July 18, 2025

Global Credit Weekly:

The signals from default activity

BlackRock

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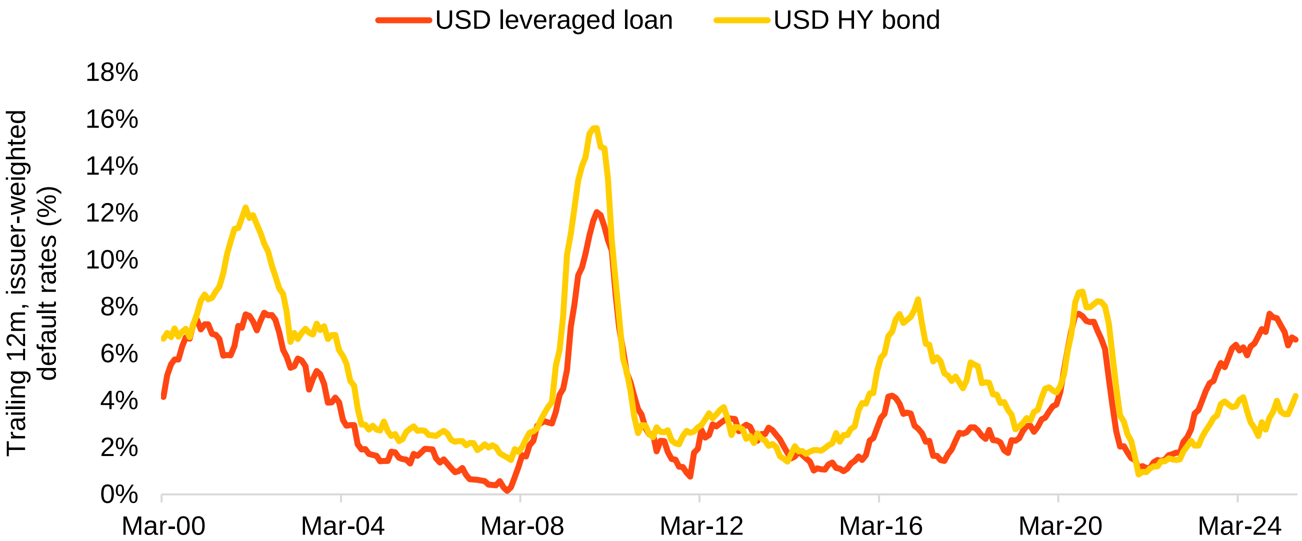
Key takeaways

- As we highlighted in our *3Q2025 Global Credit Outlook*, we expect a somewhat more challenging growth-inflation mix in the U.S., alongside a pattern of persistently elevated interest rates. This week's economic data (U.S. CPI, retail sales) reinforces our view that near-term, preemptive rate cuts from the Federal Reserve are unlikely. Against such a backdrop, many market participants are focused on how corporate borrowers have been navigating this environment, and whether new signs of stress in credit fundamentals are emerging.
- Last week, we dug into the signals from traditional fundamental credit metrics, which have generally remained resilient. This week, take stock of corporate default activity in the syndicated credit markets from 1H2025 and revisit the four 'default themes' that we highlighted at the start of the year – all of which remain in place.
- These include: (1) leveraged loan defaults are still outpacing HY bonds; (2) smaller firms are defaulting at a higher rate vs. larger peers; (3) distressed exchanges represent a greater share of default activity vs. 'traditional' bankruptcies; and (4) there remains a persistently elevated share of so-called 'repeat defaulters.'
- And while aggregate default rates are elevated vs. history (especially for loans), this has not been enough to derail the performance of lower-rated credit. For example: on a year-to-date total return basis, USD HY (+4.6%) and leveraged loans (+3.6%) have outpaced USD IG (+3.3%)[1].
- Default rates are only one part of the overall consideration for investors, as *recovery* rates are also important to monitor. Recent data shows an improvement vs. the late 2023 / early 2024 troughs. The difference between loan and HY bond recoveries has also compressed in recent months.

Exhibit 1: Leveraged loan defaults are still outpacing HY bonds
Trailing 12-month, issuer-weighted default rates for the universe of USD HY bonds and USD leveraged loans tracked by Moody's



Source: Moody's, BlackRock. As of June 30, 2025 (most recent available as of July 17, 2025). [1] Using the Bloomberg USD HY and IG Corporate indices, and the Morningstar/LSTA USD Leveraged Loan Index, all as of July 17, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

Inflation, consumer spending data: no rush to cut

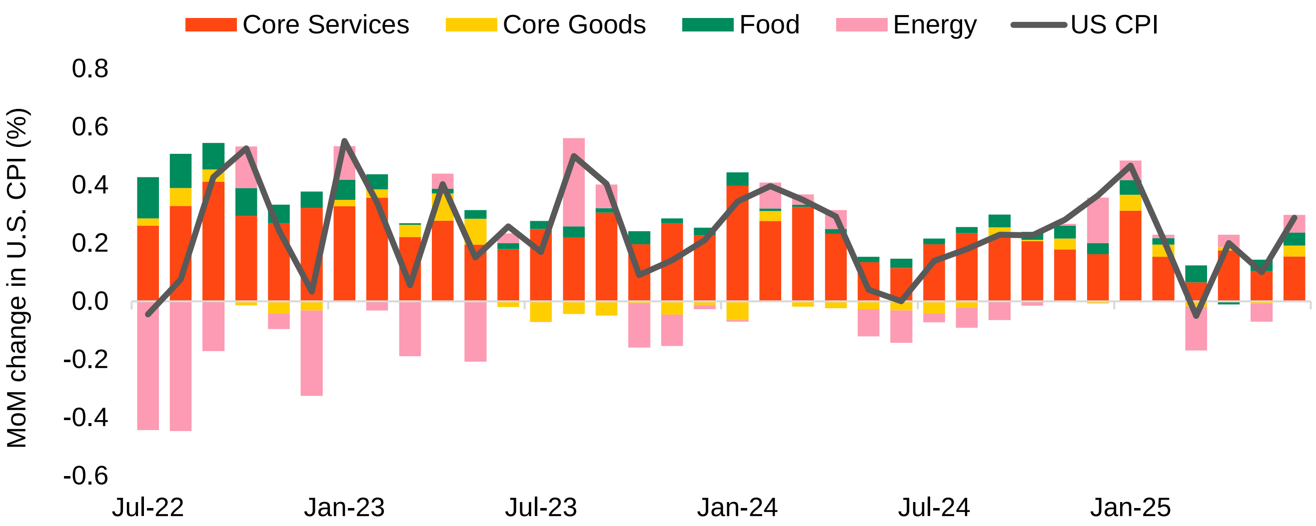
The economic data from this week – namely the June 2025 U.S. Consumer Price Index (CPI) and retail sales – reinforced our view that a near-term, preemptive rate cut from the Federal Reserve is unlikely (at least prior to 4Q2025). U.S. CPI (released July 15th) showed an increase in core goods prices across certain tariff-exposed categories such as household furnishing and apparel. This increase fueled concerns from some market participants that price data may be showing early signs of a potential tariff pass-through. We expect that the full impact of tariffs is yet to be seen, but we also believe corporates have a range of options to mitigate higher input costs, as discussed last week.

Meanwhile, June retail sales rose 0.5%, above Bloomberg consensus estimates and once again highlighting the resilient (albeit bifurcated) pattern of consumer spending.

Market expectations for the terminal rate of this cycle, using 1y1y Overnight Indexed Swap (OIS) forwards as a proxy, and for the long-term neutral rate, using 5y5y OIS as a proxy, have increased throughout July, reflecting less scope for Federal Reserve rate cuts (Exhibit 3). Indeed, market pricing for the timing of the first Federal Reserve interest rate cut of 2025 has also been extended, moving from September 2025 (as of July 1, 2025) to October 2025 (as of July 16, 2025).

Exhibit 2: Inflation increased modestly in June

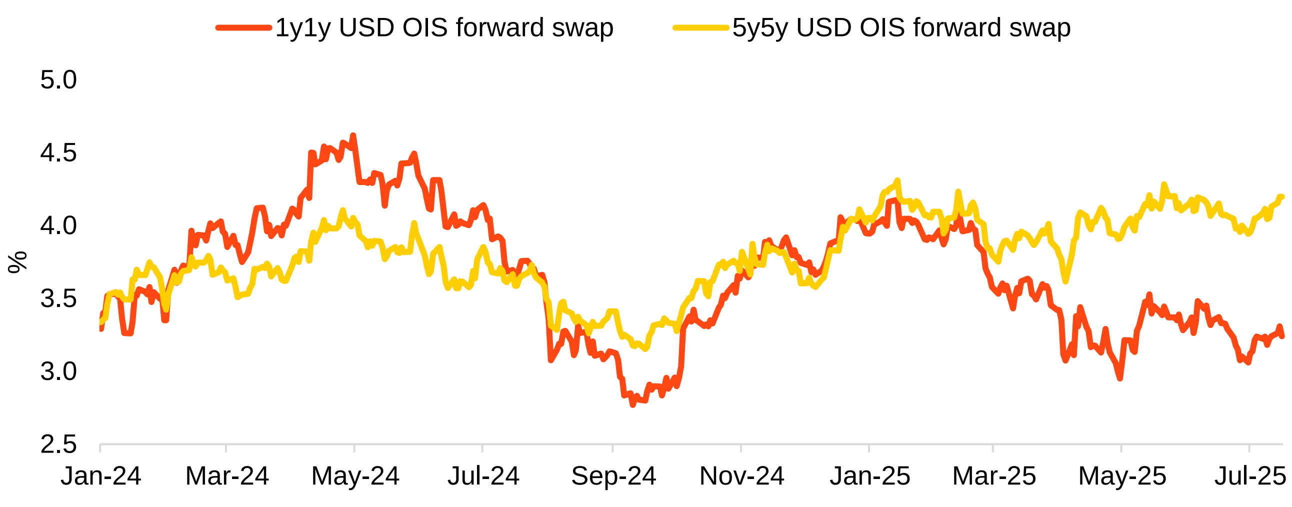
Contributions, by category, to the month-over-month (MoM), seasonally adjusted, change to US CPI



Source: Bloomberg, Bureau of Labor Statistics, BlackRock. Captures data through June 30, 2025.

Exhibit 3: Market pricing of interest rates has marched higher in July

1y1y Overnight Indexed Swap (OIS) forwards, as a proxy for the terminal rate of this cycle, and 5y5y OIS as a proxy for the long-term neutral rate



Source: Bloomberg, BlackRock. As of July 16, 2025.

Taking stock of default trends

As we highlighted in our *3Q2025 Global Credit Outlook*, we expect a somewhat more challenging growth-inflation mix in the U.S., alongside a pattern of persistently elevated interest rates. Against such a backdrop, many market participants are focused on how corporate borrowers have been navigating this environment, and whether new signs of stress in credit fundamentals are emerging.

Last week, we dug into the signals from traditional fundamental credit metrics, which have remained resilient. This week, we take stock of corporate default activity in the syndicated credit markets from 1H2025 and revisit the four 'default themes' that we highlighted at the start of the year:

1. leveraged loan defaults are still significantly outpacing HY bonds
2. smaller firms are defaulting at a higher rate vs. larger peers
3. distressed exchanges represent a large share of default activity
4. there remains a persistently elevated share of so-called 'repeat defaulters'

Theme #1: leveraged loan defaults are (still) outpacing HY bonds

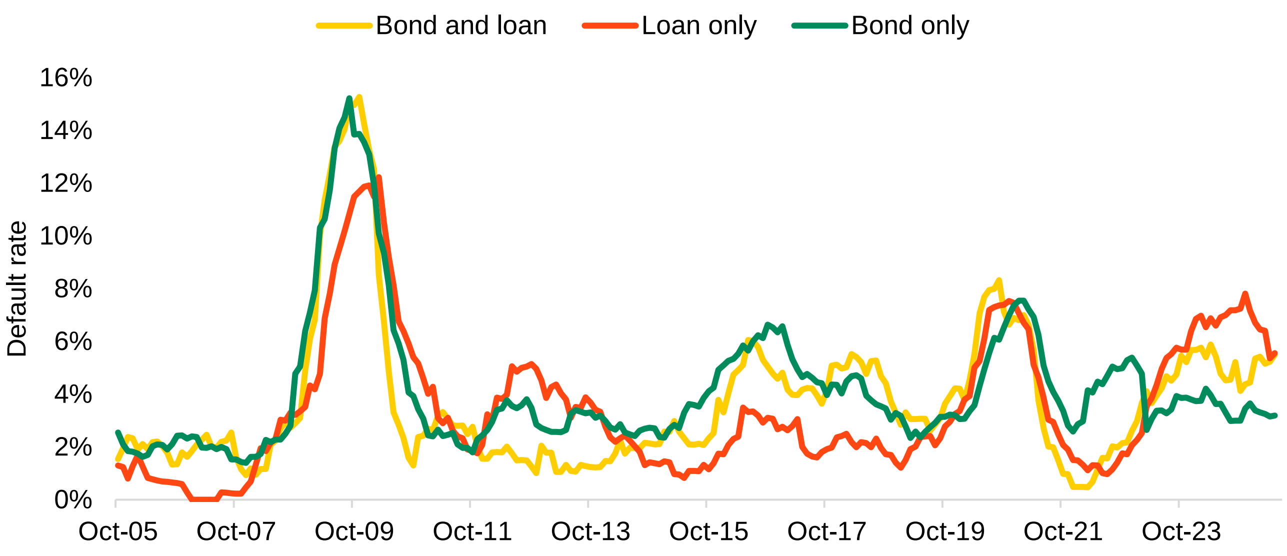
As illustrated in Exhibit 1, in the USD market, leveraged loan defaults continue to outpace HY bonds. This represents a divergence from the historical pattern of the past few decades, during which HY bond default rates tended to outpace those of loans.

In our view, the higher loan default rate reflects a residual impact from the Federal Reserve's 2022-2023 rate hiking cycle. Floating rate borrowers mechanically absorbed a higher cost of capital as the policy rate moved higher, as opposed to fixed rate borrowers, which encountered a higher cost of debt if and when they refinanced from a lower-coupon. And while the Federal Reserve has reduced the Fed Funds rate 100bp from the peak, the level (4.375%) remains elevated by historical standards.

Beyond the fixed vs. floating rate considerations, other factors are also likely contributing to the default differential between leveraged loans and HY bonds, including (1) fundamental differences between the two asset classes (i.e., rating distributions and sector exposures), and (2) the mix of default *types* (discussed later).

Encouragingly, the issuer-weighted, trailing 12-month default rates for 'loan only' capital structures have improved notably from recent peaks, falling from 7.8% in November 2024 to 5.6% as of May 2025, coming more in line with that of 'bond and loan' capital structures (Exhibit 4).

Exhibit 4: Capital structures that include loans have experienced a higher default rate
Issuer-weighted, trailing 12-month default rates for the global universe of issuers tracked by Moody's. Default rates include distressed exchanges.



Source: Moody's, BlackRock. As of May 31, 2025 (most recent available as of July 15, 2025).

Theme #2: smaller firms are defaulting at a higher rate than larger peers

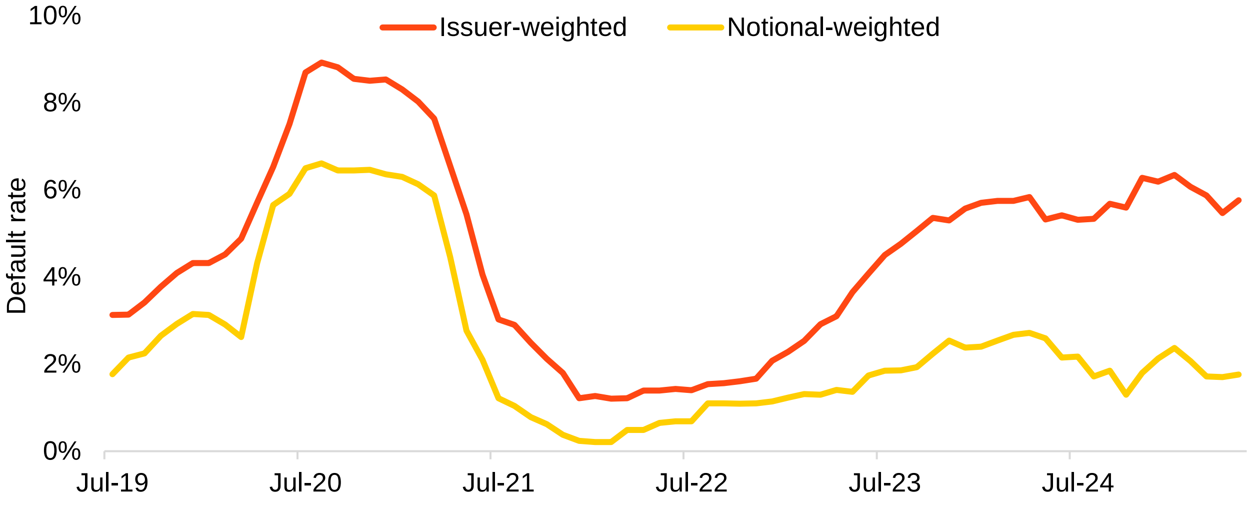
Comparing issuer-weighted (i.e., the *count* of issuer defaults) and notional-weighted (i.e., the *size* of defaulted debt) default rates provides incremental clarity into which borrower segments are driving default activity.

As demonstrated by Exhibit 5, which tracks default activity across USD leveraged loans and HY bonds, issuer-weighted defaults have consistently outpaced notional-weighted rates. More recently, the divergence between the two has widened, indicating that smaller borrowers are increasingly responsible for defaults, especially when compared to the 2019 – 2022 period.

Exhibit 6 echoes this takeaway. Notably, the divergence between the two measures is more pronounced in the HY bond market than in leveraged loans, suggesting that HY defaults skew even more towards smaller borrowers than in leveraged loan markets. (This is intuitive, in our view, considering that HY bonds tend to have larger average deal sizes than leveraged loans).

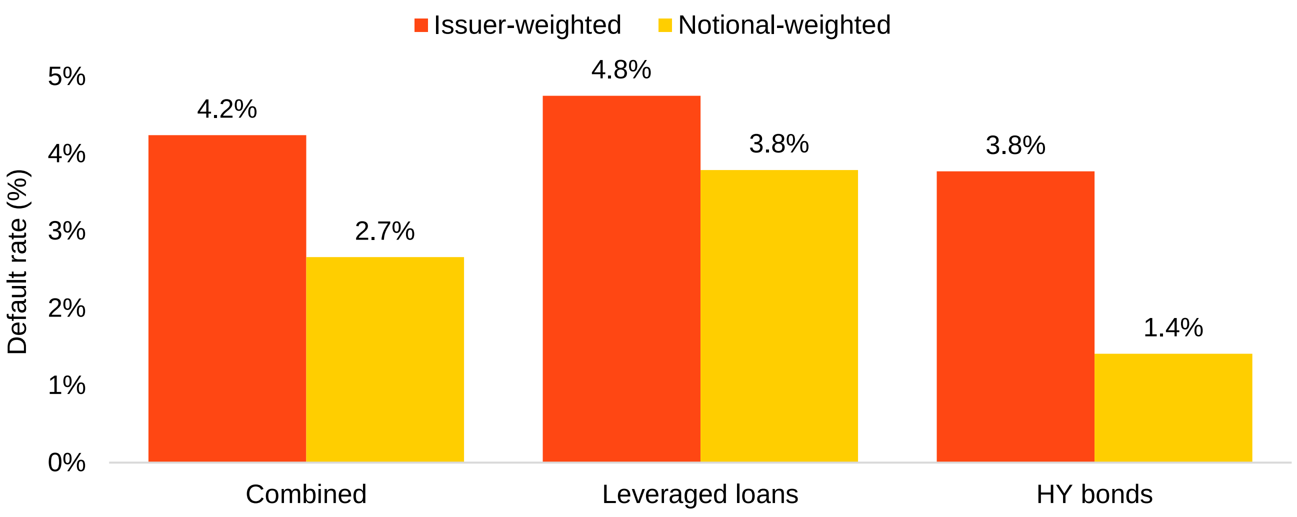
We believe this widening gap reflects the headwinds some smaller firms have faced amid a higher cost of capital. By contrast, their larger peers may benefit from more financing options and business diversification. Notably, we have also observed a similar theme in private credit).

Exhibit 5: The gap between issuer and notional default rates has widened in recent years...
Issuer-weighted and notional-weighted trailing 12-month default rates, for the universe of USD leveraged loans and HY bonds tracked by Moody's



Source: Moody's, BlackRock. As of May 31, 2025 (most recent as of July 17, 2025).

Exhibit 6: ...and is wider for HY bonds, reflecting the larger average deal size, in our view
Trailing 12-month default rate (including payment default and distressed exchanges) for the USD leveraged loan and HY bond markets



Source: J.P. Morgan, PitchBook LCD, Bloomberg, S&P/IHSMarkit, BlackRock. As of June 30, 2025.

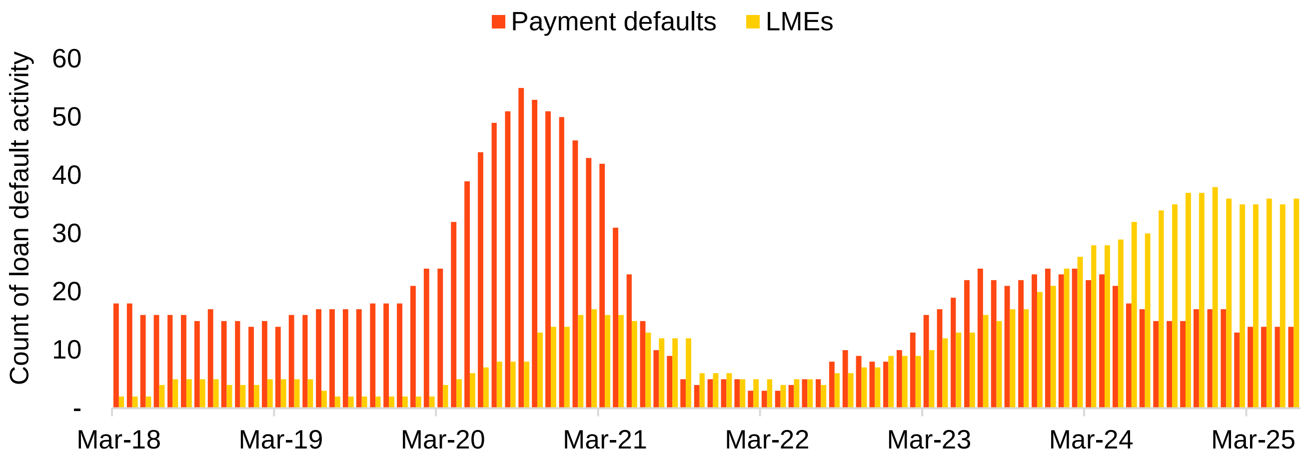
Theme #3: Distressed exchanges outpace 'traditional' defaults

According to data tracked by Moody's, distressed exchanges accounted for 64% of the global defaults in 1H2025, compared to 22% for payment defaults and 14% for bankruptcies. Distressed exchanges, which are sometimes referred to as "liability management exercises" (LMEs), have become more common in the USD leveraged loan market in recent years – a shift from the pattern evident 10-15 years ago, when HY bonds generated the bulk of LME activity (per J.P. Morgan data).

Exhibit 7 uses data from Pitchbook LCD to detail the count of default activities in the USD leveraged loan market, by type of default activity. Notably, LMEs continue to outpace payment defaults, a trend that has been in place since January 2024. A successful resolution, in our view, is one that allows the defaulted borrower to reset their capital structure to avoid future financial stress. That said, data from Pitchbook LCD suggests that the effectiveness of LME transactions has varied throughout recent years.

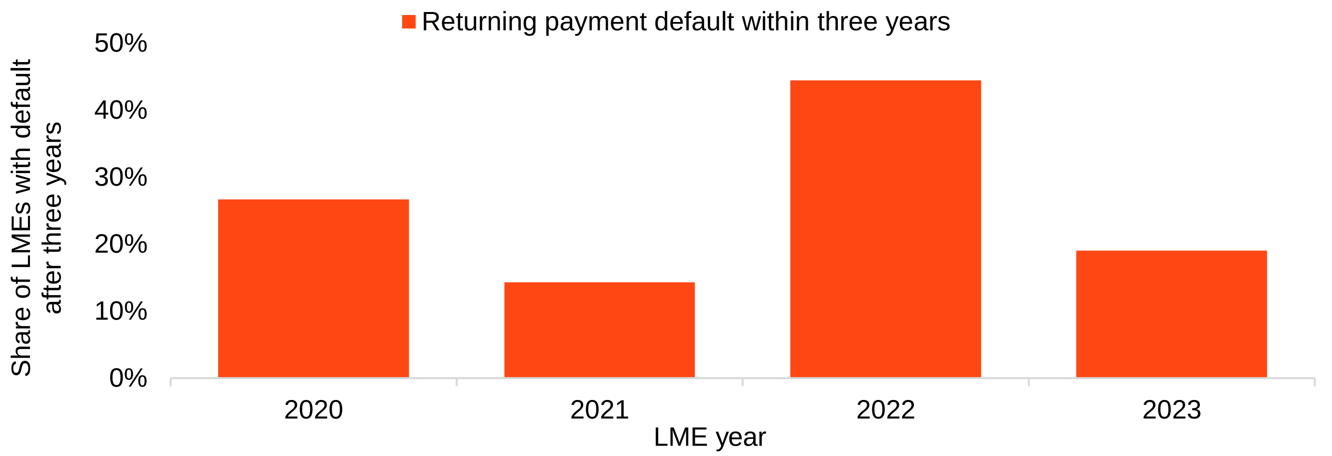
As demonstrated by Exhibit 8, the share of LME transactions each year that ultimately returned with a payment default within three years has ranged from 14% to 44%. 2023 repeat default rates are likely understated, given the 'three-year mark' has yet to pass. The 'efficacy' of such transactions also impacts the fourth theme – elevated repeat defaulters – which we'll discuss on the following page.

Exhibit 7: LMEs continue to outpace payment defaults
Count of trailing twelve-month defaults for USD leveraged loans, by default activity type (payment defaults and liability management exercises)



Source: PitchBook LCD, Morningstar / LSTA USD Leveraged Loan Index, BlackRock. Data through June 30, 2025.

Exhibit 8: 19% of companies that conducted an LME in 2023 have already returned with a payment or bankruptcy default
Share of LME transactions (by LME year) that returned with payment or bankruptcy defaults within the subsequent three years



Source: PitchBook LCD, BlackRock. Data through April 30, 2025 (most recent available). Data shows (by year of distressed LME transaction) the share of each cohort that returned with a payment or bankruptcy default in the subsequent three years.

Theme #4: elevated share of 'repeat defaulters'

Exhibit 9 demonstrates 'repeat' default activity as a share of total default activity for the USD leveraged loan and HY bond markets. In the first half of 2025, repeat defaults accounted for 30% of total, broadly in line with recent years, but significantly higher than the 10-year average of 22% (2015-2024).

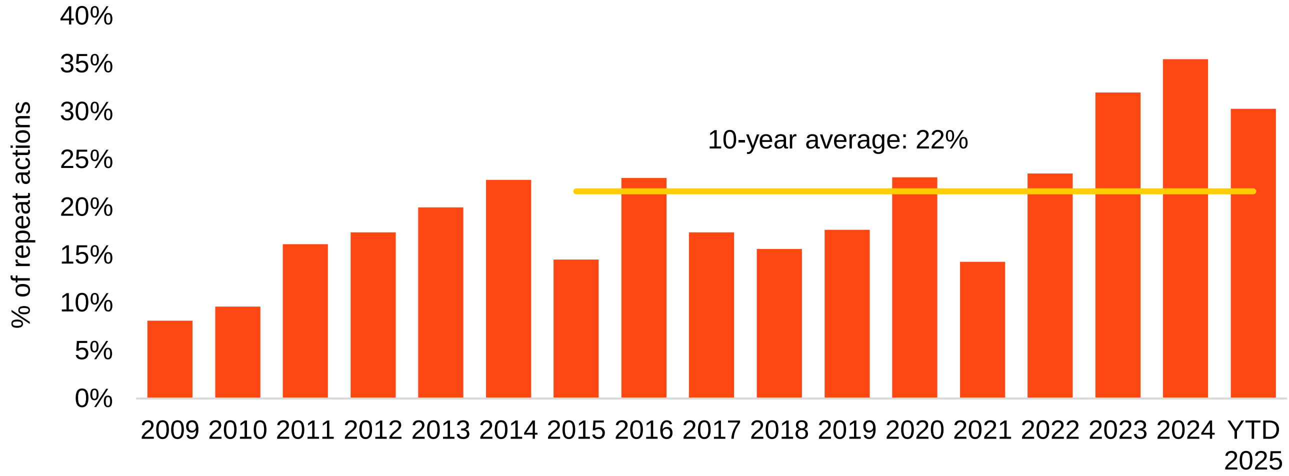
As aforementioned, this may be an outcome of how firms are choosing to resolve stress when it arises, and the effectiveness of such solutions. Building on the previous theme of increased LME activity, Exhibit 10 demonstrates the share of repeat defaults based on the *first* default activity (either LMEs or bankruptcy).

Notably, repeat defaults more often start with an LME than a bankruptcy. Over the last 10 years (2015-2024), 64% of repeat defaults conducted an LME first. This trend has been even more pronounced in recent years, with levels since 2022 averaging 72%.

With LMEs continuing to represent a meaningful share of default activity in the leveraged loan market (again, Exhibit 7), this trend warrants watching, as it may indicate a continuation of elevated repeat default activity ahead.

Exhibit 9: Repeat default activity remains elevated

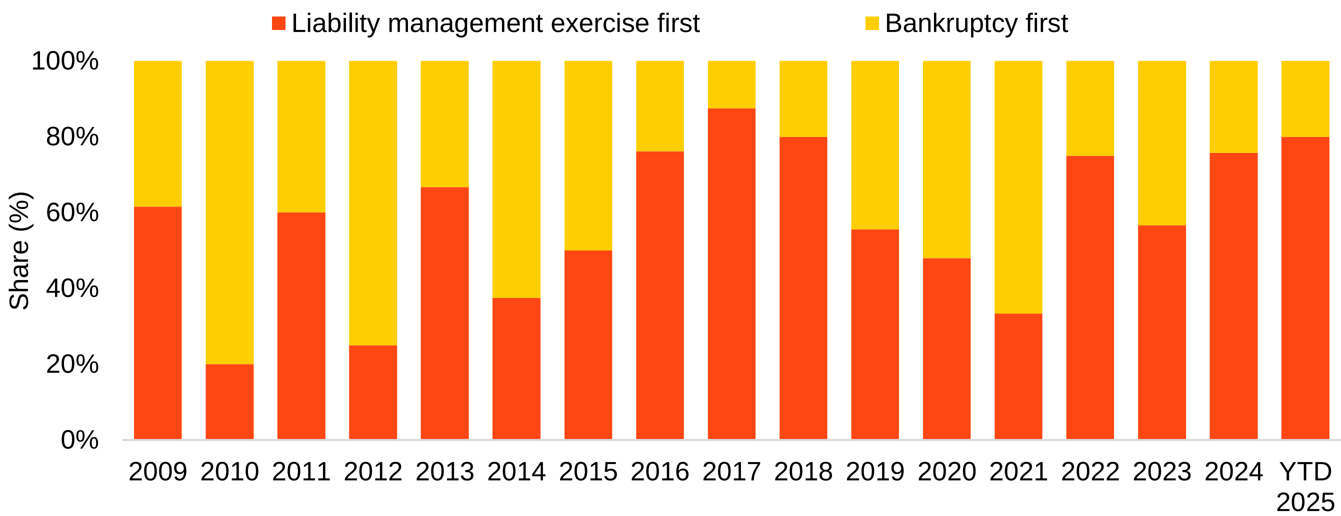
Repeat defaults as a share of total default activity for the USD leveraged loan and HY bond markets, and 10-year average (2015-2024)



Source: J.P. Morgan, PitchBook, Bloomberg, S&P/IHSMarkit, BlackRock. As of June 30, 2025.

Exhibit 10: LMEs have represented the majority of 'first default actions' in recent years

Share of repeat default activity count in the USD leveraged loan and bond markets, based on first default action



Source: J.P. Morgan, PitchBook, Bloomberg, S&P/IHSMarkit, BlackRock. As of June 30, 2025. 'Liability management exercise first' refers to borrowers that conducted an LME, then returned to conduct another LME or filed for bankruptcy after. 'Bankruptcy first' refers to borrowers that conducted a bankruptcy, then returned to conduct another bankruptcy or an LME.

Recovery rates show some signs of improvement

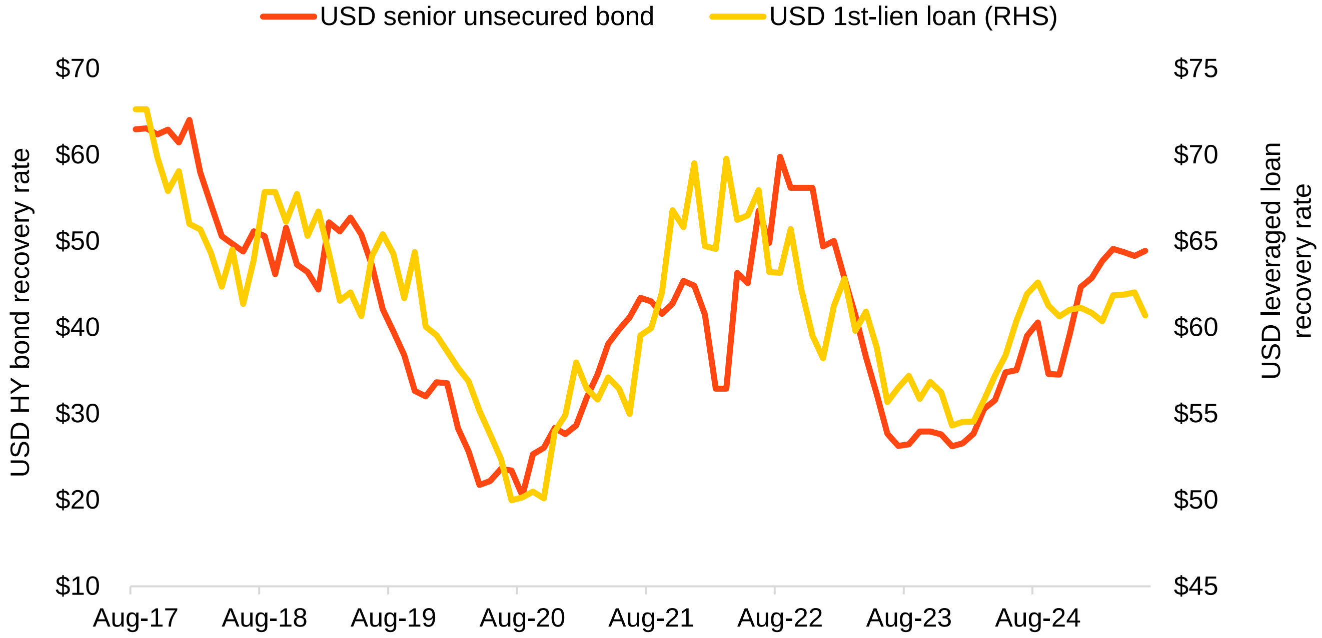
Of course, the default rates are only one part of the overall consideration for investors, as *recovery* rates are also important to monitor.

Indeed, recovery rates have improved off the troughs of late 2023 / early 2024, as shown by Exhibit 11. Recovery rates for USD first lien loans ($60.7) are higher than for USD senior unsecured HY bonds ($48.9), driven by their senior / secured position in the capital structure. That said, per the Moody's data, the difference between the two has compressed in recent months.

While not a perfect proxy for the ultimate recovery following a restructuring – as these recovery rates are captured 30 days after a default – we nevertheless view the directional trend as informative.

Exhibit 11: Recoveries remain considerably strong

Trailing 12-month USD senior unsecured bond vs. USD first lien loan (RHS) recovery rates (per $100 par)



Source: Moody's, BlackRock. As of June 30, 2025 (most recent available as of July 17, 2025). Measured by debt prices which are taken immediately prior to distressed exchanges or 30 days after non-distressed exchange defaults.

Unless otherwise stated, all reference to $ are in USD.

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