

Credit cocktail starting to look more attractive based on value and lower rates

The credit cocktail has changed after the European Central Bank announced a 50bp rate hike, thus we conclude credit is now looking more attractive due to lower rates and the value priced in. We take a look at what this means for credit, as well as some TPI considerations



The 50bp rate hike can be considered a positive for credit as the cocktail recipe changes for the second half of this year. Our rates expectations are for yields/rates to fall into 2023 and we forecast the 10yr swap rate - currently at 1.9% after dropping 12bp already - to drop to 1.5%. More stability in yields will put the focus on spreads in the second half of this year. Spreads have priced in a recession and the ECB's front-loaded approach to tightening may mean that credit is a lot better placed in the second half of this year, assuming the economic downturn is manageable. Thus we see value in credit spreads.

What this means for credit:

- Lower yields will result in an extra bid for credit yields
- Total returns will improve

- Spreads have tightening potential
- Credit curves have significant steepening potential - thus we prefer the short-belly of the curve
- Primary market opens up as funding becomes slightly cheaper
- Supply could increase, albeit marginally as there is still little necessity to come to market with significant pre-funding already done.

The credit spread reaction to the news was subtle, with corporate spreads mostly moving 1bp wider, but some higher beta sectors such as Autos, Leisure, Health, Industrials and Real Estate all outperformed with 1bp of tightening. Financials, on the other hand, widened by 2bp.

The new Transmission Protection Instrument is aimed at the public sector and will therefore not provide direct support to the corporate credit market. This does leave credit somewhat more vulnerable as reinvestments from the Corporate Sector Purchase Programme are very low for the second half of this year at just €1bn per month, before increasing to an average of €3bn per month from January 2023 onwards. However, in saying that, the TPI may offer some stability to sovereign debt spreads, which in turn will offer some stability to credit spreads if and when the programme comes online. But for the time being, the lack of detail could add some more volatility to sovereign spreads and as our rates strategists identified in their report [Rates Spark: Wider and flatter](#), the risks remain high and we may certainly see volatility in the periphery. In the case of Italy, the programme may help to stabilise corporates which are more strongly correlated to the sovereign debt, as Italian names have also been underperforming over the past months.

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