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Fitch Ratings: Lifting U.S. Corporate Default Rate Forecasts in 2023 and 2024

Fitch Ratings-New York/Toronto-30 May 2023: Fitch Ratings has raised its U.S. corporates institutional leveraged loan (LL) and high yield (HY) bond default forecasts, reflecting the tighter lending conditions and capital access resulting from stress in the banking sector and inflation uncertainty. These factors, along with higher borrowing costs are meaningful challenges to weaker issuers' ability to address refinancing and liquidity needs. Therefore, we expect an increase in bankruptcy filings and distressed debt exchanges (DDEs).

US LevFin Default Forecasts

High Yield Default Rates (%) | Leveraged Loan Default Rates (%)

Year	May 2023	Jan. 2023
2020 (actual)	5.2	5.2
2021 (actual)	0.5	0.5
2022 (actual)	1.3	1.3
2023F	4.5-5.0	3.0-3.5
2024F	3.5-4.5	3.0-4.0
Cumulative (2023F-2024F)	8.75	6.75

F – Forecast. Cumulative based on forecast mid-points.
Source: Fitch Ratings

We have raised our 2023 HY bond default rate forecast to 4.5%-5.0% in 2023 from 3.0%-3.5%. Since January, on a net basis, we have added $8.6 billion and $29.3 billion of bonds, respectively, to our Top Market Concern and Tier 2 Market Concern. Tier 2 bond list growth is largely due to the addition of DISH DBS ($15 billion of bond par value), Community Health ($12 billion) and Lumen Technologies ($6.6

billion). We added 0.5 percentage points to the low and high ends of our revised 3.5%-4.5% 2024 HY bond default rate forecast. We expect the cumulative 2023-2024 HY bond default rate to total 8.75% at the forecast mid-points, well below the 22% during 2007-2009.

Our 2023 LL default rate forecast is now 4.0%-4.5%, up from 2.5%-3.0%, previously. We increased our 2024 LL default rate forecast to 3.5%-4.5% from 3.25%-4.25%. Our forecasts imply the cumulative 2023-2024 LL default rate will total 8.25% at the forecast mid-points compared to 14% during 2007-2009.

The May TTM loan default rate advanced to 2.6% from 2.2% in April 2023, reflecting recent defaults by borrowers including Envision, Venator, QualTek and Monitronics. Year-to-date through May, loan default volumes totaled $25.8 billion, compared with $7.8 billion for the same period in 2022.

Market Concern Loans as a Percent of Market

($ Bil.)	Top Market Concern Loans	Tier 2 Market Concern Loans	Other Market At-Risk Loan Issuers	Total	Total Percent of Market
5/22	34.9	64.2	83.6	182.6	10.7
6/22	33.2	62.2	82.5	178.0	10.4
7/22	33.4	69.4	90.1	192.9	11.3
8/22	33.6	67.8	94.9	196.3	11.5
9/22	29.6	75.1	96.6	201.3	11.8
10/22	34.0	80.5	113.5	228.0	13.5
11/22	37.3	79.6	124.3	241.2	14.3
12/22	45.3	73.3	129.0	247.5	14.7
1/23	46.7	68.1	137.6	252.5	15.0
2/23	50.1	66.5	137.8	254.4	15.2
3/23	45.5	65.3	140.4	251.2	15.0
4/23	51.2	77.0	133.6	261.8	15.7
5/23	59.7	74.0	123.0	259.0	15.6

Source: Fitch Ratings U.S. Leveraged Loan Default Index.

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The Top Market Concern Loan amount has increased to $59.7 billion from $51.2 billion in April, despite the removal of the recent bankruptcy filers, including those noted above. The healthcare/pharma sector comprises the largest amount of Top Market Concern Loan List loans at 30% by par, followed by the entertainment and leisure sector (11%) and Technology (10%). There are 20 issuers on the Top Market

Concern Loan List with loans outstanding greater than $1.0 billion, with the three largest, Brand Energy & Infrastructure Services, Team Health, and Bausch, comprising 13.2% of the volume.

Top Five Sector Exposure as Percent of U.S. Top Market Concern Loans

By Loan $ Volume | By Issuer Count

Industry	(%)
Healthcare and Pharma	30
Leisure and Entertainment	11
Technology	10
Telecommunications	9
Building Materials	8

Note: Percentage takes the amount outstanding from the Top Market Concern Loan list divided by the total amount outstanding, or $59.7 billion.

Source: Fitch Ratings U.S. Leveraged Loan Default Index.

We have added 20 issuers with $17.7 billion of loan volume to our Top Market Concern Loan List since last month. Brand Energy and Infrastructure Services was the largest addition with $2.8 billion of loans. Low ratings and large 2024 maturities were key reasons for adding Brand to the Top Concern list. We added $2.3 billion of GoTo Group loans based on low secondary bids and weak performance. Lifescan was the third largest addition to our Top Concern list at $1.8 billion, based on the company's tight liquidity position.

Our Tier 2 Concern list dipped lower to $74 billion in May from $77 billion in April, primarily due to several large Tier 2 names (i.e., Brand Energy and GoTo Group) transitioning to the Top Concern list. However, the Tier 2 Concern list continued to grow by issuer count, reflecting the rise in issuers facing liquidity pressures, including declining EBITDA and negative FCF, as well as those expected to undertake DDEs.

The broader, overall Market Concern total stands at $259 billion, which represents 15.6% of the LL market, up from 10.7% a year earlier.

Contacts:

Judah Gross

Senior Director, US Leveraged Finance

+1 212 908-0884

Fitch Ratings, Inc.

33 Whitehall St.
New York, NY 10004

Ernest Tam
Senior Analyst, U.S. Leveraged Finance
+1 647 933-0260

Lyuba Petrova
Managing Director, U.S. Leveraged Finance
+1 646 582-4885

Stephen Boyd, CFA
Senior Director, Fitch Wire
+1 212 908-9153

Media Relations: Elizabeth Fogerty, New York, Tel: +1 212 908 0526, Email: elizabeth.fogerty@thefitchgroup.com

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