S&P Global Ratings

Regional Credit Conditions Chair

Jose M Perez-Gorozpe
Madrid
jose.perez-gorope@spglobal.com

Credit Conditions Emerging Markets Q2 2021:

Brighter Prospects Prone To Setbacks

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Key Takeaways

- Overall: Credit conditions in emerging markets (EMs) look brighter than last year, given that developed economies' recovery accelerates and vaccination progresses. These factors are supporting EMs' external demand and industrial activity. Nevertheless, many sectors will continue struggling amid an uneven economic recovery and lackluster domestic demand.
- Risks: Downside risks are relevant and recovery itself will bring new challenges for many EMs, especially if risks from U.S. economy overheating were to materialize and financing conditions worsen. Most EMs continue struggling to contain the pandemic, and with few exceptions, vaccine rollouts have been slow. Consequently, risks from case resurgence, partial lockdowns, and economic activity setbacks prevail. The risk of a slower economic recovery or worsening financing conditions could further pressure corporations' earnings and undermine governments' fiscal flexibility across EMs.
- Credit: Negative rating actions have plateaued, but lower rating levels and negative outlooks reflect higher leverage and vulnerability to further shocks. Ratings' negative bias remains historically high in EM Asia and LatAm. A slower economic recovery or failure to deliver a vaccine within an expected time frame could lead to further downgrades.

(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions [Asia-Pacific, EMs, North America, and Europe]. Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the EMs committee on March 24, 2021.)

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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Top EM Risks

Table 1

Top EM Risks

Debt overhang among governments and pressure on corporate earnings would constrain an economic recovery

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

Economic recovery in most EMs remains fragile and subject to setbacks resulting from pandemic developments or policy missteps. Overall, EM governments have little room to provide additional fiscal or monetary stimulus without jeopardizing their credit quality.

EM sovereign debt has rapidly increased following efforts to contain the pandemic shock. Now, considerable fiscal consolidation is needed to stabilize government debt levels. There are substantial risks to do so, including weaker real and nominal GDP growth due to extended pandemic consequences; premature stimulus withdrawal (fiscal and monetary); failure to cut spending due to political resistance; and materializing contingent liabilities. Failure to stabilize debt will probably result in weakening credit quality.

A slowdown in the recovery will depress corporate earnings, increasing sector risks, particularly for those with little flexibility to cope with continued stress. Struggling and failing corporations will most opt for additional layoffs, with knock-on effects for households. Moreover, the impact could spill over to banks, as credit forbearance and fiscal stimulus measures wind down. Combined, these factors could lead to rapid asset-quality deterioration among banks, absent additional mitigating measures.

The prevalence of COVID-19 across key EMs, slow vaccination progress, and new variants dampening economic recovery

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

Vaccine rollout across most EMs has been slow, increasing the risk for case resurgence and exposure to new virus variants. Failure to contain the pandemic exposes EMs to partial lockdowns and curbs on economic activity. Furthermore, the potential for a considerable lag of widespread immunity in many EM countries, could delay the opening of services sectors sensitive to social-distancing measures, such as tourism. This raises concerns about the prevalence of the pandemic in EMs and potential setbacks for their economies and overall credit risk.

Risk of disorderly adjustment in U.S. yield resulting in higher debt costs, volatile financing conditions, narrowing access to credit markets

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

The global recovery from the COVID-19 shock is gaining steam, powered by accelerating vaccination campaigns, and accommodative fiscal and monetary policy stances. As a result, fears of overheating and inflation have resurfaced, most notably in the U.S., reflecting the perception that over-aggressive policy will quickly close output gaps and drive wages higher. A rapid and volatile market repricing or persistently elevated inflation would put pressure particularly on corporate credit quality at the lower end of the rating scale and on EMs. The EMs most at risk are the usual suspects; those with heavy reliance on foreign funding and large external and/or fiscal imbalances.

U.S.-China strategic confrontations and geopolitical tensions escalating

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

Our base-case scenario is for the strategic confrontation between the U.S. and China to persist. While the U.S. president and Senate majority have changed, the risk of heightened tensions remains given U.S. bipartisan views in respect to the China relationship. The previous and current U.S. administrations seem to have broadly similar views on China. The Chinese government recently announced "dual circulation" philosophy, indicating a determination to be less reliant on the U.S., such as in the area of technology. Further strains in U.S.-China relations would dampen cross-border investment, with a knock-on effect on other regions' economies. The impact on supply chains and restricted access to intellectual property and markets, in turn, increase the risk of business disruption and loss of investor confidence.

Geopolitical tensions are growing in many key EMs. There is increasing potential for U.S. sanctions on Russia following a U.S. intelligence report about election interference. Overall U.S.-Russia relations are withering under the Biden administration, which could bring more tensions. Turkey's increasing military presence in EEMEA has raised tensions with its neighbors. The potential reinstatement of the Iran nuclear deal could bring discomfort to Saudi Arabia and Israel.

High income inequality, increasing poverty levels, and poor access to health services spurring social unrest

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

The pandemic has exacerbated the existing income disparities, precarious living conditions, and limited access to health services for the poor in EMs, fanning the social discontent with politicians and status quo. Furthermore, the deep economic contraction resulting from the pandemic will result in a sharp rise in poverty, a huge setback for many EMs that made progress in this area over the past years. These conditions could ignite protests, demanding changes.

Sources: S&P Global Ratings.

* Risk levels may be classified as very low, moderate, elevated, high, or very high, and are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base case rating assumptions unless the risk level is very high.

** Risk trend reflects our current view on whether the risk level could increase or decrease over the next 12 months.

Regional Credit Conditions

Risks Loom For Improving Credit Conditions

A faster economic recovery in the U.S. and China, along with vaccination progress in developed economies, should continue supporting EMs' credit conditions during the year. These conditions should be particularly favorable for exporters and commodity producers, given that external demand continues improving. Domestic demand in EMs, on the other hand, will remain subject to success in containing the pandemic and vaccine rollout, which has been slow in most key EMs. Consequently, corporations linked to the services sector, especially those related to tourism and travelling or that involve proximity to other people will remain depressed, at least until widespread immunization is achieved.

EMs will continue facing relevant risks in 2021 despite improving conditions. The most significant risk are the potential setbacks to economic recovery in EMs. Most key EMs continue struggling to contain the pandemic and have been subject to case resurgence, which authorities have responded with various degrees of social-distancing measures. Overall, the prevalence of the pandemic across EMs prevents a faster recovery and is especially harmful for domestic demand and consumer confidence. Uncertain conditions are particularly stressful for lower rated corporations in the most exposed sectors (travel and leisure, gaming, fitness, non-essential retail, airlines, restaurants, airports, cruise lines, among others). While leverage is not particularly high among EM rated corporations, the shock to revenues is significant and intermittent lockdowns are particularly harmful for liquidity. These conditions are reflected in persistently high downgrade potential across many sectors and regions.

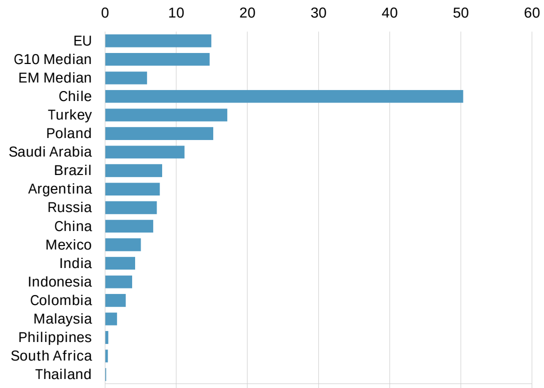
The risk for economic setbacks in EMs can also come from early withdrawal of governments' support measures. Governments have stepped up public spending to record highs, leading to a rapid increase in sovereign debt. Pressure on governments is building in two opposing directions. On one hand, sustaining support measures until economic recovery has gained momentum, and on the other, keeping their fiscal balance and debt under control to avoid further damage to credit fundamentals. Higher debt burden and weakening fiscal accounts could result in sovereign downgrades, which could reverberate across corporations and banks, because in most EMs, the sovereign ratings cap those on operating entities within that country.

The struggle to contain the pandemic and slow vaccination rollout exposes EMs to new strains of the virus, some of which have proven to be more contagious and deadly. We expect vaccination in EMs to accelerate during the year, although widespread immunization will probably happen much later than in developed markets, given logistics and health systems limitations. In our view, such conditions could also cause a sharp slowing in economic recovery during the year.

A considerable risk for EMs is the potential for an early rise in U.S. Federal Reserve interests' rates. Investors' expectations for rising inflation following U.S. substantive fiscal stimulus and the potential for a fast recovery as vaccination program gathers momentum have spurred U.S. long-term yields, but short-term yields haven't moved much so far. The fear of early interest rate normalization is generating market volatility and pressure on EM currencies. Sustained pressure on yields, and especially a rapid increase of short-term yields, could spur borrowing costs, especially for lower-rated entities. In such a scenario, the EMs most at risk are the usual suspects; those with heavy reliance on foreign funding and large external and/or fiscal imbalances.

Chart 1

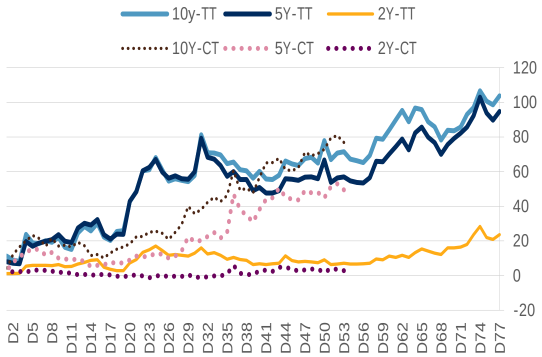
Total COVID-19 Vaccines Administered Per Hundred Population (as of March 26, 2021)



Source: OWID

Chart 2

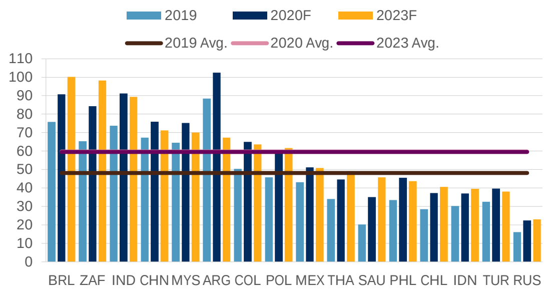
Cumulative Change In U.S. Yields Taper Tantrum Versus Covid Tantrum (bps)



Source: Bloomberg. Note: Day 1 for Taper Tantrum is May 22, 2013. Day 1 for Covid Tantrum is Jan. 5, 2021.

Chart 3

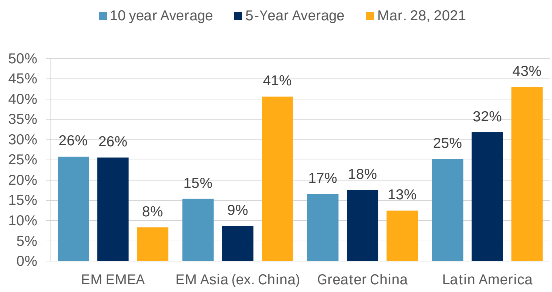
Gross General Government Debt In Key EMs



Source: S&P Global Ratings

Chart 4

Regional Negative Bias



Data as of March 28, 2021 and exclude sovereigns. Source: S&P Global Ratings.

EMs Face Uneven Recovery And Are Vulnerable To Setbacks

We expect an inconsistent economic recovery from the COVID-19 downturn across EMs. Some have already returned to their pre-pandemic GDP level, others won't until 2023, according to our projections for 16 major EMs. In our view, three important dynamics are influencing recovery trajectory for EMs.

First, the economic conditions prevalent in a given country as it entered the pandemic. In this sense, some EMs had strong fundamentals, but many were already facing economic weaknesses before the crisis, which were amplified by the downturn. Second, the efficacy in the policy response to cushion the economic blow and speed-up the recovery. Third, the success in normalizing economic activity by re-opening sectors that remain operating under capacity due to lockdown measures. The latter will be heavily influenced by the vaccination rollout's expansion, continued stimulus where necessary, and exposure to external conditions. We rank EMs on each of these three dynamics below.

Many Entered The Crisis With Slow Growth Pace And Fiscal Rigidities

We rank how an economy entered the pandemic based on several factors: the country's pre-pandemic credit rating, our sovereign risk assessment scores for fiscal flexibility and debt, and the 2017-2019 GDP growth average. We also considered the structure of the economy, in particular its exposure to the tourism sector, which the pandemic decimated. No heat map is perfect when looking at EMs, and some had relatively better fiscal accounts prior to the pandemic, and consequently, were better positioned to provide fiscal stimulus if needed. But their ratings reflected other vulnerabilities. Such is the case of Turkey and Colombia, external imbalances of which were significant sources of risk prior to the pandemic. Moreover, EM Asian countries showed better GDP growth averages before the crisis (in line with their traditionally higher growth rates than those of other EMs). Particularly for India, this factor partly compensates for its fiscal weakness.

Table 2

Pre-Existing Economic Conditions

Country	Foreign Currency Rating (Dec. 31, 2019)	GG balance/GDP (%)*	Primary GG balance/GDP (%)*	GG interest expenditure /revenues (%)*	Fiscal assessment Score: budget performance (Dec. 31, 2019)	Net GG debt/GDP (%) (2019)	Fiscal assessment Score: debt (Dec. 31, 2019)	Real GDP growth (%)*	Travel & Tourism % of GDP
Chile	A+/Stable/A-1	-2.3	-1.4	3.7	2	15.1	1	2.1	10.0
China	A+/Stable/A-1	-2.6	-2.2	1.6	4	51.5	2	6.6	11.3
Poland	A-/Stable/A-2	-0.8	0.7	3.6	3	43.2	2	4.7	4.7
Malaysia	A-/Stable/A-2	-3.4	-0.8	13.5	3	58.1	4	4.9	11.5
Saudi Arabia	A-/Stable/A-2	-4.0	-3.4	1.6	4	-76.6	1	0.7	9.5
Philippines	BBB+/Stable/A-2	-1.2	0.7	9.8	3	29.3	2	6.3	25.3
Thailand	BBB+/Positive/A-2	0.7	1.7	4.7	3	23.8	2	3.5	19.7
Mexico	BBB+/Negative/A-2	-1.5	0.5	10.9	3	42.0	4	1.4	15.5
Indonesia	BBB/Stable/A-2	-2.1	-0.6	10.6	3	27.7	2	5.1	5.7
Russia	BBB-/Stable/A-3	1.1	2.0	2.4	3	2.0	1	1.9	5.0
Colombia	BBB-/Stable/A-3	-2.0	0.9	11.5	3	43.9	4	2.4	4.9
India	BBB-/Stable/A-3	-7.1	-2.3	23.6	6	72.5	6	6.0	6.8
South Africa	BB/Negative/B	-5.0	-1.2	12.8	6	59.0	6	0.8	7.0
Brazil	BB-/Positive/B	-6.9	-1.5	15.2	5	55.4	5	1.3	7.7
Turkey	B+/Stable/B	-2.7	-0.4	7.5	4	29.3	3	3.7	11.3
Argentina	CC/Negative/C	-5.5	-2.1	11.5	6	83.4	5	-0.7	9.2

* - 2017 - 2019 Averages

Source: S&P Global Ratings; Travel & Tourism data for 2019 World Travel & Tourism Council.

Public Health, Monetary And Fiscal Policy Influenced The Pace Of The Decline And Initial Recovery

We rank the initial policy response across EMs based on the success in containing the initial economic shock and in fostering the recovery. To do this, we look at quarterly GDP growth during 2020 (see table 3). In general, those EMs that performed better had a combination of effective public health measures to contain the pandemic, and efficient and sufficient government support measures (including fiscal and monetary stimulus) that helped to cushion the blow to labor markets and most affected sectors. There are several nuances, of course. For instance, Brazil had a weak public health response, given that its COVID-19 case load was among the highest globally. But the country experienced a relatively positive economic result due to lack of lockdowns and ample monetary and fiscal support. In contrast, Thailand's public health response to the pandemic was very efficient, with very low number of cases, but the economic outcome was among the worst due to the economy's reliance on one of the hardest hit sectors by the pandemic, tourism. While Mexico seemed better positioned to face the shock, the absence of a more decisive fiscal stimulus, weak pandemic management, and preexisting weak investment dynamics have hobbled the country's recovery.

Table 3

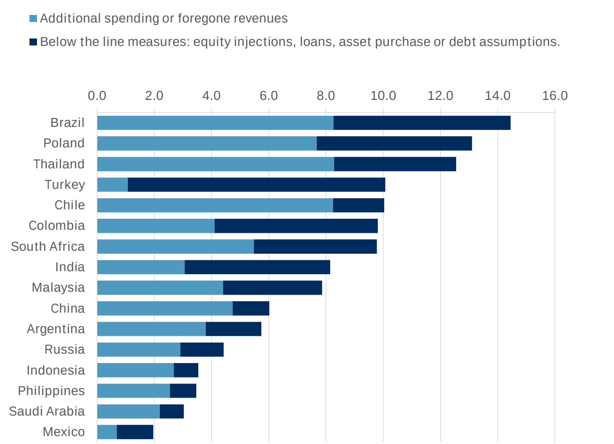
2020 GDP Growth By Quarter

Country	Foreign Currency Rating (Dec. 31, 2020)	Real GDP compared to its pre-COVID level (Q4-19)			
		Q1-20	Q2-20	Q3-20	Q4-20
China	A+/Stable/A-1	-9.7	0.8	3.8	6.5
Turkey	B+/Stable/B	0.1	-10.9	3.3	5.0
India	BBB-/Stable/A-3	1.0	-25.4	-7.8	-0.1
Brazil	BB-/Stable/B	-2.1	-11.1	-4.3	-1.2
Indonesia	BBB/Negative/A-2	-0.8	-7.7	-4.6	-2.1
Russia	BBB-/Stable/A-3	-0.5	-3.3	-2.6	-2.4
Poland	A-/Stable/A-2	-0.3	-9.3	-2.1	-2.8
Saudi Arabia	A-/Stable/A-2	-1.4	-7.2	-5.4	-3.0
Malaysia	A-/Negative/A-2	-2.0	-18.2	-3.2	-3.2
Colombia	BBB-/Negative/A-3	-2.4	-16.8	-9.0	-3.5
South Africa	BB-/Stable/B	-0.4	-17.0	-5.6	-4.2
Thailand	BBB+/Stable/A-2	-1.7	-11.0	-5.5	-4.2
Chile*	A+/Negative/A-1	-2.9	-14.7	-10.3	-4.3
Mexico	BBB/Negative/A-2	-1.0	-17.7	-7.5	-4.5
Argentina	CCC+/Stable/C	-4.1	-19.3	-8.8	-4.7
Philippines	BBB+/Stable/A-2	-5.6	-19.7	-13.2	-8.4

Note: For Chile, we use Q3 2019 as a starting point, given the dent that protests cause in Q4 2019 GDP. We then averaged out Q4 2019 and Q1 2020, and used that as Q1 2020 to smooth out the volatility. Source: Oxford Economics, Haver Analytics, and S&P Global Ratings.

Chart 5

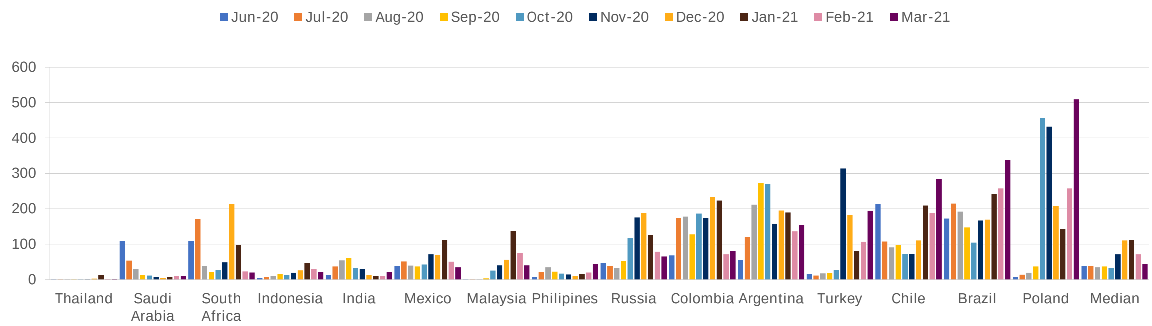
EMs' Fiscal Response To The Pandemic



Source: IMF

Chart 6

New Daily Reported COVID Cases Per Million Population (7-day moving average, end of month)



Note: Mar-21 is as of March 18. EM Median refers to EM 16 excluding China. Source: OWID.

Continued Support, Effective Vaccination Campaign, And Exposure To Favorable External Conditions

The third dynamic is essentially when we expect GDP level in a given economy to return to the pre-pandemic level (see table 4; see our macroeconomic section for more details on our assumptions). In our view, EMs that continue to have a better handle of the pandemic, especially regarding vaccinations, while providing necessary fiscal and monetary stimulus, will have an easier return to economic normalcy. Furthermore, countries with high exposure to demand from major economies where growth is picking up quickly, such as the U.S. and China, will get a stronger boost from supportive trade dynamics. As the recovery matures, laggards are likely to grow more quickly (relative to their trend growth rates) later in 2021 and early next year than leaders. The speed of recovery will then be driven by vaccine rollout, services sector reopening, and private consumption.

Getting back to pre-pandemic GDP levels first doesn't necessarily mean you end up being better off from a macroeconomic and credit perspective. Two clear examples stand out. First, Turkey, which returned to its pre-pandemic level in Q3 2020 due to a sizeable injection of credit, but imbalances have built up significantly as a result. Second, Brazil will be the first major Latin American economy to return to its pre-pandemic level, likely in early 2022, but it's getting there with serious challenges to growth, fiscal, and ultimately debt sustainability.

Table 4

EM Growth Forecast And Expected Return To Pre-Pandemic Levels

Real GDP %	Foreing Currency Rating (Mar. 26, 2021)	2019	2020	2021F	2022F	2023F	Expected Return to Pre COVID Level
China	A+/Stable/A-1	6.0	2.3	8.0	5.1	5.0	Q2 2020
Turkey	B+/Stable/B	0.9	1.8	6.1	3.0	3.0	Q3 2020
India	BBB-/Stable/A-3	4.2	-8.0	11.0	6.1	6.3	Q1 2021
Indonesia	BBB/Negative/A-2	5.0	-2.1	4.5	5.4	5.1	Q2 2021
Russia	BBB-/Stable/A-3	1.3	-3.1	3.3	2.5	2.0	Q3 2021
Poland	A-/Stable/A-2	4.6	-2.7	3.4	4.4	3.0	Q3 2021
Malaysia	A-/Negative/A-2	4.3	-5.6	6.2	5.6	5.0	Q4 2021
Thailand	BBB+/Stable/A-2	2.3	-6.1	4.2	4.5	3.6	Q4 2021
Saudi Arabia	A-/Stable/A-2	0.3	-4.1	2.0	2.7	2.2	N/A
Brazil	BB-/Stable/B	1.4	-4.4	3.4	2.5	2.4	Q1 2022
Chile	A/Stable/A-1	1.0	-6.0	5.9	3.6	3.3	Q2 2022
Colombia	BBB-/Negative/A-3	3.3	-6.8	6.0	3.5	3.3	Q2 2022
Philippines	BBB+/Stable/A-2	6.0	-9.5	7.9	7.2	7.2	Q2 2022
Mexico	BBB/Negative/A-2	0.0	-8.5	4.9	2.7	2.2	Q4 2022
South Africa	BB-/Stable/B	0.2	-7.1	3.6	2.5	1.3	Q3 2023
Argentina	CCC+/Stable/C	-2.1	-9.9	6.1	2.5	2.0	Q3 2023

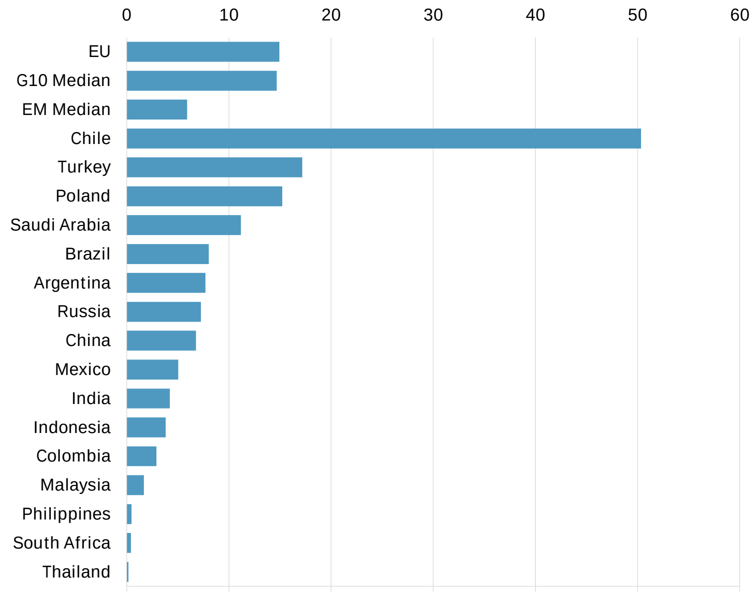
Source: S&P Global Ratings

Vaccination Programs Are Slow In Most EMs

Taking a closer look at the vaccination rollout--with some notable exceptions--progress in EM16 is sluggish. At the current pace, most countries in the sample would take a median of 2.4 years to achieve widespread immunity. Notable exceptions to get to the 70% immunization of adult population include Chile (within three months), Saudi Arabia (within 10 months), and a bit behind are Turkey (15 months) and Poland (18 months). We expect vaccinations will likely accelerate, as developed economies achieve their immunization objectives and free up doses, and more vaccines become available and production ramps up during the year. Vaccination will be key for countries with heavy dependence on the services sectors that were took a considerable hit from social-distancing measures, such as leisure and hospitality, and other tourism-related segments.

Chart 7

Total COVID-19 Vaccines Administered Per Hundred Population (as of March 26, 2021)



Source: OWID

EMs' efforts to contain the impact of pandemic have taken a toll on sovereigns' fundamentals. Since the beginning of the pandemic, S&P Global Ratings has taken negative rating actions on 8 out of the 16 key EMs covered in this sample. Most rating actions over the past months have been driven by worsening fiscal flexibility and increasing debt burden, which in most cases is the result of the government's efforts to contain the epidemic shock.

Table 5

EMs' Sovereign Ratings

Country	Foreign Currency Rating (Dec. 31, 2019)	Foreing Currency Rating (Mar. 26, 2021)
Argentina	CC/Negative/C	CCC+/Stable/C
Brazil	BB-/Positive/B	BB-/Stable/B
Chile	A+/Stable/A-1	A/Stable/A-1
China	A+/Stable/A-1	A+/Stable/A-1
Colombia	BBB-/Stable/A-3	BBB-/Negative/A-3
India	BBB-/Stable/A-3	BBB-/Stable/A-3
Indonesia	BBB/Stable/A-2	BBB/Negative/A-2
Malaysia	A-/Stable/A-2	A-/Negative/A-2
Mexico	BBB+/Negative/A-2	BBB/Negative/A-2
Philippines	BBB+/Stable/A-2	BBB+/Stable/A-2
Poland	A-/Stable/A-2	A-/Stable/A-2
Russia	BBB-/Stable/A-3	BBB-/Stable/A-3
Saudi Arabia	A-/Stable/A-2	A-/Stable/A-2
South Africa	BB/Negative/B	BB-/Stable/B
Thailand	BBB+/Positive/A-2	BBB+/Stable/A-2
Turkey	B+/Stable/B	B+/Stable/B

Source: S&P Global Ratings

Macroeconomic Conditions

Lead Economist
Emerging Markets

Tatiana Lysenko
Paris
tatiana.lysenko
@spglobal.com
+33-14-420-6748

Elijah Oliveros
New York
elijah.oliveros
@spglobal.com
+1-212-438-2228

(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.)

Improved Growth Prospects In 2021, But Several Challenges On The Radar

Brightening prospects for global growth, better-than-expected Q4 GDP performance, and in some cases, more supportive fiscal stance than we previously assumed have prompted us to lift our 2021 growth expectations for EM economies. We now expect GDP growth in the key EMs (excluding China) to average 6.4% this year, which is 50 bps higher than in our previous projection, following a 5.4% contraction in 2020. Near-term outlook for domestic activity across EMs remains soft, and tied to the pandemic's trajectory and related restrictions, which is mitigated by a resilient foreign trade. We expect growth in most EMs to accelerate as the year progresses, as vaccinations gather pace and global demand strengthens.

The 2021 outlook for global growth has improved, which should benefit EMs across all regions. Notably, we have made significant upward 2021 GDP growth revisions for the U.S. and China, which suggests a continued strength in two key sectors for EMs: manufacturing and commodities. Mexico will be the key beneficiary of stronger demand from the U.S., its major trading partner, fueled by the $1.9 trillion fiscal stimulus. And Central and Eastern European economies that are integrated into Germany's supply chains, such as Poland, will continue to benefit from strong demand for Germany's exports, especially from China.

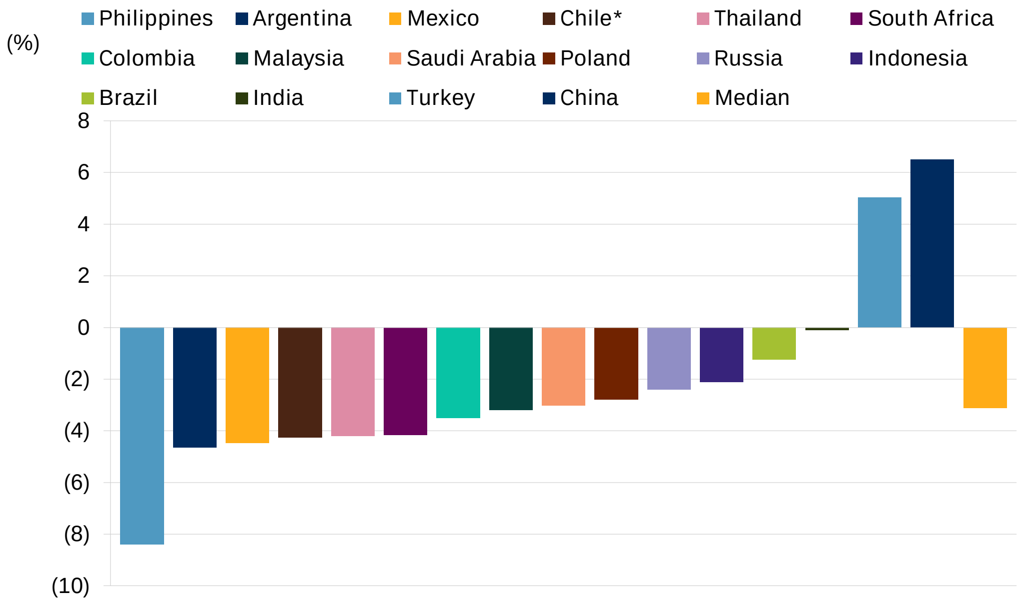
Rising commodity prices are benefiting key EM commodity exporters. Exports from key EM metals producers, such as Brazil, Chile, and South Africa should continue to perform well thanks to China's resilient demand. And if the U.S. approves a new infrastructure plan, it will provide an additional boost to metals prices. At the same time, for key EM oil exporters (Russia and Saudi Arabia), higher oil prices mean improving fiscal and current account balances, rather than higher growth in the near term.

The outlook for international tourism remains uncertain amid a slow reopening of the borders and the recent resurgence of infections in Europe and some EMs. We continue to expect only a very gradual recovery in international travel, which will weigh on the economies where tourism is an important source of employment and foreign currency revenues, such as Thailand and Turkey.

GDP growth pace in Q4 2020 was surprisingly upbeat among most EMs, with the median quarterly annualized growth rate at 12.5%. In comparison, in the G10, the median growth rate was 1.3%. The reason for stronger-than-expected growth in EMs varies by country, but in many cases, it was due to continued resilience in manufacturing and commodities, and in other cases, it had to do with an improvement in services as lockdowns were relaxed during that period, or additional stimulus. The bottom line is that the spillover from Q4 growth into 2021 is substantial for most EMs.

Chart 8

GDP Level In Q4 2020 Versus Its Pre-Pandemic Level (Q4 2019)



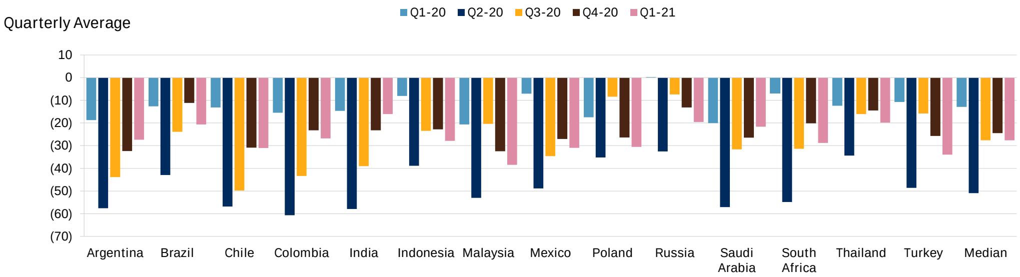
Note: For Chile, we use Q3 2019 as a starting point, given the considerable dent that protests had on Q4 2019 GDP. We then averaged out Q4 2019 and Q1 2020, and used that as the Q1 2020 value to smoothen out the volatility. Source: Haver Analytics and S&P Global Ratings.

The resurgence of daily infections across several EMs at the onset of 2021, which in many cases was followed by a re-imposition of social-distancing measures and a decline in mobility indicators (see chart), means that Q1 GDP growth is likely to be softer than in Q4 for most EMs. And in some cases, output may contract versus the previous quarter. However, we expect activity to pick up more noticeably in Q2 and afterwards, as some of the Q1 lockdown measures are relaxed, and the vaccination rollout expands in some EMs, giving more confidence to governments and populations to continue normalizing activity. The vaccination progress across EMs varies widely, with Chile fast approaching half of its population receiving at least one dose of the vaccine, but many EMs still stuck at 5% or below.

Progress in reaching high levels of vaccination will be important in determining how quickly some of the services sectors that were more affected by social distancing measures will open up, such as leisure and hospitality. We generally expect vaccination progress in most EMs to lag those in advanced economies, either due to logistical, supply, or in some cases, acceptance issues.

Chart 9

Mobility Index, Seven-Day Moving Average Deviation From Pre-Pandemic Levels



Notes: The index is an equally weighted index of retail and recreation, transit, and workplaces. The baseline is the median value, for the corresponding day of the week, during the 5-week period Jan. 3 – Feb. 6, 2020. Q1-2021 is as of March 26. Source: Google LLC "Google COVID-19 Community Mobility Reports" and S&P Global Ratings.

Major positive contribution to this year's EM GDP growth forecast upgrade comes from India, reflecting our upward growth revision to 11% from 10%, due to faster-than-expected reopening of the economy and fiscal stimulus. At the same time, in the rest of EM Asia, challenges in containing the pandemic and smaller stimulus have pushed back the recovery to later this year. In EM EMEA, Turkey's growth proved to be more resilient to the tightening of monetary policy and adverse pandemic developments, and strong carryover has prompted our forecast revision to a 6.1% GDP growth this year. However, the risks to Turkey's macroeconomic outlook have risen, following the surprise central bank leadership changes that led to a negative reaction in financial markets. We revised our 2021 GDP growth forecast for LatAm up by just shy of 1 pp. to 4.5%, thanks to a better-than-expected performance in Q4 and tailwinds from stronger global GDP growth. However, structural weakness, especially in terms of investment, will still mean that the region will be among the last in EMs to return to its pre-pandemic GDP level (most probably by mid-2022).

Despite the improved 2021 outlook, several notable risks are on the horizon, some of which are short term and others long term. The recent increase in energy prices, combined with stronger demand-side pressure on prices--and in some cases, weaker currencies—are eroding the near-term inflation outlook. Therefore, pressure is building for several EMs to start raising their currently record-low interest rates. Some, such as Brazil, Russia, and Turkey, have already done so. In EM Asia, core inflation is low (apart from India), and we expect most central banks in the region to keep rates on hold this year, but see several Latin American economies starting to tighten. Overall, the risk is skewed towards tighter, rather than looser, domestic financial conditions. Given the impact of the recent increase in long-term U.S. treasury yields on EMs, so far the adjustments have been generally orderly for most countries, because it has been accompanied by higher global growth expectations, a dynamic that's beneficial for EMs. As long as the trend of rising long-term U.S. yields is one of an orderly reflation, we expect EM credits, especially the higher quality ones to continue to adjust in an orderly fashion. However, even in an optimistic scenario, some economies might have a more challenging time adjusting to higher U.S. yields, especially those whose external and fiscal imbalances worsened recently. On the fiscal side, South Africa and Brazil stand out, while Turkey's already significant external vulnerabilities have increased further.

Moving away from the more immediate-term risks, restoring the destruction to investment and employment done by the pandemic, especially in countries where stimulus measures were limited, could be a long and painful process. This could slow the post-pandemic recovery, but it could also result in unfavorable social and political dynamics, as the businesses and jobs lost during the pandemic tended to be smaller firms and lower-income employment. In this sense, many EMs will exit the pandemic with a lower number of small and medium enterprises and higher inequality among the working population.

Table 6

Real GDP Growth (%)

	2019	2020	2021F	2022F	2023F	2024F
LatAm	0.7	-6.6	4.5	2.7	2.4	2.3
EM-EMEA	1.4	-2.5	3.7	2.9	2.3	2.3
EM-Asia	5.3	-1.3	8.3	5.4	5.3	5.2
EM-16	4.0	-2.1	7.1	4.7	4.5	4.4
EM-14	2.0	-4.3	4.4	3.6	3.1	3.1
EM Ex. China	2.6	-5.4	6.4	4.3	4.1	4.1

Source: Oxford Economics; F--S&P Global Ratings forecast. Note: GDP aggregates are based on GDP PPP Weights. EM-14 excludes China and India.

Table 7

Real GDP Changes From November Baseline, Percentage Points

	2020	2021f	2022f
LatAm	0.7	0.8	-0.3
EM-EMEA	1.0	0.6	-0.1
EM-Asia	0.4	0.7	0.1
EM-16	0.5	0.7	0.0
EM-14	0.6	0.2	-0.1
EM Ex. China	0.7	0.5	0.0

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

Financing Conditions

Primary contact

Sudeep Kesh
New York
sudeep.kesh
@spglobal.com
+1-212-438-7982

Xu Han
New York
xu.han@spglobal.com
+1-212-438-1491

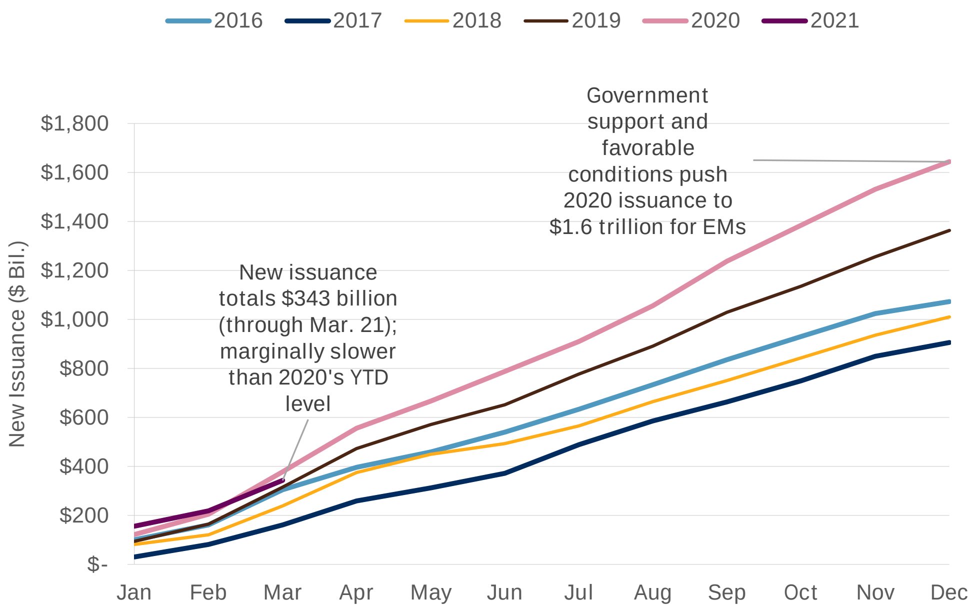
Vince Conti
Singapore
Vincent.conti@spglobal.com
+65 6216 1188

Investor Appetite For EMs Remains Strong

EMs continue to generate strong investor demand for fixed income instruments, particularly amid few low-risk alternatives. This comes as investors seek to diversify their strategy to boost yields. Such demand has resulted in $343 billion of new debt issuances in EMs, just below the pace of 2020 pre-pandemic level and above the year-to-date issuance in the past five years.

Chart 10

EMs' Corporate Debt Growth Marginally Slower Than 2020 Pre-Pandemic Pace



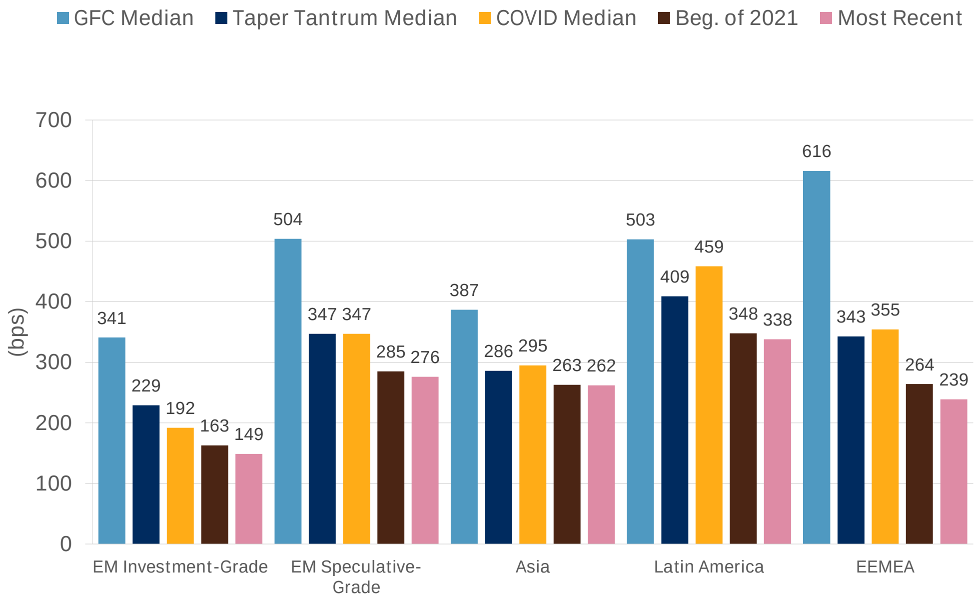
Data as of March 21, 2021. Source: S&P Global Ratings and Refinitiv.

Spreads remain tight compared to prior crises' norms, including the Global Financial Crisis, Taper Tantrum (2013), and the recent COVID-19 pandemic period. This is in no small part due to extraordinary support from major central banks, boosting market confidence in a number of key parts of the credit spectrum. Even as the market begins to reprice the U.S. yield curve, the economic recovery and continued generally loose stance of policymakers are keeping risk premia broadly stable. The risk for a disorderly repricing can't be discounted, but our base-case scenario retains that some yield curve normalization is healthy.

Regionally, LatAm credit spreads remain the widest among those in EMs, owing to particular vulnerabilities in Brazil's debt markets, which were worsening well before, and exacerbated by, the COVID-19 pandemic. Recent defaults in China also curbed otherwise healthy demand for new bonds, leading to markets differentiating between state-owned entities (SOEs; affected local ones versus those which are not, as well as the central government SOEs). These defaults, along with the risks of a delay in ending the pandemic in Southeast Asia, have led to slightly wider yield spreads more broadly in APAC compared to the end of last year.

Chart 11

Exceptionally Tight Spreads EMs May Bely Underlying Fragility In Investor Confidence

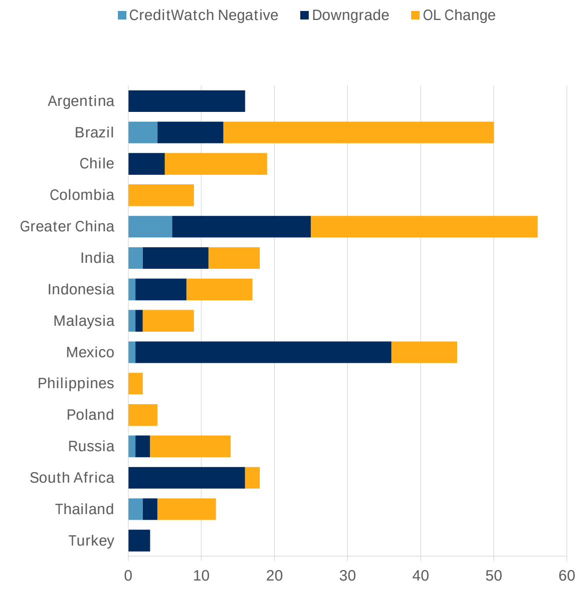


Data as of March 17, 2021. Source: S&P Global Ratings, Federal Reserve Bank of St. Louis, and Bank of America Merrill Lynch.

Sector Trends

Chart 12

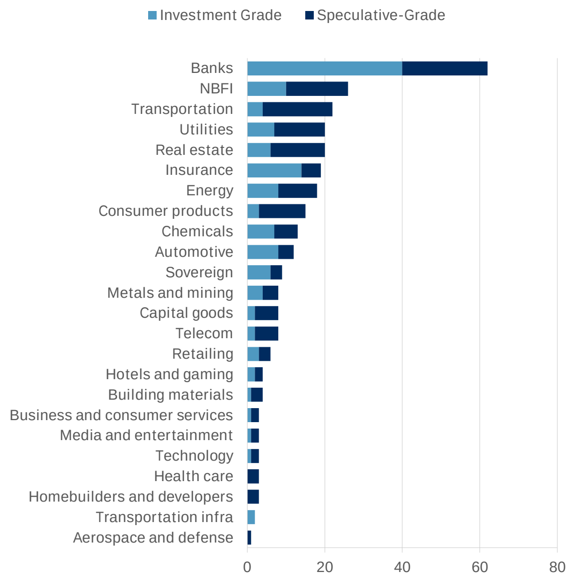
COVID-19 And Oil Related Rating Actions In EMs



Source: S&P Global Ratings. Data as of Feb. 22, 2021.

Chart 13

COVID-19 Related Ratings Actions In EMs By Sector



Source: S&P Global Ratings. Data as of Feb. 22, 2021.

Sovereigns

Primary contact

Joydeep Mukherji
New York
joydeep.mukherji
@spglobal.com
+1-212-438-7351

Frank Gill
Madrid
frank.gill
@spglobal.com
+34-91-788-7213

KimEng Tan
Singapore
kimeng.tan
@spglobal.com
+65-6239-6350

EM Asia

Risks To A Goldilocks Recovery Multiply

Supply and logistical risks to export recovery have increased. A shortage of semiconductor chips and delays in moving shipping containers back to Asia have disrupted production and raised transport costs for manufacturers in the region.

Global interest rates and commodity prices have picked up. Improving economic outlook has caused interest rates to rise in some economies. Together with supply reasons in some cases, optimism over the economic recovery has also contributed to increasing energy and non-energy commodity prices.

Widespread rebound in COVID-19 infections. If future mutations of the virus result in the rapid spread of strains of the disease that can't be controlled by existing vaccines, infection rates may rebound quickly again. This could prolong the pandemic and considerably weaken sovereign credit metrics in the region.

Sudden capital swings. A sharp deterioration in investor sentiment in EMs could result in swift capital outflows from some economies. This could happen if recent investor concerns about a rebound in inflation result in further rise in interest rates in the developed economies. In lower-rated sovereigns that are dependent on imported sources of energy, higher oil prices may weaken their external balances and exacerbate capital outflows. EM countries where governments have eased domestic funding conditions to spur debt growth are likely to be affected more in a negative scenario.

Sluggish export recovery may put pressures on growth and fiscal recovery. The rising component and commodity prices, as well as shipping costs, may slow recovery of exports in some economies. If these supply trends continue to linger later into the year, the pressures on Asian manufacturers may be intensified by weaker demand as government support for their economies are withdrawn. Economic growth and fiscal revenue recovery in Asian economies may weaken as a result. In China, this could accelerate credit growth if economic or labor market pressures mount. Growing financial instability risks limit China's sovereign credit support capacity, implicating regional sovereigns.

LatAm

Returning To GDP Growth Remains Critical For Sovereign Creditworthiness

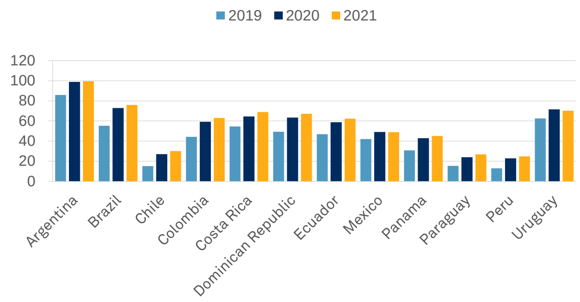
We downgraded 11 regional sovereigns in 2020 and currently have 9 negative outlooks among the 28 Latin American and Caribbean sovereigns, a higher share than in other regions. The negative rating actions reflect rising sovereign debt, weaker external positions (due largely to growing external debt), poor GDP growth prospects, and potential revision of our assessments of institutional assessments to weaker categories.

S&P Global Ratings projects that the gross commercial borrowing of 28 regional sovereigns that it rates in LatAm (excluding Venezuela) will reach $458 billion in 2021 (or 10.3% of regional GDP), down 5% from the 2020 peak (11.6% of GDP). The high borrowing is shown in rising net general government debt as a share of GDP (see chart 14), which is likely to continue rising this year in most countries. Moreover, the region as a whole has a higher share of sovereign debt denominated in foreign currency compared with other regions of the world, creating a vulnerability to adverse changes in the exchange rate. However, most of the gross borrowing by Brazil, Mexico, Colombia, and Chile will be done in the domestic markets in domestic currencies, mitigating the risk.

Many sovereigns also face a sharp rise in interest expenses in line with a higher debt stock (see chart 15). However, low global interest rates has limited the increase in the interest burden in some countries, providing relief in the near term.

Chart 14

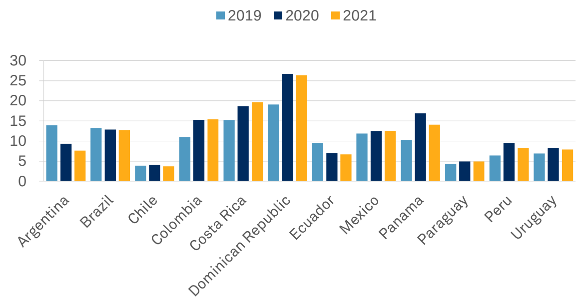
Net General Government Debt (% Of GDP)



Source: S&P Global Ratings

Chart 15

General Government Interest Paid / Revenues (%)



Source: S&P Global Ratings

The long-term impact of rising sovereign debt depends on, among other things, the cost of funding (which partly reflects the risk of inflation), the rate of economic growth, and the government's budget balance excluding interest payments. The region's economic growth was low before the pandemic and may remain modest in the next couple of years. We currently apply a negative adjustment for poor long-term GDP growth to our economic risk assessment for 14 regional sovereigns. Returning to GDP growth remains critical for sovereign creditworthiness due to its positive effects on public finances (especially tax revenue), social stability, and the overall health of the financial and corporate sectors.

Our negative outlook on Mexico reflects fiscal risks, potential contingent liabilities posed by the national oil company, Pemex, and a narrow non-oil tax base. Mexico's rating trajectory is linked with the government's ability to spur faster growth and widen its non-oil tax base, potentially with tax reforms after mid-term elections in June 2021. Similarly, our negative outlook on Colombia reflects concerns about the government's ability to stabilize and reverse the recent rise in its debt burden, which has worsened the country's financial profile. The pace of economic recovery, fiscal policy correction, and passage of ambitious structural reforms (such as recently approved central bank autonomy and a fiscal reform dealing largely with budgetary rules and procedures) will play a key role in the trajectory of Brazil's rating that has a stable outlook.

EM EMEA

What Does The Misery Index Say About Secular Stagnation In EMs?

Perhaps the defining feature of an EM economy is its higher growth potential. The multipliers to GDP growth from investment in infrastructure, transportation, and human capital should be far greater in EM economies than among their developed peers. Therefore, it's with concern that we can cite an increasing evidence of secular stagnation across much of EM EMEA sovereigns. This, more than the near-term shock from a global pandemic, is the key risk for many lower-income EM sovereigns in EMEA.

How can we measure secular stagnation in EMs? One way is to calculate a country's Misery Index (MI), which is the sum of a country's rate of unemployment and inflation. A persistently high MI suggests that formal labor markets are not functioning (which is also a fiscal problem), and that an economy is suffering from a more generalized lack of competitiveness. Indeed, limited competitiveness is probably the biggest threat to a buoyant EM recovery (outside of Asia) for the next 10 years.

Table 8

Top 10 EM EMEA Economies By Misery Index

Country	2019	2020F
Lebanon	53	90
Congo, D.R.	54	62
Angola	52	60
Nigeria	51	55
South Africa	33	33
Turkey	29	30
Iraq	25	28
Rwanda	18	27
Uzbekistan	24	26
Zambia	22	25

Source: S&P Global Ratings

While the pandemic has clearly exacerbated the situation, the trend of rising MIs in EM EMEA pre-dates 2020. The inclusion of low-income economies such as Angola and Nigeria among EMs with the highest MIs is partly a reflection of higher levels of informality in Sub-Saharan Africa labor markets. Nevertheless, it's difficult not to worry about limited growth potential (despite high population growth) in oil-dominant economies in Sub-Saharan Africa. In addition, the cost of oil production in Nigeria and Angola is close to three times that of lower-cost producers in the Gulf Cooperation Council. Therefore, the longer-term shift away from hydrocarbons is a medium-term constraint on growth among higher cost producers. The bigger challenge is to put into place reforms (including in the business environment, judiciary, and rule of law) so as to move away from capital-intensive oil-driven growth and to kick start a more labor intensive domestic economy, similar to what Kenya has done. Neither Nigeria (the largest economy in Africa) nor Angola has been able to do this, but their fiscal and broader economic health will depend on doing so.

The appearance of South Africa (the third largest economy on the continent) on the list of top 10 MIs in EMEA is perhaps unsurprising, given the steady decline in investment/GDP from around 21% in 2015 to 18% in 2019 (and an estimated 14.6% last year). This is because the domestic corporate sector has preferred to invest abroad rather than domestically. A mature mining sector, a dysfunctional labor market (with unemployment having averaged 28% in the last decade), and considerable impediments to competition, due to high concentration in sectors such as retail and banking, explain the absence of dynamism in the South African economy. Among variables that stand out, South Africa has a weak track record of creating new companies (and the high failure rate of SMEs). The country's subpar growth performance has contributed to its very difficult fiscal predicament, with fiscal flexibility extremely constrained at this point, after the deterioration in the budgetary position (fiscal year 20/21) to close to 16% of GDP.

Finally, Turkey is the only OECD member on this list. Turkey's MI has increased 11.3 ppts since 2018. In contrast to Sub-Saharan Africa, this is less a judgement on the competitiveness of Turkey's economy or the functioning of its labor markets. Rather, the persistent rise in inflation and unemployment in Turkey since 2017 reflects the government's consistent prioritization of credit-driven growth over macroeconomic stability. In the last decade, whenever the pace of largely foreign financed credit growth has exceeded 20% in Turkey, the current account deficit has widened sharply. Over time, this has eroded Turkey's net external stock position, and made its financial system highly reliant upon access to foreign capital markets. In 2020, credit growth averaged 36%. With a weak external position, the Turkish economy remains heavily dependent on foreign capital markets to refinance bank debt, and to rebuild depleted reserve buffers. The sacking of Central Bank Governor Naci Agbal on March 20, in our view, has to be interpreted as a repudiation of inflation targeting, and a continuation of boom-bust policies, which have led to increased dollarization of the economy, particularly in the past three years.

Corporations

Primary contact

Diego Ocampo
Buenos Aires
diego.ocampo@spglobal.com
+55-11-3039-9769

Xavier Jean
Singapore
xavier.jeanz@spglobal.com
+65-6239-6346

Timucin Engin
Dubai
timucin.engin@spglobal.com
+90-530-681-7943

EM Asia

The Pace Of Recovery Varies Among Countries

Credit conditions for rated corporate issuers in EM Asia are far from stabilized. About one-fourth of ratings of investment-grade issuers and almost one-third of speculative-grade issuers still have a negative outlooks or on CreditWatch with negative implications as of March 15, 2021. Compared with six months ago, downside rating risk is falling in China (slightly below 20% of issuer ratings on negative outlook) and in India (about 25%) as both economies have recovered somewhat faster than elsewhere in the region and funding conditions mildly improved even for smaller issuers. Indonesian corporate issuers are at the other end of the spectrum, with about half of outstanding ratings with a negative outlook. Recovery prospects for 2021 are more elusive amid rising COVID-19 cases, a slow vaccine rollout, subdued consumer sentiment, and selective funding by banks. More defaults or restructurings in 2021 are likely after numerous such events in 2020 among private and state-owned entities.

Access to funding is likely to remain a major credit differentiator in EM Asia in 2021. Capital market and bank funding has been ample (and sometimes at all-time lows) for the larger, investment-grade, or more diversified issuers. At the same time, signs are emerging that funding is becoming available once again for some segments. First, for smaller, more leveraged issuers, notably Chinese real estate developers (despite generally expensive and short tenors). Second, for weaker companies in Indonesia, which credit access remained mostly closed for most of 2020. Still, funding from domestic banks is likely to stay selective and potentially even tighten as debt moratoria have ended or are set to end in Malaysia, China, Thailand, Indonesia, and India through 2022.

Operating Conditions In China Are Gaining Steam

Operating conditions are picking up in China across most sectors as new COVID-19 cases are under control and amid the vaccination rollout. China's GDP grew 2.3% in 2020, slightly better than our forecast of 2.1%. Our economists now project a GDP growth of 7% for 2021. We project median EBITDA growth for Chinese corporations to be as high as 12% in 2021, at the higher end of our previous 5%-10% forecast. However, our 2021 debt growth forecast of 6% is also above our initial expectation of 5%. We maintain our view that the credit metrics of most Chinese rated companies will return to their 2019 levels by the end of 2021.

The negative rating bias of rated companies in China has slipped amid improving operating conditions. About 20% of corporate ratings have a negative outlook or on CreditWatch negative, compared with close to 25% six months ago. The negative rating bias is among the lowest in APAC, though like elsewhere in the region, rising debt levels will delay the recovery in credit quality of sectors such as homebuilders, capital goods, consumer discretionary, technology, autos, oil and gas, and chemical, to 2022 and beyond.

Funding conditions remain as polarized as elsewhere in EM Asia, even though the access of smaller issuers, especially in the sizable real estate development sector, appears to be better than elsewhere in the region. The onshore bond market is unlikely to remain as favorable as last year. The Chinese central bank's potential financing target for 2021 is likely to slow funding growth of the overall economy. With record-high debt in the country, the regulators aim to maintain a balance between real economic growth and potential systemic risk--a task made more challenging by the looming maturity wall for domestic issuers. More than RMB8 trillion in onshore bonds and nearly $100 billion in offshore bonds are coming due this year. Such a large refinancing need may raise funding costs or tighten access to funding, particularly for lower-rated corporations, such as those rated in the 'B' category and below, which account for nearly a quarter of all Chinese offshore corporate issuers.

SOEs and Local Government Funding Vehicles (LGFVs) are segments of China's credit market that are likely to stay in the credit spotlight in 2021, following high-profile defaults in 2020. We believe more defaults of SOEs are likely, as the Chinese authorities refocus on managing the financial risk of such entities after the pandemic. We estimate that the LGFV sector faces a sizable RMB2.7 trillion maturity wall in the onshore bond market in 2021, at a time of restrictions on structured issuance and limited access to wealth management products as a funding source. The local governments ability to provide support has been weakening under increasingly stringent central government regulations and the economic slowdown since 2018, with increasingly selective support to the most important SOEs. At the same time, unsustainable debt burdens of some SOEs may incentivize more in-court debt restructurings, which could allow local governments to continue operations and maintain employment while often leading to significant losses for investors.

Fragile Credit Conditions, Tight Funding In Indonesia To Remain Through 2022

Indonesian rated companies' credit metrics are likely to recover to pre-pandemic levels in the second half of 2022. That's six to 12 months later than in other countries in EM Asia. COVID-19 cases in Indonesia haven't yet stabilized, despite a vaccine rollout and an ambitious plan to vaccinate two-thirds of the population by the end of 2021. The logistical challenges of comprehensive vaccination are large in a country such as Indonesia, given the geography, infrastructure, and administrative capabilities. We don't think consumer confidence is likely to stabilize or improve unless new cases sharply slow down and consumers have the impression that the pandemic is under control.

The Indonesian corporate sector has the highest negative rating bias in the region, with nearly 50% of outstanding ratings with a negative outlook or on CreditWatch negative. Tight liquidity or refinancing risk is the underlying reason for nearly half of the negative outlooks, followed by sovereign risk (about one-third), and leverage. Our projections still indicate that credit metrics of nearly 40% of rated corporate issuers will be weaker in 2022 than in 2019, despite our current forecast of an about a 10% increase in profits among rated companies in 2021 from 2020. Nearly one-third of our ratings on Indonesian companies are in the 'B-' and 'CCC' categories, which indicate that more defaults or debt restructuring are likely in 2021.

Indonesian SOEs, like their Chinese counterparts, are likely to remain under the credit spotlight in 2021. We expect more debt restructurings or defaults among smaller entities, given that government support is turning increasingly selective and leverage keeps growing. We had revised our expectations of government support to SOEs in early 2020 amid a growing number of defaults or restructurings among these entities and the government's lessening ability to provide a blanket support to its most leveraged SOEs regardless of their policy roles. We see no likelihood that the government will move away from the more selective stance in 2021 despite rising defaults, as it prioritizes vaccine rollout and support to the wider economy.

A Faster-Than-Expected Recovery In India

The Indian economy is on track to recover in fiscal 2021. Economic revival and gaining control over the pandemic should spur demand. The recovery in the Indian economy strengthened in the third quarter of fiscal 2021 (October to December 2020), with demand for rated companies in the passenger vehicle, power, and ports segments above the 2019 levels. COVID-19 cases remain high in India, but they are far from the peak. Local containment efforts have replaced nationwide lockdowns, limiting economic costs. The vaccination campaign has started despite some concerns on efficacy. Recovery in demand has been sharper than we expected, thanks to a rebound in economic activities and a sharp increase in commodity prices. Labor and supply bottlenecks due to the sudden and unexpected lockdowns in March 2020 have now been largely resolved.

We project profits in fiscal 2021 to be stronger than in fiscal 2020 for the large majority of rated nonfinancial issuers in India. The biggest swing in earnings estimates are among commodity related entities (steel, metals, and oil and gas). The auto sector's performance has been surprisingly robust, given changes in consumer choices. For example, a preference for personal transportation for health-safety reasons have helped spur demand in the sector. Sectors that we expected to remain resilient such as telecoms, pharmaceuticals, and IT services have performed as expected. The switch to local containment measures from nationwide ones is has rejuvenated demand and removed supply bottlenecks and labor shortages, bolstering recovery in power and infrastructure use, especially ports and roadways.

Improving demand prospects have reduced the negative bias of the rated corporate and infrastructure sector. About one-quarter of outlooks on Indian corporations are now negative, down from a peak of about 37% during mid-2020. The residual negative bias implies that sustained earnings recovery will help ratings to stabilize. A resumption in capital expenditures is also worth watching, especially if earnings remain strong. However, we see capital spending as less of a risk to ratings than a reversal in earnings.

EM EMEA

Taxes Could Undermine Favorable Prospects For Russian Corporations

Russian top-tier industrial entities have largely returned to business-as-usual mode, given that pandemic restrictions have been significantly relaxed in the country. We expect 2021 to be a strong year for Russia's largest commodity exporters, because both oil and metals prices are very supportive. Even for oil producers, which still have to cap their production due to OPEC-driven cuts, a combination of higher oil and gas prices and a weak ruble should help credit metrics to recover. Consumer-driven sectors continue to be under more pressure and largely follow global EM trends, but the situation in Russia is further exacerbated by the falling disposable incomes even prior to the pandemic.

Another major risk for Russian companies is the potential increase in various taxes, which the government could implement to manage its near-term fiscal goals. This, alongside with expectation of weak economic growth, is behind our forecast of modest investments in 2021. Only a few large government-backed projects were funded over the past 12 months, while private sector remains generally cautious with allocating budgets towards domestic-focused projects.

Still, overall debt levels of Russian large and mid-size corporations remain conservative compared with their counterparts in other EMs, while the pandemic didn't cause any meaningful deterioration of their credit quality. The increasing geopolitical tensions between Russia and the Western countries remain the top risk for Russian corporations. However, the range of outcomes on that front is so wide, that it's impossible at this stage to take a view on which companies might be immediately impacted and the magnitude of such an impact. We currently don't believe that sanctions will target individual companies, but rather the government, which will have an indirect impact on the corporate issuers.

Recovery Of Saudi Corporations Will Take Time Despite Stronger Oil Prices

Despite stronger oil prices, we expect the broad-based pressures to largely remain in place in 2021. We expect that the kingdom's population contracted about 2.8% in 2020 amid rising unemployment and we don’t foresee a noticeable recovery this year. In 2020, Saudi Arabia tripled the value-added tax rate to 15% from 5%, along with higher import fees on a large range of products to support the government budget. These measures came at a time when the economy, disposable income, and consumer demand were already under pressure. We expect the effect to reverberate in 2021 (please see "GCC Corporate And Infrastructure Outlook 2021: Proceeding With Caution," published Feb. 2, 2021). Therefore, we expect a slow and gradual corporate recovery. We expect the aviation, non-food retail, and tourism and hospitality sectors to remain under considerable pressure given the impact of pandemic-related restrictions. While stronger oil prices are beneficial, we still expect a longer recovery for the companies in the oil field services, because we expect the national oil companies in Saudi Arabia and the larger GCC region to focus on cost optimization and capital expenditure management.

A Turnaround Among Turkish Export-Based Sectors And Companies

The pandemic-induced economic shock took a toll on revenue of most export-oriented companies and sectors in 2020. However, some parts of the domestic market such as sales of consumer durables, auto sales, and national housing prices had a very strong year on the back of credit fueled demand. For an example, domestic sales of refrigerators (in units) were up 17.4%, while export sales were down 6.7% in 2020. Given the major change in the central bank's monetary policy in the last quarter of 2020, and our expectations for a much slower credit growth this year, we expect a slowdown in consumer sectors, while we expect visibly stronger performance among the exporting sectors and companies. While the Turkish corporations will need to absorb higher domestic currency funding costs given the central bank's rate hikes since November, the volatility and fragility of Turkish lira remains a risk.

2020 was a very hard year for aviation and tourism, and companies catering to these sectors, given that international visitor numbers plummeted about 70%. While we expect some recovery in tourism this year, it will probably be very gradual, and the numbers should remain well below the 2019 figures.

South African Corporations On Track for Recovery, But Subject To Setbacks

There have been no rating actions on South Africa-based corporations in 2021 to date, primarily because most issuers' credit metrics remain largely in line with our forecasts in 2020. Around 36% of South African issuer ratings have a negative outlook, and 50% have stable outlooks. Notably, some companies' reported results have been slightly above our expectations. Miners' windfall earnings from record-high commodity prices (especially gold and platinum group metals) compensated for pandemic-related operational disruptions, and cash flows have largely been earmarked for a deleveraging, cash-funded growth capex, and dividends. Telecoms' earnings have remained solid despite COVID-19. Benefits from rising demand for voice, data, and mobile money services (given reduced mobility and work-from-home requirements) have largely offset the affordability stress and lower earnings from IT services and the SME customer cohort. The sectors that were most exposed to COVID-19 stress (chemicals, oil and gas, retail, and transportation), were able to generate cash flows thanks to tight cost and working capital management, capex cuts and in some cases swiftly-executed asset disposals.

Funding conditions have typically been supportive for large corporations, with South African and foreign banks taking a pragmatic approach. Covenant lifts or suspensions have been commonplace, and we're starting to see an increase in public debt issuance in domestic and global markets to refinance upcoming maturities.

The recovery trajectory from COVID-19 in South Africa is largely tracking the broader EM trend (noting that many domestic corporations have significant operations outside South Africa, in developing and developed markets). However, a muted economic recovery, slow vaccination rollout, and persistent South African rand volatility and affordability stress imply that the recovery trajectory for domestically focused corporations may lag that of global peers.

LatAm

A Slow Vaccination Program Is The Largest Barrier For Regional Corporations

We see favorable credit conditions for the regional corporate sector, and we expect financing activity to remain strong throughout the rest of the first half of the year. The Fed's guidance to maintaining the reference rate unchanged and brightening growth prospects for the global economy are keeping credit spreads at historically low levels. Also, high market liquidity and rising investor appetite towards the region should continue to drive affordable funding, particularly for debt refinancing. We continue to monitor closely entities in the lower end of our rating spectrum because heightened economic or political risks can always change abruptly investor sentiment and capital availability.

At this time, the pace of recovery in LatAm remains uneven across countries and sectors. Pandemic risks persist due to a generally slow rollout of vaccination programs, as well as social-distancing fatigue that's driving the population in large urban centers to relax sanitation safeguards. Only a few weeks ago countries like Brazil, Colombia, Argentina, and Mexico saw record highs of new daily COVID-19 cases, which we believe will dent corporate earnings in the early months of this year.

The upward correction of various commodity prices has improved growth prospects for several players in the metals, mining, protein, and agribusiness sectors. For other commodities, such as oil and gas, we don't see full recovery from the 2020 drop until 2023, despite the recent uptick in crude oil prices that are benefitting from improving global supply-demand fundamentals. While we've recently revised upward our price deck assumptions for oil and gas, further upside potential for prices could be constrained in the medium term by the energy transition. Therefore, marginal increases in prices and production volumes wouldn't bring sizable improvements to financial performance in the next 24 months.

The highest risk exposure remains for sectors that rely on close human interaction. Restaurants, transportation (including airlines), gaming, and leisure continue to suffer from the abrupt decline in demand a year ago, which wouldn't recover until immunization programs across the region and around the world enable socializing and mass interactions. We maintain our view that demand in these sectors will return to pre-pandemic levels after 2023.

Financial Services

EM Asia

Economic Recovery Should Lessen Stress On Banks

COVID-19 will continue to dominate the credit conditions of EM Asian banks in 2021. S&P Global Ratings believes strengthening macroeconomic conditions should limit the downside credit risks. Resumption of economic activity, government support measures, and buoyant liquidity are helping to reduce strains. Banks' recovery will likely be drawn out, hinging on domestic economic growth and vaccine rollouts. We expect banks to extend debt moratoriums in many EMs, spreading out credit costs over several years. Deferred loans will likely be largely resolved by 2023 only.

NPL Pressure Prevails, Though Forbearance Will Delay Recognition

We expect NPLs to be elevated over the next couple of years as the banks recognize the borrowers facing financial difficulties from COVID-19 with a lag. Credit costs are unlikely to be as high as initially feared in most markets, given that the governments stepped in to provide support to the SME borrowers. Indian banks have the weakest asset quality, with close to 9% NPLs. Thai and Philippine banks' NPLs are also likely to rise sharply to about 6% in 2021. Chinese commercial banks reported NPLs will rise only marginally to about 2% in 2021, though overall weak loans are higher at 5.4%.

Large conglomerates are better placed to weather the storm thanks to their strong business positions and wide access to liquidity. However, demand recovery is uneven, and we expect certain sectors to remain stressed. Slippage is likely in the most vulnerable sectors, such as transportation, restaurants, hotels, entertainment and recreation, and retail. Overall, banks' exposure to these sectors appears manageable. Thai banks have a relatively higher exposure to tourism-related sectors, with restaurants, hotels, and transportation accounting for 5.7% of the banks' loan book, while the SME exposure is half of this. Chinese banks are likely to see some pressure from defaults among SOEs.

High level of forbearance that the regulators provided masks the true extent of weak loans in EM Asia. Temporary relief measures will prop up borrowers' liquidity. These measures won't eliminate risks for weaker and more vulnerable debtors, though recognition of problem loans will be delayed. Loans under moratorium have declined in most markets as the strict lockdowns ended. Thailand, Indonesia, Malaysia, and the Philippines have 10%-20% of loans under moratoriums, or as restructured loans, as of December 2020, while this metric is 3% for India and 3.5% for China.

Steps that the governments and central banks took to cushion the effect of the economic crisis have helped ease the stress on bank balance sheets. Government initiatives, such as emergency credit guarantee scheme for SMEs in India, Indonesia, and the Philippines, along with partial guarantee scheme for nonbank financial companies in India, have alleviated system stress. Thai government has also provided various measures to assist troubled SMEs including tax relief, soft loans with concessional interest rate and partial guarantee, and repayment holiday.

We expect banks' earnings to gradually recover in the next two years as margin and credit cost pressures abate. Most banks reported lower profits for 2020 than in 2019 due to a surge in provisioning costs, subdued credit growth, and in some markets, narrower net interest margins.

Primary contact

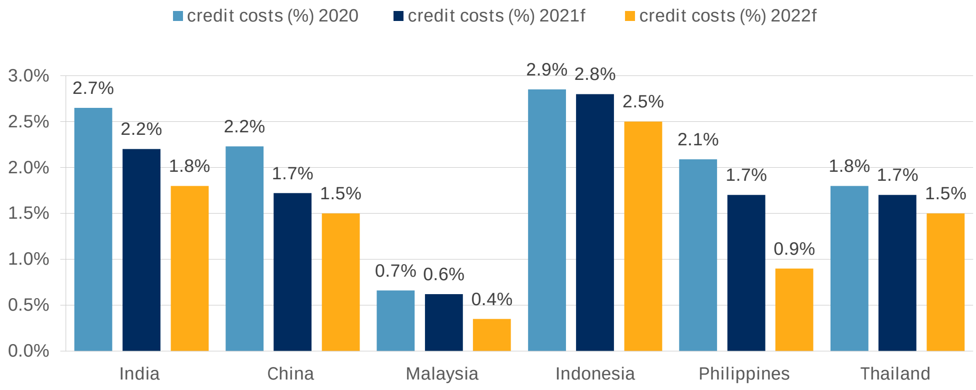
Geeta Chugh
Mumbai
geeta.chugh@spglobal.com
+91-992-0363-303

Cynthia Cohen Freue
Buenos Aires
cynthia.cohenfreue@spglobal.com
+54-11-4891-2161

Mohamed Damak
Dubai
mohamed.damak@spglobal.com
+971-4372-7153

Chart 16

Credit Costs To Remain High For EM Asian Banks



Source: S&P Global Ratings

Banks Have Built Up Capital Buffers To Prepare For Loan Defaults

Banks have raised provisioning covers. Chinese commercial banks have maintained robust levels of reserves over reported NPLs, and in our view, this is likely to remain well above 150% for the next two to three years. Indian banks, once laggards in raising provisions, have reversed course and ramped up reserves to more than 70% of their reported NPLs. We believe the sufficient capital buffers and adequate provisioning for stressed loans provide a cushion against downside risks in Malaysia, the Philippines, Thailand, and Indonesia.

India's banks are also building capital buffers to deal with the COVID crunch. Both private- and public-sector banks have been raising capital (including hybrid debt instruments) from the market to strengthen their balance sheets. The Indian government has also announced its intention to inject INR400 billion in capital into public-sector banks this year and next.

Liquidity Remains Buoyant

Most EM banks remain with abundant liquidity due to a slowdown in lending growth and deposit build-up from 2020, while deposit growth in China generally kept up with faster loan growth due to monetary loosening to support the real economy.

Shape Of Recovery

We expect recovery to be uneven, with China's banks likely to recover to pre-pandemic levels by 2022, while those in Indonesia and the Philippines will do so by 2023 and beyond. Our negative outlook on rated banks in Indonesia, Thailand, and the Philippines reflects our view that financial buffers aren't sufficient to absorb the rapid deterioration in asset quality, which is likely to occur if the recovery is derailed. Any rebound in infections and associated containment measures will likely delay the economic recovery and present key risks to banks.

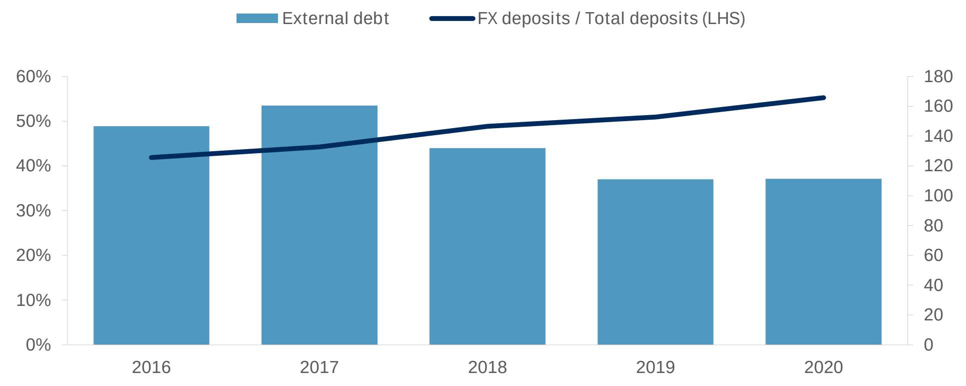
EM EMEA

Further Lira Depreciation Will Pressure Turkish Banks

We expect Turkish banks' cost of risk to rise to about 320 bps in 2021 and 2022 from an already-high 290 bps average in 2019-2020. At the end of 2020, NPLs were very low at around 4%, but we expect them to rise to about 10% when forbearance measures are phased out. This is also exacerbated by the significant lending growth in 2020 (around 35% year-on-year), which we expect will drop to about 15% in 2021 because the central bank tightened its monetary policy. Further depreciation of the lira could trim our forecast, because about 35% of the loans are in foreign currencies and corporate borrowers are still struggling after the currency crisis in 2018. External debt stabilized, according to our estimate, reaching around $147 billion or $111 billion when factoring wholesale debt only (interbank and issuances on capital markets), given that rollover rates stabilized at 95%-100%. The recent removal of the central bank's governor, potential shift in policy direction, as well as the increase in U.S. yields pose risks. The share of deposits in dollars has reached 56% at the end of 2020 and may increase further given the lira's volatility.

Chart 17

Turkish Banks' External Funding



Source: Central Bank of Turkey.

Cost Of Risk For South African Banks Will Remain High Through 2023

We expect an increase in cost of risk and a deterioration in asset quality indicators because of the sharp economic contraction. Cost of risk will remain high over the next couple of years, and we expect a return to the 2019 level only in 2023. Despite wider losses, the major banks are likely to remain profitable through the period. Banks' reliance on external funding remains limited and the central bank is providing support to ensure normal functioning of money market and interbank markets.

South African Banks Face Limited Refinancing Risk

We forecast that the growth of credit to the private sector in South Africa will be subdued in 2021. Earnings proved resilient amid widening credit losses in 2020-2021. We estimate that credit losses rose to about 1.8% in 2020 and will moderate to 1.4% in 2021; NPLs will likely increase to 6% of total loans over this period. Although top-tier banks are exposed to wholesale short-term deposits, these largely stem from domestic nonbank financial institutions. Banks are, therefore, not exposed to large-scale refinancing risk or a reversal of investor sentiment because they don't rely on international funding. We expect the system's liquidity coverage ratios to exceed the 80% minimum set by South African Reserve Bank (SARB) in 2020. We also expect SARB to lift regulatory forbearance measures for capital and liquidity only gradually.

Cost Of Risk Will Weigh On Saudi Banks' Profits

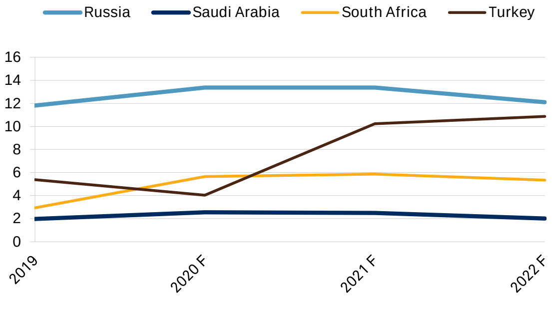
The Saudi economy will recover in 2021-2022 from the shocks of 2020 as global demand for oil recovers and private consumption increases. However, real GDP won't return to the 2019 level until 2022, in our view. We expect credit growth to stabilize in 2021 or slip after a significant pick up in 2020. Mortgage origination will remain buoyant and corporate lending is likely to pick up as Public Investment Fund programs create business for contractors. Cost of risk will remain elevated in 2021, despite stronger-than-expected estimates for 2020, as the Saudi Central Bank gradually phases out its forbearance measures. Combined with very low interest rates, this will weigh on banks' profitability.

Russian Banks' Asset Quality Should Gradually Improve Along With The Economy

We expect Russian banks' net interest margins to remain depressed amid low interest rates while banks' growth strategies will increasingly focus on operating efficiency, digital advancement, and retail business. We also expect a gradual normalization of credit losses in 2021-2022 amid anticipated economic recovery and accommodative monetary policy. Our base-case scenario assumes that the banking sector's cost of risk will fall to 1.5%-2.0% in 2021 and to 1.25%-1.5% in 2022 (under IFRS) from 2.3%-2.5% (estimated) for 2020. We don't think the cost of risk will reach the pre-pandemic level of 1.0% until at least 2023, because banks will continue to create provisions for problem assets accumulated during the pandemic, mainly loans to corporate clients. The funding base of the Russian banking sector has been overall stable, thanks to heavy reliance on domestic deposits, availability of liquidity support from the central bank, and limited exposure to external funding.

Chart 18

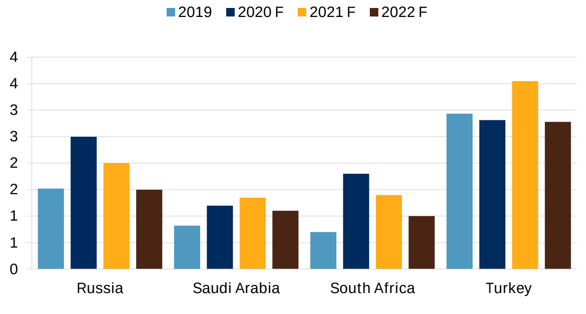
Asset Quality Will Deteriorate (NPL/Total Loans)



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

Chart 19

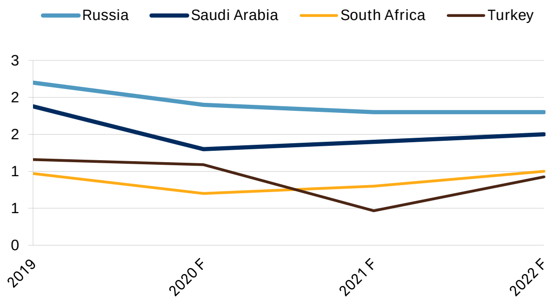
And Credit Losses Will Widen



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

Chart 20

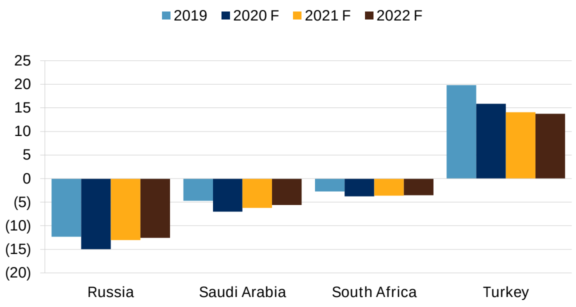
Profitability Will Decline (Return On Assets)



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

Chart 21

Limited Reliance On External Debt*



*Except for Turkey. F--S&P Global Ratings' forecast. Source: S&P Global Ratings.

LatAm

Despite Operating Resiliency, Asset Quality Will Slip Once Support Measures End

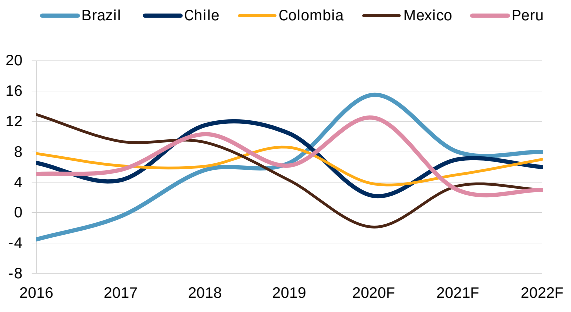
LatAm banks have held up relatively well through pandemic-related turbulence. In S&P Global Ratings' view, solid profitability has been a key factor in allowing the regional banks to withstand credit cycles and economic downturns in the past, and it has once again helped them during the pandemic. The Brazilian and Mexican banking systems' profitability has been the most resilient among the largest banking systems in the region, followed by Chilean banks. The pandemic hit Colombian and Peruvian banks' profitability harder because of their high provisions, stemming from the pandemic's toll on their economies and because they entered the crisis with weaker asset quality.

Lending growth has been robust in countries where we saw stronger incentives from the government to lend, such as in Brazil and Peru. In contrast, lending contracted in Mexico where incentives from the government have been absent. We expect banks' lending to be modest in the region for the next two years because we believe they'll take a conservative approach, given the uncertain scenario in most countries.

Loan moratoriums are delaying NPL ratios from worsening, while banks' asset quality is stronger than we expected. However, hurdles remain--high levels of informal economy, and fragile conditions for small and midsize enterprises will pressure loan portfolios as governments phase out borrower relief measures. The economic rebound is a crucial factor that could help prop up asset quality performance.

Chart 22

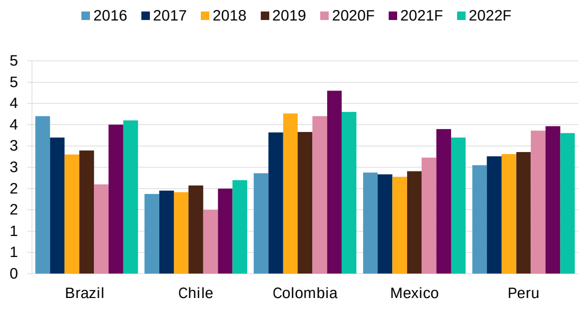
Loan Portfolio Growth (%)



Source: S&P Global Ratings

Chart 23

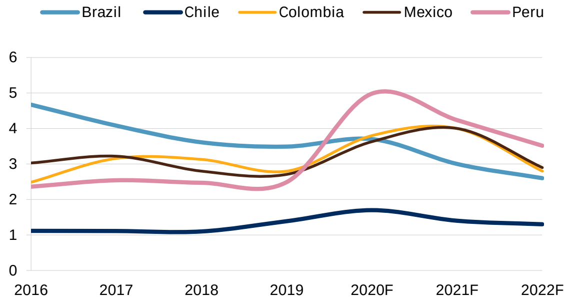
Nonperforming Assets to Total Loans (%)



Source: S&P Global Ratings

Chart 24

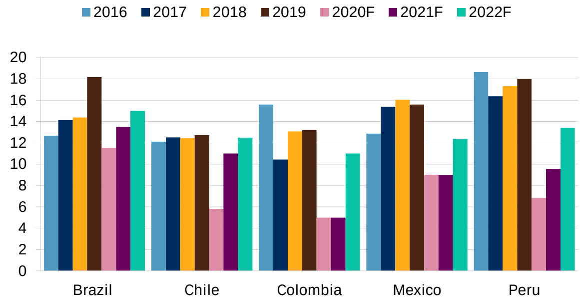
Credit Losses to Total Loans



Source: S&P Global Ratings

Chart 25

Return to Equity (%)



Source: S&P Global Ratings

Appendix 1: Economic Data and Forecast Summaries

Table 9

Real GDP %

	2020	2021F	2022F	2023F
Argentina	-9.9	6.1	2.5	2.0
Brazil	-4.4	3.4	2.5	2.4
Chile	-6.0	5.9	3.6	3.3
Colombia	-6.8	6.0	3.5	3.3
Mexico	-8.5	4.9	2.7	2.2
China	2.3	8.0	5.1	5.0
India	-8.0	11.0	6.1	6.3
Indonesia	-2.1	4.5	5.4	5.1
Malaysia	-5.6	6.2	5.6	5.0
Philippines	-9.5	7.9	7.2	7.2
Thailand	-6.1	4.2	4.5	3.6
Poland	-2.7	3.4	4.4	3.0
Russia	-3.1	3.3	2.5	2.0
Saudi Arabia	-4.1	2.0	2.7	2.2
South Africa	-7.1	3.6	2.5	1.3
Turkey	1.8	6.1	3.0	3.0

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

Table 10

CPI Inflation % (Year Average)

	2020	2021F	2022F	2023F
Argentina	42.0	47.0	42.0	36.0
Brazil	3.2	5.3	3.9	3.3
Chile	3.0	3.3	3.2	3.1
Colombia	2.5	2.8	3.4	3.0
Mexico	3.4	3.9	3.5	3.1
China	2.5	1.8	2.1	2.2
India	6.4	5.0	4.5	4.5
Indonesia	2.0	2.8	3.0	3.0
Malaysia	-1.1	2.0	1.9	2.1
Philippines	2.6	4.7	2.2	2.2
Thailand	-0.8	1.3	1.1	1.0
Poland	3.7	2.9	2.1	2.2
Russia	3.3	5.1	3.8	4.0
Saudi Arabia	3.5	2.5	2.3	2.1
South Africa	3.3	4.2	4.4	4.4
Turkey	12.3	15.0	9.7	9.2

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

Table 11

Policy Rates % (End of Period)

	2020	2021F	2022F	2023F
Argentina	38.00	42.00	33.00	30.00
Brazil	2.00	4.50	5.00	5.50
Chile	0.50	1.00	2.00	2.50
Colombia	1.75	2.25	3.25	3.75
Mexico	4.25	4.00	5.00	5.50
India	4.00	4.25	4.75	5.00
Indonesia	3.75	3.50	4.00	4.50
Malaysia	1.75	1.75	2.00	2.50
Philippines	2.00	2.00	2.25	2.75
Thailand	0.50	0.50	0.50	0.50
Poland	0.10	0.10	0.10	0.35
Russia	4.25	4.75	5.00	5.50
South Africa	3.50	4.00	5.00	6.00
Turkey	17.03	14.00	10.00	9.50

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

Table 12

Exchange Rates % (End of Period)

	2020	2021F	2022F	2023F
Argentina	84.15	125.00	170.00	200.00
Brazil	5.20	5.45	5.45	5.50
Chile	729	735	735	745
Colombia	3,432	3,600	3,600	3,650
Mexico	19.88	21.00	21.00	21.50
China	6.52	6.50	6.40	6.40
India	74.00	74.50	75.00	75.00
Indonesia	14,050	14,500	14,650	14,800
Malaysia	4.01	4.14	4.17	4.20
Philippines	48.04	51.80	51.00	49.40
Thailand	30.04	30.89	30.60	30.30
Poland	3.76	3.79	3.72	3.71
Russia	73.88	73.00	75.00	75.00
Saudi Arabia	3.75	3.75	3.75	3.75
South Africa	14.62	15.90	16.20	16.50
Turkey	7.44	8.00	8.40	8.82

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

Table 13

Unemployment % (Year Average)

	2020	2021F	2022F	2023F
Argentina	11.9	11.0	10.0	9.7
Brazil	13.5	13.5	12.6	12.1
Chile	10.8	9.9	8.6	7.9
Colombia	16.1	13.6	12.5	11.6
Mexico	4.5	4.4	4.3	4.2
China	5.7	5.4	5.1	5.0
Indonesia	6.2	6.8	6.3	5.8
Malaysia	4.5	4.3	4.0	3.7
Philippines	10.4	7.9	6.1	4.8
Thailand	1.7	1.8	1.4	1.2
Poland	3.3	4.4	3.9	3.9
Russia	5.8	5.5	4.8	4.8
Saudi Arabia	12.0	10.0	8.0	6.0
South Africa	29.2	31.1	30.2	29.9
Turkey	13.2	13.0	12.2	11.2

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

Related Research

- Global Credit Conditions Q2 2021: The Risks Of An Uneven Recovery, March 30, 2021
- Credit Conditions North America Q2 2021: As Outlook Brightens, Risks Remain, March 30, 2021
- Credit Conditions Asia-Pacific Q2 2021: Uneven Recovery, March 30, 2021
- Credit Conditions Europe Q2 2021: New Horizons, Old Risks, March 30, 2020
- Economic Outlook Emerging Markets Q2 2021: Tailwinds From Stronger Global Growth, But Several Challenges On The Radar, March 30, 2021
- Economic Outlook Latin America Q2 2021: Despite Growth Picking Up, Pre-Pandemic Weaknesses Remain, March 25, 2021
- Economic Outlook Asia-Pacific Q2 2021: Three-Speed Recovery Will Benefit From Faster Global Growth, March 25, 2021
- Economic Research: Orderly Global Reflation Will Support The Recovery From COVID-19, March 22, 2021
- Economic Research: Rising Commodity Prices Are Generally Good News For Emerging Markets--But Watch Out For Inflation, March 19, 2021

This report does not constitute a rating action.