Questions That Matter

'BBB's | Should Markets Still Worry About Fallen Angels?

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The debt of fallen angels (issuers downgraded to 'BB+' or lower from 'BBB-' or higher) could reach almost $300 billion, a record high but down from our estimate of about $375 billion in 2020.

How this will shape 2021

We expect to see lower fallen angel totals in the U.S. and EMEA in 2021, given the distribution of ratings within the 'BBB' category, the current outlooks and CreditWatch profiles, and our economists' base-case assumptions for recovery in 2021. Nominally, this is still an all-time high, but accounts for only about 5.7% of the $5.16 trillion total outstanding 'BBB' nonfinancial debt in the U.S. and EMEA as of Oct. 31. There is still lingering stress in certain sectors, although the predominance of negative outlooks indicates a reduced likelihood of downgrades in the near term relative to the number of ratings on CreditWatch.

Potential fallen angels now reflect lower downgrade risk than six months ago. Our current list of potential fallen angels (issuers rated 'BBB-' with a negative outlook or CreditWatch listing) in the U.S. and EMEA is smaller and far less concentrated (in terms of outstanding debt), than the 2020 cohort of fallen angels. Additionally, the proportion of potential fallen angels on CreditWatch negative is near an all-time low (3%), pushing most of the downgrade risk past the near term.

The speculative-grade market can likely absorb future fallen angel debt, but individual debt pricing could remain weak. Despite a large concentration of fallen angel debt in March and April, the speculative-grade market has since rebounded in step with both equities and investment-grade bonds. This rebound is largely thanks to exceptional liquidity programs by the U.S. Federal Reserve, ECB, and Bank of England, which included support for recent fallen angel debt. That said, debt from most of this year's fallen angels has seen weaker pricing relative to the speculative-grade composite.

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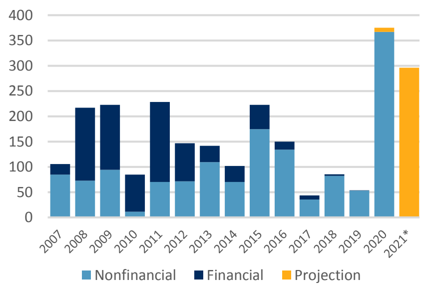
Fallen Angels Decline But Remain Elevated

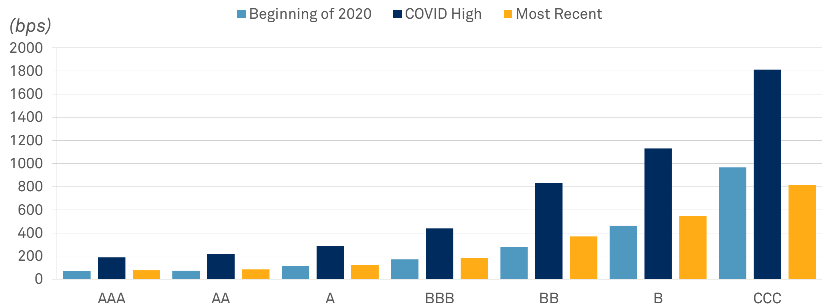


What we think and why

Historically favorable funding conditions have helped many 'BBB' issuers add cash to balance sheets or cover short term cash deficits. Market stability provided by the Fed and ECB has evolved into the most favorable lending conditions ever, particularly for investment-grade firms. Record issuance, record-low borrowing costs, and extended maturities have should give many 'BBB' entities the financial flexibility to ride out subsequent lockdowns until a vaccine is widely available and the economic recovery kicks into higher gear.

Chart 14

S&P Global U.S. Composite Spreads By Rating, Secondary Market



Source: S&P Global Ratings. Data as of November 23, 2020.

Read more

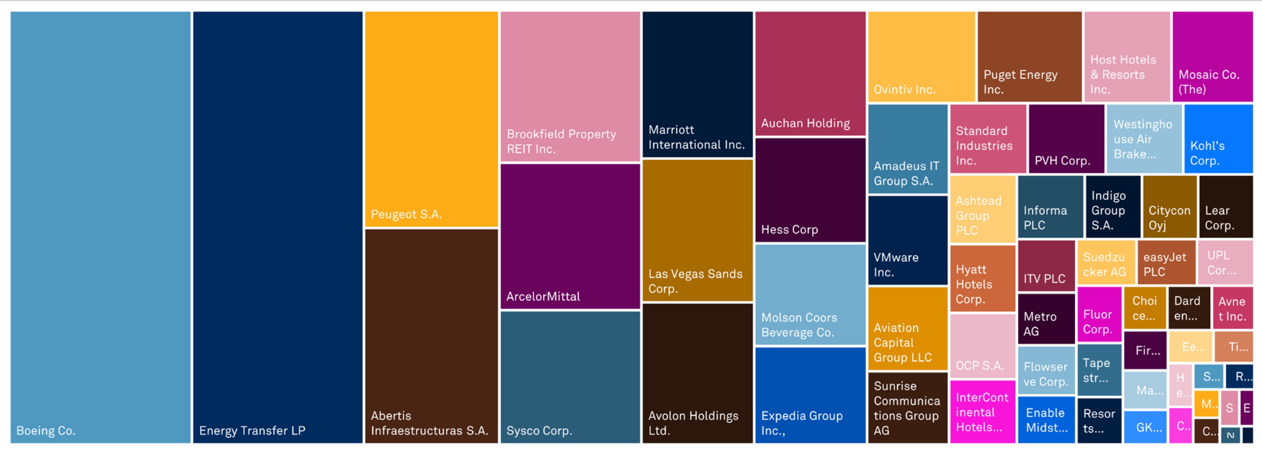
'BBB' Pulse: Fallen Angels should Decline, But Remain Historically Elevated As Virus Lingers Ahead Of Vaccines, Dec. 2, 2020

Potential Fallen Angels Decrease As Immediate Downgrade Risks Recede, Oct. 30, 2020

Concentration risk will become more balanced. The 2020 cohort of fallen angels in the U.S. and EMEA is dominated by a few large firms that constitute the majority of the $367.2 billion of debt through Nov. 9. The top five represent over 63% of the total, led by Ford Motor Co., which alone contributed $113.9 billion (31%). By contrast, the five largest potential fallen angels comprise 43% of the overall $342.5 billion debt total between the U.S. and EMEA, with only one issuer contributing more than $50 billion (Boeing Co.).

Chart 15

Concentration Risk Is Low With Current Potential Fallen Angels



Source: S&P Global Ratings. U.S. and EMEA non-financial corporates only.

But the strains of social distancing remain close for some. Retail and restaurants, along with travel-related sectors (such as airlines, hotels, and cruise operators) and oil and gas will bear the brunt of rising COVID-19 case counts, should renewed lockdowns and social-distancing measures extend beyond the first half of 2021.

And leverage will take some time to come back down to 2019 levels. While there is a tremendous variance of recovery prospects across different corporate sectors, we continue to believe it will take until well into 2022 or, in some cases 2023 or later, for many sectors to recover their 2019 credit metrics. This will put borrowers at risk if further economic stress or financial policy decisions leave credit metrics worse than expected.

What could go wrong

Persistent lockdowns and social-distancing measure would pressure travel, leisure-related, and oil and gas sectors. These include airlines, aerospace companies, hotels, cruise operators, out-of-home leisure, and mall-based retail. These sectors account for 38% of the outstanding debt of global potential fallen angels, and 4% of the overall 'BBB' rated debt in the U.S. and EMEA.

Additional waves of infections and lockdowns could weigh on market sentiment and strain financing conditions. As we saw earlier this year, prolonged lockdowns can cause negative market reactions, which can get trapped in a reinforcing, downward spiral. The global financial backdrop remains supportive, but has become more vulnerable in light of the expiring Fed facilities. The Biden administration's Treasury could resume these facilities, but this would require Congressional sign-off, which might become more difficult to secure if the Republican Party takes control of the Senate.

This report is an extract from the S&P Global Ratings report, “Global Credit Outlook 2021: Back On Track?”

This report does not constitute a rating action

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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