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A 12 mn webinar

The pandemic-driven debt overhang and the role of rating agencies in times of crisis?

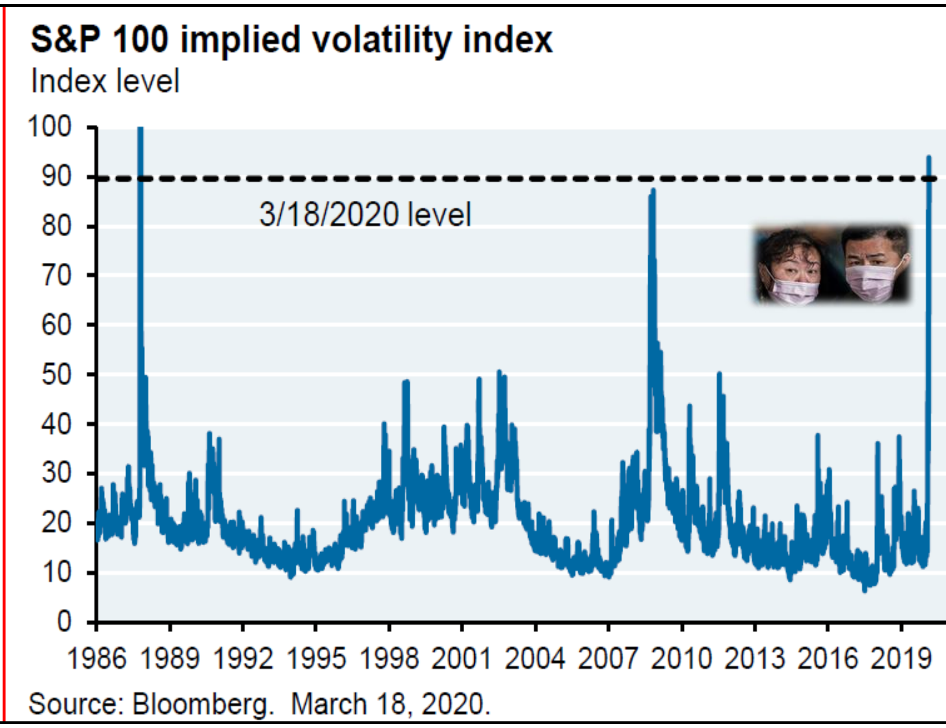
Market warning or crisis contamination?

April 15, 2020

Michel-Henry Bouchet

No early warning-signal though early warning analyses!

Volatility index = a **post** crisis-outbreak signal



2 types of crises =

• Type 1 Crisis

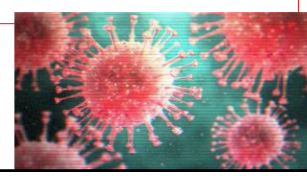
It emerges brutally, its timing and scope could not be anticipated, and it requires drastic policy adjustment

1. 1929 crisis
2. 1973 OPEC oil crisis
3. 12/2004 Asian tsunami
4. 2011 earthquake-driven Fukushima disaster
5. Twin Towers 09/2001

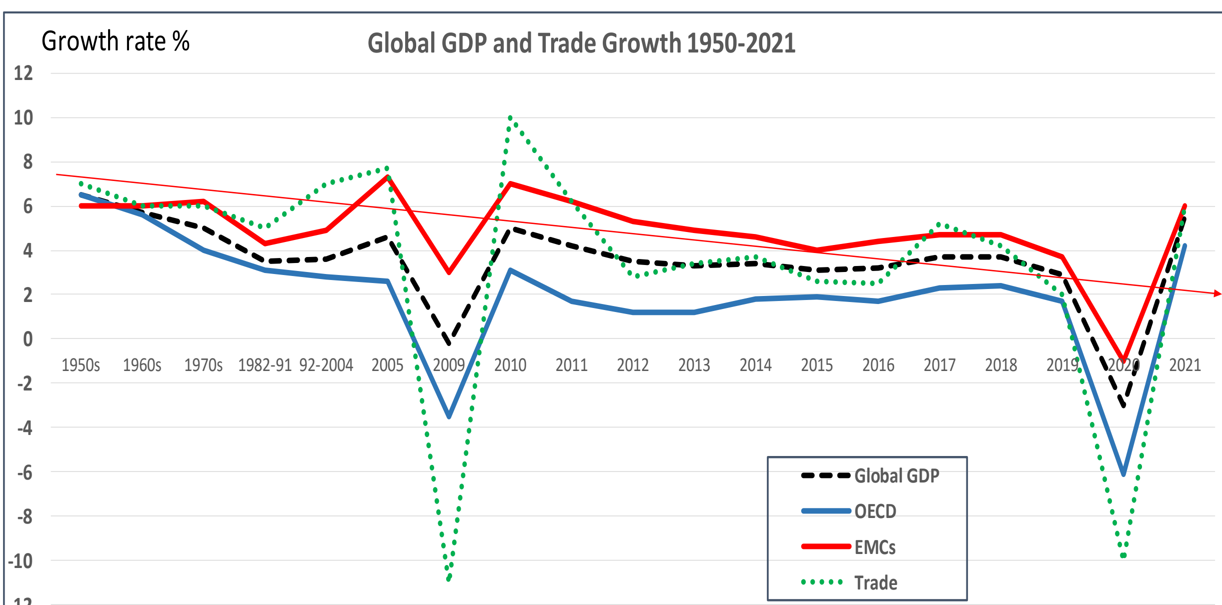
• Type 2 Crisis

It emerges brutally, it is unprecedented but **probable**, and it could have been expected

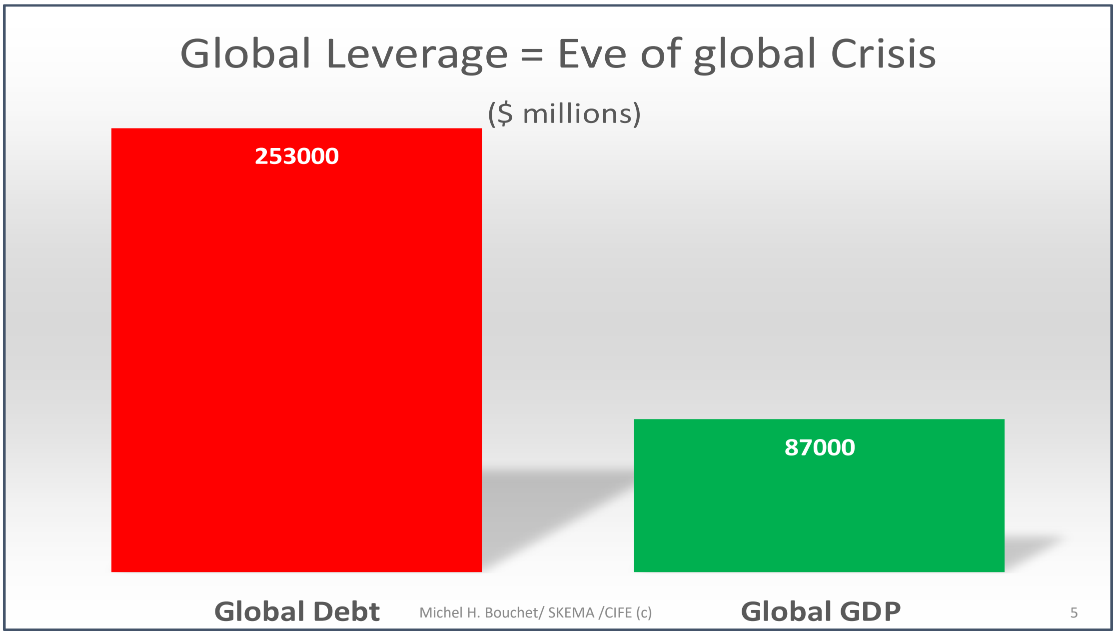
1. 1985 EMCs debt crisis
2. 1986 Chernobyl
3. 1999 Asian banking crisis
4. 2008 financial crisis
5. **CoviD-19** (CIA 2005 report, Bill Gates 2015 TED talk, 2016 World Bank Facility, Obama 2014-16 pandemic reports, 10/2019 Crimson Contagion planning exercice International Security Program)
6. (next) Environmental and cyber-crisis?!



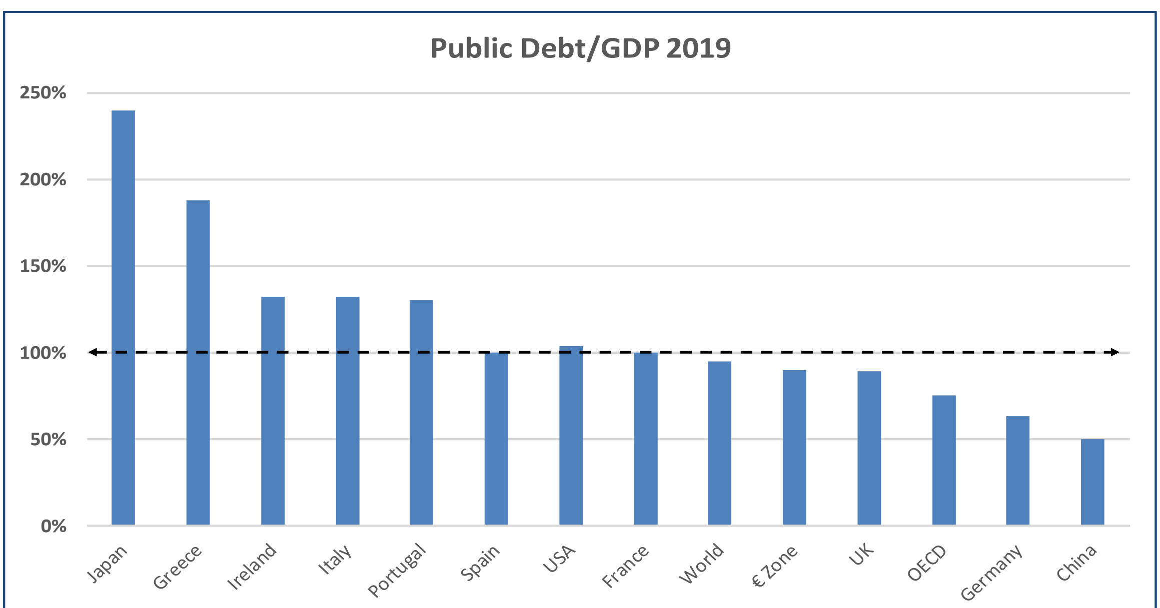
The Great Lockdown in a cycle of declining growth and secular stagnation



Global Debt/GDP ratio



The public debt overhang on the eve of the 2020 Great Lockdown



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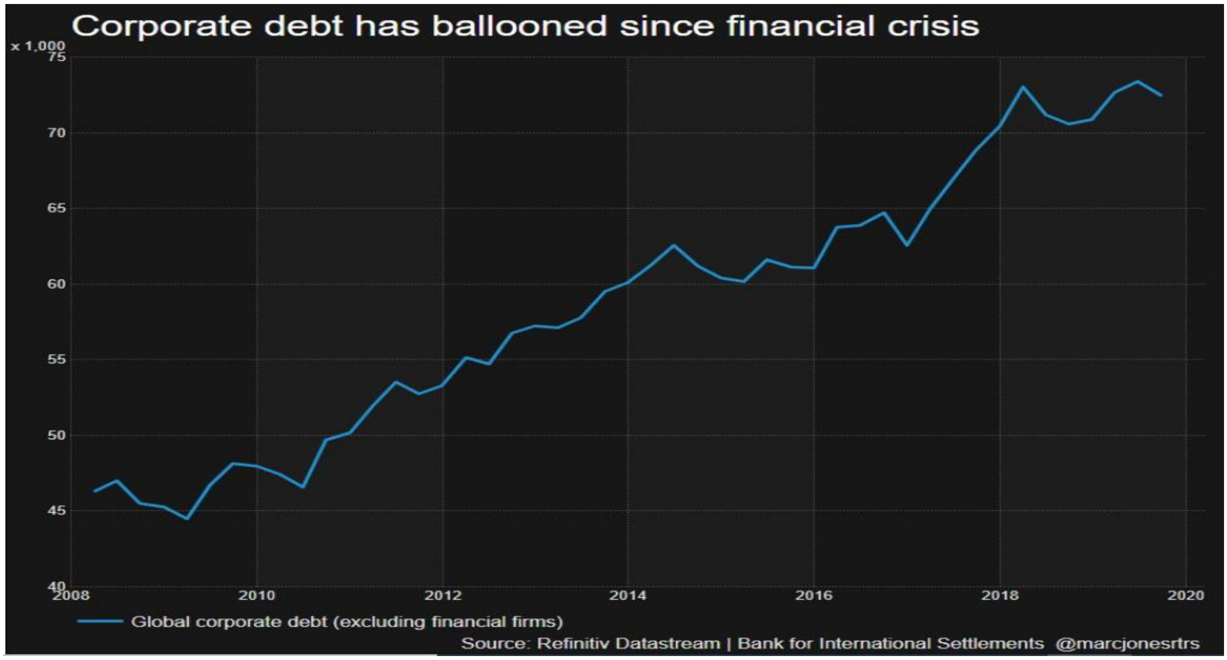
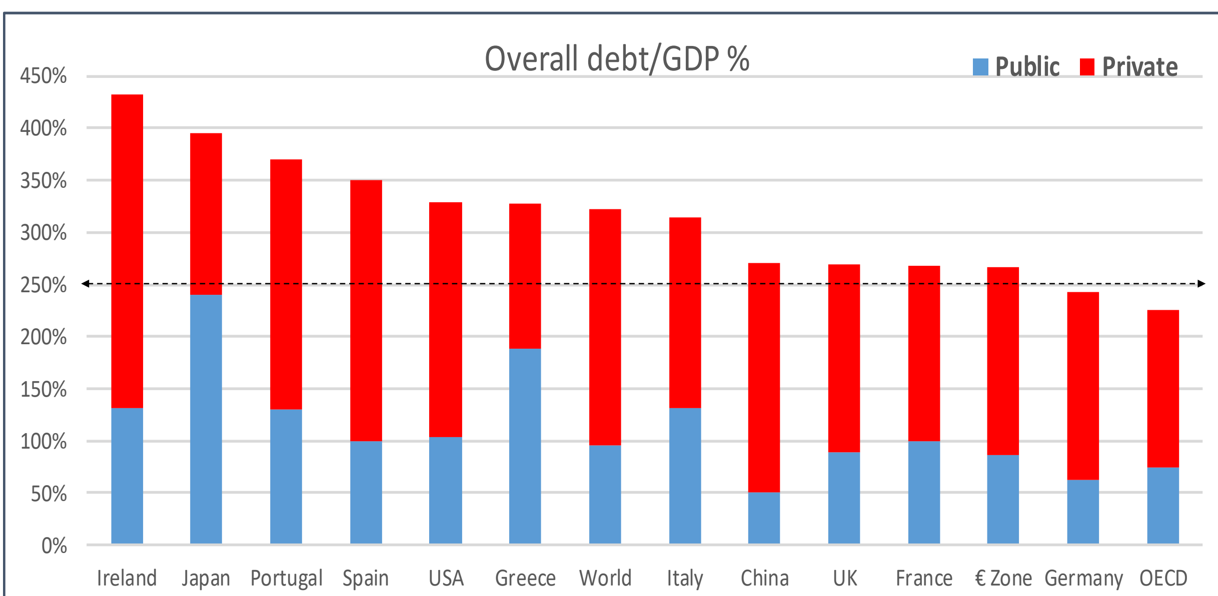
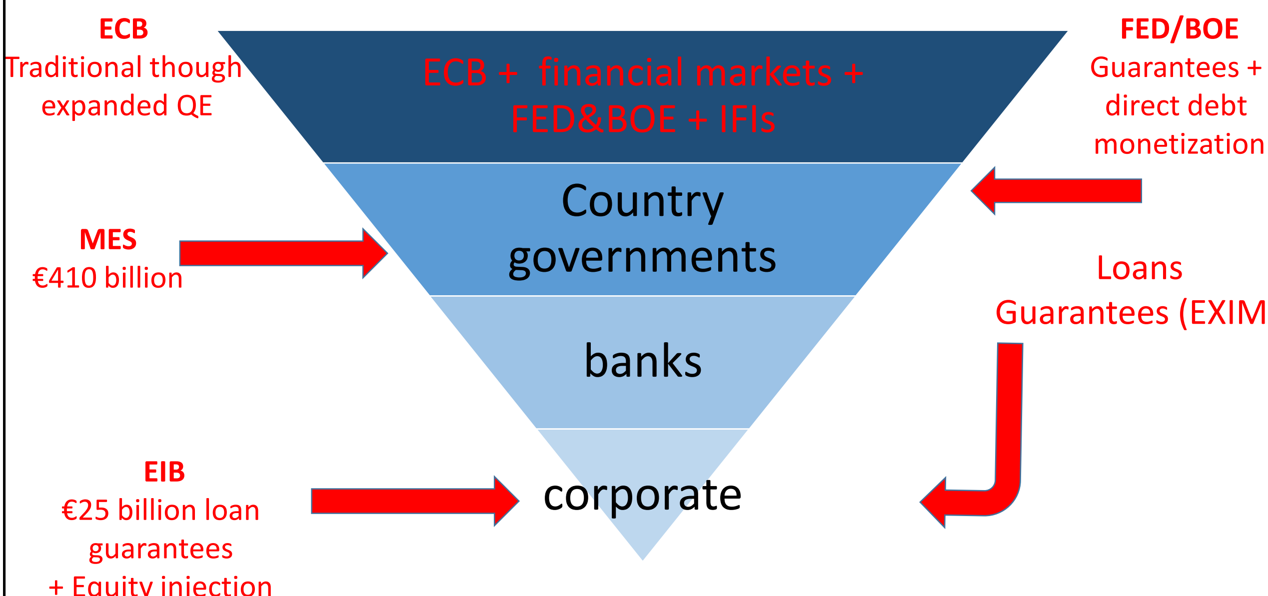


a decade of ultra-low interest rates and QE



« What ever it takes » liquidities to fight the financial crisis



The debt dynamics in time of crisis

How does the Debt/GDP ratio increase over time?

- **r = average rate of interest**
- **g = average GDP growth rate**
- **b- = budgetary deficit**

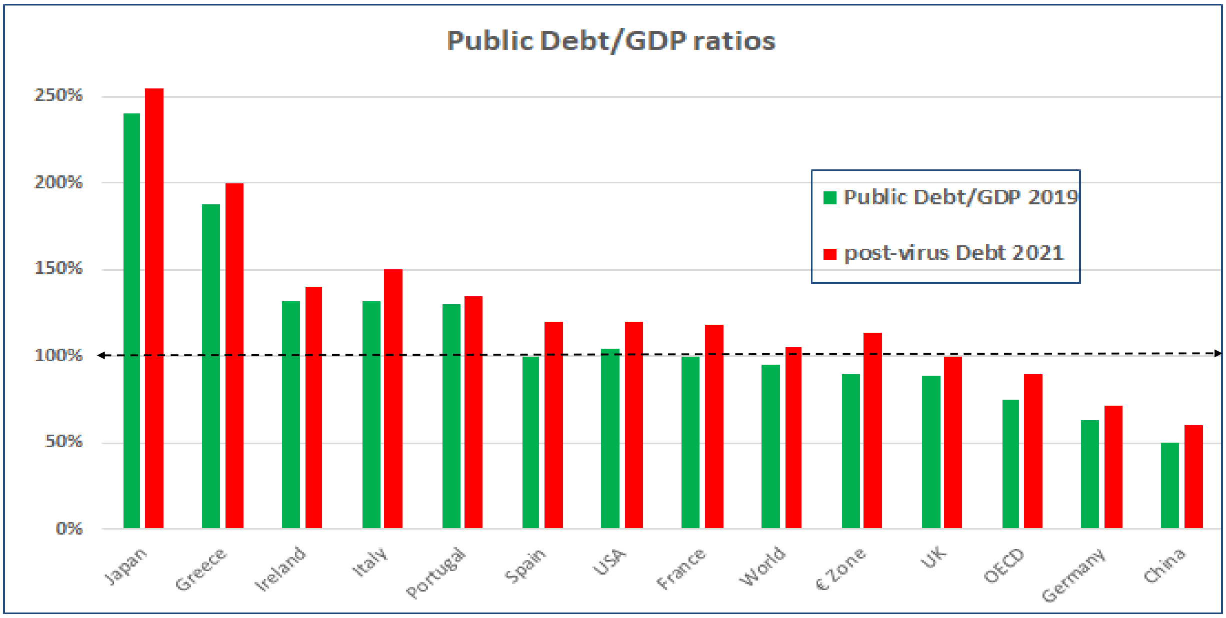
The higher r and b-, and the lower g, the higher the Debt/GDP ratio

Reducing DEBT/GDP ?= Reducing r, increasing g, or reducing primary deficit b-

Foreign K Flows

Domestic Financing

What about debt ratios end-2021?



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Tackling the post-pandemic global, national, and corporate debt overhang?

1. Low interest rates
2. Central Banks' corporate and sovereign bond purchases (to lower yield)
3. Debt monetization (BOE & FED)
4. Inflation
5. Soft loans for EMCs
6. Debt reduction for EMCs
7. Global economic recovery 2022?

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Rating Agencies country downgrading
as of April 2020

• Negative outlook revisions

Armenia, Italy, Belgium, China, Tunisia, Uruguay, Zambia, Mauritius…

• Credit Downgrading

Guatemala, South Africa, Gabon, Colombia, United Kingdom, Mexico, Ecuador, Lebanon, Oman, Angola, Argentina…

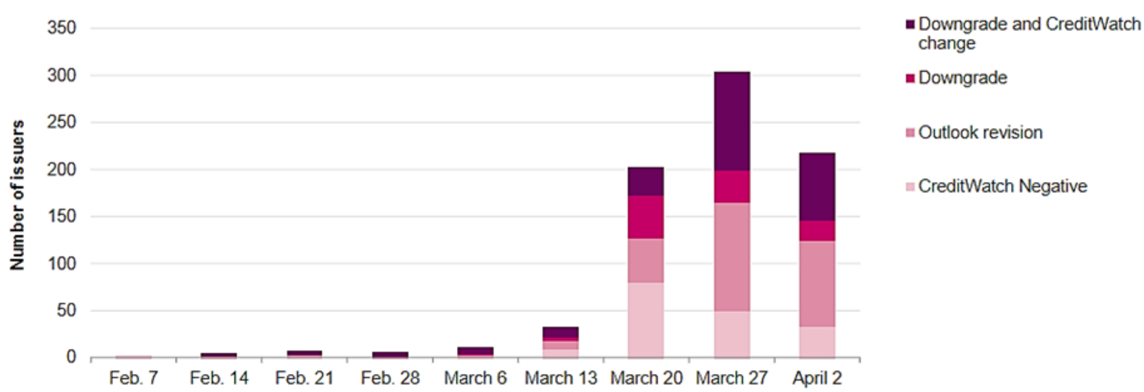
How to mitigate the risk of corporate and sovereign downgrading ?

Pitfalls 2008: Rating firms during the financial crisis and subsequent €-zone debt crisis did NOT anticipate the financial meltdown and then added to the panic by slashing credit scores

Recommendation 2020: "Working with companies to work out steps to avoid downgrades including cutting costs, halting investment plans and selling assets" **!?**

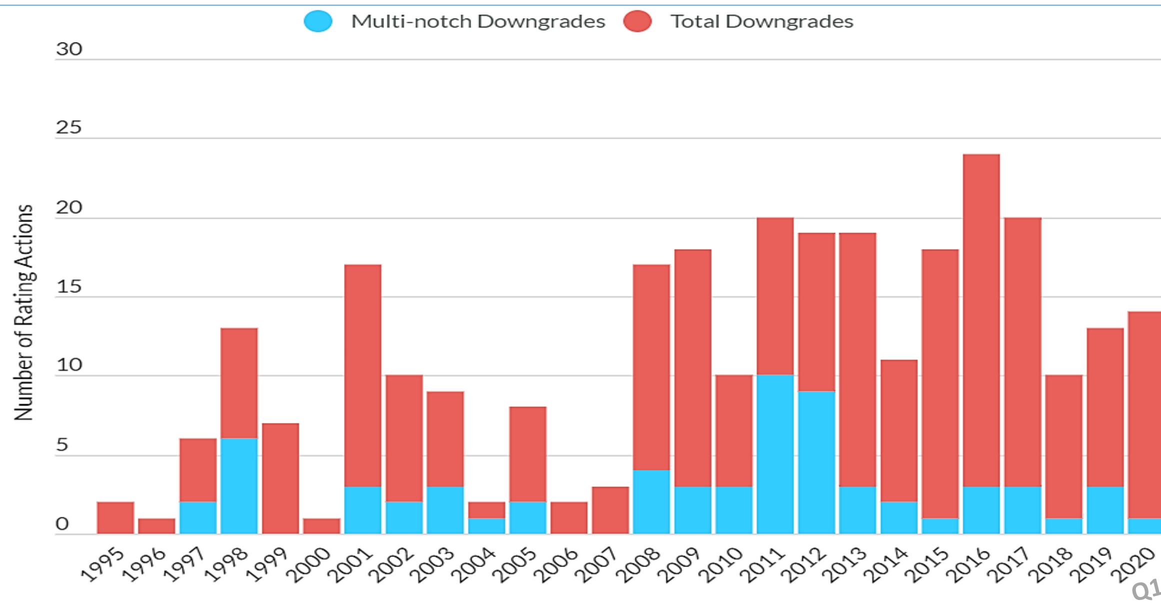
Risk 2021: Self-fulfilling prophecy and crisis contamination!

Credit rating cut = a blow for a company or a country in any circumstance
= more expensive to raise fresh debt or refinance existing bonds



Data as of April 2, 2020. Source: S&P Global Ratings Research.

Fitch Sovereign Downgrades 1995-Q1 2020



Source: Fitch Ratings

CONCLUSION?

Aside from a rating truce, more than ever, the **timing of ratings actions** must be carefully calibrated… and monitored