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# The next subprime crisis: Will corporate debt be the culprit?

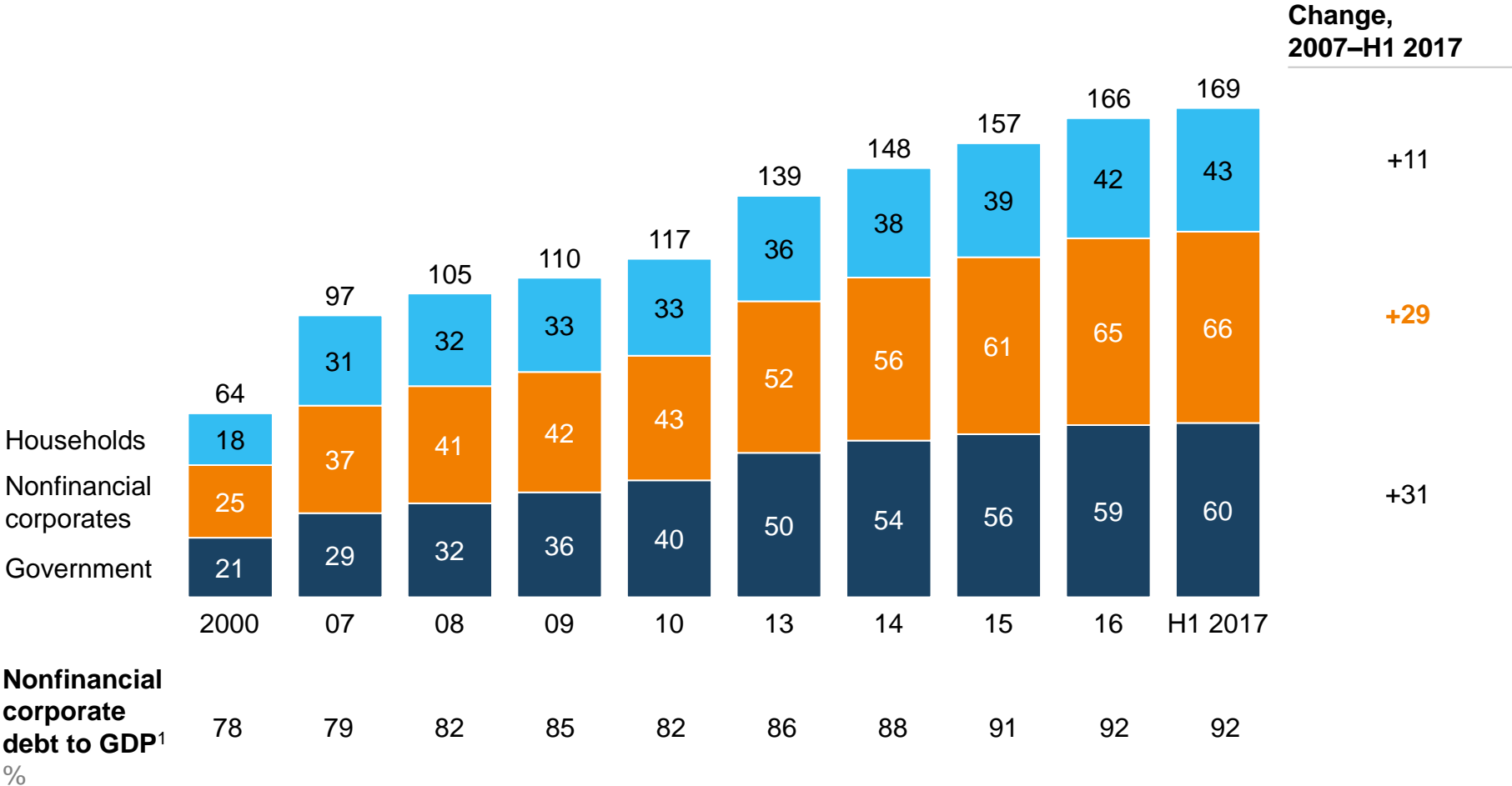
DR SUSAN LUND

September 30, 2018

# Corporate debt has grown by \$29 trillion since 2007 – nearly as much as government debt

## Total debt outstanding<sup>1</sup>

\$ trillion, constant H1 2017 exchange rate

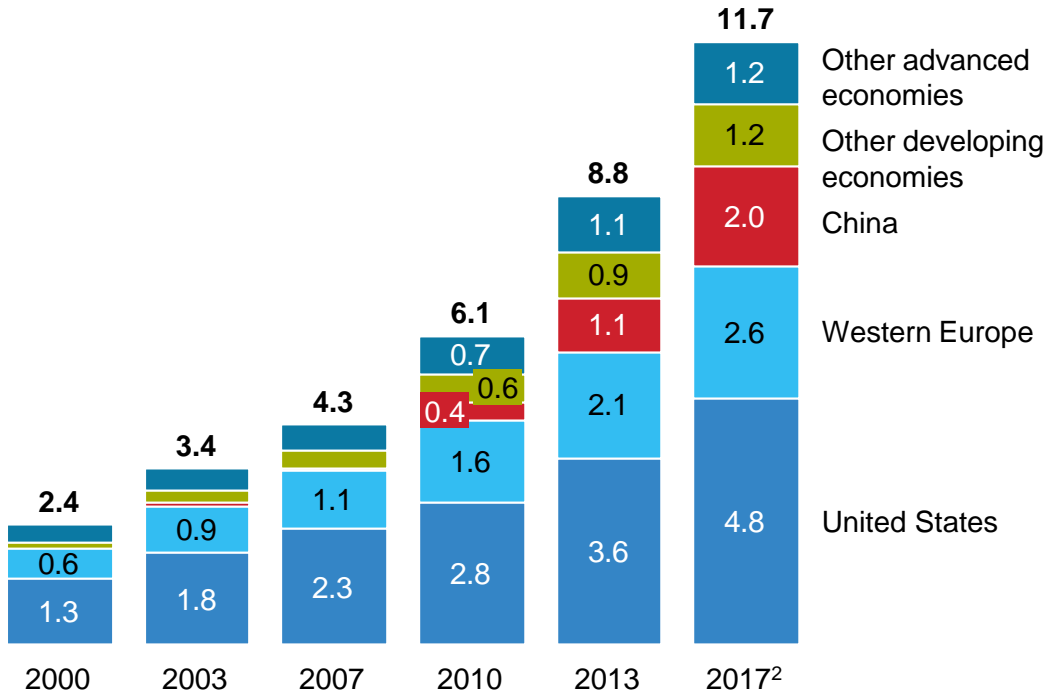


<sup>1</sup> Estimated bottom up using data for 43 countries from Bank for International Settlements (BIS) and data for eight countries from McKinsey's Country Debt Database.  
NOTE: Figures may not sum to 100%, because of rounding.

# Nonfinancial corporate bond markets increased 2.7 times over the past decade

## Global nonfinancial corporate bonds outstanding by region<sup>1</sup>

\$ trillion, nominal exchange rate



### 2007–17

	Compound annual growth rate (CAGR) %	Change \$ trillion
<b>Global</b>	<b>+10.5</b>	<b>+7.4</b>
United States	+7.8	+2.6
Western Europe	+8.6	+1.5
China	+39.9	+1.9
Other developing economies	+14.0	+0.9
Other advanced economies	+7.9	+0.6

**Global nonfinancial corporate bonds outstanding/GDP %**



<sup>1</sup> Bond nationality is based on the location of the headquarters of the parent company of the company issuing bonds.

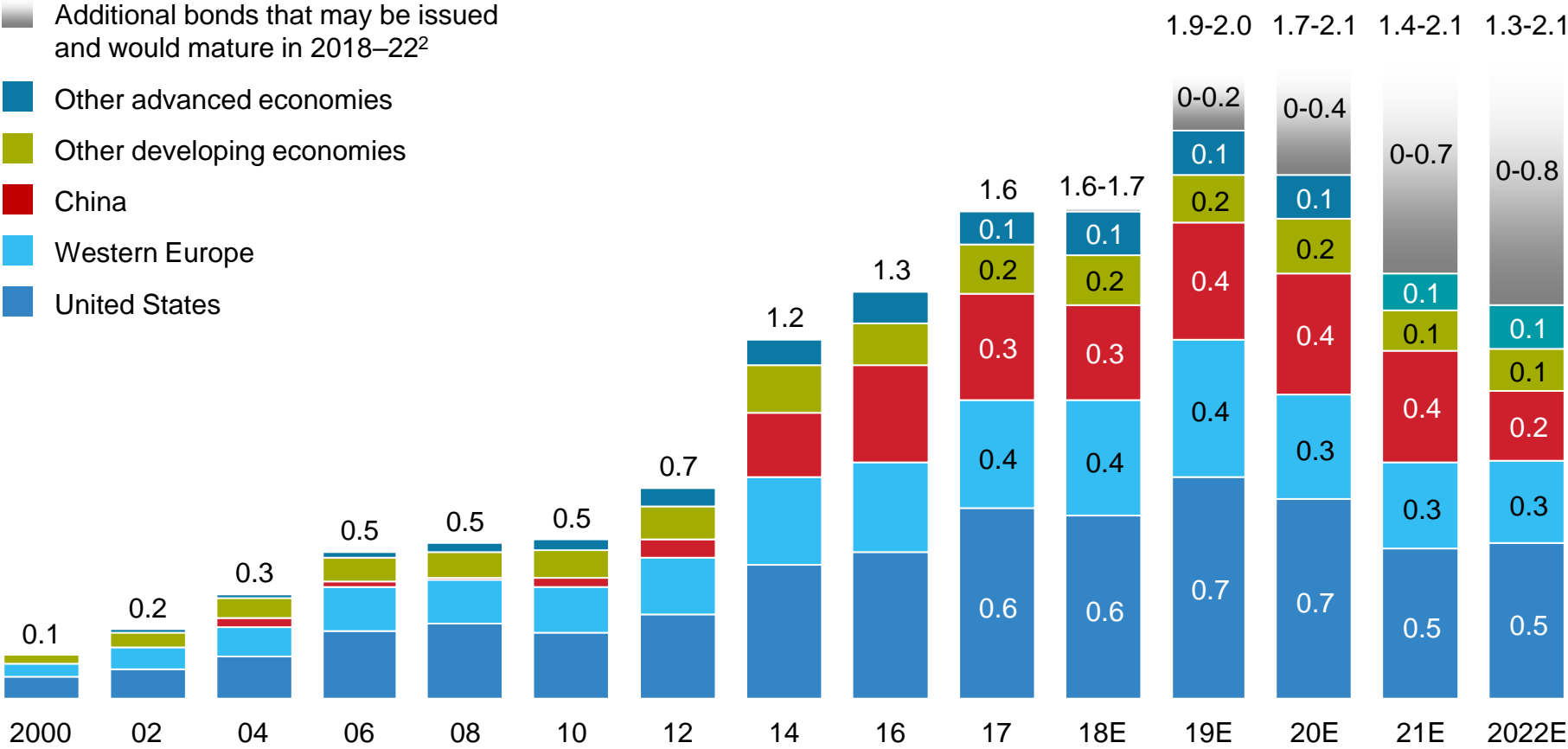
<sup>2</sup> Data as of December 4, 2017.

NOTE: Figures may not sum to 100%, because of rounding.

# A record amount of bonds will need to be refinanced over the next 5 years—up to \$2.1 trillion annually

## Global nonfinancial corporate bonds maturing annually<sup>1</sup>

\$ trillion



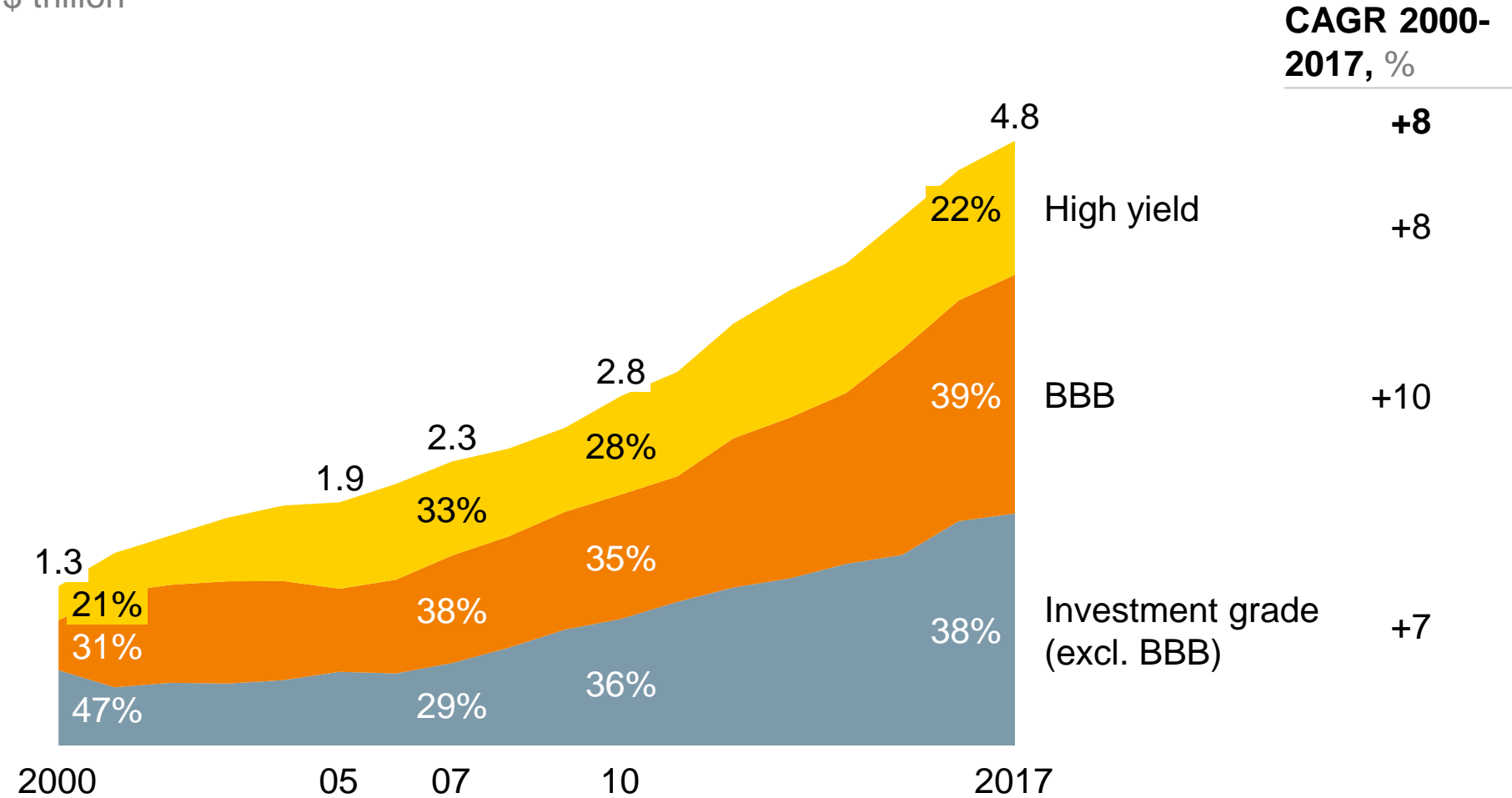
<sup>1</sup> Data as of December 4, 2017.

<sup>2</sup> Bonds of shorter maturities (less than 5 years) may be issued in coming years and would add to the amount maturing each year. We base our projection of the size of these issuances on the historical trend from 2014 to 2017 for each maturity.

NOTE: Figures may not sum to 100%, because of rounding.

# But credit quality could be a problem: BBB-rated and high yield bonds are almost two-thirds of the total

US nonfinancial corporate bonds outstanding based on S&P ratings<sup>1</sup>, \$ trillion



<sup>1</sup> Shares from Morgan Stanley applied to Dealogic numbers

# Our calculations show that pervasive repayment problems are likely for developing economy corporates

Share of bonds outstanding of nonfinancial corporates with EBITDA/interest expense ratio below 1.5

%

Value of bonds outstanding of nonfinancial corporates with EBITDA/interest expense ratio below 1.5

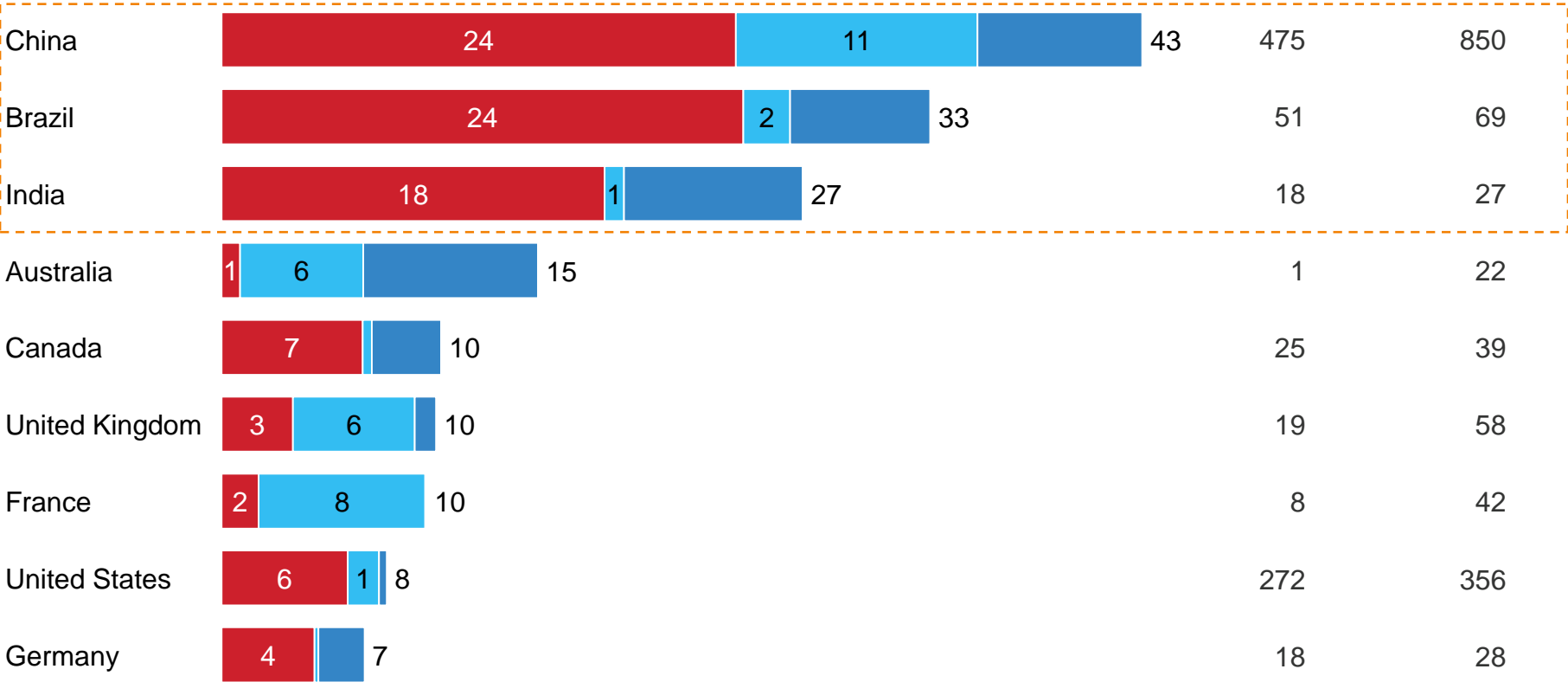
\$ billion

Scenarios for interest rate change

2016

+200 bps

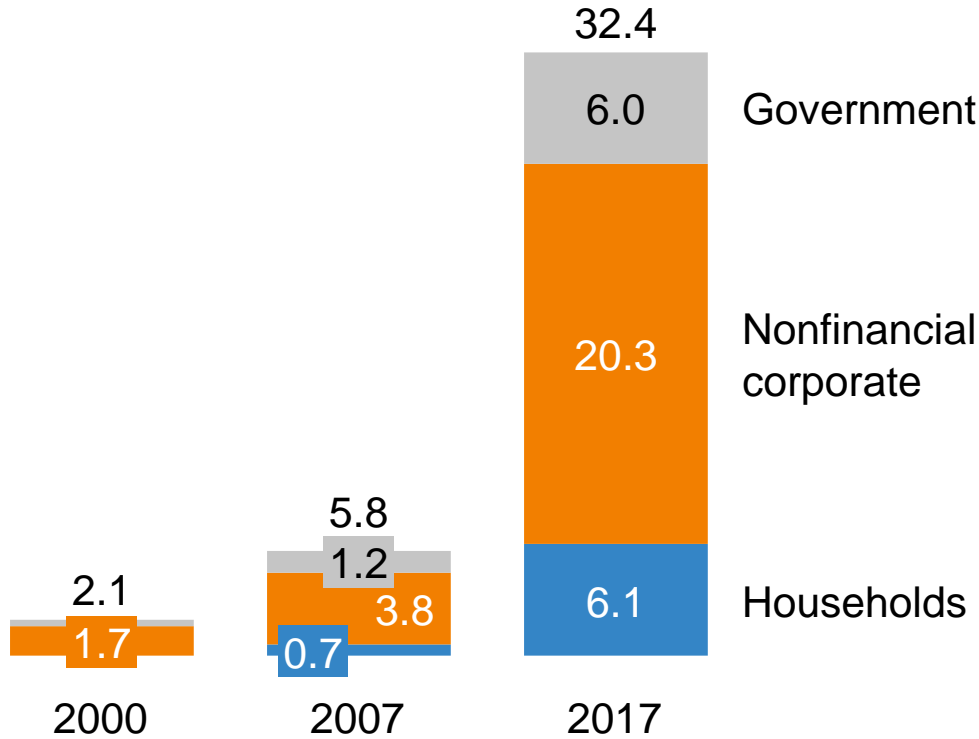
2016 +100 bps +200 bps



# China's corporate debt has increased by more than 5 times over the last decade, with ~65 percent of the growth in corporate debt

## China debt<sup>1</sup>

\$ trillion, constant 2017 exchange rate



**China debt / GDP, %**

2000	140	145	256
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### Reasons to worry about China's corporate debt

- Large portion linked to real estate, directly or indirectly
- 30% from opaque nonbank lenders
- Surplus capacity in industrial sectors
- Trade war could hurt corporate performance – enough to spark a wave of defaults?

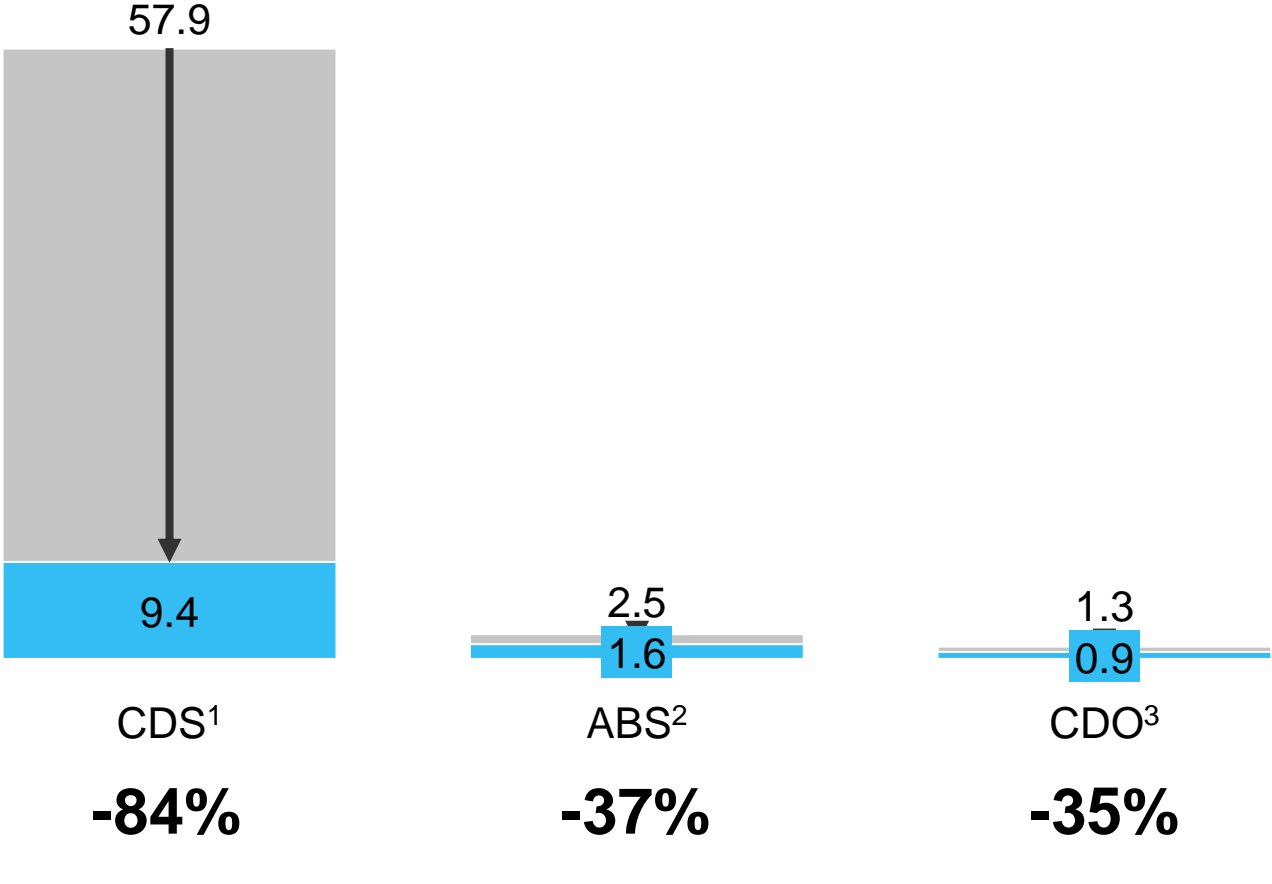
**But creditors are mainly domestic and the government has fiscal capacity for bail outs**

<sup>1</sup> Debt includes household, nonfinancial corporate, and government debt; excludes debt of the financial sector.

# Could a corporate debt crisis in one country create a global event? The instruments that created global repercussions in 2008 are mostly gone

CDS, ABS and CDO outstanding  
\$ trillion

■ 2007 ■ 2017



<sup>1</sup> Global total    <sup>2</sup> US and Europe; ABS not including MBS.    <sup>3</sup> US and Europe; including CLO, SF and Other CDO, not including CMO



# Market risks worth watching....

## Liquidity in bond markets has declined

- *Market making capacity has decline, while corporate bonds outstanding tripled. Turnover has fallen*

## CLO market is soaring

- *US CLO issuance is nearing peak of \$120 billion in 2017 – compared to \$90 billion in 2007*

## LBO market has reached pre-crisis peak

- *Private equity fundraising has surpassed 2007 level, at \$750 billion raised in 2017*



# Thank you

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