

June 20, 2025

Global Credit Weekly:

Looking ahead

BlackRock

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Market insights contributors



Amanda Lynam, CPA

Head of Macro Credit Research,
Portfolio Management Group



Dominique Bly

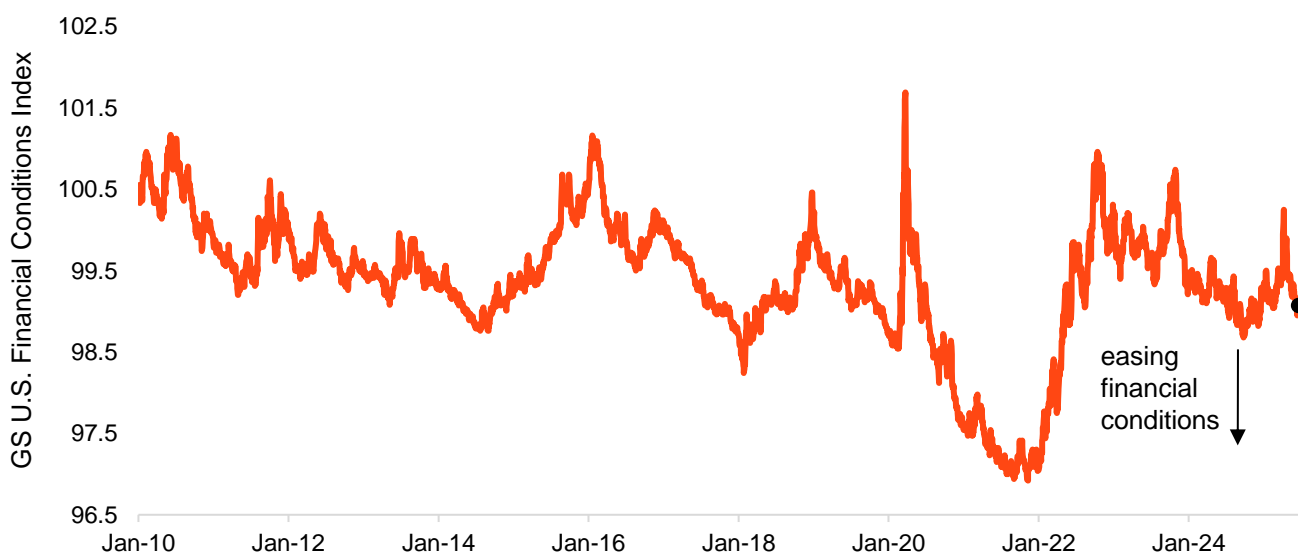
Macro Credit Research Strategist,
Portfolio Management Group

Key takeaways

- The June Federal Open Market Committee (FOMC) press conference signaled a clear wait-and-see approach, as Chair Powell pointed to the summer for incremental clarity on the path and persistence of goods inflation. He characterized the policy rate as “modestly restrictive” and pushed back against the premise that a near-term rate cut was warranted by conditions in the labor market, which he characterized as “cooling” but “broadly in balance,” with an unemployment rate that is still low by historical standards.
- Additionally, during the Q&A, Chair Powell mentioned that business sentiment in some areas appears to be *improving*, noting that firms are “working their way through this” and the tone “feels much more positive and constructive than it did three months ago.” He also highlighted that while the low 1Q2025 GDP reading was “complicated” by an “unusual swing” in net exports (due to firms’ frontloading of imports), other metrics of economic activity such as private domestic financial purchases (PDFP) are tracking at a healthy level.
- While not a Committee forecast, the refreshed quarterly Summary of Economic Projections (SEP) also provided some incremental insight into the FOMC’s reaction function. The median projections signaled a somewhat more challenging growth-inflation mix relative to the March SEP, as well as a higher terminal rate for this cycle. Overall, Chair Powell reiterated a preference to “wait to learn more” before making any adjustments (i.e., rate cuts) to the Federal Reserve’s (Fed) policy stance. As a result, we believe the next rate cut of this cycle (and the first of 2025) is unlikely to occur before 4Q2025.
- 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’ (to fixed rate credit, for example) from lower rates or tighter spreads. We also continue to favor selectively moving down in credit quality, as we discuss within.

Exhibit 1: Financial conditions have eased since early April 2025

Goldman Sachs U.S. Financial Conditions Index



Source: BlackRock, Bloomberg, Goldman Sachs Global Investment Research. As of June 19, 2025.

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Holding pattern

The June Federal Open Market Committee (FOMC) press conference once again signaled a clear wait-and-see approach, as Chair Powell pointed to the summer for incremental clarity on the path and persistence of goods inflation. And while not a Committee forecast, the refreshed quarterly Summary of Economic Projections (SEP) also provided some incremental insight into the FOMC's reaction function. The median projections (Exhibit 2) signaled a somewhat more challenging growth-inflation mix relative to the March SEP (higher inflation, higher unemployment, lower growth), as well as a higher terminal rate for this cycle. That said, Chair Powell explicitly referenced a lack of conviction in the longer-term projections, owing to unusually elevated macroeconomic uncertainty.

Below, we outline the key takeaways for corporate credit investors:

- **Why not cut rates now?** Given the macroeconomic uncertainty, Chair Powell was asked why the FOMC did not decide to cut rates preemptively. He noted some “slow continued cooling” in the labor market, “but nothing that is troubling at this time.” He added: “the labor market is not crying out for a rate cut,” highlighting the “low” level of the unemployment rate (at 4.2%). Chair Powell also pushed back on the view that pressures in the housing market (which are due in part to a longer run shortage of housing) warrant a near term rate cut. Perhaps most notable, in our view, were Chair Powell's comments on business sentiment. He suggested that firms are “working their way through this” uncertainty and the tone “feels much more positive and constructive than it did three months ago.”
- **The Fed expects “to learn a great deal more over the summer” on goods inflation.** Chair Powell acknowledged there have been three months of favorable inflation data (compared to the higher readings in January and February of 2025) but noted this was partly driven by improvement in core services (housing and non-housing). Goods inflation is expected to increase over the course of the summer, as it takes time for tariffs to work their way through the chain of distribution, per Chair Powell. He also noted – based on surveys of businesses – that “many companies do expect” to pass some or all of tariffs to the next party in the supply chain, or the end consumer. He added: “we expect a meaningful amount of inflation to arrive in coming months.”

Exhibit 2: The June 2025 SEP reflected a more challenging growth-inflation mix vs. March

The median economic projections of the 19 FOMC members, for the 4th quarter of each year shown

	2025	2026	2027	Longer-run
Real GDP growth	1.4	1.6	1.8	1.8
March 2025 projection	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	4.5	4.5	4.4	4.2
March 2025 projection	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	3.0	2.4	2.1	2.0
March 2025 projection	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	3.1	2.4	2.1	
March 2025 projection	2.8	2.2	2.0	not given
December 2024 projection	2.5	2.2	2.0	
September 2024 projection	2.2	2.0	2.0	
Federal funds rate	3.9	3.6	3.4	3.0
March 2025 projection	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

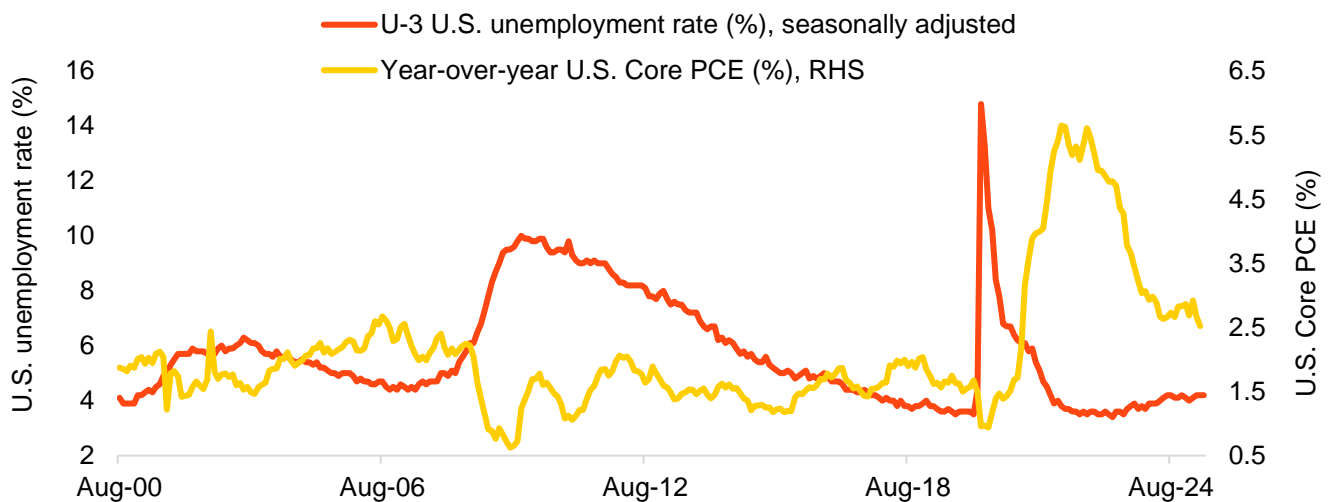
Source: Federal Reserve, BlackRock. As of the Federal Reserve's Summary of Economic Projections published on June 18, 2025.

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- **Underlying economic activity is still “solid.”** Chair Powell emphasized the private domestic final purchases (PDFP) metric over GDP, which was “complicated” by an “unusual swing” in net exports (related to businesses’ frontloading of imports during 1Q2025). PDFP excludes net exports, inventory investment and government spending, and grew at a “solid” 2.5% rate in 1Q2025.
- **Watching for potential tension in the dual mandate.** Chair Powell noted that “increases in tariffs this year are likely to push up prices and weigh on economic activity.” He added: “The effects on inflation could be short-lived – reflecting a one-time shift in the price level. It is also possible that the inflationary effects could instead be more persistent,” depending on the size, the timing of the pass-through to prices, and on whether longer-term inflation expectations are well anchored. If faced with a “challenging scenario” where the dual-mandate goals (of maximum employment and price stability) are in tension, the FOMC would consider how far the economy is from each goal, and the time horizons over which those respective gaps would be anticipated to close.

Exhibit 3: We are watching for potential tension in the Fed’s dual mandate goals of price stability and maximum employment

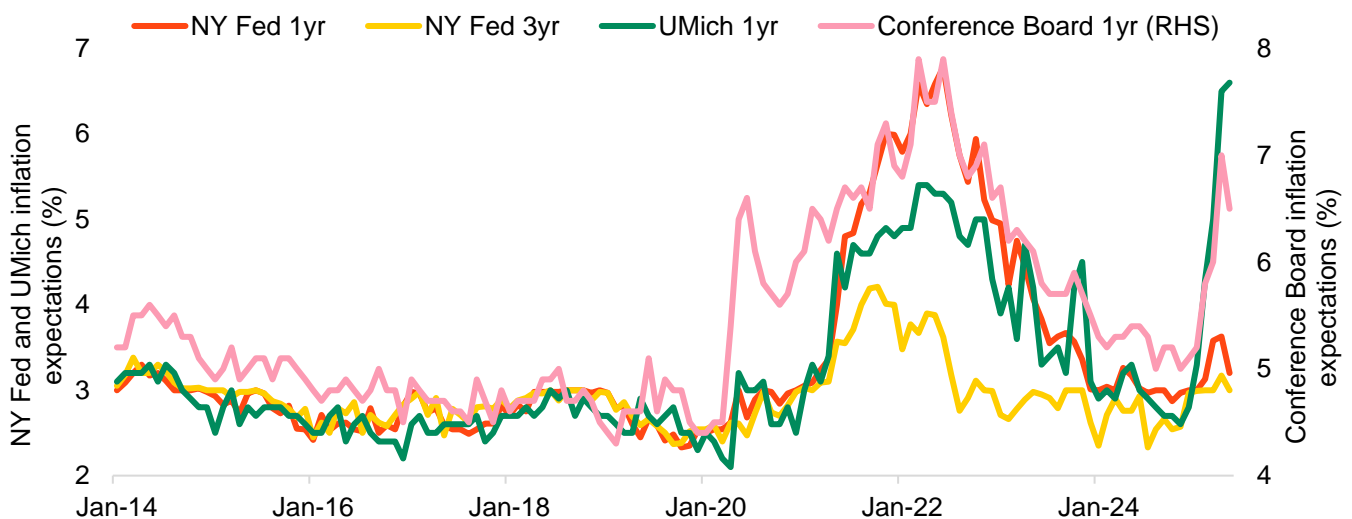
U-3 U.S. unemployment rate (%) seasonally adjusted, and year-over-year U.S. Core PCE inflation (%) seasonally adjusted, RHS



Source: Bureau of Labor Statistics, Bureau of Economic Analysis, BlackRock. Captures data through May 31, 2025 (Unemployment) and April 30, 2025 (PCE), most recent available as of June 16, 2025.

Exhibit 4: The Fed is closely monitoring longer-term inflation expectations

Inflation expectations: NY Fed 1-year and 3-year ahead, University of Michigan 1-year ahead, and Conference Board 1-year ahead



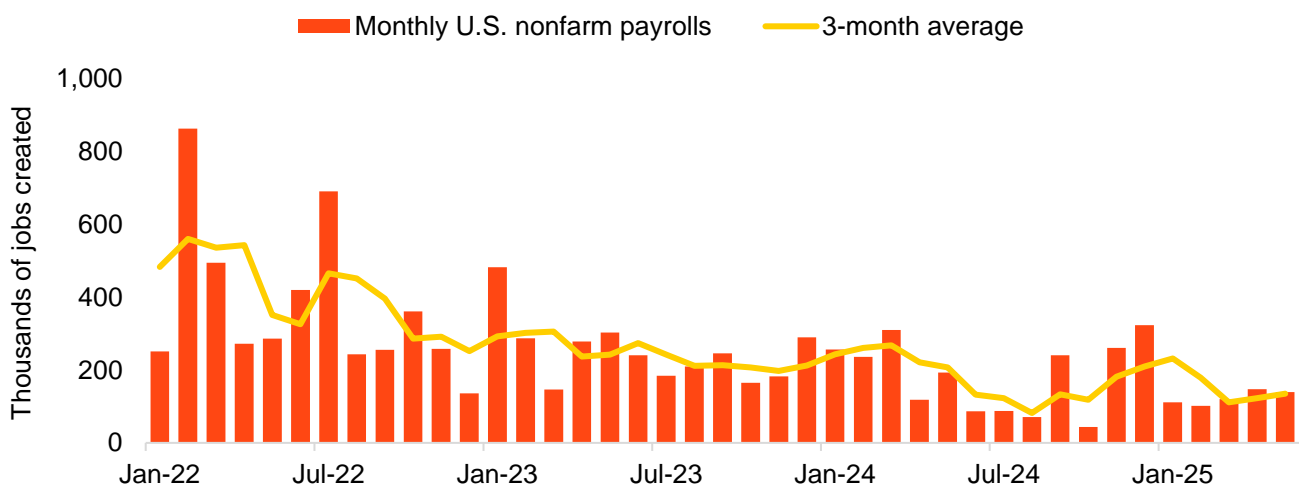
Source: Federal Reserve Bank of New York, Conference Board, University of Michigan, Bloomberg, BlackRock. As of May 31, 2025.

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- **The level of policy restrictiveness is modest.** Chair Powell noted: “For the time being, we are well positioned to wait to learn more about the likely course of the economy before considering any adjustments to our policy stance.” He added during the Q&A that interest rates “are not very high” and that monetary policy is “modestly restrictive,” again pointing to signs of resilience in underlying economic activity.
- **Longer-term inflation expectations remain key.** Chair Powell once again noted that near-term measures of inflation expectations have increased in recent months, but most measures of longer-term inflation expectations have been consistent with the FOMC’s 2% inflation goal. The median projection in the SEP for core PCE inflation at year-end 2025 is 3.1% (vs. 2.8% as of the March SEP).
- **A higher projected terminal rate for the cycle was reflected in the June SEP.** While the year-end 2025 projection remained the same at 3.9%, the median participant projected the Fed Funds rate to be 3.6% as of year-end 2026 (vs. 3.4% in the March SEP) and 3.4% by year-end 2027 (vs. 3.1% in the March SEP). Chair Powell emphasized the lack of conviction around the longer-term forecasts, however, during the Q&A (owing to the macroeconomic uncertainty impacting such projections in the current environment). He noted that uncertainty around the economic outlook has “diminished” vs. the early April peak, “but remains elevated.”

Exhibit 5: Payroll gains have averaged 135k over the past three months

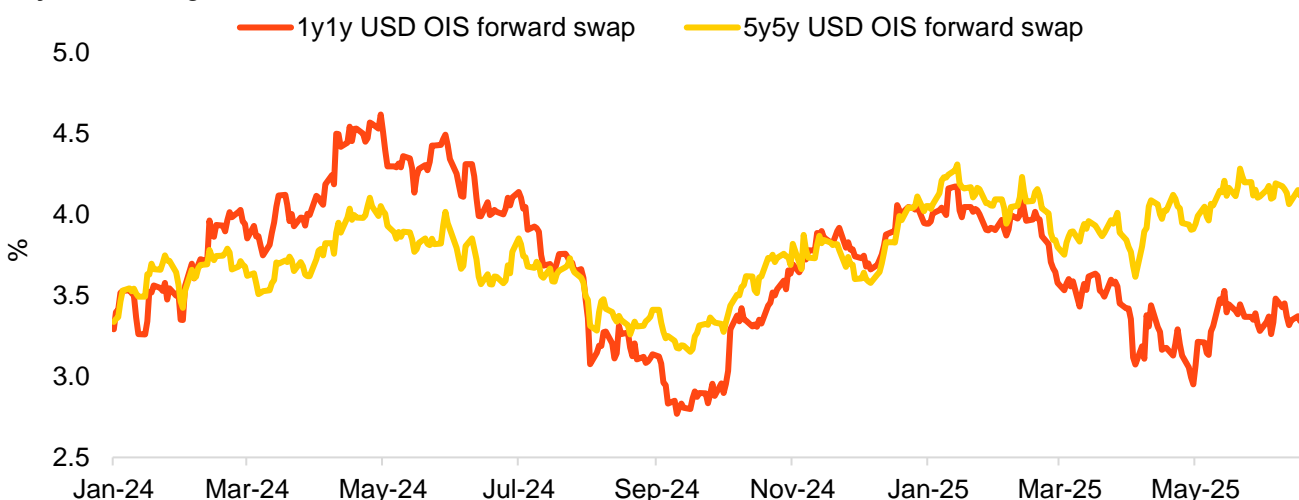
Monthly change in U.S. nonfarm payrolls and the three-month moving average pace of job creation



Source: BlackRock, Bloomberg, Bureau of Labor Statistics. Captures data through May 31, 2025 (most recent as of June 17, 2025).

Exhibit 6: Market pricing of interest rates has drifted higher in recent months

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

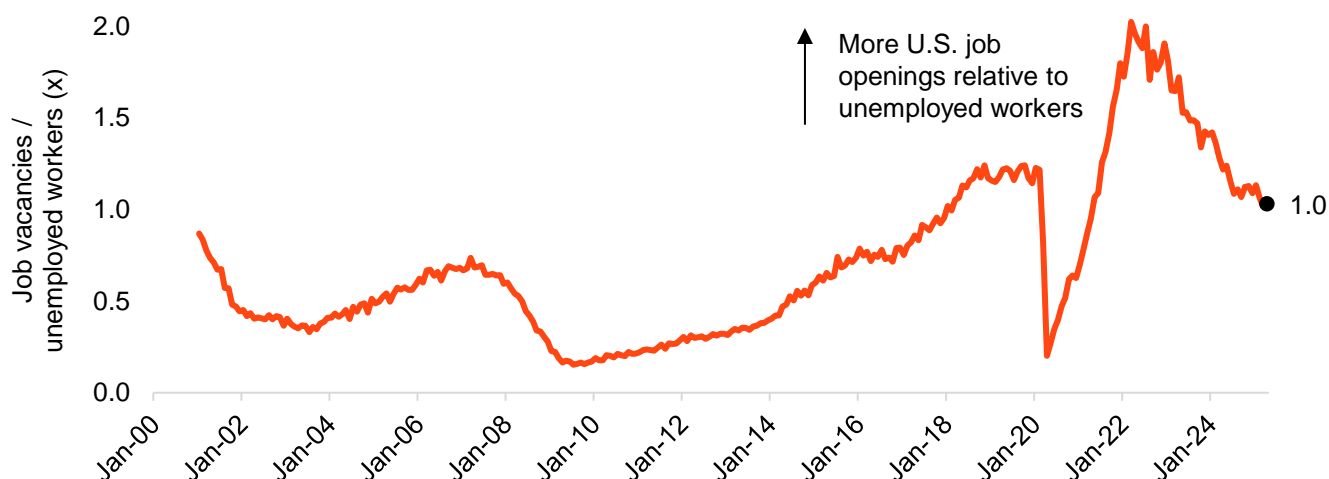


Source: Bloomberg, BlackRock. As of June 17, 2025.

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Exhibit 7: The jobs-workers gap has narrowed

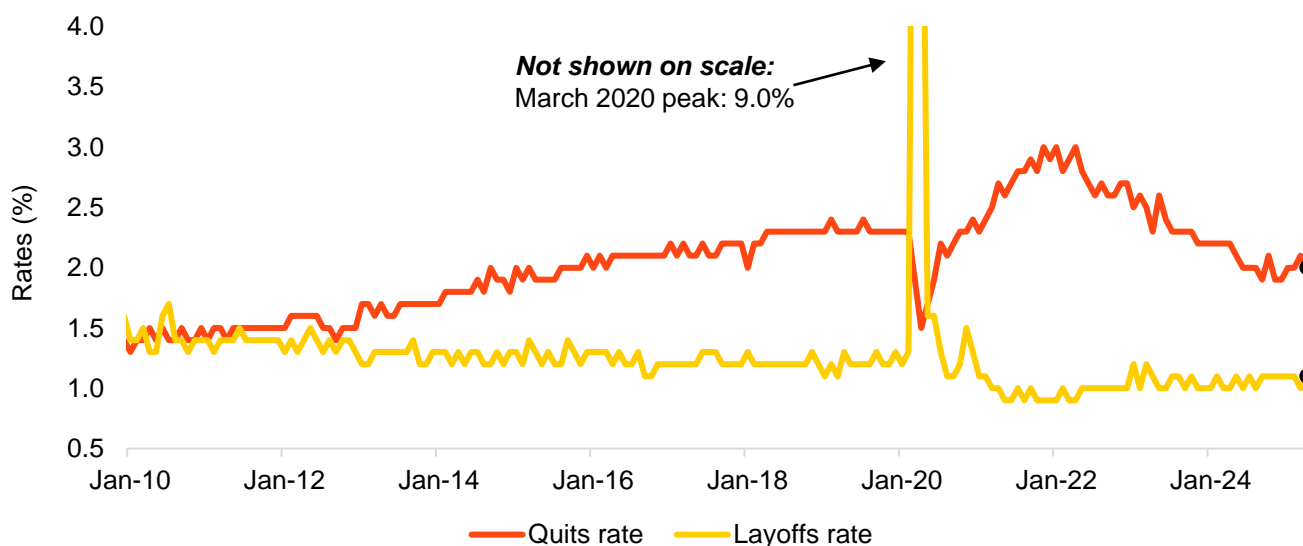
The ratio of U.S. job vacancies to U.S. unemployed workers, both seasonally adjusted



Source: Bureau of Labor Statistics, BlackRock. Captures data through April 30, 2025 (most recent available for job openings data as of June 17, 2025).

Exhibit 8: The layoff rate remains low

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



Source: Bureau of Labor Statistics, Bloomberg, BlackRock. Captures data through April 30, 2025 (most recent as of June 17, 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.

The read-through for corporate credit

With the potential for a more challenging growth-inflation mix ahead of us, there are a few takeaways for corporate credit investors, in our view.

First, a backdrop of structurally higher interest rates and below-trend growth (our base case) should focus investors on all-in yield and income opportunities within corporate credit, as opposed to the potential total return 'boost' from lower rates or tighter spreads. The supportive all-in yield backdrop has acted as a strong technical demand tailwind in both USD IG and HY, contributing to some mean reversion (tightening) in corporate credit spreads even amid market volatility (Exhibits 9 and 10).

Second, we continue to see an opportunity cost to being too defensive in this environment. We remain comfortable with selectively moving down-in-quality, to capture additional spread premium. A focus on 'back to basics' credit analysis will be critical in defining pockets of the market that can navigate this environment, as dispersion *within* asset classes and sectors is likely to remain elevated.

As we've discussed previously, we have seen a convergence in fundamentals between the lower end of the IG market (i.e., BBBs) and the higher end of the HY market (i.e., BBs). Exhibit 11 demonstrates total return year-to-date (YTD) across different ratings cohorts. Notably, BBs have seen the highest YTD return.

Related, USD HY maturities skew more near-term (Exhibit 12) and have lower duration exposure than the IG market. This more limited duration exposure is attractive, in our view, given the volatility at the long end of the U.S. Treasury curve and the drift higher in long end yields, which mechanically weighs on total returns (Exhibit 13).

That said, fundamental stress has been building in certain 'left tail' cohorts of the credit market, such as CCC-rated firms where average interest coverage cushions are very minimal. With the potential for a more challenging macroeconomic backdrop ahead, we see scope for further fundamental deterioration among some of these borrowers. This, coupled with recent default trends and the idiosyncratic nature of this cohort, underscores the importance of granular credit selection.

Exhibit 9: Spreads have retracted in IG...

Option-adjusted spread for Bloomberg USD Investment Grade Corporate Index over time, and as of June 17, 2025

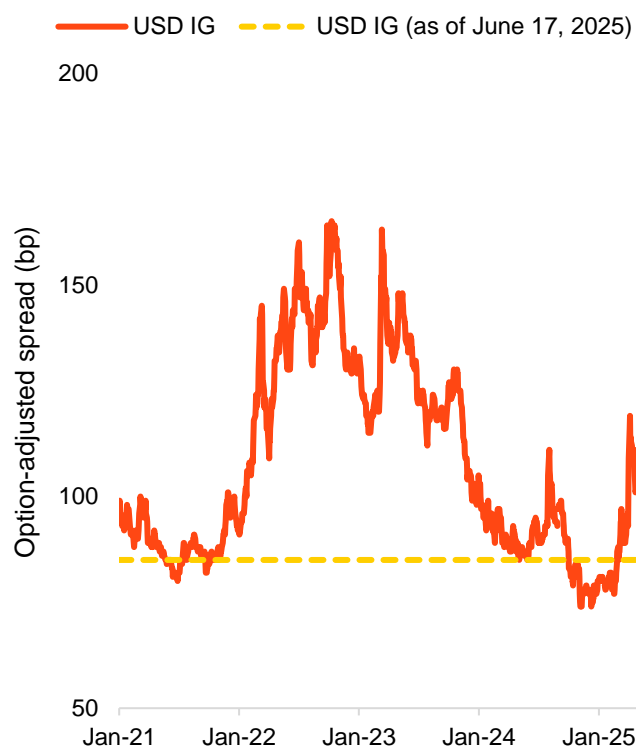
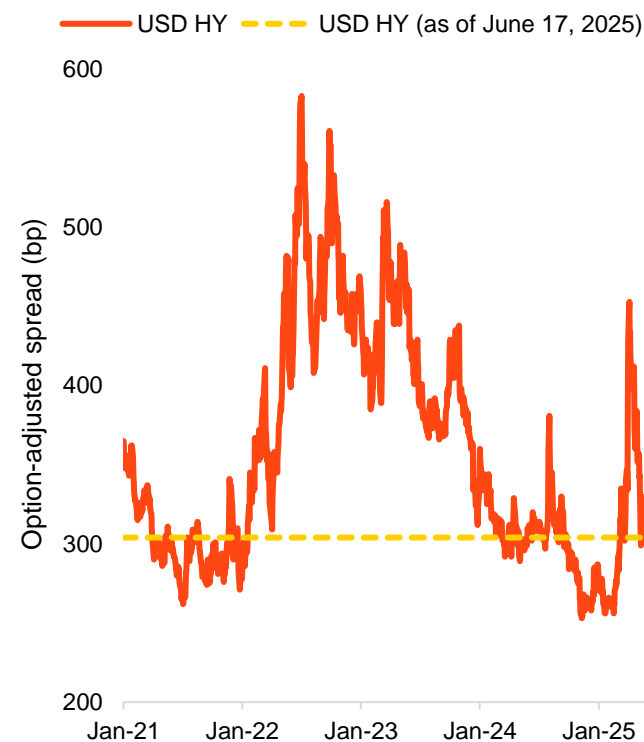


Exhibit 10: ...and HY

Option-adjusted spread for Bloomberg USD High Yield Corporate Index over time, and as of June 17, 2025

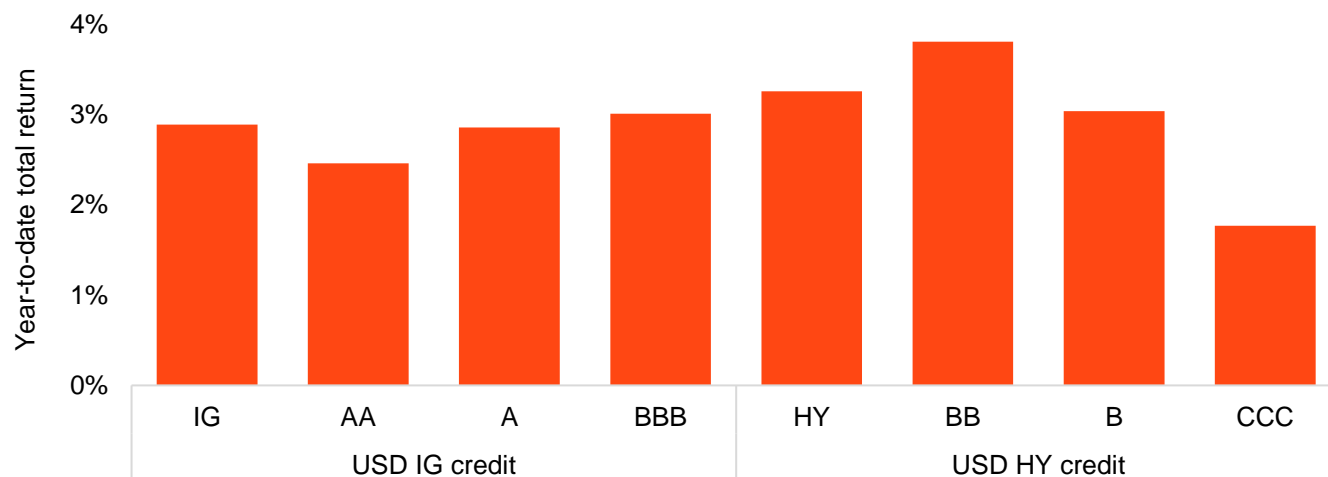


For both charts: Source: Bloomberg, BlackRock. As of June 17, 2025. The figures shown relate to past performance. **Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

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Exhibit 11: BBs have outperformed all other USD IG and HY ratings cohorts year-to-date

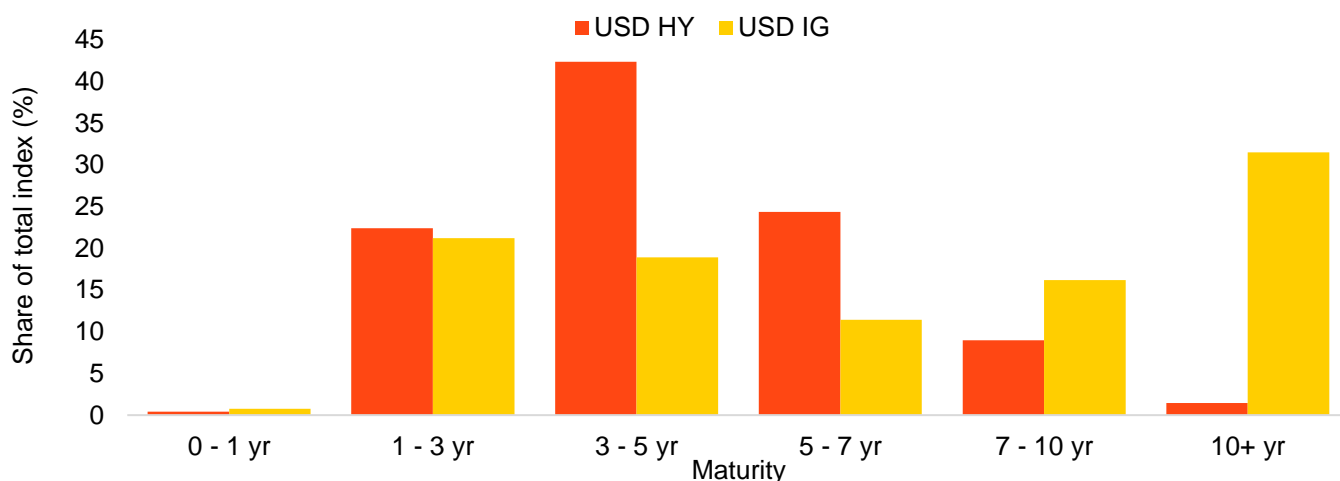
Year-to-date total returns (%) for various USD IG and HY corporate credit rating specific indices



Source: Bloomberg, BlackRock. As of June 17, 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 12: USD IG skews towards longer maturities than USD HY

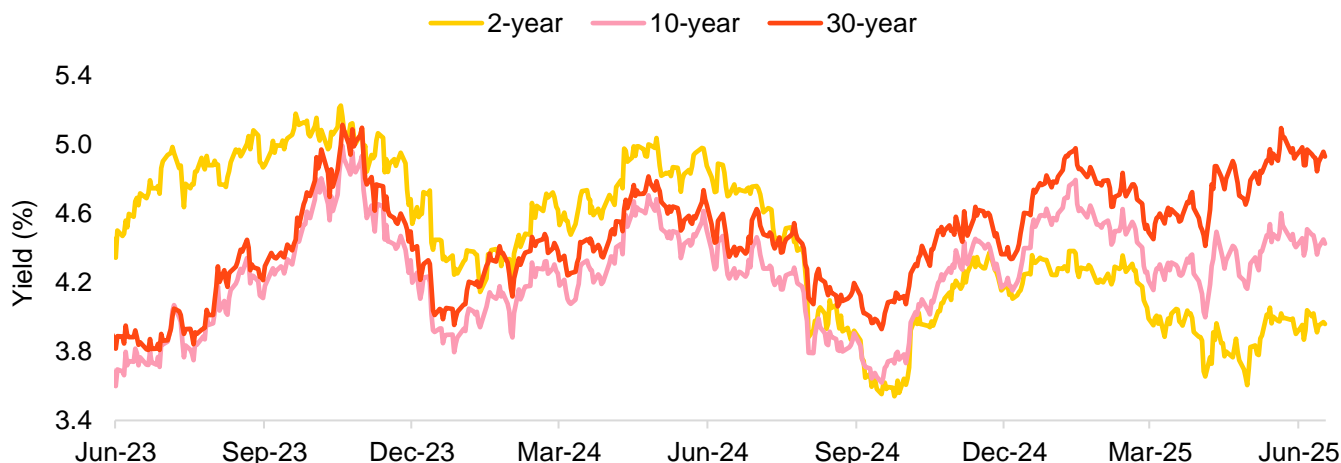
Share of Bloomberg USD HY and IG Corporate indices by maturity



Source: Bloomberg, BlackRock. As of June 18, 2025.

Exhibit 13: Long-end U.S. Treasury yields have drifted higher

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



Source: BlackRock, Bloomberg. As of June 17, 2025.

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