



## Default Study

# 2022: The end of the ultra-low default world?

#PositiveImpact

The 24th annual study finds that the last 12 months have seen us grind back down towards near zero defaults again for BB/Bs. The latest rolling 12-month US CCC default rate is the lowest for nearly 40 years. Now that the Covid default cycle is over, we show how shallow and narrow it was relative to the previous ones over the last 40 years. Nothing much will change for the remainder of 2022 but after that we think we might be coming to the end of the ultra-low default world.

First, we will likely have a cyclical US recession to address in 2023, and after that, a risk of the reversal of trends that have made the last 20 years so subdued for defaults. For most of this study's history we've been convinced the ultra-low default world would hold for as far as the eye can see. However, this year we speculate that things might become more difficult for corporates in the years ahead. Our view has long been that inflation would rise this decade for structural reasons. The pandemic and the aftermath have accelerated and exaggerated this.

We've previously been relaxed about higher inflation vis-à-vis defaults as we've thought the authorities would still have to heavily rely on financial repression to ensure the mammoth global debt pile could be smoothly financed in such a world. However, we now think that such a scenario might be more challenging for funding than we've believed in years gone by. Although financial repression will likely stay to some degree, policymakers may find it more difficult to pull all the easy policy levers as they've done in the last few decades.

As such, we think there'll be a tug of war between real yields and term premium naturally trending higher (bad for defaults) versus a desire (or need) for the authorities to intervene to prevent the debt super cycle from being exposed (good for defaults). The latter support may be slower to materialise, less aggressive, and more targeted than we've been used to if we move to a higher inflation world. The fact that we have this two-way tension though means that the two [1] decade era of low inflation, ever declining term premium and real yields, long business cycles, peak profit margins, guaranteed and immediate central bank intervention, all happening together, is likely over.

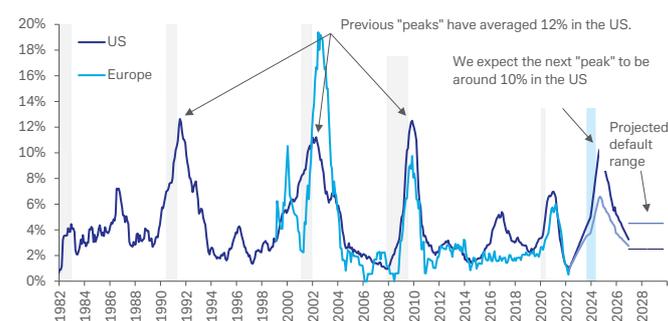
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Our view though, does depend on us being correct on inflation remaining notably above target through the end of this cycle and onto the next. If inflation does mean revert lower quickly and sustainably (without need for a long period of high rates), then we will likely be wrong on both the 2023 recession and the next default cycle, and on the start of a structural shift upwards in default rates over the years ahead.

So, will we continue with the trends of the last few decades or begin a reversal? The answer is key to many things in financial markets and for the purpose of this study, the outlook for defaults.

### Distance from Fed's policy objectives for inflation and unemployment



Source: Deutsche Bank



Deutsche Bank Research clients can access the full report [here](#).