S&P Global Ratings

Credit Conditions North America Q4 2024

Set For Improvement – With Eyes On The Election

Sept. 25, 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). Discussions center on identifying credit risks and their potential ratings impact in various asset classes, as well as borrowing and lending trends for businesses and consumers. This commentary reflects views discussed in the North America committee on Sept. 19, 2024.

Key Takeaways

- **Overall:** Credit conditions look set to steadily improve, but the forthcoming U.S. elections could create some financial market volatility and policy uncertainty.
- **Risks:** Financing costs could remain overly burdensome for some borrowers, especially those at the lower end of the ratings spectrum, if monetary-policy easing is derailed or risk aversion increases. Cost pressures could persist, threatening to hurt credit.
- **Ratings:** The region's net outlook bias, indicating potential ratings trends, has improved to negative 9.2%. We expect the U.S. trailing-12-month speculative-grade corporate default rate to fall to 3.75% by June 2025.

Credit conditions for borrowers in North America look set to steadily improve, with still-narrow spreads on corporate debt and the Federal Reserve starting to ease monetary policy—although the U.S. elections could make for some financial market volatility and policy uncertainty.

A soft landing for the U.S. economy seems to be in sight, especially with the central bank beginning to lower interest rates at a time when consumer savings have dwindled and corporate borrowers are saddled with still-high costs. We now expect policy makers to lower the federal funds rate to 3.00%-3.25% by the end of next year.

However, the central bank could keep its key rate higher than markets anticipate if inflation resurges, On the other hand, investors could demand higher risk premiums amid slowing economic growth and geopolitical uncertainty. In this scenario, financing costs could remain overly burdensome for some borrowers, especially those at the lower end of the ratings spectrum.

As the election approaches, investors could become more risk averse, especially given how tight the presidential race is, according to most polling. If the result of the run for the White House is unclear or in dispute, financial-market volatility could prove a setback to credit conditions.

Rating actions have shown positive momentum overall. Upgrades outpaced downgrades for two consecutive quarters, and the region's net outlook bias, indicating potential ratings trends,

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narrowed to negative 9.2% as of Sept. 10 (see charts 1 and 2). Also, net outlook/CreditWatch changes (positive outlook/CreditWatch changes minus negative outlook/CreditWatch changes) have largely been positive since November 2023, signaling more upgrades down the road.

Sector-level bias showed mixed movements. The metals, mining, and steel, and aerospace and defense sectors saw the largest drop in their negative bias in the past quarter (see chart 3). Meanwhile, the metric increased the most for telecom and transportation; joined by health care, these sectors lead negative bias with at least 25% of issuers having a negative outlook or on CreditWatch with negative implications.

The number of defaults in North America remains elevated at 63 through the end of August, led by consumer products and health care issuers, both higher than where we were at this point last year. Distressed exchanges continue to drive the default tally, accounting for 88% of North American defaults in August, and 56% of defaults so far in 2024.

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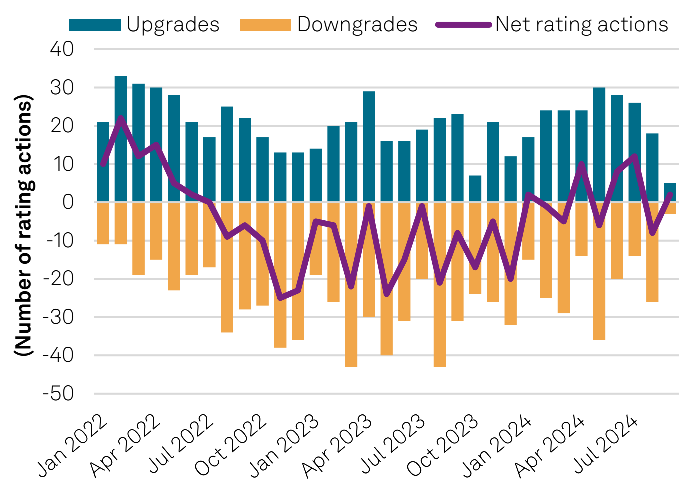
Chart 1

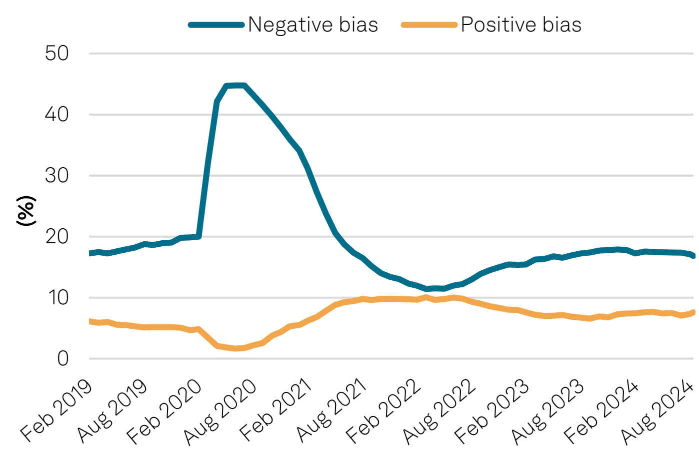
North American rating actions



Monthly data through Sept. 10, 2024, and covers financial and nonfinancial corporates. Source: S&P Global Ratings Credit Research & Insights.

Chart 2

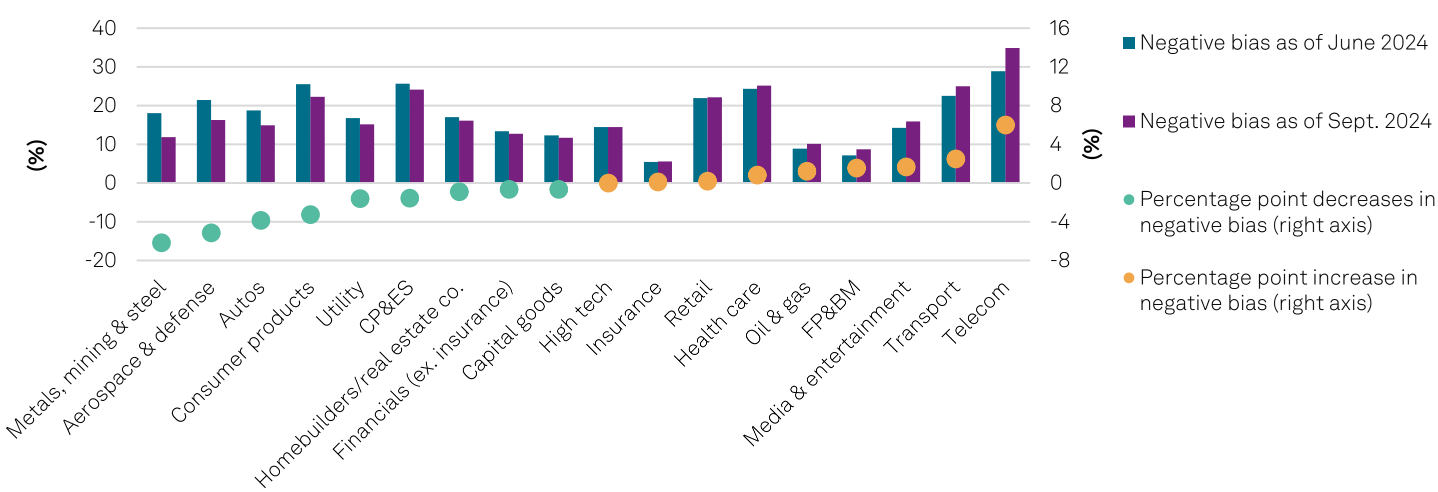
North American ratings outlook bias



Monthly data through Sept. 10, 2024, and covers financial and nonfinancial corporates. Negative bias—Percentage of issuers with a negative outlook or CreditWatch. Positive bias—Percentage of issuers with a positive outlook of CreditWatch. Source: S&P Global Ratings Credit Research & Insights.

Chart 3

Negative bias by sector



Data as of June 30 and Sept. 10, 2024. CP&ES—Chemicals, packaging & environmental services. FP&BM—Forest products & building materials. Negative bias—Percentage of issuers with a negative outlook or CreditWatch. Source: S&P Global Ratings Credit Research & Insights.

S&P Global Ratings Credit Research & Insights expects the U.S. trailing-12-month speculative-grade corporate default rate will fall to 3.75% by June 2025, from 4.6% in June of this year. For now, it seems the default rate peaked in April (at 4.9%), however our pessimistic case still calls for an elevated 6.25% default rate if existing risks materialize. A resilient economy combined with particularly strong market demand this year has kept most issuers afloat and allowed many to both refinance upcoming maturities and lower spreads on nearly one-third of all leveraged loans outstanding. These tailwinds should help push the default rate lower still, but it may persist at higher levels than historically, resulting in a slower descent in the default rate than its recent rise (see "The U.S. Speculative-Grade Corporate Default Rate Will Continue Its Descent, Reaching 3.75% By June 2025", published Aug. 19).

U.S. Elections

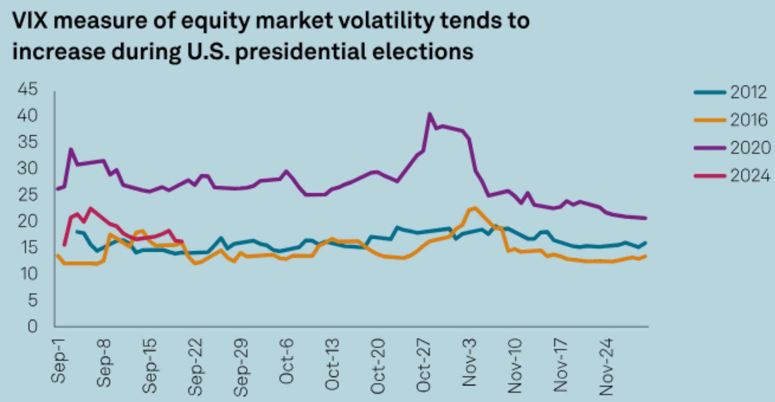
The outcome of the November elections could have broad ramifications—potentially increasing political polarization and creating policy uncertainty (see chart 4). S&P Global Ratings expects the consequences for U.S. borrowers will be predicated on the outcomes of the presidential and congressional elections—especially if there is a partisan split between the presidency and upper or lower house (or both) of Congress, which would make passage of any sweeping legislation challenging.

Chart 4

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

Risks to credit

- Financial-market volatility, especially if result of presidential election is unclear or in dispute
- Political polarization and policy uncertainty
- Could generate a wait-and-see investment climate, hurt business and consumer sentiment, and reduce economic activity



Policy areas to watch

Fiscal policy

We don't expect meaningful federal deficit reduction regardless of outcome, given pledges not to reform mandatory spending

We view the CHIPS Act, IRA and infrastructure spending as less likely to change given some areas of bipartisan support

Expiry of the TCJA at end-2025 opens the possibility for changes in tax regime

Trade policy

More trade restrictions—specifically, higher tariffs—could result in inflationary pressures, especially for sectors exposed to cross-border supply chains

We expect U.S.-China tensions to remain irrespective of the outcome of the election

Regulation

M&A may become more active if regulatory hurdles lessen for large business combinations

Uncertainties around energy and climate regulations could affect relevant sectors.

Financial regulation could be affected over time

VIX is through Sept. 20, 2024, and sourced from S&P Capital IQ Pro. Source: S&P Global Ratings.

From a credit perspective, the two policy areas of most interest are taxes and tariffs. Specifically, the fate of some of the Tax Cuts and Jobs Act's (TCJA) corporate tax provisions—such as interest deductibility, bonus depreciation, and deductions for research and development (R&D) expense—will be in the spotlight, regardless of the election outcomes.

The TCJA lowered the corporate tax rate to 21% from 35%, and did so permanently. But leaders from both parties seem eager to reopen the debate. Key Democrats are also looking at corporate taxes as a way to lower the budget deficit, and even some Republicans have mentioned raising the corporate tax rate due to concerns about the deficit.

We believe a higher corporate tax rate would add to a company's tax expense, weigh on net earnings, and have a one-time effect on deferred tax assets or liabilities, depending on the company's net tax position. However, any change in the corporate tax rate is unlikely to take effect before 2026 (unless it's applied retroactively) (see "U.S. 2024 Elections: How Dueling Tax Plans Could Matter For Corporates Post Election", published Sept. 24).

Regarding tariffs, we believe increasingly protectionist trade policies and any international responses will likely result in inflationary pressures (higher input costs for companies, higher costs for consumers, or both). Higher tariffs on imports from China (and any retaliation from China) could add to margin pressures for some sectors, hamper market access, and accelerate supply-chain diversification away from China.

We think the supply chain implications will likely be more acute for sectors that rely on highly engineered products such as high tech, renewable energy and autos. Cutting-edge products command high margins, but they also require raw materials that may not be available locally, specialized manufacturing facilities, uniquely trained staff, and assurances of intellectual property protection. This doesn't lend itself to a diverse network of suppliers. That said, shifting these supply chains will require comprehensive efforts, time and significant investments.

Sectors driven by commoditized goods, such as retail, consumer goods and building materials are also vulnerable but may be able pivot more easily. These types of business tend to be lower-margin with limited pricing power. However, given less complicated and more widely adopted manufacturing processes, there may be more opportunities to shift to different suppliers to minimize the effects of tariffs. The transition could still be costly and perhaps precarious, given these companies' narrower cushions to absorb losses.

On the other hand, certain industries may benefit from some measure of protectionism. For example, capital goods manufacturers, which have lowered their reliance on Chinese imports thanks to more diversified sourcing strategies in recent years, could enjoy greater reshoring and/or onshoring opportunities. Some U.S. chemical subsectors could benefit from higher product prices if imports of competing products from China are more expensive.

Top North American Risks

Burdensome all-in financing costs and market volatility weigh on liquidity for lower-rated borrowers

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

While the Fed has started lowering its policy rate, investors could demand higher risk premiums amid slowing economic growth and geopolitical uncertainty. Any renewed fear of inflation could also complicate the easing of monetary policy. All this means the costs of debt service and/or refinancing could be overly burdensome for some borrowers. U.S. corporates have made progress in reducing upcoming maturities so far this year--as of July 1 there remained $287.9 billion of speculative-grade debt maturing through 2025, of which 31% we rate 'B-' and lower. Some of these borrowers may suffer liquidity strains, particularly if investors become more risk-averse and market volatility picks up around the U.S. elections. Also, diverging monetary policy among major central banks could have ramifications for currencies and capital flows. For example, significant interest-rate increases by the Bank of Japan could trigger a shift in investment flows, causing volatility in capital markets such as U.S. Treasuries.

Cost pressures squeeze profits, erode credit quality

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

For many North American corporate borrowers, input prices—especially labor costs—remain elevated, and lingering supply chain bottlenecks and geopolitical tensions threaten to push up prices, such as for commodities and shipping. Any intensifying trade tensions between the U.S. and China, or other trading partners, could bring back inflationary pressures. These, coupled with challenges to pass on higher costs to consumers and customers, can erode profits and weigh on credit quality.

Falling asset values and cash flows, plus high financing costs, exacerbate CRE losses

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

Elevated financing costs are pressuring asset valuations and heightening refinancing risk for most types of CRE. Declining demand for office space in particular is further weighing on valuations and curbing cash flow. Certain segments and regions within the multifamily sector are also facing challenges as rent growth softens. All this may ultimately lead to more broad-based, and in some cases severe, loan losses for debtholders, such as U.S. banks (with regional lenders having proportionately higher exposure to CRE than larger U.S. lenders do), insurers, REITs, and commercial mortgage-backed securities (CMBS). Higher office vacancy rates and shuttered ground-level businesses could also affect tax revenue for cities.

U.S. elections spur market volatility and policy uncertainty, dent sentiment

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

With the U.S. presidency and 34 of 100 Senate seats (as well as all 435 House seats) up for grabs on Nov. 5, there's a risk of financial-market volatility, especially if the results of the presidential elections are unclear or in dispute. Moreover, the outcome could have broad ramifications, creating policy uncertainty in a context of global political polarization, and, in turn generate a wait-and-see investment climate, hurt business and consumer sentiment, and reduce economic activity. Prolonged congressional discussions about funding for fiscal 2025 budget could also add to market volatility.

U.S. economy suffers a sharper-than-expected slowdown, hurting demand

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

Even with the Fed beginning a cycle of interest-rate cuts, the costs of consumer and intermediate goods remain high. As a result, Americans' financial cushions and purchasing power continue to erode. Such pressure is particularly acute for lower-income cohorts, especially if unemployment rises measurably. More subdued business investment and/or a sharper pullback in spending could lead to a deeper slowdown in growth or a recession, causing more credit stress.

U.S. banking sector vulnerabilities erode sentiment, add to credit strains

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

U.S. regional banks remain vulnerable to sharper-than-expected slowdown, quickly shifting sentiment as well as losses due to disproportionate exposure to CRE, despite the likelihood of lower interest rates and the greater stability the banking sector has shown over the last year. An unexpected resurgence of turmoil in the banking sector could affect credit availability, market volatility, and weigh on consumer confidence. A likely tightening of bank regulation may also affect banks' appetite for risk and perhaps certain types of loans, depending on the details of any regulatory changes.

Structural risks

Escalating geopolitical tensions impede trade and investment, weighing on growth

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

Intensifying geopolitical tensions post threats to economic growth and financial stability. Any further worsening of U.S.-China tensions could disrupt supply chains and hamper trade, investment, and capital flows. Meanwhile, the potential for the Middle East conflict to escalate—and to affect the rest of the world through energy supply shocks, trade disruption, and social unrest—is also a key concern. While most borrowers in North America have limited direct exposure to the Russia-Ukraine conflict, the effects could deepen if an escalation (potentially involving NATO allies) occurs.

Climate risks intensify, energy transition adds to costs

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

More frequent and severe natural disasters increase the physical risks that public and private entities face, adding to costs. For example, extreme weather events are making it increasingly difficult for property owners in certain parts of the country to find affordable insurance, if they can get coverage at all, which could dampen housing prices and local economic growth in the longer run. Climate events also threaten to disrupt supply chains (such as for agriculture and food) and logistics. Moreover, the global drive toward a net-zero economy heightens transition risks across many sectors, requiring significant investments.

Accelerating tech transformation disrupts business models, cyberattacks threaten operations

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

Cyberattacks pose a systemic threat and significant single-entity event risk as new targets and methods emerge—with geopolitical tensions raising the prospect of major attacks. Organizations lagging on adapting to current and emerging technologies or lacking well-tested cybersecurity playbooks are more vulnerable, while adopting technological advances means more costs. The accelerating digitalization of business and economic activity—particularly the ability to influence market sentiment and shift capital rapidly and widely—also adds potential market volatility.

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.

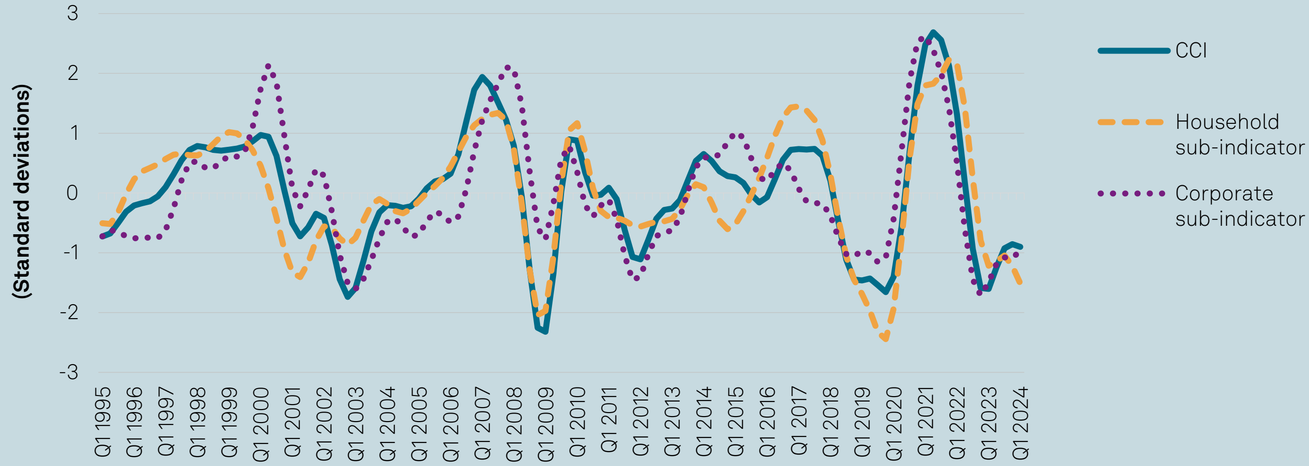
Credit Cycle Indicator

Signs of a gradual and uneven credit recovery

We believe the trough in our North American Credit Cycle Indicator (CCI), which started to form in early 2023, signals positive credit developments in 2025 (see chart 5). However, the upward momentum seems to have stalled somewhat. Despite improving market conditions and equity prices in the region, U.S. corporate and household debt-to-GDP continued to decline and the same metrics for Canada also reversed the uptrend in the recent quarter, reflecting more subdued borrowings relative to GDP growth in the face of high financing costs. As the Fed and Bank of Canada embark on their monetary easing cycle, certain interest-rate sensitive sectors (e.g., real estate) may see some relief. Meanwhile, the previous rate hikes are still feeding through the system with lagged effects (e.g., rise in Canadian household debt payments as mortgage renewals kick in). Against the backdrop of slowing economic growth, the credit recovery will likely be gradual and uneven.

Chart 5

North America CCI



Peaks in the CCI tend to lead credit stresses by six to ten 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 Q1 2024. Q1--First quarter. Q2--Second quarter. Q3--Third quarter. Q4--Fourth quarter. The North America CCI includes Canada and the U.S. Sources: Bank for International Settlements, Bloomberg, S&P Global Ratings.

Households. The household sub-indicator decreased to a new low, mainly driven by the contraction in household debt-to-GDP. While consumer spending has held up well, household financial health has been showing signs of deterioration, including new auto loan and credit card delinquencies that have steadily climbed to multi-year record levels in the U.S., and Canada's historically high debt-service ratios. Such pressure is likely more acute for the lower-income cohorts. Grappling with high prices and cooling labor markets, consumers could pull back more than expected, weighing more on the economy.

Corporates. The corporate sub-indicator increased slightly—despite the decline in corporate debt-to-GDP, equity prices have risen. Continued earnings recovery and strong refinancing and repricing activity seem to pave the way for corporate credit to stabilize and improve. Nonetheless, highly leveraged entities, especially those sensitive to the health of the consumer, remain more at risk.

Macroeconomic Outlook

- We expect U.S. real GDP growth will slow to below trend next year; S&P Global Ratings now expects the economy will expand 2.7% this year and 1.8% in 2025.
- We see the Fed's policy rate falling to 3.00%-3.25% by the end of next year.
- We forecast inflation to cool further in coming months, coinciding with the normalization of the U.S. labor market.

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U.S.

After surprisingly resilient economic activity so far this year, **we expect U.S. real GDP growth will slow to below trend next year**—accompanied by a rise in unemployment and lower inflation.

Because most recent indicators—except those showing continued weakness in the manufacturing sector—suggest economic growth momentum has continued to run slightly above trend this year, S&P Global Ratings now expects the U.S. economy will expand 2.7% in 2024 (up from 2.5% in our June forecast) and 1.8% in 2025 (up from 1.7%). We maintain our view that the probability of a recession starting in the next 12 months is 25%.

This comes as the Fed begins what we expect will be a long series of interest-rate cuts. After the central bank kicked off its easing cycle with a rate cut of 50 basis points (bps) on Sept. 18, we now believe policy makers will cut the key rate by 25 bps at the two remaining policy meetings in 2024. Looking further out, we've penciled in policy rates to reach a terminal rate of 3.00%-3.25% by the end of next year—a change to our previous forecast of 125 bps of cuts by year-end 2025.

We forecast inflation to cool further in coming months. The normalization of the U.S. labor market—with the ratio of job openings to unemployed workers back to its prepandemic level—has helped temper growth in labor costs and bring inflation expectations among households, businesses, and financial markets in line with the Fed's 2% target. The path will remain bumpy, but inflation should converge to the target by the middle of next year. Businesses still face high capital costs, which will likely limit capital spending and hiring in the next few quarters, and the unemployment rate will likely rise—to 4.5% by the end of 2025, from 4.2% currently.

Key downside risks include geopolitical tensions and a potentially disruptive U.S. election, along with the possibility of a disorderly reaction in the financial markets to actual and perceived risks that leads to a higher chance of a recession as companies respond to a sustained tightening of financial conditions by cutting back on investment and headcount.

Canada

Canada's economic growth was better than we expected in the second quarter, leading us to revise our forecasts, but the pace of expansion remains short of potential. We expect GDP growth of 1.2% in 2024 before accelerating to 2.0% in 2025.

Unemployment is likely to rise through the fourth quarter before reversing course next year when growth picks up, while we expect core inflation will fall to 2% by mid-2025. We forecast the Bank of Canada will cut interest rates to 3.75% by year-end and 2.5% in 2025, from the current 4.25%.

In our view, the cumulative lagged effect of higher interest rates will continue to weigh on consumers. Even though the BoC has started an easing cycle, borrowing costs will remain much higher in the next two years than pandemic lows, partly due to the mortgage renewal system in Canada. We think the rebound in economic growth will mainly come from fixed investment—both residential and nonresidential—rather than consumer spending.

Financing Conditions

- Since the start of August, bond issuance has remained historically strong, though largely led by investment-grade borrowers. Leveraged loans slipped in August but have since made up ground, with some increase in net supply after eight months dominated by refinancings and repricings.
- If our base case of a soft landing alongside a cycle of monetary-policy easing prevails, financing conditions should remain positive.
- Still, markets remain vulnerable to negative news. While the recent widening of spreads was both short-lived and ultimately modest, the pace of the increase in relative terms was notably swift.
- Financing conditions could turn more negative in the months ahead if economic growth falls short of expectations, policy uncertainty increases after the election, or the anticipated pace and extent of rate cuts fails to materialize.

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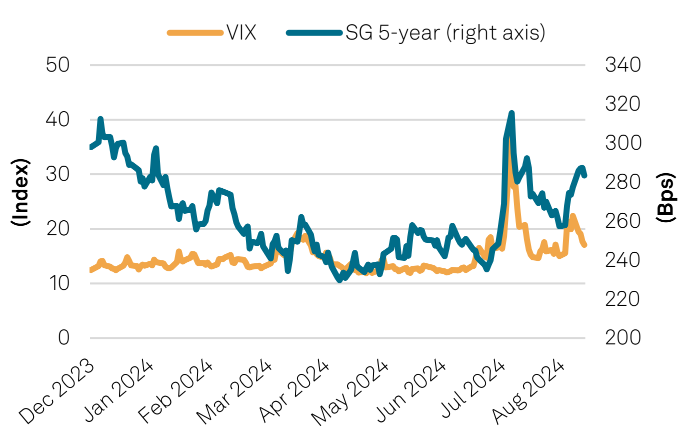
August volatility was short-lived for equity and fixed income, but it hasn't completely cleared and suggests heightened fragility. This came after the early-August release of nonfarm payrolls data, with the closely watched VIX index of equity volatility reaching a multi-year high closing level of 38.6 on Aug. 5. Speculative-grade bond spreads also widened, albeit to a lesser extent, hitting 315 bps on the same day (following an all-time low of 229.6 bps in early May). Both measures soon declined—but at a slower pace than their increases, and with both remaining higher than they were before the payrolls data. And while equity volatility is on a declining trajectory, bond spreads have seen a very recent, second widening (see chart 6). All told, the quick spike in volatility (perhaps exacerbated by other factors) suggests markets are particularly vulnerable to pessimistic economic news.

The onset of volatility may again be swift. While the recent widening of spreads was short-lived and ultimately modest, the pace in relative terms was among of the swiftest we've seen recently (see table 1). Within only a week's time, speculative-grade spreads widened 27%, through Aug. 5—near the record pace of March 2020. More telling perhaps, is the dominance of recent years in the list of periods defined by rapid spread widening; of the top 14 weeks, only three are from the Global Financial Crisis. This could be the result of the increased use of electronic trading systems, among other factors, but, in any case, these swift surges in volatility could become more common.

Chart 6

Not all of early August volatility has subsided



Data through Sept. 12, 2024. Sources: S&P Global Market Intelligence, S&P Global Ratings Credit Research & Insights.

Table 1

Recent spread volatilty was historically quick

7-day period that ended:	Spec-grade spreads widened (%):
3/20/2020	38.3
3/18/2020	33.9
3/15/2023	31.8
3/19/2020	31.2
3/12/2020	30.8
3/17/2020	30.5
3/23/2020	29.8
7/27/2007	27.0
8/5/2024	27.0
3/24/2020	26.8
7/26/2007	26.3
7/30/2007	26.2
3/16/2020	23.8
8/2/2024	23.0

This table shows the relative change rate of the U.S. speculative-grade five-year bond spread. Source: S&P Global Ratings Credit Research & Insights.

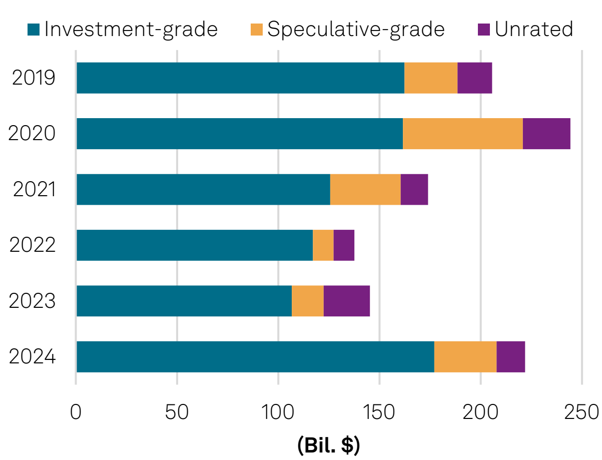
Issuance has been solid. After the short-lived market volatility, so was the slowing of bond issuance. In fact, issuance has been surprising since the start of August on the upside during what is typically a slower period of the year (see chart 7). The $222 billion in corporate bond issuance since Aug. 1 is the second-highest comparable total since 2019, beaten only by record-setting issuace through 2020. Still, some relative risk may remain, reflected in this haul being proportionately dominated by investment-grade issuance.

For leveraged loans, August represented a relative dearth, with only $7.3 billion in new institutional loan issuance. But through the first 12 days of September, this rebounded to $38 billion. Roughly 56% of loan issuance has been for refinancing and repricings—which suggests much of it is designed to reduce interest burdens—but it's substantially less than the 73% of refi and repricings from January-August.

Markets maintain aggressive assumptions about the pace of rate cuts (see chart 8), although our assumption is for fewer than the 225 bps in cuts priced in by the market (through mid-2025). If borrowing costs remain elevated, this would largely affect bond issuers, whose longer-term borrowing costs tend to adjust less quickly than moves in the federal funds rate. Conversely, loan issuers—which have already benefited from strong market demand and tight spreads to reprice more than $400 billion of debt—may stand to capitalize more quickly on rate cuts, since their benchmark (the secured overnight financing rate, or SOFR) tends to track the fed funds rate much more closely, leading to further reductions in their interest burdens.

Chart 7

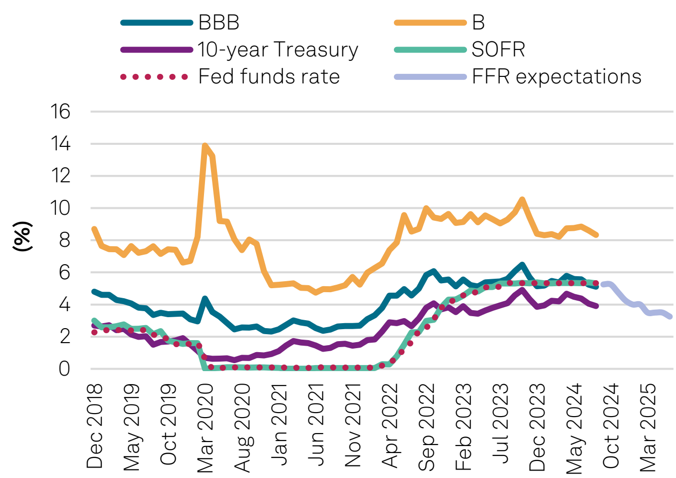
Bond issuance remains undeterred amid recent volatility



Bond issuance for August through Sep. 12 each year. Sources: Refinitiv, S&P Global Ratings Credit Research & Insights.

Chart 8

Rates may remain higher than prepandemic levels



FFR expectations—Federal funds rate expectations based on CME FedWatch tool as of Sep. 13, 2024. Sources: S&P Global Market Intelligence, CME Group, S&P Global Ratings Credit Research & Insights.

Sovereigns

- Whatever the results of the November presidential election, the composition of Congress will inform the prospects for policy; a unified government would tend to facilitate budget, government funding, and debt ceiling negotiations.
- We don't expect 2025 budget negotiations to start in earnest until after the election, and the new administration and Congress will need to discuss changes to the tax code as some of the TCJA provisions expire at the end of 2025.
- Federal fiscal deficits will likely remain around current levels regardless of the outcome, given political commitments not to reform mandatory spending such as Social Security, and we expect Congress will address the debt ceiling (suspended until January) in a timely manner.

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We expected limited Congressional action before the November elections. An agreement on full funding for fiscal 2025 isn't likely before the elections and negotiations could spill into early next year. Ultimately, we expect passage of a defense authorization bill by year-end, but negotiations on the farm bill could extend into 2025.

Progress on passing a biosecurity act, which would prohibit government agencies from financing foreign biotech companies deemed to threaten national security, highlights areas of bipartisan cooperation. Previously, efforts to secure a vote on a bipartisan immigration and border-security bill stalled in February specifically because of the election cycle, and a renewed push in May didn't advance. After approving funding for fiscal-year 2024 in line with top-line discretionary spending agreed to under the Fiscal Responsibility Act of June 2023, Congress also approved aid for Ukraine and Israel in April and May, respectively.

The composition of Congress after the election will be key role to determining policy. Despite partisanship, political leadership has advanced policies where there is consensus or overlap of the two parties' priorities. There is broad agreement on a tough stance toward China (both economically and strategically) and some overlap on the use of subsidies and tax breaks to promote certain industries deemed to be strategic, as well as infrastructure spending. On trade, the president has latitude to make changes under various executive authorities without Congressional approval. This contrasts with the review of treaties, such as the U.S.–Mexico–Canada Agreement and NATO membership.

We expect the central government budget deficit to remain near current levels in 2025-2026. This implies that the U.S.'s net general government debt will likely approach 100% of GDP in the next couple of years. The debt ceiling is suspended until early January, and we expect the next Congress and administration to act before the Treasury runs out of space to deploy extraordinary measures and remain below the debt ceiling. We also expect the next administration and Congress to take up discussions on the tax code. At the end of December 2025, key elements of the 2017 TCJA expire. Negotiations on extending certain provisions or letting them expire, and/or considering new tax policy will take center stage, as will the overall deficit path.

Financial Institutions

- Expected interest rate cuts have eased the main concerns regional banks faced last year, and the focus is now on a possible rise in losses in banks' CRE loan books.
- Negative outlooks have increased, but more than 80% of our U.S. bank ratings have stable or positive outlooks.
- As the economy slows, credit quality has been deteriorating modestly.

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Banks

Expected interest rate cuts have eased the main concerns regional banks faced in 2023—namely challenges with asset-liability management and declining deposits as high interest rates prompted bank depositors to seek better yields. However, **the focus is now on a possible rise in losses in banks' CRE loan books, mainly for smaller regional banks with large exposures.**

Lower rates should help ease CRE pricing concerns to some degree. That said, given structural changes in the demand for office properties, we don't believe it will be a panacea for deteriorating CRE credit quality. In the second quarter, CRE delinquencies and nonaccrual loans rose to about 1.5% of CRE loans, up about 20 bps from the prior quarter, as a sizable portion (20%-30%) of rated banks' CRE loans mature this year and next.

While negative outlooks have increased, more than 80% of our U.S. bank ratings have stable or positive outlooks. Stability in the sector has improved even as operating conditions remain tough. Most rated banks have manageable CRE exposures, with office loans typically making up a low-single-digit portion of loans. We believe profitability will fall somewhat this year, largely due to an expected modest decline in net interest income (NII) and higher provisions. But we still expect the industry to post a decent 11% return on equity (ROE). Some potential further pressure on NII may lead an incremental decline in profitability in 2025, but we still expect banks to earn a 10%-11% ROE. The ratings on nine U.S. banks, or 17% of the rated bank portfolio, have negative outlooks, mainly reflecting CRE risk.

As the economy slows, credit quality has been deteriorating modestly, with charge-off levels now above the historical median. Credit quality will likely continue to deteriorate, mainly driven by CRE and credit cards, although lower rates could help mitigate the extent of charge-offs. Most banks' allowances for credit losses were flat in the second quarter on a sequential basis, partially due to weak loan growth. We expect provisions and allowances to rise somewhat further, even assuming a relatively muted 2% loan growth.

We are focusing most closely on the rated banks with the largest CRE exposures (those with CRE loans exceeding 30% of their loans or 200% of tier 1 capital). For these banks, office exposures typically make up less than 10% of total loans and for the most part aren't in the gateway cities that have seen the largest declines in office prices. But multifamily properties have also suffered some price declines—albeit much more moderate than office—due to oversupply in some regions of the country, high interest rates, and the high cost of running these buildings. This could weigh on asset quality within CRE loan books.

Banks should be able to absorb much of those stresses through earnings retention and existing capital, but they are subject to vulnerabilities from the risk of a loss of confidence. If a bank needed to build a significant CRE reserve in a short period due to loan deterioration, it could dent a big portion of that bank's income. This would possibly result in a loss, which in turn, could result in customer attrition, including deposit outflows.

Deposits, which have declined 6% since the Fed began raising rates, may start growing again with the easing of monetary policy. Banks have been increasing the rate they pay on deposits since March 2022, and deposits have shifted to higher-paying accounts. Banks have also increasingly relied on brokered deposits and wholesale borrowings to support on-balance-sheet liquidity and pledged additional assets to secure more access to contingent liquidity. The easing of rates should allow for some drop in funding costs and more deposit growth or at least stabilization. Still, lower rates may further pressure profitability in the early stages of the rate reduction cycle with asset yields falling incrementally faster than funding costs. As a result, we expect continued pressure on net interest margins (NIMs).

We expect most banks to maintain or add to their capital ratios. Regulators have indicated they may repropose a plan for implementing the final components of the Basel III agreement. It appears that the re-proposal will be less stringent than the original proposal made last year. However, it could add moderately to the minimum capital requirements of the largest banks. It also likely will eliminate the ability of large regional banks to exclude unrealized losses on available-for-sale securities from their capital ratios. That may cause some large regional banks to build further capital. That said, we expect unrealized losses in banks' securities to decline further if long end of the yield curve comes down and as lower-yielding securities portfolio approach maturity. Unrealized losses totaled roughly 9% of banks cumulative securities portfolios at the end of the second quarter.

The outcome of November's elections could affect financial regulation over time. The incoming president will initially have the ability to make changes to the leadership of some regulatory bodies, such as the Consumer Financial Protection Bureau and the Federal Housing Finance Agency. The terms of some other regulatory leaders will expire later. That includes the Fed's chair and vice chair for supervision, whose current terms last until 2026. Control of Congress, which must confirm presidential appointments to many key regulatory leadership positions, may also be a factor for financial regulation. The leadership and staffing of the regulatory bodies could affect how much bank regulation changes, handling of Fannie Mae and Freddie Mac, and consumer protection regulation and enforcement, among other issues.

Our key risks for the U.S. banking sector hinge largely on the path forward for the economy. A hard economic landing, which is not in our base forecast, would weigh on banks' balance sheets and profitability. Whether banks can lower deposit pricing once rate cuts materialize and maintain cost effective funding sources will be an important ratings consideration. Stress in CRE loans, a re-emergence of confidence-sensitivity issues, regulatory uncertainty, risks from nonbank competition, and cybersecurity are also ongoing concerns.

Finance companies

Our outlook is stable on 80% of the North American finance companies (fincos) we rate. Asset quality pressures, liquidity needs, stabilizing but lower earnings, and higher funding costs continue to weigh on ratings. There remains an urgency to deploy capital this year that could influence underwriting standards, which could in turn drive asset quality. We think fincos with diversified revenue streams and sound balance sheets are best-positioned to meet these challenges over the next year.

We have one negative and 12 stable outlooks on publicly rated business development companies (BDCs) all of which have 'BBB-' ratings. The continued proliferation of newer BDCs and the recovery in broadly syndicated loan (BSL) markets have given borrowers an opportunity to refinance and lower their funding costs. This has led to spread compression for upper-middle-market direct lenders as there is a tremendous amount of capital waiting to be deployed and limited investment opportunities. Tighter credit spreads, along with investor appetite for risk, has allowed BSL markets to compete with direct lenders. We believe expected tighter banking regulations, direct lenders' ability to write larger checks, and rising club deals will continue to allow direct lenders to compete with BSLs.

So far in 2024, valuation marks have improved, and we believe they could continue to do so for the rest of the year considering expected economic growth and underlying borrower EBITDA growth. While nonaccruals are gradually rising, they remain relatively low. However, payment-in-kind (PIK) income, as a percentage of gross investment income, remains elevated across the rated universe as BDCs with scale identify and amend their potentially underperforming investments.

Fed rate cuts may not be deep enough for borrowers struggling to maintain cash flow and meet interest payments. We expect interest rates will continue to test borrowers in certain sectors that may struggle to pass rising costs to end users, constraining those borrowers' ability to service debt and increasing the probability of default. We expect PIK income to increase for most BDCs in the next few quarters, while borrowers continue to face liquidity pressures. Interest rate cuts will only marginally make an impact on PIK albeit with a lag in our opinion.

Challenging conditions will persist for CRE lenders, but CRE services companies may be at an inflection point. Interest rates continue to pressure asset valuations by keeping cap rates higher, but the extent of the impact will depend on location, property type, and the underwriting quality on the properties securing their loans. As base rates decline, we could see an uptick in CRE transactional activity as cap rates stabilize or move lower.

However, the fundamentals for CRE lenders remain under pressure, and we think CRE finance companies' loan portfolios could likely remain stressed, particularly those with high office exposures. We have seen a precipitous decline in CRE lenders' distributable earnings; that has prompted some companies to cut their dividends to protect liquidity. So far this year, of the six CRE lenders we rate, we downgraded two issuers by one notch and revised our outlook on two issuers to negative, reflecting substantial deterioration in asset quality and potential liquidity pressure. We upgraded one issuer based on its strong funding profile and sizable unencumbered assets that will allow it to navigate challenges in the CRE markets. Over the next year, CRE finance companies will, in our view, remain selective with originations and focus on preserving liquidity.

We've also seen some strain in multifamily due to increased supply, slowing rent growth, and high interest rates. A rise in troubled multifamily loans could hit asset quality since most CRE lenders have increased their exposure to multifamily since 2020 to offset office exposure.

For CRE services companies, interest rate stability and expectations around cuts could encourage occupiers and investors to deploy capital accumulated over the past two years, which would benefit their capital markets segments. Furthermore, global office leasing has gradually improved in 2024, as a result of larger deal sizes and transaction volumes from improved business confidence. However, industrial leasing has continued to normalize from elevated levels during the height of the pandemic.

We expect CRE services companies with large property and facilities management businesses will continue to perform well, benefiting from recurring revenue and multiyear contracts with high switching costs. We also expect robust growth driven by new and existing client expansion, particularly in the industrial and logistics sectors. While we expect a better operating environment over the next 12 months, we maintain a negative outlook on three of the five rated CRE services companies.

We expect fincos will have adequate liquidity to address debt maturities for the most part. The debt markets have been open for companies in certain sectors. However, any refinancing is at higher rates relative to existing debt.

Asset managers

Continued high interest rates are a mixed bag for wealth and asset managers we rate, though insight into rate cuts is a positive factor. EBITDA interest coverage remains compressed for issuers with sizable variable rate debt relative to earnings. Coverage is thin for many highly leveraged, acquisitive wealth managers, as well as some traditional asset managers with mixed records of performance and asset flows. That said, only two traditional asset managers we rate are on negative outlook—in both cases due to their credit metrics' proximity to downside thresholds. All other rated wealth and asset managers are currently on stable outlook.

For alternative managers, the trajectory for interest rates, public market stability, and relatively benign economic conditions has helped stabilize asset valuations and support realization and deployment activity over the last 12 months. Private equity activity remains somewhat subdued, but private credit continues to grow for most alternative managers.

A sharper-than-expected economic slowdown is a key risk to ratings across the industry. Traditional asset managers' earnings are particularly exposed to market volatility, the effects of which could be compounded by outflows. While wealth managers are also exposed to market volatility and redemption risk, their asset bases tend to be stickier, and they are relatively less exposed to market volatility due to the better diversification of their underlying asset bases and some non-market-correlated sources of revenue.

While market disruptions could present investment opportunities for alternative asset managers, it could also lead to weakening performance of current investments and delay realization activity. Sustained weak investment performance or stalled realizations could constrain fundraising efforts, as less capital is returned to investors from prior fund vintages.

Of the three subsectors, alternative asset managers are best-positioned to withstand deterioration in macroeconomic conditions, considering the locked-up nature of a large proportion their assets under management, solid performance and fundraising records, and diversified offerings. There are also a number of tailwinds including increasing investment allocations from institutional and private wealth clients and the opportunity for private credit to fill gaps left by bank retrenchment.

Managers we rate have adequate liquidity and few near-term debt maturities. We expect debt markets to remain open in the fourth quarter, supported by both bank and private capital availability. Any debt issuance over the near term will likely raise issuers' weighted average cost of capital and compress interest coverage further. However, we expect funding costs to decline in the longer run.

Nonfinancial Corporates

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- Robust debt issuance has contributed to longer-dated maturity profiles and capital structures more capable of navigating elevated rates.
- Supply chain hiccups persist; they remain difficult to predict and expensive to navigate.
- It remains a challenge to anticipate consequences issuers may face depending on the results of the November elections.

Falling interest rates are more likely to benefit borrowers in their regular course of business than to be the saving grace for issuers that would have otherwise failed to refinance. There's been robust debt issuance in the past 12 months, which has contributed to longer-dated maturity profiles and capital structures more capable of navigating elevated rates.

Faced with fewer prospects for investment and the rising cost of capital, many investment-grade issuers with cash to spare chose to manage their capital structures by paying off debt to minimize and sometimes even reverse rising interest expense. Many comparatively well-positioned speculative-grade borrowers also refinanced to stabilize their capital structures ahead of any uncertainty from the November elections. In more marginal cases, companies couldn't support their capital structures at prevailing rates and had to restructure. This has contributed to selective defaults at more than twice the pace than before the pandemic.

Any tailwind from lower interest rates may be muted as economic growth slows. More accessible capital markets lower ongoing costs of capital and may make certain investment opportunities viable again. However, these upsides have to be weighed against the likelihood of a weaker economy or a faltering job market, either of which can erode consumer demand. While record consumer borrowing suggests rising rates dissuaded buyers less than expected, delinquencies are also rising. A reprieve in borrowing costs may stem some of that tide, particularly for sectors heavily driven by consumer financing, such as autos and homebuilders, and even retail and consumer goods.

Supply-chain strain

Geopolitical tensions are reshaping trade routes, extending shipping times, and increasing freight and inventory costs. The lingering Red Sea crisis continues to affect shipping through the area. This has shifted trade routes south around the Cape of Good Hope just as trade volumes are peaking. As an example, a ship leaving Shanghai and traveling to New York around the southern tip of Africa would need to travel approximately 17% further than the same ship traversing Egypt's Suez Canal (almost 14,500 miles versus around 12,400 miles).

In the face of this slower and less certain supply chain, a return to elevated inventory to accommodate strained supply chains would carry risks. Beyond additional costs, higher levels of inventory expose companies to losses if customer preferences suddenly change.

Labor disputes, shipping container shortages, and lagging infrastructure are limiting shipping capacity. A bright spot has been the availability of vessels as a result of recent new ship deliveries. However, the asymmetrical trade between Asia and the U.S. results in a preponderance of shipping containers in our direction. As volumes have picked up, signs of container shortages at key Asian ports and the resulting congestion of waiting ships are intensifying.

Strained facilities have led to difficult work environments that have seemingly contributed to workforce disruptions. Rail labor strikes in Canada toward the end of August were quickly resolved, but with enduring consequences. Next on the horizon is the potential for an

International Longshoremen Association (ILA) strike starting in October. The ILA comprises 85,000 members, many working in one of over three dozen ports from Maine to Texas along the Gulf and Eastern coasts of the U.S. These ports handle 43% of U.S. imports and about $3.7 billion worth of trade per day. A prolonged strike of a week or two would create backlogs stretching late into the year or longer. Retailers have been shifting shipments to the North American West Coast, and trading partners are making alternate arrangements necessary for business continuity.

Eyes on the elections

Anticipating the consequences issuers might face with either administration remains challenging, especially given how much the fate of policy depends on the makeup of Congress. We maintain our view that fiscal spending programs such as the CHIPS and Science Act and the Inflation Reduction Act have some areas of bipartisan support and are less likely to change.

On another front, **trade policy is grabbing much of the spotlight** during the campaign season. We think increasingly isolationist sentiment could exacerbate already-brewing tensions—particularly between the U.S. and China. In our view, heavy tariffs and shocks to the supply chain from regional conflicts and other sources could increase prices or shrink profit margins for many industries if these additional costs can't be passed onto customers and consumers (see "U.S. Elections" Section).

On taxes, the sunsetting of the Tax Cuts and Jobs Act presents a second avenue for shaping fiscal policy. In this case, areas of differentiation center around how cuts might be distributed between corporate and individual taxpayers, including how cuts in the latter would be allocated across the income scale. Without further specifics, the highest risks sit with those businesses with narrow cash flow margins, particularly if those cash flows are also volatile.

Public Finance

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- Proactive management and governance remain key to credit stability across public finance sectors, particularly given the broad range of risks facing governments and not-for-profit entities, such as extreme weather events, cyberattacks, and demographic shifts.
- Despite expectations for market tumult around the elections, we see limited impact to public finance issuers given their history of stability and ability to adjust to short-term disruptions.
- Utilities, health care, and some sections of higher education still show signs of negative credit trends, but going into the fourth quarter our view of the mass transit sector has improved sufficiently to move the sector to stable after several years on negative. This sector view includes mass transit providers in the U.S., Canada, Spain, and the U.K.

Mass transit sector view revised to stable amid increased ridership

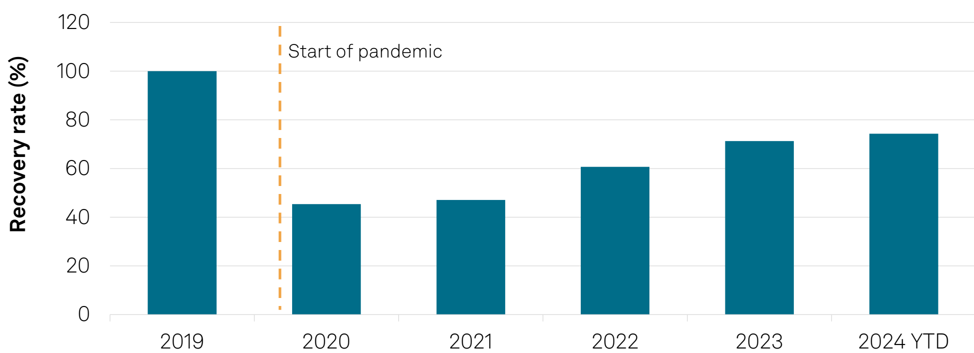
We revised our sector view on mass transit back to stable to reflect improving financial metrics that underly the sector's overall credit stability. While public transit ridership remains lower than pre-pandemic levels (see chart 9), support from dedicated transit taxes has helped offset continued weaker fare revenue. S&P Global Ratings believes most transit operators will continue to adjust service levels and re-examine fixed costs to meet lower baseline demand. However, enhancing existing recurring revenue sources or establishing new sources will be critical for operators seeking to achieve structural balance.

Sales tax growth—such as the revenues supporting mass transit providers—has been strong in some parts of the country but weaker in others, with some states down more than 10% from June 2023 to June of this year. However, when offset by states experiencing revenue growth, total year-over-year tax collections (including personal and corporate income tax plus sales taxes) through June 2024 were up 0.7%. Our view of the state and local government sector remains stable but it could lead to greater fiscal stress in some areas as the revenue trend is showing signs of a slowdown.

Our forecast for slower growth in Canada, too, means provinces will have a harder time maintaining balanced operating results, with projected lower tax revenues and higher wage settlements to date. In addition, record population growth is putting pressure on provincial and municipal services and infrastructure, which will continue to shape political and budget dynamics in the next two years.

Chart 9

U.S. public transit average ridership recapture rate



Source: American Public Transportation Association.

Credit issues that matter

The federal stimulus has begun winding down. September marks the spending deadline for schools that received funds from the Elementary and Secondary School Emergency Relief Fund (ESSER) as part of 2021's federal stimulus package. Many school districts were able to use the funds to boost reserves, so we don't expect this to be a credit cliff. However, with a deadline of December for state and local governments to designate their funds from the American Rescue Plan Act (ARPA) —and a spend-by deadline of December 2026—any credit disruptions experienced by schools adjusting to the loss of one-time monies this fall could be an indicator of things to come.

Higher capital and operating costs continue to stretch budgets. The prolonged high interest rate environment has affected budgets, most persistently though elevated capital costs and wage growth. Sectors like transportation and utilities are particularly affected by higher capital costs for heavy equipment and machinery, but higher wages remain a challenge for all issuers. This has led to some credit deterioration, and many issuers remain vulnerable to pressures created by a prolonged period of higher costs.

Inflation seems to have peaked and interest rates are falling, but costs are still at the forefront with housing, food and utility costs remaining above where most feel comfortable. This could have a longer-term effect on consumption-related taxes and estate/transfer taxes.

Climate hazards persist. Hurricanes and wildfires will likely continue through the fall months, keeping communities susceptible to these natural disasters on alert for potentially devastating events. The events also highlight the need for advanced planning and good governance to prepare for the unexpected. Longer term, rising insurance premiums continue to exacerbate housing affordability particularly in states with more frequent major storms and weather events.

The impact of remote work continues to create headwinds including some economic and budgetary uncertainty. While property tax revenues for cities might not be falling, a persistent pattern of fewer downtown workers could create a longer-term impact on the local economy and force a shift of tax burdens to residential property, even as affordability declines.

There is a potential East Coast port strike. On Sept. 30, the contract expires between International Longshoreman's Association and the U.S. Maritime Alliance representing the shipping lines and maritime terminal operators at six of the 10 busiest U.S. ports from Houston to Boston. If a strike occurs, it would involve about 45,000 workers and three dozen ports. Negotiations on a new labor agreement have stalled and while talks often get extended to avert a strike, there can be slowdowns if things drag on.

Other disruptors loom. Election-year distractions at the federal and state level can dramatically slow progress on essential legislation dependent on approval at a higher level to progress, creating policy and regulatory uncertainty. However, in our view, it is unlikely to create a deterioration in credit quality in the short term.

Structured Finance

- For CRE and commercial mortgage-backed securities (CMBS), the challenging environment for office buildings remain front and center.
- Ratings on collateralized loan obligations (CLOs) are steady, as credit stress for the corporate obligors underlying the transactions is generally contained to certain sectors.
- We expect U.S. structured finance collateral and rating performance during the next 12 months to be stable to somewhat weaker.

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While a recession in the next 12 months remains unlikely, some signs of stress on the consumer are emerging along with a slowly rising unemployment rate.

Table 2

12-month North America structured finance outlook – Q4 2024

	Collateral performance outlook	Rating trends
Residential mortgages (RMBS)		
RMBS	Stable	Stable to positive
RMBS – service advance	Stable	Stable
Commercial mortgages (CMBS)		
CMBS - N.A. conduit/fusion	Weaker	Stable to negative
CMBS - large loan/single borrower (retail)	Weaker	Stable to negative
CMBS - large loan/single borrower (lodging)	Somewhat weaker	Stable
CMBS - large loan/single borrower (office)	Weaker	Negative
CMBS - large loan/single borrower (all else)	Somewhat weaker	Stable
Asset-backed securities (ABS)		
ABS - Prime auto loans	Somewhat weaker	Stable
ABS - Subprime auto loans	Weaker	Stable to negative
ABS - Auto lease	Stable	Stable
ABS - Auto dealer floorplan	Stable	Stable
ABS - Credit cards	Somewhat weaker	Stable
ABS - Unsecured consumer loans	Somewhat weaker	Stable to negative
ABS - FFELP student loan	Somewhat weaker	Stable
ABS - Private student loan	Somewhat weaker	Stable
ABS - Commercial equipment	Stable	Stable
Asset-backed commercial paper	Stable	Stable
Structured credit		
CLOs	Somewhat weaker	Stable
ABS - Esoteric		
Timeshares	Somewhat weaker	Stable
Small business	Somewhat weaker	Stable
Tobacco	Somewhat weaker	Stable to negative
Transportation - aircraft	Somewhat stronger	Stable to positive
Transportation - container	Stable	Stable to positive
Transportation - railcar	Stable	Stable to positive
Whole business	Somewhat weaker	Stable
Triple net lease	Stable	Stable

FFELP—Federal Family Education Loan Program. Source: S&P Global Ratings.

The challenging environment for office buildings remain front and center for CRE and CMBS, as uncertainty regarding future demand for space has led to unprecedented price declines, shaky fundamentals, and a much tighter financing environment (see U.S. And European Commercial Real Estate Market Stress Reflected In CMBS Downgrades, published July 9). Overall CMBS delinquency and special servicing rates, both metrics associated with credit stress, have increased, and office-backed deals have seen numerous downgrades. That said, valuations for institutional quality CRE, according to

Green Street's Commercial Property Price Index (CPPI) are up 3.3% year to date as of August. This perhaps reflects that much of the stress is contained within office (and some pockets of multifamily) and that market participants expect rates to head lower in the near/intermediate term. Residential mortgage and residential mortgage-backed securities (RMBS) credit continue to be propped up by house price trends and the fact that many borrowers have long-term, low-rate financing locked in.

With elevated inflation during the past few years and high borrowing rates, it comes as little surprise that credit pressure on the consumer is weighted toward the lower half of the income spectrum and obligors with relatively weaker credit scores. However, we have also seen signs of deterioration within the "prime" borrower segment. Our recent U.S. auto loan ABS tracker showed 60-day-plus delinquencies at their highest July levels since 2009 for prime, and highest ever July level for subprime. Esoteric asset-backed securities (ABS) sectors continue to show mostly weaker collateral performance, excluding transportation related sectors. Rating trends are stable, or stable-to-positive (for transportation sectors). Meanwhile, ratings on CLOs are holding steady, as credit stress for the corporate obligors underlying the transactions is generally contained to certain sectors, like consumer products, media, and health care.

Taken as a whole, we expect U.S. structured finance collateral and rating performance during the next 12 months to be stable to somewhat weaker, with most rating actions in the non-investment-grade classes (see table 2). Clearly, sector performance will vary.

Insurance

- The U.S. health insurance industry remains on stable footing, though headwinds are challenging the sector.
- Our view on the U.S. property/casualty (P/C) sector remains negative amid weak underwriting results in personal lines and a reduction in capital for some insurers.
- Reinsurers have moved past their lackluster operating performance; the sector generated strong earnings in 2023 and the trend has extended into this year.

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The average financial strength rating for our core North American insurance portfolio (life, health, P/C) is at the upper half of the strong ('A') category, reflecting stability for the three-month period ended Aug. 31, 2024. Our outlook on most (75% or better) of our ratings for the core portfolio are stable, with negative bias for the health insurance sector sustained from the prior quarter.

Major rating factors include pricing, interest rates, capitalization, CRE valuation, medical utilization, escalating geopolitical tensions, and elevated catastrophe risk. We believe there is still broad access to capital for this mostly investment-grade portfolio of companies that in general aren't highly leveraged. Balance-sheet strength continues to underpin credit quality.

Table 3

North America insurance sector trends – Q4 2024

Sector	Current business conditions	Business conditions outlook	Sector outlook
Life insurers	Satisfactory	No change	Stable
Health insurers	Satisfactory	No change	Stable
Property/casualty insurers	Satisfactory	Somewhat stronger	Negative
Global reinsurers	Strong	No change	Stable
Bond insurers	Satisfactory	No change	Stable
Title insurance	Satisfactory	No change	Stable
Mortgage insurers	Satisfactory	Somewhat weaker	Stable

Note: Business conditions and sector outlook are for the next 12 months. There are no changes since Q3 2024.
Source: S&P Global Ratings.

Life insurance

If the relatively accommodating environment for life insurers persists for the remainder of the year, the sector will continue to benefit. Judging by sales year to date, the rate environment has continued to support record sales of fixed-rate and fixed-index annuities, although life insurance sales have remained flat or slightly dipped, specifically in whole life. We expect sales will begin to plateau toward the end of this year or early next year, but profitability will remain positive.

A potentially slowing economy may prompt defaults and downgrades in the corporate bond and loan markets, which make up the bulk of insurers' assets. Thus far, the impacts have been felt at the lower end of the speculative-grade spectrum, which life insurers have very little exposure to. Commercial mortgage loans, especially in the office sector, are another possible point of stress, but we believe insurers will largely be able to absorb losses that are expected to unfold in coming years. Escalating geopolitical tensions that impede trade and investment are a wildcard that may ultimately affect the sector.

We expect the mergers and acquisition (M&A) trends of that past 18 months will continue, with more blocks of legacy businesses moving from public companies to private hands.

Health insurance

The U.S. health insurance industry remains on stable footing, though headwinds are challenging the sector, particularly within the government lines. While our outlook on the majority of the portfolio is stable, a negative bias has emerged in connection with our revised view of capital after implementing our capital model criteria as well as other factors contributing to earnings and capital pressures. We continue to expect healthy revenue growth in 2024 due to premium rate increases tied to medical cost inflation. However, revenue growth may be softened overall due to Medicare Advantage rate pressures and member losses in Medicaid due to the impact of redeterminations.

The sector is grappling with earnings pressure due to elevated utilization trends and weaker rates in Medicare Advantage and the lag in rate adequacy in Medicaid as the redetermination process resulted in a higher-acuity Medicaid population. The commercial segment is experiencing pockets of higher utilization, particularly within behavioral health and due to increased usage of GLP-1 drugs. We think some health insurers will be challenged to sustain their credit profiles, while others can be expected to operate through these headwinds, incurring some credit profile strain that is unaccompanied by a rating change.

On M&A, the industry remains active, as health insurers continue to acquire non-insurance health-care services companies and tuck-in health insurance assets. Leverage and integration risks remain balanced by strong cash flows and financial flexibility, reflected by healthy debt repayment and coverage metrics.

P/C

S&P Global Ratings' view on the U.S. P/C sector remains negative, notwithstanding a significant shift in our distribution of rating outlooks attributable to the recent implementation of our new capital model criteria. The fundamental reasons for our negative sector view remain in place, most notably the weak underwriting results in personal lines and a reduction in capital for some insurers.

Strong rate momentum for most commercial lines continues to match or exceed loss-cost trends, resulting in very good underwriting profitability for the sector. Offsetting this has been the weakness in personal auto due to a sharp increase in claims costs that began in 2021. Personal auto insurers have been pursuing rate increases and their results saw significant improvement in the first half of the year. Homeowners' results remain under pressure as insurers have not been able to raise rates fast enough to offset higher claims costs from more frequent severe convective storms and because insurers are retaining more of this risk due to reduced availability of reinsurance. The P/C industry's full-year 2023 combined ratio was around 102%, and we expect this measure to return to underwriting profitability (combined ratio < 100%) this year, assuming normalized catastrophe losses.

Capital deteriorated in 2022 due to the impact of higher interest rates on bond valuations but recovered somewhat in 2023 due to lower unrealized losses on bond holdings, growth in retained earnings and reduced share repurchase activity. Further improvement in capital adequacy, together with a sustained improvement in personal lines underwriting performance, could lead us to revise our sector view back to stable.

Global reinsurance

In general, reinsurers have moved past their lackluster operating performance seen just a few years ago. The sector generated strong earnings in 2023 and the trend has extended into this year, as reinsurers continue to benefit from favorable pricing along with solid investment income.

Therefore, we maintain our stable view of the global reinsurance sector after we revised it from negative in September 2023. Overall, reinsurers' capital positions have been rebuilt thanks to strong results in 2023 and through the first half. Still, the industry remains concerned about elevated natural catastrophes, and casualty lines which saw pricing pressure from reinsurers as worries grow about the impact of economic and social inflation on loss cost trends, especially for business underwritten during the past soft cycle. Reinsurance demand is increasing and, despite signs of moderation in property pricing, we think overall conditions are still favorable, and we expect the industry will continue to post strong results.

Bond, title, and private mortgage insurers (PMIs)

In the U.S. public finance market, the majority insured par exposure for the bond issuers, insured penetration has remained elevated, which is a continuation of the increased demand for bond insurance that began in 2020. As in 2020, investor desire for protection, price stability, and market liquidity may be driving demand. Further supporting business growth has been a strong demand in the secondary market, which should continue due to uncertainty about economic volatility and headlines around the elections. It's worth noting that several large transportation projects came to market with insurance in the first half of the year. Insured issues within the USPF market have an underlying credit quality of 'A'/'A-', with some 'AA-' issues also being wrapped. While pressures related to inflation or the potential for lower consumer spending could affect collections of economically sensitive revenues, the bond insurers' underwriting strategies and conservative capital management plans are supportive of the potential growth in exposure.

The overall profitability and financial strength of title insurers depends on their ability to manage operations throughout the mortgage and economic cycles. This aspect of the title business is being tested as the residential housing market has remained under pressure due to higher interest rates and lack of supply. We expect modest revenue growth for the sector. However, the average revenue-per-direct-title order has increased, primarily due to a shift in business mix to higher premium commercial transactions and an increase in the average revenue per order for residential purchase transaction stemming from higher home prices. Due to insurers maintaining focus on managing operating expenses, 2024 as pre-tax margins are strong. Margins may further improve due to ongoing investments in data and innovative technologies to improve underwriting efficiencies. Capitalization in the title sector remains robust, benefiting from low losses and a profitable business. Title insurance results have remained strong across all rated insures with each proving successful at expense control with a solid set of risk tolerance standards including oversight of agents and we expect this trend to continue.

PMIs continue to benefit from a resilient economy, but labor market conditions and rising unemployment remain concerns. Mortgage delinquencies in the recent period picked up slightly, though they remain well below the pre-pandemic levels. PMIs outstanding loan portfolio continues to have significant embedded home equity, which we believe will provide a material cushion against any potential losses. New business volumes remain tepid, driven by higher mortgage rates, and elevated home prices, making housing unaffordable for many first-time homebuyers. However, higher persistency rate (lower lapse rates) resulted in modest growth in PMIs exposure. PMIs have maintained strong underwriting discipline, and their loan portfolio quality remains robust, with very low risk layering. We believe a combination strong underwriting quality, significant embedded home equity, along with solid capitalization will help PMIs to navigate potential near-term stresses. We believe the sector's combined ratio in 2024-2026 will average around 50%-55%, with the ROEs averaging low- to mid-teens. The revised guidelines by Fannie Mae and Freddie Mac on Private Mortgage Insurance Eligibility Criteria (PMIERs) have no material impact on PMIs. They continue to maintain healthy capital buffers against their PMIERs minimum required assets.

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Appendix 1: Nonfinancial Corporate Sectors Outlook

For analytical contacts, please see Appendix 3.

Table 4

North America nonfinancial corporate sectors outlook

Sector	Comment
Aerospace and defense	Strong demand amid constrained supply for airframes and engines remains a consistent theme across the sector, with a cascading benefit to most issuers involved with maintenance, repair and overhaul (MRO) services. At the same time, Boeing continues to receive the most attention for its well-documented production challenges and regulatory oversight. This, along with a recently announced strike by members of its largest union, has cast uncertainty regarding the pace of new aircraft deliveries. Despite profitability challenges facing several airline customers (and ongoing engine durability issues), aircraft demand is showing no sign of easing and backlogs extend into the next decade. We continue to expect revenue and cash flow across much of the sector to improve next year, but the path is likely to be lumpy. For defense companies, a higher U.S. defense budget this year (from robust levels) and growth in spending by European allies are likely to support steady revenues and ratings across much of the sector. However, certain lower-rated peers with high leverage, and the risk of elevated shareholder returns have contributed to the modestly negative ratings bias. The U.S. presidential election poses a degree of uncertainty to future spending but is unlikely to cause material disruption.
Autos	As consumers' excess savings get depleted and delinquency rates on auto loans now exceed prepandemic levels, we expect flattish sales volumes in 2024 with around 2% growth in 2025 and 2026. Production discipline and strong pent-up demand from fleet operators led to stronger-than-expected pricing in 2023, but we expect about a 10% decline through 2025. Recently announced higher tariffs on batteries and critical minerals will likely push up input costs for American EV manufacturers, delaying automakers from hitting profit targets and translating to higher EV prices for end customers until alternative supply options are identified. This, in turn, could disincentivize purchases at a time when U.S. EV sales have become sluggish as the market share for pure battery EV (BEV) (excluding plug-in) remained flat compared to 2023 levels at 7.5% for the first eight months of 2024. Rising pricing pressure and ongoing inflation implies lower ratings headroom for automakers and wage inflation will limit margin upside for suppliers, particularly if automakers get tougher on cost pass-throughs. Credit metrics will gradually stabilize by late 2024 as most companies (especially those rated 'BB' or below) will look to preserve liquidity in line with pre-pandemic levels and limit large, debt-financed acquisitions. We expect limited margin and cash flow improvement in 2024 due to high interest rates and pricing pressure amid potential demand volatility as supply normalizes further.
Building materials	The sector continues to face weak demand mainly because of lower repair and remodeling spending, delayed projects, and high interest rates. This along with weak multifamily residential construction has not fully been offset by more stable single-family residential construction. Weaker revenues and earnings have hit distributors because of lower lumber prices and soft demand in certain commercial sectors such as office. However, price stability and some commodity deflations have helped mitigate some of the impact, including preserving profitability. We expect continued modest pressure through the remainder of this year with the potential for improvement in 2025. The Fed rate cuts could help increase home renovation and other spending. However, the pace and speed of the improvement is unclear. The rating outlook for the building materials sector is largely stable.
Business and technology services	The sector’s ratings outlook bias is shifting increasingly negative, mostly due to the preponderance of highly leveraged capital structures burdened by persistently high cash interest payments amid weak earnings growth for more narrowly focused businesses and unhedged interest rate obligations. A lack of rate hedging across the sector will pressure cash flow and liquidity for issuers we rate 'B' or below (63% of the sector) this year and next. For instance, only about 35% of single 'B'-rated U.S. business services issuers are hedged through interest rate derivative contracts, and only about 22% of the notional value of outstanding debt in the sector is protected by hedges. Other key risks include inflationary challenges, rising wages for labor-intensive operations, high gas prices for distributors, and cyber risk for some information, payment, and technology-service providers. Ongoing pressure on mortgage origination due to higher interest rates has negatively impacted cash flows for several issuers. Smaller tech service providers are facing IT spending headwinds, project delays, and pricing pressures. Despite tightened client budgets and elongated sales cycles, we expect steady revenue growth for most issuers rated 'BB+' or above as they remain committed to conservative financial policies. For most larger tech issuers and value-added resellers, we expect a return to growth in 2024 as many of their customers are still increasing IT spending, and the demand recovery is strong in areas such as digital transformation, public cloud migration, cybersecurity, and automation. A lot of large clients have optimized costs through automation and vendor consolidation, which frees up budgets for executing more digital transformational projects in cloud and AI.
Capital goods	The credit outlook for capital goods is steady, as large backlogs and lower costs offset a protracted bout of destocking this year. Key manufacturing indicators turned sluggish in 2023, pushing our forecast for aggregate revenue growth down to about 1% in 2024 for the companies we rate in U.S. capital goods. Even if demand for capital goods declines because of destocking and slower order intake, we expect that credit quality can withstand a normal cyclical downturn because of good earnings and lower debt leverage industry-wide in 2023.

	Higher interest rates and widespread inventory reductions are squeezing short-cycle products. The Global Manufacturing PMI, sponsored by J.P. Morgan and compiled by S&P Global Market Intelligence, indicated weaker manufacturing output for a second month in a row in August, which is consistent with S&P Global Ratings economists' forecast for flat U.S. equipment growth this year. On the other hand, our economists expect a bounce in real equipment investment to 3% in 2025, as lower interest rates coincide with the follow-thorough of multiyear project spending. The energy transition, manufacturing onshoring (particularly for electronics), and infrastructure investments have laid a foundation of investments for longer-term projects. Most issuers rated 'BB' and higher have built some credit buffer with good earnings and little new debt. In contrast, the capital goods portfolio we rate has a large cohort of financial-sponsor-owned companies that face rising maturities in 2025 and 2026, which is taking a toll on credit quality. We have a negative rating outlook on almost one-third of those 50 issuers despite good industry conditions, mostly because these companies underperformed profit expectations for several years. Higher interest rates are putting pressure on earnings and cash flow for this group of companies with a preponderance of floating-rate debt. And refinancing these issuers' $60 billion of debt at higher rates in the next year or two will be daunting and is already contributing to defaults and debt restructuring.
Chemicals	We continue to expect a gradual recovery in demand in most chemicals subsectors as the negative impact of destocking subsides. Still, it's too early to definitively declare that the destocking is done. We see this recovery becoming more pronounced in the second half. Although we anticipate EBITDA increases for most subsectors following meaningful EBITDA declines across subsectors last year, we don't believe that such recovery will entirely offset the decline in 2023. A little over a quarter of U.S. chemicals companies are with a negative outlook or CreditWatch placement. This reflects in part the uncertainty related to the pace and extent of recovery. Some subsectors like petrochemicals face capacity buildups that will depress earnings not just this year, but also next.
Consumer products	The common theme across consumer staples is a focus on restoring volumes as consumers continue to exhibit price elasticity by trading down, destocking pantries, and deferring spending. Companies will pull familiar levers to drive volume growth: higher spending on advertising, innovation, and more promotional activity. Offsetting soft top lines will be lower input and freight costs. Except for wages and pockets of still high inflation in certain commodities, costs have come down and will contribute to improving margins over the year. In discretionary categories, such as durables and apparel, demand remains soft. Consumers are being selective and seeking value and, in turn, retailers are being cautious in orders. Over the next 12 months, consistent with our economists' forecast for slowing consumer spending, we expect demand to remain subdued before beginning to gradually improve in 2025. Despite the weak operating environment, improving financial markets support the economics behind M&A, even large transformative transactions such as Mars' acquisition of Kellanova. We also expect the pursuit of growth through small and medium acquisitions to increase.
Containers and packaging	U.S. containers and packaging issuers have been slowly climbing out of a hole following massive customer destocking that began in 2023, as a sudden drop in demand coincided with high excess customer inventory. While we believe destocking is largely completed, packaging issuers are contending with a low-growth economy, effects of previous inflation, lower consumer purchasing power and consumer confidence, unsteady labor markets, and a shift to services consumption over goods. Borrowing costs remain elevated, which greatly hinders the lowest spec-grade issuers with high debt leverage. However, despite these risks we view the sector as overall stable. Inflation has moderated, which should help sequential improvement over the next several quarters. In addition, many issuers took advantage of the availability of debt markets, refinancing and/or amending and extending debt, which improved pricing and pushed out debt maturities. Despite some weakness in the lower end of the ratings spectrum, we believe the sector should remain stable, with some upside for stronger issuers if financial policies support more conservative balance sheets.
Gaming, leisure, and lodging	Resilient leisure spending is being tested this year. With prices and rates high, consumers are looking for bargains, causing travel and leisure spending growth to moderate. We recently lowered our U.S. lodging 2024 RevPAR forecast to flat to up 2%, mostly due to slower hotel demand. Open capital markets and ratings stability contributed to a high level of debt refinancings, extending maturities for all who tapped the markets, although these conditions were not available to the most challenged low-rated issuers. We keep raising our cruise baseline expectations, floating all ratings in the sector upward. If the late-blooming cruise recovery has a multiyear arc like other leisure sectors did post-pandemic, and the price gap between cruise and land vacations remains wider than usual, it is plausible cruise vacationers continue to spend freely and credit measures improve to an even better place than we currently assume. As ratings in the cruise sector have improved, operators have continued to be active in the capital markets, refinancing higher cost debt incurred during the pandemic, repaying secured and guaranteed debt, and reducing the overall quantum of debt. M&A may take off in earnest if buyers can look past elevated rates or become flexible on how much debt to use to finance transactions. Still, if leveraging mergers and acquisitions increase, leverage cushions could decline, and ratings could be pressured. Elevated labor and other costs will pressure margin in gaming and hotel sectors where revenue is moderating.
Health care and pharmaceuticals	Our healthcare services outlook remains negative. Ratings deterioration continues as moderating but still elevated labor and supply costs, high interest rates, particularly at the highly leveraged PE-owned healthcare services companies, and the impact of Change Healthcare cyberattack and increased delays by insurance companies processing claims leading to longer cash collection times. Labor pressures remain a long-term concern, given projected continued shortages in critical areas such as nursing, doctors, and other healthcare personnel, and healthcare hiring continues to outpace the broader market. We see potential for stabilization in the second half and expect ratings deterioration to moderate as Medicaid redeterminations run their course, the effect of the No Surprise Act lessens, and refinancing needs are addressed. Still, while ratings decline moderate, we continue to see record default rates in the sector and may see more 'B-' and 'CCC' category companies as visibility on sustainability of cash flow generation remains low for a significant part of the sector and the reimbursement environment becomes more challenging going into 2025.

	Meanwhile, our outlook for pharma remains stable; we see the full normalization of demand in 2024 after the return of patients and the rollback of COVID-related vaccines and treatments. M&A has returned to the industry after a muted 2021-2022, and we expect it to continue. We believe product pipelines and newer products, such as the GLP-1 weight-loss drugs, and still adequate pricing power will drive mid-single-digit and higher growth in 2024-2026. IRA Medicare Drug price negotiation goes into effect 2026, though early feedback is that the negotiations have been reasonable thus far. Still, given the healthcare cost pressures, there is going to be increased scrutiny on drug pricing and transparency, such as the FTC's ongoing lawsuit against the pharmacy benefit managers and growing controversy over the Medicaid 340B drug pricing program.
Homebuilders	Operating performance for homebuilders remains in line with our expectations. We still expect higher revenues through more communities and closings on average and profit margins to narrow in 2025 relative to 2024. Despite mortgage rates still above 6%, homebuyers have acclimated and maintained steady buying habits. As the resale supply recovers, we expect continued discounts and incentives to spur what has become an industry focused on deliveries and returns following investments in land growth and continued operations. We expect rating stability for the remainder of this year. This follows several upgrades and revisions to positive outlooks in 2023 and 2024 and given that 93% of our ratings have stable outlooks.
Media and entertainment	Our sector outlook remains negative. Media continues to face near-term macroeconomic and political uncertainty and negative long-term secular pressures for non-digital legacy media. Advertising on legacy platforms remains weak due to secular challenges facing the broader industry and, to a lesser extent, fears of a second-half slump in consumer spending. Advertisers appear reluctant to launch new campaigns, given concerns around a potentially tense U.S. presidential election. We expect advertising on legacy media platforms to remain challenged, except for political advertising which will likely be at record levels due to local elections and issue-based spending. Linear television advertising, in particular, is in secular decline as TV audiences continue to shrink, though we expect the rate of decline to moderate versus 2023's accelerated levels due to scripted content returned to TV post the 2023 guild strikes and a strong sports slate. The accelerating decline of linear television remains a drag on traditional media companies' earnings and will pressure them to accelerate the pace to streaming profitability to replace lost linear cash flow. On the other hand, the rebound in digital advertising, especially performance-related marketing, accelerated through 2023 and we expect it to return to a more normalized rate of growth (double-digit). The landscape for streaming continues to evolve as the fight to grow subscribers at all costs has dissipated and all major industry players have shifted their strategy to improving profitability. We expect this trend to continue as the streamers that are owned by legacy media companies raise prices, and right-size content and marketing spending to quicken the path to profitability. This is an important year for legacy media companies to prove that streaming can be sustainably profitable. The rate of improvement will be important for media companies to improve credit metrics and to offset the secular challenges in the linear side of the business.
Metals and mining	A long cycle of improving credit quality has stabilized in metals and mining, and we recently had some high-profile downgrades after a two-year run of mostly upgrades. Most of our positive outlooks around the world are on steel and aluminum producers, while credit quality for miners has stabilized at a higher level. Prices for most metals are weaker so far this year, as economic growth slows around the world, but gold sits near record highs. We see higher cash production costs for most metals in recent years, which should cause prices to trough at higher levels than the previous downturn in 2020. That said, prices can still test the profitability of high-cost assets in a downturn. Steel and aluminum producers have been improving credit quality for a few years, with a defensive trade moat around North America. On the other hand, steel prices and operating rates are down, which will squeeze profits and cash flow. Most metal prices are about 20% higher than before the pandemic, so that industry profits and cash flow remain generally good. On the other hand, depleting mine reserves, elevated operating costs, and relentless capital requirements to sustain output continue eating into the margins and returns of many metals' producers. Mine productivity is coming into focus now, with good demand potentially constrained by tight supply and higher production costs. We recently raised a few of our metal price assumptions, and most importantly, we raised some longer-term assumptions for 2026 and beyond owing to structurally higher cash production costs. Moreover, the capital intensity of sustaining output generally rises as mines age and ore grades decline. And mines will continue to face varying degrees of social pressure in numerous jurisdictions around the world, including possible operating disruptions, changes to mining plans, and even forced changes in ownership. Capital spending restraint in recent years and a favorable long-term demand outlook could prompt more greenfield investment and M&A, especially as the world eyes nickel, copper, cobalt, and lithium for electrification.
Midstream energy	The North American midstream energy industry's credit quality continues to be resilient, with strong balance sheets and a level of caution as we approach the election in November. Demand from North American LNG and the growth of AI datacenters will continue to provide a tailwind for future natural gas infrastructure development. However, grid constraints and the hurdles of completing new pipeline infrastructure could place the credit benefits for the industry beyond our current ratings outlook of two to three years. Renewable development could displace some of the expected growth in natural gas from datacenters and generally be a headwind for the industry, but intermittency and reliability make this threat less urgent in the next few years. Cash flow generation remains robust, with a focus on infrastructure development in West Texas to increase egress to the Gulf Coast for export markets. The lack of egress out of regions like the Marcellus Shale, and the inability to build new pipeline infrastructure in many areas could limit production growth, which would ultimately affect midstream companies that rely on new well development. Mergers and acquisitions have accelerated in the last quarter, and we expect the trend to continue. The larger, diversified companies are at a distinct advantage; stronger balance sheets, more financial flexibility, and more bolt-on opportunities in their vast geographical footprints. In the same regard, we view the smaller more regional peers at a distinct disadvantage. We expect modest

	capital spending increases, primarily among the large, diversified companies that are finishing multiyear growth initiatives or bolt-on organic growth projects.
Oil and gas	Following recent news of no increases in Chinese or North American import demand, the sentiment that the oil markets would be tight clearly has shifted. Oil prices have retreated over the past few weeks, recently touching a 14-month low, with the price of WTI falling below $70/bbl. Concerns about global economic slowdowns, particularly from China, the world's biggest importer; recent weak economic data; and the potential for 700,000 barrels per day (bbls/d) of Libyan production re-entering the market, have pressured oil prices. In order to provide some support, OPEC last week reversed its decision to introduce 180,000 bbls/d in October and November as part of its June decision to unwind 2.2 million bbls/d of production cuts. Moreover, while geopolitical tensions remain elevated, the political risk premium is eroding because it appears the market has grown ambivalent to conflicts' resulting in sustained supply disruptions. However, U.S. and Organization for Economic Cooperation and Development crude oil inventories remain close to their five-year lows, providing limited cushion in the event of any potential supply shortfall. OPEC+ clearly will remain the "balancer" of last resort, but it is in a difficult position because certain members, particularly Saudi Arabia, want to target an $80/bbl Brent oil price for budgetary reasons while balancing other constituents' concerns and frustration about the loss of market share to rising production from non-OPEC countries, particularly the U.S. and Canada, Brazil, and Guyana. OPEC+ currently has about 5.86 million bbls/d of production offline. At its June 2024 meeting, OPEC+ agreed to extend its two production cuts: the 3.66 million bbls/d of production cuts was extended by a year to the end of 2025, and the 2.2 million bbls/d of cuts was extended three months until the end of September of this year, at which time it was to gradually reintroduce those barrels over the course of the next 12 months. Last week, OPEC stated it would delay bringing back online 180,000 of the 2.2 million of cuts until the end of November while it continues to monitor market developments. We believe that at its Dec. 1 meeting OPEC will reassess the feasibility of maintaining production cuts in support of the oil markets. Any reintroduction of supply, given the recent weak economic data, will make it highly unlikely OPEC+ will be able to maintain an oil price of $80/bb. The near-term prospects for the improvement of Henry Hub natural gas prices remain limited. Henry Hub prices reached record lows back in March due to another warm winter, record production, the Freeport LNG export terminal being off-line, and undisciplined production growth from the Permian (where gas production is a by-product of oil drilling and thus is agnostic to price). Record power burn during the summer and a 38% decline in the natural gas rig count since April of last year have supported prices somewhat, with the Hub rising above $2/mmBtu in mid-August after spending 17 days below $2/mmBtu, but prices remain very weak. However, we continue to believe the liquefied natural gas (LNG) terminal buildout over the coming years will be the remedy for low natural gas prices. With a normal winter, we expect the inventory surplus to begin eroding late this year and approach the five-year average as Plaquemines LNG begins to increase shipping and when Corpus Christi Stage III ramps up at year end. The market could meaningfully tighten in the second half of 2025 as LNG exports continue growing and when Golden Pass LNG plans to place in service the first two trains of its new three-train facility. At the same time, we should begin to see the production impact from the drop in rig count and completion activity over the past year. We expect the price of Henry Hub to begin a meaningful price rally starting in 2025 as the market tightens.
Oil refineries	The performance of North American refiners will likely be weaker in the second half of the year. Refining margins have moderated and are reverting to more of a mid-cycle average, which in some cases could be 40%-50% lower than the past several years. The main drivers of lower margins are excess supply and somewhat lower demand for gasoline and diesel. We also expect utilization to dip to the low 90% area as the Gulf Coast refining complex heads into the turnarounds after the summer driving season and higher demand. We expect refiners to continue to focus on rewarding shareholders, mostly through share buybacks and higher dividends, while keeping higher cash balances for additional liquidity. Balance sheets still have significant cushion in credit ratios and will likely be able to absorb lower cash flow the margin correction and shareholder rewards. Refineries continue to explore conversions of conventional capacity to renewable fuels such as renewable diesel and sustainable aviation fuel. Renewable margins have been weak due to lower prices for credits in California and renewable identification number (RIN) prices.
REITs	Rated entities reported resilient operating performance across most property types in the second quarter. Positive rating actions outpaced negative actions in recent months, primarily in the retail and net lease sectors. Still, we maintain a negative rating bias for the sector; about 25% of ratings have negative outlooks. Office REITs represent the bulk of that bias given that secular headwinds, cash flow pressure, and higher financing costs continue. While they reported operating results that held up relatively well in the second quarter, with some recovery in leasing and relatively stable occupancy, high concessions and low retention rates continue to pressure cash flow. We expect the bifurcation of class A to class B to persist, with REITs that hold high quality assets outperforming the broader office market and maintaining higher occupancy in the mid- to high-80% range. We expect transactions to pick up over the balance of the year as the impact of lower interest rates drives a more pronounced recovery in transactions.
Regulated utilities	Our sector outlook remains negative, reflecting the high percentage of utilities with a negative outlook (about 25%). The industry faces rising physical risks from climate change and high cash flow deficits that may not be sufficiently funded in a credit-supportive manner. Furthermore, we expect that capital spending and cash flow deficits will continue to grow, primarily reflecting the expansion data centers, which should boost the sector's electricity sales growth by about 1% after decades of flat to negative sales growth. To date, the sector's downgrades have modestly outpaced downgrades and accordingly, we expect that 2024 will likely to be the fifth consecutive year that downgrades outpace upgrades.
Retail and restaurants	Consumers are stretched by inflation and are trading down, dining out less frequently, and seeking value. Recent results from deep discounters illustrate increasing pressure on the consumer, especially in lower-income cohorts. We believe weakness will persist in areas that are discretionary in nature and categories that were hot during the pandemic or related to housing. Still, unemployment appears to be holding aggregate spending up. We expect softness to continue

	until lower rates trickle through the economy. Green shoots could stem from higher housing turnover. Retailers of discretionary categories need to have the right product at the right time to win in an environment of less demand to go around. Alternatively, they need to have the best value proposition, and to do that, they have to have scale and reach (e.g., Walmart, Costco, TJ Maxx, Amazon). Cost pressures have subsided; many retailers report meaningful benefit from lower freight costs, but not enough to offset pressure on the topline for most.
Technology	Near term expectations for the tech sector overall remain unchanged to modestly weaker. IT spending continue apace especially in AI investments whereas non-AI enterprise spend is more modest. AI spending within data centers spanning servers, storage, networking equipment and related semiconductor and components by cloud service providers continue to be exceptionally strong. Further evolution of AI that leads to productivity gains for businesses and “killer apps” for consumers would be reasons for incremental IT spending growth. Meanwhile, the recovery has been weaker than expected in PC and smartphone markets despite having bottomed in mid-2023. The upcoming PC refresh and launch of flagship smartphones should be growth catalysts for those two major end markets. Communication infrastructure, industrial, auto and consumer end markets, which are still highly sensitive to macroeconomic outlook, are seeing only tepid spending and therefore taking longer to work off excess inventory. Software and IT services represent a large proportion of overall IT spending and there seems to be some budget tightening from enterprise and commercial customers in the form of delayed large procurements. Macroeconomic environment is key, as most of the tech sector serve enterprise and commercial business globally whose IT spending is highly correlated to global GDP. Deteriorating business environment and lower inflation would present revenue and margins headwind to tech vendors and service providers. A declining interest rate trajectory and a favorable debt capital market would be important for the sector’s large number of rated issuers in the ‘B’ category or lower as they tend to have significant variable-rate debt outstanding, lower FCF/debt ratio and, for some, dwindling liquidity.
Telecom	Lower speculative-grade credits continue to be hurt by high interest rates and elevated capital intensity, which has resulted in several downgrades. These companies lack scale to absorb higher costs and have a lot of exposure to floating rate debt. Conversely, the large investment grade telcos are performing well, growing earnings while generating solid free cash flow. In wireless, we expect modestly slower postpaid net adds and service revenue growth will be more than offset by lower capex as the carriers wind down their deployments of mid-band spectrum. In cable, we have tightened thresholds for several operators due to broadband subscriber losses and earnings pressure because of increasing competition from fixed wireless access and fiber to the home (FTTH). At the same time, cable providers are upgrading their networks to offer faster data speeds, which will increase capex and contribute to lower levels of free cash flow. While the wireline operators are improving top line trends and earnings, capex to support FTTH deployments, high interest rates and elevated debt burdens are hurting free cash flow and leverage. Some of these issuers are looking at alternative financing sources, such as ABS, to fund their fiber builds.
Transportation	We recently tempered our outlook for the airline sector for the rest of the year. Passenger growth is normalizing—more than we previously anticipated—following recent reports of domestic overcapacity. We now believe there is growing downside risk to airfares for the rest of this year, and a modest decline could have a significant impact on credit profiles across the sector. This risk is most acute for the historically low-cost airlines, with outsized earnings exposure to much higher operating costs across the industry (mainly labor and maintenance) due to limited premium, loyalty program and trans-Atlantic passenger revenues. At the same time, free cash flow generation by the network carriers this year provides a downside cushion to credit measures, and we assume earnings and cash flow growth resumes in 2025. Our outlook for railroads and package express companies is generally unchanged, and we assume ratings to remain stable. Financial policies have been tested, with certain railroads limiting share repurchases to preserve credit measures. We expect this will continue and await an eventual improvement in freight volume growth that to this point in the year has largely been elusive. On the other hand, excess trucking capacity has persisted much longer than we had previously anticipated, with no tangible signs of higher prices required to materially boost trucking and logistics provider revenues and earnings.
Unregulated (merchant) power	A mild winter and gains in natural gas production have resulted in a significant decline in natural gas prices. Weakness across the natural gas curve initially pulled down power prices in all markets. Since then, the narrative has changed. A demand surge expectation from data centers, electrification, and other large loads (onshoring of manufacturing) has lifted power, especially for years 2026-2027. Power Prices in regions like Texas are $10/MWh for 2027 compared with what they were at the start of 2024. We expect volatility to be higher and regions like PJM and ERCT will be tested in the summer. We also registered a significant increase in capacity prices in PJM for delivery year 2025-2026, and expect more of the same for delivery year 2026-2027. Meanwhile, in California, resource adequacy (RA) payments continue to surge and now well into double digits levels per Kw-month.

Appendix 2: Economic Data and Forecast Summaries

Table 5

U.S. – S&P Global Ratings economic outlook

	2023	2024f	2025f	2026f	2027f
Real GDP (year % ch.)	2.5	2.7	1.8	1.9	1.8
Real consumer spending (year % ch.)	2.2	2.5	2.2	2.1	2.4
Real equipment investment (year % ch.)	(0.3)	3.0	4.0	3.6	3.0
Real nonresidential structures investment (year % ch.)	13.2	4.7	1.3	0.9	(0.6)
Real residential investment (year % ch.)	(10.6)	3.8	0.8	4.0	3.4
Consumer price index (year % ch.)	4.1	2.9	2.0	2.4	2.2
Core CPI (year % ch.)	4.8	3.4	2.5	2.1	2.1
Unemployment rate (%)	3.6	4.1	4.4	4.4	4.0
Housing starts (annual total in mil.)	1.42	1.35	1.36	1.40	1.43
Federal funds rate (%)	5.0	5.1	3.5	3.1	3.1
10-year Treasury note yield (%)	4.0	4.1	3.4	3.4	3.5

Note: All percentages are annual averages, unless otherwise noted. Core CPI is consumer price index excluding energy and food components. f—forecast. Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, the Federal Reserve, S&P Global Market Intelligence Global Link Model, and S&P Global Ratings Economics' forecasts.

Table 6

Canada – S&P Global Ratings economic outlook

	2023	2024f	2025f	2026f	2027f
Real GDP (year % ch.)	1.3	1.2	2.0	2.1	1.9
Real consumer spending (year % ch.)	1.7	2.1	2.0	2.3	2.1
Real nonresidential fixed investment (year % ch.)	(0.9)	(0.5)	5.3	3.6	1.9
Real residential fixed investment (year % ch.)	(10.3)	1.5	5.4	2.8	0.4
Consumer price index (year % ch.)	3.9	2.6	2.1	2.1	2.0
Core CPI (year % ch.)	3.9	2.6	2.1	1.9	2.0
Unemployment rate (%)	5.4	6.3	6.4	5.9	5.8
Housing starts (annual total in thousand)	240.8	245.6	241.4	245.0	235.5
Bank of Canada policy rate (% year-end)	5.00	3.75	2.50	2.50	2.75
Government of Canada 10-year bond yield (%)	3.35	3.27	2.70	2.73	2.84
CAD/USD exchange rate (per US$1, period average)	1.35	1.36	1.31	1.28	1.27

Note: All "year % ch." are annual averages percent change. Core CPI is consumer price index excluding energy and food components. f—forecast. Sources: Statistics Canada, Bank of Canada, S&P Global Market Intelligence Global Link Model, and S&P Global Ratings Economics' forecasts.

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