



US non-IG firms may benefit from favorable recovery prospects, though underlying credit risk remains high

by [Raghav Mathur](#)

- **US elections and COVID-19 vaccine progress announcements further drive down borrowing costs for US high-yield issuers**
- **NUS-CRI Forward PD demonstrates increasing credit risk for US non-IG firms for the next 1 year**

Global markets around the world drew a breath of relief during the first half of November as the uncertainty surrounding the US presidential election subsided and a vaccine for the COVID-19 pandemic was announced. This was music to the ears of US domiciled non-investment grade (non-IG) firms¹, which have been one of the biggest [beneficiaries](#) of capital inflows when compared to their investment grade counterparts. Not only did they experience a significant drop in borrowing cost, but prospects of a rebound in consumer demand has improved chances of recovery for many of these borrowers. This comes on top of the monetary and fiscal stimuli in the US over the past few months. As seen below in Figure 1a, the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) for US non-IG issuers spiked at the start of the pandemic, but Federal Reserve (Fed) intervention has led to a downward trend in the Agg PD since April. US speculative grade borrowers, however, still face a worsening credit outlook pertinent to the risks associated with the rising number of COVID-19 cases threatening near-term lockdowns and impacting the non-IG firms' highly leveraged position as shown in the NUS-CRI Aggregate (Median) Forward 1-Year Probability of Default (Forward PD²) in Figure 1b.

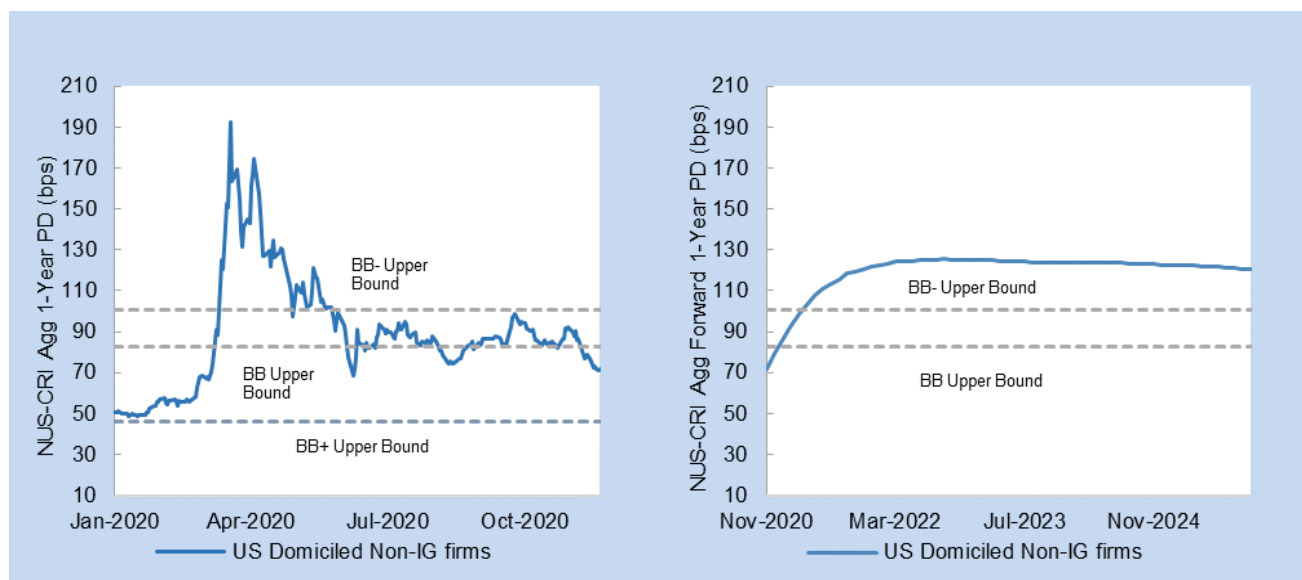


Figure 1a (LHS): NUS-CRI Aggregate 1-year PD (Agg PD) of the US domiciled non-investment grade issuers with reference to PDiR2.0³ bounds. Figure 1b (RHS): NUS-CRI Agg Forward 1-Year PD (Forward PD) of US domiciled non-investment grade issuers. *Source: NUS-CRI*

¹ Non-investment grade firms are those below BBB- as proxied by the NUS-CRI PDiR2.0 as of Nov 20, 2020.

² 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 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 1 year plus 6 months, conditional on the firm's survival in the next 6 months.

³ The Probability of Default implied Rating version 2.0 (PDiR2.0) provides a more familiar interpretation through mapping the NUS-CRI 1-year PDs to the S&P letter grades. The method targets S&P's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates.

The US high-yield credit markets have already experienced a bullish run over the past few months. The Fed, in collaboration with asset management giant BlackRock, restored confidence in the high-yield market by [resuscitating](#) demand for risky bonds during the depths of the economic slump. Though the pace of high-yield purchases by the Fed has [slowed](#) down since May and is [minute](#) when compared to their purchases of investment grade bonds, their backstop has allowed the high-yield bond markets to continue financing at a level not seen in previous global recessions. [Comprehensive](#) fiscal support from the US government has also supported US domiciled corporates. Through their Main Street lending programmes and primary and secondary market credit facilities, fiscal spending has provided vital [lifelines](#) to the whole economy.

As shown in Figure 2a below, US domiciled high-yield issuers dramatically raised the issuance of debt from USD 44bn in Q2 2019 to USD 180bn in Q2 2020. This spike in Q2 2020 is consistent with high-yield firms taking advantage of higher investor demand catalyzed by Fed’s intervention. More recently, possibly due to vaccine prospects driving positive recovery outlook, junk issuance increased to USD 67bn in November 2020, an increase of USD 57bn from October levels and USD 12bn from previous year. Furthermore, average maturity for high-yield bonds has significantly increased to levels not seen since 2015 as companies have refinanced for longer terms at record low costs. For example, [Ball Corporation](#), a US domiciled non-IG company, raised USD 1.3bn through a 10-year bond paying a record-low annual coupon of 2.875% (The YTM of this issuance is 2.806% as of November 27th).

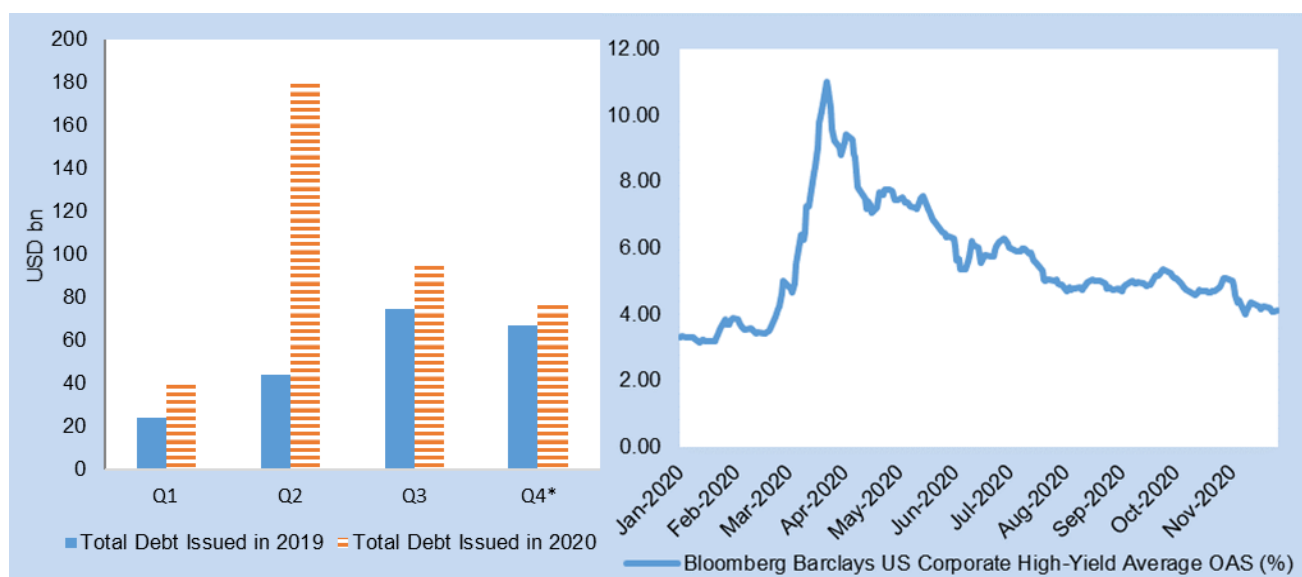


Figure 2a (LHS): Amount of bonds issued by US domiciled non-investment grade firms (*Q4 only contains October and November values)
 Figure 2b (RHS): Bloomberg Barclays US Corporate High-Yield Average OAS (%) (OAS) Source: Bloomberg

In November, the US high-yield market surged due to the announcements of COVID-19 vaccine progress by Pfizer and Moderna, as well as reduced uncertainty pertaining to the US elections. Firstly, progress on the COVID-19 vaccine has [increased](#) expectations that the US will face a stronger road to recovery, especially given its current dire state of 200,000 new cases a day. The impact of the vaccine progress announcement can also be witnessed in [industries](#) that were worst hit by the pandemic such as travel, energy and entertainment, though vaccine distribution practicalities still add [vulnerability](#) in their recovery. For example, borrowing costs for non-IG firms like American Airlines Group inc, Macy’s Inc. and Occidental Petroleum Crop have tumbled since the end of October as investors expect a rebound in the industries after the distribution of the vaccine. Furthermore, as the media called the US presidential elections for Joe Biden, high-yield credit markets have [benefited](#) likely due to [lower](#) uncertainty pertaining to election results. This has resulted in the Bloomberg Barclays US Corporate High-Yield Average OAS decreasing in November to its pre-pandemic levels (see Figure 2b).

However, the underlying credit health of non-IG companies is still a cause of worry. Even though high-yield issuers’ earning per share is [estimated](#) to increase by 15% in 2021, compared to the 22% decline in 2020, their Total Debt/EBITDA ratio was at record-high [6.1](#) as of Oct 2020. Even if there is an increase in earnings as high-yield corporates start benefitting from a revival of demand, average leverage levels may still remain elevated,

burdening issuer's credit quality. Concurrently, between March and July, the default rate for US high-yield bonds has increased by [3.5 percentage points](#) (March default rate was at 4.9%). The trailing 12-month default rate for US speculative bonds and loans decreased from 8.7% in August to [8.5%](#) toward the end of September indicating an initial slowdown in defaults as US high-yield firms benefit from easier access to liquidity in the credit markets. The default rate through to the first half of the next year is expected to range between [2.5% to 9.5%](#).

The Forward PD in Figure 1b demonstrates that the credit outlook for non-IG firms continuously increases until the start of 2022 and remains elevated thereafter. Though government stimulus may benefit short-term liquidity, and low yields might demonstrate that cost of borrowing for these firms has decreased to pre-pandemic levels, prospects of revived earnings are heavily dependent on the renewal of real economic activity in the country. Furthermore, the weighted average high-yield borrowing cost measured by an [index](#) might also be skewed due to the presence of [fallen angels](#), which make up three of the five largest companies in an index and have easier access to funding than their non-IG counterparts. A spike in the short term Forward PD may also occur due to the [threat](#) of further lockdowns in the near term. It may also reflect the uncertainty of further stimulus and the non-IG firms' high leverage levels.

In sum, November 2020 has been a positive for riskier US domiciled corporates. Speculative grade companies have been able to increase issuance to benefit from increased demand from investors as they chase higher yields, and the credit markets benefit from favorable macroeconomic events. However, US domiciled high-yield corporates have a long road to recovery as they are highly dependent upon the country's vaccine distribution capabilities. A further potential near-future dampener to recovery is the recent tensions between the US Treasury and the Fed. With the Secretary of Treasury potentially pulling key stimulus measures from a [strained](#) and vulnerable US economy, we may expect US domiciled corporates', and especially US non-IG firms' credit outlook to worsen.

Credit News**Canadian pension funds, insurers seeking private debt face shrinking pool of lower-risk firms**

Nov 29. Canadian pension funds and insurers, which solely focus on investment grade credit, face the issue of a shrinking pool of higher-quality debt investments. This tightening supply of high-yielding credit comes at a time where Canadian institutional investors have been increasing their exposure to private debt. Private credit has often had a premium over corporate bonds due to its fewer disclosures and lesser liquidity. This has encouraged institutions to increase their private debt allocation to chase high yields over the years. ([Reuters](#))

Bond investors bet on battered companies surviving virus shock

Nov 29. Debt investors are betting that some of the companies most damaged by COVID-19 will avoid bankruptcy. Low rated bonds have rallied 7% this month due to vaccine progress and the outcome of the US presidential election becoming clear. These factors have investors looking past the current spike in COVID-19 and an increase in social restrictions. S&P Global Ratings has also turned more optimistic as the rating agency cut its predicted corporate default rate next year. ([FT](#))

Subzero yields globally are at records, but Wall Street says that's good for US corporate credit

Nov 28. Global debt trading at yields below 0% has reached a record high of about USD 17tn. This is due to central banks increasing their collective balance sheets by increasing their purchases and extending emergency funding programs to provide a flow of credit to the financial markets. Although these measures have done well to keep borrowing costs low, they have also pushed investors into riskier assets that yield less than in the past, leading to a massive amount of negative-yielding debt globally. However, corporate credit metrics are weak and unlikely to improve significantly in 2021 as companies try to maintain earnings growth while they await the COVID-19 vaccine. Thus far, the Federal Reserve has utilized less than 10% of its credit programs, with the programs serving more value from a 'signaling' perspective than from actual purchases. ([Market Watch](#))

Indonesia's big banks resist pressure to lower lending rates

Nov 26. Indonesia's lenders are pushing back against central bank pressure to further lower interest rates for their customers, halting the central bank's efforts to pull the economy out of a recession. This stems from the risk-averse attitude resulting in a lack of demand for borrowing as loans shrank in October for the first time on record. Furthermore, the banks' have been reluctant to cutting borrowing costs due to non-performing loans staying above 3% since May, placing a strain on banks' balance sheets. ([Bloomberg](#))

String of defaults tests safety net for Chinese bonds

Nov 24. State-owned coal company Yongcheng Coal's USD 152mn bond default has rattled China's nearly USD 4tn corporate debt market. This challenged many investors' long-held assumption that local governments will always bail out state-owned borrowers. Analysts now fear investors will take a dimmer view of the debt, piling further pressure on borrowers. The recent defaults are also different from those in previous years because local governments are now being considered a source of risk themselves, rather than a source of stability. According to information provider Wind, 70 percent of all outstanding Chinese corporate and government debt is rated triple-A, despite economic stresses caused by Covid-19. This has therefore underlined concerns around investor disclosure. ([FT](#))

Acquisitive Chinese miner Tianqi Lithium faces debt crunch ([Nikkei Asian Review](#))

Vedanta Resources sounds out bondholders on debt extension ([Bloomberg](#))

Default concerns drive up borrowing costs for Chinese state companies ([FT](#))

Regulatory Updates

Turkey central bank lifts lira by dumping another credit rule

Nov 27. The central bank lifted the rule that encouraged Turkish banks to provide affordable costs of capital. In doing so, credit channels are tightened and interest rates are up. The new Governor hiked the key rate by 475bps in an attempt to increase the value of the lira and tackle inflation. With the policy rate up to 15%, a rollback of capital is to be expected. The reserves are forecasted to be up by TRY 12.3bn and USD 5.7bn in gold and forex. Domestically, non-performing loan ratios might increase. However, this would rely on the classification of debt by regulations. ([Reuters](#))

MAS launches world's first grant scheme for green and sustainability-linked loans

Nov 24. Under the Green and Sustainability Linked Loan Grant Scheme, MAS has released the world's first sustainability linked loans. The scheme is motivated by the push that loans are a significant source of financing across Asia. This leaves a large total addressable market for the central bank to encourage more stakeholders into sustainable practices. Singapore has been continuously making headways in Green Finance. From Jan 2019, the companies have borrowed over SGD 10bn through these loans. Moving forward, MAS will continue to support the development of this sustainable ecosystem. ([Straits Times](#))

Japan's ruling party to propose new loan schemes to ease pandemic strain - draft ([Reuters](#))

Risksbank expands QE; says more steps possible between meetings ([Bloomberg](#))

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