S&P Global
Ratings

COVID-19 Weekly Digest

October 28, 2020

Key Takeaways

- Escalating restrictions in response to Europe's second wave of COVID-19 have started to affect economic and financial market confidence.
- A new study by S&P Global Ratings considers the broader implications and risks of surging debt levels resulting from the pandemic. Risks have risen, but a near-term crisis is unlikely.
- With the U.S. presidential election less than a week away, there's a lot stake for the world's biggest economy.

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Global Research

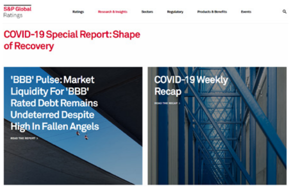
Gareth Williams
London
gareth.williams@spglobal.com
+44-20-7176-7226

Alexandra Dimitrijevic
London
alexandra.dimitrijevic@spglobal.com
+44-20-7176-3128

Joe Maguire
New York
joe.maguire@spglobal.com
+1-212-438-7507

Links

Daily research updates, including a summary of related ratings actions, are available at:
https://www.spglobal.com/ratings/en/research-insights/topics/coronavirus-special-report



Key developments

Europe's second wave of COVID-19 gathered pace, with even Germany--which handled the first wave more successfully than peers--ordering new measures, including a month-long shut down of many socially focused businesses; France, too, announced a new national lockdown until Dec. 1. Economic data and financial markets have started to reflect the effects of the surge in cases--also apparent in the U.S.--and consequent renewed restrictions on activity; for example, this week the flash eurozone's PMI index hit a four-month low. Our latest assessment of real-time U.S. economic indicators is available here. These point to an economy on the mend, but at a decelerating pace as elevated uncertainty about the pandemic and fiscal stimulus tilts risks to the downside for the economic outlook in the fourth quarter and beyond.

Global debt levels will likely surge in the wake of the COVID-19 shock, resulting in global debt to GDP surging 14%, to 265%, by year end. S&P Global Ratings' new study "Global Debt Leverage: Risks Rise, But Near-Term Crisis Unlikely", assessed the impact and risks. It concluded that a near-term debt crisis is unlikely given our baseline assumptions of continuing economic recovery, a vaccine by mid-2021, favorable financing conditions, and changes to sovereign, corporate, and household spending and borrowing behaviors. However, insolvencies and defaults are set to rise further, and higher debt levels will slow the recovery of credit metrics for hardest-hit sectors. Moreover, risks remain on the downside. These include the economic recovery stumbling, a continued spread of the pandemic or poor vaccine distribution, a sustained surge in interest rates and dramatic widening of credit spreads, no notable deceleration of growth in debt after this year, and consumption demand rebounding less than we expect.

Global bond Issuance is expected to finish the year up 16% before declining 3% in 2021. After heady second- and third-quarter issuance volumes, we expect the pace of global bond issuance to slow. The combination of continuing uncertainty over prospects for 2021 and historically robust issuance this year, leads us to project that overall bond issuance will decline about 3% next year, though with a wide range of possibilities.

The U.S. presidential election is now less than a week away, and is the first G-7 election to be conducted during the pandemic. S&P Global Ratings has published a number of reports considering potential economic and credit implications:

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

- Economic Research: U.S. Election: Promises, Policy, And The Potential Effects On The Economy And Corporate Credit. Among areas looked at, the biggest policy differences are on taxes--corporate tax in particular--fiscal stimulus, regulation, and immigration, while there are surprising similarities on trade and infrastructure.
- U.S. Corporate Tax Policy Post-Election Won't Likely Affect Ratings, Regardless Of Election Results. Democratic plans to raise the statutory tax rate for U.S. corporations would likely raise the effective rate for most companies we rate, absent tax-planning offsets, and companies with large overseas earnings would likely see even bigger increases in effective tax rates. The Biden proposal would have mixed consequences on S&P Global Ratings' adjusted ratios, and we don't foresee many rating changes solely due to an adjustment of the tax code, as companies' tax-planning efforts and financial policy changes would likely offset reductions in cash flow.
- How Diverging Energy Policies In The U.S. Presidential Election May Affect Credit Quality. Prospective energy policies vastly differ in their main tenets and will have different implications for the upstream and midstream oil and gas sectors, though the operating environment will likely remain difficult either way. Renewables--especially solar--stand to gain significantly under a Biden administration. In public finance, we expect a limited impact in the short term, although states with a comparatively large share of mining activities could face new headwinds should standing policies materially shift away from extraction and production.
- Credit FAQ: How A Big Election Win For The Democrats Could Affect U.S. Telecom And Cable Companies considers the potential impact on pricing, regulation, and M&A.

S&P Global Ratings published a number of sovereign ratings updates. We affirmed the 'AA/A-1+' rating on the **U.K.** and the outlook is stable. **Italy'**s outlook was revised to stable from negative, and the ratings affirmed at 'BBB/A-2'. In our view, despite macroeconomic uncertainties, a range of domestic (extraordinary fiscal measures this year and a pro-growth budget drafted for 2021) and supranational (ECB asset purchases and the EU Recovery and Resilience Fund) measures provide Italian authorities an opportunity to restart economic growth and to reverse the deterioration of its budgetary performance. **Zambia**'s foreign currency ratings were lowered to 'SD/SD' on suspension of debt payments to external commercial creditors. On Oct. 13, the Zambian government said it would be unable to make payments on upcoming external commercial obligations due to liquidity pressures that had been compounded by the pandemic. Since then, it has missed a coupon payment of $42.5 million (8.5% per year) on its $1 billion April 2024 eurobond, due on Oct. 14.

The COVID-19 pandemic is placing a huge strain on European rail travel as passengers continue to avoid usually crowded trains due to health concerns, public health advice, or ongoing travel restrictions. During the initial lockdown months from March-May, passenger traffic declined more than 90% in many European countries, including Italy, France, and the U.K., and has only recovered partly since restrictions were eased. Pandemic-related travel limits, remote working, and train-capacity constraints due to social distancing will prevent rail travel recovering to pre-pandemic levels before 2023 at the earliest in some European countries. Weaker passenger demand weighs on European rail operators' credit metrics due to their high operating leverage. The rating impact will depend heavily on the extent of governments' support measures.

The International Air Transport Assn. (IATA)'s announcement this week that total industry revenues in 2021 are expected to be down 46% compared to the 2019 figure of $838 billion was a reminder of the similarly acute pressure on airlines. The group's previous analysis was for 2021 revenues to be down around 29% compared to 2019. This decline in revenues is creating acute upward pressure on unit costs, adding to credit pressures, insolvency risks and the threat of further job cuts. In a similar vein, Airports Council International Europe (ACI Europe), which represents airport operators, announced this week that nearly 200 European airports faced "insolvency in the coming months if passenger traffic does not start to recover by the year end". Boeing suggested it may need to cut a further 11,000 jobs on top of previous layoffs, potentially taking its workforce from a pre-crisis figure of 160,000 down to 130,000 by end-2021.

Credit Market Update

Credit Market Research

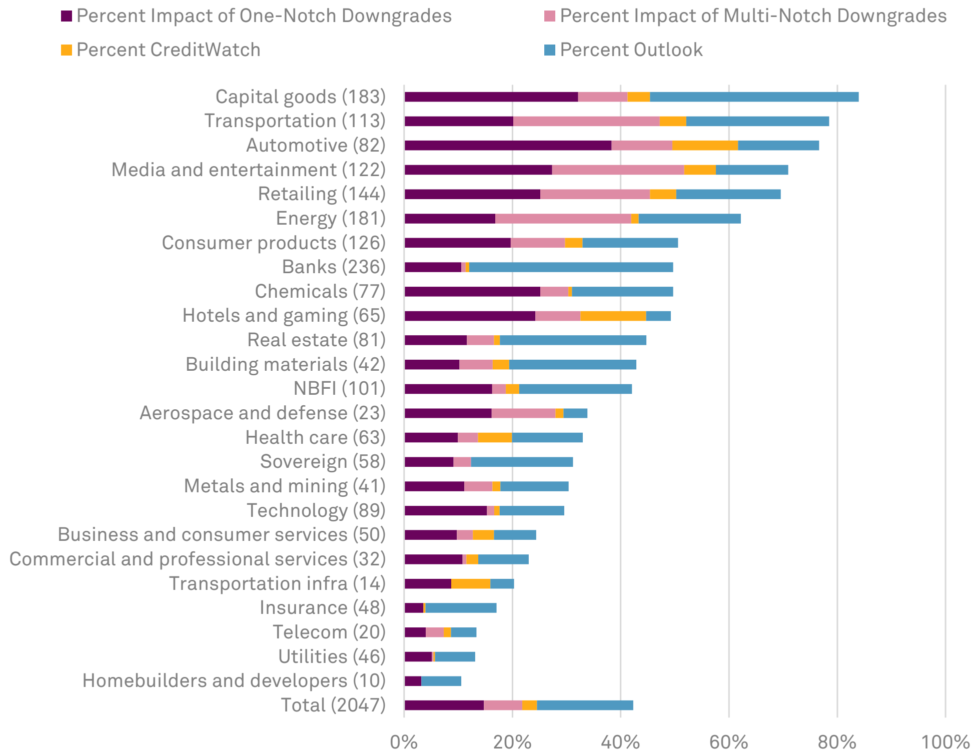
Sudeep Kesh
New York
sudeep.kesh
@spglobal.com

Nicole Serino
New York
nicole.serino
@spglobal.com

Ratings Trends

Chart 1

Percent Of Issuers Downgraded Due To COVID-19 And Oil Prices By Sector



Source: S&P Global Ratings Research. Downgrades tracked from Feb. 3rd to Oct. 26. NBFI: Non-bank financial institution.

– **S&P Global Ratings has taken 2,047 negative rating actions** (as of Oct. 26) on global corporate nonfinancial, financial, and sovereign issuers, including 1,056 downgrades, 861 outlook revisions to negative, and 130 placements on CreditWatch with negative implications. The **downgrades** for **nonfinancial companies represent roughly 22% of the rated portfolio**, higher than that of financial institutions (17%) and sovereigns (11%). In contrast, **roughly 4% of the structured finance rated portfolio experienced negative actions**, primarily consisting of **CreditWatch negative placements**.

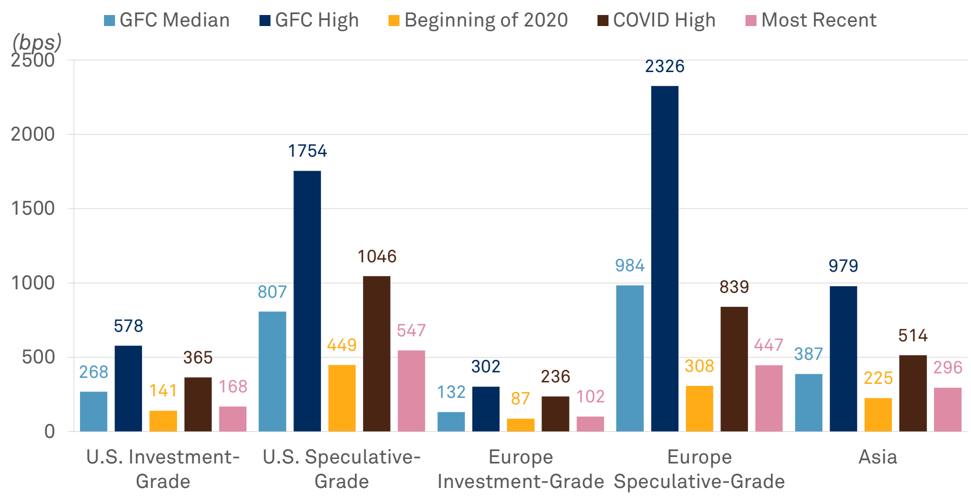
– The **pace of negative rating actions due to COVID-19 and oil-related pressures continues to steady at a slower pace,** with just 18 rating actions this week (the same as the week prior) and roughly 7% of the total actions seen at the peak of late March/early April. **Over 60% of rating actions this week are downgrades**, consistent with recent trends of downgrades leading over outlook and CreditWatch revisions, which were more prominent several months ago. Week over week, there were more outlook revisions, although there was not a clear sectoral pattern. Of the downgrades, three were sovereigns, including Zambia's selective default due to suspension of debt service, and the downgrades of both emirates of Ras Al Khaimah and Sharjah.

– **Corporate defaults now total 194 issuers so far in 2020 –the highest since the Global Financial Crisis in 2009.** Accounting for two of five defaults last week, the media and entertainment sector now has the third-highest default tally (at 28), behind oil and gas, with 39, and consumer products, with 32. Nearly 70% of defaults in the sector were from the U.S., followed by emerging markets, with five. Media and entertainment companies' (including lodging) revenues have come under heavy fire this year with the abrupt shutdown in travel, as well as social distancing measures curbing revenue generation prospects in an already-vulnerable industry (with a median rating of 'B').

Financing Conditions

Chart 2

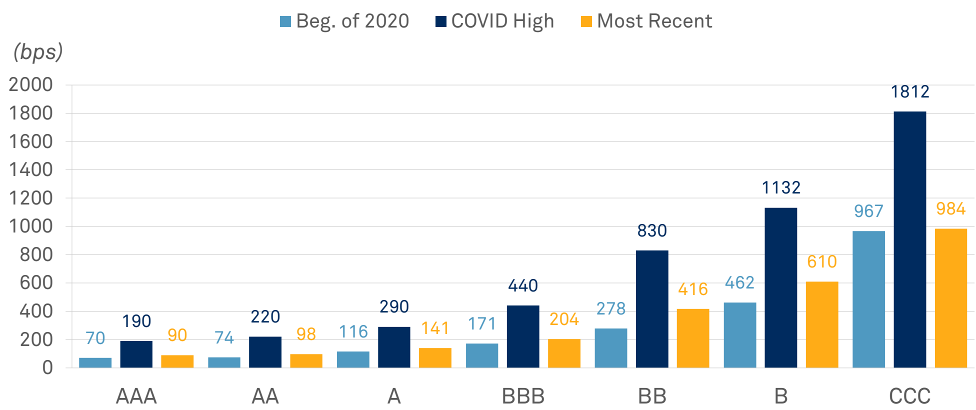
Secondary Market Credit Spreads, U.S., Europe, And Asia



Source: ICE Benchmark Administration Limited (IBA), 'ICE BofAML Asia Emerging Markets Corporate Plus Sub-Index Option-Adjusted Spread', 'ICE BofAML Europe, the Middle East, and Africa (EMEA) Emerging Markets Corporate Plus Sub-Index Option-Adjusted Spread', retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/BAMLEMRECRPIEMEAOAS, U.S. Investment-Grade and Speculative-Grade Spreads from S&P Global Ratings, Europe Investment-Grade Spreads From S&P Dow Jones Indices. October 26, 2020.

Chart 3

S&P Global U.S. Composite Spreads By Rating, Secondary Market



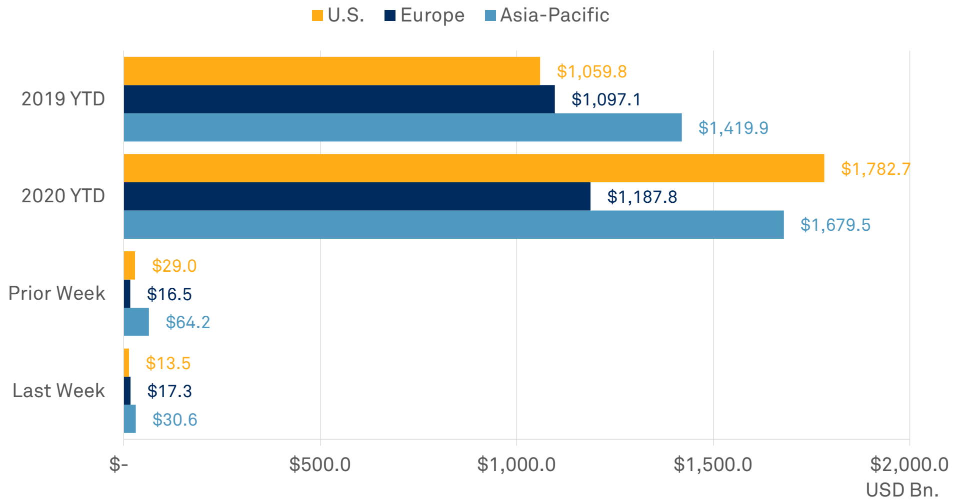
Source: S&P Global Ratings. Data as of October 26, 2020.

- **Debt issuance.** Accommodative financial conditions will likely continue to support issuance for companies with stronger and healthier balance sheets. Risk appetite continues to grow as investors continue to measure relative risk and yields remain extremely low, even negative in some instances. Europe sees the strongest week-over-week gains.
- **Spreads tighten.** Spreads continue to vary by geography, with the U.S. widening amid greater capital markets volatility stemming from both an increase in COVID19 cases, as well as uncertainty surrounding the impact of next week's election results. Spreads for Europe and Asia both tightened week over week. By rating category, spreads bifurcate by geography, widening among European speculative-grade and Asian companies and tightening generally in the U.S. By rating category, spread expansion was moderate with speculative-grade categories, expanding 1% each week over week and investment-grade categories largely flat.

Debt Capital Markets

Chart 4

Financial And Nonfinancial New Bond Issuance



Source: S&P Global Ratings. Data as of October 26, 2020.

- **Global.** Global corporate issuance totals $4.9 trillion, 8.5% over the entirety of 2019.
- **Asia.** Chinese issuers were highly active last week. Investment-grade corporates were well-received, while rising spreads matched the smaller activity volume in the speculative-grade space.
- **Europe**. The recent spurt in hybrid and speculative-grade issuance has presented an opportunity for investors searching for yields.
- **U.S.** Investment-grade supply slowed and is expected to remain muted next week, while speculative-grade issuance remained robust amid the prevailing risk-on sentiment and search for higher yields.

Asset Class Trends

Corporate

- During the week ending Oct. 26, 2020, there were a couple notable rating actions at the low end of the investment-grade range, including the one-notch downgrades of Fortis TCI Ltd., an electricity provider in the Turks and Caicos Islands, to 'BBB-/Stable' and U.S. aerospace and defense manufacturer, Hexcel Corp., to 'BBB-/Negative'. Additionally, the outlook on our 'BBB-' rating on utility NHPC Ltd. was revised to negative.
- New reports focus on higher debt levels in the wake of COVID and our expectations on the recovery for several sectors. See "Global Debt Leverage: Risks Rise, But Near-Term Crisis Unlikely" (Oct, 28, 2020) and our recovery expectations for the European rail (Oct. 22, 2020), EMEA Chemicals (Oct. 22, 2020), APAC gaming (Oct. 27, 2020), and U.S. Media (Oct. 22, 2020) sectors.

Banks and Financial Institutions

- There were no COVID-related rating actions this week. Third-quarter earnings season is in full swing. In many cases, provisions are down on first half run rate. But uncertainty remains, especially in light of a resurgence in cases in certain regions.
- We updated our article "How COVID-19 Is Affecting Bank Ratings: October 2020 Update" (Oct. 22, 2020). We continue to expect that COVID-19-related downgrades to banks will be limited by their stronger balance sheets over the past 10 years, the support from public authorities to household and corporate markets, and our base case of a sustained economic recovery next year. Asset quality will continue to be a key driver of rating actions, but in many cases that picture may remain blurry in the beginning of 2021 because of the uncertain impact of the pandemic, mitigating government measures, and the shape of the economic recovery.
- We also published our four regional Financial Monitors for the last quarter (for Asia-Pacific, Latin America, North America, and EMEA, Oct. 19, 2020).

Sovereign

- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable
- Italy Outlook Revised To Stable From Negative; Ratings Affirmed At 'BBB/A-2'
- Azerbaijan Outlook Revised To Negative On Rising Risks From Military Conflict Over Nagorno-Karabakh; Ratings Affirmed
- Zambia Foreign Currency Ratings Lowered To SD/SD On Suspension Of Debt Service Payments To External Commercial Creditors

Structured Finance

- **U.S. RMBS Webinar:** Please join our leading S&P Global Ratings Structured Finance analysts for a live interactive webinar on Oct. 29, 2020 (11:00 AM U.S. Eastern Daylight Time), for an update on the U.S. residential mortgage-backed securities (RMBS) sector seven months into COVID-19. Register here.
- **U.S. REIT, Hospitality, and Lodging Sectors (U.S. CMBS-related):** We will provide market insight and commentary on the lodging and hospitality sector, discuss credit trends as a result of COVID-19, as well as incorporate forward-looking analysis as it relates to U.S. commercial banks, REITs, and ratings. Discussion around companies' ability to meet debt service, refinance, and access capital, including through property and CMBS transactions. Webinar is scheduled for Thursday, Oct. 29, 2020 (11:00 am U.S. EST). Register here: https://pages.marketintelligence.spglobal.com/The-Impact-of-COVID-19-on-US-Hospitality-Lodging-Sector-Registration-October-2020.html?utm_source=ratings102920
- **Global Structured Finance:** See "COVID-19 Activity in Global Structured Finance as of Oct. 16, 2020" published Oct. 22, 2020.
- **Global Structured Finance:** Despite generally improving economic conditions, credit concerns loom due to the risk of resurgence of COVID-19. Global structured finance securities have experienced negative rating momentum through year to date 2020 due to the COVID-19 pandemic. The shape of the path to recovery remains uncertain, as

Analytics & Research

Cross-Practice
Gregg Lemos-Stein
gregg.lemos-stein@spglobal.com

Corporate
Jeanne Shoesmith
jeanne.shoesmith@spglobal.com

Financial Institutions
Alexandre Birry
alexandre.birry@spglobal.com

Infrastructure
Karl Nietvelt
karl.nietvelt@spglobal.com

Insurance
Simon Ashworth
simon.ashworth@spglobal.com

Sovereign
Roberto Sifon-Arevalo
roberto.sifon-arevalo@spglobal.com

Structured Finance
Winston Chang
winston.chang@spglobal.com

U.S. Public Finance
Robin Prunty
robin.prunty@spglobal.com

the economic recovery will take time (see "Global Structured Finance: Credit Concerns Loom on COVID-19 Resurgence," published Oct. 21, 2020).

- **EMEA Structured Finance:** Our report includes a round-up of the latest credit developments that we've observed across EMEA structured finance sectors, along with data on recent EMEA rating actions and underlying performance indicators. We also highlight the key takeaways from our recent research publications (see "EMEA Structured Finance Surveillance Chart Book," published Oct. 19, 2020).
- **U.S. RMBS:** Although credit risk transfer (CRT) transactions may have a long journey to forbearance resolution, structural features reduce idiosyncratic disruptions to bond interest payments. Loans with greater credit risk profiles are more likely to have entered forbearance. A sensitivity analysis applied to a generic B-1 tranche in a CRT transaction (assumed to have 7.5% forbearance rate) shows that roughly two-thirds of the loans in forbearance would need to default at a 20% loss severity in order to impair the bond, not accounting for future defaults from non-forbearance loans. The most popular forbearance resolution option so far has been reinstatement, followed by deferrals and then repayment plans. Modifications appear to be employed as a last resort (see "U.S. RMBS--After the Credit Risk Transfer Forbearance Plateau," published Oct. 23, 2020).
- **U.S. Auto ABS:** For public issuers, monthly extension rates declined for the fourth consecutive month in August due to the unemployment rate dropping to 8.4% from 10.2%. However, half of the 144a subprime issuers reported an increase. Due to borrowers coming to the end of their forbearance period, prime loans that remained in extension status as of the end of August declined over 40% to 0.99% from 1.71% in July. For public subprime issuers, they declined 34% to 7.88% from 11.90% (see "SF Credit Brief: U.S. Auto ABS Experienced A Dramatic Reduction In Loans In Extension Status In August, But Delinquencies Continued To Rise," published Oct. 22, 2020).
- **Danish Covered Bonds:** Following the COVID-19 outbreak, the Danish government introduced emergency support policy measures to help the economy. The initiatives have supported the housing market, and Danish covered bond issuers indirectly benefit from eurozone monetary stimulus. The Danish legal covered bond framework will likely need further adjustments to align with the new EU harmonization directive (see "Danish Covered Bond Market Insights 2020," published Oct. 21, 2020).
- **Australia RMBS:** The Standard & Poor's Performance Index (SPIN) for Australian prime mortgages decreased to 1.17% in August from 1.24% a month earlier. The SPIN for Australian nonconforming mortgages also dropped in August, falling to 3.42% from 3.70% the previous month. An increase in outstanding balances contributed to this result for the nonconforming sector. Arrears movements during mortgage-relief periods are being influenced by reporting nuances and are yet to reflect genuine debt-serviceability pressures. We expect these trends to surface later this year and, more meaningfully, in the first quarter of 2021 (see "RMBS Arrears Statistics: Australia," published Oct. 22, 2020).

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