

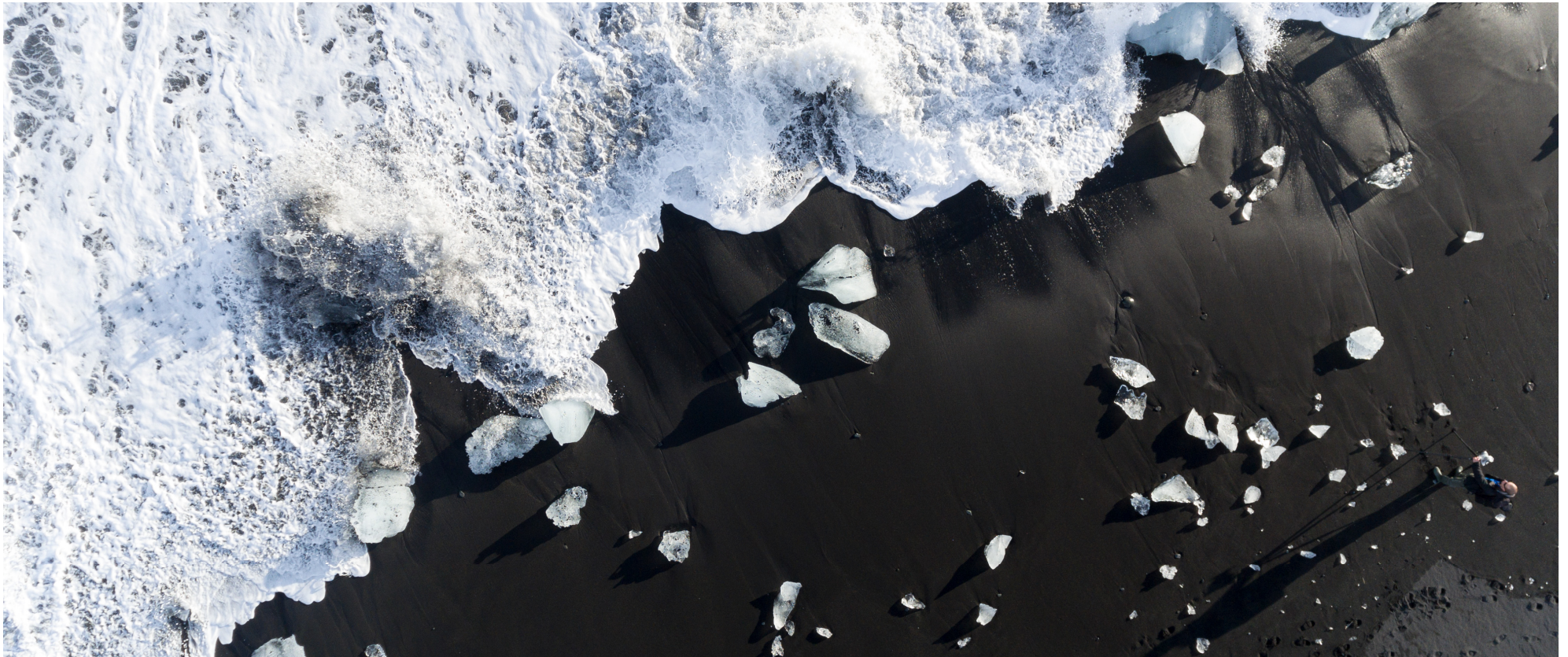
# Global Credit Conditions

## Q3 2019

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Ebbing Growth, Rising Risks

October 1, 2019



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**S&P Global**  
Ratings

# Overview | Ebbing Growth, Rising Risks

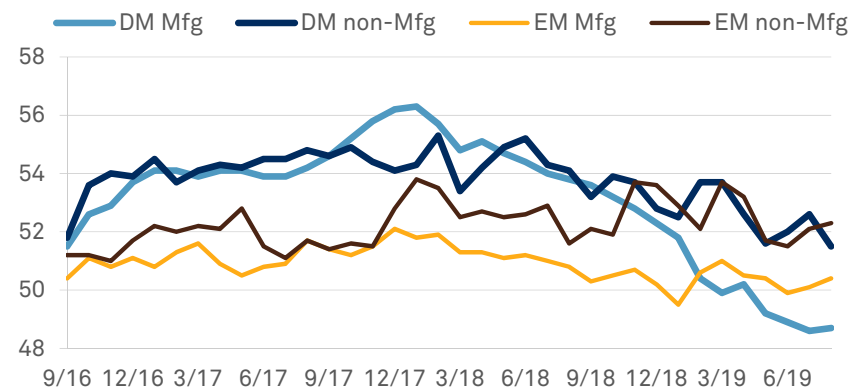
## Key Takeaways

- **Faltering growth:** Economic growth expectations are faltering as political and trade tensions stymie investment plans and erode confidence. Global recession remains unlikely given renewed monetary stimulus, but lower-for-longer rates are heightening financial-sector risks. Credit quality is deteriorating in cyclically-sensitive sectors.
- **Tensions:** Domestic political tensions – possible impeachment hearings in the U.S.; the Brexit imbroglio; elections and policy uncertainty in Latin America – are eliding with persistent global risks – U.S. and China trade and tech disputes; proxy conflict in the Middle East – to create a confidence-sapping climate of uncertainty. There is little prospect of immediate resolutions.
- **Policy response:** Central banks have once again reached for the monetary policy playbook with widespread reductions in interest rates and renewed unconventional stimulus. This has helped underpin financing conditions and is likely to mean low interest rates and flatter yield curves persist into 2020-21. Absent further shocks, this is likely to prevent a global recession.
- **Risks for the long term:** Nevertheless, this renewed stimulus poses longer term risks as it further encourages financial risk-taking through a hunt for yield, undermines financial sector profitability and exacerbates pension liability pressure. There is little sign that the stimulus has boosted investment intentions or confidence.

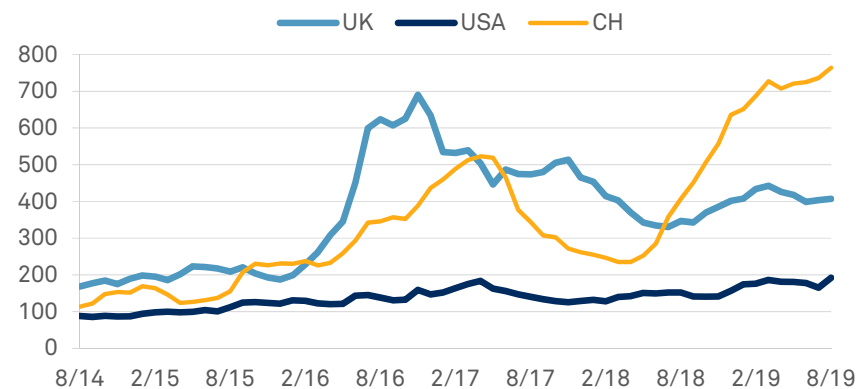
# Global Economy | Down But Not Out

- **Global growth continues to slow** as the weakness in manufacturing and trade with still-robust household spending persists. The main driver of this slowdown remains uncertainty around the U.S.-China relationship.
- **Major central banks have lowered rates** to support growth and boost inflation, with actions characterized more **as insurance cuts** than an easing cycle.
- We forecast a **continued moderate pace of activity** in the near-term with the balance of risks on the downside; labor market developments - still positive - will be key.
- **U.S.:** We forecast U.S. growth to approach 2% in 2020-2021, close to its steady-state path. However, our Business Cycle Barometer shows near-term recession risks are rising. We now put the probability at 30-35% — more than twice what it was a year ago.
- **Europe:** Key parts of the European economy are struggling – Germany, Italy and the U.K. amongst them – bringing renewed monetary easing and restarted QE. Overall, we see European growth slowing to 1.1% in next year, from 1.2% this year.
- **China:** Activity continues to slow and we expect GDP to expand 6.2% this year. There are some signals that the Chinese authorities could allow growth to slow below 6% next year, which would be a welcome development given years of credit-fueled investment.

## Purchasing Manager Indices



## Economic Policy Uncertainty Indices



Source: S&P Global Economics, CEIC, Refinitiv

# Credit Conditions | Global Top Risks

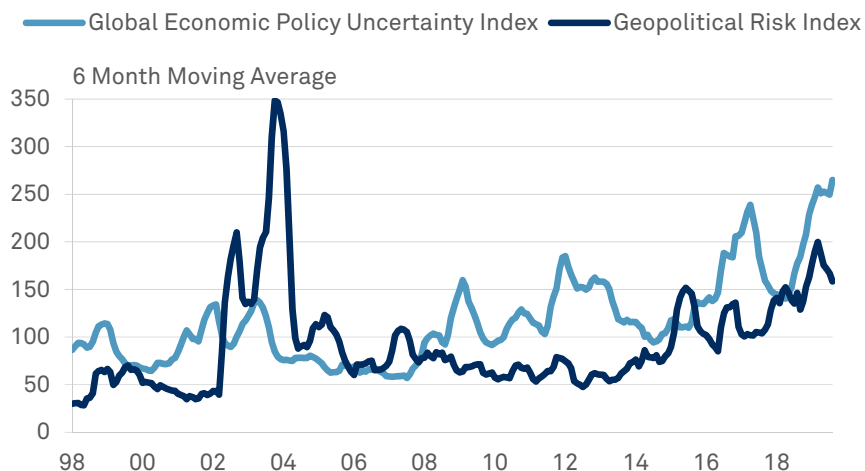
## Near-term Event Risk

### 1. Political tensions affecting growth

Risk level	Very low	Moderate	Elevated	<b>High</b>	Very high
Risk trend	Improving	Unchanged	<b>Worsening</b>		

Rising political tensions and heightened uncertainty, weighing on business and consumer confidence, risks undermining global growth prospects. The lengthening list of disputes includes the U.S.-China trade-technology war, Brexit, U.S.-Mexico-Canada Agreement delayed ratification, U.S.-Iran tensions, recent attack on Saudi oil facilities, and Japan-Korea technology dispute.

#### Economic and geopolitical policy uncertainty indices



Source: [www.policyuncertainty.com](http://www.policyuncertainty.com) Normalized data values: 100 = average for 2000-2009 for geopolitical risk index and for 1997-2015 for economic policy uncertainty index.

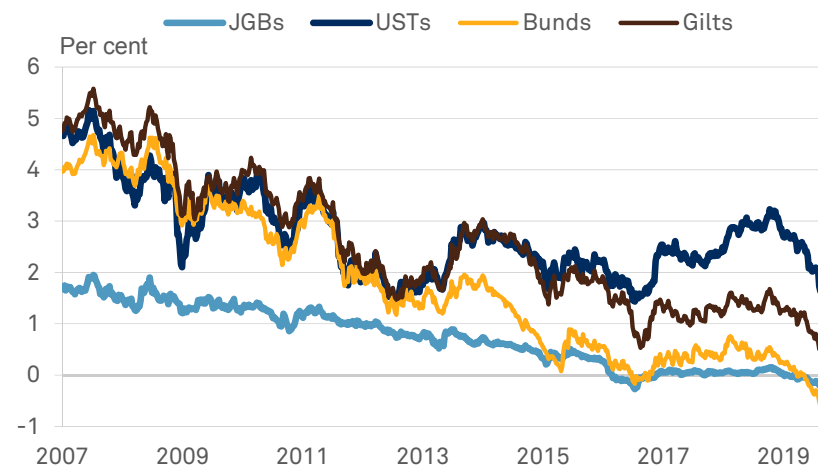
## Stage Of Cycle Risk

### 2. Mature markets negative feedback loop

Risk level	Very low	Moderate	Elevated	<b>High</b>	Very high
Risk trend	Improving	<b>Unchanged</b>		Worsening	

GDP growth trends (especially of U.S. and China), low inflation, inverted yield curves, and negative interest rates in Europe and Japan are worrying investors. In particular, overvaluation in financial assets and further debt accumulation risks becoming a source of instability, particularly if economic growth slows materially. Indeed, we now estimate the risk of a U.S. recession at 30%- 35%.

#### 10-Year government bond yields



Source: Refinitiv

# Credit Conditions | Global Top Risks

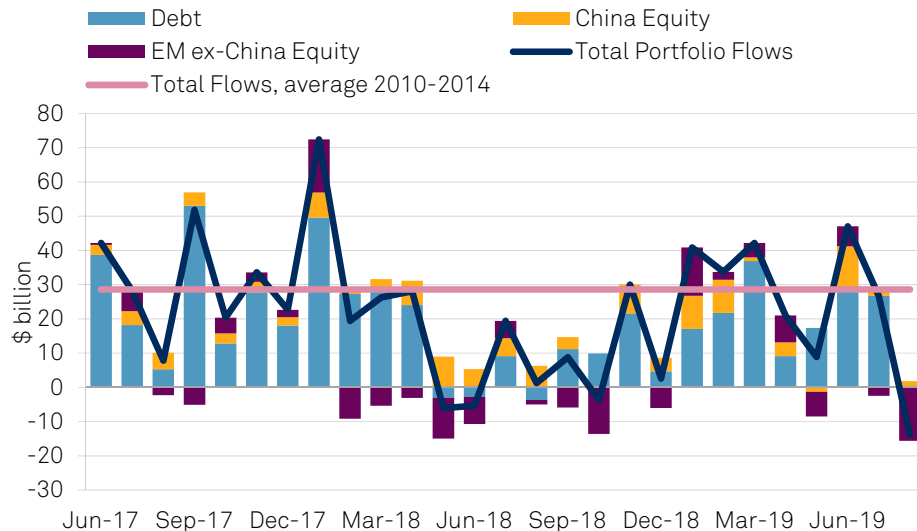
## Stage Of Cycle Risk

### 3. Trade and politics threaten Emerging Markets



Continued trade tensions between the U.S. and China, geopolitical and domestic policy uncertainty in many EMs have weighed on confidence and are hampering investment. A significant slowdown or outright reversal in capital flows to Emerging Markets would further weaken their economic outlook.

#### Non-resident portfolio flows into emerging markets



Source: Institute of International Finance

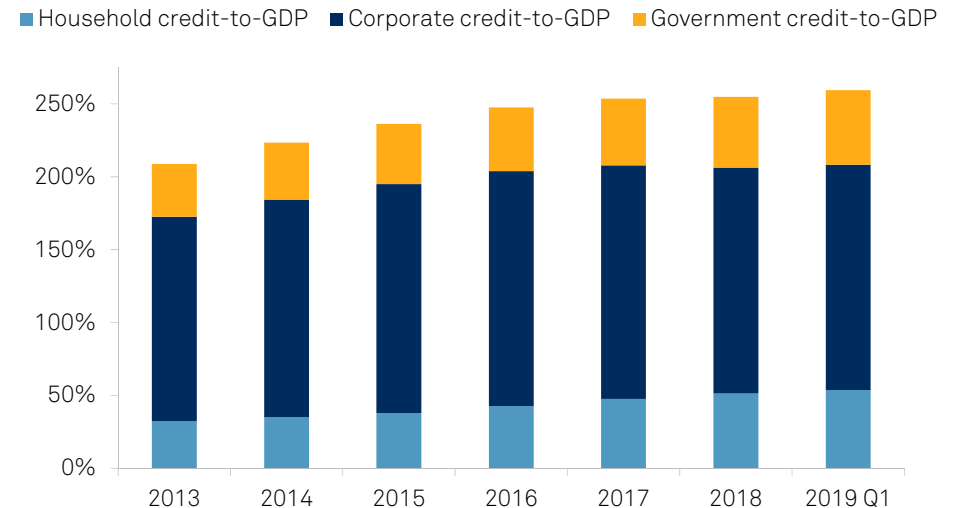
## Stage Of Cycle Risk

### 4. China's leverage hampering rebalancing



China contributes at least a third of global GDP growth. The debt overhang there remains an impediment to a rebalancing of the economy. The Chinese government's intent to deleverage the system is challenged by its desire to keep GDP growth up although the desire is showing signs of moderating.

#### China debt-ratio trajectory



Source: Bank for International Settlements

# Credit Conditions | Global Top Risks

Secular Risk

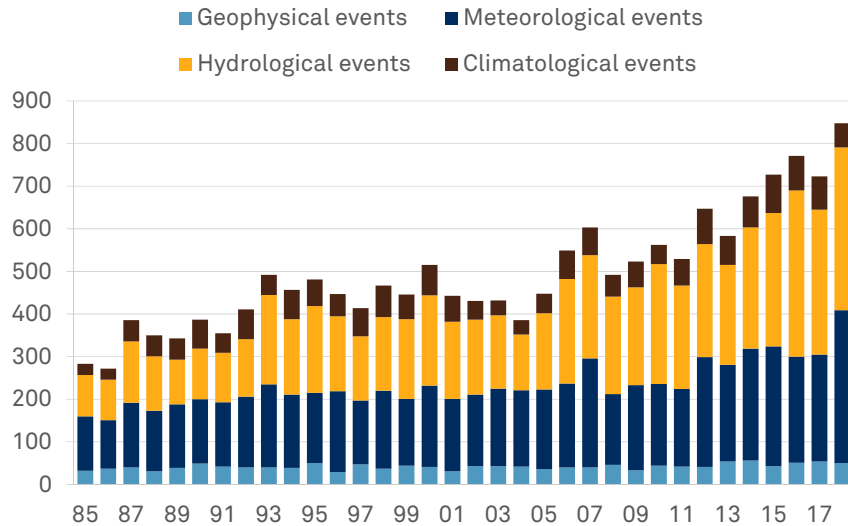
**NEW**

## 5. Climate change impact on economies

<b>Risk level</b>	Very low	Moderate	<b>Elevated</b>	High	Very high
<b>Risk trend</b>	Improving	<b>Unchanged</b>		Worsening	

Environmental risk factors related to greenhouse emissions, water, waste have become more urgent global issues. The challenge from a credit viewpoint is how to manage the asymmetric risks and related costs attached to climate change and regulation.

### Number of relevant natural loss events worldwide 1985-2018



Source: Munich Re NatCatSERVICE  
 Accounted events have caused at least one fatality and/or produced normalised losses >= US\$ 100k, 300k, 1m, or 3m (depending on the assigned World Bank income group of the affected country).

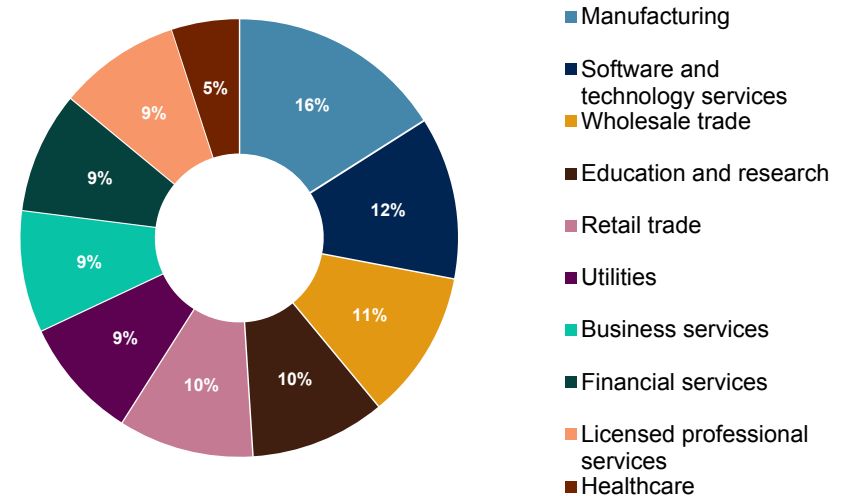
Secular Risk

## 6. Cybersecurity threats to business activity

<b>Risk level</b>	Very low	Moderate	<b>Elevated</b>	High	Very high
<b>Risk trend</b>	Improving	<b>Unchanged</b>		Worsening	

Increasing technological dependency, global interconnectedness and rapid technological change means that cyber risk has systemic dimensions.

### Widespread cloud usage across sectors highlights systemic dimension of cyber threat



Source: Cyence

# Regional Highlights

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**S&P Global**  
Ratings

# Asia-Pacific | China Slows, Trade Tensions Blow

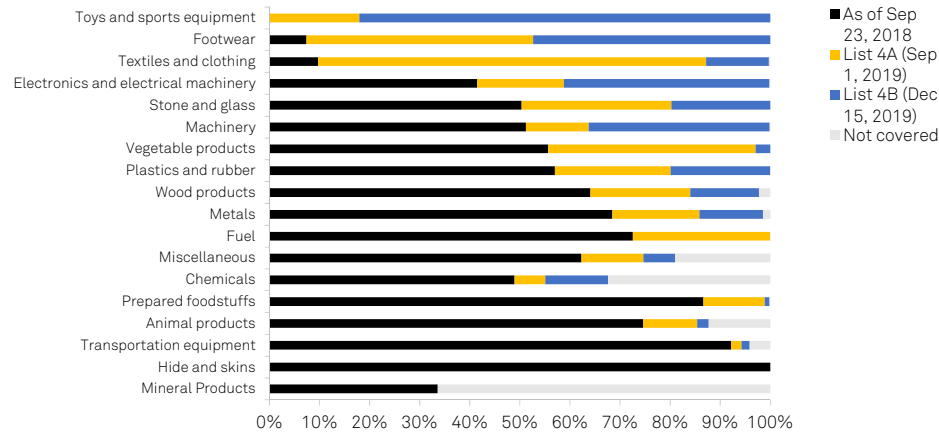
## Key Takeaways

- **Overall:** Credit conditions are expected to be bumpy. Despite looser monetary policy, China's slowdown and U.S.-China trade tensions are adversely affecting sentiment. This is hurting revenue and profit growth and intensifying refinancing risk.
- **What's changed:** Investor sentiment is becoming more cautious amid heightened geopolitical stress and slower economic growth.
- **Risks and imbalances:** The greatest near-term risk is the strategic conflict between the U.S. and China, with its attendant market impact. Other top risks include corporate refinancing and market liquidity, property repricing, and China's debt.
- **Financing conditions:** Headwinds have returned. Should investor sentiment sour interest spreads could rise, despite lower official rates.
- **Macroeconomic conditions:** U.S.-China trade-tech tensions have intensified and regional growth has come in below our expectations.
- **Sector themes:** Idiosyncratic factors are driving the continuing dichotomy in ratings bias trend between corporates (negative) and financials and governments (positive).

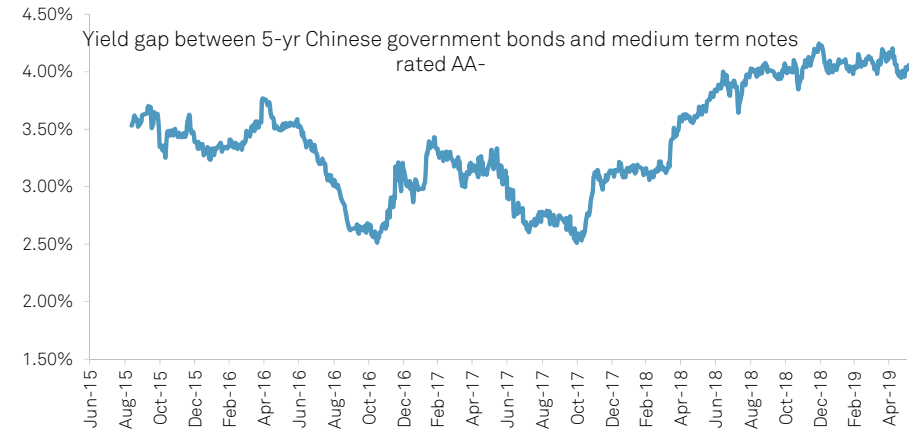


# Asia-Pacific Credit | Top Risks

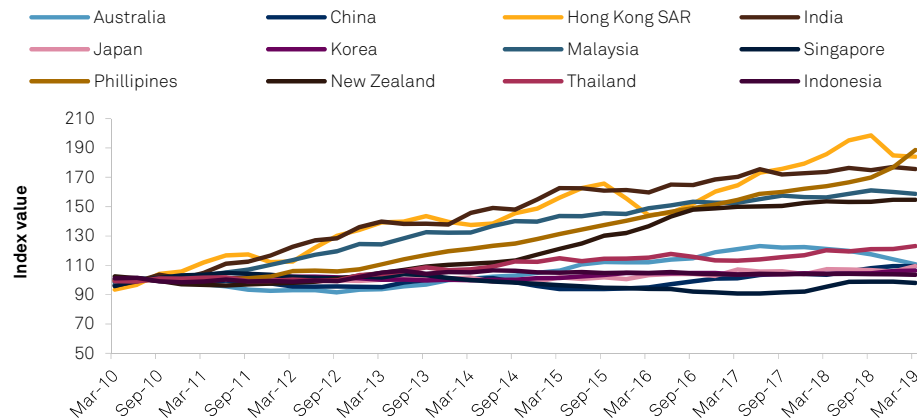
## 1. U.S.-China Strategic Confrontation



## 2. China credit spread trends



## 3. Property Valuation Correction



## 4. China's Leverage

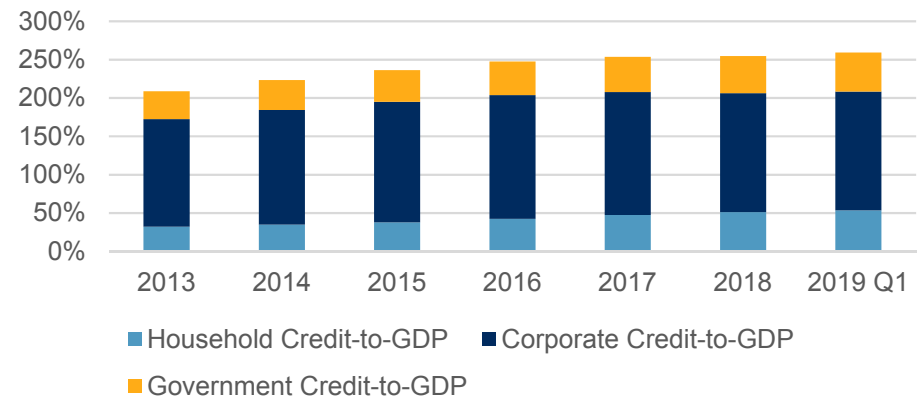
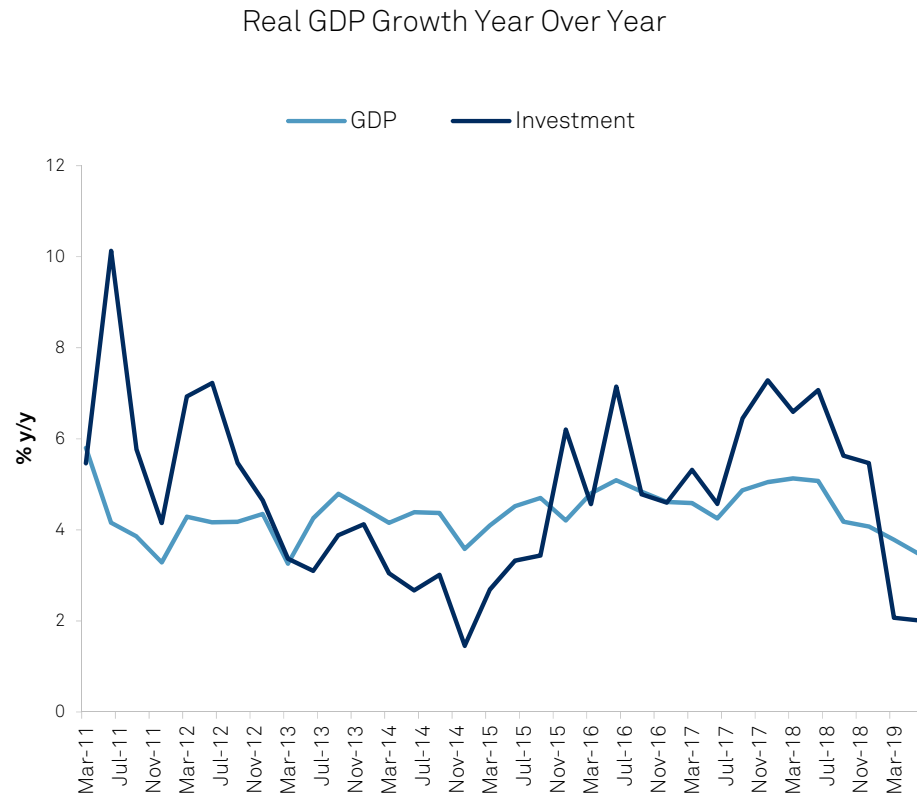


Chart 1. Source: U.S. International Trade Commission Dataweb. Chart 2. Source: CEIC. Chart 3. SAR--Special Administrative Region. Source: Bank for International Settlements. Chart 4. Source: Bank for International Settlements.

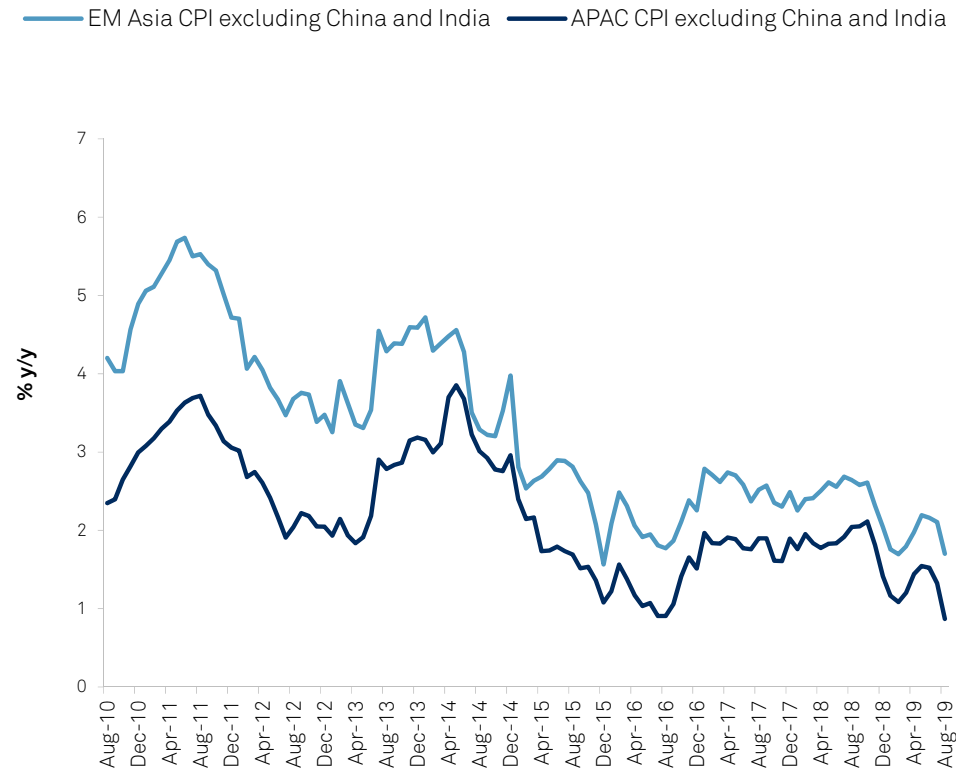
# Asia-Pacific Economics | Collateral Damage To Confidence

## Asia-Pacific's Investment-Led Slowdown



Note: PPP GDP-weighted excluding China and Vietnam due to data availability.  
Source: CEIC and S&P Global Economics.

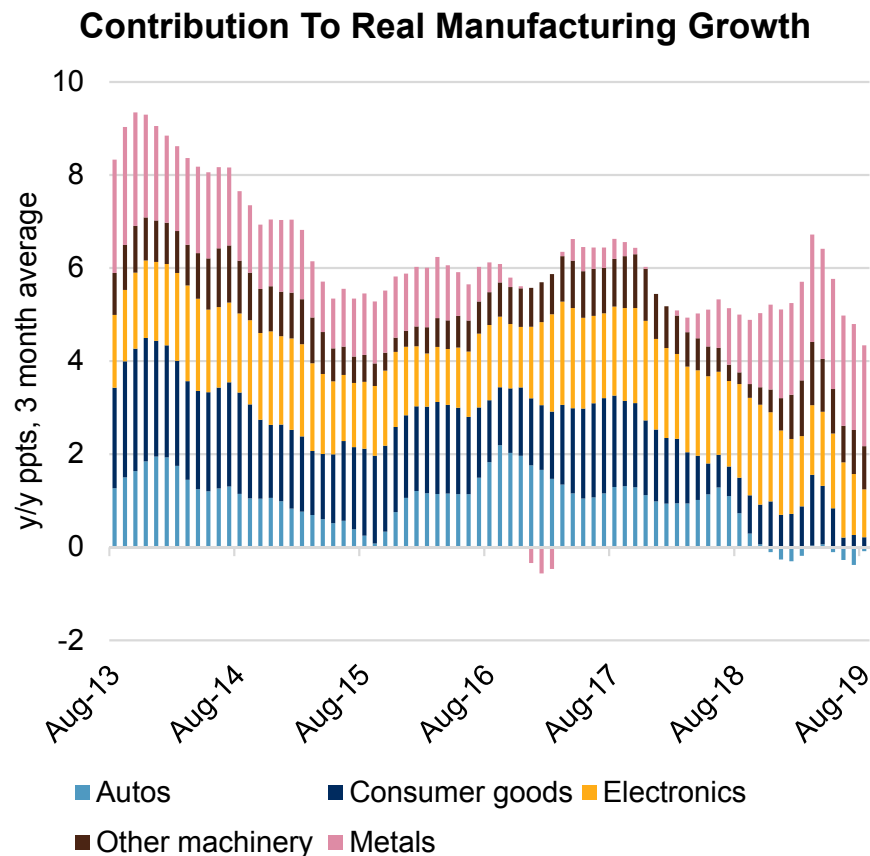
## APAC And EM Asia Inflation Slowing



Source: CEIC and S&P Global Economics

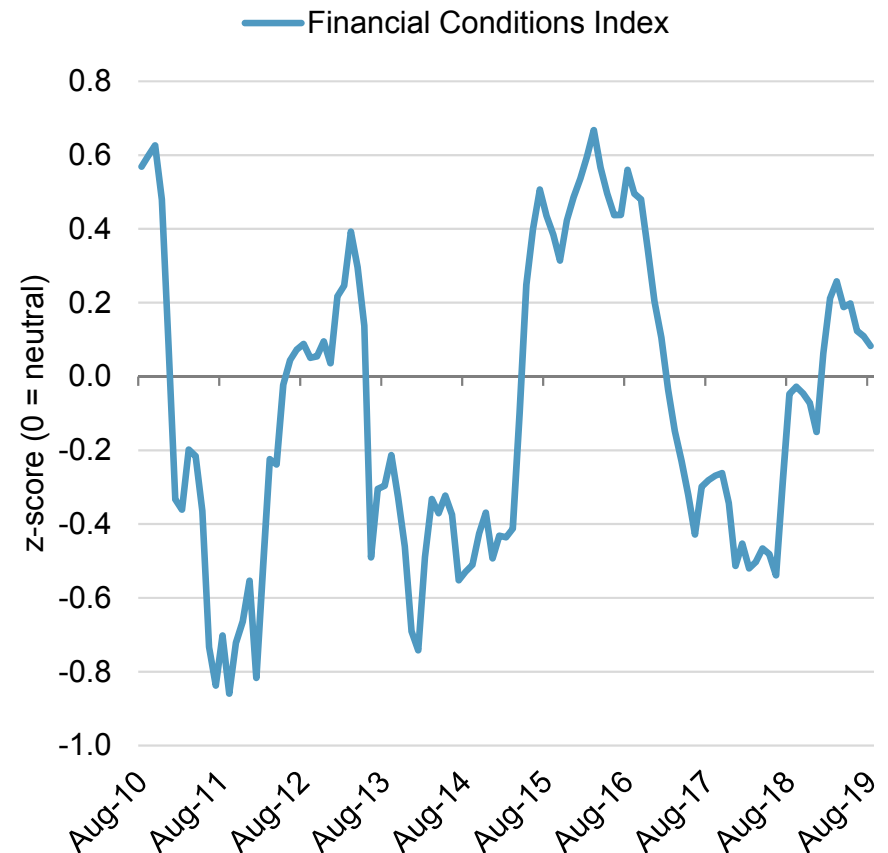
# Asia-Pacific Economics | China Slowing

## Steel Supporting Manufacturing Growth in China



Note: ppts = percentage points. Source: CEIC and S&P Global Economics.

## China's Financial Conditions Index Peaked



Note: Average of first two components from principal component analysis of 41 variables. Quarterly data interpolated using the EM algorithm." Source: People's Bank of China, CEIC and S&P Global Economics."

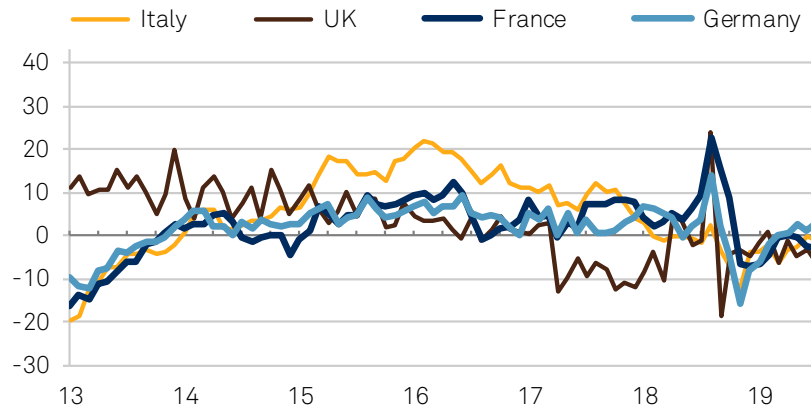
# Europe | Lingerin in the Lowzone

## Key Takeaways

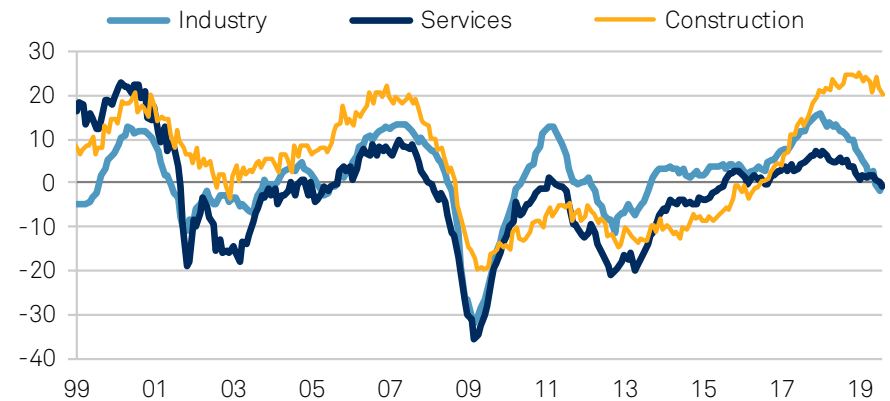
- **Overall:** Weakening economic growth, political and trade tensions and ongoing tech disruption are pressuring credit quality. Renewed monetary policy efforts are likely to prevent a broader recession, but persistently low interest rates pose serious risks for financials and corporate pension liabilities.
- **What's changed:** The ECB has gone 'all-in' to shore up growth and underpin inflation. While the Eurozone should avoid technical recession, it is acutely vulnerable to external shocks (trade, oil).
- **Risks and imbalances:** Political risks remain at the fore, particularly global trade tensions and the increasingly vitriolic Brexit imbroglio. Greater market volatility is a growing global risk as credit risk premiums tighten in a low for longer rate environment.
- **Financing conditions:** Monetary policy appears close to the point where lower-for-longer near zero rates provides minimal stimulus, but raise downside risks for financial sector profitability.
- **Macroeconomic conditions:** Growth prospects continue to be scaled back as the manufacturing recession spreads to services and construction peaks, particularly in Germany.
- **Sector themes:** The main areas of concern are around the impact of low rates (banks, insurance), Brexit (U.K. public sector entities in particular) and slowing global growth (corporates).

# Eurozone Economics | Manufacturing Recession Spreading to Services Dampening Inflation

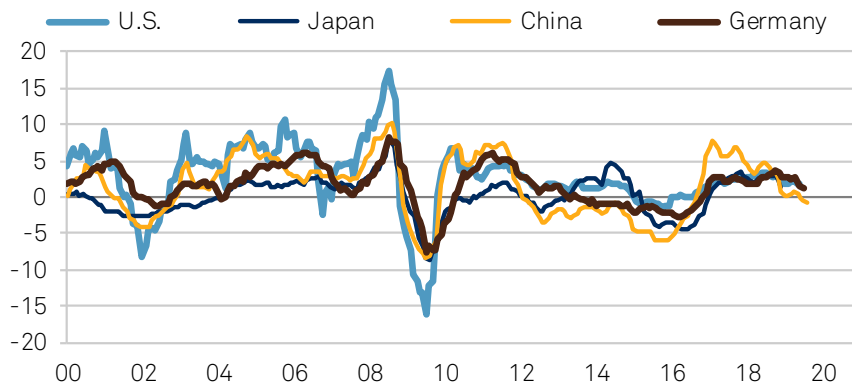
## 1. New Car Registrations (3mma YoY%)



## 2. Weakening Sentiment Spreading From Industry



## 3. China Leading Producer Prices Lower Globally



## 4. Eurozone Govt Debt Securities Not Held by ECB

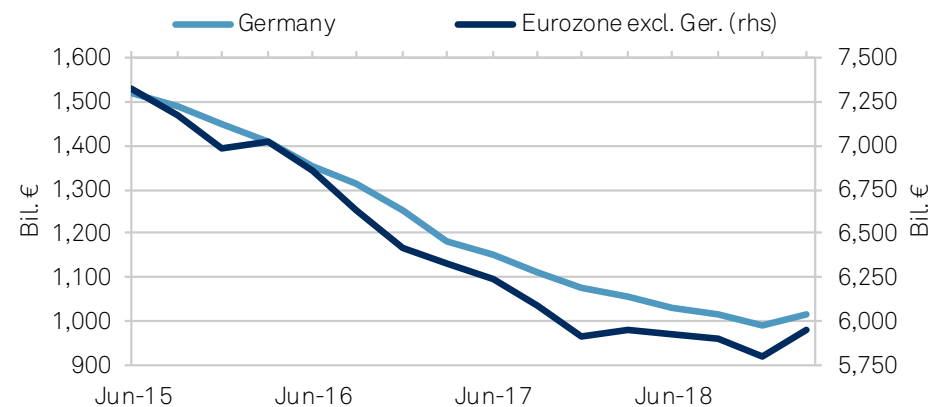
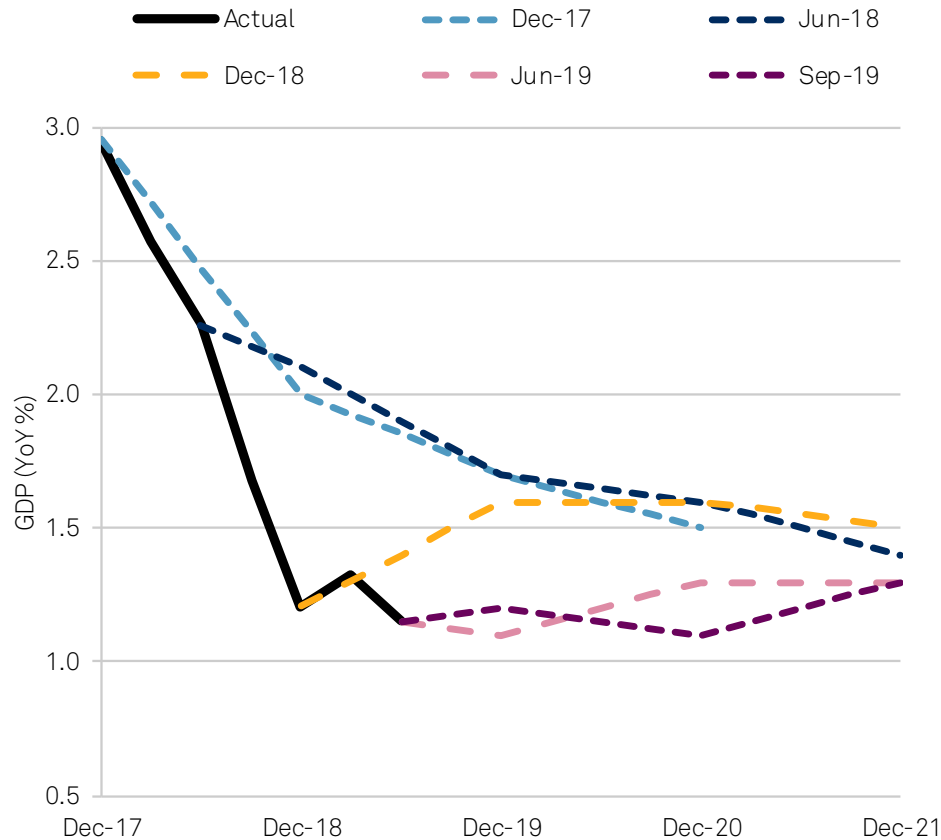


Chart 1. Source: Refinitiv. Chart 2. Source: Refinitiv, SPGR. Chart 3. Source: Refinitiv. Chart 4. Source: ECB, BIS, SPGR

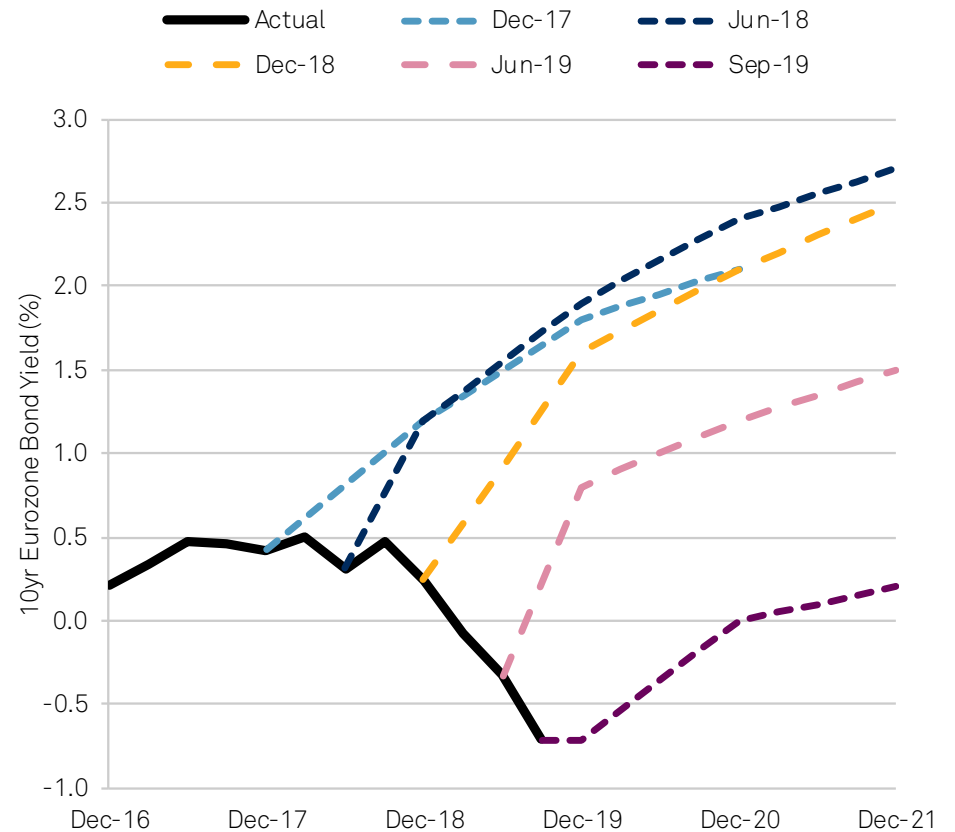
# Eurozone | Growth Flatlining; LT Yields Grounded

## 2020 Eurozone GDP Forecasts Revised Lower



Source: S&P Global Ratings

## ...10yr Bund Yields Staying Low for Longer



# Credit Conditions | EMEA Top Risks

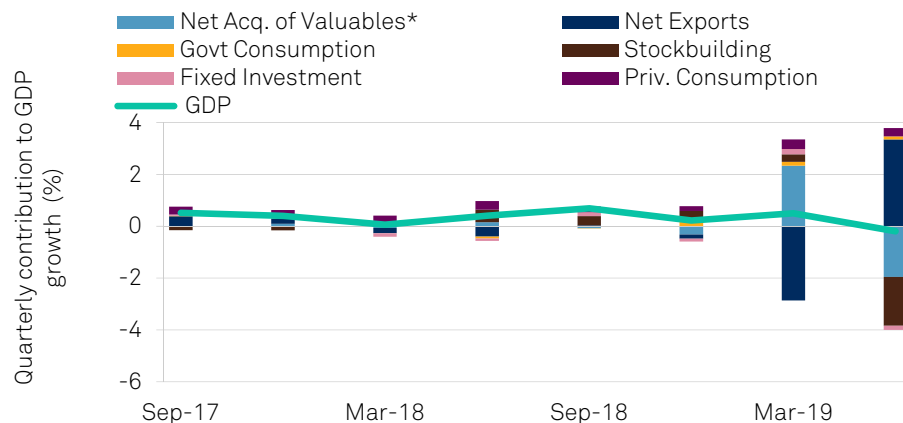
## Near-term Event Risk

### No-deal Brexit

<b>Risk level</b>	Very low	Moderate	Elevated	<b>High</b>	Very high
<b>Risk trend</b>	Improving	<b>Unchanged</b>		Worsening	

Our base case is that the U.K. will not leave the EU without a deal. Even so, given the government's intention to leave the EU, a no-deal Brexit remains a meaningful likelihood, though more likely in 2020 than in 2019. A no-deal Brexit would likely push the UK economy into a recession next year and create further rating headwinds, particularly for more cyclical sectors.

### Threat of No-deal Brexit Distorting National Income Components



Source: ONS, S&P Global Ratings

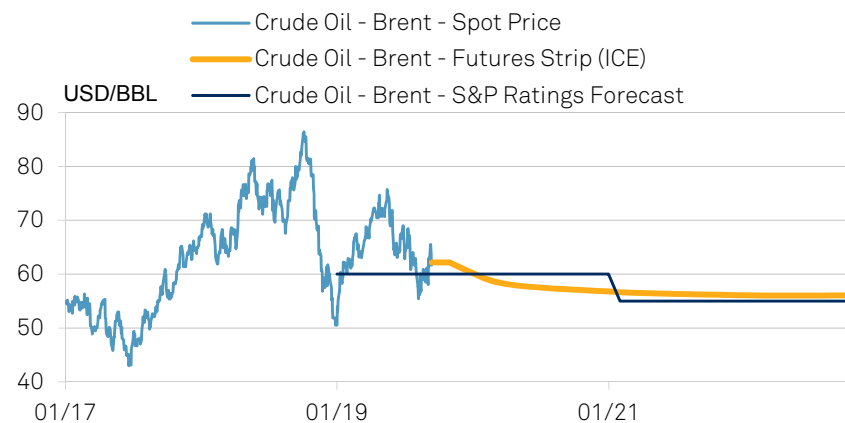
## Near-term Event Risk

### Geopolitical Risk

<b>Risk level</b>	Very low	Moderate	<b>Elevated</b>	High	Very high
<b>Risk trend</b>	Improving	<b>Unchanged</b>		<b>Worsening</b>	

Tensions between Iran and the U.S. as well as its regional allies are on the rise. While we continue to exclude direct military conflict in our base case scenario or significant disruption to global oil supply, these risks are non-negligible. In the unlikely scenario of a blockage of the Strait of Hormuz or military conflict, the ratings on sovereigns and banks in the Gulf Cooperation Council could come under significant pressure.

### Oil – Spot Prices Faded After Saudi Attack; Futures Calm



Source: Refinitiv, S&P Global Ratings. Data as of Sept. 16, 2019

# Latin America | Policy Uncertainty Undermines Growth Prospects

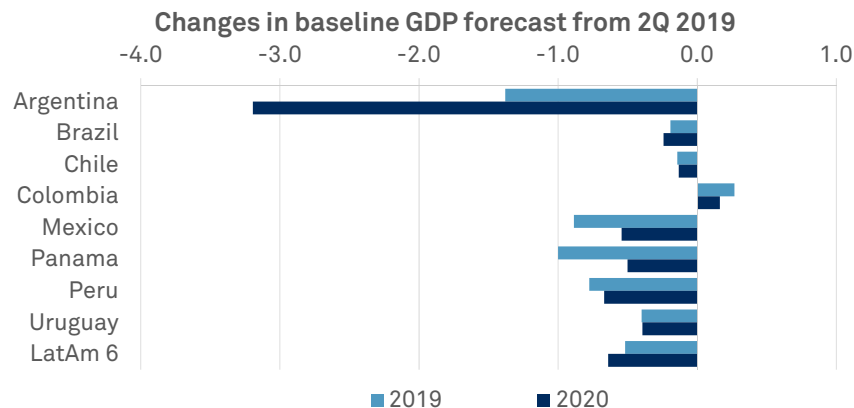
## Key Takeaways

- **Overall:** Growth prospects continue to weaken as policy uncertainty in the region's largest countries increases. We have consequently lowered our growth expectations for 2019 and 2020. Although looser U.S. monetary policy helps, external conditions remain challenging.
- **What's changed:** Investment continues to slump in the largest economies as policy uncertainty prevails. Upcoming elections in Argentina, delays in key reforms in Brazil, and lack of clarity and polemic decisions in Mexico are acting as a drag on already fragile investor confidence.
- **Risks and imbalances:** Domestic political challenges continue intensifying and are the main drag on investor confidence and economic growth in the region. External conditions all remain difficult given U.S.-China trade tensions and friction in the Middle East.
- **Financing conditions:** U.S. monetary easing has improved regional financing conditions by enabling policy rate cuts. Not all have benefitted; appetite for lower-rated issuers remains limited.
- **Macroeconomic conditions:** We have lowered our 2019 and 2020 growth expectations for major regional economies. This is due to ongoing weakness in domestic demand, adverse domestic political dynamics, and volatile external conditions.
- **Sector themes:** Weaker growth is likely to dent corporations' profits and bank's asset quality.

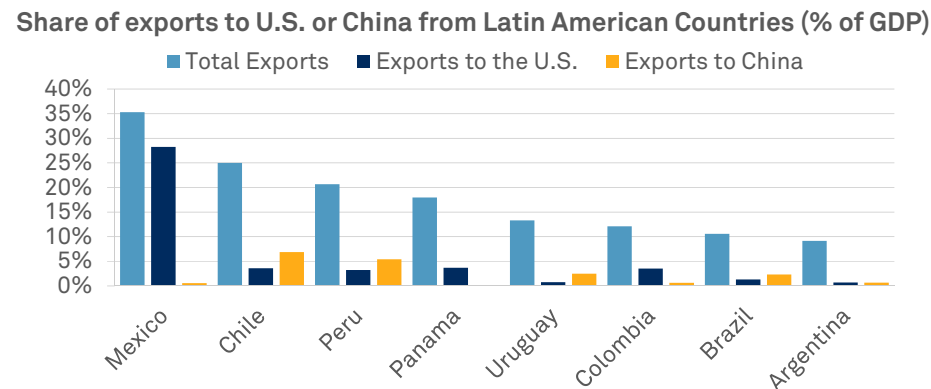


# Latin America | Policy Uncertainty Prevails

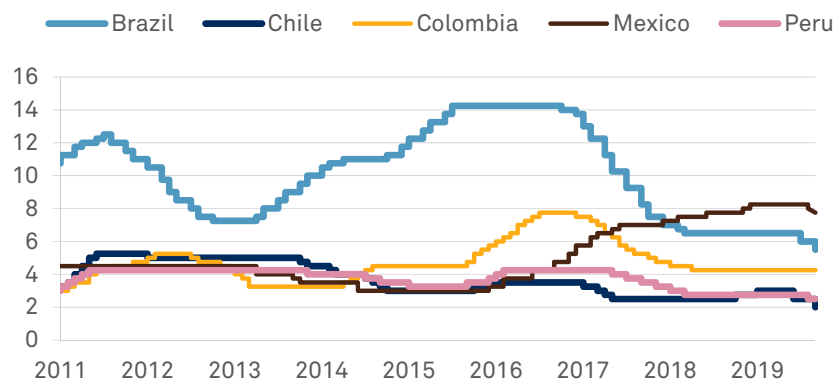
## 1. Regional Political Challenges are the main drag for domestic investor's confidence



## 2. Increasing trade tensions undermine investment and global growth expectations



## 3. Lower interest rates in advanced economies provided some room for monetary easing



## 4. Commodity prices remain volatile, lower prices could hurt growth prospects

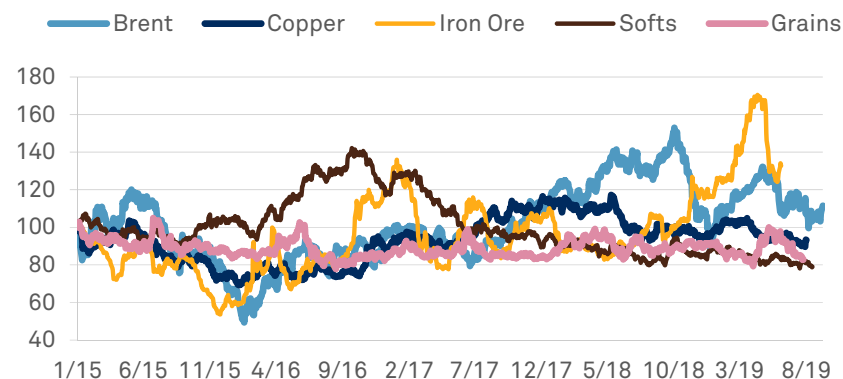


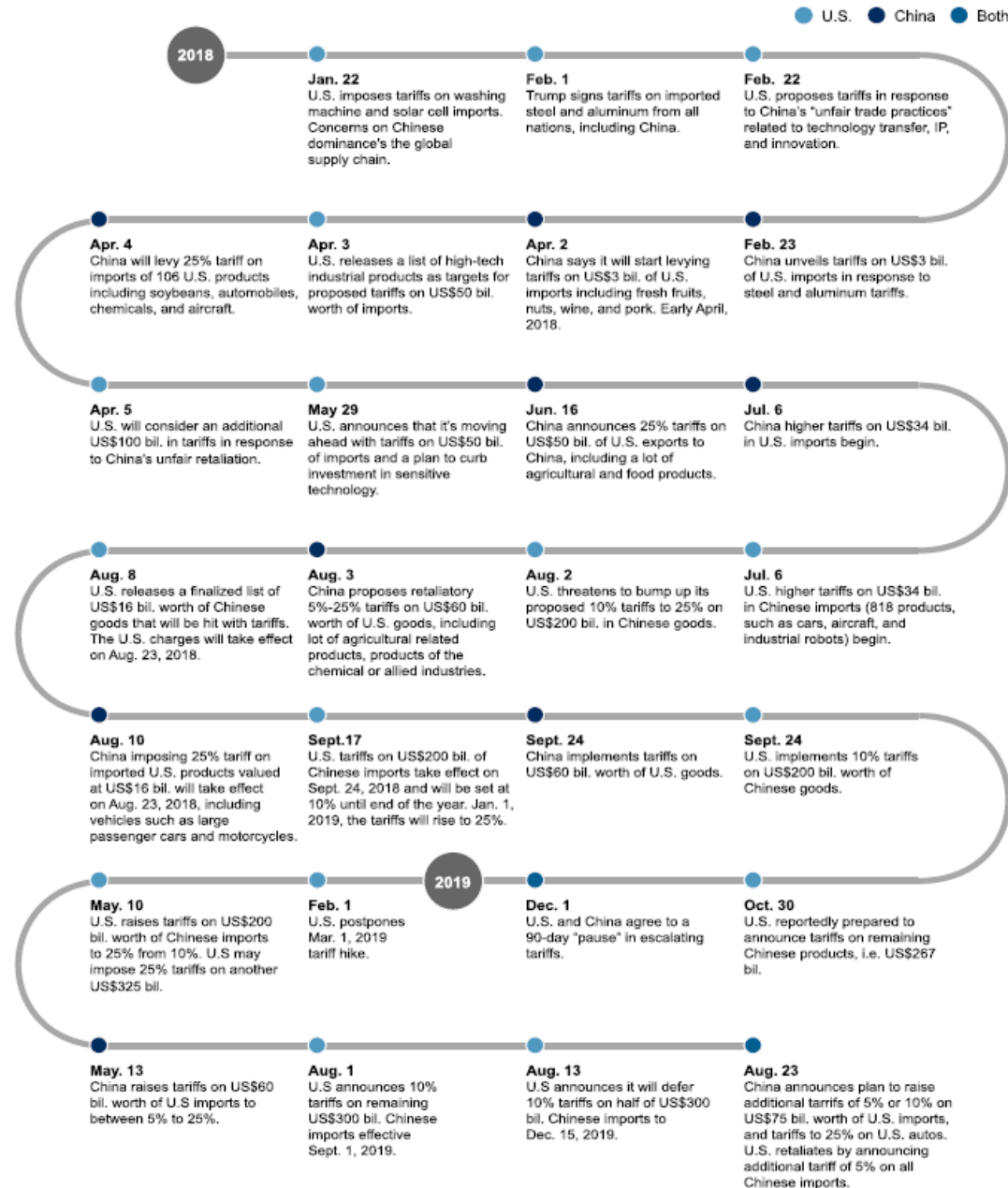
Chart 1. Source: S&P Global Economics. Chart 2. Source: World Bank. Chart 3. Source: Central Banks. Chart 4. Source: Bloomberg

# North America | Rising Recession Risk Adds To Trade, Rate Uncertainty

## Key Takeaways

- **Overall:** As U.S.-China trade tensions fuel fears of a recession, American consumers have so far propped up the world's biggest economy. Also, U.S. financing conditions have generally improved over the course of the year.
- **What's changed:** The chance that the U.S. will slip into recession is increasing. Of the 10 leading indicators of near-term U.S. GDP growth we look at, three are now negative.
- **Risks and imbalances:** Trade and geopolitical tensions are leading to more frequent and intense bouts of market volatility.
- **Financing conditions:** Borrowing conditions remain broadly supportive, but there has been a divergence between conditions for investment- and speculative-grade borrowers.
- **Macroeconomic conditions:** While the U.S. expansion is now the longest in history, the economy is showing signs of slowing. Our assessment puts the risk of a recession starting in the next 12 months at 30%-35%—more than twice what it was a year ago.
- **Sector themes:** Stalemate in trade negotiations has hurt business confidence, as evidenced by slumping capital expenditure growth and a contraction in manufacturing. Meanwhile, declining borrowing costs are pressuring lenders' net interest margins and weighing on profitability.

# U.S. & China Trade Dispute



Source: S&P Global Ratings

# Quarterly Changes

## Structured Credit

Negative	Stable to Negative	Stable	Stable to Positive	Positive
	Tobacco	Timeshares; Small business; Transportation		
	CLO			

## North America Corporate Sector Trends – U.S.

Negative	Stable to Negative	Stable	Stable to Positive	Positive
Healthcare services; Retail; Pharmaceutical; Consumer Durables	Telecom; Media and entertainment; Regulated Utilities; Consumer non-durables; Forest Products	Aerospace and Defense; REITs; Transportation; Unregulated (merchant) power; Building materials; Oil Refineries; Homebuilders; Midstream Energy		
	Chemicals; Capital Goods, Technology; Oil and Gas; Leisure and Sports; Metals and Mining			
Auto OEMs and Auto suppliers				

# Related Research

- [Credit Conditions Asia-Pacific: China Slows, Trade Tensions Blow](#), Sept. 30, 2019
- [Credit Conditions EMEA: Lingerin in the Lowzone](#), Sept. 30, 2019
- [Credit Conditions Latin America: Policy Uncertainty Undermines Growth Prospects](#), Sept. 30, 2019
- [Credit Conditions North America: Rising Recession Risk Adds To Trade, Rate Uncertainty](#), Sept. 30, 2019
  
- [Asia Pacific Economic Quarterly: Confidence Is Shaken But Policy Is Stirred](#), Oct. 1, 2019
- [Economic Research: Will Trade Be The Fumble That Ends The U.S.'s Record Run?](#), Sept. 30, 2019
- [Economic Research: Low Growth And Lower Rates: The Eurozone In 2020](#), Sept. 26, 2019
- [China Credit Spotlight: The Great Game And An Inescapable Slowdown](#), Aug. 29, 2019

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