The Ratings View

April 24, 2024

This report does not constitute a rating action.

Key Takeaways

- We published a white paper assessing how megatrends can affect credit.
- China could face a third wave of corporate bond defaults.
- U.S. local governments could be particularly exposed to climate hazards.

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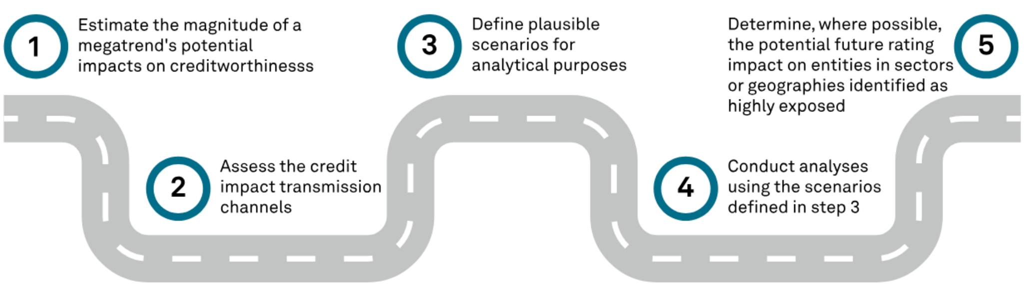
Megatrends matter for credit. Global risk trends such as climate change, increasing digitalization, geopolitical risks, aging populations, and disruptive technologies like artificial intelligence are gradually reshaping our world, often unpredictably. The impact of some trends may take many years to unfold such as, for example, sea level rise linked with climate change. Others may emerge suddenly after events like severe hurricanes, wildfires, escalation of armed conflict, or major cyberattacks. Megatrends can become material to credit ratings if they affect factors that contribute to our assessment of creditworthiness. Some megatrends have already led to credit rating changes and, depending on how they evolve, may do so in the future. In a White Paper, we outline key concepts that help assess the credit materiality of megatrends and how they might influence credit ratings, now and in the future, using climate change as an example. This paper relates to all foundational criteria articles used to assign credit ratings.

The road to credit materiality: Five steps from megatrend to credit impact

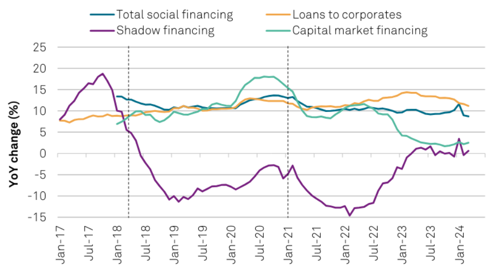


Source: S&P Global Ratings.

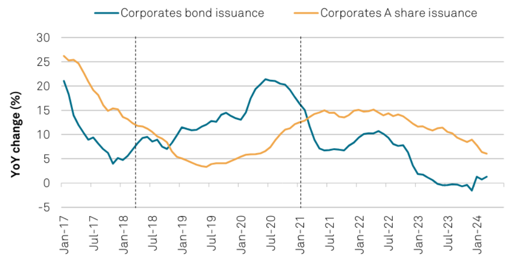
White Paper: Assessing How Megatrends May Influence Credit Ratings

China could face a third wave of corporate bond defaults. Slowing economic growth, government policies, and tight financing could trigger a third wave of corporate bond defaults in China after the current trough. The policies behind the first two waves focused on overcapacity and asset management in 2018 and real estate "three red lines" in 2021. The policies aimed to rein in excessive debt leverage, and both led to significant contractions in “shadow” or capital market financing. More policies with similar aims, scale, and effects on corporates may lead to the next wave of defaults.

Policies, Contractions, And Default Waves



Market Access An Issue After The Second Wave



Data as of Apr. 15, 2024. Shadow financing includes trust loans, entrusted loans and undiscounted bank bills of acceptance. Capital market financing includes corporates bond issuance and corporates A share issuances. YoY--Year on year. Sources: Wind, S&P Global Ratings.

China Could Face A Third Default Wave After The Current Trough

U.S. local governments could be increasingly exposed to climate hazards. Climate warming is accelerating faster in the U.S. than the global average, according to the U.S. Fifth National Climate Assessment. Data from S&P Global Sustainable1 projects more frequent extreme heat events and coastal flooding from rising sea levels will underpin exposures for U.S. local governments to 2050--that is, if global warming does not remain well below the 2 degrees Celsius ambition of the Paris Agreement. From 2010-2019, the U.S. recorded 131 disasters costing $1 billion or more (total costs reached $977.9 billion). This was up from 67 events between 2000 and 2009 ($607 billion). By 2030, if mitigation of greenhouse gas emissions is not stepped up, there could be 40% more disasters than in 2015, with 250 events globally a year, according to a 2022 report by the U.N. Office for Disaster Risk Reduction.

By the numbers: Climate change impacts in the U.S.

Sources: IPCC, NOAA, S&P Global Sustainable 1.

Sustainability Insights: Navigating Uncertainty: U.S. Governments And Physical Climate Risks
Sustainability Insights: The Impact Of Rising Insurance Premiums On U.S. Housing

U.S. cities continue to grapple with the transitional effects of remote work, and the medium-term credit outlook is marked by elevated economic and budgetary uncertainty. However, these challenges are not likely to be overwhelming or lead to significantly elevated negative rating bias. We expect cities to see sluggish revenue growth in the coming few years rather than precipitous cliffs from falling tax collections tied to commercial real estate (CRE), and we have widely observed residential valuations supporting tax base stability even in cities seeing CRE values decline. Cost pressures related to post-pandemic transition may ultimately prove as much, or even more, of a challenge as revenue underperformance, given the demands cities face to support downtown revitalization, public safety, housing, and homelessness amid upward wage pressure and higher interest rates.

Credit Quality For U.S. Cities Holds Up Despite Challenging Commercial Real Estate Market

Asset Class Highlights

Corporates

Notable publications include:

- Your Three Minutes In China Property Reorgs: Jinke's Court Workout Could Spur Others
- China Default Review 2024: Trough Before The Third Wave
- Net-Zero Targets Leave GCC Oil Companies Unperturbed For Now
- Credit FAQ: What Lies Ahead For Algonquin Power & Utilities Corp. In 2024
- White Paper: Assessing How Megatrends May Influence Credit Ratings
- CreditWeek: How Does Iran's Attack On Israel Affect Credit Conditions And Sovereign Ratings?

Financial Institutions

- We published several commentaries including:
    - Visa And Mastercard's Settlement On Interchange Fees Will Reduce Their Legal Risk And Won't Hurt Profitability
    - Japan's Bumper M&A Risky For Banks
    - Malaysian Banking Sector Review: Standing Firm In The Face Of External Headwinds
    - SLIDES: Austrian Banks In 2024: Downside Risks Are Contained
    - Asia-Pacific Financial Institutions Monitor 2Q 2024: As Good As It Gets
    - Your Three Minutes In Banking: Commercial Real Estate Isn't Worrying CEE Banks

Sovereign

- Greece Outlook Revised To Positive On Ongoing Debt Stock Reduction; Affirmed At 'BBB-/A-3'
- Benin Upgraded To 'BB-/B' On Resilient Economic Growth; Outlook Stable
- Israel Long-Term Ratings Lowered To 'A+' From 'AA-' On Heightened Geopolitical Risk; Outlook Negative
- Guatemala Outlook Revised To Positive On Sustained Macroeconomic Resilience; 'BB/B' Ratings Affirmed

Structured Finance

- **European CLO**: Here are a few "Key Takeaways" from a recent article:
    - European CLO 1.0 performance has stood the test of time, with only 1.5% of rated tranches suffering a loss since 2000.

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- European CLO 2.0 performance has also been strong, with zero defaults and a low number of downgrades in the past 11 years.
- European CLO ratings have weathered several significant macroeconomic events--such as the global financial crisis and the COVID-19 pandemic and subsequent recessions--with minimal defaults.
- See "CLO Spotlight: Twenty-Five Years Strong: European CLOs' Lifetime Default Rate Is Only 1.5%" published April 18, 2024.

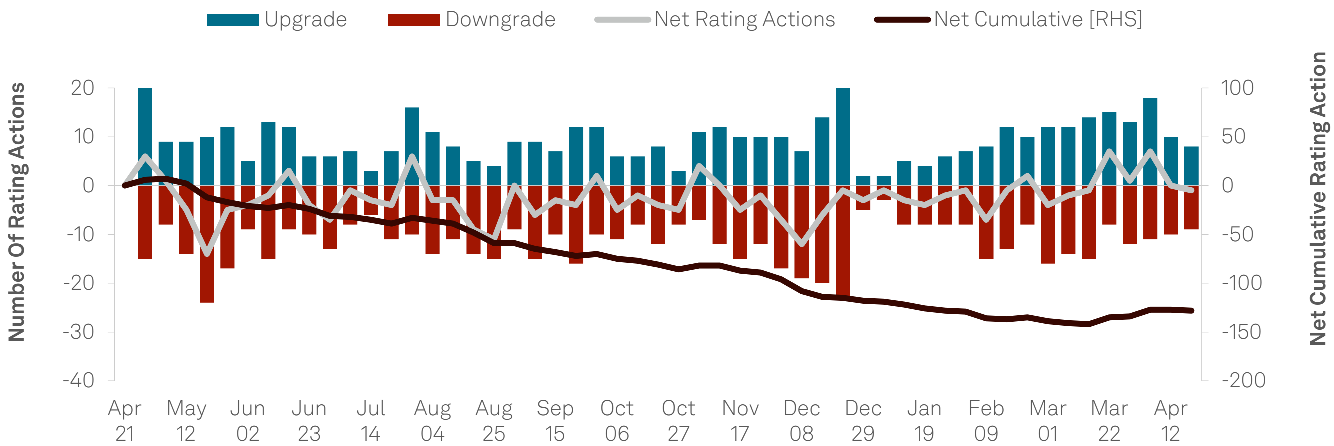
- **European CMBS:** S&P Global Ratings' new publication, "European CMBS Special Notices Summary Q1 2024", published on April 16, 2024, provides a comprehensive overview of European commercial mortgage-backed securities (CMBS) updates at the transaction level. During the fourth quarter of 2023 and early 2024, we received 20-plus special notices. Within this report, we focus on a subset of these notices, specifically on the ones that have a significant impact on the transactions. Of these notices, 25.7% relate to loan redemptions, while 23% involve proposed amendments such as loan extensions, new interest rate cap agreements, and extensions of the liquidity commitment. In addition, 9.5% pertain to property valuation or property sales. Over the last two years, 18.9% of reports received were for loan extensions, and 20.3% were for property sales.
- **U.S. RMBS:** Here are a few "Key Takeaways" from a recent article:
  - Our assessment of U.S. home price overvaluation fell roughly one percentage point to 14.3% as of fourth-quarter 2023.
  - Wage growth outpaced home price gains in the fourth quarter, but 89% of MSAs are still overvalued, though with a fair degree of regional variation.
  - The credit impact on U.S. RMBS will depend on the mortgage pools' geographic distribution and the valuation dates of the underlying properties backing the loans in those pools.
  - See "U.S. Home Price Overvaluation Softens As Wage Growth Outpaces Home Price Gains" published April 15, 2024.
- **Japan RMBS:** Here are a few "Key Takeaways" from a recent article:
  - Performance of mortgage loans underlying JHF notes remains relatively stable. Increased interest rates and slight inflation will have limited impact on delinquencies and defaults.
  - A low and stable unemployment rate will underpin performance, while delinquency and replacement/withdrawal rates have risen slightly.
  - We expect the prepayment rate to remain low since refinancing by people who borrowed in a negative interest rate environment will be curtailed amid rising interest rates.
  - See "JHF RMBS Performance Watch April 2024: Rising Interest Rates And Prices Have Limited Impact" published April 18, 2024.
- **U.S. VRDOs:** See "Your Three Minutes In U.S. VRDOs: Joint Sensitivity Analysis" published April 17, 2024.
- **Latin America Securitization:** Here are a few "Key Takeaways" from a recent article:
  - Cross-border issuance in Latin America has been focused on tailor-made transactions that have arisen from specific market opportunities. Historically,

these structures have provided a platform to access investors in international debt markets, required for issues that may be too large for any domestic market in the region.

- S&P Global Ratings currently rates 21 cross-border transactions with assets domiciled in Latin America, including repackaged transactions, consumer asset-backed securities (ABS) transactions, future flows, retranching structures, and covered loans.
- We do not expect major changes in the performance of the transactions we rate over the next 12 months. However, most of the transactions in our portfolio are also dependent on the rating on sovereigns or GREs, which could pose downside risk to deals related to sovereigns that have negative outlooks.
- See "Latin America Cross-Border Securitization Market Primer" published April 15, 2024.

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 April 19, 2024. Global rating actions include actions on both financial and non-financial corporates and sovereign issuers.

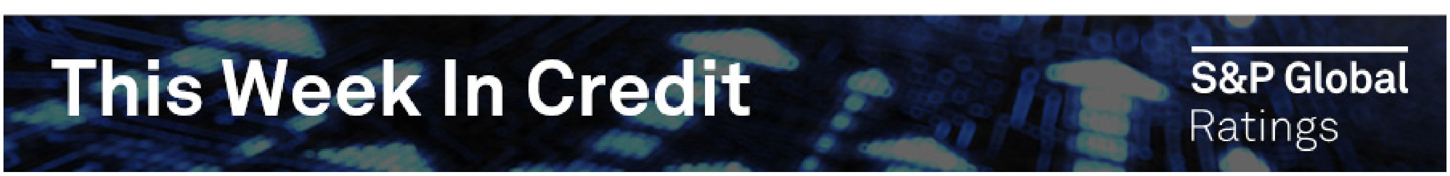
Table 1

Recent Rating Actions

Date	Action	Issuer	Industry	Country	To	From	Debt vol (mil. $)
18-Apr	Upgrade	Bausch Health Co. Inc.	Health Care	Canada	CCC+	CCC	45,650
18-Apr	Downgrade	State of Israel	Sovereign	Israel	A+	AA-	43,194
15-Apr	Downgrade	Kering S.A.	Consumer Products	France	A-	A	11,574
19-Apr	Downgrade	Colgate-Palmolive Co.	Consumer Products	U.S.	A+	AA-	7,294
18-Apr	Downgrade	Global Medical Response Inc. (Air Medical Holdings LLC)	Health Care	U.S.	CC	CCC+	4,474
19-Apr	Upgrade	Republic of Benin	Sovereign	Benin	BB-	B+	2,876
16-Apr	Upgrade	Vallourec	Oil & Gas	France	BB+	BB	1,908
19-Apr	Downgrade	Li & Fung Ltd.	Consumer Products	Bermuda	BB	BB+	1,750
16-Apr	Upgrade	Shea Homes L.P.	Homebuilders/Real Estate Co.	U.S.	BB-	B+	1,500
18-Apr	Upgrade	Getlink S.E.	Transportation	France	BB	BB-	904

Source: S&P Global Ratings Credit Research & Insights. Data as of April 19, 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**.**



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