

Selling credit - Is the Fed setting an example?

The Federal Reserve will begin selling off its corporate holdings under its Secondary Market Corporate Credit Facility (SMCCF). At first glance, this seems insignificant as the Fed is only holding the small amount of US\$13.8bn. However, this is an extra addition into the cocktail of our slight bearish outlook for the second half of the year



Source: Shutterstock

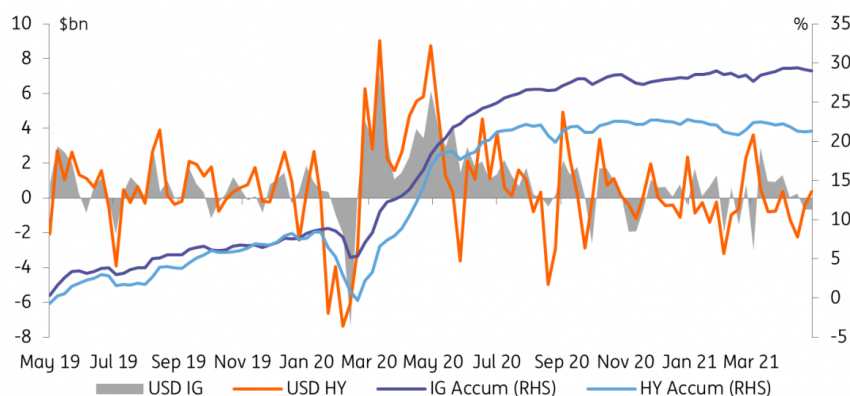
The Fed has announced that it will not just taper off its corporate holdings, but actively sell holdings under its Secondary Market Corporate Credit Facility (SMCCF). This did come as a surprise, however in the grand scheme of things, the amount is relatively small at just US\$13.8bn. Of this, just US\$5.2bn is in corporate bonds and US\$8.6bn is in ETFs. This includes both investment grade and high yield ETFs. For comparison, the European Central Bank's holdings of corporate bonds extend to a substantial €275bn. Therefore, the selling of US\$13.8bn by the Fed should not have any detrimental effect on spreads or funding levels.

Furthermore, this is fully outweighed by mutual fund (& ETF) inflows. Over the past 12 months, USD investment grade inflows have amounted to a substantial US\$44bn. On a year-to-date basis, USD investment grade inflows have accumulated to US\$5.2bn. Bear in mind, fund flows so far this

year have been positive but relatively low. This comes after the substantial inflows seen in 2020 and 2019. Looking at this year alone, the technical picture, in this sense, is now flat.

All of that said, the Fed's move does add weight to our slight bearish outlook. It is a signal that while it's not all out tapering, it is the start of a different phase.

USD Fund Flows

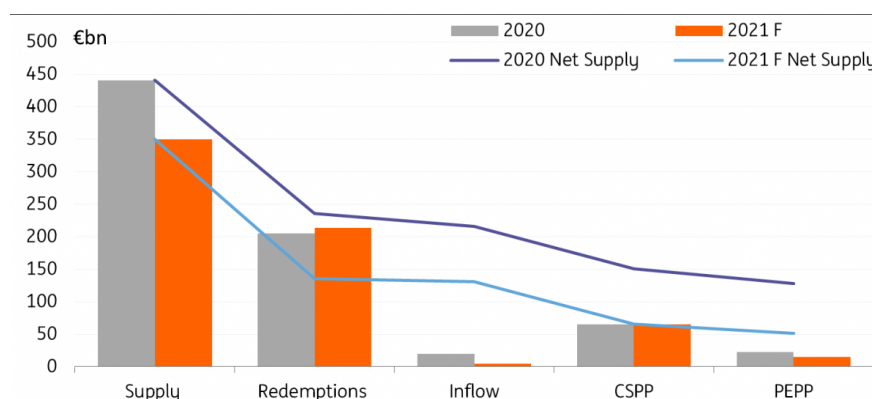


Source: ING, EPFR

On Thursday, USD spreads did push about 1bp wider in places but remained unchanged for the most part. If anything, the high yield market may be affected marginally more but all in all, we do not expect any significant pressure. In saying that, we do still remain somewhat bearish on spreads for the second half of this year. As inflationary fears increase, matched with continued tapering talks coming to the forefront and a rise in rates, we do expect to see softness in credit spreads, and a widening from these current tight levels. And we expect USD spreads to underperform against EUR spreads. In both USD and EUR, the technical picture in credit remains strong, however the technicals in EUR are certainly more supportive, namely because of the ECB. The lack of corporate bond holdings by the Fed may act as an additional minor catalyst for USD underperformance and could provide another reason for a little softness in spreads in the second half of this year.

Strong Technical Picture in EUR credit

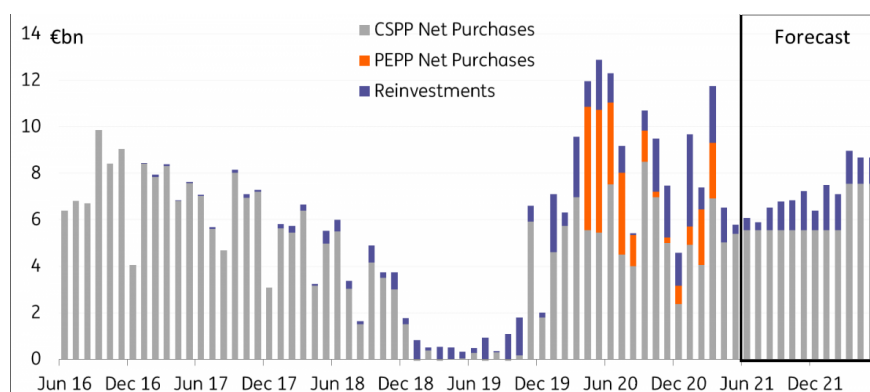
Forecast net supply after demand (CSPP, PEPP & Inflows) comes to just €50bn



Source: ING, Dealogic, ECB, EPFR

The ECB is a notable driving factor in the strong technical picture in EUR credit. The central bank has been buying €5.5bn of corporate bonds per month, on average, under its Corporate Sector Purchase Programme. It also makes a significant amount of reinvestments each month. In fact, looking long term, when the ECB does decide to end its purchases under the CSPP, the reinvestments will be so significant, we do not expect to see any taper tantrum. We do not expect the ECB to follow the Fed's lead in selling its holdings. However, if the Fed's move is successful, the ECB may want to consider something similar to ensure its holdings are sustainable. In our report: [To green or not to green: What it means for Credit if ECB becomes greener](#), we outlined the ECB's options to make its holdings more sustainable. One of these is to sell carbon intensive holdings. While this is less likely, it remains an option nonetheless.

ECB corporate purchases



Source: ING, ECB

Authors

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Jeroen van den Broek

Global Head of Sector Research

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 <http://www.ing.com>.