S&P Global
Ratings

The Ratings View

March 28, 2024

This report does not constitute a rating action.

Key Takeaways

- Resilient economies curtail recession fears, but inflation risks may delay rate cuts.
- Credit conditions improving, but labor cost, real estate and geopolitical risks still loom.
- Higher rates continue to pressure commercial real estate asset valuations.

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Economies are resilient, but rate cuts will likely be more gradual as a result. The economic response to the higher rate environment is playing out largely as we anticipated (U.S. outperformance is the notable outlier) with slower activity and falling inflation pressures. Resilient labor markets, reflecting relatively strong services demand and hoarding of employees, have tempered the slowdown and helped avoid recessions so far. We maintain our higher-for-longer view on policy rates and expect the first cuts around mid-2024 from major central banks and expect subsequent cuts to be gradual as the road back to neutral will take time. Our baseline forecast has higher 2024 growth on the back of upward revisions to the U.S. and India and is predicated on labor demand remaining strong. Aside from sharply weaker services demand and a stronger U.S. dollar, geopolitics including a spate of elections, pose downside risks.

Global Economic Outlook Q2 2024: Still Resilient, With Gradual Rate Cuts Ahead

Economic Outlook Asia-Pacific Q2 2024: APAC Bides Its Time On Monetary Policy Easing
Economic Outlook Emerging Markets Q2 2024: Growth Divergence Ahead
Economic Outlook Eurozone Q2 2024: Labor Costs Hinder Disinflation As Rate Cuts Loom
Economic Outlook U.K. Q2 2024: The U.K. Is Slowly Turning A Corner
Economic Outlook U.S. Q2 2024: Heading For An Encore

Credit conditions are improving as the soft-landing base-case appears more likely and financial markets anticipate rate cuts, but risks persist. Reflecting this, equity markets remain buoyant, corporate bond yields have retreated from autumn highs, and credit risk premia have seen a sustained fall. Nevertheless, elevated financing costs and persistent inflationary pressures could bring a bumpy ride. Many fixed-rate borrowers remain exposed to higher refinancing costs, especially if rate cuts are deferred. Labor costs remain elevated for many North America corporate borrowers, and geopolitical tensions threaten to push up prices (such as commodities and shipping) and constrain supply chains. In Asia-Pacific, China's property challenges remain a top risk given their impact on spending by households and businesses.

Credit Conditions Asia-Pacific Q2 2024: A Delicate Balance
Credit Conditions Emerging Markets Q2 2024: Unmet Expectations Could Heighten Risks
Credit Conditions Europe Q2 2024: Credit Heals, Defense Shields
Credit Conditions North America Q2 2024: Soft Landing, Lurking Risks

Higher rates continue to pressure commercial real estate asset valuations by increasing cap rates, weighing on debt service coverage ratios across property types. We expect credit quality for equity REITs to weaken modestly in 2024 given that office REITs remain pressured due to refinancing risk and weaker operating performance, while commercial mortgage REITs continued to face declining asset quality, primarily driven by office loans. In contrast, demand for housing remains resilient due to the sturdy job market, and sales for homebuilders continues to recover, supporting stable credit quality. We expect the building materials sector to face modest pressure in the first half of 2024 with potential for improvements in the second half as an expected rate cut could drive a recovery in spending.

Real Estate Monitor: Higher-For-Longer Interest Rates Will Continue To Weigh On The Sector

We revised the rating outlooks on five U.S. regional banks to negative from stable. Stress in commercial real estate (CRE) markets, such as reduced property prices and higher vacancies particularly for investor-owned office properties, has created a rising challenge for banks with sizable loan exposures to CRE. While most rated banks haven't reported a sharp rise in delinquent and nonaccrual CRE loans, increases in criticized and modified loans and increasing loan maturities may foreshadow an eventual material deterioration in asset quality and performance.

Outlooks On Five U.S. Regional Banks Revised To Negative From Stable On Commercial Real Estate Risks; Ratings Affirmed
Some U.S. Regional Banks Could Face Higher Risk If Commercial Real Estate Asset Quality Worsens

Our latest U.S. economic forecast bodes well for U.S. airports, ports, toll roads, and mass transit providers. We believe activity measures across most transportation modes will likely return to near pre-pandemic historical averages, although industry-specific variables such as airline capacity constraints, trade tariffs, geopolitical conflicts, and growing cost pressures could dampen near-term growth. Remote work trends will continue to drag on public transit ridership, with our activity estimates showing public transit recapturing about 75% of pre-pandemic activity in 2024, 80% in 2025, and only about 85% in 2026.

U.S. Transportation Infrastructure 2024 Activity Estimates Indicate A Return To Pre-Pandemic Levels And Growth, With Transit Ridership Still Recovering

A sharp dip in in the price of bonds issued by Altice France S.A. and Altice France Holding S.A. (together, Altice France) is unlikely to have significant knock-on effects for collateralized loan obligations (CLOs), despite the group's status as the largest individual issuer of debt to European CLOs rated by S&P Global Ratings. The potential for damage is cushioned because CLOs have no forced-sale mechanism, which would make them realize losses related to the market-value of the debt. All things being equal, even a default by Altice France, or a credit rating downgrade, would have limited repercussions for CLOs' performance.

Your Three Minutes In European CLOs: Altice France Isn't A Big Problem, For Now

Synthetic fuels, or e-fuels, could support decarbonization objectives across numerous sectors. We think aviation and shipping will be the main users of future e-fuels. Policy moves in Europe will likely create a market for these fuels, but huge investment will be required to supply the inputs that make them a low-carbon solution. Economic models for e-fuels remain uncertain for now. High input-energy requirements present a significant cost barrier for both producers and consumers. There are material technological hurdles still to overcome and, beyond carbon, e-fuels still emit other pollutants. Other environmental exposures could persist. We see limited credit impact in the next decade given modest regional ambitions regarding e-fuel use. They will have time to plan, but aviation and shipping companies in Europe might need to make difficult choices in the next decade as regulations take effect.

Sustainability Insights Research: E-fuels: A Challenging Journey To A Low-Carbon Future

Asset Class Highlights

Corporates

Notable publications include:

- Default, Transition, and Recovery: 2023 Annual Japanese Corporate And Public Finance Default And Rating Transition Study
- Sustainability Insights Research: E-fuels: A Challenging Journey To A Low-Carbon Future
- Credit FAQ: Will China's 'White List' Boost Housing Sentiment?
- Hong Kong Retail Property: Can The Resilience Last?
- Corporate Results Roundup Q4 2023: Earnings show signs of stabilizing
- U.S. Transportation Infrastructure 2024 Activity Estimates Indicate A Return To Pre-Pandemic Levels And Growth, With Transit Ridership Still Recovering
- Real Estate Monitor: Higher-For-Longer Interest Rates Will Continue To Weigh On The Sector
- Key Credit Drivers For North American Midstream Energy Companies In Q2 2024
- German Chemical Industry's Decarbonization Is A Team Effort

Financial Institutions

- **In the United States, we revised the rating outlooks on five U.S. regional banks to negative from stable**. Stress in commercial real estate (CRE) markets, such as reduced property prices and higher vacancies particularly for investor-owned office properties, has created a rising challenge for banks with sizable loan exposures to CRE. While most rated banks haven't reported a sharp rise in delinquent and nonaccrual CRE loans, increases in criticized and modified loans and increasing loan maturities may foreshadow an eventual material deterioration in asset quality and performance. See:
  - Outlooks On Five U.S. Regional Banks Revised To Negative From Stable On Commercial Real Estate Risks; Ratings Affirmed and
  - Some U.S. Regional Banks Could Face Higher Risk If Commercial Real Estate Asset Quality Worsens.
- **In Japan, revised the rating outlook on Aozora Bank to negative from stable**. We expect Aozora Bank's financial flexibility to be constrained because of its low profit generating capacity and uncertainties over its operating environment.
- **In the United Kingdom, Nationwide Building Society and Virgin Money UK (VMUK) have agreed the terms of a cash acquisition of VMUK by Nationwide**. The deal remains subject to regulatory and VMUK shareholder approvals. We expect our ratings on holding company (VMUK) and operating company (Clydesdale Bank PLC) to benefit from group support once the acquisition completes. As a result, we have placed all our ratings, including our 'BBB-' long-term issuer credit rating on VMUK and our 'A-' rating on Clydesdale Bank, on CreditWatch with positive implications. We expect to resolve the CreditWatch positive placement upon close of the acquisition, which is expected by the end of 2024. We affirmed our 'A+' long-term issuer credit rating on Nationwide Building Society. The outlook is stable.
- **We revised the rating outlooks on three Egyptian banks to positive from stable**, at the same time, we affirmed our 'B-/B' long- and short-term issuer credit ratings on the three banks.

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The outlook revisions follow that to Egypt amid potential further advancements in the country's external position and alleviation of foreign currency shortages.

- We published several commentaries, including:
  - Global Shadow Banks Face Scrutiny As Risks Rise
  - French Banks' Results Should Generally Strengthen In 2024 After A Mixed 2023
  - Mexico's Banks Are Well Positioned As Its Central Bank Starts Cutting Rates
  - Credit FAQ: GCC Banks' Climate Transition Journey Has Only Just Begun
  - India's Regulatory Clampdown May Raise The Cost Of Capital

Sovereign

- Albania Upgraded To 'BB-' From 'B+' On Improved Fiscal And External Positions; Outlook Stable
- Cameroon Ratings Raised To 'B-/B' On Lower Liquidity Tensions And Resilient Growth; Outlook Stable

Structured Finance

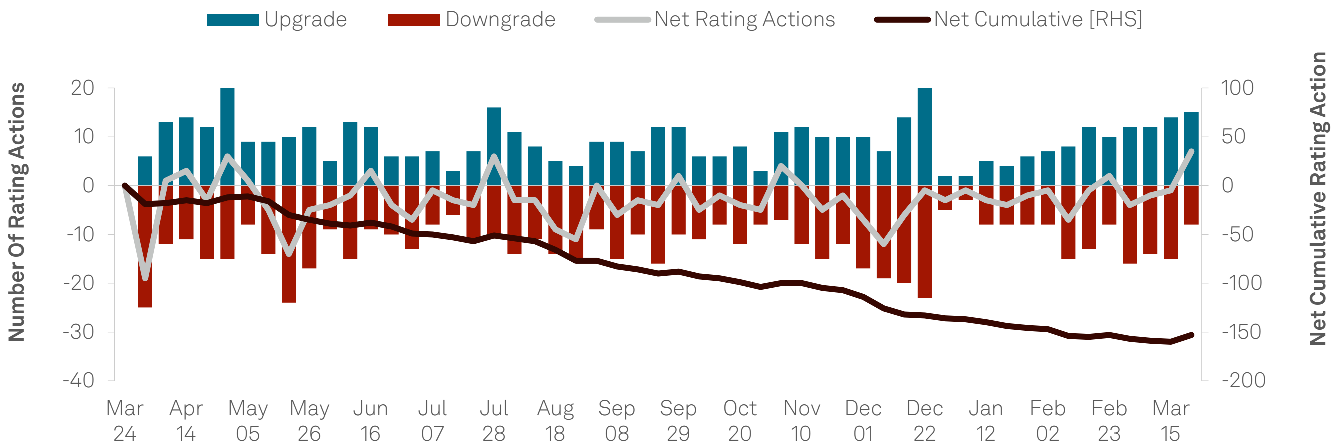
- **Global Structured Finance:** Here are a few "Key Takeaways" from a recent article:
  - The global structured finance default rate nearly tripled to 1.3% in 2023 from a 15-year low of 0.5% in 2022--still well below the long-term one-year average of 3.6%.
  - Of the 33,851 global structured finance ratings outstanding at the start of 2023, we lowered 3.3% (up from 2.3% in 2022) and raised 12.4% (up from 9.1% the prior year).
  - The CMBS sector led downgrades in the U.S. and Europe in 2023, while defaults were highest globally in U.S. RMBS, particularly among legacy asset classes, and structured credit led defaults in Europe. The RMBS sector also led upgrades in the U.S. and Europe.
  - By region, defaults were concentrated in the U.S., with a handful from Europe, one from Latin America, and none from any other regions in 2023. Latin America had the highest downgrade rate, at 4.2%.
  - See "Default, Transition, and Recovery: 2023 Annual Global Structured Finance Default And Rating Transition Study" published Mar. 18, 2024.
- **U.K. RMBS:** A Credit FAQ published on Mar. 20, 2024 by S&P Global Ratings takes a closer look at granular residential bridging lending in the U.K. We summarize the current market structure, possibility of bridging loan securitizations, our analytical considerations, and key structural features (see "ABS Frontiers: U.K. Bridging Loan RMBS Explained").
- **Asset-Backed Commercial Paper:** S&P Global Ratings published on Mar. 22, 2024 its updated methodology and assumptions for rating asset-backed commercial paper (ABCP) and medium-term note (MTN) issuances by special-purpose entity (SPE) conduit issuers. The article is titled "Global Asset-Backed Commercial Paper Methodology And Assumptions." In conjunction with these criteria, we also published "RFC Process Summary: Global Asset-

Backed Commercial Paper Methodology And Assumptions". An RFC process summary summarizes the comments received from market participants during the RFC review period, presents our responses to these comments, and summarizes how--if at all--the market feedback resulted in changes to the final criteria.

- **European ABS and RMBS:** Here are a few "Key Takeaways" from a recent article:
  - Despite rising interest rates, the size of external liquidity reserves in most European ABS and RMBS transactions have remained broadly unchanged since 2020.
  - Between Q1 2022 and Q2 2023 ABS and RMBS originators did not reflect higher interest rates to borrowers, while at the same time funding spreads and swap costs increased. This resulted in depleted excess spread and increasing reliance on external liquidity support.
  - Consequently, some transactions have less available external liquidity to address significant event-driven liquidity disruptions, such as those deriving from commingling or cyber-attack risks.
  - Generally, transactions have structural features to mitigate liquidity events, such as using principal to pay interest and deferrable notes. However, such mechanisms may affect the timing and repayment of the junior notes.
  - See "European ABS And RMBS: External Liquidity Reserves Withstand Rising Rates" published Mar. 22, 2024.
- **Covered Bonds:** S&P Global Ratings published on Mar. 19, 2024 an update to its covered bonds primer (see "Covered Bonds Primer"). This report provides a comprehensive guide to the fundamentals and key features of the product. It covers the most recent regulatory updates, the key features of the market, the role played by central banks, the investor and issuer perspectives, and more.

Chart 1

Global Rating Actions (Rolling 52-Weeks)



Source: S&P Global Ratings. Net rating actions means downgrades minus upgrades. Net cumulative means total net rating actions. Data as of Mar. 22, 2024. Global rating actions include actions on both financial and non-financial corporates and sovereign issuers.

Table 1

Recent Rating Actions

Date	Action	Issuer	Industry	Country	To	From	Debt vol (mil. $)
22-Mar	Downgrade	Lumen Technologies Inc.	Telecommunications	U.S.	SD	CC	16,687
18-Mar	Upgrade	Cenovus Energy Inc.	Oil & Gas	Canada	BBB	BBB-	7,896
18-Mar	Downgrade	Intrum AB	NBFI	Sweden	B	BB-	4,191
19-Mar	Downgrade	Essential Utilities Inc.	Utilities	U.S.	A-	A	4,026
20-Mar	Downgrade	GrafTech International Ltd.	Metals, Mining & Steel	U.S.	B-	B+	3,200
18-Mar	Upgrade	YPF S.A	Oil & Gas	Argentina	CCC	CCC-	2,900
21-Mar	Upgrade	Vericast Corp.	Media & Entertainment	U.S.	B-	CCC	2,743
22-Mar	Upgrade	Republic of Albania	Sovereign	Albania	BB-	B+	2,605
20-Mar	Downgrade	Herbalife Nutrition Ltd.	Consumer Products	Cayman Islands	B	B+	2,550
22-Mar	Upgrade	Republic of Cameroon	Sovereign	Cameroon	B-	CCC+	1,494

Source: S&P Global Ratings Credit Research & Insights. Data as of Mar. 22, 2024. U.S. means United States, U.K. means United Kingdom and U.A.E. means United Arab Emirates. NBFI - NonBank Financial Institutions (ex. Insurance)

For further credit market insights, please see our **This Week In Credit** newsletter**.**