

THEMATIC

HY default rates: recent and expected trends



Sergio BERTONCINI,
Senior Fixed Income Research
Strategist



Debora DELBO',
EM Macro Strategist



Claire HUANG,
EM Macro Strategist

Persistent supportive funding conditions and the improved macro picture are consistent with a current and expected benign picture for US and European default cycles, which are likely to remain on a downward trend in the coming months. Emerging markets' high yield corporate default rate remains quite low and we expect a further decrease in the next month. Higher risk in China, in particular in the property sector. Beijing will continue with financial de-risking and reducing housing sector leverage but systemic financial risk will be prevented.

Our views on US and Europe

Global default rates keep falling significantly, thanks to a strong economic recovery, abundant liquidity in the capital markets and persistently low cost of debt servicing. According to the latest figures from Moody's, the trailing 12-month global speculative-grade default rate was 3.3% at the end of July, the same as the pre-pandemic level, at the end of February 2020. July also marked the seventh consecutive month in which the global rate had declined since hitting a cyclical peak of 6.8% in December 2020. A look at trends by geographical area over the past few months shows that the speculative grade default rate has fallen more rapidly in the US than Europe, down from higher peaks, and finally matched the remaining gap with Europe in June. In July the US default rate finally fell to 3.1% from 4.0% in June, while the European default rate fell to 3.7% from previous month's 4.0%. In first half of this year the default number totalled 28 companies, roughly just a quarter of the 114 defaults that occurred in the same period last year (H1-'20).

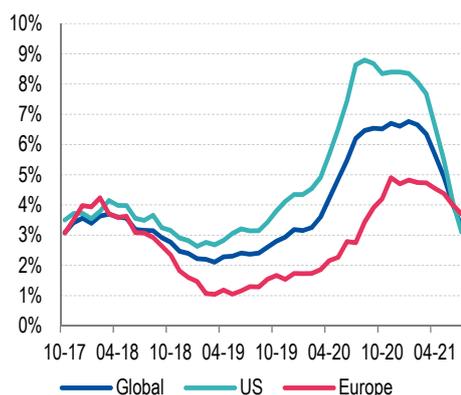
As we have often underlined in previous publications, this cycle was mostly concentrated in the lowest-rated and most vulnerable names. Thanks mainly to prompt and effective policy intervention, BB and B-rated default rates have remained very low by historical standards, as no credit crunch took place and financial conditions remained supportive. Just as CCC default rates drove this cycle upward, the recent downward move has been led by the lowest-rated segments. Over the past few months their default rate

has roughly halved from cyclical peaks above 30%, while other rating categories are already close to being quite low.

Moody's expects the downward trend to continue in the next few months and then to stabilise below 2% by the end of the year and in H1 2022. In short, the global default rate should keep falling, albeit at a slower pace than in H1, and the latest 12-month projections by the rating agency for US and European HY default rates point to 2% for both areas, while forecasting even lower levels by the end of this year, respectively at 1.5% and 1.8%. Moody's baseline scenarios for the two areas assume ongoing supportive funding conditions and an improved macro picture. In our view, this benign picture is consistent with distress ratios and other indicators of financing conditions remaining at quite favourable levels by historical standards and is consistent as well with macro and micro prospects. In this respect, a look at European market sees supportive readings from the latest bank lending standards survey published by the ECB and encouraging trends in HY primary market. On one side, loans standards applied by banks to non-financial companies have improved in the last two quarters, while, on the other, a remarkable volume of refunding activity through bonds issuance has made it possible for many companies to increase the average duration of their debt at very low costs. Fundamental trends keep showing supportive earning growth, ultimately being consistent with on-going improvement in credit metrics and lower default rates.

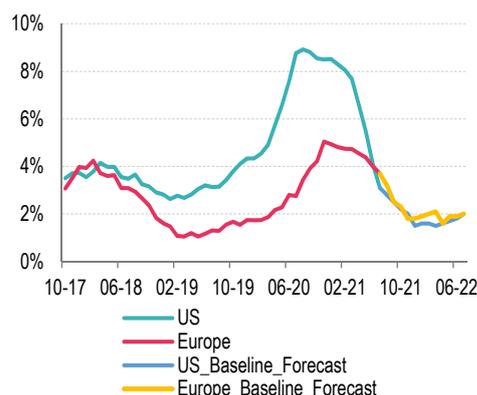
A look at the European market sees supportive readings from the latest bank lending standards and encouraging trends in the HY primary market

1/ Global HY Default rates (Moody's)



Source: Moody's, Amundi Research - Data as of 13/08/2021

2/ US and Europe HY Default rates: actual and projected by Moody's



Source: Moody's, Amundi Research - Data as of 13/08/2021

THEMATIC

The emerging high yield corporate default rate is stabilising, at slightly above 3%

Internal calculations see GEM HY corporate default rates decreasing further on a six-month horizon in the range of 1.8%-2.3%

Risk perception remains higher in China, in particular in the property sector. We expect, however, Beijing will carefully prevent systemic financial risk

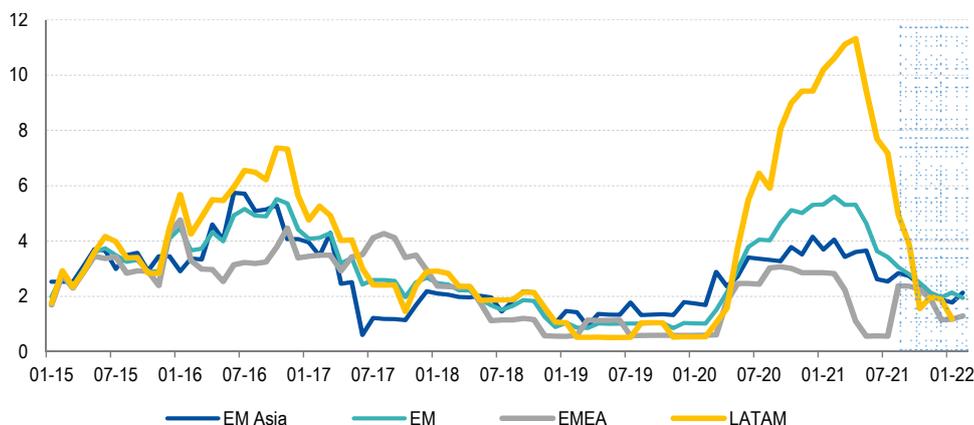
Our views on emerging markets

Emerging markets' high yield corporate default rate (source: Bank of America) is stabilising at slightly above 3% (3.4% in August from 3.6% in July). The region with the worst default rate is Latin America (7%), particularly Argentina and Mexico. The distress ratio in Latin America is close to 10.6%, but excluding Argentina is it only 2%. EMEA, on the other side, is the safest region (with a default rate of 0.56%).

In terms of forecasts, our internal calculations see GEM HY corporate default rates decreasing further on a six-month horizon in the range

1.8%-2.3%. Country risk perception (CDS) has stabilised, but spreads are not showing any further improvement, and this is visible in the distress ratio, which has moved up again to 17.6% in August from 15.5% in July. GEM earnings growth expectations are going to move down on a 12-month horizon from the current 18% to 16%, due to the slowing down recovery, which leaves less room for further pickup. On the positive side, leverage is improving for GEM, in both net (4.5) and gross (6.3) terms. Global financial conditions remains quite supportive and volatility is low.

3/ EM HY Default - forecast



Source: Bank of America, Amundi Research - Data as of 23/08/2021

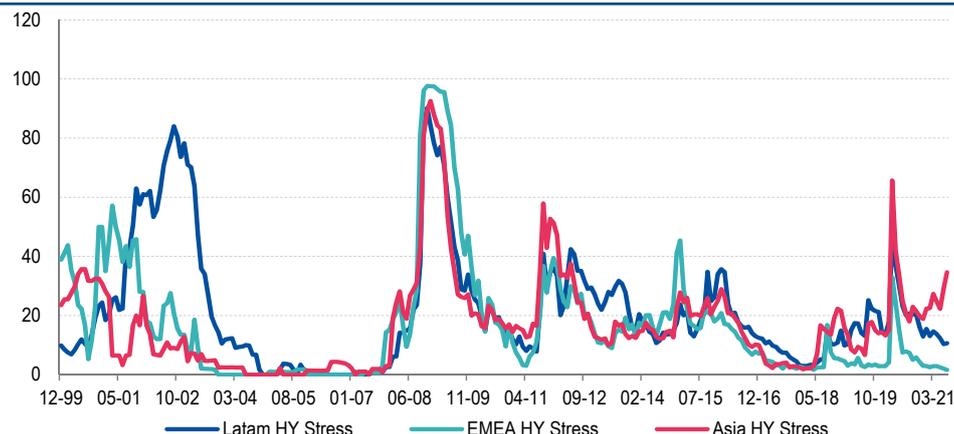
At the regional level, as we have seen, the Latin America default rate is still high, mainly in Argentina. We see some improvements in the next six months (default at 1.5%-2%) thanks to not excessive funding requests and a further recovery in earnings growth (Latin America is still a laggard).

In EMEA and EM Asia, default forecasts remain contained and not very far from current levels.

EMEA is the region where both current default rates (0.56%) and six-month forecast rates (1.2%) are lower, thanks to very contained leverage (net debt/EBITDA ratio at 2.7 and gross at 4) and distress ratios (1.6%).

On the other side, emerging Asia remains the region with the highest forecasted default rates on a six-month horizon, at slightly above 2%. In this region, the spread-to-worst increased further last month, and the distress ratio is mounting again (to 34.6% from 29%). Risk perception remains high mainly in China, in particular in the property sector, where spreads have widened. The case of Evergrande illustrates that Beijing will continue with financial de-risking and reducing housing sector leverage, but will carefully prevent systemic financial risk. In light of weakening growth momentum and with inflation risks at bay, we expect China's overall policy stance to turn more decisively to the dovish side.

4/ Distress ratio



Source: Bank of America, Amundi Research - Data as of 23/08/2021

Amundi Research Center



Find out more about
Amundi publications
research-center.amundi.com

Emerging Private Equity
Money Markets Find Monetary
Foreign Top-down Policies
Exchange Corporate Equities Bottom-up
Sovereign Bonds High Forecasts
ESG Fixed Income Yield Real Estate
Quant Investment Strategies Asset Allocation

DISCLAIMER

This document is solely for informational purposes.

This document does not constitute an offer to sell, a solicitation of an offer to buy, or a recommendation of any security or any other product or service. Any securities, products, or services referenced may not be registered for sale with the relevant authority in your jurisdiction and may not be regulated or supervised by any governmental or similar authority in your jurisdiction.

Any information contained in this document may only be used for your internal use, may not be reproduced or disseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices.

Furthermore, nothing in this document is intended to provide tax, legal, or investment advice.

Unless otherwise stated, all information contained in this document is from Amundi Asset Management SAS and is as of 2 September 2021. Diversification does not guarantee a profit or protect against a loss. This document is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The views expressed regarding market and economic trends are those of the author and not necessarily Amundi Asset Management SAS and are subject to change at any time based on market and other conditions, and there can be no assurance that countries, markets or sectors will perform as expected. These views should not be relied upon as investment advice, a security recommendation, or as an indication of trading for any Amundi product. Investment involves risks, including market, political, liquidity and currency risks.

Furthermore, in no event shall any person involved in the production of this document have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages.

Date of first use: 7 September 2021.

Document issued by Amundi Asset Management, "société par actions simplifiée" - SAS with a capital of €1,086,262,605 - Portfolio manager regulated by the AMF under number GP04000036 - Head office: 90 boulevard Pasteur - 75015 Paris - France - 437 574 452 RCS Paris - www.amundi.com

Photo credit: ©MDelporte - iStock/Getty Images Plus - MarianVejcik

Chief editor

BLANQUÉ Pascal, *Group Chief Investment Officer*

Editor

DEFEND Monica, *Global Head of Research*

With Global Research contributors

AINOUZ Valentine, *Deputy Head of Developed Markets Strategy Research, CFA*

BERARDI Alessia, *Head of Emerging Macro and Strategy Research*

BERTONCINI Sergio, *Senior Fixed Income Research Strategist*

BLANCHET Pierre, *Head of Investment Intelligence*

BOROWSKI Didier, *Head of Global Views*

CESARINI Federico, *Head of DM FX, Cross Asset Research Strategist*

DROZDZIK Patryk, *Senior EM Macro Strategist*

GEORGES Delphine, *Senior Fixed Income Research Strategist*

Deputy-Editors

BLANCHET Pierre, *Head of Investment Intelligence*

BOROWSKI Didier, *Head of Global Views*

HERVÉ Karine, *Senior EM Macro Strategist*

HUANG Claire, *Senior EM Macro Strategist*

LETORT Valérie, *Global Views*

PERRIER Tristan, *Global Views*

PORTELLI Lorenzo, *Head of Cross Asset Research*

USARDI Annalisa, *Senior Economist Cross Asset Research*

VANIN Gregorio, *Cross Asset Research Analyst*

VARTANESYAN Sosi, *Senior Sovereign Analyst*

With the Amundi Insights Unit contribution

BERTINO Claudia, *Head of Amundi Investment Insights Unit*

CARULLA POL, *Amundi Investment Insights Unit*

FIOROT Laura, *Deputy Head of Amundi Investment Insights Unit*

DHINGRA Ujjwal, *Amundi Investment Insights Unit*

PANELLI Francesca, *Amundi Investment Insights Unit*

Conception & production

BERGER Pia, *Research*

PONCET Benoit, *Research*