S&P Global
Ratings

Credit Conditions North America:

Rolling Out The Recovery

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(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly and on an ad hoc basis to review macroeconomic conditions in each of four regions (Asia-Pacific, Emerging Markets ex-Asia, 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 North America committee on June 24, 2020)

Key Takeaways

- **Overall:** As corporate borrowers confront both operating constraints due to social distancing and diminished consumer demand, the recovery path will likely be rocky and uneven, and many in the industries hit hardest by the severe economic shock will be lucky to escape default—especially if we see a significant pull-back in federal stimulus.
- **Risks:** Short of a coronavirus vaccine or effective treatment, there is a risk that a resurgence of the outbreak could lead states to extend, or restart, social restrictions and worsen the pain associated with historically high unemployment and severe business disruption. Moreover, corporate borrowers have incurred more debt, and concerns about high leverage and potential for insolvency are increasing.
- **Credit:** At the same time, amid signs the worst of the recession is behind us, financing conditions for U.S. corporations have improved even faster than economic data have. Equity and fixed-income markets are showing exceptional optimism even as new cases of the virus have risen in some areas and the full reopening of the economy is some way off.

As the U.S. economy shows signs of a nascent recovery from the pandemic-induced recession, many corporate borrowers we rate have shifted their focus from liquidity to survival.

Trillions of dollars in unprecedented fiscal and monetary stimulus from Washington D.C. undoubtedly helped stabilize the capital markets and relieve some of the intense liquidity pressures on companies across sectors. Now, as issuers confront both operating constraints due to social distancing and diminished consumer demand, a number of borrowers in the industries hit hardest by the severe economic shock will be lucky to escape default. This is especially true if we see a significant pull-back in federal stimulus, much of which is designed to bolster the labor market (which, in turn, helps to prop up consumer spending).

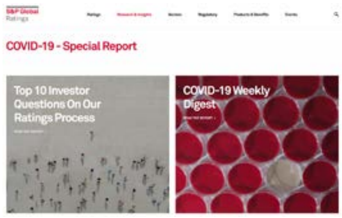
Also at particular risk of any "premature austerity" are state and local governments, which continue to shed jobs, even as the May employment report from the Bureau of Labor Statistics showed 2.5 million workers added to nonfarm payrolls. States and municipalities slashed a combined 1.5 million jobs in April and May—and that's before widespread budget cuts have taken effect. Absent additional federal stimulus there will likely be additional state and local budget cuts, which will weigh on the broader economic recovery. This comes as the three largest states by economic output—California, Texas, and New York, which account for a collective 31.5% of U.S. GDP—have been among those hurt most not just by the pandemic itself, but the associated recession.

In short, the economic recovery—and credit conditions—remain fragile. And the associated risks have been further heightened because corporate borrowers have incurred massive debt to shore up liquidity, deal with coronavirus-related disruptions, and fortify/insulate their balance sheets

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The consensus among health experts is that the pandemic may now be at, or near, its peak in some regions, but will remain a threat until a vaccine or effective treatment is widely available, which may not occur until the second half of 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.

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



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against another potential wave of infections and disruptions (see table 1). As a result, higher levels of leverage and the potential for insolvency are increasingly a concern, especially for lower-rated entities and particularly if the economic recovery falters.

Table 1

Top North America Risks

Coronavirus-related health crisis persists, affecting consumer behavior, exacerbating the economic shock

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

The U.S. economy is showing signs of a nascent recovery from the pandemic-induced shock, notwithstanding COVID-19 cases still growing in many states. However, short of a vaccine or effective treatment, which we assume won't be widely available until next year, there is a risk that a resurgence of the outbreak could lead states to extend, or restart, social restrictions and worsen the pain associated with historically high unemployment and severe business disruption. Consumers may also slowly return to old spending habits. Moreover, any pull-back in federal fiscal stimulus and the end of supplemental unemployment payments could weigh unevenly on states, the largest of which are important economic drivers for the country. Housing dislocations, as yet largely on hold, could also become a disruptive factor. Our base case sees GDP growth returning in the second half of the year. The risk that this won't materialize, and that the drag on consumer demand and business activity would persist, is firmly on the downside.

Legacy leverage and new borrowings threaten corporates' credit metric recovery if economic recovery stumbles

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

As corporate borrowers incur more debt to shore up liquidity and deal with coronavirus-related disruptions, high leverage and potential insolvency are increasingly concerns. While debt issuance has helped stave off near-term bankruptcies, especially for lower-rated issuers, companies will be saddled with a significant amount of higher-cost debt that may become unsustainable when facing years of lower revenues and earnings. Meanwhile, in another sign of the volatility around the shape of the recovery, the benchmark S&P 500 equity index has surged more than 40% from its March low, credit spreads in the secondary market have narrowed by almost one-third from March's extreme highs, and global debt issuance so far this year is nearly 40% higher than it was at this time last year. This sharp contrast with our expectation for a slow and uneven economic recovery that will weigh on corporate profits (and credit quality) suggests that a sudden return to "risk-off" positioning could spur market dislocation.

U.S.-China tensions disrupt trade and supply chains, hitting U.S. economic growth

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

As U.S.-China tensions intensify—lately involving restrictions on flights between the countries—American companies (and ultimately end consumers) continue to shoulder a significant burden of the trade dispute. Moreover, many manufacturers face political pressure to give up their reliance on China. While a sudden rewiring of supply chains seems unlikely (given the hurdles related to cost, skills, and resources), disruption related to tariffs and trade restrictions threatens the supply-demand balance in the world's biggest economy.

Low oil prices hurt Canada and U.S.

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

Diminished global demand prospects coupled with still-depressed oil prices are casting a shadow over the economies of Canada and the U.S.—both of which are net oil exporters. Not only will persistently low prices pressure the upstream oil and gas industry, this may also hurt related sectors such as midstream energy while weighing on oil-producing provinces/states. Weak demand for refined products will result in low refinery utilization rates and weak product cracks resulting in very weak margins and credit metrics for refineries.

Protests in the U.S. result in political and economic disruption

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

The sometimes violent protests in the U.S. following the death of a Black man at the hands of police are throwing into greater focus the country's persistent social and income inequality. With unemployment at levels not seen since the Great Depression, the burden of COVID-19 has fallen disproportionately on low-income workers, who are most at risk of losing their jobs, yet also most likely to be working in roles considered essential and unable to be performed from home. With a presidential election looming in November, the possibility of political tensions in Washington has increased.

Cybersecurity threats to business activity

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

Increasing global interconnectedness means cyberrisk poses a systemic threat and significant single-entity risk. As cyberattacks become more sophisticated, new targets and methods are emerging. Companies and governments face the risk of criminal, proxy, and direct state-sponsored cyberattacks. This has led to a fast-growing cyber-insurance market, though insured losses from cyberattacks are still small compared with economic losses.

Sources: S&P Global Ratings.

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

Shape Of Recovery

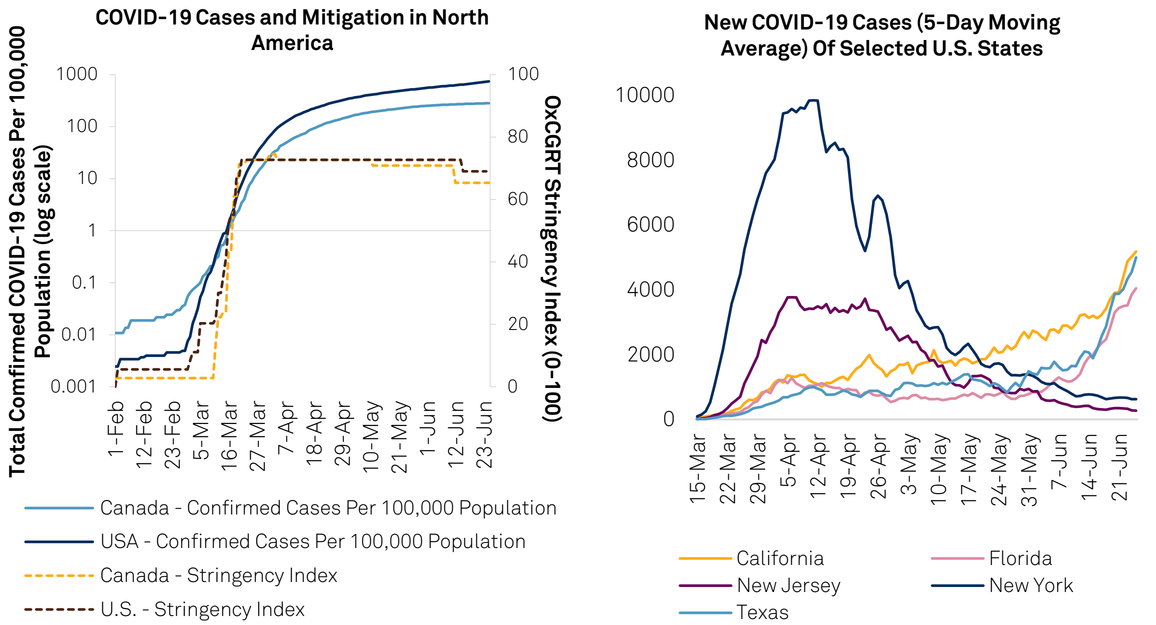
The economic damage associated with the pandemic is nonlinear. For example, if containment takes twice as long as expected, the corresponding economic damage will be more than twice as bad—and, therefore, the recovery could take longer and be weaker than initially projected. Moreover, even if the spread of the outbreak were to end tomorrow, residual scars could linger, especially if social distancing becomes a more permanent part of everyday life, or business and consumer activities don't bounce back. As North America slowly comes back online, a "new normal" will undoubtedly evolve, but the uncertainty associated with another potential wave of infections and business disruption will continue to create headwinds to the recovery.

Pandemic assumptions and economic scenarios

The number of confirmed COVID-19 cases has surpassed 2.5 million and 105,000 in the U.S. and Canada, respectively, with a combined death toll of more than 134,000 (see chart 1). In response to the outbreak, both countries have implemented a series of mitigation policies ranging from border control, school and workplace closings, to restrictions on public gatherings. At the beginning of April, about 90% of the U.S. population was under either state- or city-mandated shelter-in-place orders. According to the Oxford Stringency Index, which assesses the strictness of the lockdown, relevant mitigation measures have been around 70 in these two countries—the global average as of June 25 was 58. While new cases in some of the hardest-hit states including New York and New Jersey are flattening, others such as California, Florida, and Texas are seeing spikes as they start phased re-openings.

Chart 1

No longer the epicenter, but COVID-19 cases are rising quickly in some U.S. states

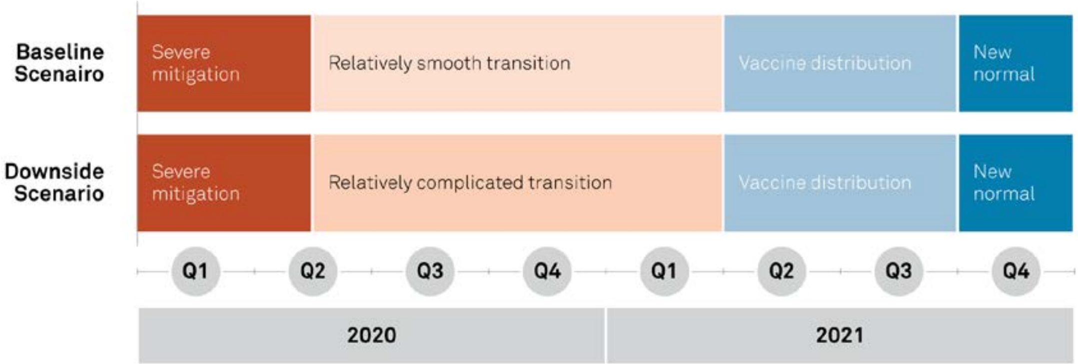


Sources: Johns Hopkins University Center for Systems Science and Engineering; Oxford COVID-19 Government Response Tracker (OxCGRT); World Bank. Data as of June 25, 2020.

Acknowledging a high degree of uncertainty about the rate of spread and peak evolution of the COVID-19 pandemic, coupled with state-level variations, we assume that following a period of severe mitigation and transition, a vaccine for the current strain of the virus will be broadly available in the fourth quarter of 2021, which will potentially help reduce the infection rate to zero in North America (see chart 2).

Chart 2

North America: Two Scenarios Of COVID-19 Exit



Source: S&P Global Ratings.

In our baseline economic scenario, which our ratings analysts use in their forward-looking credit analysis, we assume the virus will be largely contained around midyear, with the economy partially reopening, but businesses and consumers will remain constrained by mitigation policies. After that, until the third quarter of 2021, pockets of outbreaks may re-emerge, but will be controllable via targeted lockdowns, testing and contact tracing, and improved hospital capacity. In this scenario, fear of the pandemic will fade, with economic activity still somewhat limited. Accommodative macro policies will likely remain, helping to cushion the initial blow while stimulating growth, before gradually winding down after a vaccine is rolled out and the economy is back on track.

Though sharing a similar timeline, our downside scenario, paints a more complicated transition out of the pandemic. In this more severe case, following a rather unsuccessful virus containment in the first stage, broad and frequent waves of outbreaks emerge, especially in the winter months, overwhelming the health system again. Facing this more severe economic stress, state and local governments would likely be forced to reintroduce or tighten social restrictions, with economic activities and the recovery suffering. Even with a vaccine and substantial stimulus, it might take time to rebuild consumer confidence and repair business damages under this scenario.

With our updated baseline assumptions, we now forecast U.S. real GDP to contract 5.0% this year. In particular, the economy will plunge an unprecedented 33.6% in the second quarter. We foresee permanent output losses and don't expect it to reach pre-COVID-19 levels until second half of next year. Our pessimistic outlook entails an even steeper contraction of 8.7%, with larger permanent losses down the road. In the case of the Canadian economy, which was already slowing before COVID-19, we forecast real GDP to contract 5.9% this year before growing 5.4% in 2021.

Declining demand, longer-term disruption drive uneven sector recoveries

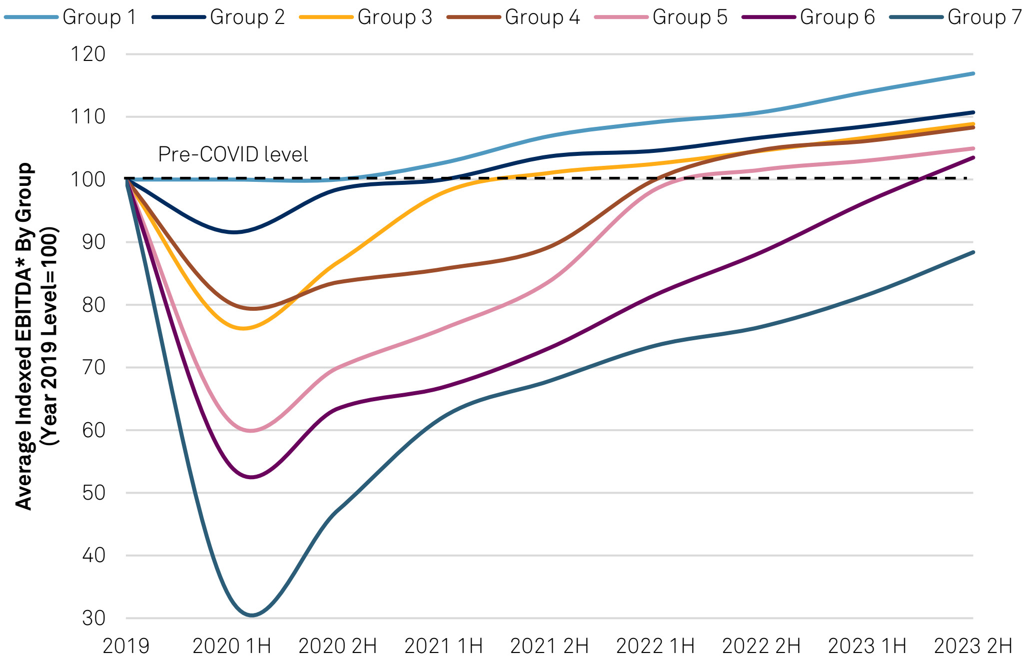
Against this health and economic backdrop, North American nonfinancial corporate sectors are affected to varying degrees and will likely go through different recovery paths post-crisis (for detailed analysis, see "**COVID-19 Heat Map: Post-Crisis Credit Recovery Could Take To 2022 And Beyond For Some Sectors**," published June 24).

Grouping sectors using our ratings analysts' estimation of EBITDA recovery to pre-pandemic levels showcases the importance of consumer demand (see chart 3). Broadly speaking, regardless of social restrictions, the more essential an industry's products and services, the quicker we expect the sector to fully regain its earnings. For example, with stable, if not increasing, demand for basic food and household products under "stay-at-home" orders, consumer staples (e.g., food and beverages) and essential retail (e.g., grocery stores) will likely experience no, or limited, earnings declines, and therefore better weather the crisis. Another sector that has been insulated so far is software, which has benefited from increasing home-based work and entertainment.

Conversely, sectors that involve people gathering in close proximity, or those that materially rely on consumer discretionary spending, or entered into the crisis with a weaker outlook—such as cruises, airlines, nonessential retail, autos, and commercial aerospace—may need several years to return to 2019 earnings levels.

Chart 3

North America: Stylized Shape Of Recovery By Sector Group



Group 1	Group 2	Group 3	Group 4	Group 5	Group 6	Group 7
No deterioration	Recovery: 1H 2021	Recovery: 2H 2021	Recovery: 1H 2022	Recovery: 2H 2022	Recovery: 2023	Recovery: Beyond 2023
- Tech - software - Consumer staples	- Defense contractors - Engineering & construction - Healthcare - pharmaceuticals - Retail essential - Telecom	- Ad supported media - Healthcare - medical products - Homebuilders & developers - Paper & packaging - Restaurants - Tech - hardware/ semi	- Building materials - Business & consumer services - Capital goods - Healthcare - services - Oil & gas - Power - Real estate (REITs) - Refining	- Chemicals - Consumer discretionary - Fitness - Gaming - Hotels - Metals & mining - Midstream - Out-of-home entertainment - Utilities	- Automotive - Commercial aerospace	- Airlines - Cruise - Retail non-essential

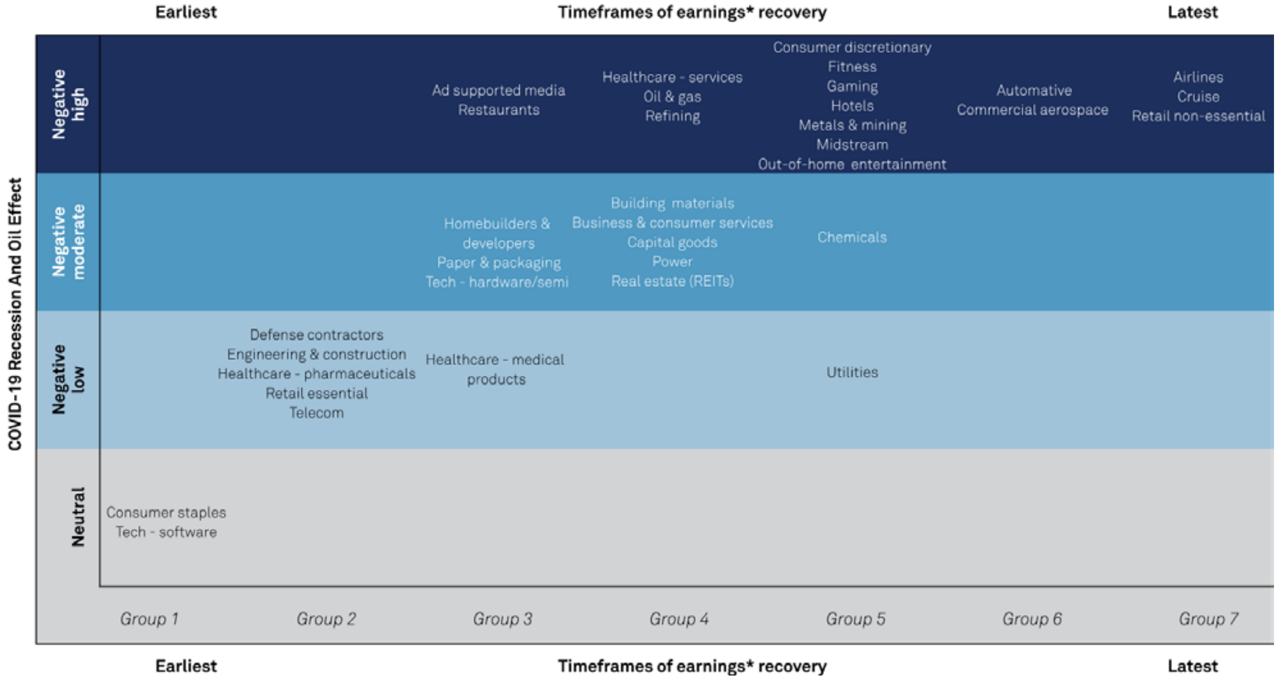
* For years 2022 and after, our opinion on credit metrics is used as a proxy for EBITDA (earnings before interest expense, tax, depreciation and amortization). Note: The chart only represents our rated issuers in North America. After a sector's EBITDA reaches 100 (2019 level), we assume it continues to grow at the rate during 2017-2019 (calculated based on industry value added reported by Bureau of Economic Analysis). If the sector is expected to have long-term negative disruptions, a discounted growth rate is assumed.

Source: S&P Global Ratings.

COVID-19 may also drive or accelerate longer-term secular changes, which could influence some sectors' recovery paths. For example, although real estate has suffered a similar blow to the paper and packaging businesses, and technology hardware and semiconductor companies, it may take longer for the sector to go back to pre-crisis levels (see chart 4). Companies may seize on the success of "working-from-home" by streamlining office space, which will further disrupt the commercial real estate market. With the potential for permanent shifts in consumer behavior to the digitalized world, mall-based REITs could further deteriorate, especially if there are amplified retail bankruptcies and tenants that never reopen.

Chart 4

North America: Sector Level Impact And Recovery



* For years 2022 and after, our opinion on credit metrics is used as a proxy for EBITDA (earnings before interest expense, tax, depreciation and amortization). Note: The chart only represents our rated issuers in North America.

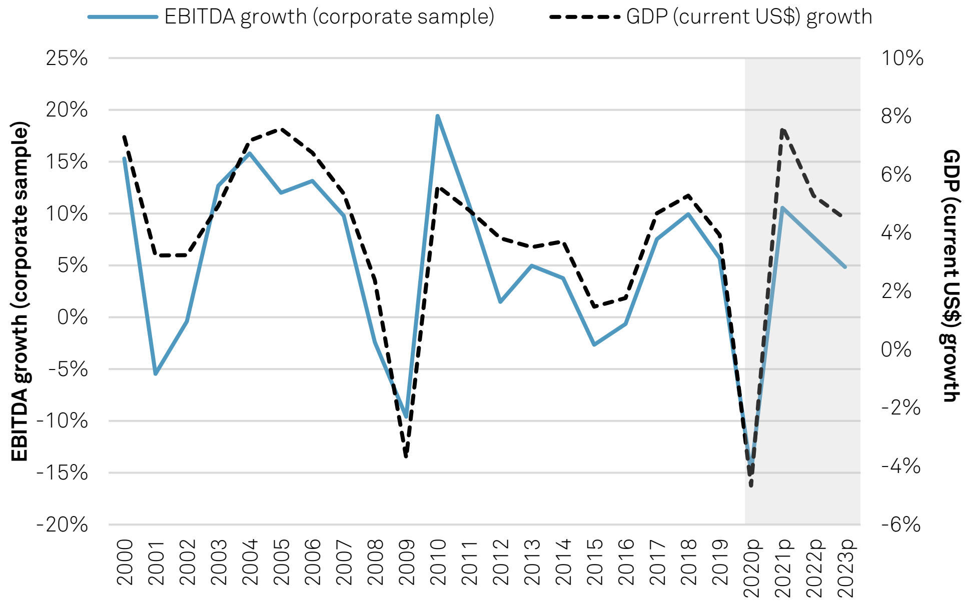
Source: S&P Global Ratings.

GDP And Sector Recovery Goes Hand In Hand

Plotting the earnings trend for a sample of North America nonfinancial corporates (rated and unrated, sample size: 2,284) against nominal GDP growth, these two variables are broadly correlated for 2000-2019 (see chart 5). There is also a similar directional relationship between our rough estimates of nonfinancial corporate earnings (rated universe only, with sectors weighted by their gross value added) and our economic forecasts for 2020-2023. More detailed research is required to analyze this relationship, but the directional guidance suggests corporate earnings and GDP tend to go hand-in-hand, and that the recovery story from the macroeconomic perspective is largely consistent with the one spotlighted through the sectoral lens.

Chart 5

North America: Corporate Earnings Versus GDP Growth



EBITDA—earnings before interest, tax, depreciation and amortization expense. p—projection by S&P Global Ratings. Data source for years 2000 to 2019: Corporate sample—S&P Global Market Intelligence; GDP—International Monetary Fund.

In short, at this critical crossroads, it seems clear that the recovery from this crisis is unlikely to be smooth and even, could very well take longer than anyone imagines, and will almost certainly involve significant modification in the behaviors of governments, businesses, and consumers. These changes, in turn, will likely trigger longer-term adjustments to credit markets.

Macroeconomic Outlook

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U.S.

With lockdowns easing in many areas of the U.S., even as COVID-19 cases spike in a number of states, some economic activity has resumed. Much of this is better-measured by nontraditional gauges of activity such as restaurant bookings and travel data, than tried-and-true economic reports such as factory orders or even quarterly GDP—as the former are often more forward-looking, while the latter tend to quantify what has already happened.

As it stands, the National Bureau of Economic Research has confirmed what we all knew to be true—that the longest-ever expansion in the world's biggest economy, at 128 months, ended in March with the shutdown-driven shock. And while we think this recession could prove to be the shortest on record (even briefer than the six-month slump that ended in July 1980), we continue to expect the recovery to be slow, uneven, and fragile.

The seemingly optimistic May employment report from the Bureau of Labor Statistics, which showed 2.5 million jobs added to nonfarm payrolls (regaining about one-tenth of the jobs lost on March and April) and a headline unemployment rate down to 13.3%, from 14.7%, came with the caveat that severe misclassification of many workers means the true jobless rate in May was likely 3 percentage points higher than reported.

In a June 10 press conference after the Federal Reserve left its benchmark interest rate near zero, Chairman Jerome Powell offered a dire outlook, saying the central bank forecasts unemployment to remain high, at 9.3% by the end of the year, and suggesting it could take years for the U.S. labor market to return to anything like it was before the coronavirus pandemic. While we expect a labor market rebound to come slightly sooner, we think persistently high unemployment will weigh on the demand side of the economic equation for the foreseeable future. And with consumer spending fueling roughly two-thirds of the U.S. economy, this would be a heavy weight indeed.

Of equal—if not greater—concern is that the federal government will pull back on the historic fiscal stimulus that, in all likelihood, not only prevented the current recession from being even deeper than it is but also set the stage for a more solid post-pandemic rebound. Mr. Powell told the House Financial Services Committee on June 17 that, with "25 million people who have been dislodged from their jobs either in full or in part due to the pandemic, it would be a concern if Congress were to pull back from the support that it's providing too quickly." Even the Fed, whose unprecedented action injected sorely needed liquidity into effectively frozen financial markets, probably wouldn't be able to do much to spur demand if fiscal stimulus wanes.

Our current baseline forecast shows U.S. GDP shrinking an unprecedented 33.6% in the second quarter before a bounce-back in activity starting in the second half. Our full-year forecast is for an economic contraction of 5.0% (see table 2 and chart 6). Our pessimistic outlook assumes an even steeper contraction in consumer spending with social-distancing measures—whether mandated or voluntary—continuing to depress demand.

Table 2

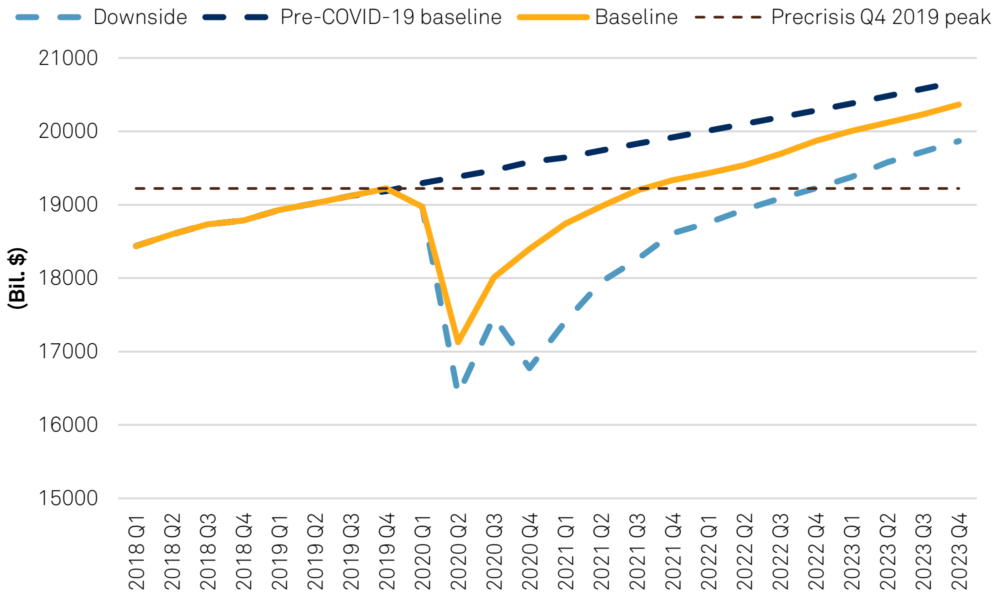
U.S. – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP (year % ch.)	2.3	-5.0	5.2	3.0	2.8
Real consumer spending (year % ch.)	2.6	-4.8	5.5	4.0	3.2
Core CPI (year % ch.)	2.2	0.7	1.4	2.0	1.8
Unemployment rate (%)	3.7	9.3	7.2	5.3	4.3
Housing starts (annual total in mil.)	1.3	1.2	1.3	1.3	1.3
Federal Reserve's fed funds policy target rate range (year-end %)	1.5-1.75	0-0.25	0-0.25	0-0.25	0.75-1.0

Note: All numbers are in annual average basis, except the Fed's policy rate and housing starts. Core CPI is consumer price index excluding energy and food components. f—forecast. Forecasts were generated before the third estimate of Q4 2019 GDP was published by the BEA. Source: Oxford Economics, S&P Global Economics Forecasts.

Chart 6

Alternative Paths Of Real GDP Contraction And Recovery



Sources: Bureau of Economic Analysis and S&P Global Economics' forecasts.

Canada

In Canada, the data suggest that the spread of COVID-19 has been largely contained and a tentative recovery has begun. Real-time data on mobility and activity have started to rise, and the labor market added 290,000 jobs in May, when shut-ins were initially eased, recouping about 10% of the 3 million jobs lost in March and April.

The increase in jobs and hours worked likely means the economy hit bottom in April, after contracting more than 8% in the first quarter (annualized). Reflecting an expected 39% annualized contraction in the second quarter, the economy likely lost nearly 13.4% from peak to trough.

Assuming any subsequent waves of infection aren't overwhelming, we expect an economic recovery in two stages: a near-term bounce back in aggregate demand and employment activity as lockdown restrictions ease, followed by more gradual, protracted, and uneven improvement.

We forecast real GDP to contract 5.9% this year before growing 5.4% in 2021. We don't see real GDP regaining its pre-pandemic level until the fourth quarter of next year. Because of the high bar to tighten monetary policy in the next couple of years, we anticipate the Bank of Canada will keep the policy rate at 0.25% through 2021 and most of 2022. We expect headline unemployment, after topping out at 13.7% in May, to come back down to 8.7% and 6.8% by the fourth quarter of this year and the next, respectively. This is above the 5.5%-6.0% before the recession.

Before the pandemic, Canada was already slowing down with soft consumer spending, high household debt-to-income ratios, and labor disruptions. The sharp drop in energy prices just made things worse. Lingering scars in the form of virus fears, bankruptcies, and social-distancing will limit capacity utilization and growth for a third of the economy. The unusual nature of this service-centric shock makes the recovery more uncertain than usual. The path of the virus remains highly unpredictable, and the possibility of an economic stop-and-go with "false dawns" means the risks to our baseline forecast are on the downside.

Financing Conditions

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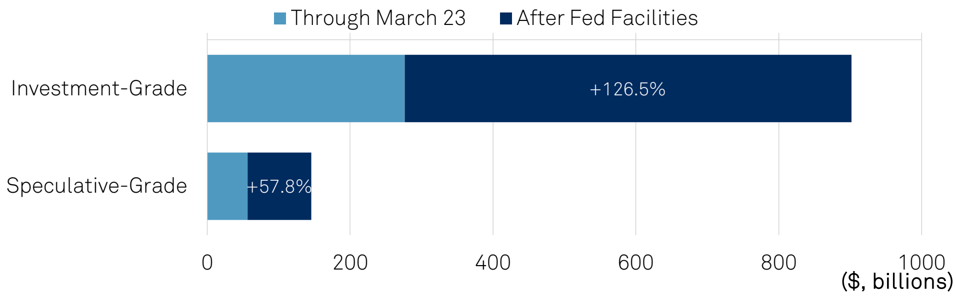
Amid signs the worst of the recession is behind us, financing conditions for U.S. corporations have improved even faster than economic data have. Equity and fixed-income markets are showing exceptional optimism despite a surge in virus cases in certain locations, and with the full reopening of the economy some way off. This comes as the Fed has introduced massive programs to provide liquidity to nearly every asset class—including its first programs to purchase corporate bonds in the primary and secondary markets. This has fostered the largest surge in rated corporate bond issuance in history in less than three months. Through June 15, the year-to-date total of $1.05 trillion was up 76% from 2019. Of this, roughly 68% has come after the initial Fed announcement of the creation of these facilities on March 23 (see chart 7). The overwhelming majority has been in the investment-grade space, though speculative-grade bond issuance has also picked up at a record pace since April. Still, a large portion of this has come from the highest-rated 'BB' segment. Leveraged loan issuance remains weak in 2020, down 21% through June 18 (to $189.2 billion).

Chart 7

Fed Facilities Drive Unprecedented Growth Rates

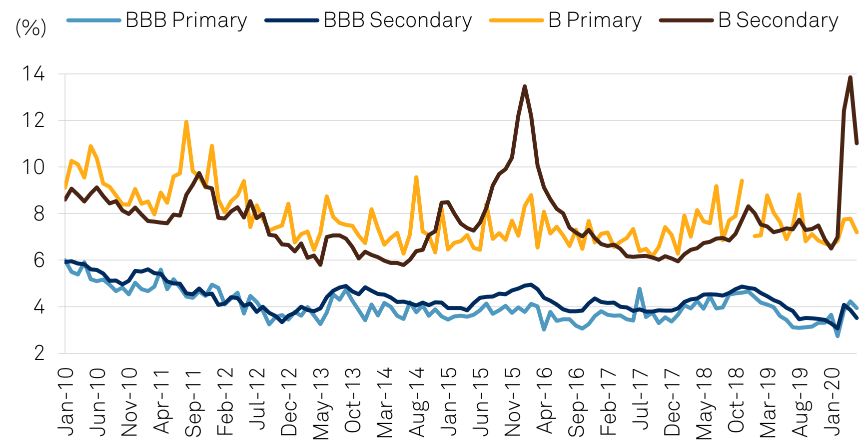


Source: Thomson Financial; S&P Global Ratings.

Demand for new debt is clearly quite strong, and while interest rates in the primary markets are above pre-pandemic levels, they are still relatively low, particularly compared to where pricing has been in secondary markets (see chart 8). Given the historically high volume of investment-grade debt, it's safe to say that issuers in the primary markets are paying rates not all that far removed from recent averages.

Chart 8

Primary Market Yields Remain Favorable Despite Recent Secondary Panic



Source: Yield-to-Maturity for primary market yields. Thomson Financial; S&P Global Ratings.

However, within the speculative-grade segment, fewer issuers than normal in the 'B' and 'CCC' ranges are able to access bond funding—but those that are able to may be skewing the average yield. This could explain some of the large divergence in yields for new issuance relative to secondary pricing. This isn't uncommon observation; such a wide spread also occurred with the 'B' primary and secondary yields during the oil price shock of 2014-2016.

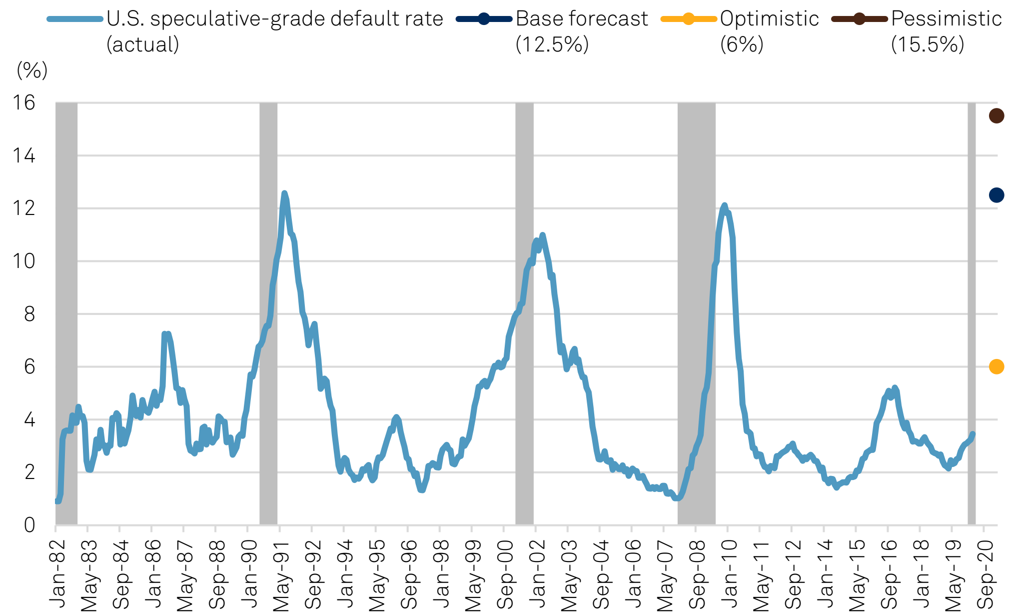
Still, unconventional funding patterns are appearing. Roughly 48 investment-grade corporate issuers have come to market multiple times since March 23, for a total of $271 billion, or roughly 43% of the investment-grade total (since then). This also seems to coincide with a marked drop-off in the use of commercial paper (CP) as a funding vehicle since CP rates experienced wild fluctuations in early March. Since then, CP rates have come in to only slightly above zero, so it remains to be seen if this potential shift will continue.

For spec-grade issuers, many have turned to their revolving credit facilities for short-term liquidity. According to S&P Global Market Intelligence Leveraged Commentary & Data, spec-grade issuers have drawn down about $117 billion since March 5. By our estimates, we rated about $226 billion in spec-grade revolving debt at the beginning of the year (by full amount of facilities). This implies there is still some room to maneuver; however revolvers only account for 8% of the total spec-grade debt outstanding in the U.S. at the start of the year.

Against this backdrop, S&P Global Ratings forecasts the U.S. trailing 12-month speculative-grade corporate default rate will rise to 12.5% by March of next year, more than three times the 3.5% in March 2020 (see chart 9). To reach this baseline forecast, 233 spec-grade companies would need to default. In our pessimistic scenario, 289 defaults would bring the rate to 15.5%.

Chart 9

U.S. Trailing 12-Month Speculative-Grade Default Rate And March 2021 Forecast



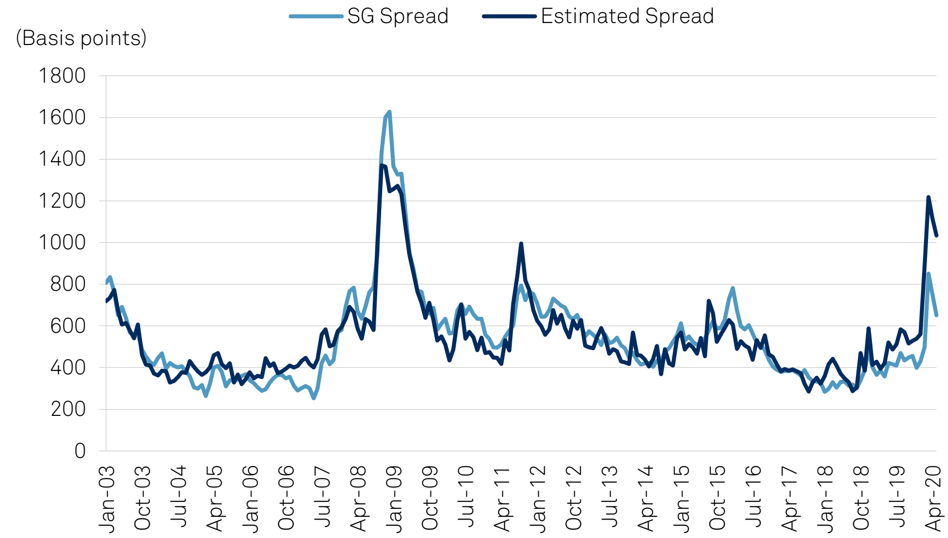
Note: Shaded areas are periods of recession as defined by the National Bureau of Economic Research.
Sources: S&P Global Ratings and S&P Global Market Intelligence's CreditPro®.

At any rate, fixed-income markets have made a quick turn in a more optimistic direction since the Fed intervened. Corporate bond spreads have been falling nearly as quickly as they rose. At the start of the year, the speculative-grade spread was at roughly 400 basis points (bps), but shot up to almost 1,000 bps on March 23. As of mid-June, they had fallen back to 597 bps. Even our distress ratio—which focuses on the weakest borrowers—is falling along with spec-grade spreads, reaching 22% in May, after hitting 30% in April. These market indicators imply a roughly 6% default rate by the end of first-quarter 2021, and is the basis of our optimistic scenario above.

Historically, credit, economic, and market measures are leading indicators of future defaults. Now, though, markets have diverged from fundamentals more than ever (see chart 10). We base our estimated spread on economic and equity-market sentiment, and money-supply indicators. At the end of May, it reached 1,033 bps, compared to the actual spec-grade spread of 652 bps. The gap between these two measures has exceeded 360 bps each month since January, indicating markets may be making bets based on an overly optimistic course of the virus and the economy, which likely includes the assumption of further rounds of Fed stimulus, or extensions and expansions of existing ones.

Chart 10

Markets Have Never Been This Far From Fundamentals



Source: S&P Global Ratings.

Sector Trends

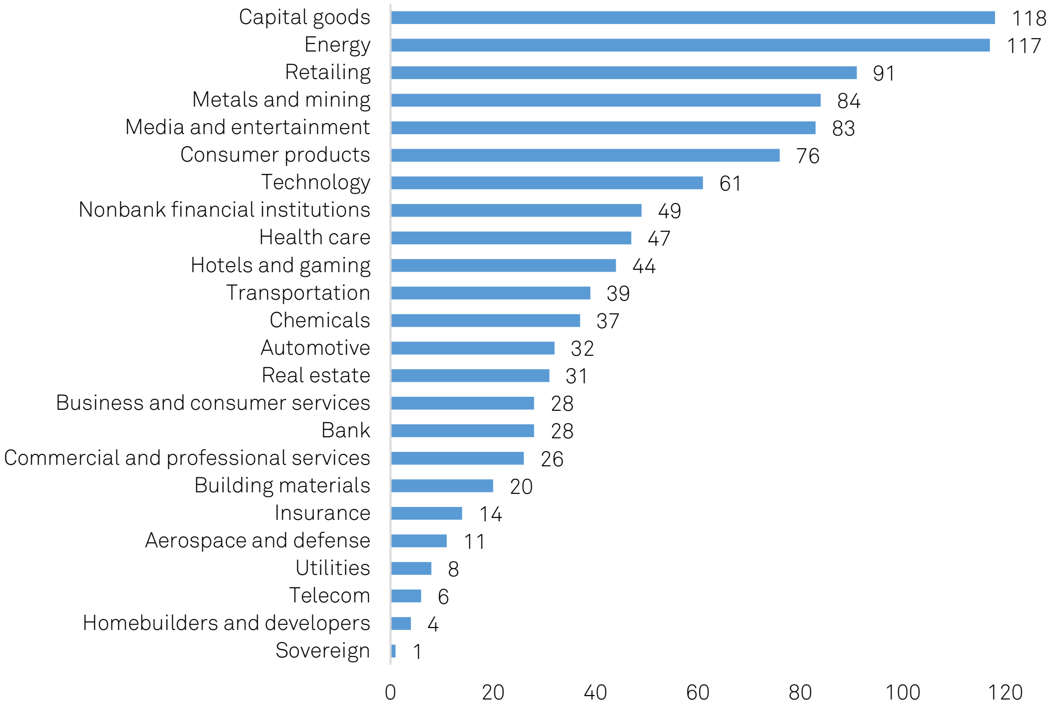
While we've seen credit quality deterioration across nearly all nonfinancial corporate sectors, those most dependent on consumer discretionary spending face an existential crisis. For example, the already-beleaguered retail and restaurant sector is suffering badly, automakers face significant sales declines (exacerbated by supply chain troubles), and airlines are being hurt so severely by social-distancing measures that we think it could stretch through 2023 for global air traffic to recover to pre-coronavirus levels.

The transition out of lockdown is prompting a recovery in activity, but fears of a second wave of COVID-19 and a corresponding further delayed economic recovery remain. Please see charts 3 and 4 above for our views on sector level recovery prospects.

Though the pace of downgrades has slowed in recent weeks, negative rating actions (downgrades, outlook changes, or placement on CreditWatch) continue to be prominent in sectors most exposed to the pandemic. Globally, the effects of COVID-19 and the oil price shock have led to negative rating actions on more than half of the corporate borrowers we rate in industries such as autos, capital goods, transportation, media and entertainment, retail, energy, banks, consumer products, and hotels and gaming. All told, S&P Global Ratings has (as of June 22) taken 990 negative rating actions on North American borrowers, including 556 downgrades (see chart 11).

Chart 11

North America COVID-19 & Oil Prices-Related Rating Actions By Sector As Of June 22



Note: These 990 rating actions pertain to ratings where we mention COVID-19 and/or oil prices as one factor or in combination with others.
Source: S&P Global Ratings. COVID-19- And Oil Price-Related Public Rating Actions On Corporations, Sovereigns, And Project Finance To Date, June 23, 2020.

The potential for downgrades has increased at a record pace. Among speculative-grade borrowers, the negative bias jumped to an all-time high of 52% as of May 15, breaking the prior high of 47% from March 2009. Currently, the net downgrade rate (the upgrade rate minus the downgrade rate) and the net bias (positive bias, or the proportion of issuers with positive outlooks or ratings on CreditWatch positive, minus negative bias) are reflecting increased prospects for downgrades as the effects of the coronavirus and resultant social-distancing measures sap earnings and strain cash flow (see "**The U.S. Speculative-Grade Corporate Default Rate Is Likely To Reach 12.5% By March 2021**," published May 28).

So far this year, the U.S. accounted for 19 of the 33 fallen angels (issuers downgraded to speculative-grade) with more than $252 billion in rated debt (as of June 26). It also has the largest count and debt volume of potential fallen angels (issuers rated 'BBB-' with negative outlooks or ratings on CreditWatch with negative implications), with 58 issuers accounting for $300 billion in rated debt. Lodging and leisure is leading with five, followed by consumer products with two (see "**The Potential Fallen Angels Tally Reaches A New High At 126**," published June 17).

This comes as we expect the global economic slump and the oil price shock to lead to a jump in 'BBB' category borrowers falling into spec-grade in the U.S. and Europe. A recent scenario analysis showed that as much $475 billion of U.S. corporate debt could take on "fallen angel" status this year (see "**'BBB' Pulse: U.S. And EMEA Fallen Angels Are Set To Rise As The Economy Grinds To A Halt**," published April 8).

Nonfinancial Corporates

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While a number of nonfinancial corporate borrowers we rate are now shifting their focus from liquidity to survival, many have already run out of time: U.S. firms have made up almost two-thirds of the 119 global corporates that have defaulted so far this year. Moreover, U.S. corporates we rate account for 424 of the 600 world's weakest links (issuers rated 'B-' or lower by S&P Global Ratings with negative outlooks or ratings on CreditWatch with negative implications) (See "**More Than One-Quarter Of Speculative-Grade Issuers Are Weakest Links**," published May 14).

Entering the current crisis, the median credit rating for corporates was significantly weaker than at the onset of the global financial crisis—particularly in the U.S. and Europe, where there were marked increases in issuers rated 'B' and lower as a share of the total rated population. In fact, by the end of 2017, the median rating for new nonfinancial corporate issuers globally had fallen to 'B', from 'BB-' in 2008.

This is largely the result of speculative-grade bond issuance having more than doubled in the past decade, as low interest rates fueled demand for corporate debt at the lower end of the ratings spectrum. This is important because spec-grade borrowers are now almost twice as likely to suffer downgrades as their higher-rated peers, with double the proportion of negative outlooks and placements on CreditWatch with negative implications.

Sectors most vulnerable to the deleterious effects of social distancing—including retail and restaurants, and media and entertainment—have seen marked increases in defaults so far this year. In some cases, the hit that sectors are taking from social restrictions are contributing and accelerating secular shifts that were already underway.

The spec-grade market has seen significant bond issuance since March. There has been less loan issuance, but the amount of loans coming due from 2020-2025 has dropped by more than $100 billion since the end of last year (through amendments or refinancing), according to S&P Global Market Intelligence Leveraged Commentary and Data. This lower near-term maturity wall may delay defaults for some issuers, but could also foster the creation of so-called zombie companies that can pay interest but are less likely to be able to refinance the now longer-dated debt maturity.

For many borrowers we rate in the **retail and restaurants** sector, top-line revenue will likely drop 20% or more this year—and earnings even more. Lingering social distancing will continue to weigh on traditional retailers, and the economic slump will damp discretionary spending. For many, cash burn is high, and leverage will spike, especially for the hardest hit, such as mall-based retailers. One-quarter of retailers and restaurants we rate are in the 'CCC' category (up from about 17% pre-pandemic), and the nine defaults so far this year already exceeds all of 2019—and we expect more.

The **auto** sector, too, entered the crisis in a weakened state, with a rising negative bias. In turn, the future doesn't look that bright; spotlighted by our belief that 2021-2022 sales will be below the 10-year average. As it stands, about 45% of auto manufacturers and parts suppliers we rate are in the 'B' category, 10% are in the 'CCC' category, and 5% face imminent default risk at 'CCC-'/'CC'.

Capital goods producers and **building materials** companies also entered the crisis under secular pressures. The former, already weakened by trade tensions, now faces a drop in demand amid the recession, and we expect material deterioration in credit metrics due to sizable revenue declines. For the latter, the profit outlook was weakening before the pandemic as slower top-line growth, combined with steady wage gains and constrained labor availability, pressured margins. Because the timing of lockdowns came during the spring-summer building season, the outlook for credit quality in the sector has worsened significantly; negative rating outlooks have tripled this year, to more than half of the companies we rate in the sector.

The pandemic is hurting the **media and entertainment** industry very badly, and in two ways: an advertising slump amid the economic recession; and a total shutdown in out-of-home entertainment. While we see ad spending growing again in the second half of the year, the recovery will be uneven in timing and degree. In the short term, social distancing will continue to limit attendance at movie theaters, and might mean no attendance at sporting events. While revenues will likely be down double-digits in the second and third quarters for most subsectors in media, the hit to profitability will be far worse. We expect defaults and bankruptcies to increase materially, especially if the economic recovery falters.

Meanwhile, **oil and gas** producers have been hit hard during the pandemic, with low prices set to persist until demand returns in earnest. Investor sentiment is very negative for the speculative-grade issuers we rate; many lack access to capital markets and are facing large debt maturities. Of the 88 issuers we rate in the upstream space, 43% of them are rated ‘CCC+’ or below. This will likely make for a number of bankruptcies or defaults in the coming 12 months. With spec-grade companies unable to refinance, and with their bonds trading at low prices and high yields, the risk of selective defaults is very high.

Financial Institutions

Banks

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Since the onset of COVID-19, we have taken 30 negative rating actions on U.S. banks (all outlook revisions) and, now, roughly one-third of the U.S. banks we rate have negative outlooks. We also recently revised our view of the economic risk trend for banks to negative—which we incorporate in our Banking Industry Country Risk Assessment (BICRA). In our view, despite the government’s extraordinary measures to support the economy, substantial pressure on banks’ earnings and asset quality could lead to steep credit losses and capital declines if the downturn lingers or the rebound is tepid. Still, even if the economic risk score of the U.S. BICRA declines to ‘4’ from ‘3’, this wouldn’t lead to a lowering of the anchor—the starting point for ratings—for U.S. banks, which is currently ‘BBB+’. We don’t expect to change a majority of our U.S. bank ratings, predicated on an economic rebound in the second half and the positive effects of fiscal and monetary stimulus. Still, we don’t expect bank earnings to approximate pre-pandemic levels until at least the second half of 2022, and likely they will still fall short in that year.

The largest U.S. banks reported weak first-quarter earnings, weighed down by large provisions, foreshadowing the economic pain that is likely ahead. Outside of a hefty buildup in allowance for loan losses, most of the other earnings measures held up reasonably well. For example, revenue for the median large banks was up 3.6% because of exceptionally high trading results and two months of the quarter (January and February) that were devoid of pandemic concerns. One bright spot in the quarter was liquidity. Despite large corporate draws, liquidity for most banks improved, aided by significant deposit inflows on the heels of the Fed’s massive quantitative easing.

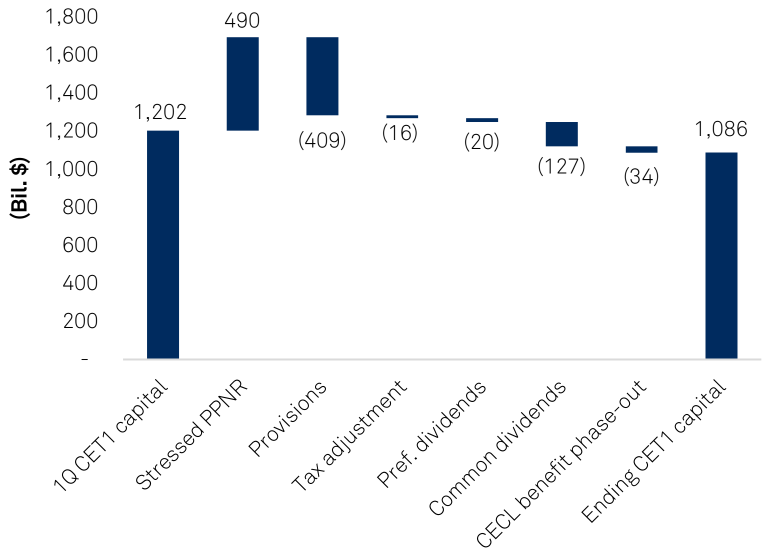
The main reason for the banks’ large allowance buildup is the weighting they placed on the dourer economic scenario that lies ahead. This was exacerbated by the adoption of the Current Expected Credit Losses (CECL) accounting methodology, in which banks set aside allowances for lifetime loss expectations. Incorporating CECL, all the banks built significant allowances in the first quarter. Despite the large buildup, we assessed the relative conservatism of a bank’s allowances at the end of the first quarter by measuring it as a percentage of the Fed’s assumed loan losses, as determined by the 2019 Dodd-Frank Act Stress Test (DFAST). In DFAST, the Fed bases its loss rate assumptions on both the composition of a bank’s loan book (for example, a higher credit card portfolio will likely equate to more losses) and the bank's underwriting standards on its loans. A higher percentage of first-quarter allowances for the Fed's nine-quarter severely adverse loan-loss assumption would reflect greater bank conservatism. From this perspective, the median allowance to DFAST losses for the largest banks at the end of the first quarter totaled 36%.

Based on a stress test we ran, we concluded that if our severely adverse stress assumptions materialized and a sharp recovery in the economy was slower than we expect, this could result in a larger number of negative bank rating actions. Our scenario incorporated loss rates from the Fed's 2019 stress test. Excluding the regulatory benefit of the CET1 ratio deferral due to incorporating CECL, the median large bank CET1 ratio declines by about 110 bps at the end of the nine-quarter stress period we ran (see chart 12). The capital decline is larger for some banks during the nine quarters.

The Fed's 2020 stress test shows that the aggregate common equity tier 1 (CET1) capital ratio for the 33 banks they tested would fall from 12.0 percent in the fourth quarter of 2019 to a low of 9.9%, before rising to 10.3% at the end of nine quarters of stress. The Fed also ran a pandemic-specific stress with three scenarios—looking at V-, U-, and W-shaped economic recoveries. Under the U and W scenarios, there are much steeper declines in banks' minimum CET1 ratio, to 8.1% and 7.7% respectively, but still above the minimum required capital levels.

Chart 12

CET1 Capital In Nine-Quarter Severe Stress, All Rated Banks



Source: S&P Global Ratings.

In Canada, we believe the pandemic will also lead to meaningful deterioration in asset quality across loan portfolios and lower earnings for the banking sector. That said, Canadian domestically systemically important banks (DSIBs, which together account for 92% of the country's commercial banking assets) are entering this recession from a position of strength. These banks have shown stable and solid operating performance over several decades and benefit from good on-balance-sheet liquidity, strong regulatory capital levels, and credit metrics that are stronger than those of similarly rated peers. That strength has been an important factor in our BICRA for Canada.

We believe the measures enacted by the Canadian government have the potential to ease the effects of sharply lower economic and business activity, and act as a bridge to support Canadian banks' retail and commercial clients. We believe the Bank of Canada's measures have bolstered liquidity and already provided a boost to confidence, particularly in the short-term funding markets. The raft of supervisory relief measures undertaken by regulators have helped maintain access to markets for all Canadian banks (for short- and long-term funding) and have ensured consistent guidance in dealing with distressed borrowers.

We haven't taken any rating actions so far on Canadian banks. That said, we see a few pockets of potential vulnerabilities where credit stress could manifest, such as consumer discretionary (including media, entertainment, and leisure), tourism and hospitality, retail and restaurants, and transportation (including aviation). Canadian DSIBs' direct exposures to oil and gas are manageable, at a modest 2% of total loans. The effects of COVID-19 on the housing market remain the biggest wild card. Still, we don't expect a severe correction in housing prices, as we believe demand- and supply-side factors will likely balance (that is, both buyers and new listings hold back). Strapped Canadian households are likely to benefit from the government's fiscal support, while ultra-low interest rates keep servicing mortgages manageable.

We stress-tested the largest Canadian banks to help us gauge DSIBs' ability to withstand a more significant credit shock, if the downturn is prolonged, the recovery is slow, and economic activity normalizes at a much lower level. Our sensitivity analysis indicated that Canadian DSIBs' capital and liquidity levels have enough strength to endure adverse downside scenarios, characterized by credit losses of up to 1.8% (this is our adverse stress scenario, which is 5x the average 2019 loss rate for the Canadian DSIBs). In our hypothetical severely adverse capital stress scenario, which applied a blended loss rate of 2.9% (just over 8x the actual 2019 PCLs of 0.35% all Canadian DSIBs), the impact on capital ratios were meaningfully higher, and would result in rating actions, but such stress currently appears to be a remote risk, in our view.

Nonbanks

Nonbanks consist of specialty finance companies, securities firms, exchanges and clearinghouses, and alternative investment funds.

We've taken a number of negative rating actions on nonbank finance companies, especially commercial real estate lenders and business development companies, given elevated funding and liquidity risks—particularly for those with near-term maturities, borrowings subject to margin calls, and limited covenant cushions. We also expect asset quality to deteriorate as delinquencies and defaults increase.

Amid reduced profitability and debt-service capacity, as well as volatility in equity markets, we've taken various rating actions on retail securities firms, as they have sizable amounts of asset-based fees, and we expect their earnings on clients' uninvested cash will be hurt due to low interest rates. Although equity indices have partially recovered, sustainability is uncertain. We have also taken rating actions on institutional securities firms as the increased potential for credit and market losses could erode the risk-adjusted capital ratios of these firms. An expected slowdown in investment banking revenue also contributes to our rating action rationale.

We also took rating actions on residential mortgage companies, amid stress on mortgage servicers' funding and liquidity. Lower interest rates could lead to substantial mark-to-market losses on their mortgage-servicing right portfolios. Lastly, we have taken some rating actions on payday lenders because of reduced originations, coupled with their inability to cut costs during the pandemic due to their large storefront presence.

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Asset managers

Increased financial market volatility is weighing on assets under management for traditional asset managers and potentially delaying realizations for alternative asset managers. That said, lower valuations could lead asset managers to invest at more attractive terms. We don't anticipate defaults in the near term, given that there are almost no debt maturities in the next two years, and asset managers can adjust operating structures and discretionary payments (such as share repurchases).

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Amid this historically severe recession, S&P Global Ratings revised all U.S. public finance sector outlooks to negative on April 1. At the start of the year, all were stable, with the exception of higher education, ports, and mass transit. The generally healthy financial position of governments and government enterprises/not-for-profits coupled with greater stability in the municipal market and the Coronavirus Aid, Relief, and Economic Security (CARES) Act have provided liquidity to meet near-term challenges. However, rapid revenue declines from the sudden recession have been substantial, and, as a result, most sectors face continued fiscal stress (see chart 13). States have started to reopen their economies, but the pace is varied, which will lead to significant variation in economic and revenue recoveries across the U.S. We also think uneven spikes in cases, both historically and to come, will weigh on the overall pace of recovery.

Chart 13

Key Sector Takeaways

State/Local
States and some local governments have seen significant revenue deterioration.
All states have re-opened their economies, but there are wide differences that will likely contribute to an uneven economic and revenue recovery. Absent additional federal stimulus there will likely be significant budget reductions that will be felt by local governments and school districts and contribute to credit pressure for them.

Not-For-Profit Health Care
The ramp-up of non-emergent and elective procedures, along with COVID trends, are the key focus for not-for-profit health care. While recent stimulus grants have provided some support, we believe managements' actions to adjust expenses and cost structure will be important for credit quality, especially as volume recovery may be uneven, and economic and state fiscal pressures could exacerbate payor mix challenges. We will continue to monitor reserves, liquidity, and short-term liabilities recently initiated in light of cash flow and margins.

Higher Education
The sector confronts an unprecedented loss of revenue and an uncertain recovery.
The pandemic and related economic and financial impacts exacerbate pressures that colleges and universities were already facing. The timing and success of re-opening campuses will be a key credit focus as we believe credit pressures will grow the longer campuses remain largely virtual or governed by social distancing. Student housing projects are uniquely vulnerable to continued loss of revenues amid social distancing and occupancy restrictions.

Transportation
Our activity estimates for transportation infrastructure show public transit and airports are most vulnerable to rating pressure. As restrictions on economic and social activities gradually lift in most states, mobility is on the rise and we are beginning to observe a recovery in demand indicators, albeit from severely depressed levels. While the CARES Act has helped bridge the liquidity challenges in the near term, the depressed activity level and how it will affect fiscal sustainability will be the key credit focus in 2020 and beyond. Nearly all transportation issuers currently have a negative outlook.

Housing
Senior housing continues to be the key area of credit volatility.
We continue to monitor policy responses related to mortgage forbearance, eviction and foreclosure, as well as economic conditions and unemployment trends as it relates to delinquencies to assess credit pressure for other housing subsectors.

Utilities
The closure of commercial and industrial establishments has negatively affected demand.
We continue to monitor how high unemployment will affect utility revenue collections and what pressure may exist to provide financial support to local governments, both of which could pressure cash flow and reserves.

Source: S&P Global Ratings.

Social factors have been front and center for U.S. public finance entities across the board, as many are at the front lines of managing the health and safety issues associated with COVID-19—and more recently the protests and community unrest that have emerged. We think there are also implications for public safety and other expenditures in the short term, and potentially economic or governance issues in the longer term that we will monitor.

Since the start of the pandemic, we've taken rating actions on 929 issuers across U.S. public finance (see "**COVID-19 Activity In U.S. Public Finance**," published June 29). While downgrades have accelerated, most actions to date have been negative outlooks. While all sectors have been affected, the changes have been more pronounced in those where demand has declined significantly given health and safety initiatives to stop the spread of the outbreak. Given the forecast for a slow recovery, we expect that credit pressure will continue well into next year.

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S&P Global Ratings affirmed the 'AA+' long-term and 'A-1+' short-term sovereign credit ratings on the U.S. on April 2. The outlook remains stable, reflecting our view that unprecedented fiscal and monetary stimulus will limit the economic downturn and set the stage for a recovery next year. We believe that the country's diversified and resilient economy, monetary policy flexibility, and status as issuer of the world's leading reserve currency will anchor its creditworthiness despite record-high fiscal deficits and a sharp rise in government debt. The U.S.'s institutional checks and balances, strong rule of law, and free flow of information should support stability and predictability of economic policies. The U.S.'s robust institutional framework provides scope for gradual reforms in many policies following recent economic and social turmoil (including public protests), which are likely to continue in the second half of this electoral year.

The ratings are constrained by high government debt and fiscal deficits, both of which will likely worsen this year. We expect an economic recovery next year, which will partly make up for the loss of output, and continued GDP growth afterward. A larger and prolonged deterioration in public finances, without positive signals of future corrective actions, could pressure the ratings. On the other hand, we could raise the ratings if we see signs of more effective and proactive policymaking beyond the policy response to the current recession.

Structured Finance

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Since our last report in late April, we have seen broad deterioration in collateral performance; year-to-date, through June 19, we have placed the ratings on some 1,275 North American structured finance tranches on CreditWatch negative. Some of the affected tranches have been downgraded, and, in a few cases, both. Our collateral performance outlook remains for "somewhat weaker to weaker" performance across the board, and our ratings outlook continues to be "stable to negative" or "negative" for most asset classes (see table 3). As has been the trend with the aforementioned actions, we still expect the bulk of negative rating actions to hit speculative-grade securities, with some pockets of investment-grade ratings activity.

The current weakness in the macro environment and employment situation, especially as it hurts consumers (and has knock-on impacts for businesses), has led to increased delinquencies and forbearance requests across many structured finance asset classes. Therefore, structural features such as reserve accounts, servicer advancing, excess spread, deferrable bonds/notes—when at least one of these features is present in many structured finance transactions/sectors—will likely (and has) help(ed) to mitigate temporary cash flow interruptions.

However, if there is a longer-than-expected disruption, or the recovery is stretched or weaker than expected, this would naturally introduce increased liquidity and credit stress. Thus, risks remain to the downside, especially under a potential "second wave" scenario. Our areas of focus haven't changed meaningfully from the last report in late April, and include collateralized loan obligations, commercial mortgage-backed securities with high exposure to retail and lodging, non-qualified mortgage residential mortgage-backed securities, aircraft asset-backed securities (ABS), subprime auto ABS, triple-net-lease ABS, auto dealer floorplan ABS, whole business ABS, small business ABS, and timeshare ABS.

Table 3

North America Structured Finance Sector Trends (12-Month Outlook) Q2 2020

	Collateral Performance Outlook	Rating Trends
Residential mortgages		
RMBS	Somewhat Weaker	Stable to Negative
RMBS - Servicer Advance	Somewhat Weaker	Stable
Commercial mortgages		
CMBS - N.A. Conduit/Fusion	Somewhat Weaker	Stable to Negative
CMBS - Large Loan/Single Borrower	Somewhat Weaker	Stable to Negative
CMBS - Large Loan/Single Borrower (Retail)	Weaker	Stable to Negative
CMBS - Large Loan/Single Borrower (Lodging)	Weaker	Stable to Negative
Asset-backed securities		
ABS - Prime Auto Loans	Somewhat Weaker	Stable
ABS - Subprime Auto Loans	Weaker	Stable to Negative
ABS - Auto Lease	Somewhat Weaker	Stable
ABS - Auto Dealer Floorplan	Somewhat Weaker	Stable to Negative
ABS - Credit Cards	Somewhat Weaker	Stable
ABS - Unsecured Consumer Loans	Weaker	Stable to Negative
ABS - FFELP Student Loan	Somewhat Weaker	Stable
ABS - Private Student Loan	Somewhat Weaker	Stable to Negative
ABS - Commercial Equipment	Somewhat Weaker	Stable
Asset-backed Commercial Paper	Somewhat Weaker	Stable
Structured credit		
CLOs	Weaker	Negative
Timeshares	Weaker	Stable to Negative
Small Business	Weaker	Stable to Negative
Tobacco	Somewhat Weaker	Stable to Negative
Transportation - Aircraft	Weaker	Negative
Transportation - Container	Somewhat Weaker	Stable to Negative
Transportation - Railcar	Somewhat Weaker	Stable to Negative
Whole Business	Weaker	Negative
Triple Net Lease	Weaker	Negative

Source: S&P Global Ratings.

Insurance

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Outlooks for the core North American portfolio reflect our expectation for limited change in the next 12 months (see table 4). Overall, the average financial strength rating for the core North American portfolio resides in the upper range of strong ('A') category, essentially unchanged from the prior quarter.

Key risks include weakened economic conditions, pricing adequacy, profitability, investment yield, and policy factors (political/regulatory). Balance sheet strength remains a pillar of credit quality support, providing a measure of protection from risks related to downside economic development broadly, and the expansion or increase in the magnitude of specific current and emerging subsector risks more specifically.

Table 4

North America Insurance Sector Trends (12-Month Outlook)

Sector	Current Business Conditions	Business Conditions Outlook	Sector Outlook
Life Insurers	Satisfactory	Somewhat weaker	Stable
Health Insurers	Satisfactory	No change	Stable
Property & Casualty Insurers	Satisfactory	No change	Stable
Reinsurers	Weak	No change	Negative
Bond Insurers	Satisfactory	Somewhat weaker	Stable
Title Insurance	Satisfactory	No change	Stable
Mortgage insurers	Weak	Weaker	Negative

Source: S&P Global Ratings.

Life insurers have been effectively navigating declining interest rates by modestly reducing their long-term rate assumptions in the past decade. However, with the current risk-free interest rate near zero, there may be grounds for life insurers to take more acute actions in upcoming quarters, which coincide with reserve reviews. We are seeing a slowdown or even a complete halt in new sales for certain rate-sensitive products as companies reprice or redesign the products to better reflect the current environment.

For health insurers, policy risk remains a top concern, though we don't expect any major legislative changes this year. However, the potential for another round of health care reform is more likely in the longer term. As for COVID-19, we are closely tracking the infection rate in the U.S. So far, we expect pandemic-related claims to be offset by the lower utilization trend from deferred non-essential medical services. Although a portion of the deferred services may come back in the second half, we expect profit margins to remain in line or better than expectation for the full year.

Concerns about loss emergence is building enough momentum for the U.S. property/casualty insurance sector to find religion once again on pricing. We characterize this hardening rate cycle as loss-cost driven rather than capital-replenishment driven, as we saw in prior cycles. The sector's capital keeps reaching new heights partly because of asset appreciation and dwindling share buybacks, though the impact of the pandemic on operating results and asset valuations may lead to a pause.

We revised our outlook on the global reinsurance sector in May to negative from stable, anticipating more negative rating actions in the next 12 months. This is due to difficult business conditions, including lower investment returns and reduced earnings, we believe reinsurers will struggle to meet their cost of capital again this year as was the case in 2017-2018.

Uncertainty in the U.S. public finance market continues to curb new issue thereby limiting bond insurers' underwriting opportunities. Somewhat mitigating this market dynamic is the growth in insured secondary-market issues driven my investors being more credit sensitive and credit spreads widening among municipal issues.

We expect revenue growth to be modest for title insurers this year, with a strong first quarter offset by a significant decrease in mortgage originations in the second and third quarters. Additionally, supply continues to somewhat lag demand for home purchases, but the low-rate environment has led to an increase in refinancing.

We expect mortgage insurers to recognize higher losses in coming quarters due to significant increase in mortgage delinquencies—but also for the average reserve per delinquent loan to be lower than usual. This is because they will likely assume delinquencies to cure at a higher rate in anticipation of economic recovery starting in the second half, leading to an improvement in the labor market, and with forbearance relief and government support helping borrowers with the transition.

Infrastructure

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The most affected subsectors in infrastructure remain midstream energy and volume-exposed project financings.

Midstream industry is being hurt primarily by production cuts and weakening counterparty credit quality that is cutting into cash flow. Independent refiners' credit quality is more severely hit by pandemic-related shutdowns and demand destruction. Refiners have focused on shoring up liquidity through the debt market until demand recovers. Higher-rated midstream companies generally have been able to raise funds for refinancing and growth projects, in stark contrast to their speculative-grade peers, which have largely been shut out of the markets and have resorted to spending cuts instead.

Toll road, stadium, airport, parking, and hotel project financings that are based on revenues from consumers have seen sharp declines in credit metrics, with the greatest hit to those with more reliance on volume-based revenues. Hotel occupancies have declined to single-digit percents for those that remain open, most sporting events have been canceled for the foreseeable future, and we've seen a drop-off of 50% or more in toll road volumes. While commuter traffic has generally fallen 60% or more, we've seen some stability in long-haul heavy-vehicle movements, which have generally fallen no more than 10%. We are seeing some green shoots of recovery in sectors like roads, while others—such as conference hotels, and sports arenas and stadiums—remain muted or uncertain.

We have seen some weakness in project-financed power projects that are exposed to market prices. Recent winters have been relatively warm, with this winter particularly mild. This has slowed term loan B sweeps and a number of financings have more debt outstanding than anticipated. The virus-induced demand decline could erode project metrics for some transactions enough to threaten financial covenants by the third quarter. The corporate merchant power sector hasn't been hurt as much. We have three independent power producers on positive outlook and we aren't seeing the volume degradation as in sectors like refining. Volume declines have been typically in the range of 5%-10%, and on the lower end of that range. Even the small commercial and industrial sector, which has seen declines of 15% early in the lockdown is now seeing recovery.

Projects with availability or cost recovery-based revenues have held up better, but remain reliant on the continuing credit strength of revenue counterparties and operators. Indeed, counterparty exposure is a key risk across the broader infrastructure portfolio and the rating on entities such as banks providing liquidity facilities, operators with performance guarantees, or revenue off takers often caps our infrastructure ratings.

As project financings generally have six to 12 months or more of dedicated debt-service reserves we don't expect defaults in the near term. The question is how long recovery will take and if the volumes recover to the same levels. The recovery may be extended in some sectors (for example, some sports leagues are planning to start the next season without any audiences in stadiums). We see the current crisis as permanently altering future demand for some projects due to factors such as increases in working from home, more remote meetings, and reduced convention activity.

Related Research

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- Canada's Economy Faces A Patchy Recovery, June 29, 2020
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- COVID-19 Weekly Digest, June 24, 2020
- COVID-19 Heat Map: Post-Crisis Credit Recovery Could Take To 2022 And Beyond For Some Sectors, June 24, 2020
- COVID-19- And Oil Price-Related Public Rating Actions On Corporations, Sovereigns, And Project Finance To Date, June 23, 2020
- Under Stress: Assessing CLO Manager Performance During COVID-19, June 1, 2020
- The U.S. Speculative-Grade Corporate Default Rate Is Likely To Reach 12.5% By March 2021, May 28, 2020
- COVID-19 Is Testing The Resilience Of Global Structured Finance, May 18, 2020

This report does not constitute a rating action.

Appendix 1: COVID-19 Impact On North America Nonfinancial Corporate Sectors

For analytical contacts, please see Appendix 3.

Table 5

COVID-19 Impact On North America Nonfinancial Corporate Sectors

Sector	Impact*	Comment
Aerospace and defense	High	The chilling effect of COVID-19 on air travel and the global economy is leading to order deferrals and some cancellations. This has prompted some aircraft manufacturers to reduce production. Cutbacks in airline capacity because of significant declines in air travel have reduced demand for aftermarket parts and services. Commercial aerospace companies will suffer pressure on earnings and cash flow, and in turn see a reduction in headcount, furloughing employees, and other actions to offset some of the effects. Earnings and cash flow should stabilize in 2021 as aircraft manufacturers and suppliers adjust their costs structures to the lower production rates. Defense contractors are much less affected near-term, but long-term defense spending could come under pressure.
Autos	High	We expect prolonged muted prospects for auto sales globally as the virus has impaired consumer discretionary spending. Specifically, we project that sales will decline 25% in the U.S. in 2020 with a 15%-20% recovery in 2021. Aftermarket suppliers are also under pressure, given less driving and sharply reduced consumer spending. As production and demand recover over the coming months, largely spurred by incentives and increasing 84 month loans, performance of pick-up truck (highest contribution margin vehicles) sales will dictate overall cash flow recovery for most issuers. Additionally, the recovery also depends on the supply chains linked to Mexican production and the financial flexibility of tier 2 and 3 suppliers to build working capital after sharp losses for two months or more. Auto suppliers' cash flow adequacy metrics will remain stretched even in 2021 as many issuers look to boost liquidity through revolver draw downs and likely debt issuance.
Building materials	Medium	The building materials sector is showing good resilience in the face of COVID-19 disruptions, with many reporting a boom in small-scale DIY projects as consumers redirect discretionary spending into their homes. The outlook for credit quality in building materials has shifted sharply negative in mid-2020, however, with negative outlooks tripling this year to more than 50% of the portfolio. Many issuers in building materials are operating with high debt levels after several years of M&A, so that a modest hit to profits from the COVID-19 economic slowdown adds to pressure from ongoing business restructuring costs. Construction stopped briefly in a few jurisdictions, but has since returned, highlighted by a quick bounce-back in homebuilding volumes. Issuers have been remarkably upbeat about their revenue prospects after the first quarter, but many public issuers still suspended earnings guidance for 2020. Cash conservation measures, like the suspension of share repurchases, remain in effect for most because of unpredictable revenue and working capital needs, but the rush draw down revolvers to shore up liquidity has reversed.
Capital goods	Medium	We expect the effects of COVID-19 and the sharp economic contraction to result in significant declines in revenues and EBITDA in 2020 putting pressure on the credit quality in the capital good sector. The extent of the impact depends on end-market exposures, with those facing weaker end markets such as oil and gas, autos, aviation, and metals and mining under greater pressure. Spec-grade issuers are more vulnerable to downgrades given limited diversity of end markets, cash flow, and liquidity pressures. We think investment-grade issuers could face more limited rating pressure given many large diversified issuers operate with cushion in credit metrics, face manageable debt maturities and enhanced liquidity positions.
Chemicals	Medium	The pandemic and related recession across the globe will reduce demand this year for most chemical products. The relatively few exceptions to this reduction will include chemicals used in sanitation, and similar applications. We expect demand declines at key chemical end markets including auto, and general industrial to reduce demand for both commodity and specialty chemicals, although commodity petrochemicals may be hit harder. Our base case considers a significant decline in EBITDA for many chemical companies relative to 2019, and relative to previous expectations for 2020. We see a related weakening in credit metrics, which will create downward pressure on credit quality across the credit spectrum. We don't expect that investment-grade specialty chemical companies that are generally more resilient to downturns will be unscathed in the especially severe recession we contemplate in 2020. However, we anticipate that credit quality at the lower end of the rating spectrum will suffer in particular, given that such companies typically have lower financial flexibility, and greater vulnerability to external shocks.

Consumer products	Medium	We expect a divergence in performance of sectors in the consumer products universe for at least the next six to 12 months. U.S. consumer products companies in food, home-cleaning products, and hygiene are well-positioned to benefit from shelter-in-place mandates and consumers' health concerns. We believe this will have a modest positive impact on credit quality. This is attributable to demand remaining strong because of shifts to at-home consumption and consumers' increased health concerns. That said, there is significant risks for sectors exposed to social activity and discretionary spending. COVID-19 has increased the risk of downgrades for consumer discretionary issuers because of reduced revenues and tight leverage headroom relative to the downgrade trigger. Issuers with links to the food service sector are also vulnerable. We believe that discretionary sectors' revenues will decline 20%-25% in 2020.
Forest products	Medium	Credit risks in the cyclical and commoditized paper and forest products industry have higher a negative bias because of COVID-19, with negative outlooks rising even further to about 30% of issuers. That said, the industry's early concerns for weaker demand volumes through a price trough appear to have abated, and prices for many wood products are rallying on better prospects for housing construction and tight inventories. Profits and debt leverage in wood products should begin improving in the second half of 2020, with a sustained improvement in credit quality only likely if market conditions hold up through 2021. Naturally, tissue producers are benefiting from strong demand, but this episode of panic buying will likely subside as it has with many consumer products. On the other hand, pulp prices are even lower in 2020 after a sharp decline in 2019 because of weaker exports to China. The outlook for paper producers is stable, given capacity closures that should at least offset structurally declining demand.
Gaming, leisure and lodging	High	With travel bans, stay-at-home orders, and restrictions on consumer activity, nearly all gaming, cruise, lodging, theme park, fitness, and sports issuers have been facing low to zero revenue environments in the second quarter and ongoing cash burn that is being financed with incremental debt. At the onset of the pandemic, many of the initial multinotch downgrades, especially those to the 'CCC' category, were based on liquidity concerns due to an abrupt shutdown in operations and subsequent negative cash flows. The high-yield credit markets ground to a near halt in March, with only higher-rated credits being extended costly financing with more stringent terms and conditions. This began to change in late March to early April as markets opened, with Fed stimulus providing further optimism and indirect support, as even lower-rated 'B'-category issuers successfully raised new debt funding. While issuance has helped to bolster balance sheets and stave off near-term bankruptcies, depending on cash burn rates companies will be saddled with a significant amount of high-cost debt as they navigate recovery and the potential for years of lower revenues. Although still very early in the reopening phase, some casinos are reporting better-than-feared EBITDA generation with fewer slot machines on the floor because of higher machine utilization and lower costs. In lodging, occupancy rates and revenue per available room were significantly below the prior year starting in mid-March through June, but are slowly improving. We expect leisure travel will recover first, business transient second, and group business third because of potential lingering concerns about gatherings and social-distancing norms. During recovery, we expect lodging companies to manage cost structures in a manner that achieves breakeven at lower occupancy rates than historically based on lower service levels on items such as food and beverage and high-touch services. We believe the cruise industry may fare the worst, with an extended period of weak demand and very weak credit measures through at least 2021 as it implements a phased resumption of cruise itineraries and given incremental debt raises to bolster liquidity. Planned ship orders will materially slow recovery in credit measures because capital expenditures for new ships, even if some are delayed, will likely exceed EBITDA potentially through 2022.
Health care and pharmaceuticals	Medium	The ratings effects in health care have been uneven, as negative rating actions have been heavily concentrated in subsectors that are more dependent on lower-acuity procedures, which have declined significantly during the pandemic. Thus, areas such as physical therapy, dental, and outpatient surgery have borne the brunt of negative actions, while subsectors such as pharmaceuticals have proven more resilient. Hospitals have also seen non-COVID-19-related volumes decline, putting stress on medical staffing and physician groups. The impact seemingly peaked in the second quarter, as procedure volume recovers, though recovery will be uneven depending on companies' service lines and geography. Longer term, we are concerned about how the unprecedented unemployment levels adversely affect payer mix and health care demand, further pressuring future margins and cash flows.
Homebuilders	Medium	U.S. homebuilder volumes are rebounding from an abrupt COVID-19 slowdown, so that monthly volumes in May and June were on par with 2019. Slower foot traffic for social distancing has given way to digitizing parts of the purchase and better sales conversion from more serious buyers. Looking ahead, however, job losses and potential construction site closures cloud the picture for new orders over the next few months in a previously healthy U.S. housing market. Homebuilders have been upbeat, as worst-case fears about construction, selling, and consumer sentiment were not realized by mid-2020. Most homebuilders have suspended earnings guidance for 2020 after disruptions early in the year, but anecdotal evidence about sales and cancellations appear favorable.

Media and entertainment	High	The pandemic is hurting the media and entertainment industry very badly, and in two ways: an advertising slump amid the economic recession; and a total shutdown in out-of-home entertainment. While we see ad spending growing again in the second half of the year, the recovery will be uneven in timing and degree. Television will likely benefit from record levels of political advertising as candidates may increase TV ad spending to get out their messages as social distancing measures could limit in-person rallies. The recovery timetable for out of home entertainment may lag both the general economic recovery and the end of formal social distancing measures. Venue re-openings may vary by country and even by region. Still, consumers may be unwilling to return to these venues until they feel safe which could be only when a vaccine is successfully developed. Consumer behavior and how out-of-home entertainment businesses operate may temporarily, if not permanently, change following this pandemic. While revenues and credit metrics could generally return to 2019 levels by 2021 (2022 for some media sectors), some company credits ratings may not recover at the same pace. That's because our view of many media businesses may change because of the trends unleashed or accelerated by the pandemic.
Metals and mining	High	Pressure on ratings in the metals sector accelerated with the concurrent COVID-19 and oil market downturns. The sector in North America is already characterized by elevated credit risk, with almost 50% rated B or lower and a 30% negative outlook bias since mid-2019. We lowered our metal price assumptions modestly (5%-10%), but the demand shock and production stoppages means that revenues could drop 20% in 2020 in these often high fixed-cost industries. Spec-grade issuers could breach leverage triggers with 2021 maturities on the horizon. Metals companies are wary amid lower prices and volumes, with some steel mills shutting output and curtailing capital spending. The mining sector could be under some strain in the next few years, as these operations are difficult to sustain without individual contact. Steel and aluminum producers in the U.S. face deteriorating cash flow with which to fund defining investments. Follow-through on large projects will determine near-term financial performance and the long-term sustainability of competitive positions. Cash flow is weakening across the sector, with lower prices for upstream mining companies and slower volumes for downstream metals processors.
Midstream energy	High	The combination of the pandemic and the oil-price war will directly hit EBITDA in 2020 and 2021 for the U.S. midstream energy sector. Volume declines and counterparty credit quality are the top risks to the sector but the uncertainty around the timing and pace of any recovery makes it difficult to predict the severity of impacts on midstream credit profiles. Investment-grade companies are better-positioned than their spec-grade peers to deal with the severe supply and demand shocks as many companies are self-funding, credit facilities have been extended, and liquidity on revolvers is sufficient. Companies are reporting about 7%-8% EBITDA declines for 2020. Spec-grade companies are unable to access the capital markets and a prolonged downturn will likely cause significant credit deterioration in 2021. There has been recent tightening in credit spreads across midstream, which followed higher crude oil prices.
Oil and gas	High	COVID-19 has significantly affected oil market fundamentals. However, due to OPEC+ implementing record production cuts and economies beginning to reopen, oil prices have rebounded but are still not at levels that support North American upstream credit quality. Furthermore, investor sentiment is still very negative for issuers in the spec-grade space and many of these issuers lack access to capital markets and are facing heavy debt maturities. Of upstream issuers, 43% are rated 'CCC+' or lower. Ultimately, we assume Brent oil price will recover to US$50 per barrel (bbl) in 2021 from US$30/bbl this year based on our expectation that COVID-19 will be contained this year leading to demand recovery and a massive supply response from the OPEC/Russia agreement to drastically cut production and production response from other producing regions particularly U.S. shale players. It's uncertain how much oil production will permanently exit the market but given existing supply and demand fundamentals, the market is well oversupplied and could benefit from some production permanently exiting the market.
Oil refineries	High	Independent oil refiners' margins are under pressure from falling demand, and the drop in oil prices has significantly impacted working capital and reduced cash positions. A number of refineries responded to the drain on liquidity with new short-term bank facilities and successful debt issuance of over $8 billion in second-quarter 2020. We believe second-quarter EBITDA will see continued weakness, due to the substantial decline in demand for jet fuel and gasoline. Cracks for both products has been negative at times, and anemic demand in the second quarter have led to massive cuts to utilization in the 65%-70% range. We expect negative EBITDA in the second quarter for most of the rated portfolio in North America. A prolonged demand response due to COVID-19 could damage credit quality.
REITs	Medium	While the impact of COVID-19 and economic recession will be felt across all property types, retail and health care assets will be more directly affected in 2020. We expect rent deferrals and increasing tenant distress to affect cash flow in 2020, particularly for retail assets given store closures and impact from social distancing. Rent collection averaged about 82% in April, with retail collecting rent in the 50% range while office rent collection was in the mid-90% area. Despite high rent collection for the office assets, we expect

		COVID-19 to accelerate the adoption of remote working and lead to a gradual reduction in office space utilization. Negative rating bias has increased in recent weeks reflecting expected pressure on cash flow and uncertain path to recovery. Still, most REITs have solid liquidity and maintain good access to debt markets given the largely investment grade sector that will help weather through this pandemic.
Regulated utilities	Low	We believe that most North American regulated utilities are well-positioned to handle the immediate impact of COVID-19. However, the pandemic could hurt some companies, especially those issuers already facing downside ratings pressure prior to the arrival of the coronavirus. Some electric utilities with disproportionate exposure to commercial and industrial class of customers could be vulnerable to reduced sales volumes, absent any regulatory counter mechanisms such as decoupling.
Retail and restaurants	High	Credit risks to the retail and restaurant sector remain elevated due to shifting shopping behaviors and a potential resurgence of the virus. We believe the recent modest improvements from the trough of the shutdown are unlikely to gain significant momentum due to the dissipation of temporary supports such as generous unemployment benefits, stimulus checks, and pent-up demand. If the pandemic appears contained and a recovery gains traction, we would expect the negative bias of our ratings to decline (about two-thirds of our ratings have a negative outlook). In the longer term, retailers and restaurants will have to adapt to changed consumer shopping habits such as a higher proportion of spend via digital channels, and incremental costs associated with health and safety measures. Discretionary and apparel retailers and dine-in restaurants remain the most at-risk issuers while essential retailers and quick-service restaurants remain relatively well-positioned.
Technology	Medium	COVID-19 will hurt enterprise and consumer IT spending, particularly, hardware and semiconductor segments. We believe software and IT services providers are not immune as customers will likely delay major upgrades or new project implementations. We expect some of the deferred spending to return gradually in the latter half of this year and in 2021 as business recovery takes place. While not in our base case, we could see more downgrades or negative outlook revisions as revenue deferrals become revenue lost or if liquidity is constrained, especially if there is a second wave of COVID-19 such that the macroeconomic recovery path is much slower than thought.
Telecom	Low	Overall, telecom and cable providers can withstand the effects of a surge in COVID-19 cases with limited impact to credit quality given their recurring, subscription-based business models. However, there are a handful of companies that have exposure to vulnerable sectors such as transportation and tourism, which could hurt their financial and operating performance in the near term. In addition, issuers that have exposure to small- and mid-sized business (SMB) customers are at risk since they are most likely to reduce telecom spending in a recession. We believe that SMB customers, in particular, are likely to scale back operations and in some cases, will go out of business.
Transportation	High	We have downgraded all U.S. airlines and the ultimate rating impact will depend on the duration and severity of the crisis, and the type and severity of measures airlines and governments take to mitigate it. Capacity reductions, along with sharply lower oil prices, will be insufficient to offset the decline in its travel demand. Government grants and loans to U.S. airlines provide a significant near-term boost for liquidity but credit quality remains under severe pressure. The aircraft-leasing sector should fare better than airlines in this coronavirus-related economic downturn, but will still face pressure on their revenues and cash flow. Car rental companies are also being hurt by the fallout from much lower air travel, with Hertz now bankrupt. Freight transportation is less affected but will be hurt indirectly through the global recession.
Unregulated (merchant) power	Medium	Most merchant power companies engage in ratable hedging and a high proportion—typically 90%—of their 2020 economic generation is hedged. Still, we expect companies with load shape risk (volumetric risk in hedges) and/or a higher proportion of large commercial and industrial customers will likely be disproportionately affected. We expect some companies that do not have a countercyclical retail power business that offsets the risks in wholesale power business to experience some credit pressures should the current environment last into the third quarter. With average peak electric demand showing signs of declining about 10%-13% at this stage, prompt and forward prices have declined. We expect ERCOT summer prices in 2020 to liquidate much lower than the forward curve suggests. While we expect demand in 2021 to be potentially lower forward power prices in 2021 and beyond are still structurally resilient suggesting some risk to renewable generation proliferation too.

*The impact descriptor above (high, medium, low) is our qualitative view of the risk. It does not directly translate to risk of rating actions, which depend on a number of factors including initial headroom under a rating coupled with the expected length and severity of the epidemic.

Appendix 2: Economic Data And Forecast Summaries

Table 6

U.S. – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP (year % ch.)	2.3	-5.0	5.2	3.0	2.8
Real consumer spending (year % ch.)	2.6	-4.8	5.5	4.0	3.2
Real equipment investment (year % ch.)	1.3	-12.4	8.4	7.9	5.5
Real nonresidential structures investment (year % ch.)	-4.3	-14.4	7.3	5.7	4.8
Real residential investment (year % ch.)	-1.5	2.5	0.3	2.0	3.0
Core CPI (year % ch.)	2.2	0.7	1.4	2.0	1.8
Unemployment rate (%)	3.7	9.3	7.2	5.3	4.3
Housing starts (annual total in mil.)	1.3	1.2	1.3	1.3	1.3
S&P Case-Shiller Home Price Index (Dec. to Dec. % ch.)	3.5	3.5	3.0	3.4	3.4
Federal Reserve's fed funds policy target rate range (year-end %)	1.5-1.75	0-0.25	0-0.25	0-0.25	0.75-1.0

Note: All numbers are in annual average basis, except the Fed's policy rate and housing starts. Core CPI is consumer price index excluding energy and food components. f—forecast. Forecasts were generated before the third estimate of Q4 2019 GDP was published by the BEA. Source: Oxford Economics, S&P Global Economics Forecasts.

Table 7

Canada – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP (year % ch.)	1.7	-5.9	5.4	3.1	2.6
Real consumer spending (year % ch.)	1.6	-6.5	6.5	3.4	1.9
Real private business fixed investment (year % ch.)	-0.4	-10.3	8.4	8.8	6.3
Core CPI (year % ch.)	2.1	0.9	1.0	1.8	2.2
Unemployment rate (%)	5.7	9.2	7.3	6.4	5.8
Housing starts (annual total in thousands)	209	185	200	203	204
CAD/USD exchange rate (per US$1)	1.33	1.36	1.37	1.34	1.34
Government of Canada 10-year bond yield (%)	1.6	0.6	1.1	1.8	2.3
Bank of Canada overnight rate (%, end of period)	1.75	0.25	0.25	0.50	0.75

Note: All numbers are in annual average basis, except central bank rates and housing starts. Core CPI is consumer price index excluding energy and food components. f—forecast. Source: StatCan, Oxford Economics, S&P Global Economics Forecasts.

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