

OUTLOOK

10 November 2021



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Contacts

Ariane Ortiz-Bollin +1.212.553.4872
Vice President-Sr Credit Officer
ariane.ortiz-bollin@moodys.com

Thaddeus Best +44.20.7772.8744
AVP-Research Analyst
thaddeus.best@moodys.com

Atsi Sheth +1.212.553.7825
Global Head - Emerging Markets
atsi.sheth@moodys.com

» Contacts continued on last page

Emerging Markets – Global

2022 Outlook – Multispeed recovery with stark differences across regions and sectors

Summary

Credit conditions will stabilize, but high leverage and deteriorating financial conditions will increase credit risks for weaker emerging markets. The ability to manage high debt, adapt to climate change effects and navigate rising political and social risks will shape performance across regions, sectors and asset classes.

Speed of economic recovery will vary across regions and sectors, determined by vaccination rates, economic structures and supply chain disruption risks. Economic activity will return to pre-pandemic levels for most, but growth rates will be lower than 2021. Higher commodity prices will boost commodity-dependent countries and companies, but travel and tourism dependent issuers will take longer to restore profits and sales.

High leverage may reshape business and growth models and constrain the choices of vulnerable debt issuers. Higher-rated issuers should be able to navigate 2022 fairly well despite higher debt, thanks to strong economic or industry positions and good access to capital. Smaller, weaker governments and companies with concentrated revenue and large external funding needs will probably endure another year of potential stress.

Risks from inflation and deteriorating financial conditions could leave lower rated issuers facing market access constraints. Although inflation is expected to slow in most economies, there is a risk that supply chain issues, along with high food and fuel costs keep it higher for longer. This would further tighten financial conditions, raising liquidity risks for companies and governments with weaker credit quality and large pending debt payments.

Increasing susceptibility to climate change effects and the demand for future proofing investment will influence credit quality. Sovereigns need significant capital investment to meet climate transition goals but lower post-pandemic revenue and higher spending needs will hamper their ability to fund them.

Higher political and social risks could shift government's policy priorities and weaken the operating environment. For companies, shifts in policy priorities and rising social risks could bring regulatory uncertainty, while many sovereigns will face tough policy choices, such as addressing income inequality or fiscal consolidation.

This report was republished on 23 November 2021 with corrected 2019 data in Exhibit 10.

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The first section of this report provides an overview of the global macroeconomic and sectoral credit themes that will influence emerging markets next year. In the second section, Moody's experts across the globe share their views on the regional and sector specific risks and opportunities they see as they look ahead to 2022.

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Credit conditions to stabilize in 2022 but risks have increased for weaker emerging markets

We expect credit conditions to stabilize across most emerging markets sectors and asset classes, reflected in the smaller share of negative rating outlooks compared with last year. Economic activity will return to pre-pandemic levels for most. However, the recovery is prone to setbacks as a result of renewed virus containment measures, with vaccination rates still low, financial conditions deteriorating and limited room for fiscal stimulus.¹ Several important factors, such as the ability to address high leverage, to adapt to increasing susceptibility to climate change effects and to navigate rising political and social risks will shape performance across regions, sectors and asset classes. Exhibit 1 illustrates how our [six global credit themes](#) will influence emerging markets in the next year.

Exhibit 1

Five credit themes will shape the outlook for emerging market credit in 2022



Multispeed economic recovery

- » Multispeed recovery across regions and sectors, determined by different economic structures, vaccination rates and the risk of sustained supply chain disruptions.



High leverage will impact growth models

- » High leverage will limit vulnerable issuers' choices, while business and growth models may be reshaped as issuers address debt overhang amid affordability concerns.



Liquidity risks and access to financing

- » Liquidity risks will increase as inflationary risks rise and financial conditions deteriorate, with lower rated issuers facing market access constraints.



Climate risk and resilience building

- » Increasing susceptibility to climate change effects and the demand for investment to meet climate transition goals will influence credit quality.



Social and Political Risks

- » Heightened health risks and a fragile recovery, combined with political and social risks exacerbated by the pandemic could shift government's policy priorities and hinder operating environment, amplifying credit risks.

Source: Moody's Investors Service

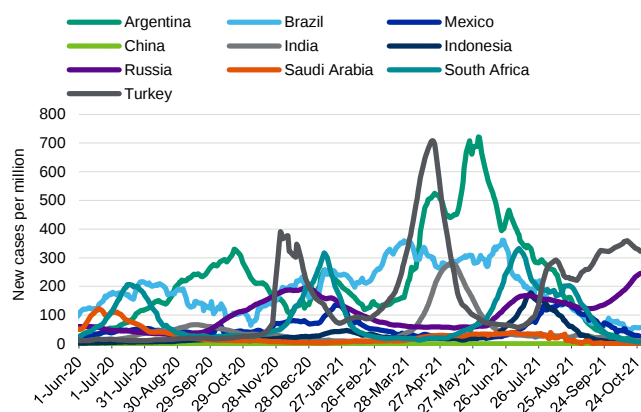
Multispeed economic recovery across regions and sectors

The coronavirus pandemic has had devastating effects on human health, resulting in nearly 5 million deaths globally so far, with 3 million deaths in emerging markets. As Exhibit 2 shows, coronavirus infection rates have been steadily declining across most emerging markets. However, as Exhibit 3 shows, emerging market economies have a higher risk of new waves of infection than advanced economies because of their lower vaccination rates.

Exhibit 2

Emerging market economies' infection rates are generally declining

New cases per million people

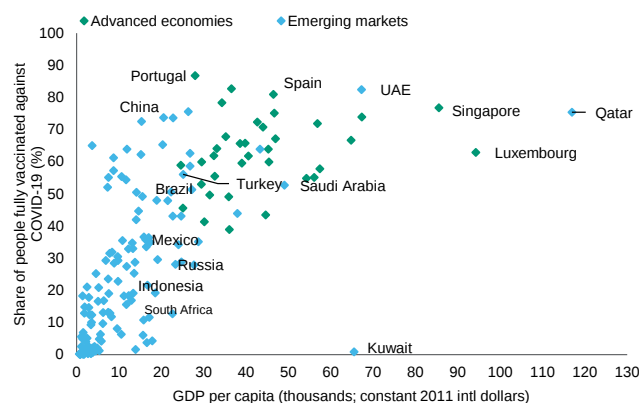


Sources: Haver Analytics and Moody's Investors Service

Exhibit 3

Emerging market vaccination rates lag advanced economies

Share of people fully vaccinated against coronavirus versus GDP per capita



Sources: Our World in Data, Haver Analytics and Moody's Investors Service

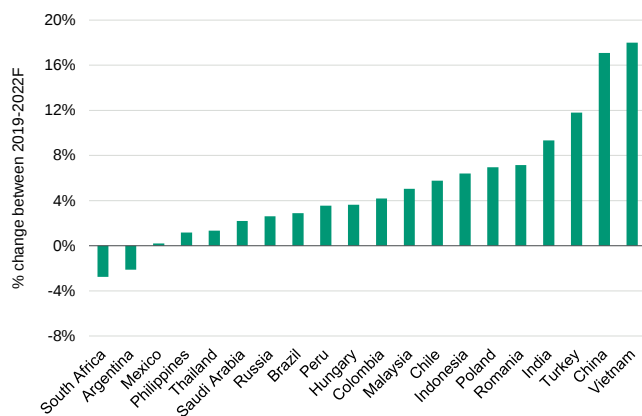
High infection rates continue to put considerable strain on local healthcare systems and prevent a return to "business-as-usual" economic conditions. This indicates a risk of renewed mobility restrictions, sustained supply chain disruptions and continued travel restrictions. [Russia](#) (Baa3 stable), [Indonesia](#) (Baa2 stable) and [South Africa](#) (Ba2 negative) are among the G-20 emerging market countries with the lowest vaccination rates.⁴ This risk will probably remain high until an effective vaccine or treatment is widely available across emerging markets, but this looks unlikely until mid-2022 at the earliest.

We expect economic activity to return to pre-pandemic levels for most emerging markets, although economic growth rates will tend to be lower than in 2021 (Exhibits 4 and 5).

Exhibit 4

Most emerging markets' economic activity levels will return to pre-pandemic levels next year

Real GDP, % change between 2019 and 2022F

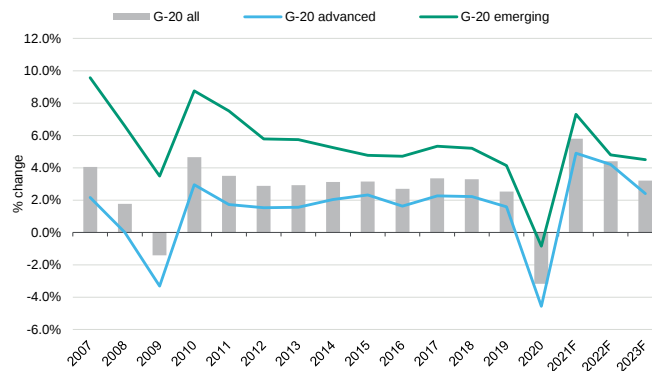


Source: Moody's Investors Service

Exhibit 5

Growth rates in emerging markets in 2022 will be lower than in 2021 but above 2019 rates

Real GDP growth, % change



Sources: IMF and Moody's Investors Service

Only a few countries' GDP growth will remain below pre-pandemic levels in 2022, including [Argentina](#) (Ca stable) and South Africa, but they should get there by 2023. Asia-Pacific will remain the world's fastest growing major economic region, as it has been for long time. However, we expect stark differences in performance across Asia-Pacific because of the shock of the pandemic.

[According to our latest global macroeconomic outlook](#), we forecast average G-20 emerging markets real GDP growth of 4.8% in 2022 and 4.5% in 2023. This is a slowing from this year's forecast rate of 7.3%. Excluding [China](#) (A1 stable), G-20 emerging market economies will grow 6.2% in 2021 and slow to 4.2% and 3.5% in 2022 and 2023, respectively. Consumer demand growth will continue to recover. However, it will vary by region and country depending on lingering health risks and mobility restrictions, limited government spending and affordability concerns. High inflation could strain household budgets and slow the recovery of consumer-related sectors and economic growth, especially if job markets remain weak.

Higher commodity prices will boost commodity-dependent countries and companies' growth. Prices are higher across a range of different commodities including minerals, oil and gas, grains and proteins thanks to tight supply and rapid global demand growth this year. The price of some commodities including copper, corn and iron ore have come close to record highs. We have revised up our medium-term price assumptions for all metals and mining commodities and [increased our medium-term oil price range to \\$50-\\$70/barrel \(bbl\), or pre-pandemic levels, from \\$45-\\$65/barrel \(bbl\) previously](#). Commodity prices will remain high through early 2022, moderating over time as supply and demand become more balanced, supported by slower GDP growth in 2022 than 2021. Growth will be boosted in countries where fuel exports represent more than 50% of total GDP like [Saudi Arabia](#) (A1 stable), [Colombia](#) (Baa2 stable) and Russia, supported by higher prices and stronger demand (see Exhibit 6).

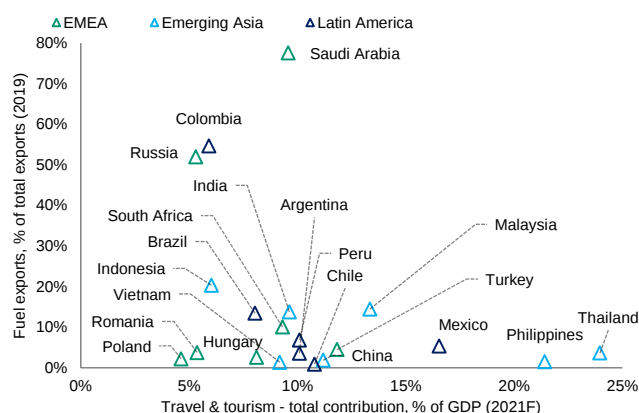
In contrast, countries and companies which rely most on travel and tourism sectors will take longer to recapture pre-crisis profitability and sales as demand remains sluggish. Recovery will be more gradual for [Thailand](#) (Baa1 stable), the [Philippines](#) (Baa2 stable) and to some extent [Mexico](#) (Baa1 negative) and [Malaysia](#) (A3 stable) where tourism is an important contributor to GDP. Any significant economic boost will probably only come in the second half of 2022, as countries' vaccination rates increase, traveler hesitancy declines and airline passenger seat volumes and ticket prices begin to normalize.

Varying corporate sector performance is also reflected in the share of ratings with negative outlooks (Exhibit 7). The share of companies across sectors where we have a negative outlook on their rating has fallen to 20% or less compared with around 30% last year. Industries hardest hit by the sluggish recovery and disrupted supply chains include business and consumer services and property. Industries hit by restricted mobility in 2021 like automotive and transportation have now recovered.

Exhibit 6

Economic structure will determine ability to restore revenue

Travel and tourism and fuel exports, %

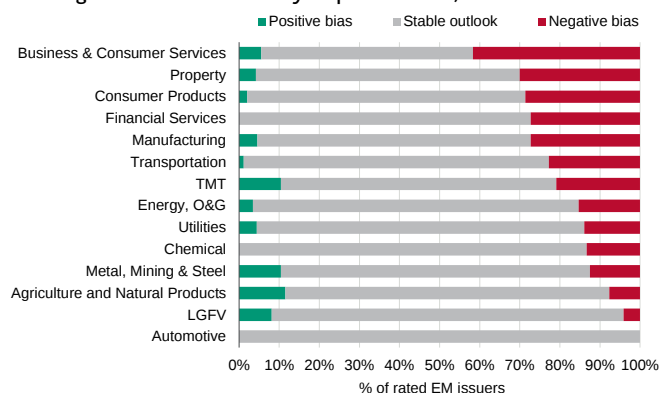


Sources: World Bank and Moody's Investors Service

Exhibit 7

Sectors hardest hit by recession will be among slowest to recover

EM rating outlook distributions by corporate sector, % share



Data as of 31 October 2021; excluding three issuers that are assigned 'no outlook'. Positive (negative) bias includes a combination of ratings with a positive (negative) outlook and ratings under review for upgrade (downgrade).

Source: Moody's Investors Service

For banks, weak job markets, high household debt and the scaling back or end of fiscal stimulus programs will fuel an increase in nonperforming loans across many countries in 2022, increasing loan-loss provisioning costs needs. Banks will probably manage this

risk well. They entered the crisis in a strong position, with reserve provisions that act as a strong buffer to problem loan development, following bank regulations tightening in the past decade. The strength of the post pandemic economic recovery will ultimately determine banks' loan growth.

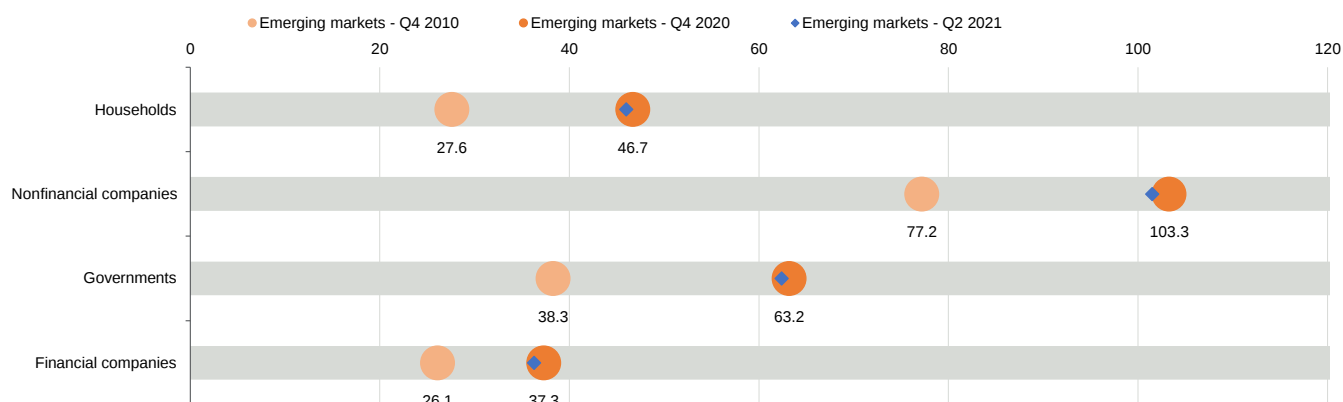
High leverage will limit choices for vulnerable issuers

Many emerging markets entered the pandemic with lower than average economic growth rates. Debt burdens across household, governments, nonfinancial companies and financial institutions have been rising since 2010, but accelerated during the pandemic (Exhibit 8).

Exhibit 8

Emerging markets debt accumulation was larger, faster and broader in the past 10 years than previous decades

Debt outstanding, % of GDP



Sources: Institute of International Finance (IIF), IMF and Moody's Investors Service

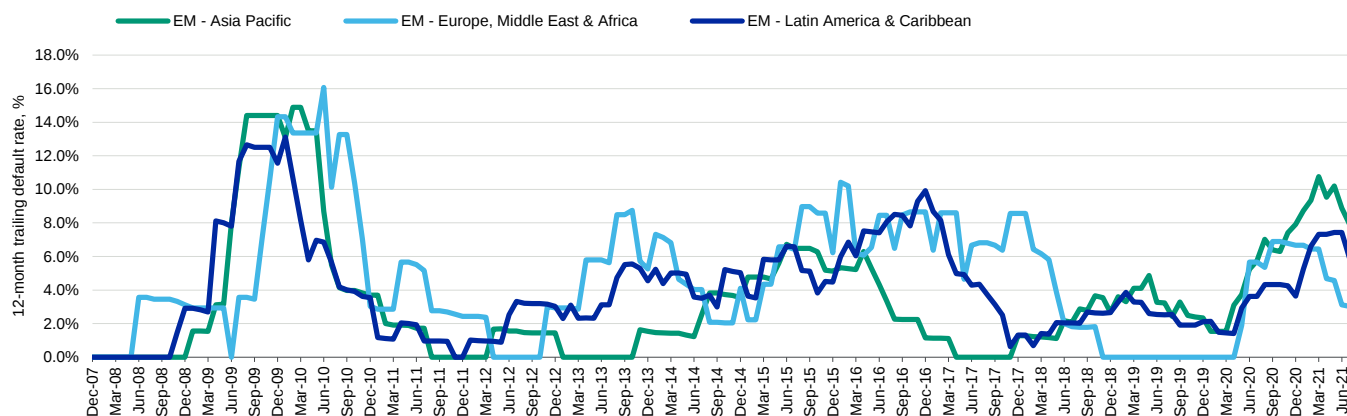
Emerging market government debt climbed to an unprecedented 63% of GDP in June 2021. Total outstanding emerging market debt reached an all-time high of \$91.5 trillion, led primarily by nonfinancial companies, which represent 42% of the total.

Governments will focus on fostering economic growth to generate revenue and restore fiscal buffers, as they move toward stabilizing debt levels. But this comes at a time when many recoveries remain fragile and governments continue to bear the brunt of the pandemic's financial and social burdens. For most, returning to pre-crisis debt to GDP ratios would require unprecedented fiscal action.

Taking on more debt can finance development and growth-enhancing initiatives and provide a backstop for the economy and companies during downturns. But the balance of risks depends on how the debt is used, the economic cycle and financial conditions. High leverage can lead to debt affordability concerns: the cost of rolling over debt can increase sharply during periods of stress. High debt can limit business and policy choices by reducing fiscal resources and financial buffers.

Higher-rated emerging market issuers should be able to navigate 2022 fairly well despite higher debt, thanks to strong economic or industry positions and good access to capital. But smaller, lower-rated governments and companies with concentrated revenue streams and significant external funding needs will probably endure another year of potential solvency stress or repayment risk. [The corporate default rate rose across all emerging market regions in 2020 and peaked in the first quarter of 2021](#) (Exhibit 9).

Trailing 12-month speculative-grade corporate default rate for EM regions



As economic activity continues to recover, we expect emerging market corporate default rates to decline. Nevertheless, a resurgence of virus infections, lagging pace of vaccinations, global financial market turbulence and country-specific risk factors are risks to our forecasts.

A complete return to pre-pandemic consumer behavior is unlikely, creating opportunities for issuers across sectors. For example, the pandemic has accelerated the move to digital banking and cashless transactions. Incumbent banks will probably partner with fintech companies to develop digital ecosystems and defend their market positions, offering nontraditional products. Emerging markets provide a unique opportunity given they have relatively young populations and limited availability and access to financial services — or financial inclusion — as well as high spreads. These changes are accelerating in emerging Asia and in Latin America — particularly in [Brazil](#) (Ba2 stable), [Chile](#) (A1 negative) and Colombia — although high rates and inflation can slow progress.

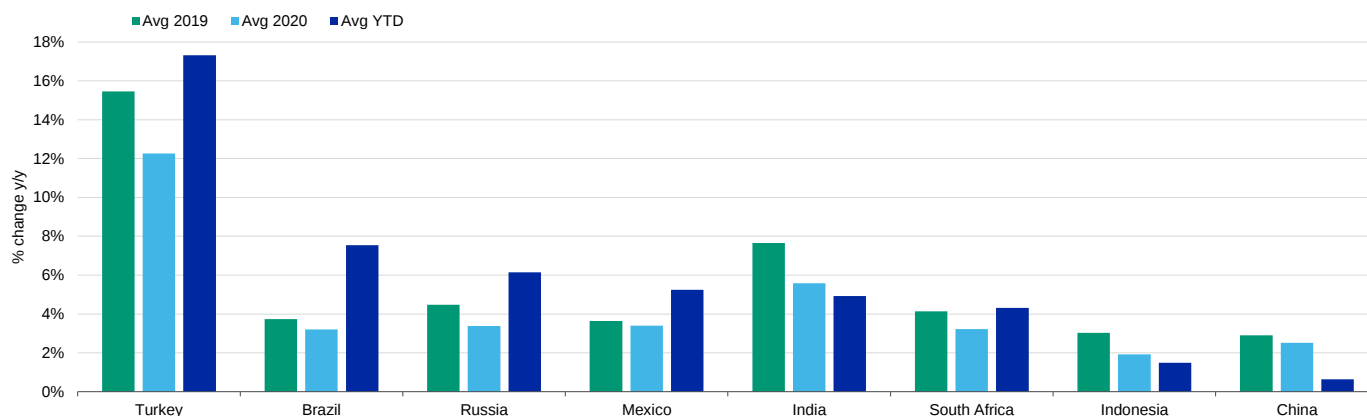
Inflation has picked up more strongly than we expected. This reflects a combination of base effects, swift demand rebounds and persistent supply chain disruptions. Uncertainty around the inflation outlook is high across countries, with elevated risks. Several central banks have already begun tightening their monetary policies to prevent what they view as a temporary spike in inflation not becoming embedded in longer-term market expectations.

The rate of inflation in most G-20 economies will slow in 2022. Base effects will reverse and the effect of one-off price increases will fade, demand growth will eventually slow to more normal levels and supply bottlenecks will ease. However, there are risks that currently high food and fuel inflation become more permanent through markets' expectations. Food and oil prices are the key drivers of higher inflation in emerging markets. Emerging market households spend a much larger share of their incomes on these items than in advanced economies. Alongside energy, food prices continue to raise headline inflation across emerging markets, with the UN's Food and Agriculture Organization's FAO food price index rising 32.8% year-on-year in September. Headline inflationary pressures are most pronounced in Turkey and Latin America, while core inflation is also gaining momentum in Russia. In contrast, consumer prices in Indonesia and China have remained stable and have started to fall in [India](#) (Baa3 stable) (Exhibit 10).

Exhibit 10

Inflation continues to accelerate across most emerging markets

Consumer price inflation, % change year-on-year



YTD 2021 data as of September, Argentina is excluded because of scale

Source: Haver Analytics

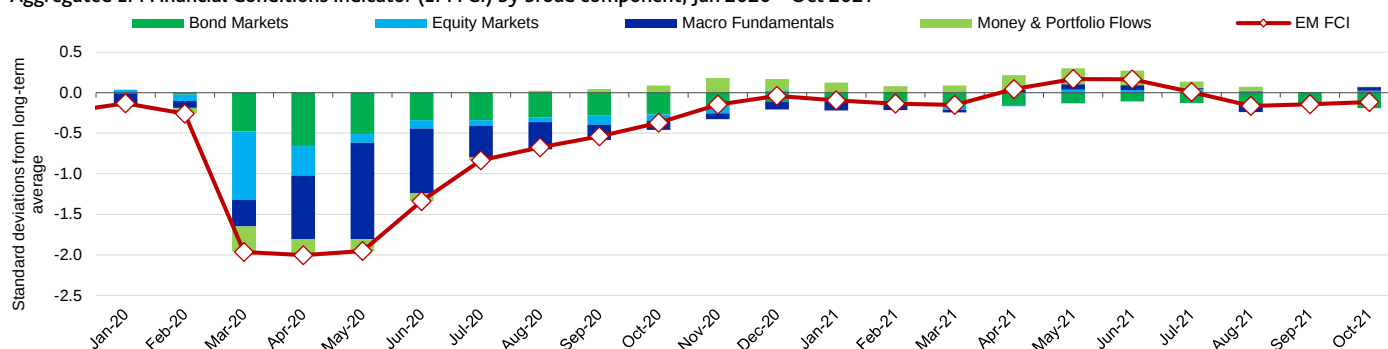
High inflation in emerging markets has the potential to trigger government-mandated food price controls and wage increases, which could weaken some companies' profits. Higher inflation also limits disposable income, with implications for consumer-related sectors. It also increases financing costs for companies, especially those which have debt costs tied to consumer price indexes or interest rates. Higher official monetary policy rates raise bank funding costs immediately. Banks that have a dominant position in a system may be able to pass on rate rises to lending operations to protect their profitability, but not all.

While financial conditions in emerging markets have improved relative to most of 2020, they will remain tight compared with the long term average, after a brief period of favorable conditions in April to July 2021. Many emerging market economies are increasing domestic interest rates to contain inflation despite macroeconomic conditions remaining weak. By contrast advanced economies' central banks policies remain accommodative and financial conditions are still extremely favorable compared with long-term averages. Our proprietary aggregate EM Financial Conditions Indicator (FCI) captures leading financial and economic trends across nine large G-20 emerging economies.³ As at the end of October, macroeconomic conditions had improved in the previous two months but not enough to counter slightly weaker equity market conditions and lower money and portfolio flows. Borrowing costs remain high compared to the long-term average, even though they have improved from last year (see Exhibit 11).

Exhibit 11

Emerging market financial conditions have slightly improved but remain below long term average

Aggregated EM Financial Conditions Indicator (EM FCI) by broad component, Jan 2020 – Oct 2021



Moody's EM Financial Conditions Indicator (EM FCI) is a monthly composite of several measures of financial and economic activity across nine of the largest EM economies globally. As of 31 October 2021 a value higher than 0 indicates looser conditions than the long-term average. A value lower than 0 indicates tighter conditions than the long-term average.

Source: Moody's Investors Service

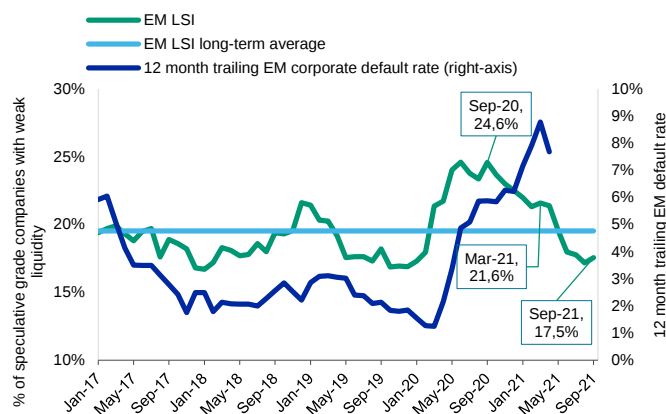
Highly rated companies will continue to access markets to improve their debt structure and extend maturities, as interest rates remain low. But lower rated debt issuers may be unable finance their larger needs and face solvency stress. However, the emerging markets

corporate default rate has begun to decline. The Emerging Markets Liquidity Stress Indicator (EM LSI), which measures the percentage of high-yield companies with our weakest speculative-grade liquidity score of SGL-4, [improved to 17.5% in September from March's reading of 21.6%](#). This is below the long term average (see Exhibit 12). This reflects that intrinsic liquidity has improved overall. All key sub-indicators strengthened from weaker levels in 2020, as companies addressed near-term debt maturities. Companies in Emerging Europe and Latin America have strengthened liquidity by successfully refinancing upcoming debt maturities thanks to improved domestic market access. Liquidity also improved for South East Asian issuers, but is weakening for lower-rated Chinese property developers.

External liquidity risks will remain high for governments with weaker credit quality and large pending foreign currency debt payments. These include governments like [Turkey](#) (B2 negative) and [Belarus](#) (B3 negative) and others in Africa and the Middle East (Exhibit 13). Many will need official support and relief in the face of acute near-term funding needs at a time when this support may be dwindling.

Exhibit 12

EM LSI strengthened to 17.5% in September 2021 from its record high of 24.6% a year ago
EM Liquidity Stress Indicator (LSI) and 12-month trailing EM speculative-grade corporate default rate by region

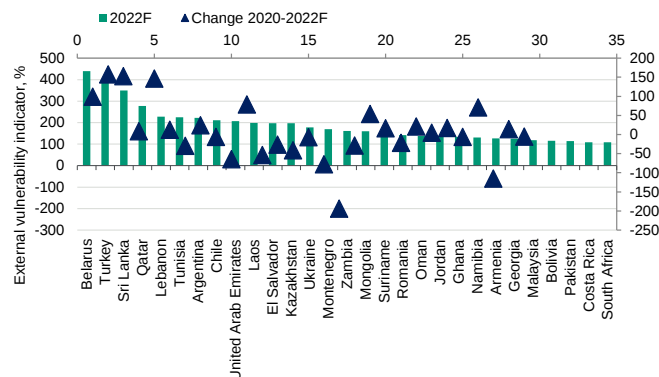


The EM LSI increases as liquidity weakens across the portfolio and decreases as liquidity broadly improves. As of 30 September, we rated 315 high-yield companies. Of that total, 302 are included in the EM indicator, of which 53 had weak liquidity compared to 65 in March 2021.

Source: Moody's Investors Service

Exhibit 13

External vulnerabilities high for many EM sovereigns
External Vulnerability Indicator, % and expected change between 2022 and 2020



The External Vulnerability Indicator (EVI) is calculated as (short-term external debt + currently maturing long-term external debt + total nonresident deposits over one year)/official foreign exchange reserves. Exhibit shows EM sovereigns with EVIs of more than 100% in 2022 (F). Excludes Bahrain and Ecuador with EVIs over 800%. Foreign exchange reserves exclude sovereign wealth fund (SWF) assets, particularly important for countries like Qatar, UAE, Oman and Chile.

Source: Moody's Investors Service

Increasing susceptibility to climate change effects and demand for investment will influence credit quality

Environmental, social and governance (ESG) factors are increasingly important credit considerations. Emerging markets are increasingly susceptible to the physical effects of climate change and pressure to decarbonize. Of the rating actions we took on emerging market sovereigns last year, 85% mentioned environmental issues (Exhibit 14). Physical climate risk was the most frequently cited environmental consideration. This underlines their relatively high exposure and limited capacity to mitigate these risks. Vulnerability to these risks can vary significantly depending on the region's geography, its reliance on agriculture, population growth, maturity of institutions and the availability and strength of central government assistance programs. Environmental considerations were cited in more than 70% of public-sector rating actions we took on issuers in Sub-Saharan Africa and the Middle East and North Africa (MENA). By contrast our private-sector rating actions cited carbon transition risk the most often. References to governance factors in rating actions also increased, to 43% in 2020 from 28% in 2019, illustrating how these factors can influence issuers' resilience and response during a crisis. There is a clear overlap between governance and physical climate risk for emerging markets, in terms of a country's ability to fund climate adaptation, improve resilience and respond to events.

Declining global demand for fossil fuels, accelerated by leading economies' concerted effort to achieve net-zero emissions by 2050, will increase carbon transition risk for all hydrocarbon exporting sovereigns, several of which are emerging market economies. Adjusting

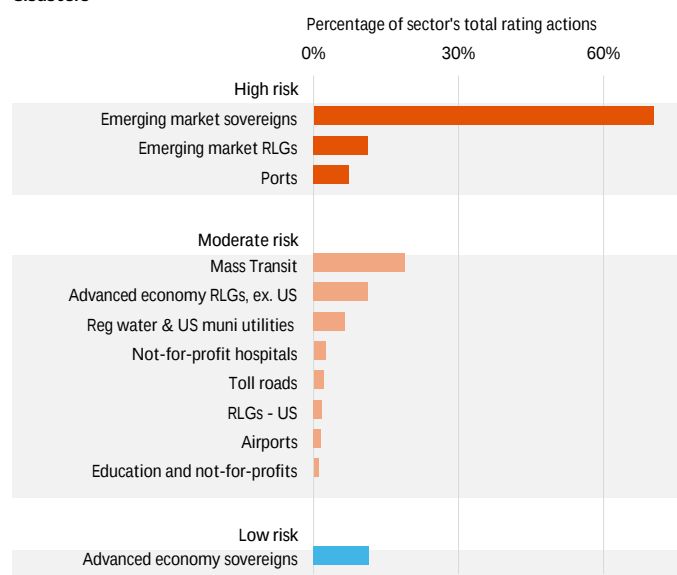
to lower secular demand and prices for hydrocarbons will be particularly hard for sovereigns with already relatively weak fiscal and external positions, which tend to be emerging markets. However, carbon transition brings a greater risk of stranded assets in advanced economies where energy demand is not increasing, than it does in emerging markets where energy demand continues to grow.

[Emerging market sovereigns need significant capital investment to meet their climate transition goals.](#) The International Finance Corporation (IFC) identified \$10 trillion in green investment opportunities between 2020 and 2030. This figure was based on the national climate change commitments and other policies of 21 emerging markets, representing 62% of the world's population and 48% of global emissions. The International Energy Agency (IEA) estimates that emerging markets will need a sevenfold increase in spending on clean energy initiatives to more than \$1 trillion a year by the end of this decade to remain on track for net-zero emissions by 2050. That equates to 3% of their GDP. The OECD estimates an annual figure of around \$4.1 trillion would be needed to address climate change mitigation and adaptation and other environmental issues in emerging markets between 2015 and 2030. As a percentage of GDP, these investment needs vary from around 20% in Europe to around 80% in South Asia (Exhibit 15). At the same time, the capacity of EM governments to invest in green initiatives is constrained: in the midst of the pandemic almost all emerging markets governments' fiscal revenue has declined significantly while spending pressure has intensified.

Exhibit 14

Emerging market sovereign rating actions often cite environmental risks

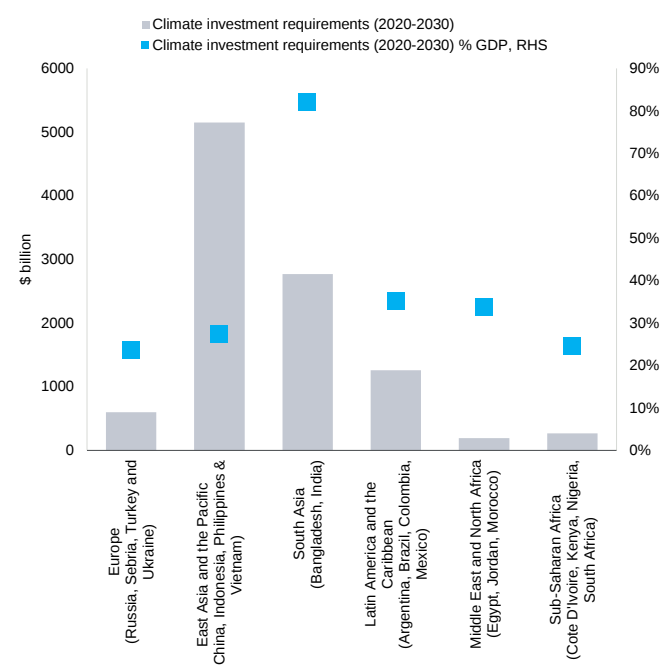
Public sector's proportion of rating actions citing natural and human disasters



Source: Moody's Investors Service

Exhibit 15

Green investment needs vary by region, but are highest relative to GDP in South Asia



We proxy the green financing requirements of 21 EMS based on the IFC's 2020 green investment opportunity estimates.

Sources: International Finance Corporation, Haver Analytics and Moody's Investors Service

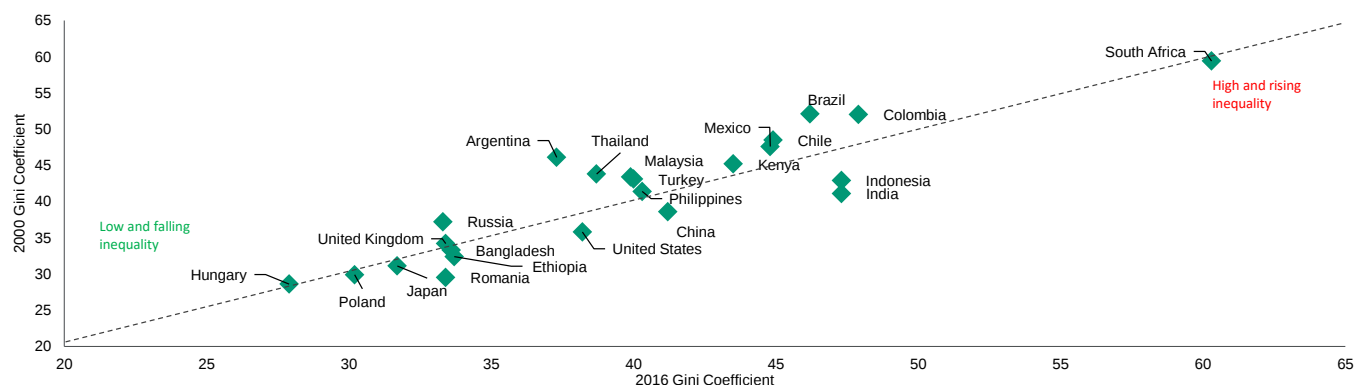
Higher political and social risks could shift governments' policy priorities and weaken operating environments

Emerging markets are at risk of further coronavirus outbreaks, leading to heightened health and social risks. Combined with rising domestic and geopolitical political risks for some, this will test governments' institutions and policy flexibility and effectiveness. Higher political and social risks could shift government's policy priorities. For companies, these shifts and rising risks could create an uncertain regulatory environment, eroding credit conditions. Many sovereigns will face tough policy choices between addressing inequality and the social and health effect of the pandemic and implementing fiscal consolidation.

Many emerging markets have low government revenue, which constrains their ability to shore up financing for spending on social transfers. As a result, the pandemic will exacerbate inequality. Disposable or after-tax income inequality, including accumulated savings and assets, as measured by the Gini coefficient, was already much higher in Sub-Saharan Africa and Latin America than other regions. Inequalities in Asia have been increasing in recent years (Exhibit 16).

Exhibit 16

Income inequality generally higher in Sub-Saharan Africa and Latin America Gini coefficient (post-tax)



Latest data for South Africa, China, Philippines, Ethiopia and Kenya is 2015, India is 2012

Source: World Bank, *The Standardised World Inequality Database*

Inequalities in terms of wealth distribution are stark among emerging market economies. For instance, the share of wealth held by the richest 1% of the population in China exceeded 30% in 2019, from about 20% in 2000. For India, the share of the richest 1% rose to more than 40% in 2019 from less than 20% in the early 2000s.

Q&A: What to watch in different regions and sectors in 2022

China - sovereigns and sub-sovereigns

Gene Fang, AMD

- » **What are the top risks the Chinese government faces in 2022?** China's focus on deleveraging will increase risks to financial stability and growth. While the government has the resources to maintain financial stability, effectively deploying these in a shifting policy landscape will be difficult. Deleveraging will also raise social risks, depending on how the authorities manage the situation. China has also launched a broad set of economic and regulatory reforms, including dual circulation and common prosperity in response to global geopolitical and trade tensions, as well as environmental, social and structural challenges to China's growth model. As policy details evolve, risks that regulatory uncertainty derails growth will rise.
- » **How will the government mitigate the risks from higher public sector debt in the context of lower economic growth?** The government will keep its focus on deleveraging, maintaining strict controls on regional and local government (RLG) debt quotas, managing state-owned enterprise (SOE) leverage and increasing scrutiny on investment project returns. The launch of dual circulation, common prosperity and other regulatory initiatives have components that aim to support productivity, countering pressures on economic growth. Their execution will be key to how well authorities can manage higher public sector debt in future.
- » **A significant deficit remains in RLGs budgets despite rapid revenue expansion. How will RLGs deal with this risk and could this lead to credit quality deteriorating?** RLGs have historically financed deficits through RLG bonds and special purpose bond issuance and off-balance-sheet funding, including through local government finance vehicles, raising direct and indirect government liabilities. Regions with stronger economic fundamentals are better able to manage these risks than those with weaker growth prospects.

China - financial institutions & structured finance

Sophia Lee, AMD & Gracie Zhou, VP-Senior Analyst

- » **What are the top risks Chinese financial institutions face in 2022?** High asset risk remains a common issue, despite stable economic growth. The government's evolving policy priorities, like decarbonization and more equitable income distribution, could trigger disruption and push up borrower delinquencies, raising capital market credit risk. Heightened risk aversion will extend the shift to lower-risk assets, including retail loans, ship leasing, investment banking and asset management.
- » **Will worsening financial conditions lead to deteriorating quality across some sectors? If so, which are most at risk?** Large nationwide banks will maintain their credit strength, but regional banks are vulnerable to further deterioration because their asset portfolios are less diversified and they have more exposure to weaker borrowers. The deteriorating financial performance of some property developers, growing weakness in some regional real estate markets and lagging aviation traffic are three major sources of financial institutions' provisions. Local government support will be less forthcoming in regions with limited fiscal resources and local real estate markets affected by recent policy tightening.
- » **Delinquency rates and loan defaults remained relatively stable in 2021. What is the performance trend in 2022 and what key risks could lead to performance deteriorating?** The gradual economic recovery and low unemployment will continue to support underlying asset quality and overall good performance. Regulations and underwriting standards will remain tight for major asset classes like residential mortgage-backed securities (RMBS) and auto loan asset-backed securities (ABS). The financial distress of some property developers threatens to weaken economic growth, as would a pandemic resurgence, posing performance risks to deals. The rising share of new energy and used car loans in auto portfolios could also expand default risk.

China - state-owned enterprises

Li Ma, Managing Director & Ivan Chung, AMD

- » **What is the leverage trend for state-owned enterprises (SOEs)?** Leverage will stay flat in 2022. EBITDA growth will be lower because domestic GDP growth will slow and reduce demand. Other factors contributing to lower EBITDA growth include high input costs and supply chain disruptions. Lower EBITDA growth will largely offset a low-single-digit percentage growth in debt as the government discourages aggressive debt-funded growth. At the same time, delayed payments from government owners whose fiscal condition has weakened will lead to slightly higher debt for SOEs.
- » **Will SOEs play an important role in China's carbon transition?** Yes; SOEs dominate most energy-producing and consuming sectors. Electricity and heat production accounts for over 40% of China's carbon emissions. National oil companies are mandated to increase natural gas supply as China's seeks to reduce its reliance on polluting coal. Large energy consumers such as steel and chemical SOEs will develop new products with low carbon footprints or upgrade their technology to increase energy efficiency.
- » **How does increased regulatory supervision of local government financing vehicle (LGFV) debt affect their funding access and credit quality?** LGFVs need to generate cash flow from nongovernment sources to meet regulatory requirements for commercial bank borrowing or bond issuance. RLGs in developed regions have more resources to support LGFVs to develop cash-generating businesses while also continuing their policy functions. These RLGs could, for example, transfer a cash-generating, low-risk asset like a mature utility to an LGFV. Differences between RLGs will intensify credit differentiation between LGFVs in developed and less developed regions.

China - private sector nonfinancial companies, infrastructure & project finance

Clement Wong, AMD; Franco Leung, AMD & Ning Loh, AMD

- » **What are the top risks Chinese nonfinancial companies and developers face in 2022?** Uneven recovery across sectors, regulatory shifts, access to funding and liquidity are the key risks. Rising input costs and supply chain disruptions will constrain commodity and manufacturing sectors' earnings. Continued leveraged investments and lack of cost pass-through will pressure some utilities. Regulatory shifts in the internet sector will slow revenue growth and reduce profit margins but ultimately result in a more transparent operating environment and steady revenue growth. Domestic funding markets will remain supportive for investment-grade companies, but funding access for weaker high-yield companies will probably be constrained.
- » **Will new investment requirements for nonfinancial companies stall deleveraging, potentially weakening credit quality?** Companies are investing in their products and services, supply self-sufficiency and environmental, social and governance initiatives. High spending needs will stall deleveraging for companies in a number of sectors such as construction and engineering, transportation and utilities. But the credit quality of most companies we rate will be stable, given their strong balance sheets and steady cash flow.
- » **For Chinese developers, will worsening financial conditions lead to material refinancing risks?** The tight credit environment, developers' large amount of debt maturing in 2022, [China Evergrande Group's](#) (Ca negative) financial distress and resulting weak investor sentiment will increase refinancing risk, especially for financially weak developers.

South East Asia & India - sovereigns

Gene Fang, AMD

- » **What are the top risks governments in Asia face in 2022?** The main risk remains a further delayed, more uneven recovery. Many governments are still struggling to balance trade-offs between faster economic normalization and persistent health risks stemming from the coronavirus. While debt levels will stabilize or peak for much of the region, fiscal challenges will persist, as governments attempt to normalize policy settings while many recoveries are fragile. Economies are also adapting to supply chain shifts brought about by the pandemic and shifting geopolitics.
- » **What is the growth outlook in 2022 compared to 2021, given lagging vaccinations across the region?** For most of APAC, growth will recover to pre-pandemic levels, although there will be a degree of scarring. Many recoveries are vulnerable to resurgences in the virus, with vaccination rates still low in many parts of the region. Governments are adjusting their responses to the disease to keep larger parts of their economies open, while minimizing virus transmission. This is resulting in uneven recoveries across the region.
- » **How will a rise in geopolitical risks lead to deteriorating credit quality in the region?** Geopolitical tensions accelerate changes to prevailing trade and investment patterns, creating uncertainty and raising costs in the transition. Increasing focus on technological self-sufficiency will need further investment, as governments and businesses seek to build secondary supply networks for sensitive technologies. Uncertainty will also dampen investment flows. Further economic gains through trade will be lower, as regional trading blocs overtake global trade in importance and geopolitical factors curb additional increases in trade.

South East Asia & India - financial institutions & structured finance

Alka Anbarasu, SVP & Gracie Zhou, VP-Senior Analyst

- » **What are the top trends Asian financial institutions face in 2022?** An improving operating environment will support credit demand from borrowers, but the pace of recovery will vary. The recovery of businesses will be slower in Thailand and the Philippines than elsewhere, but economic conditions in those two countries will still be better than in 2021. Nonperforming loans will increase in the small and medium enterprises (SME) and retail loan segments, while corporate loan quality will be stable. Policy support for borrowers will limit asset quality deterioration, but prolonged support measures in Malaysia, Indonesia and [Thailand](#) (Baa1 stable) are increasing the risk of moral hazard among bank borrowers. Large loan loss reserves and pre-provisioning profitability are enough to cover expected loan losses.
- » **As migration to digital accelerates, which forces are playing a bigger role in reshaping the Asian financial landscape?** Banks will continue to expand through digital and mobile financial services, which have gained significant traction in the past year because of social distancing measures. Banks will partner with fintech companies to develop digital ecosystems.
- » **Despite an uneven recovery, consumer demand and employment levels have recovered from pandemic lows. How will this affect structured finance transaction performance?** The pickup in economic activity will support Indian auto ABS and SME ABS' performance. Nevertheless, delinquency rates will stay high, though broadly similar to current levels. Many underlying borrowers will continue to deal with the aftereffects of the coronavirus outbreak in 2021, which has significantly eroded their financial buffers. Securities' performance may worsen if India's coronavirus situation deteriorates substantially and derails the economic recovery.

South East Asia & India - nonfinancial companies

Vikas Halan, AMD & Ian Lewis, AMD

- » **What are the top risks South and South East nonfinancial companies face in 2022?** The pandemic will continue to weigh on many companies' prospects. A surge in infections that leads to renewed restrictions, and intensified supply chain disruptions and energy shortages would drag on economic recovery and earnings. Deteriorating financial conditions, including higher interest rates, would reduce access to funding, particularly for lower-rated companies. Increased government regulation would weigh on the operating environment for the affected companies.
- » **Which companies are more susceptible to a shift in financial conditions? How will limited funding access affect credit quality?** Lower-rated companies are most susceptible to tightening financial conditions because they are generally smaller in scale, less diversified and rely more on sustained access to capital markets. Companies with weak liquidity are also exposed. Of the 42 high-yield companies in South and South East Asia we rate, 20 (48%) are rated B2 and below and 12 (29%) have weak liquidity. The high-yield companies have \$4.6 billion of rated and unrated bonds coming due through 2022, of which \$2.9 billion (63%) is issued by companies rated B2 and below. Limited funding access could hurt these companies' credit quality.
- » **The pandemic has accelerated digital transformation and increased market scrutiny of ESG risks. How are companies adapting?** Information technology service providers will continue to benefit from strong demand as companies' strive to boost IT infrastructure. A shortage in semiconductor chips will have knock-on effects on manufacturers of autos, auto parts and other modern products. ESG scrutiny has led to greater disclosure from companies on this topic. Companies with higher exposure to carbon transition have started communicating their plans to deal with carbon transition risk.

South East Asia & India - infrastructure & project finance

Ray Tay, Senior Vice President

- » **What are the top risks Asian infrastructure issuers face in 2022?** Risks will vary across projects. Utilities are more exposed to policy risks because they need to balance affordability, supply reliability and carbon transition. Toll roads and airports will remain most susceptible to new coronavirus outbreaks, given the region's lower vaccination rates and because restrictions on movement will curb traffic. Counterparty risks will increase for projects because purchasers, usually linked to governments, may have weaker balance sheets because of coronavirus. Supply chain issues may also affect contractors or suppliers to projects under construction, leading to delays or higher costs.
- » **Will liquidity risks rise for projects as financing conditions worsen and could that lead to deteriorating credit quality?** Infrastructure issuers are usually essential or strategic and tend to benefit from regulated cash flow and links to government, enhancing their access to liquidity. Risks may rise more for project bond issuers which need to refinance. However, issuers with shorter tenor debt in this region tend to be renewable energy projects, which benefit from broad stakeholder commitment to sustainability.
- » **The pandemic has increased market scrutiny of ESG risks and underscored the importance of investment in climate resilience. How is this shaping the outlook for projects in Asia?** This is credit positive for renewables in emerging Asia. Although the impetus for a green transition was there before coronavirus, the pandemic has renewed stakeholders' calls to deliver on green commitments. Growth will come from continued renewables deployment in established country markets like India but we also expect increased renewables growth in other countries as governments commit to reducing carbon emissions. This growth will also drive transmission infrastructure and energy storage needs.

Eastern Europe, Turkey, Russia & CIS - sovereigns

Dietmar Hornung, AMD

- » **What are your growth expectations for 2022?** Continued credit growth and looser monetary conditions will support Turkish GDP growth of around 4.8% next year. In Central and Eastern Europe (CEE), improving consumer confidence, increasing investment and EU recovery funding will generate output near last year's robust levels. The Confederation of Independent States (CIS) will probably return to growth next year as easing restrictions support a recovery in consumer demand, private investment and foreign direct investment flows, though performances will vary.⁴ The reimposition of restrictions and inflation are key risks to growth.
- » **Will governments start to rebuild the fiscal space lost by the pandemic?** Economic growth will increase income from consumption taxes in the CEE, while a commodity price rebound will benefit CIS governments' coffers. However, high infrastructure needs, the carbon transition and growing social pressures will curb efforts to reduce spending across regions. Strong credit growth supporting economic activity and Turkey's fiscal anchor will ensure the resilience of its public finances. On balance, sovereigns should be able to rebuild some fiscal buffers across both regions in the next few years.
- » **Where do tightening financial conditions pose financing risks?** CIS sovereigns with partly dollarized economies, like [Armenia](#) (Ba3 stable) or [Georgia](#) (Ba2 stable) and high levels of foreign currency debt are most exposed to a rise in global interest rates. Turkey's external vulnerabilities also raise its exposure. CEE countries like [Czech Republic](#) (Aa3 stable), [Slovakia](#) (A2 stable) and [Slovenia](#) (A3 stable) should weather a deterioration relatively unscathed because of generally robust institutions, flexible exchange rates or ECB policy support and narrow current account deficits.

Eastern Europe, Turkey, Russia & CIS - sub-sovereigns

Massimo Visconti, VP-Senior Credit Officer

- » **Do tightening financing conditions pose credit risks for the region's sub-sovereigns?** Funding from national banks, multilateral development banks and in some cases central governments largely met the financing needs of most sub-sovereigns in 2021. We expect similarly supportive conditions in 2022 because they are generally viewed as stable debtors. Amortizing debt structures in many jurisdictions also limit any risks.
- » **Will the economic recovery be enough to support an improvement in fiscal positions in 2022?** Accelerating economic growth should start to improve revenue intake from consumption and investment taxes and service fees. However, it will be politically difficult for local governments to roll back on spending increases introduced in the past few years, particularly on health and social care and unemployment. Local governments are also likely to come under pressure to ramp up capital spending after delays in 2020. As a result, debt levels will probably grow modestly or stabilize rather than fall.
- » **What is the biggest risk for sub-sovereigns in your region in 2022?** Low vaccination levels increase the risk of governments reimposing restrictions, which would weigh on revenue and intensify spending pressures. National policy decisions to strengthen restrictions will curb the recovery of RLGs' fiscal revenue. Against this backdrop we expect sovereigns to be generally supportive with some compensation measures.

Eastern Europe, Turkey, Russia & CIS - financial institutions & structured finance

Yaroslav Sovgyra, AMD & Martin Lenhard, VP-Senior Credit Officer

- » **What are the top trends financial institutions in your region face in 2022?** Banks' asset quality will remain stable despite governments and central banks lifting forbearance measures, underpinned by the continued economic recovery. Rising interest rates will support banks' profitability, but the near term positive effect will be muted as banks reprice liabilities faster than assets. The move to digital banking and cashless transactions is accelerating as the pandemic and lockdowns change customers' behavior. Neobanks will remain a limited threat to incumbents despite aggressive growth.
- » **How are civil unrest and demographic change in the region affecting the operating environment for banks and will this risk become a credit driver in 2022?** Most CIS countries remain exposed to the risk of a coronavirus outbreak or external or internal conflicts. These could trigger deposit outflows or an economic downturn, hurting loan quality. Aging workforces will erode bank profitability in Eastern Europe and Russia. Banks in Central Asia and Turkey will benefit more from credit demand from young, growing populations.
- » **Despite an uneven recovery, consumer demand and employment levels have recovered from pandemic lows. Will this boost covered bond issuance?** Economic growth will boost disposable income, supporting demand for new housing stock and mortgage loans in many markets and fueling covered bond issuance as banks look for inexpensive, long-term funding. The EU covered bond directive will support legislative initiatives in countries like [Bulgaria](#) (Baa1 stable) and [Croatia](#) (Ba1 stable), helping attract international investors. Issuance activity is weak, reflecting ample deposit funding. Bank regulation on issuing debt that meets the minimum requirement for own funds and eligible liabilities (MREL) has curbed covered bond issuance.

Eastern Europe, Turkey, Russia & CIS - nonfinancial companies, infrastructure & project finance

Victoria Maisuradze, AMD

- » **What are the top risks nonfinancial companies and projects in the region face in 2022?** Any further coronavirus-induced strain on Russia's economy and rising inflationary pressures could hurt consumer sensitive sectors. Taxes will rise for steel, mining and fertilizer exporters, but they will preserve credit quality thanks to their low costs, modest debt levels and a weak ruble. For Turkey, political risks and policy uncertainty could lead to further erosion in investor confidence impeding access to US dollar funding. Utilities in Eastern Europe face regulatory and political risks in the context of still-evolving regulatory frameworks and higher energy prices.
- » **Will liquidity risks rise for companies and projects as financing conditions worsen and could that lead to deteriorating credit quality?** Liquidity will stay , supported by favorable commodity prices and through a mix of conservative balance sheets, large cash balances, international operations (Turkish companies) and US dollar-linked revenue. State-controlled utilities will keep good access to funding. Highly leveraged companies hurt by the pandemic like [Ronesans Gayrimenkul Yatirim A.S.](#) (B2 negative) could face liquidity risk.
- » **How are companies positioned to adapt to carbon transition risks?** Large companies are improving ESG disclosures and ensuring they have strategies in place to cut carbon emissions. Russian oil and gas majors' business models are unlikely to radically change in the near term; their low production costs will support profitability even if oil prices decline. Rising demand for natural gas in Europe and Asia will help [Gazprom PJSC](#) (Baa2 stable) and [PAO Novatek](#) (Baa2 stable). Eastern European utilities with carbon-intensive power generation face major investments to develop renewables and reduce their fossil fuel exposure.

Africa & Middle East - sovereigns and sub-sovereigns

Matt Robinson, AMD

- » **As growth recovers, are African governments likely to regain the fiscal space they lost during the pandemic?** The recovery remains timid and fragile: low vaccination rates, the sporadic imposition of restrictions, long-term economic scarring and limited fiscal space in the wake of the pandemic shock will continue to contain economic growth to rates below those recorded in the past decade. As a result, generating revenue, restoring buffers and returning to pre-crisis debt/GDP ratios will take unprecedented fiscal action for most, at a time when governments continue to bear the brunt of the pandemic's financial and social burden.
- » **As global energy demand returns, are higher oil prices credit positive for hydrocarbon exporting countries in the Middle East and Africa?** In the Gulf Cooperation Council (GCC), higher oil prices and the unwinding of OPEC production cuts are providing a boost to fiscal revenue and relieving liquidity pressures, but balance sheets will remain weaker than pre-pandemic levels for most.⁵ In Africa, underinvestment and maintenance issues will limit the benefits of relaxed production restrictions and recovering global demand. Meanwhile, an accelerating decarbonization agenda presents a significant adaptation challenge for those unable to match their pace of diversification efforts to changing global trends.
- » **Are liquidity conditions likely to improve or worsen for African governments?** Borrowing needs will remain high in 2022 given still-wide fiscal deficits, rising interest costs and upcoming debt maturities. Tightening global liquidity and monetary policy shifts amid inflationary pressures coinciding with the end of emergency international support and relief efforts present extra financing challenges. Credit risks are highest for those with large rollover requirements and uncertain market access.

Africa & Middle East - financial institutions & structured finance

Constantinos Kypreos, SVP & Antonio Tena, VP-Senior Credit Officer

- » **What are the key issues for African and Middle East financial institutions in 2022?** Earnings will improve, loan-loss provisions will decline and capital ratios will stabilize as credit growth recovers and problem loan growth recedes. Banks will remain deposit-funded with sound liquidity, but foreign-currency liquidity may weaken if rising interest rate expectations in developed markets push investors out of Africa. Insurers' capital will remain strong, but they will struggle to grow premiums. However, credit conditions will remain uneven across the region and high interlinkages with credit-challenged sovereigns in South Africa and [Nigeria](#) (B2 negative) will continue to pressure banks' own credit quality.
- » **Which forces are playing a bigger role in reshaping the financial landscape in Africa and the Middle East?** African banks will focus on new technologies as they deepen financial inclusion, with larger banks considering regional expansion to reap the eventual benefits of Africa-wide free trade under AfCFTA.⁶ Smaller banks will continue to consolidate to improve efficiency, while regulatory enhancements will speed insurer consolidation. Shift to net-zero will be hard for banks in oil-exporting economies.
- » **What effect will record-high unemployment in South Africa have on South African structured finance transactions?** High unemployment will increase performance risk to consumer loans and mortgages' underlying securitizations. The pandemic and high household debt will exacerbate obligor strains. However, the credit quality of borrowers' underlying securitizations is stronger than the overall credit market, supporting performance.

Africa & Middle East - nonfinancial companies, infrastructure & project finance

Rehan Akbar, Senior Vice President

- » **What are the top risks nonfinancial companies and projects in Africa and the Middle East face in 2022?** Political, social and regulatory risks are key credit quality drivers in Africa, particularly in the context of weakened public finances for sovereigns. Access to funding and maintaining adequate liquidity remain key challenges for African and Middle Eastern companies and project finance issuers. The pandemic could continue to weigh on parts of their economies such as the aviation, real estate, construction, travel and hospitality industries.
- » **Will the sustained above average commodity prices support credit quality?** High commodity prices will have varying effects on credit quality. National oil companies in the Middle East will benefit significantly from high oil prices. The mineral industry in Africa will also strongly benefit. However, commodity consumers such as coal-fired power generators face higher input costs. The ability to pass on higher costs to customers will be key in supporting credit quality for these companies.
- » **How are companies positioned for adapting to carbon transition risks?** Carbon transition risks are limited for most companies because their domestic regulatory environments are benign. Some, such as coal-fired generators, face high risk because of global decarbonization trends. Businesses recognize they need to mitigate this risk and are enhancing reporting disclosures. African miners are sourcing renewable energy and seeking to reduce greenhouse gas emissions from mining equipment. Project finance issuers typically have long-term off-take agreements that pass through force majeure and change-in-law effects, making them resilient to carbon transition risks.

Latin America - sovereigns

Mauro Leos, AMD

- » **What is the growth outlook for Latin America in 2022 compared to 2021?** Economic growth will moderate and align with historical trend growth. For virtually all countries except Argentina, Mexico and [Panama](#) (Baa2 stable), GDP will return to pre-pandemic levels – output in Chile, Colombia and [Peru](#) (Baa1 stable) is already higher than 2019. Consumption will remain a strong growth driver as pandemic-related restrictions ease and vaccinations progress. Higher domestic interest rates pose risks as central banks have raised rates sooner and faster than expected. Mexico and Central America will benefit from strong US growth and remittances. Commodity prices will support recovery in Chile, Peru and [Bolivia](#) (B2 negative), with tourism-dependent Caribbean economies lagging.
- » **How can political and social risks affect credit quality in the region?** Responding to social demands while undertaking fiscal consolidation is a major policy challenge. The credit implications of political events in Peru and Chile will depend on the fiscal effect of government commitments derived from new constitutional mandates. In Colombia and Brazil, political and policy uncertainty ahead of elections may erode business and investor confidence, curbing growth.
- » **Which governments are more susceptible to a shift in financial conditions?** Most countries' international reserves exceed upcoming external debt payments. Bolivia, [Costa Rica](#) (B2 negative), [El Salvador](#) (Caa1 negative) and [Ecuador](#) (Caa3 stable) are positioned at the low end given their weak external liquidity positions. Peru, [Uruguay](#) (Baa2 stable), Mexico and Colombia are exposed to changing international investor sentiment given their high shares of nonresident domestic debt holdings.

Latin America - sub-sovereigns

Maria del Carmen Martinez-Richa, VP-Senior Analyst

- » **What are the top risks Latin American sub-sovereigns face in 2022?** The main risk is that own-source revenue and transfers are highly correlated with economic performance. RLGs with exposure to tourism remain most vulnerable to the progress on vaccination and the easing of mobility restrictions. Rising social demands, driven by inflation, rising poverty and unemployment will raise pressure to increase spending, with limited flexibility to absorb it. In Brazil, higher energy prices because of droughts will temporarily increase energy-related tax revenue but will be negative for spending and tax collection in the medium term.
- » **The pandemic shock led to lower tax revenue and higher short-term debt. Will some issuers be able to get back to pre-pandemic tax revenue and debt levels?** RLGs' tax revenue recovered to pre-pandemic levels in 2021. Some, like [Bogota](#) (Baa2 stable) and [Buenos Aires](#) (Caa3 stable) have new measures to further strengthen tax collection. But many RLGs in Mexico and Argentina have increased short-term debt. Mexico's short-term debt will go back to pre-pandemic levels as revenue pressures ease. RLGs in Argentina have eased pressure by restructuring foreign-currency debt and will continue to rely on local market short-term issuance to cover financing needs.
- » **Will liquidity risks rise for sub sovereigns as financing conditions worsen in 2022 and sovereign support declines and will that make it harder for them to secure financing?** Markets will be able to absorb manageable financing needs. In Argentina, refinancing risk and liquidity pressure will ease thanks to debt restructurings. However, the sector still faces challenges, like a still-large share of foreign-currency debt with risk of further debt restructurings around 2023.

Latin America - financial institutions & structured finance

Ceres Lisboa, AMD & Daniela Jayesuria, Senior Vice President

- » **What are the top trends Latin American financial institutions face in 2022?** Higher rates and rising business volumes will support profits, offsetting moderate economic activity, higher funding costs, competition and modest loan growth amid political uncertainties, particularly in Peru, Chile and Brazil. Asset risks will increase with generally weak job markets, record-high household debt in Brazil and the end of government support in Peru, Panama and Colombia, increasing loan-loss provisioning costs needs. High reserves will be held despite better operating conditions. Stable liquidity and capital buffers will remain enough to support new lending and credit quality.
- » **As migration to digital accelerates, which forces are playing a bigger role in reshaping the financial landscape in Latin America?** A young population, low financial inclusion and high spreads will fuel innovation and attract big tech and fintech in Brazil, Chile and Colombia, particularly after Brazil launched open banking in 2021. Incumbents will defend market positions by partnering with fintechs and offering nontraditional products, like marketplaces, to boost customer engagement and fee income. Established local investment and payment fintechs like Nubank, Stone and [XP Inc.](#) (Ba2 stable), will keep seeking banking and cross-border opportunities, particularly in Mexico and Colombia, but high rates and inflation will probably slow progress.
- » **Despite an uneven recovery, consumer demand and employment levels have recovered from pandemic lows. How will this effect the performance of structured finance transactions?** The economic recovery will help normalize delinquencies and losses for securitized mortgages and other consumer assets from their earlier deterioration and aid higher issuance. Equipment leases and other commercial assets' performance will remain strong, having largely done so throughout the pandemic.

Latin America - nonfinancial companies

Marcos Schmidt, AMD

- » **What are the top risks Latin American nonfinancial companies face in 2022?** Economic growth will continue but with some political risk in much of the region. Higher food and oil prices have increased inflation, tightening 2022 earnings for consumer-dependent sectors and interest rates will rise more quickly than central banks had anticipated. Commodity prices will remain volatile for the resource dependent region, off their 2021 peaks but still benefiting from improving global demand. Weak local currencies will help regional exporters keep their competitive edge.
- » **Will liquidity risks rise for companies as financing conditions worsen? Will that make it harder for them to secure financing?** Corporate EBITDA and cash generation will decline by about 7% from recent peaks, but overall credit quality will remain strong after pandemic cost-cutting. Companies generally improved liquidity and strengthened balance sheets using cash generated during the pandemic. Average leverage will deteriorate slightly while liquidity ratios will strengthen by end-2022. Companies in the region will maintain their access to international capital markets to help them reduce debt or pursue opportunistic investments or acquisitions.
- » **How is political and social unrest in the region affecting the operating environment?** Argentina remains shut out of international debt markets, and political tensions aggravate local operating conditions, weak local market conditions and price controls imposed in 2020 will weigh on corporate profit. Political tension in Brazil before the October election also threatens business and consumer confidence. Heightened political uncertainty in Chile and Peru could harm mining sector confidence, investment and credit quality.

Latin America - infrastructure & project finance

Cristiane Spercel, Senior Vice President

- » **Will liquidity risks rise for project and infrastructure finance as financing conditions worsen? Will that make it harder for them to secure financing?** Infrastructure issuers benefit from high cash flow predictability because of long-term contracts and regulated tariffs, which aid access to debt when investor sentiment shifts to more defensive allocation strategies. Financial closing for new projects could be delayed but liquidity risks are limited to sectors finding it harder to improve profit or which depend on strong growth. Secured project financings carrying comprehensive bondholder protections with liquidity provisions or third-party guarantees will help offset market risks.
- » **How is political and social unrest in the region affecting the operating environment for projects?** Social discontent, rising inflation and political polarization have all raised the risk of policy shifts to address customer affordability concerns. This undermines investor confidence and impairs the development of capital-intensive infrastructure projects. In recent years, decision-makers in Chile, Mexico and Brazil have become more willing to alter the regulatory processes on behalf of ratepayers, increase scrutiny of PPPs' performance or push for change on existing contracts.
- » **The pandemic has accelerated digital transformation and increased market scrutiny of ESG risks. Will projects find it easier to finance renewable or "green" projects and if so, will they use this opportunity to attract investment?** The green/sustainable bond market provides a key funding alternative for the region's much needed infrastructure investments, particularly in sanitation, renewables and energy efficiency projects. Environmental risks have gained prominence because of the region's drought, creating the need for better corporate strategies on water management and energy diversification. The path to net-zero carbon emissions is also creating investment opportunities for the transition to greener energy in Chile and Colombia.

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- » [Global Macro Outlook 2022-23: Global economy will gain steadier footing although supply troubles, inflation pose risk](#), 4 November 2021
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- » [Credit Conditions – Global: 2022 Outlook – Global credit environment will stabilize as COVID-19 uncertainties ebb](#), 1 November 2021

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- » [Emerging Markets Liquidity Stress Indicator \(EM LSI\) – November 2021](#), 1 November 2021
- » [Sovereigns – Emerging markets: Concessional and market-based financing vastly undershoots climate-resilience funding needs](#), 26 October 2021
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Endnotes

- ¹ We use the International Monetary Fund's (IMF) definition of emerging and developing economies to define our emerging market coverage. The main criteria used by the IMF to classify emerging market and developing economies are: (1) per capita income level, (2) export diversification, and (3) degree of integration into the global financial system. Using these definitions, we rate 107 EM sovereigns and nearly 1,800 EM regional and local governments, financial institutions, nonfinancial companies and infrastructure and project finance issuers.
- ² G-20-emerging economies include Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa and Turkey.
- ³ Our EM Financial Conditions Indicator (EM FCI) is a monthly composite of several measures of financial and economic activity across nine of the largest EM economies globally. Collectively, these economies represented 72% of EM GDP* and 74% of private-sector eurobond issuance in Q3 2021. The EM FCI shows the overall financial conditions implied by the combination of the individual components for each of the nine EM countries and for the EM aggregate, which is constructed as a simple average of the countries' FCIs. [Emerging Markets – Global Financial Conditions Monitor: October 2021](#), 14 October 2021.
- ⁴ CIS comprises Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine.
- ⁵ GCC comprises Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates
- ⁶ African Continental Free Trade Agreement

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Contacts

Deborah Tan AVP-Analyst/CSR deborah.tan@moodys.com	+65.6398.8335	Gersan R Zurita Senior Vice President/CSR gersan.zurita@moodys.com	+55.11.3043.6097
Benedicte Andries Analyst/CSR benedicte.andries@moodys.com	+44.20.7772.1613	Gene Fang Associate Managing Director gene.fang@moodys.com	+65.6398.8311
Sophia Lee, CFA Associate Managing Director sophia.lee@moodys.com	+852.3758.1357	Gracie Zhou VP-Senior Analyst gracie.zhou@moodys.com	+86.21.2057.4088
Li Ma MD-Corporate Finance li.ma@moodys.com	+86.21.2057.4015	Ivan Chung Associate Managing Director ivan.chung@moodys.com	+852.3758.1399
Clement Wong Associate Managing Director clement.wong@moodys.com	+852.3758.1561	Franco Leung, CFA Associate Managing Director franco.leung@moodys.com	+852.3758.1521
Ning Loh Associate Managing Director ning.loh@moodys.com	+852.3758.1668	Alka Anbarasu Senior Vice President alka.anbarasu@moodys.com	+65.6398.3712
Vikas Halan Associate Managing Director vikas.halan@moodys.com	+65.6398.8337	Ian Lewis Associate Managing Director ian.lewis@moodys.com	+65.6311.2676
Ray Tay Senior Vice President ray.tay@moodys.com	+65.6398.8306	Dietmar Hornung Associate Managing Director dietmar.hornung@moodys.com	+49.69.70730.790
Massimo Visconti, MBA VP-Sr Credit Officer/ Manager massimo.visconti@moodys.com	+39.02.9148.1124	Yaroslav Sovgyra, CFA Associate Managing Director yaroslav.sovgyra@moodys.com	+7.495.228.6076
Martin Lenhard VP-Sr Credit Officer martin.lenhard@moodys.com	+49.69.70730.743	Victoria Maisuradze Associate Managing Director victoria.maisuradze@moodys.com	+7.495.228.6067
Matt Robinson Associate Managing Director matt.robinson@moodys.com	+44.20.7772.5635	Constantinos Kypreos Senior Vice President constantinos.kypreos@moodys.com	+357.2569.3009
Antonio Tena, Ph.D. VP-Senior Analyst antonio.tena@moodys.com	+34.91.768.8235	Rehan Akbar, CFA Senior Vice President rehan.akbar@moodys.com	+971.4.237.9565
Mauro Leos Associate Managing Director mauro.leos@moodys.com	+1.212.553.1947	Maria Martinez-Richa VP-Senior Analyst mariadelcarmen.martinez-richa@moodys.com	+52.55.1253.5729
Ceres Lisboa Associate Managing Director ceres.lisboa@moodys.com	+55.11.3043.7317	Daniela Jayesuria Senior Vice President/ Manager daniela.jayesuria@moodys.com	+1.212.553.2723

Marcos Schmidt
*Associate Managing
Director*
marcos.schmidt@moody.com

+55.11.3043.7310

Cristiane Spercel
*Senior Vice President/
Manager*
cristiane.spercel@moody.com

+55.11.3043.7333