S&P Global Ratings

Global Credit Conditions Q3 2024

Soft Landing, Fragmenting Trajectories

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July 1, 2024

This report does not constitute a rating action



Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions: Asia-Pacific, Emerging Markets, Europe, and North America, which cascade into our global coverage. Discussions center on identifying credit risks and their potential rating impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the Global Committee on June 20, 2024.

Contents

Key Themes

Resilience: Most economies have seen solid growth in 2024 so far, while upgrades have outnumbered downgrades year-to-date among corporates, financial institutions, and sovereigns. But this may prove a high point because we expect growth to slow in the year's second half while rates remain elevated. Regional differences in the pace of cuts will produce rate divergence globally, which could add to volatility and capital outflows to higher-yielding locations.

Defaults to slowly subside : The descent through next March will be slower than the recent rise in defaults. Softer economic growth and still high interest rates will pressure low-rated corporates in consumer-related sectors and emerging markets. Over time, companies are refinancing more and more debt at noticeably higher rates, squeezing businesses' headroom.

Geopolitical risks to the fore: A worsening geopolitical landscape, a more severe economic downturn, a longer-than-expected period of high rates, and growing threats to global trade could derail our base case and lead to weaker business activity and market liquidity.

Global credit conditions: key highlights

Slower GDP growth in 2024

Global: 3.3%

U.S.: **2.5%**, eurozone: **0.7%**, China: **4.8%**

Trade vulnerability

Imports and exports as % of GDP, 2022 figures

U.S.: **27.4%**
China: **38.1%**
World: **62.6%**

Diverging rates ahead

Year-end policy rates for 2024

U.S.: **5.3%,** Europe: **3.4%,**
Japan: **0.25%,** China: **2.5%**

Falling negative outlook bias

As of June 17, 2024

Investment-grade: **9.7%**
Speculative-grade: **18.9%**
'B-' & lower: **34.8%**

'CCC+' and lower

All corporates (% of all spec-grade)
As of May 31, 2024

Global: 10.1%

U.S.: **11.7%**
Europe: **9.1%**
RoW.: **5.7%**

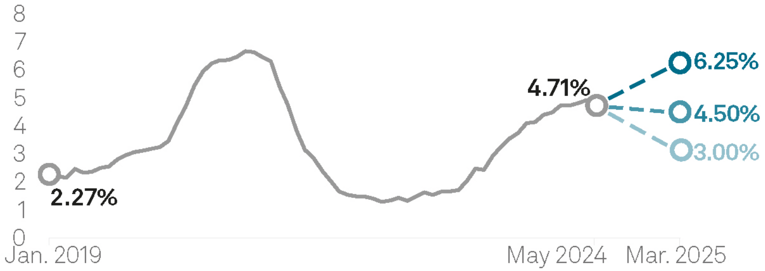
Corporate debt

As of April 1, 2024

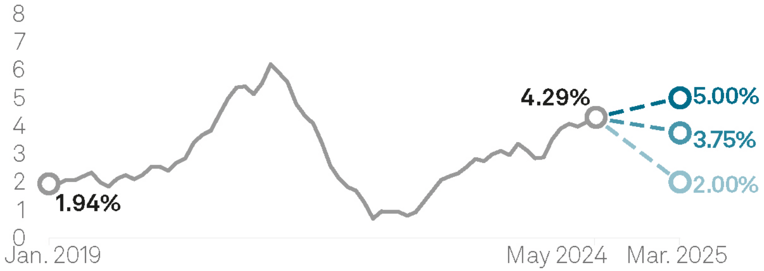
$1.26 tril.
rated 'B-' or lower and
76%
due through 2028

Trailing-12-month speculative-grade default rate and March 2025 forecast

U.S.



Europe



Note: China's one-year medium-term lending facility (MLF) rate is shown, as is the ECB's refi rate. ROW--Rest of world. Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product. Source: Worldbank, S&P Global Ratings. Most recent published default forecasts: "Resilient Growth, Resilient Yields, And Resilient Defaults To Bring The U.S. Speculative-Grade Corporate Default Rate To 4.5% By March 2025," May 16, 2024, and "The European Speculative-Grade Default Rate Should Level Out At 3.75% By March 2025," May 22, 2024.

Global Top Risks: Fragile Resilience Amid Global Challenges

Geopolitical tensions threaten supply chains, trade, and market sentiment

Risk level:	High	Risk trend:	Worsening

The protracted Russia-Ukraine war and a widening Middle Eastern conflict, along with domestic polarization in certain markets, could escalate and provoke greater unpredictability in governmental responses, force increased remedial spending by already stretched government budgets, disrupt investment flows, and increase financial market volatility. This year features over 70 elections in roughly 40 countries whose outcomes could add complexity to already strained international and domestic dynamics for many countries.

Higher interest rates persist, straining many of the weakest borrowers

Risk level:	High	Risk trend:	Improving

Some central banks have started cutting rates, and others are set to start later this year. Still, the pace of cuts will be much slower than their rise, keeping borrowing costs elevated. Higher rates in developed markets would further burden emerging market debt, both directly and through unfavorable exchange rates on nondomestic debt. Growing rate divergence between the U.S. and other major central banks could produce shifts in foreign exchange rates and capital flows.

Growing protectionism threatens global trade

Risk level:	Elevated	Risk trend:	Worsening

Initial tariff proposals on Chinese goods by the Biden administration as well as similar rhetoric from presidential candidate Donald Trump, with the potential for pre-election escalation on both sides, will likely strain bilateral trade flows between the world's two largest economies. Currently unknown is any potential response by China. This could have a global impact, producing yet unknown "winners and losers," with increased supply chain complexities and possible inflationary pressure in certain markets.

A sharper global economic slowdown would lead to greater credit stress ahead

Risk level:	Elevated	Risk trend:	Unchanged

Resilient economies have reduced recession odds in recent months, but we expect most countries to see slower growth in 2024. Still elevated interest rates and the lingering impact of permanently higher prices pose headwinds globally. Savings buffers have been declining and fiscal headwinds are also building, with many countries having taken on increased debt through the pandemic. Labor market resilience will remain a key headwind to any slowdown, but consumer confidence is showing some cracks.

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.

Moderate	Elevated	High	Very high

Source: S&P Global Ratings.

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

Improving	Unchanged	Worsening

Global Top Risks (Continued)

Global real estate markets are facing multiple challenges

Risk level: Elevated **Risk trend:** Unchanged

High interest rates, falling valuations and cash flow, hybrid work environments, high leverage among some countries' homebuilders, and the potential for continued selective market access and high financing costs have combined to present numerous headwinds for both the commercial and residential real estate sectors, globally. These risks remain greatest within the U.S. office sector. Spillover effects from vulnerable real estate holdings could further affect many banking systems via falling asset values or increased writedowns. These pressures could also spill over to broader economies, transmitted through negative effects on consumer confidence, spending, employment, and tax revenues.

Cyberattacks and the potential for rapid technological change threaten global business and government infrastructure

Risk level: Elevated **Risk trend:** Worsening

Amid increasing technological dependency and global interconnectedness, cyberattacks pose a potential systemic threat and significant single-entity event risk. The Russia-Ukraine conflict is raising the prospect of major attacks. Criminal and state-sponsored cyberattacks are likely to increase, and with hackers becoming more sophisticated, new targets and methods are emerging. A key to resilience is a robust cybersecurity system, from internal governance to IT software, all requiring additional costs. Entities lacking well-tested playbooks (such as active detection and swift remediation) are the most vulnerable. Meanwhile, increased digitization and the introduction of AI by public and private organizations will foster broader operational disruptions, and potentially increase market volatility for short periods or even pose greater economic adjustments.

Climate risks and energy transition affect business operations

Risk level: Elevated **Risk trend:** Worsening

Larger and more frequent natural disasters increase the physical risks that public and private entities face, and threaten to disrupt supply chains, such as for agriculture and food. The El Nino phenomenon has disrupted agricultural commodities this year, particularly among emerging markets. At the same time, the global drive toward a "net-zero" economy heightens transition risks (such as policy, legal, technology, market, and reputation risks) across many sectors and will likely require significant investments. That said, geopolitical fragmentation, with increased focus on energy security and domestic industrial policies, raises the risk of abrupt, and potentially contradictory, changes in climate policies. In the U.S., we see transition risks as less acute currently than in Europe, since U.S. legislative policies focus more on subsidies and incentives rather than carbon taxes and trading.

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.

Moderate	Elevated	High	Very high

Source: S&P Global Ratings.

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

Improving	Unchanged	Worsening

Economic Conditions

Still Resilient, With Gradual Rate Cuts Ahead

Inflation data as of June 2024. Policy rates including forecasts are for year-end values. *Simple average. †Median for EM 18 countries. §Refi rate. f—Forecast.
Source: S&P Global Ratings.

- The long-awaited policy rate easing cycle has begun in some advanced economies as inflation continues to decline toward targets. However, the U.S. Federal Reserve remains on hold for now, and some emerging markets are dialing back their monetary easing as a result.
- Our soft-landing narrative remains valid as labor markets remain tight and consumer spending on services remains robust; indeed, Europe has already landed, and a recovery is taking hold.
- Our GDP forecasts are broadly unchanged from the previous quarter with growth in some of the more open emerging markets revised upward; the risks around our baseline include a sharp reduction in labor demand and spillovers from a strong U.S. dollar, as well as geopolitics.

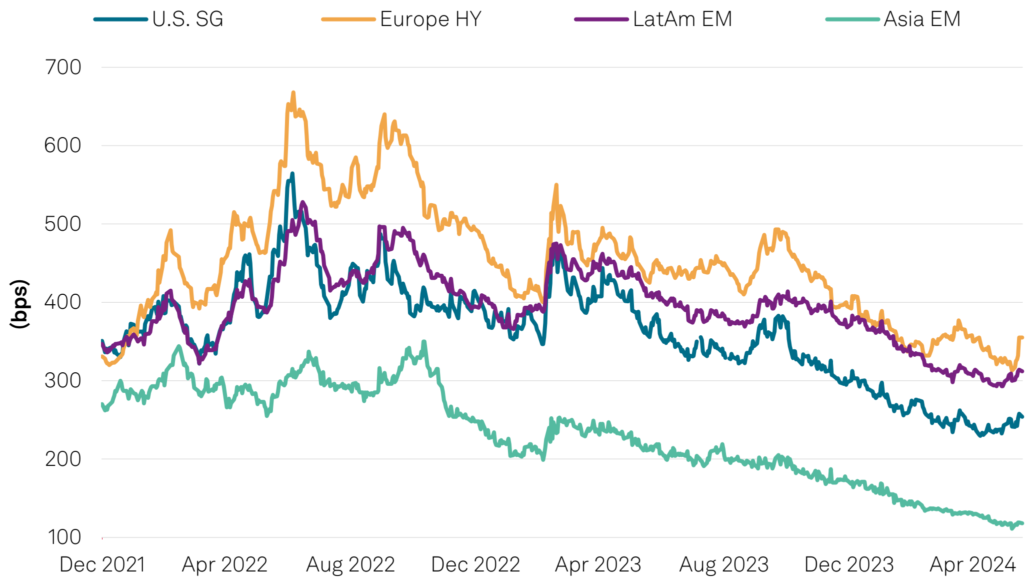
See "Q3 2024 Global Economic Update: The Policy Rate Descent Begins," June 26, 2024.

Financing Conditions

Conflicting Signals: Spreads Remain Historically Low, Yields Historically High

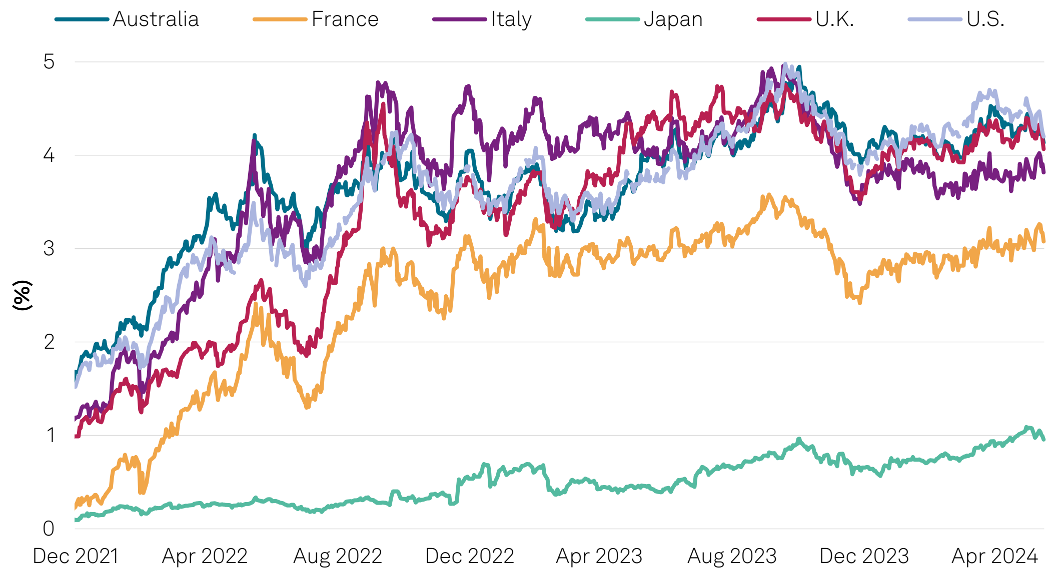
- After setting record lows in March, U.S. speculative-grade corporate bond spreads hit a new low of 230 basis points (bps) on May 7, and remain around the 250 bps mark, indicating still high demand for new debt and yield.
- Other regions may not be seeing all-time lows, but are following similar trends to the U.S. Even European speculative-grade spreads have fallen 40 bps since the start of the year, despite a recent 40 bps widening since the announcement of snap elections in France.
- This surge in market demand has produced strong bond issuance growth thus far in 2024, but spread compression is happening despite stubbornly high (and unmoving) benchmark government rates.

Global corporate bond spreads continue to tighten in 2024



Data through June 17, 2024. HY—High yield. EM—Emerging markets.
Source: S&P Global Ratings Research & Insights, ICE BofA spreads series, retrieved from FRED.

But tightening despite to stable-to-rising benchmarks

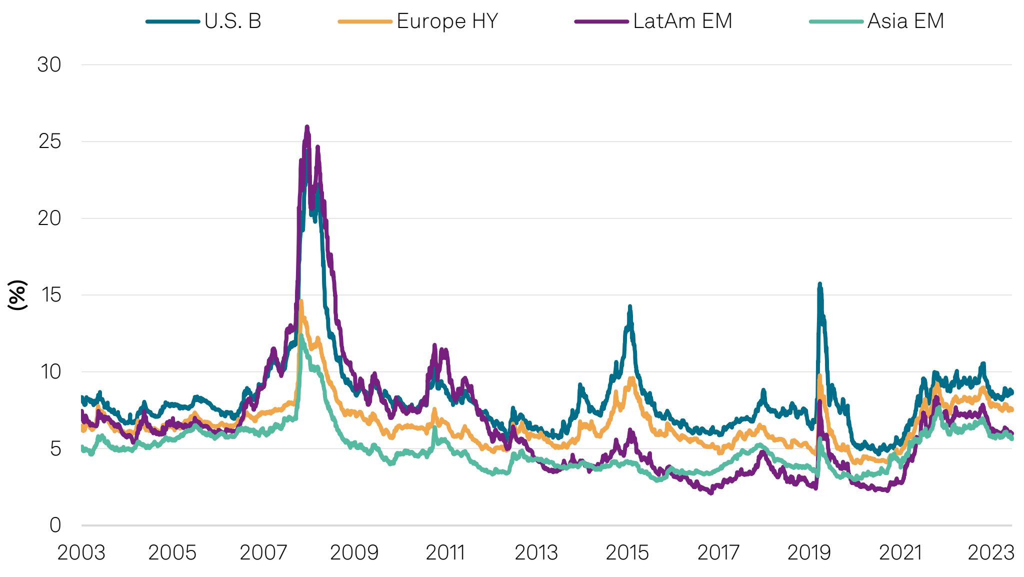


Data through June 14, 2024. Sources: S&P Global Ratings Research & Insights, S&P Global Market Intelligence.

Corporate Yields Remain Elevated, Raising Cost Of Debt

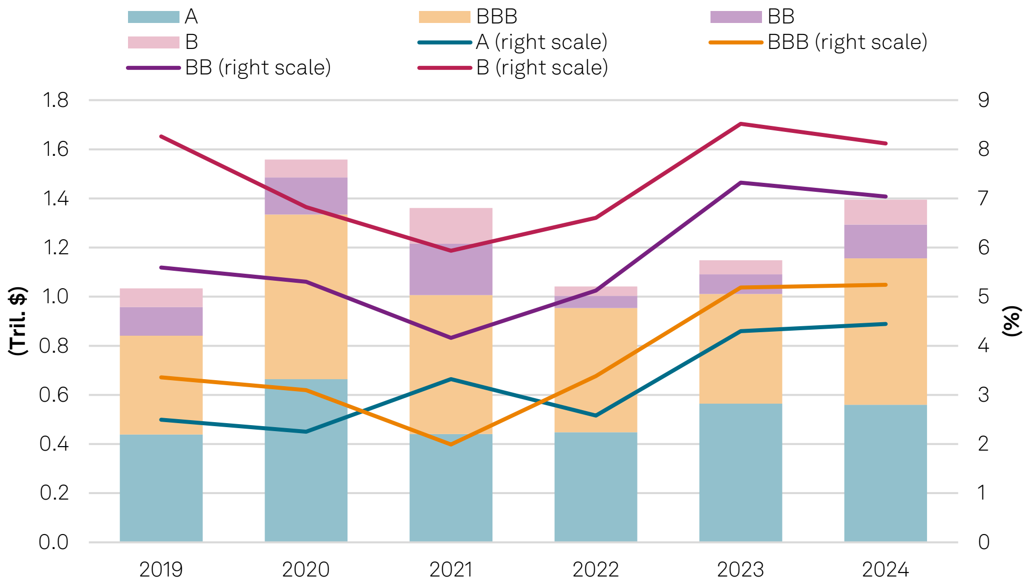
- Global corporate bond yields have fallen after a temporary spike last October but have largely remained at historically high levels since the second half of 2022.
- In our base case, we expect central banks to cut rates over the next 12 months, but only gradually. This may limit future declines in corporate yields ahead.
- As more debt gets refinanced at higher rates, increased costs may squeeze corporate margins, particularly if combined with decelerating revenue from slower projected economic growth ahead.

Global corporate yields have stabilized at their highest nonrecession levels



Data through June 13, 2024. Source: BoA ICE corporate bond yield indices, retrieved from FRED; S&P Global Ratings Credit Research & Insights.

Borrowing surge comes with higher coupons

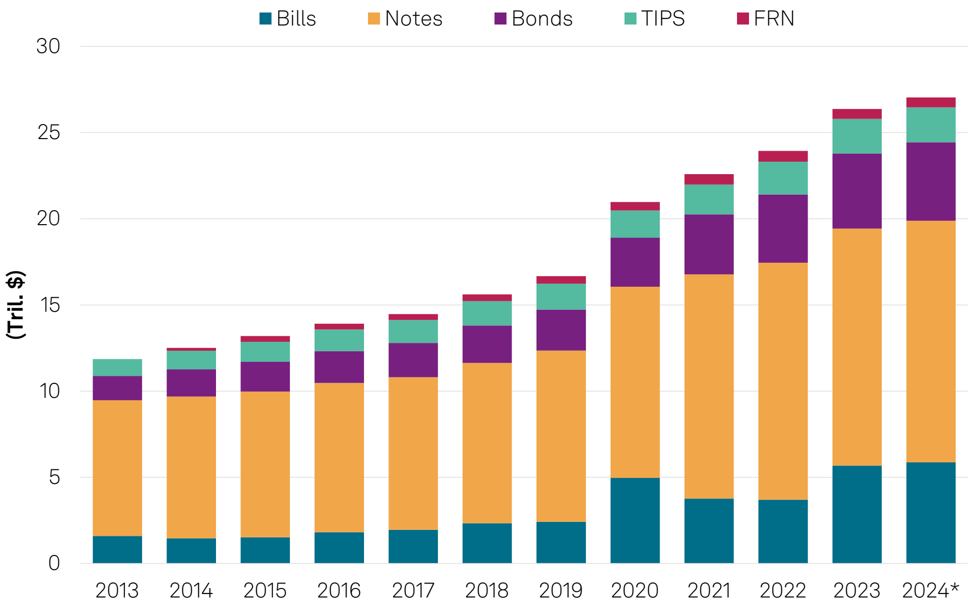


Data shows year-to-date global comparisons through June 13. Includes nonfinancial corporations and financial services companies. Lines represent average coupon rates.
Sources: S&P Global Ratings Research & Insights; Refinitiv.

Treasury Watch: Increasing Supply And Changing Demand

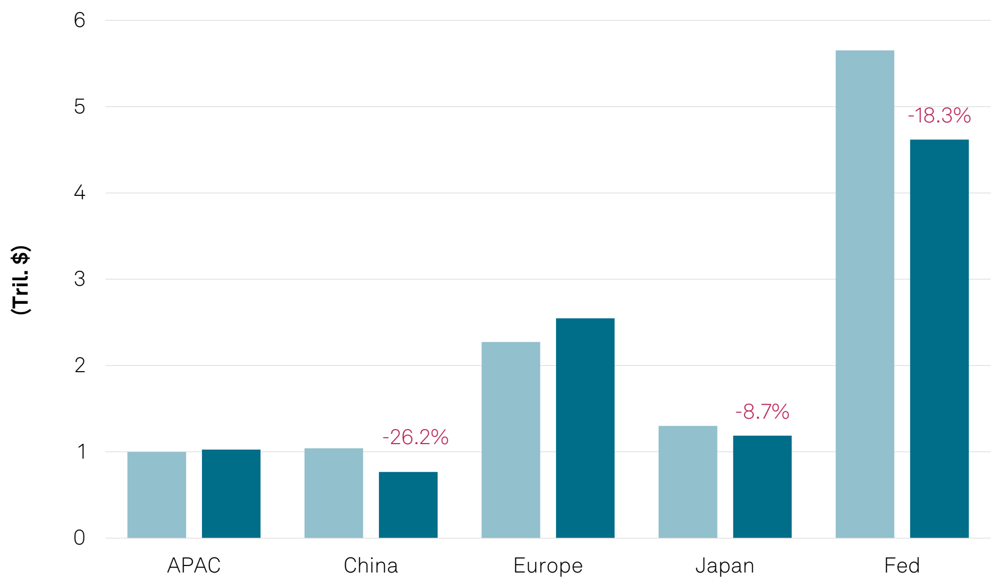
- The supply of outstanding Treasury securities has increased by roughly $3 trillion (15%) since the start of 2023.
- Most of the increase has come from shorter tenors, arguably contributing to prolonged inverted yield curve; complicating normal recession signals.
- Meanwhile, some of the largest holders of Treasuries have been cutting back since 2022: China, Japan, and the Fed. Europe and many U.S. private debtholders are filling the gap, demanding higher yields.
- We're watching this as a potential longer-term risk to the global benchmark for borrowing costs, to capital flow disruption, and potentially to working foreign exchange bands.

Short-term debt has driven large increase in supply



*As of May 31, 2024. FRN—Floating-rate notes. Source: SIFMA; S&P Global Ratings Research & Insights.

China, Japan, and Fed cut treasury holdings*



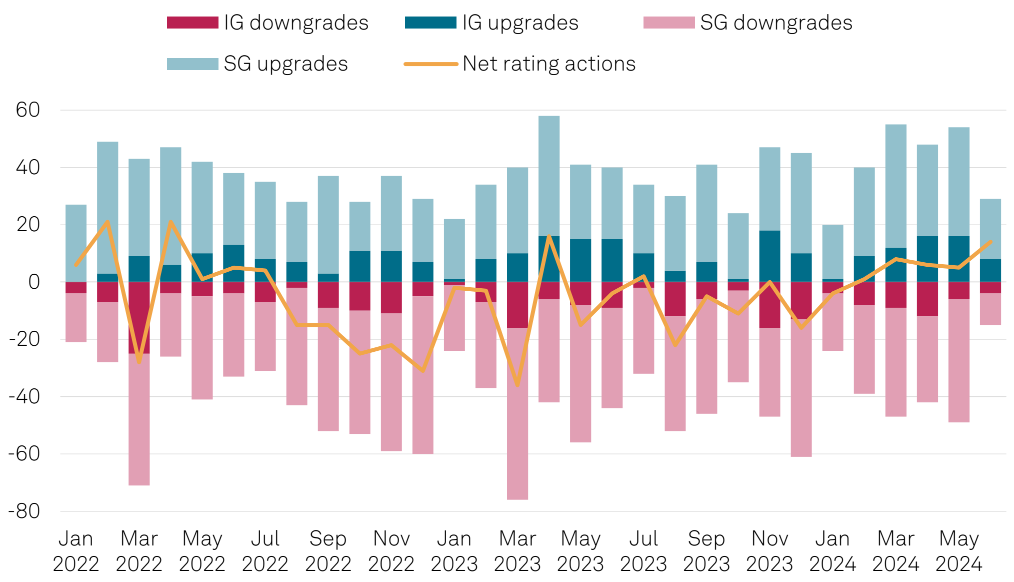
*Some Chinese holdings may appear under other countries or are not included.
Source: Treasury Department; FRED; S&P Global Ratings Research & Insights.

Rating Trends And Expectations

Rating Actions Have Been Net-Positive For The Last Five Months

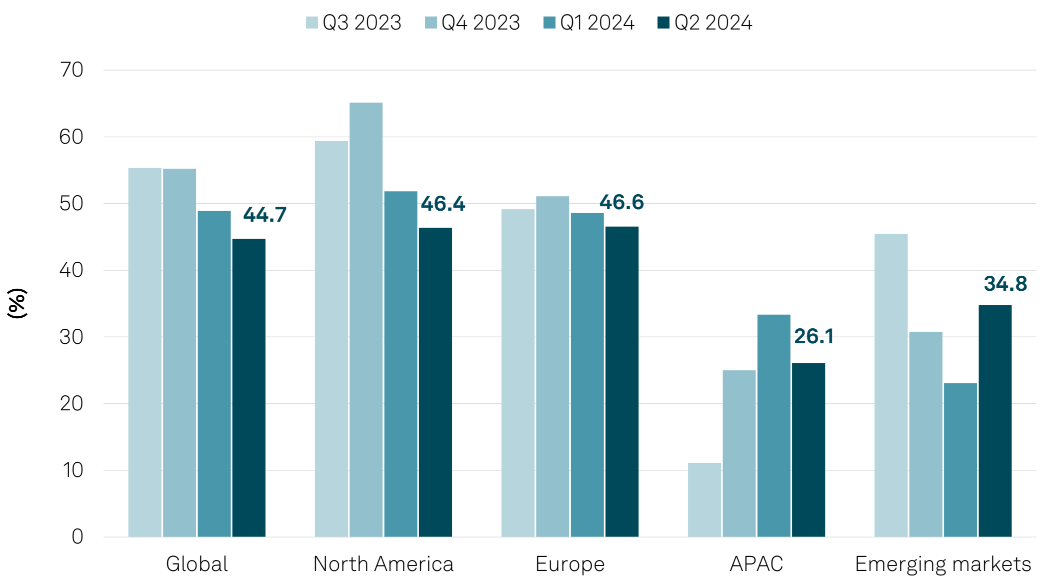
- Improvements in aggregate credit quality from the first quarter have continued through the second quarter, with the highest sustained pace of net upgrades since monetary policy tightening began in early 2022.
- Evan among speculative-grade issuers, 2024 has seen net upgrades through the first half, though some of this may be the result of weaker issuers defaulting and dropping out of the rated population in recent months.
- Through mid-June, all regions have had more upgrades than downgrades in the second quarter, led by APAC with only 26% of all rating actions being downgrades.

Global speculative-grade upgrades lead positive rating trend in 2024



Data as of June 17, 2024. Downgrades exclude defaults. IG--Investment grade. SG--Speculative grade. Source: S&P Global Ratings Credit Research & Insights.

All regions show net upgrades in the second quarter

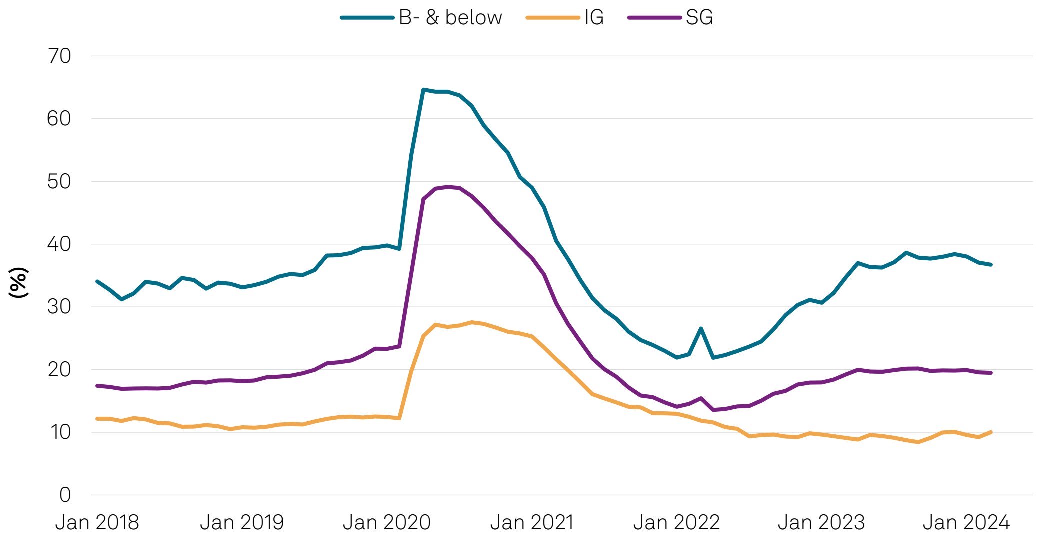


Data as of June 17, 2024. Chart displays downgrade ratios excluding defaults. Downgrade ratios include financials and nonfinancials. Source: S&P Global Ratings Credit Research & Insights.

Downgrade Potential Remains For Lowest Rating Levels But Has Eased

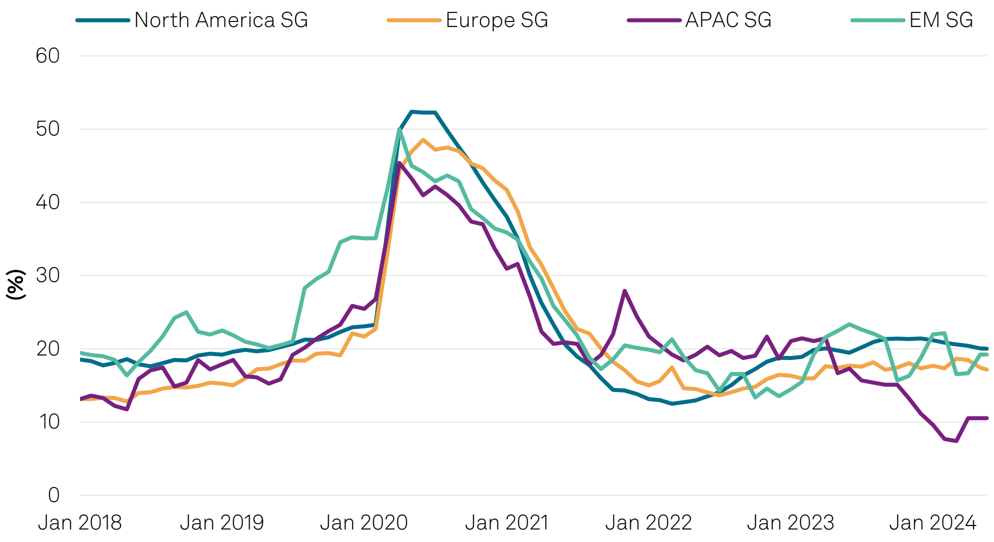
- Despite stubborn interest rates relative to beginning-of-year market expectations, negative bias has broadly held steady, and has even declined slightly for the weakest issuers (‘B-’ and lower) .
- Investment-grade companies remain on solid footing with a negative bias only slightly above its recent all-time low. Large buffers after the surge of pandemic-era issuance and more fixed-rate debt secured with very long maturities and low fixed coupons should provide tailwinds for an extended period.
- Regional speculative-grade negative bias have been stabilizing near 20% this year, while APAC negative bias is only about half that level.

Negative bias slowly eases in 2024, reflecting less downgrade pressure ahead



Excludes sovereigns. Data as of June 17, 2024. IG--Investment grade. SG--Speculative grade.
Source: S&P Global Research & Insights.

APAC maintains lower spec-grade negative bias



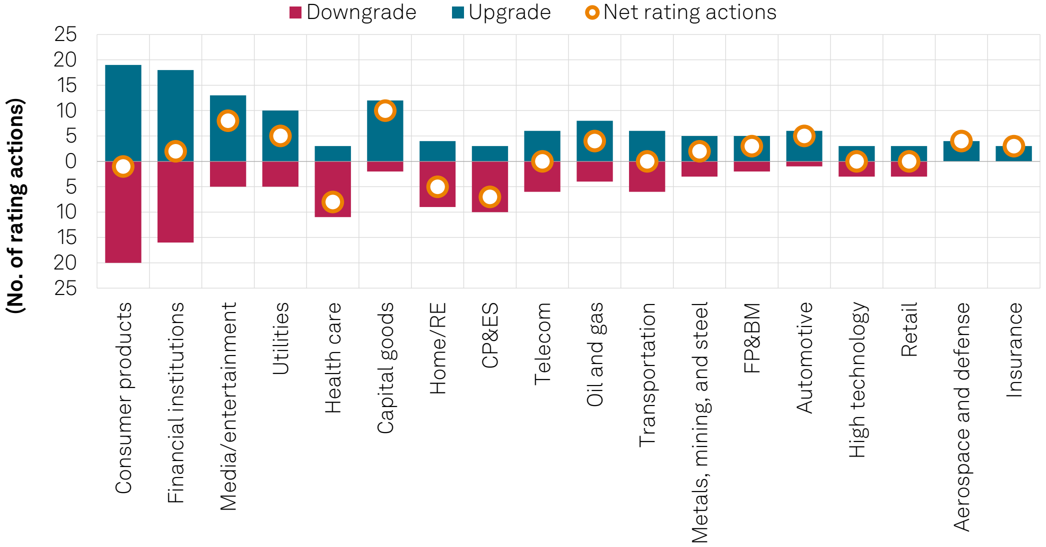
Excludes sovereigns. Data as of June 17, 2024. EM--Emerging markets. IG--Investment grade.
SG--Speculative grade. Source: S&P Global Research & Insights.

Only A Few Sectors Had Net Downgrades, And Outlooks Are Generally Easing

- Consumer products led both downgrades and upgrades, with downgrades spread across the rating spectrum after previously being dominated by actions at the lowest rating levels. Conversely, this sector's upgrades were heavily represented by the lower rating levels. Homebuilders/real estate had a higher downgrade ratio, which was driven by rating actions across the rating spectrum.
- Health care led the tally of net downgrades in the second quarter, with eight of the 11 downgrades resulting in migration to the 'CCC/CC' rating level. All these eight downgrades were from the U.S., and six of the eight were from health care service providers.
- Many sectors with higher net-downgrade rates recently also have some of the highest negative bias--indicating more concentrated downgrades are likely.

Positive rating actions lead outside of health care, chemicals, retail and consumer products

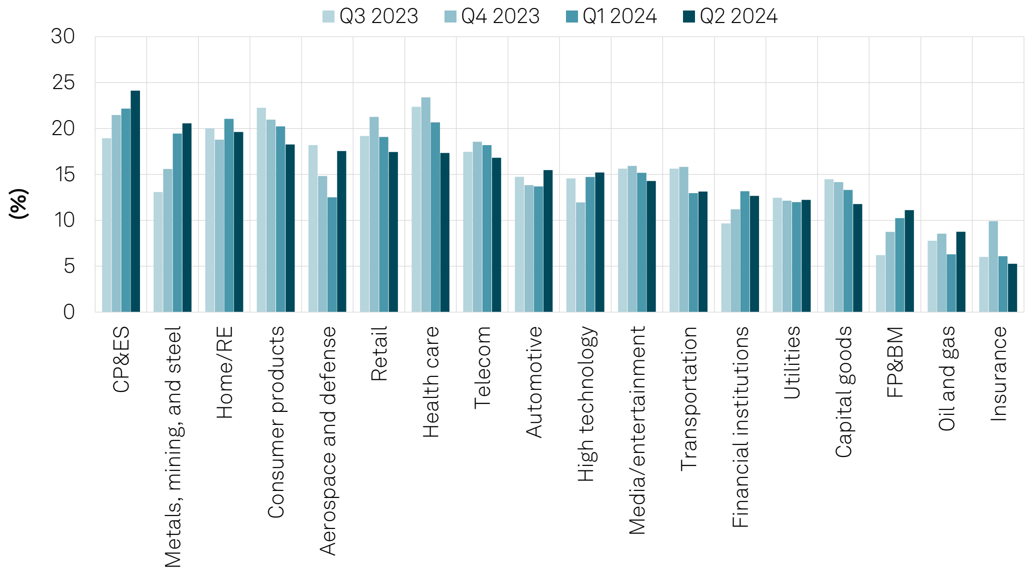
Second-quarter 2024 rating actions by sector*



Excludes sovereigns. *Rating action data as through June 17, 2024. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. RE--Real estate.
Source: S&P Global Research & Insights.

Chemicals and metals have the highest--and rising--negative bias

Sector-level negative bias

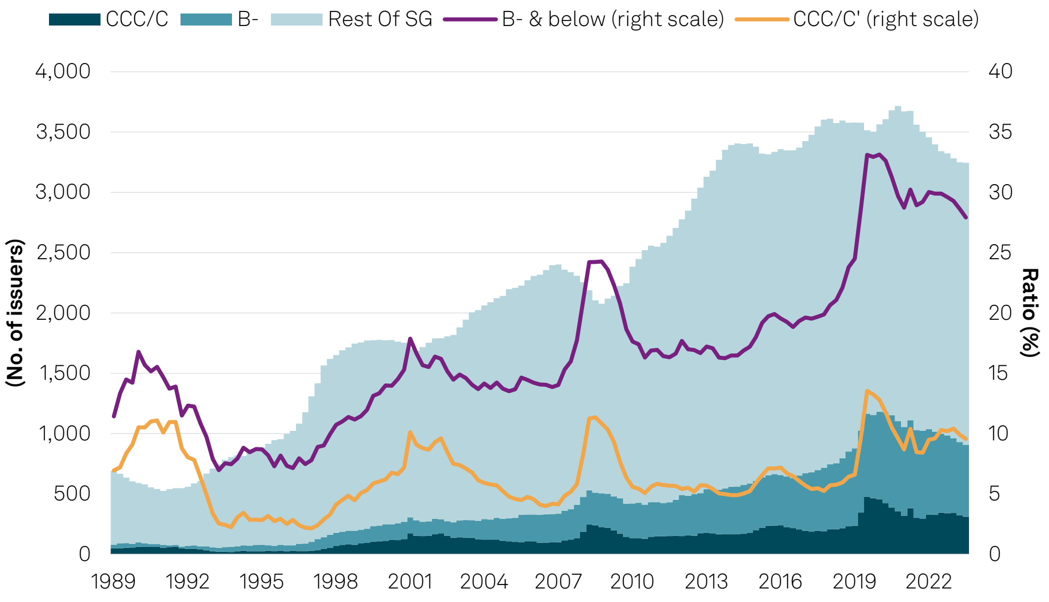


Excludes sovereigns. Bias data as of June 17, 2024. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. RE--Real estate. Source: S&P Global Research & Insights.

Ranks Of The Most Stressed Issuers Decline Again, But Again Only Marginally

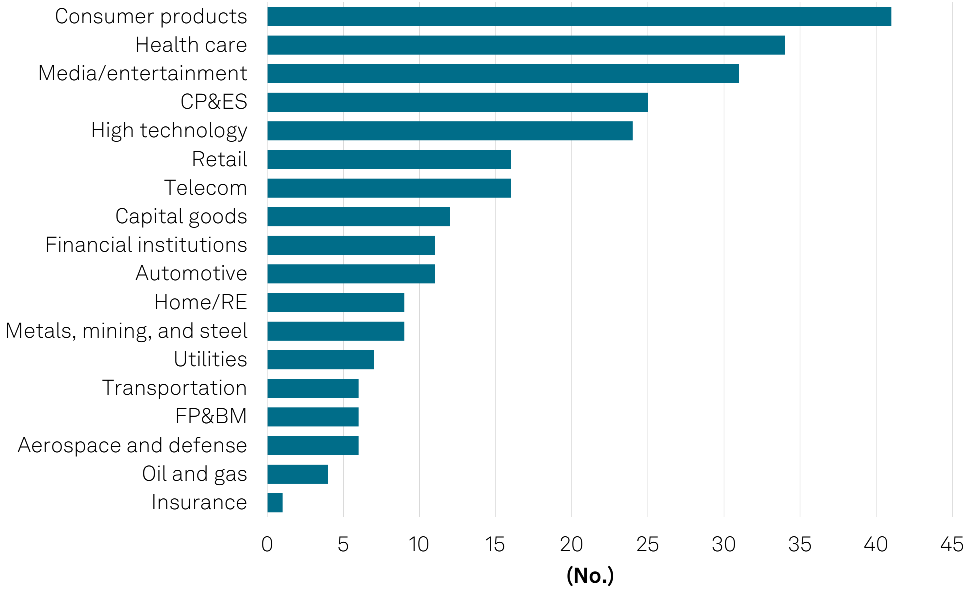
- Consumer-facing sectors, chemicals, and those with a high proportion of floating-rate debt continue to be the most vulnerable to downgrade or default.
- Weakest links tend to default at a rate of roughly 8x that of the overall speculative-grade population.
- After years of relative stability, even at the lowest rating levels, high tech is now one of the larger sectors for weakest links.

Downgrades into 'CCC/C' continue to decline slowly



Data as of May 31, 2024. SG--Speculative grade.
Sources: S&P Global Ratings Credit Research & Insights and S&P Global Market Intelligence's CreditPro.

Weakest links are highly concentrated: Top five sectors account for over half of all weakest links

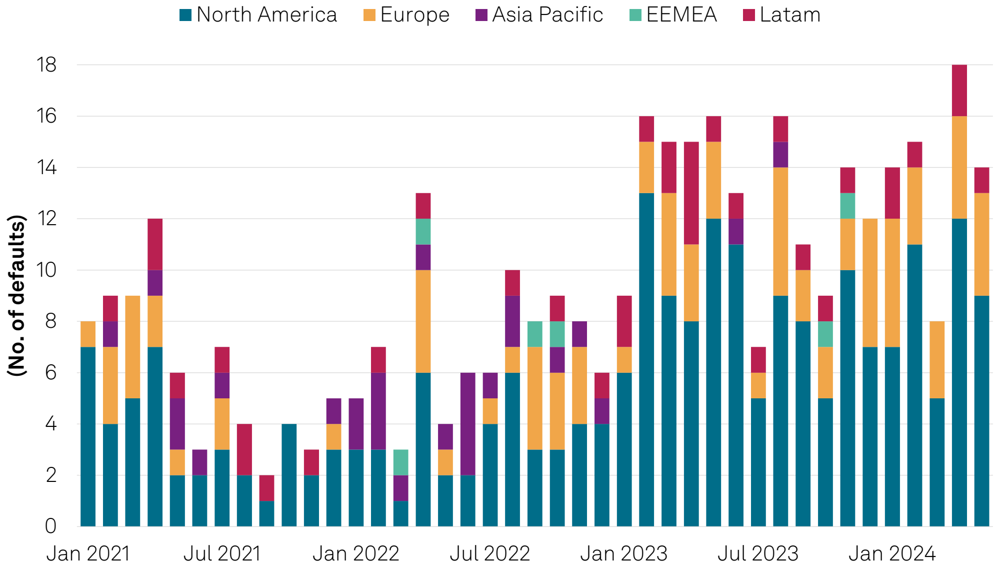


Data as of May 31, 2024. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. RE--Real estate. Sources: S&P Global Ratings Credit Research & Insights.

Global Defaults Maintain 2023's Historically Elevated Levels

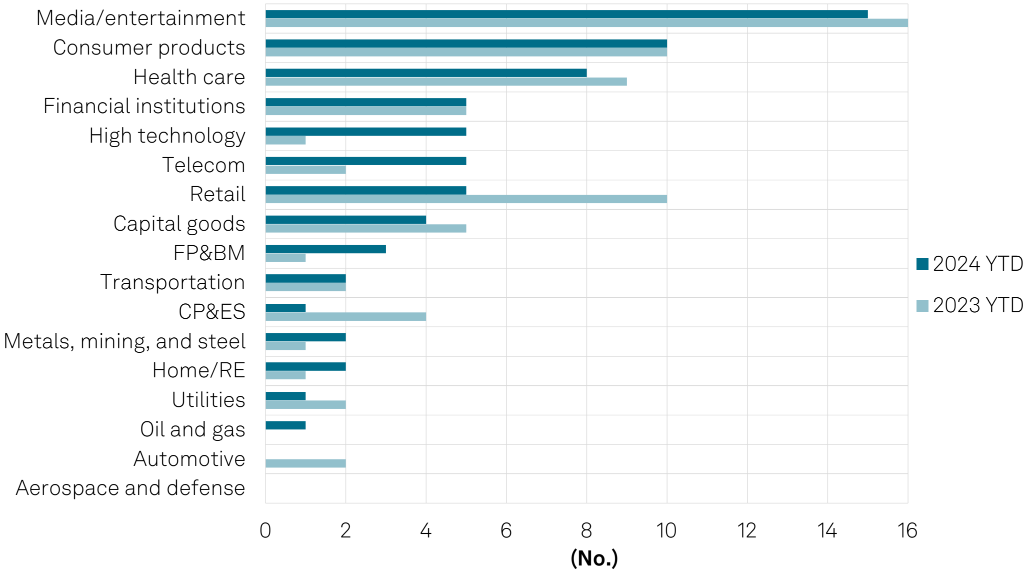
- Defaults have largely kept pace with 2023 levels year-to-date, but with Europe accounting for a larger share this year (27.5% versus 18.3% in 2023).
- Like in 2023, the top three sectors by default count are the same this year, with nearly half of all defaults year-to-date.
- Most of these sectors are the largest users of very low-rated, floating-rate debt in recent years. Media and entertainment, consumer products, and health care carry a combined 40% of the $1.26 trillion outstanding global corporate debt rated 'B-' or lower, and this rises to 54% with the addition of high technology.

Global default tally little changed from 2023, to date



Data as of May 31, 2024. Source: S&P Global Ratings Credit Research & Insights.

The top four sectors have seen nearly the same number of defaults as last year

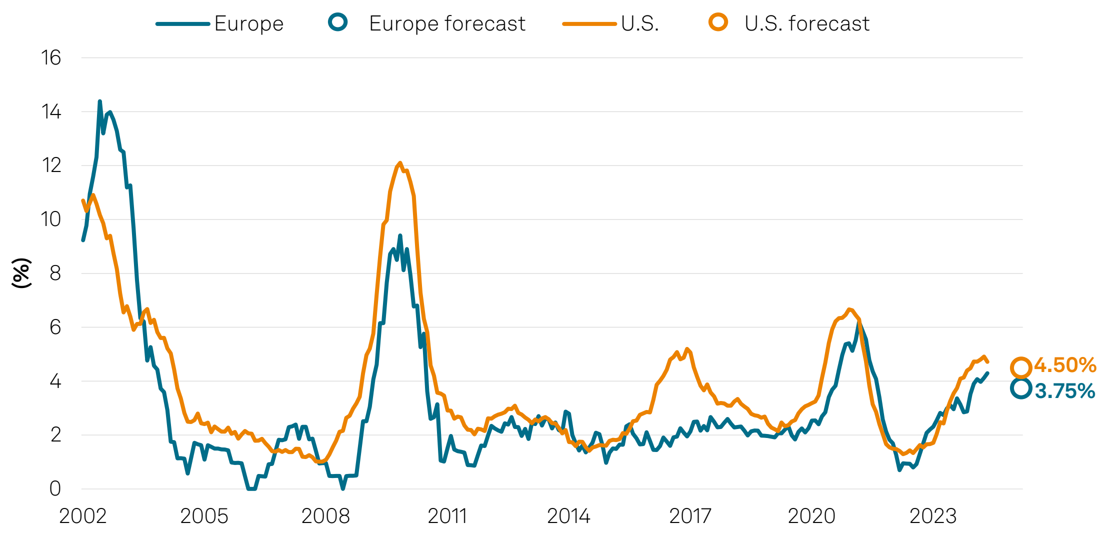


Data as of May 31, 2024. CP&ES--Chemicals, packaging, and environmental services. FP&BM--Forest products and building materials. RE--Real estate. YTD--Year-to-date. Source: S&P Global Ratings Credit Research & Insights.

We Expect Defaults To Gradually Decline

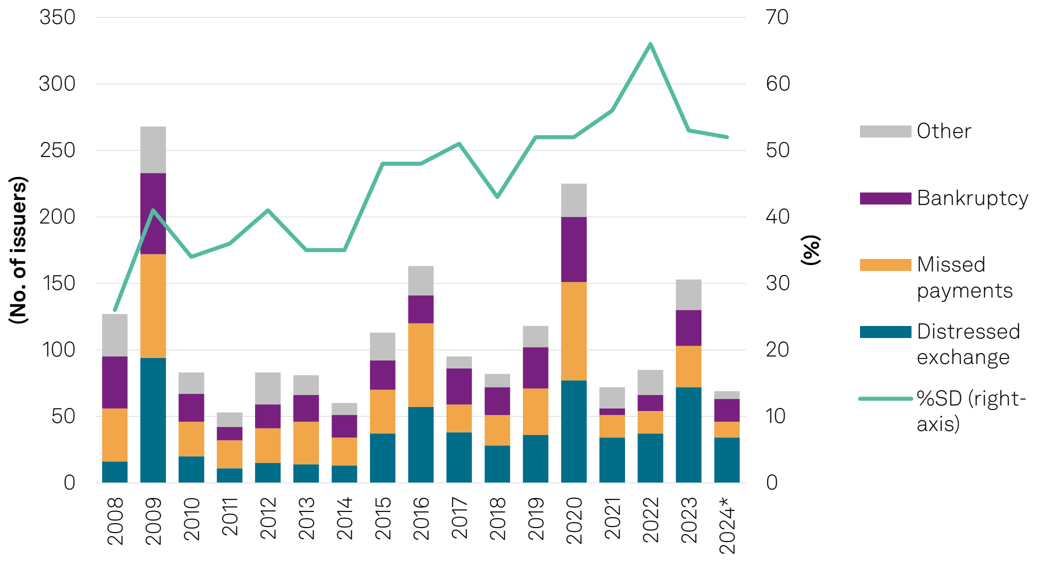
- Distressed exchanges lead with 49% of all defaults this year, and many distressed exchanges have led to repeat defaults in the past. In the U.S., they are now a majority of defaults--for the first time in a rising default rate environment.
- Through May, the U.S. speculative-grade default rate was 4.7% and Europe was 4.3%, slightly above both regions' long-term averages.
- Risks include persistently elevated market rates (in response to stubborn inflation), slower-than-anticipated economic growth, and any events that could freeze up primary markets, particularly in an election-heavy second half of the year.
- Slightly lower interest rates on the horizon and tailwinds from stronger-than-expected economic growth and corporate earnings recently should help lower the default rate through next spring, but the decline will likely be slower than the recent ascent.

Defaults expected to fall, but more slowly than they rose



Through May 31, 2024. Source: S&P Global Ratings Research & Insights.

Distressed exchanges are nearly half of all defaults this year

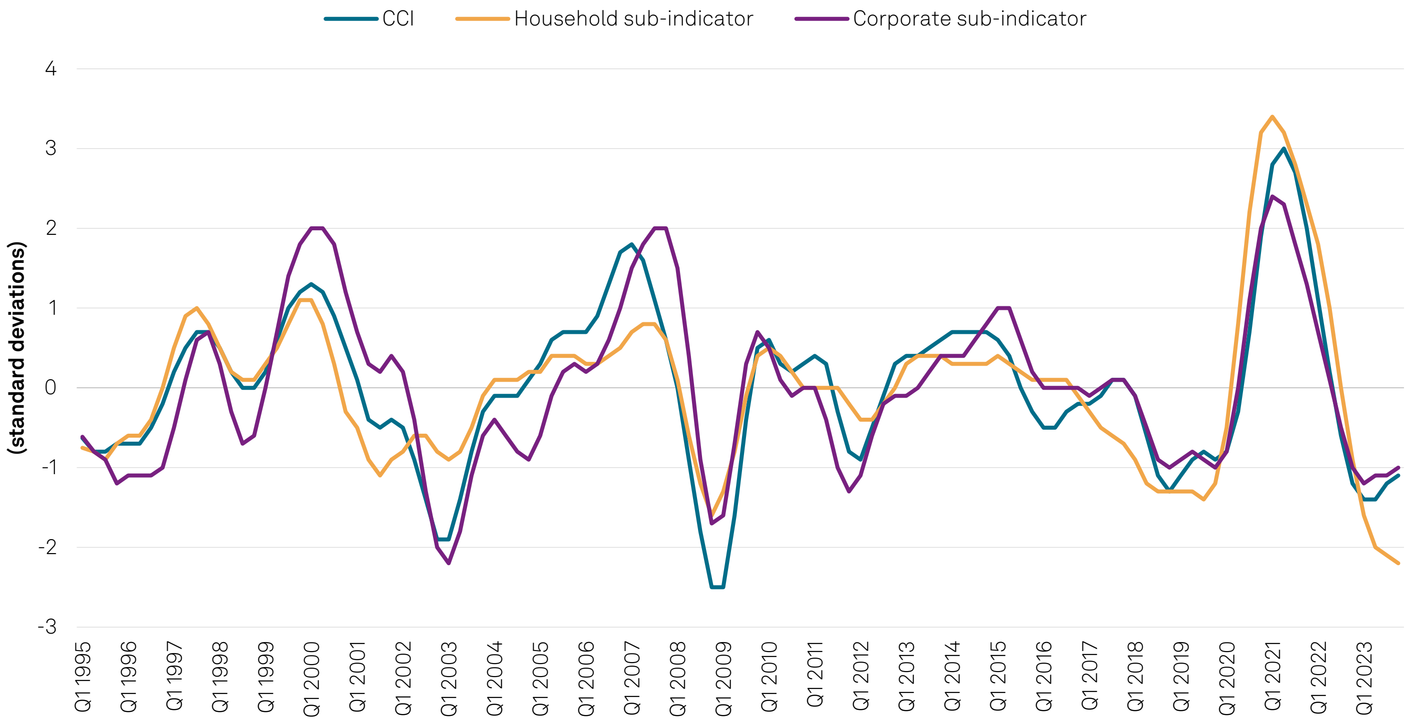


*Through May 31. SD--Selective default. Source: S&P Global Ratings Research & Insights.

Bumpy Ride Likely Before A Credit Recovery In 2025

A divergent credit recovery could come in 2025

Global credit cycle indicators



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. The CCI period ends in the fourth quarter of 2023. For our latest CCI update, see "Credit Cycle Indicator Q3 2024: Bumpy Ride Ahead Of A Credit Recovery In 2025", June 20, 2024.

Sources: Bank for International Settlements. Bloomberg. S&P Global Ratings.

- Our credit cycle indicators (CCIs) continue to signal a potential credit recovery in 2025. However, the momentum risks stalling should business and household confidence falter.
- High mortgages and sticky inflation are causing households to increasingly economize their spending, slowing demand.
- Amid costlier debt and a slower macroeconomy, cash flow and liquidity pressures could mount for some corporate borrowers.
- The divergent credit recovery could widen the divide between "winners and losers," and prompt lenders to review credit lines to affected sectors and households.
- Meanwhile, the risk of higher nonperforming loans and delinquencies could weigh on credit conditions for the rest of 2024.

Regional Credit Conditions

North America | A Brighter Outlook, Laden With Risks

2024 U.S. elections: What's at stake for credit

Elections

PRESIDENTIAL

NATIONAL CONVENTIONS:

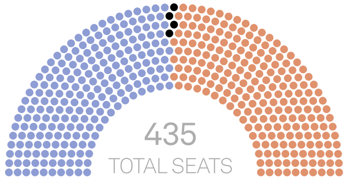
GOP July 15-18

Democratic Aug. 19-22

HOUSE

435 ELECTIONS

Seats up for election
- **213** DEMOCRATS
- **4** VACANCIES
- **218** REPUBLICANS

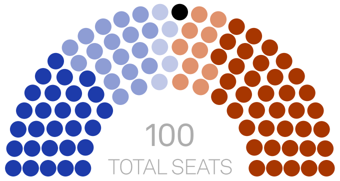


SENATE

34 ELECTIONS

33 regular, 1 special

Seats up for election
- **18** DEMOCRATS
- **5** INDEPENDENTS*
- **1** VACANCY§
- **10** REPUBLICANS



Key considerations

- Partisan split between presidency and Congress would make passage of sweeping legislation challenging
- Electoral uncertainty could delay public project funding and private capital expenditures
- Potential for increased political polarization

Specific policy areas to watch

- **Federal government deficit:** We don't expect meaningful deficit reduction regardless of outcome given pledges not to reform mandatory spending
- **CHIPS Act, IRA, infrastructure spending:** Given bipartisan support for these policies, we view them as less likely to change
- **TCJA:** Expiry of TCJA at end-2025 opens possibility for changes in taxation
- **Trade:** President has wide latitude to levy tariffs. More protectionism could result in inflationary pressures, especially for sectors exposed to cross-border supply chains
- **Antitrust:** If regulatory hurdles lessen for large business combinations, sectors ripe for consolidation may become more active with M&A

*Caucus with Democrats. §Previously held by Republican. Source: S&P Global Ratings.

- **Overall:** Borrowers in North America could enjoy more favorable credit conditions if the U.S. economy settles into a soft landing and the Fed begins to ease monetary policy. However, credit deterioration could linger, with interest rates likely staying high for longer than we previously anticipated.
- **Risks:** On top of the downside risk posed by prolonged high financing costs, input price pressures persist, and commercial real estate (CRE) losses could worsen amid cyclical and secular headwinds. U.S. elections could lead to market volatility and policy uncertainty.
- **Ratings:** The region's net outlook bias was negative 10.2% as of June 11, with telecom, consumer products, and chemicals having the highest negative bias. We expect the U.S. default rate to fall slightly to 4.5% by March 2025 after peaking in the third quarter of 2023.

North America | Higher Tariffs Will Likely Create Winners And Losers

- We think increasingly protectionist trade policies and any international responses will likely result in inflationary pressures.
- Specifically, higher U.S. tariffs on imports from China (and any retaliation from China) could add to margin pressures for some sectors; hamper market access, especially for tech; and accelerate the supply chain diversification away from China. Certain industries, such as capital goods and chemicals, may benefit from greater onshoring/reshoring opportunities or less competition.

Potential effects of even higher U.S.-China tariffs on North American corporates

EFFECT OF TARIFF*

Detrimental	Somewhat detrimental	Neutral	Somewhat beneficial	Beneficial

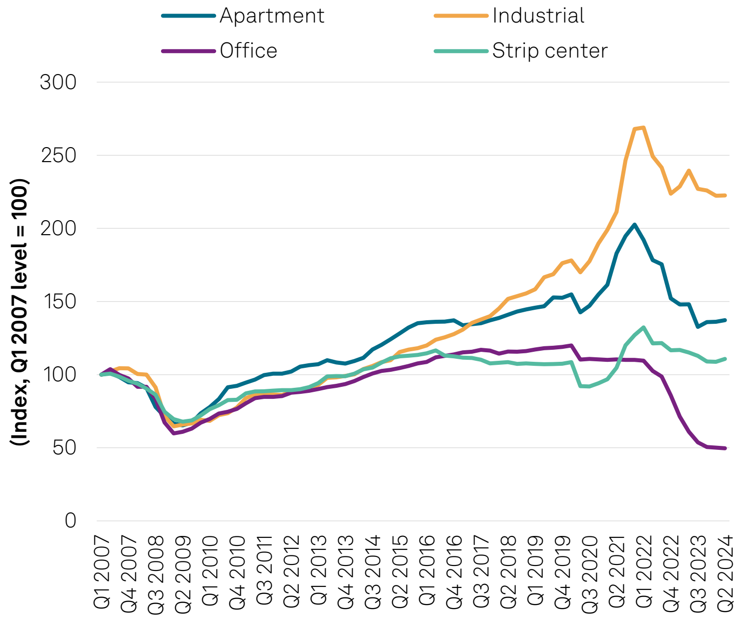
Sector	60% tariff on Chinese imports	Retaliatory tariff on U.S. goods	Current supply chain dependency on China vs. before tension§
Aerospace and defense	Neutral	Neutral	▬ No change
Auto OEMs and auto suppliers	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Building materials	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Business and technology services	Neutral	Somewhat detrimental	Not applicable
Capital goods	Somewhat beneficial	Somewhat detrimental	▼ Less dependent
Chemicals	Somewhat beneficial	Somewhat detrimental	▬ No change
Consumer products	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Containers and packaging	Neutral	Neutral	▬ No change
Gaming, leisure, and lodging	Neutral	Neutral	▼ Less dependent
Healthcare	Somewhat detrimental	Neutral	▬ No change
Homebuilders	Neutral	Neutral	▬ No change
Media and entertainment	Neutral	Neutral	Not applicable
Metals and mining	Neutral	Neutral	▼ Less dependent
Midstream energy	Somewhat detrimental	Neutral	▬ No change
Oil and gas	Neutral	Neutral	Not applicable
Oil refineries	Neutral	Neutral	▬ No change
Pharmaceutical	Somewhat detrimental	Neutral	▬ No change
Regulated utilities	Somewhat detrimental	Neutral	▬ No change
REITs	Neutral	Neutral	▬ No change
Retail and restaurants	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Technology	Somewhat detrimental	Somewhat detrimental	▼ Less dependent
Telecom	Neutral	Neutral	Not applicable
Transportation	Neutral	Neutral	▬ No change
Unregulated (merchant) power	Somewhat beneficial	Neutral	▬ No change

*These impact descriptors are our qualitative view of the potential effect on sectors as of June 2024. It doesn't directly translate to risk of rating actions. §Before the U.S.-China tension escalated under the Trump administration.
Source: S&P Global Ratings.

North America | CRE Losses Could Worsen Amid High Interest Rates

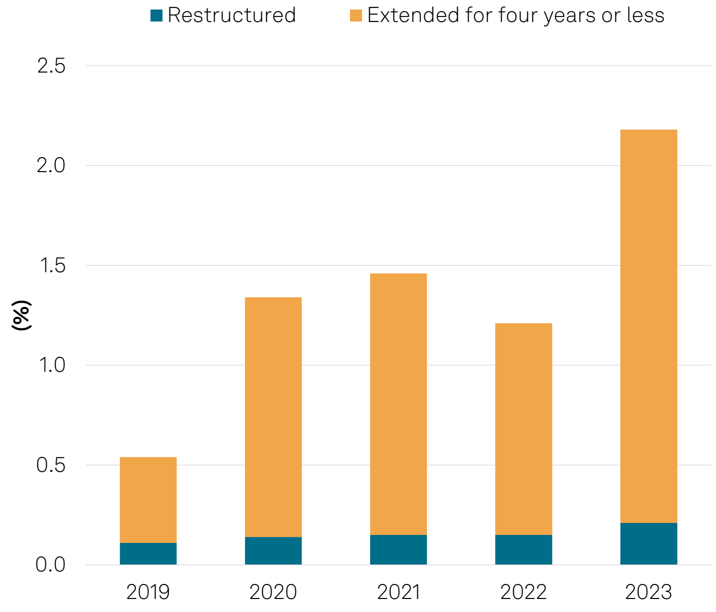
- **Higher financing costs are pressuring asset valuations and heightening refinancing risk** for most types of CRE. Office is grappling with declining demand, which further weighs on valuations and cash flows. Certain segments and regions within the multifamily sector are also facing challenges as rent growth softens.
- All this may lead to **more broad-based, and in some cases severe, loan losses for debtholders**, such as U.S. banks, insurers, REITs, and commercial mortgage-backed securities (CMBS). Higher office vacancy rates and shuttered ground-level businesses could also affect tax revenue for cities.
- Meanwhile, **U.S. regional banks remain vulnerable to quickly shifting sentiment**. An unexpected resurgence of turmoil in the banking sector could affect credit availability, market volatility, and weigh on consumer confidence.

Office value yet to bottom out
Green Street Commercial Property Price Index by property type



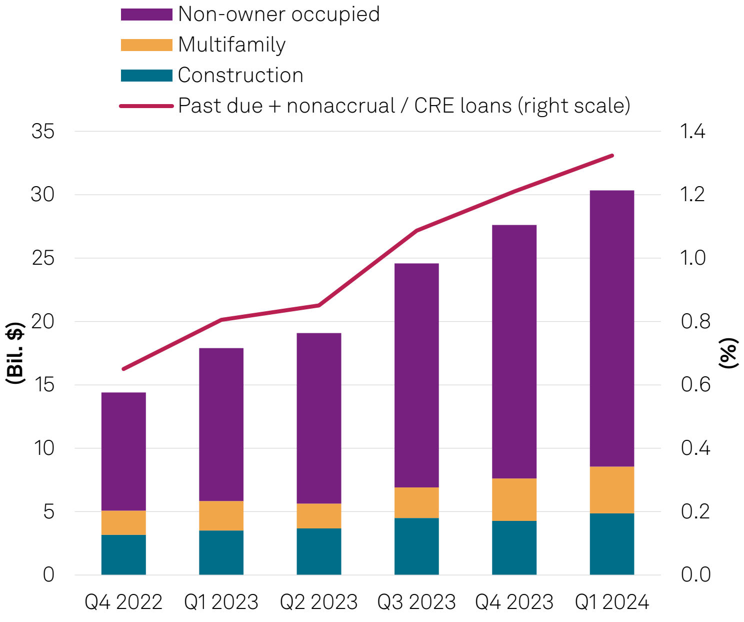
Q2 2024 data as of June 14, 2024.
Sources: Green Street, S&P Global Ratings' calculations.

Extensions are increasing in U.S. life insurers' loan portfolio
Restructured and short-term extended commercial mortgages as % of all mortgages



Sources: S&P Capital IQ Pro, S&P Global Ratings.

Banks' CRE loans past due and nonaccrual on the rise
All FDIC-insured banks



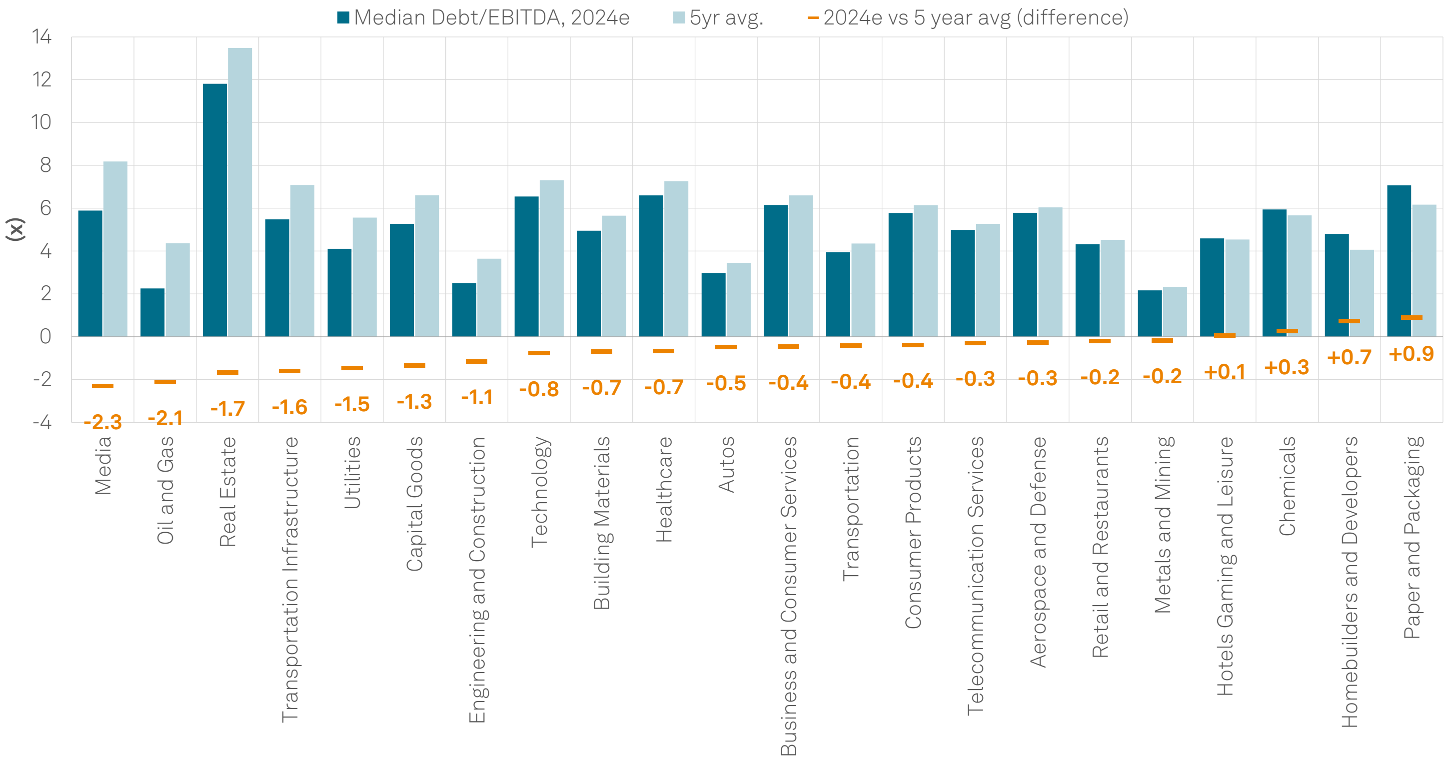
Source: S&P Global Ratings.

Europe | Keep Calm, Carry On

- **Base case:** The European economic and credit environment continues to strengthen gradually, despite significant political and geopolitical uncertainty clouding the outlook.
- **Credit:** With inflation improving, we anticipate that the trajectory for eurozone rates will return to a neutral 2.5% by the third quarter of 2025. This bodes well for financing conditions and credit trends as issuers' financial policies move beyond dealing with the fallout from higher rates and reducing debt (see chart). However, some European sovereigns may continue to face challenges in consolidating their debt positions.
- **Pockets of risk:** Some areas of credit vulnerability remain:
  - Overleveraged corporate borrowers with low fixed-rate debt maturities typically in the 'CCC' category.
  - We expect some pick up in credit losses in the banking sector as they normalize from a low level.
  - In structured finance, CMBS have seen the most downgrades, while a few negative rating actions are emerging in RMBS.

Leverage expected to be below the 5-year average for most European industries in 2024

Median speculative grade debt/EBITDA(x)



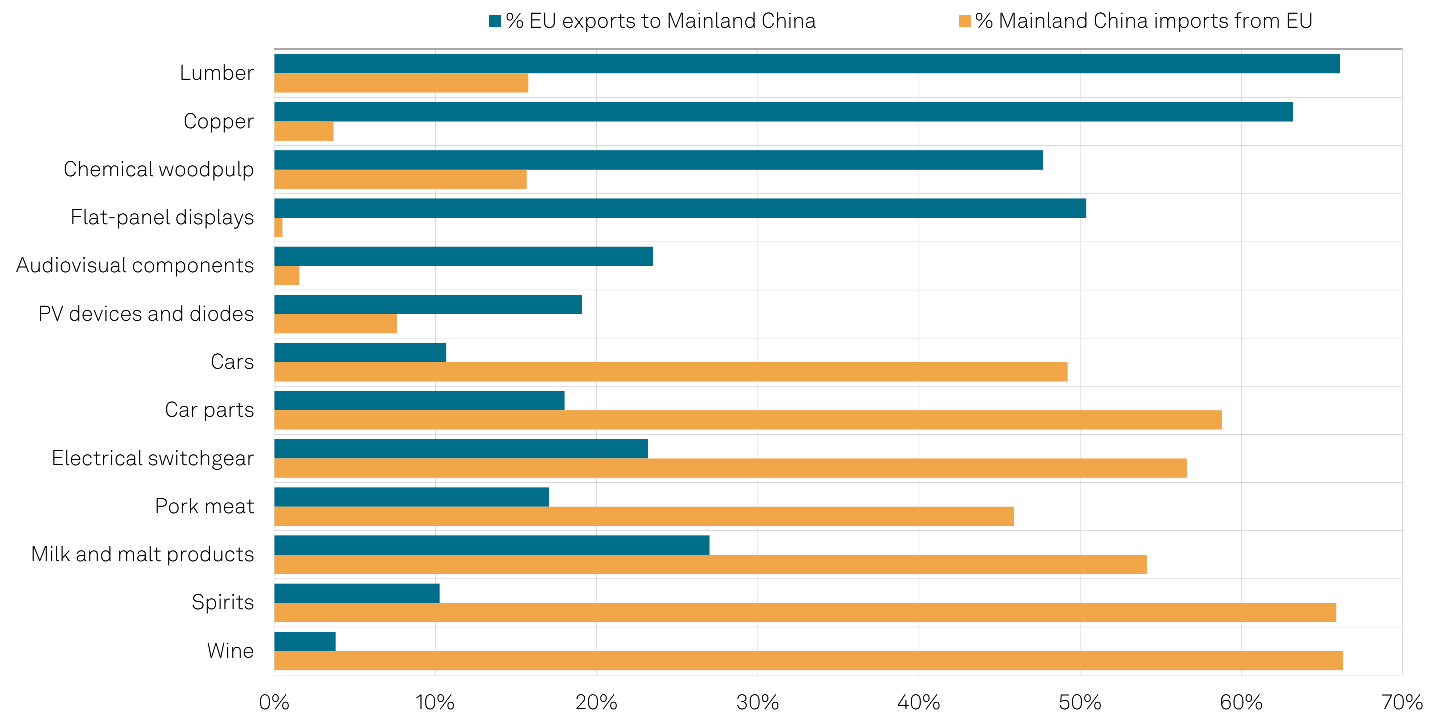
Source: S&P Global Ratings. Global Nonfinancial Corporate Medians History And Outlook Midyear 2024, June 18, 2024.

Europe | Geopolitical Fragmentation Remains Key Evolving Concern

- **Regional wars:** Geopolitical risk remains high and a significant source of event risk as two regional wars drag on. They carry the risks of drawing in other state and non-state combatants, creating an intensifying humanitarian crisis with unpredictable consequences.
- **Trade and tariffs:** Caught in the crossfire of the growing U.S.-China trade tensions, the EU is seeking to derisk, not decouple, given China's importance as a trade partner, particularly in key products (see chart). Tit-for tat tariffs could sour relations with China but also create friction between EU member states.
- **Macro:** The tail risks of longer-than-expected restrictive interest rates, or a protracted period of slower European growth, compared to our baseline forecasts, are the two main identified macro risks--albeit less systemic in nature than they were in recent years.
- **CRE:** Some positive signs from a credit perspective in terms of valuations starting to stabilize and financing conditions improving. However, commercial real estate is not out of the woods yet, particularly in more vulnerable segments such as non-prime office.

Trade asymmetry may drive tariff investigation decisions

Trade in goods in relevant product, 12 months to April 30, 2024

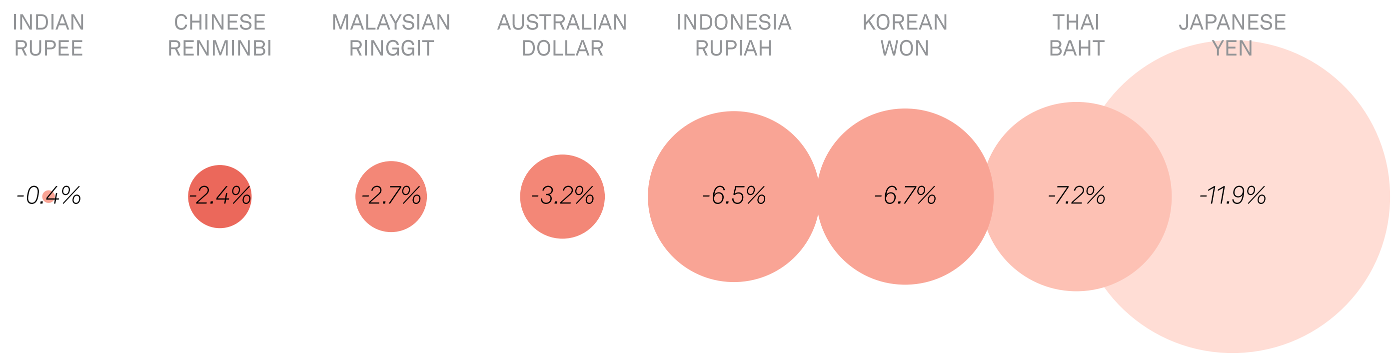


Data compiled June 24, 2024. Source: S&P Global Market Intelligence. There may be trouble ahead: Q3 2024 supply chain outlook, June 27, 2024.

Asia-Pacific | A Trade Showdown Unfolds

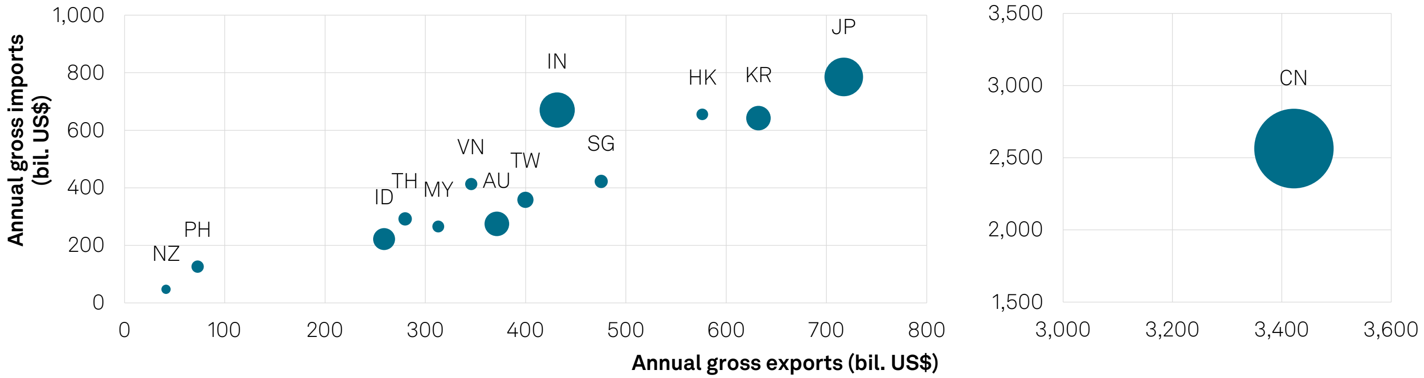
Asia-Pacific currencies are facing pressure...

Year-to-date percentage change against U.S. dollar



...diverging the performances of the region's exporters and importers

Gross exports and imports (US$ bil.)

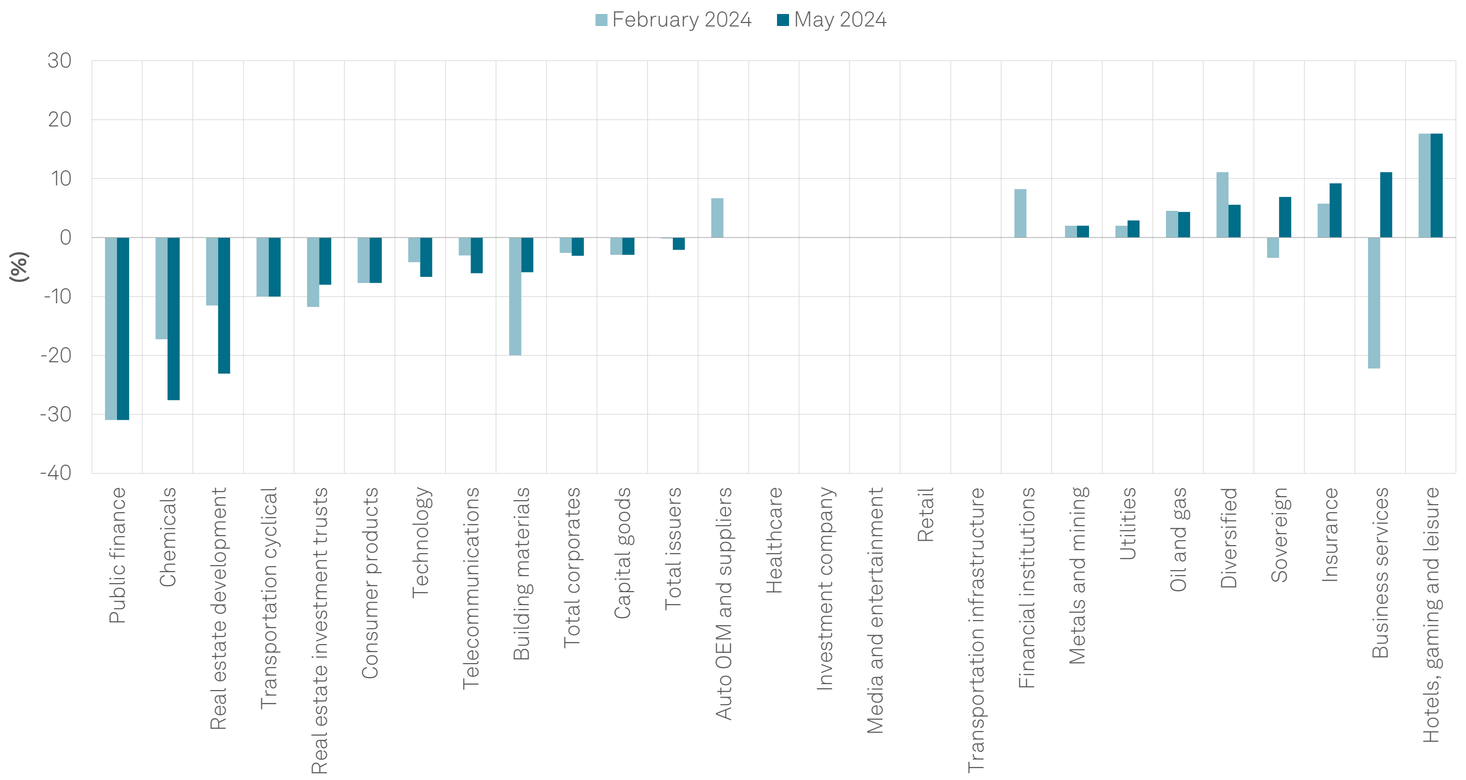


AU--Australia. CN--China. HK--Hong Kong. IN--India. ID--Indonesia. JP--Japan. MY--Malaysia. NZ--New Zealand. PH--Philippines. SG--Singapore. KR--Korea. TW--Taiwan. TH--Thailand. VN--Vietnam. Gross export and import data refer to annual 2023 figures. Bubble size represents 2023 nominal GDP (measured in US$). Data source: S&P Global Ratings, S&P Global Market Intelligence.

- **Trade tensions rise.** The China-U.S. trade conflict is unfolding following the latest imposition of tariffs on Chinese goods.
- **Trade interruptions.** Potential retaliation by China would widen the global impact. Tit-for-tat responses also run the risk of policy missteps.
- **Drags on growth.** Such escalations could weigh on confidence and sentiment, hitting business activity and growth in export-centric APAC.
- **Supply chain reviews.** Businesses may have to review supply chains. The relocation of manufacturing activities entails operational challenges and economic costs.
- **Nuanced risk landscape.** The split between winners and losers is widening. Amid decoupling and friendshoring efforts, some of the region's producers may benefit.

Asia-Pacific | A Bigger Divide Between Winners And Losers

Net rating outlook bias of Asia-Pacific issuers, February 2024 versus May 2024



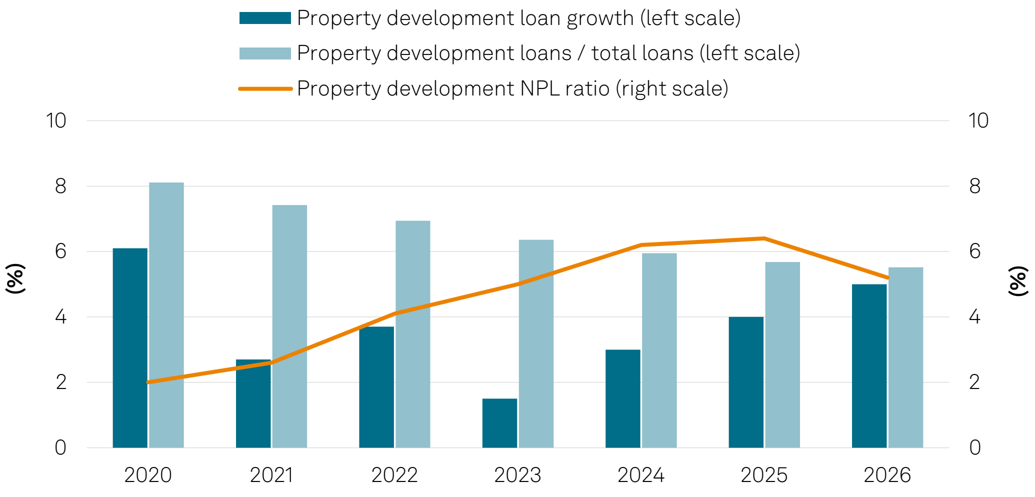
We calculate the net outlook bias by deducting the percentage of negative outlooks and CreditWatch negative listings against the percentage of positive outlooks and CreditWatch positive listings. A minus figure indicates that the former exceeds the latter, and a positive figure, vice versa. OEM--Original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

- **Uneven conditions.** The net rating outlook bias of APAC issuers slipped to negative 2% in May. The distribution points to uneven credit conditions across sectors.
- **Higher-for-longer rates.** Central banks in APAC, except for the Bank of Japan, will likely maintain tight monetary policies to limit capital outflows and currency depreciation.
- **Costlier debt.** Weak Asian currencies translate into costlier offshore debt, and the risk of imported inflation for some.
- **Cautionary mood.** Cautious consumers may cut back further. Bank lending could turn selective, and credit lines to weaker sectors could be cut.
- **Pain spots.** These include real estate (e.g., in China and Vietnam), and households stretched by high rates and cost of living (e.g., in Korea and the Pacific).

Asia-Pacific | China's Crippled Property Sector Adds Risks To Economy

- **Yet another difficult year for property.** China's property market is still searching for a bottom. Property sales and home prices continue to decline despite bolder stimulus, underlining very weak Chinese confidence. Reduced demand for new property is hitting surviving developers' liquidity.
- **Spillover risks.** A sharper property downturn would squeeze local governments' fiscal revenues (via weak land sales) and call for more spending to support local economies. This could delay fiscal consolidation further. The risk of more debt structuring of local government financing vehicles in weak regions would increase banks' burdens.
- **Intensifying tariffs.** Trade tensions could drag down China's industrial production-led economic recovery.

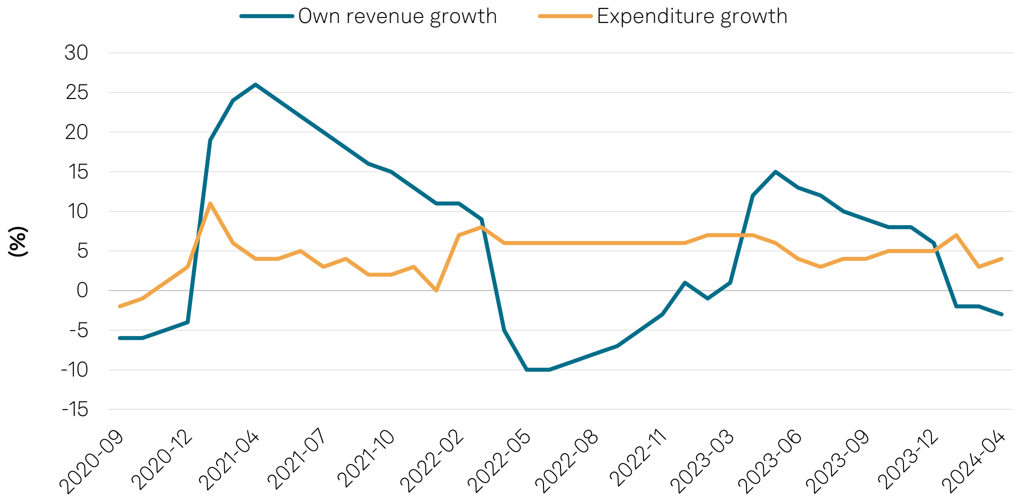
Property development NPLs to peak higher, later for Chinese banks



NPL--Nonperforming loans. Source: S&P Global Ratings.

LRGs' revenue and growth are on divergent paths

Year-on-year, using year-to-date data points



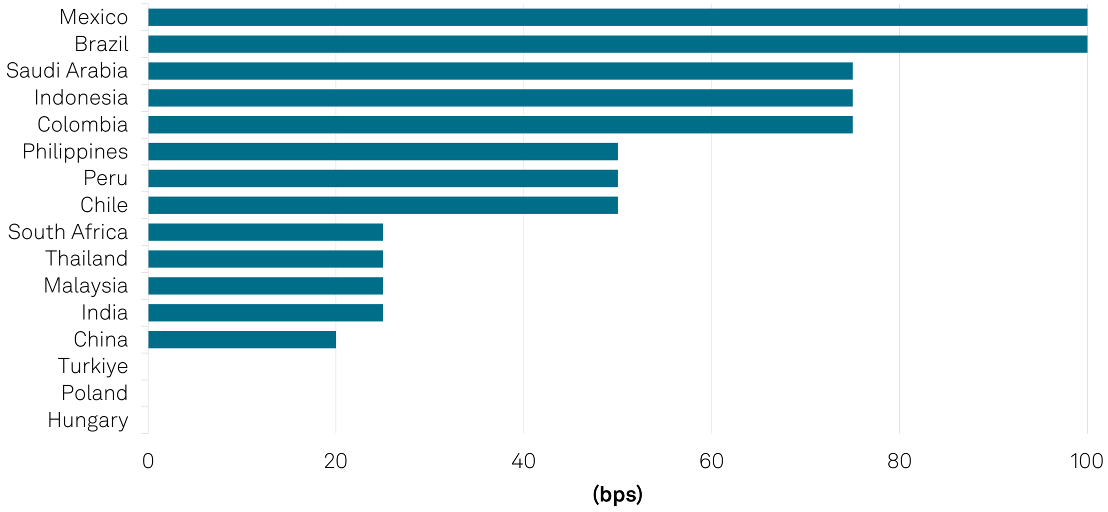
LRG--Local and regional government. Source: S&P Global Ratings.

Emerging Markets | Policy Uncertainty May Hinder Resilience

- **Credit conditions across emerging markets (EMs) continue improving amid resilient economic activity**, supported by solid domestic demand and improving global trade and financing conditions.
- **Policy uncertainty will be a key factor late in the year and into 2025** as U.S. elections play out and new administrations in key EMs begin to execute their plans. Political noise could dampen investor sentiment and cause episodes of liquidity shortfalls or capital outflows.
- **High borrowing costs will remain a key risk**, as the Fed has delayed its plans for rate cuts, slowing monetary easing in EMs. Issuers have refinanced a large amount of outstanding maturities during the first half of the year, and the second half looks manageable. However, EM maturities will pile up in 2025, and we expect issuers will continue facing high borrowing costs.

The Fed's influence on EMs' monetary easing plans

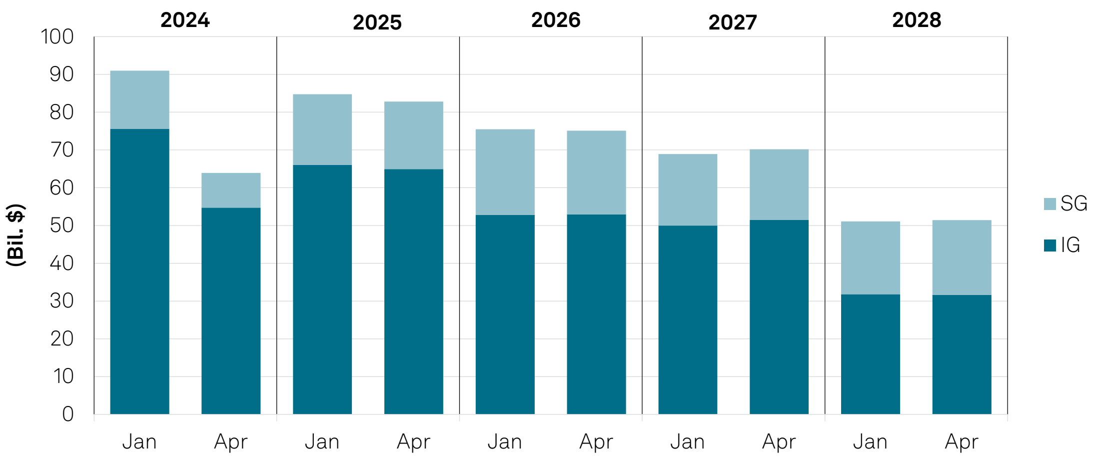
2024 policy rate forecast changes (March versus June 2024)



Changes in S&P Global Ratings' Policy Rate Forecast from March 2024. Source S&P Global Ratings.

Debt outstanding dropped 30% in Q2 from Q1 2024

EMs debt maturities as of Jan. 2024 and April 2024

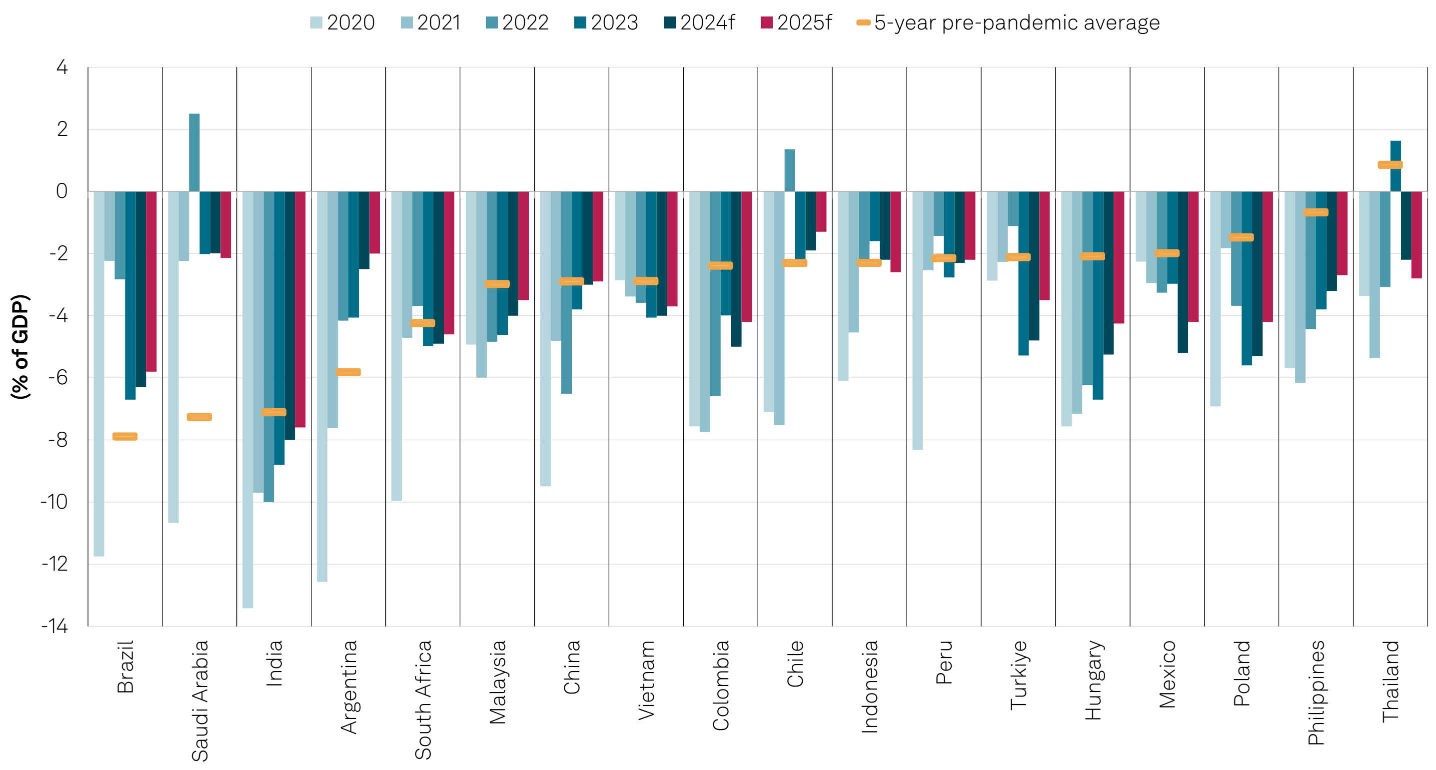


Includes bonds, notes, loans, and revolving credit facilities rated by S&P Global Ratings that were outstanding as of April 1, 2024. IG--Investment grade. SG--Speculative grade.
Source: S&P Global Ratings Credit Research & Insights.

Emerging Markets | Increasing Challenges for Fiscal Consolidation

Pursuing fiscal consolidation after 2020 has proven challenging for many EMs

General government balance (% of GDP)



f--Forecast. Source: S&P Global Ratings.

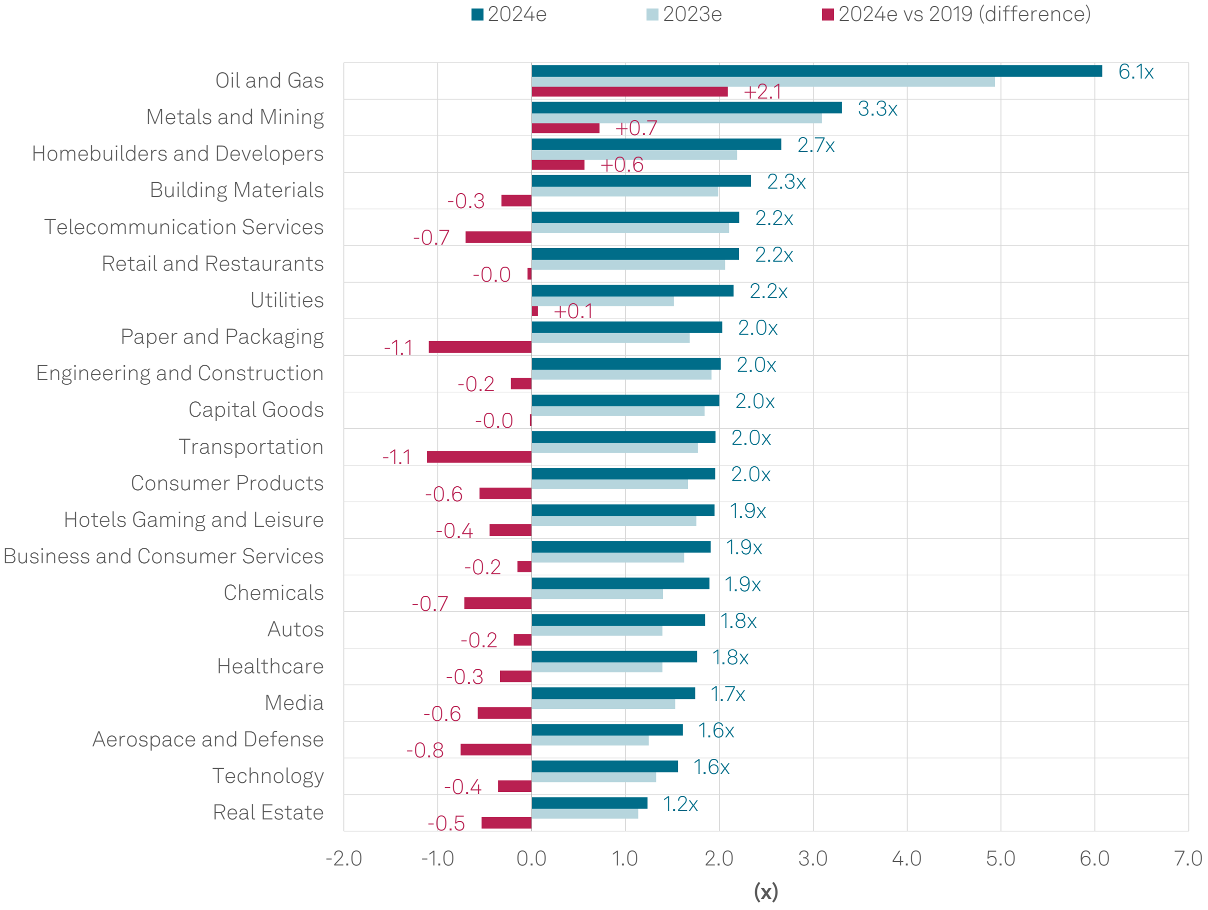
- **Most EM sovereigns kept deficits higher than historical levels** in their effort to cope with successive shocks and in dealing with the effects of high inflation on households.
- **Fiscal consolidation will be crucial over the coming years** as high interest rates will likely linger, and economic growth will remain sluggish.
- **Once again, policy is at the center stage.** Current and new administrations will need to put in place relevant reforms to foster economic growth and strengthen their fiscal flexibility.
- **Additional fiscal pressures could result in sovereign downgrades,** which usually spill over to our corporate and financial institutions ratings.

Sector Trends

Speculative-Grade Corporates | Interest Coverage Improving But Still Below 2019

- In 2024, we expect interest coverage of speculative-grade corporates to improve in all sectors thanks to the falling credit spreads, some repricings, and the fact that higher base interest rates have already been digested for most low-rated issuers.
- Still, for the majority of sectors, this improvement will not be sufficient to return to the 2019 coverage ratios.
- The only exceptions are oil and gas, metals and mining, and homebuilders and developers, which have stronger interest coverage medians than in 2019 generally owing to lower debt levels. We expect coverage for utilities to be relatively unchanged.

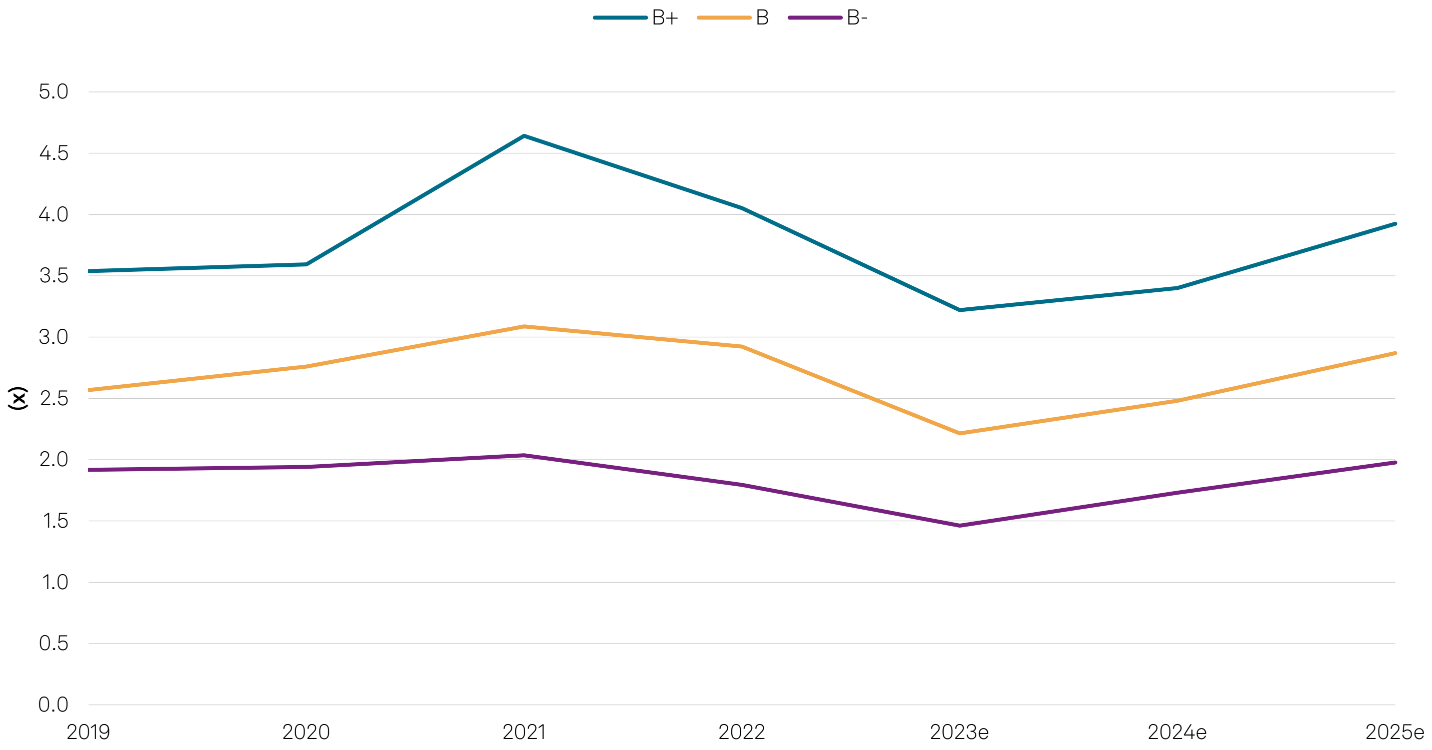
Global median nonfinancial corporate EBITDA interest coverage by industry –speculative-grade rated issuers



Calculated as of June 17, 2024. All units are US$. Global and regional aggregates exclude utility and real estate entities. e—Estimate. Source: S&P Global Ratings.

Corporates | Interest Coverage Strengthens In The 'B' Category

Global median nonfinancial corporate EBITDA interest coverage for ‘B’ rated issuers



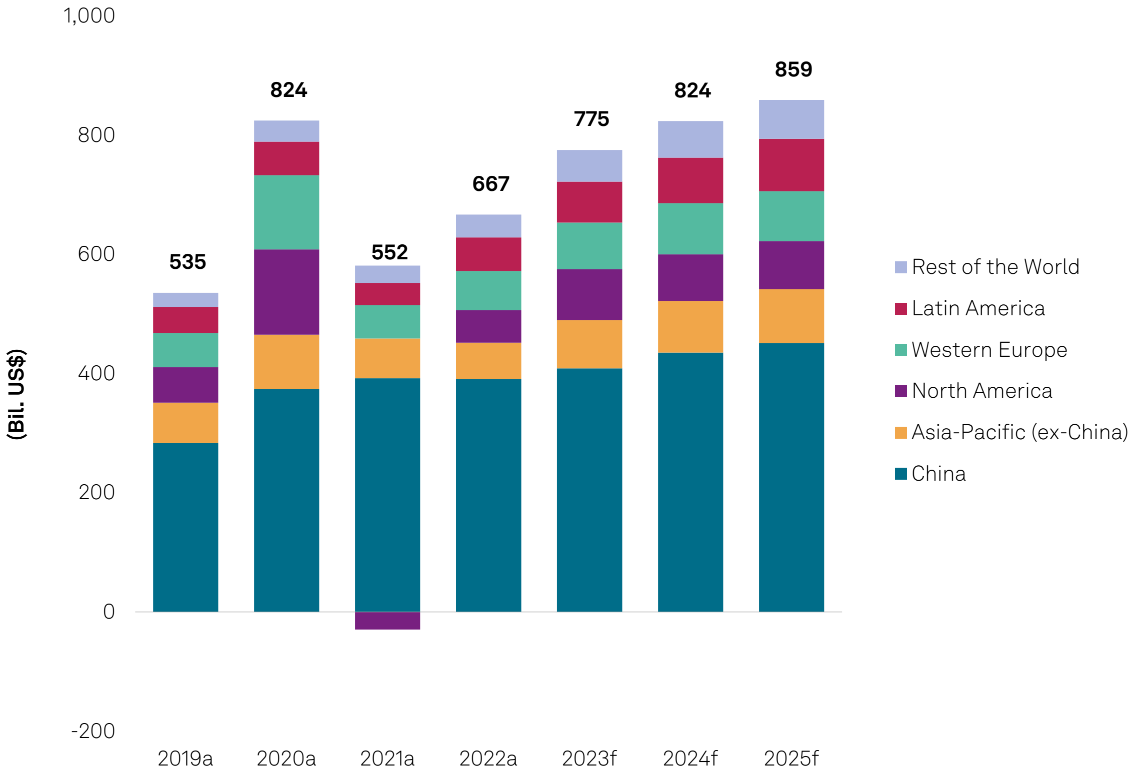
Calculated as of June 17, 2024. All units are US$. Global and regional aggregates exclude utility and real estate entities. e—Estimate. Source: S&P Global Ratings.

- The 'B' rating category represents more than 30% of our total corporate rated portfolio globally and has been the most affected by the increase in interest rates and credit spreads.
- In 2024, interest rates and credit spreads are falling both in North America and EMEA, and we expect EBITDA interest coverage to improve for 'B+', 'B', and 'B-' rated corporates.
- However, the declines won't be enough to return to the 2021 coverage ratios.

Global Banks: Higher Credit Losses Are Manageable At Current Rating Levels

We expect credit losses to increase steadily from benign levels

Domestic credit losses by region, 2019a-2025f



A—Adjusted. F—Forecast. Source: S&P Global Ratings.

Our latest outlook

- Continuing ratings stability--currently about 75% of banking groups globally have stable ratings outlooks.
- We see three key downside risks to ratings: higher-for-longer interest rates, weak economic growth, and commercial property risks, in particular in the U.S. and China.
- Geopolitical risks, domestic political risks in a year marked by elections, and structural risks are elevated and could also pose a meaningful downside risk to ratings. Furthermore, market turbulence could cause disruption considering the sector's confidence-sensitive nature.
- We forecast global credit losses will increase by about 10% to US$860 billion by the end of 2025. This is within our base case at current rating levels for most banks.

What we're watching

- If cyclical downside risks worsen materially. Unanticipated, significantly higher-for-longer interest rates and much weaker economic growth outside our base case will stress credit losses and drive more negative rating outlooks.
- Regulatory developments. The continuing evolution of prudent banking regulations, especially for capital and liquidity, will buttress banks' creditworthiness.
- The availability of government support in its various forms for banks (in the unlikely event it is required) to augment total loss-absorbing capacity and other support mechanisms.

Sovereign Net Rating Outlooks Improve Amid Economic Resilience

The overall outlook balance has improved to +10 from -8 one year ago. While this improvement shows a post-2020 stabilization of sovereign rating outlooks, it is important to consider that this is also happening at lower rating levels. Economic growth has continued to be resilient and support ratings stabilization. However, significant headwinds remain. A difficult geopolitical landscape in addition to several electoral processes across the world will continue to present a significant risk to the asset class. In addition, high borrowing costs and debt levels limit fiscal space to respond to future crises.

Sovereign rating trends

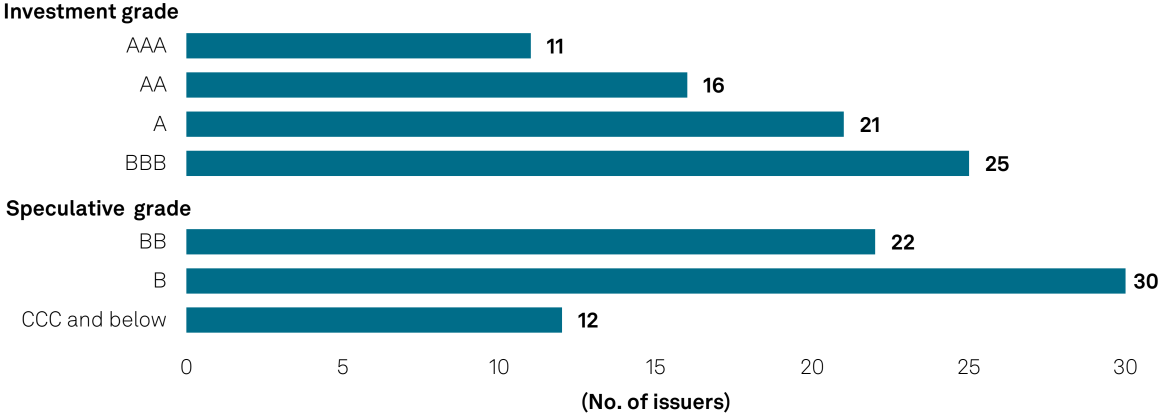
Data as of June 2024

137 Total rated entities

53% Share of investment-grade

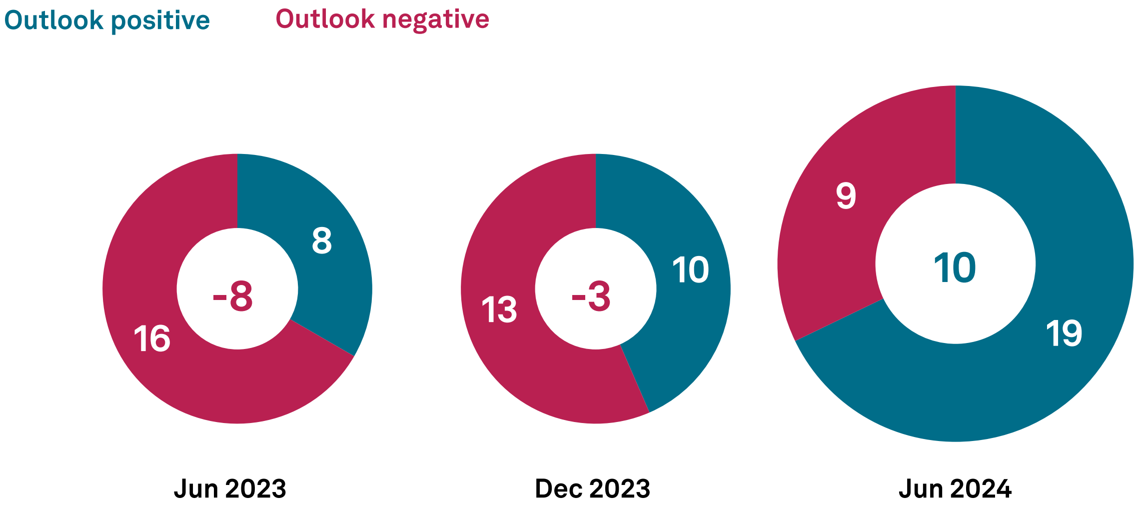
10 Outlook balance

Global rating distribution



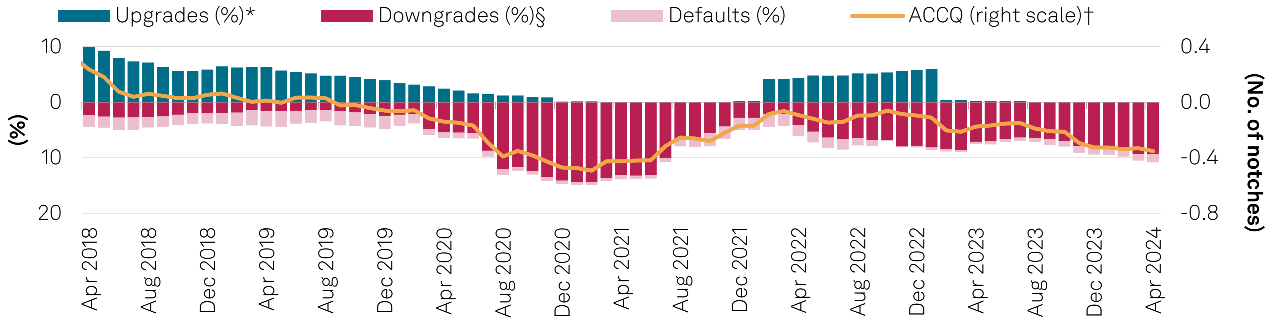
Outlook balance is the difference of total positive and negative actions. Source: S&P Global Ratings.

Outlook balance



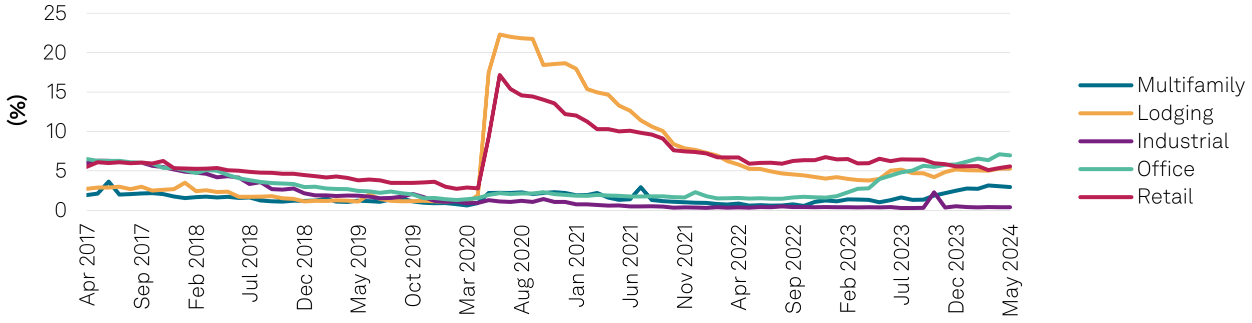
Structured Finance Ratings Remain Resilient; U.S. CMBS Faces Headwinds

U.S. CMBS – Average change in credit quality (ACCQ)



*Total number of upgrades (downgrades, defaults) divided by the total number of outstanding ratings in the sector on a trailing 12-month basis. Securities whose ratings migrated to NR over the sample period are classified based on their rating prior to NR. §The downgrade proportion excludes defaulted tranches. †The average number of notches by which ratings across all tranches in each sector changed on a trailing-12-month basis. ACCQ—Average change in credit quality. NR--Not rated. Source: S&P Global Ratings.

U.S. delinquency rate by property type



Based on loans backing CMBS transactions rated by S&P Global Ratings. CMBS--Commercial mortgage-backed securities.
Source: S&P Global Ratings.

- In the U.S., we expect continued moderate GDP growth, low unemployment, and at least one policy rate cut later this year to limit the deterioration of the collateral performance for most sectors. That said, CMBS faces headwinds. Other areas of focus include subprime segments of consumer ABS, and CLOs.
- In U.S. CMBS, with higher-for-longer benchmark rates, decelerating cash flow growth (or declining, for office), and rising expenses, refinancing prospects and commercial real estate performance in general continue to be challenged. We expect CMBS delinquency rates to increase, and rating actions to be heavily biased toward downgrades for the remainder of 2024.
- In Europe, the CMBS sector has fared relatively better than in the U.S., despite facing similar risks. Arrears reported for loan pools backing consumer-related securitizations have not increased significantly since rates started to rise. The U.K. nonconforming and buy-to-let RMBS subsectors are exceptions, however, given their high exposure to floating-rate and interest-only loans, and more borrowers that may have few refinancing options.

Related Research And Contacts

Related Research

Credit Conditions

- Credit Conditions Asia-Pacific Q3 2024: A Trade Showdown Unfolds, June 25, 2024
- Credit Conditions Europe Q3 2024: Keep Calm, Carry On, June 25, 2023
- Credit Conditions Emerging Markets Q3 2024: Policy Uncertainty May Hinder Resilience, June 25, 2024
- Credit Conditions North America Q3 2024: A Brighter Outlook, Laden With Risks, June 25 2024

Regional Credit Outlooks can be found here

Economic Outlook

- Q3 2024 Global Economic Update: The Policy Rate Descent Begins, June 26, 2024
- Economic Outlook Asia-Pacific Q3 2024: Exporters And EMs Are Outperforming, June 23, 2024
- Economic Outlook Eurozone Q3 2024: Growth Returns, Rates Fall, June 24, 2024
- U.K. Economic Outlook Q3 2024: A Cooling Labor Market Paves The Way For Rate Cuts, June 24, 2024
- Economic Outlook Emerging Markets Q3 2024: Growth On Track, Policy Risks Rising, June 24, 2024
- Economic Outlook U.S. Q3 2024: Milder Growth Ahead, June 24, 2024

Regional Macro Updates can be found here

Additional research

- Asia-Pacific Real Estate: The Great Waiting Game, June 24, 2024
- Asia-Pacific Office REITs: Rising Stress Is Manageable For Most, June 14, 2024
- China Local Governments: The Slow Road To Stabilization, June 13, 2024
- Banking Industry Country Risk Assessment On France Unchanged Despite Sovereign Downgrade, June 3, 2024
- U.S. GSIBs Q1 2024 Update: Strong Performance Underscores Resiliency, May 31, 2024
- China's Latest Property Policies Could Be A Temporary Confidence Booster, May 21, 2024
- How South And Southeast Asian Firms Will Fare As Currencies Depreciate, May 15, 2024
- China Banks Brace For Tide Of Bad Property Loans, April 15, 2024
- Global Nonfinancial Corporate Medians History And Outlook Midyear 2024, June 19, 2024,
- Credit Cycle Indicator Q3 2024: Bumpy Ride Ahead Of A Credit Recovery In 2025, June 19, 2024
- CRE Debtholders Are Confronting Increasing Refinancing Risk And Charge-Offs In 2024; Outcomes Will Vary, June 3, 2024

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