S&P Global Ratings

Credit Conditions Europe Q4 2022

Hunkering Down For Winter

Sept. 27, 2022

This report does not constitute a rating action

Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions (Asia-Pacific, Emerging Markets, North America, and Europe). Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the European committee on Sept. 21, 2022.

Key Takeaways

- **Overall**: Europe faces a difficult and uncertain geopolitical and economic outlook as Russia's political risk appetite appears to increase after losses of territory in Ukraine, and exorbitant energy prices fuel inflation, triggering interventions to support consumers and businesses, with central banks recalibrating interest levels in quick order. We expect the eurozone to stagnate in 2023 after contracting in late 2022 and early 2023, while we believe the U.K. is already in the throes of a moderate four-quarter recession that started in the second quarter.
- **Risks**: Russia resorting to an escalatory pathway over Ukraine. Financing conditions becoming more restrictive amid high inflation, even as growth stalls and the likelihood of a full recession increases. EU and U.K. energy market interventions, while necessary, are costly and complex to implement on a timely basis.
- **Ratings**: Credit ratings actions in Europe have remained balanced, but we anticipate a greater erosion of buffers heading into 2023. While refinancing is not an immediate concern for most, a recessionary outlook and falling valuations will sharpen the focus of owners and creditors on the viability of more vulnerable businesses. Defaults are starting to tick up, albeit from historically low levels, and expected to reach 3% by mid-2023.

The geopolitical shockwaves from Russia's invasion of Ukraine rumble on. Russia's weaponization of energy supplies is creating a siege mentality in Europe as governments scramble to avoid blackouts and rationing over the winter. This comes at a high and mounting cost, not least with unanticipated high levels of inflation triggering a sharp adjustment in monetary policy. High energy bills, and broadening inflation pressures sapping real incomes, are undermining consumer and business confidence to the detriment of growth. We now expect eurozone growth to stall in fourth-quarter 2022 and first-quarter 2023, with growth for the year only reaching 0.3%. The U.K. and German economies will suffer shallow recessions, with growth contracting 0.4% and 0.3% according to our forecasts.

The recent resilience in ratings performance for nonfinancial corporates appears to have reached an inflexion point. Negative rating actions in the utilities and energy-intensive sectors such as chemicals are likely to spread to consumer discretionary sectors as inflation erodes consumer's purchasing power. But slowing growth in the U.S. and China is also weighing on export industries, as illustrated by September's S&P Global Market Intelligence's flash PMI reading for German manufacturing export orders that at 40.8 is back below June 2020 levels. A

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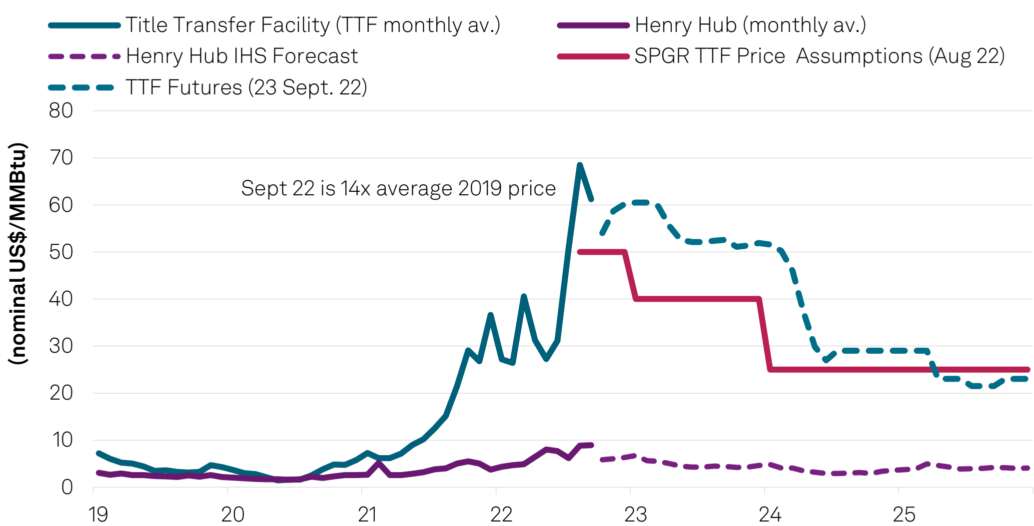
key signal is the weakness we are now witnessing in corporate margins that have fallen in many sectors since peaking in 2021 as passing through cost increases becomes more difficult amid slowing growth. Defaults are starting to tick up, albeit from historically low levels around 1%, and we expect 3% by mid-2023. Distressed exchanges are likely to become more frequent given the backup in yields and the greater sensitivity of investors to underperforming credits.

The energy emergency represents a massive terms-of-trade shock fueling inflation and undermining growth. The high reliance of Europe on the supply of Russian energy (particularly pipeline gas) enabled Russia to manipulate the market in an attempt to deter Western countries from supporting Ukraine. The shut-off of 80% of pipeline gas to Europe, frantic efforts by governments to increase gas storage ahead of winter, combined with low nuclear power generation (in France) and low hydropower generation in southern Europe due to water shortages, created a massive squeeze in benchmark gas prices in northwest Europe. In September, TTF natural gas prices averaged $61.3/mmBTU, 14x higher than the average price prevailing during 2019 (see chart 1), and equivalent to an astronomical oil price of about $355 a barrel. Furthermore, electricity prices have similarly exploded given that the current system sets wholesale prices based on the highest-cost marginal producer, namely from gas-generated power plants currently.

Chart 1

European and U.S. Benchmark Gas Prices



Source: S&P Global Commodity Insights, formerly IHS Markit, S&P Global Ratings. Data as of 23 Sept. 2022.

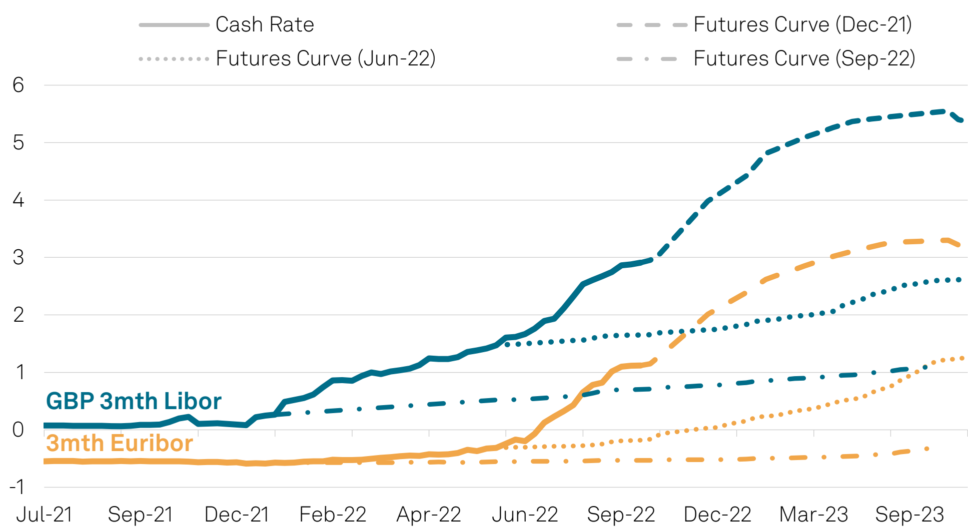
European governments have been forced back into damage limitation mode only two short years after the pandemic. National governments have adopted various policy measures to protect households and businesses from exorbitant energy bills and supply shortages over the winter. These measures range from unit price caps for consumers and businesses, to cuts in VAT and other fuel duties, direct payments and government subsidies, payment deferral schemes, as well as advocating ways to (voluntarily) cut energy consumption. The size of these support programs are significant - on average around 3% GDP on a net basis for EU countries at present prices, and potentially over 9% GDP through 2026 in the U.K. based on recent proposals. Moreover, the situation could become even worse in a downside scenario if Europe suffers a colder-than-average winter or Russia cuts off all remaining gas supply. Russia still provides 35 bcm/year of natural gas to the EU (Ukraine transit, TurkStream, and LNG), equivalent to 22% of 2021 volume supplied by Russia, and 8% of total EU gas supply. That would almost certainly entail mandatory rationing in countries such as Germany and Italy where natural gas remains a key energy source.

While these measures support affordability and limit further increases in inflation, they raise several issues impacting credit. Firstly, evidence shows that subsidizing energy bills reduces incentives for consumers to save the energy required to secure supplies over the winter. The risk is that energy-intensive sectors, less integrated into downstream supply chains, may be subject to rationing - such as glass, steel, and chemicals. Secondly, the very significant fiscal cost that will be borne by governments, partially offset by windfall taxes on non-gas energy producers in some countries, coming so soon after COVID-19, is a negative credit development. The credit implications will vary depending on scale, duration and financial flexibility of the country in question. Thirdly, as discussed in detail in a recent Breugel paper "A grand bargain to steer through the European Union's energy crisis," the implications for European industrial competitiveness as well as for the future structure of a potentially unified, and cleaner, European energy market should not be underestimated.

Just as pertinent, financing terms and conditions are expected to continue to tighten. As inflation forecasts continue to be revised higher - we now expect inflation to peak at around 10% and 12% in fourth-quarter 2022 in the eurozone and U.K., and with signs that inflationary pressures are broadening out beyond energy, central banks are eschewing forward guidance in favor of an abrupt tightening in policy. The Swedish Riksbank's recent 1% increase in its policy rate to 1.75% is testament to that. This is reflected in the sharp steepening in futures rate curves since the summer (see chart 2).

Chart 2

Short Rate Expectations Jumped Over The Summer (%)



Source: Bloomberg, S&P Global Ratings. Data as of Sept. 22, 2022

Our new baseline forecasts anticipate the ECB's deposit rate reaching the top end of the range for the terminal rate at 2% in the first-quarter of 2023 and the BOE's bank rate rising to 3.25%. The imperative to raise rates even as growth stalls, albeit with real rates still strongly negative in the near term, will translate to a much tighter financing environment than we have seen in Europe for many years. It seems inevitable, in our view, that fixed-income investors will also factor in higher risk premiums as the Bank of England shrinks its £838 billion stock of gilts held in the Asset Purchase Facility, initially by £80 billion over the next 12 months. In contrast, the ECB is yet to decide when it will even end reinvestment of their €4.9 trillion holdings of securities held for monetary policy purposes, almost 90% higher than at the end of 2019.

High inflation, higher rates, and stagnating growth and risk of recession point to a weaker outlook for corporate earnings and credit quality, particularly for more cyclical, capital-intensive sectors as well as highly indebted buyouts unable to generate free operating cash flow. This would include consumer discretionary sectors such as retail and leisure, as well as residential and commercial real estate where landlords could struggle to pass on inflation through rent indexation. The typically investment-grade utility sector remains under close surveillance, reflecting liquidity pressures arising from high prices and extreme volatility in energy markets. Stand-alone credit profiles have come under some downward pressure, mitigated in some recent high-profile cases by the provision of extraordinary support from governments: Uniper and EDF being two recent examples.

At the same time, the strength of the pandemic recovery extending through first-half 2022, and over the summer for the European travel and hotel industry, has strengthened rating headroom for many companies in these sectors. Sectors benefitting from geopolitical developments such as upstream energy producers, and certain scarce industrial metals, as well as the defense industry have also achieved solid results.

Top European Risks

Russian threats to escalate and broaden out the conflict In Ukraine

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

Russia appears to be set on an escalation of its military and economic conflict with Ukraine and the West, though key Russian allies China and India may yet intervene. While direct NATO military engagement in the conflict is not our base case, the risk is not insignificant particularly should Russia use unconventional weapons or otherwise causes Article 5 to be invoked. The asymmetric nature of these risks only acts to exacerbate existing shocks reverberating through the global economy. More broadly, the conflict illustrates a deeper geopolitical schism between autocratic and democratic blocs that could undermine decades of economic cooperation and development, with widespread implications for global security, trade, supply chains, communications, the environment, and global health.

Financing conditions become overly restrictive as European central banks front-load monetary policy tightening

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

Persistently above-target European inflation has galvanized central banks (including the ECB) to accelerate the transition to a tighter monetary policy stance. While energy subsidies may limit further increases in headline inflation over the near term, the possibility of renewed fiscal stimulus across most economies in Europe, and very tight labor markets, argues for a continued robust central bank response. In this environment financing conditions have a lot further to tighten with the risk that, as growth slows, fragilities in creditworthiness will crystallize, mainly where debt burdens are high and/or refinancing requirements are significant. This is particularly pertinent for European corporates given the still high (around 30%) of speculative-grade companies (rated 'B-' and lower) that we view as vulnerable, especially those unable to generate positive cash flow even if debt maturities remain distant. But it is also relevant to European sovereigns if progress on budget consolidation or structural reforms slip. The key test will be how government bond yields perform once the ECB ends reinvestment of maturing government bonds in its portfolio, but doesn't target that until the end of 2024.

Recession risks rising as a protracted war, energy scarcity, and slowing growth in U.S. and China take their toll in Europe

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

The European economy, already dealing with record highs in natural gas prices as Russia cuts pipeline supplies, faces further energy supply risks that could derail our base case as EU sanctions on Russian oil shipments start to take effect from Dec. 5, as well as the threat of curtailment of Russian oil supply to any G-7 countries that impose a mooted oil price cap. The risk of further Russian reprisals, including cuts to residual gas flows to Europe via Ukraine and TurkStream, is also increasing as the war shifts in Ukraine's favor ahead of the approach of winter. Combined with a weaker growth outlook in the U.S. and China, we view a high risk of this geopolitical and energy-related crisis resulting in a deeper and longer recession in Europe.

EU and U.K. energy market interventions necessary but costly and complex to implement on a timely basis

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

Excessive price volatility and continued exorbitant prices in European gas and power markets threaten market stability as well as the competitiveness of many energy-intensive industries. While the proposed market interventions announced by the EC on Sept. 15 will be beneficial, reaching consensus across EU member states and implementing the measures on a timely basis ahead of winter could prove challenging. Notably the design and implementation of any power price caps and equitable redistribution of related infra-marginal rent on power that will vary significantly across member states. Price caps on Russian oil and possibly on gas also risk further supply curtailment from Russia. Even extending the eligible collateral-backing margin calls that secures the solvency of the commodity clearing houses needs to be undertaken thoughtfully to limit the risk of unintended consequences. More broadly, the emergency government support for consumers and households across Europe comes at huge cost for governments - on average around 3% GDP on a net basis for EU countries at present prices, and potentially up to 6% GDP over the next two years in the U.K., based on recent proposals. The concern for the gilts market is that nearly all of that 6% of GDP will be funded via new debt, during a period when the BOE is shrinking its balance sheet, and sterling depreciation is adding to inflationary pressures.

Structural risks

Heightened disruptions from physical and transition risks from climate change

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

The political and economic imperative to end Europe's reliance on Russian fossil fuels has created an urgency to accelerate the energy transition, with more ambitious plans. These face implementation challenges, notably regarding slow permitting and supply chain strains - for renewables, biomethane, energy efficiency, and heat-pump rollouts, even as the phaseout of carbon-intensive energy sources is delayed to secure supply in the near term. The growing gap, between current emission trajectories and those needed to align to a 1.5 degree Celsius target by 2030, may lead to heightened societal tension as policymakers struggle to balance short-term social and economic priorities with long-term decarbonization ambitions. This may also trigger abrupt policy actions in later years, disrupting industries and business models (notably in the automotive, building, cement, steel, transportation, and utilities sectors).

Mounting cyber attack risks from geopolitical tensions and increasing digitalization

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

The pace of digitalization in the global economy exposes corporates and countries to mounting cyber risks—where targets can include anything from utilities to insurers to government agencies—that weigh on credit quality, result in substantial monetary losses, and undermine confidence in key institutions and infrastructure. In addition to the cyber threat from increasingly sophisticated criminal activity, ongoing geopolitical tensions further raise the prospect of major cyber attacks. Russia's use of cyber attacks, while largely limited to Ukraine since the invasion, could become a new front in response to the West's military support for Ukraine, with potential systemic implications.

Source: S&P Global Ratings.
Risk levels may be classified as moderate, elevated, high, or very high. They are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base case rating assumptions unless the risk level is very high.
Risk trend reflects our current view about whether the risk level could increase or decrease over the next 12 months.

Downside Scenario

A reasonable downside scenario for a broad-based recession across Europe, incorporating key elements of the risks mentioned above

This downside scenario, which we will publish as part of a global report in early October, will include the following assumptions:

- The military conflict in Ukraine drags on, with Russia using all kinds of measures to create political discord and economic pain in the West.
- The energy markets remain tight through 2023 and 2024 as: the EU embargos oil and its price caps on gas take effect, Russia cuts off all supplies of remaining gas to Europe, and Russian oil production is scaled back moderately.
- European gas prices (TTF) average $55/mmBTU in 2023 and then decline to $35/mmBTU in 2024, still 40% above our current baseline assumption.
- In a tight global LNG market, additional LNG sources of supply will not be available until 2025 at least, even though regasification facilities in Europe will be available earlier.
- Global oil prices remain elevated at around $100 a barrel in 2023, declining in 2024 to an average price of $90 a barrel, about 60% above S&P Global Ratings current ratings projection.
- The EU introduces gas rationing through winter 2022-2023 and 2023-2024, primarily targeting industry, to cut overall demand to 15% below the average winter demand over the last five years.
- BOE and ECB are forced to raise rates even faster, moving well above neutral, also to support weakening currencies (particularly through 2023). BOE's bank rate rises to 4.25%, the ECB's to 3.5% - both 1 percentage point above baseline.

This geopolitical shock to Europe is more structural in nature and potentially longer lasting than the Fed-induced U.S. downturn occurring in the US to correct cyclical overheating. The actual depth and breadth of the resulting recession in Europe will depend, in part, on the scale of the fiscal support provided by national governments.
This scenario is not intended as a worst-case stress forecast, but rather one that we consider could realistically materialize over the next two years.

Macroeconomic Outlook

- After a strong first half, and support from the holiday season in the third quarter, we expect eurozone GDP to contract in fourth-quarter 2022 and first-quarter 2023, and stagnate through 2023 mainly led by the consumer. Low unemployment, further fiscal funding, and still accommodative monetary policy (for now) are supportive factors.
- U.K. economic growth has fallen sharply in second-quarter 2022 and turned slightly negative, which we think marks the beginning of a (moderate) four-quarter recession.
- On the back of energy, eurozone inflation is expected to peak around 10% in fourth-quarter 2022 and average 5.2% in 2023.
- Risks to this outlook are predominantly on the downside, and the risk of a full-blown recession by 2023 is significant, currently assessed at a 47% probability in our model.

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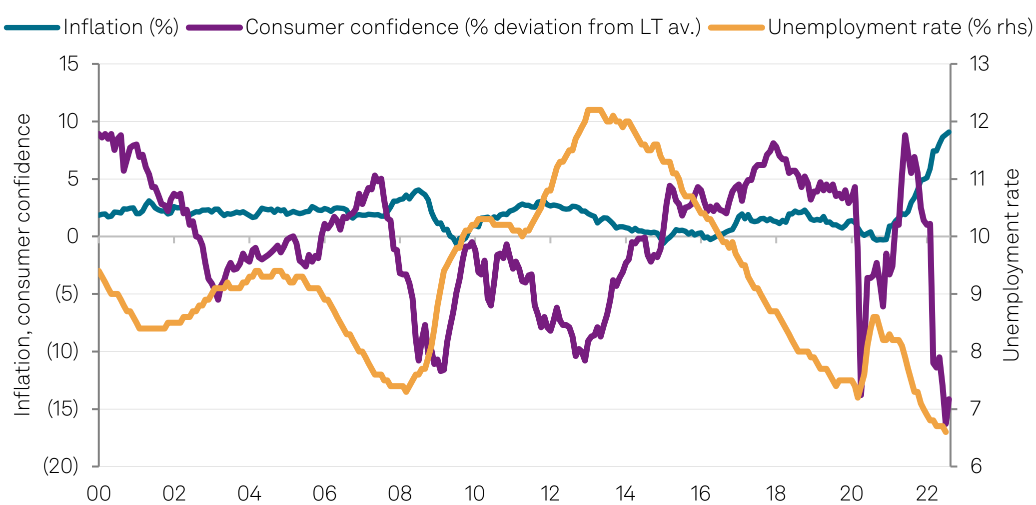
Eurozone

A sharp slowdown of the European economy is imminent. This is because an unprecedented deterioration in the terms of trade has pushed inflation to record highs and confidence to record low (see chart 3). As a result, the five consecutive quarters of solid GDP growth as of second-quarter 2022 will give way to two or three quarters of subdued and even contracting activity. While a booming tourism season has probably led GDP to expand modestly in the third quarter, we expect GDP to contract in fourth-quarter 2022 and first-quarter 2023. Although our growth forecast for this year has been uplifted to 3.1% from 2.6% on solid growth over the first half of the year, the eurozone economy will be close to stagnation next year (+0.3% versus 1.9% in our previous forecasts). This sharp slowdown in growth that the European economy will face in the coming quarters will bring the unemployment rate up to 7% in 2023 from 6.7% this year.

Chart 3

Consumer Confidence Has Collapsed As Inflation Skyrockets Despite Unemployment Falling



Source: S&P Global Ratings.

The slowdown will mostly come from a contraction in consumer spending that we expect to be severe in the final quarter of 2022 and the first quarter of next year. Indeed, recent developments in the gas and electricity markets lead us to expect peak inflation to be about 1.5

percentage points higher and one quarter later than in our previous projections. We now expect eurozone inflation to reach double digits in the fourth quarter of 2022, before slowly declining from the first quarter. On full-year average, inflation could reach 8.2% in 2022 and 5.2% next year. Real wage growth is negative. The household savings rate is declining and now very close to the long-term average. Higher interest rates will further erode financial wealth. Policy measures to shield the consumer from soaring energy prices - in the form of direct transfers or even, possibly, price caps - might take time to reach the consumer. Uncertainty surrounding our forecasts remains unusually high.

What's more, investment is also likely to suffer further from the lack of visibility about developments in the Russia-Ukraine war and as companies see a dampening in consumer spending. In the latest European business confidence survey, firms are starting to report demand constraints as a limiting factor to production, and are lowering their expectations for sales prices.

Risks to this outlook are predominantly on the downside, and the probability is significant of a full-blown recession by 2023 - with a contraction in activity greater than 1 standard deviation from potential growth for at least two consecutive quarters, across countries, sectors, households in all income categories, and the labor market. Our models that take into account different yield curves, money market volatility, and business confidence currently assess such a probability at 47% (see: "A Eurozone Slowdown Is For Sure; A Recession Is Less Certain," published July 19).

If this risk does materialize, and unless the conflict between Russia and Ukraine escalates, the recession is likely to be rather shallow, not exceeding three quarters. The short-term outlook is not just about headwinds. Still accommodative monetary policy, increasing fiscal support in response to the energy crisis, easing supply chain bottlenecks with large remaining backlogs, and a growing population due to refugee inflows are supporting the economy. Besides, we believe that the historical situation on the labor market, with employment at an all-time high, constitutes a strong support.

Monetary policy is going to be slightly restrictive by next year. Given strong economic conditions and inflation well above-target, the ECB has front-loaded interest rate hikes. We now see that the terminal deposit rate could be reached at 2% by the end of first-quarter 2023. However, lifting interest rates is maybe the most benign aspect of the ECB's monetary policy normalization. Questions remain about when the ECB balance sheet might start shrinking, and how fast it might shrink. For now, we expect the balance sheet reduction to start by the end of 2024.

Key assumptions

- The conflict in Ukraine might be protracted but it should not spread to other countries and no unconventional weapons should be used.
- Full exports of Russian gas to the EU will not resume anytime soon.
- Announced policy support will effectively reach the consumer and corporates.
- Supply chains issues continue to ease gradually.

Key risks

- Longer duration and escalation of the conflict in Ukraine, that could test the resilience of the European economy even more.
- Halt of manufacturing production due to gas rationing this winter or due to high energy costs, especially for SMEs, which could result in a massive rise in unemployment.

- Continued market turmoil, caused by the front-loading of monetary policy normalization, that could lead to financial fragmentation among member states.

U.K.

Households have been facing increasingly acute pressure on purchasing power from record-high inflation, currently running at 10%. And inflation is yet to rise further over the winter, making things worse. Consumer spending should contract over the next few quarters and lead the broader U.K. economy into a moderate recession, which we think has already started.

Fiscal support measures deployed by the government, notably the upper limit set on typical household energy bills ("Energy Price Guarantee"), will significantly protect household budgets from an even greater inflation squeeze over the winter. This, along with ongoing resilience of the labor market, are the main reasons we do not expect the U.K. economy to perform worse.

But inflationary pressures are not limited to retail prices for energy. A weaker exchange rate will stoke prices of imported goods even more, and domestic price pressure is also elevated, with core inflation at over 6%. We expect the BOE will respond to this challenge by raising rates by February next year from currently 2.25% to 3.25%, tightening financing conditions and inevitably further cooling quickly the economy in the short term for the benefit of target inflation in the medium term.

Beyond global and regional risks related to the Russia-Ukraine conflict, lasting or deepening volatility in the pound's exchange rate and gilt markets could lead to more adverse financing conditions and worsen the broader economic environment beyond what we currently expect in our forecast.

Financing Conditions

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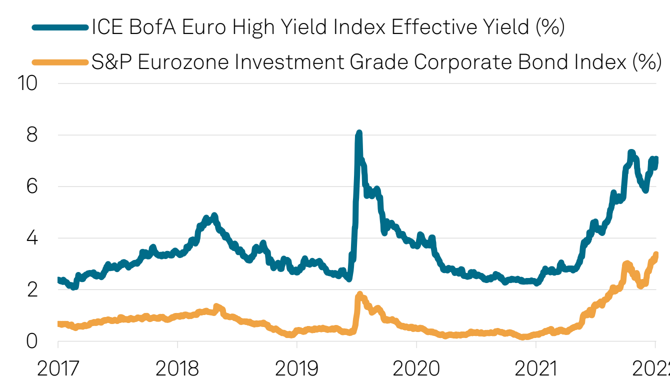
- Financing conditions will continue to tighten amid further rate hikes and a worsening credit outlook.
- Financing costs are rising for all issuers while access for speculative-grade issuers remains problematic with no visible near-term catalyst for primary markets to reopen.
- €750 billion of corporate debt matures in 2023 with telecoms, media and entertainment and consumer products the largest sectors within speculative grade.

Financing conditions will continue to tighten. The probability of further ECB rate hikes, exacerbated by a slowing economy and a deteriorating credit outlook, will likely lead to a further tightening in financing conditions. Benchmark yields (as of Sept. 26) are rising sharply with the 10-year German Bund rising by more than 220 basis points to date in 2022 and the Italian 10-year BTP rising by over 320 bps as markets perceive increasing pressures for the eurozone. Credit risk pricing is also widening again as investors turn more cautious following a short-term rally. Investment-grade spreads are close to year-to-date highs while speculative-grade spreads are above 550 bps but still below year highs. The stronger dollar will add further complications to financing conditions, potentially contributing to increased capital flows and impacting refinancing with 30% of European debt maturing though 2027 dollar denominated. Quantitative tightening, on the part of the ECB, is unlikely to begin in the near term, but any indictors of future timelines would likely lead to tighter conditions and increased volatility.

The question of access to and cost of financing will increasingly bifurcate the market. Higher-quality investment-grade names will continue to access financing but may experience lower investor demand than anticipated. All will face increasingly higher costs with the yield on the S&P Eurozone Investment Grade Corporate Bond Index recently breaching 3% (see chart 4). Speculative- grade issuers will also face higher costs but with the added hurdle that market access is not guaranteed. European corporate debt issuance is down close to 30% with the bulk of issuance relating to investment-grade. As financing conditions continue to tighten and credit conditions weaken, there is no clear catalyst for a meaningful reopening of speculative-grade primary markets. As some speculative-grade issuers trade at discounted prices and as corporate performance in certain sectors comes under increasing pressure, distressed exchanges may become more frequent.

Chart 4

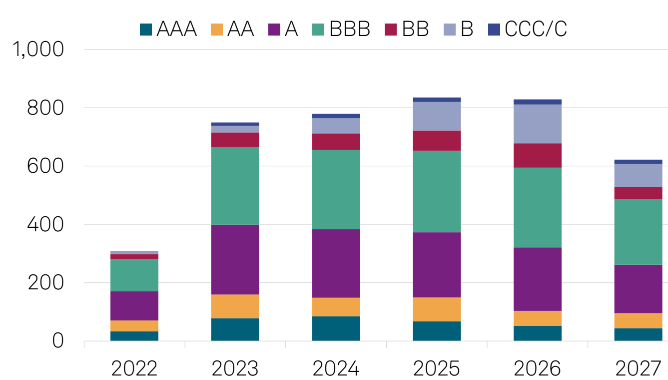
Corporate Yields Expected To Rise Further



Data as of Sept. 16, 2022. Source: FRED and S&P Global CapitalIQ.

Chart 5

European Corporate Maturities By Rating Category, Bil. €



Near term maturities could be lower due to recent refinancing and data reporting lags. Includes bonds, loans, and revolving credit facilities that are denominated in USD and rated by S&P Global Ratings (with a global scale rating) from financial and nonfinancial issuers. Data as of July 1, 2022. Source: S&P Global Ratings Research.

2023 refinancing risk is looming. As rate hikes start to bite and credit conditions likely deteriorate, the ability of issuers to refinance in 2023 and beyond becomes more pressing. Close to €750 billion of debt issued by corporates and financial institutions, rated by S&P Global Ratings, matures in 2023 (see chart 5). While almost 90% of this is investment grade, 35% is rated in the 'BBB' category. Furthermore, this still leaves a not insignificant amount of lower-rated debt that requires refinancing. Most speculative-grade issuers took advantage of cheap liquidity over the last few years to term-out debt, but the likely continuation of subdued primary markets will impact upon new financing and become increasingly problematic for refinancing. Telecommunications, media and entertainment, and consumer products are the three sectors with the highest amount of speculative-grade nonfinancial corporate debt maturing in 2023.

Financial Institutions

- The now darkened economy's outlook will present headwinds for banks' asset quality, business prospects, and operating costs, weakening profitability prospects, particularly in 2023, even if earnings are set to benefit more from the accelerated monetary policy tightening. The impact will be uneven.
- We expect European banks' capital and funding profiles to remain resilient, with tighter financing conditions rather being more of a risk for the weaker nonbank players.
- Our outlook bias remains largely stable, but we cannot disregard some negative outlooks emerging, particularly in those geographies more prone to suffering from potential energy restrictions and higher inflationary pressures.
- Risks are on the downside: The impact on economic growth and inflation could be more severe, widespread, and last longer that what we expect, aggravating the effects on banks.

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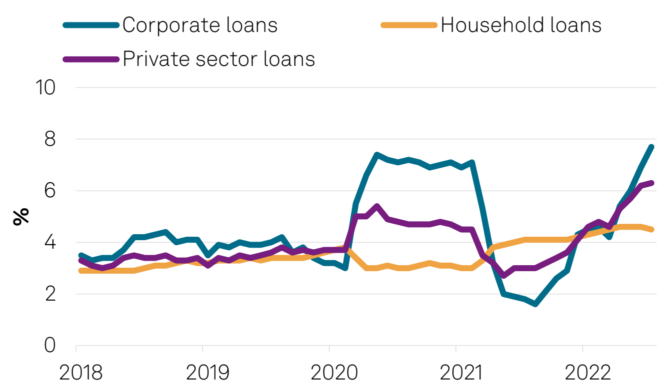
Key Developments

European banks' performance in first-half 2022 was solid, but the more difficult operating environment ahead will cloud future progress. Net interest margins will continue widening in the next quarters and benefiting banks' earnings, as central banks accelerate their monetary tightening. But volume growth will soften, after a fairly dynamic first half (see chart 6), and banks will have to ensure they keep funding costs under control. Fees will likely remain pressured, primarily those from banking services, asset management, or debt and equity underwriting. And we expect cost increases to become more evident. HSBC, for example, recently commented that it sees up to 7% cost growth in 2023 before offsetting management actions. Credit costs, however, will remain the key variable to monitor. While banks' latest public statements point to limited early signs of potential asset quality deterioration and governments plan to articulate targeted fiscal support to the more vulnerable, messaging will likely become more cautious going forward, particularly on credit loss expectations for 2023. Finally, windfall taxes or tax levies (recently implemented in Sweden, Denmark, Hungary, Spain, Poland) will add pressure to bottom-line results and could be followed by others.

SMEs and consumer lending are the portfolios more prone to show deterioration. It may still take some quarters, but in addition to pandemic-related asset quality problems yet to surface, we will likely see new problem loans emerging in industries and companies more directly affected

Chart 6

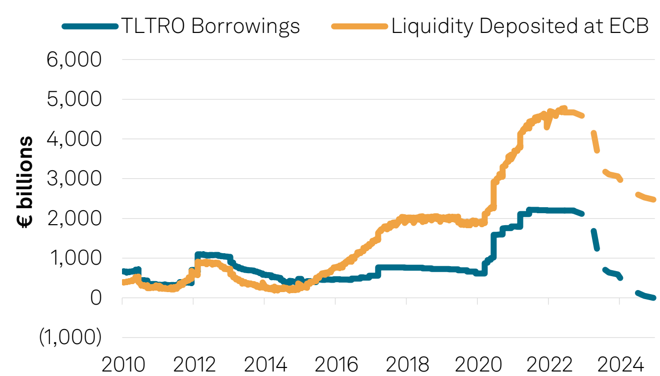
Dynamic Lending Growth During 1H22 Likely To Pause



Source: S&P Global Ratings.

Chart 7

Banks' Liquidity Ample Despite TLTRO Repayment



Source: ECB, S&P Global Ratings. Dotted lines indicate upcoming repayments of ECB refinancing operations.

by higher energy prices, with more limited ability to pass on higher costs to customers, or with more stretched debt and affordability metrics and thus more vulnerable to higher financing costs. The performance of SMEs' portfolios and consumer lending facilities are more at risk. Nevertheless, we expect asset quality deterioration to be affordable for banks under our base case that economic stress will not extend to 2024 and employment will deteriorate only slightly.

Uneven impact by region and sectors. The economic hit will be highest in those economies more reliant on Russian gas and suffering from higher inflation, including Germany, Italy, Central and Eastern Europe, and the U.K. Political uncertainty brought in by changing governments also adds risks to some, U.K., Sweden, or Italy, for example. In mid-July we revised to negative our trend for economic risks faced by the German banking system. Equally, some sectors will be harder hit than others (utilities, metals, autos, transportation, and building materials and construction).

Mortgage performance should prove resilient for as long as employment is maintained. In some countries the prevalence of fixed-rate mortgages (whose maturities vary widely) will also contribute to protect borrowers from significantly higher debt burdens, keeping credit quality under control at least for some time, even if at the cost of lower earnings. Nevertheless, we will continue monitoring trends in the property markets, particularly in those that show signs of overvaluation and experienced more rapid growth in prices and mortgage volumes in recent years amid historically low interest rates (Iceland, Sweden, Czech Republic, Luxembourg, Netherlands, Austria, and Denmark), as weaker confidence and rising rates could lead to price corrections.

Banks face the energy shock with solid capital and liquidity. Banks' capitalization reached peak levels in 2021, even as distributions to shareholders resumed. We expect some decline ahead, but banks' capital position to remain solid overall. Equally, European banks face the repayment of €1.5 trillion of TLTRO borrowings in 2023 (see chart 7), but have accumulated sizable liquidity buffers and tapped the markets earlier in the year, which place them in a comfortable position.

Long-term structural forces will continue pressuring European banks. These cover technological disruption, market fragmentation, climate change and transition risk.

Tighter financial conditions and a gloomier macroeconomic picture could put pressure on weaker nonbank players. Rated European finance companies face limited refinancing needs over the next 12-24 months. Still, if the market remains closed for long, they will have to come up with credible alternative funding plans, at a time when higher funding costs will likely tighten interest coverage and potentially weaker revenues press debt/EBITDA leverage metrics.

Key Risks

- **A full-fledged recession in Europe,** with a more significant impact on asset quality and banks' business and profitability prospects.
- **Inflation remaining persistently high,** putting further pressure on corporates and households' financial conditions, hampering banks' asset quality, and making it unfeasible for banks to contain growth of operating expenses.
- **Heightened market turbulence and restrictive financing conditions.** Facing high funding costs and limited access to financing, riskier borrowers would be more at risk, ultimately triggering higher credit losses for banks and lower profit. Banks would also see higher mark-to-market losses and weaker earnings from activities like asset management.
- **Banks' failure to deliver commercially and operationally resilient business models.** In particular, limited progress in tackling inefficiencies and digitally transforming the business to cope with rapidly changing customers' behaviors and higher competition from fintechs.
- **Widespread, high impact cyber attack events.**

Nonfinancial Corporates

- The indefinite shutdown of Nord Stream 1 gas pipeline in early September has intensified cost pressures on European companies. Utilities are clearly the most directly exposed, but also other sectors are going to be hit by the hike in energy costs and potentially by gas shortages next year.
- Another major risk is the potential contraction in demand as inflation eats into disposable incomes. Thanks to high level of employment, this has not yet been a major issue. Yet, there are differences among countries as inflation growth and the negative impact on energy bills vary. We believe this risk could intensify without measures that lessen the impact of higher energy costs.
- In EMEA, the trend in rating actions has changed from the net positive drift in the first half of the year. Since July, the number of downgrades has matched the upgrades. The negative outlook bias has increased, indicating that in the next months downgrades are likely to outpace upgrades.
- Financing conditions have tightened significantly, reflecting the increase in reference rates and in spreads. The low refinancing needs in 2022 are limiting the negative impact of this factor, but it is expected to become increasingly relevant in 2023 especially for high-yield issuers.
- Defaults are slowly reappearing, two companies defaulted in Europe in the first days of September, and six since the beginning of the year, excluding the Russian and Ukrainian defaults due to the conflict.

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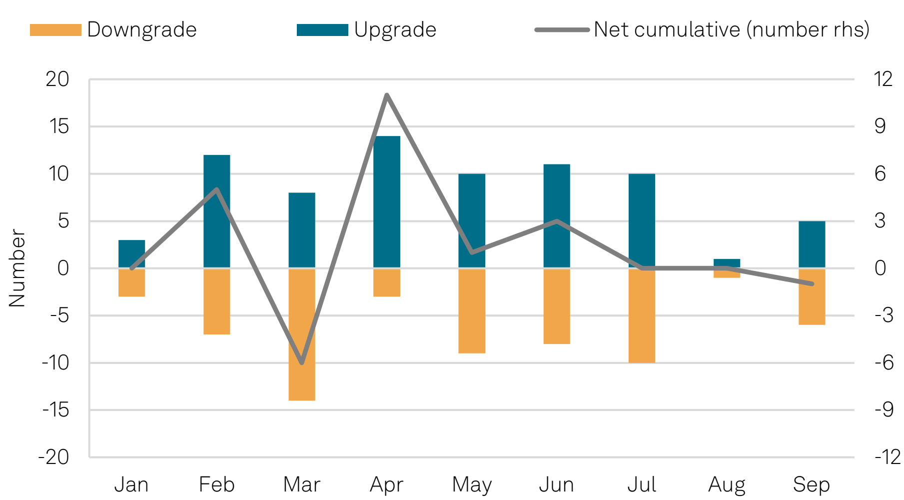
Key Developments

The positive trend in rating actions that characterized the first half of 2022, excluding rating actions on Russian and Ukrainian entities, ended in July (see chart 8). In the first part of 2022, rating actions largely reflected the structural improvement in credit metrics achieved by some companies in 2021, thanks to a strong rebound in demand as the pandemic became less lethal. In July and August, the positive actions have been counterbalanced by the negative ones due to the increasing impact of higher energy costs and rising inflation on utilities, high energy-intensive sectors and companies having lower ratings is different sectors.

Chart 8

Upgrades Outpaced Downgrades In The First Five Months 2022



Source: S&P Global Ratings. Data as of Sept. 19, 2022.

The utility sector is the most exposed to the tensions derived by the gas shortage in Europe. The recent negative rating actions and the increasing negative outlook bias flag various risks. Some suppliers and generators, notably in Central Europe, suffer from rising costs to procure sufficient volumes of gas and the effects of the volatility in gas prices on hedged positions where margin calls weigh on liquidity. On the other side, the recent German government bailout of Uniper confirms that utilities are strategic for economies at large. The measures proposed by the EU commission to address the gas shortage in our view may address a number of open questions, including enhancing security of energy supply by moderating demand, and supports to liquidity on power futures markets. The adoption of common actions should reduce the overall systemic risks related to gas in Europe and help stabilize the credit risk of utilities.

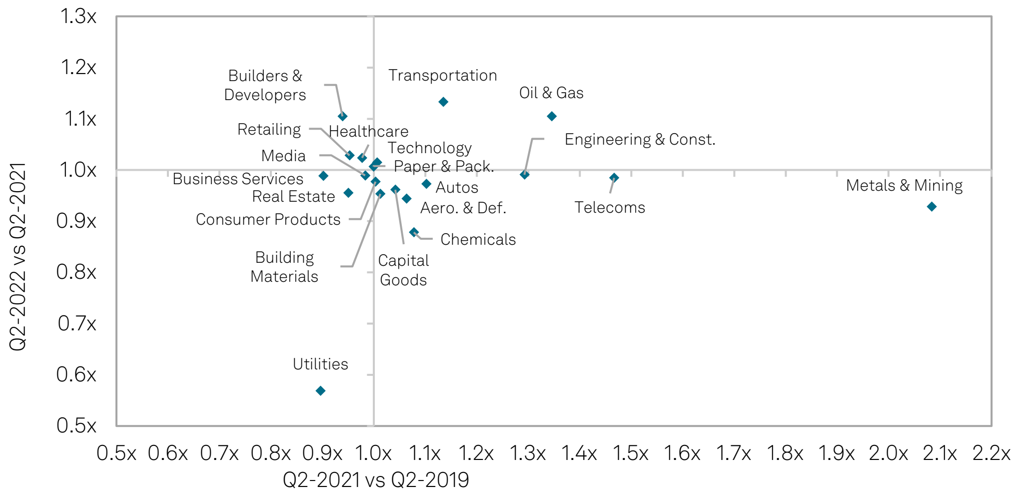
Energy-intensive sectors are also exposed to the negative impact of gas shortage. The sharp increase in energy costs is already forcing a reconsideration of production processes and potential switches to alternative sources. Energy costs that are many times higher drive up prices and open space to alternative products. This can reduce sales volumes that, with higher costs, are weighing on companies' financial and credit ratios. In many sectors, the cushion in financial ratios created by 2021 strong performances is helping to manage these difficulties. And, we expect 2022 results to be still largely in line with the targets for the current ratings. However, we have assigned negative outlooks to a few companies significantly exposed to risk of cut in gas supplies. The largest group was in the chemical sector due to operational risk because gas is not only used to generate electricity and steam but also as raw material in some production processes. Negative rating actions have also been taken on companies with ratings on the lower end of the scale that have limited headroom to cope with this extraordinary situation. We believe the pressure is not going to ease soon and that without government support more negative actions can take place in the next months.

Consumer-driven sectors are exposed to the reduction in real disposable incomes. As expected, consumer demand remained robust until the end of summer, especially in sectors most severely hit by COVID-19 (so coming from very depressed 2020-2021 levels) like leisure, media, and transportation. We do not assume that this momentum will last because consumers will increasingly rationalize their spending. That said, we don't see any clear decline in demand for goods and services so far on the back of high employment levels across most European countries. In the consumer staples segment, for example, demand for cheaper products is gaining pace and the impact of inflation will become more evident as recessionary and inflationary pressure evolves. In our view, consumers are forced to make difficult spending choices and tradeoffs, and this is why the impact on end-sectors will vary. In the airline sector, for example, the demand for travel remains healthy, spurred by unprecedented pent-up demand accumulated during the pandemic, and we note that the airlines were able to push through high (above the pre-pandemic base) ticket prices during the second and third quarter, offsetting the elevated jet fuel costs on the unhedged portion of their fuel exposure. We note that the air travel is skewed toward the wealthier populations, less affected by inflation, which will likely to continue traveling by air.

Companies' margins are at an inflection point according to first-half reported results (see chart 9). Companies' margins have declined significantly since record levels reported in 2021. This reversal is particularly salient for the chemical and metals & mining industries, where demand started to erode in response to rising prices. Autos, capital goods, building materials and telecommunication services sectors are also showing signs of stalling margins after benefitting to a different extent from supply-demand imbalances stemming from the recovery after pandemic lockdowns. While the momentum continues to be positive for companies operating in the oil & gas and transportation industries, the sharp decline in oil and freight prices point to a normalization and indicate that margins could reverse course in the near future. The most impacted sector is without surprise utilities, which are in the crossfire between rising input costs and political pressures limiting their ability to raise prices.

Chart 9

Corporate Sector Margins Coming Under Pressure In 2022 After Record Levels In 2021



Source: S&P Global Ratings.

Defaults are expected to increase. We expect defaults to increase in line with the 3% default rates expected for the 12 months ending in June 2023. Risk aversion has grown, companies have less opportunities to enlarge maturities and negotiate new financing lines. (Note that according to our methodology distressed exchanges are selective defaults.) Bankruptcies are also likely to increase for cases where renegotiations with existing creditors are unsuccessful.

Key Risks

- **Further pressures on gas.** If any gas source that has been secured becomes unavailable or the expected reduction in consumption does not take place because of a very rigid winter, gas rationing becomes a likely scenario in 2023.
- **The lack of any form of government support to help households and companies to cope with increasing energy costs**. This could squeeze household consumer spending and small enterprises that cannot afford sudden increases in costs. For large companies with heavy reliance on gas, this scenario could trigger some pressure on profitability and liquidity.
- **Escalation of the conflict.** This can impact consumer confidence and stress supply chains, potentially affecting relationships with other countries that are strategic for European supply and exports.

Sovereigns

- Our baseline macroeconomic view for Europe is stagflation, an outcome less unacceptable to issuers than to creditors, which however limits the degrees of freedom governments have to finance yet another fiscal intervention.
- The object lesson for European governments of pushing an unfunded budgetary boost too far without coordination between fiscal and monetary authorities is clearly the U.K., where income tax cuts and loosely targeted household energy subsidies have piled pressure on sterling and gilts.
- With this example in mind, the new government will likely tread carefully, largely stick with the former government's 2023 fiscal plan.
- As the Eurogroup (next meeting Oct. 3) continues to discuss amendments to the eurozone's Stability and Growth Pact's fiscal rules, we continue to expect them to be reimposed in some form in 2024. Fiscal flexibility is very close to being used up entirely.

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Key Developments

2023 is certain to be a difficult year for European developed sovereigns, with eurozone inflation at over 9% and demand fading rather rapidly from its summer peaks, as a brutal war between Russia and Ukraine continues to dampen confidence across the Continent. Large and expensive COVID-19-related fiscal stimulus has, to be fair, largely fallen off of government spending, and inflation has been benefiting tax collection (up some 20% year on year on a seasonally adjusted basis in Spain during the first seven months of 2022). As household budgets tighten, however, fiscal performance is also likely to weaken, even as global central banks, including the ECB and BOE, signal further tightening to come. Most importantly, few investors expect anything other than a gradual winding down of central bank asset purchase programs over the next several years. All of the above implies rising constraints on government's fiscal limits.

The object lesson in this regard has been the U.K., where the new government announced tax cuts and generous energy subsidies to firms and households at a minimum estimated cost of 9% of GDP through 2026. The BOE's response to this unfunded fiscal boost was a reiteration of its intention to tighten further to bring down inflation of close to 10%. The market's response was a selloff of gilts and sterling.

Nor in our view is it an accident that as the gilt market continued to see yields back up and Italian election results were released, that ECB President Christine Lagarde emphasized that the newly launched Transmission Protection Instrument would not be tapped to support the bonds of governments that make policy mistakes. In short, Lagarde appears to be stressing that fiscal policy must also play its part in curbing demand-side inflationary pressures, rather than to push in the opposite direction.

The key takeaway is that things are about to get much more difficult for European developed governments, even as they continue to benefit from negative borrowing rates. We think the official line on budgetary deviation will become increasingly tough into 2023, and especially commencing in 2024, when we expect the Stability and Growth Pact's fiscal rules to be reinstated, perhaps in a somewhat simplified form. Until then, member states will be watching closely the timeliness and thoroughness with which peripheral sovereigns carry out their own recovery and resilience plans, upon which disbursements of €750 billion in EU grants and loans depend.

Structured Finance

- The rising cost of living could affect the ability of consumers backing European structured finance transactions to maintain their debt repayments.
- In the U.K., for example, the expected 12-month rise in energy costs for a typical property would be equivalent to a 5 percentage point mortgage rate rise for the median borrower on a repayment loan in the stand-alone U.K. RMBS that we rate.
- More than 20% of the collateral backing CLOs that we rate will mature by the end of 2025, with refinancing set to be more challenging and costly than in recent years.
- We lowered only 1.5% of our European structured finance ratings over the past 12 months, while we raised 8.1%.

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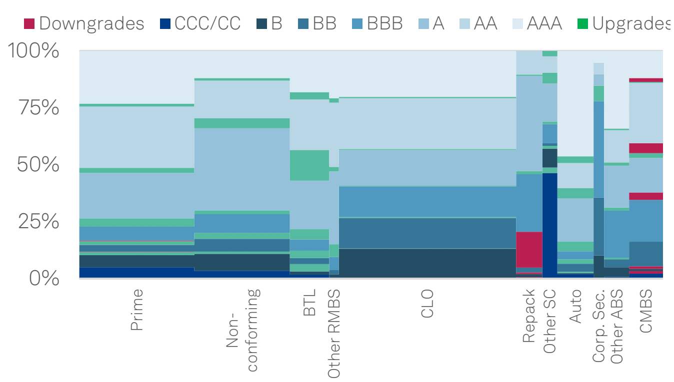
Key Developments

Across European structured finance, most recent rating actions have been upgrades, and we lowered only 1.5% of our ratings in the sector in the 12 months to end-August 2022 (see chart 10). Weakness has mostly been confined to the repack sector, where several downgrades in January 2022 were correlated and due to a rating action on a single underlying entity. There have so far been very few negative rating actions in the major consumer-backed sectors, such as residential mortgage-backed securities (RMBS), although the cost-of-living squeeze and rising interest rates will likely put some borrowers under pressure. European leveraged loan collateralized loan obligations (CLOs) have also seen few rating actions in the past year.

Chart 10

Most Recent Rating Actions Have Been Upgrades

European structured finance ratings heatmap

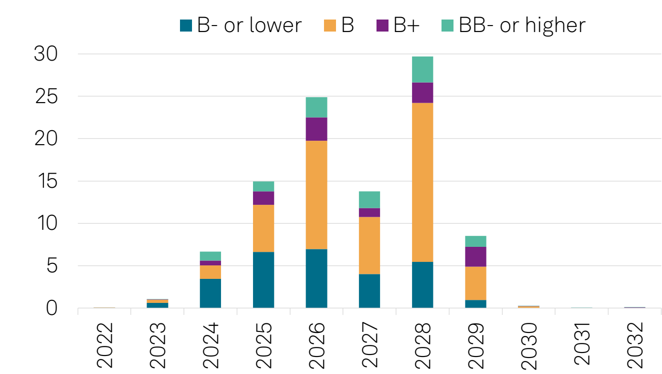


BTL—Buy-to-let. SC—Structured credit. Based on cumulative count of rating actions between Sept. 1, 2021, and Aug. 31, 2022. Source: S&P Global Ratings.

Chart 11

A Loan Maturity Wall Is Approaching For CLOs

European CLO loan maturity distribution (%)



Source: S&P Global Ratings.

Key Risks

The current cost-of-living shock will likely compromise the ability of some consumers backing European structured finance transactions to stay current on their debt repayments. However, there has not yet been any notable performance deterioration in underlying collateral pools, with aggregate arrears across RMBS and consumer ABS transactions still stable for now.

Over the past 20 years, structured finance ratings have shown limited correlation with inflation and interest rate rises. These effects have typically led to a modest or temporary rise in household expenditure, which most borrowers have been able to accommodate. This time could be different, however, given that the scale of inflationary pressures appears significantly larger than at any time in recent history.

We consider the U.K. as an example. Despite large-scale proposed government support for households, the 12-month rise in annual energy costs alone for a typical property will likely amount to about £1,300. For a typical owner-occupier with a repayment mortgage loan backing stand-alone U.K. RMBS that we rate, such a rise in expenditure would be equivalent to a 5 percentage point rise in their mortgage rate. This is on top of actual mortgage rate rises of 1 to 2 percentage points over the past year, which have already increased monthly payments for most borrowers and look set to continue. While about 40% of the loans in our sample are currently paying a fixed interest rate, these borrowers will also be exposed to a payment shock when their loans revert to a floating rate over the next few years.

For most transactions backed by corporate credit risk, there has similarly been little evidence of collateral deterioration so far. For example, the proportion of obligors backing leveraged loan CLOs that are rated in the ‘CCC’ category is a key metric of collateral credit quality, but has been stable or improving since the early months of the COVID-19 pandemic. During the pandemic, a peak annualized default rate of 6% among European speculative-grade corporates that we rate did not translate into material downgrades for CLO tranches. We currently project the corporate default rate to rise to only 3% by mid-2023.

CLO managers tend to pick initial loan portfolios that differ from the wider rated corporate universe in terms of sector composition. European CLO portfolios are generally underweight sectors that may be more affected by the cost-of-living crunch, such as consumer products and media/entertainment. They are overweight more protected sectors, such as health care and technology. Managers may also be able to make portfolio adjustments when any credit deterioration unfolds. During the period of pandemic-related stress, CLO managers generally suffered some par losses from trading out of distressed credits but were also able to capitalize on depressed prices when making new asset purchases.

That said, in the longer term, there are clearly risks associated with the new, tighter funding environment that are likely to persist. This may limit refinancing opportunities for borrowers of leveraged loans backing European CLOs as they approach their scheduled maturities. Of the collateral backing European CLOs that we rate, more than 20% of the par balance will mature by the end of 2025. A significant proportion of these maturities correspond to corporate borrowers currently rated ‘B-’ or below (see chart 11), which may find refinancing more challenging. If lenders’ risk appetite remains low, corporate borrowers face the prospect of either refinancing onto much higher rates or otherwise defaulting on their debt payments. CLO managers may of course sell such assets to mitigate their exposure, but risk incurring par losses as a result.

International Public Finance

- Public-sector enterprises are suffering from elevated inflation given that their revenues are regulated and governments plan to limit their fee increases in 2023 and potentially 2024. Any price caps would further squeeze profitability and increase the debt burdens of social housing providers, public transport, universities, and not-for-profit enterprises.
- High inflation is benefitting budgeted revenues for European local and regional governments (LRG) in the short term. In most cases, their revenue includes shares of personal, corporate income, sales, value added, and excise taxes, which generally increase in times of rising inflation. However, the ensuing economic slowdown and the need to adjust spending, including wages, repair, and support to public enterprises will eventually weigh on their budgetary performance, especially beyond 2023.

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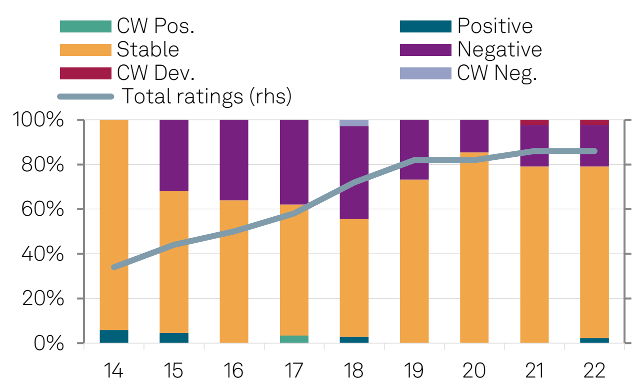
Key Developments

U.K. social housing providers (SHP) are still the primary asset class in European public finance that are experiencing downward ratings pressure (see chart 13). The rising inflation squeezes their financial performance amid the pressing need to increase investments in existing stock and deliver new units due to consistently high demand. The maximum rent increase for this financial year (4.1%) falls well short of the increase in consumer prices. Moreover, the U.K. government's launched consultation to apply a cap on social and affordable housing rent increases for existing tenants for the coming financial year (ending March 31, 2024), which adds uncertainty to the creditworthiness of the English social housing sector. The options of 3%, 5%, and 7% are being considered, all of which are well below the projected potential 10%-12% increase based on a CPI+1% formula. Also, it remains unclear how the SHPs would be able to compensate for a loss of revenues once the cap is lifted. Our analysis indicates that 12 out of 43 rated SHPs in the U.K. could see very weak interest coverage if they are unable to cover cost increases by boosting revenues or scaling down certain costs. This would put the ratings on these SHPs under pressure.

Chart 12

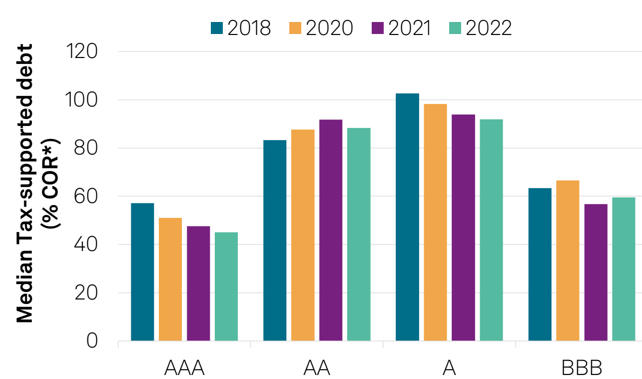
U.K. Social Housing Retains Negative Outlook Bias



Source: S&P Global Ratings.

Chart 13

EMEA LRG Debt Burden Stable Across IG Categories



*COR--Consolidated operating revenues. Source: S&P Global Ratings.

European LRGs are facing the period of high energy prices and economic slowdown from a position of financial strength (see chart 13. High inflation in most cases lifts their revenues, while spending can be adjusted with delay. However, the rising cost of materials can delay or alter capital development and large repair programs. Eventually, LRGs will also raise public servant wages and provide additional support to public transport providers and utilities. Assuming the economies start recovering and inflation slows down from 2024, we don't project any material increase in LRG debt burden in the medium term.

Insurance

- First-half results from European insurers displayed mark-to-market investment revaluations impacting reported shareholders' equity. Our view of rated insurers' capitalization, excluding unrealized gains and losses on life bonds, has not yet been materially impacted. Insurers' benefit from robust capital surplus is in excess of levels required for the current ratings.
- Operating earnings are solid and unaffected from economic turmoil. We do not expect inflation in 2022 and 2023, and recessionary risks, to fundamentally question European Insurers' business position. In many European markets, non-life premium rate increases match current inflation. Life insurers' investment margin and regulatory solvency ratio benefit from higher long-term interest rates.

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Key Developments

While rising reinvestment rates benefit European life, and non-life insurers, their illiquid assets might face some devaluation. During the lower-for-longer yield environment, European insurers in search of yield added private equity and private debt to their investment portfolios, even encouraged by favorable regulatory treatment in Solvency II. Although plain vanilla, high-quality bond investments now deliver more attractive yields, those illiquid investments might bear greater risks given high inflation, recessionary risks, and tightening monetary policy.

Economic downturn to have a limited impact on European insurers' top and bottom lines. Although a recessionary environment might dampen growth prospects in non-life insurance, many industries continue to require insurance, and insurance is mandatory for large parts of retail lines. Muted economic activity could even lead to a lower insurance claims frequency. The life insurance top line may see an impact as well, but we do not foresee contract cancellation ratios rising to a concerning level.

Premium rate increases in the reinsurance sector appear to match current and expected inflation, but maybe not enough to strengthen profitability. We remain cautious about our expectations that reinsurers' returns meet their cost of capital and maintain our negative subsector view.

Key Risks

- Impairments on illiquid investments might impact European insurers' capitalization level.
- Although not our base case, a deep recession, and higher for longer inflation, might weaken European insurers' business performance.

Chart 14

Rating Distribution

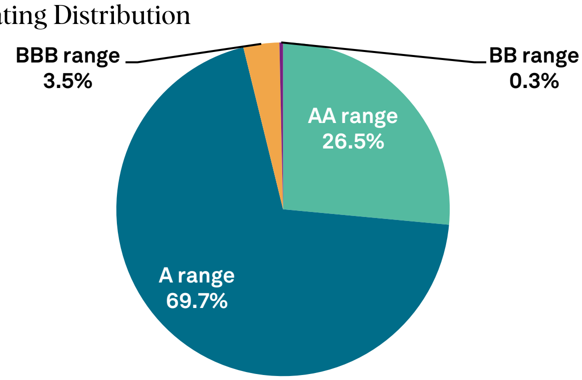
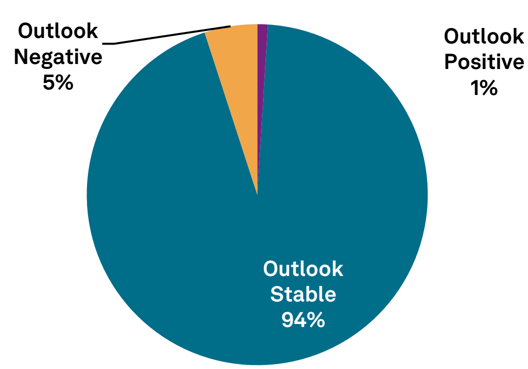


Chart 15

Outlook Distribution



Source: S&P Global Ratings, as of Sept. 20, 2022.

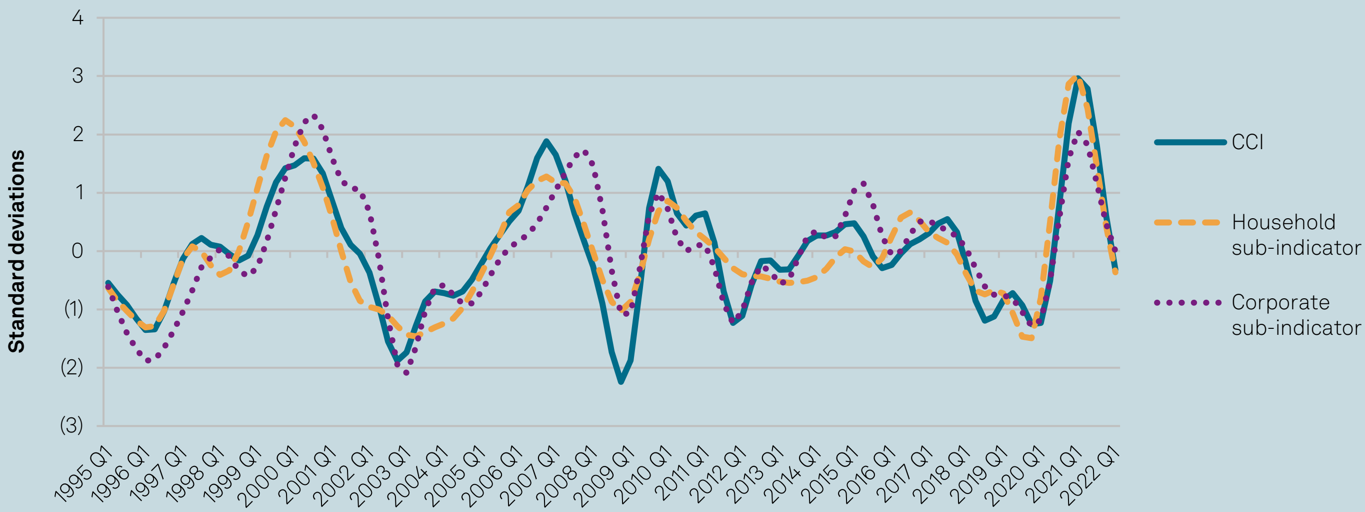
Credit Cycle Indicator

Credit Cycle Signs Point To Heightened Credit Stress In Late 2022 Or Early 2023

Over four quarters since first-quarter 2020, the Eurozone Credit Cycle Indicator (CCI) trended upward and reached a peak of 3.0 standard deviations in first-quarter 2021. This suggests potential heightened credit stress in late 2022 or early 2023 (see chart 16. While the CCI is trending downward--indicating a credit correction is underway--the potential impact of the buildup of nonperforming loans (NPLs) and defaults could linger beyond the stress period across late 2022 and early 2023. For more details about our proprietary CCI, see "White Paper: Introducing Our Credit Cycle Indicator," published on June 27, 2022.

Chart 16

CCI For The Eurozone Reached A New High Early In Q1 2021, Suggesting A Risk Of Heightened Credit Stress Ahead



Note: We view the CCI as a leading indicator for potential credit stress outcomes. The CCI period ends in 2022 Q1. Household and corporate sub-indicators were created by taking the weights in the overall CCI and rescaling such that the sub-components' weights in the sub-indicator sum to 1. Source: Bank for International Settlements, Bloomberg, S&P Global Ratings.

Corporates. Since peaking in the first quarter of 2021, the eurozone corporate subindicator has descended rapidly from a height of 2.0 standard deviations (first-quarter 2021) to zero in early 2022. The economic rebound from the pandemic has spurred growth across the eurozone, helping push down corporate credit relative to GDP from 115.2 (first-quarter 2021) to 110.0% (first-quarter 2022). Yet, even with this moderation, outstanding debt in the corporate sector remains at historic highs and though the declining CCI reading signals moderating stress, deteriorating financing conditions and an economic recession would put added pressure on corporates. Given the widespread restructuring of maturities over the last couple of years, we still see limited short-term refinancing risk. That is not to say, weaker borrowers, particularly highly indebted SMEs struggling to generate free operating cash flow, are not vulnerable from a credit quality perspective.

Households. The household subindicator follows a similar trend, a sharp peak followed by a large decline across 2021 and into early 2022. Over that period, total credit to households as a percentage of GDP has decreased from 62.5 (first-quarter 2021) to 59.4% (first-quarter 2022). Yet, this moderation is in the context of a looming cost-of-living crisis across the eurozone; furthermore, an expected recession in some European economies means falling GDP would push up household debt to GDP. The key unknown for European households is what portion of the hike in energy costs they will have to shoulder given government interventions. Accumulated financial savings from the pandemic should also help control the hit on household budgets, but an economic downturn will put many more households at risk, especially the more vulnerable cohorts. With unit level energy costs rising at an exorbitant rate, the extent to which households resort to consumer credit markets will likely hinge on the generosity of government support.

Related Research

- Credit Conditions Asia-Pacific Q4 2022, Brakes On Growth, Pain Down The Road, Sept. 27, 2022
- New Italian Government Faces Difficult Choices Amid European Recession And High Debt, Sept. 26, 2022
- Economic Outlook Eurozone Q4 2022: Crunch Time, Sept. 26, 2022
- Economic Outlook U.S. Q4 2022: Teeter Totter, Sept. 26, 2022
- Economic Outlook Emerging Markets Q4 2022: Further Growth Slowdown Amid Gloomy Global Prospects, Sept. 26, 2022
- Economic Outlook Asia-Pacific Q4 2022: Dealing With Higher Rates, Sept. 26, 2022
- Russia-Ukraine Military Conflict: Key Takeaways From Our Articles, Sept. 15, 2022
- Risky Credits: European Downgrades To 'CCC' Increase As Refinancing And Inflation Risks Bite, Aug. 22, 2022
- The European Speculative-Grade Corporate Default Rate Could Rise To 3% By June 2023, Aug. 22, 2022
- White Paper: Introducing Our Credit Cycle Indicator, June 27, 2022

This report does not constitute a rating action.

The views expressed in the Macroeconomic Outlook section (pages 7-9) are the independent opinions of S&P Global Ratings' economics group, which is separate from but provides forecasts and other input to S&P Global Ratings' analysts. S&P Global Ratings' analysts use these views in determining and assigning credit ratings in ratings committees, which exercise analytical judgment in accordance with S&P Global Ratings' publicly available methodologies.

Appendix 1: Q4 2022 Economic Data and Forecast Summaries

Table 2

Real GDP (%)

	Eurozone.	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Switz.	U.K.
2020	-6.5	-4.1	-7.9	-9.1	-10.8	-3.9	-5.7	-2.5	-9.3
2021	5.0	2.6	6.8	6.6	5.1	4.9	6.2	3.7	7.4
2022f	3.1	1.5	2.4	3.4	4.5	4.3	2.4	2.4	3.3
2023f	0.3	-0.3	0.2	-0.1	1.1	0.2	0.4	1.1	-0.4
2024f	1.8	1.2	1.8	1.5	2.1	2.1	1.7	1.6	1.4
2025f	1.7	1.3	1.5	1.1	2.6	1.8	1.9	1.4	1.6

Table 3

CPI Inflation (%)

	Eurozone.	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Switz.	U.K.
2020	0.3	0.4	0.5	-0.1	-0.3	1.1	0.4	-0.7	0.9
2021	2.6	3.2	2.1	1.9	3.0	2.8	3.2	0.6	2.6
2022f	8.2	8.4	6.1	7.8	10.1	11.1	10.2	3.1	9.5
2023f	5.2	7.0	3.3	4.3	5.6	5.4	4.9	2.6	6.3
2024f	2.2	2.2	1.9	1.9	1.3	1.1	2.0	1.5	1.4
2025f	1.7	1.6	1.9	1.8	1.5	1.2	1.9	1.0	1.8

Table 4

Unemployment Rate (%)

	Eurozone.	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Switz.	U.K.
2020	8.0	3.7	8.0	9.3	15.5	4.9	5.8	4.8	4.6
2021	7.7	3.6	7.9	9.5	14.8	4.2	6.3	5.1	4.5
2022f	6.7	3.1	7.5	8.3	12.8	3.4	5.7	4.3	3.7
2023f	7.0	3.5	7.7	8.6	12.9	4.0	6.1	4.1	4.5
2024f	6.9	3.6	7.6	8.4	13.1	4.1	6.0	3.9	4.2
2025f	6.8	3.5	7.5	8.3	13.0	3.8	5.9	4.0	3.8

Table 5

10y Government Bond Yields (% annual average)

	Eurozone.	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Switz.	U.K.
2020	0.2	-0.5	-0.2	1.2	0.4	-0.3	-0.1	-0.5	0.3
2021	0.1	-0.3	-0.1	0.8	0.4	-0.2	0.0	-0.3	0.7
2022f	1.5	1.0	1.4	3.0	2.1	1.3	1.6	0.8	2.2
2023f	2.3	2.0	2.5	4.1	3.1	2.3	2.6	1.4	3.4
2024f	2.5	2.2	2.8	4.3	3.4	2.5	2.8	1.6	3.4
2025f	2.8	2.5	3.2	4.7	3.7	2.9	3.2	1.9	3.5

f--S&P Global Ratings forecast, annual averages. Source: S&P Global Market Intelligence.

Table 6

Exchange Rates (annual average)

	---- Eurozone ----		---- U.K.----		---- Switzerland ----	
	US$/€	€/US$	US$/£	€/£	SFr/US$	SFr/€
2020	1.14	0.88	1.28	1.12	0.94	1.07
2021	1.18	0.85	1.38	1.16	0.91	1.07
2022f	1.05	0.96	1.22	1.17	0.95	1.00
2023f	1.00	1.00	1.19	1.19	0.94	0.94
2024f	1.07	0.93	1.32	1.23	0.94	1.01
2025f	1.11	0.90	1.36	1.22	0.94	1.04

Source: S&P Global Market Intelligence; f--S&P Global Ratings forecast, annual averages.

Table 7

Policy Interest Rates (% end-of-year)

	----Eurozone (ECB)----		U.K. (BoE)	Switzerland (SNB)
Policy Rates	Refi Rate	Deposit Rate	Bank Rate	Policy Rate
2020	0.00	-0.50	0.10	-0.75
2021	0.00	-0.50	0.25	-0.75
2022f	2.00	1.50	2.75	1.25
2023f	2.50	2.00	2.75	1.50
2024f	2.00	1.50	2.50	1.50
2025f	2.00	1.50	2.50	1.50

Source: S&P Global Market Intelligence; f--S&P Global Ratings forecast.