S&P Global
Ratings

Credit Conditions North America Q2 2025

# Uncertainty Prevails

**March 26, 2025**

*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 March 20, 2025. In the original version of this article, published March 26, 2025, there was a misstatement in Table 5 in Appendix 2. A corrected version follows.

## Key Takeaways

- **Overall:** Amplified policy uncertainty, and accompanying near-term market volatility, pose a risk to an environment of favorable credit conditions for North American borrowers.
- **Ratings:** Ratings momentum has been positive, with upgrades outpacing downgrades in the first quarter, and the region's net outlook bias narrowing further. We expect the U.S. trailing-12-month speculative-grade corporate default rate to fall to 3.5% by December.
- **Risks:** Higher tariffs threaten to reignite inflation and weigh on credit quality for entities exposed to imports and international markets. Borrowing costs could remain high amid increased investor risk aversion, and businesses and consumers could pull back further, leading to sharper-than-expected economic downturns in the region.

Favorable credit conditions for North American borrowers could soon deteriorate, as amplified uncertainty, along with policy shifts by the U.S. administration, threatens to ignite investor risk aversion—especially if significant economic disruption occurs as a result.

**Borrowers entered the year with notable tailwinds**, with many having taken advantage of historically low spreads to push out maturities—and benefiting from surprising economic resilience.

**President Donald Trump kicked off his second term with a slew of executive orders, including those affecting trade, immigration, and foreign and domestic policies.** Tariffs have focused on China, Canada, and Mexico—notwithstanding some delays—and on aluminum and steel worldwide. Additional tariffs are likely after early April following the administration's directive to assess uneven trade practices globally and consider reciprocal tariffs.

**Business and consumer confidence have both taken a hit.** U.S. small-business confidence dropped for a third straight month in February. The University of Michigan Consumer Sentiment Index has fallen for three straight months to its lowest since November 2022, when headline inflation exceeded 7% and the Federal Reserve was embarking on its cycle of aggressive interest-rate hikes. We think Americans will soon pull back on purchases, dealing a blow to the world's biggest economy, which is largely fueled by consumer spending. **We see a 25% probability of a U.S. recession starting in the next 12 months**, although our base case is for a slowdown to below-trend growth.


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Contents


Top North American Risks 4
Macroeconomic Outlook 6
Financing Conditions 8
Sovereigns 10
Financial Institutions 11
Nonfinancial Corporates 14
Public Finance 17
Structured Finance 19
Insurance 21
Related Research 24
Appendix 1: Nonfinancial Corporate Sectors Outlook 25
Appendix 2: Economic Data and Forecast Summaries 30
Appendix 3: List Of Analytical Contacts 31

**Higher tariffs are a top concern for many corporate borrowers we rate**, given they would likely lift input prices at a time when companies are grappling with already-elevated costs and a diminished ability to pass them through to customers and consumers. Key U.S. sectors to watch include autos, metals and mining, tech, oil and gas, capital goods, chemicals, consumer products and retail, pharma and health care, and utilities and power.

**Policy uncertainty at the federal level could affect U.S. public finance issuers' revenues and expenditures.** U.S. public finance entities entered 2025 with record levels of reserves, boosted by pandemic funding support and robust economic growth. Policy shifts, including tariffs, that slow growth or worsen inflation could have an outsized effect on issuers already struggling to maintain balanced operations in the current economic environment.

**This uncertainty is also our primary focus for U.S. and Canadian banks**. A material hit to GDP, due to measures like higher tariffs, could cause us to revise our earnings forecast down for the U.S. banking industry. Downward market pressure and overall business uncertainty could hurt fee income and loan growth, hitting bank revenue.

Equity markets have reacted sharply to the whipsaw of levied—and then quickly rescinded or postponed—tariffs by the Trump administration. The S&P 500 stock index slipped into a correction (down 10% or more from its high) before rebounding. The VIX volatility index, which gauges market fears, has climbed in recent weeks, reaching almost 28 on March 10, up from around 15 in mid-February.

**Investors may also be growing wary of relatively risky fixed-income assets.** While secondary-market spreads on U.S. speculative-grade debt remain historically narrow, they widened by approximately 60 basis points (bps) starting in mid-February before coming back in. At the same time, rising recession fears have pushed investors into 10-year U.S. Treasury notes, which are seen as among the safest assets to hold.

**The prospect of tariff-fueled inflation is also muddying the waters for Fed monetary policy.** We now forecast one rate cut late in the year, as demand weakness outweighs inflationary pressures. The dwindling chance of an interest-rate cut, combined with the prospect of a sharp economic slowdown, could weigh on market sentiment. Against this backdrop, the cost of debt service and/or refinancing may be overly burdensome for some borrowers—especially those at the lower end of the ratings spectrum.

**Still, ratings momentum has been positive to start the year.** Upgrades among financial and nonfinancial corporate borrowers outpaced downgrades in the first quarter, and the region's net outlook bias—indicating potential ratings trends—narrowed to negative 7.2% as of March 13 (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, and especially since the start of the year, signaling more upgrades down the road.

The consumer products and media and entertainment sectors led net negative rating actions in both Q4 2024 and Q1 2025, while experiencing a drop in their negative bias (see chart 3). Telecom still maintains the highest negative bias, with over one-third of the sector (most of which is rated speculative grade) having either a negative outlook or on CreditWatch with negative implications, despite some improvement from the previous quarter.

The North American default tally has fallen by more than half so far this year, compared with 2024, with distressed exchanges continuing to drive the total (accounting for 57%). Against this backdrop, S&P Global Ratings expects the U.S. trailing-12-month speculative-grade corporate default rate to fall to 3.5% by December, from 5.1% in December 2024, amid a still-resilient economy, sustained earnings growth, and a more manageable near-term refinancing burden. In

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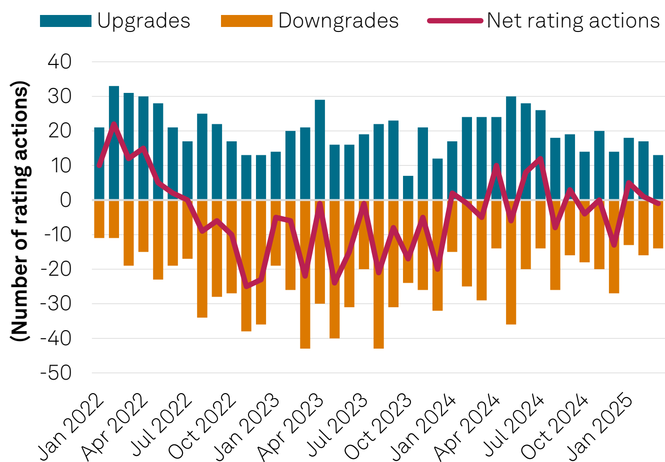
our pessimistic scenario, we forecast the default rate could rise to 6% as certain subsectors suffer from potential tariff increases and other political uncertainties.

Chart 1

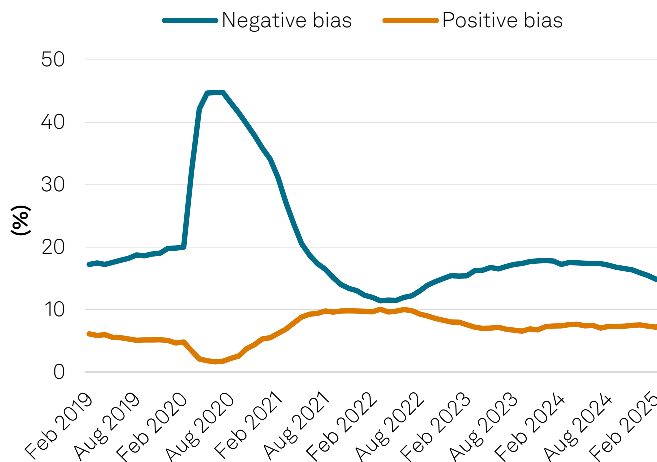
North American rating actions




Monthly data through March 13, 2025, and covers financial and nonfinancial corporates. Source: S&P Global Ratings Credit Research & Insights.

Chart 2

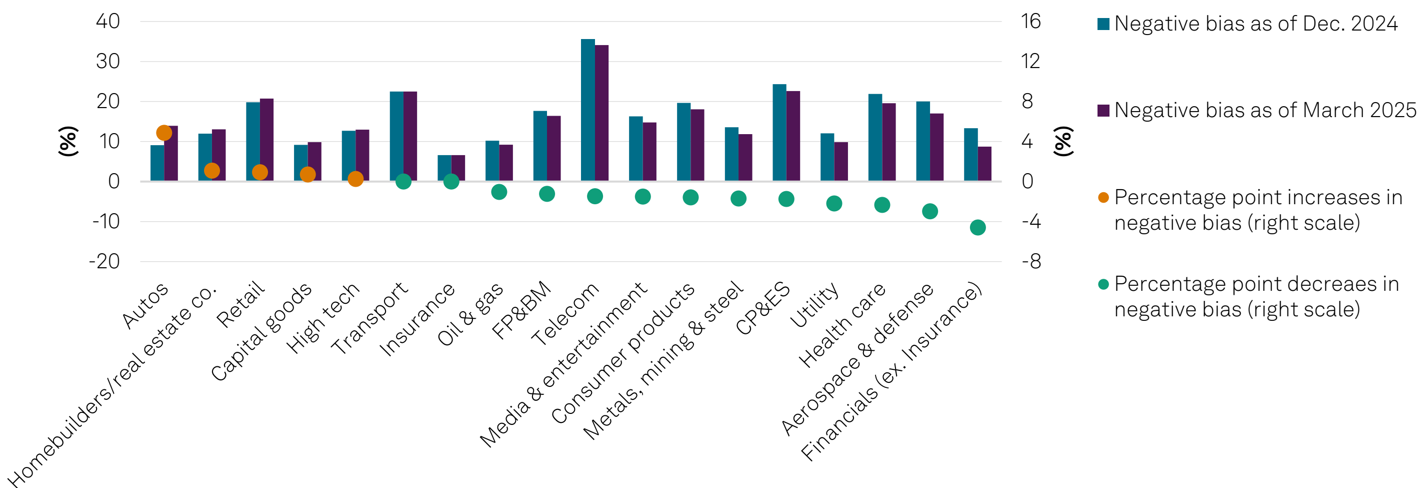
North American ratings outlook bias




Monthly data through March 13, 2025, 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 Dec. 31, 2024, and March 13, 2025. 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.

All told, we believe there is a high degree of unpredictability around policy implementation by the U.S. administration. Consequently, our baseline forecasts carry a significant amount of uncertainty. As situations evolve, we will gauge the macro and credit materiality of potential and actual policy shifts, and reassess our guidance (see our research here: www.spglobal.com/ratings/CreditConditions).

# Top North American Risks

### Tariffs reignite inflation, threaten credit quality

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

Along with the U.S. administration's rhetoric hinting at a broad trade war, protectionist trade policies—primarily in the form of sharply higher tariffs, including targeting its closest trading partners Canada and Mexico—could cause materially higher input prices for U.S. sectors exposed to imports and cross-border supply chains. This comes at a time when companies are grappling with already-elevated costs and a more difficult passthrough environment. Any retaliatory measures could also hurt those relying on key components and foreign markets. All this could result in more margin pressure for U.S. corporates, weighing on credit quality. Heightened trade tensions with the U.S. could hurt many Canadian companies as well, leading to operating inefficiencies, supply chain disruptions, reduced competitiveness in the U.S. export market, and weaker domestic demand.

### Escalating geopolitical tensions impede trade and investment, weighing on growth

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

President Trump's foreign policy is reshaping the U.S.'s role in the global order, with the potential for wide-ranging effects at home and abroad—including ramping up the pressure on other NATO countries to bear more of the burden of their own security. Negotiating a resolution in the Russia-Ukraine war remains challenging, and the risk of a continued conflict persists. At the same time, any additional worsening of the U.S.-China relationship regarding trade/tariffs or tensions over the South China Sea could further disrupt supply chains and hamper sentiment, investment, and capital flows. The threat of renewed fighting—or a wider conflict—in the Middle East also lingers.

### Interest rates remain high, underpinning burdensome borrowing costs

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

The prospect of resurgent inflation (amid higher tariffs and tighter immigration controls, which could drive up labor costs) along with slowing economic activity puts the Fed in a bind regarding monetary policy. Also, policy uncertainty and the potential for increased market volatility could push investors to demand higher risk premiums; as a result, the cost of debt service and/or refinancing may be overly burdensome for some borrowers—especially those at the lower end of the ratings ladder.

### The U.S. and Canada suffer sharper-than-expected economic downturns

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

Overriding uncertainty about U.S. policy and international responses could further dent consumer and investor sentiment in the U.S. and Canada. Businesses may be loath to boost capital expenditures (capex) amid a shifting landscape, and households may be reluctant to open their wallets, especially as their financial strength and purchasing power continue to erode owing to high prices and restrictive interest rates—all of which could lead to a sharper slowdown in growth or a recession, causing more credit stress.

### Depressed asset values and cash flows, plus elevated financing costs, exacerbate commercial real estate (CRE) losses

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

Elevated financing costs have been pressuring asset valuations and raising refinancing risk for most types of CRE. Lower demand for office space continues to weigh on valuations and cash flow dynamics. Certain segments and regions in the multifamily sector are also facing challenges as rent growth softens. All this may lead to more broad-based, and in some cases severe, loan losses for debtholders such as U.S. banks (with regional lenders having higher exposure to CRE than larger lenders do), insurers, REITs, and commercial mortgage-backed securities (CMBS). Higher office vacancy rates and weaker downtown economic activity continue to affect some cities' tax revenue; federal workforce cuts could further dampen revenue growth in more exposed places.

## Structural risks

### Climate risks intensify and add to costs, as policy shifts complicate the energy transition

| 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. This could hurt 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 splintering global policy drive toward a net-zero economy complicates transition risks across many sectors.

### 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. The U.S. administration's push to expand digital assets such as bitcoin and stablecoins could carry novel risks for investors.

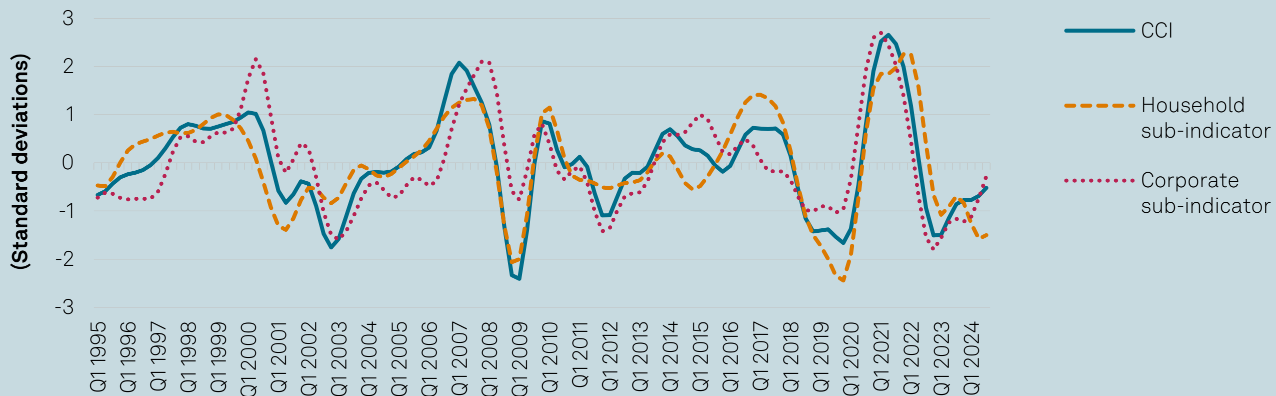
Source: S&P Global Ratings.
**Risk levels** may be classified as moderate, elevated, high, or very high. They are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base case rating 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

### Policy uncertainty challenges economic resilience and credit recovery

The North American CCI increased to -0.5 standard deviation as of third-quarter 2024, largely supported by favorable financing conditions and upbeat equity markets at that juncture (see chart 4). However, while the CCI's trend continues to signal a credit recovery likely unfolding in the region this year, significant policy uncertainty since President Trump's inauguration—around trade and tariffs, in particular—has cast a shadow over the economic trajectory for the U.S. and Canada. This has sparked market volatility and has raised concerns regarding inflation, interest rates, and liquidity. In this context, risk in certain segments—such as lower-income, highly indebted households, and lower-rated corporates with more exposure to policy-related disruptions—could be further amplified and lead to more credit stress.

Chart 4
North America CCI




Peaks in the CCI tend to lead credit stresses by six to 10 quarters. When the CCI's upward trend is prolonged or the CCI nears upper thresholds, the associated credit stress tends to be greater. Sovereign risk is not included as a formal part of the CCI. The CCI period ends in Q3 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.

**Corporates.** The corporate sub-indicator rose steadily, with corporate debt to GDP and equity prices continuing to increase as of third-quarter 2024. On the back of strong earnings momentum, supportive market conditions, and more manageable near-term maturities, we expect the U.S. speculative-grade corporate default rate to decline to 3.5% by December (see "The U.S. Speculative-Grade Corporate Default Rate Could Fall To 3.5% By December 2025," published Feb. 20, 2025). However, downside risks have increased, as escalating tariffs and retaliatory measures threaten to hurt earnings for corporates exposed to cross-border supply chains and international markets, and tighter immigration controls weigh on labor supply for those depending on immigrant workers.

**Households.** The household sub-indicator hasn't shown clear signs of bottoming out in the past several quarters, and there is mounting evidence that points to cracks in household financial strength. In Canada, the lagged effects of the previous Bank of Canada rate hikes have pushed its household debt-service ratios to historically high levels as mortgages get renewed. In the U.S., while fixed-rate mortgages shielded some of the effects of restrictive interest rates, the ratio of auto loans and credit card loans transitioning into delinquencies has been trending up across income groups (especially among lower-income cohorts), and banks' charge-off rates of credit card and consumer loans are also at multi-year highs. That said, consumer credit stress could be even more pronounced if their purchasing power erodes further, unemployment jumps materially, and wealth effects wane.

# Macroeconomic Outlook

- U.S. GDP growth is almost certain to slow in the next several quarters partially due to the rising risk of supply-side shocks from tariffs.
- We forecast real GDP growth of 1.9% this year and 1.9% in 2026.
- We see one Fed rate cut this year, as demand weakness outweighs inflationary pressures.

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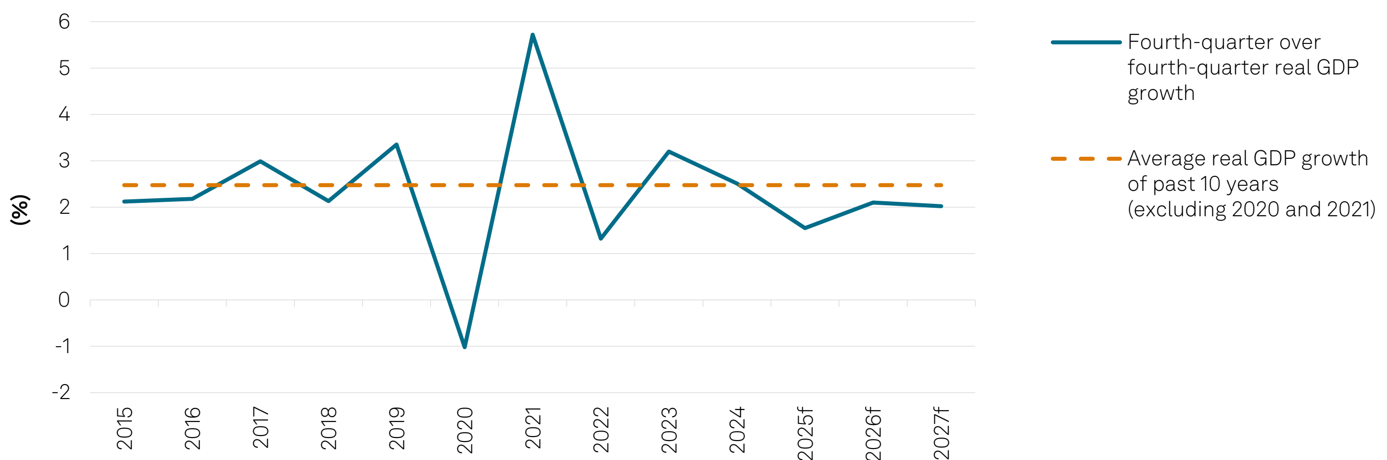
## U.S.

U.S. GDP growth is almost certain to slow in the next several quarters—irrespective of the blow that a full-fledged trade war would deliver to the world's biggest economy. We see a rising risk that supply-side shocks from tariffs, decelerating immigration growth, and a shrinking federal workforce will create a lasting negative feedback loop that weighs on overall demand.

**We now forecast real GDP growth (annualized) of 1.9% this year and 1.9% in 2026,** reflecting our assumptions about tariffs, immigration, and public sector growth. There is a sizable deceleration in our forecast as the year progresses, leading to fourth-quarter over fourth-quarter growth of 1.55% by year end (versus 2.51% at year-end 2024; see chart 5).

Chart 5

U.S. economic expansion will slow sharply in 2025 and remain below the long-term average




f—Forecast. Source: S&P Global Ratings Economics.

**We think the risk of recession has risen even as the economy entered the year with solid growth momentum.** The tariffs that President Trump has imposed on Canada, China, and Mexico—as well as those set to take effect in April—could have more serious consequences for the U.S. economy than what is reflected in our quantitative model, which puts the odds of a recession starting in the next 12 months at just 5%-10%. Given the rising risk of persistent supply shocks and negative sentiment, our subjective assessment is that there's a 25% probability of a downturn starting in the next 12 months—about twice the post-World War II unconditional recession probability of 13%.

It's always difficult to assign probabilities to economic trends, and even more so with policy uncertainty so high. But consumer confidence and equity market sentiment started to sour in mid-February, and manufacturing has taken a step back. And while the equity market doesn't represent the real economy, the wealth effect (or the reversal thereof) is relevant. A prolonged

stock market slump, especially if combined with a supply shock, would almost certainly hurt aggregate demand.

As of March 6, the most popular real-time GDP tracker, the Federal Reserve Bank of Atlanta's GDPNow, estimated a real economic contraction of 2.4% (annualized) for the first quarter. We think most of this weakness stems from events such as January's arctic blast in much of the U.S. and an unusual widening of the trade deficit, but it seems clear economic activity is decelerating. We think weak average quarterly GDP growth, from 1%-2%, is more likely than a recession (commonly defined as successive quarters of contraction, but only officially declared in retrospect by the National Bureau of Economic Research).

With GDP growth slowing over the next several quarters, we think the unemployment rate will drift higher, peaking at 4.6% by mid-2026. Amid deep cuts to the federal workforce, the public sector will likely become a headwind to payroll growth, a reversal from last two years when it directly (and indirectly) contributed significantly to jobs growth.

**Still, the Fed is likely to keep its policy rate steady in the near term.** Policy makers now expect inflation to stay higher this year than prior estimates, while economic growth will slow faster than they had forecast. We now expect one rate cut late in the year, as demand weakness outweighs inflationary pressures and employment growth comes in consistently below the neutral pace. We forecast gradual cuts through 2026 will bring the rate down to 3.13% by early 2027.

## Canada

**For Canada, our forecast for real GDP growth of 1.7% for the full year masks a sizable deceleration in quarterly growth profile as the year progresses**, as we expect the uncertainty on the trade front to weigh on consumer and business sentiment, as well as spending. We see quarterly growth averaging just 1.2% for the final three quarters of the year, and, on a fourth-quarter over fourth-quarter basis, the Canadian economy is poised to expand just 1.3%.

In our baseline, we assume the U.S. applies a 10% effective tariff rate on imports from Canada, and that this will be ramped down in 2026 until it lands near 0%. But in a scenario in which the U.S. implements tariffs of 25% and they remain in place through the year, the growth picture would look decisively worse. This could, in fact, could push Canada into a recession. Exports, a major part of Canadian economy, could suffer not only because of tariffs but also due to a weaker U.S. growth.

Against this backdrop, we anticipate the Bank of Canada will steadily lower its key interest rate until it reaches 2.00% by the end of the year, as concerns about rising unemployment will likely outweigh temporary inflationary pressures.

# Financing Conditions

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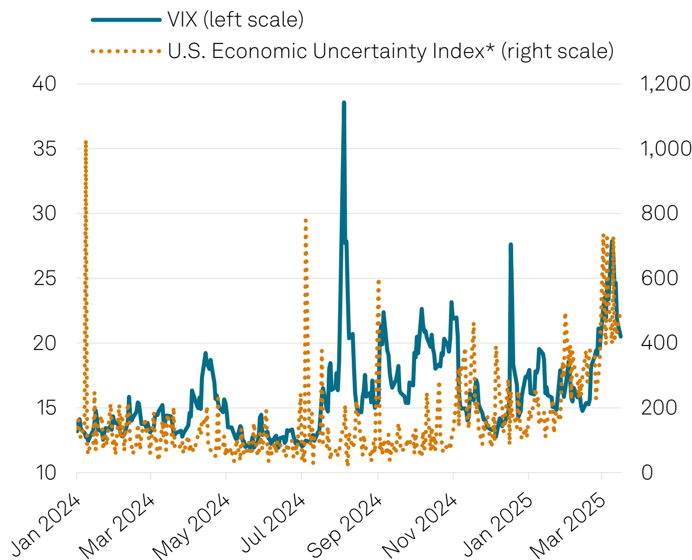
- U.S. tariff proposals and responses by other countries have increased market volatility.
- Bond spreads have widened amid investors' "flight-to-safety", pushing up corporate borrowing costs—although the widening has been modest and comes off all-time lows.
- Downside risks prevail as companies and investors try to assess the effects on business operations, consumers, and the larger economy.

**Market volatility has increased amid the shift in the global tariff environment, albeit modestly** (see chart 6). Volatility, as measured by the VIX, hasn't always aligned with the economic uncertainty index, which is derived from frequency of news articles surrounding these types of issues (with a roughly 0.5 correlation over the long term). In recent weeks, both measures of volatility are clearly trending upward, even if less than more short-lived stressors in the past year.

**The response has been uneven given unclear outcomes**. Despite the view of many that trade parters outside of the U.S. would most feel the effects of tariffs proposed or implemented thus far, it's U.S. equities that have have suffered the largest declines (see chart 7). In fact, most other major indices are higher on the year, including Canada (up 0.3%) and Mexico (up 7.5%), while the S&P 500 is down approximately 5%. Perhaps investors' wait-and-see attitude can explain this, as they anticipate drawn-out negotiations or are simply waiting for more clarity. Also, U.S. equities entered this period at record high levels, so some technical factors may also be at play.

Chart 6

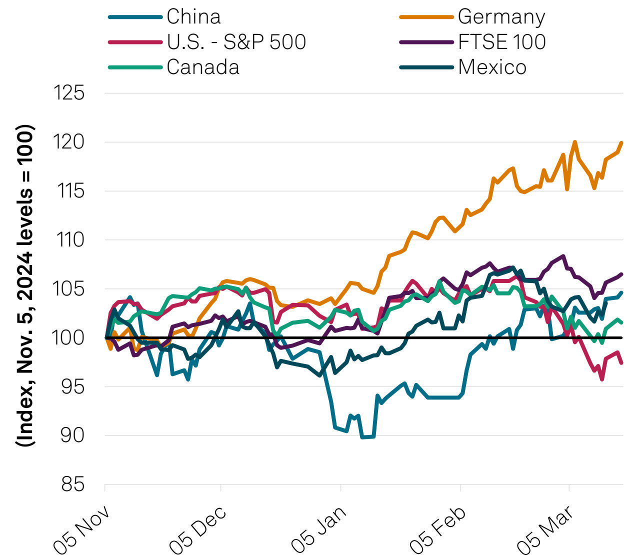
Equity volatility and negative headlines sync-up in recent weeks




*Based on newspapers in the U.S. Sources: Baker, Scott R., Bloom, Nick and Davis, Stephen J., retrieved from FRED, S&P Global Market Intelligence, S&P Global Ratings Credit Research & Insights.

Chart 7

U.S. equities see modest losses recently, yet have been harder hit, globally




Sources: S&P Global Market Intelligence, S&P Global Ratings Credit Research & Insights.

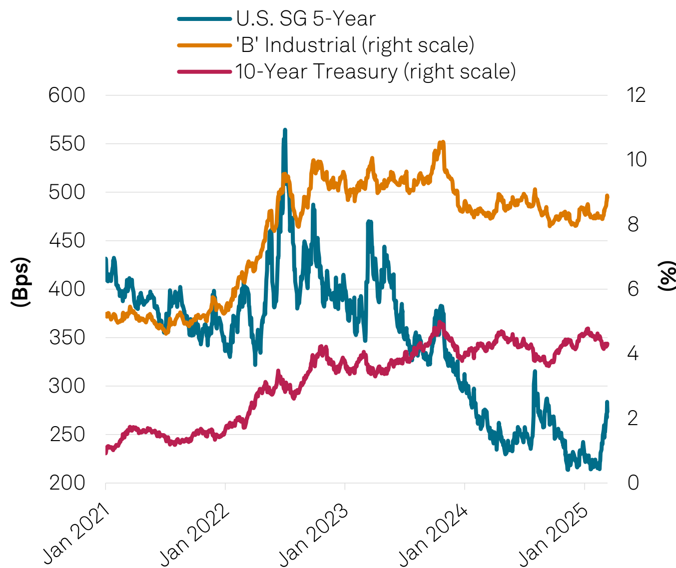
**Fixed income markets have also responded, led by fears of a U.S. economic slowdown.** Alongside equity swings, volatility in fixed-income markets have increased, largely over concerns that U.S. economic growth will slow sharply (see chart 8). U.S. Treasury yields have fallen (with prices rising) as demand for the safest assets increases.

Meanwhile, **corporate bond yields in secondary markets have been rising**, pushing the 'B' industrial yield up to 8.8% by mid-March, from 8.5% at the start of the year. This increase is still relatively modest, and speculative-grade spreads started the year extraordinarily narrow. In fact, our five-year speculative-grade spread hit an all-time low of 214 bps on Dec. 5, and the recent widening has yet to push the spread to 300 bps.

**For now, bond issuance continues apace** (see chart 9). The year is off to a strong start, with combined nonfinancial and financial services corporate bond issuance reaching $447 billion through March 14 (a modest decline of 6.2% from 2024's gangbusters totals). The month-to-date increase in March is particularly telling considering the building headwinds on the tariff front. Many issuers—particularly speculative-grade ones—refinanced heavily last year, easing some of the near-term pressures. But there remains a large amount outstanding, so some issuers may be positioning for volatility ahead by securing funding now. And day-to-day activity has been arguably sporadic as tariff communication increases, adding to temporary bouts of volatility.

Chart 8

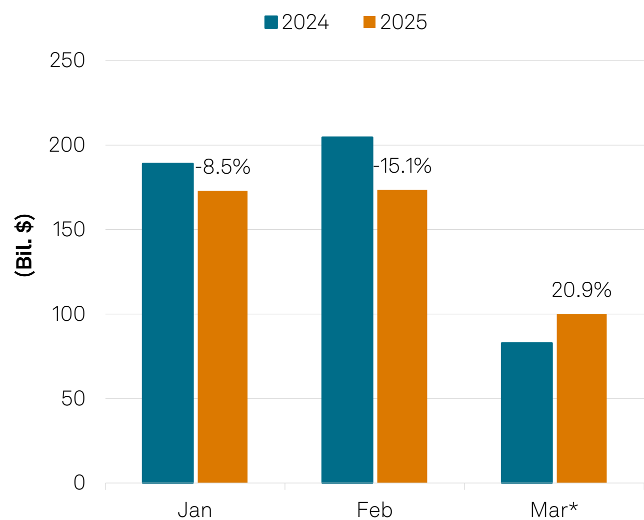
### Fixed-income markets see a (mild) flight-to-safety




Source: S&P Global Ratings Credit Research & Insights.

Chart 9

### Primary markets have become more sporadic, but still open




*Through March 14, 2025. Sources: Refinitiv, S&P Global Ratings Credit Research & Insights.

**Still, downside risks prevail**. The year began amid resilient economic growth and solid corporate earnings. However, stretched consumers, stubborn inflation, and a prolonged period of higher interest rates have pushed delinquency rates higher. The effect of tariffs has so far been more acute in sentiment readings than in economic data or in terms of rating actions. Sentiment-based inflation expectations are up, but market-based ones have largely remained steady, as investors appear more focused on the prospect of slowing GDP growth. Downside risks are growing, and it may be that markets have yet to fully price in the negative effects, which could become greater if the current tariffs and proposals become more punitive.

# Sovereigns

- The Trump administration has initiated a pronounced shift in trade, immigration, energy, and foreign policies.
- The House and Senate advanced budget resolutions with reconciliation instructions for the framework under which the administration's tax and spending policy will take shape.
- Congress averted a government shutdown, extending federal funding through Sept. 30, but the medium-term deficit trajectory will be informed by the reconciliation discussions.

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**The new administration has issued about 90 executive orders and shifted foreign, trade, immigration, and domestic government policies.** Tariffs have focused on China, Canada and Mexico—notwithstanding some delays—and on aluminum and steel worldwide. Additional tariffs are likely after early April following the administration's directive to assess uneven trade practices globally and consider reciprocal tariffs.

The commitment to end the Russia-Ukraine conflict has advanced, with some strain in bilateral relations, and with both Ukraine and NATO. There are stepped-up border-security initiatives and deportations, essentially halting immigration inflows. The president's cost-cutting initiatives have been led by the Department of Government Efficiency. Workforce-reduction plans are seemingly shifting to within agencies following a directive from the Office of Budget and Management; some cuts in aid and other funding, particularly those appropriated by Congress, are under review by the courts.

**The government is funded through September following passage of a continuing resolution, and Congress will now turn to negotiating one uniform budget resolution, as well as the details of spending and tax initiatives under reconciliation.** Republican majorities in each chamber passed their own versions of a budget resolution with reconciliation instructions to address the administration's tax and spending priorities for beyond September. The Senate focused solely on the spending side, such as on defense, energy, and immigration control/border security. The House considered both the extension of expiring provisions of the Tax Cuts and Jobs Act (TCJA) and potential spending cuts, including in Medicaid, that would be needed to offset extension of the TCJA provisions. The next steps to bring both versions together will require negotiation among Republicans in the House and Senate, and with the administration.

There is consensus on extending the TCJA and increasing spending in certain areas—but less on how to tackle other tax cut initiatives, including those suggested by the president; how much and whether to offset these initiatives with spending cuts; and what spending could be cut.

**The path for the general government budget deficit will be informed by the outcome of reconciliation process, but it should remain around 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 specific outcome of the forthcoming budget reconciliation process, spending cuts that may require legislation, and potential tariff revenue will inform the deficit path. Another key fiscal deadline entails tackling the debt ceiling before the Treasury runs out of space to deploy extraordinary measures. The so called "X" date is estimated during June-July-August. We expect Congress to act in a timely manner as it has done in the past.

# Financial Institutions

- The vast majority of U.S. banks we rate have stable outlooks.
- Downside risks for banks exposed to CRE has become more manageable, in our view.
- Policy uncertainty—in particular, with regard to tariffs—has become a main focus.

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## Banks

**Roughly 90% of U.S. banks we rate have stable outlooks**, reflecting our expectations that stable performance will continue after many banks strengthened their balance sheets last year. We're projecting the industry will generate a return on common equity (ROE) of 10.5%-11.5% this year, compared with 11.3% in 2024, assuming continued economic growth. However, the economic outlook remains uncertain, partially due to tariffs, with elevated downside risks. In a scenario in which the economy slows further or enters a recession, we believe the banking industry's ROE would most likely fall to the high-single-digit range.

**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 incrementally deteriorate, mainly driven by CRE, credit cards, and commercial loans. We believe banks are well-placed to absorb some deterioration. Most banks have held their allowances for credit losses as a percent of loans roughly flat in 2024—after increasing them in 2023—replenishing those allowances with provisions following an increase in charge-offs. We expect provisions and allowances to rise modestly this year, even assuming relatively muted 2% loan growth.

**We believe the downside risks for banks exposed to CRE has become more manageable.** We expect banks—even the rated banks most exposed to CRE—to work through additional CRE challenges over the next few years, absorbing losses through earnings. CRE valuations have shown signs of stabilizing after material declines in some assets classes, helped in part by a decline in interest rates. Banks have also shown a relatively low level of credit deterioration despite a significant amount of CRE loan refinancing. CRE delinquencies and nonaccrual loans rose to about 1.6% of CRE loans in the fourth quarter, up only about 10 bps, with relatively modest loan modifications. Banks have also strengthened their balance sheets while market confidence in banks seems to have improved. In February, we revised the outlooks on six regional banks to stable from negative, which had greater exposure to CRE than their peers. Notwithstanding this, we still consider CRE a key risk for the banking sector this year.

**Deposit levels have risen for four of the past five quarters, easing funding pressure.** Notably, deposits rose in the fourth quarter even as banks lowered their offering rates following Fed rate cuts. We believe deposit levels will increase somewhat, helped by a pickup in loan growth. Positively, the runoff in noninterest-bearing deposits seems to have stabilized, which should support net interest margins (NIMs).

**We expect capital ratio trends to be mixed.** Banks' capital actions will partially depend on the amount of capital they built above regulatory requirements. The amount of unrealized losses in their securities portfolio also plays a part, particularly for regional banks. Regional banks of a certain size may ultimately have to count unrealized losses on available-for-sale (AFS) securities in their regulatory capital ratios, depending on how regulators ultimately implement the final components of the Basel 3 capital rules.

**Policy uncertainty, particularly the impact of tariffs, have become a main focus for U.S. and Canadian banks.** Our economists expect tariffs, depending on how there are implemented, to have a modest negative impact on U.S. GDP. That could cause us to revise our earnings forecast

down for the banking industry. Downward market pressure and overall business uncertainty could hurt fee income and loan growth, hitting bank revenue. Banks may also boost allowances more than we expect, incorporating a higher chance of a recession into their allowance modelling.

We recently modestly lowered our earnings forecast for Canadian banks as tariffs could more significantly hurt the Canadian economy. We now expect Canadian bank net income could fall, with ROE from 8%-11% in 2025, versus 12% last year. That said, the high degree of uncertainty could lead to a variety of outcomes, including the possibility of market support by the Canadian government which could ease some of the impact from tariffs.

**The path ahead for U.S. bank regulation remains highly uncertain.** We don't expect a significant rollback of prudential bank regulation, particularly for large banks, but we do expect review and rationalization. The Trump administration has nominated or appointed new leadership to several regulatory bodies and is likely to make further nominations to key spots. The leadership of these agencies sets the tone for the application of existing regulation, supervisory oversight, and the stringency of new regulation. Current and potential new leaders at bank regulatory agencies in recent speeches have discussed a fairly extensive list of regulatory and supervisory areas they may review, such as the Basel 3 and other capital requirements and liquidity rules.

## Finance companies

**Our outlook is stable on about 82% of the North American finance companies (fincos) we rate.** The performances of those companies will depend meaningfully on the impact of tariffs and other geopolitical factors on economic growth, inflation, interest rates, market volatility, and regulation. With ample cash from substantial fundraising driven by ongoing demand particularly from the high-net-worth sector for business development companies (BDCs), there's likely to be a pressing need to deploy capital this year, especially for nontraded BDCs. This urgency could affect underwriting standards and degrade asset quality. We think fincos with diversified revenue streams and sound balance sheets are best-positioned to meet these challenges.

**We have two positive and 14 stable outlooks on publicly rated BDCs.** The 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 direct lenders' ability to write larger checks and rising club deals will continue to allow direct lenders to compete with BSLs. So far, origination volume is primarily driven by refinancing opportunities, and we could see increasing M&A pipeline drive origination volume in the second half of 2025.

**Asset-quality strains from older vintages will persist for CRE lenders, but CRE services companies are at an inflection point.** The performance of the economy, inflation, and interest rates will have important implications given the cyclical nature of CRE. The Fed's rate cuts last year, and any further easing could support CRE values, making it somewhat less difficult to handle impending maturities on troubled loans. Still, relatively high 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.

Secular changes in the office market have created a major challenge for CRE finance companies. We've also seen increasing strain in multifamily due to increased supply in some regions, 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.

So far this year, of the six CRE lenders we rate, we downgraded one issuer by one notch due to rising liquidity needs and revised our outlook on another to stable on steady trend in asset quality and adequate liquidity. Over the next year, CRE finance companies will, in our view, remain selective with originations and focus on preserving liquidity.

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, logistics, and data center sectors.

**Transportation equipment lessors are poised to grow and maintain strong access to capital markets depending on the impact of tariffs.** We expect steady demand for aircraft leasing, even for older planes, due to the industry supply constraints and robust travel demand. Aircraft leasing companies also benefit from production constraints, resulting in higher residual values and lease rates. On the other hand, improvements in supply chains for cars and trucks, and a moderation in demand, has tempered rental and lease pricing, as well as gains on asset sales.

Existing and new tariffs would likely suppress trade volumes, which could hurt some of the rated freight-focused lessors, such as the container lessors. We also believe higher tariffs could increase inflationary pressures and strain demand, reduce asset utilization, and influence purchase and lease pricing. Still, we believe most freight-focused lessors benefit from the staggered nature of their lease contracts as well as cash flow visibility. They also have the flexibility to reduce capital spending to meet weaker demand as necessary.

## Asset managers

The recent increase in market volatility is a notable shift from the relatively benign conditions that helped stabilize assets under management (AUM) for traditional asset managers last year. That said, we entered this period with only two traditional asset managers and one alternative asset manager we rate having negative outlooks—each due to its credit metrics' proximity to downside thresholds.

**The potential for a sharper-than-expected economic slowdown is a key risk to ratings.** Traditional asset managers' earnings are particularly exposed to market volatility. While wealth managers are also exposed to volatility and redemption risk, their asset bases tend to be stickier, and they are relatively less exposed to market volatility. This is because their underlying asset bases is more diversified and they have some uncorrelated sources of revenue.

**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 AUM, solid performance and fundraising records, and diversified offerings. There are also tailwinds including increasing investment allocations from institutional and private wealth clients and the opportunity to grow in private credit.

**Managers we rate have adequate liquidity and few near-term debt maturities.** Spreads remain narrow, but sustained volatility could lead to wider spreads for lower-rated borrowers, making access to debt markets choppier and challenging. Further, if benchmark rates remain higher for longer, that would raise the weighted average cost of capital and compress interest coverage.

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.

# Nonfinancial Corporates

- We generally view tariffs as having a somewhat negative effect on credit quality.
- The duration of the tariffs will be a key factor in how deeply issuers are affected.
- Geopolitical and immigration policies are interwoven with trade decisions.

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**We generally view tariffs as having a somewhat negative effect on credit quality, with varying impacts on North American sectors** (see table 1). U.S. tariffs are paid by American importers which will result in higher input costs for many companies. The extent to which companies can pass on these higher costs to end-market consumers determines how much margins shrink and ultimately how well issuers can continue to service their debt. For now, we anticipate a majority of sectors will be able to pass on most input price increases (see chart 10). As expected, the lowest rated issuers—since they typically have tighter margins—will be most vulnerable.

Table 1

## Key North American sectors to watch amid tariff uncertainties

**Potential credit impact**: Somewhat positive impact | Minimal impact | Somewhat negative impact

| Sector | Key factors | Potential credit impact |
| --- | --- | --- |
| **U.S.** | | |
| Chemicals | In the near term, some chemicals subsectors could benefit from higher product prices if imports of competing products rise due to tariffs. | Somewhat positive impact |
| Metals and mining | Steel and aluminum tariffs support the credit quality of domestic companies with volume gains, higher prices, and ultimately stronger profitability. | Somewhat positive impact |
| Oil and gas | Limited pipeline options lock in trade relationship between Canada and the U.S., with both parties sharing higher costs. Higher tariffs could lead to investments in the supply chains to diversify customer bases. | Minimal impact |
| Health care/pharmaceuticals | Generic drug manufacturers have narrow margins and are dependent on global suppliers. Commodity-like but critical medical supplies are sourced internationally, and therefore these companies are subject to rising input costs. | Somewhat negative impact |
| Technology | Highly engineered products employing advanced manufacturing processes are difficult and costly to relocate (e.g., semiconductors, complex electrical components). | Somewhat negative impact |
| Utilities/renewables | Highly engineered products employing advanced manufacturing processes are difficult and costly to relocate (e.g., solar panels, battery chemistries, wind turbines). | Somewhat negative impact |
| Automotive | Lower volumes would likely follow higher prices necessitated by supply shortages, increased production volatility, and the potential for increased capital spending to relocate production. | Somewhat negative impact |
| Consumers products/retail | Companies with domestic manufacturing and pricing power may fare better. However, consumers are increasingly sensitive to rising prices. | Somewhat negative impact |
| **CANADA** | | |
| Automotive | Auto suppliers with U.S. exposure may have initial success passing on costs, but may suffer from falling demand due to higher end market prices. | Somewhat negative impact |
| Building materials | The sector already faces challenging market conditions and ~15% in antidumping and countervailing duties. | Somewhat negative impact |
| Consumers products/retail | Retaliatory tariffs and a weaker economy with rising prices will constitute long term headwinds, which are only partially mitigated by a relatively weaker Canadian dollar. | Somewhat negative impact |
| Oil and gas | Excess U.S. refining capacity and limited pipeline options locks in trade relationship between Canada and the U.S., with both parties sharing higher costs. In Canada's case, these exports represent a far larger share of their domestic economy magnifying tariff ripple effects. | Somewhat negative impact |

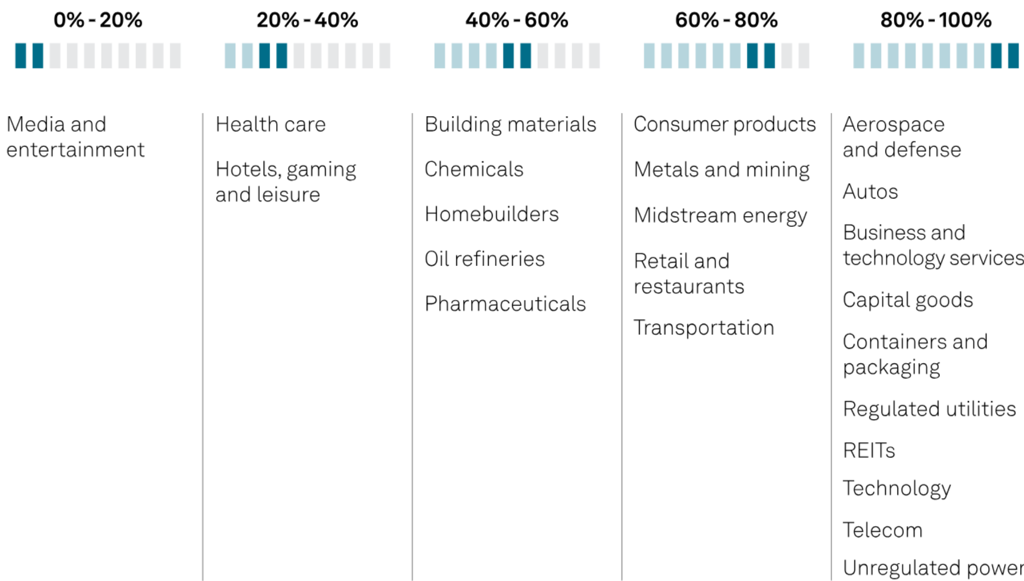
This qualitative assessment reflects potential impact of President Trump's tariff measures as assumed in our current macroeconomic base case on North American nonfinancial corporate sectors. For our tariff assumptions, see "Economic Outlook U.S. Q2 2025: Losing Steam Amid Shifting Policies," published March 25, 2025. Source: S&P Global Ratings.

**Mitigating factors include the availability of substitute inputs or alternative suppliers, margin cushions, and pricing power.** The party that values the trade relationship most is likely to bear more of the cost of the tariff. In certain cases, trade relationships are so tightly integrated that neither the seller nor the buyer has a distinct advantage. For example, U.S. oil refiners have excess capacity and the pipeline networks that supply them are geared predominantly to Canadian inputs. Such exclusively symbiotic relationships are likely to result in more-equal sharing of tariff costs. Therefore prices will likely rise while the tariffs stay in place and before accommodating supply chain adjustments are complete. Even the few pockets benefiting from a protectionist stance will pass on higher costs to customers further down in the supply chain.

Chart 10

North American sectors' current ability to pass through costs varies

% of higher costs that can be passed through to customers on average




North American nonfinancial corporate sectors' assessment as of March 2025 based on our current macroeconomic base case. Source: S&P Global Ratings.

**Tariff policy is fluid, changes quickly, and its reaches go beyond trade**. Whether it involves EU defense spending or immigration and drug flows over U.S. borders, the negotiations around tariffs go beyond trade. At the very least, we observe retaliatory responses that haven't been like-for-like and instead have bled across industry lines. Also, the broad spectrum of responses considered or implemented has extended beyond tariffs to duties, export taxes, and trade restrictions on certain products or products from certain companies. Because trade policies can be put in place (or adjusted) in short order, the uncertainty is a risk in itself. It makes it difficult for companies to conduct the long-term budgeting and planning necessary to effectively run their businesses.

## Extended Outlook

**It will likely take some time to fully and accurately factor in the effects of tariffs.** The magnitudes of certain contemplated tariffs are considerable—the prospects of a company with material input exposure to a country with a new 25% tariff are fundamentally changed. Identifying the tariffs, exposures and countries involved provides a sense of how much costs may rise, but this is only the beginning. This first phase is further complicated by how much costs can be passed through to consumers and how any price changes will affect volumes.

**We must also take retaliatory actions into consideration.** Reciprocal tariffs raise prices for U.S. exports, completing a cycle in which goods flowing in both directions become more expensive and possibly difficult to obtain. These impacts proliferate beyond the proximate industries affected by the tariffs. For instance, a sizable share of U.S. soybeans is exported to China, and a retaliatory tariff on this commodity could pressure farmers' volumes and therefore income and confidence, leading them to reduce their spending on the capital goods products they would use for production.

**Over time we expect to see other effects.** Financing conditions may become more restrictive, opportunities for growth may diminish, or higher levels of investment may be required to transform supply chains or product offerings. Any of these factors can diminish the ability to generate free cash flow.

**The duration of tariffs will be a key factor in how deeply issuers are affected.** The tariffs on China have historically been the longest-lived. However, it's unclear how long potential U.S. levies on its bordering neighbors can last. Their magnitude, at 25%, gets a lot of attention, but the duration is just as important to credit quality. If they persist beyond the middle of next year, many more companies won't be able to avoid deterioration in credit quality.

**How will companies adapt to the new trade paradigm?** Ostensibly one purpose of tariffs is to make domestic industries stronger by granting them a cost advantage in the domestic marketplace. To the extent these industries couldn't compete against imports, they will be providing a higher priced alternative to new customers. Such as in the case of steel or aluminum, issuers may not even have the capacity or inputs required to supply the entire domestic market. Overcoming as many of these hurdles as possible would bring down prices but will also take many years and billions of dollars in investment. Such changes will likely require some level of confidence that this new approach to trade is likely to persist beyond the current administration.

## Beyond Tariffs

**Geopolitical and immigration policies are interwoven with trade decisions.** The Trump administration seems to prefer more limited defense commitments to its allies. Implications have been made that the security the U.S. provides should be recouped via tariffs, and some level of support for Ukraine has been linked to an agreement on rare-minerals sharing.

Separately, tougher immigration restrictions hurt certain industries. Slowing immigration rates would likely result in rising wages for factory workers and service employees in the consumer products, and retail and restaurants sectors. Similarly, certain businesses, such as the prepaid segment of telecom, would be disproportionately strained by a reduction in immigrant customers.

**Regulatory shifts in environmental policies are emerging as a factor for certain sectors.** Policies geared toward reducing regulation can be beneficial to businesses, but only in cases where they are constrained. Oil and gas companies, for example, face reduced protections for public lands, but appear to be some time away from needing to expand. On the other hand, government leaders, public stakeholders, and industry leaders associated with the sector have expressed concern about cuts in the federal workforce and the possibility that understaffed regulatory bodies could lead to an increase in accidents or other safety incidents.

# Public Finance

- Federal policy uncertainty will keep a lid on growth and investment at a time when higher costs and lower baseline federal funding are making balancing budgets more difficult.
- We believe most public finance issuers can adjust to short-term budget disruptions, but lasting changes in federal policy could have a material credit effect on some entities.
- Policy shifts, including tariffs, that slow economic growth or worsen inflation could have an outsized effect on entities already struggling to maintain balanced operations.

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**Federal policy uncertainty could affect public finance issuers' revenues and expenditures.** Congress has funded the government through September, but significant uncertainty about federal fiscal, trade, workforce, and immigration policy increases economic and financial risks for public finance entities. This makes budget planning and investment decisions more challenging. Efforts to reduce federal workforce and spending could hurt economic and credit performance in localities with a significant share of federal employees, while reduced federal funding for infrastructure or municipal tax exemption could raise the cost of capital projects.

**Higher inflation and slower economic growth will make balancing budgets more difficult at a time when pandemic-era federal aid is expiring.** U.S. public finance entities entered the year with record levels of reserves, boosted by pandemic funding and robust economic growth. Policy shifts, including tariffs, that slow growth or increase inflation could have an outsized effect on issuers already struggling to maintain balanced operations. For Canadian provinces, additional tariffs would slow economic growth and compound preexisting fiscal pressure arising from elevated costs and Canadian federal policy changes.

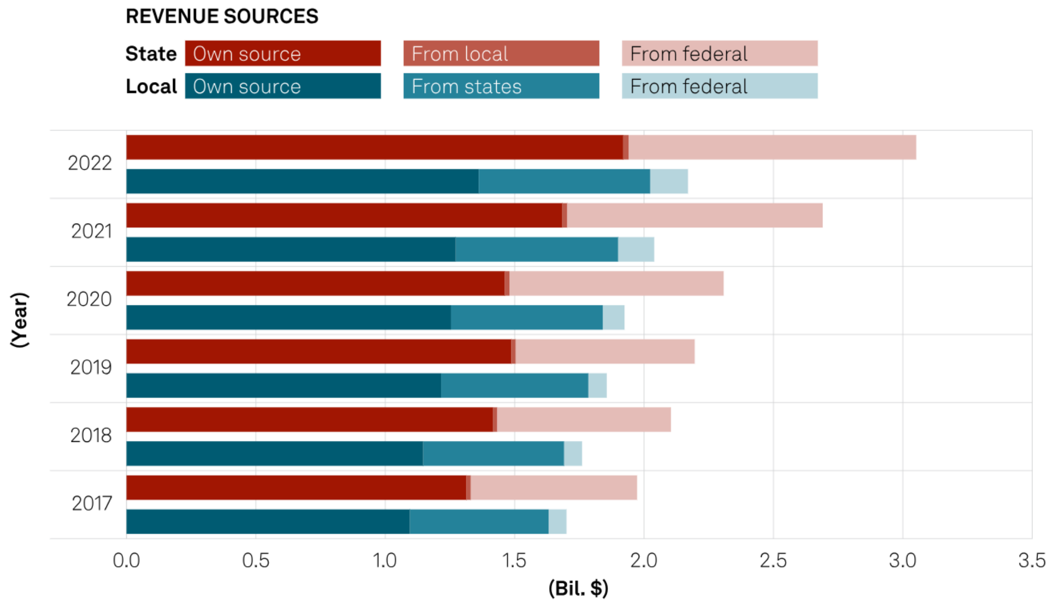
**Federal spending cuts in certain areas could have a significant impact on public finances.** Deep cuts to programs such as Medicaid would likely affect states, local governments, schools, and not-for-profit health care providers. Providers more exposed to Medicaid spending include academic medical centers, children's hospitals, insurer-provider systems with significant Medicaid membership, and safety net hospitals, which are often county-run. Cuts to education and federal disaster relief, if they result in reductions or delays in funding, could also impact public finance issuers' revenue in ways that would be difficult to offset with cost reductions.

**State budget pressure could be pushed down to cities, counties, schools, and other public entities that rely on state funding for operations** (see chart 11). The impact on local governments of any changes to federal spending—particularly regarding Medicaid—depends in part on how states react. Because Medicaid flows directly to states from the federal government, states would be the first to confront any changes in funding and eligibility at the federal level. Historically, states have made cuts to revenue sharing for local governments and schools, but they have also served as a buffer for local governments when economic pressures have arisen.

Chart 11

States average 30% of total revenue from federal sources; local governments average 30% from states

State and local government annual revenue sources




Source: U.S. Census.

**Lower immigration will slow consumption and shrink the workforce, leading to higher costs of labor.** It could also lower service costs and revenue for some governments serving immigrant populations. In addition to economic and workforce impacts, reduced immigration could put financial pressure on some public finance sectors, particularly K-12 and higher education. Tighter border policies could relieve some costs for governments that experienced higher social-services spending to support new arrivals entering the U.S. during the past few years, even as they potentially raise costs for labor and construction.

# Structured Finance

- While the outlook for North American structured finance collateral performance and rating trends is relatively stable, we see some weakness in consumer-related sectors.
- CRE segments continue to have the most bearish credit outlook.
- Consumer distress is spreading to cohorts with higher credit scores and incomes, despite low unemployment.

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The outlook for North American structured finance collateral performance and rating trends remains relatively stable, outside of continued stress on certain CRE assets (see table 2). That said, we observed some weakness in consumer-related sectors, as inflation, affordability, and higher levels of indebtedness appear to be taking a toll despite low unemployment. We expect this to continue in the near term amid broader policy-related uncertainty.

Table 2

## 12-month North America structured finance outlook – Q2 2025

| | Collateral performance outlook | Rating trends |
|---|---|---|
| **Residential mortgage-backed securities (RMBS)** | | |
| RMBS | Stable | Stable to positive |
| RMBS – servicer advance | Stable | Stable |
| **Commercial mortgage-backed securities (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 | Somewhat Weaker | Stable |
| ABS - auto lease | Stable | Stable |
| ABS - auto dealer floorplan | Stable | Stable |
| ABS - credit cards | Somewhat weaker | Stable |
| ABS - unsecured consumer loans | Somewhat weaker | Stable |
| 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 | Stable | Stable |
| **ABS - Esoteric** | | |
| Corporate securitization | Somewhat weaker | Stable |
| Data center | Somewhat stronger | Stable |
| Small business | Somewhat weaker | Stable |
| Solar | Somewhat weaker | Stable to negative |
| Timeshare | Somewhat weaker | Stable |
| Transportation - aircraft | Somewhat stronger | Stable to positive |
| Transportation - container | Stable | Stable to positive |
| Transportation - railcar | Stable | Stable to positive |
| Triple net lease | Stable | Stable |
| Tobacco settlement | Somewhat weaker | Stable to negative |
| Utility-related securitization | Stable | Stable |

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

**CRE continues to have the most bearish credit outlook.** Stubbornly high benchmark interest rates and capitalization rates have weighed on asset valuations and heightened refinancing risk for most types of U.S. CRE. Relatively lower demand for office space from both the private and government sectors is weighing on asset valuations via lower occupancy and rents. Class B/C regional malls continue to struggle to find long-term refinancing capital. The residential mortgage—and residential mortgage-backed securities (RMBS)—sector has a more positive outlook due to supply constraints and many borrowers retaining low fixed-rate mortgage loans.

We've seen some signals that consumer distress is spreading to cohorts with higher credit scores and incomes, despite low unemployment. This is happening amid higher debt levels: Credit card balances increased to a record $1.38 trillion (nonseasonally adjusted) at the end of 2024. We attribute the growing consumer distress to a combination of higher interest rates, higher debt levels, and inflation/affordability issues, along with the resumption of student loan payments. This is feeding our expectation of somewhat weaker collateral performance, but still stable rating trends, for covered sectors. While not our base case, an unforeseen increase in unemployment could lead to further distress for consumers who are already facing a myriad of stresses.

For esoteric asset-backed securities (ABS), we expect somewhat weaker collateral performance in whole business, small business, timeshare, solar, and tobacco settlement, as underlying obligors are hit by weaker consumer discretionary spending and businesses face inflationary pressures and higher operating costs. However, most portfolios benefit from asset diversification. Among those, solar and tobacco settlement also have a stable-to-negative ratings trend outlook. The decline of tobacco consumption has accelerated in recent years due to continued health concerns, utilization of alternative products such as vape/e-cigarettes, and an aging population. Meanwhile, data centers and transportation sectors have a somewhat positive bias, driven by growing demand and supply constraints.

**Credit conditions for U.S. collateralized loan obligations (CLOs) are still relatively benign,** but since the start of the year, there's been a flurry of downgrades across underlying corporate obligors. Our ratings on a handful of widely held obligors have fallen into the 'CCC' category, resulting in an uptick in average 'CCC' buckets. Still, the average junior overcollateralization cushion across our CLO index is still healthy, and exposure to obligors rated 'B-' with a negative rating outlook has declined. Regarding tariff-related uncertainty, we find U.S. CLOs of broadly syndicated loans (BSLs) have limited exposure to the more affected sectors (auto, metal and mining, oil and gas). The tech sector has considerable weight in U.S. BSL CLO collateral pools, but this includes software and services industries, which presumably would have less of a direct impact from tariffs. When we focus on the equipment-related industries within the tech sector, we find U.S. BSL CLOs have only about 2% exposure.

Overall, we generally expect stable or somewhat negative rating trends over the next 12 months (see table 2), with most rating actions in the noninvestment-grade space. Distress may be more acute for certain structured finance sectors, especially those that are more sensitive to a higher-for-longer interest rate environment.

# Insurance

- The average financial strength rating for the core North American insurance portfolio is in the upper half of the strong ('A') category.
- Balance-sheet strength continues to underpin credit quality.
- We believe there is still broad access to capital for this mostly investment-grade portfolio.

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We recently revised our sector outlook for health insurance to negative from stable, and updated our current business conditions assessment for the life insurance sector to strong from satisfactory (see table 3).

Overall, the average financial strength rating for the core North American insurance portfolio, which includes life, health, property/casualty (P/C), is in the upper half of the strong ('A') category with a relatively high percentage of stable outlooks. Major rating considerations include pricing, interest rates, capitalization, commercial real estate/private credit exposure, legislative/regulatory risk, medical utilization, elevated catastrophic risk, economic volatility, and geopolitical tensions.

We believe there is broad access to capital for this mostly investment-grade set of companies that in general aren't highly leveraged. Balance-sheet strength underpins credit quality.

Table 3

North America insurance sector trends – Q2 2025

| Sector | Current business conditions | Business conditions outlook | Sector outlook |
|---|---|---|---|
| Life insurers | Strong* | No change | Stable |
| Health insurers | Satisfactory | No change | Negative* |
| P/C insurers | Satisfactory | No change | Stable |
| 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. *Indicates changes since Q1 2025.
Source: S&P Global Ratings.

## Life insurance

**The macroeconomic landscape appears largely favorable for North American life insurers.** Some risks, such as high interest rates, corporate bond defaults, and a potential recession, remain a concern. Among the factors that could affect life insurers, either positively or negatively, in the medium- to long-term trends include increased investments in private credit that may enhance yields but elevate credit risk. The growing use of offshore reinsurance can improve capital efficiency by attracting third-party capital, though it may reduce transparency for stakeholders. Additionally, exposure to CRE is likely to result in some investment losses, though these are expected to be manageable.

The growth of private-credit investments (including loans to small- and medium-size enterprises) and asset-backed finance has been a notable shift in life insurers' portfolio toward less-liquid assets. This is partly demonstrated by the increase in privately rated bonds, although it is important to emphasize that not all privately rated bonds represent investments in these asset types. Private-credit allocations still constitute a small fraction of life insurers' portfolios; however, as the private investment markets expand, we think these allocations will grow.

## Health insurance

**We revised our U.S. health insurance sector view to negative from stable in January,** to reflect recent and projected strains in operating performance, predominantly in the Medicare Advantage and Medicaid segments, as well as the commercial segment in certain geographic markets. Moreover, the sector faces elevated legislative and regulatory risks, potentially affecting multiple health insurance and pharmacy-related segments. Seven of our 20 rated insurance groups have ratings with a negative outlook, driven by either the revised capital adequacy criteria, operating performance stress, or acquisition-related risks.

We anticipate the health sector will enjoy revenue and earnings growth this year. However, several factors are at play, including negative Medicare Advantage rates, elevated medical utilization, and inadequate Medicaid rates related to higher acuity membership. Additionally, some not-for-profit and mutual companies will face earnings pressure in their commercial business due to geography-specific competitive and medical cost risks.

The sector's operating performance stress may be temporary because companies can reprice products annually. However, regulatory restrictions and the sector's status as a "price taker" in Medicare and Medicaid will limit their repricing ability. Therefore, we expect the sector's earnings improvement will be incremental.

## P/C

**S&P Global Ratings' view on the U.S. P/C sector is stable (revised from negative in November)**, with support from a significant improvement in underwriting profitability for personal auto and homeowners' insurance, which we expect to remain. In addition, commercial lines continue to deliver strong underwriting results. Capital adequacy for some of our rated insurers has also improved.

Strong rate momentum for most commercial lines continues to stay ahead of loss cost trends and most should maintain their underwriting margins. Cumulative rate increases in personal lines in the past several years are showing results, with personal-line writers posting underwriting profits. Overall, we expect rates to moderate for both commercial and personal lines, as insurers focus on maintaining underwriting margins and growing policies in force.

**In this sector we are monitoring natural catastrophe losses, especially in light of the California wildfires, which could create earnings pressure**—especially if 2025 proves to be above average for natural catastrophes. We are also looking at how ongoing geopolitical tensions and trade policy could weigh on market sentiment, how social inflation impacts profitability and reserve adequacy, and the adoption of digital technology with potential and growing risk to cyberattacks.

## Global reinsurance

**Reinsurers have generated strong earnings despite global insured natural catastrophe losses exceeding $125 billion annually in 2023 and 2024.** This success is due to structural changes implemented in early 2023, which allowed reinsurers to take on a lower share of catastrophe losses driven by frequency rather than severity. Reinsurers are in a position of capital strength, thanks to strong underwriting performance in short-tail lines, robust net investment income, and recovering asset values in the past two years. We maintain a stable view of the global sector.

**However, adverse developments in certain U.S. casualty-loss reserves remain a key risk.** We expect reinsurers' reserves will need close monitoring amid challenges from economic and social inflation. The Los Angeles wildfires resulted in industry estimates of insured losses of $20 billion-$50 billion, highlighting modeling limitations. Reinsurers will absorb a large portion of these costs in their annual earnings, leaving less catastrophe budget for the remainder of the year. Despite

this, reinsurance demand is increasing, and with favorable pricing, we expect the industry to post strong results in 2025.

## Bond, title, and private mortgage insurers (PMIs)

**The U.S. public finance market continues to drive increased demand for bond insurance.** Further supporting business growth has been a strong demand in the secondary market. Insured issues in the U.S. public finance market have an underlying credit quality of 'A'/'A-', with some 'AA-' issues. While pressures related to inflation or potentially lower consumer spending could affect collections of economically sensitive revenues, bond insurers' underwriting strategies and conservative capital management support the potential growth in exposure.

The overall profitability and financial strength of the 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 remains under pressure due to higher interest rates and a lack of supply. We expect modest revenue growth for the sector. However, the average revenue per direct title order has increased, primarily due to higher average revenue per order for residential purchase transaction stemming from rising home prices. Margins may 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.

Policy uncertainty related to trade/tariffs, immigration, and the federal workforce poses near-term challenges. PMIs also face regulatory uncertainty given signaled intentions to end the conservatorship of government-sponsored entities, PMIs' largest customers. However, the timelines and expected impact to the mortgage insurance industry is highly uncertain.

**Combating these uncertainties include PMIs' robust capitalization and significant embedded home equity, which serve as a buffer against potential losses.** New business volumes are getting back to pre-pandemic levels as borrowers adjust to higher mortgage rates. PMIs continue to maintain strong underwriting discipline and loan quality remains robust.

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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 |
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| Aerospace and defense | Demand for airframes and engines is showing no sign of easing, with strength broadly assumed to persist through this decade and original equipment manufacturer (OEM) backlogs remain significant. In addition, the need to keep older aircraft in service longer than previously anticipated—notably on account of new aircraft delivery delays and engine reliability issues—will likely remain a key tailwind for issuers involved with maintenance, repair and overhaul (MRO) services, and replacement parts producers. Boeing continues to receive the most attention mainly related to the pace of 737 MAX production ramp-up amid well-documented production challenges, regulatory oversight, pending variant certifications, and certain money-losing defense contracts. 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. At this point, we don't expect proposed tariffs by the U.S. government to have a material impact on commercial aerospace. For defense companies, we don't envision credit implications from planned cuts to federal spending, which has included recent contract cancellations. Moreover, while we consider a strong, though likely not increasing, U.S. defense budget, changing spending priorities domestically (i.e., potentially more support for naval ships, less for crewed fighter jets) and in Europe present growth potential. In our view, commercial aerospace OEMs and defense primes are well-positioned to manage any uncertainty in the next 12 months. While the sector ratings bias is modestly negative, this mainly reflects pressure faced by certain lower-rated peers with high leverage, and the risks associated with elevated shareholder returns. |
| Autos | Increasing unemployment will weigh on consumer purchasing power and limit U.S. auto sales growth to 1%-2% in 2025 and 2026. We expect limited margin and cash flow improvement for U.S. auto issuers, and modest credit deterioration in the sector is likely, particularly for some lower-rated auto suppliers. Before the tariff implementation, we expected a 6%-8% decline in average transaction prices for new vehicles through this year as automakers increase incentives and consumers opt for lower-priced options within segments. However, after the tariff implementation in April, we expect no price declines as companies look to pass on the majority of higher costs to consumers. In this scenario, we assume U.S. light vehicle volumes drop up to 5% versus our current conservative base-case (15.8 million units in 2025) with a stronger recovery in next year.<br><br>The potential for a prolonged 25% tariff on imports from Mexico and Canada along with announced tariffs on steel and aluminum could have a multibillion-dollar impact on Ford's and GM's profitability. We expect most tier 1 suppliers would pass a substantial burden of the higher costs on to automakers, which would eventually have to pass it on to consumers. Higher risk for credit metrics for suppliers stems from longer-term secondary effects. These include lower volumes due to higher prices, higher working capital, renewed supply chain shortages, increased production volatility, and the potential for elevated capital spending to relocate production longer-term. These risks would be material if the tariffs become effective beyond three to six months or worse, extend through 2026.<br><br>Battery electric vehicle and plug-in hybrid sales will improve with many launches at more affordable prices, leading to combined segment market share approaching 20% by the end of 2026. This assumption will be at risk if EV policy changes make it harder for companies to lower the cost of EVs for consumers. |
| Building materials | We expect looming tariffs could further stress margins via materially higher prices, which could dampen demand. We anticipate margin pressure should passthrough capabilities diminish as consumer sentiment worsen and interest rates remain elevated, discouraging spending on more discretionary renovation and remodeling projects. There is more exposure for cost than revenue given that international operations are somewhat limited for most issuers. Some might have higher or lower exposure depending on the product types. In most cases, the majority of inputs are sourced domestically with only about 7% of all building products imported. Mexico and Canada account for about 25% of these imports, and China also accounts for a significant amount. |
| 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.<br><br>Ongoing pressure on mortgage origination due to higher interest rates has hurt 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 assume IT spending to grow by 9% this year (accelerating from 8.3% in 2024). Surely, tariffs, or the mere possibility of tariffs, could have chilling effects on macroeconomic growth and IT spending. We aren't contemplating tariff-related rating changes to any of the global tech service coverage at this time as 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. |

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| Capital goods | Credit quality in global capital goods looks steady and robust, with the negative outlook bias nearing a decade low of only 5%. Most of the negative bias, however, remains among the smaller, highly leveraged issuers, which only represent about 20% of the rated debt in the portfolio. Tariffs on Canada, Mexico, and China could increase the U.S. capital goods sector's total costs by 3%-5%, because those countries account for an estimated 45% of key imported material inputs for rated U.S. capital goods firms. We estimate the higher costs from these tariffs would amount to 10%-15% of EBITDA for rated U.S. capital goods companies, necessitating a break-even price increase of 2%-4% to maintain flat earnings. Destocking has run longer than expected, but our revenue growth assumption for this year is about 4.75% assuming that orders and deliveries start picking up. Key manufacturing indicators remain sluggish, but price increases appear to be passing through elevated costs, even with tepid volumes. We expect that credit quality can withstand a normal cyclical downturn because of good earnings and lower debt leverage industry-wide in 2025. Most issuers rated 'BB' and higher have built good credit buffers with steady 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 this year and next, 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. 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 effects of destocking subside. Still, it's too early to definitively declare that the destocking is done, especially in subsectors such as crop-protection chemicals. The potential for tariff-led challenges to global trade and attendant demand weakness in key chemical end markets such as auto, and cost increases for some chemical producers, are new risks. Our base case continues to be for EBITDA increases for most subsectors this year, although there is less certainty now around the increases. An important contributor to any gradual EBITDA improvement, would be cost-reduction initiatives to combat the challenging market conditions. Some subsectors like petrochemicals face capacity buildups that will depress earnings not just this year, but also in 2026. A large minority of ratings continue to have negative outlooks or are on CreditWatch negative. This reflects in part the uncertainty related to the pace and extent of earnings recovery. |
| Consumer products | We are entering this tariff cycle at higher prices after extraordinary inflation in 2021 and 2022. The price at retail of goods and services are on average 25%-30% higher than in 2018, and consumer fatigue is weighing on discretionary spending. We believe the largest near-term risk to the consumer products and retail industries is the further pressure on an already stretched consumer. Consumers are spending their savings, using more credit card debt, and the wealth and income gap is widening. These factors along with higher costs for essentials such as shelter, food, and services have pressured discretionary spending. Demand remains weak in discretionary categories and retailers and manufacturers have less pricing power entering this tariff cycle. Demand for large-ticket durables such as household appliances and mattresses hasn't recovered. Volumes for consumer staples such as packaged food remain weak, and consumers have traded down to private label. Higher rates will pressure consumers who use credit card debt and lower turnover in the housing market will delay recovery in demand for durables or home-related categories.<br><br>Consumer categories with the most imports to the U.S. from Canada include bakery products and frozen french fries, wood and paper products, metals and metal products, and furniture. With respect to Mexico, fresh vegetables, beer, tequila, mezcal, and fresh fruits such as avocados and berries are large imports. Trade policies and retaliatory tariffs would affect exports for agribusiness and commodity foods. Many U.S. consumer products companies source commodities abroad and have manufacturing facilities in Canada and Mexico, and these regions have been an extension of their U.S. supply chains. Tariffs on China will affect highly elastic categories such as durable and discretionary goods including furniture, home appliances, leisure goods such as toys and games, and apparel. Alcoholic beverages and luxury goods have larger China exposure and export risk, depending on where products are made and shipped. In 2024, we saw rating actions on U.S. consumer products companies turn more positive after lapping the inflationary periods and fully realizing price increases, and the ratio of upgrades and downgrades were about equal. Tariffs and resultant input inflation would likely result in a reversion back to negative rating actions. |
| 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 complete, packaging issuers are contending with a low-growth economy, effects of previous inflation, diminished consumer purchasing power and consumer confidence, unsteady labor markets, and now a tariff war that has the potential to strangle meaningful volume recovery. Borrowing costs remain elevated, which greatly hinders the lowest speculative-grade issuers with high debt leverage. However, despite these risks we view the sector as overall stable. Many issuers embarked on cost rationalization programs that have better positioned them to take advantage of a slower recovery. In addition, many also 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. |
| Health care and pharmaceuticals | We revised our outlook for the healthcare services industry to stable, from negative, on the return to largely normalized volumes and acuity in 2024. EBITDA margins also improved, as inflationary pressures on supplies and labor moderated and providers enacted efficiency measures. Cash flows improvements, however, lagged, as the No Surprise Act, Medicaid redeterminations, and the Change Healthcare cyber breach, along with still high interest rates, contributed to the record number of defaults among the private-equity-owned healthcare service providers. We expect cash flows metrics to improve this year, with revenues to grow in the mid-single-digit range and margins to remain stable to slightly improving. However, there are a number of wildcards that we are concerned about. Health insurers are reporting elevated medical cost ratios and are looking to lower reimbursement rates and/or utilization. Also, healthcare policy has been uncertain under the new Republican administration, given potential cuts to Medicaid, changes to Medicare, and |

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| | the looming expiration of enhanced Affordable Care Act subsidies. Meanwhile, healthcare labor remains a challenge, and tariffs may lead to higher costs. Still, for now, we expect the ratings deterioration we saw in the sector to moderate.<br><br>Our outlook for pharma remains stable, as we saw normalization of demand in 2024, and we expect that to continue. The industry has also benefited from strong sales growth, especially in the GLP-1 weight loss drugs and new classes of oncology treatments. The industry continues to demonstrate adequate pricing power, patent expirations are relatively moderate over the next couple of years, and we expect mid-single-digit and higher growth in 2025-2026. The Medicare drug price negotiation feature of the Inflation Reduction Act (IRA) goes into effect next year, though based on feedback from companies, negotiations have been reasonable thus far and the drag on growth manageable. However, policy uncertainty persists. While there hasn't been much indication on potential changes to the IRA, potential cuts to agencies such as the FDA and NIH could affect R&D spending and new drug approval timelines. The change in leadership at the various healthcare agencies could also affect the pharmaceutical industry growth in categories such as vaccines. Other developments we are keeping an eye on include potential legislation on PBMs and 340B drug pricing. Still, pharma portfolios and pipelines remain solid at most major pharmaceutical companies, and while we expect a return to more M&A this year, many companies have significant capacity at their current ratings for acquisitions. |
| Homebuilders | We expect tariffs to add meaningful cost increases (up to 3%) and further worsen housing affordability. We expect homebuilders and developers to pass along these costs to consumers when possible, but given expectations for weakening consumer sentiment and elevated mortgage rates, the ability to pass on costs is somewhat limited. Combined with high incentives (rate buy downs, lower prices), higher costs will pressure margins, particularly amid softer demand. Immigration policy could also constrain labor availability and lead to higher labor costs, but this is highly uncertain and difficult to predict. We expect builders to manage spec inventory pending consumer demand. We expect the tariffs on lumber to be the most significant exposure, but lumber is about 15% of overall construction cost and imported lumber varies across regions with no more than 30% to imported lumber. |
| Hotels, gaming, and cruise | The hotel, gaming, and cruise sectors are more heavily weighted to domestic travel and leisure-services spending, and the rating outlook is stable for these sectors. But there is still a meaningful level of leisure supplier and manufacturing risk in China and Mexico for a small subset of borrowers we rate. For example, rated outdoor recreation companies like powersports, motorcycles, and boats, source parts and materials or manufacture products in China and Mexico. While exposure to China has decreased over the past few years, we believe a universal tariff or sharply higher tariffs on Chinese or Mexican imports will translate to increased input costs and ultimately dampen gross margins.<br><br>Leisure manufacturers will try to pass on higher input costs to the degree they can, but success ultimately depends on consumers' willingness to pay higher prices amid potentially higher-for-longer interest rates, given these products are typically financed. In addition, the retail health of several outdoor recreation products, particularly motorcycles, powersports, and marine, will be at best flat this year. If revenues are flat, material tariffs could pose a significant burden on margins and may lead to weaker credit metrics compared to our base case assumptions.<br><br>Regarding leisure services sectors, to the extent higher tariffs raise prices for consumers and discretionary spending plans are tightened, then travel and entertainment spending for hotels, casinos, and cruises could suffer. |
| Media and entertainment | Secular pressures and the ongoing transition to digital distribution continue to hurt many legacy media sectors and companies, but our outlook on the sector is stable as these trends are already incorporated into our ratings. Continued healthy demand for content—including film, episodic TV, music, video games, sports leagues, concerts, books, newspapers, magazines, and even consumer-generated content—underlies our improved view on the sector. After years of overspending on content, the industry reset content budgets. Content creation will never be a stable, predictable business but it may be moving toward being a more rational one.<br><br>The landscape for streaming is rapidly evolving as the fight to grow subscribers at all costs has dissipated and all major industry players have shifted their strategies to improving profitability. Several legacy media companies have crossed the breakeven profitability line for their streaming services and are now faced with the next challenge: to build subscriber and advertising scale and improve profitability. This is an important year for these 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.<br><br>U.S. advertising weakened in the first quarter of 2025 as advertisers pulled back or paused advertising plans in the face of economic uncertainty and weakening consumer confidence. This will affect both digital and legacy media platforms. We would expect digital to feel the impact sooner but also potentially recover more quickly when economy picks up and consumer confidence returns. The long-term structural impact to legacy media platforms, such as TV, is more uncertain as recent history shows that economic weakness has led to permanent shifts in ad spending away from legacy platforms. National TV advertising may be most vulnerable today to this trend today.<br><br>Secular challenges remain. There remain subsectors within media that face an uncertain future. Five years of secular pressures, including two years of a global pandemic, have left some segments of the media sector a shell of their former selves. Consumption has become so fragmented that media's cultural impact is weakened. And the quality difference between certain professionally produced and user-generated content is shrinking. AI is accelerating this. |
| Metals and mining | A long cycle of improving credit quality has stabilized in metals and mining, after balanced upgrades and downgrades last year. Steel tariffs in the U.S. support the credit quality for American steel producers with higher domestic prices, volume gains at the expense of imports, and stronger profitability. Aluminum tariffs boost the profitability of the four smelters operating in the U.S., but limited capacity for more domestic output has pushed the U.S. Midwest aluminum premium to an all-time high. The U.S. has significant resources of iron, coal, scrap, and spare capacity to make more steel profitably. Aluminum smelters, on the other hand, have been closing for decades and need huge amounts of electricity before increasing output. Meanwhile, metal buyers in the U.S. face higher input costs than global competitors, |

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| | even before tariffs get implemented, so profitability downstream depends on higher prices for fabricated products. Flexible shareholder-return policies are kicking in across the sector, preserving cash and supporting credit quality through weaker prices and cash flows. Financial discipline has reduced the capacity or willingness to deploy cash for large corporate development and provides some balance sheet protection for projects underway through lower dividends. Total debt in the sector is lower than five years ago, and profits are about 20% higher since the 2021-2022 inflation spike. |
| Midstream energy | The North American midstream energy industry's credit quality continues to be resilient, with strong balance sheets and excess cash flow after capital spending and dividends in most cases. 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. Given the policy focus of the Trump administration, we expect an acceleration in development of traditional energy infrastructure to move natural gas and natural gas liquids to export centers around the Gulf Coast. While renewable development will continue, we believe it will slow given the uncertainty with tax incentives from the IRA and lack of substantial support from the administration. 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. 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 | After trading more than $80/bbl, Brent has been unable to maintain those levels as market fundamentals and concerns about global demand and tariffs reasserted themselves. Moreover, in a somewhat surprising move, OPEC+ announced that starting in April, it would begin to reintroduce the 2.2 million bbl/d of production through September of 2026, beginning with a 138,000/bbl per month increase. Potential sanctions by the Trump administration on Iranian oil production and the ongoing conflict between Russia and Ukraine remain a wildcard and could impact OPEC's decision to add more or lessen production from their current 5.5 million barrels of surplus capacity. Before sanctions were enacted and OPEC's decision to return barrels to the market, oil markets were under pressure. After two years of demand growth outstripping supply, we expected oil markets to shift into oversupply conditions for the next two years. Growth from non-OPEC production, particularly from North America, Brazil, and Guyana was likely to outstrip slowing demand particularly from China as it rapidly moves toward an EV society and converts its diesel truck fleet engines to compressed natural gas. And although it's uncertain how long any new tariffs will remain in effect, a prolonged period of tariffs could further lower global demand for oil. Global oil inventories remain at, or near, the bottom of the five-year average; however, they will likely increase over the next two years.<br><br>The Henry Hub has entered a period of tighter fundamentals brought on by a cold winter and producers laying down rigs and lowering production. Indeed, buoyed by exceptionally strong demand of 144 billion cubic feet per day (cf/d; 17.6 billion cf/d higher than the five-year average) in January due to the cold weather, the storage surplus that has existed over the past two years and kept a lid on prices has now been eliminated. It appears the U.S. lower 48 gas inventories may be entering a prolonged period of tightness as SPCI is projecting liquefied natural gas (LNG) feedgas demand will increase by more than 6 billion cf/d from October of last year through March 2026, which will keep the storage levels below the five-year averages and keep gas prices elevated. We assume production will continue to lag demand given the six-month lag between drilling and production, and as producers focus on generating cash flow and returning value to shareholders. We remain sanguine on the long-term lower 48 prospects for natural gas prices as SPCI forecasts a 95% increase or a 12.5 billion cf/d increase in gas demand related to LNG feedgas demand in 2029 to 25.7 billion cf/d. |
| Oil refineries | The performance of North American refiners will likely be flat to slightly positive this year. The industry came off a particularly weak fourth quarter with margins squeezed due to excess inventory and weaker demand. We believe 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. We expect refiners to continue to focus on rewarding shareholders, mostly through 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 | REITs and real estate operators of stabilized assets are less exposed to tariffs, the development exposure is generally limited (less than 10% of assets), and there is meaningful pre-leasing levels and contracts in place to mitigate cost increases. Still, the impact of tariffs on weaker consumer sentiment and unemployment could weaken demand. Interest rate policy and market volatility could impact access to capital and cost of financing. |
| Regulated utilities | Our sector outlook remains negative, reflecting the high percentage of utilities with a negative outlook (more than 20%). Last year was the fifth consecutive year that downgrades outpace upgrades, demonstrating the challenges affecting credit quality. 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. However, if this transformative growth isn't funded in a credit supportive manner, credit quality could be further negatively impacted. |

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| Retail and restaurants | Retailers with the tariff exposure are ones with higher proportions of private label offerings or directly source from suppliers and sell more hard goods, apparel, and discretionary products. Small, narrowly focused retailers will suffer more. They will have less negotiating power with suppliers and less pricing power with consumers. Industry leaders such as Walmart, Amazon, and Costco have negotiating power with their suppliers and will attempt to mitigate as much as they can before passing along the costs to consumers. They also have pricing power given their scale and unique value propositions. |
| Technology | Near-term expectations for the tech sector overall remain unchanged to modestly weaker. IT spending continues 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. AI model development remains robust and innovative methods to train AI models, such as DeepSeek's reasoning model, should allow more efficient capex and lower the cost of AI software applications. We believe continued AI development will lead to productivity gains for businesses and "killer apps" for consumers and support 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 but the magnitude of growth is uncertain and highly dependent on enterprise IT budgets. Communication infrastructure, industrial, auto and consumer end markets, which are still highly sensitive to the 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 and trade policy are key, as most of the tech sector serves enterprise and commercial business globally whose IT spending is highly correlated to global GDP. A 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 free cash flow-to-debt ratios and, for some, dwindling liquidity. |
| Telecom | We expect earnings to increase 3%-5% this year for U.S. telcos due to solid wireless service revenue growth of around 3%, low handset upgrade rates, and increasing penetration of fiber to the home (FTTH) broadband service and greater economies of scale. That said, we don't expect meaningful leverage improvement as most of the carriers have reached or are approaching their leverage targets following several years of elevated capex to fund spectrum deployments. As such, we expect the carriers to allocate more money to shareholder returns. At the same time, telcos with dense fiber networks should benefit from increasing data demand associated with AI, although this could result in higher capex. 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 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 asset-backed securities, to fund their fiber builds. |
| Transportation | Our transportation outlook is generally mixed. For airlines, we expect passenger growth to remain positive amid still solid demand that should support earnings and cash flow growth across the sector, and further deleveraging. However, the recent emergence of slower-than-expected bookings reported by several airlines amid macro-economic uncertainty has introduced potential downside to our passenger demand expectations for the year. In addition, we continue to expect the historically lower-cost airlines to continue to face margin pressure. Cost inflation is a key culprit, alongside comparatively limited exposure to outsized growth in premium, international and loyalty sales relative to the network carriers. For railroads, our outlook is generally unchanged, and we assume ratings to remain stable. Tariffs present a potential headwind to freight volumes, but not to an extent that materially affects our cash flow estimates. We continue to assume adherence to well-established financial policies, and expect railroad issuers would temper share repurchases, if necessary, to limit downside to credit measures. For package express companies, strategic initiatives announced by the larger players have introduced a degree of uncertainty to their prospective earnings, but not to an extent that affects our stable ratings outlook. On the other hand, excess trucking capacity has persisted much longer than we had previously anticipated, and any tangible improvement in prices from low levels is unlikely before the latter part of this year. We believe this is required to materially boost trucking and logistics provider revenues and earnings, and the outlook for this segment of the industry remains negative. |
| Unregulated (merchant) power | Demand surge expectations from data centers, electrification, and other large loads (onshoring of manufacturing), and hydrogen production has lifted power, especially for 2026-2027. Power prices in regions like Texas are $10-12/MWh higher for 2027 compared with what they were in 2024. We expect volatility to be higher, and regions like PJM and ERCOT 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. We see the current phase of tariff uncertainty as broadly unfavorable, especially for the competitive renewable sector's credit quality. While a slowdown affects equity valuations more, it would eventually affect credit quality in the form of reduced EBITDA, or from an increase in the cost of debt for companies refinancing. For some companies we don't see a slowdown as necessarily unfavorable. In order to claim bonus credits allowed by the IRA, many companies have elevated capital spending without concomitant equity financing. That had resulted in a deterioration in financial thresholds. For these companies, a slowdown would improve financials measures. |

# Appendix 2: Economic Data and Forecast Summaries

Table 5

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

| | 2024 | 2025f | 2026f | 2027f | 2028f |
|---|---|---|---|---|---|
| Real GDP (year % ch.) | 2.8 | 1.9 | 1.9 | 2.2 | 1.8 |
| Real consumer spending (year % ch.) | 2.8 | 2.6 | 2.1 | 2.4 | 2.5 |
| Real equipment investment (year % ch.) | 3.3 | 2.3 | 4.3 | 4.6 | 4.0 |
| Real nonresidential construction (year % ch.) | 3.4 | 0.6 | 2.8 | 1.6 | 1.2 |
| Real intellectual property investment (year % ch.) | 3.9 | 2.1 | 1.2 | 1.4 | 2.2 |
| Real residential construction (year % ch.) | 4.2 | 0.8 | 0.1 | 2.3 | 1.9 |
| Consumer price index (year % ch.) | 3.0 | 2.8 | 2.2 | 2.3 | 1.7 |
| Core CPI (year % ch.) | 3.4 | 3.3 | 2.7 | 2.3 | 2.3 |
| Unemployment rate (%) | 4.0 | 4.3 | 4.5 | 4.1 | 4.0 |
| Housing starts (annual total in mil.) | 1.37 | 1.37 | 1.38 | 1.39 | 1.44 |
| Federal funds rate (%) | 5.1 | 4.3 | 3.6 | 3.2 | 3.1 |
| 10-year Treasury note yield (%) | 4.2 | 4.2 | 3.6 | 3.6 | 3.7 |

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

| | 2024 | 2025f | 2026f | 2027f | 2028f |
|---|---|---|---|---|---|
| Real GDP (year % ch.) | 1.5 | 1.7 | 1.9 | 2.1 | 1.8 |
| Real consumer spending (year % ch.) | 2.4 | 2.3 | 2.0 | 2.1 | 2.0 |
| Real nonresidential fixed investment (year % ch.) | (1.9) | (1.7) | 0.6 | 1.6 | 1.2 |
| Real residential investment (year % ch.) | (1.1) | 3.1 | 2.3 | 2.4 | 1.4 |
| Consumer price index (year % ch.) | 2.4 | 2.2 | 1.9 | 1.9 | 2.1 |
| Core CPI (year % ch.) | 2.6 | 2.7 | 2.1 | 2.1 | 2.1 |
| Unemployment rate (%) | 6.4 | 6.8 | 6.5 | 6.0 | 5.9 |
| Housing starts (annual total in thousand) | 245.5 | 218.0 | 213.7 | 216.3 | 213.6 |
| Bank of Canada policy rate (% year-end) | 3.2 | 2.0 | 2.3 | 2.8 | 2.8 |
| Government of Canada 10-year bond yield (%) | 3.3 | 2.8 | 2.9 | 2.8 | 2.9 |
| CAD/USD exchange rate (per US$1, period average) | 1.37 | 1.44 | 1.41 | 1.35 | 1.30 |

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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