Credit Outlook

29 March 2021

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Suez Canal blockage adds more pressure to already strained supply chains

Originally published on 25 March 2021

On 23 March, container ship Ever Given ran aground and became lodged across the Suez Canal, blocking passage through a vital waterway for global trade. It is unclear when the ship will be refloated and the canal will reopen, raising the prospect of further delays to already strained supply chains, particularly for European manufacturers and automakers, a credit negative.

Depending on how global and regional volume is calculated, we estimate that the canal's temporary closure affects around 10%-15% of world container throughput. The implications of delays for global supply chains would, under normal circumstances, not be a big issue. However, very high consumer and industrial demand, a global shortage of container capacity and low service reliability from global container shipping companies already causing long delays, has made supply chains highly vulnerable to even the smallest of external shocks. In that context, the timing of this event could not have been worse.

The vessel is a so-called ultra-large container ship with a capacity of 20,100 twenty-foot equivalent units (TEUs), spanning 399 metres long and 59 metres wide. It is owned by Japan's Shoei Kise Kaisha and leased out to Taiwanese container ship company Evergreen. The canal, which connects the Mediterranean to the Red Sea, is part of the Asia-Europe trade lane and provides the shortest sea link between the two continents.

Ships that were about to enter the canal will soon need to decide whether to turn back and use the alternative, longer route around the Cape of Good Hope. That would add around 10 days to their journey compared with the main route that includes the Suez Canal.

The effect of delays on individual sectors is hard to quantify because of the uncertainty over how long the canal will be blocked. However, we believe that Europe's manufacturing industry and auto industry, including auto suppliers, will be most affected. This is because they operate “just-in-time” supply chains, meaning they do not stockpile parts and only have enough on hand for a short period, and source components from Asian manufacturers. Even if the situation is resolved quickly, port congestion and further delays to an already constrained supply chain are inevitable. Alternative modes of transportation are more or less out of the question, because airfreight capacity is already tight owing to the coronavirus pandemic and rail transportation between China and Europe is very limited.

For container shipping, the effect is credit neutral. For carriers diverting their vessels around Africa instead of going through the Suez Canal fuel costs will increase. However, spot freight rates will most likely increase or at least stop decreasing from their currently very high levels. As a reference, around 50% of the Asia-Europe volume is shipped at contracted rates that offer little flexibility to offset increased costs due to external events.

From a sovereign perspective, we do not expect significant disruption to Egypt’s (B2 stable) balance of payments as a result of this incident. Suez Canal receipts amounted to almost 2% of GDP on average before the pandemic, providing a significant contribution to total current account receipts. While declining to 1.3% of GDP during the acute phase of the pandemic, Suez Canal receipts have proven more resilient than other cross-border services such as travel receipts. A temporary disruption will not materially change our expectation of a return to pre-crisis canal receipts as global trade recovers. Despite the canal’s importance especially for hydrocarbon products transported by sea, we expect that other Suez Canal-reliant exporters, including oil-exporting countries in the Middle East, are unlikely to be affected in the absence of an extended disruption.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

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Carrefour's cash-funded acquisition of Grupo BIG will strengthen its market position in Brazil

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On 24 March, Carrefour S.A. (Baa1 negative) announced the acquisition of Brazilian food retailer Grupo Big S.A. for an enterprise value of around €1.1 billion, equivalent to an estimated 8x enterprise value/EBITDA multiple before synergies. The transaction is expected to close in 2022 following regulatory approval from the Brazilian authorities. Overall, we view the acquisition as credit positive for Carrefour because it will be funded by cash, reducing gross leverage once synergies are achieved, and strengthen its leading position in Brazil.

The acquisition will improve Carrefour's business profile by increasing its overall scale and geographical diversification, in addition to strengthening its position in Brazil. Carrefour and Grupo BIG are the country's largest and third-largest food retailers, respectively, and have complementary geographical coverage: Grupo BIG has a strong presence in the north-east and south of Brazil, where Carrefour currently has limited penetration. In addition, the similarity of Grupo BIG's formats with Carrefour's (mainly cash and carry and hypermarkets) will facilitate the companies' integration.

Carrefour will finance the transaction through a mix of cash (70%) and equity (30%) and we expect it to have sufficient cash on balance sheet to fund the acquisition. As a result, Moody's adjusted debt/EBITDA will decrease by around 0.2x pro forma for the transaction and taking into account around €260 million of run-rate EBITDA synergies that it expects to achieve over a three-year period. However, net debt will deteriorate slightly once the transaction completes because of the estimated €800 million acquisition cost. We also expect restructuring costs to partially offset the additional cash flow from Grupo BIG in the years following the transaction's closing.

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Paraguay's central bank extends special provisioning measures, a credit negative

On 25 March, Banco Central de Paraguay (BCP), the central bank, extended special loan restructuring and provisioning measures for banks by an additional six months to year-end 2021, from the original end date of 30 June 2021. The extended measures are credit negative for Paraguay's banks because they will obfuscate problem-loan ratios.

The provisions allow banks to restructure loans, including giving additional grace periods and restructuring loans that were previously restructured, instead of recognizing them as delinquent and provisioning for them. Provisioning will also be deferred and realizable over a 24- month period, which keeps the banks' profitability from reflecting the true extent of provisioning expenses.

As of January, 18% of Paraguayan banks' total loans on their balance sheets were under the central bank's special measures and these could well be restructured again. Banco Continental S.A.E.C.A. (Ba1 negative, ba2[1]) had 9.5% of its loans under special pandemic related provisioning measures, while for Banco Regional S.A.E.C.A. (Ba2/Ba2, negative, ba3) it was 31.7% and for Banco Basa S.A. (Ba2 stable, ba3) 16.0%. Banco Regional has an additional 2.3% of its loans under legacy pre-pandemic provisioning measures.

For Banco Continental, Banco Regional, BBVA Paraguay and Banco Basa, net income fell an average of 25% in 2020, according to BCP data. Profitability pressures along with the central bank's extension of special measures led banks to defer provisioning measures. With limited noninterest income buffers and interest income accounting for around 75% of total income between 2017 and 2020, banks are particularly susceptible to a sharp drop in interest income because of low interest rates, increased competition and subdued loan growth. These pressures act as incentives to smooth out provisioning over time at certain banks and will continue to do so.

Problem loans were 2.54%, down from 2.60% the year before, a direct result of the BCP's special provisioning measures announced throughout last year. Banks are also able to restructure loans that were previously restructured, granting new grace periods if the loans need it near maturity and are at risk of being nonperforming.

The BCP introduced several measures to aid banks after the pandemic began. The measures initially allowed loans to be refinanced and restructured until year-end at no additional cost to borrowers, recognition of related provisions over 36 months and one-year grace periods. They also allowed new loans to small and midsize companies until June 2020 to be provision-free for 18 months and to have their provisions recognized over 60 months.

In June, the BCP allowed all new loans made until 31 December 2020 to carry the same provisioning measures and applied a flat risk weight of 20% for capital calculation purposes. In December, the BCP allowed provisioning for loans renewed, refinanced and restructured between January and June 2021 to be gradually recognized over the following 24 months. With the latest extension, banks will be able to restructure loans until 31 December 2021 and have a flat risk weight of 50% for risk-weighted asset calculations.

Endnotes

1 The bank ratings shown in this report are the bank's domestic deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment

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Bank Pekao's headcount reduction is credit positive

Originally published on 26 March 2021

On 23 March, Bank Polska Kasa Opieki (Bank Pekao, A2 stable, baa2[1]) concluded an agreement involving redundancies and changes in employment terms with seven trade unions representing employees of the bank. The credit-positive move will reduce Bank Pekao's operating costs and support operating efficiencies, offsetting lower revenue because of low interest rates and the bank's significant investment in its digital transformation.

Although the redundancies will result in one-off additional gross costs in the first half of 2021 of PLN100-PLN120 million, they will be broadly offset in the first year already by the annual savings of about 5% of staff expenses based on multipliers form previous programs.

The bank's reported cost-to-income ratio, excluding its regulatory contributions to Poland's deposit guarantee fund and the Polish bank tax, was 44.4% as of December 2020, slightly above its 40% target before the coronavirus pandemic. Polish banks' costs are inflated by the country's significant coverage aim for the deposit guarantee fund and by being subject to the highest bank tax in Central Eastern Europe at 0.44% of balance sheet assets (excluding equity and certain assets, mainly sovereign bonds).

Including regulatory costs[2] and the bank tax, the bank's Moody's-calculated cost-to-income was 57.2% as of December 2020. However, Polish authorities' decision to delay the target date to 2034 from 2030 for meeting the 2.6% total coverage for the deposit guarantee fund will reduce Polish banks' contributions to the fund over the next years and will support their efficiency and profitability.

The agreement with the trade unions will lead to a headcount reduction of around 8%, and follows similar headcount reduction plans in 2020 and 2019 that are part of Bank Pekao's focus on controlling costs and efficiencies. Bank Pekao's latest redundancy plan will cover around 1,110 employees for termination and 1,250 for changes in employment terms. The collective redundancies will be carried out from 24 March to 30 June this year. The number of terminations exceeds the 850 additional staff that Pekao onboarded following its acquisition of the failed Idea Bank at the start of the year.

Between 12 March 2020 and 31 October 2020, the bank rolled out a plan to reduce headcount by around 1,200 employees and amend terms and conditions of employment of up to 1,350 employees. Those moves came after the bank on 4 April 2019 announced a restructuring plan to terminate employment contracts of up to 900 employees and amend the employment terms and conditions of up to 620 employees between 26 April 2019 and 31 October 2019.

Endnotes

1 The bank ratings shown in this report are Bank Pekao's deposit rating and Baseline Credit Assessment.

2 The contribution for the deposit guarantee and resolution fund.

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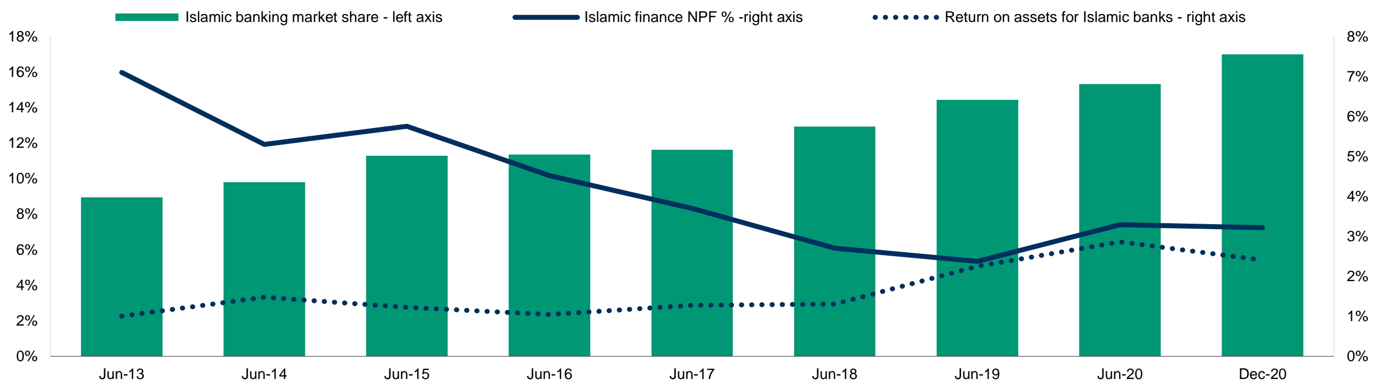
Robust growth in Pakistan's Islamic banking assets is credit positive for banks

On 24 March, the State Bank of Pakistan (SBP), the central bank, released its quarterly Islamic Banking Bulletin for December 2020, which showed that Shariah-compliant banking assets grew 30% in 2020. The growth is credit positive for Pakistani banks because it attracts customers from the previously unbanked population, which creates new business opportunities and boosts banks' financial performance.

Supported by numerous government and SBP initiatives, Islamic banking assets grew to PKR4.3 trillion as of year-end 2020, comprising 17% of total banking system assets. Islamic deposits have had a 22% annual compound growth rate since June 2013. Despite conventional deposits also growing 11% annually since June 2013, Islamic banks' new clients did not erode the existing conventional depositor base.

Islamic financing (loans) also grew faster than conventional loans and were PKR1.9 trillion, or 23% of Pakistani banks' total loans at year-end 2020 (see exhibit). The profitability of Islamic operations has also been stronger, with return on assets for Islamic banking institutions was 2.4% at year-end 2020, versus the system average ROAA of 1.8%, and Islamic nonperforming financing (NPF) was 3.2%, lower than the system weighted average of 9.2% at year-end 2020.

Islamic banking market share is increasing



Source: State Bank of Pakistan

Islamic banking growth will benefit Pakistan's banking sector because attracting previously unbanked customers facilitates deposit and loan growth while reducing funding costs because of the banks' access to a large pool of non-remunerated deposits.

We expect Shariah-compliant banking, which is as an integral part of Pakistan's National Financial Inclusion Strategy (NFIS), to continue growing by targeting customers who prefer Islamic products or are voluntarily excluded or underserved because of their religious belief. According to the enhanced NFIS targets, the government and SBP target an Islamic Banking market share of 25% by 2023. The government and central bank are also supporting the sector by introducing a Shariah-compliant regulatory framework and adopting the Accounting and Auditing organisation for Islamic Financial Institutions (AAOIFI) Shariah standard.

During the pandemic, SBP issued numerous Shariah-compliant Islamic finance schemes to pay employees' wages; purchase new plant and machinery and purchase medical equipment. SBP also issued Islamic finance government securities and attracted funds from local and Pakistani diaspora investors.

Pakistan's population is more than 96% Muslim, according to the Pakistan Bureau of Statistics, and around 100 million adults are unbanked, according to World bank Data. We believe that all rated banks will benefit from the increase in Islamic banking penetration,

especially Habib Bank Ltd. (HBL, B3 stable, caa1[1]), which, at year-end 2020, had a 7.5% market share of Pakistan's Islamic banking assets and MCB Bank Limited (B3 stable, b3) which had a 3.3% market share, the largest shares among their rated peers.

Endnotes

1 The ratings shown in this report are the bank's deposit rating and Baseline Credit Assessment.

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Anthem's acquisition of myNEXUS is credit positive

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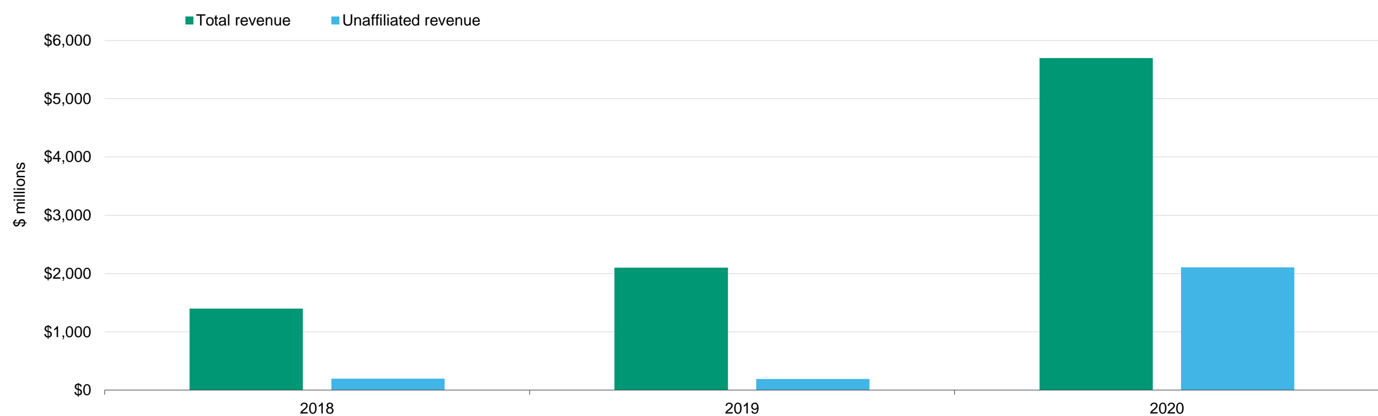
On 24 March, Anthem, Inc. (Baa2 stable) announced an agreement to acquire myNEXUS, a technology-driven company that coordinates home-based health care. While the deal, which the company expects to close in the second quarter, is relatively small for Anthem and will not have a noticeable effect on Anthem's consolidated revenue or earnings, it is credit positive because it enhances Anthem's small but growing diversified businesses. The acquisition price was not disclosed, but the deal will not increase leverage.

myNEXUS strives to improve outcomes for its members and lower medical costs through resource optimization. It serves 1.7 million Medicare Advantage members in 20 states. The company reduces costs for its payor clients by coordinating the comprehensive treatment of patients at home where possible and ensuring that all necessary care is delivered in a consistent way. Anthem is a myNEXUS client and was in a good position to evaluate the myNEXUS value proposition. As part of Anthem, myNEXUS will have improved opportunities to grow its business within the Blue Cross Blue Shield system.

We believe that health insurers must diversify into health services to more effectively close gaps in care, lower medical costs and generate increased non-regulated earnings. Among the large, national health insurers, Anthem has lagged its large, national peers, but under the leadership of CEO Gail Boudreaux since 2017, the company increased its non-regulated earnings. In 2019, Anthem began to report certain integrated health services in its own group, the Diversified Business Group, which focuses on behavioral health, advanced analytics and services and complex and chronic care. In 2020, Anthem acquired Beacon Health Options, the largest independent behavioral health organization in the US. In 2018, Anthem acquired Aspire, an outpatient palliative care provider.

The Diversified Business Group, which will incorporate myNEXUS when the deal closes, is small relative to Anthem's $122 billion of total revenue in 2020, but it has grown rapidly in the past three years. The Diversified Business Group's total revenue increased to $5.7 billion in 2020 from $1.4 billion in 2018, while unaffiliated revenue increased to $2.1 billion from less than $200 million, mostly because of Beacon (Exhibit 1).

Exhibit 1
Diversified revenue is small but growing rapidly

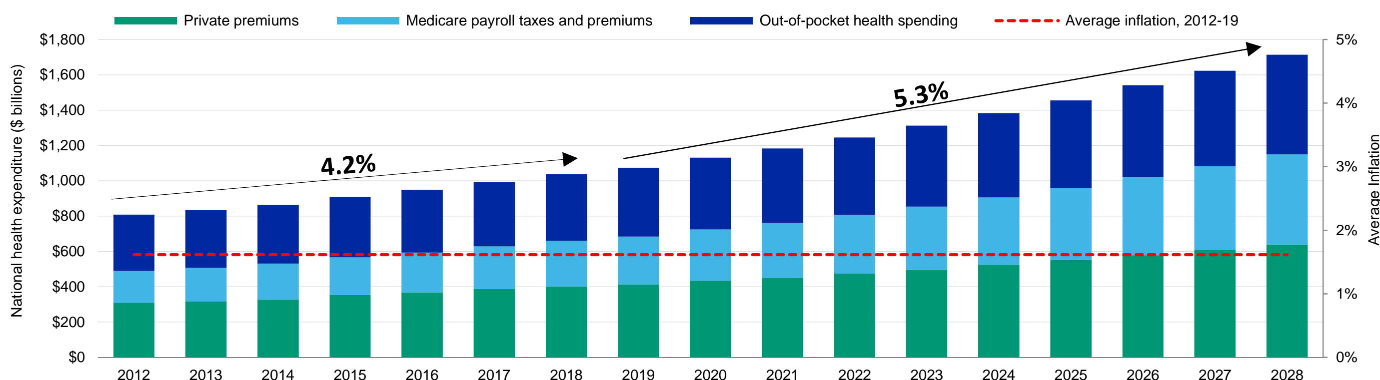


Sources: Anthem, Inc. Investor Day and Moody's Investors Service

We project diversified revenue could double by 2025. Along with IngenioRx, Anthem's start-up pharmacy benefit manager, which commenced operations in 2020, the company generated meaningful non-regulated revenue in 2020, which totaled approximately 25% of total cash flow.

Beyond the benefit of non-regulated cash flow, the addition of IngenioRx and the growth of the diversified businesses will help Anthem better control costs, which might be the most important benefit of the diversified businesses. Medical costs have consistently outpaced inflation growth for years and will likely continue to do so (Exhibit 2).

Exhibit 2
Diversified health services such as myNEXUS help control medical costs



Sources: Centers for Medicare & Medicaid Services, Office of the Actuary, US Department of Commerce, Bureau of Economic Analysis, and US Bureau of the Census, Federal Reserve Economic Data and Moody's Investors Service

The health insurance industry faces social risk, mainly policy and regulatory risks, linked to both customer relations and demographic and societal trends. Insurers are pressured to better control members' out-of-pocket costs. At the societal level, the industry will be held responsible for controlling overall medical costs while achieving improved health outcomes. myNEXUS can help mitigate these risks.

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Israel's election fails to break political deadlock and will further delay post-pandemic fiscal and reform efforts

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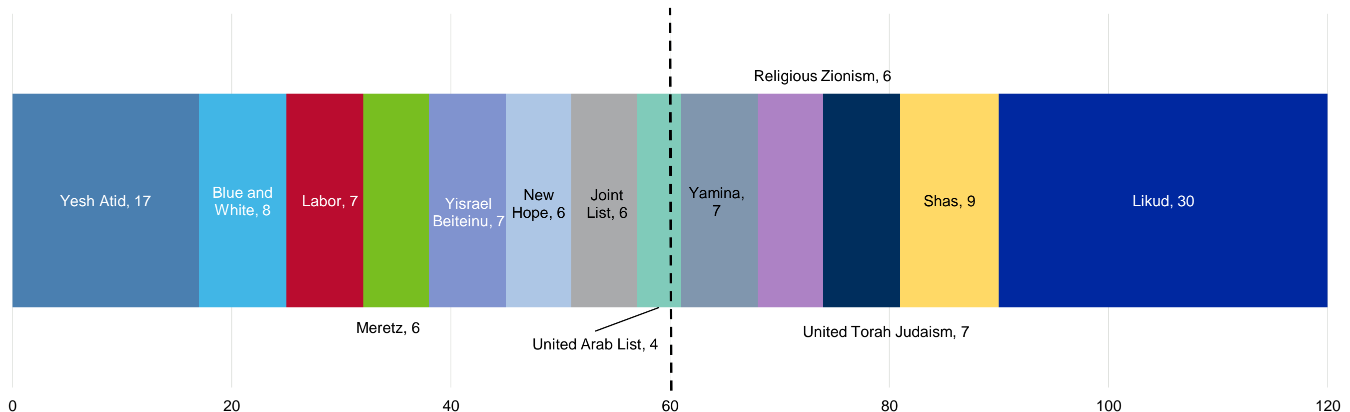
Preliminary results (with 97.1% of votes counted) from Israel's (A1 stable) fourth general election since April 2019 indicated that the 25 March election failed to break a long-standing political deadlock, which will further delay a post-pandemic fiscal consolidation course as well as structural reform efforts, a credit negative.

According to the preliminary results, Prime Minister Benjamin Netanyahu's right-leaning bloc is on course to win 59 seats in the 120-seat Knesset, leaving it two seats short of a majority. The opposition bloc won 57 seats, but is fragmented between seven disparate parties spanning the political spectrum. Neither bloc has a clear path to form a majority government with its traditional coalition partners, although the United Arab List – also known as Ra'am, an Arab party that won four seats and has not ruled out working with either side – may act as a potential kingmaker. Once the final results are announced, the next step is for President Reuven Rivlin to consult with party leaders to decide who is better placed to form a workable coalition; each prime minister-designate then has a maximum of 42 days to try to form a government (see exhibit).

The election has delivered another fragmented Parliament
Knesset composition by party and number of seats (provisional)



A majority requires 61 seats.
Sources: Knesset and Moody's Investors Service

The electoral arithmetic has remained materially unchanged throughout each of the previous three elections, and the resulting deadlock and volatile political environment have hampered effective fiscal policymaking and prolonged reform inertia. Prompted in part by the crisis caused by the coronavirus pandemic, a national unity government was formed in May 2020 between Netanyahu's Likud party and the centrist Blue and White Alliance. However, the unity government failed to pass budgets for either 2020 or 2021 and collapsed after just seven months in office. There are signs that the extended election season has eroded trust in institutions: only 37% of Israelis expressed themselves optimistic about the future of democratic governance in February 2021, down from 54% in April 2019, according to the Israel Democracy Institute's Israeli Voice Index.

The latest election outcome's failure to break Israel's political stalemate, and the emergence of an ever more fragmented Parliament – with 13 parties now represented, compared to eight in the March 2020 election – suggest that another protracted coalition formation period is likely, with limited potential to result in a stable government. As a result, the risk of a fifth election remains firmly on the table.

This will make it more challenging to elaborate and implement an effective post-crisis fiscal strategy that would seek to improve the trend in public finances and eventually return the debt burden to its historic downward trend. We already lowered our assessment of

Israel's institutions and governance strength last year to reflect the weakening in fiscal policy effectiveness in recent years. Decisions on a more comprehensive policy platform also risk being delayed, including on longer-term reforms that would seek to address the sizeable productivity, educational and labour participation differentials among Israel's various population groups, the skill gaps of low-skilled workers, as well as lags in the level of infrastructure relative to other OECD countries.

The fiscal deficit – already sizeable on a structural basis before the pandemic – reached 12.4% of GDP at the central government level on a 12-month rolling basis in February. We project Israel's debt burden to remain on a modest upward trend over the coming years, reaching around 80% of GDP by 2024 (from 60% of GDP in 2019) under our baseline growth and fiscal projections – indicating that the coronavirus-induced shock will have a lasting impact on the government's fiscal metrics. Pent-up spending pressures in health and defense also mean that any deficit-reduction strategy in the future will likely need to rely on revenue measures; these will be challenging to advance if the next governing coalition is not able to command sufficient internal consensus.

That said, the debt ratio will remain moderate relative to other advanced economies, helped by the debt reduction achieved in the decade before the pandemic shock. Israel is one of only a handful of advanced economies to have entered the shock with a lower debt-to-GDP ratio than before the global financial crisis. At the same time, rapid vaccination progress and Israel's strong pre-coronavirus macroeconomic position will support a robust economic recovery: we forecast growth of 4.7% this year and 4.4% in 2022, after the relatively modest 2.4% contraction recorded in 2020. More than half of the population has been fully vaccinated against the virus as of 25 March, the highest rate globally, and daily coronavirus cases and deaths have markedly fallen. However, limiting the lasting impact of the shock on the labour market – with the seasonally adjusted unemployment rate reaching 5.1% in February, from a low of 3.3% in February 2020 – will be a key policy challenge, in addition to addressing the structural labour market issues noted above.

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Egypt's draft budget for fiscal 2022 underpins renewed post-pandemic fiscal consolidation

On 24 March, Egypt's (B2 stable) cabinet approved a draft budget for fiscal 2022 (ending June 2022) that targets a fiscal deficit reduction to 6.6% of GDP from 7.8% in fiscal 2021, and projects a primary surplus of 1.5% of GDP in fiscal 2022, from around 0.9% in fiscal 2021. The government expects real GDP to expand by 5.4% in fiscal 2022 from 3.3% in fiscal 2021.

The projections for the budget sector renew the pre-COVID trend toward fiscal consolidation after pandemic-induced setbacks in fiscal 2020 and 2021 compared with the government's pre-crisis projections. The projections are broadly in line with our expectations for the general government.[1]

Budget data for July-December 2020 confirm the government's revenue-preservation effort through the pandemic and the gradual reduction in interest payments as a share of GDP and revenue (see exhibit). The savings leave room for the new budget's higher social spending and planned increase in the minimum wage without disrupting overall fiscal consolidation trends.

Primary surplus remains intact despite pandemic; interest burden gradually declines from high levels
(% of GDP)

	Fiscal balance / GDP	Primary balance / GDP	Revenue / GDP	Expenditure / GDP	Interest / GDP	Interest / revenue	Wages / GDP	Subsidies, grants, social benefits / GDP
Jun-16	-12.0%	-3.1%	18.1%	30.2%	9.0%	49.6%	7.9%	7.4%
Jun-17	-10.7%	-1.6%	19.0%	29.7%	9.1%	48.0%	6.5%	8.0%
Jun-18	-9.5%	0.3%	18.5%	28.0%	9.9%	53.3%	5.4%	7.4%
Jun-19	-8.0%	2.0%	17.7%	25.7%	10.0%	56.6%	5.0%	5.4%
Jun-20	-7.9%	1.9%	16.8%	24.7%	9.8%	58.3%	5.0%	3.9%
Jul-Dec '19	-4.0%	0.6%	6.7%	10.7%	4.6%	68.4%	2.5%	1.3%
Jul-Dec '20	-3.9%	0.3%	7.7%	11.5%	4.2%	54.3%	2.7%	1.7%

Fiscal year 2021 nominal GDP equals annualized seasonally adjusted July-September 2020 GDP figure
Sources: Ministry of Finance, Haver Analytics and Moody's Investors Service

Among the government's revenue-supporting measures in the current fiscal year is a 1% tax on public- and private-sector salaries exceeding a net of EGP2,000 per month; the tax took effect 1 July 2020 and will be lifted in July 2021. A 0.5% tax is also being deducted from state pensions over the same 12-month period. Non-tax revenues have also contributed to the higher revenue intake. The government aims to increase tax revenue by two percentage points of GDP over four years by strengthening revenue and customs administration, including via electronic tax collection, while preparing further tax policy measures.

On the spending side, out of the pandemic emergency package of 1.9% of GDP mobilized as of October 2020, health and social spending measures equated to almost 1% of GDP. The remainder was allocated to firms to support economic activity. Coverage of Egypt's Takaful (conditional) and Karama (unconditional) cash transfer programs[2] to support poor families has been expanded to reach an additional 400,000 of the most vulnerable households, taking the total to 3.6 million. The objective is to expand coverage to 4 million households by June 2021 with financial support from donor countries and institutions. The shift to targeted income support measures and away from regressive consumption subsidies is part of the comprehensive subsidy reform enacted over the past four years that has significantly contributed to stabilizing Egypt's fiscal accounts.

The central bank's price stability credentials built up before the pandemic and its proactive monetary policy response during the pandemic have contributed to anchoring long-term domestic yields and support our expectation of a further gradual reduction in the interest bill. The reduced effective interest rate underpins the government’s objective to lengthen the average maturity of government

debt stock to five years by the end of fiscal 2024 from 3.2 years in June 2020 and 1.3 years in June 2013. Reduced reliance on short-term debt will curtail rollover needs and government liquidity risk.

The combination of primary surpluses, lower interest costs and a return to higher growth sets the stage for a renewed reduction in the general government debt/GDP ratio, which we expect to decline from over 90% in fiscal 2021.

Endnotes

1 General government includes the budget sector, the National Investment Bank and social insurance funds.

2 Takaful (Solidarity) supports poor families with children under 18, while Karama (Dignity) supports the elderly poor and people living with disabilities.

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Spike in coronavirus infections delays Philippines' economic recovery, a credit negative

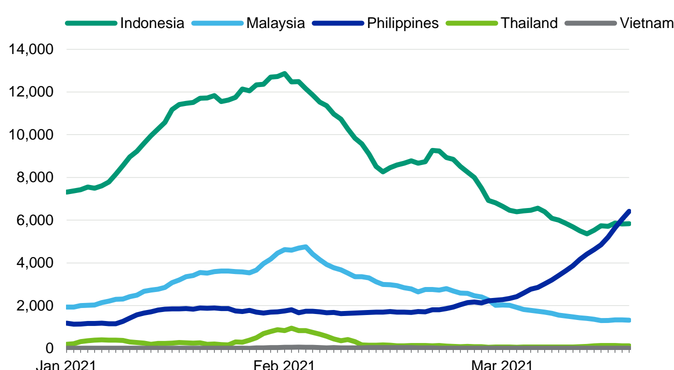
Originally published on 26 March 2021

On 22 March, the Philippines (Baa2 stable) began new pandemic containment measures as daily coronavirus infections surpassed last year's highs. The measures ban mass gatherings and indoor dining at restaurants, impose a curfew, and require all minors and senior citizens to stay at home, among other restrictions. The renewed measures will delay economic recovery, weigh on prospects for fiscal consolidation and exacerbate social risks.

In mid-March, new coronavirus cases spiked to over 7,000 a day for several days – well above the daily highs of around 4,000 in July and August last year and the roughly 2,000 cases per day in October 2020 and February 2021. The spike prompted the government's raft of restrictions in the National Capital Region and four surrounding provinces, which will remain in effect until 4 April.

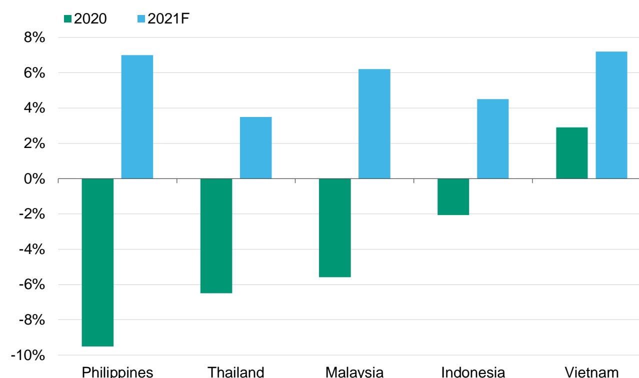
Although current measures are more forgiving than the severe lockdowns imposed in 2020, they contrast with the easing of restrictions elsewhere in the region, where infection rates are low or falling (see Exhibit 1). Because the two-week restrictions are unlikely to restore infection rates to the better levels of earlier in the year, some of the restrictions will likely remain in effect well into the second quarter, threatening our forecast for a 7.0% rebound in real GDP growth in 2021. Because the Philippines had the deepest contraction among large, developing ASEAN economies last year (see Exhibit 2), its inability to contain the spread of coronavirus slows the return of aggregate output to its 2019 peak: nominal GDP in 2020 amounted to PHP18.0 trillion ($362.9 billion), 7.9% lower than PHP19.5 trillion (PHP377.1 billion) in 2019.

Exhibit 1
Coronavirus cases have picked up in the Philippines in contrast to low or falling rates in other developing ASEAN economies...
New coronavirus cases, seven-day average



Sources: Johns Hopkins University and Moody's Investors Service

Exhibit 2
...threatening our forecast of a rapid rebound from the deepest contraction in the region last year.
Real GDP, % change



Sources: National sources, Haver Analytics and Moody's Investors Service

Weaker economic growth diminishes prospects for fiscal and debt consolidation. The government's 2021 budget calls for 10% growth in spending, assuming that economic recovery is firmly entrenched by the second half. The tightened restrictions on households and businesses have prompted calls for another stimulus package while the weak economy weighs on taxable income. At the same time, the recently passed Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act[1] may worsen near-term weakness in tax revenue. Although the CREATE Act introduces limits to tax incentives that will expand the tax base over the long run, policymakers saw this measure as facilitating the recovery from COVID in part by lowering corporate income tax rates. In 2020, national government debt rose sharply to 54.5% of GDP from 39.6% the previous year, effectively reversing the progress on debt consolidation over the past decade.

Mirroring our “Highly Negative” assessment of social risks (S-IPS score of 4), a delayed recovery will have effects on labor markets that could exacerbate income inequality and poverty. The government's new measures could reverse recovery in the unemployment rate, which fell to 8.7% in the first quarter from a peak of 17.6% in the second quarter of last year; and the poverty incidence rate, which fell to 16.7% in 2018 from 26.3% in 2009 amid rapid economic growth.

Endnotes

1 Both houses of Congress ratified the final version of the CREATE bill on 3 February and it will enter into law once signed by the president. If it is not signed by 27 March, the bill will automatically lapse into law.

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New Zealand's policy changes to curb housing boom and improve affordability are credit positive

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On 23 March, New Zealand's (Aaa stable) government announced a series of policy changes to improve housing affordability, slow house price inflation, mitigate risks to financial stability and support a sustainable economic recovery. The measures are credit positive for the sovereign, several government-related entities and New Zealand's banks.

Supply-side measures in the government's policy package will assist Kāinga Ora - Homes and Communities (Kāinga Ora, Aaa stable), the Crown's affordable housing development arm, in borrowing NZD2 billion to finance strategic land purchases. The Crown will also seed NZD3.8 billion into a Housing Acceleration Fund to increase new home building. The additional support for Kāinga Ora enhances the institution's capacity to develop nationwide affordable housing.

The measures are also credit positive for Auckland Council (Aa2 stable) because they will soften speculative activity in Auckland's housing market by spurring additional funding to ease supply-side constraints for housing and related services, which are stressed amid continued strong population growth. Moreover, the measures reflect the Crown's extraordinary support in a way that is not limited by the council's debt constraints.

For New Zealand's banks and in particular the four major banks, ANZ Bank New Zealand Limited (A1/A1 stable, a3[1]), ASB Bank Limited (A1/A1 stable, a3), Bank of New Zealand (A1/A1 stable, a3) and Westpac New Zealand Limited (A1/A1 stable, a3), which together hold around 88% of all residential loans, measures to stem a reduction in investor demand are credit positive. This is because investor loans are more vulnerable to a deterioration in economic conditions than owner-occupied. The measures reduce the likelihood of a sharp correction in the housing market, which would hurt banks' asset quality and financial stability.

Over the past 12 months, New Zealand's housing market has boomed, in part because of the successful public health and economic policy responses to the coronavirus pandemic, low interest rates, still positive population growth and chronic shortages of housing supply.

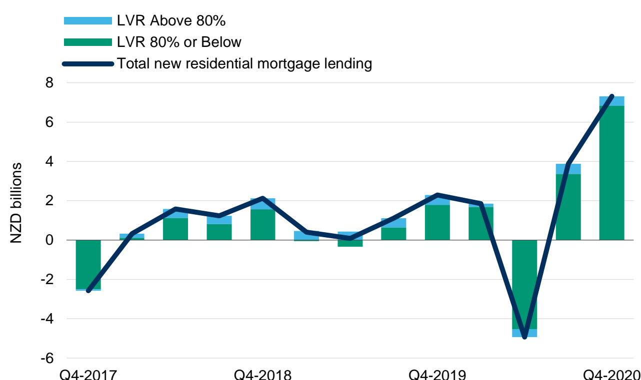
Despite closed international borders, New Zealand's population increased by slightly more than 100,000 last year, with New Zealand citizens returning from abroad driving the increase. Slightly over one third of that of gain was in Auckland, according to Statistics New Zealand.

In addition to the resilient economy and population growth supporting owner-occupied housing demand, surging investor demand also reflects current low interest rates and the temporary removal of loan/value restrictions in April 2020 at the onset of the coronavirus pandemic. Since the second half of 2020, residential lending volumes have largely rebounded, factoring into a sharp recovery in house prices (see Exhibits 1 and 2).

Exhibit 1

New residential mortgage lending has been driven by investor demand...

Four-quarter sum

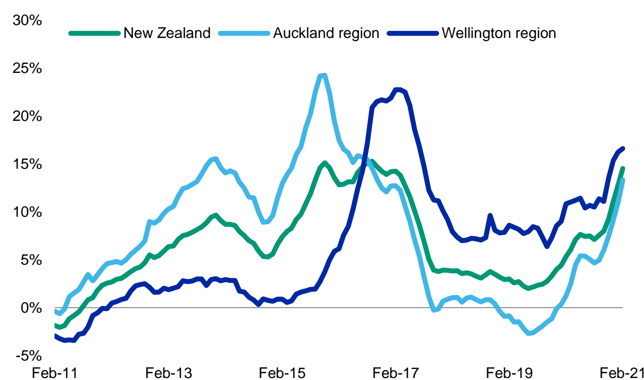


Sources: Reserve Bank of New Zealand and Moody's Investors Service

Exhibit 2

... and is a factor behind surging house prices nationwide, especially in urban centers

Annual percent change



Sources: CoreLogic and Moody's Investors Service

The government's latest measures aim to improve housing affordability particularly for first-time homebuyers. Increases in income caps (to NZD150,000 from NZD130,000) for first-time homebuyers to qualify for the government's first home loan and grant program and caps on house prices, which differ based on region, will take effect from 1 April 2021. The government estimates that these measures will enable an additional 13,000 potential first-time homebuyers to qualify for government programs.

Policies aimed at reducing investor demand include extending the "bright line test"[2] to 10 years from five currently for newly acquired properties, with the existing exemptions remaining in place for new builds. Additionally, the government has removed the ability for property investors to treat loan interest as an expense against income from the property.[3]

The policy package builds upon macroprudential measures announced in February 2021 by the Reserve Bank of New Zealand (RBNZ) that reinstated loan/value restrictions at the same level as before the onset of the coronavirus pandemic.[4] In its policy decision, the RBNZ said that there were growing concerns about the risk of a sharp correction in the housing market and implications for financial stability, along with evidence of speculative buying among increasingly leveraged borrowers.

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

2 The bright line test determines whether income tax is required to be paid on any profit made from the sale of a residential property.

3 Interest deductibility on residential property acquired on or after 27 March 2021 will not be allowed with effect from 1 October 2021. Interest on properties acquired before 27 March 2021 can still be claimed as an expense; however, the government is gradually phasing this deductibility out by April 2025.

4 With effect from 1 May 2021, loan/value restrictions for owner-occupied housing will remain at a maximum of 20% of new lending at loan/value above 80%, whereas for investors this will be raised to a maximum of 5% of new lending at loan/value above 60%.

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Business travel faces higher substitution risk post-COVID, but airlines will adapt

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- **Prospects for the recovery of business travel by air are highly uncertain, and some forms of less-critical travel may never fully recover.** Improving technology, company cost reductions and environmental concerns may put pressure on business travel. Around 10%-30% of business travel could be replaced by alternatives such as virtual meetings. As a result, business travel is unlikely to reach its 2019 level before 2024 at the earliest.
- **Our forecasts for global airline passengers factor in a lag in business travel recovery.** Airlines' recovery from the pandemic will be multistage, with the critical first phase to reach break-even cash flows, and companies' duty of care to employees restricting business trips in 2021. We forecast overall revenue passenger kilometers to remain around 5%-10% below 2019 levels by the end of 2023, with business travel lagging the recovery in leisure travel.
- **Full-service carriers will face greater pressure from a slow recovery in business travel.** An estimated 12% of global passengers travel for business but there are wide variations across airlines, with full-service carriers in advanced economies having disproportionately larger shares of business travelers[1]. Business travel is likely to be more profitable than leisure, but airlines will adapt to support profitability. Domestic business travel will return sooner, favoring carriers in large countries such as the US, Brazil, Australia, Russia and China.
- **Sectors with high site-specific activities such as manufacturing, real estate and construction will see stronger return of business travel.** As a result, business travel will recover more quickly in China, Japan and Germany and less strongly in the UK and France.
- **Airlines will offset the possible effects by managing capacity, continued growth in leisure travel and efficiency savings.** They will also gain share from weaker competitors that have failed or reduced their route networks during the pandemic. They may increase focus on leisure travel, and pricing structures may also change, with fewer deeply discounted economy fares.

Click here for the full report.

Endnotes

1 An estimate from Investopedia refers to a total of 12% of global air passengers traveling for business. This figure has been widely reported although there are also alternative figures reported by industry participants and the basis of calculation or determination of business travel varies, as detailed in our report.

US economy will recover, but COVID-19 bruises will last several years

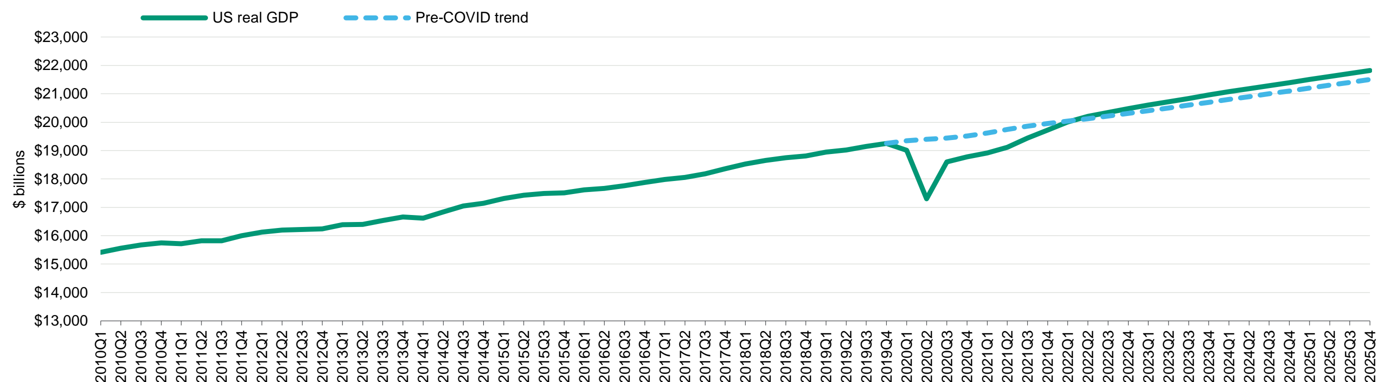
Whether the coronavirus pandemic permanently scars the US economy is a hot topic among market participants. We expect economic activity as measured by GDP to return to its pre-coronavirus path by the end of 2021, but an elevated unemployment rate and a lagging recovery in the hardest hit sectors will leave visible bruises. Moreover, the legacy of higher government and corporate debt is likely to last for several years.

As COVID-19 vaccinations increase and pandemic-related disruptions fade, Several factors augur GDP recovery to the pre-COVID-19 path by year end: the economic downturn has not stressed the financial sector, does not result from a burst credit or real estate bubble and pandemic-related supply disruptions will pass. After a financial crisis, recovery is typically slow because damage to banking system balance sheets keeps banks from providing credit to the economy for years afterwards. Similarly, when a burst credit or real estate bubble damages corporate and household balance sheets, repair takes years of deleveraging.

Aided by unprecedented government stimulus and central bank support, we expect a strong rebound of the US economy, so that by mid this year, US GDP will have surpassed its year-end 2019 level (Exhibit 1).

Exhibit 1

US economic activity will likely return to its pre-coronavirus path by year-end



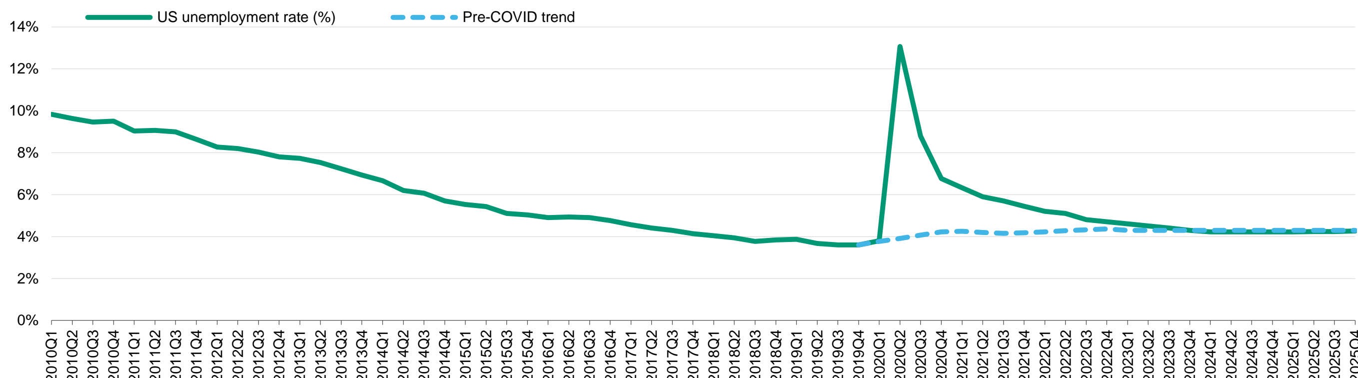
Real GDP is measured in 2012 dollars.
Source: Moody's Investors Service

In 2020, the number of bankruptcy filings and defaults was more limited than in previous economic recessions. For example, the trailing 12-month global speculative-grade corporate default rate peaked at 6.8% in December 2020 compared to a peak of 13.3% in 2009, 9.7% in May 2002 and 12.3% in June 1991. Pandemic disruptions are creating losses on capital stock (for example, hotels and aircraft), but these are a small share of the economy, and the disruptions are also spurring new investment in digital technologies.

Once the pandemic has receded and lockdown measures are rare, consumers will regain confidence. Businesses in the hardest-hit sectors, such as restaurants, travel and tourism-related sectors, will begin to recover, but at differing paces. For high-contact travel and tourism-related sectors, recovery will likely lag until anxiety about coronavirus wanes and international restrictions are lifted. Other high-contact service sectors, including retail, healthcare and education accelerated their digitization amid pandemic lockdowns. Their recovery will be faster, but requires the labor force to re-skill for the new digital economy, which will take time (Exhibit 2).

Exhibit 2

US unemployment rate will likely remain elevated until 2023



Source: Moody's Investors Service

One sustained legacy of the pandemic will be higher government and corporate debt, which will likely weigh on growth over the next five to 10 years. In the next two years, central banks will manage the debt burden with low interest rates and tolerance for periods of higher inflation, but over time, if governments and companies need to direct funds to repaying debt rather than toward investments it would constrain economic growth.

Unfavorable demographic trends and slowing productivity growth have reduced the US trend growth for decades before the pandemic. Population growth will continue to slow and productivity growth is likely to remain low. Whether digitization and advances in robotics and artificial intelligence can significantly boost productivity growth remains uncertain.

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Podcasts and Videos

Video: China's policymakers balance growth and risk, 25 March 2021

Lillian Li of the Credit Strategy and Research team examines the outcomes of China's closely watched annual policy meetings. She highlights that a conservative growth target for 2021 and a gradual normalisation of fiscal and monetary policy should enable the government to focus on quality over quantity of output and address structural issues, while avoiding excessive build-up of leverage.

Securitization Spotlight - Podcast: Libor transition looms larger for some asset classes than others, 25 March 2021

In this latest segment, Peter Hallenbeck of the Structured Credit team and Masako Oshima of the Consumer Assets team consider the effect that the Libor transition will have on various structured finance asset classes. Plus, Aaron Johnson and Greg O'Reilly discuss the performance of structured finance collateral one year into the coronavirus pandemic.

Related report: *Libor Transition - Global: Finalization of retirement delay for key US dollar benchmarks reduces credit risks*

Focus on Finance - Podcast: Cybersecurity is strongest at larger financial institutions and those with good cyber communication, 24 March 2021

With cyber risk on the rise, Lesley Ritter of the Cyber Risk team and Megan Fox, Michael Dion and Rokhaya Cisse of the Financial Institutions team discuss our survey and findings on banks', insurers' and asset managers' preparedness for a cyberattack.

Related reports: *Insurance - US: Surge in ransomware claims drives cyber insurance prices higher*, *Insurers, Insurance Brokers and Asset Managers - Global: Survey signals cybersecurity strength, with some differences across sectors, regions* and *Banks - North America: Cybersecurity strength rests on governance and prevention*

Podcast: Asian infrastructure companies' growth will strengthen in 2021 but performance will vary, 22 March 2021

Ning Loh, Ivy Poon and Abhishek Tyagi of the Project and Infrastructure Finance team discuss the growth prospects for Asian infrastructure companies in 2021. Economic growth, government stimulus and improved demand will drive the strengthening of most infrastructure sectors in 2021, but airport operators face a long road to recovery.

Related report: *Infrastructure & Project Finance - Asia: Growth of Asian infrastructure companies will strengthen in 2021 but pace will vary*

Muniland - Podcast: US state and local government outlooks improve, driven by revenue performance and robust federal support, 19 March 2021

In this special edition, Matthew Butler and Natalie Claes of the US Public Finance team discuss how better-than-expected revenue and a new wave of federal assistance spurred the outlook changes for US state and local governments in the face of the pandemic.

Related reports: *States - US: Outlook improves to stable amid stronger budgetary picture and federal support* and *Local Government - US: Outlook changed to stable as revenue conditions improve, federal aid continues*

Articles in last Thursday's Credit Outlook

NEWS & ANALYSIS

Corporates

- Canadian Pacific Rail's acquisition of Kansas City Southern will increase its leverage
- UK spectrum auction results are credit positive for UK mobile network operators
- Shortage of semiconductors thwarts Volvo's production
- PTT Global Chemical's planned tender offer for shares in Thai chemical producer is credit negative
- Lingering social risk of 2009 oil spill and Australian Court judgement are credit negative for PTT

Infrastructure

- Latest delays in key Vogtle nuclear construction activities are credit negative for Georgia Power
- Latest delays in key Vogtle construction activities are credit negative for Oglethorpe Power

Banks

- End of supplemental leverage ratio relief is credit positive for large US banks
- Banco do Brasil's CEO is replaced after six-month tenure, a credit negative
- Single Resolution Board's decision on legacy liabilities governed by UK law is credit positive
- Russia hikes key rates, increasing pressure on bank margins
- Extension of subsidised mortgage programme in Russia will support banks' revenue
- Turkish central bank governor's dismissal is credit negative for banks

Insurers

- Kuwait's new insurance regulations are credit positive

Sovereigns

- Surprise firing of Turkey's central bank governor is likely to increase credit pressures
- Australia's robust employment data signals economic recovery is well underway, supporting credit quality

CREDIT IN DEPTH

- FAQ on US federal fiscal deficits, debt and debt affordability following American Rescue Plan

Click here for last Thursday's Credit Outlook.

Editors

Elisa Herr, Jay Sherman, Andrew Bullard, Julian Halliburton and Phil Macdonald

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