Tariffs on, risk off: credit set to leak

Trump's tariffs will lead to more volatility and risk off in credit. With the technical picture weakening, there is less to be positive about

Trump announcing his tariff plan in the Rose Garden of the White House, 2 April 2025

Tariffs and technicals

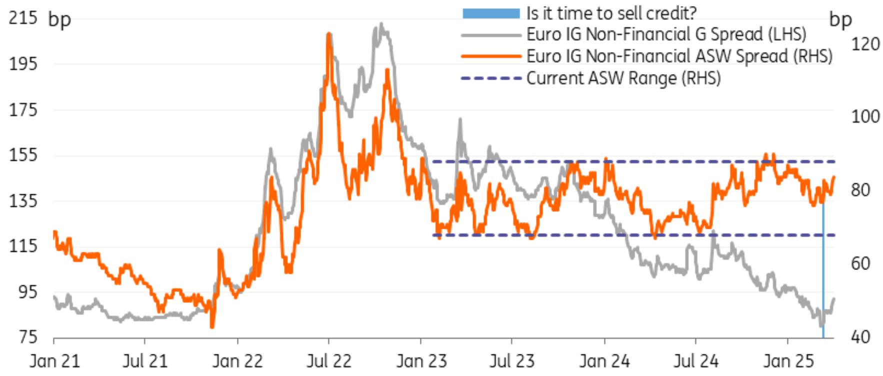
Spreads are widening further and are expected to experience increased volatility due to the announced tariffs. The risk-off sentiment is likely to persist, leading to a slowdown in primary market activity during the upcoming volatile sessions. Within the credit space, many corporates and sectors will feel the pinch, looking more at the macro/rates environment and its focus on the negative impact on eurozone growth. Spreads have already opened up wider as sellers dominate. The iTraxx main has widened by 3bp this morning, now over 10bp wider compared to a couple of weeks ago.

The technical picture is shifting more negatively with outflows, high CSPP redemptions and potentially higher supply (via more Reverse Yankee supply and tariffs absorbing margins, weakening fundamentals), all adding pressure on spreads. And with a lesser dominant demand from yield to soften the blow.

Technical strength is showing signs of weakening, with another week of negative flows from mutual funds and ETFs. The changing rates environment, where the short end is unlikely to see further reductions and the long end is expected to rise, is diminishing the appeal of yield in credit. This is particularly concerning as the bund/rate component of the yield in credit is over 80%.

EUR IG non-financials spread developments and range

The blue indicates when we published the recent piece 'Where's the credit?' where we suggested it may be time to sell credit



USD has already underperformed EUR

USD credit was a notable underperformer throughout March, with significant widening versus EUR credit. Although USD credit was coming from a very tight and rich place, it still looks a touch on the expensive side, in our opinion. The yield play may still be favourable in USD as rates could be set for some lowering, as detailed in the report *Market reaction to Liberation day - this is just the beginning*, but further widening is likely on the cards for USD credit longer term.

Regardless, this recent widening of USD spreads versus EUR does offer a larger potential cost-saving advantage for US issuers to come to the EUR market with Reverse Yankee bonds, particularly considering how low the cross currency basis swap is. The supply pressure on EUR credit adds another piece to the deteriorating technical puzzle.

Short end preferred and plenty to avoid

A conservative positioning is advisable, as higher beta and lower-rated debt are poised to underperform from these compressed levels. We also prefer shorter maturities on the curve, anticipating further steepening. Last week, only the 0-4 year maturity bucket saw inflows. We expect higher beta and lower-rated debt to underperform on the long end, with more underperformance likely as curves remain flat.

Within European corporates, consumer, pharma, technology, and industrials sectors have the largest exposure in terms of revenues from the US. Similarly, corporates from the Netherlands, Germany, France and Spain see the most exposure of US revenues. Italy is also noteworthy, considering the large manufacturing sectors that will be impacted.

The sectors that are going to feel the pinch the most and see credit underperfomance are:

- Autos
- Pharmaceuticals
- Food & Bev
- Airlines
- Chemicals
- Steel & Aluminium

- Manufacturing and other Industrials.

Whilst these tariffs offer more volatility and underperformance of certain segments in the coming sessions, in the medium term we expect spreads will continue a slow leakage wider. ASW spreads could temporarily even pierce the wide end of the range.

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