

## Questions That Matter

# Corporates | A Long Cycle Of Defaults And Debt Restructuring?

**We expect default rates, including debt restructurings, to increase to 9% in the U.S. in next 12 month, while Europe might rise to 8% and remain elevated for longer.**

## How this will shape 2021

**Credit vulnerabilities are growing.** The severity of the COVID-19-induced economic shock triggered downgrades among the weakest rungs of speculative-grade corporates, creating vulnerability in those sectors hit hardest by the pandemic: 39.4% and 32.5% of speculative-grade companies were rated 'B-' or lower in the U.S. and Europe as of Oct. 31, 2020.

**Will financial markets and credit metrics continue to diverge?** Revenues are flagging just when debt is increasing for many sectors. This has created a dichotomy between market-implied default prospects and our central view based on credit fundamentals. The disconnect can be explained by the sizable liquidity facilities the Fed and the ECB created this year that, while primarily targeted at investment-grade corporates, have indirectly benefited speculative-grade issuers as well. With government benchmark yields at historical lows and market liquidity restored, many investors are moving to riskier credit in search of yield.

## What we think and why

**The most defaults are in sectors hardest hit by lockdowns.** We forecast a rise in our default rate to 9% in the U.S. and 8% in Europe over the next year. Most defaults will occur in those sectors hardest hit by social-distancing and health concerns, such as media and entertainment, transportation, and retail and restaurants. The oil and gas sector also exhibits some vulnerability, particularly in the U.S. for shale producers.

**Forbearance will string out defaults in Europe.** Widespread official funding programs and the suspension of important insolvency regulations are dampening defaults in Europe for now. This could drag out defaults longer relative to the U.S. past a 12-month horizon.

**Debt restructurings will drive the most defaults in Europe.** Distressed exchanges (largely consensual restructurings) will continue to push up rated defaults in Europe. Almost one-half of European rated defaults since 2009 have been distressed exchanges; senior lenders want to avoid formal, lengthy insolvency processes so they can maximize post-default recoveries.

**Weak underwriting standards are undermining recoveries.** In Europe, the proportion of covenant-lite institutional loans remains around 93% in 2020, the same as in 2019. The U.S. equivalent has been above 80% since 2018 and stands at 84% in 2020. This is detrimental to recovery prospects. In the U.S., covenant-lite first-lien term loans recover about 68%, just over 10% less than covenanted deals on average. In Europe, the equivalent recovery rate could be even lower at 58%.

**Yet, markets expect a rosy outcome.** In contrast to our base case, our optimistic scenarios factor in market indicators that we have observed throughout the pandemic, which have been signaling reduced default risk ahead. Currently, our optimistic U.S. and European scenarios both point to only a 3.5% default rate through next September.

## What could go wrong

**Credit conditions could tighten.** While favorable financing conditions continue to enable most U.S. companies to refinance and term out debt, more vulnerable companies are not in the same position. They are now more sensitive to higher rates and tightening credit conditions because they have increased debt and their

**Nick Kraemer, FRM**  
New York  
Nick.kraemer@spglobal.com  
+1-212-438-1698

**Paul Watters, CFA**  
London  
paul.watters@spglobal.com  
+44-20-7176-3542

**We expect that distressed exchanges (largely composed of consensual restructurings) will continue to be the largest contributor to rated defaults in Europe**

**Companies are now more sensitive to higher rates and tightening credit conditions as a result of higher debt and weaker earnings**

## Read More

[The U.S. Speculative-Grade Corporate Default Rate Could Rise To 9% By September 2021](#), Nov. 23, 2020

[The European Speculative-Grade Corporate Default Rate Could Reach 8% By September 2021](#), Nov. 25, 2020

[European Corporate Support Schemes: A Long Unwinding Road](#), Nov. 25, 2020

**Global Credit Outlook 2021: Back on track?**

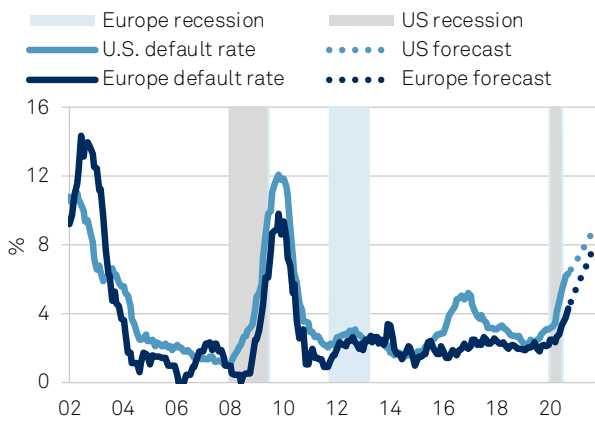
earnings have weakened after the dislocation caused by the pandemic. Firms with 'CCC/C' ratings are particularly vulnerable, and their numbers hit record-high proportions of our speculative-grade populations in both regions earlier this year.

**Additional COVID-19 waves could lead to more lockdowns.** Countries are in the middle of second waves of increased coronavirus infections, which may not subside but resurge in the months ahead —prompting renewed lockdowns. This contributes to our current pessimistic scenarios, which call for a 12% default rate in the U.S. and 11% in Europe through September 2021.

**The pandemic could continue to dominate.** In Europe, any delays in immunizing the population could force the authorities to extend emergency support measures, delaying the inevitable restructurings required to strengthen balance sheets.

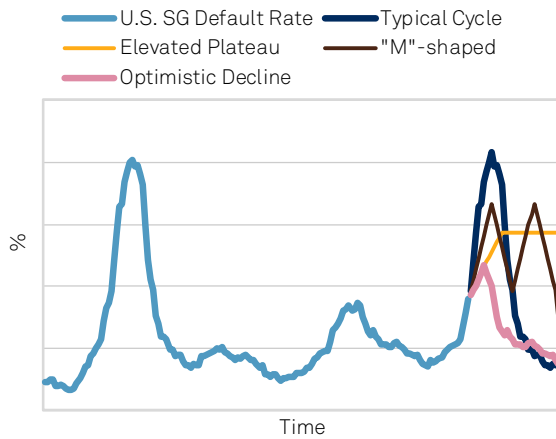
**Governments could pull fiscal support or not deliver enough.** The extension of fiscal support is not a given. This is more the case in the U.S. as the incoming Biden Administration may likely face a split Congress. However, the path is not completely clear in Europe either, as some disagreements on the EU's €750 billion recovery fund could delay initial disbursements until the end of 2021.

**Chart 12**  
**Europe Expected To Lag U.S. Default Cycle in 2021**



Source: S&P Global Ratings.

**Chart 13**  
**Unusual Stressor (And Responses) Could Produce Unusual Results**



This report is an extract from the S&P Global Ratings report, "Global Credit Outlook 2021: Back On Track?"

### **This report does not constitute a rating action**

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.capitaliq.com](http://www.capitaliq.com) (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

Australia: S&P Global Ratings Australia Pty Ltd holds Australian financial services license number 337565 under the Corporations Act 2001. S&P Global Ratings' credit ratings and related research are not intended for and must not be distributed to any person in Australia other than a wholesale client (as defined in Chapter 7 of the Corporations Act).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.

**[spglobal.com/ratings](http://spglobal.com/ratings)**