Information for investment professionals

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

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- **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 Morgan[1], 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 months[2].

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 month[3], 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.moodys.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	**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.