

## Credit Conditions North America Q4 2022

# Credit Strains Tighten

Sept. 27, 2022

*This report does not constitute a rating action*

Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions (Asia-Pacific, Emerging Markets, Europe, and North America). Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the North American committee on Sept. 21, 2022.

### Key Takeaways

- **Overall:** Credit conditions for borrowers in North America remain under stress, and could worsen further, amid the economic slump in the U.S. and the jump in interest rates.
- **Risks:** In the face of sustained cost pressures and heightened geopolitical tensions, any worsening of the economic prospects, including a steeper-than-expected U.S. recession, could further tighten financing conditions and weigh on credit quality.
- **Ratings:** Rating trends are turning negative. Negative outlook bias has begun to increase after declining for almost two years. We expect the U.S. trailing-12-month speculative-grade corporate default rate to reach 3.5% by June 2023, from 1.4% in June 2022.

**Credit conditions for borrowers in North America remain strained**, and could quickly deteriorate further, amid the economic slump in the U.S. and the sharp rise in benchmark interest rates.

**With the U.S. set to slip into what could at best be a shallow recession** by early next year, the Federal Reserve has effectively pledged to tighten monetary policy to whatever degree it must to rein in runaway inflation. Combined with a pullback by American consumers, this could push the world's biggest economy into a deep downturn. As it stands, S&P Global Economics' base case is for the U.S. to suffer a short and shallow recession (as determined by the National Bureau of Economic Research), with an associated rise in unemployment.

Against this backdrop, **investors are demanding higher returns for the risks they're assuming**. Any chance the Fed had to steer the U.S. into a "soft landing" has all but disappeared, and any perceived policy misstep could roil credit markets and result in a sharper repricing of financial and real assets, higher debt-servicing costs, and tighter financing conditions. This is especially concerning at a time of high debt levels, and could hurt lower-rated borrowers, in particular.

This comes as many corporate borrowers we rate continue to deal with elevated input costs and supply-chain disruptions. 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.

**Credit rating trends are already turning negative**. Downgrades have outpaced upgrades since August, and the negative outlook bias began to increase in the third quarter after declining for

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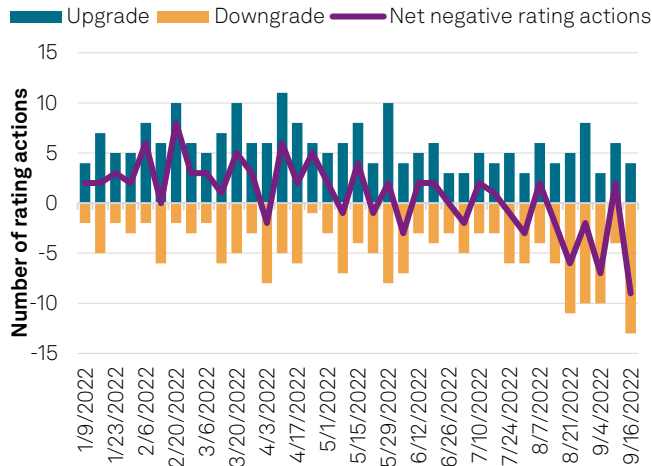
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**Credit Conditions North America Q4 2022: Credit Strains Tighten**

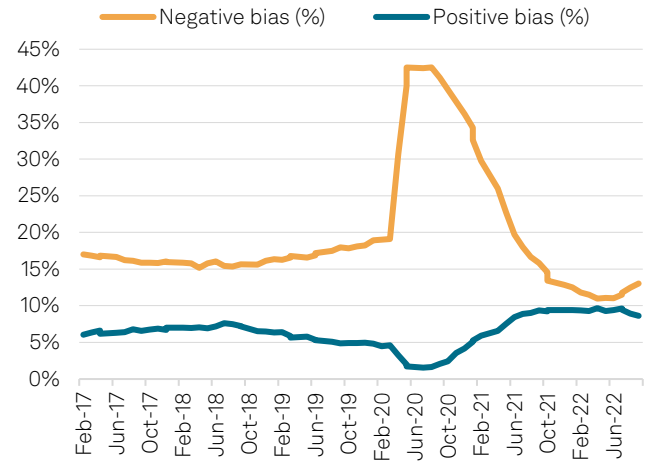
almost two years (see charts 1 and 2). Consumer products continues to lead in terms of negative bias; more than one-quarter of issuers in the sector have a negative outlook or are on CreditWatch with negative implications. Transportation, as well as forest products and building materials, also saw significant increases in negative bias in the recent quarter (see chart 3).

Chart 1  
**North American Rating Actions**



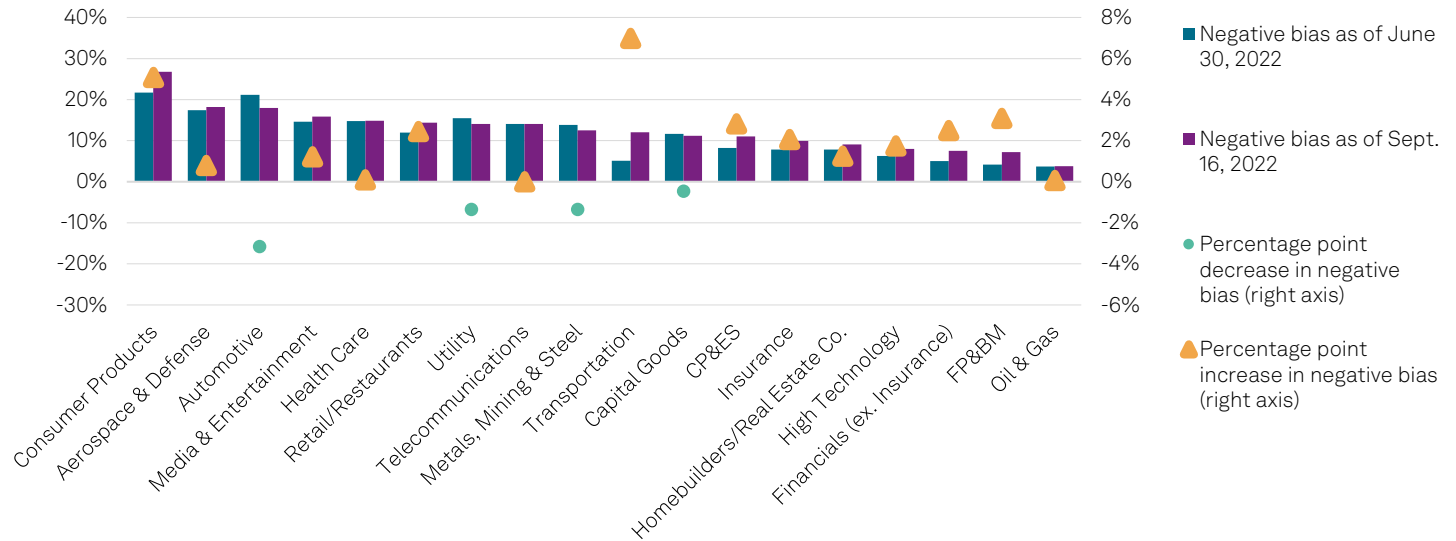
Data as of Sept. 16, 2022, and covers financial and nonfinancial corporates. Source: S&P Global Ratings.

Chart 2  
**North American Ratings Outlook Bias**



Data as of Sept. 16, 2022, and covers financial and nonfinancial corporates. Source: S&P Global Ratings.

Chart 3  
**Negative Bias By Sector**



CP&ES--chemicals, packaging & environmental services. FP&BM--Forest products & building materials. Negative bias--Percentage of issuers with a negative outlook or CreditWatch. Positive bias--Percentage of issuers with a positive outlook or CreditWatch. Source: S&P Global Ratings.

**Defaults, too, look set to tick up**, even with the headroom companies built up during the post-COVID recovery and the solid liquidity positions of most borrowers after highly favorable financing conditions in recent years allowed them to extend maturities. S&P Global Ratings now expects the U.S. trailing-12-month speculative-grade corporate default rate to reach 3.5% by June 2023, from 1.4% in June 2022. While that is lower than the long-term average of 4.2%, this base case would be more than double the current default rate. Much depends on the length, breadth, and depth of the recession.

**The U.S. housing market may have already slipped into a downturn.** The steep trajectory of home-price appreciation that started in 2020 has reversed in many pockets of the country, and S&P Global Ratings believes prices may have reached an inflection point (see [“Changing U.S. Home Price Trajectories Signal Cooldown,”](#) published Sept. 15). According to the Federal Housing Finance Agency (FHFA), five of the nine U.S. census divisions experienced month-over-month home price declines in June; that’s the first time in a decade that five or more U.S. census divisions reported month-over-month declines in a summer month. For U.S. public finance, limited housing supply and rising borrowing costs could translate into slower tax-base growth over time, although the effects of that generally lag, and so governments have time to respond.

Meanwhile, **the office real estate sector has yet to find post-pandemic equilibrium** amid the adoption of the hybrid work model. Landlords are contending with higher vacancy rates, lower rents, and lower values in the next few years—with the growing recession risk adding to pressures (see [“Property In Transition: Slowing Economies And Shrinking Demand Pressure The Credit Outlook For Office Landlords,”](#) published Sept. 12). Negative ratings bias will likely increase for rated office REITs as the credit implications unfold in the next two years given the long-term nature of leases and the diversity of tenants and assets.

For large U.S. banks, exposure to loans collateralized by nonresidential commercial properties, including offices, seems manageable; for regional and community banks, it might be less so. And, for now, delinquencies of commercial mortgage-backed securities (CMBS) backed by office loans remain low, but the class B subsector will face ongoing challenges in the hybrid work environment. Moreover, local governments revenue bases are at risk through lower property-related taxes and fees, particularly if assessed values for office assets go down.

**The recent strengthening of the dollar will benefit some and hurt others.** While drawing capital flows to the U.S., a stronger greenback also means the price of imports is lower for American consumers, and it can help temper input costs for U.S. companies that import raw materials. On the flip side, American companies that rely on foreign markets for the bulk of their sales could suffer. Moreover, a quick or disorderly reversal in the dollar could spur greater volatility in financial markets and spell trouble for companies and investors that are caught off guard.

From the standpoint of fiscal policy, **the U.S. midterm elections bear close watching**, with a host of hotly contested Congressional seats (along with 36 gubernatorial positions) at stake. Current odds suggest control in Washington will be split, with a Democratic president and a Republican House of Representatives—while the outcome in the Senate is a toss-up. This would clearly limit the prospects for major changes in economic policy.

Meanwhile, **the U.S.-China relationship remains uneasy**, with U.S. President Joe Biden recently signing an executive order to limit foreign investment in American tech companies. While the order doesn’t refer to China specifically, the listed technologies are part of the country’s “Made in China 2025” initiative. Any intensification of tensions between the two countries over Russia or the South China Sea region, or an escalation of the technology race, could impede trade, intellectual property, investments, and financial transactions for both and other economies—with some sectors suffering disproportionately.

This comes as the turmoil in the food, energy, and commodities markets resulting from the Russia-Ukraine conflict continues to weigh on growth prospects. Clearly, any escalation of the conflict to include NATO countries, or Russia’s use of a nuclear weapon (at this point a tail risk) would almost certainly throw financial markets—and perhaps many economies—into crisis.

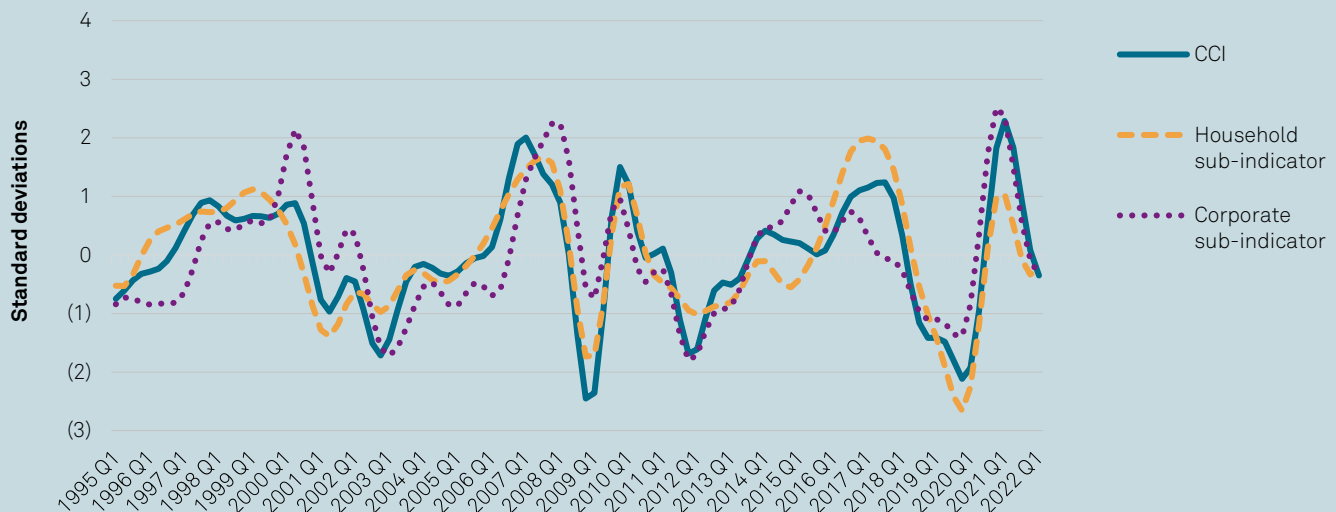
## Credit Cycle Indicator

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

Over five quarters since the fourth quarter of 2019, the North America Credit Cycle Indicator (CCI) trended upwards and reached a peak of 2.3 standard deviations in Q1 2021. This suggests potential heightened credit stress in late 2022 or early 2023 (see chart 4). While the CCI is trending downwards—indicating a 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. For more details about our proprietary CCI, see "[White Paper: Introducing Our Credit Cycle Indicator](#)," published on June 27, 2022.

Chart 4

### Recent Peak In The North America CCI Suggests Heightened Credit Stress In Late 2022 Or Early 2023



Peaks in the CCI tend to lead credit stresses by six to ten quarters. When the CCI's upward trend is prolonged or the CCI nears upper thresholds, the associated credit stress tends to be greater. Sovereign risk is not included as a formal part of the CCI. The CCI period ends in 2022 Q1. The North America CCI includes Canada and the U.S.  
 Source: Bank for International Settlements, Bloomberg, S&P Global Ratings.

**Corporates.** The corporate sub-indicator is declining steadily from the peak of 2.5 standard deviation as of Q4 2020, reflecting slowing credit growth amid momentum of GDP growth. However, the unevenness in the recovery path, persistent cost pressures and supply chain constraints, and tightening financing conditions could exacerbate the debt overhang. Corporates at the lower end of the credit spectrum are particularly vulnerable (see Top North American Risks).

**Households.** The household sub-indicator is also trending downwards. While on average household balance sheets have largely remained healthy thanks to COVID-related stimulus measures and a tight labor market, credit risks could prevail, especially for households in more vulnerable cohorts (lower income or with less liquidity) and as high prices continue to erode purchasing power. In addition, any large fluctuations in house prices could also affect household wealth.

## Top North American Risks

### U.S. economy suffers a deeper-than-expected recession and rising unemployment, amid global headwinds

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

With the Fed effectively pledging to do whatever it takes to bring inflation under control, there's a growing risk that sharply rising interest rates combined with a pullback by American consumers will push the world's biggest economy into a deeper recession than we expect, with a steep rise in unemployment. U.S. GDP has already contracted for two consecutive quarters—meeting a common definition of recession—and with inflation remaining historically high, fears are growing that we will suffer a protracted period of stagflation. Any worsening of economic momentum elsewhere (e.g., a further slowdown in China, contraction in the eurozone) could exacerbate the pain felt in the world's biggest economy.

### Sharp market repricing translates to tighter financing conditions

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

Investors are demanding higher returns for the risks they're assuming amid sustained high inflation and the prospects of a recession. Any chance of an economic "soft landing" have all but disappeared, and any perceived policy misstep by the Fed could roil credit markets and result in an even sharper 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.

### Sustained cost pressures and ongoing supply chain disruptions threaten credit quality

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

High input costs and supply-chain disruptions, exacerbated by elevated energy and commodities prices amid the Russia-Ukraine conflict, continue to plague companies in a number of sectors. Many borrowers have relied on their ability to pass through increased costs to maintain profit margins, but this has become more difficult as high food and energy prices erode consumers' purchasing power and weigh on 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.

### (Geo)political tensions roil markets, weigh on growth and business conditions

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

While most borrowers in North America have limited direct exposure to the Russia-Ukraine conflict, the turmoil in the food, energy, and commodities markets continues to weigh on growth prospects. Meanwhile, the U.S.-China relationship remains uneasy, and any rising tensions between the two countries over Russia or 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. Closer to home, there are several hotly contested Congressional seats (along with 36 gubernatorial positions) up for grabs in the U.S. midterm elections. This raises the possibility that Americans won't know for some time which party will control the House and Senate—especially given the trend of candidates' challenging election results. Beyond the policy ramifications of Congressional control, the uncertainty could exacerbate risk-aversion in financial markets.

## Structural risks

### Cyber attacks disrupt business operations and hurt credit quality

**Risk level**    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 organizations accelerate their digital transformations, 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**    Moderate    **Elevated**    High    Very high    **Risk trend**    Improving    Unchanged    **Worsening**

Larger and more frequent natural disasters increase physical risks faced by public and private entities and threaten to disrupt supply chains such as agriculture and food. Besides, 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. The energy market disruption resulting from the Russia-Ukraine fighting, and concerns about energy supply and security, are adding uncertainty to this transition.

Source: S&P Global Ratings.

**Risk levels** may be classified as moderate, elevated, high, or very high. They 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 are not factored into our base case rating assumptions unless the risk level is very high.

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

# Macroeconomic Outlook

- A recession in the U.S. economy now seems inevitable—likely as soon as early next year. And while the downturn looks set to be moderate, downside risks are growing.
- S&P Global Economics now expects full-year GDP growth of just 1.6% in 2022, and a mere 0.2% for next year.
- Geopolitical uncertainties, weakness in the U.S., and the ramifications of inflation and monetary policies at home will weigh on the Canada’s economy—although we think it will avoid recession.

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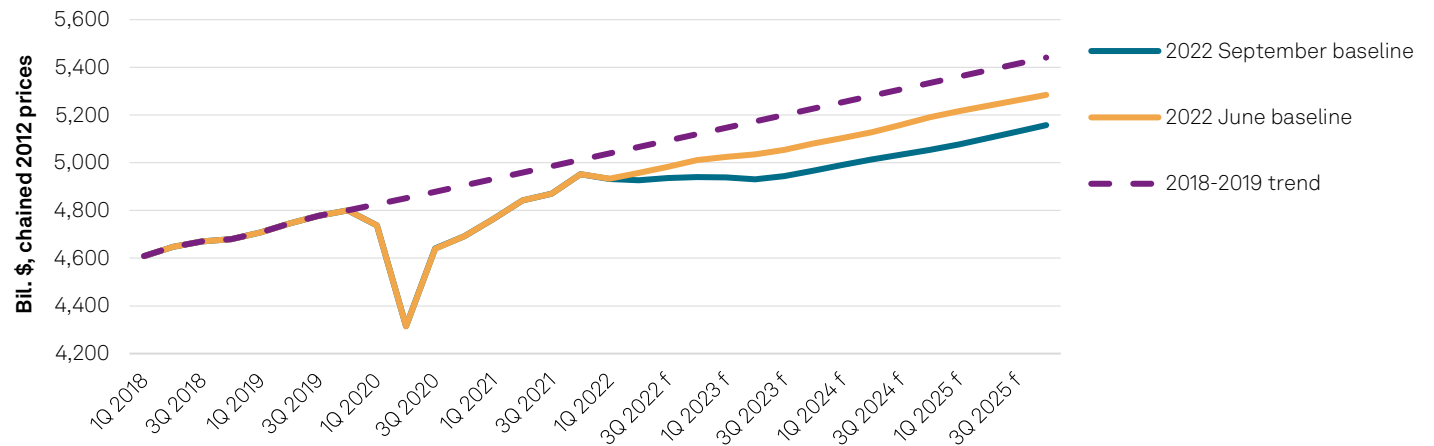
## U.S.

As U.S. economic conditions continue to worsen, S&P Global Ratings Economics believes a recession in the world’s biggest economy is now inevitable—likely as soon as early next year. And while the downturn looks set to be moderate, downside risks are growing. Inflation continues to run hot despite the Fed’s historically aggressive monetary-policy tightening, consumer sentiment has taken a hit, and the housing market—which can fuel spending through the “wealth effect” as home prices appreciate—is slumping. Affordability challenges are hitting many Americans, especially those at the lower end of the income scale, where the so-called marginal propensity to consume (that is, the proportion of income that is spent rather than saved) is higher than among more affluent households.

As it stands, our dashboard of leading indicators signals that U.S. economic momentum has continued to worsen: In August, eight of the nine indicators we track sent negative (six) or neutral (two) signals on near-term growth prospects. In the year preceding the most recent three recessions (in 2001, 2007, and 2020), the proportion of negative or neutral signals in our dashboard surpassed 60%; having 90% of them flashing non-positive signals is an especially strong signal of recession risk in the next 12 months.

Given the consecutive quarters of economic contraction to start the year, S&P Global Economics now expects full-year GDP growth of just 1.6% in 2022, and a mere 0.2% for next year (see chart 5). We expect the federal funds rate to reach 4.0%-4.25% by early next year and for unemployment to rise to 4.8% by the end of 2023.

Chart 5  
 U.S. Real GDP



f--Forecast. Sources: U.S. Bureau of Economic Analysis, S&P Global Market Intelligence, and S&P Global Ratings Economics forecasts.

## Credit Conditions North America Q4 2022: Credit Strains Tighten

While our baseline signals a shallow recession, the risk of a deeper contraction remains. In such a case, the U.S. would continue to suffer high inflation, along with persistent shortages of labor and certain goods, forcing the Fed to tighten policy even more forcefully.

With inflation continuing to outpace wage gains (as it has for 17 consecutive months), purchasing power would deteriorate further. Any savings cushions still left from the pandemic would be quickly depleted, and consumer spending would collapse in mid-2023 into early 2024. Interest rate-sensitive sectors of the economy would suffer immediately, later exacerbated by job losses, with residential investment, for example, falling further. As cumulative Fed rate hikes take hold, the shallow recession of our baseline may deepen and last longer.

For now, conditions suggest that a recession, as defined by the National Bureau of Economic Research, has yet to materialize. The NBER looks at three criteria to determine when a recession has occurred—depth, duration, and diffusion—and the latter of these has yet to be met. Unemployment is historically low, and household balance sheets remain generally healthy, with an aggregate savings rate that, while shrinking, is still historically strong.

### Canada

The likely recession in the U.S., Canada's major trading partner, combined with headwinds hitting household consumption will weigh on the Canadian economy after a healthy first half of the year. While we still expect the world's eighth-largest national economy to post solid growth this year, at around 3.1%, we see GDP slipping to just 1.1% next year (compared with 2.9% and 1.9%, respectively, in our June forecast). Geopolitical uncertainties, weakness in the U.S., and the ramifications of inflation and monetary policies at home will act as hurdles into next year.

And while the jobs market remains tight as more people return to the labor force, there have been net job losses in three consecutive months, and job postings continue to decline. We expect the labor market to weaken modestly in response to tighter monetary policy. We think the unemployment rate, at 5.4% in August (just below the pre-pandemic level), will rise through early 2024, climbing to 5.9%, on average, in 2023, from 5.3% this year.

By the end of this year, the Bank of Canada will likely raise policy rates an additional cumulative 150 bps, to 3.75%. Policy makers will use both monetary tools—rate hikes and quantitative tightening—for as long as excess demand and the tight labor market continue to push prices. We expect the central bank to cut rates starting in second quarter of next year as inflation begins to moderate. Core inflation, excluding food and fuel, is expected to reach the BoC's target of 2.0% by the fourth quarter of 2023.



# Financing Conditions

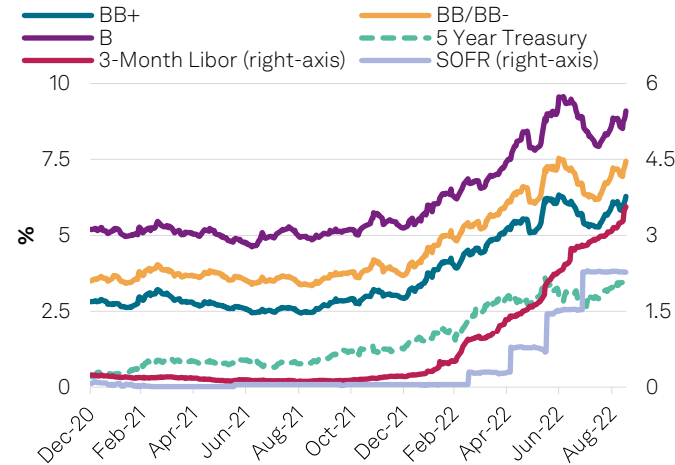
- The view that the Fed might pivot away from rate hikes and either cease or reverse course and lower rates by mid-2023 has proved short-lived.
- Most interest rates are back to or above their June 30 levels. Borrowing costs in the speculative-grade market (both fixed-rate bonds and floating-rate loans) are rising quickly, to well above levels at the end of 2021.
- Still, speculative-grade U.S. companies have reduced the amount of debt coming due through 2023 by \$90 billion (or nearly 32%), having extended maturities during the long stretch of benign financing conditions, locking-in debt for longer terms and at lower rates.

After a stretch in which financial markets grew less pessimistic, with inflation readings seeming to stabilize, the view that the Fed might pivot away from rate hikes and either cease or reverse course and lower rates by mid-2023 proved short-lived. Inflation has surprised on the upside again, forcing policymakers to remain hawkish. Unsurprisingly, most interest rates are back to or above their June 30 levels (see chart 6). Borrowing costs in the speculative-grade market (both fixed-rate bonds and floating-rate loans) are rising quickly, to well above levels at the end of 2021.

Rapidly rising rates have been a major headwind to bond issuance this year. Indeed, “execution risk,” or the risk associated with accepting new debt in an environment of rapidly rising rates, may never have been higher, in the aggregate (see chart 7). The average five-day change in yield on the 10-year Treasury is easily at its highest in more than 40 years this year (5.2 bps). This trend has also been true for investment-grade corporate bonds, making new debt highly unattractive when today’s yield will likely become inadequate a week later.

Chart 6

## U.S. Spec-Grade Corporate Yields Continue To Rise

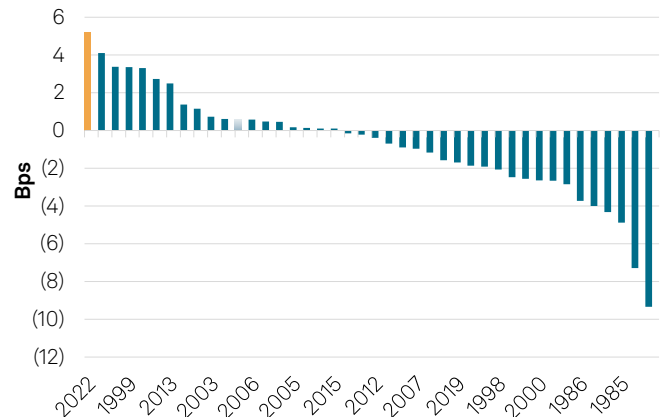


Data through Sept. 16, 2022. Sources: S&P Global Ratings, IHS Global Insight, FRED.

Chart 7

## Rapidly Rising Rates

Average 5-day change in 10-year treasury yield



Source: FRED.

History shows, however, that years of rapidly increasing interest rates tend to be followed by years of quickly declining rates. All else equal, this might be a hopeful guide for 2023, but there’s little to suggest that rates will decline any time soon; markets now expect the federal funds rate to land around 4.25%-4.50% by year-end and remain there at this time next year, while the 10-year Treasury yield is still at roughly 3.5%.

Despite the likelihood of further rate increases and a recession, relative risk assessments remain comparably benign. The VIX volatility index has remained below 30 and the spec-grade spread hit just 444 basis points (bps) as of Aug. 31 (see chart 8). That contrasts with our estimated spread of 650 bps, implying fixed-income investors are likely over-sanguine in their risk assessments.

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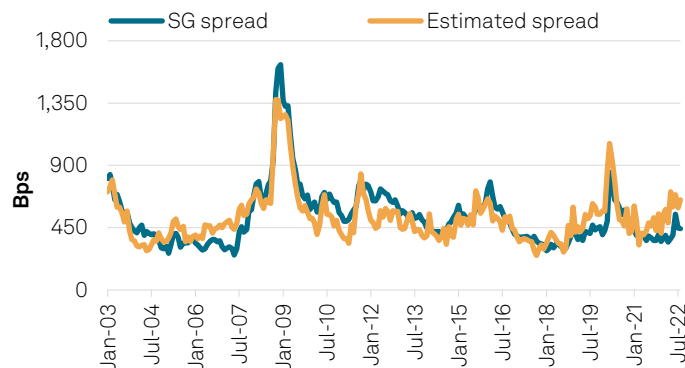
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## Credit Conditions North America Q4 2022: Credit Strains Tighten

While the effect of rising rates on issuance is clear, the impact of quantitative tightening may prove less so. Historically, growth in the Fed's total assets has coincided with similar increases in nonfinancial corporate bond issuance (see chart 9). But even with the central bank's balance sheet shrinking, the decline in issuance has well outpaced the Fed's reduction in asset holdings; corporate issuance this year has been roughly half the level of 2021. Still, corporations have stockpiled large sums of cash after historical issuance in 2020-2021, enabling them to ride out such a volatile funding environment.

Chart 8  
Spreads May See More Widening Ahead



Data through Aug. 31, 2022. Sources: S&P Global Ratings, FRED.

Chart 9  
U.S. Nonfinancial Bond Issuance And Balance Sheet Growth

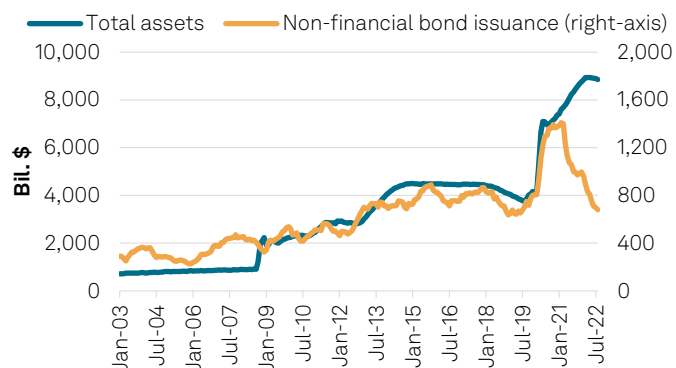
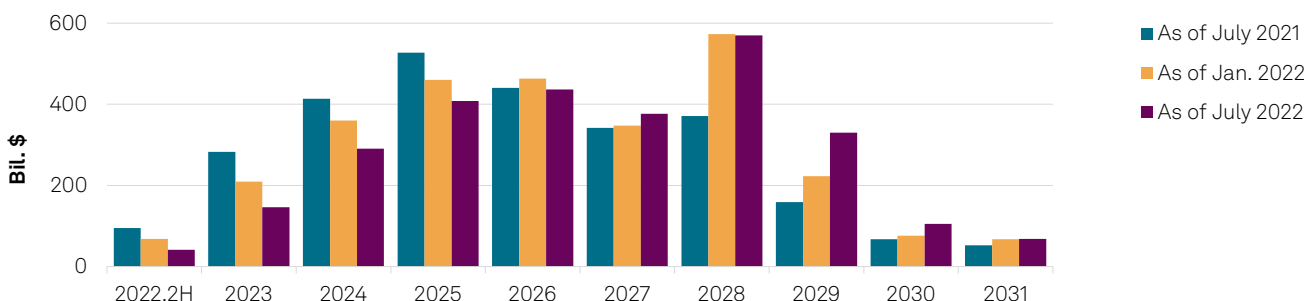


Chart shows trailing 12-month issuance totals and assets held by the Fed. Data through Aug. 30, 2022. Sources: S&P Global Ratings, FRED.

Difficult financing conditions have been especially challenging for speculative-grade borrowers. Combined issuance of leveraged loans and spec-grade bonds plunged more than 50% year-over-year in the first half, to \$284 billion—much steeper than the drop in investment-grade issuance.

Still, spec-grade U.S. companies have continued to chip away at near-term maturities, reducing the amount of debt coming due through 2023 by \$90 billion (or nearly 32%). Companies extended maturities during the long stretch of benign financing conditions, locking in debt for longer terms and at lower rates. As a result, a greater share of maturing debt remains pushed-out into later years, such as 2028, when speculative-grade maturities reach their highest level (see chart 10).

Chart 10  
U.S. Speculative-Grade Nonfinancial Corporate Maturity Wall



Includes bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings as of the respective reporting date. Source: S&P Global Ratings.

Coupled with the refinancing risk is rapidly escalating funding costs. With steep increases in benchmark interest rates, borrowers face higher debt-servicing costs. Borrowers with floating-rate debt outstanding are hit first by the higher rates, followed by companies issuing new, or refinancing existing, debt. With most spec-grade debt outstanding being floating rate (as with leveraged loans), these borrowers are seeing more rapid increases in their cost of funding. Meanwhile, investment-grade borrowers are funded with a higher concentration of fixed-rate bonds and have more time before they feel the pinch of rising funding costs.

## Sovereigns

- With the federal government likely to be divided after the upcoming elections, with a Democratic president and Republicans in control of at least one chamber of Congress, partisan acrimony may limit the prospects of major changes in economic policies.
- This may prevent passage of reforms to U.S. tax laws needed to implement a global minimum tax agreed to by 130 countries last year.
- Continued fiscal deficits will raise the government's debt toward a legal cap next year, likely triggering an impasse in Congress over raising the debt ceiling.

U.S. policy makers will have less room to maneuver due to worsening economic conditions, including high inflation, rising interest rates, and the potential for adverse external shocks (such as further negative developments in the Russia-Ukraine conflict or from new conflicts elsewhere).

Political polarization will remain high in the run-up to mid-term elections in November. But despite this polarization, Congress recently passed the Inflation Reduction Act, allocating \$369 billion to encourage American production of clean energy products and fuel. The law—which includes new spending, new tax incentives, and some increases in corporate taxes—is likely to result in significant cuts in carbon emissions.

The federal government is likely to be divided after the upcoming elections, with a Democratic president and, likely, a Republican House of Representatives—with the outcome in the Senate harder to predict. The results will almost certainly sustain the acrimony between the two parties and may limit the prospects of major changes in economic policies. This may prevent passage of reforms to U.S. tax laws needed to implement a global minimum tax—agreed to by 130 countries last year—that is designed to change rules for taxing large multinational firms, including technology-based firms.

We don't expect major legislative changes before the November elections. As in previous years, political divisions will probably prevent the Congress from passing a new budget for the fiscal year starting on Oct. 1, leading it to pass a continuing resolution to avoid a shutdown of the government. (Note: A shutdown doesn't prevent the U.S. government from paying its debts.)

However, continued fiscal deficits will raise the government's debt toward a legal cap (set at \$41.4 trillion) during 2023, likely triggering an impasse in Congress over raising the debt ceiling. Faster-than-expected growth of government revenues during the current fiscal year will likely delay the moment when the sovereign's debt reaches its authorized ceiling until late 2023, after the midterm elections. The ceiling was last extended in December 2021.

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## U.S. Public Finance

- State and local governments still enjoy strong revenues and have support from federal spending, although inflation and wage pressures could lead to tighter budgets for some.
- Inflation-driven wage increases can lock in cost pressures over the long term and burden operating margins in the short term.
- A volatile stock market makes budgeting more difficult for issuers such as states and higher education, which rely on stock market returns for taxes or earnings.

While a recession is now in S&P Global Economics' baseline forecast, ratings in the U.S. public finance (USPF) sector remain largely stable—despite some spending pressures and growing revenue softness. In general, state and local governments still enjoy strong revenue collections and have support from federal dollars received as part of the American Rescue Plan Act of 2021 (ARPA), although inflation and wage growth pressures could lead to tighter budgets for some in 2023. Given current economic conditions, borrowers that were unable to maintain or grow their reserves during the pandemic could start to struggle with structural budgetary balance.

The autumn storm season has arrived, with hurricanes in the Atlantic and wildfires burning in the Western U.S. While natural disasters have implications for residents and local economies, federal support for governments in the aftermath generally preclude direct effects on credit quality. However, longer-term stability remains contingent on the ability to rebuild after the disaster with timing clearly dependent on the severity of the event.

As recessionary pressures heat up, we'll be watching these factors as they have the greatest potential to affect credit quality, particularly as the pace and duration of the slowdown unfold (see chart 11).

Chart 11

### Key Credit Issues That Matter

#### Wage growth and inflation



Inflation-driven wage increases—particularly if they are included in long-term contracts—can lock in cost pressure over the long term and burden operating margins in the short term; we have already seen some evidence of this in USPF ratings. In addition, higher costs and material shortages continue to hamper capital projects across USPF but have not resulted in a deterioration in ratings. Should these conditions persist and put important capital plans off track, particularly for capital-heavy sectors like transportation and utilities, there could be an effect on credit quality over time.

#### Higher interest rates



Municipal issuance is down, and views are mixed about new issuance volume potentially rising again in 2022. In the meantime, many issuers have funds available to keep capital plans moving, although inflation and lingering supply chain issues could have a dampening effect on how far the money can go.

#### Equity market volatility



A volatile stock market makes budgeting more difficult for issuers like states and higher education institutions that rely on market returns for taxes or earnings. While this cyclical volatility is not uncommon, when combined with a higher recession potential it exacerbates the possibility of budgetary shortfalls in the coming year.

#### Housing market slowdown



Less housing supply and rising borrowing costs for homeowners could filter through to slower tax base growth over time, although the impact of that generally lags so governments have time to respond. S&P Global's base case forecast includes a recession as well as the expectation of a pronounced weakening in the housing market, helping to cool off the double-digit home price increases of recent years.

#### Policy shifts



The mid-term congressional elections are fast approaching and there are also gubernatorial elections in 70% of states. After the November elections we will be watching for policy and regulatory shifts at the national and state level and any potential effect on USPF issuers.

Source: S&P Global Ratings.

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# Nonfinancial Corporates

- The ratings bias for U.S. corporates has doubled to about negative 6%, indicating that our expectations for ratings actions in the next 12 to 24 months are more negative.
- Sectors closest to the end consumer, particularly consumers products, are reporting changes in consumer preferences geared toward countering rising prices.
- We expect geopolitical tensions and health-related lockdowns to continue to hit supply chains with varying effects on companies, depending on how much and how long they can modify their businesses, and the extent to which they can pass on any related costs.

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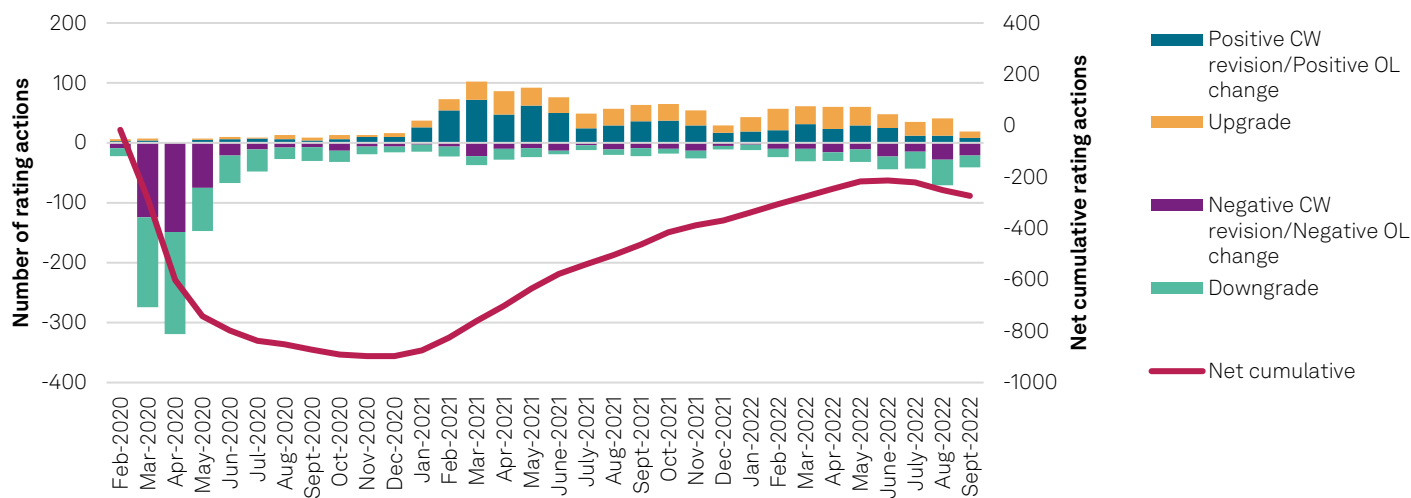
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**Ongoing macroeconomic headwinds are weighing on credit quality.** The wave of positive rating actions that took hold by the beginning of 2021 ended shortly after the conflict in Ukraine began. However, any direct effect on U.S. issuers was limited and uncommon, and ratings largely held. The focus then shifted to domestic macroeconomic concerns as raging inflation, rising interest rates, and a tight labor market all increased costs at a time when demand is beginning to falter.

In July, there was a decided shift toward negative cumulative rating actions (see chart 12). The net outlook bias for North American corporates has more than doubled to negative 5.3% in the past two months, indicating that our expectations for ratings actions in the next 12 to 24 months are more negative as well. Finally, U.S. defaults in August alone accounted for 25% of the regional year-to-date total. This represents a significant uptick and suggests an increased likelihood that defaults will outpace last year's total. Although the number of year-to-date defaults is comparable to those for last year, the vast majority of 2021 defaults had already occurred by this time in the year.

Chart 12

## Nonfinancial Corporates Rating Actions



Rating Actions tracked from Feb. 3, 2020, to Sept. 16, 2022. Net cumulative means cumulation of negative rating actions minus positive rating actions. Positive rating actions include issuers with either an upgrade, positive CreditWatch placement, or positive outlook change while negative rating actions include downgrades, negative CreditWatch placements, or a negative outlook change. Source: S&P Global Ratings.

**It will take time before the effects of macroeconomic headwinds are fully reflected in operating performance.** Heading into this year, both issuers and consumers were well-positioned with low-cost, long-dated debt and strong household balance sheets, respectively. These conditions were enabled by open capital markets and supportive fiscal policies aimed at containing the economic pain of the pandemic. As a result, ratings have remained relatively stable despite increasingly negative economic forecasts. We interpreted a relatively neutral ratings bias as an indication that negative ratings actions would be delayed just beyond the

horizons of the ratings outlooks and limited to lower-rated issuers. Indeed, in the past three months we have seen the ratings bias turn increasingly negative with the bulk of this shift reflected among speculative-grade ratings. As household balance sheets shrink, real wages continue to fall, and equity markets remain tepid, we are beginning to see changes in consumer behavior. Sectors closest to the end consumer, particularly consumers products, are reporting changes in consumer preferences geared toward countering rising prices.

While supply chains are sluggish (see chart 13), changes in consumer behavior can be costly. Some retailers increased their inventory as an effective hedge against finicky supply. Although this decreased the prevalence of the empty shelves that were so common in the early months of the pandemic, it proved a costly strategy when buying behaviors changed, stranding millions of dollars of inventory. We expect geopolitical tensions and health-related lockdowns to continue to weigh on supply chains with varying effects on companies, depending on how much and how long they can modify their businesses to accommodate the current environment, and the extent to which they can pass on any related costs.

**Sectors face unique operating challenges and varying levels of pressures on profitability.**

Different sectors each face their own unique challenges, as demonstrated by the August defaults. The most represented was health care, with about half of those defaults. However, we expect the sector to fare relatively well. The companies in question were all rated 'B-' or below in the year leading up to their defaults, which is a reminder that overall credit quality, regardless of sector, remains the key determinant of default risk.

Chart 13

**Many Sectors Expect Supply Bottlenecks To Linger Till First-Half 2023**

Timeline for supply chain issues to subside



Source: S&P Global Ratings' corporate sector analysts' assessment as of Sept. 20, 2022.

**Oil and Gas; Metals and Mining:** The windfall that accompanied spiking prices at the beginning of the year have moderated. Despite the ability to pass through costs, recession fears and increased supply have curbed topline growth (see chart 14). However, natural gas prices remain high, and the market has become globalized with Europe looking to alternative sources across the globe to replace its Russian supply.

**Airlines; Gaming, Leisure, and Lodging:** While regarded as providing largely discretionary services, borrowers in these sectors continue to perform well. Constrained supply and pent-up demand as economies reopened after the worst of the pandemic have been a recipe for stable cash flows. In many cases, companies in these sectors have been able to shore up liquidity and build cushions above downside triggers. The pent-up demand is most associated with those sectors that were most severely hurt by COVID. As the supply of flights, hotel rooms, and indoor activities trends back toward pre-pandemic levels, financial performance for these issuers will hinge on consumer demand beyond the surge, particularly as costs continue to increase.

**Consumer Products; Retail and Restaurants:** These sectors offer the first signs that consumer demand is responding to the macroeconomic environment; as consumers opt for fewer or cheaper items, it can be a sign of what's to come in the broader economy. The recent decline in gasoline prices hasn't been enough to counter overall inflation. Outputs for these sectors are highly substitutable, and customers are price-sensitive, making it difficult to pass on higher costs. A scenario of a prolonged inflationary environment and sustained supply bottlenecks threatens to squeeze profitability.

Chart 14

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?

	Rise a lot	Rise moderately	Rise a little	Fall a little	Fall moderately	Fall a lot	
<b>Cost Pass-through Ability</b> Question: How easy is it to pass on cost increases?	<b>Very easy</b>	<ul style="list-style-type: none"> <li>Out-of-home entertainment</li> </ul>		<ul style="list-style-type: none"> <li>Metals &amp; mining</li> <li>Regulated utilities</li> </ul>			
	<b>Somewhat easy</b>	<ul style="list-style-type: none"> <li>Airlines</li> <li>Cruise</li> <li>Lodging</li> </ul>	<ul style="list-style-type: none"> <li>Aerospace &amp; defense</li> <li>Unregulated power</li> </ul>	<ul style="list-style-type: none"> <li>Containers &amp; packaging</li> <li>Leisure manufacturing</li> <li>Pharma</li> <li>Technology</li> </ul>	<ul style="list-style-type: none"> <li>Autos</li> <li>Building materials</li> <li>Capital goods</li> <li>Chemicals</li> <li>Engineering &amp; construction</li> <li>Freight transportation</li> <li>Gaming</li> <li>REITs</li> <li>Telecom</li> </ul>		
	<b>Impossible to generalize</b>	<ul style="list-style-type: none"> <li>Oil and gas</li> <li>Oil refineries</li> </ul>			<ul style="list-style-type: none"> <li>Business &amp; technology services</li> <li>Midstream energy</li> </ul>		
	<b>Somewhat difficult</b>				<ul style="list-style-type: none"> <li>Healthcare services</li> </ul>	<ul style="list-style-type: none"> <li>Film and TV programming production</li> <li>Homebuilders</li> </ul>	<ul style="list-style-type: none"> <li>Retail &amp; restaurants</li> </ul>
	<b>Very difficult</b>						<ul style="list-style-type: none"> <li>Consumer products</li> </ul>

Source: S&P Global Ratings' corporate sector analysts' assessment as of Sept. 20, 2022.

## Financial Institutions

- Higher interest rates and low credit costs versus historical norms will be favorable for banks' earnings, tempered somewhat by persistently high inflation.
- Finance companies' overall asset quality remains steady, although there has been modest weakening through an uptick in non-accruals and charge-offs.
- Our stable outlook on the traditional asset managers has become more cautious following the erosion of prior supports (from low interest rates and elevated asset valuations).

### Banks

U.S. banks are poised to benefit substantially from higher interest rates—particularly if an expected recession is short and shallow. We expect that rising rates and low credit costs versus historical norms will be favorable for earnings, tempered somewhat by persistently high inflation. Positively, we believe bank regulation has improved greatly since the 2008-2009 financial crisis, and the balance sheets of U.S. lenders look as strong as they have in many years. The regulatory and supervisory enhancements implemented since the crisis 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. This, in turn, could result in higher ratings on some banks.

Industry banks earnings declined in the second quarter, down about 8.5% from a year earlier, largely due to higher provisions, which were still low compared to historical levels but up from negative levels in the previous year. Noninterest income also remained soft compared to the previous year, particularly in investment banking and mortgage banking. Operating expenses rose somewhat as banks absorbed higher inflation and continued to invest in technology. But net interest margin (NIM) expansion and robust loan growth drove higher net interest income (NII), helping banks somewhat offset some of the other negative trends.

We expect the Fed to continue to raise interest rates, which should in turn continue to boost banks' NIMs and NII. Indeed, we project 15%-20% growth in NII this year. This will help banks absorb an increase in provisions for credit losses, rising expenses, and lower fee income. Specifically, we expect NII to rise almost \$100 billion, while we project provisions to climb roughly \$70 billion-\$80 billion, up sharply from negative \$31 billion in 2021. All in all, we expect the industry to report a return on equity of 9%-10% this year. If economic conditions deteriorate more than we expect, industry return on equity could decline to the mid-single digits, driven by higher provisions.

We expect bank balance sheets to remain strong and capital ratios for many to stay steady due to a combination of uncertainty regarding the economy and the increase in capital requirements for some banks resulting from the June stress test. In addition, unrealized losses in securities portfolios for the largest banks, amid the rising rate environment, are also suppressing regulatory capital ratios generally for those that follow advanced approaches to capital. Separately, we expect funding, which has been historically strong due in part to quantitative easing during the pandemic, to weaken somewhat. The loan-to-deposit ratio started to rise in the second quarter, climbing to a still low 58%. We expect this ratio to gradually increase—particularly as the Fed unwinds its balance sheet, which should result in additional bank deposit outflow.

### Finance Companies

We have stable outlooks on more than 80% of the finance companies (fincos) we rate. In general, while there has been modest weakening in asset quality through uptick in non-accruals and

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charge-offs, the overall quality remains steady. 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—fincos took advantage of favorable financing conditions through 2021 and early 2022 to refinance near-term debt and extend their funding profiles.

We 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 commercial real estate (CRE) finance companies, to stable from negative, and today have a positive outlook on one CRE finance company and stable outlooks on the rest. We think the likelihood of substantial further deterioration in CRE loan portfolios has lessened.

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 are most affected by inflation. We expect weaker earnings for some pay-day lenders. While performance at CRE service companies exceeded expectations amid a stronger-than-expected rebound in capital markets and leasing activity, we expect a modest decline in growth due to macroeconomic uncertainty. Performance at residential mortgage companies continue to be affected by the 30-year mortgage rate, which topped 6%, the highest level since the 2008 crisis. As interest rates continue to climb, mortgage servicing rights valuations are rising, albeit at a slower pace, but origination activity and gain-on-sale margins are falling quickly. We expect market conditions to remain challenging in 2023 and could see further negative ratings actions if weak operating conditions persist.

### Asset Managers

We have stable outlooks on most asset managers we rate, which include traditional and alternative asset managers, as well as wealth managers—despite several negative rating actions this year, in most cases because of higher leverage caused by lower earnings.

Our stable outlook on the traditional asset managers has become more cautious following the continued erosion of prior supports (from low interest rates and elevated asset valuations). We expect market conditions to remain challenging into 2023 and to have a greater negative effect on traditional asset managers (versus alternative or wealth managers) due to the potential for outflows in assets under management. We also expect traditional asset managers to continue to face pressures from secular shifts, including active to passive investing and related fee pressure.

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 manager ratings largely stem from the rapid pace of inorganic, debt-financed growth.

We believe alternative asset managers remain better-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 performance (and realizations) for signs of material slowdown or weakness—particularly in areas that may be more vulnerable to rising rates, such as private equity.

## Structured Finance

- With a recession now in our macroeconomic base case, we expect most North American structured finance asset classes to show slightly weaker or stable collateral performance in the next 12 months.
- For collateralized mortgage-backed securities (CMBS), we maintain a weaker outlook on regional malls, which are still suffering price declines and difficulty refinancing. For the office sector, we see a new equilibrium emerging in the next few years, albeit with lower space demand, values, and rents.
- Our base-case collateral performance and ratings trend outlooks for collateralized loan obligations (CLOs) remain at somewhat weaker/stable.

With an “official” recession now in our macroeconomic base case, we have most North American structured finance asset classes showing slightly weaker or stable collateral performance in the next 12 months (see table 1). Given that our economic outlook shows a muted effects compared with other recessions in recent memory—especially regarding the labor market—we have kept a majority of the rating trends outlooks at stable.

Table 1

### 12-Month N.A. Structured Finance Outlook – Q4 2022

	Collateral performance outlook	Rating trends
<b>Residential mortgages (RMBS)</b>		
RMBS	Somewhat weaker	Stable
RMBS – service advance	Stable	Stable
<b>Commercial mortgages (CMBS)</b>		
CMBS - N.A. conduit/fusion	Somewhat weaker	Stable
CMBS - large loan/single borrower (retail)	Weaker	Stable to negative
CMBS - large loan/single borrower (lodging)	Stable	Stable
CMBS - large loan/single borrower (office)	Somewhat weaker	Stable to negative
CMBS - large loan/single borrower (all else)	Stable	Stable
<b>Asset-backed securities (ABS)</b>		
ABS - Prime auto loans	Somewhat weaker	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
<b>Structured credit</b>		
CLOs	Somewhat weaker	Stable
<b>ABS - Non-traditional</b>		
Timeshares	Stable	Stable
Small business	Somewhat weaker	Stable
Tobacco	Somewhat weaker	Stable
Transportation - aircraft	Somewhat weaker	Stable to negative
Transportation - container	Stable	Stable
Transportation - railcar	Stable	Stable
Whole business	Somewhat weaker	Stable
Triple net lease	Stable	Stable

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

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## Credit Conditions North America Q4 2022: Credit Strains Tighten

For CMBS, we maintain a weaker outlook on regional malls, which are still suffering price declines and much difficulty refinancing. For the office sector, we are expecting a new equilibrium to emerge in the next few years, albeit with lower space demand (on the order of 15-20% lower leasing volume), values, and rents. We expect differences by property quality, for example, class A to outperform class B, and expect differences to emerge by industry, and thus by market. We've also seen some evidence that lending has slowed in the office sector as market participants weigh longer-term outcomes. For office single-asset, single-borrower (SASB) transactions overall, we maintain a somewhat weaker outlook for collateral performance and stable-to-negative ratings outlooks while this picture becomes clearer. On the (more) positive side, we have moved single-borrower lodging transactions to stable/stable (from somewhat weaker/stable to negative), reflecting broad improvement in revenues per available room (RevPAR).

Outlooks are somewhat mixed for asset-backed securities (ABS): non-traditional. Many aircraft ABS began rapid amortization due to breach of triggers around debt-service coverage ratios (DSCR) during COVID, but most deferrals repaid. Performance remains stable for now, although a recession would clearly bring reduced demand for travel. Railcar and container lessors have seen strong demand with high utilization, reflecting a recovery of trade post-pandemic. Whole business and small business ABS are somewhat weaker on collateral performance, but stable with regard to expected rating trends.

Regarding consumer ABS, we have most collateral performance outlooks at slightly weaker. For prime auto loans, this takes into account a forward view of the economy with unemployment increasing to 4.3% by the end of 2023, inflationary pressures, and lower used-vehicle values. However, auto loan losses remain below pre-pandemic levels. In the prime space, we believe they will rise to pre-pandemic levels in the next 12 months. For subprime, we're likely to get back to pre-pandemic levels before year-end. Our rating trend outlooks for both prime and subprime auto loans remain stable to positive.

Likewise for credit card, student loan, and unsecured, we believe asset performance will normalize in 2022-2023 as losses rise toward base case expectations, which generally captures performance through economic downturns. Securitized credit card portfolios are highly seasoned, and private student loan originations maintain a strong credit profile. Therefore, rating trends there are mostly stable. Federal Family Education Loan Program (FFELP) student loans show a bit more uncertainty as a forgiveness plan emerges. Auto lease and commercial ABS (equipment and floorplan) are all stable.

Our base case collateral performance and rating trend outlooks for CLOs remain at somewhat weaker/stable. To wit, exposure to 'B-' remains elevated compared to pre-pandemic levels, while the exposure to 'CCC' and 'CCC' with negative rating outlooks has edged up, but remains well below pandemic peaks. Corporate rating actions on CLO obligors have shifted more negative of late, as August saw the highest monthly count of obligor downgrades since July 2020. That said, our June 2023 loan default forecast—for the LSTA Leveraged Loan Index default rate by issuer count—is 2.0% (base case; range 1.0%-4.25%). Also of some note, portfolio turnover has increased through 2022, as managers trade their portfolios to build par.

On the residential mortgage-backed securities (RMBS) side, market dynamics continue to support a case against significant year-over-year house price declines, although we expect the recently strong appreciation figures to moderate. In other words, high rents (to the extent they drive purchase demand) and undersupply likely somewhat offset higher mortgage rates and a slowing economy. We maintain a somewhat weaker stance for collateral performance overall in the next 12 months, but a stable ratings trend.

# Insurance

- The average financial strength rating for our core North American insurance portfolio—life, health, property/casualty (P/C)—resides at the upper half of the strong ‘A’ category.
- Balance-sheet strength remains a pillar of credit-quality support, protecting against risks related to gloomy economic prospects and any growing subsector risks more specifically.

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There were two rating changes in the three-month period ended August 2022 with no assessed changes to currently ‘satisfactory’ business conditions for North American-focused insurers. We revised our business conditions outlook for P/C downward to ‘somewhat weaker’ from ‘no change’. This follows similar downside revisions for the life and health sectors (to ‘no change’ from somewhat stronger’) in previous quarters this year (see table 2).

Table 2

### North America Insurance Sector Trends – Q4 2022

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	Somewhat weaker	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 cell indicates changes since Q3. Source: S&P Global Ratings.

Overall, the average financial strength rating for our core North American insurance portfolio (life, health, P/C) resides at 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, roughly 78% of our ratings for the core portfolio have stable outlooks. A negative bias emerged for the P/C sector in the quarter, while the life sector shifted to a neutral bias. The modestly positive bias for the health sector was sustained in the quarter. The relatively lower-rated and small mortgage sector portfolio continues to reflect a positive bias.

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

The first half of this year has proved slightly positive for life insurers, albeit not as strong as 2021. Declining COVID deaths and climbing interest rates have supported the profitability of life insurers amid a predicted decline in private equity returns and choppy public equity markets. The chance of a recession has prompted companies in the industry to shift to a more defensive investment strategy, and although rates have been climbing, we are still in a historically low interest rate environment, which does limit longer-term profitability. And although it seems to be on the decline, COVID still introduces a fair amount of uncertainty for life insurers. The industry is well-positioned to handle these risks if they indeed materialize, with healthy balance sheets and

two-plus years of pandemic experience. If the environment turns out to be more favorable and the U.S. manages to avoid a recession, then we expect the positive trajectory of the industry will continue, but most likely in a more subdued format.

The U.S. health insurance industry expects employment growth to bolster commercial membership, though these gains will be curtailed by the tight labor conditions and weakening economic conditions, which may cause some employers to reverse course on hiring (with layoffs in some cases). The federal government will stop paying for COVID vaccines in 2023, which means health insurers will need to incorporate these costs into their pricing and cost structure. On the mergers and acquisitions front, the industry remains active. Health insurers continue to acquire both health plans and health care services companies. We expect the federal government will declare that the “public health emergency” is over next year, which will lead to significant Medicaid membership losses. In August, the federal government passed the Inflation Reduction Act, which will extend enhanced Affordable Care Act marketplace subsidies for consumers through year-end 2025 (a positive for health insurers) and enact various drug pricing reforms (a manageable risk for health insurers and their pharmacy businesses).

Underwriting profitability of U.S. property/casualty insurers remained solid in 2021 and, with some exceptions, through the first half of this year. The industry’s combined ratio for full-year 2021 was 99.6%. Catastrophe losses declined somewhat but this was offset by inflation, particularly in property and auto lines, which have continued this year. Strong rate momentum for most commercial lines continues to exceed loss cost trends, resulting in margin expansion, but are expected to slow, stabilizing margins. Overall, we expect underwriting performance to be somewhat better for commercial lines writers. Offsetting the strength in commercial lines has been deterioration in personal lines, which have come under pressure from the spike in the cost of building materials, car parts, and wages. Capital adequacy has been a relative ratings strength for most P/C insurers. However, the near-term effect of rising interest rates this year has been to erase much of the unrealized capital gains insurers had accumulated in their fixed-income portfolios, which if sustained may weigh on our view of capital adequacy for some. Rising interest rates will gradually benefit net investment income as new money is invested at higher rates.

Our view of the global reinsurance sector remains negative, although we expect underwriting profitability will improve in 2022-2023 in both P/C and life reinsurance. Reinsurers will continue to struggle to sustainably earn back their cost of capital (COC) due to potential heightened natural catastrophe losses, capital market volatility, increasing COC, and high inflation. Elevated natural catastrophes and pandemic losses have severely affected performance but sparked reinsurance pricing increases, which we expect to carry on into the 2023 renewals. Reinsurers’ strategies diverge on natural catastrophe risk, and we believe alternative capital will remain an important pillar in the reinsurance space. Mark-to-market losses will erode capital buffers in 2022, but improving underwriting earnings, increasing investment income, prudent capital management, and sophisticated levels of risk management should sustain the industry’s capital adequacy.

Economic uncertainty and rising interest rates are key business factors that could affect title insurers. However, capitalization in the sector remains robust, benefiting from low losses and a profitable business. After the strong growth in business volume in 2020 and 2021 due to high refinancing volume, we expect premium and escrow fees growth in 2022-2023 to remain flat. Private mortgage insurers (PMIs) continue to benefit from a strong labor market, house-price appreciation, borrower forbearance relief, and adequate capitalization supported by access to reinsurance capacity. The demand-supply dynamics have kept home price appreciation robust (although it has slowed in the recent months), building strong home equity in PMIs’ current loan portfolios.

## Related Research

- [Credit Conditions Asia-Pacific Q4 2022: Brakes On Growth, Pain Down The Road](#), Sept. 27, 2022
- [Credit Conditions Europe Q4 2022: Hunkering Down For Winter](#), Sept. 27, 2022
- [Economic Outlook U.S. Q4 2022: Teeter Totter](#), Sept. 26, 2022
- [Economic Outlook Canada Q4 2022: Canadian Growth To Slow On Higher Interest Rates And U.S. Weakness](#), Sept. 26, 2022
- [Changing U.S. Home Price Trajectories Signal Cooldown](#), Sept. 15, 2022
- [Property In Transition: Slowing Economies And Shrinking Demand Pressure The Credit Outlook For Office Landlords](#), Sept. 12, 2022
- [U.S. Financial Institutions CRE Asset Quality Is Resilient: Long-Term Risks Remain](#), Sept. 7, 2022
- [White Paper: Introducing Our Credit Cycle Indicator](#), June 27, 2022

This report does not constitute a rating action.

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## Appendix 1: Nonfinancial Corporate Sectors Outlook

For analytical contacts, please see Appendix 3.

Table 3

### North America Nonfinancial Corporate Sectors Outlook

Sector	Comment
Aerospace and defense	We expect companies in the commercial aerospace sector to see growth in revenue and earnings in the next few quarters as a recovery in air travel in certain markets drives increased demand for aftermarket parts and services. Demand for new aircraft will likely exceed supply into next year, particularly for narrow-body planes that serve shorter routes. Widebody production is increasing more slowly, reflecting lagging recovery in international travel. Boeing also faced an extended hold on 787 deliveries that was lifted in August when the Federal Aviation Administration signed off on changes to address manufacturing quality issues. 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. We view the sector as somewhat insulated from recession risk, given pent-up demand for new aircraft and constrained supply. Air travel is more sensitive to recession, and reduced demand would result in lower aftermarket sales for OEMs, component suppliers, and service providers. In addition to recession risk, supply chain constraints persist in limiting aerospace and defense companies' ability to meet demand fully. Defense demand is supported by an increase to the fiscal year 2022 U.S. budget and fiscal year 2023 budget proposal, as well as increased spending by European allies in response to the Russia-Ukraine conflict, but won't begin generating higher revenue until at least next year. Certain sectors already considered key (intelligence, reconnaissance, cyber) will be even more in demand.
Autos	In our base-case scenario, credit metrics should stabilize to pre-pandemic levels by late 2023 as most companies will look to preserve liquidity, maintain prudence on reinstating dividends and share buybacks, and limit large debt-financed acquisitions. Though volumes and cash flows in the second half of this year and into 2023 will improve compared to last year, we expect margins and cash flow generation to be constrained due to pricing pressure amid potential demand volatility once the supply gradually normalizes. In terms of downside scenario, we don't anticipate substantial downgrades as ratings for several are already below pre-pandemic peaks. While these companies have increasingly focused on reducing debt, cost increases will add downside risks to several, especially if cost reduction prospects appear limited (see "U.S. Auto Companies Face A Tough Road Ahead With Persistent Supply Challenges And Weakening Macro Conditions," published July 19).
Building materials	While second-quarter results for rated building materials issuers were mostly positive given order backlogs, we expect slowing revenue growth for the sector over the next year. Demand is cyclical and a housing cooldown will pressure demand for materials used in remodels and renovations. In addition, weaker consumer confidence driven by inflation can also reduce spending on repairs and remodels. Currently, 88% of ratings in the sector have stable outlooks.
Capital goods	The credit outlook in U.S. capital goods is generally steady, with cracks forming among smaller issuers hit by high costs, materials availability, and tight labor markets. The negative outlook bias is rising toward 10% after stabilizing earlier in the year, with solid demand and generally good pass-through of higher costs. Profit performance is diverging more, as costs and supply chains test pricing power and manufacturing agility. Further, our assumptions for strong backlogs converting into profitable revenue could be tested by rising interest rates for capital-intensive equipment buyers, high-cost inventories, and 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. Commodities costs remain elevated, however, with persistently tight conditions for inputs like some metals and semiconductors. Most strikingly, financial sponsors added debt last year to some of the lowest-rated issuers based on the assumption of robust earnings growth that now faces cyclical pressure.
Chemicals	Credit risks are rising with early reporting by a few companies of weakening demand, and no relief in sight from elevated raw materials pricing. Weakening demand is a key risk, and although we don't yet have definitive evidence that the weakness is widespread, there is reason to believe that the chance of a recession increases the likelihood that demand across many subsectors will eventually weaken. If demand declines, companies' pricing power will diminish at a time when input-cost inflation still exists. This could weaken EBITDA margins. About 40% of our rated companies have a debt-to-EBITDA ratio that is lower than our target at the rating. Such strength in credit metrics should cushion, at least for a while, the negative effects of any demand weakness. As always, companies at the bottom of the credit scale have less cushion and are more vulnerable. Some subsectors such as agrichemicals are exhibiting solid fundamentals, with strength in demand and constrained supply driving up prices to record highs. EBITDA at some companies has jumped by 100%-200% in the past two years among stronger fertilizer companies.
Consumer products	Inflation in commodities inputs, transportation, packaging, and labor continues to be a headwind. Supply constraints are also continuing to limit capacity in pockets. Now the sector is facing new challenges: 1) consumers are pulling back discretionary spending to account for inflation and 2) retailers are cancelling orders in face of weakening consumers. Discretionary categories, especially those that benefited during the pandemic or so called "COVID categories" such as home goods, appliances, exercise equipment, casual attire, have weakened as consumers shift spending to travel and



	<p>in-person gatherings, and curtail some discretionary spending. Compounding this underlying shift is retailers' response. Most retailers invested in inventory in late 2021/early 2022 as a cushion to supply chain bottlenecks. As consumer behavior changed, many retailers were left with excess inventory and as a result reduced orders. The effect on credit quality has been felt across the board, but for lower-rated entities with limited financial flexibility, especially smaller companies with less product diversity, the impact has been greater. We expect these headwinds to continue until inflation subsides and retailers work through inventory overhangs. Meanwhile, packaged food companies benefit from being non-discretionary and therefore are more effective passing on inflation.</p>
<p>Containers and packaging</p>	<p>We have a stable outlook for sector. Packaging companies have been performing well despite some operating challenges from supply chain, labor availability, and across-the-board inflation. Spot adjustments and contractual cost-pass-through mechanisms have been working their way through the top line, which have helped to expand EBITDA margins from depressed levels last year. As we expect moderation in raw material pricing in the second half of the year into 2023, we believe issuers will have to maintain a balance in giving some of the raw material pricing back while pushing through other inflationary costs. In addition, the rising interest rate environment could prove a challenge, particularly to lower-rated issuers that have significant portion of variable rate debt. Refinancing risk remains a significant factor for these issuers as well, particularly for those that have maturities coming due over the next 12 to 18 months.</p>
<p>Gaming, leisure, and lodging</p>	<p>Consumers spent big on vacations and leisure activity this summer. Ratings are largely stable because cash flow trends have been in line or better than our base case forecasts, leading to good cushion in ratings leverage thresholds across much of the sector. While it is likely the shift in spending to experiences from products may continue for a while longer, the summer surge in travel and leisure volumes and strong rate in hotels, cruise, theme parks and other leisure activities may begin to moderate if consumers' willingness to spend on travel and entertainment going into 2023 is hit by reduced accumulated savings and continued high inflation. Acceleration in business transient and group travel in the fourth quarter could partially replace the moderation in summer leisure demand. Business transient demand in the second half of this year could be equal to 2019 levels, contributing to the lodging industry's continued overall revenue recovery. We are incorporating a moderation in rate in our forecasting beginning in 2023 because at some point the leisure consumer is likely to pull back on the rate or ticket price, they are willing to pay. We are also 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, fuel, and other costs are rising. A combination of rate moderation and higher fuel and other costs could slow cruise operator's ability to dig out from under mountains of pandemic debt. While the middle and high-end consumer across leisure remains very strong, the low-end gaming customer spend may be softening and bears watching. Also, robust margin improvement in regional gaming markets may be unsustainable if operators increase marketing and labor costs to compete with other leisure alternatives that are fully reopened. In addition, outdoor leisure activities benefited significantly from the pandemic and have been pulling back this year as the economy continued to open up.</p>
<p>Health care and pharmaceuticals</p>	<p>Our outlook on services remains stable, but on shakier ground, given inflationary pressures, especially for labor. While labor costs have moderated, they will likely remain elevated in the longer term, putting pressure on providers' ability to pass along costs to payors. Pandemic concerns, while receding, remain a wildcard in terms of impact on patient volumes and procedures, which still have only recovered to near pre-pandemic levels. Implementation of transparency and "no surprise" billing legislation may potentially cause some turmoil as well.</p> <p>The outlook for pharma remains stable and should remain so into next year, given continued strong margins, moderate inflationary cost pressures, sales growth following normalization of patient volumes post-pandemic, and a relatively quiet M&amp;A front. The Medicare drug price negotiation provision in the Inflation Reduction Act will be a drag on future industry growth and the effects may be felt more by select pharma companies, but implementation is years away and will be gradual. Still, it has implications for the industry from a research and development, product portfolio, and pricing strategy standpoint, and may lead to a much more active, and credit-negative, M&amp;A front in the near future.</p>
<p>Homebuilders</p>	<p>Second-quarter results from rated homebuilders showed a deceleration in operating momentum. We believe the sector has reached peak gross margins, which we expect to decline over the next several quarters given slowing housing demand, an increase in cancelation rates, and persistent cost pressure from supply chain issues. To continue to drive momentum, builders have been offering more incentives (from almost no incentives a year ago) which are accounted for as a reduction in the sale price of the homes, pressuring profitability. Some builders have pulled financial guidance for fiscal year 2022 as the operating environment is becoming more uncertain given sharply higher mortgages rates and a weaker economic outlook. We are seeing an uptick in cancelations as consumers reconsider their home purchases, and we expect builders to slow orders given weaker demand amid supply constraints. The positive ratings bias declined, from 40% to 33%, in the last quarter.</p>
<p>Media and entertainment</p>	<p>Our sector outlook remains negative. The media sector continues to perform better than our expectations, but a weakening economy isn't a good sign for near-term sector performance as media depends heavily on cyclical consumer and advertising spending. Advertising remains solid thus far, especially for television and billboards, which benefit from longer lead terms. Television is benefitting from the start of the football season, which generates high demand from global advertisers and from recovering ad categories (travel, entertainment) and new ad categories (streaming, sports betting) which more than offsets 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, advertising visibility remains limited, and bottom-of-the-funnel transactional advertising (digital, social media, and radio) has weakened. The sector has shifted focus for its direct-to-consumer video streaming services toward profitability (versus subscriber growth) and led by Disney, has started to raise prices aggressively. However, this strategy may backfire as already financially stressed consumers may reduce the number of services for which they sign up. At the same time, media companies continue to increase spend on film and TV content for their streaming services, which will pressure EBITDA and cash flow, at least until these services reach</p>

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).

Metals and mining	Credit quality is stabilizing at a stronger level, but prices are dropping for most metals, and profits will likely weaken in 2023 from the recent spike. That said, the buffer appears good for an inevitable downturn in this highly cyclical sector, because many issuers strengthened credit quality with disciplined capital spending and debt reduction over the last 3-5 years. Even if sentiment and demand weaken, output for many metals remains constrained by elevated energy costs and declining ore grades. Prices have dropped sharply from record levels, but generally remain above their long-term averages. Meanwhile, growing credit buffer contributed to the most upgrades in a decade in the capital-intensive metals and mining industry, but now we expect good cash flows will be directed more to corporate development and shareholder returns than debt reduction, considering recent capital spending restraint and a favorable long-term 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 sector's credit quality continues to exhibit strength, given strong commodities prices and demand, partly due to the Russia-Ukraine conflict and a rebound from the effects of the pandemic. 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 hasn't 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 will 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 have retreated recently largely reflecting concerns about recession and the on again/off again COVID lockdowns in China. However, several factors support oil prices not staying below \$75 for long in a mild recession, given that global inventory levels remain supportive; the U.S. will still remain disciplined bowing to the whims of investors to not over produce and we expect that will continue into next year as we do for gas; no resolution to the Russian-Ukraine conflict any time soon, maintaining that political price premium; and OPEC remaining supportive on the supply side, and even if they wanted to increase production, there is limited spare capacity to do so. Natural gas prices have become globalized with regional gas prices piggybacking the record high TTF, which shows no signs of abating. Likely gas prices remain at elevated levels because Europe, even after getting through the winter will pull LNG wherever they can find it, but slated LNG capacity will not address much of this demand until 2026.
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 shuttered refiners is unlikely to work as companies seek to achieve greenhouse gas-reduction goals, and the significant cost in doing so even if that 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	While overall operating results for rated REITs in the second quarter were mostly positive, we expect slowing revenue growth in the next few quarters as consumer spending weakens and the impact of rate hikes take hold. We think retail REITs could see some pressure from retail tenants holding bloated inventory levels amid weaker consumer demand. This could result in a deterioration of tenant quality and a growing tenant watch list after a period of stabilization. For the office sector, we expect a slow pace in employees returning to office and a deteriorating job market to dampen demand for office real estate over the next year. Currently 85% 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	Shifting consumer behaviors continue to buffet the retail sector. In 2021 and into this year, retailers strategically built inventory to levels that could absorb intermittent hiccups while meeting elevated demand. Now retailers are saddled

	<p>with excess inventory that consumers no longer want because they are tightening their budgets or shift spending to social activities that they missed during the pandemic, such as traveling and dining out. Some large retailers have revised downward guidance multiple times this year as they struggle to anticipate consumer demand (e.g., Target, Kohl's each 2x). The promotional environment that plagued retail before the pandemic has returned as retailers need to mark down prices to move excess inventory. This dynamic is especially true for retailers offering discretionary products and those that enjoyed a pop during covid (e.g., hobbies, home decor, basic apparel). Retailers catering to lower-income demographics report weakening demand. At the same time some discount retailers are reporting consumers trading down (e.g., dollar stores, Walmart). Most high-end retailers have fared better as their consumers are less hurt by inflation. Grocers have benefited from the inflationary environment, passing elevated costs (and then some) to shoppers.</p>
Technology	<p>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 zero-COVID 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 become more challenging 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.</p>
Telecom	<p>Overall, the outlook for U.S. telecom and cable is modestly negative, although the industry is fairly recession-resistant relative to other sectors. Inflationary pressures are resulting in higher costs while consumers are extending their payments, contributing to higher DSOs in some cases. In wireless, we see competitive intensity to increasing as carriers try to differentiate their 5G capabilities. Macroeconomic headwinds could prompt increased switching activity and customers look for value. Further, aggressive spending in recent auctions pushed up leverage for some service providers, reducing overall financial flexibility if operating conditions worsen. 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 in 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 fiber goals.</p>
Transportation	<p>The outlook varies from sector to sector. U.S. airlines continue to see strong bookings, despite the slowing economy. Ticket pricing has cooled a bit but is still above 2019. The big question is: How this will hold up now that we are past the peak summer season? The ongoing business travel recovery, which may gain as more employees return to the office, and the reopening of various overseas markets provide some support. We think that these positives will be offset by belt-tightening by consumers and corporations (which tend to squeeze T&amp;E as one of the first responses to weaker demand). In that event, the trend of improving revenues could slow sharply, though remain positive year-over-year (aided in the fourth quarter of this year and first quarter of 2023 by easy comps against omicron-affected quarters a year earlier). Had the economy not slowed and risk of recession increased, we likely would have changed some airline rating outlooks to positive and upgraded one or two, but for now almost all outlooks are stable.</p> <p>Freight transportation companies are exposed to the slowdown in spending on goods, but the picture varies across sectors. Package express companies boomed during the second half of 2020 through 2021 as quarantined consumers relied on e-commerce to deliver goods. Although the long-term trend toward e-commerce remains intact, package volumes have pulled back some this year. Slowing spending on goods affects logistics companies, a category that ranges from warehouse providers to truck brokers (which connect companies seeking transportation with those providing it), as well. Trucking freight rates, which soared with strong demand and supply chain shortages, have cooled, though they remain above pre-pandemic levels.</p> <p>Railroads, with a diversified traffic mix, didn't benefit as much from the boom in consumer goods, particularly as their mostly fixed network capacity couldn't handle the surge. But they are also less vulnerable on the downside. The outlook for traffic varies by commodity.</p>
Unregulated (merchant) power	<p>Power prices have moderated some but remain elevated at nearly twice their previous levels. 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 as they purchase more expensive wholesale power during contract extensions.</p>

## Appendix 2: Economic Data and Forecast Summaries

Table 4

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

	2021	2022f	2023f	2024f	2025f
Real GDP (year % ch.)	5.7	1.6	0.2	1.6	1.9
Real consumer spending (year % ch.)	7.9	2.4	0.7	1.9	2.1
Real equipment investment (year % ch.)	13.1	6.8	(0.8)	(0.9)	0.5
Real nonresidential structures investment (year % ch.)	(8.0)	(11.6)	(5.4)	(1.7)	(1.6)
Real residential investment (year % ch.)	9.2	(9.9)	(10.4)	4.3	4.6
Consumer price index (year % ch.)	4.7	8.3	3.7	1.6	1.4
Core CPI (year % ch.)	3.6	6.2	3.8	2.0	1.6
Unemployment rate (%)	5.4	3.7	4.3	5.3	5.7
Housing starts (annual total in mil.)	1.6	1.6	1.5	1.5	1.5
Federal funds rate (%)	0.1	2.2	4.0	3.1	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: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, the Federal Reserve, S&P Global Market Intelligence, and S&P Global Ratings Economics' forecasts.

Table 5

### Canada – S&P Global Ratings Economic Outlook

	2021	2022f	2023f	2024f	2025f
Real GDP (year % ch.)	4.5	3.1	1.1	1.9	2.1
Consumer price index (year % ch.)	3.4	6.7	4.2	1.2	2.0
Core CPI (year % ch.)	2.8	5.2	2.8	1.6	1.8
Unemployment rate (%)	7.4	5.3	5.9	5.7	5.5
Government of Canada 10-year bond yield (%)	1.4	2.6	3.0	3.0	3.1
Bank of Canada policy rate (%)	0.3	3.8	3.1	2.4	2.2

Note: All "year % ch." are annual averages percent change. Core CPI is consumer price index excluding energy and food components. f--forecast. Sources: Statistics Canada, S&P Global Market Intelligence, and S&P Global Ratings Economics' forecasts.

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