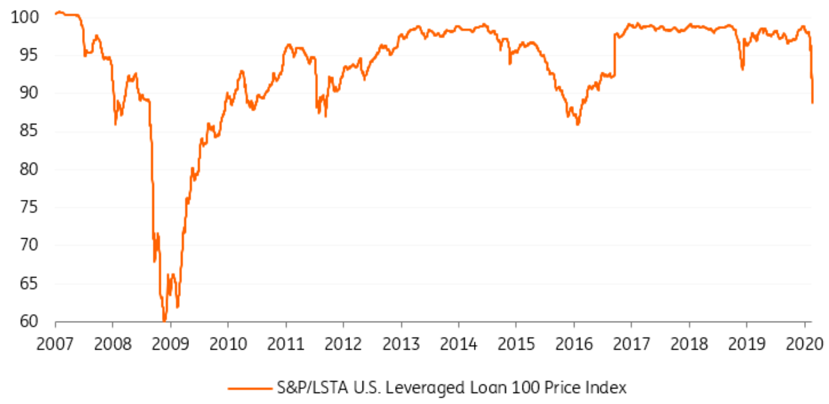
Growing concern in credit markets as yields rise amid coronavirus fears

Higher refinancing costs will add pressure to highly leveraged sectors with large refinancing needs such as Energy

Severe underperformance of high yield

The current turmoil in the credit market has led to severe underperformance of high yield and leveraged loans in both Euro and USD. As there has been and will continue to be a considerable push for higher quality. But there is a potential warning for credit market at large, as we have seen substantial outflows across investment grade and high yield in both Euro and USD from mutual funds, ETFs and leveraged loan funds. The leveraged loan index has fallen from 98bp to 89bp, surpassing the lows seen in late 2018. This build-up of pressure may well lead to an increase in default rates. As an example, the Energy and Oil & Gas sectors, in particular, are showing considerable reasons for concern.

Leverage loan price index



Source: ING, Bloomberg

Refinancing worries amid rising yields

Across the board in the European credit market, yields are on the rise. This means that the cost of refinancing for companies has increased. The table below shows the average yield per sector and the increase in these yields since the beginning of February. As you can see, the energy sector has a substantial 1.1% yield, up a considerable 97%. Of course, this is second to the Leisure sector, which has jumped over 450% to a yield of 2.2%. These large increases in refinancing costs are worrying for many sectors, particularly those highly leveraged, and with large refinancing needs.

Euro Investment Grade refinancing levels per sector

Sector	Current Yield	Increase since 1st Feb	% increase
Autos	1.1	0.5	83
Industrials	0.8	0.8	77
Capital goods	0.5	0.5	70
Consumers	0.6	0.5	96
Energy	1.1	1	97
Leisure	2.2	2.1	453
Media	0.6	0.6	70
Health	0.6	0.5	82
Real estate	0.9	0.8	32
Retail	0.6	0.6	107
Services	0.6	0.5	78
Telecom	0.7	0.7	52
Technology	0.4	0.4	134
Transport	0.6	0.2	62
Utilities	0.6	0.5	23

Source: ING

Increasing leverage across the board

In both the US and Euro investment grade space, leverage has increased across the board. As illustrated in the table below, the overall US investment grade index's leverage rose from 2.4 to 2.5 from 3Q18 to 3Q19. Utilities is the largest leveraged sector at 5.5, followed by Telecom and leisure at 3.1 and 3.0, respectively. Energy companies have certainly increased leverage, from 2.2 in 3Q18 to 2.6 in 3Q19; there are similar trends in Euro energy companies. There is also a significant fall in interest coverage. This adds pressure to sectors looking to refinance.

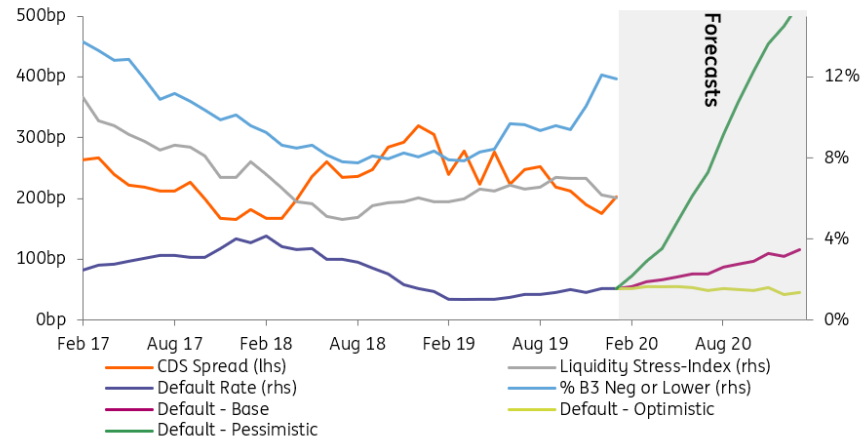
US IG Gross Leverage by Sector

	3Q07	3Q08	3Q09	3Q10	3Q11	3Q12	3Q13	3Q14	3Q15	3Q16	3Q17	3Q18	3Q19
Basics	1.7	1.6	2.4	1.9	1.9	2	2.3	2.2	2.4	2.4	2.3	2.1	2.4
Cap. Goods	1.6	1.4	2	1.4	1.4	1.5	1.5	1.6	1.8	2	2.2	2.2	2.2
Consumer	1.6	1.6	1.8	2.1	2	2	2	1.9	2.2	2.4	2.8	2.5	2.9
Energy	1.2	1.3	2.2	1.9	1.8	2.3	2.1	2	2.9	3.5	2.9	2.2	2.6
Healthcare			1.5	1.5	1.6	1.5	1.9	2.2	2.2	2.3	2.4	2.4	2.7
Leisure								2.7	2.5	4.2	2.8	2.8	3
Media	2.1	2.6	2.2	2.4	2.2	2.2	2.3	2.3	2.9	2.9	2.5	2.7	3
Retail	1.7	2	1.6	1.4	1.4	1.4	1.4	1.4	1.4	1.5	1.5	1.6	1.7
Services	2	2	2.1	2.2	2.1	2.1	2	2	2.2	2.4	2.6	2.3	2.5
Tech	1.3	1.2	1.3	1.2	1	1.1	1.2	1.3	1.6	2	2.1	1.7	1.8
Telecom	1.9	2	2.4	2.4	2.2	2.3	2.5	2.5	2.7	2.7	2.8	2.7	3.1
Transp.								1.5	2.2	2.4	2.4	2.4	2.4
Utility	3.7	3.8	4.1	4	4.1	4.1	4	3.9	4	4.1	4.1	4.6	5.2
Index	1.8	1.9	2.2	2	1.9	2	2	2	2.3	2.4	2.5	2.4	2.5

Source: ING, CreditSights

In high Yield credit in the US, the leverage has certainly increased since 4Q18, compared to 3Q19. Real Estate is the largest leveraged sector with a considerable Debt to EBITDA of 9.9x, although issuers are limited. Energy, being the sector with the largest amount of issuers (81), has a debt to EBITDA of 4.4x, up on 2Q19's 4.2x. Media is also highly leveraged relative to the amount of issuers there are, pencilling in a debt to EBITDA of 5.3x. This increasing leverage is cause for concern, as it will continue to put pressure on default rates, particularly alongside the falling interest coverage. This is even more so concerning for underperforming sectors, like the Oil & Gas sector in both US dollars and in euros.

Default rates are likely to rise



Source: ING, Moody's

US HY Total Debt to EBITDA Sector Trends

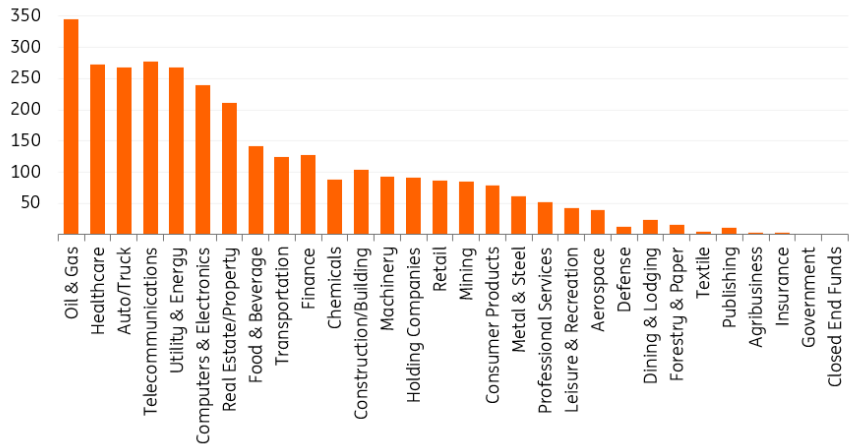
	# Issuers	2Q14	4Q14	2Q15	4Q15	2Q16	4Q16	2Q17	4Q17	2Q18	4Q18	2Q19	3Q19
Energy	81	3.3	3.1	4.1	4.8	5.8	6.0	5.3	4.9	4.4	4.1	4.2	4.4
Basic Ind.	78	3.5	3.7	4.1	5.1	4.2	3.9	3.9	3.8	3.5	3.5	4.0	4.1
Cap Goods	35	3.0	3.2	3.5	3.7	4.0	3.7	4.7	4.0	3.8	3.9	4.1	4.1
Media	31	4.3	4.3	4.2	4.6	4.5	4.9	4.3	4.7	4.9	4.1	5.3	5.3
Tech & Elec	29	2.5	2.5	2.9	3.6	3.7	4.0	3.3	3.2	3.3	3.6	3.7	3.8
Services	28	3.2	3.6	4.1	3.9	4.2	4.0	4.2	4.1	3.8	4.1	4.5	4.4
Healthcare	27	4.3	3.9	3.9	4.1	4.0	3.8	4.1	4.3	4.5	4.2	4.3	4.2
Retail	26	2.9	2.8	2.9	2.8	3.1	3.3	3.6	3.5	3.4	3.4	4.4	4.7
Cons. Goods	23	4.1	4.3	3.9	3.7	4.7	3.5	4.3	4.8	5.1	5.1	5.3	5.5
Leisure	23	4.8	6.2	6.1	5.8	5.1	4.9	4.9	5.5	5.3	5.4	5.7	5.8
Telecom	20	4.9	5.4	5.2	5.0	4.5	5.1	5.1	6.0	5.2	5.3	5.3	5.2
Autos	12	3.2	3.0	2.8	2.5	2.9	2.4	2.7	2.5	2.6	3.1	3.9	4.0
Real Estate	12	6.6	6.6	7.9	8.3	6.6	7.0	7.9	7.6	7.1	8.3	8.6	9.9
Transport	11	4.5	5.0	4.8	4.4	4.7	4.2	4.1	3.6	3.9	4.4	5.1	4.8
Utility	7	5.1	5.1	5.3	6.3	6.4	6.3	8.0	6.4	8.1	5.7	6.2	6.2

Source: ING, CreditSights

Refinancing costs increasing sharply

When we take a look at refinancing needs per sector in both EUR and USD, we can see illustrated in the chart below, the refinancing needs for the next three years per sector. Most sectors have already issued debt to around 20%-30% of their refinancing needs for 2020. Utilities & Energy, have already issued debt of a substantial 42% of their 2020 refinancing needs. However, going forward, now with increased financing costs for issuers, it is likely many sectors may not meet all the refinancing needs for the year, but sectors such as Oil & Gas will have significant refinancing needs over the next 3 years. This is worrying for sectors like Oil & Gas where the cost of refinancing is increasing considerably.

EUR and USD refinancing needs over the next 3 years per sector



Source: ING, Dealogic

Underperforming energy sector

The High yield Energy sector in the US is substantially underperforming. The average yield of high Yield Energy companies has jumped 10% since the start of the year. This is the cost of financing for high yield energy companies in the US. Euro high yield energy companies paint the same picture. With a yield of 18% for the HY US Energy index, surpassing the 17% seen in late 2008. This will drastically increase financing cost for this sector, which also happens to be the sector with the largest refinancing over the next three years. Debt service costs will rise substantially. This is worrying for the Energy sector, particularly due to the consistent decreasing earnings in the sector.

Average Yield for US High Yield Energy companies

Source: ING, ICE

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