

## Higher Bund yields: Strong technicals to subdue corporate spreads from widening

Higher Bund yields are to be expected this year, and the rise may well be front-loaded. As yields rise and tapering talk comes to the forefront, spreads are likely to widen from current levels. But this widening will be subdued as we feel the technical picture will remain strong for credit



Source: Shutterstock

### Strong technicals from less supply, inflows and ECB asset purchases

The strong technical environment in place for 2021 is driven by a large drop in net supply. There is a notable increase in redemptions this year totalling €214bn. And we forecast supply will fall to €350bn - still a sizeable amount but significantly lower than €440bn last year and €390bn in 2019.

Read more on ESG fund flows [here](#).

# €350bn

## Euro corporate supply

Forecast for 2021

Furthermore, the technical picture includes mutual fund inflows for 2021. We expect inflows into the Euro investment grade space will be marginal but positive nonetheless. Interestingly, ESG funds have seen the vast majority of inflows over the past year. Over the last two years, a whopping 85% of assets under management (AuM) have flowed into these funds. Non-ESG funds have seen only marginal inflows, amounting to just 3% of AuM over the past two years. And since August of 2020, non-ESG funds have seen mostly outflows.

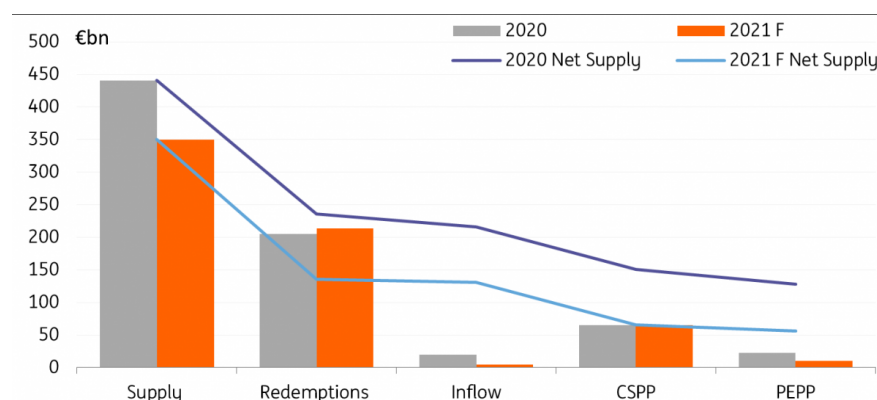
*The ECB will continue its reinvestment even after it stops actively purchasing, muting any potential taper tantrum*

The European Central Bank, meanwhile, is playing a significant role in supporting credit markets, with both the Corporate Sector Purchase Programme and corporate purchases under the Pandemic Emergency Purchase Programme. With reduced supply, the ECB is forced to concentrate purchases in the secondary market. This is further supportive for spreads.

Even if purchases under PEPP begin to slow and eventually cease, the CSPP will likely remain in full flow, pencilling in at least €65bn of net purchases for the year (gross purchases of €80bn). Additionally, the ECB will continue its reinvestment even after it stops actively purchasing, which will mute any potential taper tantrum.

As a result of lower supply and increased demand, we forecast net supply to fall from around €150bn to just €50bn, as you can see in the chart below.

### Corporate net supply is lower in 2021



Source: ING, Dealogic, ECB, EPFR

## Strong technicals will keep widening subdued

This strong technical picture will remain supportive for spreads and keep any widening subdued, however, widening from current levels is still expected as rates rise and PEPP tapering talks come to the forefront.

---

*The long end will underperform causing credit curves to steepen*

---

This is in line with our view for a more bearish outlook for the second half of this year, and in particular, our view for the long end to underperform, causing (as expected) credit curves to steepen.

We do take a more conservative stance for the second half of the year, whereby we prefer more defensive sectors such as Utilities and Telecoms and we prefer ESG debt.

## No substantial detrimental effects expected

As rates rise, we do not expect any substantial detrimental effect to funding levels as a whole or to credit metrics. The rise in Bunds of 30bp, even when matched with, for example, a 20bp widening in credit spreads is nothing too extraordinary for the short end.

The expectation of the 10-year swap rate to reach 0.55 by the end of the year, up from -0.25% in January, and the rising Bund and likely widening of credit spreads at the longer end, in particular (albeit nothing substantial), will affect the funding levels for higher beta debt at the long end. The cost of funding could rise by around 1%, in which case, it is likely we may see significant pre-funding for longer issues. This will put further pressure on the long end, pushing curves steeper.

However, this will likely leave the technical picture unaffected as, after particularly low supply in May; year-to-date supply thus far is sitting at just €144bn, which is slightly short of our expectations.

As the search for yield becomes easier in the longer term, the attraction for the high yield market will decrease, as investors will not need to take higher credit risk for relatively little yield.

---

*We do not expect any major widening of credit spreads on the back of rising Bund yields*

---

Therefore, we may eventually see outflows in the high yield space at that point. But this, too, should not be of any major concern as it is more a technical issue as opposed to any worsening of the underlying metrics. In any case, this will be seen more in the US in the long term.

All in all, we do not expect any major widening of credit spreads on the back of rising Bund yields, as technicals will keep any widening subdued. However, some widening is still expected, particularly at the long end of the curve, as PEPP tapering talks come to the forefront. As bund

yields, 10yr swap rates and spreads all rise (at the longer end) this will increase funding costs for issuers. As a result, we may see prefunding in the form of longer-dated bonds. In any case, we remain conservative for the second half of the year.

## Author

**Timothy Rahill**

Credit Strategist

[timothy.rahill@ing.com](mailto:timothy.rahill@ing.com)

**Jeroen van den Broek**

Global Head of Sector Research

[jeroen.van.den.broek@ing.com](mailto:jeroen.van.den.broek@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).