



Precision insights: Credit

May 2025

Highlights

- **Credit markets haven't escaped the indiscriminate risk selloff triggered by the early April shock to global trade**, with USD and EUR investment grade (\$IG and €IG) spreads widening 22bps and 13bps, respectively, in the first two weeks of the month.¹
- **Stretched valuations, continued pressure on USD-denominated assets and increasing concerns about the growth shock – particularly to the US economy** – cause us to turn more bearish on \$IG and maintain our negative position on USD high yield (\$HY). Within European credit, we shift from an income preference to a quality preference for ballast, given a tendency for €HY to trade with a higher beta to equities during periods of growth deterioration.

We outline our current views on broad developed market (DM) credit exposures, updated to reflect the latest macro and microeconomic developments.

Click through to explore our precision credit views in detail.

Exposure	View	Outlook
<u>€IG</u>		We maintain our mixed view on €IG, as the 3.5% ² income on offer is amplified by the largest instance of EURUSD appreciation since the risk-off episode of September 2022. ³ Despite the weaker growth outlook, fundamentals should remain strong, in our view, given the supportive starting point. Current valuations should also be supportive: the customarily large supply window in May poses some short-term headwinds, but demand is anticipated to remain strong.
<u>€HY</u>		While attractive value has opened up in €HY, with index spreads 33bps wider in the first two weeks of April, ⁴ the moves pale in comparison to previous widening-inducing shocks (early-2020 and late-2022), ⁵ suggesting room for further decompression.
<u>\$IG</u>		We turn negative on \$IG: its duration sensitivity as a long-dated asset class and the degree of foreign investor participation in the space weigh on our view. Spread volatility has reached its highest level since the regional banking crisis, ⁶ emphasising the case for a rotation into euro-denominated peers.
<u>\$HY</u>		We stay less constructive on \$HY, given rising recession risk for the US and sharp upward revisions to default rate forecasts. ⁷ While 2025/26 maturity walls looks less challenging, 2027 refinancing at prevailing yields screens as concerning for CCCs, we think. ⁸

Note: \$ denotes US dollar, unless stated otherwise.

1, 2, 3, 4, 5 Source: BlackRock and Bloomberg, as of 15 April 2025. **6** Source: Barclays, as of 11 April 2025. **7, 8** Source: Goldman Sachs, as of 10 April 2025.

€IG

€IG is now our preferred exposure within developed market credit sleeves. Healthy technicals and macro fundamentals have been overshadowed by policy uncertainty and global growth fears. We think that euro area growth should be cushioned by European Central Bank (ECB) easing, which our Fundamental Fixed Income team projects will be front-loaded versus market pricing of 85bps by year-end,⁹ as pronounced EURUSD appreciation and a simultaneous drop in oil prices have resulted in alleviation of price pressures for the region.

EURUSD appreciation also enhances attractiveness for cross-currency investors looking to diversify away from USD-denominated assets, with the safe-haven status of the currency now in question and the dollar spot index (DXY) down 9.4% from January highs.¹⁰ With a weaker growth outlook, our European credit PMs are focused on non-cyclical names and sectors that are less prone to tariff risks, such as banks, utilities and selective REITs. The Team expects US tariffs to indirectly impact European banks through the real economy transmission channel, with the potential for prolonged trade disruptions affecting credit risk metrics and profitability. However, European banks' strong balance sheets and high provision coverage provide a buffer against potential defaults.¹¹

We expect EUR credit to outperform its USD counterpart, driven by a more supportive policy backdrop in Europe. Institutional demand and fixed maturity plans continue to support the front and belly of the credit curve, in our view, reinforcing stability in these tenors.¹² As such, we expect €IG to remain in favour among yield-seeking investors with an up-in-quality preference.

€HY

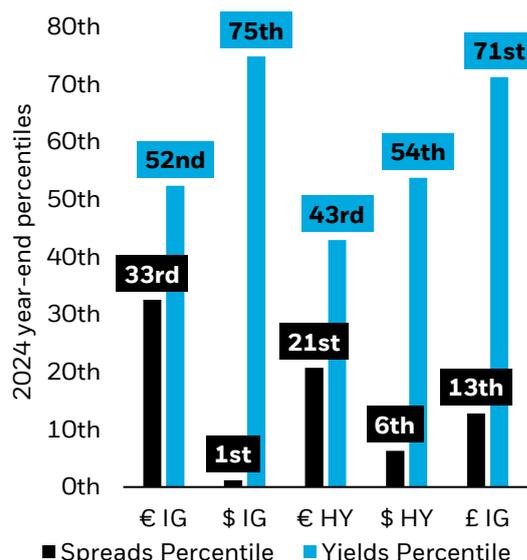
We lower our conviction on €HY, despite preservation of fundamentals – including ratings upgrades and balance sheet improvements – given higher beta to equities in risk-off episodes. While the tariff pause announcement triggered a modest relief rally, we remain in an uncertain policy environment alongside the highest tariff regime in almost a century.¹³

€HY spreads have seen attractive value open up, in our view, across cash, CDX and ETFs.¹⁴ However, this widening remains less than a third of the widening seen in inflation shock of 2022 and March 2020,¹⁵ suggesting ample room to move higher from here. Cyclical HY sectors like autos, building materials and chemicals have led the recent widening, with the cyclical/non-cyclical spread premium turning positive for the first time since 2023 (albeit remaining below historical recessionary extremes), indicating early signs of fundamental stress, rather than panic.¹⁶

We believe this elevated dispersion and further decompression risk make the case for active strategies, in order to identify potential winners and losers and idiosyncratic cases for upward convexity in certain sectors or issuers. This is particularly important, in our view, as our portfolio strategists continue to see room for an increased allocation to €HY, with the average EMEA portfolio still c.4% underweight compared to our strategic model portfolios.¹⁷

Chart 1: €IG spreads look most attractive on a 20-year percentile basis

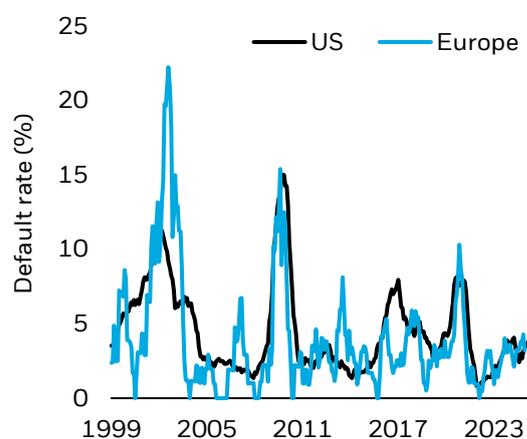
Current spread and yield percentiles for IG and HY exposures, based on 20-year history



Source: BlackRock, Bloomberg, as of 31 December 2024. Based on daily yield to worst and z-spreads for Bloomberg Euro Aggregate Corporate Total Return Index, Bloomberg US Corporate Total Return, Bloomberg Pan-European High Yield (Euro) TR Index, Bloomberg US Corporate High Yield Total Return Index & Bloomberg Sterling Corporate Total return Index for the period 01/01/2005 to 31/12/2024.

Chart 2: Default rates among US and European issuers have now equalised

12-month trailing issuer default rates, 1999-2025



Source: Moody's, Goldman Sachs, as of 30 January 2025.

9, 11 Source: BlackRock Fundamental Fixed Income, as of 15 April 2025. **10, 12, 14, 15** Source: Bloomberg, as of 15 April 2025. **13** Source: Goldman Sachs, as of 10 April 2025. **16** Source: Barclays, as of 11 April 2025. **17** Source: BlackRock Portfolio Consulting EMEA, BlackRock Aladdin, Morningstar, May 2025. Portfolio average allocation based on 291 moderate risk multi-asset EMEA domiciled portfolios collected between 28/06/2024 – 30/09/2024.

\$IG

We lower our conviction on US IG, as elevated uncertainty for firms and consumers is expected to hamper growth: our Fundamental Fixed Income team has downgraded its Q4/Q4 real GDP forecast to 0.0% from 1.0% previously.¹⁸

While we expect the US Federal Reserve (Fed) to cut rates this year, a resurgence of price pressures will likely keep the central bank cautious and reactive, given that hard data hasn't significantly deteriorated yet.¹⁹ From a fundamental perspective, the asset class remains on a strong footing, with net leverage back at pre-Covid levels and interest coverage at healthy levels. However, the duration sensitivity of \$IG keeps us cautious, with volatility continuing to roil long-end Treasury markets.²⁰

April 2025 saw record-breaking outflows from US credit, with the largest five-day outflow streak since the Covid-induced dash for cash in March 2020.²¹ The second week of April saw \$4.5B of net outflows from USD IG and \$11B from USD HY.²² International investor participation has turned from a tailwind to a headwind, as the extensive depth and breadth of US credit markets, dependable currency and perpetual stability that had previously supported the asset class through turbulent periods are now being challenged.

As with €HY, we look to active strategies to identify single names with strong pricing power and more operational agility to absorb the impact of tariffs. Our active PMs hold a single-A bias – they've outperformed lower-quality debt on a beta-adjusted basis but maintain a low spread ratio, with yields of 5.8% likely to draw LDI-related demand.²³ The team also likes pockets of high-quality US IG via utilities, banks and tech. They see software having limited exposure to tariffs and proving resilient across economic cycles.²⁴

\$HY

We maintain a cautious stance on \$HY, with the higher effective tariff rate on the US likely to have a larger impact on \$HY than other DM credit exposures.

The US growth outlook poses a continued risk to spreads, in our view, which have widened only 50bps from the tightens – equivalent to only half of the widening seen in the 2022 market shock and c.10% of the widening after the Covid shock of 2020.²⁵ This has prompted sharp upward revisions to default rate forecasts for \$HY from 3.0% to 5.0% for full-year 2025.²⁶

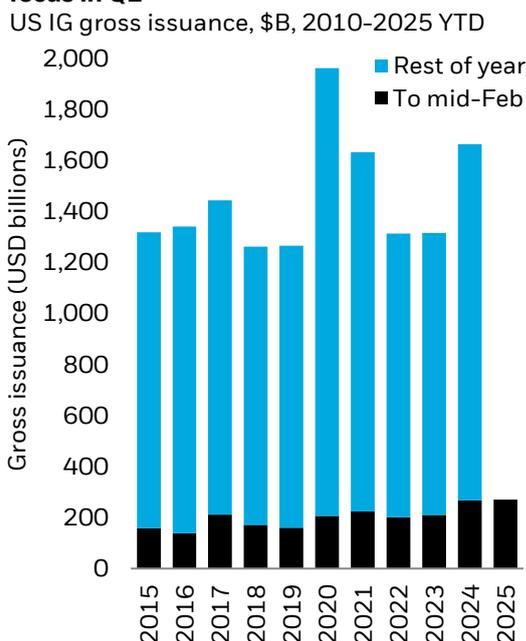
USD HY and leveraged loan funds experienced their largest weekly outflows ever in mid-April – the first shock to demand technicals in years and faring worse than European and IG counterparts.²⁷

While 2025/26 maturity walls looks less challenging, 2027 refinancing at prevailing yields screens as concerning for CCCs. The 2027 maturity wall sits at 25% of CCC issuers.²⁸ At prevailing yields, even with the headroom afforded by earnings growth, this would trigger coverage ratios to drop further below 1 from 0.8 to 0.7.²⁹

Hedging currency risk can significantly impact both total returns and yield of credit allocations. The cost or benefit of hedging is largely driven by interest rate differentials, with higher-yielding currencies incurring a hedging cost when converting to lower-yielding currencies, due to the negative carry from FX forwards. Conversely, hedging from a low-rate currency into a higher-rate currency can enable investors to enhance returns by capturing the forward premium. Over time, this dynamic has shifted: while EUR-USD hedging was once seen as uneconomical for a \$-based investor and generally worthwhile for a €-based investor, due to the stark rate differentials, higher yields in € credit and higher policy rates in the US relative to Europe, the risks have equalised, making hedging decisions more balanced in terms of return impact.²⁹

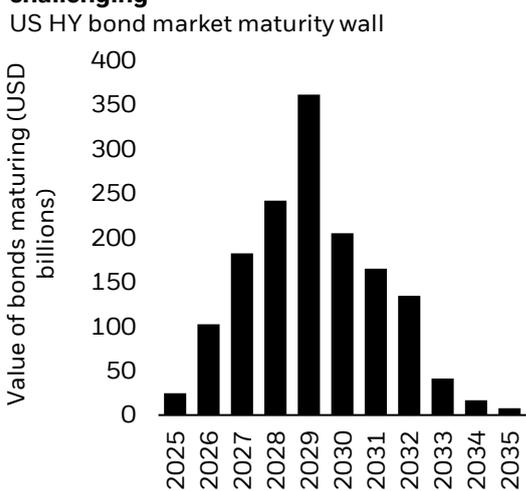
18, 23, 24 Source: BlackRock Fundamental Fixed Income, as of 16 April 2025. **19, 20, 25** Source: BlackRock and Bloomberg, as of 16 April 2025. **21** Source: index and mutual fund flows from Barclays, as of 14 April 2025. **22, 26, 27, 28, 29** Source: Goldman Sachs, as of 10 April 2025.

Chart 3: \$IG issuance absorption will be in focus in Q2



Source: Dealogic, Goldman Sachs, as of 13 February 2025.

Chart 4: \$HY maturities for 2028/29 look challenging



Source: Bloomberg, as of 13 February 2025.

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