Globally listed corporates' credit profiles stabilized in 2019 but caution remains on outlook

by Anthony Prayugo

Credit profiles of globally listed corporates have stabilized this year after a tumultuous end of the year 2018. Various central banks around the globe have shifted towards a more dovish monetary policy stance as several geopolitical events continued to pin down economic growth. Tracked by the NUS-CRI Aggregate 1-year Probability of Default (Agg PD), the Agg PD for around 35,000 active globally listed firms has roughly fluctuated between 11bps to 12bps this year after briefly dropping to 10bps earlier in 2019 (see Figure 1a). While the easing monetary policies have improved the overall globally listed corporates' short term credit outlook, their longer-term credit outlook remained virtually unchanged as several risks continued to persist.

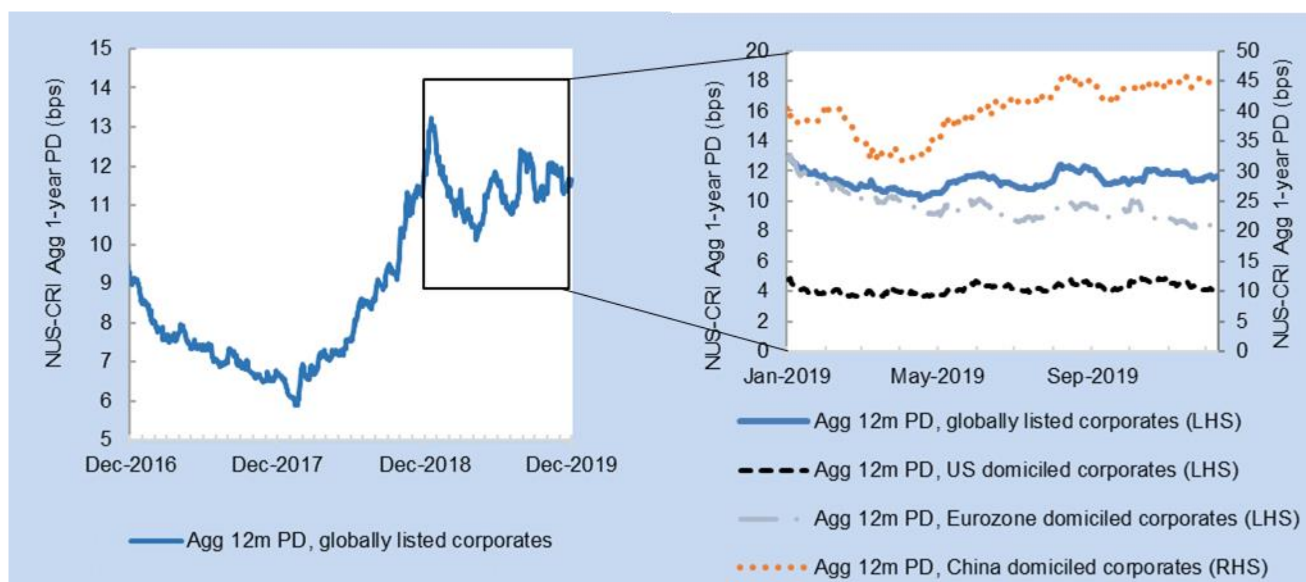

Figure 1a (LHS): NUS-CRI Agg 1-year PD for globally listed firms. Figure 1b (RHS): Selected NUS-CRI Agg 1-year PD of corporates in several countries. *Source: NUS-CRI*

Major central banks in the world such as the Federal Reserves (Fed), People's Bank of China (PBOC) and the European Central Bank (ECB) loosened their monetary policies this year due to the persistently low inflation and tepid economic growth. On top of that, the pace of central banks easing in 2019 is the fastest since the 2008 global financial crisis. A lower policy rate and reserve ratio requirement from the central banks would enable corporates to borrow at a lower cost and inject more liquidity into the markets. With the exception of China domiciled corporates in Figure 1b above, the NUS-CRI Agg 1-year PD of corporates domiciled in the US and Eurozone have slightly improved this year as their respective central banks conducted monetary easing policies.

The investors' risk appetite was captured by the Bloomberg Barclays Global Aggregate Corporate Average Option Adjusted Spreads (OAS), which measures the global aggregate corporate bond spread. As shown in Figure 2a below, the global aggregate corporate bond spread has fallen back to the early 2018 level after increasing last year. Corporates across the globe were quick to take advantage of the lower interest rate environment by issuing a record amount of bonds this year to raise more funds and refinance their debts. Global corporate bonds issuance has reached a record amount of around USD 9.9tn this year, 64% higher than in 2018.

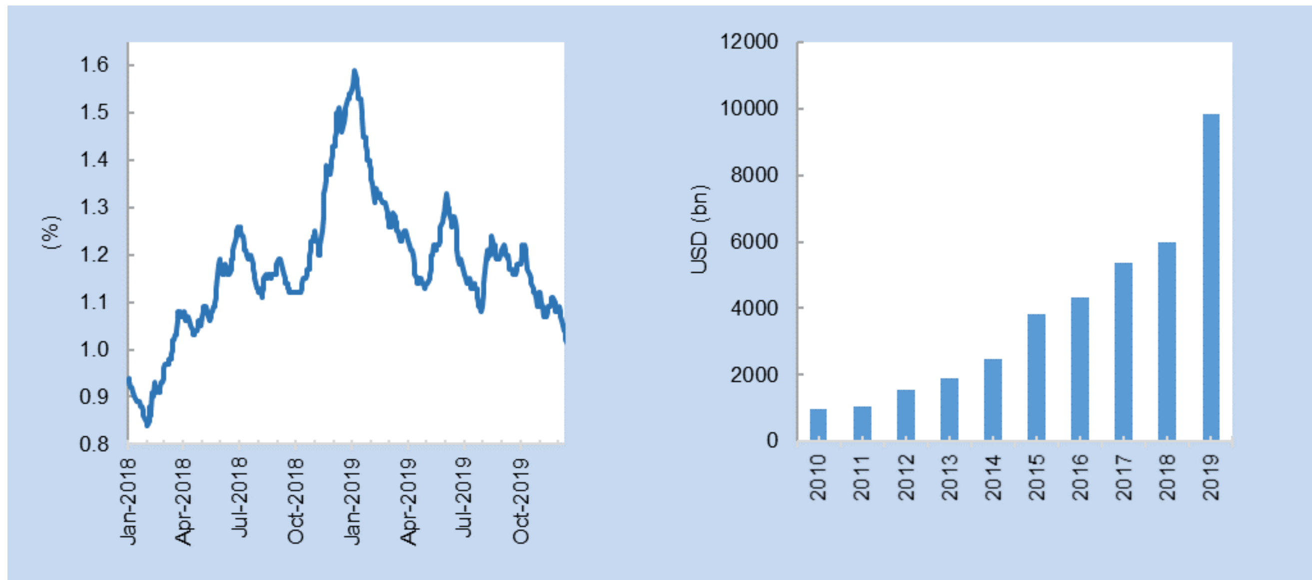

Figure 2a (LHS): Bloomberg Barclays Global Aggregate Corporate Average OAS. Figure 2b (RHS): Yearly amount of bonds issued globally. *Source: Bloomberg*

Looking into each industry group, the NUS-CRI 1-year PD model found that industry groups within the defensive sectors such as consumer non-cyclical and utilities are among that have the best credit quality in 2019. This is unsurprising as defensive sectors tend to be more resilient compared to their peers amid period of uncertainties. Healthcare has consistently been one of the industry groups that has low credit risks in the past decade as ageing population boosted the demand in this sector. Beverage and gas (utilities) companies, which are parts of the consumer non-cyclical and utilities sectors respectively, also have one of the lowest default probabilities in 2019. While not classified as a defensive sector, real estate corporates' credit quality remained resilient as the current low interest rate environment help support asset values in most property types and provide favourable access to capital. Home sales in several countries such as the US, Japan, and Australia have recovered in the second half of this year due to the availability of cheap mortgage.

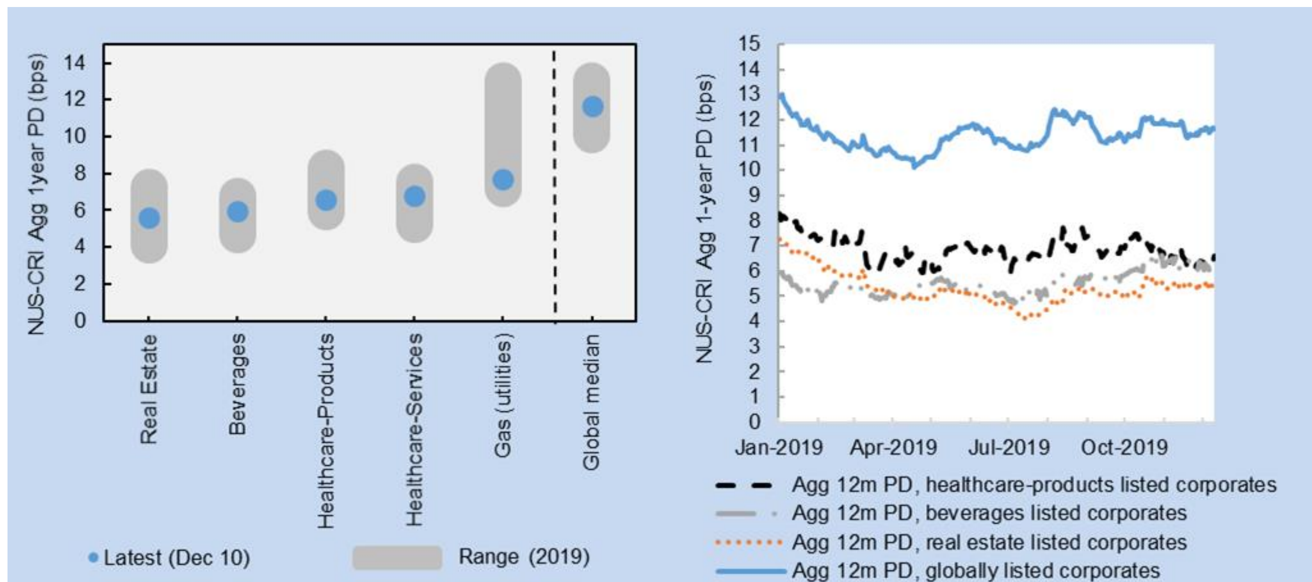

Figure 3: NUS-CRI Agg 1-year PD for industry groups with the lowest default risks in 2019 *Source: NUS-CRI*

On the other hand, the worst industry groups in credit quality as of mid-December this year are corporates in coal, oil & gas services, and airlines. The plunge in coal price this year might have been one of the main contributors to the coal corporates' increasing credit risk. Furthermore, several countries continues to shift away from using coal as a fuel source due to climate change concerns, causing a declining coal demand. Meanwhile,

with the oil price forecasted to stay low for several years and amid funding pressures, oil & gas corporates are faced with deteriorating credit profiles. In the US, which is the largest oil producer in the world, the amount of debt defaulted by its oil & gas corporates is set to largest since 2016. For airlines, slowing demand and rising costs this year has squeezed airlines' profits. Free cash flow, which enables debt to be reduced, has decreased compared to last year and debt-to-earnings ratios have started to rise once more.

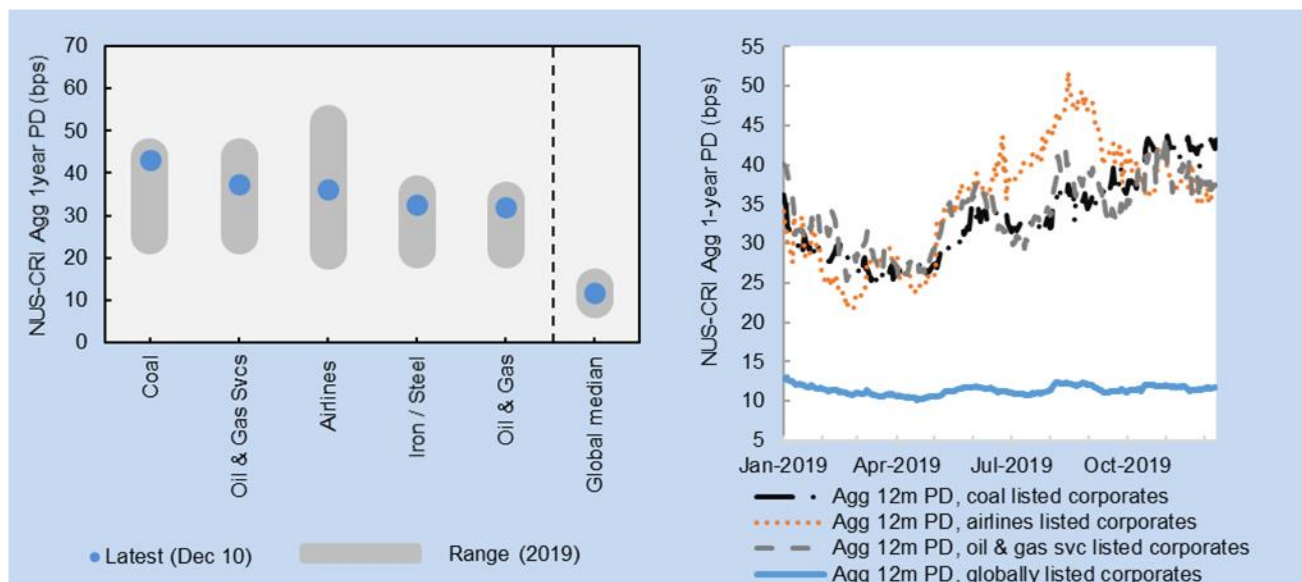

Figure 4: NUS-CRI Agg 1-year PD for industry groups with the highest default risks in 2019 *Source: NUS-CRI*

Despite the overall stabilization of credit quality, one might need to exercise a cautious view on the current situation of debt piling by corporates, which is exacerbated by the continued availability of cheap borrowing this year. IMF warned that in a recession half as severe as the 2008 financial crisis, corporate debt-at-risk — which is owned by corporates that cannot cover interest expenses with profits — could increase to USD 19tn, or almost 40% of total corporate debt in major economies. At the same time, the lowest rated part of the investment-grade market (the BBB-rated corporate debt) now represents over 50% of the investment grade debt. A Quarterly Review report by the Bank for International Settlements (BIS) back in Mar 2019 indicated that the increased investments in the BBB-rated debts could lead to significant market risks in the case of an economic downturn.

The NUS-CRI tail Corporate Vulnerability Index (CVI_{tail})[1] for global firms has managed to capture the trend of the increasing credit risks for corporates that are among the riskiest group this year. A high CVI_{tail} indicates low creditworthiness of tail firms of globally listed corporates within the next one year. In 2019, the NUS-CRI CVI_{tail} increased to 234bps, exhibiting a different trend compared to the NUS-CRI Agg 1-year PD (see Figure 5). In tandem, the riskier tier of the junk bond market (rated CCC+ and below) has seen its average spread rising this year, reaching 10% for the first time since 2016 before dropping back to 8.75%. Corporates that issued bonds rated within this range have struggled with increasing funding costs as investors demanded more returns from this group amid a period of uncertainties.

[1] The NUS-CRI CVI_{tail} is the top 5th percentile of the NUS-CRI 1-year PD representing the riskiness of the most vulnerable firms

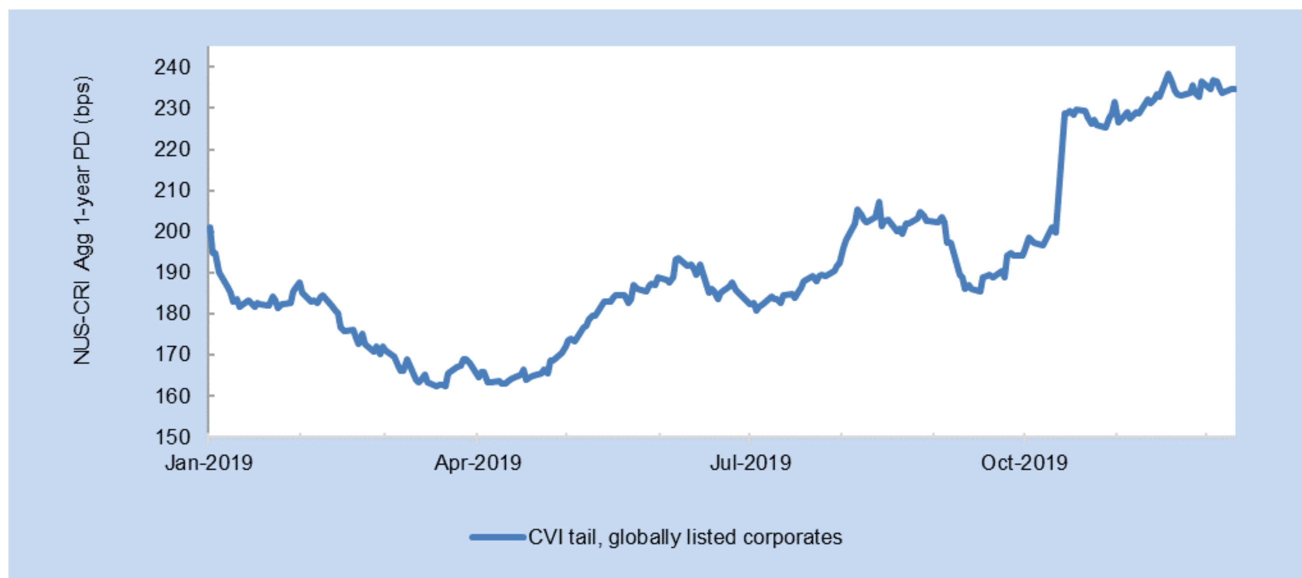

Figure 5: 2019 CVI_{tail} for global listed firms. *Source: NUS-CRI*

Figure 6 shows that in 2019, globally listed corporates' credit outlook for Jun 2020 improved compared to its longer-run outlook, which remains somewhat unchanged since the start of this year. For any month from Jan 2019, the NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD) of globally listed corporates is higher for Jun 2022 (black curve) than that for Jun 2020 (blue curve). Take Nov 2019 for example, Figure 6 shows that the 1-year PD of a typical globally listed corporate conditioning on its survival till Jun 2020 is 18 bps, while the longer-future forward 1-year PD conditioning on its survival till Jun 2022 is 31 bps. While the credit outlook for globally listed corporates in Jun 2020 is consistently better than the one in Jun 2022, it is worthwhile to note that Jun 2020 curve is in a downward trend recently, indicating that the short-term future credit outlook for globally listed corporates improved. Nonetheless, the relatively unchanged long-term credit outlook of globally listed corporates suggests that long term credit risks remain, which might underscore the need for corporates to exercise caution despite the current availability of cheap funding.

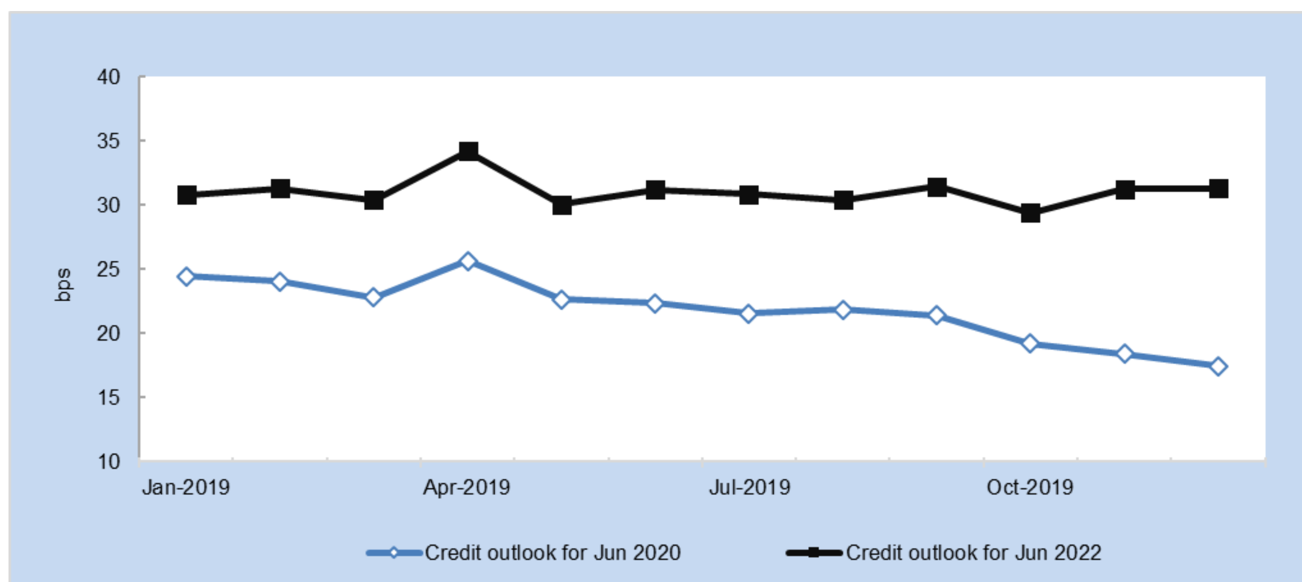

Figure 6: NUS-CRI Agg Forward 1-year PD time series for globally listed corporates based on information from different historical months looking to Jun 2020 and Jun 2022. *Source: NUS-CRI*

Credit News

Bond market wobble shrinks global pile of negative yields

Dec 23. Negative-yielding debt has been decreasing globally due to a year-end sell off in the bond markets – the pile has shrunk by USD 6tn since the summer peak – indicating that recession fears are diminishing. Signs of a phase 1 deal surrounding US-China trade tensions last week caused a drop in bond prices, pushing Japan's 10 year yield above zero for the first time since March. US 10 year treasury yields also climbed to a five-week high of 1.92%. The drop in prices (and resulting increase in yields) had surprised some fund managers who placed their bets on ever-falling yields. Three factors have come together to push yields higher, despite affirmation from central banks of the ultra-low rates for longer regime: improving global growth indicators, de-escalating trade tensions, and a market where too many are looking for a further cascading compression of yields. (FT)

Moody's warns on frothy US junk bond market

Dec 20. Moody's said that strong gains in high-yield credit in 2019 were largely unjustified – there was a lack of any observable broad-based acceleration of either business sales or corporate earnings. The spread between junk bonds and treasuries – which measures the premium in which investors are compensated for to hold the junk bonds – has rescinded significantly this year as yields declined. Last week, the spread on US junk bonds were 354 bps, tightening by 200 bps from the January peak, according to ICE. The bonds have delivered returns (inclusive of coupon payments) of 12% this year – the strongest performance since 2016. Investors have continued to seek for higher returns, taking on higher risks as the market has been starved for yield, providing a boost to poorly-rated credit. (FT)

Top-rated US companies raise record USD 129bn in euro debt

Dec 19. Taking advantage of decreasing borrowing costs from a fresh wave of stimulus from the ECB, top-rates US firms flocked to sell bonds in Europe in 2019 in record amounts. American investment grade firms have sold USD 129bn worth of Euros so far in 2019, more than double of last year's tally of USD 56bn and the previous peak of USD107bn in 2017. The ECB's renewed commitment to buying debt, as part of an effort to stimulate growth and boost inflation across the Eurozone region, has slowed yield growth. The benchmark German 10-year Bunds sits at -0.27%, compared to 0.23% in January this year and much lower than the 1.89% yield of the equivalent US Treasury. Due to this phenomenon, companies across North America are to raise financing in euros to bring down their overall cost of borrowing, even swapping the funds back to USD can achieve cost savings. (FT)

Rising demand for loans in China conceals economic weakness

Dec 19. In China, the amount of medium and long-term loans to non-financial companies have been rising year-on-year, a trend which suggests improving business sentiment as companies borrow more for investment. However, some loans have a different purpose – to help local government financing companies (LGFVs) refinance or rollover debt. About 7%, or CNY 277bn of new loans in Q3 were used to repay or swap existing debt, and 5%-12% of new loans are forecasted in the upcoming quarters to serve the same purpose. There is increasing concern about the financial health of LGFVs – the PBOC has warned about systemic risks in the LGFV sector, with one firm narrowly escaping a bond default recently. If local governments are borrowing just so they can keep paying for older debt, it would add to concerns regarding the sustainability of China's current economic growth and its debt burden. (Bloomberg)

Record Chinese defaults only add to allure of junk bonds

Dec 18. A record year of bond defaults in China only adds to allure of junk-rated debts, as the investors in the market have become more at ease with bond failures. It is good news for policy makers who want to build a more efficient capital market in China's economy so as to reduce the burden on the stretched banking

sector. Among risk lovers, the top picks are lower-rated bonds sold by local government financing vehicles and Chinese property companies, as they believe China's economic slowdown may force Beijing to ease investment and financing curbs imposed on the sector. They also find value in other sectors such as pharmaceutical companies. The investors believe that many onshore bonds have been oversold and the mis-pricing of the bonds will provide rich investment opportunities. (Bloomberg)

BofA CEO says leveraged-loan stress could ripple through economy (Bloomberg)

China central bank adviser warns on debt chain reaction (Bloomberg)

U.S. junk bond rally will be more muted in 2020 after 13.5% year (Bloomberg)

Regulatory Updates

India's central bank chief experiments with policy to ease rates

Dec 22. Reserve Bank of India Governor Shaktikanta Das is experimenting with a Federal Reserve-style 'Operation Twist', to improve rate transmission and spur credit to the economy. It is announced on Thursday that the central bank will buy longer-dated debt and simultaneously sell shorter maturity notes in order to bring down the soaring cost of borrowing. This is the optimal approach given the uncertain response from banks despite an environment of huge surplus liquidity and high credit costs, while more steps should be taken to hasten the pass-through of the easy monetary policy. (Bloomberg)

Sweden ends negative rates regime over side-effects concern

Dec 19. The Riksbank, the central bank of Sweden, raised its main repo rate on Thursday by a quarter percentage point to zero, ending its five-year experiment with negative rates. Though the Riksbank kept warning of the negative effects which might be caused by the long-run negative rates, many economists and companies criticized the proposal and questioned the wisdom of tightening monetary policy as the Sweden's economy weakens. The decision to raise interest rates was not unanimous among the board members inside the Riksbank, which laid the way to potential cut in 2020. (FT)

BOE rate cuts seen in 2020 as specter of hard Brexit returns (Bloomberg)

Bank of England to set up tough climate stress tests (FT)

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