Global Debt Monitor Insights
Growing risks in the U.S. corporate sector

INSTITUTE OF INTERNATIONAL FINANCE

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Khadija Mahmood, Associate Economist, Global Policy Initiatives, kmahmood@iif.com, +1 202 857 3309
Emre Tiftik, Deputy Director, Global Policy Initiatives, etiftik@iif.com, +1 202 857 3321
Editor: Sonja Gibbs, Managing Director, Global Policy Initiatives, sgibbs@iif.com, +1 202 857 3325

- With softening profit margins and high debt levels, some parts of the U.S. corporate sector are looking more vulnerable
- Significant shift to bond market funding since 2008 along with less reliance on bank loans (though 2018 saw an uptick)
- Firms in the utilities and real estate sectors tend to have particularly high debt-to-cash levels
- Many firms in the health care sector are experiencing more difficulty covering interest expense, though large cash holdings provide some buffer. Many firms in real estate sector also have weak interest coverage ratios—but without such buffers.

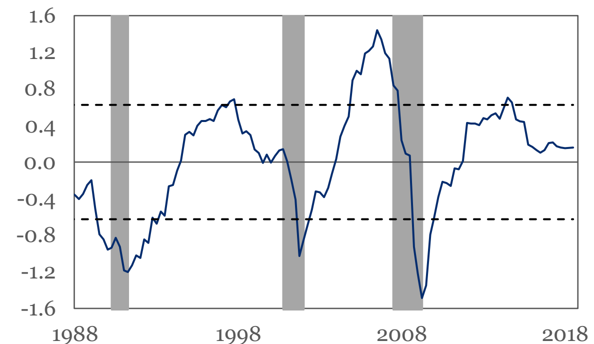
Our Financial Strengths and Vulnerabilities (FSV) index suggests that the current business cycle in the U.S. is gradually nearing its end: With debt in the non-financial business sector growing faster than underlying economic growth, greater reliance on short-term debt and declining profit margins, our U.S. FSV index highlights a range of corporate financial vulnerabilities (Chart 1).

Rapid rise in non-financial business debt: At over 46% of GDP, U.S. non-financial corporate business debt is 4 percentage points higher than it was at the onset of the 2007/8 financial crisis (Chart 2). Most of the increase is due to rapid growth in bond issuance—debt securities outstanding have risen over 7 percentage points to more than 30% of GDP. In contrast, though it has picked up recently, bank lending to non-financial corporate businesses stands at just 16% of GDP, down from almost 20% at the onset of the 2007/8 financial crisis (Chart 3). Small businesses however have taken on less debt—non-financial non-corporate business debt (mostly domestic bank loans) has risen only about 1 percentage point since the financial crisis, bringing total leverage to over 26% of GDP.

Big differences across sectors: A closer look at U.S. non-financial firms listed on U.S. stock exchanges suggests that the utilities and real estate are the most indebted sectors, with high debt/cash ratios of 30x and 16x respectively. In contrast, debt/cash ratios are the lowest in the information technology and health sectors, where relatively large cash holdings provide a buffer against adverse shocks (Charts 4 and 5).

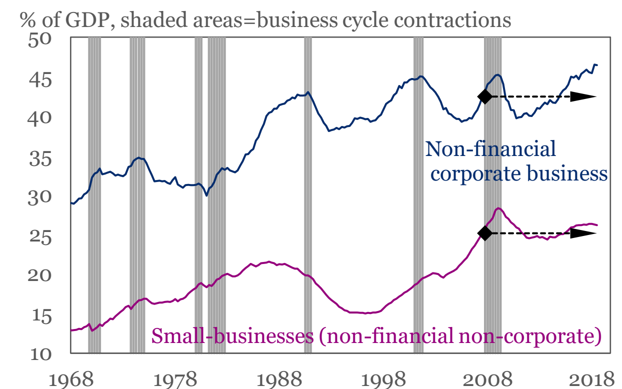
Rising borrowing costs could do serious damage: As markets mull whether the Federal Reserve will pause policy normalization, it is worth noting that an increasing number of medium-to-large U.S. firms are having difficulty servicing debt while many smaller firms look vulnerable to higher short-term borrowing costs and a potential slowdown in corporate earnings growth. Across sectors, the median interest coverage ratio (ICR) is lowest in the real estate, energy, communication services and health care sectors. By asset size, the problem looks more serious in real estate sector, with some 50% of companies falling into the "risk" category with an ICR below 2.

Chart 1: U.S. Business Health Index*



Source: IIF; a weighted average of the first four factor loadings from the twelve variables which summarize U.S. firms' financial strengths and vulnerabilities. Estimation details are available upon request.

Chart 2: Debt in the U.S. Non-Financial Business Sector



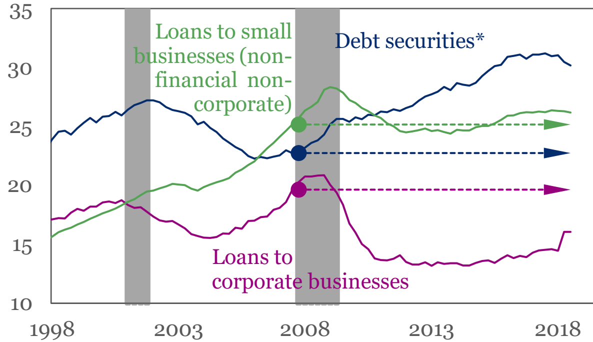
Source: IIF, Fed

Sector level indicators

Reliance on bond market funding has increased sharply since 2008, though 2018 saw a notable uptick in bank lending

Chart 3: U.S. Non-Financial Business Indebtedness

% of GDP, shaded areas=business cycle contractions

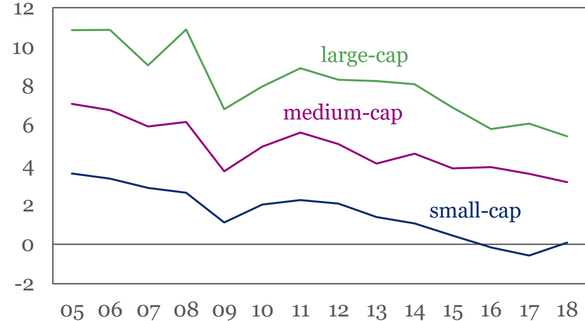


*Source: IIF, Bloomberg; *outstanding debt securities of non-financial corporate businesses*

Smaller firms having a hard time servicing debt from current earnings

Chart 6: Interest Coverage Ratios, by market cap

ratio, Interest coverage ratio (EBIT/Interest expense), median of each category

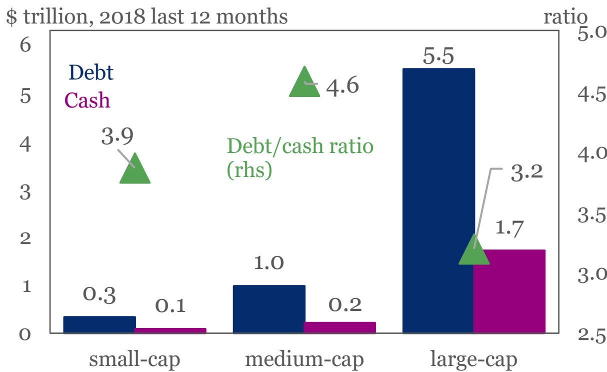


Source: IIF, Bloomberg

Large firms have most of the debt—but also bigger cash buffers

Chart 4: Debt to Cash Ratios, by market cap

$ trillion, 2018 last 12 months

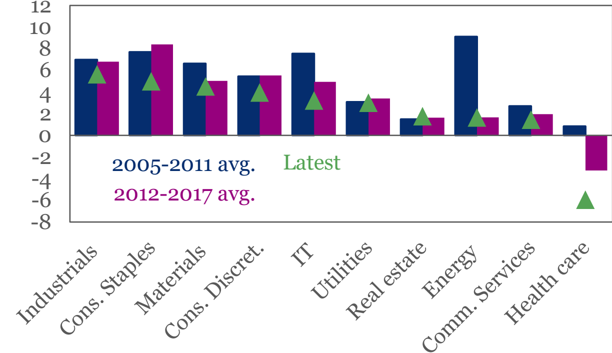


Source: IIF, Bloomberg

Weak earnings and high debt levels in the health care sector have pushed interest coverage ratios to very low levels

Chart 7: Interest Coverage Ratios, by sector

ratio, interest coverage ratio (EBIT/Interest expense)

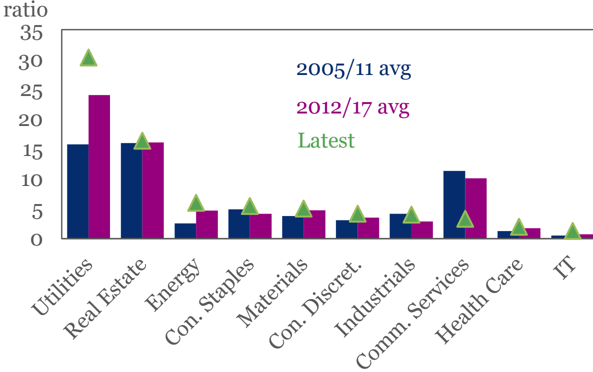


Source: IIF, Bloomberg

Utilities and real estate sectors have high debt/cash levels

Chart 5: Debt to Cash Ratios, by sector

ratio

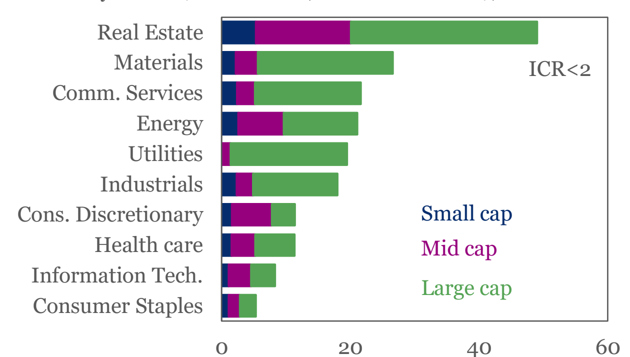


Source: IIF, Bloomberg

The real estate sector has a high incidence of stressed firms

Chart 8: Distribution of Stressed Firms (ICR<2)

% of "risky" firms (with ICR < 2, % of sector assets), 2018 ltm



Source: IIF, Bloomberg

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Appendix: IIF firm level debt data

We used the EQS function (EQS <go>) on Bloomberg to retrieve firm-level debt data metrics. We focused on firms listed on each countries' domestic stock exchanges (Table 1). Firm groups are segmented by market capitalization: small cap (firms with capitalization of less than $1 billion), mid cap (between $1 and $5 billion) and large cap (larger than $5 billion).

Table 1: Detailed information on sectoral breakdown

# of firms	Small cap	Medium cap	Large cap	Total
Consumer Discretionary	201	128	80	409
Consumer Staples	51	37	41	129
Energy	111	49	35	195
Health care	488	141	87	716
Industrials	207	162	95	464
Information Technology	219	148	123	490
Materials	51	45	35	131
Real Estate	64	87	58	209
Communication Services	59	38	36	133
Utilities	12	25	38	75
Total	1463	860	628	2951

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