Credit Benchmark

Another COVID Year: Credit Trends in 2021

January 2022

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Executive Summary

- The COVID crisis saw dramatic increases in global credit risk throughout 2020, but signs of recovery have emerged in the last 12 months. In 2021, credit upgrades outnumbered downgrades by 3:2.
- Corporate credit risk improved by 6% in 2021 after plummeting by 20% the prior year. Financials showed weaker improvement at just 1%, though had less ground to recover with a drop of 10% the previous year.
- Global Corporates are creeping back to majority investment grade, with an increase from 42% to 49% - this sat at 50% pre-pandemic.
- African Sovereigns continued to feel the strain in 2021, growing in credit risk by 10%. Globally, Sovereign credit risk was broadly stable.
- The US economy flexed its muscles, leading corporate credit recovery at 11%, while the UK languished with a modest recovery of 1.6%. EU corporates showed a moderate recovery rate of 4%.
- Travel & Leisure companies felt the COVID crash more than most, and after a disastrous 2020, continued to increase in credit risk by a further 20% in 2021. As borders reopen and restrictions ease, the sector has started to show signs of late improvement – but no such luck for UK firms.
- Argentina, China and Canada stood out as high performers with the strongest bias towards upgrades. Middle Eastern countries including Oman, Kuwait and United Arab Emirates struggled in comparison, with significantly more downgrades than upgrades.
- Rising Stars outnumbered Fallen Angels in 2021, with almost twice as many corporates upgrading from high yield to investment grade (13%) than in the opposite direction (7%). Amidst the online office boom sectors like Technology Hardware & Equipment flourished with 32% of entities achieving Rising Star status, while the beleaguered Travel & Leisure sector saw 21% of all firms descend as Fallen Angels.
- The banking industry has retained strength throughout the pandemic but there are signs of deterioration within emerging markets such as Mexico and Turkey, as well as in South Africa.

2021 will hopefully mark the beginning of the end for COVID. New variants brought continued restrictions, but the vaccine effort was a phenomenal success.

Despite empty city centers, supply chain disruptions and labor shortages, many major economies bounced back, in some cases exceeding their pre-COVID GDP levels.

Some areas continued to struggle – Travel & Leisure, Developing Economies, Aerospace. But the expected widespread increase in corporate defaults has not yet materialized, although the costs of tackling COVID are now being felt in rising prices and higher interest rates.

Consensus ratings were downgraded in 2020, and they remain below their pre-pandemic levels. But Government support has meant widespread upgrades in 2021 – and on average slightly faster than the main rating agencies.

About Credit Benchmark

Credit Benchmark produces a comprehensive view of credit risk by creating Credit Consensus Ratings ("CCRs") and analytics on the credit quality of companies, financial institutions, sovereigns, and funds.

The data is sourced from more than 40 global financial institutions, representing the work of over 20,000 analysts and is also used by regulators to monitor Basel rules on capital adequacy.

Credit Benchmark collects a specific measure of credit risk: a one-year, forward-looking Probability of Default (PD) and forward-looking senior unsecured Loss Given Default (LGD).

The underlying inputs are subject to a rigorous data quality approval process and derived from models that are approved by regulatory authorities. The resultant accuracy of each PD and LGD leads to a credible market view of credit risk for each given entity.

After being anonymized and aggregated, the contributed risk estimates are mapped to the appropriate credit category on the Credit Benchmark Consensus scale, which is calibrated periodically and can be used as a comparison to the scales published by the rating agencies.

Credit Benchmark produces regular data updates with history going back to 2015.

1. Introduction

Another year dominated by COVID and climate change. 2021 dashed hopes that COVID had run its course, bringing more hardship and heartache for millions of families. But medical developments laid the foundation for a move from pandemic to endemic and a return to freedom.

It was a year of triumph for medical technology and science. The rapid development of effective vaccines and their rollout to 60% of the global population[1] was an astounding public health achievement; one that would have been almost impossible even a decade ago. And despite a spiralling death rate, virus variants, lockdown and vaccination politics as well as supply chain disruption, economies continued to function, and civil society remained more or less intact.

There have been geopolitical tensions. Developing countries with limited medical resources have fallen behind in access to vaccines (less than 10% of the population in low-income countries have had at least one dose[2]) and have suffered proportionately more economic damage from COVID. The US Capitol riot in early 2020 showed the challenges facing the Biden government. Russia and China have been testing the new administration by threatening their neighbours and demonstrating new missile capabilities – while commercially-driven US space technology has a more constructive focus – such as a satellite-based version of the internet.

Climate change brought alarming weather events – drought, fire, rain, floods, tornadoes and rapidly melting polar icesheets. COP26 was widely seen as a missed opportunity, but climate worries galvanised the financial and corporate sectors to increased focus on ESG policies[3] – especially the "E" – with far-reaching consequences for supply chain management.

The drive for greener, sustainable energy has collided with the immediate need to fuel the post-COVID economic recovery, pushing oil and gas prices to their highest levels in many years. Rising energy prices add to the dilemma facing Central Bankers: labour and supply shortages are also pushing inflation to rates not seen in decades, and interest rates are likely to rise, signalling the end of the QE program.

Government debt is at near-record levels, and COVID has normalised Government intervention in the form of subsidies (and regulations). This, and higher interest rates will push Governments to find new sources of tax revenue to reduce the debt burden; and there will be a temptation to let rising inflation devalue the debt. But Government bond markets around the world could start to price in a sustainable positive real interest rate; and some of these higher rates will be driven in part by rising Sovereign default risk.

Changes in working practices (long weekends, flexible location) are not yet the norm, but the "Great Resignation" is changing labour market dynamics. This may provide some unexpected opportunities as supply chains move from global to local, home-grown industries in the lower-cost regions of the developed economies. From a credit perspective, this means a large number of winners and losers with major changes in credit rankings.

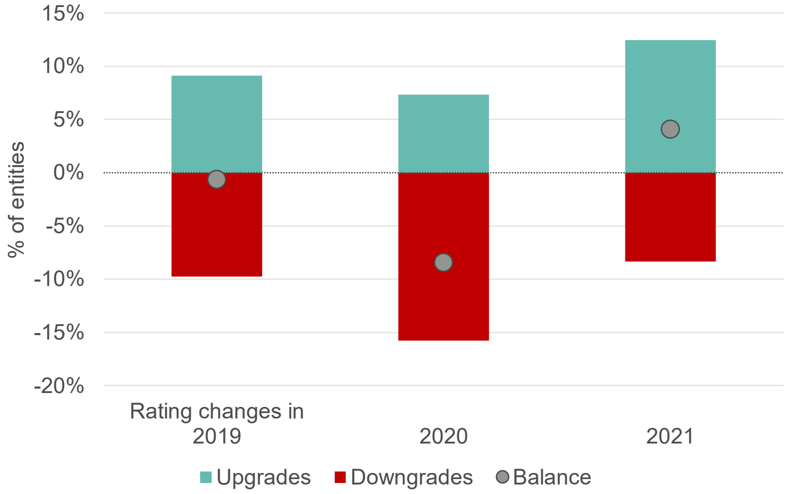
[1] https://ourworldindata.org/COVID-vaccinations?country=OWID_WRL . As of January 20, 2022.
[2] https://ourworldindata.org/COVID-vaccinations?country=OWID_WRL . As of January 20, 2022.
[3] https://www.ft.com/content/06ffb1b1-ade6-417b-9aae-4d86a47e7e78

2. Key Trends

The year 2021 brought a reversion of the credit risk deterioration sparked by the COVID crisis. Figure 2.1 shows that, in 2021, there were 1.5 times more upgraded entities than downgraded.

While the percentage of entities experiencing a rating change over a 12-month period remains close to 20% in 2019-2021, the balance between upgrades and downgrades has shifted dramatically. The percentage of upgrades and downgrades was balanced in 2019, and in 2020 there were more than 2 times as many downgrades than upgrades. In 2021, the balance shifted to upgrades with 12% upgrading and 8% downgrading.

Figure 2.1 Breakdown of upgrades and downgrades, 2019-2021



The move from downgrades to upgrades during 2021 was gradual. Q1 still showed a bias towards downgrades as countries in Europe and North America started to recover from the winter and early spring peak of COVID cases. As Figure 2.2 shows, the turning point came in April, and upgrades have been increasingly outnumbering downgrades since then.

Figure 2.2 Balance of global upgrades and downgrades in 2021, 3 month moving average

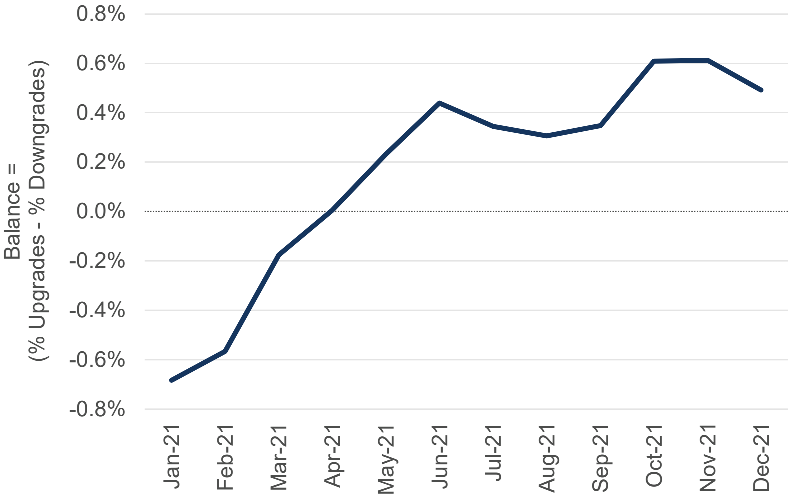
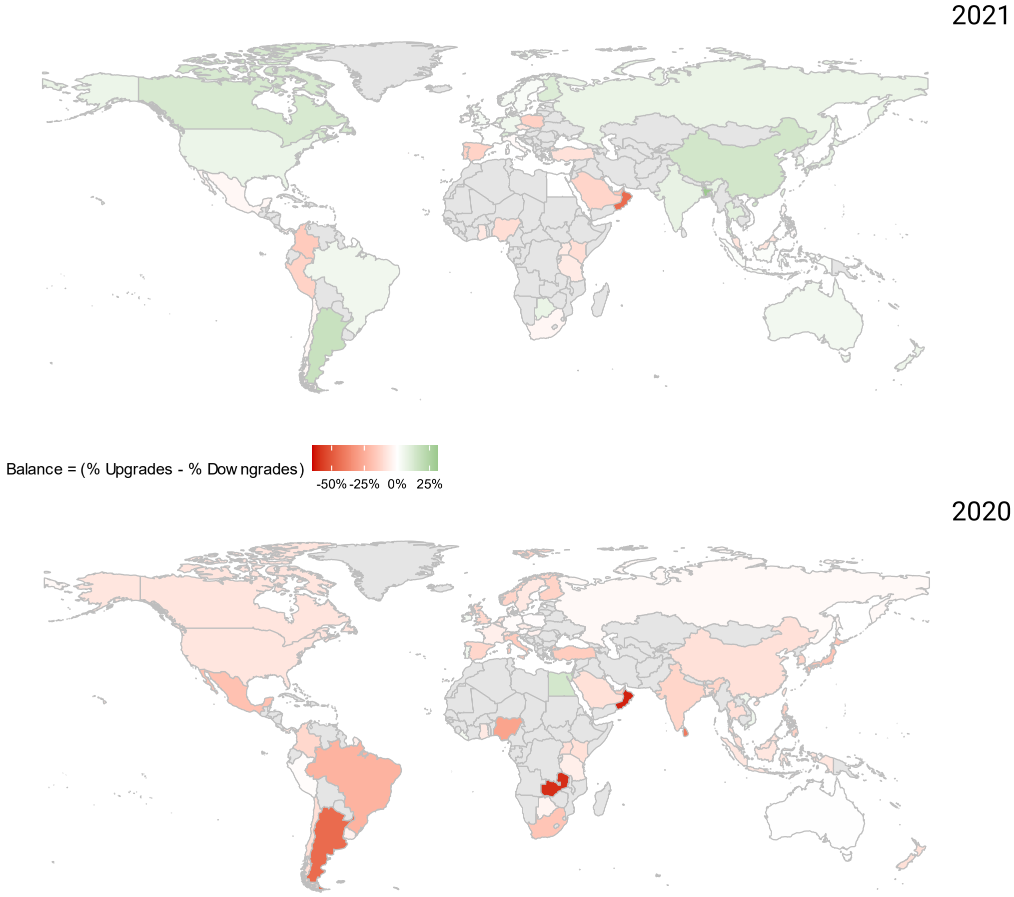


Figure 2.3 shows a clear shift from credit risk downgrades to upgrades between 2020 and 2021 across the whole world, but the effect was not uniform for all countries.

Figure 2.3 Balance of upgrades and downgrades by country in 2021 and 2020



Most countries in North America, Europe and Asia saw more entities upgrading than downgrading in 2021, but the trend was different in Africa, Middle East, parts of Latin America and a few European countries. Countries showing the strongest bias towards upgrades include Argentina, China and Canada. Oman, Kuwait and United Arab Emirates experienced significantly more downgrades.

The recovery rate differs by entity type. Upgrades outweighed downgrades for both Corporates and Financials, but the effect was stronger for Corporates. Figure 2.4 shows that almost 20% of Global Corporates were upgraded by at least one notch in 2021, compared to 15% of Financials. The downgrade rates were close to 11% for both groups.

Figure 2.4 Balance of upgrades and downgrades by entity type

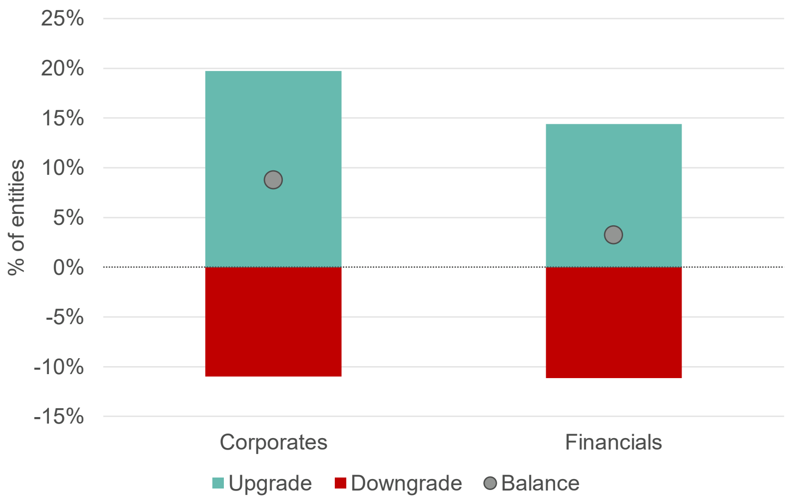
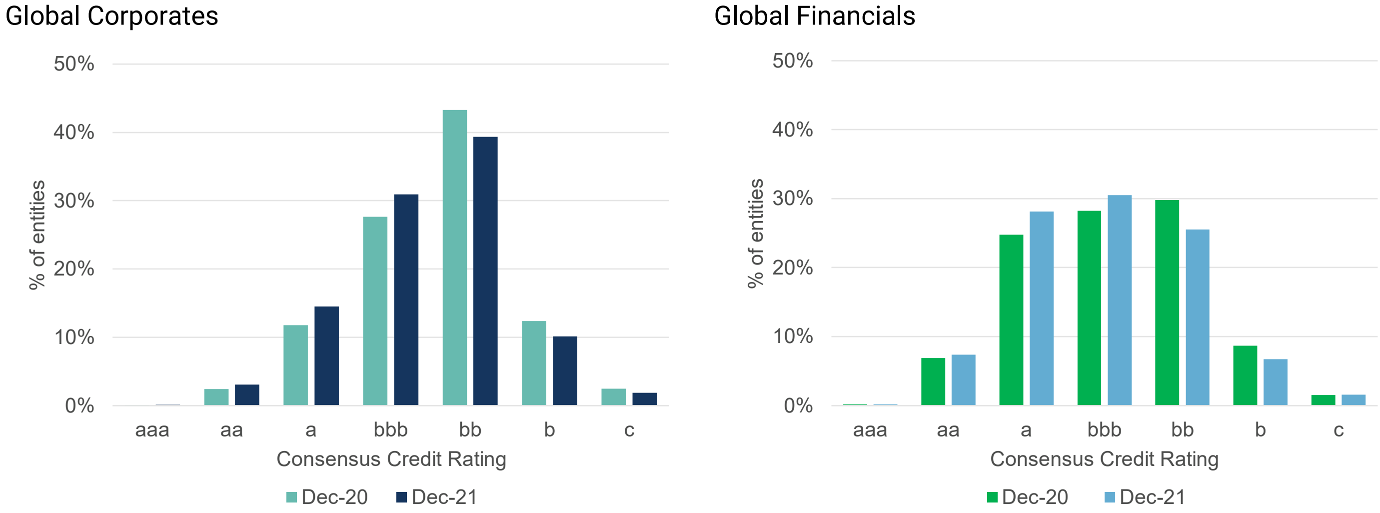


Figure 2.5 shows that the rating changes also affected the credit distribution in Corporates and Financials.

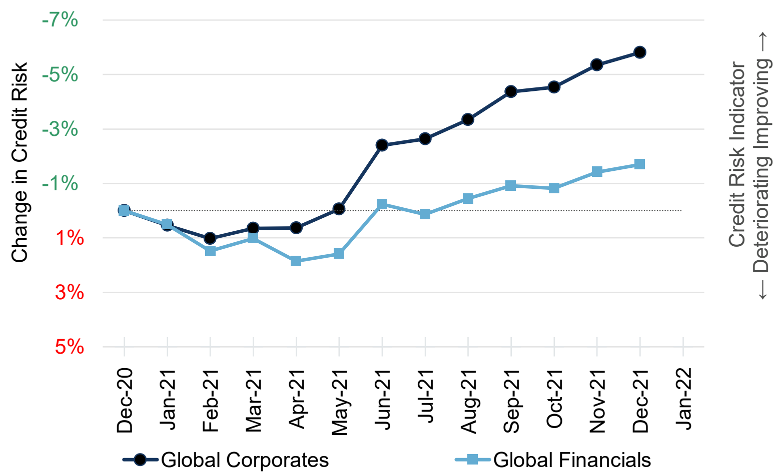
Figure 2.5 Credit risk distribution by entity type



This shows a strong shift from high yield to investment grade categories. The percentage of entities rated as investment grade increased from 42% in Dec-20 to 49% in Dec-21 for Corporates and from 60% to 66% for Financials.

Figure 2.6 shows that the average credit quality of Corporates improved by 6% in 2021 after deteriorating by 21% in 2020.

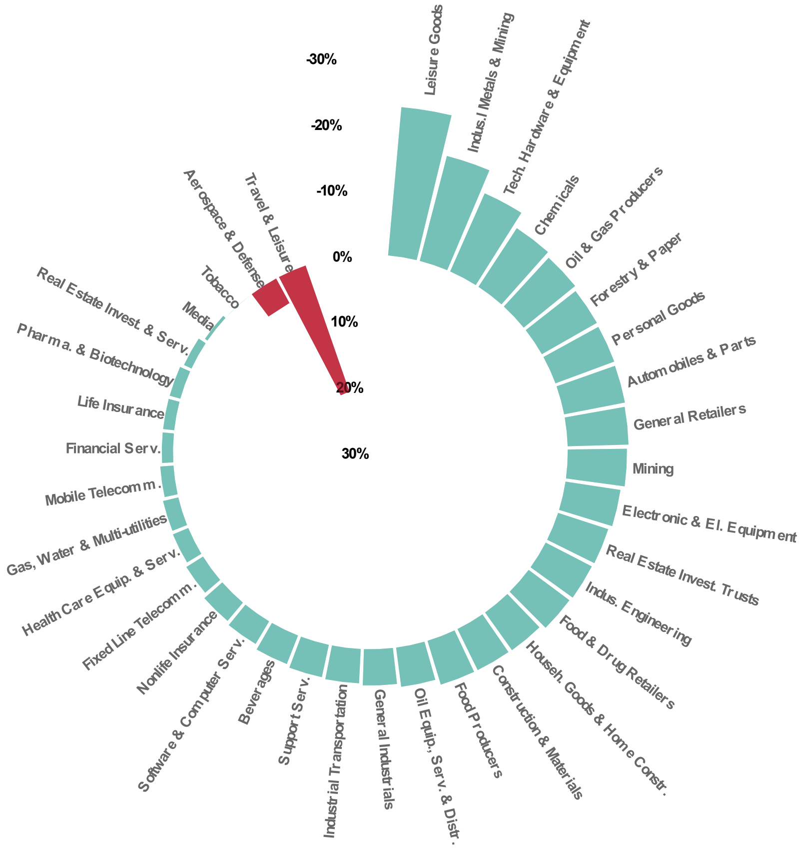
Figure 2.6 Credit trend by entity type



Credit risk peaked in Feb-21 and since then it decreased from 56 Bps to 52 Bps. Financials recovery was more moderate with credit risk decreasing by 2% in 2021, which compares to 10% credit risk increase in 2020. The highest average credit risk of 31 Bps was observed in April-21 and it has decreased to 30 Bps since then.

Figure 2.7 shows that there are further differences across sectors.

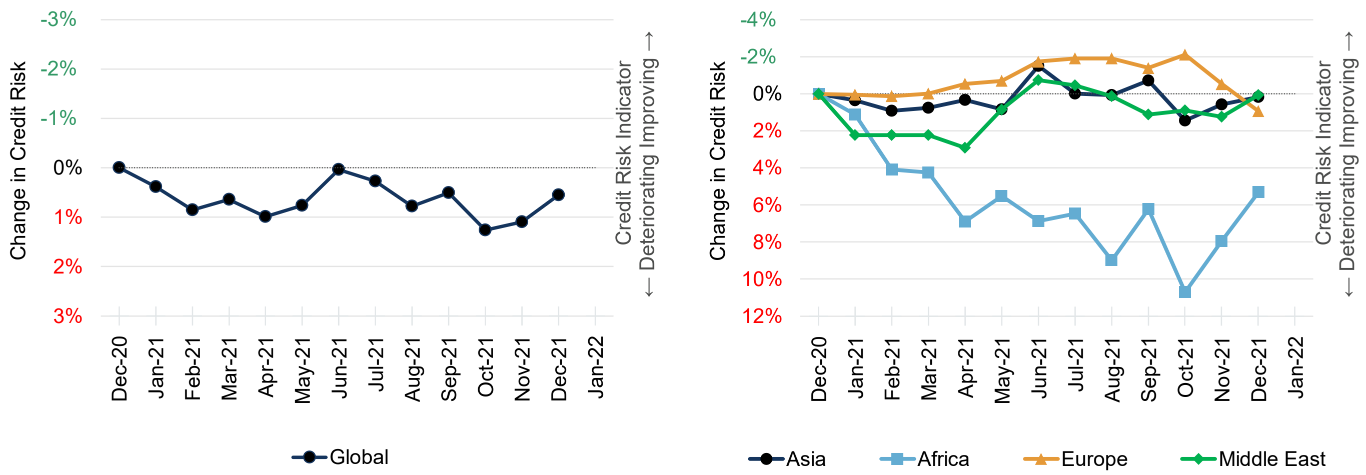
Figure 2.7 Annual credit risk changes by sector



Credit quality of most sectors improved in 2021. Global Leisure Goods, Industrial Metals & Mining and Technology Hardware & Equipment experienced the largest improvement with credit risk decreasing by more than 13%. 2021 remained difficult for Travel & Leisure (risk increased by a further 20%) and Aerospace and Defence (risk up about 5%).

The 2021 COP26 (United Nations Climate Change Conference) highlighted the link between climate burdens and economic development[4].Figure 2.8 shows recent trends in sovereign risk, split by region.

Figure 2.8 Sovereign credit trends

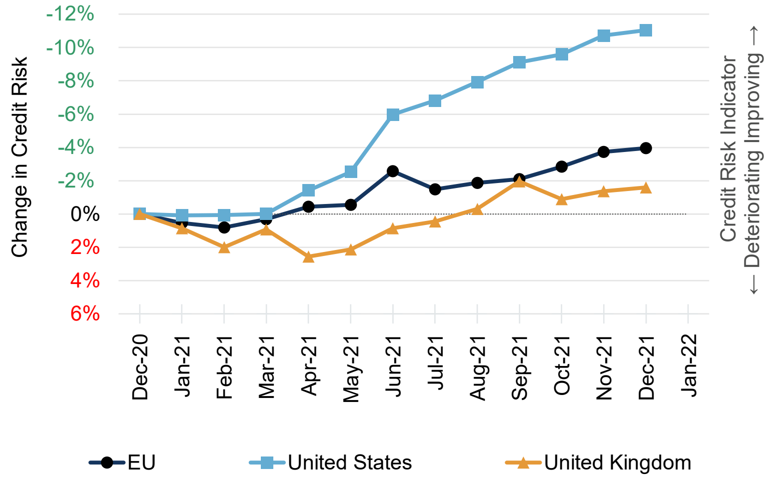


This shows that, despite the Government debt buildup, Sovereign credit risk was overall stable in 2021. However, Africa showed a sharp deterioration until October 2021, although credit risk has rapidly improved since then.

[4] https://www.creditbenchmark.com/cop26-is-credit-risk-part-of-the-problem/

Figure 2.9 shows that the United States reported more significant credit risk improvement compared to the EU and United Kingdom. The US credit quality improved by 11%, EU by 4% and UK by 1.6%.

Figure 2.9 Corporate credit trends by region

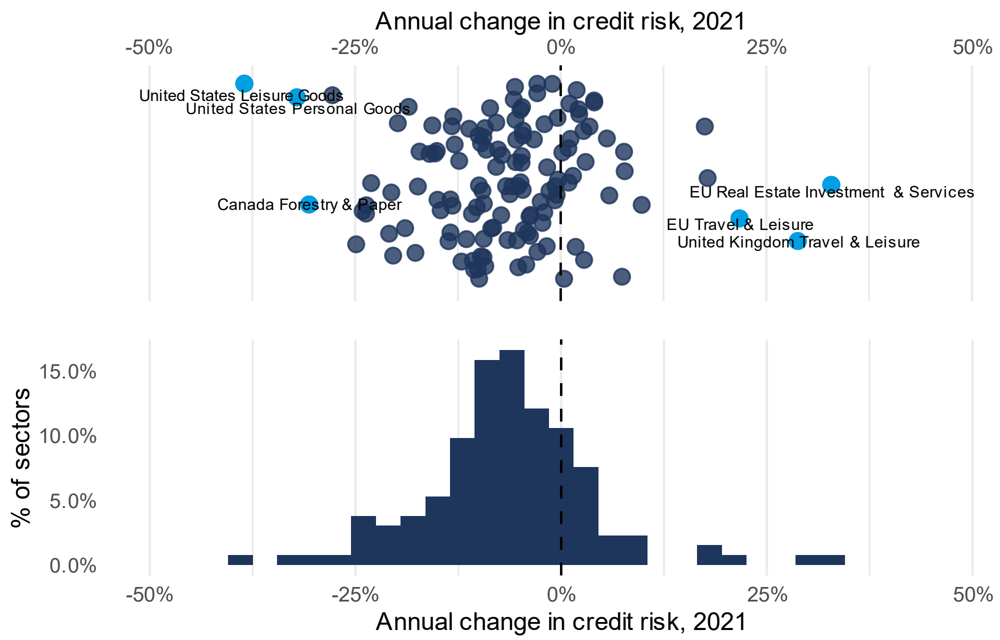


3. Sectors

This section highlights sector and geographical differences in credit risk for five regions: UK, US, EU, CA and Asia. There are 21 to 33 sector-specific aggregates available in each of the regions, accounting for 132 analyzed aggregates in total.

Figure 3.1 reveals that only 28 observed aggregates (21%) showed a deterioration in 2021, with the largest deterioration being above 25%. Other aggregates showed an improvement, and the overall median credit risk decreased by 5%.

Figure 3.1 Annual change in credit risk – regional sector specific aggregates



The best performers include US Leisure Goods, US Personal Goods and Canada Forestry & Paper. On the other hand, EU Real Estate Investment & Services, UK Travel & Leisure and EU Travel & Leisure showed the worst performance.

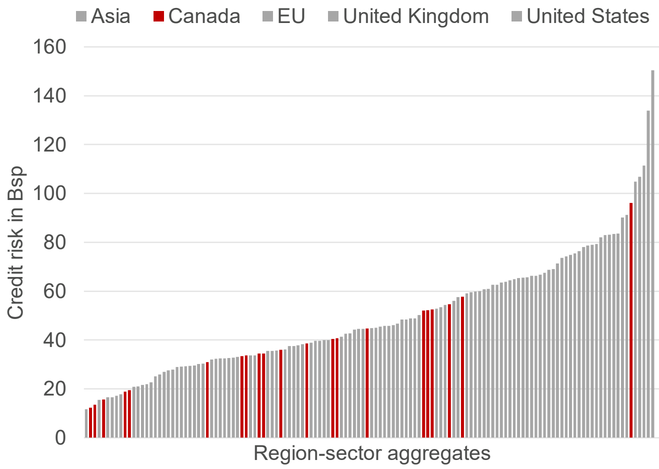
There are also regional differences in both credit risk levels and credit risk changes. The lowest average credit risk is observed in Canada and Asia and equals to 39 Bps. United Kingdom sector aggregates have the highest average credit risk equal to 60 Bps as summarized in Table 3.1.

Table 3.1 Average credit risk by region

Region	Count of sector aggregates	Average credit risk in Bps
Canada	21	38.7
Asia	23	39.2
EU	22	42.8
United States	33	57.6
United Kingdom	33	60.4

Figure 3.2 highlights the individual region-specific aggregates and shows that UK aggregates are highly concentrated in the high credit risk area.

Figure 3.2 Region-sector aggregates credit levels – Canada and United Kingdom



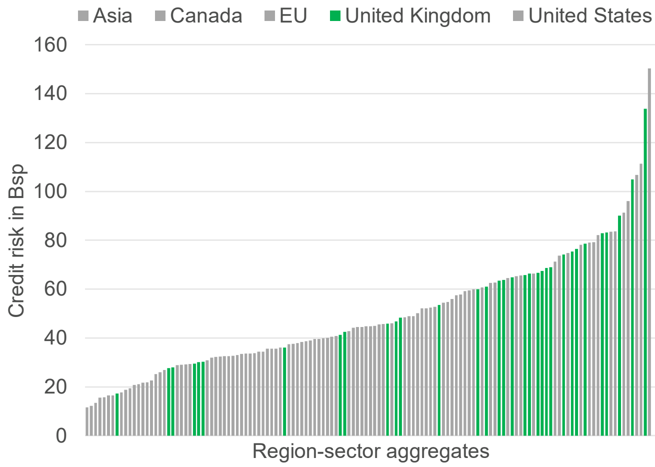
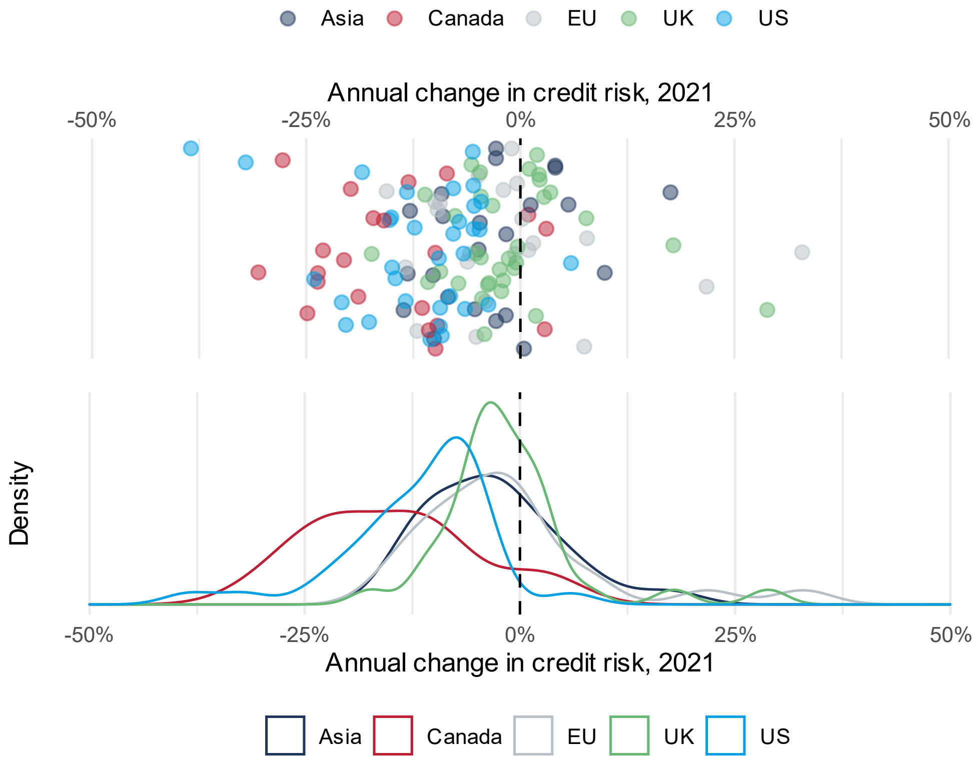


Figure 3.3 shows the annual change in credit risk by region.

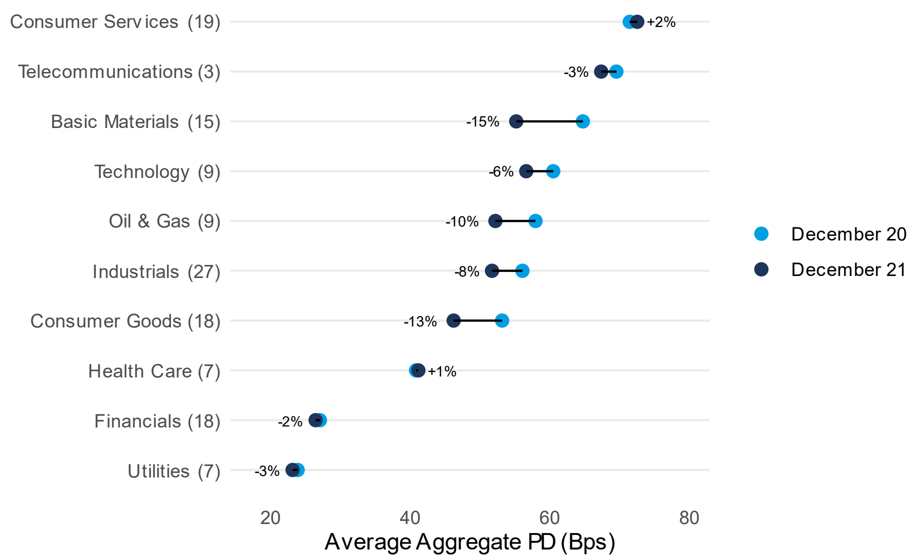
Figure 3.3 Region-sector aggregates credit changes by region



Canadian aggregates improved more than other regions with average annual credit risk improvement of 15%, followed by the US with 12% improvement. EU and UK aggregates improved on average only by 1%.

Figure 3.4 shows industry level credit risk changes in 2021. The numbers in brackets show the count of region-sector-specific aggregates available for each industry.

Figure 3.4 Average credit risk and credit risk change by industry



The Utilities sector aggregates have the lowest credit risk at 23 Bps; Consumer Services is the highest at 73 Bps. The largest positive changes are in Basic Materials and Consumer Goods with credit risk improving on average by more than 10%. Consumer Services, however, deteriorated by 2%.

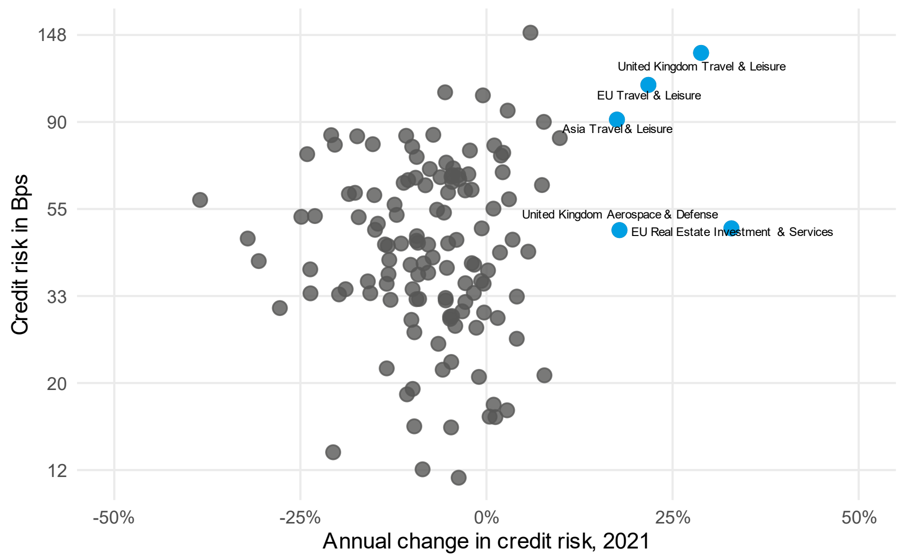
Figure 3.5 shows that while all region-sector aggregates in Basic Materials and Consumer Goods show improvement, there is a large variation for Consumer Services aggregates.

Figure 3.5 Region-sector aggregates credit changes by industry

Consumer Services represent a diverse group of entities. The details show that Retailers improved, Media stayed stable and Travel & Leisure deteriorated across all of the regions.

Analysing the relationship between credit risk levels and changes shows a low positive correlation (0.13) but it is driven by the Travel & Leisure aggregates, which have high average PD and continued to deteriorate in 2021 as shown in Figure 3.6.

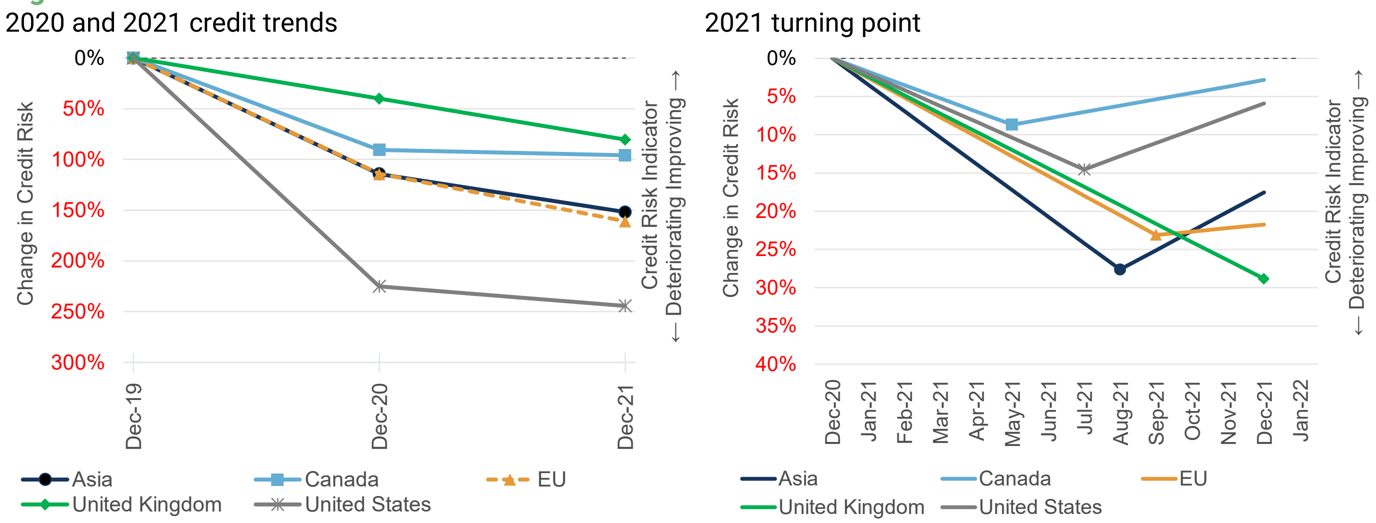
Figure 3.6 Relationship between credit risk levels and changes



3.1. Travel & Leisure

Figure 3.1.1 shows that the Travel & Leisure sector deteriorated in all 5 regions. The UK saw the lowest impact in 2020 and deteriorated at a similar pace in 2021 with credit risk increasing by 29%. EU and Asia show a very similar patterns with a significant deterioration in 2021. United States stabilized after the sharp increase in credit risk in 2020.

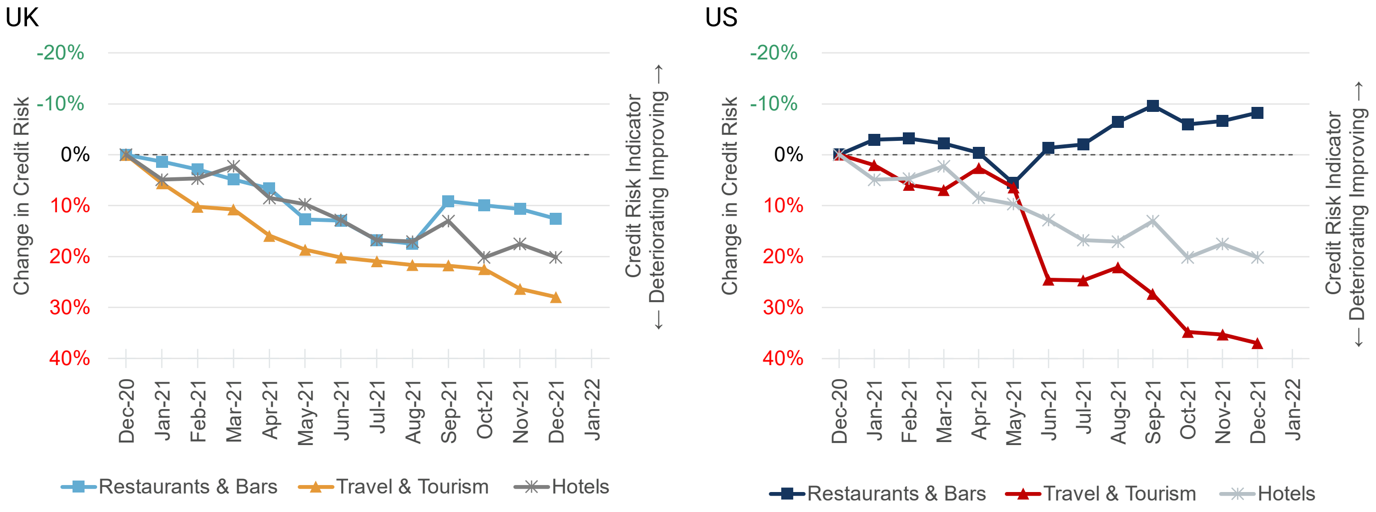
Figure 3.1.1 Travel & Leisure credit trends



Most regions reached a turning point in 2021 with Travel & Leisure starting to improve towards the end of the year. The only exception is the UK – despite the modest scale of the impact over 2020 and 2021, it has continued to decline.

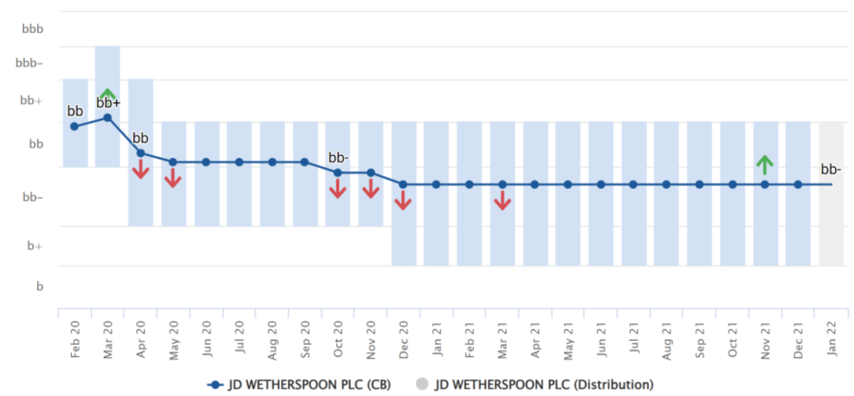
Figure 3.1.2 shows the sub-sector breakdown for the Travel & Leisure sector in the US and UK.

Figure 3.1.2 Travel & Leisure subsectors in UK and US



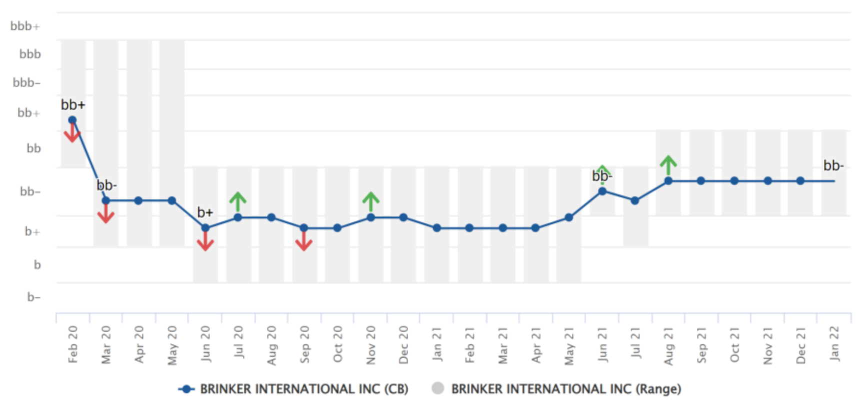
Travel & Tourism and Hotels show a continuing deterioration in both United Kingdom and United States, while Restaurants & Bars diverge across the two regions. The hospitality industry has been a high profile COVID casualty. For an already low margin business, the combination of prolonged closures followed by socially distanced openings, supply issues and staff shortages has been very damaging. For the UK, Brexit has magnified these effects. The trends suggest that US Restaurants & Bars are currently in a better position than their UK counterparts. Figures 3.1.3 and 3.1.4 show some single name examples from the Restaurants & Bars.

Figure 3.1.3 JD Wetherspoon Plc (UK)



JD Wetherspoons – a bellwether for the UK Restaurant and Bar sector – has seen a series of modestly deteriorating credit assessments from banks (red arrows). The cumulative effect is a double notch downgrade from **bb+** to **bb-**.

Figure 3.1.4 Brinker International Inc (US)

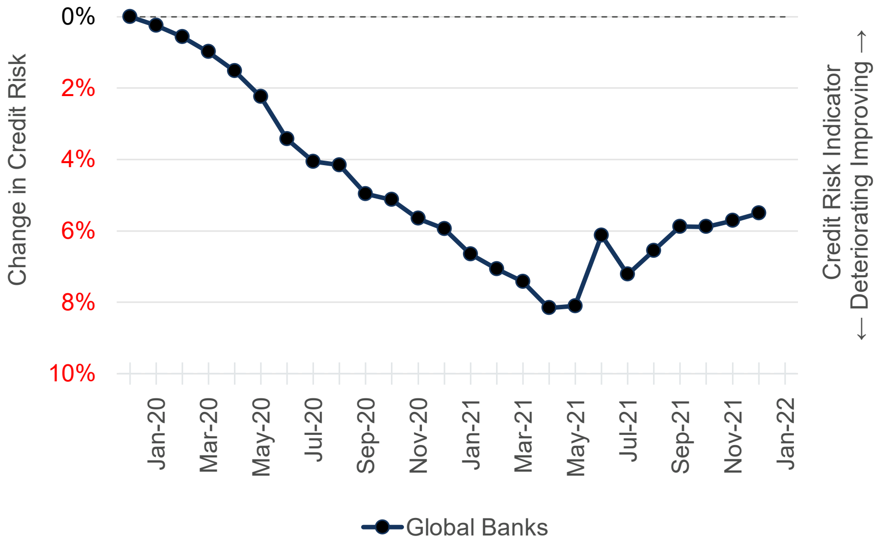


Brinker International (owner of Chili's and Maggiano's Little Italy) has seen recent improvements in bank estimates; it is currently also at **bb-** after a rollercoaster ride that has taken it from **bb+** to **b+** before recovering a notch.

3.2. Banks

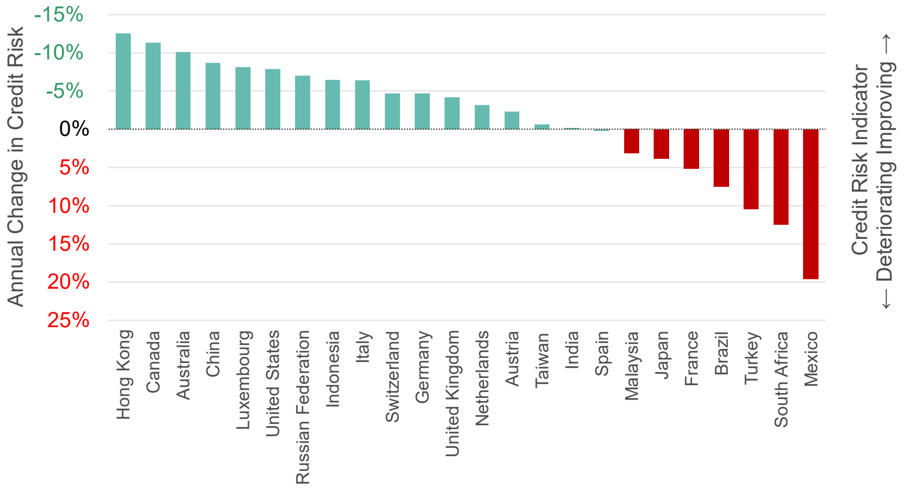
Figure 3.2.1 shows that Global Banks started to recover in May-21 and the credit risk has decreased by 2.5%.

Figure 3.2.1 Credit trend for global banks, 2020-2021



This improvement is not uniform across all countries. Figure 3.2.2 shows a number of countries with deteriorating credit risk in the Banks sector in 2021. These include Mexico, South Africa or Turkey.

Figure 3.2.2 Annual credit risk changes for Banks by country



4. Transitions

This section looks at detailed transitions by credit category. Figure 4.1 shows that almost all rating categories have higher 21-notch upgrade rates and lower 21-notch downgrade rates compared to the 2017-2019 average, confirming that the recovery is broad-based across the whole credit spectrum.

Figure 4.1 Transition rates by rating

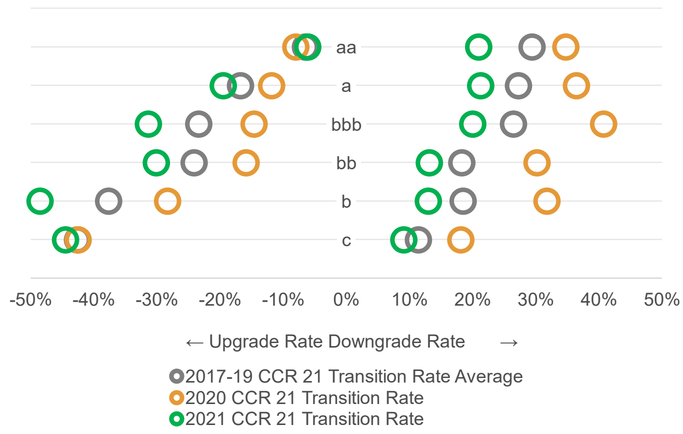


Table 4.1 focuses on the percentage of high yield (HY) Corporates upgraded to investment grade (rising stars) and investment grade (IG) Corporates downgraded to high yield (fallen angels) in 2021 by sector. In 2021, 7% of Dec-20 IG Corporates downgraded to HY, while 12.5% HY Corporates upgraded to IG. This compares to 17.6% fallen angels and 6.7% rising stars in 2020. Confirming some of the previous findings, the worst performing sectors include Travel & Leisure.

Table 4.1 Annual fallen angels and rising stars by sector

CB Sector	Count of IG entities in Dec-20	% of Fallen Angels in 2021
Travel & Leisure	137	21.2%
Leisure Goods	34	11.8%
Food & Drug Retailers	128	11.7%
Industrial Metals & Mining	80	11.3%
Industrial Transportation	369	11.1%
Media	148	9.5%
Personal Goods	67	9.0%
Construction & Materials	390	8.7%
Chemicals	365	8.5%
Oil Equipment, Services & Distr.	147	8.2%
Forestry & Paper	74	8.1%
General Retailers	672	7.7%
Support Services	597	7.5%
Industrial Engineering	309	7.4%
Full Sample	7,247	7.0%
Health Care Equipment & Services	244	7.0%
Food Producers	407	6.9%
Software & Computer Services	250	6.8%
Fixed Line Telecommunications	137	6.6%
Oil & Gas Producers	389	6.2%
Electronic & Electrical Equipment	166	6.0%
Mining	209	5.7%
Household Goods & Home Constr.	221	5.4%
Automobiles & Parts	379	5.0%
General Industrials	88	4.5%
Electricity	440	3.6%
Pharmaceuticals & Biotech.	144	2.8%
Beverages	111	2.7%
Technology Hardware & Equip.	140	2.1%
Gas, Water & Multi-utilities	292	1.7%
Aerospace & Defense	65	1.5%

CB Sector	Count of HY entities in Dec-20	% of Rising Stars in 2021
Technology Hardware & Equip.	110	31.8%
Mining	207	22.7%
Forestry & Paper	70	20.0%
Industrial Engineering	260	19.6%
Electronic & Electrical Equipment	158	17.7%
Beverages	41	17.1%
Industrial Metals & Mining	145	15.9%
Leisure Goods	46	15.2%
Fixed Line Telecommunications	126	15.1%
Aerospace & Defense	40	15.0%
Household Goods & Home Constr.	185	14.1%
Industrial Transportation	437	14.0%
Automobiles & Parts	320	13.8%
Support Services	608	13.5%
Pharmaceuticals & Biotech.	82	13.4%
Gas, Water & Multi-utilities	83	13.3%
Chemicals	325	13.2%
Food & Drug Retailers	176	13.1%
Full Sample	7,370	12.5%
Personal Goods	73	12.3%
Food Producers	428	11.9%
Electricity	152	11.8%
Construction & Materials	522	11.7%
Oil Equipment, Services & Distr.	165	10.9%
General Retailers	870	10.8%
Software & Computer Services	297	10.1%
Health Care Equipment & Services	192	9.9%
Oil & Gas Producers	435	7.4%
General Industrials	87	6.9%
Travel & Leisure	471	6.2%
Media	215	6.0%

5. Consensus vs S&P

Credit Benchmark consensus ratings and S&P opinion-based ratings both showed an increase in downgrades at the start of the crisis in Q2 2020. The bias towards downgrades persisted until Mar-21 when the balance turned towards upgrades as shown in Figure 5.1. The analysis is based on 3,600 global entities that are covered by both Credit Benchmark and S&P.

Figure 5.1 Balance of upgrades and downgrades – S&P vs CB, 3 month moving average

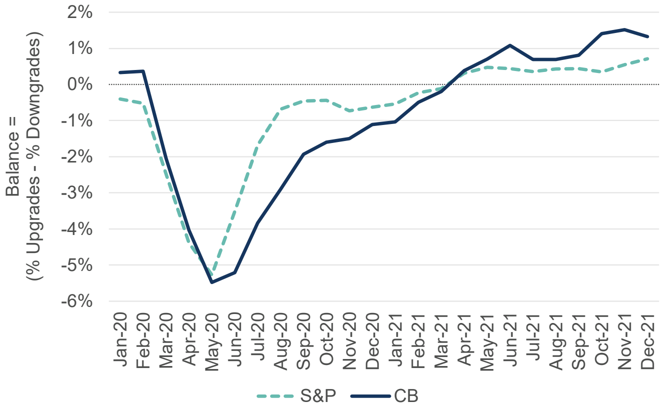
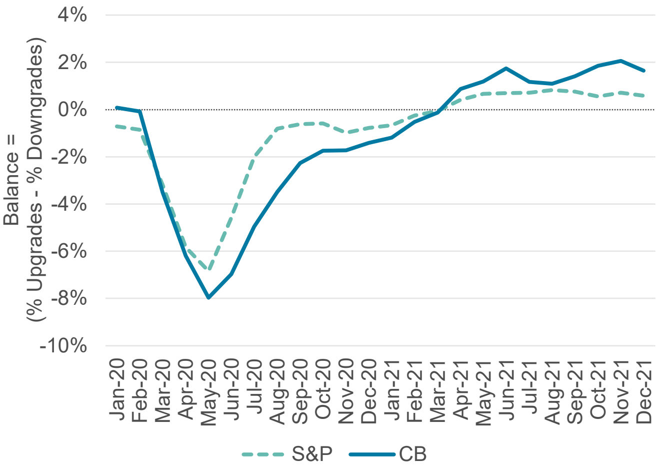


Figure 5.2 presents the analysis for Corporates (2,300 entities), Financials (1,200 entities) and provides geographical breakdown to US Corporates (1,300 entities) and non-US Corporates (1,000).

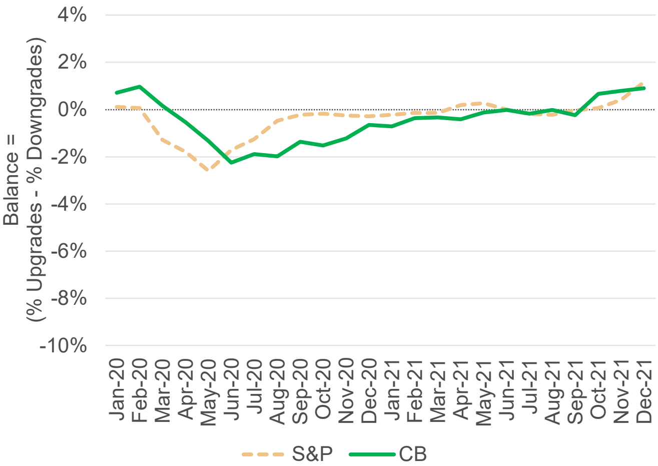
In line with the previous findings, the impact of the COVID crisis was significantly more pronounced for Corporates than Financials for both Credit Benchmark and S&P. While Corporates show a bias towards upgrades since Mar-21, Financials moved to upgrades only in the latest months. Corporate were more impacted in the US compared to the rest of the world, and US Corporates also show more significant bias towards upgrades in 2021.

Figure 5.2 Balance of upgrades and downgrades – S&P vs CB, 3 month moving average

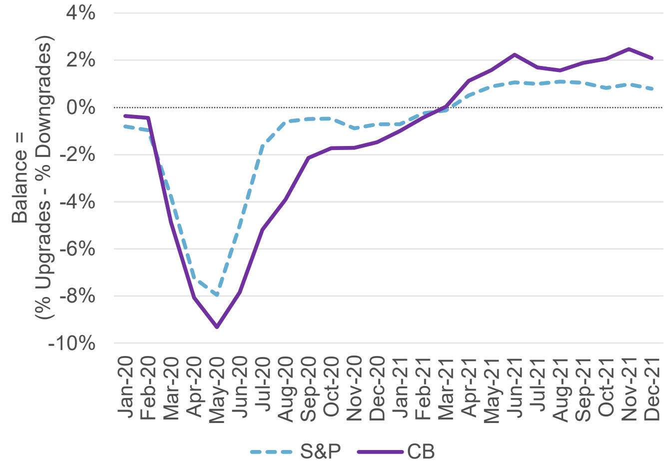
Corporates



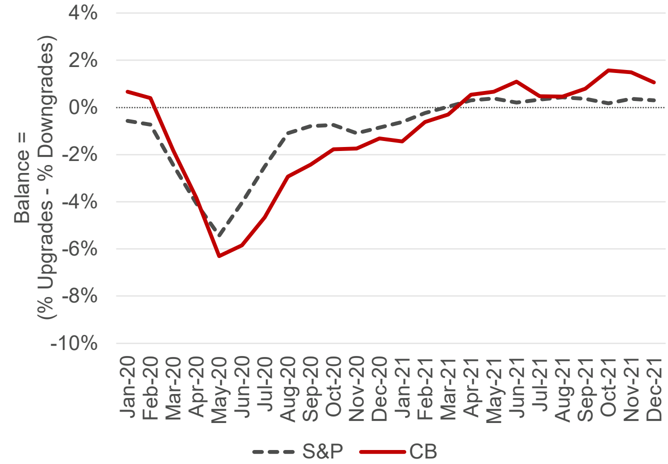
Financials



US Corporates



Non-US Corporates



Focusing on upgrades, Figure 5.3 shows that S&P has stabilized at 1% upgrade rate after a steep increase in Mar-21 and Apr-21. The Credit Benchmark upgrade rate continued to increase over the rest of the year, reaching 2.9% in Nov-21 and slightly decreasing in Dec-21. This suggests that the Credit Benchmark contributors have a modestly stronger bias towards upgrades.

Figure 5.3 Percentage of upgrades – S&P vs CB, 3 month moving average

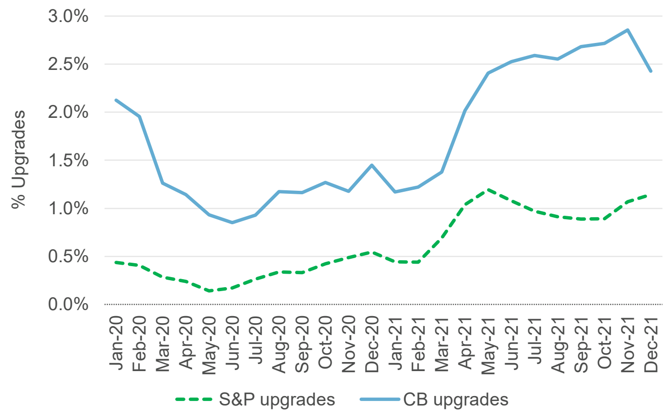
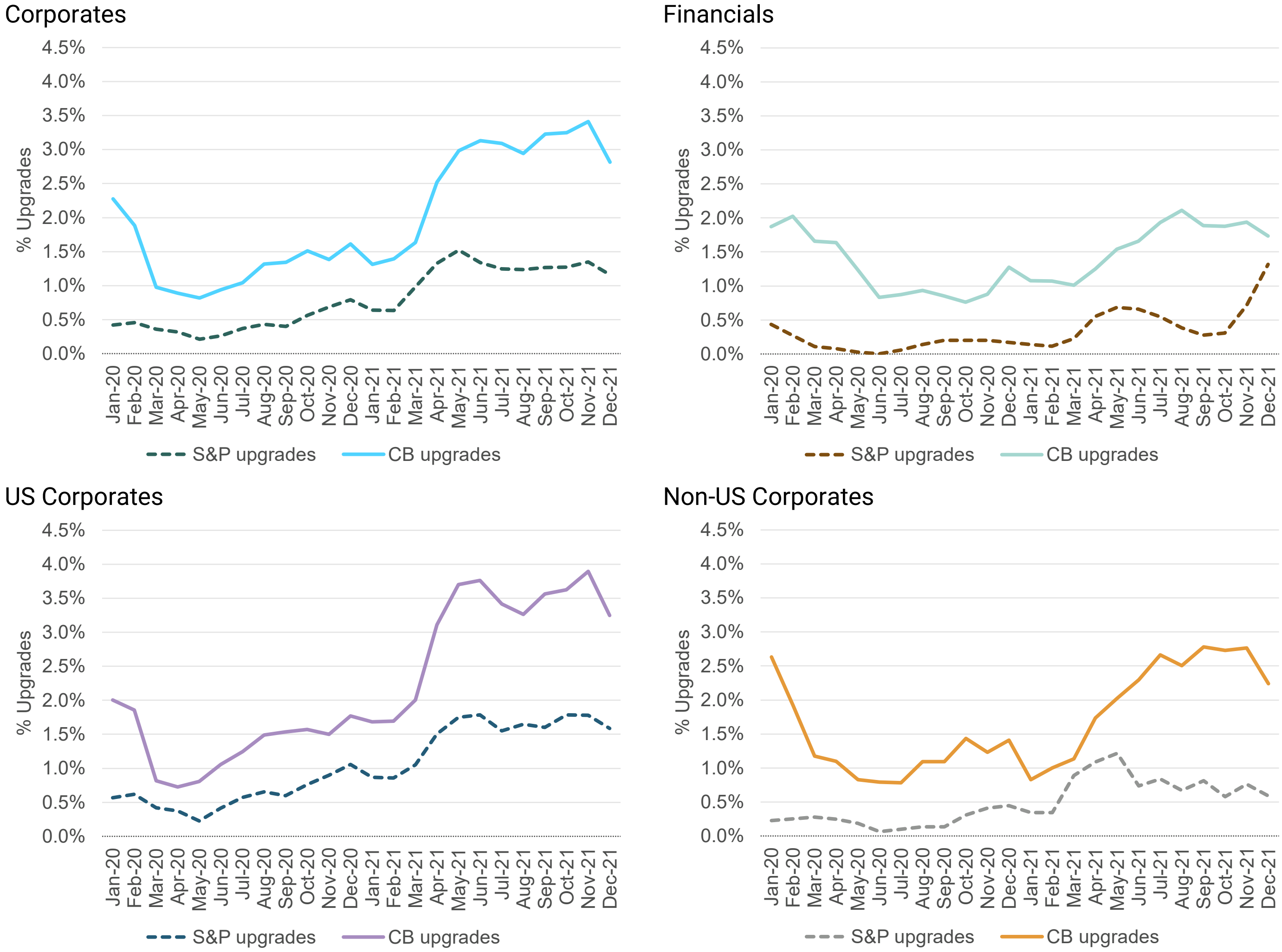


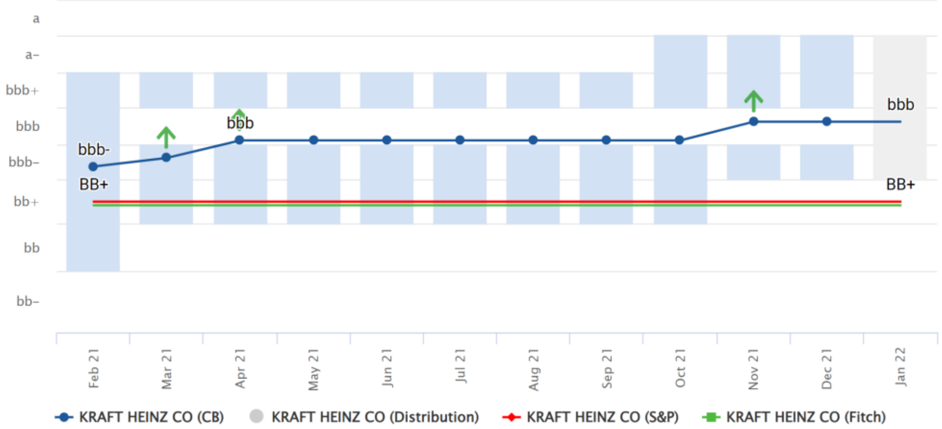
Figure 5.4 shows the detailed breakdown by entity type and region (US / non-US). The Credit Benchmark Corporate upgrade rate reached 3.5% in Nov-21, with S&P just below 1.5%. Both consensus and agency data show higher (+1%) upgrade rates for US vs. non-US Corporates. Consensus data shows increasing upgrade rates over most of 2021 in both US and non-US names, while the S&P upgrade rate in non-US countries has been decreasing since May-21.

Figure 5.4 Balance of upgrades and downgrades – S&P vs CB, 3 month moving average



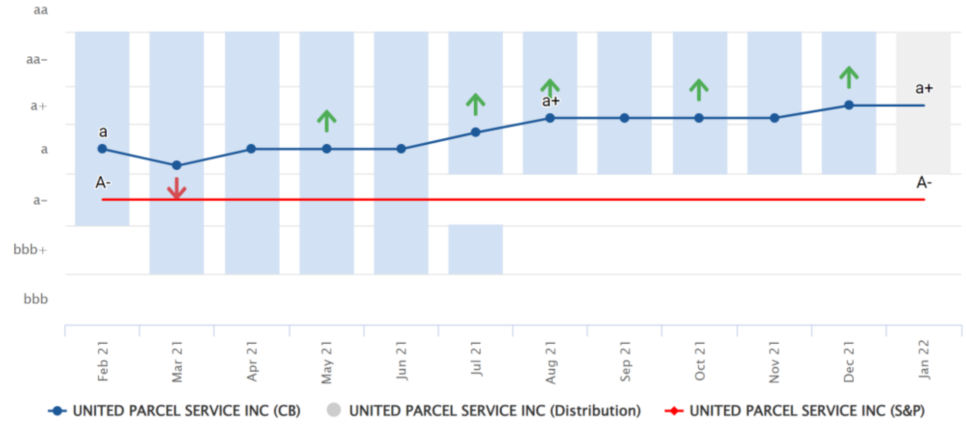
The set of single names in Figures 5.5-5.7 show examples of entities where Credit Benchmark leads the credit risk improvement and currently shows a better rating than S&P.

Figure 5.5 Kraft Heinz Co



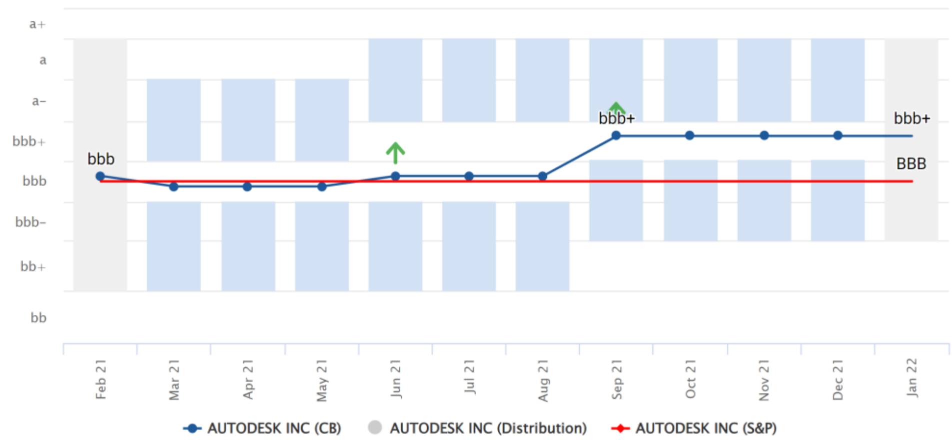
The Credit Consensus Rating for Kraft Heinz Co shows a series of modestly improving credit assessments from banks (green arrows) resulting in one notch upgrade from **bbb-** to **bbb** between Feb-21 and Jan-22. S&P and Fitch ratings have a stable **BB+** rating for the period.

Figure 5.6 United Parcel Service Inc



Similarly United Parcel Services Inc shows a number of improving credit assessments from banks leading to a one notch upgrade from **a** to **a+** between Feb-21 and Jan-22. S&P stays at **A-** for the observed period.

Figure 5.7 Autodesk Inc

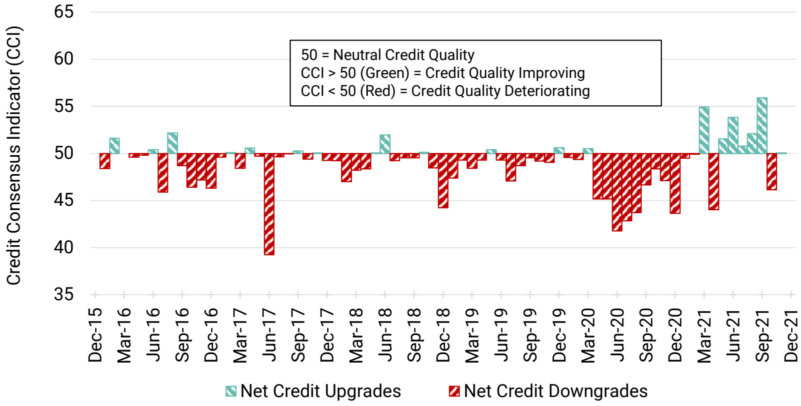


Autodesk Inc shows an upgrade in Credit Consensus Rating from **bbb** to **bbb+**, while S&P stays stable at BBB.

6. Credit Consensus Indicator (CCI)

Industrials had a strong rebound in 2021. This section shows the trends for three regions – UK, US and EU – using the Credit Consensus Indicator (based on the balance of upgrades vs downgrades).

Figure 6.1 UK Industrials: incremental gain

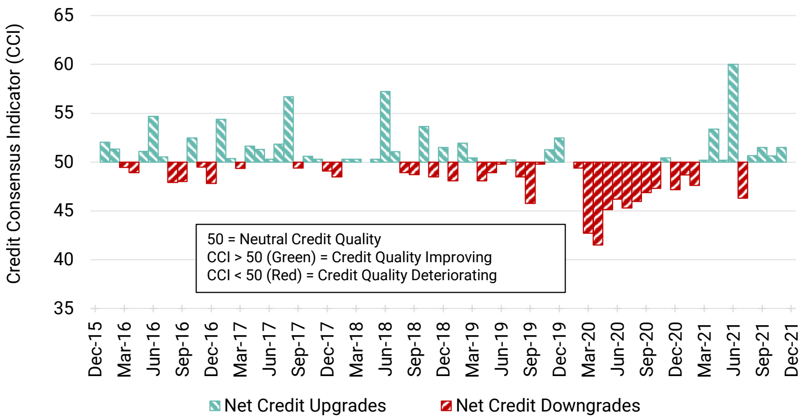


After a material negative drop last month, the consensus credit quality of **UK Industrial firms** has returned to positive territory this month, albeit incrementally.

The **UK CCI score is now 50.1**, just scraping above the neutral mark after last month's negative score of 46.1.

UK manufacturers are keeping the faith, with a survey showing 73% of firms expect conditions to improve in 2022 – though this optimism is tempered by labor shortages and rising costs.

Figure 6.2 EU Industrials: mild positivity

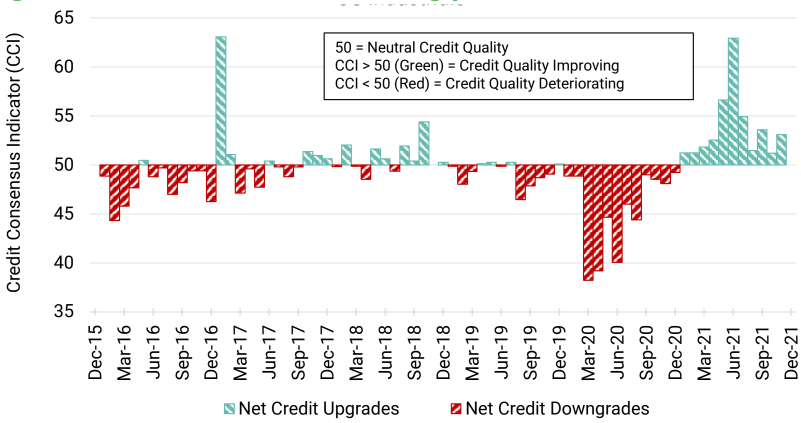


Consensus credit quality for **EU Industrial firms** has been idling for the last four months, with modest positive readings and little change month-on-month.

The **EU CCI score** has marginally improved this month, sitting at 51.5, up from 50.6 last month.

European manufacturing continued to expand in late 2021, with tentative signs that ongoing supply chain pressures are beginning to recede – though Omicron-related disruptions cannot be ruled out.

Figure 6.3 US Industrials: retaining power



US Industrial firms have gone from strength to strength in recent months, with their collective credit quality remaining in positive territory for an 11th consecutive month.

The **US CCI score is 53.1**, an improvement from last month's weaker score of 51.2.

Though last month did indicate some lowing, the industry is experiencing an easing of supply constraints and a cooling of input prices, and the credit quality of the sector reflects these tentatively positive signs.

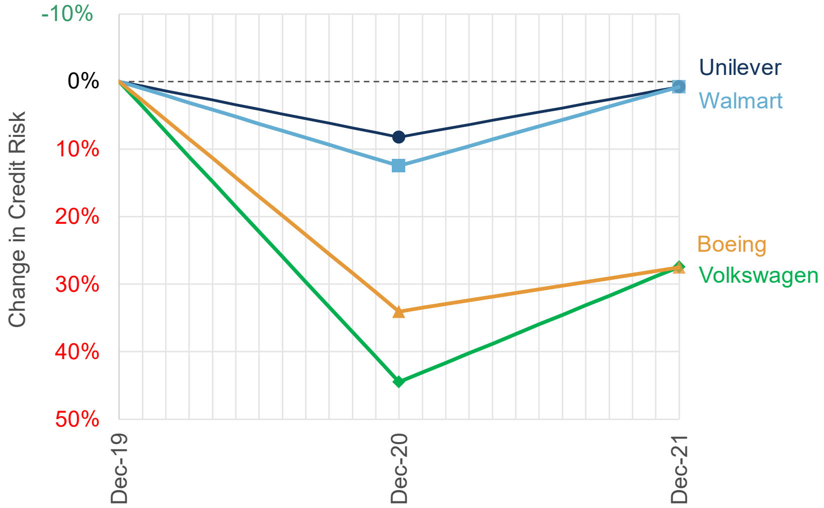
7. Supply Chains

Functioning supply chains will continue to be critical in the post-COVID world, but some of the worst disruption – measured by delays, freight costs etc. – seems to be calming down[5].

However, flows of traded goods are likely to continue be volatile, due to the collision of pent-up consumer demand with widespread skill shortages, supply bottlenecks and uncertainty about further COVID variants.

Figure 7.1 shows the impact of the crisis on some individual company supply chains in different sectors.

Figure 7.1 Supply chain credit risk



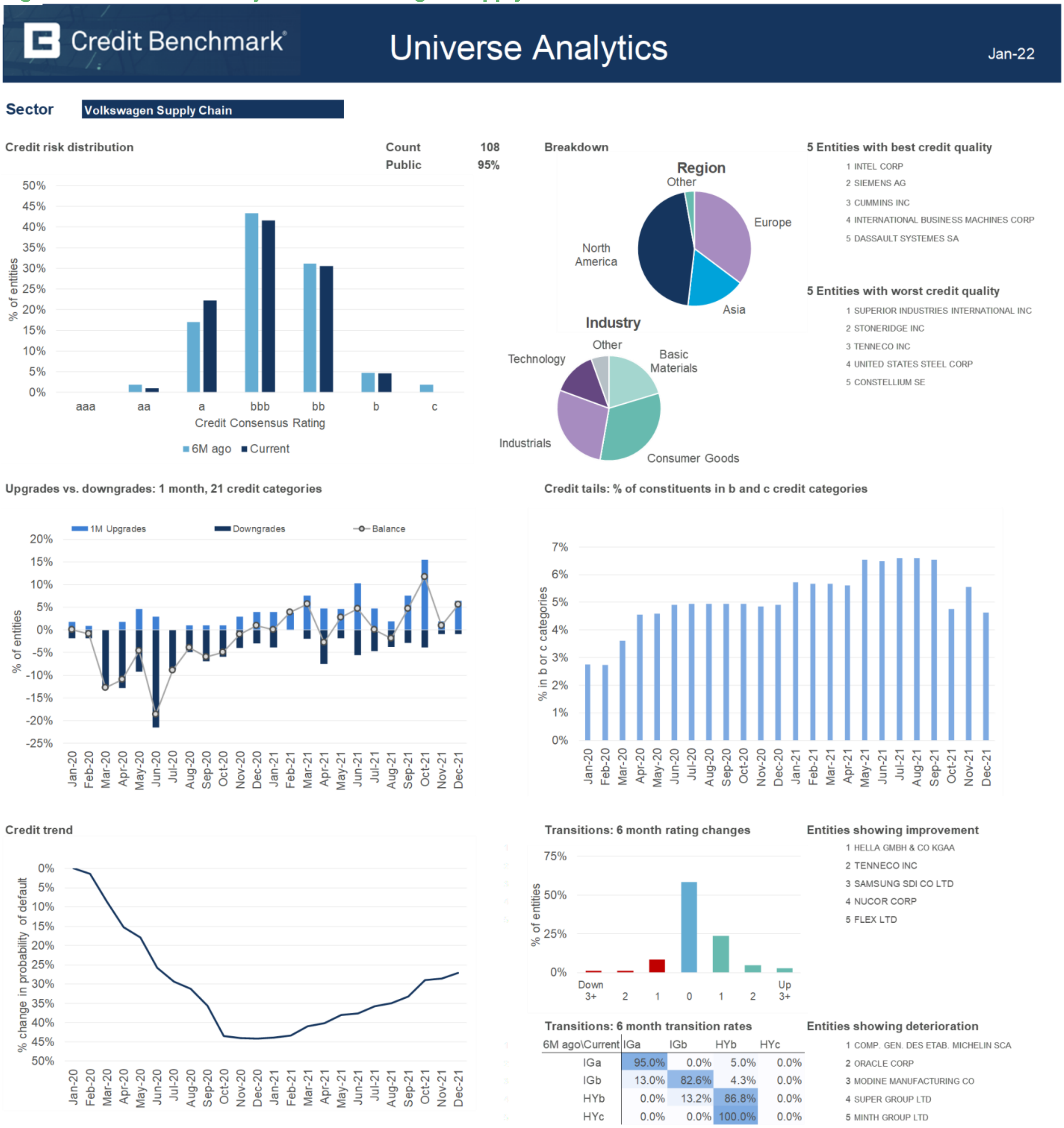
Big companies linked to nondurable consumer goods production and retail, such as Unilever and Walmart, experienced a limited impact on supply chain credit risk. The default risk of their supply chain increased by around 10% in 2020 with a strong recovery in 2021 taking it close to the pre-crisis levels.

The impact on manufacturing was much more pronounced. The credit risk of the Boeing and Volkswagen supply chains is still 30% higher than in Dec-19.

[5] https://www.reuters.com/business/global-markets-supply-pix-2021-11-03/

Credit Benchmark Universe Analytics provides a deeper insight into individual supply chains; Figure 7.2 shows an example for Volkswagen supply chain.

Figure 7.2 Universe Analytics – Volkswagen supply chain



8. Conclusion

2021 saw credit risk estimates making a broad-based recovery after the widespread deterioration of 2020. Upgrades outnumbered downgrades in a ratio of about 1.5:1, and credit risk improved in corporates and financials, with the largest improvement in US Corporates. The proportion of investment grade global corporates also increased, and the rate of transition from High Yield to Investment Grade was double the rate of companies crossing in the other direction. At the sector level, Travel and Leisure – hardest hit in 2020 – was also slowest to begin its recovery. Geographically, most countries are improving but a number of Middle Eastern countries continue to show a bias towards downgrades.

9. Outlook

With higher inflation, the possibility of rising interest rates, QE being withdrawn, ongoing supply chain challenges and the end of Government support programs, it is likely that the default rate will rise especially in the heavily indebted High Yield / Speculative names and in companies that lack price-setting power. Despite a credit recovery in 2021, the consensus still shows higher expected credit risk now than before the pandemic, so banks appear to be anticipating an uptick in default rates that has not yet materialised.

There will be some winners – higher interest rates are good for banks and insurance companies, rising inflation favours sectors like retailers with positive terms of trade. Trends in the bank consensus also suggest some scope for rating agency upgrades in the near future, especially in larger investment grade names or those that are close to crossing the boundary into investment grade.

More from Credit Benchmark

Credit Benchmark brings together internal credit risk views from 40+ of the world's leading financial institutions to provide credit consensus ratings and analytics on 60,000+ corporates, financials, funds, and sovereigns, over 75% of which are publicly unrated. The contributions are anonymized, aggregated, and published twice monthly to provide an independent, real-world measure of risk.

The data is available via the Credit Benchmark Web App, Excel add-in, flat file download, and **third-party platforms including Bloomberg.** High level credit assessments on the single name constituents of the sectors mentioned in this report can be accessed on CRPR <GO> or via CRDT <GO>.

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More of our original research and regular credit risk surveillance reports can be found on our website, including the following monthly reports:

- The Financial Counterpart Monitor provides a unique analysis of the changing creditworthiness of financial institutions. The report, which covers banks, intermediaries, buy-side managers, and buy-side owners, summarizes the changes in credit consensus of each group as well as their current credit distribution and count of entities that have migrated from Investment Grade to High Yield.
- The Industry Monitor shows the changing creditworthiness of a selection of industries and sectors. The report shows the number of entities per category with a Credit Consensus Rating, their month-on-month changes in credit distribution, and their transitioning credit quality.
- Credit Consensus Indicators (CCIs). The CCI is an index of forward-looking credit opinions for US, UK and EU Industrials. The CCI tracks the total number of upgrades and downgrades made each month by credit analysts to chart the long-term trend in analyst sentiment for Industrials.

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