S&P Global
Ratings

Credit Conditions North America Q3 2024

A Brighter Outlook, Laden With Risks

June 25, 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 June 18, 2024.

Key Takeaways

- **Overall:** Borrowers in North America could enjoy more favorable credit conditions if the U.S. economy settles into a soft landing and the Federal Reserve begins to ease monetary policy. However, credit deterioration could linger with interest rates likely staying high for longer than we previously anticipated.
- **Risks:** On top of the downside risk posed by prolonged high financing costs, input-price pressures persist, and commercial real estate losses could worsen amid cyclical and secular headwinds. U.S. elections could lead to market volatility and policy uncertainty.
- **Ratings:** The region's net outlook bias was negative 10.2% as of June 11, with telecom, consumer products, and chemicals having the highest negative bias. We expect the U.S. default rate to fall slightly to 4.5% by March after peaking in the third quarter.

Credit conditions for North American borrowers could improve in the next 12 months, especially if the U.S. economy eases into a soft landing and benchmark borrowing costs begin to fall. This outlook is far from assured, however, and some headwinds could create a turbulent second half.

Unexpected economic resilience that keeps inflation too high for the Federal Reserve's liking could force policy makers to keep interest rates elevated for even longer than we anticipate. We've already pushed out our forecast for interest-rate cuts and now believe conditions that allow for easing monetary policy won't be in place before autumn, with later in the year more likely. 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 spectrum. Increasing risk-aversion among investors, who so far this year have accepted fairly narrow spreads on corporate debt, could exacerbate this.

On top of the longstanding risks around cost pressures, tumbling commercial real estate (CRE) valuations, and economic uncertainty, market volatility could return with the approach of the U.S. elections in November. The outcome could have ramifications not just domestically but globally—potentially increasing political polarization and creating policy uncertainty. S&P Global Ratings expects the consequences for U.S. borrowers will be predicated on the outcomes of the presidential and congressional elections—especially if there is a partisan split between the

Regional Credit Conditions Chair

David Tesher
New York
david.tesher@spglobal.com
+1-212-438-2618

North America Credit Research

Joe Maguire
New York
joe.maguire@spglobal.com

Yucheng Zheng
New York
yucheng.zheng@spglobal.com

Contents

Top North American Risks 4
Macroeconomic Outlook 6
Financing Conditions 8
Sovereigns 10
Financial Institutions 11
Nonfinancial Corporates 14
Public Finance 17
Structured Finance 19
Insurance 21
Related Research 24
Appendix 1: Nonfinancial Corporate Sectors Outlook 25
Appendix 2: Economic Data and Forecast Summaries 29
Appendix 3: List Of Analytical Contacts 30

presidency and upper or lower house (or both) of Congress, which would make passage of any sweeping legislation challenging (see chart 1).

Chart 1
2024 U.S. elections: What's at stake for credit

Elections

PRESIDENTIAL

NATIONAL CONVENTIONS:

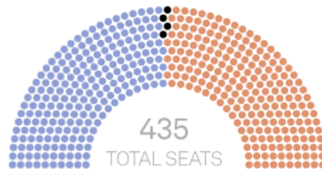
GOP July 15-18

Democratic Aug. 19-22

HOUSE

435 ELECTIONS

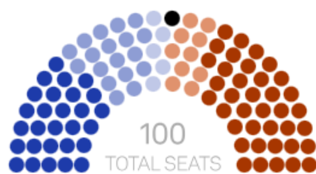
Seats up for election
- **213** DEMOCRATS
- **4** VACANCIES
- **218** REPUBLICANS



SENATE

34 ELECTIONS
33 regular, 1 special

Seats up for election
- **18** DEMOCRATS
- **5** INDEPENDENTS*
- **1** VACANCY§
- **10** REPUBLICANS



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

*Caucus with Democrats. §Previously held by Republican. Source: S&P Global Ratings.
Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

Meanwhile, climate risks have added to the cost burdens public and private entities are facing. For homeowners, insurance premiums have jumped as climate-related catastrophes such as storms, floods, and fires are more severe and occur more frequently. For example, hurricane activity in Florida has led to increased risk of housing damage, and insurance for some homeowners is either prohibitively expensive or impossible to obtain in the private market. Such trends could dent housing prices and local economic growth in the longer run.

In the second quarter upgrades outpaced downgrades for the first time in two years (see chart 2). In addition, net outlook/CreditWatch changes (positive outlook/CreditWatch changes minus negative outlook/CreditWatch changes) have largely been positive since November 2023.

However, the positive momentum hasn't significantly shifted the distribution of ratings' outlooks. **The net outlook bias stayed relatively flat and was at negative 10.2% as of June 11** (see chart 3). Telecom, consumer products, and chemicals lead the negative bias—more than 25% of issuers having a negative outlook or on CreditWatch with negative implications (see chart 4). Aerospace and defense and oil and gas saw the largest increases in negative bias.

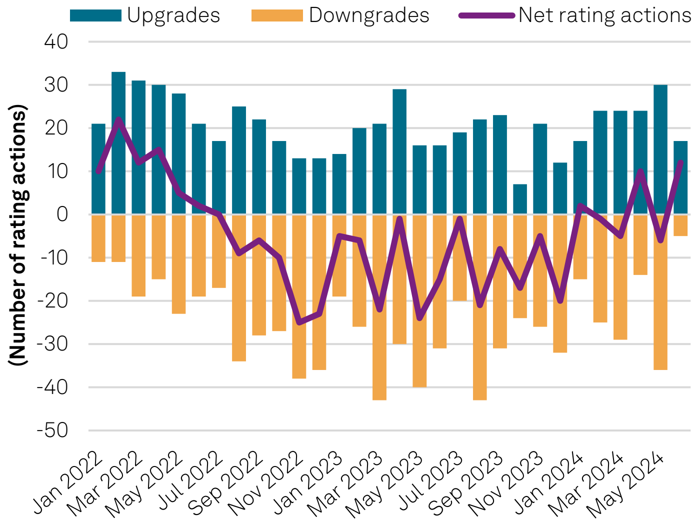
The number of defaults in North America remains elevated, led by consumer products, and media and entertainment issuers, although they are below where we were at this point last year. Health care and high tech are the only two sectors where defaults are higher than the previous year.

Ratings trends contact

Nicole Serino
New York
nicole.serino
@spglobal.com

Chart 2

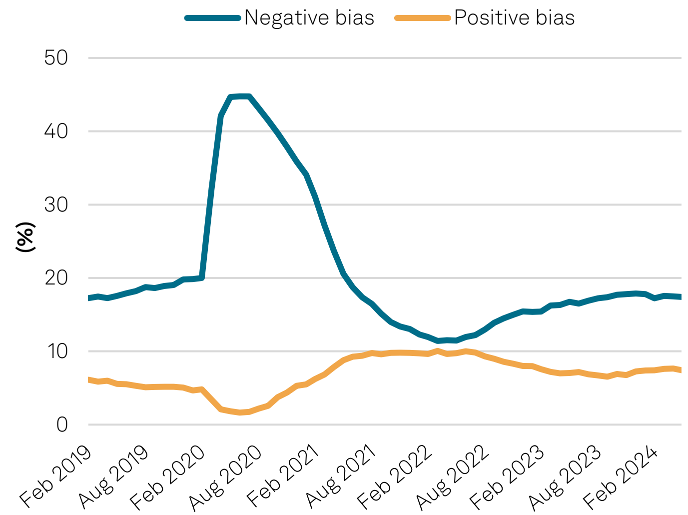
North American rating actions



Monthly data through June 11, 2024, and covers financial and nonfinancial corporates. Source: S&P Global Ratings Credit Research & Insights.

Chart 3

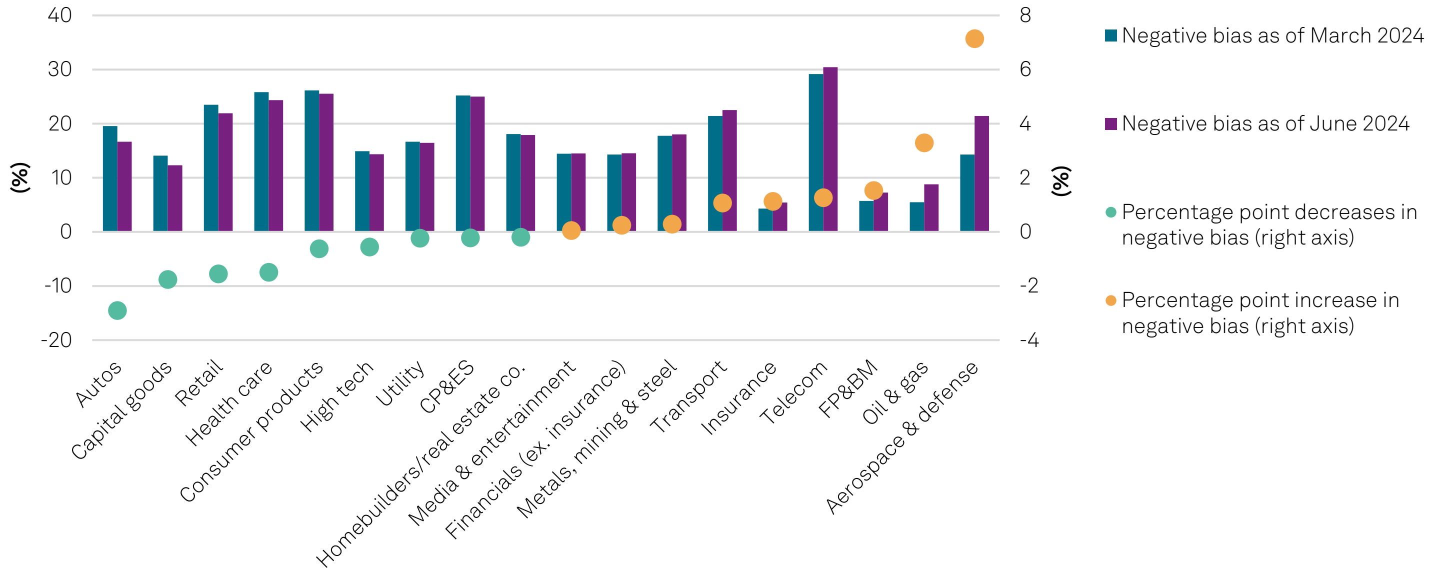
North American ratings outlook bias



Monthly data through June 11, 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.

Chart 4

Negative bias by sector



Data as of March 31 and June 11, 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.

S&P Global Ratings Credit Research & Insights expects the U.S. trailing-12-month speculative-grade corporate default rate to fall slightly to 4.5% by March 2025, from 4.8% in March of this year. This includes our assumption that defaults peak either late in the second quarter or, more likely, in the third quarter. A confluence of challenges may be beginning for consumers, and we expect defaults in 2024 to largely come from consumer-facing sectors such as consumer products and media and entertainment, as well as the still highly leveraged health care sector (see "Resilient Growth, Resilient Yields, And Resilient Defaults To Bring The U.S. Speculative-Grade Corporate Default Rate To 4.5% By March 2025", published May 16).

Top North American Risks

Continued high financing costs weigh on lower-rated borrowers' liquidity

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

If interest rates stay higher for even longer than we expect (we now forecast a first Fed rate cut in December), the costs of debt service and/or refinancing could be overly burdensome—especially for corporate borrowers at the lower end of the credit spectrum. While U.S. corporates have made progress in reducing upcoming maturities so far this year, as of April 1 there remained $354.7 billion of speculative-grade debt maturing through 2025, of which 30% are rated 'B-' and lower. Some of these borrowers may feel more severe liquidity strains, particularly if investor sentiment weakens and market volatility picks up around the U.S. elections. Challenging financing conditions could also lead to significant declines in asset valuations, including a housing slump or a deepening correction in CRE. Also, diverging monetary policy among major central banks could have ramifications for currencies and capital flows. For example, significant interest-rate increases by the Bank of Japan could trigger a shift in investment flows, causing volatility in capital markets such as U.S. 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. Recent additional tariffs on goods imported from China—and the prospect of intensifying trade tensions between the world's two largest economies—could underpin inflationary pressures. These, coupled with challenges to pass on higher costs to consumers and customers, can erode profit margin and weigh on credit quality.

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**

Elevated financing costs are pressuring 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. Certain segments and regions within the multifamily sector are also facing challenges as rent growth softens. All this may ultimately lead to more broad-based, and in some cases severe, 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 affect tax revenue for cities.

U.S. economy suffers a sharper-than-expected slowdown, hurting demand

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

The Fed is unlikely to cut its policy rate until at least the fourth quarter, and the cost of consumer and intermediate goods remains high. As a result, Americans' financial cushions and purchasing power continue to erode. Such pressure is particularly acute for lower-income cohorts, especially if unemployment rises measurably. More subdued business investment and/or a sharper pullback in spending could lead to a deeper slowdown in growth or a recession, causing more credit stress.

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, notwithstanding the greater stability the banking sector has shown over the last year. An unexpected resurgence of turmoil in the banking sector could affect credit availability, market volatility, and weigh on consumer confidence. A likely tightening of bank regulation may also affect banks' appetite for risk and perhaps certain types of loans, depending on the details of any regulatory changes.

Structural risks

Escalating geopolitical tensions impede trade and investment, weighing on growth

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

This year's U.S. elections could have ramifications domestically and abroad, potentially increasing political polarization and policy uncertainty. In this context, any further worsening of U.S.-China tensions could disrupt supply chains and hamper trade, investment and capital flows. Meanwhile, the potential for the Middle East conflict to escalate—and to affect the rest of the world through energy supply shocks, trade disruption, and social unrest—is also a key concern. While most borrowers in North America have limited direct exposure to the Russia-Ukraine conflict, the effects could deepen if an escalation (potentially involving NATO allies) occurs.

Climate risks intensify, energy transition adds to costs

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

More frequent and severe natural disasters increase the physical risks that public and private entities face, adding to costs. For example, extreme weather events are making it increasingly difficult for property owners in certain parts of the country to find affordable insurance, if they can get coverage at all, which could dampen housing prices and local economic growth in the longer run. Climate events also threaten to disrupt supply chains (such as for agriculture and food) and logistics. Moreover, the global drive toward a net-zero economy 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.

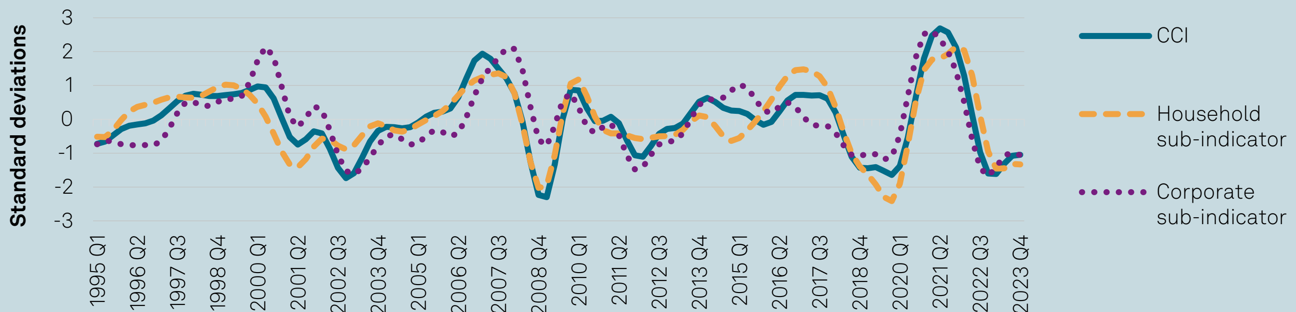
Credit Cycle Indicator

Persisting risks could complicate potential credit recovery

We believe the trough in our North American Credit Cycle Indicator (CCI), which started to form in early 2023, supports a potential credit upturn in 2025 (see chart 5). While market conditions and asset prices have largely been improving in the region, U.S. corporate and household debt-to-GDP continued to decline. This has signaled more subdued debt accumulation relative to GDP growth in the face of high interest rates. We expect a first Fed rate cut in December. But further delays could keep borrowing costs high and weaken investor sentiment. That, along with lingering inflation pressures and geopolitical risks, remain pressures for credit quality, and could derail the potential recovery. Lower-income households and consumer-facing, highly leveraged corporates will likely fare worse.

Chart 5

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 Q4 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.

Households. The momentum in the household sub-indicator seems to be stalling. This points to underlying weakness in household financial health. New delinquencies of auto loans and credit cards have been surging since 2022 in the U.S., and Canada's debt-service ratio is at its historical high. We believe the pressure is likely more acute for lower-income households. According to analysis by the St. Louis Fed, lower-income households tend to have higher credit card debt (which are typically floating rate) relative to their monthly income. Coupled with high price levels that bite into purchasing power, a sharper-than-expected pullback in consumer spending could weigh more on the economy and lead to a jump in unemployment, causing more household fragility.

Corporates. The corporate sub-indicator slightly reversed course recently. While first-quarter corporate results suggested generally positive sentiment in North America, earnings recovery has been uneven among sectors, and cash interest payments were still on the rise, weighing on liquidity (see "Corporate Results Roundup Q1 2024," published May 22). Margin pressure may persist if input-cost inflation proves to be more stubborn, and/or passthrough becomes more difficult as demand dwindles. Highly leveraged entities, especially those sensitive to the health of the consumer, could be more at risk.

Macroeconomic Outlook

- We see U.S. economic expansion slowing through the year; we forecast annual average GDP growth of 2.5% this year and 1.7% in 2025.
- Excess savings are likely depleted for all but the highest-income households, and we think consumers will increasingly rein in their spending as time goes on.
- We don't believe conditions for a monetary-policy easing by the Fed will be in place before autumn—and more likely not until very late in the year.

Primary contact

Satyam Panday
San Francisco
satyam.panday
@spglobal.com

U.S.

The U.S. economy has been remarkably resilient, despite weak headline GDP growth in the first quarter (see chart 6). Economic expansion of 1.3% (annualized) in January-March was less than half the 3.4% in the fourth quarter of last year, but the first-quarter figure masked the underlying strength of domestic demand. Excluding volatile net exports and inventories, final sales to domestic buyers grew 2.5%, with private demand expanding 2.8%.

Still, income growth has significantly lagged spending growth since the middle of last year, with American consumers relying on credit and savings. Excess savings are likely depleted for all but the highest-income households, and delinquency rates on credit cards and auto loans now exceed pre-pandemic levels. We think consumers will continue to rein in their spending as time goes on.

We see real GDP growth slowing through the year to below potential, with year-over-year growth slipping to 1.8% in the fourth quarter. The Fed's recent cycle of monetary-policy tightening—and the expected delay in easing—will likely cool economic activity, and we forecast annual average GDP growth of 2.5% in 2024 and 1.7% in 2025.

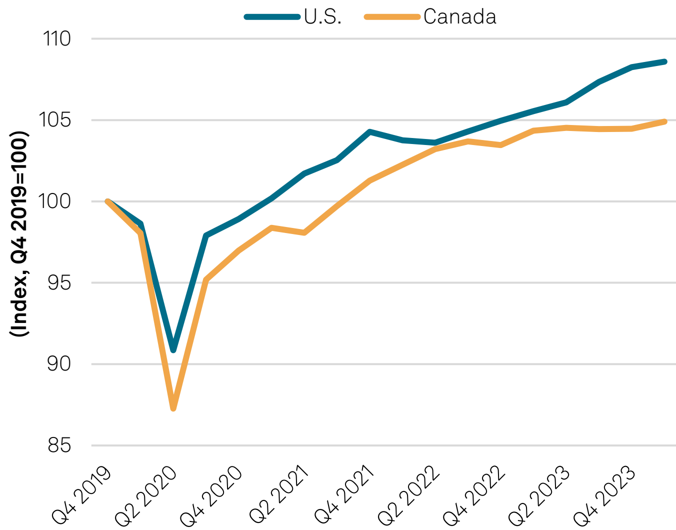
We believe conditions for a monetary-policy easing by the Fed won't be in place before autumn. Policy makers won't likely lower the federal funds rate until they see several consecutive monthly readings of 2% annualized month-over-month core inflation. The first four months of inflation readings this year likely overstate the remaining excess inflation, but they still lower our confidence in a rate cut happening soon. We now forecast the first rate cut in December—several months later than we had previously forecast.

And policy makers could, of course, wait even longer for inflation to come in consistently near the central bank's 2% target. This "last mile" could prove to be rough terrain, given that there's no shortage of upside risks to our inflation outlook, from lingering excess demand to potential supply shocks that could stall disinflation and spur another recalibration of rate-cut expectations.

That said, we don't think the Fed will feel the need to start hiking rates again. Monthly inflation may be too high to justify cuts, but it's also not enough to warrant further policy tightening. Also, the Fed's employment objectives could come into greater focus now that inflation is under 3%, thus making the central bank more sensitive to weakening in the labor market, which continues to rebalance. Churn rates that have normalized to pre-pandemic levels, and we think wage growth will trend toward 3.5% by next year—a pace consistent with the 2% inflation target if we assume productivity growth of 1.5% (the 30-year average) and stable corporate profits.

Chart 6

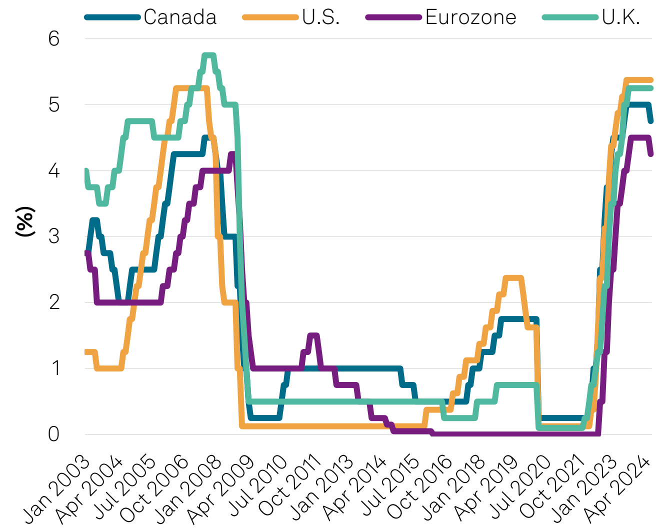
The U.S. economy widens the gap versus Canada as it continues to grow at above trend pace



Data through Q1 2024. Sources: BEA, Statistics Canada, S&P Global Ratings Economics' calculations.

Chart 7

Bank of Canada took the first move in easing policy rate amidst decelerating inflation



Data through June 21, 2024. Sources: BIS; S&P Global Ratings Economics.

Canada

After sluggish growth in the past several quarters the Canadian economy looks set to turn the corner toward a moderate growth rebound. Following an annualized expansion of 1.7% in the first quarter (in line with our expectation) we've revised upward our forecast for GDP growth for this year by 20 basis points, to 1.1%.

While we are more positive about the economic outlook, most of the rebound will likely coming from fixed investment rather than from consumer spending, as the cumulative (lagged) effect of higher interest rates will weigh on consumers.

We now assume the Bank of Canada (BoC) will lower its key rate 75 basis points (bps) this year, and we expect another 125 bps of rate cuts in total next year. But while though the BoC has embarked on a cycle of monetary-policy easing (see chart 7), borrowing costs will remain much higher than the pandemic lows in the next two years.

Financing Conditions

- First-half optimism has helped push speculative-grade bond spreads to new all-time lows, while issuance is well ahead of even 2019 levels.
- Most issuance has been used for refinancing, and the pace is slowing as market risks come to the fore.
- With interest rates likely to remain higher than the markets expected, refinancing activity is coming at a cost, keeping the default rate above the long-term average for the next nine months.

Primary contact

Nick Kraemer
New York
nick.kraemer
@spglobal.com

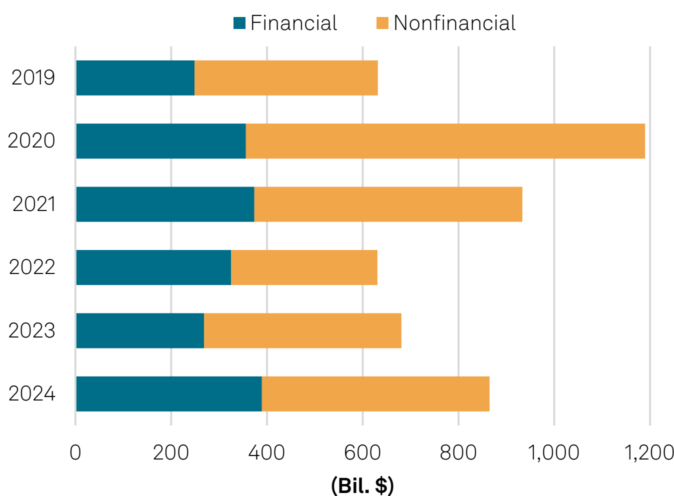
Early market optimism has largely continued through midyear, pushing bond spreads to all-time lows. Speculative-grade bond spreads narrowed to 229.6 basis points on May 7, as markets remain receptive to new supply.

Narrow spreads continue to drive strong issuance (see chart 8). Issuance is up year to date across all levels of credit quality and sectors, in some cases, substantially. Nonfinancial corporate bond issuance is up more than 15% and financial services is up 45%. Some of this is to be expected given the historically low 2023 total after the collapse of Silicon Valley Bank. Nonetheless, the $390 billion of issuance among financial services companies through June 13 represents the highest comparable total since the financial crisis. And the $475 billion from corporates easily surpasses 2019's year-to-date total of $383 billion. Most companies have used issuance for refinancing purposes rather than more growth-oriented aims.

Spreads appear far too tight. Economic resilience and a general dearth of volatility would generally support favorable spread levels, but not perhaps to their current lows (see chart 9). Our estimated spread and the North American High-Yield CDX index have been elevated relative to the speculative-grade bond spread for nearly 18 months. While all three have been trending downward for several months, these other two measures of relative risk are still higher than their pre-pandemic levels.

Chart 8

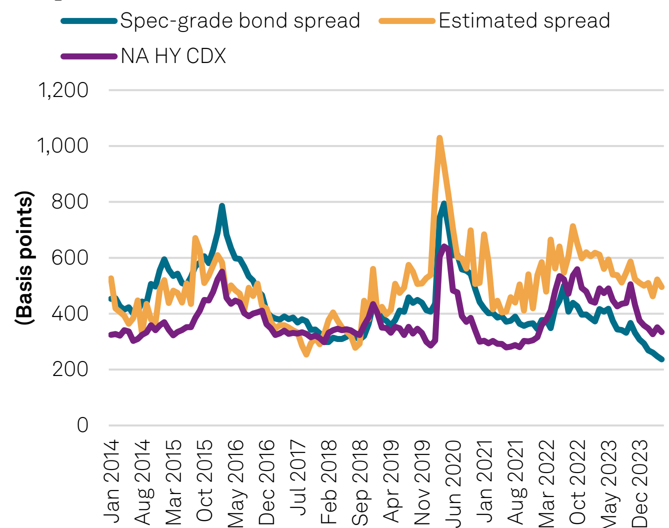
Bond issuance is off to a strong start



Year-to-date totals through June 13, 2024. Source: Refinitiv, S&P Global Ratings Credit Research & Insights.

Chart 9

As spreads reach new all-time lows



Monthly average daily spread through May 2024. Source: S&P Global Ratings Credit Research & Insights.

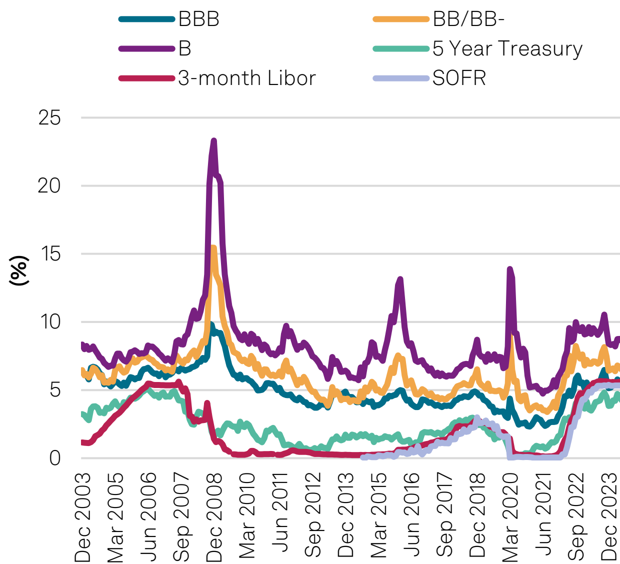
Even if spreads remain very tight, they conceal historically high borrowing costs. For most of the period after the Great Financial Crisis (GFC), narrowing spreads have come alongside falling yields, but the opposite has been happening since the Fed began its rate-hike cycle in 2022 (see chart 10). For approximately two years, corporate bond yields have not only reached but remained at levels above even their pre-GFC norms. Bonds rated 'B' have been averaging secondary-market yields just shy of 10% since mid-2022 compared with a 2006 average of 7.9%. There has been some relief with this figure now averaging 8.5% on a monthly basis, but this is still higher than at any six-month period outside of the financial crisis.

Sustained higher yields will test more issuers as time goes on. Higher yields may not have deterred issuers or investor appetite for new supply recently, and the heavy wave of refinancing has taken some immediate liquidity pressures off of many. But as time goes on, more debt is being refinanced at higher rates (see chart 11). So far, a resilient economy and consumer spending has allowed issuers to largely keep up with higher financing costs, but as the economy slows, this will leave less wiggle room for corporate profits by raising the average cost of debt. Downgrades could increase and this will likely contribute to a historically elevated default rate over a slightly protracted period; per our base-case forecast of 4.5% through next March.

Treasury market concerns are starting to appear. Underneath the backdrop of rising rates for all sectors, benchmark Treasury rates have also been rising, and more quickly—leading to a "bear-tightening" of corporate spreads. Some measures of relative risk, including Bloomberg's Treasury Liquidity Index and U.S. credit default swap (CDS) levels, have been rising to highs not seen since the GFC. Increased government spending has provoked a recent uptick in Treasury issuance, with more than $27 trillion of Treasury debt outstanding, a more than $3 trillion increase from the start of 2023. At the same time, some of the largest holders of Treasuries have been cutting back, such as Japan, China, and of course , the Fed. And most of this increased issuance has been for debt maturing in three years or less, arguably increasing yields at the shorter end and contributing to the longest-lived inversion of the 10-year/3-month yield curve.

Chart 10

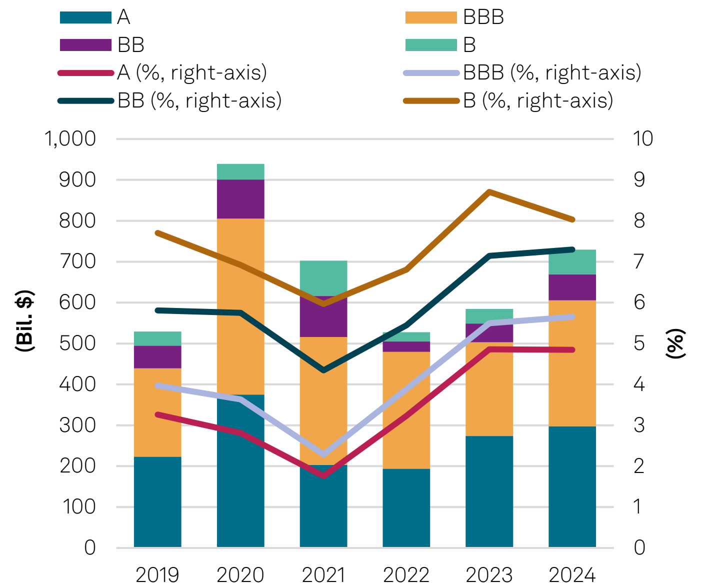
Yields (are still) likely to remain elevated



Sources: S&P Global Market Intelligence, S&P Global Ratings Credit Research & Insights.

Chart 11

Rising debt, rising coupons leave less wiggle room ahead



Year-to-date data through June 13, 2024. Bars indicate new issuance, and lines indicate coupon rates. Source: Refinitiv, S&P Global Ratings Credit Research & Insights.

Sovereigns

- Whatever the results of the November elections, the composition of Congress will inform the prospects for policy outcomes; a 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 Sept. 30, but 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} expire at the end of 2025).

Primary contact

Lisa Schineller
New York
lisa.schineller
@spglobal.com

We don't expect passage of controversial legislation before the 2024 elections. For example, efforts to secure a vote on a bipartisan immigration and border-security bill stalled in February specifically because of the election cycle, and a renewed push in May did not advance. After approving funding for fiscal year 2024 in line with top-line discretionary spending agreed to under the Fiscal Responsibility Act of June 2023, Congress also approved aid for Ukraine and Israel in April and May, respectively. However, we don't expect any action on the president's fiscal-year 2025 budget or that presented by the House Budget Committee or a fiscal commission. Come September, we assume passage of short-term continuing resolution(s) to avert a government shutdown during the campaign period.

The composition of Congress after the upcoming election will continue to play a key role in determining policy. Despite partisanship, political leadership has advanced policies where there is consensus or overlap of the two parties' priorities. 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 will likely 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

- Most of our bank ratings (roughly 80%) have stable outlooks. Stabilizing interest rates and expected eventual cuts have eased the main concerns regional banks faced in 2023.
- We are focusing on rated banks with the largest CRE exposures. Most should be able to absorb related stresses but are subject to vulnerabilities from a loss of confidence.
- Our outlook is stable on approximately 73% of the North American finance companies we rate. We have one positive and 12 stable outlooks on business development companies.

Primary contacts

Stuart Plesser
New York
stuart.plesser
@spglobal.com

Brendan Browne
New York
brendan.browne
@spglobal.com

Gaurav Parikh
New York
gaurav.parikh
@spglobal.com

Elizabeth Campbell
New York
elizabeth.campbell
@spglobal.com

Banks

Stabilizing interest rates and expected eventual cuts have somewhat eased the main concerns regional banks faced in 2023—namely the sharp rise in rates, asset-liability management, and declining deposits. However, **the focus is now on 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 as a sizable portion (20%-30%) of rated banks' CRE loans mature in 2024.

Most of our bank ratings (roughly 80%) have stable outlooks, reflecting the fact that although tough operating conditions continue, stability in the 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. The ratings on nine U.S. banks, or 17% of the rated bank portfolio, have negative outlooks, mainly reflecting CRE risk.

Credit quality has been modestly deteriorating with charge-off levels now above the historical median. Credit quality will likely continue to deteriorate, mainly driven by CRE, but also slowing economic growth and sustained higher rates. Still most banks' allowances for credit losses were flat in the first quarter on a sequential basis, partially due to weak loan growth. 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 in the gateway cities that have seen the largest declines in office prices. However, they may not be entirely immune to asset-quality deterioration. Furthermore, multifamily properties 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 bank suddenly needed to build a significant CRE reserve due to loan deterioration, it could dent a big portion of that banks' quarterly income. This would possibly result in a loss, which in turn, could result in customer attrition, including deposit outflows.

Bank deposits increased in the last two quarters (up more than 1% each quarter), but at the expense of higher funding costs. Banks raised rates they paid to keep deposits as the deposit mix shifted, with a growing reliance on higher-yielding deposits such as CDs and brokered deposits, combined with lower 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 with an incremental rise in funding costs. We believe net interest income will decline modestly this year while capital ratios remain elevated. This isn't just a defensive measure by 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). Unrealized losses in banks' securities portfolios rose modestly in the first quarter as long-term rates rose. Unrealized losses totaled roughly 9% of banks cumulative securities portfolios at the end of the first quarter.

Our key risks for the U.S. banking sector are largely the same as at the start of the year. They include challenging interest rate management due to persistent inflation, stress in CRE loans, a re-emergence of confidence-sensitivity issues, regulatory challenges and risks from growing competition from nonbanks, cybersecurity, and the ability to keep up with advancing technology.

Finance companies

Our outlook is stable on 73% of the North American finance companies (fincos) we rate. Deteriorating asset quality, rising liquidity needs, stabilizing but lower earnings, and higher funding costs continue to weigh on ratings. There will likely be an urgency to deploy capital this year that could influence underwriting standards, which in turn drive asset quality. We think fincos with diversified revenue streams and sound balance sheets are best-positioned to meet these challenges over the next year.

We have one positive and 12 stable outlooks on business development companies (BDCs). The proliferation of newer BDCs combined with improved financing conditions for broadly syndicated loans (BSLs) and speculative-grade bond markets has led to intensifying competition for direct lenders. As a result, there is tremendous amount of capital waiting to be deployed, with limited investment opportunities, which has led to spread compression for direct lenders. Tighter credit spreads, along with investor appetite for risk, has allowed BSL markets to compete with direct lenders. 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.

Despite headwinds from higher-for-longer rates and inflationary pressures, valuation marks have been better year to date (in line with rising markets) and this could continue in the remainder of the year on expected economic growth and EBITDA growth of underlying borrowers. While nonaccruals remained relatively low, payment-in-kind (PIK) income, as a percentage of gross investment income, is 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.**

Challenging conditions to persist for CRE lenders and services companies. Higher-for-longer rates continue to pressure asset valuations by pushing cap rates higher, but the extent of the impact will depend on location, property type, and the underwriting quality on the properties securing their loans. We have seen a precipitous decline in CRE lenders' distributable earnings; that has prompted some companies to cut their dividends to protect liquidity. 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 this year, 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 seen some strain in multifamily due to increased supply, 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 to offset office exposure.

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 rates relative to existing debt. We've seen increasing distressed debt exchanges 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 rate cuts will modestly 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 and equity markets. But market dislocations offer both challenges and opportunities, as distressed valuations and the continued retrenchment of regional banks may grow the opportunity for deployment, particularly in credit.

Traditional managers are the most exposed to market volatility, and net outflows could compound this pressure. Credit metrics weakened in the first quarter 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 18 months, mainly due to higher leverage from declining assets under management (AUM) and earnings, particularly in cases where the declines were concentrated in higher-fee products. Wealth managers benefit from more stable flows and a stickier asset base. Risks to wealth manager ratings stem from the rapid pace of inorganic, debt-financed growth.

Alternative asset managers are the best-positioned, considering the generally locked-up nature of a large proportion their AUM, solid performance records and fundraising, diversified platforms, and dry powder available. But 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.

Growth in private credit has partially offset headwinds for private equity. Asset managers that have developed broad credit platforms are well-positioned to compete with banks. Credit now consists of a significant portion of AUM for some issuers we rate, and we expect this to drive growth. We have also seen traditional asset managers expand their private credit capabilities. Asset-based finance strategies have also garnered inflows for alt managers especially from insurance company investors. Certain alt managers are even fundraising for CRE, as they see growing opportunities.

The sector has very little near-term debt maturities. Many asset managers refinanced when capital costs were low. A couple of managers we rate underwent distressed exchanges in the past few quarters. 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

- Amid uneven progress toward taming inflation, we've pushed out our forecast for interest-rate cuts. Capital markets are relatively open, but borrowing is more costly, and the prospect of slowing GDP growth is damping expectations for top-line growth.
- The November elections add a dimension of risk to ongoing economic concerns.
- Increasingly protectionist trade policies and any international responses will most likely result in higher input costs for companies, higher costs for consumers, or both.

Primary contacts

Chiza Vitta
Dallas
chiza.vitta
@spglobal.com

Carin Dehne-Kiley
New York
carin.dehne-kiley
@spglobal.com

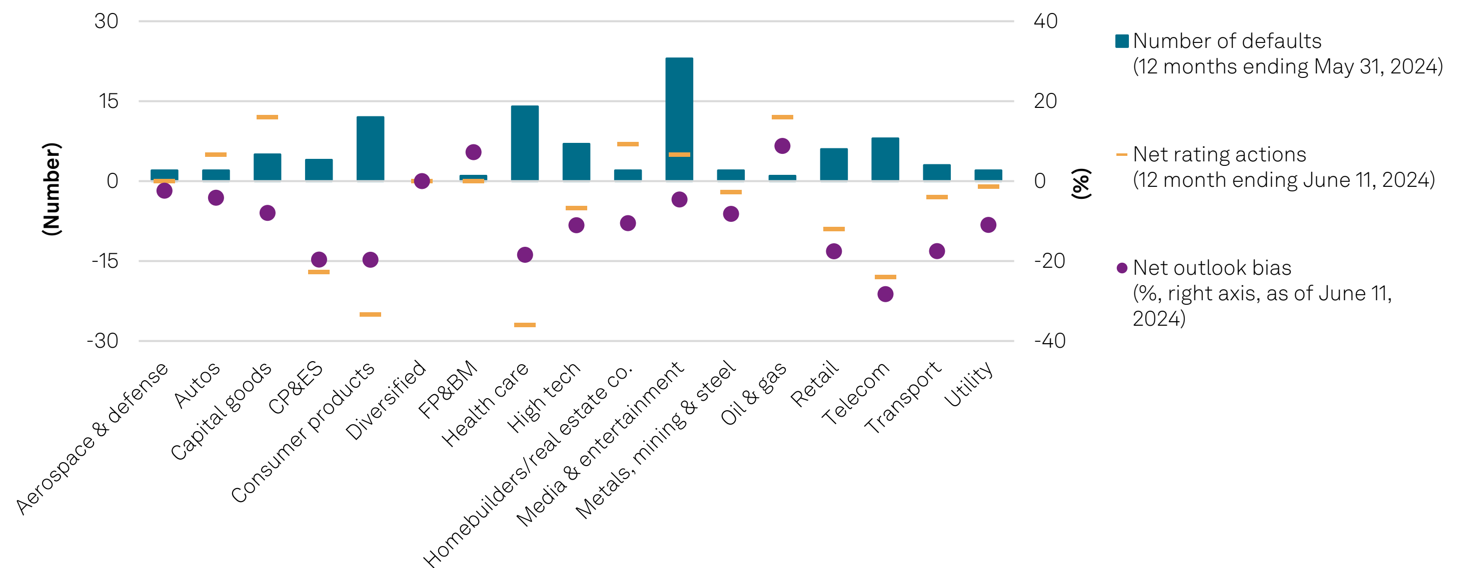
Progress in taming inflation has been uneven, and we now believe interest rates will remain high for longer. The capital markets are relatively open, but borrowing is more costly, and the prospect of slowing economic activity is tempering expectations for corporates' top-line growth.

Outlook bias: Oil and gas continues to stand out as the sector with the most ratings net positive bias—forest products and building materials is the only other sector with a net positive outlook bias (see chart 12). Optimistic outlooks for the oil and gas sector are due to supportive oil prices, ongoing capital discipline, healthy balance sheets and largely equity-funded mergers and acquisitions that have typically bolstered the outlook for the acquirors and their potential targets. Nevertheless, the bulk of our rated portfolio is characterized by sectors with varying degrees of negative outlook bias, indicating more difficult than average operating conditions in the next one to two years (see chart 4).

Net ratings actions: Health care and consumer products have experienced the most negative rating actions over the past 12 months.

Chart 12

Net outlook bias, net rating actions and defaults by sector



Includes North American nonfinancial corporates only. CP&ES—Chemicals, packaging & environmental services. FP&BM—Forest products & building materials. Net rating actions—Number of downgrades minus upgrades. Net outlook bias—Positive bias minus negative bias. Source: S&P Global Ratings Credit Research & Insights.

Defaults: The number of defaults—including selective defaults prompted by the inability to refinance near-term debt maturities—are at more than double that of 2022. While defaults within a sector tend to increase along with a negative outlook bias and negative net rating actions, this relationship is weaker than that between the latter two indicators. Media and entertainment,

health care, and consumer products stand out with significantly more defaults than other sectors over the past year.

Notable standouts: Despite positive net rating actions and a relatively modest net negative bias, the media and entertainment sector led the default tally in the past year. The media industry is going through secular changes that are affecting subsectors unevenly. This helps explain how defaults can be so high while the other indicators suggest lower levels of strain. Ratings distribution in the sector also skews toward the lower end, making the sector more susceptible to defaults, including selective defaults, during periods of stress. The chemicals sector offers a second unexpected case. Despite negative metrics for both net outlook bias and net rating actions, defaults remained low. In contrast to the media example, chemicals is somewhat shielded from defaults by a larger number of investment-grade issuers, which have more of a cushion under stress.

The potential effects of election results are difficult to assess

The elections introduce an additional dimension of risk to ongoing economic concerns. Official policy platforms for both parties remain loosely defined for now—although given the public discourse, they are hard to ignore. In certain cases, issuers have taken the opportunity to refinance earlier in the year, preferring to lock in new capital structures rather than contend with any volatility that might emerge as we approach the election later this year. We have identified key areas that we will continue to monitor as details become available, keeping an eye on those sectors that stand to gain or lose from shifts in policy.

Trade and tariffs: We believe increasingly protectionist trade policies and any international responses will likely result in inflationary pressures (higher input costs for companies, higher costs for consumers, or both). Specifically, higher tariffs on imports from China (and any retaliation from China) could add to margin pressures for some sectors, hamper market access, especially for tech, and accelerate supply-chain diversification away from China (see chart 13). On the other hand, certain industries may benefit from some measure of protectionism. For example, capital goods manufacturers, which have lowered their reliance on Chinese imports thanks to more diversified sourcing strategies in recent years, could enjoy greater reshoring and/or onshoring opportunities. Some U.S. chemical subsectors could benefit from higher product prices if imports of competing products from China are more expensive.

Foreign aid: Conflicts such as those in Ukraine or the Middle East can disrupt supply chains, contributing to rising input prices. Conversely, to the extent the U.S. becomes involved, commitments of human and financial resources would surely filter down to companies that produce the resources demanded or restricted by these conflicts.

Immigration: There are pockets of labor shortages across our service-based economy. In recent months, wage growth has come off previous peaks providing some relief for employers. Nevertheless, finding affordable workers with the right skills constrains certain companies. Industries with labor forces or skill sets that are sensitive to immigration policy will need to be prepared to make adjustments to continue meeting staffing goals if immigration restrictions are implemented.

Fiscal spending and taxation: Fiscal spending related to legislation such as the CHIPS and Science Act and the Inflation Reduction Act remains significant. We believe these policies have bipartisan support and therefore are less likely to be reversed. However, they may be adjusted in ways that reallocate the extent to which various beneficiaries receive support.

Certain provisions of the 2017 Tax Cuts and Jobs Act (TCJA) that affect corporations have expired, such as interest deductibility, and certain provisions that affect individuals are set to expire in

2025. While still very fluid, there have been proposals to retroactively reinstate the expired corporate-tax provisions as well as to work on individual-tax provisions.

Chart 13

Potential effects of even higher U.S.-China tariffs on North American corporates

EFFECT OF TARIFF*

Detrimental | Somewhat detrimental | Neutral | Somewhat beneficial | Beneficial

Sector	60% tariff on Chinese imports	Retaliatory tariff on U.S. goods	Current supply chain dependency on China vs. before tension§
Aerospace and defense	Neutral	Neutral	▬ No change
Auto OEMs and auto suppliers	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Building materials	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Business and technology services	Neutral	Somewhat detrimental	Not applicable
Capital goods	Somewhat beneficial	Somewhat detrimental	▼ Less dependent
Chemicals	Somewhat beneficial	Somewhat detrimental	▬ No change
Consumer products	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Containers and packaging	Neutral	Neutral	▬ No change
Gaming, leisure, and lodging	Neutral	Neutral	▼ Less dependent
Healthcare	Somewhat detrimental	Neutral	▬ No change
Homebuilders	Neutral	Neutral	▬ No change
Media and entertainment	Neutral	Neutral	Not applicable
Metals and mining	Neutral	Neutral	▼ Less dependent
Midstream energy	Somewhat detrimental	Neutral	▬ No change
Oil and gas	Neutral	Neutral	Not applicable
Oil refineries	Neutral	Neutral	▬ No change
Pharmaceutical	Somewhat detrimental	Neutral	▬ No change
Regulated utilities	Somewhat detrimental	Neutral	▬ No change
REITs	Neutral	Neutral	▬ No change
Retail and restaurants	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Technology	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Telecom	Neutral	Neutral	Not applicable
Transportation	Neutral	Neutral	▬ No change
Unregulated (merchant) power	Somewhat beneficial	Neutral	▬ No change

*These impact descriptors are our qualitative view of the potential effect on sectors as of June 2024. It doesn't directly translate to risk of rating actions. §Before the U.S.-China tension escalated under the Trump Administration.
Source: S&P Global Ratings.
Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

Regulation: 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

- Most sectors remain stable, but credit quality has started to weaken for some.
- Stable sectors are showing solid revenue growth, healthy reserves, and an ability to absorb rising expenditures without hurting credit quality.
- Sectors experiencing negative trends, including health care, mass transit, utilities, and some segments of higher education, continue to see pressure from labor costs, shifts in demand, or rate-setting flexibility that can lead to an operating imbalance.

Primary contacts

Jane H Ridley
Centennial
jane.ridley
@spglobal.com

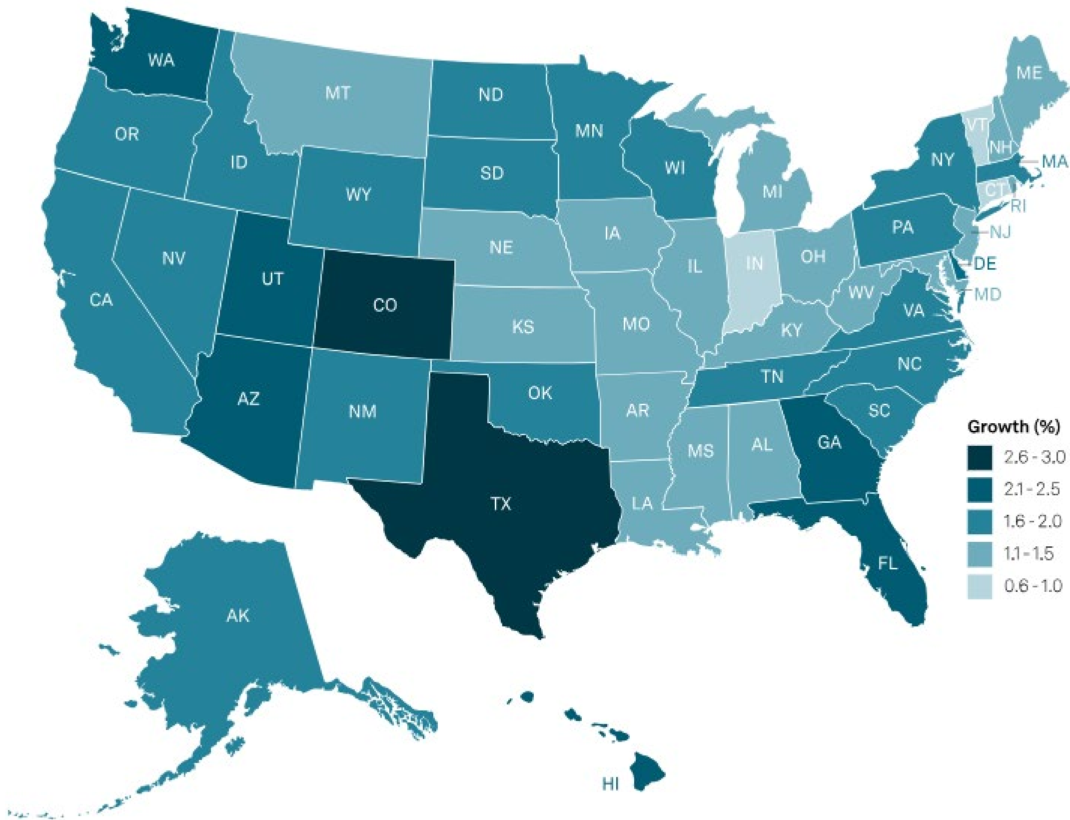
Sarah Sullivant
sarah.sullivant
@spglobal.com

Robin Prunty
New York
robin.prunty
@spglobal.com

States' credit quality remains strong—and largely unchanged from 2023—but gross state product (GSP) trends indicate some slowing. S&P Global Market Intelligence forecasts the median state's real GSP to be about equal to the national GDP level, with 2.4% annual growth this year, decelerating to 1.6% next year (see chart 14). Although slowing GSP trends don't present an outsized cause for concern for state credit quality, they do indicate a slowing trend in economic and tax revenue growth.

Our forecast for slower growth in Canada, too, means provinces will have a harder time maintaining balanced operating results, with projected lower tax revenues and higher wage settlements to date. In addition, record population growth is putting pressure on provincial and municipal services and infrastructure, which will continue to shape political and budget dynamics in the next two years.

Chart 14
Slowing but still positive in 2025
Forecast gross state product (% annual growth)



Source: S&P Global Market Intelligence.
Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

Credit Issues That Matter

Higher interest rates and rising costs: Even with projections for lower interest rates on the horizon, the prolonged higher-rate environment has an impact on budgets, particularly those of capital-heavy sectors like transportation and utilities. Higher wages remain a challenge as well and a trend unlikely to reverse itself. This prolonged period of higher costs has had more notable impacts on utilities and health care and has led to some credit deterioration.

CRE: The impact of remote work continues to pose headwinds for U.S. cities and is creating some economic and budgetary uncertainty. For the most part, we don't expect these issues to directly affect credit quality, but they could result in sluggish revenue growth from falling tax collections tied to CRE. However, when cost pressures from downtown revitalization, public safety, housing, and homelessness are added to the mix, the challenge facing cities swells markedly.

Transportation transitions: Infrastructure spending across the U.S. remains strong, but elevated costs for some construction materials, wage increases, and worker shortages don’t allow the spending to stretch as far. Ports, toll facilities, and airports are back to pre-pandemic usage, and while transit demand is encouraging and shows signs of steady-state growth, it has not regained lost ground. However, as federal stimulus dollars from the American Rescue Plan Act are coming to an end, some transit systems may face difficult choices ahead.

Other disruptors: In an operating environment filled with the potential for catastrophes—both natural and manmade—issuers must be ready for potential disasters. While planning is critical, keeping liquidity to address the unexpected, from weather to cyberattacks, is essential to guarding against credit deterioration. This includes preparing for election-year distractions at the federal and state level, which can dramatically slow progress on essential legislation dependent on approval at a higher level to progress, creating policy and regulatory uncertainty.

Structured Finance

- For U.S. structured finance, we generally expect stable or somewhat negative ratings trends in the next 12 months, with most ratings actions in non-investment grade classes.
- Given that we've pushed out our forecast for interest-rate cuts, the focus is on sectors most vulnerable to higher rates—including CRE.
- Collateralized loan obligation (CLO) ratings are holding up well after two years of stress on corporate ratings, but credit metrics are gradually declining.

Primary contacts

Winston W Chang
New York
winston.chang
@spglobal.com

James M Manzi
Washington, D.C.
james.manzi
@spglobal.com

Tom Schopflocher
New York
tom.schopflocher
@spglobal.com

Most sectors are showing stable or somewhat weaker collateral performance, with CMBS and subprime auto loan performance the exceptions (see table 1). Amid the fading risk of recession, we've pushed out our forecast for interest-rate cuts, and the focus is on sectors most vulnerable to high rates: CRE—especially office, consumer asset-backed securities (ABS) backed by obligors with relatively lower FICO scores, and lower-rated companies backing collateralized loan obligations (CLOs).

Table 1

12-month North America structured finance outlook – Q3 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	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
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	Somewhat stronger	Stable to positive
Transportation - container	Stable	Stable to positive
Transportation - railcar	Stable	Stable to positive
Whole business	Somewhat weaker	Stable
Triple net lease	Stable	Stable

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

Refinancing prospects and CRE performance in general continue to be challenged, with higher-for-longer benchmark rates, decelerating cash flow growth (or declining, for office), and rising expenses. We expect CMBS delinquency rates to increase and rating actions to be heavily biased toward downgrades for the remainder of the year. For residential mortgages and residential mortgage-backed securities (RMBS), the song largely remains the same—most borrowers are locked in at much lower-than-prevailing rates, leading to low inventory and elevated prices. As a result, credit trends remain stable to somewhat positive.

Consumer loan ABS sectors are showing rising delinquencies for both prime and subprime categories, with far more stress on the latter. Rating trends are largely stable with some potential downward bias in subprime auto loan and unsecured consumer loans. Esoteric ABS is generally showing somewhat weaker collateral performance and stable rating trends, although transportation related sectors are somewhat stronger, and rating trends for tobacco settlement related securitizations are stable to negative.

CLO ratings are holding up well after two years of stress on corporate ratings, but credit metrics are gradually declining and the average BSL CLO 'CCC' basket now sits at just over 7.5% of total assets. CLOs issued in the first quarter of 2020 and before generally have weaker collateral metrics than those issued in Q2 2020 and later, after the arrival of COVID-19 and the associated economic downturn. Metrics (both pre-pandemic and current) have been converging given the stress on leveraged borrowers from higher rates in 2022 and 2023 and corporate rating downgrades.

For U.S. structured finance overall, we generally expect stable or somewhat negative ratings trends over the next 12 months, with most rating actions in the non-investment grade classes. We do expect variation across sectors, as reflected by the discussion above.

Insurance

- Most (80% or better) of our ratings for the core portfolio maintain stable outlooks.
- Life insurers will continue to benefit from the generally stable interest-rate environment.
- Our view on the property/casualty (P/C) sector remains negative, notwithstanding a significant shift in our distribution of 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.

Primary contact

Joseph N Marinucci
New York
joseph.marinucci
@spglobal.com

The average financial strength rating for our core North American insurance portfolio (life, health, P/C) is at the upper half of the strong ('A') category. Most (80% or better) of our ratings for the core portfolio maintain stable outlooks (with emergent negative bias for the health insurance sector).

Major rating 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 continues to underpin credit quality.

Table 2

North America insurance sector trends – Q3 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. There are no changes since Q2 2024.
Source: S&P Global Ratings.

Life insurance

With the U.S. economy expected to grow 2.5% this year and inflation expected to remain above the Fed's target, the relatively accommodating environment for life insurers will likely persist for a little while longer. The sector will continue to benefit from the generally stable interest-rate environment, with the 10-year Treasury yield fluctuating around 4% but not dipping down to the low levels prior to 2021. The current rate environment continues to support record sales of fixed-rate and fixed-index annuities, although life insurance sales have dipped, specifically in whole life and variable life. We expect sales will begin to plateau at some point this year or early next year, but profitability will remain positive.

A potentially slowing economy may prompt 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 ratings 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. Escalating geopolitical tensions that impede trade and investment are a wildcard that may affect the sector.

We expect the M&A trends of that past 18 months will continue, with more blocks of legacy businesses moving from public companies to private hands.

Health insurance

The health insurance industry remains on stable footing, though headwinds are challenging the sector, particularly within the government lines. While 80% of the portfolio has a stable ratings outlook, a negative bias has emerged in connection with our revised view of capital following the implementation of our capital model criteria as well as other factors contributing to earnings and capital pressures. We expect healthy revenue growth in 2024 due to premium rate increases tied to medical-cost inflation. Though growth may soften amid member losses in Medicaid due to the ongoing impact of redeterminations and Medicare Advantage rate pressures.

We think it will be challenging for some health insurers to sustain their credit profiles, while others will operate through headwinds, incurring some credit profile strain that is unaccompanied by a rating change. The sector is grappling with greater earnings pressure due to elevated utilization trends and weaker rates in Medicare Advantage and the lag in rate adequacy in Medicaid as the redetermination process wraps up and the sector exhibits a higher-acuity population. The commercial segment is experiencing pockets of higher utilization, particularly within behavioral health and due to increased usage of GLP-1 drugs.

On M&A, the industry remains active, as health insurers continue to acquire non-insurance health-care services companies and tuck-in health insurance assets. Leverage and integration risks remain balanced by strong cash flows and financial flexibility, reflected by healthy debt repayment and coverage metrics.

P/C

S&P Global Ratings' view on the P/C sector remains negative, notwithstanding a significant shift in our distribution of rating outlooks, which we attribute 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 U.S. P/C insurers last year was again negative. The record divergence in the performance between insurers writing predominantly commercial lines and those writing personal lines remained in. 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 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 been pursuing rate increases and their results began to improve last year. There was significant improvement in first quarter as the P/C industry's combined ratio fell to about 94% from 102% a year earlier. The industry's full-year 2023 combined ratio was around 102%, and we expect this measure to return to underwriting profitability further, assuming normalized catastrophe losses. 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. The sector generated strong earnings in 2023 and we expect that trend to continue as reinsurers have benefited from favorable pricing and the unwinding of unrealized investment losses coupled with higher investment yields. Therefore, we maintain our stable view of the global reinsurance sector after we revised it from negative in September 2023.

Overall, reinsurers' capital positions have been rebuilt thanks to strong results. 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 cost trends, especially for business underwriting during the past soft cycle.

Reinsurance demand is increasing, with reinsurers generally maintaining their underwriting discipline. This should sustain the pricing momentum for the rest of 2024 renewals.

Bond, title, and private mortgage insurers

Notwithstanding tighter credit spreads at the start of the year in the U.S. public finance market, insured penetration for the bond insures has remained elevated. This trend, combined with a rebound in total new issue volume, point to a strong production environment for the bond insurers. Further supporting business growth has been a strong demand in the secondary market, which should continue due to volatility stemming from uncertainty relating to Fed rate cuts and the November election. Insured issues within the USPF market represent greater 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 plans support growth.

The overall profitability and financial strength of title insurers depend on their ability to manage operations throughout the mortgage and economic cycles. This aspect of the title business is being tested as the residential housing market has remained under pressure due to higher interest rates and lack of supply. As a result, transaction volumes remain near historic lows. Because insurers remain focused on managing operating expenses and fees per order are rising, pre-tax margins are strong. Economic uncertainty, high interest rates, and low inventory remain key factors for the decline in existing-home sales.

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 insures with each proving successful at expense control with a solid set of risk tolerance standards including oversight of agents and we expect this trend to continue. Elevated mortgage rates and low, albeit growing, inventory levels have caused transaction volumes to remain near historically low levels. During this period, we have maintained our focus on managing operating expenses.

The private mortgage insurers (PMIs) continue to benefit from a still resilient economy, with a relatively strong labor market. Although mortgage delinquencies have slightly picked up, they remain well below pre-pandemic levels. PMIs' outstanding loan portfolio continues to exhibit significant embedded home equity, which we believe will provide a material cushion against any potential losses. New business volumes remain tepid, driven by higher-for-longer mortgage rates, and rising home prices, making housing unaffordable for many first-time homebuyers. However, this has been largely offset by higher persistency rate (lower lapse rates). PMIs have maintained strong underwriting discipline and their loan portfolio quality remains robust, with very low risk layering. We believe a combination strong underwriting quality, significant embedded home equity, along with solid capitalization will help PMIs to navigate any near-term stresses. We believe the sector's combined ratio in 2024-2026 will average around 50%-55%, with the ROEs averaging low- to mid-teens.

Related Research

- Credit Conditions Emerging Markets Q3 2024: Policy Uncertainty May Hinder Resilience, June 25, 2024
- Credit Conditions Asia-Pacific Q3 2024: A Trade Showdown Unfolds, June 25, 2024
- Credit Conditions Europe Q3 2024: Keep Calm, Carry On, June 25, 2024
- Economic Outlook U.S. Q3 2024: Milder Growth Ahead, June 24, 2024
- Economic Outlook Canada Q3 2024: Turning The Corner, June 24, 2024
- Credit Cycle Indicator Q3 2024: Bumpy Ride Ahead Of A Credit Recovery In 2025, June 19, 2024
- U.S. Business Cycle Barometer: Recession Risk Remains Above Historical Norm, June 18, 2024
- CRE Debtholders Are Confronting Increasing Refinancing Risk And Charge-Offs In 2024; Outcomes Will Vary, June 3, 2024
- Resilient Growth, Resilient Yields, And Resilient Defaults To Bring The U.S. Speculative-Grade Corporate Default Rate To 4.5% By March 2025, May 16, 2024
- White Paper: Introducing Our Credit Cycle Indicator, June 27, 2022

Editor

Kelliann Delegro

Digital designer

Jack Karonika

Research contributor

Sourabh Kulkarni

This report does not constitute a rating action.

The views expressed in the Macroeconomic Outlook section (pages 6-7) are the independent opinions of S&P Global Ratings' economics group, which is separate from but provides forecasts and other input to S&P Global Ratings' analysts. S&P Global Ratings' analysts use these views in determining and assigning credit ratings in ratings committees, which exercise analytical judgment in accordance with S&P Global Ratings' publicly available methodologies.

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	Our outlook for commercial aerospace companies is mixed despite continuing strong demand for aircraft and engines, as well as related parts and services. Well-documented production challenges and regulatory oversight at Boeing have constrained the pace of new aircraft deliveries. Pent-up demand amid ongoing supply chain challenges has led to significant backlogs across the broader commercial aerospace industry that extend for several years. Reliability issues on newer generation engines also remain an overhang. On the other hand, with older aircraft remaining in service longer than anticipated, several issuers will benefit from heightened demand for parts and services. Based on our assumption for higher aircraft deliveries next year, we expect a corresponding improvement in revenues and cash flow across much of the sector. For defense companies, the year-over-year increase in the U.S. defense budget—from high 2023 levels—and growth in spending by European allies are likely to support steady revenues across the sector. However, certain lower-rated peers with high leverage, and the risk of elevated shareholder returns have contributed to the modestly negative ratings bias. The U.S. presidential election poses a degree of uncertainty to future spending but is unlikely to cause material disruption.
Autos	After stronger-than-expected auto sales in the U.S. last year, 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. 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. 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 slowing revenue growth from modest declines in repair and remodeling spending as high rates delay large projects, somewhat offset by broadly stable price realizations. We expect the building materials sector to face modest pressure, with potential for improving in 2025, as a late 2024 rate cut could drive some recovery in spending. High interest rates and lower housing turnover will continue to pressure spending on home renovation, although we expect aggregate demand to remain robust. On the new construction front, we expect strength in housing, particularly single family, to mitigate softness in multifamily and certain commercial real estate sectors such as office.
Business and technology services	The sector's ratings outlook bias is shifting increasingly negative, due to high 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 high 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 has negatively impacted cash flows for several issuers. Macro weakness weighs on spending, adding stresses to companies with exposure to SMEs (e.g., payment processors). 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, 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.
Capital goods	The credit outlook for capital goods is steady, as large backlogs and lower costs offset destocking. Megatrends and megaprojects are sustaining demand even as higher interest rates would normally slow activity in cyclical, interest-sensitive sector. The energy transition, manufacturing onshoring (particularly for electronics), and infrastructure investments have laid a foundation of multiyear spending for longer-term projects. The J.P. Morgan Global PMI Composite Output Index, produced by S&P Global, has risen so far this year despite widespread destocking. 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. Most issuers rated 'BB' and higher have built some credit buffer with good earnings and little new debt. In contrast, the capital goods portfolio we rate has a large cohort of financial-sponsor-owned companies that face rising maturities in 2024 and 2025, which is taking a toll on credit quality. We have a negative rating outlook on almost one-third of those 50 issuers despite good industry conditions, mostly because these companies underperformed their profit forecasts for several years. Higher interest rates are putting pressure on earnings and cash flow for this group of companies with a preponderance of floating-rate debt. And refinancing these issuers' $60 billion of debt at higher rates in the next year or two will be daunting and is already contributing to defaults and debt restructuring.

Chemicals	We continue to expect a gradual recovery in demand in most chemicals subsectors as the negative impact of destocking subsides. Still, it's too early to definitively declare that the destocking is done. We see this recovery becoming more pronounced in the second half. Although we anticipate EBITDA increases for most subsectors following meaningful EBITDA declines across subsectors last year, we don't believe that such recovery will entirely offset the decline in 2023. Currently a little over a quarter of U.S. chemicals companies are with a negative outlook or CreditWatch placement. This reflects in part the uncertainty related to the pace and extent of recovery. Some subsectors like petrochemicals face capacity buildups that will depress earnings not just this year, but also next.
Consumer products	The common theme across consumer staples is a focus on restoring volumes as consumers continue to exhibit price elasticity by trading down, destocking pantries, and deferring spending. Companies will pull familiar levers to drive volume growth: higher spending on advertising, innovation, and more promotional activity. Offsetting soft top lines will be lower input and freight costs. Except for wages and pockets of still high inflation in certain commodities, costs have come down and will contribute to improving margins over the year. In discretionary categories, such as durables and apparel, demand remains soft. Consumers are being selective and seeking value and in turn retailers are being cautious in orders. Over the next 12 months, consistent with our economists' forecast for slowing consumer spending, we expect demand to remain subdued. 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	With destocking largely behind the industry, we expect volume improvement as the year progresses, but demand may be uneven across end-markets as the consumer continues to be impacted by inflationary pressures. High costs caused consumers to trade down and delay spending, though we expect those dynamics to begin to reverse this year, but will hinge on consumer consumption, as well as industrial production. Cost inflation has improved, which may result in some temporary benefits to packaging companies, but we expect those savings to be passed on to customers. 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.
Gaming, leisure, and lodging	Leisure travel and spending continues to be relatively strong, and the trend toward experiences is proving to 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. Cruise bookings and pricing remain strong, and increasing visitation to the Macao gaming market continues to boost cash flow for gaming operators. M&A may take off if buyers can look past elevated rates or become flexible on how much debt to use to finance transactions. Still, if leveraging mergers and acquisitions increase, 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. 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 decline 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. 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 and better growth momentum into 2025. Demand is picking up while existing inventory remains low, which we expect will support a relatively stable average selling price (ASP). Better labor and material availability has resulted in shorter cycle times relative to pre-pandemic levels, which is enabling builders to prioritize returns through higher-asset turns. At the same time, builders are increasing spending to expand community count and capture share, driving revenue growth over the next few years. Still, profit margins remain pinched given elevated incentives offered early in 2024, but we expect margins to normalize in subsequent quarters as builders pull back on incentives and 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 remains uneven due to secular challenges facing the broader industry and, to a lesser extent, fears of a second-half slump in consumer spending. 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, except for political advertising which will likely be at record levels due to local elections and issue-based spending. Linear television advertising, in particular, is in secular decline, though we expect the rate of decline to moderate versus 2023's accelerated levels due to scripted content returned to TV post the 2023 guild strikes and a strong sports slate. The accelerating decline of linear television remains 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). The landscape for streaming continues to evolve 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. Most of our positive outlooks around the world are on steel and aluminum producers, while credit quality for miners has stabilized at a higher level. Steel and aluminum producers 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. Metal prices are about 20% higher than before the pandemic, so that industry profits and cash flow remain generally good. 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. Mine productivity is coming into focus now, with good demand potentially constrained by tight supply and higher production costs. We recently raised a few of our metal price assumptions, and most importantly, we raised some longer-term assumptions for 2026 and beyond owing to structurally higher cash production costs. Moreover, the capital intensity of sustaining output generally rises as mines age and ore grades decline. And mines will continue to face varying degrees of social pressure in numerous jurisdictions around the world, including possible operating disruptions, changes to mining plans, and even forced changes in ownership. Capital spending restraint in recent years and a favorable long-term demand outlook could prompt more greenfield investment and M&A, especially as the world eyes nickel, copper, cobalt, and lithium for electrification.
Midstream energy	The North American midstream energy industry's credit quality continues to be resilient, with strong balance sheets and a level of caution as we approach the election in November. Demand for gas will pivot on how quickly the development of new LNG capacity will occur in light of the Biden Administration's pause on new construction and the speed of growth driven by AI datacenters. Renewable development continues to be a headwind for the industry, but intermittency and reliability make this threat less urgent in the next few years. 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 more consolidation and mergers and acquisitions 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 support 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 are at the five-year high maximum band and it's likely that gas prices will remain very low during the summer. Due to the Biden administration pause on export permits for LNG, we believe a price recovery has been delayed. We expect this pause to be resolved and that LNG facility construction will continue. Once this is resolved, we expect gas prices will begin to rebound as new LNG capacity begins to pull gas demand. We are positive on long-term natural gas prices as LNG Gulf of Mexico buildout continues through 2028.
Oil refineries	North American refiners will likely have a solid third quarter. Margins remain above historical midcycle averages, and should be helped by strong summer driving demand, lower total production capacity, and tight supply. We still forecast most refiners will generate EBITDA above their midcycle run rates. 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 continue to focus on 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. Renewable margins have been weak due to lower prices for credits in California and renewable identification number (RIN) prices.
REITs	First-quarter 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. Refinancing risk remains high with office and speculative-grade issuers facing wider bond spreads and tighter lending conditions amid steep declines in values. Office leasing activity remains well below pre-pandemic levels and retention is also lower, with the West Coast market performing weaker than average.

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.
Retail and restaurants	Consumers are stretched by inflation, trading down, dining out less frequently, and seeking value. There doesn't appear to be a catalyst for an inflection in consumer demand, so we believe that consumers will continue to be cautious, hunt for bargains, and allocate discretionary dollars toward experiences. Recent results from two large restaurant chains illustrate increasing pressure on the consumer, especially in lower-income cohorts. We believe weakness will persist in areas that are discretionary in nature and categories that were hot during COVID or related to housing. Retailers of discretionary categories need to have the right product at the right time to win in an environment of less demand to go around. Alternatively, they need to have the best value proposition, and to do that, they have to have scale and reach (e.g., Walmart, Costco, TJ Maxx, Amazon). Cost pressures have subsided; many retailers report meaningful benefit from lower freight costs, but not enough to offset pressure on the topline for most.
Technology	IT spending appears to have improved somewhat. AI investment is strong and non-AI enterprise spend is more modest. While PC and smartphones sales cycles have bottomed the 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 this year as weakness in these areas recede and recovery resumes once excess inventory is worked off, coupled with anticipated AI use cases that could spur further IT spending likely later this year and beyond. 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. High interest rates and tighter financing would disproportionately affect our large number of issuers rated in the 'B' category or lower as they tend to have significant variable-rate debt outstanding, lower FCF/debt ratio and, for some, dwindling liquidity.
Telecom	Lower speculative-grade credits continue to be hurt by high interest rates and elevated capital intensity, which has resulted in several downgrades. These companies lack scale to absorb higher costs and have a lot of exposure to floating rate debt. Conversely, the large investment grade telcos continue to perform well, growing earnings while generating solid 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 initial deployments of mid-band spectrum. In cable, we have tightened thresholds for several cable operators due to broadband subscriber losses and earnings pressure because of increasing competition from fixed wireless access and fiber to the home. At the same cable providers are upgrading their networks to offer faster data speeds, which will increase capex and contribute to lower levels of free cash flow. While the wireline operators are improving top line and earnings, capex to support fiber-to-the-home (FTTH) deployments, high interest rates and elevated debt burdens is hurting free cash flow and leverage. Some of these issuers are looking at alternative financing sources such as ABS to fund their fiber builds.
Transportation	Strong demand is expected to remain a notable positive for the U.S. airline industry, but a slowing pace of passenger growth and much higher labor costs are key headwinds to higher earnings and cash flow this year. Network carriers should continue to benefit from higher-margin premium product and loyalty programs, as well as strong trans-Atlantic travel demand. We assume free cash flow generation allocated toward debt reduction will contribute to stronger credit measures for most. Alternatively, the smaller, domestic-leisure-focused airlines face uncertain prospects for future positive earnings amid much higher costs and tempered growth aspirations linked to aircraft and engine constraints. As such, free cash flow deficits and declining liquidity are key sources of rating pressure. Our outlook for railroads and package express companies is generally unchanged, and we assume ratings to remain stable. Financial policies have been tested, with certain railroads limiting share repurchases to preserve credit measures. We expect this will continue, as the rate of freight volume growth is likely to remain subdued. On the other hand, excess trucking capacity continues to pressure prices and revenues for trucking and logistics, with no appreciable signs of easing over the near-term.
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 initially pulled down power prices in all markets. Since then, the narrative has changed. A demand surge expectation from data centers, electrification, and other large loads (onshoring of manufacturing) has lifted power, especially for years 2026-2027. Power Prices in regions like Texas are $10/MWh for 2027 compared with what they were at the start of 2024. We expect volatility to be higher and regions like PJM and ERCT will be tested in the summer. We also expect higher capacity prices in PJM and higher resource adequacy (RA) payments in 2025-2026.

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	1.7	1.8	1.9
Real consumer spending (year % ch.)	2.2	2.5	2.0	2.1	2.4
Real equipment investment (year % ch.)	(0.3)	1.4	4.3	3.3	3.3
Real nonresidential structures investment (year % ch.)	13.2	4.6	1.4	1.0	0.3
Real residential investment (year % ch.)	(10.6)	4.7	2.0	2.8	2.2
Consumer price index (year % ch.)	4.1	3.0	2.0	2.1	2.1
Core CPI (year % ch.)	4.8	3.4	2.5	2.2	2.1
Unemployment rate (%)	3.6	3.9	4.2	4.4	4.1
Housing starts (annual total in mil.)	1.42	1.40	1.40	1.40	1.42
Federal funds rate (%)	5.0	5.3	4.6	3.3	2.9
10-year Treasury note yield (%)	4.0	4.2	3.6	3.5	3.5

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.)	1.3	1.1	1.7	2.1	2.0
Real consumer spending (year % ch.)	1.7	2.0	1.7	2.4	2.4
Real nonresidential fixed investment (year % ch.)	(0.9)	1.7	5.5	3.9	2.4
Real residential fixed investment (year % ch.)	(10.3)	3.8	4.7	3.4	0.7
Consumer price index (year % ch.)	3.9	2.7	2.0	2.1	1.9
Core CPI (year % ch.)	3.9	2.5	2.0	2.0	2.0
Unemployment rate (%)	5.4	6.2	6.0	5.8	5.6
Housing starts (annual total in thousand)	240.8	240.2	238.0	243.0	232.9
Bank of Canada policy rate (% year-end)	5.0	4.0	2.8	2.8	2.8
Government of Canada 10-year bond yield (%)	3.4	3.3	3.0	3.1	3.1
CAD/USD exchange rate (per US$1, period average)	1.35	1.35	1.32	1.28	1.27

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.

Appendix 3: List Of Analytical Contacts

Sector	Analyst name and contact
Aerospace and defense	**Jarrett Bilous** +1 (416) 507-2593 jarrett.bilous@spglobal.com
Autos	**Nishit Madlani** +1 (212) 438-4070 nishit.madlani@spglobal.com
Building materials	**Ana Lai** +1 (212) 438-6895 ana.lai@spglobal.com
Business and technology services	**Nishit Madlani** +1 (212) 438-4070 nishit.madlani@spglobal.com
Capital goods	**Donald Marleau** +1 (416) 507-2526 donald.marleau@spglobal.com
Chemicals	**Paul Kurias** +1 (212) 438-3486 paul.kurias@spglobal.com
Consumer products	**Sarah Wyeth** +1 (212) 438-5658 sarah.wyeth@spglobal.com
Containers and packaging	**Michael Tsai** + 1 (212) 438-1084 michael.tsai@spglobal.com
Financial institutions - banks	**Stuart Plesser** +1 (212) 438-6870 stuart.plesser@spglobal.com **Brendan Browne** +1 (212) 438-7399 brendan.browne@spglobal.com
Financial institutions - nonbanks	**Sebnem Caglayan** +1 (212) 438-4054 sebnem.caglayan@spglobal.com **Gaurav Parikh** +1 (212) 438-1131 gaurav.parikh@spglobal.com **Elizabeth Campbell** +1 (212) 438-2415 elizabeth.campbell@spglobal.com
Gaming, leisure, and lodging	**Emile Courtney** +1 (212) 438-7824 emile.courtney@spglobal.com **Melissa Long** + 1 (212) 438 3886 melissa.long@spglobal.com
Health care and pharmaceuticals	**Arthur Wong** +1 (416) 507-2561 arthur.wong@spglobal.com

Homebuilders	**Ana Lai** +1 (212) 438-6895 ana.lai@spglobal.com
Insurance	**Joseph Marinucci** +1 (212) 438-2012 joseph.marinucci@spglobal.com
Leveraged finance	**Ramki Muthukrishnan** + 1 (212) 438 1384 ramki.muthukrishnan@spglobal.com **Steve Wilkinson** +1 (212) 438-5093 steve.wilkinson@spglobal.com **Minesh Patel** + 1 (212) 438 6410 minesh.patel@spglobal.com
Media and entertainment	**Naveen Sarma** +1 (212) 438-7833 naveen.sarma@spglobal.com
Metals and mining	**Donald Marleau** +1 (416) 507-2526 donald.marleau@spglobal.com
Midstream energy /oil refineries	**Michael Grande** +1 (212) 438-2242 michael.grande@spglobal.com
Nonfinancial corporates	**Chiza Vitta** +1 (214) 765-5864 chiza.vitta@spglobal.com **Carin Dehne-Kiley** +1 (212) 438-1092 carin.dehne-kiley@spglobal.com
Oil and gas	**Thomas Watters** +1 (212) 438-7818 thomas.watters@spglobal.com
Public finance	**Robin Prunty** +1 (212) 438-2081 robin.prunty@spglobal.com **Jane Ridley** +1 (303) 721-4487 jane.ridley@spglobal.com **Sarah Sullivant** +1 (415) 371-5051 sarah.sullivant@spglobal.com
REITs	**Ana Lai** +1 (212) 438-6895 ana.lai@spglobal.com
Regulated utilities	**Gabe Grosberg** +1 (212) 438-6043 gabe.grosberg@spglobal.com
Retail and restaurants	**Sarah Wyeth** +1 (212) 438-5658 sarah.wyeth@spglobal.com
Sovereigns	**Lisa Schineller**

+1 (212) 438-7352
lisa.schineller@spglobal.com

Structured credit

Stephen A Anderberg
+1 (212) 438-8991
stephen.anderberg@spglobal.com

Structured finance

Winston Chang
+1 (212) 438-8123
winston.chang@spglobal.com

James Manzi
+1 (202) 383-2028
james.manzi@spglobal.com

Tom Schopflocher
+1 (212) 438-6722
tom.schopflocher@spglobal.com

Technology

David Tsui
+1 (415) 371-5063
david.tsui@spglobal.com

Telecom

Allyn Arden
+1 (212) 438-7832
allyn.arden@spglobal.com

Transportation

Jarrett Bilous
+1 (416) 507-2593
jarrett.bilous@spglobal.com

Unregulated (merchant) power

Aneesh Prabhu
+1 (212) 438-1285
aneesh.prabhu@spglobal.com

Copyright 2024 © by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&Ps opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.spglobal.com/ratings (free of charge) and www.ratingsdirect.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.spglobal.com/ratings/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.