

Credit Conditions Asia-Pacific:

Return Of Uncertainty

June 27, 2019

Key Takeaways

- **Overall:** The Fed's more dovish tone on interest rates and China's recent loosening of lending have eased conditions. Yet, economic growth remains soft and macro risks persist.
- **What's changed:** Investor sentiment is tilting more cautious amid heightened geopolitical stress and slower economic growth.
- **Risks and imbalances:** The greatest near-term risk is the strategic conflict between the U.S. and China, with its attendant impact on markets. Other top risks include corporate refinancing and market liquidity, property repricing, and China's debt leverage.
- **Financing conditions:** Headwinds appear to have returned sooner than expected. Interest spreads could well rise, despite low official rates, should investor sentiment sour.
- **Macroeconomic conditions:** The cyclical slowdown in Asia-Pacific trade stems from dampened demand growth across major economies; this is curtailing GDP growth.
- **Sector themes:** Idiosyncratic factors are driving the continuing dichotomy in ratings bias trend between corporates (negative) and financial services and governments (positive).

(Editor's Note: S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions (Asia-Pacific, Latin America, North America, and Europe, the Middle East, and Africa). 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 Asia-Pacific committee on June 24, 2019.)

Uncertainty has returned to Asia-Pacific's credit conditions. The year started optimistically on the back of the Federal Reserve's reversal of its tightening stance and Chinese authorities' willingness to loosen credit supply (albeit carefully) to avoid a rapid economic deceleration. However, the recent increases of tariffs by first the U.S. and then China has shaken investors' confidence.

Financing conditions. Conditions in Emerging Asia had eased in the first quarter of 2019 and were expected to continue until, as mentioned, the trade dispute increased lenders' worries.

Economic conditions. Investment growth across Asia-Pacific's trade-dependent economies including Korea, Malaysia, and Singapore, has fallen to a seven-year low. For China, investment in technology-related manufacturing is expanding at its lowest level since at least 2004 (just to clarify: investment is still growing, yes, but at slower pace).

Sector trends. Last quarter's divergence in ratings momentum has continued for the two broad sectors of nonfinancial corporates versus government and financial services. The net rating outlook bias was positive 1.4% in May 2019 up from 0.5% (amended) in February 2019. Nonfinancial corporates are at -4%, slightly improved from the previous -5%. For financial institutions, the bias has moved to a positive 6%. For insurance entities, up to positive 7%. The positive net bias for international public finance is down slightly to 18%. For sovereign, it fell to 9%.

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Credit Conditions Asia-Pacific:

Table 1 lists our top Asia-Pacific risks.

Table 1

Top Asia-Pacific Risks

Trade and strategic confrontation

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

The world's multilateral trade framework has been shaken by unilateral policy changes. In the crucial U.S.-China relationship, friction has broadened from tariffs to protectionism, including export restrictions, with a focus on technology. Prospects for a quick resolution have dimmed as the two sides remain far apart on key issues such as market access and a level playing field. Prolonged global tensions affect investment and long-term growth.

Corporate refinancing squeeze

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

With central banks poised to hold or even lower official interest rates, overall financing conditions have eased. That said, while larger and financially stronger companies benefit, smaller and less strong companies may find it challenging to refinance or access funding. Indeed, in some parts of the market, liquidity may be tight and credit spreads high.

Property valuation correction

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

There is a lot of variation among property price trends across Asia-Pacific countries. Steady or lower official interest rates should help sustain prices, but a worse-than-expected economic slowdown or weaker consumer and investor sentiment could push property prices sharply down.

China's leverage

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

Our base case is for China's debt growth to ease. This reflects the Chinese government's desire to deleverage (but on a debt-to-asset basis) its economy. To avoid a rapid economic slowdown, however, the government has allowed some credit loosening. The downside risk of a credit growth spike, compounding the existing debt overhang, therefore remains.

Commodity and currency volatility

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

As expected, some commodities (such as iron ore and oil) have experienced volatility recently. Meanwhile many Asia-Pacific currencies, including the Chinese renminbi, have depreciated against the US\$. The depreciation has been orderly. Concerns about economic growth and trade flows, or the potential for market repricing of Fed funds rate expectations, could heighten pressure.

Technology disruption and cybersecurity

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

An increasing dependency on constantly changing technology exposes countries, network systems, and issuers to competitive obsolescence and cyber risk. An example of key payment systems is found in China. The country has the highest e-commerce penetration globally. Companies face the risk of criminal, proxy, and direct state-sponsored cyber-attacks. The relative creditworthiness of issuers is exposed to evolving technology risks.

Sources: S&P Global Ratings.

* **Risk levels** may be classified as very low, moderate, elevated, high, or very high, and 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 on whether the risk level could increase or decrease over the next 12-months.

Regional Credit Conditions

U.S.-China dispute casts big shadow

What's changed?

Credit conditions are uncertain. Despite momentum from easing financing conditions earlier this year, the escalating U.S.-China trade dispute has shaken investor sentiment. Against a backdrop of slowing macroeconomic conditions, the rating trend of issuers is largely moving sideways.

Credit conditions are uncertain.

Assessment of key risks

Our top Asia-Pacific risks substantially overlap with our top global risks.

1. Trade and strategic confrontation (high, worsening)

A secular risk. The world's multilateral trade framework has been shaken by key-country unilateral policy changes. In the crucial U.S.-China relationship, friction has broadened from tariffs (see chart 1) to protectionism, including export restrictions, with a focus on technology. Prospects for a quick resolution have dimmed as the two sides remain far apart on key issues such as market access and a level playing field. Middle East geopolitical tensions pose a risk given Asia's high reliance on imported energy. Prolonged global tensions impact investment and long-term growth.

2. Corporate refinancing squeeze (high, unchanged)

A cyclical risk. With central banks poised to hold or even lower official interest rates, overall financing conditions have eased. That said, while larger and financially stronger companies benefit, smaller and less strong companies may find it challenging to refinance or access funding. Indeed, in some parts of the market, liquidity may be tight and credit spreads high. (e.g., China, see chart 2).

3. Property valuation correction (high, unchanged)

A cyclical risk. There is a lot of variation among property price trends across Asia-Pacific countries (see chart 3). While steady or lower official interest rates should help sustain prices, a worse-than-expected economic slowdown or weaker consumer and investor sentiment could push property prices sharply down.

4. China's leverage (elevated, unchanged)

A secular risk. Our base case is for China's debt growth to ease. This reflects the Chinese government's desire to deleverage (but on a debt-to-asset basis) its economy. To avoid a rapid economic slowdown, however, authorities have allowed some credit loosening. The downside risk of a credit growth spike, compounding the existing debt overhang, therefore remains.

5. Commodity and currency volatility (elevated, unchanged)

A cyclical risk. As expected, some commodities (such as iron ore and oil) have experienced volatility recently (see chart 5). Meanwhile many Asia-Pacific currencies, including the Chinese renminbi, have depreciated against the U.S. dollar. Thus far, the depreciation has been orderly. However, concerns about regional economic growth and trade flows, or the potential for market repricing of Fed funds rate expectations, could heighten pressure.

6. Technology disruption and cybersecurity (elevated, unchanged)

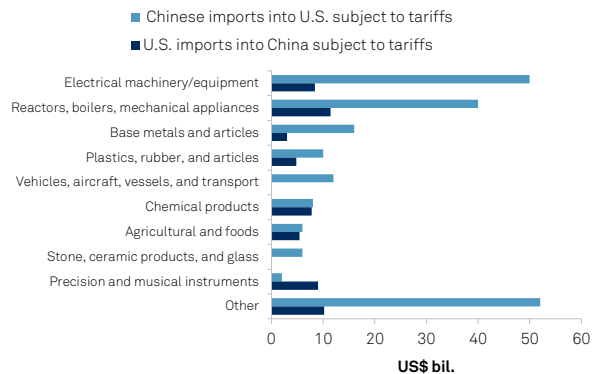
A secular risk. An increasing dependency on constantly changing technology exposes countries, network systems, and issuers to competitive obsolescence and cyber risk. An example of key payments systems is in China. The country has the highest e-commerce penetration globally (see chart 6). Companies face the risk of criminal, proxy, and direct state-sponsored cyber-attacks. The relative creditworthiness of issuers is exposed to evolving technology risks.

Credit Conditions Asia-Pacific:

Chart 1

U.S.-China Trade Dispute Escalates

U.S. raised tariffs on \$200 billion of imports, China on \$60 billion

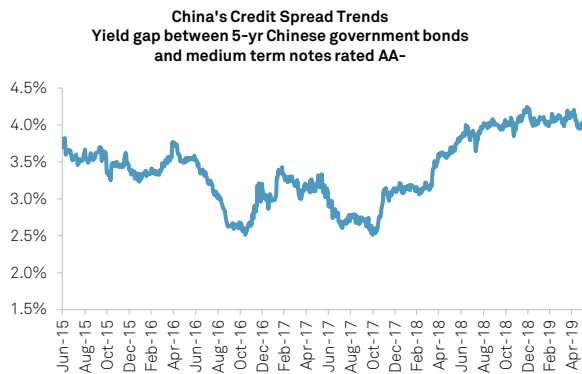


Based on 2018 trade activities. Source: China's Ministry of Finance, U.S. International Trade Commission Dataweb, U.S. Trade Representative Office, S&P Global Ratings.

Chart 2

China Credit Spread Trends

Funding conditions have generally eased but not for all

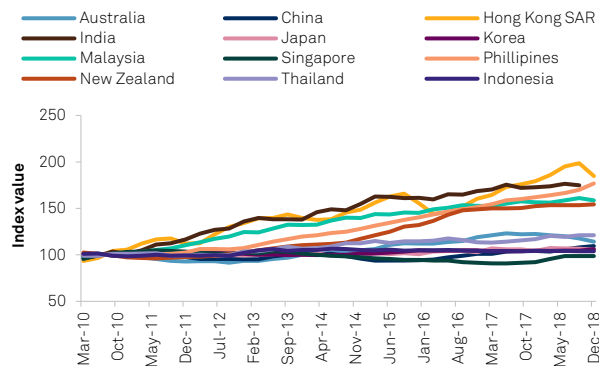


Source: CEIC, S&P Global Ratings.

Chart 3

Asia-Pacific Residential Property Price Indices

Steady interest rates may support some prices

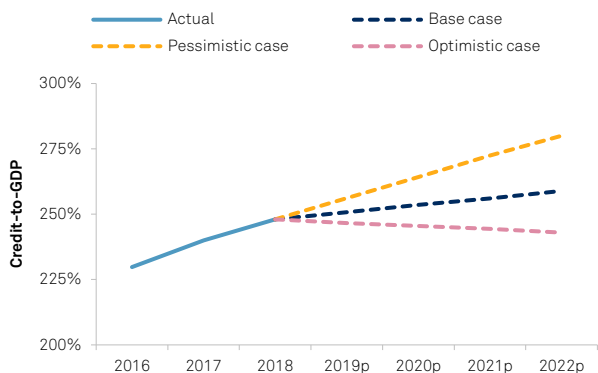


SAR--Special Administrative Region. Source: Bank for International Settlements.

Chart 4

China Debt Growth Trajectory To Ease

But pessimistic case is for historical trend to continue

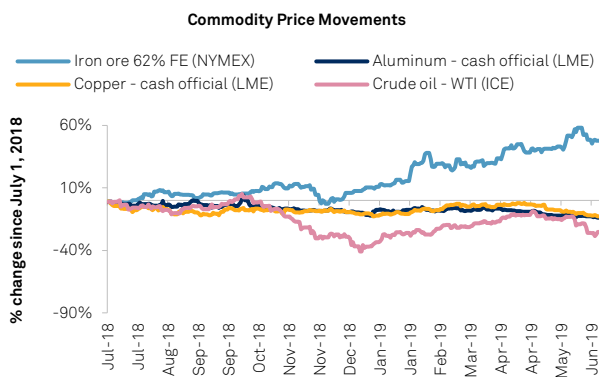


p--projected. Source: S&P Capital IQ.

Chart 5

Commodity Prices Exposed To Slower Economic Growth

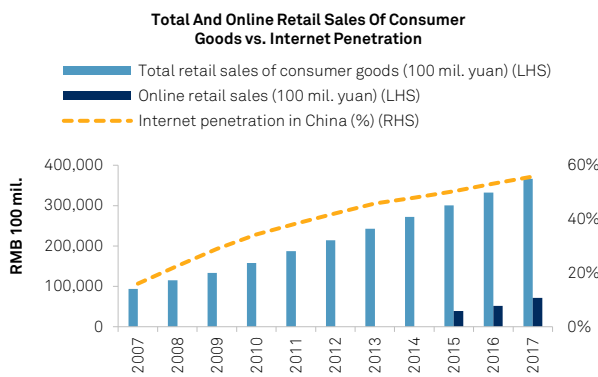
Iron ore and oil prices ease



NYMEX--New York Mercantile Exchange. LME--London Metal Exchange. WTI--West Texas Intermediate. ICE--Intercontinental Exchange. Source: S&P Capital IQ.

Chart 6

Increased e-Payment Usage Highlights Cyber Risk



Mil.--million. RMB--Renminbi. Source: China Internet Network Information Centre, National Bureau of Statistics of China.

Financing Conditions

Was easing but now uncertain

What's changed?

Easing momentum uncertain. Financing conditions in Emerging Asia had eased in the first quarter and were expected to continue (see chart 7) but the U.S.-China trade dispute has increased investor worries.

Key assumptions

Hiatus in easing. Financing conditions for emerging markets overall had improved in early 2019 relative to last year. The Institute of International Finance (IIF) emerging markets overall index value increased to 49.4 for Q2 2019 compared with 48.1 the previous quarter. In IIF's latest report, survey respondents had expected the lending conditions to continue to improve for Q2 2019. But it appears that this expectation may have been optimistic.

Key risks

Lending conditions. Although the demand for loans and funding conditions showed modest improvements, credit standards, nonperforming loans and trade finance deteriorated compared with the previous quarter. These are some of the risks that might continue for the rest of the quarter.

Economic slowdown. Economic growth projections continue to be revised slowly downward, and potential disruptors to financial markets remain unresolved while the U.S.-China trade dispute, adding uncertainty to the economies around the globe.

What to look for

Increase in issuance growth. Corporate bond issuance in APAC will likely grow in 2019. Through May this year, a total of \$603.8 billion came to market, exceeding the record high of \$584.1 billion issued in 2016 through May. This represents growth of 5.8% from the \$570.6 billion total in the same period of 2018, on track for strong issuance growth in the region through the remainder of this year, despite the aforementioned risks (see chart 8, see "Over \$1.1 Trillion In Asia-Pacific Corporate Debt Is Set To Mature Through 2023", June 10, 2019). S&P Global Fixed Income Research expects this year's global bond issuance to increase marginally over the 2018 total, by 1.2% (see "Global Financing Conditions: Bond Issuance Is Expected To Expand 1.2% In 2019" April 29, 2019).

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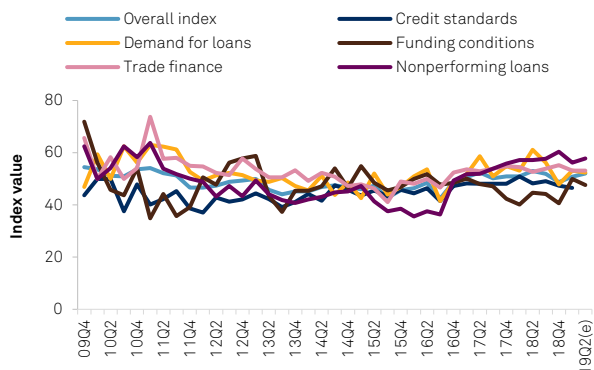
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The U.S.-China trade dispute has increased investor worries.

Chart 7

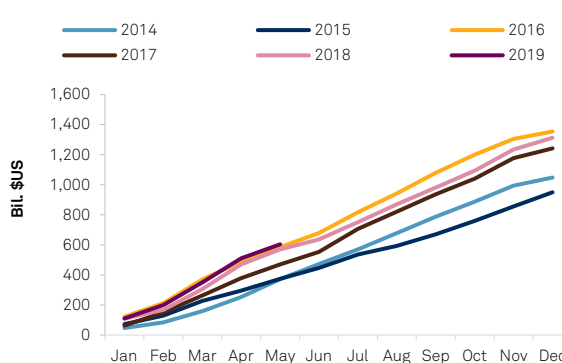
IIF Emerging Market Asia's Bank Lending Conditions Indices



Q--quarter. e--estimated. Source: Institute of International Finance. S&P Global. Data as of April 2019. Note: EMA-Emerging market Asia. Values below 50 indicate a tightening in bank lending conditions and values above 50 indicate easing.

Chart 8

Asia-Pacific's Cumulative New Corporate Bond Issuance



Data as of May 31, 2019. Source: S&P Global Fixed Income Research; Thomson Reuters.

Macroeconomic Outlook

Trade Tension Risks Materializing

(Editor's Note: The views expressed in this section are those of S&P Global Ratings' economics team. While these views can help to inform the rating process, sovereign and other ratings are based on the decisions of ratings committees, exercising their analytical judgment in accordance with publicly available ratings criteria.)

What's changed?

Trade frictions and policy uncertainty impacting growth. U.S.-China friction has intensified and signs are emerging that resulting policy uncertainty is weighing on capital expenditure (capex) and growth in China and across Asia-Pacific. As expectations build that major central banks may ease, some policymakers in the region have loosened policies.

Key assumptions

Stalemate in U.S.-China relationship. The politics are unpredictable but we expect bilateral tariffs to be at current levels for some time and a restrictive environment for investment and technology relationships. Global trade slowdown to persist, compounded by soft investment growth.

Global financial conditions to remain supportive. We now expect major central banks to either ease slightly (the Fed) or keep policies unchanged (the ECB). This will provide room for policymakers in Asia-Pacific to reduce interest rates and keep them low.

China's policy easing to stabilize growth by mid-year. Financial conditions are now firmly in easing territory and are filtering through to the real economy. This careful easing should be enough to put a soft floor under growth later this year.

Key risks

Escalating protectionism. A further round of U.S.-China tariff hikes or non-tariff barriers, including export controls, would undermine confidence and investment. Protectionism may spread to global sectors, including autos with a potentially large impact in Asia-Pacific.

A deep investment-led slowdown. Capex has softened especially in more trade-dependent economies and in Chinese sectors exposed to trade friction. Even if protectionism remains steady, lingering uncertainty may encourage firms to delay investment plans.

What to look for

Will global financial conditions offset the emerging impact of trade tension on investment? If the investment downturn deepens, the extent to which easier financial conditions provide space in the region for monetary and fiscal policies to lift demand will be key to the overall impact on growth.

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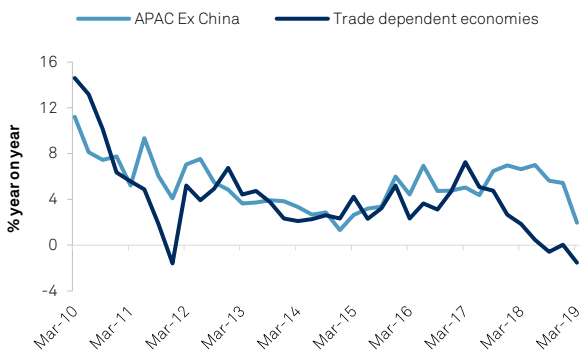
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Trade friction and policy uncertainty are weighing on capex and growth across Asia-Pacific.

Chart 9

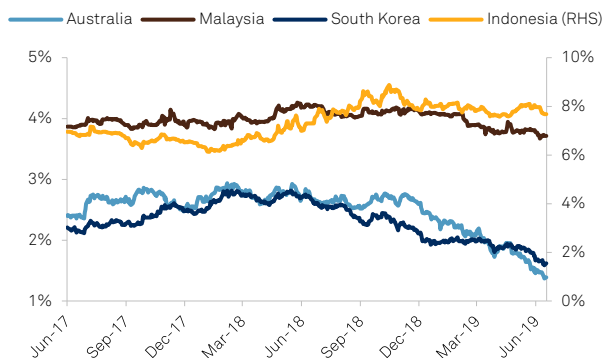
Asia-Pacific Real Investment Growth Slowed



Source: CEIC and S&P Global Economics.

Chart 10

Long Term Yields Have Fallen



Source: Bloomberg.

Sector Trends

Ratings largely treading water

Last quarter's divergence in ratings momentum in Asia-Pacific for the two broad sectors of nonfinancial corporates versus government and financial services has continued into this quarter. (see chart 11). The net rating outlook bias was positive 1.4% in May 2019 slightly up from +0.5% in February 2019.

Nonfinancial corporates are at -4%, slightly improved from previous -5%. For financial institutions, the bias has moved to a positive 6%. For insurance entities, up to positive 7%. The positive net biases for international public finance is down slightly to 18%. For sovereign, it went down by almost half to 9%.

What's changed?

Generally steady. While there are changes within sectors, the net rating bias (-4%) for nonfinancial corporates slightly up on -5% last quarter. This is a similar story for governments and financials, whose combined net bias rose to +8% from +7%

Key assumptions

Capex holds up. We assume steady, albeit slower, economic growth and continued capital spending to hold up operating conditions.

Key risks

Trade, liquidity, credit cycle. The U.S.-China trade dispute; currency, interest and liquidity risks, and a potential turn in the global credit cycle remain the main risks.

What to look for

Confidence, refinancing risk. Softening business and consumer confidence could affect demand, and tightening lending conditions may undermine issuers' ability to manage refinancing risks.

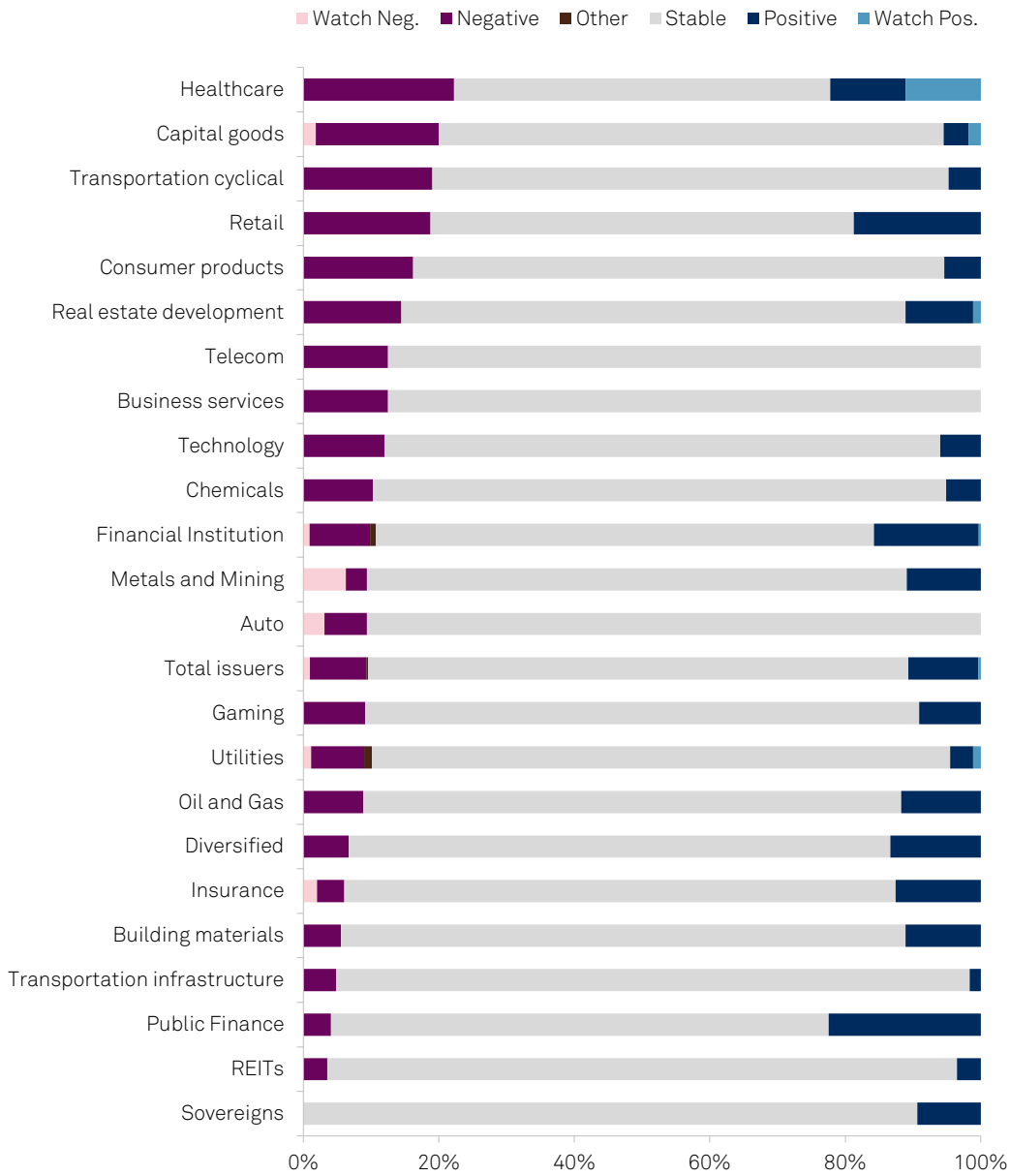
(We calculate the net rating bias by deducting the percentage of negative outlooks and CreditWatch listings against the percentage of positive outlooks and CreditWatch listings. A minus figure indicates that the former exceeds the latter; and a positive figure, vice versa.)

The overall rating outlook trend is flat.

Credit Conditions Asia-Pacific:

Chart 11

Net Outlook Bias Distribution Of Asia-Pacific Issuers By Sector, May 31, 2019



REITs--real estate investment trusts. Source: S&P Global Ratings.

Nonfinancial Corporates

Slower growth, uncertain demand

- Rising demand uncertainty and competitive pressures indicate a worsening outlook for many industries despite somewhat supportive, albeit slower, economic growth.
- Some real estate developers could be vulnerable to a liquidity crunch scenario in view of a spike in maturities for 2019-2020.
- The weakening likelihood of extraordinary support from China's local governments for their financing arms indicates a higher risk of default in this subsector.

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What's changed?

Slowing growth. Uncertainty in demand growth for many industries such as auto, building materials, capital goods, consumer products, real estate development, retail, and technology is becoming more evident.

Key assumptions

Moderate sales. Possibly lower growth in auto, capital goods, food staples, real estate development, retail, and technology. Some growth is likely in cosmetics, sportswear, and healthcare, and telecommunications, and prices may be more stable for metals and mining.

Mixed capex. For auto, new technology costs may be needed. Capex would be lower for capital goods; stable-to-mixed for metals and utilities; and higher for chemicals and transportation infrastructure.

Key risks

Demand decline. Further slowdown in demand (for example, if China's GDP growth is below expectations) would compound the challenge facing corporates in Asia-Pacific.

Trade tariffs. Potential imposition of trade tariffs could affect trade flows and the import and export activities of regional businesses, e.g. automakers.

Liquidity. Should financing conditions tighten again, this could trigger a lender pullback for more leveraged issuers. Currency volatility remains a risk factor.

If the credit cycle turns. An abrupt credit cycle downturn would constrain issuers' ability to refinance.

What to look for

Business confidence. China continues to be the growth engine for Asia-Pacific economies and commodities. Any economic shock emanating from China or other major economies would dampen business and consumer confidence.

Financial conditions. Some industries will need to fund their capex (e.g. telecommunications' 5G rollout) and some corporates, mergers and acquisitions (M&A). A market shutdown in Asia-Pacific, as occurred for U.S. speculative grade debt in Q4 2018, would have a ripple effect.

For many industries, demand growth is uncertain.

Financial Institutions

Positive trend driven by Japan sovereign

- Most ratings outlooks are stable. The regional net positive outlook bias is driven by the positive outlook on the Japanese sovereign on Japanese banks. But for this, the regional outlook bias would be -4%.
- High private sector debt and elevated asset prices pose threats.
- A point of contrast with Western Europe and the U.S, is that systemically-important banks in most Asia-Pacific jurisdictions should be beneficiaries of extraordinary government support, if ever required.

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What's changed?

GDP growth slowing. Our outlook has not significantly changed over the past quarter. Improving sovereign creditworthiness in Japan is skewing the net rating outlook bias on banks to + 6%. Except for this factor, it would be -4%. Banks' stand-alone credit factors across the region are relatively stable.

High private sector debt and elevated asset prices pose threats.

Key assumptions

Manageable macroeconomic conditions .The cyclical downturn in Asia-Pacific trade continues to be manageable, at current rating levels, for the majority of Asia-Pacific financial institutions.

Governments remain supportive. We don't expect a significant weakening of government support for systemically-important banks in Asia-Pacific, over the short- to medium-term.

Key risks

High debt, high prices. Debt levels and asset prices remain relatively high amid a protracted low interest rate environment. These factors set the stage for a potential deterioration in credit quality, especially if a sharp correction in asset prices and a pullback in market liquidity were to occur.

If the credit cycle turns. A significant and abrupt credit cycle downturn would likely result in negative ratings momentum for some Asia-Pacific financial institutions. We expect, however, that most banks can weather a moderate and less-abrupt downside scenario outside our base case at current rating levels.

What to look for

Asset quality, capital, and earnings stable. Aside from India, nonperforming loans (NPLs) should remain relatively low at or about current levels in most Asia-Pacific jurisdictions in 2019. Earnings and capital should continue to remain generally supportive of ratings at current levels.

Insurance

Market volatility To Dent Profits, Not Financial Strength

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- Forex and investment market volatility could dent insurers' profitability.
- Evolving regulatory and accounting frameworks may alter business and capital management strategies.
- U.S.-China trade tensions present both risks and opportunities for Asia-Pacific insurers.

What's changed?

Increasing market volatility. Higher equity market volatility following the reigniting of the U.S.-China trade dispute will likely dent profits for some insurers. Foreign exchange volatility may affect insurers (Taiwan, Japan, and Korea) with sizable overseas investment exposure. The build-up of retained earnings and moderate guarantees on liabilities over the past few years should help weather the volatilities.

U.S.-China trade tensions. While the fundamental demand for insurance remains strong given still-low penetration in the region, slower economic activity may reduce demand for marine cargo and trade credit insurance. Recent tax-deduction measures by the Chinese government will position the wider insurance sector for faster growth as insurers share tax savings with policyholders through improved affordability and yield.

Market volatility could undermine investment performance.

Key assumptions

Capital buffers. Built-up retained earnings and moderate guarantees on liabilities had shored up capital buffers to absorb recent investment market volatility. Available underwriting capacity and absence of a major catastrophe are keeping premium rates low for property and casualty insurers and reinsurers. Higher acquisition and compliance costs may dent profits.

Asset growth. Further strong growth in assets at life insurers increases credit risk exposures. In China, insurers' widening role in supporting equity capital markets and banks' perpetual bonds present downside credit prospects. The higher correlation between insurers and banks increases sensitivity to economic risks.

Key risks

Offshore investment. Insurers' pursuit of more-aggressive strategies for overseas investments exposes them to greater balance-sheet volatility. Those with unhedged offshore investments will see potential foreign-exchange (forex) fluctuations and lower-than-expected investment yields. Amid low interest rates and volatile EM forex markets, hedging costs are likely to rise.

Non-modeled risks. Ongoing urbanization and changing weather patterns will require insurers to revisit their pricing assumptions on catastrophes (natural and man-made). This could impact their reinsurance arrangements

Regulatory changes. Evolving regulatory developments may lead to changing business and investment strategies. The need to adapt to changing regulations will mean increasing compliance costs and human resources.

What to look for

Pick-up in investment markets volatility. Lower for longer interest rates could cut yields.

Public Finance

Fiscal expansion to heighten transition risks

- China's fiscal expansion highlights risks of budgetary performance and debt position for Chinese local and regional governments (LRGs).
- Australian LRGs' fiscal positions are weakening as consumption and transaction based taxes soften. Further, ramped-up government infrastructure spending is driving debt to record levels.
- Slower economic growth prospects pose the main risk.

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What's changed?

High positive ratings bias turning down. The positive ratings bias remains in place, mainly driven by positive outlook on sovereign ratings for New Zealand and Japan, however is less than before due to rising leverage risks by some LRGs, especially in China.

China's public investment yet to revive. China's public investment growth remained subdued regardless of the authority's increased loosening in monetary policies and accelerating fiscal expansion.

Key assumptions

Chinese LRGs issuance on rise. Chinese LRGs will continue to expand new bond issuance for refinancing and new investment. At the same time, central authorities will control LRGs' overall debt burden by limiting further extensions of off-budgeting borrowings. Public investment growth hence will remain modest only.

Most Australian states to increase borrowing. Record infrastructure spending plans will hike borrowing needs, especially as taxation revenue slows. Weaker domestic conditions are reducing the growth in goods and services taxes, while falling property prices are leading to conveyance duty writedowns. New accounting standards are resulting in operating leases being recognized as debt.

Key risks

Revenue pressure. China's central government has reduced taxes and social-security contributions for fiscal 2019. If the central government does not provide sufficient offset, some LRGs may face greater budgetary stress or more volatility in balances.

Off-balance sheet borrowing could rekindle. If economic growth decelerates rapidly, China may allow for local government off-balance sheet borrowing to take off sharply again, resulting in weaker transparency and another expansion in the debt burden for the LRG sector.

If the credit cycle turns. Tighter credit conditions such as driven by U.S.-China trade tensions could weigh on economic growth and LRGs' fiscal metrics.

What to look for

Policy shifts if growth weakens. Should economic performance weaken more than we expected, the responses of local governments could materially affect longer term credit trends in the LRG sector. Possible scenarios include rising debt from more infrastructure investment and heightened contingent liabilities risks if capital markets weaken.

Infrastructure spending to rise amid economic slowdown.

Sovereign

Trade tension risks back to the fore

- Risks to credit metrics from international trade tensions and abrupt capital flow reversals have rebounded with the latest turn in the U.S.-China trade negotiations.
- Risks to economic and fiscal performances could increase if global economic growth slips much more than we expect.
- Results of elections in key countries point to policy continuity.

What's changed?

Trade risks return. The threat of U.S. tariffs covering almost all Chinese imports has risen as trade talks between the U.S. and China took a turn for the worse. New sanctions on China's largest mobile phone manufacturer further complicate bilateral relations between the world's two most important economies, with potential disruptions for global trade flows.

Investor outlooks on emerging market weaken. The higher tariffs on Chinese imports into the U.S. has increased uncertainty for U.S. interest rate trends and growth in emerging markets.

Elections have bolstered the likelihood of policy stability in key countries. Elections in Indonesia and India returned incumbents to power while the Philippines ballot appeared to have cemented support for the current administration. We expect these results to lead to continuity in the policy environments in these countries.

Key assumptions

Impact of trade actions will not derail growth in major economies. Despite the intensifying U.S.-China trade tensions, the economic slowdown in key economies in the Asia-Pacific will be moderate. Stimulus measures undertaken by governments to offset the associated pressures will not materially weaken credit metrics.

Policy responses to capital flows. Policy responses and external support will continue to support international investor confidence by those sovereigns more sensitive to global capital flows. In some cases, we expect IMF programs to underpin the policy settings where sovereigns have agreed to receive support from the institution.

Key risks

Sudden capital swings possible. Expectations of rising interest rates and changes in international and domestic politics could still trigger investor risk aversion. Abrupt capital flow reversals remain a risk.

China's deleveraging could reverse. If the U.S.-Sino talks fail and economic pressures on China mount further, China's deleveraging policy could reverse. Sovereign credit support for the government is likely to weaken due to growing risks of financial instability.

What to look for

Geopolitical and economic risks. The recent increase in tensions in the Middle East has the potential for souring international investor sentiment and poses a risk to energy prices. The impact of this standoff may also have implications on North Korea's attitude toward further negotiations.

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**Worsening U.S.-
China economic
relations increase
risks.**

Structured Finance

Slowing conditions, subdued credit elevate risks

- China's continued macro and industry issues won't materially affect securitization performance of retail assets.
- Softening economic conditions in Australia are putting some pressure on debt serviceability.
- Stable employment in major securitization markets will keep arrears and defaults low.

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What's changed?

Slowing economic growth in Australia. Softer economic conditions including slower wage growth and high household debt are elevating arrears, albeit from low levels.

Increased refinancing pressure. Tighter lending conditions due to regulatory measures are affecting the refinancing prospects of borrowers with weaker credit profiles. Australian regulators have proposed to remove the reference to specific interest-rate floors used in debt serviceability calculations.

Policy easing helps address imminent challenges in corporate China, but the renewed trade conflict reintroduces uncertainty. Continued policy easing in funding costs and availability have reduced the risk of more corporate defaults in China's private sector, and brought back some important industrial performance numbers lowering the likelihood of loan performance deterioration. However, renewed concerns over trade conflict cast doubt on the market stability in 2019.

Softening macroeconomic conditions have put some pressure on arrears.

Key assumptions

Stable employment. Ratings performance should remain largely stable, given relatively steady employment and economic growth, albeit at lower than expected levels.

Key risks

Debt serviceability pressures. Rising arrears, and reduced credit availability, combined with property price declines may put pressure on sub-investment grade tranches of some Australian residential mortgage-backed securities (RMBS) transactions. While overall the portfolio characteristics are strong, some borrowers with higher loan-to-value (LVRs) and less seasoning will have less ability to self-manage out of arrears.

Planned consumption tax increase. Japan's planned consumption tax increase in October 2019 (to 10% from 8%) could affect economic conditions.

If the credit cycle turns. Should economic conditions worsen, unemployment and mortgage defaults could rise across the region.

What to look for

China's macro slowdown and trade conflict. Slowing growth in China could hit employment, potentially worsening loan performance. Still, a highly diversified obligors' profile and the accumulation of credit enhancement levels with fast paydown of loans will underpin stable performance across Asia-Pacific's structured finance transactions.

Related Research

- Economic Research: APAC Economic Snapshots, June, 2019
- Credit Trends: Over \$1.1 Trillion In Asia-Pacific Corporate Debt Is Set To Mature Through 2023, June 10, 2019
- Credit Trends: Global Financing Conditions: Bond Issuance Is Expected To Expand 1.2% In 2019, April 29, 2019

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Appendix 1: Ratings trends

Table 2

Net Rating Bias Of Asia-Pacific Issuers By Sector, May 31, 2019

	Feb. 2018	May 2018	Aug. 2018	Oct. 2018	Feb. 2019	As of 31 May 2019	No. of entities	Notional average rating
Auto OEM and suppliers	-14%	-17%	-17%	-6%	-6%	-9%	32	BBB
Building materials	23%	13%	20%	14%	0%	6%	18	BB+
Business services	0%	0%	-9%	-9%	-8%	-13%	16	BB
Capital goods	-2%	-2%	-5%	-11%	-12%	-15%	55	BBB-
Chemicals	19%	23%	9%	2%	-3%	-5%	39	BBB-
Consumer products	0%	-3%	-5%	-5%	-11%	-11%	37	BBB-
Diversified	8%	8%	7%	0%	0%	7%	15	BBB+
Gaming, media and entertainment	-4%	0%	8%	8%	0%	0%	22	BB+
Healthcare	-38%	-14%	-13%	-11%	0%	0%	9	BB
Investment Company	0%	0%	0%	0%	0%	0%	11	BBB+
Metals and mining	2%	2%	-2%	-3%	-3%	2%	64	BB+
Oil and gas	0%	0%	-6%	-3%	-6%	3%	34	BBB+
Project finance	0%	0%	0%	0%	0%	0%	0	--
Real estate development	-11%	-5%	-3%	-4%	-5%	-3%	90	BB-
Real estate investment trusts	-2%	-2%	-5%	-2%	-4%	0%	57	A-
Retail	-5%	0%	6%	0%	6%	0%	16	BBB-
Technology	0%	-2%	-4%	-6%	-13%	-6%	50	BBB-
Telecommunications	-9%	-8%	-9%	-11%	-6%	-13%	32	BBB
Transportation cyclical	-5%	5%	5%	-4%	-14%	-14%	21	BBB-
Transportation infrastructure	0%	0%	0%	0%	0%	-3%	61	BBB+
Utilities	2%	5%	2%	-3%	-5%	-4%	90	BBB+
Total corporates	-1%	0%	-2%	-3%	-5%	-4%	769	BBB-
Financial Institutions	-10%	-6%	-3%	-2%	5%	6%	336	BBB+
Insurance	-8%	-3%	-1%	1%	3%	7%	199	A
Public Finance	-4%	3%	2%	6%	19%	18%	98	A+
Sovereign	-8%	7%	7%	10%	16%	9%	32	BBB+
Total issuers	-7%	-1%	-1%	-2%	1%	1%	1,434	BBB+

Light blue colored cells indicate improvement from prior period, navy blue deterioration.

Appendix 2: Economic data and forecast summaries

Table 3

Australia – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	2.8	2.2	2.5	2.6	2.7
CPI inflation %	1.9	1.5	1.9	1.9	2.1
Unemployment rate %	5.3	5.1	5.3	5.3	5.2
Policy rate %	1.50	1.25	1.00	1.00	1.25
Policy rate % (EOP)	1.50	1.00	1.00	1.00	1.25
Exchange rate (A\$ per US\$)	0.75	0.70	0.69	0.71	
Exchange rate (A\$ per US\$) EOP	0.72	0.68	0.70	0.71	

Source: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 4

China – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	6.6	6.2	6.2	5.8	5.5
CPI inflation %	2.1	2.1	2.0	2.2	2.0
Unemployment rate %	3.8	3.8	3.9	3.9	3.9
Exchange rate (per US\$)	6.61	6.91	7.04	6.97	
Exchange rate (per US\$) EOP	6.91	7.05	7.02	6.95	

Source: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 5

Hong Kong – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	3.0	2.2	2.4	2.5	2.5
CPI inflation %	2.4	2.0	2.0	2.2	2.0
Unemployment rate %	2.8	3.4	3.4	3.2	3.0
Exchange rate (per US\$)	7.84	7.84	7.82	7.80	
Exchange rate (per US\$) EOP	7.83	7.84	7.80	7.80	

Source: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Credit Conditions Asia-Pacific:

Table 6

India – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	6.8	7.1	7.4	7.6	7.7
CPI inflation %	3.4	3.8	4.5	4.5	4.5
Policy rate %	6.34	5.56	5.88	6.00	6.00
Policy rate % (EOP)	6.25	5.50	6.00	6.00	6.00
Exchange rate (per US\$)	69.92	70.53	71.25	72.94	
Exchange rate (per US\$) EOP	70.50	71.00	72.00	73.50	

Source: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values. Data for all years is for fiscal years. For India, 2017=FY2017-18, 2018=FY2018-19, 2019 = FY 2019-20, 2020 = FY 2020-21, 2021 = FY 2021-22.

Table 7

Indonesia – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	5.2	5.1	5.2	5.4	5.5
CPI inflation %	3.2	3.2	3.3	3.2	3.4
Unemployment rate %	5.2	5.1	5.2	5.0	4.6
Policy rate %	5.00	5.94	5.50	5.00	5.00
Policy rate % (EOP)	5.88	5.75	5.25	5.00	5.00
Exchange rate (per US\$)	14231	14314	14533	14274	
Exchange rate (per US\$) EOP	14780	14500	14437	14230	

Sources: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 8

Japan – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	0.8	0.8	0.1	1.2	0.9
CPI inflation %	1.0	0.9	2.1	1.7	1.2
Unemployment rate %	2.4	2.6	2.7	2.6	2.7
Policy rate %	(0.06)	(0.05)	(0.05)	(0.05)	(0.05)
Policy rate % (EOP)	(0.07)	(0.05)	(0.05)	(0.05)	(0.05)
Exchange rate (per US\$)	110.43	109.30	106.75	104.75	
Exchange rate (per US\$) EOP	112.75	108.00	106.00	104.00	

Sources: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 9

Malaysia – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	4.7	4.4	4.5	4.6	4.6
CPI Inflation %	1.0	1.0	1.9	2.0	2.1
Unemployment rate %	3.4	3.4	3.4	3.3	3.3
Policy rate %	3.23	2.94	2.75	2.75	2.75
Policy rate % (EOP)	3.25	2.75	2.75	2.75	2.75
Exchange rate (per US\$)	4.04	4.16	4.22	4.24	
Exchange rate (per US\$) EOP	4.17	4.21	4.22	4.24	

Source: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 10

New Zealand – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	2.8	2.5	2.7	2.7	2.7
CPI Inflation %	1.6	1.5	1.8	1.8	2.2
Unemployment rate %	4.3	4.2	4.2	4.2	4.2
Policy rate %	1.75	1.56	1.50	1.50	1.75
Policy rate % (EOP)	1.75	1.50	1.50	1.50	1.75
Exchange rate (per US\$)	0.69	0.67	0.67	0.68	
Exchange rate (per US\$) EOP	0.67	0.66	0.67	0.68	

Source: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 11

Philippines – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	6.2	6.1	6.4	6.6	6.7
CPI inflation %	5.2	3.0	3.2	3.4	3.7
Unemployment rate %	5.3	5.0	4.9	4.0	3.7
Policy rate %	3.64	4.44	3.69	3.50	3.50
Policy rate % (EOP)	4.62	4.00	3.50	3.50	3.50
Exchange rate (per US\$)	52.66	52.39	52.70	52.23	
Exchange rate (per US\$) EOP	53.20	52.60	52.60	52.00	

Source: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 12

Singapore – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	3.1	2.3	2.4	2.5	2.5
CPI inflation %	0.4	0.8	1.4	1.6	1.7
Unemployment rate %	2.1	2.2	2.2	2.1	2.0
Exchange rate (per US\$)	1.35	1.36	1.38	1.38	
Exchange rate (per US\$) EOP	1.37	1.37	1.38	1.37	

Sources: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 13

South Korea – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	2.7	2.0	2.6	2.6	2.7
CPI inflation %	1.5	1.1	1.5	1.5	1.8
Unemployment rate %	3.8	3.8	3.5	3.1	2.8
Policy rate %	1.52	1.63	1.50	1.63	2.00
Policy rate % (EOP)	1.58	1.50	1.50	1.75	2.00
Exchange rate (per US\$)	1100.16	1159.51	1155.25	1138.25	
Exchange rate (per US\$) EOP	1127.43	1165.00	1150.00	1135.00	

Source: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 14

Taiwan – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	2.6	2.0	2.0	2.4	2.4
CPI inflation %	1.3	0.9	1.2	1.3	1.5
Unemployment rate %	3.7	3.5	3.2	3.1	3.0
Policy rate %	1.38	1.38	1.38	1.38	1.38
Policy rate % (EOP)	1.38	1.38	1.38	1.38	1.38
Exchange rate (per US\$)	30.16	31.28	31.23	30.81	
Exchange rate (per US\$) EOP	30.86	31.40	31.10	30.70	

Sources: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Table 15

Thailand – S&P Global Ratings Economic Outlook

	2018	2019f	2020f	2021f	2022f
Real GDP %	4.1	3.5	3.5	3.6	3.5
CPI inflation %	1.1	0.7	1.4	1.6	1.6
Unemployment rate %	1.1	1.0	1.1	1.1	1.0
Policy rate %	1.51	1.69	1.50	1.50	1.50
Policy rate % (EOP)	1.53	1.50	1.50	1.50	1.50
Exchange rate (per US\$)	32.31	31.48	31.36	31.23	
Exchange rate (per US\$) EOP	32.81	31.40	31.33	31.15	

Sources: Oxford Economics; f: S&P Global Ratings forecast; End of Period - Q4 values.

Credit Conditions Asia-Pacific:

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