

Current State of the Economy and a Look Ahead

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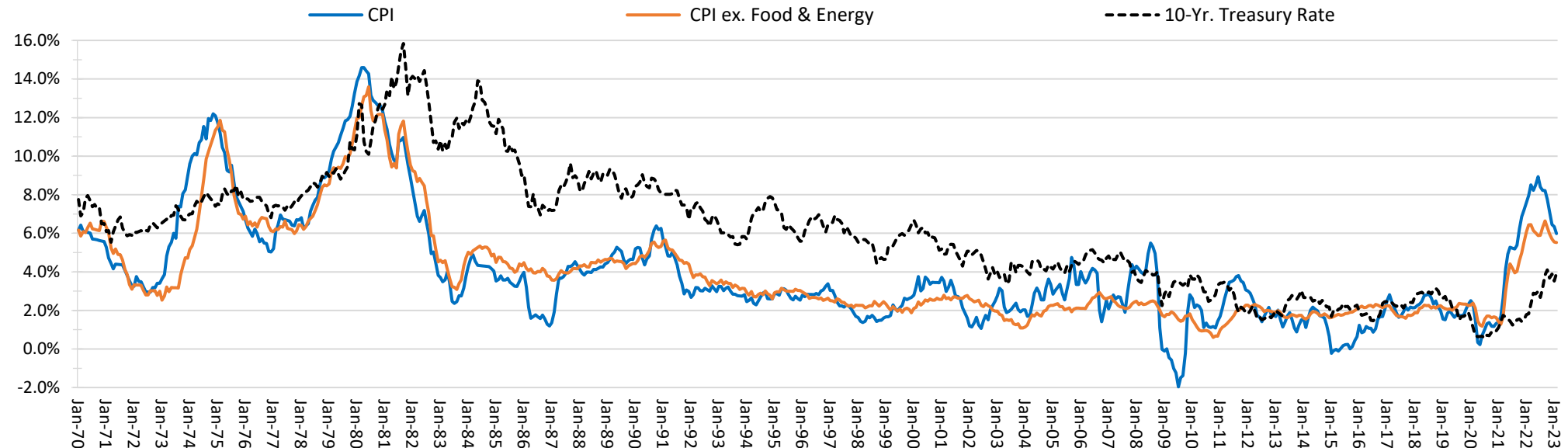
Financial markets selloff since early 2022 reflects reaction to high inflation, economic uncertainties and aggressive Fed tightening

- The Fed has hiked its targeted range for the Fed Funds Rate nine times since March 2022 to 4.75%-5.00% currently, including an unprecedented four consecutive hikes of 75 bps each in 2022. A few smaller rate hikes are expected in 2023.
- Current FOMC Dot Plot shows expected Fed Funds Rate topping out at 5.25% in late 2023 and moving to 4.1% towards the end of 2024.
- Central banks of most major industrialized countries are hiking interest rates to confront inflation globally.
- QT initiatives by the Fed are shrinking its balance sheet by up to \$95 billion monthly, which has also kept upward pressure on interest rates. By early March, the Fed's balance sheet shrunk by \$600 billion from its 2022 peak of \$8.9 trillion.
- Bank failures and depositor panic since mid-March have cast uncertainty over path of monetary policy in the months ahead.
- 3-month LIBOR and SOFR (with credit spread adjustment) rates are approaching 5.0% vs. 0.2% in late 2021, substantially increasing the cost of borrowing for floating rate loans.
- HY bond yields (YTW) have widened by 370 bps (BB), 425 bps (B), and 720 bps (CCC/C) since early 2022.
- Major market indexes are now near their lows of late 2022, with a rally in early 2023 giving way to a selloff in March.
- Prevailing market, business and academic sentiment now expects a mild U.S. recession in mid-to-late 2023.
- Inflation will likely moderate further in 2023 from its peak but will remain elevated and well above the Fed's 2.0% target rate.

Inflation

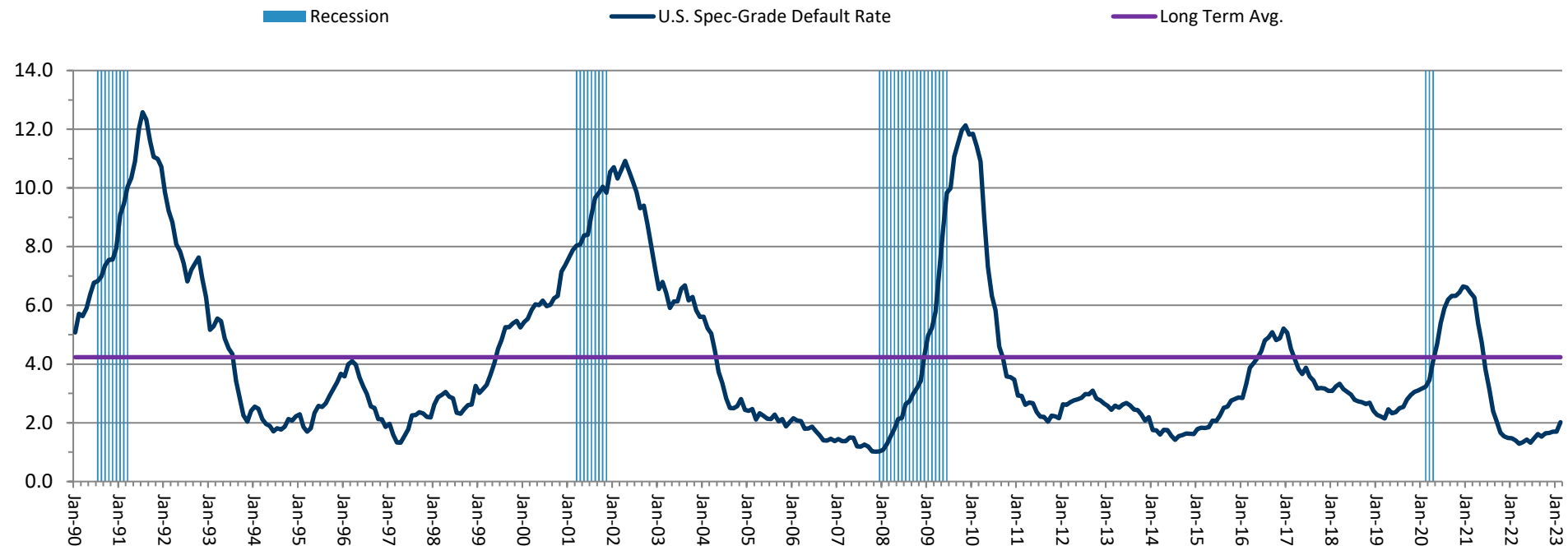
- Although consumer level inflation appears to have peaked at 8.9% in mid-2022, the CPI increase of 6.0% (YOY) in February 2023 is still far above FOMC's target inflation rate of 2.0%, indicating that further Fed tightening is likely.
- Core inflation (excluding food & energy) of 5.5% also remains high even as commodity price increases have subsided.
- Last time U.S. economy experienced high inflation was in the mid-1970's through early 1980's, which was far more severe and chronic. Between 1979-1980, the Fed Funds Rate increased from 11% to 17% in seven months. This was followed by another round of rate hikes from August 1980 through January 1981. These policies resulted in two painful recessions that strangled high inflation, as Fed tightening then was far more severe than currently.
- Ten-year Treasury rate today remains low relative to the rate of inflation and the U.S. dollar remains strong as financial markets apparently don't expect high inflation to persist much past 2023, while the likelihood of recession is high.

U.S. Consumer Price Indices



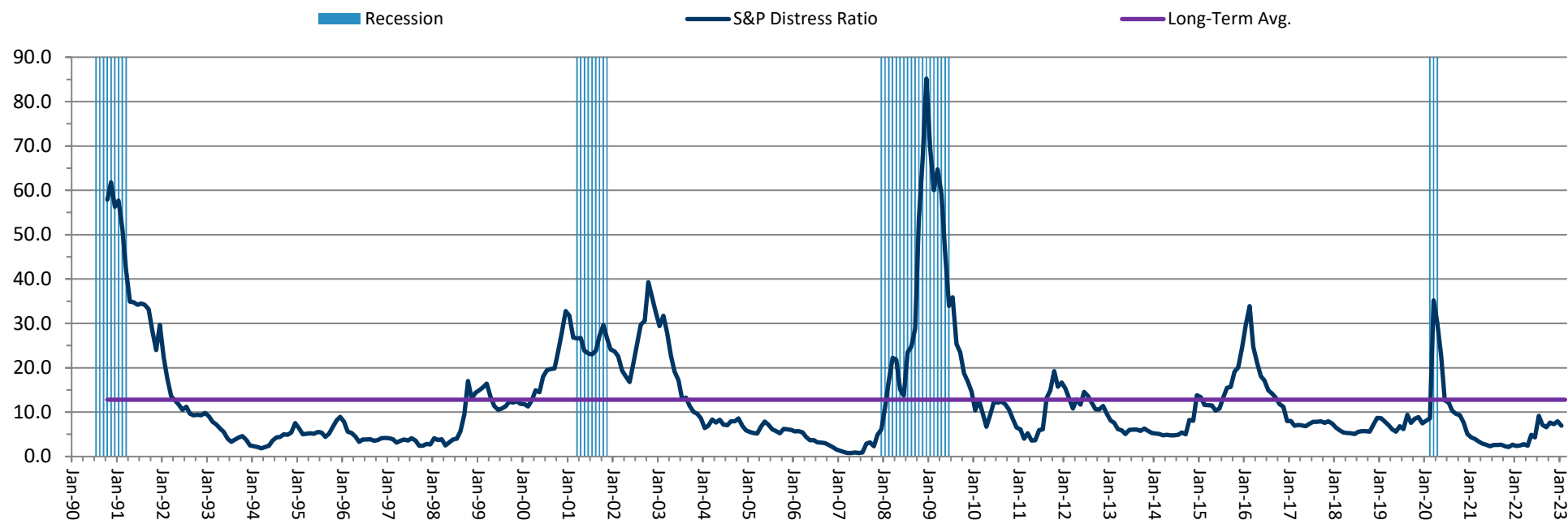
Speculative-Grade Default Rate

- **S&P recently revised its base case speculative-grade default rate forecast to 4.0% by the end of 2023**, slightly higher than its previous forecast, vs. a current default rate of 2.0%.
- Moody's baseline global default rate forecast is 4.4% by year end and peaking at 4.6% in early 2024.
- Rated debt defaults have increased notably in the most recent quarter from exceptionally low levels for most of 2022. **The major rating agencies expect elevated default activity in 2023 but nothing resembling a full-on default cycle.**



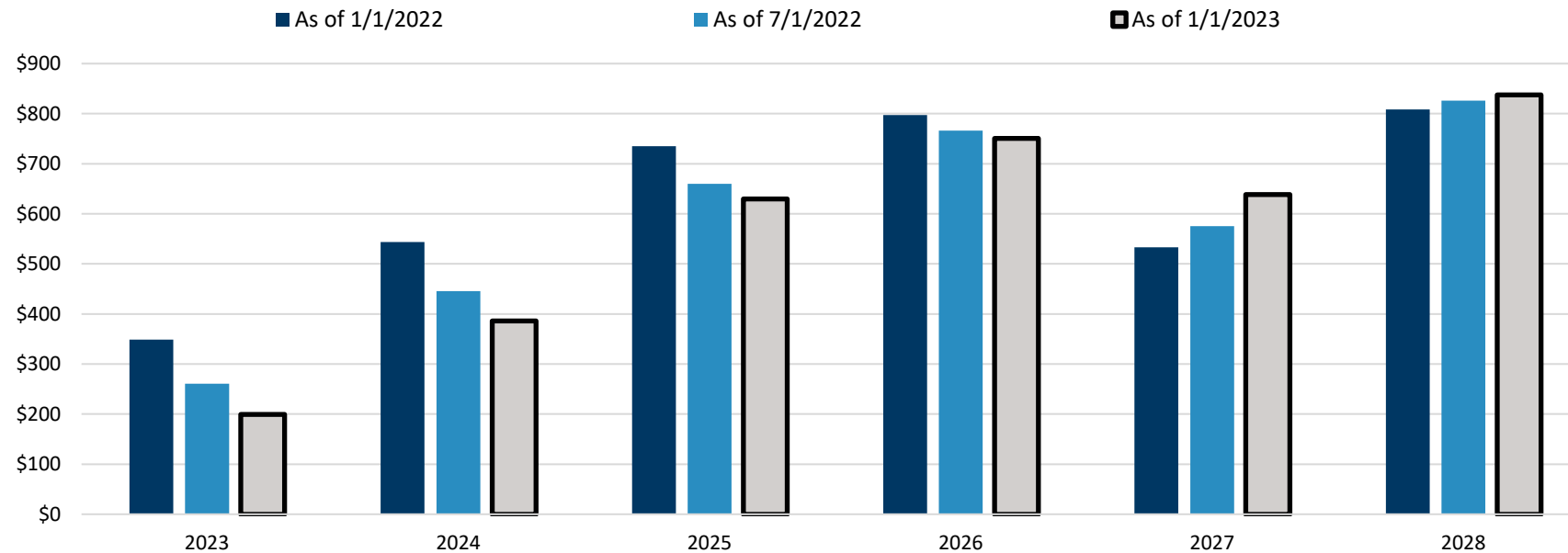
Distressed Debt Ratio

- S&P's distressed debt ratio is **near 8.0% currently** compared to a **7-year low of 2.4% in April 2022** but far less than the spike to 35.0% early in the pandemic and below its long-term average of 12.5%.
- There is **\$85 billion (135 issues) of S&P rated distressed debt currently** vs. \$115 billion (186 issues) in mid-2022 and just \$28 billion (58 issues) at the end of 2021.
- Healthcare leads all industry sectors with a distressed debt ratio of 17% while Media & Entertainment accounts for the largest number of distressed issues.



Global Spec-Grade Corporate Maturity Wall (\$B)

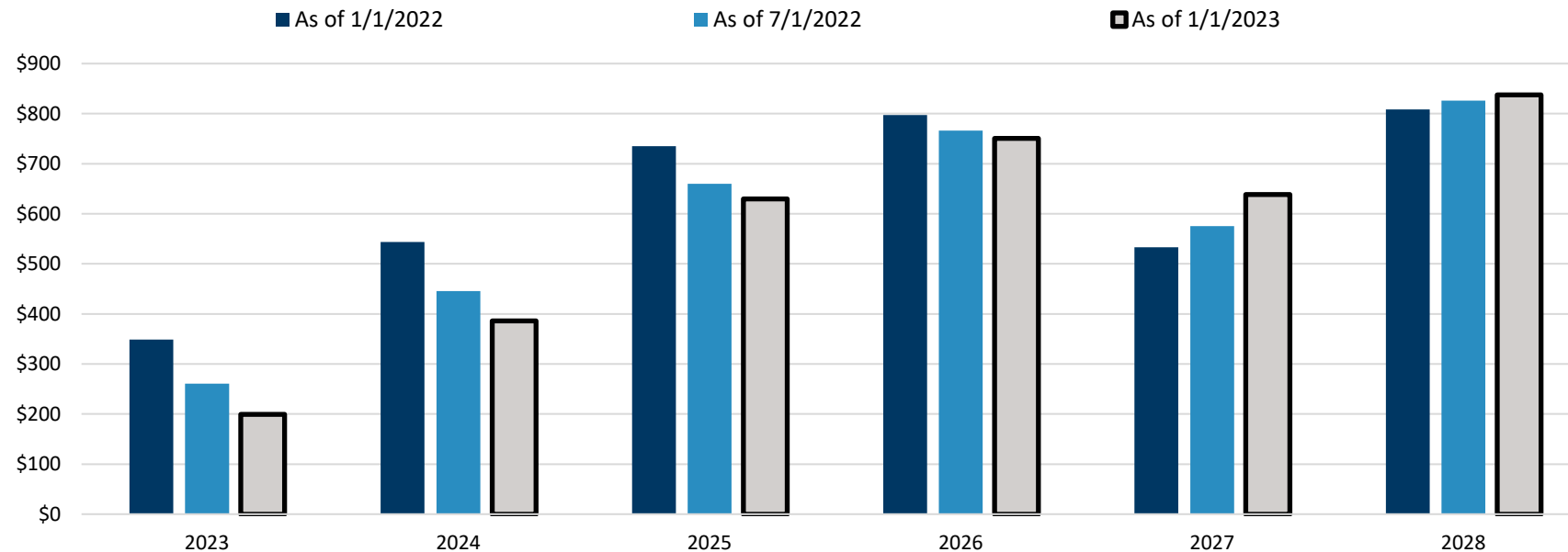
- Speculative-grade issuers took advantage of wide-open leveraged credit markets in **2021 to refinance several hundred billion dollars of debt originally scheduled to mature in 2022-2023**
- Globally, **more than \$400 billion of scheduled speculative-grade corporate debt** maturities in 2023-2025 was **refinanced over the past year**.
- Current U.S. speculative-grade debt maturities of \$115 billion in 2023 is a modest total.
- Speculative-grade debt maturities do not become sizeable until 2025.





U.S HY Bond & Leveraged Loan Issuance (\$B)

- Leveraged debt issuance **fell precipitously in 2022** as rising interest rates greatly reduced refinancing activity and made borrowing costs considerably more expensive than in 2020-2021.
- **Leveraged credit markets are not frozen but have become more selective**, while many borrowers balk at the high cost of credit in today's markets.
- **Spec-grade issuance volumes have stalled since early March** as banking system concerns spook credit markets while issuers wait to see if a Fed pause, or pivot is coming.



2022 Bankruptcy Statistics

According to statistics released by the Administrative Office of the U.S. Courts –

- Bankruptcy filings fell 6.3% for the 12-month period ending December 31, 2022. (December was the busiest month for filings. The rate of corporate filings for bankruptcy in the first nine months was off 14% from 2021.)
- Annual bankruptcy filings in calendar year 2022 totaled 387,721, compared with 413,616 cases in 2021.
- Business filings fell 6%, from 14,347 to 13,481 in the year ending December 31, 2022.
- Chapter 11 cases increased 1.7%, to 4,918, compared with 4,836 in the previous year.

30% of bankruptcies that filed in the first half of 2022 were financial, insurance, and real estate companies, according to a report by Cornerstone Research on bankruptcy trends among large corporations.

**BUSINESS AND NON-BUSINESS FILINGS,
YEARS ENDING DECEMBER 31, 2018-2022**

Year	Business	Non-Business	Total
2022	13,481	374,240	387,721
2021	14,347	399,269	413,616
2020	21,655	522,808	544,463
2019	22,780	752,160	774,940
2018	22,232	751,186	773,418

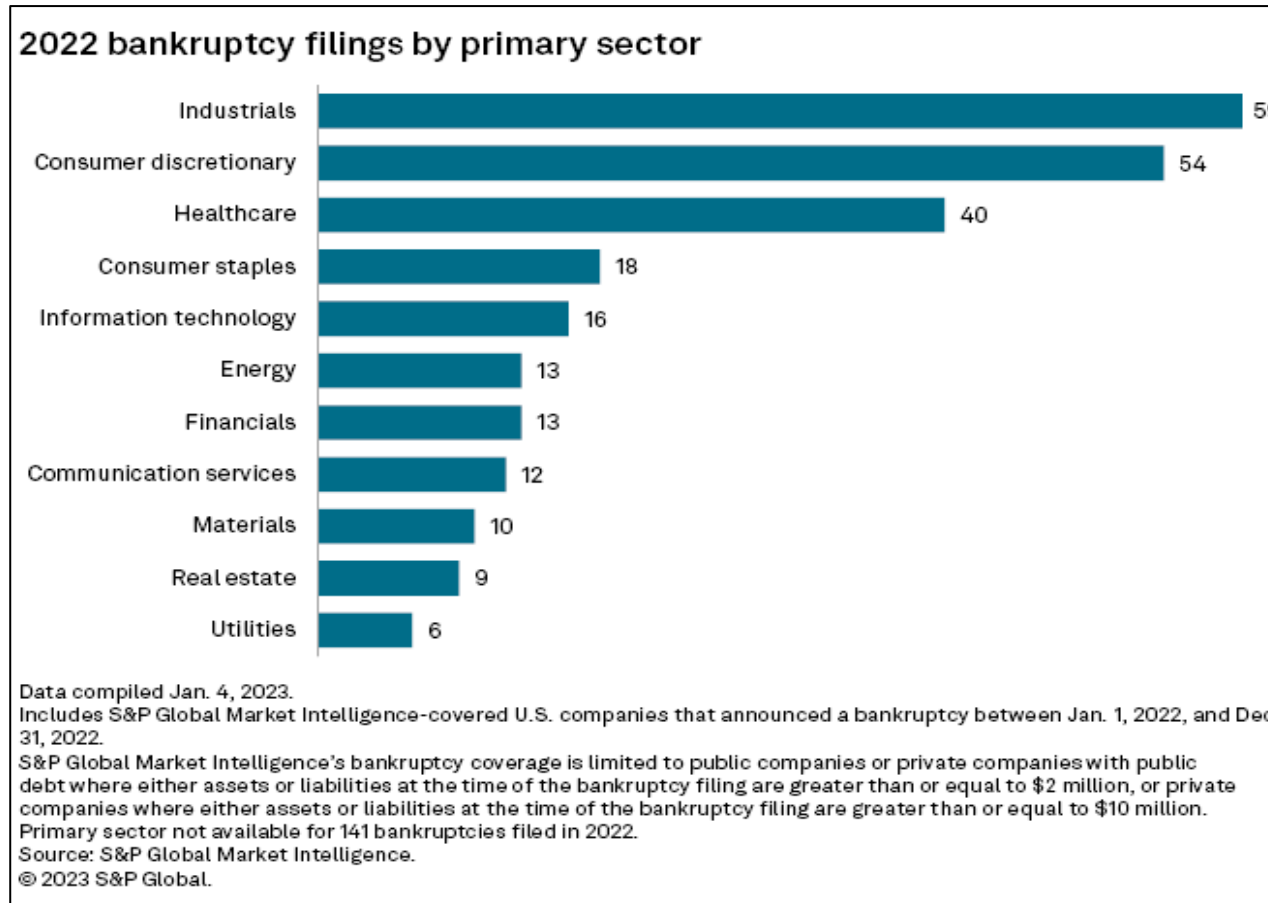
*See [Bankruptcy Filing Drop 6.3 Percent](#), Administrative Office of the U.S. Courts, [Bankruptcy Filings Drop 6.3 Percent | United States Courts \(uscourts.gov\)](#) (Feb. 6, 2023).

**TOTAL BANKRUPTCY FILINGS BY CHAPTER,
YEARS ENDING DECEMBER 31, 2018-2022**

Year	Chapter			
	7	11	12	13
2022	225,455	4,918	169	157,087
2021	288,327	4,836	276	120,002
2020	378,953	8,333	560	156,377
2019	480,206	7,020	599	286,979
2018	475,575	7,095	498	290,146

*See [Bankruptcy Filing Drop 6.3 Percent](#), Administrative Office of the U.S. Courts, [Bankruptcy Filings Drop 6.3 Percent](#) | [United States Courts \(uscourts.gov\)](#) (Feb. 6, 2023).

2022 Bankruptcy Filings by Sector



*See Michael O'Connor and Chris Hudgins, [US Corporate Bankruptcy Filings Sink to New Low in 2022](https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-bankruptcy-filings-sink-to-new-low-in-2022-73708392#:~:text=The%20pace%20of%20U.S.%20corporate%20bankruptcies%20fell%20to,2010%2C%20according%20to%20S%26P%20Global%20Market%20Intelligence%20data), S&P Global Market Intelligence, <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-bankruptcy-filings-sink-to-new-low-in-2022-73708392#:~:text=The%20pace%20of%20U.S.%20corporate%20bankruptcies%20fell%20to,2010%2C%20according%20to%20S%26P%20Global%20Market%20Intelligence%20data> (Jan. 6, 2023).

Largest Bankruptcies of 2022

Largest bankruptcies of 2022				
Bankruptcies with more than \$1 billion in liabilities				
Company	Primary sector	Bankruptcy announcement date	Liabilities at initial filing (\$M)	Assets at initial filing (\$M)
Core Scientific Inc.	Information technology	12/21/22	More than 1,000	More than 1,000
AIG Financial Products Corp.	Financials	12/14/22	More than 1,000	100-500
Reverse Mortgage Investment Trust Inc.	Financials	11/30/22	More than 1,000	More than 1,000
BlockFi Inc.	Information technology	11/28/22	More than 1,000	More than 1,000
Vital Pharmaceuticals Inc.	Consumer staples	10/10/22	1,175.5	710.0
Carestream Health Inc.	Healthcare	08/23/22	More than 1,000	More than 1,000
OSG Group Holdings Inc.	Information technology	08/06/22	More than 1,000	500-1,000
Aearo Technologies LLC	Information technology	07/26/22	More than 1,000	More than 1,000
Celsius Network LLC	Information technology	07/13/22	More than 1,000	More than 1,000
Revlon Inc.	Consumer staples	06/15/22	More than 1,000	18.4
TPC Group Inc.	Materials	06/01/22	1,851.6	0.0
Talen Energy Supply LLC	Utilities	05/09/22	More than 1,000	More than 1,000
GWG Holdings Inc.	Financials	04/20/22	1,799.7	1,567.2
Wireless Systems Solutions LLC	Information technology	03/09/22	More than 1,000	1-10
Data compiled Jan. 4, 2023.				
Includes S&P Global Market Intelligence-covered U.S. companies that announced a bankruptcy between Jan. 1, 2022, and Dec. 31, 2022, with liabilities of \$1 billion or greater.				
S&P Global Market Intelligence's bankruptcy coverage is limited to public companies or private companies with public debt where either assets or liabilities at the time of the bankruptcy filing are greater than or equal to \$2 million, or private companies where either assets or liabilities at the time of the bankruptcy filing are greater than or equal to \$10 million.				
Source: S&P Global Market Intelligence.				
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*See Michael O'Connor and Chris Hudgins, [US Corporate Bankruptcy Filings Sink to New Low in 2022](https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-bankruptcy-filings-sink-to-new-low-in-2022-73708392#:~:text=The%20pace%20of%20U.S.%20corporate%20bankruptcies%20fell%20to,2010%2C%20according%20to%20S%26P%20Global%20Market%20Intelligence%20data), S&P Global Market Intelligence, <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-bankruptcy-filings-sink-to-new-low-in-2022-73708392#:~:text=The%20pace%20of%20U.S.%20corporate%20bankruptcies%20fell%20to,2010%2C%20according%20to%20S%26P%20Global%20Market%20Intelligence%20data> (Jan. 6, 2023).

Factors Driving Restructuring Activities in 2023

- Volatile market conditions
- Increasing interest rates and higher cost borrowing
- Lenders tightening their lending standards; limited credit availability
- Rising inflation
- Supply chain disruptions
- Reduced government support
- Reduced market activity and consumer demand
- Labor shortages; underemployment
- Shift to e-commerce
- Global factors - war in Ukraine, emerging and unstable markets, information vulnerability, pandemic

Supply Chain Issues

Is there contagion in the supply chain?

- The question is important because if a distressed firm can infect other firms, bail outs may be justified
- If the answer is yes, how big is the effect?
- Can we forecast when it is likely to be an issue?

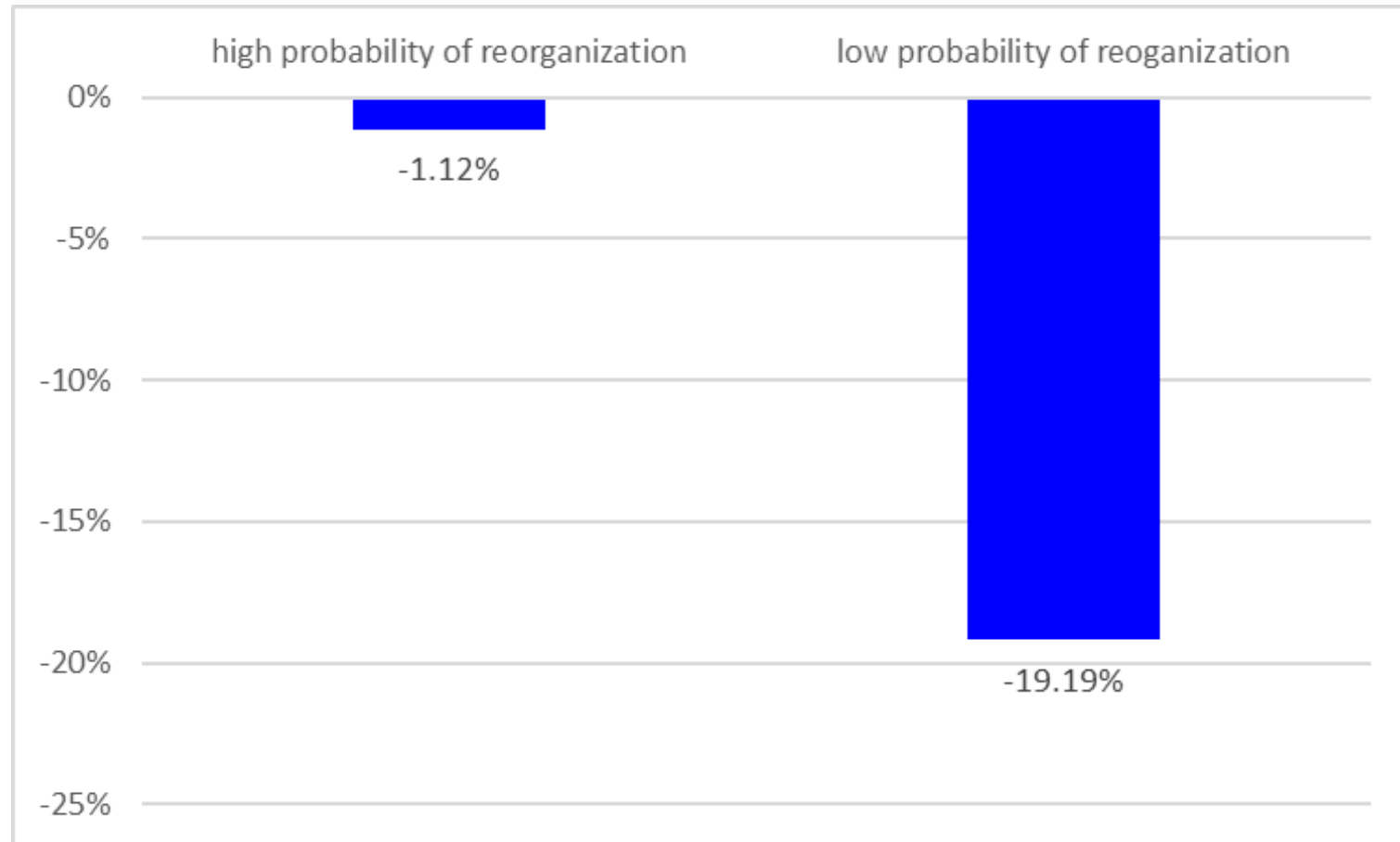
Example: GM, filed June 1, 2009

- Survey results reported in November 2008 found, “...68% of participants in a survey of executives for industry suppliers said their companies would have to downsize if General Motors declared bankruptcy, while 12% said their businesses would likely close or would definitely do so. In the Midwest alone, some 275,000 jobs would be lost as a result of a GM bankruptcy.”
- On March 19, 2009, the Treasury announced the Auto Supplier Support Program, which committed up to \$5 billion of TARP funds for automobile parts suppliers

Silicon Valley and Signature Banks, March 2023

- The FDIC “transferred all deposits—both insured and **uninsured**—...in an action designed to protect all **depositors** of Silicon Valley Bank.” [emphasis added]
- “The transfer of all the deposits was completed under the **systemic risk exception...**” [emphasis added]

Impact on value to suppliers to filing firms



Source: Kolay, Lemmon, Tashjian (2016)

Summary

- There is strong evidence that bankruptcy spills over along the supply chain, both to suppliers to and customers of a failed firm
- However, the effects vary widely and depend on the expected cost of replacing a failed trading partner
- This suggests there may be a limited role for intervening in cases where the potential for contagion is large

Things to consider

- **Collateral costs of allowing firms to fail**
 - Otherwise healthy firms in the supply chain may fail before finding trading partners, adversely affecting employment, taxes, lenders/investors, and infrastructure
 - The national economy may lose important capacity or key competitors
- **Collateral costs of bailouts**
 - It can be healthy to allow marginal firms to fail and redeploy capital more effectively
 - Reduces incentives for trading partners to monitor
 - Encourages management and boards to take excessive risk

2023 Sectors to Watch

- Cryptocurrency Exchanges
- Financial Services
- Automotive / Transportation
- Real Estate / Housing
- Health Services
- Pharmaceuticals and Life Science
- Retail

2023 Financial Bankruptcy Filings

Company	Primary industry	Bankruptcy announced	Liabilities at initial filing (\$M)	Assets at initial filing (\$M)
SVB Financial Group	Regional banks	03/17/23	More than 1,000	More than 1,000
Eletson Finance (US) LLC	Specialized finance	03/07/23	NA	NA
With Purpose Inc.	Regional banks	02/08/23	50-100	500-1,000
Cash Cloud Inc.	Financial exchanges and data	02/07/23	143.1	71.1
Industrial Human Capital Inc.	Asset management and custody banks	02/07/23	NA	NA
SaveSolar Corp. Inc.	Specialized finance	02/02/23	10-50	1-10
World Business Lenders LLC	Specialized finance	01/26/23	NA	NA
Project Verte Inc.	Transaction and payment processing services	01/26/23	100-500	1-10
Genesis Global Holdco LLC	Specialized finance	01/19/23	100-500	100-500

Data compiled March 20, 2023.
 NA = not available; YTD = year to date as of March 19, 2023.
 Includes S&P Global Market Intelligence-covered US financial companies that announced a bankruptcy between Jan. 1, 2023, and March 19, 2023.
 Excludes an involuntary petition for liquidation under Chapter 7 against With Purpose Inc.-related entity Animo Services LLC on Jan. 4, 2023, since the company later filed voluntarily under Chapter 7 on Feb. 8, 2023.
 S&P Global Market Intelligence's bankruptcy coverage is limited to public companies or private companies with public debt where either assets or liabilities at the time of the bankruptcy filing are greater than or equal to \$2 million or private companies where either assets or liabilities at the time of the bankruptcy filing are greater than or equal to \$10 million.
 Source: S&P Global Market Intelligence.
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*See Chris Hudgins, Financial Bankruptcy Filings on the Rise in 2023, S&P Global Market Intelligence, Financial bankruptcy filings on the rise in 2023 | S&P Global Market Intelligence (spglobal.com) (Mar. 23, 2023).

2023 Bankruptcy Filings With Reported Liabilities of at Least \$1 billion

- SVB Financial Group
- Diamond Sports Group LLC
- Serta Simmons Bedding LLC
- Party City Holdco Inc.
- Avaya Inc.

*See Philippa Maister, *Corporate Bankruptcies Rose Dramatically in Q1*, ALM GLOBEST.com, <https://www.globest.com/2023/04/11/corporate-bankruptcies-rose-dramatically-in-q1/> (April 11, 2023).

What to expect in 2023?

- “Year-over-year commercial filings were up 24 percent to 2,305 compared to 1,854 in March 2022. Commercial chapter 11 filings (including subchapter V) increased 79 percent to 548 versus the 306 filings registered the previous year.”
- “Total overall commercial bankruptcies increased 19 percent in the first quarter of 2023, as the 5,733 filings surpassed the 4,808 commercial filings during the first quarter of 2022.”
- “Total commercial chapter 11 filings registered a 77 percent increase to 1,301 during the first quarter of 2023 from the 735 total commercial chapter 11s during the same period in 2022.”

*See Rochelle Daily Wire, Bankruptcy Filings Increase Across All Chapters in March; Commercial Filings Up 79 Percent Year-over-year, AM. BANKR. INST., <https://www.abi.org/newsroom/press-releases/bankruptcy-filings-increase-across-all-chapters-in-march-commercial-filings> (April 3, 2023).