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Amidst oversupply concerns, structural demand slowdown poses risks to the credit outlook of EV battery metals miners

by Raghav Mathur

- **NUS-CRI Agg PD shows a pressured credit risk profile of global EV battery metal miners, with the Forward PD suggesting further deterioration amidst oversupply concerns and longer-term demand challenges impacting profitability prospects**
- **Stress tests suggest that current market forecasts of Lithium and Nickel prices are likely to not materially impact the median credit risk of miners, although the industry's tail risk is likely to increase**

Key commodities' providers continue their battle with inflation-driven increases in operating and procuring costs amidst a tighter credit environment globally as structural demand headwinds continue to put downward pressure on metal prices. The Bloomberg Lithium price index has already fallen more than 63% from its YTD peak of 1186.12 in Jan-2023, whereas Nickel futures have also dropped close to 40% in value YTD. The impact of global demand slowdown for EV battery metals suggests that the profitability prospects of metal miners are likely to remain subdued, especially as China's domestic economic slowdown remains prevalent. As such, the credit risk profiles of base metal miners, particularly those of EV battery metals such as Nickel and Lithium, have deteriorated and are likely to continue feeling pressures on their bottom lines and free cash flow positions in the near future. As seen in Figure 1a, the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) for global nickel and lithium miners, although still investment grade according to PdiR2.0 bounds[1], has slightly worsened since the beginning of this year. The NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD[2]) in Figure 1b suggests that miners that produce battery metals are likely to see their credit risk increase in the absence of a positive demand shock that boosts profitability prospects for the industry and a low repayment burden over the next twelve months.

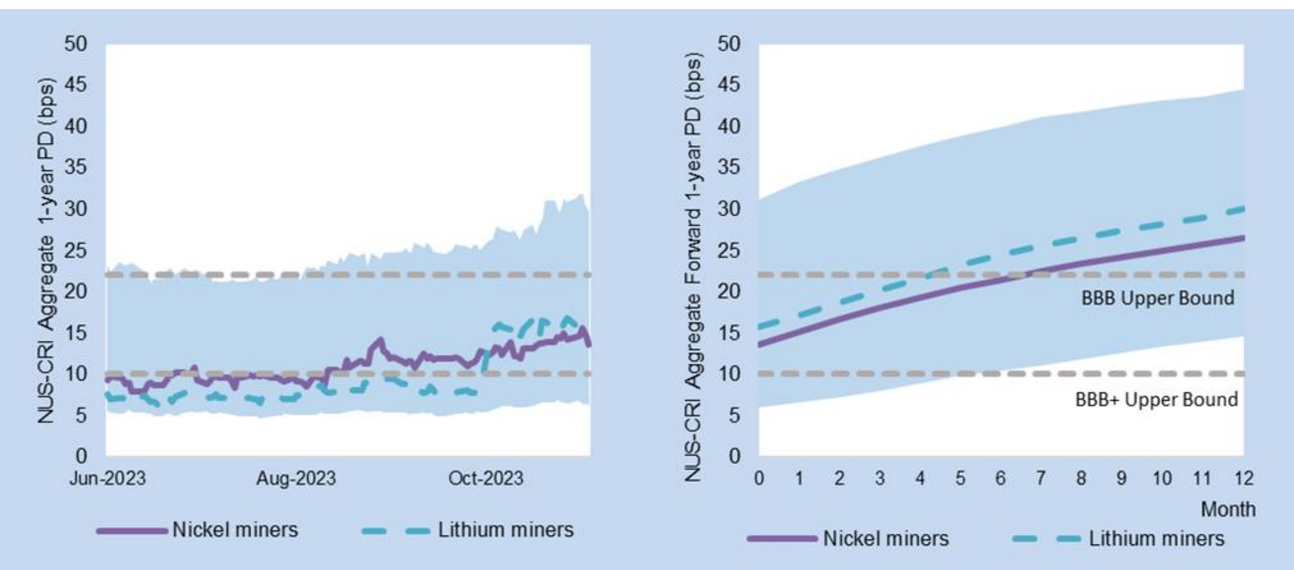

Figure 1a (LHS): NUS-CRI Aggregate (median) 1-year Probability of Default for Nickel and Lithium miners and the interquartile range of PD for all base metal miners, with reference to PDiR2.0 bounds. Figure 1b (RHS): NUS-CRI Aggregate (median) Forward 1-year Probability of Default for Nickel and Lithium miners and the interquartile range of Forward PD for all base metal miners, with reference to PDiR2.0 bounds. *Source: NUS-CRI*

[1] The Probability of Default implied Rating version 2.0 (PDiR2.0) provides a more familiar interpretation by 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.

[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 18 months, conditional on the firm's survival in the next 6 months.

Interestingly, unlike during the initial phases of the pandemic when demand for battery metals soared and the transition to EV vehicles picked up steam, the market for leading battery metals is facing a glut of oversupply as global demand has dropped amidst rising recession risk. The supply of batteries stemming specifically from China, which has expanded its battery capacity during the pandemic to meet rising demand, is almost double the current domestic and exported demand. According to Benchmark Mineral Intelligence, lithium and nickel are likely to be oversupplied until 2028, posing a structural risk to the bottom line of miners that expanded capacity over the past three years. Oversupply concerns are also likely to hinder expansion plans and cause potential delays in new mines and refineries over the long term, although with the sector being of strategic importance to major economies, policy support may continue buoying expansion plans across major global producers such as China and Indonesia.

Higher borrowing costs amidst a weaker consumer sentiment on discretionary spending have led to global EV manufacturers reducing their expansion plans, with the market expecting lower global growth in the near term. The Bloomberg EV price return index has already tumbled close to 7% since the middle of Oct-2023, as market participants priced in lower growth and capacity expansion plans for EV manufacturers.[3] Shifting demand dynamics are likely to trickle further upstream and reduce demand in the short term for battery metals, impacting longer-term cash flows for miners with excess capacity specifically built out during the pandemic. Furthermore, as the electric vehicle market matures and technology advances persist, there may be a transformation in the specific materials required to build out EV batteries. For instance, breakthroughs in solid-state battery technology could reshape the demand landscape for lithium-ion batteries, posing a long-term threat to miner operations and revenue-generating capabilities. A silver lining for the industry is its relatively small short-term maturity wall which eases instantaneous repayment pressures arising from the current market downturn. For the companies in our sample, only 5% of outstanding debt is due by the end of next year. However, close to 50% of all outstanding debt is set to mature by 2025, which may cause an increase in repayment pressure should profitability margins remain muted in the long term.[4]

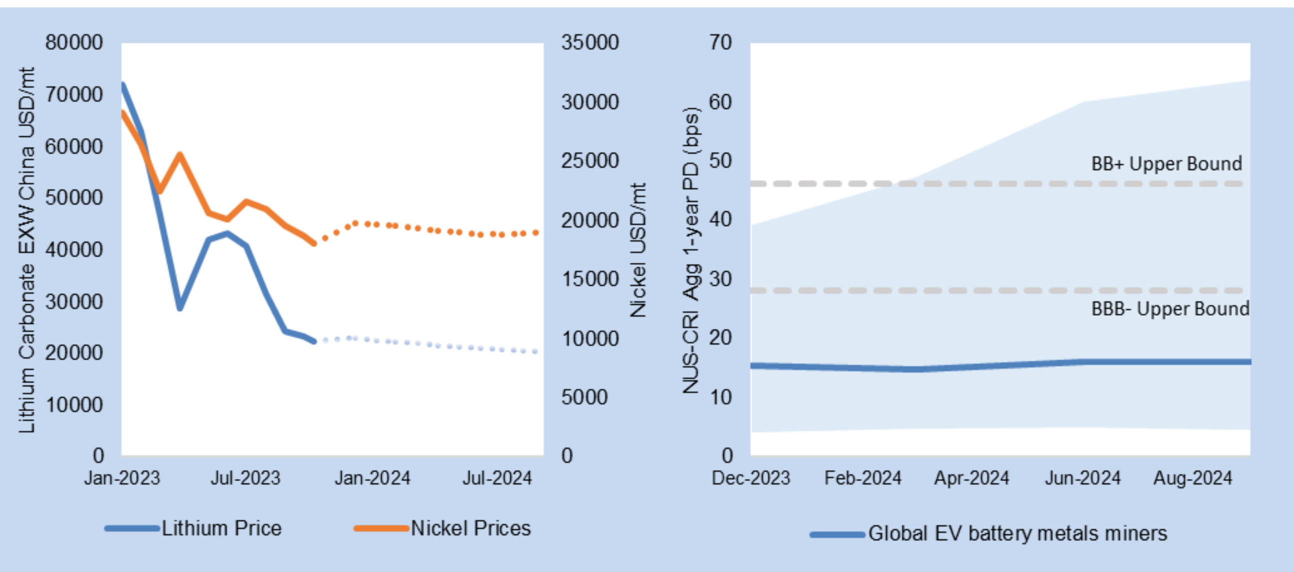

Figure 2a (LHS): Historical (solid) and Forecasted (dotted) lithium (LHS axis) and nickel (RHS axis) prices from the start of the year to Q3 2024. Figure 2b (RHS): NUS-CRI Aggregate (median) 1-year stressed PD for global EV battery metal miners based on forecasted lithium and nickel prices. *Source: Bloomberg, BuDA V3.5.1*

As seen from Figure 2a above, the price of both Lithium and Nickel has been trending down since the beginning of the year, with market expectations suggesting that the price of both metals is likely to continue trending downwards, although at a relatively lower pace, over the next twelve months. Recessionary sentiments are likely to keep demand for EVs subdued, which is going to impact the bottom line of both lithium and nickel miners. To measure the impact of the price drop on the credit risk profiles of Global EV battery metal miners, the NUS-CRI Bottom-Up Default Analysis toolkit can be utilized (See Figure 2b). As seen from the simulated PD, under the current forecast for metal price movements, the median credit risk of the sector remains relatively stable at around 15bps till Q3 2024. This may also suggest that despite the prices of EV battery metals decreasing, especially in China due to slower domestic demand growth than in the past which suggests a peak in metal demand, margins for large miners have remained strong. However, tail risk in the sector (proxied by the upper

[3] In China, although the EV market grew 107% YoY, it was still below expectations and previous months.
[4] Data by Bloomberg

quartile) increases substantially, crossing the BB+ upper bound over the next three months, highlighting that miners with weaker credit profiles are more sensitive to price changes than their peers.

Furthermore, the repercussions of a macro environment marked by elevated interest rates and inflation extend beyond just influencing the upstream industry through changes in end demand; they also directly impinge on the material miners themselves. Elevated interest rates have the potential to augment the cost of capital for mining projects, which are frequently characterized by their capital-intensive and long-term nature. Alongside this, the escalating operational costs in the mining sector, combined with mounting environmental and sustainability pressures amidst other geopolitical challenges[5], present risks to the industry's overall profitability. As such, even though the current credit profile of battery metal miners remains strong, a plethora of headwinds pose challenges to the short-to-medium-term credit risk outlook for the industry.

[5] For instance, Indonesia which is the world's largest nickel producer has recently seen a corruption investigation resulting in delays in the allocation of nickel quotas.

Credit News

Oversupply of US debt leaves few takers for treasuries

Nov 06. The substantial borrowing by the US government is triggering a significant drop in treasury bond prices, raising the issue of whether there's a sufficient market for the burgeoning debt. From August to October, yields on US Treasuries leaped a full point, even amid beliefs that the Federal Reserve was nearly done increasing interest rates. The cause is partly due to the anticipation that US rates will remain elevated longer than expected because of the economy's surprising durability. Additionally, the heavy issuance of bonds to address a substantial budget deficit has exerted upward pressure on yields. With the Federal Reserve's balance sheet already bulging with over USD 7tn in long-term securities and the cessation of its bond-buying program, a key source of demand has vanished. (FT)

Bankers seek legal cover after backing USD 1.5tn of ESG debt

Nov 05. Amid the explosive growth of sustainability-linked loans (SLLs), which have ballooned into a USD 1.5tn market, bankers are now pursuing legal safeguards against possible accusations of greenwashing. These loans, which tie terms to environmental or social benchmarks, lack public documentation and regulatory oversight, cloaking them in opacity. Legal advisors to SLL bankers are cautioning about the reputational damages of potential misrepresentation. Transparency issues plague the market; not all transactions are visible in public records. Recent data from Bloomberg NEF shows a downturn in SLL activity, with the volume of loans in the first three quarters of 2023 dropping to just 40% of the previous year's figure at the same point, totaling around USD 136 bn. (Bloomberg)

A USD 69bn debt problem will hurt pandemic darling stocks

Nov 03. Companies that thrived during the pandemic, like Peloton and Just Eat Takeaway.com, are bracing for financial strain as the zero-interest convertible bonds they issued in the era of abundant and cheap credit approach maturity. During the height of the pandemic, investor appetite for growth stocks allowed these companies to issue USD 58bn in convertible bonds in 2021, up by almost 1,100% from 2019. With the pandemic boost waning, offices reopening, and interest rates climbing, the once inexpensive debt threatens to become a hefty liability. Unless there's a dramatic market recovery, these businesses are staring down a daunting USD 69bn in debt due over the next three years. (Bloomberg)

Companies rush to sell bonds as higher rates become 'old normal'

Nov 01. Blue-chip corporates are seizing one of the last windows of opportunity this year to raise fresh capital in US bond markets, resigning themselves to tougher financing conditions as the cheap-money era fades into history. Companies unleashed a wave of high-grade bond sales this week, with the $22.5 billion raised on Monday alone beating out forecasts calling for $15 billion to $20 billion of issuance for the entire week. That helped push October sales to $81.75 billion, just short of estimates of about $85 billion. Activity was muted on Wednesday as the Federal Reserve held interest rates at a 22-year high for a second straight meeting. (Bloomberg)

Elevated yield drives foreign inflows into Indian debt to six-year high

Nov 06. Foreign portfolio investors sold Indian stocks for two consecutive months, while overseas investments in Indian debt reached a six-year high due to rising interest rates in 2023. This surge marked the highest level since 2017, with initial inflows from January to May and a subsequent significant increase. The rising Indian debt investments are concurrent with the 10-year government bond yield increase. In contrast, the equity market faced volatility linked to Middle East tensions. These foreign investments in Indian debt are expected to bolster India's balance of payments and enhance the Indian bond market's credibility, making it easier for the government and corporations to secure global debt capital. India's potential inclusion in global indices may attract substantial foreign inflows, with growing expectations of increased foreign portfolio investment in high-yield corporate bonds. (BQ Prime)

Company insolvencies in England and Wales at highest level since 2009 (FT)

S&P indicates it could cut Orsted's credit rating after losses (Reuters)

Catastrophe bond returns rebound as hurricanes miss US east coast (FT)

Regulatory Updates

Fed extends pause on rate hikes but keeps door open to moving higher

Nov 01. Federal Reserve Chair Jerome Powell indicated a temporary halt in interest rate increases while not completely ruling out future hikes. In a unanimous decision, officials opted to maintain the current 22-year high rates. The market's expectations for no December rate increase remained unchanged, and this was reflected in stock markets, with the Dow Jones Industrial Average gaining nearly 222 points. A bond market rally also continued after the Treasury Department's announcement of slowing the issuance of long-term debt. Although earlier projections hinted at another rate hike this year, officials seem hesitant to act unless robust economic data compels them. This pause comes at a time when Treasury yields have surged by almost 1% since rates were last raised in July. (WSJ)

After BOJ policy tweak, focus turns to exit from negative rates

Nov 01. The Bank of Japan's (BOJ) decision to remove the strict ceiling on 10-year yields has sparked discussions about the potential end of its negative interest rate policy. This shift in policy would mark a significant change in the BOJ's approach, though it faces both economic and political hurdles. BOJ Governor Kazuo Ueda expressed caution, noting that Japan hasn't yet reached the stage where ending negative rates can be considered, despite approaching a sustainable 2% inflation rate. The BOJ's focus remains on monetary easing to address the side effects of capping long-term interest rates. Key factors influencing this decision include inflation, wage growth, and political considerations, including the possibility of a lower house election. Furthermore, external factors such as geopolitical tensions and their impact on oil prices are also being closely monitored by the BOJ. The central bank is expected to maintain its commitment to easing while carefully assessing the timing of any exit from negative rates. (Nikkei Asia)

Singapore looking at using AI in fight against money laundering, says central bank chief (CNA)

Bank of Korea may keep policy tight another year, ex-member says (Bloomberg)

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