S&P Global
Ratings

Asia-Pacific Sector Roundup Q3 2024

Trade Tensions To Drive A Bigger Wedge

June 26, 2024

This report does not constitute a rating action

Editor's Note: This report is an expansion of the "Sector Trends" section from our "Credit Conditions Asia-Pacific Q3 2024: A Trade Showdown Unfolds" report, published June 25, 2024.

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Key Takeaways

- **Uneven growth.** We expect Asia-Pacific growth to hold up this year, but to be uneven across geographies and sectors. Most emerging markets should still see robust growth, even as we lowered our 2024 forecast for Thailand, Vietnam, and the Philippines. China's industrial production-led growth continues, but the country is grappling with soft demand. In Japan and Australia, elevated inflation and interest rates are eroding households' real income and balance sheets.
- **Delays on fiscal consolidation.** Local government spending could remain elevated in China, Australia and New Zealand, leading to growing debt levels. In China, the protracted property downturn is pressuring local and regional governments' (LRGs) revenues, and could slow their deleveraging.
- **Refinancing challenges to rise.** Most central banks in the region could delay policy rate cuts, following the U.S. Federal Reserve, leading to costlier offshore borrowing. Onshore financing is still available, but lenders could turn selective towards riskier sectors. Among the vulnerable sectors are real estate (e.g., in China and Vietnam), and households stretched most by high rates and cost pressures (e.g., in Australia, New Zealand, and Korea where unemployment is also rising).
- **Deteriorating outlook bias.** The net rating outlook bias for Asia-Pacific issuers slid to negative 2% as of end-May. The bright spots that we have noted previously, such as gaming, remain as such. However, pressures are growing on others. The chemicals, real estate, and transportation cyclical sectors have the largest negative outlook percentages.

Trade tensions are turning up the heat. Recent trade disputes are straining diplomatic relationships between China and the West. Tariffs have been imposed on a range of Chinese goods, including battery electric vehicles, steel and aluminum, and solar cells.

Rated players in the auto sector should be able to withstand the impact from steeper tariffs on electric vehicles (EVs), due to their limited direct exposure to the U.S. and European markets. Should the trade conflict intensify where other markets develop EV value chains locally, Chinese auto exports may be squeezed. To cope, Chinese automakers will increasingly diversify their production base to Europe and Southeast Asia in the next few years.

Similarly, the technology sector is seeing rising risks from geopolitical tensions. Further tightening of controls on Chinese tech exports could hit global tech trade and supply.

China's property woes persist. The country's beleaguered property sector has yet to reach a bottom. Sales and home prices are still declining, especially in lower-tier cities. Authorities have recently rolled out policy measures to support the sector, but homebuyer confidence is proving challenging to restore.

The spillover effects of China's property woes on other parts of the economy are multifold. Weak demand continues to hit producers along the value chain (e.g., building materials and capital goods). Crippled household confidence is weighing on consumer-facing sectors such as retail.

For Chinese banks, nonperforming loans from property lending could peak later and higher in 2025. We could see tighter risk appetite and lending selectivity in this space. Revenue pressures on local and regional governments (LRGs) remain, given weak land sales. That, and continued spending intensity, could delay LRGs' fiscal consolidation by another year.

Currency weakness bites harder for some. The strong U.S. dollar keeps regional currencies weak. Soft domestic currencies can boost export competitiveness. In our view, the chemicals, commodity and energy exporters stand to gain. The benefits are also particularly pronounced for upstream commodity producers where revenues are generally linked to the U.S. dollar. These include agribusiness, mining, and oil and gas.

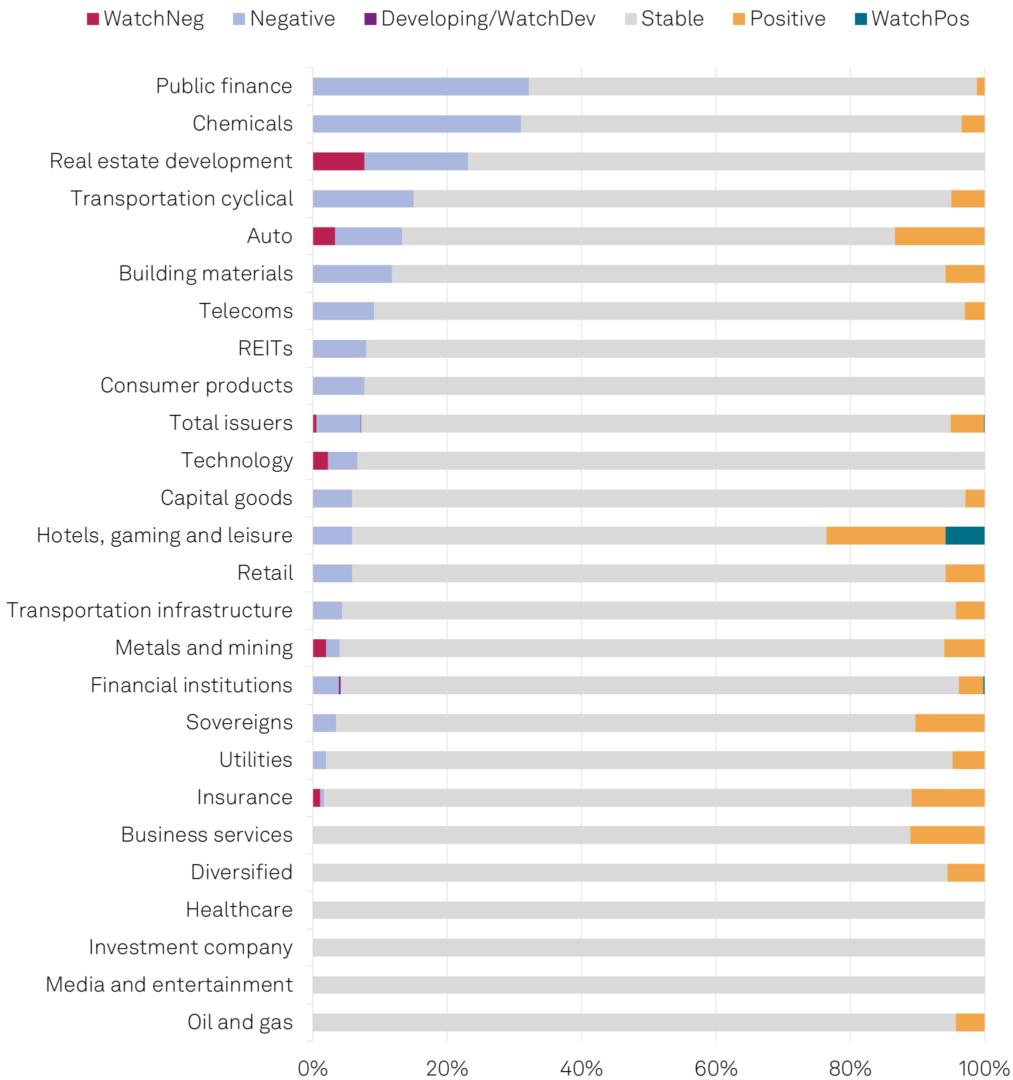
On the other hand, cost pressures could mount for producers reliant on imported goods, given their higher input prices in domestic-currency terms. Sectors such as airlines, transportation cyclical, and raw material or energy-intensive manufacturers are most vulnerable. While large domestic conglomerates may pass on higher costs to customers, softening demand could curtail this ability, in turn squeezing profit margins.

On the financing front, some issuers are hedging against U.S. dollar-denominated borrowings. However, risks of weaker currencies could strain borrowers with substantial offshore debt obligations. Refinancing risks are pronounced for those struggling or unable to tap onshore lending channels, for instance due to reduced lending appetite toward their sector.

A growing divide. Credit conditions in Asia-Pacific are steady, but treading on delicate ground. Across sectors and income cohorts, we foresee a widening divide between winners and losers. Although our net rating outlook bias has deteriorated on the net, the underlying distribution across sectors is still uneven. In our view, the current conditions and risk landscape mean pain points will be most acutely felt in the auto, chemicals, technology and real estate sectors. Indeed, these are the sectors seeing a deterioration in their bias.

Chart 1

Outlook distribution of Asia-Pacific issuers by sector



Data cut-off is as of May 31, 2024. Source: S&P Global Ratings.

Table 1

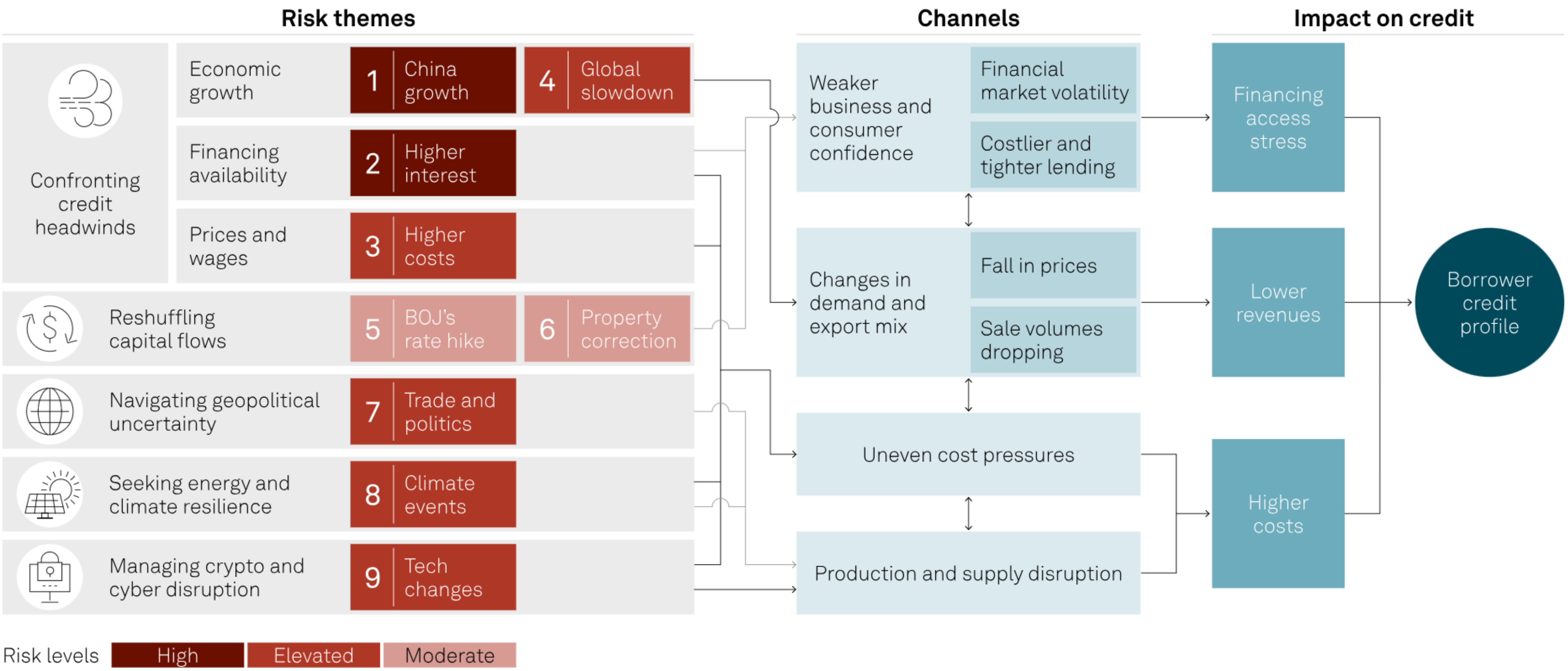
Net outlook bias of Asia-Pacific issuers by sector, May 31, 2024

	May 2023	Aug. 2023	Oct. 2023	Feb. 2024	May 31, 2024	No. of entities	Notional average rating
Auto OEM and suppliers	-3%	-6%	-3%	7%	0%	30	BBB
Building materials	-13%	-19%	-19%	-20%	-6%	17	BB+
Business services	7%	-8%	-17%	-22%	11%	9	BB+
Capital goods	-6%	-9%	-9%	-3%	-3%	34	BBB
Chemicals	-3%	-3%	0%	-17%	-28%	29	BBB
Consumer products	0%	-4%	-4%	-8%	-8%	26	BBB
Diversified	17%	6%	11%	11%	6%	18	A-
Healthcare	-14%	0%	17%	0%	0%	6	BBB-
Hotels, gaming, and leisure	-12%	-6%	-6%	18%	18%	17	BB
Investment company	0%	0%	0%	0%	0%	6	A
Media and entertainment	-9%	-9%	-9%	0%	0%	10	BBB+
Metals and mining	13%	4%	0%	2%	2%	50	BBB-
Oil and gas	9%	9%	9%	5%	4%	23	BBB+
Real estate development	-13%	-14%	-11%	-12%	-23%	26	BBB-
Real estate investment trusts	-15%	-19%	-19%	-12%	-8%	50	BBB+
Retail	6%	13%	13%	0%	0%	17	BBB+
Technology	-12%	-10%	-12%	-4%	-7%	45	BBB
Telecommunications	3%	0%	3%	-3%	-6%	33	BBB
Transportation cyclical	-17%	-17%	-11%	-10%	-10%	20	BBB
Transportation infrastructure	-6%	-6%	-2%	0%	0%	46	A-
Utilities	-7%	-3%	-1%	2%	3%	103	A-
Total corporates	**-4%**	**-5%**	**-4%**	**-3%**	**-3%**	**615**	**BBB**
Financial institutions	5%	8%	8%	8%	0%	385	BBB+
Insurance	-8%	-8%	-1%	6%	9%	174	A
Public finance	-11%	-13%	-13%	-31%	-31%	84	A+
Sovereign	-3%	-7%	-3%	-3%	7%	29	BBB+
Total issuers	**-2%**	**-2%**	**-1%**	**0%**	**-2%**	**1,287**	**BBB+**

We calculate the net outlook bias by deducting the percentage of negative outlooks and CreditWatch negative listings against the percentage of positive outlooks and CreditWatch positive listings. A minus figure indicates that the former exceeds the latter, and a positive figure, vice versa. OEM--Original equipment manufacturer. Teal colored cells indicate improvement from prior period, red, deterioration. Source: S&P Global Ratings.

Chart 2

Interconnected risks are complicating the credit landscape



BOJ--Bank of Japan. Not all relationships are displayed. Rank-numbered risks are discussed in our "Credit Conditions Asia-Pacific Q3 2024: A Trade Showdown Unfolds" report; colors denote risk levels: brown--high, red--elevated, light red--moderate. Source: S&P Global Ratings.

Auto

Slower growth amid strains

What do we expect over the next 12 months?

- Softer demand momentum, intensifying pricing pressure and rising electric vehicle sales will weigh on auto makers' profitability and cashflows.
- That said, modest volume growth, product mix adjustment, tightened cost control, and low leverage will anchor steady credit quality for most rated Asia-Pacific auto companies.
- Our net rating outlook bias for the sector turned neutral from positive, after recent rating actions on two electric vehicle (EV) battery makers.

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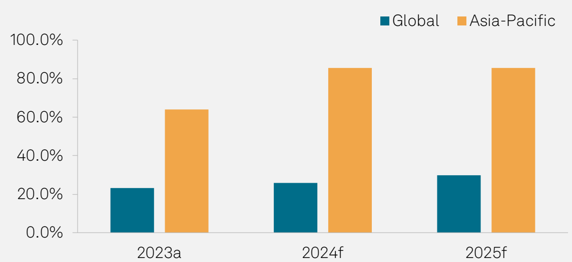
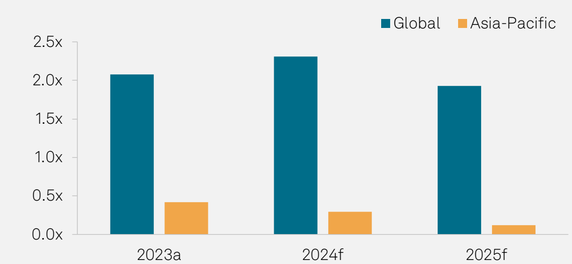
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.
Source: S&P Global Ratings.

What are the key risks around the baseline?

Challenging macro outlook. Economic growth prospects remain clouded in China given weakness in consumption and in the property market. In the U.S, further delays in the timing of rate cuts will further crimp consumer purchasing power. In Europe, higher refinancing costs and less disinflation than we previously expected could squeeze growth and derail a soft landing.

Increasing trade restrictions. Rising trade hurdles in Europe and the U.S. on China-made EVs have limited impact on rated Chinese issuers given their small exposure to those markets. Yet, trade barriers from other markets could arise amid growing Chinese exports, as countries aim to build and expand EV value chains locally.

Slower electrification. We believe electrification will remain the long-term trend globally. However, less aggressive emission reduction targets and a lack of affordable models could slow the EV transition progress.

What do they mean for the sector?

Weaker demand. Sales growth of global light vehicles will likely fall below our expected 1%-3% range in 2024, if macro conditions worsen. Price cuts and auto trade-in subsidies can still support modest growth in China. However, volume in U.S. and Europe will see pressure as inflation and high interest rates hurt affordability.

Margin pressure varies. A softer pricing environment, a greater emphasis on lower-margin EV sales, and potentially lower exports will dampen profitability of Chinese auto makers. Cost control and product-mix optimization are vital for margin protection. For Japanese and Korean auto makers, modest volume growth, continuous mix adjustment, more diversified geographical exposure, and strong demand for hybrid vehicles in ex-China markets will be key to the resilience of their profitability over the next 12 months. Nonetheless, there is growing pressure for Japanese auto OEMs to catch up in EVs, given their weakening performance in China.

Building Materials

Divergence widens among Asia-Pacific producers

What do we expect over the next 12 months?

- The satisfactory competitive position and sufficient financial headroom of most rated Asia-Pacific building material companies will help them manage demand uncertainty.
- A further deterioration in the Chinese property sector continues to weigh on the building material sector, with fewer new housing starts and construction areas. Similarly, Korean producers' operating performance is under pressure with weak demand. Construction project orders are declining and housing-market sentiment remains weak amid high interest rates.
- The Australian market will stay healthy, with a strong pipeline in the residential sector as growth in net overseas migration supports housing demand, and public sector investment improves.

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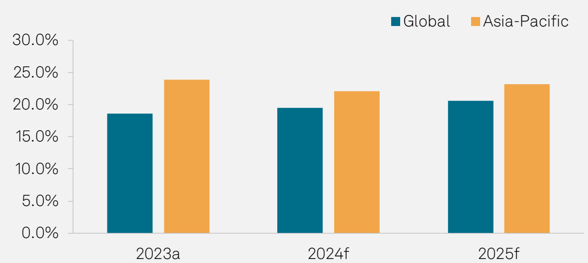
FFO to debt (median, adjusted)



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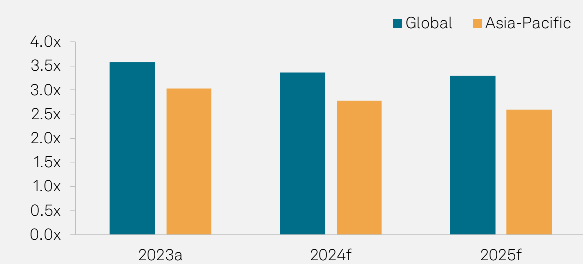

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What are the key risks around the baseline?

Sharper downturn in the Chinese property sector, and high interest rates outside of China. China's challenging property market underlines still-weak momentum for new construction, hitting demand for building materials. Furthermore, China's infrastructure investment growth will also moderate in 2024 due to more disciplined local government spending. Outside China, prolonged high interest rates continue to weaken housing market sentiment.

Still-high input costs and supply-chain challenges. High raw material and labor costs stemming from inflation, supply constraints, and geopolitical risks outside China are keeping input costs high. Meanwhile, extreme weather risks supply-chain bottlenecks and delays in construction.

What do they mean for the sector?

Ongoing drag on demand. Weak homebuyer confidence and slower economic growth in China would dampen investment into new properties, hitting construction and demand for building materials, especially for basic building materials (cement). Other building materials, such as waterproofing material, may fare better with support from rising renovation needs. Weak housing market sentiment outside China due to high interest rates will have the same impact.

Margin squeeze. While the price of coal--a key energy source--continues to moderate, still-high raw material and labor costs will likely constrain building material companies' profitability. Chinese players may face greater strains on profitability among regional peers because of limits on their ability to raise prices amid sluggish demand.

Capital Goods

Slow recovery in China weighs on earnings outlook

What we expect over the next 12 months

- A slow recovery in China and some end-markets continues to weigh on the earnings outlook in Asia-Pacific.
- Key risks include persistently high interest rates and uncertainty around a soft global economic landing. The factors may hurt corporate customer sentiment in terms of capital spending, in turn impeding the recovery of key leverage measures.
- The demand outlook and degree of margin protection, as well as cash flow management, will be key drivers of credit quality.

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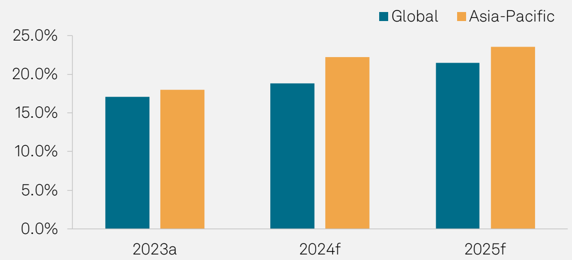

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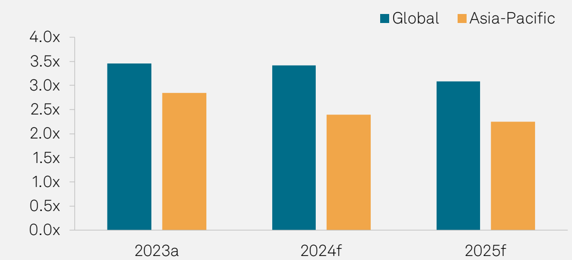

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Source: S&P Global Ratings.

What are the key risks around the baseline?

Slower recovery in China and some end-markets. The weak property sector as well as slow consumption and investment in China will continue to weigh on demand within the Chinese corporate sector for capital goods, despite stimulus by the government. Stagnant demand recovery in some end-markets, such as factory automations for manufacturing, means slower capital expenditure by corporate customers.

Global economic slowdown. Although the demand outlook in the U.S. still looks solid, it continues to be curbed among European economies. Persistently high interest rates should cool capital spending by corporate customers and the construction sector. Some Asia-Pacific capital goods companies--especially Japanese ones--have exposure to the European market. A weaker macroeconomy will erode EBITDA and cash flow, potentially hurting credit metrics.

What do they mean for the sector?

Margin pressure. Weaker demand and soft sales, together with a tough competition, would prevent Asia-Pacific companies from achieving a meaningful improvement in EBITDA and margins.

Delayed improvement in cash flow metrics. Given our continued expectation for cautious economic conditions, we assume capital goods companies will carefully manage growth investment and shareholder returns. However, if the economic outlook weakens further, cash flow ratios could deteriorate.

Chemicals

Chronic overcapacity raises credit risk

What do we expect over the next 12 months?

- Profitability is likely to stay weak beyond 2024, for longer than we previously anticipated, because of tepid demand growth and high oil prices.
- It could take longer for excess capacity to be absorbed, despite slowing capacity additions.
- Leverage should stay high amid weak cash flows.

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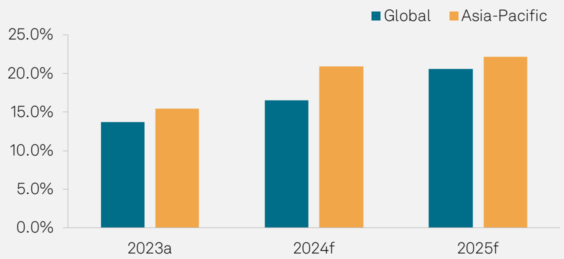

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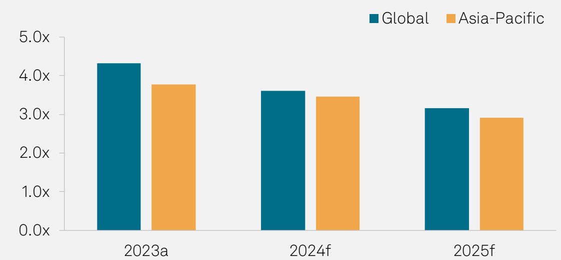

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What are the key risks around the baseline?

Stalling market demand. Ongoing weakness in China's property market could prevent a significant rebound in demand growth, despite recovering exports from the region.

A weaker ability to pass through costs. High crude oil prices could constrain the ability of commodity chemical companies to pass through product costs if demand does not pick up sufficiently to support higher chemical prices.

Persistent overcapacity. Aggressive capacity additions in China in combination with weak demand could keep utilization low for longer, adding additional pricing and cost pressures to Asia's chemical companies.

What do they mean for the sector?

Depressed profitability. A recovery in chemical companies' profitability could stall in 2024, keeping the level of profitability below the average of past cycles.

Higher leverage. Leverage could stay elevated without significant improvement in profitability over the next 12 months.

Rising credit risk. Chronic oversupply and low profitability could raise business risk and erode financial buffers for commodity chemical makers. Credit risk rises without a quick fix to significant supply and demand imbalances in sight.

Consumer Products

Stable input costs to support performance

What do we expect over the next 12 months?

- Subdued real income weighs on consumer confidence across the major economies.
- Profitability remains stable thanks to past markup efforts by consumer goods companies and lower input cost inflation.
- Prudent financial policies will support the credit profiles of consumer-product companies.

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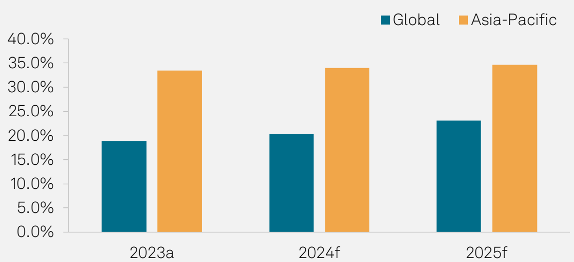
FFO to debt (median, adjusted)



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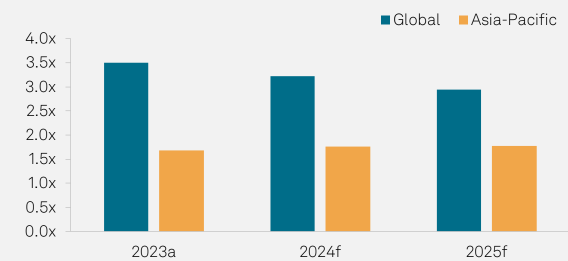

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What are the key risks around the baseline?

Price competition intensifies. Lower input costs, when combined with weak consumer confidence, could constrain markup behavior by consumer goods companies. This adds to consumers' tendency to trade down to cheaper, no-brand goods in such circumstances, which could benefit private-label brands.

Subdued spending in China. Continued uncertainties in the real estate sector sap consumers' spending appetite. Tight household budgets and higher propensity to save will drive consumers toward value with their daily purchases, leaving profitability of consumer goods companies under pressure.

Souring financing conditions. Growing refinancing costs stemming from unfavorable exchange rates, along with high interest rates, weigh on companies with a highly leveraged capital structure.

What do they mean for the sector?

Brand equity matters. High value-add and a differentiated offering enable a firm to protect its profitability in an environment of intensified price competition. Companies without solid brand equity will face fewer opportunities to mark up, thus constraining their ability to drive up profits.

Sluggish recovery in performance. Consumer goods companies operating in China could face a slower recovery in profitability than others due to intensified competitions amid macro headwinds. A further reduction in household spending, depending on the extent of the property crisis' hit to consumer confidence, could hamper their credit headroom.

Slower debt growth. Higher funding costs push highly leveraged companies toward prudent financial policies. Tough economic conditions also encourage companies to focus more on their core businesses, rather than engaging in large M&A transactions.

Financial Institutions

Higher interest rates will pressure asset quality

What do we expect over the next 12 months?

- Asia-Pacific banks are managing property-sector risks and other key risks satisfactorily at current rating levels. We have stable outlooks on about 95% of the Asia-Pacific banks we rate.
- We see limited ratings upside during 2024, however, given higher-for-longer interest rates, weaker economic growth, and property market sensitivities.
- More so, if downside risks outside our base case emerge in property or other risk areas, it could become much tougher for banks to maintain outlooks at current levels.

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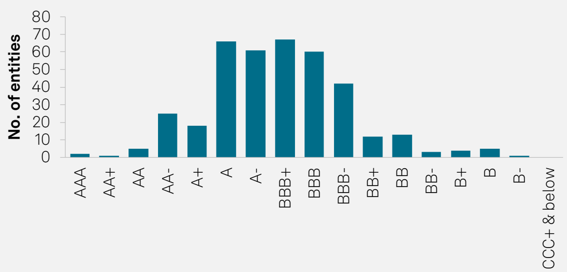
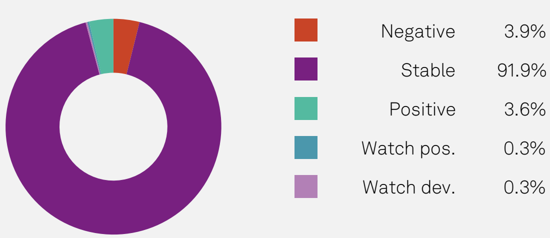
Rating distribution



Outlook distribution



As of May 31, 2024. Source: S&P Global Ratings.

What are the key risks around the baseline?

Property downside risks intensify. Banks' net interest margins benefit from higher interest rates, but higher-for-longer rates or weaker-than-expected economic growth outside our base case will eventually hurt banks' asset quality. This is especially true for property markets in the region that are under strain, most notably China's.

Structural risks. Climate change, cyber risks, and digitalization trends will affect the competitive banking landscape. While these risks typically are a slower burn for banks, they increasingly will test banks' business models and financial flexibility.

What do they mean for the sector?

Credit losses will increase. We anticipate that Asia-Pacific banks' credit losses will increase in 2024 to in excess of US$400 billion. If economic hurdles worsen outside our base case, banks' asset quality will weaken further, testing rating outlooks. Profitability and capitalization buffers are adequate for most financial institutions at current rating levels.

Greater credit differentiation. Potentially more vulnerable are Asia-Pacific financial institutions with high direct exposures to weak counterparties or sectors; and those that are inherently weaker and non-systemically important.

Governments throw a lifeline. In the unlikely event it were required, we believe extraordinary government support for systemically important private sector commercial banks across most Asia-Pacific banking jurisdictions will buffer banks' credit-quality.

Gaming

Going beyond recovery mode

What do we expect over the next 12 months?

- In Macao, we forecast mass gross gaming revenue (GGR) in 2024 to be 5%-15% stronger than in the pre-COVID year of 2019. Higher visitation and expanded hotel capacity should fuel the growth. Based on trends so far this year, the 2024 mass GGR is likely to be at the upper end of our forecast range.
- Gaming revenue in Singapore and Malaysia should continue to improve, benefiting partly from higher visitations thanks to the visa free arrangement with China.
- In Australia and New Zealand, soft economic conditions will continue to take a toll on mass GGR.

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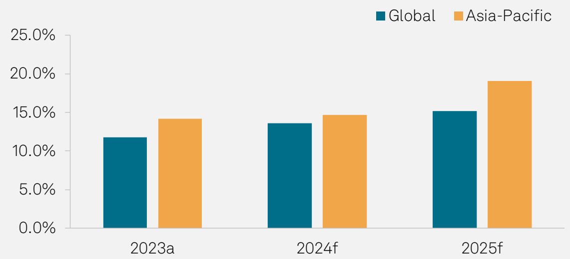
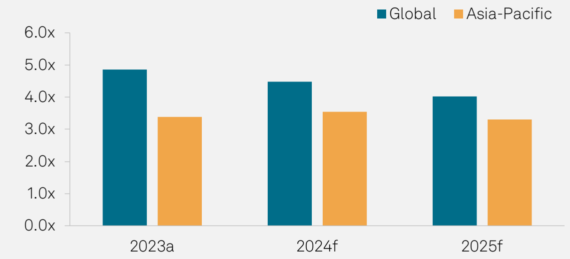
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



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Source: S&P Global Ratings.

What are the key risks around the baseline?

Higher capital expenditures for development projects. Global operators such as Las Vegas Sands, Wynn Resorts Ltd., MGM Resorts International, and Genting Bhd. will likely bid for three full-scale casino licenses available in New York. Many of them also have development projects underway in other regions of the U.S., and also around the world in Singapore, the United Arab Emirates, and Japan.

Economic headwinds. Subdued economic conditions and cost of living pressures are weighing on gaming revenues in Australia and New Zealand. For example, electronic gaming machine revenue at SkyCity Entertainment Group Ltd.'s flagship Auckland casino has softened considerably since the start of 2024. We expect this trend to persist for the remainder of the year.

What do they mean for the sector?

The outcome of New York gaming licenses will be a watchpoint for multiple rated issuers this year. The scale of the project could add leverage compared with our base-case forecasts and slow improvement in operators' credit measures, or eat into the leverage cushion of others.

Casino operators could expand into Southeast Asian markets. Macao operator Melco Resorts & Entertainment Ltd. is partnering with a local conglomerate in their integrated resort development in central Colombo in Sri Lanka. Thailand is also in the process of legalizing casinos. These markets could be attractive to smaller casino operators with less financial flexibility with their low investment costs, compared with developed markets.

Insurance

Capital market and forex volatility calls for more active risk oversight

What do we expect over the next 12 months?

- Stable credit profiles to continue, while insurers navigate market volatility.
- Market swings and forex risk could weigh on earnings, diluting capital buffers.
- Extreme weather will test insurers' abilities to manage risk.

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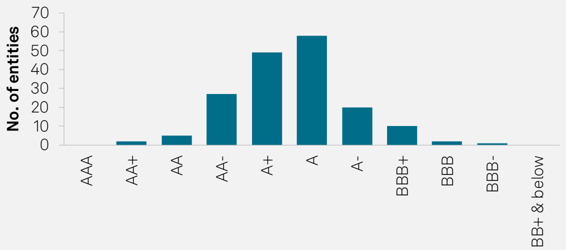
Rating distribution



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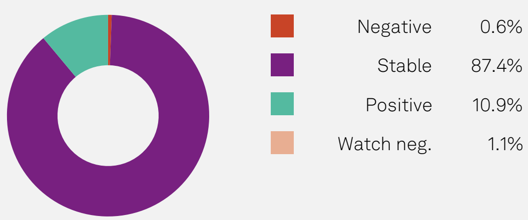

As of May 31, 2024. Includes public ratings only.
Source: S&P Global Ratings.

What are the key risks around the baseline?

Market strains persist. Monetary policy adjustments by major central banks could spur capital market volatility. Forex risks persist for insurers with large overseas investments (e.g., Taiwan and Japan). Credit stresses, notably in real estate and alternative investments, could prompt insurers to reassess risk-returns.

Extreme weather intensifies. The severity and high-impact frequency of extreme weather could raise catastrophe-related insurance losses. While returning capacity could moderate premium rate hikes, market conditions continue to test insurers' overall effectiveness in risk mitigation.

What do they mean for the sector?

Market swings to test investment strategy. Equity market volatility weighs on earnings, diluting capital and earnings. Still high interest-rate differentials and forex volatility will keep hedging costly for insurers in Japan and Taiwan, squeezing profitability. High rates (ex-China) improve reinvestment returns and help the management of asset-liability mismatches, despite unrealized losses staying in place.

Compressed insurance margins. Underwriting margins may come under strain as the frequency of extreme weather increases, and as the effects of nonmodeled exposure start to bite. High reinsurance costs, though with moderating price rises, could disrupt the risk mitigation plans of nonlife insurers, weighing on profit margins.

Regulatory and accounting framework updates. International Financial Report Standard 17 and new regulatory frameworks call for more focus on asset liability management. This could result in changes to capital management and associated target measures. Insurers also face higher operational costs.

Media And Entertainment

Tepid growth outlook for 2024

What do we expect over the next 12 months?

- China advertising spending growth to remain stable in 2024, following a recovery in 2023.
- Intense competition, particularly in e-commerce, will somewhat offset the effects of stable economic growth in Asia-Pacific. This could erode margins for some issuers.
- Large internet companies have plenty of financial buffer to withstand slowing growth and investments to remain competitive.

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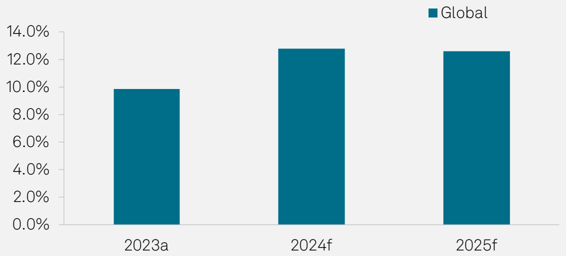
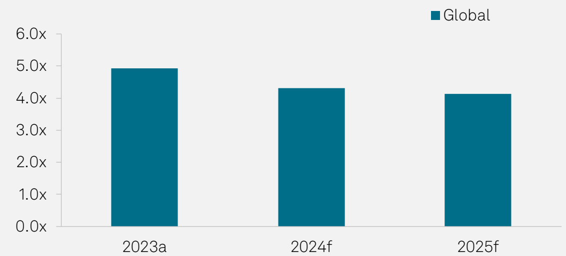
FFO to debt* (median, adjusted)



Debt to EBITDA* (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. *Metrics for Asian issuers are not included in the chart, as more than half of the Asia-Pacific media & entertainment rated portfolio are net cash on an adjusted basis. FFO--Funds from operations. a--Actual. f--Forecast.
Source: S&P Global Ratings.

What are the key risks around the baseline?

Challenging macroeconomic environment remains a burden to incumbent Chinese online retail platforms. Consumers spending remains geared toward services and value-for-money products. This trend can be a challenge for some online retailers as they adapt their platforms to focus more on bargain products and cost reduction. This could result in further shifts in the share of online retail spending for incumbent platforms. However, revenues and profits for such platforms should remain stable so long as online retail spending continues to grow.

Emerging platforms will continue to pressure ad pricing. Short-form video platforms and other emerging platforms are accelerating efforts to monetize their growing user base. This will pressure ad pricing for at least the next 12 months, particularly in China. Such efforts include building up e-commerce capabilities on social media platforms or increasing ad load. Growing ad supply and monetization of e-commerce opportunities on social media will spread advertisers' spending across more channels. This could reduce ad prices and allocation to more established social media platforms and other online ad platforms.

What do they mean for the sector?

Stiff competition and evolving user preferences will push online platforms to scale up investments. Companies are under pressure to increase spending on marketing, user experience, and content. Advances in artificial intelligence are creating opportunities for internet companies to invest. Together, they will weigh on profitability and increase capital investments.

Most Asia-Pacific media and entertainment companies have sufficient financial buffers. Most of our rated media and entertainment issuers in Asia-Pacific have dominant market positions and large financial buffers to absorb rising investments, margin pressure, and rising regulatory costs.

Metals And Mining

Uncertainty lingers over demand recovery

What do we expect over the next 12 months?

- Demand for industrial metals to remain lackluster given the weak growth of base metals consumption in the U.S. and Europe, and still-subdued property construction in China.
- Supply tightness, upbeat demand outlook for critical minerals due to the energy transition and Russia metal sanctions are supportive to some metals, such as copper and aluminum. Supply surplus will persist for some other industrial metals and downstream industries, such as China's steel and Indonesia's nickel.
- Macroeconomic signals from different economies will determine the direction of metals markets.

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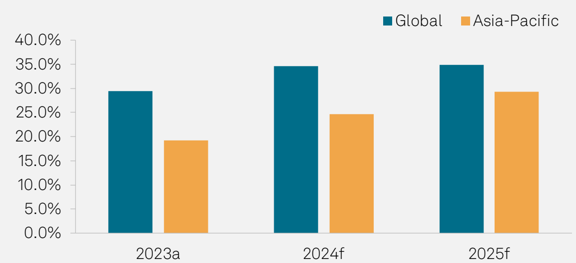
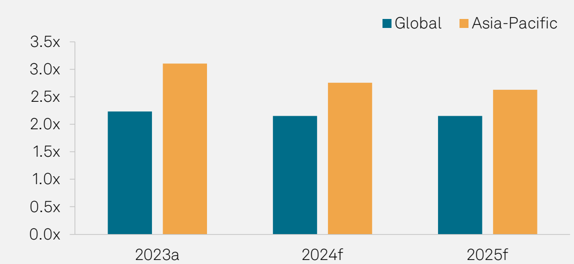
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.
Source: S&P Global Ratings.

What are the key risks around the baseline?

Economic pressure looms. We have made some modest upward adjustments to our base-case price assumptions for most base metals on tighter supply and higher cost. Overall global macroeconomic outlook remains mixed with muted demand in Europe and China. Risks of a harsher downside persist.

Geopolitical risks escalate. The uncertainty of how these risks unfold further limits price visibility. The Israel-Hamas and Red Sea conflicts have a limited impact on the metals market for now as they are not the main transportation routes. But coupled with Russia sanctions, these could cause supply disruptions.

Pressure on metal downstream players. China's steel companies' profitability remains under pressure, with low product prices; coking coal and iron ore prices remain resilient. China is expected to curb steel production in 2024 and clean out inefficient players in the industry.

What do they mean for the sector?

Credit quality of upstream companies has levelled off after a long run of improvement. Credit quality for upstream mining companies has stabilized. Most issuers can withstand further price pressures before testing our downside credit threshold.

Downstream players' profitability is volatile amid macroeconomic uncertainties. Soft end-use demand is limiting pass through of high material cost. Meanwhile, upstream materials' prices are volatile, though they remain at a high level despite the moderating macroeconomic trend.

Less earnings visibility amid high volatility in prices for commodities and energy. This is the result of different catalysts, including economic uncertainty, currency swings, and geopolitical risks.

Oil And Gas

Global demand slows as supply is turning to a deficit

What do we expect over the next 12 months?

- Full-year 2024 global oil demand growth to lose steam amid trade tensions, geopolitical conflicts, and uncertainty in inflation and policy interest rates.
- Supply to turn to a deficit in the latter half of 2024 given extended production cuts. We assume Brent oil price to stay unchanged at US$85 per barrel in 2024, and US$80 in 2025 and 2026.
- Geopolitical tensions have increased concerns over energy security, potentially hindering the region's effort to address the energy transition.

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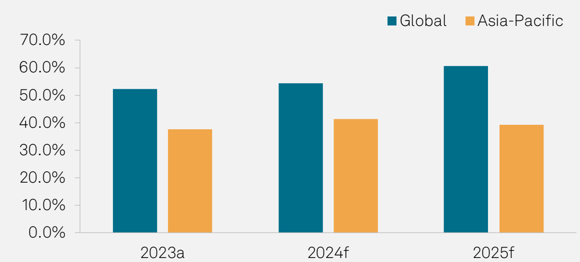
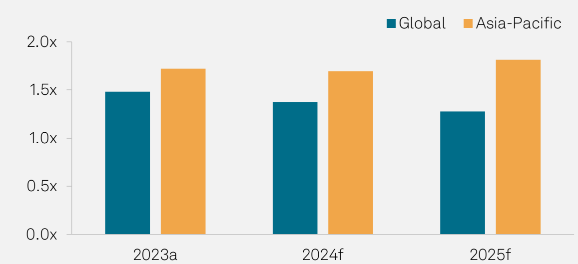
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. e--Estimated. f--Forecast.
Source: S&P Global Ratings.

What are the key risks around the baseline?

Global demand growth losing steam. China, India, and Brazil will remain the key growth drivers, as growth prospects are lackluster for Europe, Japan, Canada, and the U.K. Still, uncertainties around trade tensions, geopolitical conflict, inflation, and policy interest rates are hindering demand expansion for the remainder of 2024, with demand expected at 1.7 million barrels per day, compared with 2.1 million barrels per day recorded in 2023.

Oversupply situation to subside. The extension of crude oil production cuts through the end of 2025, led by the OPEC+, has reduced oversupply pressure on oil prices. The 2.2 million barrels per day of production cuts have been extended until the end of September, and will be phased out over the following 12 months. Our Brent oil price assumption in 2025 and 2026 remains US$80 per barrel.

Geopolitical unrest adds to the volatility. Ongoing geopolitical tensions will continue to fuel unease about oil supply and energy security. Adding to the volatility are uncertainties on inflation and policy interest rates.

What do they mean for the sector?

Persistent volatility and earnings headwinds. High volatility will pose potential downside risks that depress earnings. Geopolitical turbulence and the uplift this gives to energy prices, while positive to earnings, could lead to large swings in producers' inventory gains and losses. Given most rated Asia-Pacific producers are national oil companies, they will likely face more pressure to direct investment toward securing energy supplies, rather than for energy transitioning, for their respective countries. Balancing investment needs and maintaining prudent financial policy will also be crucial amid likely volatility over the next 12 months.

Public Finance

Fiscal divergence becoming normal

What do we expect over the next 12 months?

- Interest rates remain high in most Asia-Pacific jurisdictions. High rates will further weigh on local and regional governments (LRGs) and their associated enterprises that maintain elevated funding plans.
- Local governments in China, Australia and New Zealand will continue to spend on large infrastructure pipelines resulting in growing debt levels and higher interest burdens. New Zealand LRGs are behind the regions with a large negative bias over the rating outlook distribution.
- Tail risks include the Chinese economy failing to restore confidence amid a faltering property market, and inflation amplifying strains as New Zealand LRGs await details of new water reform.

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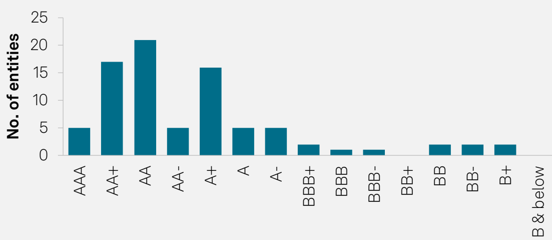
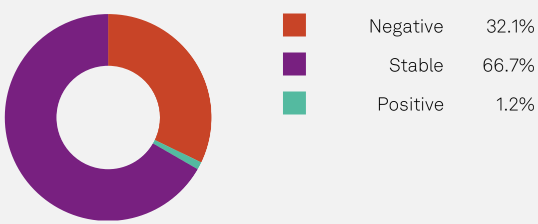
Rating distribution



Outlook distribution



As of May 31, 2024.Source: S&P Global Ratings.

What are the key risks around the baseline?

Higher for even longer. Persistent inflationary pressures, high interest rates, and downside risks to the global economy, could further squeeze the region's consumption, supply chains, and economic growth, leading to revenue headwinds for LRGs.

Property market correction. Most LRGs in the region are fiscally dependent on revenues tied to domestic property sales and prices. With China's property sector flagging, a lack of recovery in market confidence could dampen fiscal positions further.

Policy shifts. To restore the economic growth momentum and market confidence, select LRGs could roll out further fiscal stimulus, including tax cuts and spending. Local state-owned enterprises (SOEs) in China may potentially be called upon to support the property market by purchasing inventories, or by other means. New Zealand awaits new water reform, with potential impact on local government finances that is driving the large negative outlook bias for the region.

What do they mean for the sector?

Divergence becomes the normality. Some LRGs with aggressive fiscal stimulus, including tax cuts or more spending, are seeing fiscal deficits and debt reaching levels that are difficult to restore to prior levels.

Leveraging SOE investments in China. Chinese LRGs may add to leverage if they let their policy-driven SOEs use more debt to support public investment.

Real Estate Development

China's primary property market is searching for a bottom

What do we expect over the next 12 months?

- China's primary property sales may stabilize at RMB10 trillion, and then follow an extended L-shaped recovery path.
- Hong Kong's home prices will continue to fall in 2024 before stabilizing in 2025 when interest rates ease.
- Indonesia residential property sales growth is likely to be flat over the next 12 months. Sales will be front-loaded in 2024, driven by the value-added tax reduction that will expire by the end of the year.

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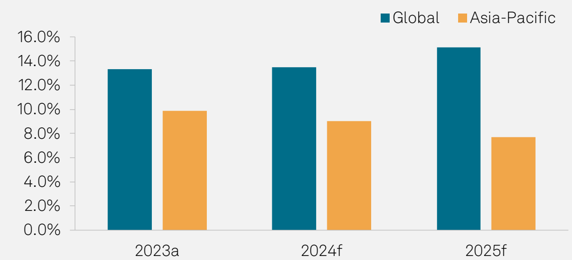
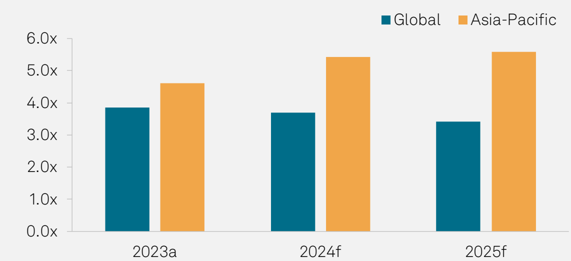
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.
Source: S&P Global Ratings.

What are the key risks around the baseline?

Structural factors could dampen China's primary property sales. This is because homebuyers are increasingly purchasing in the secondary market, as they might want to avoid the uncertainties of not being able to receive completed units from liquidity-strained developers. Furthermore, social housing for sale offered by the government could cannibalize the sales of rated developers.

Hong Kong's home prices could continue to fall. Recent easing in property-cooling measures will stimulate demand somewhat. However, a high level of inventory, a slew of new supply in 2024, and elevated interest rates will add pressure to price recovery.

Access to funding for Indonesian developers remains selective. This will increase the refinancing risk for the sector again, due to the offshore maturity wall in 2025 of about US$710 million.

What do they mean for the sector?

Chinese developers will be competing for a slice of a smaller primary market. Rated developers who focus on higher-end projects in higher-tier cities, and offer better quality products and value-added services, will fare better in the still tough operating environment.

Hong Kong developers will approach land acquisitions with prudence. Rated developers will likely attempt to control their leverage amid a market downturn. We estimate most of our rated developers have over five years of land reserves, and they therefore have no immediate need to replenish their land banks.

Indonesian developers will restructure most of the notes that are due to mature before the end of 2025. Most developers have limited surplus cash to address the upcoming maturities. For developers with weak credit quality, obtaining bank loans could be an uphill task even if they have sufficient unpledged assets. The likelihood for such developers conducting notes restructuring is high.

Real Estate Investment Trusts

Higher-for-longer interest rates are hurting landlords

What we expect over the next 12 months

- Asia-Pacific office landlords will continue to bear the brunt of structural and cyclical challenges. Valuation pressures remain for major Australian cities and Hong Kong.
- Credit metric and covenant headroom diminishes as higher interest rates persist.
- Logistics, hospitality, and retail (nondiscretionary) assets remain well supported.

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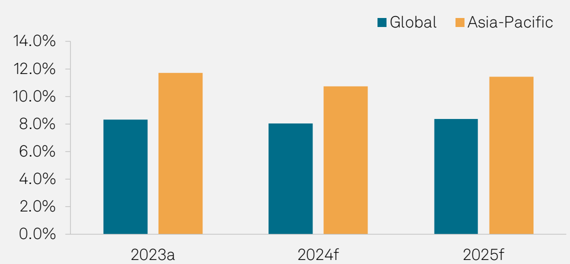
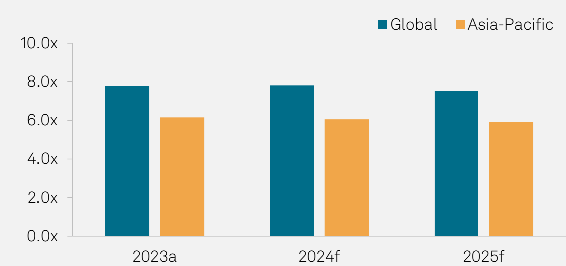
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. e--Estimated. f--Forecast. Source: S&P Global Ratings.

What are the key risks around the baseline?

Higher-for-longer interest rates will crimp credit metric headroom. Landlords will be more exposed to elevated interest rates as their fixed-rate debt and interest-rate hedges roll off. This will weaken their interest coverage ratio and pressure covenant headroom.

Landlords' ability to monetize assets to deleverage will be constrained. Elevated interest rates will keep purchasers on the sideline, stymying landlords' efforts to deleverage. Sales of office assets at depressed prices will exert further downward pressure on office valuations. These could further erode gearing covenant headroom and funding avenues for our rated landlords.

What do they mean for the sector?

Financial buffers are thinning. While financial headroom is likely to diminish, we expect most rated Asia-Pacific REITs can still withstand the challenging operating and financial conditions. Cities with stronger return-to-office adoption or a continued increase in tourist arrivals will temper those strains.

Office asset valuations remain under the spotlight. Further deterioration in valuations will increase gearing. As a result, some REITs' articulated targeted gearing ranges will be tested. Covenant headroom will decline but remain manageable for most.

Shorter debt maturity profiles to challenge liquidity. We may see a further reduction in debt maturity profiles as landlords opt for bank loans over bonds. A shorter-dated funding profile could weigh on the entities' liquidity and capital structure. That said, rated REITs' refinancing risk remains largely manageable.

Multiple capital management levers to be pulled. Asset divestments, distribution payout reduction, deferral of non-essential capital expenditure, and equity raisings are some capital initiatives deployed by Asia-Pacific REITs under rating pressure. Capitalization rate stabilization should encourage capital inflows to the sector.

Retail

Revenue growth to slow amid weak spending

What do we expect over the next 12 months?

- Topline stays weak with low consumer confidence. China retail is seeing a small boost from policy support, while Australian grocers enter a period of heightened political scrutiny over grocery pricing.
- EBITDA margins to broadly weaken across our coverage. Companies generally need to spend more on promotion to stimulate demand. Cost pressures are elevated in the Pacific region.
- Credit ratios for China and Japan should improve, but Pacific companies will see relatively weaker metrics.

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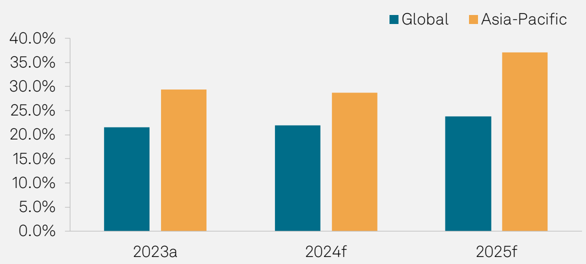
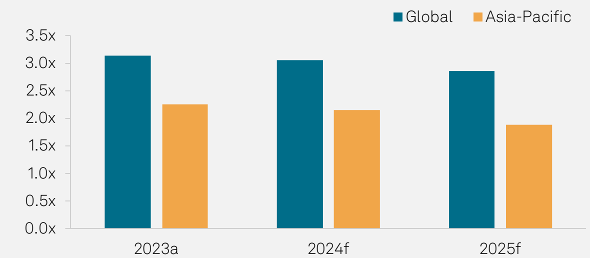
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.
Source: S&P Global Ratings.

What are the key risks around the baseline?

Cautious spending continues. Consumers are cautious with shrinking real disposal income (in Japan and Pacific) or low confidence (in China). Spending is disciplined and biased toward downtrading and necessities. We expect growth to slow but remain positive.

Regional drivers diverge. In Australia, allegations of price gouging could potentially lead to a shift in market share among supermarket operators. In China, the government is deploying subsidies to encourage upgrades to new, energy-efficient products driving sales of larger-ticket items. In Japan, a weaker yen lifts tourists' inflow but not enough to offset softening trends domestically.

Diminishing returns. Pacific issuers experience most margin pressures as cost inflation persists. Japan issuers are relatively shielded from slowing domestic consumption given most of their earnings comes from overseas, and this level is growing.

What do they mean for the sector?

Low confidence. It would take time to rebuild consumer confidence. COVID savings have largely been used up in Japan and the Pacific, while the recent wage hikes could slow the pace of real wage declines.

Tighter corporate spending. Corporations are taking a cautious stance on capital spending, focusing more on maintenance than expansion. Reorganization of companies in Japan's retail market is accelerating as the population shrinks, which could prompt further consolidation locally and abroad.

Credit metrics to diverge. A growing EBITDA base in China and Japan along with measured spendings should support cash flows and low leverage ratio trends. Weaker EBITDA generation in the Pacific would weaken credit metrics such as leverage and discounted cash flows.

Sovereign

Geopolitical risks back to the forefront

What do we expect over the next 12 months?

- International uncertainties to remain elevated, with geopolitical risks and higher U.S. interest rates putting pressure on external accounts.
- Current account balances and inflation in most economies should stabilize, following improvements over 2023.
- We still expect governments' fiscal performances to improve, although a return to pre-COVID fiscal performances will take longer in many cases.

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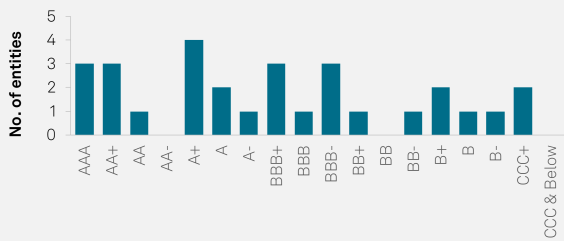
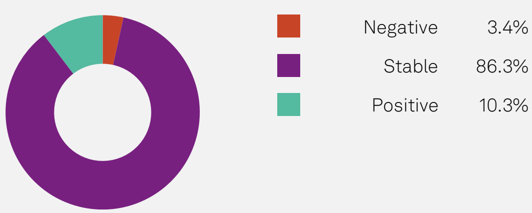
Rating distribution



Outlook distribution



As of May 31, 2024. Includes public ratings only, and ratings on policy-related financial institutions and corporates.
Source: S&P Global Ratings.

What are the key risks around the baseline?

A potential rebound in energy prices seriously undermine external and fiscal metrics. This could result if risks related to the Israel-Hamas conflict intensify.

Sudden capital swings. Further escalations in the war in Ukraine and/or the Middle East could bring about a more negative outlook for the global economy and exacerbate investor risk aversion. Should sentiment toward Asian emerging markets deteriorate sharply, capital outflows could intensify.

What do they mean for the sector?

A spike in funding costs could weaken fiscal support and economic growth. Higher interest payments are negative for fiscal support to sovereign ratings, especially where government debt is high and nonresidents are important sources of funding. If higher financing costs also significantly affect economic growth, this could exacerbate the hit to fiscal performance.

A rebound of energy imports could damage external support for some Asia-Pacific sovereigns. Net external indebtedness would weaken where current-account deficits persist or widen because of energy imports. Additionally, such a deterioration could worsen investor confidence and further raise financing costs. These deteriorations could damage the credit support of some sovereigns.

Structured Finance

Slowing lending activity and consumers watching household balance sheets

What do we expect over the next 12 months?

- Consumer confidence remains soft across several markets, discouraging purchases and dampening the outlook for households; this will be reflected in lower loan volumes.
- Cost-of-living pressures and higher interest rates are stretching some households, leading to higher delinquency levels and adding to subdued consumer outlooks.
- Some weakening in asset performance is likely over the second half of 2024, as unemployment increases moderately in some markets.

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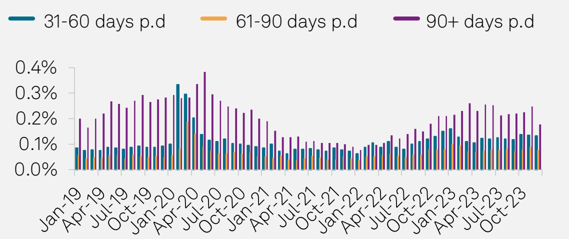
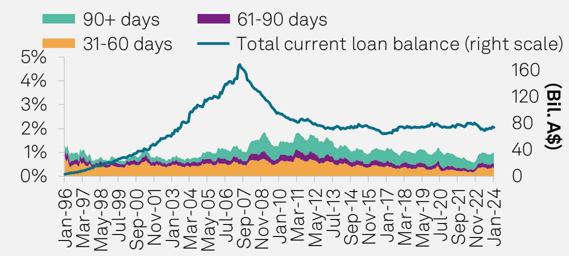
China auto loan ABS w.a. asset delinquency rates



Data as of Mar. 31, 2024. The delinquency rates of the first three months after transaction close are excluded. ABS--Asset-backed securities. w.a.--Weighted average. p.d.--Past due.
Sources: Trustee reports published on Chinabond's website; compiled by S&P Global Ratings.

Australian RMBS prime SPIN data



Data as of Apr. 30, 2024. Source: S&P Global Ratings.

What are the key risks around the baseline?

China's housing sector risk. This sector remains vulnerable to shocks that may further weaken sentiment. Weak consumer sentiment as well as a prolonged L-shaped recovery in residential property markets remain delicately poised. This may impact house prices, resale values and loan volumes.

Unemployment. We are seeing unemployment rise from pandemic lows for Australia, New Zealand, and Korea.

Rates and inflation. Australia and New Zealand continue to digest the impact of higher interest rates to tackle inflation. This is translating into some borrower cohorts facing strains from both higher costs of living and higher mortgage repayments. For Japan, modest increases in interest rates could be meaningful for the country, after years of low interest rates and persistent deflation. In our view, inflation could stress household finances if it is not accompanied by a growth in real wages.

What do they mean for the sector?

Issuance is likely to diverge. Lower consumer lending and macroeconomic weakness could see less issuance of structured-finance assets. We expect consumer ABS issuance to remain active across the region. The outlook for RMBS issuance is mixed with China and Japan seeing lower issuance volumes.

Delinquencies to rise. We expect delinquencies to increase across most markets and asset types, particularly those exposed to rapid interest rate increases. However, this is off historically low levels and is generally supported by broadly low levels of unemployment trends and expected to be modest.

Structural supports are in place. Most transactions have or can build support to mitigate downside risks.

Technology

An uneven recovery comes with challenges

What do we expect over the next 12 months?

- Uneven recovery across sub-sectors. An AI super cycle could continue, propelling sales of product categories such as high-bandwidth memory and AI servers. The recovery in consumer electronics could be lukewarm. Demand from industrials and auto end markets could stay subdued.
- Higher capital expenditure (capex) among certain tech firms, due to production diversification or new business development. Firms more dependent on non-AI end markets could face rising profitability pressure from competition or growth in new capacity.
- Most rated tech issuers have sufficient rating buffer. Yet the rating headroom could narrow for selected Japanese firms. Refinancing remains a challenge for lower-rated issuers.

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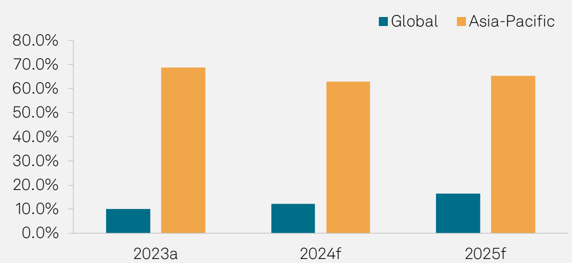
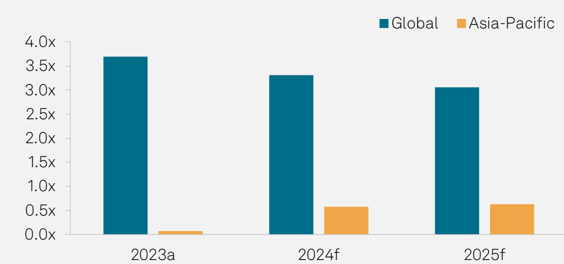
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.
Source: S&P Global Ratings.

What are the key risks around the baseline?

Macro strains. This could derail a likely recovery of the export-oriented Asia-Pacific tech sector, as both corporate and consumer demand--particularly in the U.S. and the eurozone--could be dampened.

Rising geopolitical tensions and a further tightening of U.S. tech export controls. The risk is compounded by the proposed tariff hike by the U.S. on China's semiconductor exports. The development could hit global tech trade, create supply bottlenecks, and prompt duplicated capacity buildout across geographies.

Overcapacity of mature semiconductors. Sizable new capacity using mature process nodes at 28 nanometers or above will be added in 2024, outpacing IT spending growth. Most of the addition will come from China. Asia-Pacific foundries specializing in mature chips face low utilization and profitability.

What do they mean for the sector?

Margin pressure diverges by sub-sectors. Profitability upside expected for memory producers supplying high-bandwidth memory for AI applications and firms debuting other AI-enabled new products. Yet margin pressure is high for players dependent on other end markets.

Cash flow volatility remains high. This is due to a confluence of factors: working capital swings; investment in capacity; new technology and relocation of production facilities; and macro and geopolitical uncertainties.

Sufficient rating buffers for most Asia-Pacific tech issuers. Most rated tech firms can maintain market position and financial metrics commensurate with current ratings, despite working capital swings and other investments. Rating headroom of some Japanese firms could narrow on soft customer demand, M&A or investment in new business. High funding costs and weak capital structures weigh on lower-rated issuers.

Telecommunications

More network sharing, less capex allow telcos to invest in growth

What do we expect over the next 12 months?

- Telecom operators' earnings will, on average, rise by a mid-single digit in 2024 from increased mobile data traffic and fixed broadband adoption. Cost cutting, supported by AI adoption and simplified business structures, will mitigate the effect of inflation on margins.
- Average capex intensity should ease as 5G investment declines, even as telcos pivot spending to other digital infrastructure such as fiber, cloud and data centers.
- Moderating competition in Asia-Pacific, such as Indonesia and Taiwan, because of market consolidation.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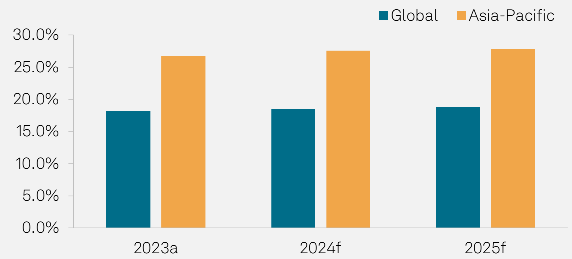
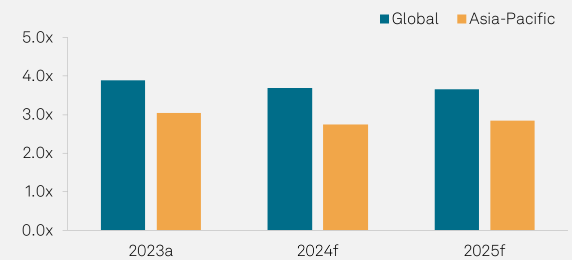
FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.
Source: S&P Global Ratings.

What are the key risks around the baseline?

A need for more 5G capex. Telcos that rolled out non-standalone 5G may need to fund another investment wave as they move toward standalone 5G. Sporadic spectrum buys could also exacerbate leverage.

Inflation and currency risks. Inflation strains could slow upgrades to pricier plans and 5G-enabled handsets and weigh on telcos' ability to execute on price increases. Macroeconomic pressures could weaken demand from enterprise customers. Input cost inflation could undermine telcos' cost cutting. Axiata Group Bhd. and Bharti Airtel Ltd. are more exposed to currency risk. A sizable proportion of Axiata's debt is denominated in U.S. dollars; domestic currencies have weakened substantially in Bharti Airtel's African operations.

Rising investment in growth engines. Telcos have been investing in high-growth segments such as fiber, cloud, and data centers. Such investments, if debt-funded, can erode rating headroom, as new earnings streams take time to ramp up. Execution risks could also lead to higher-than-expected capital intensity.

What do they mean for the sector?

Telcos will be more open to infrastructure sharing. We expect to see more active and passive network sharing, subject to regulatory and competition considerations. Players in markets such as Australia, the Philippines and Malaysia have proposed or entered network sharing agreements. Tower sharing in the region is also set to rise after the spate of tower sales in the past three to five years.

Timely and strategic divestments will be the key leverage management tool. With rated Asia-Pacific telcos mostly at investment grade, the focus is on financial policy. We believe telcos will consider selling non-core businesses and passive infrastructure assets to fund investments in new growth engines. We see signs of this as some telcos restructure their businesses, which could facilitate subsequent divestments. There is also some initial momentum in bringing in strategic partners for new growth engines such as data centers.

Transportation Cyclical

Focus on cost management amid normalizing post-pandemic strength and macroeconomic pressures

What do we expect over the next 12 months?

- Asia-Pacific airlines turn their focus to cost management as air traffic growth decelerates.
- Freight rates correction continues, although Red Sea disruptions provide some temporary respite.
- Push towards decarbonization will drive costs higher.

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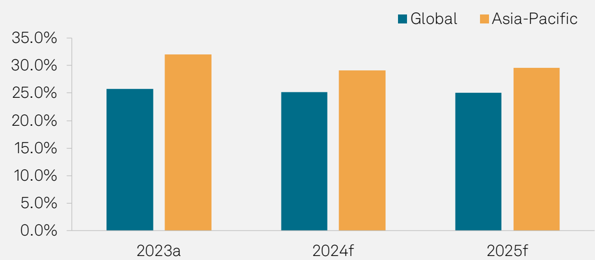

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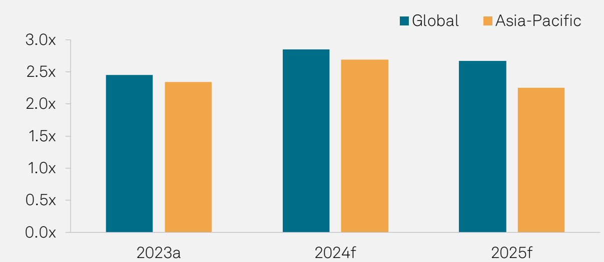

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Source: S&P Global Ratings.

What are the key risks around the baseline?

Slowing economy, geopolitical shocks. Slower growth and geopolitical escalations could derail the recovery in aviation and weigh on global trade. While prolonged Red Sea disruptions could ease shipping supply-demand imbalances, it may increase demand for air freight, and stoke inflation.

Elevated interest rates and costs. Persistent high rates, labor cost inflation, and volatile oil prices pose risks to earnings recovery, debt reduction and interest serviceability. These could gradually moderate the improvement in airlines' credit metrics. Lower-rated entities could face elevated liquidity and refinancing risks. Decarbonization targets further add to costs.

Supply-side constraints linger for aviation, ease for freight. Delayed aircraft deliveries, maintenance backlogs, engine problems and staff shortages could impede airlines' path to full capacity, and aviation growth prospects generally. But a surge in new-build ship deliveries will lead to a freight correction.

What do they mean for the sector?

Airlines need to manage costs more tightly. Passenger traffic growth, load factors and yields will moderate as the post-pandemic recovery plateaus, amid intensifying competition. Airlines' ability to maintain their competitive advantage and implement cost savings will be crucial to preserving profit margins.

Capacity management and cash buffers are key for freight operators. Container liners could continue offloading tonnage and carrying out blank/slower sailings to reduce capacity. Freight operators will rely on strong cash flows built up in 2021/2022 to counter disruptions in the Red Sea and to weather weaker margins. They will also remain nimble in their supply-chain logistics strategies.

Renewed focus on growth and green initiatives may mean higher capital expenditure. Entities could invest in more fuel-efficient fleets after spending reductions during the pandemic, and to meet growth aspirations. This could limit meaningful deleveraging. But supply-chain constraints in aviation could slow fleet renewal.

Transportation Infrastructure

Growth normalizes, inflation lingers, and interest rates stay high

What do we expect over the next 12 months?

- Growth of passenger traffic will further decelerate from the first quarter of 2024 (mainly due to a low base in the first quarter of 2023). Freight demand growth will stay resilient underpinned by capacity additions.
- Capital expenditure (capex) will be increasingly demand-oriented. We see tapering capex appetite and a prioritization of key projects under central oversight in China, due to a pressing need for debt resolution.
- Our overall rating bias is largely balanced. A few negative outlooks are due to weakening external support amid heightened debt burden, positive outlooks reflect likely cash flow improvement by higher tariffs.

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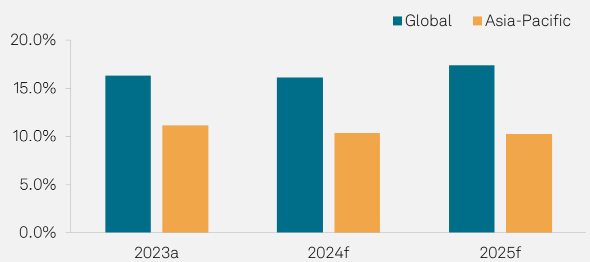

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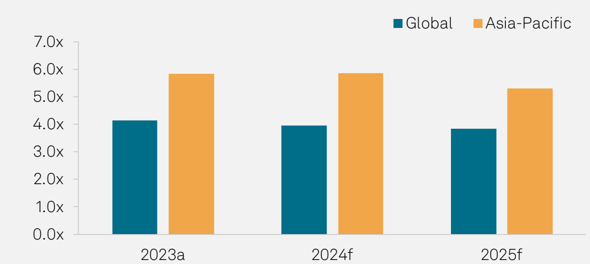

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What are the key risks around the baseline?

Global trade tensions and supply chain risks. This is despite the region's export resilience seen so far. The sustainability of traffic/volume growth hinges on demand from buying countries. Continued shipping disruptions in the Red Sea imply supply chain uncertainties.

Inflation continues to affect some markets. Inflation is easing but may not come down as much, or as quickly, as we had expected, and will remain uneven across the region. This may constrain trade demand and travel needs.

High interest rates in some markets may pressure borrowers. This is particularly true for issuers more reliant on dollar funding, those with lower interest rate hedging, or those with large refinancing or capex needs.

What do they mean for the sector?

Demand growth could be lower than expected. Tariff hikes by the U.S. on electric vehicles, semiconductors and batteries from China, if followed suit by the EU and other regions, could hurt demand from exports. Supply chain disruptions may affect operating efficiency.

Still, domestic funding costs are helping issuers across parts of the region. Indian issuers experience continued access to cheaper costs from domestic banks and the onshore bond market. Chinese issuers also have access to favorable funding costs. Some countries' issuers are benefiting from inflation-linked tariff/toll increases.

Leverage will stay elevated, higher than the global level. This is mainly due to continued large capex to improve efficiency or to meet demand growth.

Utilities

Renewables facing higher volatility in pricing and volume in some markets

What do we expect over the next 12 months?

- Demand will grow at mid-single-digit in line with economic growth; declining fuel costs will support earnings and margins.
- Large spending on renewables (including grid and storage) and coal-fired capacity (for energy security) will keep leverage high.
- The rating bias remains positive reflecting a recovery in volumes, accelerated capacity expansion, and declining fuel cost pressures.

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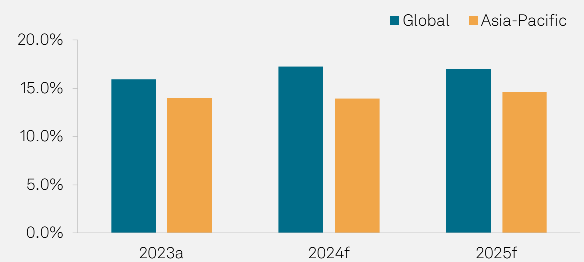

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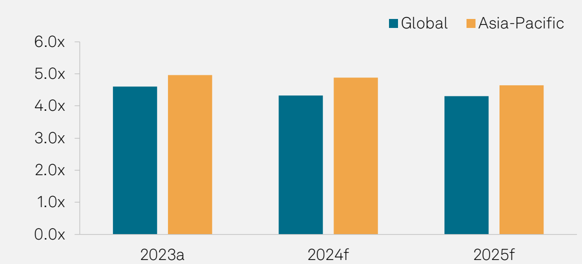

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What are the key risks around the baseline?

Geopolitical conflicts continue. This may lead to spikes in fuel costs, reversing the trend of margin recovery. As such, the effectiveness of cost passthroughs will be key to support cash flows. Companies may still have to factor in supply-chain risks in budgeting and capital expenditure (capex) delivery processes.

Inflation and high interest rates to bite. Fuel cost passthrough is in place in some markets but may not be even across all entities. High interest rates in most markets could alter funding options and costs for most entities, except in a few countries (such as China) that face less pressure on this front.

Accelerated new investments and funding needs. We view excessive debt funding of new developments, adverse regulatory reforms or interventions, and grid constraints as risks. Capex will focus mainly on renewables, integrated hybrid projects, grid and energy storage, and the acquisition of renewables.

What do they mean for the sector?

Rapid new capacity addition could weigh on utilization. Accelerated expansion of renewables without sufficient grid or storage facilities could heighten the risk of curtailment and increase volatility of contract pricing and volume. This risk is rising in China, and is apparent in some Asia-Pacific markets such as Australia, due to a lack of contractual protection.

High working capital needs due to electricity-price volatility in some markets. In China, power tariffs will moderate as marketized reform continues. Any fuel cost spike due to the disruption of energy supply could hurt profitability in some markets.

Constrains in funding could increase interest costs and lead to capex reviews. Higher funding costs will require closer capex reviews, except for Chinese SOEs benefiting from robust domestic financing support.

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