S&P Global Ratings

Credit Conditions North America Q3 2022:

Credit Headwinds Turn Stormy

June 28, 2022

Key Takeaways

- **Overall:** The run of remarkably favorable financing conditions has come to an apparent end, and there's a growing risk that sharply higher interest rates and persistent inflation, combined with renewed consumer caution, will push the U.S. into a recession, raising the possibility credit conditions will deteriorate even further.
- **Risks:** A further slowdown in economic activity could roil credit markets and result in the repricing of assets, higher debt-servicing costs, and even tighter financing conditions. If borrowers' cost pressures don't ease—or if inflation weighs heavily on confidence and demand—profit erosion could become more widespread and steeper than we expect.
- **Credit:** For now, credit quality is proving resilient. But we see signs of demand deterioration in the most price-sensitive sectors, such as consumer products and retail. We now expect the U.S. trailing-12-month speculative-grade corporate default rate to reach 3% by March 2023, more than double the 1.4% in March of this year, with risk weighted to the downside.

(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly and on an ad hoc basis to review macroeconomic conditions in each of four regions—Asia-Pacific, Emerging Markets, Europe, and North America covering Canada and the U.S. Discussions center on 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 North America committee on June 21, 2022.)

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As the Federal Reserve tries, in its battle against runaway inflation, to steer the world's biggest economy into a "soft landing," there's a growing risk that aggressive monetary-policy tightening, combined with renewed consumer caution, will push the U.S. into a recession—or, worse, a protracted period of stagflation. Naturally, this raises the possibility of markedly deteriorating credit conditions, particularly for borrowers at the lower end of the ratings ladder.

The recent run of remarkably favorable financing conditions has already come to an apparent end, and we believe investors could soon demand significantly higher returns for the risks they're assuming; any further slowdown in economic activity could roil credit markets and result in the repricing of financial and real assets, higher debt-servicing costs, and tighter financing conditions.

For now, credit quality is proving resilient, whether looking at ratings actions, the net bias, or the level of defaults (which remain low). Many drivers underpin this, not the least of which are the headroom built into ratings given the strength of the post-COVID recovery and the solid liquidity positions of most companies given that highly favorable financing conditions in recent years allowed them to extend maturities.

Nevertheless, many corporate borrowers we rate continue to deal with sharply higher input costs and supply-chain disruptions that have been exacerbated by the rising energy and commodities prices caused by the Russia-Ukraine conflict (see table 1). With consumers—especially in the low- and middle-income levels—becoming more price sensitive, companies' ability to pass along these costs is finite. If cost pressures don't ease, or if inflation begins to weigh heavily on demand, the resultant profit erosion could hit credit quality. We are already seeing signs of demand deterioration in the most price-sensitive sectors, such as consumer products and retail. For example, U.S. grocery retailers and distributors will be among the hardest hit retail subsectors this year with the potential for steep margin and profit pressure if rising costs aren't offset with other

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savings. Our analysis shows that margin stress of 150 basis points could result in negative rating actions for more than half the grocers we rate, including 75% of speculative-grade companies.

Against this backdrop, defaults could rise. We now expect the U.S. trailing-12-month speculative-grade corporate default rate to reach 3% by March 2023, more than double the 1.4% in March of this year. In our pessimistic scenario, the default rate would jump to 6%, and the risks are weighted to the downside. On the banking sector, we forecast credit losses of around $104 billion for the two years to end-2023. If the economy moves into a prolonged recession, they will likely increase.

And while borrowers in North America have limited direct exposure to the Russia-Ukraine conflict, the turmoil in the energy and commodities markets is already eating into economic expansion and adding to recession risk. Continuing uncertainties around the conflict, along with other geopolitical tensions, could further weigh on trade, capital flows, market confidence, and business conditions. Nor will this risk disappear when the last shot of the war is fired. The West's sanctions on Russia, along with the severe disruptions to food and natural resources supplies, look set to linger for years to come—making it all the more difficult to bring inflation back to more palatable levels.

As it stands, the U.S. is poised for a period of below-potential economic growth, in what might be called a "slow-growth recession" (see Macroeconomic Outlook on page 5). We also see an increased risk of a "technical" recession, commonly defined as two or more quarters of economic contraction.

In this light, we've developed a downside scenario—with a roughly one-in-three likelihood of occurring—covering key macro variables in the next two years and centering on two core components: persistent high inflation in the U.S. requiring a more aggressive Fed response, and continued dislocation in the energy market as the Russia-Ukraine conflict drags on, resulting in Brent crude oil trading at $155 per barrel in the first quarter of next year.

In this scenario, downstream price pressures would broaden further across the supply chain as the Fed faces the difficult task of having to further accelerate its tightening of monetary policy even as growth slows. As a result, inflation as measured by the Consumer Price Index would remain above 8% for the rest of 2022, declining to 3.5% toward the end of next year, and back to policymakers' target of 2% only in 2024. The Treasury yield curve would reflect the tightening of financing conditions, with long-term yields rising to about 4.6% by the end of this year, 1.5 percentage points higher than our base case, and peaking at around 4.7% in early 2023.

With the economy contracting in early 2023, unemployment would begin to rise, from below 4% to 6%, by the end of next year and reach 7.2% in late-2024 even as the inflationary shock dissipates.

Most notably, economic activity would slow sharply in the second half of this year and contract in 2023, with conditions taking full-year 2022 growth down to 1.7%—compared to 2.4% in our baseline. Next year, under this scenario, the U.S. economy would fall into recession, with GDP contracting 0.6% for the full year, compared to growth of 1.6% in our baseline.

(Note: This scenario isn't intended as a worst-case forecast; we have focused on developing a scenario that reflects a reasonably possible downside.)

At the same time, S&P Global Ratings' Credit Cycle Indicator (CCI) is pointing to potential heightened credit stress in North America in late-2022 or early 2023 (see Credit Cycle Signs Point To Heightened Credit Stress In Late 2022 Or Early 2023 on page 4). With five main components—corporate and household debt leverage, equity and house prices, and our proprietary Financing Stress Indicator—the CCI for North America peaked in the first quarter of last year. Given that peaks in the CCI tend to lead credit stresses by six to 10 quarters, we could see heightened credit stress in late-2022 or early 2023.

Table 1

Top North America Risks

U.S. economy suffers a “hard landing”

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

As the Fed forges ahead with an aggressive cycle of monetary-policy tightening, there’s a growing risk that sharply rising interest rates, combined with a pullback by U.S. consumers in the face of nagging inflation, will push the world’s biggest economy into recession (with an associated rise in unemployment). In a worse scenario, fuel and food inflation could remain high even if core inflation declines, leading to stagflation. All of this is compounded by the lingering effects of the pandemic. The chance of a sustained downturn is growing—our qualitative assessment of recession risk in the next 12 months is now at 40% (in a range of 35%-45%).

Sustained cost pressures and ongoing supply chain disruptions threaten credit quality

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

Companies continue to deal with sharply higher input costs and supply-chain disruptions, further fueled by higher energy and commodities prices amid the Russia-Ukraine conflict. Many borrowers have relied on their ability to pass through increased costs to maintain profit margins, but this could become more difficult as high food and energy prices erode consumers’ purchasing power and discretionary spending. If cost pressures don’t soon ease—or if inflation weighs on confidence and demand—profit erosion could become more widespread and steeper than we expect. This, in turn, could harm credit quality.

Sharp market repricing translates to tighter financing conditions

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

Investors could soon demand significantly higher returns for the risks they’re assuming because of sustained high inflation and the prospects of an economic slowdown. As the Fed tries to navigate an economic “soft landing,” any perceived policy misstep could roil credit markets and result in the repricing of financial and real assets, higher debt-servicing costs, and tighter financing conditions. This is especially concerning against the backdrop of high debt levels and could hurt lower-rated borrowers, in particular.

Geopolitical tensions weigh on growth and business conditions

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

While borrowers in North America have limited direct exposure to the Russia-Ukraine conflict, the turmoil in the energy and commodities markets is already hitting growth prospects. Continuing uncertainties around the conflict could further weigh on trade, capital flows, market confidence, and business conditions. Meanwhile, the U.S.-China strategic confrontation looks set to continue. Rising tensions between the two countries over Russia and the South China Sea region, or an intensifying technology race, could impede trade, intellectual property, investments, and financial transactions for both and other economies—with some sectors suffering disproportionately.

Structural Risks

Cyber attacks disrupt business operations and hurt credit quality

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

Cyber attacks pose a systemic threat and significant single-entity event risk, as new targets and methods emerge—with geopolitical tensions raising the prospect of major attacks. As public and private organizations accelerate their digital transformation, a key to resilience is a robust cyber security system, from internal governance to IT software. Entities lacking well-tested playbooks (such as active detection or swift remediation) are most vulnerable.

Climate risks and energy transition affect business operations

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

Beyond the physical risks of climate change that many companies are subject to, the global drive toward a “net-zero” economy also heightens the transition risks (e.g., policy, legal, technology, market, reputation risks) across many sectors, and will likely require significant investments. At the same time, the energy market disruption resulting from the Russia-Ukraine fighting, and concerns about energy supply and security, are adding significant uncertainty to this transition.

*Risk levels may be classified as very low, moderate, elevated, high, or very high, and are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks aren’t 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 in the next 12 months. Source: S&P Global Ratings.

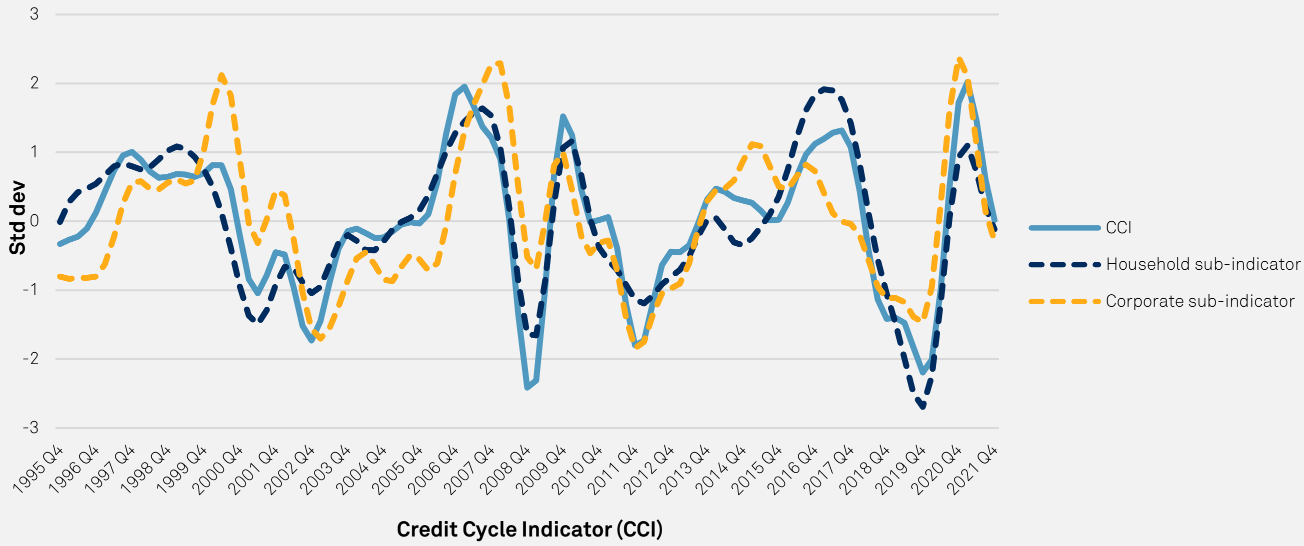
Credit Cycle Signs Point To Heightened Credit Stress In Late 2022 Or Early 2023

We are trialing a proprietary Credit Cycle Indicator (CCI) at the macro geography 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 June 27). Our preliminary results show the peaks in the CCI tend to lead credit stresses by six to 10 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 fourth-quarter 2019, the North America CCI has trended upward and reached a peak of 2.0 standard deviations (compared to its historical average) in first-quarter 2021, mainly driven by large-scale borrowings across sectors coinciding with weaker economies. This suggests potential heightened credit stress in late 2022 or early 2023 (see chart 1). While the CCI is trending downwards--indicating credit correction is underway--the potential impact of the buildup of nonperforming loans (NPLs) and defaults could linger beyond the stress period across late 2022 and early 2023.

Chart 1

Recent Peak In The North America CCI 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 subindicators were created by taking the weights in the overall CCI and rescaling such that the subcomponents' weights in the subindicator sum to 1. The North America CCI includes Canada and the U.S. Sources: Bank for International Settlements, Bloomberg, and S&P Global Ratings.

Corporates. The corporate subindicator saw a sharp upswing since fourth-quarter 2019 and surpassed the 2 standard deviation mark in fourth-quarter 2020, largely due to a significant rise in corporate debt-to-GDP levels. The subindicator has since fallen steadily for four quarters to below its historical average. However, the unevenness in the recovery path, persistent inflationary pressures, and rising borrowing costs could exacerbate the debt overhang (see table 1).

Households. The household subindicator climbed to 1.1 standard deviation in first-quarter 2021 with an increase in household debt-to-GDP. While on average household balance sheets have so far remained healthy thanks to COVID-related stimulus measures and a tight labor market, credit risks could still prevail especially for households in more vulnerable cohorts (such as those with less liquidity) given the uneven distribution of cash and debt across households and as high prices erode purchasing power.

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

Macroeconomic Outlook

U.S.

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With the U.S. economy still trying to find its footing after the pandemic-induced shock in 2020, the recent deterioration in many macro variables raises the question of whether a recession is in the offing. After enjoying economic expansion of an average of 5.7% in the past year, S&P Global Economics' dashboard of leading indicators is signaling that economic momentum continues to worsen. Seven of the 10 leading indicators of near-term economic growth prospects that we track sent negative or neutral signals (two negative, five neutral) in April, a deterioration from November 2021, when eight out of 10 were positive. Historically, after the dashboard has flashed four negative signals, the U.S. has fallen into recession.

Economic momentum will likely protect the U.S economy from a technical recession this year. But the weight of extremely high prices amid continued supply chain disruptions, and aggressive Fed policy tightening as falling equity prices slash household net wealth, make it hard to see the economy skating through 2023 unscathed. S&P Global Economics' qualitative assessment of the risk of recession in the next 12 months is now at 40%, in a range of 35%-45%—with the risk greater in 2023. We now forecast full-year GDP growth of just 2.4% this year and 1.6% in 2023, down from 3.2% and 2.1%, respectively, in our March forecast (see "Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent," published June 27).

After a notably weak first-quarter GDP reading, sustained high energy and commodity prices, the dragging on of the Russia-Ukraine conflict, and a Fed poised to raise its policy rate faster than at any time in the central bank's 109-year history, the economic outlook faces more headwinds than we saw in our March forecast. The world's biggest economy unexpectedly shrank an annualized 1.5% in the first quarter—the first contraction since April-June 2020 and representing a sharp turnaround from the robust 6.9% expansion in the final three months of last year.

While the drivers of the reading were a steep drawdown in inventories and a sharp rise in imports—both of which suggest strong underlying demand—we see signs that Americans are becoming more price-sensitive (see "Closing Time: The U.S. Retail Party Ends As Consumers Push Back On Inflation," published May 23, 2022). And with the University of Michigan Consumer Sentiment Index slipping to an 11-year low in May as high prices ate into household purchasing power, the spending that has kept the American economic engine humming is starting to sputter.

A significant savings cushion in the U.S. helps explain why households have been willing to absorb higher prices at checkout stands. But even in an economy comparatively shielded from the Russia-Ukraine conflict—and driven primarily by domestic activity—a longer war and slower growth in China will likely weigh further on supply chains and add upside pressure to already high inflation. We now expect headline CPI to average 7.5% this year before easing to a still high 3.4% in 2023.

We now expect the Fed to be even more aggressive in tightening monetary policy, accelerating rate hikes this year so that the federal funds rate reaches 3% by year-end and 3.5%-3.75% by mid-2023. Given that monetary policy affects economic activity with a lag, we expect the cumulative effects to be felt in 2023.

Federal Reserve

For now, we see no reason to think Fed policymakers will pull back on the throttle. Rather, S&P Global Economics forecasts them to remain on their current path. Already increasing rates 75 basis points (bps) at their June meeting, the first time since 1994, the Fed will likely keep raising the federal funds target rate at each meeting until it reaches 3.50%-3.75% by January.

Underpinning the Fed's view that the U.S. economy can withstand higher rates is continued tightness in the U.S. labor market, which has almost two open jobs for every available worker and the fastest wage growth for nonsupervisory employees in almost four decades—especially in lower-income fields such as leisure and hospitality. Companies added 390,000 jobs in May, which is well above average gains under more normal circumstances, and headline unemployment remained at 3.6%. The world's biggest economy is now just about 800,000 jobs short of where it was just before the pandemic.

But as the Fed raises rates in a bid to slow down consumer demand, the resultant cooling effects on job and wage growth will warrant close inspection. The high household savings rate (fueled by federal fiscal stimulus) won't last forever, and wage gains have been swallowed up by rampant inflation. With energy prices (particularly at the gasoline pump) set to remain elevated and financial market turmoil weighing on asset prices, there are signs that consumers are becoming increasingly price-sensitive and could soon pull back on spending. While the "wealth effect" spurs consumers to open their wallets when asset prices rise, a sort of "belt-tightening effect" could soon take hold.

This could be exacerbated by the ramifications that Fed rate increases will likely have on the U.S. housing market. Given that homeownership is the main contributor to household wealth, with home equity accounting for more than one-third of aggregate U.S. net worth (by asset type and excluding income), any leveling off—or decline—in home prices could add to consumer caution.

The U.S. Housing Market

Shortly after the pandemic began in early 2020, the pace of U.S. home-price growth increased dramatically before stabilizing at an approximate annualized 20% rate of appreciation a year or so ago. While this pace is unsustainable, we believe home prices are supported by several fundamental economic factors that are unlikely to end any time soon.

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Most significant among these is the demand-supply imbalance. Millennials continue to make up the largest share of homebuyers, and despite this cohort's increasing demand, the past decade marked a period of underbuilding in the residential housing market.

While privately owned housing completions have increased steadily since the Global Financial Crisis (GFC), the figure was less than 1.5 million units (seasonally adjusted, annualized) as of May—well below the more than 2 million in 2006. Because there is a shortage of several million homes in the U.S., the pace of building would have to increase substantially to meet demand in coming years. This dominating driver of prices is unlikely to be entirely offset by opposing factors. Indeed, we expect continued price appreciation nationally, albeit at a more subdued pace, with declines only in certain regions.

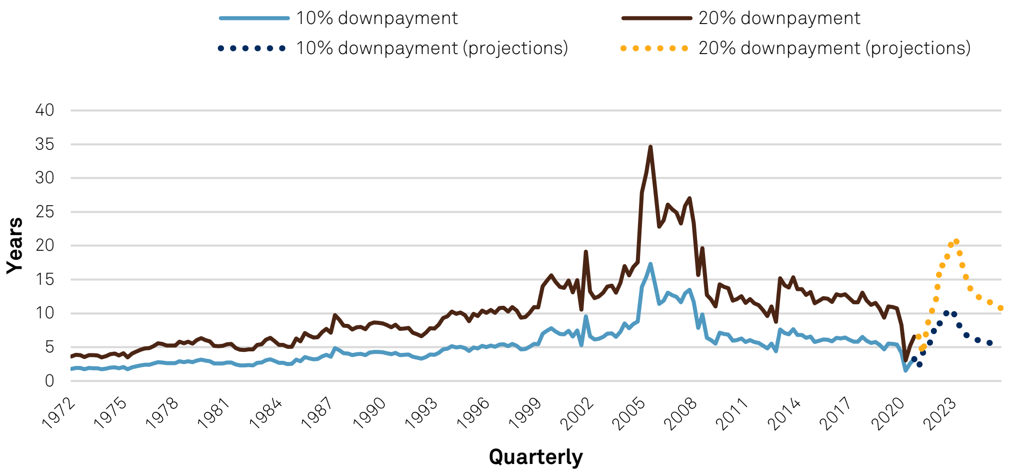
Naturally, interest rates are another important part of the home-price story. From July 2020-November 2021, the 30-year fixed-rate mortgage was typically below 3%. While this eased some of the affordability constraints across the country, it also contributed to upward pressure on home prices. According to the S&P Global Ratings measure of relative housing affordability, the U.S. is roughly 15% overvalued in the aggregate. At a more granular level, approximately 88% of regions we monitor are overvalued, with several by more than 40% and one by almost 70%.

Most Americans take out fixed-rate mortgages to purchase homes. To manage monthly costs in the current rate environment, however, the proportion of adjustable-rate mortgages may increase. The 30-year fixed mortgage rate has increased sharply, and as of mid-June the Freddie Mac survey rate registered 5.78%—the highest since 2008. This rising rate environment has further eroded housing affordability, especially with inflation at a 40-year high. Moreover, higher rates may disincentivize some homeowners to sell—and give up a very low mortgage rate locked in over the past few years—which could exacerbate the supply shortage.

As it stands, roughly 60% of American households may find a typical mortgage for a starter home unaffordable after this year (with affordability defined as mortgage payments at less than 25% of income). It would take roughly a decade for a first-time home buyer to save up a 10% down payment for a starter home in 2025 versus six years from 2010-2019, with lower-income prospective buyers finding it even harder to do so (see chart 2).

Chart 2

Number Of Years To Save For Down Payments, First-Time Homebuyers



Note: Shaded areas indicate periods of recession as defined by the National Bureau of Economic Research. Dotted line indicates projections/estimates from 2021 to 2025. Sources: U.S. Census Bureau, U.S. Department of Housing and Urban Development, Freddie Mac, U.S. Bureau of Economic Analysis, Federal Reserve Bank of St. Louis, and S&P Global Ratings Economics Calculations.

Although the most recent reading of the S&P Case-Shiller U.S. National Home Price Index was up 20.4% year-over-year in April, most borrowers lock in mortgage rates two to three months in advance. This suggests that any effect of rising rates on home prices will manifest only in the coming months. As the 10-year Treasury rate and the closely linked 30-year fixed-rate mortgage go up, we expect some downward pressure on home prices. However, the extent to which rising rates offset the effect of the supply-demand imbalance remains to be seen.

Canada

Posting solid first-quarter GDP growth of 3.1% (seasonally adjusted, annualized), boosted by household spending and business investment as quarantine measures were loosened, the Canadian economy proved surprisingly resilient in the face of high inflation—and certainly in comparison to the U.S., where the world's biggest economy contracted 1.5% in January-March.

However, under the weight of higher prices and rising interest rates as the Bank of Canada tries to tamp down inflation, we expect Canadian economic activity to decelerate. In addition, the U.S. (Canada's biggest trading partner) is set to confront even more headwinds from higher prices and an aggressive Fed, which will further weaken Canada growth. We now expect GDP to expand 2.9% this year and just 1.9% in 2023—down from 4.5% last year and much slower than the respective 3.7% and 2.6% we forecast in March as the path remains below its pre-pandemic trend rate.

The Bank of Canada has already raised its policy rate to 1.5%, on June 1, from 25 bps as of March 1. And on the following day, Deputy Governor Paul Beaudry hinted to the Gatineau Chamber of Commerce that the bank might double rates to defeat rising inflation. And while Canada's household savings rate improved to 8.1% in the first quarter, from 6.9% the previous period, price pressures and rising mortgage rates expose households to increasing vulnerabilities as much of their savings must be reallocated to nondiscretionary spending.

Sovereigns

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Both global and domestic developments have worsened U.S. economic prospects for the coming year. Policymakers enjoy less room to maneuver due to worsening economic conditions, including higher inflation, key product shortages, and higher interest rates—all in a highly polarized political environment.

Fiscal policy will likely be stable for the remainder of the year. Congress may pass minor legislation on economic matters, but its ability to act is constrained by partisan polarization. Such fiscal measures may be targeted at sectors most affected by rising prices, such as food, energy, and transportation. However, we don't expect major legislative changes in the months leading to the November midterm elections.

The direction of monetary policy is clear, as the Fed has signaled substantial increases in its policy rate following an unexpectedly rapid rise in inflation. However, the central bank must balance the need to contain inflation with the risk of contributing to a recession (by creating excessively high interest rates and tight financial conditions).

The long-term political and economic fallout from the conflict in Europe, along with rising prices, supply shortages, and heightened event risk is already changing the contours of the global economy. Rising disruptions in supply chains, trade flows, and the spread of economic sanctions has unleashed long-term changes in the world's financial and commercial architecture. American policymakers' abilities to respond effectively to these challenges will likely be constrained by a split government in Washington, with the Republicans likely to gain a majority in at least one of the two chambers of Congress, limiting the Biden Administration's ability to pursue its legislative agenda.

Financing Conditions

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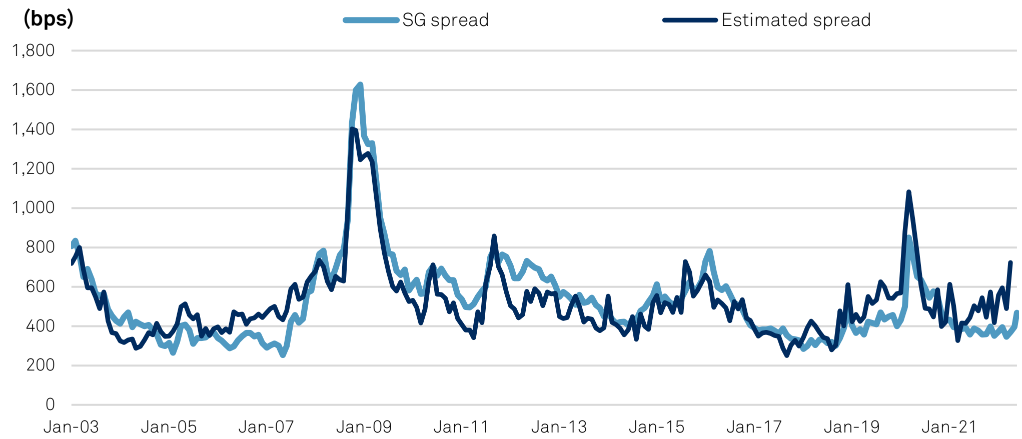
After enjoying a brief shift in a positive direction toward the end of last month, credit markets reverted to pessimism after the June 10 release of May CPI data. Yields on both Treasuries and corporate bonds have resumed their steep upward climb as bets grow that the Fed will need to respond even more aggressively to inflation than previously expected. But while recession fears have been rising, pricing suggests that duration effects are still in in play, with yields on investment-grade and Treasury debt rising faster than those on the lowest-rated debt. In fact, yields on 'AAA' through 'A' bonds are now roughly 100 bps higher than at the peak of pandemic fears in March 2020.

Market expectations indicate rates will likely rise for some time. The May CPI reading prompted markets to quickly price in another 75 bps to expectations for the federal funds rate by year-end—up to 350-375 bps, on average. Given that current 10-year Treasury yields are still below that level, if market expectations on the fed funds rate are right, Treasury and corporate yields still have room to climb.

Still, as rates continue to rise across all asset classes and levels of credit quality, spreads have been somewhat subdued thus far, albeit rising from historical lows at the end of 2021. Bond markets may be taking something of an overly optimistic stance in light of building headwinds. Our estimated spread ended April 353 bps above the actual reading of 371 bps (see chart 3). Speculative-grade spreads have widened a bit since April, coming in at 467 bps as of June 17, but if the estimate is a guide, some further widening may be ahead. This could happen quickly if markets perceive high odds of a recession, which could push Treasury yields down and corporate yields up in a flight to safety.

Chart 3

Gap Between Actual And Estimated Spread Near All-Time High

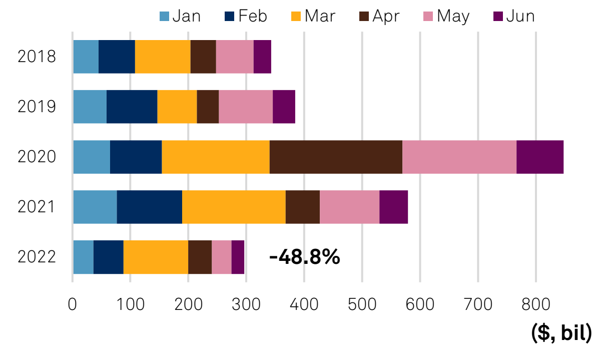


Note: Data through June 17, 2022. Source: S&P Global Ratings and FRED. SG--Speculative grade.

At the same time, there's been a sharp drop in issuance, particularly in corporate bonds (see chart 4). Through mid-June, nonfinancial corporate bond issuance has been down to just about half of last year's same-period total, with the pace generally weakening with each successive month and well below any similar period in the past 10 years. Even in a rising rate environment, leveraged loan issuance has dropped (see chart 5). Interest rate volatility has kept many issuers on the sidelines, as well as many lenders who either demand higher yields than offered, or who are growing more concerned about a downturn.

Chart 4

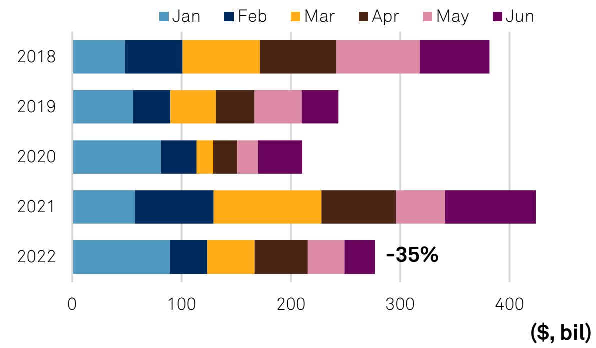
Bond Issuance Plummets



Note: Through June 17, 2022. Source: Refinitiv and S&P Global Ratings.

Chart 5

Loan Issuance Falls Despite Rising Rates



Note: Through June 17, 2022. Source: Leveraged Commentary & Data (LCD).

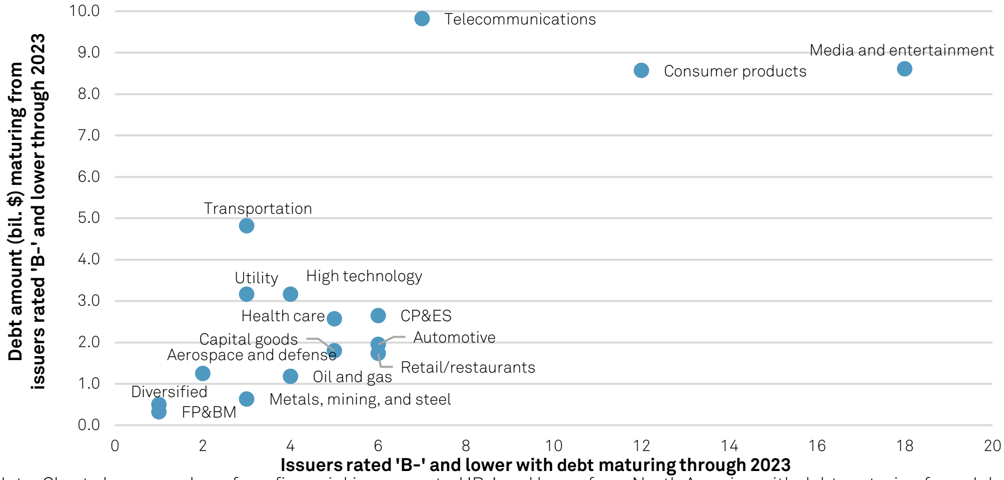
But the prior two years' issuance was clearly well ahead of the norm. Much of that was used to refinance at better terms (lower coupons and longer maturities)—which, though increasing debt outstanding, enabled firms to reduce near-term maturities—made them largely manageable, particularly through next year.

For North American borrowers, $228 billion in debt from speculative-grade nonfinancial companies is set to mature from July 1, 2022-Dec. 31, 2023. Capital markets continue to show enough capacity to provide liquidity for companies to meet maturing debt demands—at least at the macro level. However, the longer markets remain constrained, the greater the risk grows.

Few spec-grade nonfinancial issuers (just 16%) in North America have any debt maturing through next year. Lower-rated issuers tend to be more susceptible to refinancing risk, and based on our analysis, we find 86 issuers rated 'B-' or lower have debt maturing through 2023. Consumer-focused sectors, including media and entertainment and the consumer products sector account for more of these issuers, and this may add to the challenges these sectors face from weaker consumer sentiment (see chart 6).

Chart 6

Consumer-Focused Sectors In North America Have Relatively More Lower-Rated Maturities Through 2023



Note: Chart shows number of nonfinancial issuers rated 'B-' and lower from North America with debt maturing from July 1, 2022, through Dec. 31, 2023, and the maturing debt amount. Debt includes bonds, notes, and term loans; excludes revolvers. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. Source: S&P Global Ratings.

U.S. Public Finance

Ratings performance across U.S. public finance (USPF) remains stable despite continued high inflation, supply-chain issues, and a weaker economic outlook (see chart 7). While these economic conditions are all felt by USPF issuers differently, they have yet to affect credit quality directly. Revenue growth remains positive due to relatively healthy employment and real estate conditions. Revenues have also benefited in the short term from inflation, but this won't be sustainable as the economy slows.

Federal stimulus and strong revenue performance have kept reserves robust, which provides fiscal cushion. A significant amount of the $350 billion in stimulus governments received as part of the American Rescue Plan Act (ARPA) remains unobligated; while inflation and rising costs may affect the number or scope of projects that can be completed, a spending deadline of 2024 means it will continue to flow through the system for at least the next 18 months, generating jobs and supporting the economy.

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Chart 7

Key Credit Issues That Matter

Equity market volatility: How issuers respond to changing circumstances could affect credit quality

- Some states rely heavily on capital gains taxes and although many state reserve funds are at record levels, slowing revenues can create rapid changes in operational structural balance, which could pressure revenues.
- Higher education endowments and municipal pension funds enjoyed record returns in 2021 but those gains could be wiped out in 2022, which could create fiscal pressure.
- Growing pessimism among households from ongoing stock market declines is exacerbated by higher prices and could create a squeeze on consumer demand, slowing the economy further and reducing revenues for governments that rely on sales taxes.

Labor market: Wage demands ramp up in tight job market

- High inflation is leading to growing wage demands from workers, especially in highly skilled positions or where pandemic fatigue has set in, like education and health care.
- Large raises given now (particularly for long-term contracts) set the bar higher, creating potential for structural imbalance in the future.

Ongoing inflation: Could result in credit pressure over the long term

- Supply chain constraints, high energy prices, and rising wages all affect the budgetary balance of public finance issuers. As federal stimulus is spent down there could be more effect on credit quality, especially for those that started from a weaker financial position.
- Higher inflation is expected to eventually dampen consumer spending and that could swiftly weaken retail sales tax collections.
- Persistent inflation can affect rate-setting ability, a key lever for utilities and other government enterprise operations to maintain credit quality.

Rising interest rates: Higher rates not affecting issuers now but could do so over time

- Higher interest rates are slowing capital market issuance, but federal stimulus dollars play a role here, too: with funds on hand to complete projects, the need to issue debt is significantly reduced.
- Rising interest rates are expected to translate to slower housing demand. Any shift in real estate values would eventually slow property tax base growth, but that would likely be gradual, allowing time for adjustment.

Source: S&P Global Ratings.

Nonfinancial Corporates

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Earnings in many corporate sectors have returned to pre-pandemic levels, with notable exceptions including leisure and airlines, and companies have refinanced debt to take advantage of low interest rates and push out maturities. These trends have contributed to the improvement in our outlook bias, to just -3%, from close to -45% in mid-2020 (see table 2).

Table 2

Outlook Bias By Sector And Rating Category

Sector	IG	SG ex/CCC	CCC	ALL
Aerospace/defense	(33%)	13%	(33%)	(4%)
Auto/trucks	0%	2%	(57%)	(5%)
Business and consumer services	(17%)	4%	(88%)	(7%)
Capital goods/machinery and equipment	(15%)	(3%)	(54%)	(9%)
Chemicals	0%	6%	(50%)	3%
Consumer products	(8%)	(13%)	(82%)	(20%)
Forest products/building materials/packaging	6%	4%	N/A	4%
Gas	(5%)	12%	N/A	3%
Health care	3%	1%	(69%)	(4%)
High technology	2%	(2%)	(25%)	(2%)
Media, entertainment, and leisure	12%	9%	(48%)	2%
Mining and minerals	17%	0%	(40%)	0%
Oil	(7%)	14%	(27%)	6%
Real estate	8%	14%	N/A	11%
Restaurants/retailing	3%	10%	(77%)	1%
Telecommunications	(8%)	(6%)	(60%)	(10%)
Transportation	4%	9%	(50%)	6%
Electric	0%	N/A	N/A	0%
Energy merchants	25%	(8%)	N/A	0%
Diversified	(25%)	0%	N/A	(20%)
Diversified energy	(33%)	8%	0%	0%
Integrated	(50%)	(8%)	(67%)	(24%)
Regulated transmission/transport	0%	N/A	N/A	0%
Regulated utilities	(3%)	(67%)	N/A	(4%)
Independent power producers	0%	0%	N/A	0%
ALL	**(2%)**	**3%**	**(57%)**	**(3%)**

Note: Corporate and infrastructure ratings. Includes U.S. and Canadian issuers as of June 13, 2022. Outlook bias defined as positive outlooks and credit watches less negative outlooks and credit watches divided by total number of ratings.
Source: S&P Global Ratings.

Despite intensifying downside risks, the outlook bias overall remains relatively neutral, reflecting our expectation that many issuers can support their ratings just beyond the one-year outlook horizon for speculative-grade ratings, and the two-year horizon for investment-grade. Additionally, the portfolio is buoyed by the oil and gas sector, which was already enjoying elevated commodities prices prior to the Ukraine conflict and has continued to do so to an even greater extent since. Some metals and mining issuers have also had a somewhat similar trajectory. Finally, sectors such as automobiles continue to report that volumes, backlogs, and pricing are holding. Generally, companies are keeping up with maintenance capital spending requirements, although acquisitions are markedly down.

Nevertheless, weakening demand remains a key risk we are monitoring. The number of companies issuing negative earnings guidance is rising, and many are revising guidance downward, or temporarily suspending it altogether. Consumer sentiment never recovered to the extent that earnings did in 2021, and the wealth effect that is supporting spending in the face of inflation may be fading. Rising interest rates and the bear market in equities limit accessible cash, real wages continue to shrink, and household savings are being depleted. We are already seeing signs of demand deterioration in the most price-sensitive sectors, such as consumer products and retail, and we expect this to spread to the consumer-facing subsectors of technology and—if advertising budgets are trimmed—to ad-driven media and entertainment providers as well. Rising interest rates exacerbate the impact on sectors reliant on financing. However, automobile manufacturers continue to report sustained sales levels.

We forecast the greatest margin expansion in the oil and gas sector this year as it benefits from elevated commodities prices and a geographically robust customer base. While airlines, cruises, and lodging are in the same category (see chart 8), this is partly due to easy comparisons against a weak 2021. Also, in these cases we believe margins are bolstered by pent-up demand. We don't expect this imbalance to persist given the discretionary nature of this spending, and as capacity is rebuilt to bring supply closer to historical levels. In contrast, consumer products and retail companies are finding it increasingly challenging to maintain margins. We expect margins in these sectors to fall a lot partly as a result of weakening demand dynamics that will make it more difficult to pass on high input costs (see chart 8).

Chart 8

Pass-Through Ability And EBITDA Margin Trends By Sector

Average EBITDA Margins in 2022 vs. 2021

Question: Reflecting your assumptions for costs, product mix and any other relevant factors, how do you expect average EBITDA margins to develop for 2022 versus 2021?

Cost Pass-through Ability (Question: How easy is it to pass on cost increases?)	Rise a lot	Rise moderately	Rise a little	Fall a little	Fall moderately	Fall a lot
Very easy		• Out-of-home entertainment		• Metals & mining • Regulated utilities		
Somewhat easy	• Airlines • Cruise • Lodging	• Aerospace & defense	• Containers & packaging • Leisure manufacturing • Pharma • Technology • Unregulated power	• Autos • Building materials • Capital goods • Chemicals • Engineering & construction • Freight transportation • Gaming • Homebuilders • REITs • Telecom		
Impossible to generalize	• Oil and gas • Oil refineries		• Midstream energy	• Business & technology services		
Somewhat difficult				• Healthcare services	• Film and TV programming production	• Retail & restaurants
Very difficult						• Consumer products

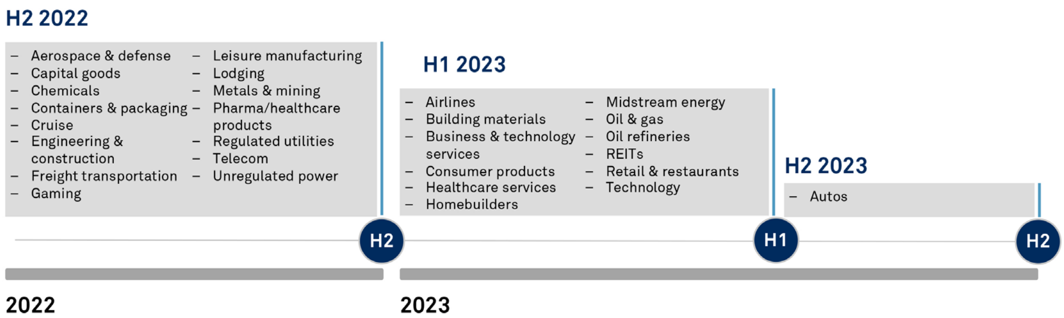
Source: S&P Global Ratings' corporate sector analysts' assessment as of June 23, 2022.

Most industries continue to contend with supply disruptions, with an expectation that there won't be a material improvement until at least the end of the year (see chart 9). Freight costs, backlogs, and shipping delays are generally better than they were six months ago, but still far from pre-pandemic levels. This suggests that logistics and distribution challenges will continue to have cost consequences, and the supply side is unlikely to contribute to easing inflation any time soon.

Chart 9

Most Sectors Expect Supply Bottlenecks To Linger At Least Until The Second Half

Question: If your sector is being affected by supply chain and cost issues, till when do you expect the most important effect to persist?



Source: S&P Global Ratings' corporate sector analysts' assessment as of June 23, 2022.

Structured Finance

The North American structured finance base-case collateral performance and ratings outlooks remain generally stable, buoyed by a strong labor market, and still-healthy consumer and corporate balance sheets (see table 3). However, sustained inflation could affect both the consumer and commercial sectors, especially those that can't pass on price increases as easily as others, over time. Also, recession risk is rising, especially as we look into 2023, and new issuance has been somewhat choppy—most notably for longer-duration sectors—amid wider spreads.

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Table 3

Q3 2022: 12-Month North America Structured Finance Outlook

	Collateral performance outlook	Rating trends
Residential mortgages		
RMBS	Somewhat weaker	Stable
RMBS – service advance	Somewhat weaker	Stable
Commercial mortgages		
CMBS - N.A. conduit/fusion	Stable	Stable
CMBS - large loan/single borrower	Stable	Stable
CMBS - large loan/single borrower (retail)	Weaker	Stable to negative
CMBS - large loan/single borrower (lodging)	Somewhat weaker	Stable to negative
CMBS - large loan/single borrower (office)	Somewhat weaker	Stable to negative
Asset-backed securities		
ABS - Prime auto loans	Stable	Stable to positive
ABS - Subprime auto loans	Somewhat weaker	Stable to positive
ABS - Auto lease	Stable	Stable
ABS - Auto dealer floorplan	Stable	Stable
ABS - Credit cards	Somewhat weaker	Stable
ABS - Unsecured consumer loans	Somewhat weaker	Stable to negative
ABS - FFELP student loan	Somewhat weaker	Stable
ABS - Private student loan	Stable	Stable
ABS - commercial equipment	Stable	Stable
Asset-backed commercial paper	Stable	Stable
Structured credit		
CLOs	Somewhat weaker	Stable
Timeshares	Stable	Stable
Small business	Somewhat weaker	Stable
Tobacco	Somewhat weaker	Stable
Transportation - aircraft	Weaker	Stable to negative
Transportation - container	Somewhat weaker	Stable
Transportation - railcar	Somewhat weaker	Stable
Whole business	Somewhat weaker	Stable
Triple net lease	Stable	Stable

Note: FFELP—Federal Family Education Loan Program. Source: S&P Global Ratings.

For collateralized mortgage-backed securities (CMBS), the story has been the lingering pandemic effects in the retail, lodging, and office sectors. For retail, we believe the inevitable continued growth in e-commerce and property competition, in general, for sales will continue to challenge certain malls. Lodging performance has broadly improved from pandemic lows, but not all property types and locations have recovered at the same pace. For instance, properties that depend heavily on corporate travel, and meeting and group demand have recovered much slower than those that depend on leisure travel. Hotels in major urban markets are also recovering slowly. The future of offices is an ongoing source of uncertainty. We expect overall occupancy and demand to decline compared with pre-pandemic levels due to the rise in hybrid work arrangements. However, the ultimate magnitude of this shift may not be entirely clear for years, mainly due to the longer-term leases common in the office market. Taken together, we have a stable-to-negative view on rating trends for single-borrower deals backed by retail, office, and lodging assets.

Collateralized loan obligations (CLOs) issuance has fallen off the frenetic pace of last year, especially refinancings and resets, which depend on prevailing spreads. Market sentiment aside, credit has been generally stable. Rating actions on speculative-grade corporates (including those that issue the loans held by CLOs) are seeing fewer upgrades and more downgrades, in a reversion to patterns typically seen in 2019 and before. Inside CLO collateral pools, we continue to observe a modest deterioration in recovery ratings and a historically high proportion of obligors rated 'B-'. On the other hand, the spec-grade corporate default forecast remains relatively low (3%), along with the S&P/LSTA Leveraged Loan Index default forecast for the same period (1.75%). We maintain a stable view of CLO ratings trends for the next 12 months.

Looking at consumer credit and specifically within residential mortgage-backed securities (RMBS), market dynamics suggest home prices will continue to increase in 2022, although the pace may slow as interest rates increase. That said, the most recent print from the S&P Case-Shiller index was a record, up over 20% year-over-year. All in all, we maintain a somewhat weaker stance for collateral performance overall during the next 12 months, but ratings should be stable.

Recent performance trends for consumer asset-backed securities (ABS) remain generally benign, although cracks are emerging. Vehicle price appreciation (and the resultant high recoveries in the event of payment default) has lifted the auto ABS sector; however, sharply higher gas prices could damp consumer confidence, and inflation may begin to hit borrowers with weaker credit scores. Credit card performance metrics have been very strong, but may normalize over time as consumers lean more heavily on cards due to inflation or if the labor market weakens. The U.S. labor market remains tight but as market rates rise and economic growth slows, some upward drift in unemployment is expected in the next 12 months. Historically, that portends softer credit quality in consumer credit. Non-traditional ABS remains mostly stable, with pockets of weakness in aircraft and tobacco.

Commercial Real Estate

While the worst of the pandemic may be behind us, the lingering effects on certain areas of commercial real estate (CRE) will likely continue. High inflation and the rising recession risk may start to weigh more heavily on both cash flows and valuations (capitalization rates), although the results can and likely will vary widely by sector, market, and even at the individual property level. One area where we have already seen downward ratings pressure is in single-borrower CMBS backed by retail, lodging, and office collateral (See "U.S. Single-Borrower CMBS Reviews Show Common Themes And Mixed Outcomes," published June 9, 2022).

For retail, the fundamental paradox for malls that are no longer considered 'A' quality remains: Although these malls can still generate considerable cash flow—often with debt yields near 10%—lenders are generally unwilling to provide nonrecourse capital to refinance mall-backed loans that have near-term maturities, given the cloudy outlook. This lack of liquidity continues to burden the sector and is a factor we've considered in ratings actions within the past few months.

Lodging performance has broadly improved from pandemic lows, but not all property types and locations have recovered at the same pace. In general, the main differentiator is that the collateral backing recently downgraded transactions/classes relies more on corporate travel and meeting and group demand, and the affected properties are located mainly in urban centers such as New York, Chicago, New Orleans, Minneapolis, and Portland, Ore. The New York market, in particular, continues to see weak international demand as well as oversupply that predates the pandemic.

We see the most variance in recent rating actions in the office sector. This reflects numerous factors, including tenant mix, leverage levels, land value, location, and risks from existing or near-term lease rollovers. The future of office demand is the most uncertain of the three sectors. We expect overall occupancy and demand to decline compared with pre-pandemic levels due to the rise in hybrid work arrangements. However, the ultimate magnitude of this shift may not be entirely clear for years, mainly due to the longer-term leases common in the office market. That said, we are continuing to monitor all of these trends and the potential credit impact they could have on class B office properties/loans—especially given the rising risk of recession.

Financial Institutions

Banks

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On balance, we expect banks to continue to perform well notwithstanding increasing macroeconomic uncertainty. We expect that higher interest rates and low credit costs versus historical norms will be favorable for earnings, tempered somewhat by persistently high inflation that could crimp bank borrower finances or if the economy falls into recession. Positively, we believe bank regulation has improved greatly since the 2008-2009 GFC, and the balance sheets of U.S. lenders look as strong as they have in many years. We believe the regulatory and supervisory enhancements implemented since the GFC benefited banks' financial performance leading up to and during the pandemic. Based on this, we have a positive industry risk trend for the U.S. anchor which could result in the anchor for the U.S. moving to 'A-' from 'BBB+' in the next one to two years, which in turn, could result in higher ratings on some banks.

Banks' earnings declined in the first quarter, down about 25% from a year earlier, largely due to provisions, which were still low compared to historical levels but were up from negative levels in the previous year. In addition, higher expenses and lower fee income offset improving net interest income (see "U.S. Banks: Net Interest Income Gains Offer Buffer Amid Emerging Risks," published May 17, 2022). As the Fed raises interest rates, it should boost banks' net interest margins from multidecade lows, which should increase net interest income double-digits. But this will likely be offset by a sizable increase in provisions for credit losses, rising expenses, and lower fee income—particularly mortgage banking revenue as higher rates have largely curtailed refinancing activity and the likelihood of lower capital markets revenue (which we currently project down 10% this year). All in all, we expect the industry to report a return on equity of 9%-10% this year, supported by a more than 10% rise in net interest income assuming mid-single-digit loan growth.

We expect bank balance sheets to remain strong but see capital ratios declining moderately due to continued share repurchases. The results of the annual stress test in June should also dictate where capital ratios are heading. In addition, unrealized losses in the securities portfolios for the largest banks, resulting from the rising rate environment, may also weigh on their regulatory capital ratios. Separately, we expect the loan-to-deposit ratio, which at the end of the first quarter hovered at a historical low of 55%, to gradually increase—particularly as the Fed unwinds its balance sheet, which should result in some bank deposit outflow.

Some of the key risks we are monitoring for U.S banks include an increased probability of recession, persistently high inflation and market disruption, and a sharp decline in asset prices. We currently forecast credit losses of around $104 billion for the two years to end-2023, We expect those losses to rise from last year's negative levels given that reserves for credit losses have already fallen close to pre-pandemic levels. With loan growth accelerating, banks will have to add to those reserves. Still, credit losses should remain fairly benign this year—below 2019 levels—before normalizing to around historical averages in 2023. If the economy moves into a prolonged recession, though, our credit loss estimates will likely prove optimistic.

Finance Companies

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We have stable outlooks on most finance companies (fincos) we rate. In general, asset quality remains favorable on the heels of the strong economic recovery from the pandemic. Although market conditions have been volatile since the beginning of the year—with supply-chain disruptions, the Russia-Ukraine conflict, and the Fed aggressively raising rates to fight inflation—fincos took advantage of favorable financing conditions through 2021 and early 2022 to refinance near-term dent and extend their funding profiles.

We continue to have stable outlooks on all business development companies (BDCs) we rate. We will monitor the effects of rising interest rates and inflation on portfolio companies but don't expect significant asset-quality deterioration in the near-term. Last year, we revised our outlooks on most rated CRE finance companies, to stable from negative, and today have a positive outlook on one CRE finance company and stable outlooks on the rest that we rate. We think the likelihood of substantial further deterioration in CRE loan portfolios has lessened. As workers return to the office, this should relieve some pressure on some of the most affected property types, such as office properties and hotels in central business districts.

Overall, performance in the consumer finance segment has been resilient, even during the pandemic shutdowns. That said, we expect some normalization of asset quality, particularly related to lower-income consumers who may be most affected by inflation and rising prices. We expect weaker earnings for some pay-day lenders. Performance at CRE service companies exceeded expectations driven by a stronger-than-expected rebound in capital markets and leasing activity. Performance at residential mortgage companies will be affected by the 30-year mortgage rate, which is now closer to 6%, the highest level since 2018. As interest rates climb, mortgage servicing rights valuation are rising but origination activity and gain-on-sale margins are falling quickly. Although we expect market conditions will normalize in 2023, we could see negative ratings actions if weak conditions persist longer than expected.

Asset Managers

We have stable outlooks on most asset managers we rate, which include traditional and alternative asset managers, as well as wealth managers. The macroeconomic backdrop has worsened since our sector outlook in January, with rising interest rates, inflation, and geopolitical turmoil contributing to equity and debt market declines, posing more challenges than we anticipated.

Our stable outlook on the traditional asset mangers has become more cautious as the support from low interest rates and elevated asset valuations has eroded in the current economic environment. We also expect traditional asset managers to continue to face pressures from secular shifts, including active to passive investing.

While wealth managers and traditional asset managers may be similarly vulnerable to market movements, we expect a potentially stickier asset base within wealth manager's clients—as many of these (generally high-net-worth) retail investors value services such as investment advisory, tax planning, estate planning, and insurance guidance. Risks to wealth manger ratings largely stem from the rapid pace of inorganic, debt-financed growth.

We continue to believe alternative asset managers remain relatively well-positioned due to largely locked-up assets under management and strategies that are harder to index, and diversified platforms, including private credit, that benefit from higher interest rates. Alternative asset managers enjoyed significant net inflows last year due to good investment returns as investors searched for yield. As such we have seen a general expansion in the size of average funds and broadening platforms. That said, we believe risks for alternative asset managers remain, as any material, protracted valuation declines could hit returns and overall performance, and fundraising could slow as limited partner investors reach allocation capacity. Our areas of focus for the rest of this year include monitoring the cycle of fundraising, deployment, and realization for any signs of slowdown or weakening performance—particularly in areas that may be more vulnerable to rising rates, such as private equity. Although we expect market conditions to normalize by 2023, we could see negative ratings pressure if weak conditions persist longer or are sharper than we expect.

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While there were no ratings changes in the three-month period ended in May, with no assessed changes to currently satisfactory business conditions for North American insurers, we did revise our business conditions outlook assessment for the health sector downward to 'no change' from 'somewhat stronger' (see table 4). We made the same change for the life sector last quarter.

Overall, the average financial strength rating for the core insurance portfolio (life, health, property/casualty [P/C]) is in the upper half of the strong ('A') category, reflecting slight improvement in credit quality for the life sector due to minor changes in the portfolio mix. In addition, a high percentage (84% or better) of our ratings have stable outlooks. There is modest negative bias for the life and P/C sectors, and modest positive bias for the health sector. The relatively lower-rated and small mortgage sector portfolio ('BBB+') has a positive outlook bias.

Major ratings factors include volatile capital markets, rising interest rates, inflation, pricing, employment, and regulatory and legislative policy. Financial conditions remain accommodative as borrowing costs haven't yet increased enough to materially affect issuers, which, in general, aren't highly leveraged. Balance-sheet strength remains a pillar of credit-quality support, providing some protection from risks related to downside economic developments broadly, and the expansion or increase in the magnitude of specific subsector risks.

Table 4

North America Insurance Sector Trends

Sector	Current business conditions	Business conditions outlook	Sector outlook
Life insurers	Satisfactory	No change	Stable
Health insurers	Satisfactory	No change	Stable
Property/casualty insurers	Satisfactory	No change	Stable
Global reinsurers	Weak	Somewhat stronger	Negative
Bond insurers	Satisfactory	No change	Stable
Title insurance	Satisfactory	No change	Stable
Mortgage insurers	Satisfactory	No change	Stable

Note: Business conditions and sector outlook are for the next 12 months. The shaded cells indicate changes since Q2.
Source: S&P Global Ratings.

The year started on a slightly positive note for life insurers. Choppy equity markets and elevated mortality due to COVID early in the year weighed on earnings but were somewhat balanced by rising interest rates. Annuity sales took a small dip and early indications of life insurance sales may show a similar trend. The result was overall good performance in the first quarter, although not as strong as in 2021. We don't see major headwinds that will increase risk for life insurers but also don't expect a banner year. Life insurers may need to continue to navigate volatile capital markets, a higher risk of a recession, and possible elevated mortality charges. The good news is that the industry is well-positioned to handle some or all of these, with healthy balance sheets and two-plus years of pandemic experience. If the environment turns out to be more favorable, we expect that the positive trajectory the industry was on last year may continue, but most likely with lower sales growth, stable capital levels, and reduced earnings compared to last year.

For health insurers, the recovering economic environment will likely bolster employer-sponsored commercial membership, though in-group gains may take time to show up given many employers' retention/recruitment difficulties. The industry is closely watching when the Biden Administration will end the public health emergency, as it will mean the restart of Medicaid redeterminations, which will result in membership losses. The industry continues to frame COVID as an overall earnings headwind. It also remains highly acquisitive, focused on tuck-in deals, particularly in the non-insurance space. On the public policy front, the administration may still try to pass some health care elements of the Build Back Better proposal. If they are unsuccessful, the ARPA's enhanced Affordable Care Act premium subsidies won't get extended beyond 2022, which could result in some membership losses for insurers for 2023.

Underwriting profitability of P/C insurers remained solid last year, with a combined ratio for the year of 99.6%, up one point from 2020. Catastrophe losses declined somewhat but this was offset by inflationary pressures, particularly in property and auto lines. Strong rate momentum for most commercial lines exceeded loss-cost trends, resulting in further margin expansion. Rate increases are expected to slow this year and margins to stabilize. Offsetting the strength in commercial lines to some extent was deterioration in personal lines, which came under pressure from the spike in the cost of building materials, car parts, and wages. Personal auto insurers are pursuing rate increases as they attempt to catch up with rising claims costs, so their results should improve. Overall, we expect underwriting performance this year—assuming a normal level of natural catastrophe losses—to be similar to 2021. Interest rates have begun to rise and will benefit investment income. Capital adequacy has been a relative strength to our ratings on most P/C insurers. We expect this to remain the case though the decline in equity markets through the first five months of the year doesn't help.

The global reinsurance sector has struggled to earn its cost of capital in the past several years and the trend continues. This underperformance was driven by COVID and natural catastrophe losses, adverse loss trends in certain casualty lines, and lower investment returns—as well as fierce competition, exacerbated by alternative capital. As a result, our outlook on the sector has been negative since May 2020, but it may become more stable if we believe reinsurers can sustainably earn their cost of capital. Capitalization remains robust. In the first quarter, reinsurers' shareholders' equity was hit because of unrealized losses on fixed-income portfolios. In addition, inflation is another risk. As a mitigating factor, reinsurance pricing has been hardening in the past few years, further supported by COVID and natural catastrophe losses in 2021. We believe pricing increases will continue but at a decelerating rate. Losses related to the Russia-Ukraine conflict in the first quarter are manageable, but losses could further develop in the next few quarters.

Financial uncertainty in the U.S. public finance market as result of the pandemic caused renewed interest and demand in the financial guarantee products aligned with bond insurers. Investors focused more on credit quality, trading value stability, and market liquidity, which pushed demand of bond insurance and the trend appears set to continue. Additionally, secondary market insurance demand continues to benefit as institutional investors use bond insurance as a risk-mitigation tool.

While the title sector benefits from a rise in homeownership, economic uncertainty and rising interest rates are key factors that could affect the title insurers. Overall profitability and financial strength will depend on their ability to manage operations through the mortgage cycle, as well as employ proper risk and underwriting controls during periods of high business volume. While rising interest rates may damp residential refinancings and lead to lower overall mortgage applications, revenue per order is expected to rise due to higher average deal size in the commercial business and the effect of strong home-price appreciation on residential purchases.

Private mortgage insurers (PMIs) continue to benefit from the economic recovery, borrower forbearance relief, the strong housing market, and adequate capitalization supported by access to reinsurance capacity. Demand-supply dynamics have kept house-price appreciation robust, helping build strong equity in PMIs' loan portfolios. However, high prices, along with rising mortgage rates, are creating affordability issues and pushing many first-time homebuyers out of the market. Hence, we expect new business volumes to remain tepid. Most PMIs' delinquent inventory remains in forbearance. However, since third-quarter 2020, PMIs have enjoyed favorable loss trends. PMIs have now realigned their loss reserves to pre-pandemic assumptions, which signals a normalization of loss trends.

Related Research

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- Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent, June 27, 2022
- Economic Outlook Canada Q3 2022: Near-Term Growth To Slow Amid Faster Rate Hikes And Surging Inflation, June 27, 2022
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- Where To Look For Refinancing Vulnerabilities Through 2023 Amid Market Turmoil, June 13, 2022
- U.S. Single-Borrower CMBS Reviews Show Common Themes And Mixed Outcomes, June 9, 2022
- U.S. Public Finance Rating Activity, May 2022, June 7, 2022
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- The U.S. Speculative-Grade Corporate Default Rate Could Reach 3% By 2023 As Risks Continue To Increase, May 19, 2022
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- Housing Overvaluation Trend Continues: What It Means For U.S. RMBS, April 5, 2022

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Appendix 1: Nonfinancial Corporate Sectors Outlook

For analytical contacts, please see Appendix 3.

Table 5

North America Nonfinancial Corporate Sectors Outlook

Sector	Comment
Aerospace and defense	We expect most companies to see growth in revenues and earnings in the next few quarters as higher air travel in certain markets (e.g., U.S. domestic, trans-Atlantic) drives increased demand for aftermarket parts and services, widebody production rates stabilize at low levels, and companies benefit from cost-reduction efforts. Air travel volume will likely reflect pent up demand, though the effect of high fuel prices on tickets is an offsetting factor. Widebody production is unlikely to increase until at least 2023 and requires more countries dropping pandemic-related restrictions on international travel. For Boeing, the key is also to resume deliveries of the 787, currently held up while the company addresses manufacturing quality issues to the satisfaction of the Federal Aviation Administration. Production of the Boeing 737 MAX should continue to increase as it recovers from the grounding, and Airbus plans to increase A320 production later this year. Russia isn't a large market for either Boeing or Airbus, and both have suspended business there. Cash flow should also improve, helping liquidity, but will remain weak or negative for most commercial aerospace suppliers as they operate at suboptimal production rates. The biggest risk is a resurgence of the virus or a new variant that causes the recovery in air travel to slow or reverse. The second-biggest risk is weak suppliers not being able to invest in working capital and workers to support increasing production rates. Defense demand is supported by an increase to the fiscal year 2022 U.S. budget and fiscal year 2023 budget proposal and increased spending by European allies in response to the Russia-Ukraine conflict but will begin generating higher revenue until at least next year. Certain sectors already considered key (intelligence, reconnaissance, cyber) will be even more in demand.
Autos	Credit quality in the sector will likely weaken slightly in the next 12 months as inflation headwinds offset the combined effects of slightly better year-over-year supply levels after semiconductor shortage-related production disruptions in 2021. Key drivers for steady metrics for many issuers will be sustained consumer demand, improved inventory management, better factory utilization, and the ongoing favorable product mix (more pickup trucks and SUVs, together classified as trucks) than in previous years. The economic consequences of the fighting in Ukraine add to ongoing supply-side risks related to the shortage of semiconductors. We now see a material threat to our previous base case for moderate growth in sales and production this year and have revised our estimates downward. Global supply disruptions and inflation due to raw-materials scarcity are critical risks for the industry. Specifically, the impact from the disruption of critical auto parts from the region, including wire harness manufacturing in Ukraine, potential shortages for materials like palladium and price hikes for steel, copper, aluminum, and nickel represent key industry risks. In our view, the combined effects of marginally higher volumes and higher pricing may not fully offset cost inflation. As a result, we expect to see pressure on margin and cash flow generation in the next two years.
Building materials	Demand could slow in the next 12 months for the building materials sector given the cooling housing market and growing recession risks. While first-quarter results continued to benefit from a robust backlog, we expect slowing revenue growth and inflationary pressure to put further margin pressure from more limited ability to pass on costs increases. Rating actions for the sector was mixed, with some positive and negative actions depending on companies' financial policies and ability to manage inflationary pressures. Currently 87% of ratings have stable outlooks, 10% are on positive, and 3% on negative.
Capital goods	The credit outlook in U.S. capital goods is steady, with solid demand and generally good pass-through of higher costs. Profit performance is diverging more, however, as costs and supply chains test pricing power and manufacturing agility. Further, our assumptions for strong backlogs translating into good revenue could be tested by rising interest rates for capital-intensive equipment buyers, as well as logistical constraints that are disrupting sales for some smaller issuers. Demand remains strong for machinery, with high industrial output driving replacement volumes, while onshoring and infrastructure investments lay a foundation of longer-term projects. Commodity costs remain elevated, with potential shortages apparent for some meaningful inputs like nickel for stainless steel or oil and gas feedstocks for plastics. Finally, financial sponsors are adding debt to some of the lowest-rated issuers based on robust prospective earnings growth.
Chemicals	The outlook remains stable, but credit risks may be building up. We believe most chemical companies will report strong first half results. Our expectation for favorable demand and domestic/global GDP growth, combined with some cushions built up in credit metrics at many companies contribute to our view for a stable outlook. Overall sector margins may decline slightly, but enough to hurt credit quality at most companies. Cost pressures will rise for almost all. There are varying levels of capabilities within the sector to pass through these pressures. Many commodity-chemical companies—not involved in these basic chemicals—will pass on a large portion, but not necessarily, all

	their costs and see margins decline somewhat. A few companies especially those with weaker market positions (mainly at the lower end of the rating scale) will see margins fall. Rising working capital requirements caused by higher input costs could test liquidity at lower rated credits. Rising credit risks include the potential for an economic downturn or weakened demand at key end markets such as housing, auto, and general industrial.
Consumer products	Inflation continues to be a headwind in the consumer space, with margins weighed down by commodity, freight, and labor costs. For most packaged food companies, we believe about 80% of costs have been passed through. Passing through additional costs will be challenging given growing consumer price sensitivity and resulting tougher negotiations with retailers. Still, we assume volumes will remain higher than pre-pandemic levels, but below 2020 and 2021 levels. Private label is likely to regain share as consumers trade down. Durables, which have benefitted from some pull-forward demand during the pandemic, are likely to see softness as retailers reduce bloated inventories and consumers reduce discretionary spending and shift to experiences. Outlook bias is significantly negative (22% negative, 7% positive on May 31).
Containers and packaging	We have a stable outlook for containers and packaging sector despite our expectations of continued operating challenges. We expect margins to be slightly improved as cost pass-through mechanisms begin to catch up to high and persistent inflationary pressures as raw-materials costs begin to level out—although we expect stronger gains in the second half as inflation continues to remain a concern. Other operating costs, including labor, logistics, energy, and supply chain issues, have affected the industry will continue to add to volatility, and the conflict in Ukraine will likely have far-reaching effects and add further unpredictability, particularly in the near term. Still, packaging demand continues to be strong, which should give issuers more power to attain additional price to offset further inflation. We also expect capital spending to be slightly elevated this year as such strong demand has incentivized many issuers to invest further in capacity expansions.
Gaming, leisure, and lodging	Much of the leisure sector is still recovering from the pandemic, and as a result, we are seeing not just travel and leisure activity volume improve, but also surprising rate strength in hotels, cruise, theme parks, ski, and other leisure activities. But we are beginning to incorporate a moderation in rate in our forecasting later this year and in 2023 because at some point the leisure consumer is going to pull back on the rate or ticket prices they are willing to pay. As a baseline, we are assuming that continued leisure strength through the third quarter of this year is probably a sound assumption because people still want their vacation or to engage in leisure activity through this summer. After the summer, we are more cautious particularly on our profitability assumptions, because of the possibility people pull back on what they're willing to pay at the same time labor and other costs are rising. The middle and high-end leisure consumer is still very strong, one area where we are seeing softening spending is in the low-end gaming customer but that typically represents a small portion of revenue and profitability for most casinos. However, it's a signal worth watching in our sector.
Health care and pharmaceuticals	Our credit outlook for the health care services sector remains stable, though potentially weakening. The top-line projection should remain intact, given the inelastic demand of health care in general, the backlog of delayed discretionary procedures from the pandemic, and the receding impact of the pandemic. The potential recession may be a drag on revenue growth, given the sizable out-of-pocket consumer costs that may delay discretionary health care, but the expanded coverage under the Affordable Care Act should forestall any significant declines in patient volumes in case employment levels drop in the face of a severe recession. EBITDA margins may be squeezed though, given the persistent high (though moderating) labor costs and the uncertain ability to pass along those costs to payors. Service providers, such as hospitals, have streamlined their processes to save on costs, but a stretched labor force and supply chain inefficiencies remain threats. The outlook for pharma is stable, previously negative earlier this year. Mergers and acquisitions done in previous years have done much to address near term product pipelines, cash balances at the largest pharma companies are at highs, a number of companies benefitted from the pandemic with successful vaccines and treatments, and we believe legislative risk has declined given the stalling of the Build Back Better bill and the Medicare drug price reform as part of it.
Homebuilders	Rising mortgage rates could cool housing demand, temper revenue growth, and moderate positive ratings bias for homebuilders (currently 40% on positive outlook). Despite growing risks of a recession, we think performance for the rest of 2022 is somewhat insulated given that job growth remains good for now amid the still-healthy backlogs of the builders. Still, rapidly rising mortgage rates along with weaker economic growth could slow demand for homes in the next year, particularly for prospective first-time homebuyers as affordability worsens. Softer-than-expected pricing power, rising costs, and increased incentives to complete closings could pressure margins as we head into 2023.
Media and entertainment	Our sector outlook is increasingly negative. A weakening economy is a growing concern as the media sector is highly dependent on cyclical consumer and advertising spending. Even if the economy doesn't fall into recession, a pullback in consumer spending will hurt the sector. Advertising remains solid thus far, especially for television and billboards, as recovering ad categories (travel, entertainment) and new ad categories (crypto, streaming, sports betting) more than offset categories that are hurt by supply chain issues (auto, consumer electronics, consumer products). Expectations for political advertising for this year are for record levels for a midterm election and could approach presidential-election-year levels. Still, visibility is limited and cracks, especially for bottom-of-the-funnel transactional advertising, have begun to appear. The sector is counting on strong growth from consumers signing up for direct-to-consumer video streaming services but this spending is discretionary and stressed consumers may reduce the number of services for which they sign up. At the same time, media companies continue to aggressively spend on film and TV content for their streaming services, which will continue to pressure EBITDA and cash flow, at

	least until these services reach cash flow breakeven. We expect TV subscribers and viewership metrics will continue to decline as users move toward streaming alternatives, which will increase pressure on the legacy TV model (linear networks and cable bundles). The media sector in general has made great strides in recovering from the effects of the pandemic, in many cases like the TV station and billboard operators, returning to pre-pandemic operating and credit metrics. We could see a reversal of these trends If a pullback in consumer spending were to occur.
Metals and mining	Credit quality is stabilizing at a stronger level in metals and mining after a round of upgrades in 2021 and this year. We've upgraded about 10 issuers every quarter since mid-2021, which averages to a one-notch upgrade for a remarkable 20% of the global portfolio in the last year. In contrast, we lowered the ratings on about 15 entities directly affected by the Russia-Ukraine conflict and subsequently withdrew many of those ratings. Business conditions in metals remain generally good, with strong prices owing to tight supply. Meanwhile, the confirmation of financial policies and growing credit buffer contributed to the most upgrades in a decade in the capital-intensive metals and mining industry. On the other hand, we expect good cash flows will be directed more to corporate development and shareholder returns than debt reduction, considering five to 10 years of capital spending restraint and a generally favorable demand outlook. Steel and aluminum producers in North America and gold producers around the world have been improving credit quality for a few years. Coal producers, meanwhile, are benefiting from sharply higher prices, so that higher credit ratings depend on competitive prospects like product and demand horizon, as well as financial capacity to fund obligations amid declining sources of capital.
Midstream energy	The North American midstream-energy industry's credit quality continues to exhibit strength, given strong commodity prices and demand, partly due to the Russia-Ukraine conflict and a rebound from the effects of the pandemic and subsequent credit stress. Domestic upstream producers have remained disciplined, generally living within cash flows, which has led to more modest growth expectations but high utilization midstream rates in the most favorable basins such as the Permian, Williston, and the Appalachian. Producer discipline and Russian sanctions have led to a supply/demand imbalance and inflation surge but has not materially affected midstream companies. Most companies have allowances for inflation in their contracts which protect them at least partially from cost increases. We expect modest capital-spending increases, primarily among the large, diversified companies that are finishing multiyear growth initiatives or small bolt-on organic growth projects. Companies that are more volume-dependent are spending modestly to maintain current volumes or to expand processing capacity in areas with higher natural-gas and natural gas liquids volumes. Volume dependent companies are seeing strong cash flow across the board, regardless of commodity focus, as higher prices are "raising all boats." Most of this spending with be funded internally, protecting balance sheets. Liquidity is adequate across ratings, although weaker issuers in the 'B' category may find it harder to refinance in the capital markets and will likely have to rely on banks.
Oil and gas	Oil prices continue their upward trajectory and are set to increase further. With the EU and other nations effectively banning Russian oil, the dearth in supply is unlikely to be made up from OPEC or North American shale producers that continue to remain disciplined on production and focused on generating cash flow to be returned to investors. All this has been occurring despite the COVID-driven shutdowns in China. With China reopening, we are expecting further increases in demand and with global inventory levels at five-year lows, we will likely see further increases in oil prices, barring a recession. With Europe also trying to reduce its reliance on Russian gas by two-thirds come October, global gas supplies are being diverted to Europe where the TTF had been at record highs. The Henry Hub price has responded in kind effectively becoming more globalized. Barring a major recession, its likely high oil and natural gas prices will remain high well into next year.
Oil refineries	North American refiners will likely have a strong year as margins at their highest and several multiples of levels of historical peaks in the commodity cycle. For example, some refiners will make as much EBITDA in the second quarter as they did in a full year of a mid-cycle price environment. There are several reasons for this, including stronger post pandemic demand, and the doubling of crude prices since 2019 (approximately 60% of the cost of refined products is based on the crude oil price in the U.S.). Utilization rates are strong, and the ability to increase capacity is limited because refineries are running close to the peak capacity of about 19 million barrels per day. Pressure to restart shutter refiners is unlikely to work as companies seek to achieve greenhouse gas (GHG) reduction goals, and the significant cost in doing so even if GHG goals weren't a consideration. Plus, a restart wouldn't be ready for the summer driving season to alleviate prices when most needed. We expect refiners to continue to chip away at higher debt burdens, which they used to bolster liquidity when demand fell in 2020-2021. We also believe shareholders could benefit from a return of capital as balance sheets strengthen. Latin America will likely see mixed results due to more systemic operating challenges and possible shifts in political views. China continues to manage domestic capacity, closing smaller refiners in favor of large, integrated refining and petrochemical complexes and a strong push to electrify the vehicle fleet.
REITs	We expect revenue growth for REITs to slow as economic pressure builds and consumer spending is increasingly fragile. Following a period of solid recovery with operating metrics across many property types reaching pre-pandemic levels, REITs face the likely prospect of slowing growth as record inflation pressures consumer spending and pandemic habits become rituals. We expect operating performance to lose momentum over the next few quarters, with revenue growth moderating. Property types that are more vulnerable to a recession are retail and office, while we expect industrials and rental housing to remain more resilient due to robust demand. About 88% of REITs have stable outlooks.
Regulated utilities	The sector outlook has been negative since early 2020. Credit quality for the investor-owned North America regulated utility industry weakened in 2020-2021 with the median rating falling for the first time ever to the 'BBB' category.

	Given the relatively high percentage of the industry with a negative outlook (about 20%), the strategic management of financial measures with only minimal cushion from the downgrade threshold, the industry's high capital spending, ESG credit risks, inflation, rising interest rates, and higher commodity prices, we expect that it is more likely that downgrades will again outpace upgrades this year. Should this occur, it would be the first time in more than 30 years that downgrades outpaced upgrades for three straight years.
Retail and restaurants	Coming off of a great 2021 when consumers appeared to buy whatever was on the shelf without balking at price increases, the retail sector is finally experiencing a consumer pushing back on inflation. This was illustrated in Walmart and Target's earnings releases in May, which also disappointed because of inflation pressure. Both cited consumers deferring discretionary purchases and spending more in grocery on account of inflation. This theme echoed across the space in subsequent announcements, painting a picture of consumers with lower income levels reacting to the pinch of higher gas and grocery prices while retailers serving consumers with higher incomes continue to enjoy good demand and price insensitivity (e.g. in the dept store space value player Kohl's fared the worst, mid-tier Macy's better, higher-end Nordstrom best). Inflation is unlikely to abate as we are aware that most consumer products companies have not pushed forward all of their costs. Retailers will have to be strategic in pricing. Off-price and deep discounters will face a more price-sensitive consumer but could benefit from the trade down. Discretionary categories in home, sporting goods, and other categories that benefitted during the pandemic are at risk. Restaurants appear to be mixed, with reports of lower traffic in some quick-service restaurants as consumers tighten budgets, but still good demand in some casual diners as pent-up demand for experiences persists. As consumers return to office, go out to eat, and take vacations, they are switching to dressier attire from basics, catching apparel some retailers off-guard. Rating outlook are largely balanced, having come down from peak positive bias in Nov 2021. Most positive rating actions have been in apparel, where the reopening is providing tailwinds.
Technology	The consumer-focused end markets within the tech sector, i.e., PC and smartphones, have turned negative, more so because of the significant pull forward of demand (PC especially Chromebooks) China's COVID-zero policy, and weaker consumer sentiment rather than deteriorating macroeconomic environment or the Russia-Ukraine conflict. Supply constraints remain the key issue for vendors to meet demand, leading to increasing backlogs. We still expect the tech sector to perform well this year, given our expectation for IT spending to still grow faster than global GDP growth and incremental semiconductor capacity become available. Tech companies have been successful in passing along higher input costs to customers, thereby maintaining profitability, but we anticipate it to be more challenging going forward given the higher recessionary pressure at the risk of customers cancelling orders. Secular trends of cloud computing, digital transformation, 5G buildout, electrification of auto, etc. are intact.
Telecom	We expect competitive intensity to increase in wireless as the carriers try to differentiate their 5G capabilities as well as increased competition from cable. We expect wireless service revenue growth to moderate in 2022 due to slowing subscriber growth, partly offset by consumers migrating to higher priced data plans as they upgrade to 5G. While incumbent cable providers will continue to benefit from rising demand for broadband, we expect growth to moderate because of increasing competitive pressures from fiber-to-the-home (FTTH) and fixed wireless access providers. Among wireline companies, we expect cash flow and leverage metrics to weaken over the next couple of years as they invest in FTTH. Global supply chain issues and labor shortages could also make it more challenging for the telcos to reach their goals for homes passed with fiber.
Transportation	The outlook for transportation companies rests on a balance of positive and negative factors, which may play out differently for various subsectors. Airlines are seeing strong near-term revenue trends as easing of COVID restrictions and pent-up demand for travel support demand. The summer season is likely to be the strongest since the start of the pandemic, with full planes and high ticket prices on domestic and some international routes. Headwinds to this positive trend are much higher fuel prices and cooling demand as a slowing economy affects spending after Labor Day. The combined effect should be to slow but not reverse the industry's financial recovery. Global aircraft leasing companies are benefiting from strong demand for the latest-technology narrowbody (single aisle) planes used on short to medium distance routes and stabilization of demand for widebody (twin-aisle) planes. The Russia-Ukraine conflict and Western sanctions have resulted in Russia seizing leased Western aircraft to avoid their repossession. The proportion of aircraft value affected for rated lessors ranges from 2%-10% of their portfolios. Those companies that have reported calendar first-quarter results have written off the value of the affected planes, raising reported leverage. Lessors carry insurance against an inability to repossess planes due to the actions of the airline or a country, but there may be protracted legal struggles between lessors and their insurance companies over this. Demand for freight transportation remains strong thus far—although meeting it has been difficult given various supply chain constraints. In the meantime, pricing for trucking and equipment leasing is substantially higher than normal. Freight companies can generally raise prices to offset costlier fuel through surcharges or market rates, so that is less of an issue than for airlines. The slowing economy will cool demand for freight transportation, but off of a high base. A silver lining in the cloud of slowing freight demand will be easing at least some of the supply chain problems (e.g., driver shortages, container chassis shortages).
Unregulated (merchant) power	Power prices have more than doubled since January. Only a severe recession is likely to affect volumes. Also, power prices have risen not only because of the steep rise in the price of natural gas but also from supply shortages. Energy margins have commensurately risen, resulting in stronger spark spreads (gross margins). However, this has been offset by lower capacity prices. Overall, we expect stronger performance from all generators. Retail power providers will see lower margins.

Appendix 2: Economic Data And Forecast Summaries

Table 6

U.S. – S&P Global Ratings Economic Outlook

	2021	2022f	2023f	2024f	2025f
Real GDP (year % ch.)	5.7	2.4	1.6	1.9	2.1
Real consumer spending (year % ch.)	7.9	3.4	1.9	2.1	1.9
Real equipment investment (year % ch.)	13.1	5.0	0.0	0.9	2.2
Real nonresidential structures investment (year % ch.)	(8.0)	(4.1)	1.2	1.4	1.4
Real residential investment (year % ch.)	9.2	(4.6)	(2.1)	1.6	1.5
Consumer price index (year % ch.)	4.7	7.5	3.4	1.7	2.0
Core CPI (year % ch.)	3.6	5.6	3.3	2.4	2.3
Unemployment rate (%)	5.4	3.7	4.1	4.6	5.0
Housing starts (annual total in mil.)	1.6	1.6	1.5	1.5	1.5
Federal funds rate (%)	0.1	1.7	3.5	3.5	2.8

Note: All percentages are annual averages, unless otherwise noted. Core CPI is consumer price index excluding energy and food components. f—forecast.
Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, the Federal Reserve, S&P Global Market Intelligence, and S&P Global Ratings Economics' forecasts.

Table 7

Canada – S&P Global Ratings Economic Outlook

	2021	2022f	2023f	2024f	2025f
Real GDP (year % ch.)	4.5	2.9	1.9	2.3	2.0
Household real final consumption (year % ch.)	5.0	4.7	2.3	1.9	2.2
Business nonresidential investment (year % ch.)	2.3	6.4	2.5	2.8	1.8
Consumer price index (year % ch.)	3.4	6.3	3.3	1.5	2.0
Unemployment rate (%)	7.4	5.4	5.1	5.1	5.4
Government of Canada 10-year bond yield (%)	1.4	2.6	2.9	3.0	3.0
Bank of Canada policy rate (%)	0.2	1.6	3.0	2.7	2.3

Note: All "year % ch." are annual averages percent change. f—forecast.
Sources: Statistics Canada, S&P Global Market Intelligence, and S&P Global Ratings Economics' forecasts.

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