S&P Global
Ratings

Corporate Top Trends Update

Asia-Pacific Corporate Credit in 2024: Taking The Slow Road

Jan. 30, 2024

This report does not constitute a rating action

Asia-Pacific

Asia-Pacific Companies: Subdued Export Markets, China Growth Limit Upside Credit Potential In 2024

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Key Takeaways

- Rating trends in Asia-Pacific are turning more positive, with diminishing default risk for rated companies.
- Profit growth and rating upside in 2024 are limited by the continued slowdown in consumer demand in China, soft GDP growth in key export markets in Western economies, and input cost pressures.
- The issuance trend is more positive for 2024 than 2023, amid greater clarity on the trajectory of U.S. interest rates. Funding is likely to stay selective for speculative grade issuers.

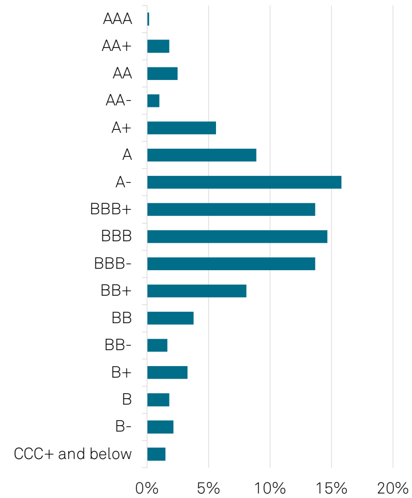
Rating trends are becoming more positive. Rating actions (on a net basis) turned positive in early 2023 and the momentum continued in the first month of 2024. This was driven mostly by the recovery after COVID restrictions were lifted across the region towards the end of 2022. Gaming and media companies have the highest positive bias among the sectors. Real estate companies continue to have the highest negative bias, reflecting the poor sales outlook for developers and elevated vacancies for some commercial property lessors. Overall, 88% of ratings in Asia-Pacific are on a stable outlook with a net negative bias of 2%. Further ratings upside will be limited by China's slow recovery and by sluggish demand in developed economies.

Default risk is diminishing. In 2023, defaults (or restructurings we considered as defaults), dropped to two from 12 in 2022. The survival bias in our portfolio--following the defaults or debt restructurings at Chinese developers and withdrawal of our ratings on them—tilted the rated universe towards the investment grade level. The improvement in the default rate reflects this shift, but unrated entities in real estate and construction or related sectors have continued to struggle to stay afloat. Developers are prominent defaulters, not only in China but also in Vietnam, Indonesia, and, increasingly in South Korea. Outside of real estate, defaults in other sectors have been manageable.

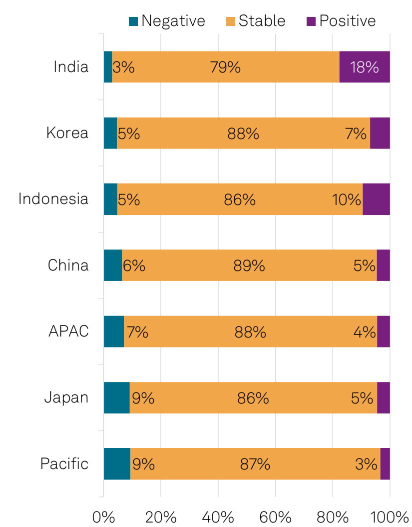
The sector outlook is subdued. Overall, we expect profits at most rated companies in Asia-Pacific to grow at 5% or less in 2024 compared with last year. The profit growth rate will be slower than the nominal GDP growth rate for Asia-Pacific. The tone is one of caution among firms, given the continued slowdown in consumer demand in China as well as in key Western export markets. At the same time, rising input costs continue to weigh on profitability. Two sectors--technology and chemicals--will post above-average growth due to the recovery of demand for semiconductors and our expectation of a modest margin recovery for chemicals from very low 2023 levels.

A mixed picture for capital expenditure (capex) and investment. Our diverging growth outlook for China vs. the rest of Asia is most evident in capex trends. In China, companies are cautious about expansion, given subdued domestic demand and overcapacity. The real estate sector remains saddled with high inventory. In India, Indonesia, and South Korea, companies are demonstrating a larger appetite for growth to capture new business opportunities brought about by technology change and

Ratings distribution



Outlook distribution



Data as of Jan. 23, 2024.
Source: S&P Global Ratings.

expanding economies. In Japan, mergers and acquisitions are picking up after stalling in 2023, as firms continue to look overseas for growth opportunities.

Indian companies: the bright spot. Indian firms are benefiting from robust growth, strong pricing power, and deleveraging efforts. The companies we rate --which represent some of the largest firms in India--have the largest positive rating bias (+18%) among key markets in APAC. Corporate earnings are about 50% higher on average than before COVID, and the profit outlooks of telecommunications and airport operators stand out. Nevertheless, the positive momentum for rating transitions should slow in 2024 as the scope for further deleveraging narrows against increasing spending and investments.

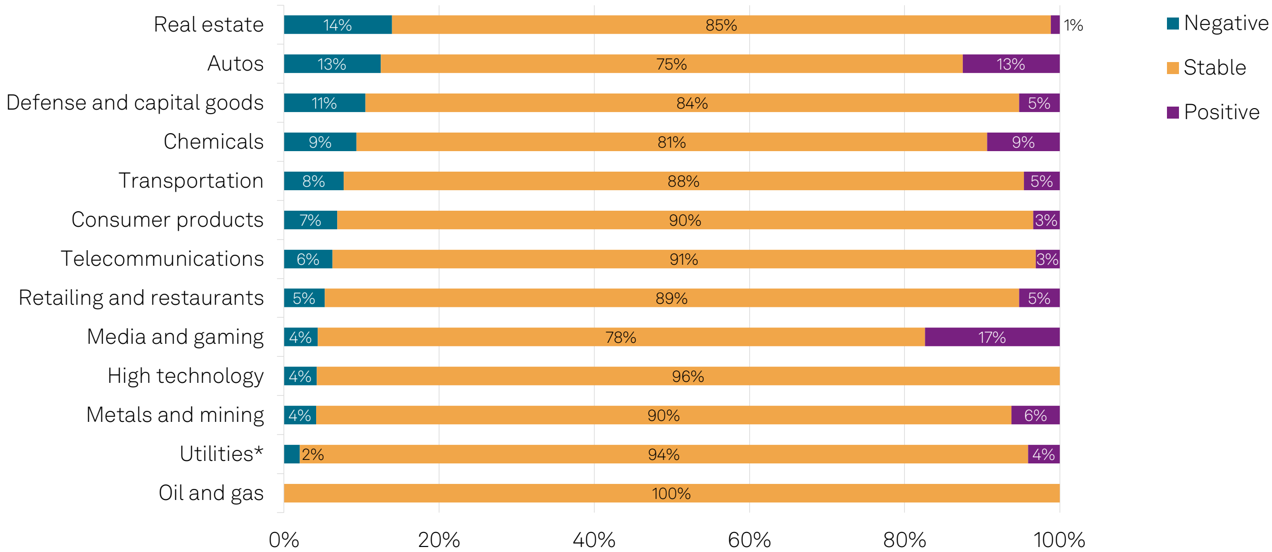
A big year for elections. Major elections in India (general elections) and Indonesia (presidential and general elections) in 2024 mean potential change to political leadership in key markets. We don't expect election results will change policy and economic trajectory. The pro-growth agenda for India and Indonesia is a popular mandate and will remain intact. We expect GDP to grow by 6.4% in India and 4.9% in Indonesia in 2024, with inflation under control.

Issuance outlook for G3 (U.S. dollar, euro, and Japanese yen) currencies. The issuance outlook is somewhat more positive in 2024 vs. 2023 as investors expect U.S. interest rate cuts and a clearer trend trajectory for interest rates. We expect investment grade companies, which represent 75% of rated firms in Asia-Pacific, to continue to dominate issuance. Two factors could limit significant upside in G3 issuances. First, a still large differential between offshore U.S. interest rates and domestic interest rates in countries such as China and Japan may incentivize companies to raise funds domestically in local currency. And second, tepid Chinese capex and investment--which has dominated G3 currency bond issuances in Asia for the past 10 years.

Chart 1

Further downside credit risk is more evident in the real estate, capital goods, autos and chemicals sectors

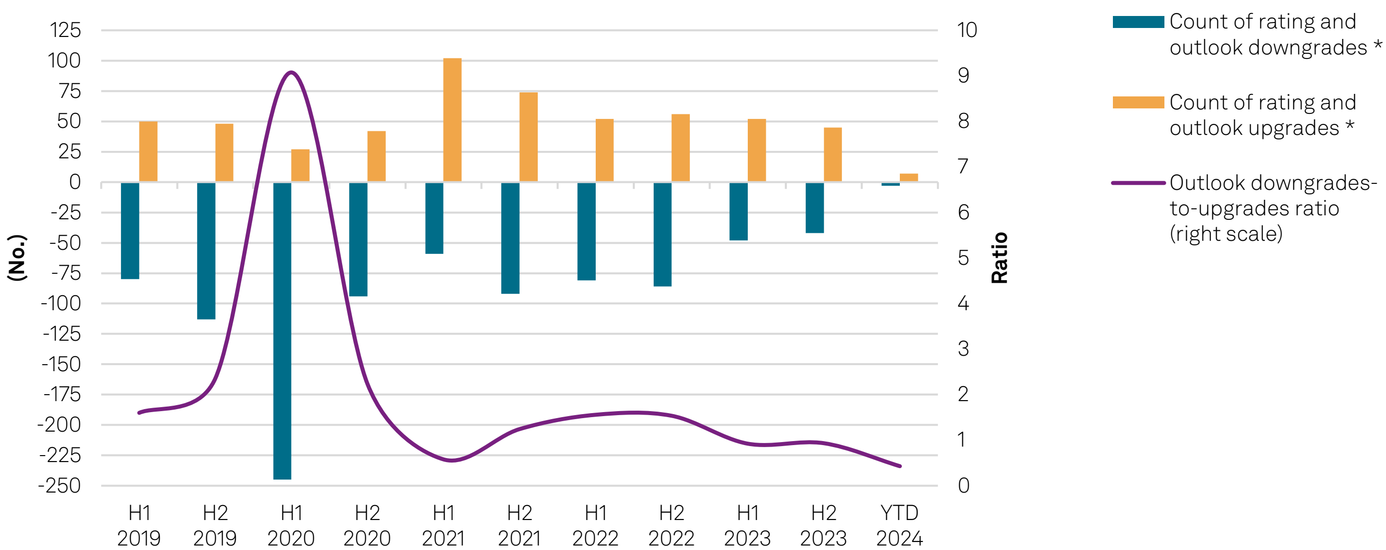
Outlook distribution, rated companies (%)



Data as of Jan. 23, 2024. *Utilities include regulated and unregulated power, water and gas utilities.
Source: S&P Global Ratings.

Chart 2

Rating and outlook changes have slowed over the past 12 months

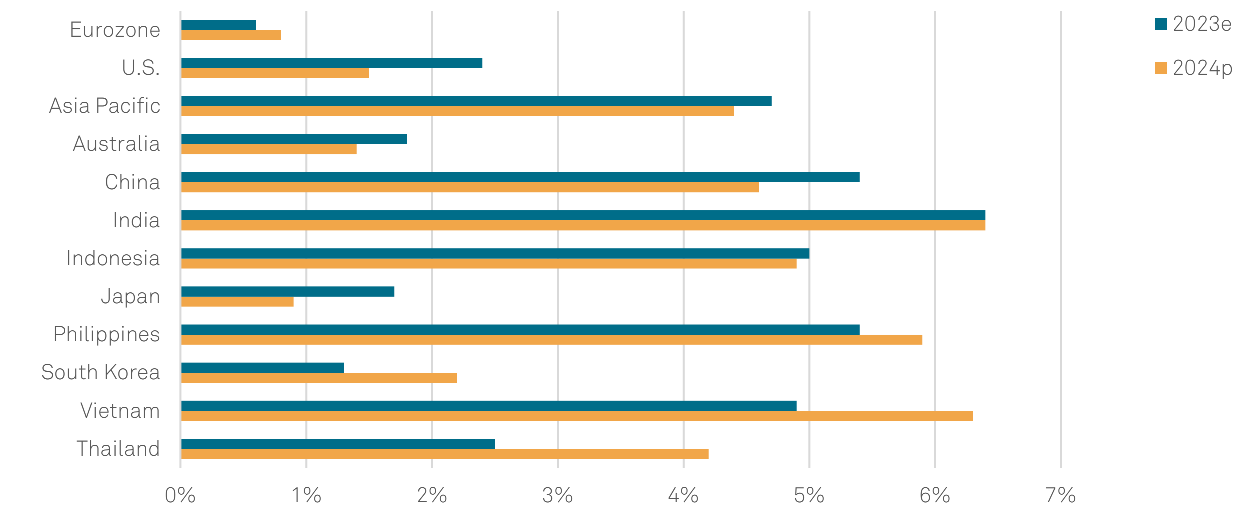


Data as of Jan. 23, 2024. *Outlook downgrades include positive outlooks revised to stable. Outlook upgrades include negative outlooks revised to stable. YTD--Year-to-date. Source: S&P Global Ratings.

Chart 3

Domestic consumption generally supports GDP growth across Asia-Pacific in 2024 despite a soft performance in developed economies and slowing growth in China

GDP growth, selected countries (%)

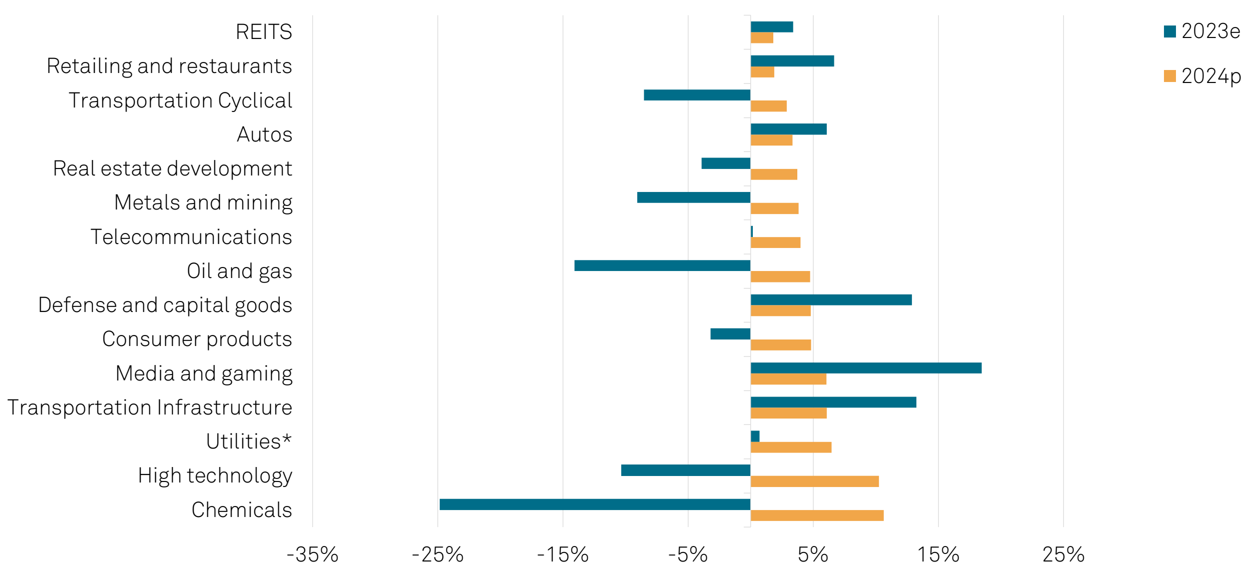


Data as of Jan. 23, 2024. e--Estimate. p--Projection. Source: S&P Global Economics.

Chart 4

Profit growth momentum is likely to be slow for most sectors in 2024

Median EBITDA growth at rated companies, year on year



Data as of Jan. 23, 2024. *Utilities include regulated and unregulated power, water and gas utilities. Median EBITDA growth at rated corporate and infrastructure entities in Asia-Pacific. e--Estimate. p--Projection. Source: S&P Global Ratings.

Australia & New Zealand

It Is Still About Inflation, Interest Rates, And China

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Key Takeaways

- Persisting cost pressures and moderating demand may crimp margins, but stronger companies should take market share and continue to grow.
- REIT credit quality remains under pressure from investor redemptions, elevated capital expenditure (capex), high interest rates, and falling valuations.
- Energy transition remains a key theme with implications for energy prices, operating costs, capex, and business strategies.
- M&A activity is likely to pick up across a range of sectors, including commodities and real estate.
- The rating outlook is mostly stable, with a negative rating bias most evident in the office REIT and postal sectors.

Rating outlooks remain mostly stable. Approximately 87% of the rated portfolio has a stable outlook, compared with about 90% a year ago. The largest negative ratings bias remains in the office REIT sector, where ratings on 43% of office REITs remain on negative outlook. The ratings outlook for postal operators also remains negative on the back of a structural decline in mail volumes. Commodity producers, on the other hand, remain on a stable footing following strong cash flow over the past two years. Non-discretionary retailing, gaming, and telecommunications company ratings also demonstrate resilience amid inflationary and cost-of-living pressures.

Elevated operating and debt costs are likely to persist. Many businesses continue to raise prices as raw material, fuel, and labor costs remain elevated. This is despite some moderation in inflationary forces in recent months. The ability to pass on higher prices could become more difficult as demand slows, particularly in sectors with strong competition or products and services sensitive to price changes. Regulatory or government intervention in sectors such as food retailing may also squeeze margins. The sectors most at risk from higher costs are discretionary retail, construction, and hospitality. That said, we expect larger, well capitalized companies to seek market share growth as weaker entities struggle.

Companies are likely to prioritize cost efficiencies, to limit cost pressures and improve lackluster productivity. Interest rate management will also remain a focus given rates are likely to stay high for six to 12 months. For some firms, the decision whether to hedge and, if so, for how long, will be an important competitive and credit issue, particularly for large debt users such as REITs.

Growth prospects in China and government policies will dictate the fortune of some sectors. Slower growth in China may squeeze some commodity prices, although government stimulus policies should provide an offset. For Australia, Chinese efforts to support the steel industry are helping to sustain iron ore prices despite the weaker Chinese property market. Evolving demand-and-supply dynamics associated with new minerals linked to the energy transition also provide growth opportunities. However, those exposed to these markets likely face a bumpy ride as large capital investments and variable demand drive inevitable price volatility. Recent price trends in the lithium

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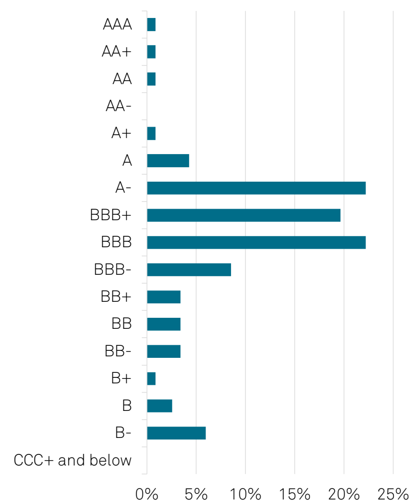
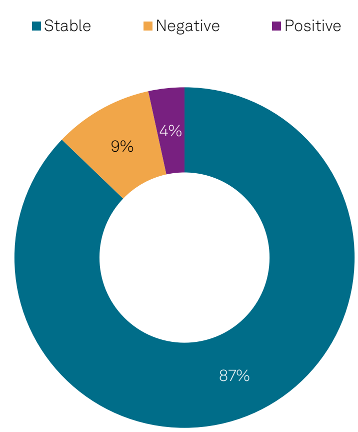


Outlook distribution



Data as of Jan. 23, 2024.
Source: S&P Global Ratings.

and cobalt markets highlight this volatility. The balance sheets of our rated companies in the commodity sector have strengthened over the past two years. They can accommodate some moderation in commodity prices while still funding their large capex programs within ratings tolerances.

M&A activity is likely to pick up. Although M&A volumes were down in 2023, we expect some recovery in 2024 as the more capitalized companies adjust to higher interest rates and seek growth opportunities in slowing macroeconomic conditions. We expect continuing activity in the commodities space following the takeover of gold miner Newcrest Mining Ltd. by Newmont Corp. in 2023, as operators seek scale or adapt their businesses to address longer-term challenges associated with the energy transition. We also expect the ongoing migration of companies from public to private markets to continue across a range of industries. M&A activity in the real estate sector could also increase as companies seek to capitalize on the valuation differences between public and private markets.

Investment-grade firms are likely to increase capital market funding. We expect investment-grade issuers to increase capital markets borrowings over the next 12 months to prefinance or refinance their debt. Many issuers increased their exposure to bank financing in the past 12 months due to market volatility and uncertainty regarding the trajectory of interest rates. This has shortened the debt maturity profiles of some issuers, which they will need to address. In the high-yield capital markets, we expect the cost and availability of capital to remain constrained. Most of our rated high-yield issuers have two to three years before maturity on their existing financing, providing time and flexibility to deliver ahead of refinancing. Private credit will be a growing source of funding for these issuers.

Headwinds will continue to confront commercial real estate

Investor redemptions and elevated capex will continue to pressure the credit quality of REITs, particularly within the office sector. Continuing uncertainty about the trajectory of interest rates, together with structural obstacles such as hybrid working, are driving a valuation disconnect between buyers and sellers of commercial property. As a result, some REITs are unable or reluctant to sell assets to fund redemptions and capex, which is squeezing key credit metrics and ratings. We expect commercial property prices to fall further in the next six to 12 months as markets adjust to higher capitalization rates and other factors. That could lead to a pick-up in transactional activity later in the year as valuations adjust.

Although the office sector will continue to experience structural and cyclical challenges, other sectors such as data centers, retirement living, student accommodation, and build-to-rent will benefit as investors seek to deploy capital to maintain or reweight their real estate exposure in these growing subsectors.

China

Resilient Ratings Against A Slowing Growth

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Key Takeaways

- The appetite for capex among rated Chinese companies is moderating, which should ease leverage and improve rating headroom.
- Nationwide property sales will moderately decline by 5%. Rated developers' cash flow and leverage will weaken over the next two years.
- Corporate ratings are likely to be resilient to slowing growth: 86% are investment grade; 89% have stable outlooks; and 5% have positive outlooks.

Portfolio composition implies resilience. About 86% of rated Chinese companies are investment grade (42% with a rating of 'A-' and above; and 44% in the 'BBB' rating category). 89% of rated firms have a stable rating outlook and 5% have positive outlooks. We expect these rated issuers to be resilient. This leaves greater risks among relatively small parts of our rated companies, such as the 14% of issuers in the speculative-grade category or the 6% with negative outlooks.

Defaults are falling as the rated universe tilts toward higher quality issuers. The offshore default rate among Chinese companies fell to less than 1% in 2023 after a record 6.7% in 2022. This stemmed partly from the fact that the weakest issuers had already defaulted in the previous two years. Defaults have occurred mainly in the property sector. There have been few defaults in other sectors.

Property developers continue to drive the negative outlooks in our portfolio. They account for more than 40% of our ratings with negative outlooks. By contrast, consumer-related sectors such as consumer products, and media, entertainment and leisure, account for 40% of ratings with positive outlooks.

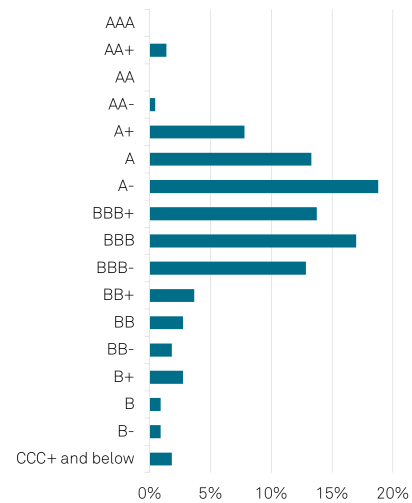
Policy measures are key to supporting growth and boosting confidence. In the third quarter of 2023, the Chinese government launched a range of policy measures to support growth. We don't expect a large stimulus, given policymakers' focus on containing financial risks and reducing debt growth. Also, incremental measures rolled out to support the economy are starting to show results, especially in the housing market. Property and related sectors could remain a drag, but they are likely to have less impact on the economy in 2024.

The appetite among Chinese firms for capex is moderating. Cautious spending among issuers reflects lower expectations about the trajectory of China's GDP and the prospects for profitability and return. Firms most willing to borrow to expand tend to belong to policy-supported areas, such as infrastructure, electric vehicles, clean energy, and technology. A more conservative approach toward capex and debt-funded growth should lead to ratings headroom. We anticipate companies' debt leverage will start to fall in 2024, after peaking in 2023.

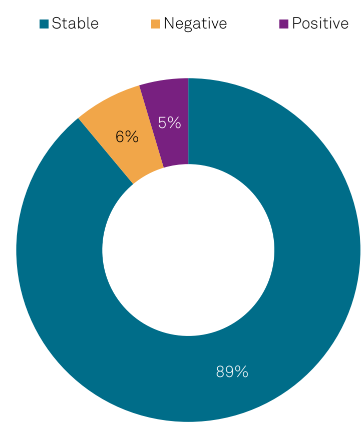
Offshore funding conditions remain weak. With U.S. interest rates likely to stay elevated, onshore banking and capital markets will be the main sources of funding for corporate entities. Domestic interest rates are falling, and liquidity is abundant. However, higher-risk issuers still face selective financing despite the opening of onshore funding to more borrowers in this group.

Geopolitical tensions remain high. Leadership changes in the context of 2024 elections globally could compound geopolitical risks stemming from U.S.-China tensions, and the Russia-Ukraine and Middle East conflicts. Volatile energy costs and supply-chain disruptions could intensify and affect Chinese firms. Overseas operations and investments may also face regulatory and execution risks as tensions rise.

Ratings distribution



Outlook distribution



Data as of Jan. 23, 2024.
Source: S&P Global Ratings.

Property

We believe China's property sales will trace an extended L-shaped recovery in 2024. Several rounds of policy support should help stabilize upper-tier cities; lower-tier cities will still contend with excess supply and weak demand. We expect sales in the four first-tier cities to rise by 3% in value, and those in second-tier cities to decline by 3%. Overall, we estimate nationwide sales will decline a moderate 5% to Chinese renminbi (RMB) 11 trillion-RMB11.5 trillion in 2024.

China's property sales may be close to finding a bottom. Based on China's past property cycles, we estimate the country's annual property sales will find a support level at RMB10 trillion-RMB11 trillion. In our view, the state will continue to intervene to support the market. Further policy easing in higher-tier cities, such as relaxing purchase restrictions and downpayment requirements, could support sales but divert demand from lower-tier cities. In those, demand recovery may continue to lag over the next year or two, given larger inventory overhangs.

Our rated developers' cash flow and leverage will weaken over the next two years. Nearly two-thirds of the developers we rate are investment grade. Price cuts will further raise leverage. We expect the median ratio of debt to EBITDA to rise to close to 5x between 2023 and 2025, from about 3x in 2019. Developers benefiting from State ownership can continue to access funding, which gives them an advantage in buying land and funding construction of new projects over privately owned developers. Consolidation in the sector is likely to accelerate as state-owned developers gain greater market share at the expense of privately owned ones.

LGFV

Some local government financing vehicles (LGFVs) are still walking a tightrope. We expect regulations to tighten LGFV financing will continue because the legacy debt risk remains top of mind for the central government. Total LGFV debt stock growth will continue to fall as local governments issue more bonds to settle LGFV debt. Regulators will also scrutinize and restrict these entities' new debt, including bond issuances.

Recent policy measures may have boosted market confidence to some extent. The sector still faces repayment pressure, because it has increasingly relied on short-term financing. This has led to very large maturities coming due every year, exposing these issuers to the volatility and vagaries of the bond market, if dislocations occur.

At the same time, cash flows at most LGFVs remain insufficient to service their high debt burden. They will continue to rely on refinancing to roll over maturities. Local government bond swaps mainly target so-called hidden-debt resolution and are far from sufficient to deal with the huge debt maturities of LGFVs. Special refinancing bond issuance is likely to slow down, after large issuances in the fourth quarter of 2023. The policy to transform LGFVs by encouraging them to undertake more commercial activity is a long-term goal. It will not resolve their immediate refinancing risks.

Energy transition

Utilities: Leverage will stay high because energy-transition targets and demand growth will keep utilities' capex elevated. Decarbonization remains the biggest challenge to financial metrics improvement for most independent power producers (IPPs), because debt-funded capex for renewables may weigh on their credit profiles just as softening fuel costs prop up their profitability.

More extensive energy market reforms could raise the volatility of tariffs and earnings for utilities, noting that a recent policy to introduce capacity tariffs will stabilize coal-fired IPPs' profitability. Increasing competition for new renewable projects and additional costs to install energy storage may also erode new project returns.

Energy: Coal, oil and gas companies play important roles in China's energy transition, given their sizable investments in solar, wind, and hydro projects. At the same time, they remain the key energy resources for China, and therefore need to continue to invest in upstream exploration. These companies have accumulated financial buffers in the past three years, so we don't expect green projects to burden their credit profile.

Metals and building materials: High energy consuming sectors, such as steel, cement, and aluminum are investing in technology upgrades to improve sustainability of production, capture emissions, and use less energy and more renewable power. Given that these are mostly industries with overcapacity, consolidation and phase-out of obsolete capacities will help. Industry leaders remain committed to environmental goals and investments despite tough operating conditions.

Upstream miners: geopolitics are becoming a focal point for overseas acquisitions. For midstream miners, slowing end-user growth has led to supply surpluses. This is more prominent in lithium processing and battery materials. Oversupply will continue to weigh on their product prices and profitability.

India

A Solid Operating Outlook And Onshore Funding Access Support Credit Profiles

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Key Takeaways

- We expect resilient operating performance for most rated Indian companies, with broadly stable debt loads.
- The telecom and airport sectors are likely to maintain solid growth, in our view. Regulated utilities will continue to benefit from the established, stable, and supportive regulatory framework, while renewables will face execution risks associated with aggressive capex.
- We believe global interest rates will ease gradually, with India to cut rates around mid-2024. A slower improvement in funding costs than we anticipate, and currency volatility pose external risks to Indian renewable entities.

The credit quality of Indian companies should steady in 2024. This is due to supportive operating conditions such as a growing economy, better entrenched financial discipline, and adequate access to multiple financing channels.

A further material and widespread improvement in credit quality is unlikely over the next 12 months, however. Most companies have already deleveraged significantly over the past two years. Major reforms are also unlikely over the next two to three quarters, considering the next parliamentary elections are scheduled for April-May 2024.

Earnings growth is broad based. On average, we expect EBITDA to grow in the high single-digit in 2024, similar to 2023. Following a couple of years of robust growth in India, EBITDA of our rated portfolio is on average 50% higher than pre-pandemic levels. Deleveraging will continue selectively, with overall debt levels remaining stable.

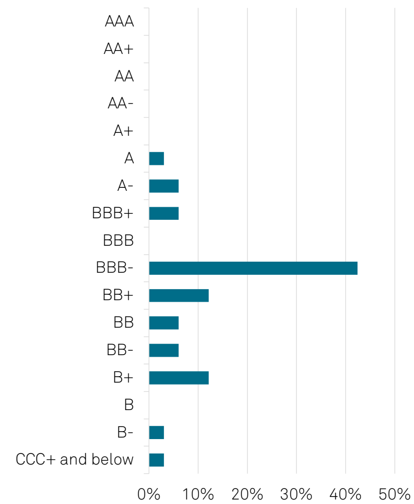
Solid performance in telecoms and airports. We project the EBITDA of rated telecom operators will grow about 15% due to subscriber growth and increasing data usage. Additional tariff hikes will also boost growth. Free cash flows will remain solid and support higher capex, especially for 5G rollouts.

Robust passenger traffic, higher today than pre-pandemic levels, will support performance at airports. We forecast profit margins recovering to at least 2019 levels by fiscal 2025 (year ending March 31, 2025), if not earlier. Leverage should steadily improve over the next two years, but it will remain higher than pre-pandemic levels.

Healthy economic growth supports power demand. We forecast power demand growth of 5%-7% a year, tracking our projected GDP growth of 6.4% for the country in 2024. Our base case assumes that the upcoming tariff reviews (for the next five years) will follow the regulatory framework of full-cost pass-through.

For most rated power utilities in India, the ratio of debt to EBITDA will decline to 5x in 2024, from 6x in 2023, given a higher earnings base. However, the ratio will remain at this elevated level because of high growth and transition capex.

Ratings distribution



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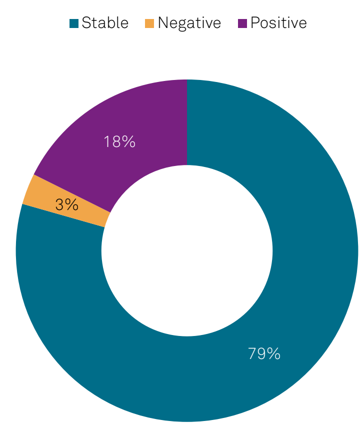


Data as of Jan. 23, 2024.
Source: S&P Global Ratings.

Renewables will continue to expand. Wind power generation in India remained two to three percentage points lower than P90 levels (meeting power generation probability at least 90% of the time) during 2023, weighing on cash flows of developers. We do not think this will prevent the sector from continuing to attract significant private-sector investments.

Many companies are looking to expand into pumped storage and round-the-clock power projects, though these often have longer commissioning and payback periods. Leverage is likely to stay high for Indian renewable producers with ongoing capex, leading to a ratio of debt to EBITDA of above 6x and thin EBITDA interest coverage of about 1.5x for 2024.

Structural weaknesses in state discoms to persist. We expect power generators and transmission companies to continue to receive timely payments from state distribution companies (discoms) this year supported by the government's Late Payment Surcharge Scheme of 2022.

However, the surcharge scheme does not resolve the structural weaknesses of the state discoms, which have weak financial profiles but are also facing rising power and interest costs. Also, state discoms are unable to raise tariffs in an adequate and timely manner because of socio-political considerations, despite high aggregate technical and commercial losses.

Seaports benefit from adequate buffers in credit metrics. Seaport cargo volumes have been growing despite challenging global market conditions, primarily led by containers. Geopolitical tensions could hit trade volumes, although credit metrics should have sufficient buffer given recent seaport operators' deleveraging efforts. Improving operational efficiency supports stable margins. Sustained high expansion investments in international ports and logistics could increase credit risks.

Other industrial sectors are resilient. The IT sector should post stronger growth in 2024. This is due to strong deal wins over the past few quarters. Commodity exports, especially steel and chemicals, will likely benefit from lower input costs despite prices having also come off historically high levels seen in 2022. That said, these two sectors have manageable capex relative to cash flows, limiting downside risk to credit quality.

Limited funding needs and refinancing risks. Most rated firms do not have large funding needs, given favorable operating outlooks and relatively modest capex needs. Ample onshore liquidity through banks and domestic capital markets supports liquidity. In particular, the broadening and deepening of the onshore bond market (non-convertible debentures) by issuance size and tenor has given lower rated companies an alternative funding channel when offshore funding costs were much higher.

The currency exposure of renewable companies is meaningful. Renewable producers face more currency risk with their higher capex spending and greater reliance on foreign-currency debt, especially U.S. dollar debt. Regulated utilities benefit from a cost pass-through mechanism (including hedging costs and currency movement), protecting their cash flows. Rated airports have largely raised sufficient funds to meet expansion capex and have limited refinancing needs.

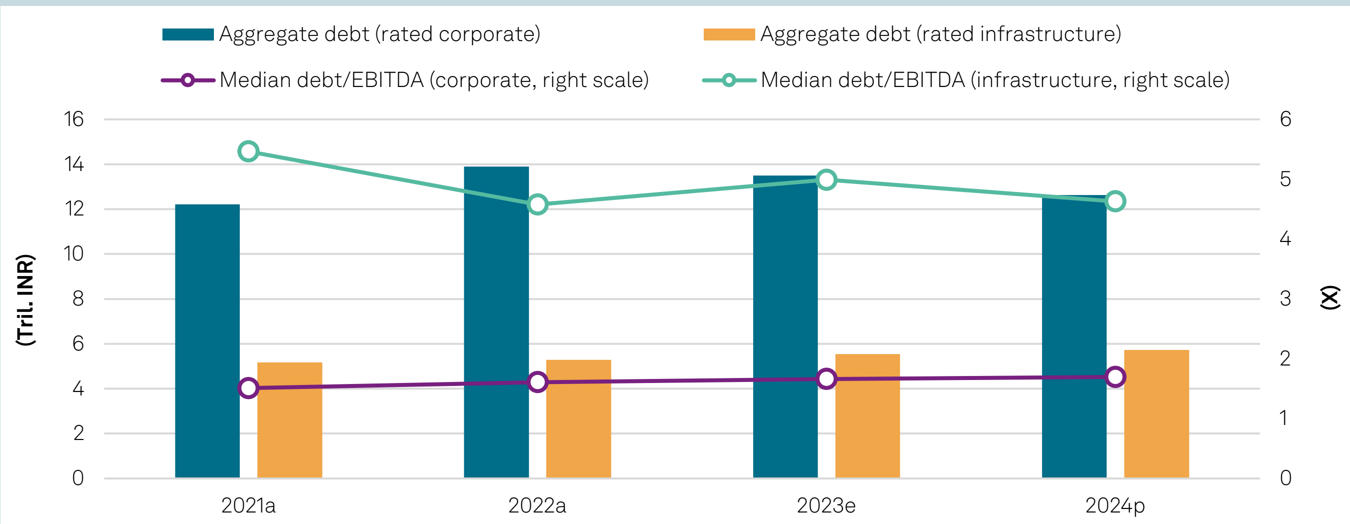
Debt levels and leverage for rated Indian entities in check

Balance sheet discipline and strong operating cash flows will likely keep the aggregate debt of rated companies broadly unchanged in 2024. Leverage of corporate entities will likely remain unchanged, while that of infrastructure companies should decline slightly, due to a larger earnings base as capacities get commissioned.

Disciplined financial policy with an intent to reduce debt drove corporate deleveraging in 2023. Several companies have looked for means other than free operating cash flow to cut their debt, including asset sales and equity issuances to a lesser extent. During 2023, six companies announced or executed such transactions aggregating about US$5 billion. While this represents only 3% of our estimate for total debt as of March 2024, it comes on the back of several such transactions in the previous three years that have led to substantial deleveraging. Companies have also identified potential assets that could unlock value in the coming years, either resulting in further debt reduction or building flexibility for further investments.

Similarly, power companies will also aim to release capital for further investments through operating asset monetization, in our view. The issuers would rely on various modes including infrastructure investment trusts, securitization of receivables, equity stake sale and/or disposal of noncore businesses.

Leverage to remain stable at rated Indian entities



Aggregated debt and median debt/EBITDA ratio for rated entities in India. Debt figures and ratio are adjusted. Fiscal year ended March 31 of the following year: 2021 = FY2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24, 2024 = FY 2024 / 25. INR--Indian rupee. a--Actual. e--Estimate. p--Projection.
Source: S&P Global Ratings.

Indonesia

Consumers A Brighter Spot Amid Subdued External Conditions, Moderating Commodity Prices

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Key Takeaways

- Moderating commodity prices and external headwinds will subdue operating performance of the Indonesian corporate sector in 2024.
- Ample banking and capital market liquidity is available for larger firms although weaker issuers continue to have limited access to the offshore bond market.
- The forthcoming presidential elections are unlikely to have a major bearing on the operating performance of the corporate sector or investor confidence.

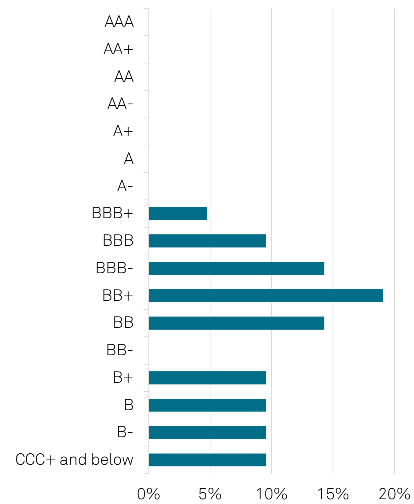
Expect subdued operating performance in 2024. Our economists forecast Indonesia GDP will grow 4.9% in 2024. That's shy of the 5% in 2023 and below the 5.3% posted in the last big COVID-disrupted year in 2022. Slow growth in the Western economies and China (key export markets for Indonesia), will limit top line growth of export-oriented and commodity sectors (capital goods, textile, mining, metals, energy and chemicals). Domestic-focused sectors (consumer products, retailing and light manufacturing) should fare better given moderate unemployment and subsiding inflation.

About 86% of the companies we rate have a stable outlook. This distribution is largely due to stabilizing credit profiles at lower rating levels over the past two years. Withdrawals or the completion of debt restructuring transactions of entities have also moved some ratings on negative outlook back to stable. Our portfolio experienced largely negative ratings trends amid weaker operating performance, liquidity or debt-funded capital spending until 2023 when there were fewer, albeit positive, rating actions. These actions include positive rating and/or outlook changes on mining companies PT Antam Tbk. and PT Vale Indonesia Tbk.

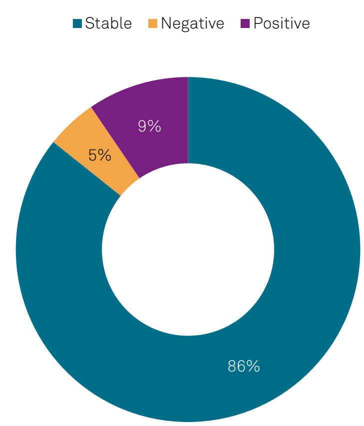
Credit metrics are likely to stay broadly stable in 2024. We estimate the median ratio of debt to EBITDA for rated companies in Indonesia to inch up to about 3.0x in 2024 from 2.8x in 2023. That's a combination of resuming spending, particularly on energy transition and in the commodity and infrastructure sectors, and of modest, single-digit growth in EBITDA. We estimate that about half of the rated companies will post negative discretionary cash flows in 2024 (about twice the level of 2021 and 2022) and require further financing including debt.

Forthcoming elections are not a material risk for the corporate sector. Previous election cycles have not had a notable effect on consumer, corporate or investor sentiment, except for a short-lived slowdown in real estate buying activity and slower investments in the mining sector amid new policies on value-addition. The current political landscape makes it unlikely in our view that economic priorities and the fiscal strategy of the new administration will be markedly different from those of the Widodo administration.

Ratings distribution



Outlook distribution



Data as of Jan. 23, 2024.
Source: S&P Global Ratings.

Funding to stay selective throughout the year. Domestic liquidity is ample, but lenders will continue prioritizing lower margin (but less risky) loans to larger private and state-owned firms with more solid financial standing or critical public policy roles as non-performing loans creep up.

Domestic capital markets, which have also been selective and more active in the financial institutions and state-owned space, could become a more attractive venue as the cost differential with dollar-denominated debt shrinks. Issuances in foreign capital markets are likely to be limited to larger private companies, SOEs or their subsidiaries. Funding windows for weaker-rated issuers are still likely to stay short-lived.

Rupiah volatility is unlikely to be a major risk to Indonesia Inc. Indonesian companies have been dealing with a weaker rupiah for most of the past four years and have generally been resilient. The currency has been fluctuating between 14,500 and 16,000 since 2019, with only a moderate weakening since the Fed hiking cycle started. The impact on margins and interest servicing has been modest and limited to issuers in the real estate, consumer, automotive and agribusiness sectors.

The bulk of US$14 billion in dollar-denominated maturities between 2024 and 2026 will be borne by large SOEs or commodity companies, which often have a natural hedge. Rupiah-related pressures could increase if the currency rapidly depreciates well above 16,000 to the U.S. dollar. Real estate issuers, which have material foreign currency liabilities and no natural hedge for these exposures, would be the most vulnerable to rapid currency depreciation.

Credit quality stays polarized in the SOE sector. State-owned entities (SOEs) in the power and energy sectors, which dominate foreign currency bond issuances, should maintain resilient credit profiles. They often have conservative balance sheets, benefit from direct and indirect government support, and maintain ample access to funding.

However, the credit quality of less strategic SOEs in competitive sectors such as construction, manufacturing, transportation, or retailing are receiving more differentiated support from the government. In those sectors, leverage has increased the most over the past five years and even domestic funding has become selective for some SOEs, including those in the construction sector.

The reorganization of SOEs into industry-holding companies will devolve borrowings to their subsidiaries, which are likely to raise more debt in 2024 and 2025 for capital spending and acquisitions. In these relatively new and larger SOE structures, support mechanisms and timeliness are likely to be key credit considerations.

Indonesia property sector outlook 2024: Watch the 2025 maturity wall

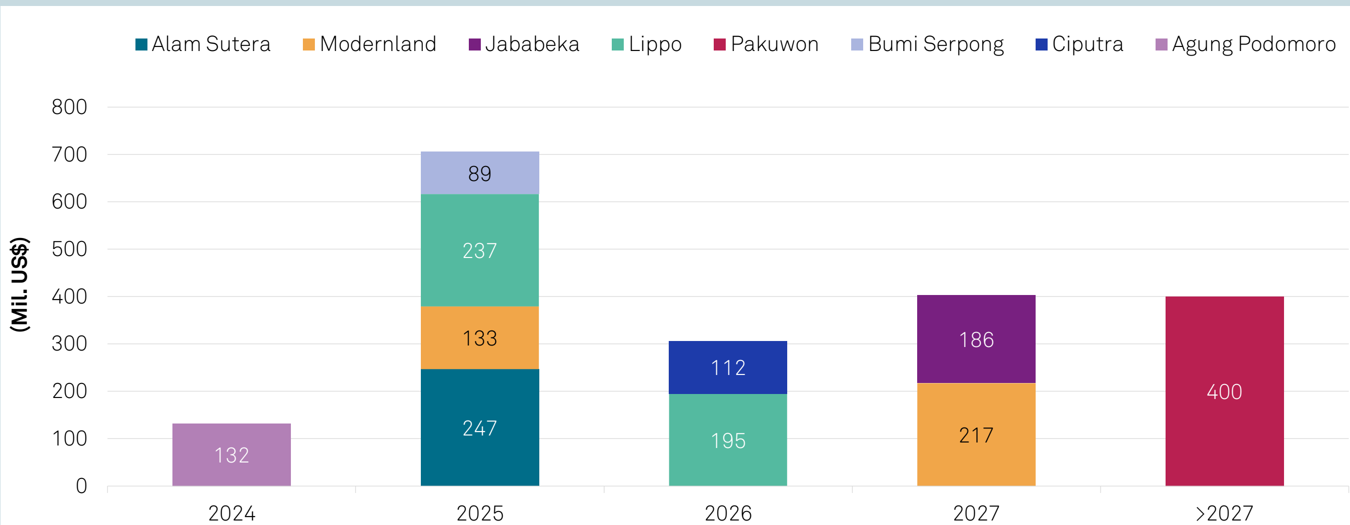
Indonesian property developer credit quality will further diverge in 2024, with refinancing risk a key credit driver.

Refinancing pressure remains high for developers because of a fairly large maturity wall of US$700 million in 2025. This may bring back refinancing scares for investors, especially for the smaller and more leveraged developers whose access to offshore funding remains constrained. Some have turned to domestic banks to meet refinancing needs over the past 12 to 18 months with some success. However, domestic banks are unlikely to fully satisfy the sector's refinancing needs.

Developers rated in the 'BB' category could see a modest deleveraging in 2024, benefiting from good marketing sales and improving rental income. Increasing shopper traffic and healthy rent growth will support an acceleration in rental income. For the more leveraged developers, reported leverage improved in 2023 because they bought back bonds below par. But the improvement is unlikely to last, with leverage in 2024 likely to worsen toward 2022 levels. That's because less active new launches and lower marketing sales in the past two years will lead to lower revenue and EBITDA recognition until the launch pipeline normalizes.

We expect residential marketing sales to grow a modest 5%-10% in 2024, underpinned by supportive regulatory policies and end-user demand for landed residential homes. The new policy for a phased reduction on value-added tax (VAT) from November 2023 to December 2024 will help reduce developers' inventory. Homebuyers will save up to 11% on VAT for residential units priced below IDR2 billion, provided they are handed over to the buyer before the end of 2024. The new policy will support the end-user demand of landed houses, which constitutes most residential marketing sales in Indonesia.

A maturity wall looming in 2025



Data only comprises maturing foreign-currency bonds, converted into U.S dollars, and excludes bonds refinanced with bank loans. Mil.--Million.
Source: S&P Global Ratings computations from company financial statements.

Indonesia commodities sector outlook 2024

Most rated commodities companies have a stable rating outlook heading in 2024. That is backed by a positive cash flow and reducing debt load amid an extended period of high commodity prices. Improving balance sheets are likely to withstand moderating commodity prices. While our base case assumes oil prices will remain elevated at US$85 per barrel through 2025 (compared with US$82.5/barrel in 2023), we expect other commodities prices (excluding gold) to largely trend lower from last year's levels. We have also started to see elevated price volatility for several commodities, adding further downside risk to cash flows in 2024.

The more interesting story and the big mover last year has been nickel--the worst performing metal in 2023, with pricing collapsing by about 40%. Rapid expansion, including 40%-50% supply growth in Indonesia in 2023, has pushed the market into oversupply.

Surging demand from the EV story appears to be lagging, and the Indonesian output will easily cover the expected growth in nickel consumption. Weakness in the Chinese economy is also constraining growth in nickel consumption: weaker end market demand (hitting nickel pig iron) and slower growth in sales of EVs in China, the world's largest market for these vehicles. Nickel miners are starting to close operations and curtail production. We expect this to result in earnings headwinds for Indonesian nickel producers, including rated firms Aneka Tambang Tbk. PT (BB+/Stable/--) and Vale Indonesia Tbk. PT (BB/Positive/--). Yet, we do not envisage downside risks to rating levels over the next 12 months. These companies can navigate a period of lower nickel price given strong balance sheets (compared to pre COVID-19) after years of deleveraging during the latest commodity price cycle.

Along with earnings headwinds, spending is likely to weigh on free cash flows. We could see oil and gas capex and exploration programs expand by up to 20% in 2024, on reserve replenishment initiatives, downstream expansion and opportunistic M&A. Indonesian miners still have significant downstream spending. We believe it will be difficult for issuers to delay capex programs already under way, such as the development of copper smelters and nickel high-pressure acid-leaching plants that are linked to the EV value chain.

Our base case assumes no material change in the operating environment and mining regulations, especially regarding rules on the export of unprocessed ores. Copper miners must adhere to strict deadlines to complete their copper smelters following a temporary extension in export permits for copper concentrates. Meanwhile, nickel miners have also committed capital to smelting and to develop a downstream segment that will target the global EV value chain. Coal miners continue to spend on energy transition with downstream coal gasification projects or a pivot into renewables.

Energy transition: A long road ahead

Indonesia's energy transition will be a long, highly capital-intensive journey with significant execution risks. The country needs massive investments and technological breakthroughs to increase its renewable capacity and meet its net-zero targets. The government's estimate points to an investment of US$97 billion over 2023-2030, which is nearly 10% of the country's GDP in 2022.

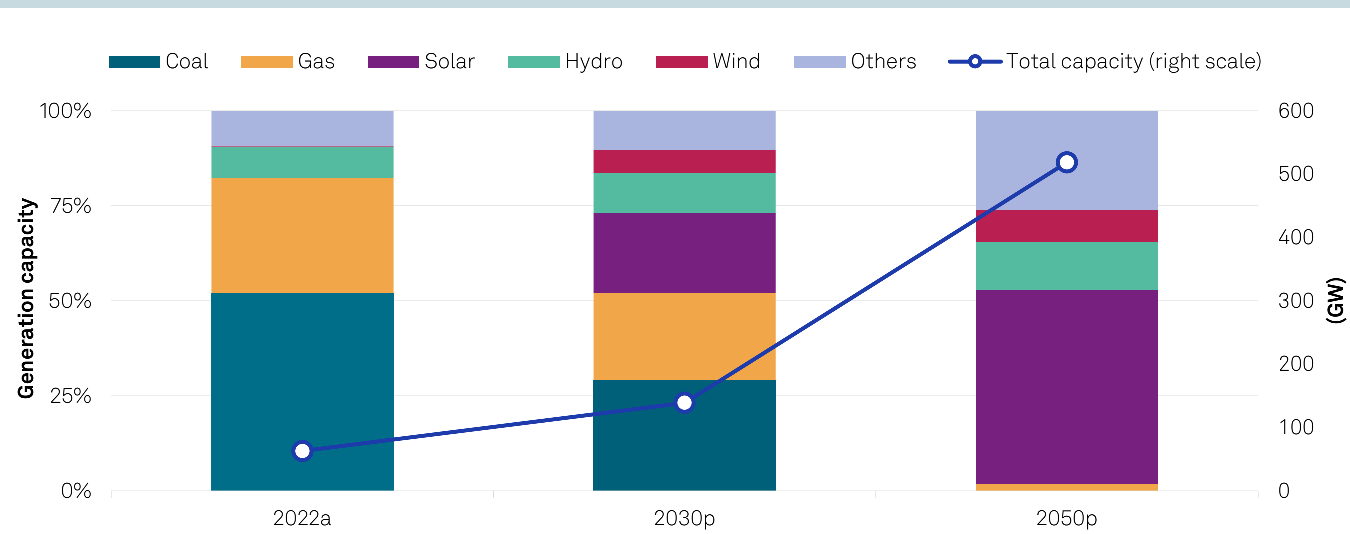
Who bears the cost of energy transition will have implications for the credit profile of utilities. Credit profiles of power utilities may deteriorate if they undertake aggressive investments and if their cash flows do not increase in a commensurate manner. The impact will be more pronounced for unregulated than regulated utilities as regulated utilities benefit from cost pass-through.

Funding for energy transition remains inadequate. The grants and concessional funds committed to energy transition under recent funding support agreements account for only a small percentage of the expected investments required. However, they can support and accelerate structural reforms to encourage private investments.

Power subsidies and suppressed coal prices deter a more efficient allocation of resources and risks. Market-based electricity and coal pricing would encourage investment in green power generation and increase the efficiency of power utilization.

Indonesia plans to reduce coal-fired power generation capacity after it reaches a peak in 2030. However, the early retirement of these relatively young plants (with an average life of 12 years) will mean financial losses for investors and lenders. It would make more sense to retire older and less efficient plants. A combination of grants and concessional loans could be used to subsize the capital cost of plant retirement.

Indonesia: Capacity addition plan and projected contribution



Others include hydrogen-fired gas, storage, geothermal and bioenergy. A--Actual. P--Projection. GW--Gigawatt.
Source: Comprehensive Investment and Policy Plan 2023, S&P Global Ratings.

Japan

Growth Spending Likely To Raise Negative Rating Bias

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Key Takeaways

- Inflation, a slowing global economy, and geopolitical tensions will be key risks to the operating outlook of Japan's corporate sector.
- Aggressive spending will likely squeeze the credit quality of companies we rate. Less creditworthy entities may continue to struggle with high repayment costs for foreign currency-denominated bonds.
- 86% of our rated companies have a stable outlook, with a net negative bias of 6%, but we expect it to increase in 2024.

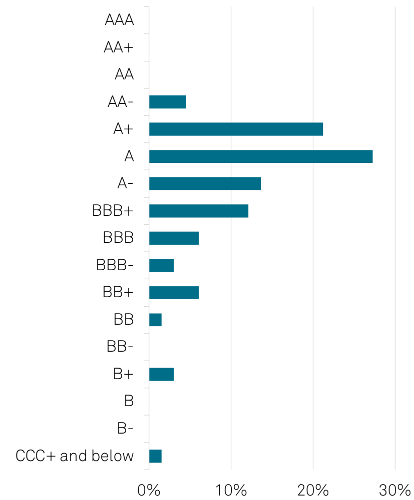
Rated companies' credit quality has stabilized. 86% of the outlooks on our long-term issuer credit ratings on Japanese corporations are stable. This is a sizable increase from 64% a year earlier. 22% of our ratings and outlook changed in 2023 compared with just 4% in 2022. But rating actions were balanced on the upside and downside. High commodity prices helped improve credit quality in oil, steel, and general trading and investment companies (GTICs). Robust demand did likewise for some technology companies. We lowered ratings on technology and auto companies that are less competitive. We also lowered Toshiba Corp. by three notches after it completed its leveraged buyout--an epoch-making credit event in the Japanese capital market.

Our ratings have a small net negative bias. After these rating actions, we have a net negative bias of 6%. The ratio is likely to increase in our view because of the global slowdown as well as inflation, which is fueled by a depreciation of yen. Japan is a net importer of energy and essential goods. These two factors will be the key risks for the operating performance of the companies we rate. In addition, the large appetite among Japanese firms for acquisitions of overseas businesses has not abated. Alongside this, growing calls from shareholders to improve capital structure efficiency and increase cash flow allocations will likely suppress any meaningful improvement in credit quality.

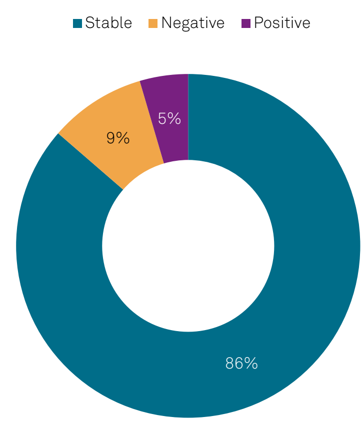
Geopolitical tensions are a risk factor. Any escalation in geopolitical tensions is likely to increase global market volatility and reignite supply-chain disruptions and input cost inflation. Relations between the U.S. and China remain volatile, and the Russia-Ukraine conflict has entered a phase of extended attrition. The war between Israel and Hamas has disrupted shipping lanes, further complicating global supply chains. Japan's dependence on energy imports is very high at about 90%, and China accounts for 20% of Japan's exports. Consequently, any meaningful disruptions in trade and logistics will increase the likelihood of a spike in energy costs and supply-chain disruptions.

Aggressive growth and investment appetite. In 2023, the weakening yen and fears of a global slowdown temporarily curbed the appetite of Japanese companies for M&A. We believe the appetite has returned. In December 2023 and January 2024, we observed two big acquisitions: Nippon Steel Corp.'s acquisition of United States Steel Corp., and Sekisui House Ltd.'s acquisition of U.S.-based MDC Holdings Inc. A greater scale and investments in advanced technology and decarbonization are the main objectives of numerous large Japanese companies. Global efforts to decarbonize will inevitably cause an increase in the research and development costs of Japanese companies.

Ratings distribution



Outlook distribution



Data as of Jan. 23, 2024.
Source: S&P Global Ratings.

Growing investment may constrain financial metrics. In our base case, we expect the aggregated debt-to-EBITDA ratio of rated issuers in Japan (excluding GTICs, investment holding companies, and REITs) to be about 2.0x in 2024. The ratio is unchanged from a year earlier and has improved modestly from 2.2x in 2019 before the pandemic. Solid domestic demand and yen depreciation lead us to anticipate aggregate EBITDA will rise by 4%-5% in 2024 compared with 2023. Issuers will likely maintain a stable debt level (a 1%-3% growth in aggregated debt). However, this excludes strategic growth initiatives and M&A/reorganizations, which could materialize. Although these are event risks (which we do not incorporate in our ratings), sizable transactions could strain issuers' financial risk profile.

Financial discipline will be tested. Japanese corporations we rate are generally resilient to a deterioration in external conditions. We still attribute investment-grade ratings ('BBB-' or higher) to about 90% of the companies we rate in Japan. This is despite volatility of the past several years, namely pandemic disruptions, currency depreciation, and escalating U.S. interest rates. Our base case assumes that investment-grade rated companies will adhere to disciplined financial management. That includes taking mitigating actions, such as cost-cutting, reduction in cash outflows, asset sales, or hybrid debt/equity financing, to protect rating headroom. Many rated companies such as Seven & i Holdings Co. Ltd., Ajinomoto Co. Inc., Hitachi Ltd. and Panasonic Holdings Corp. have accumulated substantial cash or divested less competitive businesses to allow them to absorb the financial impact of a large investment or acquisition or fortify financial positions.

Conditions support funding and liquidity. The refinancing risks of yen-denominated bank loans are manageable. Japanese banks have solid balance sheets and can support long-term borrowers. Still, in the case of rated companies that have relatively low creditworthiness ('BB+' or lower), funding and liquidity will continue to depend on financial market conditions. Despite a recent easing in conditions, some issuers may find it challenging to refinance maturities when they come due. There are large maturities in 2024-2025 for bonds issued at low yields in foreign currencies before the pandemic when the yen was stronger.

Demand for hybrid refinancing will be high. We see a relatively high probability of Japanese companies refinancing hybrid bonds we assess as having intermediate equity content with bonds or loans with similar equity content. In our view, the following factors have raised the probability of refinancings: low interest rates, good credit quality of rated companies, and the proportion of syndicated hybrid loans the companies hold. Syndicated hybrid loans are unique to Japan and are less volatile than hybrid bonds. We anticipate demand for refinancing hybrid instruments on their first callable dates will remain high. Some issuers that have improved their credit quality were able to redeem their hybrid bonds without refinancing in 2023. We also expect the issuing of some new hybrid bonds to reduce the financial burden stemming from acquisitions.

Autos: Tougher times ahead with slower growth and secular changes

Downward earnings pressure will persist for Japanese automakers over the next 24 months. We anticipate the pace of recovery in global auto sales to decelerate to 1%-3% in 2024 from 5%-7% in 2023. High interest rates and slowing global growth are likely to dampen consumer purchasing power for vehicles over the next one to two years. Global auto sales are likely to remain weak. Impending secular change could add to the downside risk for auto sales. Japanese producers are behind the curve on EV offerings in the global market. Their market share in China continued to decline in 2023, as it has since 2021, as demand for electrification accelerates in the country. Domestic players in China will continue to cut prices this year, particularly for EV models. The ability of Japanese automakers to quickly roll out competitive EV models will be crucial for competitive positions in China. In fiscal 2022, China accounted for about 20% of Toyota's auto sales and 30% for those of Honda and Nissan. Continued weak sales and severe price competition in China could squeeze overall earnings of Japanese automakers.

Nevertheless, a resilient earnings base and healthy financial profiles of Japanese automakers will support our ratings on them. Key earnings support for Japanese auto original equipment manufacturers include:

1. High brand recognition and pricing strategy for their gas or hybrid models;
2. Large and competitive product ranges, including sedans, SUVs, vans, and luxury and mini vehicles;
3. Customer loyalty because of a focus on affordability over luxury; and
4. Strong operational and cost control capabilities.

Japanese automakers also have sound financial profiles with large net cash positions. To maintain global competitiveness, they are increasing investments in next-generation technologies for environmentally friendly vehicles and autonomous driving. However, they are trying to curb their financial burden by using technology originally meant for hybrid vehicles and by reducing development expenses for conventional products.

Electronics: Growth investments, financial discipline drive credit quality

We expect global IT spending to rebound in 2024 to 8%, up from 4% in 2023--well above global GDP growth. Supporting this growth is recovering demand for hardware such as PCs, smartphones, and servers, which improves the outlook for the semiconductor industry.

Amid this rebound in growth, we expect the Japanese electronics sector's net negative rating bias to improve. It stands at 25% compared with 13% a year ago. Three quarters of ratings in the sector are on stable outlooks as of January 2024. We anticipate aggregate revenue will increase by 2%-3% over the next one to two years, along with a recovery in demand for hardware and a weaker yen. The pace of the revenue increase will be slower at Japanese electronics makers because of their diversified business portfolio, which includes capital goods, auto, and entertainment--these are susceptible to the global macro economy. Because of electronic makers' efforts to increase prices and strengthen businesses, the median EBITDA margin in 2024 will slightly improve to about 14% compared with 13% in 2023.

Most of the companies we rate in the sector have adequate financial headroom because of low leverage. We project the median debt-to-EBITDA ratio in 2024 for the electronics companies with an investment-grade rating to stay at about 1x despite increasing investment for growth. The risk for companies in the sector, in our opinion, is mostly around financial discipline: persistently large investments and sizable shareholder returns without mitigating measures (such as asset sales or equity issuance) would diminish financial headroom. We have seen this in the case of Sharp Corp. and Rakuten Group Inc., which have a negative outlook on the rating due to weaker earnings prospects and a narrower financial buffer.

Regulated electric and gas utilities: Oversight supports resilience

The outlook for the Japanese utilities sector is stable. Market positions in respective supply regions are resilient, regulatory frameworks favorable, pricing systems transparent, with the possibility of extraordinary support from the government in times of need. All these factors support creditworthiness.

Cash flow metrics for Japanese utilities will improve to pre-2020 levels. Funds from operations (FFO) to-debt ratios will be about 10% for most electric utilities and slightly above 25% for city gas operators. Earnings will recover and stay steady over the next 12 months, thanks primarily to rate hikes in mid-2023. This will allow electricity utilities to pass on fuel costs. However, the metrics will improve only slowly when excluding the positive impact of the time lag in transferring volatility in fuel costs to electricity sales prices for electric utilities. This is because debt will stay elevated following aggressive investments after a significant rise over the past two years.

Fuel prices could climb for electric utilities if, for example, underlying geopolitical risks crystallize. Higher fuel prices would delay our baseline assumptions that earnings and finances for the industry will recover in 2024. However, higher fuel prices will not cause immediate credit stress at Japanese electricity utilities as has occurred over the past two years. That’s because the Japanese government approved new pricing formulas in early 2023 that allow the regulated power companies to pass-through higher fuel costs more easily.

Japan's leading regulated gas companies aim to accelerate investments in domestic electricity retailing, renewable energy, and overseas businesses such as gas upstream projects or independent power producers. Recent examples include Tokyo Gas Co. Ltd.'s acquisition announced in December 2023 of a U.S. shale gas development and production company for US$2.7 billion. Profit is more volatile in these businesses than in the regulated domestic gas utility business. Higher exposure to such areas could heighten the volatility of earnings.

South Korea

Mixed Credit Outlook With A Slight Negative Bias

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Key Takeaways

- Rated Korean companies have a mixed credit outlook for 2024 with a slight negative bias on sluggish demand/consumption and large capital spending.
- Earnings for semiconductor firms will rapidly bottom out in 2024 owing to growing AI-related high-end memory chip demand.
- A slowdown in EV demand casts a shadow on Korean firms that have invested aggressively across the EV value chain.
- Risk tolerance for large investments and transparency and commitment to financial policy will be key factors for individual creditworthiness.
- Domestic property market weakness, high input costs, and elevated funding costs will also contribute to difficult operating conditions.

A mixed outlook in 2024 for our rated portfolio. Although stable outlooks account for about 88% of rated companies in South Korea, the credit outlook is mixed with a slight negative bias. We took several negative actions in the first half of 2023, followed by more positive actions in the later part of 2023 reflecting profitability recovery.

While operating performances improved modestly in the second half of 2023, weak global demand and consumer spending await in 2024. Major Korean firms are also aggressively investing in business expansions, including in EV-related areas, which will likely weigh on financial metrics.

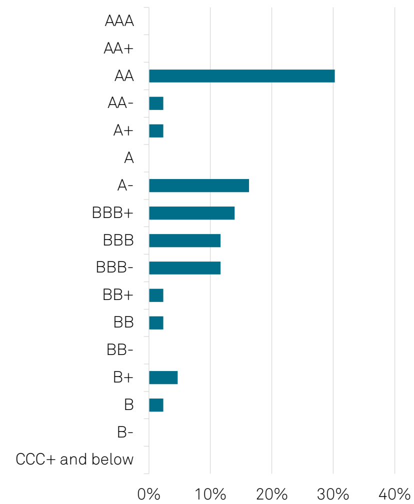
Semiconductor sector recovery. After a severe downturn from mid-2022 to late 2023, the supply-demand dynamics for the semiconductor sector look set to improve over the next 12 months. This is largely owing to robust AI-related chip demand, combined with a recovery in the broader DRAM industry. The meaningful improvement in profitability for SK Hynix (BBB-/Stable/--) in 2024 led to our outlook revision on the rating to stable from negative in December 2023.

EV-related sectors under pressure. With global EV sales growth moderating, a slowdown in EV demand will hit Korean firms that have invested aggressively across the EV value chain. We anticipate Korean EV battery makers, such as LG Energy Solutions, Ltd. (BBB+/Stable/--) and SK Innovation Co. Ltd. (BBB-/Negative/--) will show weak operating performance over the next several quarters due to sluggish demand. In addition, aggressive investments for capacity expansions will require more debt over the next two years, straining their creditworthiness.

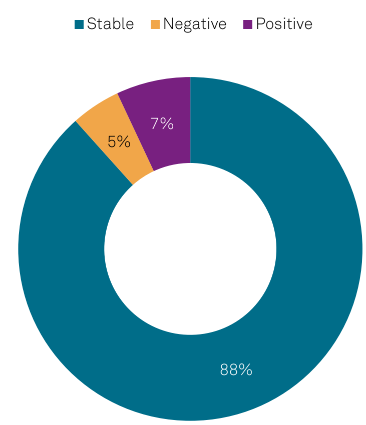
Ample funding access for major firms despite the property market downturn. A weak domestic consumption, combined with high interest rates and a subdued property market in Korea, could strain top lines and profitability. The recent debt restructuring of Taeyoung Engineering & Construction Co. Ltd. underscores rising credit risk for real estate project financing.

However, the property market downturn and related credit risks will have a minimal impact on rated Korean companies given their limited exposure to this sector. Also, we believe major Korean firms will maintain strong access to the capital market as demonstrated by recent bond issuances by SK Hynix and Posco in early 2024.

Ratings distribution



Outlook distribution



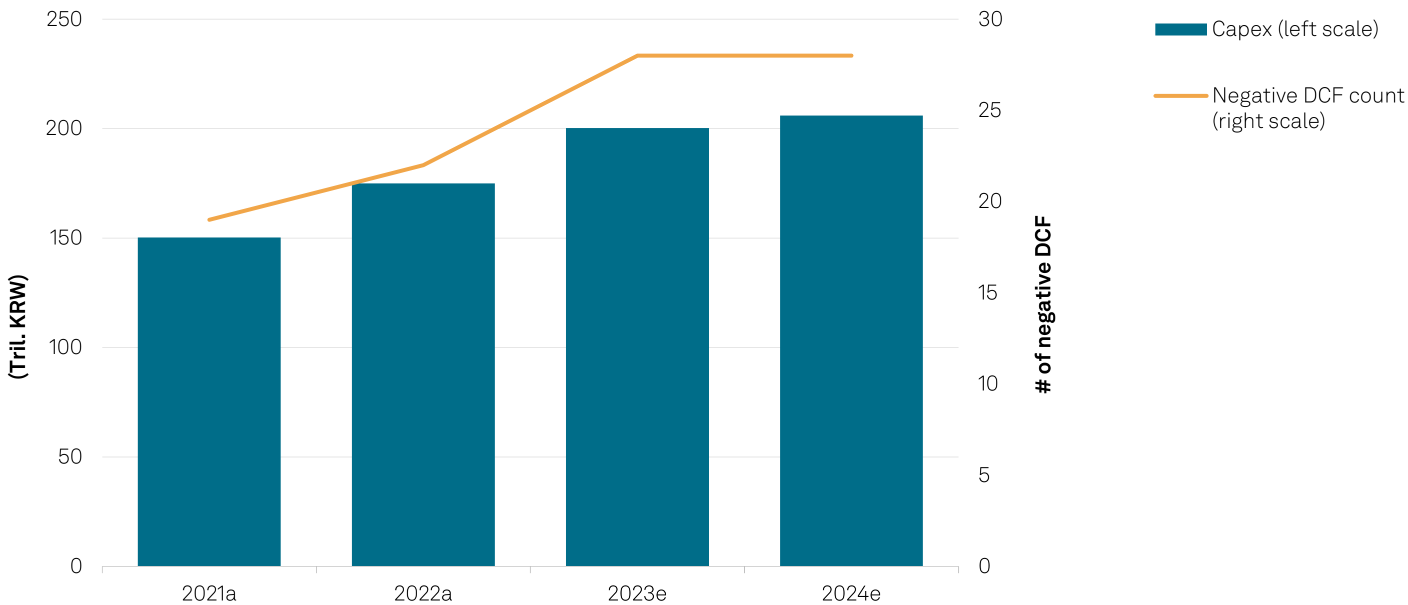
Data as of Jan. 23, 2024.
Source: S&P Global Ratings.

Aggressive financial policy is a key risk to rating headroom. The aggressive investment appetite of some Korean firms is the main downside risk to credit in 2024. We expect negative discretionary cash flow (DCF) for 28 of the rated companies in 2023-2024, rising from 19 and 22 in 2021-2022, respectively. We project aggregate capital spending to be about 25% higher in 2024 than in 2022 (see chart 5).

Rising capex and negative DCFs are closely related to Korean conglomerates' investing aggressively in new business segments, such as the EV value chain or renewable energies. Major drivers for creditworthiness in 2024 will be how flexibly the companies can manage investment/expansion spending, balance earnings generation against capex, and diversify funding sources including non-debt financing.

Chart 5

Aggressive financial policy could pressure creditworthiness



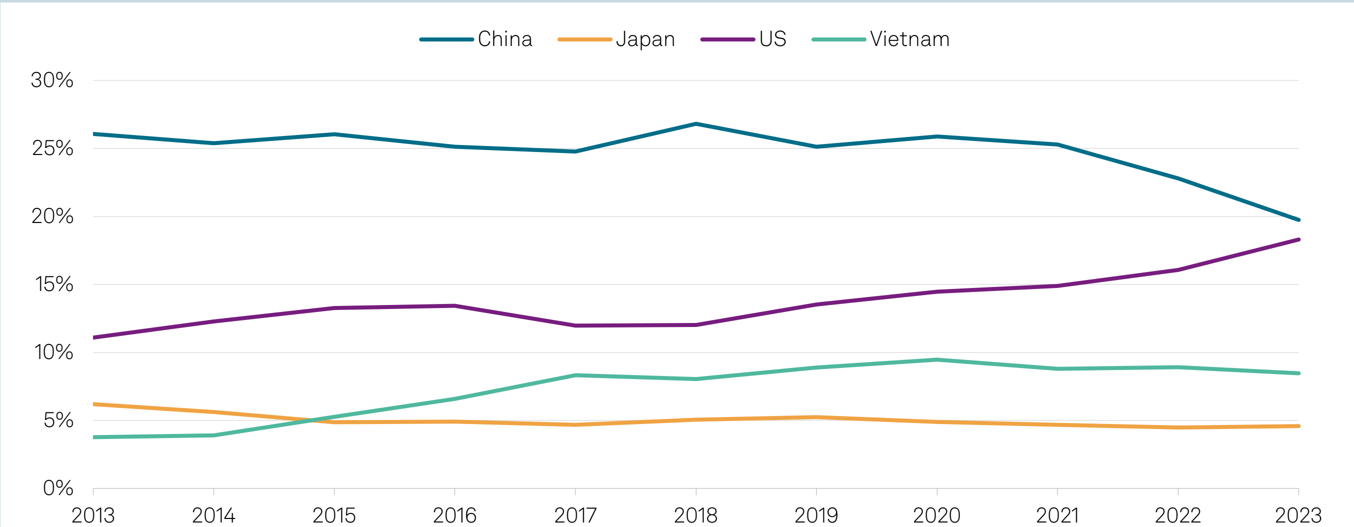
Tril. --Trillion. KRW--Korean won. a--Actual. e--Estimate. DCF--Discretionary cash flow.
Sources: Company filings, S&P Global Ratings.

China risk: How are Korean companies dealing with the slowdown in China?

While South Korea's exports to China have been declining in recent years, the country is still one of South Korea's most important trading partners (see chart below). Some sectors are more exposed to the slowdown in China because of overcapacity and sluggish demand. For example, we anticipate Korean chemical and steel companies will perform weakly over the next few quarters amid intense competition and subdued product margins. We see gradually narrowing rating headroom for some entities in these sectors such as Hanwha TotalEnergies Petrochemical Co. Ltd. (BBB/Stable/--), LG Chem Ltd. (BBB+/Stable/--), and Posco Holdings (A-/Stable/--).

South Korea exports by country

Share of exports in value



Source: Korea International Trade Association.

That said, major Korean manufacturers have been shifting their investment priorities to outside of China and focusing more on the U.S. and other developing markets including South and Southeast Asia. Technology firms such as Samsung Electronics Co. Ltd. and LG Electronics Inc. do not currently have any meaningful investment projects in China, and Hyundai Motor Company (HMC)/Kia Corp. closed some plants in the country. In our view, this is due to lingering geopolitical uncertainties as well as tougher operating conditions there amid sluggish demand and intense competition.

Overall, despite the challenges on several sectors including chemicals, we believe Korean firms are effectively managing their China exposure by timely adjusting their business portfolio and gradually lowering their dependence to the country.

Korean autos: Can Hyundai Motors/Kia stay resilient amid tough market conditions?

We revised our outlook on Hyundai Motor and Kia to positive from stable in January 2024, while affirming our 'BBB+' issuer credit rating on the two companies. We anticipate HMC-Kia's operating performance will be resilient, despite a more difficult global automotive market in 2024. The Korean automotive group expanded margins over the past few years, with improving product mix, rising average selling price, and solid volume growth. While its wholesale volume growth momentum looks set to moderate in 2024, we still project relatively robust margins.

An improving product mix and good geographical diversity should mitigate pressures from sluggish auto demand, intense competition and rising input costs. The company's stronger market position in the U.S. should underpin its growth to some degree, while its positions in the Western Europe and Korea should sustain or strengthen. Exposure to China's weak market is less material now, given less than 5% of HMC-Kia's sales volume are now derived from the country. Meanwhile, the group has expanded exposure to other emerging markets, including India.

Slower EV growth could hurt volume growth, but we view the impact on HMC-Kia should be milder than for EV battery makers or other suppliers. HMC-Kia's agility to switch between battery EV and hybrid cars provides some room to adapt to the changing demands.

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