S&P Global
Ratings

Credit Conditions Europe Q2 2023

Costs Rising To Cure Inflation

March 28, 2023

This report does not constitute a rating action

Key Takeaways

- **Overall**: Persistent and excessively high inflation requiring interest rates to remain in restrictive territory (potentially for about two years) even as the European economy stagnates, points to a marked change in financing conditions. This has been exacerbated by the erosion of confidence in the banking sector following, most recently, the forced takeover of Credit Suisse.
- **Risks**: Tighter financing conditions could uncover pockets of financial vulnerability, rendering refinancing difficult. The economy could lapse into recession if consumer confidence materially falters and unemployment accelerates. Potentially severe tail risks relating to the Russia-Ukraine conflict.
- **Ratings**: Rated European banks don't have the same funding and business profiles as the failed U.S. regional banks, and rising rates remain a significant tailwind to banks' profitability. Yet, heightened macro uncertainty and higher operating and credit costs are likely to dampen any positive rating momentum in the sector.

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 March, 22, 2023.

The string of regional bank failures in the U.S. and the demise of Credit Suisse in Europe in recent weeks is a clear signal that the music is slowing. Liquidity is contracting as nominal (and real) interest rates move higher and quantitative tightening shrinks bank's excess reserves. S&P Global Ratings' baseline view is that regulated European banks are well capitalized and well provisioned with liquidity. Furthermore, the European and U.S. authorities have supervisory tools to protect financial stability and to prevent contagion spreading through the regulated banking system. Consequently, we expect monetary authorities will continue down the path of policy tightening to bring (particularly core) inflation back towards target.

The resulting outlook for European credit prospects is fundamentally different from the systemic shocks of COVID-19 and the energy emergency. Firstly, the macro policy priority remains to steer inflation back to target, primarily by taking rates into restrictive territory. Secondly, there is no compelling case for European governments to provide additional fiscal support to protect the economy given the resilience exhibited in the region in recent quarters, especially with regards to employment.

Risks loom large. Confidence in the banking system will remain fragile. But away from the banking system, we can expect further financial vulnerabilities in Europe to surface sporadically and in unexpected areas. This could be similar to events such as the U.K's liability-driven

Regional Credit Conditions Chair

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

Contents

Investment (LDI) pension debacle, or the collapse of New York-based Archegos Capital Management. In our view, this is a natural, but painful, adjustment process stemming from the end of a decade of cheap and available debt financing. We think these vulnerabilities are most likely to appear outside of the European banking system as financing conditions tighten, lenders' risk tolerance is scaled back, and funding liquidity becomes more constrained. This could affect business models due to increased uncertainty around growth required to generate cash to service debt. It could also affect non-bank financial institutions, such as shadow banks, that are operating with high leverage, have structural liquidity mismatches, or significant asset-quality risk.

European banks have ample liquidity and, generally, diversified and strong deposit franchises. That is underpinned by large household savings deposits, which equate to about 30% of all bank liabilities. Only a few banks are reliant on corporate deposits, which cover a maximum of 30%-35% of total liabilities. This Is different to the corporate client base that fueled the rapid expansion of Silicon Valley Bank's (SVB) largely-uninsured deposit base. At the same time, given growing sensitivity to the deposit base, many (especially smaller) European banks are likely to start increasing deposit rates to more closely track official rates, raising their funding costs overall.

Most unrealized losses on banks' securities portfolios have been recognized. This has been done either through banks' profit and loss statements (P&L) or their capital accounts. However, about 5% of bank's assets on average are carried at amortized cost with losses not accounted for. In our view that looks manageable, and would only need to be realized where a bank had exhausted all other funding alternatives.

Looking more broadly, we are watching a handful of sectors and related indicators for signs of potential credit vulnerabilities:

- **Bank lending:** We expect that banks will continue to tighten their underwriting standards for both households and companies. That, coupled with weaker loan demand, should result in a deceleration in bank loan growth this year, from 4%-5% last year. Downside risks have increased materially and a negative event could curtail lending activity, with knock-on effects throughout the broader economy.
- **Property:** Pressured by rising interest rates, a price correction is underway in most European property markets, which we think will lead to falls of 5% to 15% from the highs of June 2022. In commercial real estate, offices (particularly non-prime), logistics, and lower yielding assets appear more exposed as yields adjust. For residential, we generally anticipate more pressure in countries with a high share of variable rate mortgages and where the interest rate rise is largest, such as Sweden. European banks continue to have moderate exposure to real estate in their loan books, although it is higher than average in Sweden and Germany (equating to about one-third of the corporate loan book in Germany, for instance). While we understand banks are likely to continue supporting the property sector, notably with existing clients, they could become more selective. In the current environment of difficult bond markets, commercial real estate investors are also seeking to deleverage by raising liquidity by other means such as cutting capital expenditure, dividends, raising equity, and disposing of assets where possible. In the residential sector strong levels of employment and accumulated wealth provide support for the moment, although transaction volumes have fallen significantly.

  This is mirrored in the structured finance market, where we see greater weakness in commercial real estate, for instance, in the U.K., where there have been some downgrades of commercial mortgage-backed securities (CMBS) transactions backing U.K. shopping malls. On the residential side, we have not yet seen delinquencies increase significantly for mortgage pools supporting residential mortgage-backed securities (RMBS) transactions despite rising cost of living pressures and higher rates starting to feed through.

- **Corporates:** Near term refinancing risk is relatively low for corporates, but defaults in the form of distressed exchanges could still occur if stressed companies buy back outstanding bonds below par that we do not view as opportunistic. Even so, speculative grade borrowers in the retail/restaurants, telecommunications, transportation, and utility sectors have an above average 10% of outstanding debt maturing in 2023. This could be a particular issue for sectors that still have a high proportion of companies rated at 'B-' or below, notably including the consumer goods, business & consumer services, and media & leisure sectors.

Risks relating to the ongoing war in Ukraine can't be ignored. Russia's invasion of Ukraine has entered its second year, and the duration and outcome of the military conflict remains unclear. Tail risks remain extremely high even if the macro-credit impact in Western Europe has, so far, proven much less important than was feared.

Russia-Ukraine Conflict: S&P Global Ratings' Basecase Scenario

We anticipate that the hot phase of war will continue through the summer, possibly at a greater intensity. Nonetheless, a stalemate remains the most likely outcome as both sides fail to achieve their military objectives. This could produce a fragile ceasefire before year-end even as territorial claims remain contested.

- Expect the Western alliance to continue ramping up military, financial and humanitarian support for Ukraine including the extension of full trade liberalization (which originally entered into force on June 4, 2022).
- This will demonstrate the strong political support for Ukraine provided by NATO countries, shore up Ukraine's defense capability, and underpin the economy. At the same time, it is calibrated to restrict the use of Western weaponry against targets inside the Russian Federation.
- Russia's military offensive is likely to continue to struggle to secure territory. It will also prove costly in terms of casualties and raise questions over the political sustainability of the war in the medium term, even as the Russian economy moves to a war footing.
- Russia's targeting of energy infrastructure in Ukraine, and periodic nuclear threats, are unlikely to undermine the still high levels of public support for the war effort in Ukraine and most NATO countries. We believe Russia wants to avoid direct military engagement with NATO, and China's tacit political support for Russia is believed to be contingent on it not deploying its nuclear arsenal, nor broadening the conflict into the EU.
- In the absence of any negotiated peace plan, existing Western sanctions are (broadly) expected to continue. The focus will switch more to enforcement rather than any material extension in the breadth of primary sanctions. We expect agriculture, food, and fertilizers to continue to be exempt.
- Under the scenario of a military stalemate, a de facto partition of Ukraine could eventually emerge, with the EU responding by deepening investment and trade with Central and Western Ukraine.

We continue to closely monitor a handful of key potential risks related to the conflict in Ukraine:

- **Direct NATO engagement.** To enhance Ukraine's ability to defend itself and retake its sovereign territory, the Western Alliance has committed to providing more sophisticated and longer-range weapons to Ukraine. The risk is that this provokes a hostile Russian response that embroils NATO, for instance, should Russia use unconventional weapons or otherwise cause Article 5, which sets out NATO's principle of collective defense, to be invoked.
- **Economic.** The durability of the Western Alliance's commitment to provide the necessary military and financial support to Ukraine is a key concern. This is particularly the case if the

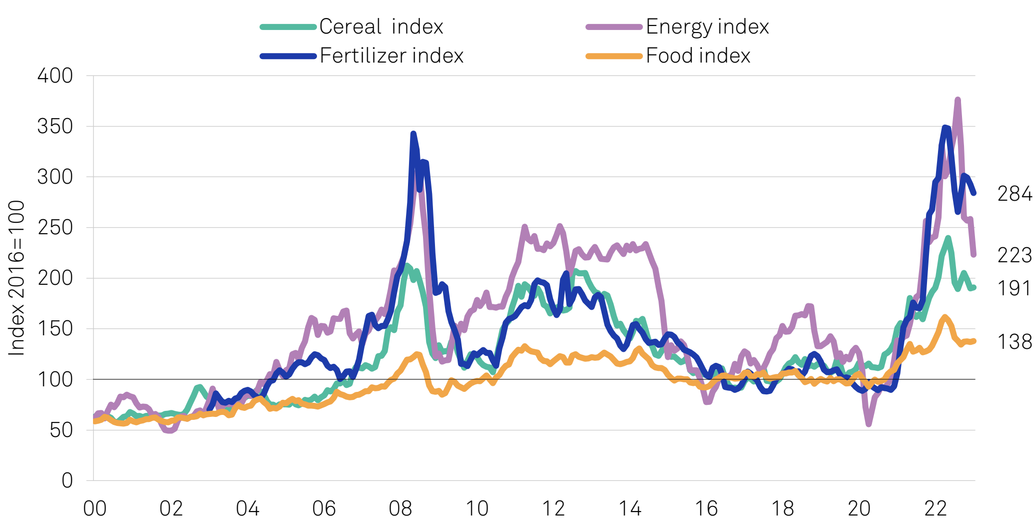
war still looks intractable towards year end, more so if China starts providing material military support to shore up Russia's campaign. Wearing down public support in Europe and the U.S., and fostering division between NATO countries (including by increasing the burden of post war reconstruction in Ukraine), is a strategic part of Russia's plan.

- **Cyber Hostilities.** Cyber space provides opportunities to expand the conflict zone in several dimensions. Ukraine's government, military, and civilian infrastructure is reported to have been under almost constant attack from Russia and associated criminal groups, including in the months prior to the war. In contrast, hostile cyber activities targeting critical infrastructure in the West appears to have been sporadic and below a threshold that could trigger Article 5. Nonetheless, as detailed in Google's recent report "Fog of War", there is a clear and growing risk that the Kremlin and associated criminal groups will intensify cyberattacks on critical infrastructure within NATO member states in response to the growing military support being provided to Ukraine. Western-leaning ex-Soviet states (such as Georgia and Moldova) could be targets for cyber activity aiming to stir-up political instability.
- **Food prices.** The war has compounded problems in global supply chains, many of which were already struggling in the aftermath of the pandemic. This is particularly evident in the agricultural sector, where some food prices, such as cereals and vegetable oils, remain up over 70% compared to pre-pandemic levels (see chart 1).

Chart 1

Food security remains problematic following disruptions caused by the war in Ukraine

Primary Food Price Indices 2016 = 100



Source: IMF. Data as of February 2023.

In summary, central banks may have created problems in the future by raising interest rates sharply into restrictive territory. The financial implications of that move will feed through, with a lag, to businesses and consumers. That is especially the case where debt is locked in at fixed rates, consumers remain employed, and households have accumulated savings during the pandemic. But restrictive rates combined with stagnating growth in Europe, fault lines appearing in the banking system, and a dangerous war dragging on in Ukraine, presents a highly unsettled and uncertain outlook that we expect will tighten financing conditions and weigh on credit quality through 2023.

Top European Risks

Higher financing costs and reduced funding availability weigh on financial risk profiles

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

Rising nominal and real rates, and the return of elements of financial instability in the banking system, could give rise to financial vulnerabilities elsewhere, especially where borrower risk-profiles are poor and if funding conditions tighten. Vulnerable categories could include corporate business models premised on uncertain growth needed to generate cash flow to service debt, or financial institutions, such as shadow banks, operating with high leverage, running structural liquidity mismatches, or taking significant asset-quality risk. Most borrowers have termed out their debt and hedged much of their interest rate exposure in the near term, yet stressed corporate borrowers could still default if they conduct distressed exchanges.

Escalation and broadening of the Russia-Ukraine conflict

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

Russia's invasion of Ukraine has entered its second year. Despite preparations for increased hostilities over the summer, our basecase remains that a stalemate is the most likely outcome as both sides fail to achieve their military objectives. Tail risks remain significant, particularly If NATO becomes embroiled should Russia use unconventional weapons or trigger Article 5. China's provision of lethal weapons to Russia would be a destabilizing development. The asymmetric nature of the risks, should they eventuate, will exacerbate existing shocks to the global economy and financial markets. More broadly, a deepening geopolitical divide between autocratic and democratic blocs increasingly undermines decades of economic cooperation and development, with implications for global security, trade, communications, the climate, and health.

Economic growth fragility, despite recent resilience

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

European economic growth remains fragile despite the economy withstanding the worst of the energy crisis and receiving a boost from the reopening of China's economy. We are particularly wary of risks arising from further vulnerabilities in the financial sector stoking financial market volatility, core inflation peaking much later than expected, and a destabilizing escalation of the war in Ukraine. Any of those events could trigger a recession in Europe, working primarily through consumer confidence and financial channels. The severity of any recession would largely depend on the strength of the service sector and employment levels.

Secular risks

Heightened disruptions linked to climate change and the energy transition

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 via more ambitious plans. These plans face implementation challenges, notably regarding slow permitting and supply chain strains affecting renewables, biomethane, energy efficiency, and heat-pump rollouts. The phaseout of carbon-intensive energy sources has been delayed to secure energy supplies in the near term. The widening 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 action in later years, disrupting industries and business models, notably in the automotive, building, cement, steel, chemicals, transportation, and utilities sectors.

Mounting cyberattacks due to 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, with targets ranging from utilities to insurers and government agencies. This can weigh on credit quality, result in substantial monetary losses, and undermine public confidence in key institutions and infrastructure. In addition to the threat from increasingly sophisticated cybercriminality, geopolitical tensions have stoked fears of state-sanctioned cyber threats. Russia's recent use of cyberattacks has been largely limited to Ukraine, but could expand in response to the West's military support for Ukraine. Most likely, this would involve (mis)information operations to subvert Western backing for the war in Ukraine. Less likely, but more systemic, would be a destructive cyber event on vital infrastructure in the West.

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

Macroeconomic Outlook

- Our outlook for 2023 is for economic stagnation in the EU, with an elevated risk of mild recession.
- Euro area monetary policy is clearly turning restrictive this year, with the deposit rate likely to reach 3.5% this summer, and it is likely to remain so next year. We expect it will take until 2025 for inflation to return to target levels and for monetary policy to become neutral.
- Risks are largely associated with a disorderly tightening of global financing conditions, potentially exacerbated by real yields becoming positive in 2024.

Primary contacts

Sylvain Broyer
Frankfurt
sylvain.broyer
@spglobal.com
+49-69-33-9991-331

Aude Guez
Frankfurt
aude.guez
@spglobal.com

Boris Glass
London
boris.glass
@spglobal.com
+44-20-7176-8420

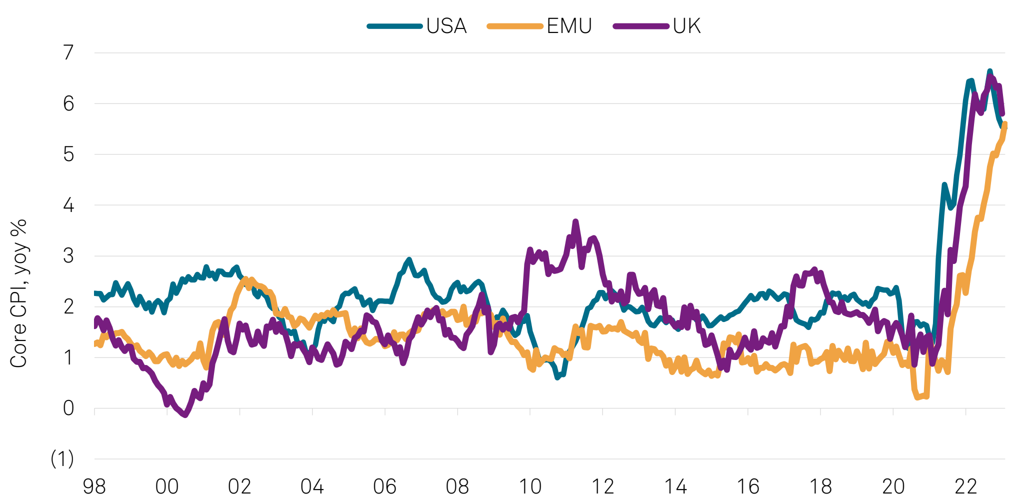
Eurozone

A complicated but not dire economic outlook. This year's GDP growth should be slightly higher than previously estimated. We expect growth of 0.3%, up from 0% in our previous baseline forecast. This revision is, however, not akin to stronger demand. The growth carryover from 2022 was 0.4%, following a strong finish to the year for the European economy in Q4, so our scenario for 2023 is still one of stagnation, with an elevated risk of a mild recession down the road. The economy still needs time to absorb and adapt sustainably to the unprecedented terms of trade shock delivered by the war in Ukraine.

We materially revise down our GDP forecast for 2024 to 1.0%, from 1.4%. This Is the result of inflation proving more persistent than expected. Monetary policy is clearly turning restrictive this year and likely to remain so next year. We believe that it will take until 2025, when inflation has come back to target and monetary policy to neutral, for the European economy to close the negative output gap that has accumulated since the pandemic (and which it would have closed last year absent geopolitical shocks). We expect GDP growth to be more solid in 2025 and 2026, at 1.7% and 1.6%, respectively.

Chart 2

Eurozone core inflation is now as high as in the U.K. or the U.S.



Source: S&P Global Ratings.

Some positive developments can be observed on the inflation front. Eurozone producer price index (PPI) inflation slowed markedly to 15% in January 2023, from 44% last August, and headline inflation appears to have peaked. This is definitively not an "all-clear". Core inflation in the eurozone has accelerated, reaching 5.6% in February, and is now as high as in the U.K. and the U.S. (see chart 2). Headline inflation will not return to target before the first quarter of 2025, while core inflation will likely take until the third quarter of 2025.

Sticky inflation will force the European Central Bank (ECB) to raise rates more than we had originally thought. The increases will probably continue until the deposit facility rate reaches 3.50% in the summer, and will come in prudent 25 basis points (bps) steps. Potential fragilities in the banking system and concerns over financial stability are increasing, but they should be addressed by policy instruments other than interest rates (See: "The Macro Fallout from the Silicon Valley Bank Collapse Appears Limited for Now," published March 16, 2023). The ECB has plenty of instruments at hand to steer bank and market liquidity.

The near-term outlook is complicated but not dire. Economic conditions remained favorable at the beginning of the year (in terms of production, demand, and employment), but we believe that 2023 and 2024 will prove complicated for the European economy as the restrictive monetary policy weighs on demand. Long-term interest rates will exceed inflation next year, for the first time in several years, and will affect domestic demand via financing. The situation will be further complicated by the fading of the strong momentum, seen last year, in industrial production and the labor market. More positively, however, consumer spending should benefit from government measures, accelerating wages, and disinflation. External demand will benefit from China's reopening. Public investment will help cushion the cyclical slowdown, adding half a point of GDP a year for the coming three years, and could enhance long-term potential GDP.

Key assumptions

- The conflict in Ukraine does not spread to other countries and no unconventional weapons are used.
- Rationing of the energy supply to the European economy remains a remote risk for the coming winter.
- Supply chains issues continue to ease gradually.

Key risks

- Longer duration and escalation of the conflict in Ukraine, that could further test the resilience of the European economy.
- An unwarranted and disorderly tightening of global financing conditions. This risk is on the rise, as exhibited by the recent market turmoil, and will continue to increase as real long-term yields move to positive, from negative, especially in 2024.
- Production and employment growth could slow more markedly as the post COVID-19 economic rebound fades.

What to look for over the next quarter

- Developments in the conflict between Russia and Ukraine.
- The speed of disinflation and the resilience of labor markets, which together will determine the extent to which central banks tighten monetary policy.
- The impact of higher interest rates on financing conditions and domestic demand.

U.K.

Although growth in fourth quarter 2022 stagnated, the performance was better-than-expected and has put the economy on a somewhat stronger footing going into 2023. A relatively mild winter that required less spending on heating also helped.

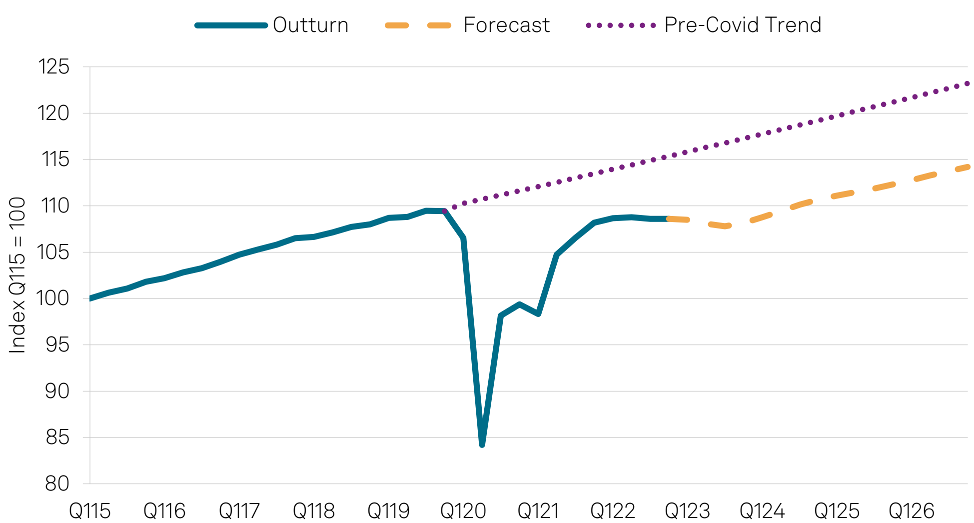
The easing of European natural gas prices will bring headline inflation down faster than we had previously expected, although it will still average a high 5.8% for the full year. Along with a historically tight labor market, which should weaken only moderately, that will translate into a modest economic contraction of 0.5% this year. We have raised our forecast somewhat beyond 2023, to 1.6% on average in 2024-2026, partly owing to some of the budget measures announced on March 15--notably the 100% tax deductibility of certain capital investments and the expansion of free child care allowances.

Beyond the possibility of deepening financial market turmoil in the U.S. and Europe, related to bank failures, higher-than-expected core inflation remains a key risk to our forecast. Unless core inflation proves stickier than we currently forecast, we believe the Bank of England (BoE) has come to the end of its tightening cycle and could start easing again as early as 2024.

Chart 3

GDP will not catch up over the forecast horizon

Volumes index (Q115 = 100)



Source: ONS, S&P Global Ratings.

Financing Conditions

- Higher-for-longer rates and continued market turbulence will lead to a tightening of financing conditions. Credit spreads have given up gains made in early 2023 and the risk of further widening remains.
- A solid start to 2023 on the primary markets is likely to be undone in the near term by market turmoil. Manageable refinancing risk in 2023 gives way to greater challenges in 2024 and beyond, with floating rate borrowers increasingly vulnerable.
- Risks are mounting for lower-rated issuers at 'B-' and below. We believe a combination of factors will result in a moderate rise in defaults this year to a 12-months trailing average of 3.25%, up from 2.5% as of end February.

Primary contact

Patrick Drury Byrne
Dublin
patrick_drurybyrne@spglobal.com
+353-1-568-0605

Ekaterina Tolstova
Dubai
ekaterina.tolstova@spglobal.com
+971-5479-23598

Higher-for-longer interest rates and continued market turbulence will tighten financing conditions. The collapse of SVB, the ensuing contagion fears, and the rescue deal for Credit Suisse triggered a sharp drop in 10-year Bund yields, which are down about 50 bps since the start of March to about 2.2%. This was triggered both by safe-haven demand and question marks over the ECB's ability to keep on tightening amid increasing banking turmoil. Contrary to recent market indications , we continue to expect that inflation trends will lead the ECB to keep rates higher for longer, and that the 50 bps hike on the March 11, which raised deposit rate to the highest level since 2008, is unlikely to be the last. Therefore, the recent decline in benchmark yields may only be temporary.

Financial market turbulence and the return of risk aversity has seen credit spreads on European investment grade and speculative grade shed the gains of early 2023. Credit spreads are now back at levels last seen in November 2022. Investment grade and speculative grade spreads widened by about 40 bps and 100 bps, respectively, since the start of the recent market turmoil in early March. Those levels are still well below the peaks reached last July, when investment grade and speculative grade spreads were about 200 bps and 670 bps, respectively. Credit widening spread risks remain, notably due to fears of contagion and the uncertain outlook for the global and European economies.

Refinancing risk is rising and will likely be complicated by reduced liquidity and the proportion of floating rate debt. Europe's primary markets started the year on a better footing, with a 5% rise in rated corporate bond issuance compared to the first quarter of 2022, though this momentum may be difficult to sustain and has recently been brought to a halt by increasing market turmoil. Year to date issuance is primarily driven by IG, which accounted for around 90% of total rated debt. However, 77% of that was issuance by financial institutions. Negative current sentiment towards that sector and the complete write-off of Credit Suisse's CHF17 billion outstanding alternative tier 1 instruments, or AT1s, means financial institution issuance is likely to remain muted in the near term. In addition, current market turmoil is likely to pause or materially reduce primary issuance among non-financial corporates, with instances of postponements already reported. Current market disruption, alongside persistent inflation and higher rates may also contribute to further cooling of the general business environment. That could affect operational and financial performance and result in further pressure on credit quality, particularly among lower-rated issuers, which may make refinancing more difficult.

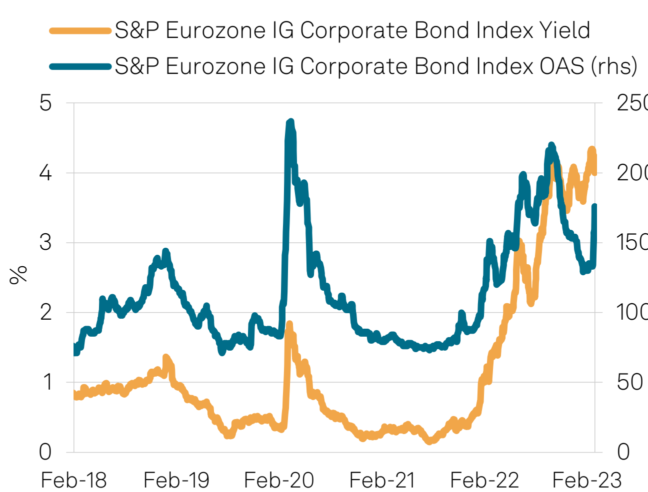
Difficult capital markets conditions are likely to be compounded, at least in the near term, by further tightening of bank lending standards. This tightening, which was reflected in the most recent ECB lending survey, is a result of reduced risk appetite and tighter terms and conditions. That is a challenge for European issuers, which rely more heavily on bank funding than U.S counterparts. Furthermore, the commencement of quantitative tightening this month (initially at about €15 billion a month, but likely to ramp up in due course) will further remove liquidity from the market.

Maturities in 2023 remain broadly manageable, but refinancing risk rises materially in the following years. Issuers may still have cash on hand and, as of January 1, only 10% of European debt maturing through 2023 was speculative grade. Speculative grade issuers in the retail/restaurants, telecommunications, transportation, and utility sectors have elevated maturities in 2023, when each sector has more than 10% of outstanding debt maturing. That Is substantially more than other sectors. In addition, as of January 1, close to €11 billion of financial institution speculative grade debt, much of which is likely to be impacted by current market conditions, was due to mature in 2023. Speculative grade 2024 refinancing risk is already firmly in the spotlight. Maturities in 2024 are close to being 50% higher than in 2023, while maturities ramp up further in 2025-2026, with more than 26% of outstanding speculative grade debt falling due in 2026.

Speculative grade issuers tend to be more immediately exposed to interest rate risk as they have a higher proportion of floating interest-rate debt. About 52% of speculative grade rated debt maturing through 2027 is floating-rate primarily in the 'B' rating category and below. While 2023 risk is limited, floating rate refinancing risk ramps up materially to close to €50 billion in 2024, and reaches almost €90 billion in 2025. With the deposit rate already at its highest point since 2008 (and with the risk of further hikes and the lagged impact of rate hikes upon the economy), debt servicing and refinancing may become more difficult. if current conditions persist, precisely when speculative grade maturities, and floating rate maturities in particular, come due.

Chart 4

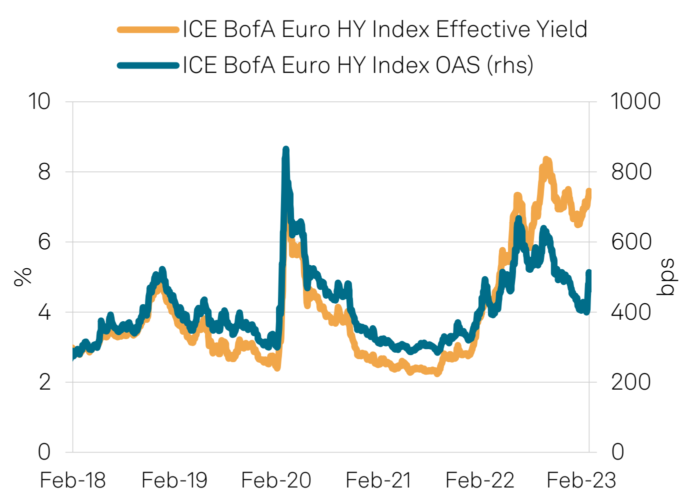
Credit spreads widen amid uncertainty...



Data as of March 17, 2023. IG--investment grade, OAS--option adjusted spread. Source: S&P Global Ratings, S&P Dow Jones Indices.

Chart 5

...But nowhere near September 2022 highs



Data as of March 17, 2023. HY--high yield, OAS--option adjusted spread. Source: ICE, S&P Global Ratings.

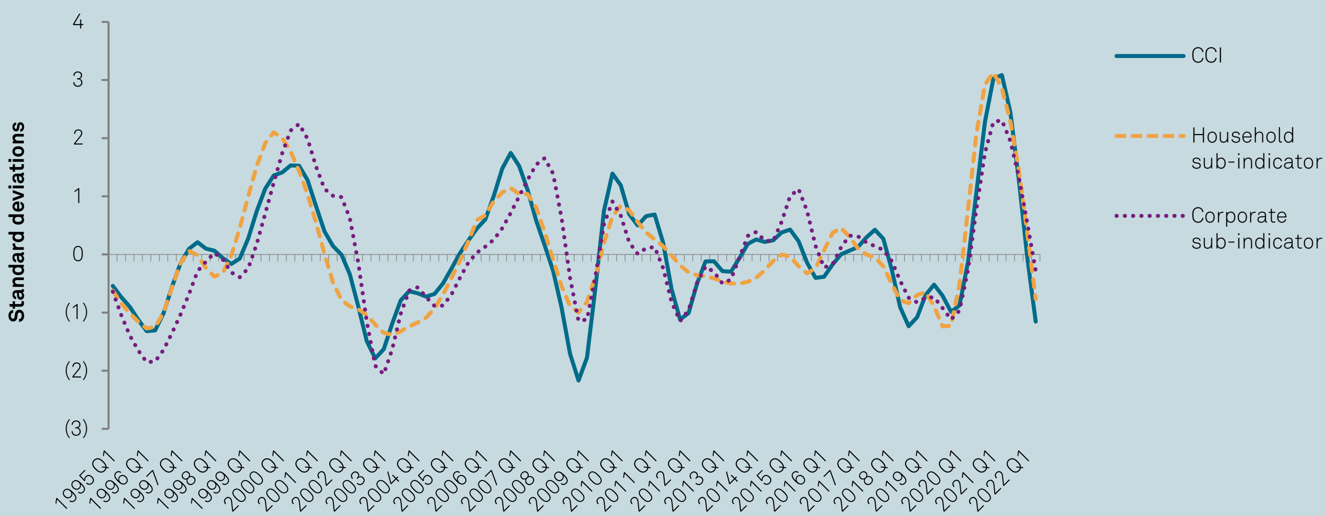
Credit Cycle Indicator

Credit Cycle Signs Flagged The Potential For Heightened Credit Stress In Late 2022 Or Early 2023

Over the four quarters from 1Q 2020, as the COVID-19 pandemic took hold, the eurozone Credit Cycle Indicator (CCI) trended upwards, reaching a peak of 3.0 standard deviations in 1Q 2021 (see chart 6). Based on statistical precedent, this points to potential heightened credit stress in late 2022 or early 2023. The most recent figures, for 2022, were characterized by the post COVID-19 recovery, which was reflected in the CCI trending downwards. Yet, latent financial vulnerabilities often take time to surface, and the seeds may already be sown for the next credit downcycle, when nonperforming loans (NPLs) and defaults could pick up in response to a trigger event. For more details about our proprietary CCI, see "White Paper: Introducing Our Credit Cycle Indicator," published on June 27, 2022.

Chart 6

Recent peaks in eurozone CCI suggests heightened credit stress in late 2022 or early 2023



CCI--Credit Cycle Indicator. Peaks in the CCI tend to lead credit stresses by six to ten quarters. When the CCI's upward trend is prolonged or the CCI nears upper thresholds, the associated credit stress tends to be greater. Sovereign risk is not included as a formal part of the CCI. Source: Bank for International Settlements, Bloomberg, S&P Global Ratings. Data as of Q3 2022.

Corporates. Since peaking in the first quarter of 2021, the Eurozone corporate sub-indicator has descended rapidly from a height of 3.0 standard deviations (1Q 2021) to -0.3 in early 2022. The economic rebound from the pandemic has spurred growth across the eurozone, helping push down the corporate credit-to-GDP ratio, which fell to 110% in 1Q 2022, from 115.2% a year earlier. Yet, even with this moderation, debt in the corporate sector remains at historic highs in nominal terms. And though a declining CCI reading signals moderating stress, higher rates, tougher financing conditions, and a stagnating economy may expose financial vulnerabilities within the corporate sector. Given the widespread extension of debt maturities in recent years, we still see limited short-term refinancing risk, although weaker borrowers seeking additional financing for working capital or growth, especially unrated SMEs, may struggle.

Households. The household sub-indicator follows a similar trend to that of corporates: 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 decreased to 59.4% by 1Q 2022, down from 62.5% a year earlier. Yet, this moderation is in the context of an ongoing cost-of-living squeeze across the eurozone. A key unknown for European households is how long they will have to shoulder the high energy costs. Promisingly, many governments continue to have subsidy programs in place to dampen the pain. At the same time this will likely keep retail energy prices higher for longer, even if wholesale prices fall back. Accumulated financial savings from the pandemic should help fund household budgets, but an economic downturn involving higher unemployment would expose many households, especially those with little savings, prompting them to turn to expensive consumer credit markets.

Financial Institutions

- The material and rapid eroding in mid-March of Credit Suisse's franchise and liquidity pushed Swiss authorities to intervene and orchestrate an acquisition by UBS, in a deal that will involve substantial financial support from the government.
- Confidence could remain fragile for some time, increasing risks for the weaker players.
- Rising rates continue to support banks' profitability, even if operating and credit costs are set to increase as well. But this cyclical boost to profits, after many years of subdued returns, is unlikely to lead to positive rating momentum across the board.
- Asset quality will weaken, primarily among small and midsize enterprises (SMEs) and unsecured consumer lending portfolios, but the impact should be manageable, with provisioning charges normalizing rather than spiking.
- If authorities carefully balance tightening monetary policy with financial stability risks, banks should be able to preserve solid capitalization and funding profiles.

Primary contact

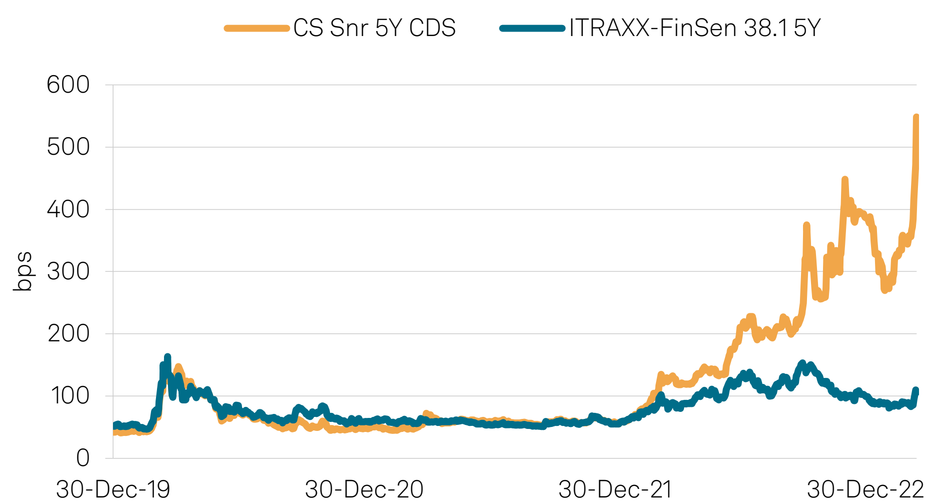
Elena Iparraguirre
Madrid
elena.iparraguirre
@spglobal.com
+34-91-389-6963

Key Developments

Swiss authorities orchestrated a deal to rescue Credit Suisse. This was prompted by concerns over its viability following sustained business outflows and deepening liquidity problems. Resolution tools were not activated. Instead, authorities articulated a last-minute deal to facilitate its acquisition by domestic competitor UBS. The Swiss government committed substantial resources to enable the deal to go through, including a CHF 9 billion second-loss protection against credit losses, and up to CHF 100 billion of additional liquidity support. Authorities also enforced the contractual write-down of CHF 16 billion of Credit Suisse's AT1 instruments, generating a wider debate around the risks inherent in European bank AT1s. The acquisition by UBS should help stabilize the Credit Suisse franchise, its funding, and liquidity, but execution risks remain material. We thus revised to negative our outlook on UBS Group AG and placed most of our ratings on Credit Suisse entities on CreditWatch with positive implications.

Chart 7

Credit Suisse five-year CDS spread widened sharply compared to peers



CDS--Credit default swaps. Source: S&P Global Market Intelligence. Data as of March 14, 2023.

Confidence will remain fragile for some time, which is an issue for the banking sector given its confidence-sensitive nature. Weaker players and nonbanks with refinancing needs will be under particular scrutiny. The wholesale funding market will remain choppy for a while, particularly for capital instruments. Banks may feel forced to increase remuneration of deposits earlier than they anticipated, and most likely will no longer anticipate the repayment of targeted longer-term refinancing operations (TLTRO) facilities. Finally, we expect banks' underwriting standards to tighten, with the pace of loan growth decelerating from still solid growth of 4.9% in January 2023.

We don't see European banks having the key funding and interest rate vulnerabilities that led to stress on some U.S. regional banks. While there are a few custodian and private banks whose funding relies on corporate and wholesale deposits, that is not the case for the majority of European banks, for which sticky household deposits account for about 30% of liabilities. Additionally, while the shift in monetary policy has led to unrealized losses on banks' securities portfolios, most of them have been recognized either through the profit and loss statement or capital accounts. In the first nine months of 2022, for example, the increase of banks' unrealized losses on fair-valued financial assets reduced European banks' Common Equity Tier 1 (CET1) capital ratio by about 40 bps. The size of European banks' securities portfolios carried at amortized cost with unrecognized losses looks manageable, representing 5% of assets on average. While there is variance around this average, in our view, it would take an acute liquidity crisis to force the materialization of such unrealized losses. One of the reasons for that is that banks enjoy ample liquidity, with the bulk of it in the form of cash, and will likely have access to other funding sources as required.

Rising rates will continue to boost European banks' revenues. To the point that, despite operating costs growing due to inflationary pressures, credit losses normalizing, and lending growth further decelerating, banks will be able to report better returns in both 2023 and 2024. We expect the median return on equity (RoE) of the top 100 European banks to increase to 7% in 2023, and 7.7% in 2024, up from an estimated 6.3% in 2022. Banks with largely floating rate balance sheets and cheap deposit bases are set to benefit the most. How much earnings will improve will depend on how far and how fast is the rise in the funding cost of deposits, which are banks' most relevant funding source. Trends will differ from one country to the other. In France, for example, the existence of regulated savings (Livret A), currently remunerated at 3%, provide a competitive benchmark to customers. Additionally, in some countries public authorities are increasing scrutiny on the so far slow pace at which banks are raising deposit rates.

There is limited evidence of asset quality deterioration, but some problems will emerge this year and next, most likely in SMEs and unsecured consumer lending portfolios. As reference, according to the European Banking Authority (EBA), 9.5% of European banks loan books were classified as Stage 2, or potentially problematic, as of Sept. 2022. Overall, we expect asset quality deterioration to be contained, requiring only a modest increase in provisions. Government guarantees provided during the pandemic will help contain credit costs in some markets. The more vulnerable corporate borrowers are those who have not been able to fully recover from the pandemic hit, those more directly affected by high prices, or with limited ability to pass on higher costs to customers through pricing, and those with more stretched debt and affordability metrics--which will now face much higher financing costs. Among households, unsecured consumer lending recently granted to low income, highly indebted clients presents more risks.

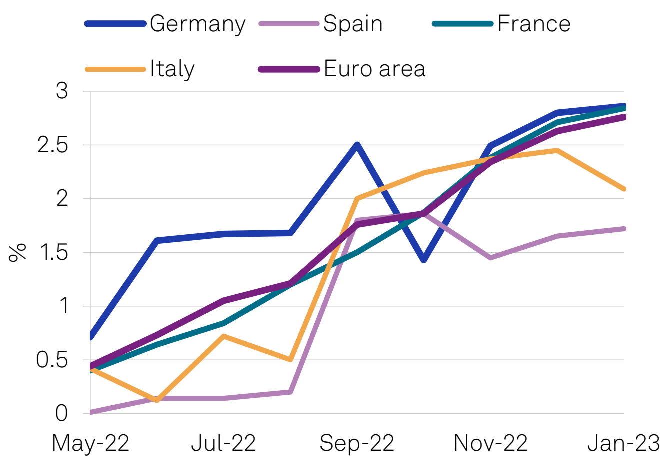
A price correction is underway in several European property markets, in response to higher rates and weaker confidence. We anticipate a scenario of soft-landing rather than an abrupt correction, with limited consequences on the quality of banks' mortgage books for as long as employment holds up. Banks' exposures to commercial real estate could be more vulnerable, as, in addition to weaker price dynamics, companies will face higher financing costs and potential refinancing risk. Among the large economies, Swedish and German banks report higher exposures to commercial real estate.

Despite banks' regulatory capital ratios declining in 2022 due to risk-weighted asset inflation, they remained solid enough to afford the higher distributions to shareholders that banks are pursuing. Dividend payouts, including both cash dividends and buy backs, increased to 50% of net profits in the Eurozone, from 35% the year before. And they should remain at that level this year. 2023 SREP capital requirements have increased only for a few European banks, although higher countercyclical buffer requirements will kick in overtime in some countries.

The EBA formally launched its 2023 stress test exercise. It will be conducted on 70 banks (20 more than in the previous exercise), accounting on aggregate for about 75% of the EU's and Norway's banking assets. Results will be communicated by the end of July 2023. The adverse macroeconomic scenario looks harsher than in previous tests and for the first time it incorporates different performance assumptions by economic sectors.

Chart 8

Banks are increasing the remuneration of deposits at different paces*

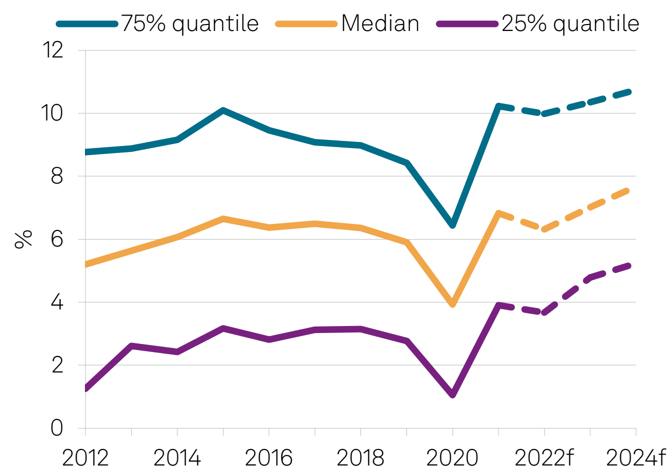


*Rates paid on new corporate deposits over one year. Source: ECB.

Chart 9

Rising profits ahead

Return on average common equity (%) at European rated banks



f--Forecast. Source: S&P Global Ratings.

Key Risks

- **Core inflation remaining persistently high, putting further pressure on banks' operational costs and returns, as well as on the financial condition of corporates and households.** In this scenario, monetary policy may need to further tighten, taking a toll on economic growth and employment, and leading also to weaker asset quality and business prospects.
- **Market volatility and restrictive financing conditions.** Weaker borrowers could face excessively high funding costs and limited access to financing, ultimately triggering higher credit losses for banks. Equally, nonbank players could also be exposed to that situation and spread the risk to the broader financial system.
- **Banks' failure to deliver commercially and operationally resilient business models.** In particular, by failing to tackle inefficiencies, failing to digitalize the business, and failing to improve protection against cyberattacks.

Nonfinancial Corporates

- Corporates navigated 2022 largely without structural deterioration in credit metrics, although management guidance and our forecasts for 2023 are striking cautious notes. We envisage increasing pressure in the lower end of the ratings.
- Rising interest rates pose threats, especially to speculative grade issuers (entities rated 'B' or below), which account for about 35% of rated issuers. Refinancing needs are limited for 2023, but 2024 maturities are, already, top of the agenda. New financing will be more expensive and possibly hard to obtain, depending on the issuer.
- The Infrastructure, real estate, and consumer goods sectors have the highest net negative bias. The latter two have experienced the most negative rating actions in 2023. In several other sectors the percentage of negative outlooks has grown, but net bias is lower due to the presence of positive outlooks that are more credit-specific.
- So far in 2023, EMEA rating actions remain quite balanced. Defaults have been limited but we expect the default rate to rise to 3.25% by year end, up from 2.5% at end-February, as refinancing becomes more pressing.

Primary contact

Barbara Castellano
Milan
barbara.castellano@spglobal.com
+39-2-7211-1253

Key Developments

Difficult and uncertain economic conditions increase expectations of a more negative rating trend, especially in the lower end of the ratings spectrum. European corporates' 2022 results show that, in many cases, companies have coped with challenges (from the war, the gas supply shock, higher inflation, and higher interest rates) without structural deterioration in credit metrics, while operating margins continue to recover after COVID-19 (see table 1). European companies' guidance for 2023 indicates that most are cautious in the face of heightened uncertainty surrounding inflation's evolution and the outlook for growth against the backdrop of rising funding costs. Our forecasts now incorporate more difficulty passing through further price increases and the gradual effect of higher interest costs. We do not expect a sharp jump in negative rating actions in investment grade ratings, at this stage, as we expect the increase in borrowing costs to be much more manageable with existing cash flows.

Table 1

Sector profitability in the eurozone

2019-2022 (%)

Sector	2020	2021	2022	2019-2022
Agriculture (2%)	-1%	9%	20%	29%
Construction (5%)	-4%	10%	15%	21%
Trade, tran., acc.,fd (19%)	-18%	18%	23%	19%
Manufacturing (17%)	-8%	15%	13%	19%
Total (100%)	-6%	9%	11%	13%
Inform. & comms (5%)	2%	6%	1%	10%
Real estate (11%)	0%	3%	4%	8%
Finance & insce (4%)	0%	1%	3%	4%
Prof. & technical (12%)	-6%	6%	3%	2%
Public admin (19%)	-4%	6%	-2%	0%
Arts, ent., & others (3%)	-24%	3%	12%	-13%

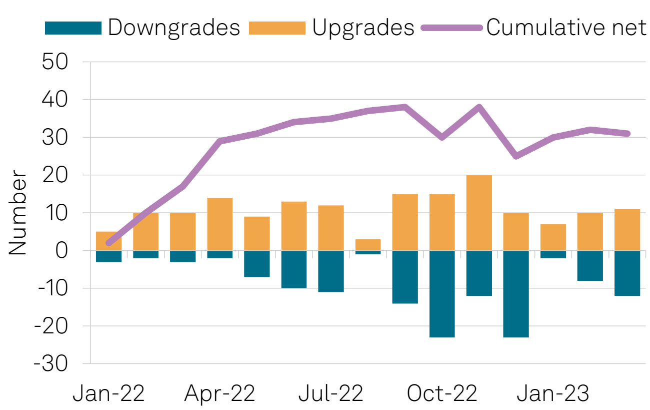
Note: Profitability comprises gross operating surplus. Trade, tran., acc., fd--trade transportation, accommodation and food. Figures in brackets are 2019 weights in total gross value added (GVA). Source: Eurostat.

Rising interest rates represent the largest risk for EMEA rated companies given the significant presence of entities with 'B' or lower ratings. Financing conditions are tightening, banks are going to pass through higher funding costs to borrowers, and banks and investors are becoming more selective on riskier credits (and are applying higher risk premiums). About 35% of EMEA corporates and infrastructure issuers are rated 'B' or below, with a large presence of consumer goods, business and consumer services, and media and leisure companies. The most immediate pressure will fall on companies with refinancing needs in 2023 (though they are few at this point) and 2024. The difficult economic environment is also putting pressure on companies without immediate maturities, but which will struggle to maintain positive cash flow if their interest costs eventually reset to prevailing market rates.

Infrastructure, real estate and consumer product sectors have the highest negative outlook bias, and the last two sectors are also well represented in the list of recent downgrades. In real estate, nearly 20% of rated entities are on negative outlook, we downgraded four companies since the beginning of the year and three companies are among our potential fallen angels (out of 11 companies in EMEA). We are closely watching this sector as it is among the most exposed to the effect of rising interest rates, also because that puts pressure on property valuations. In consumer goods about 18% of companies are on negative outlook and there have been six downgrades since the beginning of 2023. This was caused by the large presence of 'B' or lower ratings, which account for nearly 50% of rated consumer goods entities. In the transportation infrastructure sector, many companies are still suffering from the pandemic. Airports, railways, and ports depend on a more positive economic outlook for traffic to fully recover.

Chart 10

EMEA corporate rating actions remain balanced in recent months

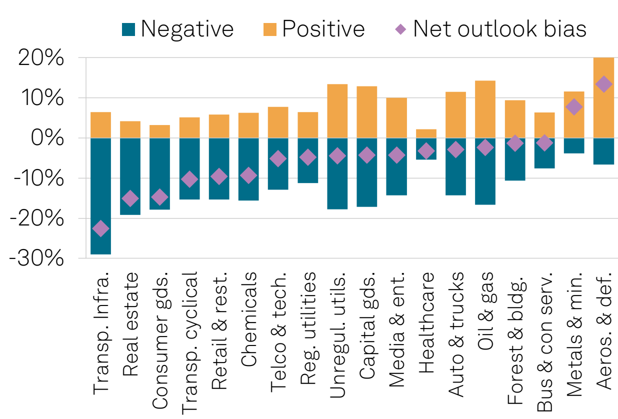


Data as of March 22, 2023. Source: S&P Global Ratings.

Chart 11

EMEA outlook distribution by sector

Transport infrastructure still suffering a pandemic hangover



Data as of March 23, 2023. Source: S&P Global Ratings.

Higher interest rates have pushed deleveraging to the top of the agenda and companies are taking actions to optimize debt structures. We believe that in 2023 some relief might come from a reduction in cash absorbed by working capital, compared to 2022, as supply chain shortages are no longer a serious concern and companies are likely to reduce the stock of inventories. We note also that M&A opportunities are being selected carefully. We assume limited revisions to capital expenditure plans while external growth ambitions are likely to moderate. We see some companies considering alternative funding solutions that entail the sale of minority stakes in subsidiaries or join ventures.

Key Risks

Market volatility and reduced availability of funding. Financial market turbulence that makes it difficult or impossible for lower rated entities to access financing could trigger liquidity squeezes and push debt financing costs to unsustainable levels.

Higher for longer inflation and weaker than expected economic conditions. In this scenario it will be increasingly difficult to continue passing through price increases to customers. Many companies would experience pressure on sales volumes and decreasing operating margins that would pressure credit ratios.

Structured Finance

- Interest rate benchmarks continued to rise at the beginning of 2023, putting further pressure on some borrowers whose loans back European structured finance.
- In RMBS, the effect this has on borrowers' scheduled loan installments varies widely by sector due to differences in typical loan characteristics, such as seasoning and the prevalence of interest-only products.
- We lowered only 1.2% of our European structured finance ratings over the past 12 months, and raised 8.9%.

Primary contact

Andrew South
London
andrew.south
@spglobal.com
+44-20-7176-3712

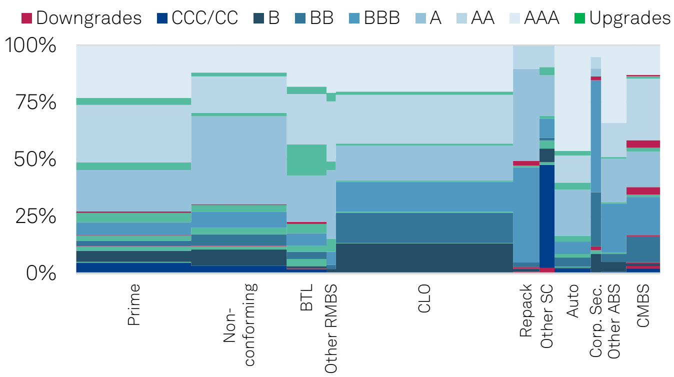
Key Developments

Across European structured finance, most recent rating actions have been upgrades. We lowered only 1.2% of our ratings in the sector in the 12 months to end-February 2023 (see chart 10). Weakness has mostly been confined to CMBS, with most downgrades involving transactions backed by U.K. shopping malls. Over the past 12 months, there have been very few negative rating actions in the major consumer-backed sectors, such as RMBS, although the cost-of-living squeeze and rising interest rates are putting some borrowers under pressure. European leveraged loans 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

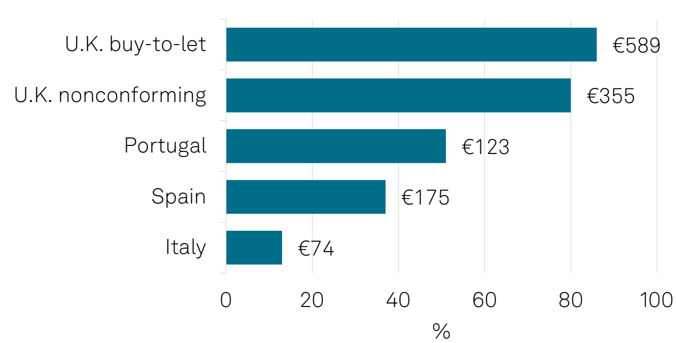


Based on cumulative count of rating actions between March 1, 2022, and Feb. 28, 2023. BTL--Buy-to-let. SC--Structured credit. Source: S&P Global Ratings.

Chart 11

Impact of rate rises varies by mortgage sector

Average payment shock on mortgage installments*



*For loans backing RMBS that we rate. Based on a hypothetical 500 basis point rise in mortgage rates between end-2021 and mid-2023. Source: S&P Global Ratings.

While European investor-placed securitization issuance has been subdued in the early part of 2023, benchmark covered bond issuance has started strongly, reaching nearly €67 billion in the first two months of the year, up more than 80% on the equivalent period in 2022. Normalizing monetary policy has supported covered bond supply as some issuers seek to replace funding they drew down under central bank schemes, such as the ECB's TLTROs. Similarly, while securitization volumes are muted in absolute terms, bank-originated issuance is a potential bright spot, after a decade of stagnation. This type of supply represents 28% of issuance volumes so far in 2023, compared with only 9% in the first two months of 2022.

Key Risks

Market interest rate benchmarks continued to rise at the beginning of the year, putting further pressure on some borrowers whose loans back European structured finance transactions. We quantified the hypothetical effect on mortgage borrowers' monthly loan installments of a 500 bps rate rise between the beginning of 2022 and mid-2023 for a representative sample of loans backing RMBS. In most sectors, this would correspond to a further rate increase of about one to two percentage points from current levels, on top of the rise that has already occurred since 2021. This analysis reveals a nuanced picture, with significant variations between countries and subsectors. For example, loans backing Italian RMBS would see only a €74 or 13% average increase in monthly payments (see chart 11). This is because they tend to have small balances, averaging only €60,000, and scheduled repayments comprise a high principal component as the loans are well-seasoned. By contrast, loans backing U.K. buy-to-let RMBS are typically three times larger, nearly all pay on an interest-only basis, and are therefore much more sensitive to rate rises. In U.K. buy-to-let, the average monthly payment shock in our analysis was £515 (€590) or 86%.

In general, severe delinquencies reported for the mortgage pools backing RMBS that we rate have not yet increased significantly, despite rises in the cost of living and interest rates. Even if they did, the ratings on senior RMBS tranches are likely well-protected by structural features. We simulated the impact of increased 90+ day arrears and house price declines on a sample of 50 U.K. prime, nonconforming, and buy-to-let RMBS that we rate. Even under increased stress, 'AAA'-rated tranches demonstrate significant stability, with no more than a quarter of ratings lowered--and only by one or two notches--in even the most stressful scenario of an eight percentage point rise in 90+ day arrears. Full details of the scenario analysis are available through our interactive dashboard.

In the CMBS sector, a key risk in the current environment is underlying borrowers' inability to refinance at loan maturity. Rising interest rates affect commercial real estate loans in different ways. They can, for instance, make new loans or inadequately hedged floating-rate loans more expensive for borrowers, and they also tend to lower property values, which increases loan leverage. However, because most loans that we monitor in European CMBS are either on a fixed interest rate or are hedged against rising rates, we believe that refinance risk is currently a greater concern than term risk.

About one-third of the loan balances backing CMBS that we monitor, equating to about €5 billion, will mature by the end of 2024. Generally, we believe that office and retail loans will be harder to refinance in the current environment than industrial/warehouse or residential loans given the outlook on the market fundamentals for these property types. For office collateral, the uncertainty surrounding future workspace needs--in the face of an increasing trend toward working from home--leaves real estate investors and lenders concerned about the extent of possible cash flow and value declines. Retail property values seem to have stabilized after many years of continuing decline. Nevertheless, the trend toward more online shopping continues, so many properties continue to be under pressure regarding declining rents and occupancy rates. Overall, we believe most of the loans that are due to mature over the next 12 months are in a good position to refinance. Even if they default, most of them should be able to fully repay the debt during a workout process.

International Public Finance

- European local and regional governments (LRGs) remain resilient to rising interest costs and economic slowdown.
- We project that their budgetary performance will gradually consolidate in line with restored balanced budget requirements in many countries. Short-term financial improvements, though, will result in stagnation of public capital investments, which will be crowded out by rising operating spending needs.
- In contrast, social housing providers and not-for-profit transport enterprises with limited revenue flexibility suffer more from elevated inflation. Their financial performance drops, while their ability to raise fees In line with inflation rate is limited amid a much higher cost of living.

Primary contact

Felix Ejgel
London
felix.ejgel
@spglobal.com
+44-20-7176-6780

Key Developments

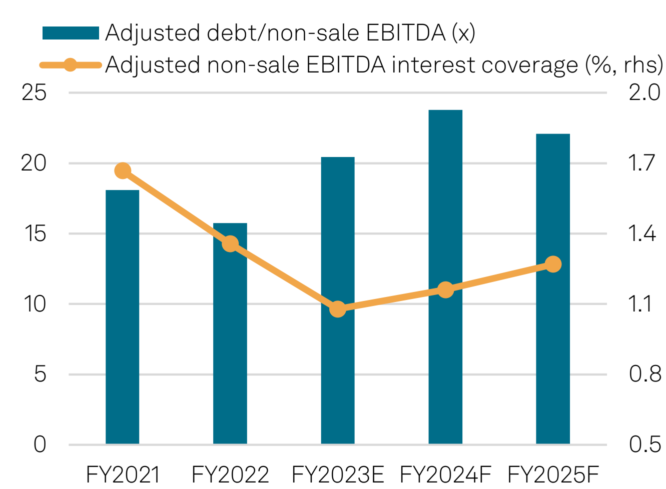
The financial performance of European social housing providers (SHP) is constrained. This is due to rising demand for new social housing units and regulatory pressure to improve the quality of existing stock, their restricted ability to raise fees, and higher interest costs.

We assume that indicators of debt burden of U.K. SHP will reach high levels this year. They should then further improve, though very marginally, over the next two-to-three years. As a result, we have observed merger activity among relatively large U.K. SHP, and anticipate a slowdown in development activity. Also, a large number of negative outlooks on their ratings highlight an increased probability of downgrades, including the transition of ratings into the 'BBB' category.

In our view, European LRGs are more resilient to the ongoing economic challenges. This is due to an inflation-fueled revenue increase and the availability of central government and EU funds earmarked for general use and investment. Moreover, shrinking budget deficits and reliance on long-term funding make LRGs largely immune to elevated interest rates. We consider Spanish regions to be most vulnerable to high interest rates on average.

Chart 12

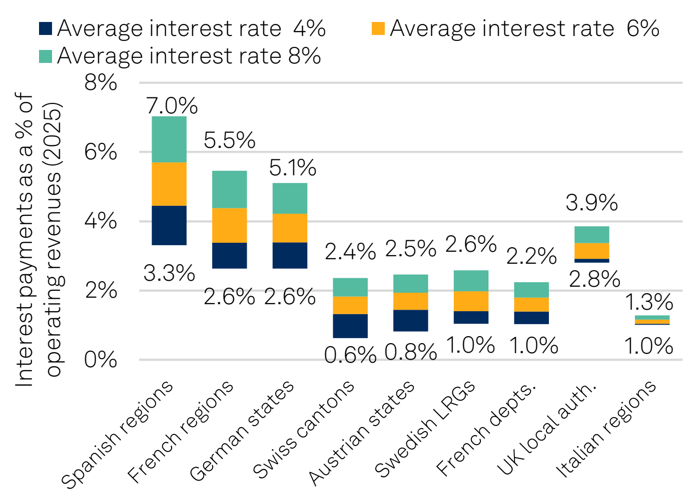
Debt burden of U.K. social housing providers stays high



Source: S&P Global Ratings.

Chart 13

Spanish regions are more vulnerable to higher interest rates



Source: S&P Global Ratings.

Numerous LRGs have accumulated cash buffers. These could be use before building up debt in the coming years. In the longer term, we expect borrowing will resume, since operating spending will catch up with inflation as demand for services and interest costs rise. With the squeeze on operating balances and constrained borrowing capacity, either because of fiscal rules or deficient debt management, we expect that many European LRGs will scale back their investments in infrastructure.

Key Risks

- **Restricted central government ability to provide financial support to LRGs and public-sector enterprises.** This could result from other pressing spending needs, including on social assistance, defense, and due to higher interest costs.
- **Constraints on the ability of public-sector enterprises to raise fees.** The cost of living crisis could limit the ability to cover rising costs by increasing fees in line with inflation.

Insurance

- Following a series of premium rate increase by primary insurers to reflect high inflation, re-insurers saw material premium rate increases during January re-insurance renewals. We expect re-insurance renewal rounds in April, June, and July to follow the same trend.
- Despite the insurance sector benefitting from higher re-investment rates on fixed income assets, we expect some life insurers could, over 2023-2025, suffer impairments on some illiquid investments acquired to boost yield.

Primary contact

Volker Kudszus
Frankfurt
volker.kudszus
@spglobal.com
+49-69-33999-192

Key Developments

Primary insurers secured premium rate increases across industrial, corporate, and retail lines in most markets. Following a series of material rate adjustments in 2021 and 2022, the impact of heightened inflation on claims costs appears to be adequately reflected in non-life insurance pricing. The outlooks of non-life insurers' ratings are mostly stable. The residual risk is that higher-for-longer inflation will require more extensive reserve adjustments.

Re-insurers struggled to earn their cost of capital over 2017-2022, however, 2023 might be different. We have indicated for the re-insurance sub-sector a negative rating trend since 2020, as the sub-sector failed to earn a margin on top of its cost of capital. This was mainly driven by insufficient prices to offset natural catastrophes, and those catastrophes severity and frequency in recent years. Recent material rate increases marked the end of softer markets, though it remains to be seen if the higher rates are enough to generate sufficient margins.

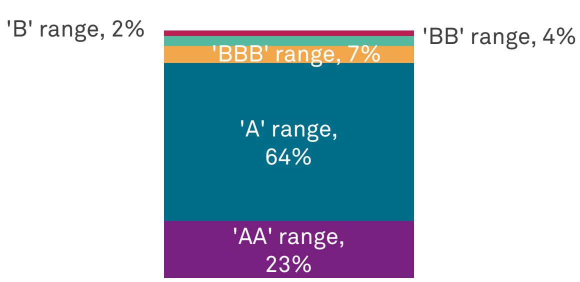
Life insurers benefit from higher re-investment rates, but given the long duration of assets it will take many years for that to take full effect. Higher interest rates are leading to pressure from insurance clients to increase bonus rates on top of guarantees. This could push life insurers to use part of their policyholder reserves to boost bonus rates to avoid an increase in lapses. At the same time, higher refinancing costs are a burden for sectors that life insurers are exposed to in their private credit, private equity, and real estate investments. European insurers seem to have very limited exposure to bank AT1s, including those issued by Credit Suisse.

Key Risks

- Impairment of illiquid investments in private credit and private equity.
- Higher for longer inflation.
- Bonus payouts by life insurers that exceed recurring earned coupons on bond investments and thus squeeze investment margins.

Chart 14

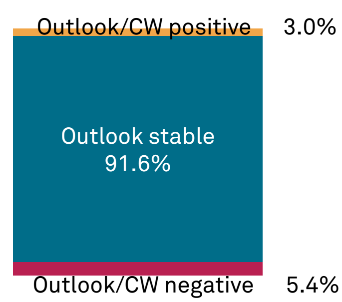
Rating distribution



Data as of March 6, 2023. Source: S&P Global Ratings.

Chart 15

Outlook distribution



CW--CreditWatch. Data as of March 6, 2023. Source: S&P Global Ratings.

Related Research

- Economic Outlook Eurozone Q2 2023: Rate Rises Weigh On Return To Growth, March 27, 2023
- Economic Outlook U.K. Q2 2023: Growth Eludes This Year Even As Inflation Eases, March 27, 2023
- European Banks Can Weather The Market Turmoil, March 21, 2023
- European Bank AT1 Hybrids In A Post-Credit Suisse World, March 21, 2023
- CCC – A more difficult way out, March 20, 2023
- European Banks See Limited Contagion Risk From SVB, March 14, 2023
- Corporate Results Roundup: Still Avoiding The Slump, March 9, 2023
- EMEA Structured Finance Chart Book: March 2023, March 8, 2023
- Scenario Analysis: How Much Shock Can U.K. RMBS Take? March 1, 2023

This report does not constitute a rating action.

The views expressed in the Macroeconomic Outlook section (pages 6-8) 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: Q2 2023 Economic Data and Forecast Summaries

Table 3

Real GDP (%)

	Eurozone.	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Switz.	U.K.
2021	5.3	2.6	6.8	7	5.5	4.9	6.1	4.2	7.6
2022	3.5	1.8	2.6	3.9	5.5	4.5	3.1	2.1	4
2023f	0.3	0	0.4	0.4	1.1	0.9	0.5	0.6	-0.5
2024f	1	0.9	1.2	1	1.6	1.3	1.4	1.2	1.5
2025f	1.7	1.8	1.6	1.4	2.3	1.8	1.8	1.7	1.8
2026f	1.6	1.7	1.4	1.4	2.2	1.9	1.3	1.2	1.6

Table 4

CPI inflation (%)

	Eurozone.	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Switz.	U.K.
2021	2.6	3.2	2.1	1.9	3.0	2.8	3.2	0.6	2.6
2022	8.4	8.7	5.9	8.7	8.4	11.7	10.4	2.9	9.1
2023f	5.9	6.7	5.4	6.5	4.6	4.8	4.6	2.5	5.8
2024f	2.7	2.9	2.3	2.3	3.2	3.4	2.6	1.5	1.4
2025f	2.0	2.0	2.0	2.0	1.7	2.3	1.3	1.5	1.1
2026f	1.9	1.6	2.1	2.0	2,0	2.3	1.8	1.6	1.7

Table 5

Unemployment rate (%)

	Eurozone.	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Switz.	U.K.
2021	7.7	3.6	7.9	9.5	14.8	4.2	6.3	5.1	4.5
2022	6.7	3.0	7.3	8.1	12.9	3.5	5.5	4.3	3.7
2023f	6.9	3.2	7.6	8.2	13.0	3.9	5.9	4.2	4.3
2024f	7.2	3.2	7.9	8.2	13.2	4.0	6.0	4.2	4.5
2025f	7.0	3.1	7.9	8.0	12.9	3.8	5.9	4.0	4.2
2026f	6.8	3.0	7.6	7.8	12.6	3.7	5.7	4.0	4.0

Table 6

10y Government Bond Yields (% annual average)

	Eurozone.	Ger.	Fra.	Ita.	Spa.	Neth.	Belg.	Switz.	U.K.
2021	0.1	-0.3	-0.1	0.8	0.4	-0.2	0.0	-0.2	0.7
2022	1.8	1.2	1.6	3.2	2.2	1.4	1.7	0.8	2.3
2023f	3.4	2.8	3.3	4.7	4.0	3.3	3.4	1.6	3.5
2024f	3.7	3.1	3.6	5.0	4.3	3.3	3.7	2.1	3.4
2025f	3.5	2.8	3.3	4.8	4.1	3.1	3.4	1.9	3.3
2026f	3.4	2.7	3.2	4.7	3.8	3.0	3.3	1.8	3.3

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

Table 7

Exchange rates (annual average)

	---- Eurozone ----		---- U.K.----		---- Switzerland ----	
	US$/€	€/US$	US$/£	€/£	SFr/US$	SFr/€
2021	1.18	0.85	1.38	1.16	0.91	1.08
2022	1.04	0.96	1.22	1.17	0.96	1.00
2023f	1.07	0.93	1.21	1.13	0.92	0.99
2024f	1.12	0.89	1.29	1.15	0.92	1.03
2025f	1.17	0.86	1.37	1.17	0.94	1.09
2026f	1.17	0.86	1.38	1.18	0.95	1.12

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

Table 8

Policy Interest Rates (% end-of-year)

	----Eurozone (ECB)----		U.K. (BoE)	Switzerland (SNB)
Policy Rates	**Refi Rate**	**Deposit Rate**	**Bank Rate**	**Policy Rate**
2021	0.00	-0.50	0.25	-0.75
2022	2.50	2.00	3.50	1.00
2023f	4.00	3.50	4.25	1.75
2024f	3.50	3.00	2.85	1.25
2025f	2.50	2.00	2.50	1.00
2026f	2.50	2.00	2.50	1.00

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