

## Credit Conditions Europe:

# The Lowdown On Lockdowns

April 27, 2020

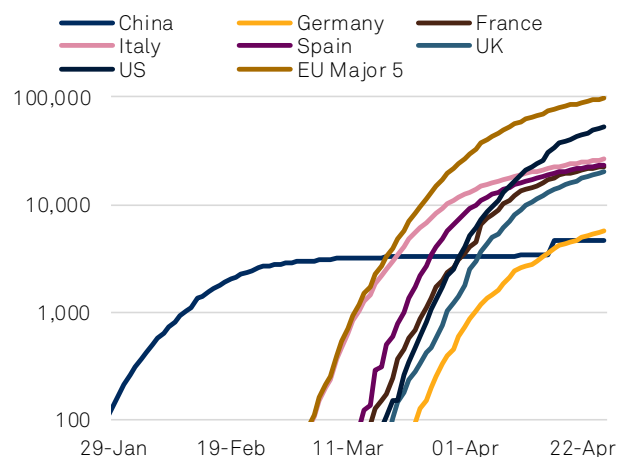
(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions (Asia-Pacific, Emerging Markets, North America, and Europe). Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the European committee on April 21, 2020. Please see "[Global Credit Conditions, Rising Credit Pressures Amid Deeper Recession, Uncertain Recovery Path](#)," published April 22, 2020, for a comprehensive view of credit conditions globally.)

### Key Takeaways

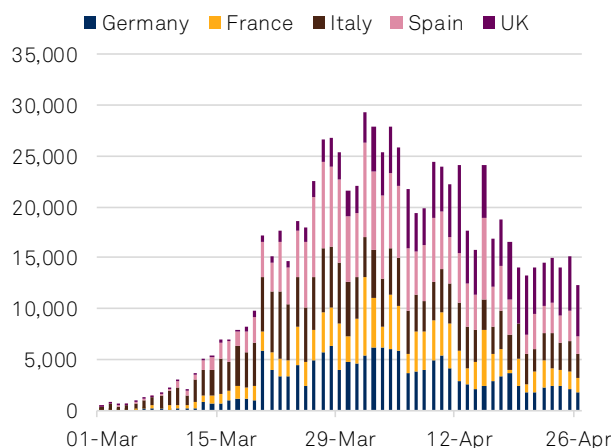
- **Overall:** Extended lockdowns, a slower pace of normalization, and key trading partners embroiled in the same predicament have all contributed to a very sharp downward revision to European economic growth for 2020. We expect a deeper two-quarter recession in the eurozone with full-year growth falling by 7.3%.
- **Risks:** Top risks remain the pandemic not being contained despite all efforts, a scarcity of financing for indebted corporate borrowers, the re-emergence of global trade tensions including between the EU and U.K., and asymmetric fiscal costs from the pandemic placing renewed pressure on the EU's cohesion.
- **Credit:** While emergency measures by the authorities to provide short-term funding support for businesses and households are important, they do not drive improvement in business conditions or financial risk profiles that are typically the main drivers for credit performance. Wealthy, diversified sovereigns with reserve currencies should be able to rely upon negative real refinancing costs to weather the initial fiscal shock. Longer-term damage in their ability to create wealth would see creditworthiness suffer.

What started as a health scare in China is at risk of becoming a financial crisis in Europe. The region has the misfortune of having the highest death toll of any continent in the world (see chart 1), and governments have responded by freezing all nonessential social interactions in their economies. This is proving effective in curtailing the spread of infection (see chart 2). However, the economic costs appear much higher than initially thought. What's more, the path to normalization is fraught with uncertainty, risks, and challenges.

**Chart 1**  
Europe Hardest Hit Region (Cumulative COVID-19-Related Deaths)



**Chart 2**  
COVID-19 Daily Confirmed Cases Falling In Europe



Source: ECDC. Data as of April 26, 2020

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# Top European Risks

Table 1

## Top European Risks

### Economic costs mount without a COVID-19 vaccine

**Risk level\*** Very low Moderate Elevated High **Very high** **Risk trend\*\*** Improving **Unchanged** Worsening

Despite the sharp downward revision to our 2020 global and European growth forecasts, the uncertainties attached to the strength and shape of the recovery in 2021 remain significant. In large part, this reflects the severity of the disease and the risks involved in normalizing social interactions until antibody testing and a vaccine become widely available. But it also reflects growing concerns about how long it could take for (tangible and intangible) barriers to trade to be removed (reopening external borders, for instance). Various adverse developments could extend the recession and weaken the recovery path more than we currently expect.

### Risk aversion affecting market liquidity

**Risk level\*** Very low Moderate Elevated **High** Very high **Risk trend\*\*** Improving Unchanged **Worsening**

The surge in financial market volatility following the twin shocks of the coronavirus pandemic and the oil price collapse has severely tightened financial market liquidity. While emergency central bank and government measures have reduced market volatility and enabled the (investment-grade) bond market to reopen, speculative-grade primary markets remain largely shuttered. This is proving problematic for speculative-grade issuers needing to raise additional funding or to refinance, particularly for companies unable to access new government-sponsored funding programs.

### Global trade tensions still cast a shadow over growth

**Risk level\*** Very low Moderate **Elevated** High Very high **Risk trend\*\*** Improving **Unchanged** Worsening

The path to recovery of the economy, reeling from the structural challenge to global supply chains arising from the pandemic, might be impaired further by any resurgence in global trade tensions. While existing trade tensions appear to have faded from view, they haven't disappeared. The phase 1 deal between the U.S. and China does not resolve the underlying structural issues relating to technology, intellectual property, and market access. Friction between the U.S. and Europe extends from digital sales and carbon border adjustment taxes to penalties applied in relation to state subsidies to Boeing and Airbus. And closer to home, negotiations between the U.K. and EU over their future trade relationship remain contentious, although because of the pandemic we now expect the parties to extend the transition by up to a year from December 2020.

### Public health emergency challenges EU's fiscal framework

**Risk level\*** Very low Moderate **Elevated** High Very high **Risk trend\*\*** Improving Unchanged Worsening

The pandemic is testing the EU's willingness to coordinate a large fiscal response to an unprecedented demand and supply shock that has plunged the region into recession. In particular, any undue delay in establishing the Recovery Fund would diminish the capacity of the monetary union to mount a proportionate and shared response to COVID-19. The lack of adequate fiscal solidarity among eurozone member states could erode market confidence, impair financing conditions, limit fiscal capacity for governments, and, in the longer term, place renewed pressure on EU cohesion, though the willingness and ability of the ECB to continue to backstop the fiscal response at the national level should not be understated.

Source: S&P Global Ratings.

\* **Risk levels** may be classified as very low, moderate, elevated, high, or very high. They 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 about whether the risk level could increase or decrease over the next 12 months.

## Regional Credit Conditions

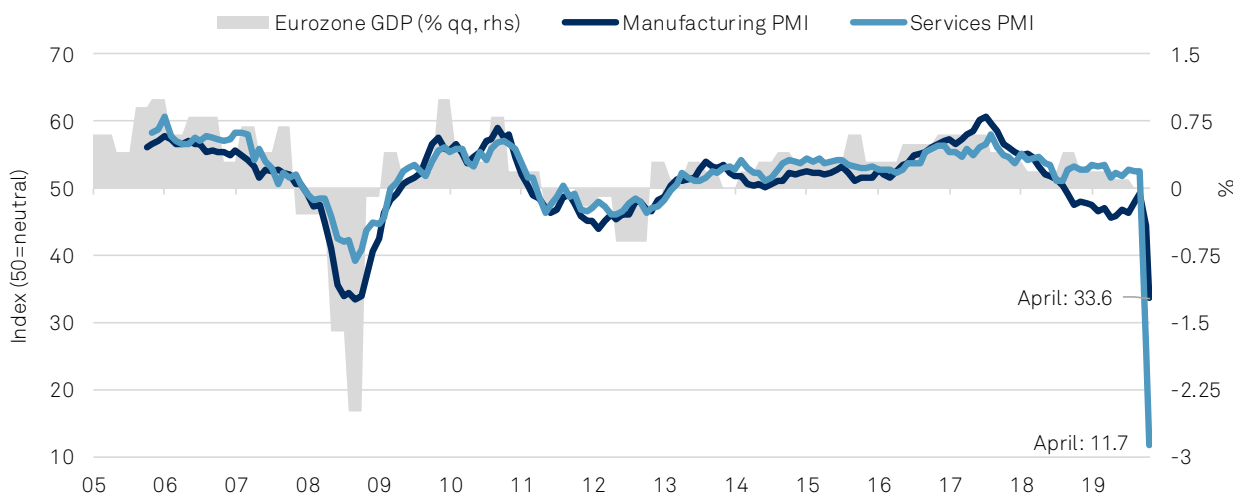
**Economic conditions.** We now expect the eurozone and U.K. to shrink by 7.3% and 6.5% this year before rebounding by 5.6% and 6% in 2021. This is on the back of stricter public health measures being taken across the world. We now assume eight weeks of lockdowns on average and only a gradual reopening, with social-distancing measures staying in place until a vaccine or effective treatment is found (perhaps by mid-2021). The external environment has worsened too, with the U.S. economy heading for a steeper recession (-5.2% in 2020) than expected a month ago.

Thus, economic activity is unlikely to stabilize by the end of the second quarter, and external EU borders might not fully reopen in time for the summer tourist season. Moreover, the lockdowns don't affect the economy in a linear way: The longer they last, the more they play into investment decisions, tear the economic fabric, and lower GDP prospects. We expect losses in potential output in capital accumulation and maybe even human capital, linked to lower investment and school closures. The long-term outlook for productivity is quite uncertain, but overall we expect the eurozone and U.K. economy to be roughly 1.4% smaller by 2023 than before the pandemic erupted.

Services-led, especially tourism-dependent, economies are set to suffer more (see chart 3), as well as those where lockdowns are more restrictive. By contrast, bigger fiscal support through credit and job guarantees should lead to a swifter recovery. To date, Germany has unveiled the biggest fiscal bazooka: Contingent liabilities and the direct fiscal costs amount to more than 30% of GDP, compared with just around 8% for Spain. While partial unemployment schemes are likely to limit the rise in unemployment, they will be less effective at keeping lower-skilled and temporary workers in a job, leading to steeper rises in unemployment in places like Spain. We expect the eurozone unemployment rate to rise to 8.6% this year from 7.6% in 2019.

Chart 3

### Eurozone Services PMI Plummets Way Below Financial Crisis Levels in April



Source: Refinitiv

Monetary policy has loosened further in the past month. In addition to close to €870 billion in announced asset purchases, the European Central Bank has also loosened its collateral standards, enlarging the universe of assets banks can use to refinance themselves. Meanwhile, EU leaders have agreed on a three-layer safety net for workers, companies, and member states, with €100 billion from the European Commission to support national short-time work schemes; €200 billion from the European Investment Bank to guarantee lending to small-and-midsize enterprises that are particularly hit by the lockdowns; and up to €240 billion (limited to 2% of GDP for each country) in credit lines from the European Stability Mechanism for EU countries to finance healthcare expenditures linked to COVID-19.

Nonetheless, we still see mainly downsides to our forecast. The pandemic could evolve differently than we currently assume and could involve longer lockdowns or interruptions in loosening social-distancing measures. Financing conditions could also worsen, which might cause more companies to default and jeopardize the recovery. The external environment could weaken as well if the

economic impact of the pandemic is more pronounced in the U.S. or Asia, Europe's main trading partners. On the upside, an enhanced fiscal response at the EU level would provide a positive signal for the cohesion of the eurozone and help speed up the economic recovery.

**Financing conditions.** With a substantial portion of the European economy hitting the lockdown wall, many business payments and contracts are being withheld, postponed, or not honoured at all. Unsurprisingly, companies are scrambling to shore up liquidity by cutting variable and fixed costs and aggressively managing working capital. Discretionary spending, including capital expenditure to fund growth, buybacks, and dividends, are being scaled back sharply.

The authorities have rolled out emergency measures to bridge short-term liquidity problems, hoping to avoid a surge in insolvencies and unemployment. And the fiscal programs are enormous, ranging from 8% of GDP in Spain to 32% of GDP in Germany, and delivered in the form of grants, loan guarantees, deferred tax arrangements, as well as worker subsidy packages.

Together with the rapid infusion of liquidity by major central banks to ensure functioning of markets and the dialing down of macroprudential measures to free up banks' balance sheets, financial markets have found their footing. Companies have wasted no time in prudently boosting liquidity to bridge to a recovery that we expect to build strength gradually--once lockdowns ease.

However, the challenges to creditworthiness remain formidable on many levels. Fundamentally, the emergency measures, while bolstering liquidity, do not drive improvements in business conditions or financial risk profiles. Primarily, that is reliant on the infection rates remaining below 1.0 and a loosening of lockdowns. Secondly, these programs by their nature are not able to support all businesses. Where governments are not assuming 100% of the risk, banks are continuing to scrutinize credit applications carefully, which is difficult given the lack of near-term earnings visibility in many cases. And gaps remain, particularly for those businesses unable to demonstrate that they were fundamentally sound prior to the health emergency. This includes many speculative-grade credits with unsustainable capital structures, especially those that struggled to generate positive free operating cash flow even before the pandemic. And thirdly, those companies taking on more debt on a net basis will need to pay that back, usually within one or two years. That is likely to be more difficult for many, with growth set to resume from a lower base when companies get back to business.

Overall, we anticipate that the default risk for lowly rated companies has risen to recessionary levels. Distressed exchanges may be more frequent in the near term, given the combination of adequate liquidity and the prospect of a few months of very severe weakness in operating performance. But once the recovery starts, more companies may find themselves unable to finance the additional working capital required to expand the business without restructuring their balance sheets. Consequently, we expect the 12-month speculative-grade default rate (including distressed exchanges) to rise to 8% in Europe over the next year from 2.5% at the end of February 2020.

## Sector Trends

Following the exceptional collision of external shocks in the last two months – COVID-19, the oil price collapse, and the nosedive in the price of financial risk assets – we have taken negative rating actions on 24% of the EMEA region's corporate and sovereign ratings as of April 22. Of these, 69% relate to speculative-grade entities. This breaks down into 49% downgrades, 13% CreditWatch negative placements, and 40% revisions of the outlook to negative.

Chart 4

EMEA COVID-19 And Oil-Related Rating Actions

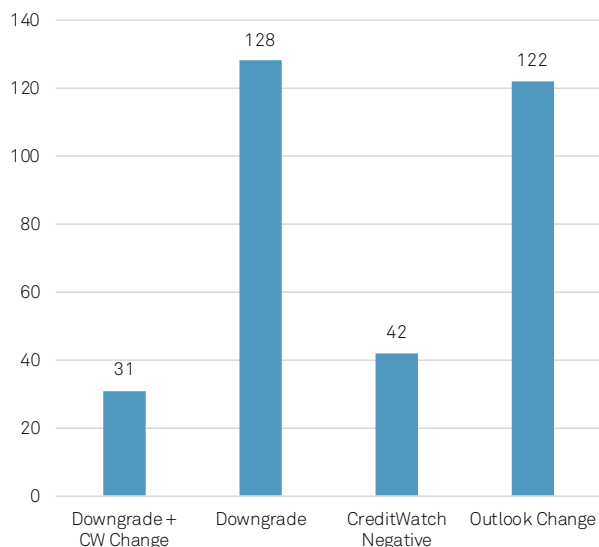
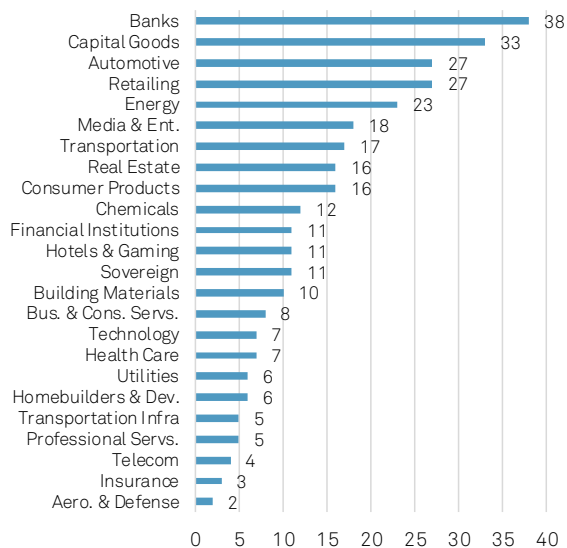


Chart 5

EMEA COVID-19 And Oil-Related Rating Actions By Sector



Note: These 323 rating actions pertain to ratings where we mention COVID-19 or oil prices as factors or in combination with others.

Source: S&P Global Ratings.

### Sovereign

The ultimate fallout from a severe and synchronized global recession on sovereign creditworthiness in advanced economies will depend on the shape and trajectory of the recovery. Wealthy, diversified economies with reserve currencies backed by quickly expanding central bank balance sheets should be able to rely upon negative real refinancing costs to weather the initial shock. However, should there be long-term damage to economies' ability to create wealth and therefore to government revenues, sovereign creditworthiness will suffer. The cost of "shock and awe" fiscal packages at the national level has been large increases in public debt, averaging about 20 percentage point of GDP in the eurozone. However, we do not expect the nominal cost of servicing that debt to increase. Other economic variables—external indicators and private debt stocks matter just as much or even more than the size of government debt to GDP in our determination of an economy's resilience. Fortunately, most European economies—including Italy, Portugal, and Spain--entered the current recession with considerably less private-sector debt (though rather more public debt) than in the run-up to the global financial crisis. Nevertheless, should the shock be longer and deeper than we currently project, ratings will change. Europe includes some of the world's largest net exporters of tourism services, which is a labor-intensive sector that may require more than a single year to return to 2019 levels. Rising unemployment could perpetuate the economic downturn.

Of course, the purpose of the massive fiscal packages being rolled out across the OECD is to limit job shedding and to prevent viable taxpayers from insolvency. If governments manage that, then they should be able to preserve their tax bases. In exchange, public authorities, starting in 2021, will ask the private sector to pay more tax and not only tax on flows (that is, GDP) but on wealth (savings and assets). Will steps to tax wealth lead to capital flight or political instability? That is not our core assumption, but it is certainly a risk.

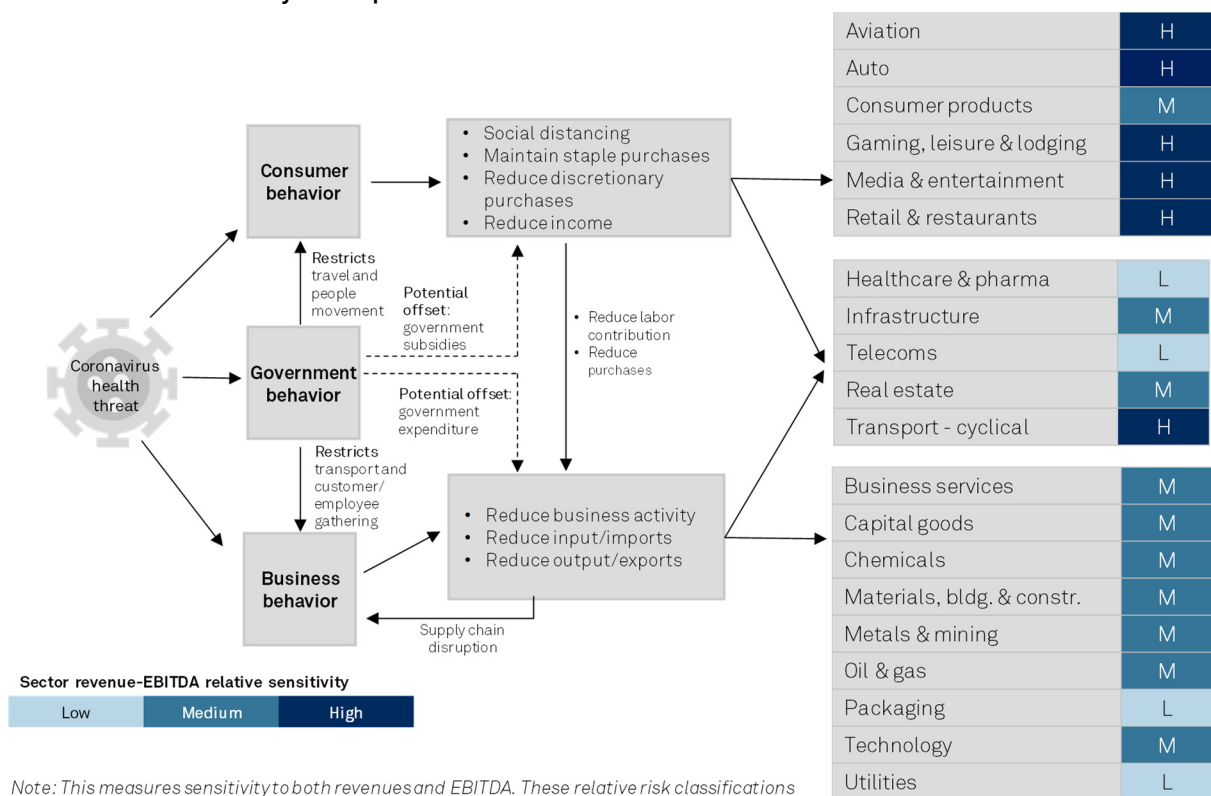
Emerging markets, with narrower economies, shallower domestic markets, and frequently high levels of foreign currency debt lack the same monetary firepower to deal with shocks from the pandemic and a global recession.

Since March 1, S&P Global Ratings has not changed any ratings on the 36 member countries of the OECD, with the exception of Mexico, though we have revised several outlooks. In contrast, we have lowered the ratings on five oil producers, Angola, Cameroon, Nigeria, Oman, and Kuwait, as well as on Botswana (the highest rated government in Africa) and Lebanon (to SD (selective default); before raising it back up to 'CC' on April 23).

## Nonfinancial Corporates

Negative rating actions have varied greatly across nonfinancial corporate sectors (see chart 5 above and chart 6), largely reflecting the direct effects of lockdowns on consumer discretionary activities and the knock-on effects of supply chain disruptions and the uncertain economic outlook. The oil shock has its own repercussions for upstream and downstream oil and gas companies.

Chart 6  
**COVID-19 Sector Sensitivity in Europe**



Note: This measures sensitivity to both revenues and EBITDA. These relative risk classifications are based on our analytical teams' qualitative opinions and do not indicate any potential rating trend or actions. Source: S&P Global Ratings

Source: S&P Global Ratings

From a business and credit perspective, now we see a two-stage transition that companies will have to navigate. Although inevitably, given the uncertainty of dealing with a highly infectious global pandemic, there will be setbacks along the way.

- **The first stage: survival.** What measures do businesses, households, and governments need to adopt to protect the population and the social fabric?

Business is in the front line, and companies have responded aggressively to bolster liquidity by cutting variable costs, discretionary expenditure (capital spending, dividends, share buybacks, management incentive schemes, and in some cases defined benefit pension contributions) and fixed costs wherever possible (furloughing staff and, controversially, deferring rent in some sectors). Many have also drawn down their committed facilities and are working on arranging new loans or extending existing loans for precautionary purposes.

European governments have announced a series of emergency measures to prevent businesses from becoming insolvent and unemployment from soaring. The scale is significant but, as ever, the devil is in the details. As time is of the essence, the trick is rolling out these schemes to those in critical need while minimizing the risk of moral hazard. In other words, balancing the need to protect the economy while not burdening taxpayers by granting excessive support to businesses that are overleveraged or do not have viable business prospects over the longer term.

**The second stage: getting back to business.** In our view, the issue is how companies can return to normal social interaction without risking renewed coronavirus outbreaks. We think that will happen slowly until a vaccine or some other treatment is widely available. In consequence, we are assuming that full recovery in sectors most affected by social distancing may take 12-18 months,

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and some, such as airlines and airports, may be scarred for longer if consumer and business travelling patterns change.

On the industrial side, we anticipate that a recovery can proceed more quickly than in services, although its strength will be determined largely by underlying demand in the relevant sector. The capital goods sector is a good bellwether. Here, we will be watching for signs that new equipment sales are starting to pick up once excess capacity has been absorbed. At the same time, we still see certain segments holding up quite well including infrastructure projects in their various forms, as well as health care and agriculture, and activity appears to be picking up again in China.

An overarching credit concern continues to be for speculative-grade issuers, which have less financial flexibility, less of an ability to withstand macroeconomic stresses, and difficulty in accessing funding channels--whether from the capital markets, markets, or government emergency funding programs.

Chart 7

### European Public Speculative-Grade NFC\* Rating Distribution

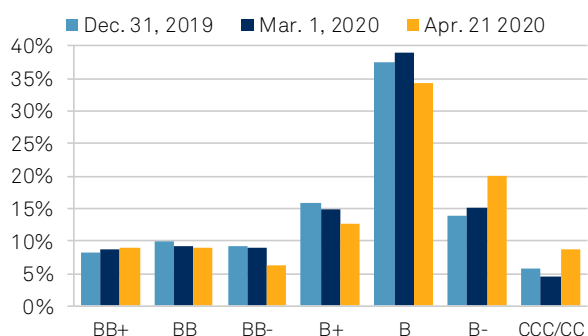
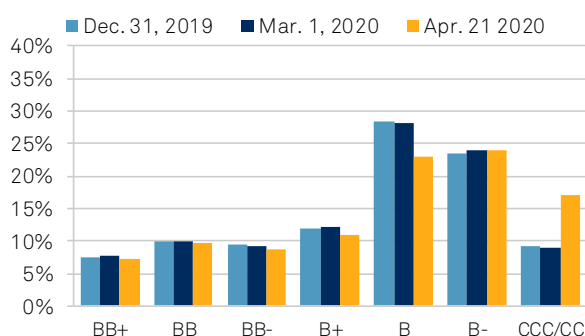


Chart 8

### U.S. Public Speculative-Grade NFC\* Rating Distribution



\* NFC—nonfinancial corporate (excluding infrastructure and project finance). Source: S&P Global Ratings.

For these reasons, speculative-grade companies in the 'B' rating category are seeing increased negative rating actions that we expect to translate into an 8% default rate in Europe over the next nine to 12 months. The proportion of publicly rated speculative-grade credits in Europe rated 'B-' or 'CCC' has risen sharply to 28.8% from 19.4% since the beginning of March (see chart 7). This is a sharper rise, albeit from a lower level, than the equivalent increase to 40.8% from 32.8% in the U.S. market (see chart 8). For just issuers 'CC' or 'CCC', the proportion now amounts to 8.7% in Europe and 17% in the U.S.

The deterioration in credit quality, and any rise in the default rate, have potential implications for collateralized loan obligations (CLO) and ratings of CLO liabilities. In particular, 'CCC' holdings by individual CLOs in excess of 7.5% of assets are typically carried at lower than par value in transactions' coverage tests. So a significant buildup of 'CCC' rated assets could lead to failure of the junior overcollateralization test that may cause the CLO to pay down its liabilities and delever until compliance with the test was restored.

The default experience is also important. A recent scenario analysis we completed on a typical European CLO structure<sup>1</sup> showed that a 5% default rate in its underlying loan portfolio could lead to liability downgrades, ranging in severity from a one-notch downgrades for the 'A' and 'BBB' rated tranches, to a two-notch downgrade for the 'BB-' rated tranche, with no rating change for the 'AAA' and 'AA' rated tranches. In comparison, a 10% default rate in the CLO's underlying loan portfolio could lead to liability downgrades, ranging in severity from one notch on the senior ('AAA' rated) notes to three notches or more further down the capital structure (for example, on the notes rated 'BB-').

CLO strains also loop back to the current freeze within primary loan markets with CLO funds, typically the largest investors in primary loan issuance -- now effectively on the sidelines -- and their return as a meaningful force likely depends upon the duration and depth of the downturn.

<sup>1</sup> Scenario Analysis: How Credit Distress Due To COVID-19 Could Affect European CLO Ratings, April 2, 2020

## Banks

While we expect banks across Europe to remain resilient to the economic shock due to measures to combat the coronavirus, asset quality, revenue, profitability, and, potentially, capitalization are likely to take a substantial hit. We expect very few of these negative trends to be strongly evident in banks' first-quarter results, but become increasingly apparent in subsequent quarters, with profitability potentially halving compared to 2019 and weakness persisting into 2021. Banks' asset quality will be key to this outcome.

Overall, we foresee lower revenues and hikes in credit provisions, the latter in spite of significant government support packages. For example, we expect systemwide domestic loan losses to be a key indicator of the evolution of the negative trend that we now assign to economic risk as part of our U.K. banking industry country risk assessment (BICRA). Specifically, we estimate that the domestic loan loss rate could rise to 100 basis points (bps) in 2020, which would be around five times the level we have observed in each of the past six years. In 2021, on the back of the recovery, we assume that the systemwide loss rate would fall to around 67 bps, which we judge to be closer to, but still slightly above, the long-run U.K. average.

Even under our latest economic base case, the policy responses taken by countries across Europe may be less than totally successful in avoiding permanent economic damage. A significant component of these fiscal support packages comprises additional indebtedness--for the sovereign, some households, and many businesses. And at best, the easing of social distancing will not start for some weeks in some countries, is likely to be slow, and could be subject to setbacks. The longer the delay in the recovery of economic activity, the less sustainable this extra debt will be.

## Structured Finance

Areas linked to corporate credit (for example, corporate securitizations, CLOs, and commercial mortgage-backed securities) appear most at risk, given direct exposures to industry sectors that have seen the greatest disruption from virus-related lockdown policies. By contrast, asset classes backed by lending to consumers (for example, residential mortgage-backed securities, covered bonds, and most asset-backed securities) could be better insulated. Most transactions contain structural mechanisms that should allow them to weather short-term cash flow disruptions due to underlying borrowers taking payment holidays, although junior notes in some transactions may come under ratings pressure if the economic recovery is materially delayed.

## Insurance

Insurers' balance sheets are likely to see impairments on invested assets, but for most insurers this will generally not be a capital event. We believe the insurance exposure impact for Europe's primary insurers is limited, whilst some industrial lines insurers and re-insurers are likely to report some insurance claims. For European life insurers, low interest rates remain a key risk to ratings as investment margins in traditional life insurance are compressed further.

## International Public Finance

**European LRGs:** Many, especially those subject to mandated lockdowns, will record weaker budgetary performance due to lower tax revenues and higher spending, predominantly in health and social care and public transportation, while maintenance and capital spending may be delayed. The credit implications depend on the duration and severity of the economic disruption.

**English universities:** We expect financial performance to suffer if significantly fewer international students enroll for the academic year starting in September 2020.

**Public transport:** Global operators face a significant reduction in passenger volumes. The negative outlook on Transport for London indicates our view that its financial profile is stretching, leading to declining cash balances at a time of heightened risks as a result of economic uncertainty and delivery of large capital projects.

See Appendix 1 for more information on how we view the credit outlook across the sectors and practices that we rate in Europe.



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. As the situation evolves, we will update our assumptions and estimates accordingly.

[“Coronavirus Impact: Key Takeaways From Our Articles”](#) summarizes our latest research related to COVID-19.

This report does not constitute a rating action.

## Appendix 1: COVID-19 Impact On European Sectors

Table 2

COVID-19 Impact on European Sectors (for analytical contacts, please see Appendix 3)

| By Sector           | Impact*                           | Comment  |
|---------------------|-----------------------------------|--|
| Aerospace & Defense | Defense – Low<br>Aerospace-Medium | <p>The impact of COVID-19 on the defense sector has been low thus far, and conditions in the sector are stable to negative. Prime and tier 1 defense companies tend to benefit from large multiyear contracts with governments and defense departments. In almost all countries, defense-related manufacturing has been classified as essential.</p> <p>On the other hand, Aerospace has been hit harder. Airlines are seeking to defer accepting delivery of new planes or are cancelling orders where able, which will affect airplane makers' delivery and production rates into 2021. While the immediate impact on the majority of rated companies in the supply chain has been limited so far, as liquidity remains good and leverage relatively low, cuts in production rates by Airbus and Boeing will likely result in negative credit developments.</p>  |
| Autos               | High                              | <p>We expect automakers to experience a severe decline in global light vehicle sales of almost 15% in 2020 to less than 80 million units. In Europe and the U.S., we forecast a 15%-20% drop, with a smaller impact in China, down 8%-10%.</p> <p>We expect this sales scenario to lead to intense credit pressures ahead, and that potential government stimulus packages and central bank actions to facilitate access to funding will only offer only partial relief.</p>   |
| Building Materials  | Medium                            | <p>We expect the industry to experience significant disruption. Due to temporary shutdowns, many European construction projects are paused or slowed. Weak business and consumer confidence is further weighing on consumption of building materials, notably in commercial and residential building construction. For most rated companies, this means a revenue decline at least in the low double-digits. Companies with ratings in the 'B' category are most exposed because they entered the period with increased financial leverage following refinancings in 2018 and 2019. Companies in the investment-grade category typically display stronger balance sheets, driven by positive results in 2019, but are not immune and may need to quickly adapt their financial policy. Lessening our concerns about the sector, public infrastructure works may support a quick recovery, given current solid backlog.</p>   |
| Capital Goods       | Medium                            | <p>We expect a significant negative impact due to reduced orders, lower production volumes, and delivery postponements, with gradual recovery over the following two years. The impact will be more pronounced for issuers whose businesses rely on new equipment sales, which will remain depressed across multiple industrial end markets as until excess capacity is absorbed. Issuers with exposure to autos, commodities (especially oil &amp; gas), and aerospace are at largest risk of negative rating actions. Additionally, project-related businesses will be at risk due to negative working capital movement.</p> <p>The main ratings impact has been to companies with speculative-grade ratings, particularly at the lower end, where we expect the combination of less stable operational performance, high leverage, and limited liquidity sources to trigger further negative rating actions. Provided that lockdowns are contained to about eight weeks on average and followed by a gradual reopening, we expect to see little movement in the higher investment-grade category comprising industry majors. In most cases, we observed solid ratings headroom before the pandemic and currently forecast a comfortable level of liquidity.</p> |
| Chemicals           | Medium                            | <p>Downside for the ratings is most visible for companies in the 'B' category, but investment-grade issuers are not protected, notably those whose rating headroom was already low before the pandemic. While the impact for commodity and specialty chemicals varies depending on end market and geographical exposure, the profitability</p>   |

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|                              |        |   |
|------------------------------|--------|---|
|                              |        | of fertilizer issuers should remain steady, driven by the demand for food and shrinking arable land.  |
| Consumer Goods               | Medium | We see a significant impact on discretionary spending and out-of-home consumption, weakening operating performance and cash flow generation. If containment measures in Europe and the U.S. are not relaxed in the second quarter and discretionary spending remains curtailed, a slower pace of deleveraging could warrant negative rating actions for certain companies in the personal luxury goods, alcoholic beverage, and beauty care industries. We see less of an impact for staple products. For discretionary goods and out-of-home consumer products (like certain alcoholic beverages), weakness in the retail and restaurants sector due to lockdowns will have a follow-on impact on working capital (both on inventory and cash receipts) and pricing flexibility.   |
| Financial Institutions       | Medium | We expect an increasing number of negative outlooks on European banks. Bank profitability could halve compared to 2019. We foresee lower revenues and hikes in credit provisions, the latter in spite of significant government support packages. Performance is likely to improve in 2021, but not reach pre-pandemic levels. Capital deterioration, however, should be modest (although uneven), particularly if banks do not distribute dividends as recommended by authorities, and funding should not be an issue for banks given ample availability of central bank funding. Ratings pressure is more likely to affect banks with existing fragilities (such as weak earnings, incomplete restructurings or turnarounds, business model challenges, tighter capital); banks with material exposure to regions most affected by the lockdown or with limited fiscal space to undertake borrowers' support measures; and those banks, particularly nonbank financial institutions, reliant on market funding access.  |
| Forest Products              | Medium | We expect the recession to lead to lower revenues, but see no immediate material ratings impact. In most jurisdictions, the plants of our rated companies have so far been classed as essential and have been allowed to continue operating.<br>Corrugated paper producers could benefit from the rise in sales to supermarkets and in e-commerce. We may see a rise in recycled paper prices, depending on the magnitude of the decline in industrial production. Pulp producers could benefit from the rise in demand for tissue paper. We expect the decline in demand to hurt dissolving wood pulp producers due to their exposure to the fashion retail industry; we also expect social-distancing measures to hurt wood product producers as their end products are more discretionary.   |
| International Public Finance | Medium | We see a moderate impact on local and regional governments (LRGs), social housing providers, universities, health care institutions, and public transport operators from lockdowns and the recession in Europe.<br>Many European LRGs, especially those subject to mandated lockdowns, will record weaker budgetary performance due to lower tax revenues and higher spending, predominantly in health and social care and public transportation, while maintenance and capital spending may be delayed. The credit implications depend on the duration and severity of the economic disruption.<br>We expect financial performance at English universities to suffer if significantly fewer international students enroll for the academic year starting in September 2020.<br>We assume that traditional social housing providers (SHPs) benefit from the countercyclical nature of their services and face manageable impact on financial performance. However, they may experience a temporary spike in arrears. We believe that the most vulnerable U.K. SHPs are those for which a large share of revenues comes from market sales. They may face substantially lower revenues leading to a much higher debt burden.<br>Global public transport operators face a significant reduction in passenger volumes. The negative outlook on Transport for London indicates our view that its financial profile is stretching, leading to declining cash balances at a time of heightened risks as a result of economic uncertainty and delivery of large capital projects. |
| Leisure                      | High   | At this stage, we expect European hotel operators to suffer a 20%-30% decline in revenue per available room for 2020, with a severe impact in the first and second quarters due to lockdowns of various European countries and a fall in occupancy rates to almost zero. This translates into negligible or zero bookings, before a modest pickup in the third and fourth quarter. From a credit perspective, we view asset-light lodging and travel companies as having a lower fixed-cost base and therefore greater resiliency than players that are asset-heavy.  |
| Media                        | High   | Lockdowns have hurt many media segments, and we have little visibility about the timing of a recovery. These segments include movie exhibitors; event organizers; live event companies; content producers; and advertising-dependent segments such as broadcasters, print and outdoor advertisers, and ad agencies (particularly travel and retail dependent).  |

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|                        |        |   |
|------------------------|--------|---|
|                        |        | The broadest threat to media is a pullback in advertising spending. Advertising, which remains a key revenue component for much of the industry, has dropped, and companies have few means to offset most of the declines. Subscription-based services including data publishers, streaming services, and B2B online service providers are the only resilient segments.   |
| Mining                 | Medium | We see a growing shock to demand for mining companies due to the global economic slowdown. More workforce-related production disruptions are being reported. Pricing adjustments have been mixed so far. Copper and aluminum prices are approaching 2016 lows, while iron ore is relatively unscathed (albeit supported by some supply issues). Gold prices were up almost 10% in March despite price volatility because some investors sold to raise liquidity.  |
| Oil & Gas - Downstream | High   | Demand has collapsed for jet fuel and gasoline, with less of a decline for diesel and cracks. Refining profitability is therefore under pressure even though drops in crude oil prices may allow margin-capturing opportunities. Some refinery runs are being cut in response to weak demand, and the impacts are refinery specific.  |
| Oil & Gas - Upstream   | High   | The impact is high because of the price collapse, largely emanating from the drop in demand for oil products and in spite of the belated OPEC+ supply agreement. Producers are implementing aggressive cost and capex cuts to deal with demand and price shocks. The international agreement to cut supply dramatically from May is helpful but insufficient to balance the market in the next couple of months. Some U.S. shale and other players will be forced to cut their production.  |
| Packaging              | Medium | Most of our rated packaging producers are exposed to the more stable food or beverage industry. Paper packaging suppliers with exposure to supermarkets and e-commerce might benefit from the rise in supermarket sales and the rise in deliveries. We expect a temporary decline in sales for our cosmetic packaging producers, but no material rating impact so far.  |
| Pharma & Health Care   | Low    | We see a limited impact on the pharma sector, which remains operational to provide essential services and access for customers and faces minimal supply issues as supply chains are under control. Likewise, distributors of medicine and medical supplies should see a minimal impact.<br><br>The impact on health care service providers is more mixed, depending on geography and type of services. Although we expect hospitals to be reimbursed for services that have been redirected to create capacity for COVID-19 cases, these will be at lower rates and weaken profitability. Nursing homes have had limited impact so far, but close monitoring of virus containment management on the premises and among staff will be crucial for their future ability to operate.<br><br>We are likely to see a more pronounced impact on laboratories and dentists whose routine tests and procedures have been postponed. While we anticipate a negative effect on med tech products that are targeting elective surgeries, those that manufacture gloves, gowns, etc., will benefit. |
| Real Estate            | Medium | We expect a weakening in credit quality as tenants' creditworthiness and capacity to pay contracted rents start to diminish. Government lockdowns and support for struggling businesses, such as allowing companies to skip rental payments, are credit negative for landlords. Deteriorating financing conditions and reduced access to capital markets, especially in a sector that is highly capital intensive and reliant on debt capital markets, will likely be negative for corporate liability management. Overall we believe the commercial real estate sector is likely more negatively affected than residential real estate.  |
| Retail                 | High   | We expect sales to decline substantially in the next three to six months and think travel retail, casual dining, mall-based retail, and discretionary spending are at particular risk. Most nonfood retailers have been deemed as nonessential and therefore forced to close stores due to lockdowns. E-commerce in nonfood is restricted due to operational bottlenecks, while demand has also dropped sharply. Grocers continues to see robust demand for food and household goods, but meanwhile labor and operating costs are increasing sharply, capping margin growth. The risk of distress is heightened for restaurants and pubs.<br><br>Across the sector, liquidity is in the spotlight as the focus on preserving cash through a variety of means including government funding and furlough schemes, cutting capex and shareholder returns, and, in some cases, delaying or deferring rent and supplier payments.  |
| Insurance              | Medium | Insurers' balance sheets are likely to see impairments on invested assets, but for most insurers this will generally not be a capital event. We believe the insurance exposure impact for Europe's primary insurers is limited, whilst some industrial lines insurers and re-insurers are likely to report some insurance claims. For European life insurers,   |

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|                    |        |   |
|--------------------|--------|---|
|                    |        | low interest rates remain a key risk to ratings as investment margins in traditional life insurance are compressed further.   |
| Service Companies  | Medium | <p>Service companies are exposed to a variety of end markets, so the <b>impact</b> on each depends on the subsector. We expect a steep and immediate hit to catering and some facilities services due to social-distancing measures. However, those subsectors will also rebound quickly as lockdowns ease and contracts resume. Staffing providers are expected to take a hit from subdued economic activity and the closure of offices and plants, although some staff may be able to work remotely.</p> <p>We forecast some margin erosion across these subsectors. The magnitude will depend upon cost base flexibility (generally high for service companies) and the ability to take advantage of government initiatives.</p> <p>We expect more limited effects on the security services sector, as the additional demand for remote-monitoring services is likely to be offset by the lower staffing levels needed for guarding. We see a mixed impact on the call service industry, with higher call volumes and demand for services but a slower ramp-up of contracts and efforts to maintain quality of service.</p> <p>At this stage, a number of service companies have operations and earnings that will be largely unaffected by the pandemic, albeit with future growth tempered by recession. Examples include submetering, financial services, some insurance brokers, patent renewal, and trust and corporate services.</p> |
| Steel              | High   | 2020 is likely to be even more challenging than a weak 2019, especially in Europe, given the severe drop in steel demand in the second quarter. Capacity is already being cut, and government furlough schemes are addressing costs. However, given still high iron ore prices, margins will suffer.  |
| Structured Finance | Medium | Areas linked to corporate credit (for example, corporate securitizations, CMBS, and CLOs) appear most at risk, given direct exposures to industry sectors that have seen the greatest disruption from virus-related lockdown policies. By contrast, asset classes backed by lending to consumers (for example, RMBS, covered bonds, and most ABS) could be better insulated. Most transactions contain structural mechanisms that should allow them to weather short-term cash flow disruptions due to underlying borrowers taking payment holidays, although junior notes in some transactions may come under pressure if the recovery is delayed.   |
| Technology         | Medium | What began as a supply chain disruption in China has now morphed into global IT demand destruction. We believe the industry is still underestimating the potential for a multiquarter loss of demand. While we anticipate some recovery in the second half, we believe some demand, especially in hardware, will be permanently lost as enterprises, service providers, and consumers lose confidence in the economy and, in turn, reduce orders for later quarters.  |
| Telecoms – IG      | Low    | Broadband demand has spiked as people are isolating at home, creating modest potential for customer upgrades to more premium packages, lessening the risks related to lower equipment and roaming revenues, both of which are minor contributors to earnings. Reduced capex and smaller dividends are additional mitigants as companies conserve cash with an eye toward recessionary headwinds on revenue, especially from business customers.   |
| Telecoms – HY      | Low    | Despite facing the same operational situation as the investment-grade sector, there is more pressure in the speculative-grade sector driven by less financial flexibility, difficulty in accessing capital markets, and less of an ability to withstand macroeconomic stresses. At present, we observe just a few cases of direct impacts to mobility service providers, for example, satellite companies providing connectivity to aviation and maritime customers.  |
| Transportation     | High   | <p>Within the broader transportation sector, we view airlines and airline service providers as facing the most immediate and largest risks from the pandemic. We have lowered all of our EMEA-based airline and airline service provider ratings by one or two notches and placed them on CreditWatch with negative implications (or have assigned a negative outlook for two airline service providers), as we continue to assess the magnitude of the ratings impact.</p> <p>Unprecedented government travel restrictions and quarantine orders have led most of our EMEA-based airline issuers to temporarily ground their entire (or the majority of) their fleets, in response to the plunge in air passenger traffic. In such times of high uncertainty, we will continue to focus on airlines' proactive efforts to drastically lower operating costs and preserve liquidity. We also note that most airlines are turning to European governments for support.</p> <p>We view shipping companies as the next most at risk, and note that many of our rated issuers already have low ratings (in the 'B' category and below) and face liquidity challenges. We forecast a reduction in global container volumes for the remainder of</p>  |

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|                                     |      |  |
|-------------------------------------|------|--|
|                                     |      | <p>the year (of about 15%), albeit expect cargo traffic to be significantly more resilient than passenger traffic.</p> <p>We expect U.K. bus and rail operators to suffer from a material drop in revenue over the coming months, although we expect substantial protection from contractual structures and government support in certain businesses.</p> <p>In general, apart from airlines, government support will likely be offered to other transportation sectors, and we await details about that. However, for most companies, we expect lower revenue and cash flow to significantly weaken credit metrics in at least 2020 compared to our previous expectations.</p>  |
| Transport Infrastructure - Airports | High | <p>The airport sector in Europe is facing an unprecedented plunge in air traffic. As a result, we expect materially weaker cash flow and credit ratios for European airports, resulting from a highly uncertain business environment with an uncertain and more prolonged recovery than seen in the past.</p> <p>Under our current base case, we forecast that the number of passengers for European airports could fall by up to up to 35%-40% compared with 2019, with further downside possible. This takes into account an average drop of at least 70% in traffic over three peak coronavirus months (based on what happened in the peak weeks of the outbreak in China and in Italy). We assume continued severe disruption in the next three months, with a slow recovery starting from the fourth quarter.</p> <p>Even after the outbreak is contained, we expect global airports to see a slower rebound in air traffic over the following 24 months as now we expect recession in 2020. On March 26, 2020, we took negative rating actions on all European airports.</p> |
| Utilities                           | Low  | <p>European utilities are more resilient than most other sectors given the essential services they provide and the regulated or long-term contracted nature of a portion of their activities. Nevertheless, we see several risk factors that will weigh on credit performance. These include: weaker power demand and power prices amid commodity price falls (not imminent given hedges in place); lack of timely payment of power bills; lower investment spending than previously planned (down 10% to 15%); an increase in pension and asset-retirement obligation deficits; and refinancing risks for weaker companies.</p>   |

## Appendix 2: European Economic Forecasts

Table 3

### Real GDP %

|       | Ger. | Fra. | Ita. | Spa. | Neth. | Belg. | Eurozone | U.K. | Switz. |
|-------|------|------|------|------|-------|-------|----------|------|--------|
| 2018  | 1.5  | 1.7  | 0.7  | 2.4  | 2.5   | 1.5   | 1.9      | 1.3  | 2.8    |
| 2019f | 0.6  | 1.3  | 0.2  | 2.0  | 1.7   | 1.4   | 1.2      | 1.4  | 0.9    |
| 2020f | -6.0 | -8.0 | -9.9 | -8.8 | -6.7  | -7.2  | -7.3     | -6.5 | -6.5   |
| 2021f | 4.3  | 6.1  | 6.4  | 5.1  | 6.2   | 5.2   | 5.6      | 6.0  | 6.3    |
| 2022f | 3.3  | 4.5  | 3.2  | 4.3  | 4.0   | 4.1   | 3.7      | 3.2  | 4.0    |

Source: Oxford Economics; f--S&amp;P Global Ratings forecast.

Table 4

### CPI Inflation %

|       | Ger. | Fra. | Ita. | Spa. | Neth. | Belg. | Eurozone | U.K. | Switz. |
|-------|------|------|------|------|-------|-------|----------|------|--------|
| 2018  | 1.9  | 2.1  | 1.2  | 1.7  | 1.6   | 2.3   | 1.8      | 2.5  | 0.9    |
| 2019f | 1.4  | 1.3  | 0.6  | 0.8  | 2.7   | 1.2   | 1.2      | 1.8  | 0.4    |
| 2020f | 1.0  | 0.7  | 0.2  | 0.8  | 0.8   | 0.9   | 0.6      | 0.7  | -0.3   |
| 2021f | 1.2  | 1.2  | 1.0  | 1.3  | 1.2   | 1.4   | 1.1      | 1.3  | 0.4    |
| 2022f | 1.3  | 1.5  | 1.1  | 1.3  | 1.3   | 1.5   | 1.4      | 2.2  | 0.5    |

Source: Oxford Economics; f--S&amp;P Global Ratings forecast.

Table 5

### Unemployment Rate %

|       | Ger. | Fra. | Ita. | Spa. | Neth. | Belg. | Eurozone | U.K. | Switz. |
|-------|------|------|------|------|-------|-------|----------|------|--------|
| 2018  | 3.4  | 9.1  | 10.6 | 15.3 | 3.8   | 6.0   | 8.2      | 4.1  | 4.7    |
| 2019f | 3.2  | 8.5  | 9.9  | 14.1 | 3.4   | 5.4   | 7.6      | 3.8  | 4.4    |
| 2020f | 3.6  | 9.5  | 11.1 | 16.4 | 3.8   | 6.0   | 8.6      | 6.1  | 5.3    |
| 2021f | 3.8  | 9.7  | 11.2 | 16.5 | 3.9   | 6.1   | 8.6      | 6.0  | 5.1    |
| 2022f | 3.6  | 9.1  | 10.6 | 16.1 | 3.7   | 5.8   | 8.1      | 4.4  | 4.7    |

Source: Oxford Economics; f--S&amp;P Global Ratings forecast.

Table 6

### 10y Government Bond Yields

|       | Ger. | Fra. | Ita. | Spa. | Neth. | Belg. | Eurozone | U.K. | Switz. |
|-------|------|------|------|------|-------|-------|----------|------|--------|
| 2018  | 0.5  | 0.8  | 2.6  | 1.4  | 0.6   | 0.8   | 1.2      | 1.5  | 0.0    |
| 2019f | -0.2 | 0.1  | 1.9  | 0.7  | -0.1  | 0.2   | 0.4      | 0.9  | -0.5   |
| 2020f | -0.5 | 0.0  | 1.5  | 0.6  | -0.2  | 0.0   | 0.2      | 0.5  | -0.4   |
| 2021f | -0.5 | -0.1 | 1.4  | 0.4  | -0.3  | 0.0   | 0.2      | 0.8  | -0.5   |
| 2022f | -0.3 | 0.1  | 1.7  | 0.5  | -0.1  | 0.1   | 0.4      | 1.3  | -0.4   |

Source: Oxford Economics; f--S&amp;P Global Ratings forecast; End of Period - Q4 values.

Table 7

### Exchange Rates

|      | Eurozone |      | U.K.   | Switzerland |       |
|------|----------|------|--------|-------------|-------|
|      | US\$/€   | €/£  | US\$/£ | SFr/US\$    | SFr/€ |
| 2018 | 1.18     | 1.34 | 1.13   | 0.98        | 1.15  |
| 2019 | 1.12     | 1.28 | 1.14   | 0.99        | 1.11  |
| 2020 | 1.09     | 1.26 | 1.15   | 0.97        | 1.06  |
| 2021 | 1.14     | 1.33 | 1.17   | 0.98        | 1.11  |
| 2022 | 1.13     | 1.31 | 1.16   | 1.02        | 1.15  |

Sources: Oxford Economics; f--S&amp;P Global Ratings forecast; End of Period - Q4 values.

Table 8

## Policy Interest Rates %

| Policy Rates | Eurozone (ECB) |           | U.K. (BoE) | Switzerland (SNB) |
|--------------|----------------|-----------|------------|-------------------|
|              | Deposit Rate   | Refi Rate |            |                   |
| 2018         | -0.40          | 0.00      | 0.60       | -0.75             |
| 2019         | -0.44          | 0.00      | 0.75       | -0.75             |
| 2020         | -0.50          | 0.00      | 0.23       | -0.75             |
| 2021         | -0.50          | 0.00      | 0.16       | -0.75             |
| 2022         | -0.50          | 0.00      | 0.58       | -0.75             |

Sources: Oxford Economics; f--S&amp;P Global Ratings forecast; End of Period - Q4 values.

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|------------------------------|--|
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|-------------------------------------|---|
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## Related Research

- [Coronavirus Impact: Key Takeaways From Our Articles](#), April 24, 2020
- [Global Credit Conditions: Rising Credit Pressures Amid Deeper Recession, Uncertain Recovery Path](#), April 22, 2020
- [COVID-19 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
- [Economic Research: Europe Braces For A Deeper Recession In 2020](#), April 20, 2020
- [Economic Research: COVID-19 Deals A Larger, Longer Hit To Global GDP](#), April 16, 2020
- [Credit FAQ: Sovereign Ratings And The Effects Of The COVID-19 Pandemic](#), April 16, 2020



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