A photograph of a blue industrial building with yellow metal stairs and railings. The building has a corrugated metal facade. The stairs lead up to a platform. The overall scene is brightly lit, suggesting an outdoor setting.

December 19, 2024

Global Credit Weekly:

A hawkish cut and “a new
phase”

BlackRock

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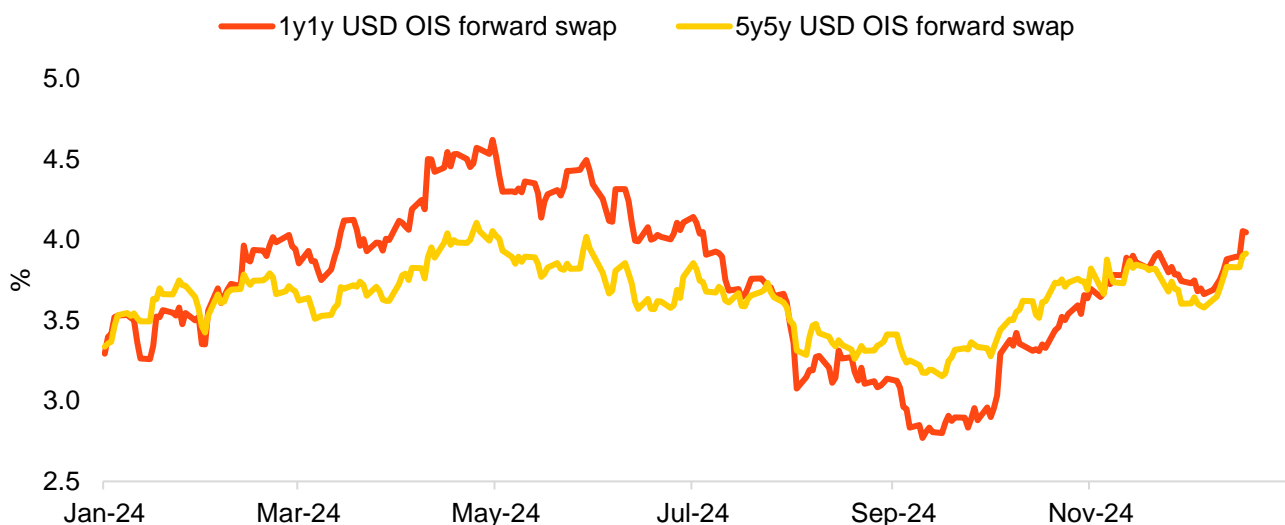
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Key takeaways

- At the December FOMC, Federal Reserve Chair Jerome Powell delivered a widely-anticipated 25bp rate cut but noted this most recent reduction was a “closer call”. He also signaled “a new phase in the process,” with a more cautious approach to future rate reductions, dependent upon further inflation progress. The December Summary of Economic Projections (SEP) now points to a median policy rate forecast of 3.9% by year-end 2025 (vs. 3.4% as of the September SEP), alongside projections for stronger growth, higher inflation and lower unemployment (Exhibit 2).
- Despite 100bp of rate cuts vs. the August 2024 peak, Chair Powell views the current level of monetary policy as “meaningfully restrictive” – a posture that is likely necessary to achieve further progress on inflation, in his view. This backdrop appears consistent with a monetary policy *normalization* cycle, as opposed to an outright *easing* cycle – a distinction that is important for corporate credit investors to monitor, as we have outlined previously.
- Corporate credit borrowers’ ability to navigate this higher interest rate environment will depend on the degree of support in the growth backdrop. For now, the news is encouraging, with 4Q2024 U.S. real GDP growth tracking at an above-trend pace of 3.2% (as of December 18th). Moreover, fixed rate coupons are adjusting higher only gradually (Exhibit 6), and floating rate borrowers in liquid and private credit have already experienced some modest rate relief, as we highlighted in our 1Q2025 Global Credit Outlook. Furthermore, near-term HY maturity walls are very low (Exhibits 8 and 9), owing to a wave of proactive refinancing activity over the past several quarters.
- A *gradual* rise in U.S. Treasury yields (across the curve) may support yield-based demand for credit – so long as the rise in the risk-free rate is driven by stronger growth expectations. By contrast, a more “disorderly” move higher in U.S. Treasury yields – in response to fiscal concerns or elevated inflation expectations – would likely warrant higher risk premiums in credit.

Exhibit 1: Market pricing reflects a shallower cutting cycle

1y1y Overnight Indexed Swap (OIS) forwards, as a proxy for the terminal rate of this cycle, and 5y5y OIS as a proxy for the long-term neutral rate



Source: Bloomberg, BlackRock. As of December 19, 2024. **There is no guarantee any forecasts may come to pass.**

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December FOMC: a “closer call,” while entering “a new phase”

The [December FOMC meeting](#) delivered a widely-anticipated 25bp rate cut, bringing the Federal Funds policy rate to 4.25%-4.50% (now 100bp lower vs. this cycle’s peak in August 2024). During the press conference, however, Federal Reserve (Fed) Chair Powell characterized this most recent decision to cut rates as “a closer call.”

Indeed, this was reflected in one formal dissent, as well as the full distribution of FOMC members’ year-end 2024 projections (three of which called for an *unchanged* Fed Funds rate). Chair Powell added: “we are in a new phase in the process,” pointing to a slower and more cautious approach to “the timing and extent” of future rate cuts. Chair Powell said the FOMC needs to see (1) further progress on inflation, as well as (2) continued strength in the labor market, for future rate reductions.

The [December 2024 Summary of Economic Projections \(SEP\)](#) shifted significantly relative to the last quarterly update in September. [Chair Powell's public remarks in early December](#) pointed to this possibility, when he outlined how U.S. growth had exceeded the FOMC’s projections.

While not an official FOMC forecast, the SEP captures the range of forecasts penciled in by the 19 FOMC members (as well as the median forecast, or “dot”). As shown in Exhibit 2, projections for 2024-2025 were updated to reflect stronger growth, higher inflation, and lower unemployment. This translated into a projection for fewer rate cuts in 2025 and a higher longer-run “neutral” rate (again, Exhibit 2).

Exhibit 2: The December SEP pushed the long-run neutral rate higher, yet again

The median economic projections of the 19 FOMC members, for the 4th quarter of each year shown

	2024	2025	2026	2027	Longer-run
Real GDP growth	2.5	2.1	2.0	1.9	1.8
<i>Sept 2024 projection</i>	2.0	2.0	2.0	2.0	1.8
<i>June 2024 projection</i>	2.1	2.0	2.0		1.8
<i>March 2024 projection</i>	2.1	2.0	2.0	<i>not given</i>	1.8
<i>December 2023 projection</i>	1.4	1.8	1.9		1.8
Unemployment rate	4.2	4.3	4.3	4.3	4.2
<i>Sept 2024 projection</i>	4.4	4.4	4.3	4.2	4.2
<i>June 2024 projection</i>	4.0	4.2	4.1		4.2
<i>March 2024 projection</i>	4.0	4.1	4.0	<i>not given</i>	4.1
<i>December 2023 projection</i>	4.1	4.1	4.1		4.1
PCE inflation	2.4	2.5	2.1	2.0	2.0
<i>Sept 2024 projection</i>	2.3	2.1	2.0	2.0	2.0
<i>June 2024 projection</i>	2.6	2.3	2.0		2.0
<i>March 2024 projection</i>	2.4	2.2	2.0	<i>not given</i>	2.0
<i>December 2023 projection</i>	2.4	2.1	2.0		2.0
Core PCE inflation	2.8	2.5	2.2	2.0	
<i>Sept 2024 projection</i>	2.6	2.2	2.0	2.0	
<i>June 2024 projection</i>	2.8	2.3	2.0		<i>not given</i>
<i>March 2024 projection</i>	2.6	2.2	2.0	<i>not given</i>	
<i>December 2023 projection</i>	2.4	2.2	2.0		
Federal funds rate	4.4	3.9	3.4	3.1	3.0
<i>Sept 2024 projection</i>	4.4	3.4	2.9	2.9	2.9
<i>June 2024 projection</i>	5.1	4.1	3.1		2.8
<i>March 2024 projection</i>	4.6	3.9	3.1	<i>not given</i>	2.6
<i>December 2023 projection</i>	4.6	3.6	2.9		2.5

Source: Federal Reserve, BlackRock. As of the Federal Reserve’s Summary of Economic Projections published on December 18, 2024. There is no guarantee any forecasts may come to pass.

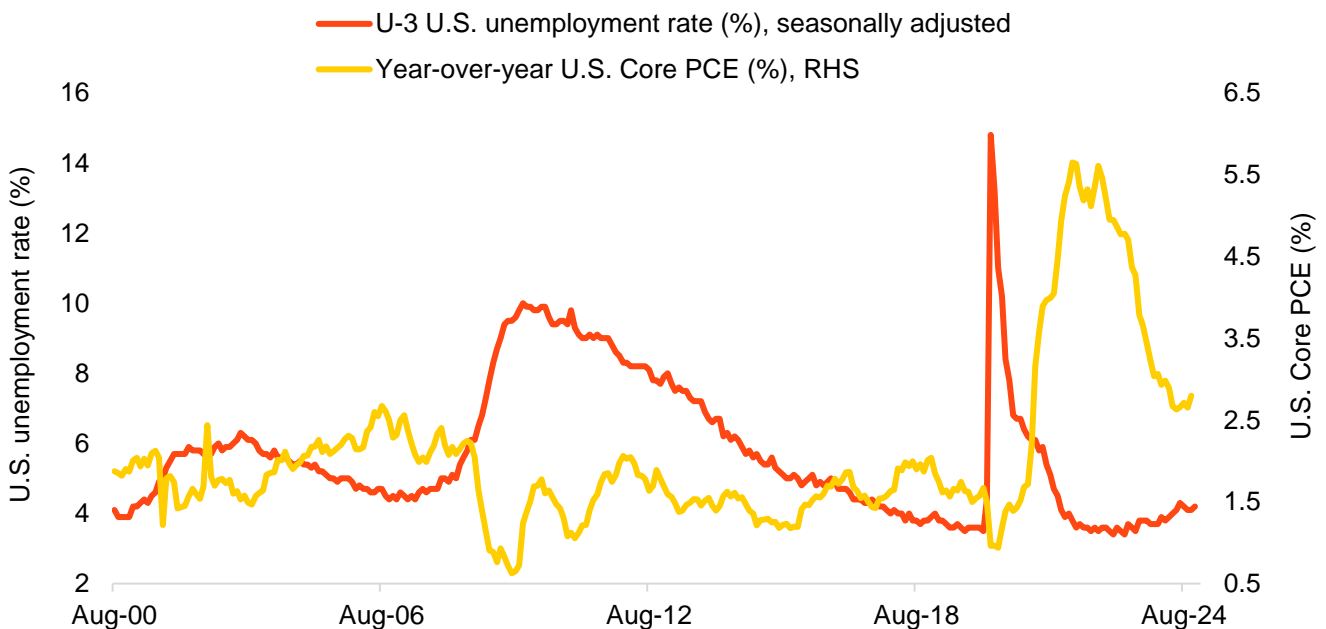
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Key takeaways for corporate credit investors:

- **Why cut rates at all?** In outlining the rationale for this month’s rate cut (during the Q&A), Chair Powell pointed to the labor market, which he characterized as (1) now looser than pre-pandemic levels and (2) “clearly still cooling further...in a gradual and orderly way” based on a variety of measures (surveys, quit rates, job creation, vacancies; Exhibits 4 and 5).
- **Potential policy changes are not *uniformly* reflected in the FOMC projections.** During the Q&A, Chair Powell was asked whether the higher inflation forecasts reflected expectations of future policy changes (such as potential tariffs) following the November 5th U.S. election. He said the FOMC is discussing ways in which tariffs can affect inflation in the economy, so the FOMC can make a more “thoughtful assessment” on the appropriate policy response when more clarity on the actual policies materialize. That said, he acknowledged the individual FOMC members varied in their approaches. Some, for example, took a “very preliminary” step of incorporating “highly conditional” estimates of economic effects of policies, while others did not. And some FOMC members identified policy uncertainty as a driver of higher inflation uncertainty. This was a more nuanced response relative to Chair Powell’s comments on the topic during the [November FOMC press conference](#), where he said: “we don’t guess, we don’t speculate, and we don’t assume.”
- **The longer-run neutral rate moved higher, again.** The December SEP included an upward revision to the longer-run Fed Funds rate estimate, consistent with the pattern that has been developing since December 2023 (again, Exhibit 2 red box). As he has done repeatedly, Chair Powell underscored the uncertainty inherent in measuring such a rate, saying again that “we know it by its works.” That said, he acknowledged the current stance of monetary policy is now closer to neutral given the 100bp of rate cuts delivered since the September meeting, which warrants proceeding cautiously from here.

Exhibit 3: More progress on inflation is desired by the FOMC

U-3 U.S. unemployment rate (%) seasonally adjusted, and year-over-year U.S. Core PCE inflation (%) seasonally adjusted, RHS

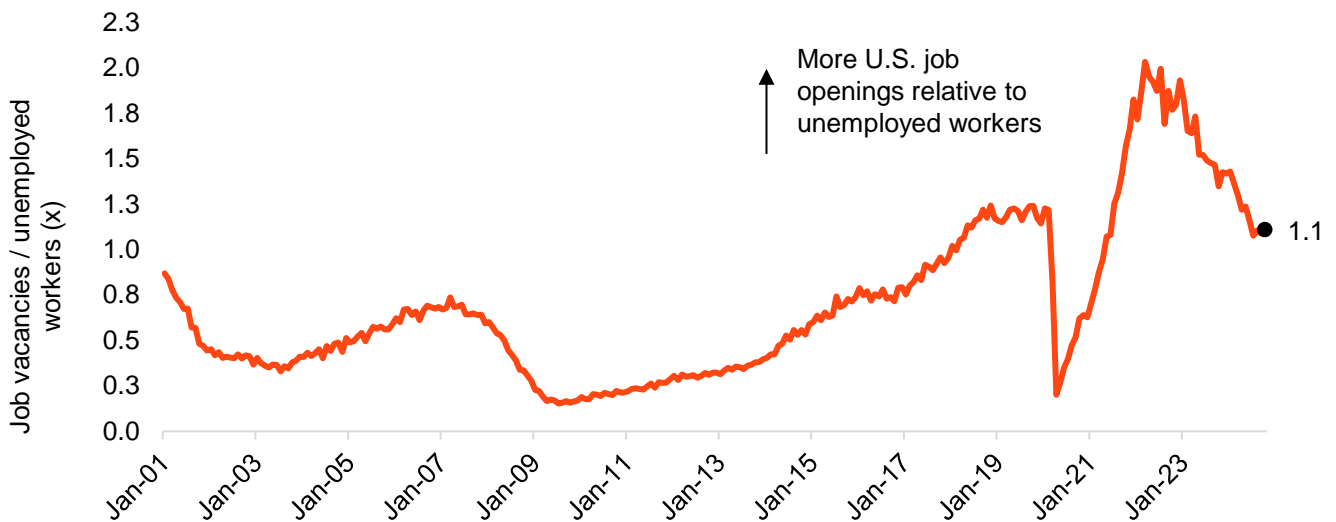


Source: Bureau of Labor Statistics, Bureau of Economic Analysis, BlackRock. Captures unemployment rate data through November 30, 2024 and inflation data through October 31, 2024 (most recent available as of December 18, 2024).

- **Rates are still “meaningfully restrictive”...** Even after 100bp of rate cuts, Chair Powell noted the current level of monetary policy “is still meaningfully restrictive.” He views restrictive policy as required, however, as inflation remains above the FOMC’s 2% target.
- **...which is required, as more progress on inflation is desired:** Chair Powell noted the FOMC’s year-end projection for inflation has “kind of fallen apart as we approached the end of the year,” owing in part to higher than anticipated readings in September and October. “We really want to see progress on inflation...as we think about further cuts,” he said. Keeping the policy rate in restrictive territory is necessary to “stay on task” in order to get inflation down to 2%, while keeping the “labor market pretty close to where it is.” Chair Powell said the FOMC is still confident inflation will reach 2%, but it might “take another year or two from here.”

Exhibit 4: The “jobs-workers gap” has rebalanced to the pre-pandemic level

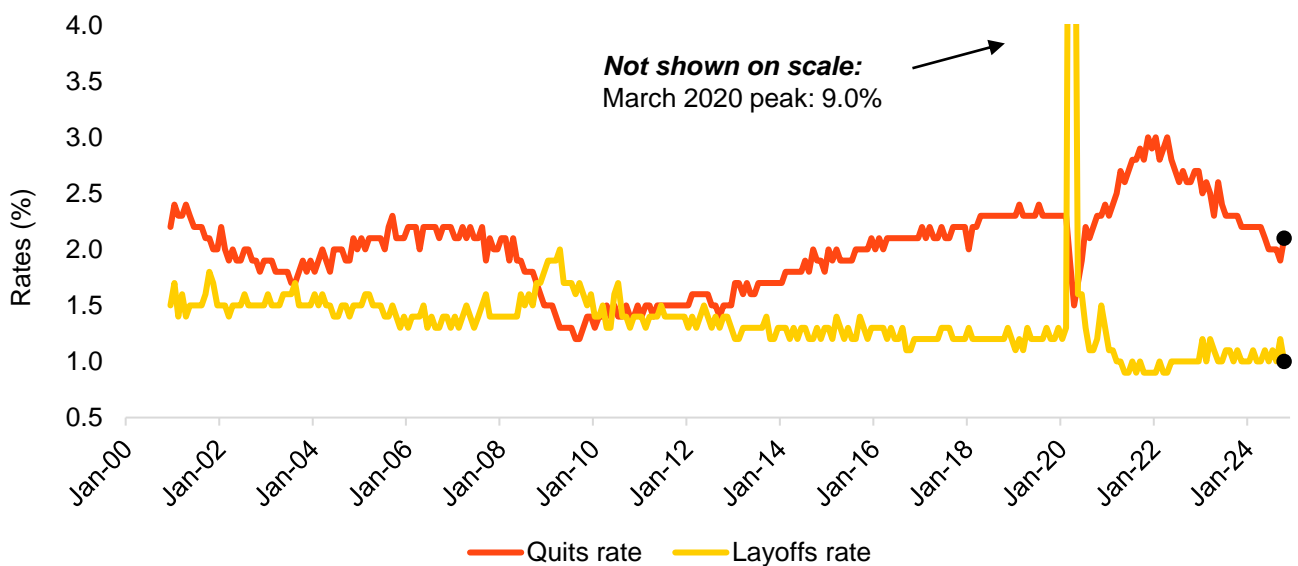
The ratio of U.S. job vacancies to U.S. unemployed workers, both seasonally adjusted



Source: BlackRock, Bureau of Labor Statistics. Captures data through October 31, 2024 (most recent).

Exhibit 5: The quits rate has declined, but the layoff rate is still low

U.S. Layoffs & Discharge Rate (%) and the U.S. Quits Rate (%), both seasonally adjusted



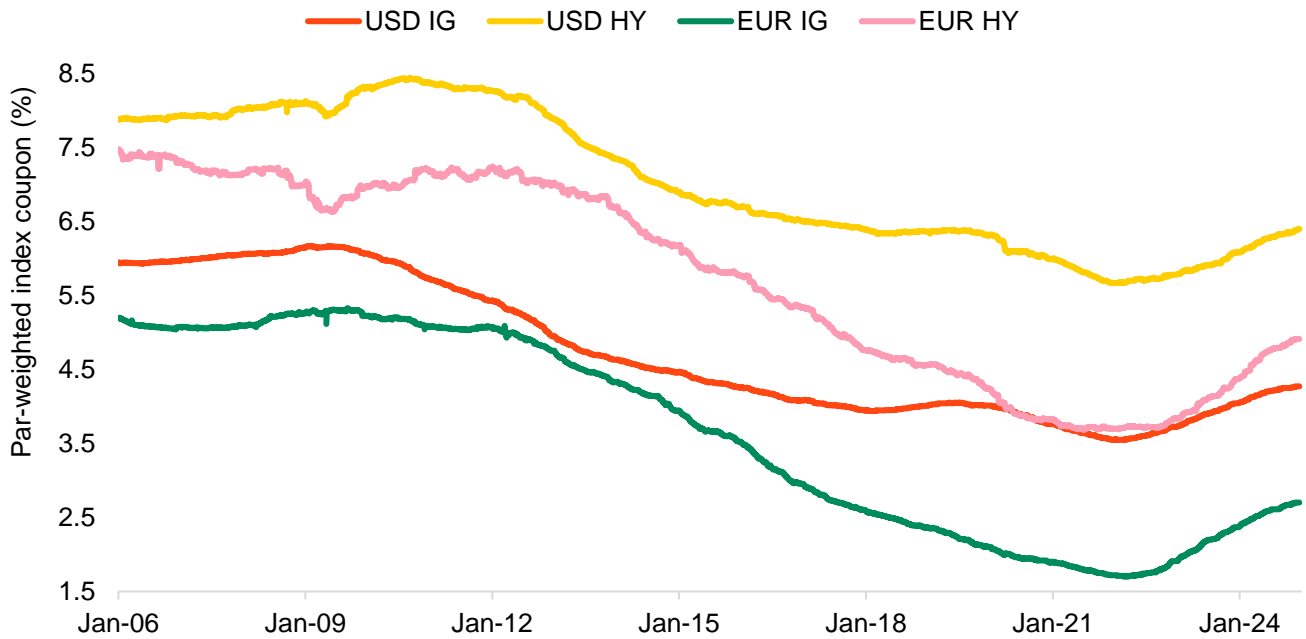
Source: Bureau of Labor Statistics, Bloomberg, BlackRock. Captures data through October 31, 2024 (most recent). The Layoffs & Discharge Rate tracks involuntary job separations initiated by the employer, while the Quits Rate tracks voluntary job separations initiated by the employee.

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Corporate fundamentals and maturity walls

Exhibit 6: Fixed rate coupons have been adjusting gradually to higher rates

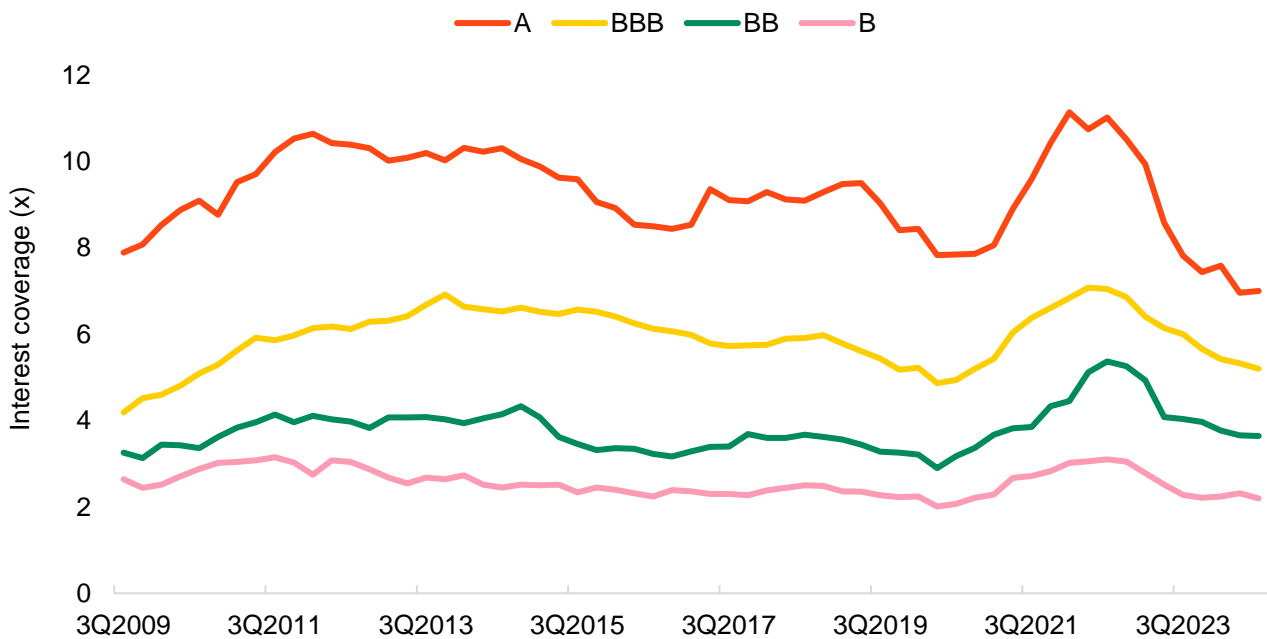
Average par-weighted coupon of the Bloomberg USD and EUR Corporate indices



Source: Bloomberg, BlackRock. As of December 17, 2024.

Exhibit 7: Interest coverage metrics have weakened over the past several quarters, but appear to be stabilizing

Trailing 12-month EBIT / gross interest expense, for the Bloomberg USD A, BBB, BB and B Corporate indices

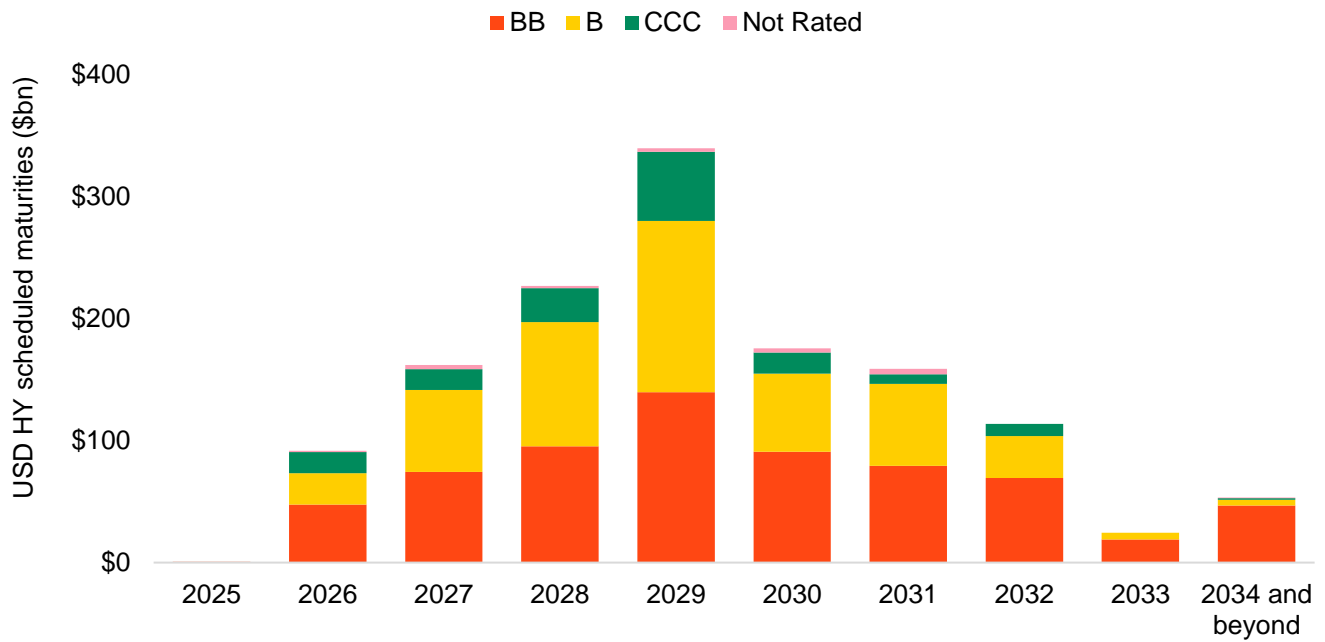


Source: Bloomberg, BlackRock. As of 3Q2024 (most recent as of December 17, 2024).

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Exhibit 8: Near-term maturity walls in the USD HY market are very modest

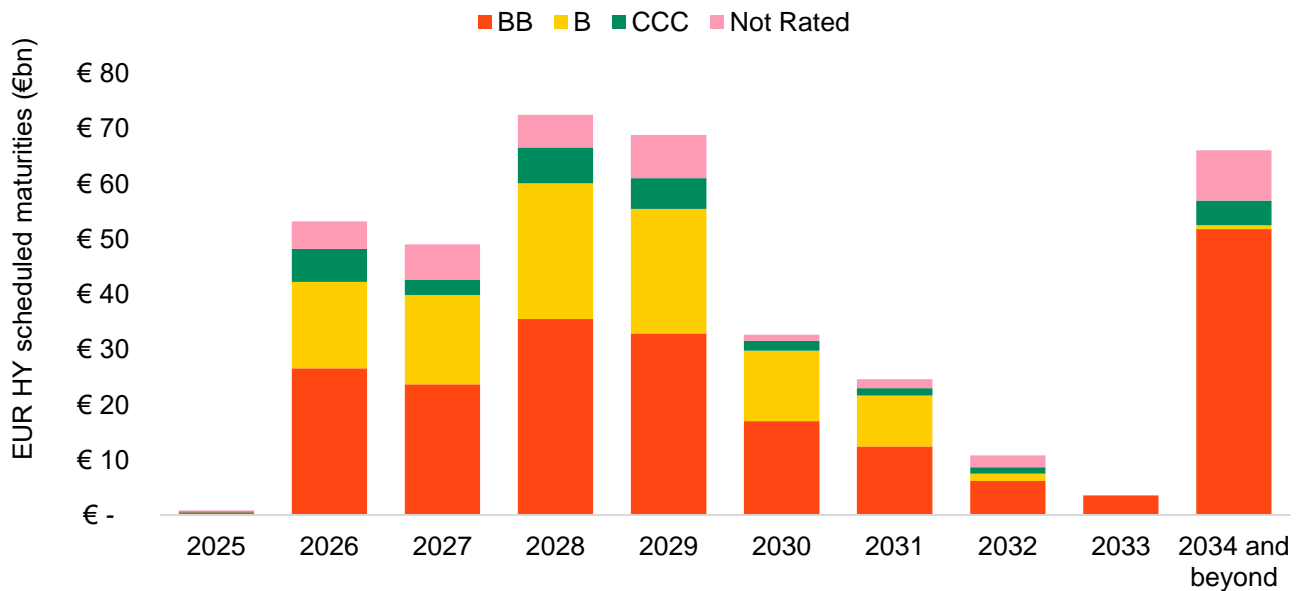
Maturity schedule for the bonds included in the Bloomberg USD HY Corporate Index, by Bloomberg Composite rating.



Source: Bloomberg, BlackRock. As of December 17, 2024. Excludes bonds which are not index eligible.

Exhibit 9: Near-term maturity walls in the EUR HY market are somewhat steeper vs. the USD market, but still manageable

Maturity schedule for the bonds included in the Bloomberg Pan-Euro HY Corporate Index, by Bloomberg Composite rating.



Source: Bloomberg, BlackRock. As of December 17, 2024. Excludes bonds which are not index eligible.

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