Credit Outlook September 2018: Regional Highlights

	North America	Europe, Middle-East and Africa	Asia-Pacific	Latin America
Risks and imbalances	Indirect effects on investor, business and consumer sentiment could increase the economic disruption from tit-for-tat retaliatory tariffs between the U.S. and its major trading partners. The corporate debt build-up continues despite monetary policy normalization, pushing a mature U.S. credit cycle nearer to a turning point. Housing market imbalances remain a key vulnerability for Canada's economy.	Escalating trade tensions threaten to ensnare the European auto industry. The likelihood of a disruptive Brexit in March 2019 is increasing and unwillingness of the U.K. and EU to publicly coordinate their "no deal" safeguarding measures risks exacerbating disruption. Risk is increasing for Turkish banks because of the significant depreciation of the Turkish lira and deteriorated relationships with Western allies.	The U.S.-China trade battle could spill over into services as China's goods imports from the U.S. total $130 billion and China cannot quantitatively match U.S. tariffs on $250 billion of its imports from China. The corporate sector's deleveraging trend is pausing alongside decelerating earnings. Developing market portfolio outflows also hit the Indian rupee, Indonesian rupiah.	Investor sentiment toward emerging markets remains fragile and volatile -- episodes of capital outflows and pressure over currencies could threaten access to financing. The recent softening in some commodity prices (notably metals) could bring additional risks for Latin America. Uncertainty persists around Brazil's elections and the ability of next administration to pass crucial reforms for the country.
Macroeconomic conditions	U.S. economic momentum is likely to remain solid this year and next amid a strong labor market, still-bullish consumer confidence and favorable manufacturing sentiment. In a full-blown trade war, corporate spending could dry up, with disrupted or severed supply chains harming production efficiency, boosting costs, and curbing job growth. Business spending, falling unemployment and buoyant consumer sentiment is supporting Canadian GDP.	Eurozone GDP growth has peaked and is converging gently toward potential. Core inflation is likely to converge slowly toward target as wage growth accelerates modestly. We expect the euro to remain at its current level until mid-2019 in a context of political uncertainty and rising monetary policy divergence with the US. The U.K. looks to be on track for GDP to increase 1.3% or slightly better through the status quo Brexit transition until 2020.	Sentiment indicators are now weaker across the region suggesting trade war uncertainties might be taking a toll. The second round effects on confidence from the trade war appear to be materializing, and the recent flare-up in capital markets volatility imparts additional downward pressure to our outlook. For now solid data flow is keeping our baseline growth outlook unchanged.	Economic growth in the region is no longer synchronized and now we are expecting a recession in Argentina and lower growth in the region overall. External financing conditions for Latin American borrowers have tightened further amid ongoing U.S. dollar strength and rising U.S. short-term interest rates. For Mexico, we continue to see services-led growth, and expect trade and investment relations with the U.S. to remain broadly unchanged.
Financing conditions	We expect the Fed to continue along its current path, raising rates a total of four times this year and three times in 2019, which could see the yield curve invert. Corporate bonds yields have crept up somewhat from their decade-long lows, but credit spreads remain tight.	Private-sector credit conditions remain borrower-friendly in the Eurozone -- credit standards remaining lax for loans to households and enterprises. Tighter U.K. financing conditions are dampening consumer credit and business lending. Borrowing appetite should ebb except for working capital and short-term facilities ahead of Brexit.	For emerging Asia specifically, financing conditions are expected to deteriorate later this year. Chinese authorities have been engaged in an aggressive effort to deleverage corporations since 2016, yet in the year to date, the region's nonfinancial bond issuance is up 50%.	Despite the high levels of liquidity in the markets, investors are asking higher risk premiums and are becoming more adverse to emerging markets and speculative grade issuers. Although banks have adequate to solid fundamentals, their appetite to originate loans is highly linked to economic growth.
Sector trends	Auto, commercial real estate, and credit-card lending are among the "at-risk" sectors we're watching to gauge asset quality for U.S. banks. Pockets of weakness for U.S. corporate sectors include consumer products and retail, while the rapid expansion in speculative-grade bond issuance and leveraged lending, as well as covenant-lite deals are vulnerabilities that could amplify credit stresses if lender risk appetites sour. U.S. states are operating in a stronger revenue environment and yet their fiscal health is challenged by upward pressure on mandatory expenditures for Medicaid, pension contributions, and retiree health benefits costs.	Although European banks balance sheets remain sound, profitability is generally still sub-par. Business conditions are satisfactory for European corporates even as profitability margins in certain sectors appear to be softening due to rising input costs from the labor market. Companies, especially in the UK and Ireland, would also have to overcome supply-chain bottlenecks if faced with a disruptive Brexit scenario. The end to the ECB's quantitative easing and its impact on asset prices and therefore asset allocations is one of the main risks that insurers face in coming quarters.	The asset quality outlook for Indian banks remains weak, but this is an outlier amid a trend of relatively low non-performing loans for financial institutions in many Asia-Pacific jurisdictions, including Taiwan, Australia, New Zealand, Singapore, Hong Kong, and Japan. Automakers and suppliers are facing intensifying competitive pressure while telecommunications players in a few Southeast Asian countries, India, Australia, and Taiwan are dealing with mounting competition or regulatory change. Aggressive investments to enhance profits, amid intensifying market competition across the region, expose insurers to greater investment volatility.	The region will grow at a modest pace again this year, highlighting its structural weaknesses. Many years of recession in Brazil, and low GDP growth in Mexico, have contributed to recent political trends that raise the risk of populist or ineffective economic policies. Credit demand remains subdued in the largest economies (Brazil, Mexico and Argentina) due to weak investor confidence and economic performance. Banks financing needs will remain manageable, also because they are mainly funded by retail deposits. Political risk continues to weigh on nonfinancial companies' growth prospects and they're also challenged by depreciated currencies, subdued access to capital markets financing and worsening domestic conditions.

Source: S&P Global Ratings.

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