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Widening Credit Spreads Could Accelerate Corporate Credit Downgrades, Says S&P Report

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MELBOURNE (S&P Global Ratings) Jan. 5, 2017--Corporate bond investors should track credit spreads to gauge likely credit downgrade actions, according to S&P Global Ratings.

"We see a further upward repricing of risk, and hence higher credit spreads, to be an elevated and increasing risk as investors shy away from the 'lower (rates) for longer' axiom of past years," S&P Global Ratings credit analyst Terry Chan said in an article published today, titled "Track The Fed But Watch The Spread."

Global investors pushed the credit yield curve up at the longer end in reaction to the U.S. Federal Reserve Bank's recent 25-basis point increase in the federal funds rate and guidance of more to come in 2017. Even before the Fed's move, the market had priced in higher inflation following the U.S. election, in anticipation of fiscal stimulus under the incoming Trump administration.

"Credit spreads are the additional yield required for taking on risk. We found a strong correlation between debt downgrades and spreads," added S&P Global Ratings credit analyst David Tesher.

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In a black-swan stress scenario in which spreads reached levels seen during the Global Financial Crisis, and stayed at these levels for some time, S&P Global Ratings could lower ratings on 9% of the global corporates it covers. This would come on top of downgrades already expected in its base-case scenario for the current year, elevating the corporate downgrade ratio to more than 20% from 2015.

"Asia-Pacific and Latin American corporate issuers could be hardest hit, with 16% downgraded under our black-swan stress scenario," said Mr. Chan.

Sector-wise, homebuilders, and metal and mining, are the most sensitive to interest rate hikes.

S&P Global Ratings notes that many rated corporates have been restructuring their debt in expectation of worsening credit conditions. Issuers in a sector or region can change their interest rate sensitivity by altering their debt maturity profiles or the mix of fixed versus floating interest rate debt. This would lower the impact of widening credit spreads; however spreads remain a key factor for corporate bond investors.

"The speed at which credit spreads widen is driven more by investor expectations than Federal Reserve decisions. Consequently, we watch the Fed but track the spreads," said Mr. Chan.

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

The report is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. If you are not a RatingsDirect subscriber, you may purchase a copy of the report by calling (1) 212-438-7280 or sending an e-mail to research_request@spglobal.com. Ratings information can also be found on the S&P Global Ratings' public website by using the Ratings search box located in the left column at www.standardandpoors.com. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow (7) 495-783-4009.