European high yield: default rate coming down

Fixed income | October 2024

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- **We have lowered our two-year default forecast, from 8.3% to 7.2%, which reflects the completion of a number of recapitalisation transactions and a recent pick-up in refinancing activity**
- **The fundamental backdrop is relatively stable, with the deteriorating outlook in automotives set against a well-capitalised issuer base**
- **Bifurcation of credit buckets continues with CCCs trading at distressed levels. Although the spread difference to single Bs has improved to 1,140bps, it remains 350 above the 10-year average**
- **On a sector basis, TMT remains the sector with the worst default outlook, but financials is not far behind**

Our par-weighted default rate forecast for European High Yield (EHY) is 3.8% for the forward 12-month period and 7.2% for the forward 24-month period. Excluding hybrid issuers, the default rate increases to 4.5% over 12 months and 8.5% over 24 months. This compares to a LTM (last 12 months) default rate for Europe, to April 2024, of 4.1%[1], and a recent peak through the Covid-19 pandemic of 6.9%.[2] For context, Moody's calculates a long-run average global speculative grade cumulative default rate of 4.1% over 12-months and 8.2% over 24-months.

Our headline forecast is lower than six months ago, falling from 8.3% to 7.2% over the forward 24-month period. This is largely the result of a number of liability management exercise (LME) transactions being completed since our last forecast, most notably Adler in real estate. Excluding this effect, underlying fundamentals have remained stable and refinancing activity has contributed to a slight decline in default expectations for certain issuers. We have not seen a notable increase in restructuring or LME candidates and would expect our forward forecast to continue to decline as more contemplated restructuring transactions are completed.

[1] S&P, as at October 2024

[2] Moody's, as at October 2024

Sector commentary

Autos The automotive sector has seen sizeable profit warnings ahead of Q3 earnings, with a slowdown in global sales and continued high costs – notably in Europe – all pointing to a weak outlook for the remainder of 2024 and into 2025. However, with the bulk of the EHY automotive sector being BB rated, this positively influences the automotive default forecast with balance sheets able to withstand the current sizeable pressure.

Capital goods The increased default expectation reflects the departure of Rolls-Royce from the index since our last forecast.[3] The ticker represented 13% of the sector and had a zero probability of default assigned to it.

Financial services The increase in financial services has been driven by the debt-collector space, with Intrum close to completing a discounted debt exchange transaction and GFKLDE likely to follow a similar path in the coming months.

Healthcare The healthcare sector has had a slight improvement, driven by refinancing activity.

Leisure Gaming names continue to be resilient, despite macro-economic uncertainties, with name-specific improvements feeding through to an overall slight reduction in default forecasts. Some of the improvement in Leisure stems from Stonegate falling out of the scope (having previously been at 15.5% and 18.5%). The company refinanced its large 2025 maturity this summer through a private transaction[4] and is no longer included in our forecast.

Real estate The improved forecast in real estate is primarily a result of Adler Group executing a second restructuring following the last forecast date. Adler is one of the largest cap structures in the sector so has an outsized impact on the forecast. We also improved the forecast for SBB and MPW, which have moved forward with transactions that support near-term liquidity (although their absolute default risk remains elevated). On the other hand, we have significantly increased the forecast for Peach. While its November 2025 bond is trading in the 90s, reflecting a high recovery expectation, there is an expectation that shareholders will insist on some form of A&E or haircut before they provide funds for a recently announced deleveraging rights issue.

Services A key contributor to deterioration here is Zenith, which saw its default probability rise following a drastic change in the expected electric vehicle resale value. Elsewhere, there is marginal deterioration as companies opt to preserve capex while waiting through a slower period for the construction business.

TMT The telecoms sector default forecast continues to be heavily driven by the ongoing Altice France situation, where we expect a discounted LME in the near future. In Technology & Electronics the main story remains Atos where a restructuring process is ongoing – the optical reduction in default forecast stems from a perimeter change (bonds coming off index, mostly).

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[3] S&P Global, August 2024

[4] Bloomberg, Stonegate Starts Debt Refinancing With £250 Million From TDR, 29 July 2024

Figure 1: Columbia Threadneedle HY default forecast (12- and 24-month, sector & rating bucket

12-Month Forecast	Apr-24	Oct-24	Change Q/Q
By sector			
Automotive	1.4%	1.9%	0.5%
Basic Industry	1.5%	2.6%	1.2%
Capital Goods	5.7%	6.5%	0.8%
Consumer Goods	2.7%	1.9%	-0.8%
Energy	1.8%	1.7%	-0.1%
Financial Services	11.2%	18.8%	7.6%
Healthcare	2.6%	2.5%	-0.1%
Insurance			
Leisure	2.7%	2.3%	-0.4%
Media	0.0%	0.0%	0.0%
Real Estate	6.6%	3.2%	-3.4%
Retail	3.6%	2.7%	-0.9%
Services	1.7%	2.0%	0.3%
Technology & Electronics	27.2%	21.3%	-5.8%
Telecommunications	5.1%	4.8%	-0.2%
Transportation	0.5%	0.1%	-0.3%
Utility	1.4%	0.0%	-1.4%
By rating bucket			
BB	1.0%	0.8%	-0.2%
B	7.2%	2.6%	-4.6%
CCC	13.8%	17.3%	3.5%
Total	**4.0%**	**3.8%**	**-0.2%**
Total excl hybrids	4.7%	4.5%	-0.2%

24-Month Forecast	Apr-24	Oct-24	Change Q/Q
By sector			
Automotive	3.8%	4.0%	0.1%
Basic Industry	6.3%	5.8%	-0.4%
Capital Goods	16.0%	17.9%	1.9%
Consumer Goods	6.3%	4.9%	-1.5%
Energy	4.9%	4.9%	-0.1%
Financial Services	20.1%	23.4%	3.3%
Healthcare	5.7%	5.3%	-0.4%
Insurance			
Leisure	5.5%	4.6%	-0.8%
Media	2.4%	2.8%	0.4%
Real Estate	16.6%	6.3%	-10.3%
Retail	6.8%	6.7%	-0.1%
Services	4.7%	4.7%	0.0%
Technology & Electronics	28.9%	22.9%	-6.0%
Telecommunications	10.3%	9.9%	-0.3%
Transportation	1.5%	0.4%	-1.1%
Utility	1.5%	0.1%	-1.4%
By rating bucket			
BB	2.9%	2.3%	-0.5%
B	14.2%	5.5%	-8.7%
CCC	24.7%	34.9%	10.1%
Total	**8.3%**	**7.2%**	**-1.1%**
Total excl hybrids	9.6%	8.5%	-1.2%

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