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# Heightened refinancing pressures and weakening demand worsen the credit risk outlook of Swedish non-financial corporates

by Amrita Parab

- **NUS-CRI Agg Forward PD for Swedish non-financial corporates indicates a steep deterioration in the group's credit profile over the coming 12 months**
- **Higher borrowing costs and weaker consumer demand remain key driving factors negatively impacting the credit outlook of Swedish non-financial corporates**

Sweden is currently grappling with macroeconomic hurdles brought on by its vulnerable real estate market, soaring inflation, and falling demand. The economy experienced a contraction in Q2 2023, with the GDP down 0.8% compared to Q1 2023. This contraction is expected to persist in 2023 as the Swedish central bank, the Riksbank, remains committed to maintaining higher interest rates in an effort to combat inflation and support a weak Swedish krona, putting pressure on corporate profitability and debt serviceability. Consequently, as seen from the NUS-CRI Aggregate (median) 1-year Probability of Default (Agg PD) for Sweden-domiciled non-financial corporates in Figure 1a, the credit risk profile of Swedish companies has gradually worsened closer to BBB upper bound. Over the next 12 months, amidst slowing economic growth, as significant debt maturities loom, the heightened borrowing costs may heighten refinancing risk and substantially erode debt serviceability in the near term. As such, the NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD[1]) in Figure 1b indicates that the credit health of Swedish non-financial corporates may experience a steep deterioration, as the Agg PD may potentially crossover into the non-investment grade territory over the next 6 months when referenced to PDiR2.0 bounds.

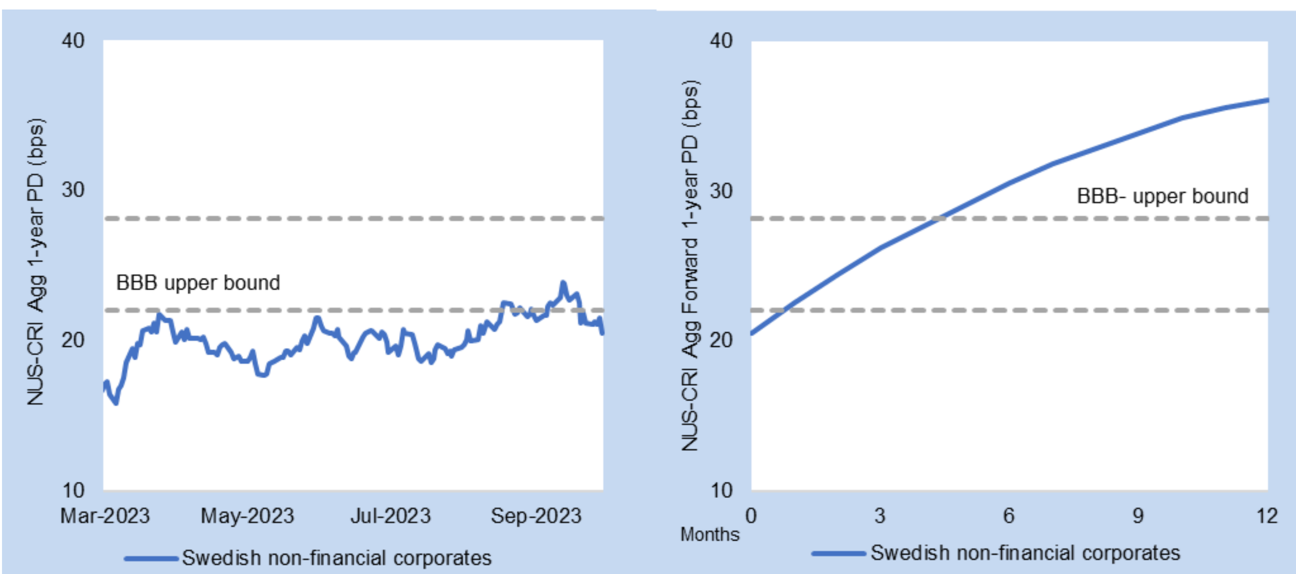


Figure 1a (LHS): NUS-CRI Agg (median) 1-year PD for Sweden-domiciled non-financial corporates with reference to PDiR2.0[2] bounds
Figure 1b (RHS): NUS-CRI Agg (median) Forward 1-year PD for Sweden-domiciled non-financial corporates as of Sep-2023, with reference to PDiR2.0 bounds. *Source: NUS-CRI*

Sweden has experienced a substantial surge in bankruptcy cases, marking the highest level in the past decade, with a 14% YoY surge in bankruptcies in Sep-2023[3]. While the construction and real estate sectors made up a

[1] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted as 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.

[2] 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.

[3] With 5,500 businesses filing for bankruptcy in the period from Jan - Aug, marking a 35% increase over the previous year.

higher proportion of the bankruptcies, other sectors such as retail, hospitality, and automotive also saw a significant surge in bankruptcies as compared to last year. The factors weighing on corporate balance sheets and pushing them to the brink include the big jump in the cost of borrowing and the faltering consumer demand. Households have pushed back purchase plans as the rising cost of living puts a dent in their disposable income and mortgage costs surge to new highs. With 54%[4] of the current debt outstanding priced at floating rates, corporates' debt serviceability may have already begun to deteriorate as borrowing costs continue to climb (see Figure 2a). In its meeting held on Sep 20, 2023, the Riksbank underlined its commitment to bring inflation under control by raising the policy rate yet again and providing forward guidance towards additional rate hikes in the future. The central bank's guidance signifies that borrowing costs may potentially remain higher for a longer period of time, weighing on the corporates' refinancing ability. Swedish corporates face significant maturities in the near term as 53% of their total outstanding debt is set to mature over the next 3 years. Additionally, the Swedish Krona is currently weak and over the past year has hit record lows, especially against the euro. Around 66% of the total outstanding debt of Swedish corporates is denominated in a foreign currency, with the euro constituting 57%. The weakened krona further erodes debt serviceability and increases refinancing risk.

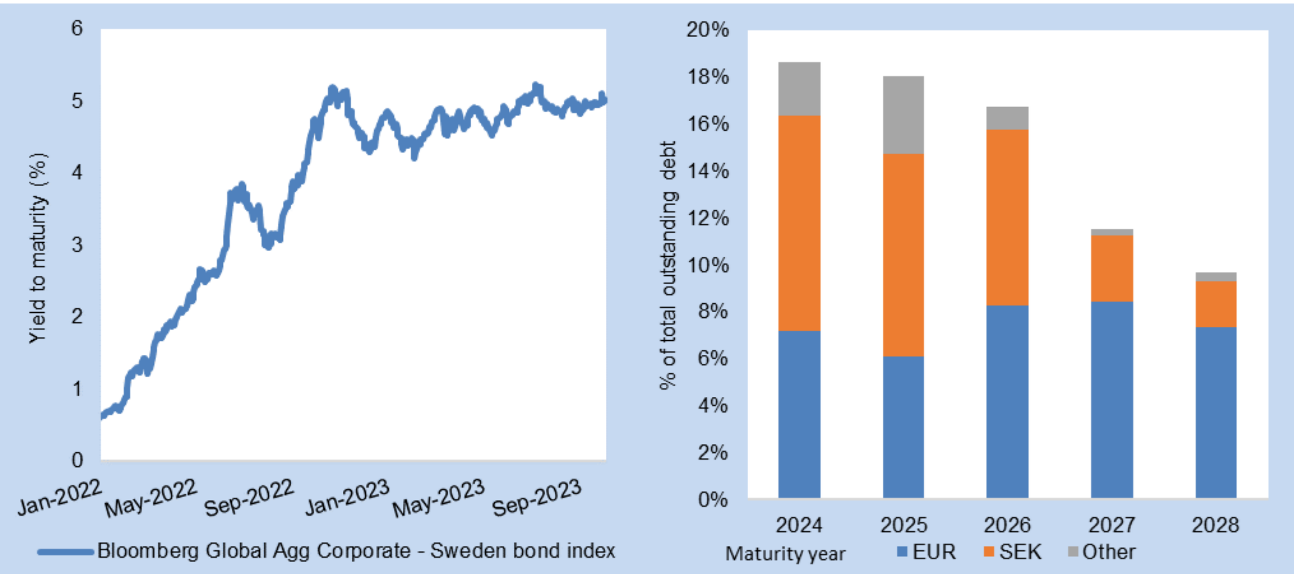


Figure 2a (LHS): Yield to maturity(%) of the Bloomberg Global Aggregate Corporate - Sweden bond index. Figure 2b (RHS): Debt maturity distribution of companies in the sample *Source: Bloomberg*

On a sectoral level, the pain in the property sector is expected to persist. The number of housing starts in the economy have continued to decline in the second half of the year driven by higher construction costs and declining house prices. The commercial real estate segment of the property market is also expected to experience a deterioration in credit health due to increasing vacancies and increased refinancing risk linked to upcoming maturities. Sweden's property companies have found it increasingly difficult to raise financing, especially through capital markets as soaring borrowing costs have priced out the majority of them. Consequently, real estate companies have turned to raise funds from banks. However, banks may also tighten their credit standards in response to a contracting economy, potentially exacerbating the financing troubles faced by property firms. Consumer-facing sectors such as retail are also facing declining profitability prospects as the cost of living crisis forces consumers to restrict spending. Sweden's retail sales have declined for 16 consecutive months, weighing on corporate profitability. On the other hand, several export-oriented industries such as machinery, automotive, chemicals, and timber have been able to benefit from a weak krona as exports were up 6% in the period of Jan-Jul 2023 and may have had a positive impact on the credit profile of Swedish corporates during the same period.

Going forward, the Swedish economy is expected to contract in 2023, thereby diminishing the corporates' revenue-generating opportunities and consequently negatively impacting debt serviceability. Moreover, sector-specific challenges, particularly in the property and retail segments, underscore the widespread strain felt by the firms in the economy. With the Riksbank forecasted to hold rates at a higher level well into 2024, the upcoming debt maturities promise to heap additional pressure on the Swedish corporates' credit health as indicated by the forward PD in Figure 1b.

[4] Data from Bloomberg for the sample

## Credit News

### Companies find a fundraising sweet spot with convertible bonds

**Sep 28**. This year has posed challenges for global bond and stock sales, particularly for riskier or unprofitable firms, notably those from China. US dollar junk-bond issuance in Asia has slowed significantly. Despite this, hedge funds and sophisticated investors are showing interest in convertible bonds of fast-growing companies, particularly Chinese electric vehicle manufacturers. NIO, a Shanghai-based company, recently raised USD 1bn from a convertible bond sale, with US hedge funds among the buyers. Chinese firms, including EV makers, have raised USD 26.7bn through convertible-bond sales in 2023, offering investors a way to bet on China's economic prospects amid stock market volatility. (WSJ)

### More CFOs pull back spending plans due to higher interest rates

**Sep 27.** A survey by Duke University's Fuqua School of Business and the Federal Reserve Banks of Atlanta and Richmond reveals that more finance chiefs are trimming spending plans due to elevated interest rates impacting their profitability. Despite the Federal Reserve keeping rates steady, 41% of CFOs report scaling back capital spending, and 42% are cutting costs in areas like travel and advertising. If rates persist at current levels or rise further, 21% anticipate reducing capital spending, and 15% plan cuts in operational costs. The survey, conducted from Aug. 21 to Sep. 8 with 320 CFO respondents, indicates growing concerns about higher borrowing costs. (WSJ)

### Rising loan costs are hurting riskier companies

**Sep 27.** Petco, having borrowed USD 1.7bn at 3.5% interest two years ago, is now facing a spike to almost 9% in interest costs. This surge, impacting a quarter of the company's free cash flow in Q2 2023, prompts executives to prioritize debt reduction. The trend extends beyond Petco, with many companies facing higher costs on leveraged loans acquired during the pandemic. Approximately USD 270bn of leveraged loans with weak credit profiles are at potential risk of default, driven by rising rates. Investors are concerned about a potential economic slowdown, which could lead to increased defaults, posing challenges for companies like Hanesbrands, currently paying rates between 7.2% and 8.9%. (WSJ)

### Small business bankruptcies rising at worst pace since pandemic

**Oct 01.** Small-business bankruptcies are surging in 2023 as rising interest rates, stricter lending standards, and increased operational costs strain entrepreneurs. The end of pandemic aid programs further compounds challenges. Federal Reserve rate hikes disproportionately affect businesses with narrow profit margins. Nearly 1,500 small businesses filed for Subchapter V bankruptcy this year, approaching the 2022 total. Loan delinquencies and defaults rose above prepandemic levels since Jun-2022. The termination of aid programs, like Covid disaster loans, leaves entrepreneurs struggling to repay debts. Limited capital-raising options and negative impacts from rising interest rates add to their woes. Entrepreneurs, dealing with short-lived demand surges and evolving market dynamics, are considering bankruptcy for a critical financial reset. (WSJ)

### US junk-bond funds post the biggest outflow in seven months

**Sep 29**. Investors are withdrawing from US high-yield corporate bond funds at the fastest pace since February, with about USD 2.4bn exiting in the week ending Sep. 27. Concerns over prolonged high-interest rates have intensified, leading to the largest weekly outflow in months. Despite recent inflows, escalating inflation fears driven by surging oil prices have sparked worries. In September alone, companies tapped the junk bond market for approximately USD 20bn, but rising borrowing costs amid economic uncertainty are causing caution among buyers and borrowers. Additionally, US investment-grade bond funds experienced a withdrawal of around USD 1.7bn in the latest week. (Bloomberg)

**Moody's warns federal shutdown would be 'negative' for US debt rating** (FT)

**UK bonds lead global selloff as higher-for-longer bets sink in** (Bloomberg)

**China comes under growing pressure to fix the country's housing market** (WSJ)

**Regulatory Updates**

**European bond market hit by Italy's plans for higher borrowing**

**Sep 28.** European government bond prices fell sharply as Italy's larger-than-expected budget deficit and concerns over prolonged high interest rates led to a sell-off. Italy's 10-year government bond yields rose to 4.96%, the highest in a decade after the government revised its fiscal deficit targets and lowered growth forecasts. The sell-off extended to the UK, with 10-year yields rising to 4.57%, the largest daily increase since February. Investors fear the US Federal Reserve will keep rates "higher for longer," contributing to market jitters. Rising oil prices have added to concerns about inflation, prompting a reevaluation of market risks. (FT)

**Regulators turn up heat on shadow banks after market blow-ups**

**Sep 30.** Global financial regulators are taking action to address the risks associated with shadow banking, as concerns grow over the consequences of previous regulatory reforms that pushed risks into less transparent corners of the financial system. The rise in interest rates has amplified these concerns, with regulators in various countries taking steps to increase transparency and limit leverage in the shadow banking sector, including hedge funds and private equity firms. These non-bank entities now represent a significant portion of global financial services assets, making them a focal point for regulatory attention. Policymakers are working to strike a balance between allowing market participants to take risks while ensuring global financial stability in the face of potential shadow banking disruptions. (FT)

**Bank of Thailand raises policy rate as govt gears up for stimulus** (WSJ)

**Chinese central bank vows to step up policy support** (WSJ)

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