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Credit Convictions in 2024

European credit in 2024: easing is pleasing

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Credit
Europe
Credit Strategy

View Transcript

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That old school feeling

Credit was about carry in '23, as spreads battled rising yields and monetary policy hawks. The tables turn in '24, though, as central banks likely bring the rate cutting music. Total returns will step-up a gear: we expect 7.5% for IG, and 8.5% for HY. 2024 may not be the halcyon days of financial repression again, but more meagre yield backdrops have only ever been good news for credit demand. We see tighter spreads in this environment.

520 rate hikes later…it's time for something new

The political backlash from eye-watering inflation meant many central banks simply kept hiking in this cycle. Now there are growing signs that policy might be too restrictive. We think a tangible easing cycle is ahead for the ECB, with disinflation trends more evident than elsewhere. Rate cuts should reduce the "crowding out" of credit demand that has been problematic for performance this year. But we caution one size doesn't fit all: more entrenched inflation points to a less dovish BoE, hence less Sterling spread tightening.

Growing pains

Will the lags of monetary policy finally kick-in with an umph, and catch the market off-guard? We are cognizant that US growth could be a lot less strong in '24, with the US fiscal impulse declining too. Weaker US growth will matter more for European high-yield. Hence, we prefer IG over HY in 2024. HY lacks the duration that IG offers, too.

The "big government" trade

It's election mania in '24. 40% of the world's population heads to the polls. inflation-weary consumers will not want to hear about government belt-tightening. Hence, "debt" and "deficits" will be buzzwords in '24, and mini rates shocks may still crop-up. But in Europe, common ground needs to be found on fiscal rules. Little agreement risks an unwanted tightening in fiscal policy. History says defensive IG bonds could suffer.

The future of people

Corporates' EBITDA margins are contracting. Labour costs are likely part of this. But firms are evolving, and their labour intensity is falling, especially for industrials. Over time, Artificial Intelligence has the potential to transform worker productivity much more. But it's a long journey. Near-term, AI means more dispersion in credit, given leaders and laggards in implementation. As such, '24 should be rich in alpha for investors.

Only time will tell…

Can rate cuts come quickly enough to bail-out a credit market that was largely created amid a backdrop of negative rates? CCC spreads say no. With the Euro HY maturity wall more serious in 2024, we see an environment of lingering distress and 3-4% defaults.

What to do in 2024?

Long BBBs vs As (on rate cuts), long BBs vs Bs (on value), long cap goods, consumers (credit demand returns), short services sectors (tight to recession risk), long industrials (labour "lite" + cash hoards), caution on healthcare (fiscal), "nibble" on real estate (self-help opportunities)…and long banks vs corporates.

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European credit in ’24: easing is pleasing

Carry is the best way to describe credit’s performance in 2023, as spreads battled an environment of rising yields and sticky-high rates volatility. Yet, we think the tables turn for corporate bonds in 2024, as central banks bring the rate cutting music. And with it likely comes a stronger year for credit returns: we expect around 7.5% total for IG, and 8.5% total for HY. Rates do a lot of the heavy lifting here. Yet, spreads should head tighter too as inflows strengthen. It may not be the halcyon days of financial repression again, but a more meagre yield backdrop can only be good news for the relative demand for corporate bonds, and duration, we think.

520 rate hikes later…it’s time for something new

For over two years, fixed-income markets have had to endure an unprecedented volume of rate hikes. The political backlash from eye-watering inflation meant that many central banks had to err on the side of caution, and simply keep hiking. But now there are growing signs that policy is too restrictive, as more economies reach 2% inflation again. Hence, we think the big story next year will, finally, be that of central bank cuts. And we think a tangible easing cycle is ahead for the ECB, with today’s deposit rates of 4% far in excess of where we think they should be in the long-term (2%).

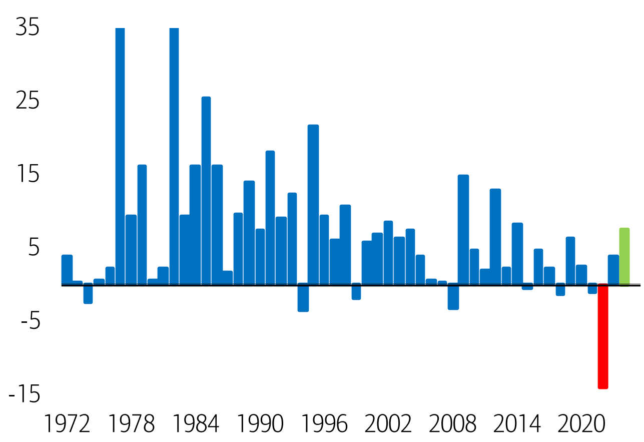
Rate cuts will help Euro credit in many ways. First, they should reduce the “crowding out” of corporate bond demand that attractive front-end govvie yields have resulted in. Second, they should improve the conspicuously weak Euro Area demand backdrop, supporting profits. And third, they should kick-start better credit creation, a necessity still for many European SMEs, with limited financing avenues.

But one size doesn’t fit all in ‘24. While disinflation trends add weight to ECB cuts, we see the BoE on hold next year as the UK battles entrenched inflation. That means stickier UK rates vol, we think, and less scope for Sterling credit spreads to tighten.

Growing pains

As helpful as rate cuts are likely to be, they can’t completely paper over all the risks for ‘24. We still worry about the hidden growth damage from the most intense hiking cycle in history. Will the lags of monetary policy finally kick-in with an umph, and catch the market off guard? Economic weakness is already apparent in the Eurozone, though, so we worry less about another big leg down in the European macro cycle. But a loss of US macro momentum concerns us, especially with the economy fresh off an almost 5% annualized GDP print, and the fiscal impulse due to fade in ’24. We keep a close eye on developments here: US growth perceptions matter most, in fact, for European HY.

Chart 1: ECB cuts to the rescue in 2024. Annual Euro IG returns
2024 could be the best total return year since 2014 for Euro IG



Source: ICE Data. Total returns. Using Global IG index pre-1998, Euro IG index from 1998-today.
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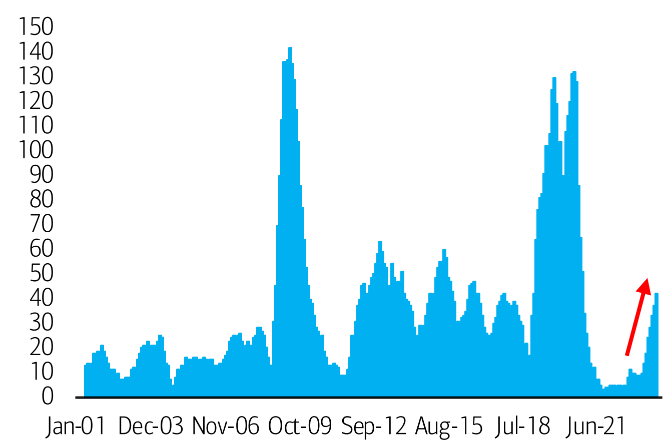
Chart 2: TINA (There Is No Alternative) for credit, when the ECB cuts
Global central bank rate cuts (6m sums): fixed-income’s friend in 2024



Source: Bloomberg. Using a large sample of global central banks. 6m rolling sums of CB cuts.
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The "big government" trade

It's election mania in 2024. Over 40% of the world's population head to the polls to make their voices heard. And inflation-weary consumers are unlikely to be in the mood to hear about government belt-tightening. Hence, "debt" and "deficits" could be buzzwords in '24 again. Mini rates shocks could still appear (especially in the US).

Europe could be in the thick of this story too, but from the other side. New European fiscal rules continue to be debated, with a year-end deadline set. Failure to reach an agreement could see an unwanted tightening in European fiscal policy in '24. History says that higher quality credits could be more vulnerable in this scenario.

The future of people

Unlike in the US, corporate Europe continues to see EBITDA margin erosion. Wage growth is far higher than during pre-Covid times. Similar to our US colleagues, we find that productivity gains tend to follow periods of wage inflation. Signs are already emerging that firms' labour intensity is declining, especially for industrials.

Artificial Intelligence has the potential to transform worker productivity and economic growth much more dramatically. Over the long-term, this feels bullish for credit compression. But, nearer-term, A.I. could drive greater dispersion of credit spreads, given leaders and laggards in its implementation. 2024 should be a rich environment of alpha opportunities, therefore.

Refi's: only time will tell…

Rate cuts will be the 2024 bright spot, but don't expect the era of zero or negative rates to return anytime soon. We worry less about impending coupon resets for IG firms, as interest income from their sizeable cash hoards is rising too. But with a record 18% of the € HY market maturing over the next 2yrs, some credit damage seems inevitable for levered firms. We expect an environment of still-elevated distress, and a 3-4% defaults.

You can't keep a good story down

As is customary in year-ahead season, November has already seen markets pounce on the idea of monetary easing, and risk assets have rallied significantly. We wouldn't be surprised, therefore, if spreads correct wider early in 2024, as markets sell the hubris. Q2 should see the rally back on, though, as rate cuts get much nearer.

Our key recommendations and themes for next year are:

- We prefer **IG** over **HY**, based on relative '24 returns, and weak EZ growth. HY lacks the duration that IG offers. And defaults will take a chunk of HY's potential upside,
- We like longs in **BBBs (vs As)** in IG, and longs in **BBs (vs Bs)** in HY. BBBs will benefit from ECB cuts. BB spread percentiles are still very high,
- On the crowding "back in" of credit demand, we think the **capital goods, consumer** and **tech** sectors stand to benefit,
- On a potential easing of real rates in Europe, we think **corporate hybrids** and **financials** would be the best beneficiaries,
- On the macro: we think **services-oriented** sectors are too tight given the slowdown underway in this part of the economy. Conversely, **Spanish credits** look encouraging longs given their rising order backlogs,
- On fiscal follies, history says **healthcare** and **telecoms** would be most exposed if Europe sees a big fiscal retrenchment next year,
- We think **industrials** are transforming to a "labour lite" sector, and thus stand to outperform in a cost-conscious world.
- Finally, we would "nibble" on **real estate**: "self-help" opportunities will emerge from calmer rates. We prefer residential exposure over office, however.

The sweetest cuts

The big change next year is that the ECB will likely be reducing interest rates. We expect meaningful cuts in this cycle, albeit not a return to the extreme negative rate policies of yesteryear.

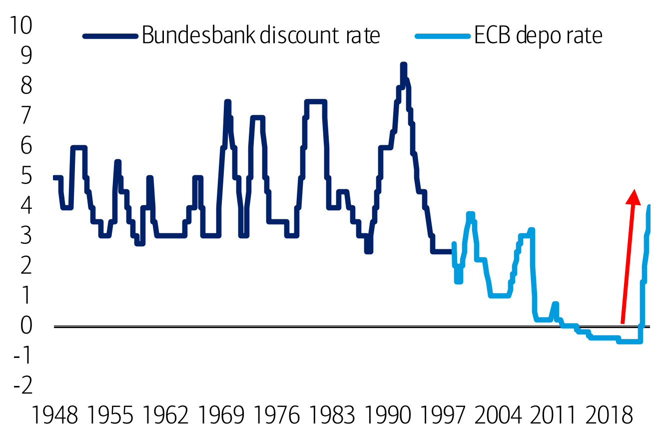
For a central bank that presided over an average interest rate of around 0% during the last decade, 4% deposit rates increasingly feels too high to us today. This has been the fastest, most intense, hiking cycle in the ECB's history (chart 3). Yet, Eurozone trend growth continues to hover around 1%, according to the European Commission.

Plenty of other signposts point to a need for the ECB to ease in '24:

- **Weak demand:** Euro Area growth has fizzled out. In fact, Q3 '23 Euro Area GDP contracted by 0.1% QoQ, while expanding by 1.2% in the US. Euro Area demand is struggling under the weight of 4% rates, which can also be seen in the conspicuously weak new export orders for German manufacturers (chart 4),
- **Weak credit creation:** In Europe, credit creation is now a shadow of its former self (chart 5), something that ECB president Lagarde has reflected on numerous times lately. But credit remains the lifeblood of a European economy where small firms have limited access to alternative sources of finance. Italian non-financial loan-flows are now sharply negative, after healthy growth last year (chart 6),
- **Disinflation signs growing:** Unlike the US (excess demand) and the UK (tight labour market), we see fewer drivers of sticky inflation across the Euro Area. Energy price base effects are now at work (chart 8) and Euro Area wage growth is well below the highs now (chart 7) – and importantly never reached the lofty levels seen in the UK or US.

Chart 3: 4% ECB rates now starting to feel too high

The fastest and most intense hiking cycle in Europe in almost 100yrs



Source: Bloomberg

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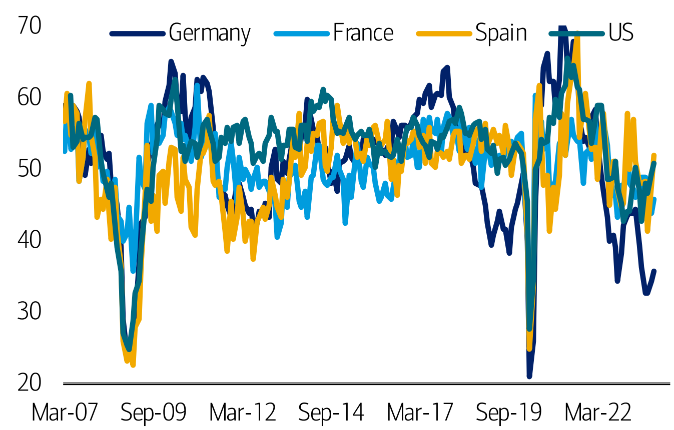
Chart 4: German manufacturing demand conspicuously weak

Weakest manufacturing new export orders, in Germany



Source: Bloomberg. Manufacturing PMI new export orders.

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We expect the ECB to remain vigilant into Spring next year, to ensure that the European wage bargaining season does not create upside risks to inflation. If the newsflow is benign, we expect the ECB to deliver the first cut in June '24, and quarterly thereafter.

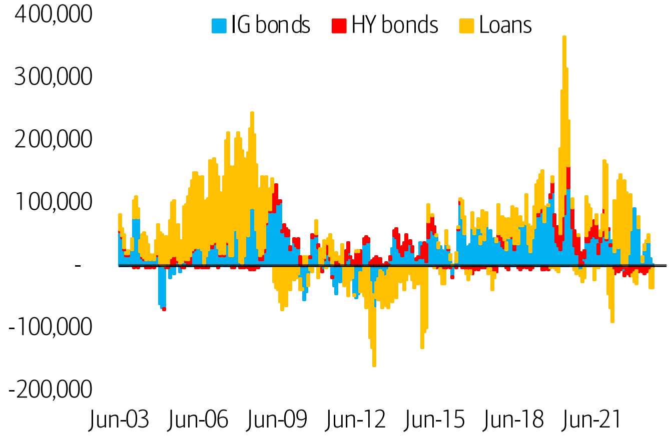
But unlike the US, we see a risk of the ECB undershooting its inflation target in this cycle, implying a rising probability of faster cuts to the deposit rate.

The return of TINA (There Is No Alternative)

We view rate cuts as a net positive for Euro credit markets next year, even though economic weaknesses are partly driving them. An environment of more rates certainty points to declining interest rate vol: an environment which has always been supportive of credit performance.

- Chart 9 shows that Euro interest rate volatility has declined in the aftermath of last hikes, when economic growth was subdued (such as 2000 and 2007/2008),

Chart 5: Credit creation has fizzled-out (net credit flows, 3m sums)
A problem for a European economy where credit is still the lifeblood of firms



Source: ICE, ECB. Net issuance of IG + HY bonds, plus flow of EA bank loans to non-fin corps. €mn.
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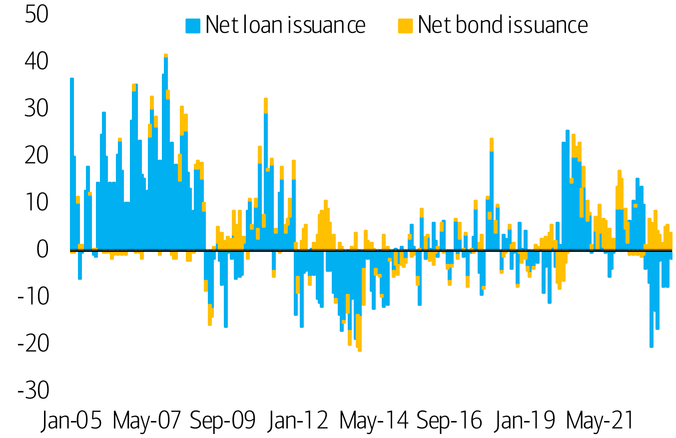
Chart 6: Italy: net loan and bond issuance
A clear trend today of Italian firms repaying loans



Source: ICE Data Indices, ECB. Monthly sums, Eur mn.
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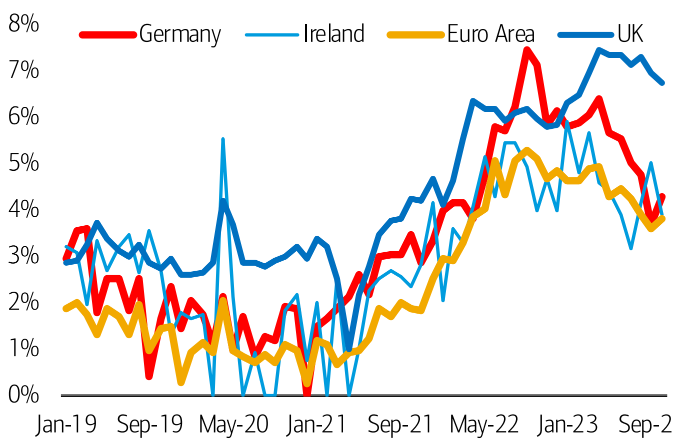
Chart 7: Wages: less sticky inflation in the Euro Area
Wage growth (online job postings) well down from the peak for Euro Area



Source: Indeed Wage Tracker, Central Bank of Ireland. YoY %.
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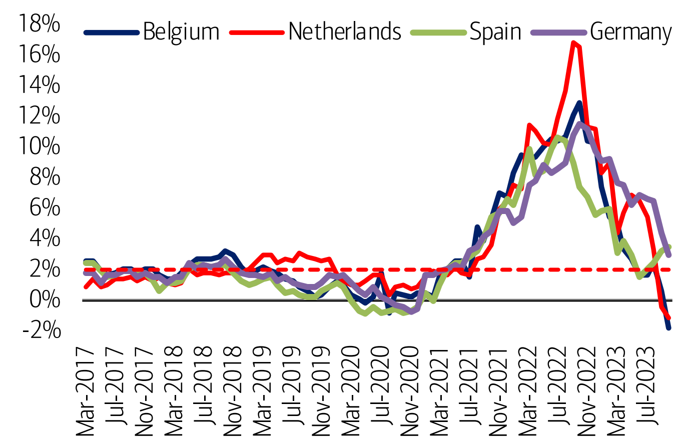
Chart 8: European (headline) inflation YoY (%)
More economies back in deflation, as energy base effects take hold



Source: Haver. HICP measures, YoY %. Dotted line shows 2% inflation goal.
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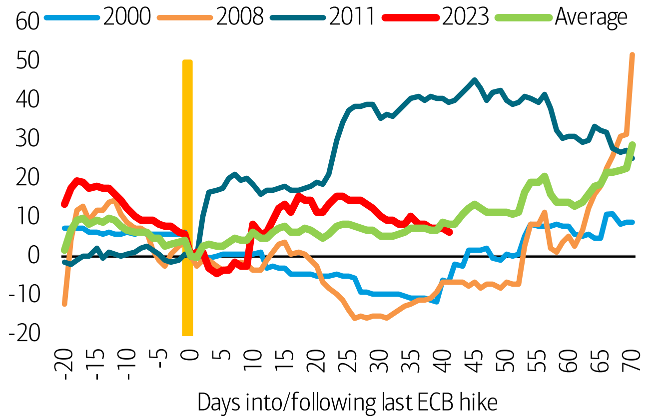
But away from the vol effect, **we expect cuts to drive spread tightening next year, as lower rates mean less "crowing out" of corporate bond demand**.

- Chart 10 shows why rate hikes over the last year have, ironically, resulted in less, not more, corporate bond demand, despite the tantalizing yields on offer.
- The significant inversion of the govvie curve in Europe has meant that short-dated government bills have been competitive investments compared to 7-10yr high quality credit, for instance.

And Chart 11 shows that European corporate bonds have frequently been bought for their relative appeal, vis-à-vis Euro govt debt, and less so for their outright appeal.

- Note that € credit inflows were 2.5x larger in 2019, compared to this year, despite a minimal yield environment back then.

Chart 9: Rates vol, and the aftermath of ECB pauses
Lower EUR rates vol post the final ECB hikes of 2000 and 2008



Source: Bloomberg. Y axis is change, over time, in vol from time t = 0. Using SMOVEU3M index.

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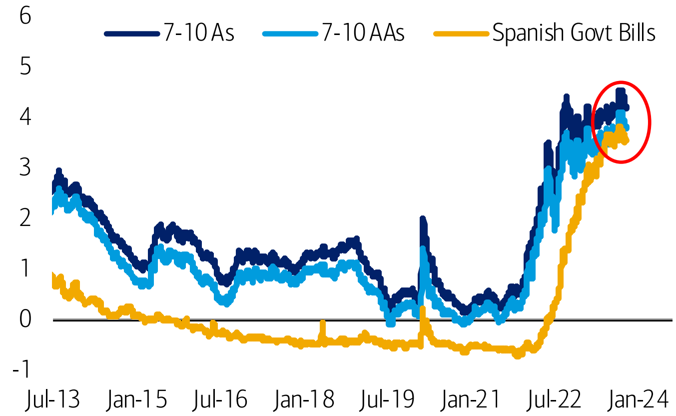
Chart 10: Corporate bonds crowded out in '23 by attractive govvies
Higher govvie yields were problematic for credit demand in 2023



Source: ICE Data Indices LLC. Yields %.

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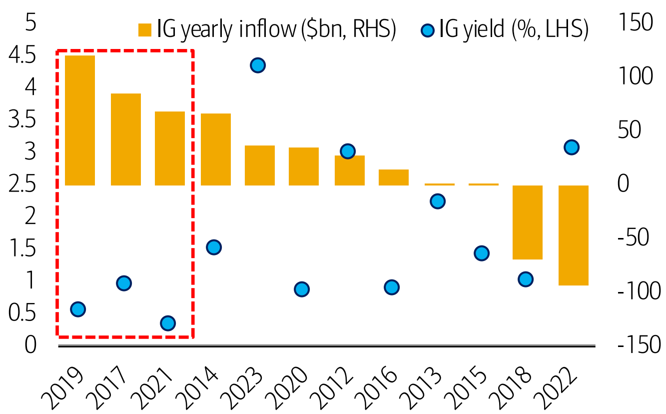
And there remains plenty of scope for traditional buyers of credit to step back into the corporate bond market in 2024, driving spreads tighter:

- Chart 12 shows the quarterly change in € non-financial corporate bond holdings, across different investors bases. The start of the rates shock in '22 saw significant selling of Euro-denominated corporate bonds by almost all investor bases.

- With the exception of households, we find few investors have returned meaningfully to credit buying over 1H '23 (pension & insurance, for instance).

That said, history says the return of long-term credit buyers takes time. Chart 13 shows that, historically, IG spreads have started to rally around 5-6m *after* the last ECB hike. This suggests volatility until the back end of Q1/start of Q2 next year.

Chart 11: TINA (There Is No Alternative) for European credit
Ironically, the best years for € credit demand have been when yield was scarce, not plentiful.



Source: EPFR Global. Yearly IG credit inflow vs yield (%).

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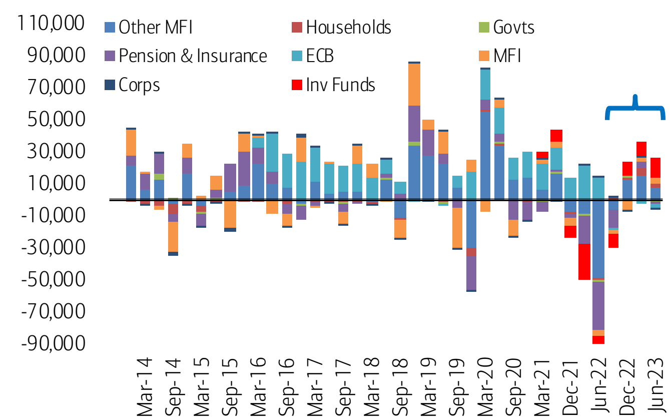
Chart 12: Sluggish new buying of corporate bonds in 1H '23 2023
Quarterly change in holdings of Euro non-financial credit



Source: ECB. Eur mn.

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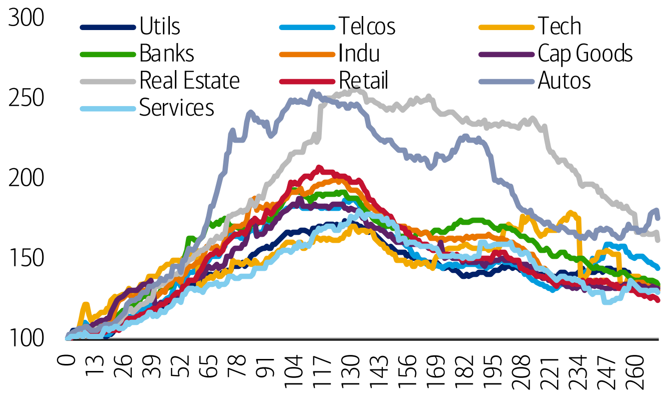
The big trades for the big cuts

We see 3 important trades on the back of ECB cuts in 2024:

1. **From crowding out, to crowding "back-in"**. With rate cuts, we see demand for some parts of the credit market reviving. Investors will find themselves crowded "back in" to corporate bonds. Chart 14 shows the % of debt across each IG sector with yields below today's ECB deposit rate. Hence, we expect demand for **capital goods**, **consumers** and **tech** bonds to benefit, if ECB rates settle far below 4%.

Chart 13: Rating performance after last ECB hikes (3 periods)
Be patient with real estate bonds, but they eventually rally back.



Source: ICE Data Indices. Avg performance of IG spreads, post last ECB hikes. Rebalanced to 100.
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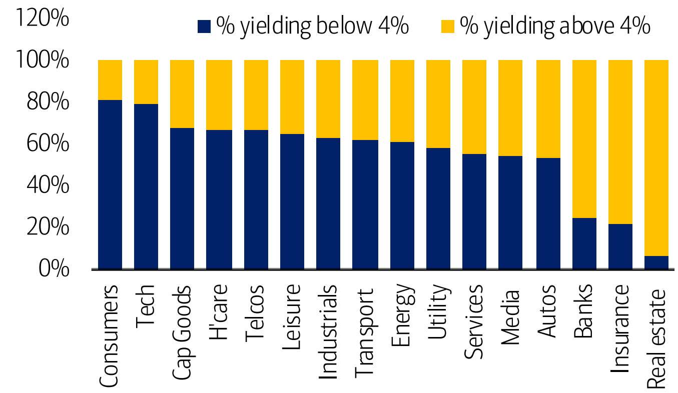
Chart 14: Where could ECB cuts help revive credit demand the most?
Cap goods, consumers and tech bonds could benefit the most from ECB cuts



Source: ICE Data Indices LLC. % of IG sectors yielding below 4% (ECB deposit rate).
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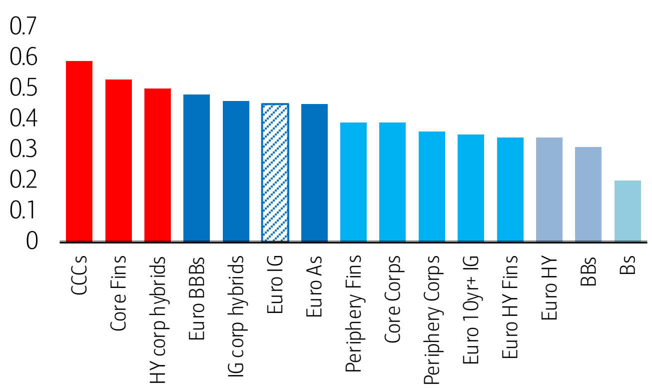
2. **<u>Who benefits from lower real rates?</u>** For the Euro Area, 10yr real yields now stand at +50bp – the highest since Nov 11. This has been a significant tightening of financial conditions, something that the ECB will look to ease, in 2024, we think. Chart 15 shows long-term correlations of credit spreads against 10yr real bund yields (i.e. the higher the correlation, the more helpful lower real yields will be to performance). Hence, lower real yields should be good news for **corporate hybrids**, **BBBs** and **financials**.

3. **<u>Self-help, and the benefits for real estate</u>**. As a rates sensitive area, ECB easing should improve sentiment towards **real estate**. We still prefer exposure to residential real estate, over office and retail sectors, however, given the structural and operational strengths of the former. But ECB cuts should buy time for more of the sector to engage in balance sheet repair, improving overall sentiment. Note in chart 16, while real estate is 5% of the overall IG credit market size, it represents almost 10% of the IG market's spread.

Chart 15: Credit spread correlations with 10yr real bund yields
Fins, corporate hybrids and BBBs could benefit most from lower real yields



Source: ICE Data Indices. Correlation of levels since 2015-Feb '23. Using real 10yr bund yields.
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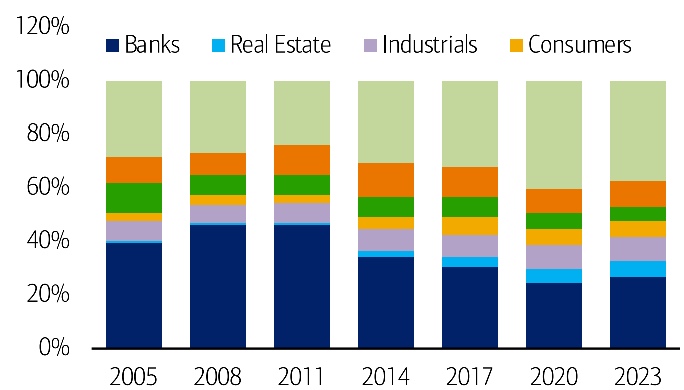
Chart 16: Banks and real estate now 33% of the € IG market size...
...but real estate is 10% of the Euro IG market's spread



Source: ICE Data Indices LLC. ER00 index. Contribution to Euro IG market size.
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Surfing the "credit lite" economy

ECB hikes have been quickly passed on to the Euro Area economy: YoY household loan growth, for instance, now sits at the lowest level since early 2015. But credit has been a staple for the Euro Area economy for much of the last decade.

Chart 17 highlights where European firms' sales have tended to be more, or less, sensitive to changes in credit availability.

Here, we correlate industry sales volumes (1yr forward), to YoY growth in bank loans to households.

We find that:

- Sales volumes for **healthcare** firms**,** for instance, have tended to be more sensitive to the credit environment. Sales volumes for **energy** firms, have been less sensitive.

We think this is worth keeping in mind as the ECB try to stimulate credit growth again, via rate cuts.

Big is beautiful

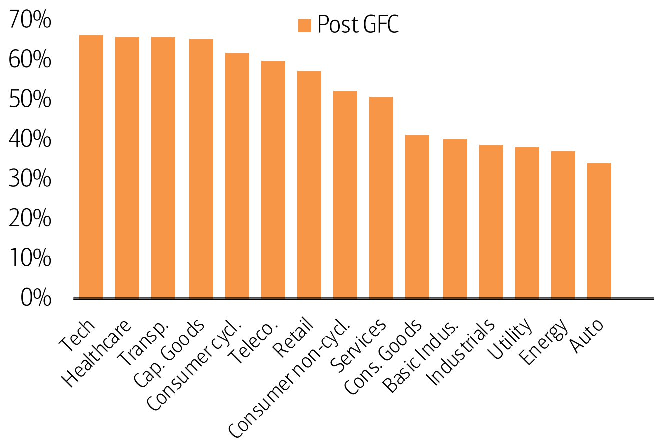
By the same token, credit conditions are also tight for a Eurozone economy where non-financials remain reliant on bank loans for financing.

- Today, the picture is one of corporate loan rates rising faster for smaller firms and SMEs, as opposed to larger non-financials.

For now, we prefer longs in large, publicly listed names, where issuers are more likely to have access to a broader set of financing options.

Chart 17: Sales for healthcare firms, for instance, have tended to be more sensitive to the Euro Area credit environment

Correlation of industry sales (1y ahead) vs YoY growth in Euro Area bank lending to households



Source: Haver, Bloomberg. We correlate industry sales volumes (1yr forward), to YoY growth in bank loans to households. Post GFC correlation.

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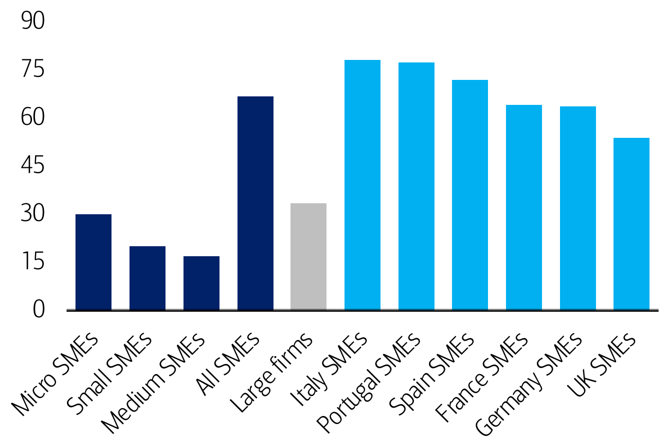
Chart 18: % of total non-financial business employment for SMEs across the EU

Italian SMEs account for >75% of all non-financial employment



Source: EC SME Survey '21-'22. Large Corps are those with 250+ employees.

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Growing pains

Economies have had to endure many shocks over the last few years, ranging from national lockdowns, wars, rising rates, bank failures, energy shocks, food shocks, political uncertainty and geopolitics. As such, global growth is forecast to come in at just 2.9% next year, according to the IMF, the lowest since 2019 (excluding Covid). Advanced Economy growth is forecast to be just 1.4%.

More the just the sluggish GDP outlook though, it's the disparate nature of growth across economies that we think is equally important.

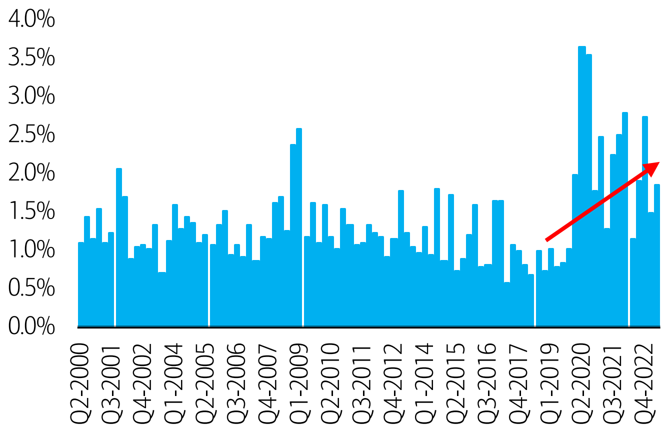
- Chart 19 shows the standard deviation in growth rates across advanced economies, over time. 2017 and 2018 generally saw a period of harmonious growth. Growth rates across regions then began to disperse more as trade tensions surfaced, and Covid struck.
- But even in the post-Covid era, the last 18m has seen rising growth divergence across the world, as economies prove more, or less, resilient to the rapid rise in rates.

Perhaps nowhere is the growth divergence more conspicuous at the moment, than between the US and Europe.

- Chart 20 shows the almost record gap between US and European manufacturing PMIs, at present.

Charts 21 reflects the problem of too-restrictive rates now in the Eurozone. Growth has fizzled-out for major Euro Area economies, while it has continued to forge ahead for the US (and Japan). Even economies such as Italy – beneficiaries of significant EU recovery funds – have seen growth rates wilt, of late.

Chart 19: Diverse growth rates across the world
Standard deviation of global growth rates across advanced economies



Source: Haver, Bloomberg.
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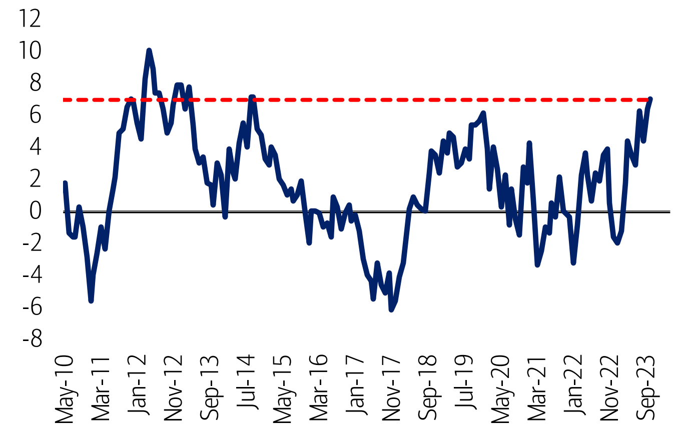
Chart 20: Global divergences glaring: US vs EZ manufacturing PMIs
US manufacturing PMI still at 50, and 7pts higher than for the Euro Area



Source: Haver, Bloomberg. S&P Global Manufacturing PMIs. US PMI minus EZ PMI.
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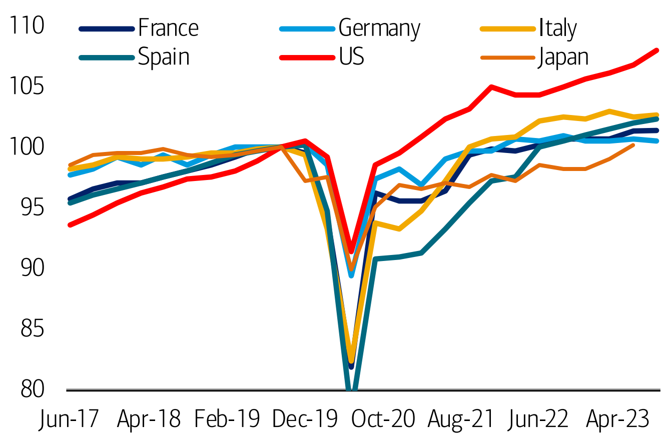
And while all manufacturing firms were able to run down their order backlogs once Covid stress started to fade, note that order backlogs have continued to fall for many European manufacturers, yet have started to rise recently for US manufacturers.

Chart 21: European growth fizzling out vs US (and Japan)
Cumulative GDP, rebalanced to 100 pre-Covid



Source: Haver, Bloomberg.
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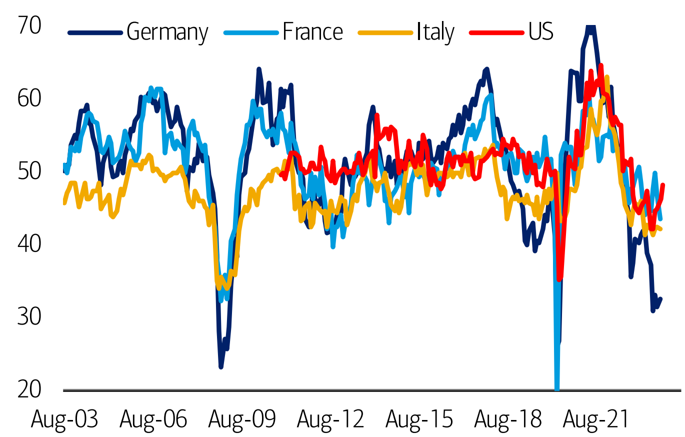
Chart 22: Order backlogs: down for Europe, rising for the US
PMI manufacturing order backlogs



Source: Bloomberg.
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The wall of worry

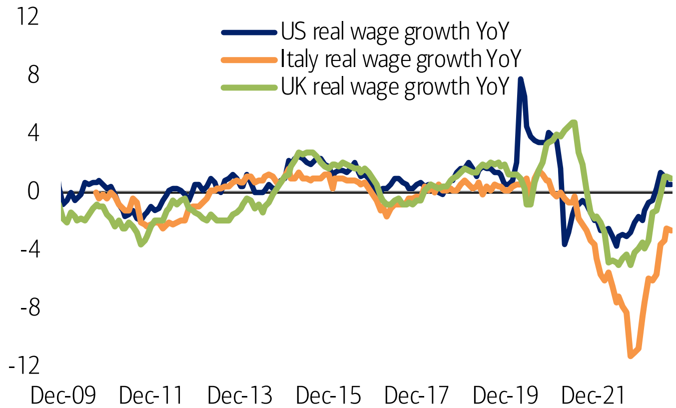
In 2024, BofA economists expect Eurozone growth of just 0.5%, but stronger US growth of 1.1%. Hence GDP will clearly be more recessionary-like, for the Euro Area.

Yet, as we have been flagging for some time, credit markets respond to rates of change in the macro momentum.

In this sense, **we are more concerned about US growth developments next year** given how meaningfully it is due to step down, in addition to a fading fiscal impulse.

- And US growth perceptions matter a lot for European credit. Chart 24 shows that European HY spreads have the greatest sensitivity over time to US growth.

Chart 23: Real wage growth
Likely supporting the US consumer, but not yet the Euro Area consumer



Source: Haver, Bloomberg. Nominal wage growth minus CPI YoY (%).
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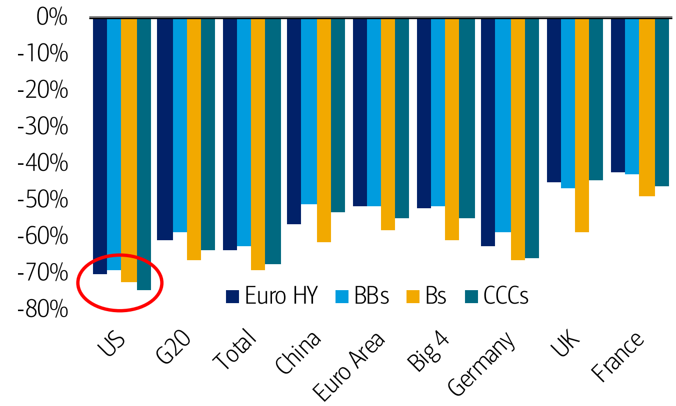
Chart 24: Born in the USA: Euro credit market's sensitivity to growth
US growth very relevant for Euro HY spreads, French growth less relevant



Source: OECD, ICE Indices. Monthly correlation of levels. -ve correl = stronger data, tighter spreads
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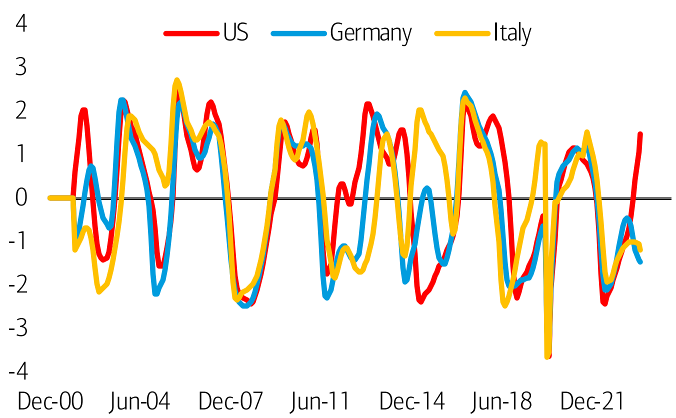
Chart 25 highlights this. We show 2yr Z-scores of OECD Lead Economic Indicators.

- US LEIs are currently at +1.5 standard deviations, not far from peak macro momentum seen historically (+2 SD). In other words, US macro momentum looks more vulnerable to a decline next year.

- Conversely, LEIs are at -1.5 SDs for Germany, and -1.1 SDs for Italy, with both having declined recently. Rarely are reading below -2 SD. i.e. it looks tougher to see another leg lower in Eurozone macro momentum in 2024.

Chart 25: Macro momentum more likely to fade in the US
2yr Z-scores of OECD Lead Economic Indicators



Source: Bloomberg, OECD.
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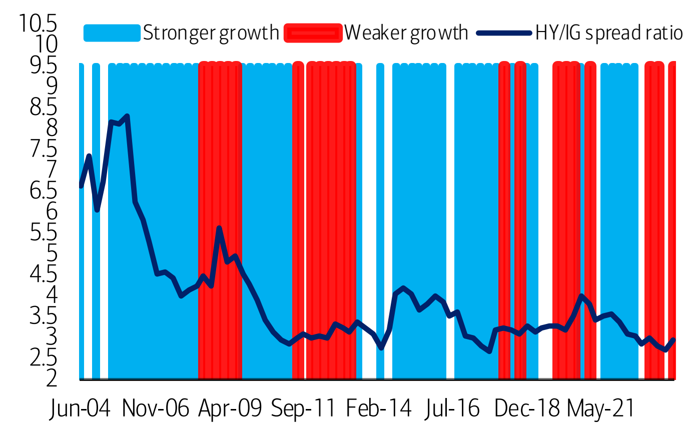
Chart 26: HY/IG spread ratios were well below 3x pre the sell-off…
…but history says HY tends to underperform IG, when EA growth fades



Source: ICE Data. QoQ Eurozone growth. "Strong" defined as QoQ growth of +0.4%, or higher. "Weak" defined as QoQ growth of +0.1% or less. Showing HY/IG spread ratios.
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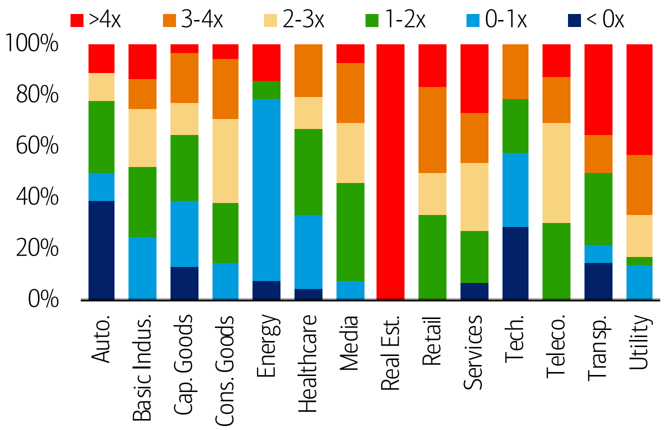
The growth playbook

What are the rules and tools for a world of fragile growth in 2024? We think the following themes are pertinent:

- Sluggish growth favours IG > HY, relatively. Note that Euro Area growth of +0.1% QoQ, or less, has often seen HY/IG spread ratios decompress,

- Should US growth momentum wane in 2024, this would likely be felt more in € Bs and CCCs,
- Away from real estate and utilities, keep an eye on sectors with hidden leverage: IG transport and services have a preponderance of highly levered firms (chart 27).
- We remain cautious on services-orientated credits, that still look tight vs Euro Area recession pricing (chart 28).

Chart 27: Real estate, utilities are home to the most levered IG credits
Distribution of leverage across sectors as of Q3-22, Euro IG



Source: BofA Global Research, ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituents of the ER00 index..

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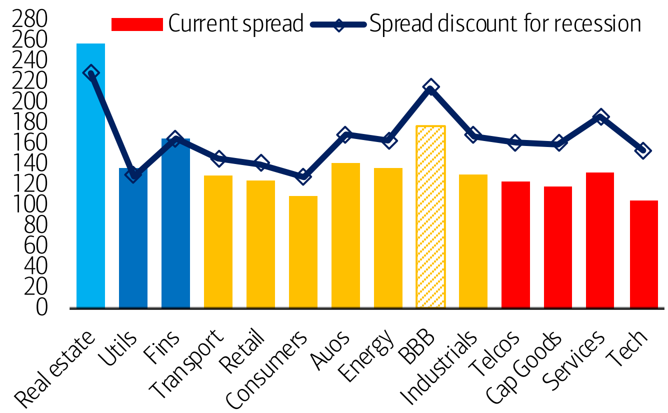
Chart 28: What price recession?
Current IG spreads vs historical spreads corresponding to recessionary times



Source: ICE Data Indices LLC. OECD.

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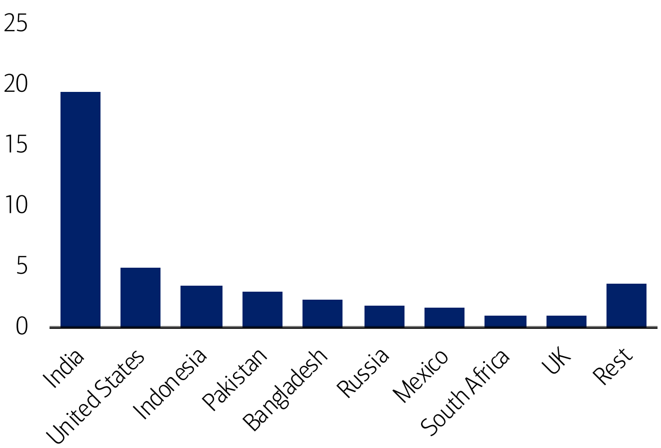
The "big government" trade

"Debt" and "deficits" will likely be buzzwords in 2024, we feel. Next year will be intense of the election front, with 40%+ of the world's population heading to the polls. India, US, Indonesia and Pakistan will have the largest contingent of voters. Yet, inflation-weary consumers will likely be in no mood to hear about fiscal belt tightening. Hence, governments should remain on the fiscally loose side (witness growing UK newsflow over pre-election tax cuts).

Chart 29: Elections galore in 2024 (% world population represented)
40%+ of the world's population will vote in 2024



Source: Bloomberg. UN Population Database. % of world population.

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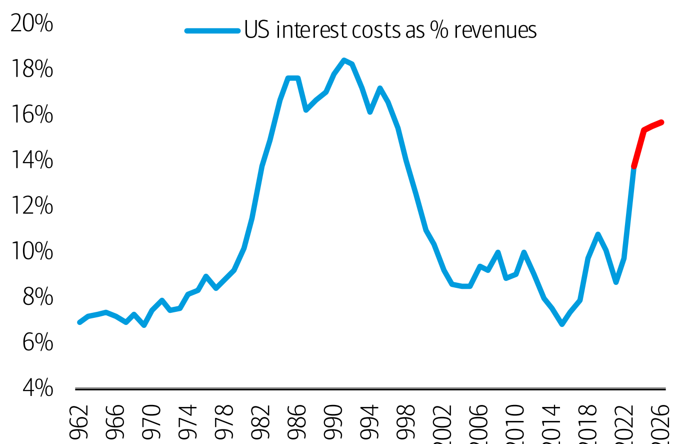
Chart 30: US fiscal fears
Rising US debt interest costs (as % revenues)



Source: Federal reserve. CBO projections.

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Of course, this will do little to placate worries over fiscal sustainability. Especially so for the US, where rates shocks in 2023 have been a reminder of its precarious fiscal position (chart 30). US rates shocks could, therefore, still pop up in '23, despite Fed cuts.

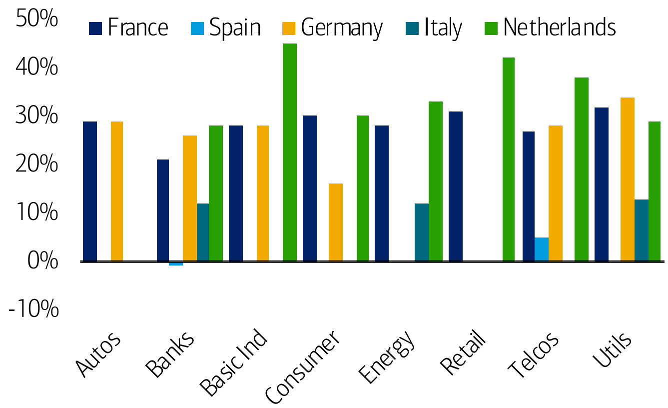
Fiscal folly or fiscal freeze?

The moment of truth is also arriving for the Euro Area, but from the other side. EU governments are in the process of debating core elements of new fiscal rules (recall that fiscal rules were suspended post-Covid).

As our economists flag, a compromise – one that allows fiscal policy to move in the right direction, but for individual investment needs to still be met – has not yet been reached. **That creates risk of an unwelcome tightening in European fiscal policy next year**.

More likely, though, is that a failure to agree on new rules by end '23, is met with some kind of "standstill" situation, that avoids a sizeable fiscal shock in 2024, but still sees some marginal tightening of fiscal policy.

Chart 31: Correlation of yearly spread changes to yearly Eurozone budget balance changes
Spanish credit react the least favourably to Spanish fiscal loosening, we find



Source: OECD, ICE Data Indices LLC.

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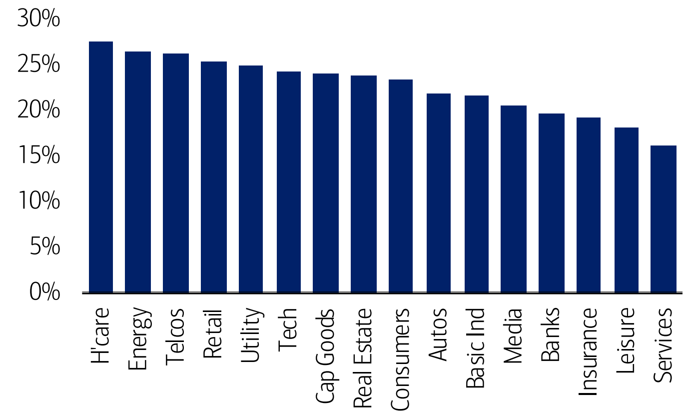
Chart 32: Correlation of yearly spread changes to yearly Eurozone budget balance changes
Higher budget deficits, tighter credit spreads, and vice-versa



Source: OECD, ICE Data Indices LLC.

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What does history say about fiscal tightening and its impact on credit markets? The charts above show the correlation of yearly spread changes, to changes in government budget balances, over time (a +ve correlation shows fiscal *tightening* goes hand in hand with *wider* credit spreads, and vice-versa).

- By sector, we find that it's **higher-rated sectors** (like healthcare) that tend to widen when Europe is being fiscally more restrictive (and vice-versa).
- And by country, we find **French** credits are likely to see a more negative impact from any fiscal tightening in France. Conversely, Spanish credits have been more immune to fiscal tightening from the Spanish government in the past.

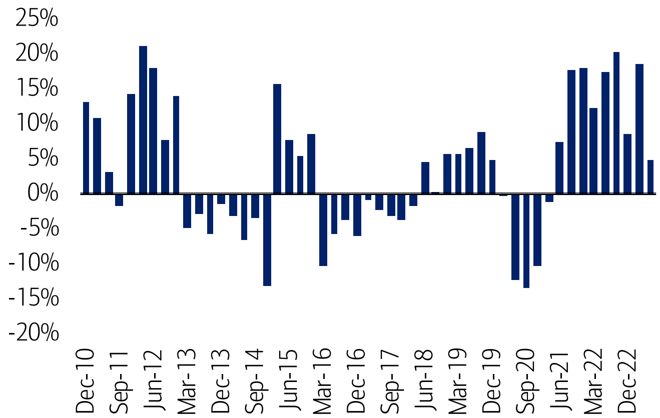
How to spend it

For firms, the pressure to spend over the medium term remains stark: net zero transition, secular growth opportunities, supply chain resiliency and Artificial Intelligence.

The silver lining could be that **lower yields – especially at the longer-end of the curve – are precisely what firms need to prevent capex spend from being curtailed**.

- We think this means firms' capex trends should remain vibrant for another year, as they have since Q3 '21,
- Chart 34 shows the share of issuers, in each sector, spending more on capex today than vs. pre-Covid times. Note that 88% of IG utility issuers are now spending more on capex vs pre-pandemic times. 83% of industrials are too.

Chart 33: Consistent increase in Capex the past couple of years
YoY changes, on a quarterly basis, for average IG issuer capex



Source: BofA Global Research. ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituents of the ER00 index.

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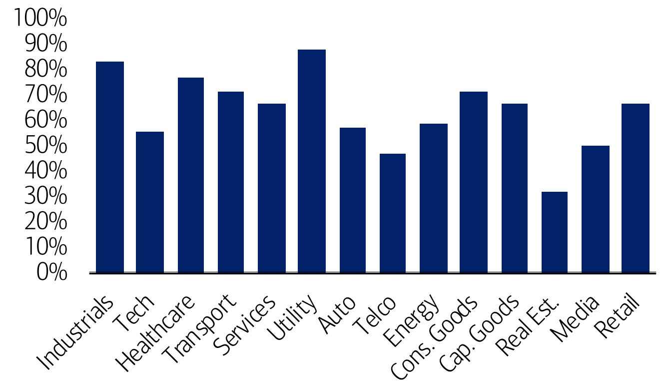
Chart 34: Which sectors have seen a larger share of their issuers investing more than pre-Covid?
Share of companies with June-23 capex > pre-pandemic capex (June-19)



Source: BofA Global Research. ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituents of the ER00 index.

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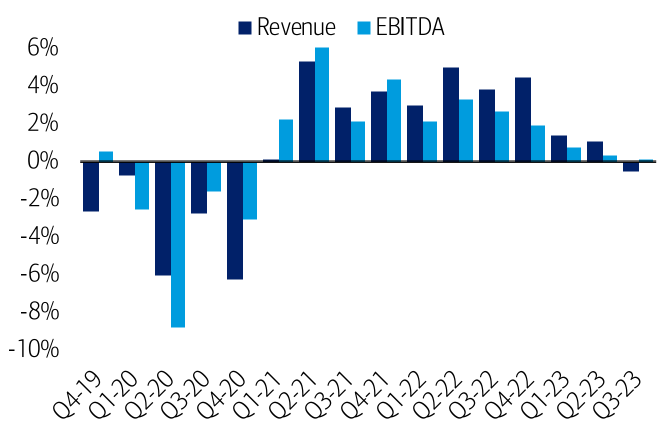
We think the capex "winners" in 2024, are also firms that are likely to offer investors more **sustainable, high-quality, top line growth**…something much needed in today's world of mounting cost pressures.

The future of people

2023 is ending with the first signs of an earnings recession in Europe, after 9 consecutive quarters of top-line growth. What stands out is that unlike the US, European firms' EBITDA margins continue to take a leg lower.

- Some of this reflects a greater fall in output prices, compared to input prices, as reflected in manufacturing PMI surveys, for instance. This should be seen as yet another sign that disinflation trends across Europe are growing.
- However, some of it reflects still-high labour costs, compared to the pre-2020s average. And labour costs are not just wages and salaries, "other" costs (such as search or training costs) are still rising notably too.

Chart 35: Euro IG fundamentals: quarterly change in revenue and EBITDA
Revenue growth was finally negative over the past quarter. EBITDA QoQ growth has fallen to almost zero now



Source: BofA Global Research, ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituents of the ER00 index.

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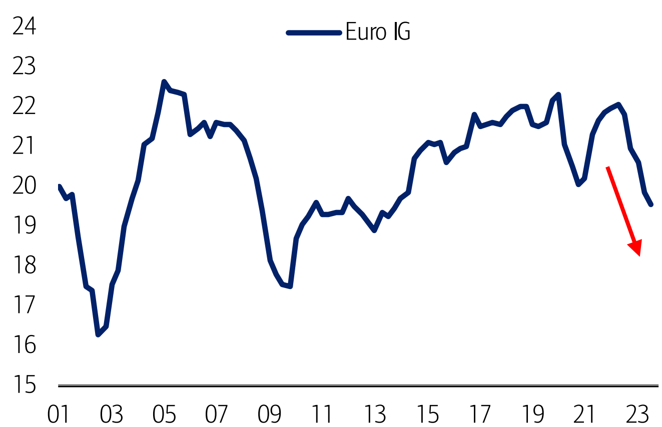
Chart 36: Euro IG fundamentals: EBITDA margins

Margins decline again in Q3 '23, and are now back to 2014 levels



Source: BofA Global Research, ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituents of the ER00 index.

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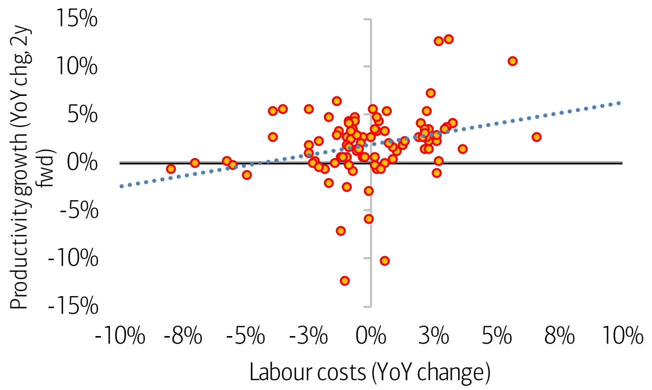
Similar to the findings of our US equity strategy colleagues, chart 37 suggests that **productivity gains could follow a period of wage inflation** in Europe. And signs are emerging that better worker productivity is already in the making, perhaps as a function of a post-lockdown world.

- Chart 38 shows trends in revenue-per-worker for Euro IG non-financials. While worker productivity growth remained roughly stagnant in the pre-Covid decade, we see that 2022 has brought a notable jump in revenue-per-worker.

Chart 37: Rising labour costs could usher-in better worker productivity

Higher YoY labour cost growth has tended to suggest lagged productivity gains, in Europe.



Source: BofA Global Research. European commission. Haver.

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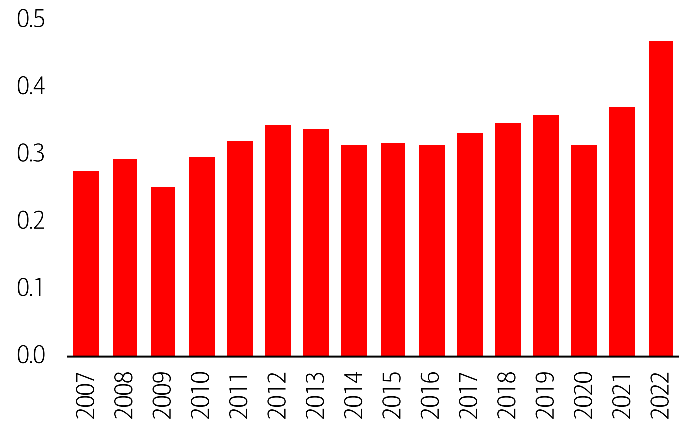
Chart 38: Revenue-per-worker

Some signs of productivity gains emerging over the last year



Source: BofA Global Research, ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituents of the ER00 index.

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Looking forward, Artificial Intelligence (AI) has the potential to transform firms' labour productivity much more, although history says revolutionary technology has often taken longer than expected to show though in productivity gains (just as was the case with the adoption of the personal computer, for instance[1]).

While it's still early days, we would expect the adoption and growth of artificial intelligence to have some of the following impact on credit spreads, and the structure of the credit market:

1. **Greater credit market spread dispersion**. Adopting AI is unlikely to be just a case of "plug and play" for companies. Firms will need to have a much more digital-centric business model, to reap the full benefits. Staff will need significant training to "co-exist" with AI and integrate with it harmoniously. Corporates may simply balk at the upfront investment required. And AI "new entrants" in a sector may start to hinder the profits of incumbent firms. All in all, we think this points to greater dispersion in revenues, profits and credit metrics for firms in each sector, and across the market.

The good news for credit investors is that this AI adoption phase points to a rich environment for alpha opportunities.

2. **Spread compression**. McKinsey estimates that the economic potential of Generative AI could be between $6tr-$8tr [2]. Transformative economic growth is likely to be good news, generally, for more levered firms in credit. This suggests spread compression will play out across corporate bonds, over the longer-term.

[1] See "Have Computers Made Us more Productive? A Puzzle" 1998, Adam M Zaretsky, Federal Reserve Bank of St. Louis.

[2] See the economic potential of generative AI, June 2023, McKinsey and Company.

Chart 39 shows spread ratios of common credit “pairs”, since 2010. While there has been much compression already, we would argue that high-yield spreads still have room to compress versus IG, and corporate hybrids room to compress against their seniors.

3. **Labour “lite” wins**. AI does not mean the end of the human worker. As McKinsey highlight, it is *activities* rather than *jobs* that are being automated. Moreover, productivity gains will invariably come from augmenting labour with AI. That said, some processes will likely become automated, removing the labour input completely (autonomous agents). Hence, we expect the labour intensity of European non-financials to fall further over the longer-term, a trend already underway after the strong wage growth seen in 2022.

Across European credit, we find industrials are making progress in reducing their labour intensity, and enhancing worker productivity (chart 40).

Note that cumulative total returns for industrial bonds (less labour intensive) have outperformed those for transport bonds (more labour intense), since the post-Covid era.

4. **Less crowding out for credit**. For countries with ageing populations, AI could help alleviate the impact [3]. The decline in working age populations have been particularly acute for some European economies, since 2010, given low birth rates (chart 41). In the absence of large inwards migration – something that feels politically more difficult for governments to achieve at the moment – AI could help buttress economies’ labour forces, by increasing skills and innovation. Potentially lower sovereign risk should filter through into tighter credit spreads for firms in those respective countries.

In the case of the periphery, for instance, if AI adoption reduces concerns over growth stagnation, and debt sustainability, then we would expect to see tighter peripheral credit spreads.

5. **“Plunging” bonds**. As a disruptive technology, AI has the potential to exacerbate the perception of “weak links” in a sector, sooner. For some names, this may heighten concerns over unsustainable business models and balance sheet leverage, resulting in bond prices gapping lower (perhaps, later on though, leading to more consolidation/M&A in a sector).

6. **Unease among voters and policy uncertainty**. Powerful new technologies can create unease among voters. AI implementation failures could mean significant media headlines. Moreover, income inequality may rise, as high-skilled workers uniquely partner with AI, while low skilled workers find themselves displaced. All of this points to the potential for heighted political uncertainty, one that at times in the past has been a less favourable one for overall credit performance (think 2018/2019 trade tensions).

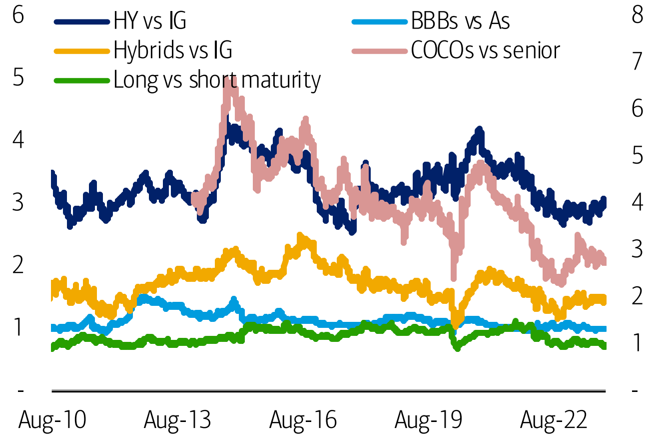
7. **Supply**. The obvious: new technologies are expensive, and will require material spend/capex by firms. AI could mean structurally higher levels of corporate bond supply over the longer-term, and possibly weaker technicals in places.

8. **Credit market liquidity**. We think AI should be a tailwind for credit market liquidity. A faster, more sophisticated, mechanism for pricing the vast number of corporate bonds across the globe, could highlight and reduce pricing discrepancies across bond issuer curves. In addition, better infrastructure should make bond portfolio trades more popular over time, improving the underlying liquidity across the credit market too.

[3] See GenAI will raise economic productivity but bring social risk, policy dilemmas, Moody’s, Sep ‘23

Chart 39: The growth of artificial intelligence suggests more spread compression in credit over the long-term

HY still has more room to squeeze to IG, over the long-term, and hybrids vs seniors (spread ratios).



Source: ICE Data Indices LLC. Spread pairs. Showing ratios of spreads. CoCos vs seniors (RHS).

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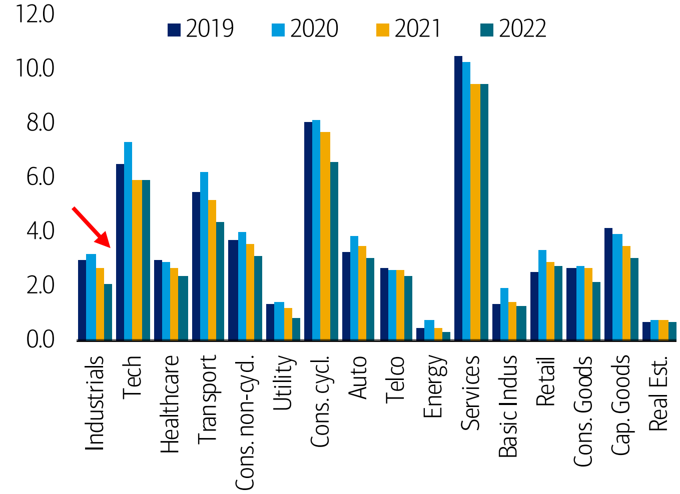
Chart 40: Current labour intensity: Euro IG, by sector

Number of employees per Eur 1mn sales



Source: BofA Global Research, ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituents of the ER00 index

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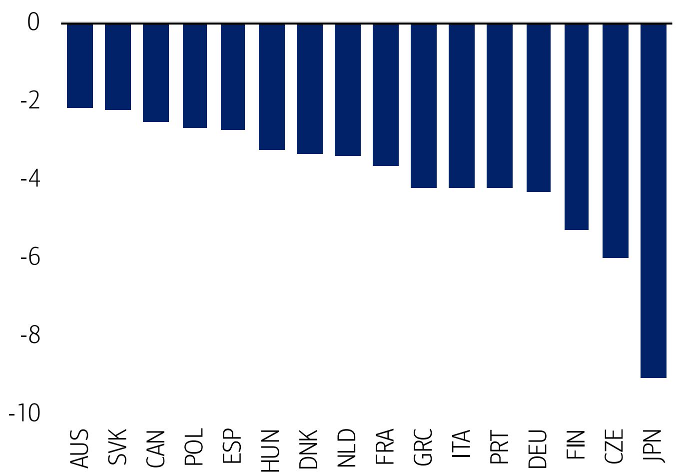
Chart 41: Artificial intelligence could help ease the burden of declining working age populations, lowering sovereign risk

Change in working age populations, 2010-2022



Source: OECD. Decline in working age population 2010-2022. %.

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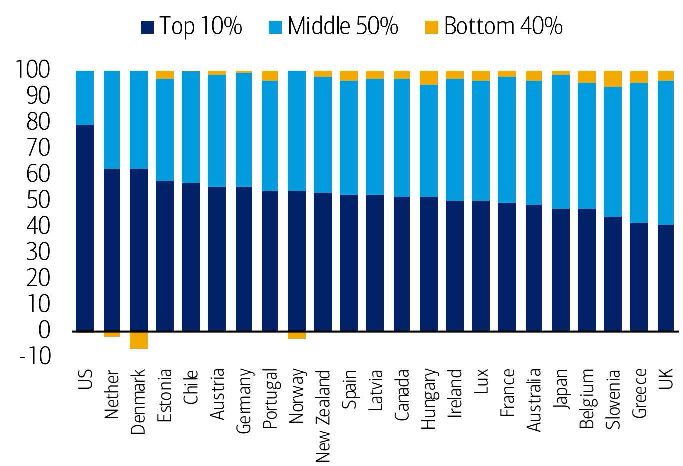
Chart 42: Artificial intelligence may exacerbate income and wealth inequalities, however. More policy uncertainty for credit markets

Share of total net wealth



Source: OECD Wealth Distribution Database. Latest available data.

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Only time will tell…

While rate cuts will be a welcome sight for the € credit market next year, the era of negative ECB rates will likely not be seen again. Voters and governments turned their anger on central banks last year, pointing the finger at years of exceptional monetary policy as a catalyst for eye-watering inflation.

- In this cycle, our economists' base case is that ECB rates are lowered back to 2% by Sep '25.

This should provide relief to IG issuers, given that around 10-15% of the IG market is set to mature each year until 2026.

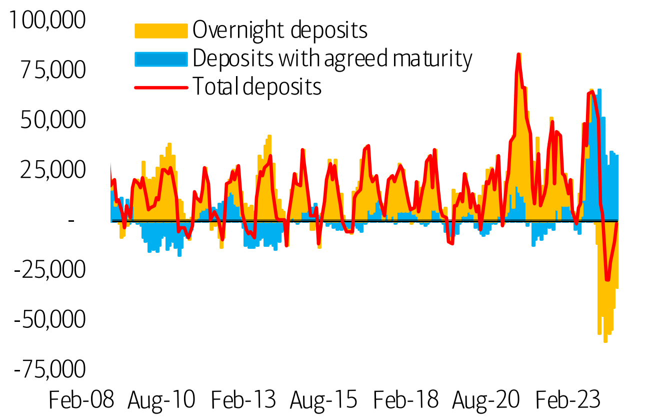
Given much of the Euro market was issued between 2018-2021, it won't prevent issuers' coupons from rising.

Even still, we worry less about investment-grade issuer debt costs, given the often-overlooked asset side of their balance sheet.

- Euro non-financials have been busy funnelling their big cash piles into higher-interest bank accounts, as chart 43 shows. And banks continue to increase corporate deposit rates each month, lately, we find. This means high-grade firms are not just seeing rising interest expense...they are seeing rising interest income too.

Chart 43: Germany: corporate deposit flows (6m sum)

Corporate starting to shuffle money from overnight deposits, into term deposits, attracted by higher rates of return



Source: ECB. 6m sum of monthly flows. Note total deposit flows also includes deposits redeemable at notice. Eur mn.

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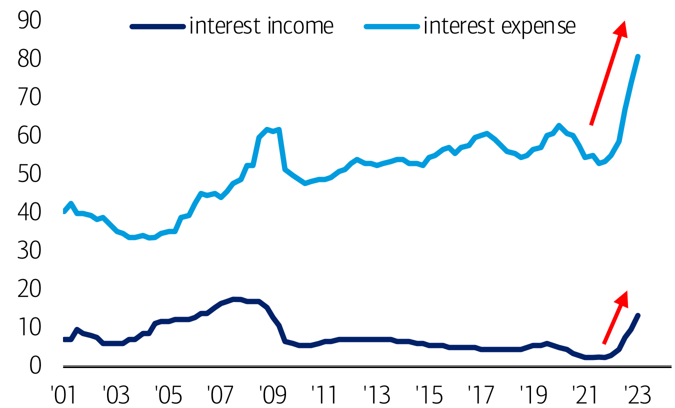
Chart 44: IG interest expense has increased notably over the past 18m, but interest income is also increasing substantially

Median interest income and median interest expense across a large pool of Euro IG issuers (in €mn, 4-quarter rolling average). Eur mn



Source: BofA Global Research. ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituents of the ER00 index.

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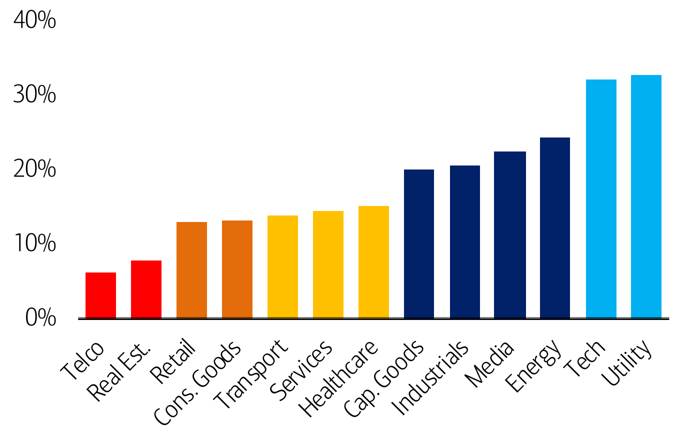
The upshot is that – when taking both into account – the deterioration in firms net interest coverage metrics has not been as dramatic thus far.

- Chart 45 shows IG firms with the highest ratios of cash/debt. Note **industrials** have cash covering almost 25% of total debt at present.

In addition, these are the sectors that may see greater bond tender activity in '24.

Chart 45: Who has the cash?

Cash/Debt by sector, Euro IG



Source: BofA Global Research, ICE Data Indices LLC, Bloomberg. Large sample of listed European non-financial corporate constituent of the ER00 index. Median ratio across each sector.

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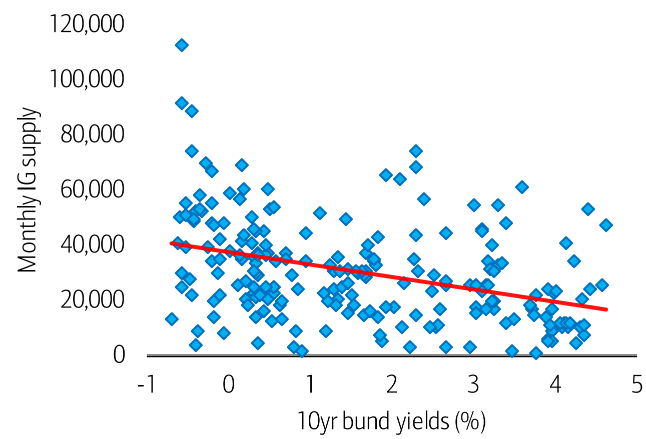
Chart 46: Monthly IG issuance vs 10yr bund yields (2003-today)

Debt is used more abundantly by issuers when it is cost effective, and vice-versa



Source: ICE Data Indices LLC.

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2024 net IG supply: the disappearing act

Next year, we forecast net IG supply to be negative to the tune of around €25bn. We expect this to be the first year since 2013 where Euro IG net supply proves to be meaningfully negative.

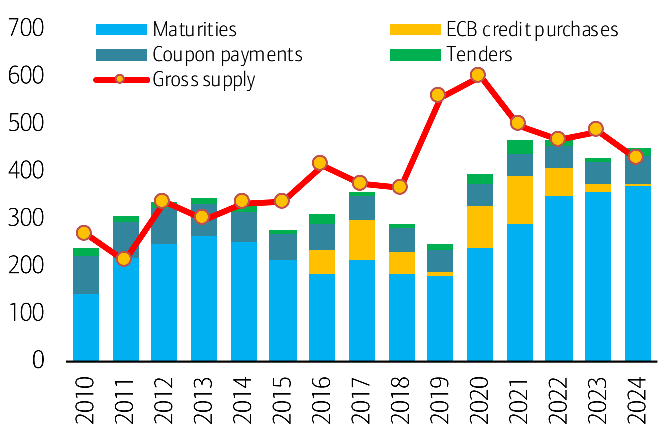
Doubtless to say that such a backdrop will be a helpful technical for 2024, although with our expectations of rate cuts next year, we may see less supply in 1H, and more lumpy – and crowded – issuance from '2H onwards.

What are the building blocks that get us to this forecast?

- **Our starting point, though, is that we get 10-15% less gross IG supply next year**. The simple rule of thumb is that when yields are low, debt is efficacious, and thus issuers use relatively more of it. Yet, when yields are high, debt will not be used as freely. True, rates will be cut in 2024, but it is unlikely that IG corporate bond yields will ever return to just 12bp again (the 2021 lows).
- Chart 46 highlights this simple relationship over time, for IG markets. Looking back over the last 20yrs, months of high corporate bond supply have tended to be when bund yields were low, and vice versa.
- This year, bank supply was conspicuously large as issuers pre-funded TLTRO maturities, expected loan growth, and MREL ratio build. As our banks team highlight, most of the TLTRO will be out of the way by the end of next March - but the discussion on Mandatory Reserve changes could still add an element of uncertainty over senior preferred supply.
- Maturing IG debt creeps up next year to around €370bn.
- We assume IG bond tenders are likely a bit higher next year, at €15-€20bn, as issuers focus on liability management to reduce debt costs further along their curves (and make future new issuance potentially cheaper).
- Finally, coupon payments jump materially in 2024. We estimate over €60bn of coupon payments next year.

Chart 47: Net supply breakdown: Euro IG (€ bn)

Gross supply will decline 10-15% next year, we forecast, given debt is simply more expensive now



Source: BofA Global Research, ECB, ICE Data Indices LLC, Bloomberg. 2023 full year estimates for gross supply. Eur bn.

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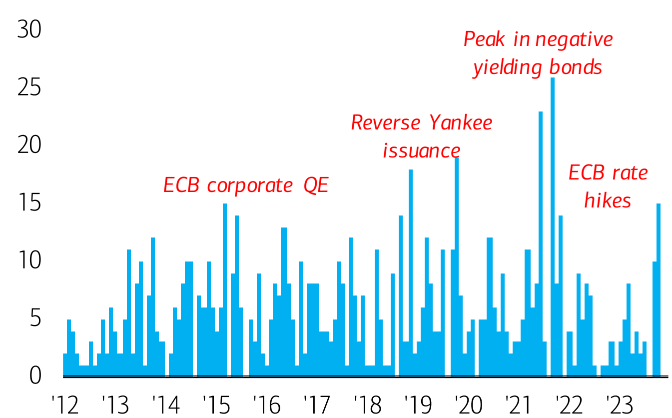
Chart 48: Notable pick-up of the number of bonds from debut issuers recently

Monthly sum of Euro IG bonds issued from debut funders



Source: ICE Data Indices, LLC. Count of bonds that are issued per month from issuers that have never issued an IG bond before and not captured in the ER00 index. We extrapolate the Oct'23 figure based on MTD data.

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Given the tightness in bank lending standards at present, and the stickiness in loan yields, we would expect a reasonable volume of debut issuers still in 2024 (chart 48).

Table 1: Net supply breakdown: Euro IG (€ bn)
Gross supply will decrease in 2024, coupons will jump, debt tenders accelerate.

	Gross supply	Redemptions	Maturities	ECB credit purchases	Coupon payments	Tenders	Net supply
2010	**267.1**	**237.1**	*141.1*	*0.0*	*81.8*	*14.3*	**30.0**
2011	**211.7**	**304.5**	*217.0*	*0.0*	*76.9*	*10.7*	**-92.9**
2012	**334.1**	**335.1**	*248.3*	*0.0*	*74.2*	*12.6*	**-1.0**
2013	**300.0**	**343.7**	*264.7*	*0.0*	*67.6*	*11.4*	**-43.7**
2014	**332.9**	**327.2**	*252.3*	*0.0*	*60.9*	*14.0*	**5.7**
2015	**335.1**	**278.6**	*212.3*	*0.0*	*55.6*	*10.7*	**56.5**
2016	**414.1**	**309.7**	*182.6*	*51.3*	*54.5*	*21.3*	**104.4**
2017	**373.4**	**358.0**	*215.7*	*81.5*	*50.0*	*10.7*	**15.4**
2018	**364.6**	**288.8**	*184.4*	*47.8*	*48.2*	*8.3*	**75.8**
2019	**556.3**	**248.6**	*181.4*	*7.7*	*46.6*	*12.9*	**307.7**
2020	**600.0**	**395.0**	*240.8*	*88.2*	*46.0*	*20.0*	**205.0**
2021	**497.0**	**466.4**	*290.0*	*100*	*46.4*	*30*	**30.6**
2022	**465.0**	**466.0**	349.5	57	48.5	11	**-1**
2023	**485**	**428.9**	358.4	15.5	45.0	10	**56**
2024	**425**	**448**	371	-	62	15	**-23**

Source: BofA Global Research, ECB, ICE Data Indices LLC, Bloomberg. 2023 full year supply numbers are forecasts .

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Wildcards to the supply story next year would be:

- There could be upside pressure to our 2024 gross supply numbers if disinflation spreads and ECB rate cuts are brought forward from June next year, or cuts happen at a faster pace. Conversely, an oil price shock, leading to delayed ECB cuts, could add downside pressure to our supply outlook.

- Finally, a situation where the ECB is cutting quicker than the Fed, could drive greater momentum in **Reverse Yankee** issuance, adding upside pressure to our 2024 gross supply number.

2024 return forecasts – yielding to the inevitable

The table below highlights our total and excess return forecasts for 2024. For our year-end target, we assume IG spreads finish '24 tighter at around 130bp, acknowledging both the positive impact of rate cuts on credit demand, but also the strong credit rally that has transpired already this month.

We expect smaller spread tightening to emerge in Sterling IG credit, given our expectations of no BoE cuts in 2024.

We expect HY spreads to finish '24 between 375bp-400bp. This reflects some beta decompression to IG, on the back of a weaker US macro cycle, and a pick-up in issuance.

- For Euro IG credit, we forecast total returns of around 7.5%. Much lower govvie yields, and a longer IG duration, help.

- Euro IG excess returns will be 2.3%, although down on 2023's returns.

- For Euro high-yield, we forecast around 8.5% total returns. The lack of duration, vis-à-vis IG is a hindrance to performance. Note credit losses from a 3.5% default rate also take away almost 2% of returns.

Table 2: Return forecasts for 2024

Around 7.5% total return forecast for Euro IG next year

	IG (ER00)	HY (HE00)	Sterling (UN00)
Constant maturity yield change (bps)			
Treasury	-69	-87	22
Spreads	-15	-40	-4
Curve rolldown (bps)			
Treasury	-3	-3	1
Spreads	-9	-20	-5
Spread change (bps)	**-95**	**-150**	**15**
'24 year-end duration	3.5	2.2	4.7
'24 price change (%)	**3.34**	**3.24**	**-0.71**
Default Rate (40% rec)		3.5%	
Defaults loss		1.86%	
Current yield (%)	4.19	7.14	5.57
'24 total return (%)	**7.54**	**8.51**	**4.86**

	IG (ER00)	HY (HE00)	Sterling (UN00)
Constant maturity yield change (bps)			
Spreads	-15	-40	-4
Roll down			
Spreads	-9	-20	-5
Spread change	**-24**	**-60**	**-9**
'24 year-end duration	3.5	2.2	4.7
'24 spread return (bps)	**85**	**130**	**42**
Default Rate (40% rec)		3.5%	
Defaults loss		1.86%	
Current spread (bps)	145	440	124
'23 Excess return (bps)	**230**	**384**	**167**

Source: BofA Global Research

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One thing that is worth noting is that with the material rally in bund yields next year, credit spread widening needs to be significant for Euro IG total returns to be negative for the full year.

- We estimate **IG spreads would need to more than double** for 2024 total returns to be negative. For reference, that would take us past the energy crisis wides of 2022.

Euro high-yield in 2024: the waiting game is over

Thus far, the European HY market has been somewhat of a bystander, amid the rise in rates. Concerns over debt refinancing have been palpable. Yet, given little in the way of HY maturities in either 2022 or 2023, high-yield firms have enjoyed the luxury of time.

- In fact, coupons for Euro HY non-financials have risen by just 50bp from their lows (from 3.5% to 4%).

Thus, firms have so far avoided incurring debilitating jumps in their debt costs. But now things get serious, and the waiting game is over.

Chart 49: A record 18% of Euro HY is set to mature over the next 2yrs

ECB rate cuts in '24 may not be a "get out of jail" card, but they will certainly help prevent a worse-case credit stress scenario

Source: ICE Data Indices LLC. 2yr maturing HY debt, over time.

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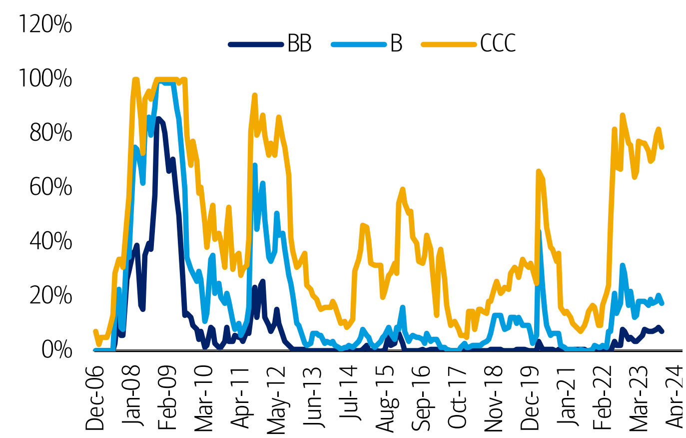
Chart 50: Where's the distress?

Very little distress in BBs, but ticking up in Bs and very clear in CCC still



Source: ICE Data Indices LLC.

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- As chart 49 shows, a record 18% of the Euro high-yield market is set to mature over the next two years.
- By sector, those with the highest 2yr rollover needs are transport (25% total debt), banks (23%), real estate (21%) and capital good (21%).

Of course, ECB cuts next year will be music to the ears of the Euro high-yield market. But the real question is can they come quickly enough for issuers to avoid succumbing to material credit stress? After all, a large share of European HY bonds in existence today were issued between 2018-2020…a time of absolute lows in HY funding costs…when ECB rates were negative.

Chart 50 shows HY distress by rating (here we show the percentage of the market yielding 10% and above).

- Note that distress has barely fallen over the last few weeks, despite an impressive rally in Euro fixed-income.

Elevated distress points to defaults reaching 3-4% across European HY next year, we think (they are currently around 2%).

And with the market already pricing close to 85bp of ECB cuts by October next year (faster than BofA economists' expectations), HY clearly needs a much more dovish outlook for rates, for credit distress to materially retreat.

- Hence in 2024, we **prefer owning BBs**, where spreads are still wide after the October rates shock, and where distress trends are still fairly benign.

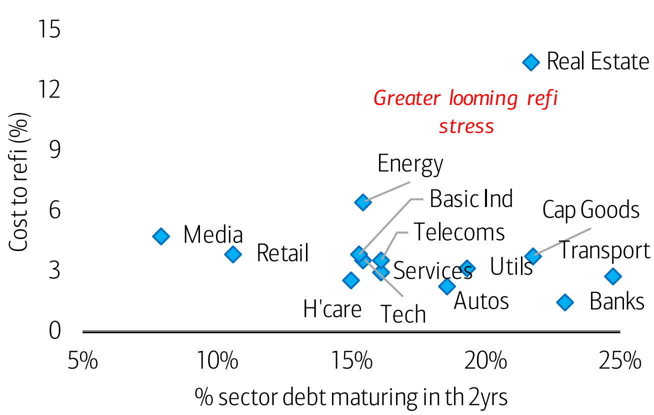
Easy does it

Whatever the speed of cuts though, just as with the IG market, it's likely to spice up the relative demand for European HY bonds, and elicit spread tightening next year.

- Note **healthcare** spreads tend to rally first in the aftermath of last ECB hikes (chart 52).

Chart 51: Credit stress ahead: sectors with a high debt rollover share, and high cost to refi, will be under the microscope

Energy and real estate are some of the most distressed HY sectors today



Source: ICE Data Indices LLC. Cost to refi = today's yields – existing coupons.

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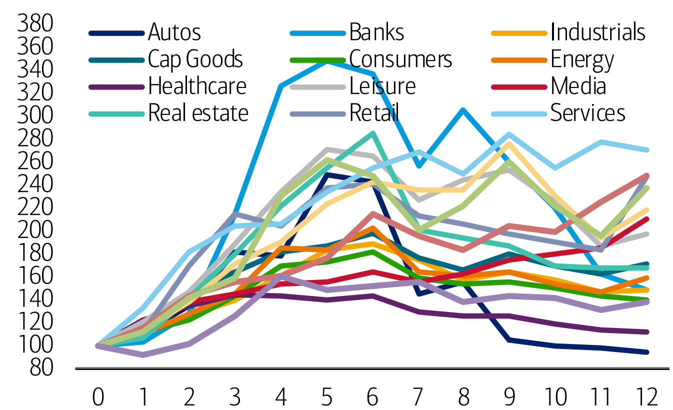
Chart 52: What rallies first in HY, after final ECB hikes?

HY Healthcare spreads tend to peak first after a final ECB hike (3months)



Source: ICE Data. Tracking HY spreads in aftermaths of last ECB hikes. Spreads rebalanced to 100.

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EM-bracing the change

Emerging market central banks were the first to start hiking interest rates in this cycle. Striking early, has put them in a better position to have conquered the inflation problem.

And so now, unsurprisingly, they are proving to be the first to start cutting rates. In addition, Fed easing is likely to boost sentiment towards Emerging Market economies.

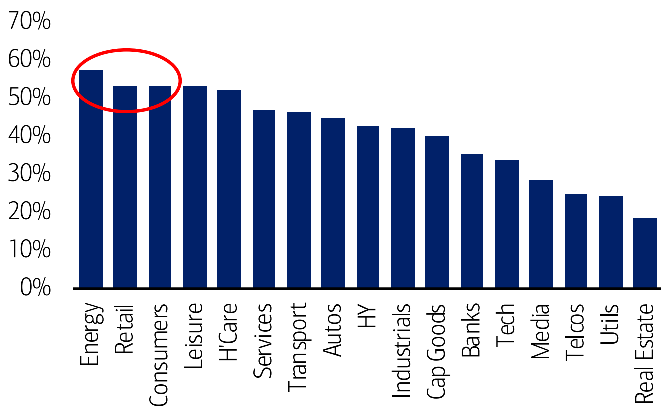
What Euro HY sectors stand to benefit from this, and which could lag?

Chart 53 shows the correlation between HY sector spreads and the Emerging Market composite PMI new orders index. While a better EM growth story is good for EM sectors generally, some sectors are a lot more sensitive than others.

- HY investors should be longer **consumer** and **retail** sectors, where spreads for these sectors have historically been the most sensitive to the EM macro story.

Chart 53: HY sector spread sensitivity to the EM macro story

Correlation of HY sector spreads to EM composite PMI new orders index



Source: Bloomberg. Correlation of levels. EM composite PMI new orders.

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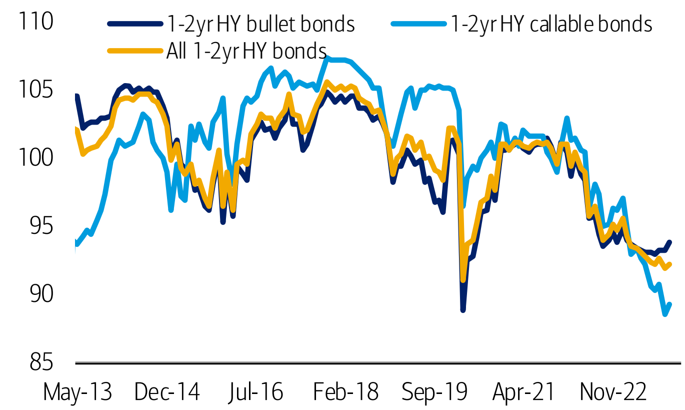
Chart 54: Front-end HY callable bonds now trading at the lowest cash prices in a decade

Cash prices, callables and bullets, front-end bonds.



Source: ICE Data Indices.

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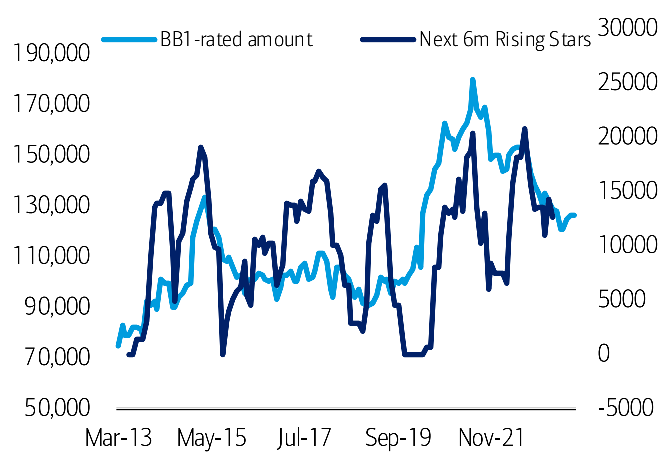
- Conversely, **HY real estate, TMT and utilities** have been much less sensitive to the EM macro story, historically.

Call me quick

Amid the rates shock of the last year, understandably not all issuers have been rushing to refi their bonds at the first call opportunity. But as the ECB heads towards rate cuts next year, and credit costs begin to tangibly decline, we expect more firms to call and replace debt, even if uneconomical, just to ensure balance sheets are resilient to future rates worries.

Chart 55: Volume of BB1-rated Euro HY bonds...

...has been quite a good indicator of Rising Star volumes down the line



Source: ICE Data Indices LLC. BB1-rated debt (LHS).

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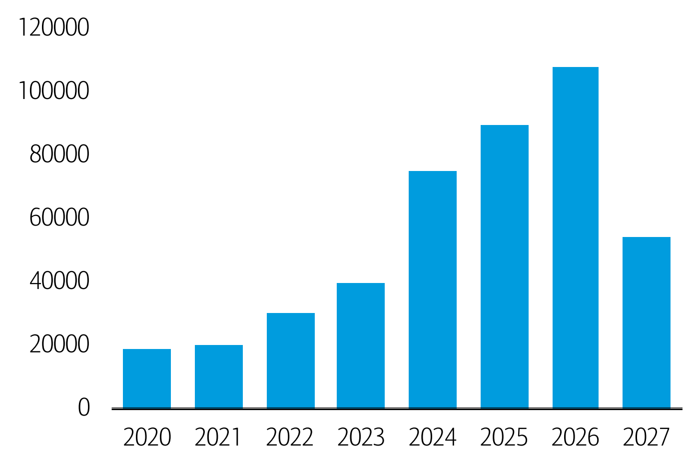
Chart 56: 2024-2026 are pressing years for Euro HY maturities

We expect €70-80bn of HY supply in 2024



Source: ICE Data Indices. Eur mn.

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- Chart 54 shows that the last few months have not been favourable to short-dated HY bond prices. We find that cash prices for 1-2yr callables have fallen materially, to the lowest in a decade (and note that callables traded higher in cash price than bullet bonds for most of last year).

Hence, we see **material upside for front-end HY callable bonds** next year.

The 2024 all stars

One thing has been a constant in the post-Covid era, even amid rates shocks, energy price shocks and geopolitics. And that has been *Rising Stars*.

And we think the spectre of ECB rate cuts will be a tailwind for the Rising Star cycle in 2024.

What could 2024 have in store for Rising Star volumes?

- Similar to our US colleagues, we find a healthy amount of BB1-rated debt across the Euro HY market.
- BB1-rated debt peaked at €180bn in June '21, but is still at an above-average €130bn today.
- And chart 55 shows a reasonably good link between volumes of BB1-rated debt and gross Rising Star volumes 6m ahead.

Hence, we estimate €15-20bn of gross Rising Stars in 2024. The market is currently pricing high amounts of BB auto, tech and utility debt as if it was already BBB-rated, we think, implying high confidence of rating upgrades here.

Off the wall

2023 saw Euro HY issuance rise to €55bn, recovering from a very dry 2022 where only €30bn of new bonds appeared.

Next year, we expect gross issuance volumes of €75-90bn. As chart 56 shows, the HY maturity wall jumps meaningfully in 2024 vs 2023. Some firms will use excess cash to proactively manage upcoming maturities, given debt costs are still high, so we don't expect everything to get rolled over into the HY bond market.

But with CFOs' decisions in 2023 to "wait out" market volatility a nerve-racking one, we sense many firms will use the welcome rally in fixed-income in 2024 to reembrace primary markets.

Risks to our view

How could we be *too bullish* for 2024? Some scenarios would be:

- Middle East fighting results in damage to energy infrastructure, causing a surge in oil prices. Despite it being heavily negative for Euro Area growth, the ECB delivers more rate hikes to stop inflation expectations jumping. Higher-for-longer is thus the outcome, pressuring firms' interest coverage metrics more seriously. IG downgrades dominate, widening IG spreads. HY defaults reach 5%+. Periphery debt concerns flare-up again.
- Elections galore in 2024 mean fiscal taps remain on, causing deficit angst across markets, and global debt-to-GDP to rise again (especially with inflation less helpful for nominal GDP now). Governments look to placate frustrated voters with corporate windfall taxes, leaving EPS growth subdued.
- Despite cuts, the delayed effect of policy tightening eventually catches up with economies. Growth surprises to the downside, rekindling recession fears. Risk-off markets see credit spreads struggle to tighten.

- EU governments fail to agree on fiscal rules by the end of this year. A work-around cannot be agreed for 2024, hence pre-Covid fiscal rules kick-in, leading to a significant tightening in fiscal policy across European countries.

- Geopolitics broaden out, and global economic policy uncertainty rises. A US election year sees (US-China) protectionist rhetoric rise.

How could we be *too bearish* for 2024, and spreads end up much tighter next year? We think some important scenarios would be:

- The weight of positive total returns and the speed of falling bund yields, causes real money credit investors to move en-masse, into corporate credit. IG spreads head back to the 100bp area, with investors fixated on the “cheapness” of credit still, versus its all-time tights (just 74bp, seen in early 2018).

US growth surprises to the upside in an election year. “Goldilocks” economic narratives prevail. European IG credit spreads tighten towards 100bp.

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