Asia-Pacific Credit Outlook 2019

Cold Wind Blowing
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Asia-Pacific Credit Conditions

Cold Wind Blowing

Key Takeaways

− **Overall:** We expect credit conditions in Asia-Pacific to tighten further in 2019. With U.S. interest rates rising and sentiment weaker, financing conditions are likely to constrict as macroeconomic indicators soften.

− **What's changed:** Market optimism is fading. Given that the U.S. economy is likely to slow down through 2019, investors are turning conservative, leading to credit tightening, capital flow volatility, and pressure on some emerging market currencies.

− **Risks and imbalances:** Corporate refinancing risk, U.S.-China strategic confrontation (most visibly over trade), asset repricing risk, and China’s debt leverage are the top risks for the region going into 2019. In particular, the first two risks are high and worsening.

− **Financing conditions:** Headwinds in 2019 include climbing borrowing costs (as the Fed continues its rate hikes), refinancing of U.S. dollar-denominated debt, capital market volatility, and declining investor sentiment.

− **Macroeconomic conditions:** The pace of the regional slowdown is the key uncertainty. Current data and economic policies are still supportive of a gradual and benign slowdown. We forecast China’s GDP growth to ease to 6.3% in 2019 from 6.5% in 2018.

− **Sector themes:** Corporates will find refinancing more challenging in 2019. While banks will also be challenged by higher interest rates; most bank outlooks will remain stable. For sovereigns, protectionist policies between China and the U.S. could intensify, weighing on regional growth. The Chinese authorities’ softer tone toward local and regional governments should stabilize infrastructure investment. Stable employment prospects in major structured finance markets will keep arrears low. The outlook for insurers is stable.

(Editor’s Note: S&P Global Ratings’ Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions (Asia-Pacific, Latin America, 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 Asia-Pacific committee on Nov. 26, 2018.)

Indonesian President Joko Widodo’s “winter is coming” quote aptly characterizes the trend in Asia-Pacific credit conditions going into 2019. At the International Monetary Fund’s meeting in Bali, October 2018, President Widodo highlighted that the continuing U.S.-China trade dispute and technology disruption on many industries are among the many issues plaguing the world. Likewise, S&P Global Ratings considers these two issues to be among the top-five credit risks in Asia-Pacific. In addition, the Asia-Pacific faces the risk of commodity, currency, equity, and property price volatility. Corporate refinancing risk and China’s high leverage round up our top-five credit risks. In summary, the outlook for 2019 is more pessimistic than it was a year ago.
Table 1
Top Asia-Pacific Risks

Corporate refinancing risk

<table>
<thead>
<tr>
<th>Risk level</th>
<th>Very low</th>
<th>Moderate</th>
<th>Elevated</th>
<th>High</th>
<th>Very high</th>
<th>Risk trend</th>
<th>Improving</th>
<th>Unchanged</th>
<th>Worsening</th>
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A near-term risk. Financing conditions for nonfinancial corporates in some countries have tightened as both Fed rate hikes and the Chinese government’s deleveraging policy continues. Lower liquidity and wider credit spreads may be forming in some pockets e.g. Chinese small private-owned enterprises. Borrowers exposed to refinancing (higher interest rates) and currency (US$) risks are most vulnerable if the credit cycle turns. For example, spreads in China have risen. Nonperforming loans and defaults are likely to rise in Asia-Pacific.

U.S.-China strategic confrontation §

<table>
<thead>
<tr>
<th>Risk level</th>
<th>Very low</th>
<th>Moderate</th>
<th>Elevated</th>
<th>High</th>
<th>Very high</th>
<th>Risk trend</th>
<th>Improving</th>
<th>Unchanged</th>
<th>Worsening</th>
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A near-to-medium term risk. The U.S. seems determined to confront China strategically and economically. Trade is the most prominent dispute with the list of imports subject to tariffs widening. Disputes are also ongoing over technology intellectual property (IP), market access, espionage (e.g. chips), South China Sea ‘freedom of navigation’, and North Korea earlier in the year. The tensions dampen economic confidence.

Commodity, currency, equity, and property price volatility

<table>
<thead>
<tr>
<th>Risk level</th>
<th>Very low</th>
<th>Moderate</th>
<th>Elevated</th>
<th>High</th>
<th>Very high</th>
<th>Risk trend</th>
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</table>

A near-term risk. Except for oil prices that are supported by unique geopolitical supply risks, commodity prices are exposed to the slower economies of China and the U.S. in 2019. With the U.S. dollar strengthening, emerging market currencies (such as the Indian rupee and Indonesian rupiah) and some commodity prices are under pressure. Despite some correction, equity and real property valuations in the region still look generous.

China’s leverage

<table>
<thead>
<tr>
<th>Risk level</th>
<th>Very low</th>
<th>Moderate</th>
<th>Elevated</th>
<th>High</th>
<th>Very high</th>
<th>Risk trend</th>
<th>Improving</th>
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A near-to-medium term risk. The Chinese government faces a two-edged sword. While seeking to structurally deleverage the system (a debt-to-asset perspective), the government has loosened the credit purse strings because of fears regarding a rapid economic slowdown. With lenders remaining cautious (given declining credit quality), a large spike in credit growth will only compound the existing debt overhang.

Technology disruption and cybersecurity

<table>
<thead>
<tr>
<th>Risk level</th>
<th>Very low</th>
<th>Moderate</th>
<th>Elevated</th>
<th>High</th>
<th>Very high</th>
<th>Risk trend</th>
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A medium-to-long-term risk. An increasing dependency on constantly changing technology (‘Industry 4.0’) exposes nations, industries, and data networks to competitive obsolescence and cybersecurity risk. Recognizing this risk, governments in Asia are taking steps. Most notable is China, with its ‘Made in China 2025’ manifesto. The relative creditworthiness of issuers may change because of technology (mis)adoption.

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.

§On Dec. 1, 2018, the White House Press Secretary announced that the U.S. has agreed to begin a 90-day period of negotiation with China. See article titled, “Global Trade At A Crossroads: Pause In U.S.-China Trade Dispute is Confidence Positive,” published Dec. 3, 2018.

Compared with our article titled "Credit Conditions Asia-Pacific: Tighter, Weaker, Riskier" published on Sept. 27, 2018, we have:

- Renamed "trade and investment interruption" risk as "U.S.-China strategic confrontation" to reflect the latter’s broader scope.
- Split the previous "asset price volatility and liquidity pullback" risk into two: "commodity, currency, equity, and property price volatility" and "corporate refinancing”. We changed the trend for the latter to worsening.
- Renamed "China’s debt overhang" to "China’s leverage" to emphasize the Chinese authorities’ on-and-off deleveraging effort.
- Replaced "geopolitical tension" (which was on an improving trend) with the global risk of "technology disruption and cybersecurity."
Regional Credit Conditions
Tighter, Weaker, Riskier

What’s changed?
Credit conditions are somewhat worse, with financing conditions tighter and macroeconomic sentiment weaker going into 2019. The rating trend is slightly more negative. The net rating bias was -2% in October 2018 compared with -1% in August 2018.

Assessment of key risks
We regard Asia-Pacific’s top risks as corporate refinancing risk, driven partly by higher interest rates, U.S.-China strategic confrontation, commodity, currency, equity, and property repricing, China’s leverage, and technology disruption and cybersecurity threats (see table 1). These regional vulnerabilities substantially overlap with our top global risks.

1. Corporate refinancing risk (high, worsening)
A near-term risk. Financing conditions for nonfinancial corporates in some countries have tightened as rate hikes by the U.S. Federal Reserve and the Chinese government’s deleveraging policy continue. Lower liquidity may be forming in some pockets e.g. Chinese small private-owned enterprises. Borrowers exposed to refinancing (higher interest rates) and currency (US$) risks are most vulnerable if the credit cycle turns. Spreads in Asia-Pacific have risen (see chart 1). Nonperforming loans and defaults are likely to rise in Asia-Pacific.

2. U.S.-China strategic confrontation (high, worsening) §
A near-to-medium term risk. The U.S. seems determined to confront China strategically. Trade is the most prominent dispute with a widening list of imports subject to tariffs (see chart 2). Disputes are ongoing over technology intellectual property (IP), market access, espionage (e.g. chips), South China Sea “freedom of navigation”, and (earlier) North Korea. The tensions dampen economic confidence.

3. Commodity, currency, equity, and property price volatility (high, unchanged)
A near-term risk. Except for oil prices that are influenced by unique geopolitical supply risks, commodity prices are exposed to the slower economies of China and the U.S. in 2019 (see chart 3). With the U.S. dollar strengthening, emerging market currencies (such as the Indian rupee and Indonesian rupiah) have come under pressure (see chart 4). Despite some correction, equity and real property valuations in the region still look generous.

4. China’s leverage (elevated, unchanged)
A near-to-medium term risk. The Chinese government faces a two-edged sword. While seeking to structurally deleverage the system (a debt-to-asset perspective), the government has loosened the credit purse strings because of fears regarding a rapid economic slowdown. With lenders cautious (given declining credit quality), a large spike in credit growth will only compound the existing debt overhang (see chart 5).

5. Technology disruption and cybersecurity (elevated, unchanged)
A medium-to-long-term risk. An increasing dependency on constantly changing technology (“Industry 4.0”) exposes nations, industries, and data networks to competitive obsolescence and cybersecurity risk (see chart 6). Recognizing this, governments in Asia are taking steps. Most notable is China, with its ‘Made in China 2025’ manifesto. The relative creditworthiness of issuers may change because of technology (mis)adoption.

§On Dec. 1, 2018, the White House Press Secretary announced that the U.S. has agreed to begin a 90-day period of negotiation with China. See article titled, “Global Trade At A Crossroads: Pause In U.S.-China Trade Dispute Is Confidence Positive,” published Dec. 3, 2018.

The rating trend is turning negative.
Pressure On Asia U.S. Dollar High-Yield Bonds

Funding conditions remain tight in the region, while the U.S. dollar is strengthening and Fed interest rates are rising.

U.S.–China Trade Dispute Escalates

China has placed tariffs on $110 billion of imports; U.S. on $250 billion.

Commodity Prices Exposed To Slower Economic Growth

Source: S&P Capital IQ.

Indian, Indonesian Currencies Under Pressure

Source: Bloomberg, S&P Global Ratings.

China’s Credit-To-GDP Trajectory


Widespread Cloud Usage Highlights Cyber Threat

Source: Cyence.
Financing Conditions
Tighter As Fed-Rate Rises

What's changed?

**Conditions tighten.** Financing conditions in emerging market Asia have tightened since early 2018. The Institute of International Finance’s indices indicate that this would likely continue (see chart 7).

Key assumptions

**Low refinancing risks.** Refinancing risks for rated issuers are likely to remain low, with just 10% of rated Asia-Pacific debt maturing through 2023 (see chart 8) in the speculative-grade category. Asia remains a top choice for global debt investors according to our S&P Global Bond Survey.

Key risks

**Higher borrowing costs.** Risks include climbing borrowing costs as the Fed raises rates, refinancing of dollar-denominated debt (due to an appreciating dollar), capital market volatility, and reduced investor sentiment stemming from global trade tensions.

**Credit cycle turn.** Speculation about a turn in the U.S. credit cycle is increasing, though we do not anticipate a rapid turn in the credit cycle in the near term. In Asia-Pacific, this potential turn, specifically, could affect risk and asset pricing and refinancing costs.

What to look for in 2019

**Marginal issuance growth.** Our preliminary forecast is for a very modest growth rate in global new bond issuance of 0.62%, or $6.09 trillion. Emerging markets’ prospects will likely fluctuate as they manage capital outflows through adjusting their domestic interest rates.

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**Chart 7**
IIF Emerging Market Asia’s Bank Lending Conditions

**Chart 8**
Asia-Pacific Corporate Maturity Wall

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EMA: Emerging market Asia *Dashed line denotes expectation in the next 3 months. Values below 50 indicate a tightening in bank lending conditions and values above 50 indicate easing. For NPLs, values below 50 indicate a rise in NPLs and vice-versa. The 2018Q3 survey covering 90 EM banks was conducted during October 2018, e-estimate.

Note: Includes bonds, loans, and revolving credit facilities with global scale ratings by S&P Global Ratings on the respective reporting date. $2018 maturities estimated as of 6/30/2018 reflect debt scheduled to mature in the second half of the year.
Macroeconomic Outlook
The Cyclical Tide Is Receding

(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.)

What's changed?

Growth continues to ebb and flow. The pace of the regional slowdown is the key uncertainty. Current data and economic policies are still supportive of a gradual and benign slowdown (see chart 9).

Key assumptions

Global factors influence regional slowdown. The slowdown in China is spreading across the country's economy, including real estate, and starting to spill over the region. Moderate external demand from other regions is contributing to a possible peak in Asia's trade cycle (see chart 10).

Tighter U.S. dollar liquidity dampens funding needs. The dollar and U.S. treasury yields have stabilized, easing pressures on emerging markets in Asia but external financing remains tighter.

Property growth slowdown in some key economies. Authorities are trying to limit financial stability risks or directly cooling housing markets such as in Australia, China, Hong Kong, and Singapore. This could slow housing investment growth and dampen household consumption.

Key risks

Global trade tensions. These amplify what looks to be the start of a downswing in the trade cycle.

Capital outflow. Despite recent U.S. dollar stability, the risk of further capital outflows and currency pressure remains on our radar.

What to look for in 2019

Trade, liquidity, and property cycles turn; downside risks remain. An escalation in global trade tensions remains the largest threat to growth. So far, U.S.-China tariff tensions have small direct effects, but the ratcheting up of tensions could further erode confidence and weaken business investment. There is the possibility of an abrupt tightening in U.S. dollar liquidity conditions.

Chart 9
Asia-Pacific Real GDP Growth

Sources: CEIC, IMF WEO, and S&P Global Economics.
1/ Asia-Pacific includes Australia, China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan, Thailand, and Vietnam. ASEAN-6 includes Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam. Aggregates weighted by current price PPP GDP in U.S. dollars.

Chart 10
Asia-Pacific Manufacturing Trade Cycle

Sources: CEIC and S&P Global Economics.
1/ Manufacturing exports in U.S. dollar value terms. Asia-Pacific includes Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand, and Vietnam. Cycle is extracted from an asymmetric band-pass filter with frequencies set between 3 and 12 years.
Asia-Pacific Sector Outlook 2019
Ratings Bias Gradually Turning Negative

Key Takeaways

- Overall: Business and consumer sentiment has turned more conservative given concerns about the U.S.-China trade dispute, emerging market stresses, and rising U.S. interest rates.
- What’s changed: As a result, our net negative rating bias deteriorated slightly to -2% in October 2018 from -1% in August 2018.
- Key assumptions: Regional capex spending is likely to hold up despite China’s economy slowing marginally, unless investor confidence declines markedly.
- Key risks: Uncertainty caused by the U.S.-China trade dispute; currency, interest and liquidity risks; and the potential turn in the global credit cycle in 2019-2020 remain the main risks.
- What to look for in 2019: Softening business and consumer confidence could affect demand, and climbing U.S. interest rates may affect issuers’ ability to manage refinancing risks.

This time last year, the ratings momentum was more positive. In contrast, the overall rating trend for Asia-Pacific (see chart 11 and table 2) has in recent months turned slightly negative going into 2019. Economic activity remains firm, but sentiment has soured. Financing conditions compared with a year ago are tighter. The net rating outlook bias is negative 2% in October 2018, slipping from negative 1% in August 2018.

We calculate the net rating bias by deducting the percentage of negative outlooks and CreditWatch listings against the percentage of positive outlooks and CreditWatch listings. A minus figure indicates that the percentage of negative outlooks and CreditWatch listings exceeds the percentage of positive outlooks and CreditWatch listings; and a positive figure, vice versa.

For sovereigns, while geopolitical tensions, increasingly protectionist trade policies, and more recently, the emerging market rout, pose tail risks, the still-steady economic conditions in major developed economies and growing domestic demand will support sovereign ratings in the region. In public finance, the Chinese authorities’ slight softening of its policy tone is stabilizing infrastructure investment and the local regional government sector’s reasonable credit growth.

The region’s corporate sectors are likely to face tighter borrowing conditions in 2019. Meanwhile, the credit cycles for financial institutions in many Asia-Pacific jurisdictions (except for India—where nonperforming loans are high) are at their peaks. Insurers continue to face a largely stable operating environment.

Outlook By Nonfinancial Corporate Sector

While the U.S.-China trade dispute and China’s slowing economy have dampened business and consumer sentiment, Asia-Pacific’s capital expenditure and consumption are still likely to grow, albeit at a slower rate than previous quarters. Indeed, economic growth and infrastructure investment underpin the stable credit trend for the building materials sector.

A downside risk is that sales and price growth in China’s real estate development sector (Asia-Pacific’s largest market) could have peaked, implying a tougher environment. Meanwhile, Asia-Pacific REITs’ prudent financial stance has provided a buffer for the ratings to withstand debt-funded growth and economic shocks. Stable employment prospects in all major securitization markets will keep structured finance arrears and defaults low, although softening property prices in Australia add to borrower refinancing pressures.

Consumption growth and steady employment will bolster some industries. China’s rising middle classes would further lift consumption—albeit a little slower—supporting the stable credit trend of consumer product companies. However, mounting competition and higher input costs could squeeze the margins of consumer
product companies. Likewise, margin pressures continue to challenge retail players because of consumers’ shifting preference toward price discounts and online products. In gaming, the better profit margins of the mass-market segment would still support profit growth despite slower Macau revenue growth mainly due to the VIP segment.

Slowing demand growth, coupled with capacity expansion in display and semiconductors, pose a risk to the profitability and cash flows of information technology and consumer electronic companies. Competition is intensifying in several countries for telecommunications operators, albeit their credit quality is stable.

The region’s existing infrastructure deficit will support demand for transportation infrastructure, although trade dispute headwinds pose a risk for transportation cyclical companies. Likewise, favorable commodity prices (input costs) and the capital expenditure needs of the auto manufacturing and construction sectors drive the capital goods industry’s stable credit quality. Nevertheless, automakers face stiff competition and slowing sales. In the chemicals sector, weaker demand amid rising input costs and global capacity expansion could lower petrochemical spreads over the mid to long term.

On the other hand, the metals and mining industry continues to reap good earnings due to still-attractive metal prices despite volatility in commodity markets. The credit metrics of oil and gas companies are likely to improve in 2019, based on our oil price assumptions and corporates controlling their spending. For utilities, stable energy demand supports players, although higher fuel costs, particularly coal and oil, remain a risk.

Source: S&P Global Ratings. REITs – real estate investment trusts.
Table 2

Net Rating Bias Of Asia-Pacific Issuers By Sector, October 2018

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<tbody>
<tr>
<td>Auto OEM and suppliers</td>
<td>-10%</td>
<td>-14%</td>
<td>-17%</td>
<td>-17%</td>
<td>-6%</td>
</tr>
<tr>
<td>Building materials</td>
<td>17%</td>
<td>23%</td>
<td>13%</td>
<td>20%</td>
<td>14%</td>
</tr>
<tr>
<td>Business services</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>-5%</td>
<td>-9%</td>
</tr>
<tr>
<td>Capital goods</td>
<td>-14%</td>
<td>-2%</td>
<td>-2%</td>
<td>-5%</td>
<td>-11%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>18%</td>
<td>19%</td>
<td>23%</td>
<td>9%</td>
<td>2%</td>
</tr>
<tr>
<td>Consumer products</td>
<td>0%</td>
<td>0%</td>
<td>-3%</td>
<td>-5%</td>
<td>-5%</td>
</tr>
<tr>
<td>Diversified</td>
<td>0%</td>
<td>8%</td>
<td>8%</td>
<td>7%</td>
<td>0%</td>
</tr>
<tr>
<td>Gaming, media and entertainment</td>
<td>-15%</td>
<td>-4%</td>
<td>0%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>-38%</td>
<td>-38%</td>
<td>-14%</td>
<td>-13%</td>
<td>-11%</td>
</tr>
<tr>
<td>Investment Company</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Metals and mining</td>
<td>-6%</td>
<td>2%</td>
<td>2%</td>
<td>-2%</td>
<td>-3%</td>
</tr>
<tr>
<td>Oil and gas</td>
<td>-8%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
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<tr>
<td>Project finance</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Real estate development</td>
<td>-14%</td>
<td>-11%</td>
<td>-5%</td>
<td>-3%</td>
<td>-4%</td>
</tr>
<tr>
<td>Real estate investment trusts</td>
<td>-5%</td>
<td>-2%</td>
<td>-2%</td>
<td>-5%</td>
<td>-2%</td>
</tr>
<tr>
<td>Retail</td>
<td>-11%</td>
<td>-5%</td>
<td>0%</td>
<td>6%</td>
<td>0%</td>
</tr>
<tr>
<td>Technology</td>
<td>-2%</td>
<td>-3%</td>
<td>-2%</td>
<td>-4%</td>
<td>-6%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>-9%</td>
<td>-9%</td>
<td>-8%</td>
<td>-9%</td>
<td>-11%</td>
</tr>
<tr>
<td>Transportation cyclical</td>
<td>-5%</td>
<td>-5%</td>
<td>5%</td>
<td>5%</td>
<td>-6%</td>
</tr>
<tr>
<td>Transportation infrastructure</td>
<td>2%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Utilities</td>
<td>6%</td>
<td>2%</td>
<td>5%</td>
<td>2%</td>
<td>-3%</td>
</tr>
<tr>
<td>Total corporates</td>
<td>-4%</td>
<td>-1%</td>
<td>0%</td>
<td>-2%</td>
<td>-3%</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>-13%</td>
<td>-10%</td>
<td>-5%</td>
<td>-3%</td>
<td>-2%</td>
</tr>
<tr>
<td>Insurance</td>
<td>-7%</td>
<td>-6%</td>
<td>-3%</td>
<td>-1%</td>
<td>1%</td>
</tr>
<tr>
<td>Public Finance</td>
<td>-3%</td>
<td>-4%</td>
<td>3%</td>
<td>2%</td>
<td>8%</td>
</tr>
<tr>
<td>Sovereign</td>
<td>-11%</td>
<td>-8%</td>
<td>7%</td>
<td>7%</td>
<td>10%</td>
</tr>
<tr>
<td>Total issuers</td>
<td>-7%</td>
<td>-5%</td>
<td>-1%</td>
<td>-1%</td>
<td>-2%</td>
</tr>
</tbody>
</table>

Light blue colored cells indicate improvement from prior period, navy blue deterioration.

Table 3

Summary Of Key Assumptions And Risks For Asia-Pacific's Industries

<table>
<thead>
<tr>
<th>Sector</th>
<th>Key assumptions</th>
<th>Key risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auto</td>
<td>Low growth in main markets</td>
<td>Higher tariffs in the U.S.</td>
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<td>Inflexible capital expenditure (capex) and R&amp;D expenditure</td>
<td>Higher spending for new technologies</td>
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<td>Stiffer Chinese competition</td>
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<td>Building materials</td>
<td>Curtaild capex and investments</td>
<td>Demand slowdown</td>
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<td>Solid infrastructure investment to support demand</td>
<td>Liquidity and refinancing risks</td>
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<td>Capital goods</td>
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<td>Weaker end-markets in China</td>
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<td>Higher capex</td>
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<td>Polymer spreads to decline on supply glut</td>
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<td>Consumer products</td>
<td>Consumption driving growth</td>
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<td>Higher raw material prices and selling costs</td>
<td>Rapidly changing consumer tastes</td>
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<td>Commodity price impact on margins</td>
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### Table 3

**Summary Of Key Assumptions And Risks For Asia-Pacific’s Industries (continued)**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Key assumptions</th>
<th>Key risks</th>
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</thead>
</table>
| Financial institutions  | Macroeconomic conditions stable  
                          | Governments remain supportive                                                  | High debt, high prices  
                          |                                                                              | Market risks              |
| Gaming                  | Steady profit margins helped by mass-segment  
                          | Japan integrated resorts still a few years away  
                          | Asia-Pacific gaming growth in line with GDP                                   | Chinese regulation  
                          |                                                                              | Gaming concession expiry  |
| Insurance               | Earnings pressure  
                          | Asset growth                                                                     | Offshore investment  
                          |                                                                              | Non-modeled risks  
                          |                                                                              | Rising interest rates    |
| Metals and mining       | Metal prices to sustain credit metrics  
                          | Profits over volume growth                                                      | Shift in focus to shareholder returns  
                          |                                                                              | Rising input costs      |
| Oil and gas             | Credit metrics remain robust  
                          | Refining margin relatively stable                                               | Liquidity and refinancing risks  
                          |                                                                              | Structural change in oil demand growth                                       |
| Public finance          | Chinese LRGs’ bond issues provide fiscal space                                 | Policy reversal                        |
| Real estate development | Prices no longer buoyant  
                          | Land acquisitions to also taper                                                  | More restrictive conditions  
                          |                                                                              | Muted demand in Indonesia  
                          |                                                                              | Materially heavier refinancing burden                                         |
| Real estate investment trusts | Solid revenue growth  
                          | Rising interest rates  
                          | Financial discipline                                                           | Sharper rise in interest rates  
                          |                                                                              | Digital disruption  
                          |                                                                              | Erosion of prudent financials                                                |
| Retail                  | Slower retail sales growth  
                          | Rising interest rates                                                            | Shifting consumer preferences  
                          |                                                                              | Investment needs to digitize                                                  |
| Sovereign               | Impact of trade actions limited  
                          | Policy responses to global flows                                                | Sudden capital swings  
                          |                                                                              | China’s deleveraging policy                                                   |
| Structured finance      | Property prices soften  
                          | Increasing automation                                                            | Transition from interest-only to amortizing loans  
                          |                                                                              | Planned consumption increase                                                  |
| Technology              | Increasing downside risk  
                          | Slow growth in hardware demand  
                          | Consumption growth                                                              | Oversupply risk  
                          |                                                                              | Higher technology costs  
                          |                                                                              | Rising trade dispute                                                        |
| Telecommunications      | Gradually intensifying competition  
                          | Growing mobile data usage                                                       | Aggressive pricing and new entrants  
                          |                                                                              | Pressure from NBN in Australia  
                          |                                                                              | 5G capex and rollout                                                      |
| Transportation—cyclical | Oil prices to moderate  
                          | Fundamentals remain sound                                                        | Slowing growth or rising trade tensions  
                          |                                                                              | Higher U.S. dollar  
                          |                                                                              | Slowdown in trade volumes                                                   |
| Transportation infrastructure | Economic growth supports demand  
                          | Stable regulation, strong investor appetite  
                          | Capex growth                                                                     | Tighter Chinese regulations  
                          |                                                                              | Geopolitical tensions                                                       |
| Utilities               | Mixed capex trends                                                           | Regulatory changes/policies                                                     |

Auto

Stiff Competition And Slowing Sales Pressure Companies

Key Takeaways

− Pressure on Asia-Pacific’s automakers is increasing due to stiff competition amid slowing sales.
− Consequently, the negative outlook bias remains high.
− Downside risk could increase if U.S.-China tensions increase costs.

What’s changed?

Rating pressure heightening. Competitive pressure is rising amid a market slowdown in the U.S. and China. Stress is also arising from high research and development (R&D) expenses on new technologies.

Key assumptions

Low growth in main markets. We expect only moderate sales growth in China and Europe. Growth in light vehicle sales in the U.S. would be relatively flat in 2019-2020, pressuring margins.

Inflexible capital expenditure (capex) and R&D expenditure. New models in 2019-2020 will introduce new electrification features and connectivity options.

Key risks

Higher tariffs in the U.S. Potential tariffs on U.S. auto imports would materially affect Japanese and Korean automakers. Mitigating the impact is the fact that local production in the U.S. requires time to implement.

Higher spending for new technologies. Environmental compliance is increasing, lifting R&D costs. Companies need to invest in electrification and other new technologies.

If the credit cycle turns. Sharp global sales decline would significantly affect earnings and hurt the asset quality of captive finance operations.

What to look for in 2019

Stiffer Chinese competition. We expect competition in China to further intensify if recent weakness in new car sales growth continues.

Related research:
− Industry Top Trends 2019: Autos
Building Materials
Trade Dispute Increases Demand Uncertainty

Key Takeaways
− Steady economic growth and increasing infrastructure investment underpin a stable credit trend.
− Prices remain resilient, while companies are likely to deleverage further and control capex.
− However, uncertainty over demand growth is rising due to the trade dispute.

What's changed?
Rising demand uncertainty. The performance of companies has remained robust. However, the U.S.-China trade dispute brings higher uncertainty for demand growth in 2019.

Key assumptions
Curtailed capex and investments. We expect companies to restrain their capex over the next two years, and don’t expect aggressive merger and acquisition (M&A) in the region. Most companies are deleveraging, i.e. through asset sales and debt repayment.

Solid infrastructure investment to support demand. Continuing economic growth will support infrastructure investment and construction activity. Varied prospects in the property industry will have a mixed impact on the sector.

Key risks
Demand slowdown. As the impact of the trade dispute on global economic growth deepens, demand could slow down, resulting in overcapacity becoming severe again. If the Chinese government maintains its deleveraging initiative, investment may not offset any demand slowdown.

Liquidity and refinancing risks. These remain key risks especially for smaller players, amid a tightening capital market and more gloomy demand outlook. Small Chinese cement companies may struggle given that banks are reluctant to lend.

If the credit cycle turns. With tighter credit conditions and a potential decline in GDP growth, investments in the region could fall significantly, reducing prices and demand.

What to look for in 2019
Refinancing and demand uncertainty. Liquidity and refinancing pressures are increasing while oversupply remains a short-term risk for pricing, particularly in China. Price volatility would dampen profitability and amplify liquidity risks for small to midsize players.

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Related research:
− Industry Top Trends 2019: Building Materials

Source: S&P Global Ratings. All figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations. f—forecast.
Capital Goods

Lower Economic Or Trade Growth Could Dampen Outlook

Key Takeaways

− Still-favorable commodity prices and solid capex needs in end-markets in the auto and construction sectors underpin the stable credit quality of the capital goods sector.
− The U.S.-China trade dispute and slower Chinese growth could dampen the outlook.
− Profits remain stable, but refinancing and liquidity risks are increasing for speculative-grade issuers amid volatile equity and foreign markets.

What’s changed?

Slightly increasing negative credit pressure. Most of our pool of capital goods issuers that we rate can absorb the direct impact of the U.S.-China trade dispute and investment interruption, but the knock-on effects will hit the auto industry.

Key assumptions

Cost-management efforts. Despite the trade dispute and weakening financial market sentiment, continued business restructuring and cost-cutting should underpin profitability.

Weaker end-markets in China. Weaker end-markets in China’s auto and infrastructure sectors cast doubt on future capex and investment decisions. A shift in supply chains or cooling investment climate could pressure capex.

Key risks

U.S.-China trade and economy. In China, corporate deleveraging has paused, mainly because of a slowdown in earnings growth rather than profligate spending or borrowing. Also, a weakening macro landscape in China and emerging countries could affect the sector.

Liquidity and interest rates. Speculative-grade entities have rolled debt maturities onto later years (2021-2022), posing a possible refinancing risk given the increasing interest rates.

If the credit cycle turns. Some subsectors will feel the effects more. Weakening auto sales in China coupled with trade flows may decrease, putting auto-related companies under pressure.

What to look for in 2019

Disciplined financial management. Given the softer figures in GDP and car sales in China and South East Asia, we project weaker demand from end-markets.

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Related research:
− Industry Top Trends 2019: Capital Goods
Chemicals

Slowing Demand Amid Expanding Supply Would Weaken Earnings

Key Takeaways

− Weak demand amid rising input costs resulted in polymer product spreads contracting by around 10% during the recent quarter, and we expect spreads to further normalize to around midcycle levels.
− Global capacity expansions are materializing, which would lower petrochemical spreads over the mid to long term.
− Capital spending has increased for 2018, which can be funded mostly by operating cash flows.

What’s changed?

Demand slowdown and ample supplies. Polymer product spreads are normalizing on weakening Chinese demand and high inventory. Companies have enjoyed above mid-cycle petrochemical margins amid steady demand growth in 1H18. We expect weaker earnings as macro volatility persists amid the trade dispute.

Key assumptions

Global expansion plans. Capacity expansion plans are likely to materialize from Q4 2018, which could pressure petrochemical spreads. About 25 million tons of new ethylene lines would come on stream by 2020, versus annual global incremental demand of 4-6 million tons. However, we cannot rule out the possibility of sizable expansion delays, especially in Asia and North America.

Higher capex. Aggregate capital spending across Asia-Pacific chemical companies has increased for 2018 as capacity expansion plans are announced. Much of the spending can be funded via operating cash flows.

Key risks

China slowdown. With ongoing overcapacity and slowing economic growth in China, capacity utilization rates could weaken for the chemical sector.

Rising oil prices. While product spread compression could still be manageable at an oil price range of US$50-US$60 per barrel (bbl), an oil price jump to beyond US$90/bbl could pose a risk to a few chemical producers, given that product prices adjust with a lag.

If the credit cycle turns. Commodity chemicals suffer from inherent earnings volatility, given that product spread fluctuations are driven by macroeconomic trends, capacity expansion, and volatile raw material prices.

What to look for in 2019

Polymer spreads to decline on supply glut. Based on global capacity expansion plans, we expect incremental supply to outpace demand in 2019, resulting in spread contraction. That said, further delays in expansion are possible. Slowing economic growth in China would also be a drag.
Consumer Products
Rising Middle Class Supports Sales But Changing Tastes Pressure Margins

Key Takeaways
- Rising middle classes will further lift consumption, albeit slower, supporting stable credit trends.
- Intense competition, product development, and higher input costs could squeeze margins.
- Discipline over investment, new products, and operating efficiency will differentiate credit quality.

What’s changed?
Rating pressure increasing. Debt-funded acquisitions and investments in China and Japan are placing moderate downward pressure.

Key assumptions
Consumption driving growth. The region’s growing middle class will moderately lift consumption, sustaining stable credit trends. While Chinese sentiment has dampened, the region’s middle class should be willing to pay more for premium and healthier products. Growth in cosmetics, sportswear, and healthcare should continue to outpace GDP. However, growth in food staples and low-end products might hit low single digits.

Higher raw material prices and selling costs. Potentially higher input costs and rising promotional expenses may pressure profitability. Competition to develop products to meet changing consumer tastes and online shopping preferences will remain intense. Product upgrades or cost streamlining may temper the impact.

Key risks
Debt-funded M&A. Given slowing organic growth, companies could borrow to pursue sales growth via M&A. In China, market fragmentation and companies’ desire to control high-quality raw material sources or better brands could spur M&A. In response to a saturated domestic market, Japan’s major food, beverage, and tobacco producers will continue to seek growth opportunities in emerging markets.

Rapidly changing consumer tastes. Companies’ adaptability to changes in consumer tastes and preferences for trendy products, rising online sales, online to offline services, and mobile payments are key to survival.

If the credit cycle turns. Any abrupt sales decline in global markets would lead to further earning pressure. Large companies that have solid business portfolios with high brand recognition and robust capability in product development are likely to maintain some resilience in the face of those challenges.

What to look for in 2019
Commodity price impact on margins. Most consumer-product input prices have stayed at relatively low levels as global demand slows down, but recent trends indicate a moderate price recovery for certain commodities. Any sudden surge in commodity prices could lead to higher raw material costs and pressure margins.

Related research:
− Industry Top Trends 2019: Consumer Products
Financial Institutions

Stable Outlook, Rising Downside Risk

Key Takeaways

- Except for India, where nonperforming loans are high, the credit cycles for financial institutions in many jurisdictions are at their peaks.
- High private sector debt, increasing interest rates, and volatile currencies pose threats.
- We see little rating upside, but some notable downside risks that could affect ratings in particular if the turn in the credit cycle is significant and abrupt.

What's changed?

Rating outlook remains stable. The majority (78%) of rating outlooks are currently stable, and our base case is that this trend will likely continue into 2019.

Key assumptions

Macroeconomic conditions stable. While our outlook for macroeconomic conditions is relatively stable, we are cautious toward a potential deterioration in credit conditions triggered by higher U.S. interest rates and more-volatile domestic currencies.

Governments remain supportive. We currently envisage no significant weakening of government support for systemically-important banks in Asia-Pacific, with the possible exception of Australia.

Key risks

High debt, high prices. There are currently high debt levels and asset prices amid a protracted low interest rates environment. These factors set the stage for a potential deterioration in credit quality, especially if associated with a sharp correction in asset prices and pullback in market liquidity.

Market risks. The existing environment of depreciating domestic currencies and skittish bond markets, as well as expectations for higher interest rates and more difficult financing conditions in 2019, pose additional risks and further challenges for financial institutions.

If the credit cycle turns. A significant and abrupt credit cycle downturn will likely result in negative ratings momentum for some Asia-Pacific financial institutions. We expect, however, that most banks can weather a moderate and less-abrupt downside scenario outside our base case at current rating levels.

What to look for in 2019

Asset quality, capital and earnings stable. Except for India, nonperforming loans should remain relatively low in many jurisdictions in 2019, with earnings and capital also generally supportive of ratings at current levels.
Gaming

Profit Growth Likely To Outpace Revenue Growth

**Key Takeaways**
- Despite a growth slowdown in Macau gaming revenue in 2019, driven by the VIP segment, the better profit margins of the mass-market segment should support profit growth.
- For the rest of Asia-Pacific, gaming revenue growth should be in line with that of GDP.
- Casino operators’ financial discipline in capital spending and shareholder distributions, and their ability to maintain or gain market share, will differentiate their rating outlooks.

**What's changed?**

**Profit growing faster than revenue.** We forecast Macau’s 2019 gross gaming revenue (GGR) growth to slow to about 4%–8% from 12%–14% in 2018, largely as a result of slowing VIP GGR, which is partly offset by the steady growing mass-segment. Because the mass segment is far more profitable with margins that are 3x-4x higher than the VIP segment, profits should grow faster than GGR.

**Key assumptions**

**Steady profit margins helped by mass-segment.** EBITDA margins should remain steady or improve slightly due in large part to mass-market segment growth and rising consumption at newly opened casinos in Macau.

**Japan integrated resorts still a few years away.** We do not expect Japanese integrated resorts (IR) to hit the scene before 2024. This is because the request-for-proposals and licensing process are likely to take some time and operators are unlikely to incur any meaningful development capital spending in Japan before 2021.

**Asia-Pacific gaming growth in line with GDP.** For the rest of Asia-Pacific, we expect GGR to increase broadly in line with GDP growth. Key longer-term drivers are rising disposable incomes and improving infrastructure.

**Key risks**

**Chinese regulation.** Any unfavorable regulatory change by the Chinese government over capital controls could swing growth of the VIP segment across the region, given that the majority of VIP customers are from China.

**Gaming concession expiry.** Macau’s gaming concession will expire in 2020 and 2022, posing a risk for operators. However, we do not presume any existing operators will lose their gaming licenses during rebidding.

**If the credit cycle turns.** Any abrupt decline in economic activity or gamer sentiment could pressure revenues.

**What to look for in 2019**

**Debt-funded expansion, shareholder returns.** A few major new gaming casino projects remain in Asia until Japan’s IR openings; however, operators’ financial discipline on shareholder distributions remain key.

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**Mass-market segment supports casinos’ steady profit margins.**

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**Related research:**
- Industry Top Trends 2019: Hotels, Gaming, And Leisure
Insurance

Market Volatility Dampens Stable Prospects

Key Takeaways

- The slight positive rating bias reflects a largely stable operating environment for Asia-Pacific insurers.
- Foreign exchange (forex) and investment market volatility could dent insurers’ profitability.
- Escalating U.S.-China trade tensions present both risks and opportunities for Asia-Pacific insurers.

What’s changed?

**Increasing market volatility.** Forex volatility, particularly in emerging markets, affect insurers with sizable overseas investment exposure. Rising interest rates benefit overseas investments (in U.S. dollar fixed income) but affects existing asset valuation (impairing capital), while higher forex hedge costs dilute investment yields.

**Escalating U.S.-China trade tensions.** While the fundamental demand for insurance remains strong given still low penetration within the region, demand for marine and credit insurance could reduce.

Key assumptions

**Earnings pressure.** Available underwriting capacity and a catastrophe-benign environment are keeping premium rates low for property and casualty (P&C) insurers and reinsurers. Higher acquisition expenses and compliance costs, amid stiffer domestic competition, will cut profitability. Given the unprecedented strengths of typhoons in Japan and Hong Kong, we expect marginal premium hikes to offset some underwriting losses.

**Asset growth.** Further strong growth in assets at life insurers increases credit risk exposures. In China, the greater involvement of insurers in equity capital markets presents new risks. While the allocation toward equity investments may increase marginally, insurers are likely to manage it closely against their capital.

Key risks

**Offshore investment.** Insurers’ pursuit of more aggressive overseas investments, amid intensifying market competition across the region, exposes them to greater balance-sheet volatility. Unhedged offshore investments expose insurers to potential forex fluctuations and pressure on capital.

**Non-modeled risks.** Weather patterns and rising urbanization lift exposure to natural or manmade catastrophes, which have yet to be modeled explicitly, especially for emerging markets with less claims history. Emerging risks like cyber-related exposures present new challenges and opportunities for re/insurers.

**If credit cycle turns.** Abruptly lower economic activity could cut premium growth and investment returns.

What to look for in 2019

**Rising interest rates.** This would increase reinvestment options, but higher funding costs may curb offshore debt.
Metals And Mining
Productivity Gains Could Offset Higher Input Costs

Key Takeaways
- The industry continues to reap good earnings due to still-attractive metal prices.
- Better credit metrics should sustain in 2018, in the absence of aggressive capital returns or M&A.
- Higher global interest rates and trade tensions may worsen price volatility or fundamentals.

What’s changed?
Global growth slowing. Slower global growth and a potential negative impact from the U.S.-China trade dispute on global demand and prices, could lead to tougher trading conditions, deviating from our base case.

Key assumptions
- Metal prices to sustain credit metrics. We continue to expect generally stable prices for most metals, reflecting our views of relatively balanced global supply-demand conditions.
- Profits over volume growth. Production is likely to remain relatively stable in 2019. Companies continue to focus on maximizing profits rather than just increasing production to grow revenue.

Key risks
- Shift in focus to shareholder returns. Most companies reduced or stopped dividend payments during the industry downturn to conserve cash. Pressure from shareholders to increase returns has emerged. As a result, companies have started to shift their focus to shareholder returns.
- Rising input costs. Companies are focused on productivity gains to mitigate higher input costs (i.e., oil), freight expenses, and contractor rates. Margins could moderate if efficiency gains or higher prices are not attained.
- If the credit cycle turns. If the credit cycle turns unexpectedly in 2019, we expect liquidity for this sector to dry up, in particular for high yield issuers. It may be more difficult for miners to source finance to fund growth. Therefore, a recovery in investment could be delayed. In addition, such credit tightening may affect downstream demand for materials, placing downward pressure on metal prices.

What to look for in 2019
China and global trade. Given that China accounts for over 50% of the global demand for raw materials, any weakening in its downstream sectors could pressure this sector. If a trade dispute affects the real economy, it could hurt global demand and commodity prices. Although the Chinese government could raise infrastructure investments to mitigate the impact of a demand slowdown, the need to deleverage the whole economy may constrain how much spending can increase. Growth in China’s fixed assets investment slowed to 5.4% during the first nine months of the year, from 7.5% last year, with infrastructure investment only growing by 3.3%.

Related research:
- Industry Top Trends 2019: Metals And Mining
Oil And Gas

Prices Are Steady But Uncertainty Is Rising

**Key Takeaways**

- We assume Brent oil price would average US$70 per barrel (/bbl) for the rest of 2018, and US$65/bbl for 2019. Our long-term assumption for oil prices remains at US$55/bbl.
- The credit metrics of Asian oil companies will improve in 2019 based on steady oil prices and controlled spending.
- Lower global oil demand due to the trade dispute and geopolitical risks could lift oil price volatility.

**What’s changed?**

**Rising uncertainty.** Oil and gas companies have benefited from higher oil prices this year. Uncertainty regarding oil prices and demand is rising due to the trade dispute and tighter credit conditions. As a result, oil companies’ steps to control costs and deploy cash will set different them apart in terms of credit quality.

**Key assumptions**

**Credit metrics remain robust.** Oil companies have significantly reduced operating costs and capital spending during the last price cycle trough. Their cash flow and credit metrics improved when prices recently recovered. We assume stable prices in our forecasts—credit metrics should improve in 2019 despite higher capex.

**Refining margin relatively stable.** Despite higher crude oil prices in 2018 and 2019 (than in 2017), we expect refiners to maintain healthy margins and robust operating cash flows, maintaining their credit metrics.

**Key risks**

**Liquidity and refinancing risks.** If credit conditions tighten due to slower economic growth or the trade dispute, oil companies, especially smaller ones, could face heightened liquidity and refinancing risks.

**Structural change in oil demand growth.** Although electric vehicles are a longer-term trend, any major initiatives by governments on clean energy signaling a potential ban on fossil fuel vehicles, or a breakthrough in technology, may cast doubt on long-term demand, and therefore, pressure oil prices.

**If the credit cycle turns.** With tighter credit conditions and a potential decline in GDP growth, oil prices and demand could see downward pressure. Despite oil companies’ improved cost structures after the last oil price fall, a persistent and significant drop in oil price will still hurt oil companies’ profitability and cash flow.

**What to look for in 2019**

**Demand and refinancing risks.** For small players in particular, refinancing risk remains if oil prices weaken. Banks, therefore, may become more cautious about their exposure to the sector. A global economic slowdown could bring down oil demand and oil prices.
China has moved to resuscitate infrastructure investment amid a slowing economy.

**Key Takeaways**

- Chinese authorities have softened its policy tone slightly to stabilize infrastructure investment and the local regional government (LRG) sector’s reasonable credit growth.
- We don’t expect this easing to lead to a reversal in the central government’s policy agenda of containing LRG sector debt risk in the medium and long term.
- We expect LRGs’ debt burden, even after considering off-balance-sheet items, to sustain at well below 50% of nominal GDP over the next three to five years.

**What’s changed?**

**Breathing space for China’s public investment.** China’s deleveraging initiative paused mid this year, signaled by loosening monetary policy and accelerating fiscal expansion via tax cuts and public debt. With macroeconomic headwinds from U.S.-China trade tensions plus a slump in infrastructure investment growth, China moved to resuscitate infrastructure investment and support LGFVs’ financing needs to ensure existing infrastructure investment can be implemented with little disruption.

**Key assumptions**

**Chinese LRGs’ bond issues provide fiscal space.** Chinese authorities have directed LRGs to speed up bond issuances to alleviate the funding shortage for infrastructure investments. By the end of the third quarter, LRGs’ issuances were already very close to the full-year quota. We expect the central government to lift new LRG bond issuances to Chinese renminbi (RMB) 4 trillion by 2020.

**Key risks**

**Policy reversal.** Although we don’t expect current easing measures to completely derail the China’s deleveraging agenda, current accommodative measures do create uncertainty regarding the public sector’s near-term credit growth trajectory. If these measures intensify, it may herald a return of LGFVs’ risk appetite.

**If the credit cycle turns.** In the unlikely event of a sharper GDP downturn in China and much tighter credit conditions, revenue pressures and financing challenges could arise.

**What to look for in 2019**

**Policy shift to resuscitate credit growth.** China’s macro policy setting is becoming more accommodative amid an expansionary fiscal policy. Authorities are softening their deleveraging tone that hit public financing and infrastructure investment hard in H1 2018. The impact occurred amid concerns regarding a weakening Chinese economy. Recent easing measures, however, have avoided sectorwide financial stress for LGFVs that could pose significant contingent risks for the local government sector.
Real Estate Development

Sales Growth Is Past Its Peak For China’s Property Developers

Key Takeaways
- Sales and price growth have likely peaked and mild declines could appear over the next few months in lower-tier cities, creating a tougher sales environment.
- Funding conditions have eased moderately including refinancing in the domestic bond market, but continue to weigh on weaker developers that lack a good standing in credit markets.
- A liquidity squeeze is shortening some small developers’ capital structure, exerting negative pressure.

What’s changed?
Sales growth peaked. Although prices grew strongly this year, some leading indicators point to growth having peaked. More failed land auctions have occurred and investment into the sector has weakened.

Key assumptions
Prices no longer buoyant. Lower-tier cities are likely to see price trends turn down as government stimuli wear off and developers start to use promotional tactics to accelerate sales. Larger developers are likely to fare better with stronger execution and branding, but sales margins are unlikely to sustain for most.

Land acquisitions to also taper. Land sale prices will continue to fall as developers brace for a tougher environment. While well-funded developers could take advantage, most will not see it as a good opportunity.

Key risks
More restrictive conditions. Smaller players could face liquidity shortfalls if a regulatory stance and market appetite don’t support large refinancing. Some have been forced to take shorter term funding, further weighing on their liquidity profiles. In addition, recent restrictive policies affecting property could instigate a sharper sales decline, leading to weaker homebuyer sentiment and dampening sales and cash flows.

Muted demand in Indonesia. The key risk continues to be political or regulatory uncertainties during election years. Sales are bottoming out but staying muted as buyers stay on the sidelines. Many developers have been trying to make up the shortfall with block sales of land or units. This could exacerbate the gradual impairment of credit quality, especially liquidity over time due to slower-than-expected sales for developers.

If the credit cycle turns. With tighter credit conditions, demand and prices could fall.

What to look for in 2019
Materially heavier refinancing burden. Developers are faced with a large maturity concentration over the next two years. While most developers have sufficient financial buffers, weak players with low cash generation could see funding drying up, and would need to redeem domestic bonds with put options.
Real Estate Investment Trusts
Players Are Well Placed To Withstand Higher Interest Rates

FFO/Debt (Median, Adjusted)
Debt/EBITDA (Median, Adjusted)

Key Takeaways
- The sector is largely stable due to REITs' solid market positions.
- Asia-Pacific REITs' prudent financial stance has provided a buffer for the ratings to withstand debt-funded growth and economic shocks.
- A sharp increase in interest rates will have limited impact.

What's changed?
Credit quality stable. Credit quality has remained consistent with expectations and moderately improved.

Key assumptions
Solid revenue growth. We see stable revenue growth for real estate companies as economic growth remains solid, though risks of a slowdown are increasing due to tightening funding conditions, trade tensions, and emerging political risks. Growth in the gateway cities is likely to remain in the low single-digit range.

Rising interest rates. Most real estate companies have built a cushion in their credit metrics, along with a largely fixed rate capital structure with limited refinancing needs, to withstand a modest pace of rate hikes.

Financial discipline. We expect financial policies to remain fairly disciplined, supporting the current risk profiles. This is despite somewhat higher appetite for share repurchases or development projects to enhance growth given limited acquisition prospects.

Key risks
Sharper rise in interest rates. Interest rates rising faster than our expectations in 2019 is a key risk for the sector because it could pressure valuations in several markets. We recently tested the global sector for increases of 100 basis points (bps), 200 bps, and 300 bps in rates.

Digital disruption: Disruption in retail and the development of co-working rental alternatives are forcing some REIT landlords to reshape their leasing offer—a trend that we expect to continue in 2019.

If the credit cycle turns: A potential liquidity pullback from trade-affected economies could reduce debt availability for real estate entities in gateway cities, making it difficult to source debt and refinance.

What to look for in 2019
Erosion of prudent financials. REITs' adherence to prudent financials is key to rating stability amid this lumpy debt-funded growth. A quickening trend to increased debt usage without a commensurate weakening in asset values could increase credit risks.

Related research:
- Industry Top Trends 2019: Real Estate
- When The Cycle Turns: Asia-Pacific REITs Build A Rating Buffer As Interest Rates Rise
Retail

Will Consumer Sentiment Remain Resilient?

Key Takeaways

- The U.S.-China trade dispute is likely to dampen consumer sentiment to some extent, and subdue consumption growth.
- Margin pressure continues due to consumers’ shifting preference to price discounts and price-competitive online products.
- Online retail growth would outpace the growth of offline retailers. In addition, offline retailers’ investment burden for both physical stores and online infrastructure is expanding.

What’s changed?

**Subdued consumer sentiment.** The prolonged U.S.-China trade dispute could dampen consumer sentiment in the region, potentially slowing retail sales growth. We expect online retail to significantly outpace offline sales.

Key assumptions

**Slower retail sales growth.** Despite the current robust momentum, in 2019 we anticipate the trade dispute to soften consumer sentiment to some extent. Retail sales growth in emerging markets like China will be at high-single digits, slower than in 2018, and reach low-single digits in Japan and Australia.

**Rising interest rates.** Upward pressure on interest rate and spreads is likely to continue in 2019. Given that the EBITDA interest coverage ratios of speculative-grade issuers in emerging countries are already low, these issuers have less room to absorb the increasing interest expense.

Key risks

**Shifting consumer preferences.** The profitability of largely offline retailers is unlikely to recover materially, as consumers seek more price discounts and retailers have to compete on price with online retailers.

**Investment needs to digitize.** Retailers need to further invest in physical stores to remain competitive. In addition, the need to also invest in e-commerce infrastructure will increase their financial burden.

**If the credit cycle turns.** If a sharp downturn in the global economy were to occur, regional retailers’ operating performance will dampen significantly. However, for emerging countries, the likelihood of increasing middle-class consumers will underpin retail sales growth over the longer run.

What to look for in 2019

**Consumer sentiment resilience.** Despite the U.S.-China trade dispute, consumer confidence remains relatively strong for now. Retailers’ ability to quickly adapt their operations and price strategy to consumer preferences, and reduce costs are key credit factors.

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**Related research:**

- Industry Top Trends 2019: Retail And Restaurants
Sovereign Credit Quality Faces More Pressures

Key Takeaways

− Geopolitical tensions, increasingly protectionist trade policies, and more recently, the emerging market rout, pose tail risks for sovereigns in Asia-Pacific.
− We believe steady economic conditions in major developed economies and growing domestic demand will support sovereign ratings across Asia-Pacific.

What’s changed?

Escalating trade risks. The threat of U.S. tariffs covering almost all Chinese imports has intensified economic uncertainty. Investors are also concerned about the deterioration in bilateral relations.

Emerging market aversion. With U.S. interest rate hikes continuing, some sovereigns in the region face global aversion toward emerging market assets. Capital outflows could intensify, exerting further pressure on forex.

China deleveraging policy faces headwinds. While Chinese policymakers see deleveraging as necessary, they have become concerned about declining economic growth and weakening confidence. Reopening the credit taps, while good for short-term growth, heightens the likelihood of an abrupt correction.

Key assumptions

Impact of trade actions limited. Trade actions implemented so far are unlikely to significantly weigh on regional growth this year, with the U.S. and China still seeking ways to resolve trade differences.

Policy responses to capital flows. Policy responses will likely develop to maintain investor confidence by those sovereigns more sensitive to global capital flows, to prevent a sharp pullout of funds.

Key risks

Sudden capital swings. Abrupt capital flow reversals remain a risk that could sharply increase financing costs, damaging confidence and short-term growth prospects in economies reliant on external funding.

China’s deleveraging policy. If trade tensions were to add to the already pressured Chinese economy, the deleveraging policy could reverse. Sovereign credit support for the government is likely to weaken due to growing risks of financial instability.

What to look for in 2019

Geopolitical tensions, rising protectionism. Protectionist trade policies between China and the U.S. could intensify, weighing on the region’s growth prospects and weakening cooperation between China and the U.S. in respect to geopolitical risks in the region.
Structured Finance

Softer Property Prices Weigh On Borrower Refinancing

Rating Distribution

Outlook Distribution

What’s changed?

Property prices soften. Tighter financing conditions weigh on property prices in larger Australian cities. The weighted average loan-to-value (LTV) ratio of Australian RMBS is around 60%, providing a buffer against moderate price falls. However, loans originated in the past 12 months (peak of the boom) are more exposed.

Increasing automation. Digital disruption is rapidly progressing across origination and underwriting functions, with a strong focus on technology enabling greater efficiency gains and dramatic reductions in loan application processing times, as banks prepare themselves for increased competition from fintechs.

Key assumptions

Stable employment. We expect asset performance including arrears and losses to remain low, given that we forecast employment conditions to remain relatively stable in the region’s major securitization markets. This will help to offset the softening in property markets in Australia and rising interest rates more broadly.

Key risks

Transition from interest-only to amortizing loans. Around 50% of interest-only (IO) loans in Australian RMBS transactions will reach their IO maturity dates by 2019. IO loans underwritten prior to 2015—when lending standards for interest-only loans were less stringent—may be more exposed to repayment shock.

Planned consumption tax increase. For Japan, the planned consumption tax increase in October 2019 (from 8% to 10%) could affect general economic conditions. We do not expect this to cause any material deterioration in asset performance across Japanese structured finance transactions.

If the credit cycle turns. If economic conditions worsen, unemployment and mortgage defaults could rise.

What to look for in 2019

U.S.-China trade dispute. An extensive conflict across the region may negatively affect employment conditions, leading to deterioration in loan performance eventually. The risk and how it spreads are, however, highly uncertain. In our perspective, the highly diversified obligor’s profile and the quick accumulation of credit enhancement levels with fast paydown of loans will underpin stable performance across structured finance transactions in the Asia-Pacific.

Key Takeaways

− Softening property prices in Australia are adding to refinancing pressures for some borrowers.
− The China trade dispute with the U.S. is yet to affect employment conditions or asset performance, though its impact could present risks.
− Stable employment prospects in all major securitization markets will keep arrears and defaults low.

Related research:

− An Overview Of Australia’s Housing Market And Residential Mortgage-Backed Securities
− China Securitization Performance Watch 3Q2018

Australian RMBS have a buffer to withstand moderate falls in property prices.
Technology

Slowing Demand, Trade Dispute Aggravate Risk

Key Takeaways

- Profitability will come under significant pressure because business uncertainties stemming from the trade dispute are hurting demand that is already slowing.
- Credit pressures on highly leveraged companies will grow.
- Protectionism, increasing costs, and shifts in technology continue to present material risks.

What’s changed?

Increasing downside risk. Slowing demand growth for IT and consumer electronics, coupled with capacity expansion in display and semiconductors, pose a risk to profitability and cash flows. Competition and tightening regulations in China may slow internet companies’ earnings growth.

Key assumptions

Slowing growth in hardware demand. Semiconductor growth is likely to moderate to low single digits as nonmemory chip growth offset a memory market correction. Memory chip prices are likely to decline due to supply expansion despite strong demand. Hardware (e.g. smartphones) growth could slow due to market saturation.

Consumption growth. Chinese internet companies face a slowing economy and trade dispute, although government stimulus could sustain domestic growth. Internet players could benefit from digitization. Indian IT services companies are increasingly servicing clients’ needs for new technology.

Key risks

Oversupply risk. High capex could increase oversupply risk. The Chinese government is aggressively promoting advanced manufacturing capabilities, particularly semiconductors. Significant capacity additions would cap display panel prices over the next one to two years.

Higher technology costs. Technology development costs present material risks. Trade tariffs on components or capacity relocations could increase production costs. Demand for legacy hardware would continue to fall.

If the credit cycle turns. Should economic conditions worsen, credit pressures on highly leveraged companies, such as those in China, could rise.

What to look for in 2019

Rising trade dispute. Protectionism is a risk for the hardware supply chain in China, Japan, Korea, and Taiwan. A full-blown trade dispute could weaken companies’ cash flows. However, strong cash flows, relatively low debt leverage, and business-geography diversity are buffers. Rating impact could be limited to highly-leveraged companies.

A full-blown trade dispute could weaken tech companies’ cash flows.
Telecommunications
Rising 5G Capex Amid Mounting Competition

Key Takeaways

Steady regional GDP growth and increasing mobile data consumption should support the generally stable credit quality of Asia-Pacific's telecom operators.

However, we see intensifying competition in several countries including India, Indonesia, Australia, Singapore, and Taiwan, with pricing becoming more aggressive.

Capex would increase modestly given the ongoing investments for advanced network and wireless spectrum, including fifth generation (5G) networks for developed countries.

What’s changed?

Gradually intensifying competition. Competition is mounting in India, Indonesia, Australia, Singapore, and Taiwan, with ongoing large capital investment required for advanced networks including spectrum. This is the major reason for the net negative outlook (-11%) in the Asia-Pacific telecom sector.

Key assumptions

Growing mobile data usage. We expect generally stable ratings for Asia-Pacific telecom operators because steady regional GDP growth and growing mobile data usage will support their overall credit quality.

Steady performance for developed markets. For more developed markets such as Japan, Korea, and China, we expect steady operating performances because 4G penetration has reached over 70%. However, we do not anticipate profitability improvement given the ongoing regulatory pressure on tariffs and market saturation.

Ongoing M&A. M&A should continue as operators diversify revenue streams and prepare for industry change. Korea’s SK Telecom acquired security/surveillance provider ADT Caps, aiming for Internet of Things synergies. Japan-based SoftBank Group’s financial policy would remain aggressive with M&A for new technology.

Key risks

Aggressive pricing and new entrants. Major players in India, Indonesia, Malaysia and Philippines are adopting aggressive pricing strategies. We also expect new telecom operators in Singapore, Australia and Japan.

Pressure from NBN in Australia. The growing presence of Australia’s National Broadband Network (NBN) has pressured some local telecom operators’ credit quality such as Telstra Corp. Ltd.

If the credit cycle turns. Should economic conditions worsen, consumer demand growth could be curtailed.

What to look for in 2019

5G capex and rollout. Developed market players are investing in 5G wireless networks for the commercial rollout of 5G in 2019 or 2020. This could require substantial investments in Korea, Japan, China, and Australia.

Related research:

Industry Top Trends 2019: Telecommunications
Transportation Cyclical
Reduced Trade Volumes Will Hurt Companies

Key Takeaways
- A trade confrontation between the U.S. and China could hurt certain Asia-Pacific transportation sectors more directly.
- We expect fuel prices to moderate, which should ease margin pressure.
- Lower trade volumes, a stronger U.S. dollar, or higher oil prices could undermine transportation companies in the region.

What's changed?
**Trade tensions continue to escalate.** A trade confrontation between the U.S. and China would affect certain Asia-Pacific transportation sectors more directly.

Key assumptions
**Oil prices to moderate.** We assume oil prices could moderate from current levels in 2019 (Brent crude average $65/barrel and West Texas Intermediate [WTI] crude $60), with 2020 levels $5 lower in each case.

**Fundamentals remain sound.** Air traffic remains strong but we expect recent growth to moderate. For shipping, soft new vessel deliveries are likely to support rates. Conditions remain healthy for equipment lessors.

Key risks
**Slowing growth or rising trade tensions.** Containerized freight volumes are highly sensitive to economic conditions. We also note that China is the largest importer of certain dry bulk commodities.

**Higher U.S. dollar.** Currency weakness versus the U.S. dollar makes it costlier for non-U.S. transportation companies to pay for oil, acquire dollar-denominated equipment, and service dollar-denominated leases or secure debt to finance equipment.

**If the credit cycle turns.** Higher debt costs or reduced access to capital could pressure capital-intensive transportation companies. We note that debt for the sector is largely on fixed rates.

What to look for in 2019
**Slowdown in trade volumes.** A slowdown of trade volumes would directly harm the global shipping industry. We will also monitor how the transportation industry responds to fuel price and currency movements.

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**Related research:**
- Industry Top Trends 2019: Transportation
Transportation Infrastructure

Funding Mix Of Heavy Planned Capex Is Key

<table>
<thead>
<tr>
<th>FFO/Debt (Median, Adjusted)</th>
<th>Debt/EBITDA (Median, Adjusted)</th>
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<td>2018f</td>
<td>2019f</td>
</tr>
<tr>
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<td>Asia-Pacific</td>
</tr>
<tr>
<td>0.0%</td>
<td>5.0%</td>
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</tbody>
</table>

Source: S&P Global Ratings. All figures are converted into U.S. Dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations. f—forecast.

Key Takeaways

− Healthy economic growth and existing infrastructure deficit will support demand, while rising interest rates, volatile currencies, and trade headwinds remain as risks.
− Regulations remain stable and investor appetite continues to be strong, although funding and market conditions could sour with increasing macroeconomic risks.
− Increasing capex and funding mix will be key credit drivers.

What's changed?

**Economic growth supports demand.** Healthy regional GDP growth support demand for transportation infrastructure. The existing infrastructure shortage cushions the impact of any slower economic growth. Rising interest rates, high currency volatility, and an intensifying trade dispute can create some headwinds.

**Key assumptions**

**Stable regulation, strong investor appetite.** Regulations remain broadly supportive and investor appetite is still strong, sustaining M&A valuations. Investments remain strong, primarily for roads and airports, which are performing better overall compared with other subsectors.

**Capex growth.** High passenger growth will drive airport capex e.g. Australia, New Zealand. To meet demand, toll road investment is scaling up in Indonesia, China, and India. India’s freight corridor and metro-bullet train projects in Asia are driving rail investment. China’s Belt and Road Initiative supports other investments.

**Key risks**

**Tighter Chinese regulations.** LGFVs in the region, such as those in China, are exposed to higher policy risk than other sectors. Tightening control over local governments’ funding and potential gradual weakening in support from central government increases LGFVs’ refinancing risks.

**Geopolitical tensions.** We view the likely impact of security and trade disputes as limited with key transport routes likely to remain accessible. Tariffs could have greater impact on export-oriented ports in China and South East Asia. The redirection of trade destinations and economic growth impacts are key factors.

**If the credit cycle turns.** A more challenging funding environment due to heightened macroeconomic risks may pause or reduce some infrastructure investments.

What to look for in 2019

**Huge infrastructure plans.** Developing Asia (Indonesia, India, Philippines) and China (e.g. Belt And Road) have significant plans for infrastructure. Some government-driven infrastructure’s feasibility can be uncertain.
Utilities

M&A And Renewable Policy Changes Increase Negative Bias

Key Takeaways

− Economic growth and demand conditions should underpin utilities’ steady credit profiles.
− M&A, subdued growth in renewables due to shift in government policies (mainly in China), and elevated capex levels are key risks.
− Modest headroom exists in current ratings, although pockets of higher leverage exist.

What’s changed?

Steady environment but M&A pose risks. Energy demand continues to be stable, driven by supportive economic conditions. Higher fuel costs, particularly coal and oil, remain a risk. China’s power sector deregulation and changes to subsidy regime for solar farms may affect Chinese utilities. Recent M&A plans have led to an increase in the negative outlook bias, heightening the focus on liquidity.

Key assumptions

Mixed capex trends. China’s capex is lower with the country’s deleveraging push and coal power slowdown. Capex is high in India and Indonesia, benign in Australia, and moderating elsewhere.

Key risks

Regulatory changes/policies. Unexpected adverse changes or policies to green energy, tariff changes or cost recovery can affect cash flow stability. Government intervention, such as delays in tariff adjustments (as in China for coal prices or Indonesia to adequately cover costs), remain a risk. Australian utilities face the threat of government intervention should power prices remain high.

Aggressive M&As, high capex: Offshore expansion by Chinese entities and consolidation within Thailand have increased M&A. Continuing expansion of new capacity is also likely to elevate capex.

If the credit cycle turns. An unexpected spike in interest rates would cause stress. Pressure on economic conditions will have a lagged effect, and liquidity management will be crucial. Some flexibility exist to defer capex but appropriate discipline to do so and reduce M&As in a timely manner will also be equally important.

What to look for in 2019

M&A and capex funding. Debt-funded M&A have been made by some Chinese state-owned entities for overseas investments and acquisition of renewables assets. Leverage is high among Chinese utilities and in some pockets of Asia on the back of debt-funded capex for new capacity. While some rating headroom remains in the sector, rising interest costs remain a risk, particularly if tariffs do not provide adequate and timely returns.
Related Research

- Global Trade At A Crossroads: Pause In U.S.-China Trade Dispute Is Confidence Positive, Dec. 3, 2018
- Credit Conditions Asia-Pacific: Cold Wind Blowing, Nov. 29, 2018
- Credit Conditions EMEA: Bracing for turbulence, Nov. 29, 2018
- Credit Conditions Latin America: Tough Fixtures, Home And Away, Nov. 29, 2018
- Credit Conditions North America: Signs The Cycle is Topping Out, Nov. 29, 2018
- Economic Research: APAC Economic Snapshots, Nov. 26, 2018
- Emerging Markets Focus: Where Are The Pockets Of Risk From EM Currency Depreciation?, Nov. 5, 2018
- Economic Research: Global Trade At A Crossroads: It's Hard To See Any Winners In A U.S.-China Trade War, Sept. 5, 2018

This report does not constitute a rating action.