Credit profile of global listed firms improved amid looser monetary policies, but long-term risk remains

by Luo Weixiao

The change to a more dovish stance in monetary policies among global central banks and expansionary fiscal policies pursued by some governments have helped to improve corporates' near term credit profile in the early 2019 and is reflected in the NUS-CRI aggregate 1-year Probability of Default (Agg PD). The NUS-CRI 1-year Agg PD for about 35,000 active global listed firms dropped to 10.08bps at the end of April, after rising to the highest level in the recent two years. The NUS-CRI tail Corporate Vulnerability Index (CVI_{tail}) for global firms, which is the top 5th percentile of NUS-CRI 1-year PD representing the riskiness of the most vulnerable firms, fluctuated around 185bps, down from 220bps at the end of last year, exhibiting the same trend as global listed firms.

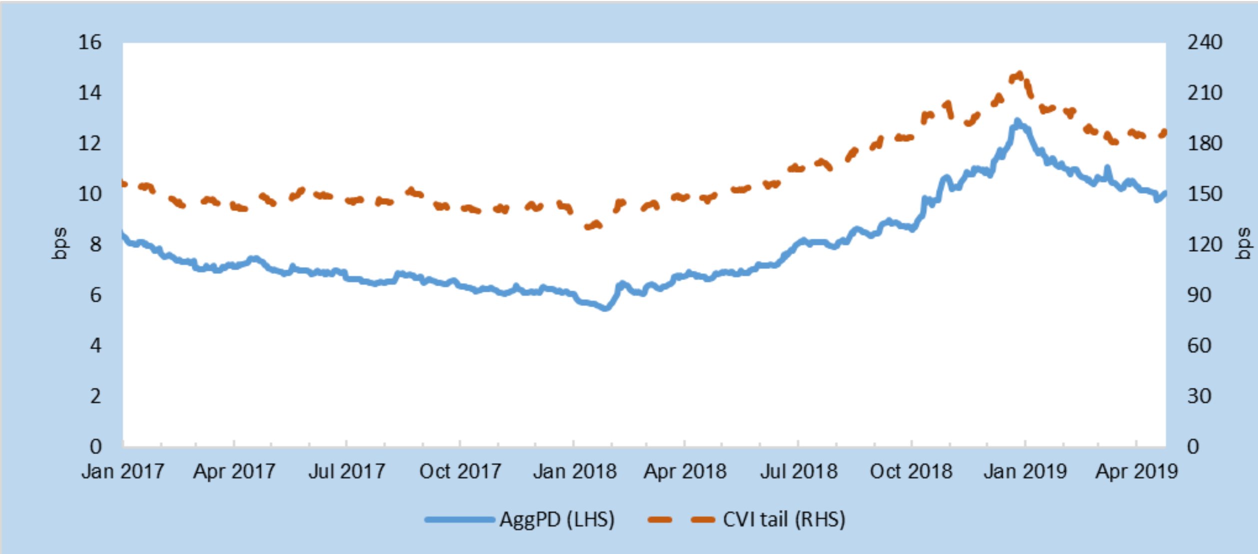

Figure 1: NUS-CRI Aggregate 1-year PD and CVI_{tail} for global listed firms from 2017. *Source: NUS-RMI*

Global central banks have turned to looser monetary policies and some governments have engaged in expansionary fiscal policies after the year started. The US Federal Reserve paused further interest rate increase after four consecutive rate hikes last year. The People's Bank of China cut required reserve ratio (RRR) three times in Jan 2019 and the government implemented fiscal measures including tax cut to cushion the economic growth. The European Central Bank (ECB) pushed back its rate hiking plan and announced the third injection of targeted longer-term refinancing operations (TLTRO), the cheap loans provided by ECB to euro banks. The more liquid environment and lower tax rates are expected to boost corporate earnings and thus help improve companies' aggregate credit risk profile.

Amid the dovish monetary policies, corporates are rushing to issue more debt as bond sales are running at a record pace. Global corporate bonds issuance for non-financial companies has peaked at almost USD 747bn in the year to date, surpassing the previous record high of USD 734bn in the same period of 2017. Asian offshore bond issuances are particular active due to the monetary policy as well as a greater willingness by Chinese regulators to approve offshore debt. A USD 6bn bond sale by Chinese technology group Tencent attracted USD 27bn and Chinese streaming service company iQIYI issued a USD1.05bn six-year convertible bond with a borrowing cost as low as 2%, compared to 3.75% last time with a shorter tenor. The high corporate debt sale highlights credit market's optimism and helps companies to refinance or fund large projects.

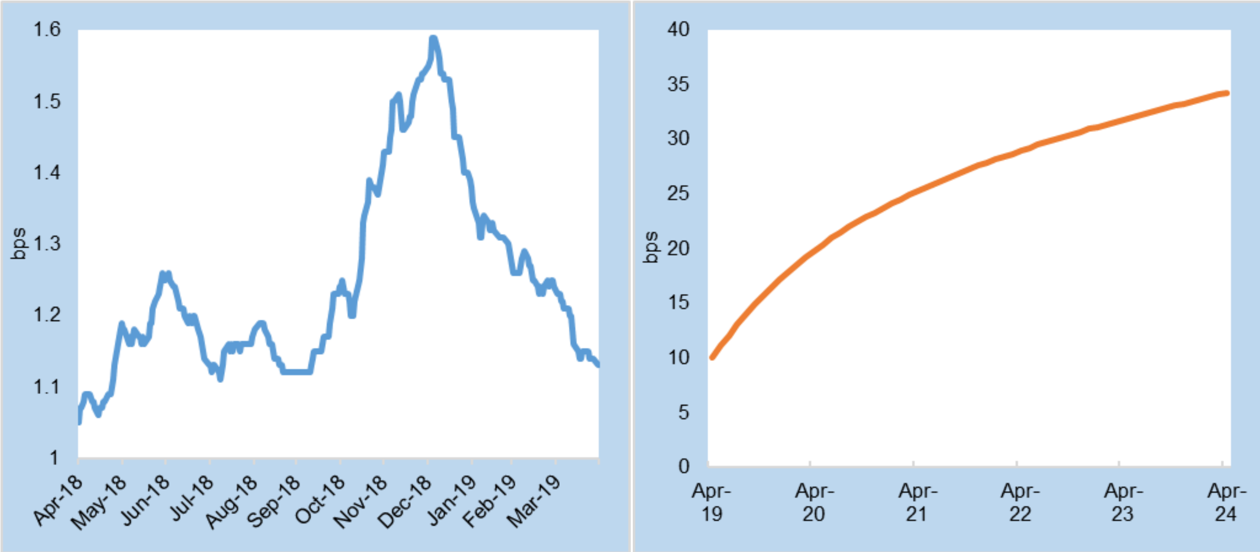

Figure 2a and 2b: Bloomberg Barclays Global Aggregate Corporate Average Option Adjusted Spreads and NUS-CRI Aggregate Forward 1-year PD term structure for global listed firms on April 24, 2019. *Source: Bloomberg, NUS-CRI*

The corporate bonds market also reflects optimism as investors channel their capital back to these bonds. As seen in Figure 2a, the global aggregate corporate bond spread has fallen back to mid-2018 level. US corporate bond funds saw a large inflow in the week after the Fed's dovish shift. According to Lipper, US investment-grade corporate bond funds took in USD 5.2bn and high-yield bond funds saw USD 1.8bn of inflows.

However, the increasing bond issuance and rising corporate financial leverage may lead to more serious problems in the long term. High corporate debt is shown across nearly three quarters of the global economy and large economies representing 70% of global GDP have elevated levels of corporate debts, according to IMF. Firms are loading up their balance sheets despite the risk of economic slowdown, increasing the threat to long term economic performance. In the latest World Economic Outlook by IMF, a globally weakening expansion is expected due to a confluence of factors affecting major economies, such as weakened consumer and business confidence in euro area, regulatory tightening in shadow banking in China and trade tensions still taking a toll on market sentiment.

The prolonged decline in overall bond quality is another concern. The number of junk-rated firms tracked by NUS-CRI Probability of Default Implied Ratings (PDiR) has climbed to 12,518 at the end of last year and the total percentage has reached to nearly 30%. If global economic growth slowdown further, the percentage of firms rated junk could rise. Looking ahead, Figure 2b indicates the NUS-CRI Aggregate Forward 1-year Probability of Default (Forward PD) term structure for global listed firms at the end of April. The Forward PD computes the credit risk of a company in a future period. For instance, 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 surviving the next 6 months. As shown in the figure, a worsening credit outlook is expected.

Credit News

Bond sellers come under scrutiny after Hyflux's troubles

Apr 29. Accoring to S&P Global Ratings, more defaults could happen as earnings worsen in a weakening economy and riskier borrowers that borrowed amid low interest rates may struggle to pay back. Borrowers excluding banks and other financial firms face SGD 5.1bn of debt in 2019 and climbs to SGD 12bn in 2020. Firms that have a lot of short-term debt and in sectors that are vulnerable to business cycles such as commodities and property development could face difficulties. Some smaller firms that have bonds marturing by the end of next year such as CWT Pte, Vibrant Group and Oxley Holdings have attracted investors' scrutiny amid the collapse of Hyflux. (The Straits Times)

Why triple-C bonds are still too hot to handle

Apr 27. US triple-C and lower rated companies have failed to recover from a disastrous Q4 2018, during which they returned a loss of 9.6%: despite the Federal Reserve's dovish stance. The ratio of rating downgrades to upgrades in 2019 is the worst since the energy crisis in 2016, according to rating agency S&P Global. Overall, US triple-C and lower rated bonds have so far returned slightly over 10% in 2019, slightly outperforming the overall high-yield market at 9%, but at a higher risk to investors as these companies are expected to fall the most in a downturn. Industries such as the traditional bricks-and-mortar retailers and energy companies are some of the most vulnerable sectors. (FT)

Default sparks angst over China's USD bond market structure

Apr 26. After China Minsheng Investment Group Corp (CMIG) announced a triggering of cross-default clauses last week due to debt problems with its affiliate, a standby letter of credit (SBLC) could be drawn down for a public Asian bond for the first time. A SBLC acts as a credit booster, in which the issuer of the letter pledges to honour the borrower's obligations in a pre-agreed grace period. However, the length and logistics of such a repayment process is so far unclear. CMIG's notes, which include a USD 300mn bond a SBLC from China Construction Bank Corp, could therefore set a precedent for the Chinese bond market, which has about USD 7.3bn of outstanding notes that carry SBLCs. (Business Times)

Junk-rated energy debt rises on crude revival

Apr 25. As oil prices have rallied nearly 40% since the start of 2019, junk-rated bonds in the US energy sector have outperformed the general high-yield bond market in the US. According to Ice Data Services, these bonds were able to to achieve a total return of 10.3% for 2019, with the general high-yield bond market returning 8.7% on average. The decision by the Trump administration to not renew the waivers for US sanctions on oil imports from Iran's customers, such as India and China, has triggered a further rise in oil prices. Despite the recovery of oil prices, some companies are not getting the benefits. Some oil and gas producer have filed for bankruptcy and it is a sector that remains difficult for investors to make big bets. The decline in oil prices in the Q4 2018 has led to more troubles for distressed energy companies. (FT)

Argentine bonds sink into distressed territory as Macri falters

Apr 25. Recent polls conducted concerning the presidential election of Argentina have shown that the current president, Mauricio Macri, may not be able to secure a re-election: his approval ratings, around 30%, are currently lower than his main competitor's, former president Cristina Fernandez de Kirchner, at 36%. This uncertainty has driven down Argentine markets, as probability of default in the next five years (as implied by credit-default swaps) now exceeds 60%. Yields on the government's short-term dollar bonds rose as high as 20%. Despite a recent USD 56bn rescue package by the International Monetary Fund to attempt to stabilize the economy, the pressing issue of rampant inflation hitting 55% in March, has driven interest rates to 68%, the highest in the world. (Bloomberg)

Investor exodus from loan funds stretches into sixth month (FT)

Italian bonds set for relief rally as S&P refrains from downgrade (Business Times)

Debt investors should look out for China's east-west divide (FT)

Regulatory Updates

Singapore closer to becoming Asia's debt restructuring hub

Apr 29. After a landmark ruling by an English court to recognise Singapore's new moratorium law for insolvency and corporate restructuring, Singapore is close to become an international debt restructuring hub. The ruling came after the Parliament made a major overhaul of Singapore's corporate restructuring and insolvency laws in 2017. It would be easier for companies, with creditors around the world, to be rescued and rehabilitated. Singapore has incorporated elements of the US Chapter 11 Bankruptcy Code which has extra-territorial reach through the personal jurisdiction of the US bankruptcy courts that can extend to acts outside of the US, and uses the traditional creditor scheme of arrangement. These elements will assst Singapore to attract debtors and creditors in the region for corporate restructuring. (Business Times)

Hong Kong regulators warn banks over complex lending risks

Apr 24. In an effort to combat the misuse of risky financial practices, both the Securities and Futures Commission (SFC) and Hong Kong Monetary Authority (HKMA) have released a joint statement on Wednesday warning about the exploitation of so-called complex lending arrangements. In the case of an unnamed Chinese bank, a highly complex transaction involving the bank's subsidiary, a private fund and a special purpose vehicle which was used to unlawfully benefit a substantial shareholder of a public company. The bank's subsidiary had also provided lending to other public companies in exchange for equity that was illiquid or of doubtful quality. Both the SFC and HKMA warn about the illegality of such practices, as well as the increase in balance sheet risk they cause. (Bloomberg)

FCA chief eyes 'lower burden' regulation after Brexit (FT)

Federal Reserve may end up seeing 1995-96 rate cuts as template for today (Business Times)

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