S&P Global Ratings

Global Credit Conditions Q2 2024

Between Economic Resilience And Market Exuberance

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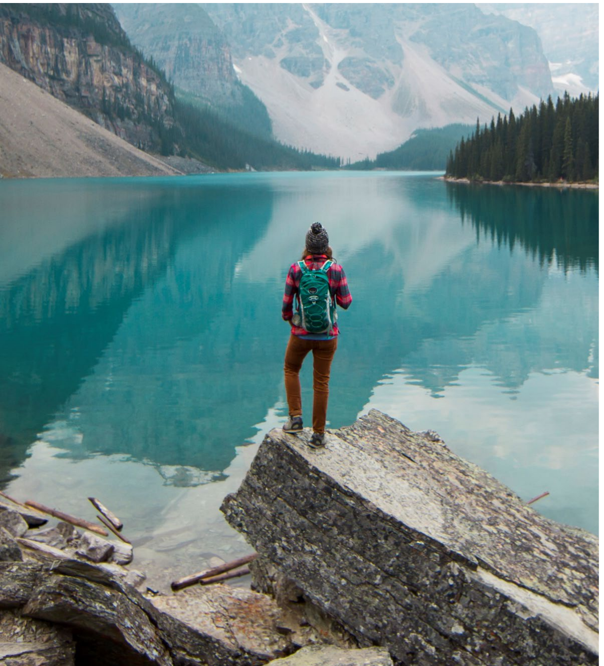
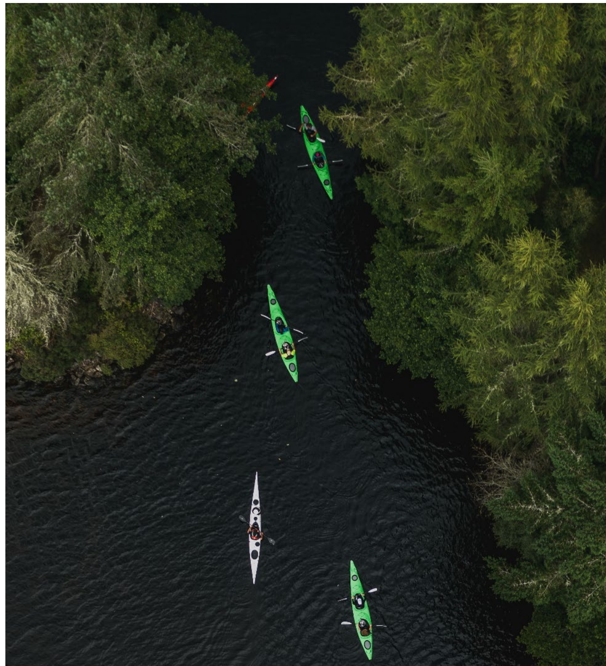
This report does not constitute a rating action





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, which cascade into our global coverage. Discussions center on identifying credit risks and their potential rating impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the Global Committee on Mar. 25 2024.

Contents

Key Themes

Resilience: Most economies maintained better-than-expected growth in 2023, helping offset the negative impact of persistently higher interest rates.

Defaults to peak around the fall: Defaults will remain near current levels by the end of the year after peaking around Q3. Softer economic growth and still-elevated interest rates will pressure low-rated corporates in consumer-related sectors and emerging markets. Early 2024 has provided an opportunistic window for issuers to refinance debt, albeit at noticeably higher rates.

Risks remain high: A more severe economic downturn, a longer-than-expected period of high rates, a worsening geopolitical landscape, and challenges for China could derail our base case and lead to weaker business activity and market liquidity.

A new playbook: Tight financing conditions, heightened geopolitical risks, new challenges from climate-related risks, and accelerated technology transformation will require new approaches from governments and corporations.

Global credit conditions: key highlights

Slower GDP growth in 2024

Global: **3.2%**

U.S.: **2.5%**, eurozone: **0.7%**, China: **4.6%**

Persistent inflation 2024

Core CPI inflation (Q1 Jan-Feb YoY % change)

U.S.: **3.8%**
eurozone: **3.2%**
U.K.: **4.8%**

Higher for longer

4.6%

median estimate for Fed Funds Rate at end of 2024*

Diverging negative outlook bias

As of Mar. 15, 2024

Investment-grade: **10.1%**
Speculative-grade: **19.4%**
'B-' & lower: **36.6%**

'CCC+' and lower

All corporates (% of all spec-grade)
As of Feb. 29, 2024

Global: **10.1%**

U.S.: **12.2%**
Europe: **10.0%**
RoW.: **6.2%**

Corporate debt

As of Jan. 1, 2024

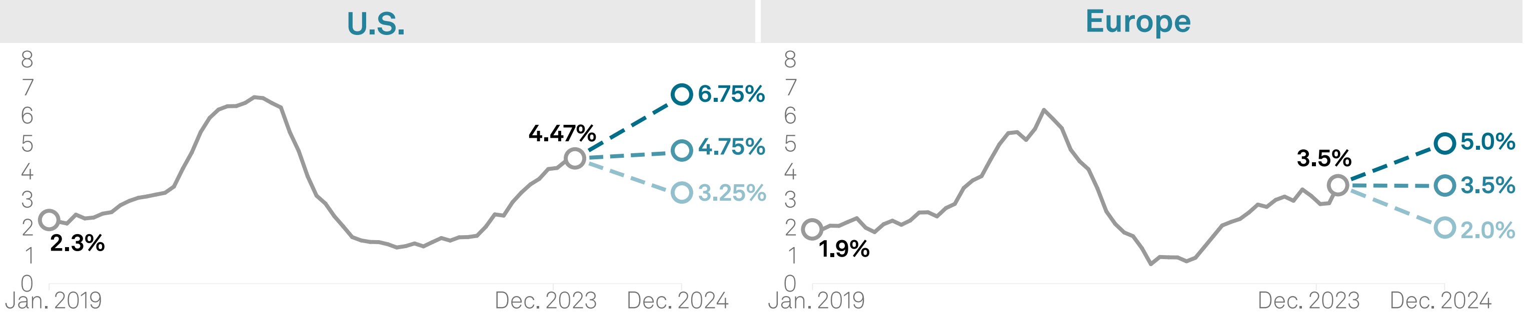
$1.2 tril.

rated 'B-' or lower and

80%

due through 2028

Trailing-12-month speculative-grade default rate and December 2024 forecast



*Based on March dot-plot and S&P Global Ratings economists. ROW--Rest of world. SG--Speculative grade. Source: S&P Global Ratings.

Most recent published default forecasts: "Default, Transition, and Recovery: U.S. Speculative-Grade Corporate Default Rate To Hit 4.75% By December 2024 After Third Quarter Peak," Feb. 15, 2024 and "Default, Transition, and Recovery: European Speculative-Grade Default Rate To Stabilize At 3.5% By December 2024," Feb. 16, 2024.

Global Top Risks: Geopolitical Risks Rise To The Fore

Geopolitical tensions threaten supply chains, trade, and market sentiment

Risk level:	High	Risk trend:	Unchanged

The protracted Russia-Ukraine war and a widening Middle Eastern conflict, plus the potential for a further escalation in U.S.-China tensions and domestic issues in certain emerging markets, could escalate and disrupt business activity, trade, supply chains, and investment flows--as well as increase financial market volatility. This year features over 70 elections in roughly 40 countries whose outcomes could add complexity to already strained international and domestic dynamics for many countries. Protectionism is expected to continue and, if heightened, would further constrain global trade and growth.

A sharper global economic slowdown would lead to greater credit stress ahead

Risk level:	Elevated	Risk trend:	Unchanged

Resilient economies--notably the U.S.--have reduced recession odds in recent months. But we expect most countries to see slower growth in 2024. Still-elevated interest rates and the lingering impact of permanently higher prices pose headwinds globally. Savings buffers have been declining and fiscal headwinds are also building, with many countries having taken on increased debt through the pandemic. Labor market resilience will remain a key headwind to any slowdown, but consumer confidence is showing some cracks.

Higher interest rates persist, straining many of the weakest borrowers

Risk level:	High	Risk trend:	Improving

Interest rate pressures are starting to decline in expectation that major central banks will start to cut rates later this year. But strong labor markets and the slow decline in core inflation among developed markets could delay or even derail central banks' efforts to cut rates this year. This would negatively affect market sentiment, which had already been pricing in deeper cuts than central banks' base cases. If the Bank of Japan were to raise rates more aggressively, this could eventually amplify market reactions and capital flows. Higher rates in developed markets would further burden emerging market debt, both directly and through unfavorable exchange rates on nondomestic debt.

China's economic slowdown could weaken global exports, pulling global growth down with it

Risk level:	Elevated	Risk trend:	Unchanged

China's growth is slowing, faced with weakening consumer and business confidence, weak exports, real estate sector troubles, and high leverage among corporations and local government financing vehicles. A slower growth outlook could worsen these headwinds. Given China's large proportion of global trade and demand, its slump could spread to multiple regions.

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.

Moderate	Elevated	High	Very high

Source: S&P Global Ratings.

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

Improving	Unchanged	Worsening

Global Top Risks (Continued)

Global real estate markets are facing multiple challenges

Risk level:	Elevated	Risk trend:	Unchanged

High interest rates, falling valuations and cash flow, hybrid work environments, and high leverage among some countries' homebuilders have combined to present numerous headwinds for both the commercial and residential real estate sectors, globally. These concerns are greatest within the U.S. office sector. Spillover effects from vulnerable real estate holdings could further affect many banking systems via falling asset values or increased writedowns. These pressures could also spill over to broader economies, transmitted through negative effects on consumer confidence, spending, and employment.

Climate risks and energy transition affect business operations

Risk level:	Elevated	Risk trend:	Worsening

Larger and more frequent natural disasters increase the physical risks public and private entities face, and threaten to disrupt supply chains, such as for agriculture and food. This may quickly become a headline risk in the near term as the El Nino phenomenon is expected to disrupt agricultural commodities this year, particularly among emerging markets. At the same time, the global drive toward a "net-zero" economy heightens transition risks (such as policy, legal, technology, market, and reputation risks) across many sectors and will likely require significant investments. The energy market disruption resulting from the Russia-Ukraine conflict, and concerns about energy supply and security, are adding uncertainty to this transition. In the U.S., we see transition risks as less acute currently than in Europe, since U.S. legislative policies focus more on subsidies and incentives rather than carbon taxes and trading. But policy and, hence, transition risks can shift over time as the climate emergency escalates.

Cyberattacks and the potential for rapid technological change threaten global business and government infrastructure

Risk level:	Elevated	Risk trend:	Worsening

Amid increasing technological dependency and global interconnectedness, cyberattacks pose a potential systemic threat and significant single-entity event risk. The Russia-Ukraine conflict is raising the prospect of major attacks. Criminal and state-sponsored cyberattacks are likely to increase, and with hackers becoming more sophisticated, new targets and methods are emerging. A key to resilience is a robust cybersecurity system, from internal governance to IT software, all requiring additional costs. Entities lacking well-tested playbooks (such as active detection and swift remediation) are the most vulnerable. Meanwhile, increased digitization and the introduction of AI by public and private organizations will foster broader operational disruptions, and potentially increase market volatility for short periods or even pose greater economic adjustments.

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.

Moderate	Elevated	High	Very high

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

Improving	Unchanged	Worsening

Source: S&P Global Ratings.

Economic Conditions

Still Resilient, With Gradual Rate Cuts Ahead

- The macroeconomic response to the higher rate environment is playing out largely as we anticipated (the U.S.' outperformance is the notable outlier) with slower activity and falling inflation pressures.
- Resilient labor markets, reflecting relatively strong services demand and hoarding of employees, have tempered the slowdown and helped avoid recessions, at least so far.
- We maintain our higher-for-longer view on policy rates and expect the first cuts around mid-2024 from major central banks. We expect subsequent cuts to be gradual as the road back to neutral will take time.
- Our baseline forecast has higher 2024 growth on the back of upward revisions to the U.S. and India and is predicated on labor demand remaining strong. Aside from sharply weaker services demand and a stronger U.S. dollar, geopolitics--including a spate of elections--pose risks.

See "Global Economic Outlook Q2 2024: Still Resilient, With Gradual Rate Cuts Ahead," March 28, 2024.

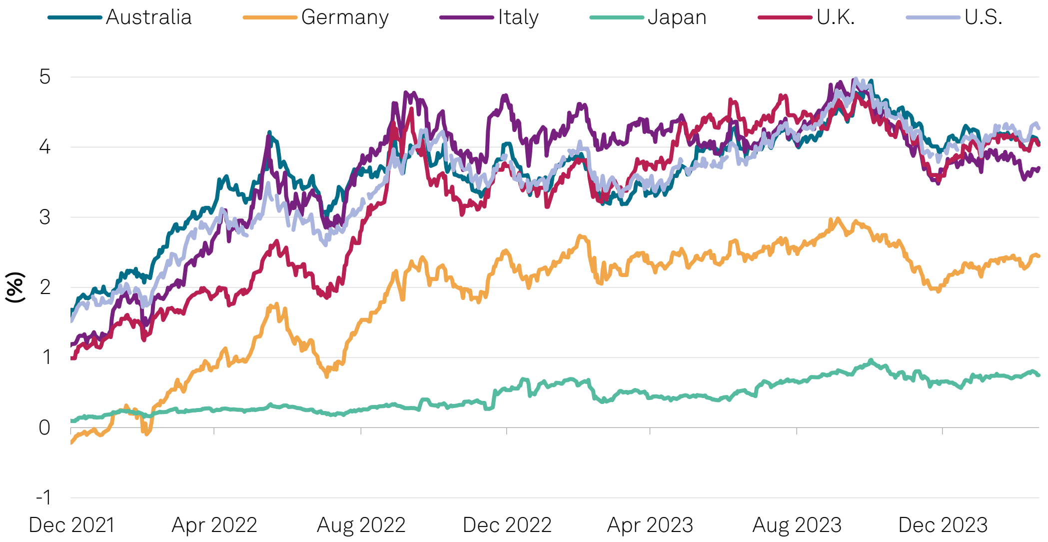
Inflation data as of March 2024. Policy rates as of December 2023. *Simple average. †Median for EM 18 countries. §Refi rate.
Source: S&P Global Ratings.

Financing Conditions

Higher-For-Longer Rates Expected, Even With Positive Sentiment Recently

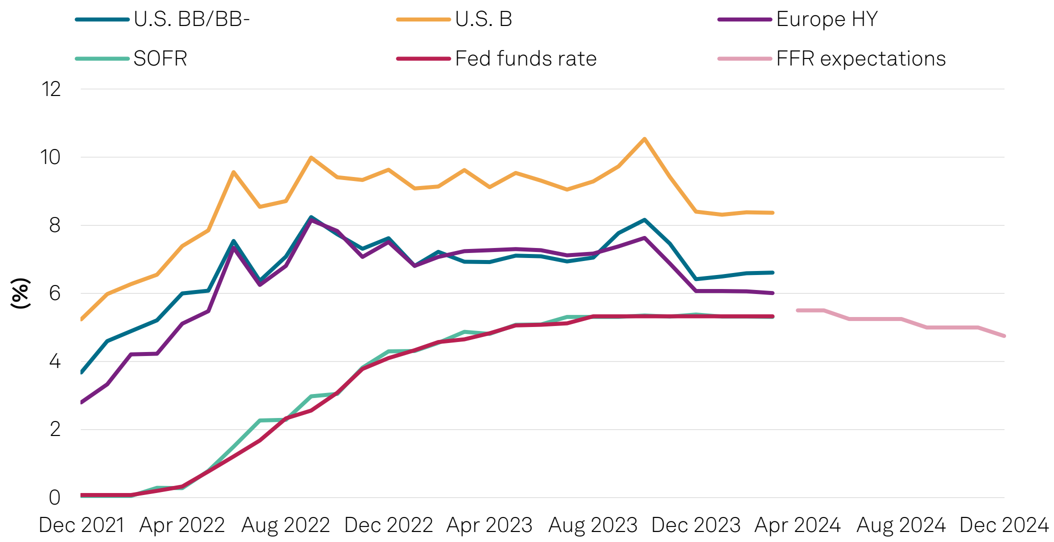
- Long-term yields (five-year maturities and longer) have fallen relative to the start of the fourth quarter but remain near rate-hike cycle levels.
- Broad consensus is that central banks will start cutting rates in the summer, but cuts will be somewhat measured this year, keeping policy rates higher than initial market expectations at the start of 2024.
- Core inflation in developed markets is falling but at a slowing pace, which, if continued, could complicate the path ahead for central banks.
- Corporate secondary bond market yields have already fallen in line with expectations for rate cuts this year, which could temper the extent of further declines. Meanwhile, loan benchmarks tend to track policy rates much more closely and should decline alongside second-half cuts.

10-year government bond yields fall in Q4, rise slightly in 2024



Data through March 18, 2024.
Source: S&P Global Ratings Research & Insights, S&P Global Market Intelligence.

Are three cuts already priced into the long-end for corporates?



Data through March 20, 2024. HY--High yield. FFR--Fed fund rate.
Sources: S&P Global Ratings Research & Insights, CME Group, and S&P Global Market Intelligence.

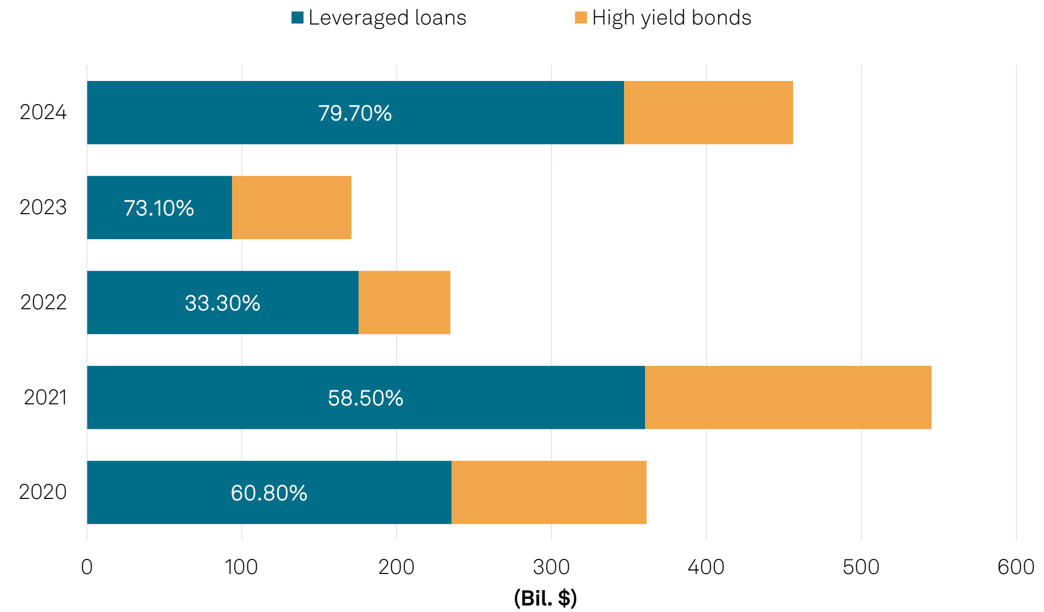
Pre-GFC Spread Levels Have Opened Opportunistic Window For Borrowers

- Demand for corporate debt remains high despite higher benchmark yields. U.S. speculative-grade bond spreads **hit an all-time low** on March 21 of 246 bps.
- Leveraged loan totals in 2024 thus far are close to the 2021 record pace, but most of this has been for refinancing--consistent with overall bond proceeds.
- Spread levels this tight have come before recessions in the past. While recessions look unlikely, markets may still be overly optimistic.

Global bond spreads tighten to multi-year lows

Data through March 18, 2024. bps--Basis points. EM--Emerging markets. HY--High yield. SG--Speculative grade.
Sources: S&P Global Ratings Research & Insights and ICE BofA Option-Adjusted Spreads.

Global Q1 '24 speculative-grade debt issuance dominated by refinancing



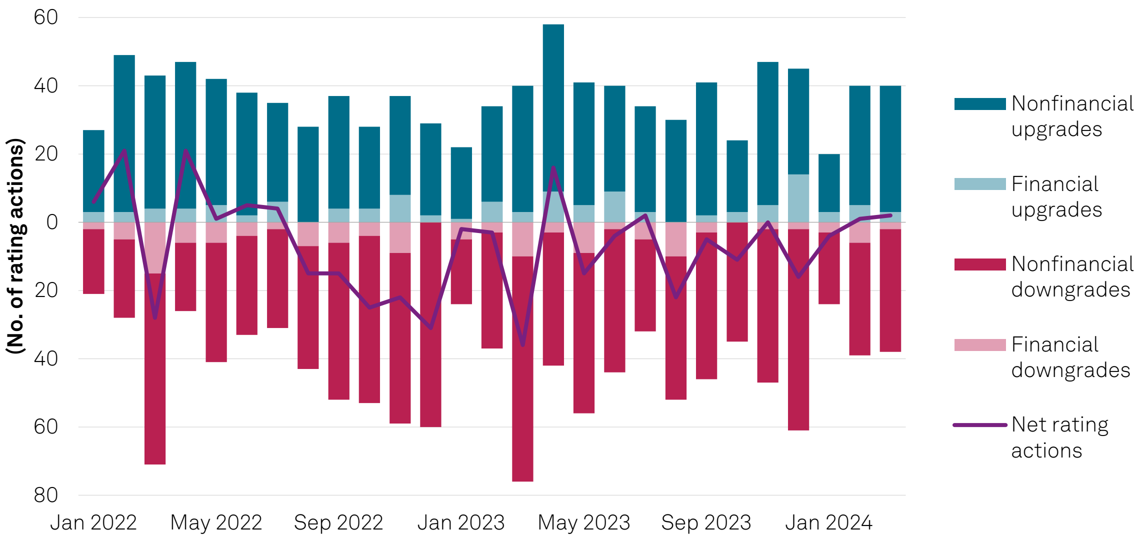
Data is year-to-date through March. Percentages show amount used for refinancing purposes of leveraged loans.
Sources: S&P Global Ratings Research & Insights' Pitchbook LCD, and Refinitiv.

Rating Trends And Expectations

Rating Actions Have Been Balanced In 2024, With Some Regional Dispersion

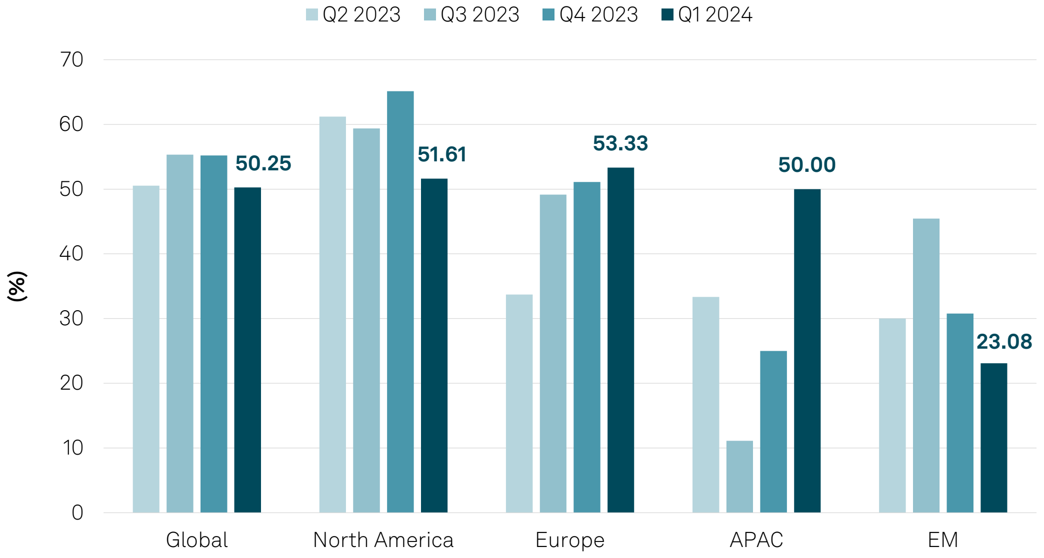
- The downgrade ratio in the first quarter was 50% but below parity in February and March, indicating a recent trend of improving credit quality.
- Given current risks, we anticipate a continued pace of slightly increased defaults as well as increased uncertainties ahead for speculative-grade issuers.
- Rating actions have been balanced in most regions but consistently more favorable for emerging markets (EMs) given their more manageable debt maturity schedule and relative strength of the corporate sector, along with substantial fiscal stimulus across the board. Continued disinflation should support an improvement in households' purchasing power, which should prop up domestic demand, further supporting EM corporate revenues ahead.

Net rating actions have been positive in February and March



Data as of March 20, 2024. Downgrades exclude defaults. Source: S&P Global Ratings Credit Research & Insights.

Downgrade ratios in Q1 largely balanced outside of emerging markets

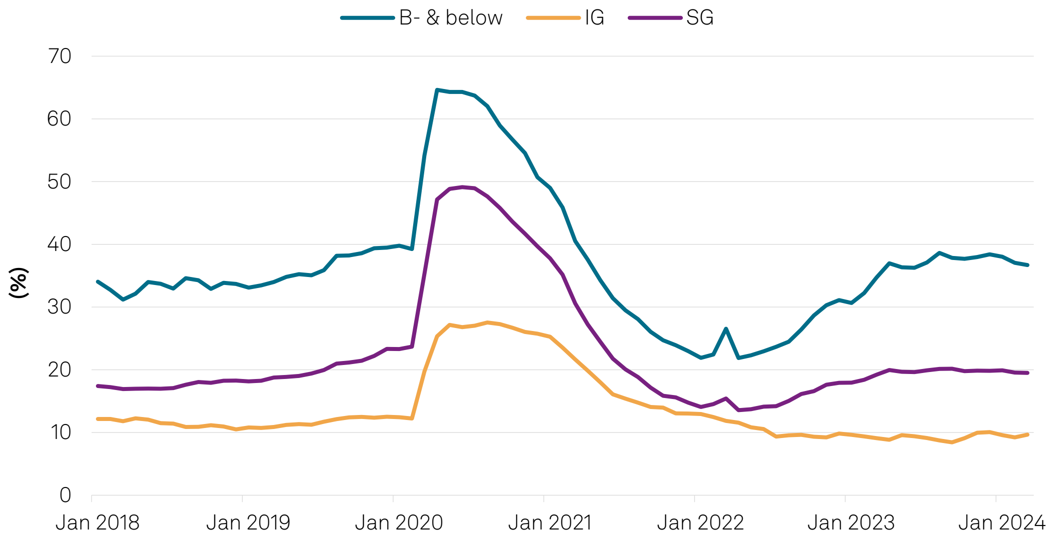


Data as of March 20, 2024. Downgrade ratios exclude defaults. Downgrade ratios include financials and nonfinancials. Source: S&P Global Ratings Credit Research & Insights.

Downgrade Potential Remains For Lowest Rating Levels But Has Eased

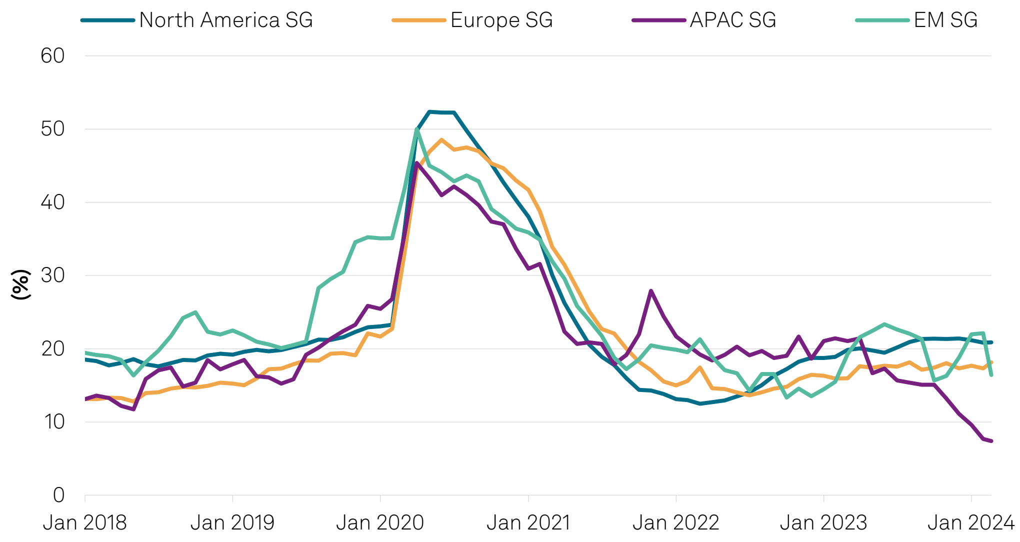
- Recent optimism and interest rate declines have eased some of the recent pressure on the lowest-rated issuers, which have seen a slight decline in their negative bias.
- Investment-grade companies remain on solid footing with a negative bias only slightly above its recent all-time low. Large buffers after the surge of pandemic-era issuance and more fixed-rate debt secured with very long maturities and low fixed coupons will provide tailwinds for an extended period.
- Regional differences in downgrade expectations are relatively small. Asia-Pacific is becoming an outlier, but after recent defaults among Chinese homebuilders, regional issuers turning to more onshore financing, and a rise in speculative-grade upgrades since mid-2021, the negative bias has fallen in recent months.

'B-' and below negative bias starts to ease



Excludes sovereigns. Data as of March 20, 2024. IG--Investment grade. SG--Speculative grade. Source: S&P Global Research & Insights.

Developed markets see higher and more stable negative bias



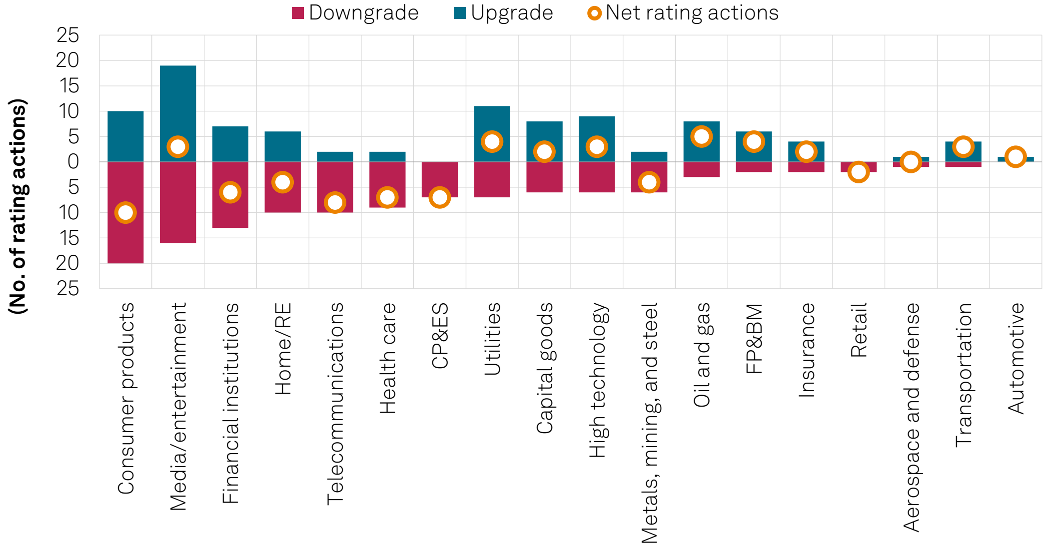
Excludes sovereigns. Data as of March 20, 2024. EM--Emerging markets. IG--Investment grade. SG--Speculative grade. Source: S&P Global Research & Insights.

Credit Deterioration Becoming More Focused At A Sector Level

- Media and entertainment led upgrades as leisure operators in developed markets have shown resilience in three of the past four quarters.
- Consumer products led downgrades, with most coming at the lowest rating levels. Conversely, homebuilders/real estate saw a higher downgrade ratio, which was driven by rating actions across the rating spectrum.
- Many sectors with higher downgrade rates recently also have some of the highest negative bias--indicating more downgrades are likely.

Both positive and negative rating actions were concentrated in consumer-reliant sectors

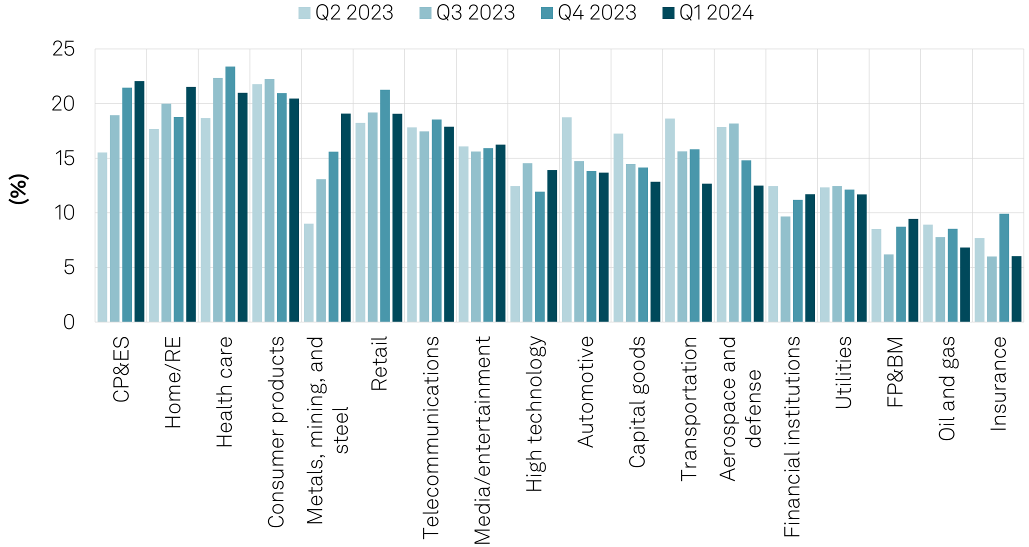
First-quarter 2024 rating actions by sector



Excludes sovereigns. Rating action data as of March 20, 2024. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. RE--Real estate.
Source: S&P Global Research & Insights.

Chemicals, homebuilders, and health care have the highest --and rising--negative bias

Sector-level negative bias

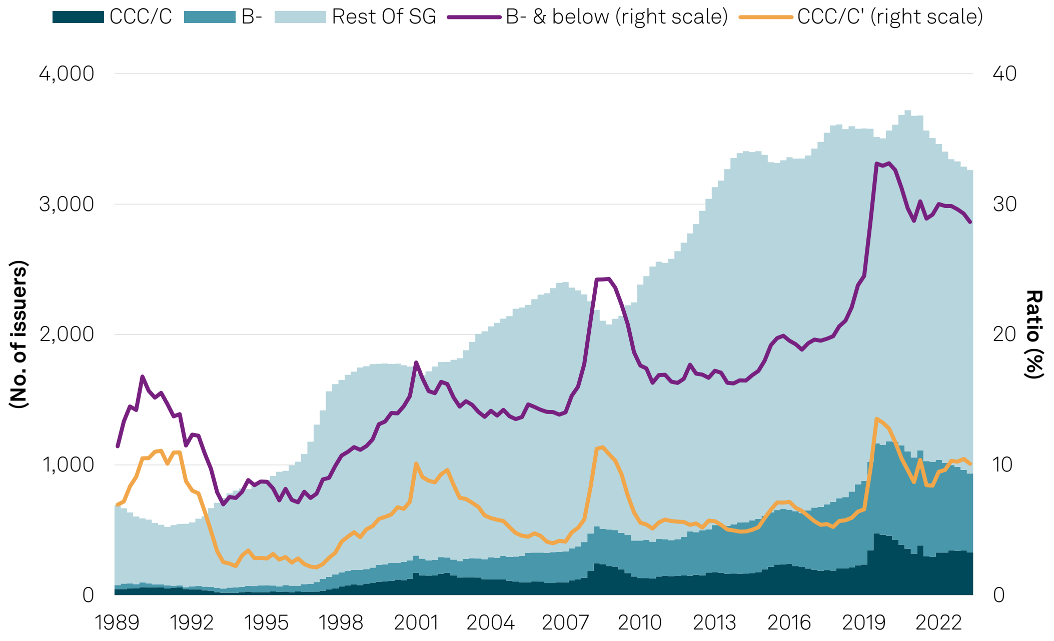


Excludes sovereigns. Bias data as of March 20, 2024. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. RE--Real estate. Source: S&P Global Research & Insights.

Ranks Of The Most Stressed Issuers Has Declined, But Only Marginally

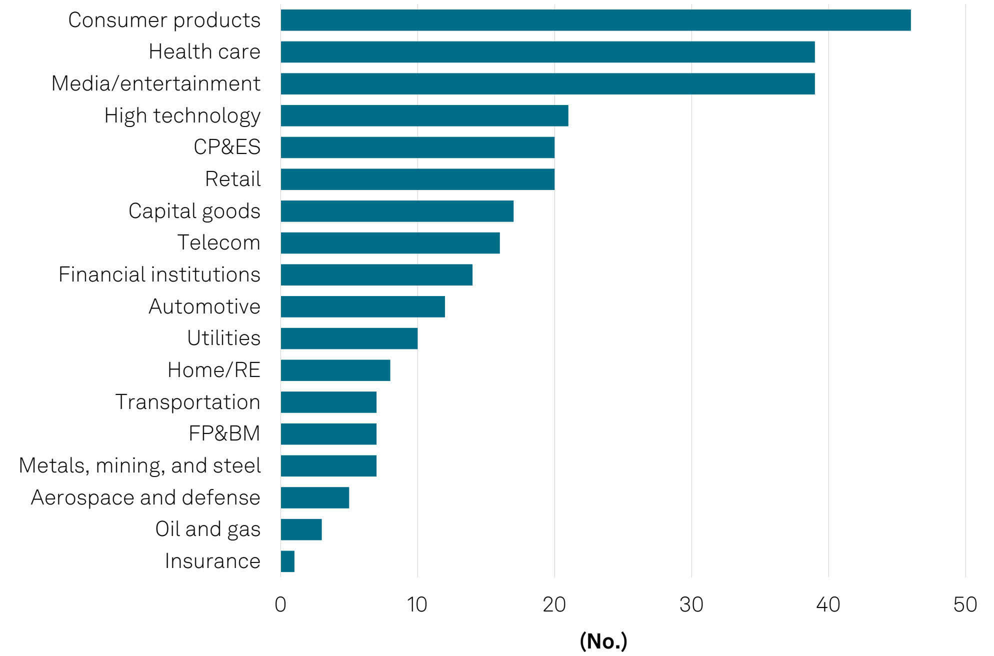
- Consumer-facing sectors and those with a high proportion of floating-rate debt continue to lead among most vulnerable.
- Weakest links tend to default at a rate of roughly 8x that of the overall speculative-grade population.

Downgrades into ‘CCC/C’ start to slow



Data as of Feb. 29, 2024. SG--Speculative grade.
Sources: S&P Global Ratings Credit Research & Insights and S&P Global Market Intelligence’s CreditPro.

Weakest links are highly concentrated: 42% are in consumer products, health care, and media and entertainment

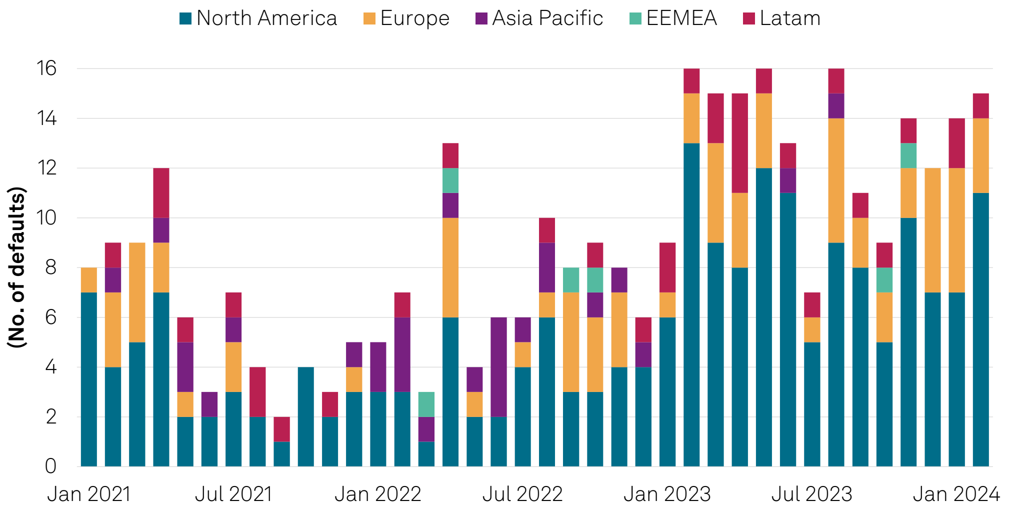


Data as of Feb. 29, 2024. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. RE--Real estate. Sources: S&P Global Ratings Credit Research & Insights.

Global Defaults Remain At A Steady, Elevated Pace

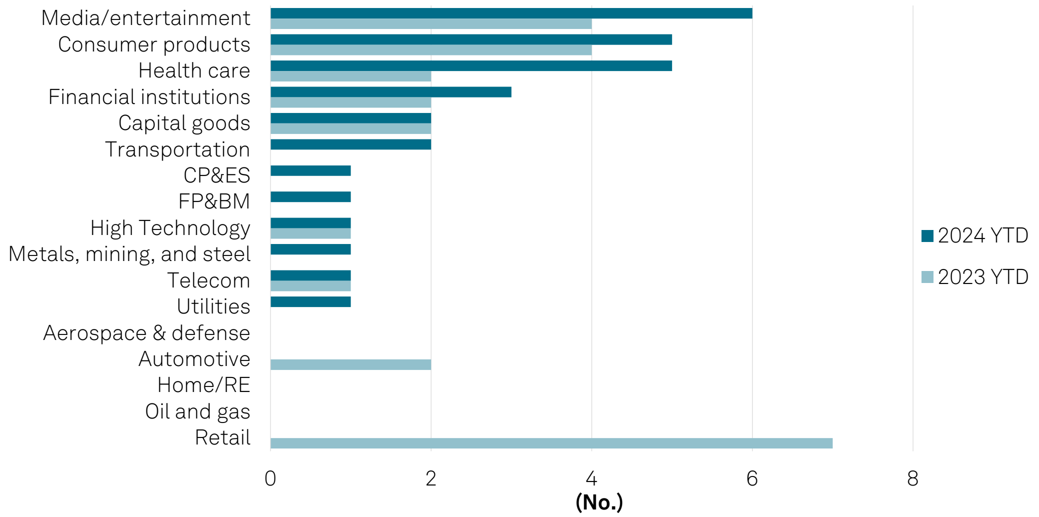
- Defaults have picked up since 2023, alongside interest rate burdens, in sectors with the most floating-rate debt and the highest shares of ratings in the 'B-' and lower categories.
- Defaults among the top three sectors are roughly 55% of all defaults in year to date and come from sectors most anticipated to see increased defaults ahead.
- Most of these sectors are the largest users of very low-rated, floating-rate debt in recent years. Media and entertainment, consumer products, health care, and retail/restaurants have a combined 62% of their speculative-grade debt in loans/revolvers, which have floating interest rates.

European defaults have increased in recent months



Data as of Feb. 29, 2024. Source: S&P Global Ratings Credit Research & Insights.

Media and entertainment, consumer products, and health care are over half of all defaults this year

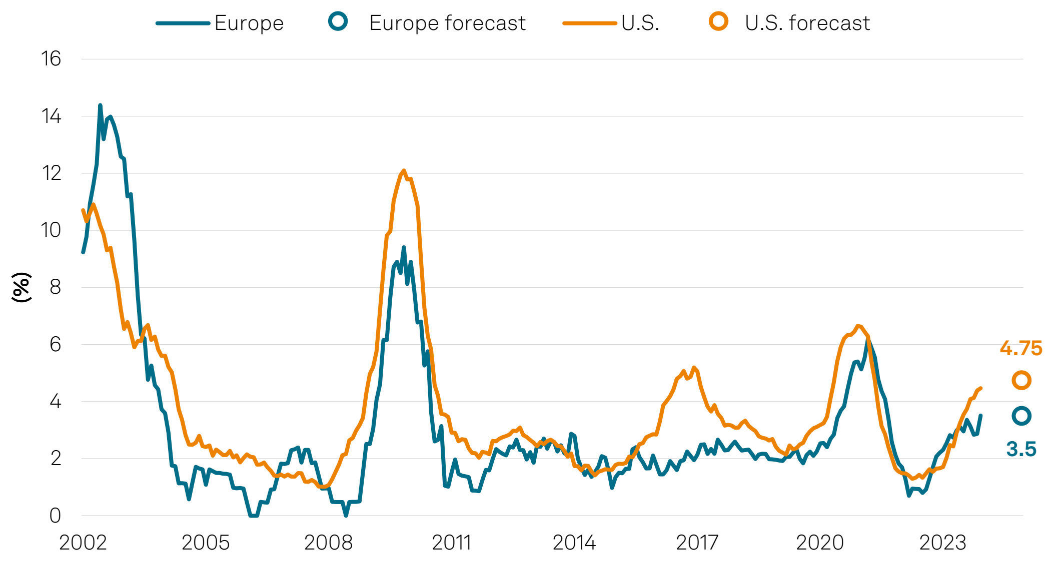


Data as of Feb. 29, 2024. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. RE--Real estate. YTD--Year-to-date. Source: S&P Global Ratings Credit Research & Insights.

Defaults Are Expected To Peak In Q3; Distressed Exchanges Lead

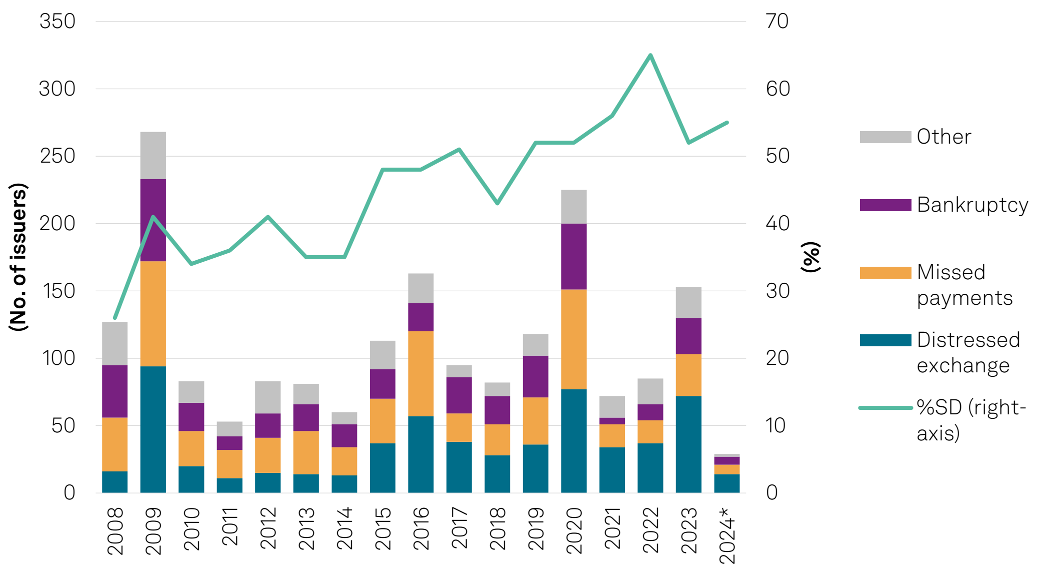
- Distressed exchanges are leading with nearly half of all defaults this year, and many distressed exchanges have led to repeat defaults in the past.
- Through February, the U.S. speculative-grade default rate was 4.7%, and Europe was 4.06%, slightly higher than our expectations from a year ago.
- Risks include persistently elevated market rates, slower-than-anticipated economic growth, and any events that could freeze up primary markets.
- Easing rates and slowing input costs amid positive economic growth should help bring down the default rate later this year from an anticipated peak in the third quarter.

Defaults are expected to peak in Q3 but only fall marginally by year-end



Through Dec. 31, 2023. Source: S&P Global Ratings Research & Insights.

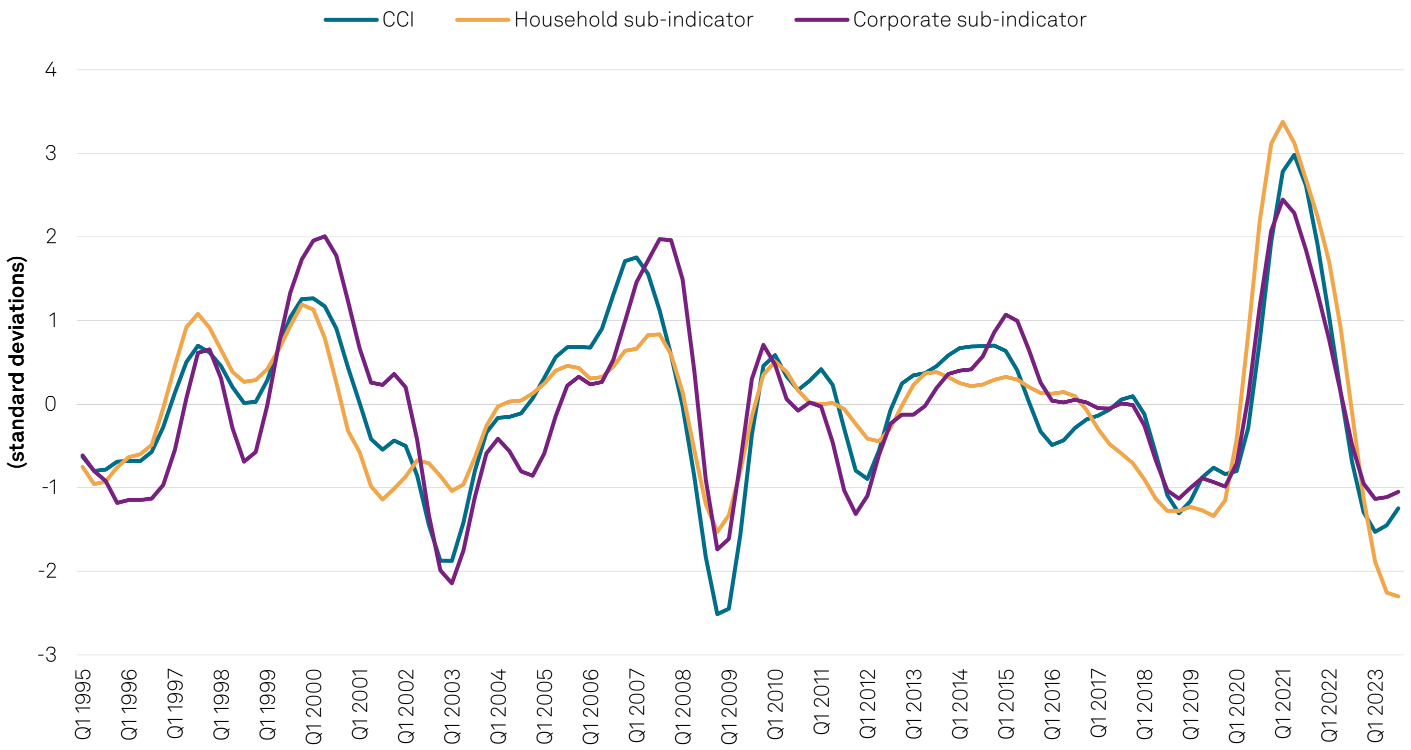
Distressed exchanges are 48% of all defaults this year



*Through Feb. 29. SD--Selective default. Source: S&P Global Ratings Research & Insights.

Credit Cycle Indicator Indicates Upward Momentum For A Recovery In 2025

Global credit cycle indicator



Note: Peaks in the CCI tend to lead credit stresses by six to 10 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.
Sources: Bank for International Settlements, Bloomberg, and S&P Global Ratings.

For more details about our proprietary CCI, see "White Paper: Introducing Our Credit Cycle Indicator," June 27, 2022.

- Our forward-looking global and regional Credit Cycle Indicators (CCIs) tend to **lead credit stress and recovery** by six to 10 quarters.
- With our CCIs maintaining their upward trajectory, a **credit recovery in 2025** is looking increasingly probable.
- However, the lagged effects of the ongoing credit correction could mean a **bumpy ride to recovery throughout 2024**.
- **Costlier debt, households' weak propensity to spend, and lenders' risk aversion** will strain corporate borrowers' profit margins and liquidity profiles--exacerbating credit pressure.
- Risk of **stickier-than-anticipated inflation** could prompt central banks to keep rates high. A sharp economic slowdown and squeezed disposable income could lead households to pull back on consumption.

Regional Credit Conditions

North America | Soft Landing, Lurking Risks

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

Elections

PRESIDENTIAL

NATIONAL CONVENTIONS:

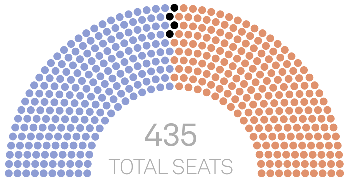
GOP July 15-18

Democratic Aug. 19-22

HOUSE

435 ELECTIONS

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

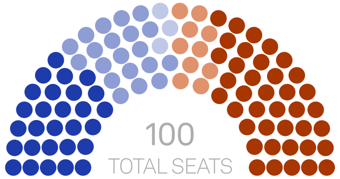


SENATE

33 ELECTIONS

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

*Caucus with Democrats



Source: S&P Global Ratings.

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

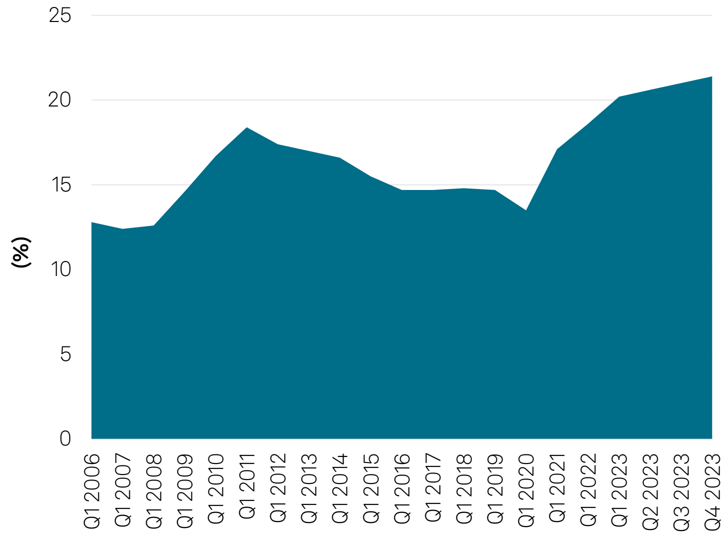
- **Overall:** As the year progresses, credit conditions could brighten somewhat, especially if the U.S. economy settles into a soft landing and the Federal Reserve eases monetary policy in an orderly fashion.
- **Risks:** Downside risks around high financing costs and input-price pressures persist. The upcoming U.S. elections could add to rising (geo)political tensions.
- **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 continue to have the highest negative bias--with around 30% of issuers having a negative outlook or on CreditWatch with negative implications.

North America | Cyclical And Secular Headwinds For Commercial Real Estate

- **Higher financing costs are weighing on asset valuations and heightening refinancing risk** for most types of commercial real estate. Office is grappling with declining demand, which further pressures valuations and cash flows. Multifamily could face challenges as rent growth softens.
- All this may lead to **elevated loan losses for debtholders**, such as U.S. banks, insurers, REITs, and commercial mortgage-backed securities (CMBS). Higher office vacancy rates and shuttered ground-level businesses could also reduce tax revenue for cities.
- Meanwhile, **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.

U.S. office vacancy rate trends up to more than 20%

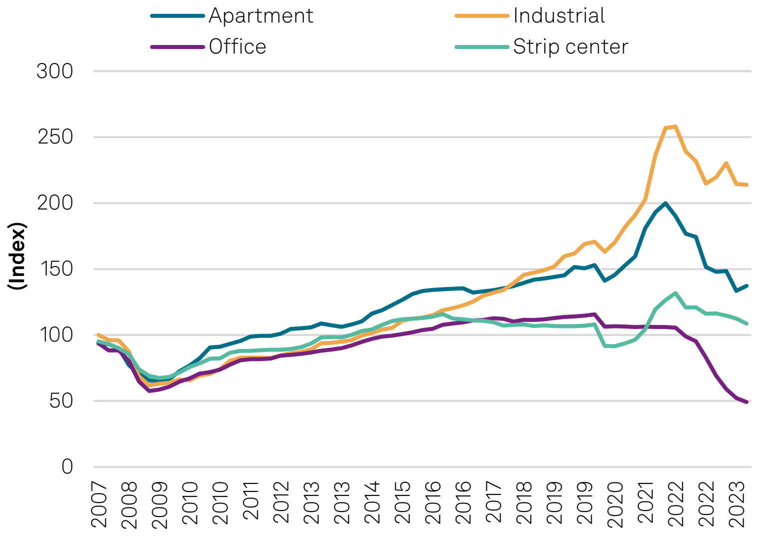
U.S. office vacancy rate



Data through Q4 2023. Source: S&P Global Ratings.

Office value down more than half since Q1 2022

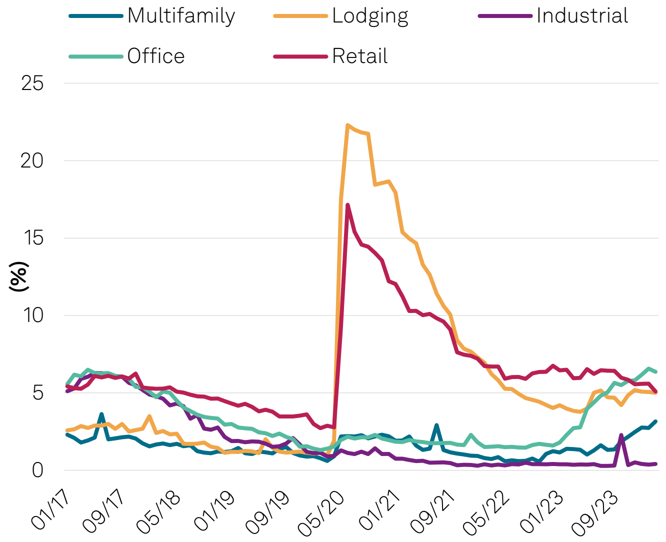
Green Street Commercial Property Price Index by property type



Data through Q4 2023. Note: Green Street's commercial property indices incorporate the valuations of class 'B' and 'B+' commercial properties. Source: Green Street.

Office delinquencies continued to increase

U.S. CMBS delinquency rate by property type



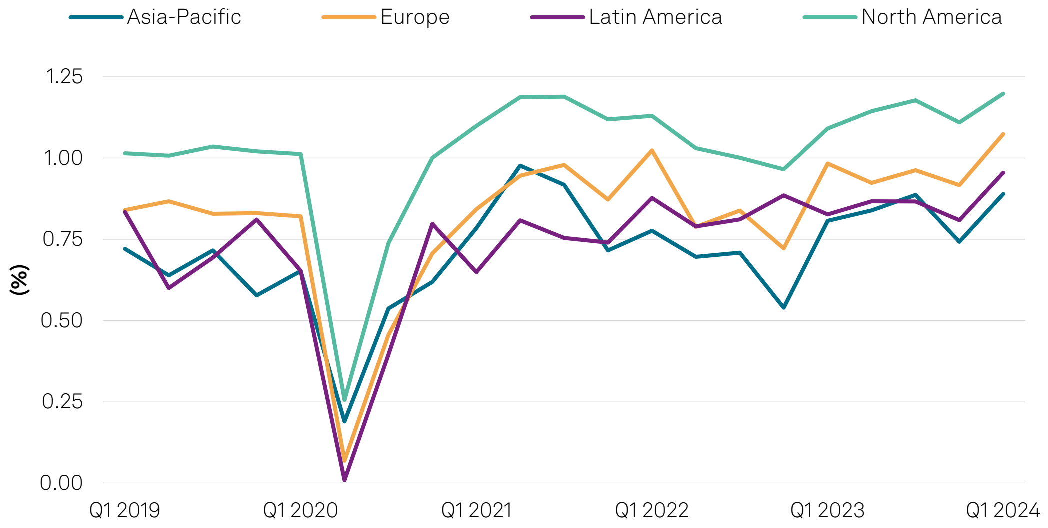
Data through March 2024. Source: S&P Global Ratings.

Europe | Credit Heals, Defense Shields

- **Base case:** We expect a soft landing in 2024 with labor markets remaining tight, disinflation continuing, enabling the European Central Bank (ECB) to start cutting rates in June.
- **Credit:** Balanced ratings activity is benefitting from a more stable macroeconomic outlook and easing financing conditions (barring the weakest credits).
- **Pockets of risk:** Lagged impact of inflation and higher rates will feed through incrementally to asset quality with bank's credit losses normalizing and a few potential negative rating actions in residential mortgage-backed securities (RMBS) and auto asset-backed securities (ABS). Corporate default rate expected to end the year around 3.5%.

Corporate sentiment improves

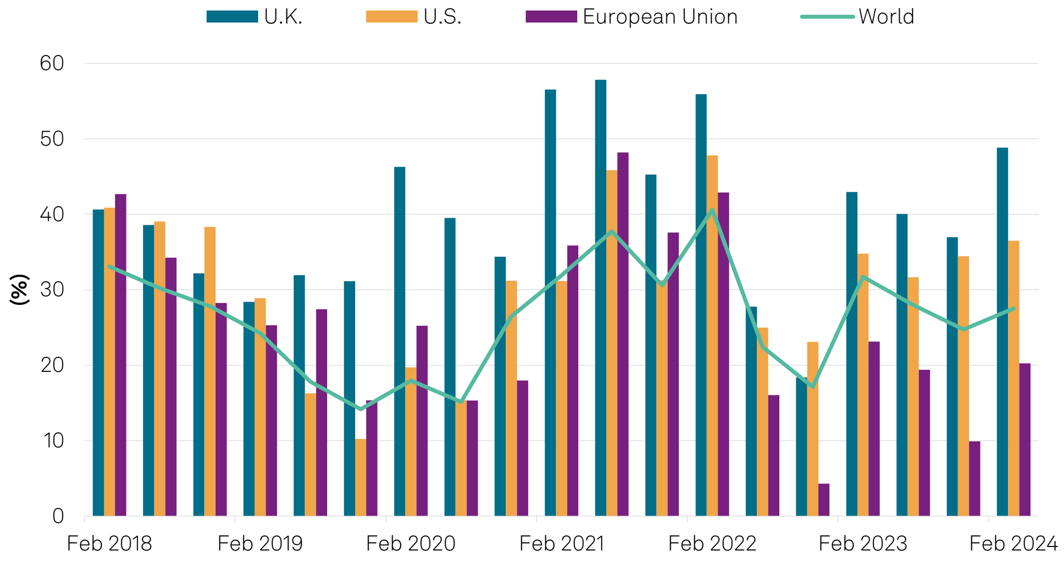
Median net positivity score by region



Sources: S&P Capital IQ Pro, S&P Global Ratings. Derived from transcripts and investor presentation sentiment analysis.

PMI business activity expectations pick up

Net balance

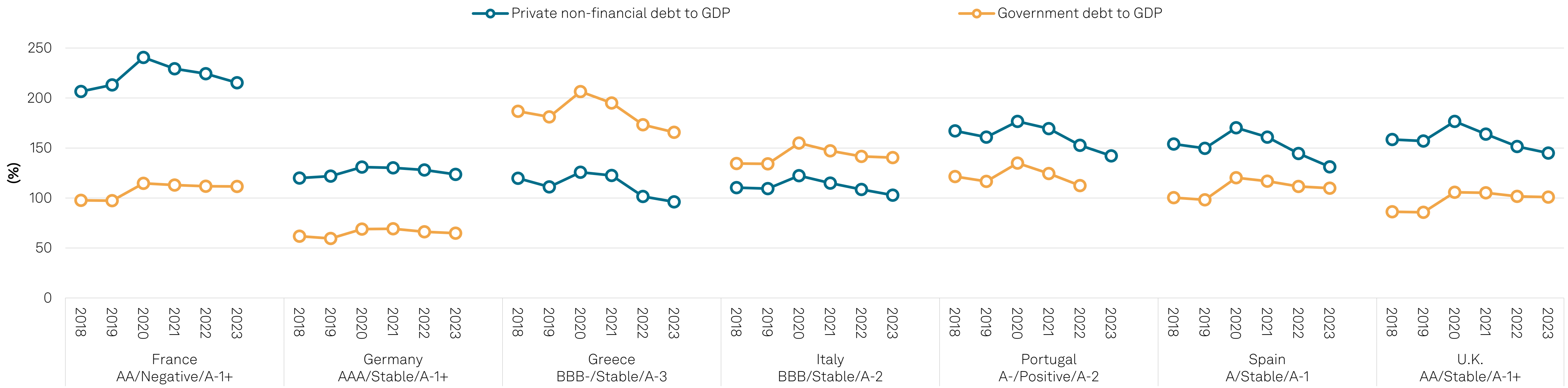


PMI--Purchasing managers' index. Source: S&P Global Market Intelligence.

Europe | Geopolitical Fragmentation Is The Highest Risk

- **Geopolitical risk:** Conflicts in the region could spread across borders. Beyond that, protectionism represents a growing threat to European trade. Security and defense concerns arising from geopolitical uncertainty pressure sovereign balance sheets.
- **Refinancing:** Fixed-rate borrowers exposed to refinancing at higher rates remain a material credit risk for more vulnerable credits.
- **Macro:** An extended period of slow growth in Europe is the more pertinent downside macro risk rather than an outright recession.

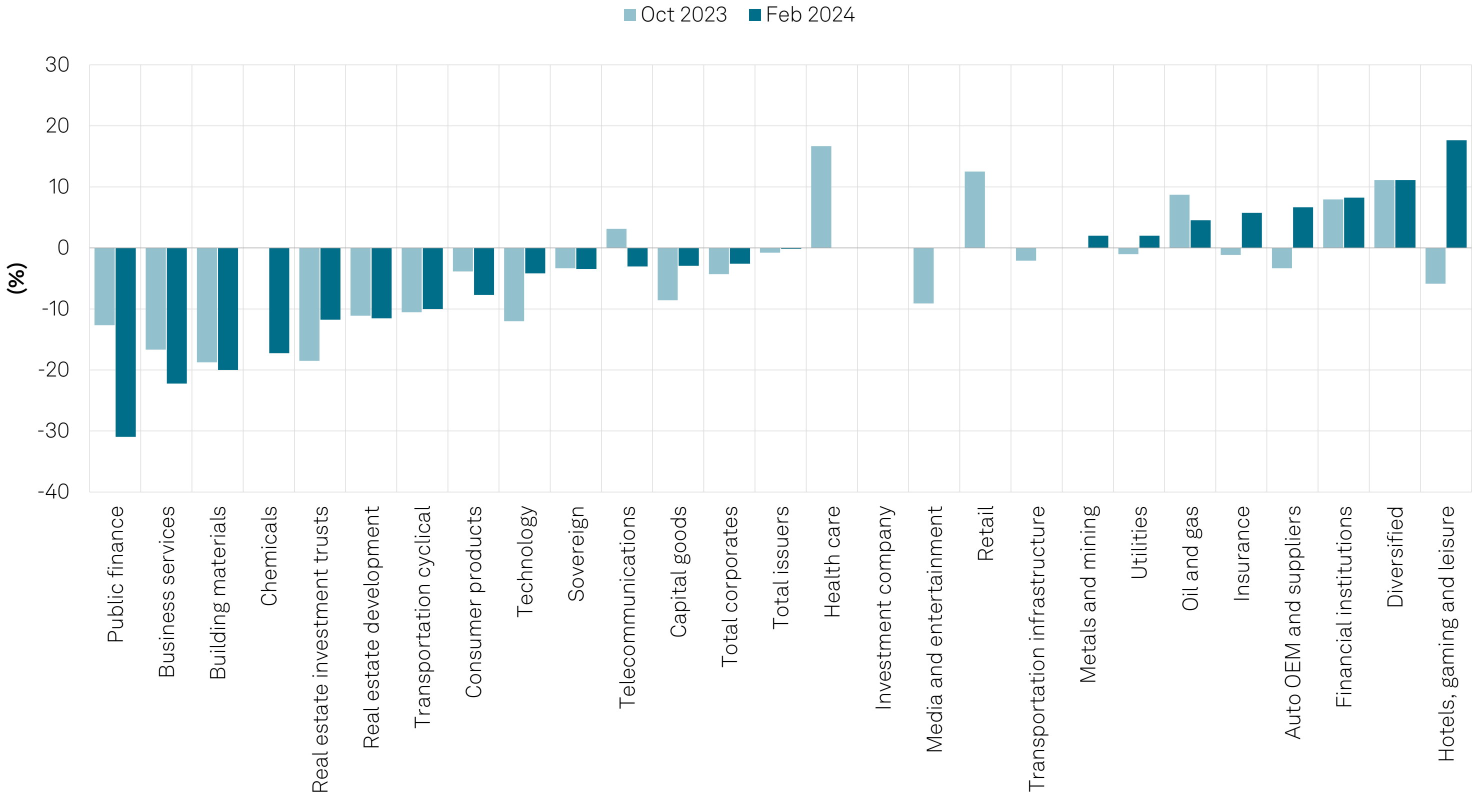
The diverging paths of public and private (corporate plus household) debt in Europe



Data for 2023 is for Q3 2023. Ratings as of March 25, 2024. Sources: BIS, S&P Global Ratings.

Asia-Pacific | A Delicate Balance

Net rating outlook bias of Asia-Pacific issuers, Oct. 2023 versus Feb. 2024



Note: We calculate the net outlook bias by deducting the percentage of negative outlooks and CreditWatch negative listings against the percentage of positive outlooks and CreditWatch positive listings. A minus figure indicates that the former exceeds the latter, and a positive figure, vice versa. OEM--Original equipment manufacturer. Source: S&P Global Ratings.

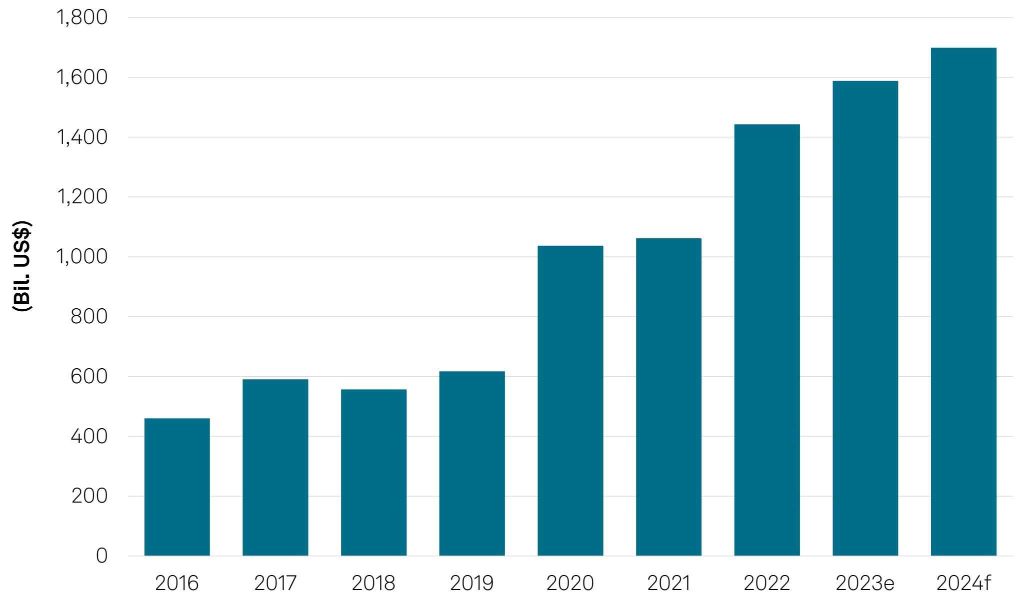
- While the net rating outlook bias of Asia-Pacific issuers is balanced at 0%, the underlying distribution is **uneven across sectors**.
- The region's central banks are biding their time to ease monetary policy. High rates (relative to post-Global Financial Crisis) mean **larger interest burdens for borrowers.**
- Meanwhile, weak currencies could keep **offshore funding costs elevated.** They also raise the risk of imported inflation.
- The risks of a widening Middle East conflict and a more drawn-out Russia-Ukraine war compound **geopolitical tensions.**
- Together, they raise the (remote) risk of an **energy shock** that could reignite inflation for the net energy-importing region.

Asia-Pacific | Risk Around China's Growth Is High

- **No easy fix for property.** China's property sector remains weak. Lackluster sales are hurting developers' liquidity and the balance sheets of local governments, in turn crimping their ability to support LGFVs. This could spill over to hit regional banks, hurting capital.
- **Rising indebtedness.** China's already high debt-to-GDP ratio will worsen as it aims to revive confidence, potentially with more stimulus. That said, we believe authorities will maintain tight control over the real estate sector while also being selective about its support.

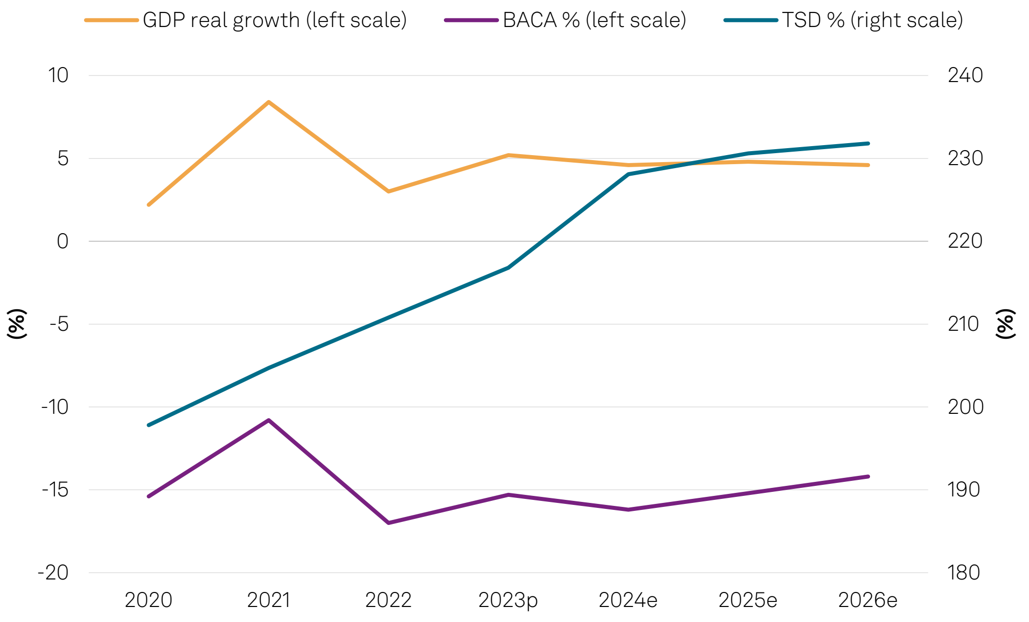
China--Sovereign commercial issuance and debt

Gross commercial long-term borrowing



e--Estimate. f--Forecast. Source: S&P Global Ratings.

Local and regional governments face a long path to fiscal consolidation



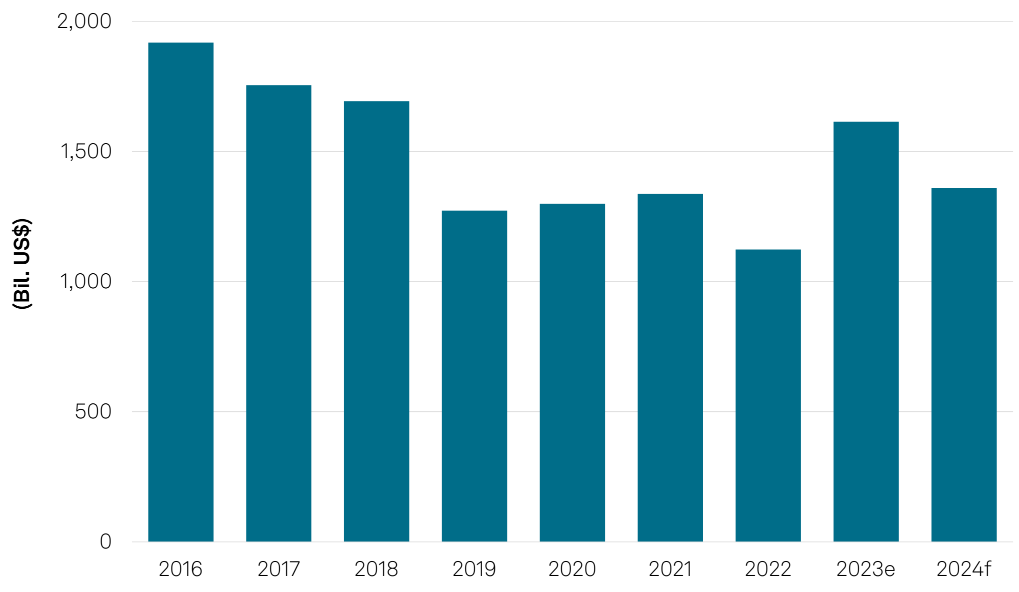
LRG--Local and regional government. BACA %--Balance after capital account of LRGs, as a percentage of adjusted total revenues. TSD %--Tax-supported debt, including direct debt and debt of key SOEs, as a percentage of consolidated operating revenues. p--Preliminary. e--Estimate. Sources: Ministry of Finance. S&P Global Ratings.

Asia-Pacific | Japan's Rate Hike Puts Some To Test

- **Smaller issuance:** We believe Japanese government debt issuance will drop sharply in 2024, falling by more than US$250 billion on the back of a slightly smaller budget deficit and a large decline in refinancing needs, to US$1.4 trillion (from US$1.6 trillion in fiscal 2023).
- **Japan hikes:** The Bank of Japan has increased its policy rate, and although we expect rate increases in coming years to be modest, funding and liquidity pressures could intensify for small and midsize enterprises (mostly unrated) amid higher debt costs. In turn, Japanese banks may limit credit appetite.

Japan--Sovereign commercial issuance and debt

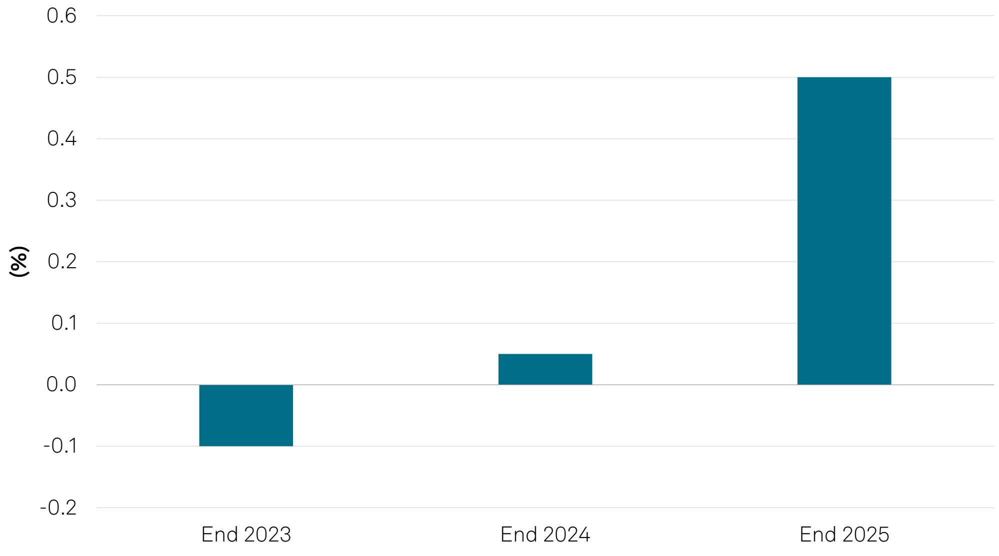
Gross commercial long-term borrowing



e--Estimate. f--Forecast. Source: S&P Global Ratings.

Japan--Policy rate forecast

Policy rate

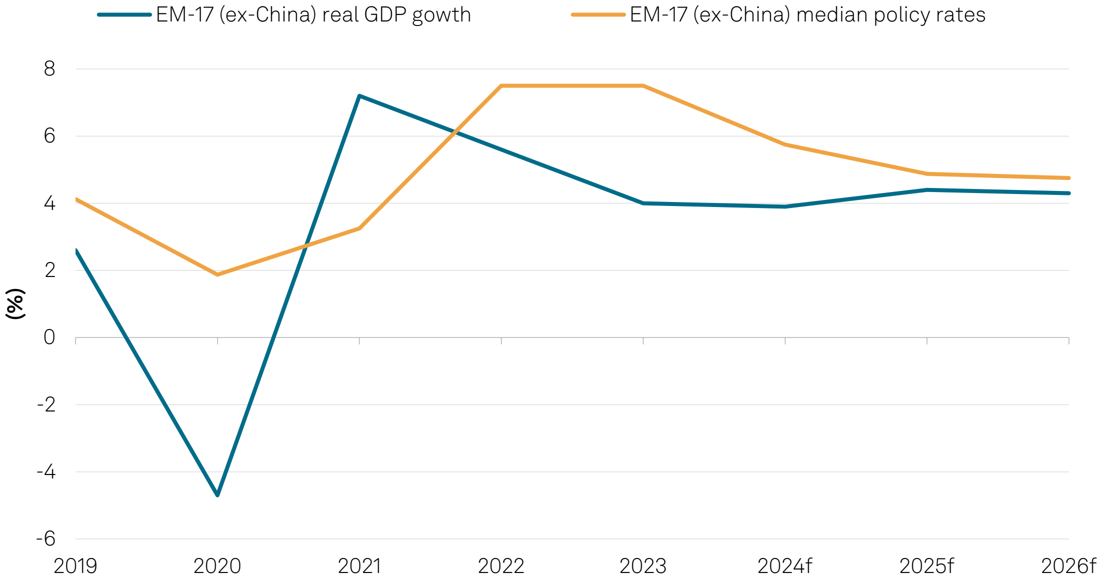


Sources: CEIC. S&P Global Ratings.

Emerging Markets | Unmet Expectations Could Heighten Risks

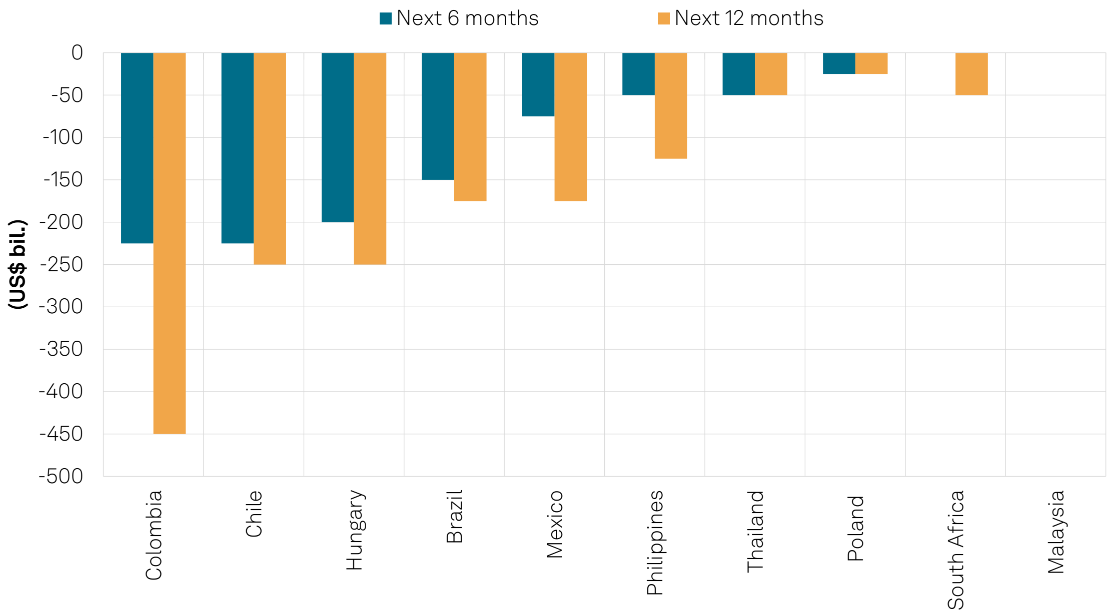
- Expected soft landings of advanced economies will continue supporting credit conditions in EMs and risks are receding to a certain degree, but the long-term outlook remains challenging.
- The Federal Reserve could delay monetary easing if the U.S. economy and labor markets remain strong. Lingering high interest rates in advanced economies will likely undermine the ability of EM central banks to further ease monetary policy.

EMs' resilience despite significant monetary tightening and inflation



Aggregates are weighted by PPP GDP (2019-2021 average) share of total. f--S&P Global Ratings forecasts.
Source: S&P Global Market Intelligence.

Strength in advanced economies could delay EMs' monetary easing



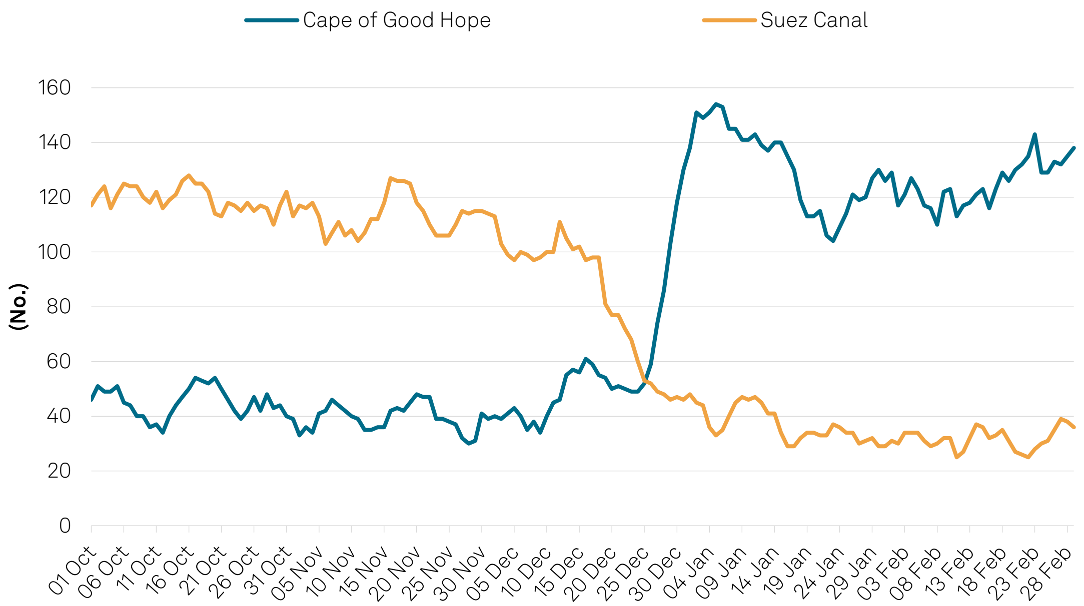
Market-implied policy interest rate cumulative changes. Note: implied interest rate changes are based on interest rate swaps as of March 19, 2024. Sources: Haver Analytics and S&P Global Ratings.

Emerging Markets | Ongoing Conflicts Could Weaken Credit Conditions

- The latest Israeli-Hamas war is already taking a toll on supply chains, and if the conflict continues, rising shipping costs will likely seep into corporate costs, and ultimately into consumer goods.
- Successive shocks will likely drive EM sovereigns' debt levels to new highs, and current conditions will likely amplify pressures on sovereigns and leave them with limited fiscal room to face any further shocks without compromising their credit fundamentals.

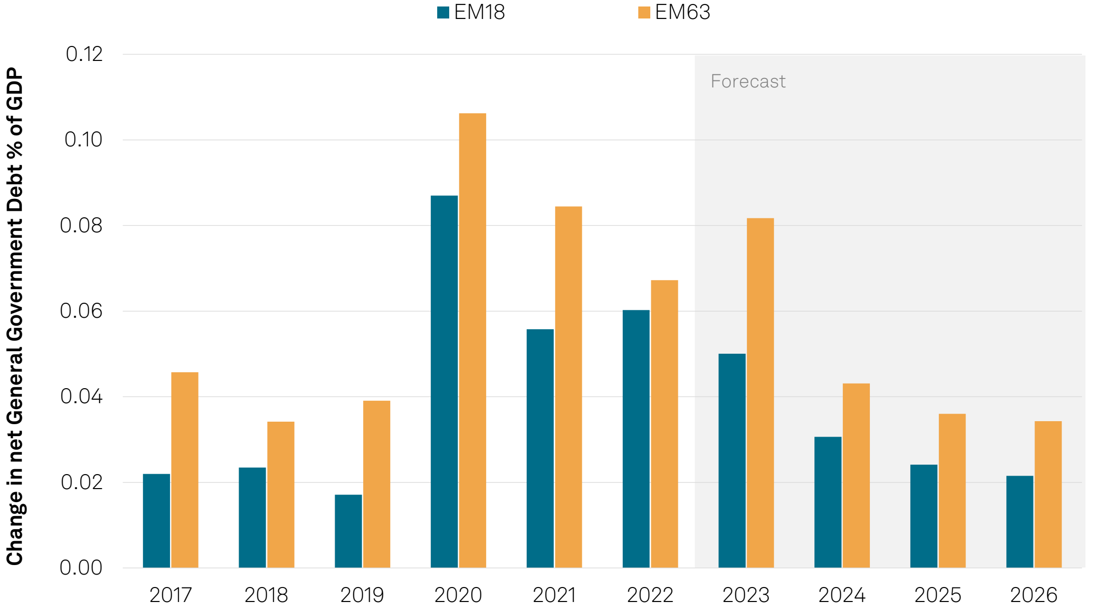
Shipping routes disrupted by the Israeli-Hamas war

Vessel crossings, east- and westbound combined, 7-day trailing total



Data compiled March 7, 2024. Vessel crossings, east- and west-bound combined, seven-day trailing total.
Source: S&P Global Market Intelligence.

Successive shocks will likely drive EM sovereigns' debt levels to new highs

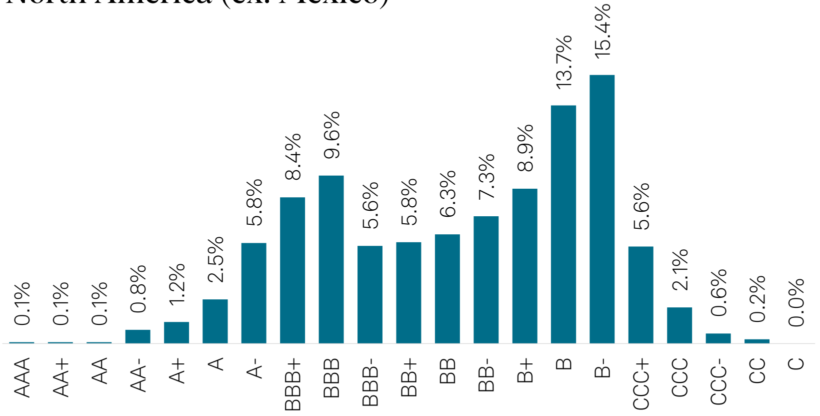


Average for each year. Source: S&P Global Ratings.

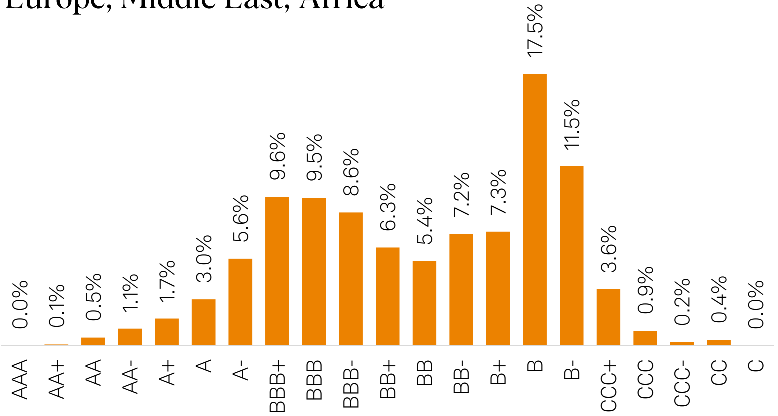
Sector Trends

Corporate Rating Distribution Varies By Region

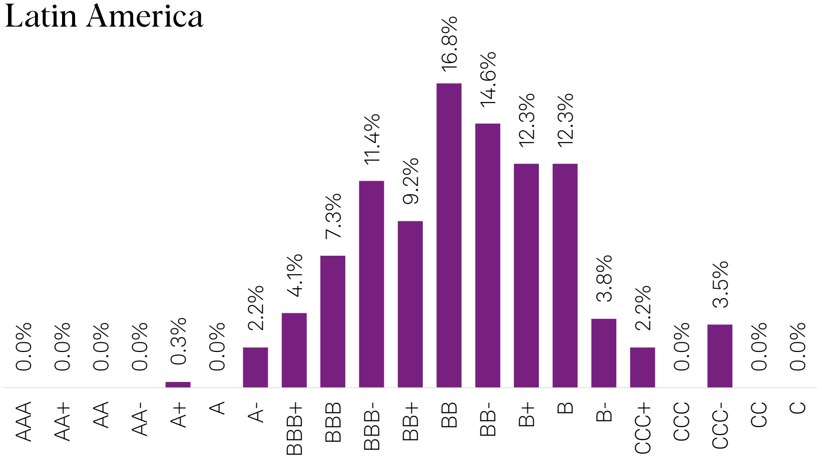
North America (ex. Mexico)



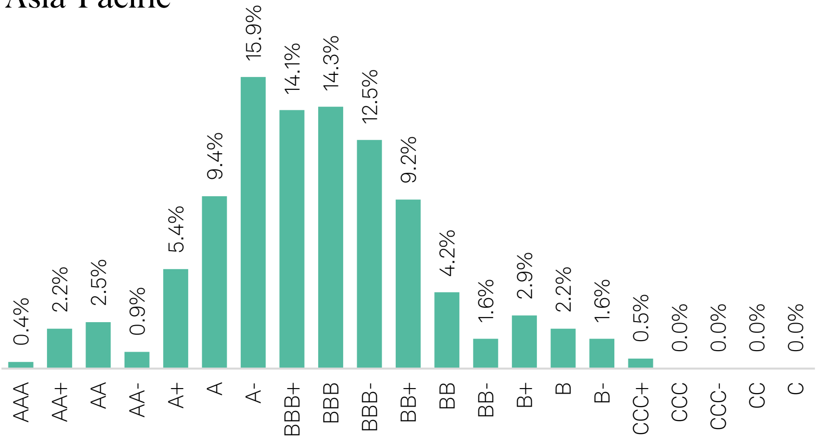
Europe, Middle East, Africa



Latin America



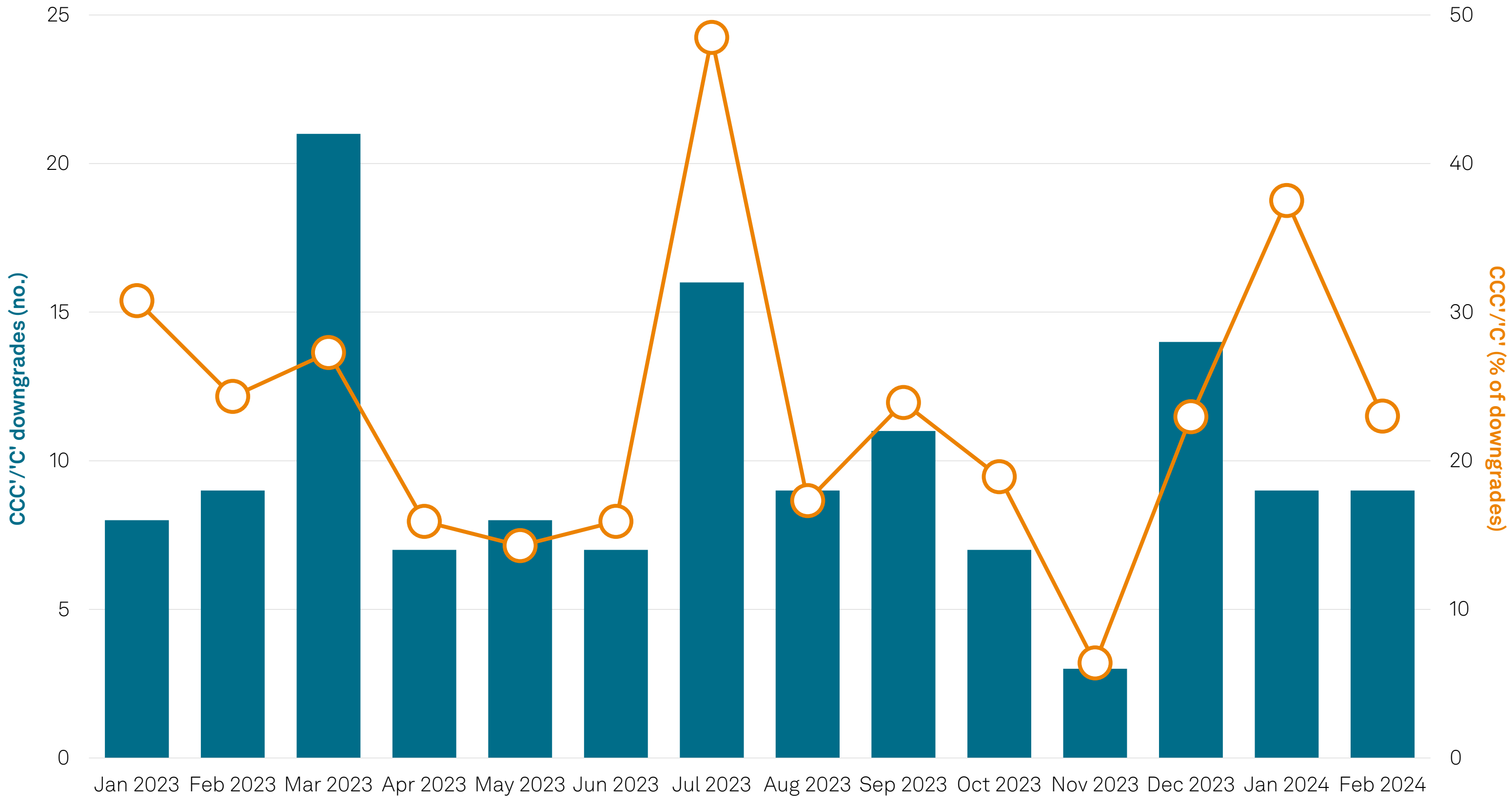
Asia-Pacific



Regions and specifically sectors skewing toward the weaker end of the rating distributions are more sensitive to high rates and difficult operating environments.

Data as of Feb. 29, 2024. Source: S&P Global Ratings Credit Research & Insights and Capital IQ.

Corporate Downgrades Have Been Focused On The Lowest Rated Issuers



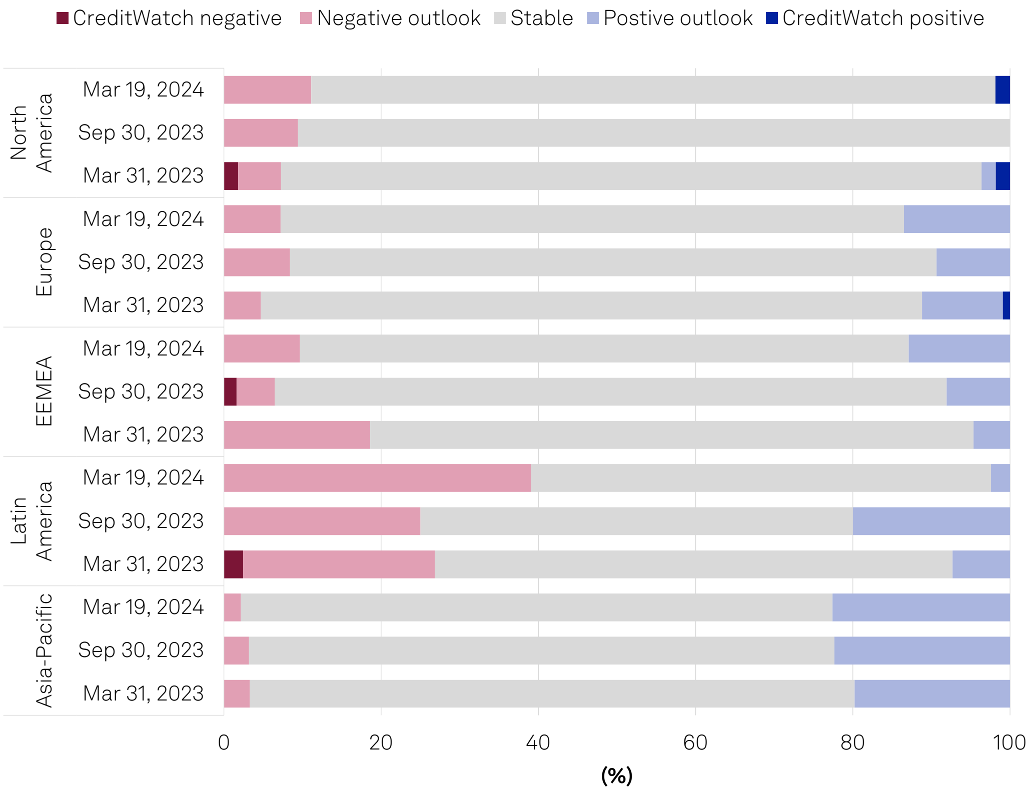
Data as of Feb 29 , 2024. Source: S&P Global Ratings Credit Research & Insights.

- Total rating actions have been relatively balanced over the past year.
- Consumer-facing sectors have been the most active in terms of both upgrades and downgrades.
- Negative rating actions have been focused on the deep speculative-grade levels.
- In 2023, on average, nearly a quarter of all downgrades were from the ‘CCC/C’ rating categories. In the first quarter so far, we have seen over 30% of all downgrades from this category.

Global Banks: Stable Outlooks Persist As Property Risks Creep Up

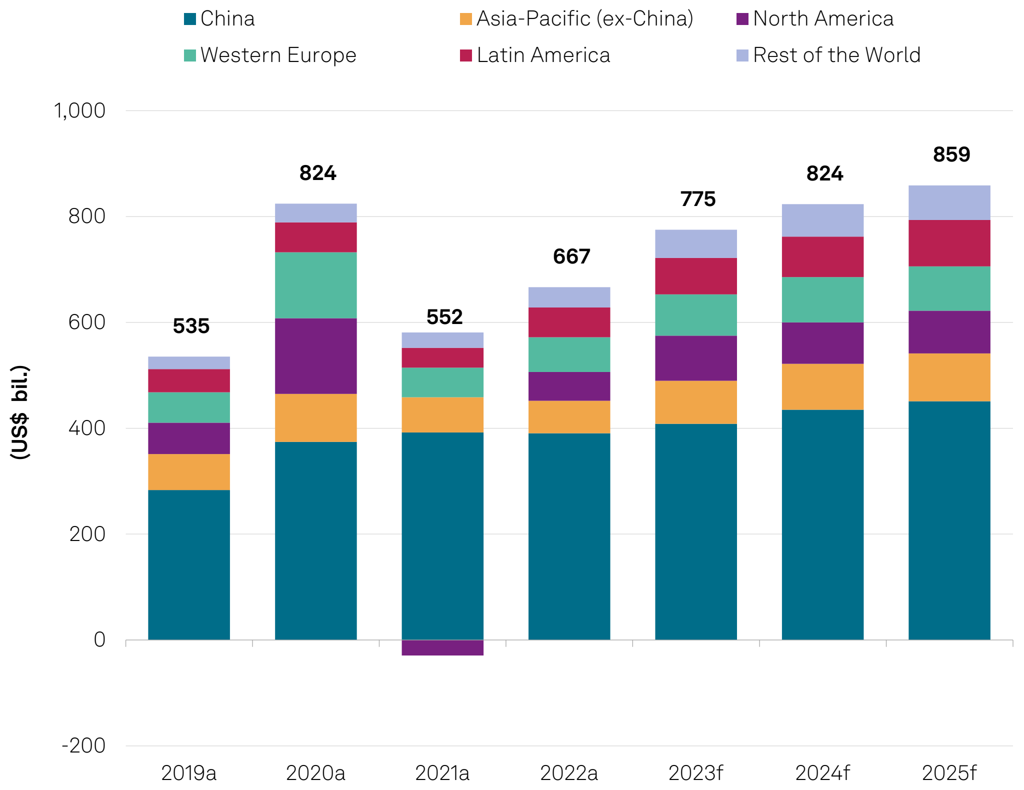
77% of bank ratings are on stable outlook

Evolution of ratings distribution for rated banks



We expect credit losses to increase steadily from benign levels

Domestic credit losses by region, 2019a-2025f



EEMEA--Eastern Europe, Middle East, and Africa. Source: S&P Global Ratings Credit Research & Insights. Data shown on a constant currency basis, based on 2022 year-end exchange rates. Data for China relates to commercial banks. a--Actual. f--Forecast. Source: S&P Global Ratings. Global Banks: Our Credit Loss Forecasts--Asset Quality Faces Rising Risks, published Nov. 16, 2023.

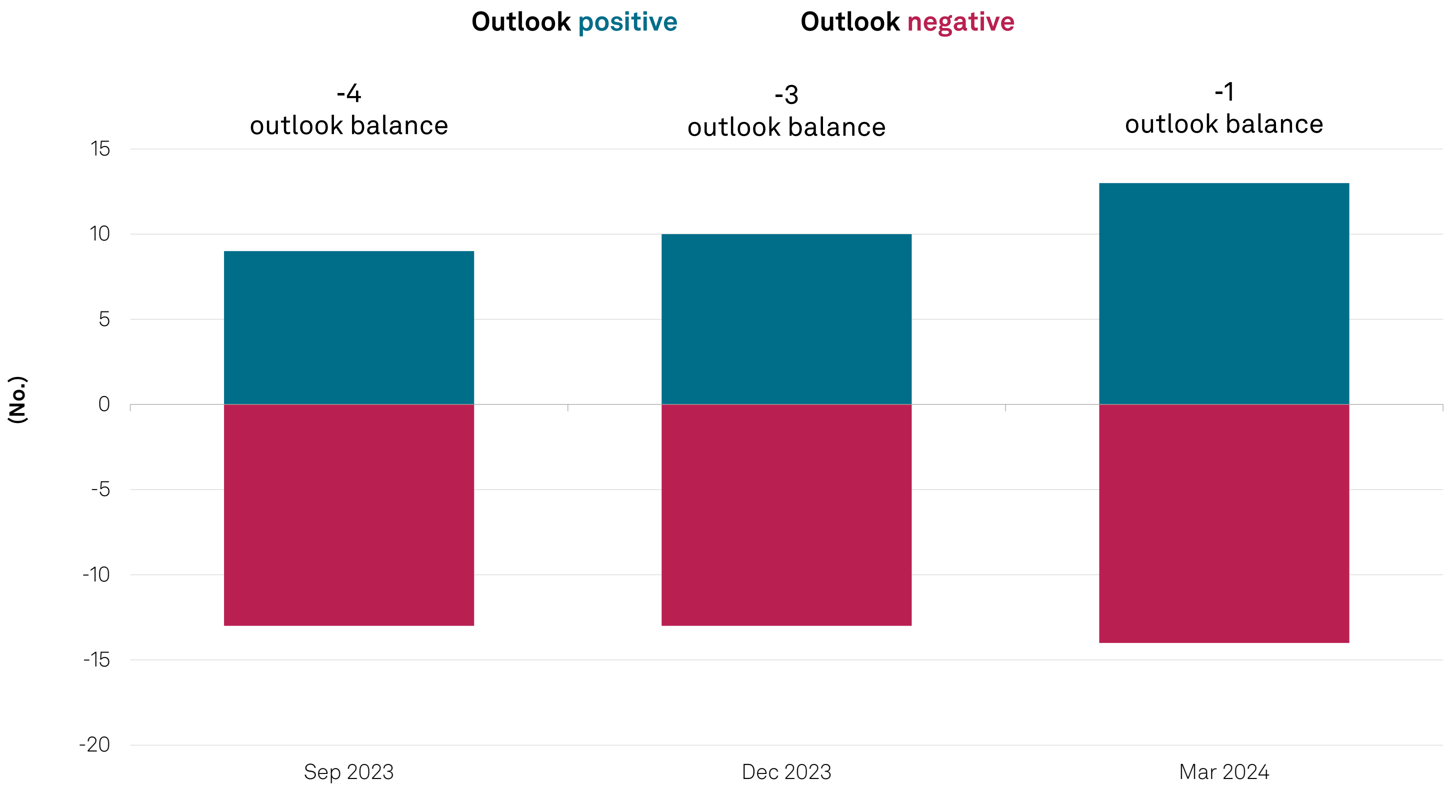
What Have We Learned In The Year Since SVB Triggered Turmoil In The Banking Sector?

- Regulators have taken steps to reinforce financial-system resilience
- Ultimately, banks are responsible for their own risk-management
- We see tougher regulation on liquidity as a net positive for creditors
- On the downside, this could result in less lending
- Tighter regulation won't resolve all systemic risks
- Social media can be a disruptor, but bank runs are unlikely to be baseless

Source: S&P Global Ratings. CreditWeek: What Have We Learned In The Year Since SVB Triggered Turmoil In The Banking Sector?, published March 14, 2024.

Sovereign Rating Outlooks Stabilize Amid Economic Resilience

Global sovereign ratings outlook balance improving



Outlook balance is the difference of total positive and negative actions. Source: S&P Global Ratings.

Outlook: The overall rating outlook balance improved over the last 12 months alongside a stable rating distribution (with a median rating of 'BBB-'). Resilient economies and large cushions among developed and larger EMs have helped improve the outlook distribution, but governments will have more limited space to respond to future economic downturns.

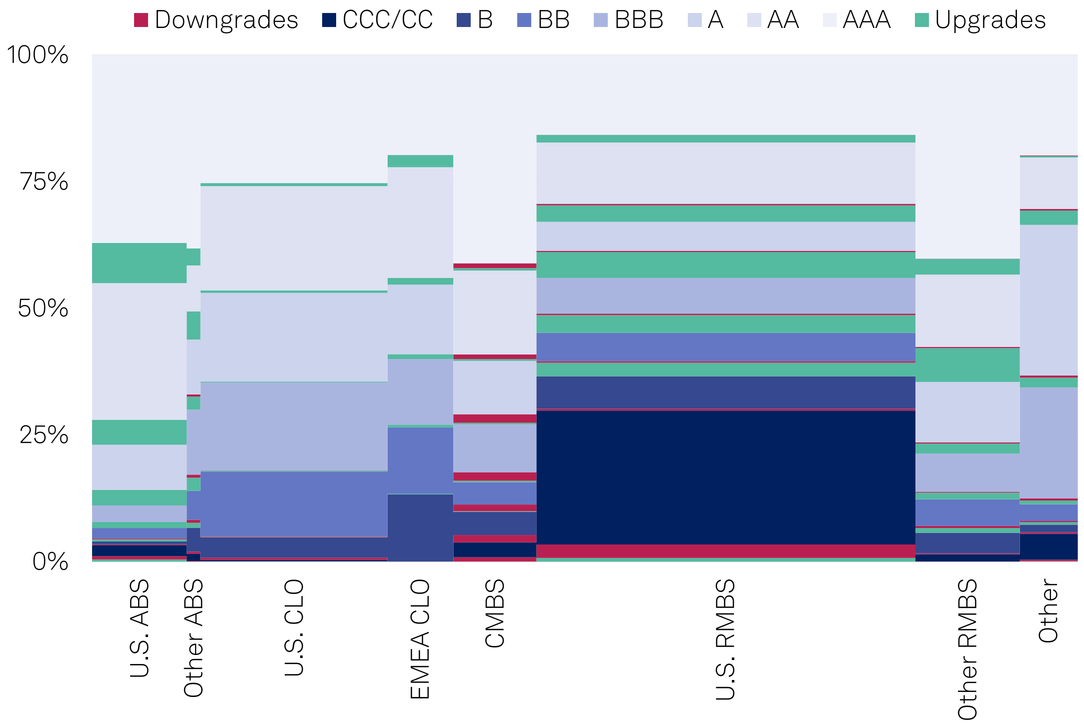
Risks: Geopolitical factors, elevated interest rates, and rising fiscal strains will test sovereigns.

So far in 2024, there has been one default (Argentina), and seven sovereigns are rated 'CCC+' or lower.

High debt levels limit options: In most cases, government debt exceeds pre-pandemic levels. In a year with many elections and mounting geopolitical uncertainties, there is limited fiscal space to respond to any new economic emergency. With growth expected to slow globally this year, and refinancing costs higher than in the past, uncertainties are rising, and credit may be strained. Governments may also search for ways to tax sectors that benefit from a higher-interest-rate environment, including banks.

Structured Finance Ratings Remain Resilient; Upgrades Exceed Downgrades

Distribution of ratings and 12-month transitions



Screenshot March 29, 2024. Based on rating movements over the previous 12 months as of Mar. 20, 2024. Excludes confidential ratings. Source: S&P Global Ratings.

- In the U.S., we expect moderate GDP growth, contained unemployment, and the likelihood of policy rate cuts later in the year to limit the deterioration in collateral performance for most sectors. That said, CMBS is an area of focus, along with subprime segments of consumer ABS, and CLOs.
- In both the U.S. and Europe, higher interest and capitalization rates have weighed on asset valuations and increased refinancing risk for most types of commercial real estate-backing CMBS, especially those with slowing or declining rent growth. We see most stress in the office sector, where rising vacancy rates, sparse leasing activity, and falling property cash flows are all resulting in significantly lower property values. We expect elevated downgrade activity to continue in 2024.
- In Europe, arrears reported for loan pools backing consumer-related securitizations have not increased significantly since rates started to rise. The U.K. nonconforming and buy-to-let RMBS subsectors are exceptions, however, given their high exposure to floating-rate and interest-only loans, and more borrowers who may have few refinancing options.

Related Research And Contacts

Related Research

Credit Conditions

- Credit Conditions Asia-Pacific Q2 2024: A Delicate Balance, March 27, 2024
- Credit Conditions Europe Q2 2024: Credit Heals, Defense Shields, March 27, 2023
- Credit Conditions Emerging Markets Q2 2024: Unmet Expectations Could Heighten Risks, March 27, 2024
- Credit Conditions North America Q2 2024: Soft Landing, Lurking Risks, March 27 2024

Regional Credit Outlooks can be found here

Economic Outlook

- Global Economic Outlook Q2 2024: Still Resilient, With Gradual Rate Cuts Ahead, March 28, 2024
- Economic Outlook Eurozone Q2 2024: Labor Costs Hinder Disinflation As Rate Cuts Loom, March 26, 2024
- Economic Outlook Q2 2024: The U.K. Is Slowly Turning A Corner, March 26, 2024
- Economic Outlook Emerging Markets Q2 2024: Growth Divergence Ahead, March 26, 2024
- Economic Outlook U.S. Q2 2024: Heading For An Encore, March 26, 2024
- Economic Outlook Asia-Pacific Q2 2024: APAC Bides Its Time On Monetary Policy Easing, March 25, 2024

Regional Macro Updates can be found here

Additional research

- Credit FAQ: Will China's 'White List' Boost Housing Sentiment?, March 26, 2024
- Some U.S. Regional Banks Could Face Higher Risk If Commercial Real Estate Asset Quality Worsens, March 26, 2024
- Credit FAQ: What China's Shifting Priorities May Mean For Its Central SOEs, March 18, 2024
- Credit FAQ: Policy Implications Of China's 2024 “Two Sessions”, March 18, 2024
- Credit Cycle Indicator Q2 2024: Upward Momentum For A Recovery In 2025, March 11, 2024
- Sovereign Debt 2024: Asia-Pacific Central Government Borrowing Stabilizes At Close To US$4 Trillion, Feb. 28, 2024
- Sovereign Debt 2024: Borrowing Will Hit New Post-Pandemic Highs, Feb. 27, 2024
- Global Refinancing: Maturity Wall Looms Higher For Speculative-Grade Debt, Feb. 5, 2024

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