Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases — Update

How Fitch Applies these Scenarios: To maximize consistency across the wide range of sectors and geographies covered by Fitch's credit ratings, all ratings groups globally are now evaluating the impact of the coronavirus relative to a common set of baseline and downside scenario parameters. As Fitch reviews its portfolios, rating actions will be taken in line with expected trajectories under the baseline scenario. This report replaces Fitch's original scenarios published April 2, 2020; if scenarios are revised in the future, Fitch will publish another update.

Baseline

Core Narrative

Sharp economic contractions hit major economies in 1H20 at a speed and depth that are unprecedented since World War II. Sequential recovery begins from 3Q20 onward as the health crisis subsides after a short but severe global recession. Eurozone experiences the most prolonged recession among major economies but the U.S. also is hit very hard. GDP remains below its 4Q19 level until mid-2022. Although this baseline scenario is aligned with the current Global Economic Outlook (GEO), published April 22, 2020, future changes in the GEO will prompt a revision of the scenario if they are considered material.

Key Assumptions

- Lockdown measures of varying degrees in place for 2–3 months in key economies, with 8–9 weeks of peak stringency.
- Rapid spike in unemployment coupled with sharply reduced personal income.
- Sharp falloff in demand for discretionary goods and services.
- Cumulative corporate high yield (HY)/leveraged loan (LL) default rates of 12%–15% in Europe and U.S. in 2020/2021.
- Sustained spread widening, high volatility in funding costs, and market access challenges outside of issuance eligible for government programs.
- Oil prices ranging from $20–$30 bbl for much of 2020.

Future Trajectory

Fiscal stimulus and balance sheet support extend to large swathes of the economy. Widening deficits and easing monetary/ fiscal policy limit the depth of the initial downturn to some extent, but only become more effective once the health crisis subsides. This helps growth to recover, but incomes fall sharply from 4Q19 levels through 2H20 and remain depressed through 2022. Wide-ranging debt relief programs are implemented, spanning multi-month payment holidays for consumers and business lessees to sovereign debt suspension for low-income countries. Overhang and eventual unwind of liability transfer on such an unprecedented scale have long-lasting effects on credit conditions.

Downside

Core Narrative

Re-emergence of infections in the major economies prolongs the health crisis and confidence shock, prompting extensions and/or renewals of lockdown measures and preventing a recovery in financial markets. This provokes a longer-lasting, negative wealth shock and confidence shock that depress consumer demand and lead to a prolonged period of below trend economic activity, with recovery to pre-crisis GDP levels delayed until around the middle of the decade.

Key Assumptions

- Even sharper economic contractions in the U.S. and Europe, with major setbacks in containing the spread of the virus necessitating extensions or re-impositions of lockdowns that cause GDP to fall by ~12% in 2020.
- Double-dip slowdowns in China/East Asia, and recessions across most other emerging markets for FY 2020.
- Wage declines/job losses across income brackets in major economies
- Cumulative corporate HY/LL default rates of 17%–25% in the U.S. and Europe by 2021.
- Prolonged downturn in financial markets and sustained difficulty in funding conditions.
- Demand collapse continues to depress oil prices and constrain spending in oil economies.

Future Trajectory

Extensive fiscal interventions become a mainstay in major economies, but government largesse merely contributes to arresting a downward spiral. Assumed daily loss of GDP during lockdown is 30%, compared to our baseline assumption of 25%; the latter accounts for roughly half of the additional shock to 2020 GDP relative to the baseline, with the remainder explained by a longer lockdown. As significant portions of the economy cease to be productive, wide-scale corporate zombification delays a meaningful recovery beyond a technical rebound in growth in 2021. Outside of official-sector programs, credit markets are only reliably open to the strongest borrowers with the lowest risk business profiles. Episodes of social and political instability could emerge in some jurisdictions.

	Baseline	Downside
Practical Implications	• Following lockdowns, activity resumes slowly amid weak demand. • Healthcare systems continue to cope, though overstretched. • Remote working implemented wherever possible for 3–4 months. • Schools/universities closed for 3–4 months, sporadically thereafter. • Collapse in leisure travel for most of 2020, returning only gradually.	• Extended lockdowns in 1H20 spanning 13 weeks with only gradual easing over following 2 months or a re-imposition of lockdowns later in 2020. • Healthcare systems overwhelmed, with large-scale human impact. • Business closures cause additional layoffs and bankruptcies. • Prolonged impairment of consumer credit quality and rising non-performance levels. • Widespread disruption to civic life threatens to erode social contract.

Baseline

- All Fitch Ratings sector teams globally are screening or have screened their rating portfolios on the basis of these macroeconomic and market assumptions.
- Reviews are being prioritized on the basis of perceived vulnerability to the baseline scenario.
- Fitch Economics may revise country-level forecasts frequently as conditions change.
- If these forecasts change to an extent that becomes inconsistent with the above narrative, assumptions, and trajectory, Fitch will revise and republish its baseline scenario.

Downside

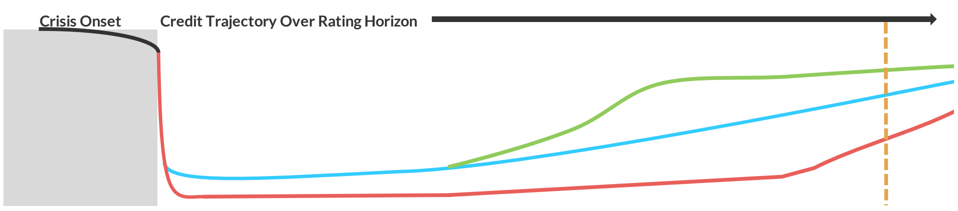
- Assumptions from this more severe scenario inform stress-based analysis by those sectors, which commonly assign ratings at the highest part of Fitch's rating scale.
- On a broader basis, this scenario is being used by sector teams globally to evaluate future rating headroom and to develop benchmarks for rating sensitivities under a more severe set of operating conditions.

Fitch's Forward Looking Rating Approach

Fitch's ratings are forward-looking, with the aim of achieving stability in its ratings through a typical credit cycle. Ratings are intended to change only when there is a structural or secular shift for the rated entity / transaction or its sector rather than a cyclical change in credit quality. However, making this distinction in practice can be a challenge, especially at the lower end of the rating scale.

Fitch aims to look through troughs in economic cycles or short-term volatility to analyze the credit quality using a mid-cycle credit profile. In cases where there are significantly large negative movements in the key credit metrics, Fitch's rating actions will depend on the size of the shock and the length of time until Fitch expects the metrics to come back in line with the mid-cycle view.

Estimated Key Metric Trajectories under Baseline Scenario



Source: Fitch Ratings.

- Green trajectory: Key performance metrics see a sharper uptick immediately after the peak impact of lockdowns.
- Blue trajectory: Key performance metrics see slower recovery, given high developed market unemployment, wealth deterioration and supply chain disruptions.
- Red trajectory: Key performance metrics see the possibility of distress or at best a greatly delayed recovery, particularly for those most exposed to effects of movement restrictions, payment holidays, cash flow timing mismatches, and volatile financial markets.

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For more information, see the Coronavirus landing page of Fitch's web site.

Related Research

Fitch Ratings 2020 Sector Outlooks Updated for Coronavirus Impact (March 2020)