
# The Credit Outlook 1Q18

Link to Interactive Report

# Global Rating Outlooks Most Positive Since Crisis

**The prospect of rating upgrades outnumbering downgrades this year and next is higher than at any time since the financial crisis. But credit quality may start to weaken beyond this as ultra-supportive monetary policy is phased out and rising interest rates start to affect funding costs and asset quality.**

The rating outlook trend is the most upbeat in a decade, with positive outlooks outnumbering negatives. But the net bias is only just over 1% and occurs as the world is about to hit peak growth in the current cycle. The continued tightening of monetary policy, together with significant policy and political uncertainty, is likely to pose increasing challenges to ratings.

Global rating outlooks continue to improve. The average net outlook balance across all sectors globally turned positive for the first time since the financial crisis, at 1.1% as at 30 November 2017, up from -7.9% at the start of the year.

The trend is evident across sovereigns, corporates and financial institutions, with prospects brightening for developed and emerging markets alike. The outlook for structured finance has the most pronounced positive bias, at net 9%. Other sectors are largely experiencing rating stability, although there are pockets of rating pressure in some regions and certain subsectors.

The key drivers of the expected widespread improvement in credit quality are economic growth, still largely supportive monetary and fiscal policies, and more stable commodity prices. Fitch expects global growth to edge up to 3.3% in 2018, boosted by increased investment. However, beyond 2018 growth is likely to moderate, while monetary policy conditions will tighten.

The two main macro risks to ratings are the unwinding of quantitative easing and policy and political uncertainty, including from a heavy election cycle in emerging markets this year.

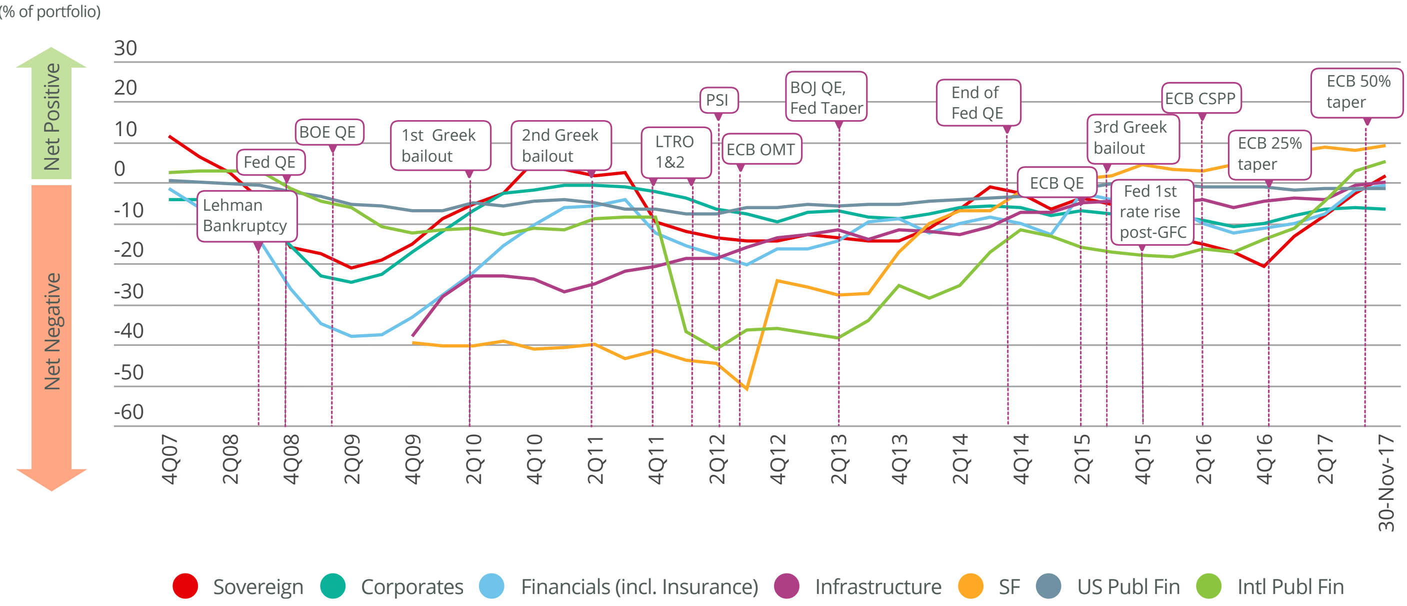
The QE unwind is likely to put pressure on sovereigns as government debt is high in many countries. Banks could be exposed to asset-quality problems following the long period of cheap credit, with high property prices in some countries at risk of deflating as the interest rate cycle turns. In the eurozone, banks will also need to rely more on market funding rather than the ECB.

In the corporate sector, emerging-markets issuers could be challenged by the reversal of capital flows but those in developed markets are likely to cope quite well. However, certain sub-sectors face rating pressure for idiosyncratic reasons, including traditional retail in the US and Europe, and utilities in the UK.

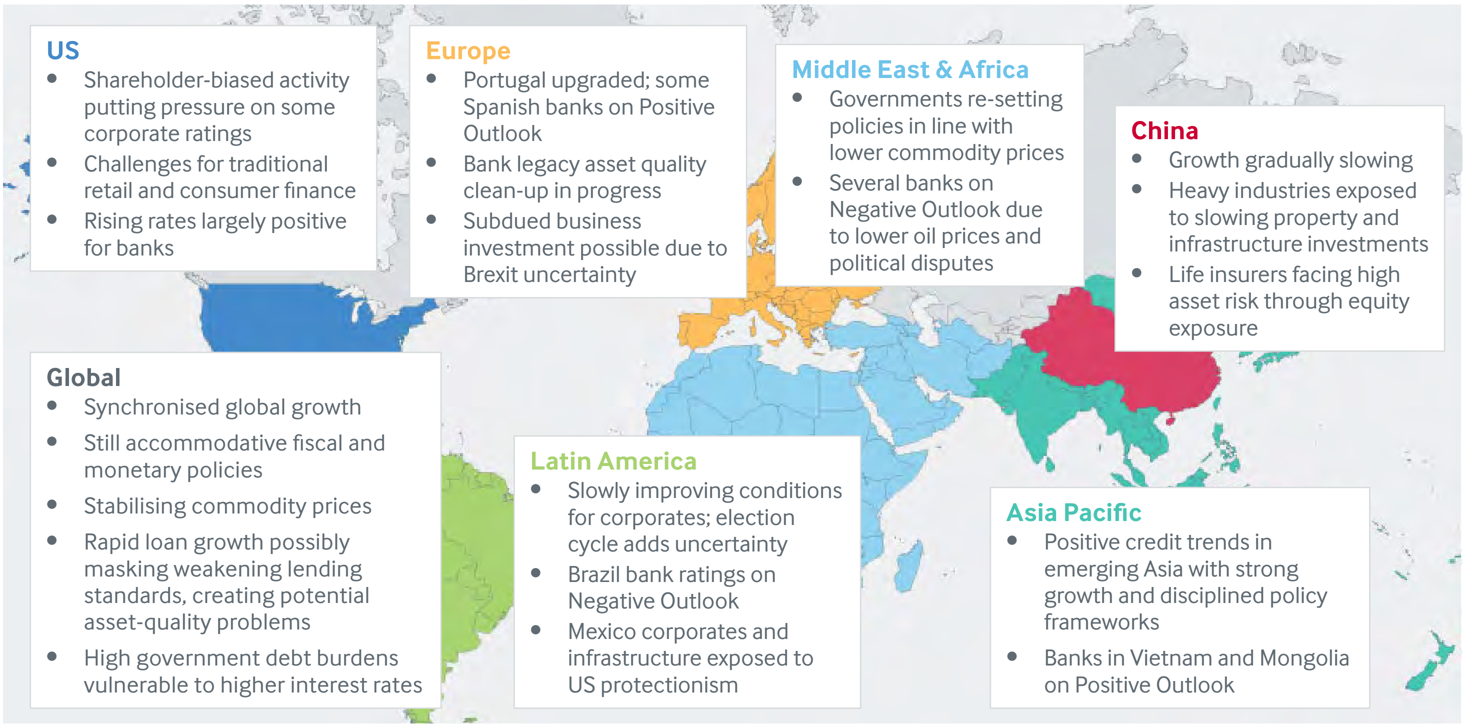
Geographic areas with negative rating outlook bias include the Middle East, Africa, China and Latin America, where several countries will hold elections this year and outcomes are uncertain.

The more positive outlook for rating activity in the short term should be seen against the backdrop of downward rating migration in several sectors in recent years. This trend has been most pronounced for sovereigns and financial institutions, with the share of 'AAA' to 'A' ratings in the latter hitting a low of 37% on 30 November 2017, having fallen steadily from 54% at end-2007.

**Rating Outlooks Improving**
(Positive minus Negative Outlooks and Watches)



## World at a Glance



**US**
- Shareholder-biased activity putting pressure on some corporate ratings
- Challenges for traditional retail and consumer finance
- Rising rates largely positive for banks

**Europe**
- Portugal upgraded; some Spanish banks on Positive Outlook
- Bank legacy asset quality clean-up in progress
- Subdued business investment possible due to Brexit uncertainty

**Middle East & Africa**
- Governments re-setting policies in line with lower commodity prices
- Several banks on Negative Outlook due to lower oil prices and political disputes

**China**
- Growth gradually slowing
- Heavy industries exposed to slowing property and infrastructure investments
- Life insurers facing high asset risk through equity exposure

**Global**
- Synchronised global growth
- Still accommodative fiscal and monetary policies
- Stabilising commodity prices
- Rapid loan growth possibly masking weakening lending standards, creating potential asset-quality problems
- High government debt burdens vulnerable to higher interest rates

**Latin America**
- Slowly improving conditions for corporates; election cycle adds uncertainty
- Brazil bank ratings on Negative Outlook
- Mexico corporates and infrastructure exposed to US protectionism

**Asia Pacific**
- Positive credit trends in emerging Asia with strong growth and disciplined policy frameworks
- Banks in Vietnam and Mongolia on Positive Outlook



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The Credit Outlook provides an overview of Fitch Ratings' outlook across all rated sectors and regions, identifying the main macro factors that will drive credit trends over the next 12-24 months. It focuses on outlook outliers — negative and positive — as the vast majority of ratings are typically stable by definition. The Credit Outlook is published semi-annually.

### Related Research

The Credit Outlook 3Q17 (September 2017)

Credit Outlooks 2018

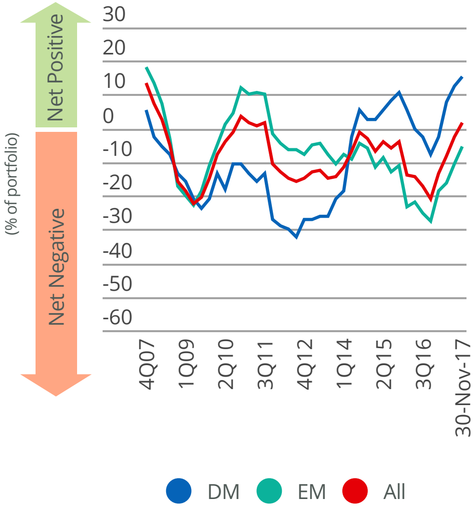
Source: All charts are based on Fitch Ratings data

# Sovereigns

## Outlooks More Positive on Stronger Economy

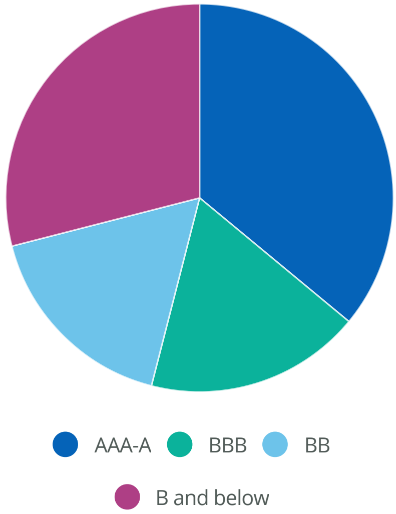
**Net Outlooks & Watches**

(Positive minus Negative Outlooks & Watches)

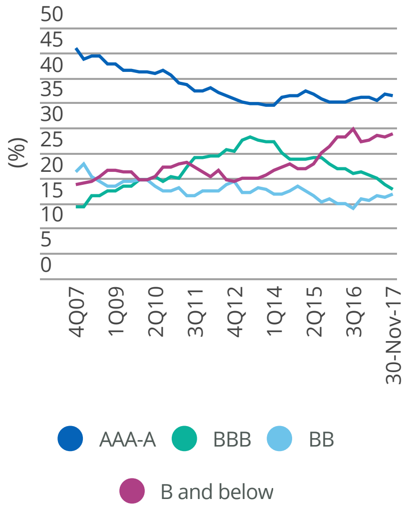



**Rating Distribution**

30 Nov 2017




**Rating Distribution History**




### Outlook Trend

- The global sovereign outlook is the most positive it has been since 2011, supported by a favourable economic backdrop, still largely accommodative fiscal and monetary policies and stabilising commodity prices. Unlike in recent years, Fitch expects a roughly similar number of sovereign rating upgrades and downgrades in 2018, absent unforeseen shocks. However, this relatively benign global trend belies some distinct regional differences.

- The trend for ratings of developed-market (DM) sovereigns is upward, led by eurozone countries, where ongoing post-crisis adjustments to fiscal and external balances have enhanced sovereign credit profiles and diminished the risks of renewed market pressures. Emerging Europe sovereigns are benefitting from the spillover of strong eurozone growth and loose monetary conditions, and rising allocations of EU structural and investment funds.

- Credit trends are also positive in emerging Asia. Strong growth, as is typical of the region, and disciplined policy frameworks that guard against the emergence of macroeconomic imbalances should support modest upward rating momentum. Fitch forecasts China's growth to slow to 6.4% in 2018 from 6.8% in 2017, but an improved inventory position in the housing market – an important growth driver and contributor to Chinese import demand – should ensure a gradual deceleration. However, underlying corporate debt issues have yet to be addressed, portending an eventual medium-term adjustment, accompanied by greater downside risk.

- The highest number of Negative Outlooks is in the Middle East and Africa, as several governments continue to adjust policy settings to account for lower commodity prices. The worst of the downward credit cycle appears to have passed, but downgrades will outnumber upgrades in 2018. Even with an improved commodity price outlook, sub-Saharan African sovereigns' basic infrastructure needs make it harder to prioritise fiscal consolidation, and several are now burdened with higher commercial debt that will have higher refinancing costs, representing a meaningful medium-term challenge.

- Upgrades since 30 November include Portugal, Ireland, Iceland, Serbia, Indonesia and the Philippines while downgrades include Oman.

### Key Risks

- Higher interest rates are accounted for in our economic and debt-service forecasts, but there is a risk that even Fitch's above-market rate expectations will be overtaken by a more rapid increase in inflation or inflation expectations due, for example, to a tightening of DM labour markets or geopolitical stress that pushes oil prices higher. Sovereigns are not well positioned to deal with higher rates, as government debt remains high in every region and at every rating level.

- Notable EM elections in 2018 include those in Brazil, Mexico, Colombia, Hungary, Malaysia and Thailand. The most uncertain outcomes are in Latin America, with a fragmented contest in Brazil and steady support for a leftist candidate in Mexico. Brazil's incoming administration will need to undertake an austerity and reform programme if it is to preserve the sovereign's credit profile, while Mexico's future policy orientation is unclear, as the leading candidate supports higher social spending, rolling back some structural reforms.

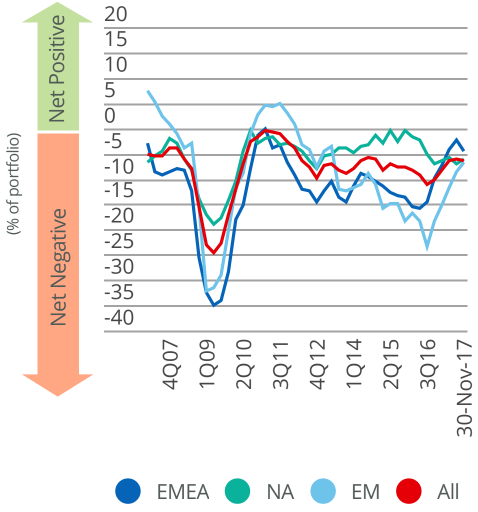
- Politics in Europe still has the capacity to surprise. Realistically, Brexit negotiations need to be concluded by year-end if a deal is to be agreed and approved by EU member states before implementation in March 2019. One consequence of Brexit's increasing call on regional political and bureaucratic resources is that other EU priorities, such as questions surrounding the merits and modalities of deeper integration, may not progress. Italian elections, due by late May, could result in political gridlock, resulting in another large EU member lacking a strong regional voice, as with Germany at the start of the year.

# Corporates

## Global Growth and Solid Commodities Support Outlooks

**Net Outlooks & Watches**

(Positive minus Negative Outlooks & Watches)

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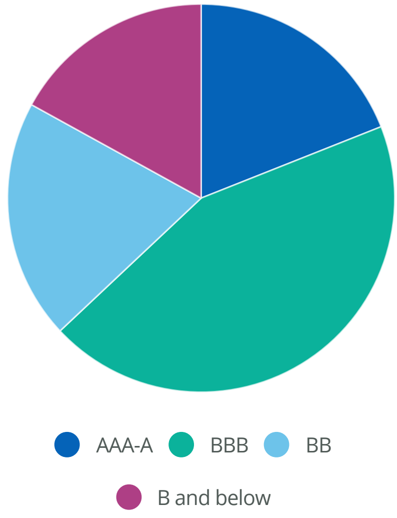


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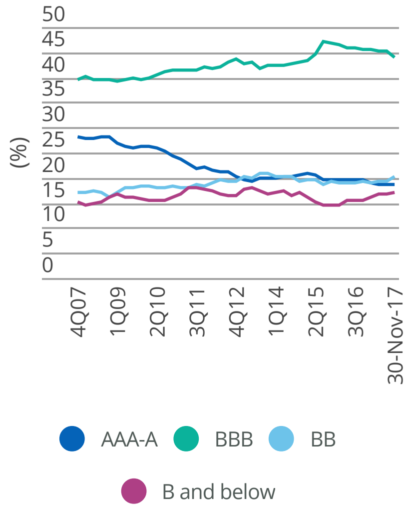



### Outlook Trend

- Fundamental conditions should improve for most corporates in 2018, with another year of good global growth and stabilising commodity prices. The corporate portfolio's outlook balance outlook balance is better than a year ago, but retains a mild negative bias, with 12% of rated corporates on Rating Watch or Outlook Negative, compared with 8% on Positive at 30 November 2017. However, this net 4% should be seen in the context of an average negative score of 8% for the last 10 years.

- Latin America is the most negative region, even excluding Negative Outlooks related to the Brazil sovereign, with 16% of ratings on Negative, against 4% on Positive. This is an improvement on a year ago and we expect the situation to continue to improve in 2018, partly due to signs of an economic turnaround in Brazil. In contrast, in Mexico there is anxiety regarding the ongoing NAFTA renegotiation. Uncertainty regarding outcomes in the heavy election cycle in Brazil, Chile, Mexico and Colombia clouds the improving credit horizon for the region in 2018.

- The US Outlook bias is also mildly negative, with 14% of issuers on Negative Outlook or Watch, compared with 8% on Positive. Credit conditions in most sectors are stable, but the negative bias comes from the overhang from shareholder-friendly actions and M&A – further evidence that it is often corporate policy decisions, rather than movements in the business cycle, that influence rating movements.

- Developed EMEA and Asia both have balanced outlooks, with EMEA overall being dragged into negative territory by the Middle East and Africa.

- Key negative sector outlooks are European retail, Hong Kong retail property, Latin American telecoms and utilities in the UK, the Middle East and Africa.

### Key Risks

- Rising interest rates should present few first-round challenges to DM corporates. Interest rate stress tests in the US and European portfolio show a high degree of resilience to rising rates and refinancing profiles for leveraged issuers look benign by historical standards. Effects may be more serious in the event of a policy mistake that leads to a recession rather than engineering a gradual normalisation of policy.

- Rising US rates could have a knock-on effect in emerging markets (EMs), although a major strengthening of the US dollar is not our base case. This could lead to capital flight, depreciating EM currencies and pressure on foreign-currency debt service.

- A growth slowdown in China would be likely to have a disproportionate effect on commodity prices, affecting oil, mining and metals producers in developed and EM. Credit conditions in China are likely to remain tight in 2018 following a significant rise in the cost of domestic debt funding during 2017. We believe the authorities will keep policy options open and maintain adequate liquidity in key sectors to ensure target economic growth rates can be met, although there may be pockets of weakness in heavy industries linked to slowing property and infrastructure investments.

- Trade disputes could slow growth and have a negative impact on specific corporates. The most likely areas for these are NAFTA and US/China.

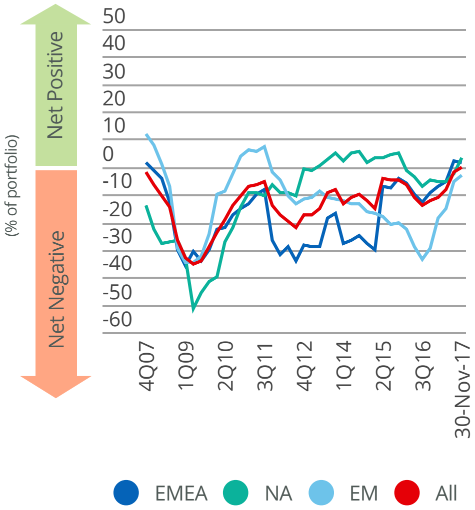
- An unexpected acceleration of online retailing could have negative consequences for the already pressured traditional retail sector, particularly in the US and Europe.

# Financial Institutions

## Economic Growth & Muted Inflation Support Bank Outlooks

**Net Outlooks & Watches**

(Positive minus Negative Outlooks & Watches)

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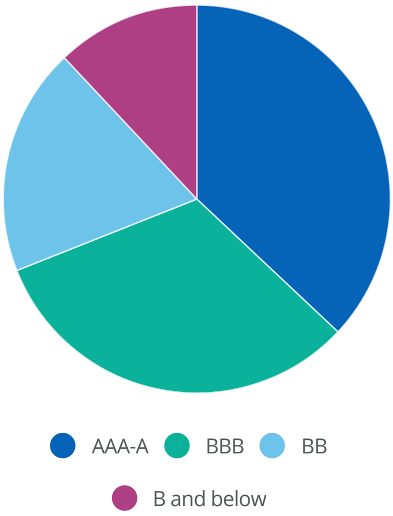


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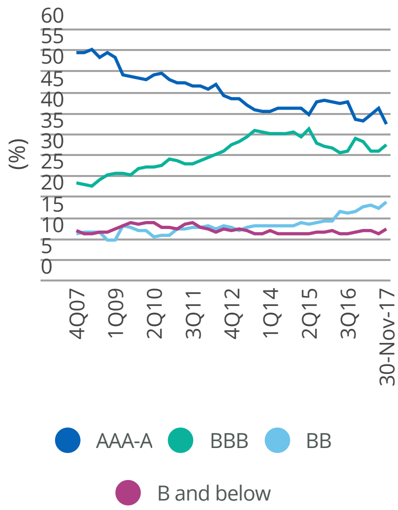



### Outlook Trend

- Strong global growth and muted inflation support loan growth and asset quality for banks in all regions. In Japan, the rating outlook has stabilised as the operating environment improved in 2017. In Turkey, the banks remain under pressure, although the rating outlook has stabilised following downgrades in February 2017.
- Several banks in the Gulf Cooperation Council are on Negative Outlook, including in Bahrain, Oman, and Qatar. Qatari banks' Negative Outlooks reflect the political dispute with Saudi Arabia, resulting in the sovereign's reduced ability (but not propensity) to provide support if needed. Bank ratings in Bahrain and Oman reflect continued feed-through of pressure from lower oil prices. Bank Outlooks in Brazil remain Negative.
- Positive Outlooks on some Spanish banks reflect improving financial metrics and economic prospects and the build-up of loss-absorbing buffers.
- Most US bank Outlooks are stable as rising rates hold the potential for improvement in net interest margin, offset by deterioration in asset quality, notably in commercial real estate.
- In Asia, Outlooks are now Stable, except in Mongolia and Vietnam where they are Positive, reflecting the sovereign Outlook. Banks in China face higher funding costs and net interest margin pressure (especially for the smaller banks), and capital demands to finance continued credit growth. But their Outlooks remain Stable as these ratings are based on expectations of state support. Over time, tighter regulation may benefit bank Viability Ratings.
- Consumer finance and commercial lenders in the US face pressure from the competitive underwriting environment and lower used-vehicle values. Traditional investment managers globally are under fee pressure and face the continued rise of passive investing. However, many issuers have improved their funding profiles and asset quality is generally strong.

### Key Risks

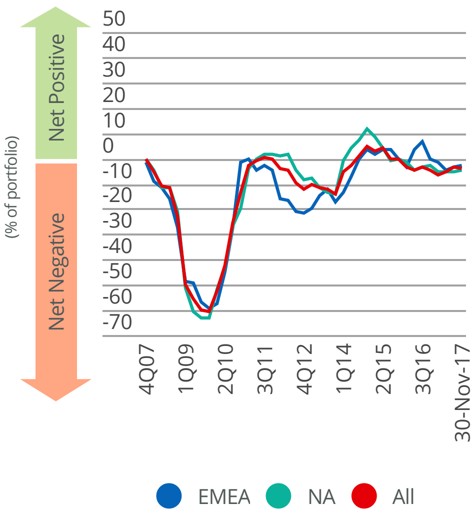
- Rapid loan growth and more competitive pricing could mask weakening lending standards for some banks and non-bank financial institutions, creating potential asset-quality problems, notably in consumer finance. Problems could be precipitated by rising interest rates or an economic downturn.
- The need to retain international market access remains a key risk for banks in many EMs, notably Turkey, as US interest rates tighten. Asset-quality risk from foreign-currency lending is also high, including in most Commonwealth of Independent States countries and Nigeria and in some parts of Central America.
- High property prices remain a feature in many DM markets, including in Australia, Canada, Hong Kong, Norway and Sweden. Banks have built up buffers and some regulators have used macro prudential tools to mitigate tail risks from house prices bubbles, but these mitigants are untested.
- Failure to clean up bad loans by EU banks under continued pressure from the ECB could, in extreme cases, result in further failures, including if markets are unwilling to provide fresh capital when needed or if positive economic growth prospects reverse. Cyprus, Greece, Ireland, Italy, Portugal, Slovenia, Bulgaria and Spain are all working through legacy asset-quality issues in their banking sectors.
- QE unwind is likely to be accompanied by higher interest rates (which should benefit margins but could put pressure on asset quality), normalisation of government bond yields (which could adversely affect valuations of liquidity portfolios), and, for some banks notably in the eurozone the need to replace central bank funding with market funding. It could also precipitate corrections in real asset values including real estate.

# Insurance

## Outlook Stability Reflects Benign Conditions

**Net Outlooks & Watches**

(Positive minus Negative Outlooks & Watches)




**Rating Distribution**

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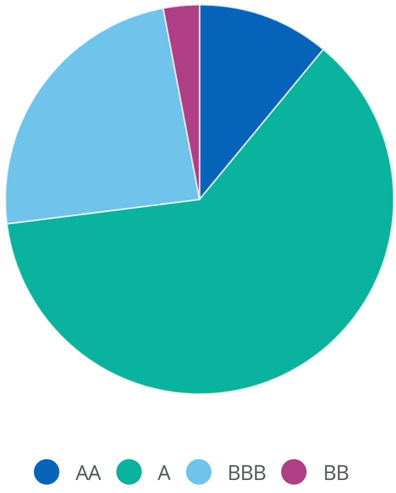


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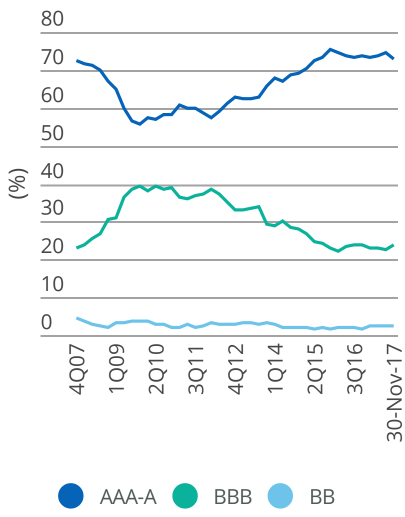



### Outlook Trend

- Roughly 10% of insurance Outlooks are split almost evenly between Negative and Positive. Issuer-specific idiosyncratic factors rather than broad fundamental trends or improving market conditions are the primary drivers of both the Negative and the Positive Outlooks.
- Key issuer-specific factors driving Negative Outlooks include uncertainty surrounding the success of ongoing deleveraging efforts in North America, heightened exposure to riskier assets in China, and the effect of Brazil's Negative sovereign Outlook. Higher-than-anticipated third-quarter catastrophe losses that struck North America also resulted in a limited number of (re)insurers' Outlooks being revised to Negative.
- Positive Outlooks primarily reflect improving operating performances, principally in North America, that align more closely with those expected at higher rating levels, and the effect of Spain's Positive sovereign Outlook.
- North American issuers represent roughly half of the Negative and two-thirds of the Positive Outlooks, with the balances divided roughly evenly among European, Asian and Latin American issuers. Negative and Positive Outlooks cut across both the life and non-life sectors.

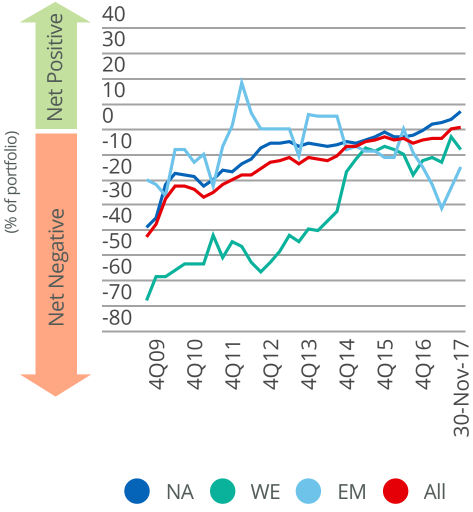
### Key Risks

- Non-life insurers in North America and reinsurers globally are the sectors most under pressure as their ability to earn rates of return that exceed their cost of capital remains challenged. Competition in these markets is intense and while significant catastrophe losses in 2017 will push up premium rates in some markets, they are not likely to result in changes in market dynamics that promote lasting increases necessary to improve long-term rates of return. Non-life insurers elsewhere generally face more favourable market conditions.
- Pressure on life insurers in North America has partly eased as expectations for rising market interest rates and corresponding investment yields have firmed. Interest rate rises should begin to alleviate some of the compression between investment yields and policy crediting rates that North American life insurers have faced since the financial crisis. This spread compression has been more acutely felt by life than non-life insurers as the former rely more heavily on spread-based investment income to generate earnings. European life insurers continue to face spread compression. Re-investing cash at higher yields will take time and could raise the risk profile of portfolios. Life insurers will also need to carefully manage crediting rates to retain product competitiveness in a rising rate environment.
- Asset risk at Chinese life insurers remains high, making their capitalisation vulnerable to unfavourable market swings and potential credit-quality deterioration during an economic slowdown. Fitch estimates that the Chinese life insurance sector's equity exposure, including listed stocks and long-term equity investments, was equal to roughly 150% of the sector's net assets at the end of August. Favourably, regulatory efforts in China to slow the sales of savings-oriented products and shift life insurers' sales more towards protection-oriented products began to take hold in 2017 and appear to be having their intended effect.

# Infrastructure & Project Finance

## Outlooks Improving, including in EM

**Net Outlooks & Watches**
(Positive minus Negative Outlooks & Watches)




**Rating Distribution**
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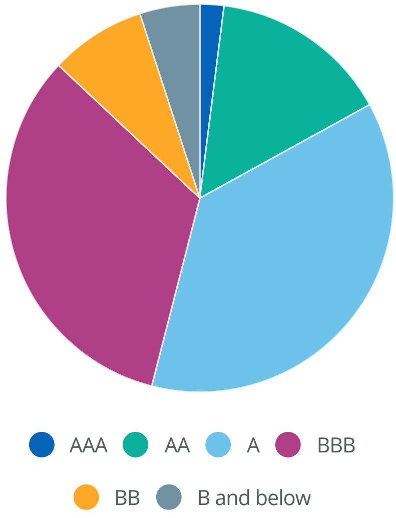


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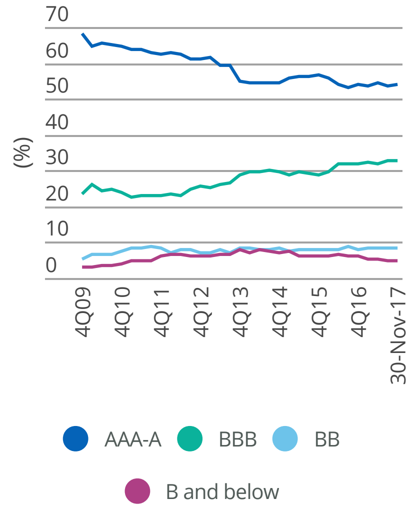



### Outlook Trend

- Globally, Fitch's sector and rating outlooks remain broadly stable in a positive macroeconomic environment. Negative Outlooks in the portfolio have declined as we expect fundamentals to be buoyed by stronger global economic growth in 2018. Low oil prices continue to support the macroeconomic drivers of demand for transportation infrastructure globally.

- Ratings in EMs remain the most vulnerable. However, the number of Negative Outlooks in EMs has reduced significantly since end-June, driven predominantly by the bottoming-out of the deep recession in Brazil and stronger global commodity prices.

- Remaining Negative Outlooks are mainly driven by asset-specific and regional issues. For ports, rating pressures reflect local contexts, including in Turkey and Russia. There is also some downside risk for UK port profitability stemming from Brexit. The outlook for transportation in Brazil remains negative and the nascent economic recovery, the terms of NAFTA renegotiations in Mexico and presidential elections in both countries are key issues to watch in 2018.

- Mexico infrastructure assets may be negatively affected by shifts in manufacturing activity if the new US administration's rhetoric regarding increased protectionism comes into play. Recent decisions to relocate plants in anticipation of policy shifts may begin to reduce road and bridge traffic volumes.

- Most energy projects are insulated by contractual frameworks from price and demand movements triggered by the low oil and gas prices and Outlooks generally remain Stable.

### Key Risks

- Policy and political uncertainty remain key risks to the credit outlook for infrastructure and project finance. Potential changes in tax, trade and border policies could affect growth for some transportation segments, notably along the Mexico border, while tax reform could stall momentum for US renewable projects in 2018. Uncertainties about the final shape of the UK's future trading and regulatory arrangements with the EU could also lead to subdued business investment, slower GDP growth in 2018 and credit deterioration of Fitch's UK infrastructure credits. Tensions in the Middle East could affect projects in the region, especially in Qatar, if the situation deteriorated further.

- A downward shift in commodity prices, slower-than-expected improvement in advanced-economy growth and tightening of global financial conditions would erode the positive external backdrop for EMs in 2018. A slowdown in China could dampen growth in intra-EM trade next year, but as long as the deceleration is modest China's continued growth should remain a supportive factor.

- In Brazil, the absence of a rebound in transportation volume growth in 2018 may lead to further negative rating actions. We believe Mexico will retain competitive US market access but a negative outcome in NAFTA negotiations could weigh on investment and dampen near-term growth prospects.

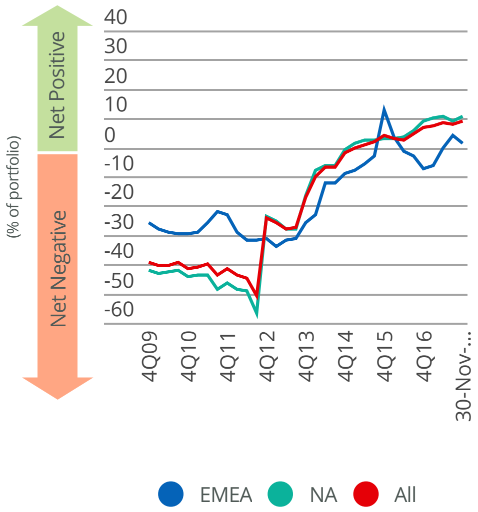
- Issuers with exposure to energy merchant risk (ie oil, gas or power transactions exposed to market prices as they do not have a purchase contract) would be negatively affected if prices declined.

# Structured Finance

## Sound Transaction Structures Drive Improving Outlooks

**Net Outlooks & Watches**

(Positive minus Negative Outlooks & Watches)

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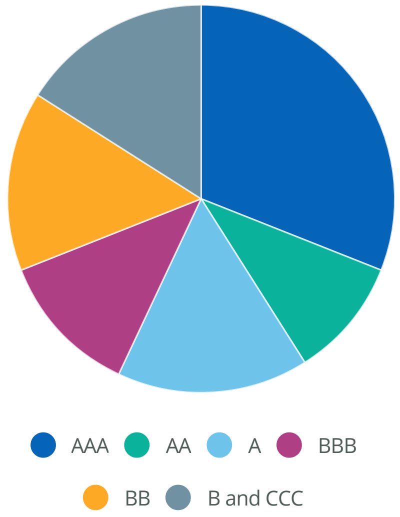


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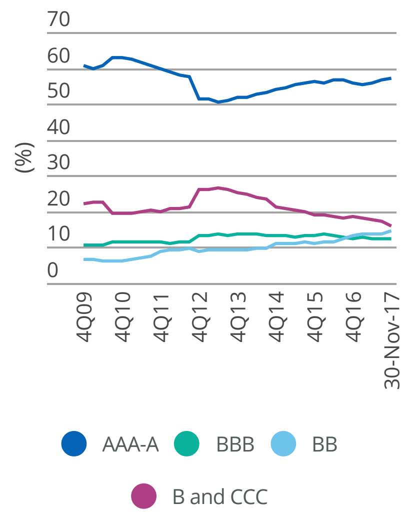



## Outlook Trend

- Less than 10% of North American ratings are on Negative Outlook. Most of these are in US RMBS, including legacy transactions constrained by increasing concentration risk (due to loan repayments) and interest shortfall risk. A minority are in US CMBS, where poorer-performing regional malls are causing asset performance concerns, reflecting pressure on traditional retail from rapidly expanding online and discount formats.
- Just under 20% of North American ratings are on Positive Outlook. The vast majority of these are in US RMBS, with many bonds issued since 2009 reflecting sound transaction structures and strong asset performance.
- About half of all EMEA RMBS ratings are on Rating Watch Evolving following publication of the revised European RMBS criteria in October 2017. We do not expect the revised criteria to cause significant rating migration. The outlook for the remaining EMEA ratings is predominantly stable, underpinned by expectations for continuing economic growth, positive consumer and business sentiment and minor interest rate increases expected through 2019.
- Most Positive Outlooks in EMEA are concentrated in SME CLOs and government-related ABS, while Negative Outlooks are mainly in CMBS and pre-crisis structured credit deals.
- Outlooks in Asia and Latin America are largely stable.

## Key Risks

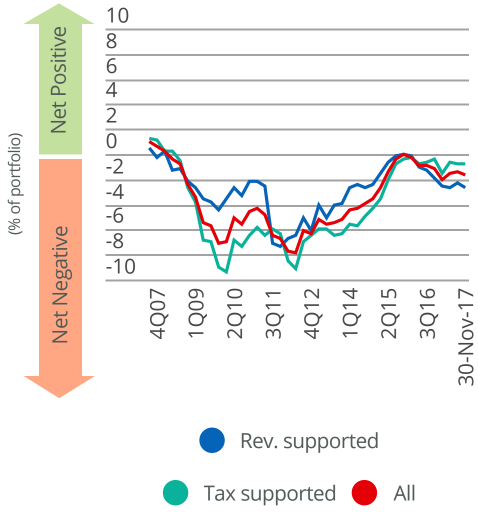
- The QE retrenching implies that central banks will be gradually replaced by traditional investors with more commercial credit standards, motivations and credit limits, gradually restricting the credit available and tightening credit conditions. Higher rates will test the robustness of post-crisis lending practices and the increased household debt in many jurisdictions. Restricted access to credit may put pressure on consumer asset performance and sectors where performance is influenced by refinancing conditions, like CMBS, CLO and buy-to-let RMBS.
- Changes in US fiscal policy are likely to create new headwinds for selected sectors. The new tax law will have an impact on property buying incentives, particularly in higher priced cities on the coasts. Likewise, the reduced corporate tax rate and the new limits on the interest expense deduction will put pressure on high-yield corporates with large debt burdens and a high cost of debt.
- The UK ratings outlook is stable but Brexit uncertainty and the related heightened risk of rate rises could drive asset performance deterioration. The key risks are inflated property prices, particularly in and around London, and rising household indebtedness. Similar conditions exist in Scandinavia and, more importantly, in Australia, where household indebtedness is at record highs, although the risk of economic slow-down or recession appears remote.
- Increased evidence of acceleration in secular shifts driven by e-commerce, technology advancements, environmental regulation changes, collaborative economies and customer demographics, combined with relaxed lending practices, changing consumer attitude and increased households indebtedness may result in a worsening of currently solid consumer asset performance.
- New regulation could mean that some EMEA transactions may have to post collateral in swaps, which would deplete cash flows and possibly stop banks from acting as hedging counterparties to SF issuers, which would negatively affect ratings.

# US Public Finance

## Outlook Stability Except in Healthcare

**Net Outlooks & Watches**

(Positive minus Negative Outlooks & Watches)

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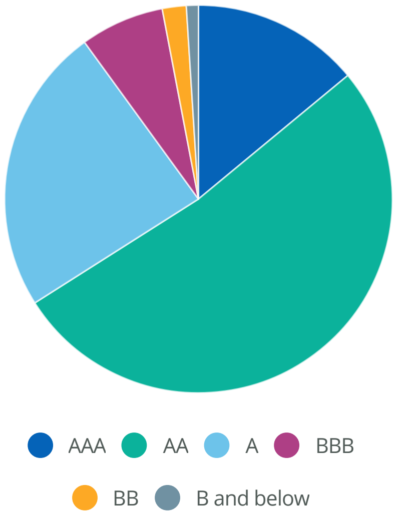


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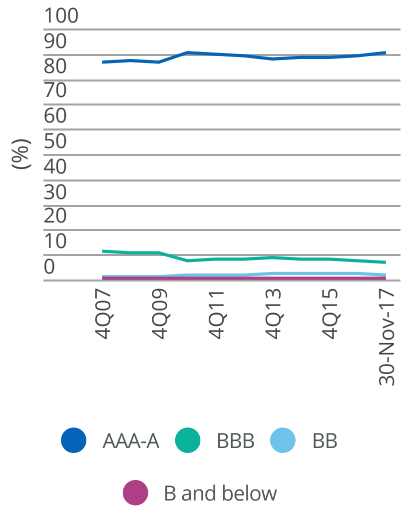



### Outlook Trend

- Ratings are generally stable for tax-backed and revenue-backed bond issuers. Most of the small number of Positive and Negative Outlooks and Watches are in the healthcare and nonprofit sectors and are primarily due to recent criteria changes.
- Healthcare providers face a challenging environment as continuing efforts to change the Affordable Care Act creates uncertainty for the not-for-profit healthcare business model and potential stress on operating margins in the sector. Fitch maintains a negative outlook for this sector.
- The Outlooks of states and local governments remain Stable; US economic growth will generally continue to support revenue growth at state and local levels. However, pension obligations and legal challenges to pension reform will continue to put pressure on some credit profiles.
- The outlook for not-for-profit utilities remains stable despite regulatory uncertainties around expected rule revisions from the Environmental Protection Agency and the proposed repeal of the Clean Power Plan.

### Key Risks

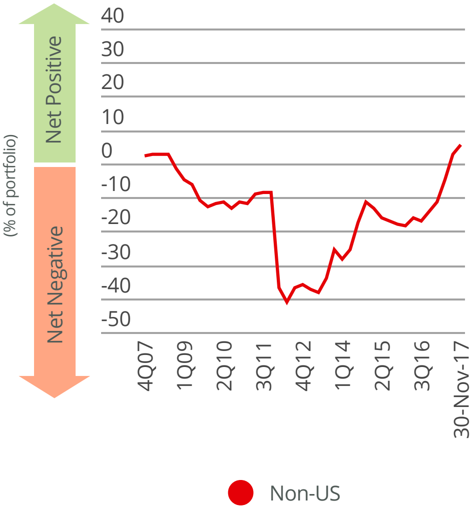
- The elimination of the individual mandate for health insurance and broader modification of the Affordable Care Act may increase the number of uninsured citizens and drive up premiums for the insured, and will increase the amount of uncompensated care in the not-for-profit healthcare sector. This would reverse recent positive trends in operating margins.
- The proposed elimination of the deduction for state and local taxes available to individual taxpayers may make it more difficult to raise taxes and reduce revenue flexibility particularly in high-tax states including California, Connecticut, New York and New Jersey.
- Trade policy shifts may have economic consequences affecting state and local revenues benefiting from trade with Mexico.
- The onset of recession or a period of very low growth would reduce state and local tax revenues.
- Oil prices reverting to lows would negatively affect energy-producing states.

# International Public Finance

## Rising Revenues Support Outlook Recovery

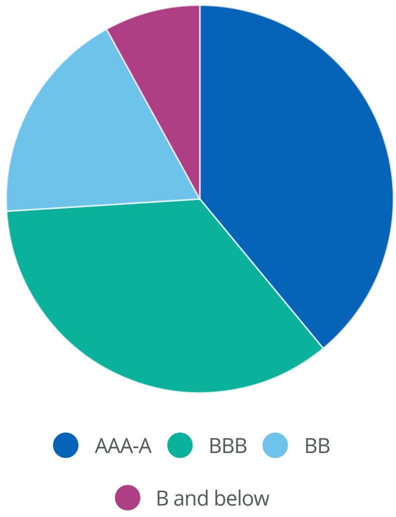
**Net Outlooks & Watches**

(Positive minus Negative Outlooks & Watches)

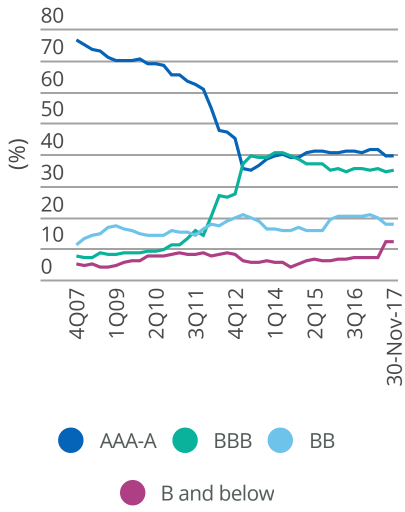



**Rating Distribution**

30 Nov 2017




**Rating Distribution History**




### Outlook Trend

- Brighter prospects for revenue generation amid improving economies underpin a stable outlook for non-US local and regional governments (LRGs) for 2018. Nearly 80% of LRGs outside the US have a Stable Outlook, while Positive and Negative Outlooks are broadly matched for the first time since 2008.

- Upgrades could be triggered by a continued rise in taxes, improved commodity prices leading to higher royalties, and higher transfers from central government. Conversely, downgrades may be driven by unexpected rises in spending in the run-up to elections, weaker budget outturns from the reversal of austerity in Europe, inflationary pressure materialising in Latin America and central Europe, deflating house prices in Canada and any sharp slowdown in land right sales in China.

- Negative Outlooks are mainly in Brazil, due to the sovereign cap, and in Italy due to the inherent weaknesses of cities' revenue. In Brazil, delays in reforming pensions are continuing to have a negative impact, although the adoption of International Public Sector Accounting Standards reporting will help strengthen national oversight and enforce spending ceilings. Growing revenues from lower tax evasion and increased tariffs/taxes, and higher transfers to less dynamic states in the north and the north-east should improve operating margins and stabilise subnational debt.

- In China, increased central government oversight resulted in a lower volume of overseas debt issuance by local government financing vehicles (LGFVs) in the early part 2017 but this has since picked up. Overall, the aggregate debt of LRGs and LGFVs in China is rising, although Outlooks remain Stable as the increased overall debt burden is still manageable within current rating levels.

### Key Risks

- A sharp slowdown in growth in China could expose weaker subnationals to material strains on revenues, particularly from land right sales, testing the control and solidarity links with the central government and from local governments on their LGFVs.

- Chinese LRGs' backing for borrowing vehicles remains strong but there are questions about the likely timeliness of support for less important LGFVs due to pressure from the national authorities to enforce market discipline. Balanced budget requirements are likely to lead to growing off-balance-sheet debt elsewhere as well, such as in Italy and Germany, to cope with infrastructure spending needs. Fitch's notching down from local government ratings for LGFVs may be widened if the policy role of these vehicles is diluted.

- Spending rises for LRGs heading into elections in Latin America and Europe will add to traditional financial risks. Inflationary pressures in Argentina, Brazil, Mexico and Poland may push up interest rates, while unhedged currency risk may erode Turkish LRGs' comfortable operating margins. Interest coverage by operating balance is fairly low in Latin America (2x) and Europe (3x), where predictability underpins ratings, while opaque reporting offsets China's strong coverage (about 30x).

- Prolonged low commodity and oil prices would weaken fiscal performance in several large emerging economies (Mexico, Colombia, Russia and Nigeria) and LRGs dependent on oil-related transfers.

# Related Research

## Sovereigns

2018 Global Sovereign Outlook (December 2017)

Global Economic Outlook (December 2017)

2018 Regional Sovereign Outlooks (December 2017)

## Corporates

EMEA Corporate Outlook (December 2017)

How NAFTA Abrogation would Affect Mexico (October 2017)

What Investors Want to Know – Emerging Market Corporates (November 2017)

EMEA Leveraged Loan Stress Test (July 2017)

Pockets of Interest Rate Risk: Select U.S. Leveraged Issuers and their Exposure to Rising Rates (April 2017)

## Financial Institutions

Quantitative Easing: The Beginning of the End (November 2017)

Fitch 2018 Outlook: Asia-Pacific Banks (November 2017)

Fitch 2018 Outlook: U.S. Banks (November 2017)

Fitch 2018 Outlook: Finance and Leasing Companies (November 2017)

Shock Scenarios: U.S. Bank Deposits (Rise in Retail Bank Deposit Rates Would Dampen Bank Profitability) (November 2017)

## Insurance

2018 Outlook: U.S. Property/Casualty Insurance (December 2017)

Chinese Life Insurers Asset and Liability Mismatch Increases Risk (July 2017)

Cyber Insurance Risk and Opportunities (November 2017)

## Infrastructure & Project Finance

Fitch 2018 Outlook: North American Energy Infrastructure (December 2017)

Fitch 2018 Outlook: U.S. Transportation Infrastructure (December 2017)

Fitch 2018 Outlook: EMEA Transport Infrastructure (November 2017)

Fitch 2018 Outlook: EMEA Energy and Water Infrastructure (December 2017)

Fitch 2018 Outlook: Latin American Infrastructure (November 2017)

## Structured Finance

Fitch 2018 Outlook: U.S. and Canadian Structured Finance (December2017)

Fitch 2018 Outlook: European Structured Finance (December 2017)

Fitch 2018 Outlook: Asia-Pacific Structured Finance (November 2017)

Fitch 2018 Outlook: Latin America Structured Finance (Stabilizing along with Sovereign Ratings) (December 2017)

## US Public Finance

Fitch Focus on Munis: Trade in the Time of Trump – Part 1 (Select U.S. Regions Could Feel Pinch if NAFTA Trade Policy Changes Dramatically) (August 2017)

Trade in the Time of Trump – Part 2 (Border Blues: Is Uncertainty over NAFTA Impacting Border Cities?) (November 2017)

Fitch 2018 Outlook: U.S. Local Governments (Financial Stability Amid Federal Policy Uncertainties) (December 2017)

Fitch 2018 Outlook: U.S. States (Federal Uncertainty and Revenue Sluggishness Heighten Challenges) (December 2017)

Fitch 2018 Outlook: U.S. Not-for-Profit Hospitals and Healthcare Systems (Increasing Pressure Amid Uncertainty) (December 2017)

Fitch 2018 Outlook: U.S. Colleges and Universities (Greater Challenges for Certain Segments) (December 2017)

## International Public Finance

Fitch 2018 Outlook: Local and Regional Governments (December 2017)

Exposure Draft: Government-Related Entities Rating Criteria (November 2017)

Currency Volatility Heightens FX Risk for Turkish Metropolitan Municipalities (November 2017)