NOVEMBER CREDIT OUTLOOK

Slowing Capital Markets and Negative Rating Momentum

Bankruptcy

Overall bankruptcy filings in October were up at 4% compared to a year ago. Small business subchapter V elections within Chapter 11 increased to 28%. This is attributed to persistent high inflation coupled with rate hikes that have squeezed struggling small businesses. This group is being faced with tough financial decisions, and it seems they are turning to bankruptcy for financial relief.

Unemployment

The U.S. added 261,000 jobs in October, which was above economist expectations, but is a slight softening in labor market conditions. The unemployment rate went back up to 3.7% from 3.5% and remains close to historic lows. October average hourly wages grew to 4.7% from a year ago, indicating pressure by high inflation. The Fed would have liked for both these metrics to have declined, but job growth was relatively flat, and wages have yet to taper off. Overall, the U.S. job market continues to show its strength and resilience despite high inflation and fears of a recession.

Inflation

Inflation has eased in October from its 40 year high. The consumer price index was down to 7.7% from 8.2% compared to September, over the last 12 months. These results are the smallest monthly gain since January 2022, an optimistic sign for consumers. The consumer price index for all items was at .04%, which matched prior month. Shelter contributed to over half all items increases in addition to climbing energy prices. Overall, inflation is moving in the right direction, and it's expected the Fed will ease its rate hikes likely sub 75 basis points.

CURRENT & EVOLVING CREDIT RISKS

Amendment Activities

For a third consecutive month, loan amendments slowed down as market conditions become increasingly unfavorable. The cost of debt now would be higher than the original transaction for most, which has slowed demand. Also, covenant relief activity is down significantly to just 25 for the year, which is the lowest level in more than a decade. The slowdown in these type of activities signals a tightening and restrictive credit market.

Capital Market Activity

As the Fed raises interest rates to tame inflation, the bond and debt issuance market have been hammered. Investment grade corporate bonds are down about 20% from a year ago. Also, capital markets aren't boding well for private equity debt deal making because in the third quarter they only raised $10.6 billion, which is down $35.0 billion in the same quarter prior year. Ultimately, financing conditions for highly leveraged or weaker credit entities is becoming more challenging with fewer options available.

Weak Ratings

Negative rating momentum continues to grow with 51% of new potential downgrades caused by inflationary pressures. The "BBB" category has the highest downgrade potential at 21% on negative CreditWatch with consumer products, auto, retail, and restaurant having the highest downgrade potential. During previous recessions, typically a quarter of "B-" rated companies were downgraded to "CCC" or below within the recession year. The number of "CCC" rated entities increased in the third quarter. The entities lowered to the "CCC" or below this year had negative cash flow and decreasing EBITDA. The deterioration of these metrics signals eroding and weakening credit.

U.S. Annual Inflation Rate