S&P Global
Ratings

Credit Conditions North America Q2 2024

# Soft Landing, Lurking Risks

**March 27, 2024**

*This report does not constitute a rating action*

Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions (Asia-Pacific, Emerging Markets, Europe, and North America). 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 North America committee on March 21, 2024.

## Key Takeaways

- **Overall:** As the year progresses, credit conditions could brighten somewhat, especially if the U.S. economy settles into a soft landing and the Federal Reserve eases monetary policy in an orderly fashion.
- **Risks:** High financing costs and input-price pressures remain persistent risks. A prolonged period of elevated borrowing costs could make the burden of debt service and/or refinancing too heavy for borrowers in need of interest-rate relief.
- **Ratings:** The net outlook bias, indicating potential ratings trends, stayed relatively flat over the past quarter and was at negative 10.3% as of March 15. Telecom, health care, and consumer products still have the highest negative bias—with around 30% of issuers having a negative outlook or on CreditWatch with negative implications.

A soft landing in the U.S. economy could help stabilize—or even improve—credit conditions for borrowers in North America, but downside risks around high financing costs and input-price pressures continue to lurk.

**We expect that, as the year progresses, credit conditions could brighten somewhat, paving the way for a potential credit upturn in 2025 as signaled by our Credit Cycle Indicator.** This assumes the U.S. avoids an economic slump and the Fed eases monetary policy in an orderly fashion. The U.S. economy has proven surprisingly resilient, and the chance of recession has moderated, thanks to a healthy labor market. The central bank looks poised to begin lowering its policy rates in July, and GDP will likely grow 2.5% for the year, in our baseline forecast.

**However, headwinds could make for a bumpy ride and borrowing costs could stay high for some time.** Unexpected economic potency could give the Fed cover to keep interest rates elevated for longer than we anticipate as policymakers look to wring the last of above-target inflation from the world's biggest economy. This could make the burden of debt service and/or refinancing too heavy for borrowers in need of interest-rate relief—especially those at the lower end of the ratings scale. Maturities of debt rated 'B-' and lower more than double from this year to next, rising to $95.8 billion in 2025 from $44.1 billion in 2024.

**Input-cost pressures, along with weakening passthrough capability, could lead to more severe profit erosion and credit strains.** Labor costs remain elevated for many North American corporate borrowers, and geopolitical tensions threaten to push up prices (such as commodities and shipping) and constrain supply chains. Profit margins and credit quality could suffer further if companies can't easily pass through higher costs to protect volumes.


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**The collapse of Baltimore's heavily traveled Francis Scott Key Bridge is the latest example of supply chain vulnerabilities that could create logistical bottlenecks and increase costs.** As U.S. port volumes have fallen from pandemic-era peaks, capacity exists at other East Coast ports to accommodate a portion of the Port of Baltimore's over 11.6 million tons of general cargo handled in fiscal 2023, albeit with regional implications on traffic and logistics. We anticipate the economic implications of trade disruptions will be regional and not pressure ratings on the city, state, or public enterprises (see "Maryland Transportation Authority's Credit Quality Not Affected By Francis Scott Key Bridge Collapse", published March 26). However, Baltimore is the top-ranked U.S. port for autos, heavy machinery, coal and gypsum, and a prolonged disruption to port operations will impede supply chains for those goods and commodities.

**Risks around commercial real estate (CRE) persist, as well.** Higher financing costs are weighing on asset valuations and heightening refinancing risk for most property types. Specifically, declining demand for office space has hurt property prices and curbed cash flow. The multifamily sector could also face challenges as rent growth softens. All this may lead to elevated loan losses for debtholders, including U.S. banks, with regional lenders having higher exposure than larger U.S. lenders do. We believe most rated banks have manageable CRE exposures, and we're focusing most closely on those that have CRE loans that exceed 30% of their loans.

**Meanwhile, the upcoming U.S. elections add to rising (geo)political tensions.** In a calendar year rife with national elections, perhaps the most consequential will be in the U.S. In addition to the presidential election, 33 of the 100 Senate seats and all 435 seats in the House of Representatives are at stake (see chart 1). The outcome could have significant ramifications not just locally but globally—potentially increasing political polarization.

Chart 1

## 2024 U.S. elections: What's at stake for credit

### Elections

**PRESIDENTIAL**

NATIONAL CONVENTIONS:

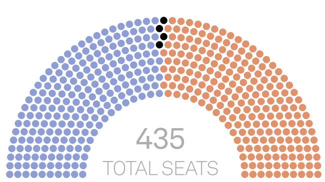
**GOP** July 15-18

**Democratic** Aug. 19-22

**HOUSE**

435 ELECTIONS

Seats up for election
- **213** DEMOCRATS
- **4** VACANCIES
- **218** REPUBLICANS

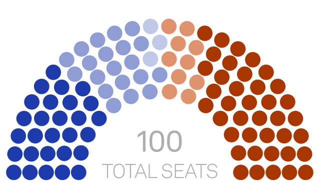



**SENATE**

33 ELECTIONS

Seats up for election
- **20** DEMOCRATS
- **3** INDEPENDENTS*
- **10** REPUBLICANS

*Caucus with Democrats




### Key considerations

- Partisan split between presidency and Congress would make passage of sweeping legislation challenging
- Electoral uncertainty could delay public project funding and private capital expenditures
- Potential for increased political polarization

### Specific policy areas to watch

- **Federal government deficit:** We don't expect meaningful deficit reduction regardless of outcome given pledges not to reform mandatory spending
- **CHIPS Act, IRA, infrastructure spending:** Given bipartisan support for these policies, we view them as less likely to change
- **TCJA:** Expiry of TCJA at end-2025 opens possibility for changes in taxation
- **Trade:** President has wide latitude to levy tariffs. More protectionism could result in inflationary pressures, especially for sectors exposed to cross-border supply chains
- **Antitrust:** If regulatory hurdles lessen for large business combinations, sectors ripe for consolidation may become more active with M&A

Source: S&P Global Ratings.

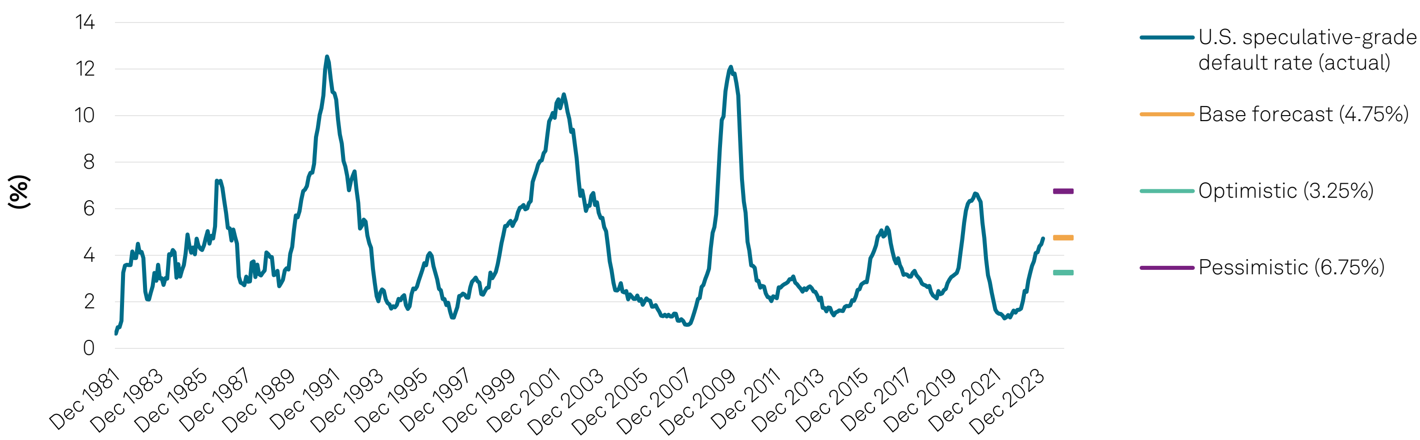
S&P Global Ratings expects the ramifications for U.S. corporate borrowers will be predicated on the outcomes of both presidential and congressional elections—especially if there is a partisan split between the presidency and upper or lower house (or both) of Congress, which would make passage of any sweeping legislation challenging.

**Against this backdrop, we expect defaults will likely continue to increase, but may moderate before the end of the year.** S&P Global Ratings Credit Research & Insights expects the U.S. trailing-12-month speculative-grade corporate default rate to reach 4.75% by year end—slightly above the 4.1% long-term average (see chart 2). Consumer-reliant sectors, which make up roughly half of borrowers in the 'CCC/C' categories, will likely lead the default tally. Stress is widespread, as loan-heavy sectors like health care could also see more defaults. If the U.S. growth slumps later this year, the default rate could jump to 6.75% (our pessimistic scenario).

Chart 2

### Defaults will remain high until year end, after third-quarter peak

U.S. trailing-12-month speculative-grade default rate and December 2024 forecast




Data as of Dec. 31, 2023. Sources: Leveraged Commentary and Data (LCD) from Pitchbook, a Morningstar company; S&P Global Ratings Credit Research & Insights and S&P Global Market Intelligence's CreditPro®.

We expect defaults to peak around the third quarter as financing conditions should improve in the second half, once the Fed begins lowering rates. That said, cuts may be limited to 75 basis points (bps) total, which may already be priced into downstream interest rates and only provide marginal relief.

**The net outlook bias, indicating potential ratings trends, stayed relatively flat in the past quarter and was at negative 10.3% as of March 15** (see chart 5). Telecom, health care, and consumer products continue to have the highest negative bias—with around 30% of issuers having a negative outlook or on CreditWatch with negative implications (see chart 3). Metals, mining, and steel, homebuilders and real estate, tech, and chemicals saw the largest increases in negative bias.

**On the positive note, upgrades outpaced downgrades in January for the first time since June 2022,** led by an uptick in hotel, lodging, and leisure issuers, as consumers continue to spend on experiences (see chart 4). In addition, net outlook/CreditWatch changes (positive outlook/CreditWatch changes minus negative outlook/CreditWatch changes) have been positive for three consecutive months—a signal that more upgrades could come.

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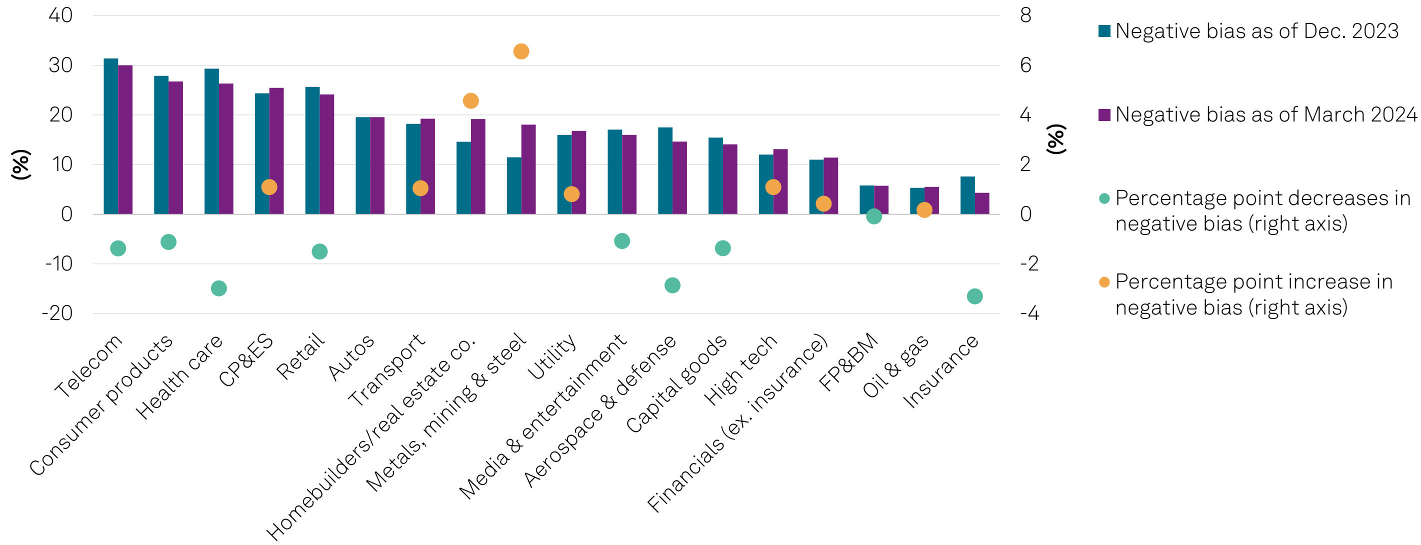
Chart 3

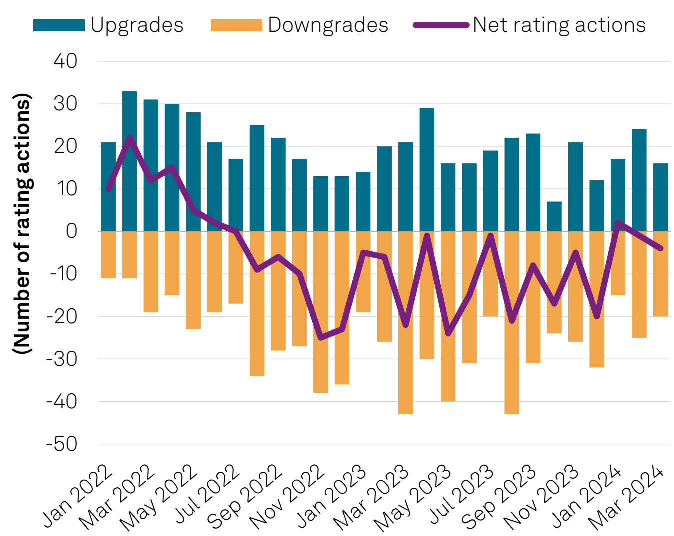
## Negative bias by sector




Data as of Dec. 31, 2023 and March 15, 2024. CP&ES—Chemicals, packaging & environmental services. FP&BM—Forest products & building materials. Negative bias—Percentage of issuers with a negative outlook or CreditWatch. Source: S&P Global Ratings Credit Research & Insights.

Chart 4

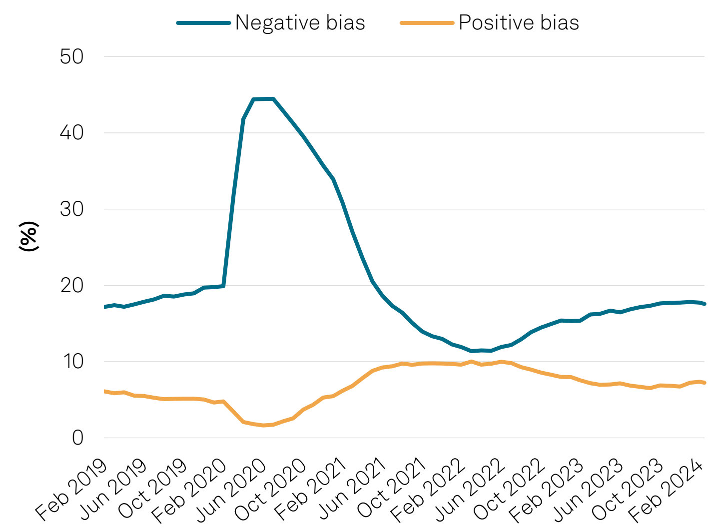
## North American rating actions




Monthly data through March 15, 2024, and covers financial and nonfinancial corporates. Source: S&P Global Ratings Credit Research & Insights.

Chart 5

## North American ratings outlook bias




Monthly data through March 15, 2024, and covers financial and nonfinancial corporates. Negative bias—Percentage of issuers with a negative outlook or CreditWatch. Positive bias—Percentage of issuers with a positive outlook of CreditWatch. Source: S&P Global Ratings Credit Research & Insights.

# Top North American Risks

### Continued high borrowing costs pressure borrowers' liquidity

**Risk level** Moderate | Elevated | **High** | Very high — **Risk trend** **Improving** | Unchanged | Worsening

If interest rates remain elevated for even longer than we anticipate, the costs of debt service and/or refinancing could be overly burdensome—especially for borrowers at the lower end of the ratings scale. With near-term U.S. speculative-grade maturities looming ($149 billion due in 2024 and $305 billion due in 2025), some of these borrowers may feel more severe liquidity strains, particularly if investors become more risk-averse. Challenging financing conditions could also lead to significant declines in asset valuations, including a housing slump or a deepening correction in CRE. Moreover, in the longer term, any significant monetary policy normalization by the Bank of Japan could trigger a shift in capital flows, causing volatility in capital markets such as treasuries.

### Cost pressures squeeze profits, erode credit quality

**Risk level** Moderate | Elevated | **High** | Very high — **Risk trend** **Improving** | Unchanged | Worsening

For many North American corporate borrowers, input prices—especially labor costs—remain elevated, and geopolitical tensions threaten to push up prices, such as for commodities and shipping. Meanwhile, some are finding it more difficult to pass along costs to consumers and customers given demand headwinds. If profit erosion worsens more than we expect, credit quality could suffer further at a time when defaults are already rising.

### Falling asset values and cash flows, plus high financing costs, exacerbate CRE losses

**Risk level** Moderate | **Elevated** | High | Very high — **Risk trend** Improving | Unchanged | **Worsening**

Higher financing costs are weighing on asset valuations and heightening refinancing risk for most types of CRE. Declining demand for office space in particular, is further weighing on valuations and curbing cash flow. The multifamily sector could also face challenges as rent growth softens. All this may ultimately lead to elevated loan losses for debtholders, such as U.S. banks (with regional lenders having proportionately higher exposure to CRE than larger U.S. lenders do), insurers, REITs, and commercial mortgage-backed securities (CMBS). Higher office vacancy rates and shuttered ground-level businesses could also reduce tax revenue for cities.

### U.S. slips into recession, hurting demand

**Risk level** Moderate | **Elevated** | High | Very high — **Risk trend** Improving | **Unchanged** | Worsening

With the Fed likely to keep monetary policy tight for some time and the cost of consumer and intermediate goods remaining high, financial cushions and purchasing power continue to erode. If inflation doesn't cool enough for the Fed to pivot as we expect, more subdued business investment and/or a sharper pullback in spending could lead to a deep slowdown in growth or a recession, causing more credit stress. While the U.S. economy has notably outperformed its peers during the round of steep policy rate hikes, the performance of other advanced economies—with growth slowing as rate hikes took effect—is closer to what we were expecting for the U.S.

### U.S. banking sector vulnerabilities erode sentiment, add to credit strains

**Risk level** Moderate | **Elevated** | High | Very high — **Risk trend** Improving | **Unchanged** | Worsening

U.S. regional banks remain vulnerable to quickly shifting sentiment, and any renewed or heightened fears among stakeholders could further disrupt money flows, fuel market volatility, and weigh on consumer confidence and spending. As banks become more selective in lending to preserve their balance sheets and look to comply with more stringent proposed regulation, entities such as small and medium-sized businesses (SMBs), as well as households, may find it harder to gain funding.

## Structural risks

### Escalating geopolitical tensions impede trade and investment, weighing on growth

**Risk level** Moderate | **Elevated** | High | Very high — **Risk trend** Improving | Unchanged | **Worsening**

The Israel-Hamas conflict and the attacks on shipping in the Red Sea are heightening geopolitical strife already intensified by the Russia-Ukraine war, now in its third year. The potential for the Middle East conflict to escalate—and to affect the rest of the world through energy supply shocks, supply disruption, and risks to social cohesion—is a key concern. Most borrowers in North America have limited direct exposure to the Russia-Ukraine conflict, but the effects could deepen if an escalation (potentially involving NATO allies) occurs. Meanwhile, any further worsening of U.S.-China tensions could also kink supply chains, and disrupt trade, and investment and capital flows. This year's U.S. elections could have ramifications domestically and around the world, potentially increasing political polarization.

### Climate risks intensify, energy transition adds to costs

| Risk level | Moderate | Elevated | High | Very high | Risk trend | Improving | Unchanged | Worsening |
|---|---|---|---|---|---|---|---|---|

More frequent natural disasters increase the physical risks that public and private entities face, adding to costs. Extreme weather events are making it increasingly difficult for homeowners in certain parts of the country to find affordable insurance—if they can get coverage at all, with some providers abandoning high-risk markets altogether. Natural catastrophes also threaten to disrupt supply chains (such as for agriculture and food) and logistics. The global drive toward a net-zero economy also heightens transition risks across many sectors, requiring significant investments.

### Accelerating tech transformation disrupts business models, cyberattacks threaten operations

| Risk level | Moderate | Elevated | High | Very high | Risk trend | Improving | Unchanged | Worsening |
|---|---|---|---|---|---|---|---|---|

Cyberattacks pose a systemic threat and significant single-entity event risk as new targets and methods emerge—with geopolitical tensions raising the prospect of major attacks. Organizations lagging on adapting to current and emerging technologies or lacking well-tested cybersecurity playbooks are more vulnerable, while adopting technological advances means more costs. The accelerating digitalization of business and economic activity—particularly the ability to influence market sentiment and shift capital rapidly and widely—also adds potential market volatility.

Source: S&P Global Ratings.
**Risk levels** may be classified as moderate, elevated, high, or very high. They are evaluated by considering both the likelihood and systemic impact 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 about whether the risk level could increase or decrease over the next 12 months.

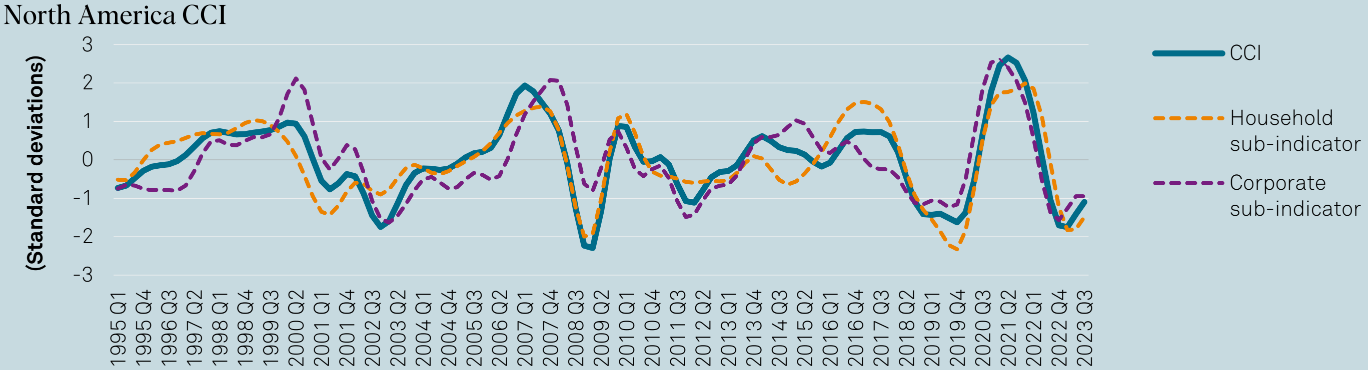
## Credit Cycle Indicator

### Stresses will linger before a potential credit upturn in 2025

The North American Credit Cycle Indicator (CCI) continued to increase after reaching a trough in late 2022 and early 2023 (see chart 6). This suggests a potential credit upturn in 2025, given the historical six to 10 quarters of lead time between CCI readings and credit developments (for more details on our proprietary CCI, see "White Paper: Introducing Our Credit Cycle Indicator", published June 27, 2022). While market conditions and some asset prices have improved slightly, leverage in the system, such as corporate and household debt-to-GDP in the U.S., is still undergoing a correction. We could see continued credit deterioration among North American borrowers throughout 2024. This is because of higher borrowing costs, weakening demand from tighter monetary policy, and protracted higher prices from recent years of inflationary pressures.

Chart 6

North America CCI




Peaks in the CCI tend to lead credit stresses by six to ten quarters. When the CCI's upward trend is prolonged or the CCI nears upper thresholds, the associated credit stress tends to be greater. Sovereign risk is not included as a formal part of the CCI. The CCI period ends in Q3 2023. Q1--First quarter. Q2--Second quarter. Q3--Third quarter. Q4--Fourth quarter. The North America CCI includes Canada and the U.S. Sources: Bank for International Settlements, Bloomberg, S&P Global Ratings.

**Corporates.** The region's corporate sub-indicator stayed relatively flat in the third quarter of 2023 at -0.9 standard deviations. The probability of a U.S. recession in the next 12 months has decreased thanks to the sturdy labor market. However, we expect borrowing costs will remain elevated in 2024 and weigh on the ability of corporates to service debt and refinance. Meanwhile, supply chain constraints remain as do cost pressures, particularly related to labor. Companies at the lower end of the ratings scale may feel more severe liquidity strains if approaching maturities coincide with tough financing conditions.

**Households.** The household sub-indicator modestly increased to -1.5 standard deviations. Despite the resilient labor market, households' financial health has shown signs of weakness. In the U.S., new delinquencies of auto loans and credit cards have been surging, with transition rates now above pre-pandemic levels. In Canada, the mortgage component is driving the household debt service ratio to a historical high as borrowers renew variable-rate mortgages. A sharper-than-anticipated pullback in consumer spending could weigh more on the economy and lead to a jump in unemployment, causing more vulnerability in the household sector.

# Macroeconomic Outlook

- The U.S. economy has been surprisingly resilient and appears on track for 2.5% growth this year, with support from a sturdy labor market.
- We expect the U.S. will avoid a recession in the next 12 months, but GDP growth should eventually soften, and the economy will transition to below-trend growth.
- We've nudged our full-year GDP growth forecast for Canada higher, to 0.9%. However, we believe near-term economic expansion will be sluggish before strengthening in 2025.

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## U.S.

**The U.S. economy appears on track for 2.5% growth this year (with support from a sturdy labor market), repeating last year's outperformance versus peers.** However, the average growth forecast gives an overly positive outlook of the economy. A strong end to the year—with 3.1% growth in fourth-quarter 2023—masks the forecasted slowdown to 1.8% by fourth-quarter 2024.

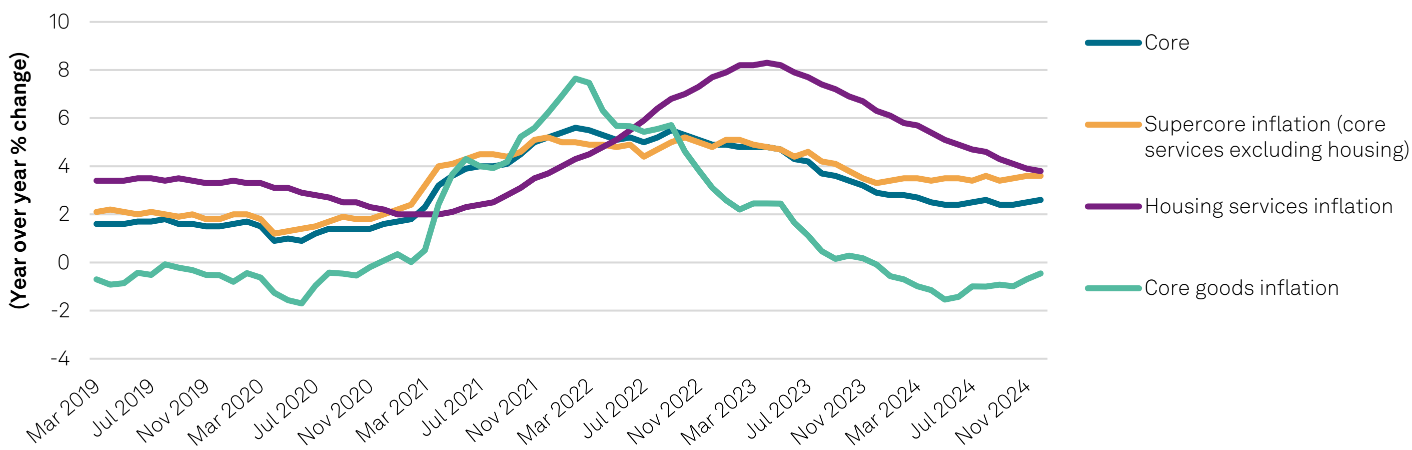
The comparatively slow transmission of policy rate increases to debt service pressure is a boon to growth—but the benefit is transitory and may result in policy staying higher for even longer to damp demand as desired. GDP growth should eventually soften, but we expect the U.S. will remain resilient and continue to avoid a recession in the next 12 months.

**Weaker growth in the second half will likely cause demand for labor to slacken further,** which could lead to a gradual uptick in the unemployment rate over the next two years, to 4.3% by the end of 2025 from 3.9% currently. Inflation will likely remain above (but approaching) the Fed's target of 2% through 2024, reflecting persistently higher service price inflation, even as goods prices ease modestly (see chart 7).

Chart 7

### Core PCE inflation and major components

We assume the monthly sequential growth averages of the components return to 2000-2019 averages




Sources: Bureau of Economic Analysis; Jordan Rappaport, Andrew Lee Smith, Shu-Kuei X. Yang (2024), and the Federal Reserve Bank of Kansas City; and S&P Global Ratings Economics' calculation assuming monthly price gains of the three components follow 2000-2019 average starting March.

In this light, we believe the Fed won't cut its policy rate until July, with three cuts totaling 75 bps this year. In our base-case forecast, we expect sharper rate cuts of 125 bps next year, but there are risks that could slow the pace of total easing in 2024 and 2025.

Weakness has been rolling from sector to sector, and we think it's likely to move to services sectors through the year. We continue to expect the economy to transition to below-trend growth as the year progresses, even as it avoids a recession. We forecast GDP growth of just 1.5% next year.

We've seen some normalization of measures of labor market churn. Layoffs, the quit rate (when workers leave of their own volition), the hiring rate, the labor participation rate, and the ratio of job openings to unemployed workers are now at or near 2018-2019 levels. And more of the jobs added are coming from acyclical sectors (such as health care, education, and public sectors), even as the overall pace of layoffs remains subdued.

## Canada

**We've nudged our full-year 2024 GDP growth forecast for Canada higher, to 0.9%—up from the 0.7% we forecast last November**. However, we continue to believe near-term economic expansion will be sluggish before strengthening in 2025. In short, we don't see a sustained pickup in growth momentum until the Bank of Canada (BoC) begins easing monetary policy (later this year, in our view). At its March policy meeting, the BoC kept the overnight rate unchanged at 5% and maintained its messaging that the path of inflation remains the key factor in its deliberations, even though the economy has weakened considerably.

Since the beginning of the year, headline unemployment has risen by a 0.8 percentage point to 5.8% in February, which is partially due to an increase in the number of people in the labor force, fueled by a growing immigrant population. Employment gains have been muddling through just about the pre-pandemic average after a sharp slowdown in private sector hiring in early 2023, with job creation lagging population growth for 13 straight months.

As more people join the labor force, unemployment will likely increase further. We see headline unemployment at 6.3%, on average, by the fourth quarter—above last year's average of 5.4%. Wage growth has slowed a bit as well, up 5% year-over-year in February, compared with 5.3% in January and 5.7% in December. We expect that trend to continue as the labor market loosens further.

# Financing Conditions

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- Recent market optimism has caused spreads to tighten to near lows reached before the Global Financial Crisis (GFC) in the U.S., particularly for speculative-grade bonds; leveraged loan issuance has rebounded.
- That said, most issuance has been used for refinancing, and previous market expectations for six Fed rate cuts this year have been dialed back.
- It's becoming more likely that interest rates will remain higher than expected for longer than expected, keeping the default rate on a rising trajectory in the near term, despite otherwise solid economic trends.

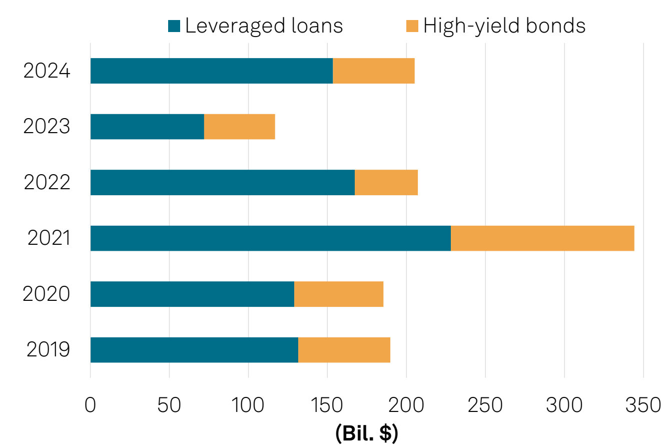
**Markets began the year on a wave of optimism amid economic resilience in the U.S.** Aggregate bond spreads for speculative-grade debt have retreated to rougly 250 bps—a low not seen since before the GFC.

**With spreads so low, issuers took advantage of some of the most favorable pricing in a while** (see chart 8). Combined leveraged loan and high-yield bond issuance has rebounded sharply from last year at this time, reaching $205 billion through March 15, from the $117 billion through the same period in 2023. This rebound isn't necessarily a boom of new issuance but rather a return to more typical levels around the $200 billion mark. Issuers used most of this issuance for refinancing as they contend with a large amount of maturing principal this year and next.

**It will be hard for spreads to remain so tight**. While some optimism is arguably warranted given the steady decline in inflation and strong economic growth, it will become harder for markets to justify such aggressive pricing ahead. For some time, our estimated spread has remained elevated relative to the actual (see chart 9), and is now roughly double the February average daily spread of 269 bps (compared with our estimate of 523 bps). Economic growth remains strong, but not across the board, while the Fed has been on a commited path to reduce the size of its balance sheet.

Chart 8

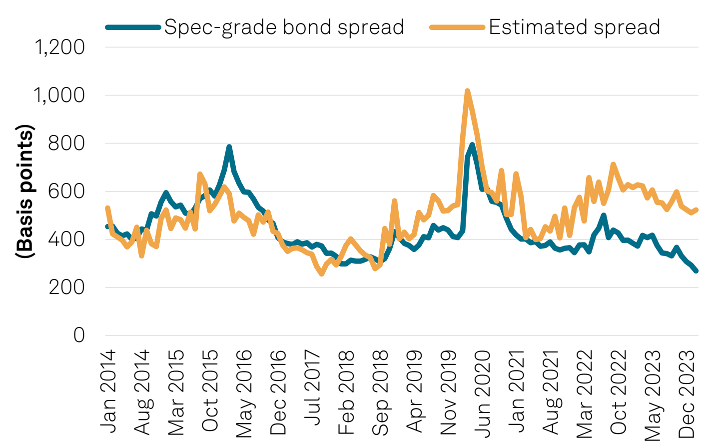
### Leveraged lending sees an initial rebound this year




Year-to-date totals through March. March 2024 through March 15. Sources: Refinitiv, Pitchbook LCD, S&P Global Ratings Credit Research & Insights.

Chart 9

### How much tighter can spreads go?




Sources: Refinitiv, CME Group, S&P Global Ratings Credit Research & Insights.

**Yields may only fall so far this year.** The all-in cost of debt remains historically high and stubbornly so (see chart 10). This is arguably the most protracted period that speculative-grade bond and loan yields have remained this high. Normally, once yields reach these levels (such as roughly between 8%-10% for 'B' bonds) they typically fall as quickly as they arrived. But this hasn't been the case since 2022's rate-hike cycle.

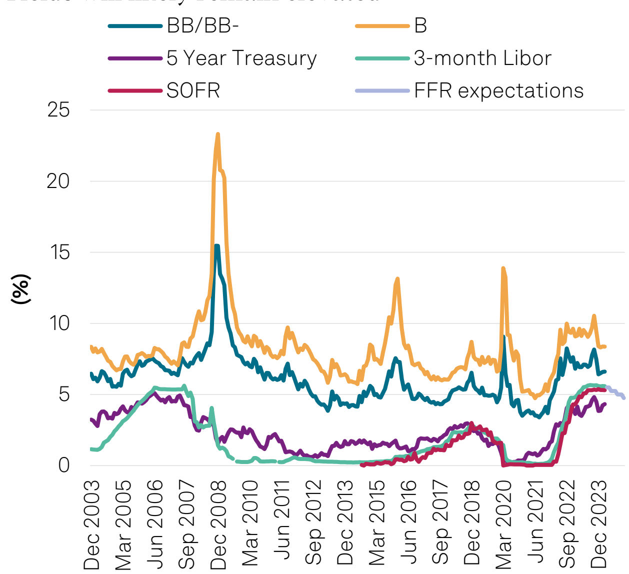
And expectations for rate cuts this year are being tempered quickly. At the start of 2024, markets had priced in a total of 150 bps in cuts to the federal funds rate through year end. The Fed's dot-plot and our own economists had expected a more modest 75 bps in cuts. Markets are now pricing in 75 bps as well, given the economic resilience so far this year, characterized by still robust labor markets and inflation rates falling at a slow pace.

**Robust issuance by the Treasury may also keep rates higher**. Corporate bond yields have fallen recently, but spreads are also being kept low by benchmark Treasury yields having fallen much more modestly. A significant contributing factor to recent Treasury pricing has been a large increase in the supply of outstanding debt (see chart 11). In the 12 months through February the volume of outstanding Treasuries rose 10.5%, to $26.8 trillion. By comparison, from 2013-2019, the supply of Treasuries increased an average 5.9% annually.

We expect policy rates to fall this year, but its unclear how much effective yields will fall. It's more likely that borrowing costs will remain historically elevated for a more protracted period, further stressing the large pool of low-rated issuers. Even with robust growth, higher borrowing costs have already produced more defaults and will likely keep defaults elevated.

Chart 10

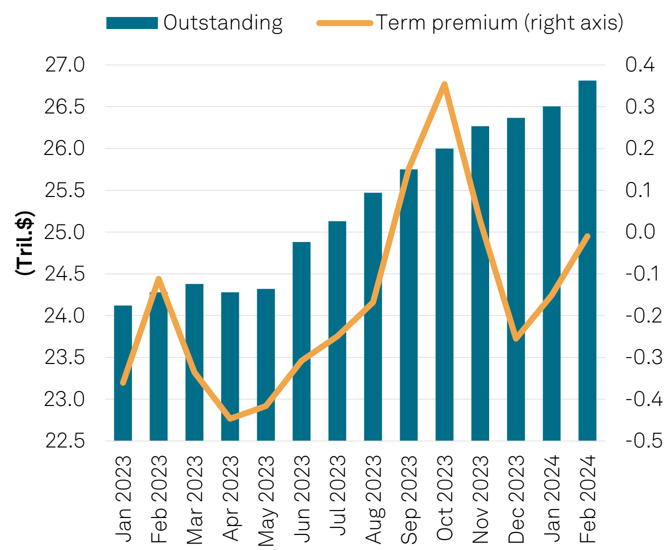
### Yields will likely remain elevated




FFR—Fed funds rate. Sources: S&P Global Market Intelligence, S&P Global Ratings Credit Research & Insights.

Chart 11

### Treasury supply could keep benchmark yields elevated




Source: Treasury Department; FRED; S&P Global Ratings Credit Research & Insights.

# Sovereigns

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- The November election season has begun, with U.S. President Joe Biden and former President Donald Trump set for a rematch, along with elections for 33 Senate seats and the entire House of Representatives.
- The composition of the next Congress will inform the prospects for policy outcomes; unified versus divided government tends to facilitate budget, government funding, and debt ceiling negotiations.
- We expect fiscal deficits will remain around current levels under any electoral outcome given political commitments not to reform mandatory spending, such as social security.
- The government is funded through September, and we don't expect 2025 budget negotiations to start until after the election—with passage of short-term continuing resolutions in the interim to preclude a government shutdown during the campaign.
- The next administration and Congress will need to address the debt ceiling, (which is suspended until January 2025) and the tax code (portions of the 2017 Tax Cuts and Jobs Act (TCJA) expires at the end of 2025).

**Congress isn't likely to undertake controversial legislation before the 2024 elections.** It just passed funding for fiscal 2024 ending Sept. 30, via individual appropriation bills, in line with top-line discretionary spending agreed to under the Fiscal Responsibility Act of June 2023. The process entailed some controversy, and recent efforts to secure a vote on a bipartisan immigration and border-security bill failed. That said, aid for Israel and Ukraine may come up for a vote in April. We don't expect any action on the president's fiscal-year 2025 budget or that presented by the House Budget Committee. Come September, we assume passage of short-term continuing resolution(s) to avert a government shutdown during the campaign period.

**While still seven months away, whatever the outcome of the election, the composition of Congress will continue to play a key role in determining policy.** Despite partisanship, political leadership has advanced policies where there is consensus or overlap in the priorities of the two parties. There is broad agreement on a tough stance toward China (both economically and strategically) and some overlap on the use of subsidies and tax breaks to promote certain industries deemed to be strategic, as well as infrastructure spending. On trade policy, the president has latitude to make changes under various executive authorities without Congressional approval. This contrasts with the review of treaties, such as the U.S.–Mexico–Canada Agreement and NATO membership.

**We expect the central government budget deficit to remain near current levels in 2024 and 2025.** This implies that the U.S.'s net general government debt is likely to approach 100% of GDP in the next couple of years. The debt ceiling is suspended until January, and we expect the next Congress and administration to act before the Treasury runs out of space to deploy extraordinary measures and remain below the debt ceiling. We also expect the next administration and Congress to take up discussions on the tax code. At the end of December 2025, key elements of the 2017 TCJA expire. Negotiations on extending certain provisions or letting them expire, and/or considering new tax policy will take center stage, as will the overall deficit path.

# Financial Institutions

- After the banking sector turmoil in 2023, we are shifting our focus to a possible rise in losses in banks' CRE loan books, mainly for regional and small banks with large exposures.
- Most rated banks have manageable CRE exposures, with office loans typically making up a low-single-digit portion of loans.
- We expect limited deposit growth in the first half of 2024 with an incremental rise in funding costs. As such, we expect net interest income to decline in 2024, albeit modestly.

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## Banks

**Stabilizing rates and expected cuts have somewhat eased the main concerns regional banks faced in 2023, namely the sharp rise in interest rates, asset-liability management, and declining deposits.** However, the focus is now a possible rise in losses in banks' CRE loan books, mainly for regional and small banks with large exposures. The issue has gained traction as delinquencies and criticized loans have risen and CRE loans begin to mature. A fourth-quarter loss at New York Community Bancorp. related to its need to build reserves on its CRE loan portfolio, added to our focus.

**In March, we revised the outlooks on five regional banks to negative from stable.** This mainly reflected the risk that deterioration in these banks' CRE portfolios could significantly hurt their asset quality and performance. In May and August 2023, we had also revised our outlook on two banks for reasons partially related to CRE. The ratings on nine U.S. banks, or 18% of the rated bank portfolio, now have negative outlooks, mainly reflecting CRE risk. The preponderance of stable outlooks reflects that although tough operating conditions continue, stability in the U.S. banking sector has improved since early 2023. Most rated banks have manageable CRE exposures, with office loans typically making up a low-single-digit portion of loans. We believe profitability will fall somewhat this year, largely due to an expected modest decline in net interest income and higher provisions, but we still expect the industry to post a decent 10% return on equity.

**Credit quality has normalized after a near-pristine period of very low problem loans and charge-offs.** It will likely continue to deteriorate, with CRE likely the main driver. Most banks' criticized loans and allowances for credit losses increased in the fourth quarter. We expect provisions and allowances to rise somewhat further, even assuming a relatively muted 2% loan growth, with net charge-offs climbing to 0.65% of loans. That would be above the roughly 0.5% charge-off rate banks have averaged over the last several years.

**We are focusing most closely on the rated banks with the largest CRE exposures (those with CRE loans exceeding 30% of their loans or 200% of Tier 1 capital).** Office exposures typically make up less than 10% of these banks' total loans and for the most part aren't located in the gateway cities that have seen the largest declines in office prices. However, they may not be entirely immune to asset quality deterioration, in our view. Furthermore, multifamily properties, which banks often lend against, have also suffered some price declines—albeit much more moderate than office—due to high interest rates and the high cost of running these buildings. This could weigh on asset quality within CRE loan books.

**Banks should be able to absorb much of those stresses through earnings retention and existing capital, but they are subject to vulnerabilities from a loss of confidence.** If a bank were to suddenly need to build a significant CRE reserve due to loan deterioration, it could dent a big portion of that banks' quarterly income—possibly resulting in a loss, which in turn, could result in customer attrition, including deposit outflows.

**Bank deposits increased in the fourth quarter (up more than 1%), but at the expense of higher funding costs.** Banks raised rates they paid to keep deposits as the deposit mix continued to shift to a growing reliance on higher-yielding deposits such as CDs and brokered deposits, combined with a reduction in noninterest-bearing deposits. Banks have also increased their wholesale borrowings to bolster on-balance-sheet liquidity and have increased the amount of assets they pledge, to be better prepared for liquidity needs. The resulting rise in funding costs has pressured net interest margins (NIMs).

**We expect limited deposit growth in the first half with an incremental rise in funding costs. As such we expect net interest income to decline, albeit modestly.** We expect capital ratios will continue to rise. This isn’t just a defensive measure by bank managements but also due to a likely tightening of capital regulation. For instance, regulators have proposed eliminating the ability of many large banks (more than $100 billion in assets) to exclude unrealized losses on available-for-sale securities from their capital ratios (note: the global systemically important banks and one other large bank already must count unrealized losses in their capital ratios). Positively, unrealized losses in banks' securities portfolios in the fourth quarter declined about 30% as long-term rates fell. Unrealized losses totaled roughly 8% of banks cumulative securities portfolios at the end of 2023, an improvement from a peak loss of 12% in the third quarter.

## Finance companies

**Our outlook is stable on approximately 78% of the North American finance companies (fincos) we rate.** Deteriorating asset quality, rising liquidity needs, stabilizing but reduced earnings, and higher funding costs continue to weigh on ratings. There likely will be an urgency to deploy capital this year that could influence underwriting standards, which in turn drive asset quality. We believe fincos with diversified revenue streams and sound balance sheets are best positioned to meet the challenges over the next year.

**We have one positive and 12 stable outlooks on business development companies (BDCs) we rate.** Financing conditions for broadly syndicated loan (BSL) and speculative-grade bond markets have improved. Tightening credit spreads along with investor appetite for risk, has allowed BSL markets to compete with direct lenders. We expect originations will rise as the pipeline of new originations regains momentum and as companies look to refinance upcoming maturities. We believe expected tighter banking regulations, direct lenders' ability to write larger checks, and rising club deals will continue to allow direct lenders to compete with BSLs.

Given aggressive rate hikes last year, we anticipate interest coverage ratios will decline further as many borrowers have yet to feel the rate hikes' full impact. While nonaccruals have modestly increased and remain low, payment-in-kind (PIK) income, as a percentage of gross investment income, has been elevated as interest coverage declined. We expect PIK income to increase for most BDCs in the next few quarters while borrowers continue to face liquidity pressures. That said, PIK income decreased for some rated BDCs in the fourth quarter.

**Challenging conditions persist for CRE lenders and services companies.** We expect lenders will continue to face headwinds, but the extent of the impact will depend on location, property type, and the underwriting quality on the properties securing their loans. To navigate through difficult CRE market conditions over the next year, CRE finance companies will, in our view, remain selective with originations and focus on preserving liquidity.

Of the six CRE lenders we rate, we have downgraded two by a notch and revised our outlook to negative on one issuer so far in 2024, reflecting substantial deterioration in asset quality and potential liquidity pressure. We think it's still likely that CRE finance companies' loan portfolios will deteriorate further, particularly those with high office exposures.

We've also started to see some strain in multifamily due to slowing rent growth and high interest rates. A rise in troubled multifamily loans could hit asset quality since most CRE lenders have increased their exposure to multifamily since 2020 as an offset against office exposure.

**From a refinancing risk and liquidity perspective, we expect fincos will have adequate liquidity to address debt maturities for the most part.** Amid the recent rally in interest rates and the continued tightness of credit spreads, the debt markets have been open for companies in certain sectors. However, any refinancing is at higher interest rates relative to their existing debt. We've seen an increasing level of distressed debt exchanges as companies refinance and will continue to monitor for such transactions as refinancing risk starts to rise in 2024-2025.

## Asset managers

**We expect rates to remain elevated in the near term, but upcoming rate cuts will improve asset managers' cash flow and EBITDA interest coverage.** Clarity on interest rates may also stabilize asset valuations, supporting deployment and realization activity for alternative asset managers. That said, the full effect of monetary tightening may not yet be reflected, and market volatility and a slowing economy could pressure both debt (public and private) and equity markets. But market dislocations offer both challenges and opportunities, as distressed valuations and the retrenchment of regional banks may grow the opportunity for deployment.

**Of the three subsectors, traditional managers are the most exposed to market volatility, and net outflows could compound this pressure.** Credit metrics weakened for some asset managers as earnings declined, and interest coverage has compressed for those with significant variable-rate debt exposure. We took several negative rating actions in the past 15 months, mainly due to higher leverage from declining assets under management and earnings. Wealth managers are similarly vulnerable, though for some their asset base may be stickier due to the relationship-based nature of the business and breadth of services provided.

**Alternative asset managers are the best-positioned of the three**, considering the generally locked-up nature of a large proportion their assets under management, solid records of performance and fundraising, diversified platforms, and dry powder available for deployment during market dislocation. But risks remain, as any material, protracted valuation declines could continue to delay realization activity and hit returns and overall performance, and fundraising could slow as limited partner investors reach allocation capacity (particularly in private equity).

**Growth in private credit has partially offset persistent headwinds for private equity.** Credit strategies have grown in the past few years and those asset managers that have developed broad credit platforms are well-positioned to take on new borrowers that banks may be shedding. Credit now consists of significant portion of assets under management for some issuers we rate, and we expect this strategy to drive growth for these alternative managers in the next few years. We have also seen traditional asset managers expand their private credit capabilities, intensifying the competition. Certain alternative asset managers are even fundraising for real estate, as they perceive growing opportunities.

**The sector has very little near-term debt maturities.** Many asset managers refinanced when capital costs were low. From a liquidity perspective, most issuers remain well-positioned, with few near-term debt maturities. A couple of managers we rate underwent distressed exchanges in the past few months. While we believe original investors weren't adequately compensated in these cases, post-transaction capital structures are stronger. We expect those with maturities in 2024- 2025 to have adequate liquidity to repay, or refinance with short-term debt, if they are unwilling to refinance with longer-term debt.

# Nonfinancial Corporates

- The earnings outlook for corporate borrowers is mixed for the balance of 2024, though slightly more positive than macroeconomic expectations would indicate.
- Media, chemicals, and health care have emerged as areas of credit-quality concerns.
- Significant ratings transitions have been driven by mergers and acquisitions (M&A) on the upside and debt restructurings on the downside.
- Potential shifts in government policies will have disparate and varying levels of impact on a broad set of industries.

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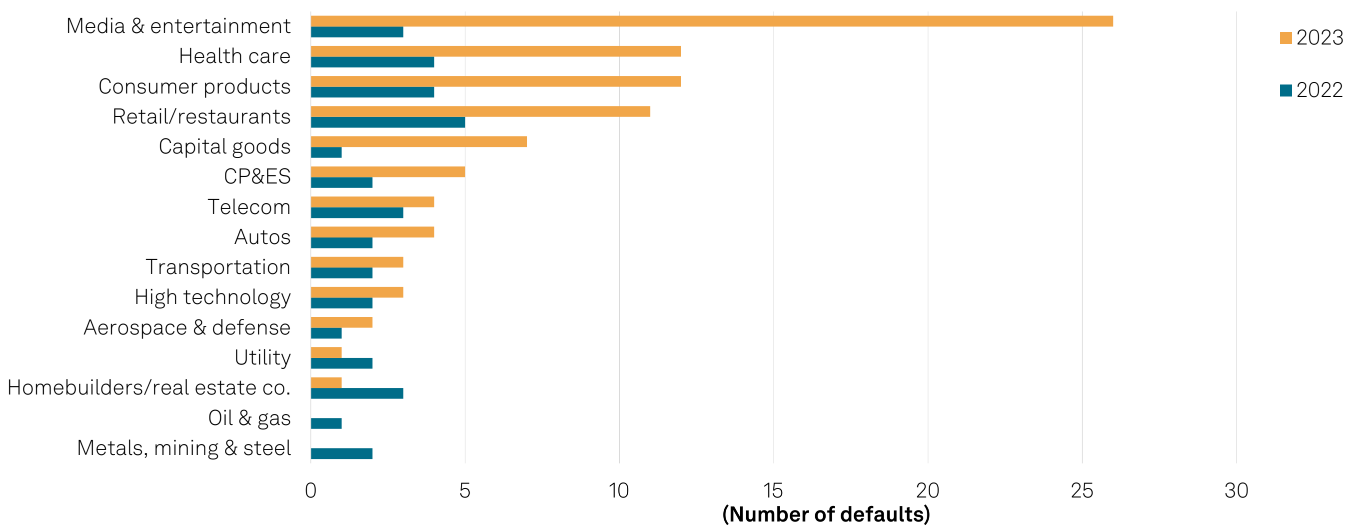
## More sectors come under pressure

**The media and chemicals sectors are entering the spotlight, with health care returning, as the latest industries to show signs of stress.** Media companies stand out with the highest number of defaults in the past year (see chart 12). The sector is broad and diverse, and while certain companies are benefiting amid favorable secular trends, others (those associated with legacy media, in particular) have suffered weakening operating metrics. Given high interest rates are most challenging for lower-rated issuers, and about 85% of our media portfolio is speculative-grade, the sector is showing more negative rating actions.

Chart 12

### Media and entertainment led defaults in 2023

Annual U.S. defaults by sector




CP&ES—Chemicals, packaging & environmental services. Source: S&P Global Ratings Credit Research & Insights.

U.S. health care companies are also struggling and lead in net downgrades in the past 12 months. The sector has been under pressure due to rising wages, but it seems that costs in general are now stabilizing. Unfortunately, the overhang of difficult operating conditions endures, and for the health care services subsector and borrowers near the bottom of the speculative-grade scale, relief is less likely to come before the second half of the year.

Finally, the outlook bias has turned sharply negative in the chemicals sector, driven in large part by a destocking trend on top of slowing economic growth—both of which have dampened demand.  Prospects will likely remain unfavorable until a balance returns to supply-demand dynamics.

## Significant rating transitions

**A return of M&A (with upside benefits) and increasing cases of selective defaults (on the downside) have driven the most significant rating actions in the sector.** The most significant upgrades have been driven by uplifts due to higher-rated acquirers. The oil and gas industry has been the biggest beneficiary of this trend, with Crestwood Equity Partners, Centurion Pipeline, NexTier Oilfield Solutions, BEP Ulterra Holdings, and PDC Energy all having been acquired in the past year in transactions that were associated with multi-notch upgrades. Other multi-notch upgrades came from acquisitions in other industries, as well as various types of external support from parent or investor entities.

On the other end of the spectrum, default rates are holding steady, with no signs of returning to lower 2022 levels. These defaults are overwhelmingly due to restructurings resulting in selective defaults, which made up more than half of all defaults in 2023. While our expectations for defaults among speculative-grade ratings are marginally lower compared with our last forecast, we still expect the default rate to rise 25 bps through the year, to 4.75%.

## 2024 earnings may outpace economic growth

**We generally expect corporate EBITDA to grow faster than the U.S. economy.** At the beginning of the year, we forecast EBITDA for North American corporates we rate would grow a robust 9% on average. This would outpace broader economic expansion.

Nonetheless, a number of factors suggest outcomes may be mixed. First, the tail end of 2023 outperformed expectations. As a result, forecasts for the end of last year were probably below outcomes, which would have inflated growth projections. Second, despite some recent improvement, the outlook bias in the portfolio remains more negative compared with a year ago. Third, even if earnings do improve modestly, this doesn't necessarily preclude further credit deterioration at the lower end of the ratings scale. It's certainly true that the correlation between economic growth and earnings is complex, it can be relatively weak among niche sectors that don't mirror the broad economy and it can also display some leading and lagging earnings outcomes.

## Policy changes will have disparate effects on sectors

**The uncertainty from pending elections has spurred some issuers to tap the capital markets and lock in current rates.** Others are focusing on how they might contend with shifts in government policy and the related effects on their operating landscapes.

The fiscal spending related to legislation such as the CHIPS and Science Act and the Inflation Reduction Act remains significant. We believe these policies to have bipartisan support and therefore are less likely to change.

In our estimation, more isolationist trade policies and any international responses will most likely result in higher input costs for companies, higher costs for consumers, or both—with notable exceptions in domestic-oriented industries that benefit from some measure of protectionism. Given a renewed emphasis on chip manufacturing, the technology space will be a key area of focus as trade policy evolves.

A looser environmental stance that might open new lands for mining or lessen the restrictions or costs associated with transporting natural resources might benefit certain oil and gas or metals and mining companies.

Finally, if regulators are more open to large business combinations, sectors ripe for consolidation such as health care and pharmaceuticals may become more active on the M&A front.

# Public Finance

- U.S. public finance began 2024 with mostly stable sector views.
- Upward revisions to U.S. economic growth projections add to overall credit strength, even with higher interest rates and inflation creating some pressure.
- Proactive management and governance remain key to credit stability, particularly given the broad range of risks facing governments and not-for-profit entities, such as extreme weather events, cyberattacks, demographic shifts, and an ongoing labor force imbalance.

U.S. public finance sectors with a stable sector view are largely buoyed by solid revenue growth, healthy reserves, and the ability to absorb rising expenditures without hurting credit quality (see chart 13). Sectors with negative or mixed sector views still face pressure from labor costs, shifts in demand, or rate setting that can lead to an operating imbalance if not actively managed.

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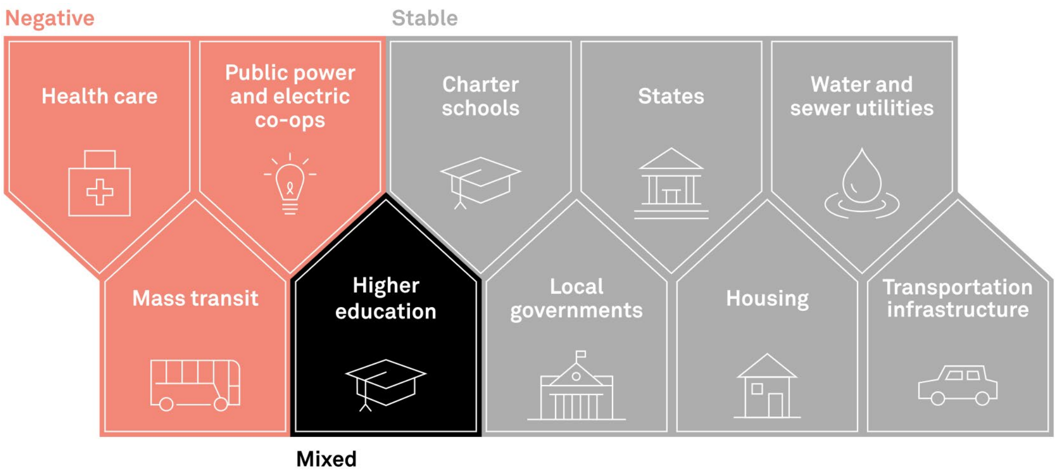
Chart 13

### U.S. public finance sector views for 2024




Mixed—some negative, some positive. Source: S&P Global Ratings.

**Credit issues that matter:**

- **Elevated interest rates.** A prolonged period of higher rates has led to lower issuance volume, particularly since some governments still have federal stimulus funds to spend. As rates fall, issuance may accelerate as the year progresses.
- **Inflation continues to create pressure.** Despite projections for cooling inflation, issuers must still grapple with rising infrastructure costs, particularly in capital-heavy sectors like transportation and utilities. The combination of elevated interest rates and construction costs could squeeze capital budgets and require some projects to be reprioritized.
- **Rising wages are an ongoing challenge.** Issuers across the country are still seeing budgetary pressures from high wages. While most can handle the strain without it affecting general credit quality, the not-for-profit health care sector is feeling it more acutely. For some issuers, it has led to credit deterioration and prompted the sector's negative sector view for the second year in a row.
- **Policy uncertainty.** In a presidential or gubernatorial election year, legislative action at the national and state levels can slow dramatically and be unpredictable. If any project funding or revenue enhancements are dependent on approval at a higher level to proceed, progress could be delayed until 2025.

# Structured Finance

- Higher benchmark interest rates and capitalization rates have weighed on asset valuations and heightened refinancing risk for most types of CRE/commercial mortgage-backed securities. We expect elevated downgrade activity to continue this year.
- For collateralized loan obligations, stress on highly leveraged borrowers from high(er) interest rates continues, but the pace of downgrades has been moderating.
- For U.S. structured finance overall, we generally expect stable or somewhat negative rating trends in the next 12 months.

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**We believe most sectors' collateral performances will be stable or slightly weaker** amid expectations for moderate GDP growth, contained unemployment, and likely short-term rate cuts in the second half (see table 1). The focus of the credit markets continues to be CRE—especially office—followed by certain segments of the consumer asset-backed securities (ABS) markets and collateralized loan obligations (CLOs).

Higher benchmark interest rates and capitalization rates have weighed on asset valuations and heightened refinancing risk for most types of U.S. CRE/commercial mortgage-backed securities (CMBS), especially those property types with slowing or declining rent growth. We see far higher stress on office loans/properties, where climbing vacancy rates, sparse leasing activity, and declining property cash flows are all resulting in significantly lower property values. We expect elevated downgrade activity to continue in 2024.

Table 1

### 12-Month North America structured finance outlook – Q2 2024

| | Collateral performance outlook | Rating trends |
|---|---|---|
| **Residential mortgages (RMBS)** | | |
| RMBS | Stable | Stable to positive |
| RMBS – service advance | Stable | Stable |
| **Commercial mortgages (CMBS)** | | |
| CMBS - N.A. conduit/fusion | Somewhat weaker | Stable to negative |
| CMBS - large loan/single borrower (retail) | Weaker | Stable to negative |
| CMBS - large loan/single borrower (lodging) | Stable | Stable |
| CMBS - large loan/single borrower (office) | Weaker | Negative |
| CMBS - large loan/single borrower (all else) | Somewhat weaker | Stable |
| **Asset-backed securities (ABS)** | | |
| ABS - Prime auto loans | Somewhat weaker | Stable to positive |
| ABS - Subprime auto loans | Weaker | Stable to negative |
| ABS - Auto lease | Stable | Stable |
| ABS - Auto dealer floorplan | Stable | Stable |
| ABS - Credit cards | Somewhat weaker | Stable |
| ABS - Unsecured consumer loans | Somewhat weaker | Stable to negative |
| ABS - FFELP student loan | Somewhat weaker | Stable |
| ABS - Private student loan | Somewhat weaker | Stable |
| ABS - Commercial equipment | Stable | Stable |
| Asset-backed commercial paper | Stable | Stable |
| **Structured credit** | | |
| CLOs | Somewhat weaker | Stable |
| **ABS - Esoteric** | | |
| Timeshares | Somewhat weaker | Stable |
| Small business | Somewhat weaker | Stable |
| Tobacco | Somewhat weaker | Stable to negative |
| Transportation - aircraft | Stable | Stable |
| Transportation - container | Stable | Stable |
| Transportation - railcar | Stable | Stable |

| | | |
|---|---|---|
| Whole business | Somewhat weaker | Stable |
| Triple net lease | Somewhat weaker | Stable to negative |

FFELP—Federal Family Education Loan Program. Source: S&P Global Ratings.

Regarding auto loan ABS, we see a bifurcation in performance between prime, where metrics are normalizing to prepandemic levels but remain generally strong, and subprime, which is still deteriorating. We note 2022 vintage subprime losses continue to underperform relative to historical standards. The first- and second-quarter 2023 vintages are performing relatively better than their 2022 counterparts, but high delinquencies may portend higher losses. Our rating outlook for prime/subprime reflects the differences between the performance in the two areas, with prime at stable to positive and subprime at stable to negative.

On the CLO side, stress on highly leveraged borrowers from high(er) interest rates continues, but the pace of downgrades has been moderating. In addition, the proportion of 'CCC'-rated assets has leveled off along with several other metrics ('B-', junior overcollateralization ratios), perhaps indicating a plateau. We generally expect rating stability in the sector, though we note that there may be downward actions, primarily for speculative-grade classes of CLOs issued before the pandemic.

For U.S. structured finance overall, we generally expect stable or somewhat negative rating trends in the next 12 months, with most rating actions in the speculative-grade classes (see table 1). We don’t expect risks to be uniform across sectors.

# Insurance

- Our outlooks on most of our ratings for the core insurance portfolio are stable, with an emergent positive bias for the property/casualty sector.
- We believe there is still broad access to capital for this mostly investment-grade portfolio of companies that in general aren't highly leveraged.
- Balancing out the positive factors for the industry are the potential effects of a slowing economy on insurers' investment portfolios—primarily the threat of increased defaults and downgrades in the corporate bond and loan markets.

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Overall, the average financial strength rating for the core North American insurance portfolio resides at the upper half of the strong ('A') category. Our outlooks on most (85% or better) of our ratings for the core portfolio are stable, with an emergent positive bias for the property/casualty (P/C) sector. We've updated our business conditions outlook for the P/C sector to somewhat stronger from somewhat weaker (see table 2).

Major ratings factors include pricing, interest rates, capitalization, escalating geopolitical tensions, and elevated catastrophe risk. We believe there is still broad access to capital for this mostly investment-grade portfolio of companies that in general aren't highly leveraged. Balance-sheet strength (influenced during the prior six-month period by interest rate stability and equity market appreciation) continues to underpin credit quality. Capital adequacy is reflecting relative improvement with the implementation of our new capital model.

Table 2

### North America insurance sector trends – Q2 2024

| Sector | Current business conditions | Business conditions outlook | Sector outlook |
|---|---|---|---|
| Life insurers | Satisfactory | No change | Stable |
| Health insurers | Satisfactory | No change | Stable |
| Property/casualty insurers | Satisfactory | Somewhat stronger | Negative |
| Global reinsurers | Strong | No change | Stable |
| Bond insurers | Satisfactory | No change | Stable |
| Title insurance | Satisfactory | No change | Stable |
| Mortgage insurers | Satisfactory | Somewhat weaker | Stable |

Note: Business conditions and sector outlook are for the next 12 months. The shaded cell indicates changes since Q1 2024.
Source: S&P Global Ratings.

## Life insurance

**The U.S. and Canadian life insurance sectors continue to benefit from the relatively stable interest rate environment**, with the 10-year U.S. Treasury rate fluctuating around 4% but not dipping down to the low levels of the long period prior to 2021. The rate environment is fueling historically high sales, especially of fixed-rate and fixed-index annuities, as well as some permanent life insurance products. Higher rates are also boosting profitability, due to better spread-based earnings. Inflation is on the decline and the threat of an outright recession in the U.S. has largely been supplanted by the expectation of a slowdown, both of which are good news for the life insurance sector.

Balancing out the positive factors for the industry are the potential effects of a slowing economy on insurers' investment portfolios--primarily the threat of increased defaults and downgrades in the corporate bond and loan markets, which make up the bulk of insurers' assets. Thus far, the impacts have been felt at the lower end of the speculative-grade spectrum, which life insurers have very little exposure to. Commercial mortgage loans, especially in the office sector, are another possible point of stress for investment portfolios, but we believe insurers will largely be able to absorb losses that may unfold in coming few years. Escalating geopolitical tensions are a wildcard that may ultimately affect the sector. We expect the trend of M&A of the past 18 months will continue, with more blocks of legacy businesses moving from public companies to private hands.

## Health insurance

**S&P Global Ratings holds a stable sector view on the U.S. health insurance industry.** Premium rate increases tied to medical-cost inflation will support healthy revenue growth. But the sector may see some moderation due to a softening economy, membership losses in Medicaid due to the ongoing impact of redeterminations, and Medicare Advantage rate pressures.

Greater earnings pressure exists within government lines, with Medicare Advantage exhibiting elevated utilization pressures arising from pent-up demand. In Medicaid, there's the potential for claims pressure from Medicaid redeterminations if there is a lag in rates being actuarially sound.

The commercial segment is also experiencing pockets of higher utilization, particularly within behavioral health and due to increased use of GLP-1 drugs for weight loss. The industry remains acquisitive, pursing both horizontal and vertical acquisitions. However, leverage and integration risks remain balanced by strong cash flows and the manageable tuck-in aspect of many deals. Health insurers are using M&A to strengthen core businesses, as well as to diversify into noninsurance lines, including primary care, home health, and health care technology. These noninsurance lines can help to provide better control of medical and administrative costs as well as unregulated cash flows, which can be useful for financial flexibility and capital deployment.

## P/C

**S&P Global Ratings' view on the U.S. P/C sector remains negative**, notwithstanding a significant shift in our distribution of ratings outlooks attributable to the recent implementation of our new capital model criteria. The fundamental reasons for our negative sector view remain in place, most notably the weak underwriting results in personal lines.

Overall underwriting performance for P/C insurers in 2023 was again negative, and the record divergence in the performance between insurers writing predominantly commercial lines and those writing personal lines remained. Strong rate momentum for most commercial lines continues to match or exceed loss cost trends, resulting in very good underwriting profitability for insurers in that sector. Offsetting the strength in commercial lines has been the continued weakness in personal auto due to a sharp increase in claims costs that began in 2021. In addition, catastrophe losses remained elevated in 2023, hurting the results of homeowners' insurers.

Personal auto insurers have pursued rate increases, and their results began to improve last year, with further improvement expected. We believe the industry's 2023 combined ratio was around 103% and expect this measure to improve to the 100%-102% range this year. Capital improved in 2023 as unrealized losses on bond holdings recovered somewhat and growth in retained earnings. Further improvement in capital adequacy, together with a sustained improvement in personal lines underwriting performance, could lead us to revise our sector view back to stable.

## Global reinsurance

**In general, reinsurers have moved past their lackluster operating performance of the past few years.** They didn't earn their cost of capital in 2020-2022, but they're expected to do so in 2023-2024, with support from strong earnings. Therefore, we maintain our stable view of the global reinsurance sector after we revised it from negative in September. Capacity was more available during the Jan. 1, 2024, renewals for short-tail lines (property and property catastrophe) compared with 2023. Reinsurers had more of an appetite for writing more business given the still-favorable pricing environment and the capital positions that they have rebuilt thanks to strong earnings in 2023, as well as the unwinding of unrealized investment losses coupled with higher investment yields.

Still, the industry remains concerned about elevated natural catastrophes, and casualty lines, which saw pressure from reinsurers as increasing worries about the impact of economic and social inflation on loss reserve adequacy and loss experience influenced renewal negotiations. In response to the inflationary environment, some reinsurers strengthened their reserves last year. Overall, reinsurance demand is increasing, with reinsurers generally maintaining underwriting discipline. This should sustain pricing momentum.

## Bond, title, and private mortgage insurers

**While new issuance in the U.S. public finance market was relatively low, bond insurers experienced an overall increase in gross insured par.** Supporting this was strong demand in the secondary market. We expect demand will remain high given wider credit spreads than in past years and economic uncertainty. Insured issues within the USPF market represent more than 90% of total par insured by the bond insurers in recent years with the underlying credit quality of the insured issues remaining at 'A'/'A-'. While pressures related to inflation or lower consumer spending could affect collections of economically sensitive revenues, bond insurers' underwriting strategies and conservative capital management support the potential growth in exposure.

The overall profitability and financial strength of the title insurers depends on their ability to manage operations throughout the mortgage and economic cycles, as well as employ proper risk and underwriting controls during periods of high business volume. Title insurers' efforts have served them well as pre-tax margins are strong. Macroeconomic uncertainty, high interest rates, and low inventory continue to be key factors that have seen existing home sales fall. These factors shape our view that business volume will be little changed from last year. However, capitalization in the title sector remains robust, benefiting from low losses and a profitable business. Title insurance results have remained strong across all rated insurers with each proving successful at expense control with a solid set of risk-tolerance standards.

The private mortgage insurers (PMIs) continue to benefit from a still resilient U.S. economy, with a relatively strong labor market. Mortgage delinquencies remain low, and cure rates continued to mitigate losses from new delinquencies in 2023. Home prices increased 5.5% last year, according to the S&P Case Schiller Index, supporting the substantial home equity cushions that will help reduce losses for PMIs in stress periods.

High mortgage rates have significantly reduced refinancing originations and have kept affordability constrained, outpricing many first-time homebuyers. As a result, mortgage originations have slowed considerably, resulting in tepid new premium volumes, offset by high persistency levels (lower lapse rate in current portfolio). Last year, PMIs profitability remained robust, continuing to benefit from the release of the pandemic loss reserves as those borrowers restarted making mortgage payments. However, our view on prospective profitability is tempered by potential economic headwinds, particularly if unemployment rises. Mortgage delinquencies could increase and result in elevated losses. Therefore, we expect the sector's combined ratio in the range of 50%-55% in 2024-2025. While underwriting losses are expected to increase, we believe they will be contained within PMIs' earnings.

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# Appendix 1: Nonfinancial Corporate Sectors Outlook

For analytical contacts, please see Appendix 3.

Table 3

## North America nonfinancial corporate sectors outlook

| Sector | Comment |
|---|---|
| Aerospace and defense | The outlook for commercial aerospace remains generally stable, as the unprecedented strength in demand for new aircraft and engines has been overshadowed by well-documented production issues and supply constraints. Airlines remain intent on replenishing and expanding fleets with more modern, fuel-efficient aircraft, but widespread delivery deferrals are expected to continue at least through next year. The Federal Aviation Administration (FAA) has increased oversight of Boeing's quality procedures (following a mid-flight incident involving a door plug that blew off a Boeing 737 Max-9 fuselage) and capped production of the company's Max aircraft until its investigation is complete. Shortages of skilled labor and critical parts have exacerbated supply woes. Moreover, engine reliability issues remain an overhang, and have led to the parking of aircraft that has further limited maintenance capacity. However, the backlog of new aircraft orders extends into the next decade—in our view, supportive of an eventual rebound in profitability and cash flow as productivity across the broader sector improves.<br>For defense companies, ratings should also remain mostly stable through next year. A higher U.S. defense budget in 2024 (3%) and growth in spending by European allies are key assumptions that should support steady revenues. The looming U.S. presidential election poses a degree of uncertainty regarding future spending, but is unlikely to cause disruption to defense suppliers. We expect spending growth to flatten relative to recent rates regardless of the outcome. Shareholder returns will remain more pronounced relative to the broader commercial aerospace sector and supported by steady cash flow but pose downside rating risk to certain higher-rated issuers. |
| Autos | After stronger-than-expected auto sales in the U.S. in 2023, we expect the momentum to brake modestly. We expect flattish volumes in 2024 with sales failing to recover to pre-pandemic levels by year-end 2025. Production discipline and strong pent-up demand from fleet operators led to stronger-than-expected pricing in 2023, but we expect about a 10% decline through 2025. Rising inventories for several electric vehicles and plug-in hybrids indicate slowing demand.<br>We expect modest credit deterioration in the auto sector, particularly for some lower-rated suppliers. Credit metrics will gradually stabilize by late 2024 as most companies (especially those rated 'BB' or below) will look to preserve liquidity in line with pre-pandemic levels and limit large, debt-financed acquisitions. Given the United Auto Workers (UAW) strike, credit metrics deteriorated somewhat in the fourth quarter, but our ratings incorporate some short-term fluctuation in credit metrics. We expect limited margin and cash flow improvement in 2024 due to higher interest rates and pricing pressure amid potential demand volatility as supply gradually normalizes. |
| Building materials | We expect the building materials sector to face modest pressure in the first half, with potential for improving in the second half as an expected rate cut could drive a recovery in spending. Higher interest rates and lower housing turnover will continue to pressure spending on home renovation, although we expect aggregate demand to remain robust in 2024. On the cost side, headwinds remain as lumber prices have gone up and there is limited ability to pass on price increases given softer demand. |
| Business and technology services | Our sector ratings outlook bias is shifting increasingly negative, due to higher interest rates and slowing economic growth. This will weaken cash flows for several issuers and slow the deleveraging assumed in our ratings. Key risks include higher interest rates for most issuers, inflationary challenges, rising wages for labor-intensive operations, high gas prices for distributors, and cyber risk for some information, payment, and technology-service providers. Ongoing pressure on mortgage origination due to higher interest rates have negatively impacted cash flows for several issuers. Macro weakness weighs on spending, adding stresses to companies with exposure to SMEs (e.g., payment processors).<br>Larger investment-grade issuers are still fairly resilient. For most tech issuers and value-added resellers, we expect a return to growth in 2024 as many of their customers are still increasing IT spending year over year and the demand recovery is strong in areas such as digital transformation, public cloud migration, cybersecurity and automation. A lot of large clients have optimized costs through automation and vendor consolidation, which frees up budgets for executing more digital transformational projects in cloud and AI. Mortgage origination volume recovery due to lower mortgage rates, improved housing inventory—may help the year-over-year performance for a few issuers like Equifax, CoreLogic. Distributors, facilities maintenance providers, and software and information services providers are most vulnerable to downside risks. Conversely, we believe the impact on companies providing education and publishing services, security and safety services, insurance services and payment services will be minimal. |
| Capital goods | The credit outlook for capital goods is steady, as large backlogs and lower costs generally offset destocking amid easing supply chains, so that a large working capital investment for manufacturers are starting to convert into cash. Even if demand for capital goods declines because of destocking and slower order intake, we expect that credit quality can withstand a normal cyclical downturn because of persistently large backlogs on top of good earnings and lower debt leverage industry-wide in 2023. Demand in the U.S. is holding up well despite higher interest rates, as large fiscal incentives support increased investment in manufacturing, particularly for electronics capacity. The J.P. Morgan Global PMI Composite Output Index, produced by S&P Global, has risen quickly so far this year despite widespread destocking. This increase is the fastest rise since mid-2023. Demand remains strong for machinery, with high industrial output driving |

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| | replacement volumes, while onshoring and infrastructure investments lay a foundation of demand from longer-term projects. Commodities and energy costs are mostly lower, but labor costs are still rising as availability remains tight. Most of the negative ratings pressure in U.S. capital goods is concentrated in the 'B' category. Poor free cash flows in 2022, rising interest costs in 2023, and maturities in 2024-2025 are heaping credit pressure on a group of smaller companies that will need a big bounce in profits to improve ratios. About 45% of issuers in the U.S. are rated 'B' or lower, owing to a preponderance of financial sponsor-owned companies, often with weaker competitive characteristics or undergoing transformation through acquisitions. The negative outlook bias for this cohort is over 20% and pricing for many tranches of debt are well below par, indicating credit stress as maturities roll over unless earnings rise in the next two years. |
| Chemicals | In 2024 we expect a gradual recovery in demand because of a decline in the negative impact of destocking. We see this recovery becoming pronounced in the second half. The pace of recovery is likely to vary across subsectors. Ultimately, we don’t believe the recovery in 2024 will fully offset the decline in EBITDA in 2023. At this point about one-third of our outlooks are negative, reflecting in part the uncertainty related to the pace and extent of recovery. |
| Consumer products | The common theme across consumer staples is a focus on restoring volumes as consumers continue to exhibit price elasticity by trading down, de-stocking pantries, and deferring spending. Companies will pull familiar levers to drive volume growth: higher spending on advertising, innovation, and more promotional activity. Offsetting soft toplines will be lower cost inputs. Except for wages and pockets of still high inflation in commodities, costs have come down and will contribute to improving margins over the year. While financial markets and the operating environment remain uncertain, M&A is likely to be limited to portfolio refining rather than transformative. Still, companies that have capacity at their current rating could opportunistically pursue targets that would augment growth, a common playbook in the space. |
| Containers and packaging | As destocking is starting to run its course, we expect some earnings improvement for U.S. container and packaging issuers in 2024, with more meaningful growth in volumes in the second half. It seems that for most end-markets, the inventory overhang has been brought down, though lower consumption levels from a weaker consumer could continue to minimize recovery. Issuers continue to spend this downtime rationalizing their footprint, closing and/or idling less efficient capacity as new capacity comes online from previous investments. Packaging issuers continue to position themselves to serve many of their customer’s needs, including their sustainability goals, which can include initiatives such as lightweighting of materials, more easily recyclable packaging, and the use of more recycled content.<br><br>We expect issuers, particularly on the lower end of the ratings spectrum with tighter liquidity and cash flows, will keep acquisitions and capital spending to a minimum and manage costs until the sector reaches an inflection point. We still believe the highest risks for the sector are refinancing risks and interest rates remaining elevated, which will have a disproportionate impact on lower rated issuers. Still, most of the issuers we rate in the lower speculative-grade categories do not have long-term debt maturities due until 2026, which will give them some runway to navigate the current operating environment. |
| Gaming, leisure, and lodging | Leisure travel and spending remains relatively strong, and the trend toward experiences may be sticky, but a strained consumer hit by reduced savings and inflation could cause revenue in the sector to moderate. As a result, resilient leisure spending will be tested this year. With prices and rates high, consumers may look for bargains, causing travel and leisure spending growth to moderate. Higher labor and other costs could pressure margin performance. Cruise and Macao gaming are rapidly catching up with overall leisure sector. Full fleets are sailing, and China's reopening will remain an enormous boost to the Macao gaming market. M&A may restart as buyers may look past elevated rates or become flexible on how much debt to use to finance transactions. Still, if leveraging mergers and acquisitions occur in a slowing economy, leverage cushions could decline, and ratings could be pressured. Revenue per available room (RevPAR) growth in U.S. and European lodging will moderate this year, and regional gaming growth has slowed and performance across markets is mixed. Las Vegas continues to experience strong leisure travel, the convention and group market continues to recover, and a favorable sports and entertainment calendar in 2024 may provide some revenue tailwinds. |
| Health care and pharmaceuticals | Our healthcare services outlook remains negative, at least through the first half. Ratings deterioration continues as moderating but still elevated labor and supply costs, high interest rates, particularly at the highly-leveraged PE-owned healthcare services companies, and the impact of No Surprise Act and Medicaid redetermination process pressure cash flow generation. Labor pressures remain a long-term concern, given projected continued shortages in critical areas such as nursing, doctors, and other healthcare personnel, and healthcare hiring continues to outpace the broader market. We see potential for stabilization in the second half and expect ratings deterioration to moderate as Medicaid redeterminations run their course, the effect of the No Surprise Act lessens, and refinancing needs are addressed. Still, while ratings declines moderate, we may see more 'CCC' category companies as visibility on sustainability of cash flow generation remains low for a significant part of the sector and the reimbursement environment becomes more challenging going into 2025.<br><br>Our outlook for pharma remains stable; we see the full normalization of demand in 2024 after the return of patients and the rollback of COVID-related vaccines and treatments. M&A has returned to the industry after a muted 2021-2022, and we expect it to continue. We believe product pipelines and newer products, such as the GLP-1 weight-loss drugs, and still adequate pricing power will drive mid-single-digit and higher growth in 2024-2026. IRA Medicare Drug price negotiation goes into effect 2026, though early feedback is that the negotiations have been reasonable thus far. |
| Homebuilders | We expect better operating performance for U.S. homebuilders in 2024, with year-over-year growth in both revenues and EBITDA given the contraction in 2023 from sharp increases in mortgage rates. Fourth-quarter 2023 earnings were somewhat better than expected with revenue declines decelerating, and 2024 guidance from rated builders support a year of recovery in 2024. Demand is picking up while existing inventory remains low, which we expect will support a relatively stable average selling price (ASP). Shorter cycle times are enabling builders to prioritize returns through higher asset turns and builders are increasing spend to grow community count and capture share, driving revenue growth over |

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| | the next few years. Still, margins remain under some pressure given elevated incentives offered early in 2024 but should start to normalize in subsequent quarters as builders pull back on incentives as demand recovers. |
| Media and entertainment | Our sector outlook remains negative. The media sector continues to face near-term macroeconomic and political uncertainty and negative long-term secular pressures for non-digital legacy media. Advertising on legacy platforms continues to remain uneven due to secular challenges facing the broader industry and, to a lesser extent, fears of a second-half economic slump. Advertisers appear reluctant to launch new ad campaigns in the second half, given concerns around a potentially tense U.S. presidential campaign and election. We expect legacy media advertising to remain challenged through 2024, except for political advertising which will likely be at record levels. Linear television advertising, in particular, is in secular decline, and we expect the scope and scale of that decline will become clearer as the broader advertising market improves. The accelerating decline of linear television will be a drag on traditional media companies' earnings and will pressure them to increase the pace to streaming profitability to replace lost linear cash flow. On the other hand, the rebound in digital advertising, especially performance-related marketing, accelerated through 2023 and we expect it to return to a more normalized rate of growth (double-digit).<br><br>The landscape for streaming has drastically changed over the last two years as the fight to grow subscribers at all costs has dissipated and all major industry players have shifted their strategy to improving profitability. We expect this trend to continue as the streamers that are owned by legacy media companies raise prices and right-size content and marketing spending to quicken the path to profitability. This is an important year for legacy media companies to prove that streaming can be profitable. The rate of improvement will be important for media companies to improve credit metrics and to offset the secular challenges in the linear side of the business. |
| Metals and mining | A long cycle of improving credit quality has stabilized in metals and mining, and we recently had some high-profile downgrades after a two-year run of mostly upgrades. Lower metal prices in 2024 are still about 20% higher than before the pandemic, so that industry profits and cash flow remain generally good despite a price downdraft. On the other hand, depleting mine reserves, elevated operating costs, and relentless capital requirements to sustain output continue eating into the margins and returns of many metals' producers. Also, mines will continue to face various degrees of local pressure, including operating disruptions, changes to mining plans, and even forced changes in ownership. Capital restraint and healthy cash flow have bolstered financial capacity for large investments or acquisitions, and we expect that debt usage could increase to fund capital spending after several years of lower debt levels. Our metal price assumptions point to fairly steady profits and cash flow in 2024, after a sharp retreat from near-record levels in 2022. Cost pressures are eating into profits, but many of the industry's input costs for energy or consumables are generally correlated with metals' prices. Even with weaker sentiment and prices, output for many metals remains constrained by limited investment, declining ore grades, elevated energy costs, and unexpected operating disruptions. Capital spending restraint in recent years and a favorable long-term demand outlook could prompt more greenfield investment, especially as the world eyes nickel, copper, cobalt, and lithium for electrification. Steel and aluminum producers around the world have been improving credit quality for a few years, with a defensive trade moat around North America, while output remains constrained by unpredictable factors like energy availability, costs, and pollution controls. |
| Midstream energy | The North American midstream energy industry's credit quality continues to be resilient as it confronts higher interest rates, slower growth, and persistent regulatory, environmental, and social headwinds. Demand for natural gas and crude-based refined products has slowed somewhat, due to inflationary pressures and slower demand related to increased economic uncertainty. Cash flow generation remains robust, with a focus on infrastructure development in West Texas to increase egress to the Gulf Coast for export markets. The lack of egress out of regions like the Marcellus Shale, and the inability to build new pipeline infrastructure in many areas could limit production growth, which would ultimately affect midstream companies that rely on new well development. We expect consolidation to continue, with the larger, diversified companies at a distinct advantage; stronger balance sheets, more financial flexibility, and more bolt-on opportunities in their vast geographical footprints. We view the smaller more regional peers at a distinct disadvantage in this regard, which could result in more industry consolidation during the next few years. We expect modest capital spending increases, primarily among the large, diversified companies that are finishing multiyear growth initiatives or bolt-on organic growth projects. |
| Oil and gas | Oil prices have remained relatively stable, and we believe they should trade from $70-$90 per barrel. If not for OPEC cuts, the market would be oversupplied as total demand growth this year is likely to be met through non-OPEC production growth, particularly from the U.S., Brazil, and Canada. We continue to believe that OPEC, particularly Saudi Arabia, will remain supportive of prices staying above $80. Natural gas prices in the U.S. remain very weak due to a warm winter and production that remained stubbornly high. Inventory levels in the U.S. are at the five-year high maximum band and it's likely that gas prices will remain very low heading into the heating restocking season. We expect gas prices will begin to rebound on the second half and into 2025 as new LNG capacity begins to pull gas demand. We are more positive on long-term natural gas prices as LNG Gulf of Mexico buildout continues through 2028. |
| Oil refineries | North American refiners look set to have another good year. Margins remain above historical midcycle averages, albeit below the super-cycle peaks of 2022. In the second half of 2023 gasoline margins were weak, but we expect margins to improve as we come out of the slower-demand winter months. Diesel and jet fuel margins continue to be resilient on strong demand. We still forecast most refiners will generate EBITDA above their midcycle run rates. The underlying factors for margins remaining above midcycle are unchanged: relatively solid demand, higher crude prices, and lower inventory levels. Utilization rates are strong, and the ability to increase capacity is limited because refineries are running close to the peak capacity of about 18 million barrels per day. We expect refiners to shift from repaying debt to rewarding shareholders, mostly through share buybacks and higher dividends, while keeping higher cash balances for additional liquidity. Refineries continue to explore conversions of conventional capacity to renewable fuels such as renewable diesel and sustainable aviation fuel. |

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| REITs | Fourth-quarter 2023 earnings for rated U.S. equity REITs largely met our expectations with most property types showing resiliency in demand and positive, albeit slower net operating income growth. However, performance for the office REITs remains weak given pressure to occupancy and net effective rents in the quarter. Continued pressure from hybrid work is expected to weigh on office performance, and we assume a further 2-3% drop in occupancy while net effective rents decline modestly. Office leasing activity remains well below pre-pandemic levels and retention is also lower, with the West Coast market performing weaker than average. Refinancing risk remains significant given higher borrowing costs, valuation pressure and tighter lending standards by banks. |
| Regulated utilities | We recently revised the sector outlook to negative from stable, reflecting the increasing percentage of utilities with a negative outlook (about 28%). The industry faces rising physical risks from climate change and high cash flow deficits that may not be sufficiently funded in a credit-supportive manner. For the past four years downgrades have outpaced upgrades by more than three times. Given the relatively high percentage of companies with negative outlooks, we expect that 2024 will be the fifth consecutive year that downgrades outpace upgrades. To date the industry has already experienced 17 downgrades and only two upgrades. |
| Retail and restaurants | Consumers are stretched, trading down, dining out less frequently, and seeking value. Retailers cite a cautious consumer in their own guarded outlooks for 2024. Nevertheless, the pace of decline in some of the weakest areas, such as department stores, is slowing, suggesting 2024 could be a bottom. Similarly, rating actions have trended less negatively sequentially in the past several months. A handful of issuers have tapped receptive markets to address maturities, reprice, or issue incremental debt. We believe weakness will persist in areas that are discretionary in nature and categories that were hot during Covid or related to housing. |
| Technology | IT spending appears to have improved vs. 2023 to account for continued AI investments and a modest pickup in non-AI enterprise spend. While PC and smartphones sales cycles have bottomed but recovery has been weaker than expected. We see green shoots in improving sales conditions in areas such as servers, storage, software after a period of inventory digestion but networking and communication infrastructure, industrial, auto and consumer end markets are still highly sensitive to macroeconomic outlook which remains uncertain. We are cautiously optimistic about growth in 2024 as weakness in these areas recede and recovery resumes once excess inventory is worked off, coupled with increasing AI use cases that spur accelerated spending likely in the second half. Macroeconomic environment is key, as most of the tech sector serve enterprise and commercial business globally whose IT spending is highly correlated to global GDP. Deteriorating business environment and lower inflation would present revenue and margins headwind to tech vendors and service providers. Debt maturity in the tech sector is manageable over the next 12 months. Higher for longer interest rate and tighter financing would disproportionately affect our large number of issuers rated ‘B’ or lower as they tend to have significant variable debt outstanding, lower free-cash-flow/debt ratio and, for some, dwindling liquidity. |
| Telecom | Lower speculative-grade credits continue to be hurt by higher interest rates and elevated capital intensity. These companies lack scale to absorb higher costs and have a lot of exposure to floating rate debt. Conversely, we expect improving credit quality for the larger investment grade issuers that are modestly growing EBITDA while improving free cash flow. In wireless, we expect modestly slower postpaid net adds and service revenue growth will be more than offset by lower capex as the carriers wind down their deployments of mid-band spectrum. Wireline operators are scaling back their fiber buildouts somewhat given the high interest rate environment and leveraged capital structures while also looking at alternative financing sources such as ABS transactions to fund their fiber builds. Revenue and customer growth for U.S. cable providers has stagnated due to increasing broadband competition from fixed wireless access and fiber to the home, which could affect earnings growth. At the same time, these companies are upgrading their networks to offer faster data speeds, which will increase capex and contribute to lower levels of free cash flow. |
| Transportation | The outlook for the airline industry is mixed. Network carriers are poised to generate another year of solid operating results while most smaller carriers face heightened ratings pressure. We assume passenger demand will remain strong and support relatively stable/favorable average prices and modest capacity growth (following a sharp increase in 2023). Robust international travel demand, and higher-margin premium product and loyalty programs have become competitive advantages for the network carriers and should mitigate the impact of structurally higher labor costs on margins. Conversely, smaller airlines face the prospect of free cash flow deficits and declining liquidity, with greater relative exposure to industry-wide capacity constraints (namely aircraft delivery delays, engine reliability issues, and pilot shortages).<br>Our outlook for freight-related companies is generally unchanged, and the majority of ratings are expected to remain stable. On one hand, we are encouraged by our recent economic forecast that includes growth in the goods-based economy this year. We believe this lends support to our expectation for modest volume growth for the railroads and package express companies in 2024 (following pressure last year, particularly in the railroad intermodal segment). Certain railroads have also taken steps to limit share repurchases in order to preserve credit measures, consistent with their stated financial policies. On the other hand, our outlook bias for the trucking and logistics industry, which primarily includes lower-rated issuers, remains negative. Excess truck capacity is showing limited signs of easing, and continuing low prices remain a key source of risk to cash flow. |
| Unregulated (merchant) power | A mild winter and gains in natural gas production have resulted in a significant decline in natural gas prices. Weakness across the natural gas curve pulled down power prices in all markets. Most of the impact will be felt in 2024 and less so in future years. While the natural gas curve has declined substantially (20% for 2025 since year-end 2022), the forward power calendar strip for 2025-2026 is only modestly lower than at year-end 2022. We see a drag in forward natural gas prices that are now below $4/Mcf through 2026. However, demand has exploded. Our view has been that shrinking baseload supply would tighten power markets, but the ramp-up in demand has happened faster than anyone expected. |

# Appendix 2: Economic Data and Forecast Summaries

Table 4

## U.S. – S&P Global Ratings economic outlook

| | 2023 | 2024f | 2025f | 2026f | 2027f |
|---|---|---|---|---|---|
| Real GDP (year % ch.) | 2.5 | 2.5 | 1.5 | 1.7 | 1.9 |
| Real consumer spending (year % ch.) | 2.2 | 2.3 | 1.9 | 2.0 | 2.3 |
| Real equipment investment (year % ch.) | (0.1) | 1.6 | 4.9 | 3.8 | 3.6 |
| Real nonresidential structures investment (year % ch.) | 11.7 | 4.8 | 0.9 | 1.3 | 0.1 |
| Real residential investment (year % ch.) | (10.7) | 3.0 | 2.1 | 2.2 | 2.3 |
| Consumer price index (year % ch.) | 4.1 | 2.8 | 2.0 | 2.4 | 2.1 |
| Core CPI (year % ch.) | 4.8 | 3.4 | 2.5 | 2.2 | 2.3 |
| Unemployment rate (%) | 3.6 | 3.9 | 4.2 | 4.2 | 3.9 |
| Housing starts (annual total in mil.) | 1.4 | 1.4 | 1.4 | 1.4 | 1.4 |
| Federal funds rate (%) | 5.0 | 5.1 | 3.7 | 2.9 | 2.9 |
| 10-year Treasury note yield (%) | 4.0 | 4.0 | 3.5 | 3.3 | 3.4 |

Note: All percentages are annual averages, unless otherwise noted. Core CPI is consumer price index excluding energy and food components. f—forecast. Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, the Federal Reserve, S&P Global Market Intelligence Global Link Model, and S&P Global Ratings Economics' forecasts.

Table 5

## Canada – S&P Global Ratings economic outlook

| | 2023 | 2024f | 2025f | 2026f | 2027f |
|---|---|---|---|---|---|
| Real GDP (year % ch.) | 1.1 | 0.9 | 1.5 | 2.2 | 2.1 |
| Real consumer spending (year % ch.) | 1.7 | 0.6 | 1.5 | 2.2 | 2.4 |
| Real nonresidential fixed investment (year % ch.) | (0.8) | 2.7 | 1.8 | 2.1 | 1.2 |
| Real residential fixed investment (year % ch.) | (10.2) | 1.2 | 2.8 | 5.1 | 2.2 |
| Consumer price index (year % ch.) | 3.9 | 2.5 | 2.3 | 2.1 | 2.0 |
| Core CPI (year % ch.) | 3.9 | 2.6 | 2.1 | 1.9 | 2.0 |
| Unemployment rate (%) | 5.4 | 6.1 | 5.7 | 5.5 | 5.4 |
| Housing starts (annual total in thousand) | 240.8 | 210.1 | 210.4 | 215.5 | 213.2 |
| Bank of Canada policy rate (% year-end) | 5.0 | 4.3 | 2.8 | 2.8 | 2.8 |
| Government of Canada 10-year bond yield (%) | 3.4 | 3.4 | 3.1 | 3.0 | 3.2 |
| CAD/USD exchange rate (per US$1, period average) | 1.35 | 1.32 | 1.28 | 1.28 | 1.28 |

Note: All "year % ch." are annual averages percent change. Core CPI is consumer price index excluding energy and food components. f—forecast. Sources: Statistics Canada, Bank of Canada, S&P Global Market Intelligence Global Link Model, and S&P Global Ratings Economics' forecasts.

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