

# The Ratings View

October 18, 2023

This report does not constitute a rating action.

## Key Takeaways

- The Israel-Hamas war is compounding global geopolitical risks.
- Financing conditions remain challenging with rising defaults, a higher cost of capital, and more cautious lending.
- Supply-chain problems in 2020-2022 contributed to negative rating actions for more than 200 corporate issuers, highlighting their importance as a credit factor.

**The Israel-Hamas war is compounding global geopolitical risks.** The eruption of war between Hamas and Israel puts upward pressure on our assessment of geopolitical risk that we already view as elevated and worsening. It is compounding the strain on international relations related to Russia's invasion of Ukraine and the tense relationship between China and the U.S. While not underestimating the severity of the human tragedy unfolding, our current base case assumes the conflict will remain largely contained to Israel and Gaza, limiting the geographic and credit impact of the conflict. The risks of escalation involving the opening of a second front with full military engagement of Hezbollah remain material, but we think it less likely that Iran would become directly involved. A key risk in the event of escalation would be the potential for an energy supply shock, which could underpin inflation and weigh on economic activity.

[Credit Conditions: War In The Middle East Compounds Global Geopolitical Risks](#)

**Financing conditions remain challenging.** Amid record-high global leverage, a trifecta of rising defaults, a higher cost of capital, and more cautious lending will challenge borrowers over the next two years. Of our sample of 20,000 global corporates (mostly not rated), 9% were cashflow negative in 2022, more than twice the 2019 level, despite the post-pandemic economic rebound. Our base case expects the ratio to creep up to 10% in 2023-2024. The ratio could jump to 13% if financing contracts by 1%. This result from our stress test reflects vulnerability due to high corporate leverage built up during the pandemic and yet-to-recover cashflows.

[Global Leverage: A 1% Financing Contraction Could Push Cashflow Negative Corporates To 13%](#)

**Supply-chain events and bottlenecks in 2020-2022 led to negative rating actions on more than 200 corporate issuers.** The complexity and interconnectivity of supply chains can, depending on the severity of the risk of disruptions, affect issuers' creditworthiness, broader economic performance, and long-term inflation. Questioning and analyzing key factors that might affect supply-chain linkage, individual supply-chain metrics, wider economic indicators, and topology analysis can be extremely beneficial to understand interconnectivity and where and when supply-chain problems may have significant negative consequences for an entity or industry.

[Supply-Chain Risks: A Credit Perspective](#)

**S&P Global Ratings is making some modest changes to its metal price assumptions** taking into account elevated prices for most metals despite soft economic indicators in late 2023. Credit quality has held up through 2023, a third consecutive year of upgrades and a positive outlook

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bias. That upswing is moderating, however, as lower prices in 2023 coincide with rising capital demands and robust shareholder distributions based on record trailing earnings. Our global net outlook bias is only about 5% positive and encompasses mostly steel and aluminum producers. As such, under our price assumptions, we expect downgrades and upgrades will even out in 2024.

### [S&P Global Ratings Metal Price Assumptions: Holding Higher For Longer](#)

**China's property sales will likely see an extended L-shaped recovery.** After a likely 10%-15% drop in sales this year, we expect a 5% drop in 2024 and the sector to bump along the floor for years. We expect that the low number of construction-starts, an inventory overhang in lower-tier cities, and ever-tightening escrow restrictions will keep property sales depressed. The sector will also continue to diverge. Government policy relaxations aimed at stabilizing the sector will benefit upper-tier markets, while lower-tier cities are contending with excess supply and depleted confidence. Conditions will also widen the gap between the state-owned developers - more focused on upper-tier markets - and the private ones. A string of large private property firms have missed debt payments, hitting market confidence. All developers will have to manage slowing sales as their leverage will stay high for the next two years, in our view.

### [China Property Watch: A Slow, Sequential Recovery In 2024](#)

**China's rated retail firms have emerged from COVID-19 with a more cautious attitude.** Their risk appetites are so reduced that their margins and cash flow will likely improve next year despite cautious consumer outlays. We maintain our forecast for China's retail sales growth (ex-petroleum) at 5.8% for 2023. Next year will decelerate to 4.2%, slower than our GDP growth forecast of 4.4%. Overall rating actions for consumer companies have veered positive in 2023, and we expect some further upside into 2024. These are mainly related to issuers in the food and beverage (F&B), catering, and leisure subsectors.

### [China Retail: Tighter Belts, Broader Defenses](#)

**Japan's corporates have limited room to further improve creditworthiness.** Japanese corporations will rely over the next one to two years on a steady domestic economy and their strong financial positions for support. However, geopolitical tensions, inflation, a global economy in the doldrums, and extensive investments by management teams hungry for growth could all throw spanners into the works.

### [Japan Corporate Credit Spotlight: Scant Room For Improvement](#)

**The decade-long expansion of private credit**, against the backdrop of rising credit pressures, has put the focus on the burgeoning challenges in an opaque market. As signs of credit stress emerge and defaults creep up, it remains to be seen whether this "golden age of private credit" can continue. In two Credit FAQs, S&P Global Ratings looks at some of the credit dynamics in this burgeoning market.

### [Credit FAQ: What Is Private Credit?](#)

### [Credit FAQ: What Risk Factors Are Associated With Private Credit?](#)

**Cyber attacks remain a top credit risk across geographies and asset classes.** Amid increasing technological dependency and global interconnectedness, cyber attacks pose a potential systemic threat and significant single-entity event risk. We view cyber threats as among the most significant structural risks and expect they will increasingly affect the credit landscape. The best prepared organizations are those whose board members are able to ask probing questions to uncover cyber risks within strategic plans. It is worth noting that board members do not need to be cyber experts. We expect that governance structures will evolve to keep up with rising cyber threats and that entities will consider cyber risks in all aspects of strategic business decisions.

### [C-Suite Must Walk The Cyber Talk](#)

## Asset Class Highlights

### Corporates

Notable publications include:

- [Supply-Chain Risks: A Credit Perspective](#)
- [Japan Corporate Credit Spotlight: Scant Room For Improvement](#)
- [European Equipment Rental Firms Are Flourishing, Despite Some End-Market Slowdown](#)
- [China Retail: Tighter Belts, Broader Defenses](#)
- [U.S. Consumers Could Rally Despite Higher Debt Burden](#)
- [U.S. Auto Sector Ratings Could Remain Resilient Despite Slowing Macro Conditions And Rising Pricing](#)

### Financial Institutions

- **In North America**, we revised the rating outlook of Canada-based Laurentian Bank of Canada to negative from stable. The outlook revision primarily reflects our view that, given significant turnover at the seniormost levels, the bank could face some challenges in executing and fulfilling its strategy amid operating headwinds for banks in line with a slowing macroeconomy.
- We published several commentaries:
  - [U.S. Regulatory Proposals For Large Bank Resolutions Could Result In Higher Ratings On Bank Subsidiaries](#)
  - [Comparative Statistics: U.S. Banks \(October 2023\)](#)
  - [Metro Bank's Rescue Deal Has No Direct Consequence For Rated U.K. Banks](#)
  - [Elevated Credit Costs To Weigh On Thai Banks Amid Uneven Recovery](#)
  - [Japan Is Robust Enough For Rising Yen Rates](#)

### Structured Finance

- **U.S. Consumer:** Here are a few “Key Takeaways” from a recent article:
  - U.S. consumers, especially the overextended, are feeling the burden of persistent inflation, reduced affordability, and declining savings.
  - Debt service ratios and delinquency rates are poised to increase further due to the higher interest rates for new debt and the commencement of student debt repayments in October after a three-year moratorium.
  - We believe the robust U.S. economy, still healthy labor market, and tightening lending standards will help stressed consumers keep defaults at bay--if they remain resilient and continue to manage their balance sheets prudently.

See “[U.S. Consumers Could Rally Despite Higher Debt Burden](#)” published October 13, 2023.

- **U.S. CMBS:** Here are a few “Key Takeaways” from a recent article:

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## The Ratings View

- The office market is the credit focus of U.S. CMBS. The 30-plus day delinquency rate has increased for nine consecutive monthly periods, and the office sector has contributed to most of the recent rating actions. We include a detailed look at third-quarter 2023 rating actions in the Appendix.
- Private label issuance was steady quarter-over-quarter at \$10 billion, but still subdued compared to 2022 levels. A majority of 2023 issuance was in conduits, with single-borrower issuance down more significantly from recent vintage levels.
- Within conduit deals priced in the third quarter, loan-to-value ratios rose a bit, but remain well-below 2021 and 2022 vintage levels. 2023 deals continue to be smaller and more concentrated by loan count and size, and full-term interest-only concentration percentages reached another new high.

See "[U.S. CMBS Update Q3 2023: Office Distress Driving Rating Actions: Conduits Leading Subdued Issuance](#)" published October 13, 2023.

- **U.S. Auto ABS:** Here are a few "Key Takeaways" from a recent article:
  - In the month of August, prime U.S. auto loan ABS performance stabilized with annualized losses marginally declining month over month, while subprime weakened with annualized losses increasing month over month. Additionally, prime losses fell below the pre-pandemic level of August 2019.
  - Like in July 2023, delinquencies continue to rise month over month and year over year for both prime and subprime composites.
  - In September, we reviewed 26 U.S. ABS transactions and lowered our expected cumulative net loss levels on 22 transactions. We upgraded and affirmed our ratings on 41 and 47 classes, respectively. There were no downgrades.

See "[U.S. Auto Loan ABS Tracker: August 2023 Performance](#)" published October 12, 2023.

- **Ireland RMBS:** Here are a few "Key Takeaways" from a recent article:
  - Prime Irish RMBS transactions issued since new macroprudential lending rules were implemented in 2015 have performed strongly, with minimal arrears to date. These issuances tend to be issued by tier 2 and non-bank lenders, with larger pillar banks preferring to issue from their covered bond programs given the pricing advantages and flexibility on note tenor.
  - Residential mortgage arrears peaked at 23.5% in June 2013. The Code of Conduct on Mortgage Arrears and the Mortgage Arrears Resolution Process, initially introduced in February 2009 and January 2011 respectively, have provided servicers with the tools needed to adequately deal with long-term arrears, particularly with vulnerable borrowers.
  - Banks have consistently reduced their nonperforming asset ratios since 2013, through active restructuring and asset sales, supported by reperforming and nonperforming RMBS issuances.
  - Arrears in the reperforming transactions we rate are increasing. Most loans are on variable rates and borrowers are adjusting to higher interest rates and living costs. As of June 2023, reperforming RMBS transactions had a higher weighted-average interest rate (4.98%) than prime transactions (3.65%). A year earlier, reperforming transactions had a lower weighted-average interest rate (2.32%) than prime transactions (2.81%).

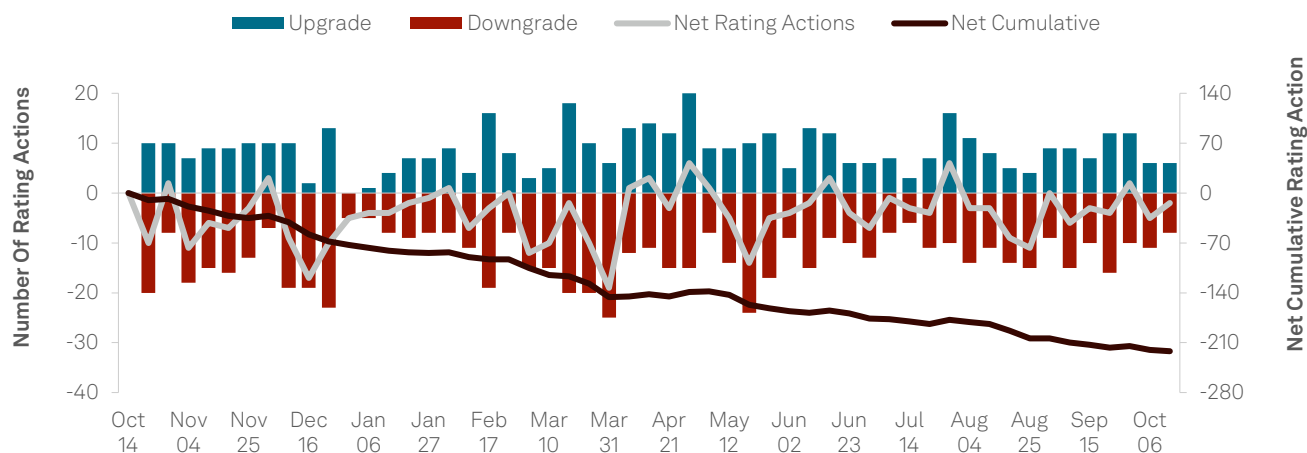
See "[A Primer On Ireland's RMBS Market](#)" published October 10, 2023.

- **China Leasing Securitization:** S&P Global Ratings published on October 12, 2023 a Credit FAQ, titled "How We Rate China Leasing Securitizations." Asset-backed securities (ABS) backed by lease receivables have some unique features that differ from those of similar transactions collateralized by other types of secured financing, such as auto loans. These features can differ significantly, depending on transaction structure and the relevant jurisdiction's applicable laws. In this report, we discuss recent market trends, specific risks facing lease-backed ABS in China, as well as our ratings methodology and major considerations to address these risks.
- **Mexican Structured Finance:** S&P Global Ratings recently gained valuable insights into the Mexican structured finance market during a series of meetings with various market participants, and we're excited to share our findings and forward-looking perspectives. Despite some challenges, we believe Mexico's securitization market infrastructure is robust, providing a solid foundation for growth and significant potential for sustainable development. See "[Mexican Structured Finance Market Update: Resilience, Challenges, And Potential](#)" published on October 10, 2023.
- **Australian RMBS:** Australian prime home loan arrears fell in August and nonconforming home loan arrears rose. That's according to S&P Global Ratings' recently published "RMBS Arrears Statistics: Australia." The Standard & Poor's Performance Index (SPIN) for Australian prime mortgages loans excluding noncapital market issuance declined in August to 0.92% from 0.96% a month earlier. Nonconforming arrears rose to 3.70 % from 3.63% in July. This movement was influenced by a contraction in outstanding loan balances in the nonconforming sector, increasing the SPIN in percentage terms. The fall in prime arrears reflects the annual arrears cycle, whereby arrears typically decline in the second half of the year before rising again over the Christmas and summer holiday period. Continued strong conditions in labor markets have kept advanced arrears low to date. We expect that unemployment will increase in the coming year, which for some households would increase debt-serviceability burdens and, by extension, migration from early arrears to more advanced arrears categories. In our opinion the effects of higher interest rates for households still has some way to go in terms of delinquency levels. Declining household savings levels suggest that these buffers are being used currently and that mortgage delinquencies could increase once these buffers have been depleted.

## The Ratings View

Chart 1

### Global Rating Actions (Rolling 52-Weeks)



Source: S&P Global Ratings. Net rating actions means downgrades minus upgrades. Net cumulative means total net rating actions. Data as of Oct. 13, 2023. Global rating actions include actions on both financial and non-financial corporates and sovereign issuers.

Table 1

### Recent Rating Actions

Date	Action	Issuer	Industry	Country	To	From	Debt vol (mil. \$)
12-Oct	Upgrade	<a href="#">ICON PLC</a>	Consumer Products	Ireland	BBB-	BB+	6,015
12-Oct	Upgrade	<a href="#">Peer Holding III B.V.</a>	Retail/Restaurants	Netherlands	BB	BB-	3,745
12-Oct	Downgrade	<a href="#">Petroleos del Peru Petroperu S.A.</a>	Oil & Gas	Peru	B+	BB	3,000
9-Oct	Downgrade	<a href="#">Eutelsat Communications S.A.</a>	Telecommunications	France	B+	BBB-	2,740
9-Oct	Upgrade	<a href="#">Shelf Drilling Holdings Ltd.</a>	Oil & Gas	Cayman Islands	B-	CCC+	2,305
11-Oct	Upgrade	<a href="#">Ashton Woods USA LLC</a>	Homebuilders/Real Estate Co.	United States	BB-	B+	2,000
12-Oct	Downgrade	<a href="#">ClubCorp Holdings, Inc.</a>	Media & Entertainment	United States	CC	CCC+	1,600
12-Oct	Downgrade	<a href="#">Badger Finance, LLC (Badger Intermediate Holdings LLC)</a>	Consumer Products	United States	CCC	CCC+	1,180
13-Oct	Downgrade	<a href="#">Ensign Energy Services Inc.</a>	Oil & Gas	Canada	SD	CCC	700
12-Oct	Downgrade	<a href="#">Premier Dental Services Inc.</a>	Health Care	United States	CCC+	B-	540

Source: S&P Global Ratings Credit Research & Insights. Data as of Oct. 13, 2023. U.S. means United States, U.K. means United Kingdom and U.A.E. means United Arab Emirates. NBFi - NonBank Financial Institutions (ex. Insurance)

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



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