

MOODY'S RATINGS

2024 Credit Risk Forum | London

Macro vs (geo)political risks: Do they impact credit differently?

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Key messages

1

**Global economy will stabilize in 2024
European growth is recovering, policy rates will decline**

2

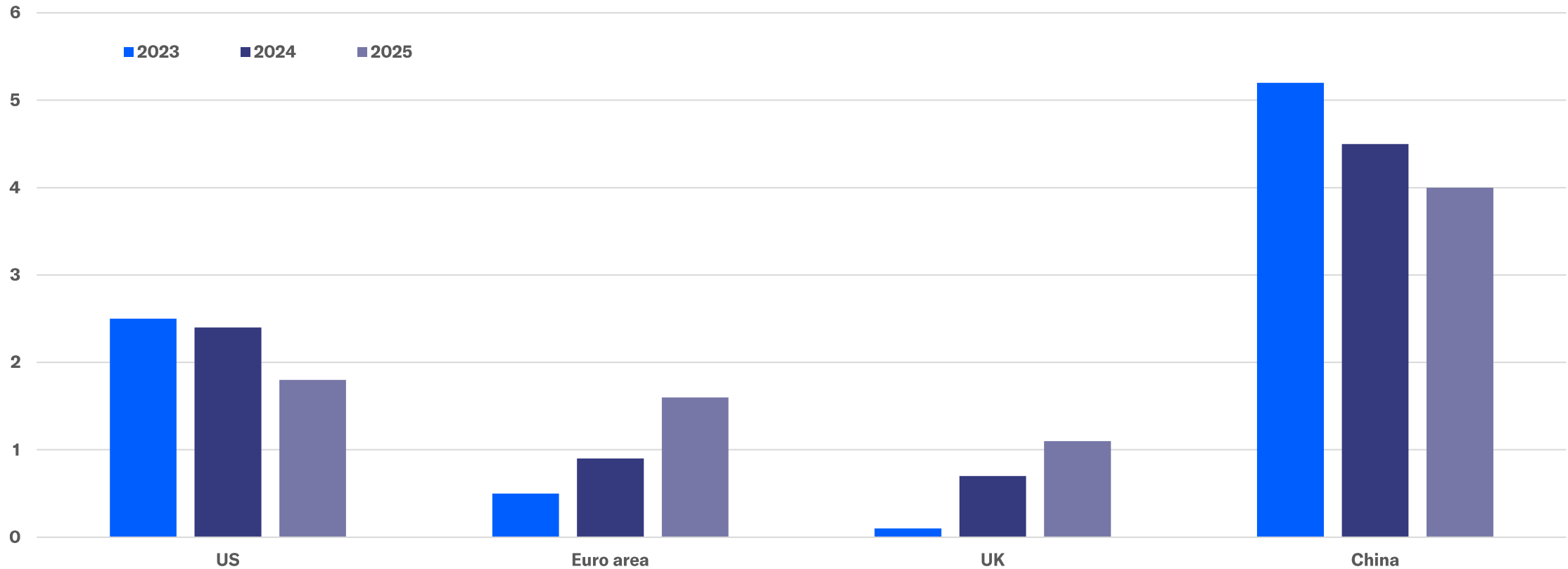
**Geopolitical risks will take centre stage as macro risks fade
Next UK government faces big challenges**

3

**Credit downturn may already have peaked
But even as default rates decline, recoveries will remain weak**

European growth will rise as US growth eases

Calendar year growth rates for real GDP (%)

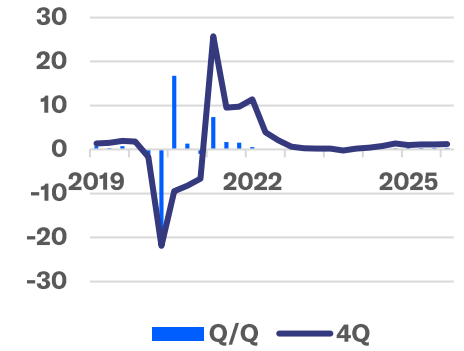
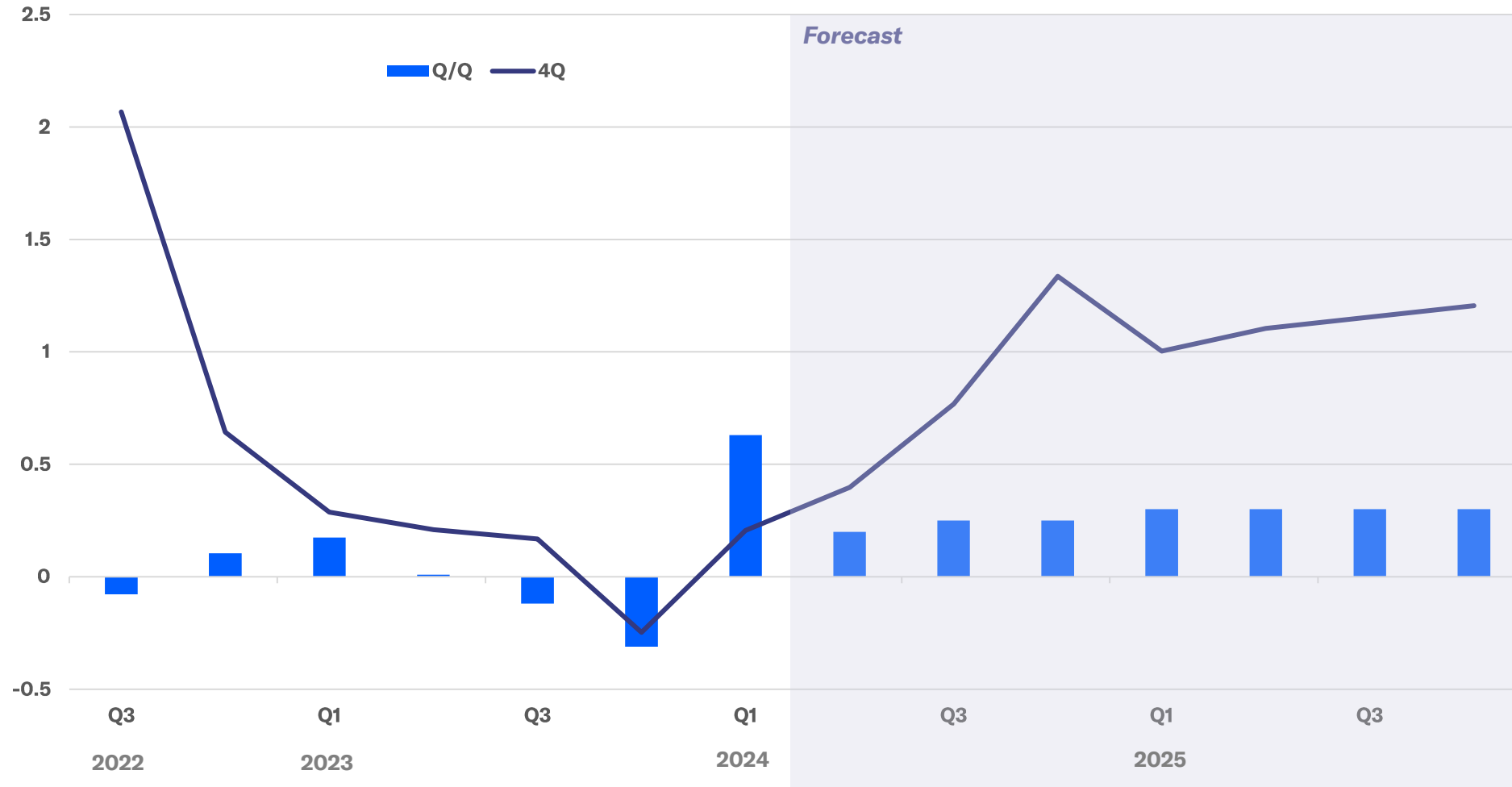


Source: Moody's Ratings.

https://www.moody.com/research/Global-Macro-Outlook-2024-25-May-2024-update-G-20-momentum-persists-in-Outlook--PBC_1407806

UK growth: Q1 not likely to be sustained

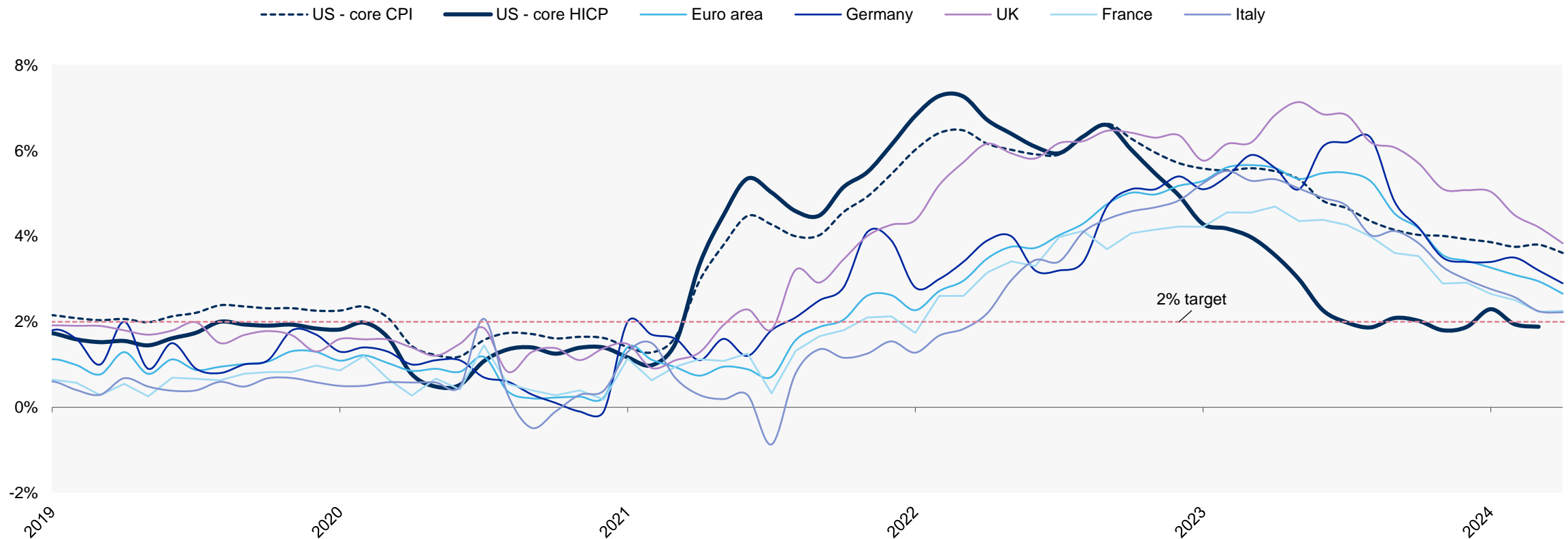
Growth rates for UK real GDP (%)



Source: Moody's Ratings.

Inflation: general decline evident across countries

Twelve-month core inflation rates by country (%)

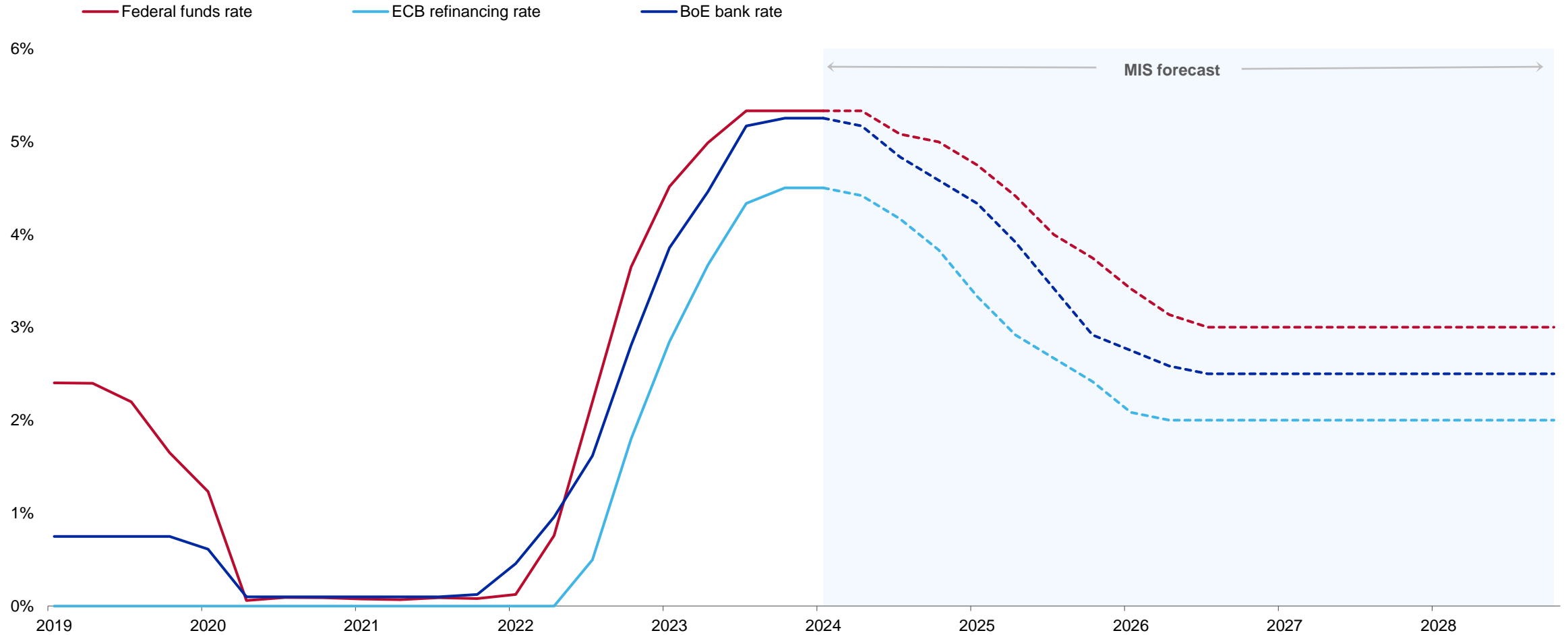


Source: Moody's Ratings.

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We expect policy rates to fall slowly

Central bank main policy rates



Geopolitical risks to persist as macro risks fade

Lower inflation
Reduction in rates
Growth stabilising

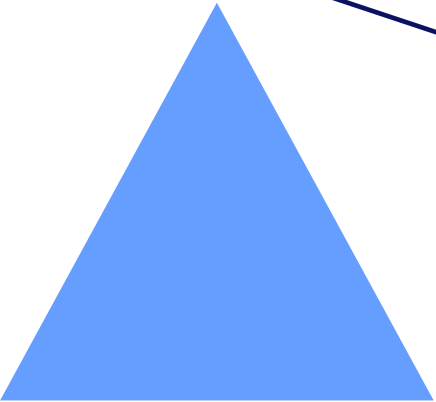


Macro factors



Israel – Iran tensions
Russia/Ukraine war
US & China spillovers
Elections?

Geopolitical factors





Baseline

Middle East Conflict



Downside

Hostilities between Israel - Iran and Iranian proxies
Attacks on military and commercial assets in the region;
Tit-for-tat exchanges; some disruption to Red Sea shipping; temporary airspace closure

- Higher Israeli defense spending
- Minimal infrastructure damage
- Fatalities and displaced population (Gaza and Israel)
- Volatility in global oil price
- Moderate impact on shipping routes
- Weaker economic sentiment in Israel
- Lower tourism (Egypt, Jordan)
- Lower Suez Canal revenues (Egypt)
- Temporary market impact, limited impact on inflation

- **Region:** moderate impact on debt issuers in Israel, Egypt and Lebanon
- **Global:** limited impact on some import-dependent European corporates

Risk transmission channels



Affected credits

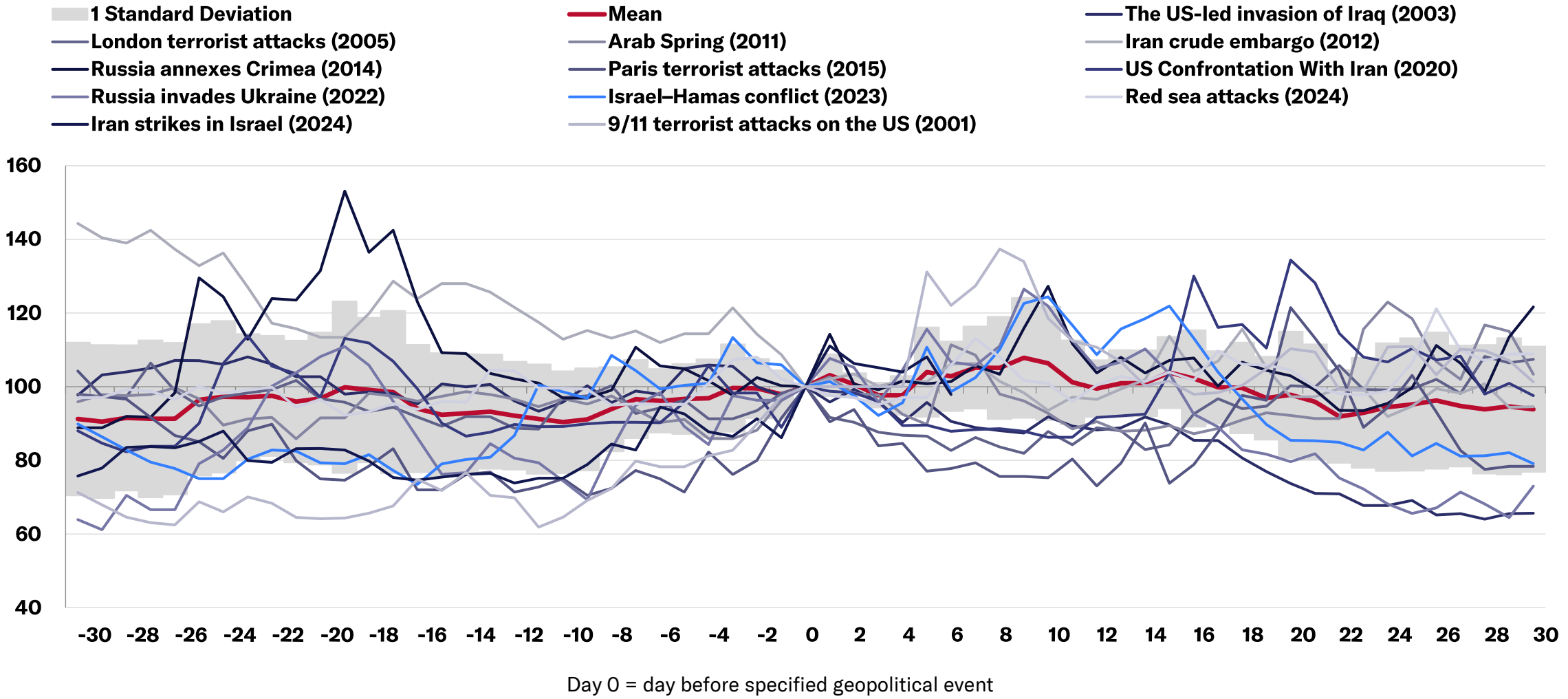
Outright military conflict between Israel/allies – Iran;
Protracted disruption of the Strait of Hormuz and Red Sea shipping; protracted airspace closure

- Higher defense spending in affected countries
- Deepening geopolitical fissures
- Considerable damage to infrastructure in ME
- Fatalities and populations displaced in wider region
- Initial spike in global oil prices that is sustained for a prolonged period
- Higher gas prices (esp. Europe and Asia)
- Sustained and severe supply chain disruption
- Significant negative impact on global growth
- Higher credit spreads, capital flight, falling asset prices
- Sustained significant market impact
- Rise in inflation that reverses monetary easing

- **Middle East** most exposed
- **Global: negative** (high-yield, energy intensive, confidence sensitive sectors, affected ports)
- **Global: positive** (defense sector)

Geopolitics: some signals are better than others

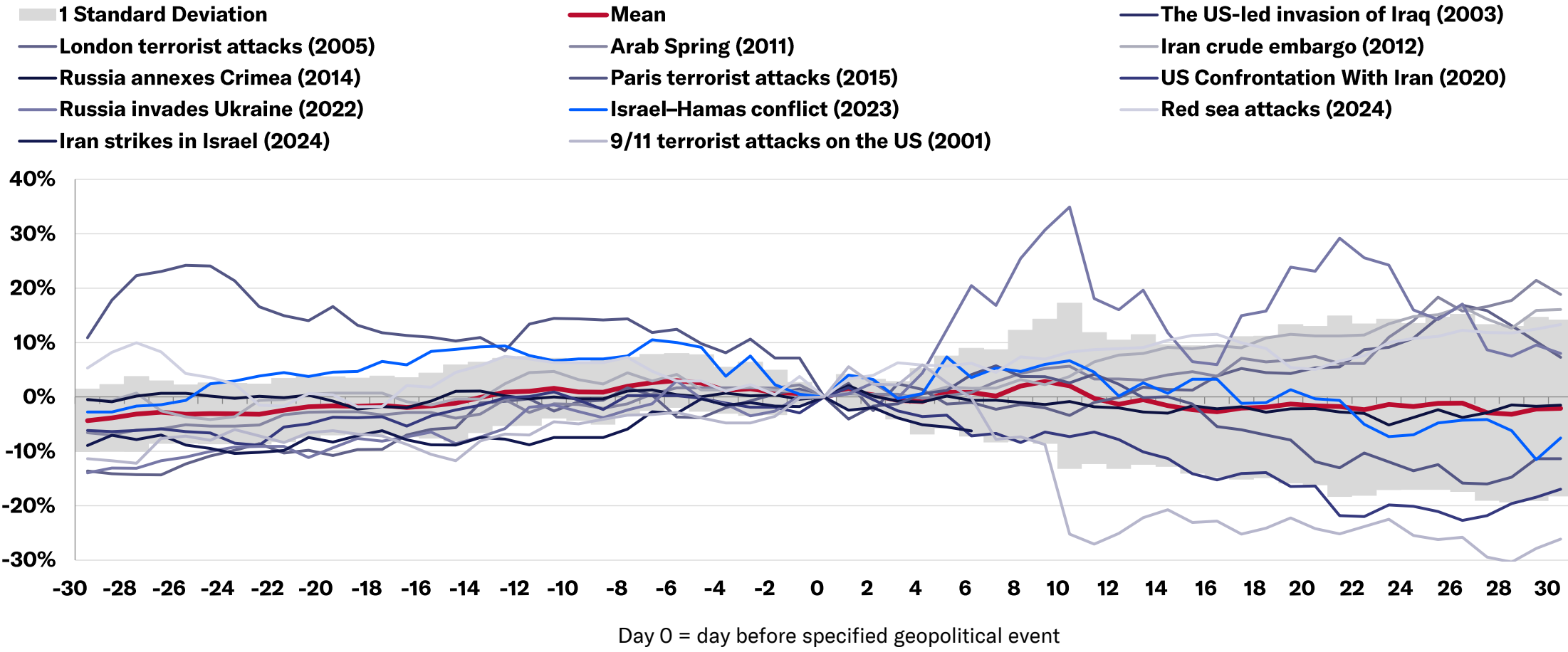
VIX reaction to geopolitical events (% change vs Day 0)



Source: Moody's Ratings.

Geopolitics: some signals are better than others

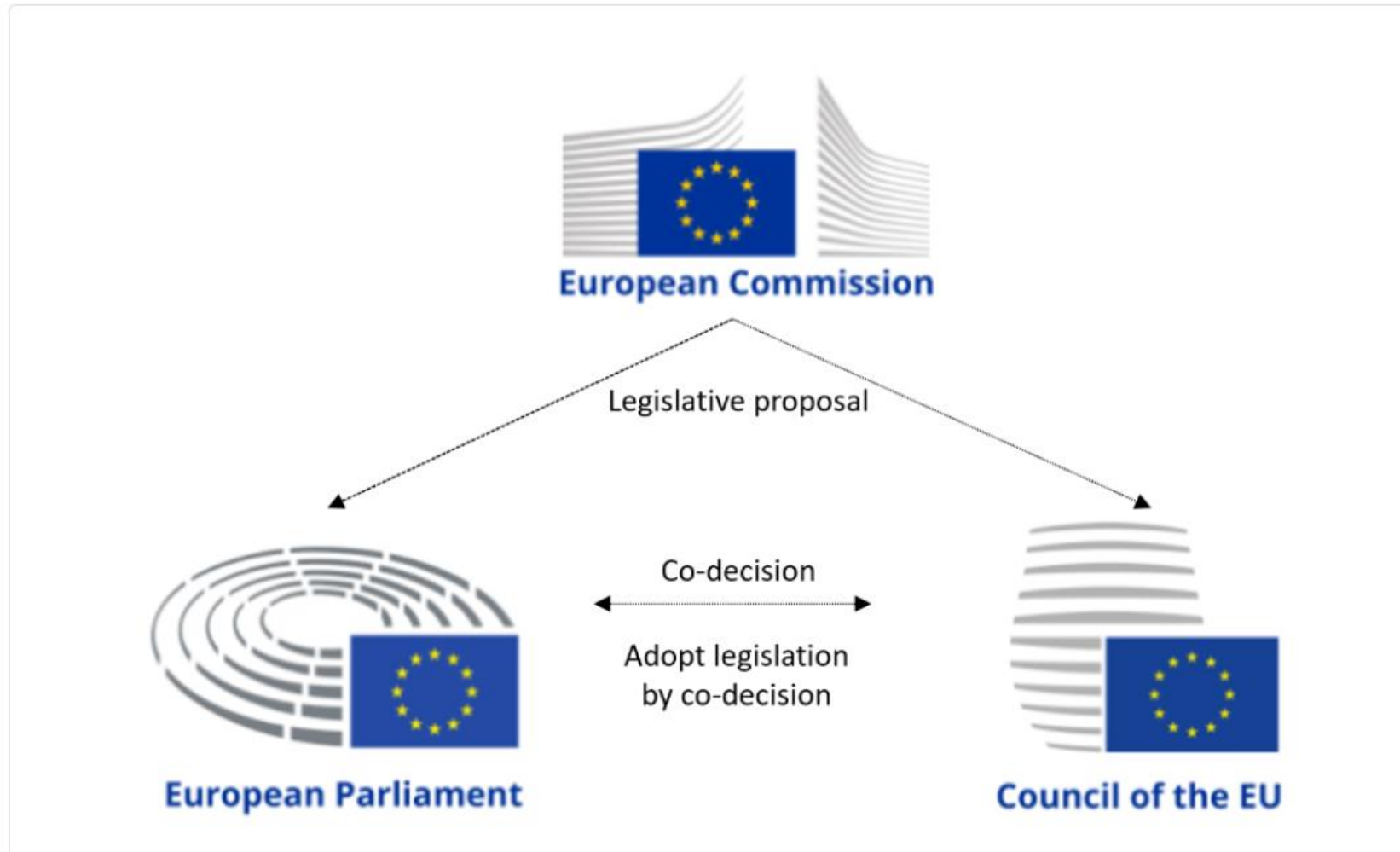
Oil price reaction to geopolitical events (% change vs Day 0)



Source: Moody's Ratings.

Europe: shift to security & competition likely with new parliament

Commission proposes legislation which Parliament and Council amend and approve



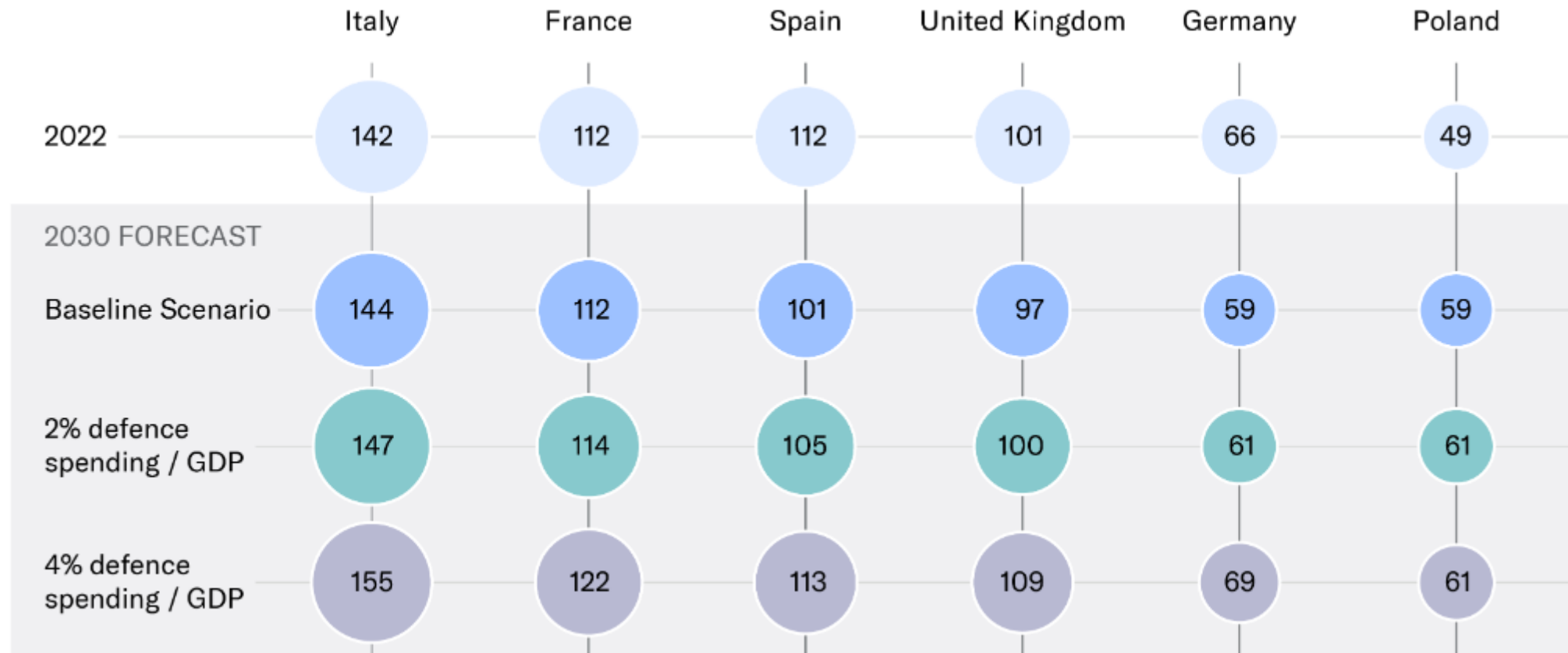
Source: Moody's Ratings.

https://www.moody's.com/research/Political-risk-Europe-EU-Parliament-elections-provide-continuity-as-priorities-Sector-Comment--PBC_1406911

Increased defence spending poses risk to European debt ratios

Scenario analysis of debt impact from increased defence spending

General government debt, % of GDP



Sources: National Statistical Offices and [Moody's Ratings](#)

US elections: Key policies are we monitoring

- Credit conditions for issuers will hinge on how the forthcoming administration and new Congress maintain or redirect 5 key issues: fiscal policy, economic policy, climate and immigration policy, financial and technology regulations, and geopolitics.
- The balance of power within Congress will determine the extent to which the next administration can reform existing laws or pass new legislation to advance its agenda.



Fiscal policy

- Reversal of deterioration in debt affordability will be key to avert US downgrade.
- Political polarization, debt service and non-discretionary budget spending will complicate this.



Economic policy

- Bipartisan collaboration likely on policies that safeguard national security, boost supply-chain resilience and US competitiveness.
- Risk of overarching restrictive policy on trade and investment (China).



Climate and social

- Policy reversal risk on major IRA tax incentives low.
- While risks to green investment momentum have increased.
- Immigration will remain key challenge but could bolster labor supply.



Financial and tech

- Changes to prudential regulatory capital and liquidity standards and LT debt holdings possible.
- Digital asset regulatory to focus on illicit finance and national security.
- Regulatory intervention likely on AI.



Geopolitics

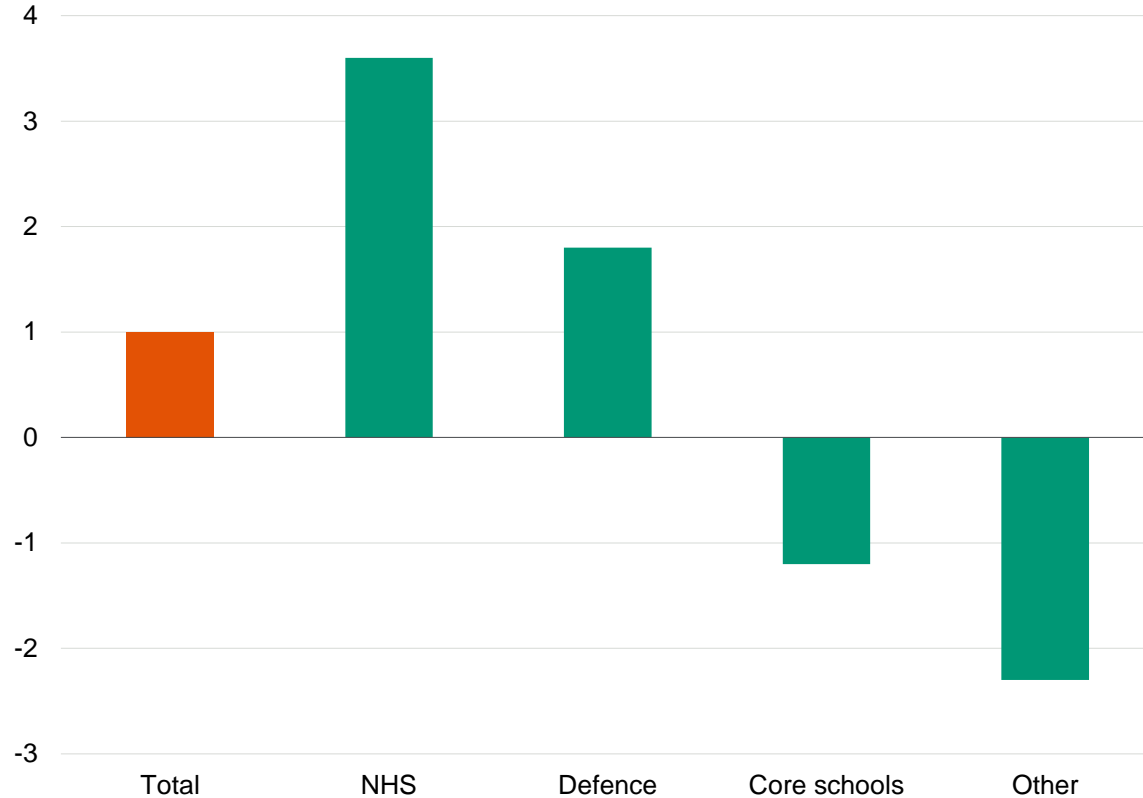
- Geopolitical realities will continue to influence key US policies on trade, finance, immigration and cybersecurity.
- A US agenda that emphasizes more protectionist strategies will likely exacerbate geopolitical divisions and affect financial markets.

See: [Political Risks – US: Next administration's handling of key policy areas to have wide-ranging credit effects](#), 20 March 2024.

UK election winner faces significant challenges

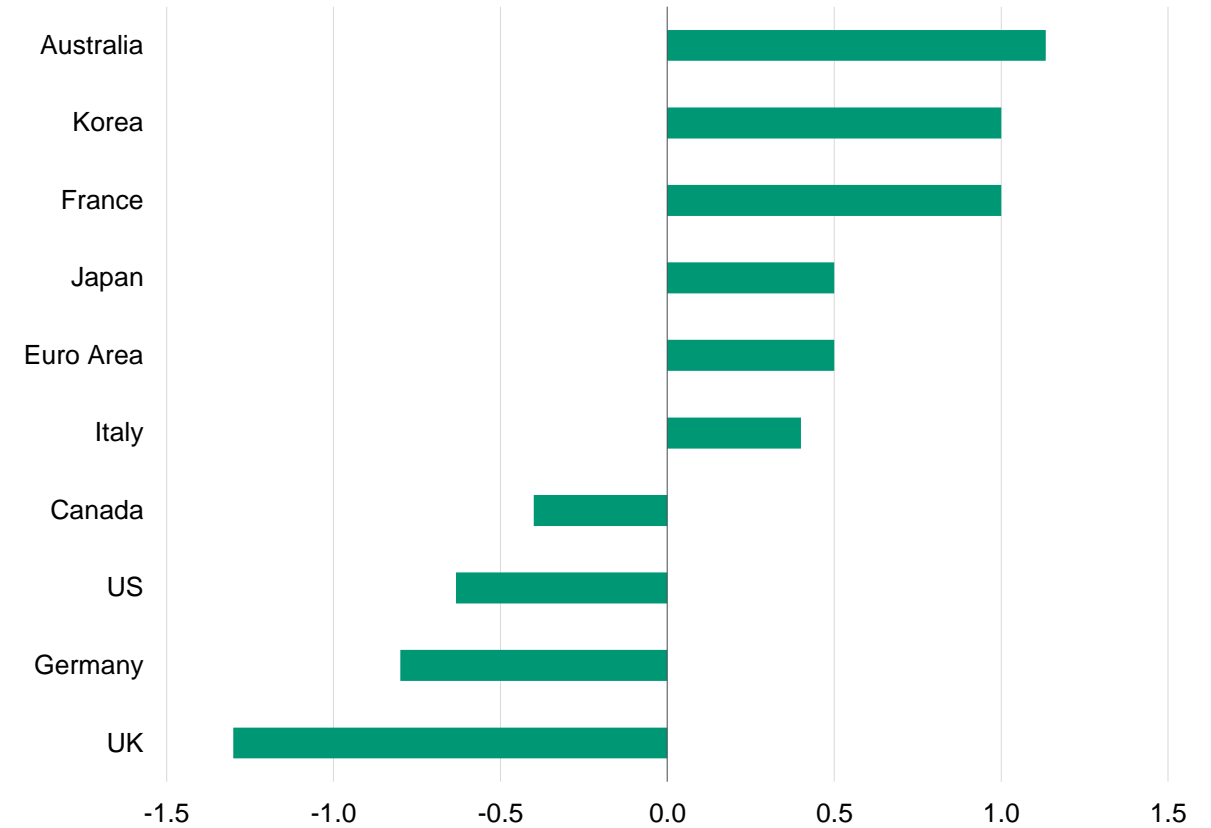
Austerity will return under current plans

Real terms spending growth (2026-9) implied to meet debt target



Activity rate has fallen sharply

Change in 15+ labour force activity (ppts), 2019 Q4 to 2023 Q4

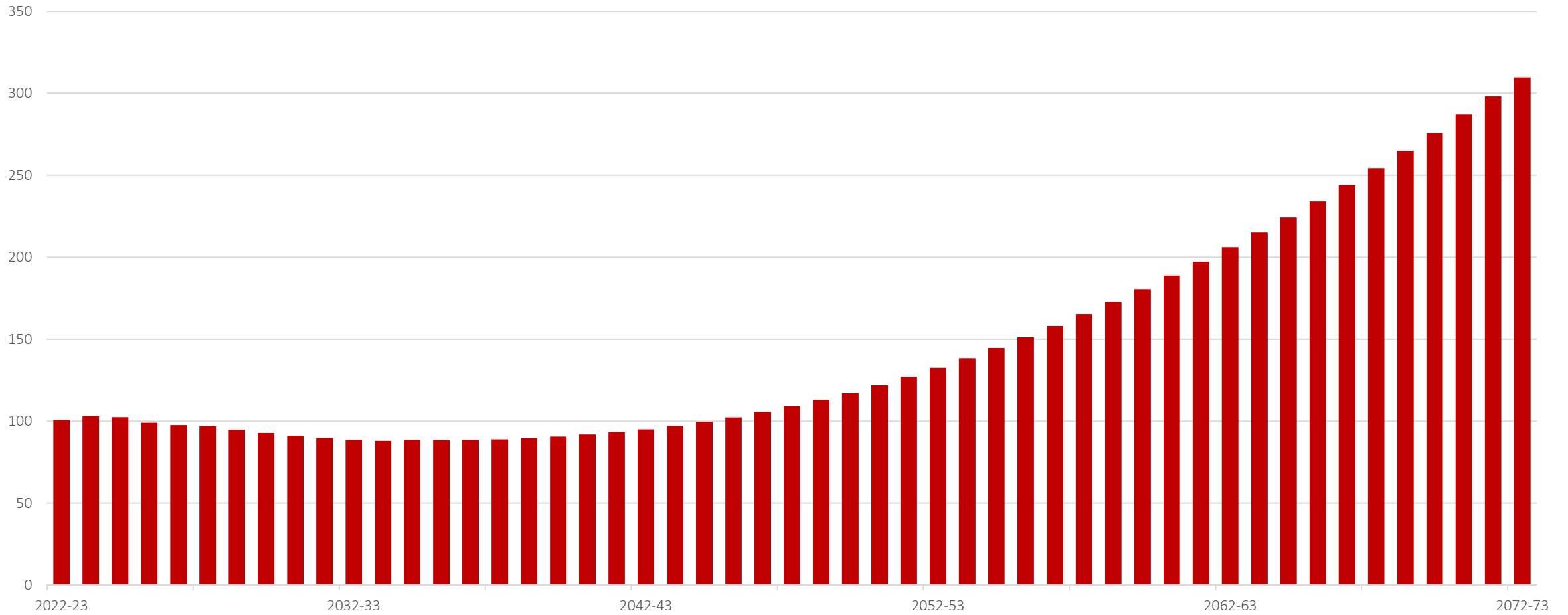


Source: Moody's Ratings.

https://www.moody.com/research/Government-Policy-UK-New-government-could-boost-growth-but-faces-Sector-In-Depth--PBC_1410205

UK has serious long-term fiscal challenges

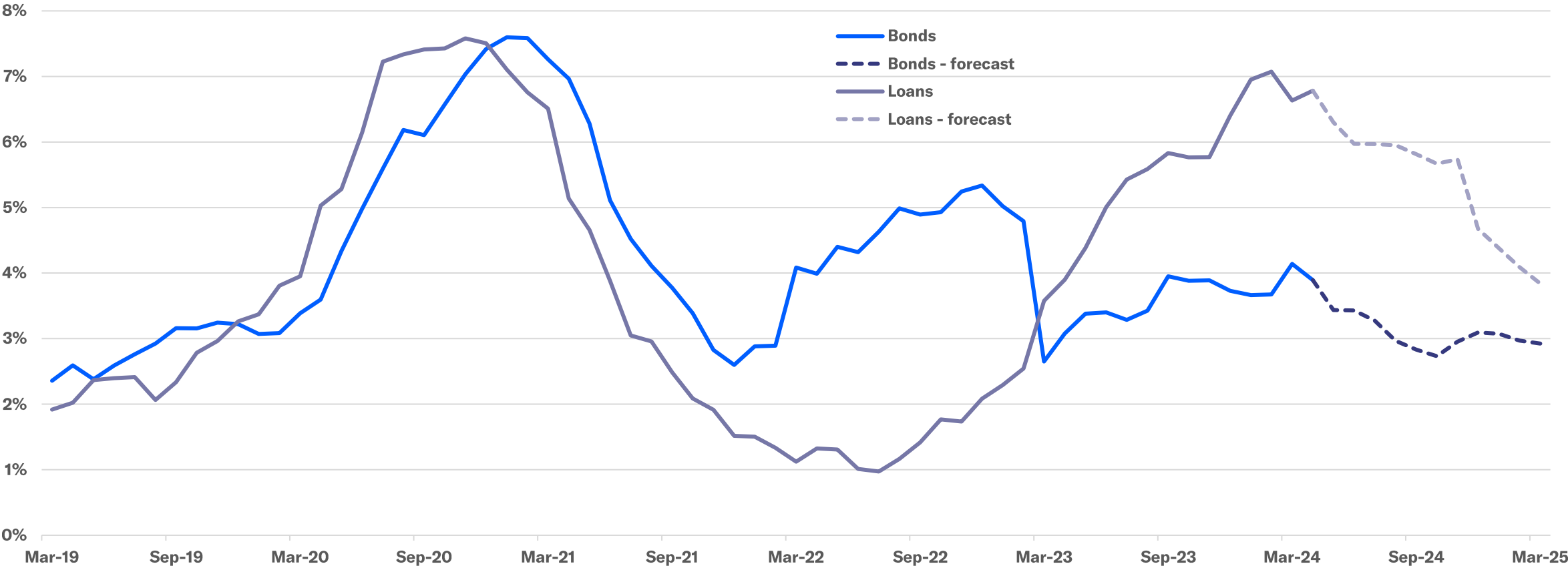
Long-term UK public debt forecast (% of GDP)



Source: Office for Budget Responsibility.

Bond vs loan defaults: floating rates have hit loans

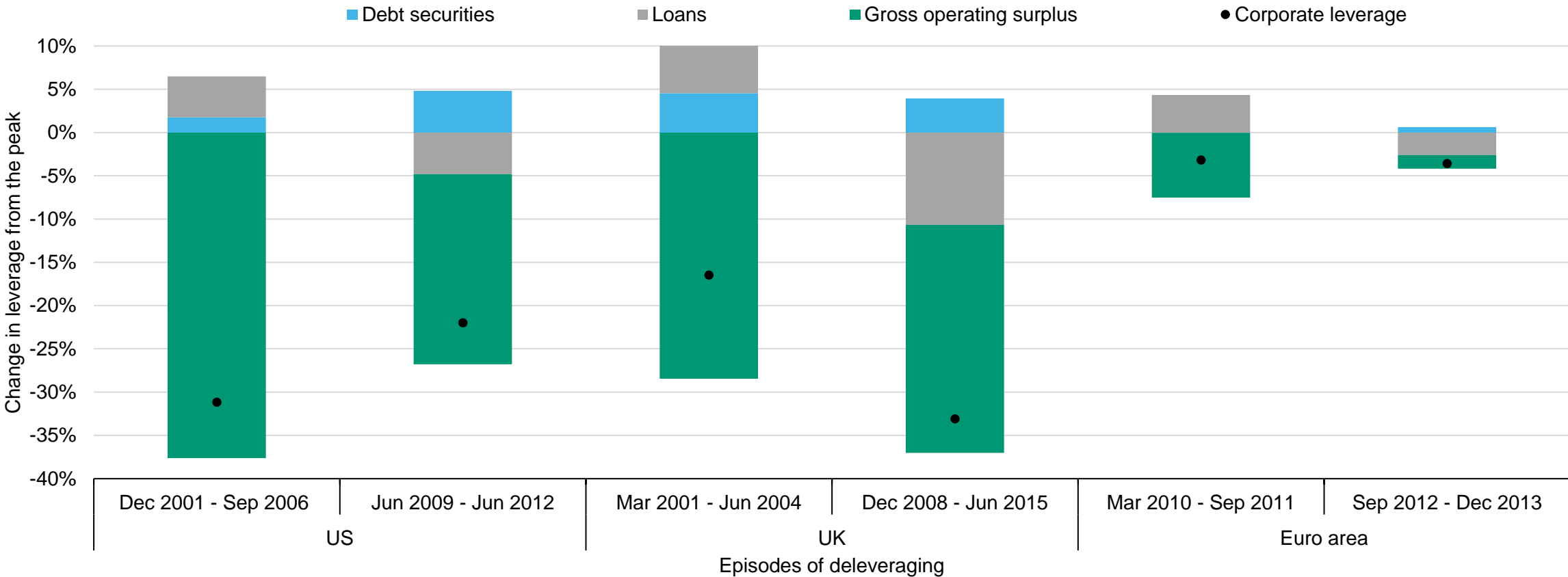
12-month trailing default rates and forecasts



Source: Moody's Ratings.
https://www.moody.com/research/Default-Trends-Global-April-2024-Default-Report-Default-Report--PBC_1408012

Weak growth makes deleveraging unlikely

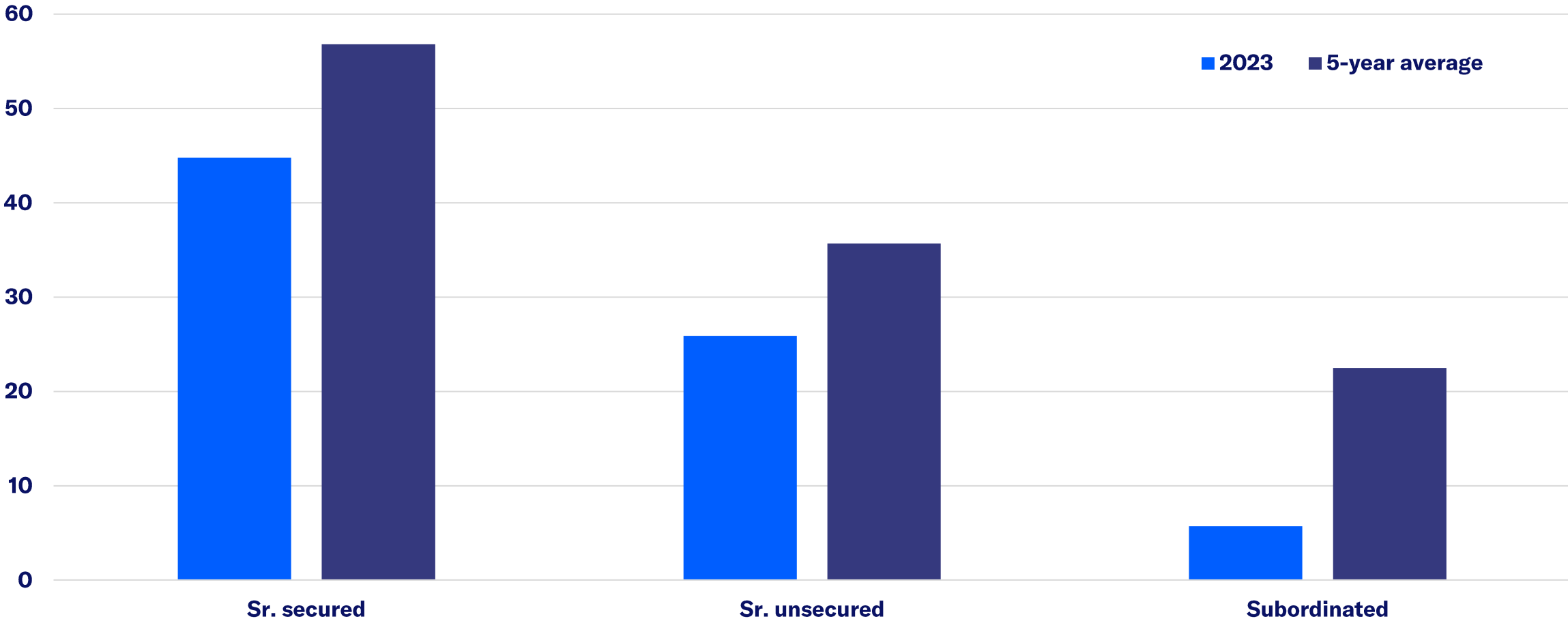
Accounting approach for past periods of sectoral debt reduction



Source: Moody's Ratings.
https://www.moodys.com/research/doc--PBC_1179956

So lower recoveries may be here to stay

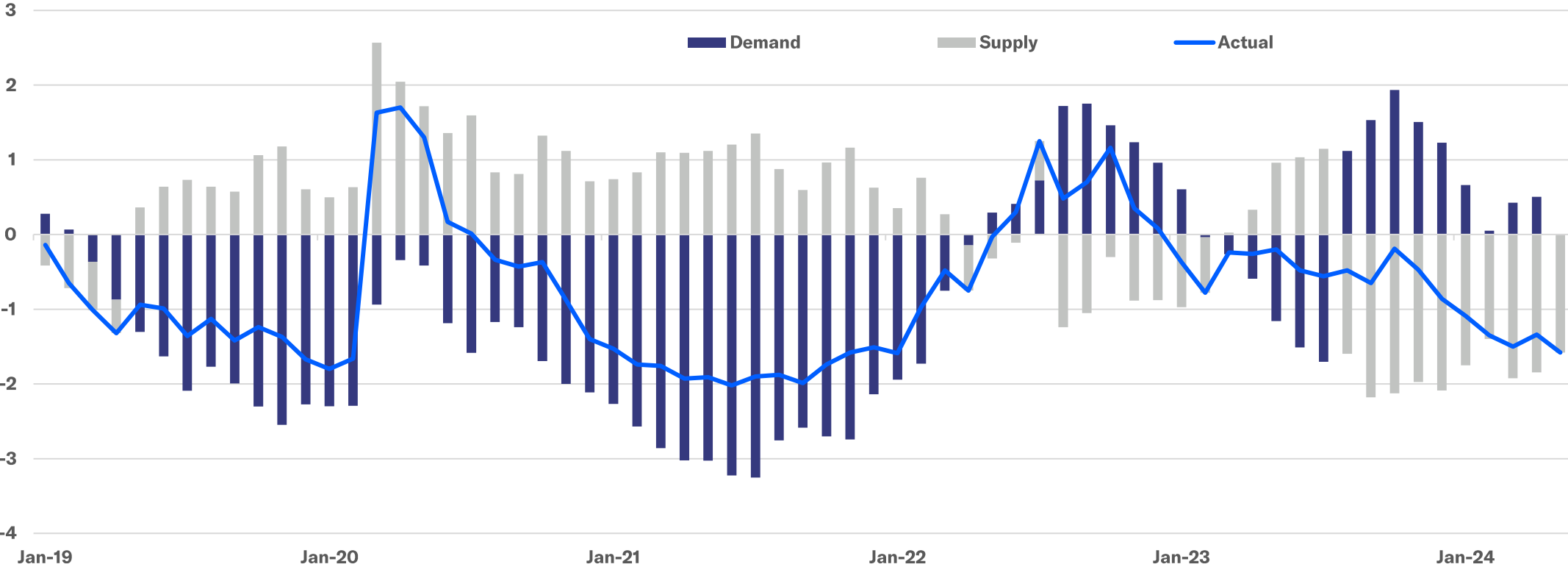
Interim estimates of recovery rates (based on trading prices)



Source: Moody's Ratings.
https://www.moody.com/research/doc--PBC_1394375

HY Europe: Demand has driven recent spread tightening

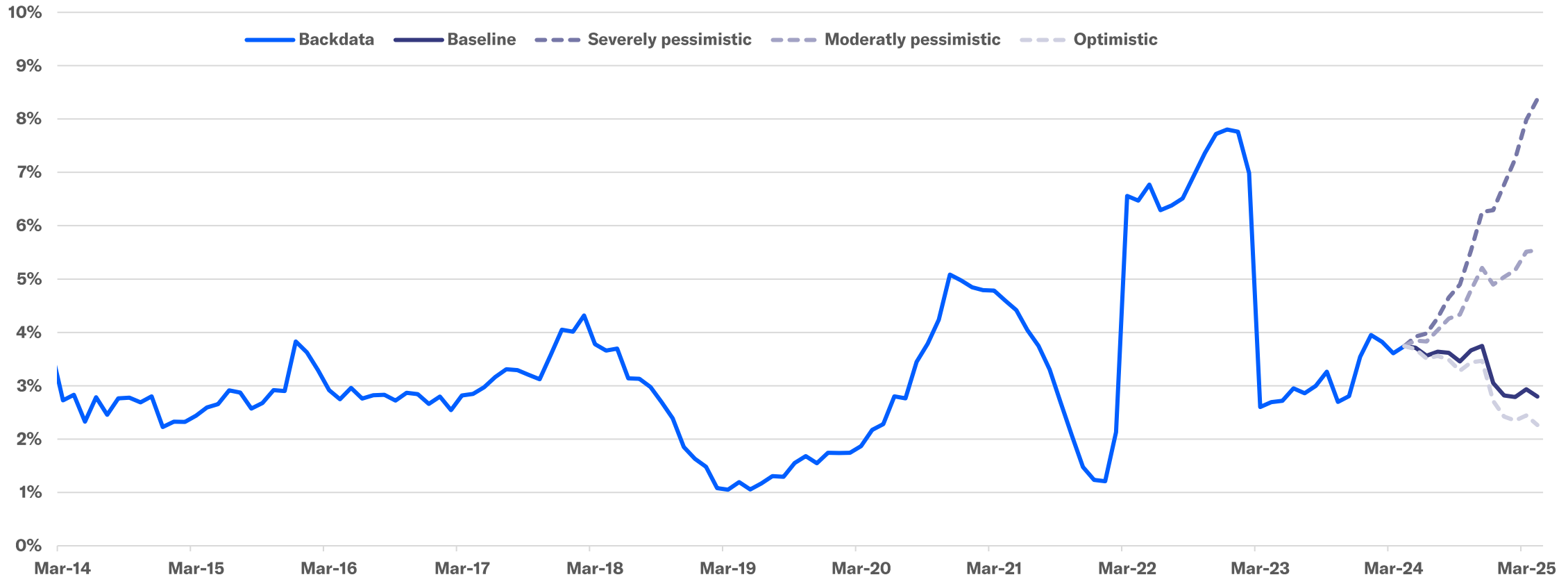
Cumulative changes in European HY spreads since December 2018 (ppts)



Source: Moody's Ratings. https://www.moody.com/research/Credit-Strategy-Global-What-drives-the-bond-market-Demand-and-Sector-In-Depth--PBC_1362535

Europe SG default rate will decline this year

Twelve-month trailing default rate (%)

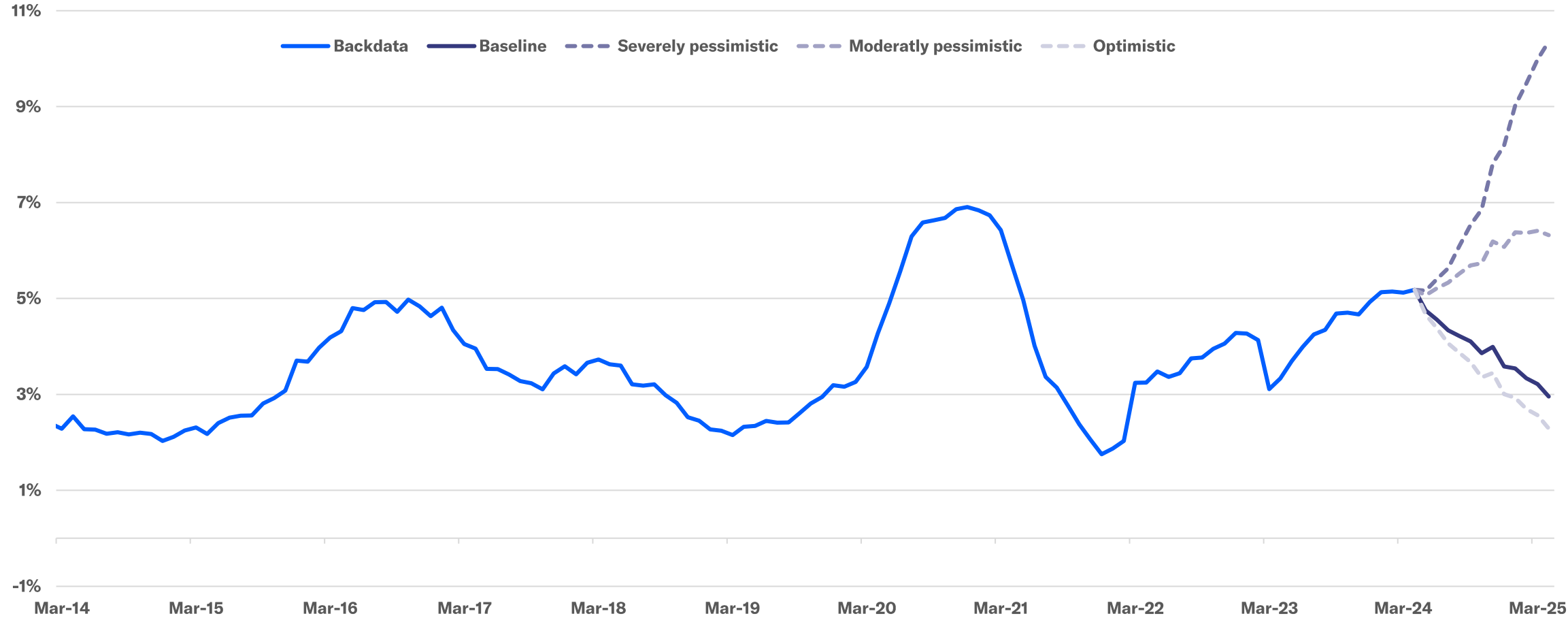


Source: Moody's Ratings.

https://www.moody's.com/research/Default-Trends-Global-April-2024-Default-Report-Default-Report--PBC_1408012

Global SG default rate may just have peaked

Twelve-month trailing default rate (%)



Source: Moody's Ratings.
https://www.moody's.com/research/Default-Trends-Global-April-2024-Default-Report-Default-Report--PBC_1408012

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Q&A

Thank you

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