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Asia-Pacific Study: Economic Cycle Drives Changes In Sectoral Credit Quality

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SINGAPORE (S&P Global Ratings) Feb. 16, 2017--A study of four advanced Asia-Pacific countries shows clear statistical evidence that the economic cycle affects the credit quality of companies, said S&P Global Ratings in a report published today, titled "How The Economic Cycle Drives Changes In Sectoral Credit Quality."

Using data from S&P Global Market Intelligence, we analyzed the behavior of sectoral credit quality, measured as the probability of default, over the economic cycle in four advanced Asia-Pacific economies--Australia, Japan, New Zealand, and South Korea.

"We found evidence that phases of the economic cycle affect credit quality in the expected way; for example, credit quality improves most in the recovery phase of growth," said Paul Gruenwald, Asia-Pacific chief economist for S&P Global Ratings.

We also confirm that perceived high-beta sectors, such as metals and mining and energy, have the most variation in credit quality over the cycle, with perceived low-beta sectors, such as utilities and transportation, having the least variation.

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"The worst credit quality is exhibited in the pre-dawn phase of the economic cycle, with slower-than-trend growth and slack capacity," Mr. Gruenwald said. "This suggests that slow growth and perhaps the shedding of unneeded capacity are weighing down credit quality."

"In terms of sectors, metals and mining, telecoms and, surprisingly, healthcare had the most fluctuations in probability of defaults. Not surprisingly, utilities and transportation had relatively stable probability of defaults over the cycle. Energy and real estate provided some anomalies," Mr. Gruenwald said.

Our data set contains annual observations from 2007 to 2015 and includes 3,255 company-level observations, which we aggregate into 13 sectors.

Only a rating committee may determine a rating action and this report does not constitute a rating action.