
Euro high yield default rates forecast – mostly benign with an undercurrent

Fixed income | May 2023



Tom Southon
Senior Analyst,
High Yield

- **We continue to forecast near-term default rates to remain relatively benign, but note the underlying trend is modestly negative**
- **The outlook has been helped by Europe’s primary market reopening, though refinancing prospects for over-levered issuers remain challenged**
- **We still expect default rates to move higher as the 2025/26 maturity wall draws closer**

Mid-way through Q2 2023 the Columbia Threadneedle default rate forecast for European High Yield (EHY) is 1.4% for the forward 12-month period and 3.7% for the forward 24-month period. Our headline forecast is essentially unchanged from October but is moderately worse in the longer term. This compares to a trailing 12-month default rate (to December 2022) for EHY of 0.4%, according to JP Morgan¹, and a recent peak through the Covid-19 pandemic of 6.9%. For context, Moody’s calculates a long-run average global speculative grade cumulative default rate of 4.1% over a 12-month period and 8.2% over 24 months².

Main drivers

There are several reasons behind this forecast:

- **Adler has already defaulted** Following approval of the German real estate group’s restructuring plan last month³, default risk has been greatly reduced. If this hadn’t occurred our 12-month forecast would have increased by 0.2% and our 24-month forecast by 0.3%.

¹ <https://am.jpmorgan.com/gb/en/asset-management/institutional/insights/portfolio-insights/fixed-income/top-of-mind-high-yield-market-questions-for-investors/>

² <https://www.moody.com/creditfoundations/Default-Trends-and-Rating-Transitions-05E002>

³ Reuters, UK court refuses Adler bondholders right to appeal restructuring plan, 25 April 2023

- **European energy pricing** In Europe, the heightened level of concern around energy pricing that prevailed over much of the second half of 2022 has abated and a more severe growth/inflation downside cases appear to be off the table – for now.
- **Improved financing conditions** With a less severe fundamental outlook, the average yield for EHY issuers (as per the ICE Bank of America HPS2 index) fell around 120bps from its post-Covid peak of 7.6% in October 2022 to 6.4% currently. This has helped reopen the primary market in recent weeks and facilitate a number of refinancing transactions of existing 2024/25 maturities.
- **Alternative sources of financing** At the margin we have seen an increase in funding sources such as receivables financing and export credit, which has helped support front-end liquidity and term-out near-term refinancing needs.
- **The 2025 maturity wall is getting closer** With Europe's primary market only recently reopened, there is still a sizeable maturity wall to refinance. This has driven an increase in our default expectation, specifically in our 24-month forecast, for a number of issuers.

Sector-by-sector commentary

Figure 1: Columbia Threadneedle HY default forecast (12-month, sector and rating bucket)

12-month forecast	Oct-22	Apr-23	Change Q/Q
By sector			
Automotive	1.2%	1.0%	-0.2%
Basic Industry	1.1%	1.2%	0.1%
Capital Goods	1.5%	1.6%	0.1%
Consumer Goods	2.7%	2.6%	-0.1%
Energy	2.9%	2.3%	-0.6%
Financial Services	0.9%	1.4%	0.5%
Healthcare	2.8%	2.5%	-0.3%
Insurance			
Leisure	4.3%	4.4%	0.1%
Media	0.6%	0.3%	-0.3%
Real Estate	5.7%	2.2%	-3.4%
Retail	2.6%	3.9%	1.2%
Services	1.0%	1.6%	0.6%
Technology & Electronics	0.0%	0.3%	0.2%
Telecommunications	0.0%	0.0%	0.0%
Transportation	0.4%	2.3%	1.8%
Utility	0.0%	0.1%	0.1%
By rating bucket			
BB	0.9%	0.3%	-0.6%
B	2.0%	0.5%	-1.5%
CCC	5.2%	0.9%	-4.2%
Total			
Total	1.4%	1.4%	0.0%
Total excl hybrids	1.6%	1.6%	0.0%

*Oct-22 forecast excl. Adler was 1.2%

Source: Columbia Threadneedle Investments analysis, 27 April 2023

TMT and Utilities – remain a safe-haven. While this is partly driven by inherently stable/non-cyclical business models, there is also a favourable mix effect in terms of hybrid and/or large-cap issuers with well-termed “out” structures. The optical increase in the Utilities default rate comes from the inclusion of gas pipeline operator EP Infrastructure, which was previously in Energy. Decline in the Media default rate comes from United Group where there will be improved liquidity following the announced sale of its towers business.

Figure 2: Columbia Threadneedle HY default forecast (24-month, sector and rating bucket)

24-month forecast	Oct-22	Apr-23	Change Q/Q
By sector			
Automotive	3.7%	3.9%	0.2%
Basic Industry	3.7%	3.9%	0.3%
Capital Goods	4.5%	4.5%	0.1%
Consumer Goods	6.0%	6.6%	0.6%
Energy	6.4%	5.6%	-0.8%
Financial Services	4.2%	4.7%	0.5%
Healthcare	5.9%	5.9%	0.0%
Insurance			
Leisure	7.7%	9.0%	1.3%
Media	2.3%	1.4%	-0.9%
Real Estate	8.4%	5.4%	-3.0%
Retail	5.8%	7.3%	1.5%
Services	3.5%	5.0%	1.5%
Technology & Electronics	1.0%	1.1%	0.1%
Telecommunications	0.5%	0.4%	-0.1%
Transportation	3.4%	4.5%	1.1%
Utility	0.0%	0.3%	0.3%
By rating bucket			
BB	2.8%	1.0%	-1.8%
B	4.8%	1.3%	-3.5%
CCC	8.4%	1.8%	-6.6%
Total	3.6%	3.7%	0.1%
Total excl hybrids	4.1%	4.2%	0.1%

*Oct-22 forecast excl. Adler was 3.4%

Source: Columbia Threadneedle Investments analysis, 27 April 2023

Leisure and Transportation – still seen as high risk. The risk to consumer spending and somewhat shorter-dated/over-levered capital structures remain a concern.

Real estate – driven by idiosyncratic factors The reduced default expectation is entirely due to Adler, which effectively defaulted this month following the approval of its restructuring plan.

Autos – [headwinds largely compensated by strong balance sheets](#). Easing supply chain and inflation-led concerns this year are offset by concerns over discretionary spend pressure. Balance sheet strength is generally very good, particularly for the larger/double-B issuers.

Retail – [refinancing pressures](#). The sector saw a material increase in default rate expectations, mostly due to two issuers: fuel retailer EG Group, and French supermarket group Casino. The former is over-leveraged and has a very significant maturity wall starting in February 2025; the latter is struggling to deleverage and burning large amounts of cash. Casino has maturities due in 2024 and 2025 which it will not be able to repay unless it executes its repeatedly delayed disposal plan.



Important Information

For use by professional clients and/or equivalent investor types in your jurisdiction (not to be used with or passed on to retail clients). For marketing purposes.

This document is intended for informational purposes only and should not be considered representative of any particular investment. This should not be considered an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services. Investing involves risk including the risk of loss of principal. Your capital is at risk. Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. The value of investments is not guaranteed, and therefore an investor may not get back the amount invested. International investing involves certain risks and volatility due to potential political, economic or currency fluctuations and different financial and accounting standards. The securities included herein are for illustrative purposes only, subject to change and should not be construed as a recommendation to buy or sell. Securities discussed may or may not prove profitable. The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Threadneedle Investments (Columbia Threadneedle) associates or affiliates. Actual investments or investment decisions made by Columbia Threadneedle and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. Past performance does not guarantee future results, and no forecast should be considered a guarantee either. Information and opinions provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. This document and its contents have not been reviewed by any regulatory authority.

In Australia: Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Cth) and relies on Class Order 03/1102 in respect of the financial services it provides to wholesale clients in Australia. This document should only be distributed in Australia to "wholesale clients" as defined in Section 761G of the Corporations Act. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws.

In Singapore: Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore.

In Hong Kong: Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the Companies Ordinance (Chapter 622), No. 1173058.

In Japan: Issued by Columbia Threadneedle Investments Japan Co., Ltd. Financial Instruments Business Operator, The Director-General of Kanto Local Finance Bureau (FIBO) No.3281, and a member of Japan Investment Advisers Association and Type II Financial Instruments Firms Association.

In the UK: Issued by Threadneedle Asset Management Limited, No. 573204 and/or Columbia Threadneedle Management Limited, No. 517895, both registered in England and Wales and authorised and regulated in the UK by the Financial Conduct Authority.

In the EEA: Issued by Threadneedle Management Luxembourg S.A., registered with the Registre de Commerce et des Sociétés (Luxembourg), No. B 110242 and/or Columbia Threadneedle Netherlands B.V., regulated by the Dutch Authority for the Financial Markets (AFM), registered No. 08068841.

In Switzerland: Issued by Threadneedle Portfolio Services AG, an unregulated Swiss firm or Columbia Threadneedle Management (Swiss) GmbH, acting as representative office of Columbia Threadneedle Management Limited, authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

In the Middle East: This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Market Counterparties and no other Person should act upon it.

This document may be made available to you by an affiliated company which is part of the Columbia Threadneedle Investments group of companies: Columbia Threadneedle Management Limited in the UK; Columbia Threadneedle Netherlands B.V., regulated by the Dutch Authority for the Financial Markets (AFM), registered No. 08068841.

Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.