

# Resilience Under Pressure Amid Tighter Financial Conditions

Sept. 26, 2023

*This report does not constitute a rating action.*

## Key Takeaways

- **Overall:** We expect official rates, which are at or close to their peak, will stay high for longer as inflation in the eurozone might only return to its 2% target in late 2025. This will weigh on growth, keep financing conditions tight--even tighter in real terms--and inevitably increase the focus on cash flows, debt service, and sustainability.
- **Risks:** The four key risks have changed little between the second and third quarter. They include a stagnating European economy on the cusp of a shallow recession; tight financing conditions exposing financial vulnerabilities, with the default rate gradually rising toward 3.75% in the coming quarters; tail risks linked to Russia's invasion of Ukraine; and higher refinancing costs and lower valuations putting pressure on real estate credit quality. Also on our radar are potential spillovers from a sharper economic slowdown in China than we expect and heightened trade tensions.
- **Ratings:** The trend in credit quality is turning negative for corporates, especially for speculative-grade issuers, as financing conditions tighten. Real estate remains one of the most exposed sectors. For European banks, while asset quality deterioration will emerge, credit losses are expected to only normalize. We expect structured finance ratings will remain robust in the face of modest stress.

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. 20, 2023.

**The European economy is close to stalling as financing conditions ratchet tighter, labor markets come off the boil, and businesses face slowing earnings momentum.** Consequently, the resilience of corporate ratings is fading as margins start to normalize, albeit unevenly, across sectors and rating categories. The European bank rating outlook remains stable. Asset quality deterioration will become more evident in the coming quarters, but most banks are well placed to absorb higher credit costs. Similarly, structured finance ratings remain generally robust. They reflect inherent structural protections, only a gradual erosion in collateral asset quality, and high employment levels, even as high inflation and interest rates place consumer categories under increasing pressure.

**In this context, European speculative-grade defaults will continue to increase gradually and reach 3.75% by June 2024 in our base case, from the latest print of 3.4% in August 2023.**

Defaults include some companies with significant amounts of outstanding debt. Recent defaults

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## Credit Conditions Europe Q4 2023: Resilience Under Pressure Amid Tighter Financial Conditions

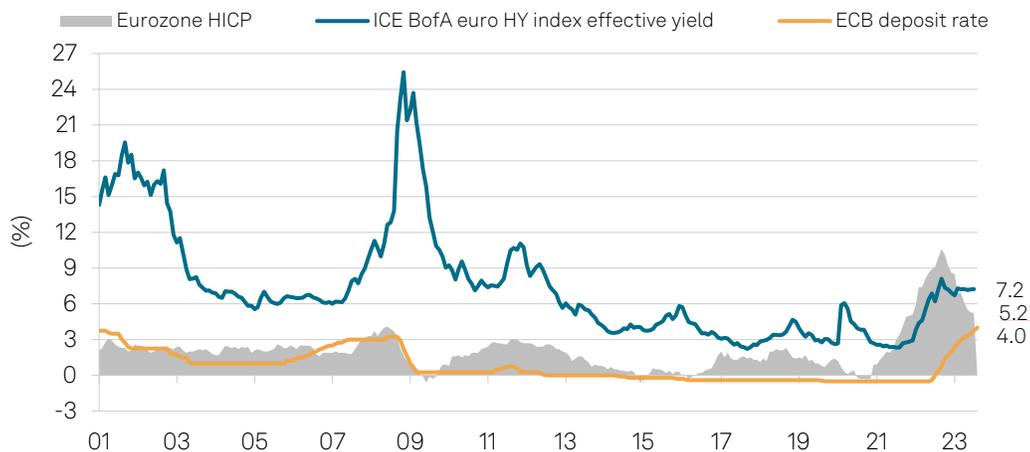
comprise Casino Guichard - Perrachon S.A. (defaulted with over €9 billion of outstanding debt), Transocean Ltd. (€6.9 billion), and Mallinckrodt PLC (€4.9 billion). Among the weakest links other highly indebted companies include Adler Group S.A., Samhallsbyggnadsbolaget i Norden AB (publ), and Vedanta Resources Ltd.

**The outlook for inflation and central banks' reaction to it remain a key focus from a credit perspective.** While headline inflation decreases, the path to price stability will be bumpy. We expect inflation will only return to the ECB's 2% target in late 2025. Even though interest rates in the eurozone may have peaked, we do not expect that the ECB will start cutting rates until the second half of 2024. Furthermore, the ECB might accelerate scaling back its balance sheet considerably by actively selling bonds, which could put upward pressure on yields.

**Consequently, financing conditions will remain tight in nominal terms and become even tighter in real terms.** This raises the incentive for borrowers to delever if they have the financial flexibility. As highlighted in chart 1, the post-COVID-19 dip in inflation and the, in retrospect, extensive policy support by western authorities brought the era of financial repression to a close. In line with our expectation that official rates and sovereign yields in Europe will turn positive in real terms in the coming quarters, even as growth stagnates, the focus on cash flows, debt service, and sustainability will increase inevitably.

Chart 1

### Revenge of inflation: The end of financial repression (2009-2021)



HICP--Harmonised index of consumer prices. Sources: ECB, Eurostat, FRED at Federal Reserve Bank of St. Louis, and S&P Global Market Intelligence.

**In this environment, we expect that corporate credit quality will deteriorate through the rest of the year, after holding up relatively well in the first half of 2023 because of strong results.**

The negative outlook bias, particularly on the ratings on speculative-grade companies, has increased since summer 2022 (see chart 2). Yet, we saw marked shifts in the net outlook bias at the sector level (see chart 3). Real estate and technology are the weakest sectors in that regard and have suffered sharp falls in the net negative outlook bias since December 2022.

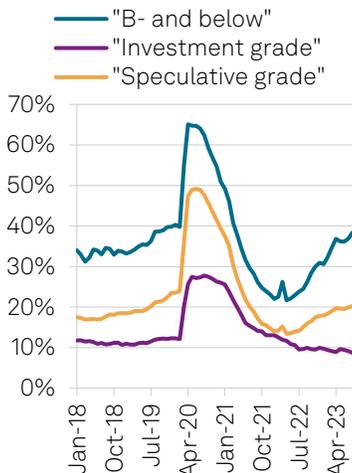
**Liquidity is a key issue for real estate companies, especially for speculative-grade entities, as refinancing risks have increased.** Banks' tightening underwriting standards, a surge in debt maturities, and a gradual downward trend in external valuations contribute to the liquidity squeeze. For rated European real estate investment trusts (REITs), we continue to assume an average peak-to-trough asset correction of just over 10%, ranging from 5%-24%. Location and asset quality will be key determinants. We do not expect that the investment market will recover fully before interest rates stabilize in 2024. We note that most European leases are linked to

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inflation via indexation and expect that indexation will remain robust this year, partially mitigating any potential drops in occupancy levels and market rents.

Chart 2

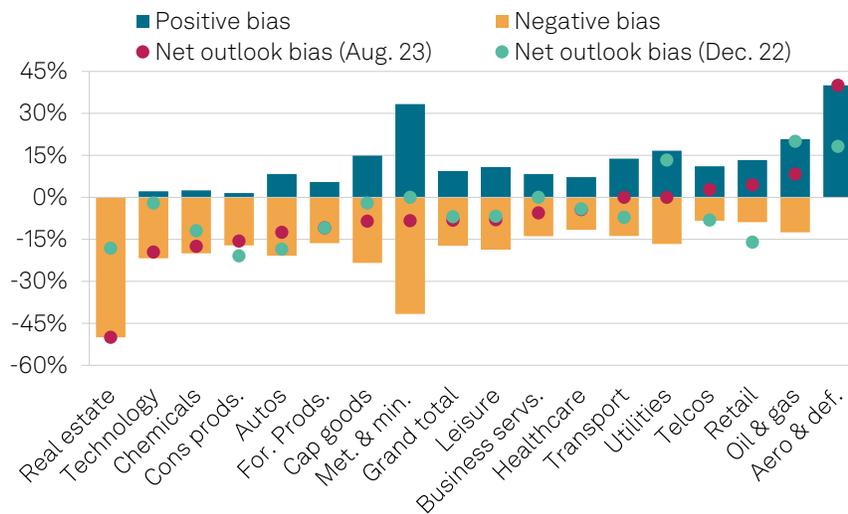
### Negative outlook bias for lower-rated European issuers increases



Data as of Aug. 31, 2023.  
Source: S&P Global Ratings

Chart 3

### European speculative grade corporate outlook bias by sector



Positive bias--Percentage of issuers with a positive outlook or CreditWatch placement. Negative bias--Percentage of issuers with a negative outlook or on CreditWatch. Net outlook bias--Percentage of issuers with a positive bias minus the percentage of issuers with a negative bias. Source: S&P Global Ratings.

**In the tech sector, some weaker IT service providers experience slower-than-expected growth, continued supply chain pressures, and rising costs due to inflation.** This could translate into weaker profitability and minimal or negative cash flow generation, including situations where working capital outflows could increase as trading volumes pick-up.

**Many chemical companies' operating performance has decreased sharply from top cycle levels because of underlying demand softness across many end-markets and customer destocking.** This has eroded cash flow generation and liquidity for some more vulnerable companies and delayed any expected deleveraging.

**Within financial institutions, we expect European banks will be broadly resilient to the economic slowdown.** Asset quality metrics remain benign for now. This means the increase in asset quality deterioration will not lead to a spike, but a normalization, of loan losses from their current lows. We expect asset quality deterioration will intensify in the coming quarters, with small and midsize enterprise (SME) loans, commercial real estate (CRE) exposures, and unsecured consumer credit among the most vulnerable. With loan growth slowing and deposit costs rising, we expect banks' net interest margins will peak this year and will be broadly flat in 2024. Concerns center more on non-bank financial institutions where the funding market remains unsupportive of weaker names that see pressure on business volumes, weakening debt service coverage, or both.

**In European structured finance, ratings have generally continued to rise.** Delinquencies increased in transactions backed by U.K. buy-to-let (BTL) mortgages and nonconforming mortgage loans. Even so, signs of stress elsewhere in structured finance deals--including mortgage pools backing prime and owner-occupied residential mortgage-backed security (RMBS) deals as well as in asset-backed security (ABS) deals in the auto sector--are limited, despite cost-of-living pressures on household borrowers. Strong labor markets continue to support credit quality. In asset classes that exhibit performance deterioration, credit performance is unlikely to stabilize before the second half of 2024.

**For EU sovereigns, a more contractionary fiscal stance applies from 2024 as the escape clause of the EU Stability and Growth Pact comes to an end.** The reduced scope for public spending and slowing growth will likely test voters' patience and strain governing coalitions across the continent. Adding disinflation to slowing growth means that government tax receipts will be much lower than in 2022.

**The primary insurance sector maintains a position of capital strength, liquidity, and rising re-investment rates.** This underpins our broadly stable outlook on the sector. We remain cautious over life insurers' illiquid investments in real estate, private credit, and private equity, which may lead to higher impairments over the coming years.

**Local and regional governments' budgetary performance will suffer from the economic slowdown as higher interest rates and higher operating expenses take their toll.** Property-related transaction fees and property taxes will likely decline further as activity and valuations in real estate markets cool down.

**In terms of systemic risks, we see the overall risk trend over the next twelve months as generally quite stable, although our risk assessment remains high for the three top risks, namely:**

- **The stagnating European economy being dragged into a shallow recession as high--and rising--real rates feed through to the economy, the pandemic recovery fades, and business confidence falters.** To a large extent, the severity of any recession, which potentially could occur at the end of this year or the beginning of 2024, depends largely on the resilience of labor markets and the extent to which the NextGen EU investment program is implemented as planned.
- **Tighter financing conditions expose financial vulnerabilities for entities finding access to financing restricted and the cost of debt service prohibitive.** A potential red flag is that borrowers who are least able to refinance are most likely to run down the maturity of their cheap debt, in the hope that the cycle will turn or that a corporate event can provide the necessary liquidity.
- **Russia's ongoing invasion of Ukraine remains the key geopolitical risk for the region.** The high risk relates not so much to the credit complications caused by the fighting in the conflict zone in eastern Ukraine. In fact, we think the line of conflict is fairly static, which supports our view that a military stalemate is the most likely outcome. Instead, the high risk relates to the highly negative effect of various low-probability tail risks that could lead to an escalation of the conflict, with severe negative repercussions for the economy and financial markets regionally if not globally.

**In real estate, downside risks in certain segments and regions continue to build, particularly if interest rates rise even further to ease inflationary pressures.** Consequently, we have moved our risk assessment to elevated from moderate. While the market remains orderly, property transactions remain infrequent. This raises the risk of distressed sales, which could lead to a rapid repricing in some parts of the market and expose banks and investors to higher credit losses.

**We have incorporated as a new moderate risk potential spillovers from a further unexpected economic slowdown in China.** This could impair other economies, particularly those with strong trade links with China, for example Germany and the Netherlands. The risk of Europe adopting a more aggressive protectionist stance in certain key product areas, including electric vehicle batteries, solar panels, and semiconductors, increases trade tensions with China and could disrupt supply chains, slow down investments, and negatively affect businesses with material operations in China.

## Top European Risks

### Recession in Europe remains a downside risk

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

European economic growth remains lackluster as higher rates feed through to the economy, the pandemic recovery fades, and consumer and business confidence remains brittle. In this environment, we are particularly wary of credit risks that result from an extended period of high interest rate increases in real terms and a stronger focus on debt sustainability. While CRE markets and trends in consumer behavior are among the most visible signals, a significant negative credit and fiscal impulse could presage a downturn in the production and investment cycle and drag stagnant European economies into recession. The severity of any recession would largely depend on the resilience of labor markets and the extent to which public investments, notably related to the NextGen EU program, are implemented on time.

### Tighter financing conditions will test financial vulnerabilities

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

High short-term nominal interest rates in restrictive territory and, as headline inflation subsides, an extended period of positive real rates could increase financial vulnerabilities for issuers finding access to financing restricted and the cost of debt service prohibitive. Tightening credit standards for bank lending and central banks aiming to shrink their balance sheets could exacerbate the situation. More vulnerable categories include CRE, corporates with near-term refinancing requirements and high leverage, and non-bank financial institutions that operate with high leverage, run structural liquidity mismatches, or take significant asset quality risks.

### Escalation of the Russia-Ukraine conflict could have a destabilizing effect

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

The fairly static line of conflict in Ukraine reinforces our base-case assumption that a stalemate is the most likely outcome. Yet, tail risks remain high, even though western nations' provision of sophisticated military support to Ukraine and more frequent drone strikes on the Russian mainland have not provoked Russia into launching asymmetric actions against NATO countries or into using unconventional weapons in Ukraine. Russia's procurement of lethal weapons from China or, possibly, North Korea would be a destabilizing development. Any material escalation or broadening of the conflict could reverberate through the global economy and destabilize financial markets.

### Real estate companies' exposure to cost of capital remains high

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

High interest rates and falling valuations continue to put pressure on credit quality in the European real estate sector. A clear risk is that interest rates and associated financing costs could remain at their current high levels over an extended period. This would exacerbate the increasing challenge of financing renovations to meet environmental regulations, on top of the difficulties borrowers are already experiencing, given the lower risk appetite for CRE in the bond market and among banks. While banks brace for a deterioration in CRE asset quality, most CRE bank lending in the EU comes from larger banks, whose capacity to absorb potential losses is higher. Even so, any surge in distressed sales could undermine sentiment in the market and expose banks to higher credit losses. For residential property, higher mortgage rates and softening prices feed through to existing borrowers and new transactions. This creates spillovers for the broader economy, including negative effects on consumer confidence and spending and employment in the construction sector.

### China's structural economic slowdown amplifies potential spillovers from international trade tensions

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

An increase in trade tensions and protectionist sentiment means that certain sectors in Europe already struggle with de-risking China-linked global supply chains. They are exposed to any material shortfalls in China's economic growth that arise from further strains in the property market or evaporating consumer confidence. China's economic slowdown could have a detrimental effect on the operating performance of European multinational companies with substantial China exposures, including consumer product groups, original equipment manufacturers, and chemical companies. Second-order effects, resulting from a deterioration in business and financial market sentiment, could be significant.

## Structural risks

### Disruptions linked to climate change and the energy transition could increase

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

The necessary acceleration in Europe's energy transition, following the curtailment in Russian fossil fuel supplies, faces significant implementation challenges, even though the situation has improved, with greater preparedness and visibility on renewables implementation

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plans. Yet, slow permission processes and supply chain strains affect the market penetration of renewables, hydrogen, and biofuels, as well as energy efficiency improvements and heat-pump rollouts. On the one hand, the widening gap between the current emission trajectories and the ambitious decarbonization targets the EU aims to meet by 2030 may trigger policy action. On the other hand, heightened societal tensions could prompt policymakers to delay the 2030 goals. Abrupt, and potentially contradictory, changes in climate policy could disrupt industries and business models, notably in the automotive, building, cement, steel, chemicals, transportation, and utilities sectors.

### Cyber risks rise

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

The pace of digitalization, including artificial intelligence, 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 cybercrime organizations, 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 western authorities' military support for Ukraine. This could involve (mis)information operations and deepfake hoaxes to subvert western backing for the war in Ukraine. A more systemic risk would be a destructive cyber event on vital infrastructure in western nations.

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

- With higher interest rates curbing demand and post-pandemic tailwinds dissipating, we forecast eurozone GDP growth of just 0.6% this year and 0.9% in 2024. We see high risks for a shallow recession, particularly if labor markets weaken more than we expect.
- Inflation is falling, but price stability is still some way off. We expect inflation will only return to the ECB's 2% target in late 2025. The slow disinflation implies high interest rates for longer. Rates may have peaked, but we do not expect that the ECB will start cutting rates until the second half of 2024.
- Even with no further rate rises, the ECB is not yet done with monetary policy normalization. A more active form of quantitative tightening--such as the ECB reducing its reserves through selling bonds on the market rather than letting them expire--could be on the cards if slow disinflation persists. This would likely result in upward pressure on bond yields.

### Eurozone

**We confirm our GDP growth forecast for the eurozone economy.** We still expect growth will soften considerably to 0.6% this year and barely accelerate to 0.9% next year, before returning to growth of 1.5% in 2025 and 2026, in line with the growth potential.

**Our growth forecasts for certain countries are slightly different from our previous view.** We have revised downward our growth forecasts for 2023 and 2024 in countries that are heavily dependent on world trade and where the real estate market is correcting rapidly, such as Germany and the Netherlands. We have revised upward our growth forecasts, particularly for 2023, in countries where disinflation is faster and the labor market more resilient than we expected, such as Spain and Belgium. Otherwise, our baseline narrative has largely materialized.

**The slowdown is here to stay as post-COVID-19 tailwinds--companies hoarding labor and processing order backlogs--fade, while high inflation and rising interest rates significantly curb demand.** While the first normal tourist season since 2020 supported demand in the third quarter of 2023, the risk of the eurozone sliding into a shallow recession over the coming quarters is still high. The labor market, which surprised positively in the second quarter, will be decisive for growth prospects next year. Its tightness and resilience are the main reasons why we do not expect a more pronounced slowdown as accelerating wages, combined with slowing inflation, ease income constraints for households. The recovery in real disposable income should mitigate the dampening effects of rising interest rates on demand by 2024 and even exceed them by 2025. Should the labor market weaken more than we expect, we may have to revise our base scenario downward.

**We revised downward marginally our inflation forecast for 2023 to 5.6%, from 5.8%, due to a faster-than-expected fall in energy prices, particularly in Spain.** Yet, we continue to expect that inflation will reach 2.7% next year and will not return to the 2% target until the second half of 2025. The recent surge in oil prices and the removal of government subsidies on domestic energy prices in some countries will translate into slower disinflation from now on. While first-round effects fade, second-round effects persist. Growth in unit labor costs accelerated to 6.3% in the second quarter. Even if headline inflation halved to 5.3% in August from its peak of 10.6% in October 2022, price stability is still a long way off. We estimate that prices for two-thirds of the consumer basket will continue to rise at a rate of over 4% a year (see chart 4).

**Against a backdrop of slow, limited disinflation, we believe the ECB is not yet done with normalizing its monetary policy.** Interest rates may have reached their peak--at 4% for the deposit rate--but we believe the ECB has further work to do on quantitative tightening and the

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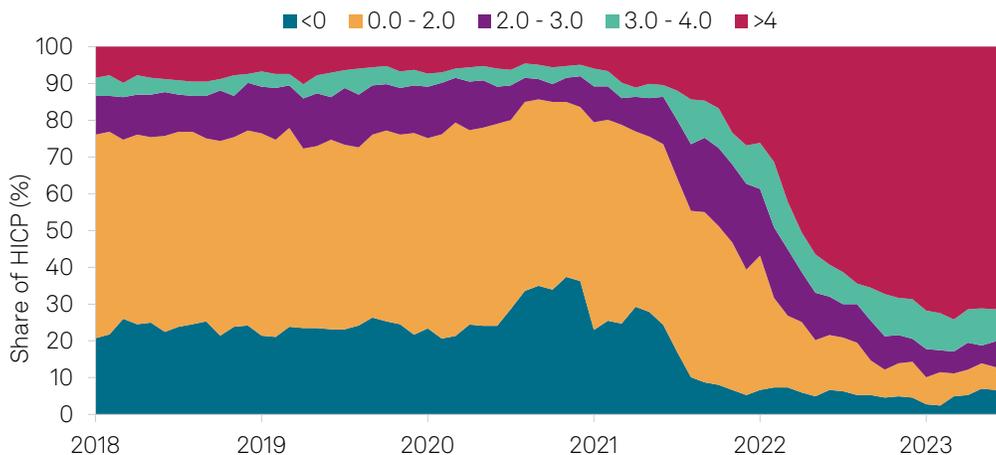
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way it supplies banks with liquidity (see "[What An Acceleration of Quantitative Tightening Could Mean for Eurozone Banks](#)," Sept. 13, 2023). If inflation does exceed the 2% target for another two years, the current form of quantitative tightening--extinguishing bank reserves by letting bonds held by the ECB mature--could give way to a more active form that sees the ECB selling bonds on the market. We expect the ECB Governing Council will discuss this by the end of the year. Some upward pressure on bond yields would be likely. Yet, it is not certain that active quantitative tightening would have the same effect on bond market yields as quantitative easing in reverse. We do not expect that the ECB will start cutting policy rates before the second half of 2024.

Chart 4

### Breakdown of the eurozone HICP basket by inflation rate

Share of goods and services by inflation rate band (in % of consumer basket)



HICP-- Harmonized index of consumer prices. Source: S&P Global Ratings.

### Key assumptions

- The conflict between Russia and Ukraine does not spread to other countries and no unconventional weapons are used.
- Energy supplies remain stable and bottlenecks in supply chains will not reappear.
- The Chinese economy does not slide into recession.
- The correction in European real estate markets does not derail financial conditions.

### Key risks

- Escalation of the conflict in Ukraine that could further test the resilience of Europe's economy.
- An unwarranted and disorderly tightening of global financing conditions, with central banks approaching peak rates and potentially accelerating quantitative tightening.
- Unemployment rate rising more than we expect due to sharp rises in unit labor costs that could weigh on corporate profits.

### What to look for over the next quarter

- Developments in the conflict between Russia and Ukraine.
- Effect of higher interest rates on financing conditions and domestic demand.

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- Labor market resilience.
- ECB communication about the future pace and form of quantitative tightening.

### U.K.

**Economic growth in the U.K. is set to remain muted into 2024 under the lingering impact of high inflation and high interest rates that will become increasingly restrictive in real terms.**

**Our fundamental view of the U.K. economic outlook has changed little since our last update in June this year.** The composition of growth components reported for the second quarter meant that we slightly revised the allocation of growth in 2023 and 2024. In particular, we expect household consumption, which expanded strongly in the second quarter, will see a downward correction in the second half of this year because the one-off factors that contributed to the expansion are no longer at play. We now expect some of the slowdown will materialize in 2024, instead of this year. We therefore forecast GDP growth of 0.3% in 2023, up from 0%, and 0.5% in 2024, down from 0.8%.

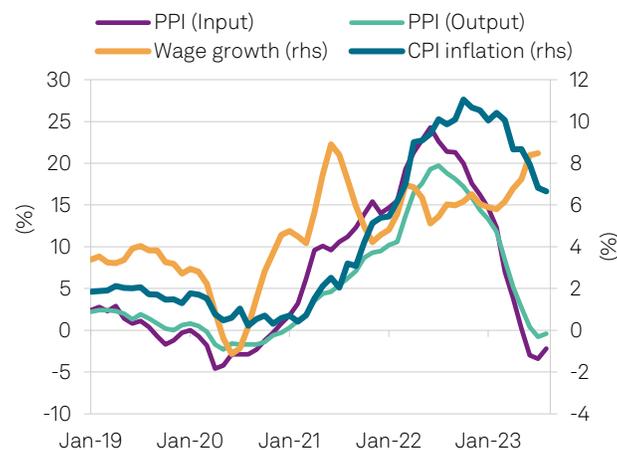
**Core and services inflation reduced markedly in August, although levels remain high.** An uptick in global oil prices prevented headline inflation to fall to a similar degree, but there are still significant downward pressures in the pipeline, notably from producer prices (see chart 5), and inflation could reach the 2% target in the second half of next year.

**The Bank of England has increased its policy rate aggressively over the past quarters.** The recent decline in core inflation provided some good news the BoE had been waiting for. The BoE did not raise rates further in its meeting on Sept. 21, 2023. Further action will depend on whether disinflationary trends can be confirmed in the next months. The BoE will, in particular, watch out if pay growth, currently still at record highs, will start to ease.

**Meanwhile, tighter financing conditions are already taking hold in the economy, but it will take some time until they reach their full effect.** As inflation continues to decrease gradually, the policy rate will become increasingly restrictive in real terms (see chart 6). It should curb activity and underlying inflation pressures sufficiently, so that the BoE might not have to increase rates beyond the current levels of 5.25%.

Chart 5

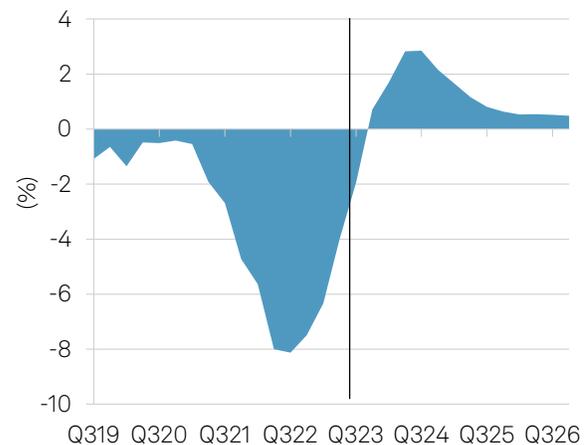
#### Inflation is easing, but wage growth has remained elevated



Note: Total wage growth whole economy - three- month moving average. PPI--Producer price index. Rhs --Right axis. Sources: ONS, S&P Global Ratings.

Chart 6

#### Interest rates become increasingly restrictive Bank rate, adjusted for inflation



Source: S&P Global Ratings.

## Financing Conditions

- High-for-longer interest rates and positive real rates in 2024 will likely lead to tightening financing conditions, which could be exacerbated by an acceleration in quantitative tightening.
- Recent tightening trends in credit pricing will likely stall, particularly among lower-rated speculative-grade issuers, as economic pressures remain and financing costs increase.
- Near-term refinancing risk is limited, but high-for-longer interest rates bring upcoming maturities into view, with speculative-grade maturities peaking at 25% in 2026.
- We see a further divergence of credit trends between investment- and speculative-grade issuers. Defaults will continue to rise and we expect the European trailing 12-month speculative-grade corporate default rate will reach 3.75% by June 2024, from 3.40% in August 2023.

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**Elevated nominal and real interest rates will remain an overarching theme.** The ECB's recent rate hike, the 10th in succession, has brought rates to their highest point since the establishment of the ECB. Arguably as important was the communication that rates will likely remain elevated for a "sufficiently long duration." We expect high-for-longer rates will underpin credit financing costs for the foreseeable future.

**Real rates (looking at German bunds) are on an upward trajectory and will likely increase further as nominal rates stay high for longer and monetary policy effects lag the fall in inflation.** At the same time, we cannot rule out that the ECB will accelerate quantitative tightening. We expect overall financing conditions will tighten in 2024 and affect lower-rated issuers the most.

**Credit markets remain generally constructive, but the question is, for how long.** While corporate yields moved upward, credit risk premia generally remained stable. The iTraxx Europe index spread was at about 70 basis points (bps) as of Sept. 20, 2023, after starting the year at 79 bps. The positive tone is also evident at the speculative-grade level, with the iTraxx Crossover index spread at about 405 bps, compared with 475 bps at the beginning of 2023 (see chart 7). Still, further tightening might be unlikely. For example, the cost of credit options is moving higher as investors hedge against tail risk. Additionally, appetite for lower-rated assets may remain muted in a high-for-longer environment as investors seek better relative value higher up the credit spectrum.

**Refinancing risk is limited but more challenging for lower-rated issuers with floating-rate debt.** The rebound in speculative-grade bond issues, which is up by about 37% compared with the same period in 2022, has alleviated some near-term refinancing concerns, specifically for lower-rated issuers. As of mid-year 2023, only 7.5% of corporate debt maturities remaining in 2023 were speculative-grade and the majority of them were higher-rated 'BB' issuers. Refinancing risk will increase in subsequent years but only marginally, at least initially. It will remain below 10% in 2024 before jumping to 17% in 2025 and reaching its peak of 25% in 2026 (see chart 8). While this may suggest limited risk, issuers generally seek to refinance at least 12-24 months in advance of maturities. This brings 2025 maturities firmly into view, especially against the backdrop of the highest nominal rates since the creation of the ECB. Refinancing risk is not limited to high yield bond markets since approximately 44% of speculative-grade debt maturing through 2024 is floating rate, primarily in the 'B' rating category.

**The divergence in rating performance becomes increasingly pronounced as defaults rise.** Investment-grade rating trends remain stable, but the picture on the speculative-grade side differs, with more pronounced negative pressure at the lower end. We saw a sharp rise in the number of weakest links (rated 'B-' and below with a negative look), which recently hit their

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highest point in over two years. The negative bias is also mounting for issuers that are rated 'B-' and below and is the highest since April 2021. Many of the weakest issuers come from consumer-facing sectors, such as consumer products and media and entertainment. Both sectors rely on resilient consulspending--which is under pressure due to inflation and high interest rates--and will likely contribute to the future increase in European defaults. We expect the European trailing 12-month speculative-grade corporate default rate will reach 3.75% by June 2024, from 3.40% in August 2023. We have seen 19 defaults in the year so far (to end-August), compared with seven for the same period last year.

Chart 7

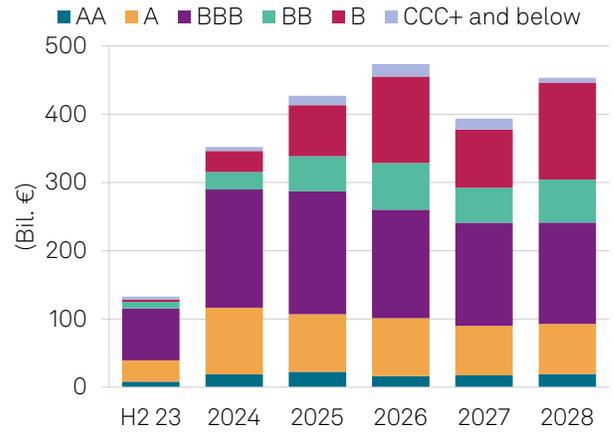
**Recent resilience in credit pricing will likely come under pressure**



Bps-- Basis points. Data as of Sept. 12, 2023. Source: S&P Global Market Intelligence.

Chart 8

**European nonfinancial corporate debt maturities by rating category**



Data as of 1, 2023. Includes European nonfinancial corporate issuers' bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings. Source: S&P Global Ratings Credit Research & Insights.

## Credit Cycle Indicator

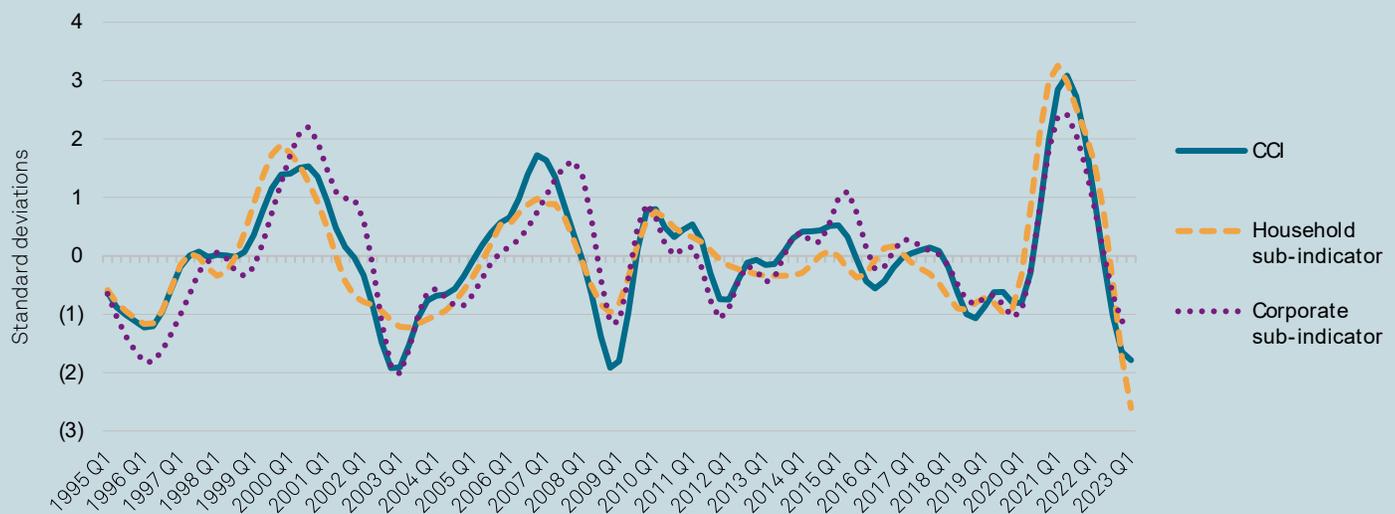
### Early signs of decreasing credit stress, but economic resilience will be tested further

Our eurozone Credit Cycle Indicator (CCI) reached a peak of 3.1 standard deviations in the second quarter of 2021 (see chart 9). Based on statistical precedent, this points to potentially heightened credit stress six to 10 quarters later, meaning in the period from the fourth quarter of 2022 to the fourth quarter of 2023. Yet, material credit stress has been relatively limited in Europe so far. The economy proved resilient and inflation helped ease corporate and household debt burdens in real terms. Indeed, the recovery in the CCI over the past six quarters has been unprecedented in the relatively short history of this series. Nonetheless, we remain cautious, given the softening economic outlook for the rest of year and next and because the full effect of high-for-longer nominal interest rates--and positive rates in real terms from 2024--is still uncertain.

For more details about our proprietary CCI, see "[White Paper: Introducing Our Credit Cycle Indicator](#)," June 27, 2022.

Chart 9

### High interest rates will likely become positive in real terms and point to credit stress deferred, not avoided



CCI--Credit Cycle Indicator. Peaks in the CCI tend to lead credit stresses by six to 10 quarters. When the CCI's upward trend is prolonged or the CCI nears upper thresholds, the associated credit stress tends to be I. Sovereign risk is not included as a formal part of the CCI. Sources: Bank for International Settlements, Bloomberg, S&P Global Ratings. Data as of the first quarter of 2023.

**Corporates.** After peaking in the first quarter of 2021, the eurozone corporate sub-indicator descended rapidly from 2.4 standard deviations in the first quarter of 2021 to minus 1.2 at the start of this year. The economic and inflationary rebound from the pandemic spurred nominal growth across the eurozone and substantially helped reduce the corporate credit-to-GDP ratio to pre-pandemic levels. According to the Bank for International Settlements, the ratio was 101% in the first quarter of 2023, from a pandemic peak of 112% in the first quarter of 2021. Although a declining CCI reading signals moderating stress going forward, higher rates, tougher financing conditions, and a stagnating economy may expose financial vulnerabilities in certain segments of the nonfinancial corporate sector in the near term.

**Households.** The household sub-indicator follows a trend that is similar to that of corporates in that a peak of 62% in the first quarter of 2021 was followed by a significant decline through to the start of this year. Over that period, total credit to eurozone households as a percentage of GDP decreased to a pre-pandemic level of 56% by the first quarter of 2023. To some extent, this moderation reflects the benefits of a strong labor market and the lagged effect of higher rates feeding through to end users. As the effect of rate rises on debt repayments materializes, households with minimal savings could struggle and face difficulty accessing credit, especially in the event of an economic downturn and rising unemployment.

# Financial Institutions

- European banks should be resilient to the ongoing economic slowdown. Asset quality deterioration will likely become more evident over the coming quarters, particularly for SME loans, unsecured consumer credit, and CRE exposures. Yet, the deterioration should be contained, with credit costs normalizing, not spiking.
- For 2024, subdued business volumes, flattening net interest margins, and higher credit costs will likely stall the sharp uptick in bank profits that we are seeing in 2023. Still, we expect earnings will remain solid and enable banks to continue shareholder distributions while maintaining capital ratios.
- Tighter financial conditions are a key risk. For example, the ECB's move to a significantly more active approach to quantitative tightening could accelerate a liquidity drainage and cause market turbulence, raising refinancing risks for non-banks and exposing banks to counterparty risks.

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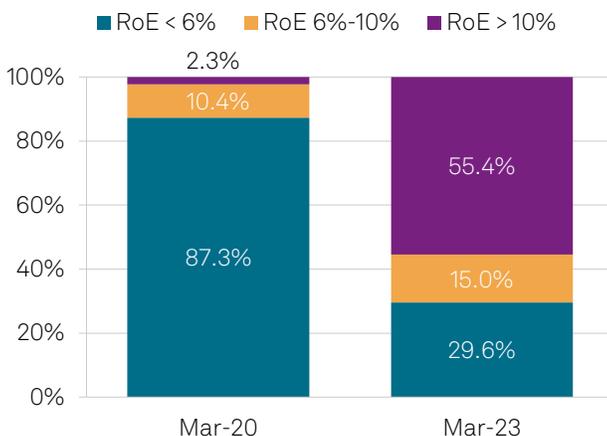
## Key Developments

**Higher interest rates have the effects expected.** The annual growth rate of loans eurozone banks made to resident households and the corporate sector fell to 1.6% in July, from 5.4% in December 2022. Further deceleration is likely, given prevailing high rates, the slowdown in economic activity, and banks' tightening credit standards. For deposits, similar trends are at play. The increase in household deposits almost came to a standstill in July, while corporate deposits are declining. If quantitative tightening accelerates, further deposit outflows from the banking system are inevitable. Yet, we expect that outflows will remain moderate and that banks' solid liquidity positions can help absorb them.

**Banks' profitability maintains its upward trend.** Most banks continued to report stronger results in the second quarter (see chart 10). Some raised their guidance for year-end as assets continued to reprice at higher rates and the increase in deposit costs remained contained (see chart 11). For most banks, net interest income will likely peak in 2023 and remain flat in 2024. Strong earnings more than offset some pressure on costs and likely higher credit provisions.

Chart 10

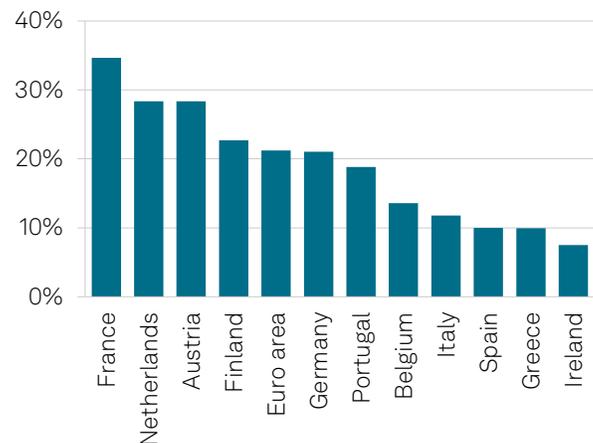
**European banks become more profitable**  
 More than half now report RoE in excess of 10%



Distribution of banks' return on equity. RoE--Return on equity. Source: EBA.

Chart 11

**Slow deposit repricing supports bank margins**  
 Eurozone banks' deposit beta on new deposits



Data shows eurozone banks' deposit beta on new deposits between June 2022 and June 2023 Source: S&P Global Ratings.

**Distributions to shareholders increase.** With improving profits, capital headroom above management targets, and modest expected balance sheet growth, many banks have increased or established new share buyback programs. Many banks' total distributions, including dividends and share buybacks, will remain at about 50%, meaning capitalization will remain solid.

**The EBA/ECB stress test results confirmed the resilience of banking systems to a severe asset quality deterioration and market shocks.** The results show that EU banks would, on average, see a capital depletion of 459 bps in the stress scenario. In aggregate, banks' common equity tier 1 (CET1) ratios would remain comfortably over 10%. Only three banks would experience a drop in capital below their capital requirement and a further 34 banks would be forced to skip distributions to shareholders and holders of additional tier 1 (AT1) instruments. The stressed macro assumptions were harsher than in the previous exercise in 2021, resulting in higher modelled losses. It is worth noting, though, that banks benefited from higher earnings, partly because of higher interest rates.

**Asset quality remains solid so far, although some signs of weaknesses emerge.** Corporate bankruptcies in Europe have increased for six consecutive quarters. Higher pricing costs put pressure on some riskier portfolios, including unsecured consumer loans, CRE exposures, and BTL mortgages. At the same time, banks increase credit loss provisions, albeit from overall very low levels. As economic activity continues to slow, asset quality deterioration will become more evident, particularly among highly leveraged SMEs and low-income individuals. We expect the deterioration will be contained, with credit costs normalizing, not spiking.

**CRE remains under pressure.** In light of lower valuations and slowing activity, CRE companies still face refinancing challenges. Capital markets have been reluctant to refinance weaker names in the sector, while banks tighten underwriting for CRE exposures, as happened with Swedish real estate landlord SBB. German and Swedish banks have the highest exposures to CRE, accounting for about 18%-19% of total loans, versus an average of 10% for other large European banks. For several banks in those systems, exposure exceeds their CET1 capital by at least two times.

**Targeted longer-term refinancing operation (TLTRO) borrowings are down by over 70%, but banks' liquidity remains solid.** TLTRO borrowings amounted to just below €600 billion at the end of July, down from €2.2 trillion in January 2022. Despite the decrease, banks' liquidity in the ECB deposit facility--the amount deposited in excess of mandatory reserve requirements--remained solid at €3.6 trillion.

**Non-bank financial institutions continue to see an outsized share of negative rating actions.** Non-bank financial institutions have diverse business models and performance drivers. The funding market remains unsupportive for weaker names that see pressure on business volumes, weakening debt service coverage, or both.

## Key Risks

- **Market turbulence and financial instability due to tighter financing conditions.** The ECB may accelerate the reduction of its balance sheet, draining liquidity at a higher pace than we expected initially. Financial institutions with weaker funding structures, especially non-bank financial institutions with high refinancing needs, will be more vulnerable. Banks could also be exposed to higher counterparty credit risks.
- **A protracted, painful recession.** This could undermine the financial health of corporates and households, weaken banks' asset quality, and cloud business prospects beyond our expectations.
- **Commercially and operationally fragile business models.** These will become an issue if banks do not tackle inefficiencies, digitalize their business, and sustain cyber resilience.

## Nonfinancial Corporates

- The effects of higher interest rates increasingly affect companies' credit metrics especially in the high yield segment. While the leverage ratio has reduced in several sectors relative to 2019, interest coverage ratios have weakened in others.
- For about two-thirds of the corporate sector, we forecast 2023 EBITDA margins in line with or below 2022 levels. An exception is the utilities sector, which was highly negatively affected by gas price increases in 2022. It should report the most significant rise in EBITDA margins.
- Ratings pressure increases for speculative-grade entities. The effects of higher interest rates and economic slowdown already affect lower-rated speculative-grade entities.
- We expect speculative-grade defaults will increase over the next 12 months. More challenging refinancing conditions and higher interest rates already led to an increase in the number of missed repayments, capital restructuring, and amendments and extensions that we consider as defaults under our methodology.

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### Key Developments

**The positive trend in rating actions is over.** Over the first eight months of this year, positive rating actions for European corporates outnumbered negative rating actions by more than 100 to less than 70. Yet, high yield companies increasingly deal with higher costs of debt and fewer, less favorable financing conditions. We expect that the number of downgrades among speculative-grade issuers will rise in the fourth quarter and, to a greater extent, in 2024. We do not envisage any similar trend in investment-grade companies but expect they will be resilient.

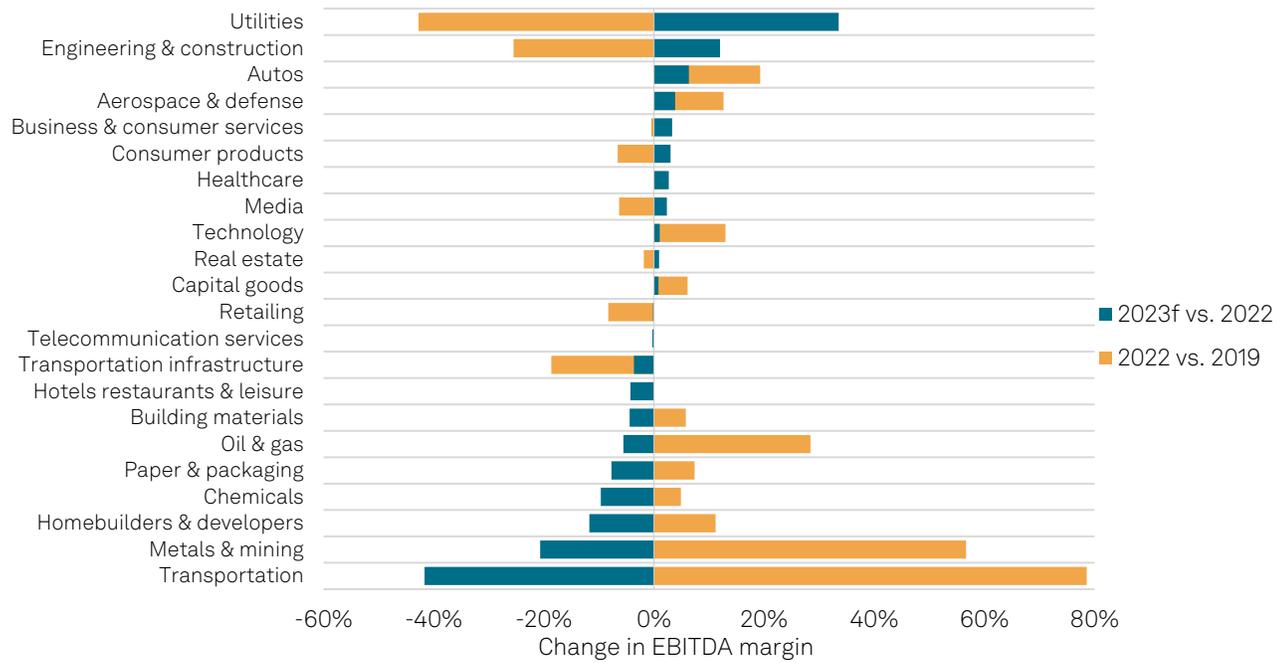
**Some sectors, including real estate, will suffer more than others.** The European CRE sector remains under pressure as higher rates increase the cost of debt and reduce asset valuations. Secular changes continue to negatively affect some CRE segments, such as the office market. More than 25% of ratings in the sector carry a negative outlook, with more than 13 downgrades (in some cases more than one notch) so far this year. We expect more to come.

**The chemical sector faces tougher conditions.** The spike in gas prices in 2022 eroded operating profits, but many chemical companies maintained solid credit ratios, supported by the post-pandemic increase in demand in 2021. Gas prices are now lower but still considerably higher than they were before the Russia-Ukraine war. This, combined with a cross-border economic slowdown and reduced rating headroom, has led to an increase in negative rating outlooks and the downgrades of some chemical companies, including the downgrade of BASF SE (A-/Stable/A-2) on Aug. 2, 2023.

**Margin normalization is under way, but some sectors remain on top (see chart 12).** After several years of substantial monetary and fiscal stimuli, business dynamics are normalizing. In particular, supply demand imbalances are dissipating, evidenced by diminishing inflation and corporate margins returning to more typical levels. Sectors that were among the primary beneficiaries of the post-COVID-19 landscape witness the swiftest normalization. Profitability in sectors such as transportation, metals and mining, and oil and gas declined, compared with 2022, but remains significantly above pre-pandemic levels, indicating potential for further contraction (see chart 12). That said, many entities within these sectors used the post-COVID bounce to reduce leverage and enhance credit profiles, which supported the ratings on these entities.

Chart 12

EBITDA margins normalize across European corporate sectors

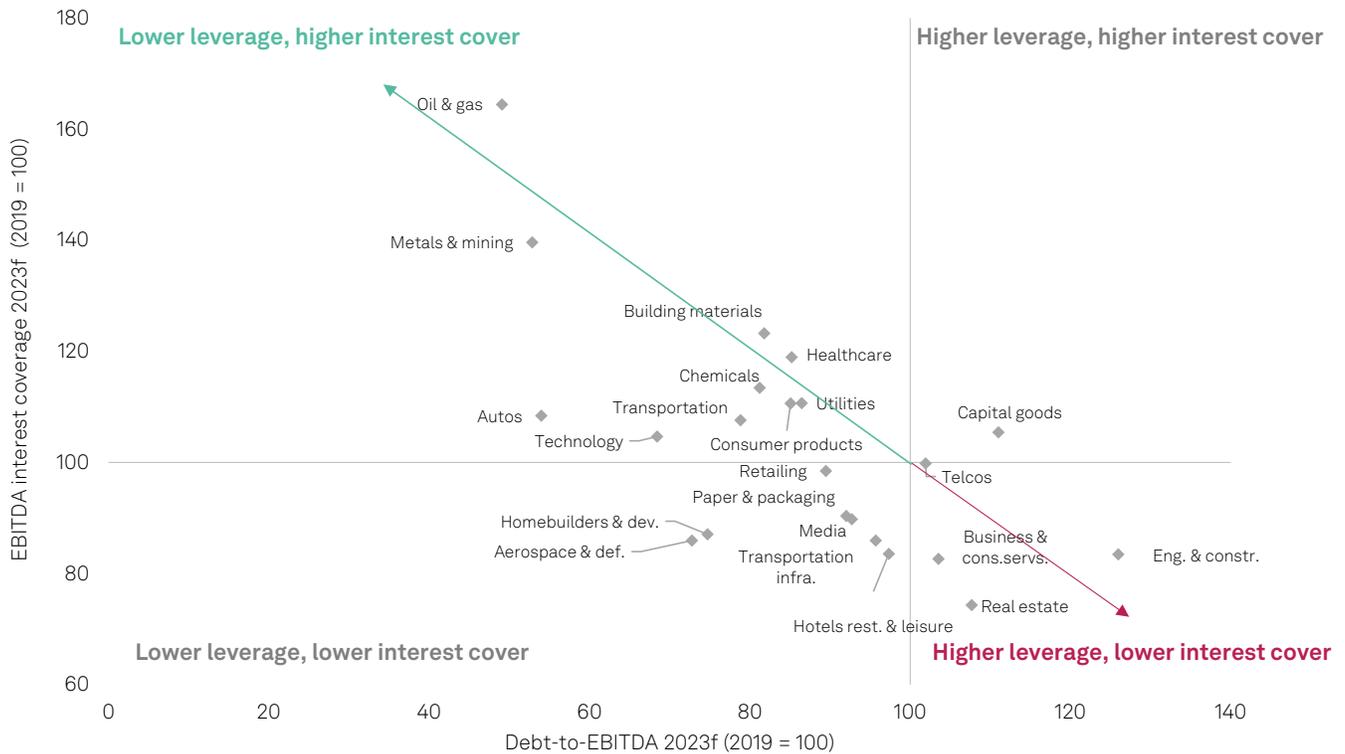


f--Forecast. Source: S&P Global Ratings.

Chart 13

Leverage is reducing, but in some sectors interest coverage is weakening

Forecast 2023 leverage and interest cover by sector, relative to 2019



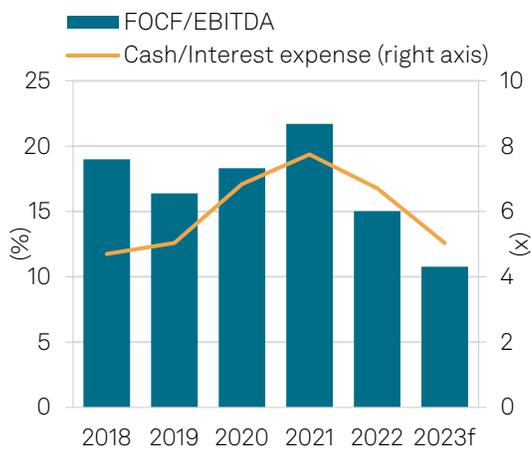
f--Forecast. Source: S&P Global Ratings.

**The impact from higher interest rates on debt servicing costs gradually materializes.** Among the 22 corporate sectors, 17 currently have lower leverage than in 2019. The increase in EBITDA outpaced the rise in debt servicing costs and bolstered interest coverage for 11 of these sectors, relative to 2019 levels. Among the sectors facing the greatest challenges in this context, real estate, business and consumer services, and engineering and construction emerge as the most adversely impacted, as they bear higher debt burdens and consequently grapple with more substantial interest obligations relative to their EBITDA (see chart 13).

**Rising rates squeeze corporates' liquidity.** Liquidity is depleting as surplus cash accumulated during COVID-19 diminishes. Higher interest rates affect corporate balance sheets. On average, corporate cash reserves now stand at five times their interest expense, which is lower than the peak of eight times in 2021 and marks a return to pre-pandemic levels (see chart 14). Rising interest rates and working capital requirements also impair the conversion of EBITDA into cash.

Chart 14

European corporates' liquidity is reducing



f--Forecast. Credit metrics are S&P Global Ratings-adjusted. Source: S&P Global Ratings.

Key Risks

**Weaker-than-expected economic conditions.** Slower demand could hit volumes, revenues, and operating margins and put pressure on credit ratios and ratings, especially for lower-rated entities.

## Sovereigns

- Negative net lending, weakening external demand, soft manufacturing, and rising oil prices raise recession risks for many European sovereigns, albeit natural gas prices remain constrained.
- High and more costly government debt, and the re-activation of EU fiscal rules in 2024, rule out any contra-cyclical fiscal response to any new economic shocks. Bright spots include resilient labor markets, gradual disinflation, and buoyant tourism earnings, though all are likely to be tested this year and next.
- If there is a silver lining, it is that household savings are on the rise and that they represent an attractive alternative source of funding for European governments.

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## Key Developments

**Considering that the eurozone governments' fiscal response to the 2020 COVID-19 and 2022 energy shocks has resulted in a large build-up in government debt, relative to GDP, fiscal space to fight any future economic emergencies is very limited.**

**Weakened public finances, in our view, already have led to a deterioration in creditworthiness among sovereign borrowers.** But things may be about to become even more challenging for European treasuries. As intended, the ECB's successive policy hikes, which commenced in 2022, have materially weakened European domestic demand. As a consequence, private consumption and investment are beginning to roll over, even as external factors, especially the recent rise in oil prices and a flagging Chinese economy, impinge on growth. The slowdown, combined with disinflation, is already dragging on tax receipts after the very strong revenues enjoyed in 2022.

**On top of these pressures, a more contractionary EU wide fiscal stance takes effect from 2024.** At the end of this year, the general escape clause of the EU Stability and Growth Pact will be deactivated. EU member states must demonstrate how they will ensure a general government deficit below 3% of GDP over the medium term. They also need to maintain primary spending growth below country-specific recommendations and present credible plans to reduce debt significantly. Notwithstanding possible disagreements regarding the EU Commission's proposals to revise EU fiscal rules, fiscal policy will be contractionary next year, assuming no new external shocks.

**At the same time, the ECB continues to shrink its balance sheet and unwind its government bond purchases.** Rates on new debt are rising. To be clear, we do not expect large volatility in financing costs for governments. We believe the cost of new debt for eurozone governments is close to its peak. However, the average cost of total debt continues to rise.

**The higher-rate environment is also (again as intended) leading to outright declines in net bank lending across Europe--where activity is waning in more leveraged sectors, such as construction and property development--and an increase in private sector savings.** At 14% of gross income, household saving rates in the eurozone currently exceed pre-pandemic levels and might increase even further.

**Eurozone banks have been slow in passing on higher rates to savers and European debt management offices compete for savings.** This has resulted in notable declines in deposits in most eurozone banking systems. Sovereign issuers are increasingly tapping into the retail bond market, while, in many cases, reducing debt issuance to the wholesale market. This is evidenced by:

- Belgium's €22 billion one-year bond sale in late August;

## Credit Conditions Europe Q4 2023: Resilience Under Pressure Amid Tighter Financial Conditions

- Italy's sale of €18.9 billion in BTP Valore four-year bonds in June, with another issuance planned for October;
- Portugal's ramp-up in the issuance of short-maturity savings certificates to retail investors; and
- The fact that the bond spreads of sovereigns like Spain, whose issuance to retail investors is less tailored, have seen a slightly worse performance.

### Key Risks

**Rising political disunity leading to an increase in market volatility.** Eurozone governments' budgets will be under increasing scrutiny over the coming months to determine whether budgets target at least 0.5 percentage points of GDP in fiscal tightening and whether the path to reaching such budgets is credible. This could place strains on the governing coalitions, particularly in Italy. Other countries are not immune either. Apart from Italy, we also expect that Belgium and France will exceed the benchmark's general government deficit ceiling of minus 3% of GDP significantly in 2024.

**Worsening external conditions.** Should the external environment worsen significantly beyond our base case, policymakers could once again re-open some of the big policy debates on European risk-sharing and the fiscal union. Yet, we consider this as highly unlikely at this point. As was the case before, the absence of a large single European asset that can compete with U.S. Treasuries or Japanese government bonds puts eurozone national borrowers at a disadvantage from a cost and liquidity perspective. The EU's mandate to issue debt to finance the NextGen EU investment program and other eurozone facilities could change this (and provide some counter-cyclical support), but the size relativities at present are enormous.

# Structured Finance

- Overall delinquencies for prime owner-occupied RMBS did not increase significantly, but the U.K. BTL sector and nonconforming sectors deteriorated somewhat.
- The performance of auto ABS declined only slightly, given stable unemployment, but ratings on transactions should, in any case, be robust to moderate stress.
- With more collateralized loan obligations (CLOs) entering their amortization periods, the possibility of upgrades increases.
- We lowered only 1.3% of our European structured finance ratings over the past 12 months and raised 11.0%.

## Primary contact

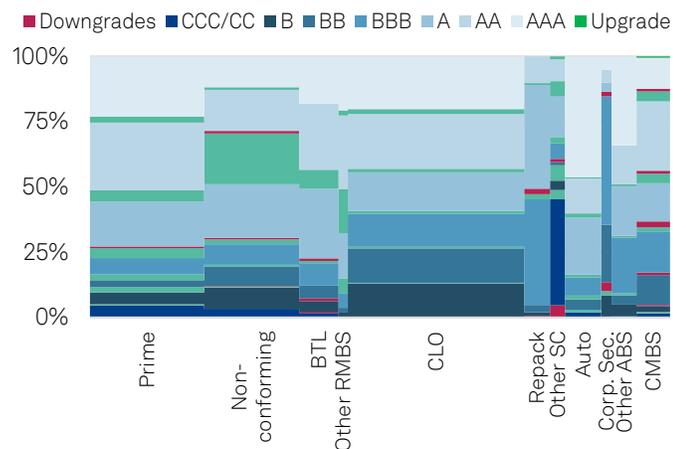
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## Key Developments

**In European structured finance, ratings have generally continued to move higher, despite cost-of-living pressures.** We lowered only 1.3% of our securitization ratings in the 12 months to end-August 2023, while we raised 11% (see chart 15). So far, any signs of weaknesses have been idiosyncratic and were spread widely across different underlying sectors. In recent years, commercial mortgage-backed securities (CMBS) have exhibited the weakest credit performance. Even for this sector, however, the net ratings migration over the past 12 months has turned positive, despite ongoing challenges for real estate values. High inflation and rising interest rates put households under pressure, with potential implications for securitization sectors backed by consumer credit. So far, this has not led to negative rating actions for RMBS or auto ABS, for example.

Chart 15

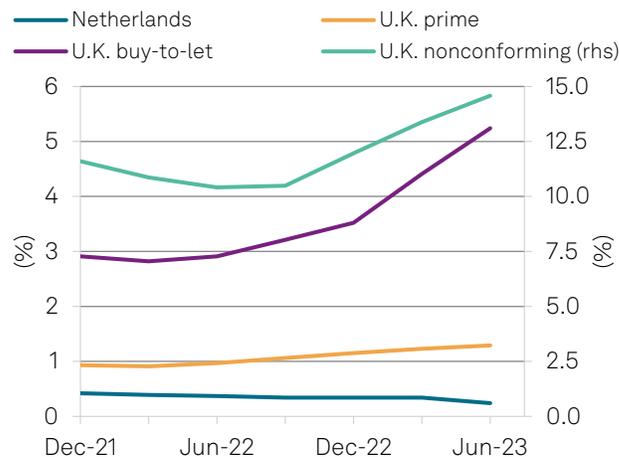
**Most recent rating actions have been upgrades**  
 European structured finance ratings heatmap



BTL--Buy-to-let. SC--Structured credit. Based on the cumulative count of rating actions between Sept. 1, 2022, and Aug. 31, 2023. Source: S&P Global Ratings.

Chart 16

**U.K. buy-to-let RMBS see rising arrears**  
 European RMBS total arrears rate, selected sectors



RMBS-- Residential mortgage-backed securities. Rhs--right axis. Source: S&P Global Ratings.

## Key Risks

**Increasing pressure on household borrowers whose loans back European structured finance transactions.** In general, delinquencies reported for the mortgage pools backing prime and owner-occupied RMBS that we rate have not yet increased significantly. Even so, transactions backed by U.K. BTL or nonconforming mortgage loans begin to show signs of credit deterioration

## Credit Conditions Europe Q4 2023: Resilience Under Pressure Amid Tighter Financial Conditions

(see chart 16). Both RMBS sectors include a significant number of legacy loans that were originated before the financial crisis and were subject to looser underwriting standards than more recent lending. Many of the related borrowers may now be so-called "mortgage prisoners", who typically pay a floating rate and are unable to qualify for potentially lower or fixed rates on new loan products. The securitized loan universe is therefore not representative of the wider cross-section of outstanding mortgage loans.

In addition, almost all securitized BTL mortgage loans make payments on an interest-only basis, meaning that any rate rise affecting the loans since early 2022 has had a direct proportional effect on the borrowers' monthly instalments. While ongoing strength in labor markets--and therefore only modest rises in unemployment--has been a substantial mitigant to credit risk for owner-occupied mortgages, the same does not apply for BTL loans. While stable unemployment reduces the risk of tenant defaults, it does not mitigate borrowers' potential inability to mirror sharply rising mortgage payments with equivalent rent rises.

Still, RMBS ratings will remain stable for now, despite this level of collateral performance deterioration. Even in the U.K. BTL sector, our scenario analysis has revealed that approximately four times the current level of stress would be necessary to cause RMBS rating actions, and then typically only of one or two notches for investment-grade tranches.

**Credit deterioration in the auto ABS sector.** So far, observable credit deterioration has been minimal. Reduced affordability due to cost-of-living pressures and potentially weakening used car prices may affect the default and recovery performance of European auto loan and lease ABS transactions. The post-pandemic used car market in Europe was remarkably strong but is now under some pressure from rising inflation and declining consumer confidence, along with an increasing supply of new vehicles.

As with owner-occupied RMBS, however, borrowers' propensity to default in auto ABS transactions has historically correlated strongly with unemployment, for which the picture still looks relatively benign. But even if collateral performance were to deteriorate, auto ABS ratings should be well protected. For example, we applied nine hypothetical stress scenarios--including rising default rates and declining recovery rates--to a representative sample of 29 of the auto loan and lease ABS transactions that we rate. Even under increased economic stress, 'AAA' rated tranches demonstrated significant stability. More than 75% would not suffer any downgrades, even if the gross loss base case were to rise to 10%. Full details of the scenario analysis are available through our [interactive dashboard](#).

**Decline in CLO performance due to rising corporate risks.** We note that recent pricing dynamics have curbed the trend of CLO refinancings and resets that was prevalent in 2021 and early 2022. As a result, more existing CLOs are reaching their amortization periods. Assuming stable collateral performance, this could lead to an increasing number of CLO upgrades if transactions start to delever.

## International Public Finance

- European local and regional governments (LRGs) continue to demonstrate their resilience to an economic slowdown. We anticipate some weakening in their budgetary performance, driven by rising spending, but it will be marginal on average.
- The U.K. public sector remains under pressure. Social housing entities largely cut their development plans and are more proactive in asset management, while some local authorities face challenges in balancing operating spending with available revenues.
- Universities may need to adjust strategies if geopolitical risks result in materially fewer overseas students.

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### Key Developments

**We expect the ongoing economic slowdown will weaken LRG's budgetary performance due to elevated interest rates and inflation-driven increases in wages and utility bills.** Nevertheless, balance after capital account will remain relatively strong, with, on average, minor projected deficits across all rating categories (see chart 17).

**A noticeable cooling in the real estate sector will reduce property transaction fees.** French departments and large cities will suffer more from a drop in revenue than other European LRGs.

**Many U.K. public sector entities continue to face a financial weakening.** Some English local authorities, including the second-largest city Birmingham, have recently issued section 114 notice, highlighting difficulties in balancing operating budgets.

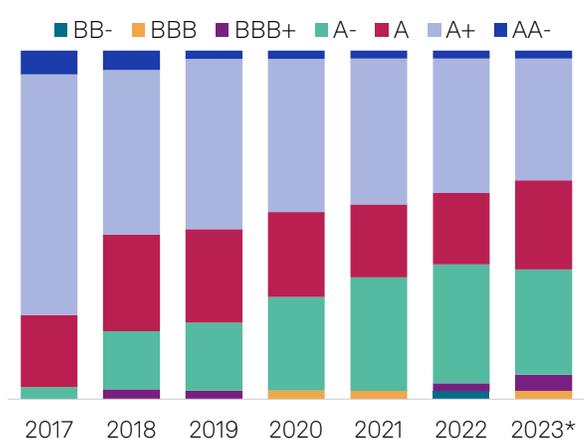
**U.K. social housing entities, which face pressure from slower rent increases and higher spending requirements, continue to cut development plans.** We anticipate a further divergence in credit quality in the sector (see chart 18).

Chart 17  
 EMEA LRG budgetary performance will weaken modestly



f--Forecast. Data for publicly rated LRGs. Source: S&P Global Ratings.

Chart 18  
 Ratings on U.K. social housing providers are sliding down



\*YTD- Year-to-date. Data for publicly rated LRGs. Source: S&P Global Ratings.

### Key Risks

- **Investment constraints.** Elevated interest rates could reduce investments of LRGs and public sector enterprises, including public transport and housing.
- **Constraints on 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

- The primary insurance sector maintains its key strengths. Following the drop in capital surplus in 2022, we see ongoing recovery and expect this trend to continue.
- In primary non-life insurance, we expect technical performance in major European markets will stay robust, amid still-heightened claims inflation. Still, some insurers failed to raise premium rates enough to cover claims inflation.
- Notwithstanding increased competition from banks, most life insurers' focus is on protection and unit-linked products, for which bank deposits are no alternative.
- Favorable property/casualty reinsurance pricing conditions, pre-pandemic earnings levels in life reinsurance, and increasing net investment income underpin our now stable view of the global reinsurance sector.

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## Key Developments

**After some weak years, reinsurers increased premium rates materially.** For 2023 renewals, much-needed structural changes in reinsurance underwriting, including tighter terms and repricing of risk, resulted in the hardest market in short-tail lines in decades and shifted pricing power back to reinsurers. We believe this will continue into at least 2024. With higher attachment points, frequency losses are back with primary insurers, who also must get used to higher reinsurance prices for covering peak losses (see "[Global Reinsurance Stabilizes As Green Shoots Emerge In Underwriting](#)," Sept. 5, 2023). Our ratings on insurers in Europe and our outlook on the ratings are largely stable (see charts 17-18).

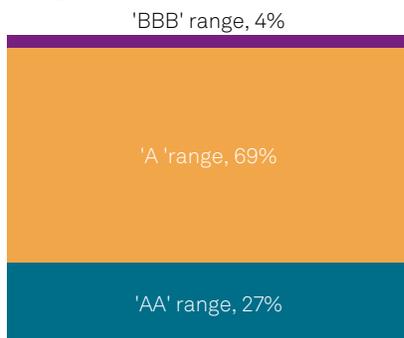
**The European insurance sector maintains its robust capital surplus and, following the decline in 2022, will recover its capital surplus position by about 5% in 2023.** We expect this trend will continue into 2025 (see "[European Insurance Mid-Year Outlook 2023](#)," July 21, 2023).

## Key Risks

- **Higher-for-longer inflation.** While non-life insurers' claims inflation deviates from the consumer prices index and is sometimes higher, long-tail lines' reserve additions might need to increase disproportionately if elevated claims inflation persists for an even more prolonged period.
- **Heightened impairments on illiquid investments.** Life insurers increased their exposure to illiquid assets in search for yield during the low-interest-rate era. Private equity, private debt, and some real estate investments might see further asset value declines.

Chart 17

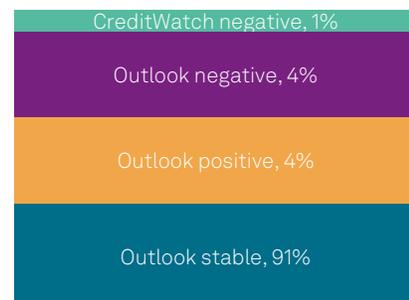
### Ratings on European insurers



Data as of Sept. 14, 2023. Source: S&P Global Ratings.

Chart 18

### Outlook on the ratings on European insurers



Data as of Sept. 14, 2023. Source: S&P Global Ratings.

## Related Research

- [Credit Conditions Asia-Pacific Q4 2023: China Downside Risk Is High](#), Sept. 26, 2023
- [Credit Conditions Emerging Markets Q4 2023: High Interest Rates Sour The Mood](#), Sept. 26, 2023
- [Credit Conditions North America Q4 2023 Shift To Low Gear](#), Sept. 26, 2023
- [Economic Outlook Asia-Pacific Q4 2023: Resilient Growth Amid China Slowdown](#), Sept. 25, 2023
- [Economic Outlook Eurozone Q4 2023: Slower Growth, Faster Tightening](#), Sept. 25, 2023
- [Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted](#), Sept. 25, 2023
- [Economic Outlook Emerging Markets Q4 2023: The Lagged Effects Of Monetary Policy Will Test Resilience](#), Sept. 25, 2023
- [Economic Outlook U.K. Q4 2023: High Rates Keep Growth Muted](#), Sept. 25, 2023
- [EMEA Structured Finance Chart Book](#), Sept. 22, 2023
- [Credit FAQ: What An Acceleration Of Quantitative Tightening Could Mean For Eurozone Banks](#), Sept. 13, 2023
- [Corporate Results Roundup Q2 2023: Interest payments surge, EBITDA declines](#), Sept. 6, 2023
- [Global Reinsurance Stabilizes As Green Shoots Emerge In Underwriting](#), Sept. 5, 2023
- [EU Banks Resist Tough Assumptions In Latest Stress Tests](#), Aug. 1, 2023
- [European Insurance Mid-Year Outlook 2023: Challenges Loom](#), July 21, 2023

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: Q4 2023 Economic Data And Forecast Summaries

Table 1

### Real GDP (%)

	Eurozone	Germany	France	Italy	Spain	Netherlands	Belgium	Switzerland	U.K.
2021	5.6	3.1	6.4	7	5.5	6.2	6.3	4.2	7.6
2022	3.4	1.9	2.5	3.8	5.5	4.4	3.2	2.1	4.1
2023f	0.6	-0.2	0.8	0.9	2.1	0.5	1	0.6	0.3
2024f	0.9	0.6	0.9	0.7	1.6	0.9	1.2	1.2	0.5
2025f	1.5	1.4	1.5	1.3	2.2	1.5	1.8	1.4	1.5
2026f	1.5	1.4	1.4	1.3	2.2	1.7	1.4	1.5	1.6

f--Forecast, annual averages. Source: S&amp;P Global Ratings Research.

Table 2

### CPI inflation (%)

	Eurozone	Germany	France	Italy	Spain	Netherlands	Belgium	Switzerland	U.K.
2021	2.6	3.2	2.1	1.9	3	2.8	3.2	0.6	2.6
2022	8.4	8.7	5.9	8.7	8.3	11.6	10.3	2.8	9.1
2023f	5.6	6.3	5.6	6.3	3.5	4.9	3.2	2.3	7.5
2024f	2.7	2.8	2.6	2.3	2.6	3.1	2.5	1.6	2.5
2025f	2	2	1.9	2.1	1.9	2.2	1.9	1.5	2
2026f	1.8	1.6	1.7	2	1.9	2	1.9	1.4	2

f--Forecast, annual averages. Source: S&amp;P Global Ratings Research.

Table 3

### Unemployment rate (%)

	Eurozone	Germany	France	Italy	Spain	Netherlands	Belgium	Switzerland	U.K.
2021	7.6	3.6	7.9	9.5	14.8	4.2	6.3	5.1	4.5
2022	6.7	3.1	7.3	8.1	12.9	3.5	5.6	4.3	3.7
2023f	6.4	2.9	7.3	7.6	12.1	3.6	5.6	4	4.3
2024f	6.5	3	7.5	8.0	12.1	3.7	5.6	4	4.7
2025f	6.5	3	7.5	7.9	12	3.7	5.6	3.9	4.4
2026f	6.3	3.1	7.3	7.8	11.8	3.6	5.5	3.9	4.2

f--Forecast, annual averages. Source: S&amp;P Global Ratings Research.

Table 4

### 10-year government bond yields (% annual average)

	Eurozone	Germany	France	Italy	Spain	Netherlands	Belgium	Switzerland	U.K.
2021	0.2	-0.3	-0.1	0.8	0.4	-0.2	0	-0.3	0.7
2022	2	1.2	1.5	3.2	2.2	1.4	1.7	0.8	2.3
2023f	3.3	2.6	3	4.3	3.6	2.9	3.2	1.2	4.1
2024f	3.7	2.9	3.3	4.7	4	3.2	3.5	1.4	4
2025f	3.5	2.7	3.1	4.5	3.8	2.9	3.3	1.5	3.4
2026f	3.3	2.6	3	4.4	3.5	2.8	3.2	1.6	3.3

f--Forecast, annual averages. Source: S&amp;P Global Ratings Research.

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Table 5

### 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	1.05	0.95	1.23	1.17	0.96	1
2023f	1.09	0.92	1.24	1.13	0.9	0.98
2024f	1.11	0.9	1.27	1.15	0.91	1.01
2025f	1.16	0.87	1.36	1.18	0.92	1.06
2026f	1.18	0.85	1.38	1.17	0.93	1.09

f--Forecast, annual averages. Source: S&P Global Ratings Research.

Table 6

### Policy interest rates (% end-of-year)

Policy rates	----Eurozone (ECB)----		U.K. (BoE)	Switzerland (SNB)
	Refinancing 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	4.50	4.00	5.25	2.00
2024f	3.75	3.25	4.47	1.25
2025f	2.50	2.00	2.62	1.00
2026f	2.50	2.00	2.50	1.00

f--Forecast. BoE--Bank of England. SNB--Swiss National Bank. Source: S&P Global Ratings Research.

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