

Credit Conditions Emerging Markets:

Longer Lockdowns, Heightened Risks

April 23, 2020

Key Takeaways

- Overall: Credit conditions continue weakening across emerging markets (EMs); we now expect a deeper global recession and a slower recovery. COVID-19 has rapidly advanced in EM economies, and governments are implementing social distancing measures to contain the epidemic, halting most business activities and severely shocking employment.
- Risks: The risk of policy mistakes is on the rise, given that failure to contain the pandemic could lead to longer lockdowns at some point and a deeper economic shock. Moreover, the absence of proper economic stimulus could derail recovery and prolong the economic downturn. Most EMs have limited room to maneuver.
- Credit: The combination of extended lockdowns in developed market (DM) economies and domestic social distancing is deepening the shock to EM economies. Longer lockdowns could have a severe impact on household income, corporations' liquidity, and banks' asset quality.

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(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, North America, and Europe, the Middle East, and Africa]. 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 EMs committee on April 17, 2020.)

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Top Emerging Markets Risks

Table 1

Top EM Risks

COVID-19 spreading across key EMs

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

The COVID-19 pandemic continues to advance quickly across EMs, and most are now taking containment measures. We expect these measures to depress domestic demand over the coming months. At the same time, conditions in advanced economies have worsened as social distancing measures were extended and we now expect the economic shock to be more severe. The combination of a steeper global recession and weakening domestic conditions will result in a deeper recession across EMs, which will put drastic pressure on all economic sectors. We expect most economies (EM and DM) to rebound during the second half of 2020; nevertheless, the path of the recovery will depend on policy measures to cushion the economic impact, especially on labor and small and medium enterprises.

Volatile capital flows, fickle financing conditions, and disorderly currency movements

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

The COVID-19 crisis has triggered significant risk aversion towards risky assets. Spreads have widened sharply across EMs. Although they have yet to reach the peak levels during the 2008-2009 global financial crisis, the speed of deterioration in the past few weeks is without precedents. If the pandemic extends beyond the second quarter of 2020, refinancing risk will escalate, especially for speculative-grade rated issuers. Over the past week, significant monetary easing taken by DM central banks have stabilized the markets, and investment-grade rated issuers have been taping the markets. However, speculative-grade rated companies haven't been able to issue debt. Our base-case scenario assumes that access to capital markets should gradually extend to all issuers, although spreads will remain high with tighter conditions for low rated issuers. Currency depreciation can act as a buffer in countries with an open economy and flexible exchange rate. Nevertheless if global demand were to remain muted, a steep currency slide might hike the prices for imported basic goods, which could ignite inflationary pressures in some countries. Other countries in which corporate entities (financial and non-financial) or governments depend on external financing could face suddenly soaring debt costs and rising refinancing risks.

Commodity price volatility

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

The pandemic crimped global demand, which in turn caused commodity prices to tumble. Moreover, oil prices remain subdued despite the OPEC+ agreement to cut production, which reflects the significant shock to demand and high level of inventories. We have revised down our assumptions for key commodities for the rest of 2020 including oil and metals. We expect the plunge to be temporary and as the pandemic fades, demand for commodities, along with prices, should gradually recover. Falling commodity prices have mixed effects across EMs. While many EM economies are net exporters and depend on commodity revenues, others could benefit, especially from falling fuel costs. However, weak commodity prices curtail investor confidence in EMs, because such a scenario usually stems from soft global growth. In our view, factors behind falling prices, including slower global growth and tighter financial conditions, will pressure credit quality across EM economies.

Policy choices derailing recovery

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

Policy makers are facing significant challenges in containing the COVID-19 pandemic and keeping their economies afloat. Over the next weeks and months, policy measures will be critical to cushion the potential impact of coronavirus on EM economies. So far, we have seen an uneven response and believe that policy mistakes and failure to mitigate the spread of the virus could slow or delay the expected recovery.

U.S.-China dispute reigniting

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

The January 2020 'Phase 1' trade deal seem to be marking a hiatus in the strategic and trade dispute between the U.S. and China. In the meantime, both countries seem more focused on dealing with the effects of COVID-19. However, given that China may find it difficult to fulfill its pledges under the trade deal for 2020 because of global public health emergency, the dispute could reignite during the U.S. presidential election year.

Sources: S&P Global Ratings.

* Risk levels may be classified as very low, moderate, elevated, high, or very high, and 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 on whether the risk level could increase or decrease over the next 12 months.

Regional Credit Conditions

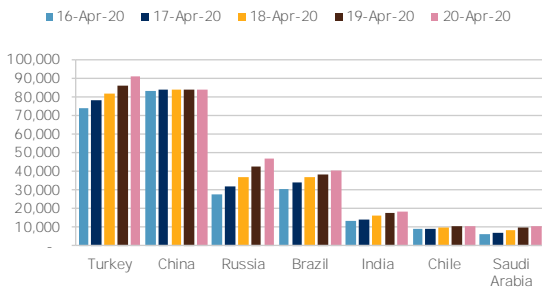
Policies Will Mark The Difference

Credit conditions continue slipping across EMs; we now expect a deeper global recession and a slower recovery. COVID-19 has rapidly spread across EM economies, and governments are taking restriction measures to contain the epidemic, halting most business activities and causing unemployment to soar. The combination of extended lockdowns in DM economies and domestic social distancing is deepening the shock to EM economies. Risks remain firmly on the downside given that longer lockdowns could impair household income, corporations' liquidity, and banks' asset quality.

The risk of policy mistakes is on the rise, failure to contain the pandemic could lead to longer lockdowns at some point and a deeper economic shock. Moreover, the absence of proper economic stimulus could derail recovery and prolong the economic downturn. Most EMs have limited wiggle room in light of weak per capita income, fiscal rigidities, high or rising leverage in some cases, and dependence on external financing in a few countries. Therefore, policymakers will need to decide which fiscal and monetary policies to implement to cushion the economic blow and protect employment in order to foster a future recovery. At the same time, as cases of the virus rise, policymakers will need to adjust lockdowns and quarantines. With very few exceptions, most EM health systems are ill equipped and have insufficient personnel to face a pandemic.

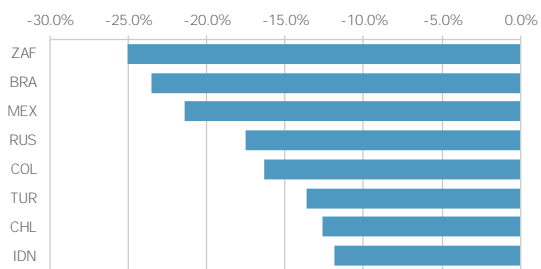
Financing conditions have stabilized following the strong monetary easing by DMs' central banks. Investment-grade rated entities have regained access to capital markets, although at higher spreads than prior to the pandemic. On the other hand, issuances among speculative-grade remain muted. Although we expect these entities to tap the markets over the coming weeks, financing conditions for them will remain very stringent.

Chart 1
The Rapid Spread Of COVID-19 Across EMs



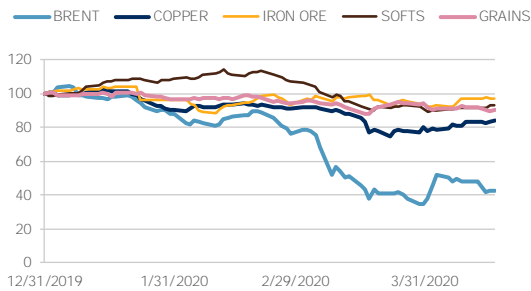
Key EMs with more than 10,000 cases. Source: John Hopkins Center of System Science and Engineering

Chart 2
Adverse Investor Sentiment Towards EMs Pressuring Currencies (FX Depreciation Worst Performers)



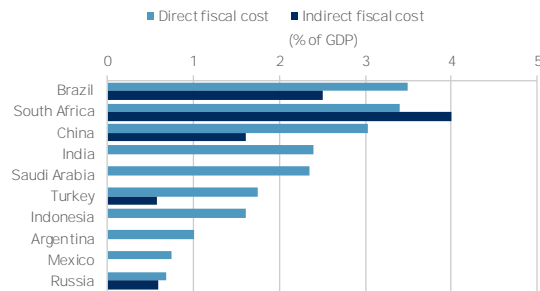
Source: S&P Market Intelligence (Jan 1, 2020=100; Jan. 1, 2020 - April 17, 2020)

Chart 3
Tumbling Commodity Prices



Source: Bloomberg

Chart 4
Policy Choices Could Slow Or Delay Recovery Prospects



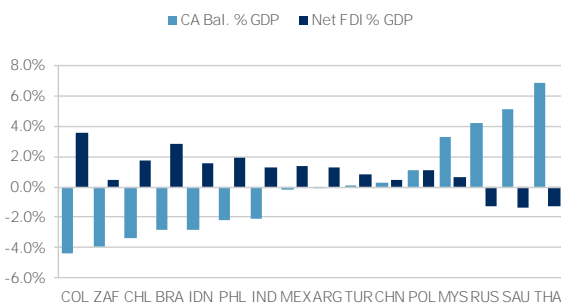
Fiscal response to COVID-19. Source: IMF and S&P Global Ratings

No Generalized Balance Of Payments Crisis, But Extended Lockdowns Could Ratchet Up Pressure

During the past few months, EMs have suffered unprecedented capital outflows, triggered by risk aversion as shocks affecting emerging economies compound. The latter has squeezed EM currencies, amplifying risks for issuers with unhedged foreign currency exposure, along with refinancing risks for speculative-grade entities. In our view, key EMs are not facing a generalized balance of payments crisis, despite the significant capital outflows. Overall key EMs had manageable current account deficits prior to the crisis, mostly financed with foreign direct investment and with moderate foreign currency debt. The exceptions are Argentina and Turkey, which high dependence on foreign currency debt made them vulnerable to external shocks before the pandemic hit. In addition, Colombia and Indonesia's external vulnerabilities increased as a result of falling oil prices and decreasing non-oil exports resulting from falling global demand. An additional source of external vulnerability is the foreign participation in local currency government bonds, which is relevant in many key EMs, including Indonesia, South Africa, Russia, Mexico, Malaysia, Colombia, and Poland. Heightened risk aversion could trigger a quick exit from these assets, weighing further on interest rates and currencies.

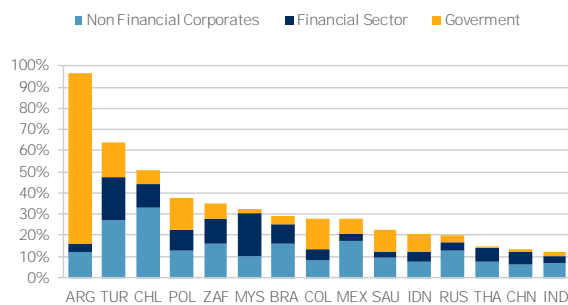
External risks remain on the downside if lockdowns in both EMs and DMs remain in place for longer periods, causing a deeper recession; this could result in a steeper toll on corporations' liquidity, mounting risk aversion, and a second round of capital outflows.

Chart 5
Key EMs' Current Account And Net Foreign Direct Investment



Source: S&P Global Ratings. Data as of December 2019.

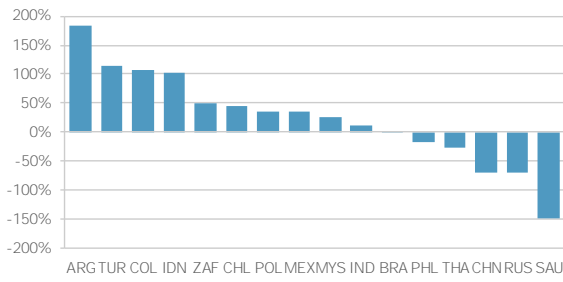
Chart 6
Foreign Currency Gross Debt % Of GDP By Sector



Source: IIF. Data as of December 2019.

Chart 7

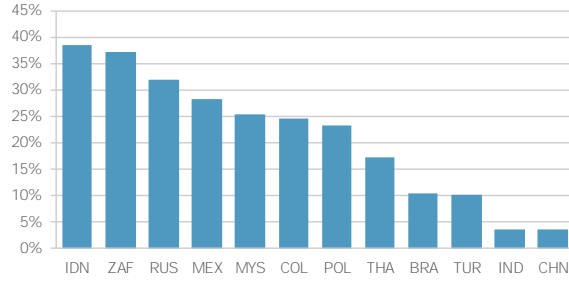
Narrow Net External Debt % Of Current Account Receipts



Source: S&P Global Ratings. Data as of December 2019.

Chart 8

Foreign Participation In Local Currency Government Bond Markets



Source: IIF. Data as of December 2019.

Financing Conditions

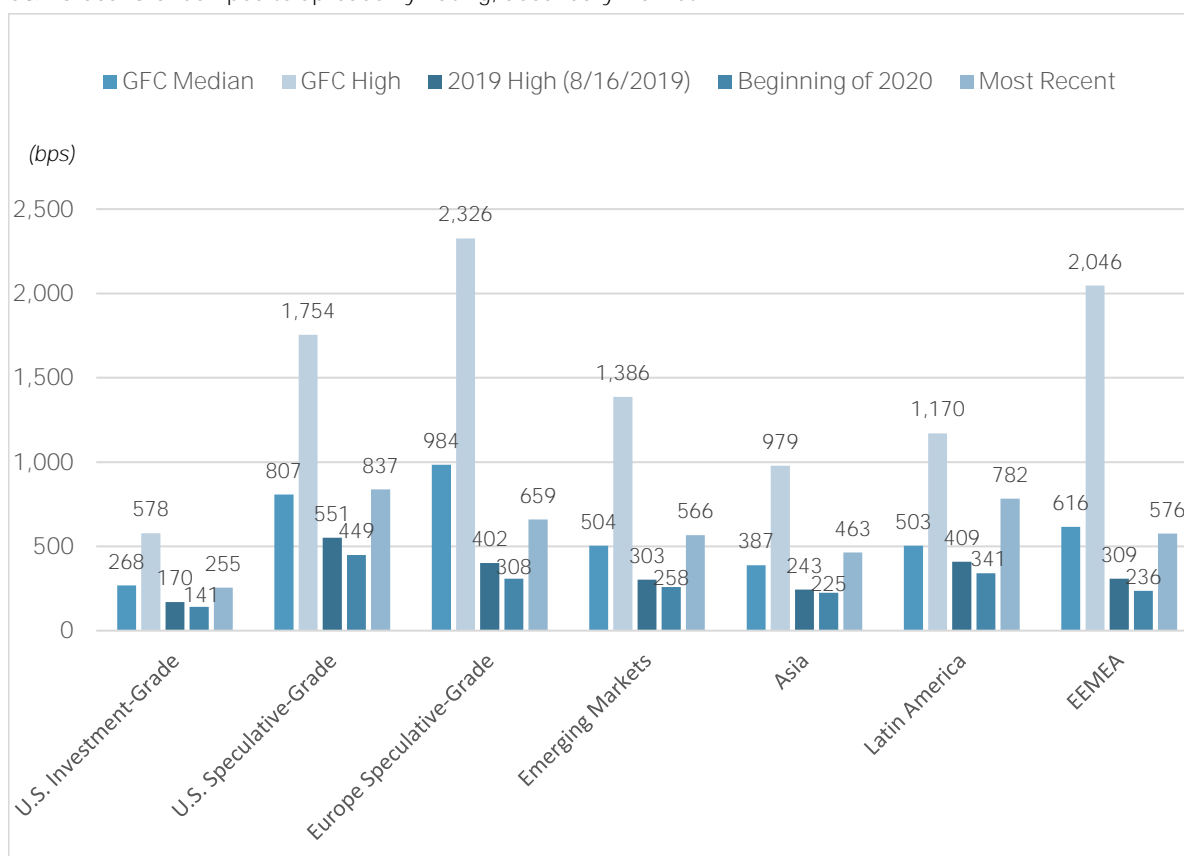
Financing conditions have stabilized thanks to significant monetary stimulus in DM economies. Markets are gradually opening; nevertheless, bond spreads remain above the 2008-2009 global financing crisis levels in most markets. We expect investors to gradually return to the high-yield markets as confidence begins to rise, though volatility and investor skittishness are likely in the near term.

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Risks remain firmly on the downside. Social distancing is still imperiling revenues, despite the opening up of secondary markets, and will constrain capital demand. Weak investor confidence is felt globally and volatility is expected as investors are juxtaposed by spread compression driven by central bank action and harsh fundamentals due to social distancing measures, mandated business closures, and significant health risks still present.

Chart 9
 S&P Global U.S. Composite Spreads By Rating, Secondary Market



Source: ICE Benchmark Administration Limited (IBA), 'ICE BofAML High Grade Emerging Markets Corporate Plus Sub-Index Option-Adjusted Spread', 'ICE BofAML Emerging Markets Corporate Plus Index Option-Adjusted Spread', 'ICE BofAML Asia Emerging Markets Corporate Plus Sub-Index Option-Adjusted Spread', 'ICE BofAML Latin America Emerging Markets Corporate Plus Sub-Index Option-Adjusted Spread', 'ICE BofAML Europe, the Middle East, and Africa (EMEA) Emerging Markets Corporate Plus Sub-Index Option-Adjusted Spread', retrieved from FRED, Federal Reserve Bank of St. Louis: <https://fred.stlouisfed.org/series/BAMLEMRECRPIEMEOAS>, U.S. Investment-Grade and Speculative-Grade Spreads from S&P Global Ratings. April 14, 2020.

Central banks across EMs have taken several measures to support domestic liquidity and keep bank financing flowing. These measures include, lowering reference rates and liquidity requirements, relaxing capital and provisioning rules, quantitative easing measures in some cases that allow central banks to provide liquidity to lower rated corporate securities. Moreover, authorities in most EM economies have rolled out some kind of forbearance scheme allowing for payment deferrals for loans to small and mid-size enterprises, mortgages, and other types of retail loans.

Macroeconomic Developments And Assumptions

(Editor's Note: The views expressed in this section are those of S&P Global Ratings' economics team. While these views can help to inform the rating process, sovereign and other ratings are based on the decisions of ratings committees, exercising their analytical judgment in accordance with publicly available ratings criteria.)

The economic impact of COVID-19 to be longer and more intense than expected

We have made another round of substantial downward revisions to our 2020 GDP growth forecasts for EM economies. We now expect the average EM GDP to contract 0.5%, compared with a 4.6% growth forecast before the pandemic emerged. This would be the first contraction in output for key EM economies as a group in at least two decades (see chart 12). No region will be spared a severe downturn this year. We forecast Latin America's GDP to fall around 5% in 2020. We also expect a deep contraction in key EM EMEA economies, including Russia and South Africa. Among EMs in APAC, we now forecast both India and Indonesia to grow 1.8% this year, previously unthinkable rates for two high-speed economies (see Table 3). More importantly, we now expect a flatter U-shape recovery, with the level of activity returning to pre-outbreak trend, if at all, only in 2023.

Our expectations of a longer and deeper impact of COVID-19 on the U.S. and the Eurozone economies will imperil external demand for EMs. This is particularly true for Mexico, which is exposed to the U.S., and Poland and Turkey, which are exposed to the Eurozone. For the economies to which tourism contributes meaningfully and is an important source of foreign currency, such as Thailand and Turkey, the expected prolonged hit to international travel will be keenly felt.

The key driver of our more pessimistic view on the outlook for EM economies is the pernicious impact of more stringent containment measures on domestic demand, as the virus has spread widely across key EMs. Most EM economies, even those where the number of infections is still not very large, have implemented widespread restriction measures. We estimate that every month of a strict lockdown lowers annual GDP growth by around 3%, although this varies across countries.

We believe the recovery will be uneven across EMs, depending crucially on the policy response that can help soften the blow and limit economic dislocation. The starting point, as well as the resilience and adaptability of the private sector, also matter for the recovery prospects.

Economies that have been quick to implement social-distancing policies, along with robust economic stimulus, should see stronger recoveries (for example, Chile). Generally, countries with delayed public health responses and limited stimulus programs would see tepid recoveries (Mexico). Brazil is somewhere in the middle, with an uncoordinated public health response, but moderate economic stimuli measures.

The Russian economy has been hit by two shocks--collapse in oil prices and COVID-19. The economy has policy space to cushion the blow, but so far, the decisive policy response has been slow to arrive. Turkey has entered the crisis with a strong growth momentum (although imbalances started to reemerge), and its dynamic business sector is relatively better positioned to confront the economic fallout. The delayed public health response may require a stricter lockdown later on. Turkey's capacity to refinance still-high external debt could be challenged in the riskier environment.

South Africa implemented a lockdown early on, and has so far managed to keep the number of infections low. However, the country entered the crisis at the time when confidence was already low amid very weak growth and concerns over the fiscal trajectory. The recently announced large fiscal package, likely to be partly financed by international financial institutions, should help in partially mitigating the economic toll. Nevertheless, the recovery will be impeded by long-standing structural issues.

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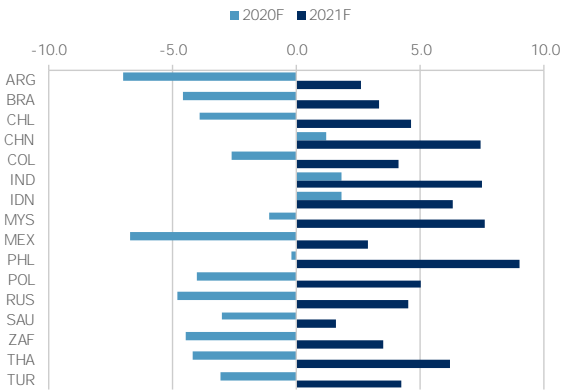
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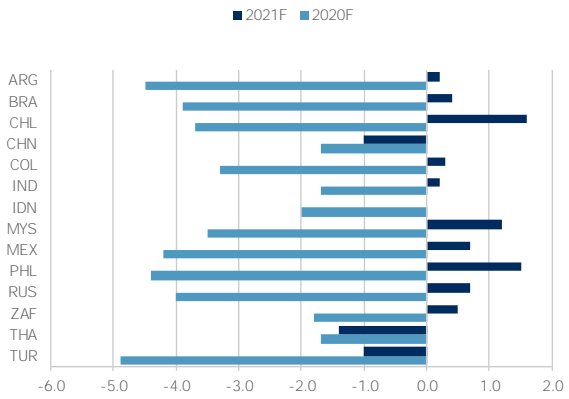
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Chart 10
Key EM GDP Growth



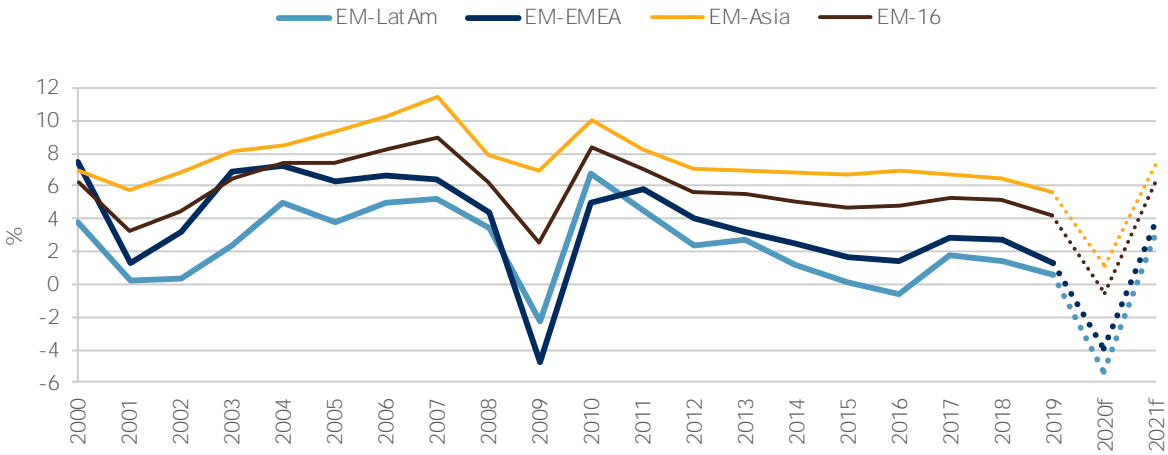
Source: Oxford Economics. F--S&P Global Ratings' forecast.

Chart 11
Change In Baseline Forecast From March 2020



Source: S&P Global Ratings. F--S&P Global Ratings' forecast.

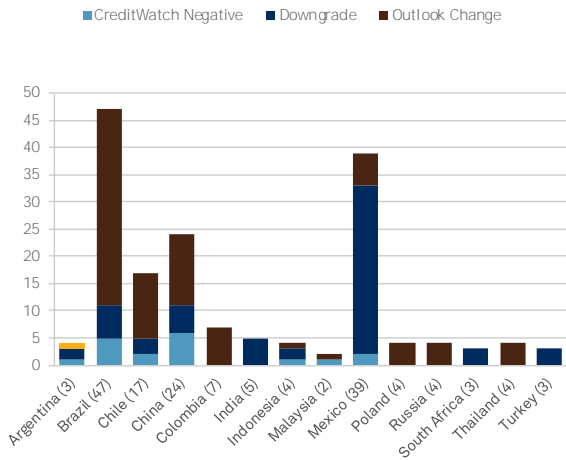
Chart 12
Emerging Markets Real GDP Growth



Source: Oxford Economics. S&P Global Ratings' forecasts. Note: The average GDP aggregates are based on PPP GDP weights of selected major key Emerging Market economies covered in this report.

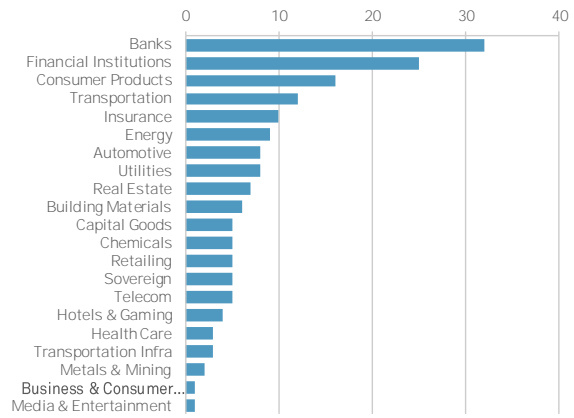
Sector Themes

Chart 13
COVID-19 and Oil Related Rating Actions In EMs



Source: S&P Global Ratings. Data as of April 21, 2020.

Chart 14
COVID-19 Related Ratings Actions In EM By Sector



Source: S&P Global Ratings. Data as of April 21, 2020.

Sovereigns

We expect that investment-grade rated sovereigns that finance themselves in their own currencies, and benefit from deep domestic capital markets will show more resilience and flexibility to withstand the economic shock better than EM sovereigns, particularly outside of Asia, where public- and private-sector balance sheets are heavily dollarized. The ratings on more diversified economies with greater resilience, a stronger financial profile, and more credible policymaking are likely to experience lesser pressure. In contrast, speculative-grade rated sovereigns, especially at the lower end of our scale, are more vulnerable to downgrades, given their inherently weaker finances and narrower economies. Most governments are using expansionary fiscal and monetary policy to cushion the economic pain of the crisis. The impact of such policies on sovereign ratings depends in large part on how much fiscal and monetary flexibility each sovereign possessed entering into the crisis. In general, countries with limited fiscal and monetary flexibility have less room to issue more debt, or extend credit from the central bank, without risking greater economic instability (including greater exchange rate volatility and higher inflation).

The pandemic has worsened an already bleak panorama for Latin America in 2020. Prior to the spread of coronavirus, we had expected the region to head into a seventh consecutive year of GDP growth of below 2%. Subsequently, we revised our projections that shows severe economic contraction this year, with only a modest recovery in 2021. The revised forecast has already led to several negative rating actions or outlooks changes, including on investment-grade rated countries. Argentina and Ecuador have defaulted on their debt since the beginning of the global health crisis.

For some APAC sovereigns--such as Pakistan, Sri Lanka, and India--fiscal or other constraints prevent them from rolling out large stimulus measures. This limits the short-term pressures on fiscal support for the ratings. However, if the pandemic is prolonged, it could accumulate social dissatisfaction that could increase political instability. At the same time, the economic damage of businesses and households could weigh on the subsequent recovery. Rating pressures on these sovereigns may still mount over time.

In EMEA, South Africa, Bahrain, Oman, and Romania entered into 2020 with large fiscal imbalances, while Turkey started the year with limited net FX reserves and large private-sector foreign currency redemptions. In the past five years, many Sub-Saharan sovereigns sold commercial Eurobonds for the first time ever in large amounts, despite generally weak capacity to raise tax revenue or to weather a severe and synchronized global recession.

Table 2

Sovereign Rating Actions Since The Start Of The Pandemic

(Ratings as of April 21, 2020)	Current long-term foreign currency rating/outlook	Previous long-term foreign currency rating/outlook
Rating or outlook changes		
Mexico	BBB/Negative	BBB+/Negative
Colombia	BBB-/Negative	BBB-/Stable
Brazil	BB-/Stable	BB-/Positive
Argentina	SD	CCC-/Negative
Thailand	BBB+/Stable	BBB+/Positive
Indonesia	BBB/Negative	BBB/Stable
Ratings or outlook affirmed		
Saudi Arabia	A-/Stable	A-/Stable
Russia	BBB-/Stable	BBB-/Stable
Malaysia	A-/Stable	A-/Stable

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Nonfinancial Corporations

APAC

The fallout from the COVID-19 pandemic and sharp decline in oil price has hit many sectors in Asia-Pacific. The most acute pain is felt by the following sectors-- aviation; auto; consumer products; gaming, leisure and lodging; building materials and construction; metals and mining; oil and gas; retail and restaurants; and transportation infrastructure.

China's corporate sector is experiencing rating pressures due to weak economic demand and high refinancing risk. Production activity has started to recover in March and April, but consumption and manufacturing investment remain weak. Slump in demand continues to erode revenue and operating cash flows. Low rated corporations are still vulnerable to refinancing risk given the large amount of maturities in next two years.

We took several negative actions on speculative-grade rated entities due to a gloomy earnings outlook. Investment-grade rated companies have been more resilient. A prolonged slowdown could lead to further negative actions in some cases, given that we now expect meaningful earnings recovery in fiscal 2022. Refinancing risk for both speculative- and investment-grade entities is manageable, at least for the rest of this year.

The Indonesian corporate sector is facing the global health crisis in a weakened state, given years of substantial growth in leverage. More than one-third of rated companies in Indonesia are currently on negative outlook, with nearly half of the private companies we rate with ratings of 'B-' and below. Refinancing risk is a growing concern for the sector, because weaker investor sentiment and the currency depreciation are likely to complicate access to funding for smaller issuers amid the maturity wall coming in 2021 and 2022.

The rated corporate sector in Malaysia is predominantly investment grade, with moderate leverage in sectors such as telecoms, which are proving somewhat more resilient to the coronavirus-induced swoon. Negative rating actions in Malaysia have mostly occurred in the commodity sectors, notably the metals, and oil and gas and associated services, given freefalling commodity prices amid elevated capital spending or investments in working capital.

The rated corporate sector in Thailand has been somewhat more resilient to the COVID19 outbreak because it mostly consists of the larger, well diversified, and more financially prudent companies or players in sectors such as telecoms that are weathering the crisis better than other sectors. Debt-funded expansions, however, left a number of prominent conglomerates much more leveraged currently than in the early last decade amid weaker operating performance. Given the tourism's high contribution to Thailand's economy, the hospitality and retailing will be among the hardest hit sectors over the next few months. Commodity and energy producers will continue to face significant operating headwinds in the next few quarters amid dwindling oil and gas prices and chemical spreads.

Key EMs In EMEA

In Turkey, the tourism, retail, energy, real estate and construction, and automotive sectors are more exposed, similar to their peers in other countries. We now expect broader pressure across various sectors, while certain sectors such as telecoms should remain more resilient. Potential erosion in revenues is a challenge, while companies with unhedged dollar-denominated liabilities are more exposed, given the volatile Turkish lira.

In Saudi Arabia, the operating conditions are weakening amid of the plunge in oil prices and sluggish economy. We believe the national oil companies (NOCs) in the GCC region are generally well positioned to operate in a low price environment, given their very low extraction costs. However, we expect a rising pressure on the oil field services companies, because NOCs' potential capex reductions could erode day rates and imperil contract negotiations. In the GCC region, we already started to see early termination of contracts for oil field services as cost discipline becomes key. In addition, we now see a broader toll across most sectors as the global and local economies

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are weakening, while tourism and hospitality and contracting are more exposed and could witness greater damage, but telecoms and utilities to hold up.

Introduction of soft quarantine is dragging down Russia's economic performance. The government has extended the initial support measures to the economy; however, they're not as comprehensive as those in developed economies, and could result in a more pronounced GDP decline and sluggish recovery. Yet only a few rated companies in the transportation and travel sectors are immediately impacted. The economic toll on commodity producers is softened by the tax regime and weakening of the Russian ruble. Domestic-focused businesses are managing the situation by cutting capex meaningfully. Liquidity in the domestic banking sector is available, especially for the large corporations.

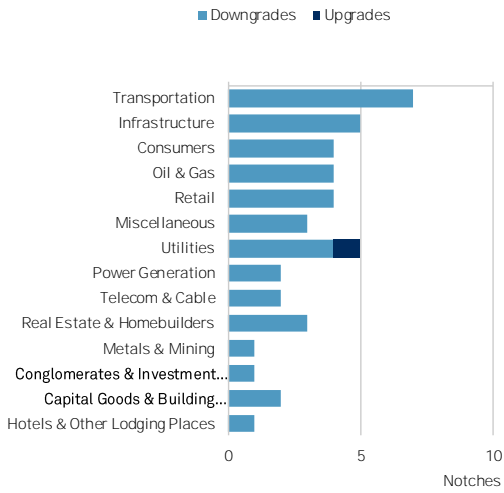
South Africa's government has instituted a five-week lockdown, including a shelter-in place order and severe restrictions to operations of industries not classified as essential services. Utilities, banks, mining, telecoms, and producers and suppliers of fuel, chemicals, paper products and medical supplies, as well as providers of healthcare, cleaning, food, and security services, amongst others, continue to function, albeit with varying levels of restrictions. Industry, non-food retail and non-essential transportation are largely shuttered. The lockdown and subsequent GDP contraction are likely to reduce demand for a range of domestic and export-focused goods and services. Based on our initial assessments, domestic retailers, cyclical transportation businesses and producers of non-essential items are likely to experience volume reductions of 10%-20% and EBITDA declines in excess of 20% in 2020. Export commodity producers (of diamonds, precious and base metals, coal, wood pulp, and chemicals, for example) are also exposure to weak global demand and pricing, with speculative-grade rated entities particularly vulnerable. Given lower import and export activity, port and freight volumes are also likely to suffer. We expect rated telecoms, non-power utilities, gold miners, and domestic coal suppliers to be resilient. The South African rand's steep slide may increase imported capex costs, but stimulate exports in the remainder of 2020. Lower oil prices are generally slightly positive for the South African economy.

Latin America

Since the outbreak of the pandemic, we've downgraded 12% of rated corporations in the region, particularly in sectors such as infrastructure, transportation, and oil and gas (see chart 15). We took negative rating actions on other sectors such as retail, consumer products, utilities, and telecom and cable following Mexico's downgrade on March 26--an action that prompted many ratings cuts among corporate, infrastructure, and financial institutions ratings.

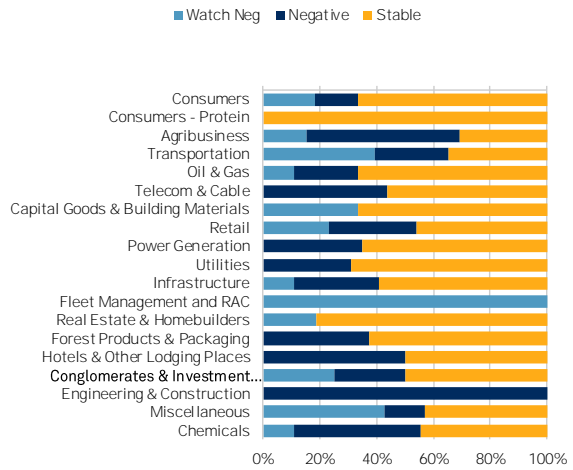
But as the crisis unfolds and economies weaken, we expect credit quality to continue slipping. Chart 16 shows how widespread is downside risk to rated corporate and infrastructure entities, affecting not only light sectors such as retail and consumer products but also commodities sectors--agribusiness (sugarcane producers mainly), oil and gas, and metals and mining--and heavy industries such as automotive, transportation, engineering and construction, chemicals, and infrastructure.

Chart 15
Latin America: Rating Actions



Source: S&P Global Ratings. Data from Feb. 27 – April 21 2020.

Chart 16
Latin America: Corporates Negative Bias



Source: S&P Global Ratings. Data as of April 21, 2020

In such difficult times, liquidity is key and we're closely monitoring cash reserves and market access. In terms of liquidity, Latin American companies were generally well positioned at the onset of the COVID-19 outbreak, with cash to short-term debt ratios largely above 1x, except for infrastructure. But they'll have to minimize cash burns for the next few quarters because we expect banks to become more selective in lending and debt markets to remain active for investment-grade entities names only.

Financial Services

APAC

Amid perfect economic storm--COVID-19, the plummeting commodity prices, and market volatility--the banking systems of China, India, and Indonesia will be hit the hardest. We expect the impact on China's largest banks to be manageable, while asset quality, performance, and capitalization among smaller banks with aggressive risk appetite or high geographic concentration in heavily hit regions could erode. The nonperforming assets (NPAs) among Chinese banks could rise to 7.25% in 2020.

Indonesian banks' asset quality is also likely to weaken because the country is a major commodity exporter and domestic corporations heavily rely on foreign currency funding, with sizable unhedged portions. Rupiah's depreciation and debt refinancing are key risks for the corporate sector and could spill over to banks. We expect NPAs to rise to 9.3%, and credit losses to rise to 285 basis points in 2020. However, Indonesian banks' strong capitalization and high provisioning buffers offer a sizable capital cushion.

India's closure of non-essential businesses, personnel shortages, supply constraints, and slumping demand are hurting economy. We expect India's GDP growth to plummet to 1.8% in fiscal 2021 (ending March 2021), while NPAs would worsen to 11.4% and credit losses to 3.1%. We have revised the outlooks on a few Indian banks to negative because the downside risk has increased and these lenders are entering the down cycle from a precarious position. The very high likelihood of government support somewhat cushions the downside risk for public banks.

Key EMs In EMEA

We expect Turkish banks' asset quality to continue deteriorating because of weakening economy, a high level of foreign currency loans amid a volatile Turkish lira and declining confidence. This will weigh on banks' profitability, while costs of swapping foreign currency into Lira and funding costs continue to rise as banks continue to roll over their external debt. The latter continued to decline, pointing to a drop in rollover rates and rising investor concerns.

For South African banks, we expect an increase in cost of risk and a deterioration in asset quality indicators because of the economic contraction. We have observed significant capital outflows from the country lately, but given banks' limited dependence on external funding, we believe the overall impact will be limited. In addition, the central bank is providing support to ensure normal functioning of money and interbank markets.

We expect asset quality indicators of Saudi banks to erode as the steep decline in oil price, the slowing non-oil economy, and the lockdown measures exert pressure on the contracting, hospitality, and retail sectors. While we view favorably the support package introduced by the government, we haven't yet seen any measures that would diminish credit risk for banks' balance sheets.

We expect the higher cost of risk and slipping asset quality indicators for the Russian banking sector. This will weigh on their profitability in 2020-2021. Nevertheless, the funding base of the sector has been demonstrating certain stability, supported by predominant reliance on domestic deposits, availability of liquidity support from the central bank, and moderate exposure to external funding.

Given a temporary economic shutdown, we expect cost of risk to rise and asset quality to slump among Polish banks towards the end of 2020 and in early 2021 when the loan payment forbearance ends. Sharp interest rate cuts could also additionally weigh on banks' profitability. However, we believe that Poland's financial sector is still generally profitable, liquid, and well-capitalized to mitigate the virus-induced economic shock. We expect a strong recovery in 2021.

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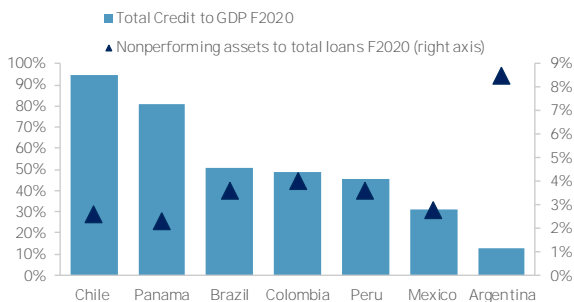
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Latin America

In Latin America, we expect a recession in 2020. Some regional economies were already growing below potential because of specific issues (for example, debt restructuring in Argentina, soft business and investor confidence in Mexico, and social unrest in Chile). Therefore, we expect asset quality indicators to deteriorate **especially among** small- to mid-size enterprises (SMEs) and self-employed workers. Loan forbearance, like in most jurisdictions around the globe, will probably delay the full impact of the erosion of banks' balance sheets to between 2020 and 2021. Nevertheless, Latin American banks have benefitted from sound margins and they have experience in operating under volatile conditions. Despite strong net profits at the onset of the crisis, the magnitude of the operating damage will depend on the duration of lockdown measures. While governments have offered some alleviating measures, they could be insufficient. On the other hand, we believe that Latin America's major banks can cope with a temporary disruption in capital markets. This is because retail deposits provide the bulk of their funding, and because of the absence of significant debt maturities in 2020. Moreover, large banks are benefitting from flight to quality, given that investors and depositors are shying away from the capital markets and funds, while parking their funds in banks. However, smaller banks and financial companies don't benefit from this trend. Argentina will suffer the most in the region. Argentinian banks were already operating in a weak economy and government actions to contain the impact are mainly taking a toll on the low-income portion of population, but appear insufficient to contain the credit risk, given the sovereign's limited fiscal capacity.

Chart 17

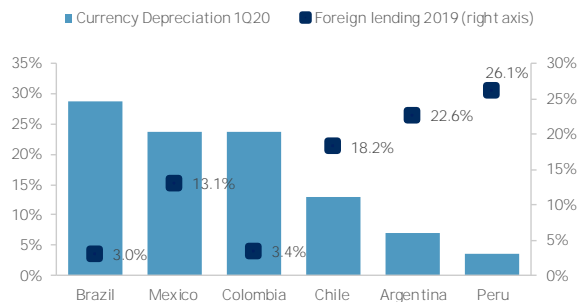
Latin America Bank's Asset Quality



Source: S&P Global Ratings

Chart 18

Latin America Bank's Foreign Currency Lending



Source: S&P Global Ratings

Appendix 1: Economic Data And Forecast Summaries

Table 3

Real GDP %

	2019	2020F	2021F	2022F
Argentina	-2.1	-7.0	2.6	2.5
Brazil	1.1	-4.6	3.3	2.9
Chile	1.0	-3.9	4.6	3.2
Colombia	3.3	-2.6	4.1	3.4
Mexico	-0.1	-6.7	2.9	2.3
China	6.1	1.2	7.4	4.7
India	5.0	1.8	7.5	6.5
Indonesia	5.0	1.8	6.3	5.6
Malaysia	4.3	-1.1	7.6	5.1
Philippines	5.9	-0.2	9.0	6.7
Thailand	2.4	-4.2	6.2	4.2
Poland	4.2	-4.0	5.0	2.7
Russia	1.3	-4.8	4.5	3.3
Saudi Arabia	0.3	-3.0	1.6	2.7
South Africa	0.2	-4.5	3.5	1.5
Turkey	0.9	-3.1	4.2	3.5

Source: Oxford Economics. F--S&P Global Ratings' forecast. For India, 2019 = FY 2019 / 20, 2020 = FY 2020 / 21, 2021 = FY 2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24.

Table 4

CPI Inflation % (Year Average)

	2019	2020F	2021F	2022F
Argentina	53.5	47.0	33.0	28.0
Brazil	3.7	3.3	3.8	4.1
Chile	2.3	3.2	3.5	3.2
Colombia	3.5	3.3	3.6	3.2
Mexico	3.6	3.2	3.4	3.2
China	2.9	3.2	1.2	1.4
India	4.7	4.4	4.5	4.4
Indonesia	2.8	2.8	3.3	3.2
Malaysia	0.7	1.1	1.6	1.7
Philippines	2.5	1.0	2.2	2.5
Thailand	0.7	-0.5	0.0	1.2
Poland	2.2	3.0	2.6	2.5
Russia	4.5	4.1	4.0	4.0
Saudi Arabia	-1.2	1.9	2.0	2.1
South Africa	4.1	3.9	4.4	4.5
Turkey	15.2	10.3	9.5	9.0

Source: Oxford Economics. F--S&P Global Ratings' forecast. For India, 2019 = FY 2019 / 20, 2020 = FY 2020 / 21, 2021 = FY 2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24.

Table 5

Policy Rates % (End of Period)

	2019	2020F	2021F	2022F
Argentina	55.0	30.0	27.0	25.0
Brazil	4.5	3.25	4.00	4.50
Chile	1.75	0.50	1.50	2.00
Colombia	4.25	3.00	3.50	4.00
Mexico	7.25	5.00	5.00	5.50
India	4.40	3.50	5.00	5.00
Indonesia	5.00	4.25	4.50	4.50
Malaysia	3.00	1.75	2.00	2.25
Philippines	4.00	2.00	2.50	3.00
Thailand	1.25	0.50	0.75	0.75
Poland	1.50	0.20	0.75	1.00
Russia	6.25	5.00	5.00	5.50
South Africa	6.50	4.25	4.50	5.00
Turkey	11.43	8.50	9.00	9.00

Source: Oxford Economics. F--S&P Global Ratings' forecast.

Table 6

Exchange Rates % (End of Period)

	2019	2020F	2021F	2022F
Argentina	59.89	85.00	95.00	100.00
Brazil	4.03	4.90	4.75	4.65
Chile	745	815	800	785
Colombia	3,277	3,850	3,800	3,800
Mexico	18.93	22.00	21.50	21.00
China	6.99	7.11	7.15	7.19
India	74.4	73.0	74.5	76.5
Indonesia	13,883	15,300	15,100	14,900
Malaysia	4.09	4.28	4.24	4.20
Philippines	50.74	53.00	52.33	51.67
Thailand	30.15	32.50	32.00	31.70
Poland	3.80	4.20	4.30	4.40
Russia	61.91	72.00	70.00	72.00
Saudi Arabia	3.75	3.75	3.75	3.75
South Africa	14.01	17.00	16.00	16.25
Turkey	5.95	6.80	7.00	7.20

Source: Oxford Economics. F--S&P Global Ratings' forecast. End of Period - Q4 values. For India, 2019 = FY 2019 / 20, 2020 = FY 2020 / 21, 2021 = FY 2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24.

Table 7

Unemployment % (Year Average)

	2019	2020F	2021F	2022F
Argentina	10.1	12.7	11.0	9.8
Brazil	11.9	13.3	13.0	12.2
Chile	7.4	9.5	8.0	7.4
Colombia	10.6	12.5	11.9	10.7
Mexico	3.5	5.4	4.6	3.6
China	3.6	4.9	4.5	4.1
Indonesia	5.2	6.2	5.6	5.5
Malaysia	3.3	4.3	3.8	3.7
Philippines	5.1	6.8	5.5	5.4
Thailand	1.0	1.9	1.7	1.5
Poland	5.4	9.0	5.0	4.5
Russia	4.6	6.0	5.3	4.7
Saudi Arabia	5.5	8.5	7.0	6.0
South Africa	28.7	30.0	29.9	29.6
Turkey	13.7	13.8	12.5	11.2

Source: Oxford Economics. F--S&P Global Ratings' forecast.

Related Research

- Credit Conditions North America: Pressure Persist, Risks Resound; April 23, 2020
- Global Credit Conditions: Rising Credit Pressures Amid Deeper Recession, Uncertain Recovery Path; April 22, 2020
- Credit Conditions Asia-Pacific: COVID-19: Flatter Growth, Tougher Recovery; April 22, 2020
- Coronavirus Impact: Key Takeaways From Our Articles, April 21, 2020
- Economic Research: Economic Recovery From The COVID-19 Pandemic Will Be Uneven Across Latin America, April 17, 2020
- Economic Research: Up Next: The Complicated Transition From COVID-19 Lockdown; April 16, 2020
- Credit FAQ: Sovereign Ratings And The Effects Of The COVID-19 Pandemic; April 16, 2020
- Economic Research: COVID-19 Deals A Larger, Longer Hit To Global GDP; April 16, 2020

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