global Ratings Credit Research & Insights. Data as of Aug. 30, 2024. 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**.**