Flash Economics

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United States, euro zone: Which credit markets are the most fragile?

Many investors are concerned about a possible deterioration in credit markets in the United States and the euro zone.

Thanks to the demand-stimulating policies, we can rule out a significant weakening of growth in these two countries.

We can also rule out a rise in interest rates.

This leaves us with watching trends in profitability, comparing growth in real wages and productivity and determining whether a decline in profitability could cause a solvency problem.

Profitability continues to increase in the United States, but, which is worrying, it has been declining in the euro zone since the second quarter of 2018.

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Concerns about credit markets

Many investors **are concerned that credit spreads will widen,** especially in the High Yield segment **(Charts 1A, B, C** and **D), which is starting to happen**.

Chart 1A
Investment Grade credit spread* (asset swaps, in bp)

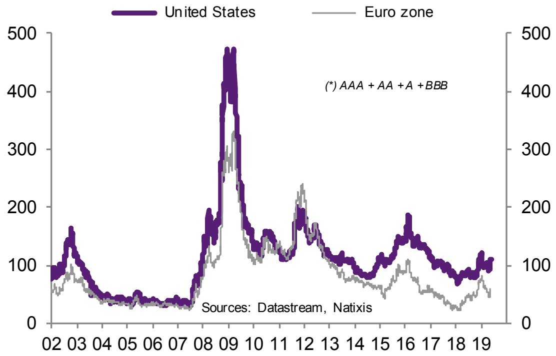


Chart 1B
High Yield credit spread (asset swaps, in bp)

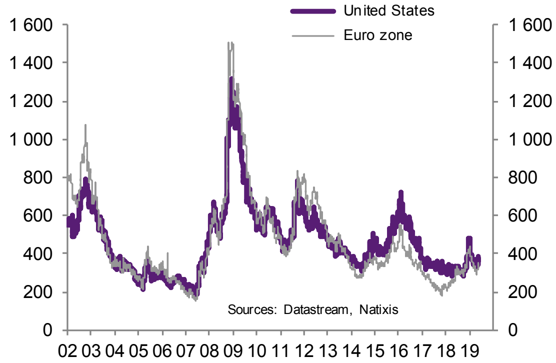


Chart 1C
Investment Grade credit spread* (asset swaps, in bp)

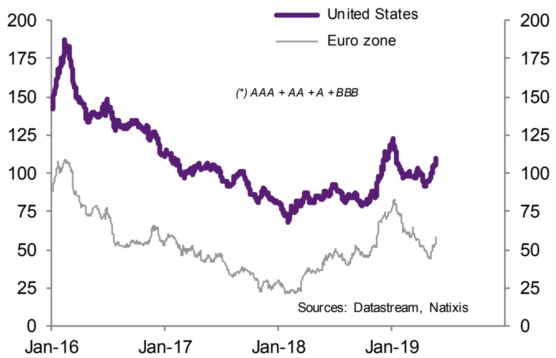
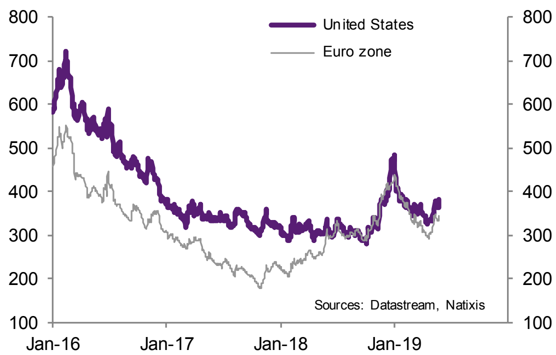


Chart 1D
High Yield credit spread (asset swaps, in bp)



What can we see currently?

- **Ratings (Charts 2A** and **B) are improving for Investment Grade, but deteriorating slightly for High Yield;**

Chart 2A
Investment Grade upgrade/downgrade ratio*

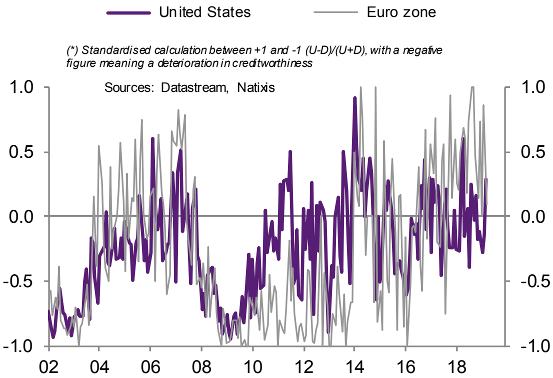
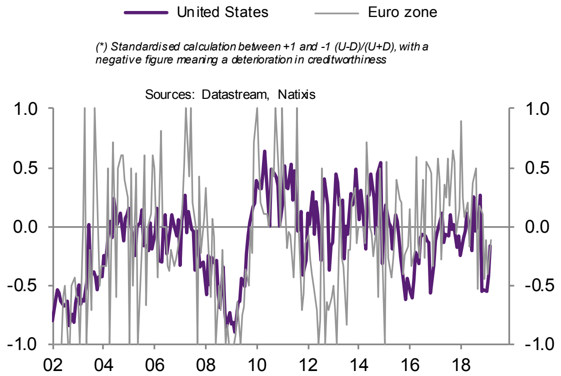
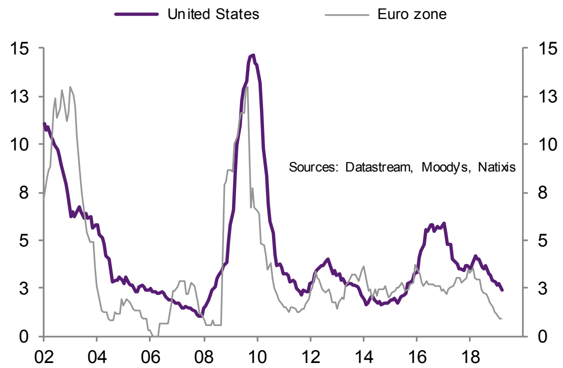


Chart 2B
High Yield upgrade/downgrade ratio*



- **Default rates (Chart 3) are declining.**

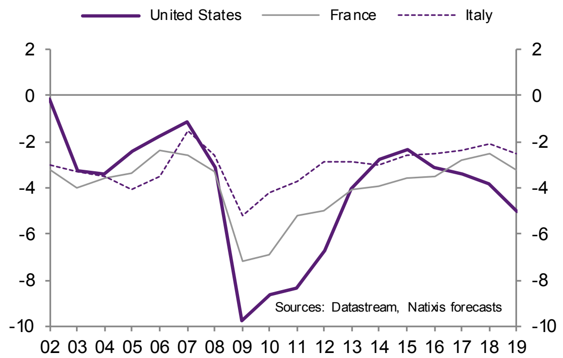
Chart 3
High Yield default rate (as %)



What should we watch to predict the situation of credit markets?

1. Monetary policies will remain stimulatory, and fiscal policy is stimulatory in the United States, France and Italy (Chart 4),

Chart 4
Fiscal deficit (as % of nominal GDP)



inflation is declining, which **increases employees' purchasing power (Charts 5A** and **B).**

Chart 5A
United States: Nominal per capita wage and inflation (Y/Y as %)

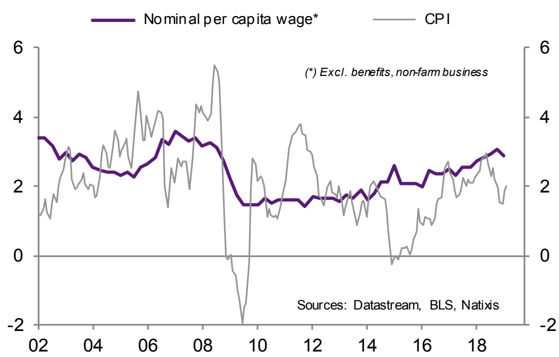
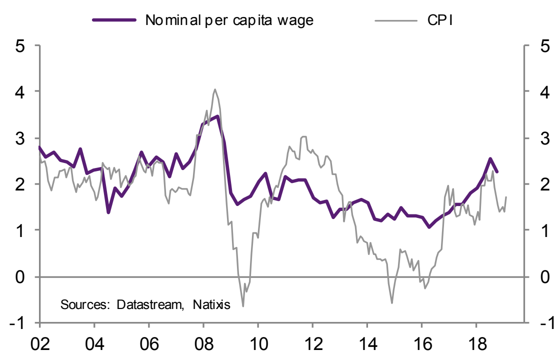


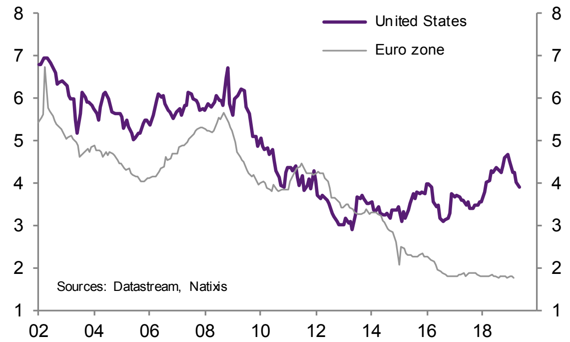
Chart 5B
Euro zone: Nominal per capita wage and inflation (Y/Y as %)



All this means that:

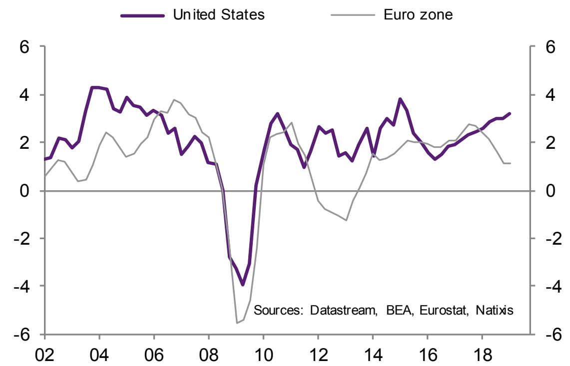
- **The interest paid by companies will remain low (Chart 6);**

Chart 6
Interest rate on fixed-rate loans to companies
(as %)



- **It is very unlikely that growth will become very weak (Chart 7).**

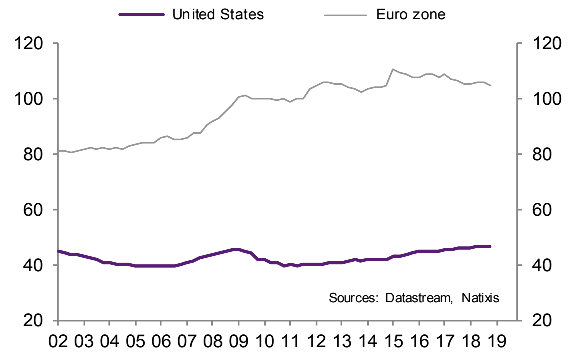
Chart 7
Real GDP growth (Y/Y as %)



2. The only threat could therefore be a deterioration in companies' profitability leading to a deterioration in their solvency.

Non-financial corporations' debt (Chart 8) is low, but rising in the United States, and high but falling in the euro zone.

Chart 8
Debt of non-financial corporations
(as % of nominal GDP)



We must therefore **compare trends in real wages and in productivity in the recent period (Charts 9A, B, C** and **D),** and also in unit labour costs and in the GDP deflator **(Charts 10A** and **B).**

Chart 9A
United States: Per capita real wage and productivity

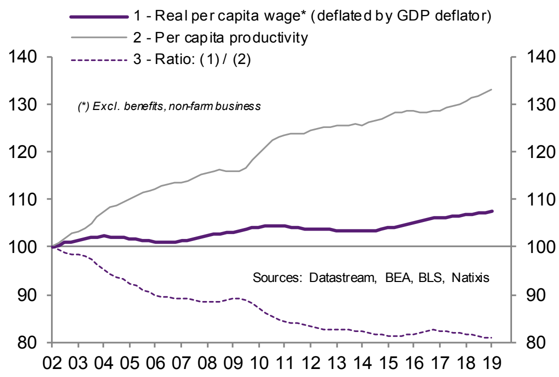


Chart 9B
Euro zone: Per capita real wage and productivity (2002:1 = 100)

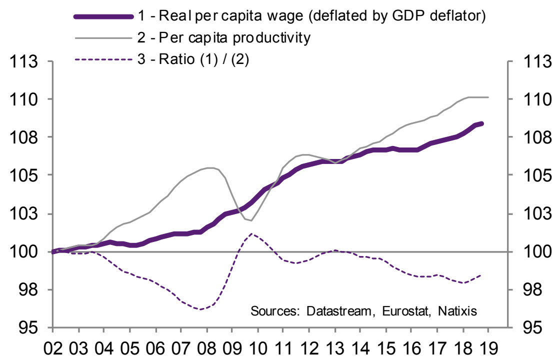


Chart 9C
United States: Per capita real wage and productivity (Y/Y as %)

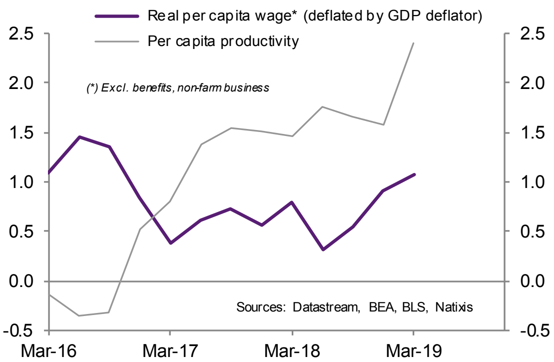


Chart 9D
Euro zone: Per capita real wage and productivity (Y/Y as %)

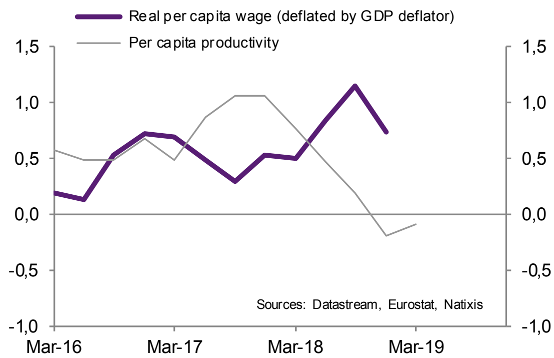


Chart 10A
United States: Unit labour costs and GDP deflator (Y/Y as %)

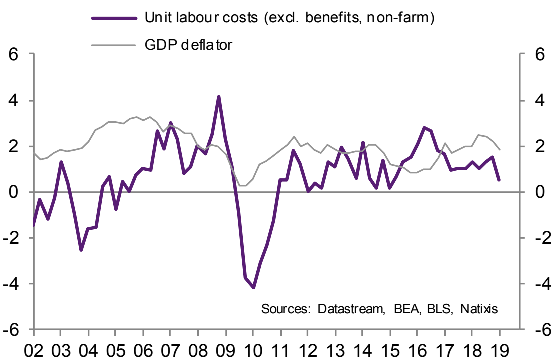
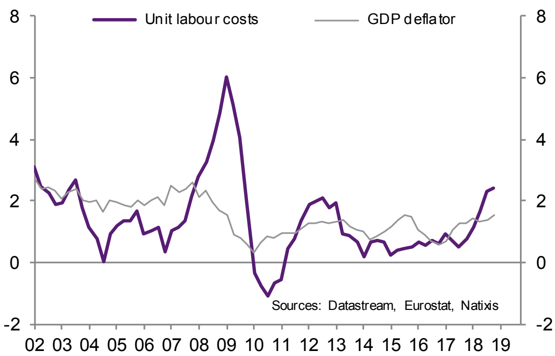


Chart 10B
Euro zone: Unit labour costs and GDP deflator (Y/Y as %)



We see that:

- **Corporate profitability continues to improve in the United States;**
- **It has fallen since the second quarter of 2018 in the euro zone.**

Conclusion: All things considered, should we be concerned about the credit market?

It seems that **there is no reason to be concerned about a possible significant decline in growth or a rise in interest rates.**

The risk could therefore be **that of a marked decline in profitability.**

It is still increasing in the United States, but has been declining since mid-2018 in the euro zone.

Disclaimer