S&P Global Ratings

Regional Credit Conditions Chair

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Credit Conditions Emerging Markets Q2 2022:

Conflict Exacerbates Risks

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Key Takeaways

- Overall: The Russia-Ukraine military conflict is hampering already feeble credit conditions in emerging markets (EMs). Inflationary pressures were already denting corporations' margins and households' purchasing power prior to the conflict. Now the rising energy and food prices have intensified challenges, at least over the short term, because the potential for a severe confidence shock could weaken global demand and cool off prices.
- Risks: Downside risks for EMs are significant. Additional inflationary pressures and persistently high energy prices could result from an extended conflict between Russia and Ukraine, especially if sanctions on Russia hit its hydrocarbon exports. EM sovereigns are struggling to deal with the pandemic costs, managing inflation, and meeting protracted social demands, a balance between fiscal consolidation and social strife. At the same time, financing conditions could weaken rapidly following the hasty U.S. monetary tightening or continued escalation of the military conflict.
- Credit: Financing conditions have tightened amid rising volatility. Spreads have surged for EM corporates, particularly those in the EEMEA region. Investors are becoming more selective, while some low-rated entities may struggle to refinance their debt or raise capital if current market conditions persist.

(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions [Asia-Pacific, EMs, North America, and Europe]. Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the EMs committee on March 22, 2022)

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Top EM Risks

Table 1

Heightening geopolitical tensions and difficult domestic political conditions weaken credit fundamentals

Risk level* Very low Moderate Elevated **High** Very high Risk trend** Improving Unchanged **Worsening**

The ongoing Russia-Ukraine military conflict has spurred food and energy prices, further heightening inflationary pressures. If the conflict continues escalating, triggering further sanctions on Russia that curtail gas and oil purchases from this country, energy prices will rise further, weighing on confidence and growth. The conflict is undermining Russia and Ukraine's significant role in global food commodity exports, which is also causing food prices to rise. An escalating and long-lasting conflict will further pressure food and energy prices, which would rise tensions across EM households that could trigger social unrest. At the same time, EMs are still dealing with the fallout from the pandemic, which heightened debt burdens and fiscal pressures. For EMs, maintaining economic growth while containing fiscal trajectories and potential inflation-related social backlashes, will be critical over the coming quarters. Population in EMs has become more sensitive to higher taxes or reduction in government transfers, given historical income inequalities and lack of access to basic services. Sustained pressure on households, along with governments' attempt to roll out fiscal consolidation measures, could result in social unrest, ultimately reducing policy predictability.

Disorderly monetary tightening raises volatility in financing conditions and borrowing costs, and reduces access to credit markets

Risk level* Very low Moderate Elevated **High** Very high Risk trend** Improving Unchanged **Worsening**

Many EM markets, most notably those in LatAm, are exposed to a rapid tightening cycle in the U.S., which could result in investment outflows, lower investor appetite, and headwinds for dollar-denominated debt in the form of higher financing costs and potential currency depreciation. At the same time, many EM central banks (except in China) are already increasing interest rates amid domestic inflationary pressures- while the Russia-Ukraine conflict has curtailed access to credit markets for many borrowers, most notably for those at the lower end of the rating scale. The EMs most at risk are the usual suspects; those that heavily rely on foreign funding and with large external and/or fiscal imbalances, and those with a high proportion of lower rated borrowers confronting near-term refinancing risk. If the Federal Reserve were to accelerate monetary tightening with an objective beyond its neutral interest rate, financing conditions could rapidly worsen and cause a sudden liquidity squeeze for EM issuers.

Sustained inflationary pressures and persistently high prices weaken fundamentals among corporations, households, and banks

Risk level* Very low Moderate Elevated **High** Very high Risk trend** Improving Unchanged **Worsening**

EMs were already facing inflationary pressures amid uneven economic recovery and supply-chain disruptions. The military conflict in Ukraine has exacerbated inflationary pressures, as energy and food prices have spiked. If the military conflict continues escalating, sanctions on Russia could heighten, which could curtail its energy exports, raising pressure further on gas and oil prices. The conflict could also cause knock-on effects on food prices, not only from the energy hike pass-through, but given Ukraine and Russia's large share of global wheat and corn exports, on fertilizers. Furthermore, continued supply-chain disruptions in metals exports, such as palladium, and hydrocarbons, are likely given Russia's relevance in these markets. Overall, higher prices could depress corporate margins, households' purchasing power, and banks' asset quality. In some EMs, these dynamics could result in stagnation.

China's policy stance clouds credit and growth trajectories

Risk level* Very low Moderate **Elevated** High Very high Risk trend** Improving **Unchanged** Worsening

Downside risks to China's GDP growth are relevant, not only for 2022 but for the long term as well. China's very strict approach to COVID-19 containment results in recurring imposition of lockdowns. The risk of a wider outbreak of COVID-19 could undermine domestic consumption and economic growth. Concurrently, ongoing weakness in the property sector could spill over into finances of local and regional governments and of other exposed sectors. Meanwhile, China's widening scope of socio-economic policies ('common prosperity' and 'dual circulation') and efforts to curb leverage could weaken business and consumer confidence, fueling contagion risk. Moreover, intensifying strategic confrontation between the U.S. and China (over Russia and the South China Sea region) would dent investment, trade, and supply flows within and outside the area. Beyond China, these policy and economic developments could affect other countries reliant on China for exports or finance (e.g., EMs) and imports (e.g., component parts).

The prevalence of COVID-19 across key EMs, slow vaccination progress, and new variants dampen economic recovery

Risk level* Very low Moderate **Elevated** High Very high Risk trend** **Improving** Unchanged Worsening

Risk remains that a new more contagious and severe COVID-19 variant could undermine economic activity. COVID-19 cases are trending down rapidly across most EMs. The Omicron wave had little impact on economy, given that containment measures were milder, people have learned to live with the virus, and the health emergency didn't overwhelm hospitals thanks to vaccinations. China remains a notable exception because it continues to follow a zero-tolerance COVID policy and implementing severe containment measures to control the pandemic. Such measures could cause temporary supply-chain disruptions for some industries.

Climate change and rising adaptation costs

Risk level* Very low Moderate **Elevated** High Very High Risk trend** Improving Unchanged **Worsening**

If current policies to achieve net zero carbon emissions are not stepped up, physical risks of climate change are set to increase in frequency and impact. EMs located near the equator are particularly exposed to heatwaves and droughts as global warming increases, while island states are set to face more frequent storms and will be more exposed to higher sea levels. These climate hazards become more costly and disruptive, they could pressure sovereigns' creditworthiness. At the same time, stepping up adaptation to climate change may represent an additional fiscal burden for the most vulnerable countries.

Source: S&P Global Ratings.

* Risk levels may be classified as very low, moderate, elevated, high, or very high, and are evaluated by considering both the likelihood and systemic effect of such an event occurring over the next one to two years. Typically, these risks are not factored into our base case rating assumptions unless the risk level is very high.

** Risk trend reflects our current view on whether the risk level could increase or decrease over the next 12 months.

Regional Credit Conditions

Risks Intensify For EMs

EMs are already confronting challenging credit conditions due to mounting inflationary pressures and tightening financing conditions. The shockwaves from the pandemic are compounded by the spillover from the Russia-Ukraine military conflict. Our baseline assumptions for the year incorporate lower GDP growth and higher inflation (see chart 1). The balance of risks is quickly worsening, and negative rating bias will probably pick up over the coming quarters, especially if the conflict further escalates.

Rising inflationary pressures and financing costs will impede fiscal consolidation and strain EM governments' credit quality. The Russia–Ukraine conflict has exacerbated inflationary pressures by ratcheting up energy and food prices (see chart 2), which could prompt governments to extend or reimpose some of the temporary fiscal measures that were established during the pandemic, instead of originally phasing them out. This would weigh on growth and prolong fiscal rebalancing, which would hurt creditworthiness and ratings.

The pandemic has exacerbated long-standing paltry living conditions and curtailed access further to services in EMs, which limits room for governments to make politically difficult economic decisions. We have seen bouts of social unrest in some EM countries (Kazakhstan, Chile, Colombia, and South Africa), which have prevented governments from adopting fiscal belt-tightening measures.

Persistent inflationary pressures and high prices will erode credit fundamentals across EMs. Inflation has a greater impact on households in EMs than on those in developed economies, because spending on food, gas, and transportation represents a larger portion of their disposable income. Rising energy costs, along with elevated food prices, raise concerns about potential social instability in several EMs, ultimately reducing policy predictability. So far, rated EM corporations have been absorbing higher costs, but stress could heighten if inflation lasts much longer. At the same time, higher interest rates could raise debt servicing costs.

Higher interest rates could give EM banks a boost if inflation is temporary. However, if interest rates jump at a rapid pace, nonperforming loans and credit losses could soar as debt service needs for loans at variable rates increase. Such a scenario would have the potential to slow credit supply and demand, hindering economic activity.

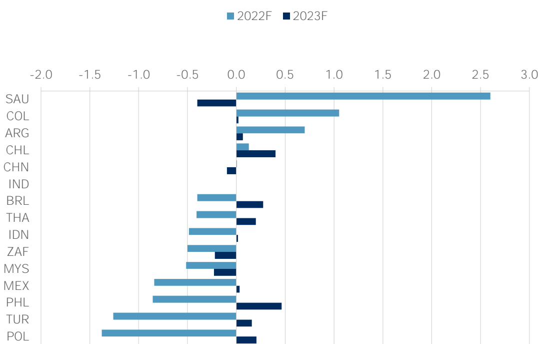
Amid tighter financing conditions, liquidity could be squeezed if the Federal Reserve's monetary tightening accelerates with an objective beyond its neutral interest rate. Most key EMs were raising their policy rates (see chart 3) prior to the military conflict because of inflationary pressures from supply-chain disruption and the uneven economic recovery. Overall, these factors, combined with the Russia-Ukraine military conflict, are causing financing conditions to tighten and borrowing costs for EM issuers to rise. Currently, lower rated issuers in EMs (in the 'B' category) are already finding difficulties in refinancing their debt or raising new capital. Financing conditions could worsen if the conflict escalates and/or the Federal Reserve accelerates its tightening beyond its current objectives.

Despite the volatile market conditions, EM currencies (with some exceptions) have remained fairly stable, some have even appreciated over the recent weeks. We believe this trend responds to investors' rebalancing their positions away from Russia, Ukraine, and the surrounding countries. Investors are still searching for yield in countries with a similar risk return profile; therefore, many EMs are receiving these capital flows. Nevertheless, EM currencies could weaken if current conditions prevail and there is a confidence shock.

Our last reading for negative rating bias has soared in EM EMEA because of the Russia-Ukraine military conflict (see chart 4) So far, most rating actions related to the conflict have been among entities based in Russia and Ukraine and their subsidiaries or affiliates. We downgraded or revised the outlook to negative on a small number of entities, given their relative exposure to Russia, Ukraine, or the conflict spillover (see Rating Actions Waypoint: The Russia-Ukraine Conflict As of March 18, 2022). In our view, our negative rating bias could increase across EM economies if the conflict escalates and its pernicious impact on food and energy prices rises.

Chart 1

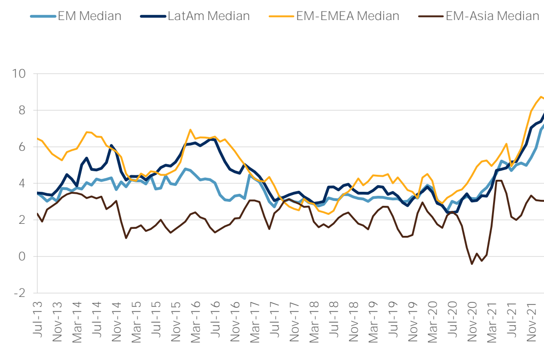
Change In Baseline Forecast From November 2021



Source: Oxford Economics. F--S&P Global Ratings forecast.

Chart 2

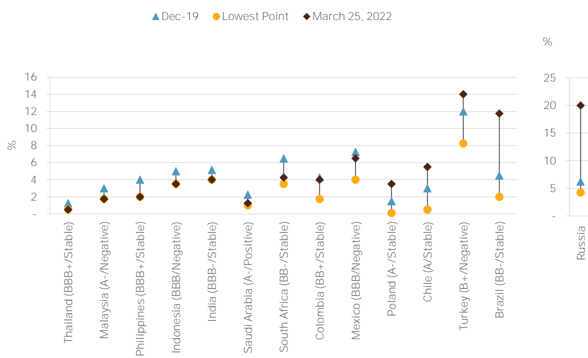
Inflation Will Exceed Central Banks' Targets In Most EMs



Source: S&P Global Ratings, Haver Analytics.

Chart 3

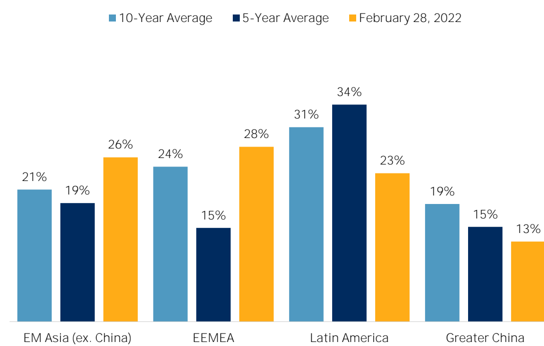
Inflation Weighs On Monetary Tightening



Source: Central banks and monetary authorities from respective countries. Sovereign ratings as of March 28, 2022.

Chart 4

EEMEA Overtook EM Asia (Excluding China) With The Highest Negative Bias



Note: Data as of Feb. 28, 2022, and exclude sovereigns.
Source : S&P Global Ratings Research.

Macroeconomic Conditions

(Editor's Note: The views expressed in this section are those of S&P Global Ratings' economics team. While these views can help to inform the rating process, sovereign and other ratings are based on the decisions of ratings committees, exercising their analytical judgment in accordance with publicly available ratings criteria.)

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Growth Moderation Amid Higher Commodity Price Inflation

- Overall, we have lowered our real GDP growth forecasts for EMs to 4.0% in 2022 and 4.3% in 2023 (from 4.8% and 4.4% earlier). The bulk of downward revision to growth is for EM Europe, while impact on growth is less severe on other EMs.
- Supply shocks from higher commodity prices and logistics cost will exacerbate price pressures. Although commodity producers will benefit from higher prices, consumer price inflation in median EM will be 1.2 percentage points (ppts) higher in 2022 than our November inflation forecast, deepening the hit on households' purchasing power.
- Broadening inflationary pressure means we now expect tighter monetary policy across most EMs, especially with the Federal Reserve indicating a swifter policy tightening stance.
- A prolonged Russia-Ukraine conflict is a key downside risk for EMs. The concurrent risks of faster Fed tightening and sagging investor sentiment due to the conflict may trigger financial market volatility, leading to weaker exchange rates and significantly higher yields.

As most EM economies continue to recover from the COVID-19 crisis, the Russia-Ukraine conflict and inflation risks now dominate the outlook. The circumstances surrounding geopolitical tensions continue to evolve quickly in unexpected ways and the implications for the global economies are highly uncertain. In the near term, the conflict is likely to ratchet up pressure on inflation and weigh on economic activity across core EM economies.

Stronger-Than-Expected Macro Data Since Our Last Report

The conflict escalated midway through first quarter--at a time when macro data since our last Credit Conditions Committee report (in November) posted stronger-than-expected levels globally, including across most EM economies. Combined with historical revisions, overall real GDP growth in 2021 was 7.3% for our sample of EM-16 countries, 0.3 ppts higher than we expected in November. Excluding China and India, EM-14 likely grew 5.6% during the year, sharply above our 5.0% forecast. In the fourth quarter of 2021, Mexico, the Philippines, and Thailand were the only economies among 16 EMs with real GDP growth still below 2019 Q4 levels.

The Omicron variant of COVID-19 spread quickly, but its economic impact was limited. S&P Global's Manufacturing PMIs (previously, IHS Markit) in the first two months of the year pointed to decent industrial growth even as the Omicron variant's spread was acute during that period. Only two out of 16—Russia and Mexico—were struggling (manufacturing PMI index of less than 50) before the conflict began. However, PMI surveys also suggest that supply chains remain stretched. Supplier delivery times are still increasing, albeit at a slower rate, and backlogs of work are continuing to build.

The Russia-Ukraine Conflict Likely To Exacerbate Supply Shocks

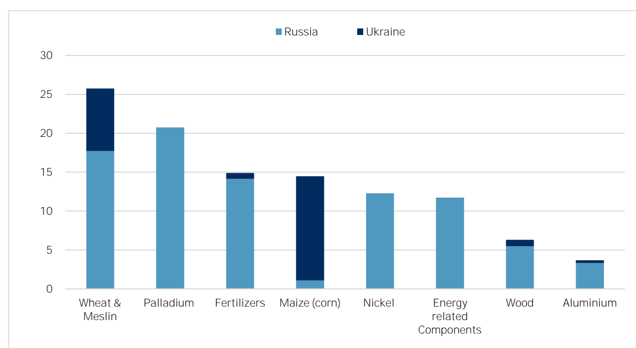
The Russia-Ukraine conflict could cause shortages to deepen and pressure on prices to rise. Russia is an important exporter of hydrocarbons, fertilizers, and metals, while Russia and Ukraine are major producers of grains, particularly, wheat and corn (see chart 5). Russia is facing difficulties in exporting some of its products because of sanctions, logistical issues, and unwillingness of some established trade partners to buy Russian products, while Ukraine has been cut off physically in many ways. In addition, Belarus (which is subject to international sanctions) is a major exporter of fertilizers, particularly potash, accounting for one-fifth of the world's total exports. The conflict has caused a widespread surge in commodity prices. Prices for some commodities have jumped by more than 30% in the past several weeks (see chart 6).

For most EMs outside of emerging Europe and Central Asia, direct trade, and financial and other economic ties with Russia are very small as a percentage of each country's GDP--and even smaller

with Ukraine. Nevertheless, the conflict is disrupting Russia and Ukraine's role as major exporters across many commodity classes, straining global supply chains, which would weigh on the EMs' industrial production. Disruptions to the supply of metals (such as palladium and nickel) and gases (such as xenon) could deepen capacity underutilization in the EM auto production (Mexico and Brazil), which is already hampered by the ongoing semiconductor shortage. On the other hand, South Africa—a major exporter of platinum group metals that include palladium, one of the rarest metals on earth used in auto production--is poised to increase its investments and exports to compensate partly for the removal of such metals from the market (either due to sanctions imposed on Russia or self-avoidance from sourcing companies).

Chart 5

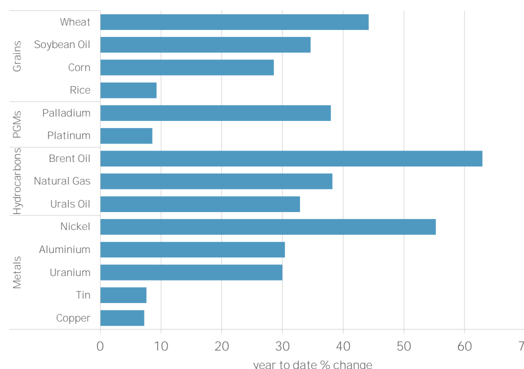
U.S. Dollar Exports 2020



Source: UN Comtrade, WITS, and S&P Global Economics. Note: (1) The product categories identified are based on HS-2017 classification. (2) Energy related components comprise of all items HS 2012-27.

Chart 6

Change In Price Indices For Key Commodities Since Jan. 1, 2022



Source: Datastream, S&P Global Ratings Economics, as of March 24, 2022.

Summary Of Key Baseline Forecast And Policy Changes Since November

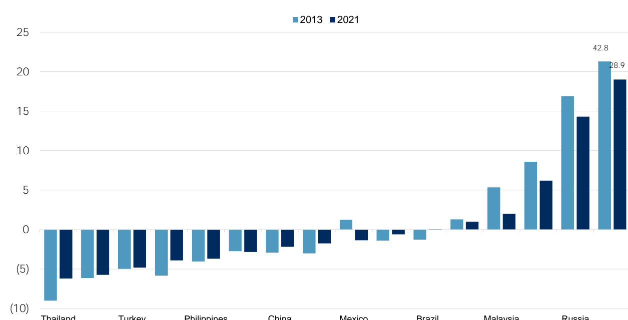
- Macro Data Revision And Omicron Impact: Since our last Credit Conditions Committee report, global macro data has been stronger than expected, including across most EM economies. For some countries, the "carry-over effect" has a strong effect on 2022 growth. The Omicron variant of COVID-19 spread quickly, but its economic impact was limited. We assume the economic cost of subsequent virus waves will be less than those of previous waves.
- Global Growth Forecast Trimmed: World growth revised downwards by 0.6 ppts in 2022 and 0.2 ppts in 2023. Contribution to consumer demand growth shifts from tradable goods to non-tradeable services as normalization of service sector strengthens.
- The Russia-Ukraine Conflict: We assume the most acute impact of the conflict on key commodity markets, supply chains, and global confidence to occur in the first and second quarters, with lingering but lesser impact the rest of the year and beyond in our forecast horizon. A key assumption is that energy flows from Russia will continue.
- Russia's Growth: We pencil in Russia's real GDP to decline by 8.5% this year, compared with previous expectation of a 2.7% growth.
- The Federal Reserve: We now pencil in a 175 basis points (bps) federal funds rate increase in 2022 (including the March hike), followed by 100 bps cumulative rate rise in 2023. The Fed's tapering of asset purchases has ended, and we expect an announcement on the strategy for reducing the size of the balance sheet as early as in May.
- China: We assume an accommodative policy reaction to offset the damage to growth from the Russia-Ukraine conflict designed to keep our forecast growth rate this year broadly unchanged at around 4.9%.
- Energy prices: They're likely to remain higher over the coming months than our forecast a couple of months ago—prompting us to revise energy prices recently (see "S&P Global Ratings Raises Near-Term Oil & Gas Price Assumptions," published Feb. 28, 2022). We assume Brent crude price averaging $85 per barrel for the remainder of the year.

The Bulk Of Impact: Higher Commodity Prices

Commodity prices could influence deeply EM economies. Energy prices are likely to remain higher over the coming months than our forecast just a couple of months ago—as seen in our recent upward revision of energy prices (see "S&P Global Ratings Raises Near-Term Oil & Gas Price Assumptions," published Feb. 28, 2022). Ten out of EM-16 economies are net importers of energy (see chart 3). Structural vulnerability metrics point to Thailand, Turkey, Chile, the Philippines, India, and Poland as most at risk to the energy price shock (see "What Higher Energy Prices Mean For Emerging Markets," published March 4, 2022). Malaysia, Indonesia, South Africa, and Latin American countries (excluding Chile) are net exporters or close to neutral in energy trade. But composition of energy trade matters. In our view, because Indonesia, South Africa, and Latin American countries rely on refined oil imports, consumers in those countries will grapple with a higher price tag either directly or indirectly.

Chart 7

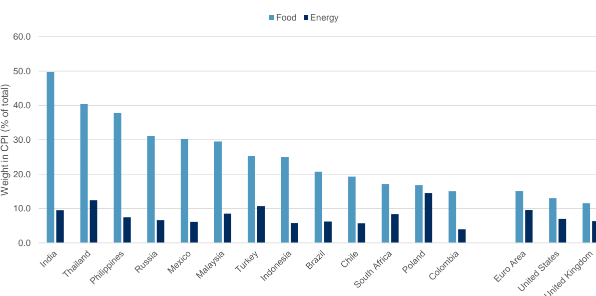
Energy Trade Balance As % of GDP In EMs



Source: World Bank (WITS), Oxford Economics, and S&P Global Ratings Economics. Note: Energy trade data is based on HS Code Chapter 27.

Chart 8

Food Consumption Accounts For A Higher Share Of Consumption In EMs



Source: Haver Analytics, Oxford Economics, and S&P Global Ratings Economics,

Agricultural commodity prices will potentially rise further in the coming months, given Russia, Ukraine, and Belarus's major role in global food commodity and fertilizer production. According to the World Food Programme, global inventories are already tight and last year's planting season took a hit from adverse weather conditions to the degree that the upcoming harvest looks bleak. Compared with advanced economies, food consumption accounts for a higher percentage of EMs' consumption baskets (see chart 8). In general, EM Asia seems to be less vulnerable to spillovers from the conflict in Ukraine, given its greater reliance on rice (instead of wheat).

Rising food prices have long been a catalyst for social and political upheavals in EM economies. In many countries in North Africa and the Middle East that are dependent on food imports, there are already reports of the population protesting against a sharp rise in prices. Governments might be tempted to try to shield households from the impact of higher food and energy costs. Latin American countries are particularly vulnerable. Given that they rely on refined oil imports, governments must choose between extending fuel subsidies and seeing deficits balloon or allowing inflation to run away from central banks' targets for a second straight year. Taxes make up a large share of energy prices in Brazil and Mexico (especially gasoline), and both governments have started to lessen the tax burden on energy consumption. While mitigating the impact of the price increases on inflation, income, and growth, it would likely add to fiscal strains. Overall, fiscal policy in many EM economies is constrained after two years of COVID-19-related budgetary support.

Updated Forecasts

We have lowered our real GDP growth forecast for 16 EMs for 2022 by 0.8 ppts to 4.0%, reflecting the downward revision for EM EMEA (see tables 1 and 2), largely driven by a massive revision to Russia (severe recession, while we expected a 2.7% GDP growth previously) and more than 1 ppt

downward revision to Poland and Turkey. We trimmed our forecast for EM-16 for 2023 by 0.1 ppt to 4.3%. Forecasts for 2024 and 2025 remain broadly unchanged, averaging 4.4%.

Inflation will be 1.2 ppt higher in median EM than our November forecasts, with median EM Asia 0.7 ppt higher, while median LatAm and median EM EMEA more than 2 ppts higher. Inflation will likely exceed central bank targets in more countries. Inflation will likely exceed central bank targets in more countries. Higher inflation will keep central banks across the EM in tightening mode in 2022. We have raised policy interest rates assumptions broadly for 2022 and beyond. Anchoring inflation expectations amid the upward pressure on headline inflation, combined with rising U.S. interest rates, will dictate the central bank policy decisions in the short term. In 2023, however, we expect central banks in Latin America to start cutting policy rates as inflation starts returning to targets, and the need to support growth will outweigh risk of de-anchoring inflation expectations.

Risks to our baseline forecasts are squarely on the downside. If the pandemic has taught us anything, it is that given the world's interdependent and complex supply chains, small disruptions in one region can be seriously amplified somewhere else; and a significant supply shock can lead to an even greater demand shock. Additionally, the virus continues to circulate, and the possibility of new variants remains a concern. New COVID-19 lockdowns in China also pose headwinds to globally integrated demand and supply, at least in the near term.

A key downside risk to growth and inflation forecasts come from energy prices staying elevated for longer than currently assumed in our baseline forecast. On average, our forecasts for oil and gas prices are about 30% higher in 2022 than in our November baseline. The effect is a spike in inflation in the next two quarters as prices rises sharply, followed by a decline in inflation as energy prices drift lower. Importantly, we also assume that oil and gas continue to flow from Russia to its energy trading partners. Our assumption could prove to be too optimistic if the current geo-political conflict worsens, raising energy prices much higher than in our baseline assumption.

Additionally, in the case of a sharper Fed tightening than what S&P Global Ratings currently assumes (or the market is currently pricing for that matter), the feed through to tighter monetary conditions would follow broadly in the EMs--those that have dollar pegs (e.g. the Gulf--—Saudi Arabia), follow the Fed closely (e.g. Mexico), or are at an early stage of their hiking cycles (South Africa), would face more upward pressure on their domestic interest rates. The interest- sensitive part of consumer demand will in turn likely be weaker and business investments delayed, all else equal. Higher interest rates, in the absence of stronger growth prospects, would in turn tame domestic demand. Combined with a higher commodity bill for many net importers, current account and public debt vulnerabilities may turn out to be larger than currently appreciated in our baseline case. (For our discussion on EM vulnerability, see "How Prepared Are Emerging Markets For The Upcoming Fed Policy Normalization?" published Jan. 27, 2022.)

Read our latest Emerging Markets Economic Outlook HERE

Russia

The Russian economy will experience significant fallout from the impact of international sanctions and decisions by Western businesses to either halt operations in Russia or cut ties with the country altogether. Such a combination of sanctions placed against it has never been imposed on a large, globally integrated economy before. Therefore, we have little to go on to predict how big the impact will be, other than that it will be deep and painful. Still, with a high degree of forecast uncertainty (and humility), we pencil in Russia's real GDP to decline by 8.5% this year. For comparison, the sharpest one-year decline was in 1992 when the economy shrank 14.5%, part of a much larger multiyear shrinkage of about 40% during transition from a centrally-planned to a market-oriented economy in the early 1990s. The Russian economy contracted 5.3% in 1998 during the financial crisis, and by 7.8% during the global financial crisis. The 2015 recession--triggered by falling oil prices and international sanctions--was milder, with GDP declining by 2%, while the pandemic-related downturn resulted in a 3% drop in output in 2020.

Even under the assumption that sanctions will spare Russia's commodity exports, we expect the country's overall export volumes to decline this year. Large-scale capital outflows have led to a

sharp drop in the ruble's value, prompting the central bank to hike the policy rate to 20% and introduce capital controls. The pass-through of the currency sharp depreciation to domestic prices is fueling inflation, which we expect to average 16% this year. Investment is set to plummet amid a confidence shock, a sharp tightening of financing conditions, and uncertainty about future demand. Even though a fiscal response will likely offset some of these trends, the overall decline in domestic demand will be sizable.

EM EMEA (Poland, Russia, Saudi Arabia, South Africa, And Turkey)

EM Europe Is The Most Exposed Region To The Russia-Ukraine Conflict

Given its geographical and economic proximity, EM Europe is the most vulnerable region to the Russia-Ukraine conflict through trade, financial links, and confidence. More importantly, through higher energy prices, because most of EM European economies are net energy importers. Moreover, they're exposed to elevated and highly volatile European gas prices. Higher energy and food prices are fueling already high inflationary pressures, with weaker exchange rates exacerbating these trends. Meanwhile, spreads have widened, more sharply than in other regions, tightening financial conditions. For the rest of key EM EMEA, the picture is mixed. Direct trade links with Russia are small, while commodity price rally is benefiting some commodity exporters, such as Saudi Arabia (oil) and South Africa (iron ore, platinum, and gold). However, the deceleration in global growth and a decline in confidence will likely limit these gains. A prolonged conflict, resulting in more severe trade, supply-chain, and possibly energy supply disruptions, is a primary downside risk for EM Europe.

To read our full report on EM EMEA, click HERE.

LatAm (Argentina, Brazil, Chile, Colombia, Mexico, And Peru)

The Impact Of The Russia-Ukraine Conflict On The Region's GDP Is Mild

This is due to LatAm's low trade and financial linkages with both countries. The main channel of transmission to the region is commodity prices. Most of the major LatAm economies are net commodity exporters, if food, metals, and energy-related commodities are included. As a result, commodity producers in the region could benefit from higher prices, assuming demand for those goods doesn't fall deeper than their respective increase in price. However, the region's consumers will feel the pinch from higher commodity prices through higher inflation, especially food and energy prices, which combined account for about one-third of the typical consumer price basket in LatAm. In our view, the net impact of the current increase in commodity prices on LatAm's 2022 GDP is harmful. We expect a weak first half of 2022, given that an uptick in inflation and interest rates, lower fiscal stimulus, continued supply-chain disruptions, and the initial hit to confidence from the Russia-Ukraine conflict take a toll on economic activity. We trimmed our 2022 GDP growth forecast for LatAm by 0.2 ppts to 1.7%.

To read our full report on Latin America, click HERE.

EM Asia (India, Indonesia, Malaysia, The Philippines, And Thailand)

Growth Likely To Be Resilient Despite External Shocks

While the region posted a strong recovery during the final quarter of 2021, a slower rise in global demand and impact from the Russia-Ukraine conflict will hinder growth. These factors will lower the expansion of exports and manufacturing, which were main growth drivers in 2021, while greater uncertainty and higher energy prices will weigh on domestic consumer sentiment. As a result, we lowered our 2022 growth forecast for EM Asia (excluding China) to 6.7% from 6.9% in November. High energy prices will be a sore point for the region's consumers, and in some economies, it will strain current account balances. While consumer price inflation remains low, it will rise this year, given higher energy and food prices. Excluding energy and food, core consumer price inflation is currently rising gradually in the region as well, presenting difficulties for central banks. Broadening

inflationary pressure will strengthen the case for tighter policy and higher interest rates, especially given the likelihood of a sharp rise in interest rates in the U.S. But weaker confidence and risk sentiment will weigh on growth and core price pressures. Central banks would want to avoid tightening policy in such an environment if they can.

To read our full report on EM Asia, click HERE.

Financing Conditions

A Period Of Commonality And Discordance Amid Rising Concerns

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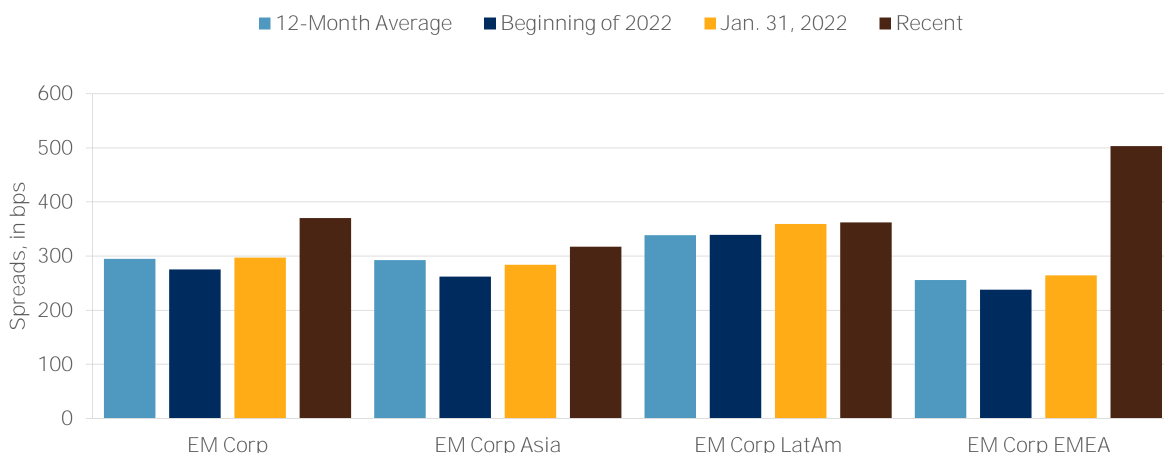
Global financing conditions are tightening as rising inflation and the conflict are generating significant market volatility. On the surface, EMs are no different from other major regions with benchmark yields and credit spreads, rising and falling issuance volumes and risk appetite. EMs have a lot to fear in terms of the global outlook and outcome of these risks, but a closer examination highlights both commonality and discordance by subregion and even sector: EM EMEA is bearing the brunt due to its geography and economic proximity to the Russia-Ukraine conflict.

Increasing food and energy prices--with many EMs as net importers of energy--will compound the woes that confront EM central banks that are already grappling with rising inflation and the consequences of a potential rapid rise in U.S. interest rates. Many, but not all, EM benchmark yields have risen to date in 2022--most notably in EEMEA--along with those for dollar-denominated debt--and many central banks in EMs are likely to continue to raise rates through 2022, raising financing costs.

Credit spreads are also rising but point to the diverging underlying risk tone among EMs. EM corporate spreads have widened by around 35% since the start of the year, which is broadly on par with credit spread widening in the other major regions. Concerns regarding credit pricing due to rising inflation and the consequence of tightening monetary policy, - as much as pockets of concern regarding current credit fundamentals have provoked this rise. However, the widening pales in significance to the over 100% jump in corporate EEMEA spreads where economic, credit, and market risks are soaring and unlikely to dissipate as the conflict continues. The focus on EEMEA should not ignore increasing corporate credit spreads within LatAm. While the latter to date has been contained - LatAm is probably the most vulnerable region to a rapid rise in U.S. interest rates and a stronger dollar, which could lead to investment outflows and soaring refinancing costs on dollar-denominated debt.

Chart 9

EM Spreads By Region (bps)

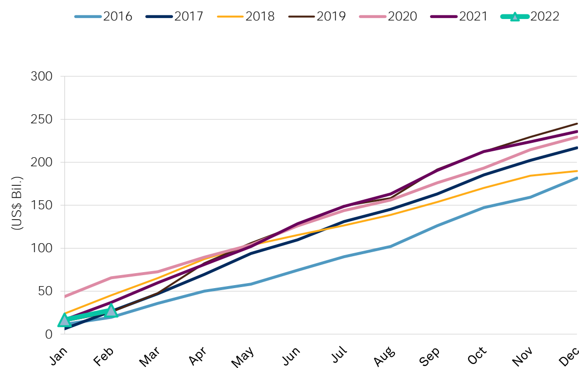


Note: Data as of March 24, 2022. Source: S&P Global Ratings Research, Thomson Reuters, ICE Data Indices, and Federal Reserve Bank of St. Louis.

Rising financing costs bring concerns over primary market activity and EM refinancing risk to the fore. Primary market activity is generally muted and down on 2021, although issuance volumes in EM Asia have held up well and Greater China volumes have surpassed the 2021 year-to-date volumes. However, issuances have mostly occurred among investment-grade entities, creating difficulties for speculative-grade issuers that will only increase, the longer primary markets remain volatile.

Chart 10

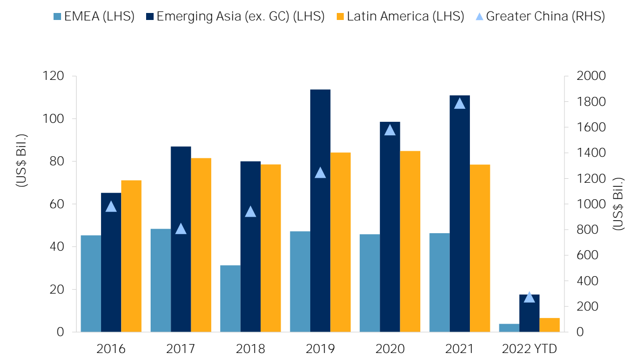
EM Cumulative Corporate Bond Issuances



Data as of Feb. 28, 2022, excluding Greater China. Data including not rated and both financial and non-financial entities. Source: S&P Global Ratings Research and Refinitiv.

Chart 11

EM Regional Bond Issuances



Data as of Feb. 28, 2022. For both financial and non-financial entities. Source: S&P Global Ratings Research and Refinitiv.

In term of refinancing risk, and according to data as of the beginning of 2022, LatAm seems to be relatively insulated from current volatility as an estimated 30% of rated corporate maturities in 2022 will be speculative-grade issuers, less than half of which have ratings below 'BB'. On the surface, and based upon the same data, the more exposed EEMEA seems to have a similar, if slightly weaker, profile with an estimated one-third of rated corporate debt in the region maturing in 2022 is from speculative-grade issuers. Around 50% of EEMEA maturities through 2023 will occur in two sectors, oil and gas and financial institutions. Both sectors may experience diverging credit impacts from the ongoing conflict.

Sector Trends

Chart 12

Negative Rating Actions In EMs

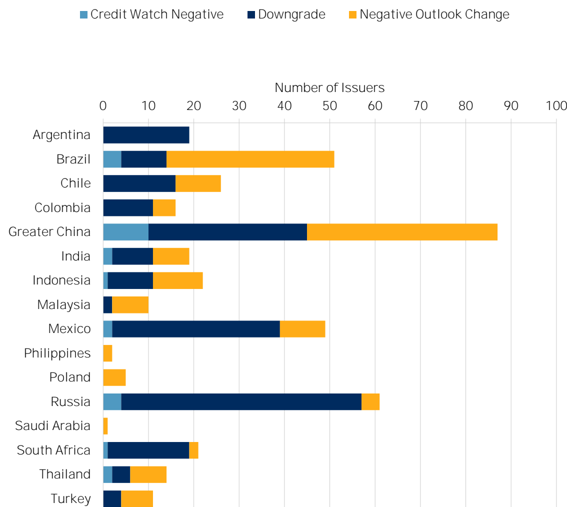
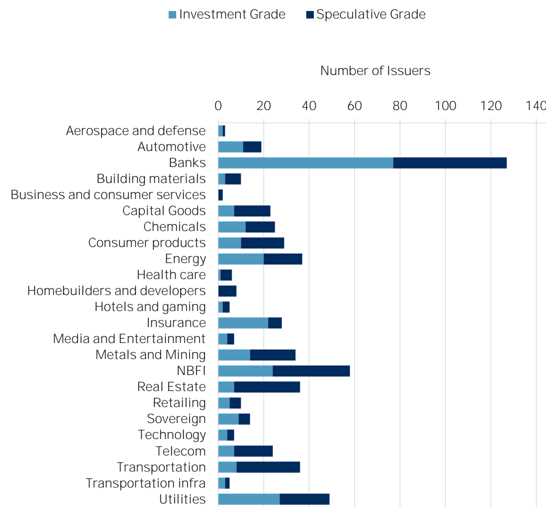


Chart 13

Rating Actions In EMs By Sector



Data is from February 2020 - March 20, 2022. Source: S&P Global Ratings.Data is from Feb. 3, 2020 - March 20, 2022. Source: S&P Global Ratings.

Sovereigns

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EM Asia

- The military conflict in Ukraine poses risks to inflation and growth that could slow the credit improvement among sovereigns in EM Asia.
- Nevertheless, the recovery from the pandemic should continue.

The military conflict in Ukraine has rocked commodity markets. The surge in prices, especially energy prices, risks spurring inflation further. The impact on the EM Asia is greater because most of its major economies are net energy importers.

Geopolitical uncertainties have dimmed global growth prospects. Greater risk aversion and rising input costs act as a drag on economic growth.

Easing of COVID restrictions. With vaccination rates at high levels, many EM Asian economies are resuming normal activities and opening borders. Although new infection numbers are high in some countries, the number of seriously ill is manageable. This has helped the economic recovery.

Downside Risks To Growth, Fiscal Consolidation, And Financing Conditions Prevail

Sudden capital swings. An unexpected rise in geopolitical tensions could prompt investors withdraw from EM Asia, making financing conditions significantly weaker for some.

Growth and fiscal recovery interrupted. High inflation, weaker demand, greater uncertainty stemming from the conflict in Ukraine, and continued supply-chain disruptions may hinder the economic and fiscal recovery to a much greater degree than we currently expect.

Widening geopolitical tensions that cause economic slump in EM Asia. If the military conflict in Ukraine expands or involves more parties, investor sentiment could take a greater hit. Such a scenario could derail economies and financial markets in the region.

New variants that may prolong the pandemic. Vaccines may be less effective against new variants of COVID, extending the pandemic's duration.

In our base case global economic activity recovers, albeit at slower-than-expected pace. Economies continue to recover but slowed by higher inflation and uncertainties associated with the conflict in Ukraine. Governments are still able to slash fiscal deficits, although returning to pre-COVID fiscal performances will take longer.

LatAm

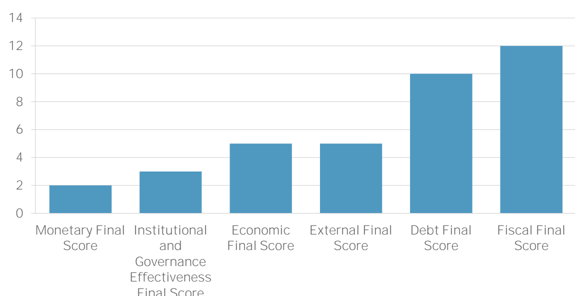
Worsening Conditions Jeopardize Already Muted Economic Recovery

- Recent global events will dampen an already modest economic recovery in LatAm and the Caribbean.
- Fiscal rigidities limit the ability of regional governments to boost spending to support GDP growth without creating more risks to long-term economic stability.
- Higher commodity prices can help some net commodity exporters in South America but are likely to have negative to neutral impact on other countries.

We have downgraded nearly 60% of the sovereigns in LatAm and the Caribbean since the start of the pandemic. We currently have 6 negative outlooks on regional sovereigns (Peru, Bolivia, Mexico, Panama, El Salvador, and Trinidad and Tobago), indicating the likelihood of further negative rating actions. While each sovereign has a distinct rating profile, there are common credit features that characterize much of the region. The most common impact of the pandemic has been a weakening of public finances, which has often led to a downgrade. We have revised our fiscal and debt assessments (see chart 14) of sovereigns to a weaker category more frequently than our other rating assessments (the data refer to the period from January 2020 to March 2022). In contrast, only twice we have revised our monetary assessment of regional sovereigns to a lower category, reflecting the ability of many governments to create more resilient financial and exchange rate systems that were able to manage the stress caused by the pandemic and economic downturn.

Chart 14

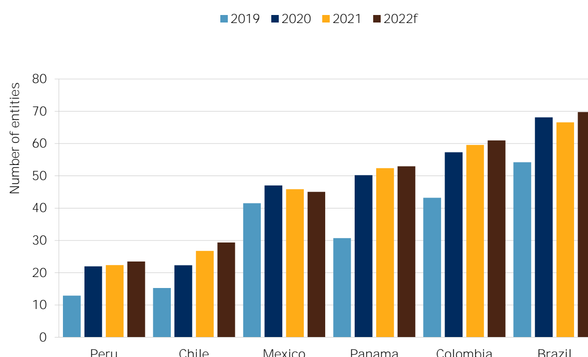
Negative Changes In Rating Scores



Note: From January 2020 to March 2022. Source: S&P Global Ratings.

Chart 15

Net General Government Debt (% Of GDP)



Source: S&P Global Ratings.

Inflation will test the performance of monetary policy this year. Food prices rose 23% in 2021 in LatAm, the fastest pace in more than a decade. Food is a larger share of the consumer basket in poor countries (accounting for more than 20% in LatAm, compared with about 15% in advanced countries). The rising inflation, tightening monetary policy in the U.S. and in other advanced countries, and heightened uncertainty due to conflict in Europe threaten to derail an already

moderate economic recovery in much of the region. We currently assign a negative modifier to 11 out of 28 regional sovereigns for the economic assessment, reflecting below-average GDP growth compared with those of peers at a similar level of economic development. Growth prospects are likely to slip due to potentially worsening financial conditions in many countries.

Central banks in the region had already started raising their policy interest rates before the most recent hike in inflation sparked by geopolitical tensions. They now face a harder trade-off, at least in the short term, between further tightening of monetary policy to contain inflation (and avoid abrupt capital outflows) and promoting long-term economic recovery.

Fiscal rigidities limit the ability of governments to boost spending to support GDP growth without creating more risks to long-term economic stability. Debt burden among most of the region's governments has surged since 2019, limiting their ability to run large fiscal deficits (see chart 15). The recent rise in interest rates further crimps the scope for running substantial fiscal deficits without weakening public finances. Our 'BBB' ratings on Mexico incorporate the likelihood of continued weak economic performance. Although GDP may grow about 5% in 2021 after contracting 8.5% last year, the country's long-term growth trajectory is likely just above 2%, below that of other countries at the same level of economic development. Poor growth prospects partly reflect strained relations between the government and much of the private sector, dampening prospects for private investment and limiting the government's ability to maintain moderate fiscal deficits. Our negative outlook on our rating on Mexico reflects the risk of a weaker fiscal profile (including from off-budget contingent liabilities).

National elections in Colombia and Brazil inject further uncertainty. Although we expect broad continuity in macro-economic policies in both countries, the new political leadership will face a difficult task in meeting expectations for improved public services, relief from higher inflation, and other challenges while maintaining GDP growth and stable public finances. Although Chile has a stronger rating profile than other countries in LatAm, its recently elected government also faces public demands for more spending while a constitutional convention drafts a new constitution, creating some investor uncertainty. Similarly, continued conflict between Congress and the administration in Peru contributes to weaknesses in policy implementation. However, we expect that the impact of political conflicts on fiscal and monetary policy in Peru will remain limited.

Higher commodity prices can help some net commodity exporters in South America but are likely to have adverse to neutral impact on other countries. Countries such as Colombia, Chile, and Peru may gain more export revenue from higher oil and copper prices, but the fiscal gain will be partly offset by demands for higher government spending—in the form of higher subsidies--to compensate for inflation. Brazil's government has announced plans to limit the rise in fuel prices using fiscal measures, which will partly offset the benefits of higher export and fiscal revenues from oil production. Similarly, the Mexican government plans to use subsidies to contain the retail price of gasoline, thereby reducing the gain to the public sector from higher revenues at Pemex, the national oil company. Higher commodity prices, especially for oil and fertilizer, are likely to strain current account balance, inflation, and GDP growth rates in Central American and Caribbean countries.

EM EMEA

The Region Will Confront Multiple Shocks From The Russia-Ukraine Military Conflict

The conflict in Ukraine, arriving on the tail of the global pandemic, is resonating across EM EMEA. From a macroeconomic perspective, we see the conflict as triggering multiple shocks (mostly negative, but in some cases positive) to regional EMs and balance sheets:

External Part 1: For Eastern European economies with large trade flows and financial linkages with Russia, the near certainty of a protracted economic depression in that country will weigh on their GDP. Exports from The Czech Republic and Hungary to Russia account for about 1.4 ppts of their GDP. For Poland and Turkey, it's slightly below 1 ppt of their GDP. Remittance inflows to Kyrgyzstan, Tajikistan, and Turkmenistan will plummet due to the weakness of the Russian

economy and the falling value of the Russian ruble. Those considerations are also pertinent to what happens to tourism earnings in Egypt and Turkey; they may find new markets, but the loss of Russian arrivals will hurt.

External Part 2: The terms of trade effects of higher energy and commodity prices will be more widespread across EMEA. Since the end of 2021, Brent crude price has jumped 37%, wheat futures (up to 40%), aluminum (21%), and the overall Bloomberg Commodities Index (25%). During the second half of 2021, energy and food prices were already on the rise, given the surging late pandemic era global demand, as well as pandemic-related labor and component shortages. This time, it is only the supply side (a potential loss of Russian crude/metals exports, along with Ukrainian and Russian grain deliveries, to global markets) that's fueling the increases. The clear winners are the net hydrocarbon exporters of the Gulf Cooperation Council (GCC), those in Sub-Saharan Africa, particularly Angola and Nigeria, and Kazakhstan, which is also a substantial grain exporter. The clear losers are large manufacturing economies that operate net energy and other commodity deficits: Central and Eastern Europe including Turkey. On food imports, Egypt is the world's largest importer of wheat. Mozambique, Lebanon, Jordan, and Morocco are also all large net food importers.

Monetary Part 1: Higher food and fuel prices mean yet another global inflationary shock. Inflationary pressures will be particularly intense in those countries where food makes up a large share of the consumption basket. In EMEA, the weight of food and drink in CPI varies from 17.5% in the Czech Republic to 33% in Egypt and 51% in Nigeria. Since the early 1980s, the long-term secular trend in global inflation has been consistently downward, not least due to productivity gains from the integration of global supply chains, as well as generally well behaved energy and commodity prices. All the indications are now that the geopolitical and economic fallout from the conflict in Ukraine has pushed this trend into reverse.

Monetary Part 2: On March 16, the Federal Reserve announced the first of what we expect 175-bps rate increase during 2022. The strength of the economic recovery in the U.S., the tightness of the labor market, and multiple inflationary pressures point to quickly rising U.S. policy rates and a strengthening dollar. These two trends are likely to cool investors' appetites for high-yield high-risk EM assets. This is already clear from the pace of portfolio outflows we have seen over the past few months from several sovereigns including Ghana.

Fiscal: Energy and food subsidies together exceed 5% of GDP in Iran, Iraq, Jordan, Lebanon, and Tunisia, crowding out expenditure on health and education. While Egypt has made major strides in cutting energy subsidies since 2017, they're still equivalent to 2.2% of GDP. As the cost of imports rises, so too the cost of subsidies. Rising food prices are arguably a risk to political stability, having contributed to other triggers that led to widespread protests during the Arab Spring of 2010-2011. In 2022, we have already seen worsening food protests in Albania, Iraq, and Sri Lanka. Authorities in several EM economies (Hungary, Russia, Turkey, Iran, and Indonesia) have already imposed controls on food exports. Governments' first instinct will be to protect populations from the immediate cost increases by expanding fiscal subsidies for food and fuel. This would imply weakening fiscal positions while public balance sheets are already reeling from the cost of fighting the pandemic.

Net Immigration: An additional fiscal risk to economies located close to Ukraine, particularly Hungary, Poland, and Romania is the three million Ukrainians that have left the country to seek safety. Initially, the cost of housing and feeding refugees is likely to fall onto national balance sheets. However, the crisis seems to be reducing the appetite among EU members to penalize Hungary and Poland for rule-of-law violations, which only a few months ago appeared to have put large EU budgetary transfers to these two countries at risk. Some sort of EU grant facility to offset the costs of refugee inflows appears to be highly likely. For many years, Hungary and Poland have been suffering from endemic labor shortages and economic overheating. It may be that the inflow of refugees will benefit long-term labor supply in their economies, albeit this effect is unlikely to materialize for quite a few years. Anecdotal evidence of high-skilled worker emigration from Russia to Armenia, Georgia, Kazakhstan, and Turkey may have an earlier positive effect on IT exports.

Finally, there's scant evidence so far of any contagion from the volatility of the valuations of Russian and Ukrainian debt securities as a result of the conflict or from the imposition of international sanctions on the Russian state, including its central bank. For many years, Russia's ratings strength has been its formidable net external liquidity position. A large part of that position is now inaccessible, given the freezing of the central bank's assets. The greater impediment to Russia's ability to avoid default on its foreign debt are the sanctions against U.S. persons receiving interest and principal payments (without a waiver) from Russia starting May 25, as part of the U.S. Treasury's Russian Harmful Foreign Activities Sanctions package. Our expectation, and the key rationale for our recent downgrade of Russia to the 'CC' category, is that the conflict will persist, and these sanctions including the U.S. Treasury's prohibition on the receipt of payment will remain in place and prevent investors from receiving interest and principal payments commencing May 25th, 2022. We believe that the contagion effects from investor losses in connection with Russia's default are unlikely to be systemic, and that the case is specific to Russia, and its military campaign against Ukraine. Nevertheless, the losses are coming during a period of monetary policy normalization in the U.S., with the dollar still by far the most important funding currency in EMs.

Corporations

EM Asia

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Volatile Investor Sentiment, Geopolitical Tensions, And Rising Costs To Curb Access To Funding

- Moderating revenue growth, cost inflation, and volatile investor sentiment in EM Asia limit broad-based upside for credit ratings, which remain tilted to the downside.
- Issuers rated 'B' and below continue to grapple with a liquidity crunch and refinancing risks prior to rising maturities in 2022 and 2023, because investor sentiment remains skittish amid fears of rising interest rates geopolitical tensions, and new COVID-19 variants.
- Sector and country differentiation is deepening. Revenue, profits, and credit quality are stabilizing or moderately improving among rated Indian issuers, but remain sluggish among those in Indonesia. Real estate developers in China remain under considerable refinancing pressure amid widespread investor confidence loss and rising debt maturities.

The credit trajectory of rated companies in EM Asia remains on a downward path. We still have negative outlooks on about one in seven companies that we rate in the region. The share of weaker rated companies of those that we rate in EM Asia should remain at a near record in 2022. We currently rate nearly one in 10 companies at the 'B' level and below, and a little over than one in 20 at the 'B-' level and below. We expect additional defaults in the real estate and mobility-related sectors (cyclical transportation, hospitality, and discretionary retail), and among weaker state-owned companies across the region in 2022.

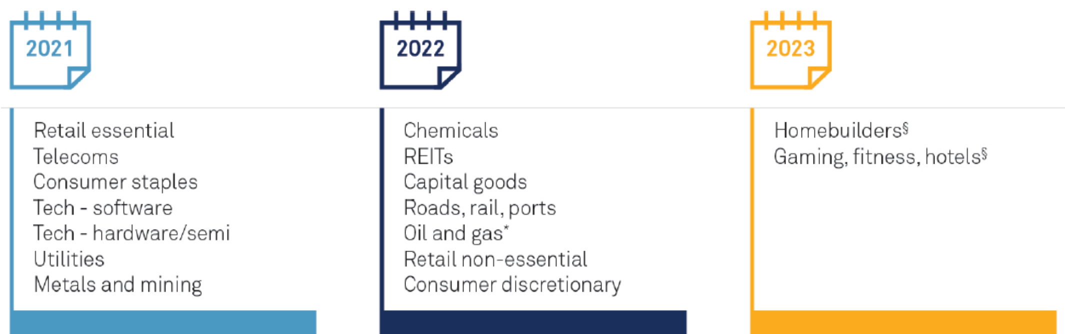
The knock-on effects of the Ukraine-Russia conflict on investor sentiment and rising commodity prices are more pronounced than the direct revenue or asset exposure. We estimate that less than 3% of about 520 publicly rated issuers in EM Asia have some direct exposure to Russia through operations, assets, or sourcing, especially energy companies in China and Japan. The risk is more pronounced among issuers with the weaker credit quality. Roughly two dozen issuers in the region at the 'B' rating level and below are exposed, particularly if they depend on capital markets to refinance maturities in 2022 or 2023, many in the real estate sector in China. A few of these issuers have recently postponed proposed bond issuances due to market volatility.

Rising energy and commodity prices are overall biting into the margins across most sectors. At the same time, demand and consumer sentiment haven't fully recovered from the COVID-19 pandemic across EM Asia. Sectors or companies with a high share of raw material or feedstock expenses in their cost base (chemicals, autos, building products, airlines, and processors) or those facing government-mandated price caps will find it difficult passing through rising input costs to customers.

Sector and country differentiation is deepening. As of the end of 2021, average credit metrics had recovered to pre-pandemic levels for about half of the sectors that we cover. That either reflected resilience to the pandemic (essential consumer and retail, and telecommunications) or rapidly improving demand and pricing conditions (technology, metals, and mining). Capital goods, oil and gas, and REITs are likely to recover further in 2022--most notably oil and gas amid sustained higher pricing. In contrast, the recovery is likely to be slower for mobility-related sectors (e.g., travel). We now expect a recovery for these sectors in 2023, 6-12 months later than originally anticipated. A recovery of airlines and airports is also unlikely before 2024 (see chart 16).

Chart 16

Timeline Of Recovery Of (Run Rate) Rated Corporate Credit Metrics To 2019 Levels



Source: S&P Global Ratings. Note: *Sectors in which average credit metrics we expect will recover sooner than indicated in our January 2021 publication. §Sectors in which average credit metrics we expect will recover later than indicated in our January 2021 publication.

Among countries, we see more stable credit quality for India and Korea because of steady demand and free cash flow generation among majority of domestic issuers that we rate. Conversely, the credit recovery is likely to be slower in Indonesia amid a slow pickup in profits, still volatile consumer confidence, a resumption of capital spending, and negative outlook on the sovereign rating, which influences the outlook on rated state-owned companies.

Key Risks

Funding availability amid diverging trends. Liquidity and funding are likely to remain the major differentiators of credit quality in EM Asia. Three main concerns will keep investor sentiment volatile in 2022. First, rising interest rates and their potential impact on currency volatility, and consequently, refinancing, especially in Southeast Asia. Second, lingering uncertainties over the impact of the Omicron variant and trajectory in demand and operating performance . Finally, a protracted Russia-Ukraine conflict depressing investor sentiment well into 2022 will curtail access to funding for issuers with weaker credit quality that depend on capital markets to refinance debt. Funding by domestic banks is also likely to stay selective. Debt maturities are elevated in 2022 -- particularly among speculative-grade borrowers.

Rising cost inflation and more supply-chain disruptions. Supply-chain problems are likely to persist across most sectors, particularly in the agriculture and energy sectors if the conflict in Ukraine worsens. At the same time, cost inflation has been gradually building up. While our base-case scenario already incorporates margin compression and falling profits in the chemicals, most manufacturing and auto sectors, more permanent price increases will start eroding financial buffers built during 2021.

Omicron and emerging COVID-19 variants continue to drive disparity in recoveries. Most countries in EM Asia have yet to experience the massive Omicron wave that hit Europe at the beginning of 2022. That wave appears to be rising in countries such as Thailand, Malaysia, and China. The latter country is implementing stricter localized lockdowns. Sectors dependent on mobility and travel (e.g., retail, gaming and entertainment) will continue grappling with lingering risks.

Our base-case scenario assumes moderating revenue growth, margin pressure because of cost inflation in 2022. We forecast revenues and profits to remain flat or rise by mid-single digits in 2022 across nearly 80% of the companies we rate. That contrasts with the high-single digit pace for the bulk of rated companies in 2021. Our base-case scenario for 2022 assumes that cost inflation will erode margins for about 60% rated Asian companies, especially in the energy, commodities, raw materials, and transportation sectors. Resumption of capital spending or acquisitions among rated companies in Indonesia and selected sectors in China will limit free cash flow generation and balance-sheet improvements.

EM EMEA

Saudi Arabia Continues To Recover Gradually, Accompanied By Healthy Capital Market Activity

The recovery momentum in the Saudi corporate sector gained steam in 2021, as seen in stronger results for most listed domestic companies, particularly for those in the oil and gas, and chemical sectors. Given the initiatives under the Saudi Vision 2030, we continue to observe acceleration in key investments, particularly by the large government-related entities, which we expect will support the overall activity across most corporate sectors, particularly energy, infrastructure, and contracting. The surging of oil prices are shoring up Saudi Arabia's macro picture, given that the country is a large petrochemical exporter, which should further strengthen operating conditions for corporations in 2022. Given the relaxation of the pandemic-related restrictions on Hajj, the Islamic pilgrimage, we also expect recovery in tourism this year.

Saudi capital markets were active in the second half of last year, particularly in the IPO market. In 2021, three companies controlled by the kingdom's Public Investment Fund performed equity market transactions. International Co. for Water and Power Projects, one of the largest players in the global utilities industry, listed its shares on the Tadawul. In addition, Saudi Telecom Co. listed 20% of its shares of its subsidiary, Arabian Internet and Communications Services Co. Ltd., on the stock exchange. Finally in December 2021, Tadawul itself, the largest exchange in the Middle East in terms of traded value, also floated its shares. Moreover, a large number of private-sector entities tapped the market, and we expect similar trends in 2022. Year to date, we have already seen more than 10 IPOs in the market, while there was market chatter in February about Saudi Aramco's another stake sale, which had initially been listed in 2019.

Risks For Turkish Corporations Are Rising

In line with the recovery in global economy and in Turkey's key export markets, Turkish exporters posted a strong rebound in 2021. In addition, some of the services sectors showed healthy performance , and tourism inflows recovered sharply. Macro uncertainties such as the volatility and weakness of the Turkish lira remained a key theme, particularly in the last quarter of the year, given that strain among companies with FX liabilities without matching revenues continued to rise.

We expect a more difficulties among corporations in 2022. They were experiencing inflationary pressures following sharp depreciation of the Turkish lira starting in mid-November. Given the spike in commodity prices, woes will further increase and exacerbate operating conditions for the domestic-focused companies, while we expect relative weakness in Turkey's key export markets. Russia and Ukraine, particularly the former, are Turkey's important trading partners. In addition, there's a large number of Turkish companies across various sectors that operate in Russia, which will tip into recession this year.

Despite the post-pandemic recovery in global tourism, about 27% of the foreign tourists in Turkey were from Russia and Ukraine last year. The conflict between both countries will undermine the Turkish tourism sector.

Similar to 2021, we expect the potential volatility and weakness in the Turkish lira will remain the greatest source of vulnerability for the sector, particularly as U.S. interest rates are starting to increase and the overall EM sentiment to weaken. Given limited visibility, we expect the stance of most Turkish corporations to remain very cautious, focusing on managing liquidity and cash flows, and less so on new investments.

Infrastructure Constraints Curtail The South African Corporate Sector's Rebound

South Africa-based corporations continued to deleverage through 2021 as pandemic-related economic fallout moderated amid supportive commodity prices, meaningful cost-containment measures, and improved mobility and vaccination rates. However, global supply-chain challenges, compounded by the country's insufficient electricity supply, and railway and port infrastructure, which persist unabated into 2022, are preventing domestic companies from capitalizing on higher commodity prices. South Africa's bulk commodities, such as coal and pulp, are bearing the brunt of these difficulties.

Companies are also not immune to rising energy prices. Local operations are typically powered by Eskom, which generates coal-fired baseload under largely long-term contacts, which are somewhat insulated from higher energy costs. Nevertheless, an electricity rate increase of around 10% has been announced for 2022. Domestic companies with European operations are more exposed to natural-gas price volatility. In the meantime, those operating across Africa could feel the pinch of increasing diesel prices, given some sectors' heavy reliance on road transportation, and poor grid reliability across the continent, prompting the use of back-up diesel generation in many industries.

On a macro level, we expect the inflation effects of higher global oil and food prices to be somewhat offset by the country's commodity exports. We forecast a slowing economic growth, and higher inflation and interest rates, given that South Africa imports a significant portion of refined fuels and wheat. South Africa produces and exports several commodities which may be in shorter supply due to sanctions on Russia--coal, platinum-group metals (PGMs), gold, and diamonds, for example.

Following the July 2021 riots, we noted that social unrest wouldn't be a major credit factor for South African corporations in the short term, but could damage investor confidence in the longer term. We don't believe that widespread social frustration, which is partly to blame for the riots, has abated. Income inequality, poverty, and poor service delivery have worsened through the pandemic. However, civil unrest related event risk currently seems more muted.

On the positive side, vaccination statistics have improved substantially, with labor-intensive industries such as mining being instrumental in rolling out vaccines to employees and surrounding communities. Funding conditions in the domestic and international markets have also remained largely supportive, with the requirement for lender forbearance largely over.

The Conflict's Impact And Sanctions Will Strain Russian Corporations' Credit Fundamentals

We have downgraded almost all Russian companies to 'CCC-' following a similar rating action on the sovereign. The downgrade primarily reflects the likelihood of near-term default due to a soft moratorium for debt repayment. However, several big companies already received approvals from the government to make payments to bondholders (Gazprom, Rosneft, and Norilsk Nickel). Still, it is very unclear how these authorizations to pay will work, so as long as the temporary limits remain in place, the ratings are likely to remain in the 'CCC' category.

The impact of the conflict and related sanctions on the Russian corporations is currently difficult to assess. Russia's oil exports have dropped by about 30%, while gas exports are almost unimpacted. Some of Russia's metals producers can no longer export to Europe and the U.S., which will require them to find alternative markets for their production, which will pressure their profits. Many of Russia's exports are also hampered by logistics issues (operating interruption on Black Sea ports, unwillingness of many global freight carriers to accept cargos from Russia, limited air traffic, etc.). This will further crimp export volumes, especially in the near term. Magnitude is difficult to quantify, however, as situation changes very rapidly. In addition, the duration of these limits is uncertain, leading to a wide range of possible outcomes. We note that very high prices and the weak Russian ruble partly offset the overall adverse impact on Russian exporters. Moderate leverage and limited FX risk exposure will further support the credit profiles of the corporations once the operations stabilize.

LatAm

Corporations Won't Escape The Shockwaves From The Russia-Ukraine Conflict

As the conflict continues to unfold, the magnitude and duration of the shock to LatAm corporations remains uncertain. However, the rapidly emerging downside risks will take a toll on credit conditions across industries and the rated issuers.

Corporations in LatAm largely bounced back from the pandemic-induced lows and are in a relatively favorable financial position to endure the global repercussions that the conflict will bring. For instance, leverage is overall fairly contained across most of the sectors, with net debt-to-EBITDA ratios below 3.5x, while EBITDA interest coverage is exceeding 4x. The stronger commitment to financial discipline hasn't only kept leverage lower than in other regions, but it has also improved liquidity to mitigate short-term risks. Debt refinancing to extend debt maturities are partly responsible for the relatively low refinancing risk among LatAm corporations in 2022, given that short-term market debt represents slightly more than 5% of the total outstanding balance, both in local and foreign currencies.

Most industries in the region have negligible business interactions or a direct sales exposure to Russia, nor much of an operating footprint there. Therefore, downside risks don't stem from the suspension of business activities in that part of the world. Instead, global cost inflation is one of the main risks for LatAm corporations, because pressures have been amplified, notably for energy and other important raw materials such as lithium, nickel, palladium, and wheat. The Russia-Ukraine conflict remains the biggest risk to oil and gas prices, although underlying global supply and demand fundamentals have also strengthened in recent months and could support higher near-term prices regardless.

Russia is also a leader in the production of certain metals such as aluminum, nickel, and palladium, as well as grains and fertilizers. Therefore, cost inflation will affect a wide array of industries, and margins could narrow among energy-intensive sectors and commodity-dependent industries, including building materials, consumer products, and auto production. For LatAm commodity producers, higher prices will bolster cash flows and credit metrics in the near term. Yet, upside potential for credit quality could be constrained by the inherent volatility of these industries and our assessment that short-term peak performance would gradually normalize in the upcoming years as prices return to pre-crisis levels.

Another important risk for LatAm corporations are supply-chain disruptions. The conflict represents the second global supply shock this decade after COVID-19, with disruptions and bottlenecks due to scarcity of specific raw materials, parts, and port closures, even as China's zero-tolerance policy towards COVID-19 continues to crimp trade and supply chains. Many companies in the region have opted to redirect sourcing efforts locally, as a short-term alternative. We see increasing downward pressure on the region's corporate credit quality if supply-chain bottlenecks and high logistics costs remain unresolved before year-end.

Financial Services

EM Asia

Alongside With COVID-19, Geopolitical Tensions, Inflation And Interest Rate Hikes Are Taking Center Stage

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Limited direct exposure to the Russia-Ukraine conflict, yet side effects could be severe. The lack of large direct exposures to Russian and Ukrainian counterparties will mitigate the direct impact of the crisis on EM Asian banks. However, second-order effects could be meaningful. Market volatility and rising commodity prices are the most significant risks posed by the Ukraine crisis.

EM countries with major energy imports are particularly vulnerable. Higher oil prices would hit current account balances, real domestic consumption, and investment. This dynamic would be most keenly felt among the largest net energy importers (relative to GDP): India, the Philippines, and Thailand. Some bank loan borrowers in these jurisdictions will feel the pain, which will hinder banks' asset quality. Higher energy prices would be favorable for some of EM Asia's net energy exporters: Indonesia, Malaysia, and Brunei.

Geopolitical uncertainty could slow interest-rate hikes, which would have a two-fold effect. It will dampen the benefit of upward repricing on net interest margins for Asian banks, portfolios of which are strongly weighted toward variable-rate loans. On the other hand, slower rate hikes would reduce credit risk, especially in banking sectors that are still recovering from COVID-19 and have a high level of restructured loans, such as those in Indonesia and Thailand.

Outflows from EMs and currency volatility may squeeze Indonesian companies. More than half of large Indonesian corporations' liabilities are in U.S. dollars, with a significant fraction not fully hedged. These entities are still vulnerable to rupiah's fluctuation.

Risks for Philippine banks diminish amid strong economic recovery. Following a plunge to around 1% in 2021, we expect credit costs to fall even further to 0.6%-0.8% of loans in 2022 as credit conditions stabilize. Nonperforming loans (NPLs) at 4% and restructured loans (performing) at 2.2% of total loans are manageable, and substantially lower than those of regional peers such as Indonesia, Malaysia, and Thailand. The quality of the restructured loan pool may slip, particularly in the services sector and among stretched consumers. Given their enhanced capitalization and substantial provisioning coverage, we believe Philippine banks are well positioned to absorb this residual stress. Philippine banks' return on assets will edge closer to the pre-pandemic level of 1.2% as credit costs continue to fall.

Malaysia's banking recovery could be stymied by uneven recovery of loans under moratorium. Higher capital spending, a booming oil and gas industry, and the low cost of bank loans amid capital market volatility will bolster credit demand among large corporations. However, fragile consumer confidence, severe stress across small- to mid-size enterprises (SMEs) throughout COVID-19, greater inflation, and already high household debt will weigh on loan demand and asset quality of these portfolios. After various loan moratorium policies expired by mid-2022, NPLs could rise to 2.5%-3.0% in the next 12 months from 1.4%. Also, Malaysian banks' net interest income (NIM) will continue to fall in the first half of 2022 as their funding costs rise and competition for deposits heats up.

Chinese banks' asset quality to remain pressured amid weakness in property loans. We believe nearly one-third of property developers are experiencing financial difficulties, and the property NPLs could double. On the other hand, the pandemic-related deferred loans have performed better than predicted, somewhat offsetting this impact. As banks release provision coverage, we believe credit costs will begin to moderate this year. To keep the reported NPL ratio steady, write-offs are likely to remain high. We expect annual loan losses to average RMB2.0 trillion during the four years to 2023, according to our predictions, down from RMB2.5 trillion in August (our previous forecast).

While Russia is a strategic partner and a collaborator with China's Belt and Road Initiative (BRI), the domestic banking sector's exposures to Russia are not significant as a share of banks' assets. We

expect Chinese financial institutions to continue to support the government's economic and development strategies, while complying with domestic and international sanction rules against Russia.

EM EMEA

Banks Have Limited Exposure To Russia and Ukraine, But Spillovers Could Be Significant

We understand that the overall direct exposure of the rated Middle East and African banks to Russia and Ukraine is very limited and unlikely to have a meaningful impact on banks' profitability or cost of risk. Indirect impact could be substantial, though. The conflict triggered a surge in energy, transport, and food prices because of higher commodities prices including oil and gas. S&P Global Ratings revised its oil price assumption to $85 per barrel in 2022 from its previous forecast of $75. The impact on the Middle Eastern and African countries and banks depends on the extent of, and resilience to, external shocks, which are often tied to economic diversification and level of wealth. Oil exporters are likely to benefit, while oil importers are likely to suffer. The tourism sector could also take a hit, acting as a drag on these countries' economies and their banks, particularly the tourism sectors that depend on Russian and Ukrainian tourists, such as in United Arab Emirates (UAE), Turkey, Egypt, and Tunisia. Rising food prices, particularly for countries heavily dependent on cereals imports—such as Egypt and Tunisia--is another form of knock-on effect. Already high external imbalances could widen further and fiscal positions to deteriorate if these countries need to increase subsidies to compensate for increased costs of cereals. The other indirect effect is through the impact on investors' risk appetite. Qatar, Turkey, and Tunisia would be the most vulnerable due to high external debt of the Qatari and Turkish banking system, and Tunisia's high external financing needs.

GCC. The cost of risk for banks has declined because of sufficient provision cushions to meet the expected NPL increase. At Dec. 31, 2021, the average coverage ratio increased to 159.9% from 145.9% at the end of 2020. It ranged from a strong 304.7% in Kuwait to just adequate 92.8% in the UAE. We expect the regional coverage ratio to slip in 2022 but remain well above 100%. The NPL ratio fell slightly due to lower inflow of NPLs and write-offs. It was about 3.5% at Dec. 31, 2021, compared with 3.7% at the end of 2020. Regulatory measures for borrower relief prevented the ratio from rising sharply and gave corporations time to recover. Although cash flows are still below historical levels among many corporations, most have managed to generate enough revenue to remain current on their bank loans. We expect NPLs to continue increasing but not exceed 5% on average. We expect cost of risk to normalize over the next couple of years and margins to benefit from the expected increase in interest rates.

Turkey. We have updated our inflation forecast to 55% on average for 2022 from already high 49.5% and expect growth to slow down with GPD only growing 2.4% in 2022, compared with our former expectation of 3.6%. Soaring inflation, together with a weak lira and slowing economic activity, will further strain retail and corporate borrowers' creditworthiness and increase risks for the banking system. While we have seen a limited rise in NPLs in 2021 and cost of risk at a high but still manageable 260 bps, we believe that stalling economy will put additional stress on banks' asset quality, and that it's only a matter of time until problem loans start emerging on banks' balance sheets. Therefore, we project NPLs to increase above 9% of total loans by 2023 from 3.2% as of Dec. 31, 2021, with cost of risk further increasing above our previous expectation of about 320 bps in 2022-2023.

Due to forbearance measures in the capital ratio calculation, the bulk of the lira's depreciation isn't reflected in the reported 18.3% total capital ratio for the banking sector at the end of 2021. We estimate that the total capital ratio would be about 300 bps lower, once the full magnitude of the lira's fall is incorporated. Despite an about 9% decline in FX deposits following the incentive from the new FX protected TL deposits scheme introduced in late December, dollarization remains elevated accounting for 58.5% of total deposits as of early March. We also acknowledge that while

depositors are losing confidence in the lira, so far, they have maintained confidence in the banking sector because we haven't observed any significant withdrawals.

Turkish banks remain also vulnerable to adverse market sentiment and risk aversion due to their declining but still high external debt ($150 billion on Sept. 30, 2021). Amid rising inflation and unpredictable monetary policy, and the conflict's hit on investors' sentiment, we believe that Turkish banks' ability to roll over their external debt could lessen. Expected rate increase by the Federal Reserve and the European Central Bank's earlier monetary policy normalization would reduce global liquidity and heighten refinancing risks for Turkish banks. Our base-case scenario doesn't assume major disruption in Turkish banks' access to external funding sources in 2022, if the government is able to stem the lira's depreciation, but we expect reduction of external debt to continue in the next couple of years. Although Turkish banks have sufficient foreign currency liquidity to handle lower rollover rates, most of it is either with the central bank or placed in government securities, which reduces its availability in a highly stressed scenario.

South Africa. We expect earnings to recover to pre-pandemic levels in 2022 with return on average equity at 16%, up from about 14% in 2021. Lower impairment charges and higher interest rates will support banks' NIMs and earnings, with return on average assets improving to 1.3% in 2022 from 1.0% in 2021. We estimate credit losses almost halved in 2021 close to 1.2% of total loans from 2.1% in 2020. However, they will remain slightly higher in the next two years than historical levels and 0.8% in 2017-2019. We forecast that credit losses will average 1% in 2022-2024 while the NPL ratio will continue to fall below 4% by 2023 from an estimated 4.5% of systemwide loans in 2021. We assume a more muted economic growth in 2022 at about 2%, compared with a robust GDP rebound of 4.9% in 2021. The South African Reserve Bank raised its benchmark rate in March 2022 for the third time to 4.25% after keeping it at a record low at 3.5% between April 2020 and November 2021. This is in a context of global rates tightening because of a higher inflation outlook. Nonetheless, we expect credit to the private sector in 2022 to grow at a similar rate to that in 2021 at about 4.5%, largely benefitting households. Household leverage (defined as household debt to disposable income), which has stabilized at an estimated 68%, will likely increase by 50-100 bps as a result of higher inflation in 2022. This continues to pose a risk for banks because of weak savings. Corporate lending will remain muted but reverse its trajectory from contraction in 2020. SMEs will gradually recover from the pandemic-induced interruption in business activity in 2020-2021. In addition, commercial real estate continues to exhibit signs of stress with office vacancy rate rising to 15.4% in 2021 from 13.3% in 2020. Structural shifts stemming from the pandemic will continue to play out over the medium term. Exposure to this sector poses limited risk to the banking sector, in our view, because it accounted for about 6% of total exposures among top-tier banks and is diversified in nature.

LatAm

Weaker Economic Conditions Will Halt Credit Fundamentals Improvements

We expect LatAm banks' profitability to plateau in 2022 after the improvement last year, as banks will need to generate more provisions due to the expected softening of economy. As interest rates pick up, NIMs should be resilient thanks to the banks' ability to transfer the higher funding costs to ultimate borrowers and given the high share of variable-rate loans and the short tenor of the bulk of fixed-rate loans.

Lending growth should be slower in 2022 than historical levels, due to the coming economic slump and political uncertainty, which curtail private investment and internal demand. We expect retail loans to grow at a higher pace, thanks to the high demand in this sector, than those of corporate loans due to limited growth prospects for companies.

Asset quality metrics remain stronger than expected, although they're likely to slip due to the flagging economic growth, still sluggish labor market, and modest credit growth in 2022. Still, asset quality should remain manageable thanks to banks' conservative growth strategies that were implemented prior to the pandemic. Residual stress is a key risk for the SME and retail lending sectors, given that the recovery so far has been uneven. Government-guaranteed loans have helped support the SME sector, but the expected weak economic performance in 2022 could pressure solvency of struggling companies.

Appendix 1: Economic Data And Forecast Summaries

Table 2

Real GDP %

	2021	2022F	2023F	2024F
Argentina	10.3	2.8	2.0	2.0
Brazil	5.0	0.4	1.7	2.0
Chile	11.7	2.1	2.4	2.8
Colombia	10.6	4.6	3.0	3.2
Mexico	5.0	2.0	2.3	2.1
China	8.1	4.9	5.0	4.9
India	8.9	7.8	6.0	6.5
Indonesia	3.7	5.1	4.8	4.9
Malaysia	3.1	5.8	5.4	4.7
Philippines	5.6	6.5	6.8	7.0
Thailand	1.6	3.2	4.0	3.8
Poland	5.6	3.6	3.1	2.7
Russia	5.5	(8.5)	0.3	1.0
Saudi Arabia	3.3	5.8	2.9	2.9
South Africa	4.9	1.9	1.7	1.5
Turkey	11.0	2.4	2.9	3.3

Source: Oxford Economics; F--S&P Global Ratings forecast. For India, 2019 = FY 2019 / 20, 2020 = FY 2020 / 21, 2021 = FY 2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24.

Table 3

CPI Inflation % (Year Average)

	2021	2022F	2023F	2024F
Argentina	48.4	52.5	45.0	36.5
Brazil	8.3	8.9	4.1	3.3
Chile	4.5	7.9	3.5	3.1
Colombia	3.5	7.1	3.4	3.1
Mexico	5.7	6.5	3.5	3.1
China	0.9	2.8	2.6	2.2
India	5.5	5.4	4.5	4.5
Indonesia	1.6	3.2	3.1	3.0
Malaysia	2.5	2.6	2.2	2.2
Philippines	3.9	4.0	3.0	2.3
Thailand	1.2	2.5	0.9	0.8
Poland	5.2	8.6	5.1	4.1
Russia	6.7	16.0	9.0	5.5
Saudi Arabia	3.1	3.2	2.9	2.8
South Africa	4.5	5.9	4.7	4.8
Turkey	19.6	55.0	17.0	12.0

Source: Oxford Economics; F--S&P Global Ratings forecast. For India, 2019 = FY 2019 / 20, 2020 = FY 2020 / 21, 2021 = FY 2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24.

Table 4

Policy Rates % (End of Period)

	2021	2022F	2023F	2024F
Argentina	38.0	42.0	37.0	35.0
Brazil	9.25	13.25	8.50	7.50
Chile	4.00	7.50	5.50	4.50
Colombia	3.00	7.00	6.00	5.50
Mexico	5.50	8.00	7.00	6.50
India	4.00	4.75	5.25	5.25
Indonesia	3.50	4.00	4.75	5.25
Malaysia	1.75	2.25	3.00	3.00
Philippines	2.00	2.50	2.75	3.50
Thailand	0.50	1.00	1.50	1.75
Poland	1.25	4.84	5.50	5.50
Russia	8.50	18.00	10.00	8.00
South Africa	3.75	5.00	5.75	6.50
Turkey	13.00	9.50	9.50	9.50

F--S&P Global Ratings' forecast. Source: Oxford Economics.

Table 5

Exchange Rates % (End of Period)

	2021	2022F	2023F	2024F
Argentina	102.72	155.00	215.00	275.00
Brazil	5.58	5.20	5.30	5.40
Chile	866	815	820	820
Colombia	3,981	3,900	3,950	3,975
Mexico	20.50	21.00	21.50	22.00
China	6.35	6.40	6.40	6.30
India	76.50	77.50	79.00	80.00
Indonesia	14,253	14,550	14,660	14,770
Malaysia	4.18	4.20	4.20	4.20
Philippines	50.27	51.50	51.90	51.60
Thailand	33.42	33.30	33.00	32.80
Poland	4.06	4.30	4.10	3.80
Russia	74.29	115.00	115.00	115.00
Saudi Arabia	3.75	3.75	3.75	3.75
South Africa	15.96	15.90	16.90	16.80
Turkey	13.32	16.00	16.50	17.00

Source: Oxford Economics; F--S&P Global Ratings forecast; End of Period - Q4 values. For India, 2019 = FY 2019 / 20, 2020 = FY 2020 / 21, 2021 = FY 2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24.

Table 6

Unemployment % (Year Average)

	2021	2022F	2023F	2024F
Argentina	9.3	9.2	9.0	8.6
Brazil	13.2	12.2	12.0	11.3
Chile	8.9	8.0	7.2	7.2
Colombia	13.7	12.7	11.9	11.5
Mexico	4.1	3.8	3.7	3.6
China	5.6	5.3	5.2	5.1
Indonesia	6.3	5.7	5.4	5.2
Malaysia	4.6	4.0	3.6	3.4
Philippines	7.8	6.8	5.9	4.6
Thailand	2.0	2.0	1.7	1.4
Poland	3.4	2.8	2.7	2.6
Russia	4.8	6.5	7.0	6.0
Saudi Arabia	10.0	8.0	6.0	6.0
South Africa	34.0	32.4	31.6	31.0
Turkey	12.0	11.9	11.1	10.1

F--S&P Global Ratings' forecast. Source: Oxford Economics.

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