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Bankruptcy Forecaster Sees Junk-Debt Bubble Bursting Next Year
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By Tiffany Kary and Laura J. Keller
(Bloomberg) -- A bubble in the leveraged-finance market is growing and may burst in 12 to 18 months, said Edward Altman, a specialist in credit markets who developed a model for predicting corporate bankruptcies.

"We think it's building," Altman told a gathering of corporate restructuring experts Wednesday in New York. He said the current "benign credit cycle" encouraged by low interest rates has been going on for five years and led to a "frothy" market. "You'll be busier at this time next year."

A financial crisis isn't necessarily expected, since few economists are also predicting a U.S. economic recession, Altman told the Turnaround Management Association, a group of consultants, lawyers, liquidators and other professionals who advise distressed companies.

Altman is the director of research in credit and debt markets at New York University's Salomon Center for the Study of Financial Institutions. He developed the "Z-Score," a method of predicting a company's likelihood of bankruptcy.

The riskier a company, the more it pays in borrowing costs because lenders and bond investors demand higher interest to compensate for greater default probabilities.

Altman predicted the default rate will climb to around 3.3 percent in 2015 from 2.1 percent because the cost of debt capital has risen and the number of companies trading at distressed levels doubled last year. Already this year, the default rate is 0.85 percent, with the bankruptcy filing of the main operating unit of Caesars Entertainment Corp., Altman said.

More Scrutiny

Increased regulatory scrutiny of underwriting standards has been predicted by some to hold down leveraged loan issuance this year. Companies last year issued $507.9 billion of U.S. loans sold to institutional investors, down from a record $684 billion in 2013, according to data compiled by Bloomberg.

Energy Future Holdings Corp., which filed the biggest U.S. bankruptcy of 2014, accounted for half of last year's rate, he said. He said he expects the number of big bankruptcy filings to rise this year while staying below historic averages.

He said his predictions about the credit markets are based on quantitative factors such as the ratios of debt to earnings, and don't factor in qualitative factors such as rising oil prices or geopolitical events.

Altman identified several possible catalysts for a jump in the default rate -- less access to credit and continued drops in commodity prices chief among them. Energy producers who issued new bonds and took out loans while borrowing costs were low have since been hit with plunging oil prices.

Central banks will eventually have to account for easy-money policies, he said. "At some point, they'll have to back up because of their own balance sheets or the lack of success."

The last time Altman predicted a bubble was in 2007, shortly before the financial crisis. At the time, the debt-to-earnings ratio by one measure had peaked at 6.2 in the U.S. Last year, that number was 5.8.

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--With assistance from Christine Idzelis in New York.

To contact the reporters on this story:
Tiffany Kary in New York at +1-718-875-1459 or
tkary@bloomberg.net;
Laura J. Keller in New York at +1-212-617-0382 or
lkeller22@bloomberg.net
To contact the editors responsible for this story:
Andrew Dunn at +1-212-617-2529 or
adunn8@bloomberg.net;
Shannon D. Harrington at +1-212-617-8558 or
sharrington6@bloomberg.net
Charles Carter