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Globally listed corporates' credit risk reaches the highest since 2009

by [Anthony Prayugo]

The sudden outbreak of COVID-19 has unleashed a whirlwind on many corporates in the world. This is inevitable as, through globalization, the world is getting more interconnected than ever before and thus ensuring the ripple effects of this pandemic to be keenly felt all over the world. Many stock and corporate bond markets saw their worst bearish run since 2008 amid the explosion of infections around the globe. The credit profiles of globally listed corporates, tracked by the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD), have increased in tandem of this outbreak since the beginning of the year and have reached their highest since 2009. In addition, the NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD[1]) time series indicated that credit outlook for globally-listed corporates has deteriorated since the COVID-19 outbreak.

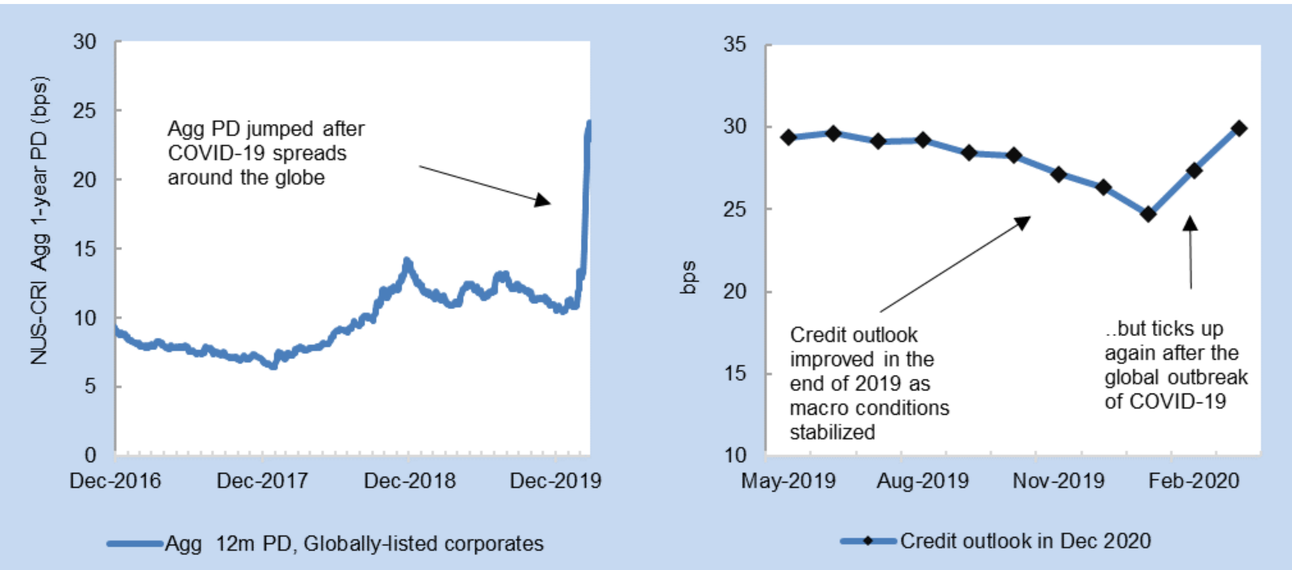

Figure 1a (LHS): NUS-CRI Aggregate 1-year PD for globally-listed corporates from Dec 2016. Figure 1b (RHS): NUS-CRI Agg Forward 1-year PD time series for globally-listed corporates based on information from different historical months looking to Dec 2020. *Source: NUS-CRI*

By utilizing iRAP[2], we found the main driving factors to the globally listed corporates' Agg PD increase since the end of 2019 to be: (1) The companies' Distance-to-Default (DtD), and (2) their liquidity. The change in Distance-to-Default[3] (DtD) indicates a higher level of volatility adjusted leverage and could be partially explained by the calculation of the implied asset volatility. The recent bearish run and high volatility in the stock market have both caused globally listed corporates getting closer to their default points which in turn increased the Agg PD. Take the VIX index for example, which on Mar 16 closed at its highest level ever at 82.69, even higher than its peak

[1] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For example, the 10 month Forward 1-year PD in Feb 2020 displayed in Figure 1b (around 27bps) is the probability that the firm defaults during the period from 10 months onwards to 1 year plus 10 months, conditional on the firm's survival in the next 10 months.
[2] The results were produced with iRAP (intelligent Risk Analysis Platform), which is a software developed by CriAT (https://www.criat.sg/) for conducting both firm-level and portfolio-level credit analysis. iRAP utilizes the NUS-CRI Probability of Default (PD) model and links to the live NUS-CRI database offering PDs on over 70,000 exchange-listed corporates globally.
[3] DtD measures the standardized distance between firms' current asset value and their future obligation. The decrease of a positive DtD means getting closer to the default point.

during the 2008 financial crisis. While the level has somewhat gone down since then, it is currently still trading at around its 2008-2009 level.

Years of low interest rates environment and quantitative easing since the 2008 global financial crisis has incentivized corporates to issue debt for the past decade, which in turn has caused them to become increasingly leveraged. The rapid expansion of corporate debt for the past decade might not cause debt servicing issues for corporates during a period of economic expansion and low interest rates, but the COVID-19 outbreak has raised a red flag on the creditworthiness of corporates as it threatens their profits and causes them to face a much higher cost to roll over their debts. Take Exxon for instance, which recently raised USD 2bn through a new 10-year debt. Compared to a year ago when it was able to issue 10-year bonds with a spread of 75bps, the latest debt was priced to yield 240bps above a similarly maturing US Treasury, suggesting that investors are now demanding higher pay outs over fear of the global economy.

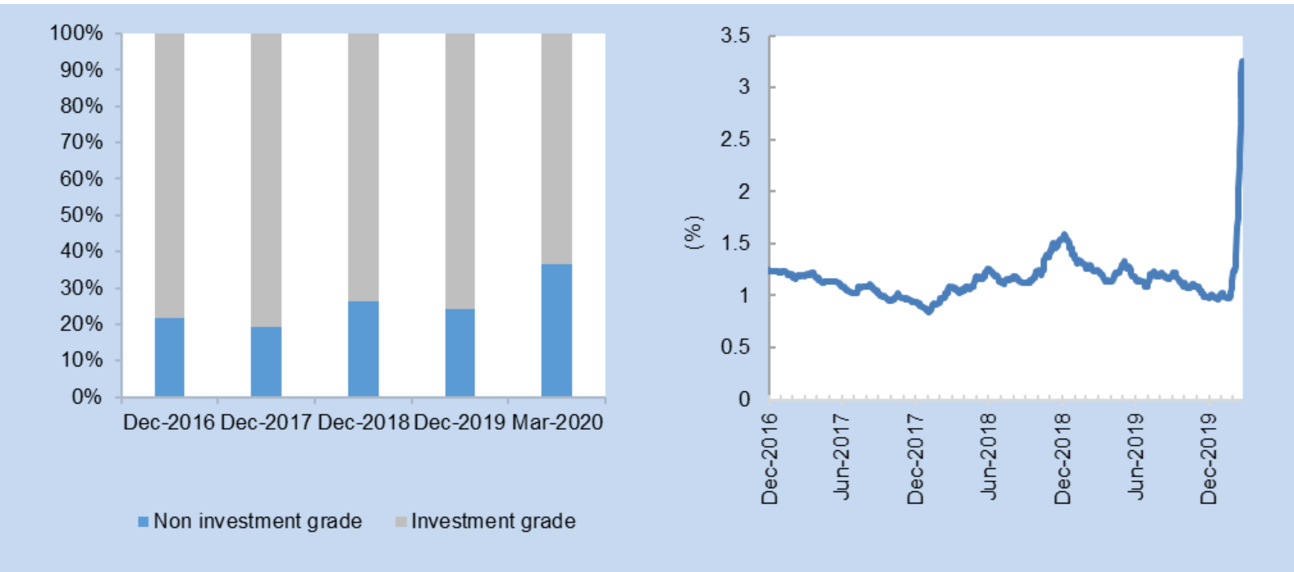

Figure 2a (LHS): Proportion of investment and non-investment grade globally-listed corporates according to PDiR. Figure 2b (RHS): Bloomberg Barclays Global Aggregate Corporate Average OAS. *Source: NUS-CRI, Bloomberg.*

Figure 2a above shows that the proportion of globally-listed corporates rated as non-investment grade has risen by 12 percentage points from 24% to 36% since the COVID-19 outbreak according to the NUS-CRI Probability of Default Implied Ratings (PDiR[4]). Furthermore, global corporate bond issuance number of deals between January and March this year is at a nine year low over fears of the spread of COVID-19 and the slump in oil price. 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 and it showed that the global aggregate corporate bond spread has surged upwards to its highest level in 11 years amid the increase in the number of COVID-19 infections globally (see Figure 2b).

While concerns over the refinancing abilities for some of the most vulnerable corporates have been brewing since last year, the recent turmoil in the markets suggested that even highly-rated corporate issuers are not spared from facing tighter liquidity conditions. The bid-ask spread for corporate bonds rated between A to BBB with a maturity between one to five years, long considered to be part of the highly liquid corner of the corporate debt market, has shot up to an average of 120bps. Issuers could further face liquidity crunch should their credit ratings get downgraded to junk rating as many institutional investors who are mandated to only hold investment-grade rated bonds will be forced to sell the downgraded bonds. The situation is now even worse for corporates in the riskier corner of the market, which are having difficulties in raising funds, as most investors tried to steer away from taking excessive risks during a period of uncertainty. On top of the tight liquidity conditions and refinancing difficulties, globally-listed corporates are facing approximately USD 5.9tn of bonds maturing this year(see Figure 3a), highlighting the heightened default risk amid this period of uncertainty.

[4] The NUS-CRI Probability of Default Implied Rating (PDiR) provides a more conventional interpretation of PDs – it translates NUS-CRI 1-year PDs to letter ratings by taking reference from the historically observed default rates of S&P's rating categories.

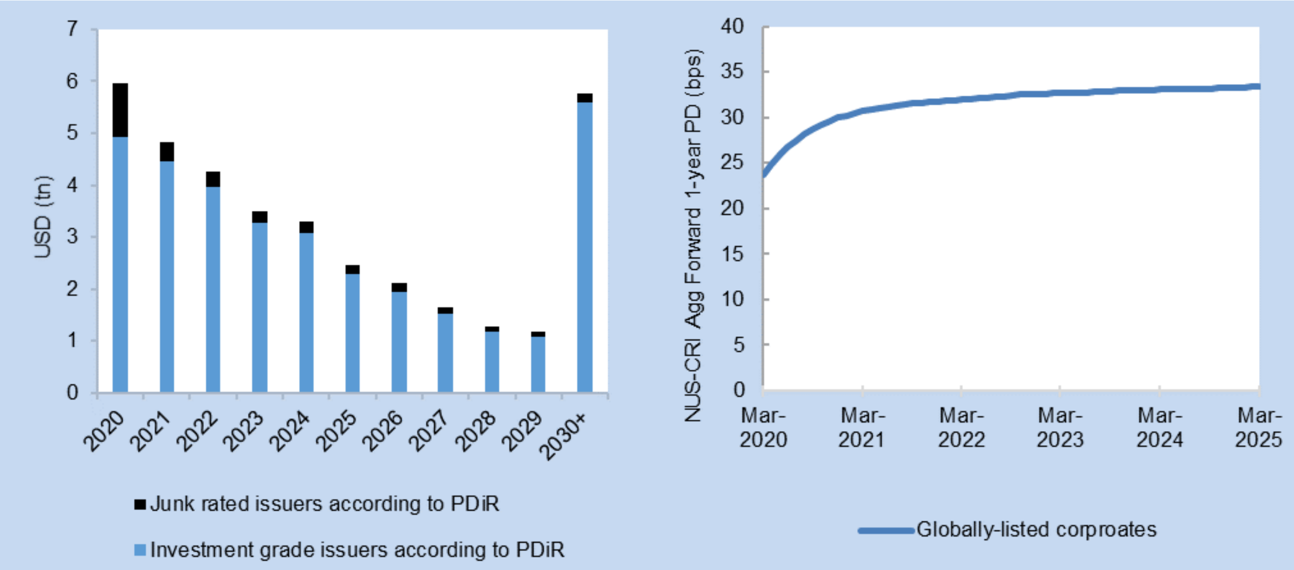

Figure 3a (LHS): Amount of maturing corporate bonds issued by globally-listed corporates. Figure 3b (RHS): NUS-CRI Forward 1-year PD of globally-listed corporates based on information available in Mar 2020. *Source: Bloomberg, NUS-CRI*

Worryingly, it seems increasingly likely that central bankers will have limited tools to combat recession. A stress test conducted by the International Monetary Fund (IMF) based on a hypothetical economic shock half as severe as the 2008 global financial crisis suggested that almost 40% of the corporate debt in eight major countries[5] would be impossible to service. Currently, the Forward PD pattern also suggests that credit outlook for globally-listed corporates will continue to deteriorate for the next 5 years (see Figure 3b). Central banks across the world have already cut interest rates to record lows which left quantitative easing as one of the few remaining tools to combat an economic downturn. In terms of fiscal policy, governments in various countries have also promised an unprecedented amount of stimulus packages to prevent the coronavirus crisis from turning into a full blown economic crisis. Questions remain, however, on whether those remaining available tools can be an effective cushion to protect the global economy from the blow caused by this outbreak. Only time can tell.

Credit News

Bad debt surge threatens Chinese banks' balance sheets

Mar 30. An coronavirus-caused incoming surge of bad debts and lenders having to brace much higher levels of non-performing loans lead to the risk of capital levels of some Chinese banks falling below crucial thresholds. Forecasts of rating agencies indicate that common equity tier-1 capital, which is meant to protect banks against financial crisis, would not be sufficient to bear the risks. Fitch estimated non-performing loans to rise to 5 percent, Moody's lowered the credit outlook of six mid-tier Chinese banks' from stable to negative, and S&P warned about USD 2.1tn loans becoming either non-performing or late. Especially mid-and small-sized banks' asset quality will be hit the hardest. (FT)

Dollar strength exposes cracks in Asian emerging-market debt

Mar 30. The strengthening of the dollar and resulting weakness of Asian currencies amid the COVID-19 outbreak is raising default risk amongst Asian companies. This year, about USD 115bn debt from the Asian emerging-market is expected to mature and another USD 200bn is set for the following year. The high reliance of emerging markets on foreign exchange funding is exceptionally risky and the current situation of dollar liquidity premium is not to its advantage. Plans to refinance the debts were greatly affected by dollar's

[5] The countries are US, China, Japan, Germany, Britain, France, Italy and Spain.

appreciation and a blowout in Asia ex-Japan credit spreads, forcing companies that have relied on the dollar market for funding to restructure or default on some of their bonds. (Nikkei Asian Review)

US crude oil price falls below USD 20

Mar 30. US crude oil price dropped below USD 20 a barrel after trading reopened on Monday, close to the lowest level in 18 years, as traders forcast crude consumption could fall further with the widening spread of the coronavirus pandemic. While demand has collapsed, the supply of oil has also increased due to the price war between Saudi Arabia and Russia. Prices are expected to remain under pressure until the market adjusts. Producers might be forced to shut off production at an unexpected scale, which could lead to a quick reckoning in the industry. (FT)

Big companies raise record sums from bond market in dash for cash

Mar 29. The global investment-grade corporate bond issuance surges to USD 244bn in March, whereby the largest proportion was raised in the US with USD 150bn of new bonds sold. Last week central banks and governments worldwide announced further measures to support financial markets, such as the Federal Reserve beginning to buy corporate bonds. Furthermore, borrowing costs for US companies that hold an investment-grade shave risen due to the threatened creditworthiness of issuers and dislocations within financial markets. On the contrary, lower-rated corporates did not experience a sharp increase in bond sales. Analysts warn of increasing corporate defaults since around USD 9tn of corporate debt outstanding has been built up over the past decade amid low borrowing costs. (FT)

Echoes of Asia financial crisis haunt region's debt market

Mar 27. Debt market in Asia is facing high stress from the COVID-19 pandemic as borrowing costs spike and investor's confidence in the region dampen. This was made worse with the region's historical record of a debt fuelled economic growth, which had drawn many investors to invest in high-risk bonds in the region. According to Goldman Sachs Group analysis, spread on junk bonds have soared to its highest in a decade after the coronavirus outbreak and default numbers is predicted to rise. Moreover, Asian currencies have also weakened and this poses additional strain on companies who borrowed in dollars. According to Bloomberg data, among borrowers with yields above 15%, USD 23bn of bonds mature by 2020 year end and 40% of the USD 11.3tn bonds issued by Asian companies mature before 2021 December. This, accompanied by large withdrawals of funds from corporate bonds due to smaller investor risk appetite would mean that default risks of Asian companies increases and debtors will need to pay dearly to refinance their debts. (Bloomberg)

Global airlines raised more than USD 17bn from banks in weeks (Bloomberg)

Investors are buying credit ETFs faster than the bonds can rally (Bloomberg)

Real estate woes mean China has new locus for credit stress (Bloomberg)

Regulatory Updates

China eased rules to raise capital but then markets turned wild

Mar 28. In order to help struggling companies, China relaxed its financing rules some weeks ago. This caused companies to take their chance to sell their stocks and bonds causing a flurry of issuance announcements to arise. But contrary to the original purpose, buyers are not so interested in the securities and more than 30 corporates abandoned their plans for bond issuance in the interbank market due to yield volatility. If volatility continues, companies will struggle to get funding support by using equity to reduce debt burden, carry out new investments, or have capital to protect against the epidemic impact. Within the corporate bond market, issuers wait for lower borrowing costs and hope to benefit from those. (Bloomberg)

Fed to launch multitrillion dollar helicopter credit drop

Mar 26. The Federal Reserve is going to spray trillions of dollars into the US economy once a massive aid package to fight the coronavirus is signed into law. In the aid package, USD 454bn will be set aside for Treasury to backstop lending by the Fed. Combined with an unlimited quantitative easing program, the Fed's lending facilities will push the central bank's balance sheet up sharply from an already record high USD 4.7tn, with some analysts saying it could peak at USD 9tn to10tn. (Bloomberg)

EU backs bank rule delay to spur crisis lending (FT)

Switzerland is prepared to raise USD 21bn Loan Package (Bloomberg)

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