S&P Global Ratings

Regional Credit Conditions Chair

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Credit Conditions Emerging Markets Q3 2022:

Risks Accumulate As Conflict Lingers

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This report does not constitute a rating action.

Key Takeaways

- Overall: Credit conditions in emerging markets (EMs) will likely worsen, given persistent inflationary pressures, tightening financing conditions, slower growth in China, and the potential for a recession in the U.S. Inflation is not abating and its effects on EM households, corporations, and banks are yet to surface. So far, households and corporations have been able to manage higher prices thanks to fiscal and monetary stimulus, as economic activity resumes amid the ebbing effects of the pandemic.
- Risks: A protracted Russia-Ukraine conflict will likely keep pressuring prices, especially those of food and energy, through the year and potentially into next one. Price pressures for the next year are already accumulating. We expect that ongoing fertilizer shortages, harvest disruptions in Ukraine, export controls, and escalating fuel and transport costs will exert upward pressure on food prices next year. U.S. monetary tightening is already faster than expected. In our view, as high prices linger, the Federal Reserve will likely be aggressively increasing its rates in an effort to tame inflation. These conditions not only raise market volatility but also tighten overall financing conditions for issuers across EMs, as investors' risk aversion grows. Furthermore, at current speed, monetary tightening has the potential to lead the U.S. into a recession, which would hurt global growth and trade, leading to knock-on effects for EMs.
- Credit: We expect our negative bias for rated issuers across EMs to increase over the coming quarters as rising interest rates, stubborn inflation, and weakening demand have the potential to erode corporate profits, households' purchasing power, and banks' asset quality. Few issuers will benefit from the complex panorama, mainly commodity exporters.

(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 June 21, 2022)

Contents

Top EM Risks

Table 1

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**

Inflation is not abating and its effects on EM households, corporations, and banks are yet to surface. So far, households and corporations have been able to manage higher prices thanks to fiscal and monetary stimulus, as economic activity resumes amid the ebbing effects of the pandemic. The inflationary pressures stemming from an unevenly recovering global economy and supply-chain disruptions, have been magnified by the Russia-Ukraine conflict. A protracted conflict will keep pressuring prices, especially those of food and energy, through the year and potentially into next year. Price pressures for the next year are already accumulating. Ongoing fertilizer shortages, harvest disruptions in Ukraine, export controls, and escalating fuel and transport costs will all exert upward pressure on food prices next year. Overall, higher prices could depress corporate margins, households' purchasing power, and banks' asset quality. In some EMs, these dynamics could result in stagnation.

Accelerating monetary tightening in the U.S. weakens financing conditions and increases the risk of a recession.

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

U.S. monetary tightening is already faster than expected. As high prices linger, the Federal Reserve will likely be aggressively increasing its rates in an effort to tame inflation. These conditions not only raise market volatility but also tighten overall financing conditions for issuers across EMs as investors' risk aversion grows. The dollar is also strengthening; the relative weakening of EM currencies could ratchet up inflationary pressures in the form of a pass-through effect. Furthermore, at current speed, monetary tightening has the potential to lead the U.S. into a recession, which would be hurt global growth and trade, leading to knock-on effects for EMs. A U.S. recession will be particularly harmful for those EMs with high trade linkages and those that receive substantial remittances from the world' largest economy. Likewise, EMs most at risk are 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.

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 is already lasting more than expected, with little potential for a resolution over the near term. 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 eroding Russia and Ukraine's significant role in global food commodity exports, which is also causing food prices to rise. An intensifying and long-lasting conflict will probably heap pressure on food and energy prices, which would raise 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.

China's continued pursuit of zero COVID strikes consumption, disrupts supply chains, and weighs on growth

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. This year's COVID lockdowns of cities and towns, after the 2021 crackdown on the property and technology sectors, have accelerated China's economic slowdown. While lockdowns are easing for some affected cities, any outbreaks of infection could bring new mobility restrictions. Moreover, the economic damage wrought from recent multi-week lockdowns will take time to repair. Credit pressures for small- to mid-size enterprises (SMEs), particularly in the services sector, could intensify--resulting in a prolonged uptick in unemployment and banks requiring higher loan-loss provisions. In turn, corporations and households could borrow more to make up for income shortfalls, hiking debt growth. Additional government spending, if any, won't likely be an immediate panacea. The likelihood of **the faltering economic momentum** continuing is high. These policy and economic developments may affect other countries reliant on China for tourism, exports, or finance (e.g., EMs) and supply chain or imports (e.g., component parts).

The prevalence of COVID-19 across key EMs, 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 (structural risk)

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. As 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

The Conflict Derailed The Recovery For EMs

Credit conditions in EMs will probably worsen given persistent inflationary pressures, tightening financing conditions, slower growth in China, and the potential for a recession in the U.S. Our ratings on issuers across EMs reflect the recovery's trajectory as reopening boosted activity across most sectors and consumer optimism as the pandemic's effects subside. The first quarter of the year reflected these factors, and indicators such as GDP growth and EBITDA margins were on the upward trend, despite inflationary pressures at the beginning of the year. But the Russia-Ukraine conflict are derailing these trends and its knock-on effect began to show up in the second quarter of 2022 and will likely continue doing so for the rest of the year and 2023. We expect our negative bias to increase over the coming quarters as rising interest rates, stubborn inflation, and weakening demand have the potential to erode corporate profits, households' purchasing power, and banks' asset quality. At the same time, many EM sovereigns will likely need additional funding to support fiscal measures that offset increasing fuel and food prices. This could curtail consolidation efforts and increase debt burdens, which could in turn erode their credit quality.

Higher Inflation Can Overwhelm Households And Corporations

We expect inflationary pressures to persist during the rest of the year. While slower global growth will offset inflationary pressures, we expect the supply side to remain stressed in light of sanctions on Russia and the ongoing conflict, which will likely keep energy and food prices high. Reopening resulted in an economic rebound and improving labor markets, which helped corporations and households to deal with rising prices. Stubbornly high inflation, tightening financing conditions, and slowing economic growth spell trouble for corporations, households, and banks. Confluent risks will probably dent corporations' margins as their ability to pass through costs wanes, along with consumer confidence as high prices erode household's purchasing power, and ultimately banks' asset quality as borrower credit quality weakens.

According to our baseline assumptions, most investment-grade corporations across EMs should be able to weather worsening conditions (see the macroeconomic section below). However, financial metrics will likely deteriorate and for those entities in the lower rated spectrum we could expect downgrades and rising defaults. A full global recession scenario would strain financial metrics beyond pandemic levels and pressure ratings further.

Ongoing inflationary pressures, and in particular rising food prices, could have adverse implications for EMs, impairing GDP growth, fiscal performance, and social stability. The potential impact of such developments on sovereign credit ratings will depend upon, among other things, the extent and severity of the food shock, the ability of governments to minimize the social and economic costs, and international efforts to help vulnerable countries. Although many of the sovereigns most exposed to this risk already have very low credit ratings, the economic or political fallout of the food crisis could trigger downgrades (see chart 2).

Worsening Financing Conditions Adds To EMs' Dilemmas

Financing costs for EM issuers are increasing rapidly, and we expect conditions will continue worsening as the Fed accelerates its efforts to tame inflation, and most EM central banks continue tightening their policy rates to anchor domestic inflationary pressures and prevent capital outflows (see chart 3). Access to credit markets over the past quarters has been limited, and lower rated issuers are facing difficulties in refinancing their debt. Domestic capital markets and bank financing are feasible alternatives for smaller amount issuances, but subject to shorter maturities and higher financing costs.

EMs Face A Complicated Political Landscape

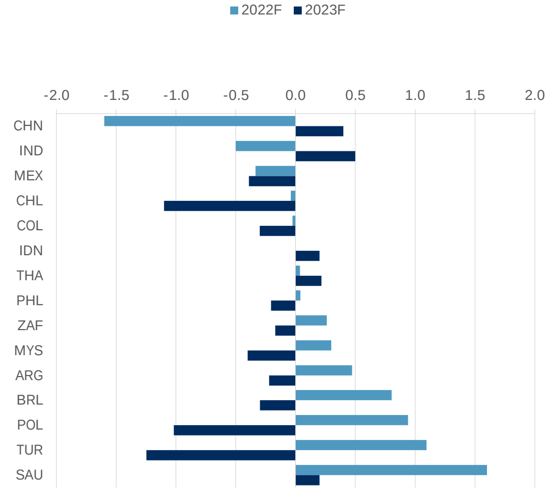
Geopolitical risks stemming from the Russia-Ukraine conflict derailed a fragile recovery despite the fading pandemic effects. Spillover from the conflict is evident through mounting inflation and disruption in food supplies; a protracted conflict will continue weighing on the global economy. At the same time, the political landscape is becoming highly complex across many EMs. Governments were still dealing with the pandemic knock-on effects when the conflict inflicted a new blow through increasing fuel and food prices. A handful of EMs will benefit from high commodity prices, but higher food prices are hitting hard low-income households. EM sovereigns are struggling to deal with the pandemic costs, increasing rates, stubborn inflation, and addressing protracted social demands—a tricky balance to strike between fiscal consolidation and social strife.

Negative Bias Will Probably Rise Amid Confluent Risks

Our latest reading of negative rating bias levels is in line with historical averages in most cases, except for LatAm where negative bias is noticeably below previous years (see chart 4). Two factors are relevant for the region's negative bias. First, ratings reflect a sound recovery trajectory as activity resumed and pandemic effects tapered off. Second, the region suffered many downgrades during the pandemic, so ratings are overall lower, reflecting higher vulnerability. In our view, our negative rating bias will probably increase across EM economies as confluent risks erode the credit quality of issuers. Few issuers will benefit from the complex panorama, mainly commodity exporters.

Chart 1

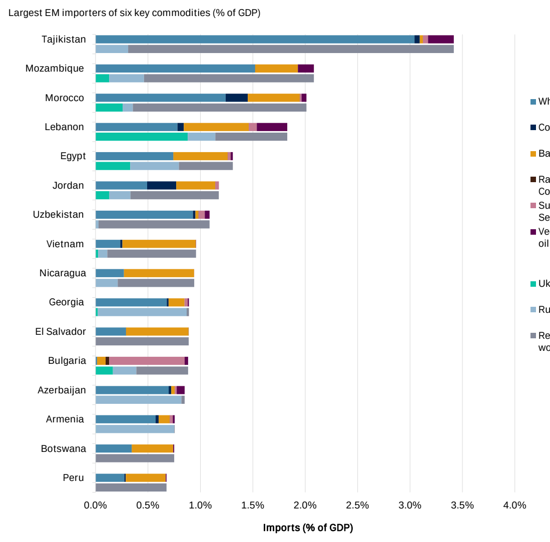
Change In Baseline Forecast From March 2022



F--S&P Global Ratings forecast. Source: S&P Market Intelligence.

Chart 2

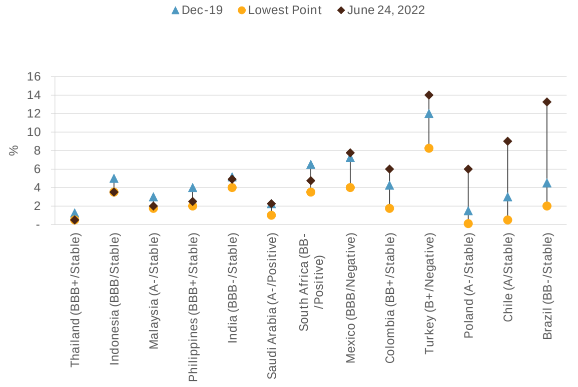
Food Shock: The Most Vulnerable Economies Are In Central Asia, Middle East, Africa, and Caucasus



Source: COMTRADE and S&P Global Ratings.

Chart 3

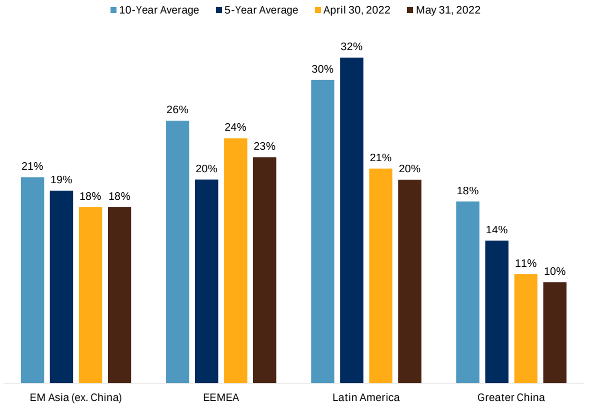
Inflation Weighs On Monetary Tightening



Sovereign ratings as of June 27, 2022. Source: Central banks and monetary authorities from respective countries.

Chart 4

Negative Bias Will Probably Rise



Data as of May 31, 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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Testing Times Ahead For EM Resilience

- Growth: S&P Global Ratings lowered its real GDP growth forecasts for EMs to 4.2% in 2022 (from 4.8% in the March projection), triggered by a weaker forecast for China. For EMs, excluding China, upside growth surprises in several EM economies in the first quarter offset a slackening growth momentum starting in the second quarter, which led to a small upward revision for 2022. Growth forecast for EMs excluding China in 2023 remains unchanged at 4.1%. Risks to baseline growth forecasts remain squarely on the downside.
- Inflation: We raised our consumer price inflation forecast across the board—annual average inflation in a median EM will be 6.8% and 4.1% this year and the next, respectively (0.9 ppt and 0.6 ppt higher, respectively, than March forecasts), emphasizing the deeper hit to consumers' purchasing power and subsequently lower real domestic demand the rest of 2022 and in 2023.
- Monetary policy: Broadening domestic inflationary pressure combined with the U.S. Federal Reserve and other major central banks' plan for swifter policy tightening means we now expect tighter monetary policy across the EMs despite the weakening growth. Turkey is a notable exception despite acute exchange rate and inflationary pressures.

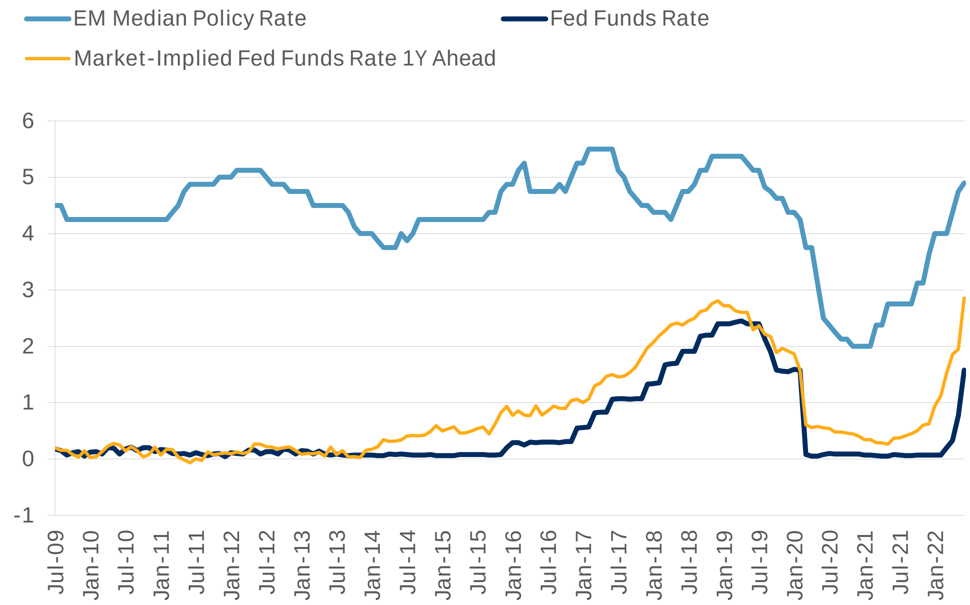
Global macroeconomic headwinds, including geopolitical and financial conditions, have deteriorated further since our March forecast. A longer-than-expected Russia-Ukraine conflict, higher energy and commodity prices, economic damage from Covid lockdowns and restrictions in China, and faster monetary policy normalization in the U.S., eurozone, and by many other major central banks have weakened the global economy. This led us to mark down our global GDP forecasts in an interim update in May, with growth forecast in the U.S. downgraded by 80 basis points to 2.4%, in the eurozone by 60 basis points to 2.7%, and in China by 70 basis points to 4.2%.

We have further trimmed our growth projections for key large economies and increased inflation forecasts across the board during the current (June) global forecast round. We did so marginally for the U.S. and eurozone this year and a bit more for next year. For China, we have further lowered our baseline 2022 growth forecast by 0.9 ppt to 3.3%, considering the slower-than-expected easing of Covid restrictions and sluggish recovery of domestic demand so far in the second quarter. Consequently, global growth is now forecasted to come in weaker in 2022 and 2023. Concurrently, inflation forecasts are now higher in both years globally.

The Fed has pivoted to a more hawkish stance by increasing rates at a faster clip. We now expect the Federal Reserve to raise the federal funds rate above 3.5% by mid-2023, a much swifter pace of normalization and due to a higher envisioned terminal level (more than 1 percentage point) than just three months ago. The current rate hike cycle has the advanced economies catching up to the earlier moves in EMs (see chart 5). Most central banks (excluding EM Asia where inflationary pressures were moderate until early 2022) had already been raising their policy rates prior to the Fed's lift-off. More recently, risk-off sentiment has taken hold, and domestic financial conditions (including external financing conditions) have tightened, with sizeable currency depreciations across EMs against the dollar.

Chart 5

Most EM Central Banks (Excluding EM Asia) Raised Policy Rates Ahead Of The Fed's Lift-Off.



Note: EM median is of 12 major EMs. We use the ACM 1-year risk neutral yield to represent the market-implied Fed Funds Rate 1-year head. Source: Haver Analytics and S&P Global Ratings

Despite sputtering global economy, GDP growth held up relatively well across most of the EMs in the first quarter, but momentum softened in the second quarter. Solid activity growth among commodity importers and exporters in the first quarter partly reflects resilient domestic demand, given the economic rebound from the pandemic, and in some cases the lingering impact of government stimulus measures. However, there are signs of slowing momentum (the change in the change) in the second quarter, such as softening manufacturing output and new export orders outside of commodity exporters. Lockdowns in China have so far haven't had a major impact on manufacturing production in other EMs, but it hasn't helped business confidence either. The Russia-Ukraine conflict is taking an increasing toll on EM Europe. Severe flooding in the KwaZulu-Natal province and worsening power cuts dealt a big blow to South Africa's manufacturing sector, with preliminary estimates on mining and manufacturing showing a sharp decline in April. The South African Reserve Bank's (SARB's) composite leading business cycle indicator decreased by 0.3% in April 2022 and by 4.7% on an annual basis: the largest year-on-year contraction since May 2020.

Softer global growth could act as a drag on the demand for EM manufactured goods. Moreover, contribution to consumer demand growth was already due to shift from tradable goods to non-tradeable services as normalization of service sector strengthens.

Authorities are relaxing restrictions on international travel, which is supporting tourism activity in EMs and provides a modest economic boost. The recovery in tourism has gained steam in Turkey, thanks to the ebbing pandemic and competitive lira. In the first four months of 2022, foreign visitor numbers were 2.7 times higher than last year, with the gap from pre-pandemic levels narrowing to 12% from 46% in 2021. Arrivals from Europe and other regions are surging, while a decline in the number of visitors from Russia has been contained so far (an 18% drop in January-April compared with the same period in 2021).

However, the story is a bit different in countries where tourists from China accounted for a significant share of overall arrivals prior to the pandemic, namely EM Asia. While China's borders remain closed, a full tourism recovery is unlikely. Thailand, the tourism sector of which suffered deep losses from the pandemic and contributes the largest share to the overall economy than those of other Asian countries. Tourist arrivals there were only about 10% of pre-pandemic levels in April. This proportion will rise throughout the year with a steady recovery in tourism arrivals, but we don't expect tourism to normalize during our forecast horizon, and the scars in the sector will take time to heal.

Upside growth surprises in several EM economies in the first quarter triggered a small upward revision to our 2022 GDP growth forecast for our sample of EMs, excluding China, offsetting increasingly weaker global economy. The statistical lift for the entire 2022 is most apparent in EM EMEA, the projection for which is up 1.1 ppt. All countries in our EM EMEA sample posted better-than-expected performance. LatAm's robust first-quarter performance--in Brazil more than anywhere else--led to a 0.2 ppt upward revision for the region. Poland, South Africa, Brazil, and Chile are on track to experience a contraction in the near stagnant second quarter and third quarters. Turkey will see contraction in the second half of this year following a relatively resilient first half. We revised down our GDP forecast for EM Asia, excluding China, in 2022 by a 0.3 ppt from the one three months ago, which is due to downward revision of our assumptions for India. EM Asia has more scope to benefit from China emerging out of lockdowns of April and May, although we assume there will be lingering impact of “zero Covid policy” on Chinese growth (mainly on consumption, tourist travel of which are counted as exports of receiving country) with a potential for further disruption as a key downside risk. Growth forecast for EMs, excluding China, in 2023 remains unchanged at 4.1%, with many countries facing protracted recoveries to their pre-pandemic trend amid lingering inflation shock.

Table 2

Q1 Growth Supports Our 2022 Forecast

Real GDP %

	2019	2020f	2021	2022f	2023f	2024f	2025f
LatAm	0.6	-6.5	6.5	1.9	1.7	2.2	2.2
EM-EMEA	1.4	-1.9	6.9	4.7	2.2	2.8	2.7
EM-Asia	5.2	-1.0	7.5	4.6	5.6	5.4	5.3
EM-Asia Ex. China	4.0	-5.8	6.6	6.4	5.9	6.0	6.1
EM-15	4.1	-1.9	7.3	4.2	4.7	4.6	4.6
EM-15 Ex. China	2.6	-5.2	6.7	4.9	4.1	4.4	4.4

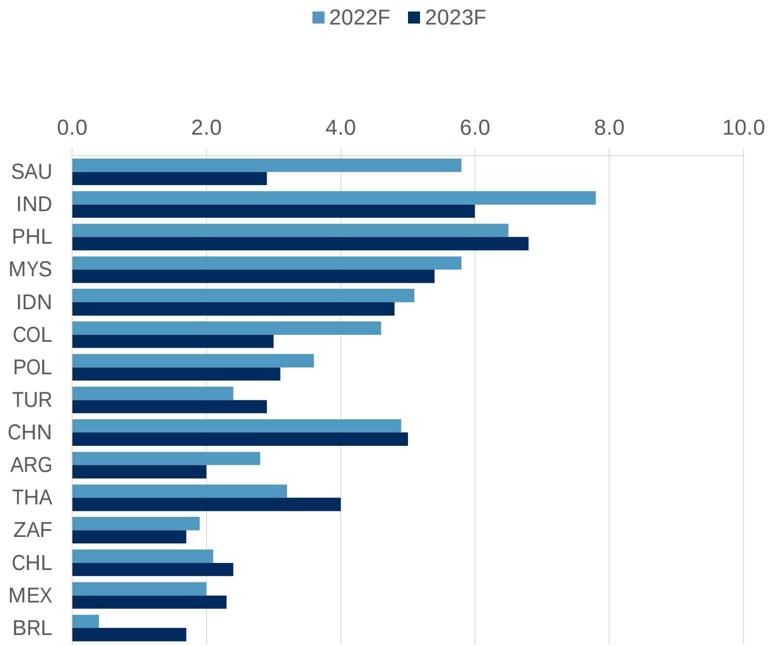
Real GDP Changes From March Baseline, percentage points

	2021	2022f	2023f
LatAm	0.0	0.2	-0.4
EM-EMEA	0.1	1.1	-0.6
EM-Asia	-0.1	-1.1	0.4
EM-Asia Ex. China	-0.1	-0.3	0.3
EM-15	0.0	-0.6	0.2
EM-15 Ex. China	0.0	0.1	0.0

F--S&P Global Ratings forecast. Note: GDP aggregates are based on GDP PPP Weights. EM-14 excludes China and India.
Source: S&P Market Intelligence and S&P Global Ratings.

Chart 6

GDP Forecasts For Key EMs



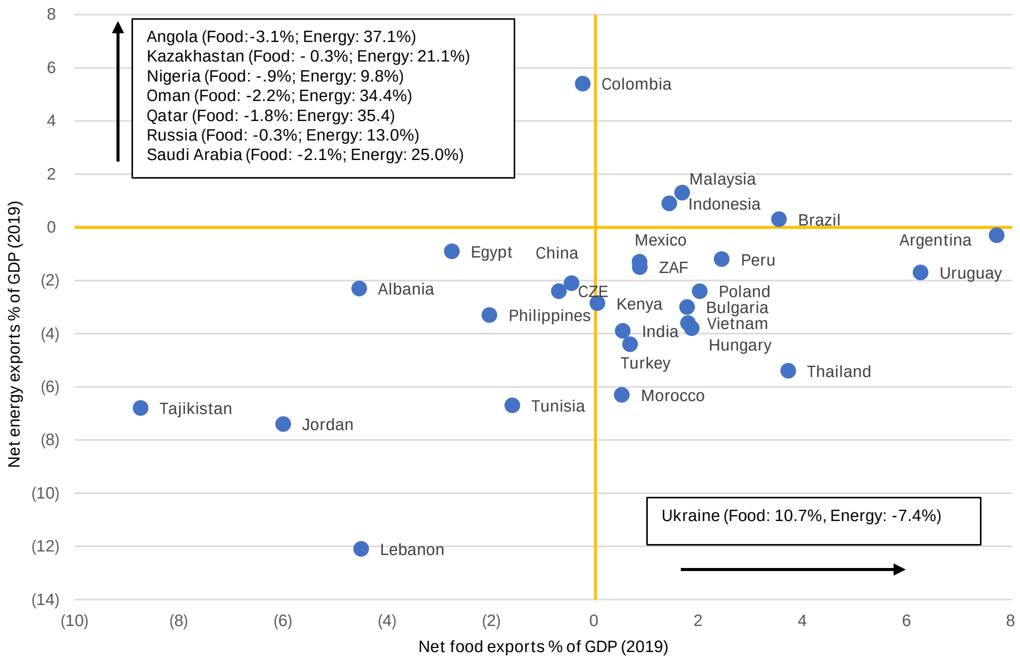
F--S&P Global Ratings forecast. For India, 2019 = FY 2019 / 20, 2020 = FY 2020 / 21, 2021 = FY 2021 / 22, 2022 = FY 2022 / 23, 2023 = FY 2023 / 24. Source: S&P Market Intelligence.

Higher energy and food commodity prices are causing upward revisions to consumer price inflation for the rest of 2022 and for 2023. S&P Global Ratings now assumes that Brent will average $100 per barrel (bbl) the rest of 2022 and $85 per bbl in 2023 (see "S&P Global Ratings Raises Oil And Natural Gas Price Assumptions On Further Market Price Step-Ups", published June 8, 2022), $15 higher than our March assumptions. Energy prices are persistently higher and appear likely to remain elevated for longer as the Russia-Ukraine conflict and sanctions continue. Demand for oil and related products continues to trend upward despite supply constraints and tightly balanced markets before the conflict.

More importantly, fertilizer shortages, export controls, global trade disruptions, and escalating fuel and transport costs will continue to exert upward pressure on the cost of food staples. Rising food prices and diminishing supplies will last through 2024 and possibly beyond, in S&P Global Ratings' view (see "The Global Food Shock Will Last Years, Not Months" published June 1, 2022). EM households spend much more on food than on energy ; therefore, food price increases are having a greater pernicious impact on their budgets than energy price increases of the same magnitude. Moreover, higher energy prices bleed into producer prices, both domestic and global, and at least partly into core consumer prices ("Which Emerging Markets Are Most Vulnerable To Rising Food And Energy Prices?" published April 21, 2022).

Chart 7

Emerging Markets' Food and Energy Trade Balances



CZE--Czech Republic. KEN--Kenya. ZAF--South Africa. Sources: WTO, World Bank (WiTS), S&P Market Intelligence, and S&P Global Ratings.

Underlying price pressures in the past five months have been more acute in emerging Europe and LatAm. We have raised our projections for inflation for all EM economies, except Saudi Arabia. The latter is because the stronger U.S. dollar, against which the Saudi riyal is pegged, has helped contain inflation. These revisions are due to higher energy and commodity prices, weaker exchange rates, and in a few cases, larger pass-throughs as economies recover and core inflation picks up amid decreasing slack.

Table 3

Inflationary Pressures Remain (CPI Inflation Y/Y%; Annual Average)

	2019	2020	2021	2022F	2023F	2024F	2025F	Central bank inflation target
Argentina	53.5	42.0	48.4	62.0	59.0	45.0	35.0	No target
Brazil	3.7	3.2	8.3	10.5	5.0	3.7	3.0	3.5% +/- 1.5%
Chile	2.3	3.0	4.5	10.2	5.5	3.2	3.0	3.0% +/- 1.0%
Colombia	3.5	2.5	3.5	9.0	4.1	3.2	3.0	3.0% +/- 1.0%
Mexico	3.6	3.4	5.7	7.4	4.1	3.2	3.0	3.0% +/- 1.0%
China	2.9	2.5	0.9	2.3	2.5	2.2	2.2	3.0%
India	4.8	6.2	5.5	6.8	5.0	4.5	4.5	4.0 +/- 2.0%
Indonesia	2.8	2.0	1.6	4.1	4.0	3.6	3.6	3.5% +/- 1.0%
Malaysia	0.7	-1.1	2.5	2.9	2.2	2.3	2.3	No target
Philippines	2.4	2.4	3.9	4.5	3.7	2.6	2.6	3.0% +/- 1.0%
Thailand	0.7	-0.8	1.2	6.0	2.3	1.0	1.0	2.5% +/- 1.5%
Poland	1.8	3.7	5.2	12.0	10.0	4.5	2.0	2.5% +/- 1.0%
Saudi Arabia	-2.1	3.4	3.1	2.8	2.6	2.1	1.9	3.0% +/- 1.0%
South Africa	4.1	3.3	4.6	6.1	5.0	4.6	3.9	3.0% - 6.0%
Turkey	15.2	12.3	19.6	68.6	23.1	12.7	12.7	5.0% +/- 2.0%
Median-EM	2.9	3.2	4.5	6.8	4.1	3.2	3.0	

Source: S&P Market Intelligence; 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

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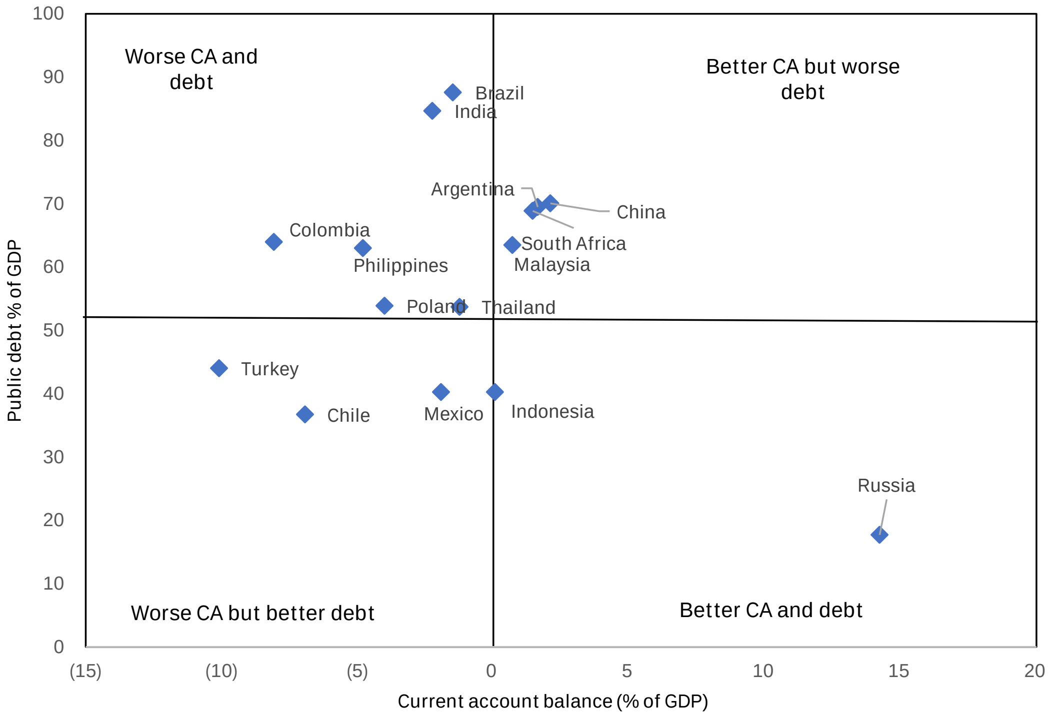
The speed and scale of monetary tightening will vary across EM economies. Higher inflation expectations (see chart 9) and greater hawkish tilt by the Federal Reserve and other major global central banks will continue to put pressure on EM central banks to raise rates in the next few quarters. Maintaining anchored inflation expectations and protecting capital flows are top priority for policy makers. This is especially the case for net energy importing EMs with current account deficits. This is the case in Turkey, Chile, Poland, India, the Philippines, and Thailand (see chart 8), where the current account deficits are likely to get only wider in the coming quarter due to higher energy prices that more than offset food trade surplus in some of these countries.

Chart 8

Current Account And Public Debt As Of 1Q 2022

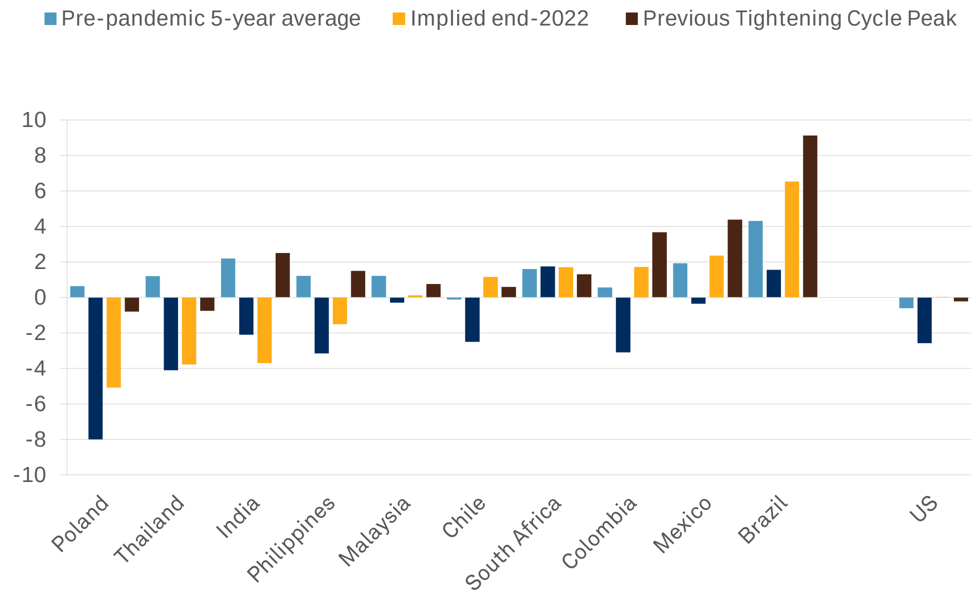


Note: Q1 uses estimates in some cases. Source: IIF, S&P Market Intelligence, and S&P Global Ratings.

LatAm countries have already increased the magnitude of their interest-rate hikes to match the Fed's larger increases in recent meetings, and we now see a higher terminal interest rate for the current tightening cycles across the board. Poland's central bank has already raised the key rate by 425 bps to 6% this year, and we expect it will raise it further to 7.5% by the end of 2022 to tackle broad-based inflation that's running well above the May target of 13.9%. Once inflation is on a firm downward path next year (although at a higher level than our March forecast), we expect some EM central banks to start lowering rates, most notably those in Brazil, Chile, and Poland. At the same time, inflation in South Africa is within the target range of 3%-6% (though close to the upper band), while core inflation is contained. The SARB will likely gradually normalize monetary policy in 2022-2024. EM Asia is the laggard of monetary policy adjustment during this cycle, while Turkey is a notable exception given that its central bank is set to hold off on raising rates despite acute exchange rate and inflationary pressures.

Chart 9

Higher Inflation And Hawkish Tilt Will Continue Pressuring EM Central Banks



Note: Implied end-2022 takes into account the interest rate discounted in the 6 month-ahead interest rate swap minus the end-2022 inflation expectation. In some EM cases, no data series for inflation expectations was available; in those cases we used end-2022 consensus forecast for inflation. For the U.S., we use CME implied fed funds rate for December 2022 and UMich inflation expectations 1-year ahead.

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

Macroeconomic Outlook Remains Somber, Despite Upside Growth Surprises

First-quarter GDP growth in major EM EMEA economies surprised to the upside, both in commodity-importing countries in emerging Europe (Poland and Turkey), as well as in commodity exporters (Saudi Arabia and South Africa). Domestic demand was somewhat resilient to a set of shocks thanks to post-pandemic recovery, and in some cases policy stimulus. Trade performance diverged, given that exports fell in Poland and Turkey the previous quarter, but they expanded strongly in South Africa. After a solid first-quarter, we expect slower growth in the coming quarters amid mounting headwinds from a prolonged Russia-Ukraine conflict, accelerated tightening of monetary policy by the Fed and other major central banks, and weaker global growth prospects. Elevated food and energy prices have fueled inflation (outside of Saudi Arabia), with weaker exchange rates adding to price pressures. The hit to consumer purchasing power, tighter financial conditions, and slackening post-pandemic recovery will weigh on domestic demand for the rest of the year.

The sensitivity to these developments varies across economies. The Russia-Ukraine conflict is taking an increasing toll on emerging Europe, and high frequency and leading indicators point to a slowing growth momentum in Poland and Turkey. With the conflict lasting longer than initially expected the risks of more severe disruptions to trade, supply chains, and energy supply have risen. At the same time, energy exporters in the Middle East And North Africa (MENA) are enjoying windfall revenues that more than offset higher food import bills, but slower global growth and tighter financing conditions will moderate these gains. Meanwhile, several commodity-importing MENA economies are among the most vulnerable to current developments, given that they're net importers of food and energy, and sourcing a large part of their cereal supplies from Russia and Ukraine (see "Food Price Shock Reverberates Through MENA Economies" published May 26, 2022).

To read our full report on EM EMEA, click HERE

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

Resilience So Far This Year, But Weakness Expected Ahead

LatAm economies have been more resilient than expected to the current mix of external headwinds so far this year. Domestic demand held up relatively well across most of the region, reflecting ongoing recovery from the pandemic-induced downturn, and in some cases, the lingering impact of government stimulus measures. In some countries, exports picked up as well, most notably in Brazil, thanks to strong commodity exports. The lockdowns in China have so far not had a major impact on LatAm's manufacturing production, despite fears of potential supply-chain disruptions filtering through the region. However, the recent tightening in global financial conditions, continued upward supply-side pressures on inflation, and greater uncertainty over global growth are likely to weaken growth in the region for the rest of 2022 and into 2023.

Given these factors, our 2022 GDP growth forecast for LatAm increased to 1.9% from our previous 1.7% assumption but decreased for 2023 to 1.7% from 2.1%. Risks to our GDP growth forecasts are mainly to the downside. Given high inflation, weak employment dynamics, and high economic uncertainty, policy predictability in the region is low, with potentially adverse implications on investment. Another key risk to the region is a potentially weaker-than-expected U.S. economy, which would hit Mexico the most due the strong trade links between both countries. But the associated deterioration in confidence and financial conditions would also imply lower growth for the rest of the major LatAm economies.

To read our full report on LatAm, click HERE.

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

Reopening Fuels Growth Momentum

Emerging Asia is seeing recovery in economic activity as the region re-opened gradually following intermittent lockdowns over 2021. Recovering consumer demand is a key growth driver and is likely to remain resilient over the next few months. We expect steady growth for the region of 6.4% in 2022 following a 6.6% growth last year, even in the current uncertainty the global economy. First-quarter growth in the region was broadly resilient. It was in line with expectations in Indonesia (5.0% year-over-year [y/y]) and Thailand (2.2% y/y). In Indonesia, public consumption growth was sharply weaker than in the same period last year, which offset steady private demand and trade growth. First-quarter growth was strong in Malaysia (5.0% y/y) and the Philippines (8.3% y/y) on robust private demand. India's growth was slightly weaker than expected (4.1% y/y), and in contrast to the rest of the region, tepid consumer activity growth weighed on overall growth.

Inflation will rise in the second half of 2022 across EM Asia, but it currently remains moderate relative to the U.S. or eurozone. The recovery in consumer demand began in late 2021. As a result, core consumer price pressures have only currently started picking up. Food and energy prices will be influential in the inflation trajectory. Energy price inflation remains high, except in Malaysia and Indonesia. The two economies are net energy exporters and are not passing some of the energy commodity cost increases to consumers. Food price inflation is at moderate levels but is currently rising. A significant proportion of agricultural trade is intra-regional but will nevertheless be affected by rising global food inflation. Capital outflow pressures remain moderate. There have been significant equity outflows from India and the Philippines, but other portfolio outflows are limited. EM Asian currencies have depreciated less against the U.S. dollar relative to the major currencies. However, rising U.S. interest rates pose a risk of heightened capital outflow pressures.

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

Risks To Our Baseline Growth Forecast Are Squarely On The Downside

The risks to our forecasts have picked up since our last forecast and remain firmly on the downside. The Russia-Ukraine conflict is more likely to drag on and escalate, in our view, pushing the risks to the downside. As S&P Global Ratings noted in its previous global macroeconomic outlook report, a hard downside scenario would involve a broad-based trade rupture between Russia and the German-centered industrial complex, depressing growth, incomes, employment, and confidence, with a knock-on effect to the wider global economy. A second worry is inflation remaining higher for longer, requiring central banks to raise rates more than is currently priced in, risking a harder landing, including a deeper hit to output and employment. In a particularly bad variation of this risk, fuel and food inflation would remain high even if core inflation (which central banks more directly control) declines, leading to stagflation. That's a sure fire recipe for regression in living standards, deterioration in policy credibility, and social unrest.

China matters for the rest of EMs. The S&P Global EM Manufacturing PMI for May suggests that the easing of virus-related disruptions in China supported a small rebound in EM manufacturing for that month, but the sector remains weak in China. Given that restrictions on people's movements were lifted only gradually, new restrictions imposed in other parts of the country, and overall sentiment remaining poor, the recovery is slower than in 2020.

Given that consumer spending is hit harder by the lockdowns than investment and industrial production mitigates the harm to other economies, as China's consumption is less import-intensive. Nonetheless, China's imports have plunged, in part because of the impact of the property downturn on commodity imports. It hasn't gone unnoticed that S&P Global Rating's GSCI industrial metals prices peaked in March and has now dropped to August 2021 levels (still above than pre-pandemic highs), hinting at shallower industrial demand problems for China and its peers.

EM Asia is the most at risk from weakening Chinese consumption and tourism. Thailand, Malaysia, and the Philippines stand out as having the highest exposure from this angle. They are also among the most at risk from further supply-chain disruptions, although manufacturing continues to operate with limited disruptions under pandemic restriction. And it's not just EM Asia. Mexico, for example, has the highest value-added share coming from China in the computer and electronics sector at nearly a one-fifth of total output. However, unless lockdowns take place in key manufacturing hubs, disruptions to those supply chains may be limited. Raw industrial metals and minerals exporters such as South Africa, Brazil, and Chile are vulnerable to downward price shocks in the global industrial sector.

Financing Conditions

Global Recession Risks Weigh On Financing Conditions

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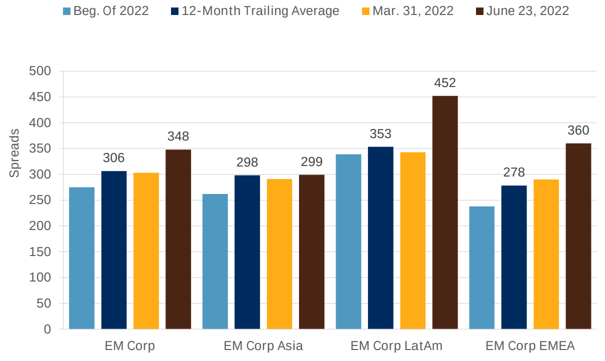
Global and regional headwinds place central banks in an unenviable position. Price increases for food and energy, of which many EMs are net importers, are fueling inflation and forcing many central banks to raise rates despite the risks to economic activity. This situation has become more complicated given the possibility of a recession and higher rates in the U.S., along with a stronger dollar. Nevertheless, many central banks are likely to continue to raise rates--at least through the end of 2022--placing further strain on some economies already grappling with high debt.

Financing costs are on the rise. Benchmark yields are rising--most notably across LatAm and EEMEA--with Polish 10-year yields as of June 23 up by over 350 bps since the start of the year and Brazilian 10-year yields recently reaching 13%. Relevant real yields are also rising sharply--most notably in the U.S. and LatAm. Alongside the continued increase in benchmark yields, corporate credit spreads are also widening steadily, if not dramatically, particularly in LatAm and EEMEA. However, lower liquidity and subdued primary activity make it difficult to accurately gauge credit risk premia, and it's likely that the confluence of risks confronting EMs will ensure credit spreads will widen , further increasing the cost of financing.

Chart 10

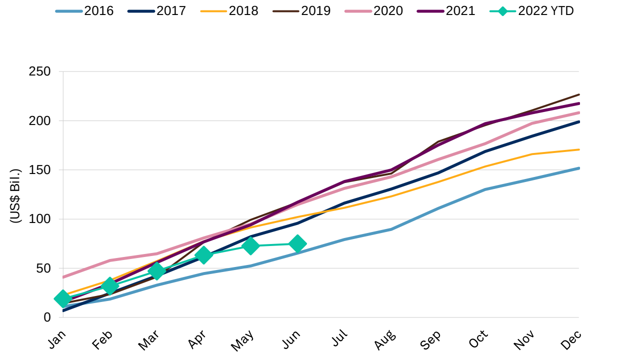
EM Spreads By Region



Data as of June 23, 2022, Source: FRED, The Federal Reserve Bank of St. Louis.

Chart 11

EM Issuances



Data as of June 15, 2022. Data including NR (not rated) and both financial and non-financial entities. Source: S&P Global Ratings Research, Refinitiv.

Corporate refinancing risk looks manageable, despite subdued primary markets. Consistent with other regions, primary market activity across EMs plunged in 2021, and remains subdued particularly for lower rated speculative grade issuers. Refinancing foreign debt could become increasingly challenging because of weaker local currencies or investment outflows. Local bank financing appears accessible, although underwriting conditions may tighten if economic conditions deteriorate. Despite these risks, the estimated maturity profiles among corporations that we rate look balanced--with peak maturities not occurring until 2024--and only 10% of maturities through 2026 due before the end of 2022. Furthermore, near-term maturities are mostly among investment-grade issuers, with peak speculative-grade maturities not occurring until 2025. However, our data doesn't provide a complete refinancing profile, and the longer volatility remains, the greater the level of refinancing risk.

Rating performance presents a mixed picture. In contrast to trends in other regions, EMs' year-to-date defaults are higher than in 2021, and EMs show a higher 12-month trailing default rate (2.1%). More in line with other regions, positive rating actions in EMs exceeded negative rating actions in May, while year-to-date actions are broadly neutral. Negative bias--an indicator of future negative actions--also remains below the five-year average on a regional basis and across most sectors. However, consumer products, and homebuilders and real estate, two sectors heavily exposed to persistent inflation and changing consumer sentiment, are posting above-average readings.

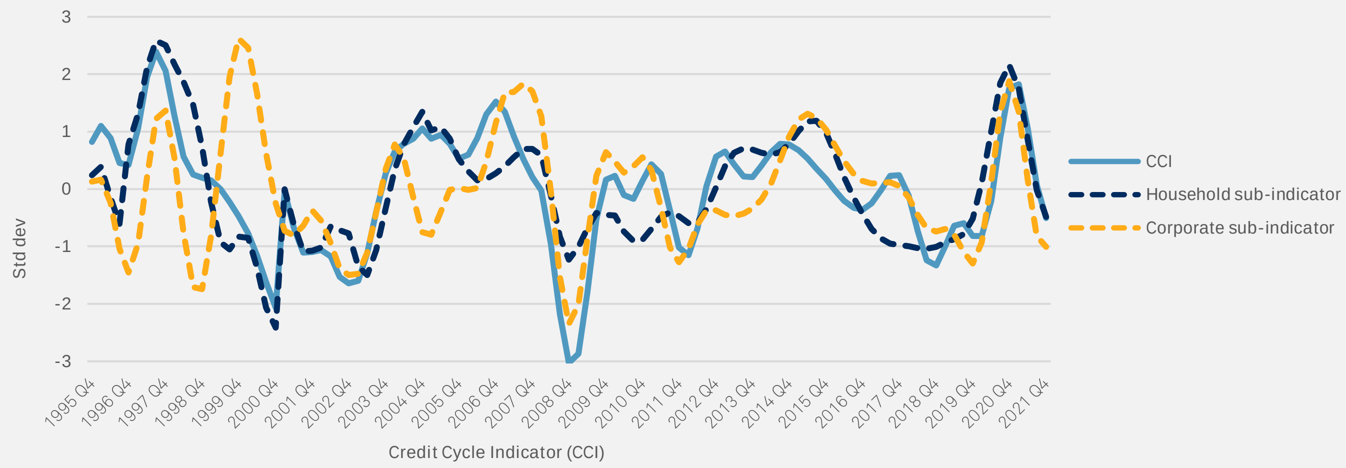
Credit Cycle Signs Point To Heightened Credit Stress In Late 2022 Or Early 2023

We are trialing a proprietary Credit Cycle Indicator (CCI) at the macro geographical level. The CCI has five components: corporate and household debt leverage, equity and house prices, and our proprietary Financing Stress Indicator (FSI) (see "White Paper: Introducing Our Credit Cycle Indicator," published on June 27, 2022). Our preliminary results show the peaks in the CCI tend to lead credit stresses by six to ten quarters. Moreover, when the CCI's upward trend is prolonged or the CCI nears upper thresholds, the associated credit stress tends to be greater.

Overall. Over five consecutive quarters since Q3 2020, the EM ex-China CCI trended upwards and reached a peak of 1.8 standard deviations (compared to its historical average) in Q1 2021. This suggests potential heightened credit stress in late 2022 or early 2023 (see chart 12). While the CCI is trending downwards--indicating credit correction is underway--the potential impact of the recent buildup of nonperforming loans (NPLs) and defaults could linger beyond the stress period across late 2022 and early 2023.

Chart 12

Recent Peak In CCI Across EMs (Excluding China) Suggests Heightened Credit Stress In Late 2022 Or Early 2023



Note: We view the CCI as a leading indicator for potential credit stress outcomes. The CCI period ends in 2021 Q4. Household and corporate sub-indicators were created by taking the weights in the overall CCI and rescaling such that the sub-components' weights in the sub-indicator sum to 1. Emerging Markets geographies included in the EM ex-China CCI: Brazil, Chile, Colombia, India, Indonesia, Malaysia, Mexico, Poland, South Africa, Thailand, and Turkey. Source: Bank for International Settlements, Bloomberg, and S&P Global Ratings.

Corporates. Corporate debt-to-GDP levels dropped during the pandemic but as activity resumed, corporate credit begin accelerating. It is a mixed picture across EMs, but by the 4Q of 2021 our corporate sub-indicator, across our most of the selected countries, were above pre-pandemic metrics. Corporate Credit to GDP has been easing over the latest quarter as the Omicron variant caused a temporary setback on credit growth, at the same time economic activity remained resilient, therefore Credit to GDP fell. Financing conditions have been rapidly tightening over the past few months, as developed countries accelerate their monetary normalization in an effort to tame inflation; this will probably be reflected in falling Corporate Credit to GDP going forward, bringing pressure for those corporates at the lower rated spectrum, especially those in need of refinancing. Meanwhile, some groups of corporate borrowers (especially highly indebted SMEs) remain vulnerable with revenues and earnings yet to fully rebuild.

Households. House-hold credit to GDP is relatively low in most EMs in our sample, except for Thailand in which we have signaled household leverage as a key concern and Malaysia where we assess credit risk as high, but household assets offsets household leverage to some extent. That said leverage has been growing steadily across EMs, similar to corporations it is a mixed picture across countries, but by the 4Q of 2021 our household sub-indicator was already above pre-pandemic levels. Slower growth and tighter financing conditions ahead will weight on credit growth over the coming quarters; sustained inflationary pressures and eroding household purchasing power will probably dent banks asset quality.

Governments. Sovereign risk is not included as a formal part of the CCI.

S&P Global
Ratings

Sector Trends

Chart 13

Negative Rating Actions Still Dominate In EMs

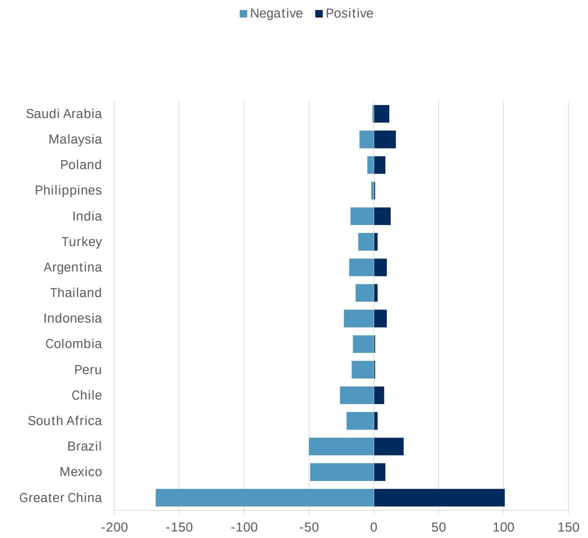
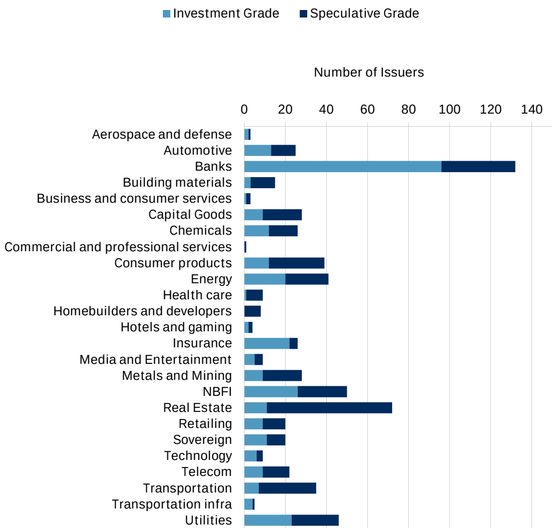


Chart 14

Rating Actions In EMs By Sector



Data is from February 2020 - June 10, 2022. Source: S&P Global Ratings.

Sovereigns

EM Asia

- The Ukraine-Russia conflict has stoked inflation and increased risks to growth. These developments could slow the credit improvement among EM Asian sovereigns.
- The recovery from the pandemic should continue despite these headwinds.

Intensifying sanctions on Russia sustain high commodity and food prices. Some governments have increased subsidies to cushion the rising cost of living. A few have imposed food export restrictions. These moves may postpone credit improvements if they become persistent.

Interest rate expectations rise further. Expectations of monetary tightening in the U.S. and eurozone have also caused interest rates to rise in EM Asia. Exchange-rate volatility, especially the Japanese yen and Korean won, has also increased, although EM Asian exchange rates have seen smaller moves so far.

Outside China, COVID restrictions have eased markedly. Reduced border controls have allowed a resumption activity in tourism and business, relieving pressures on service industries across the region. Stronger investment spending and domestic consumption should also result from these changes to help offset downward pressures on growth from adverse international developments.

Growth And Fiscal Consolidation At Risk

Sudden capital swings. An unexpected deterioration of geopolitical risk or interest-rate expectations could see investors withdraw from EM Asia, making financing conditions significantly more challenging for some. Steep exchange-rate depreciations could also worsen imported inflation.

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Growth and fiscal recoveries interrupted. High inflation, weaker demand, and increased uncertainty arising from the Russia-Ukraine military conflict and continued supply-chain disruptions may slow the economic and fiscal recoveries at a steeper-than-expected level.

Widening geopolitical tensions that affect EM Asia more materially. If the Russia-Ukraine conflict expands or involves more parties, it would seriously damage investor sentiment and stoke further price increases. The conflict's impact on economies and financial markets in the region may worsen significantly.

New variants that may prolong the pandemic. Vaccines may be less effective against new variants of COVID, prolonging the pandemic.

LatAm And The Caribbean

Inflation Threatens To Derail An Already Fragile Recovery

-Rising inflation will dampen economic recovery.

-Much of the region has strengthened the monetary policy framework in recent decades, and we expect that this to persist, despite potential political pressures for changes in some countries.

-Higher food and energy prices will hurt most countries in the region and moderately help only a few ones.

Slowing global economic growth, rising inflation, higher interest rates, and the impact of a stronger U.S. dollar will heighten political uncertainty in LatAm. However, the rating impact of these pernicious global trends may be moderate, given that sovereign ratings in the region are already quite low (nearly 60% of the regional sovereigns have suffered a downgrade since the start of the pandemic). We currently have negative outlooks on Bolivia, Mexico, Panama, El Salvador, and Trinidad and Tobago, indicating the likelihood of further negative rating actions. Guatemala is the only sovereign with a positive outlook on its rating.

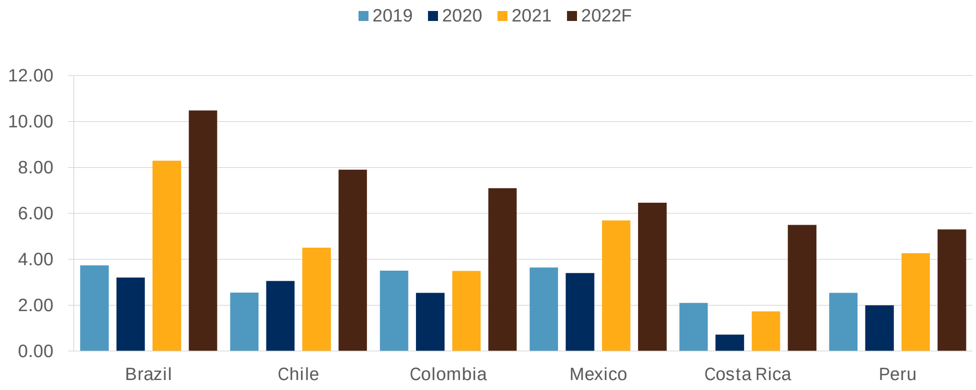
The pandemic's lingering impact and the disruption caused by the Russia-Ukraine conflict have caused shortages of agricultural and food products, as well as energy. Poorer countries are more vulnerable to shocks, because fuel, agricultural, and food items usually constitute a higher share of their imports than those of wealthier countries. Food prices rose 23% in 2021 in the region, the fastest pace in more than a decade, and may rise at a similar pace this year.

Rising inflation (see chart 15) is close to imperiling the already subpar economic recovery in many countries by worsening their financial conditions. Central banks in the region will likely continue to raise their policy interest rates, preventing the return to hyper-inflation that plagued the region in the late 20th century. However, central banks face a hard trade-off, at least in the short term, between policy tightening to contain inflation (and avoid abrupt capital outflows) and promoting economic recovery.

Moreover, high inflation may exacerbate social discontent and prompt governments to pursue fiscal and other policies to limit it. Many countries if the region (especially investment-grade sovereigns and large countries such as Brazil and Colombia) have strengthened their central banks in recent decades and adopted inflation-targeting policies. We expect that these factors will remain in place, despite potential political pressures for changes in some countries.

Chart 15

Rising Inflation Will Dampen LatAm's Economic Recovery (CPI Change %)

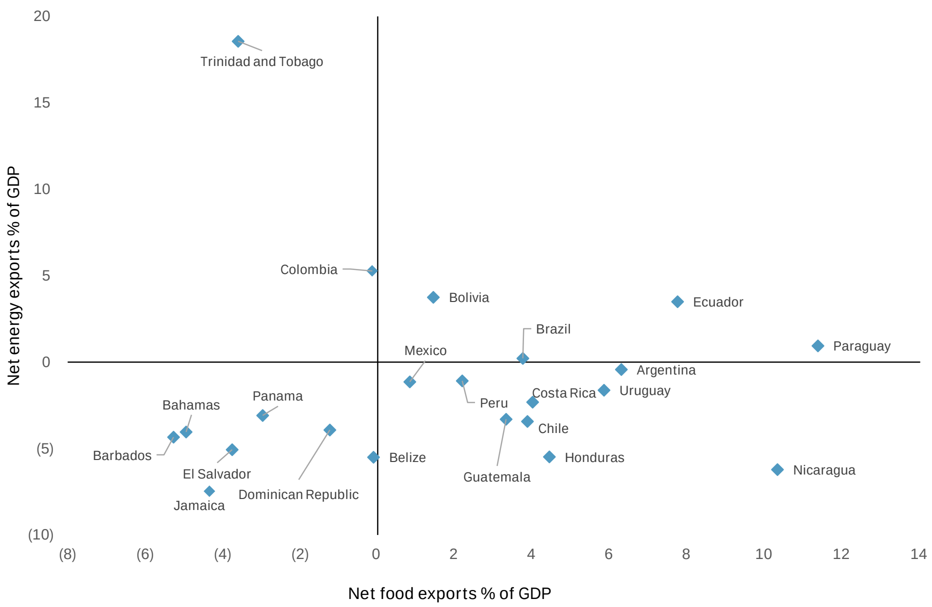


Source: S&P Global Ratings.

The impact of higher commodity prices varies across the region, as LatAm has both net importers and net exporters of food and energy products (see chart 16). Several countries (Ecuador, Paraguay, Brazil, and Bolivia) are net exporters of energy and food, and could benefit from the price increases. However, higher export earnings alone aren't likely to lead to a change in their currently low ratings (ranging from 'B-' to 'BB'), given structural weaknesses. Other countries (Barbados, Jamaica, the Bahamas, Belize, El Salvador, Panama, and the Dominican Republic) are net importers of energy and food. Other than Panama ('BBB') and the Dominican Republic ('BB'), this set of sovereigns has low ratings (ranging from 'B+' to 'CCC+'), reflecting weaknesses that may be intensified by prolonged high commodity prices. Trinidad and Tobago is in a unique position because it's a substantial net exporter of natural gas and only a moderate importer of food.

Chart 16

Food And Energy Trade Balance % of GDP



Note: The reference period is average of 2017-2020. Source: WTO, S&P Market Intelligence, S&P Global Ratings.

However, even countries that are substantial net energy or food exporters are facing political pressure to compensate their citizens for higher prices for basic items. Much of the windfall for net exporting countries from the high prices will go towards subsidies or other programs to limit the increase in domestic prices. For example, as a net exporter, Colombia benefits from higher oil prices (mainly through a stronger current account balance), but high domestic energy prices have led the government to expand subsidies. The country's Fuel Price Stabilization Fund, designed to contain the volatility of fuel prices, accumulated a deficit of almost 1.4% of GDP by the end of March of this year. The government plans to transfer money into the fund, largely eliminating the fiscal gains from royalties and dividends from the national oil company, Ecopetrol S.A. Similarly, in Mexico and Brazil, the benefits of higher oil export earnings and fiscal revenues from oil production will be offset by fiscal measures to limit domestic fuel price increases.

EM EMEA

Financing Conditions Continue To Tighten

This year continues to be challenging for EM EMEA sovereigns, The conflict's consequences are visible primarily through a food and energy terms-of-trade shock. Therefore, OPEC members (excluding Nigeria, where maintenance and pipeline closures have led to sharp production cuts) are enjoying the fiscal, external, and growth windfall from higher oil prices. For example, we estimate that natural resource rents in Saudi Arabia have returned to 2014 levels, i.e. close to 40% of GDP, boosting activity and improving fiscal and external positions, and even contributing to a reset of Saudi's relations with the U.S. In contrast, larger more populous net energy importers such as Turkey, Poland, and the rest of Central and Eastern Europe (CEE) are seeing hard currency cost of imports jump by more than 40% y/y, as state-controlled fuel distributors are forced to raise rates to cover costs, further pushing up already high inflation. In tandem, as central banks are uniformly front-loading rate increases, domestic and external financing conditions are tightening, while supply-side disruptions and the demand and fiscal overhangs from the global pandemic linger.

Many EM central banks now face a choice of either tightening further to put a lid on price pressures (but dragging down growth) or letting their currencies fall further (but importing more inflation). Food importers such as Egypt are seeing merchandise deficits widen by around 1.5% of GDP on average on an annualized basis. In any other year, this would be easily financed through capital inflows. But largely given the Fed's increasingly hawkish rate decisions, net portfolio outflows continue from most of EMEA, most recently during the second quarter of 2022. 'B' rated Egypt and 'B-' rated Ghana, moreover, remain locked out of Eurobond (though not syndicated) loan markets, barring IMF programs or an end to the Russia-Ukraine conflict.

For EM EMEA sovereigns, the balance of outlooks remains negative, but also due to idiosyncratic to specific credit trends. Therefore, we have taken a few positive rating actions so far during 2022, such as upgrading oil exporters, Angola and Oman, as well as the Democratic Republic of Congo, while revising the outlook on South Africa to positive thanks to its external resilience. Most of the negative rating actions taken so far during 2022 have occurred for direct participants in the Russia-Ukraine conflict.

And yet, while the uncertainty over inflation, growth, and geopolitics have aggravated pressures in EM EMEA, there are still distinct patches of resilience, which cause us to pause. Part of this reflects our starting points on ratings in EM EMEA:

- EM EMEA ratings are already close to multi-year lows after a series of pandemic-linked downgrades.
- Central banks such those in South Africa and Kenya have arguably moved faster than their developed market peers to tighten monetary policy. In some cases, this has put a floor under exchange rates, and should stabilize the cost of domestic funding for many EM EMEA governments, although at high levels.
- Economic growth for 2022 will take a hit from rate hikes and terms-of-trade shocks. But individual sectors (services, especially tourism and manufacturing) are showing resilience.
- While the Russia-Ukraine conflict is taking its toll on confidence, and consequently growth, recent economic growth data surprised on the upside including in Poland, where the central

bank of which recently upgraded its full-year GDP projection to 4.0%-4.5%. More dynamic African economies, such as Ghana and Kenya, are revising down their growth expectations for 2022, but they are doing so from relatively high levels.

- There are bright spots in recent balance of payment (BOP) data even among net energy importers, suggestive of underlying resilience. GCC sovereigns appear to be recycling their windfall energy earnings through the financial accounts of Egypt, Turkey, and CEE. Turkey's large errors and omissions surpluses so far this year are a larger contributor to external financing than the drawdown in reserves (though the latter continues to be a major concern).
- These finding don't support the view that EM EMEA can avoid a BOP shock, but rather that there are alternative new sources of funding it, other than reserve depletion.
- Fiscal fundamentals are, moreover, improving in a subset of EM EMEA sovereigns which are either posting significant primary surpluses (Egypt) or are implementing consolidation measures (Ghana).
- Finally, in our view, many of the weakening credit trends in EM EMEA are less due to the fraught external environment than due to country-specific policy settings, which in some cases appear to us as unsustainable. Turkey's off-balance sheet liabilities continue to accumulate. These include the central bank and treasury's implicit short dollar positions, equivalent to 7% of GDP, along with the risk of further decapitalization of state banks if the lira continue to depreciate.
- In the last 15 years, the composition of external financing for much of EM EMEA has shifted away from equity towards debt in countries such as Turkey, Egypt (excluding the energy sector), South Africa, Ghana, Nigeria, and Kenya. Were governments, in response to the worsening global financing conditions, to refocus their reform efforts on the reduction of impediments to equity inflows into their non-oil economies, their resilience to external shocks would improve (consequently, improving the performance of their jobs markets). Except for CEE sovereigns, which benefit from their EU membership, there's little evidence so far that this is happening.

Corporations

EM Asia

Inflation, Rising Funding Costs, And Dour Investor Sentiment Weigh On Credit Prospects

- Cost inflation and rising borrowing costs are starting to narrow the rating headroom for issuers, and the pace of negative ratings actions is likely to accelerate in the second half of the year.
- Lockdown effects, slowing economy, rising unemployment, as well as high energy and commodity prices dent the performance of rated companies in China.
- Volatile investor sentiment, expensive and selective capital markets are accelerating erosion of finances at the weaker end of the rating spectrum.

Cost inflation and rising funding costs are reducing the rating headroom amid slowing revenues. We still have negative outlooks on about 15% of the companies that we rate in EM Asia, a level that's broadly unchanged from the previous quarter. But inflation, rising funding costs, and slowing revenue growth prospects are eroding the rating headroom. We estimated that about 18% of rated companies in EM Asia (about 16% in Asia-Pacific as a whole) could breach downside financial rating triggers under a mild scenario of rising interest rates and current cost inflation persisting in 2022 and 2023. Asset-heavy or leveraged sectors--infrastructure, transportation, power, real estate--or those with lesser ability to pass through higher costs to customers--consumer discretionary, auto makers, infrastructure, capital goods--face the greater risks of downgrades in the next 12 months, especially in China and India.

COVID restrictions and weakening growth outlook in China on top of the current margin and funding challenges. The recent COVID-related restrictions in China have had a significantly more severe economic hit than most prior lockdowns in the country. Lockdowns in major cities including Shanghai has been constraining China's domestic consumption and heaping pressure on global supply chains. Even as lockdown measures have started to ease, we don't expect the government's COVID stance to shift substantially any time soon. We now expect China's GDP to grow 3.3% in 2022, down from our previous forecast of 4.2%, mostly on account of lower domestic consumption.

Larger-than-expected interest-rate hikes and a further bout of inflation. We estimate that ratings on about 25% of companies in EM Asia (about the same proportion for the Asia-Pacific region as a whole) could drop amid a stressed scenario of doubling of credit spreads from current levels and a more substantial earnings drop stemming from inflationary pressures. The sectors most exposed to persisting inflation are those that find it difficult to pass through costs to end customers (light discretionary manufacturing and retail, merchant power, infrastructure, transportation cyclical, capital goods, chemicals, and auto makers). While we currently assume no change to China's monetary policy, a shift to tightening will raise borrowing costs for often highly leveraged sectors such as real estate, infrastructure, and power, and local government funded vehicles.

Funding availability is narrowing as a result of poor external conditions. The increasingly cautious investor sentiment and selective capital markets are intensifying cost inflation and refinancing risk for the entities rated in the 'B' category and below (approximately 12% of rated companies in EM Asia). Liquidity and funding are likely to remain as major credit quality differentiators, with increasingly volatile investor sentiment, short windows to raise funds in capital markets, and higher funding costs, even for entities with stronger credit quality. Funding by domestic banks is also likely to stay selective as we enter the second half of 2022. Currency volatility in Southeast Asia--an almost 'forgotten' risk during and after the pandemic--is likely to return to center stage amid increasing U.S. rates and prospects for capital outflows.

Moderating revenue growth, margin pressure on cost inflation in 2022. We forecast revenues and profits to remain flat or rise by mid-single digits in 2022 among nearly 80% of the companies we rate in EM Asia. That will contrast with a high-single digit growth for most rated companies in 2021. We now project cost inflation to erode margins (especially energy, commodities, raw materials, and

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transportation) across almost 75% of companies we rate in EM Asia (about 70% for the Asia-Pacific region), compared with about 60% three months ago.

Capital market volatility. Gyrations are likely to persist, given the threat of a faster-than-expected tightening pace of U.S. monetary policy or a return of currency volatility in Southeast Asia, battering investor sentiment. A prolonged Russia-Ukraine conflict is further intensifying this volatility as persistent inflationary pressures, driven by elevated commodity prices and higher input costs, may force central banks to accelerate monetary tightening.

EM EMEA

Saudi Arabia's Recovery Gains Pace, Accompanying Healthy Capital Market Activity

The recovery of the Saudi corporate sector continues to gain steam, following the economic strengthening thanks to strong oil prices and robust fiscal spending. The oil and gas, and chemical sectors continue to fuel the recovery, while the first-quarter financial results for most companies and sectors are also strong. Despite the global sell-off in risk assets, Saudi Arabia's stock exchange Tadawul was up 11.7% year to date, as of June 12 partly thanks to the price appreciation of the listed oil and gas companies, given their high share of the index. But inflationary pressures are also building up in Saudi Arabia. We expect sectors such as utilities and telecoms to be immune to meaningful cost pressure, while some of domestic-focused sectors such as the consumer staples could face more pressure on pricing the incremental costs. While 2020 was plagued by the pandemic-related disruptions, we have seen visible acceleration in the Vision 2030 projects in 2021. We expect this trend to continue this year, which should fuel demand for funding, particularly for project finance transactions, while we're seeing a sharp pick-up in the infrastructure and contracting sectors. The residential real estate market remains strong. Government efforts to increase homeownership bolstered real estate transactions. Under the government plans, given the expected investments across a large number of sectors, the population of Riyad, the Kingdom's capital is set to further increase , which should continue to support construction activity.

Saudi capital markets were active in the second half of last year, particularly in the IPO market. As we discussed in "GCC Asset Sales Will Increase Transparency, Broaden Funding Sources, And Support Capital Market Development, published on March 21, 2022", we expect this trend to continue in 2022–2023. As of early June, eight IPOs occurred to date in the Tadawul main market, while we forecast a number of large transactions will come to the market over the next few weeks. While the corporate bond issuance has been slow amid the global market volatility, we expect some large deals to come to the market in the second half, given the potential hard currency funding requirements of some of the key projects under Vision 2030.

Rising Risks For Turkish Corporations

Turkish's dynamic private sector and corporations navigated through significant macroeconomic strains and uncertainties including the volatility and the weakness of Turkish lira over the past several years. And we believe 2022 is an even more challenging year. Inflationary pressures flared up following the lira's sharp depreciation since mid-November last year. The trend further exacerbated amid the sharp increase in commodity prices including energy and agricultural commodity prices since the start of the Russia–Ukraine conflict, as well as the continued weakness and volatility of the lira. Given the gap between wage/income growth and affordability of basic consumer products to households purchasing power continue to decline, we expect overall weakening in the performance of most sectors catering to domestic demand, as well as their ability to fully pass through the impact of cost inflation to their end customers. Inventory management is becoming a particular challenge amid stubbornly high inflation.

Given the macroeconomic uncertainties and questions over the lira's trajectory, we expect the key priority for most corporations will be to preserve cash, focus on managing the cost base amid high inflation, deleverage whenever possible, and refrain from unnecessary capital expenditures.

While most of Turkey's exporting sectors posted strong performance in 2021, the worsening global macroeconomic conditions, and the relative weakening in some of Turkey's key export markets will pose challenges. There's also a sizable number of Turkish companies across various sectors operating in Russia, which will continue to face pressures. In the meantime, foreign tourism for the first five months of the year increased by over 200% relative to the same period last year, given a strong recovery in most of Turkey's markets.

Manageable Inflation For South African Corporations Amid Missed Opportunities

As highlighted on our report, "Sub-Saharan Africa's Down But Still Not Out," published June 8, 2022, on RatingsDirect, persistent but moderating COVID-19 effects, exposure to the impact of geopolitical risks, inflationary pressures, and risk aversion in global capital markets are the biggest factors influencing prospects for South Africa-based corporations. On the COVID-19 front, most economically active people have returned to work, and consumer spending is recovering, but some companies are still suffering from elevated absenteeism rates, supply chain constraints, and strained discretionary incomes. The impact of geopolitical risks is muted in South Africa compared with that on other markets. Exposure is mainly through the inflationary effects of higher transport, food, and housing prices. Lower-income groups are disproportionately the most vulnerable, given the higher weighting of food and utilities (including power and fuel) in their consumption basket.

We view inflationary pressures on corporations, while not benign, as manageable. South Africa's CPI is rising; we forecast it at about 5.8% for 2022 versus 4.1% before the pandemic. Cost-efficiency initiatives and a focus on deleveraging have enabled companies to absorb higher costs. Higher prices for commodities are also supporting cash flows, enabling commodity exporters to absorb higher input costs and supply-chain inefficiencies. However, inflation's impact on consumer spending and affordability could depress the revenue of domestically focused companies such as retailers, telecoms, and health care providers. The modest pace of inflation is partly due to South Africa's power generation mix, with around 90% of electricity fueled by coal, which is mined domestically and supplied under long-term contracts. Limited gas and diesel generation protects the country from even higher utility bills. Still, electricity tariffs rose 9.6%--well above CPI--from mid-2022. Higher inflation also leads to rising wage pressures, which increase the risks of strikes and civil unrest.

South Africa continues to experience infrastructure challenges, notably electricity shortages and inefficient rail networks and ports. Failures at coal-fired plants hamper economic growth and increase the use of diesel generators to keep the lights on, which will enlarge power utility Eskom's cost base and could elevate electricity tariffs in the future. Power supply interruptions and the rising cost of fuel and its derivatives are taking the greatest toll on companies in the heavy industry, mining, and transportation sectors. The use of road transport has accelerated in recent years, given capacity constraints on several key bulk-commodity export rail lines, which have also prevented some commodity exporters from taking full advantage of higher prices. This significant opportunity loss is seen in the increase in the value of commodity exports (price effect) since 2019, while volumes are lower.

The South African corporate sector's leverage is manageable, and net debt to EBITDA is reducing across most corporate segments. Average net debt to EBITDA among rated domestic corporations is 2x, well below the EM average of 3.5x. Many companies raised debt in the past two years, mainly for refinancing or to acquire operating assets, contributing to improved leverage metrics and longer maturity profiles. We expect further net debt reduction through 2023, given that elevated--although moderating--commodity prices should keep commodity producers' leverage low, while top-line and margin recovery among domestic-focused companies (somewhat slowed by inflationary pressures on consumers) supports debt reduction. Admittedly, tight financing conditions make it difficult for high-yield issuers to raise debt in global capital markets, but limited debt-issuance needs currently offset the impact of the risk-off stance. Furthermore, South Africa's deep domestic markets remain largely supportive of new issuances. Consequently, we don't expect current market conditions to constrain the corporate sector's performance for the next one-two years.

LatAm

Mounting Economic Risks Pose A Threat

Up until now, the region's non-financial corporations have generally withstood both supply and demand shocks, including supply-chain bottlenecks, a weaker consumer spending power, global inflation, and more expensive borrowing costs. Profit margins remain largely intact among commodity producers in the oil and gas, chemical, metals and mining, agribusiness, and forest and paper industries, among others. In other cases, companies with strong pricing power in the consumer products and building materials industries have implemented price adjustments to pass through incremental costs to end consumers.

Non-financial corporations in general also maintain a disciplined approach to leverage, with average net debt-to-EBITDA ratios below 3.5x, which are lower than those of peers in other regions. At the same time, addressing short-term risks is still a priority in the region, which explains generally healthy liquidity and limited refinancing risks. So far, these factors have supported credit quality. Since early this year, we have barely seen any changes in our rating distribution or our net outlook bias—which as of mid-June stood at 2%, meaning that issuers that currently have negative outlooks represent less than 10% of all the regional rated corporations .

The worsening economic and financial factors are rapidly compounding downside risks for LatAm corporations. We expect a deterioration of credit fundamentals due to a combination of economic slowdown, political uncertainty, higher borrowing costs and eventually a persistent subdued market access.

Inflation is one of the biggest headaches for LatAm corporations because of its direct repercussions on profitability and demand. As consumer spending power continues to deteriorate, companies will have less flexibility to pass cost increments to end consumers, which would gradually squeeze margins. Also, a scenario of long-lasting inflation under which end-consumers are unable to absorb higher prices would erode demand, reducing volume sales. This is the case for energy and food prices, which have direct impacts on industrial activities and household spending.

Comparing quarterly revenues in the first quarter of 2022 and the fourth quarter of 2021, half of the industries within our rated portfolio may already be facing a top-line contraction. That is normal in some industries like consumers and retail due to seasonality factors, but for others like hotels, telecom or homebuilding & real estate it is not.

Downside risks on revenue growth could further escalate due to prevailing supply-chain disruptions that increasingly take a toll on product availability and inventories. Under a scenario of slower growth, we expect a reduction in capex allocations to prevent cash flows from dwindling. Only few sectors, such as lodging, transportation, and agribusiness, are currently underinvesting relative to historic median levels.

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EM Asia

Downside Risks Are Rising

This is due to lingering effects of Covid-19, the longer-than-expected Russia-Ukraine conflict and the accelerating risk of inflation and higher interest rates. Additionally, the Fed's tapering plan could intensify capital outflows and currency pressures in emerging economies. Government support continues to provide a buffer.

High Leverage And Weak Tourism Volumes Hammer Thai banks

Thailand has been one of the worst hit economies in the region. The travel and tourism sector contributed about 20% to the country's GDP in 2019, but the sector was decimated by COVID-19 and then the Russia-Ukraine conflict. Also, Thailand is one of the largest oil importers, with net energy import balance at 6.0% of GDP in 2019. Higher energy prices will pressure the current account and squeeze purchasing power for consumers and firms, which will be an additional drag on economic activity.

Banks have had to conduct extensive restructuring of loans to these embattled borrowers--both in the large corporate and SME segment. The household leverage at 90% of GDP has also become unsustainable. Reported nonperforming loans (NPLs) at 3% bely underlying stress. We estimate that 10%-15% of the industry loans will need restructuring and the majority of it is likely to be deep (under the so-called blue scheme). We have lowered ratings on many Thai bank by a notch to reflect high systemic risks. We have a stable outlook on Thai banks because they have some buffer to absorb expected deterioration in asset quality in the next 12-24 months.

Risks for Philippine banks diminished amid a 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. 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.

Choppy Waters For Weak Chinese Banks

China's continuing lockdowns, most notably in Shanghai, are disrupting business and consumer activity. Loans to small businesses and the property sector are the most vulnerable. We estimate the COVID-19 drag on economic growth may add Chinese renminbi (RMB) 1.1 trillion (0.6% of loans) in new forborne loans this year, raising the share of such loans to 1.4% of total loans by the end of 2022. By our estimates, nonperforming assets (NPA), as a percentage of total loans, will worsen to 6.5% this year from 6.0% at the end of 2021.

The Chinese banking sector has the buffers to withstand even our downside economic growth scenario of 3.5% for 2022. Megabanks and some joint-stock commercial bank ratings are more resilient to new stresses, deepening the credit divergence within the sector. Polarization of the Chinese banking sector could intensify during this testing time. We expect some aggressive and weak banks to face heightened financial risk while undergoing tougher regulatory scrutiny.

High Volume Of Restructured Loans And Rupiah Volatility Could Test Indonesian Banks' Resilience

Our negative trend in Indonesia's banking sector reflects elevated credit risks in the aftermath of COVID, noting still high levels of restructured loans. The pandemic-induced restructured loans, which peaked at about 18% of total loans in 2020, declined to 11% at the end of 2021. We forecast such loans to continue declining to 8%-10% by 2023 as the economy recovers, and borrowers start repaying. In our opinion, one-tenth to one-eighth of the restructured loans are at risk and vulnerable to slippage into NPLs, mainly those for SMEs, and to entities in the tourism and hospitability industries. This could add up to 1.5% of NPLs, which would crystallize in 2023 when the moratorium expires, suggesting that NPLs could peak at 5% in 2023.

Vulnerability stems from the high share of foreign currency-denominated debt securities in the corporate sector. We estimate that such debt accounts for slightly more than half of total corporate borrowing in Indonesia, exposing them to rupiah volatility.

Macro Headwinds Cast A Shadow On Indian Banks, Polarization To Intensify

We see favorable growth prospects for the Indian economy over the next couple of years, but macroeconomic headwinds remain a key risk to the country's economic recovery. We believe credit losses and NPAs to head towards the long-term average after unwinding of stresses in the banking system in the past four years. We expect earnings of Indian banks to continue to improve as credit costs normalize.

India is a net oil importer, and uncertainty stemming from the geopolitical tensions and rising oil prices has boosted inflation in India. The Reserve Bank of India has increased the interest rates twice in the last couple of months, and more is in the offing.

Sharp divergence in the banks' credit losses is set to continue, in our view. The largest bank in the country, State Bank of India, and the leading private-sector banks have largely addressed their asset quality challenges. In contrast, many large public-sector banks are still saddled with large amounts of weak assets, which would continue to fuel credit losses.

EM EMEA

The Conflict Spillovers Could Be Significant For Banks

The overall direct exposure of rated Middle East and African banks to Russia and Ukraine is very limited, and we don't expect it to have a meaningful impact on banks' profitability or cost of risk. Indirect impact could be significant, though. The conflict triggered a significant increase in energy, transport, and food prices because of higher commodities prices, including for oil and gas. The impact on MEA 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 take a hit. The tourism sector is another channel through which the conflict could take its toll on countries and banks in MEA. The impact could be pernicious for some countries, especially those where the tourism sector depends on Russian and Ukrainian tourists. Rising food prices, particularly for countries heavily dependent on cereals imports such as Egypt and Tunisia, is another important channel. Higher food prices could widen already considerable external imbalances and erode fiscal positions if countries need to increase food subsidies. The other indirect channel is through the impact on investors risk appetite. In the MEA countries, we believe that Qatar and Turkey would be the most vulnerable due to high external debt of their banking system, while Tunisia grapples with high external financing needs.

In the GCC, thanks to higher oil prices, we expect operating conditions for banks to become more supportive. While we still expect to NPLs to rise given the pandemic hangover, we don't expect the NPLs ratio to exceed 5%, which was about 3.5% at the end of 2021 among the top 45 banks in the region. We expect banks' profitability to improve thanks to lower cost of risk and higher interest rates. Based on the top 45 banks' disclosure, a 100 bps increase of interest rates would raise bottom-line revenue by an average of 13%.

We have some concerns over the speed and the extent of the Qatari banking system's external debt accumulation. However, we believe that a significant portion of non-resident deposits and amounts due to banks abroad is relatively stable and has proven to be so through various episodes of stress. A significant portion of these funds is linked to longer-term investment interests in Qatar. We expect growth in external debt to moderate over the next couple of years as several large infrastructure projects and preparations for the World Cup 2022 are finalized. This pace reflects also the new central bank rules that increase reserve requirements for short-term non-resident deposits and the weight of non-resident deposits in liquidity coverage ratio and net stable funding ratio calculations. This is a change from previous policy and clearly designed to deter banks from expanding their balance sheets further from external sources. Given that external debt grew an average of 18% from 2019 to 2021, we expect the pace to slow to about 5% over the next couple of years. Finally, higher oil prices should result in stronger domestic deposit growth than we have seen over the past few years. We also expect funding to be available from the government and central bank, if needed.

In order to assess Qatari banks' potential vulnerability to external funding outflows, we first assessed overall capacity to cover their external liabilities (including interbank deposits, customer deposits, and capital market instruments) using their stock of external assets. To account for the potential illiquidity of some of these assets, we used haircuts ranging from 0% for cash to 100% for other assets, as the nature of these weren't disclosed. We used a 15% haircut for the interbank deposits as Qatari banks tend to generally place their money with creditworthy foreign banks. We have also used a 50% haircut on banks' lending portfolios, where they exist, as we assumed that under stressed conditions, banks will have to fire sell some of these loans in order to generate liquidity. The results show that banks could withstand a substantial level of stress. If we factor in the government support in a similar manner to the boycott, the banking system appears fairly protected from the expected volatility in market conditions, particularly given the recent increase in oil and gas prices.

Table 4

Qatari Banks Can Absorb A Substantial Level Of Stress

Non Resident Deposits/ Interbank Deposits	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
10%	33.9	26.2	18.4	10.7	3.0	-4.7	-12.4	-20.1	-27.8	-35.5
20%	29.4	21.7	13.9	6.2	-1.5	-9.2	-16.9	-24.6	-32.3	-40.0
30%	24.9	17.1	9.4	1.7	-6.0	-13.7	-21.4	-29.1	-36.8	-44.5
40%	20.4	12.6	4.9	-2.8	-10.5	-18.2	-25.9	-33.6	-41.3	-49.0
50%	15.8	8.1	0.4	-7.3	-15.0	-22.7	-30.4	-38.1	-45.8	-53.5
60%	11.3	3.6	-4.1	-11.8	-19.5	-27.2	-34.9	-42.6	-50.3	-58.1
70%	6.8	-0.9	-8.6	-16.3	-24.0	-31.7	-39.4	-47.1	-54.8	-62.6
80%	2.3	-5.4	-13.1	-20.8	-28.5	-36.2	-43.9	-51.6	-59.4	-67.1
90%	-2.2	-9.9	-17.6	-25.3	-33.0	-40.7	-48.4	-56.1	-63.9	-71.6
100%	-6.7	-14.4	-22.1	-29.8	-37.5	-45.2	-52.9	-60.7	-68.4	-76.1

Source: Central Bank of Qatar and S&P Global Ratings calculations.

Turkish banks remain highly vulnerable to adverse market sentiment and risk aversion due to their declining, but still high, external debt totaling about $143 billion as of March 31, 2022. The monetary policy normalization by major central banks will reduce global liquidity and increase the refinancing risk for Turkish banks. The risks are compounded by the country's very high inflation, unpredictable monetary policy, and the fallout from the Russia-Ukraine conflict on commodities imports, tourism sector, and investor sentiment. Our base-case scenario doesn't assume major disruption in Turkish banks' access to syndicated or other major bilateral funding lines in 2022--representing about 51% of the total short-term external debt at March 2022. This assumes that the government will be able to stabilize the lira to some extent. This is also confirmed by recent track record as banks were able to rollover most of their syndicated loans with foreign counterparties, in April-June 2022, with rollover rates fluctuating between 88% and 101%, although at higher price. Nevertheless, we expect lower appetite for senior and subordinated bank bonds.

The other risk for Turkish banks that we forecast is the increase in deposit dollarization, and ultimately deposit withdrawal if residents start to lose confidence in the system. On May 27, 2022, 58% of deposits were denominated in foreign currencies, up from 44% in 2017. Since the sharp currency depreciation in December 2021, local authorities have implemented several measures to push banks and depositors to convert their foreign exchange (FX) deposits to the lira including a FX protected deposit scheme with an objective of converting 20% of deposits by Sept. 2, 2022. Banks that won't comply with this limit will be subject to penalties. While those measures have helped reducing the dollarization from the peak of 69% in mid-December 2021, the deposits benefiting from this scheme covered about 13.7% of total at the end of May 2022. As a result, the benefit might turn to be only temporary.

Turkish banks have still some cards up their sleeves, but pulling them might be more complicated than what the numbers suggest. We estimate broad liquid assets in foreign currency at about $154.8 billion at March 31, 2022 (including mandatory reserves of about $49.9 billion). This should suffice to cover upcoming funding maturities for the next 12 months, which totaled about $85.7 billion at the end of March 2022. Therefore, on paper, the position appears well matched. However, $75.9 billion of Turkish banks' foreign assets are placed with the Central Bank of the Republic of Turkey (CBRT). As such, under a hypothetically extreme scenario, the CBRT could restrict access to these assets, given its already low FX reserves, and push banks to default. Clearly, a significant increase in FX demands by depositors would add pressure on the lira and in turn on CBRT's FX reserves, increasing risk of capital controls. In 2022, the CBRT started requiring exporters and companies operating in the service sectors to convert 40% of their FX revenues to liras to contain reserves from eroding.

Soaring inflation, the lira's declining value, and slower economic growth will further strain retail and corporate customers' creditworthiness and increase risks for the banking system. NPLs fell in 2021 largely thanks to loan forbearance measures, strong credit expansion, and significant restructuring efforts over the past years, characterized by very accommodative conditions. Once those factors gradually phase out, we expect NPLs to increase above 9% of total loans by 2023, up from 3.3% as of Dec. 31, 2021, with cost of risk further increasing above our previous expectation of about 320 bps in 2022-2023 from a high but still manageable at 240 bps.

We expect South Africa's credit growth will be muted at 5% in 2022, given moderate GDP growth. The South African Reserve Bank (SARB) has been actively adjusting its main lending rate since late 2021 and raised it by another 50 bps in May 2022 to 4.75%. This will raise the household debt to disposable income ratio but stabilize at 68% through 2024. The country's reforms are taking shape gradually, which supported an improvement in business confidence in early 2022, but geopolitical risks could suppress investments. Still, we consider the Ukraine-Russia conflict to have the least impact on the South African banking sector among EMs. Corporate lending grew 6.2% in 2021 after a contraction of almost 1% in 2020. The digital spectrum auction reform and the independent power producer program could spur lending opportunities in the telecom and renewable energy sectors. That, along with lower impairment charges and higher interest rates, will support banks' bottom lines. We forecast that credit losses will average 1% through 2023, closer to the 0.8% level in 2017-2019, although top-tier banks will likely record a ratio below the sector average. NPLs will continue to drop below 4% of total loans by 2023, down from 4.5% in 2021. We forecast return on equity will rise 16% in 2022 from 14% in 2021, while return on assets will rise to 1.3% from 1.0%. The South African banking sector is inherently exposed to concentrated short- and medium-term wholesale funding from nonbank financial institutions. Still, in a crisis, the rand liquidity remains in the country because of resident exchange controls, which mitigate banks' exposure to institutional funding. Finally, on the regulatory front, the Financial Sector Laws Amendment Bill was promulgated in 2022 and we expect a deposit insurance scheme, and ultimately an effective resolution regime will be implemented over the short term.

LatAm

Rising Interest Rates Will Prompt Banks To Hike Their Rates, Pressuring Asset Quality

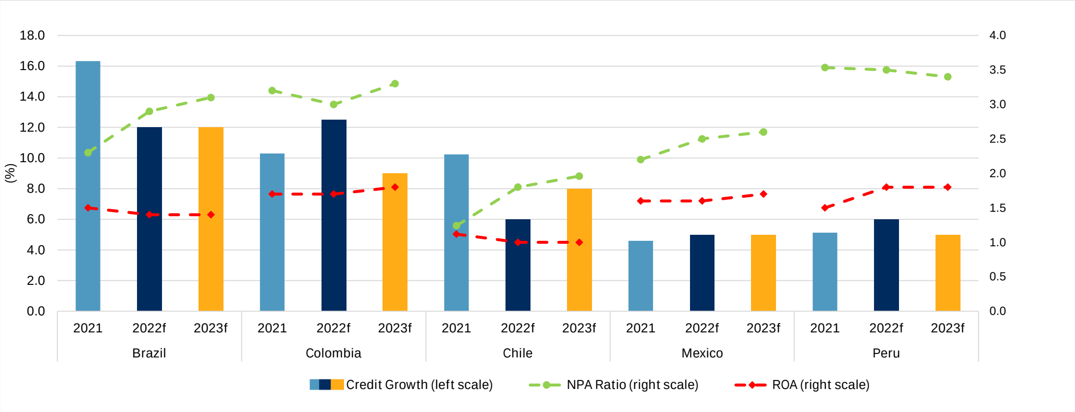
Although banks could transfer the growing financing costs to borrowers, this would push down the demand for credit, because higher loan costs could prompt individuals to postpone consumption and companies to delay investment decisions. This could hurt economic activity, which is already suffering from political volatility and lack of investment. In addition, lower demand for credit could intensify competition among banks, discouraging passing on the total increase in the cost of funding, pressuring margins.

Moreover, high inflation and rising interest rates would likely inhibit the payment capacity of households and companies, and as a result, the quality of banks' assets. The combination of high inflation and interest rates could prevent lenders from servicing debt on time, which in turn could prompt banks to increase provisions, which would squeeze profitability.

Political instability remains the key factor affecting economic growth and banks' operating performance. In our view, social unrest and political instability could pressure investment and economic performance. This could result in weaker internal demand, which could crimp lending growth and asset quality for banks. Amid these factors, financial institutions' operating performance could struggle.

Chart 17

Latin American Banks' Credit Growth, NPAs And ROA



*Blue, dark blue, and yellow bars show credit growth. f - forecast. Source: S&P Global Ratings.

S&P Global
Ratings

Appendix 1: Economic Data And Forecast Summaries

Table 5

Real GDP %

	2021	2022F	2023F	2024F
Argentina	10.3	3.3	1.8	2.0
Brazil	4.9	1.2	1.4	2.0
Chile	11.9	2.1	1.3	2.8
Colombia	10.7	4.6	2.7	3.2
Mexico	5.0	1.7	1.9	2.1
China	8.1	3.3	5.4	4.9
India	8.7	7.3	6.5	6.7
Indonesia	3.7	5.1	5.0	5.0
Malaysia	3.1	6.1	5.0	4.6
Philippines	5.7	6.5	6.6	6.9
Thailand	1.5	3.2	4.2	3.8
Poland	5.8	4.5	2.1	2.6
Saudi Arabia	3.2	7.4	3.1	2.6
South Africa	4.9	2.2	1.5	1.7
Turkey	11.2	3.5	1.7	3.4

Source: S&P Market Intelligence; 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 6

CPI Inflation % (Year Average)

	2021	2022F	2023F	2024F
Argentina	48.4	62.0	59.0	45.0
Brazil	8.3	10.5	5.0	3.7
Chile	4.5	10.2	5.5	3.2
Colombia	3.5	9.0	4.1	3.2
Mexico	5.7	7.4	4.1	3.2
China	0.9	2.3	2.5	2.2
India	5.5	6.8	5.0	4.5
Indonesia	1.6	4.1	4.0	3.6
Malaysia	2.5	2.9	2.2	2.3
Philippines	3.9	4.5	3.7	2.6
Thailand	1.2	6.0	2.3	1.0
Poland*	5.2	12.0	10.0	4.5
Saudi Arabia	3.1	2.8	2.6	2.1
South Africa	4.6	6.1	5.0	4.6
Turkey	19.6	68.6	23.1	12.7

Source: S&P Market Intelligence; 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. *-Poland reflecting of CPIH measure of inflation.

Table 7

Policy Rates % (End of Period)

	2021	2022F	2023F	2024F
Argentina	38.0	55.00	45.00	35.00
Brazil	9.25	13.75	9.50	7.50
Chile	4.00	9.50	6.50	5.00
Colombia	3.00	9.00	8.00	6.00
Mexico	5.50	9.25	8.00	6.50
India	4.00	5.65	5.25	5.00
Indonesia	3.50	4.00	4.75	5.25
Malaysia	1.75	2.50	3.00	3.25
Philippines	2.00	3.00	3.25	3.75
Thailand	0.50	1.00	1.50	1.75
Poland	1.25	7.50	7.00	5.50
Saudi Arabia	1.00	3.900	4.50	4.24
South Africa	3.75	5.48	6.02	6.06
Turkey	14.00	14.00	9.50	9.50

F--S&P Global Ratings' forecast. Source: S&P Market Intelligence.

Table 8

Exchange Rates % (End of Period)

	2021	2022F	2023F	2024F
Argentina	102.72	160.00	240.00	325.00
Brazil	5.58	5.10	5.15	5.25
Chile	866	835	840	845
Colombia	3,981	3,900	3,950	3,975
Mexico	20.50	20.50	21.00	21.50
China	6.39	6.82	6.75	6.69
India	76.50	78.00	79.50	81.00
Indonesia	14,329	14,800	14,900	15,000
Malaysia	4.18	4.32	4.22	4.12
Philippines	50.44	53.35	53.75	52.94
Thailand	33.42	35.10	35.50	35.90
Poland	4.06	4.27	4.05	3.83
Saudi Arabia	3.75	3.75	3.75	3.75
South Africa	15.39	16.08	16.68	16.79
Turkey	11.14	18.05	18.50	19.00

Source: S&P Market Intelligence; 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 9

Unemployment % (Year Average)

	2021	2022F	2023F	2024F
Argentina	8.8	8.5	8.5	8.3
Brazil	13.2	10.9	10.7	10.3
Chile	8.8	7.7	7.8	7.8
Colombia	13.7	11.9	10.9	10.1
Mexico	4.1	3.6	3.7	3.6
China	5.6	5.9	5.8	5.7
Indonesia	6.3	5.6	5.4	5.2
Malaysia	4.6	3.9	3.6	3.3
Philippines	7.9	6.5	5.7	5.2
Thailand	2.0	1.8	1.7	1.4
Poland	3.4	3.0	2.9	2.9
Saudi Arabia	6.6	6.3	5.4	5.4
South Africa	34.3	36.1	34.7	34.4
Turkey	12.0	11.9	11.6	10.4

F--S&P Global Ratings' forecast. Source: S&P Market Intelligence.

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