

Which Emerging Market Banking Sectors Are Vulnerable To Property-Related Losses?

S&P Global
Ratings

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This report does not constitute a rating action

Property-Related Pain Varies Across EM Banking Sectors

- Downside property-related risks for emerging market (EM) banks are diverse and differentiated across the various markets.
- Property stress in China and Vietnam will weigh on the asset quality of banks. The ongoing turmoil could weaken homebuyers' confidence and further curb home sales.
- China banks have sufficiently diverse lending and adequate capitalization to absorb these strains. We also expect quantitative easing and regulatory forbearance in Vietnam to blunt property headwinds.
- Several other property markets across EMs could see price adjustments due to tighter lending conditions, slowing economic activity, and cyclical factors. We expect this to be gradual and manageable.
- We note that in our sample of countries, exposures are predominantly weighted toward mortgages. These tend to be more resilient as long as labor conditions remain supportive. Pockets of higher risk in construction and commercial real estate (CRE) are contained, and loan-to-value (LTV) ratios are conservative.

China | Weak Homebuyer Confidence May Further Delay Loan Recovery

Lending to China's weaker developers discouraged

Delaying recovery in loan quality (%)



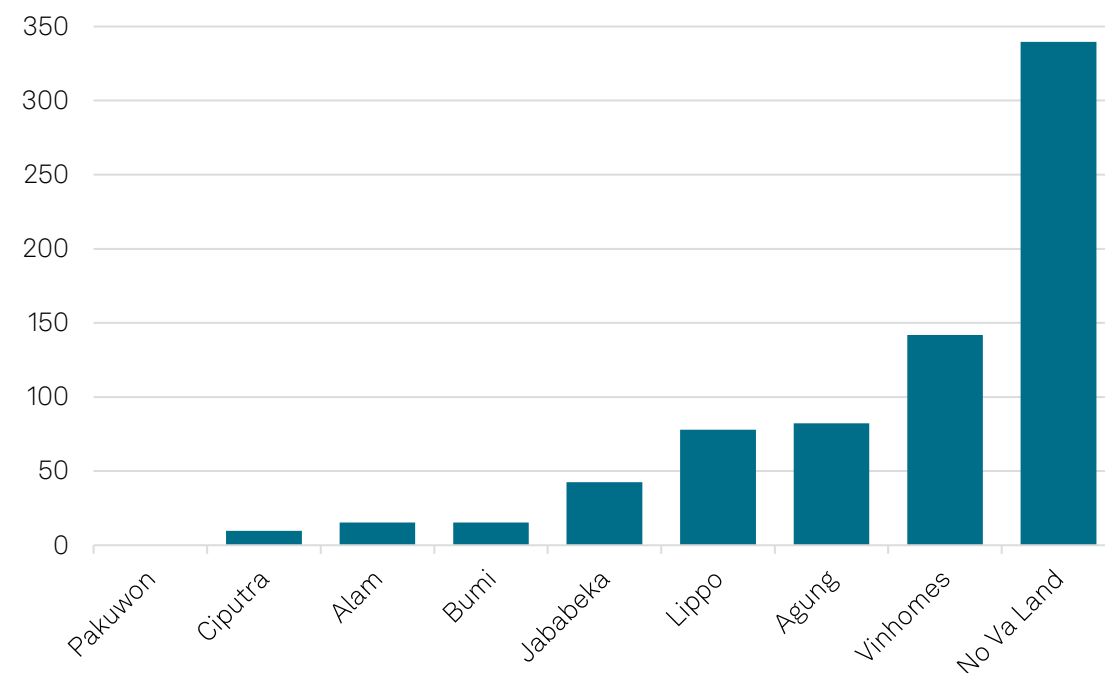
NPL--Nonperforming loan, e--Estimate, f--Forecast. Source: S&P Global Ratings.

- After signs of stabilization earlier in the year, China's property market faces more stress. Potential defaults by developers could cause a disorderly correction.
- By our estimates, national property sales will fall 10%-15% this year. In absolute numbers, that is equivalent to RMB11.5 trillion-RMB 12 trillion in 2023. We expect 2024 sales will decline by another 5% to RMB11 trillion-RMB11.5 trillion. Nonetheless, a greater decline in 2024 in property sales is less likely given the double-digit shrinkage seen in both 2022 and 2023.
- Property-related loans make up about 23% of total bank loans: of which 17% is mortgage and about 6% property development loans. Bank exposure to CRE is limited and about half the property development loans are for affordable housing projects, which carry relatively low credit risks.
- Nonperforming loan (NPL) risk is manageable for mortgage loans; the NPL ratio remains low at less than 0.5% generally.
- Property development loans have higher risk. Under our base-case scenario, NPLs for the segment would rise to about 4.7% over the next two years, before recovering to 4.0% in 2025.

Vietnam | Property Strain Is Spilling Over To Banks

Vietnam developers have greater reliance on short-term funding

Short-term debt as % of total cash as end of Dec. 2022



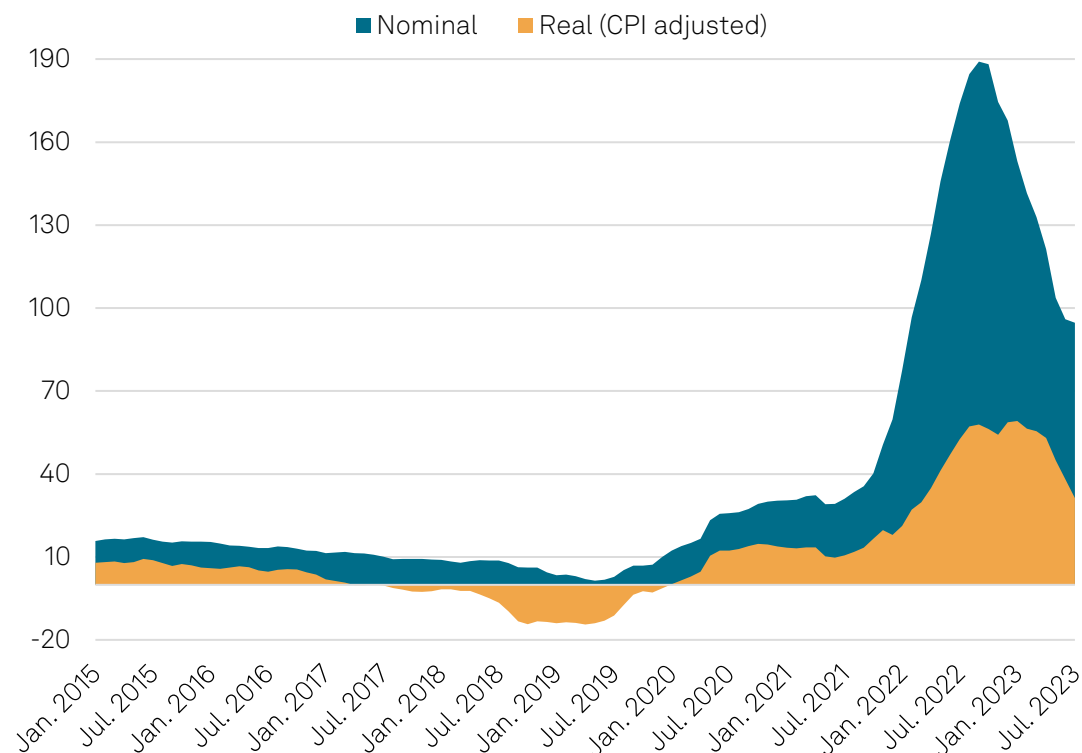
For comparison, the chart includes Indonesian developers: Lippo--PT Lippo Karawaci Tbk. Ciputra--PT Ciputra Development Tbk. Bumi--PT Bumi Serpong Damai Tbk. Alam--PT Alam Sutera Realty Tbk. Agung--PT Agung Podomoro Land Tbk. Pakuwon--PT Pakuwon Jati Tbk. Jababeka--PT Kawasan Industri Jababeka Tbk. The Vietnamese companies are Vinhomes--Vinhomes Joint Stock Company and No Va Land--No Va Land Investment Group Corp.. Sources: Company disclosures, S&P Global Ratings.

- Vietnam's property developers are still struggling to repay debt after the government cracked down on the rapidly expanding sector in 2022 (see more on the measures in [“Vietnam’s Property Strain Could Spill Over To Banks,”](#) July 25, 2023).
- By our estimates, aggregate residential sales will contract by 15%-20% in 2023; this follows growth of 25%-30% in 2022. These factors have weakened the debt-servicing capacity of real estate developers.
- Property exposures make up about 25% of banks’ total loans. Of this: mortgage loans at about 15%, followed by CRE at about 7%, and corporate bond holdings at roughly 3%.
- We think mortgage loans look manageable. Banks are more likely to suffer nonpayment from CRE loans. In a worse-case scenario, sector-wide NPLs would rise to about 4.5% from 2.8% as of March 2023.
- Vietnamese authorities have acted swiftly this year, with rate cuts, delayed loan payments and debt restructuring assistance. This will alleviate, but not eliminate, the fallout from the property sector on banks.

Türkiye | Property Prices Should Gradually Adjust After Prolonged Strength

Residential property prices showing deceleration

Residential property prices index (annual % change)



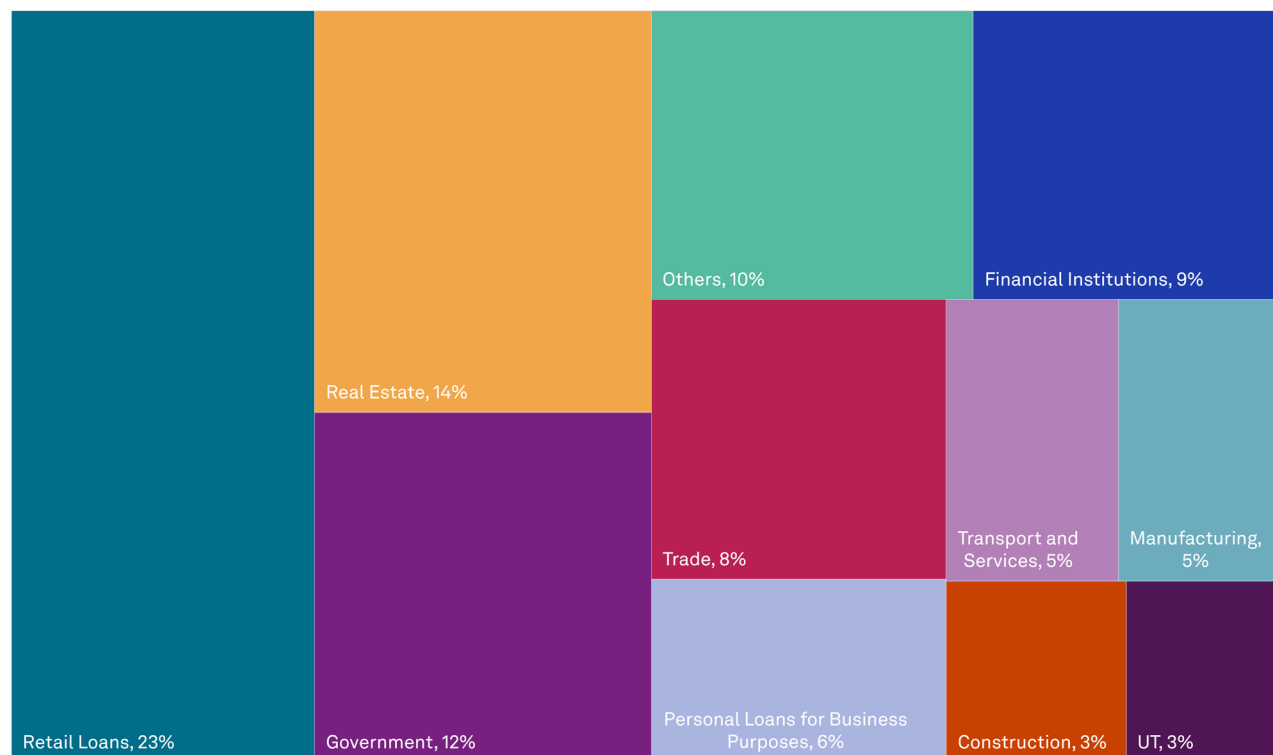
Source: Central Bank of The Republic Of Türkiye.

- Real estate prices have been strong for years as residents seek to hedge inflation. Foreign investment was lively (particularly from GCC and Russia) in part on easing of foreign homeownership rules—which are now tightening again.
- We now also expect tighter financing conditions under the new central-bank leadership. This will likely weaken the momentum in the real estate prices over the next 12-18 months; however, we expect the process will be gradual given negative real interest rates and a good proportion of self-financed buyers.
- Risk for banks are currently contained as housing loans represent less than 5% of total loans and are all at fixed rates.
- We view the construction sector--representing 7% of systemwide loans--as riskier for banks given its sensitivity to the economic cycle. With further weakening of the lira, rising costs, tightening financing conditions, and slowing demand we expect Turkish constructors to face increasing difficulties.
- Although not our base case scenario, a sharp housing market correction could result in a substantial increase in bank credit losses because this would lower the valuation of real estate assets held as collateral.

Dubai | Going Strong But Volatility Is Inherent

Loan books are pretty well diversified in Dubai

Breakdown of loan portfolio by sector



Data as of June 2023. Sources: Central Bank of the UAE, UT: Utilities

- Demand for Dubai residential real estate is demonstrated by a double-digit surge in transaction numbers, price increases, and record presales for developers over the past 12-24 months. This was supported by the new visa regime, liberalization of social laws, and a good economic and tourism recovery.
- We believe that price growth will taper over the next 12-18 months. The contribution of residential mortgages in total real estate transactions has slowed as interest rates rose. The impact on real estate demand will be limited due to the high proportion of self-financed transactions.
- Risk for banks is contained due to the strong performance of the real estate sector over the past three years, as well as favorable cash-collection terms for the developers allowing faster project de-risking.

South Africa | CRE-Related Risks Are Manageable For Banks

South African banks exposures to real estate (%)



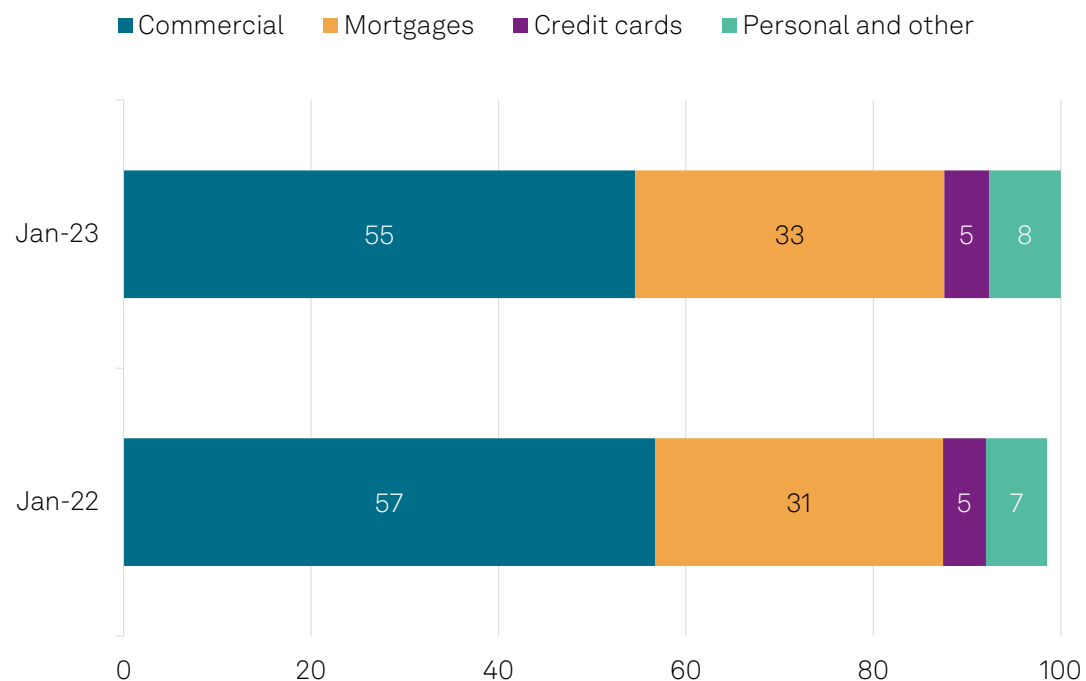
Data as of year-end 2022. Source: Banks' financial statements

- Returns in the South Africa's listed property sector turned negative in 2022 amid higher inflation and rising interest rates. We expect pressures on CRE valuation will persist in 2023, with rent and earning curtailed by vacancy rates exceeding 15%.
- Residential prices will soften in 2023 on waning household affordability. Mortgage growth will also be muted as banks will tighten their risk appetite and prioritize customers with high disposable incomes.
- Risk appetite toward CRE differs among banks. But sector exposure is moderate at less than 4% of total exposures at year-end 2022.
- Banks' CRE portfolios mostly have conservative LTVs of about 50% and good collateral because the underlying anchor tenants are large retail groups. SA banks are generally exposed to low geared top REIT companies. Banks' credit loss ratio in this portfolio has been low, at below 0.5%.

Chile | Property-Related Risks For Banks Are Contained

Commercial loans dominate

Chilean bank system's portfolio distributions (%)



Sources: Chile's Financial Market Commission, S&P Global Ratings.

- Real-estate performance in Chile is negatively affected by higher financing and construction costs, plus lower demand due to high prices relative to income.
- We expect property prices to moderate in 2023, though a lack of land and restrictions to expand puts a limit on price falls. Our base case is that prices will adjust gradually since investments in construction have been manageable.
- Mortgage credit growth moderated to 3.7% year on year as of June 2023, from 7.6% in June 2022. Residential prime mortgages represented 33% of total loans in June 2023.
- Some construction companies failed in the past year. Chilean banks have been reducing their exposure to the sector since the pandemic and they mainly only lend to large players.
- Weakness in construction has not, thus far, undermined the strong asset-quality metrics of local banks. We don't expect a major impact because the exposure to construction companies and developers is around 12%, of which construction companies only 3%. Bank exposure to offices is low because most of the developments have been for housing.

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