This Month In Credit

May 2023, Volume 5

S&P Global Ratings

Growing Divide

This report does not constitute a rating action.

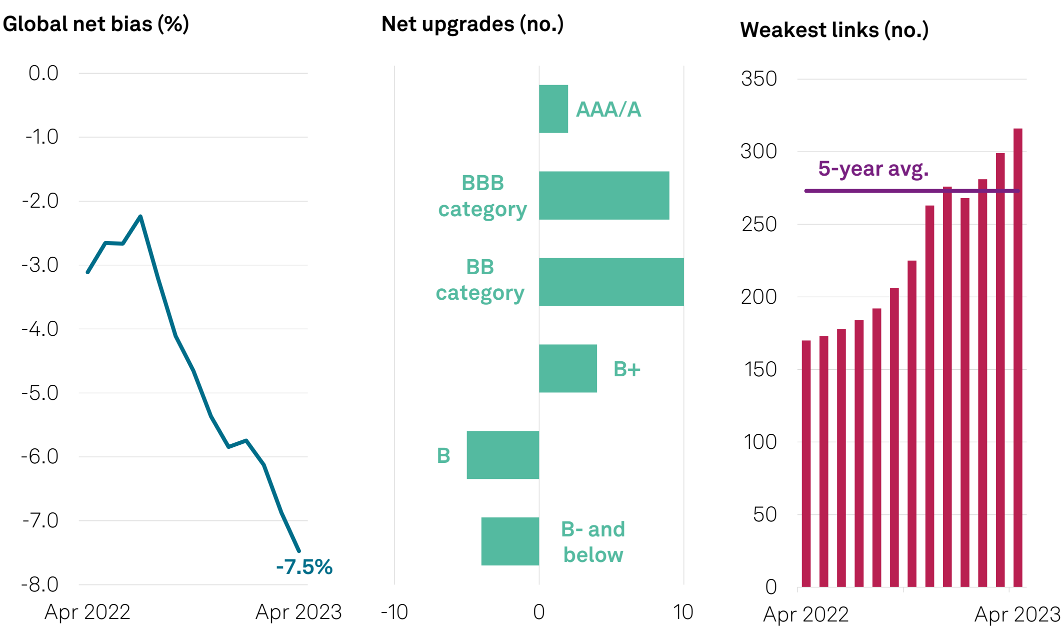
(Editor's note: For additional exhibits on credit trends, including rating actions, outlooks, fallen angels, rising stars, weakest links, and the U.S. distress ratio, please see the related data publication: "[This Month In Credit: 2023 Data Companion.]")

Key Takeaways

- Downgrades continued to outnumber upgrades for issuers rated 'B' and below in April, even as upgrades rebounded (especially at higher rating levels).
- Weakest links reached a two-year high of 316 in April as the pool of companies at the greatest risk of default grows.
- Over the past year, the health care and high technology sectors have had the largest increase in weakest links, a notable downward shift in performance since the height of the COVID-19 pandemic.
- High leverage increasingly was cited as a factor in the negative outlook and CreditWatch revisions in April.

Softness on the underbelly

A growing number of weakest links points toward rising default rates



Data as of April 30, 2023. Net bias is the positive bias minus the negative bias (for both investment- and speculative-grade issuers). Issuers include those in the sovereign, financial, and nonfinancial corporate sectors. Net upgrades represent upgrades minus downgrades (excluding defaults) for the month. Weakest links are financial and nonfinancial corporate issuers rated 'B-' and below with either negative outlooks or ratings on CreditWatch negative. Source: S&P Global Ratings Credit Research & Insights.

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For a weekly snapshot of rating trends and credit conditions, please see **"This Week In Credit,"** released every Monday.

Credit Notes: Weakening Links

When is good news arguably bad news? Maybe when the Fed indicates it may pause rate hikes but cites credit stress as a factor, as Chairman Powell recently intimated. This follows increasing market commentary regarding a potential credit crunch, and while unsurprising, it adds a cautionary note to the credit outlook. Investment-grade rating performance seems largely unaffected. But talk of credit stress and a potential credit crunch seems far more relevant at the lower echelons of speculative grade, especially 'B-' and below.

For more accompanying data, click here

The monthly increase in weakest links (issuers rated 'B-' and below with either negative outlooks or ratings on CreditWatch negative) and the continued rise in ‘B-‘ and lower negative bias signal increasing credit pressures. Negative bias for 'B-' and lower rose by three percentage points in April to 37%--surpassing its five-year average. Weakest links increased by 17 in April to 316--a two-year high. This growing pool of companies at risk of default could add to the quickening pace of defaults we’ve already seen this year.

By sector, consumer products and media and entertainment continue to lead weakest links in absolute terms--which, in a sense, is no surprise because these sectors also have the highest number of rated, as well as speculative-grade-rated, issuers. But also weighing on the sectors is the impact that higher inflation, slowing economic growth, and higher European energy costs have had on shifting patterns in consumer spending.

The changing composition of weakest links shows two other sectors to watch. Over the past year, the health care and high technology sectors have had the largest increase in weakest links. Higher interest expense is a factor across both sectors for companies with significant debt burdens. Furthermore, labor costs are compounding the pressure on health care companies, and revenues are slowing for many of these technology companies. This marks a notable shift over the past year, as both of these sectors had benefited from new demand and investment during the height of the COVID-19 pandemic.

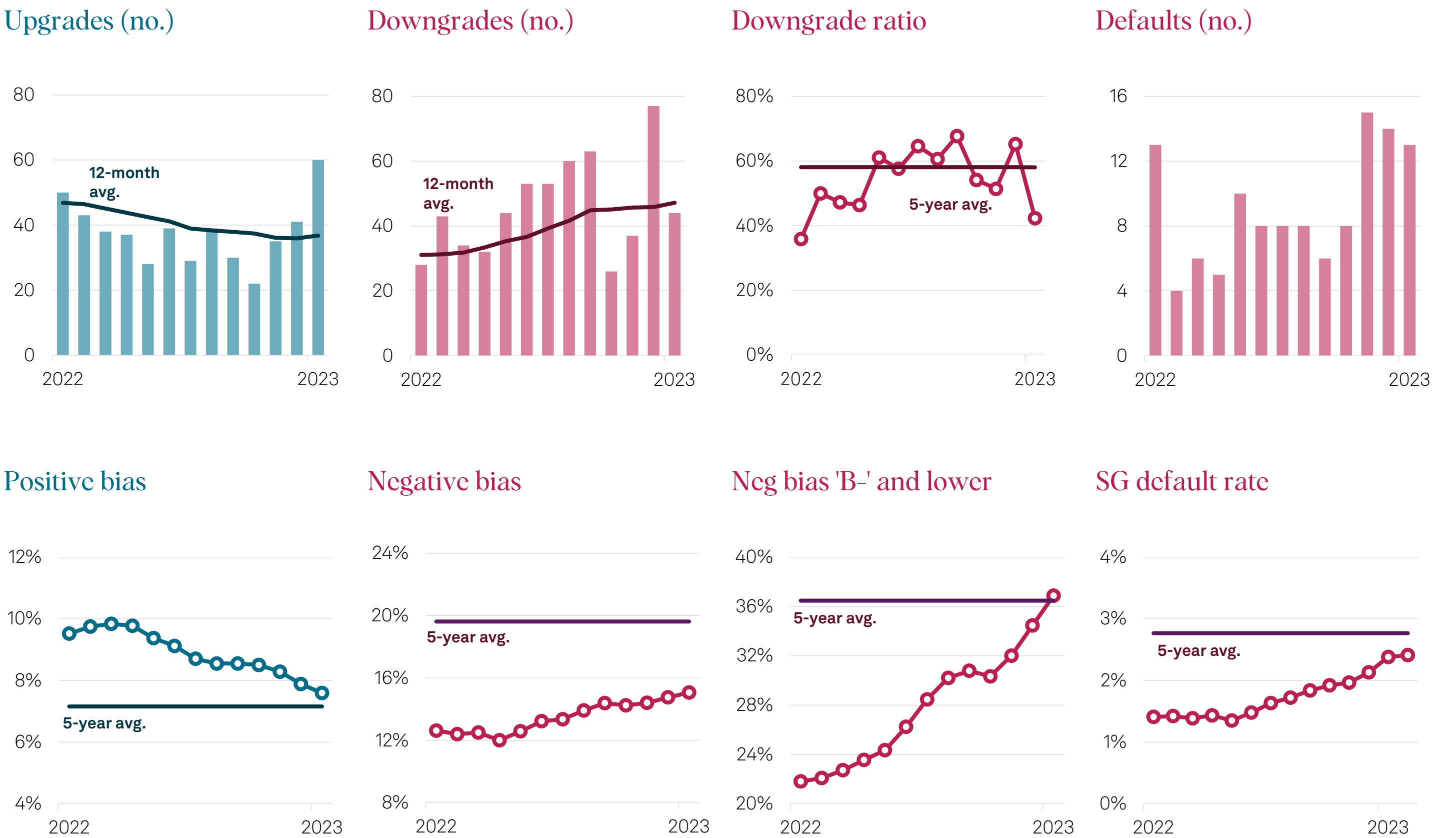
Talk of credit stress and a potential credit crunch seems far more relevant at the lower echelons of speculative grade, especially 'B-' and below.

Pressures continue to build for issuers rated ‘B’ and lower. With this in mind, we recently adjusted our forecast for the trailing-12-month default rate for speculative-grade corporate issuers up to 4.25% in the U.S. by March 2024 (from 2.5% in March 2023) and to 3.6% in Europe (from 2.8%). These expected increases will bring default rates back near their long-term averages.

The macro outlook--particularly higher-for-longer interest rates and increased labor costs--will not help weaker credits. Issuers with limited capacity to raise prices in response to higher input costs, and those with already constrained credit metrics, could be increasingly exposed the longer these challenges persist.

Overall rating performance may seem relatively stable, and indeed upgrades had a notable uplift in April. But it is a different story at the bottom end of the credit spectrum where continued pressure in certain sectors stands in marked contrast to the more positive tone higher up.

Ratings Trends Snapshot – Y/Y Through April 30, 2023



Data as of April 30, 2023. Data represents rating actions and biases for sovereign, financial, and nonfinancial corporates issuers globally. Downgrade counts exclude defaults. Defaults and speculative-grade default rate exclude sovereigns.
Source: S&P Global Ratings Credit Research & Insights.

Credit Trends: Deterioration At The Low End

Upgrades got a lift In April. After uncertainty picked up in March, many companies reported earnings that beat street expectations. Granted, earnings expectations had been declining in recent months, with slowing growth (and recession) the baseline for many. Upgrades jumped to 60 (from 41), downgrades (excluding defaults) fell to 44 (from 77), and defaults remain elevated at 13 (from 14).

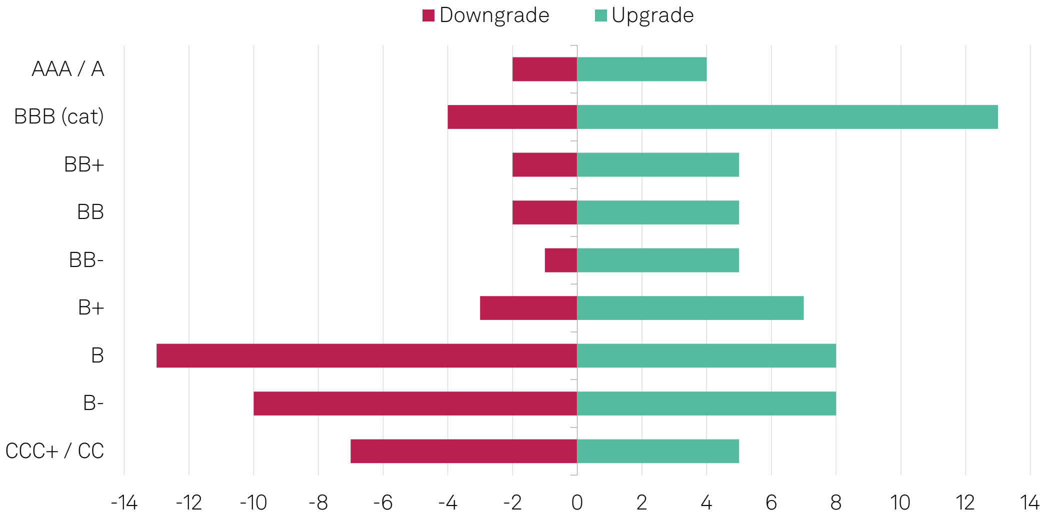
Although speculative grade accounted for more upgrades than investment grade, we saw some divergence within speculative grade, as upgrades outnumbered downgrades for each rating level of 'B+' and above. However, downgrades outnumbered upgrades for issuers rated 'B' and below.

Downgrades were more concentrated among lower rating levels--two-thirds of the downgrades in April were of issuers rated 'B' and below. Among these downgrades were 11 issuers downgraded to the 'CCC' category. Financing can become increasingly difficult for issuers downgraded below the 'B' category since portfolio and collateralized loan obligation managers typically are limited in the amount of this debt they are willing and able to hold.

> We saw some divergence within speculative grade, as upgrades outnumbered downgrades for each rating level of 'B+' and above.

Chart 1

Rating actions trended more negative among lower rating levels in April (no.)



Data as of April 30, 2023. Includes sovereign, financial, and nonfinancial corporate upgrades and downgrades globally, excluding defaults. Downgrades shown as a negative number. Source: S&P Global Ratings Credit Research & Insights.

Rating actions were broadly distributed across sectors in April. Media and entertainment and financial institutions led upgrades while the health care and consumer products sectors contributed the most downgrades, with these two sectors combined accounting for one-third of all downgrades. By dollar amount, April's largest downgrades included three issuers from the telecommunications sector. One of these was an investment-grade issuer downgraded following the completion of an acquisition, and the other two downgrades were of speculative-grade issuers facing cash flow uncertainties amid higher interest rates.

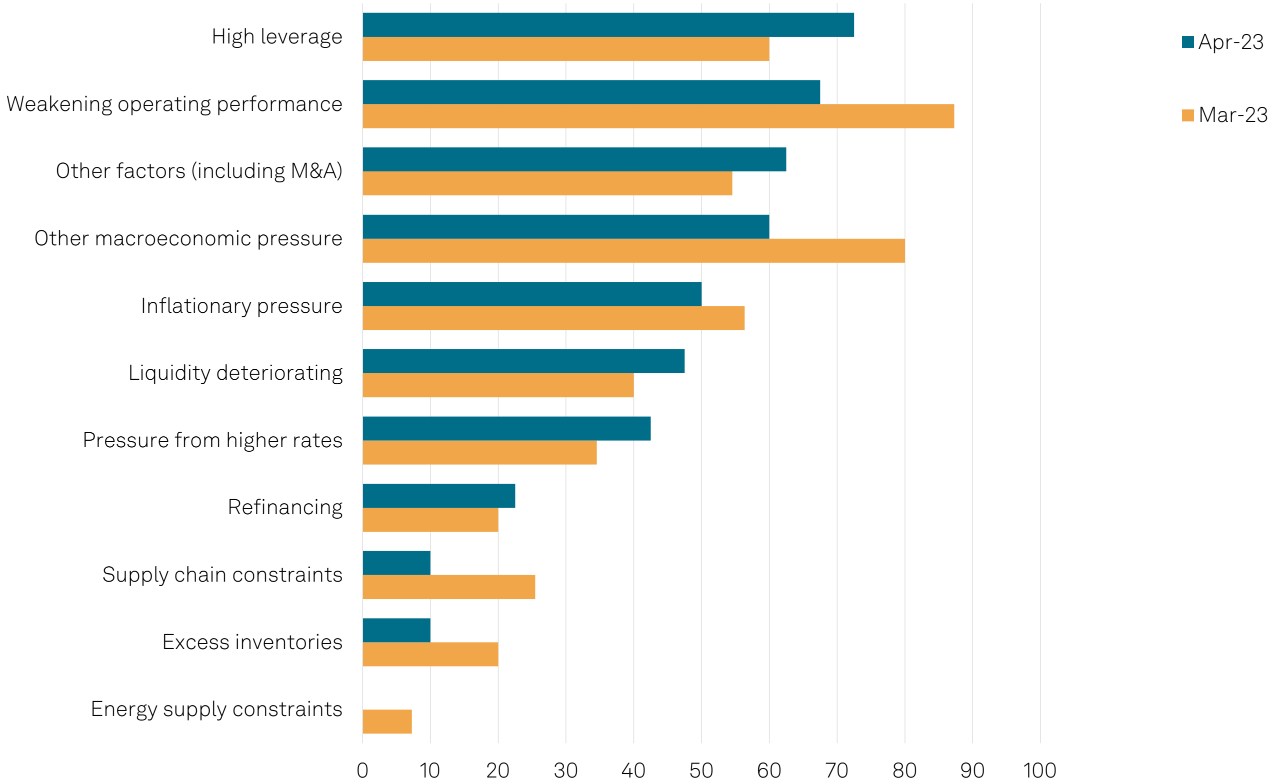
Despite increasing upgrades, the global net bias was basically unchanged--down about 0.6 percentage points to -7.5%. The steady progression of this bias deeper into negative territory suggests that the recent uptick in upgrades among speculative-grade issuers may be fleeting.

The number of potential downgrades (issuers with negative outlooks or ratings on CreditWatch negative) increased as 40 issuers were added during the month, nearly half were from the U.S. The most common reason for these outlook revisions was high leverage, cited as a factor in 73% of outlook revisions, an increase from March. By contrast, fewer of the new potential downgrades cited weakening operating performance, perhaps reflecting that many companies outperformed expectations through the first quarter, even if those expectations had already been lowered owing to macroeconomic headwinds.

Many companies outperformed expectations through the first quarter, even if those expectations had already been lowered owing to macroeconomic headwinds.

Chart 2

High leverage is increasingly a factor among potential downgrades in April (%)



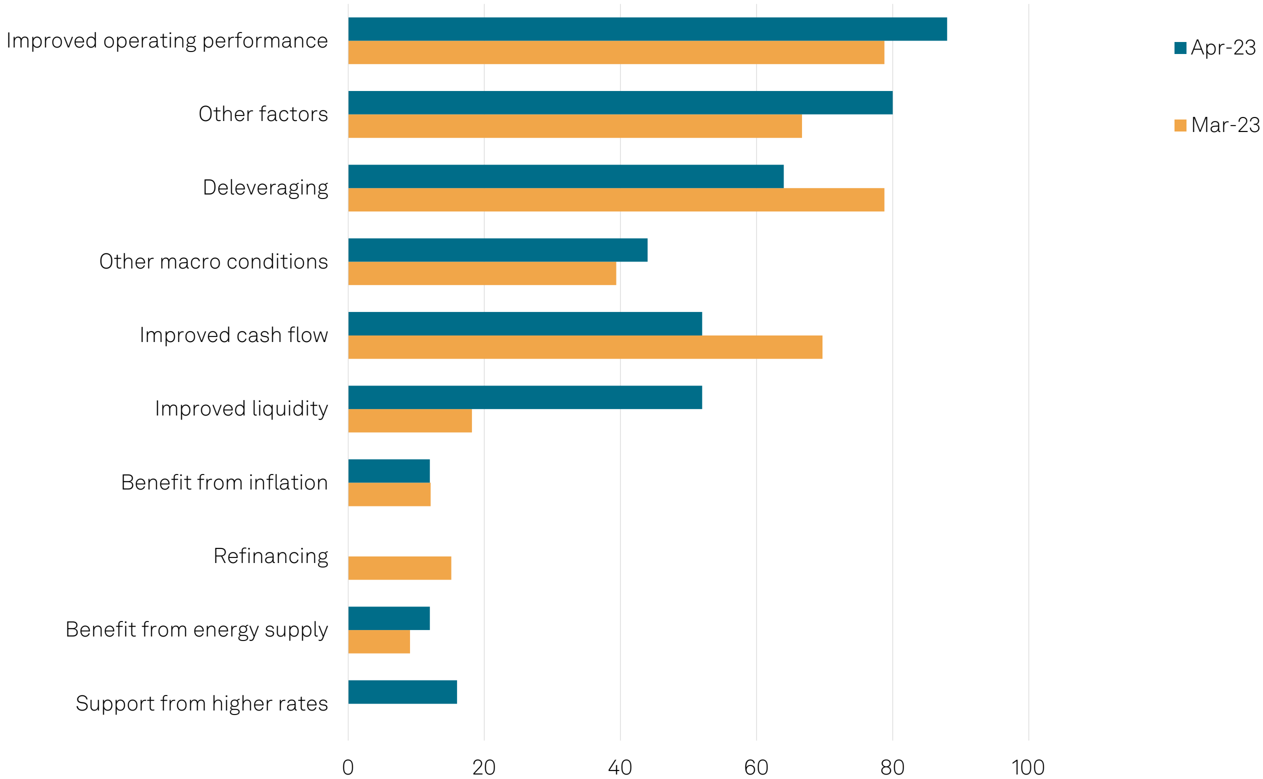
Data as of April 30, 2023. We take stock of the main risks outlined in new potential downgrade and weakest links rating reports and group them by qualitative factors. One rating action can have multiple qualitative factors. M&A--Mergers and acquisitions. Source: S&P Global Ratings Credit Research & Insights.

Twenty-five potential upgrades (issuers with positive outlooks or ratings on CreditWatch positive) were added in April, down from 33 in March. Improved operating performance was cited in most outlook revisions and CreditWatch placements (88%), while there was a notable increase in positive rating actions associated with improved liquidity. The financial institutions sector had the largest increase in new potential upgrades in April, most based outside of the U.S. Benefits from interest rates and liquidity factored into most of the outlook revisions for these issuers, especially in Europe, where elevated rates are expected to enhance loss absorption and capital-building capacities.

Improved operating performance was cited in most outlook revisions and CreditWatch placements (88%), while positive rating actions associated with improved liquidity picked up.

Chart 3

Improving operating performance is factoring in most potential upgrades in April (%)

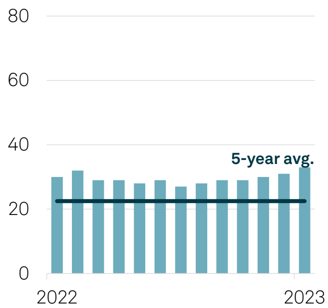


Data as of April 30, 2023. We take stock of the main factors outlined in new potential upgrade rating reports and group them by qualitative factors. One rating action can have multiple qualitative factors.
Source: S&P Global Ratings Credit Research & Insights.

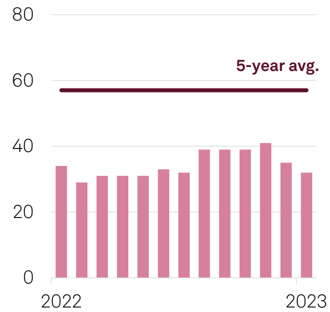
Global corporate defaults dipped slightly in April, to 13 from 14 in March, but remained elevated--up 75% year over year and 25% higher than the 10-year average. Even though economic resilience and corporate earnings have surprised to the upside, corporates may already be in an earnings recession, which could add to future default risk.

Specific Credit Indicators – Y/Y Through April 30, 2023

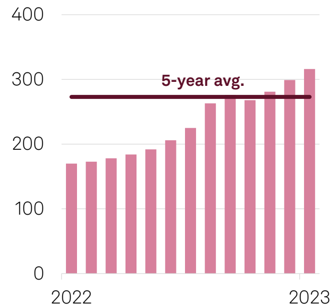
Potential rising stars (no.)



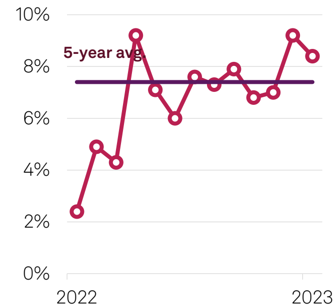
Potential fallen angels (no.)



Weakest links (no.)



Distress ratio



Data as of April 30, 2023. Data represents sovereign, financial, and nonfinancial corporates issuers globally, except for the S&P Global U.S. distress ratio, which is defined as the number of U.S. speculative-grade issues with option-adjusted spreads of more than 1,000 basis points above U.S. Treasury bonds. Source: S&P Global Ratings Credit Research & Insights.

Fallen angels: The new fallen angel tally slowed to just one in April, from seven in March. April's fallen angel, U.S. capital goods company Fluor Corp., was downgraded as its profit margins, earnings, and cash flow lagged those of engineering and construction peers. So far this year, the capital goods and homebuilders and real estate sectors are adding to the fallen angel tally as they face headwinds from the slowdown in commercial real estate.

The number of potential fallen angels (issuers rated 'BBB-' with negative outlooks or on CreditWatch negative) dipped by three in April (to 32) as investment-grade issuers continued to show resilience. Despite this decline, commercial real estate's problems appear to be causing a drag. Homebuilders and real estate is the most represented sector. Consumer products and aerospace and defense are the next most represented sectors.

Rising stars: Rising stars (issuers upgraded to investment grade from speculative grade) continue to outnumber fallen angels year to date, and they showed surprising strength, with five additions in April. Factors we've observed that have contributed to the rising star additions this year include the resurgence of consumer spending on leisure and travel, which has benefited some companies in the leisure and gaming subsector, while the overall media and entertainment sector accounts for one-third of the rising stars so far this year.

The number of potential rising stars (issuers rated 'BB+' with positive outlooks or on CreditWatch positive) continues to tick up. The number rose by two in April, to 33. The financial institutions sector has the most potential rising stars, with five (mostly European issuers). The media and entertainment and oil and gas sectors follow, with four each.

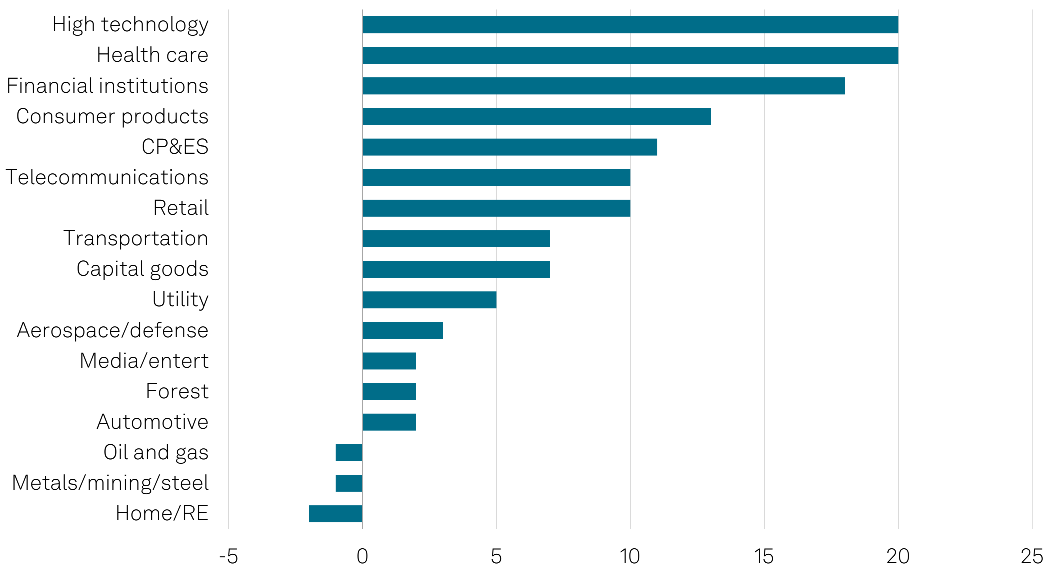
Weakest links: The global number of weakest links continues to rise, reaching 316 this month--the highest since April 2021. The health care sector added the most new weakest links during the month (with six), followed by consumer products (with five). Over the past year, both the health care and the high technology sectors have experienced the greatest increase in weakest links, each with a net increase of 20, signaling climbing default risk. This marks a notable shift over the past year, as both of these sectors benefited from new demand and investment during the pandemic.

So far this year, the capital goods and homebuilders and real estate sectors are adding to the fallen angel tally as they face headwinds from the slowdown in commercial real estate.

On the flip side, the homebuilders and real estate sector has seen the greatest year-over-year decline in weakest links, much of this following defaults and rating withdrawals in the sector, especially from Asia-Pacific. Furthermore, commodity-producing sectors of metals, mining, and steel and oil and gas have also seen a reduction in the number of weakest links as these sectors have benefited from strong commodity pricing over the past year.

Chart 4

Net change in weakest links over the past 12 months (no.)



Data as of April 30, 2023. CP&ES--Chemicals, packaging, and environmental services. RE--Real estate.
Source: S&P Global Ratings Credit Research & Insights.

Distress ratio: The U.S. distress ratio moderated in April as market concerns eased regarding contagion in the U.S. banking sector. The U.S. distress ratio fell in April to 8.4% after spiking to 9.2% in March. (The distress ratio is the share of speculative-grade issues with option-adjusted spreads of more than 1,000 basis points relative to U.S. Treasury bonds divided by the total number of speculative-grade issues.) However, the distress remains about one percentage point above its five-year average, reflecting continued uncertainty in U.S. credit markets.

By sector, telecom leads with the highest sector distress ratio this month at 26.2%, down by two percentage points from last month. Distress issues in this sector are mostly from a few lower-rated issuers, including Lumen Technologies Inc., Dish DBS Corp., and CSC holdings LLC.

The health care and high tech sectors are under pressure and hold a higher-than-average sector distress ratio at 18.1% and 16.1%, respectively. For speculative-grade health care companies, inflationary pressures including labor, materials, and energy are weighing on EBITDA and cash flows. For some technology issuers, ongoing macroeconomic challenges and pockets of technology-specific weakness for semiconductors and hardware segments have pulled some lower-rated issuers into distress Territory.

For more data and charts on fallen angels, potential fallen angels, rising stars, potential rising stars, weakest links, and the U.S. distress ratio, please see the related publication: "This Month In Credit: 2023 Data Companion."

Relative Risks By Region And Sector

Latin America continued to have the highest negative bias, though it did dip by a percentage point during the month to 21%. Eastern Europe, the Middle East, and Africa had the second-highest negative bias (20%), as there are negative outlooks on five sovereigns within this region. Meanwhile, the U.S. has the greatest absolute number of potential downgrades.

By sector, **retail** and restaurants has the most new potential downgrades, followed by health care and utilities.

For retail, the potential downgrades largely are issuers that exhibited weaker-than-expected credit metrics as of year-end 2022 and first-quarter 2023. The rating actions in the retail sector cited significant margin pressure due to elevated inflation, higher labor and operating expenses, and prolonged weaker consumer demand over the next 12 months.

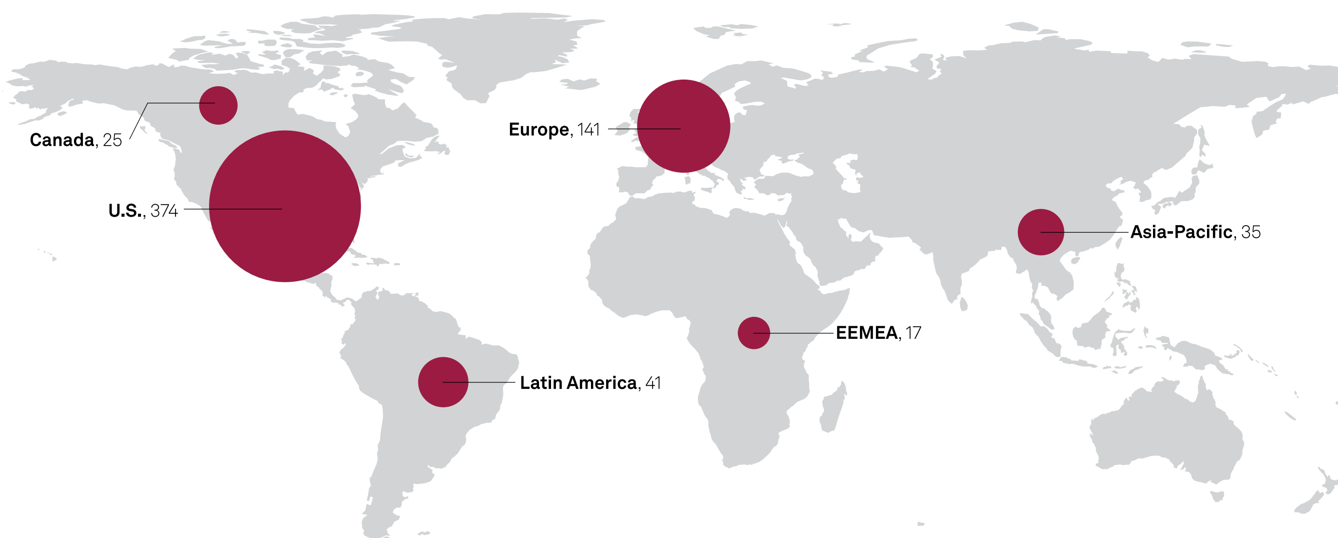
The negative outlooks and CreditWatch placements in the **health care** sector were mixed across subsectors, but commonly were owing to free cash flow deficits. Operating conditions are difficult as practices are underutilized, and interest expenses continue to increase. Additionally, for many of these issuers, substantial upcoming debt maturities pose refinancing challenges.

On a positive note, **financial institutions** and oil and gas led new potential upgrades during the month. The **oil and gas** sector continues to benefit from elevated oil prices, even given recent declines. We expect this to bolster cash flow generation and allow continued debt reduction.

Chart 5

Potential downgrades (no.)

By region



Data as of April 30, 2023. EEMEA--Eastern Europe, the Middle East, and Africa.
Source: S&P Global Ratings Credit Research & Insights.

Table 1

Potential downgrades distribution by sector and region (no.)

Sectors	Global	U.S.	Europe	Asia-Pacific	Latin America	EEMEA	Canada
Aerospace and defense	15	14	1				
Automotive	19	11	6	2			
Capital goods	35	21	9	1	1		3
Consumer products	98	71	20	2		4	1
CP&ES	30	17	11		1		1
Diversified	1				1		
Financial institutions	57	20	12	5	12	6	2
Forest PBM	10	5	5				
Health care	47	38	7	1			1
High technology	37	28	5	3			1
Home/real estate	29	13	10	4			2
Insurance	13	6	5	2			
Media/entertainment	65	51	9	3	2		
Metals, mining, and steel	12	7	1	1			3
Oil and gas	14	2	3	1	2	3	3
Retail/restaurants	36	26	8	1	1		
Sovereign	16		5		6	5	
Telecommunications	28	14	6		3	3	2
Transportation	30	8	12	5	2	1	2
Utilities	50	23	9	4	9	1	4

Data as of April 30, 2023. The darker red indicates more potential downgrades per region.
PBM--Products and building materials. CP&ES--Chemicals, packaging, and environmental services.
Source: S&P Global Ratings Credit Research & Insights.

Table 2

Potential upgrades distribution by sector and region (no.)

Sectors	Global	U.S.	Europe	Asia-Pacific	Latin America	EEMEA	Canada
Aerospace and defense	6	3	2	1			
Automotive	8	3	3	1		1	
Capital goods	11	3	6	1			1
Consumer products	14	9	3	1			1
CP&ES	14	5	4	1	1	1	2
Diversified	2			1	1		
Financial institutions	43	10	19	9		3	2
Forest PBM	5	2	2			1	
Health care	13	9	2			1	1
High technology	13	8	4	1			
Home/real estate	15	12	1			1	1
Insurance	10	6	3	1			
Media/entertainment	41	28	9	2			2
Metals, mining, and steel	20	9	4	3	2		2
Oil and gas	29	19	7	1			2
Retail/restaurants	10	7	3				
Sovereign	4		2			2	
Telecommunications	6		6				
Transportation	20	11	5	2	1		1
Utilities	30	17	6	1	3	1	2

Data as of April 30, 2023. The darker blue indicates more potential upgrades per region.
PBM--Products and building materials. CP&ES--Chemicals, packaging, and environmental services.
Source: S&P Global Ratings Credit Research & Insights.

Table 3

Top 10 downgrades in April*

Issuer	Sector	Downgrade date	Downgrade to	Downgrade from	Country	Amount (bil. $)
Rogers Communications Inc.	Telecommunications	4/6/2023	BBB-	BBB+	Canada	27.6
Charles Schwab Corp.	Financial institutions	4/19/2023	A-	A	U.S.	27.6
Altice France S.A. (Altice Europe N.V.)	Telecommunications	4/26/2023	B-	B	France	25.6
DISH Network Corp.	Telecommunications	4/27/2023	CCC+	B-	U.S.	22.5
Republic of Ukraine	Sovereign	4/6/2023	CCC	CCC+	Ukraine	22.5
Buckeye Partners L.P.	Utilities	4/26/2023	BB-	BB	U.S.	6.3
Seagate Technology Holdings plc	High technology	4/26/2023	BB	BB+	Ireland	5.5
Global Medical Response Inc. (Air Medical Holdings LLC)	Health care	4/27/2023	CCC+	B-	U.S.	4.5
MultiPlan Corp.	Health care	4/21/2023	B	B+	U.S.	3.7
SK Mohawk Holdings, SARL	Chemicals, packaging and environmental services	4/21/2023	CCC+	B-	Germany	3.6

Data as of April 30, 2023. *Excluding defaults. Table shows 10 largest issuer nondefault downgrades, excluding defaults, by debt amount, in April 2023. Source: S&P Global Ratings Credit Research & Insights.

Table 4

Top 10 upgrades in April

Issuer	Sector	Upgrade date	Upgrade to	Upgrade from	Country	Amount (bil. $)
Anheuser-Busch InBev S.A./N.V.	Consumer products	4/21/2023	A-	BBB+	Belgium	118.6
NatWest Group plc	Financial institutions	4/12/2023	BBB+	BBB	U.K.	77.5
Uruguay	Sovereign	4/26/2023	BBB+	BBB	Uruguay	21.5
Compagnie de Saint-Gobain	Forest products and building Materials	4/24/2023	BBB+	BBB	France	11.0
Mars Inc.	Consumer products	4/17/2023	A+	A	U.S.	8.0
NGL Energy Partners LP	Utilities	4/19/2023	B-	CCC+	U.S.	7.3
Deutsche Lufthansa AG	Transportation	4/17/2023	BB+	BB	Germany	6.7
Nexstar Media Group Inc.	Media and entertainment	4/5/2023	BB+	BB	U.S.	6.2
Tata Motors Ltd. (Tata Sons Pte. Ltd.)	Automotive	4/25/2023	BB	BB-	India	6.0
Republic of Guatemala	Sovereign	4/11/2023	BB	BB-	Guatemala	5.4

Data as of April 30, 2023. Table shows 10 largest issuer upgrades, by debt amount, in April 2023. Source: S&P Global Ratings Credit Research & Insights.

Related Research

'BBB' Pulse: Rising Stars And Fallen Angels Pick Up Amid Economic Uncertainty, May 17, 2023

Global Corporate Default Tally Reaches 50, May 16, 2023

Growing Strains Will Push The U.S. Speculative-Grade Corporate Default Rate To 4.25% By March 2024, May 15, 2023

The European Speculative-Grade Corporate Default Rate Could Rise To 3.6% By March 2024 As Stressors Mount, May 14, 2023

Global Financing Conditions: Tumultuous March Cuts Into Full-Year Issuance Projections, April 26, 2023

Distressed Exchanges Spur A Sharp Rise In Corporate Defaults, April 13, 2023

Glossary And Abbreviations

Downgrade ratio--The number of downgrades divided by the number of downgrades plus upgrades

Fallen angels--Issuers downgraded to speculative grade from investment grade.

Investment grade--Issuers rated 'BBB-' or above.

Negative bias--Percentage of issuers with negative outlooks or ratings on CreditWatch negative.

Net outlook bias--Percentage of issuers with a positive bias minus those with a negative bias.

OLCW--Outlooks and CreditWatch placements.

Positive bias--Percentage of issuers with positive outlooks or ratings on CreditWatch positive.

Potential downgrade--An issuer rated by S&P Global Ratings with a negative outlook or on CreditWatch negative.

Potential fallen angels--Issuers rated 'BBB-' with either negative outlooks or on CreditWatch negative.

Potential upgrade--An issuer rated by S&P Global Ratings with a positive outlook or on CreditWatch positive.

Rising stars--Issuers upgraded to investment grade from speculative grade.

Risky credits--Issuers in the ‘CCC’ rating category.

Speculative grade--Issuers rated 'BB+' or below.

S&P Global U.S. distress ratio--The proportion of speculative-grade issues with option-adjusted spreads of more than 1,000 basis points relative to U.S. Treasury bonds divided by the total number of speculative-grade issues.

Speculative grade--Issuers rated 'BB+' or below.

Weakest links--Issuers rated 'B-' and below with either negative outlooks or on CreditWatch negative.

Weakest links ratio--The number of weakest links divided by the total speculative-grade ratings population.