May 8, 2025

Global Credit Weekly:

Holding pattern

BlackRock

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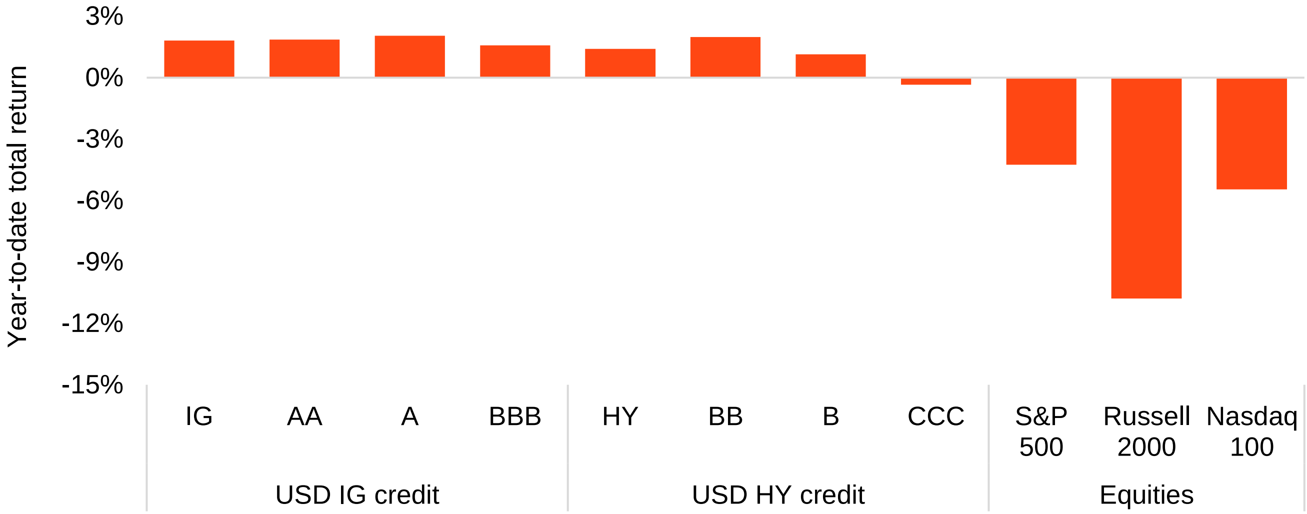
Key takeaways

- The May FOMC press conference provided some incremental clarity on the Federal Reserve's reaction function – specifically, how it is monitoring the potential for tension between its dual mandate goals of price stability (inflation) and maximum employment, while navigating broader uncertainty. On net, the comments from Chair Powell left us comfortable with our view – which we have held since January 2025 – that a rate cut in 1H2025 is unlikely. We also continue to see limited scope for the Fed to cut rates preemptively.
- For corporate credit investors, and given this monetary policy backdrop, we continue to emphasize the all-in yield and income opportunities within the asset class – as opposed to a potential total return 'boost' from lower rates or tighter spreads.
- While we are expecting a more challenging growth-inflation mix and an eventual 'catch down' of the hard economic data to the soft (survey based) indicators, the magnitude and timing remains highly uncertain. Importantly, this does not automatically equate to a broad 'risk-off' posture, in our view. As we outlined a few weeks ago, we are comfortable *selectively* moving down in credit quality – to capture additional spread premium in pockets of the market we view as fundamentally solid. Indeed, the relative resilience of certain subsets of the lower-rated credit universe has persisted (Exhibit 1).
- That said, the *very lowest quality* portions of the market – which have already been under pressure prior to any deterioration in the economic data – are likely to face increased headwinds over the next few quarters. This is consistent with the theme of issuer and sector-level dispersion we highlighted in our *2Q2025 Global Credit Quarterly* and is evident across a range of metrics that we track. For corporate credit investors, this underscores the importance of 'back to basics' credit analysis, in our view.

Exhibit 1: We remain comfortable *selectively* moving down in credit quality

Year-to-date total returns (%) for various USD corporate credit and equity indices



Source: Bloomberg, Standard & Poor's, Russell, NASDAQ Global Market, BlackRock. As of May 7, 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.

May FOMC: waiting for clarity

As was widely expected by market participants – based on remarks from Federal Reserve (Fed) officials over the past several weeks – the May Federal Open Market Committee (FOMC) meeting left the policy rate unchanged at 4.25-4.5%. After 100bp of rate cuts delivered from September 2024 – December 2024, the Fed's policy rate remains 100bp below the peak level reached in July 2023.

Despite the unchanged rate decision, the May press conference provided some incremental clarity on the Federal Reserve's reaction function – specifically, how it is monitoring the potential for tension between its dual mandate goals of price stability (inflation) and maximum employment, while navigating uncertainty related to trade policy. The statement included a reference to increased risks of higher unemployment and higher inflation relative to the March meeting (when the most recent quarterly Summary of Economic Projections were published; Exhibit 2).

On net, the comments from Chair Powell left us comfortable with our view – which we have held since January 2025 – that a rate cut in 1H2025 is unlikely. We also continue to see limited scope for the Fed to cut rates preemptively (i.e., prior to any material, visible deterioration in the labor market data).

Implications for USD corporate credit

For corporate credit investors, and given this monetary policy backdrop, we continue to emphasize the all-in yield and income opportunities within the asset class – as opposed to a potential total return 'boost' from lower rates or tighter spreads.

While we are expecting a more challenging growth-inflation mix and an eventual 'catch down' of the hard economic data to the soft (survey based) indicators, the magnitude and timing remains highly uncertain.

Importantly, however, this does not automatically equate to a broad 'risk-off' posture, in our view. As we outlined a few weeks ago, we are comfortable *selectively* moving down in credit quality – to capture additional spread premium in pockets of the market we view as fundamentally solid (owing in part to improved credit metrics and proactive refinancing done in recent years). Indeed, the relative resilience of subsets of the lower-rated credit universe has persisted (Exhibit 1). The recent retracement of a large portion of the April spread widening has also been notable.

Exhibit 2: The March SEP reflected a more challenging growth inflation mix vs. December – another SEP will be released at the June FOMC

The median economic projections of the 19 FOMC members, for the 4th quarter of each year shown, per the March 2025 Summary of Economic Projections (SEP)

	2025	2026	2027	Longer-run
Real GDP growth	**1.7**	**1.8**	**1.8**	**1.8**
December 2024 projection	*2.1*	*2.0*	*1.9*	*1.8*
September 2024 projection	*2.0*	*2.0*	*2.0*	*1.8*
Unemployment rate	**4.4**	**4.3**	**4.3**	**4.2**
December 2024 projection	*4.3*	*4.3*	*4.3*	*4.2*
September 2024 projection	*4.4*	*4.3*	*4.2*	*4.2*
PCE inflation	**2.7**	**2.2**	**2.0**	**2.0**
December 2024 projection	*2.5*	*2.1*	*2.0*	*2.0*
September 2024 projection	*2.1*	*2.0*	*2.0*	*2.0*
Core PCE inflation	**2.8**	**2.2**	**2.0**	
December 2024 projection	*2.5*	*2.2*	*2.0*	*not given*
September 2024 projection	*2.2*	*2.0*	*2.0*	
Federal funds rate	**3.9**	**3.4**	**3.1**	**3.0**
December 2024 projection	*3.9*	*3.4*	*3.1*	*3.0*
September 2024 projection	*3.4*	*2.9*	*2.9*	*2.9*

Source: Federal Reserve, BlackRock. As of the Federal Reserve's Summary of Economic Projections published on March 19, 2025.
There is no guarantee any forecasts may come to pass.

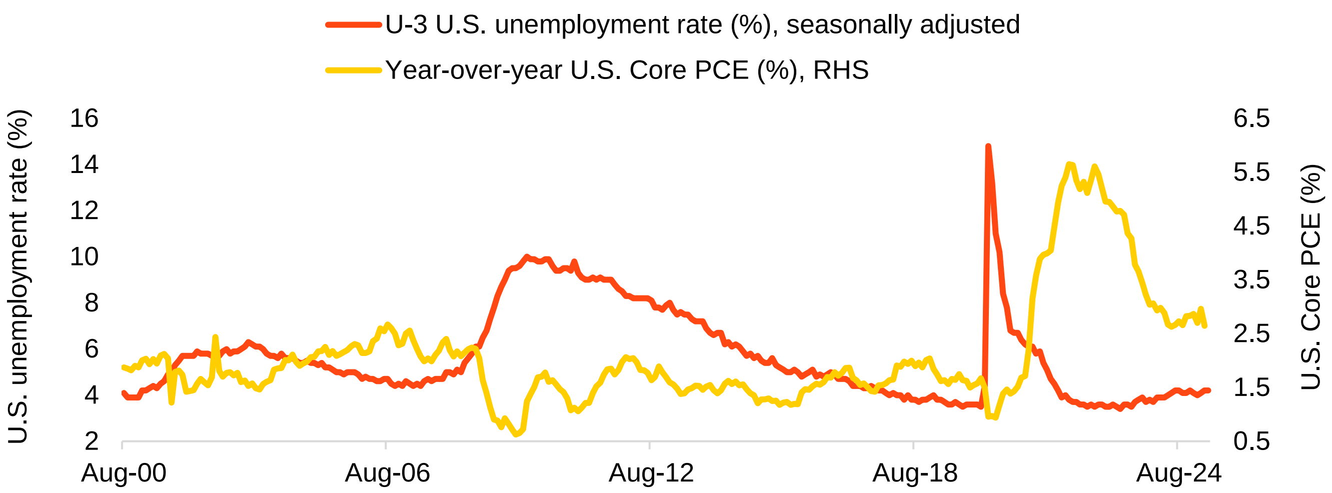
‘Back to basics’ credit analysis

That said, the *very lowest* quality portions of the market – which have *already* been under pressure *prior* to any deterioration in the economic data – are likely to face increased headwinds over the next few quarters. This is consistent with the theme of issuer and sector-level dispersion we highlighted in our *2Q2025 Global Credit Quarterly* and is evident across a range of metrics that we track including ‘repeat defaulters’, payment in kind (PIK) utilization, covenant amendments, and ‘outliers’ with high leverage and/or low interest coverage.

For corporate credit investors, this underscores the importance of ‘back to basics’ credit analysis, in our view. The ‘feedback loop’ between corporate margins, the layoff rate, consumer spending and overall economic activity remains key to monitor.

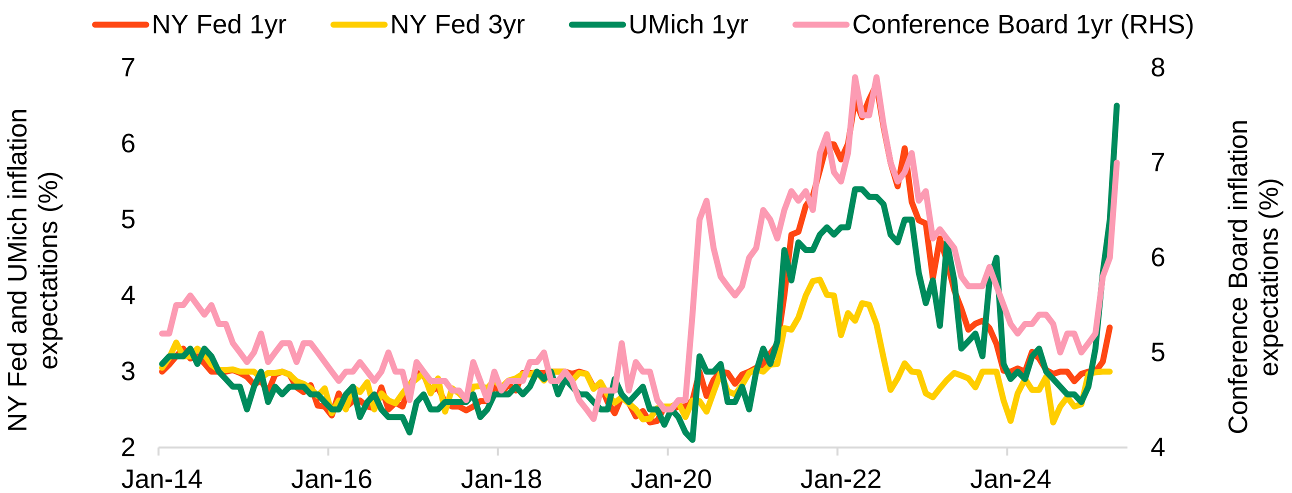
Our review of company-level commentary across a range of industries suggests any potential impacts to affected business models (i.e., those sensitive to shifts in international trade policies) could occur over the next few quarters.

Exhibit 3: Fed officials have flagged the potential for tension in the dual mandate
U-3 U.S. unemployment rate (%) seasonally adjusted, and year-over-year U.S. Core PCE inflation (%) seasonally adjusted, RHS



Source: Bureau of Labor Statistics, Bureau of Economic Analysis, BlackRock. Captures data through April 30, 2025 (unemployment) and March 31, 2025 (PCE), most recent available as of May 7, 2025.

Exhibit 4: Survey-based measures of inflation expectations have increased
Inflation expectations: NY Fed 1-year and 3-year ahead, University of Michigan 1-year ahead, and Conference Board 1-year ahead



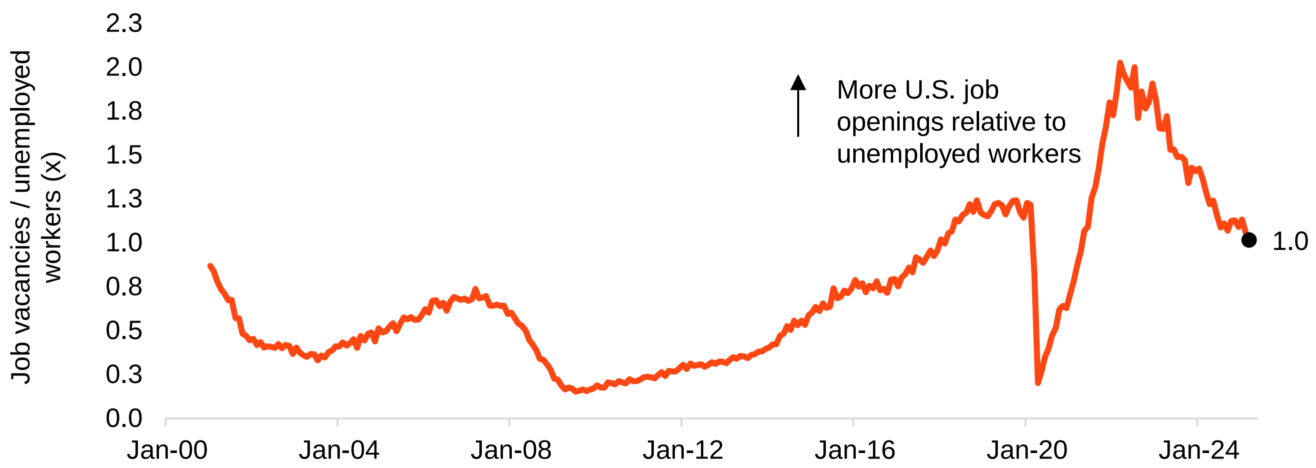
Source: Federal Reserve Bank of New York, Conference Board, University of Michigan, Bloomberg, BlackRock. NY Fed 1 and 3 year as of March 31, 2025. UMich 1 year and Conference Board 1 year as of April 30, 2025 (latest available as of May 7, 2025).

Below, we outline key takeaways from Chair Powell's remarks during the May FOMC press conference.

- **Potential for tension in the dual mandate.** Chair Powell noted the risks to higher unemployment and higher inflation have risen relative to March, but there is "a great deal of uncertainty" related to the *specific* economic implications. In a "complicated and challenging" hypothetical scenario where the two goals move into tension with each other, the Fed would consider (per its framework) how far each variable is from its goal, as well as the time it would take to return to target. Chair Powell added: right now, "there is no real need to make a choice" between the two goals, and "no real basis for doing so."
- **The economy is "solid" – despite the 1Q GDP print.** Chair Powell referenced the "historically large" increase in imports during 1Q2025, which weighed on GDP through the net exports calculation. This may be "reversed" somewhat in the coming quarters and could provide a *positive* contribution to GDP in 2Q2025. Looking through the "distortions" in 1Q2025 GDP, he noted the economy and labor market both appear to be "solid."
- **The labor market is not currently showing signs of weakness.** While the risks to the labor market have increased, Chair Powell made the point that the unemployment rate has been "moving sideways" over the past few months, and, at 4.2%, is "well in the range" of mainstream estimates of full employment. He also referenced a variety of other indicators – including the low layoff rate (Exhibit 6) and the pace of job creation (Exhibit 7) as context for a "solid" characterization of the labor market.

Exhibit 5: The "jobs-workers gap" has rebalanced to the pre-pandemic level

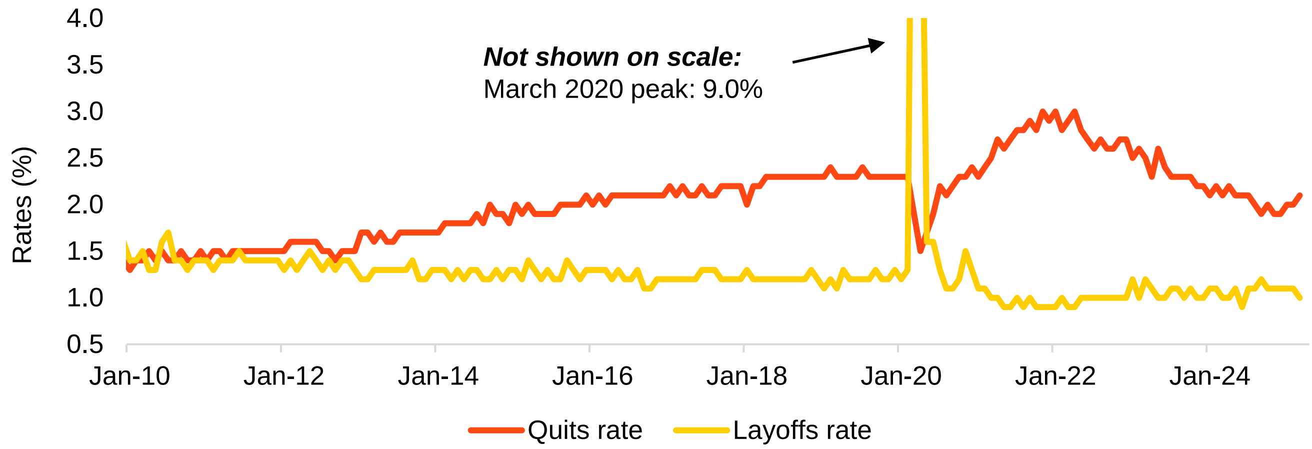
The ratio of U.S. job vacancies to U.S. unemployed workers, both seasonally adjusted



Source: Bureau of Labor Statistics. BlackRock, Bureau of Labor Statistics. Captures data through March 31, 2025 (most recent as of May 7, 2025).

Exhibit 6: The layoff rate is still low, for now

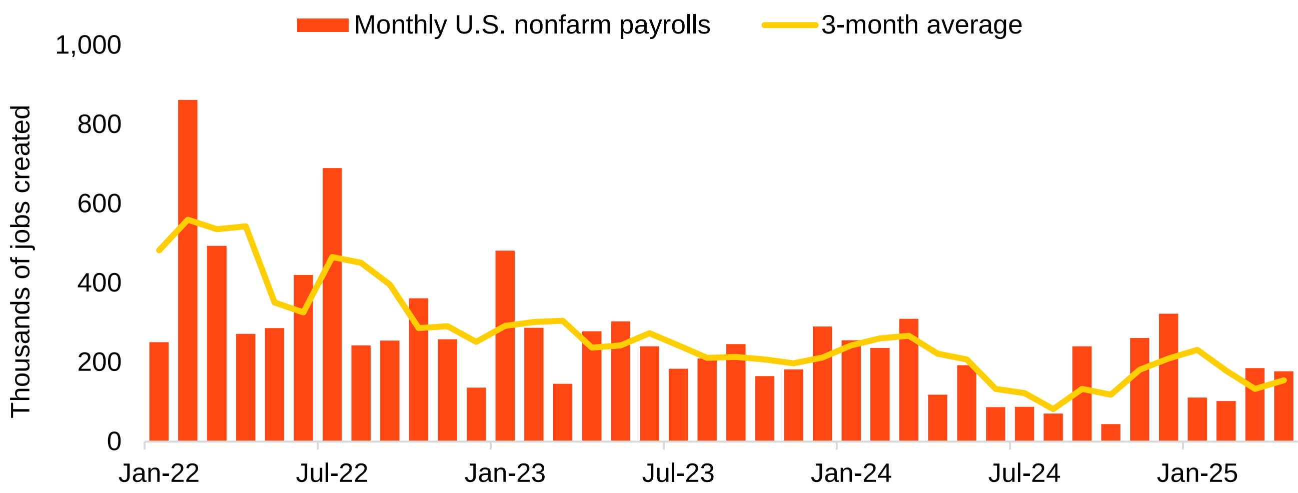
U.S. Layoffs & Discharge Rate (%) and the U.S. Quits Rate (%), both seasonally adjusted



Source: Bureau of Labor Statistics, Bloomberg, BlackRock. Captures data through March 31, 2025 (most recent as of May 7, 2025). The Layoffs & Discharge Rate tracks involuntary job separations initiated by the employer, while the Quits Rate tracks voluntary job separations initiated by the employee.

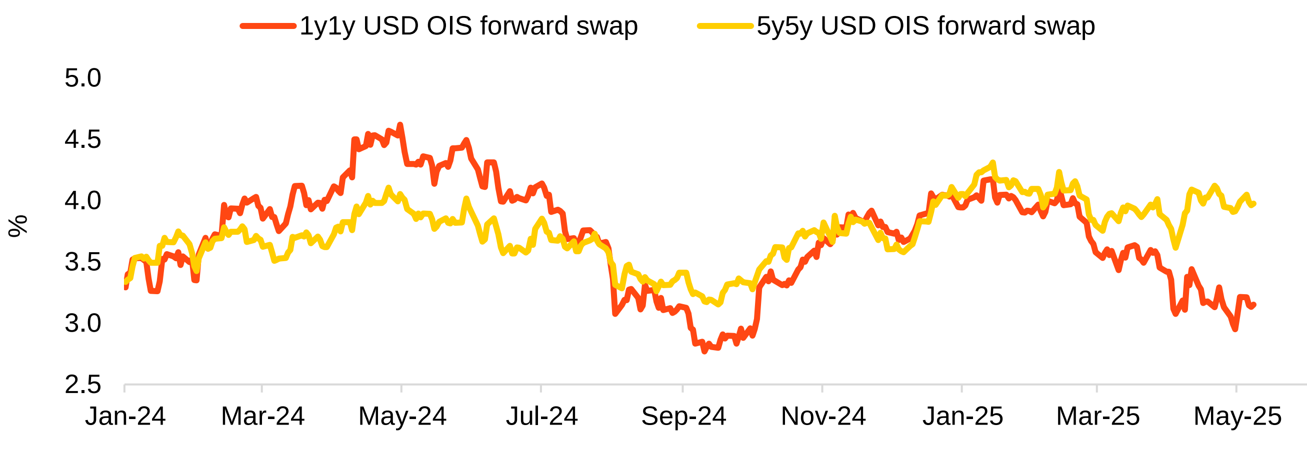
- **A patient reaction function.** The policy rate "is in a good place" and is "moderately restrictive" as the FOMC awaits further clarity on trade policy and the ultimate implications for the economy. He added: "the costs of waiting…are fairly low." Chair Powell specifically cited "uncertainty" related to the "scale, scope, timing and persistence of tariffs." He also noted: "we don't think we need to be in a hurry… we think we can be patient…we can move quickly when that's appropriate…the right thing to do is to await further clarity" on the direction of the economy.
- **The disconnect in the hard vs. soft data.** Downside risks to the economy (i.e., higher inflation and higher unemployment) "haven't materialized" in the hard data, as of yet. Chair Powell acknowledged the headwind posed by prolonged uncertainty (for example, pauses on business investment and household spending), while also flagging the possibility for developments which may "change that narrative" of "downbeat sentiment."
- **Preemptive rate cuts are unlikely.** Chair Powell stated this "is not a situation where we can be preemptive," because it is not clear what the right response is (more data is required). He added: the "policy rate is in a good place…[and] leaves us well positioned to respond in a timely way to potential developments." During the Q&A, Chair Powell said the rate cuts delivered in 2H2024 were not preemptive, and "if anything, it was a little late." The 2019 cuts by contrast, were considered preemptive – but, at that time, inflation was below the Fed's target (as opposed to above target, currently).

Exhibit 7: The pace of job creation has averaged 155k over the past three months
Monthly change in U.S. nonfarm payrolls and the three-month moving average pace of job creation



Source: BlackRock, Bloomberg, Bureau of Labor Statistics. Captures data through April 30, 2025 (most recent available as of May 7, 2025).

Exhibit 8: Market pricing reflects a terminal rate for this cycle of 3.15%
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 May 7, 2025 (post the May FOMC meeting).

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