

Asia-Pacific Sector Roundup Q1 2023

Cracks In The Wall

November 14, 2022

This report does not constitute a rating action

Key Takeaways

- **Confluence of headwinds.** Asia-Pacific is fighting on four fronts: the global economic slowdown, high inflation, rising interest rates, and weakening currencies. China is contending with subdued growth amid its COVID policy stance and real estate sector woes. And some sectors and issuers in the region are feeling the heat from rising geopolitical tensions (e.g., Asia-Pacific tech firms amid the U.S. Chips Act). These risks are forming cracks in Asia-Pacific's credit wall.
- **A greater divide.** Monetary policy remains divergent across Asia-Pacific central banks. Most continue to hike rates to slow inflation and stem capital outflows; China and Japan are exceptions. Concurrently, domestic currency depreciation has created winners and losers. The region's exporters benefit from being competitive, but midstream and downstream sectors dependent on imported materials could see costlier inputs, denting margins. The ability to pass through input costs will differentiate corporate sectors.
- **Higher financing, tighter liquidity.** The availability of and access to financing could tighten as investors and lenders turn more selective. Demand for higher yields and a strong U.S. dollar could intensify debt burdens, particularly for offshore borrowers. To cope, borrowers could turn onshore by tapping bank loan facilities and domestic capital markets. While banks could see higher interest income from such loans, the economic downturn may entail higher loan-loss provisions.
- **Negative net rating outlook bias.** Risks remain firmly on the downside, underpinning the net rating bias at negative 3% as of October 2022. China's COVID policy and property sector downturn have hit consumption and discretionary spending. Vulnerable industries remain real estate developers and mobility-dependent sectors (such as leisure, retail, and transport infrastructure).

Global growth sputters. The slowdown in the U.S. and Europe has had repercussions for China's growth, collectively denting business and consumer confidence. Weaker global demand will hit Asia-Pacific producers' export activities and corporate revenues. This will have knock-on effects for the region's governments that are dependent on export activity, slowing the growth outlook. Amid increasing economic uncertainties, consumers could turn more selective with discretionary spending, further dragging economic growth.

Tight financing conditions. Narrow financing access and spikes in borrowing costs could hurt borrowers, compounding headwinds amid an increasingly uncertain and volatile economic environment. Five-year bond yields across the region have generally risen since early 2022, tracking that of the U.S. (see chart 1). Financiers and investors could start to demand higher yields commensurate with the credit risks undertaken.

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Rating headroom may narrow for some issuers as constrained access to funding or more selective lending terms threaten their liquidity and debt-servicing ability. The stronger U.S. dollar also compounds the debt burdens of issuers with significant foreign currency borrowings. Also, Japan's yield curve controls, in a bid to boost inflation, have led the Japanese yen to slump. While a weak yen could enhance competitiveness for Japanese corporates, offshore borrowings could turn costly for issuers (including the Japanese sovereign).

Margin squeeze. Global commodity prices may soften, in view of subdued external demand; but widespread currency depreciation across the region (see chart 2) means prices in domestic currency terms have not retreated as much. Thus, input prices may continue to sting. The slower global growth outlook and soft domestic consumption point to weak business and consumer confidence, impeding producers' ability to pass-through higher input costs to consumers.

Building materials, chemicals, and capital goods are among the sectors notably vulnerable to margin squeezes. In consumer discretionary sectors like hotels, gaming, leisure, and retail, consumers could become more selective with their discretionary spend. That said, softer domestic currency helps with export competitiveness. Concurrently, the commodity and energy exporters could benefit from a windfall given the strong dollar.

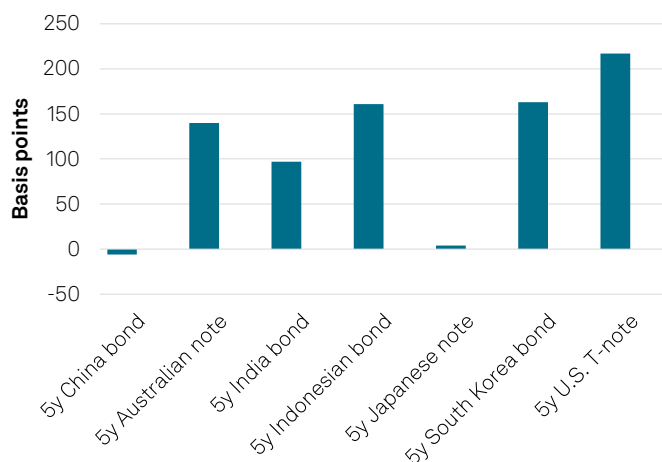
China's weaker growth. Given the winter flu season and rising COVID cases across the country, we don't expect a meaningful lifting of COVID restrictions until after March 2023. The pace of easing mobility restrictions will be very gradual. Restrained mobility and still-weak property market are hurting business activities and domestic consumption. Also, souring relations between the U.S. and China are exacerbating the pressures on chip makers and supply chains. Weak land sales, reduced tax revenues, and COVID-containment costs in China will intensify fiscal strains faced by Chinese local and regional governments (LRGs).

Rating outlook bias. The region's net rating outlook bias is stable at negative 3% (as of October 2022) (see table 1). Given slower global growth, attributable to that of U.S. and Europe, slower export activity will knock the region's 2023 economic outlook. Most of the region's issuers would see downside credit pressures intensify because of the uncertain external environment and elevated input and borrowing costs.

Chart 1

Asia-Pacific government bond yields diverge

Change in 5y government bond yields since March 15 (bps)

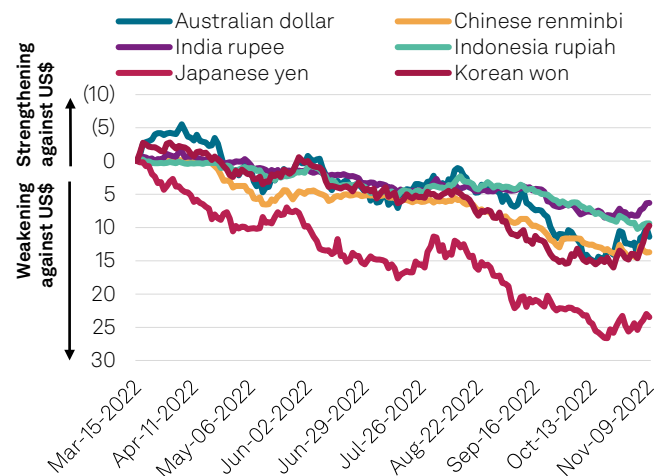


Data as of Nov. 9, 2022. 5y--5-year. bps--Basis points.
Source: S&P Global Market Intelligence.

Chart 2

Downward pressures abound for Asia currencies

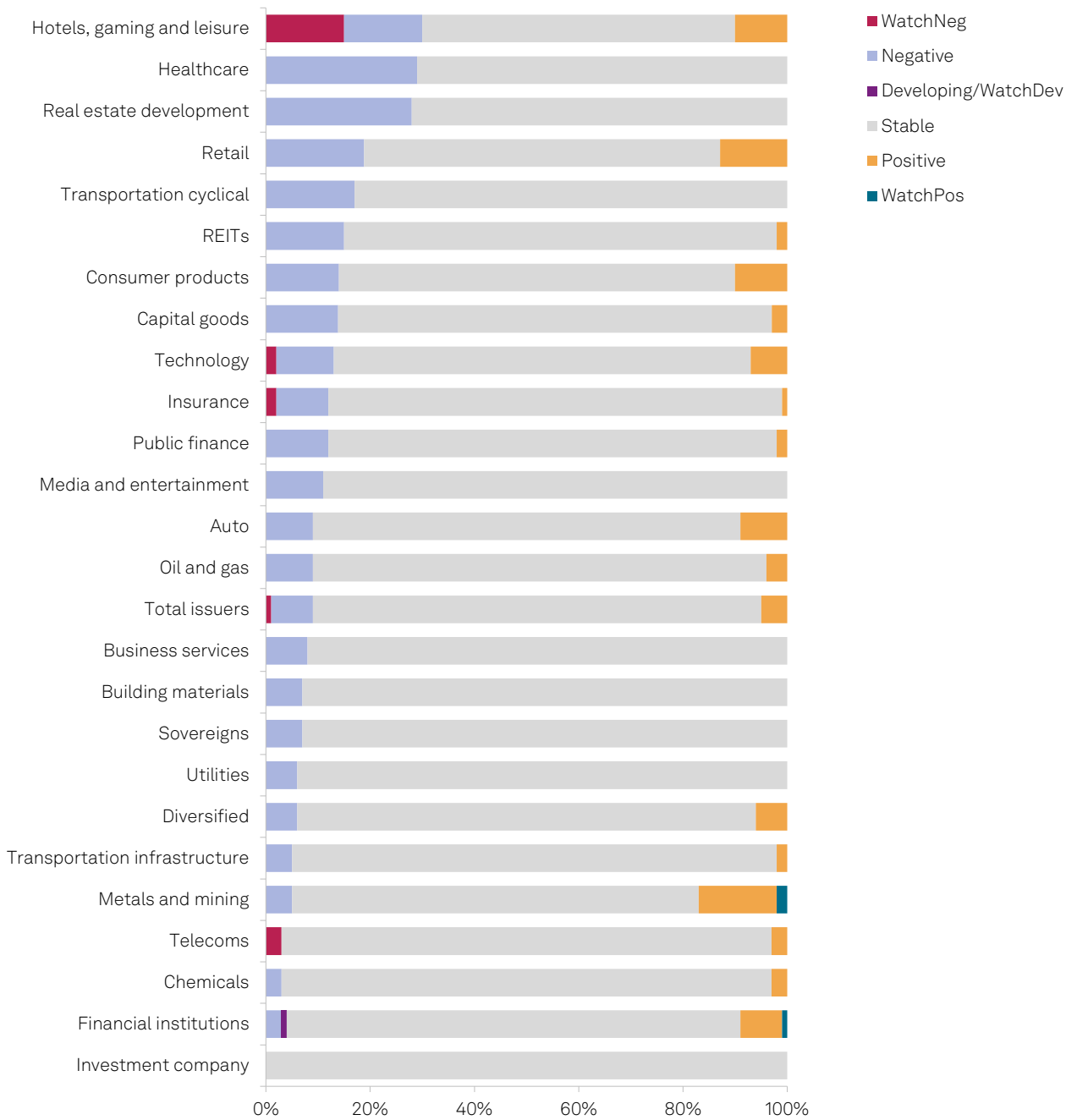
Percentage change from March 15 (%)



Data as of Nov. 9, 2022.
Source: S&P Global Market Intelligence.

Chart 3

Outlook distribution of Asia-Pacific issuers by sector



Note: Data cut-off is at October 31, 2022.

Source: S&P Global Ratings.

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Table 1

Net outlook bias of Asia-Pacific issuers by sector, Oct. 31, 2022

	Oct. 2021	Feb. 2022	May 2022	Aug. 31, 2022	Oct. 31, 2022	No. of entities	Notional average rating
Auto OEM and suppliers	-12%	-3%	-3%	0%	0%	34	BBB
Building materials	-6%	-7%	-14%	-8%	-7%	14	BBB-
Business services	-25%	-23%	-17%	-15%	-8%	13	BB+
Capital goods	-17%	-29%	-19%	-11%	-11%	37	BBB
Chemicals	-7%	0%	0%	3%	0%	34	BBB
Consumer products	-4%	-8%	-11%	-4%	-3%	29	BBB
Diversified	13%	20%	0%	0%	0%	16	A-
Healthcare	-14%	-11%	-22%	-13%	-29%	7	BB
Hotels, gaming, and leisure	-20%	-19%	-24%	-15%	-20%	20	BB+
Investment company	0%	0%	0%	0%	0%	8	A-
Media and entertainment	-20%	-20%	-20%	-22%	-11%	9	BBB+
Metals and mining	11%	9%	9%	11%	12%	59	BB+
Oil and gas	-21%	-26%	-17%	-9%	-4%	23	BBB+
Real estate development	-18%	-32%	-39%	-32%	-28%	32	BB+
Real estate investment trusts	-12%	-12%	-13%	-13%	-13%	52	BBB+
Retail	-29%	-31%	-19%	-6%	-6%	16	BBB
Technology	0%	0%	-2%	0%	-5%	55	BBB-
Telecommunications	-21%	-7%	-10%	-10%	0%	31	BBB
Transportation cyclical	-11%	-11%	-17%	-17%	-17%	18	BBB-
Transportation infrastructure	-8%	-7%	-10%	-3%	-4%	57	A-
Utilities	-5%	-4%	-5%	-6%	-6%	95	BBB+
Total corporates	-9%	-9%	-10%	-7%	-6%	659	BBB
Financial institutions	1%	3%	-1%	3%	6%	389	BBB+
Insurance	-1%	-3%	-2%	-11%	-11%	176	A
Public finance	-14%	-13%	-13%	-12%	-9%	86	AA-
Sovereign	-7%	-7%	-7%	-7%	-7%	29	BBB+
Total issuers	-5%	-5%	-7%	-5%	-3%	1,339	BBB+

Note: We calculate the net outlook bias by deducting the percentage of negative outlooks and CreditWatch negative listings against the percentage of positive outlooks and CreditWatch positive listings. A minus figure indicates that the former exceeds the latter, and a positive figure, vice versa. OEM--Original equipment manufacturer.

Teal colored cells indicate improvement from prior period, red, deterioration.

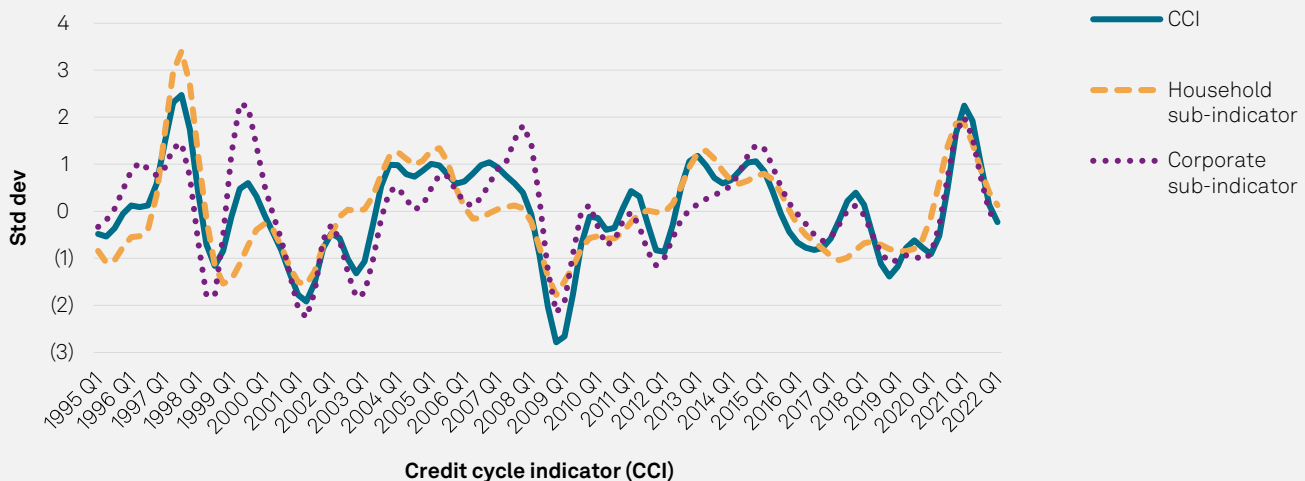
Credit Cycle Indicator

Credit Correction Is Underway As Credit Cycle Indicator Trends Down

The Asia ex-China, ex-Japan Credit Cycle Indicator (CCI) reached a peak of 2.2 standard deviations in Q1 2021. This suggests potential heightened credit stress in late 2022 or early 2023 (see chart 4). The CCI is trending downwards, indicating a credit correction is underway, but 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 Asia ex-China, ex-Japan CCI suggests heightened credit stress in late 2022 or early 2023



Note: Peaks in the CCI tend to lead credit stresses by six to 10 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.
Source: Bank for International Settlements, Bloomberg, S&P Global Ratings.

Corporates. The corporate sub-indicator has come down as of late, on the back of corporates across the region reining in borrowing. That said, with interest rates rising in the region, any unexpectedly sharp or sudden upward movements could exacerbate the interest rate burdens of corporates. Japan is especially vulnerable to this as the central bank has opted to keep rates low, in contrast with the rest of the region (except China). Japan's gross corporate debt is climbing up in recent quarters, supported by the country's deliberate efforts to keep interest rates flat--contrary to that of the Fed.

Overall corporate indebtedness in the region is a key risk. For Asia-Pacific corporates, the ratio of nonfinancial corporate debt to GDP rose to 125% as of June 2022 from 85% in June 2007 (pre-global financial crisis). This points to potential credit strains to come. Finally, some groups of corporate borrowers (especially highly indebted small and mid-sized enterprises) can still face risks to creditworthiness since their revenues and earnings have yet to fully recover to pre-pandemic levels.

Households. This decline in the household sub-indicator reflects a slower pace of household borrowing. In the face of a weaker and increasingly uncertain economic environment, households are demonstrating more caution and limiting discretionary spending. Meanwhile, pockets of high property prices could face correction given the economic downturn. Concurrently, with interest rates rising across most of the region, larger mortgage repayments could further strain discretionary spending.

Amid these challenges, Asia's savings habits could still offer some reprieve. In parts of the region, aggregate household financial savings may exceed household debt. However, cash distribution could vary wildly across households with different degrees of indebtedness. Credit risks could still prevail, especially for those in more vulnerable cohorts (lower income or with lesser liquidity).

Macroeconomic Outlook

Growth continues in a challenging environment

- We expect a slowdown in 2023 as weakening global growth creates headwinds for exports. Nonetheless, resilient domestic demand should keep GDP growth significant.
- With inflation generally less of a problem than in the U.S., interest rates will likely lag those in the U.S., maintaining pressure on FX markets.

The global outlook is subdued. We expect growth in the U.S. and the Eurozone to be only 0%-0.5%. In the U.S. and Europe, inflation remains a major issue. We expect the U.S. Fed to continue to raise its policy rate into 2023. This is leading to exchange rate adjustments and capital flows, globally.

China's recovery in Q3 masks weakness. The economic data for Q3 surprised on the upside, with industrial production growth rising in September and GDP growth being relatively strong. This poses upward risks to our forecast for growth in 2022 of 2.7%. However, organic growth remains weak and sentiment weak amid a broadly unchanged COVID stance and a property downturn.

China's growth should pick up somewhat in 2023. We assume another Shanghai-style lockdown can be avoided and the government will start to gradually and meaningfully lift COVID restrictions after 1Q 2023. We anticipate growth will improve next year, but weak export demand and property weakness could be drags. Further delays in relaxing the COVID stance are the biggest risk to our 4.7% growth forecast for 2023.

The work report presented at China's 20th Party Congress in October suggested a broadly unchanged approach to economic policymaking, with a continued focus on growth and market-oriented reform. But there was a lot of emphasis on various aspects of security.

Growth in the rest of Asia-Pacific is holding up relatively well. Slower global growth and higher interest rates are a headwind. But most economies in the region have been able to overcome these, in part because of ongoing domestic recovery from earlier COVID weakness.

The slowdown in 2023 will vary across the region. Economies where exports matter a lot (e.g., South Korea and Taiwan) are more exposed to the global slowdown. In economies such as India and the Philippines, the recovery from COVID weakness still has further to run. Growth will be hit more strongly where interest rate increases or other policy tightening bites heavily. This points to Australia, New Zealand and, again, South Korea. In all, we project South Korea will see the largest slowdown in 2023, with India and Indonesia likely to experience a relatively modest slowdown.

While inflation has risen, it is generally less of a problem than in the U.S. That is largely why in many Asia-Pacific economies interest rates have lagged those in the U.S.

Hawkish U.S. Fed interest rate increases have triggered capital outflows. Together with worsening current account positions in net energy importers this is putting pressure on currencies. Exchange rate depreciation has absorbed most of this pressure. But foreign reserves have fallen in Asian emerging markets, even after adjusting for large valuation changes.

The pressure on Asian forex will be maintained into 2023 as the US Fed continues to raise its policy rate. Exchange rates are particularly vulnerable if monetary policy remains relatively accommodative, such as in Japan, or the current account has worsened substantially, as in net energy importing economies. Most of Asia is better prepared for pressure from high U.S. interest rates than during the taper tantrum and the Asian financial crisis. Macro policy has improved and more borrowing is in domestic currency. However, vulnerabilities exist, notably in emerging markets with rising current account deficits.

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Financing Conditions

Tight financing conditions restricting access to markets

- Sustained global rate hikes, weak currencies and reduced risk appetite continue to make borrowing in offshore corporate bond markets more expensive for Asia-Pacific issuers.
- Regional lenders' cautious risk appetite and central banks' policy rate hikes, though at a slower pace relative to the U.S. Fed, contributed to higher local currency financing costs for issuers.
- Rapidly tightening financing conditions both onshore and offshore have severely restricted market access for lower-rated issuers.

Global central bank actions have continued to drive up regional external financing costs.

Expectations for terminal U.S. interest rates continue to climb while the Fed still attempts to tame inflation. The markets are pricing in a terminal Fed funds rate of above 5% as of early November. With lower inflation pressures, Asia-Pacific central banks are generally hiking at a slower pace relative to the U.S., and the resulting unfavorable yield differentials have kept capital outflows and currency depreciation at the forefront for the region. Most Asia-Pacific currencies are 10%-20% weaker against the dollar, with the yen having depreciated almost 30%.

These developments along with reduced risk appetite are combining to make external borrowing significantly more expensive. Already, Asian dollar bonds have seen yields go up over 400 bps year-to-date for investment-grade, and nearly 1,200 bps for high yield.

Local currency funding costs have not been spared. Five-year local currency benchmark yields across the region are mostly up 100 bps-300 bps year-to-date. Local currency corporate bond yields have risen sharply in recent months, with many rising by 50 bps or more since September alone. This is driven not only by recent global developments in global rates and risk appetite but also by further expectations of policy rate hikes by Asia-Pacific central banks as they begin to see inflation pressures beyond energy and food prices. The effect on local currency lending has been uneven, though.

Notable exceptions to rate hikes could include the People's Bank of China, which is likely to retain an accommodative stance, and the Bank of Japan; they are the only major central banks that retain negative rates. In other jurisdictions, bank lending is still available, and rates on those are even taking a while to pass through in terms of policy rate hikes in some cases. For others like Korea, securities markets are beginning to show signs of a liquidity crunch.

Rising funding costs and high investor hesitancy continue to translate to low market access for speculative-grade issuers. Total bond issuance for the year (including local and foreign currency deals) has been only slightly weaker than 2021's record volume. However, much of this is happening in large local currency markets where easy monetary policy has been the exception (China and Japan). In offshore markets, issuance has been at its lowest point in the past five years. The bulk of this issuance has been by well-known and relatively higher-quality borrowers.

Speculative-grade deals have been few and far between all year long. As such, the continuation of tight financing conditions in this segment will increasingly pose key refinancing risks, given that roughly half of speculative-grade bonds (both onshore and offshore) are coming due before the end of 2025.

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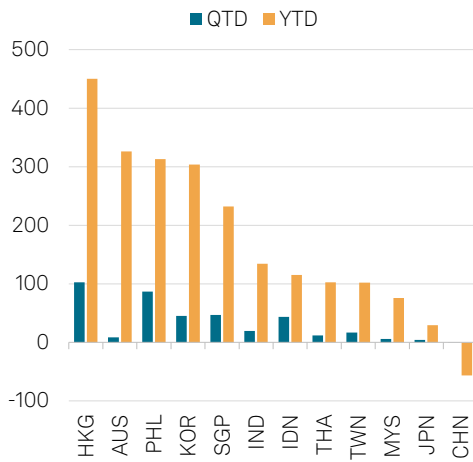
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Chart 5a

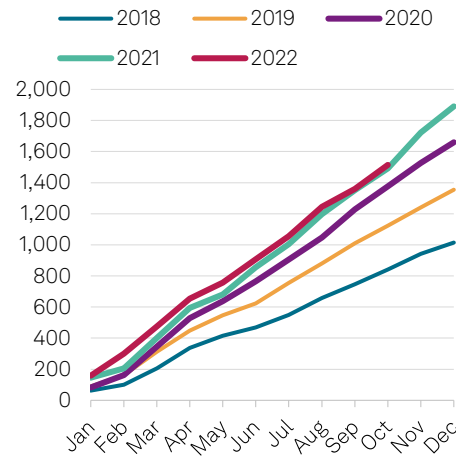
Local currency corporate bond yields
Changes in L.C. corp bond index YTM, bps



Note: Data as of Nov. 4, 2022. L.C.--local currency. YTM--Yield to maturity. QTD--Quarter to date. YTD--Year to date. bps--Basis points. Source: S&P Dow Jones Indices, S&P Global Credit Research & Insights.

Chart 5b

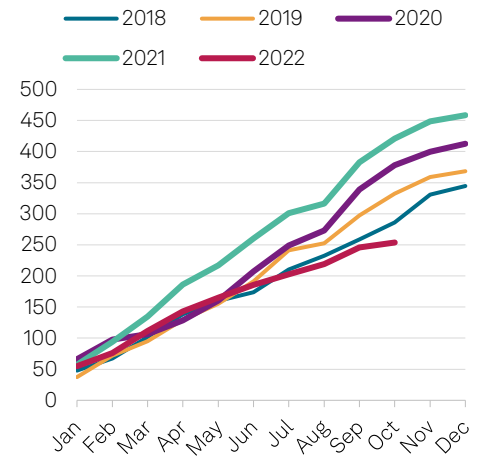
Local currency issuance
Cumulative issuance, bil. US\$



Note: Data as of Nov. 4, 2022. Includes financial and non-financial corporates incorporated in Asia-Pacific. Source: Refinitiv; S&P Global Credit Research & Insights.

Chart 5c

Foreign currency issuance
Cumulative issuance, bil. US\$



Note: Data as of Nov. 4, 2022. Includes financial and non-financial corporates incorporated in Asia-Pacific. Source: Refinitiv; S&P Global Credit Research & Insights.

Auto

Carmakers and suppliers to drive through demand uncertainty

What we expect over the next 12 months

- The creditworthiness of most rated Asia-Pacific auto companies will likely remain stable over 2023, on slight margin improvement and sufficient financial headroom.
- We expect modest volume growth, fewer pandemic-related disruptions, softer commodity prices, as well as continued internal restructuring for some producers to ease the margin pressure for carmakers.
- Electrification will progress steadily and weigh on margins and cash flow of original equipment manufacturers (OEMs). The performance of auto manufacturers in this segment will be increasingly important for their competitiveness and financial performance.



Primary credit analyst

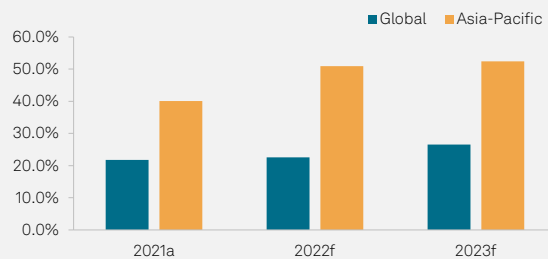
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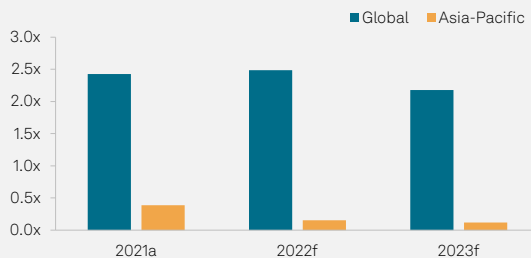
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast. Source: S&P Global Ratings.

Downside risks...

Subdued economic prospects. We assume China will gradually ease its stance on zero-COVID policy after March 2023. A lack of or later-than-expected relaxation may constrain economic recovery and consumption. Persistently high inflation and energy shortage in U.S. and Europe could cause protracted slowdown.

Supply chain bottleneck. The global auto supply chain remains vulnerable to external shocks, including pandemic-related disruptions, extreme weather, and geopolitical events.

Cost inflation. The inflationary environment in the U.S and Europe will keep production, labor and logistics cost high for manufacturers. While auto makers generally see less inflationary pressure, electric vehicle producers may still suffer from elevated battery costs, with lithium prices at an all-time high.

... and what they mean for the sector

Demand uncertainty. We expect China's light vehicle sales to rise 0%-2% in 2023, after our estimated 4%-6% growth in 2022. The 3%-8% sales recovery for 2023 in the U.S and Europe reflects a low base and pent-up demand. Weaker economic growth in these key markets could hurt business sentiment and consumption.

Margin and cash flow pressure. Our base case envisages slight improvement in the supply chain and operating efficiency of rated issuers. Prolonged chip shortage will weigh on margins and working capital. Carmakers and suppliers that have higher exposure to the U.S and Europe may see higher cost pressure than other regional peers that focus more on the local markets. OEMs that are progressing more rapidly in electrification could face greater difficulties in bringing margins back to pre-pandemic levels.

Building Materials

Asia-Pacific producers to brace for market volatility

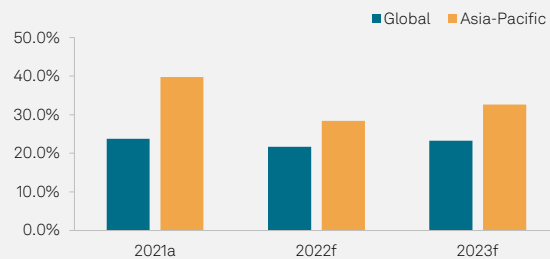
What we expect over the next 12 months

- The creditworthiness of most rated Asia-Pacific building materials companies will stay stable over 2023, given a sufficient financial buffer to weather through uncertainty on demand and profitability.
- Chinese producers face persistent downside risk on financial performance, due to a weak property sector and economic outlook. The Korean market will likely turn weaker after a robust 2022. Rising interest rates and waning housing prices as seen in the recent months could continue to weigh down demand.
- The Australian market will be the most favorable in the region. This is supported by strong residential activity on a material backlog over the near-term and healthy public sector investment.

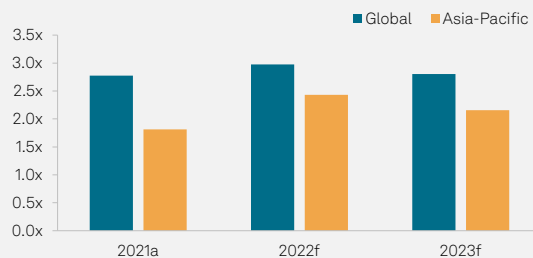


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Downside risks...

Weak economic prospect for China and rising interest rate outside of China. We assume a subdued 2023 economic growth in China, given the still-weak property sector. This comes despite our expectation that zero-COVID policy could ease after March 2023. Outside China, the macro risk largely comes from the higher interest rates that could subdue the property sector.

Ongoing supply chain constraints. The industry could continue to face raw material shortages due to a supply chain bottleneck following the pandemic disruptions, geopolitical events, and extreme weather events.

Input cost inflation. This includes higher fuel prices and power costs driven by the Russian-Ukraine conflict, and higher labor costs. Thermal coal is the major energy source for building materials producers and is subject to high price volatility on supply constraints and geopolitical risks.

... and what they mean for the sector

Demand pressure. Subdued economic growth and low property new launches in China will continue to hit construction activities and thus the demand for building materials. Supply chain constraints for the rest of the region could cause construction delays and limit demand growth for building materials.

Margin squeeze. Still-high raw material and fuel prices will likely pressure building material companies' profitability. Companies' focus on managing costs through operational efficiencies and execution of price increases is key to mitigating input cost inflation. Chinese players could have a weaker cost pass-through than peers in the rest of the region on more subdued demand and oversupply.

Capital Goods

Demand weakening is increasingly likely

What we expect over the next 12 months

- We expect the earnings and profit growth to slow down due to inflation and weakening economic activities in and outside Asia-Pacific.
- Key risks include recession-related slowdowns in capital spending by corporate customers.
- Demand outlook and the degree of margin protection, as well as cash flow management, will be key drivers for credit quality.



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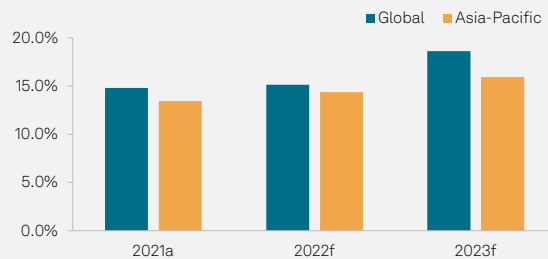
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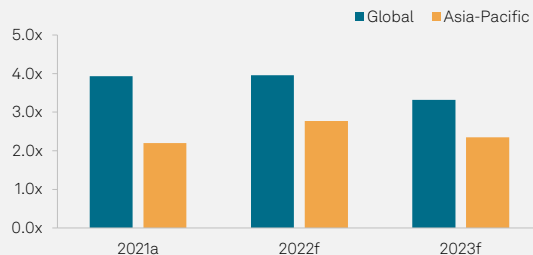
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Downside risks...

Weakening economic activities and demand slow down. The economic slowdown in China, and protracted recessions in the U.S. and Europe, could spill over to Asia-Pacific. Weaker economic activities could depress corporate investment sentiment, slowing capex investments (especially semiconductor and auto sectors).

Inflation will dampen profit growth. Increasing costs due to higher materials and logistics costs would dampen the growth in profits. Capital goods companies' ability to pass the increased costs to customers is tested.

High spending but weaker cash flow. Capital expenditures (capex) and spending for shareholders' return are likely to increase for capital goods companies, at least in 2022. But EBITDA and cash flow would be eroded due to inflation or weaker macroeconomy, potentially leading to weaker credit metrics.

... and what they mean for the sector

Margin erosion. We do not believe capital goods companies in Asia-Pacific, especially in Japan, can pass on most of their cost increases to customers, given harsh competition. A lowered ability to pass on costs, together with weaker demand and sales, will result in reduced profitability.

Cash flow management. Given our continued expectations of a weaker economic environment, we assume capital goods companies will tighten working capital management and control discretionary spending, such that the industry's ratio of debt to EBITDA may improve in 2023. However, if a recession is prolonged, the ratio may stay as the same level as in 2022.

Chemicals

A steeper downturn will test financial cushion

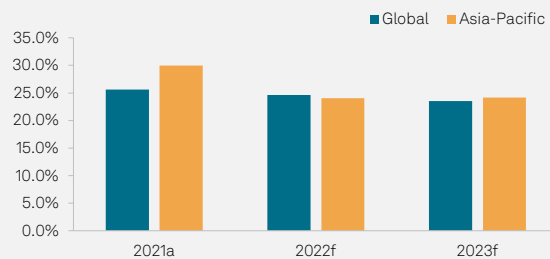
What we expect over the next 12 months

- Supply could outpace demand, given a slowing economy and capacity additions in China, as well as weaker exports from Asia.
- Feedstock costs could remain high for crude oil-based chemical companies in Asia, leaving them in inferior positions against gas-based chemical companies in the Middle East and the U.S.
- Companies that are more exposed to commodity chemicals could see product spreads narrow most.

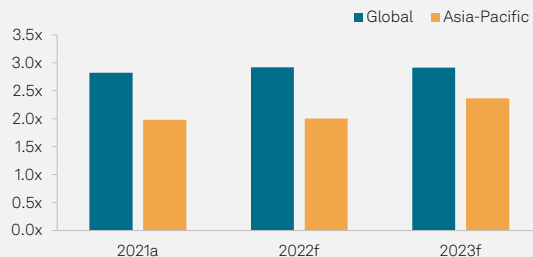


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Downside risks...

Weaker chemical demand. A severe downturn in global GDP could weaken exports and consumption in Asia, undermining demand for chemicals.

Weaker cost pass-through ability. Chemical companies, especially commodity producers, may not be able to pass-through rising input costs. Greater supply, particularly in China, and imports from low-cost producers could suppress Asian chemical companies' pricing power.

Rising debt. Weaker profitability, high cash dividends, and continued capital spending will increase debt, reversing a trend of deleveraging since 2021.

... and what they mean for the sector

Weaker-than-expected profitability. The decline in chemical companies' profitability is likely to be steeper. We now forecast that the sector's profitability could fall to about or slightly below the average of past cycles in 2022 and 2023.

Sufficient financial buffer for now. Strong balance sheets after a very strong 2021 are likely to be sufficient to cushion weaker profitability and higher debt.

Rising downside risk. Downside rating pressures could rise due to the growing uncertainty in the global growth under high inflation and interest rates. The steeper and longer market downturn in Asia will diminish most rating buffers, particularly for companies that have high exposure to commodity chemicals.

Consumer Products

Weak sentiment to stay

What we expect over the next 12 months

- Consumer sentiment to remain weak.
- Bipolarization of products to continue as consumers turn cost conscious or look for differentiation.
- Slower recovery could prompt to earnings downside and thinner rating buffers.



Primary credit analyst

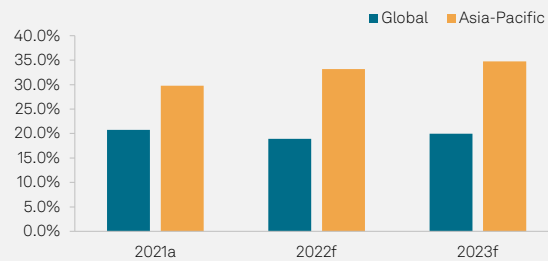
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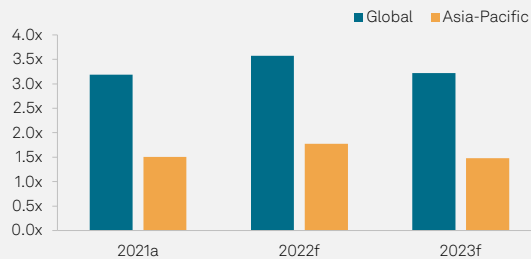
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



Note: All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast. Source: S&P Global Ratings.

Downside risks...

Consumers tighten discretionary spend. Slower GDP growth in the region reflects a weaker economy and spending power. This has a dampening effect on discretionary spending.

Competition escalating. Companies need to have a clearer product value proposition amid softer demand, in our view.

Souring financing conditions. Growing refinancing costs from unfavorable exchange rates and higher interest rates will test companies' financial policy and capital structure management.

... and what they mean for the sector

Raw material cost hike to ease somewhat but remain elevated. Weakening Asia-Pacific currencies against the U.S. dollar add to inflation for firms relying on imported ingredients. Inflationary pressure will be acute for firms with a high material input cost structure, and a weak ability to pass on cost increases, particularly price takers and weaker brands.

Promotions and discounts to manage accumulated inventory. Limited margin improvement for the sector with companies looking to lower inventory accumulated from higher safety stocks and weaker sales.

Lowering revenue and profitability forecasts. Rating buffer could be squeezed further with lower forecasts and higher financing costs. Weakening credit profiles--particularly for those with limited ratings headroom--could see negative rating action.

Financial Institutions

Downside risks endure

What we expect over the next 12 months

- Weaker economic growth and higher inflation could strain asset quality.
- Banks are showing some resilience thus far, as indicated by most bank outlooks being stable. Should economic and financing conditions deteriorate materially, negative ratings momentum would seem inevitable.
- Stand-alone credit profiles of financial institutions in New Zealand may face downside risks.



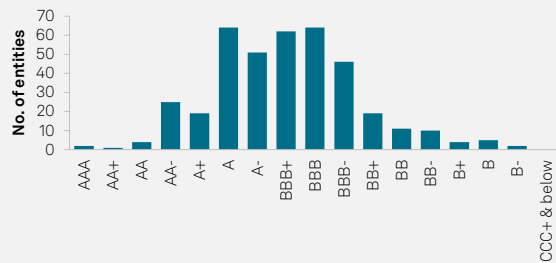
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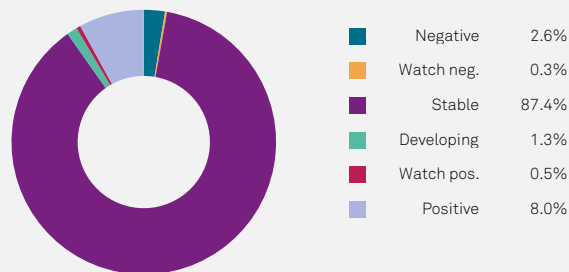


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Rating distribution



Outlook distribution



As of October 31, 2022. Source: S&P Global Ratings.

Downside risks...

Macro headwinds. The weaker economic growth, higher interest rates, tighter financial conditions and weaker currency across many jurisdictions will increasingly strain borrowers and their lenders.

High leverage. Highly leveraged corporate, household, and government sectors in many jurisdictions pose risks. Higher interest rates will particularly test banks' mortgage portfolios in countries where leverage is high. These jurisdictions include Australia, New Zealand, Thailand, Malaysia, and Korea.

Property market stress in China. About 40% of Chinese developers are in financial stress. Defaults could rise. Also, suspension in mortgage repayments by some borrowers, if not contained, could manifest into systemic risk.

... and what they mean for the sector

Strain asset quality. Net interest margins for most financial institutions are benefitting from higher interest rates. However, worse than anticipated headwinds would dampen credit demand, pressurize SMEs that are still healing from the impact of the pandemic, and push highly leveraged consumers to the edge of default.

Negative economic trend in New Zealand. Most banks across Asia-Pacific have some resilience at current rating levels, supported by capital buffers and buildup in provisioning coverage. While the stand-alone credit profiles of financial institutions in New Zealand may face greater challenges, systemically important banks still have stable outlooks supported by highly rated parent banks.

Increasing divergence. Considering the weaker economic outlook, the gap could potentially widen between relatively stronger and weaker financial institutions.

Gaming

Road to recovery for Macao remains bumpy, amid macro headwinds and regulatory risks

What we expect over the next 12 months

- Gaming revenue across most Asian markets should largely recover to pre-pandemic level in 2023, except for Macao.
- China's stringent COVID restrictions could continue to cloud Macao's recovery.
- Regulatory risks persist across Asia.



Primary credit analyst

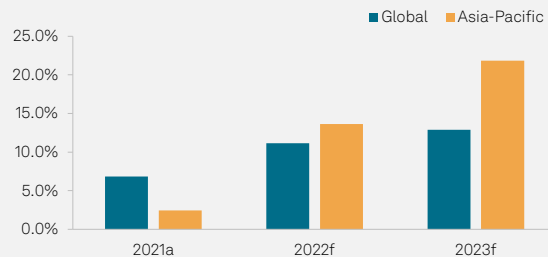
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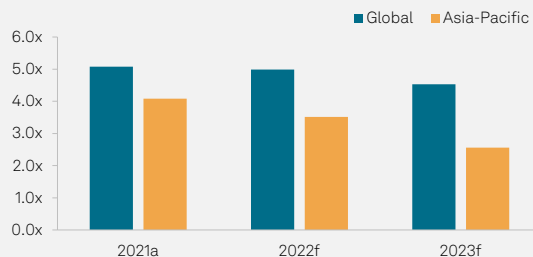
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



Note: All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast. Source: S&P Global Ratings.

Downside risks...

Slower GDP growth in the region reflects weaker economy and spending power. This will negatively impact travel demand and discretionary spending on leisure activities.

Regulatory changes and pressures. Outcomes on license rebidding and regulatory changes in Macao remain a key watch point as of the date of this report. Operators in Singapore will also face higher regulatory pressure with a new gambling law becoming effective this year.

Growing refinancing costs from higher interest rates and still weak operating performance. These will test companies' liquidity and capital structure management.

... and what they mean for the sector

Macao casino ratings stay on CreditWatch negative on continued uncertainties about recovery, licensing.

The likelihood is increasing that leverage may not improve below our downgrade threshold before 2024, given continued strict COVID-control measures in China.

Pace and magnitude of recovery. As most Asian markets are set for a turnaround in operating performance in 2022 and a return to pre-pandemic level in 2023, we are monitoring for possible structural changes in gaming-visit trends or spending behavior due to shrinking consumer wallets or COVID-19-associated travel fears.

Macao license bid may worsen issuers' balance sheet. Genting Group's unexpected entry into license bidding adds uncertainty to the outcome. This may trigger existing operators to increase their economic and social commitments over the license period. Genting may switch focus to debt-funded growth from deleveraging, if it gets the gaming concession.

Insurance

Market headwinds ratchet up capital strains

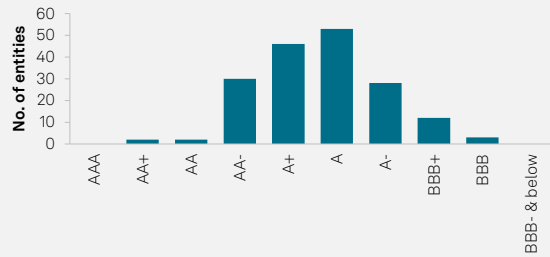
What we expect over the next 12 months

- Stable credit trends will largely prevail, though with increasing downside risks amid prolonged market headwinds.
- Capital market and forex volatility could heighten capital and earnings swings.
- Economic slowdown will undermine growth, while elasticity of insurance demand remains supportive.

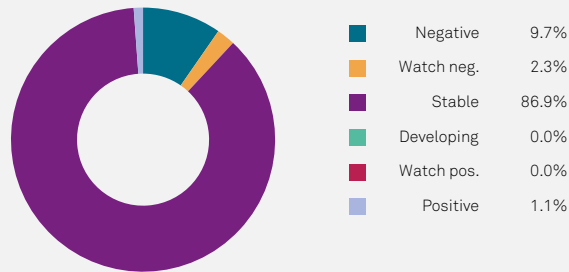


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Rating distribution



Outlook distribution



As of October 31, 2022. Includes public ratings only.
 Source: S&P Global Ratings.

Downside risks...

Persistent market headwinds. Sharp and prolonged market swings could dent insurers' capital and earnings, amid forex volatility with a widening interest rate differential (particularly U.S. dollar against Japanese yen and New Taiwan dollar), spillovers from slowing economy and geopolitical tensions.

Sharper-than-expected economic slowdown. Slower economic growth could hinder insurers' premium growth, particularly trade-related business lines (marine cargo and trade credit insurance). However, still-low insurance penetration and government initiatives should support the elasticity of insurance demand.

Narrowing insurance margin. COVID-related policies and extreme weather events weigh on insurers' underwriting profits and capitalization. Rising reinsurance costs will add to insurers' margin pressure.

... and what they mean for the sector

Heightened volatility in capital and earnings. Capital market fluctuation and rate hikes (except China and Japan) undermine asset valuation and incur unrealized losses. Shifting forex and interest rate differentials will hike hedging costs, and suggest earnings volatility from unhedged exposures. However, life insurers could see gradually easing demand on reserve provisions and improving recurring yield due to rate rises.

Slower premium growth. Slow macroeconomy in China amid strict COVID policies hinders new business momentum. Insurers' product and channel reform could drive slower interim growth.

Ramp up risk selection and pricing. Insurers will likely evolve their risk management to support insurance margins. Climate change and rapid urbanization in emerging Asia calls for more regular updates on catastrophe models.

Media And Entertainment

Slowing economic growth weighs on recovery

What we expect over the next 12 months

- China's slowing growth amid COVID lockdowns will weigh on a potential revenue recovery for the China internet sector in late 2022 or early 2023.
- Rising inflation and interest rates in some Asia-Pacific economies outside of China and Japan could hurt consumption spending, including for digital entertainment and e-commerce.
- Most Asia-Pacific media and entertainment companies have sufficient financial buffer to withstand economic slowdown.



Primary credit analyst

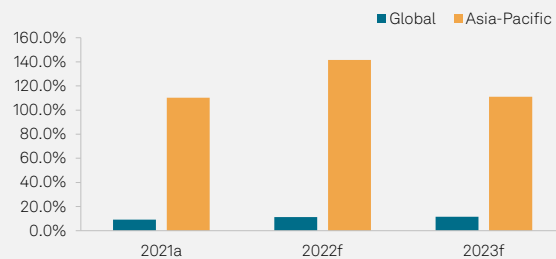
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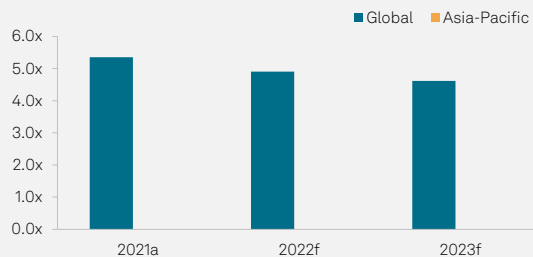
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



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Downside risks...

Macro slowdown and lockdown measures in China weigh on internet companies. Advertising is highly correlated to economic growth. Slowing growth and waning consumer sentiment will hurt consumer spending and dampen advertising spending and e-commerce sales. Additional lockdowns could further strain revenue and profits for these companies.

Outside of China, companies face rising inflation and interest and global economic slowdown. Inflation, higher interest rates and a global slowdown could slow economic activity and consumer spending in the broader Asia-Pacific region. This would reduce our revenue growth forecasts for media and entertainment companies exposed to e-commerce, digital entertainment, and advertising revenues.

... and what they mean for the sector

China internet faces easier comparisons into 2023, but recovery outlook remains lackluster. Revenues could recover, lapping a sector downturn that started in the fourth quarter of 2021 due to intensifying regulatory actions in the sector. However, stiff competition, economic slowdown, and sporadic lockdown measures will limit the upside.

Most Asia-Pacific companies within the sector have sufficient financial buffers. Most of our rated media and entertainment issuers are net cash or have large financial buffers to withstand challenges posed by slowing economic growth and rising interest and inflation. A small minority will benefit from the lifting of lockdown measures across some Asia-Pacific countries and outdoor activities recover.

Metals And Mining

A commodity downdraft as slowdown fears grow

What we expect over the next 12 months

- Lower growth expectations for China are likely to dampen the outlook for commodities, though stimulus measures to revive its economy could provide some support.
- The ongoing Russia-Ukraine conflict will cause further shortages and fuel some commodity price spikes.
- Geopolitical risks, an uneven recovery path out of COVID, and additional supply disruptions will exacerbate the volatility in commodity markets.



Primary credit analyst

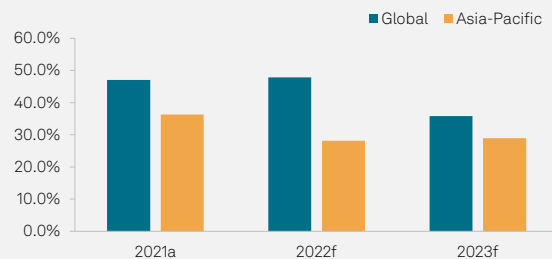
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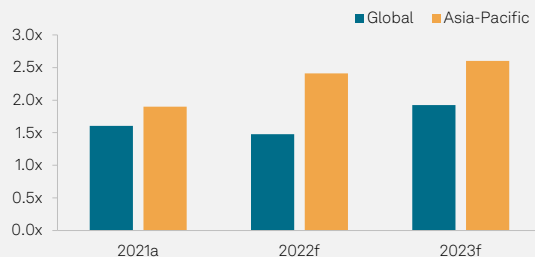
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



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Downside risks...

Economic pressure, low growth and rising geopolitical risks. Lower growth prospects and higher costs pose a key threat to demand. Rising geopolitical risks and how they unfold further limit price visibility.

Further economic slowdown and lockdowns in China. China's economic activity continues to be disrupted by extended curbs as it continues to put areas under COVID-19 lockdowns. A weak property market also weighs on the Chinese economy, further dragging on other sectors such as manufacturing.

Commodity downdraft unfolds as economic activity drops. With prices moderating, costs rising, margins and cash flow are dropping. Some issuers continue to distribute trailing dividends to shareholders. Therefore, we expect weaker profits and lower cash holdings to consume some credit buffer.

... and what they mean for the sector

Subdued conditions slow China's growth engine and its demand for commodities. Given China accounts for over half of global demand for raw materials, any prolonged weakness in its economy would erode support for prices. Still, government measures to boost the economy could provide some support for steel demand.

Lower prices point to softer earnings and cash flows, yet balance sheets remain solid. The credit quality for many issuers in metals and mining has been improving with greater capital discipline and lower debt. While our ratings bias remains positive, the pace of positive rating actions should slow as earnings weaken.

Russia-Ukraine conflict adds to supply disruptions, exacerbating volatility in prices. Even with this current downdraft, most metal prices remain above their long-term averages and well above stressed levels for the profitability of most issuers. Higher energy prices are resulting in supply curtailments for downstream metals producers and are likely to cap supply additions.

Oil And Gas

Fragile demand outlook will add to uncertainties

What we expect over the next 12 months

- Output cuts by OPEC+ will further tighten global supply as persistent geopolitical tensions and seasonality effects have already shored up hydrocarbon prices.
- Asia-Pacific will account for almost a third of the global oil demand growth in 2022. Yet, demand outlook remains fragile over the next one to two years, given a recessionary impact from sustained oil and gas prices.
- Windfall earnings could lead to more government intervention on national oil companies.



Primary credit analyst

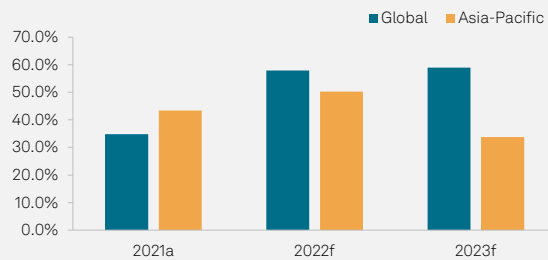
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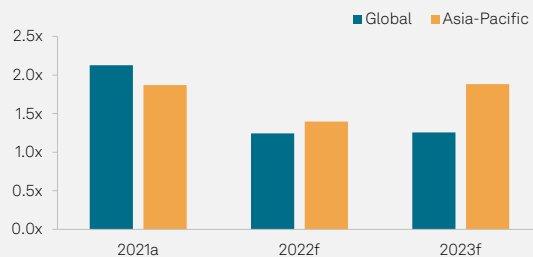
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



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Downside risks...

Demand pullback and recession fears. Soaring hydrocarbon prices have led to rising inflation across the region, tempering the region's oil demand over the next 12 months. Prolonged strict COVID policy in China adds to concerns, on top of the slow growth momentum in the U.S. and Europe.

Supply situation. Hydrocarbon prices could further fluctuate amid supply shortages in Europe as OPEC+ cuts November outputs, the northern hemisphere winter heating season looms, and geopolitical conflicts intensify. Asia-Pacific will likely turn to liquefied natural gas to bolster security of supply and secure their supplies way in advance as their European counterparts are looking eastward for new sources to replace Russian supply.

Government intervention. Rated oil and gas giants in Asia-Pacific--most of which are national oil companies--are vulnerable to decline in profitability due to increasing regulatory risks such as profit-sharing schemes or windfall taxes. Some rated companies may incur sizable receivables as high oil prices and subdued economic outlook could challenge the governments' ability to keep up with the funding of their oil subsidy programs.

... and what they mean for the sector

More industry volatility up ahead. Demand pullback could offset earnings headwinds driven by sustained prices. Governments' negative intervention may temper rated companies' profitability and cash flow viability.

Urgency to invest in renewable assets. High fossil-based energy prices will increase the urgency for rated producers to increase their renewable energy assets. The investment costs of doing so, however, will likely be extortionate under current industry conditions and amid rising interest rates. Rated producers will have to balance the need to bolster balance sheets amid volatility, invest to reduce exposure to volatile oil and gas prices, and sustain shareholders' returns in light of earnings headwinds over the next 12 months.

Public Finance

Fiscal weaknesses amid external challenges

What we expect over the next 12 months

- Energy price shocks, inflation, and rate hikes will hit local and regional governments (LRGs) and their associated enterprises.
- China will face additional challenges amid property strains as well as extensive lockdown to contain COVID cases.
- Local governments in Australia, New Zealand, and China are using large infrastructure projects to stimulate economies, a practice that will persist until at least 2023.



Primary credit analyst

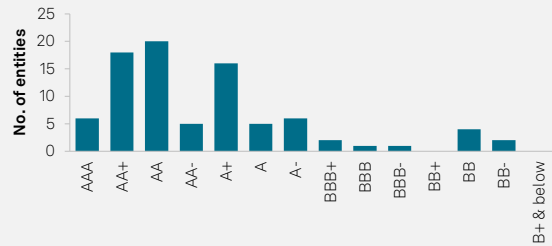
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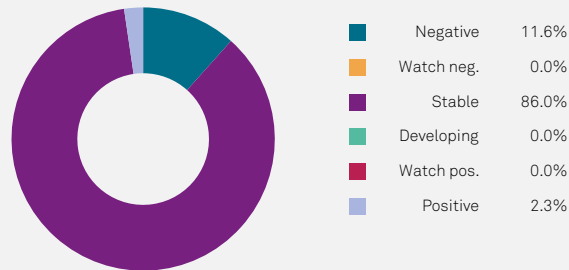
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Rating distribution



Outlook distribution



As of October 31, 2022.
Source: S&P Global Ratings.

Downside risks...

Economy shock. Persisting inflation and higher interest rates, and downside risks to the global economy, could further pressure the region's consumption, supply chains, and economic growth.

Property market correction. Most LRGs in the region are fiscally dependent on revenues tied to domestic property sales and prices, while China's "L-shaped" property slowdown will further depress local growth and weaken market confidence.

Policy shifts. To ameliorate the economic slowdown and restore confidence, selective LRGs could roll out aggressive fiscal stimulus, including tax cuts and additional spending. Chinese LRGs under increasing fiscal strains could see additional risks if they leverage their SOE investment vehicles to stimulate local economic growth. The Three Waters Reform in New Zealand may alter its public finance system as details are disclosed in upcoming legislation. With fiscal metrics already weakened by the pandemic, LRGs face heightened risks to credit ratings should the above policy shifts play out.

... and what they mean for the sector

Delayed fiscal recovery. LRGs pushing forward their aggressive fiscal stimulus amid inflationary pressures and higher funding costs will disrupt fiscal recovery, widen deficit, weaken liquidity and lift debt burdens. China's resumption of leveraging SOEs and providing support to their SOEs indicate additional debt burden.

Real Estate Development

Only the government can help revive Chinese homebuyers' confidence

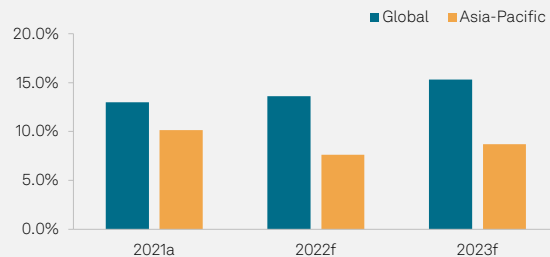
What we expect over the next 12 months

- China's government could roll out more supportive measures to help restore homebuyers' confidence.
- Home prices in Hong Kong could continue to drift down in 2023 as economic downside risks remain.
- U.S. dollar refinancing and potential distressed exchanges will remain the key risks for Indonesian developers.

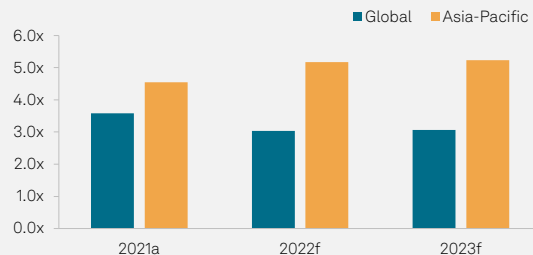


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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



Note: All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast. Source: S&P Global Ratings.

Downside risks...

China's property downturn has turned into a crisis of confidence. Recovery is unlikely until 2023. Developers' offshore U.S. dollar bond refinancing channels will unlikely open due to rising rates and a strong dollar. Domestic bond market refinancing will only be available for selective developers.

Hong Kong's residential property prices continue to fall amid economic headwinds. Hong Kong's home prices have fallen by 8%-10% since the recent peak in Q3 2021 amid economic contraction. In 2023, home prices could continue to drift down as economic downside risks remain.

Residential property demand in Indonesia will be weakened. This is on the back of higher inflation and mortgage rates, and in the absence of fresh policy support.

... and what they mean for the sector

Only the government has the means to shore up confidence in China property. If falling sales tip more developers into distress, homebuyers' confidence will further deteriorate. The central government is rolling out supportive policies, including the launch of funds to help get unfinished projects finished.

Hong Kong developers who have a strong pipeline of mass-market products are better positioned. Amid weakened homebuyer sentiment, residential property transaction fell significantly in 2022. That said, developers still achieved high sell-through rates from their mass-market launches due to solid demand.

Lower-rated Indonesian developers with sizable near-term U.S. dollar debt maturity could face refinancing risks. In particular, developers with less recurring income will experience liquidity squeeze.

Real Estate Investment Trusts

Asia-Pacific REITs to weather interest rate hike cycle

What we expect over the next 12 months

- Office sector is under a secular change. Impact varies across different cities in the region, depending on supply and demand trends.
- The return of inbound tourism in some countries will drive further recovery across downtown retail malls in gateway cities.
- Curtailment in development and refurbishment given inflationary pressures and supply chain delays.



Primary credit analyst

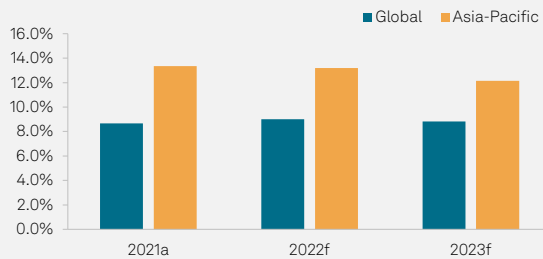
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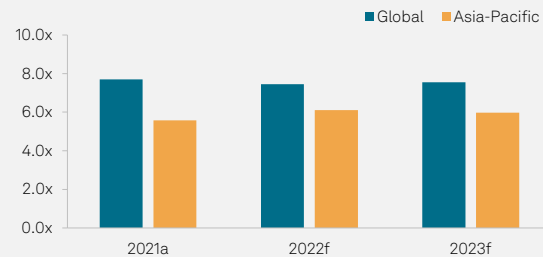
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



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Downside risks...

Interest rate cycle. Rising interest rates on floating rate debt reduces credit metric headroom.

Rising interest servicing and debt burden. Current favorable debt pricing from the banks gravitates to the risk premium that bond markets are currently demanding from the sector.

Further deterioration in business and consumer confidence. This can result in higher vacancies than expected.

... and what they mean for the sector

Buffers amid largely favorable conditions. While financial headroom could deteriorate, we expect most rated Asia-Pacific REITs can tolerate rising interest rates due to a high proportion of fixed-rate debt and well-spread debt maturities. We expect asset valuation to remain stable for high-quality assets, given favorable supply-demand dynamics and higher replacement costs.

Going green. Ongoing "flight to quality" and tenants' preference for buildings with green credentials will support rated Asia-Pacific REITs, given their portfolio of quality assets.

Impact of earnings pressure. Net effective rental rates will decline and weaken our earnings forecasts. REITs will strategize about debt reduction by scaling down new development to offset downward pressure.

Retail

Gloomy consumer sentiment to drive a pullback in retail consumption

What we expect over the next 12 months

- Consumer sentiment will remain weak across Asia-Pacific amid inflation in daily necessities.
- Profitability will come under pressure as retailers face challenges in passing on growing costs as inflation erodes household's disposable income.
- Challenging funding conditions presents higher debt costs and, for speculative-grade issuers, refinancing risks while it curbs excessive investments seen in recent years.



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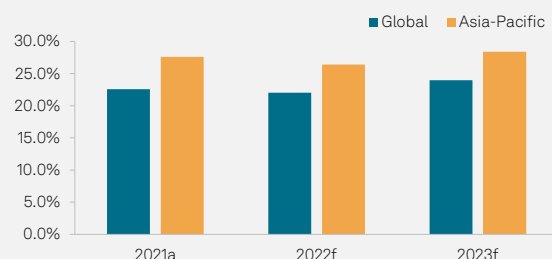
Sam Playfair

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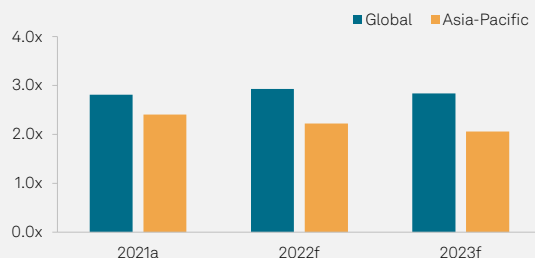
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



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Downside risks...

Inflation outpacing wage growth. Household budgets will be strained, leading to a slump in overall retail consumption. Higher food shelf prices, energy bills, and petrol prices will suppress consumer confidence.

China's COVID policy. Uncertainties will remain if the Chinese government maintains its strict COVID policy. This may expose retailers and restaurants operating in China, to significant operational and cash flow pressures. Risks for retailers in the wider Asia-Pacific include further supply chain disruptions.

Challenging funding conditions. Central banks will continue to raise interest rates where inflation exceeds target ranges, and to quell consumer spending. This will lead to higher funding costs and may test the sustainability of capital structures.

... and what they mean for the sector

Squeezed profitability. Retailers will have to absorb rising input prices. Maintaining EBITDA margin stability will depend on the ability to pass on higher input and operating costs. Retailers also face price increase requests from suppliers, whose margins are eroding.

Bloated inventories. Retailers will need to manage inventory balances amid future supply-chain disruptions. As the cost of living rises and consumers forgo discretionary purchases, retailers carrying more seasonal products are potentially at risk of being left with inventory consumers no longer want or can afford.

Rising cost of debt to have bifurcated effects. Rising debt costs increases refinancing risks, which may test capital structures of speculative-grade issuers. Meanwhile, it directs Investment-grade issuers to a conservative financial policy, staying away from large debt-funded investments, underpinning finances.

Sovereign

Risks to external metrics increase

What we expect over the next 12 months

- Global economic activity weakens, but not so sharply that it creates financial volatility. Economic conditions are weakened by higher inflation and uncertainties associated with the Russia-Ukraine conflict.
- Current account balances in most economies should improve even if energy prices do not fall significantly, since consumers and businesses reduce consumption where subsidies are absent or limited.
- We still expect governments to meaningfully lower fiscal deficits, although a return to pre-COVID fiscal performances will take longer.



Primary credit analyst

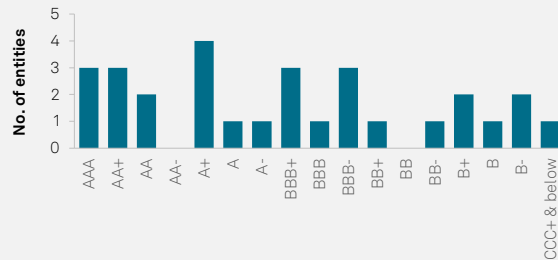
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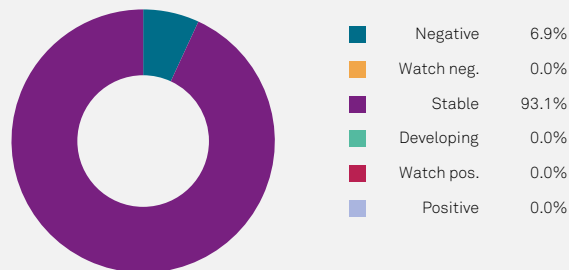
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Rating distribution



Outlook distribution



Note: As of Oct. 31, 2022. Includes public ratings only, and ratings on policy-related financial institutions and corporates. Source: S&P Global Ratings.

Downside risks...

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

High energy prices seriously undermine external and fiscal metrics. Current account deficits could remain wide, especially in places where governments subsidize energy consumption, to exacerbate inflation or erode foreign exchange reserves. Governments that provide significant subsidies could also see related spending maintained at high levels.

... and what they mean for the sector

Sharp increase in funding costs could weaken fiscal support and economic growth. Interest payments could rise to weaken fiscal support for sovereign ratings, especially where government debt is high and non-residents are important sources of funding. If higher financing costs also affect economic growth significantly, it could exacerbate the negative impact on fiscal performance.

High energy imports can damage external support for some Asia-Pacific sovereigns. Net external indebtedness would weaken where current account deficits persist or widen because of energy imports. Additionally, this deterioration could worsen investor confidence to raise financing costs further. These deteriorations could damage credit support of some sovereigns.

Structured Finance

Rates, inflation, and confidence key for households

What we expect over the next 12 months

- Slowing growth in most markets will translate to slowdowns in consumer credit as consumers reprioritize spending.
- For markets where rates are rising, we expect house prices to fall or moderate as borrowing capacity and serviceability affect borrowers' budgets.
- We expect modest weakening in asset performance because employment remains at low and stable levels across markets.



Primary credit analyst

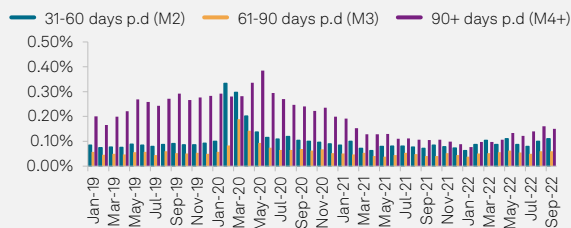
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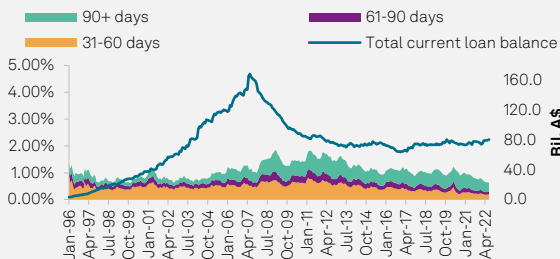
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China auto loan ABS w.a. asset delinquency rates



Note: Data as of Sept. 30, 2022. The delinquency rates of the first three months after transaction close are excluded. ABS--Asset-backed securities. w.a.--Weighted average. p.d.--Past due. Source: Trustee reports published on Chinabond's website; compiled by S&P Global Ratings.

Australian RMBS prime SPIN data



Note: Data as of July 31, 2022. Source: S&P Global Ratings.

Downside risks...

Rates and inflation. Most Asia-Pacific economies including Australia, New Zealand and Korea are facing higher interest rates to tackle inflation. This is likely to translate into some borrower cohorts facing strains from both higher costs of living and higher mortgage repayments. Should inflation prove to be more persistent than expected, higher rates will start to have a more significant impact for households.

China's COVID-19 strategy and housing sector risks. For China the downside risks related to ongoing restrictions on activity related to management of COVID-19 could further drag on consumer confidence and employment. A further prolonged weakening of sentiment in housing markets may ultimately impact house prices and resale values.

... and what they mean for the sector

Issuance is likely to reduce. Lower lending activity and concerns around macroeconomic factors could see less issuance of structured finance assets.

Delinquencies to rise. We expect that delinquencies are likely to increase across most markets and asset types, particularly those experiencing rapid interest rate increases, however this is off historically low levels.

Structural supports are in place. Most transactions have or build up supports to mitigate downside risks. We may see prepayment levels affected by constrained household budgets and also the level of refinance activity.

Technology

Outlooks remain stable despite growing downside risk

What we expect over the next 12 months

- Tech companies' reinforced balance sheet and resilience should support stable credit outlook.
- A further global macroeconomic slowdown could turn rating bias more negative.
- Consumer electronics are turning weaker, but server, auto, and industrial markets should remain resilient and support overall demand.



Primary credit analyst

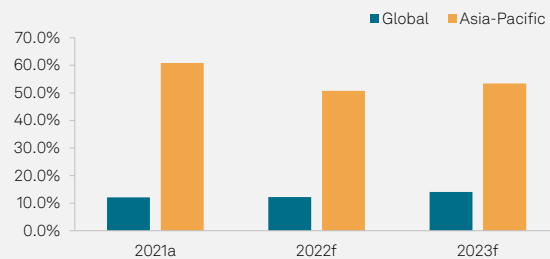
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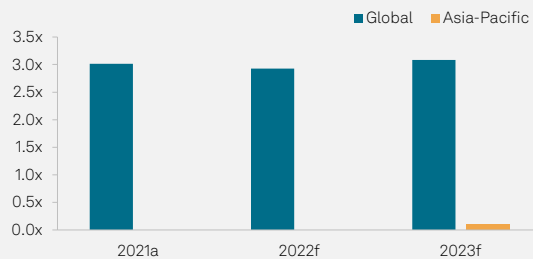
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



Note: All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast. Source: S&P Global Ratings.

Downside risks...

Macroeconomic risks. Increasing macroeconomic risks--such as inflation, rising interest rates, geopolitical tensions, and COVID-related restrictions in China--could decelerate economic growth momentum with much slower consumer spending in electronics such as PC and smartphone. The geopolitical tensions particularly U.S. export restrictions on semiconductors to China, expose Asia-Pacific tech firms to long-term risk. The impact will depend on the tightness of enforcement efforts. On the other side, industrial tech demands remain relatively healthy but could also face pressure when consumer spending weaken further.

Inventory correction takes time. Industry-wide inventory build-up could take times to digest with falling demand. The correction which spreads throughout the value chain could last for several quarters into 2023.

Narrowing financial buffer. Most of our Asia-Pacific technology hardware issuers have enough cash flow and leverage buffer to withstand a moderate shortfall in revenue and profitability. However, a prolonged downturn in demand could reduce such headroom.

... and what they mean for the sector

A lower global IT spending. The current IT spending growth of 4.3% could be lowered further due to pessimistic macroeconomic outlook, which would be meaningfully negative to certain tech hardware issuers.

Increasing cash flow volatility amid inventory correction. Change of inventory behavior magnifies the risk during a demand downturn. We expect higher cash flow volatility for rated hardware companies, with declining operating cash flow and persistent higher working capital needs.

Rating bias could turn more negative. Despite a still-stable credit outlook for Asia-Pacific tech firms, the macro downturn and rising rates could turn the rating bias more negative.

Telecommunications

Rising data demand, asset sales provide support

What we expect over the next 12 months

- Telecom operators' earnings will benefit from rising data traffic and the return of roaming revenues.
- Cost-push inflation and dampened consumer sentiment could temporarily dent earnings of some telcos.
- We anticipate telcos will contemplate more passive infrastructure sales to gain financial flexibility to navigate competition, large capital investments, and shareholder returns. We expect telcos will continue to invest further away from the traditional connectivity business to boost longer-term growth prospects.



Primary credit analyst

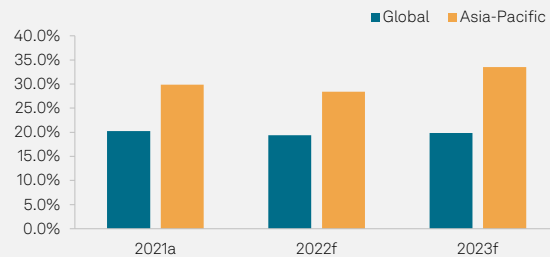
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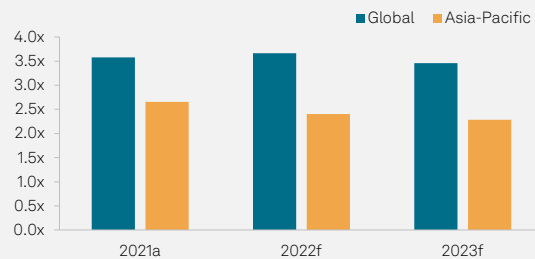
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



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Downside risks...

Cost-push inflation and weakness in consumer sentiment. We have seen mitigating price hikes in some markets, such as Australia, to counter inflationary pressures. Margins may narrow in markets where stiff competition makes price hikes difficult. Consumers' spending power could also weaken, with a temporary dial-back in spending on telco services. Supply-chain constraints may slow 5G and fiber rollouts.

Intense competition. Telcos in countries such as the Philippines and Thailand continue experiencing competitive pressure, with tariff cuts and aggressive marketing. New players in Japan (Rakuten Inc.), Singapore (Simba Telecom) and the Philippines (Dito Telecommunity Corp.) will raise wireless competition.

Lag between investments and returns from 5G. Telcos must make upfront 5G network and spectrum investments, while meaningful monetization from industrial-use cases remains distant. 5G has been mainly used to offer faster mobile and fixed-wireless access. Supply-chain delays and weakened consumer spending power could temporary slow handset upgrades and migration to 5G where 5G-enabled devices are required.

... and what they mean for the sector

Temporary weakness in earnings for some telcos. Reduced consumer purchasing power amid inflation could weigh on some operators' enterprise services and slow consumers' upgrades to higher-priced services. But it should not inflict significant or permanent harm to our rated telcos, given the sector's utility-like demand characteristics. Rising data demand and return of roaming revenues could mitigate such pressures.

Careful leverage management amid M&A. We expect telcos to continue reevaluating infrastructure asset portfolios and business structures. Tower sell-downs by telcos had achieved high multiples and rendered telcos some financial flexibility. Other M&A activity will continue; consolidation could ease competitive pressure while investments adjacent to the traditional connectivity business could support better earnings.

Transportation Cyclical

Bumpy road to recovery

What we expect over the next 12 months

- Interest rate hikes and local-currency depreciation remain key threats to liquidity and refinancing of Asia-Pacific transportation companies. This is in addition to risks from economic headwinds.
- Accelerating air traffic recovery and improving profitability of passenger airlines as more regional borders reopen. Meanwhile, aircraft lessors' growth could slow from supply chain challenge.
- Shipping companies' profits face contraction as slowing economy affect international trade and freight rates. Liquidity stress and operation disruption on China's car rental companies due to lockdown measures.



Primary credit analyst

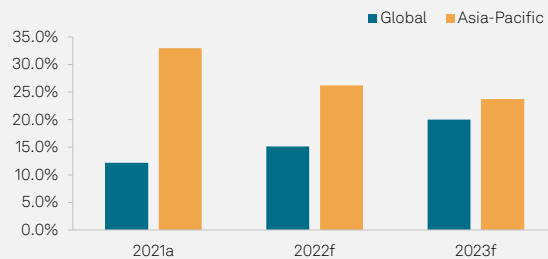
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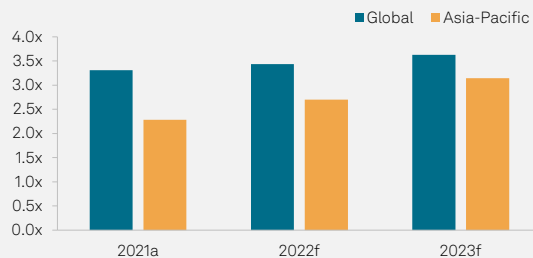
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



Note: All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast. Source: S&P Global Ratings.

Downside risks...

Economic slowdown. Global economic downturn could lower the pace of recovery for passenger traffic because falling business activities and leisure spending should affect some pent-up demand. Shipping companies could see more instant downside risk as a result of weakening global trade and freight rate.

Interest rate hikes and local-currency depreciation. Rising rates will increase funding costs, which could be substantial for companies with high leverage and refinancing needs. For companies more exposed domestic revenue sources and foreign debt funding, depreciating currency further adds to their cost of debt servicing.

China's anti-virus measures. This could cap transportation sector's long-term recovery in the region. China's contribution to travel and international trade suggests its significant impact on the sector's performance. The transportation sector may not recover to pre-COVID level without China's relaxation of its COVID policy.

... and what they mean for the sector

Recovery is uneven across locations and sub-sectors and faces multiple headwinds. Pent-up demand for travel and border reopening should remain a dominant and favorable driver for passenger-focused companies at least in the next few quarters. Yet profitability of freight transportation could face higher downside risk from a slowing economy. We anticipate refinancing and liquidity risk to further increase for lower-rated transport companies, particularly for those reliant on foreign debts and domestic revenues.

Transportation Infrastructure

COVID in rear view, rising rates in front

What we expect over the next 12 months

- Increasing interest rates (barring China and Japan) and the economic slowdown may pose challenges to the sector just as most have largely recovered from the COVID shock.
- Domestic travel has picked up sharply for Asia-Pacific airports and international traffic is recovering fast with easing of travel restrictions; the exceptions are China and Hong Kong.
- Among our rated entities, a stabilization of Pacific airport ratings has improved the net outlook bias to negative 4% (as of Oct. 31, 2022) from negative 10% (as of May 31, 2022).



Primary credit analyst

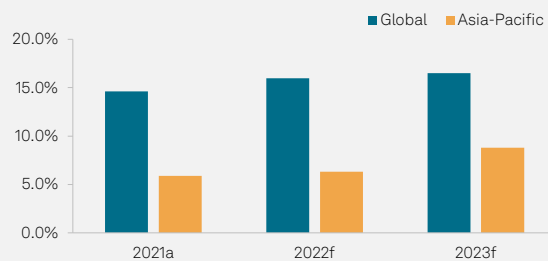
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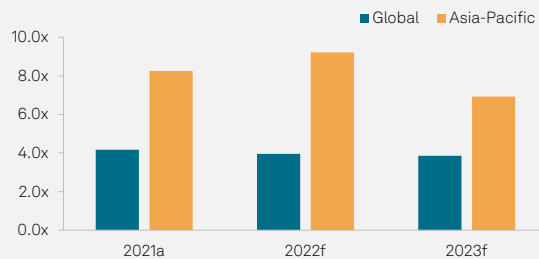
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



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Downside risks...

Inflation and supply chain risks rising. Increasing interest rates consequent to high inflation could put pressure on financial metrics of leveraged infrastructure players.

Travel restrictions. The easing travel and testing requirements will support recovery. However, China's still low COVID tolerance and Hong Kong's testing requirements could lead to an uneven path for recovery.

Higher interest rates could create some financial pressures. This could be acute particularly for issuers more reliant on dollar funding and with large refinancing or capex needs.

... and what they mean for the sector

Potential margin pressures. Higher energy prices fueled by the Russia-Ukraine conflict; potential wage inflation, and supply-chain risks could squeeze margins.

Air traffic to recover but international traffic will remain well short of pre-COVID levels. Domestic travel will recover faster to about 80% of pre-pandemic levels by mid-2023 for key markets; and in India we expect full domestic passenger traffic recovery by March 2023. International travel will also recover to around 50% of pre-COVID-19 levels by mid-2023. The recovery will be gradual in China and Hong Kong. Other transport infrastructure sectors will grow in line with the economic growth.

Financial metrics can weaken for some. Increasing interest rates consequent to high inflation could put pressure on financial metrics of leveraged infrastructure players. China, on the other hand has lowered interest rates and this might benefit some Chinese infrastructure players.

Utilities

High renewable investments amid economic headwinds could weigh on ratings

What we expect over the next 12 months

- Most regional countries will continue development of renewables which will keep capex elevated.
- Investment in grid infrastructure to support renewables is drawing attention, raising the question of funding and impact on end consumers.
- Negative rating bias remains due to high leverage in the sector and our forecasts of high investments and fuel prices, in some markets. Overall outlook is stable for Chinese issuers, based on supportive regulatory framework amid deepening market-based reform.



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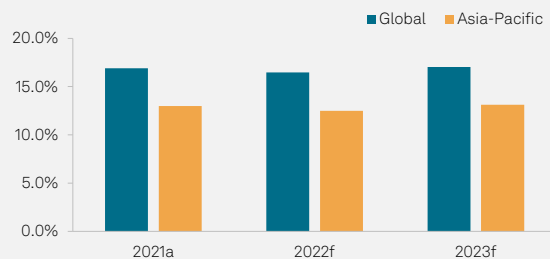
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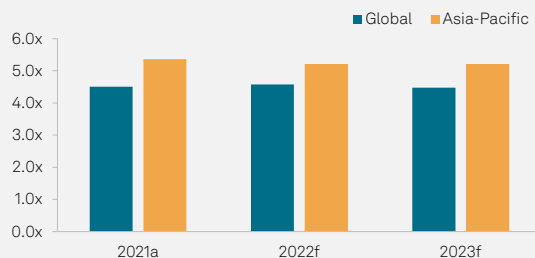
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FFO/debt (median, adjusted)



Debt/EBITDA (median, adjusted)



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Downside risks...

Inflation and high interest rates could be a drag in some Asian markets. Fuel cost is a pass-through in most markets; but it may not be even across all entities. Rising interest rates in most markets can alter funding options and costs for most entities, except China.

Lingering supply chain issues due to global shipping delays. These remain a risk to cost and time of completion to new projects, subject to project stage. Companies may still have to factor this risk in budgeting processes as we don't expect it to ease soon. Chinese issuers benefit from a resilient domestic supply chain.

Aggressive pace of new investments and funding. Excessive debt funding of new developments, adverse regulatory reforms or interventions, and grid constraints are risks. We expect capex mainly in renewable projects, integrated hybrid projects or coal majors acquiring renewable assets.

... and what they mean for the sector

Weaker profitability due to less timely recovery of fuel cost and electricity price volatility. In China, with tariff hike and stabilizing fuel cost, profitability will recover from the low ebb in 2021.

Higher funding costs or delayed access to funding can increase interest costs and risk liquidity. Chinese players mostly have strong financing capability, as supported by government.

Ambitious expansion into new projects without adequate contract protection can affect balance sheets. Chinese issuers mostly are making heavy investments into renewable energy generation and grid assets to improve power system's efficiency and flexibility. Investments are still also pouring into fossil-fuel generated power, mainly to replace old equipment or to ensure capacity at times of peak demand.

Appendix 1

Related research

- [Technology And Geopolitics: What If The Semiconductor Industry Bifurcates?](#), November 14, 2022
- [Asia-Pacific's Strong-Dollar Problem: Inconvenience Today, Headache Tomorrow](#), November 10, 2022
- [Economic Research: China's Trend Growth To Slow Even As Catchup Continues](#), November 10, 2022
- [Credit FAQ: A Slower China: Where Are The Pockets Of Risk?](#) November 3, 2022
- [Credit FAQ: A Slower China: Is Stimulus Working And Who's Paying For It?](#) November 3, 2022
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- [China Trades Immediate Economic Growth For Uncertain Benefits](#), September 20, 2022
- [China's Zero-COVID Stance Poses A Bigger Threat To Firms Than Inflation](#), September 20, 2022
- [Global Debt Leverage: China's SOEs Are Stuck In A Debt Trap](#), September 20, 2022

Appendix 2

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