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The Credit Overhang: U.S. Nonfinancial Corporate Credit Stability In 2013 Will Be Dependent On Fiscal Policy And Capital Market Liquidity

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The Credit Overhang: U.S. Nonfinancial Corporate Credit Stability In 2013 Will Be Dependent On Fiscal Policy And Capital Market Liquidity

Last year may well be remembered as the time when the decline in corporate credit quality began. While a highly favorable U.S. capital market and liquidity environment over the last three years has allowed nonfinancial corporate issuers to raise capital for both new issuance and refinancing at historically low interest rates, in 2012 Standard & Poor's Ratings Services has seen a reversal of the favorable rating trends in 2011 and 2010. Last year, the ratings downgrade to upgrade ratio for U.S. nonfinancial corporations deteriorated to 1.3 to 1, up from 0.9 to 1 in 2011. And this deterioration accelerated materially in the second half of 2012, to a 2.1 to 1 ratio. Weakening earnings and higher leverage growth--particularly at the speculative-grade level ('BB+' or lower)--were the primary causes. In the last three months of 2012, the debt to EBITDA ratio for new U.S. leveraged loan issues rose to 5x, up from 4.3x in the last quarter of 2011, according to Standard & Poor's Leveraged Loan Commentary & Data (LCD). The highest quarterly debt to EBITDA leverage ratio for new loan issuance prior to the Great Recession was 5.1x, in the third quarter of 2007. Years of chronic underinvestment in capital spending by speculative-grade issuers, which we believe is sowing the seeds for future weakening in competitive positions and creditworthiness, poses a further major risk entering 2013.

Recent weak economic growth, reflecting the country's failure to bounce back strongly from the Great Recession, is the major reason why an increasing number of issuers are struggling to maintain profit margins. Companies have focused on countering slow revenue growth through aggressive cost cutting to boost profit margins. But in the past year, meaningful additional cost efficiencies have become increasingly harder to attain, as companies have already picked all of the lower-hanging fruit. In addition, slowing revenue growth from emerging markets and flat or negative growth in Europe is further pressuring many U.S. issuers with overseas operations.

Overview

- We expect creditworthiness across nonfinancial corporate sectors to be generally stable in 2013, despite markedly negative rating trends in the second half of 2012.
- We base this expectation on the likelihood of continuing favorable capital market and liquidity conditions.
- If fiscal austerity results in a slowing of the economy or if interest rates rise, however, credit rating trends would likely turn negative very quickly.

A Fragile Stability At Best

Easy central bank monetary policies have been particularly beneficial for speculative grade U.S. issuers, which have been able to refinance maturing debt cheaply and on increasingly favorable terms. This has led to markedly lower levels of defaults versus what might otherwise have been as a result of the weak economy over the past three years. However, it has not eliminated nervousness and uncertainty in the markets. We believe that the combination of weak global economic fundamentals and a global thirst for yield, along with strong market liquidity and issuance growth, are setting the foundation for a credit bubble in the corporate credit markets. Part of the trend of loosening credit terms includes the increasing number of transactions containing "covenant-lite" terms and other liberal structures, such as pay-in-kind toggle features. The protracted uncertainty overhang, which we anticipate to permeate the global capital markets in 2013, leads us to believe market participants will, at best, confront a very fragile peace in the immediate future.

At the beginning of 2013, stable and positive outlooks accounted for 85% of U.S. nonfinancial corporate ratings--a level we view positively for creditworthiness for the year ahead. Notwithstanding that weakening rating trends are a growing concern, we believe that our corporate rating outlooks, as well as the performance of U.S.-domiciled corporate credit issuers, will remain relatively stable in 2013. This is because we expect U.S. corporate new issuance and the default rate to continue to benefit from the highly favorable capital market and liquidity environment and improving U.S. economic growth. In our baseline forecast, our economists have recently revised U.S. GDP growth upwards to 3% for this year, from 2.2% previously. We see the risk of the U.S. falling into another recession in the next 12 months in the 10% to 15% range. Our forecast for 2014 GDP growth is also 3%. However, if the current liquidity safety net provided by the frothy capital markets were to weaken markedly in 2013, we would expect a material increase in negative rating trends. Factors that could reverse current debt market confidence include fiscal austerity slowing the economy or interest rates rising from their currently extremely low levels.

Even taking into consideration the reversal of some key ratings metrics in 2012, corporate financial strength remains much stronger than during the recession--including cash balances and overall liquidity. However, the issue now confronting creditors and investors is the sustainability of this improvement. One major issue in this regard is that while the large increase in cash on the balance sheet since the recession has boosted corporate liquidity and creditworthiness in the short term, it has also led to underinvestment in capital expenditure. This trend has cut into top-line growth and is hurting competitive positions. Operating cash flow and cash from financing sources have often not been ploughed back into the business, but been kept on the balance sheet as a defensive measure or returned to shareholders. We estimate a $175 billion capital investment shortfall from 2009 until the end of 2011 for the U.S. nonfinancial corporate issuers that Standard & Poor's rates. Many speculative-grade issuers, in particular, have focused on building liquidity rather than investing for long-term growth. This trend has continued into 2012. We don't see this as sustainable for these entities over the long term, as we believe it will materially undermine their competitiveness and profit margins. In 2013, we will continue to monitor whether U.S. issuers continue to hoard cash because of concerns about the economy and deficit, or return to necessary capital expenditure levels. (See "The Credit Overhang: U.S. Corporations Have Underinvested By $175 Billion To Bolster Cash," Dec. 12, 2012.)

Downgrades again begin to dominate rating actions after a two-year hiatus

After recovering markedly in 2010 and 2011, overall downgrades outstripped upgrades in 2012 (see chart 1 and table 1).

Chart 1
Downgrades Outstripped Upgrades In 2012

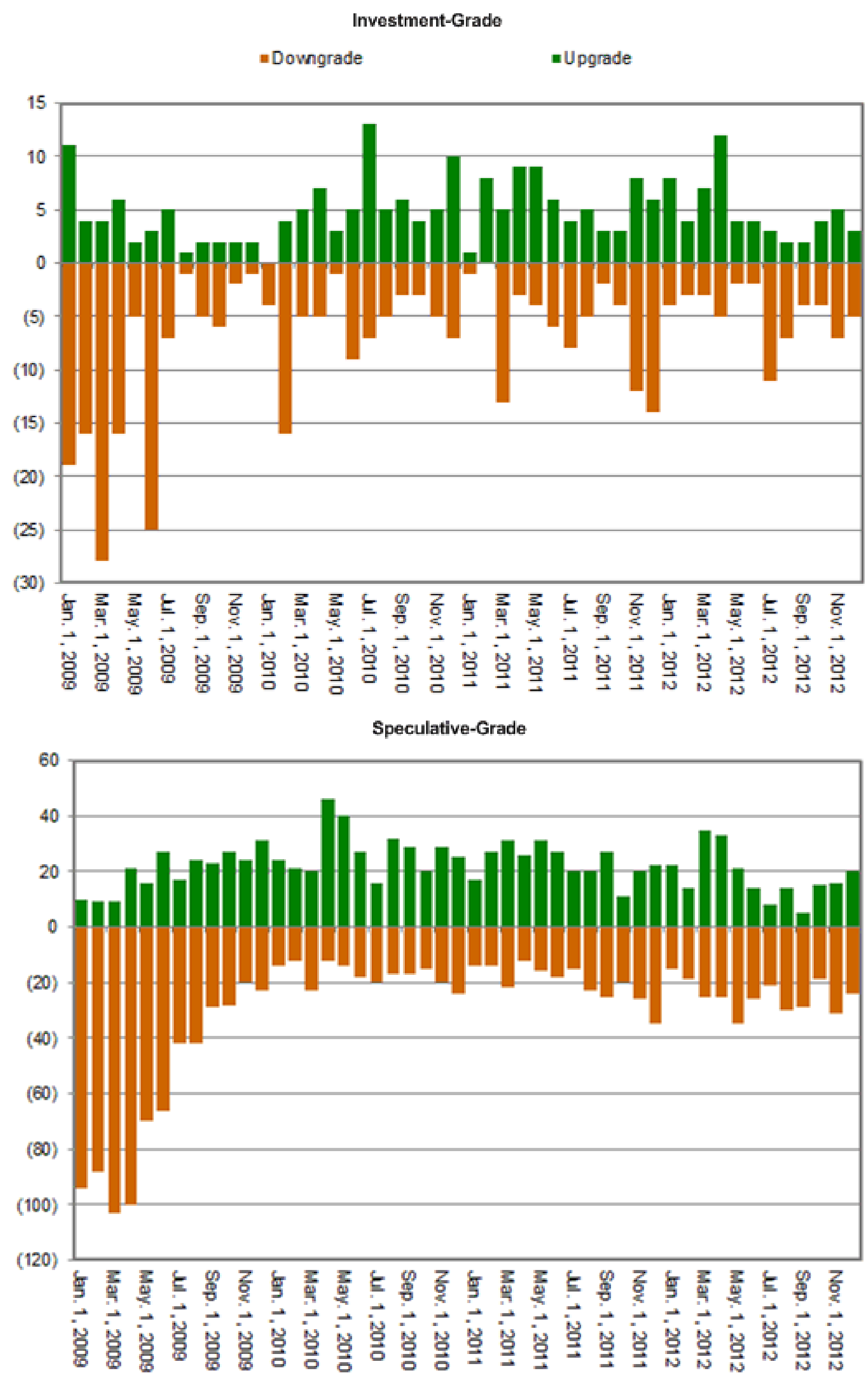


Table 1

U.S. Corporate Upgrades And Downgrades: A Marked Resurgence In Downgrades In The Second Half Of 2012

	Investment-Grade Downgrades	Investment-Grade Upgrades	Investment-Grade Downgrade/ Upgrade Ratio	Speculative-Grade Downgrades	Speculative-Grade Upgrades	Speculative-Grade Downgrade/ Upgrade Ratio	Overall Downgrade/ Upgrade Ratio
2009	131	44	3x	705	238	3x	3x
2010	70	67	1x	206	329	0.6x	0.75x
2011	72	67	1.1.x	240	279	0.9x	0.9x
2012	57	58	1x	299	217	1.38x	1.3x
June 30, 2012 to Dec. 31, 2012	38	19	2x	154	78	2x	2x

Higher Risk	(red)
Stable	(yellow)
Lower Risk	(green)

Sectors registering the highest downgrade to upgrade ratios in 2012 include aerospace and defense, merchant energy, transportation, media and entertainment, forest products/building materials/packaging, health care, metals and mining, project finance, and telecoms. Sectors bucking the trend and registering stronger performance in 2012, with positive upgrade to downgrade ratios, included automotive, midstream energy, real estate, capital goods, and utilities. (See table 2.)

Table 2

A Majority of U.S. Sectors Registered Negative Downgrade To Upgrade Activity In 2012

Annual downgrade to upgrade ratio

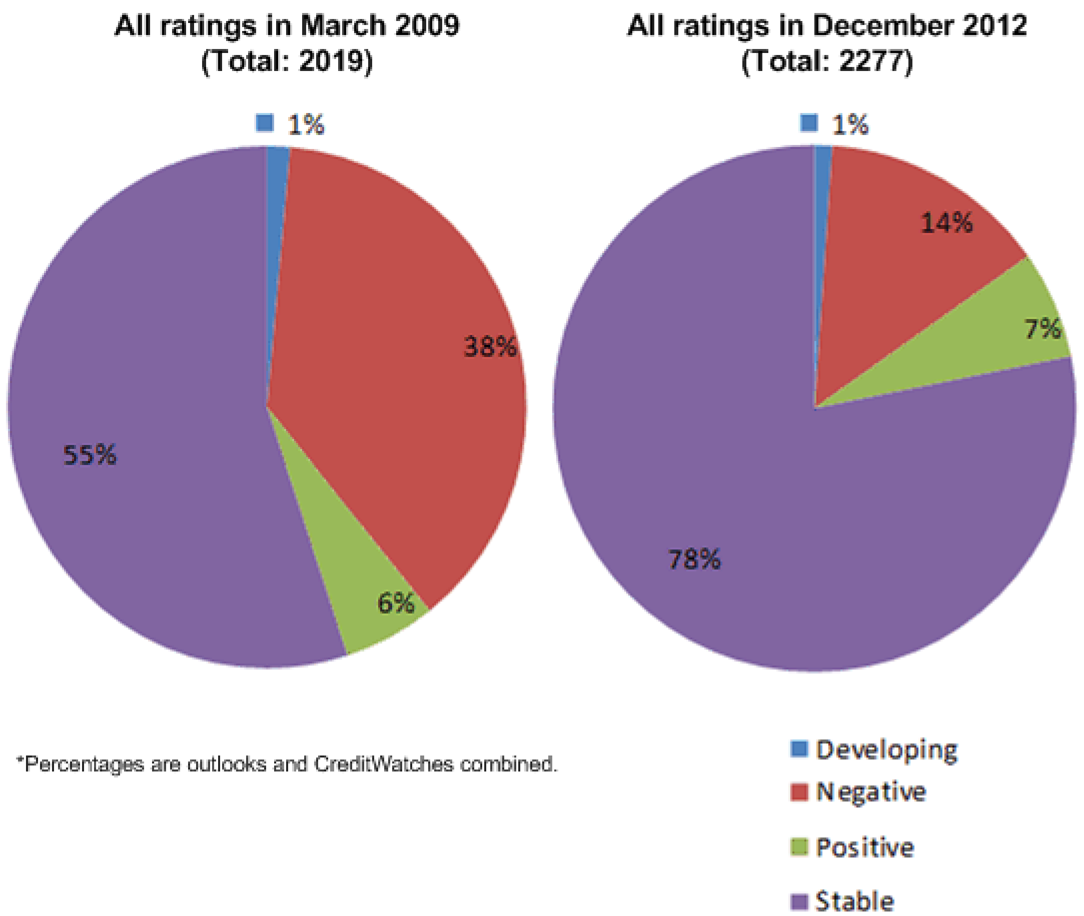
	2012	2011	2010	2009
Merchant Energy	10 to 1	1.3 to 1	2 to 1	1.5 to 1
Aerospace & Defense	8 to 1	1.3 to 1	0.7 to 1	2.3 to 1
Transportation	3.4 to 1	1.9 to 1	0.7 to 1	4.2 to 1
Forest Prod/Building Materials/ Packaging	2.3 to 1	1.2 to 1	0.4 to 1	5.6 to 1
Healthcare	1.9 to 1	1.1 to 1	0.9 to 1	0.5 to 1
Metals and Mining	1.9 to 1	0.4 to 1	0.6 to 1	3.5 to 1
Telecoms	1.8 to 1	1 to 1	1.1 to 1	1.6 to 1
Project Finance	1.6 to 1	3.5 to 1	3.1 to 1	1.9 to 1
Media, Entertainment & Leisure	1.6 to 1	0.9 to 1	0.8 to 1	4 to 1
Oil & Gas	1.3 to 1	0.7 to 1	0.6 to 1	2.7 to 1
Consumer Products	1 to 1	1.4 to 1	0.7 to 1	2.7 to 1
Retail & Restaurants	1 to 1	1.4 to 1	0.7 to 1	2.5 to 1
Chemicals	0.9 to 1	0.3 to 1	0.3 to 1	2.6 to 1
Technology	0.9 to 1	0.3 to 1	0.4 to 1	2.1 to 1
Automotive	0.8 to 1	0 to 1	0 to 1	5.6 to 1
Midstream Energy	0.7 to 1	0.6 to 1	2 to 0	2 to 0
Utilities	0.7 to 1	0.8 to 1	1.2 to 1	0.9 to 1
Capital Goods	0.6 to 1	0.6 to 1	0.4 to 1	5.9 to 1
Real Estate	0.6 to 1	0.7 to 1	0.8 to 1	6.8 to 1

Higher Risk	(red)
Lower Risk	(green)

U.S. Outlook Distribution By Sector

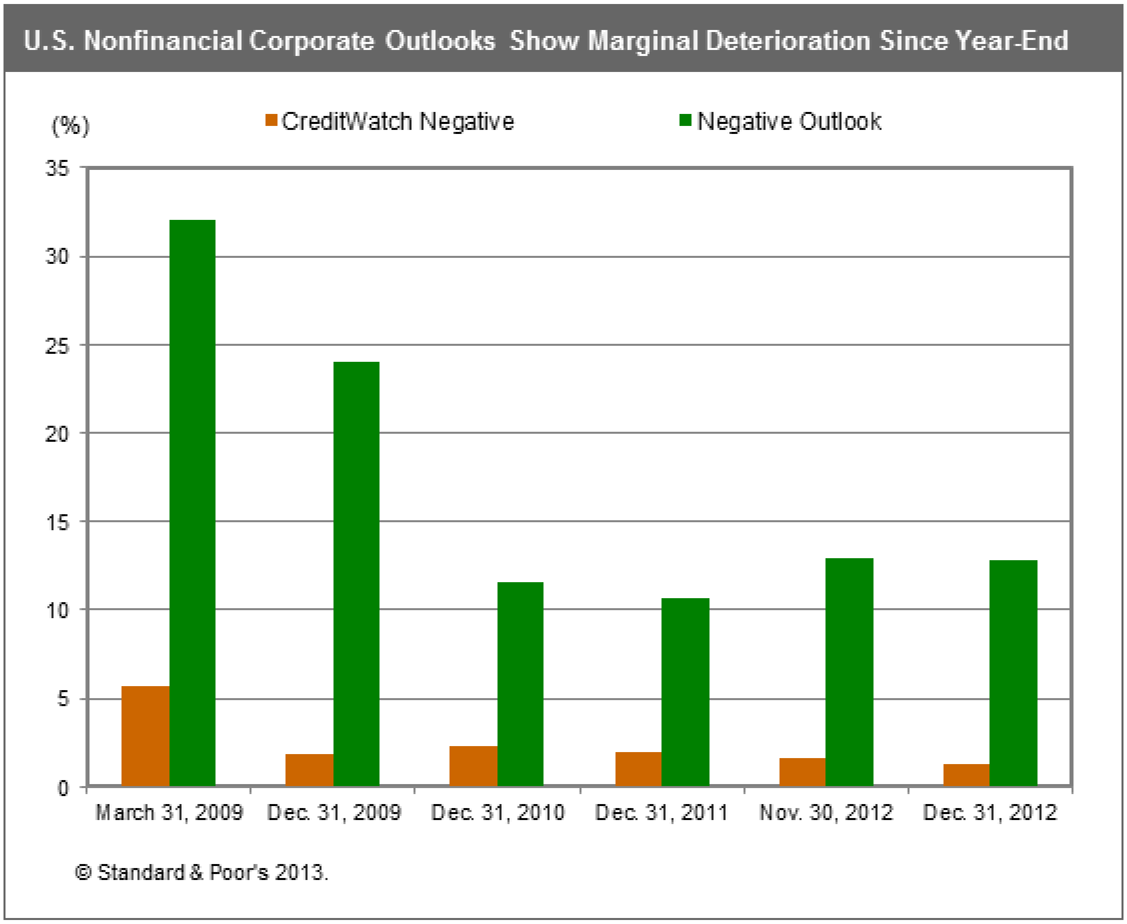
Standard & Poor's U.S. ratings outlook distribution among rated nonfinancial corporate issuers has improved from March 2009 to December 2012. At March 31, 2009, stable and positive outlooks accounted for only 61% of our overall ratings on these companies, while negative outlooks and CreditWatch listings were responsible for 38% (see chart 2). By Dec. 31, 2012, negative outlooks and CreditWatch listings had shrunk markedly, to 14% of the total. At year-end 2012, stable and positive outlooks accounted for 85% of U.S. nonfinancial corporate ratings, though there has been a marginal deterioration in our outlook distribution since the end of 2011 (see chart 3).

Chart 2
Outlook Distributions Show Marked Improvement Since 2009*



*Percentages are outlooks and CreditWatches combined.

Chart 3



Sectors showing above-average levels of negative outlook and CreditWatch distributions include media and entertainment, where a material number of issuers are encountering major challenges to their business models due to changes in technology and consumer preferences, and paper and packaging, where issuers are facing secular demand declines. Telecommunications was one sector that showed some material deterioration at year-end 2012 from an outlook perspective. U.S. corporate sectors that are well positioned going into 2013, with negative outlooks and negative CreditWatch implications below 10% of overall outstanding ratings, include chemicals, health care, utilities and real estate. The sector showing the greatest improvement since the Great Recession is the automotive industry, where the percentage of negative outlooks and CreditWatch implications fell to 11% at year-end 2012, from 77% at March 31, 2009. (See table 3.)

Table 3

Negative Outlooks/CreditWatch As % Of Total Outlooks/CreditWatch

% as of date

	Dec. 31, 2012	Dec. 31, 2011	Dec. 31, 2010	Dec. 31, 2009	March 31, 2009
Project Finance	29	22	31	37	40
Media, Entertainment & Leisure	24	22	18	38	59
Forest Prod/Building Materials/ Packaging	20	23	14	47	72
Transportation	19	14	20	38	39
Consumer Products	17	14	18	28	36
Metals and Mining	16	9	17	34	9
Telecoms	16	5	12	14	29
Aerospace & Defense	15	5	15	15	12
Retail & Restaurants	14	17	13	25	44
Merchant Energy	13	26	20	18	22
Capital Goods	12	9	8	35	32
Technology	12	7	10	19	26
Automotive	11	6	2	39	77
Midstream Energy	11	11	4	26	47
Oil & Gas	10	13	19	18	33
Chemicals	9	10	14	28	34
Healthcare	8	10	7	12	22
Utilities	7	7	6	13	22
Real Estate	6	22	20	36	40

Riskier	(red)
Medium	(yellow)
More Stable	(green)

We see debt maturity levels for speculative-grade issuers in 2013 as being relatively low and manageable. However, maturities for issuers rated 'B' and lower will escalate in 2014, to about 30% of total debt coming due, and remain at similar levels through 2016 (see charts 4 and 5). Considering the amount of debt that these borrowers need to pay off or refinance, defaults may increase as these weaker issuers struggle--either because of unsustainable capital structures and/or weak operating fundamentals, or negative effects of years of underinvestment in plant and equipment, which has eroded competitiveness.

Chart 4

After Manageable Speculative-Grade Maturities In 2013, Refinancing Needs Will Escalate From 2014 Through 2017

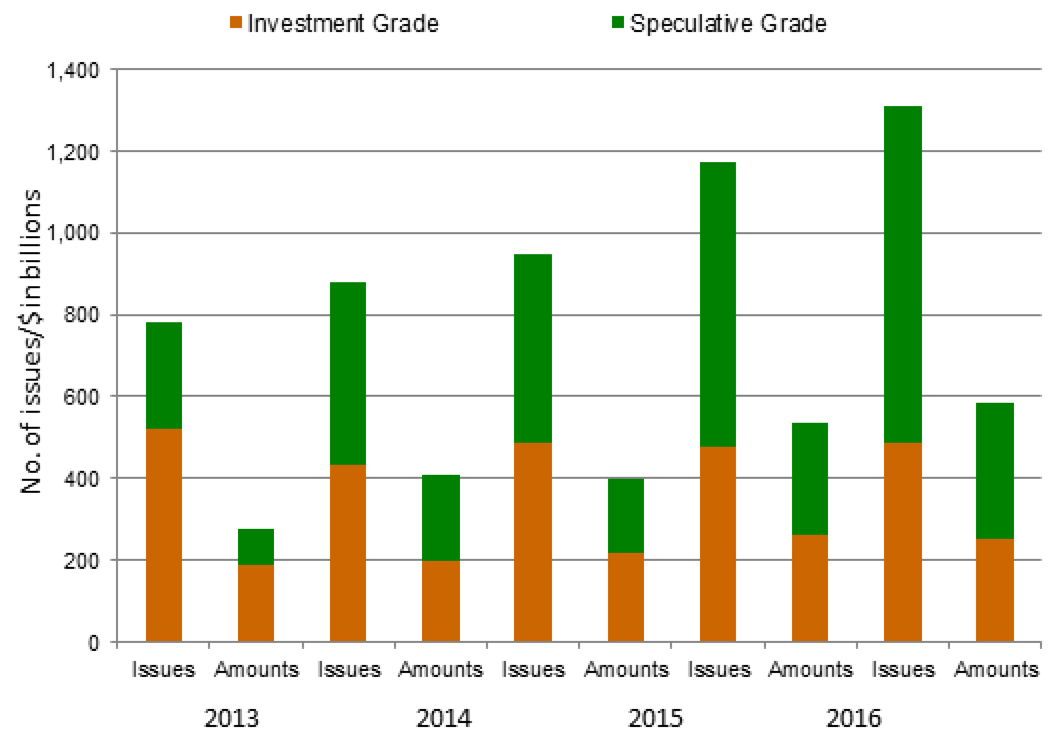
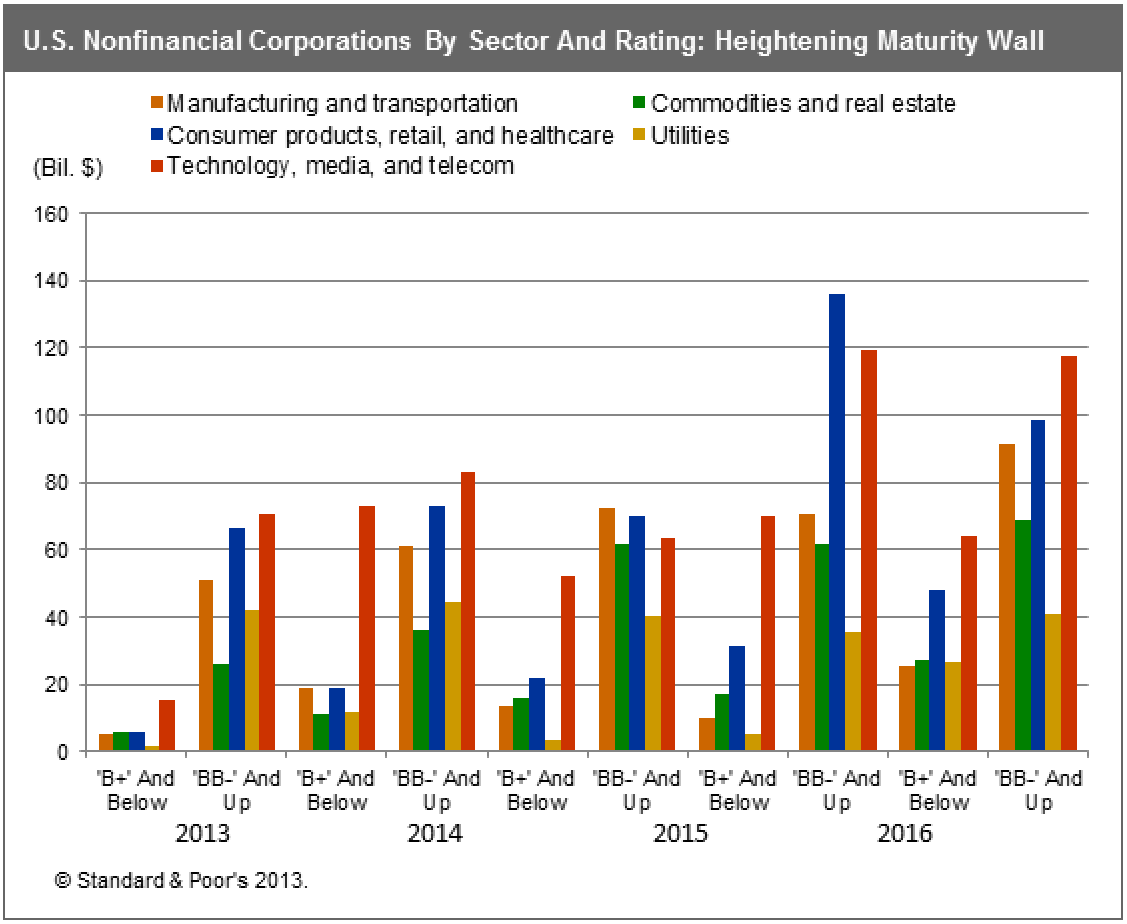


Chart 5



During a time when credit was flowing freely, we believe that some lower-rated speculative-grade issuers that have yet to refinance their debt have already been frozen out of the capital markets because of their higher credit risk profiles. Stronger issuers that have been able to capitalize on the historical low interest rate environment have mostly already done so. Clearly, the credit outlook for nonfinancial corporations is not monolithic--industry sectors are positioned differently.

Aerospace and defense

Overall, we see the outlook for U.S. aerospace and defense ratings in 2013 as being relatively stable. The one area of potential weakness is likely to be smaller speculative-grade defense issuers with poor diversification across U.S military contracts. Companies with these characteristics could be subject to downgrade if major contacts are cut back. Larger U.S. investment- grade defense contractors are better diversified and we expect them to better weather any defense budget cuts in 2013.

The outlook for commercial aerospace ratings is more favorable than for the defense industry in the year ahead. Factors driving the favorable industry environment include:

- Aircraft manufacturers continuing to increase production to reduce large order backlogs and
- Demand for new commercial airliners being driven by airlines looking to replace older aircraft with more

fuel-efficient planes due to high oil prices.

Branded pharmaceuticals

While the sector is currently facing an environment of uncertainty and change, we do not expect any significant deterioration to credit quality in the near term. Most rated companies have maintained strong margins and cash flows despite current challenges, which include:

- Multiyear patent expirations, which began in 2010 and run through 2014, and
- Government policies to reign in health care costs in the U.S. and Europe.

In order to compensate for eroding revenues from patent expirations, companies have responded by:

- Accelerating new product development, and
- Restructuring costs.

Automobiles

The U.S. auto market continues to recover and nearly 90% of U.S. automotive ratings currently carry stable or positive outlooks. Last year marked the third consecutive year of increasing sales, with auto production at a healthy 14.4 million units. Major factors supporting our outlook include the following:

- Our economists are projecting 15.4 million unit sales of light vehicles in 2013.
- Our 'BB+' ratings on Ford Motor Co. and General Motors Co. (GM) are the highest we've assigned to either company since May 2005, and a one-notch upgrade would bring both companies back to investment grade.
- We revised our outlook on Ford to positive in August 2012, but have stated that an upgrade to investment grade isn't likely to occur until late 2013 at the earliest.
- Our outlook on GM is currently stable. In the longer term, a restructuring of its European operations for a return to profitability, along with a positive evolution of its ownership and long-term capital structure, would be factors for any eventual upgrade.

In addition regarding GM, we recently announced that the company's intention to acquire 200 million of its common stock for $5.5 billion held by the U.S. Treasury (UST) would have no impact on our rating. The eventual full exit of the UST from GM ownership clarifies the uncertainty regarding the longer-term ownership structure, and is a credit positive, in our view.

Consumer products

Despite economic weakness and decelerating growth in emerging markets, the credit quality of the rated U.S. global consumer products companies is likely to be fairly stable over the next year. We believe the direction of U.S. investment-grade consumer goods company ratings will largely relate to companies' individual financial policies. Speculative-grade consumer goods companies, on the other hand, are less diversified, typically have weaker brands (or none), and are more highly leveraged than their investment-grade peers. Their credit measures could come under pressure if the economic recovery weakens. Major factors supporting our sector outlook include:

- Most issuers remain ready for a slow economic recovery and volatile raw material prices.
- We expect investment-grade players in all consumer products sectors to make the most of their price-setting influence, emerging markets footprint, investment in research and development (R&D), and cost-cutting flexibility.
- Sector issuers have lowered their costs and increased cash flows, and typically have "adequate" liquidity or better.

- Food, beverage, and personal care companies will likely continue to benefit from their products being less discretionary.
- U.S. durables companies (major home appliances/white goods, furniture, home improvement products, small appliances, office products, and other consumer discretionary household products companies) should benefit from the strengthening U.S. housing market, some pent-up demand, and storm-related activity.

Retailing

Our outlook for retailers should remain generally stable in 2013 despite slow economic growth. We expect positive factors supporting the sector in 2013 to include:

- Relatively favorable gasoline prices,
- Improved consumer confidence entering 2013,
- Healthy issuer liquidity positions due to material cash build ups arising from a considerable slowdown in the amount that retailers are investing, and
- The refinancing of higher-cost debt, which will continue to support creditworthiness.

Technology

Key credit notes in the tech sector include the following:

- The positive rating trend of the past few years has shifted, and downgrades have outstripped upgrades in 2012.
- Despite the recent negative trend, 88% of our technology ratings coming into 2013 carry stable or positive outlooks.
- Continued weak economic growth may put a damper on the industry's revenue growth, though we expect credit measures and liquidity to support current rating levels in most instances.

Metals and mining

Despite a reversal in favorable rating trends in 2012 from the prior two years, a large majority of ratings in the industry have a stable outlook coming into 2013. This is because:

- The U.S. is a relative bright spot for the industry globally.
- The slowly growing economy should lead to improved demand and, eventually, improving pricing for companies that benefit from a strong presence in the U.S. market.
- We are projecting that nonresidential construction spending, although still historically weak, will improve in 2013 (our current projection is 3.6% growth), which could help support credit quality for companies producing structural steel in the coming year.
- The uptick in housing (our economists are forecasting 1.05 million housing starts in 2013 compared with about 770,000 this year) could result in better demand as 2013 progresses and help alleviate overcapacity across the industry.
- We expect automobile production to remain robust in 2013, which would also boost steel demand.

Other pockets of relative strength include special bar quality steel, which producers use in transportation and industrial and farm equipment, as well as oil country tubular goods. Although these have shown some signs of slowing, they will likely remain profitable for producers in 2013.

Real estate

We expect materially improved financial performance for rated U.S. homebuilders in 2013. After a few false starts, homebuilders have finally emerged from the deepest and sharpest downturn since the Great Depression. Our outlook is based on the following factors:

- Our forecast unit delivery growth is in the 20% range, which should put most homebuilders on the path to sustained profits and strengthened debt-protection metrics.
- Modestly higher debt burdens for some homebuilders could leave them vulnerable to a sudden drop in demand should the recovery lose traction. Last year's opportunistic debt issuance activity, which many companies largely pursued in anticipation of growth, will slow the pace of ratings improvement.

As for U.S. real estate investment trust (REIT) ratings, we expect them to be largely stable in 2013. Our outlook is based on the following considerations:

- That the sector will again deliver same-store net operating income (NOI) growth in the 3%-4% range in 2013.
- New supply will remain largely contained (amid still tight lending), and tenant demand will strengthen, albeit modestly and unevenly.
- REITs, with their high-quality portfolios and improved capital positions, are well positioned to compete for tenants, but attractive acquisition opportunities could be limited. As such, we expect financial performance to generally hold steady or modestly improve for REITs with unique refinancing or investment opportunities.

Telecom and cable

Our ratings outlook for the sector in the U.S. in 2013 is largely stable, with the exception of regional wireless providers, which have recently been under significant ratings pressure. Our views on the sector include the following:

- Demand for most telecommunications and cable services is fairly resilient against changes in the macroeconomic environment, as these services have become a near necessity for most households.
- Changes in technology and consumer preferences, rather than economic factors, largely propel demand shifts in these sectors (for example, the ongoing shift to wireless services from wireline).
- Most wireless and cable industry players will experience low growth in 2013.
- Wireline revenue will continue to decline.

Utilities

Our outlook for U.S. utilities remains stable, based on:

- The essentiality of the services that regulated utilities provide.
- Generally supportive rate regulation and responsive cost recovery for incremental capital investments.
- Investor appetite for utility debt and equity offerings, which is important to maintaining liquidity and access to capital markets.

Transportation

We expect ratings to be mostly stable in 2013, but weak economic growth poses downside risk. Dangers include:

- The cyclical sensitivity of transportation companies to macroeconomic factors (to varying degrees),
- An imbalance between supply and demand, and
- Volatility in oil prices.

Capital goods

While the majority of sector outlooks are stable coming into 2013, and upgrades have outnumbered downgrades last year, the outlook distribution trend has begun to weaken. In 2012, negative outlooks have more often resulted from financial decisions by individual companies, such as acquisitions that weakened financial metrics, than from actual deterioration in operating trends. Still, with the weakening demand and business performance outlook, the capacity for

U.S. capital goods companies to undertake large debt-financed initiatives is shrinking.

Following the recovery of the past two years, capital goods companies are facing weaker demand globally as a result of the following factors:

- The recession in Europe,
- Tepid economic growth prospects in the U.S.,
- A slowdown in China, and
- Uncertainty about governments' abilities to resolve fiscal challenges.

This weak demand is dampening business confidence and capital spending, creating conditions for negative industry operating performance trends. Still, we have factored these conditions into our current ratings, and we expect industry credit measures to remain broadly stable amid sluggish domestic manufacturing expansion and slowly recovering nonresidential construction markets.

Oil and gas

In 2012, the favorable rating trends previously seen in the U.S. oil and gas sector in 2011 and 2010 reversed, with downgrades exceeding upgrades. However, our ratings outlook for the sector in the U.S. shows that nearly 90% of ratings have stable or positive outlooks, demonstrating an expectation of relative strength, but with some caveats:

- We expect crude oil prices to drop marginally in 2013, but remain relatively high.
- The industry is in a period of dynamic change. During the past decade, U.S. operators have been so successful in extracting natural gas from shale reserves that production levels have reached all-time highs and prices have dropped precipitously.
- More recently, producers have become more successful in tapping oil shale plays. Given this success, the U.S. may be on track to become a major global oil and gas producer by 2020.
- The North American onshore oilfield services and contract drilling markets continue to experience declining margins and utilization.
- We expect low natural gas drilling levels and the once unthinkable oversupply of service equipment and rigs to continue to hurt margins and utilization in 2013. Nevertheless, we don't expect this to hurt most credit ratings because of E&P companies' generally strong balance sheets and adequate liquidity.
- Strong crude oil prices should provide strong returns on liquids production. As a result, we expect North American drilling levels to remain stable despite the decline in natural gas drilling levels.

Chemicals

Some 90% of rating outlooks in the sector coming into 2013 were stable or positive, and we largely expect continued stability into 2013, assuming no major economic reversals. Factors supporting sector credit stability this year include:

- Our base case economic view for GDP growth is modestly higher in 2013 relative to 2012,
- Forecasted growth in 2013 to translate into stable or marginally higher demand and revenue for the North American chemical sector, for which the U.S. is a key market,
- A trend of gradual but steady improvement in the operating environment,
- Improved cash flow and profit quality at many issuers,
- Low input natural gas costs,
- Favorable debt maturity profiles,
- A relatively tight supply versus demand situation,

- A gradual improvement in key fundamentals for chemicals demand, including housing, auto sales, manufacturing, and consumer spending, although the downside case could result in volume deterioration and weaker credit metrics, and
- Our latest economic forecasts consider a slowdown in real GDP growth rates at U.S. trading partners to be a potential weakness. This should not affect credit quality in the base case, however, particularly given that diversified companies typically benefit from a presence in regions with demand growth rates higher than U.S. rates.

Building materials

Our outlook for U.S. building material and products companies in 2013 is stable, despite only slowly growing markets in the U.S., based on:

- Recently improved operating efficiency,
- Cost reductions in response to weak demand, and
- Maintenance of "adequate" or "strong" liquidity by nearly all rated industry players.

Forest products

We maintain a stable outlook on the industry as a whole. Nearly three out of four rated issuers currently carry a stable rating outlook. Expectations for 2013 include the following:

- A continued recovery in U.S. housing markets.
- A sustained improvement in North American wood products manufacturers' and timberlands operators' earnings from depressed levels.
- Paper and packaging will remain a weak spot because of soft demand conditions for paper-based products.

Packaging

Over 90% of rated U.S. packaging issuers carry stable rating outlooks. The performance of the industry is closely linked to trends in consumer spending and GDP growth. So with most consumers cautious about their discretionary spending, the prospects for the packaging sector are far from buoyant. Volume growth is unlikely to surpass the low-single digits in 2013, but we expect credit stability this year to be supported by:

- Relatively stable EBITDA margins, primarily due to input cost pass-through clauses in a large portion of contracts or timely price negotiations, and
- The "adequate" or "strong" liquidity profiles exhibited by all rated sector issuers in the U.S.

Media and entertainment

Overall, we expect a gradual deceleration in the brisk pace of downgrades of U.S. media and entertainment companies in 2013, assuming that ad spending does not slow materially. However, this sector still has among the highest proportion of ratings with negative outlooks or CreditWatch implications of any U.S. industrial sector. The following industry subsectors still face major challenges to their business models due to changes in technology and consumer preferences:

- Advertising,
- Newspapers,
- Magazines,
- Television,
- Radio, and
- Printing.

Certain Risks Could Derail Our 2013 Credit Outlook

The 2012 reversal of the favorable ratings trend that occurred in 2011 and 2010 for nonfinancial U.S. corporates accelerated materially in the last six months of the year, during which period the downgrade to upgrade ratio was 2.1 to 1. For the year as a whole, the ratio was 1.3 to 1, versus 0.9 to 1 for 2011. Major factors behind this deterioration included weakening earnings margins and heightened leverage--particularly for speculative-grade borrowers. Chronic underinvestment by speculative-grade issuers is also a growing risk. While these weakening trends are a mounting concern, we believe that rating outlooks and performance for U.S.-domiciled nonfinancial corporate credit issuers in 2013 will remain relatively stable. We expect U.S. corporate new issuance and the default rate to continue to benefit from a highly favorable capital market and liquidity environment and a slowly improving economy. Entering 2013, stable and positive outlooks accounted for 85% of U.S. nonfinancial corporate ratings--a level we view as a credit positive for the year ahead. Nonetheless, we believe that policies facilitating easy corporate borrowing have sowed the seeds of a credit bubble. A slowing economy due to fiscal austerity or a rise in interest rates from current extremely low levels could markedly exacerbate this risk.

Related Criteria And Research

- Policy Decisions Are Key To The 2013 Global Credit Outlook, Dec. 18, 2012
- Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011