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APRIL CREDIT OUTLOOK

Banks Embroiled & Credit Contractions

PMI Index

The United States manufacturing sector contracted for the fifth straight month with PMI at 46.3% for March. This was a 1.4% decrease when compared to the prior month, which is the lowest level since May 2020. Also, it's important to note that 10 of the subindexes that directly impact this metric were in negative territory. It's clear the economy is slowing down and companies have been putting a greater emphasis on cost-saving initiatives to combat declining earnings.

Unemployment & Inflation

The unemployment rate for March was unchanged at 3.5% and down only .1% when compared to the prior month. The U.S. added 236,000 jobs, which was in line with economist estimates and the lowest levels since December 2020. Additionally, the inflation rate fell to 5.0% from 6.0%, which is the lowest since May 2021 and many are calling it an inflection point. The Fed will be pleased with these metrics and will likely take a less aggressive approach with rate hikes going forward. We expect a rate hike of 25 basis points or less.

Insolvency

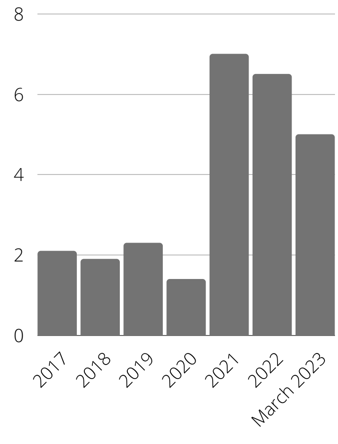
New bankruptcy filings in March increased year over year for the third straight month as total filings grew to over 40,000 for the first time since April 2021. Total new filings for March increased to 17% when compared to prior year while Chapter 11 continued to stay elevated at 79% and small business filings were 12% year over year. Typically, March is the highest month for bankruptcies, but the first quarter of 2023 showed an 18% increase when compared to the prior year. Overall, this signals heightened risk for this current year, and we expect this trend to stay elevated.

CURRENT & EVOLVING CREDIT RISKS

Defaults Accelerating

The default rate has accelerated to a 22-month high and it's the highest level since 2009. It's expected the default rate for the end of the year will be 4.0%, which is more than double its previous expectation of 1.7%. Also, distressed exchanges have risen to tie 2016 highs and are 50% higher when compared to 2009. Lastly, about 86% of credit managers surveyed stated they expect default rates in North America to trend higher as liquidity issues, elevated rates, and weaker earnings plague credit metrics.

U.S. Annual Inflation Rate



Distressed Exchanges

These exchanges accounted for about half of the insolvencies this year. Distressed exchanges seem to be the preferred method of restructuring in 2023. The running tally year to date is 16, which is 50% higher than 2016 and 2009. We expect more pressure on credit metrics with an increase in negative outlooks and junk bond status.

Bank Turmoil

The failure of Silicon Valley bank and other bank pressures has brought turmoil to the financial sector. It's important to note that credit risks were high prior to this, but the credit crunch caused by the banks has made the situation more difficult for all. We expect significant credit contractions and corrections to take place over the course of the year as lenders try to reduce risk. In the beginning of 2023, banks were already reporting tighter standards and weaker demand for commercial & industrial (C&I) loans.