S&P Global Ratings

Regional Credit Conditions Chair

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Credit Conditions Europe Q3 2021:

Late-Cycle Redux

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(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 June 23, 2021.)

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Key Takeaways

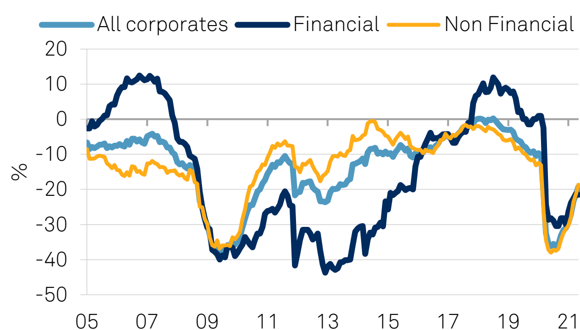
- **Overall:** High vaccine efficacy, falling COVID-19 case numbers (notably among older vaccinated persons including in the U.K.), and extensive policy support have boosted confidence and reflated the regional economy. When and how to rebalance policy settings are two big questions.
- **Risks:** COVID-19 and new variants as well as corporate debt sustainability remain key but moderating risks due to the success of the vaccine and improving outlook for the economy. Cost pressures, creating greater volatility in financial markets, remain an elevated risk.
- **Credit:** Timely policy interventions have shored up the economy, limited the severity of credit deterioration, ensuring that banks, corporates, and households are well placed to feed the recovery. Pockets of vulnerability remain, notably in services catering to social activities, while cost input pressures and late-cycle behavior warrant close monitoring.

The "all hands on deck" policy response to COVID-19 has proved largely successful in preventing households, businesses, and banks from capsizing in the storm over the last year. Evidence is mounting that vaccines are highly effective at preventing severe disease, and confidence in the sustainability of recovery is growing. This is also reflected in credit quality as rating actions swing into more positive territory and outlooks improve (see chart 1).

While the turn of events is welcome, the questions are many, not least how and when to scale back extraordinary policy support as well as restore monetary policy to a more neutral setting as fiscal policy remains lax. We think supply bottlenecks and rising commodity costs globally are unlikely to generate a wage-price spiral typically associated with longer-term inflation. Nonetheless, near-term inflationary pressures will bring tapering into sharp focus at the U.S. Federal Reserve, and even the European Central Bank, in the autumn. This carries the risk of unsettling financial markets, if not communicated appropriately.

Chart 1

European Corporate Net Negative Ratings Bias Continues To Narrow*

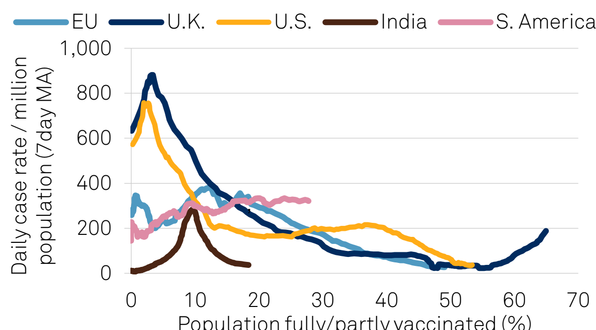


*--Net ratings bias is positive bias minus negative bias. Data as of May 31, 2021. Source: S&P Global Ratings.

Chart 2

Vaccinations In Europe And U.S. Way Ahead Of ROW; Delta Variant Of Growing Concern In U.K.

(Daily data from Dec. 31, 2020 – Jun. 25, 2021)



Source: Our World In Data, S&P Global Ratings.

The other big question is who ultimately will pay the costs incurred from the pandemic. Although many businesses have taken on more debt, much of which has not yet been spent, government balance sheets have borne the brunt, with central bank funding a significant portion of general government deficits in the U.K. and EU. How sustainable is that? Our view is that a gradual improvement in public finances in Europe will depend upon a buoyant economic recovery, with withdrawal of budgetary support to households and firms unlikely to happen until next year. Fiscal consolidation will also require a gradual and progressive multiyear increase in the tax burden for households and firms. Any political impediments to necessary budget tightening could pose a risk to sovereign ratings commencing even as early as next year.

Of course, the revived recovery hangs on the vaccination program reaching critical mass and existing vaccines preventing severe illness even against new variants. So far so good: 63% and 47% of the populations in the U.K. and EU have received at least one dose of vaccine, with supply sufficient to provide second doses to 70% of the adult populations over the summer (see chart 2). Evidence points to vaccinations limiting the severity of disease and lowering the rate of hospital admissions even caused by the highly contagious delta variant currently dominant across the U.K. This is encouraging for the EU that is bracing for a delta wave but should help motivate more people to get vaccinated as soon as possible. Even so, the reality remains that vaccine supply constraints, particularly in South America, Africa, and many parts of East Asia, will delay widespread immunization globally until well into 2022 if not 2023. This carries a significant risk that further mutations of the virus could undermine the protection provided by first-generation vaccines. We expect this will inevitably further weaken global supply chains and delay any recovery in international discretionary travel.

The effectiveness of government support measures, and confidence in the strength of the economic rebound underway, are benefiting banks as they have reduced the likelihood of a large deterioration in asset quality that could undermine their capital strength. Nevertheless, while profitability may improve in 2021, compared with 2020, as credit provisions reduce and commission and fee income increases, the persistence of negative eurozone rates for several more years will remain a strong headwind to achieving adequate risk-adjusted pricing in the most overbanked markets.

Similarly, structured finance ratings have generally held up well during the pandemic, with most rating actions confined to smaller asset classes backed by distressed corporate sectors, such as retail and leisure, with few actions on consumer-backed securitizations and collateralized loan obligations (CLOs). Some potential deterioration in collateral performance remains a risk for consumer-backed securitizations as government support measures unwind to the extent that unemployment rises. Elevated default rates remaining above 5% could have credit implications for those CLOs unable to trade out or hedge their exposures.

For nonfinancial corporates, pathways continue to diverge between more resilient construction, manufacturing, and export-facing sectors that are starting to invest for future growth, and those more socially disrupted sectors, including parts of the leisure sector, airlines, and airports, still struggling to protect cash flow amid uncertainty about the timing and strength of recovery. Regarding investment, we have some concerns about potential capital misallocation given the exceptionally low cost of capital, unrestrained funding availability, as well as accelerated capital allowances in certain countries such as the U.K. Another developing concern is the impact of rising cost push inflation on corporate margins, most obviously in those sectors without cost pass-through clauses in their contracts or lacking pricing power, such as building material and airline sectors[1]. We think the effect will likely become more visible in 2022 once companies' short-term raw material hedges run off.

[1] Global Debt Leverage: Spreads, Costs Shocks May Double Rate Of Loss Making, June 22, 2021

Top European Risks

Table 1

Near-Term Risks

Corporate debt sustainability remains as an issue when emergency support measures are scaled back

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

As the recovery gains traction, financially stronger companies are likely to prioritize higher working capital, capital investment, and expectation of higher shareholder returns before paying down debt that has increased during the pandemic. At the same time, the recovery remains uneven and protracted for the most disrupted (largely service) sectors, threatening debt sustainability, translating into a still higher-than-average risk of default for companies rated 'B' or 'CCC'--notwithstanding favorable financing conditions. This also applies to (largely unrated) small and midsize enterprises, whose business models, cash generation ability, or capital structures may no longer be viable without, at a minimum, restructuring their debt. Premature withdrawal of emergency measures (including regulatory forbearance) would exacerbate this risk.

Vaccine hesitancy and new variants could disrupt economic recovery

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

Vaccine hesitancy rather than supply in Europe is more the binding constraint to reaching the 70% adult population target over the summer. This creates some vulnerability in the unvaccinated population to severe disease from a new more transmissible variant such as delta. Nonetheless, barring a new variant that undermines the efficacy of existing vaccines, the economic and credit impact is becoming less severe as economies adapt and stringency measures become more targeted on nonessential social activities such as international travel. In this context, the risk remains of a curtailment of the important European summer holiday season.

Inflation pressures creating greater volatility in financial markets and tighter credit conditions

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

Input cost pressures and supply bottlenecks are driving wholesale inflation higher. If this persists longer than we currently expect, particularly if combined with the start of tapering in QE later this year, it could lead to further tightening in financial conditions as yield curves steepen, and greater volatility in financial markets. While a more pressing near-term concern for the U.S. at this point in the cycle, Europe faces a similar predicament and is exposed to potential financial spillovers from the U.S.

Longer-Term Structural Risks

Technology, climate present challenges and risks in a post-COVID-19 world

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

COVID-19 has accelerated secular change and raised the bar for governments' commitment to protect the environment, not least to reach net zero by 2050. Technology will likely play a key and positive role in this transition but also brings some additional systemic risk vulnerabilities. With IT infrastructure powering the network economy, these vulnerabilities have been evident recently in ransomware attacks and outages suffered by major content delivery network providers. In the medium term, transitioning to a low-carbon world will significantly disrupt industries and business models, creating winners and losers. Global policy alignment, including regulation, will be also important in reaching the net zero target but will inevitably create tensions between governments, for instance, as the EU moves to set global standards by unilaterally introducing policies such as the carbon border adjustment tax.

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.

Macroeconomic Outlook

- Progress in battling the virus and a more resilient economic performance have led us to modestly increase our EU 2021 GDP growth forecast to 4.4%.
- We expect headline inflation to fall back into a 1.4%-1.6% range from next year as input cost pressures subside (including energy) and wage pressures remain subdued.
- The EU recovery, bolstered by the Next Generation plan that should add 1.5%-4.1% of additional GDP over the next five years, will focus attention on how to scale back QE, possibly as early as September. We do not see key EU interest rates rising before 2024.
- In the U.K., strong resilience in the first quarter and 2.1% growth in April have restored economic momentum, leading us to uplift our 2021 growth forecast to 7.0% from 4.3%, largely due to growth being brought forward from 2022.

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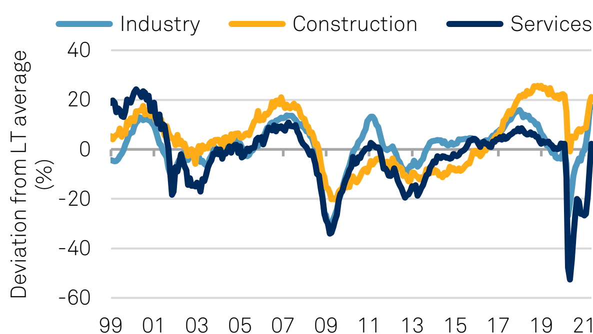
- **The eurozone is leaving the third wave of COVID-19 behind.** 7-day case incidence was down below 30 (per million population) in late-June from over 240 two months ago. Vaccination has stepped up significantly and is now open to larger groups of the population, including young people. Social-distancing measures and restrictions to activities have been eased steadily since the beginning of April.

  At the same time, the contraction of GDP in the first quarter of 2021 was one-half what we expected in our baseline scenario. Consumer spending fell on extended lockdowns, especially in Germany, but its impact on GDP was mitigated by a strong restocking and, to a lesser extent, by a further increase in foreign trade and construction investment. The retreat of the virus and a slightly higher-than-expected level of GDP at the end of March led us to revise our 2021 growth projection slightly upward to 4.4% from 4.2% previously.
- **The grand reopening gives a strong boost to the services sector**, which is catching up with manufacturing and construction. Confidence in services is back to its pre-crisis level--2.3 points above long-term average--for the first time in 15 months (see chart 3). Real-time data is encouraging. Mobility at retail and recreation has normalized in full, according to Google data. The hospitality and tourism sectors are hiring back people quicker than the rest of the economy, according to online job postings (see chart 4). At the same time, momentum in manufacturing and construction is lessening. German industrial production declined 1% in April due to shortages of semiconductors and lumber. Shortages could persist for several more months, but the slowdown in industrial activity should only be temporary as backlogs remain.

Chart 3

EU - Economic Sentiment By Sector



Source: Refinitiv, S&P Global Ratings

Chart 4

Online Job Postings In France

Source : Indeed HiringLab, S&P Global Ratings

- **Inflation will rise at a much slower pace from now, before falling back early next year.** Headline inflation rose further to 2% in May, while core inflation is stuck at 1% year on year. The large gap between the two price indices indicates that the short-term dynamics mostly rely on transitory factors, primarily energy prices and secondarily limited pass-through from soaring purchasing prices. We expect inflation to rise at a much slower pace until the end of the year, as the normalization of the German VAT will add to the past rise in energy prices, before retreating in the first months of 2022. The slowdown in negotiated wages to 1.4% in the first quarter from 2.0% in the fourth quarter 2020--the slowest increase in four years--suggests that the pickup in core inflation, which is expected over the next three years as unemployment recedes, is likely to be fairly gradual. At the end of the first quarter, the eurozone economy was still short of 3.3 million jobs compared to pre-COVID-19 levels of employment. In its new projections, the

European Central Bank confirmed its previous expectation of 1.3% inflation in 2023, which is well below target.

- **The fiscal stimulus is changing nature.** The EU got the green light from all member states to raise joint debt on the capital markets to finance its Next Generation EU recovery plan. The European Commission, on behalf of the EU, is expected to raise some €800 billion in debt by 2026, of which €80 billion in the second half of this year--if the plan reaches its maximum wingspan. For this to happen, member states will have to make full use of the €386 billion in loans offered to them. So far, seven countries have applied to the EU for €166 billion in loans. But even if the EU only issues €500 billion-€600 billion in five years, the European supranational debt market will experience an unprecedented boom, considering that since 2011, the EU has issued a bit less than €150 billion in benchmark bonds. The implementation of Next Gen EU comes at a time when member states are considering withdrawing some of their support to corporates and so somewhat reduces the risk of a cliff effect. We estimate that the Next Gen plan could contribute 1.5%-4.1% of additional GDP to the EU over the next five years, depending on the ability of member states to use EU funds and the multiplier effects of public spending.
- **Monetary policy is at a turning point.** The ECB decided to maintain an elevated pace of QE at its June meeting, as expected, arguing that the recovery is nascent and that the increase in long-term yields since March was unwarranted, reflecting co-movements with U.S. yields rather than improvement in the European economy. That said, a few members of the governing council have signaled their willingness to reassess the pace of QE in September. If the virus remains under control, net bond purchases under the pandemic QE program PEPP are likely to wind down by the end of March 2022, with a total envelope not exceeding €1,850 billion.

  However, many questions arise regarding an exit from PEPP, under which the ECB currently buys €80 billion out of €100 billion securities per month. A first question is whether the ECB will slow the program's net purchases from September. And if yes, by how much. A second question is whether the ECB will continue to reinvest maturing bonds under PEPP until the end of 2023 as planned or stop sooner. A third and perhaps the most challenging question is whether the ECB will change the principles set for its other QE program (the Asset Purchase Programme), possibly stepping up purchases, to avoid a cliff effect while phasing out PEPP and try to overcome some constraints on the composition of bond purchases. At the end of May, under its two QE programs PEPP and APP, the ECB holds a portfolio of debt securities worth €4.1 trillion (see chart 6), which is 36% of 2020 GDP. Regarding rates, we still do not expect the ECB to start lifting them before 2024.

Chart 5

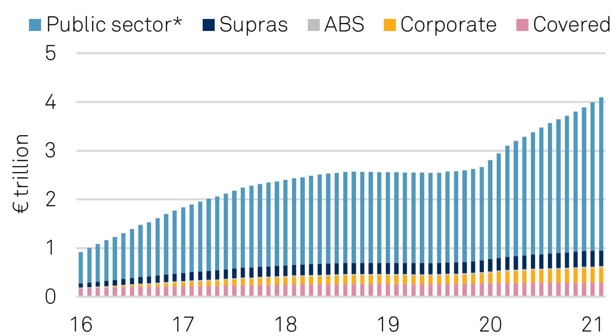
Eurozone Households Net Financial Assets

Source: ECB, S&P Global Ratings

Chart 6

ECB Cumulative Net Asset Purchases

(Sum of APP and PEPP)



*--Public sector excluding supras. Source: ECB, S&P Global Ratings

Key Assumptions

- **We do not expect new COVID-19 variants to cause governments to dramatically inhibit the normalization of social and economic life**. We assume that available vaccines are effective, and that the vaccination strategy is appropriate to the epidemiological situation. Our baseline forecasts suppose a gradual return to business as usual until early next year.
- **We assume that financing conditions will not worsen significantly throughout our forecast horizon.** This supposes that the ECB will look through a further increase in inflation this year and will not to start lifting key rates before 2024. It also requires the ECB to manage a smooth exit from its pandemic QE program and address possible co-movements between U.S. and European long-term yields when the U.S. Fed starts discussing phasing out QE.

- **We expect the fiscal stimulus to provide significant support to the European economy**. Now that most member states have submitted their spending plan to the EU, we expect the EU to approve them and member states to spend the money received under Next Gen EU in a timely and effective manner, leading to sizable multiplier effects.

Key Risks

- **The main risk to our base case remains a possible resurgence of COVID-19 due to the delta variant.** Current developments in the U.K. show that a quick vaccination campaign is not enough to keep incidence at record low and may derail the authorities' agenda for the return to business as usual if hospitalizations rapidly increase.
- **A worsening of market conditions is another risk to our baseline**. This risk is probably not congruent with the former risk and may not be high over the next few months, but rather beyond that: later this year when Germany forms a new government after the Federal elections, in the run-up to the French presidential elections in spring 2022, and when the ECB faces transitioning out of its pandemic QE program at the same time the U.S. Fed discusses tapering.
- **Household spending of excess savings is the main positive risk to our baseline**. We estimate that eurozone households accumulated about 2.7 % of GDP (€300 billion) in excess cash reserves last year, and these reserves are likely to have increased further in first-quarter 2021. It remains challenging to figure out how much, how fast, and how they will spend it, but excess savings definitively poses an upward risk on our baseline assumptions for housing investment, consumer spending, and domestic prices.

U.K Recovery To Build On First-Quarter Resilience

- **In the first quarter of this year, the U.K. economy proved highly resilient to a fresh and severe lockdown** under which the country was placed through the quarter, and the economy contracted by just 1.5%. The recovery now underway will build on that resilience, helped by ongoing support from the government and the Bank of England.

  The success of the vaccination campaign has allowed not only the gradual but sustained reopening of the economy since March but also appears to have, in combination with better treatment, all but eliminated mortality from COVID-19. Because of these favorable effects, we do not expect the government to reimplement more drastic restrictions, even as the recent step in its reopening schedule has been postponed by four weeks amid higher caseloads from the so-called delta variant of the virus.

  Strong resilience in the first quarter and monthly GDP growth of 2.1% in April has frontloaded the recovery momentum. As the effects unwind from the way the Office for National Statistics measures public output, this will further strengthen growth numbers, and we now expect GDP growth of 7% in 2021, before it slows to 5.2% in 2022.
- **Large savings accumulated during lockdowns and helped by government job support mean households have been ready to spend** and will continue to spend at above-average rates over the next few quarters while still retaining considerable amounts of savings accumulated during lockdowns. However, middle and higher incomes have amassed the most savings, which will limit the impetus of spending out of savings for the household sector as a whole.
- **Another dampener to household spending growth is the still high degree of slack in the labor market.** Before significant numbers of jobs are created, employers will bring back furloughed workers full time. As some currently furloughed workers will become unemployed and labor market participation recovers, the unemployment rate will rise later this year, although only moderately so, weighing on household spending growth. Yet, these headwinds should prove modest, especially under the circumstances, and not prevent a strong consumer-led recovery of the U.K. economy.
- **Inflation should remain just above the 2% target until early next year**, driven by higher global prices for oil, metals, and minerals, as well as by food inflation picking up later this year thanks to the higher cost of imports from the EU. However, while supply bottlenecks may lead to longer-lasting price pressures from individual items, overall pressures should remain contained, and we expect the Bank of England to see through these transitory pressures and start raising rates moderately only late 2023.

Financing Conditions

- Issuance volumes of corporate nonfinancial debt to date stand clearly below last year's level, driven by the drop in investment-grade rated issuance due to weak funding needs.
- Corporates took advantage of favorable financing conditions from the second quarter of last year to increase their cash balances and refinance debt at lower cost, limiting their financing needs over the first months of this year.
- As demand and business investment recover, corporates' needs for external financing will increase and lead to a pickup in debt issuance.

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Subdued Nonfinancial Issuance Despite Favorable Financing Conditions

Cumulative bond issuance in 2021 by European nonfinancial corporates stood at €84 billion as of end-May, about one-third lower than at the same time last year (see chart 7). This stems from weak issuance volumes in the investment-grade sphere, which was less than half of last year's, while speculative-grade issuance more than doubled. This comes in the context of capital costs trending down and ample liquidity in the market caused in large part by the ECB's accommodative monetary stance, especially the €1.85 trillion PEPP that will run through March 2022. While markets are anticipating an ECB announcement in September about how it will taper its asset purchase programs, the ECB has confirmed its intention to continue its pace of purchases at €100 billion a month until then (see chart 8).

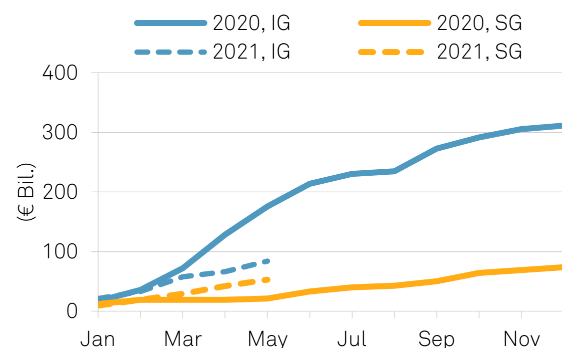
The Reopening Of The Economy Should Boost Corporates' Financing Needs

Over the last year corporates took advantage of low borrowing costs to increase their cash holdings and refinance at lower costs. However, in the first quarter of this year, weak business activity limited corporates' need for working capital and appetite to invest. This was reflected in the ECB' s first-quarter bank lending survey showing a decline in firms' demand for commercial loans for the third consecutive quarter. What's more, government support schemes represented an important alternative source of financing, especially for SMEs, substituting for market or bank funding.

Now that the economy is reopening, we expect pent-up demand to be released. Expanding production and building inventories will require an increase in working capital. Moreover, with uncertainties receding and business confidence high, we are seeing a broad expansion in capital investment across most sectors, partly to catch up but also to adapt technology to improve efficiencies. On top of that, private firms are positioning to capitalize on public investment arising from the Next Gen recovery plan that is starting in the second half of this year. While internal cash flow and excess cash balances will be absorbed first, we would still expect a gradual pickup in the need for external debt finance. The wild card also, typical for late cycle, is how strongly large debt-funded M&A will increase.

Chart 7

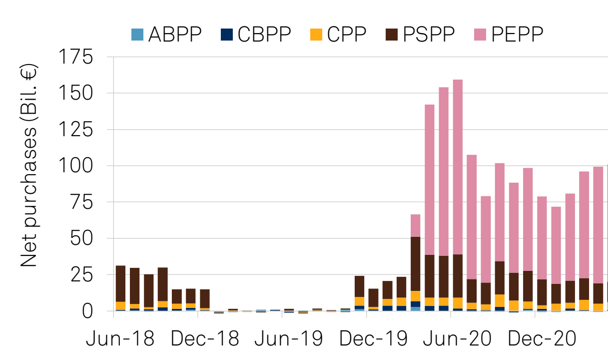
Weak Capital Needs Among Investment-Grade Issuers Weighs On European Non-Financial Issuance Volumes



Source: Refinitiv, S&P Global Ratings

Chart 8

ECB's Monthly Purchases Will Keep Yields Low And Appetite For Lower Rated Issuance Strong



ABPP—asset backed purchase programme, CBPP—covered bond purchase programme, CPP—corporate purchase programme, PSPP—public sector purchase programme, PEPP—pandemic emergency purchase programme. Source: ECB, S&P Global Ratings

Financial Institutions

- Our outlook bias for European banks has markedly improved, with the percentage of negative outlooks for the top 100 European banks declining to 10% from about one-third three months ago.
- While we have yet to see the full impact of the pandemic on banks' asset quality, and no doubt problem loans will rise from contained levels, the proven effectiveness of government support measures and confidence in the strength of the economic rebound underway have reduced the chances of severe asset quality deterioration that would undermine banks' capital strength.
- Profitability challenges, however, have deepened for some banks and banking systems and are the key driver behind some recent downgrades. The likely persistence of negative eurozone interest rates well into 2024 undermines revenue prospects and adequate risk-adjusted pricing in the most overbanked markets. This comes when banks also need to invest to digitalize, to seize process efficiencies and deliver enhancements to customer service.

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Key Developments

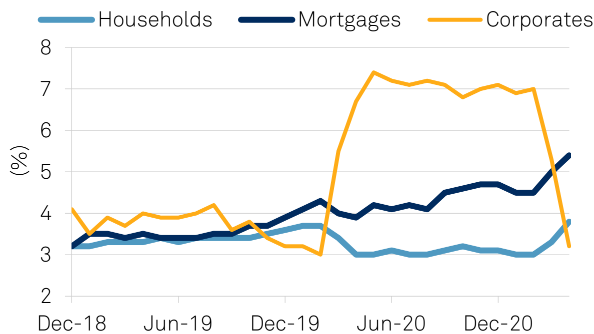
- **The gradual end to debt moratoriums has not resulted in a meaningful hike in delinquencies.** While some moratoriums remain in place, they have almost entirely expired throughout most of Europe, with most borrowers likely to resume and sustain normal payments.
- **Strong recovery of activity will help contain asset quality deterioration.** Problem loans are yet to rise, particularly in banks' corporate loan books, but better prospects ahead should support borrowers' creditworthiness and result in a manageable, rather than significant, increase in nonperforming assets at most banks. Asset quality performance will vary across banks and countries, however, with problems likely to be concentrated in the sectors hardest hit by social-distancing measures (hospitality, lodging, transportation, entertainment, and retail). This is the primary reason why, in the past weeks and months, we revised a swathe of negative outlooks to stable across Western European banks.
- **Some U.K. banks started to release provisions in first-quarter 2021, but we see them as the exception rather than the rule.** They set aside more provisions than the rest of European banks in 2020, and the economic rebound in their home market is likely to prove stronger and come earlier than in Continental Europe. Given that most other European banks opted for a more gradual recognition of credit provisions in 2020, we don't expect them to follow suit. We expect provisioning charges in most markets in 2021 to be lower than in 2020, but generally remain elevated, at above normalized levels.
- **Corporate lending growth decelerated in the past few months** (see chart 9). The pace of bank lending to residents in the eurozone dropped to 3.2% in April from the fairly consistent 7% reported between April 2020 and February 2021. The latter trend is naturally a reaction to the exceptionally high demand for credit following the COVID-19 outbreak. Borrowers initially drew down on their committed credit lines to pile up cash to deal with an uncertain environment, and they subsequently took advantage of the government-guaranteed schemes that were made available to refinance or increase their debt at better terms. Except for those companies operating in sectors more vulnerable to the pandemic shock, they have only partly used the additional lending, which remains as a cash buffer on their balance sheets. This suggests a limited need for further bank lending in the months ahead, at least until investment resumes.
- **Conversely, demand for credit from households is returning, which banks generally see as the main growth engine for 2021.** There is evidence of growing mortgage demand in a few countries, and consumer lending is likely to rebound gradually as private consumption takes off after more than a year of excess saving and deleveraging. This also points to a gradual reduction in accumulated customer deposits that built rapidly during the pandemic.
- **Banks' aggregate first-quarter results point to a gradual recovery, which resulted in somewhat better equity valuations (see chart 10), but it is just the beginning of a long journey.** We expect most European banks to report better profits in 2021 than in 2020, thanks to lower credit provisions, higher fee and commission income, and efficiency gains in some cases. But pressure on net interest income will continue, despite the beneficial effect of funding through the ECB's targeted longer-term refinancing operations, which most eurozone banks have resorted to materially. Net interest income is by far the largest contributor to European banks' revenues. As a result, it will be hard for most banks to achieve a level of returns that at least aligns with their cost of capital.

That will likely remain the case in 2022 and 2023, absent a major transformation and reshuffle that addresses excess capacity and suboptimal efficiency. Restructuring announcements have become more common in recent months, with banks undertaking further downsizing initiatives, refocusing business lines, and exiting foreign markets (recent moves by BBVA and HSBC are good examples of the latter). While all banks are conscious of the need to transform their business and are focusing their strategies in that direction, the sense of urgency, budget depth, ability to deliver, and quality of execution vary widely.

Chart 9

Corporate Lending Growth Is Decelerating, Household Lending Resuming, Supported By Mortgages

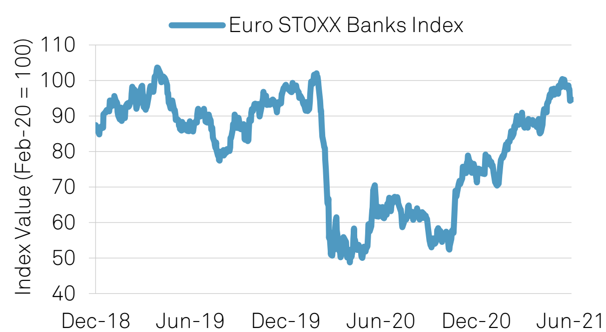
Annual Annual Growth Rate of European Banks Lending to Residents



Source: European Central Bank. Rates based on adjusted loan growth

Chart 10

Banks' Equity Valuations Bounced Back, But Continue To Weight Weak Profitability Prospects



Source: Refinitiv, S&P Global Ratings

- **We recently lowered the ratings of a handful of European banks, mainly in Germany and France, and maintained negative outlooks on others** to reflect profitability challenges and our view of their more limited ability and willingness to tackle them.
- **Capital ratios so far proved resilient, but likely already peaked for most banks.** By end-2021 and into 2022, we expect the rise in NPAs and the return of dividend distributions to depress capital ratios, albeit moderately in most cases. Limited distributions restarted already, and the BOE and ECB are likely to further ease their stance during the third quarter. Looking into 2022 and 2023, the reversal of some COVID-19 regulatory relaxations and the implementation of the final elements of Basel III are likely to create further headwinds.
- **The collapse of supply chain financer Greensill and U.S. hedge fund Archegos had no systemwide implications for European banks.** However, the large exposure to Archegos prompted us to revise the ratings outlook to negative on Credit Suisse because of potential implications for the quality of the group's risk management and calibration of its risk appetite. Credit Suisse estimates its overall loss from the exposure at Swiss francs 5 billion. As a result, it would be only marginally profitable in 2021.

Key Risks

- **Interruption of the economic recovery,** potentially because of a resurgence in infections provoked by a virus mutation, as vaccination is far from being complete, or because of a too early or too abrupt phaseout of fiscal stimulus. Such a scenario would prove painful to the private sector, resulting in higher asset quality problems for banks than we currently anticipate, higher provisioning needs, and weaker profitability.
- **Banks' limited success in revamping their operating models**, adapting quickly to an increasingly digitalized word, and improving profitability. If weak profitability persists, it will impair banks' capacity to build up capital internally and externally, reducing their capacity to deal with unexpected shocks, effectively channel credit to the economy, and invest to transform business processes and strengthen their customer proposition.
- **A reversal of today's favorable market conditions**, ultimately increasing funding costs for governments, companies, and banks--or causing greater difficulties in accessing funding. This could happen either because inflationary pressures prove sticky and require a shift in extremely accommodative monetary policy or because of a turn in investors' perceptions or risk appetite. The most affected players would be those with weaker credit quality and market access.
- **Distortion of risk pricing and the buildup of asset bubbles**, particularly in the property market, as a result of prolonged accommodative monetary policy and excess savings.

Nonfinancial Corporates

- Diverging paths continue between more resilient manufacturing and export-facing sectors and more socially disrupted sectors struggling to adapt amid uncertainty about the timing and strength of recovery.
- Key risks relate to the timing of withdrawal of support measures, growing cost push inflation eroding margins, and greater volatility in financial markets tightening credit conditions.

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Key Developments

- **Ratings continue to stabilize,** reflecting the effects of the recovery in many sectors. Some sectors are feeling a stronger positive impact than others. Recovering faster than initially expected are metals and mining, chemicals, construction, and generally sectors exposed to exports toward China and North America. The percentage of negative outlooks for rated corporates in Europe has fallen to 23% from almost 34% at year-end 2020 (see chart 11) and upgrades outnumbered downgrades in the second quarter of 2021 for the first time since the beginning of the pandemic (see chart 12). Year to end-May, positive rating actions total 58 and negative 56, although credit rating levels remain lower than they were pre-pandemic; 55% of rated nonfinancial corporates are now speculative grade, with 9% rated 'CCC' or 'CC'.

Chart 11

European Nonfinancial Corporate Outlooks Recovering

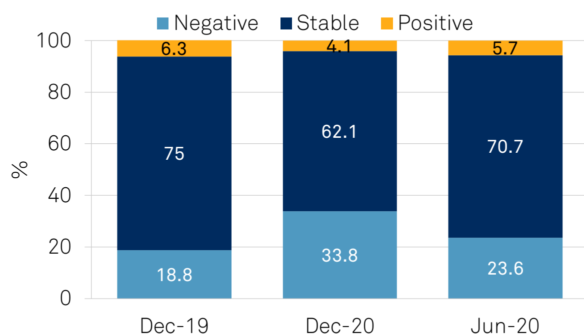
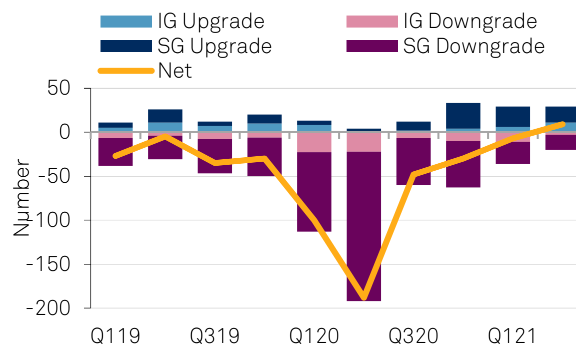


Chart 12

European Nonfinancial Rating Actions Net Positive in Q221



Source: S&P Global Ratings

- **Personal spending and capital expenditures are returning to a more normal level**. After one year of very low spending in many sectors during lockdowns, companies are returning to more normal behaviors. This includes a broad-based increase in capital investment across many sectors. On this point, we have some concerns about potential capital misallocation given the exceptionally low cost of capital, unrestrained funding availability, as well as accelerated capital allowances in certain countries such as the U.K. Other sectors still suffering from limitations related to the pandemic, including parts of the leisure industry, airlines, and airports, are not benefiting so much from this positive trend in spending and investment.
- **The demand for metals is continuing to grow.** Metals prices already started to increase in the second part of 2020, supported by solid demand from China. In 2021, the recovery in North America and more recently in Europe has added to the demand-supply imbalance caused by lower-than-usual inventory and limited investment in recent years. These factors probably don't fully explain the increase in prices of copper, cobalt, or lithium, among others. Indeed, the transition to green economies is structurally increasing demand for some raw materials, and the impossibility of rebalancing supply quickly indicates that some metal prices are likely to remain well above their historical average.
- **Chemicals and building materials are recovering faster than expected.** Similar dynamics apply to chemicals, which supply many other general industrial sectors. Here, we assume the increase in supply cannot be immediate, but on average it should be faster than for metals. The building materials sector is also recovering earlier than expected thanks to an increase in activity for homebuilders. The persistence of low interest rates and increased home working have pushed up demand for new houses and prompted refurbishments of existing homes.
- **The European luxury goods sector is benefiting from demand abroad.** The pandemic has taken a large toll on luxury companies: revenues and EBITDA fell 15%-25% and 25%-40%, respectively. Given the discretionary nature of these products and uncertainty about the shape

and timing of recovery, we assumed that the improvement of credit metrics to 2019 levels for most of the sector was going to take place only in 2023. However, healthy demand from China, and, more recently, the U.S. is more than offsetting the weakness in European sales due to the lack of tourists and we now expect recovery to be brought forward to 2022.

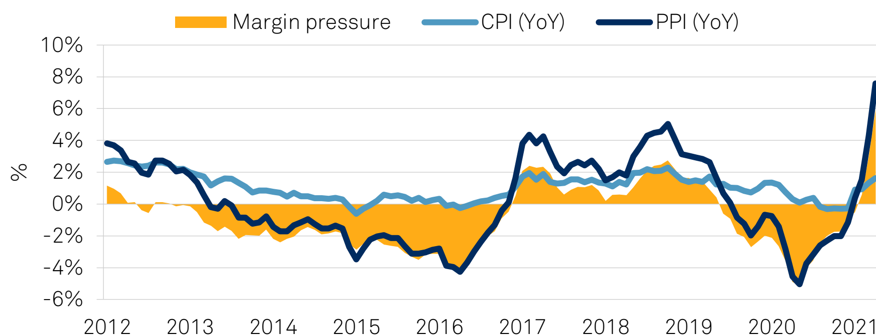
– **A late recovery is still on the horizon for parts of the leisure sector, as well as airlines and airports.** The rapid increase in vaccinations in the past two months has raised hopes that the summer holiday season can be saved, and the pick-up in reservations confirms that. Adoption of common rules for mobility in the EU would provide further momentum. For hospitality and lodging, we assume that part of lost international demand can be absorbed by domestic and other European travelers, even if full recovery of the sector is currently expected only in 2023. For airlines and airports, domestic and short-haul leisure travel are going to help, but a full recovery depends on business travel and international routes that are usually more profitable. Both are still far from normalizing with a full recovery only expected beyond 2023.

Key Risks

– **The increase in raw material costs puts pressure on corporates' operating profits.** The sharp rise in raw material costs is increasing the cost of goods sold for many companies and can impinge on profitability when producer prices materially exceed consumer prices for an extended period, which we are starting to see now (see chart 13). The effect will likely be more visible in 2022 once companies' short-term raw material price hedges run off. The ability to pass through raw material cost increases varies by sector and company. For instance, inflation can help justify staple branded consumer goods companies negotiating price increases with retailers. Conversely, this is more difficult for intermediate producers if they do not have pass-through clauses in their contracts.

Chart 13

Margins Expected To Come Under More Pressure In 2022 As Hedges Run-Off



Source: Eurostat, S&P Global Ratings

– **Further signals of late cycle behavior in the leveraged finance market.** Currently, we are seeing aggressive structures dominating the sponsor-backed leveraged finance space amid signs of frothy markets that are testing investors' risk tolerance levels. Leverage for European private equity-funded buyouts has steadily increased, with average marketed net indebtedness now approaching 6x (according to S&P Global Market Intelligence's Leveraged Commentary & Data). Year-to-date dividend recap activity is the highest recorded since 2007 and transactions often include an additional 0.5x of senior leverage. Higher leverage is only partially mitigated by robust cash interest coverage ratios due to lower interest rates and meaningful equity contributions, particularly in new LBOs.

– **Higher interest rates or credit spreads would hurt the more weakly rated European corporates.** Financing costs for corporates are still historically low thanks to the combination of low interest rates and very low premiums for credit risk. The uneven recovery and rising input costs might trigger a change in one of these two components. According to our base case, inflation should be transient and in consideration of the supportive financing conditions favored by the ECB's policies and by the European Commission's recovery plans. Therefore, we do not see a big increase in interest rates as an immediate risk for corporates. Regarding credit spreads, ample liquidity supports access to financing. However, evidence that some sectors might not recover for a long time, due to weak demand or permanent changes in consumer preferences and habits, could trigger a repricing in risk. Such an event in sectors with a large number of companies rated 'B', 'CCC', or 'CC', like leisure, entertainment, or energy, could translate into a higher number of defaults.

Sovereigns

- A gradual improvement in public finances will depend upon a buoyant economic recovery and withdrawal of budgetary support to households and firms next year.
- With few exceptions, eurozone bond markets enter midsummer with yield curves below zero up to the five-year maturity. Upcoming potential trigger points include the conclusion of the ECB's strategy review over the next month and its Sept. 9 press conference.
- Rising input prices indicate supply bottlenecks are not exclusive to the U.S. Nevertheless, our view is that the longer-term macro risk for Europe is not inflation but a reversion to lower growth, amid a failure to tackle structural rigidities, particularly in labor markets.
- Political impediments to budget tightening could pose a risk to ratings commencing next year.

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Key Developments

- **Sovereign debt markets will focus squarely on macroeconomic developments in the next six months,** where the story in advanced economies has been steadily brightening since April. Eurozone PMIs and startups are now above their pre-crisis levels. And private consumption is recovering, reflecting that vaccinations are on track to reach 70% by August.
- **Meanwhile, we project that the EU's Recovery and Resilience Facility will boost European public investment by at least 2 percentage points of GDP this year and a similar figure in 2022.** The ECB is now forecasting that the eurozone will exceed 2019 levels of output one quarter earlier than previously anticipated. Nor is the recovery restricted to the core economies of Germany and France; recently, Banca d'Italia revised its GDP projection for Italy up to 5.0% from 4.4%, and despite a more protracted recovery of tourism, Banco de Espana improved its GDP growth estimate for this year and next to 6% and 5.8%, respectively.

Key Assumptions

- **Not only is the epidemiological situation improving (despite the risk of the delta variant), but the sensitivity of private spending to lockdowns continues to lessen**, as investment in digitalization accelerates in services as well as manufacturing. As a consequence, the early signs about productivity trends and unit labor costs in the eurozone are highly encouraging. Part of this productivity improvement will involve large job losses in transport, retail, tourism, and banking as companies restructure to free up resources to invest and government support ends. This will create churn in labor markets (as is already the case in the U.S.), but with the possibility of better matching between employees and employers. While European unemployment rates have ticked higher, they remain solidly below levels in 2017 (thanks to short-term work schemes), but it is difficult to interpret the strength of European labor markets given a decline in overall participation, particularly among women.

Key Risks

- **Short-term risks to the strength of the recovery** include potential new variants as well as the recent surge in wholesale inflation via higher prices of commodities and construction inputs. European economies are considerably more export driven, compared with those in the U.S. or Japan, and the rise of the delta variant in emerging markets, including in Asia, could cool the strength of sales abroad.
- **Supply chain bottlenecks are numerous**, but these appear to be largely affecting manufacturing rather than services (with the exception of transport and construction). Our house view continues to be that inflation in Europe is transitory, and that temporary reinflation is actually a positive for demand conditions (as well as for fiscal performance). The ECB agrees; it projects that after peaking at 1.9% this year, due to temporary factors, inflation will subside to 1.5% on average in 2022 and 1.3% in 2023.
- **What does this all mean for fiscal performance in advanced European economies?** Public finances ought to mend as demand recovers but not until extraordinary fiscal support for households and firms is phased out, and that is not going to happen until next year. Indeed, for 2021, we are generally projecting further widening of fiscal deficits in advanced economies. This is the case even though EU government revenues are already back above 2019 levels. Early indications from EU states' fiscal reform plans is that most of the budgetary consolidation effort over the next decade will take place via increasing taxes on households and firms, but for political reasons, as gradually and progressively as possible.

International Public Finance

- Substantial financial support from central governments and projected economic recovery is strengthening the credit outlook of many European local and regional governments (LRGs).
- Notable exceptions include regions in European federal states, such as Austria, Belgium, and Germany, that have adopted countercyclical fiscal policies. We believe the delayed exit from the pandemic will result in relatively wide LRG budget deficits in these countries in 2021.
- A post-pandemic transformation of local economies with signs of accelerated suburbanization will test the budget strengths of large urban areas.
- The balance of credit risks for U.K. social housing providers is more to the downside given higher maintenance spending and compelling need for more affordable homes.

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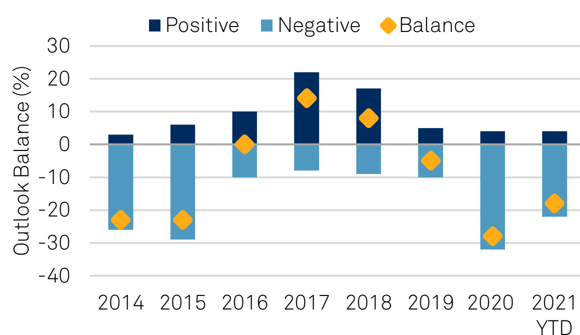
Key Developments

Chart 14

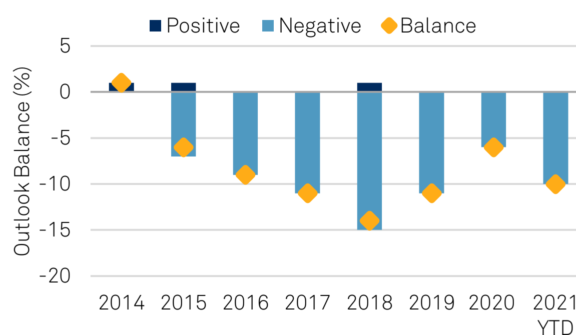
Outlook balance -- EMEA LRGs



LRGs—local and regional governments. Source: S&P Global Ratings

Chart 15

Outlook balance U.K. Social Housing



Source: S&P Global Ratings

- **Substantial support from central governments are helping European LRGs in unitary countries to weather the pandemic with little impact on financial performance.** In unitary counties, LRGs received central government grants that largely covered revenue loss as well as their elevated spending on health care, social care, and transport. Nevertheless, the gradual reduction of the central government's support, combined with demographic pressures in the Nordics and accumulated infrastructure investment backlog in France and Italy, will lead to a moderate widening of budget deficits in 2021 and 2022. Due to the peculiarities of the financing system, most Spanish regions and municipalities may anticipate smaller revenues in 2022.
- **Regional governments in Austria and Germany, though, remain committed to expansionary financial policy.** The constitutional "debt brake" rule, which requires German states to balance their annual budget, have been lifted for 2020 and 2021 and might not be reinstated in full after the pandemic. We believe that regional governments in European federal countries continue to provide a substantial fiscal stimulus to the local economies suffering from the consequences of COVID-19. As a result, debt burdens for some states may increase materially above our previous expectations. Since the start of the pandemic, we lowered two ratings on German states and revised outlooks to negative on two other German states and four Austrian states.
- **In our view, large urban areas might face prolonged budget deficits as a result of the post-pandemic transformation of their economic fabric.** With accelerated suburbanization, demand for transport services and commercial and residential real estate in core cities could diminish. That would deal a double blow to city finances, due to the erosion of the property tax base and a rising demand for subsidies to municipal companies. We maintain negative outlooks on ratings of Greater London Authority and the city of Paris, and recently downgraded the city of Brussels.
- **We assume that U.K. social housing providers face renewed financial pressure** due to the government's intention to raise quality standards for social housing, including fire safety and energy performance, without providing substantial additional resources. Growing spending on existing units could accelerate borrowings or delay development projects, necessary to meet still strong demand. Despite the projected recovery in revenue, we have no positive outlooks in the sector, while negative outlooks have increased this year (see chart 15). Positively, most large housing associations have sufficient liquidity facilities and benefit from strong access to capital markets and local banks.

Insurance

- We note insurance companies' operating performance so far in 2021 mirrors the different speeds of economic recovery in Europe, with many markets moving back to normal.
- The recovery of the bond and equity markets helped restore much of the capital surplus European insurers lost in 2020. Some of the assumed stress on defaults and migrations did not unfold completely in 2020 and so far this year. We estimate their capital surplus is now about 11% lower than at year-end 2019.
- Rate improvement in non-life industrial and corporate lines and reinsurance is set to continue and bolster technical profits.

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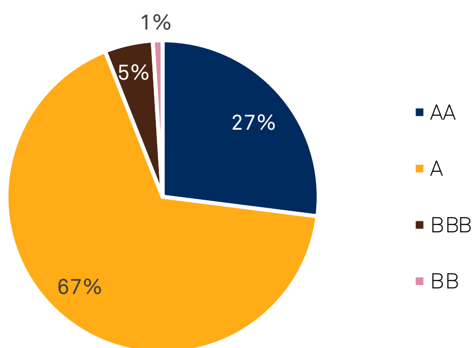
Key Developments

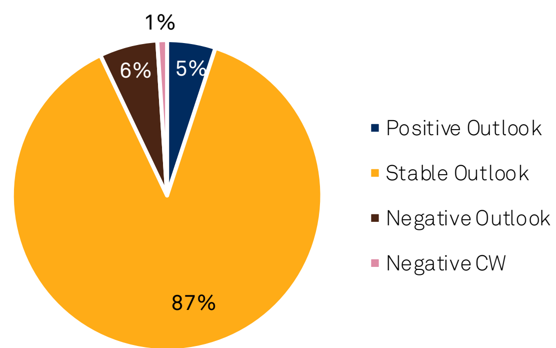
- **Results to date for 2021 show "back to normal" premiums in many regions, new business sales, and profitability.** Alongside the pickup in economic activity with the end to lockdowns, insurers report a recovery of new business sales. Motor insurance frequency claims picked up from 2020 lows, but still are somewhat below pre-COVID-19 levels.
- **European insurers' capital surpluses are still slightly below 2019 levels.** On average they now display a capital surplus of about 11% below pre-COVID-19 levels. Capital market volatility and potential asset impairments remain an important risk, albeit one we assess as only elevated given favorable market developments over the last year (see risk table page 3).
- **Low interest rates to remain a drag on insurers' investment returns.** Despite some discussions about a rise in inflation and subsequently higher interest rates, we expect both to remain muted. Life insurers continue to promote capital-light products, and we noted some continued market discussions about offloading capital-intense legacy back books.
- **Reinsurance rates continue to firm.** During renewal dates in 2021, reinsurance prices continued their positive momentum, and we see some tightening in terms and conditions, with an increasing focus on communicable disease and exclusions for silent cyber. We believe the global reinsurance sector didn't earn its cost of capital in the last couple of years, and the trend continued in first-quarter 2021 due to COVID-19-related losses, large natural catastrophe losses, adverse loss trends, and lower investment returns. As a result, our credit outlook remains negative for the global property & casualty reinsurance sector.

Chart 16
Rating Distribution



Source: S&P Global Ratings

Chart 17
Outlook Distribution



Source: S&P Global Ratings

Key Risks

- Low interest rates, a burden on the investment margins of life insurers with legacy back books.
- COVID-19-related capital market volatility and subsequent investment losses.
- Downgrades of corporate bond investments, raising capital requirements.

Structured Finance

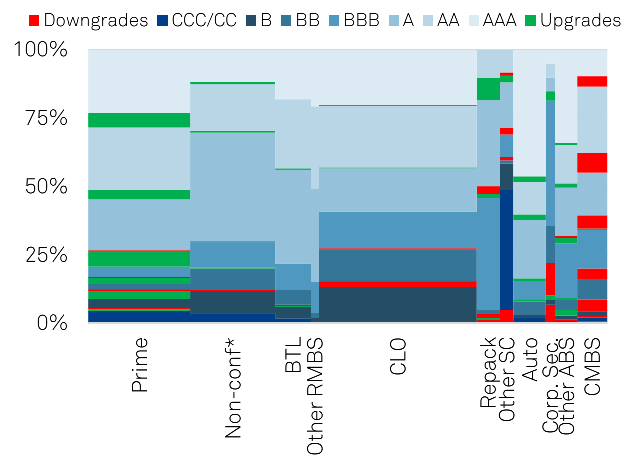
- Downgrades on less than 4% of European structured finance ratings over the past 12 months.
- Most rating actions have been confined to smaller asset classes backed by distressed corporate sectors, such as retail and leisure, with few actions on consumer-backed securitizations and CLOs.
- In the leveraged loan CLO sector, refinancing and reset activity has surged, as transactions that were issued at unusually high funding costs in 2020 are restructured.

Key Developments

Structured finance ratings have generally held up well during the pandemic, with only relatively small pockets of weakness. We lowered less than 4% of our ratings on structured finance securities in Europe in the 12 months to end-April 2021 (see chart 18). Commercial mortgage-backed securities linked to retail and hotel real estate and corporate securitizations backed by leisure businesses have been the most affected but constitute a small portion of the overall European securitization landscape. By contrast, we have lowered relatively fewer ratings on European leveraged loan CLOs (collateralized loan obligations), which are backed by a more sector-diverse array of corporate exposures and where active management of the underlying loan portfolios helped stem the decline in credit quality. In sectors backed by lending to consumers—such as residential mortgage-backed securities (RMBS) and auto asset-backed securities (ABS)—there have been more upgrades than downgrades, partly due to methodology changes.

Chart 18

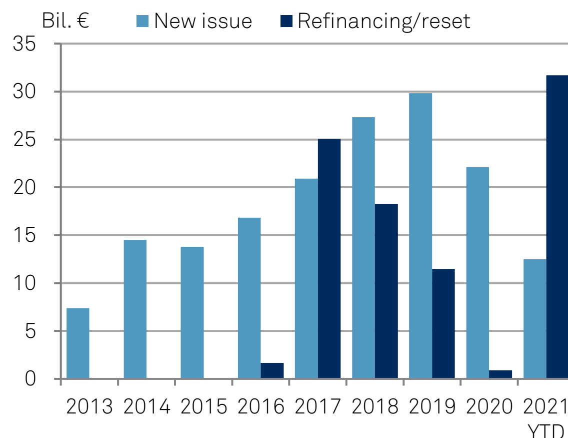
European Structured Finance Ratings Heatmap



*Non-conforming. BTL—Buy-to-let. SC—Structured credit. Based on cumulative count of rating actions between May 1, 2020 and April 30, 2021. Source: S&P Global Ratings.

Chart 19

European CLO Volumes—New Issue v Refinancing And Resets



Year-to-date (YTD) figures as of end-May each year. Source: S&P LCD, S&P Global Ratings.

One important development in the first half of the year has been strong activity growth in the leveraged loan CLO sector. In terms of conventional new issuance, volumes were up by more than 50% year-to-date at the end of May, to more than €12 billion (see chart 19). This is on a par with the first five months in 2019, which ultimately saw the highest annual CLO issuance since the 2008 financial crisis. However, the market disruption in 2020 has also precipitated an explosion in the volume of CLO refinancing and reset activity. Significant spread tightening on CLO liabilities since mid-2020 has motivated collateral managers to refinance transactions that they structured when spreads were higher, calling the outstanding securities and reissuing debt with lower coupons. While this type of activity typically happens two years into a transaction's life, many 2020 vintage CLOs were structured with a shorter, one-year non-call period in anticipation of tighter liability pricing that has since materialized.

For consumer-backed securitization sectors, support measures like unemployment protection and loan payment deferral schemes continue to prevent any significant deterioration in credit

performance. We expect limited evidence of collateral credit deterioration in these types of transactions through 2021, with any uptick in arrears not likely to peak until 2022. In most countries, the deadline for applications has now passed for mortgage payment deferral schemes, with no evidence of a significant spike in applications ahead of those deadlines, suggesting that the number of borrowers deferring payments should gradually begin to decline. Consumers will continue to benefit from significant policy support for some time, however, with the Spanish and Irish salary assistance schemes, for example, both recently extended by several months.

Key Risks

We expect European structured finance credit performance to remain under pressure through 2021. For securitization sectors backed by lending to consumers, underlying borrowers have benefited from both income support through furlough schemes and reduced outgoings through payment deferral schemes, as well as repossession moratoriums for those already in credit distress. Many of these schemes have been extended past their originally intended end dates, but as social restrictions ease and these support measures finally come to an end, collateral performance could eventually begin to deteriorate in line with rising unemployment. These effects will likely not begin to materialize until the second half of 2021.

For corporate-backed transactions too, there remains some risk to ratings in case of rising credit distress among underlying borrowers. For example, the annualized default rate for European speculative-grade corporates was 6.1% at the end of March—a greater than twofold increase over the previous 12 months—and will likely remain elevated, in our view. We expect the default rate will still be over 5% by March 2022, and this prolonged period of higher defaults could have a knock-on effect for European CLOs. That said, CLO ratings migration will also depend on how well collateral managers continue mitigating credit deterioration through trading activity.

Related Research

- Credit Conditions North America Q3 2021: Looking Ahead, It's Looking Up, June 29, 2021
- Credit Conditions Asia-Pacific Q3 2021: One Region, Two Recoveries, June 29, 2021
- Economic Outlook Europe Q3 2021: The Grand Reopening, June 24, 2021
- Economic Research: Early Momentum Boosts The U.K. Recovery, June 24, 2021
- As Near-Term Risks Ease, The Relentless Profitability Battle Lingers For European Banks, June 24, 2021
- Global Debt Leverage: Spreads, Costs Shocks May Double Rate Of Loss Making, June 22, 2021
- COVID-19 Heat Map: Pent-Up Demand And Supply Shortages Further Improve Recovery Prospects For Credit Quality, June 8, 2021

This report does not constitute a rating action.

The views expressed in the Macroeconomic Outlook section (pages 4-7) are the independent opinions of S&P Global Ratings' economics group, which is separate from but provides forecasts and other input to S&P Global Ratings' analysts. S&P Global Ratings' analysts use these views in determining and assigning credit ratings in ratings committees, which exercise analytical judgment in accordance with S&P Global Ratings' publicly available methodologies.

Appendix 1: Economic Data and Forecast Summaries

Table 2

Real GDP %

	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Eurozone	U.K.	Switz.
2019	0.6	1.8	0.3	2.0	1.6	1.8	1.3	1.4	1.1
2020	-5.1	-8.0	-8.9	-10.8	-3.7	-6.3	-6.7	-9.8	-3.0
2021f	3.5	5.6	4.9	6.3	2.8	4.7	4.4	7.0	3.5
2022f	4.9	4.2	4.9	6.4	3.2	3.6	4.5	5.2	3.1
2023f	2.2	2.0	1.8	2.9	2.0	2.8	2.2	1.9	1.7
2024f	1.6	1.7	0.9	2.3	1.8	1.5	1.6	1.6	1.7

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

Table 3

CPI Inflation %

	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Eurozone	U.K.	Switz.
2019	1.4	1.3	0.6	0.8	2.7	1.2	1.2	1.8	0.4
2020	0.4	0.5	-0.1	-0.3	1.1	0.4	0.3	0.9	-0.7
2021f	2.5	1.4	1.3	1.7	1.7	1.9	1.8	1.7	0.3
2022f	1.5	1.3	1.1	1.1	1.5	1.5	1.4	1.9	0.4
2023f	1.6	1.4	1.2	1.4	1.6	1.6	1.5	1.7	0.5
2024f	1.7	1.5	1.3	1.5	1.6	1.8	1.6	1.7	0.6

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

Table 4

Unemployment Rate %

	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Eurozone	U.K.	Switz.
2019	3.1	8.5	9.9	14.1	3.4	5.4	7.6	3.8	4.4
2020	4.2	8.1	9.1	15.6	3.8	5.6	8.0	4.5	4.8
2021f	4.2	8.4	10.0	15.8	3.8	5.7	8.2	5.0	4.9
2022f	3.6	8.7	9.5	15.0	4.1	5.6	7.9	4.8	4.8
2023f	3.4	8.3	9.2	14.5	3.9	5.5	7.5	4.1	4.6
2024f	3.3	7.8	9.0	14.0	3.7	5.4	7.2	4.0	4.4

Source: Oxford Economics; f--S&P Global Ratings forecast, annual averages.

Table 5

10y Government Bond Yields

	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Eurozone	U.K.	Switz.
2019	-0.2	0.1	1.9	0.7	-0.1	0.2	0.4	0.9	-0.5
2020	-0.5	-0.2	1.2	0.4	-0.3	-0.1	0.1	0.3	-0.5
2021f	-0.3	0.1	0.9	0.5	-0.1	0.1	0.1	0.8	-0.2
2022f	0.0	0.4	1.4	0.8	0.2	0.4	0.5	1.1	0.1
2023f	0.2	0.6	1.7	1.1	0.4	0.7	0.7	1.4	0.2
2024f	0.4	0.8	2.0	1.3	0.6	0.9	0.9	1.6	0.3

Source: Oxford Economics; f--S&P Global Ratings forecast, annual averages.

Table 6

Exchange Rates

	Eurozone	------ U.K-----		Switzerland	
	US$/€	US$/£	€/£	SFr/US$	SFr/€
2019	1.12	1.28	1.14	0.99	1.11
2020	1.14	1.28	1.13	0.94	1.07
2021f	1.21	1.39	1.15	0.91	1.10
2022f	1.21	1.40	1.16	0.94	1.13
2023f	1.21	1.40	1.16	0.95	1.15
2024f	1.21	1.40	1.16	0.95	1.15

Sources: Oxford Economics; f--S&P Global Ratings forecast, annual averages.

Table 7

Policy Interest Rates %

	----Eurozone (ECB)----		U.K. (BoE)	Switzerland (SNB)
Policy Rates	Deposit Rate	Refi Rate		
2019	-0.43	0.00	0.75	-0.75
2020	-0.50	0.00	0.23	-0.75
2021f	-0.50	0.00	0.10	-0.75
2022f	-0.50	0.00	0.10	-0.75
2023f	-0.50	0.00	0.13	-0.75
2024f	-0.44	0.00	0.29	-0.69

Sources: Oxford Economics; f--S&P Global Ratings forecast, annual averages.

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