

## Credit Conditions Asia-Pacific: Recovery Roads Diverge

Sept. 29, 2020

### Key Takeaways

- **Overall.** The road to recovery is hardly smooth or even. China continues to be a relative bright spot while many other emerging markets struggle to contain COVID-19. Economic fallout has bottomed but the rebound is showing a big disparity among countries as well as sectors, potentially leading to widening variation in credit trends.
- **Risks.** These include mounting debt with suppressed revenue, disruption from lingering containment measures, spillovers from the U.S.-China strategic confrontation, and uneven access to U.S. dollar funding.
- **Credit.** Negative rating actions have tapered for the region in the past quarter with no defaults by rated issuers. However, the net negative outlook bias worsened to nearly one-fifth of ratings. Consequently, the likelihood of downgrades and defaults persists.

*(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions (Asia-Pacific, Latin America, North America, and Europe, the Middle East, and Africa). Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the Asia-Pacific committee on Sept. 23, 2020.)*

Deepening divergence in the COVID-19 recovery is weighing on credit conditions in Asia-Pacific. These differences cut across geographic, sector, and borrower profiles. Some "early exiters" such as China have already begun to tighten financial conditions, piling on stress for weaker borrowers. Other countries are still battling case resurgence yet have limited capacity to cushion the fallout with fiscal stimulus. While regional monetary settings remain accommodative, S&P Global Ratings sees limited space for lowering policy rates further.

China will continue to lead Asia's uneven recovery from COVID-19's economic disruption. We have adjusted our GDP forecasts to bring forward slightly more growth for China as well as Korea, Taiwan, and Vietnam. We expect normalization to take longer for the rest of the region, with the largest downward adjustments for India and the Philippines.

Lenders will remain selective, especially as tapering relief measures, including loan moratoriums, threaten to reveal masked difficulties. Even though credit growth is slowing in most countries, deleveraging will not be easy to achieve given revenues will remain sluggish for many sectors until travel and other restrictions are normalized. Highly leveraged and other weaker borrowers could face limited market access, especially for dollar funding.

While our downgrade actions have slowed in the region, ratings bias has turned even more negative.

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Table 1 lists our top Asia-Pacific risks.

Table 1

**Top Asia-Pacific Risks**

**Larger surge in leverage, slower return of revenue**

**Risk level\*** Very low Moderate Elevated High **Very high** **Risk trend\*\*** Improving **Unchanged** Worsening

Our baseline assumptions incorporate the expectation of higher leverage for corporations, households, and governments, and a recovery to trend-line economic activity over 2021-2023 (varying by geography and sector). However, if debt growth is faster and income recovery is slower than we expect, the resultant surge in leverage would be harder to manage. Currently, low risk pricing generally supports debt servicing ability but could pressure issuer credit quality further if it recalibrates. This is particularly so for emerging markets which continue to lag in pandemic containment and resumption of economic activity.

**Economic disruption from COVID-19 measures and post-COVID policies**

**Risk level\*** Very low Moderate Elevated High **Very high** **Risk trend\*\*** Improving **Unchanged** Worsening

The region is climbing out of the most stringent measures and the heaviest drops in economic activity, albeit in different speeds. While China appears to be a clear "early exiter" from COVID-19, some high-income countries (such as Korea, Australia, and New Zealand) have seen moderate resurgences, highlighting the potential for bumps along the recovery path. Other "late exiters" (such as India), where containment look more distant, a full rebound make take longer. Hence, government and regulatory policies of these countries, particularly around when monetary and fiscal stimuli will taper off, could be crucial in avoiding a protracted recovery. The disjoint between capital market performance and the speed of economic recovery also presents risks if gaps in expectations widen.

**Economic spillovers from U.S.-China strategic confrontation**

**Risk level\*** Very low Moderate Elevated **High** Very high **Risk trend\*\*** Improving **Unchanged** **Worsening**

U.S.-China relations have deteriorated on three prominent economic and financial fronts: trade, access to U.S. financial markets, and technology. Broader political disputes, including on Hong Kong, the "Clean Network" program, among others, continue to be sources of tension and policymaking. Currently, tapering cross-border investment and lasting effects on supply chains and trade is expected. In addition, the developments in access restriction and potential sanctions could add profound risks to business disruptions. Given the key role of the U.S. dollar in global trade and funding, abrupt moves could disrupt financial conditions across the region.

**Uneven access To U.S. dollar funding**

**Risk level\*** Very low Moderate Elevated **High** Very high **Risk trend\*\*** Improving **Unchanged** Worsening

This risk exacerbates the refinancing challenges faced by highly leveraged borrowers in slower recovering sectors and particularly within emerging economies with insufficient or fading government support. Even as exchange rates could be playing to their favor as the U.S. dollar is generally on a weakening trend, market appetite for these borrowers have waned and may not return imminently. For weaker issuers with looming maturities, the funding challenge will be much more difficult at a time when their operations could be materially hampered. We anticipate funding and capital flows in general will remain selective and uneven.

Sources: S&P Global Ratings.

\* **Risk levels** may be classified as very low, moderate, elevated, high, or very high, and are evaluated by considering both the likelihood and systemic effect of such an event occurring over the next one to two years. Typically these risks are not factored into our base case rating assumptions unless the risk level is very high.

\*\* **Risk trend** reflects our current view on whether the risk level could increase or decrease over the next 12 months.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

## A "K-shaped" Recovery.

Although inhibited economic activity has bottomed out in the second quarter, the recovery is taking diverging paths for different geographies and sectors.

Even early exiters from COVID-19, such as developed countries like Australia and South Korea, have met some setbacks in cases and hence in the reopening of their economies. Emerging markets in the region, including India and the Philippines, continue to struggle to contain the outbreak and its economic impact.

China is a bright spot but is not without vulnerability. An industrial-led rebound is both capital-intensive and supply-driven, which could lead to over-leverage and oversupply issues down the road. Meanwhile, support from consumer demand remains feeble. Financing conditions are also tightening, potentially reversing the benefits of cheaper credit (see: "[Rising Funding Costs May Tip China's Weaker SOEs Into Default](#)," Sept. 15, 2020).

S&P Global Ratings continues to emphasize the health emergency as a top risk for Asia-Pacific. The longer economies operate at a subnormal levels, the sharper the pain and credit impact across corporates, households, and governments. That said, some green shoots are sprouting as economic activities gradually reopen.

## Geopolitics Add Stumbling Blocks

The recovery is progressing against a backdrop of deteriorating U.S.-China relations. With criticism of China increasingly evolving into policy in the U.S., the threat of more material economic spillover is worsening and is placing additional pressure on economic and credit conditions in the region (see: "[Economic Risks Rise As U.S.-China Disputes Heat Up](#)," Aug. 25, 2020).

This is especially pertinent for the technology sector where complex supply chains could be disrupted, potentially changing the business landscape and creating new losers and winners (see: "[U.S. Actions Against Huawei Reverberate Across Asian Tech](#)," July 29, 2020). On the flip side, the probability of severe U.S. sanctions on financial institutions operating in Hong Kong remain improbable (see: "[What Is The U.S. Sanction Risk For Banks Operating In Hong Kong?](#)" Sept. 17, 2020).

## Flight To Quality Leaves Some Borrowers Behind

Highly leveraged and weak borrowers face intensified funding challenges. Access to financial markets is far from equal, as demonstrated by relatively limited issuance in recent months by speculative-grade issuers. In our view, government relief initiatives, while substantial in some countries, may still not open broader access to U.S. dollar capital markets. Fundamental sector rebounds are better factors for attracting lenders to riskier borrowers. This flight to quality creates lingering refinancing risks and could contribute to further increases in default rates as time progresses.

Debt moratoriums, government guarantees, and other stimulus programs are buying time. Once these fade out or expire, the stickier difficulties may be unmasked. Governments could also be left with a heftier bill if they choose to extend these programs in a prolonged pandemic scenario (see: "[Asia-Pacific Sovereign Rating Trends Midyear 2020](#)," July 31, 2020).

## Sluggish Business Will Drag On Deleveraging

Rising leverage, amid a slow and uncertain return to corporate revenues, is one of our top regional risks, even as expectations of credit profiles further deteriorating have slowed, for now.

Bank loan growth across most of the region has slowed to low- to mid-single digits so far this year, except in China and other jurisdictions with government-dominant financial sectors. Even with slower credit expansion, the risk is a lackluster rebound in revenues. As for China and other countries with faster, guided credit expansion, much of the funding could be directed to the needier (hence riskier) entities.

**Credit Conditions Asia-Pacific: China First To Recover**

Service-oriented sectors have taken on the most incremental debt since the pandemic, along with the auto and chemical sectors. These sectors also exhibit some of the highest negative rating biases.

We see a slow route to normalization for hotels, gaming and leisure, given this sector's income will remain repressed until travel and other restrictions are lifted, allowing for renewed tourism and visits to restaurants and casinos. A jump in borrowing to plug cash flow holes, mixed with hard-hit income, spurred the largest leverage spike in this sector than any other. We may have to wait until there is a widely available vaccine (our assumption for this is mid-2021) before a more complete rebound in mobility and travel is possible. Likewise, poor auto sales in the first half and slow recovery prospects have placed a drag on the auto sector, despite a more apparent warming in China (see: "[China Auto's Recovery Path Is Accelerating](#)," Sept. 22, 2020).

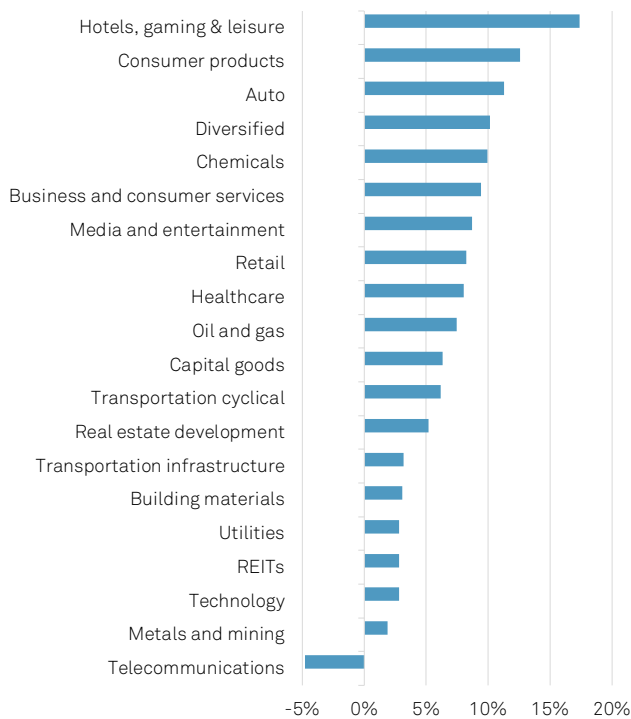
Higher debt leverage will weaken credit profiles and lift default risks for corporates. This will ultimately stress loan performance for regional banks, on which we have already taken a spate of negative actions earlier in the year. Generally, stronger companies can weather this given the suppressed funding costs is helping to boost debt servicing capacity. However, risk pricing or even access may not be so favorable to the weakest end of the credit spectrum.

Meanwhile, another obstacle for a stronger economic recovery is households' repayment capacity, which is also weakening. The blow on employment and household incomes could take longer to surface and much longer to restore in many markets.

**Chart 1**

**Debt Growth By Sector Since The Outbreak**

Debt change varied significantly among sectors

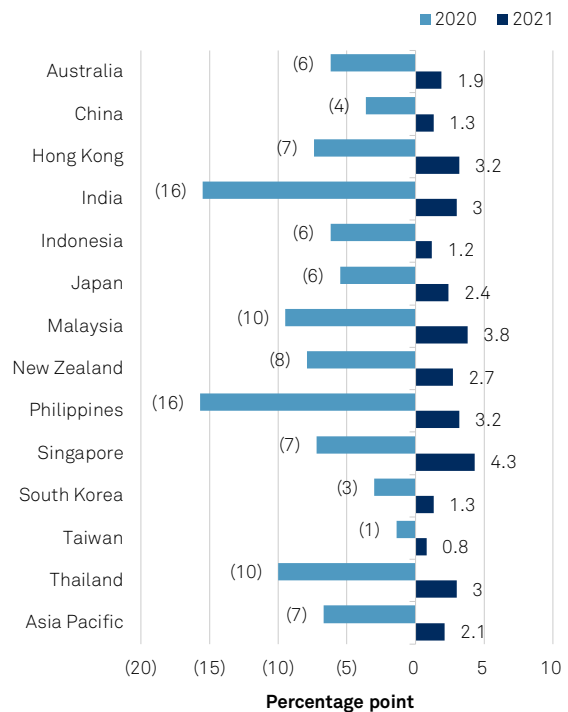


Note: Debt growth measures the percentage difference of reported debt of 17,425 nonfinancial corporates in Asia Pacific with financial reports from a starting period between Nov 2019 and Feb 2020 and an ending period between May and Aug 2020. Source: S&P Global Market Intelligence.

**Chart 2**

**Asia-Pacific: Changes In Economic Forecast**

Current forecast versus Dec. 2019, large dip followed by a rebound



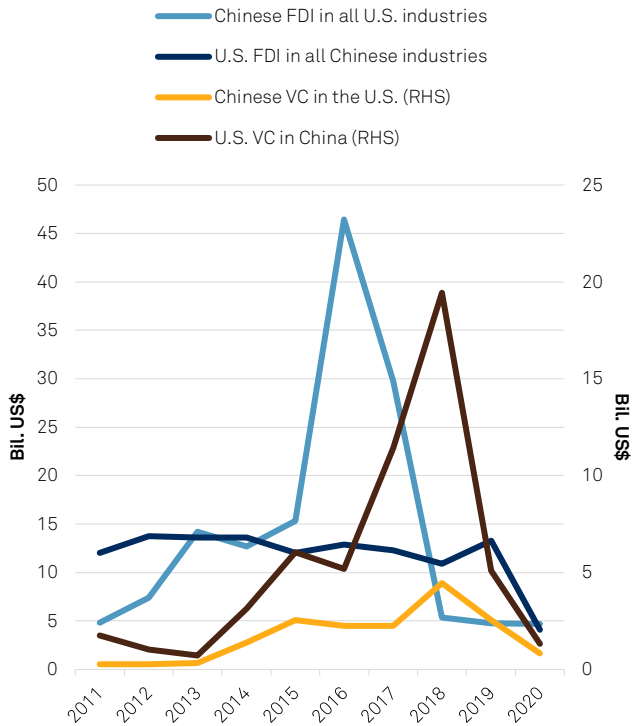
Note: For India, the year runs April to March, e.g. 2019--fiscal 2019 /2020, ending March 31, 2020. ppt--Percentage point. Source: S&P Global Economics.

**Credit Conditions Asia-Pacific: China First To Recover**

**Chart 3**

**U.S.-China Relations And Interactions Cooling**

Cross-border investment activities markedly dropping

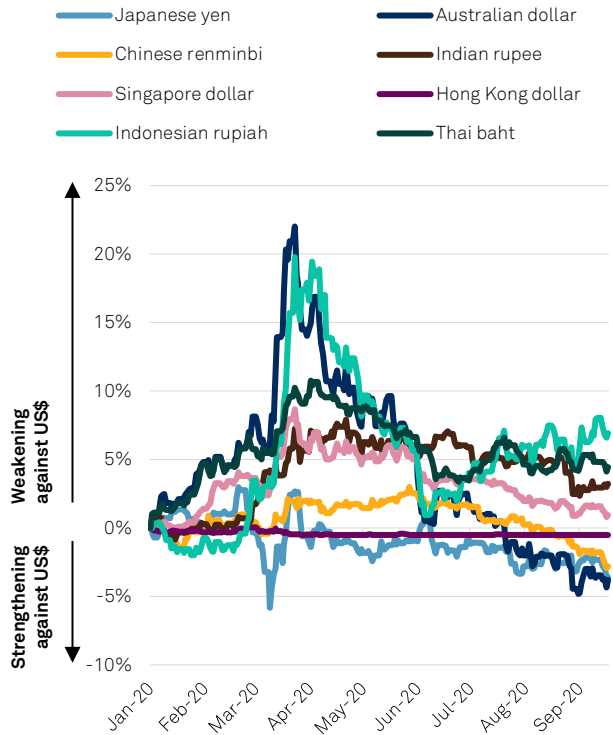


FDI--Foreign direct investment. VC--Venture capital. Bil--Billion. Source: Rhodium group.

**Chart 4**

**Foreign Exchange Bottomed Out Against The Dollar**

Does not mean access has improved for the weakest



Source: S&P Capital IQ.

# Macroeconomic Outlook

## Asia-Pacific's Divergence Deepens

*(Editor's Note: The views expressed in this section are those of S&P Global Ratings' economics team. While these views can help to inform the rating process, sovereign and other ratings are based on the decisions of ratings committees, exercising their analytical judgment in accordance with publicly available ratings criteria.)*

The pandemic is not over but the worst of its economic impact has passed. New waves of infection are, in most cases, resulting in lower fatality rates. Governments are adopting more targeted strategies for flattening COVID curves, with less recourse to nationwide lockdowns. Households are spending again on services as well as goods. The pandemic is proving hard to beat but prospects for a widely available vaccine in early 2021 have brightened (our baseline assumption). In the meantime, people are moving and spending more, testament to a world becoming accustomed to COVID-19. Trade growth has bottomed. The recovery is underway.

The hard work now begins. As relief measures taper, we will find out how much economic damage has been wrought. Phasing out of temporary tax cuts, wage subsidies, loan moratoriums, and other measures will force banks, businesses, and households to make hard decisions. The credit impulse is likely to wane and real lending rates may edge higher. Furloughed jobs may become permanent job losses. Businesses only getting by due to grace periods on debt service may be forced to close up shop. Banks will have to assess whether to restructure or foreclose on questionable loans. The true deterioration across balance sheets will become apparent even as economies reopen.

Jobs will shape the recovery. The scale of reported job losses across countries varies due to statistical quirks, support policies, and the unique features of each market. Still, we know that COVID strikes at jobs-rich sectors of the economy and that jobs are easily lost and hard to regain. We expect employment to return to pre-COVID trends only by 2022, at the earliest, in most cases. This will put a lid on wages, drag on consumer spending, and keep inflation low across the region. With fiscal policies and credit conditions likely to tighten, central banks have no option but to keep policies exceptionally easy. For some emerging markets, the challenge will be to maintain sufficient support and policy credibility at the same time.

Strategic choices in the U.S.-China relationship are crystallizing with profound implications for productivity in the long term. China's new "dual circulation" policy may represent a harder turn towards self-reliance in industries where China sees risks of global supply chain disruptions. Such industries range from software and semiconductors to energy and agriculture. Our analysis suggests that a more self-reliant China could mean an average growth rate closer to 3.5% through 2030 compared to the 4.6% in our base case (see: "[The Great Game and China's Inescapable Slowdown](#)," Aug. 29, 2019). The results of the U.S. election may affect the tone of this relationship but have a muted impact on what really matters from an economics perspective—we have said since 2018 that this is technology not trade.

Our forecast for Asia-Pacific growth is -2% in 2020 and 6.9% in 2021. We revise down 2020 from -1.3% as the upgrade in China is offset by the large downgrade in India and much smaller downgrades elsewhere. We revise up 2021 as more of the recovery is delayed until next year. We now expect Asia-Pacific's economic activity—the level of real GDP—to be 4.8% below our pre-COVID forecasts by the end of 2021. Excluding China, that gap widens to 7.1%. We have begun to shave our longer term forecasts lower as some major economies turn inward.

Risks to growth are more balanced than at mid-year but still on the downside. Countries are managing the economic impact of COVID-19 and prospects for an early vaccine have improved. Still, the pandemic is proving hard to beat and can still impose material economic costs when cases resurge. The U.S.-China relationship remains a downside risk, mainly for the medium term, with the likelihood of a far-reaching post-U.S. election rapprochement remote.

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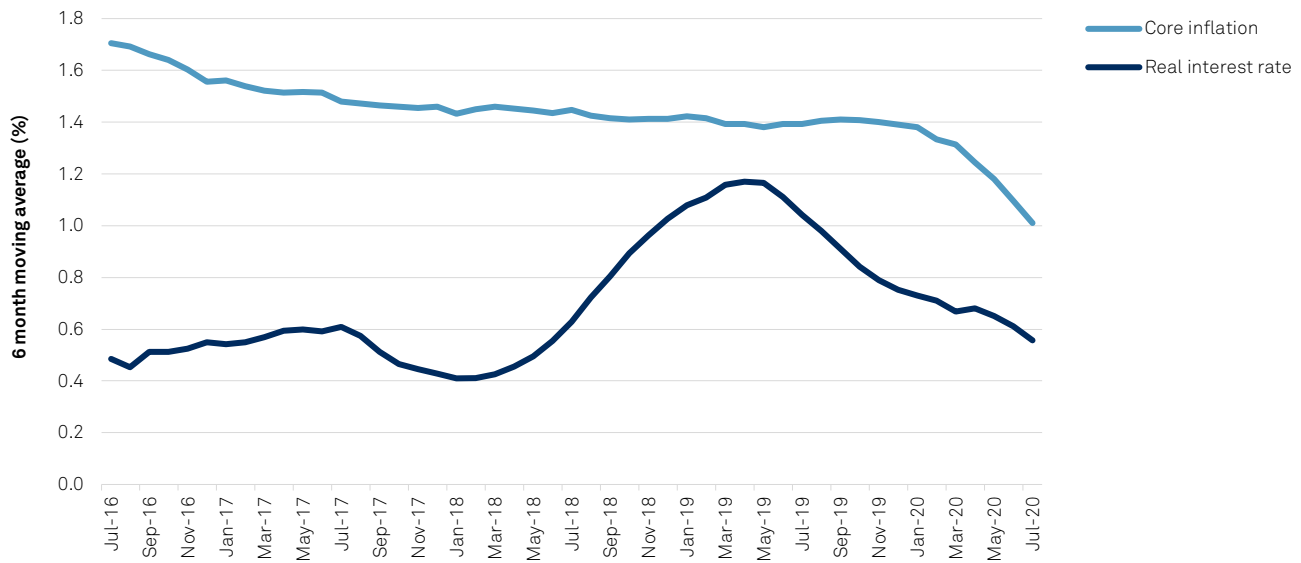
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Chart 5

**Core Inflation Trending Lower In Asia-Pacific**

APAC ex-China and India core inflation and real rates



Note: Included in the APAC ex-China India group are Australia, Hong Kong, Indonesia, Japan, Malaysia, New Zealand, the Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam. Data for core inflation and real interest rates are aggregated using real PPP. Source: CEIC, regional central banks, and S&P Global Economics.

# Financing Conditions

## Financing Conditions Will Remain Accommodative, On The Whole

We expect Asia-Pacific financing conditions to continue to be accommodative, in line with global trends. Central banks worldwide are still focused on meaningful economic recovery as market conditions recover following a large widening of credit spreads earlier in the year. While Asia-Pacific is leading the global economic recovery, its path has been uneven, with some countries fighting new outbreaks. It is likely that financing conditions will remain supportive for most economies for the region.

Credit spreads tapered in the third-quarter of 2020 (see chart 6) with the U.S. investment-grade credit composite at 175 basis points and speculative-grade spread at 569 basis points (data as of Sept. 15, 2020). This comes after hitting five-year peaks for both investment-grade credit composites (at 366 basis points) and speculative-grade (at 1047 basis points) on March 23, 2020. Although spreads have calmed, they are much higher than those at the beginning of 2020; a sign of lingering risk aversion. The continuing pressure on lower-rated issuers elevates business, financial, and even default risk stemming from COVID-19. Meanwhile, for equity markets, the S&P Asia 50 index, rallied along with the S&P 500, reaching all-time highs (data as of Sept. 16, 2020) for the past decade.

### What to look for

Bond issuance is up which means bigger maturities in future. Year to date Asia-Pacific cumulative corporate (for both financial and nonfinancial) bond issuance rose to US\$ 1.4 trillion (data as of Sept. 15, 2020). This is ahead of same time last year (see chart 7), though not by the margins of increase seen in the U.S. Asia-Pacific refinancing needs remain robust with over US\$1.1 trillion of debt scheduled to mature through year 2025. The overall corporate maturity wall will peak in 2022, and this includes bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings for data as of July 1, 2020 for the region. Of the total, financial debt accounts for US\$605.9 billion and nonfinancial US\$516.9 billion. Japan, Australia, and China account for the bulk part of the refinancing needs (82% combined) in the region. Chinese property developers have a relatively stronger concentration of ratings in the 'BB' and 'B' categories. As such, this is one of few sectors with a sizable concentration of low-rated debt that will need refinancing in 2021. Should market conditions turn more negative, as they had earlier this year, low-rated issuers may once again facing higher risk aversion, which could elevate debt-servicing costs despite otherwise accommodative monetary policy.

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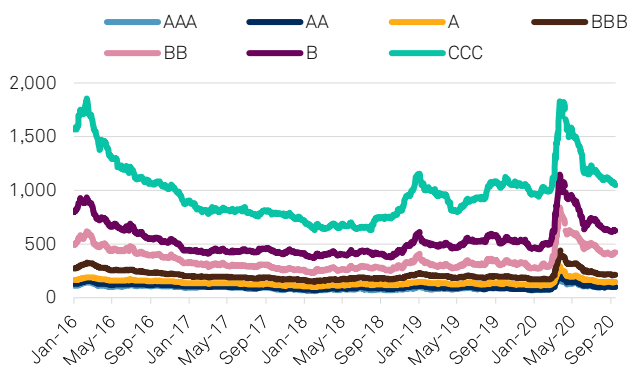
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Chart 6

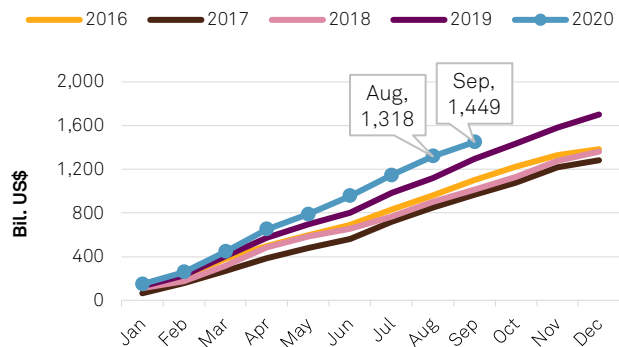
Spreads\* By Rating Category



\*Option-adjusted spreads computed on a pool of over 20,000 U.S.-domestic bonds with par values of over \$100M that are rated by S&P Global Ratings. Data as of Sept. 15, 2020. Source: S&P Ratings Research; Thomson Reuters.

Chart 7

Asia-Pacific Cumulative New Corporate\* Bond Issuance



\*Financial and nonfinancial. Data as of Sept. 15, 2020. Bil.--Billion. Source: S&P Ratings Research; Thomson Reuters.



# Sector Trends

## Fewer Rating Actions But Not Out Of The Woods

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### Regional Credit Conditions--What's Changed?

Economic divergence has deepened, with China leading the recovery as others dig out from a bigger contraction. Our regional GDP growth rate estimate has been revised further downwards to -2% for 2020 from -1.3% last quarter. An earlier recovery in China is outweighed by a larger downside adjustment for India and most Southeast Asian countries.

In the region, lower official interest rates and government stimulus have provided some relief, but these measures may not last and may not completely offset the demand slump in certain sectors. Credit quality and default risk, particularly among issuers with already weak credit profiles, continue to be under pressure (see "[COVID-19 And Oil Price-Related Public Rating Actions On Corporations, Sovereigns, And Project Finance To Date](#)", published Sept. 22, 2020).

### Rating actions

We have taken 222 ratings actions this year (as of Sept. 21, 2020) related to COVID-19 and oil prices in Asia-Pacific (see charts 8 and 9). The pace is much milder in recent months as much of the impact and recovery trajectory have been factored into our ratings for sovereigns, banks, or corporates. However, on a net basis, one-fifth of our regional ratings are on negative outlook or CreditWatch with negative implications; this is up from one-sixth in May, signaling that negative actions are likely to continue (see table 2).

The worsening net negative bias is largely attributable to sovereigns and public finance ratings, while corporates held largely steady at an already severe level of -25%. Hotels, gaming and leisure, together with auto, continue exhibit the highest proportions of negative outlooks, though the net bias on these sectors has come off a peak as ratings are downwardly adjusted.

Chart 8

**Asia-Pacific: Number Of Issuers Affected By Rating Actions Related To COVID-19 And Oil Prices, By Geography**

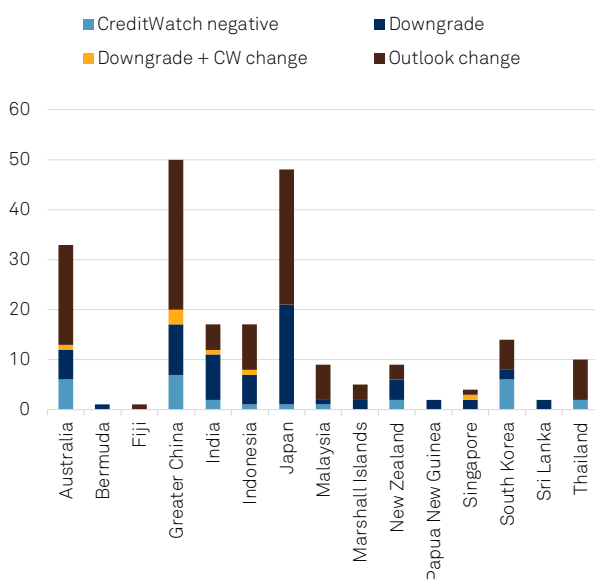
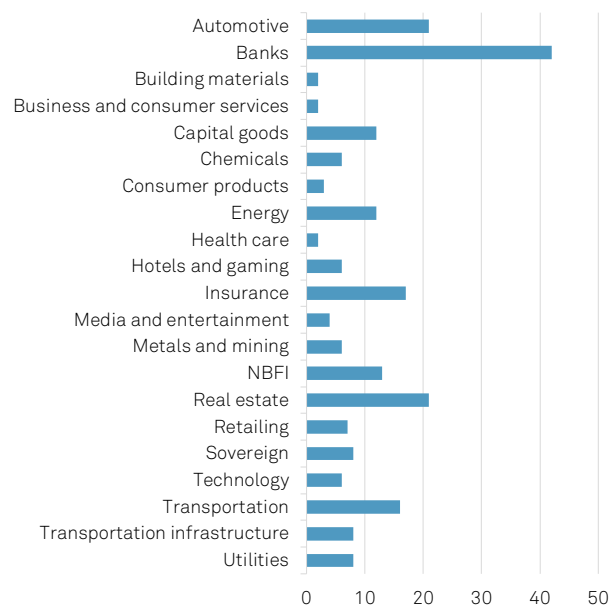


Chart 9

**Asia-Pacific: Number Of Issuers Affected By Rating Actions Related To COVID-19 And Oil Prices, By Sector**



Note: These rating actions pertain to ratings where we mention COVID-19 as one factor or in combination with others. Data as of Sept. 21, 2020. CW--CreditWatch. NBFI-- Nonbank financial institution. Source: S&P Global Ratings. COVID-19: Coronavirus- And Oil Price-Related Public Rating Actions On Corporations, Sovereigns, And Project Finance To Date, Sept. 22, 2020.

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Table 2

Net Rating Bias Of Asia-Pacific Issuers By Sector, Aug. 31, 2020

	Aug. 2019	Oct. 2019	Feb. 2020	May, 2020	Aug. 2020	No. of entities	Notional average rating
Auto OEM and suppliers	-18%	-17%	-23%	-71%	-67%	36	BBB-
Building materials	12%	-6%	0%	-13%	-20%	15	BBB-
Business services	-23%	-15%	-8%	-25%	-36%	11	BB+
Capital goods	-15%	-15%	-7%	-15%	-15%	39	BBB
Chemicals	-2%	-18%	-20%	-30%	-46%	35	BBB-
Consumer products	-18%	-19%	-20%	-24%	-21%	34	BBB-
Diversified	7%	6%	13%	-7%	-13%	15	A-
Hotels, gaming and leisure	-25%	-31%	-25%	-78%	-67%	18	BB+
Media and entertainment	-17%	-29%	-29%	-22%	-22%	9	BBB-
Healthcare	0%	-11%	-38%	-38%	-38%	8	BB
Investment company	0%	0%	0%	0%	0%	10	BBB+
Metals and mining	-2%	2%	-7%	-24%	-22%	55	BB+
Oil and gas	-3%	-9%	-14%	-34%	-39%	28	BBB
Project finance	0%	0%	0%	0%	0%	0	--
Real estate development	-8%	-12%	-8%	-11%	-11%	82	BB-
Real estate investment trusts	2%	2%	-6%	-25%	-22%	51	A-
Retail	-5%	0%	0%	-31%	-38%	16	BBB-
Technology	-12%	-19%	-9%	-17%	-20%	41	BBB-
Telecommunications	-29%	-30%	-32%	-26%	-26%	27	BBB+
Transportation cyclical	-14%	-19%	-10%	-55%	-40%	20	BB+
Transportation infrastructure	-3%	-2%	-3%	-37%	-31%	62	BBB+
Utilities	-2%	-2%	3%	-5%	-6%	97	BBB+
<b>Total corporates</b>	<b>-7%</b>	<b>-10%</b>	<b>-9%</b>	<b>-25%</b>	<b>-25%</b>	<b>709</b>	<b>BBB-</b>
Financial institutions	12%	9%	8%	-14%	-17%	379	BBB+
Insurance	10%	11%	15%	1%	-4%	180	A
Public finance	17%	16%	17%	2%	-10%	93	A+
Sovereign	9%	9%	12%	4%	-10%	21	BBB
<b>Total issuers</b>	<b>2%</b>	<b>0%</b>	<b>1%</b>	<b>-17%</b>	<b>-19%</b>	<b>1,382</b>	<b>BBB+</b>

Light blue colored cells indicate improvement from prior period, navy blue, deterioration.

# Nonfinancial Corporates

## First Steps On A Long Journey

- Most sectors will not return to pre-COVID operating conditions until 2022, despite some green shoots in certain sectors and regions.
- U.S.-China conditions could hit the tech-sector recovery.
- Financial conditions are likely to remain difficult or expensive for deeply high-yield issuers due to risk aversion.

### What's changed?

**Persistence and resurgence of COVID-19.** The persistence of the virus in many countries has led to new restrictions or prolonged lockdowns, dampening consumer sentiment and hurting demand. While our negative rating bias has softened for some sectors, the overall trend of downwards ratings pressure continues.

**Rising risk of spillovers from U.S.-China tensions.** U.S.-China relations have deteriorated markedly in recent weeks which could add to the risk of business disruptions, particularly for Chinese companies. The tech sector, both within China and those in the supply chain with high exposure to targeted companies, face increasing headwinds. The restrictions on financial market access are another facet of the confrontation that could have severe implications for entities that rely on U.S. dollar funding. It is worth noting that regional non-Chinese firms could stand to benefit if they capture trade and investment diverted from China.

### Key assumptions

**A gradual revenue recovery for most sectors in 2021 and 2022.** We expect operating conditions at issuers in most rated sectors to recover to their 2019 levels only by 2022 at the earliest. That's on the basis of gradually normalizing GDP growth and slowly improving consumer confidence through 2022. Also at play will be "catch-up" effect on demand volumes for the most affected sectors (albeit prices will likely remain constrained as companies continue to offer discounts to stimulate volumes). The more resilient consumer staples, telecoms, and essential retail will recover in 2021.

### Key risks

**Additional waves of infections.** Further waves of COVID-19 reintroducing or prolonging containment measures will dampen demand, dragging the pace of operating and financial recovery. This could lead to a worsening in credit metrics against our current base case of recovering balance sheet quality.

**Liquidity crunch.** In an extended period of stressed cash flows, small and midsize companies will face liquidity problems due to limited operational flexibility and not-so-robust bank relationships against the backdrop of a tighter credit market for high-yield issuers.

### What to look for

**Economic drags, or spillovers from geopolitical tensions.** The pace of recovery to pre-COVID jobs growth will determine consumer sentiment and demand. On the supply side, deteriorating relations between U.S and China as well as other political disputes in the region could have a lasting effect on supply chains.

**Financing conditions.** Access to funding remains important for the prospective credit quality of issuers in Asia rated in the 'B' category or below. This segment represents nearly one quarter of outstanding corporate ratings in Asia-Pacific, and nearly 60% in a country like Indonesia.

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Further waves of COVID-19 reintroducing or prolonging containment measures will dampen demand, slowing the pace of operating and financial recovery.

## Financial Institutions

### Risks Of A Slow Recovery Weigh On Banks

- COVID-19 is hitting lenders hard. We have taken 50 negative rating actions on banks and finance companies in Asia-Pacific in the second quarter.
- The extent of banks' credit losses will become clearer when fiscal support from governments unwinds and banks end their loan-repayment moratoriums.
- Downside risks would intensify if the U.S.-China strategic confrontation heightens or COVID-19 inflicts greater damage to the region's economies than we now assume.

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#### What's changed?

**COVID-19 is hitting lenders hard.** We forecast that bank credit losses will rise and earnings will fall because of the pandemic's blow to the Asia-Pacific economies. During the second quarter, we took 50 negative rating actions on banks and finance companies in countries including Australia, India, Indonesia, Japan, Malaysia, New Zealand, and Thailand.

**Support from authorities is aiding resilience.** Fiscal, monetary, policy, and prudential support are providing buffers in the region. In addition, banks in many Asia-Pacific countries benefit from strong earnings capacity compared with European peers. As of Aug. 31, 2020, we had a stable outlook on 78% of financial institutions in the region.

#### Key risks

**More severe downturn than our base case.** A more severe or prolonged hit to the economies than our current baseline remains the main downside risk. This could happen if the U.S.-China strategic confrontation intensifies or if COVID-19 threatens greater economic spillover than we assume now. Such a scenario would almost certainly push banks' credit losses higher, drive their earnings lower, and amplify other risks.

**Disorderly correction in asset prices.** In many countries in the region, banks have high exposure to the property sector, and property prices and private sector debt remain high. These characteristics, along with economic uncertainty, could trigger a disorderly correction in asset prices, which would heighten and prolong banks' asset quality problems.

#### Key assumptions

**Strong economic rebound post the downturn.** We expect that most banks will be able to absorb a multifold increase in credit losses. Bank earnings should start to improve with the economic recovery by the end of 2021. In our view, governments in most countries would support systemically important banks, if needed.

#### What to look for

**The end of supports and moratoriums.** Asset quality will become clearer when banks end their moratoriums on loan repayments and the governments reduce fiscal support. A number of households and businesses are likely to struggle to meet their financial obligations at that time, in our view. Interest margins for the banks are also likely to remain subdued, in line with the outlook for persistent low interest rates..

**We expect that many banking systems in the region will stage full recovery only by 2023.**

## Insurance

### Lower Rates Intensify The Yield Chase

- Negative rating bias as volatile investment markets weaken capitalization.
- Prolonged low interest rate environment prompts riskier investments to boost yields.
- Slower macroeconomic conditions impedes growth momentum.

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#### What's changed?

**Lower for...even longer.** Low growth, low rates, and volatile capital markets create mounting challenges for returns. To cope, insurers may increase investment risk appetite. Foreign exchange (forex) volatility may affect Taiwan, Japan, and Korea players with big overseas investments. In addition, we anticipate insurers will review their actuarial pricing.

**Recurring COVID waves dampen sales channels.** Traditional insurance distribution channels (tied agency and bancassurance) are seeing displacement as sales activities shift online. Social distancing in Asia-Pacific will drag on growth momentum through the rest of the year. For Hong Kong's insurers, we expect a drastic contraction of 2020 premiums because cross-border restrictions limit arrivals from China-based customers.

#### Key risks

**Flattening yield curve.** Asset-liability mismatches could worsen for life insurers. We anticipate increasing reinvestment challenges as insurers review both investment and insurance pricing assumptions. Potential hikes of reserve provisions could further narrow capital buffers for insurance companies.

**Revenue headwinds to persist beyond 2020.** Prolonged social distancing and higher unemployment point to declining top lines and increasing lapses/surrenders. A slow economic recovery will undermine trade-related insurance (marine cargo and credit) and mortgage insurance providers. COVID-19 induced business interruptions and event cancellation claims may hit profitability.

#### Key assumptions

**Capital buffers will narrow.** Financial market volatility and lower prospective earnings will eat into capital. Increasing frequencies of natural catastrophes in Asia-Pacific will also raise reinsurance-related costs.

#### What to look for

**Yield chase to pick up.** Investment appetite will rise for credit and market risks. While recent buoyant stock markets may see unrealized investment gains on interim results, market volatility continues to strain capital buffers.

**Pent-up demand for greater insurance awareness.** COVID-19 will bring about stronger consumer awareness on insurance protection, particularly for health and medical coverage. The social distancing initiatives ramp up insurers' digital distribution strategies.

**Non-modeled risks.** Urbanization and changing weather patterns make it harder to model risks. Events such as China's floods, Japan's typhoons, and Australia's bushfires require insurers to revisit catastrophe budgets, including reinsurance arrangements.

**Yield chasing amid low interest rates signals riskier investments to come.**

## Public Finance

### Slow Recovery Adds Fiscal Strain

- The slow recovery continues to threaten economic growth and undermine fiscal positions for local and regional governments (LRGs).
- China has more room than India to mitigate constraints on LRGs, though LRGs in both countries remain highly dependent on fiscal measures led by central governments.
- Australia, including LRGs and universities, and Japan are supported by their higher budgetary flexibility as they await recovery.

#### What's changed?

**Spike of negative ratings outlooks.** In addition to linkages to negative sovereign rating actions, LRG credit profiles are pressured by declining revenue and rising debt-funded spending.

#### Key risks

**Virus duration.** Setbacks in containment could lead to further cuts to GDP forecasts for Asia-Pacific. Contagion fears will prevent travel and consumption, dragging down revenue for most LRGs, and some pandemic-sensitive public-finance segments such as Australian universities.

**Slowing property markets.** Property-related revenue accounts for a large portion of some LRGs' revenues, especially in China and Australia, making them sensitive to market volatility in real estate.

#### Key assumptions

**Varying scope for countercyclical measures.** Most LRGs will not raise tax rates, hence they will unlikely recover their revenue bases soon. Slowdowns will spur LRGs to increase spending, further risking their fiscal standing. Still, Australian and Japanese LRGs will have higher discretion to respond with deficit spending. China has stricter deficit caps and India's are already stretched; this feeds through to less flexibility for their LRGs.

#### What to look for

**Policy shifts.** We could see increased stimulus to boost economies. Any aggressive LRG fiscal expansion could lead to lingering, longer-term erosions of credit quality.

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**Slow recovery despite lockdowns easing in some countries.**

## Sovereign

# Lower Interest Rates Help Cushion Credit Quality

- Geopolitical tensions add another complication to recovery from COVID-19.
- Debt is materially higher for most Asia-Pacific sovereigns due to policies to support growth and employment.
- Prolonged low interest rates should ease countries' financing burden in the absence of risk events.

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### What's changed?

**Virus upended credit assumptions.** After bringing down COVID-19 infections, some countries have seen resurgences and many reimposed measures that are needed to cap infection rates. As the pandemic drags on, hopes are dimming for a strong economic comeback in 2021. Budget deficits that have opened up this year might not quickly close.

**Lower global interest rates and energy prices.** A renewed deterioration in the economic outlook has cut demand for commodities. Despite crude oil's recent rebound from its low in late April, the price remains well below levels at the beginning of the year. Further, central banks have eased monetary policies. Given significant uncertainty over the duration of the pandemic, interest rates and energy prices look likely to remain relatively low for a while.

### Key risks

**Sudden capital swings.** A sharp deterioration in investor sentiment in emerging markets (EM) could see swift reversals of capital flows out of these economies. Reversals risk is larger in EM countries where governments ease domestic funding conditions to increase leverage in the public or private sector.

**China's deleveraging wanes.** If economic or labor market pressures mount further, China could allow faster credit growth to maintain social stability. Growing risks of financial instability would weaken China's capacity to provide sovereign credit support, with negative implications for other sovereigns in the region.

**Intensifying U.S.-China tensions increase global economic uncertainties.**

### Key assumptions

**No sustained, serious market disruptions due to U.S.-China relations.** Trade tariffs and other measures between the world's two largest economies have so far had moderate economic effects. We expect that bilateral tensions will not escalate such that more damaging measures follow.

### What to look for

**Deteriorating U.S.-China relations.** The pressures of a looming presidential election and still-elevated COVID-19 infection rates has hardened U.S. attitudes toward China. While our base case does not assume an escalation in tensions, this is a risk. Apart from the direct economic effect, the associated uncertainties could also trigger volatility in international financial markets and capital reversals from emerging Asia.

## Structured Finance

### Consumer Asset Classes Will Be Further Tested

- Employment recovery is the key determinant for consumer asset class performance, in our view, and prolonged pandemics in Japan and Australia could test resilience.
- Pressure looks to have eased in China, judging from stabilized delinquency rates in auto-loan ABS and RMBS.
- Government support measures will remain in place over the coming months, which could delay the full impact on borrower performance.

#### What's changed?

**Worst is behind us in China.** Pressure has eased in China, as indicated by stabilized delinquency rates in auto-loan asset backed securities (ABS) and residential mortgage backed securities (RMBS). The cumulative default rate increased only slightly during the height of China's outbreak. The story is different in Japan and Australia, where infection rates are not yet under control, and could hinder economic recoveries.

#### Key risks

**Second economic shock to China and Japan.** Such shocks could come from virus resurgence, or ripple effects from weak overseas markets to export-related sectors. Such outcomes, if prolonged, may feed through to consumer credit-backed and mortgage-backed loan performance.

**Employment hit in Australia.** The second round of lockdowns for Victoria as well as restrictions on interstate travel will hit employment in some sectors and geographies and may extend through to affected property markets in the longer term. Some mitigation on employment comes via government support that ties incentives to maintaining jobs. Lenders also have extended timeframes for repayment by hard-hit borrowers.

#### Key assumption

**Temporary hits to growth.** Ratings should be stable, with low levels of speculative-grade ratings and structural supports to cushion some deterioration. Diversified consumer asset pools mitigate event risks.

#### What to look for

**A tick-up in default rates.** The cumulative default rate will rise on RMBS in China as "default" kicks in after arrears are 90 days past due. For our rated deals, we estimate the additional default rate due to COVID-19 to be 30-60 basis points based on the arrears trend in the past two quarters, and our economic view. There is no rating effect for now in light of our rating stress assumptions and credit enhancements provided. In Australia, the level of loans under temporary "hardship" arrangements should moderate. If they don't, this will be a signal that jobs might not come back even amid broader recovery.

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**The employment outlook is key for consumer asset classes (RMBS & ABS). Lingering or new COVID cases would drag on a jobs' recovery.**



## Related Research

- [Economic Research: Asia-Pacific's Recovery: The Hard Work Begins](#), Sept. 24, 2020
- [COVID-19- And Oil Price-Related Public Rating Actions On Corporations, Sovereigns, And Project Finance To Date](#), Sept. 22, 2020
- [China Auto's Recovery Path Is Accelerating](#), Sept. 22, 2020
- [What Is The U.S. Sanction Risk For Banks Operating In Hong Kong?](#) Sept. 17, 2020
- [Rising Funding Costs May Tip China's Weaker SOEs Into Default](#), Sept. 15, 2020
- [Economic Risks Rise As U.S.-China Disputes Heat Up](#), Aug. 25, 2020
- [Asia-Pacific Sovereign Rating Trends Midyear 2020](#), July 31, 2020
- [U.S. Actions Against Huawei Reverberate Across Asian Tech](#), July 29, 2020
- [The Great Game and China's Inescapable Slowdown](#), Aug. 29, 2019

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## Appendix 1: Economic Data And Forecast Summaries

Table A1

### Australia – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP %	1.8	-4.0	4.2	3.3	2.6
CPI inflation %	1.6	1.0	1.5	1.6	1.8
Unemployment rate %	5.2	7.1	6.8	6.0	5.4
Policy rate % (EOP)	0.75	0.25	0.25	0.25	0.50
Exchange rate (US\$ per A\$)	0.7	0.72	0.73	0.73	0.74

Source: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A2

### China – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP %	6.1	2.1	6.9	4.8	5.2
CPI inflation %	2.9	3.1	1.7	1.8	1.9
Unemployment rate %	5.2	5.7	5.5	5.2	5.0
Exchange rate (per US\$)	6.99	6.8	6.86	6.98	7.1

Source: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A3

### Hong Kong – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP %	-1.2	-7.2	5.3	3.3	2.2
CPI inflation %	2.9	1.0	2.1	1.9	1.8
Unemployment rate %	3.0	5.7	4.7	4.0	3.7
Exchange rate (per US\$)	7.79	7.75	7.8	7.8	7.8

Source: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A5

### India – S&P Global Ratings Economic Outlook

	2019	2020f	2021f	2022f	2023f
Real GDP %	4.2	-9.0	10.0	6.0	6.2
CPI inflation %	4.76	5.2	4.5	4.5	4.1
Policy rate % (EOP)	4.40	3.50	4.50	5.00	5.25
Exchange rate (per US\$)	74.4	74	74.5	75	76.5

Source: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. 2019 figure is an estimate for India. For India, 2019 = FY 2019 / 20, 2020 = FY 2020 / 21, 2021 = FY 2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24.

Table A6

**Indonesia – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	5.0	-1.1	6.3	5.8	5.4
CPI inflation %	2.8	2.2	3.3	3.3	3
Unemployment rate %	5.1	6.3	6.0	5.5	5.3
Policy rate % (EOP)	5.00	4.00	4.00	4.25	4.75
Exchange rate (per US\$)	13883	14800	14961	15150	15250

Sources: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A7

**Japan – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	0.7	-5.4	3.2	1.0	0.9
CPI inflation %	0.5	0.2	0.5	0.6	0.8
Unemployment rate %	2.4	2.7	2.6	2.5	2.4
Policy rate % (EOP)	-0.07	-0.05	-0.05	-0.05	-0.05
Exchange rate (per US\$)	109.12	105	103.8	103	103

Sources: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A8

**Malaysia – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	4.3	-5.0	8.4	6.2	4.9
CPI Inflation %	0.7	-1.5	2.2	2.1	2.1
Unemployment rate %	3.3	4.5	4.1	3.5	3.2
Policy rate % (EOP)	3.00	1.50	1.50	2.00	2.50
Exchange rate (per US\$)	4.09	4.18	4.21	4.23	4.27

Source: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A9

**New Zealand – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	2.3	-5.5	5.2	3.2	2.9
CPI Inflation %	1.6	1.5	1.7	1.7	1.9
Unemployment rate %	4.1	5.3	5.1	4.9	4.8
Policy rate % (EOP)	1.00	0.25	0.25	0.50	0.75
Exchange rate (US\$ per NZD)	0.67	0.66	0.67	0.68	0.68

Source: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A10

**Philippines – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	6.0	-9.5	9.6	7.6	7.4
CPI inflation %	2.5	2.5	2.5	2.7	2.4
Unemployment rate %	5.1	12.3	9.3	7.3	5.7
Policy rate % (EOP)	4.00	1.75	1.75	2.75	3.00
Exchange rate (per US\$)	50.74	49	52	51.2	50.2

Source: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A11

**Singapore – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	0.7	-5.8	6.3	2.7	2.5
CPI inflation %	0.6	-0.4	1.0	1.2	1.6
Unemployment rate %	2.3	2.7	2.4	2.2	2.1
Exchange rate (per US\$)	1.35	1.37	1.38	1.39	1.4

Sources: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A12

**South Korea – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	2.0	-0.9	3.6	3.4	2.6
CPI inflation %	0.4	0.5	0.7	0.8	1.1
Unemployment rate %	3.8	4.1	3.9	3.7	3.6
Policy rate % (EOP)	1.25	0.50	0.50	0.50	0.50
Exchange rate (per US\$)	1157.8	1189	1180	1170	1160

Source: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A13

**Taiwan – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	2.7	1.0	3.0	2.6	2.4
CPI inflation %	0.6	-0.3	0.9	1.0	1.1
Unemployment rate %	3.7	3.9	3.7	3.7	3.6
Policy rate % (EOP)	1.38	1.13	1.13	1.13	1.13
Exchange rate (per US\$)	30.11	29.3	29	28.8	28.6

Sources: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A14

**Thailand – S&P Global Ratings Economic Outlook**

	2019	2020f	2021f	2022f	2023f
Real GDP %	2.4	-7.2	6.2	4.4	4.0
CPI inflation %	0.7	-1.3	1.1	0.8	1.0
Unemployment rate %	1.0	1.8	1.7	1.3	1.1
Policy rate % (EOP)	1.25	0.50	0.50	0.50	0.50
Exchange rate (per US\$)	30.15	31.4	31.2	31	30.8

Sources: Oxford Economics; f--S&P Global Ratings forecast; End of Period - Q4 values. Unemployment rate shown is the period average.

Table A15

**Regional – S&P Global Ratings Economic Outlook**

Real GDP (%)	2019	2020f	2021f	2022f	2023f
Asia Pacific	4.6	-2.0	6.9	4.6	4.7
Eurozone	1.3	-7.4	6.1	3.0	2.0
Latin America 5	0.5	-8.3	4.0	3.1	2.7
U.S.	2.2	-4.0	3.9	2.4	2.6

Asia Pac and Latin America 5 aggregate GDP growth numbers are based on current purchasing power parity GDP weights. U.S. percentages are annual average percentage changes. Latin America 5 comprises Argentina, Brazil, Chile, Colombia, and Mexico.

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