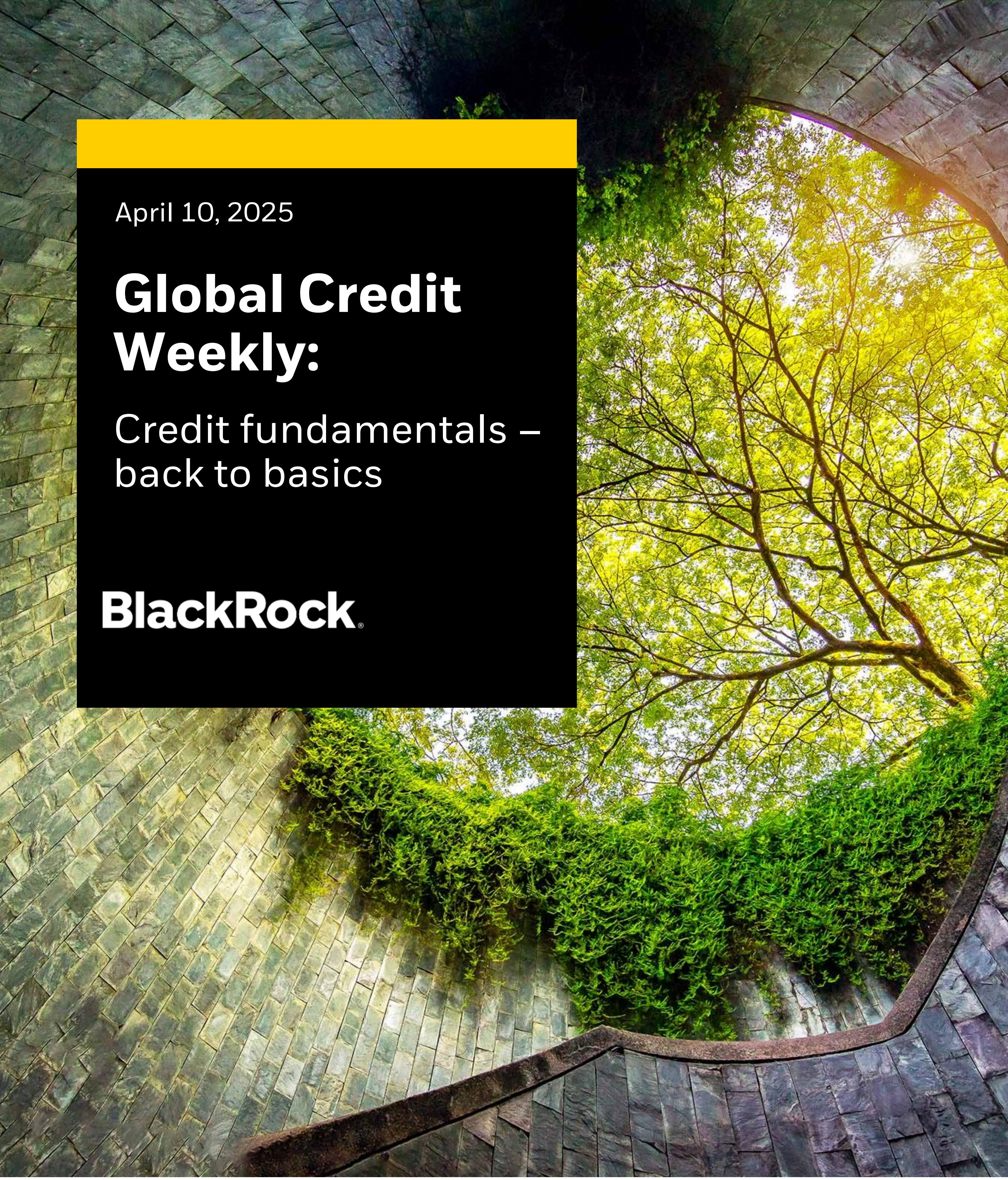

April 10, 2025

Global Credit Weekly:

Credit fundamentals – back to basics

BlackRock

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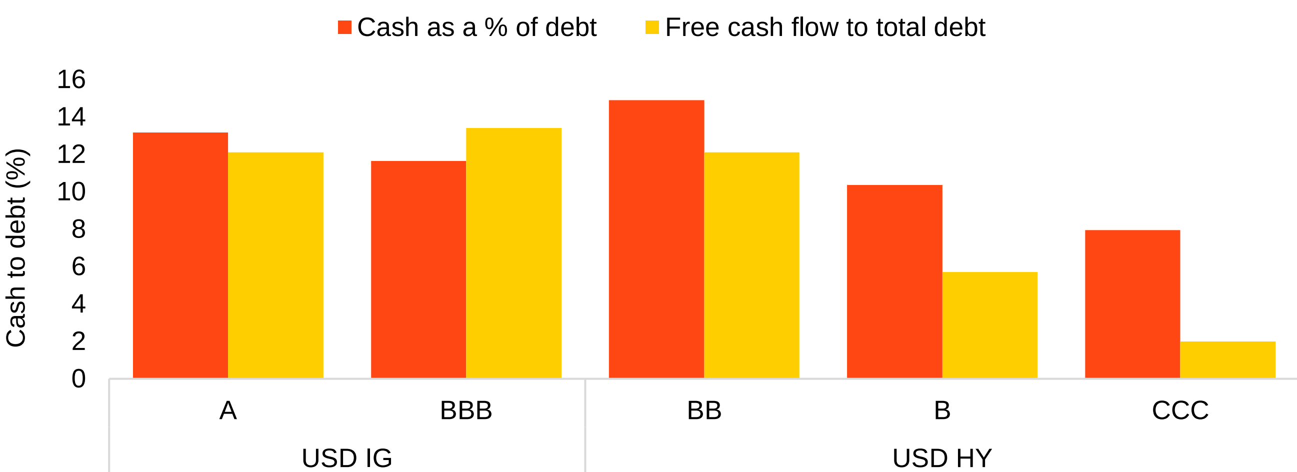
Key takeaways

- On April 9th, President Trump made a series of announcements related to previously communicated tariff plans. Our colleagues in the *BlackRock Investment Institute* estimate the average U.S. effective tariff rate is now approximately 20% and will evolve from here. Policy uncertainty is likely to remain elevated in the coming months. We expect a more challenging growth-inflation mix – the magnitude and duration of which have yet to be fully determined.
- For corporate credit investors, we see two primary implications. First, at the sector and product level, tariffs on affected goods will increase costs of goods sold and mechanically weigh on profit margins – albeit to varying degrees across industries and products (driving heightened dispersion). Second, we expect some deterioration in the global growth backdrop, as corporates appear likely to pare back on hiring, investment and strategic activity (owing to profit pressures and lingering policy uncertainty), and consumers' real disposable income declines further.
- IG and HY corporate credit spreads have widened meaningfully since mid-February, to appropriately reflect a more challenging macro backdrop. That said, spreads are still below post-financial crisis averages in the USD and EUR markets. Some additional spread widening – and an increase in distress/default activity – is possible in the event of a sharp growth slowdown.
- On the more positive side, corporates are entering this period from a position of fundamental strength, based on a variety of closely watched metrics. Near-term maturity walls are also low. This fundamental backdrop leaves us comfortable *selectively* moving down in quality.
- Earnings estimates have been revised lower as corporate management teams and analysts have begun to reflect recent tariff details into their forward expectations. That said, we believe this pattern is still in its early stages. The 'feedback loop' between corporate margins, the labor market, consumer spending and overall economic activity will be key to monitor. High-frequency data on jobless claims and company level commentary will be most informative, in our view.

Exhibit 1: Credit fundamentals leave us comfortable *selectively* moving down in quality
Trimmed mean (excludes top / bottom 10%) cash to debt metrics, for the last twelve months ended 4Q2024, as calculated by Bloomberg Intelligence. Captures issuers in the Bloomberg USD IG and HY Corporate indices.



Source: Bloomberg, BlackRock. Captures trailing 12-month metrics as of 4Q2024 (most recent available as of April 9, 2025). We exclude the 'AAA / AA' category due to its outsized figures (82.9% cash to debt, and 65% free cash flow to debt).

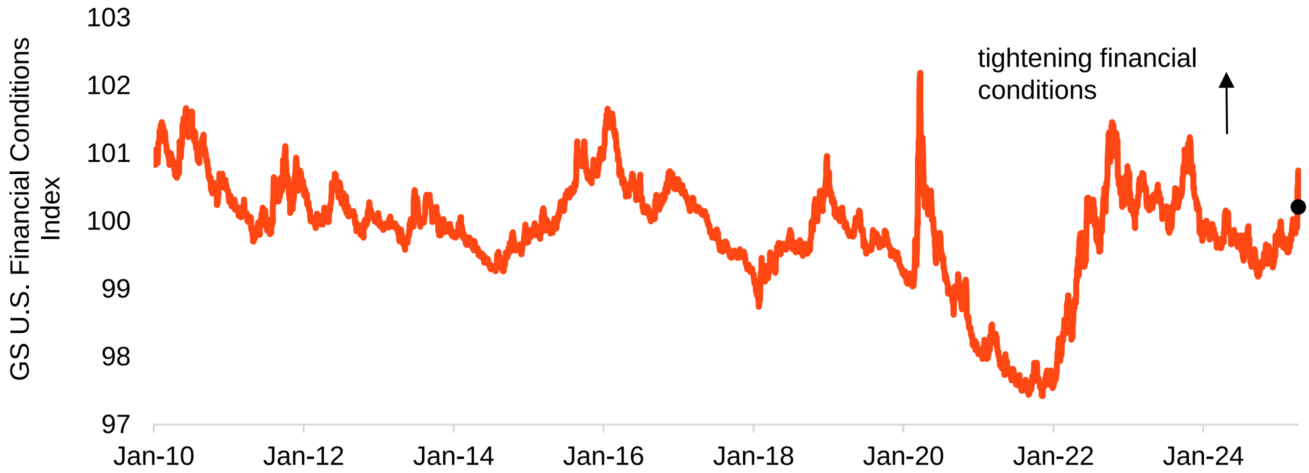
A more challenging growth-inflation mix

On April 9th, President Trump made a series of announcements related to the administration's previously communicated tariff plans. While the 10% universal baseline tariff remains in effect, a 90-day pause was granted for the country-specific 'reciprocal' tariffs and applies to countries which have not retaliated against the tariffs imposed by the United States. President Trump also announced a further increase to the tariff rate on imports from China, to 125%.

Following these developments, our colleagues in the *BlackRock Investment Institute* estimate the average U.S. effective tariff rate is now approximately 20% and will likely evolve from here. The news of a 90-day pause was met with a sharp rally in USD corporate credit and equity markets on Wednesday afternoon. That said, overall financial conditions have still tightened in recent weeks (Exhibit 2).

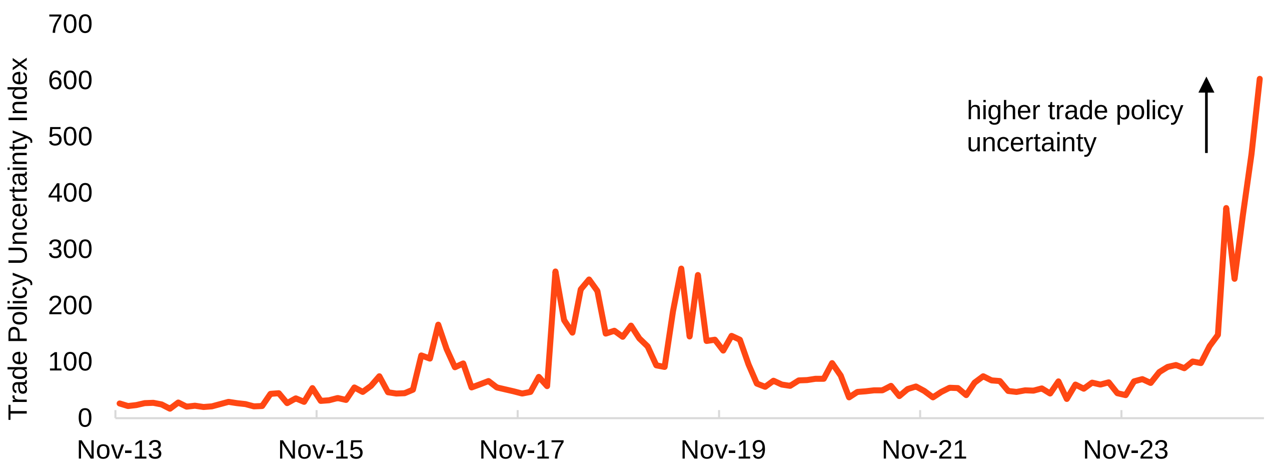
As we outlined in our *2Q2025 Global Credit Quarterly*, policy uncertainty (Exhibit 3) is likely to remain elevated in the coming months, given the potential for negotiations and/or responses from other countries. We expect a more challenging growth-inflation mix – the magnitude and duration of which have yet to be fully determined.

Exhibit 2: Financial conditions tightened following recent tariff announcements
Goldman Sachs U.S. Financial Conditions Index



Source: BlackRock, Bloomberg, Goldman Sachs Global Investment Research. As of April 9, 2025.

Exhibit 3: Trade policy uncertainty has far exceeded the 2018-2019 episode
Trade Policy Uncertainty Index (measured monthly)



Source: Haver Analytics, BlackRock. Captures data through March 31, 2025. The Trade Policy Uncertainty (TPU) Index is based on automated text searches of the electronic archives of seven newspapers: Boston Globe, Chicago Tribune, Guardian, Los Angeles Times, New York Times, Wall Street Journal, and Washington Post. The measure is calculated by counting the monthly frequency of articles discussing trade policy uncertainty (as a share of the total number of news articles) for each newspaper. The index is then normalized to a value of 100 for a one percent article share. Developed by Dario Caldara, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo.

The two-fold headwinds for corporate credit: margins and growth

For corporate credit investors, we see two primary implications. First, at the sector and product level, tariffs on affected imported goods into the U.S. will increase costs of goods sold and mechanically weigh on profit margins – albeit to varying degrees across industries and products (driving elevated sector dispersion). Second, we expect some deterioration in the global growth backdrop, as corporates appear likely to pare back on hiring, investment and strategic activity (owing to profit pressures and lingering policy uncertainty), and consumers' real disposable income declines further.

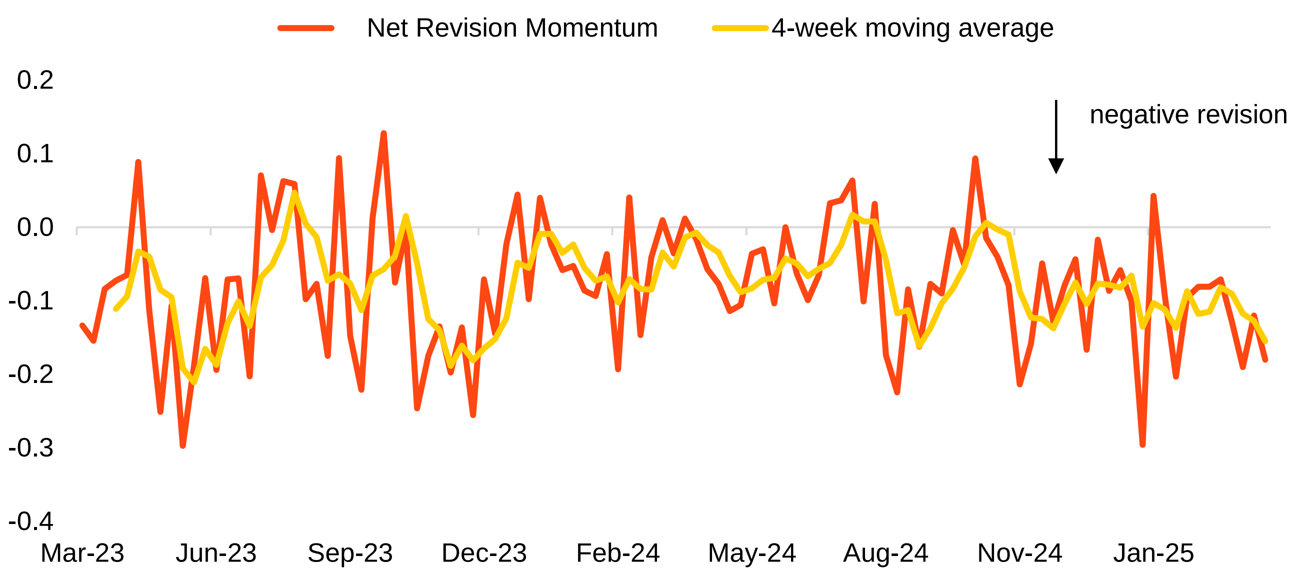
As Exhibit 4 illustrates, earnings estimates have been revised lower as corporate management teams and analysts have begun to reflect tariff details into their forward expectations. That said, recent company commentary suggests this pattern is likely still in its early stages. We see further scope for estimates and guidance to move lower.

We expect corporate profit margins will eventually 'catch down' to these lower earnings estimates and company guidance. While tariff-exposed goods sectors are most vulnerable, we also expect some pressure on services-based businesses, owing to the potential for a broader slowdown in economic activity. For the lowest quality subsets of the corporate credit market, this will likely place upward pressure on distress and default activity. That said, fundamentals across many subsets of the corporate credit market are solid and near-term maturity walls are very low, providing some cushion.

The *magnitude* of the potential growth slowdown is key for corporate credit investors to monitor. The severity and duration of the growth deterioration will depend on the forward path for trade policy as well as the duration of lingering policy uncertainty. As we discuss later, we view preemptive Fed rate cuts as unlikely, barring visible deterioration in the economic data (especially the labor market). Indeed, the 'feedback loop' between corporate margins, the labor market, consumer spending and overall economic activity will be key to monitor. High-frequency data on jobless claims and company level commentary will be most informative, in our view.

So far, the (backward looking) economic data appears generally disconnected from the recent market volatility and the weaker consumer and C-suite sentiment surveys. We highlighted this disconnect a few weeks ago, and it has been further underscored with recent data releases. For example, the NFIB small business optimism survey (released April 8th) illustrated a decline in respondents' optimism around business conditions. Meanwhile, the March non-farm payrolls report (released April 4th) reflected a still-solid labor market, and weekly jobless claim measures have also been low by historical standards.

Exhibit 4: We see scope for analyst revisions to move further into negative territory
Net Revision Momentum of 12-month forward EPS for the S&P 500, as calculated by Bloomberg Intelligence, and the 4-week moving average



Source: Bloomberg, BlackRock. As of April 4, 2025 (most recent update as of April 9, 2025). Net Revision Momentum = (Positive Revisions – Negative Revisions) / Total Revisions.

Spread widening: likely some room for more

Index-level USD and EUR investment grade (IG) and high yield (HY) corporate credit spreads have widened meaningfully in recent weeks, even after considering the sharp reversal on April 9th (Exhibits 5 and 6). We believe this rebuild of risk premia appropriately reflects the more challenging growth-inflation mix as well as the heightened policy uncertainty that we expect to persist. Still, historical context indicates that the market is not currently pricing in a sharp growth slowdown in either region.

For example, using the ICE-BAML indices, USD IG and EUR IG spreads were at 121bp and 125bp, as of April 9th. While this represents notable widening vs. the local tights of mid-February, spreads remain below the post-financial crisis averages of 139bp and 137bp for USD IG and EUR IG, respectively.

HY bonds tell a similar story, widening to 437bp for USD HY and 429bp for EUR HY as of April 9th. Here again, the context is important. Given the 'starting point' for spreads was already quite tight, these wider levels are still below the post-financial crisis averages of 465bp and 444bp, respectively.

For context, we believe USD HY spread levels around 550bp-650bp would *begin* to reflect an expectation for a sharp growth slowdown, and spreads 800bp-850bp or higher would *begin* to reflect a recessionary outcome. For USD IG, these levels would be closer to 140bp-150bp (sharp growth slowdown) and 180bp-200bp or higher (recessionary outcome), respectively.

Exhibit 5: Spreads have widened...

Index-level option adjusted spreads (bp) for the ICE-BAML USD and EUR IG Corporate indices

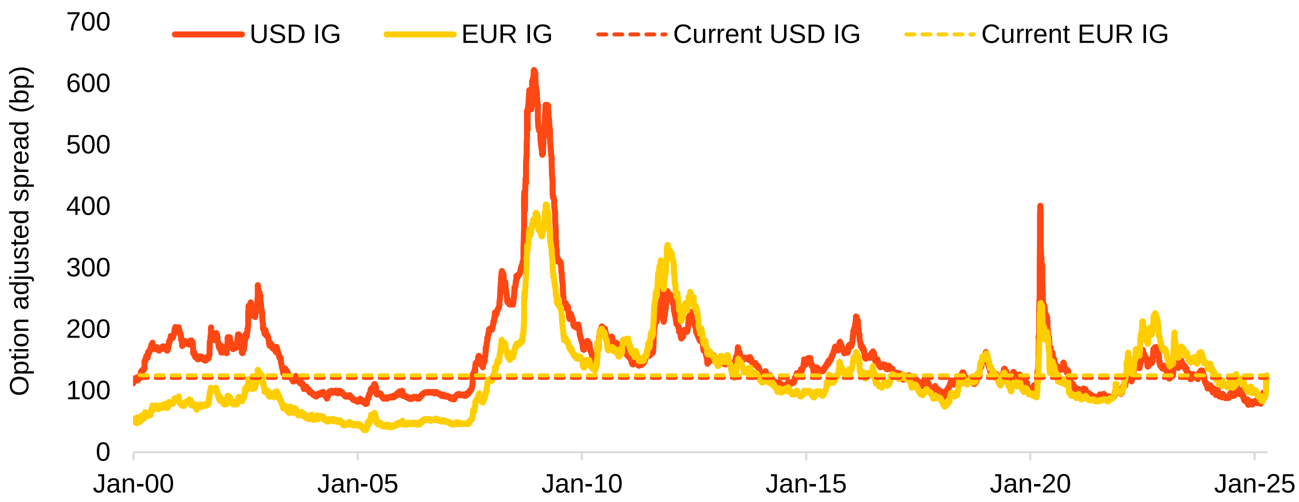
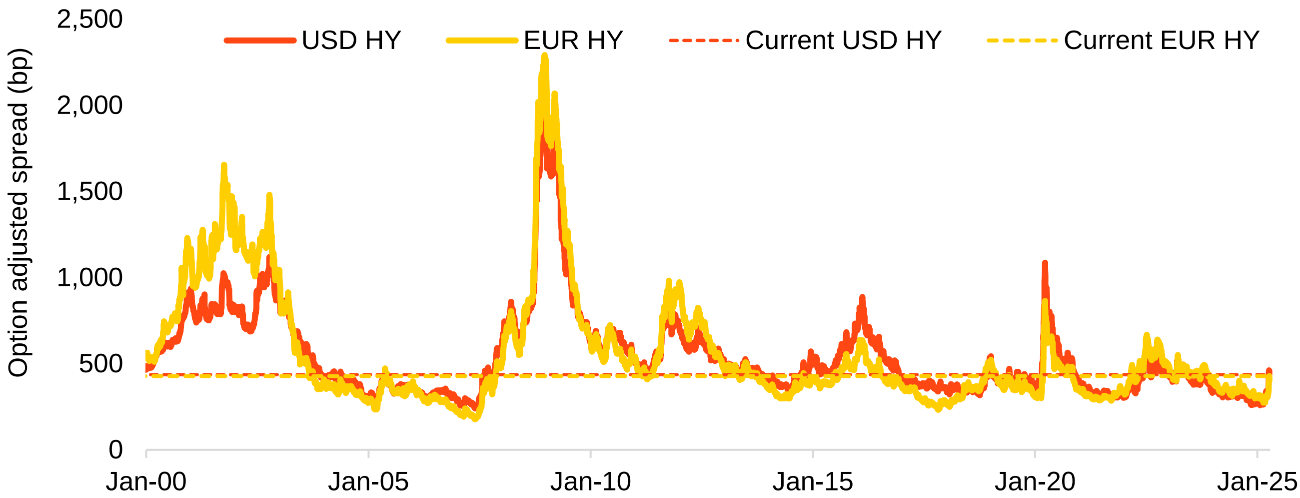


Exhibit 6: ... but do not reflect a sharp growth slowdown, in our view

Index-level option adjusted spreads (bp) for the ICE-BAML USD and EUR HY Corporate indices



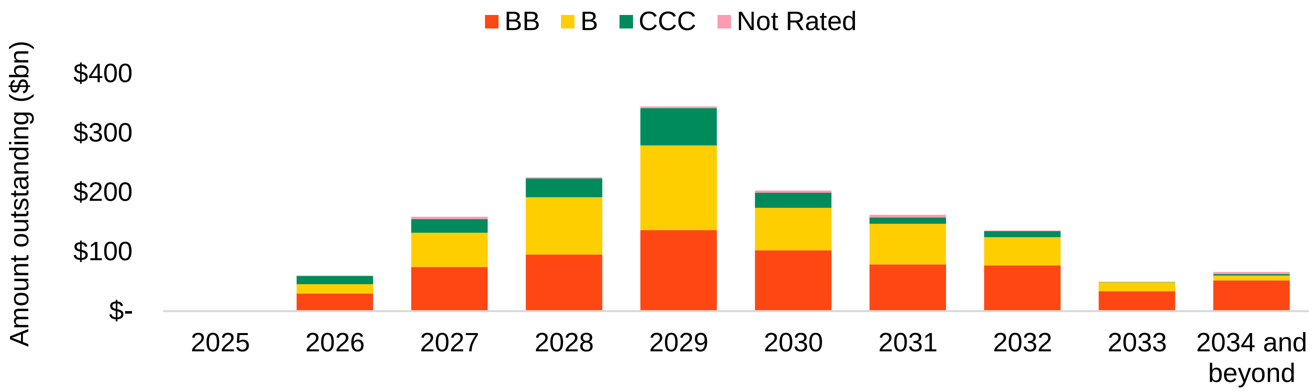
Source for both charts: ICE-BAML, Bloomberg, BlackRock. As of April 9, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

Near-term corporate maturity walls are low

New issue markets in corporate credit – especially in the leveraged finance universe – have been quiet in so far this month. For now, these corporate borrowers generally have an ability to be patient, owing to very low near-term maturity walls (Exhibits 7 through 9). From a fundamental perspective, this provides some cushion around liquidity needs. A sustained 'restarting' of debt capital markets activity will be an important signpost to watch in our view, as an indicator of confidence in overall market functioning.

Exhibit 7: Less than 5% of the USD HY index matures through year-end 2026

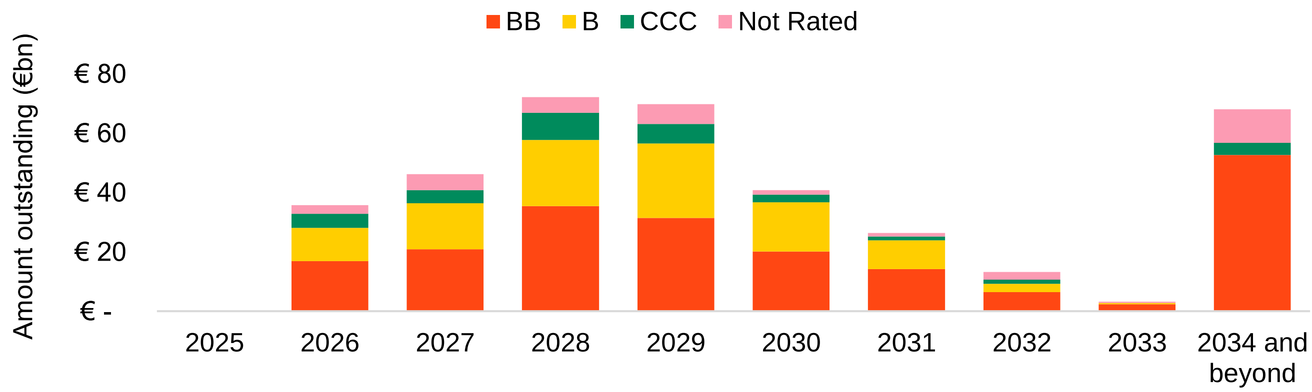
Maturity schedule for bonds in the Bloomberg USD HY Corporate Index, by Bloomberg Composite rating



Source: Bloomberg, BlackRock. As of April 9, 2025. Excludes bonds which are not index eligible. Also excludes bonds rated C+ or lower.

Exhibit 8: Less than 10% of the EUR HY index matures through year-end 2026

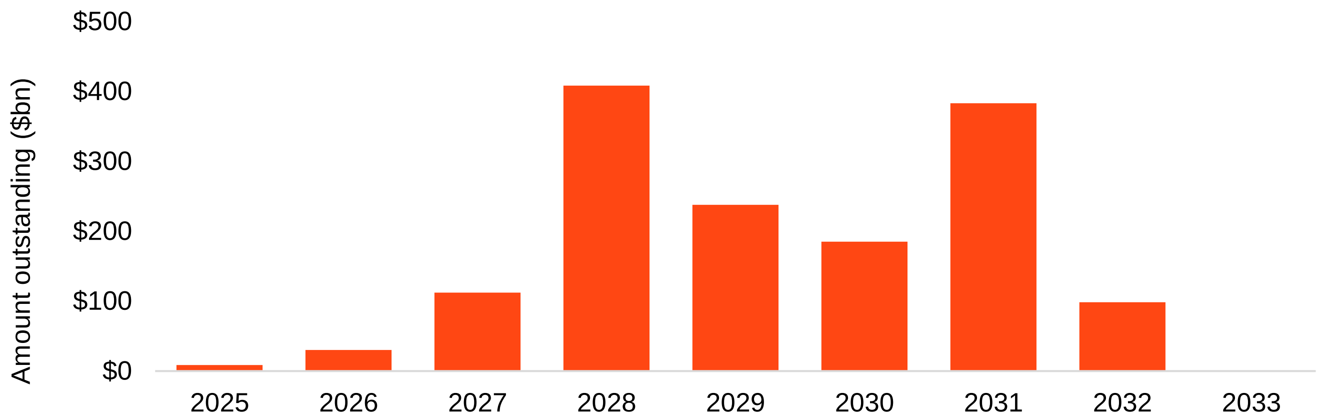
Maturity schedule for bonds in the Bloomberg Pan-Euro HY Corporate Index, by Bloomberg Composite rating



Source: Bloomberg, BlackRock. As of April 7, 2025. Excludes bonds which are not index eligible. Also excludes bonds rated C+ or lower.

Exhibit 9: Near-term maturities for USD leveraged loans are minimal

Maturity schedule for performing loans in the Morningstar / LSTA USD Leveraged Loan Index



Source: Pitchbook LCD, BlackRock. As of April 4, 2025. Data excludes defaulted facilities and is based on par amount outstanding.

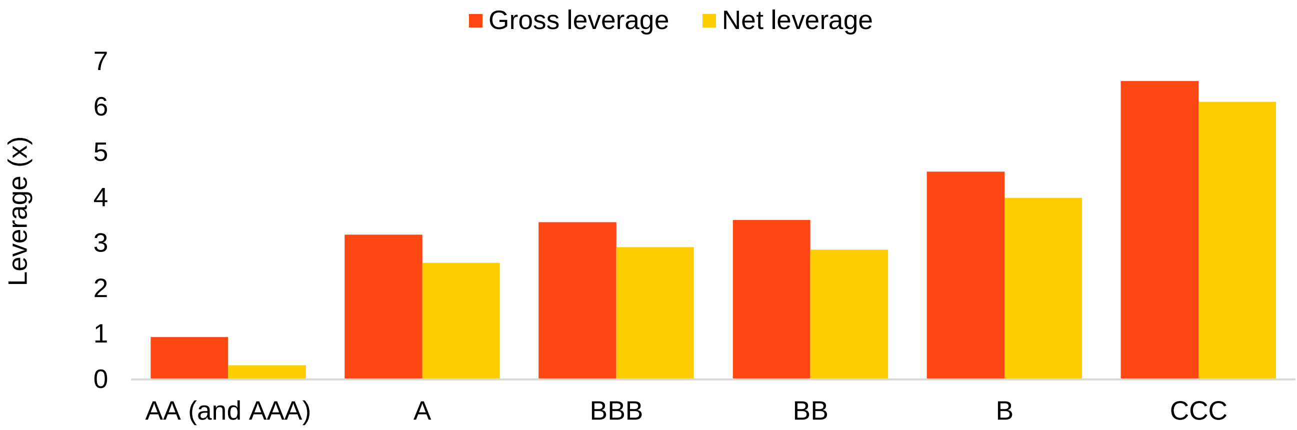
Opportunities in credit

As we highlighted in our _2Q2025 Global Credit Outlook_, within the USD IG and HY fixed rate corporate credit universe, we are comfortable moving down in quality, within reason, and with the expectation that margins are likely to moderate from current levels (as discussed earlier).

For example, as of April 9th, the USD BBB cohort traded at an average OAS of 137bp, compared to 94bp for its USD A peer group. There are only modest differences in key credit fundamentals between the two groups (Exhibits 1, 10 and 11). And we see less scope for balance sheet deterioration among BBB rated capital structures, where we expect most management teams to prioritize maintaining a debt rating within IG territory. By contrast, A and AA rated firms would have much more capacity to add debt onto their balance sheets (if the 'only' key parameter is to stay IG rated).

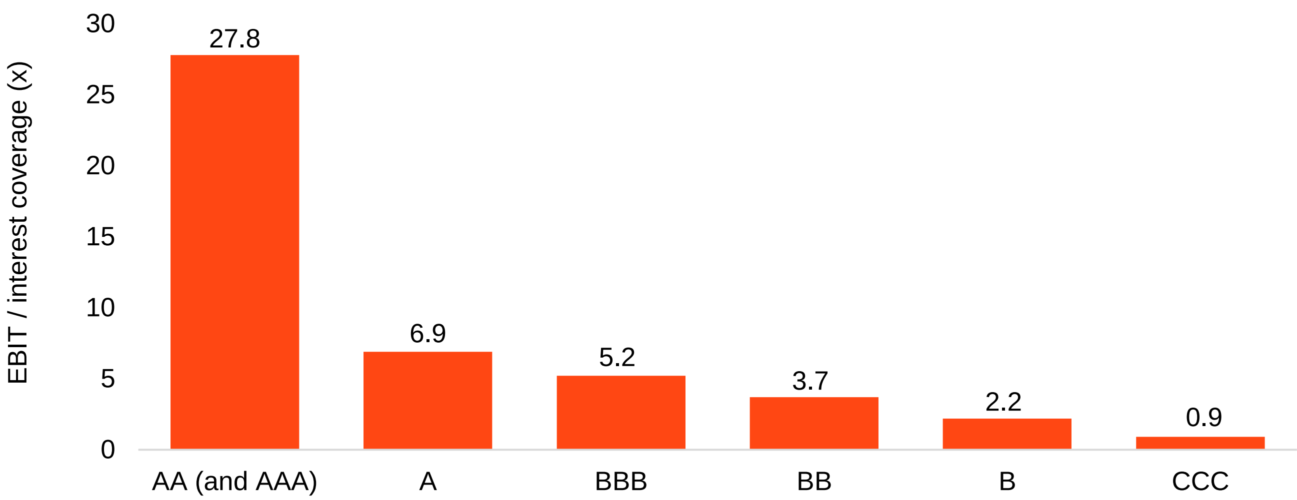
Similarly, we still see value in reaching into the 'high-end' of the HY market (BBs), considering how fundamental metrics have converged to resemble BBBs. That said, USD CCCs have been a clear underperformer and *already* have weak credit metrics (*prior* to any visible, material downturn in U.S. economic activity). While CCCs are a highly idiosyncratic group, we would need to have more confidence on the U.S. growth outlook before becoming constructive on the risk-reward in this cohort.

Exhibit 10: Leverage across As, BBBs and BBs is similar (and modest)
Trimmed mean (excludes top / bottom 10%) leverage metrics, for the last twelve months ended 4Q2024. Captures issuers in the Bloomberg USD IG and HY Corporate indices.



Source: Bloomberg, BlackRock. Captures trailing 12-month metrics as of 4Q2024 (most recent available as of April 2, 2025).

Exhibit 11: Average interest coverage for USD CCCs is *already* below 1x
Trimmed mean (excludes top / bottom 10%) EBIT / interest expense coverage metrics, for the last twelve months ended 4Q2024. Captures issuers in the Bloomberg USD IG and HY Corporate indices.



Source: Bloomberg, BlackRock. Captures trailing 12-month metrics as of 4Q2024 (most recent available as of April 2, 2025).

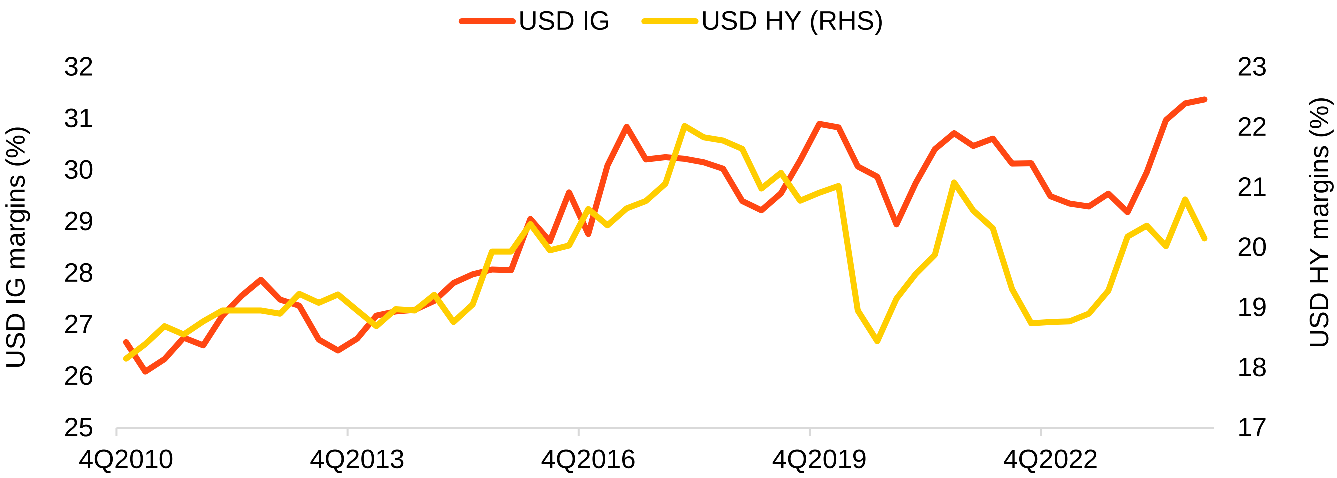
Corporate margins are key to the economic 'feedback loop', in our view

Margins are the key metric to monitor, in our view. As we noted in our *2Q2025 Global Credit Quarterly*, we see a clear feedback loop between (1) the health of the U.S. labor market, (2) the strength of U.S. consumer spending, and (3) overall U.S. economic activity. But a key ingredient in corporates' demand for labor (workers) is their profit margins. Sustained downward pressure on profit margins (from higher input costs, for example) increases the risk that corporates could use layoffs more aggressively, to protect profitability. An increase in layoffs, coupled with the current low *hiring* rate, could result in broad-based weakness in consumer spending (as it may take longer for laid-off workers to find jobs and restore their income).

For now, layoffs remain muted by historical standards, and USD IG and HY margins have not shown signs of sharp deterioration (Exhibit 12). That said, these metrics will be important to monitor as tariffs are implemented – especially for firms that already have weaker credit metrics (Exhibit 13). High-frequency labor market data is especially important, as is company-level commentary on headcount plans, margins, pricing power and operational leverage. Amid bouts of volatility, companies' access to financing – whether in public or private credit markets – is also important to track, in our view.

Exhibit 12: Margins are key to monitor over the next few months

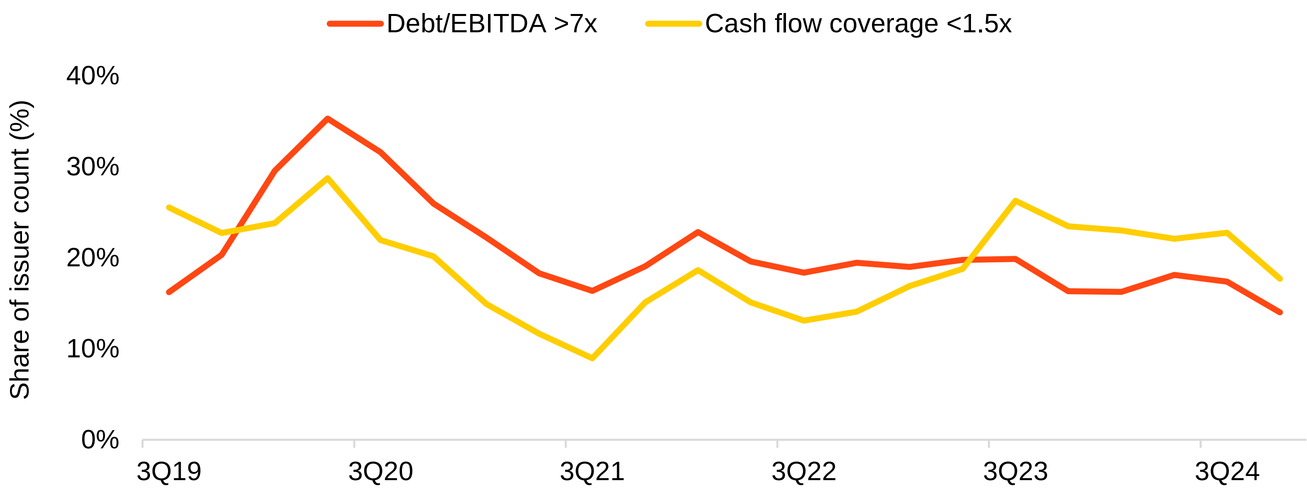
Trailing 12-month adjusted EBITDA margins for the median issuer in the Bloomberg USD IG and HY Corporate indices



Source: Bloomberg, BlackRock. Captures data through 4Q2024 (most recent as of April 2, 2025).

Exhibit 13: Firms with 'outer edge' (weaker) credit statistics have less cushion to absorb margin pressures

Share of issuers (with public financials) in the Morningstar LSTA USD Leveraged Loan Index, by issuer count, with debt/EBITDA >7x and cash flow coverage <1.5x



Source: Pitchbook LCD, BlackRock. As of December 31, 2024. LCD's sample for 4Q2024 included 150 issuers with public financials, or 14% of index count, which is a subset of all issuers with public financials.

The outlook for defaults

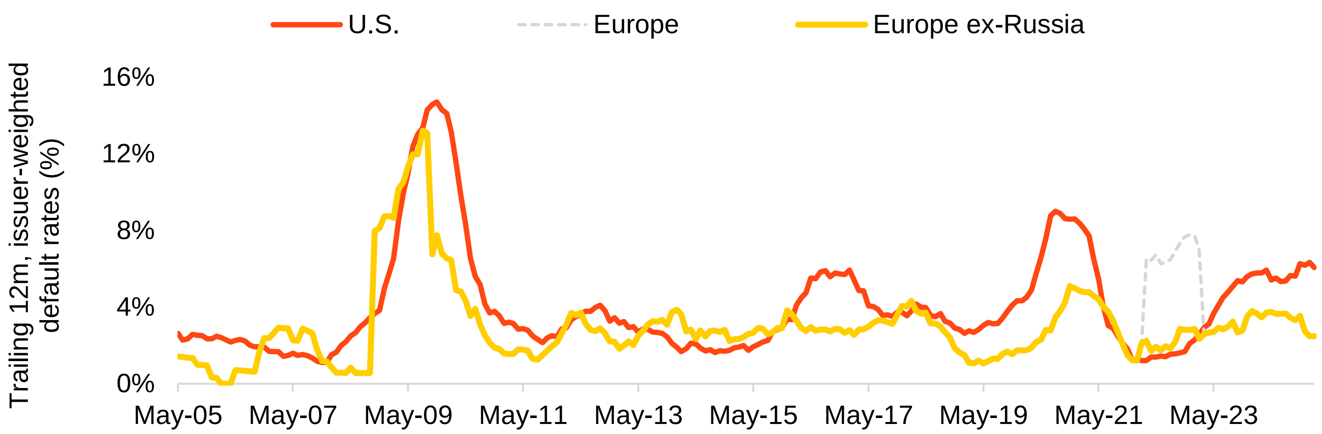
A more challenging growth-inflation backdrop will likely increase distress and default activity. Corporate default rates (as measured on an issuer-weighted, trailing 12-month basis) had *already* increased over the past several quarters (Exhibits 14 and 15) – despite above-trend growth in the U.S. This was a direct function of the transmission of monetary policy to floating rate borrowers, following the central bank hiking cycles of 2022-2023.

An added headwind of sluggish growth may cause default activity to remain elevated, rather than improve in response to rate cuts delivered by the Fed and ECB since 2H2024. The magnitude of the increase in defaults will largely depend on the extent of the growth downturn – as has been the case in prior cycles.

We expect many of the default 'trends' that we highlighted in our *2Q2025 Global Credit Quarterly* to remain in place – especially the pattern of defaults among smaller issuers, the skew towards distressed exchanges (vs. Chapter 11s), and the elevated share of 'repeat defaulters.' That said, given the nature of the potential trade-related margin pressures, we believe sector and company-specific exposures will now play a greater role in driving default activity – as opposed to the broader theme of central bank rate hikes and elevated borrowing costs, which took center stage for much of 2022-2024.

Exhibit 14: The USD corporate default trade was above 6% as of February 2025

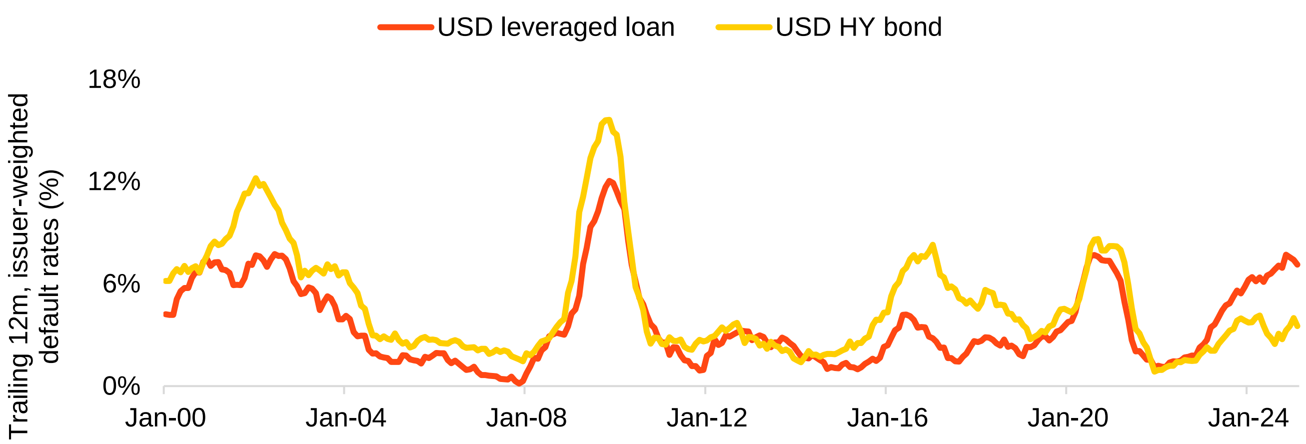
Trailing 12-month, issuer-weighted default rates for the universe of USD and EUR HY and leveraged loans (combined) tracked by Moody's



Source: Moody's, BlackRock. As of February 28, 2025 (most recent available as of April 7, 2025). The increase in defaults in the EUR market in early 2022 reflects the defaults of Russian issuers following the onset of the Russia-Ukraine war. Distressed exchanges are counted as a default, alongside payment defaults.

Exhibit 15: Leveraged loan defaults have recently outpaced their HY bond peers, owing to the swifter transmission of Fed rate hikes to floating rate borrowers

Trailing 12-month, issuer-weighted default rates for the universe of USD leveraged loans and HY bonds tracked by Moody's



Source: BlackRock, Moody's. As of February 28, 2025 (most recent available as of April 7, 2025). Distressed exchanges are counted as a default, alongside payment defaults.

Fed's reaction function: still likely constrained

The combination of lower growth and higher inflation creates a challenge for the Federal Reserve's reaction function, given its dual mandate of maximum employment and price stability. While downside risks to growth appear clear, near-term rate cuts are unlikely in our view, owing to inflation that is *already* above the Fed's target (and poised to move higher).

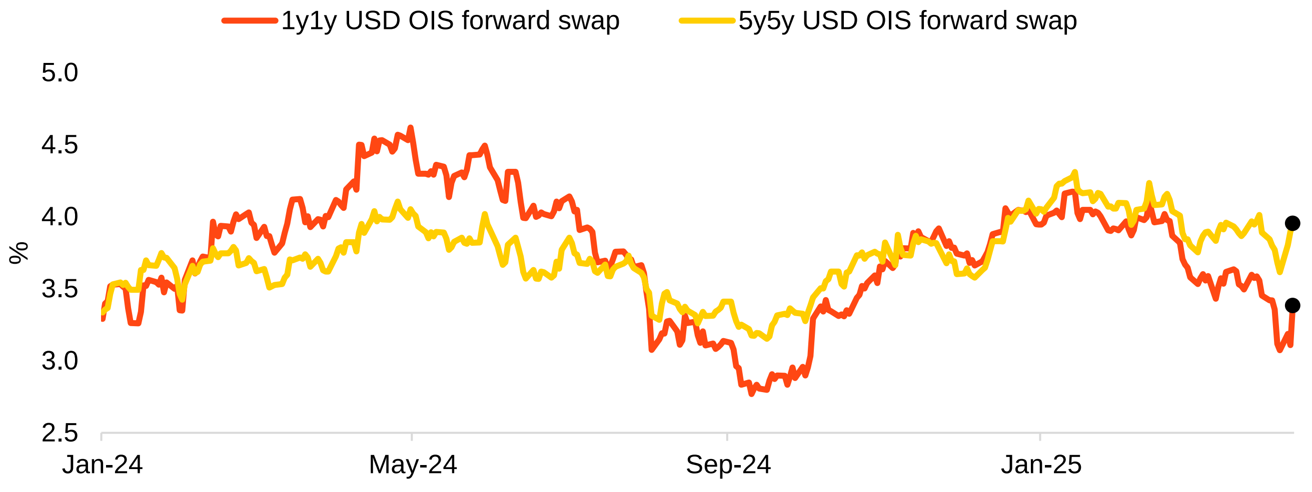
In an interview last Friday (April 4th) Chair Powell provided comments that skewed somewhat more hawkish, in our view, relative to the March 19th FOMC press conference. For example, at the March FOMC, Chair Powell noted that tariff-related impacts on inflation *could* be one-time in nature (i.e., something the FOMC might be able to look through). But last week, Chair Powell flagged the larger than expected tariffs relative to the FOMC's placeholder forecasts. He also noted that the Fed will wait to understand the impacts of policy before cutting rates (beyond the 100bp already delivered since September 2024).

This stance further supports our view that rate cuts in 1H2025 are unlikely, barring a sharp downturn in growth and evidence of deterioration in economic activity and/or the labor market.

There were a few other important themes in Chair Powell's comments, in our view:

- **Larger than expected tariffs:** Chair Powell acknowledged that "tariff increases will be significantly larger than expected," though the "size and duration of these [tariff] effects remain uncertain." He noted that uncertainty is widespread, and that the Fed is "kind of in the same place, which is waiting for clarity about what our policy path should be."
- **Policy is in the right place:** Chair Powell reiterated that monetary policy was "moderately restrictive," and "well positioned to deal with the risks and uncertainties" as policy changes work through the economy. He noted the Fed is "waiting for greater clarity before we [they] consider adjustments."
- **Which mandate will the Fed favor if the two become at odds? It depends:** Chair Powell noted that if the Fed's two mandates—stable prices and maximum employment—come into tension, their policy outlines that the Fed must account for "how far each of the two variables is from its goal" and "how long it would take to get back," then weigh those considerations. He clarified that the two goals do not appear to be in tension, right now.
- **Waiting for hard data:** While Chair Powell acknowledged that soft data (i.e., survey data) has been negative, Powell attributed this to the "increase in the price level that happened when inflation was high."
- **Inflation expectations are critical:** Chair Powell underscored the importance of keeping "longer-term inflation expectations well anchored." We view this anchoring as critical to a future rate cut.

Exhibit 16: The market pricing of rate cuts reflects broader market volatility
1y1y Overnight Indexed Swap (OIS) forwards, as a proxy for the terminal rate of this cycle, and 5y5y OIS as a proxy for the long-term neutral rate



Source: Bloomberg, BlackRock. As of April 9, 2025.

Unless otherwise stated, all reference to $ are in USD.

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