



Evaluating sector credit risk in the context of Covid-19



info@scopegroup.com
www.scopegroup.com

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Covid-19 has been a source of huge social and economic disruption. But the severity of the economic impacts on different industries has depended on a variety of factors:

- i) Where each sector is in its business cycle,
- ii) At what point of its cycle it entered 2020,
- iii) The sector's capital intensity
- iv) The level of fixed costs
- v) The importance of travel and human interaction,
- vi) The availability of technology and web-based solutions.

Impacts also differ because different countries have tackled the pandemic and its economic challenges differently. Based on credit transition and default studies, 2019 was already a challenging year for bricks-and-mortar, non-food retailers and energy companies, for example. This is reflected in the decline in credit quality of companies in these sectors as evidenced by defaults and public ratings downgrades.

Covid-19 puts additional pressure on companies in those industries or other industries in the down curve of their cycles. Smaller companies are likely to be severely affected if pandemic conditions are extended, delaying the economic rebound particularly once government support schemes end. In countries where strict lock-down regimes have been implemented, business and service companies will be adversely impacted.

Bias to sector downgrades across sectors

Looking at the transition of Credit Review Scores in 2020, there was a bias to downgrades across all sectors, in line with expectations.

Figure 1: Percentage of companies downgraded by Credit Review Scores by sector: FY 2020

Sector Name	Germany	Spain	France	UK	Italy
1 Agriculture meat agro food and wines	11.4%	14.6%	19.1%	25.2%	19.5%
2 Wood and furniture	9.7%	14.2%	20.5%	23.4%	18.6%
3 Mineral products Chemicals petroleum plasti...	21.5%	17.5%	24.7%	26.3%	19.5%
4 Metals	20.0%	21.4%	21.2%	25.2%	22.7%
5 Paper packaging and printing	15.7%	17.5%	20.9%	26.2%	18.5%
6 Construction	9.2%	12.7%	20.0%	24.4%	17.7%
7 Textiles leather and clothing	11.4%	12.9%	24.2%	21.4%	17.3%
8 Mechanics and precision	26.2%	19.1%	26.6%	25.7%	26.9%
9 Electrical equipments Eletronics and Informat...	14.5%	17.1%	26.1%	23.9%	19.7%
10 Motor vehicles motorcycles other vehicles an...	17.1%	13.8%	25.9%	24.1%	16.8%
11 Non specialised trade	10.1%	14.6%	21.7%	22.7%	16.4%
12 Utilities and public services	11.1%	14.5%	14.1%	18.6%	16.7%
13 Financial services					
13 Business and personal services	12.4%	15.1%	24.6%	23.6%	18.7%
14 Miscellaneous	10.3%	11.6%	24.3%	23.9%	16.9%
Average:	14.3%	15.5%	22.4%	23.9%	19.0%
Min:	9.2%	11.6%	14.1%	18.6%	16.4%
Max:	26.2%	21.4%	26.6%	26.3%	26.9%
Standard deviation:	5.2%	2.7%	3.4%	2.0%	2.8%

Cells in red: Sectors with the highest proportion of downgrades; cells in blue: sectors with the lowest proportion of downgrades

The severity of the changes differs depending on the country and the sector. The UK has experienced the biggest proportion of downgrades: 23.9% of companies on average, while Spain experienced the smallest, at 15.5%. In the UK, all sectors experienced a relatively homogeneous proportion of downgrades. The disparity is the largest in Germany. Looking at the comparison between 2019 and 2020, we can observe some intuitive trends (See Figures 2 & 3 below). Business and consumer services experienced a higher proportion of downgrades in France and Italy in 2020 vs. 2019;

the opposite trend was true in Germany. This could be due to the different levels of restrictions the three countries applied during the pandemic. The more capital-intensive Mechanics and Precision sector saw a consistent decrease in credit quality in all three countries.

It is also interesting to note that the three countries entered 2020 from a different starting point in terms of credit quality changes. In 2019, downgrades exceeded upgrades by 3% in France on average; and by 10.1% in Germany, evidencing a negative credit quality bias. In Italy, however, average upgrades were 5.8% higher. In 2020, however, downgrades perhaps not surprisingly exceeded upgrades in all three countries. Italy suffered the biggest hit compared to 2019.

Figure 2: Downgrades by Credit Review Scores, by country and sector – 2019 vs 2020

Sector	France			Italy			Germany		
	2019	2020	Difference	2019	2020	Difference	2019	2020	Difference
1 Agriculture meat agro food and wines	13.6%	19.1%	5.5%	16.0%	19.5%	3.5%	15.7%	11.4%	-4.3%
2 Wood and furniture	18.4%	20.5%	2.1%	14.8%	18.6%	3.8%	17.9%	9.7%	-8.2%
3 Mineral products Chemicals petroleum plasti...	20.8%	24.7%	3.9%	16.3%	19.5%	3.2%	19.4%	21.5%	2.1%
4 Metals	21.9%	21.2%	-0.7%	14.9%	22.7%	7.8%	17.9%	20.0%	2.1%
5 Paper packaging and printing	19.5%	20.9%	1.4%	18.4%	18.5%	0.1%	28.5%	15.7%	-12.8%
6 Construction	18.2%	20.0%	1.8%	15.0%	17.7%	2.7%	14.3%	9.2%	-5.1%
7 Textiles leather and clothing	19.3%	24.2%	4.9%	15.4%	17.3%	1.9%	15.9%	11.4%	-4.5%
8 Mechanics and precision	22.7%	26.6%	3.9%	16.4%	26.9%	10.5%	25.0%	26.2%	1.2%
9 Electrical equipments Eletronics and Informat...	21.9%	26.1%	4.2%	17.3%	19.7%	2.4%	18.5%	14.5%	-4.0%
10 Motor vehicles motorcycles other vehicles an...	20.6%	25.9%	5.3%	16.6%	16.8%	0.2%	21.5%	17.1%	-4.4%
11 Non specialised trade	19.5%	21.7%	2.2%	15.5%	16.4%	0.9%	17.3%	10.1%	-7.2%
12 Utilities and public services	8.0%	14.1%	6.1%	16.1%	16.7%	0.6%	27.7%	11.1%	-16.6%
13 Business and personal services	18.4%	24.6%	6.2%	14.3%	18.7%	4.4%	21.7%	12.4%	-9.3%
14 Miscellaneous	15.0%	24.3%	9.3%	15.0%	16.9%	1.9%	16.2%	10.3%	-5.9%
<i>Average Downgrade (Upgrade):</i>	18.4%	22.4%	4.0%	15.9%	19.0%	3.1%	19.8%	14.3%	-5.5%
<i>Difference = Avg. Downgrades - Avg. Upgrades</i>	3.0%	5.0%		-5.8%	1.6%		10.1%	4.6%	

Figure 3: Upgrades by Credit Review Scores, by country and sector – 2019 vs 2020

Sector	France			Italy			Germany		
	2019	2020	Difference	2019	2020	Difference	2019	2020	Difference
1 Agriculture meat agro food and wines	11.8%	11.4%	-0.4%	20.9%	15.4%	-5.5%	10.1%	8.7%	-1.4%
2 Wood and furniture	16.0%	16.5%	0.5%	27.1%	18.3%	-8.8%	9.0%	11.6%	2.6%
3 Mineral products Chemicals petroleum plasti...	17.2%	22.8%	5.6%	22.2%	16.9%	-5.3%	13.8%	9.2%	-4.6%
4 Metals	16.4%	24.7%	8.3%	25.1%	15.4%	-9.7%	12.6%	9.1%	-3.5%
5 Paper packaging and printing	14.6%	16.8%	2.2%	22.1%	18.9%	-3.2%	9.2%	10.4%	1.2%
6 Construction	15.8%	17.2%	1.4%	22.3%	18.1%	-4.2%	11.8%	12.7%	0.9%
7 Textiles leather and clothing	14.3%	11.8%	-2.5%	19.3%	14.5%	-4.8%	5.8%	6.9%	1.1%
8 Mechanics and precision	19.5%	22.9%	3.4%	25.0%	14.7%	-10.3%	9.8%	7.2%	-2.6%
9 Electrical equipments Eletronics and Informat...	18.9%	22.9%	4.0%	23.5%	18.5%	-5.0%	12.7%	11.0%	-1.7%
10 Motor vehicles motorcycles other vehicles an...	16.0%	20.5%	4.5%	20.1%	20.7%	0.6%	9.9%	7.2%	-2.7%
11 Non specialised trade	15.5%	17.5%	2.0%	19.1%	16.3%	-2.8%	7.9%	10.6%	2.7%
12 Utilities and public services	9.2%	10.1%	0.9%	21.6%	18.6%	-3.0%	6.1%	16.8%	10.7%
13 Business and personal services	15.0%	14.6%	-0.4%	18.9%	14.0%	-4.9%	7.5%	8.2%	0.7%
14 Miscellaneous	16.0%	14.1%	-1.9%	16.0%	13.3%	-2.7%	9.8%	7.3%	-2.5%
<i>Average Downgrade (Upgrade):</i>	15.4%	17.4%	2.0%	21.7%	16.7%	-5.0%	9.7%	9.8%	0.1%

Scope SE & Co. KGaA

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin
Phone +49 30 27891 0

Paris

23 Boulevard des Capucines
F-75002 Paris
Phone +33 1 8288 5557

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main
Phone +49 69 66 77 389 0

Oslo

Karenslyst allé 53
N-0279 Oslo
Phone +47 21 62 31 42

Madrid

Edificio Torre Europa
Paseo de la Castellana 95
E-28046 Madrid
Phone +34 914 186 973

Milan

Via Nino Bixio, 31
20129 Milano MI
Phone +39 02 30315 814

Scope Ratings UK Limited

111 Buckingham Palace Road
London SW1W 0SR
Phone +44020-7340-6347

info@scoperatings.com
www.scoperatings.com

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