Inflation and Corporate Credit Risk: Global Evidence

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Abstract

We provide novel international evidence that inflation is positively associated with corporate credit risk on average. A one-standard-deviation increase in inflation is associated with a 21-basis-point increase in next-year CDS spreads. Importantly, this relationship is convex: it is negative or weak at low inflation levels, but is much more positive in high-inflation environments. The positive relation between inflation and credit risk is stronger for firms with greater refinancing vulnerability and more rigid operating cash flows, and in countries with more inflation-responsive monetary regimes and weaker institutional environments. Our findings are consistent with opposing roles for debt rigidity and operating rigidity.

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I. Introduction

This study investigates the relation between inflation and corporate credit risk across firms and countries, and how this relationship varies with debt rigidity, operating cash-flow rigidity, and the monetary and institutional environments in which firms operate. Understanding this relationship has become especially important in the wake of the global inflation surge following the COVID-19 recovery and subsequent macroeconomic disruptions.[1] While recent studies examine the relation between inflation and credit risk in single-country settings (e.g., Bhamra, Dorian, Jeanneret, and Weber (2023) and Bonelli, Palazzo, and Yamarthy (2025)), much less is known about how this relation differs across countries facing very different inflation regimes, monetary-policy responses, debt structures, and institutional environments.

This international variation is central to our analysis. The relation between inflation and corporate credit risk need not be uniform across countries or firms. Inflation may ease the real burden of nominal debt for some firms, while tightening financing conditions and compressing operating margins for others. Which force dominates should depend on firms' exposure to refinancing risk, their ability to pass rising input costs through to customers, and the country-level conditions under which they operate. By exploiting firm-level data from 50 countries, we use the global setting as a natural laboratory to examine when inflation is associated with higher

[1] Since mid-2021, there has been a worldwide surge in inflation, with many countries experiencing their highest inflation rates in decades. This has been attributed to several factors, including COVID-19 pandemic and fiscal and monetary stimuli policy responses, supply chain disruptions, price overcharging, and higher energy and input prices following Russian invasion of Ukraine. The International Monetary Fund (IMF) identified that food, energy and transportation costs are the key drivers of this surge. (See https://www.imf.org/en/Blogs/Articles/2022/09/09/cotw-how-food-and-energy-are-driving-the-global-inflation-surge).

corporate credit risk, when the relation is attenuated, and how the balance varies between two opposing mechanisms: a debt-rigidity channel, under which inflation reduces the real burden of nominal debt when debt obligations are insulated from contemporaneous repricing, and an operating-rigidity channel, under which inflation raises credit risk when firms cannot adjust prices and operating cash flows sufficiently to offset rising input costs. This comparative cross-country structure is the paper's key advantage: it allows us to study how inflation-credit risk sensitivities differ systematically across settings in ways that single-country studies cannot easily capture.

Figure 1 presents a heat map of global inflation, illustrating the average inflation rate of each country from 2001 to 2022. Average inflation rates vary widely, ranging from near-zero levels in Japan (0.23%) and Switzerland (0.4%) to persistently high levels in Russia (8.74%) and Turkey (8.8%), compared with 2.19% in the United States. This substantial cross-country dispersion is not merely descriptive background. It provides a valuable setting for examining how inflation-related credit-risk exposure differs across countries with distinct inflation levels, monetary-policy regimes, financial structures, and institutional environments. By exploiting this international heterogeneity, our study goes beyond asking whether inflation is associated with corporate credit risk on average and instead asks how and why this relation varies across firms and countries.

[Insert Figure 1 here]

On the one hand, inflation can reduce the real burden of nominal liabilities, thereby easing financial pressure and lowering credit risk (e.g., Bhamra, Fisher, and Kuehn (2011), Kang and Pflueger (2015), Gomes, Jermann, and Schmid (2016), Bhamra et al. (2023), and Schnorpfeil, Weber, and Hackethal (2023)). This debt-rigidity channel should be especially relevant for firms whose debt obligations are relatively insulated from contemporaneous inflation and interest-rate adjustments, such as firms with more fixed-rate or longer-maturity debt. On the other hand, inflation raises the costs of key production inputs such as raw materials, energy, and labor. When firms cannot pass these higher costs through to customers, operating margins and cash flows deteriorate, increasing default risk (Gorodnichenko and Weber (2016) and Augustin, Cong, Corhay, and Weber (2025)). This operating-rigidity channel should be especially relevant for firms with rigid prices and sticky cash flows.

The relative strength of these two mechanisms should also depend on country-level conditions. In particular, two country-level features are especially relevant. First, in countries where monetary policy responds more aggressively to inflation, higher inflation is more likely to trigger policy-rate increases, tighter borrowing conditions, and greater refinancing pressure for firms. Second, in countries with weaker institutional environments, firms often have less stable access to external finance, weaker shock-absorption capacity, and more volatile operating cash flows, making inflation-driven refinancing costs and input-cost pressures more likely to translate into higher default risk. More generally, cross-country differences in debt structure, refinancing exposure, price flexibility, and institutional support can shift the relative importance of the debt-rigidity and operating-rigidity channels.

Using a comprehensive firm-level dataset of more than 1,100 firms with traded credit default swap (CDS) contracts across 50 countries from 2001 to 2022, we document three main findings. First, inflation is positively associated with corporate credit risk on average. Second, this average effect masks a pronounced nonlinear pattern. The relationship between inflation and credit risk is convex: it is negative or weak at low inflation levels, but becomes much more positive in high-inflation environments. Third, and most importantly, the positive relation between inflation and credit risk is highly heterogeneous. It is stronger for firms with higher leverage and greater short-term refinancing needs, and in countries with more inflation-responsive monetary regimes. In contrast, it is weaker for firms operating in industries with greater price flexibility and for those whose operating cash flows better keep pace with rising input costs. The positive relation is also more pronounced in countries with weaker institutional environments. These findings highlight that the value of the global setting lies not merely in broader external validity, but in identifying how the inflation-credit risk relation depends on both firm-level and country-level conditions.

To investigate the inflation-credit risk relationship, we employ CDS spreads as our primary proxy of corporate credit risk, which is widely regarded as a forward-looking and market-based measure of corporate credit risk.[2] Our baseline analysis reveals that a one standard deviation increase in inflation is, on average, associated with a 21-basis-point rise in the following year's CDS spread, equivalent to a 13% increase relative to the sample mean, after controlling for firm and industry-year fixed effects. To assess sensitivity to omitted variables, we implement the Oster (2019) coefficient-stability test, which suggests that the estimated inflation effect is not particularly fragile to omitted-variable bias of the conventional sort. We also complement the baseline analysis with an instrumental-variables approach using WTI crude oil

[2] CDS spreads are widely regarded as a cleaner and more standardized proxy for firm-level credit risk than corporate bond spreads. For example, see Blanco, Brennan, and Marsh (2005), Longstaff, Mithal, and Neis. (2005), Acharya and Johnson (2007), Jorion and Zhang (2007, 2009), Oehmke and Zawadowski (2017), Lee, Naranjo, and Velioglu (2018), Augustin and Izhakian (2020), Lee, Naranjo, and Sirmans (2021), and Agca, Babich, Birge, and Wu (2022). Investment sentiments, liquidity needs, or trading noise are less likely to trigger price fluctuations in the CDS market.

prices and the Baltic Dry Index as instruments for inflation, as both capture exogenous global input-cost shocks that feed into inflation.[3] To strengthen identification, we interact these global price measures with country-specific oil and shipping betas, thereby generating instruments that vary across both time and countries according to national exposure to input-cost shocks. Further, excluding countries with unusually high GDP-growth sensitivity to oil price fluctuations yields qualitatively similar IV results. Combined, these analyses provide supportive evidence that the positive relation between inflation and corporate credit risk is not simply driven by omitted macroeconomic conditions.

Next, we test for nonlinear effects and find strong support for a convex relationship between inflation and corporate credit risk. First, including both inflation and its squared terms in the regression reveals a significantly negative linear term and a significantly positive squared term, supporting a convex relationship. Second, a spline regression by inflation terciles shows that the relation is significantly positive only in the high-inflation regime, whereas it is negative, albeit insignificant, in the low-inflation regime.

Moreover, the balance between the opposing forces (i.e., the debt-easing benefit of sticky leverage and the risk-enhancing effect of rising input costs) varies across firms and countries, motivating our analysis of how such heterogeneity moderates the inflation-credit risk

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[3] The WTI crude oil price, a major economic input, has long been recognized as a key driver of inflation. The Baltic Dry Index, a composite measure of global shipping rates for dry bulk cargo, reflects tighter global shipping supply and higher input costs for goods and commodities, thereby contributing to inflation (e.g., Carrière-Swallow, Deb, Forcer, Jiménez, and Ostry (2023)). Both instruments are closely linked to global economic activity and can capture exogenous global shocks that are independent of a firm's specific characteristics. By isolating the variation in inflation driven by these exogenous global cost shocks, the instrumented component of inflation is less likely to correlate with unobserved firm- or country-level factors that affect corporate credit risk.

relationship. A key factor is firms' refinancing vulnerability, which reflects the extent to which debt obligations are insulated from contemporaneous inflation and interest-rate adjustments. When debt is fully indexed to inflation, the debt-easing benefit vanishes because inflation directly raises nominal repayment obligations. More generally, firms with greater leverage and more short-term debt are more exposed to inflation-induced refinancing pressure, especially when higher inflation is met by tighter monetary policy. Consistent with this reasoning, we find that the positive relation between inflation and credit risk is stronger for highly leveraged firms, for firms with greater short-term refinancing needs, and for firms operating in countries where monetary policy responds more aggressively to inflation. These effects are particularly pronounced in high-inflation environments.

Another key source of heterogeneity is cash-flow stickiness, defined as the extent to which a firm's operating cash flows fail to keep pace with rising input costs. Firms with greater pricing flexibility are better able to pass cost increases through to customers and thereby protect margins during inflationary periods. By contrast, firms facing more rigid pricing conditions are less able to absorb inflation-driven cost shocks, leading to weaker cash flows and higher credit risk. To capture this mechanism, we rely primarily on an industry-level measure of price flexibility based on Cavallo's (2018) micro-price data, specifically the frequency of price changes, as well as a firm-level measure of the sensitivity of operating cash flows to inflation. Our results show that the positive relation between inflation and credit risk is weaker for firms operating in industries with greater price flexibility and for firms whose operating cash flows respond more favorably to inflation. These moderating effects are again concentrated in high-inflation environments.

Lastly, we examine country-level heterogeneity in institutional quality.[4] We conjecture that the positive relation between inflation and credit risk is stronger for firms facing greater underlying uncertainty. This implication is especially relevant in emerging markets and in countries with weaker governance, lower transparency, and less developed financial systems. In such environments, firms typically have weaker shock-absorption capacity, less stable access to external finance, and more limited ability to withstand inflation-driven increases in refinancing costs and input-cost pressures. As a result, inflation is more likely to translate into tighter financial conditions, weaker operating cash flows, and higher perceived default risk. Consistent with this view, we find that the positive relation between inflation and credit risk is significantly stronger in these settings. By contrast, firms in commodity-exporting countries, such as Australia, Canada, and New Zealand, benefit from inflation through higher international commodity prices, which can partially offset the adverse effects of inflation on credit risk.

While our main analysis focuses on 5-year CDS contracts, which are the benchmark in the CDS market, we also examine the relation between inflation and credit risk across CDS contract maturities ranging from 6 months to 30 years. We expect a stronger effect at shorter maturities because nominal rigidities limit firms' ability to pass rising input costs through to customers in the short run, while inflation also heightens expectations of near-term operational adjustments and tighter monetary policy. Empirically, we find that inflation is positively associated with CDS spreads across the term structure, with the relation peaking at the 2-year

[4] Country-level factors often explain more variance in corporate behaviors than firm-specific traits (e.g., Doidge, Karolyi, and Stulz (2007)). Research indicates that country-level institutional quality significantly impacts market assessments of credit risk (e.g., Lee, Naranjo, and Sirmans (2016), Hasan, Marra, To, Wu, and Zhang (2023), and Hasan, Marra, Wu, and Zhang (2025)).

maturity and remaining statistically significant up to 7 years. These results suggest that the inflation-credit risk relation is strongest over the short to medium term.

We conduct a broad set of robustness checks to validate our findings. We show that the main results are not driven solely by realized inflation: when expected inflation, inflation surprises, and inflation volatility are examined jointly, realized inflation remains the most robust predictor of future CDS spreads. In subsample analyses, the inflation-credit risk relation is insignificant for U.S. firms on average, but remains convex, with significantly negative effects in the low- and medium-inflation regimes, consistent with Bhamra et al. (2023). Similar convex patterns also appear in the Japan subsample, which is consistent with Japan's persistently low inflation environment. Our findings are also robust to alternative measures of CDS spreads and inflation, including median CDS spreads, year-end CDS spreads, log CDS spreads, and quarterly inflation, as well as to first-differenced regressions. In addition, the positive and convex inflation–credit risk relation continues to hold under alternative clustering methods, including two-way clustering, after adding controls for real short-term interest rates, banking crises, sovereign rating downgrades, and policy-rate changes, after restricting the sample to countries with at least 10 firms, and after controlling for currency-by-year fixed effects and exchange-rate movements.

Finally, we use 5-year forward-looking default probabilities from the National University of Singapore's Credit Research Initiative (NUS-CRI) as an alternative credit risk measure. A one standard deviation inflation increase on average corresponds to a 7% rise in the firm's 5-year default probability. Importantly, this relationship is concentrated in the medium- and high-inflation regimes, reinforcing the non-linear inflation-credit risk link found in our CDS analysis.

Our study makes three key contributions to the literature on inflation and credit risk.[5] First, we provide new international evidence on the relation between inflation and corporate credit risk using CDS spreads. More importantly, the global setting allows us to show that the inflation–credit risk relation varies systematically across monetary regimes, institutional environments, and firm financing and operating characteristics in ways that are difficult to identify in single-country or narrower-sample settings. In this sense, our paper complements prior work on inflation and credit risk in more limited settings, such as Kang and Pflueger (2015) and Bhamra et al. (2023), and builds on related evidence that nominal rigidities matter for asset pricing and firm-level outcomes (Weber (2015) and Gorodnichenko and Weber (2016)).

Second, we document a convex relationship between inflation and corporate credit risk, with the relation being negative or weak at low inflation levels but becoming much more positive in high-inflation environments. This nonlinear pattern helps reconcile why prior studies conducted in different inflation settings may reach different conclusions and complements Bhamra et al. (2023) by showing how the net effect of inflation on credit risk varies across inflation regimes in a broad international setting.

Third, we show that the inflation-credit risk relation depends jointly on financing-side and operating-side rigidities. In this respect, our evidence complements prior studies on debt

[5] Our findings contribute to the broader literature on inflation's impact on the economy (e.g., Fischer (1981 and 1993), Barro (1996), Bruno and Easterly (1998), Fischer, Sahay, and Végh (2002)) and on equity markets (e.g., Fama (1981), Chen, Roll, and Ross (1986), Ang, Briere, and Signori (2012), and Boons, Duarte, Roon, and Szymanowska (2020)). The traditional view attributes equity sensitivity to inflation to the discounting of real cash flows using nominal rates. More recent research highlights additional channels, such as sticky prices (Weber (2015)) and the combined effects of sticky leverage and cash flows (Bhamra et al. (2023)), through which inflation risk is priced in equity returns.

structure, price rigidity, and inflation transmission, including Weber (2015), Gorodnichenko and Weber (2016), D'Acunto et al. (2018), and Augustin et al. (2025), by linking these mechanisms directly to firm-level credit risk in a global setting. More broadly, our study advances the credit-risk pricing literature by incorporating inflation into firm-level credit-risk analysis using forward-looking, market-based CDS spreads and a broad set of robustness and supplementary identification tests.[6]

II. Conceptual Framework and Hypotheses Development

We develop a stylized model as a conceptual framework to organize our hypothesis development and discipline the empirical predictions. The model is not intended to be a full structural model of endogenous capital structure, debt indexation, or pricing choice. In practice, firms' leverage, debt maturity, and pricing decisions are themselves endogenous responses to inflation risk. Our framework abstracts from these endogenous choices for tractability and adopts a reduced-form structure to derive qualitative restrictions on how debt rigidity (related to leverage and debt maturity) and operating rigidity (related to price and operating cash-flow stickiness) shape the inflation-credit risk relation. Appendix A presents the basic model setup. The model illustrates how these two channels can jointly generate a convex inflation-credit risk

[6] Previous studies have focused on the effects of macroeconomic conditions (e.g., economic cycles, GDP growth, stock market returns and volatility, interest rates), firm characteristics (e.g., volatility and leverage), and country institutional environments (e.g., property rights and creditor rights) on firm credit risk. A partial list includes Collin-Dufresne, Goldstein, and Martin (2001), Longstaff et al. (2005), Duffie, Saita, and Wang (2007), Campbell, Hilscher, and Szilagyi (2008), Ericsson, Jacobs, and Oviedo (2009), Bai, Collin-Dufresne, Goldstein, and Helwege (2015), Benzoni, Collin-Dufresne, Goldstein, and Helwege (2015), Lee et al. (2016), Augustin and Izhakian (2020), and Hasan et al. (2025).

relation and how the strength of this relation can vary across firms with different levels of debt rigidity and operating rigidity and countries with different institutional environments.[7]

To make the conceptual framework more transparent, we summarize below the core setup and motivating equations from Appendix A to clarify the mechanism that links inflation, debt rigidity, operating rigidity, and firm default risk. In the model, firm value depends on inflation-sensitive operating cash flows and nominal debt obligations. Let firm cash flows be given by

(1) $$X = \mu(1 + \delta\pi - \psi\pi^2 + \varepsilon)$$

where $\mu > 0$ is the firm's baseline cash flow component, π is the inflation rate, $\delta \in [0,1]$ is the pass-through parameter capturing the revenue-side elasticity of nominal cash flows with respect to inflation, $\psi > 0$ captures nonlinear input-cost pressures,[8] and $\varepsilon \sim N(0, \sigma^2)$ is an idiosyncratic cash flow shock.

Debt obligation (i.e., coupon payment obligation) is given by

(2) $$C(\pi) = (1 - \lambda)c + \lambda c e^{\pi} = c[(1 - \lambda) + \lambda e^{\pi}]$$

When $\lambda = 0$, the coupon payment is fully fixed at c; when $\lambda = 1$, it is fully indexed to inflation. Hence, λ captures the extent of debt-easing from nominal rigidity. Default risk increases when cash flows fall relative to debt obligations. Thus, inflation is associated with credit risk through two opposing channels: the debt-rigidity channel, which reduces the real burden of debt when

[7] While our baseline framework treats leverage, debt maturity, and price flexibility as predetermined for tractability, the observed cross-sectional heterogeneity in these variables can be interpreted as reflecting firms' ex ante optimization under different inflation exposures.

[8] As inflation intensifies, input costs often rise at an accelerating pace due to factors such as supply chain disruptions, surging commodity prices, and wage pressures. Thus, higher inflation tends to produce disproportionately larger cost increases.

nominal obligations are sticky, and the operating-rigidity channel, which compresses margins when firms cannot pass rising input costs through to customers.

Combining the two channels implies that the effect of inflation on credit risk can be written as a nonlinear function of inflation,

$$\frac{dPD}{d\pi} = f(\pi, c, \psi, \delta, \mu, \sigma, \lambda), \tag{3}$$

Where *PD* is the firm's probability of default, and the sign of the derivative depends on the relative strength of the debt-rigidity and operating-rigidity channels. At low inflation levels, the debt-rigidity channel may dominate; at sufficiently high inflation levels, the operating-rigidity channel becomes stronger. It can be shown that the turning point of inflation level π^* satisfies

$$\frac{c}{\mu}\lambda e^{\pi^*} + 2\psi\pi^* - \delta = 0 \tag{4}$$

At low inflation levels such that $\pi < \pi^*$, $\frac{dPD}{d\pi} < 0$ and debt-easing dominates. At sufficiently high inflation levels such that $\pi > \pi^*$, $\frac{dPD}{d\pi} > 0$ and the operating-rigidity channel dominates. Appendix A formalizes these channels in a stylized reduced-form framework, while the main text focuses on the qualitative comparative statics that motivate the empirical analysis. Specifically, the model yields predictions about the sign, curvature, and heterogeneity of the inflation-credit risk relation, which guide the empirical analyses that follow.[9]

A. Debt Rigidity versus Operating Rigidity

As illustrated in Appendix A.1, inflation affects firm credit risk through two competing mechanisms. The first is the debt-rigidity channel. When debt obligations are fixed in nominal terms, higher inflation reduces the real value of promised repayments and can thus lower default risk. This is important when leverage is high and debt is long duration, fixed rate, and only

[9] Please refer to Appendix A for the full derivations of the model and empirical predictions.

weakly indexed to inflation. This channel has been theoretically and empirically supported in prior work (e.g., Bhamra et al. (2011); Kang and Pflueger (2015), Gomes et al. (2016), Bhamra et al. (2023), and Schnorpfeil et al. (2023)).

The strength of the debt-rigidity channel depends critically on a firm's debt structure, particularly the share of fixed- vs. floating-rate debt and the maturity profile of its liabilities. Firms with a higher share of fixed-rate, long-term debt benefit more from inflation, as the real cost of servicing debt declines. Conversely, for firms reliant on floating-rate debt or with significant short-term refinancing needs, inflation can raise borrowing costs. According to the Fisher Effect (Fisher, 1930), nominal interest rates adjust with expected inflation. Central banks typically counter inflation by raising policy rates (Mishkin (1981)), which tighten credit conditions (Bernanke and Blinder (1992)). Ippolito, Ozdagli, and Perez-Orive (2018) describe this as the "floating-rate channel," where monetary policy directly increases financing costs for firms with floating-rate loans. Kirti (2020) further notes that banks favor floating-rate contracts, as they enable lenders to pass on rate hikes to borrowers. This, however, amplifies firms' debt service burdens.[10]

This dynamic is particularly relevant in global markets. According to the IMF (2023), in 45 countries, floating-rate debt accounts for more than half of total corporate borrowing,

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[10] The IMF (2023) warned that a sudden tightening in financial conditions, such as a shift in inflation expectations, could trigger corporate distress and test the resilience of highly leveraged firms. Despite some pass-through of inflation-driven costs, U.S. corporate earnings have declined, reflecting margin pressures. Weakened profitability, combined with tighter funding conditions, is expected to erode financial buffers globally (Figure 1.13, panels 5 and 6). These adverse dynamics are also reflected in recent bankruptcy trends. These dynamics are echoed in the 58% surge in U.S. business bankruptcies in 2023, attributed to persistent inflation, rising interest rates, and tighter lending standards (see https://www.foxbusiness.com/economy/business-bankruptcies-surged-58-percent-2023).

exposing firms to heightened sensitivity to rising interest rates. Furthermore, the IMF (2024) highlights a growing gap between existing coupon rates and prevailing refinancing yields. These developments call into question the generalizability of the sticky leverage channel across global markets, where floating-rate debt and refinancing pressures may dominate.

The second mechanism is operating rigidity (Gorodnichenko and Weber (2016) and Augustin et al. (2025)). While some firms can pass rising input costs, such as those for raw materials, energy, and labor, on to consumers and maintain their operating margins, others cannot. For these firms, escalating costs compress profit margins, weaken cash flows, and increase default risk. The effectiveness of cost pass-through is constrained by cash-flow stickiness, which reflects nominal rigidities, a central concept in New Keynesian macroeconomics.

Nominal rigidity refers to the slow adjustment of prices in response to shocks, particularly in the short run, due to staggered price-setting, menu costs, informational frictions, contractual constraints, and behavioral inertia. Prior research (e.g., Nakamura and Steinsson (2008) and Gorodnichenko and Weber (2016)) provides robust evidence that firms struggle to adjust prices and revenues promptly in response to inflation, reinforcing the notion of sticky cash flows. When output prices are less flexible than input prices, inflation compresses margins by raising costs more than revenues, thereby reducing profitability and increasing default risk. Empirical studies also show that price rigidity varies substantially across firms, sectors, and countries (e.g., Galí, Gertler, and Lopez-Salido (2001), Pasten, Schoenle, and Weber (2020), and Cho, Kim, and Kim (2023)).[11]

[11] Bils and Klenow (2004) observe more frequent price adjustments than usually assumed in calibrated macro models. Weber (2015) finds that sticky-price firms are riskier and command an equity return premium compared to

Due to heterogeneity in factors such as leverage structure, debt maturity profiles, and pricing rigidity (IMF (2023 and 2024) and ECB (2024)), the dominance of one channel over the other varies across countries. As a result, the global relationship between inflation and firm credit risk remains an open empirical question determined by the interplay between debt-easing benefits and inflation-induced cost pressures. If the debt-rigidity channel dominates on average, we expect:

H1a: *The global relationship between inflation and firm credit risk is on average negative.*

Conversely, if inflation-induced cost pressures outweigh debt relief, then:

H1b: *The global relationship between inflation and firm credit risk is on average positive.*

B. The Convex Relationship Between Inflation and Firm Credit Risk

In our framework, debt-rigidity and operating-rigidity channels jointly determine a convex U-shaped relationship between inflation and firm credit risk. Intuitively, at low to moderate inflation levels, the debt-rigidity channel dominates: inflation reduces the real value of nominal liabilities, alleviates financial constraints, and lowers the probability of default. Firms can incrementally adjust output prices without materially affecting demand.[12] In addition, nominal rigidities, such as fixed input contracts and sticky wages, can reduce real input costs, improving margins. However, as inflation rises, this dynamic reverses. The input-cost channel

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firms with more flexible prices. Gorodnichenko and Weber (2016) show that, following monetary policy announcements, the conditional volatility of stock returns increases more for firms with stickier prices than for those with flexible prices.

[12] Moreover, central banks are unlikely to tighten monetary policy aggressively when inflation is low.

begins to dominate, driven by compounding frictions, such as disrupted supply chains, rising commodity prices, and wage pressures as workers seek to maintain real incomes.[13]

Section A.1 of Appendix A formally shows that the interaction between debt rigidity and nonlinear operating-cost pressure can generate a turning point beyond which the inflation-credit risk relation becomes positive. The shift occurs via a convex cost function, where input costs rise at an increasing rate as inflation intensifies. Persistent inflation also erodes households' real purchasing power, weakens demand, and compresses firms' pricing power. As Mishkin (1981) emphasizes, high inflation undermines price stability and increases macroeconomic uncertainty, distorting investment and consumption.

Therefore, our framework motivates a convex inflation-credit risk relationship: the marginal effect of inflation may be weak or even negative at low inflation levels, but increasingly positive once inflation becomes sufficiently elevated. We do not treat this convexity as mechanically implied in all settings. Rather, it is a prediction that depends on the relative strength of the two channels and is therefore examined directly in the data. This framing also motivates our later heterogeneity tests, which assess whether the nonlinear pattern is more pronounced when firms face greater refinancing vulnerability, stronger pass-through constraints, or more fragile country-level institutional environments:

> ***H2:*** *At low levels of inflation, the relation tends to be negative, whereas at high inflation levels it becomes positive.*

C. Leverage Stickiness, Cash-flow Stickiness, and Country-Level Characteristics

[13] At the same time, central banks are likely to respond with tighter monetary policy, raising refinancing costs and debt-servicing burdens (Asquith, Gertner, and Scharfstein (1994)).

Our theoretical framework also highlights how firm- and country-level heterogeneity shape the convex relationship between inflation and credit risk. Sections A.2 and A.3 of Appendix A present the comparative statics showing that the inflation-credit risk relation becomes more positive when firms face greater refinancing vulnerability, stickier cash flows, and greater underlying cash-flow uncertainty.

The framework shows that a central source of heterogeneity is debt stickiness, which determines the extent to which firms benefit from the debt-easing effects of inflation. In the baseline case with fixed nominal debt (i.e., sticky debt), moderate inflation reduces the real value of future debt obligations, improving creditworthiness, especially for highly leveraged firms. This benefit, however, depends critically on the extent to which debt payments are insulated from inflation and interest-rate adjustments. When coupon payments are fully indexed to inflation, the debt-rigidity channel vanishes because inflation raises nominal repayment obligations directly, producing a more monotonic increase in credit risk. With partial indexation, credit risk becomes more sensitive to inflation as the share of indexed debt rises. More generally, firms with less insulated debt structures are more exposed to the adverse financing consequences of inflation.

Empirically, firm-level data on inflation-indexed or floating-rate debt are often unavailable. We thus use debt maturity structure as a proxy for inflation exposure, focusing on the share of short-term debt. Firms with more short-term debt face more frequent refinancing needs and are more exposed to increases in borrowing costs during inflationary periods. As inflation accelerates, these firms are more likely to experience tighter financial conditions and elevated credit risk.

The inflation-credit risk relation should also depend on the monetary regime in which firms operate. When monetary policy responds more aggressively to inflation, inflationary shocks are more likely to translate into higher policy rates, tighter borrowing conditions, and greater debt-servicing burdens. As a result, the relation between inflation and credit risk is expected to be more positive in countries where inflation feeds more strongly into policy-rate increases. This cross-country variation in monetary-policy responsiveness is one of the key comparative advantages of our global setting.

H3.1: *The positive relation between inflation and credit risk is stronger for firms with higher leverage and more short-term debt, and for firms operating in countries with more inflation-responsive monetary regimes.*

The second key factor shaping the inflation-credit risk relationship is cash-flow stickiness, that is, the extent to which a firm's operating cash flows fail to keep pace with rising input costs. In our model, this arises when inflation-driven input cost increases outpace a firm's ability to adjust output prices, often due to limited pricing power, rigid contracts, or highly elastic demand. A firm's ability to pass through costs depends critically on market structure, product differentiation, and demand conditions. Firms with strong pricing power (e.g., due to brand strength, technological advantage, or customer loyalty) can better preserve margins during inflationary periods. In contrast, firms in highly competitive industries face rigid pricing constraints (Weber (2015)), limiting their ability to offset rising input costs.[14] This leads to margin compression, weakened cash flows, and increased credit risk. As a result, firms with greater cash-flow stickiness exhibit a stronger sensitivity of credit risk to inflation.

[14] This issue is consistent with the findings of Rotemberg (1982) and Nakamura and Steinsson (2008), who highlight price stickiness at both macro and micro levels.

To capture this idea empirically, we rely primarily on proxies for price flexibility. Specifically, we use a measure of industry-level price-change frequency constructed from Cavallo's (2018) micro-price data. We complement this industry-level proxy with a firm-level measure of the responsiveness of cash flows to inflation. Together, these measures allow us to assess whether firms with more flexible pricing and less sticky cash flows are less exposed to inflation-induced credit risk.

H3.2: *The positive relation between inflation and credit risk is stronger for firms operating in industries with lower price flexibility and for firms whose operating cash flows do not keep pace with rising input costs.*

Finally, we extend our analysis to country-level heterogeneity by incorporating macro-institutional heterogeneity.[15] Sections A.2 and A.3 in Appendix A show that greater underlying cash-flow uncertainty amplifies the positive relation between inflation and credit risk. In the model, this appears as higher volatility of firm cash flows. Such higher volatility can arise in countries with weaker governance, lower transparency, and weaker contract enforcement, all of which increase cash flow volatility and reduce firms' ability to absorb inflation-induced shocks, thereby increasing their default risk.[16] Thus, we expect:

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[15] In a global study, country-specific characteristics may explain significantly more variance than observable firm-level characteristics. For instance, Doidge et al. (2007) demonstrate that country-level factors explain a larger share of the variance in corporate governance (39% to 73%) compared to firm-level factors (4% to 22%). Prior studies indicate that a country's institutional environment, encompassing both formal and informal institutions, affects market assessments of firm credit risk (e.g., Lee et al. (2016) and Hasan et al. (2025)). Hasan et al. (2023) show that country-level factors like political stability and crisis management impact corporate CDS spreads during Covid-19.

[16] For example, poor law enforcement and contract enforcement in a country may lead to expropriation by managers. Johnson, Boone, Breach, and Friedman (2000) show that countries with weak corporate governance standards

H3.3: *The positive relation between inflation and credit risk is stronger in countries with weaker institutional environments.*

Taken together, our theoretical framework predicts that the inflation-credit risk relation should become more positive when firms face greater refinancing vulnerability, more sticky operating cash flows, and greater underlying cash-flow uncertainty. It also predicts that these forces should become more salient in high-inflation environments. Our empirical tests in subsections B and C in section IV are organized around these restrictions implied by theory. Notably, we interpret the corresponding heterogeneity variables as observed equilibrium outcomes that summarize firms' financing and operating flexibility, rather than as exogenous primitives. We acknowledge that our model yields a set of qualitative empirical restrictions rather than a full structural mapping.

III. Data, Sample, and Summary Statistics

A. Data and Sample

We obtain CDS pricing data from Markit and focus on five-year maturity contracts, which represent the most liquid segment of the CDS market. All selected contracts are written on senior debt. CDS spreads are converted from daily to annual frequency using the average value.[17]

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suffered the most during the Asian Financial Crisis, as managers in these countries lacked the incentive to exert maximum effort to recover from the crisis, knowing they were unlikely to be replaced. Kang and Pflueger (2015) find that inflation risk is incorporated into credit spreads in developed countries with moderate inflation and predict that its impact on credit risk is even greater in emerging markets with more volatile inflation.

[17] For robustness, we also use end-of-year and annual median values. Results are consistent with our baseline results.

Inflation data and other country-level indicators are sourced from the World Bank, while firm-level data are obtained from Compustat and Compustat Global. Our final sample consists of 13,237 firm-year observations from 1,127 firms across 50 countries, covering the period from 2001 to 2022. This dataset allows for a comprehensive analysis of the relation between inflation and corporate credit risk across diverse economic and institutional environments.[18]

Table 1 presents the distribution of our sample firms by country. The sample is geographically diverse, and the distribution of firms varies widely across countries, with the largest representations from the United States (39.86%), Japan (19.84%), the United Kingdom (5.85%), Germany (3.81%), France (3.28%) and India (3.1%).

[Insert Table 1 here]

Table 2 reports the level of inflation (i.e., Consumer Price Index headline inflation) by country and year within our sample. We find that different countries face significantly different inflation rates. The countries with the highest average inflation rates are Turkey (8.8%), Russia (8.74%), and Pakistan (7.59%), whereas the countries with the lowest inflation levels are Japan (0.23%), Switzerland (0.4%), and United Arab Emirates (0.66%). Regarding inflation trends by year, the highest levels were observed in 2022 (6.96%) and 2008 (5.3%). These spikes

[18] Our CDS-based analysis is naturally centered on large, publicly listed, and internationally active firms for which market-based credit risk measures are observable. Because traded CDS contracts are concentrated among firms that are typically investment-grade or near-investment-grade, our evidence most directly speaks to the relation between inflation and the market-based credit risk of this segment of firms. Accordingly, the results should not be interpreted as applying uniformly to all firms, especially smaller firms, private firms, or firms that rely primarily on bank finance rather than traded debt markets.

correspond to global financial crisis and the post-pandemic periods. Conversely, the lowest inflation levels were recorded in 2015 (1.44%) and 2020 (1.63%).

[Insert Table 2 here]

Figure 2 presents a scatter plot, which illustrates a positive relationship on average between average CDS spreads and inflation at the country-year level.

[Insert Figure 2 here]

B. Summary Statistics

We control for a range of firm and country characteristics when examining the relation between inflation and corporate CDS spreads. At the firm-year level, our controls include firm size, leverage, return on assets, investment-grade credit rating status, and stock return volatility. At the country level, we control for GDP, GDP growth, private credit-to-GDP ratio, and the unemployment rate.[19] These characteristics have been identified as significant determinants of CDS pricing in previous studies (e.g., Ericsson et al (2009), Lee et al (2016), and Hasan et al. (2023)). Appendix B provides detailed definitions of all variables.

Table 3 presents the descriptive statistics for our sample. The average firm in our sample has a CDS spread of 1.63% (163 basis points), log total assets of 9.27 (equivalent to total assets of $10,615 million), a leverage ratio of 29%, a ROA of 12% and stock return volatility of 2%. Additionally, 53% of firms carry investment-grade credit rating. The countries in our sample have an average inflation rate of 1.88%, GDP growth of 1.84%, Credit-to-GDP ratio of 154%, and unemployment rate of 5.64%.

[Insert Table 3 here]

[19] All continuous variables are winsorized at the 1st and 99th percentiles to mitigate the influence of outliers.

IV. Empirical Results

This section presents our empirical results. Section A reports the baseline findings for the global sample, including instrumental variable estimates. Section B tests the convexity of the inflation–credit risk relationship. In Section C, we examine how this relationship varies with firm-level debt and cash-flow stickiness, as well as country-level financial and institutional environments. Section D analyzes the relation between inflation and credit risk across the CDS term structure. Section E presents results for the U.S. sample and various robustness checks. Finally, Section F validates our findings using forward-looking default probabilities.

A. Baseline Findings

1. Baseline Regression Results

To examine the relation between inflation and corporate CDS spreads, we estimate the following model:

$$(5) \qquad CDS\_Spread_{i,t+1} = \alpha + \beta Inflation_{c,t} + \gamma Z_{i,c,t} + Industry_j Year_t + Firm_i + \varepsilon_{i,c,t}$$

where *c* denotes country, *j* denotes industry, *i* denotes firm and *t* denotes year. The dependent variable, $CDS\_Spread_{i,t+1}$, represents the average CDS spread of Firm *i* in Year *t*+1. The key independent variable, $Inflation_{c,t}$, measures the annual inflation rate in Year *t* in the headquarter country of Firm *i*. $Z_{i,c,t}$ includes firm and country characteristics that may influence a firm's CDS spread. We control for industry-by-year fixed effects $Industry_j Year_t$ to account for time-varying differences across industry groups over time, and firm fixed effects $Firm_i$ to control for time-invariant firm-specific factors. Standard errors are clustered at the country level to account for potential correlations in the error terms across firms within the same country.

We begin with an unconditional regression without control variables and fixed effects. Column (1) of Table 4 presents the results. We find a positive and significant relationship between inflation and firm CDS spreads in the subsequent year at the 1% level, suggesting that the operating-rigidity channel on average dominates the sticky leverage channel in our global sample.

Next, in Column (2), we introduce industry-by-year fixed effects to control for industry-specific economic shocks. The positive relationship between inflation and CDS spreads remains significant at the 1% level. In Column (3), we add firm-level and country-level controls, and the positive relation persists, still significant at the 1% level. In Column (4), we incorporate country fixed effects to focus on within-country variation, finding that inflation continues to exhibit a significant positive relation with CDS spreads at the 5% level. Importantly, in Column (5), we include firm fixed effects to examine within-firm variation, where inflation's positive relationship with CDS spreads is again significant at the 1% level. The coefficient estimates on the control variables generally exhibit the expected signs. In particular, higher CDS spreads are associated with firms that are smaller in size, more highly leveraged, less profitable, rated below investment grade, and exhibit greater stock return volatility.

[Insert Table 4 here]

In economic terms, after controlling for firm fixed effects and industry-year fixed effects, Column (5) suggests that a one-standard-deviation increase in inflation (i.e., 1.9%) in a firm's headquarter country is, on average, associated with a 21-basis-point increase in CDS spreads in the following year (i.e., $0.112 \times 1.9\%$). This corresponds to a 13% increase relative to the sample mean of 163 basis points and amounts to about 8% of the overall sample standard deviation of CDS spreads (252 basis points).

In addition, we compare the 21-basis-point estimate with three relevant benchmarks. First, it amounts to roughly 20% of the average within-firm time-series standard deviation of CDS spreads, which is 104 basis points. Second, relative to the cross-country standard deviation of average CDS spreads (210 basis points), it represents about 10% of the variation across countries. Third, compared with typical movements in monetary policy, measured as an average absolute annual change in policy rates of 65 basis points, it is approximately one-third as large. Taken together, these comparisons suggest that the relation between inflation and CDS spreads is economically meaningful.

2. Identification

A potential endogeneity concern in our baseline analysis is omitted variable bias. Although we control for a comprehensive set of firm- and country-level characteristics, as well as firm fixed effects and industry-by-year fixed effects, unobserved time-varying shocks, such as macroeconomic policy shifts or firm-specific hedging strategies, may still be correlated with both inflation and corporate CDS spreads, potentially biasing our estimates.

To address this concern, we follow Oster (2019) to assess sensitivity to omitted variable bias under proportional selection (e.g., see Bachmann, Born, Goldfayn-Frank, Kocharkov, Luetticke, and Weber (2021)). Because our preferred specification includes firm and industry-by-year fixed effects, we implement the test using a baseline model that retains these same fixed effects but excludes observable controls. We then compare this baseline to the fully specified model, so that the only difference between the two specifications is the inclusion of observable controls. As reported in Appendix C.1, the implied Oster coefficient δ required to explain away the estimated δ is negative (i.e., -0.72). This arises because the estimated coefficient on inflation remains essentially unchanged, and even increases slightly, when controls are added (0.112

compared to 0.107). This finding helps alleviate the concern that omitted variables would attenuate the estimated effect.

To further address the endogeneity concern, we employ an instrumental variable (IV) strategy, using two global cost-shock proxies as instruments for inflation: WTI crude oil prices and the Baltic Dry Index (BDI). Both instruments transmit inflationary pressures primarily through their effects on input costs—with crude oil serving as a critical input for production and transportation, and the BDI reflecting global shipping and logistics expenses.[20] These cost components directly contribute to inflation, thereby satisfying the relevance condition for valid instruments. Conditional on firm characteristics, macroeconomic controls, and firm fixed effects, fluctuations in oil prices or shipping costs are less likely to affect a firm's CDS spread through channels other than inflation, although we do not view the exclusion restriction as airtight. Global cost shocks may also affect corporate credit risk through broader macroeconomic channels, such as investor sentiment, consumption, aggregate demand, or wider disruptions in global economic conditions. Accordingly, we interpret the IV results cautiously and view them as supplementary evidence supporting our baseline findings rather than as a definitive source of causal identification.

[Insert Table 5 here]

Table 5 reports the results from the two-stage least squares (2SLS) regression analysis. The first-stage results of Panel A in Column (1) and (2) confirm that both instruments are

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[20] The IMF ascertained that food, energy and transportation costs are the main drivers of the global inflation wave in 2021 to 2022. (See https://www.imf.org/en/Blogs/Articles/2022/09/09/cotw-how-food-and-energy-are-driving-the-global-inflation-surge).

strongly and significantly associated with inflation.[21] In the second stage, the coefficient estimate on instrumented inflation remains statistically significant at the 1% level, consistent with our baseline finding of a positive relation between inflation and corporate credit risk.

To further strengthen our identification strategy, we incorporate country-specific exposure to oil prices and shipping costs. Countries vary considerably in their dependence on oil imports and global shipping, leading to heterogeneity in how global cost shocks pass through to domestic inflation. We exploit this cross-country variation to construct instruments that vary across both time and space. Specifically, we compute two country-level inflation betas by regressing national inflation on WTI crude oil prices and the Baltic Dry index, respectively, capturing each country's sensitivity to oil price shocks changes in global shipping costs.

We interact each beta with its respective global shock to create two refined instruments: oil beta × WTI oil price and shipping beta × BDI. To account for sector-specific inflation sensitivity, we also include industry-by-year fixed effects in our 2SLS regressions. The second-stage results of the 2SLS regressions in Column (3) and (4) of Panel A remain statistically significant at the 1% level, consistent with a positive relation between the exogenous component of inflation and future CDS spreads.

In Panel B of Table 5, we exclude countries with unusually high macroeconomic exposure to oil price fluctuations. In such economies, oil prices may affect CDS spreads through broader macroeconomic channels beyond inflation, thereby weakening the exclusion restriction. To identify these countries, we estimate country-level regressions of GDP growth on oil prices

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[21] The Hansen *J* test statistic is 1.911, with one degree of freedom, yielding a high *p*-value that indicates we fail to reject the null hypothesis that the instruments are valid. This indicates that the instruments are uncorrelated with the second-stage residuals and correctly excluded from the structural equation.

and use the resulting oil-price sensitivity (beta) as a measure of macroeconomic oil exposure. We then exclude countries whose absolute beta lies in the top decile of the distribution and, alternatively, in the top quintile.[22] We reestimate the IV specification on these restricted samples. The results, reported in Panel B, remain qualitatively similar to our baseline IV findings, providing a partial check that the findings are not solely driven by countries with unusually high macroeconomic sensitivity to oil-price shocks, although they do not fully resolve exclusion-restriction concerns.

In summary, our 2SLS findings provide supplementary evidence consistent with a positive relation between inflation and corporate credit risk, but we interpret these results cautiously and place greater weight on the broader set of baseline and robustness analyses.

B. The Convexity of the Inflation-Credit Risk Relationship

To test Hypothesis H2 (i.e., the convex relationship between inflation and corporate credit risk), we employ two empirical strategies, with results presented in Table 6. First, we include both the linear and squared terms of inflation in our regression model. Columns (1) and (2) show that the coefficient on the linear term is negative and marginally significant at the 10% level, while the coefficient on the squared term is positive and highly significant at the 1% level, supporting Hypothesis H2. The empirical results indicate a convex relationship: when inflation is below the inflection point of 1.29% (calculated as $1.29 = 0.067 / (2 \times 0.026)$), the relationship between inflation and credit risk is negative. However, once inflation surpasses this threshold, the relation turns positive and becomes increasingly more positive as inflation rises.

[Insert Table 6 here]

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[22] We focus on the absolute value of the beta because the exclusion-restriction concern arises whenever a country is highly sensitive to oil price shocks, regardless of whether the effect on domestic activity is positive or negative.

Second, we estimate a spline regression by dividing inflation into terciles: *Low Inflation*, *Median Inflation*, and *High Inflation*. Each spline variable equals the inflation value if inflation falls within the corresponding tercile, and zero otherwise. As shown in Columns (3) and (4), the coefficient on *Low Inflation* is negative but statistically insignificant, while *Median Inflation* is positive but also insignificant. Importantly, only *High Inflation* exhibits a statistically significant and positive relation with CDS spreads at the 1% level. These results further support the nonlinear, convex relationship between inflation and corporate credit risk. At low inflation levels, firms may benefit from moderate price increases through a "sticky leverage" mechanism, as rising inflation reduces the real burden of nominal debt. However, at high inflation levels, surging input costs and financial tightening outweigh these benefits, leading to higher credit risk.

Visually, Figure 3 presents a plot of CDS spreads with a smooth convex curve (estimated using kernel-weighted local polynomial regression) across deciles based on the level of inflation at the firm's headquarter country, where decile 1 contains the observations with the lowest inflation and decile 10 contains the observations with the highest inflation. Consistent with our regression results, the figure reveals a clear convex relationship between inflation and CDS spreads: the relation is negative at low inflation levels (deciles 1-3), remains relatively flat at intermediate inflation levels (deciles 4-7), and becomes markedly more positive at higher levels (deciles 8-10).

[Insert Figure 3 here]

C. Heterogeneity in Leverage Stickiness, Cash-flow Stickiness, and Institutional Factors

1. Leverage, Short-term Debt, and Monetary Regimes

Next, we test Hypothesis H3.1. We anticipate that the inflation effect on credit risk is more pronounced in firms with higher leverage and a higher proportion of short-term debt relative to long-term debt, as these firms face greater refinancing needs.[23] We interpret leverage and debt maturity here as observed equilibrium features of firms' financing structures that summarize their refinancing vulnerability, rather than as exogenous choices. In this sense, the tests are designed to assess whether the observed cross-sectional variation in financing rigidity affects the inflation-credit risk relation in the direction implied by the conceptual framework.

We first interact firm leverage with inflation to assess the relation between inflation and CDS spreads, conditional on a firm's leverage level. The results, presented in Column (1) of Panel A of Table 7, show that the relation between inflation and CDS spreads is more substantial in highly leveraged firms. The economic magnitude is large. A one standard deviation increase in inflation is, on average, associated with an incremental increase of 15 basis points in one-year-ahead CDS spreads (i.e., $1.9 \times 0.368 \times (0.39 - 0.18)$) when a firm's leverage increases from the 25th percentile to the 75th percentile.

[Insert Table 7 here]

Next, we examine how debt maturity affects the relationship between inflation and credit risk by interacting the ratio of short-term debt to long-term debt (i.e., *Short Term Debt / Long Term Debt*) with inflation. The results in Column (2) indicate that firms with a higher ratio of short-term to long-term debt exhibit a stronger positive relation between inflation and CDS

[23] We focus on firm-level debt structure rather than country-level corporate debt structure for two reasons: 1) data on country-level corporate debt structure is missing for most country-years in our sample, and 2) it is firm-level debt structure that moderates the relationship between inflation and firm-level credit risk.

spreads, supporting the idea that greater refinancing needs are associated with greater vulnerability to inflation-related financing pressures.[24]

We further hypothesize that the positive relation between inflation and credit risk is more pronounced in countries operating under inflation-targeting monetary regimes. The underlying mechanism is that central banks in such regimes are more likely to respond to increases in inflation by raising policy rates, thereby increasing firms' cost of funding and, in turn, credit risk. To proxy for the extent of inflation targeting, we estimate country-level regressions of domestic policy rates (sourced from the IMF) on inflation and obtain the corresponding sensitivity, *Beta (Monetary Regime)*. Countries with higher *Beta (Monetary Regime)* are interpreted as exhibiting stronger inflation-targeting behaviour, as their monetary policy responds more aggressively to inflation fluctuations. We then interact this beta with inflation in our baseline specification. The results, reported in Column (3) of Panel A, indicate that the relation between inflation and CDS spreads is significantly stronger in countries with more inflation-responsive monetary regimes, consistent with our hypothesis.

In Panel B of Table 7, we further interact inflation terciles (i.e., *Low Inflation*, *Median Inflation*, and *High Inflation*) with *Leverage*, *Beta (Monetary Regime)* and *Short Term Debt / Long Term Debt* in Columns (1)-(3), respectively. The interaction terms are statistically significant only in the high-inflation tercile. These findings support our prediction that firms with higher leverage and greater refinancing needs, and firms operating in countries with more

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[24] Notably, U.S. firms in our sample have an average short-term to long-term debt ratio of only 0.26, reflecting a relatively low refinancing need compared to non-U.S. firms, which average 0.62. This disparity provides another explanation for the differing inflation-credit risk findings for US firms reported in Bhamra et al. (2023).

inflation-responsive monetary regimes, are more vulnerable to inflation-induced credit risk, particularly in high-inflation environments.

2. Cash-flow Stickiness

When assessing the relation between inflation and corporate credit risk via the operating-rigidity channel, it is important to recognize that firms with sticky cash flows are particularly vulnerable. Sticky cash flows occur when a firm's cash flows fail to rise, or even fall, in response to inflation, due to weak pricing power and inflexible cost structures. As articulated in Hypothesis H3.2, we expect the relation between inflation and credit risk to be more positive for firms with greater cash-flow stickiness.

To test this mechanism, we first construct a direct measure of industry-level price flexibility using the online micro-price data of Cavallo (2018). This dataset contains daily product-level prices from four large U.S. retailers (i.e., a supermarket, a department store, a drugstore, and an electronics retailer) over the period 2008 to 2010. For each product, we compute the frequency of price changes, defined as the number of days with a price change divided by the total number of observed days for that product. Each product is classified using COICOP codes. Following official UN correspondence tables, we map COICOP codes to ISIC classifications and then to NAICS industries. We then assign each three-digit NAICS industry a dominant COICOP category based on the modal mapping, thereby constructing industry-level measures of price flexibility.

Although this measure is derived from U.S. micro-price data over a relatively short period, we use it only as an industry-level proxy for relative price flexibility. The rationale is that repricing flexibility partly reflects product-market characteristics that are often shared across broad industries, even though the absolute degree of price rigidity may vary across countries and over time. We therefore apply this industry-level measure across our full sample, implicitly assuming that relative differences in price flexibility across industries are reasonably stable across countries and over time. Industries with above-median price-change frequency are classified as having lower price stickiness, that is, greater price flexibility.

We interact this indicator with inflation and report the results in Column (1) of Panel A in Table 8. The negative interaction implies that the positive relation between inflation and CDS spreads is weaker in industries with greater repricing flexibility. Economically, this suggests that firms operating in such industries are better able to pass rising input costs through to customers and thereby protect operating margins during inflationary periods.

Next, we construct a firm-level measure of cash-flow stickiness by estimating firm-specific sensitivities of cash flows to inflation. Firms with higher sensitivity (beta) exhibit greater cash flow responsiveness to inflation, indicating lower cash-flow stickiness and higher cash flow flexibility. We interact this beta with inflation and present the results in Column (2). The negative interaction indicates that the positive inflation-credit risk relation is attenuated for firms whose operating cash flows respond more favorably to inflation. This pattern is consistent with the idea that more flexible cash flows help firms absorb inflation-driven cost shocks.

Panel B of Table 8 further explores heterogeneity by interacting inflation terciles with the cash-flow stickiness measures. The results show that the interactions between High Inflation and the two cash-flow stickiness measures are both negative and significant. This finding reinforces the notion that firms with greater pricing power are better able to withstand the adverse credit effects of inflation, particularly in high-inflation environments.[25]

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[25] As supplementary, indirect proxies for cash-flow stickiness, we also use the industry-level Lerner index and firm-level ROA volatility. A higher Lerner index indicates greater market power and thus stronger ability to pass rising

[Insert Table 8 here]

To summarize, our findings show that inflation-induced credit risk is more pronounced for firms operating in industries with lower price flexibility and for firms whose operating cash flows do not keep pace with rising input costs. This moderating effect is particularly strong in high-inflation environments. The measures we employ capture, to some extent, equilibrium differences in firms' pricing and operating flexibility. Although we do not explicitly model endogenous firm choices, the results suggest that the observed equilibrium heterogeneity in cash-flow responsiveness affects the inflation-credit risk relationship in the predicted direction.

3. Interaction between Leverage Stickiness and Cash-flow Stickiness

We next examine the joint effects of debt rigidity and cash-flow stickiness to assess whether these two mechanisms reinforce or offset each other in shaping the relation between inflation and corporate credit risk. The preceding analyses consider these channels separately. Here, we bring them together to test whether the positive inflation-credit risk relation is strongest when firms are simultaneously more exposed to refinancing pressure and less able to absorb rising input costs through price adjustment.

To do so, we sort firms into four groups based on debt stickiness and cash-flow stickiness: (i) low debt stickiness and high cash-flow stickiness, where both channels predict a

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input costs on to customers. Low ROA volatility serves as an indirect indicator of less sticky cash flows, consistent with Gorodnichenko and Weber's (2016) argument that greater price rigidity can generate more volatile profits. In Appendix C.2, we find that the interaction between inflation and the Lerner index is significantly negative, and that the interaction between inflation and an indicator for low ROA volatility is also significantly negative. In tercile tests, the interaction between high inflation and low ROA volatility remains negative and significant. Overall, these supplementary results are consistent with the main evidence based on the Cavallo (2018) price-flexibility measures and firm-level cash-flow sensitivity to inflation.

stronger inflation-induced increase in CDS spreads; (ii) high debt stickiness and high cash-flow stickiness; (iii) low debt stickiness and low cash-flow stickiness; and (iv) high debt stickiness and low cash-flow stickiness, where both channels predict a weaker effect. If the two mechanisms reinforce one another, we expect the first group to exhibit the strongest sensitivity of CDS spreads to inflation, while the fourth group should exhibit the weakest sensitivity.

We classify firms as having low debt stickiness when they have high leverage and a high ratio of short-term debt to long-term debt (both above the sample median), as these firms face greater refinancing vulnerability when inflation translates into tighter borrowing conditions. We classify firms as having high cash-flow stickiness when they exhibit low price-change frequency based on the Cavallo (2018) price-flexibility measure, indicating a more limited ability to pass rising input costs through to output prices.

Panel A of Table 9 reports the baseline interaction results. We find that the coefficient estimate on inflation is positive and statistically significant at the 5% level for the group with low debt stickiness and high cash-flow stickiness, and this group also exhibits the largest coefficient estimate (0.143). By contrast, the coefficient estimate (0.019) is smallest in magnitude and statistically insignificant for the group with high debt stickiness and low cash-flow stickiness. The two intermediate groups lie between these extremes. These findings are consistent with the view that the refinancing-vulnerability channel and the cash-flow-stickiness channel reinforce one another in shaping firms' inflation exposure.

In Panel B of Table 9, we further estimate spline regressions for each group to assess whether this interaction is more pronounced in different inflation regimes. The results show that the coefficient estimate on *High Inflation* is positive and statistically significant at the 1% level for the group with low debt stickiness and high cash-flow stickiness, whereas the corresponding coefficient estimates are weaker and generally insignificant for the other groups. This pattern suggests that the interaction between the two channels becomes more salient when inflation is high, which is consistent with the convex relationship documented earlier. In other words, when inflation reaches elevated levels, firms that are simultaneously more exposed to refinancing pressure and less able to pass through rising input costs experience the strongest increase in credit risk.

[Insert Table 9 here]

Overall, we document supportive evidence that debt rigidity and operating cash-flow stickiness jointly shape the relation between inflation and corporate credit risk. The inflation effect is strongest when both mechanisms point toward greater vulnerability and weakest when both point toward greater insulation. These results complement the separate analyses in the previous sections and are consistent with our interpretation that the relation between inflation and credit risk is jointly shaped by debt and operating rigidities.

4. Country-level Institutional Environments

Our theoretical framework predicts that the positive relation between inflation and credit risk is stronger in countries with weaker institutional environments (Hypothesis H3.3). To measure institutional quality, we draw on several indicators from the World Bank Governance Indicators, originally developed by Kaufmann, Kraay, and Mastruzzi (2009), including rule of law, regulatory quality, government effectiveness, political stability, control of corruption, and voice and accountability.

- The *Rule of Law* index reflects perceptions of the quality of contract enforcement, police, courts, and the prevalence of crime and violence.

- The *Regulatory Quality* index measures perceptions of the government's ability to formulate and implement sound policies and regulations that enable private sector development.
- The *Government Effectiveness* index assesses the quality of public services and the formulation and implementation of policy.
- The *Political Stability* index captures perceptions of a country's political stability.
- The *Control of Corruption* index measures perceptions of the extent to which public power is exercised for private gain.
- The *Voice and Accountability* index reflects the degree to which citizens can participate in selecting their government, and the extent of freedom of expression, association, and media.

We interact inflation with each institutional quality indicator to examine how these factors moderate the relationship between inflation and credit risk. Table 10 shows that interaction terms are all negative and statistically significant, suggesting that the positive relation between inflation and credit risk is stronger in countries with weaker institutional environments. For example, a one standard deviation increase in inflation is, on average, associated with an incremental increase of 5 basis points in one-year-ahead CDS spreads (i.e., $1.9 \times 0.1 \times (1.61\text{-}1.34)$) when the rule of law index shifts from the 75th percentile to the 25th percentile.

[Insert Table 10 here]

In summary, our findings indicate that the positive relation between inflation and credit risk is stronger for firms in countries with weaker institutional environments. This evidence is consistent with the model's prediction that greater underlying uncertainty and weaker shock-absorption capacity make the inflation-credit risk relation more pronounced.[26]

D. CDS Term Structure

In our previous analyses, we focus on 5-year maturity CDS contracts, which are widely regarded as the benchmark in the CDS market. In this section, we broaden our analysis to assess the relation between inflation and CDS spreads across a range of maturities, from 6 months to 30 years. We anticipate a more pronounced relation at shorter maturities, reflecting stronger nominal price rigidity in the goods market in the short run, which limits firms' ability to pass input-cost pressures onto consumers. Moreover, inflationary shocks are more likely to trigger immediate market expectations of operational disruptions and tighter monetary policy (such as interest rate hikes) that are associated with higher near-term borrowing costs.

Table 11 presents the results. We observe that the relationship between inflation and CDS spreads remains positive across the CDS term structure. The relation peaks at the 2-year maturity and gradually declines for longer maturities, though it remains statistically significant up to 7 years. These results suggest that the inflation-credit risk relation is strongest at short to medium maturities, while remaining statistically significant across a broader portion of the CDS term structure.

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[26] As supplementary evidence, we also examine broader proxies for economic and financial development, including GDP per capita, credit-to-GDP, financial openness, emerging-market status, and commodity-exporter status. These results, reported in Appendix C.3, show that the positive inflation-credit risk relation is weaker in more economically and financially developed environments, stronger in emerging markets, and attenuated in commodity-exporting countries. We report these results in the appendix because they are less directly tied to the core conceptual framework than the institutional-quality tests.

[Insert Table 11 here]

E. Robustness Tests

1. Inflation Expectations, Inflation Surprises, and Inflation Volatility

We perform a battery of robustness checks on the relation between inflation and CDS spreads. First, we examine whether our results are driven by realized inflation, inflation forecasts, inflation surprises, or inflation volatility. To do so, we construct four year-t inflation-related measures that are used to predict CDS spreads in year $t + 1$. *Inflation* is the realized (actual) inflation rate in year t. *Inflation forecast* is the expected inflation rate for year $t + 1$, as forecast at time t. *Inflation surprise* is defined as realized inflation in year t minus the forecast of inflation for year t formed at time $t - 1$. *Inflation volatility* is measured as the standard deviation of monthly inflation in year t. This timing aligns the forecast variables with our baseline specification, which relates inflation in year t to CDS spreads in year $t + 1$.

[Insert Table 12 here]

The results are reported in Panel A of Table 12. In Columns (1)-(4), realized inflation, next-year inflation forecasts, inflation surprises, and inflation volatility are each positively associated with CDS spreads when considered separately. In Column (5), where all four measures are included jointly, realized inflation remains positive and statistically significant, whereas the coefficients on inflation forecasts, inflation surprises, and inflation volatility are no longer statistically significant. Thus, realized inflation contains the strongest incremental predictive content for future CDS spreads in our sample.

We interpret this result cautiously. Our framework does not imply that realized inflation is the only theoretically relevant object for credit risk. In forward-looking credit markets, expected inflation is naturally important. At the same time, realized inflation may retain incremental predictive content because it captures contemporaneous inflationary pressure that directly affects firms' input costs, current financing conditions, and the updating of beliefs about future inflation and monetary policy. Moreover, forecast-based measures of expected inflation are likely measured with greater noise than realized inflation in our setting. Accordingly, we view these horse-race regressions as showing which observable dimension of inflation risk contains the strongest empirical information for subsequent CDS spreads in our data, rather than as identifying the deeper theoretical object priced by credit markets.

In Panel B, we estimate tercile specifications for each inflation-related measure. Consistent with the baseline results, the positive association between inflation-related measures and CDS spreads is concentrated primarily in the high-inflation regime.

2. U.S. Sample

Second, to better reconcile our findings with Bhamra et al. (2023), we separately examine the relation between inflation and corporate CDS spreads for U.S. firms. Panel C of Table 12 reveals that this relationship is statistically insignificant for the U.S. subsample (Column 1 and 2).

The weaker inflation–credit risk relationship for U.S. firms, compared to the global sample, likely stems from three main factors. First, we find that the relationship is convex, initially negative at low inflation levels but turning positive at higher levels. Given that the average U.S. inflation rate is relatively low (2.19%), the relation with CDS spreads is muted. When we divide inflation into terciles, the relationship is significantly negative in the low and medium inflation groups (Column 3), consistent with Bhamra et al. (2023).

Second, as discussed earlier, U.S. firms have a lower average short-term to long-term debt ratio than non-U.S. firms, indicating lower refinancing needs and reduced sensitivity to inflation-driven financing costs. Third, the positive link between inflation and credit risk is more pronounced in emerging markets, where weaker financial and institutional environments amplify firms' vulnerability to inflationary shocks. In contrast, U.S. firms benefit from a stronger environment that helps buffer such shocks.

Additionally, given that Japan has the lowest average inflation rate in our sample and accounts for 19.84% of the observations, we also investigate the relation between inflation and CDS spreads for Japanese firms. As reported in Appendix C.4, we find that the inflation-credit risk relationship is statistically insignificant for the Japan subsample. Moreover, the relationship remains convex—insignificantly positive in the high inflation tercile, insignificantly negative in the medium tercile, and significantly negative in the low inflation tercile.

Overall, the subsample analyses in this section reinforce the convex nature of the inflation-credit risk relationship and highlight how prevailing inflation levels and institutional environments jointly shape its magnitude and direction.

3. Other Robustness Checks

We further conduct several other robustness checks on our findings.

First, we explore alternative measures for both CDS spreads and inflation. Results are presented in Panel D of Table 12. We use the median CDS spread over a year, end-of-year CDS spread, and the log of CDS spread as alternative CDS spread measures in Columns (1)-(3). We use quarterly inflation data from the OECD in Column (4). We find that the relation between inflation and CDS spreads is qualitatively similar across all alternative measures.

In Column (5) of Panel D, we conduct regressions using first differences, where changes in CDS spreads within firms are regressed on changes in inflation and other independent variables. The results confirm that changes in inflation are positively related to changes in firm

CDS spreads, consistent with our baseline findings. In terms of economic magnitude, a one standard deviation increases in the change in inflation (i.e., 1.49 as reported in Table 3) is, on average, associated with an increase in CDS spread change by 16 basis points (i.e., 1.49 × 0.109).

We also estimate spline regressions by dividing inflation into terciles (low, medium, high) and report robustness results using alternative measures of both CDS spreads and inflation in Panel E of Table 12. The results indicate that the relation between inflation and credit risk is significantly positive only in the high-inflation tercile. The medium-inflation tercile also exhibits a positive, though less precisely estimated, relation. By contrast, the low-inflation tercile is associated with a negative, though statistically insignificant, coefficient. Taken together, these findings provide further support for a convex relationship between inflation and credit risk.

Second, given the importance of global factors for inflation and the potential for cross-sectional correlation in residuals within a given year, it is important to examine whether our inference is sensitive to the clustering structure. We reestimate our baseline regressions using alternative standard error clustering methods: clustering by year, by firm, and two-way clustering by country and year, as well as by firm and year. As reported in Appendix C.5, the relation between inflation and CDS spreads remains statistically significant at the 1% level across all clustering methods, and the convex relationship between inflation and firm credit risk continues to hold.

Third, we examine whether the observed inflation effect persists after controlling for additional variables. First, following Collin-Dufresne et al. (2001), we account for the fact that nominal interest rates reflect both real interest rates and inflation by controlling for the real short-term interest rate, calculated using the Fisher equation from each country's nominal short-term interest rate and inflation rate. Second, to address the concern that our results may be driven by broader macroeconomic conditions rather than inflation, we include controls for banking crises, sovereign rating downgrades, and changes in cash rates. The results, reported in Appendix C.6, remain qualitatively similar to those in our main analysis.

Fourth, we address concerns about limited firm representation in some countries by restricting the sample to those with at least ten firms. As shown in Appendix C.7, our main results remain robust: Column (1) confirms the positive relationship in the global sample, while Column (2) supports the convex inflation effect using terciles. Since CDS spreads may be denominated in different currencies, we also control for currency-by-year fixed effects and exchange rate effects, and our findings continue to hold (Appendix C.8).

Finally, we further examine the inflation-CDS relationship conditional on debt stickiness (Appendix C.9) and cash-flow stickiness (Appendix C.10). To isolate within-country variation, we include country-by-year fixed effects, which absorb the main effect of inflation. We find that the coefficient estimates on *Inflation* × *Leverage* and *Inflation* × *Short-Term Debt to Long-Term Debt* remain positive, with the former statistically significant at the 1% level, suggesting that firms with higher leverage are more vulnerable to inflation-induced credit risk. Similarly, the coefficient estimates on *Inflation* × *High Price Change Frequency* and *Beta (Cash flow stickiness)* are negative, with the latter significant at the 10% level. These results suggest that firms with greater pricing flexibility (i.e., less sticky cash flows) are better able to absorb inflation shocks, thereby weakening the relation between inflation and credit risk. Taken together, these findings reinforce the theoretical mechanism that both debt and cash-flow stickiness play a central role in shaping firms' inflation-induced credit risk.

F. Inflation and forward-looking probability of default

Furthermore, we provide additional evidence using the forward-looking probability of default from the NUS-CRI database as an alternative measure of credit risk. The NUS-CRI probability of default (PD) is similar to the expected default frequencies (EDF) computed by Moody's KMV but is publicly available data. They provide default signals for firms globally, derived from multiple data sources. These PD measures have been used in several studies on default risk (e.g., Berndt (2015) and Hasan et al. (2025)).[27] The results, shown in Appendix C.11, are consistent with our primary findings using CDS spreads as a measure of credit risk.

Specifically, we find that inflation is positively associated with the firm-level 5-year forward-looking probability of corporate default, and the association is statistically significant at the 1% level (Columns 1-5). In terms of economic magnitude, Column (5) suggests that a one-standard-deviation increase in inflation (i.e., 1.9%) in a firm's headquarter country is, on average, associated with a 0.17 percentage point increase in the firm's 5-year forward-looking probability of default (i.e., 0.092 × 1.9%). This is equivalent to a 7% increase in the firm's 5-year forward-looking probability of default relative to the sample mean (the average 5-year forward-

[27] The NUS-CRI database includes over 60,000 publicly listed firms from 117 countries across the globe (of these firms at least 30,000 have sufficient data to release daily updated probability of default). The proprietary database that underlies this output includes extensive panel data on firm stock price, financial statement data, and default events from 1990 to the present, categorized by default class. The measure is real-world default probability similar to EDF computed by Moody's KMV. However, the CRI default forecasts depend on a richer information set, including financial ratios besides the distance to default as predictors. Furthermore, it uses a completely transparent methodology described in a detailed technical report, which is continuously updated. Berndt (2015) shows that Moody's EDF and NUS-RMI probability of defaults (PD) are quite close: the median annualized five-year EDF PD and the median NUS-RMI PD are, respectively, 35 and 37 basis points over a sample of 240 firms from January 2001 to June 2010.

looking probability of default in our sample is 2.41%). Moreover, Column (6) shows that both medium- and high-inflation terciles are associated with significantly higher default probabilities in the following year, while the low-inflation tercile is not.

To summarize, the evidence based on forward-looking probability of default as an alternative measure of firm credit risk aligns with our CDS-based findings and further reinforces the conclusion that inflation influences firm-level credit risk in a nonlinear manner.

V. Conclusion

This study provides international evidence on the relation between inflation and corporate credit risk. Using firm-level data from 50 countries, we show that inflation is positively associated with CDS spreads on average and that this relation is convex.[28] It is negative or weak at low inflation levels, consistent with debt-easing effects that reduce the real burden of nominal liabilities. However, at high inflation levels, input-cost pressures, tighter monetary conditions, and refinancing burdens become more salient, leading to a markedly stronger positive association between inflation and credit risk. This nonlinear relationship helps reconcile why related studies conducted under different inflation environments emphasize different aspects of the inflation-credit risk relation.

We also show that this relation is stronger for firms with greater refinancing vulnerability, weaker for firms with more flexible prices and more responsive cash flows, and stronger in countries with more inflation-responsive monetary regimes and weaker institutional

[28] This nonlinear relationship is also consistent with Weber, Candia, Afrouzi, Ropele, Lluberas, Frache, Meyer, Kumar, Gorodnichenko, Georgarakos, Coibion, Kenny, and Ponce (2025), who show that low- and high-inflation environments differ systematically in how agents attend to and learn from information about inflation.

environments. Taken together, these findings are consistent with the view that the inflation-credit risk relation is jointly shaped by debt rigidity and operating rigidity, and that the global setting helps clarify when each channel becomes more important.

Our evidence should be interpreted in light of the sample. Because traded CDS contracts are concentrated among large, publicly listed, internationally active firms, our findings apply primarily to the market-based credit risk of these firms. Inflation may affect smaller, private, or more bank-dependent firms differently, particularly because they often face tighter financing constraints, rely more on bank credit, and have less ability to pass through rising input costs. Because our data do not directly cover these firms, we do not overstate the external validity of our findings beyond the CDS sample.

Our findings have implications for academics, policymakers, and credit-market participants. For academics, we provide new international evidence on how the relation between inflation and corporate credit risk operates through both financing and operating channels. For policymakers, the results show that the inflation-credit risk relationship is nonlinear and depends on monetary regimes, financial structures, and institutional environments. For investors and risk managers, the findings highlight that inflation should be incorporated explicitly into credit assessment, especially for firms with high refinancing needs, rigid cash flows, or exposure to weaker institutional and financial environments.

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Figure 1: World Inflation Heat Map

This figure presents a heat map of global inflation. Inflation levels represent the average inflation rate of each country from 2001 to 2022, with deeper colors indicating higher levels of inflation.

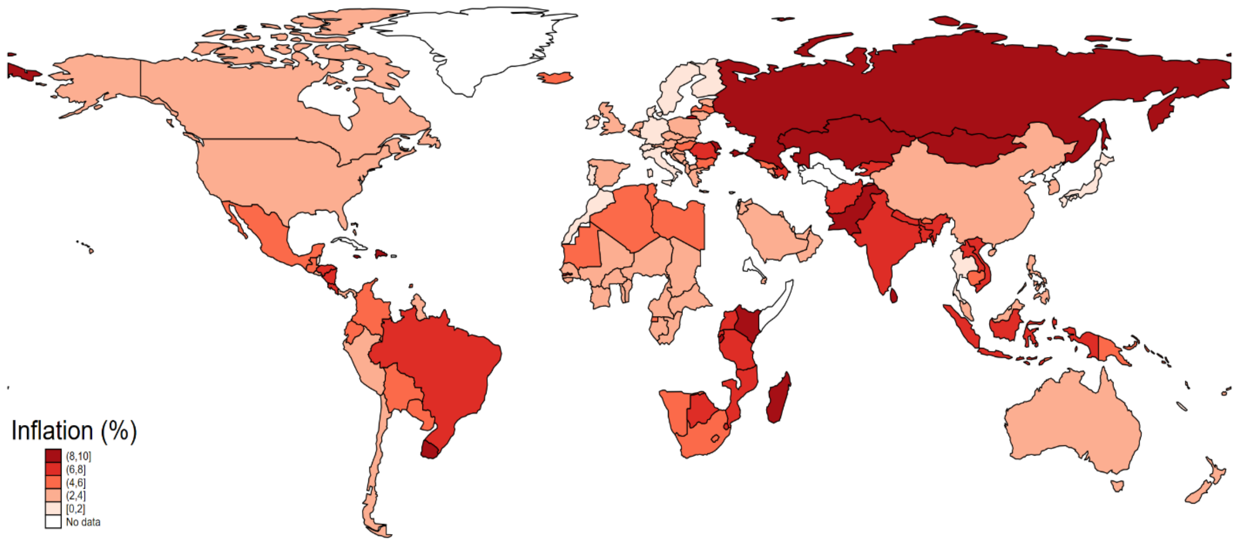

Figure 2: Scatter Plot of the Relationship between CDS Spreads and Inflation

This figure presents a scatter plot illustrating the relationship between average CDS spreads and inflation at the country-year level. The plot includes country-years with at least 10 firms.

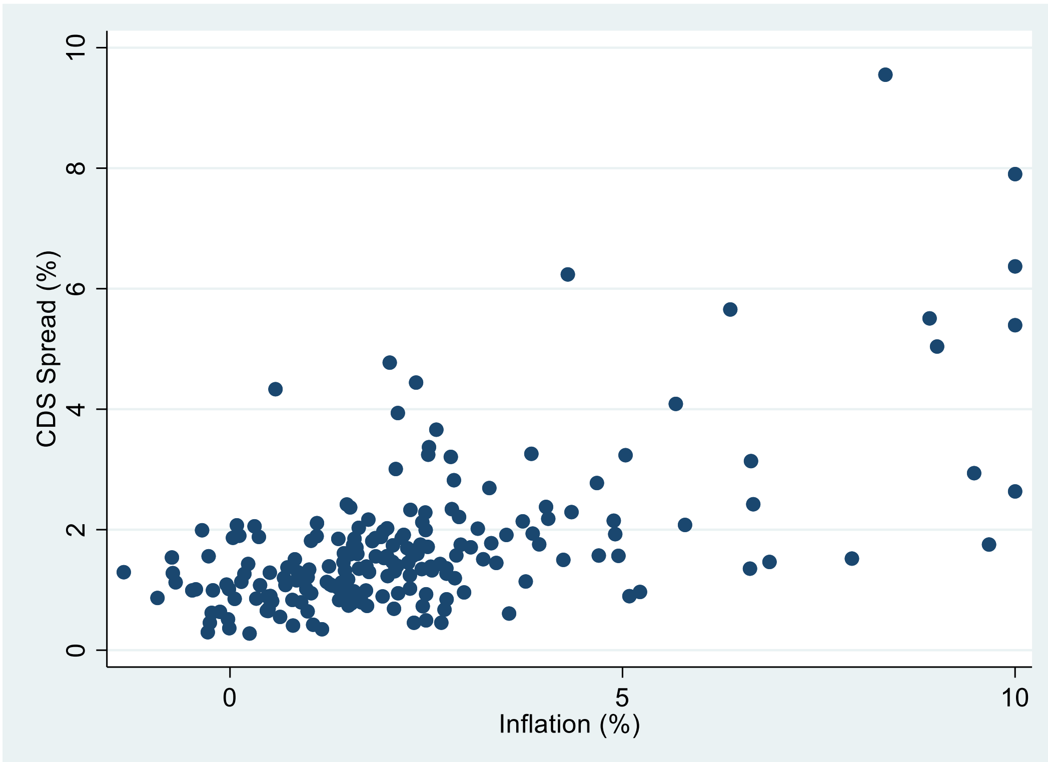

Figure 3: Scatter plot with Smooth Convex Curve across Inflation Deciles

This figure presents a scatter plot of CDS spreads with smooth convex curve across deciles based on the level of inflation at the firm's headquarter country, where decile 1 contains the observations with the lowest inflation and decile 10 contains the observations with the highest inflation.

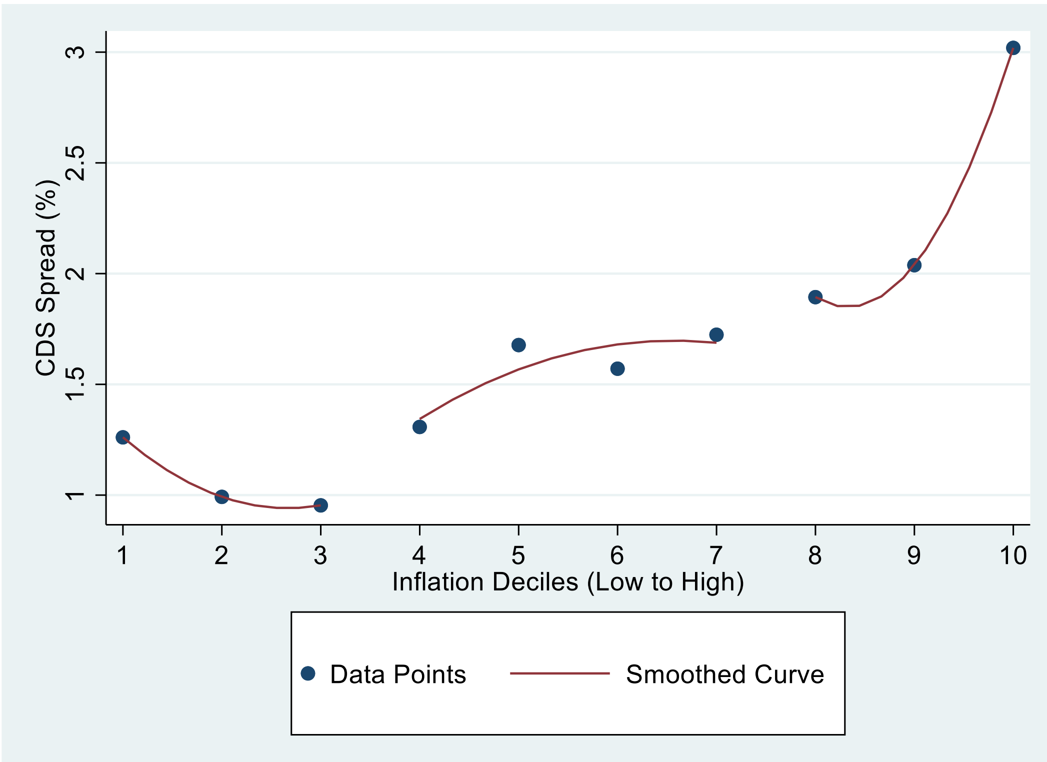

Table 1: Sample Distribution

This table provides the breakdown of our global firm sample by country from 2001 to 2022.

Country	Number of Firms	%	Number of Firm-year	%
Australia	27	2.39	231	1.75
Austria	5	0.44	54	0.41
Bangladesh	1	0.09	7	0.05
Belgium	4	0.35	62	0.47
Brazil	13	1.15	130	0.98
Canada	32	2.83	196	1.48
Chile	2	0.18	26	0.2
China	12	1.06	87	0.66
Colombia	2	0.18	5	0.04
Cote d'Ivoire	1	0.09	7	0.05
Czechia	1	0.09	5	0.04
Denmark	1	0.09	9	0.07
Finland	1	0.09	11	0.08
France	37	3.28	418	3.16
Germany	43	3.81	569	4.3
Greece	1	0.09	22	0.17
Hong Kong SAR, China	16	1.42	196	1.48
India	35	3.1	312	2.36
Indonesia	6	0.53	25	0.19
Ireland	7	0.62	99	0.75
Israel	3	0.27	35	0.26
Italy	10	0.89	102	0.77
Jamaica	1	0.09	10	0.08
Japan	224	19.84	3,219	24.32
Korea	18	1.59	243	1.84
Luxembourg	1	0.09	17	0.13
Malaysia	2	0.18	41	0.31
Mauritius	1	0.09	20	0.15
Mexico	8	0.71	48	0.36
Netherlands	11	0.97	121	0.91
New Zealand	3	0.27	27	0.2
Norway	7	0.62	73	0.55
Pakistan	1	0.09	19	0.14
Peru	1	0.09	2	0.02
Philippines	5	0.44	60	0.45
Poland	1	0.09	8	0.06
Portugal	3	0.27	29	0.22
Qatar	1	0.09	11	0.08
Russian Federation	11	0.97	83	0.63
Saudi Arabia	1	0.09	12	0.09
Singapore	8	0.71	59	0.45
South Africa	4	0.35	41	0.31
Spain	10	0.89	116	0.88
Sweden	11	0.97	126	0.95
Switzerland	16	1.42	187	1.41
Thailand	1	0.09	16	0.12
Turkey	1	0.09	15	0.11
United Arab Emirates	2	0.18	10	0.08
United Kingdom	66	5.85	791	5.98
United States	450	39.86	5,225	39.47
Total	1,127	100	13,237	100

Table 2: Inflation by Country and Year

This table presents summary statistics on inflation by country (Panel A) and by year (Panel B).

Panel A: Inflation by Country (%)							
Country	Mean	Std. dev.	P5	P25	P50	P75	P95
Australia	2.67	1.26	1.28	1.77	2.47	2.98	4.41
Austria	2.20	1.62	0.89	1.44	2.00	2.30	3.29
Bangladesh	5.89	0.54	5.51	5.54	5.69	6.19	6.99
Belgium	2.25	1.94	0.34	1.44	2.01	2.47	4.49
Brazil	6.16	2.15	3.45	4.18	6.20	8.30	9.28
Canada	2.27	0.29	1.86	2.07	2.24	2.45	2.76
Chile	3.59	2.37	0.35	2.18	3.05	4.41	10.00
China	2.28	1.75	-0.73	1.44	2.00	2.90	5.93
Colombia	5.19	2.79	3.17	3.42	4.29	5.05	10.00
Cote d'Ivoire	0.71	1.10	-1.11	0.36	0.69	1.25	2.58
Czechia	2.92	2.04	1.02	1.86	2.53	2.85	6.36
Denmark	1.55	2.35	0.25	0.45	0.76	1.15	7.70
Finland	1.29	1.11	-0.21	0.36	1.04	2.19	3.42
France	1.55	1.11	0.09	0.86	1.64	1.95	2.81
Germany	1.72	1.36	0.31	1.03	1.53	2.01	3.07
Greece	2.05	2.59	-1.31	0.25	2.20	3.53	4.71
Hong Kong SAR, China	1.90	1.95	-1.35	0.58	2.02	2.99	4.42
India	6.10	2.40	3.73	3.94	5.13	8.35	10.00
Indonesia	3.91	1.46	1.56	3.03	4.21	5.13	6.41
Ireland	2.02	2.33	-0.92	0.18	1.95	3.93	4.90
Israel	1.59	1.79	-0.60	0.46	1.23	2.69	4.55
Italy	1.86	1.79	-0.09	0.77	1.83	2.47	3.35
Jamaica	5.36	2.22	2.35	3.74	4.80	6.87	9.34
Japan	0.23	1.00	-0.92	-0.27	-0.02	0.48	2.50
Korea	2.46	1.33	0.54	1.30	2.52	3.51	4.67
Luxembourg	2.05	1.49	0.29	0.82	1.74	2.66	6.34
Malaysia	2.11	1.38	0.58	1.42	2.06	3.14	3.87
Mauritius	4.49	2.86	0.69	2.76	3.76	5.73	9.87
Mexico	4.51	1.23	2.82	3.64	4.13	5.12	6.37
Netherlands	2.23	1.96	0.60	1.26	1.70	2.51	4.16
New Zealand	2.23	2.12	0.29	1.23	1.62	1.85	7.17
Norway	2.24	1.20	0.70	1.29	2.17	2.76	3.75
Pakistan	7.59	2.63	2.53	5.08	7.92	10.00	10.00
Peru	3.14	1.60	2.00	2.00	3.14	4.27	4.27
Philippines	3.79	1.82	1.25	2.58	3.60	4.83	6.52
Poland	1.63	2.05	-0.87	-0.31	1.94	2.80	5.06
Portugal	1.99	1.93	-0.28	0.49	1.84	3.11	4.37
Qatar	1.76	1.90	-1.35	0.26	2.30	3.22	5.00
Russia	8.74	1.64	5.07	7.82	9.67	10.00	10.00
Saudi Arabia	3.63	2.73	-0.84	2.14	3.20	5.20	9.87
Singapore	1.49	1.97	-0.53	0.43	0.78	2.23	5.94
South Africa	5.01	2.18	0.69	4.10	5.09	6.15	8.61
Spain	2.26	2.02	-0.32	0.70	2.62	3.20	4.08
Sweden	1.64	1.84	-0.18	0.45	1.57	2.16	3.44
Switzerland	0.40	0.88	-1.14	-0.33	0.64	0.90	2.43
Thailand	1.83	2.11	-0.90	0.43	1.56	3.13	6.08
Turkey	8.80	1.37	6.25	7.67	8.89	10.00	10.00
United Arab Emirates	0.66	1.84	-1.35	-1.35	0.80	1.97	3.07
United Kingdom	2.29	1.50	0.99	1.45	2.19	2.52	3.86
United States	2.19	1.18	0.12	1.59	2.13	2.85	3.84

Panel B: Inflation by Year (%)							
Year	Mean	Std. dev.	P5	P25	P50	P75	P95
2001	2.60	1.80	-0.74	1.42	2.53	4.07	4.87
2002	2.67	2.50	-0.92	1.52	2.26	3.60	8.45
2003	2.71	2.39	-0.26	1.24	2.39	3.50	10.00
2004	2.51	2.33	-0.38	1.16	2.12	3.31	7.44
2005	3.03	2.29	0.43	1.69	2.36	3.55	9.06
2006	3.14	2.11	0.96	1.79	2.53	3.61	8.91
2007	3.14	2.13	0.46	2.04	2.39	3.97	8.83
2008	5.30	2.62	2.37	3.40	4.42	6.63	10.00
2009	2.18	3.19	-1.35	-0.05	0.90	4.22	10.00
2010	3.12	2.51	-0.73	1.53	2.49	4.09	10.00
2011	4.07	2.13	0.23	3.16	3.42	5.31	8.91
2012	3.26	2.27	0.70	2.01	2.77	4.05	8.89
2013	2.91	2.59	-0.04	1.41	2.18	3.54	7.69
2014	2.52	2.65	-0.18	0.49	1.61	3.81	7.82
2015	1.44	2.29	-0.90	0.04	0.67	2.17	6.19
2016	1.72	2.21	-0.55	0.25	0.98	2.41	6.57
2017	2.23	1.91	0.34	1.12	1.88	2.85	5.70
2018	2.37	1.84	0.44	1.06	1.91	3.20	5.31
2019	2.02	2.28	-0.67	0.66	1.61	2.88	5.59
2020	1.63	2.60	-1.25	-0.02	0.85	2.58	6.62
2021	3.25	2.24	0.98	1.85	2.53	4.27	8.30
2022	6.96	2.40	1.97	5.22	7.43	8.55	10.00

Table 3: Summary Statistics

This table provides the summary statistics for the variables used in our baseline regressions. All continuous variables are winsorized at the 1st and 99th percentiles. All variable definitions are provided in Appendix B.

	Mean	Std. dev.	P5	P25	P50	P75	P95
Firm-level variables							
CDS Spread$_{t+1}$ (%)	1.63	2.52	0.19	0.43	0.79	1.74	5.71
ln(Assets)	9.27	1.39	7.11	8.34	9.23	10.20	11.63
Leverage	0.29	0.16	0.10	0.18	0.27	0.39	0.58
ROA	0.12	0.07	0.03	0.08	0.11	0.16	0.25
Investment grade	0.53	0.50	0.00	0.00	1.00	1.00	1.00
Stock volatility	0.02	0.01	0.01	0.02	0.02	0.03	0.05
Short term debt / Long term debt	0.52	1.23	0.00	0.06	0.20	0.48	1.70
Beta (Cash Flow Flexibility)	-0.03	3.25	-1.92	-0.52	0.00	0.53	1.31
ROA Volatility	0.03	0.03	0.00	0.01	0.02	0.03	0.08
ΔCDS Spread	0.06	1.15	-1.17	-0.16	-0.01	0.13	1.45
NUS-CRI Probability of Default (%)	2.41	4.26	0.18	0.63	1.28	2.51	7.79
Industry-level variables							
Price Change Frequency	0.06	0.02	0.02	0.05	0.07	0.08	0.09
Lerner Index	0.12	0.08	0.04	0.08	0.10	0.13	0.30
Country-level variables							
Inflation (%)	1.88	1.90	-0.36	0.47	1.64	2.83	4.95
ln(GDP)	29.16	1.29	26.52	28.53	29.10	30.41	30.60
GDP growth (%)	1.84	2.48	-2.77	0.96	2.01	2.80	5.95
Credit to GDP (%)	153.78	43.54	52.76	131.56	167.35	184.60	206.35
Unemployment rate (%)	5.64	2.30	2.81	4.04	5.08	6.97	9.63
Beta (Monetary Regime)	0.37	0.28	-0.01	-0.01	0.52	0.60	0.60
Rule of Law	1.38	0.49	0.02	1.34	1.53	1.61	1.78
Regulatory Quality	1.30	0.48	0.04	1.14	1.42	1.58	1.79
Government Effectiveness	1.42	0.46	0.14	1.43	1.52	1.62	1.84
Political Stability	0.54	0.55	-0.50	0.29	0.58	1.00	1.18
Control of Corruption	1.34	0.58	-0.27	1.27	1.40	1.69	2.00
Voice and Accountability	1.05	0.43	0.40	0.99	1.10	1.31	1.50
Emerging markets	0.06	0.24	0.00	0.00	0.00	0.00	1.00

Table 4: Inflation and CDS Spread

This table reports the relation between inflation and CDS spread. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)
			CDS Spread $_{t+1}$		
Inflation	0.309***	0.342***	0.277***	0.124**	0.112***
	(5.889)	(10.188)	(9.769)	(2.122)	(2.883)
ln(Assets)			-0.077**	-0.095**	-0.221*
			(-2.219)	(-2.350)	(-1.822)
Leverage			3.320***	3.188***	2.206***
			(10.062)	(10.557)	(7.373)
ROA			-4.587***	-5.278***	-4.374***
			(-5.325)	(-7.296)	(-5.281)
Investment grade			-0.957***	-1.087***	-0.491*
			(-4.766)	(-5.482)	(-1.870)
Stock volatility			43.896***	42.619***	17.458**
			(3.118)	(2.843)	(2.368)
ln(GDP)			-0.024	-1.278***	-0.195
			(-0.333)	(-2.740)	(-0.633)
GDP growth			0.080**	-0.007	-0.016
			(2.137)	(-0.250)	(-0.619)
Credit to GDP			0.002	0.004	0.002
			(0.938)	(0.924)	(0.478)
Unemployment rate			0.087**	-0.009	-0.000
			(2.512)	(-0.191)	(-0.009)
Country FE	N	N	N	Y	N
Firm FE	N	N	N	N	Y
Industry-Year FE	N	Y	Y	Y	Y
N	13237	13237	13237	13237	13237
Adjusted R^2	0.054	0.204	0.414	0.439	0.709

Table 5: Inflation and CDS Spread: Instrumental Variable Analysis

This table reports the results of the instrumental variable analysis. Panel A reports the 2SLS regressions of inflation on CDS spread. WTI crude oil prices and the Baltic Dry transportation index are used as instruments in the left panel. In addition, we compute two country-level inflation betas. The first (*Beta 1*) is obtained by regressing national inflation on WTI crude oil prices, capturing each country's sensitivity to oil price shocks. The second (*Beta 2*) is estimated by regressing inflation on the Baltic Dry Index, reflecting exposure to changes in global shipping costs. We interact each beta with its respective global shock to create two refined instruments: *Beta 1* × *WTI Crude Oil Price* and *Beta 2* × *Baltic Dry Index*. These refined instruments are used in the right panel, with industry-year fixed effects additionally included. Panel B reports the 2SLS regressions of inflation on CDS spread excluding firms headquartered in countries with large oil exposure. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

Table 5 (Continued)

Panel A: WTI crude oil prices and the Baltic Dry Index as instruments				
	(1)	(2)	(3)	(4)
	First Stage Inflation	Second Stage CDS Spread $_{t+1}$	First Stage Inflation	Second Stage CDS Spread $_{t+1}$
WTI Crude Oil Price	0.023***			
	(9.802)			
Baltic Dry Index	0.098**			
	(2.305)			
Beta 1 × WTI Crude Oil Price			0.358***	
			(3.047)	
Beta 2 × Baltic Dry Index			0.392**	
			(2.467)	
Inflation		0.552***		0.547***
		(7.555)		(3.236)
Control Variables	Y	Y	Y	Y
Firm FE	Y	Y	Y	Y
Industry-Year FE			Y	Y
Cragg-Donald Wald F statistic	1582.43***		371.88***	
Hansen J test statistic		1.911		1.242
N	13237	13237	13237	13237
Adjusted R^2	0.690		0.812	

Table 5 (Continued)

Panel B: Instrumental Variable Analysis Excluding Countries with Large Oil Exposure								
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Exclude countries with top decile oil exposure				Exclude countries with top quintile oil exposure			
	First Stage Inflation	Second Stage CDS Spread $_{t+1}$	First Inflation	Second CDS	First Stage Inflation	Second CDS	First Inflation	Second CDS
WTI Crude Oil Price	0.022***				0.021***			
	(12.429)				(13.040)			
Baltic Dry Index	0.103**				0.101**			
	(2.639)				(2.642)			
Beta 1 × WTI Crude Oil Price			0.264**				0.278**	
			(2.446)				(2.169)	
Beta 2 × Baltic Dry Index			0.527***				0.555***	
			(4.111)				(4.127)	
Inflation		0.519***		0.399**		0.521***		0.365**
		(7.675)		(2.670)		(7.489)		(2.222)
Control Variables	Y	Y	Y	Y	Y	Y	Y	Y
Firm FE	Y	Y	Y	Y	Y	Y	Y	Y
Industry-Year FE			Y	Y			Y	Y
Cragg-Donald Wald F statistic	1551.77***		357.56***		1528.62***		360.81***	
Hansen J test statistic		1.064		1.576		0.929		1.417
N	12770	12770	12759	12759	12618	12618	12607	12607
Adjusted R^2	0.656		0.816		0.654		0.817	

Table 6: Convex relationship between Inflation and CDS Spread

This table reports the convex relationship between inflation and CDS spread. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)
		CDS Spread $_{t+1}$		
Inflation	-0.063*	-0.067*		
	(-1.723)	(-1.829)		
Inflation^2	0.025***	0.026***		
	(5.556)	(4.623)		
High Inflation			0.110***	0.117***
			(3.099)	(2.995)
Medium Inflation			0.058	0.073
			(1.062)	(1.170)
Low Inflation			-0.011	-0.016
			(-0.201)	(-0.292)
ln(Assets)		-0.231*		-0.219*
		(-1.912)		(-1.805)
Leverage		2.164***		2.193***
		(7.308)		(7.251)
ROA		-4.367***		-4.387***
		(-5.133)		(-5.304)
Investment grade		-0.488*		-0.489*
		(-1.869)		(-1.855)
Stock volatility		17.732**		17.523**
		(2.437)		(2.391)
ln(GDP)		-0.269		-0.203
		(-0.828)		(-0.680)
GDP growth		-0.026		-0.016
		(-1.062)		(-0.633)
Credit to GDP		0.003		0.001
		(0.687)		(0.331)
Unemployment rate		-0.018		0.000
		(-0.684)		(0.009)
Firm FE	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y
N	13237	13237	13237	13237
Adjusted R^2	0.694	0.711	0.693	0.709

Table 7: Inflation and CDS Spread Conditional on Debt Stickiness

This table reports how the relation between inflation and CDS spreads varies with debt stickiness. Panel A reports the relation between inflation and CDS spread, conditional on debt stickiness. Panel B reports the relation between inflation and CDS spread, conditional on debt stickiness using inflation terciles. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

Panel A: Inflation Levels and CDS Spread Conditional on Debt Stickiness			
	(1)	(2)	(3)
		CDS Spread $_{t+1}$	
Inflation x Leverage	0.368***		
	(3.800)		
Inflation x Short Term Debt / Long Term Debt		0.019**	
		(2.265)	
Inflation x Beta (Monetary Regime)			0.161**
			(2.150)
Short Term Debt / Long Term Debt		0.026**	
		(2.057)	
Leverage	1.439***	2.316***	2.247***
	(4.468)	(8.082)	(7.621)
Inflation	-0.001	0.108***	0.057
	(-0.020)	(2.782)	(1.113)
ln(Assets)	-0.220*	-0.225*	-0.223*
	(-1.806)	(-1.857)	(-1.832)
ROA	-4.239***	-4.559***	-4.541***
	(-5.206)	(-6.175)	(-5.730)
Investment grade	-0.472*	-0.481*	-0.483*
	(-1.757)	(-1.814)	(-1.825)
Stock volatility	17.698**	17.113**	17.593**
	(2.355)	(2.271)	(2.379)
ln(GDP)	-0.203	-0.140	-0.156
	(-0.644)	(-0.439)	(-0.489)
GDP growth	-0.011	-0.018	-0.013
	(-0.438)	(-0.702)	(-0.518)
Credit to GDP	0.002	0.002	0.002
	(0.517)	(0.475)	(0.430)
Unemployment rate	-0.002	-0.001	0.002
	(-0.074)	(-0.028)	(0.073)
Firm FE	Y	Y	Y
Industry-Year FE	Y	Y	Y
N	13237	13018	13137
Adjusted R^2	0.710	0.711	0.709

Table 7 (Continued)

Panel B: Inflation Terciles and CDS Spread Conditional on Debt Stickiness			
	(1)	(2)	(3)
		CDS Spread $_{t+1}$	
High Inflation x Leverage	0.400***		
	(4.200)		
Medium Inflation x Leverage	0.186		
	(0.761)		
Low Inflation x Leverage	-0.449		
	(-1.246)		
High Inflation x Short Term Debt / Long Term Debt		0.021**	
		(2.446)	
Medium Inflation x Short Term Debt / Long Term Debt		0.014	
		(0.554)	
Low Inflation x Short Term Debt / Long Term Debt		0.000	
		(0.016)	
High Inflation x Beta (Monetary Regime)			0.131*
			(1.747)
Medium Inflation x Beta (Monetary Regime)			0.170
			(0.829)
Low Inflation x Beta (Monetary Regime)			0.198
			(1.019)
Short Term Debt / Long Term Debt		0.024**	
		(2.435)	
Leverage	1.506***	2.302***	2.236***
	(4.167)	(7.849)	(7.474)
High Inflation	-0.006	0.112***	0.072
	(-0.139)	(2.851)	(1.428)
Medium Inflation	0.012	0.066	0.022
	(0.142)	(1.080)	(0.210)
Low Inflation	0.081	-0.021	-0.034
	(0.933)	(-0.383)	(-0.692)
ln(Assets)	-0.225*	-0.224*	-0.221*
	(-1.845)	(-1.838)	(-1.812)
ROA	-4.254***	-4.570***	-4.544***
	(-5.475)	(-6.177)	(-5.756)
Investment grade	-0.486*	-0.480*	-0.481*
	(-1.756)	(-1.801)	(-1.811)
Stock volatility	17.734**	17.204**	17.645**
	(2.357)	(2.301)	(2.399)
ln(GDP)	-0.210	-0.144	-0.162
	(-0.691)	(-0.466)	(-0.531)
GDP growth	-0.010	-0.018	-0.013
	(-0.444)	(-0.721)	(-0.539)
Credit to GDP	0.001	0.001	0.001
	(0.353)	(0.310)	(0.327)
Unemployment rate	-0.004	0.000	0.002
	(-0.120)	(0.013)	(0.080)
Firm FE	Y	Y	Y
Industry-Year FE	Y	Y	Y
N	13237	13018	13137
Adjusted R^2	0.710	0.711	0.709

Table 8: Inflation and CDS Spread Conditional on Cash-flow Stickiness

This table reports how the relation between inflation and CDS spreads varies with cash-flow stickiness. Panel A reports the relation between inflation and CDS spread, conditional on cash-flow stickiness. Panel B reports the relation between inflation and CDS spread, conditional on cash-flow stickiness using inflation terciles. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

Panel A: Inflation Levels and CDS Spread Conditional on Cash-flow Stickiness		
	(1)	(2)
	CDS Spread $_{t+1}$	
Inflation x High Frequency of Price Change	-0.099*	
	(-1.968)	
Inflation x Beta (Cash Flow Flexibility)		-0.022***
		(-2.781)
Inflation	0.133**	0.113***
	(2.303)	(2.906)
ln(Assets)	-0.556***	-0.223*
	(-2.813)	(-1.846)
Leverage	1.828***	2.221***
	(5.065)	(7.352)
ROA	-4.273***	-4.222***
	(-4.375)	(-4.968)
Investment grade	-0.647*	-0.493*
	(-1.845)	(-1.886)
Stock volatility	17.690**	17.455**
	(2.278)	(2.365)
ln(GDP)	0.362	-0.194
	(1.281)	(-0.622)
GDP growth	-0.012	-0.015
	(-0.405)	(-0.596)
Credit to GDP	0.005	0.002
	(1.305)	(0.489)
Unemployment rate	-0.037	-0.000
	(-1.371)	(-0.012)
Firm FE	Y	Y
SIC2-Year FE		Y
NAICS3-Year FE	Y	
N	7032	13237
Adjusted R^2	0.717	0.709

Table 8 (Continued)

Panel B: Inflation Terciles and CDS Spread Conditional on Cash-flow Stickiness		
	(1)	(2)
	CDS Spread $_{t+1}$	
High Inflation x High Frequency of Price Change	-0.117**	
	(-2.505)	
Medium Inflation x High Frequency of Price Change	-0.071	
	(-0.899)	
Low Inflation x High Frequency of Price Change	0.196	
	(1.443)	
High Inflation x Beta (Cash Flow Flexibility)		-0.020**
		(-2.121)
Medium Inflation x Beta (Cash Flow Flexibility)		0.003
		(0.167)
Low Inflation x Beta (Cash Flow Flexibility)		-0.022
		(-0.854)
High Inflation	0.138**	0.118***
	(2.356)	(3.022)
Medium Inflation	0.080	0.070
	(0.829)	(1.130)
Low Inflation	-0.034	-0.020
	(-0.360)	(-0.348)
ln(Assets)	-0.559***	-0.221*
	(-2.858)	(-1.828)
Leverage	1.847***	2.210***
	(5.135)	(7.263)
ROA	-4.284***	-4.185***
	(-4.353)	(-4.870)
Investment grade	-0.648*	-0.489*
	(-1.840)	(-1.859)
Stock volatility	17.552**	17.503**
	(2.253)	(2.383)
ln(GDP)	0.360	-0.197
	(1.311)	(-0.657)
GDP growth	-0.010	-0.015
	(-0.343)	(-0.620)
Credit to GDP	0.005	0.001
	(1.254)	(0.338)
Unemployment rate	-0.038	0.000
	(-1.398)	(0.017)
Firm FE	Y	Y
SIC2-Year FE		Y
NAICS3-Year FE	Y	
N	7032	13237
Adjusted R^2	0.717	0.709

Table 9: Joint Effects of Debt Stickiness and Cash-flow Stickiness Mechanisms

This table examines how the debt-stickiness and cash-flow-stickiness mechanisms jointly influence the relation between inflation and CDS spreads. Panel A reports the joint effects using the continuous inflation measure, while Panel B presents the corresponding analysis across inflation terciles. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

Panel A: Joint effects of the debt-stickiness and cash-flow-stickiness mechanisms between inflation and CDS spreads				
	(1)	(2)	(3)	(4)
	Firms with Low Debt Stickiness and High Cash-flow Stickiness (Both increases the inflation effect on CDS spreads)	Firms with High Debt Stickiness and High Cash-flow Stickiness	Firms with Low Debt Stickiness and Low Cash-flow Stickiness	Firms with High Debt Stickiness and Low Cash-flow Stickiness (Both reduces the inflation effect on CDS spreads)
	CDS Spread $_{t+1}$			
Inflation	0.143**	0.120*	0.037	0.019
	(2.454)	(1.943)	(0.464)	(0.713)
ln(Assets)	-0.751	-0.572**	-0.106	-0.458***
	(-1.421)	(-2.085)	(-0.639)	(-4.793)
Leverage	3.723***	1.834***	-0.756	1.278***
	(4.035)	(3.271)	(-0.232)	(3.306)
ROA	-4.564*	-3.181***	-8.235*	-5.724***
	(-1.973)	(-6.478)	(-1.950)	(-4.502)
Investment grade	0.000	-0.765*	-0.338	0.055
	(.)	(-1.917)	(-0.675)	(0.801)
Stock volatility	17.535	15.006**	15.779	17.554*
	(1.451)	(2.136)	(1.343)	(2.010)
ln(GDP)	0.156	0.457	-2.107	0.445
	(0.177)	(0.851)	(-0.849)	(1.130)
GDP growth	0.114	-0.038	0.016	-0.040
	(1.381)	(-1.009)	(0.183)	(-1.243)
Credit to GDP	0.012	0.002	-0.010	-0.001
	(1.114)	(0.477)	(-1.535)	(-0.444)
Unemployment rate	0.004	-0.021	-0.153**	-0.002
	(0.047)	(-0.598)	(-2.270)	(-0.082)
Firm FE	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y
N	1028	3409	428	1650
Adjusted R^2	0.726	0.710	0.841	0.747

Table 9 (Continued)

Panel B: Joint effects of the debt-stickiness and cash-flow-stickiness mechanisms between inflation terciles and CDS spreads				
	(1)	(2)	(3)	(4)
	Firms with Low Debt Stickiness and High Cash-flow Stickiness (Both increases CDS spreads)	Firms with High Debt Stickiness and High Cash-flow Stickiness	Firms with Low Debt Stickiness and Low Cash-flow Stickiness	Firms with High Debt Stickiness and Low Cash-flow Stickiness (Both reduces CDS spreads)
	CDS Spread $_{t+1}$			
High Inflation	0.169***	0.120*	0.065	0.009
	(3.116)	(1.975)	(0.861)	(0.329)
Medium Inflation	-0.174	0.184*	0.233*	-0.080**
	(-1.256)	(2.012)	(1.820)	(-2.651)
Low Inflation	-0.405	0.049	-0.280	0.081*
	(-1.681)	(0.473)	(-1.078)	(1.959)
ln(Assets)	-0.827	-0.574**	-0.096	-0.460***
	(-1.587)	(-2.103)	(-0.607)	(-4.847)
Leverage	3.718***	1.809***	-0.617	1.359***
	(4.332)	(3.250)	(-0.189)	(3.621)
ROA	-5.104*	-3.158***	-7.987*	-5.655***
	(-2.050)	(-6.749)	(-1.908)	(-4.430)
Investment grade	0.000	-0.759*	-0.377	0.057
	(.)	(-1.877)	(-0.849)	(0.773)
Stock volatility	15.686	15.395**	17.331	17.751*
	(1.309)	(2.216)	(1.594)	(2.023)
ln(GDP)	0.363	0.421	-2.454	0.498
	(0.409)	(0.784)	(-1.165)	(1.381)
GDP growth	0.111	-0.043	0.028	-0.048
	(1.482)	(-1.110)	(0.321)	(-1.710)
Credit to GDP	0.008	0.002	-0.010	-0.001
	(0.872)	(0.463)	(-1.510)	(-0.470)
Unemployment rate	0.009	-0.026	-0.159**	-0.002
	(0.132)	(-0.750)	(-2.310)	(-0.074)
Firm FE	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y
N	1028	3409	428	1650
Adjusted R^2	0.732	0.711	0.841	0.749

Table 10: Inflation and CDS Spread Conditional on Country Institutional Environment

This table reports the relation between inflation and CDS spread, conditional on the quality of country-level institutional environment. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

Table 10 (Continued)

	(1)	(2)	(3)	(4)	(5)	(6)
	CDS Spread $_{t+1}$					
Inflation x Rule of Law	-0.100***					
	(-3.624)					
Inflation x Regulatory Quality		-0.115***				
		(-3.393)				
Inflation x Government Effectiveness			-0.108***			
			(-2.811)			
Inflation x Political Stability				-0.069**		
				(-2.606)		
Inflation x Control of Corruption					-0.099***	
					(-3.951)	
Inflation x Voice and Accountability						-0.071***
						(-3.518)
Rule of Law	-0.237					
	(-1.035)					
Regulatory Quality		0.142				
		(0.837)				
Government Effectiveness			0.226			
			(1.364)			
Political Stability				0.291**		
				(2.248)		
Control of Corruption					0.237*	
					(1.696)	
Voice and Accountability						0.288
						(0.993)
Inflation	0.208***	0.211***	0.215***	0.123***	0.191***	0.167***
	(4.820)	(5.101)	(4.018)	(4.751)	(5.453)	(3.931)
ln(Assets)	-0.229*	-0.229*	-0.229*	-0.226*	-0.231*	-0.225*
	(-1.898)	(-1.908)	(-1.903)	(-1.877)	(-1.926)	(-1.886)
Leverage	2.160***	2.200***	2.193***	2.203***	2.194***	2.211***
	(7.045)	(7.277)	(7.469)	(7.584)	(7.213)	(7.395)
ROA	-4.404***	-4.381***	-4.378***	-4.392***	-4.400***	-4.372***
	(-5.274)	(-5.227)	(-5.203)	(-5.265)	(-5.257)	(-5.306)
Investment grade	-0.500*	-0.480*	-0.490*	-0.469*	-0.489*	-0.502*
	(-1.926)	(-1.793)	(-1.857)	(-1.768)	(-1.845)	(-1.894)
Stock volatility	17.485**	17.553**	17.492**	17.595**	17.530**	17.408**
	(2.389)	(2.388)	(2.376)	(2.385)	(2.384)	(2.365)
ln(GDP)	-0.283	-0.106	-0.125	-0.258	-0.120	-0.231
	(-0.919)	(-0.344)	(-0.391)	(-0.863)	(-0.421)	(-0.798)
GDP growth	-0.022	-0.015	-0.017	-0.020	-0.017	-0.016
	(-0.898)	(-0.597)	(-0.695)	(-0.731)	(-0.703)	(-0.642)
Credit to GDP	0.003	0.003	0.003	0.002	0.003	0.002
	(0.777)	(0.826)	(0.708)	(0.550)	(0.677)	(0.557)
Unemployment rate	-0.010	-0.014	-0.008	-0.008	-0.005	-0.003
	(-0.382)	(-0.496)	(-0.284)	(-0.283)	(-0.178)	(-0.100)
Firm FE	Y	Y	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y	Y	Y
N	13237	13237	13237	13237	13237	13237
Adjusted R^2	0.710	0.710	0.710	0.710	0.710	0.709

Table 11: Inflation and CDS Term Structure

This table reports the relation between inflation and credit risk across CDS term structure. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
	6-month CDS Spread_{t+1}	1-year CDS Spread_{t+1}	2-year CDS Spread_{t+1}	3-year CDS Spread_{t+1}	4-year CDS Spread_{t+1}	5-year CDS Spread_{t+1}	7-year CDS Spread_{t+1}	10-year CDS Spread_{t+1}	15-year CDS Spread_{t+1}	20-year CDS Spread_{t+1}	30-year CDS Spread_{t+1}
Inflation	0.074***	0.079***	0.085***	0.082**	0.081**	0.062**	0.059*	0.051	0.041	0.040	0.037
	(2.808)	(2.885)	(2.711)	(2.628)	(2.463)	(2.239)	(1.812)	(1.580)	(1.370)	(1.348)	(1.299)
ln(Assets)	-0.042	-0.051	-0.108	-0.115	-0.162	-0.237	-0.169	-0.151	-0.096	-0.115	-0.110
	(-0.413)	(-0.427)	(-0.788)	(-0.898)	(-1.171)	(-1.595)	(-1.533)	(-1.510)	(-1.275)	(-1.522)	(-1.534)
Leverage	1.756***	2.066***	2.491***	2.728***	3.037***	3.267***	3.215***	3.177***	3.034***	3.073***	3.022***
	(4.746)	(5.192)	(6.573)	(8.058)	(8.825)	(9.204)	(10.249)	(10.558)	(11.465)	(11.673)	(11.658)
ROA	-2.618***	-2.820***	-3.167***	-3.384***	-3.611***	-4.146***	-3.545***	-3.432***	-3.132***	-3.147***	-3.041***
	(-6.099)	(-6.125)	(-6.672)	(-7.380)	(-7.488)	(-8.298)	(-8.437)	(-8.619)	(-8.763)	(-8.778)	(-8.316)
Investment grade	0.023	0.039	0.066	0.042	0.058	-0.209	0.033	0.038	-0.003	0.017	-0.002
	(0.345)	(0.636)	(1.137)	(0.553)	(0.514)	(-0.993)	(0.211)	(0.246)	(-0.023)	(0.122)	(-0.018)
Stock volatility	8.177**	9.615**	11.433**	11.846**	12.633**	11.808*	11.697**	10.803**	9.330**	9.304**	9.064**
	(2.031)	(2.185)	(2.231)	(2.251)	(2.208)	(1.981)	(2.184)	(2.194)	(2.167)	(2.170)	(2.202)
ln(GDP)	0.008	-0.031	0.023	-0.059	-0.055	-0.548	-0.111	-0.137	-0.250	-0.219	-0.341
	(0.014)	(-0.049)	(0.035)	(-0.093)	(-0.087)	(-0.943)	(-0.223)	(-0.300)	(-0.580)	(-0.493)	(-0.767)
GDP growth	-0.041	-0.041	-0.041	-0.040	-0.043	-0.031	-0.041	-0.039	-0.036	-0.034	-0.033
	(-1.163)	(-1.084)	(-1.075)	(-1.132)	(-1.181)	(-0.953)	(-1.289)	(-1.326)	(-1.434)	(-1.389)	(-1.390)
Credit to GDP	0.002	0.003	0.003	0.004	0.003	0.003	0.002	0.002	0.001	0.001	0.001
	(0.697)	(0.801)	(0.887)	(0.924)	(0.817)	(0.649)	(0.638)	(0.493)	(0.337)	(0.339)	(0.240)
Unemployment rate	0.033	0.037*	0.039*	0.034	0.036	0.025	0.026	0.024	0.016	0.014	0.013
	(1.522)	(1.778)	(1.752)	(1.446)	(1.453)	(1.314)	(0.917)	(0.854)	(0.553)	(0.509)	(0.459)
Firm FE	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
N	6715	6715	6715	6715	6715	6715	6715	6715	6715	6715	6715
Adjusted R^2	0.531	0.537	0.574	0.616	0.635	0.717	0.688	0.705	0.723	0.721	0.723

Table 12: Inflation and CDS Spread: Robustness Tests

This table evaluates the robustness of the relation between inflation and CDS spreads across alternative inflation measures, regression specifications, samples, and CDS spread measures. Panel A reports the relation between alternative inflation-related measures and CDS spreads. Realized inflation is the actual inflation rate in year *t*. Inflation forecast is the forecast of inflation in year *t*+1 available at time *t*. Inflation surprise is defined as realized inflation in year *t* minus the forecast of inflation for year *t* formed at time *t*-1. Inflation volatility is the standard deviation of monthly inflation in year *t*. Panel B reports the relation between inflation-related measures and CDS spreads using tercile regressions. Panel C reports the relation between inflation and CDS spread using the U.S. sample. Panel D reports the relation between inflation and CDS spread using alternative measures of CDS spreads and Inflation. Column (1) to (3) use median CDS spread over a year, end-of-year CDS spread, and the log of CDS spread as alternative CDS spread measures. Column (4) use quarterly inflation from the OECD. In Column (5), we conduct regressions using first differences, where *changes* in CDS spreads are regressed on *changes* in inflation and other independent variables (i.e., the independent variables in this column should be interpreted as changes measured in year *t*). Panel E reports the relation between inflation terciles and CDS spread using alternative measures of CDS spreads and Inflation. Column (1) to (3) use median CDS spread over a year, end-of-year CDS spread, and the log of CDS spread as alternative CDS spread measures. Column (4) uses quarterly inflation from the OECD. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

Table 12 (Continued)

Panel A: Inflation forecast, Inflation surprise, Inflation volatility and CDS Spread					
	(1)	(2)	(3)	(4)	(5)
			CDS Spread $_{t+1}$		
Inflation	0.112***				0.083***
	(2.883)				(3.165)
Inflation forecast		0.102**			0.036
		(2.626)			(1.265)
Inflation surprise			0.070*		-0.002
			(1.718)		(-0.058)
Inflation volatility				0.240*	0.152
				(1.946)	(1.615)
ln(Assets)	-0.221*	-0.228*	-0.222*	-0.245*	-0.242*
	(-1.822)	(-1.879)	(-1.812)	(-1.880)	(-1.876)
Leverage	2.206***	2.201***	2.172***	2.115***	2.137***
	(7.373)	(7.257)	(7.084)	(6.885)	(7.102)
ROA	-4.374***	-4.310***	-4.373***	-4.591***	-4.678***
	(-5.281)	(-5.088)	(-5.269)	(-5.870)	(-6.086)
Investment grade	-0.491*	-0.477*	-0.480*	-0.542**	-0.529*
	(-1.870)	(-1.808)	(-1.842)	(-2.086)	(-2.007)
Stock volatility	17.458**	17.326**	17.744**	17.426**	17.083**
	(2.368)	(2.365)	(2.394)	(2.304)	(2.263)
ln(GDP)	-0.195	-0.248	-0.330	-0.061	0.024
	(-0.633)	(-0.827)	(-0.934)	(-0.187)	(0.087)
GDP growth	-0.016	-0.025	-0.018	-0.017	-0.021
	(-0.619)	(-0.882)	(-0.635)	(-0.570)	(-0.669)
Credit to GDP	0.002	0.003	0.003	0.003	0.002
	(0.478)	(0.668)	(0.742)	(0.825)	(0.466)
Unemployment rate	-0.000	-0.008	-0.018	-0.031	-0.004
	(-0.009)	(-0.268)	(-0.599)	(-0.858)	(-0.126)
Firm FE	Y	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y	Y
N	13237	13237	13237	12904	12904
Adjusted R^2	0.709	0.708	0.708	0.710	0.711

Table 12 (Continued)

Panel B: Inflation forecast terciles, Inflation surprise terciles, Inflation volatility terciles and CDS Spread					
	(1)	(2)	(3)	(4)	(5)
	CDS Spread $_{t+1}$				
High Inflation	0.117***				0.087***
	(2.995)				(2.993)
Medium Inflation	0.073				0.048
	(1.170)				(1.037)
Low Inflation	-0.016				0.050
	(-0.292)				(0.972)
High Inflation forecast		0.104***			0.046**
		(2.855)			(2.142)
Medium Inflation forecast		0.084**			0.033
		(2.287)			(1.143)
Low Inflation forecast		-0.055			-0.066
		(-0.918)			(-1.269)
High Inflation Surprise			0.107		0.006
			(1.604)		(0.084)
Medium Inflation Surprise			0.498**		0.470
			(2.088)		(1.560)
Low Inflation Surprise			0.020		-0.012
			(0.800)		(-0.408)
High Inflation Volatility				0.259*	0.130
				(1.707)	(1.044)
Medium Inflation Volatility				0.188	-0.023
				(0.867)	(-0.135)
Low Inflation Volatility				0.645	0.573
				(1.268)	(1.212)
ln(Assets)	-0.219*	-0.229*	-0.221*	-0.248*	-0.248*
	(-1.805)	(-1.889)	(-1.804)	(-1.917)	(-1.946)
Leverage	2.193***	2.154***	2.182***	2.084***	2.087***
	(7.251)	(6.960)	(7.210)	(6.498)	(6.730)
ROA	-4.387***	-4.339***	-4.361***	-4.624***	-4.740***
	(-5.304)	(-5.210)	(-5.270)	(-6.022)	(-6.460)
Investment grade	-0.489*	-0.477*	-0.491*	-0.530**	-0.536**
	(-1.855)	(-1.836)	(-1.856)	(-2.046)	(-2.067)
Stock volatility	17.523**	17.482**	17.769**	17.468**	17.240**
	(2.391)	(2.419)	(2.407)	(2.310)	(2.286)
ln(GDP)	-0.203	-0.356	-0.321	-0.140	-0.184
	(-0.680)	(-1.093)	(-0.896)	(-0.414)	(-0.612)
GDP growth	-0.016	-0.030	-0.022	-0.011	-0.019
	(-0.633)	(-1.134)	(-0.762)	(-0.334)	(-0.563)
Credit to GDP	0.001	0.002	0.003	0.004	0.001
	(0.331)	(0.406)	(0.760)	(0.859)	(0.193)
Unemployment rate	0.000	-0.000	-0.017	-0.029	0.010
	(0.009)	(-0.007)	(-0.589)	(-0.820)	(0.339)
Firm FE	Y	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y	Y
N	13237	13237	13237	12904	12904
Adjusted R^2	0.709	0.709	0.708	0.710	0.712

Table 12 (Continued)

Panel C: US Sample				
	(1)	(2)	(3)	(4)
		CDS Spread $_{t+1}$		
Inflation	0.051	0.129		
	(0.410)	(1.528)		
High Inflation			0.026	0.113
			(0.250)	(1.403)
Medium Inflation			-0.163*	-0.001
			(-1.826)	(-0.008)
Low Inflation			-0.191**	-0.024
			(-2.193)	(-0.132)
ln(Assets)		-0.224**		-0.217**
		(-2.282)		(-2.089)
Leverage		2.216***		2.336***
		(3.766)		(4.087)
ROA		-6.104***		-6.160***
		(-6.981)		(-7.181)
Investment grade		-2.532**		-2.562**
		(-2.459)		(-2.491)
Stock volatility		38.141***		37.752***
		(3.292)		(3.286)
ln(GDP)		1.816		1.849
		(1.466)		(1.538)
GDP growth		0.076		0.085
		(1.023)		(1.235)
Credit to GDP		0.003		-0.002
		(0.221)		(-0.120)
Unemployment rate		0.184***		0.166***
		(3.655)		(3.447)
Firm FE	Y	Y	Y	Y
N	5225	5225	5225	5225
Adjusted R^2	0.570	0.642	0.576	0.643

Table 12 (Continued)

Panel D: Alternative Measures of CDS Spread and Inflation					
	(1)	(2)	(3)	(4)	(5)
	Yearly Median CDS Spread $_{t+1}$	End-of-Year CDS Spread $_{t+1}$	ln(CDS Spread $_{t+1}$)	Quarterly CDS Spread $_{t+1}$	ΔCDS Spread
Inflation	0.103***	0.088***	0.029***		0.109**
	(2.785)	(3.033)	(2.824)		(2.242)
Quarterly Inflation				0.110*	
				(2.025)	
ln(Assets)	-0.220*	-0.236	-0.028	-0.226*	-0.357
	(-1.979)	(-1.583)	(-0.840)	(-1.918)	(-0.336)
Leverage	2.118***	1.831***	1.156***	2.301***	0.154***
	(7.653)	(5.637)	(10.860)	(9.119)	(3.451)
ROA	-3.780***	-4.452***	-1.740***	-3.970***	-0.052*
	(-4.873)	(-6.731)	(-5.788)	(-6.733)	(-1.990)
Investment grade	-0.430*	-0.580	-0.139	-0.536**	
	(-1.844)	(-1.659)	(-1.383)	(-2.190)	
Stock volatility	15.950**	11.188**	4.464***	15.450**	2.939
	(2.359)	(2.052)	(3.135)	(2.335)	(1.439)
ln(GDP)	-0.061	-0.539	-0.829***	-0.277	12.536
	(-0.200)	(-1.596)	(-3.197)	(-0.763)	(0.378)
GDP growth	-0.010	-0.022	0.000	-0.047	0.005***
	(-0.473)	(-0.655)	(0.010)	(-1.430)	(2.985)
Credit to GDP	0.003	0.002	0.002	0.002	0.806
	(0.673)	(0.383)	(1.378)	(0.454)	(1.158)
Unemployment rate	-0.003	-0.020	-0.019	-0.004	0.141
	(-0.113)	(-0.585)	(-0.816)	(-0.174)	(1.012)
Firm FE	Y	Y	Y	Y	
Industry-Year FE	Y	Y	Y	Y	Y
N	13237	13237	13237	45770	11695
Adjusted R^2	0.718	0.654	0.846	0.719	0.257

Table 12 (Continued)

Panel E: Inflation Terciles and CDS Spread: Alternative measures of CDS spread and inflation				
	(1)	(2)	(3)	(4)
	Yearly Median	End-of-Year		
High Inflation	0.106***	0.098***	0.034***	
	(2.851)	(3.573)	(3.799)	
Medium Inflation	0.059	0.088*	0.040***	
	(1.017)	(1.834)	(2.682)	
Low Inflation	-0.012	-0.074	-0.041	
	(-0.222)	(-1.490)	(-1.544)	
High Quarterly Inflation				0.122**
				(2.201)
Medium Quarterly Inflation				0.077
				(0.997)
Low Quarterly Inflation				-0.025
				(-0.535)
ln(Assets)	-0.219*	-0.235	-0.028	-0.222*
	(-1.957)	(-1.583)	(-0.850)	(-1.889)
Leverage	2.111***	1.793***	1.134***	2.294***
	(7.539)	(5.433)	(10.809)	(9.032)
ROA	-3.789***	-4.482***	-1.756***	-3.968***
	(-4.893)	(-6.812)	(-5.902)	(-6.639)
Investment grade	-0.430*	-0.569	-0.132	-0.540**
	(-1.825)	(-1.623)	(-1.331)	(-2.202)
Stock volatility	15.977**	11.450**	4.619***	15.586**
	(2.377)	(2.155)	(3.399)	(2.370)
ln(GDP)	-0.061	-0.591*	-0.861***	-0.228
	(-0.206)	(-1.722)	(-3.101)	(-0.697)
GDP growth	-0.010	-0.022	0.000	-0.046
	(-0.490)	(-0.659)	(0.021)	(-1.380)
Credit to GDP	0.002	0.001	0.002	0.001
	(0.530)	(0.285)	(1.305)	(0.193)
Unemployment rate	-0.003	-0.019	-0.019	0.002
	(-0.101)	(-0.582)	(-0.840)	(0.103)
Firm FE	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y
N	13237	13237	13237	45770
Adjusted R^2	0.718	0.654	0.846	0.719

Appendix A

A Stylized Model on the Relationship between Inflation and Corporate Credit Risk

1. Basic Model with Sticky Leverage

We develop a stylized model to guide our hypothesis development and subsequent empirical analysis. We consider a single-period model where a firm issues a *fixed* nominal coupon c (i.e., sticky leverage) at time 0 and realizes a nominal cash flow X at time 1. The cash flow has the form:

$$X = \mu(1 + \delta\pi - \psi\pi^2 + \varepsilon) \quad \text{(A1)}$$

where $\mu > 0$ is the firm's baseline cash flow component, π is the inflation rate, $\delta \in [0,1]$ is the pass-through parameter capturing the revenue-side elasticity of nominal cash flows with respect to inflation, $\psi > 0$ captures nonlinear input-cost pressures, and $\varepsilon \sim N(0, \sigma^2)$ is an idiosyncratic cash flow shock.

While modest inflation enables firms to adjust prices gradually without deterring demand, high inflation erodes consumers' real purchasing power and can outpace firms' capacity to revise nominal prices, particularly when menu costs or contractual pricing clauses impose delays. As a result, the pass-through parameter δ may decline at higher levels of inflation. For tractability, we assume δ is constant, though our results remain robust when allowing δ to decrease with π. As inflation intensifies, input costs often rise at an accelerating pace due to factors such as supply chain disruptions, surging commodity prices, and wage pressures. This relationship is convex: higher inflation tends to produce disproportionately larger cost increases. A larger ψ captures this convexity, which means that costs rise at an increasing rate as inflation increases. The firm defaults at time 1 if $X < c$, which is equivalent to default occurring if $\varepsilon < \frac{c}{\mu} - (1 + \delta\pi - \psi\pi^2)$.

In this framework, π can be either realized or expected inflation rate without affecting the model's core implications. The real value of the coupon is:

(A2) $$C_R(\pi) = ce^{-\pi} \approx c(1-\pi)$$

where the first-order approximation holds for moderate values of π. Thus each 1% rise in π reduces the firm's real debt burden by roughly $c \times 1\%$, easing the firm's cash-flow constraints. We refer to this mechanism as the debt-rigidity channel under sticky leverage.

The firm's probability of default (PD) is then given by:

(A3) $$PD(\pi) = \Phi(\frac{\frac{c}{\mu}-1-\delta\pi+\psi\pi^2}{\sigma})$$

where Φ is the standard normal cumulative distribution function (CDF). This function serves as a stand-in for the firm's credit risk. Differentiating PD with regards to π, we have:

(A4) $$\frac{dPD}{d\pi} = \frac{1}{\sigma}(2\psi\pi - \delta)\varphi(\frac{\frac{c}{\mu}-1-\delta\pi+\psi\pi^2}{\sigma})$$

where φ is the standard normal probability density function (PDF).

Because the debt coupon c is fixed in nominal terms, an increase in π erodes its real value, pushing the cash flow buffer $(X-c)$ upward. This captures the 'sticky leverage' debt-easing and pass-through channel of Bhamra et al. (2023). In our framework, this *debt-rigidity* mechanism dominates when inflation (π) is relatively low (i.e., $2\psi\pi < \delta$). However, for sufficiently large π (i.e., $2\psi\pi > \delta$), we have $\frac{dPD}{d\pi} > 0$.

Intuitively, at high levels of inflation, the input-cost pressures, which we refer to as the *operating-rigidity* channel, dominates the debt-rigidity channel, thereby raising the firm's default risk. The turning point π^* is given by:

(A5) $$\pi^* = \frac{\delta}{2\psi}$$

For $\pi < \pi^*$, $\frac{dPD}{d\pi} < 0$, implying that inflation reduces firm credit risk at low levels. Conversely, for $\pi > \pi^*$, $\frac{dPD}{d\pi} > 0$, meaning that inflation increases credit risk at high levels. *Thus, the relationship between PD and inflation is U-shaped: low inflation is beneficial for firm credit risk, while high inflation is detrimental.*

2. Comparative Statics and Firm Heterogeneity

Let:

(A6) $$z \equiv \frac{\frac{c}{\mu} - 1 - \delta\pi + \psi\pi^2}{\sigma}$$

z is typically less than zero, since $z > 0$ means the firm would already be in the "default zone" ex ante (e.g., the firm would already be in financial distress). So, we mainly focus on the normal case $z < 0$ for comparative statics. We next examine how variations in key parameters drive changes in firm credit risk.

2.1. Firm Leverage

From Equation (A3), it is clear that higher firm leverage ratio, $\frac{c}{\mu}$, increases credit risk $PD(\pi)$, as it raises the argument of the standard normal PDF from Equation (A4). When $\pi > \pi^*$ (i.e. $2\psi\pi > \delta$) and thus $\frac{dPD}{d\pi} > 0$, higher $\frac{c}{\mu}$ shifts the argument of the normal PDF, z, closer to its peak, amplifying the positive slope of $\frac{dPD}{d\pi}$. That is, given greater leverage ratio $\frac{c}{\mu}$, credit risk is more sensitive to inflation due to the greater exposure to inflation-driven input-cost pressures. Similarly, when $\pi < \pi^*$ (i.e. $2\psi\pi < \delta$) and thus $\frac{dPD}{d\pi} < 0$, a higher $\frac{c}{\mu}$ still raises the value of $\varphi(\frac{\frac{c}{\mu} - 1 - \delta\pi + \psi\pi^2}{\sigma})$, steepening the negative slope of $\frac{dPD}{d\pi}$. In this regime, inflation reduces credit risk more sharply for higher leveraged firms, reflecting the debt-easing benefits of moderate inflation.

2.2. Firm Cash-flow Stickiness

From Equation (A4), when $\pi > \pi^*$ (i.e. $2\psi\pi > \delta$) and hence $\frac{dPD}{d\pi} > 0$, a lower pass-through parameter δ steepens the $\frac{dPD}{d\pi}$ curve. This is because a smaller δ both increases the term $(2\psi\pi - \delta)$, which governs the slope, and also shifts the argument of the density function, z, closer to the peak of the PDF, amplifying the marginal effect of inflation on default probability. This implication does not change when δ is allowed to decrease in π. When $\pi < \pi^*$ and thus $\frac{dPD}{d\pi} < 0$, a smaller δ reduces the absolute value $|2\psi\pi - \delta|$, which flattens the slope, but simultaneously increases the value of the PDF $\varphi(\frac{\frac{c}{\mu} - 1 - \delta\pi + \psi\pi^2}{\sigma})$, resulting in an ambiguous effect on $\frac{dPD}{d\pi}$. This continues to be the case when δ is allowed to decrease in π.

Similarly, a higher input-cost sensitivity ψ steepens the $\frac{dPD}{d\pi}$ curve when $\pi > \pi^*$. A higher ψ increases the term $(2\psi\pi - \delta)$, directly amplifying the slope, and simultaneously shifts the argument of the PDF closer to its peak, enhancing the magnitude of the density function. Both effects reinforce the positive sensitivity of default probability to inflation. When $\pi < \pi^*$, however, a higher ψ reduces the absolute value $|2\psi\pi - \delta|$ but still moves z closer to the center of the distribution, increasing the PDF. Consequently, the overall effect of a higher ψ on $\frac{dPD}{d\pi}$ in the $\pi < \pi^*$region is again ambiguous.

We define the firm's cash-flow stickiness as

(A7) $$S(\pi) \equiv \frac{dX}{d\pi} = \mu(\delta - 2\psi\pi)$$

When $S(\pi) > 0$, revenues (pass-through) dominate, so cash flows rise with inflation (i.e., low cash-flow stickiness). When $S(\pi) \leq 0$, input costs dominate and firm cash flows tend to fall with inflation (i.e., high cash-flow stickiness). Thus,

(A8) $$\frac{dPD}{d\pi} = -\frac{S(\pi)}{\sigma\mu}\varphi\left(\frac{\frac{c}{\mu}-1-\delta\pi+\psi\pi^2}{\sigma}\right)$$

It is clear that when $\pi \geq \pi^*$ (i.e. $2\psi\pi \geq \delta$), $S(\pi) \leq 0$: cash flows stop rising with inflation (i.e., they are sticky or even decline) and thus $\frac{dPD}{d\pi} > 0$. Moreover, a smaller δ or a higher ψ makes $S(\pi)$ even smaller or more negative (i.e., stickier cash flow) and hence amplifies the positive sensitivity of default probability to inflation.

2.3. Institutional Weakness

In the model, the parameter σ captures firm-specific volatility. While σ can arise from inherent firm characteristics, it may also be interpreted more broadly as a reduced-form proxy for institutional weakness, reflecting low economic and financial development, poor enforcement, weak governance, and low policy predictability. Such environments expose firms to larger cash-flow uncertainty.

When $\pi > \pi^*$ and thus $\frac{dPD}{d\pi} > 0$, a higher σ has two counteracting effects on the slope of the credit risk curve. First, it decreases the $\frac{1}{\sigma}$ prefactor in $\frac{dPD}{d\pi}$, which reduces the slope. Second, it shrinks $|z|$ (i.e., shifts z closer to zero), moving the argument of the PDF closer to its peak and thereby increasing the slope. The net effect of σ is characterized by the following cross-partial derivative:

(A9) $$\frac{\partial^2 PD}{\partial\pi\partial\sigma} = \frac{2\psi\pi-\delta}{\sigma^2}\varphi(z)(z^2-1)$$

This expression implies that the effect of a weaker institutional environment (i.e., a higher σ) on the sensitivity of credit risk to inflation, $\frac{dPD}{d\pi}$, depends on the location of the firm in the distribution. If the firm is in the tail region ($z^2 > 1$), i.e., farther from the default threshold, then $\frac{\partial^2 PD}{\partial\pi\partial\sigma} > 0$, meaning that a higher σ increases $\frac{dPD}{d\pi}$ and makes credit risk more sensitive to inflation. Conversely, if the firm is near the center of the distribution ($z^2 < 1$), the slope may decline.

When $\pi < \pi^*$ and thus $\frac{dPD}{d\pi} < 0$, a similar logic applies. If the firm is in the tail region ($z^2 > 1$), then $\frac{\partial^2 PD}{\partial\pi\partial\sigma} < 0$, so a higher σ steepens the negative slope of $\frac{dPD}{d\pi}$, intensifying the easing effect of inflation on credit risk.

In summary, the model implies that, for firm not close to default, credit risk tends to be more sensitive to inflation in weaker institutional environments.

3. Extended Model with Debt Indexed to Inflation

3.1. Inflation-indexed Coupon Payment

Now we extend the model to the situation where the debt coupon payment of the firm is indexed to inflation. The cash flow of the firm continues to be determined by Equation (A1), but we now have the following nominal coupon payment:

(A10)
$$C(\pi) = ce^{\pi}$$

The firm's default condition now becomes:

(A11)
$$X = \mu(1 + \delta\pi - \psi\pi^2 + \varepsilon) < C(\pi) = ce^{\pi}$$

The probability of default is:

(A12)
$$PD(\pi) = \Phi\left(\frac{\frac{c}{\mu}e^{\pi} - 1 - \delta\pi + \psi\pi^2}{\sigma}\right)$$

Differentiating PD with regards to π, we have:

(A13) $$\frac{dPD}{d\pi} = \frac{1}{\sigma}\left(\frac{c}{\mu}e^{\pi} + 2\psi\pi - \delta\right)\varphi\left(\frac{\frac{c}{\mu}e^{\pi} - 1 - \delta\pi + \psi\pi^2}{\sigma}\right)$$

It can be seen that unlike the original model with a fixed nominal coupon, in the extended model, the debt-rigidity channel is eliminated. That is, inflation no longer reduces the real burden of debt, because the coupon rises with inflation. Instead, inflation mechanically increases the default threshold (since $e^{\pi} > 1$ for all $\pi > 0$), raising the firm's debt repayment obligation. Assuming $\frac{c}{\mu} > \delta$ (i.e., the firm's leverage ratio is larger than the pass-through parameter), then the term $(\frac{c}{\mu}e^{\pi} + 2\psi\pi - \delta)$ is positive and strictly increasing in π. That is, we have $\frac{dPD}{d\pi} > 0$ for all $\pi > 0$. Thus, there is no turning point or U-shape in the relationship, and inflation is unambiguously detrimental for credit risk.

Let:

(A14) $$z' \equiv \frac{\frac{c}{\mu}e^{\pi} - \mu - \delta\pi + \psi\pi^2}{\sigma}$$

We again consider the case where $z' < 0$ for comparative statics in the extended model (since $z' > 0$ suggests that the firm would be in the "default zone" ex ante).

From Equation (A13), we can see that a higher $\frac{c}{\mu}$ (i.e., greater leverage ratio) always increase $\frac{dPD}{d\pi}$ by increasing $(\frac{c}{\mu}e^{\pi} + 2\psi\pi - \delta)$ and shifting z' toward the center of the distribution, leading to a greater $\frac{dPD}{d\pi}$. Similarly, a lower δ or a higher ψ, which makes $S(\pi) = \mu(\delta - 2\psi\pi)$ smaller or more negative and hence increases cash-flow stickiness, steepens the $\frac{dPD}{d\pi}$ curve through increasing $(\frac{c}{\mu}e^{\pi} + 2\psi\pi - \delta)$ and shifting z' toward the peak of the PDF, increasing $\frac{dPD}{d\pi}$. As before, a higher σ decreases the $\frac{1}{\sigma}$ prefactor of $\frac{dPD}{d\pi}$, but it also decreases $|z'|$, thus moving z' toward the center of the distribution. It can be shown that:

(A15) $$\frac{\partial^2 PD}{\partial\pi\partial\sigma} = \frac{\frac{c}{\mu}e^{\pi}+2\psi\pi-\delta}{\sigma^2}\varphi(z')(z'^2-1)$$

Therefore, the effect of a weaker institutional environment (i.e., a higher σ) on $\frac{dPD}{d\pi}$ depends on whether $z'^2 > 1$. When the firm is not close to default and hence $z'^2 > 1$, $\frac{\partial^2 PD}{\partial\pi\partial\sigma} > 0$, meaning that firm credit risk is more sensitive to inflation in weaker institutional environments.

To summarize, when the firm's debt payment is indexed to inflation and thus not sticky, the model implies that inflation always increases firm credit risk. Moreover, the positive relation between inflation and credit risk tends to be more pronounced when the firm has higher leverage, stickier cash flow, or operates under weaker institutional environments.

3.2. Mixed Coupon Payment

Now we consider the case where a part of the coupon payment is fixed, and the remainder is indexed to inflation. Let $\lambda \in [0,1]$ denote the weight on the inflation-indexed component, so that the nominal coupon at inflation rate π is given by:

(A16) $$C(\pi) = (1-\lambda)c + \lambda c e^{\pi} = c[(1-\lambda)+\lambda e^{\pi}]$$

When $\lambda = 0$, the coupon is fully fixed at c; when $\lambda = 1$, it is fully indexed to inflation. The firm's default condition now becomes:

(A17) $$X = \mu(1+\delta\pi-\psi\pi^2+\varepsilon) < C(\pi) = c[(1-\lambda)+\lambda e^{\pi}]$$

The probability of default (PD) is then:

(A18) $$PD(\pi) = \Phi(\frac{\frac{c}{\mu}[(1-\lambda)+\lambda e^{\pi}]-1-\delta\pi+\psi\pi^2}{\sigma})$$

Differentiating PD with regards to π yields:

(A19) $$\frac{dPD}{d\pi} = \frac{1}{\sigma}(\frac{c}{\mu}\lambda e^{\pi}+2\psi\pi-\delta)\varphi(\frac{\frac{c}{\mu}[(1-\lambda)+\lambda e^{\pi}]-1-\delta\pi+\psi\pi^2}{\sigma})$$

Let:

(A20) $$z'' \equiv \frac{\frac{c}{\mu}[(1-\lambda)+\lambda e^{\pi}]-1-\delta\pi+\psi\pi^2}{\sigma}$$

We again focus on the case where $z'' < 0$ for comparative statics. It is evident that the mixed coupon case lies between the fixed and fully indexed coupon cases. Note that both $(\frac{c}{\mu}\lambda e^{\pi} + 2\psi\pi - \delta)$ and $\varphi(z'')$ are increasing in λ. The turning point of inflation level π^* satisfies

(A21) $$\frac{c}{\mu}\lambda e^{\pi^*} + 2\psi\pi^* - \delta = 0$$

Thus, when λ and/or π is sufficiently large such that $\frac{c}{\mu}\lambda e^{\pi} + 2\psi\pi - \delta > 0$, we have $\frac{dPD}{d\pi} > 0$ and $\frac{\partial^2 PD}{\partial\pi\partial\lambda} > 0$. In this case, the effect of inflation on credit risk is positive and tends to be more pronounced when the firm has a higher portion of debt coupon payments indexed to inflation.

Appendix B: Variable Definitions

This table provides the definitions and data sources of all the variables used in the study.

Variable name	Variable definition	Source
CDS Spread $_{t+1}$	Yearly average firm CDS spreads in the next year.	Markit
Inflation	Annual inflation of the firm's headquarter country.	World Bank
High Inflation	Equals to inflation if inflation level is the top tercile, and zero otherwise	World Bank
Medium Inflation	Equals to inflation if inflation level is the middle tercile, and zero otherwise	World Bank
Low Inflation	Equals to inflation if inflation level is the bottom tercile, and zero otherwise	World Bank
Inflation forecast	Next-year inflation forecast of the firm's headquarter country.	IMF
Ln(Assets)	Natural logarithm of total assets (AT) in $US dollars.	Compustat
Leverage	Book value of debt (DLTT+DLC) scaled by the book value of total assets (AT)	Compustat
ROA	Operating income before depreciation (OIBDP) scaled by the book value of total assets (AT).	Compustat
Investment grade	An indicator variable that equals 1 if the firm has an investment grade rating, and zero otherwise.	Markit
Stock volatility	Annualized standard deviation of stock returns	Compustat
ln(GDP)	A country's ln(GDP), in thousands of $US dollars.	World Bank
GDP Growth	A country's GDP growth.	World Bank
Credit to GDP	A country's domestic credit to private sector as a proportion of its GDP.	World Bank
Unemployment rate	A country's unemployment rate.	World Bank
Baltic Dry Index	An index of average prices paid for the transport of dry bulk materials across more than 20 routes in the world.	Refinitiv Eikon
WTI Crude Oil Price	Price of WTI Crude Oil.	Federal Reserve Economic Data
Beta 1	Beta 1 for each country is obtained by regressing national inflation on WTI crude oil prices. It captures each country's sensitivity to oil price shocks	Federal Reserve Economic Data and World Bank
Beta 2	Beta 2 for each country is obtained by regressing inflation on the Baltic Dry Index. It reflects each country's exposure to changes in global shipping costs.	Refinitiv Eikon And World Bank
Short term debt	Book value of short term debt (DLC)	Compustat
Long term debt	Book value of long term debt (DLTT)	
Beta (Monetary regime)	Obtained by regressing national policy rates on national inflation.	IMF and World Bank
Price Change Frequency	Number of days with a price change divided by total observed days for the product, averaged at the industry level	Cavallo (2018)
Beta (Cash flow flexibility)	Obtained by regressing operating firm cash flow on national inflation	Compustat
Lerner index	Median industry net profit margin. Net profit margin is computed as operating income before depreciation (OIBDP) divided by sales (SALE)	Compustat Compustat
ROA Volatility	Standard deviation of ROA in the past 5 years.	Compustat
Rule of Law	Rule of law index obtained from Worldwide Governance Indicators. Higher values indicate that citizens have higher confidence in the rules of the country.	World Bank
Regulatory Quality	Regulatory quality index obtained from Worldwide Governance Indicators. Higher values indicate better regulatory quality.	World Bank
Government Effectiveness	Government effectiveness quality index obtained from Worldwide Governance Indicators. Higher values indicate better government effectiveness.	World Bank
Political Stability	Political stability index obtained from Worldwide Governance Indicators. Higher values indicate better political stability.	World Bank
Control of Corruption	Control of corruption index obtained from Worldwide Governance Indicators. Higher values indicate better control of corruption.	World Bank
Voice and Accountability	Voice and Accountability index obtained from Worldwide Governance Indicators. Higher values indicate better voice and accountability.	World Bank
Emerging Market	An indicator variable that equals to one if the firm is headquartered in an emerging market, and zero otherwise.	MSCI
Financial Openness	Chinn-Ito Index (KAOPEN)	https://web.pdx.ed

		u/~ito/Chinn-Ito_website.htm
ln(GDP per capita)	A country' ln(GDP per capita)	World Bank
5-year forward-looking Probability of Default	Firm-level NUS-CRI 5-year forward-looking probability of default.	NUS Credit Research Initiative
Banking Crisis	An indicator variable that equals to one if the firm is headquartered in a country experiencing banking crisis, and zero otherwise.	Reinhart and Rogoff (2014)
Sovereign rating downgrade	An indicator variable that equals to one if the firm is headquartered in a country experiencing sovereign rating downgrade, and zero otherwise	Capital IQ
Policy cash rate	Policy rate for firm's headquartered country	IMF
Inflation surprise	Actual inflation minus forecast inflation	IMF
Inflation volatility	Standard deviation of monthly inflation	IMF

Appendix C: Additional Empirical Tests

Appendix C.1: Inflation and CDS Spread: Oster Test

This table reports the Oster test results of inflation on CDS spread. Column (1) is the baseline model with firm and industry-by-year fixed effects, and Column (2) includes observable controls and the same set of fixed effects. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)
	CDS Spread $_{t+1}$	
Inflation	0.107***	0.112***
	(3.074)	(2.883)
ln(Assets)		-0.221*
		(-1.822)
Leverage		2.206***
		(7.373)
ROA		-4.374***
		(-5.281)
Investment grade		-0.491*
		(-1.870)
Stock volatility		17.458**
		(2.368)
ln(GDP)		-0.195
		(-0.633)
GDP growth		-0.016
		(-0.619)
Credit to GDP		0.002
		(0.478)
Unemployment rate		-0.000
		(-0.009)
Firm FE	Y	Y
Industry-Year FE	Y	Y
Oster test statistic		-0.72
N	13237	13237
Adjusted R^2	0.692	0.709

Appendix C.2: Inflation and CDS Spread Conditional on Alternative Cash-flow Stickiness Measures

This table examines whether the moderating role of cash-flow stickiness in the relation between inflation and CDS spreads is robust to alternative measures of cash-flow stickiness. Panel A reports the relation between inflation and CDS spread, conditional on alternative cash-flow stickiness measures. Panel B reports the relation between inflation and CDS spread, conditional on alternative cash-flow stickiness measures using inflation terciles. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

Appendix C.2 (Continued)

Panel A: Inflation Levels and CDS Spread Conditional on Cash-flow Stickiness Measures		
	(1)	(2)
	CDS Spread $_{t+1}$	
Inflation x Lerner Index (SIC3 level)	-0.373*	
	(-1.897)	
Inflation x Low ROA Volatility		-0.033**
		(-2.508)
Low ROA Volatility		-0.004
		(-0.093)
Inflation	0.159***	0.127***
	(2.691)	(3.174)
ln(Assets)	-0.126	-0.225*
	(-1.069)	(-1.868)
Leverage	2.051***	2.190***
	(5.484)	(7.217)
ROA	-3.836***	-4.421***
	(-5.493)	(-5.384)
Investment grade	-0.492	-0.447*
	(-1.506)	(-1.681)
Stock volatility	17.159**	17.288**
	(2.578)	(2.329)
ln(GDP)	-0.034	-0.138
	(-0.095)	(-0.444)
GDP growth	-0.016	-0.018
	(-0.510)	(-0.707)
Credit to GDP	0.002	0.002
	(0.467)	(0.499)
Unemployment rate	0.034	-0.002
	(0.980)	(-0.052)
Firm FE	Y	Y
SIC2-Year FE		Y
SIC3-Year FE	Y	
N	12249	13218
Adjusted R^2	0.705	0.710

Appendix C.2 (Continued)

Panel B: Inflation Terciles and CDS Spread Conditional on Alternative Cash-flow Stickiness Measures		
	(1)	(2)
	CDS Spread $_{t+1}$	
High Inflation x Lerner Index (SIC3 level)	-0.325	
	(-1.527)	
Medium Inflation x Lerner Index (SIC3 level)	0.267	
	(0.824)	
Low Inflation x Lerner Index (SIC3 level)	-0.911	
	(-1.656)	
High Inflation x Low ROA Volatility		-0.051***
		(-4.231)
Medium Inflation x Low ROA Volatility		-0.028
		(-0.905)
Low Inflation x Low ROA Volatility		-0.068
		(-0.868)
Low ROA Volatility		-0.003
		(-0.073)
High Inflation	0.158**	0.144***
	(2.573)	(3.383)
Medium Inflation	0.020	0.090
	(0.249)	(1.373)
Low Inflation	0.076	0.031
	(0.845)	(0.342)
ln(Assets)	-0.122	-0.220*
	(-1.036)	(-1.822)
Leverage	2.048***	2.178***
	(5.355)	(7.148)
ROA	-3.830***	-4.466***
	(-5.430)	(-5.335)
Investment grade	-0.488	-0.454*
	(-1.478)	(-1.712)
Stock volatility	17.187**	17.362**
	(2.615)	(2.353)
ln(GDP)	-0.026	-0.162
	(-0.075)	(-0.549)
GDP growth	-0.016	-0.018
	(-0.511)	(-0.733)
Credit to GDP	0.001	0.001
	(0.285)	(0.351)
Unemployment rate	0.033	-0.002
	(1.001)	(-0.056)
Firm FE	Y	Y
SIC2-Year FE		Y
SIC3-Year FE	Y	
N	12249	13219
Adjusted R^2	0.706	0.710

Appendix C.3: Inflation and CDS Spread Conditional on Country Economic and Financial Development

This table reports the relation between inflation and CDS spread, conditional on country economic and financial development. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)
	CDS Spread $_{t+1}$				
Inflation x ln(GDP per capita)	-0.089***				
	(-4.315)				
Inflation x Credit to GDP		-0.001*			
		(-1.743)			
Inflation x Financial Openness			-0.089***		
			(-4.819)		
Inflation x Commodity Export Countries				-0.083*	
				(-1.822)	
Inflation x Emerging Markets					0.235***
					(3.397)
ln(GDP per capita)	-0.059				
	(-0.229)				
Financial Openness			0.179		
			(1.518)		
Inflation	0.980***	0.236**	0.209***	0.047*	0.113***
	(4.791)	(2.632)	(7.104)	(2.008)	(2.896)
ln(Assets)	-0.228*	-0.224*	-0.200	-0.234*	-0.220*
	(-1.889)	(-1.875)	(-1.569)	(-1.961)	(-1.816)
Leverage	2.226***	2.200***	2.207***	2.205***	2.210***
	(7.894)	(7.471)	(7.936)	(7.612)	(7.388)
ROA	-4.351***	-4.388***	-4.189***	-4.393***	-4.378***
	(-5.149)	(-5.263)	(-4.838)	(-5.233)	(-5.299)
Investment grade	-0.501*	-0.492*	-0.549*	-0.490*	-0.488*
	(-1.912)	(-1.884)	(-1.815)	(-1.856)	(-1.858)
Stock volatility	17.681**	17.589**	18.346**	17.685**	17.460**
	(2.428)	(2.413)	(2.506)	(2.426)	(2.368)
ln(GDP)	0.204	-0.157	-0.297	-0.211	-0.197
	(0.432)	(-0.487)	(-0.856)	(-0.680)	(-0.638)
GDP growth	-0.019	-0.019	-0.028	-0.015	-0.017
	(-0.765)	(-0.740)	(-1.131)	(-0.625)	(-0.643)
Credit to GDP	0.003	0.005	0.005	0.003	0.002
	(0.753)	(1.079)	(1.101)	(0.649)	(0.456)
Unemployment rate	-0.015	-0.009	-0.019	-0.007	-0.000
	(-0.484)	(-0.297)	(-0.765)	(-0.237)	(-0.017)
Firm FE	Y	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y	Y
N	13237	13237	13237	13237	13237
Adjusted R^2	0.694	0.711	0.693	0.709	0.709

Appendix C.4: Inflation and CDS Spread: Japanese Sample

This table reports the relation between inflation and CDS spread using the Japanese firm sample. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by year are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)
Inflation	0.006	-0.061		
	(0.054)	(-1.068)		
High Inflation			0.166	0.013
			(1.038)	(0.304)
Medium Inflation			-0.700	-0.691
			(-0.881)	(-1.229)
Low Inflation			-0.373***	-0.363*
			(-3.045)	(-1.927)
ln(Assets)		0.106		0.057
		(0.562)		(0.268)
Leverage		2.403***		2.358***
		(4.382)		(4.430)
ROA		-2.262*		-2.112
		(-1.856)		(-1.693)
Investment grade		-0.364		-0.405*
		(-1.546)		(-1.756)
Stock volatility		3.661		3.846
		(1.391)		(1.340)
ln(GDP)		13.999***		15.347***
		(3.744)		(3.924)
GDP growth		-0.052**		-0.029
		(-2.167)		(-1.148)
Credit to GDP		-0.008		-0.007
		(-1.004)		(-0.918)
Unemployment rate		0.588***		0.583***
		(4.605)		(5.370)
Firm FE	Y	Y	Y	Y
N	3219	3219	3219	3219
Adjusted R^2	0.510	0.577	0.528	0.583

Appendix C.5: Alternative Standard Error Clustering

This table reports the relation between inflation and CDS spread using alternative standard error clustering. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	CDS Spreads $_{t+1}$							
	Cluster by Year		Cluster by Firm		Double Cluster by Country and Year		Double Cluster by Firm and Year	
Inflation	0.112***		0.112***		0.112***		0.112***	
	(4.453)		(5.424)		(3.016)		(4.122)	
High Inflation		0.117***		0.117***		0.117***		0.117***
		(4.434)		(5.499)		(3.136)		(4.112)
Medium Inflation		0.073**		0.073**		0.073		0.073**
		(2.277)		(2.354)		(1.321)		(2.082)
Low Inflation		-0.016		-0.016		-0.016		-0.016
		(-0.288)		(-0.393)		(-0.258)		(-0.289)
ln(Assets)	-0.221**	-0.219**	-0.221	-0.219	-0.221*	-0.219*	-0.221	-0.219
	(-2.531)	(-2.500)	(-1.581)	(-1.569)	(-1.778)	(-1.762)	(-1.526)	(-1.512)
Leverage	2.206***	2.193***	2.206***	2.193***	2.206***	2.193***	2.206***	2.193***
	(6.036)	(6.046)	(5.724)	(5.654)	(6.065)	(6.042)	(4.843)	(4.823)
ROA	-4.374***	-4.387***	-4.374***	-4.387***	-4.374***	-4.387***	-4.374***	-4.387***
	(-7.499)	(-7.473)	(-6.600)	(-6.619)	(-5.100)	(-5.132)	(-5.842)	(-5.839)
Investment grade	-0.491***	-0.489***	-0.491*	-0.489*	-0.491*	-0.489*	-0.491*	-0.489*
	(-3.866)	(-3.802)	(-1.861)	(-1.849)	(-1.999)	(-1.983)	(-1.960)	(-1.942)
Stock volatility	17.458***	17.523***	17.458***	17.523***	17.458**	17.523**	17.458***	17.523***
	(3.096)	(3.110)	(6.549)	(6.529)	(2.200)	(2.224)	(3.088)	(3.098)
ln(GDP)	-0.195	-0.203	-0.195	-0.203	-0.195	-0.203	-0.195	-0.203
	(-0.401)	(-0.413)	(-0.588)	(-0.616)	(-0.428)	(-0.443)	(-0.366)	(-0.379)
GDP growth	-0.016	-0.016	-0.016	-0.016	-0.016	-0.016	-0.016	-0.016
	(-0.604)	(-0.567)	(-0.744)	(-0.744)	(-0.618)	(-0.599)	(-0.552)	(-0.526)
Credit to GDP	0.002	0.001	0.002	0.001	0.002	0.001	0.002	0.001
	(1.529)	(0.893)	(0.684)	(0.439)	(0.539)	(0.369)	(0.710)	(0.447)
Unemployment rate	-0.000	0.000	-0.000	0.000	-0.000	0.000	-0.000	0.000
	(-0.018)	(0.016)	(-0.013)	(0.012)	(-0.011)	(0.011)	(-0.012)	(0.012)
Firm FE	Y	Y	Y	Y	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y	Y	Y	Y	Y
N	13237	13237	13237	13237	13237	13237	13237	13237
Adjusted R^2	0.709	0.709	0.709	0.709	0.709	0.709	0.709	0.709

Appendix C.6: Additional Controls

This table presents the regression results of inflation on CDS spreads, controlling for additional control variables. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

Appendix C.6 (Continued)

	(1)	(2)
	CDS Spreads $_{t+1}$	
Inflation	0.073**	
	(2.199)	
High Inflation		0.066*
		(1.911)
Medium Inflation		0.023
		(0.578)
Low Inflation		-0.020
		(-0.322)
ln(Assets)	-0.227***	-0.229***
	(-3.052)	(-3.087)
Leverage	2.256***	2.262***
	(7.958)	(7.988)
ROA	-4.501***	-4.505***
	(-5.764)	(-5.772)
Investment grade	-0.622*	-0.638*
	(-1.916)	(-1.958)
Stock volatility	19.134**	19.080**
	(2.187)	(2.183)
ln(GDP)	-0.617	-0.622
	(-1.366)	(-1.381)
GDP growth	-0.022	-0.022
	(-0.766)	(-0.750)
Credit to GDP	-0.004	-0.004
	(-1.076)	(-1.106)
Unemployment rate	0.002	0.002
	(0.069)	(0.080)
Real short-term rate	0.050	0.042
	(1.132)	(0.918)
Past stock return	-0.100**	-0.099**
	(-2.092)	(-2.083)
Banking Crisis	0.209*	0.188*
	(1.814)	(1.770)
Sovereign rating downgrade	0.033	0.060
	(0.406)	(0.699)
Change in policy cash rate	-0.036	-0.036
	(-1.413)	(-1.364)
Firm FE	Y	Y
Industry-Year FE	Y	Y
N	11401	11401
Adjusted R^2	0.691	0.691

Appendix C.7: Countries with at least 10 firms

This table presents the regression results of inflation on CDS spreads for countries with at least 10 firms. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)
	CDS Spreads $_{t+1}$	
Inflation	0.113***	
	(2.859)	
High Inflation		0.117***
		(2.967)
Medium Inflation		0.074
		(1.174)
Low Inflation		-0.013
		(-0.239)
ln(Assets)	-0.222*	-0.220*
	(-1.827)	(-1.810)
Leverage	2.200***	2.188***
	(7.306)	(7.188)
ROA	-4.370***	-4.384***
	(-5.239)	(-5.262)
Investment grade	-0.499*	-0.498*
	(-1.883)	(-1.867)
Stock volatility	17.550**	17.614**
	(2.369)	(2.392)
ln(GDP)	-0.182	-0.189
	(-0.585)	(-0.629)
GDP growth	-0.017	-0.017
	(-0.646)	(-0.659)
Credit to GDP	0.002	0.001
	(0.477)	(0.334)
Unemployment rate	-0.001	-0.000
	(-0.036)	(-0.018)
Firm FE	Y	Y
Industry-Year FE	Y	Y
N	13193	13193
Adjusted R^2	0.709	0.709

Appendix C.8: Controlling for Currency Effects

This table presents the regression results of inflation on CDS spreads controlling for currency effects. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)
		CDS Spreads $_{t+1}$		
Inflation	0.154***		0.114***	
	(3.453)		(2.997)	
High Inflation		0.156***		0.118***
		(3.503)		(3.041)
Medium Inflation		0.173***		0.074
		(2.766)		(1.190)
Low Inflation		0.108		-0.013
		(1.341)		(-0.258)
ln(Assets)	-0.213*	-0.213*	-0.002	-0.001
	(-1.841)	(-1.840)	(-0.606)	(-0.198)
Leverage	2.209***	2.207***	-0.223*	-0.220*
	(6.983)	(6.981)	(-1.817)	(-1.787)
ROA	-4.408***	-4.416***	2.198***	2.191***
	(-5.605)	(-5.625)	(7.409)	(7.309)
Investment grade	-0.525*	-0.520*	-4.382***	-4.389***
	(-1.868)	(-1.838)	(-5.258)	(-5.272)
Stock volatility	17.722**	17.738**	-0.488*	-0.489*
	(2.357)	(2.363)	(-1.869)	(-1.855)
ln(GDP)	-0.027	-0.009	17.484**	17.527**
	(-0.078)	(-0.026)	(2.367)	(2.389)
GDP growth	-0.025	-0.026	-0.195	-0.202
	(-0.751)	(-0.768)	(-0.627)	(-0.677)
Credit to GDP	0.000	0.000	-0.016	-0.016
	(0.098)	(0.092)	(-0.625)	(-0.634)
Unemployment rate	-0.007	-0.007	0.002	0.001
	(-0.153)	(-0.160)	(0.512)	(0.347)
CDS Currency to USD			0.002	0.001
			(0.082)	(0.037)
Firm FE	Y	Y	Y	Y
Industry-Year FE	Y	Y	Y	Y
Currency-Year FE	Y	Y	N	N
N	13230	13230	13237	13237
Adjusted R^2	0.712	0.712	0.709	0.709

Appendix C.9: Inflation and CDS Spread Conditional on Debt Stickiness Controlling for Country-Year Fixed Effects

This table reports the relation between inflation and CDS spread, conditional on debt stickiness and controlling for country-year fixed effects. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)
	CDS Spreads $_{t+1}$	
Inflation x Leverage	0.394***	
	(3.616)	
Inflation x Short Term Debt / Long Term Debt		0.004
		(0.382)
Short Term Debt / Long Term Debt		0.031**
		(2.292)
Leverage	1.432***	2.232***
	(4.580)	(8.041)
ln(Assets)	-0.254**	-0.260**
	(-2.655)	(-2.719)
ROA	-4.316***	-4.519***
	(-5.786)	(-6.641)
Investment grade	-0.618*	-0.601*
	(-1.891)	(-1.851)
Stock volatility	19.922**	19.515**
	(2.326)	(2.263)
Firm FE	Y	Y
Industry-Year FE	Y	Y
Country-Year FE	Y	Y
N	12964	12764
Adjusted R^2	0.730	0.731

Appendix C.10: Inflation and CDS Spread Conditional on Cash-flow Stickiness Controlling for Country-Year Fixed Effects

This table reports the relation between inflation and CDS spread, conditional on cash-flow stickiness and controlling for country-year fixed effects. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country and are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)
		CDS Spread $_{t+1}$	
Inflation x High Frequency of Price Change	-0.045		
	(-1.026)		
Inflation x Beta (Cash Flow Stickiness)			-0.018*
			(-1.864)
ln(Assets)	-0.554***	-0.554***	-0.255**
	(-4.256)	(-4.267)	(-2.677)
Leverage	2.120***	2.119***	2.206***
	(8.980)	(9.081)	(7.961)
ROA	-4.565***	-4.567***	-4.324***
	(-4.861)	(-4.867)	(-5.451)
Investment grade	-1.211**	-1.211**	-0.648*
	(-2.283)	(-2.285)	(-2.020)
Stock volatility	19.709**	19.714**	19.606**
	(2.184)	(2.182)	(2.350)
Firm FE	Y	Y	Y
SIC2-Year FE			Y
NAICS3-Year FE	Y	Y	
Country-Year FE	Y	Y	Y
N	6735	6735	12964
Adjusted R^2	0.736	0.717	0.729

Appendix C.11: Inflation and Forward-looking Probability of Default

This table reports the relation between inflation and forward-looking probability of default of firms provided by NUS-CRI. Variable definitions are provided in Appendix B. *t*-statistics are calculated from robust standard errors clustered by country are displayed in parentheses. Statistical significance at the 10, 5, and 1% level is indicated by *, **, and ***, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)
	NUS-CRI 5-year forward-looking Probability of Default $_{t+1}$					
Inflation	0.529**	0.655**	0.450***	0.080**	0.092***	
	(2.126)	(2.661)	(3.582)	(2.078)	(3.000)	
High Inflation						0.096***
						(3.219)
Medium Inflation						0.122***
						(3.328)
Low Inflation						0.071
						(0.896)
ln(Assets)			0.263**	0.444**	0.793***	0.792***
			(2.304)	(2.358)	(3.379)	(3.366)
Leverage			5.352***	5.021***	3.679***	3.659***
			(4.962)	(4.786)	(4.211)	(4.211)
ROA			-11.133***	-10.348***	-7.940***	-7.949***
			(-7.172)	(-5.797)	(-4.676)	(-4.690)
Investment grade			-1.041***	-1.317***	0.152	0.160
			(-3.042)	(-3.804)	(0.342)	(0.358)
Stock volatility			65.762**	69.361**	36.031*	36.187*
			(2.273)	(2.239)	(1.909)	(1.919)
ln(GDP)			0.451***	6.388*	4.740	4.704
			(2.802)	(1.762)	(1.560)	(1.535)
GDP growth			0.308**	-0.038	0.003	0.003
			(2.319)	(-1.055)	(0.118)	(0.124)
Credit to GDP			-0.005	-0.009*	-0.013**	-0.013**
			(-0.738)	(-1.777)	(-2.576)	(-2.460)
Unemployment rate			0.094	0.024	0.105*	0.106*
			(1.611)	(0.392)	(1.799)	(1.820)
Country FE	N	N	N	Y	N	N
Firm FE	N	N	N	N	Y	Y
Industry-Year FE	N	Y	Y	Y	Y	Y
N	12400	12394	12394	12394	12389	12389
Adjusted R^2	0.056	0.137	0.302	0.390	0.635	0.635