Credit Conditions Emerging Markets Q1 2024

Not Getting Easier

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This report does not constitute a rating action.

S&P Global Ratings

Regional Credit Conditions Chair

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Key Takeaways

- Credit conditions in emerging markets (EMs) will likely deteriorate in 2024, as major economies slow down (the U.S., China, and the eurozone), the effects of rapid monetary tightening surface, and debt maturities pile up.
- The balance of risks for EM credit conditions remains on the downside, given an extended period of high interest rates, the potential for further inflationary pressures, and weaker-than-expected growth in the largest economies. Debt refinancing will likely complicate the picture, as the global maturity wall is building up with considerable peaks in 2025.
- Credit quality across key EMs will likely be strained as risks unfold.

Editor's Note: S&P Global Ratings' EM Credit Conditions Committee took place on Nov. 20, 2023.

Credit conditions in EMs will likely erode in 2024, as major economies slow down (the U.S., China, and the eurozone), the effects of rapid monetary tightening surface, and debt maturities pile up. For many corporations, this will mean falling revenues upon increasing financing costs as debt comes due, resulting in pressured cash flows. EM banks have largely benefited from higher interest rates, reflected in higher margins, but EMs' sluggish economic growth will slow credit expansion and weaken asset quality. EM sovereigns will continue struggling given the trade-off between keeping key prices under control and avoiding social strife, while maintaining fiscal accounts balanced on rising debt burdens and high financing costs. Moreover, there is a heavy electoral calendar for key EMs in 2024, which will shape the political landscape for years to come.

EMs face difficult political dynamics, which have been exacerbated by the pandemic and geopolitical conflicts. Thirty emerging and frontier economies will hold elections next year. All these countries grapple with various challenges, and issues are highly idiosyncratic. For most of these countries, a critical issue is providing a predictable and stable political environment that fosters sustainable economic growth and improving living conditions. Most EMs also confront substantial fiscal challenges after boosting debt during the pandemic, so pursuing fiscal consolidation in an election year will prove tricky. On the positive side, many EMs could benefit from developing structural global trends, such as supply-chain relocation and energy transition. Policy predictability and investments in critical infrastructure will be key in benefiting from unfolding opportunities.

Financing conditions may improve as economic trends stabilize and there is more visibility about the peak of interest rates across advanced economies. However, financing costs will remain elevated for all EM issuers, especially for the lower-rated ones. Debt refinancing will likely complicate the picture, as the global maturity wall is building up with sizeable amounts coming due in 2024 and 2025. EM issuers will be at a disadvantage as investors will likely ask for additional returns, given comparatively higher country risk premia. For many issuers, the new interest-rate environment could be unsustainable, leading to defaults and bankruptcies. Access to primary markets could also be impeded if geopolitical risks were to rise further.

Adverse weather events are becoming more frequent and taking a heavy toll on EMs. El Niño phenomenon has had uneven effects during the year with many EMs suffering from either severe droughts or abnormal rains. An intense hurricane hit Mexico's Pacific coast, causing significant physical damage and human losses. The severe drought is affecting the Panama Canal's transit, the reduction of traffic on which could mean a considerable hit to freight fees and influence supply chains. Full effects of El Niño phenomenon are yet to be seen, but past occurrences have caused food prices to jump and other supply shocks.

Top EM Risks

Higher interest rates amid increasing refinancing risks

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

Uneven global monetary policy trajectories still pose risks for EMs. As inflation eases, many EMs are now in position to lower their policy rates and some have begun an easing cycle, including Brazil, Chile, Hungary, Peru, and Vietnam. However, despite recent inflation readings in the U.S., mixed signals remain over the path of the Federal Reserve's approach to interest rates. While the peak of U.S. rate is certainly near, or perhaps already occurred, we expect the Fed will take much longer to lower interest rates, and more importantly, the terminal rate will likely be higher than the past decades' average. Financing conditions may improve as economic trends stabilize; however, financing costs will remain high for all EM issuers, especially for the lower-rated ones with refinancing needs in 2024 and 2025. Access to primary markets could also narrow if geopolitical risks were to continue rising. For many issuers, the new interest-rate dynamics could be unsustainable, leading to defaults and bankruptcies.

A sharper-than-expected downturn in advanced economies impedes global trade

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

Once again, EM economies will be facing tough external conditions as advanced economies slow down. The key question is if domestic demand resilience will be able keep EM economies afloat in 2024. The lagged effects of the rapid monetary tightening are still yet to be seen. Our base-case scenario assumes an economic slump across key advanced economies, and the risk for a recession in the U.S. and eurozone remains considerable. China's economy is also struggling, and expected growth for 2024 is far below levels in previous years that were supportive for many EMs. We expect these factors will be a drag on trade and will hurt EM exporters. A deeper-than-expected downturn could depress exports from key EMs by reducing trade volumes, portfolio flows, and foreign direct investment. Slower economic activity could imperil their corporate sectors' fundamentals and banks' asset quality. Unemployment could rise, hitting households already burdened by inflation.

Weakening economy and increasing financing costs squeeze corporate fundamentals

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

EM corporations will be facing growing headwinds in 2024. Our economic growth baseline for EMs already points to a below-trend expansion across the board, which will be much pronounced for major exporters. This will likely reduce revenues for most sectors, with only a few ones to be spared. Cost pressures continue, especially as workers demand higher salaries to cope with the rampant inflation and high prices that accumulated over the past few years. Moreover, we expect financing costs will remain high, unbearable for low-rated issuers. Sooner or later, EM corporations will need to refinance at higher costs, likely leading to credit deterioration.

Geopolitical tensions and difficult domestic socio-political conditions erode credit fundamentals

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

The eruption of war between Hamas and Israel brings back another disturbing focal point to an existing global geopolitical strife. While not underestimating the human tragedy that's unfolding in Gaza and Israel, our assessment is that the geographic and credit impact can largely be contained to Israel and its nearest neighbors—for the time being. The key risk is the potential for the conflict to escalate and spread more widely in the region with significant repercussions that could extend globally. The Russia-Ukraine conflict will drag into 2024. Ongoing hostilities, and both countries' large role in key commodity markets increase the risk for energy and food prices to rise, which could undermine confidence and growth in EMs. In addition, the political landscape across many EMs remains complicated amid a heavy electoral year. Overall fragile institutions, along with fragmentation and polarization at the legislative level, are making it difficult to carry out relevant reforms to support long-term growth. The disenchantment with politicians and democracy is growing, which could in the long run erode policy predictability and sovereigns' ability to deal with fiscal challenges and to support economic growth.

China's economy: Deepening property sector woes, weak confidence, and high debt levels to weaken growth momentum

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

The spreading contagion from China's real estate crisis (to local governments and real estate-related sectors) is curbing the country's economic growth momentum. Risk of financiers curtailing lending amid China's very high corporate leverage could exacerbate credit stresses for borrowers. China's weakening economy could filter into the region's economies and EMs reliant on China for tourism, exports, imports (product components), finance, or the supply chain.

Structural risk: Climate change and rising adaptation costs

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

Larger, more frequent natural disasters increase physical risks for public- and private-sector entities and threaten to disrupt supply chains such as for agriculture and food production in some EMs. El Niño phenomenon has had uneven effects during the year with many EMs suffering from either severe droughts or abnormal rains. Full effects of El Niño phenomenon are yet to be seen but past occurrences have caused food prices to jump and other supply shocks.

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.