



Credit risk for global corporates rises in 2022 as recessionary headwinds and high inflation dominate the outlook

by [NUS-CRI Market Monitoring Team](#)

- **Rising borrowing costs due to widespread rate hikes, in the face of recessionary headwinds, catalyze an increase in the credit risk of globally listed corporates**
- **Sectoral breakdown of NUS-CRI Forward PD suggests the energy sector is set to worsen the most as a global slowdown in consumption and production potentially reduces demand**

Global credit conditions have deteriorated since the beginning of this year, despite [stabilizing](#) in 2021, with the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) (See Figure 1a) for all publicly listed companies inching higher to a peak of around 19bps in 2022. One of the factors that drove the increase in global credit risk was rate hikes by major central banks around the world to curb rampant inflation, increasing borrowing costs, and debt service burdens for corporates globally. Looking forward over the next 12 months, as seen in Figure 1b, the NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD¹) shows that further headwinds may be present in 2023 for global credit conditions, including the pace of major central banks' policy rate hikes, developments in geopolitical tensions, such as the Russia-Ukraine war, impacting supply chains, and the impact of China's reopening in the coming quarters.

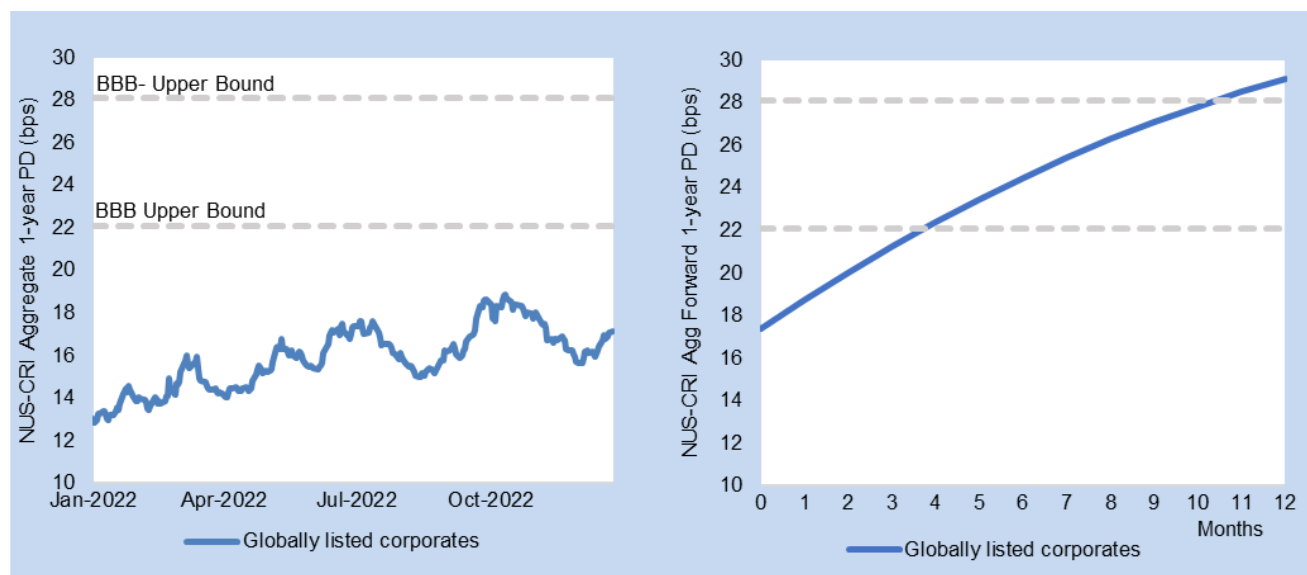


Figure 1a (LHS): NUS-CRI Agg (median) 1-year PD for Globally listed corporates, with reference to PDiR2.0² bounds from Jan-2022 to Dec-2022. Figure 1b (RHS): NUS-CRI Agg (median) Forward 1-year PD for Globally listed corporates as of Dec-2022, with reference to PDiR2.0 bounds. *Source: NUS-CRI*

Though rampant inflation was a peripheral concern near the end of 2021, it became the forefront cause of market upheaval in 2022 as the majority of central banks around the world pivoted from pandemic-induced monetary easing to tightening in response. Inflation concerns ramped up during the initial months of 2022 as Russia's invasion of Ukraine saw the supply of major commodities decline, impacting global supply chains and raising the costs of production. Though the rising commodity prices played a bigger part in driving prices in [Europe](#), where YoY inflation reached an [all-time high](#) of 10.6% in Oct-2022, climbing consumer prices in the US (where

¹ The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similarly 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 18 months – this is conditional on the firm's survival in the next 6 months.

² 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.

inflation reached a high of [9.1%](#) YoY in Jun-2022) stemmed primarily from an [increase](#) in household spending on durable goods, such as autos and household appliances, possibly due to pent-up demand and tight labor market conditions. However, the increase in inflation and resultant monetary policy tightening has not been a homogenous trend across the globe. For example, in 2022, China saw inflation increase by a maximum of only [2.8%](#) YoY in Sep-2022.³

Acting as a leading global indicator of central bank hawkishness, the Federal Reserve (Fed) has [raised](#) its policy rate from 0.25% in Mar-2022 to 4.50% by 2022 year-end⁴ to curb the growth in US consumer prices. Consequently, rising borrowing costs are becoming a prominent concern for corporates globally due to their potential impact on corporates' debt servicing ability. As seen in Figure 2a, global borrowing costs for both investment-grade and non-investment-grade firms have increased throughout 2022 by close to 2.5 and 4.2 percentage points respectively. Though companies have continued to raise funds through bond issuances possibly to shore up liquidity, a higher debt servicing cost may see corporates have trouble in refinancing upcoming maturities in 2023⁵. As global growth prospects hamper and corporate profitability is affected, the impact of rising rates on households is also a cause of concern. With households' mortgage costs rising steadily around the world, consumers are facing an inflationary pinch⁶ that may lead to heightened recessionary pressures that affect corporate top lines. Initial signs of the economic slowdown can already be seen throughout the latter half of 2022 in Figure 2b, with the JPMorgan global manufacturing PMI index decreasing well below 50 to 48.8 in Nov-2022, signaling widespread contraction in economic activity.

Another cause of concern impacting global credit conditions is China's ability to maintain the reversal of its zero-COVID policy in the short term. [In Dec-2022](#), China dropped its strict zero-COVID curbs, which hampered the country's growth projections throughout 2022. Though the re-opening of China has generally been viewed as a net credit positive event due to the perceived positive impact on growth and global supply chains, with the virus spreading quickly through the country, a potential policy reversal by the Chinese government presents a risk to global corporate credit health. As such, for the country's domestic markets, growth in corporate profitability may remain relatively stagnant in the near term as consumers remain cautious about the virus, and as foreign investors may be [wary](#) about allocating capital, access to financing for corporates that are searching for near-term liquidity relief such as the country's domestic real estate sector may remain limited.

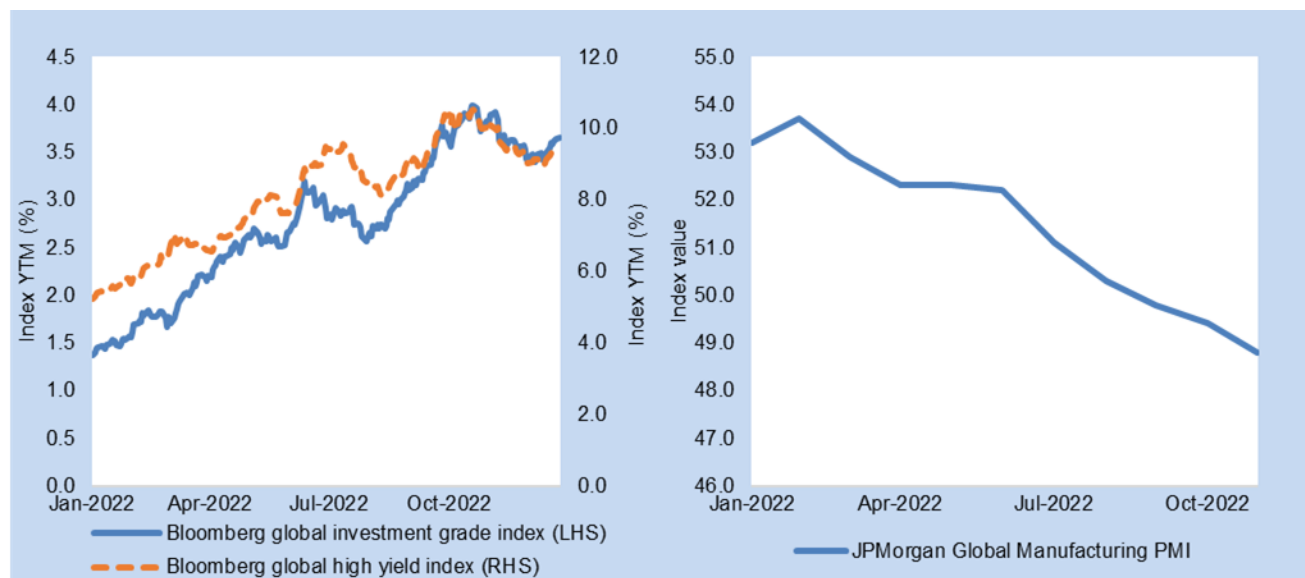


Figure 2a (LHS): Index YTM (%) of the Bloomberg global investment grade index and the Bloomberg global high-yield index. Figure 2b (RHS): Value of the JP Morgan Global Manufacturing PMI Index Source: Bloomberg

Figure 3 shows the credit outlook for major sectors over the next 12 months, with the NUS-CRI Forward PD indicating a potential increase across the board. Though the energy sector largely [benefitted](#) in 2022 from an upswing in commodity prices, Forward PD indicates that the credit health of the sector is poised to worsen the most compared to others. This may be driven by [global recessionary headwinds](#) which may lead to a substantial slowdown in consumption and hence, reduce demand for energy. Oil prices have [consistently](#) tracked

³ Inflation has since declined to 1.6% YoY in Nov-2022 driven by a decline in the cost of food. The People's Bank of China (PBOC) has reduced rates by 15bps to 3.65% since the beginning of this year

⁴ Similar tightening was seen across other major central banks, barring China, Japan, Turkey, Russia, and Indonesia.

⁵ According to Bloomberg, Global corporates have close to USD 4.7tn maturing in 2023, amounting to around 11.7% of total debt due.

⁶ In an extreme scenario, the impact of a widespread housing market downturn on financial institutions and the global real estate industry may follow a similar trajectory to the housing market crash currently happening in [Sweden](#).

downwards for the second half of 2022 as the global growth forecast remains lackluster. Weak [manufacturing](#) data from China, which is the world's largest energy importer, also poses a potential challenge moving forward. Despite the marginal benefits of the country reopening, the current [upsurge](#) in COVID-19 cases threatens to limit manufacturing activity, impacting the global demand for energy into 2023.

In contrast, NUS-CRI Forward PD indicates that the Financials sector may remain well-positioned in the face of a global recession. Particularly, banks have benefited so far from interest rate hikes as higher net interest margins boost their profitability. However, headwinds remain in 2023, as banks may see an increase in delinquencies and higher NPAs as corporates and households struggle with higher interest costs amidst demand declines. Additionally, with mortgage costs increasing around the world, demand for new houses is poised to decrease, worsening the outlook for the real estate sector. However, it is [probable](#) that government support, like those recently seen in the battered Chinese housing market⁷, could limit the extent to which the sector's credit quality deteriorates relative to its peers.

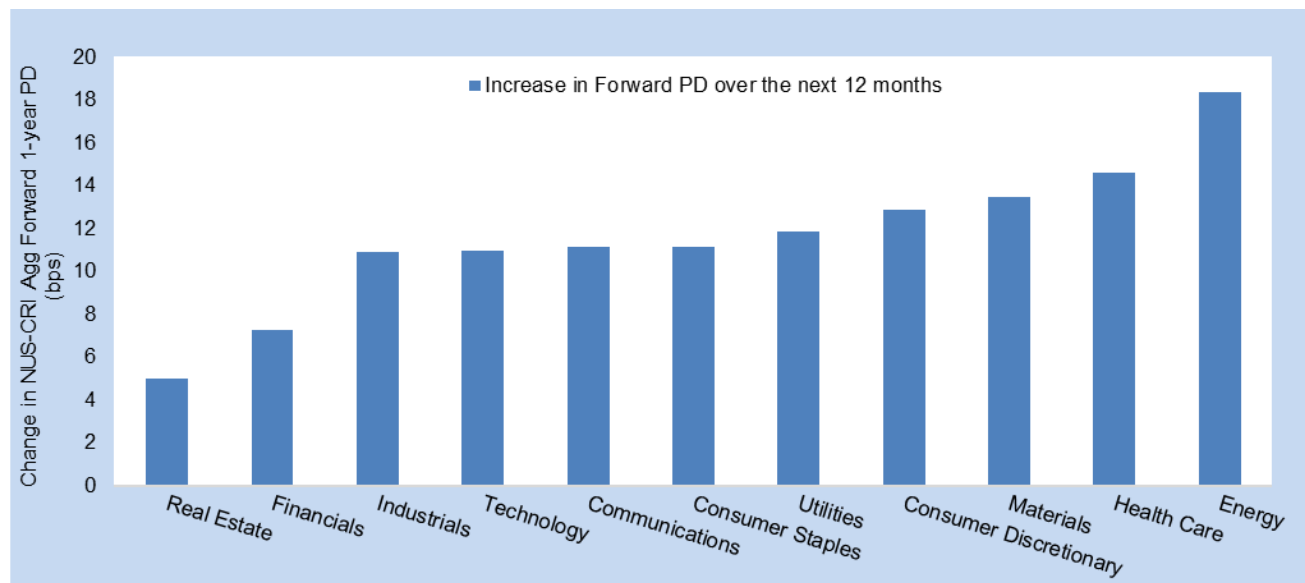


Figure 3 (LHS): Change in the NUS-CRI Agg (median) Forward 1-year PD of major sectors over the next 12 months. Source: NUS-CRI

Looking forward, corporate credit health in 2023 will depend upon the severity and impact of a potential global recession. Although some major central banks may have opted to lower the pace of rate hikes, most central bankers reiterate that the rate-hiking cycle has not yet concluded indicating that corporates' financing costs are expected to remain high for the most of 2023. In such a scenario, the onset of a recession may exacerbate the stress faced by companies as their cash-generating abilities take a hit, further deteriorating their debt servicing ability and overall credit health, as suggested by the NUS-CRI Forward PD in Figure 1b.

⁷ The Chinese government released [16](#) supporting measures for the real estate sector. In addition, around USD [256bn](#) has been committed by Chinese state-owned banks as credit support to selective developers.

Credit News

European bond markets were roiled this year in ways few imagined

Dec 31. The unpredictable inflation driven by the energy crisis poses uncertainty over where interest rates will end up, which unsettles the European bond market in ways rarely seen in the past decade. The implied volatility of rates in Europe has surpassed the US equivalents, making accurate pricing of bonds difficult and increasing transaction costs due to more frequent positions taken to hedge against rising borrowing costs. To alleviate the liquidity squeeze in the market, some of the governments led by Germany plan to increase asset supply in the repo market and increase issuance in 2023. ([Bloomberg](#))

Negative-yielding bonds could be approaching their final days

Dec 28. As major central banks raise interest rates, Japan might be the last country with sub-zero-yielding debt. However, the BOJ seems to have become hawkish since the past week, causing yields on notes with less than 10-year maturity to turn positive. It is anticipated that the counterintuitive investment on negative yielding bonds could come to an end, as the possibility of BOJ setting a positive target interest rate in 2023 increases. Fixed-income investors could only buy riskier corporate bonds or currency swaptions to secure positive yields, but they can achieve this by buying government bonds, which carry lower risk. ([WSJ](#))

After muni-bond 'bloodbath,' expectations for 2023 are muted

Dec 30. In 2022, Municipal bonds (munis) posted their worst performance in the last 20 years, with the total value of the market less than USD 4tn for the first time since 2014. Investors continued to withdraw money from the muni market, causing total outflows of USD 90bn. The declining asset prices forced fund managers to cut their holdings which further pushed the market down with more investors liquidating their positions. Although in the past, strong rebounds have been witnessed after slumps in the muni market, analysts still show concerns over the current situation. Faced with continuous rate hikes, inflation, and slowing tax revenue, the credit outlook for the government and state might deteriorate. ([WSJ](#))

For battered bonds, threats of further losses linger

Jan 02. The Bloomberg U.S. Aggregate bond index decreased by 13% in 2022, the largest decline ever since the 1970s. The hawkish rate hikes of the Fed resulted in higher borrowing costs, a sharp drop in bond prices, and value losses of more than 10% in the stock market. Despite hiking interest rates above investor expectations, the Fed is still not satisfied with the results. Increasing labor costs which are a major driver of inflation might require higher interest rates to be restrained, though the overall inflation indicator does show a reprieve. ([WSJ](#))

Wall St stocks fall, bond yields rise as China drops quarantine rule

Dec 28. U.S. stock indices dropped and U.S. Treasury yields rose after the U.S. released the economic data and as China reopened after abandoning its long-standing zero-COVID policy. The 10-year benchmark yield increased 10.7 basis points to 3.845%, and the 30-year bond yield was up 12 basis points to 3.9417%. The growth sectors such as rate sensitive technology sector are faced with the pressure of rising yields, yet the prices of commodities such as crude oil and gold have climbed to a higher level due to anticipated demand recovery from China. However, concerns over the surging infection cases in China persist. ([Reuters](#))

Oil-and-Gas companies seek ESG loans, pledging emissions cuts ([WSJ](#))

Brazil's record 2023 bond bill underscores rising debt burden ([Reuters](#))

Small UK companies struggle to secure affordable bank loans ([FT](#))

Regulatory Updates

Bank of Japan makes unscheduled bond purchases for third straight day

Dec 30. The BOJ has not yet given up its ultra-loose monetary policy like most of the other central banks, instead, it continued to purchase government bonds proving speculators, who were betting on tightening, wrong. The BOJ bought bonds totalling USD 128bn in Dec in an unscheduled manner. Bond traders and analysts pointed out the contradiction between the BOJ's intention and its actions as the BOJ tweaked its yield control policy while simultaneously purchasing bonds to alleviate the market volatility. ([FT](#))

US central bankers hope lower profit margins will aid inflation fight

Dec 30. Central bankers take delight in the possible "earnings recession" as it bodes well for taming inflation. The contracting retail margins will help restrain the core PCE index, the preferred inflation gauge of the Fed, decreasing to 3.5% by the end of 2023. A lot of companies chose to raise product prices to offset the increasing costs in recent years. Although the consumers seemed not very sensitive to aggressive price changes in some of the industries, the price-driven growth is unsustainable and most of the corporates are now seeing the limits of their price hikes. However, a margin compression may lead to more unemployment and even a recession. ([FT](#))

Bank of Israel hikes key rate 1/2-point with inflation at 14-year high ([Reuters](#))

Fed reverse repo facility hits record \$2.554 trillion ([Reuters](#))

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