
A 200-basis-point increase in interest rates could cause a sharp rise in emerging-market corporate debt at risk of default. (Image: Reuters)

A 200-basis-point increase in interest rates could cause a sharp rise in emerging-market corporate debt at risk of default, with Brazilian and Indian companies most vulnerable, a report from McKinsey Global Institute showed. Following a decade of loose monetary policy and historically low-interest rates aimed at boosting economic growth after the 2008-9 financial crisis, central banks, including the U.S. Federal Reserve and the European Central Bank, are either raising rates or signalling an end to accommodative policies.

That is pushing many central banks in the developing world into raising rates as well. India, for example, raised rates this month for the first time since 2014. McKinsey researchers found more companies had shifted to bond market financing after the 2008 crisis, with nearly 20 percent of corporate debt now in the form of bonds — around double the levels of a decade ago.

Higher interest rates will push up refinancing costs and put more bonds at risk of default by lowering companies' interest coverage ratio — a gauge of how easily a company can pay interest on its debt. "In advanced economies, the impact of rising interest rates on companies' ability to service their debt will likely be modest," McKinsey analysts told clients.

“In developing countries, it could raise the portion of bonds at risk of default even higher,” they said in their paper, which simulated the effect on companies’ interest expenses from a 200 bps rate rise in their countries. In that situation, the share of bonds at higher risk of default would rise to one-third from 24 percent in Brazil and to 27 percent from 18 percent in India.