The Ratings View

September 28, 2023

This report does not constitute a rating action.

Key Takeaways

- We forecast a period of subpar global growth fueled by higher-for-longer rates ahead.
- This will challenge resilient credit conditions, particularly for weaker borrowers.
- U.S. recession probability has fallen but remains elevated at 30%-35%.

Resilient global credit conditions are coming under pressure. The global economy has weakened less than feared this year, partly offsetting headwinds from rising rates. Even so, defaults have picked up in 2023 and will increase into next year among weaker borrowers. Persistent core inflation, a drawn-out period of high rates, and slower growth will challenge lower-rated corporates and emerging markets. Real estate could see some downgrades. Credit quality remains an important driver of relative performance, investment-grade ratings can better absorb higher borrowing costs and are expected to see only muted credit deterioration. Risks to the outlook remain high. A more severe economic downturn, a longer-than-expected period of high rates, geopolitical events, and challenges for China could derail our base case and lead to weaker business activity and market liquidity when large 2025 maturities loom.

Global Credit Conditions Q4 2023: Resilience Under Pressure
Credit Conditions Asia-Pacific Q4 2023: China Downside Risk Is High
Credit Conditions Emerging Markets Q4 2023: High Interest Rates Sour The Mood
Credit Conditions Europe Q4 2023: Resilience Under Pressure Amid Tighter Financial Conditions
Credit Conditions North America Q4 2023: Shift To Low Gear

Nearing the end of the rate-tightening cycle, While the fast pace of policy rate increases over the past year and a half is now behind us, service sector activity remains surprisingly robust across a wide swathe of economies. Nonetheless, rate hikes have begun to gain traction: demand pressures now appear to be easing and (core) inflation appears to have peaked, although it remains well above central bank targets. We forecast a period of subpar growth fueled by higher-for-longer rates ahead, with a relatively slower and softer adjustment back to steady states; this is conditional on strong labor markets. The main risk is that demand and inflation pressures remain higher and stickier than expected, prompting even higher policy rates, tighter financing conditions, and an eventual harder landing.

Global Economic Outlook Q4 2023: Nearing The Rate Plateau
Economic Outlook Asia-Pacific Q4 2023: Resilient Growth Amid China Slowdown
Economic Outlook EM Q4 2023: The Lagged Effects Of Monetary Policy Will Test Resilience
Economic Outlook Eurozone Q4 2023: Slower Growth, Faster Tightening
Economic Outlook U.K. Q4 2023: High Rates Keep Growth Muted
Economic Outlook U.S. Q4 2023: Slowdown Delayed, Not Averted

The probability of a U.S. recession starting in the next 12 months has moderated since the beginning of the year but remains elevated at 30%-35%. Data from the key coincident indicators shows the current expansion is in its late cycle, indicating that any further short-run
cyclical boost to growth is limited by the economy's underlying growth potential. The principal leading indicators give mixed signals for near-term growth prospects, and the current expansion is likely to enter a period of slower-than-trend growth in the coming quarters.

**U.S. Business Cycle Barometer: Recession Risk Still Elevated Amid Uncertain Growth Prospects**

Emerging markets are grappling with declining real estate valuations. As in the U.S. and Europe, tighter lending conditions have increased refinancing risk for REITs, while higher mortgage rates reduced homebuilders' revenues and profits. Home sales in emerging markets will continue to decrease in 2023, particularly in mainland China. It's not all doom and gloom, though. We expect that real estate companies in our rated emerging market universe—which is geographically concentrated in Latin America—will exhibit credit rating resiliency through the end of 2023. Favorable government policies (Brazil) and supportive banking sectors (Indonesia) are keeping credit ratings resilient.

**Emerging Markets Real Estate Issuers Stand Their Ground**

China's efforts to stabilize its property markets are now focused on the largest cities. In recent weeks, central policymakers have rolled out new measures and guided for these to be applied to all cities. Earlier supports were mostly aimed at the lower-tier municipalities, which have been harder hit in the property downturn that has persisted since 2021. The property downturn is an obstacle to China's economic recovery. For this reason, we believe authorities will continue rolling out measures until they at least stabilize markets in the largest cities. This stimulus could be more effective for higher-tier cities, given their stronger underlying fundamentals. Lower-tier cities will likely have to wait longer for recovery.

**China Still Has More Policy Tools To Stabilize The Higher Tier Property Markets**

Digitalization and automation are driving significant changes to banks' products, systems, and operational efficiency. Tech adoption rates are influenced by infrastructure, regulation, local preferences, and competitive pressures, and are thus uneven. Emerging technology gaps between banks and countries will benefit or inhibit the wealth of clients and nations. We expect banks in many regions will have a greater capacity to innovate due to stronger earnings from rising interest rates, and thus create a virtuous circle in which tech-driven savings enable greater investment in tech. Emergent technologies, such as generative artificial intelligence, promise material change that could create opportunities and threats for banks and fintechs.

**Tech Disruption In Retail Banking: Country-By-Country Analysis 2023 | Leaders And Laggards Emerge**

Through 2030, we expect regulated gas operators in most European countries will experience a limited and gradual decline in residential and industrial demand. Gas will remain key to balancing energy markets, even allowing for government decarbonization efforts. This, paired with supportive regulatory frameworks across all jurisdictions, should underpin healthy and predictable cash flows for network operators in the next three to five years. However, we foresee a sharper drop in demand from 2030, which heightens business risk, making leverage reduction increasingly important for maintaining creditworthiness. As regulatory periods end, operators could face higher regulatory reset risk, depending on the pace of the energy transition. Regulatory support will be a major variable including timeliness of cost recovery, tariff setting changes, and compensation for decline in gas usage.

**Utilities Handbook 2023: Western Europe Regulated Gas**
Asset Class Highlights

**Corporates**

Notable publications include:

- [Asia-Pacific Sector Roundup Q4 2023: A Skewed Recovery](#)
- [Emerging Markets Real Estate Issuers Stand Their Ground](#)
- [Utilities Handbook 2023: Western Europe Regulated Gas](#)
- [Weak Cash Flow Pressures Ratings For North American Speculative-Grade Health Care Issuers](#)

**Financial Institutions**

- In **Latin America**, we have revised our outlook on [Banco de Brasilia (BRB)](#) to negative from stable. Lower net interest margins have hit BRB’s profitability, which, combined with continued expansion, has pressured capitalization. At the same time, BRB has been searching for ways to improve its capital, such as portfolio sales and potential follow-on process planning.

- In **Europe**, we have revised our outlook on [Bank of Valletta](#) to stable from negative. Although Maltese banks’ exposure to the real estate market remains a point of concern in a rising interest rate environment, sound fundamentals continue to reduce the risk of a sharp correction, in our opinion. We consequently see a stable trend for the economic risk Maltese financial institutions face.

We have also lowered our long-term ratings on [Deutsche Boerse AG](#) to ‘AA-‘ from ‘AA’, after the announcement of the completion of its acquisition of SimCorp, funded primarily with new debt.

We have also lowered our long-term rating on [Europe Arab Bank](#) to ‘BB’ from ‘BB+'. Arab Bank group’s exposure to Jordan (B+/Stable/B) remains above 25% of its total exposure and is unlikely to fall materially in the short term; we therefore cap our assessment of the group’s credit profile (GCP) to ‘bb’, two notches above our ratings on Jordan. Our ratings on Europe Arab Bank PLC, the group’s U.K.-based core subsidiary, are aligned with the GCP.

Rising interest rates and an end to the benefits of the European Central Bank’s third targeted longer-term refinancing operations put temporary pressure on large French banks’ net revenues in the first half of 2023. In our report [Large French Banks’ Net Interest Income Should Pick Up From Mid-2024](#), we discuss how, unlike their European counterparts, French banks have not seen rising interest rates translate into strong profits. This is because their liabilities reprice more quickly than their assets--such as fixed-rate mortgages--thus reducing their net interest income. That said, we expect a gradual rebalancing of domestic net interest income, with a return to growth around mid-2024. Asset quality has held up well in the first half of 2023, but a deterioration should become more apparent in the coming quarters. However, French banks’ provisions should continue to protect them against defaults, and credit costs should normalize rather than spike.
Sovereign

- **Albania Outlook Revised To Positive On Improving Economic Fundamentals; 'B+/B' Ratings Affirmed**

Structured Finance

- **EMEA Structured Finance:** S&P Global Ratings published on Sept. 22, 2023 its "EMEA Structured Finance Chart Book: September 2023". Investor-placed securitization issuance volumes for July and August 2023 were €6.8 billion and €3.4 billion, respectively--each down on the same months in 2022. Overall year-to-date issuance (€51 billion) was down 16% at end-August. However, other measures--such as growth by transaction or originator count--paint a more positive picture. The number of banks using securitization has grown by nearly a third. European benchmark covered bond issuance is still robust, reaching €140 billion year-to-date by the end of August 2023--up more than a quarter on volumes for the same period in 2022.

In July and August 2023, we raised 48 of our ratings on European securitization tranches, mostly in the CLO and RMBS sectors. There were 15 downgrades, mostly across three transactions in the U.K. CMBS and nonconforming RMBS sectors.

- **Global Auto ABS:** On September 22, 2023, S&P Global Ratings published slides on the global auto loan ABS market, titled "Global Auto Loan ABS: A Brief Market Update." The slides present updates on 2023 auto ABS performance, benchmark metrics, and issuance in China, Japan, Australia, the U.S., and Europe. They also look at vehicle sales and global electric vehicle penetration rates.

- **U.K. Pub Corporate Securitizations:** Here are a few “Key Takeaways” from a recent article:
  
  o The U.K. pub sector faced unprecedented stress during the pandemic, followed by a sharp increase in labor, energy, and food costs. Together with rising cost of living pressures affecting U.K. households, the pressure on the topline will also add to the weakness in profitability.
  
  o The nature of the business model impacts also has a bearing on operating performance and profitability. The EBITDA margins of leased and tenanted operating models have rapidly recovered to pre-pandemic levels, while fully managed or hybrid models will recover more slowly.
  
  o As fully managed and hybrid models recover, our scenario analysis indicates that strong liquidity support in the S&P Global Ratings’ rated U.K. pub corporate securitizations will cushion any potential reductions in EBITDA until the industry recovers to near pre-pandemic levels by 2025-2026, in our view.
  
  o The results of our scenario analysis, for the managed and hybrid-model-backed U.K. pub corporate securitizations we rate, indicate that a 10% decline in our long-term forecasted EBITDA would generally not affect our current ratings and a 25% decline could result in an up to a four-notch downgrade.

The Ratings View

Chart 1
Global Rating Actions (Rolling 52-Weeks)

Table 1
Recent Rating Actions

<table>
<thead>
<tr>
<th>Date</th>
<th>Action</th>
<th>Issuer</th>
<th>Industry</th>
<th>Country</th>
<th>To</th>
<th>From</th>
<th>Debt vol (mil.$)</th>
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<td>25-Sep</td>
<td>Upgrade</td>
<td>Democratic Socialist Republic of Sri Lanka</td>
<td>Sovereign</td>
<td>Sri Lanka</td>
<td>CCC</td>
<td>SD</td>
<td>12,553</td>
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<td>Downgrade</td>
<td>Democratic Socialist Republic of Sri Lanka</td>
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<td>SD</td>
<td>CC</td>
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<td>Uber Technologies, Inc.</td>
<td>High Technology</td>
<td>U.S.</td>
<td>BBB-</td>
<td>B+</td>
<td>8,211</td>
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<td>18-Sep</td>
<td>Upgrade</td>
<td>Alimentation Couche-Tard Inc.</td>
<td>Retail/Restaurants</td>
<td>Canada</td>
<td>BBB+</td>
<td>BBB</td>
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<td>20-Sep</td>
<td>Downgrade</td>
<td>Staples Inc.</td>
<td>Retail/Restaurants</td>
<td>U.S.</td>
<td>B-</td>
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<td>20-Sep</td>
<td>Downgrade</td>
<td>Deutsche Boerse AG</td>
<td>NBFI</td>
<td>Germany</td>
<td>AA-</td>
<td>AA</td>
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<td>Garrett Motion Inc.</td>
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<td>U.S.</td>
<td>BB-</td>
<td>B+</td>
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<td>20-Sep</td>
<td>Downgrade</td>
<td>SK Mohawk Holdings, SARL</td>
<td>Chemicals, Packaging &amp; Environmental Services</td>
<td>Germany</td>
<td>CCC</td>
<td>CCC+</td>
<td>3,550</td>
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<tr>
<td>18-Sep</td>
<td>Downgrade</td>
<td>Foundeover Group</td>
<td>Media &amp; Entertainment</td>
<td>Luxembourg</td>
<td>BB-</td>
<td>BB</td>
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<td>20-Sep</td>
<td>Upgrade</td>
<td>Latam Airlines Group S.A.</td>
<td>Transportation</td>
<td>Chile</td>
<td>B</td>
<td>B-</td>
<td>2,250</td>
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Table 1

For further credit market insights, please see our This Week In Credit newsletter.