

COVID-19 Is Testing The Resilience Of **Global Structured Finance**

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S&P Global
Ratings

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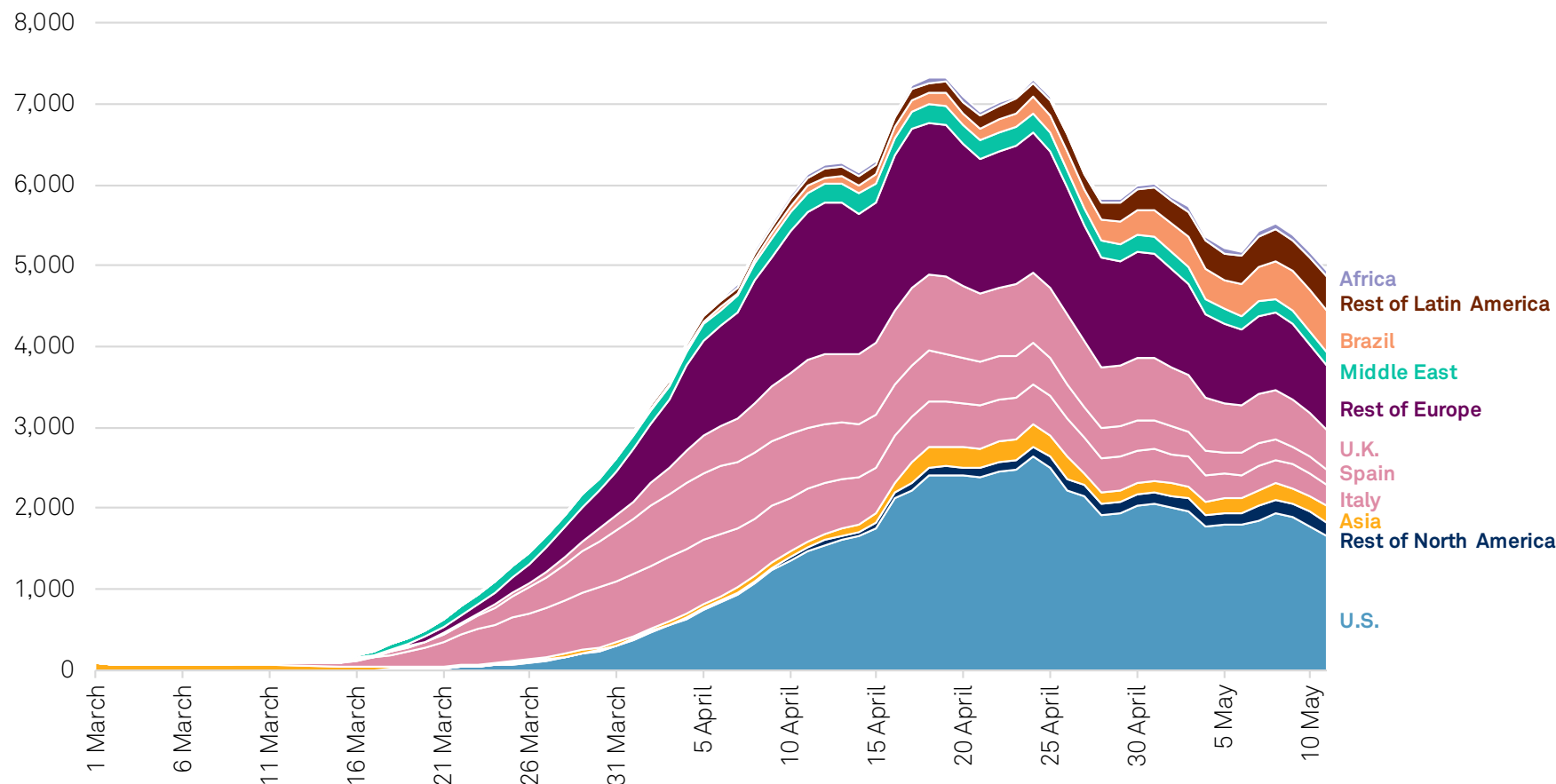
S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Key Takeaways

- Extended coronavirus containment measures are pushing the world into the deepest recession since the Great Depression. Although we expect the drop in economic activity to be sharp and fairly short, the path to recovery remains very uncertain.
- As of May 8, 2020, we have taken 1,104 structured finance rating actions globally due to the effect of the COVID-19 pandemic and/or the decline in oil and gas prices.
- Based on our current global economic forecasts, we expect the bulk of negative rating actions to affect speculative-grade securities. Areas of focus include collateralized loan obligations (CLOs), commercial mortgage-backed securities (CMBS), certain asset-backed securities (ABS), some residential mortgage-backed securities (RMBS), and some Latin American structured finance sectors.
- In a hypothetical adverse stress scenario, characterized by a slower and weaker economic recovery, we would expect a significant increase in the risk of downgrades and defaults, even for some investment-grade securities.
- The combination of COVID-19 and a sharp decline in oil prices has resulted in a reduction in obligor credit quality within CLO portfolios, and is putting pressure on lower mezzanine and subordinate tranche ratings.
- Our main areas of focus in both U.S. and European CMBS are the lodging and retail sectors, although there may be some other pockets of weakness.

COVID-19's Global Spread | U.S. Now The Epicenter

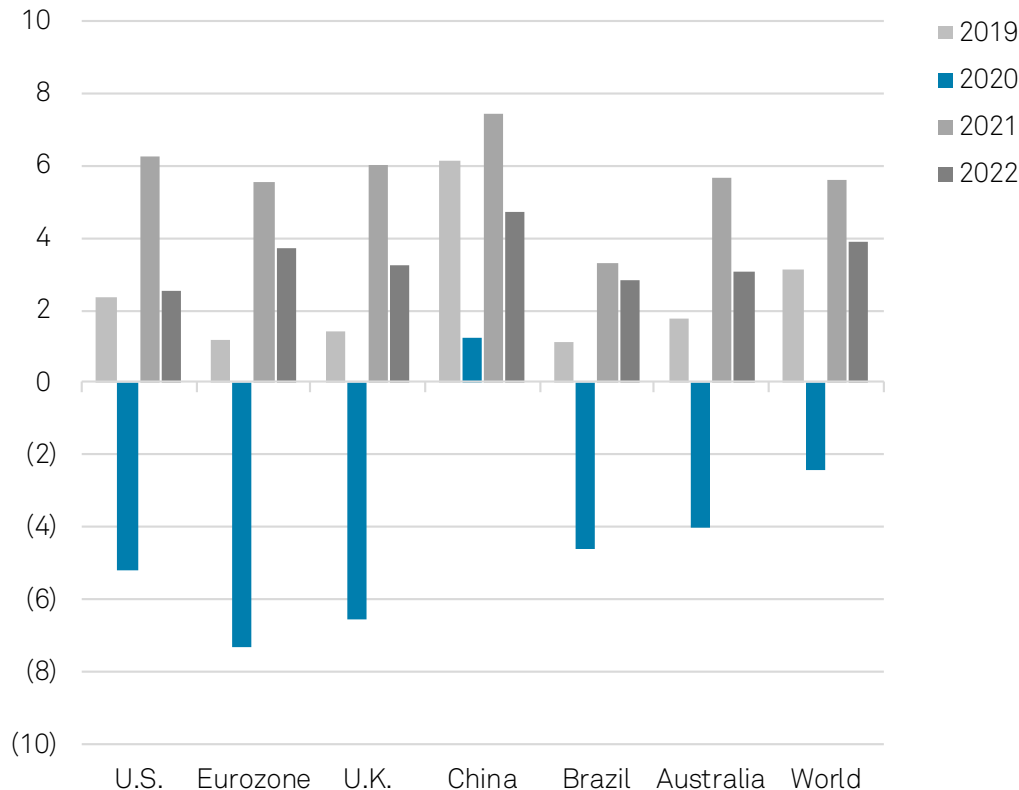
Daily Deaths Of Confirmed COVID-19 Cases (10-Day Rolling Average)



Source: European Centre for Disease Prevention and Control. Data as of May 10, 2020.

Economic Conditions | Containment Measures Are Pushing The World Into A Deep Recession

Global GDP Growth Forecasts, 2019-2022



Sources: S&P Global Economics and Oxford Economics. [Global Credit Conditions: Rising Credit Pressures Amid Deeper Recession, Uncertain Recovery Path](#), April 22, 2020.

Recession

We now see global GDP falling by 2.4% this year, with the U.S. and eurozone contracting by 5.2% and 7.3%, respectively.

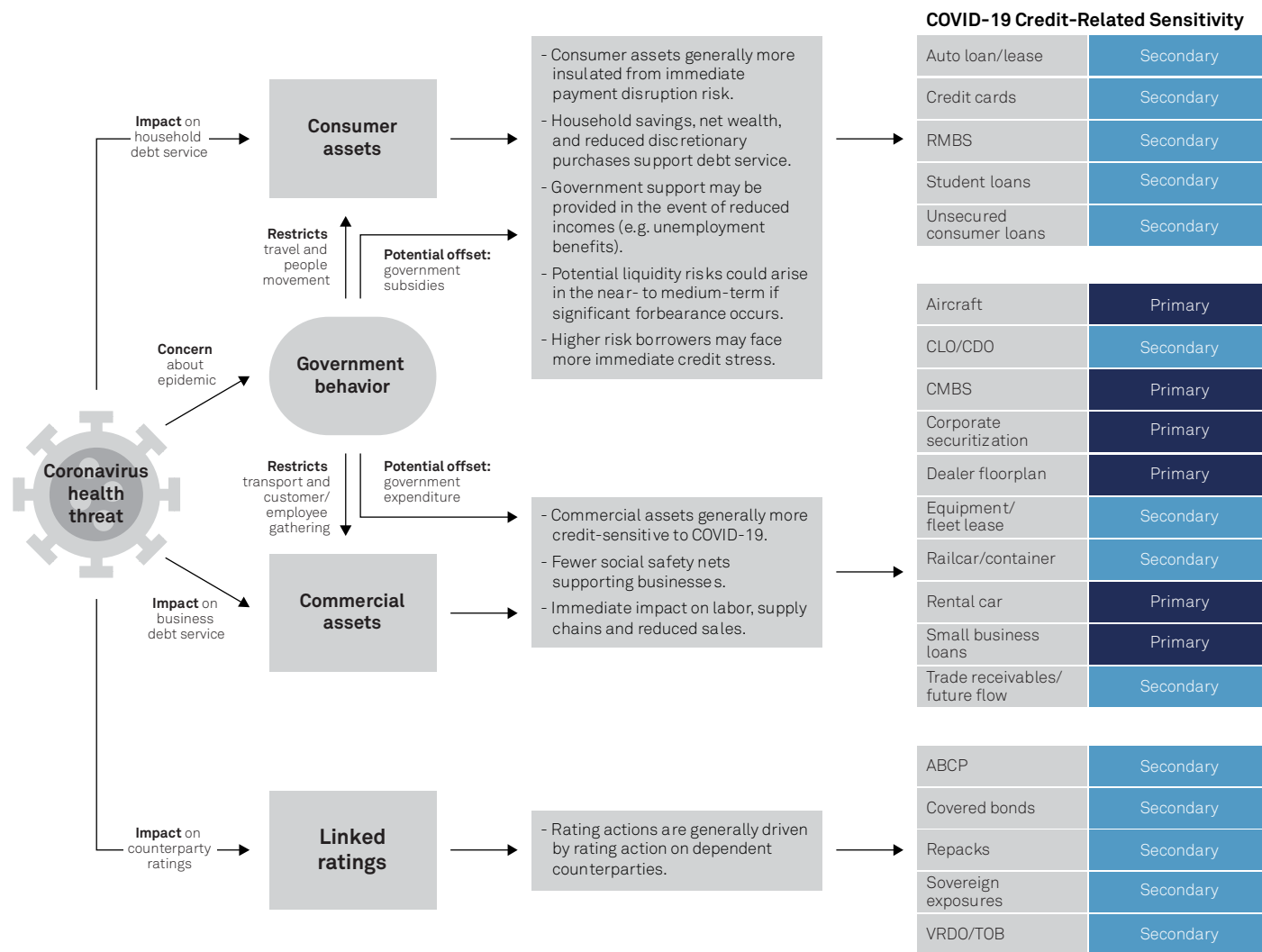
Policy response

Central banks and governments have deployed large fiscal and monetary policy packages to help workers and companies bridge the gap to recovery.

Recovery contours

Infection curves are flattening and the focus has turned to the recovery. Its length and pace will depend on the combination of health and economic policy, the response of people and firms, and the condition of the labor market and small and midsize enterprises.

COVID-19 Sector Sensitivity | Structured Finance

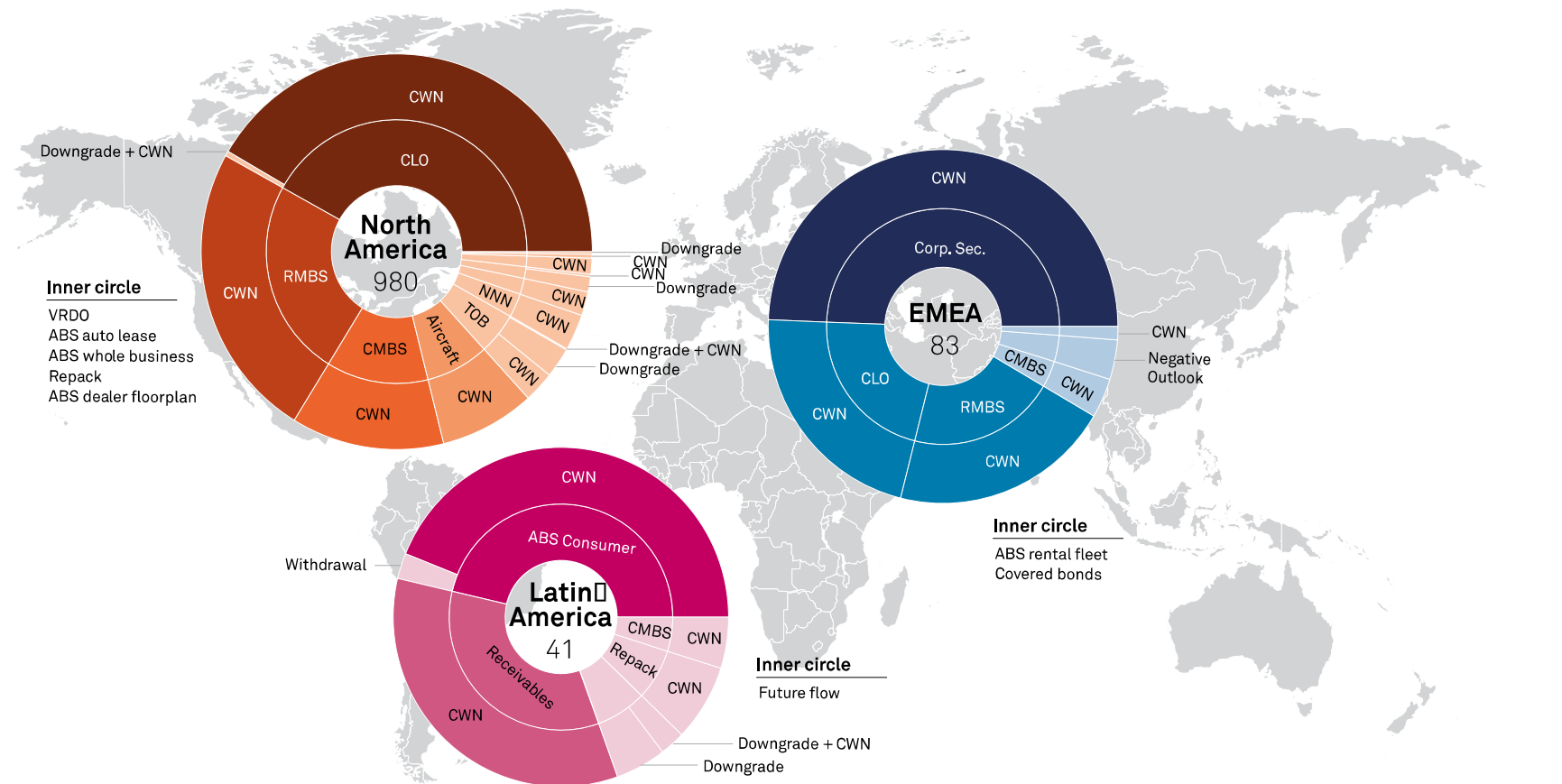


Note: This measures the expected credit-related sensitivity of securitized asset performance attributed to COVID-19. Primary exposure results from demand dropping because of fears of health and safety of potential customers. Secondary exposure includes asset performance deteriorating due to declining GDP or increasing unemployment, which is initially caused by COVID-19.

Source: S&P Global Ratings. [European ABS And RMBS: Assessing The Credit Effects Of COVID-19](#), March 30, 2020.

Rating Actions | Mainly CreditWatch Placements So Far

Structured Finance Rating Actions Through May 8, 2020



CWN--CreditWatch negative. CLO--Collateralized loan obligation. RMBS--Residential mortgage-backed securities. VRDO--Variable rate demand obligation. ABS--Asset-backed securities. CMBS--Commercial mortgage-backed securities. TOB--Tender option bond. NNN--Triple net lease ABS. Corp. Sec.--Corporate securitizations. Source: S&P Global Ratings. [COVID-19 Activity In Global Structured Finance For The Week Ending May 8, 2020](#), May 14, 2020.

The Base-Case Scenario | Downgrades And Defaults Limited To Speculative-Grade Classes

Expected Performance Under The Base-Case Scenario

		North America	Europe	Latin America	Australia	Japan	Greater China
ABS	Credit cards and other consumer unsecured	Moderate	Low	Moderate	Very low	Very low	Very low
	Secured consumer (auto)	Moderate	Low				
	Whole business / corp securitization	Moderate	Moderate				
	Other commercial ABS	Moderate	Moderate				
RMBS		Moderate	Moderate	Moderate	Low	Very low	Very low
ABCP		Very low	Very low				
Covered Bonds			Very low				
CLO		Elevated	Elevated				
CMBS		Elevated	Elevated				

Scenario	Expected outcomes					
	Downgrades SG	Downgrades low IG	Defaults SG	Downgrades high IG	Defaults low IG	Defaults high IG
Very low						
Low	X					
Moderate	X	X				
Elevated	X	X	X	X		
High	X	X	X	X	X	
Very high	X	X	X	X	X	X
No ratings						

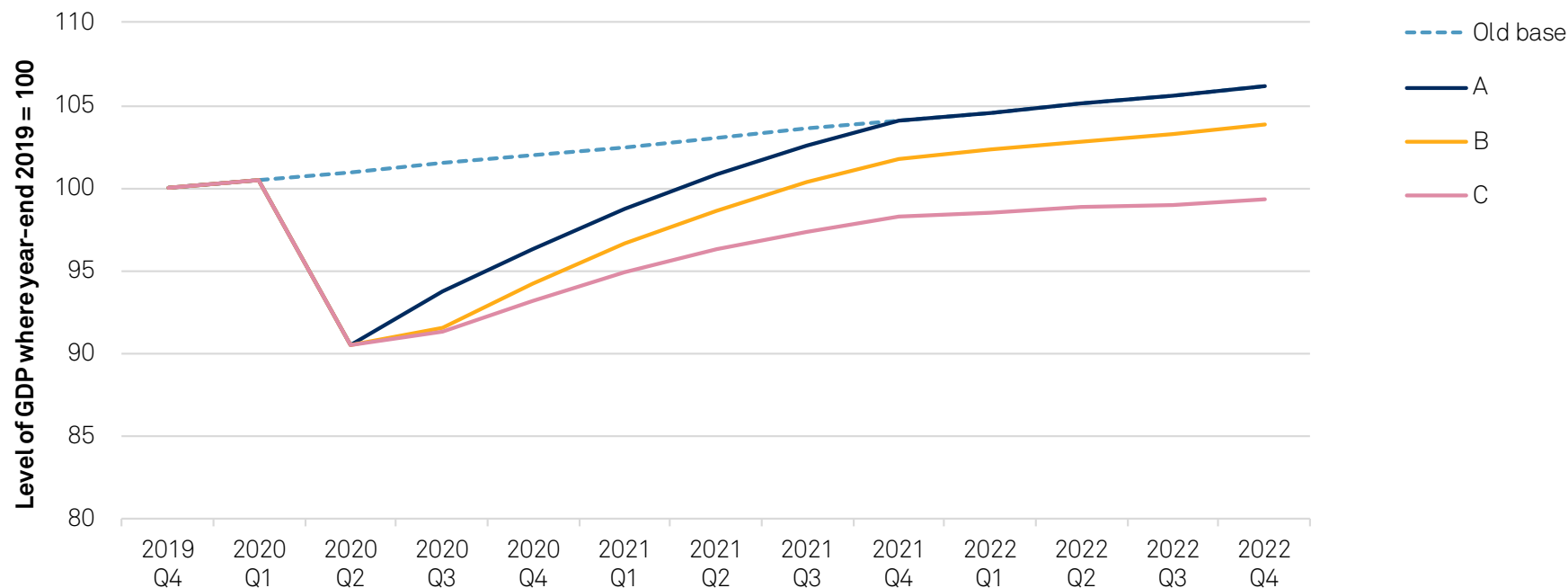
IG--Investment grade. SG--Speculative grade. Source: S&P Global Ratings.

- Given our most recent global economic forecasts, we believe that downgrade and default risks for most structured finance sectors and regions would be limited to speculative-grade classes.
- CLOs, CMBS, some RMBS, and certain ABS sectors merit a closer look.
- These results are consistent with the results of a stress test that we undertook recently to estimate the impact of a potential market downturn (see: “[When The Cycle Turns: How Would Global Structured Finance Fare In A Downturn?](#),” published on Sept. 4, 2019).

Stress Scenario

- We consider three possible output paths relative to the pre-COVID-19 path.
- We undertook a stress test to estimate the effect of a hypothetical slower and weaker economic recovery on structured finance ratings (path C).
- We have assumed negative rating actions on certain financial institutions and sovereign ratings.

Stylized COVID-19 Recovery Scenarios



Source: S&P Global Economics. [COVID-19 Deals A Larger, Longer Hit To Global GDP](#), April 16, 2020.

Stress Scenario | Downgrades And Defaults Could Also Affect Investment-Grade Securities

Expected Performance Under The Hypothetical Scenario

		North America	Europe	Latin America	Australia	Japan	Greater China
ABS	Credit cards and other consumer unsecured	Elevated	Moderate	Moderate	Moderate	Moderate	Moderate
	Secured consumer (auto)	Elevated	Moderate				
	Whole business / corp securitization	Elevated	Elevated				
	Other commercial ABS	Elevated	Elevated				
RMBS		Elevated	Elevated	Moderate	Moderate	Moderate	Moderate
ABCP		Elevated	Elevated				
Covered Bonds			Elevated				
CLO		Elevated	Elevated				
CMBS		Elevated	High				

Scenario	Expected outcomes					
	Downgrades SG	Downgrades low IG	Defaults SG	Downgrades high IG	Defaults low IG	Defaults high IG
Very low						
Low	X					
Moderate	X	X				
Elevated	X	X	X	X		
High	X	X	X	X	X	
Very high	X	X	X	X	X	X
No ratings						

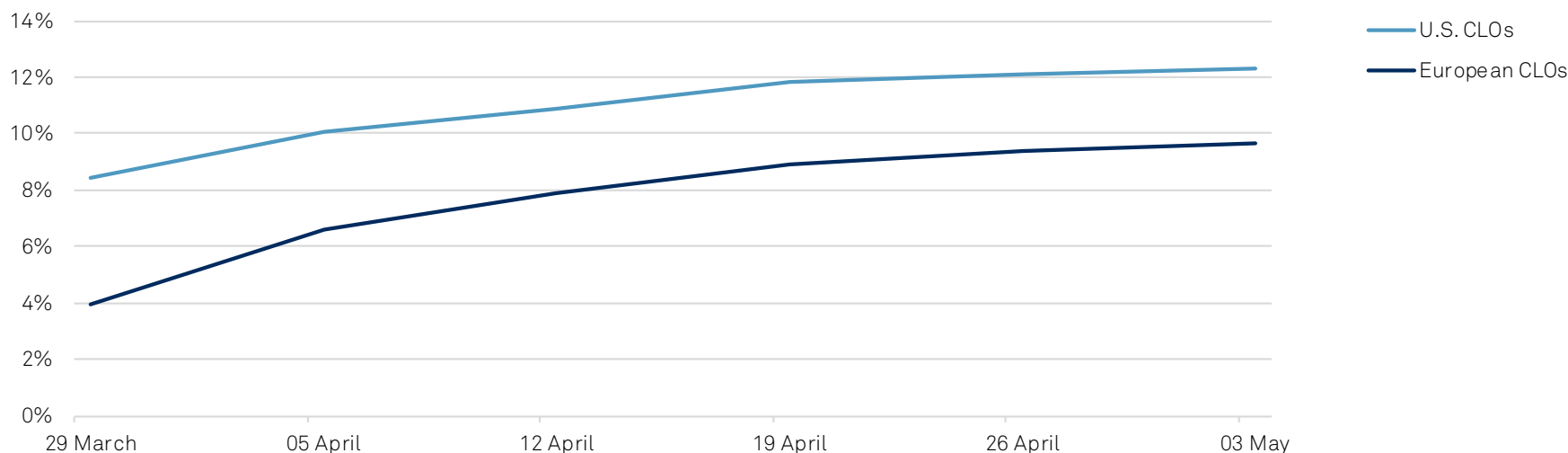
IG--Investment grade. SG--Speculative grade. Source: S&P Global Ratings.

- In a hypothetical adverse stress scenario, we expect that downgrades and defaults could also affect investment-grade securities.
- U.S. and European CLOs, CMBS, certain ABS sectors and some RMBS would be more at risk.
- Rating actions on financial institutions could put pressure on credit-linked securities such as ABCP and covered bonds.
- Sovereign downgrades could also put pressure on some ratings in the European periphery.

Global CLOs | COVID-19 Adds Additional Stress

- Leveraged loan market challenges existed before COVID-19, including high leverage ratios, EBITDA add-backs, and a preponderance of covenant-lite loans.
- The combination of COVID-19 and a sharp decline in oil prices has led to numerous corporate downgrades. This has worsened obligor credit quality in both U.S. and European portfolios, with increased exposures to obligors rated 'B-' and in the 'CCC' category.
- These changes are already constraining CLO ratings, especially for lower mezzanine and subordinate tranches.

'CCC' Rating Curve Has Increased But Is Flattening For Now

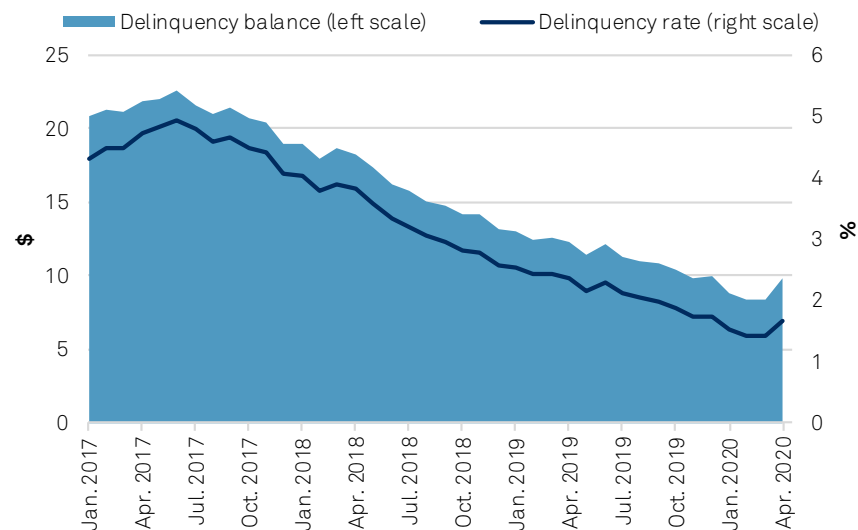


Source: S&P Global Ratings.

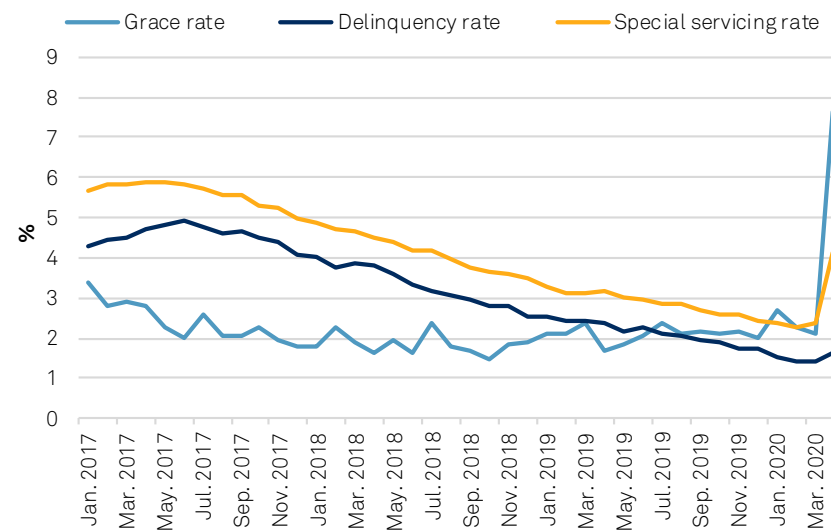
Global CMBS | Lodging And Retail Take A Hit

- Demand in the global lodging industry has already rapidly declined, resulting in severe hits to occupancy, average daily room rate, and revenue per available room.
- The effects of COVID-19 have exacerbated existing issues in the retail sector and continue to present a major threat to retail property owners, as the closures of shopping centers and social isolation requirements are significantly denting their tenants' revenues.
- The highest increases in U.S. delinquency and grace rates are for the retail and lodging sectors.

While The U.S. CMBS Delinquency Rate Increased By Just 24 Basis Points In April...



... The Grace Rate Increase Indicates A Looming Concern For The Upcoming Months



Source: [U.S. CMBS Delinquency Rates Saved By Grace With Modest Increase Of 24 Basis Points](#), May 12, 2020.

Related Research

- [COVID-19 Activity In Global Structured Finance For The Week Ending May 8, 2020](#), May 14, 2020
- [U.S. CMBS Delinquency Rates Saved By Grace With Modest Increase Of 24 Basis Points](#), May 12, 2020
- [European CMBS: Assessing The Liquidity Risks Caused By COVID-19](#), May 6, 2020
- [How COVID-19 Changed The European CLO Market In 60 Days](#), May 6, 2020
- [COVID-19 Credit Update: Latin American Structured Finance Begins To Feel the Pandemic's Effects](#), April 29, 2020
- [Scenario Analysis: How Credit Distress Due To COVID-19 Could Affect U.S. CLO Ratings](#), April 24, 2020
- [Global Credit Conditions: Rising Credit Pressures Amid Deeper Recession, Uncertain Recovery Path](#), April 22, 2020
- [Economic Research: COVID-19 Deals A Larger, Longer Hit To Global GDP](#), April 16, 2020
- [European ABS And RMBS: Assessing The Credit Effects Of COVID-19](#), March 30, 2020
- [When The Cycle Turns: How Would Global Structured Finance Fare In A Downturn?](#), Sept. 4, 2019

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