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Corporate debt loads a rising risk as virus hits economy

By PAUL WISEMAN, BERNARD CONDON and CATHY BUSSEWITZ12 minutes ago

WASHINGTON (AP) — A gyrating stock market is seizing headlines as the coronavirus threatens corporate profits and economic growth. Yet it's in the normally temperate bond market, where companies go to borrow money, where the gravest dangers may lurk.

Investors fear that businesses that have borrowed heavily, especially energy, airline and cruise line companies, will struggle to pay their debts as customers cancel trips and hunker down at home. The shutdown of normal business is shrinking demand for energy in particular, sending oil prices sinking and intensifying pressure on indebted oil-and-gas production firms.

The numbers are enormous.

Having binged on borrowing, companies that are outside the financial sector owe $9.6 trillion in the United States — up more than 50% in a decade. Worldwide, companies have issued $13 trillion in bonds, according to the Organization for Economic Cooperation and Development. That's twice what they owed in the financial crisis year of 2008. Corporate debt in China alone has soared from virtually nothing to $590 billion.

Add in what companies owe banks and other creditors, and their debts come to $75 trillion worldwide, up from $32 trillion in 2005, the Institute of International Finance says.

Struggling to meet debt payments under the pressure of a virus-induced economic slump, companies are more likely to lay off workers, delay investments and cut costs. All of which could deepen any economic downturn.

Still, optimists note that banks are far healthier than they were in 2008, when millions of homeowners were saddled with mortgages they couldn't pay. And central banks are striving to limit the damage. The Federal Reserve has stepped up its daily short-term lending to help businesses meet short-term financing needs such as meeting payrolls.

"I don't think we have anything shaping up like 2008 or 1929, particularly in the United States," said Kenneth Rogoff, a Harvard economist who has written about the history of financial crises.

Over the past decade, though, companies have borrowed heavily to capitalize on record-low rates. Many have used the proceeds not to hire or expand but to issue dividends to shareholders or to buy back their own stock.

The strain is showing. In the United States, the bonds of such iconic names as Macy's and Kraft Heinz have been downgraded to junk status.

Companies had been selling tens of billions in new bonds each month. That pace ground to halt in late February. Companies started canceling sales as investors balked at buying corporate bonds. In the last week of that month, no U.S. company sold new bonds, according to S&P Global Ratings. That’s virtually unheard of outside of a holiday or an emergency like the financial crisis.

The canceled sales coincide with perilous times for many companies. Oxford Economics has warned that nearly $4 trillion of U.S. corporate bonds will come due within five years — a “massive wall of maturities,” it calls it.

Corporate America has used new bond sales to pay off old bond holders, akin to homeowners during the housing bubble paying off their mortgages with proceeds from new mortgages. Now, the corporate refinancing cycle is shuddering.

“High debt levels make the corporate sector in key economies, including the U.S., particularly vulnerable to the sharp slowdown in global economic activity,” said Eswar Prasad, a former top economist at the International Monetary Fund official who teaches at Cornell University.

On Wall Street, the corporate bond market turned chaotic this week when a standoff between Saudi Arabia and Russia sent oil prices plunging 25% Monday, the biggest drop since the 1991 Persian Gulf War.

“I’ve never seen anything like this in 30 years of trading,” said John Dixon, who trades junk bonds at Dinosaur Financial Group. “People are confused.”

The U.S. energy industry is especially vulnerable.

“That’s been a ticking time bomb,” said Alexis Crow of the consultancy PwC.

The shale boom, which catapulted the U.S. into the world’s largest oil producer once companies learned to extract oil cheaply from shale rock formations, was fueled largely by debt. Many of those bills will come due in the next few years. With now-shrunken oil prices and high bond yields, many of the smaller operators won’t be able to repay loans or refinance.

In an industry where 200-plus oil producers filed for bankruptcy protection in the past five years, more such filings are expected, especially among small companies. Analysts were expecting companies to struggle to repay debts when oil was around $50 a barrel. This week, it’s been trading between $30 to $35.

“This industry has funded the shale gale with cheap and available credit for 10 to 15 years,” said Hassan Eltorie, director at IHS Markit. “Now that cheap and available credit is no longer there.”

The 88 oil and gas producers tracked by IHS, large and small, have a combined debt load of about $225 billion, Eltorie said.About a third of outstanding debt is coming due within four years.

Borrowing costs will be especially high for gas-focused producers because of the bleak outlook for natural gas prices, according to IHS Markit. Smaller companies focused on natural gas were already struggling with high debt loads and low gas prices. Chesapeake Energy, a shale producer that's long struggled to contain costs amid falling natural gas prices, saw its bonds due in the next three years trading at 25 cents to 35 cents on the dollar Wednesday.

Overall, the quality of corporate bonds has deteriorated in recent years, suggesting more defaults ahead. Companies worldwide have issued $3.6 trillion in bonds rated "BBB" — one notch above junk. BBB bonds account for 54% of investment-grade corporate bonds, up from 30% in 2008.

If ratings agencies downgrade BBB-rated bonds to junk, many investors will seek to sell them, putting even more pressure on markets. On Wednesday, the Standard & Poor's ratings agency reduced the bonds of Sabre Corp., which makes airline ticketing technology, to junk status, saying that damage from the virus would hurt cash flow.

With the market so volatile, some bond investors can't find buyers, raising the prospect of a "liquidity crisis" similar to the 2008 financial crisis. Prices plunged as investors ran for the exits.

"The economy is sort of shutting down, and that is real problem," said Michael Lewitt, who's been trading debt since the 1980s. "This is truly systemic in a way that we haven't seen since 2008."

Money manager Marilyn Cohen is telling her clients with bonds to stay calm and ride out the storm and not force her to sell in a market with so few buyers. But not everyone is listening.

"One lady said she wanted to sell, and I said, 'To who?'" Cohen recalled.

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Condon and Bussewitz reported from New York.

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AP Business Writers Stan Choe in New York and Martin Crutsinger in Washington contributed to this report.