A photograph of a blue industrial building with yellow metal stairs and railings. The building has a corrugated metal facade. The stairs lead up to a platform. The railings are made of yellow pipes. The overall scene is industrial and modern.

February 13, 2025

Global Credit Weekly:

The resilience of lower-
rated credit

BlackRock®

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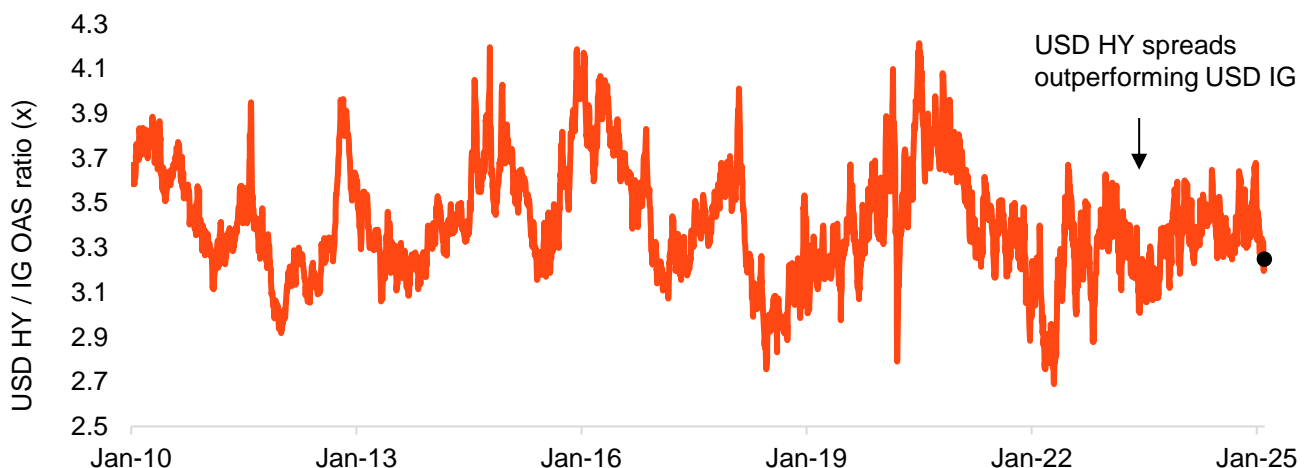
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Key takeaways

- This week's CPI inflation data – while noisy due to the typical seasonal factors – has done little to change our view that additional Fed rate cuts are unlikely in 1H2025. And away from the policy-sensitive front-end, U.S. Treasury yields at the long-end also remain elevated.
- This has two implications for corporate credit investors. First, it should support the well-telegraphed, attractive all-in yield proposition of the asset class, which has persisted despite spreads at the tight end of the historical range. It also supports the diversification benefit of adding floating rate exposures (via liquid and private credit) to portfolios, in our view.
- Second, borrowers will likely continue operating in an environment of structurally higher borrowing costs. As we highlighted in our 1Q2025 Global Credit Outlook, so far, corporates have generally navigated this with resilience (albeit with some dispersion). But the growth backdrop remains critical.
- Last week, we addressed why an escalation in trade tensions – if it were to materialize over the next few months – could catalyze a rebuild of risk premia in USD and EUR corporate credit spreads. That said, the potential spread widening we outlined is still relatively modest and would leave index-level spreads well below the long-term averages of the post-financial crisis period, reflecting a mix of favorable fundamental and technical factors.
- Perhaps somewhat counterintuitively, we also noted that we expect the HY / IG spread ratios to remain somewhat constant across regions, even as widening may occur – indicating that we do *not* expect decompression (or underperformance of lower rated credit). In this *Global Credit Weekly*, we unpack a few of the factors contributing to the resilience in the lower-rated portion of the USD corporate credit market (i.e., USD HY) over the past few quarters – which we expect will remain relevant. These include very low near-term maturity walls, a heavy focus on refinancing and pre-funding in recent years, and credit metrics which remain solid (especially among BBs).

Exhibit 1: USD HY spreads have outperformed their IG peers, at the index level

Option adjusted spread (OAS) ratio for the Bloomberg USD HY and IG Corporate indices



Source: Bloomberg, BlackRock. As of February 11, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

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Still waiting for further inflation progress

At the January FOMC, Federal Reserve (Fed) Chair Jerome Powell noted that further progress on inflation (or, alternatively, weakness in the labor market) would be required before any additional rate cuts were delivered. As we outlined at the time, Chair Powell's comments were consistent with our expectation for a *normalizing* monetary policy cycle, as opposed to *easing*. They also indicated, in our view, that while additional rate cuts for this cycle are still possible, they are unlikely to materialize in 1H2025.

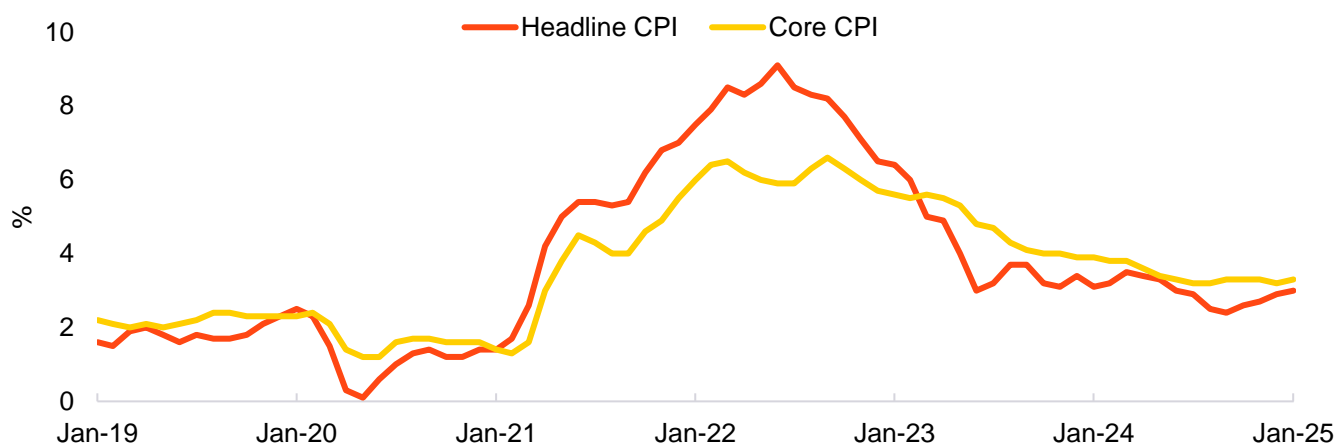
This week's U.S. Consumer Price Index (CPI) inflation data (released February 12th) – while noisy due to the typical seasonal factors – has done little to change our expectations on the timing of future monetary policy actions. Headline CPI for January 2025 increased 3.0% on a year-over-year (YoY) basis, slightly above Bloomberg consensus estimates of 2.9%, and marking the fourth consecutive month of increasing YoY CPI (Exhibit 2). Month-over-month (MoM) CPI rose at a pace of 0.5% on a seasonally adjusted basis (vs. 0.3% Bloomberg consensus estimates; Exhibit 3).

Core services drove the MoM increase, with shelter representing nearly 30% of the total rise, per the Bureau of Labor Statistics. Energy also increased 1.1% MoM in January, though this represents a moderation relative to December's growth of 2.4%. A range of other categories also contributed to the MoM increase, including used cars, airfares, car insurance, medical care, and communication.

Following the data, market pricing reflects less scope for cuts in 2025, relative to even a few weeks ago (Exhibit 4). And 1y1y OIS swaps point to 4.1% as a rough proxy for a terminal rate for this cycle. This was as low as 2.8% in September 2024, underscoring how market expectations have shifted in recent months.

Exhibit 2: Year-over-year headline CPI ticked up for the fourth consecutive month

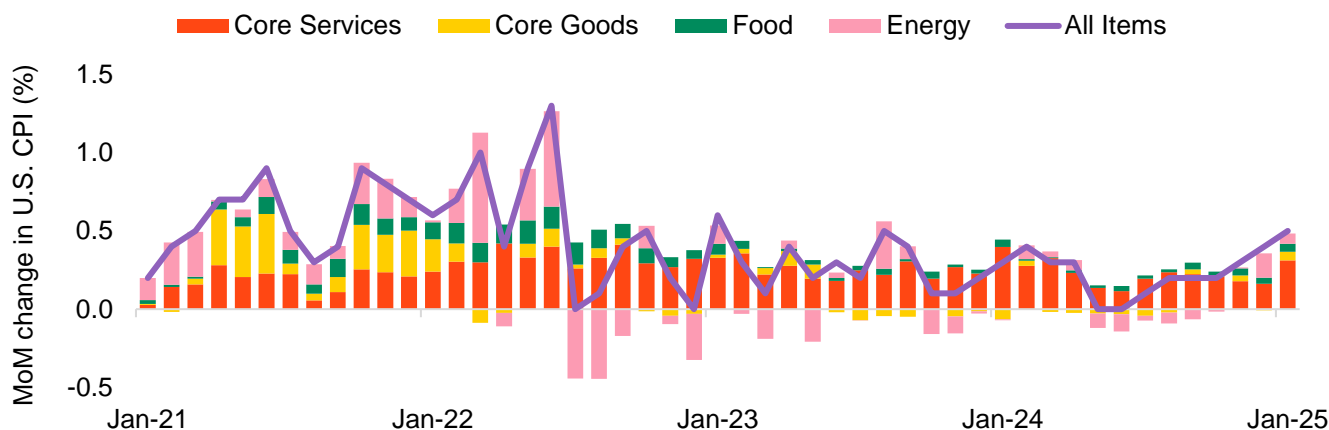
Year-over-year % change in headline and core U.S. CPI (not seasonally adjusted)



Source: BlackRock, Bureau of Labor Statistics, Bloomberg. Captures data through January 31, 2025.

Exhibit 3: Core services drove the month-over-month increase in U.S. CPI

Contributions to month-over-month (MoM) headline U.S. CPI (seasonally adjusted)



Source: Bloomberg, Bureau of Labor Statistics, BlackRock. Captures data through January 31, 2025.

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While market pricing has recalibrated its expectations for monetary policy actions (at the front-end of the curve), rising long-end rates have also been in focus for corporate credit investors. A rebuilding of term premia since late 2024 has been one of the driving forces, in our view. Our colleagues in the *BlackRock Investment Institute* expect this backdrop of structurally higher interest rates (relative to pre-pandemic levels) to persist, owing in large part to the interaction of structural forces with higher budget deficits.

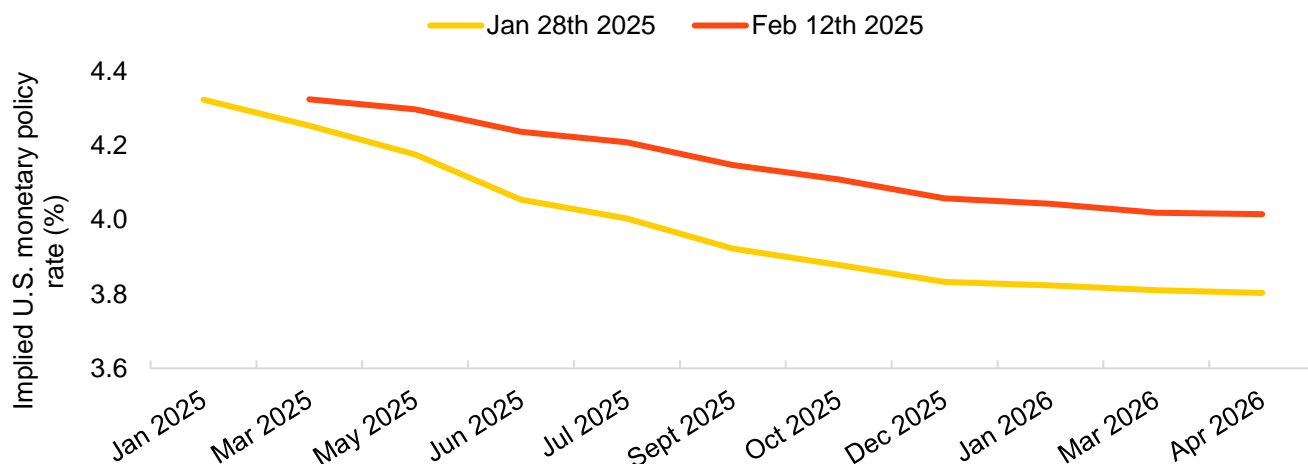
The impact for corporate credit

This has two implications for corporate credit markets. First, it should support the well-telegraphed, attractive all-in yield proposition of the asset class (Exhibit 6), which has persisted despite spreads that continue to hover at the tight end of the historical range (Exhibit 7). It also supports the diversification benefit of adding floating rate exposures (via liquid and private credit) to portfolios, in our view.

Importantly, we favor allocating to corporate credit in this environment because of its yield and potential for income generation. While spread tightening and declining interest rates have historically been drivers of total return in (fixed rate) credit, we see less scope for those factors at the current juncture. But as Exhibit 6 highlights, the yields available across the credit spectrum are attractive by historical standards.

Exhibit 4: Post-CPI release, market pricing reflects some additional delay around the timing of the next Fed rate cut

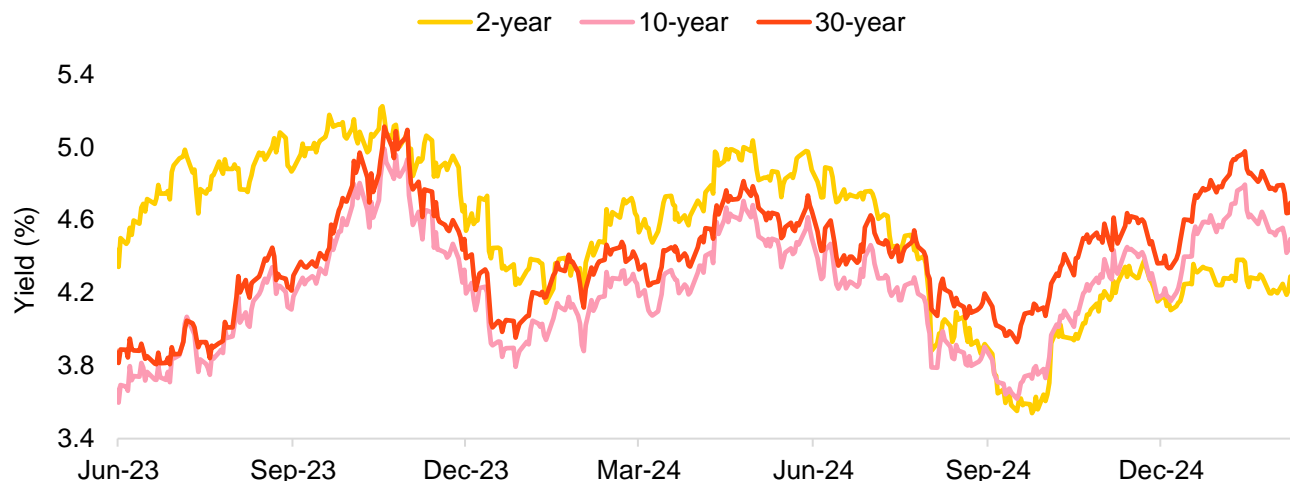
The U.S. monetary policy rate implied by Fed Funds Futures, as of January 28, 2025 (just before the January 29 FOMC) and February 12, 2025 (just after the U.S. CPI release).



Source: Bloomberg, BlackRock. **There can be no guarantee any forecasts may come to pass.** As of February 12, 2025.

Exhibit 5: Away from the front-end rate dynamic, long-end rates are still elevated

Yield-to-worst of the 2-year, 10-year and 30-year U.S. Treasuries (on-the-run securities, mid levels)



Source: Bloomberg, BlackRock. As of February 12, 2025.

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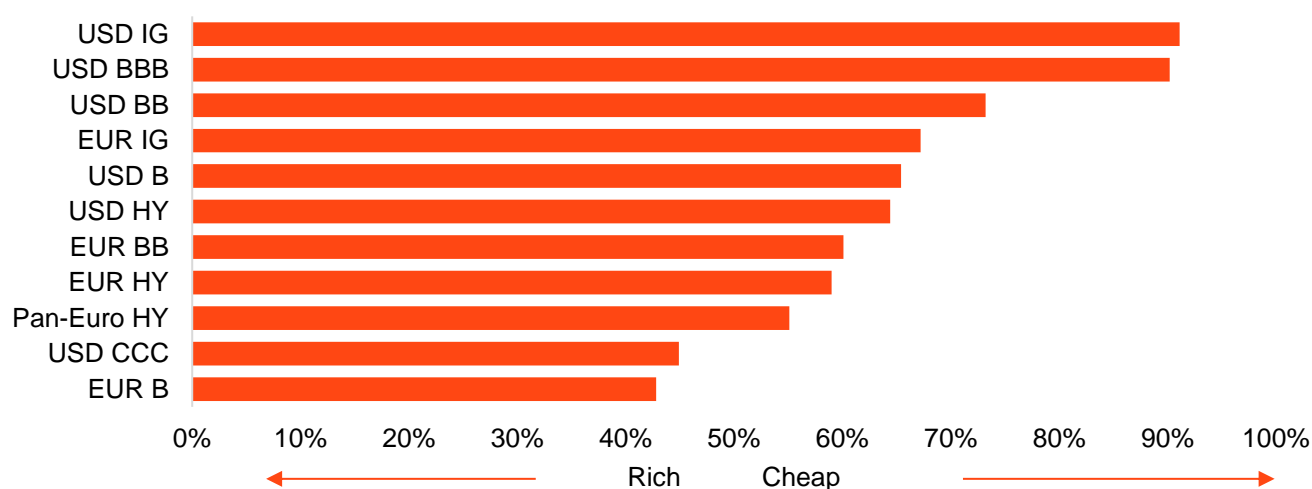
Second, borrowers will continue operating in an environment of structurally higher borrowing costs – at least relative to the post-financial crisis era. As we highlighted in our [1Q2025 Global Credit Outlook](#), so far, corporates have generally navigated this with resilience (albeit with some dispersion).

That said, the growth backdrop remains critical to monitor. So far, U.S. real GDP is tracking at an above-trend [pace](#) of 2.9% (as of February 7th, and most recent as of writing). We believe maintaining a trend pace of growth (or, ideally, above-trend) is important to support both credit fundamentals (amid higher borrowing costs) and investor risk appetite for credit – both of which influence credit valuations.

Nonetheless, even with solid growth, we expect the trend of elevated dispersion to persist, driven by underperformance in firms and business models unable to sustainably grow into their capital structures. This is evident, for example, in the [patterns](#) surrounding corporate default activity over the past 18 months, which highlight (among other themes) elevated shares of “repeat defaulters” and distressed exchanges.

Exhibit 6: Yields across corporate credit remain attractive from a historical context

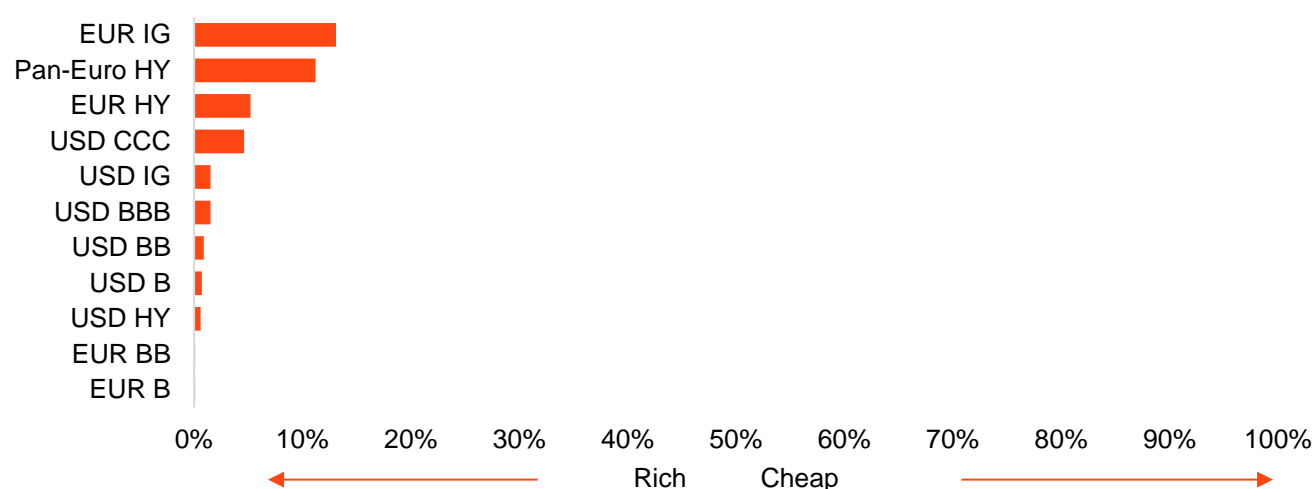
Percentile rank of daily index-level corporate bond yield-to-worst levels, since January 1, 2010



Source: ICE-BAML, Bloomberg, BlackRock. As of February 11, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

Exhibit 7: Spreads continue to hover at the tight end of the historical range

Percentile rank of daily index-level corporate bond option adjusted spreads, since January 1, 2010



Source: ICE-BAML, Bloomberg, BlackRock. As of February 11, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

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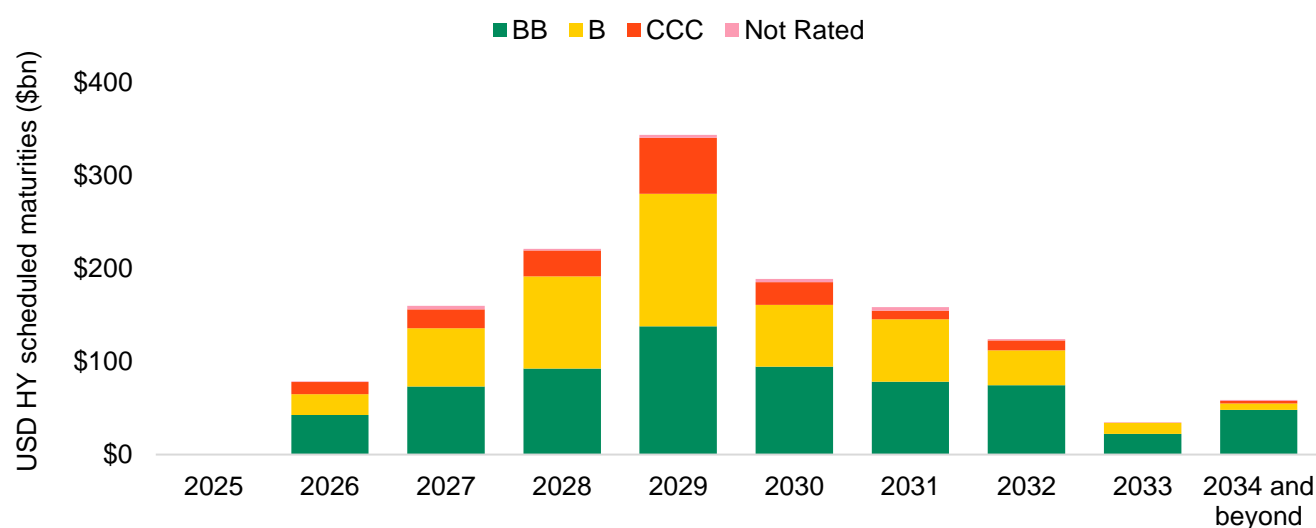
Trade and tariff uncertainty: why we see only modest scope for spread widening

Last week, we outlined why an escalation in trade tensions – if it were to materialize over the next few months – could catalyze a rebuild of risk premia in USD and EUR corporate credit spreads. That said, the potential widening we outlined is still relatively modest and would leave spreads well below the long-term averages of the post-financial crisis period, reflecting a mix of favorable fundamental and technical factors.

Perhaps somewhat counterintuitively, and as we also highlighted last week, we expect the HY / IG spread ratios to remain somewhat constant across regions, even as widening may occur – indicating that we do *not* expect decompression (or underperformance of lower rated credit). In this *Global Credit Weekly*, we unpack a few of the factors contributing to the resilience in the lower-rated portion of the USD corporate credit market (i.e., USD HY) over the past few quarters – which we expect will remain relevant.

Exhibit 8: Less than 6% of the USD HY index matures by the end of 2026

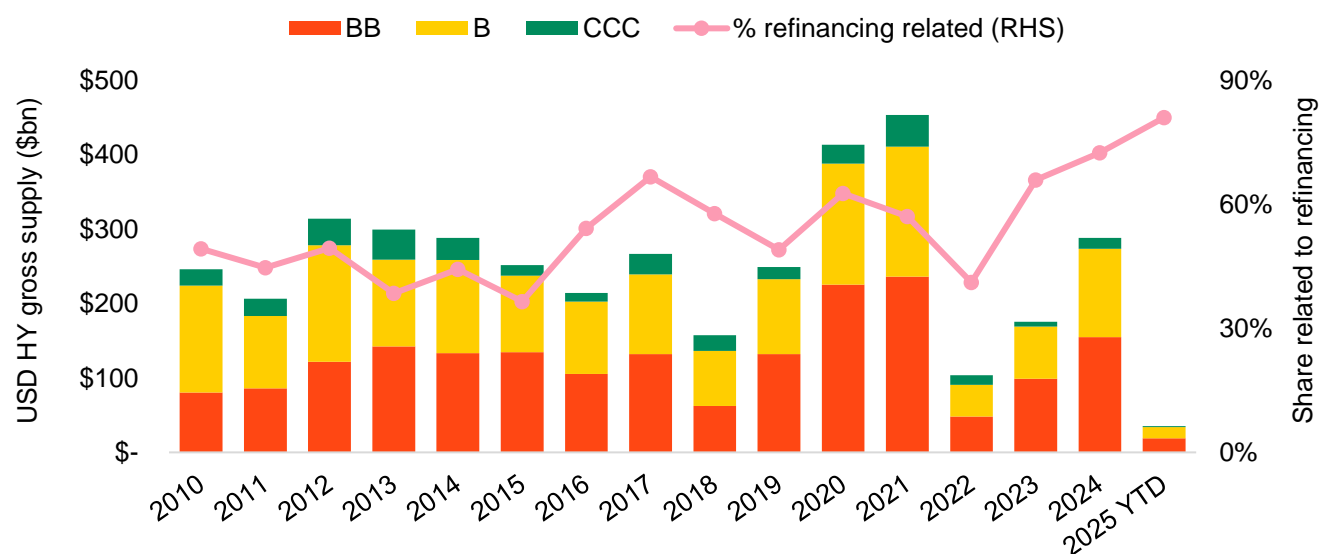
Maturity schedule for the bonds included in the Bloomberg USD HY Corporate Index, by Bloomberg Composite rating



Source: Bloomberg, BlackRock. As of February 11, 2025. Excludes bonds which are not index eligible.

Exhibit 9: USD HY gross new issuance remains heavily skewed towards refinancing

USD HY gross supply (\$bn) by Dealogic Effective Rating at Launch, and the share of gross issuance earmarked for debt repayment or refinancing (as captured by Dealogic's "primary use of proceeds"), RHS



Source: Dealogic (ION Analytics), BlackRock. As of February 12, 2025

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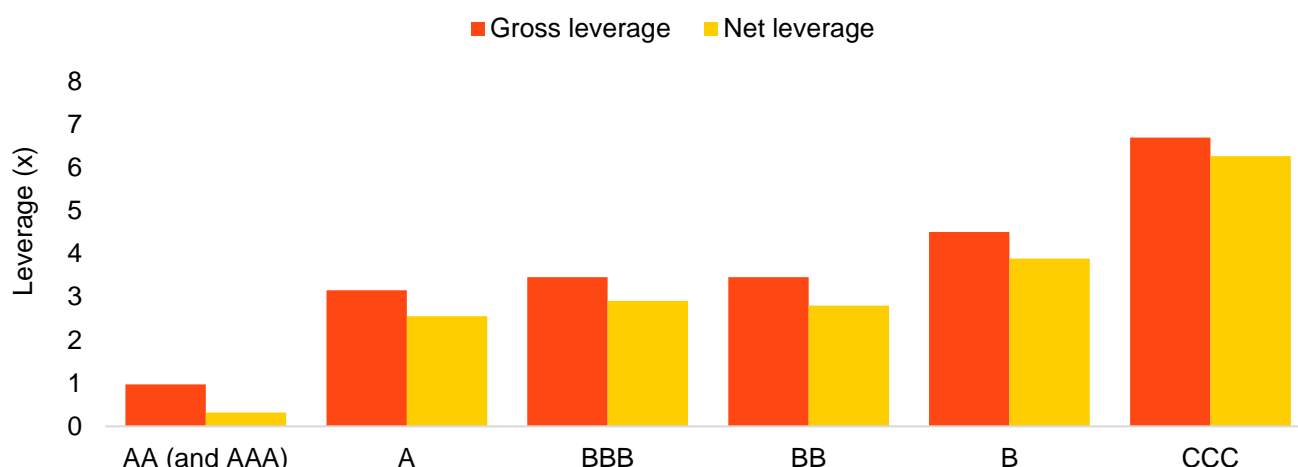
Starting with Exhibit 8, near-term maturity walls for the bonds in the Bloomberg USD HY Corporate Index are extremely low. In fact, less than \$80 billion of index-eligible debt (or 6% of the index) matures between February 2025 and December 2026.

The very light near-term maturity walls reflect borrowers' proactive approach to pre-funding and refinancing over the past few years. This is illustrated in Exhibit 9, which highlights how the "use of proceeds" for USD HY gross issuance has demonstrated a strong skew towards refinancing activity – a trend which has extended into issuance during the early days of 2025.

Fundamental metrics should also play a role in the resilience of the USD HY market, in our view. For example, as Exhibit 10 illustrates, trimmed mean gross and net leverage between the "low-end" of the IG market (i.e., BBBs) and the "high-end" of the HY market (i.e., BBs) are directly comparable, with very little differentiation. This is relevant, as BB-rated credits represent more than 48% of the \$1.4 trillion market value of the Bloomberg USD HY Corporate Index. Additionally, as Exhibit 11 highlights, interest coverage metrics for BBs and Bs (38% of the USD HY index) also remain solid. The exception is in the (highly idiosyncratic) CCC cohort (10.5% of the USD HY index), where coverage is less than 1.0x.

Exhibit 10: Trimmed mean net leverage metrics between the USD BBB and BB cohorts are very similar

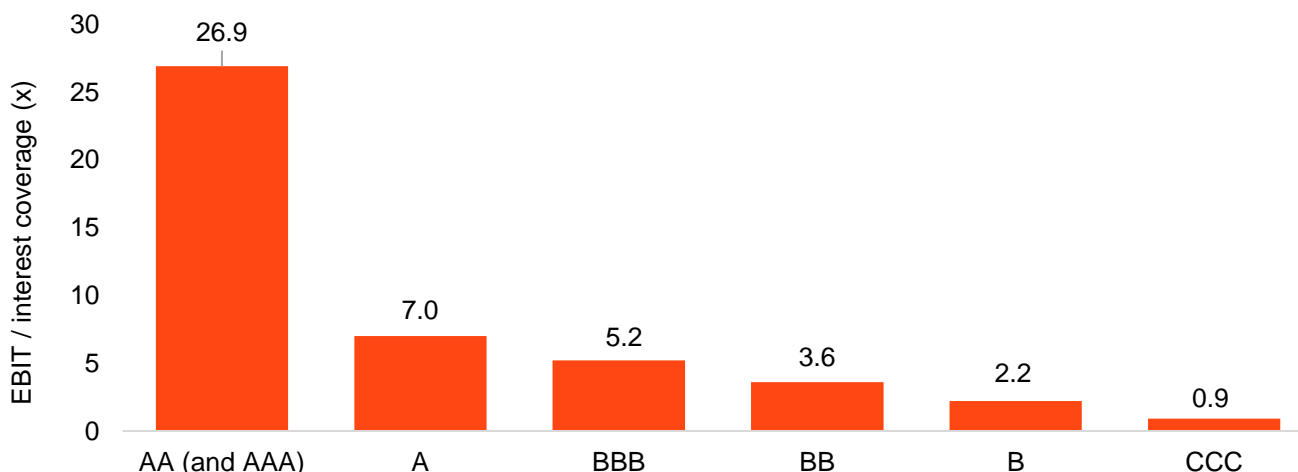
Trimmed mean (excludes top / bottom 10%) leverage metrics, for the last twelve months ended 3Q2024. Captures issuers in the Bloomberg USD IG and HY Corporate indices.



Source: Bloomberg, BlackRock. Captures trailing 12-month metrics as of 3Q2024 (most recent available as of February 12, 2025).

Exhibit 11: Average interest coverage metrics for USD CCCs are below 1x, but this is a smaller subset of the USD HY universe, vs. BBs and Bs

Trimmed mean (excludes top / bottom 10%) interest coverage metrics, for the last twelve months ended 3Q2024. Captures issuers in the Bloomberg USD IG and HY Corporate indices.



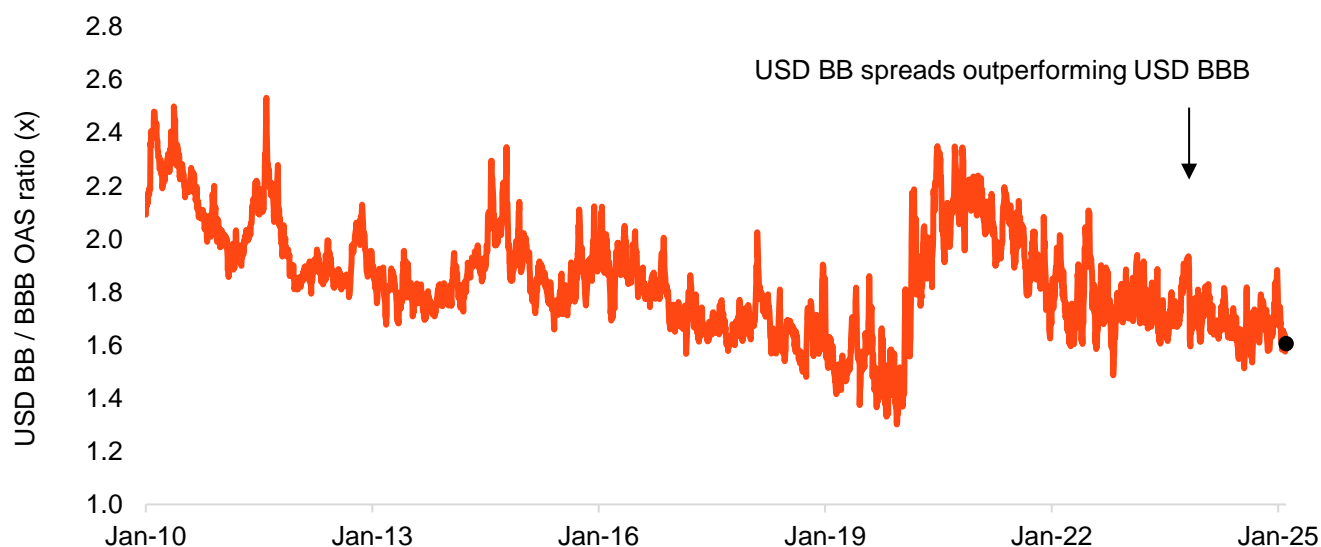
Source: Bloomberg, BlackRock. Captures trailing 12-month metrics as of 3Q2024 (most recent available as of February 12, 2025).

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Exhibits 1, 12, and 13 illustrate the recent relative outperformance of lower-rated USD credit in three ways: (1) HY vs. IG spread ratio, (2) BB vs. BBB spread ratio, and (3) CCC vs. BB and B spread ratios. While scope for material, additional outperformance may be limited from here, the fundamental and technical factors mentioned earlier should also limit the potential for underperformance relative to higher-rated credit – even during episodes of modest spread widening.

Exhibit 12: BB spreads have outperformed their higher-rated BBB peers

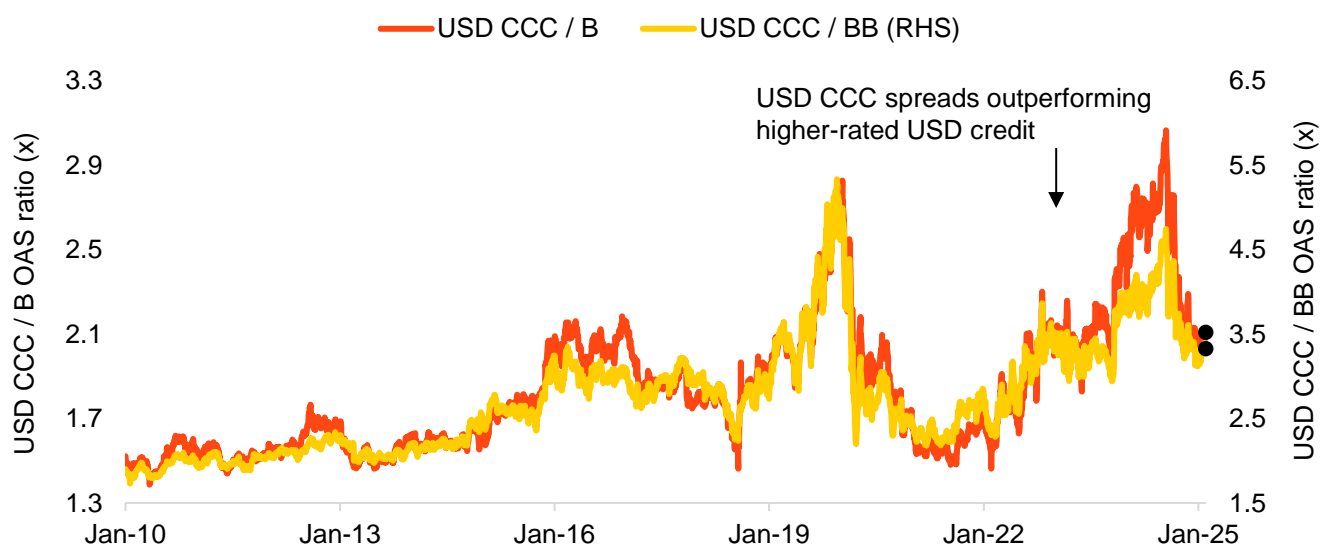
Option adjusted spread (OAS) ratio for the BB and BBB subindices of the Bloomberg USD IG and HY Corporate indices



Source: Bloomberg, BlackRock. As of February 11, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

Exhibit 13: CCC index-level spreads have outperformed the higher-rated BB and B cohorts

Option adjusted spread (OAS) ratios for the CCC, B and BB subindices of the Bloomberg USD HY Corporate Index



Source: Bloomberg, BlackRock. As of February 11, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

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