

Credit Outlook

20 July 2020

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Mass takeover of Twitter accounts highlights enduring challenge of platform abuse

Originally [published](#) on 17 July 2020

On 15 July, unknown attackers took over the accounts of prominent [Twitter, Inc.](#) (Ba2 stable) users in what appeared to be a financially motivated attack. The incident in isolation is unlikely to have any material ramifications for Twitter's creditworthiness, but it raises questions about the company's internal security measures and poses reputational risks at a time of increased scrutiny on social media entities. The incident also reinforces concerns about the possibility of reputational damage for issuers that have Twitter accounts, as well as the potential vulnerability of the platform to disinformation campaigns during an election year.

Twitter is investigating the incident to identify the source of the compromise but says it believes the attackers targeted the company's internal systems and tools and leveraged that access to take over a large number of accounts, including those of well-known individuals with millions of followers, such as Bill Gates, Joe Biden, Barack Obama and Elon Musk. Once the attackers seized control of the accounts, they used a technique known as an "advance-fee scam" to solicit money from followers with the promise that the money would be returned to them twofold. The attackers succeeded in netting upward of \$100,000 in Bitcoin. In response to the attack, Twitter rapidly restricted access to its internal systems.

The attack also highlights the challenges for social media companies in protecting their platforms from abuse and the increasingly important roles they play in many regions. Twitter is in a sector that we view as one of the most exposed to cyber risk as discussed in our [framework report](#) on the cyber risk exposures of 35 broad sectors.

The incident could strengthen or renew calls for more oversight of social media companies in the US, where most of the victim accounts appeared to be based, and where the Federal Bureau of Investigation has [launched](#) an investigation into the incident. Already, a growing body of regulations and legislation worldwide will add to compliance costs for social media companies, including the 2018 General Data Protection Regulation in Europe, Australia's 2019 Sharing of Abhorrent Violent Material Act, and Russia's 2015 law requiring social media companies to store data about from Russian users on domestic servers.¹

The Twitter attack also highlights the potential risks for issuers that communicate through social media platforms. In this incident, the attack was widespread and easily identified as anomalous behavior. However, if the attackers had instead targeted the accounts of a few specific corporate issuers and used them to publish damaging material, this could have harmed the companies' reputations and brands, with the potential for longer-term negative effects on their financial health and creditworthiness.

This incident also occurred in an election year, when voters and officials are concerned about a repeat of disinformation campaigns that flourished on social media platforms, including Twitter, ahead of the 2016 US presidential election. In a recent [report](#), we discussed how attackers can use social media to disseminate false or misleading information, which in the short term could influence voters' perceptions of candidates and ultimately influence their voting decisions on Election Day. A longer-term result could be increased political apathy and decreased trust in institutions if the interference is uncovered and deemed to have materially influenced the final outcome of the election. This type of interference could have credit-negative economic implications if it exacerbates sociopolitical tensions or disrupts the stability and functioning of institutions and governance, impeding the development and implementation of timely policymaking.

Endnotes

¹ [Social media: How do other governments regulate it?](#), BBC News, 12 February 2020.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

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Dell's potential spin-off of VMware's stake increases uncertainty for both

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On 15 July, Dell Technologies, Inc., the parent of [Dell Inc.](#) (Ba2 stable) acknowledged that it is exploring a potential spin-off of its 81% equity ownership interest in [VMware Inc.](#) (Baa2 stable), among other strategic options with respect to its ownership interest in VMware, to enhance shareholder value for both Dell and VMware shareholders. In a spin-off scenario, the loss of implied equity cushion from Dell's majority ownership of VMware and the potential adverse effect on its business after the spin-off would be credit negative.

Dell said that in any potential spin-off transaction its goal would be to maintain VMware's investment grade credit rating and improve Dell's credit rating at the time or shortly following a potential spin-off. In a spin-off scenario, which the company does not expect before September 2021, VMware would incur additional debt to fund a special dividend to its shareholders and Dell would use its pro rata share of the special dividend to reduce its outstanding indebtedness. Dell and VMware's ratings are unaffected at this time because it is not clear whether any transaction will be consummated and if consummated, the effect on Dell and VMware's capital structures and business profiles is uncertain.

We believe that a scenario that involves the spin-off of Dell's equity interest in VMware could have the most significant credit impact for both companies. The spin-off of Dell's ownership interest in VMware would mark a significant turnaround in Dell's strategy after it consolidated its direct equity interest in VMware through the Class V transaction in December 2018.

The operating performance of both companies has benefited from a closer relationship since that transaction. Both have outperformed their respective markets and have benefited from collaboration in go-to-market approaches and product development, developing integrated solutions, and leveraging sales channels. Dell was the fastest growing distribution channel for VMware and VMware is benefiting from Dell's equipment financing operations. Dell implemented an integrated solutions-oriented approach and had success in cross-selling to VMware's large installed base of enterprise and government customers. Dell's cloud solutions marketing has prominently featured VMware's infrastructure technologies and the integrated approach has improved execution of their hybrid cloud strategy. Dell and VMware expect to formalize certain existing arm's-length commercial arrangements that benefited both companies if the two companies negotiate a spin-off. In that event, the strength of the agreements governing the sharing of resources and technology between two independent companies with widely diverging growth prospects will be a key consideration in assessing business risks after a potential spin-off.

Despite its strong growth prospects and profitability, VMware's credit profile has been constrained by the high financial leverage of its parent and Dell's 81% ownership of VMware. In a spin-off scenario, VMware's governance risk will likely abate but the increase in debt by an uncertain, though likely large amount, could more than offset the benefits. Acquisitions are integral to VMware's growth strategy and nearly a third of its free cash flow in the LTM 1Q 2020 period was allocated toward share repurchases. It is unclear how VMware's capital structure and financial policies would balance higher financial leverage with allocations for acquisitions and shareholder returns in a spin-off scenario.

As a standalone business, Dell would have substantial scale and strong market positions in some of the largest IT hardware segments, including enterprise storage, servers and PCs. At the same time, Dell's business would comprise product segments that are mature and primarily indexed to on-premise infrastructure spending. We believe that pressure on the business could remain elevated as the pandemic is driving an accelerated adoption of cloud computing which will result in a commensurate cut in investments in hardware equipment in data centers maintained by enterprises. We expect IT spending to decline in the high single digits in 2020, and declining EBITDA will likely increase Dell's total debt to EBITDA (Moody's adjusted) over the next 12 months. We expect total debt to EBITDA for Dell to approach 5x, incorporating the \$5.5 billion of gross debt reduction Dell has committed to in fiscal year ending January 2021.

In a scenario in which Dell's ownership of VMware is spun-off, the effect on Dell's credit profile would depend on, among other factors, the magnitude of debt reduction; financial policies; an assessment of Dell's ability to grow and compete as a standalone business, including execution of its hybrid cloud strategy; the prospects for the traditional on-premise IT hardware market after the Covid-19 pandemic; and strategic goals of Dell's large shareholders, including Michael Dell and affiliates of Silver Lake Partners.

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Ocado Group's changing consumer behaviour drives strong online grocery growth, a credit positive

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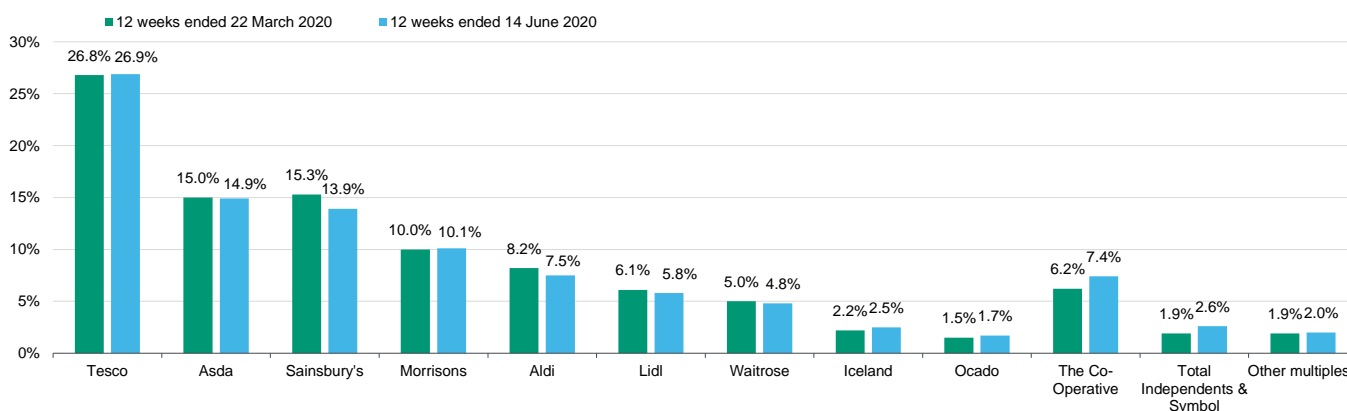
On 14 July, [Ocado Group plc](#) (B2 stable), the UK's only scale pure-play grocery retailer, published results for the 26 weeks ended 31 May 2020 (first-half fiscal 2020) showing that the company's retail division benefited materially from a surge in demand for online groceries because of the coronavirus crisis. Although the company did not have the capacity to meet all orders, we think the higher online penetration across the industry during the crisis is likely to lead consumers to increase their online shopping, which is credit positive for both Ocado's retail business and Solutions division, which supports grocers around globally in meeting customers' desire to shop online.

In first-half fiscal 2020, Ocado recorded overall revenue growth of 23.2% to £1.087 billion from £882.3 million a year earlier. Despite the strong performance in the Retail segment, where revenue rose 27.2% to £1.022 billion and EBITDA increased 87.3% to £45.7 million, group EBITDA fell 35.5% to £19.8 million from £30.7 million a year earlier. Driving the decline was a combination of factors including higher support costs with the launch of initial Customer Fulfilment Centres (CFCs) in its International division, the full-year effect of Morrison's agreed "holiday" from using the Erith CFC and continued investments to improve its platform. Nevertheless, the company showed progress in building its International Solutions operation, whose fees invoiced increased 58% year on year to £73.7 million.

The strong growth in retail revenue and profit was driven by higher average basket sizes as a consequence of the coronavirus pandemic, which had a material effect on consumer behaviour from the second half of March (i.e., the latter weeks of the fiscal period). Ocado was unable to meet the spike in the short-term demand because of capacity constraints that led to a 14% fall in the number of active customers compared versus a year earlier. However, those fewer customers shopped more frequently and with larger basket sizes (up 27.7%). This resulted in high efficiency in both order picking and deliveries per van, which led to the improvement in Retail EBITDA margin to 4.5% for the period from 3.0% a year earlier.

We anticipate that after the unique conditions that led to the spike in demand recede, the company's Retail margin in future periods will not be as strong. However, our outlook over the next several years is positive for online grocery given the change in consumer behaviour because of the coronavirus crisis. We expect that Ocado will continue to benefit from the channel shift and that its Retail operation will continue to record the low-double-digit growth it has recorded over the past several years. Data from [Kantar](#) shows that Ocado's overall market share in the 12 weeks to 14 June increased to 1.7% from 1.5% for the 12 weeks to 22 March (see exhibit).

Ocado had a 1.7% share of the UK's overall grocery market Data for the 12 weeks ended 14 June and 22 March



Source: Kantar Worldpanel, June 2020

Ocado's International Solutions division opened its first two CFC sites in France (Groupe Casino) and Canada (Sobeys) during the period, adding to its existing commitments for 54 CFCs globally. However, International Solutions' revenue in the immediate future will be modest: the company guided to less than £10 million of revenue in fiscal 2020 despite expecting more than 40% growth in fees invoiced. Additionally, Ocado indicated that to support clients' needs it will accelerate the ramp-up of new CFCs, which risks resulting in slightly higher net outflows per CFC than its previous guidance of an average of around £30 million. Ocado has said that total capital spending will be around £600 million in fiscal 2020 and we expect at least a similar amount over the next couple of years.

Ocado's liquidity is supported by cash on its balance sheet of £2.3 billion after factoring in £600 million of proceeds from a convertible bond issued in December 2019 and its recent raising of [£1.0 billion](#) of additional funds through via a £657 million share issue and £350 million of convertible debt.

We [downgraded](#) Ocado's corporate family rating to B2 from Ba3 on 25 March 2020 to reflect a doubling of its gross debt after the £600 million convertible bond issuance and its weak credit metrics. Additionally, Ocado is challenged by execution risks associated with various commitments to develop online delivery solutions for international partners and meet demand growth in the UK, and the significant capital spending involved in meeting those commitments.

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Shenzhen, China's moves to cool property market are credit negative for developers there

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On 15 July, the Shenzhen Municipal Government in China's Guangdong province announced new measures aimed at curbing increasing residential property prices, which have climbed over the past six to nine months amid low level of supply. The new measures apply to homebuyers for both new and secondhand apartments.

The measures are credit negative for property developers that have relatively large operations in the city, such as [Kaisa Group Holdings Ltd](#) (B1 stable) and [Logan Group Company Limited](#) (Ba3 positive) (see exhibit), because the measures are likely to suppress property demand by reducing the number of eligible buyers and discouraging second-home buyers. However, although the new policy is likely to reduce demand for Kaisa Group and Logan Group's properties in Shenzhen, these developers' competitive product pricing, strong brand and ability to adjust to changing market conditions will mitigate any adverse effects.

Rated Chinese developers with substantial operations in Shenzhen

Company	Corporate Family Rating	Outlook	Exposure to Shenzhen	
			Saleable resources as of end of 2019	Contracted sales in 2019
Logan Group Company Limited	Ba3	Positive	20.5%	12.4%
Kaisa Group Holdings Ltd	B1	Stable	32.9%	Around 30%

Sources: Company information and Moody's Investors Service

The regulations will delay these developers' presale cash flow and adversely affect their liquidity. The new measures are also likely to accelerate industry consolidation because developers that have small operations and weak access to funding will become less competitive and face the risk of asset sales or exiting from the market.

The key measures include tightened eligibility for homebuyers; lengthened holding period requirements for value-added tax (VAT) exemptions on secondhand properties; raising deposits for mortgages of "nonordinary" housing; that is, luxury residences with a plot ratio (total gross floor/total land area) of less than 1.0; apartments with building areas of more than 120 square meters or gross floor area of more than 144 square meters; and apartments with transaction prices of more than RMB7.5 million.

Shenzhen is a key market in the Greater Bay Area and a first-tier city, along with Beijing, Shanghai and Guangzhou. The tightened policies are in line with our expectation that local governments will continue to adjust regulatory measures to stabilize property prices and discourage investment and speculative demand. We expect there will be policy tightening implemented to curb property price growth in other cities where price growth has also been strong.

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CAL FIRE determines PG&E equipment caused 2019 Kincade fire, increasing utility's social risk

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On 16 July, the California Department of Forestry and Fire Protection (CAL FIRE) announced that electrical transmission lines owned and operated by [Pacific Gas & Electric Company](#) (PG&E, Baa3 senior secured, stable) caused the 2019 Kincade fire, which occurred while the company was in bankruptcy. The fire began on 23 October 2019 in Sonoma County, burned 77,758 acres and destroyed 374 structures before it was fully contained on 6 November 2019. Although media and public scrutiny of PG&E will be heightened as a result of CAL FIRE's findings, increasing the already elevated social risks.

While the total liabilities associated with the Kincade fire are still uncertain, we expect the company's insurance coverage will cover a large portion and the residual amount will not materially impact PG&E's financial profile.

PG&E has indicated that it does not yet have access to CAL FIRE's investigative report or the evidence collected. However, PG&E did file an electric incident report with the California Public Utilities Commission (CPUC) on 24 October 2019, the day after the fire started, indicating that the utility's equipment was found damaged at the focal point of the fire's ignition. In its announcement, CAL FIRE also indicated that tinder dry vegetation and strong winds combined with low humidity and warm temperatures contributed to extreme rates of fire spread.

In PG&E's recent first quarter 2020 10-Q SEC filing, the company estimated that potential liabilities associated with the Kincade fire could exceed \$600 million before available insurance coverage. Under AB1054, California legislation passed in 2019 to address wildfires, insolvent utilities involved in a wildfire event are able to access a Wildfire Insurance Fund to cover liabilities of up to the lesser of amounts in excess of \$1 billion or 40% of total fire costs. PG&E had \$430 million of liability insurance coverage for wildfire events at the time of the Kincade fire. Under the revised prudency standards within AB1054, PG&E may be able to seek recovery of costs greater than its insurance coverage.

PG&E, and its parent company, [PG&E Corporation](#) (PCG, Ba2 CFR, stable), emerged from Chapter 11 bankruptcy protection on 1 July 2020. Upon bankruptcy exit, PG&E's credit profile incorporated this more onerous political and legislative environment, the continued high degree of exposure to wildfires and the potential for future wildfire liabilities to be incurred by the utility under inverse condemnation. The possibility of additional wildfire events remains high due to both climate change and population growth in high fire-threat areas. However, the financial impact of future wildfire events should be mitigated by PG&E's participation in the above mentioned Wildfire Insurance Fund as well as the new, but untested, regulatory cost recovery framework outlined by AB1054. Over the next three years, we expect PG&E's ratio of cash flow from operations pre-working capital changes (CFO pre-W/C) to debt to be in the 14-16% range.

PG&E is a regulated vertically integrated utility serving northern and central California and is the principal subsidiary of PG&E Corporation, a regulated utility holding company headquartered in San Francisco, California. PG&E is regulated by the CPUC and by the Federal Energy Regulatory Commission. Upon bankruptcy exit, PCG's assets were over \$85 billion and total reported debt of approximately \$38 billion. PG&E serves approximately 5.4 million electric distribution customers and 4.5 million natural gas customers.

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US global investment banks preserved capital strength in second quarter amid heavy credit provisions

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This report provides key take-aways from the second-quarter (Q2) results of the five US-based Global Investment Banks (GIBs): [Bank of America Corporation](#) (BAC, A2 stable¹), [Citigroup Inc.](#) (C, A3 stable), [The Goldman Sachs Group, Inc](#) (GS, A3 stable), [JPMorgan Chase & Co.](#) (JPM, A2 stable), and [Morgan Stanley](#) (MS, A3 review for upgrade). All comparisons are to Q2 2019 unless otherwise noted.

The US-based global investment banks (GIBs) reported aggregate pretax profit of \$18.5 billion in second-quarter (Q2) 2020, down 43% from \$32.6 billion in Q2 2019 and up 29% from \$14.3 billion in first-quarter (Q1) 2020. The coronavirus pandemic hit income statements during the quarter via sharply higher loan loss provisions and compressed net interest margins, but also set off a gusher of trading and underwriting revenue. The US GIBs deftly managed their balance sheets through this turbulence, preserving strong liquidity while building loan loss reserves and regulatory capital ratios.

As the economic implications of the pandemic unfold, the GIBs will need to continue balancing earnings pressure, customer forbearance and support for the economy against the need to maintain capital and liquidity strength. The new Current Expected Credit Loss (CECL) accounting standard and regulatory vigilance in this period of uncertainty are keeping capital that might otherwise be paid to shareholders preserved within the banks to absorb loan losses and protect bondholders. Our coronavirus [profitability shock scenario](#) indicates that the GIBs are reasonably well placed to weather a downturn this year. Our current [global macro outlook](#) suggests that the G-20 economies will experience an unprecedented slowdown in the first half and will contract in 2020 as a whole, but we expect improvement in 2021.

The key credit developments in Q2 2020 included:

- » Sharply higher loan loss provisions (up \$20.9 billion) to build reserves for the pandemic under the CECL accounting framework
- » Robust trading revenue (up \$14.2 billion), reflecting substantially increased client activity and widened bid/ask spreads
- » Stable to improving regulatory capital ratios compared with Q1 because of proactive RWA management, cessation of stock buybacks, and regulatory phase-in provisions
- » Disclosure of DFAST results and preliminary stress capital buffers
- » NIM contraction because of interest rate cuts
- » Rebound in asset valuations that helped stabilize asset-based fee income
- » Steady consumer asset quality due in part to government relief programs, but some weakening of corporate asset quality

[Click here](#) for the full report.

Endnotes

¹ Ratings refer to senior unsecured rating.

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Fiscal stimulus and forbearance defer US banks' asset quality erosion in second quarter

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In this report, we provide key take-aways from the quarterly consumer loan results of the largest US retail banks, including [American Express Company](#) (AXP, A3 negative), [Bank of America Corporation](#) (BAC, A2 stable), [Capital One Financial Corporation](#) (COF, Baa1 negative), [Citigroup Inc.](#) (C, A3 stable), [Discover Financial Services](#) (DFS, Baa3 stable), [JPMorgan Chase & Co.](#) (JPM, A2 stable), [US Bancorp](#) (USB, A1 stable) and [Wells Fargo & Company](#) (WFC, A2 stable).

Though unemployment skyrocketed in the second quarter, consumer loan asset quality metrics deteriorated only modestly because of forbearance programs and the substantial consumer fiscal stimulus. However, as borrowers leave forbearance and stimulus programs abate, we expect performance will rapidly deteriorate. With unemployment likely to remain very elevated well into 2021, we expect credit card and auto loan charge-offs to peak in 2021 at around double 2019 levels of around 3.5% for the large credit card lenders and around 0.75% for the large bank auto lenders. Given solid underwriting quality since the financial crisis, and only a modest forecast decline in home prices after years of solid appreciation, we expect residential mortgage asset quality to deteriorate far less.

- » **Credit card charge-offs increased to 3.83% in Q2 2020, up 22 basis points (bps) from Q2 2019.** With retail spending down significantly and consumers using some of the generous fiscal stimulus to pay down higher-cost debt, Q2 2020 card balances declined a material 9.5% from Q1 2019 and 8.4% from Q1 2020.
- » **Auto loan charge-offs increased 0.32% from Q1 2019.** The increase was driven by COF and WFC with WFC indicating the increase was prompted by a suspension of involuntary repossessions and payment deferrals. With car sales down significantly, auto loan originations declined around 10% (based on the large banks that have so far reported such data) from Q2 2019, resulting in annual growth slowing to 3.2% in Q2 from 4.1% in Q1 and balances declining 0.7% sequentially.
- » **Residential mortgage charge-offs increased seven bps from a year ago.** Residential mortgage portfolios were down a modest 2.7% compared with the same quarter last year.

[Click here](#) for the full report.

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Greek banks' low-cost deposits increase, mitigating pressure on margins and profitability

On 14 July, the Bank of Greece (BoG) [published](#) its May bulletin of systemwide loan and deposit data, which showed that household deposits are shifting toward cheaper sight and saving deposits from more expensive time deposits. Greek banks' average cost of deposits declined significantly in recent years compared to interest rates on household loans, and in line with reduced European Central Bank funding costs.

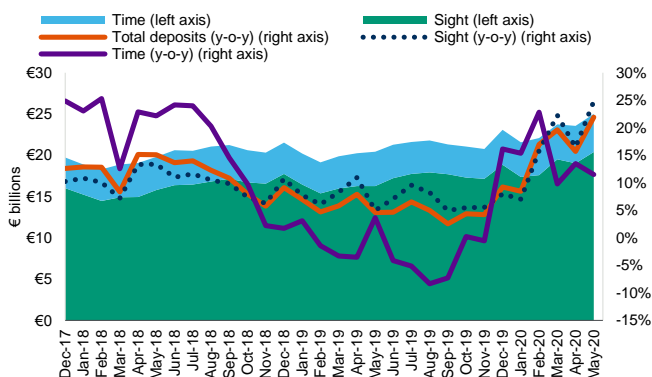
The increased access to cheap funding mitigates coronavirus-related pressure on Greek banks' margins and profitability in 2020. Pandemic-related economic disruption reduces quality lending opportunities and erodes fee and commission income, trading gains and investment returns.

According to the BoG data, May household and nonfinancial corporation deposits increased around €1.5 billion from April to a total of €144.5 billion¹. Household deposits increased by €68.4 million in May, with most of the gain from a 6% month-on-month increase in nonfinancial corporation deposits (see Exhibit 1).

Households in Greece are gradually shifting their savings toward sight and saving deposits (see Exhibit 2) with interest rates very close to zero, and away from higher-interest-rate time deposits. According to BoG data, time deposits comprised around 34% of total household deposits in May, down from 41% in December 2017. The reduction in funding cost will help Greek banks reduce pressure on their net interest margins (NIM) this year. The banks' NIMs have declined in recent years, mainly from reducing loan balances and amid generally low interest rates in the European Union.

Exhibit 1

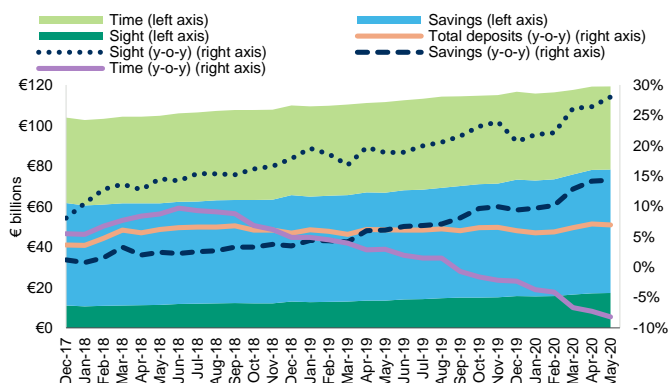
Nonfinancial corporation deposits evolution



Source: Bank of Greece

Exhibit 2

Household deposits evolution

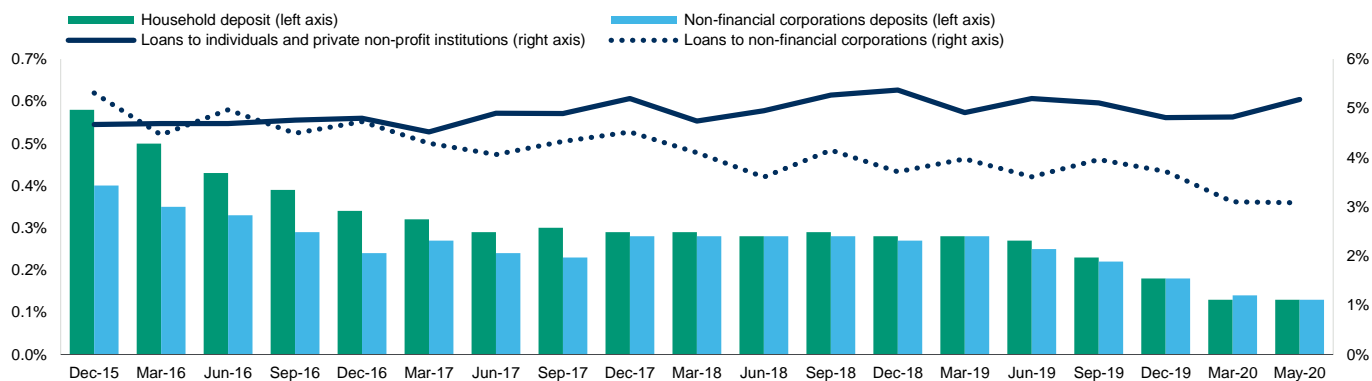


Source: Bank of Greece

The trend in the mix of household deposits reflects banks' progressively lower interest rates on such new deposits, with the average cost at 0.13% in May 2020 from 0.58% at year-end 2015 (Exhibit 3). It also reflects depositors wanting instant access to their deposits amid pandemic-related economic uncertainty. The May average interest rate for current deposits was 0.12% and for savings deposits it was 0.03%, while the average cost for time deposits with a one-year maturity was 0.28%. Similarly, the average cost of deposits from nonfinancial corporations decreased to 0.13% in May from 0.4% at year-end 2015. The gradual reduction in deposit interest rates is consistent with the EU's ultralow interest rate environment and has been achieved as local depositors' confidence in Greek banks has strengthened.

Exhibit 3

Greek banks' average interest rates for new deposits and loans



Source: Bank of Greece

Concurrently, the average interest rate for new loans to nonfinancial corporation has decreased to 3.1% in May 2020 from 5.3% at year-end 2015, while for new loans to households has actually increased to 5.2% in May 2020 from around 4.7% in December 2015. Because the bulk of Greek banks' new loans are corporate and there is very limited growth on the retail side, the more than 200 basis points decline in corporate loan rates has also contributed to the pressure on banks' NIMs and profitability.

Reducing funding and operating costs while originating new corporate loans has supported the banks' profitability amid declining loan balances, which follows extensive sales and securitisations of nonperforming loans to improve asset quality. In addition, the increasing access to cheap ECB funding cost will also help Greek banks support their margins and profitability this year and next.

Endnotes

1 Deposits from domestic residents in Greece.

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UnitedHealth Group's strong earnings, lower leverage is credit positive

Originally [published](#) on 15 July 2020

On 15 July, [UnitedHealth Group Incorporated](#) (A3 stable), the largest health insurer in the US, reported strong second-quarter 2020 earnings, increased equity and reduced short term debt, a credit positive (see exhibit). The results, which included the brunt of the first wave of coronavirus hospitalizations, indicate that the pandemic is manageable for UnitedHealth and the industry, which supports our stable outlook for the health insurance sector.

UnitedHealth second-quarter highlights: Strong earnings, lower leverage

	2Q19	1Q20	2Q20	% chg YoY
Total revenue	60,595	64,421	62,138	2.5%
Medical costs	39,184	41,000	34,678	-11.5%
EBITDA	5,398	5,719	9,958	84.5%
Adjusted debt-to-capital	44.4%	47.4%	42.3%	
Debt-to-EBITDA	2.0x	2.3x	1.7x	

Sources: Company reports and Moody's Investors Service

The incremental costs related to the coronavirus, including \$1.5 billion in premium rebates, the waiver of cost sharing for diagnosis and treatment and premium rebates among other actions, were more than offset by savings from the deferral of treatment for non-coronavirus conditions. Overall, consolidated EBITDA of \$10 billion was up 85% year over year and leverage with Moody's adjustments improved to 42.3% from 47.4% in the first quarter. We estimate that parent cash remains well above the company's typical target of \$500 million - \$1 billion.

Although credit positive, the results are not sustainable. Despite the record jump in earnings, UnitedHealth did not increase guidance and expects utilization to be above normal in the second half of 2020 as previously deferred procedures take place. In addition, the waiver of coronavirus diagnosis and treatment cost-sharing will also weigh on earnings, as well as additional assistance efforts, such as at least \$1 billion in additional premium rebates. The additional planned premium rebates suggest that higher medical costs in the second half of the year will not fully offset the strong results to date.

In April, we affirmed our stable outlook for the health insurance industry. We derived three scenarios: mild, medium and severe. In the mild case, all of Moody's-rated issuers incurred a net benefit for the year as coronavirus costs were more than offset by the temporary deferral of non-essential treatments and procedures. In the mild scenario, we projected 800,000-1,000,000 hospital stays. So far, we estimate total hospitalizations have been in the 250,000-350,000 range; although this number continues to grow. Despite a recent surge in cases in certain areas, the pandemic still appears to be consistent with our mild scenario. However, the ultimate effect of the coronavirus remains uncertain, depending on its severity and duration.

UnitedHealthcare, UnitedHealth's insurance subsidiary, was a main beneficiary of the deferred utilization. Operating earnings were \$7.0 billion in the quarter, up from \$2.6 billion a year ago. Despite this, commercial membership was down by 990,000 from year-end 2019, reflecting the coronavirus economic disruption. We expect continued attrition as long as the economy struggles and as individuals who were initially furloughed and maintained their health insurance coverage are laid off. Commercial membership losses have been partly offset by increases of 335,000 in Medicare Advantage and 310,000 Medicaid. Given that the states have temporarily stopped eligibility re-determinations, along with increases in unemployment and contract wins in Kentucky and Indiana, Medicaid should be a source of growth.

Optum, UnitedHealth's health service subsidiary, performed well despite the low utilization during the quarter. Operating earnings of \$2.2 billion were up 6% year-over-year. In OptumHealth, the provider business, reduced fee for service earnings was offset by strong performance in the risk business (in which providers receive capitated payments). At OptumRx, the pharmacy services subsidiary, lower script volume was partly offset by home infusion services, specialty, behavioral and other services. We expect script volumes to return to normal levels in the second half of the year.

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Travelers preannounces large second-quarter catastrophe losses, and a small coronavirus-related impact

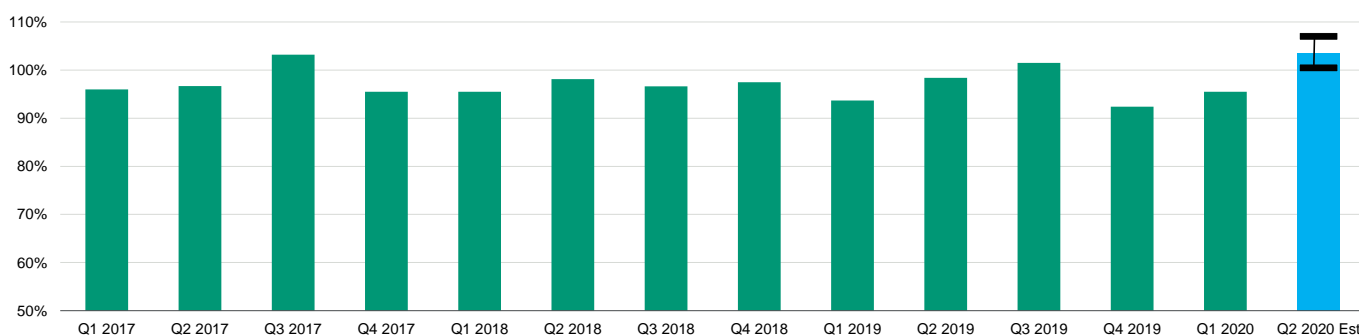
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On 14 July, [The Travelers Companies, Inc.](#) (A2 stable) preannounced that it expected a second-quarter 2020 net loss after \$854 million of pretax catastrophe losses, most of which relate to severe storm losses across the US. The company also reported \$234 million of pretax losses from its non-fixed-income portfolio, reflecting a first-quarter 2020 decline in equity markets, recorded on a one-quarter lag.

Given that second-quarter combined ratios were 97%-98% over the past three years and generated property and casualty (P&C) underwriting income, we expect Travelers to report an underwriting loss in the second-quarter (Exhibit 1). Although the catastrophe losses are significant, the non-fixed income results for the third quarter will likely reflect, to some extent, the recoveries in the broader equity markets during the second quarter. The second-quarter catastrophe losses for Travelers are not unique. For example, [Allstate Corporation](#) (A3 stable) estimated natural catastrophe losses for April and May 2020 at \$982 million pretax last month. In addition to storms, Travelers' also incurred catastrophe losses from civil unrest claims.

Exhibit 1

Traveler's quarterly combined ratio including Moody's estimated range for second-quarter 2020



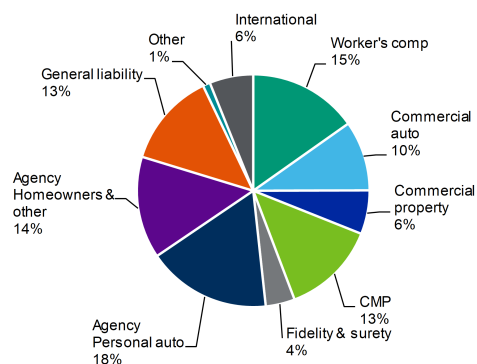
Combined ratio estimate based on second-quarter 2017-19 pretax catastrophe combined ratios, and \$854 million of catastrophe losses in second-quarter 2020 and a +/- 3% range.
Sources: *Company filings and Moody's Investors Service*

The company is well capitalized and has solid reinsurance protection. Travelers renewed its underlying property CAT treaty that covers accumulation from first dollar of qualifying losses from PCS-designated CAT events, for which Travelers incurs losses of \$5 million or more per event. From January through December 2020, the treaty provides up to \$280 million of \$500 million of coverage, subject to a \$1.55 billion annual aggregate deductible. Coverage for and contributions to the \$1.55 billion annual deductible from hurricanes and earthquakes are limited to \$250 million per event. Through March, the company accumulated \$414 million of qualifying losses toward the aggregate retention. We expect much of the second-quarter losses will qualify as well.

Travelers announced that in terms of the company's underlying underwriting results, coronavirus and related economic conditions had a modest net impact in the second quarter. This follows \$86 million of pretax pandemic-related charges in the first quarter related to an increased allowance for doubtful accounts, lower audit premiums receivable and modestly higher claim expenses. The company also stated that insurance losses directly related to the pandemic of \$114 million pretax and a \$63 million pretax reduction in the estimate of ultimate audit premiums receivable were approximately offset by initial estimates of favorable frequency from the shelter-in-place environment, primarily in short-tail lines (net of premium refunds), and other items. These directly attributable claims are relatively low given the company's large size and national footprint. The relatively modest loss reflects Travelers' product lines with a core focus on small and middle market accounts, management of terms and conditions, and broad diversification of business lines (Exhibit 2 and 3).

Exhibit 2

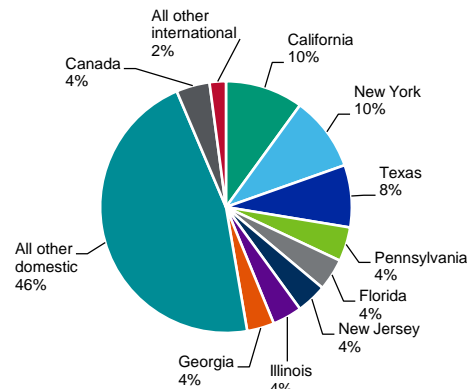
Net premiums written by line of business for first-quarter 2020



Sources: Company filings and Moody's Investors Service

Exhibit 3

Direct premiums written by geography, 2019



Sources: Company filings and Moody's Investors Service

Other insurers reported or estimated significant coronavirus losses: [Chubb Limited](#) (A3 positive - Chubb INA Holdings) \$1.4 billion pretax; [Zurich Insurance Company Ltd.](#) (A1 stable) \$750 million; [Munich Reinsurance Company](#) (A2 (hyb) stable) €800 million – particularly from event cancellation insurance; and [Swiss Re Ltd.](#) (Aa3 stable) in April reported a pretax charge of \$476 million from coronavirus-related losses. Among US insurers, [American International Group, Inc.](#) (Baa1 stable) in May reported \$272 million of coronavirus losses from its travel, event cancellation, commercial property, trade credit, workers' compensation and reinsurance lines of business. We expect additional coronavirus-related losses during second-quarter earnings season, particularly for commercial insurers and reinsurers.

Travelers also announced an estimate of its subrogation recoveries related to claims against [PG&E Corporation](#) (Ba2 stable) resulting from the 2017 and 2018 California wildfires. In connection with PG&E's emergence from bankruptcy on July 1, 2020, Travelers expects to recognize favorable prior year reserve development related to these claims of approximately \$400 million, pretax and net of expenses and reinsurance, in its third quarter 2020 earnings.

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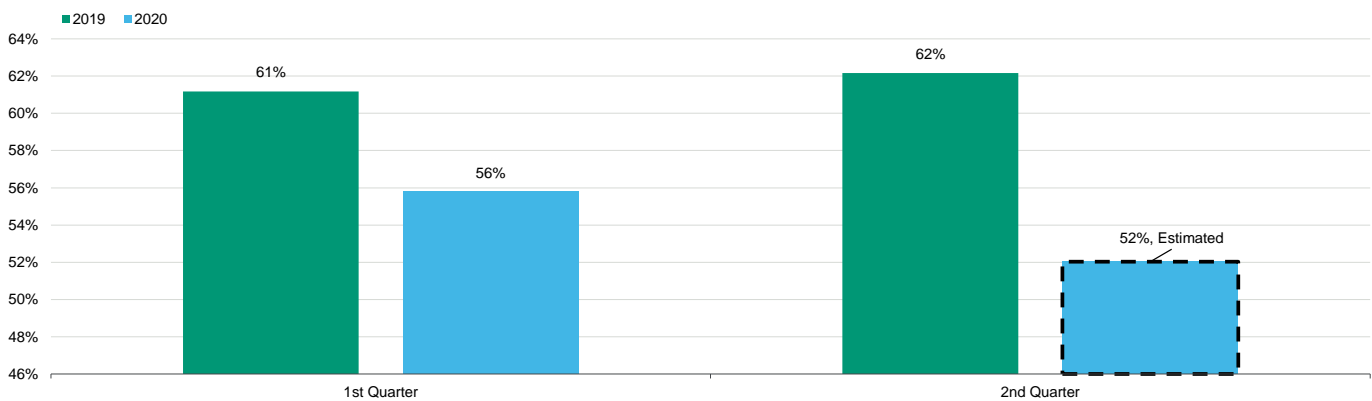
Mexico's second-quarter car thefts and collisions decline, benefitting auto insurers

On 14 July, the Mexican Insurance Association (AMIS) said that insured car thefts fell 16% over the 12 months to June, after second-quarter thefts of insured cars fell 18% and collisions dropped 44% from the first quarter. The data is credit positive for auto insurers because the sharp drop in loss frequency will benefit their profitability.

The decline in claims frequency will have a net positive effect on insurers' underwriting results. For 2020, we expect the auto insurance loss ratio – claims as a percentage of net earned premiums – to decline at least 52% in the first half of 2020 from 63% at year-end 2019, which would lead to a combined ratio (i.e., claims, brokerage and general expenses as a percentage of net earned premiums) below 90%. In first-quarter 2020, which included only one month of lockdown, the auto insurance loss ratio fell to 56% versus 61% in first-quarter 2019 because of fewer insured car thefts and collisions (see Exhibit 1). We estimate that auto insurers' loss ratio will fall below 52% for first-half 2020.

Exhibit 1

The loss ratio declines in the first two quarters will benefit Mexican car insurers' 2020 operating performance

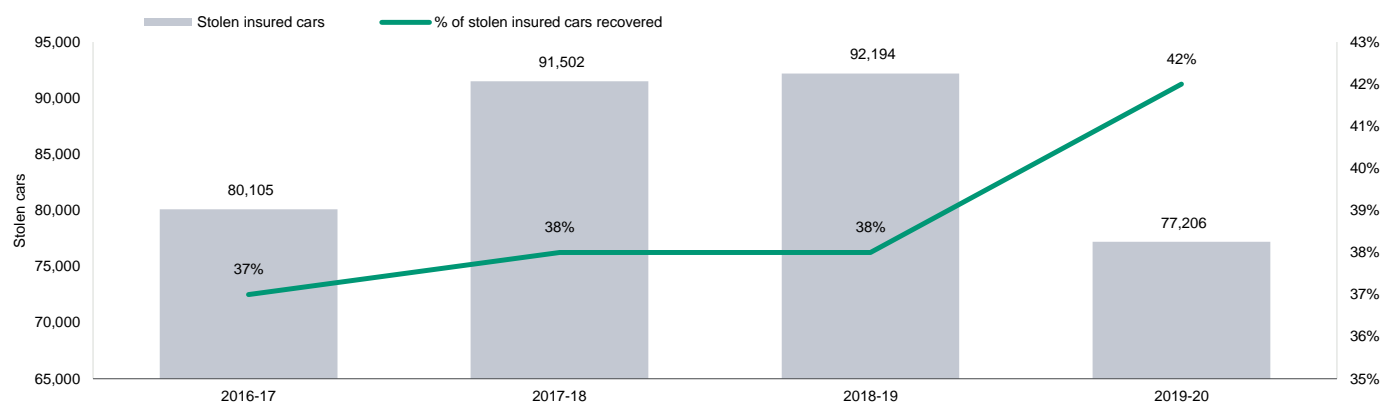


Sources: Comisión Nacional de Seguros y Fianzas and Moody's Investors Service

As Exhibit 2 shows, insured car thefts declined 16% from July 2019 to June 2020 and the percentage of vehicles recovered increased over the last 12 last months, the recovery of insured cars that were stolen improved four percentage points to 42%, increasing insurance companies' salvage value and reducing the total loss paid. Additionally, collisions involving at least one insured car dropped by around 44% in the second quarter from the first quarter.

Exhibit 2

Insured car thefts fell on a last-12-month basis, while the recovery of stolen insured cars increased over the July 2019 to June 2020 period



Sources: Comisión Nacional de Seguros y Fianzas and Moody's Investors Service

The decline in thefts and collisions mostly reflects the lockdown amid the coronavirus pandemic, while the increased recovery of stolen insured cars relates more to public safety programs. Despite the benefits of these developments on car insurers' profitability, the lockdown led to severe economic contraction in the second quarter, sharply reducing new car sales and the issuance of new auto insurance policies.

We expect large auto insurers Quálitas, Compañía de Seguros, S.A. de C.V., HDI Seguros, S.A. de C.V., A.N.A. Compañía de Seguros, S.A. de C.V., [Seguros Sura, S.A. de C.V.](#) (Baa3 negative) and [Seguros Azteca Danos, S.A. de C.V.](#) (Ba1 stable) to register increased earnings given their strong client retention rates and business volumes. For multiline insurers, particularly those with exposure to medical and health coverage, the developments in the auto sector will mitigate increased claims associated with coronavirus treatments, strengthening their aggregate result.

Small auto insurance companies such as SPT, Sociedad Mutualista de Seguros, La Latinoamericana Seguros, S.A., Aseguradora Patrimonial Daños, S.A. El Águila, Compañía de Seguros, S.A. de C.V., and the startup CRABI, S.A. de C.V. will experience challenges because of a decline in policy origination. We expect claims to gradually return to previous levels, particularly in relation to collisions, as the lockdown ends and the economy recovers. This risks increasing price competition among insurers and weakening long-term underwriting performance, which would work against smaller insurers.

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Tunisian prime minister's resignation and the ensuing political deadlock exacerbate mounting liquidity risks

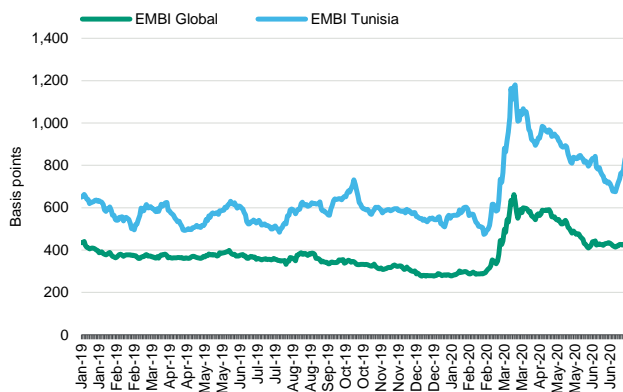
On 15 July, [Tunisia](#) (B2 review for downgrade) Prime Minister Elyes Fakhfakh resigned after just a few months in office, setting up a difficult quest for a replacement government that can garner the support of a sharply divided parliament. This latest development is credit negative and adds to the event risk that has taken place in Tunisia since the start of the coronavirus pandemic and [prompted](#) us to put Tunisia's ratings on review for downgrade in April.

Prolonged government formation consultations, or a return to elections in a more credit-negative outcome, would delay negotiations for a new International Monetary Fund (IMF) support program. The government expected a new program to be in place later this year after the early cancellation of a previous four-year new Extended Fund Facility that began in May 2016 in favor of a \$745 million disbursement under the IMF's Rapid Financing Instrument on 10 April. We view the agreement for an IMF program as key to securing continued access to bilateral and multilateral funding sources that cover around half of Tunisia's gross funding requirements at 14% of GDP.

Tunisia is challenged by an acute tightening in global financing conditions that created a sustained period of high financing risk and are exacerbated further by weakening near-term economic growth prospects, a deteriorating fiscal position and a fragile external position. While the government was able to refinance from domestic sources a \$400 million eurobond that matured in June 2020 and a \$250 million Qatari loan that matured in April 2020, the sovereign's eurobond maturity profile over the next decade points to increased refinancing risks unless the government is able to quickly restore its access to international capital markets at affordable rates (see Exhibits 1 and 2).

Exhibit 1

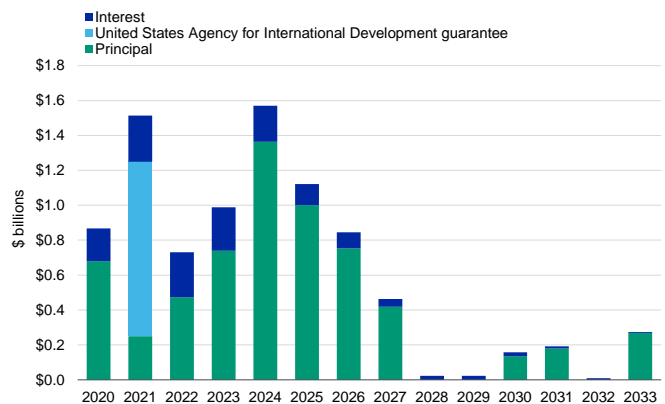
Tunisia's spreads have risen again recently... Emerging Market Bond Index (EMBI)



Sources: Haver Analytics and JPMorgan

Exhibit 2

... amid a significant eurobond maturity profile



Sources: Bloomberg, Tunisia's Ministry of Finance and Moody's Investors Service

The recent announcement by the Tunisian government that it is negotiating with [Saudi Arabia](#) (A1 negative), [Qatar](#) (Aa3 stable), [France](#) (Aa2 stable) and [Italy](#) (Baa3 stable) to postpone bilateral official debt service payments indicates the mounting liquidity pressures the government faces. According to our estimates, bilateral funding covers about 10% of annual gross borrowing requirements in the 10%-15% of GDP range. However, because multilateral and bilateral official funding already accounts for almost 50% of total gross borrowing requirements, we do not expect a significant further expansion of official funding access, except on an ad hoc basis, and not on a scale to permanently substitute for international capital market access. Similarly, a domestic debt-to-GDP ratio of only around 20% over the past few years attests to the domestic banking system's limited funding capacity in light of an already high loan-to-deposit ratio of more than 100%. The government's forecast of an economic contraction of 6.5% in 2020, a widening of the fiscal deficit to 7% of GDP and a debt ratio at more than 80% of GDP will further exacerbate Tunisia's financing needs and liquidity risks.

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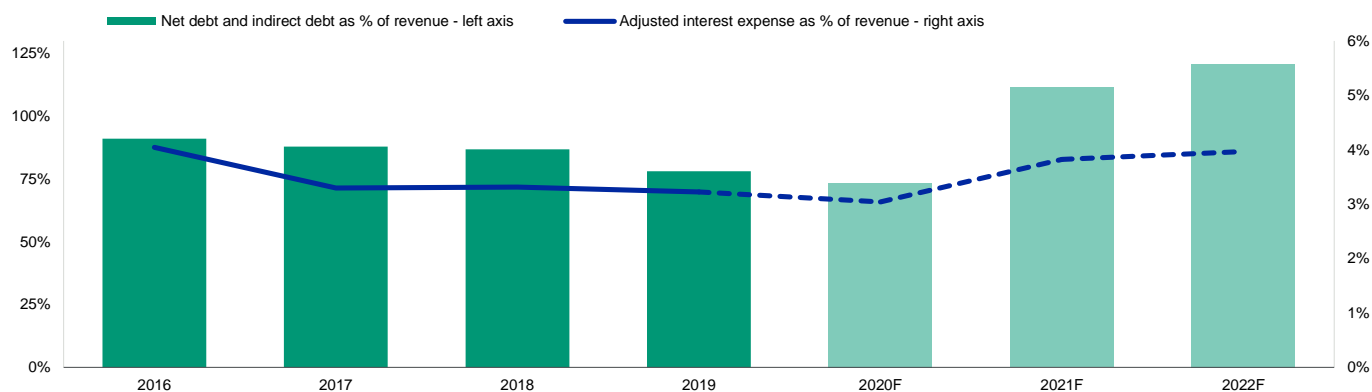
British Columbia projects broader sectoral weakness in 2020-21, resulting in higher deficit and debt

On 14 July, the Canadian [Province of British Columbia](#) (Aaa stable) released its economic and fiscal update for the current year, fiscal 2020-21, ending 31 March 2021. In its update, the province indicates a potential CAD12.5 billion deficit, or 23.1% of revenue. The province's scenario, which we consider to be its base case, features coronavirus-related fiscal deterioration including lower tax, commodity, Crown and agency income, as well as tax and relief measures and higher spending for pandemic response and economic recovery. In its scenario, the province projects that real GDP could decline by 6.8% this year before a 3.1% recovery in 2021. The projected deficit is credit negative because it indicates broad sectoral weakness which would not only result in larger revenue losses than we previously assumed, but could delay the province's efforts to return to balance quickly, resulting in multiple years of material deficits.

Further, the province's deficit projection under its base-case scenario materially exceeds our previous deficit estimate of around CAD3.4 billion (5.9% of revenue) for fiscal 2020-21. If its scenario materializes, we project continued deficits in fiscal 2021-23 of 3%-7% of revenue and expect BC to finance its future operating deficits with debt. Therefore, we project a debt burden (net debt to revenue) of around 105%-125% for 2020-23, versus our previous May estimate of 90%-100% (see exhibit).

British Columbia's increased debt burden is credit negative, but low interest rates ease the interest burden

Fiscal years end 31 March



Sources: Province of British Columbia and Moody's Investors Service

The province's base-case scenario is based primarily on March-May 2020 data and despite the larger than anticipated revenue losses has significant built-in buffers under its CAD5 billion spending allocation, which includes spending buffers for health and mental health and emergency benefits for workers and for economic recovery. The allocations ensure that the province retains some fiscal flexibility should the recovery be slower than anticipated. In addition, the province has access to nearly CAD6 billion in liquidity sources that it can use to reduce its reliance on debt financing the operating deficits. Debt affordability remains strong given comparatively lower debt levels than the majority of Canadian provincial peers. Affordability is supported by lower-for-longer interest rates and recent Bank of Canada policy actions including successive benchmark rate cuts and provincial bond and money market purchases. On 16 July, the federal government also announced a CAD2 billion support for the province to help restart the economy.

In addition to its main economic and fiscal scenario, the province presented two alternative scenarios for faster or slower economic recovery. Although the province did not present an estimate of the fiscal effects of its alternative scenarios, we forecast that they could result in a 20-30% improvement or deterioration relative to the projected CAD12.5 billion 2020-21 deficit.

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Mexican State of Nuevo León's pension reform will alleviate liquidity pressures over the next decade

Originally [published](#) on 17 July 2020

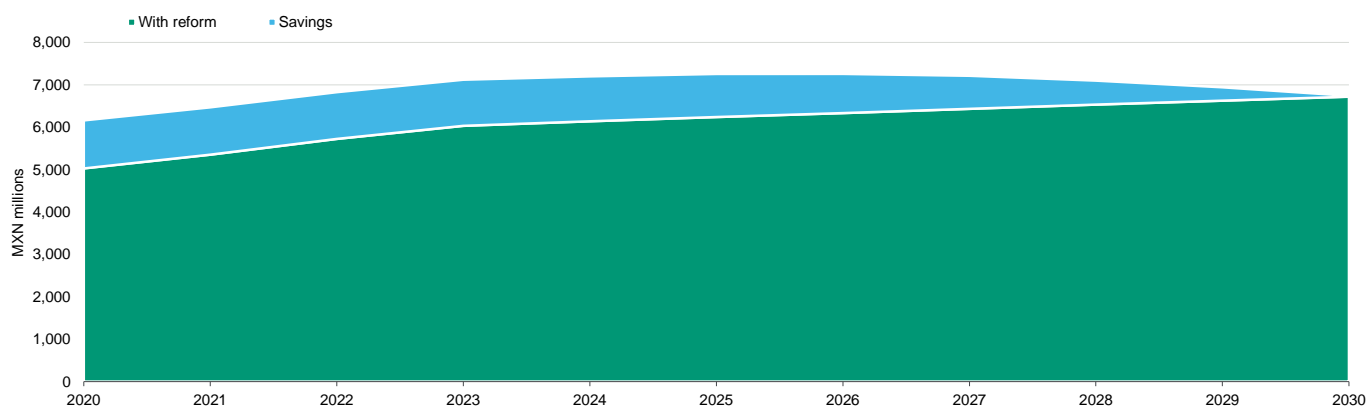
On 14 July, lawmakers in Mexico's [State of Nuevo León](#) (Ba2/A2.mx negative) approved a reform to the state's pension plan that will reduce its pension spending over the next 10 years, a credit positive. The reform allows the state to use the employee and employer pension contributions of workers to pay current pensions and healthcare benefits.

The reform will alleviate stress on the state's liquidity over the next 10 years, a period in which pension spending was due to peak, by reducing annual spending by 11% on average. However, other approved changes, including new employee benefits and reimbursement of the contributions used to pay current pension benefits starting in 2029, will increase the state's total unfunded pension liabilities¹ by 7%.

Pension spending accounted for 9% of Nuevo León's operating revenue in 2019, or MXN5.7 billion (\$260 million). Without the reform, the state's pension spending would have grown 17% by 2030. The biggest annual increases, of 6% on average, would have been in 2020, 2021 and 2022, and pension spending would have peaked in 2023 at 10% of operating revenue. The increased pension spending would have exacerbated pressure on the state's weak financial performance. In 2019, Nuevo León posted a negative operating margin of 1.3% of operating revenue. As a result of the reform, the state's pension spending will decrease by 11% a year on average (see Exhibit 1), dropping to 6.9% of operating revenue by 2030.

Exhibit 1

Pension reform will reduce the state's pension spending over the next 10 years

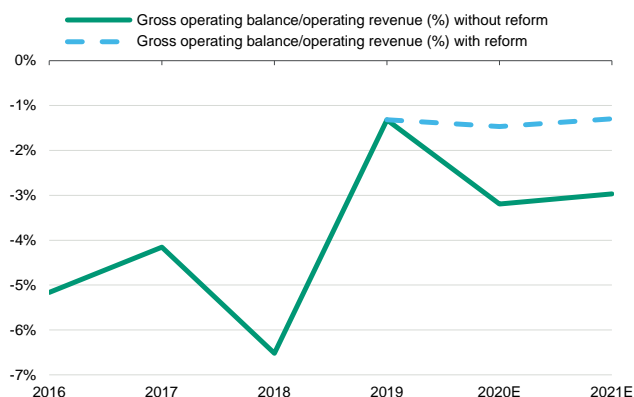


According to information provided by Valuaciones Actuariales del Norte, the actuarial firm that led the pension reform, the spending reduction will last until 2030.
Sources: Valuaciones Actuariales del Norte and Moody's Investors Service

The state will continue to register negative operating margins in 2020 and 2021 because of structural spending pressures related to education and public security, exacerbated by an increase in spending and lower tax revenue collection as a result of the coronavirus pandemic. However, the negative operating margins will be smaller than our estimates before the reform. We now expect operating margins of negative 1.5% of operating revenue in 2020, compared with our original estimate of negative 3.2%, and negative 1.3% in 2021, compared with negative 3% previously (see Exhibit 2). These revisions will lead to financial deficits of 2.5% of revenue in 2020, compared with our previous expectation of 4%, and 1.6% in 2021, compared with 2.7% previously (see Exhibit 3).

Exhibit 2

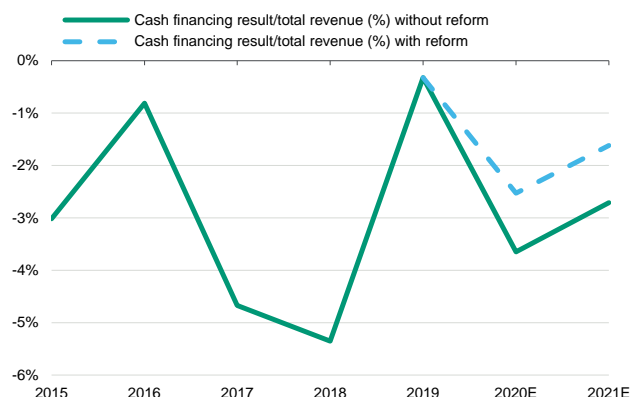
Pension reform will reduce financial pressures on Nuevo León



Sources: Nuevo León's financial statements and Moody's Investors Service

Exhibit 3

Pension reform will reduce financial pressures on Nuevo León



Sources: Nuevo León's financial statements and Moody's Investors Service

While the reform will alleviate pressure on Nuevo León's liquidity over the next 10 years, the state's total unfunded pension liabilities will increase by 7% and equal 141% of operating revenue in 2020, compared with 132% without the reform. The increase in unfunded pension liabilities reflects new benefits, such as a new minimum guaranteed pension, and the reimbursement starting in 2029 of the contributions used to pay current pension benefits.

To strengthen the pension system's funding, the reform also increased the contributions of employees under the defined contribution pension scheme to 17.3% of their salaries from 12.25%, and employer contributions to 27.4% of salaries from 18.75%. For employees under the defined benefit pension scheme, the reform increased employee contributions to 9% of their salaries from 6%, and employer contributions to 12% of salaries from 6%. In addition, the state will create a reserve funded with additional contributions from both employees (1.2% of their salaries) and employers (1.8% of salaries) to ensure a minimum guaranteed pension of double the minimum salary.

Endnotes

¹ Unfunded pension liabilities reflect the pension system's estimated assets and liabilities for the next 100 years using a discount rate of 3.5%.

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Airline industry disruption has far-reaching effects

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The global airline industry, which is featured in our [infographic](#), has been disproportionately affected by the [coronavirus pandemic](#). It is one of just a few industries that saw more than 90% of demand fall away within weeks of the global spread of the coronavirus in March. The strain on the industry's previously flourishing fundamentals is (and will continue to be) felt across a broad swath of the [global economy](#), well into 2022 and beyond. This is driven by our expectation of a gradual and protracted return of passenger traffic, which will be inextricably linked to coronavirus-related health and safety concerns, and the importance of the [passenger airline industry](#) as a critical cog in the broader global economy.

Passenger airlines supported about 3% of world GDP in 2019, according to the International Air Transport Association (IATA). Airline cargo operations materially bolster international trade, with movement of more than \$5 trillion of goods across supply chains in 2019. Air travel is also a key facilitator of tourism spending, connecting travelers to points all over the world, paving the path for spending on lodging, local transportation, and attractions and restaurants, among other items and services. And the outsourcing by airlines of many services, along with the significance of their employment rolls and consumption of refined petroleum in normal economic times, supports economic activity across many sectors of the global economy.

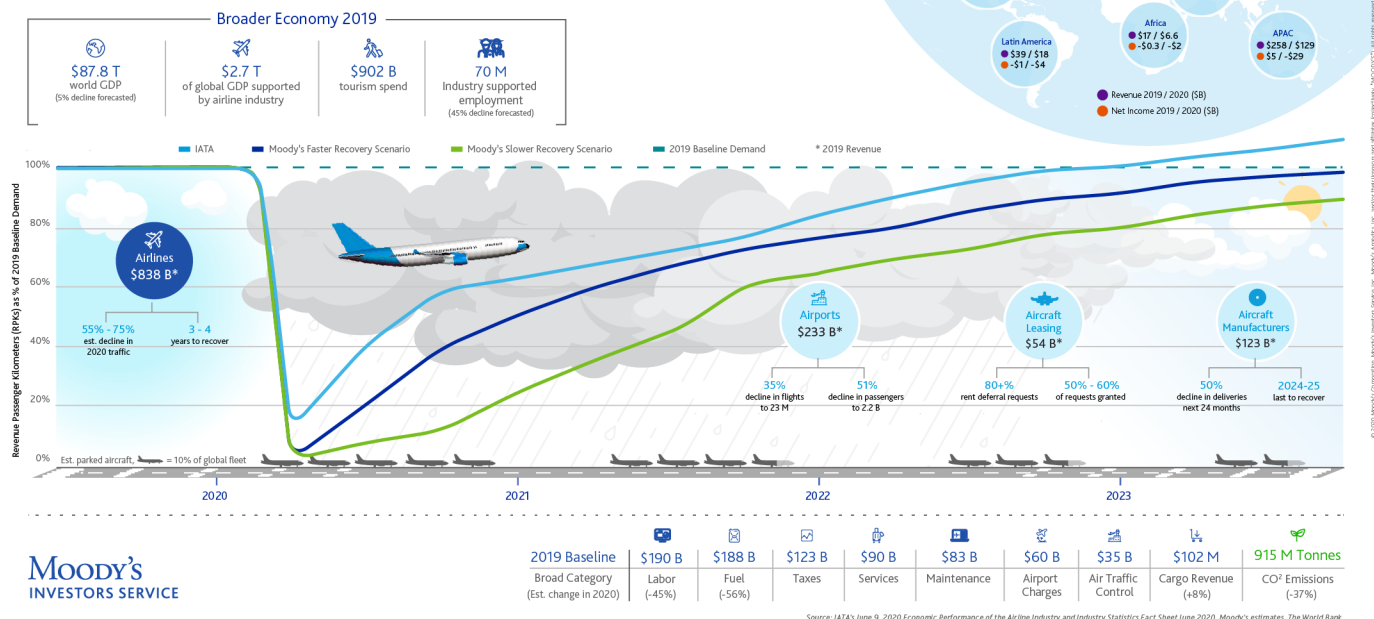
Knock-on effects are big for industry stakeholders. Passenger demand for air travel drives demand for key stakeholders in aviation – [airports](#), [aircraft leasing companies](#) and the [aircraft manufacturers](#), as well as a multitude of service providers that keep daily airline operations and airports humming during normal economic times.

Our infographic (see below) also highlights some broad categories of activities for which airlines incur significant costs, either directly (e.g., labor, jet fuel) or through outsourcing (e.g., airport services, maintenance and repair), along with a host of required services (e.g., air traffic control, airport charges). Each of these stakeholders will be significantly affected for at least the next three years. Anticipated declines in their respective activity levels of 40% to 50% or more in 2020 will closely mirror those of the airlines.

For more information, visit www.moody.com/airlines

Airline industry disruption has far-reaching impact

Seatbelts fastened for turbulent multi-year recovery.



We expect the fundamental performance of airports will move hand-in-hand with demand for air travel because every journey starts and ends at an airport. We expect airports to recover largely in step with the airlines.

Aircraft lessor recoveries will be next in line. As passenger demand recovers, airlines will return aircraft to service, likely in a stair-step fashion, re-starting the market for leasing and trading aircraft, which currently remains in hibernation. Aircraft lessors will benefit as recurring requests for rent deferrals gradually subside, and there will be a greater willingness to repossess aircraft from more weakly positioned airlines as gradually recovering demand facilitates placement of aircraft on new leases.

We expect that aircraft manufacturers, including [Airbus](#) (A2 negative) and [Boeing](#) (Baa2 negative) – and the broader global supply chain feeding into their operations – will be the last of the direct aviation industry stakeholders to regain their 2019 footing, and that this will not occur before 2023.

Demand recovery scenarios. Our current forecast scenarios continue to anticipate an eventual recovery in passenger demand, once the concerns related to personal health and safety are relieved. These assume that there will be effective pharmaceutical remedies, including vaccines and medicines that will help to control and treat the coronavirus after regulatory approval. Restoration of passenger demand – measured in revenue passenger kilometers – to 2019 levels by the end of 2023 reflects these assumptions.

Projections from various industry stakeholders, including IATA, point toward a substantial recovery in 2023, relative to 2019 traffic levels. At the moment, we are also modeling a recovery roughly equivalent to 2019 levels in 2023, although risk of late is skewing more towards a potentially longer timeframe. We show a faster recovery case and a slower recovery case, both of which we considered in our assessment of the global airline industry and airline company credit quality.

The faster recovery case considered an earlier (albeit not “fast”) and steadier multi-year recovery of passenger demand between 2020 and 2023, with somewhat of a plateau in the first half of 2021 under the assumption that the coronavirus would flair up in the next Northern Hemisphere winter.

The slower recovery case considered that the coronavirus would be more of an impediment, restraining the start of any meaningful recovery in passenger demand for a more extended period. Recent experience of increasing rates of infection concurrent with loosening social distancing and quarantine protocols indicates that passenger demand will likely align more with our slower recovery case, as

social distancing and quarantine protocols are more likely to be maintained and/or revert to more restrictive mandates as infection rates rise again. To the extent that passenger demand is more constrained because of sustained concerns related to personal health and safety and/or heightened travel restrictions beyond 2021, the risk of more extensive industry disruption and a more protracted recovery period could meaningfully increase.

[United Airlines'](#) (Ba1 negative) and [Qantas Airways'](#) (Baa2 negative) recent experience are stark reminders of the fragility of passenger demand across the globe. In late June, United saw a quick and stark reversal in its bookings for travel to and from its Newark, New Jersey, hub within hours of the governors of the states of New York and New Jersey instituting 14-day quarantine requirements for visitors from more than 20 US states – including Arizona, Florida, North Carolina and Texas.

In Australia in early July, the governors of New South Wales (Sydney) and Victoria (Melbourne) re-closed the borders between their states after more than 100 new cases appeared in Melbourne in one day. These were reportedly imported by travelers that returned to Australia and were transmitted to local citizens working in quarantine facilities, which led to community spread. Qantas suspended the majority of its service between Melbourne and Sydney as a result. Unrelated to the state border closure, Qantas has also now suspended almost all of its international flights through at least March 2021.

[Delta Air Lines](#) (Baa3 negative) announced on 14 July that it will cut in half (to 500) the number of weekly flights it had planned to add to its August schedule, before the recent flare-ups of coronavirus infections. Other US airlines will also slow their heretofore planned restoration of capacity. Delta also disclosed that its available capacity for sale in the 2020 third quarter will be 20% to 25% of last year's third quarter level, about half of what it had planned as recently as last month. These are but a few examples of how quickly and meaningfully the coronavirus ebbs and flows will effect air travel, and the increasing risk that passenger demand will more closely align with our slower recovery scenario – potentially as a “best case” scenario, now.

We believe many governments, whether local, regional or at the state level, are likely to slow re-openings because of the demonstrated persistence and resilience of the coronavirus. However, there is not a one-to-one relationship between passenger demand and the number of aircraft in service. The US airlines parked 65% or more of their fleets in the 2020 second quarter, while passenger demand declined more than 90%. Across the globe, many carriers including [easyJet](#) (Baa3 negative), Cathay Pacific, Emirates Airline, Garuda Indonesia and Singapore Airlines, to name a few, parked 90% or more of their fleets. We expect a non-uniform return of aircraft to service, with airlines that fly mainly domestic or intra-continental service (e.g., Europe and Asia) bringing aircraft back sooner than legacy carriers with long-haul international operations.

Key factors to support recovery. Timely success of the [pharmaceutical industry's race to a vaccine](#) will be key to the ultimate trajectory of the aviation industry flight path, both fundamentally and financially.

[Government support](#) – whether via grants, loans and/or equity investments – will remain a key differentiator in airlines' ability to avoid financial restructurings or liquidations. Lack of adequate government support – whether at all, with conditions or in a timely manner – has been a key contributor in recent airline insolvencies (or not) in different regions of the world.

With an effective coronavirus vaccine likely not available before well into 2021 – and likely longer to cover potential mutations of the virus and to ensure adequate dosage supply for the masses – additional government support will be required for the airline industry if employment levels are to be maintained near already reduced levels, and potentially to stave off additional airline restructurings and insolvency proceedings (whether preemptive, or otherwise).

Eventually, a full recovery of passenger demand will drive demand for aircraft. Notwithstanding the harsh market environment we envision for the next several years, when passenger demand ultimately returns to 2019 levels, we believe the industry will then need almost as many aircraft as were in operation in 2019. The sooner demand recovers, the better the recovery prospects for aircraft lessors and aircraft manufacturers, particularly because of the retirements of older, less efficient aircraft that will occur because of the coronavirus.

Seat density and network planning will affect the total demand for aircraft in respective airline fleets as new models with higher seat counts replace smaller, older aircraft, and airlines more efficiently utilize aircraft assets. Some will change their networks, with stronger carriers expanding, and others retrenching somewhat.

Potential changes to long-haul flying are also on the table. Some carriers may expand point-to-point operations, while others may revert to concentrating on hub-to-hub flying, relying on code-share or joint venture partners to complete a passenger's long-haul journey. To replace retired aircraft and to minimize costs related to carbon emissions, the former would require mid-size wide-bodies like Boeing's 787 or Airbus' A350-900, and the latter would promote demand for Boeing's 777-9 or Airbus' A350-1000 – both the largest available passenger models in each manufacturer's lineup. The need to reduce carbon emissions will also hold out hope for deliveries of A320neo and 737MAX narrow-bodies, including if regulators make carbon reduction schemes more demanding, as some European governments have already done as a condition for their financial support.

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PODCASTS AND VIDEOS

Podcasts and Videos

[Podcast: Coronavirus unlikely to cause US municipal defaults in 2020](#), 16 July 2020

Genevieve Nolan of the US Public Finance team and Al Medioli of Rating and Process Oversight discuss potential defaults driven by COVID-19 and key developments in Puerto Rico's efforts to settle with creditors after years of defaults.

Related report: [US municipal bond defaults and recoveries, 1970-2019](#)

[Podcast: Structured finance in a post coronavirus world](#), 15 July 2020

Jody Shenn and Anthony Parry of the Structured Finance team discuss how COVID-19 will cause a paradigm shift for key credit risk components and drivers of the global structured finance market.

Related report: [Coronavirus pandemic will accelerate and reshape credit trends in structured finance](#)

[Podcast: The future of the office has mixed credit implications for CMBS](#), 15 July 2020

Kevin Fagan and Blair Coulson of the Structured Finance team discuss the future of office usage in the US amid fallout from the coronavirus pandemic and its implications for commercial mortgage-backed securities.

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