High-Yield Corporate Bonds

Evidence of Monetary Policy Lags in the High-Yield Market

More impact from tighter monetary policy ahead as debt rolls over.

Given its sensitivity to economic cycles, the high-yield market has faced heightened scrutiny throughout the year. Concerns over tightening financial conditions and the looming specter of a recession have stoked fears of higher defaults, which have indeed seen an increase. According to Bank of America research, the 12-month par-weighted high-yield default rate ended September at 2.5 percent, up from 1.5 percent at the end of 2022.

The positive economic backdrop has supported healthy high-yield credit fundamentals. Public filing data show that the sector's aggregate interest coverage ratio (EBITDA/interest expense) remains slightly above 5x as of the second quarter while gross leverage (debt/EBITDA) is a manageable 4.5x. Upside surprises in economic data have further contributed to narrowing credit spreads in the third quarter to 416 basis points, with market-implied forward default rates reflecting a soft-landing scenario. The fourth quarter is likely to see spreads remain rangebound given this momentum, although heightened geopolitical tensions in the Middle East present a very meaningful risk that credit spreads could widen.

The high-yield sector's resilience to rising interest rates can be attributed in part to the fixed-rate nature of its debt and the lag with which issuers can adapt to market interest rates if they consider them unattractive. The average yield on newly issued BB-rated and B-rated bonds this year has been 7.7 percent and 10 percent, respectively, but the average coupon rate on high-yield bonds in the index is only 6.0 percent, ranging from as low as 5.3 percent for BB-rated bonds to 7.5 percent for CCC-rated bonds. It is yet unclear how well high-yield bond issuers will adapt to higher interest rates. Trends in the loan market, where transmission is more immediate, suggest that many issuers could pursue distressed exchanges or explore financing alternative in the private lending channel as borrowers seek better financing terms.

In any event, high-yield issuers face less than $50 billion in maturities in 2024, but this figure rises to about $260 billion when including scheduled 2025 maturities (including index-eligible and non index-eligible U.S. debt). This maturity wall dynamic is the reason that we believe there is still more impact from tighter monetary policy ahead as debt rolls over. Many issuers may find high interest costs unsustainable, and we continue to forecast a default rate of about 5 percent for high-yield corporate bond issuers in 2024.

By Thomas Hauser and Maria Giraldo

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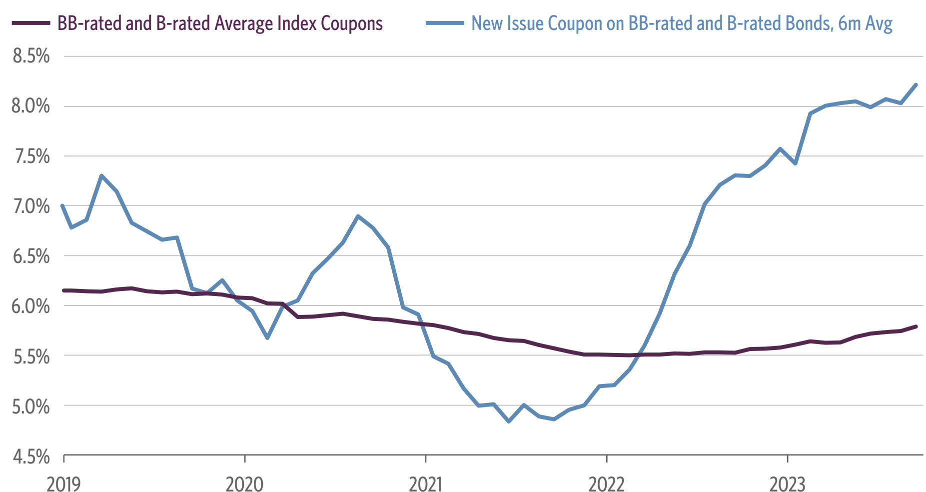
High-Yield Issuers Have Delayed Absorbing High Interest Rates

Average Index Coupons and New Issue Coupons



Source: Guggenheim Investments, S&P LCD, Ice Index Services. Data as of 9.30.2023.

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