S&P Global
Ratings

The Ratings View

October 26, 2023

This report does not constitute a rating action.

Key Takeaways

- China's economic growth rate could fall below 3% if property woes worsen.
- Slumping interest cover ratios are closing out a 40-year uptrend, posing debt servicing risks for vulnerable corporate credits.
- S&P Global Ratings revised the outlook on its 'AA-' long-term foreign and local currency ratings on Israel to negative from stable.

China's property woes are creating serious risks to growth. Weak sales--property sales are 30% below their 2021 peak--and high leverage are stressing cash flow and raising default risk among Chinese developers, as highlighted by adverse developments at Country Garden, once China's largest privately owned property developer. In turn, lower land sales are hurting local government finances and their ability to support state-owned enterprises. The resulting hit to business and household confidence is dragging on China's economic rebound, which further hits property sales in a negative feedback loop. Our downside scenario, to which we assign a 1-in-5 probability, assumes a further 20%-25% decline in 2024 property sales from 2022. This would cause China's real GDP growth to drop to 2.9% in 2024 from our base case of 4.4%.

China Growth Could Fall Below 3% If The Property Crisis Worsens
What If Chinese Corporate Earnings Further Decline?
Emerging Markets Monthly Highlights: Turbulence Abroad Will Fuel Uncertainty

The slump in corporate interest cover brings risks for weaker credits. The 40-year uptrend in interest cover ratios for U.S. nonfinancial corporates is likely over. The rise in cover reflected a sustained period of rising profit margins and falling interest rates, boosted by factors linked to deepening globalization. These drivers are likely reversing, and interest cover will become more important. More broadly, the end of financial repression may bring the risks from unsustainable capital structures to a head. Investment-grade and stronger speculative-grade entities are not likely to see cover ratios become challenging, but the risks are much greater for 'B' rated credits where median interest cover is expected to fall below one this year. Industries with a significant proportion of entities with trailing EBIT interest cover of less than one include telecoms, tech, media, and pharmaceuticals and biotech.

Interest-cover risks are growing for vulnerable corporate credit

S&P Global Ratings revised the outlook on its 'AA-' long-term foreign and local currency ratings on Israel to negative from stable. Our baseline scenario assumes that the Israel-Hamas war will remain centered in Gaza, but there are risks that it could spread more widely with a more pronounced impact on the economy and security situation in Israel. We now forecast the Israeli economy will contract by 5% in the fourth quarter of 2023 compared with the third, before rebounding in early 2024. The contraction will stem from security-related disruptions and reduced business activity; the drafting of a large number of reservists; the foreign tourism sector shutdown; and a broader confidence shock. Meanwhile, we expect that additional budgetary

Contacts

Gareth Williams
London
Head of Corporate Credit Research
+44-20-7176-7226
gareth.williams@spglobal.com

Gregoire Rycx
Paris
Senior Analyst
gregoire.rycx@spglobal.com

Gregg Lemos-Stein
New York
Chief Analytical Officer, Corporate Ratings
+1-212-438-1809
gregg.lemos-stein@spglobal.com

Joe Maguire
New York
Lead Research Analyst
joe.maguire@spglobal.com

For latest Sector and Industry Research **Click Here** measures to support households and businesses, as well as an increase in defense spending, will increase the average general government deficit to 5.3% of GDP in 2023-2024, compared with 2.3% of GDP in our previous forecast.

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Cyber threats are a growing risk for corporates. No sector is immune, but threat actors predominantly target sectors with extensive and sensitive customer data or sectors that provide critical services, such as information technology (IT), telecommunications, media and entertainment, and retail. Our analysis indicates that data breaches and ransomware attacks are the most common types of cyber incidents. While a large proportion are driven by phishing or employee errors, many cyber breaches arose from issues at third-party vendors. Third party cyber is an additional risk that organizations need to prepare for. While cyber incidents haven't weakened business or financial risk profiles or directly resulted in negative rating actions, they increasingly have the potential to erode credit quality, accentuate other credit risks, and put downward pressure on credit ratings over a period of time.

Corporates Up Their Cyber Preparedness As Cyber Attacks Become More Widespread

The global corporate default tally for 2023 has reached 118 following 11 defaults in September. This is nearly twice the comparable 2022 total, and well above the year-to-date five-year average of 101 defaults. Defaults came from a broad range of industry sectors. The industries with the most defaults in the month--automotive and capital goods--accounted for only two each. Media and entertainment and consumer products still lead the year-to date-count by industry. Distressed exchanges led in September, accounting for 55% of the defaults, and adding to the highest year-to-date tally of distressed exchanges since 2009.

Distressed Exchanges Drive 2023 Global Corporate Defaults To 118

Poland's incoming government faces tough choices. Poland's election results indicate that the incumbent Law and Justice Party (PiS) and its likely coalition partners have not won a majority, meaning power will likely transfer to a centrist coalition led by opposition party Civic Platform. We expect a centrist coalition will aim to ease tensions with the EU, in turn unlocking EU funding under the recovery and resilience program. Regardless of its composition, the newly formed government will face several hurdles, including volatile global financial markets, the implications of a stagnating German economy, elevated domestic inflation, and fiscal imbalances.

Poland's Incoming Government Faces Tough Policy Choices

For Japan's automakers, things look good for now. Modest sales growth and efforts aimed at efficiency should underpin stable credit profiles for key Japanese automakers over the next one to two years. We expect their cash flows and profitability to be stable over this period even as growth in global demand for cars weakens in 2024 and electrification continues its rise. Recently declining market share in China is an emerging risk, and we believe Japanese carmakers will increase resources for electric vehicles, although commitments to positive free operating cash flows restrict flexibility to meaningfully enlarge total investment.

Japan Autos: Prepared For Weaker Momentum And Secular Change?

Asset Class Highlights

Corporates

Notable publications include:

- Latin America Sector Roundup Q4 2023: Uneven Trends Amid Rising Crosscurrents
- Default, Transition, and Recovery: Distressed Exchanges Drive 2023 Global Corporate Defaults To 118
- Credit Conditions: War In The Middle East Compounds Global Geopolitical Risks
- Japan Autos: Prepared For Weaker Momentum And Secular Change?
- A Closer Look At The Three Major California Investor-Owned Electric Utilities Amid The 2023 Wildfire Season
- Brazilian For-Profit Education Industry Set To Lift Itself Up After Pandemic Upheaval

Financial Institutions

- **In EMEA**, we revised the rating outlook of Georgia-based Cartu Bank JSC ('B/B') to positive from stable. The revision of the outlook on Cartu Bank to positive from stable reflects that we expect the bank to further improve asset quality, supported by a favorable macroeconomic environment.
- **In North America**, we revised the rating outlook of U.S.-based financial company, Burford Capital Ltd., to positive from stable. At the same time, we affirmed our 'BB-' issue rating on the company's senior unsecured notes. The outlook revision follows Burford's improving operating performance.
- **In Latin America**, we revised the rating outlooks on two Chilean Banks, Banco del Estado de Chile and Scotiabank Chile to negative from stable. The rating actions on the financial entities follow our revision of the outlook on Chile (foreign currency: A/Negative/A-1; local currency: A+/Negative/A-1) to negative from stable, which captures the risks stemming from weakening political consensus on the key parameters of Chile's political and economic agenda.
- We published several commentaries:
  - Asia-Pacific Financial Institutions Monitor 4Q 2023: Outlook Stable, Strains Manageable
  - Asia-Pacific Banking Country Snapshots: Outlook Stable, Strains Manageable
  - Nordic Banks: Resilient To Economic Weakening
  - Auto Lenders Face Headwinds From High Rates And Economic Challenges
  - Credit FAQ: Will Australia Increase The Likelihood Of Bank AT1 Loss Absorption?
  - Highlights From The European Financial Institutions Conferences 2023

Sovereign

- Israel Outlook Revised To Negative On Geopolitical Risks; 'AA-' Ratings Affirmed
- Egypt Downgraded To 'B-' On Mounting Funding Pressures; Outlook Stable

Research Contributors

Corporate
Gregoire Rycx
gregoire.rycx@spglobal.com

Financial Institutions
Alexandre Birry
alexandre.birry@spglobal.com

Mehdi El mrabet
mehdi.el-mrabet@spglobal.com

Structured Finance
Winston Chang
winston.chang@spglobal.com

- Greece Upgraded To 'BBB-/A-3' On An Improved Budgetary Position; Outlook Stable
- Benin Outlook Revised To Positive From Stable On Improving Economic Prospects; 'B+/B' Ratings Affirmed
- Chile Outlook Revised To Negative On Weaker Political Consensus; 'A/A-1' Foreign Currency Ratings Affirmed

Structured Finance

- **Scenario Analysis - U.S. Middle Market CLO:** Here are a few "Key Takeaways" from a recent article:
    - Middle-market (MM) collateralized loan obligations (CLOs) are a segment of the U.S. CLO market backed by senior secured loans to smaller companies, typically those with an EBITDA of $100 million or lower (and often much lower). They represent approximately 17% of total outstanding S&P Global Ratings-rated U.S. CLOs by par value of the assets, and a bit less by transaction count.
    - We applied a series of four hypothetical stress scenarios to a sample of 137 of our rated middle-market CLO transactions, generating quantitative analysis for each one using our CLO rating models (CDO Evaluator and S&P Cash Flow Evaluator) and review the model-driven rating transitions.
    - As with our previous published stress scenarios of CLO ratings, this exercise shows the fundamentals of the CLO structure protecting the noteholders, especially for the senior CLO tranches, and shows that middle-market CLOs can withstand comparable defaults with less rating impact than BSL CLOs.

See "Scenario Analysis: How Resilient Are Middle-Market CLO Ratings (2023 Update)?" published Oct. 16, 2023.

- **Global Covered Bonds:** Here are a few "Key Takeaways" from a recent article:
    - Most European countries will see a sustained correction in nominal house prices as eurozone growth softens considerably into next year.
    - Our analysis of historical housing market corrections suggests that mortgage arrears are generally linked to unemployment, house prices, and--for the U.K.--interest rates.
    - We have conducted a scenario analysis of mortgage performance. Under a baseline scenario, which reflects our economic and house price forecasts, we see only a modest increase in mortgage arrears, mainly driven by weakening house prices.
    - In a downside scenario, we see more material increases in mortgage arrears, especially in Italy and Ireland. However, the credit enhancement available in the covered bond programs that we rate should be sufficient to absorb the related losses.

See "Global Covered Bond Insights Q4 2023: Weathering The Housing Market Correction" published Oct. 20, 2023.

- **U.S. Middle Market CLO and Private Credit:** See "Middle-Market CLO And Private Credit Quarterly: Strong CLO Growth, But Weakening Underlying Credit Q4 2023" published Oct. 20, 2023.

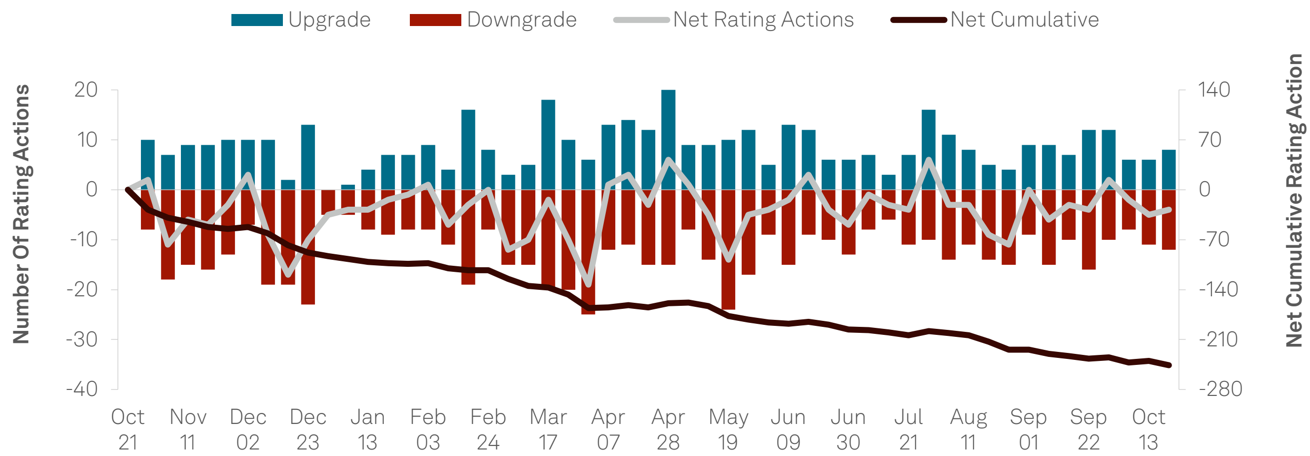
- **U.S. Agency Credit Risk Transfer Transactions:** Here are a few "Key Takeaways" from a recent article:
  - Excessive loan modifications could result in credit support depletion for agency CRT structures, depending on the degree and type of modifications, in addition to transaction specific structural features.
  - A scenario analysis on typical CRT transaction structures suggests the presence of a hypothetical coupon on the most subordinate B-3H class along with an elevated SOFR offers a considerable amount of protection against modification losses to the supported classes, particularly under higher interest rate reduction and forbearance stresses.
  - M-1 classes under this analysis remain largely unscathed by principal write-downs even under severe modification assumptions applied on 5% of the mortgage pool.
  - The net benefit of loan modifications to a CRT (comparing principal write-downs from loan modification losses to write-downs from the alternative of default and liquidation losses) depends on the level, duration, and effectiveness of the loan modifications and corresponding rate and timing of recidivism. Assuming a recidivism rate of 50% or less, it may take a moderate to severe level of interest rate reductions and/or forbearance on over 5% of a mortgage pool to result in higher write-downs to CRT transactions than would have occurred under liquidation absent loan modifications.

See "Quantifying The Potential Effect Of Loan Modifications On Agency Credit Risk Transfers" published Oct. 19, 2023.

- **U.S. Non-Traditional ABS:** S&P Global Ratings recently published a slide deck highlighting issuance trends and our fourth-quarter 2023 outlook for the U.S. non-traditional asset-backed securities (ABS) sector: "Non-Traditional ABS Year-To-Date 2023 Issuance And Fourth-Quarter Outlook," published Oct. 19, 2023.

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. 20, 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. $)
20-Oct	Upgrade	Hellenic Republic	Sovereign	Greece	BBB-	BB+	155,935
20-Oct	Downgrade	Arab Republic of Egypt	Sovereign	Egypt	B-	B	32,668
19-Oct	Downgrade	Walgreens Boots Alliance, Inc	Retail/Restaurants	U.S.	BBB-	BBB	9,658
17-Oct	Upgrade	Sedgwick L.P.	Insurance	Cayman Islands	B+	B	7,000
16-Oct	Downgrade	Rite Aid Corp.	Retail/Restaurants	U.S.	D	CCC-	2,169
16-Oct	Downgrade	SUSE S.A.	High Technology	Luxembourg	B+	BB-	1,950
20-Oct	Upgrade	Prestige Consumer Healthcare Inc.	Consumer Products	U.S.	BB	BB-	1,600
18-Oct	Downgrade	Sotheby's (BidFair Holdings Inc.)	Retail/Restaurants	U.S.	B	B+	1,358
18-Oct	Upgrade	TI Fluid Systems plc	Automotive	U.K.	BB	BB-	1,212
20-Oct	Downgrade	Alstria Office REIT-AG	Homebuilders/Real Estate Co.	Germany	BB+	BBB-	1,159

Source: S&P Global Ratings Credit Research & Insights. Data as of Oct. 20, 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**.**