

The Ratings View

May 29, 2024

This report does not constitute a rating action.

Key Takeaways

- The European speculative-grade default rate could dip to 3.75% by April 2025.
- Deteriorating interest coverage is still a concern for weaker U.S. corporates.
- Competition is set to intensify in China's EV market.

We expect a European trailing-12-month speculative-grade corporate default rate of 3.75% by March, only slightly below the 4.1% default rate for the 12-months-ended April 2024. Most credit and market measures moved little in the first quarter, with some yields falling and some spreads narrowing, but defaults rising. This appears to support our view of a plateauing default rate ahead. Slower-than-expected economic growth, higher-than-expected interest rates, and a greater acceptance of distressed exchanges could together push the default rate higher--to 5%--in our pessimistic scenario. We think consumer-facing sectors will likely lead the default tally in 2024. The chemicals and telecommunications sectors may also experience some defaults as they have many issuers with negative cash flow and 'CCC'/'C' ratings.

[Default, Transition, and Recovery: The European Speculative-Grade Default Rate Should Level Out At 3.75% By March 2025](#)

Deteriorating interest coverage remains a concern for weaker U.S. corporates. U.S. speculative-grade corporate issuers showed promising signs of credit stabilization in Q4 2023, supported by sustained earnings and continued growth in free operating cash flow. Nonetheless, the downward trajectory of reported EBITDA interest coverage has persisted for the sixth consecutive quarter, sliding to a median of 3.1x from 3.3x in Q3 2023. Since the start of the rate hike cycle in March 2022, the proportion of 'B-' issuers with EBITDA interest coverage less than 1x surged from 22% to 34%, placing significant pressure on ratings despite good earnings performance and relatively favorable business characteristics.

[U.S. Leveraged Finance Q1 2024 Update: For Most 'B-' Rated Issuers, Solid Businesses Have Shaky Finances](#)

Competition in China's EV market is set to intensify, with a prolonged price war, continuous upgrades to technology and products, and disruption from new players. There were close to 500 EV producers registered in China in 2019, but many never even began production for various reasons and only 46 EV producers have recorded EV sales. As EV producers struggle amid the changes, their creditworthiness will hinge on scale, profitability, and free cash flow trends. The credit standing of large legacy car firms may also slip as they embark on the challenging shift to electrification. The pace of EV transition of these traditional auto makers, the competitiveness of their EV products, and the resilience of their gasoline vehicles will determine the progress of consolidation.

[China EV Startups Struggling To Stay Afloat](#)
[Asian Auto: Resiliency Over Adversity](#)

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The Ratings View

Uses for AI in real estate will be numerous. AI's application in the real estate sector remains relatively nascent, but the technology will increasingly differentiate operations and products in the next five to 10 years and thus drive profits, competitiveness, valuation, and sustainability. The benefits of AI are unlikely to accrue evenly across real estate's sub-segments, with datacenters set to benefit most from AI-fueled demand, while both office and retail real estate face a mix of opportunities and uncertainty due to AI-inspired changes to work and shopping habits.

[AI In Real Estate: What To Watch As Adoption Accelerates](#)

Generative AI's real estate applications and technical solutions



Design creation

Generative adversarial networks (GANs)--machine learning architecture that pits two neural networks (a generator and a discriminator) against each other to generate new outcomes. It can be deployed to create designs for engineering and construction.



Image-quality enhancement for engineering and design

Diffusion models--machine learning architecture that aims to generate a probability distribution for a given dataset to create new images.



Anomaly detection, materials classification, action recognition

Vision transformers (ViT)--break an image into a sequence of smaller parts (called patches) that can be more easily processed. It offers improved computational efficiency and greater accuracy when trained on large data sets then applied to tasks with fewer data points.



Construction safety

GANs and transformers are being deployed.



Market dataset enrichment

GANs can be applied to data handling, where they can enrich small datasets with synthetic data, or to create reconstructed data sets by inserting missing data.

Variational AutoEncoders (VAE)--generative models that can generate synthetic data to enlarge limited data sets and improve training for deep learning models.

Source: S&P Global Ratings.

Commercial real estate (CRE) exposure risks appear manageable for U.S. life insurers. The U.S. life insurance industry's exposure to CRE across commercial mortgage loans (CMLs), commercial mortgage-backed securities (CMBS), and real estate equity has grown over the last decade but has plateaued in the last few years. The credit quality of the industry's CRE exposure is high, driven by the conservative, diversified nature of its investment in the space. The office sector is experiencing stress, but thus far the magnitude is very limited within life insurers' commercial mortgage loan portfolios. While life insurers will likely incur some losses from mortgages on office properties in the next few years, the combination of high credit quality and limited exposure will keep these losses manageable.

[Commercial Real Estate Exposure At U.S. Life Insurers: It's All About The Office. But It's Manageable](#)

Asset Class Highlights

Corporates

Notable publications include:

- [Default, Transition, and Recovery: 2023 Annual U.S. Corporate Default And Rating Transition Study](#)
- [Default, Transition, and Recovery: 2023 Annual Emerging And Frontier Markets Corporate Default And Rating Transition Study](#)
- [AI In Real Estate: What To Watch As Adoption Accelerates](#)
- [China EV Startups Struggling To Stay Afloat](#)
- [Credit FAQ: Equity-Like Risks Of Bond-Type Class Shares Under Japanese Law](#)
- [Update On Southeast Asia Property: Developers' Credit Quality Hinges On Refinancing Conditions](#)
- [U.S. Leveraged Finance Q1 2024 Update: For Most 'B-' Rated Issuers, Solid Businesses Have Shaky Finances](#)
- [What's Next For Protein Processor Ratings After A Grinding 2023?](#)
- [Corporate Results Roundup Q1 2024: Recovery continues excluding commodity sectors but remains fragile and fragmented](#)
- [Default, Transition, and Recovery: The European Speculative-Grade Default Rate Should Level Out At 3.75% By March 2025](#)
- [Asian Auto: Resiliency Over Adversity](#)

Financial Institutions

Over the past week, we took several rating actions:

- [Research Update: HSBC USA Inc. And Subsidiary Ratings Affirmed On Strategy Shift; Outlook Remains Stable](#)
- [Research Update: LD Holdings Group Downgraded To 'CCC+' On Announced Debt Exchange, Outlook Stable; New Senior Secured Notes Rated 'CCC'](#)
- [Research Update: Carrefour Banque Outlook Revised To Negative On Increased Profitability Headwinds; Ratings Affirmed At 'BBB/A-2'](#)
- [Research Update: BFA Tenedora de Acciones Upgraded To 'BBB-/A-3' On Reduced Leverage, Stronger Revenue; Outlook Positive](#)
- [Research Update: Raiffeisen Bank International Affirmed At 'A-'; Outlook Remains Negative On Elevated Risks With Russian Operations](#)

We published several commentaries including:

- [Your Three Minutes In China Bank Mortgages: Risks To Rise In Lower-Tier Cities](#)
- [Japan's Securities Groups Halfway To Stabilizing Performance](#)
- [Top Nordic Banks' Continued Strong Performance In Q1](#)

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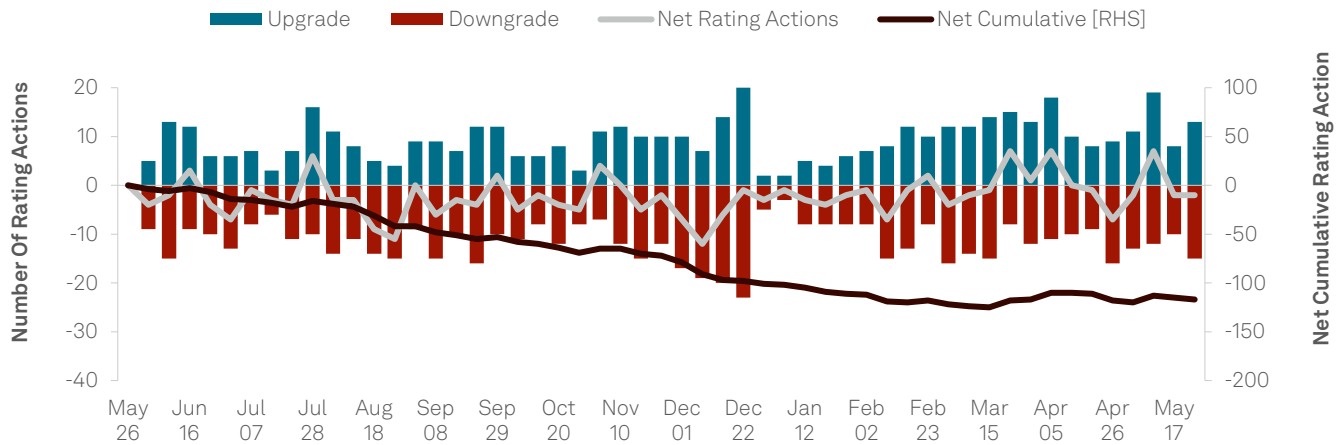
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Structured Finance

- **European and U.S. CLOs:** S&P Global Ratings published on May 23, 2024 a 2024 update to its comparative overview highlighting key themes and differences between European and U.S. broadly syndicated loan (BSL) collateralized loan obligations (CLOs) (see "[U.S. And European BSL CLOs: A Comparative Overview \(2024 Update\)](#)"). We also updated our interactive dashboard, which allows a user to compare European and U.S. BSL CLOs through the lens of different data sets themselves. The interactive dashboard is accessible by clicking [here](#).
- **U.S. CMBS:** Here are a few "Key Takeaways" from a recent article:
 - Over the past 18 months, S&P Global Ratings has observed more loans structured with debt service coverage (DSC) near 1.0x, especially those backing single-borrower deals; these loans appear to be banking on rising net cash flow and declining interest rates to increase DSC levels.
 - Revenue growth projections are slowing for most property types. At the same time, interest rates, while projected to decline somewhat from current levels, are likely to remain high for a while--certainly higher than the low figures prevalent in 2019-2021.
 - Loans with DSCs that dropped below 1.0x during their terms had significantly higher default rates than those that maintained more robust coverage levels.
 - See "[Lower Margin For Error On Debt Service Coverage Raises U.S. CMBS Performance Risk](#)" published May 21, 2024.

The Ratings View

Chart 1
Global Rating Actions (Rolling 52-Weeks)



Source: S&P Global Ratings. Net rating actions means downgrades minus upgrades. Net cumulative means total net rating actions. Data as of May 24, 2024. Global rating actions include actions on both financial and non-financial corporates and sovereign issuers.

Table 1

Recent Rating Actions

Date	Action	Issuer	Industry	Country	To	From	Debt vol (mil. \$)
22-May	Upgrade	SoftBank Group Corp.	NBFI (ex. Insurance)	Japan	BB+	BB	20,216
22-May	Upgrade	Global Medical Response Inc	Health care	U.S.	B-	SD	4,474
20-May	Downgrade	Global Medical Response Inc	Health care	U.S.	SD	CC	4,474
21-May	Upgrade	SPX FLOW Inc	Capital goods	U.S.	B	B-	3,233
20-May	Downgrade	Calumet Specialty Products Partners LP	Utilities	U.S.	CCC+	B-	2,800
23-May	Upgrade	ISS A/S	Consumer products	Denmark	BBB	BBB-	2,281
24-May	Upgrade	Informa PLC	Media and entertainment	U.K.	BBB	BBB-	1,873
24-May	Downgrade	LD Holdings Group LLC	NBFI (ex. Insurance)	U.S.	CCC+	B-	1,525
23-May	Upgrade	Turk Telekom	Telecommunications	Turkey	BB-	B+	1,500
23-May	Downgrade	Astra Acquisition Corp.	High technology	U.S.	SD	CCC	1,300
23-May	Downgrade	Guardian US Holdco LLC	Telecommunications	U.S.	B-	B	1,041

Source: S&P Global Ratings Credit Research & Insights. Data as of May 24, 2024. U.S. means United States, U.K. means United Kingdom and U.A.E. means United Arab Emirates. NBFI - NonBank Financial Institutions (ex. Insurance)

For further credit market insights, please see our **This Week In Credit** newsletter.



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