CREDIT MARKETS SPECIAL | EUR CORPORATE BONDS | HIGH YIELD BONDS

EUR-Corporate High Yield 2026

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Outlook: Slight spread narrowing expected

After the shock caused by US trade policy at the beginning of April, HY spreads narrowed steadily in the course of 2025 and are currently at the levels seen before “Liberation Day.” This trend was supported by the subsequent provisional reduction in tariffs and the start of negotiations, as well as by the ECB's key interest rate cuts in the first half of the year. However, it remains to be seen whether the uncertainty caused by US trade policy has completely subsided.

Despite market turbulence, the HY segment significantly outperformed both the IG segment and the German Bund index with a performance of +5% in 2025. In 2026, we consider a performance in line with current average HY yields or slightly above to be realistic. Although the HY spread level is currently relatively low and the cycle of key interest rate cuts has ended, eliminating this positive influencing factor, we expect HY spreads to decline slightly in 2026. Apart from the progress of US trade talks, spread development in the medium term will depend on economic developments. We expect solid economic growth in the eurozone of +1.1% in 2026 (2025e: +1.4%). Support is likely to come from the substantial EU-level spending packages for defense and infrastructure in Germany. These should have a positive impact on the credit profiles of HY companies.

The fundamentals of HY companies and key credit metrics have improved slightly recently, partly due to lower (re)financing costs. However, these will only decline slowly in 2026 because the cycle of interest rate cuts has already ended. A positive factor for spreads is that refinancing requirements in the HY segment will be relatively low over the next two years. This is because companies already took advantage of the more favorable conditions on the primary market during the years of extremely low interest rates and were thus able to successfully extend the maturity profiles of their financial liabilities.

Despite the increase in the default rate during the last six months of 2025, Moody's assumes in its baseline scenario that it will decline again from February 2026 and reach 2.4% at the end of November 2026.

Within the HY rating categories, we continue to recommend BB bonds. These have the strongest credit metrics. However, if geopolitical risks intensify, increased spread volatility is to be expected.

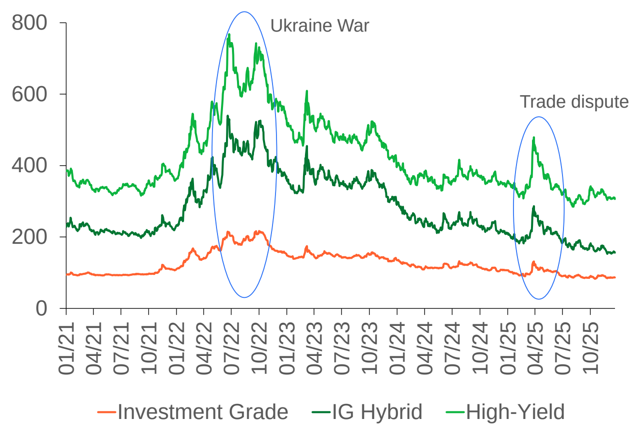
Good performance despite market turbulence

Significant spread reaction due to US trade policy declined in the course of 2025

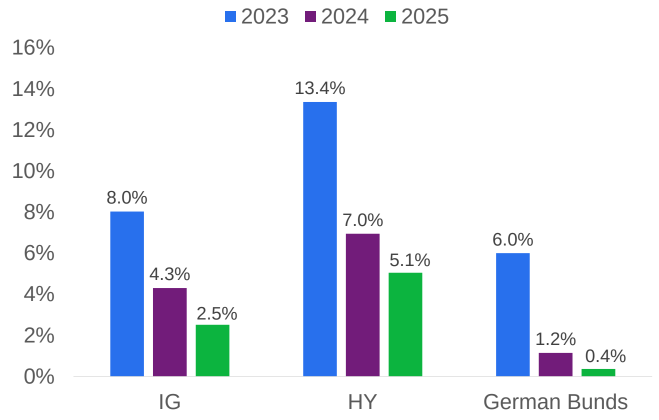
After the financial markets started 2025 with confidence, sentiment deteriorated rapidly in March. The reason for this was a profound change in US President Trump's trade policy, which triggered growing fears of recession in the US and led to increased nervousness on the financial markets. This was followed by announcements of massive US tariffs on Liberation Day (including US-China escalation and US-EZ reciprocal tariffs). In this environment, credit spreads rose sharply in March until around mid-April, particularly in the weaker rating categories, but starting from relatively low levels. In the HY segment, risk premiums widened by +170 basis points during this period.

Issues such as France's rating downgrade as a result of the government crisis and growing doubts about AI-driven high valuations in the US IT sector only had a temporary impact on credit spreads in the second half of the year. Ultimately, they narrowed again steadily and are currently at the levels seen before “Liberation Day.” The decisive factors here were the ECB's key interest rate cuts in the first half of the year and the positive development of corporate fundamentals.

Spreads currently at “Pre-Liberation Day” levels
Historical development of credit spreads, in bps



HY segment significantly outperforms German government bonds and IG segment
Total returns in %



Source: Markit, Erste Group Research (own calculations)

Significant outperformance of the EUR HY Index

All broader corporate indices generated higher returns than German government bonds in 2025. Specifically, the EUR HY Index significantly outperformed both the IG Index and the German Bund Index with a performance of +5%.

Stable fundamentals

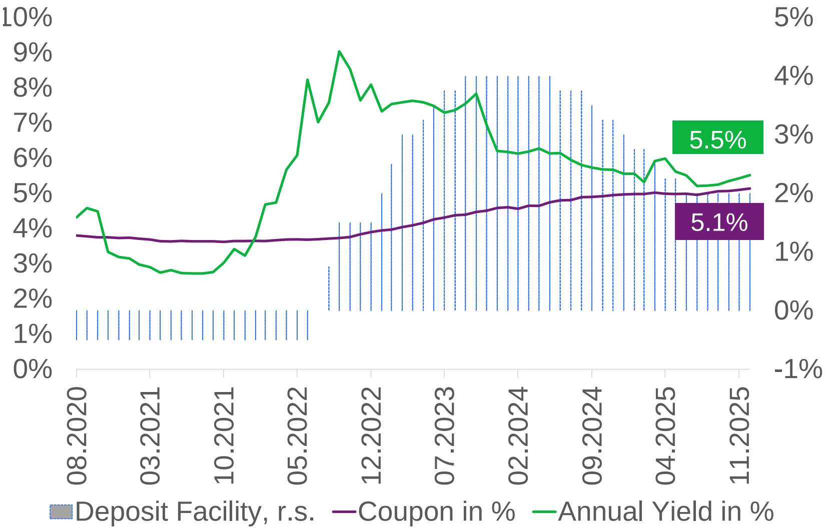
Economic stimulus packages are likely to have a positive effect on the fundamentals of HY issuers

The economic stimulus packages at EU level and in Germany are likely to have a positive impact on the credit profiles of HY companies. From today's perspective, the consensus is that the aggregate earnings of European Stoxx600 companies will improve steadily from the first quarter of 2026 onwards, with a significant increase in earnings of just under +8% y/y expected in Q3/26.

The drastic key interest rate hikes from Q3/22 to Q3/23 and rising government bond yields significantly increased financing costs. However, most companies were able to demonstrate flexibility through cash and working capital management. On a positive note, refinancing costs have fallen steadily since the ECB eased its monetary policy in June 2024.

(Re)financing costs have become cheaper

Ø-EUR-HY-Yield vs. Ø-Coupon outstanding HY bonds



Source: Markit, Erste Group Research (own calculations)

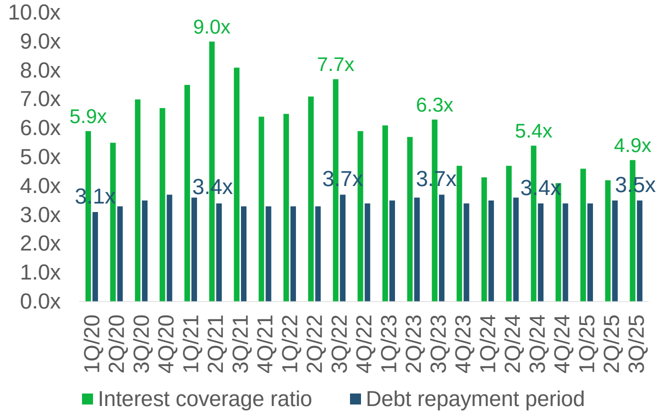
Average return level significantly decreased

The average yield level of the EUR HY index has fallen from its peak in September 2022 (9%) to 5.5%, but remains high by historical comparison. Currently, newly issued HY corporate bonds have an average yield that is only about 40 basis points higher than the average coupon of outstanding corporate bonds with HY ratings.

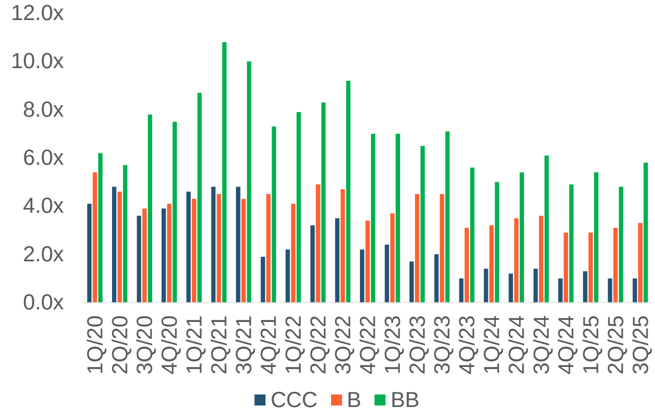
Interest coverage ratio improved in Q3/25

The forward-looking raising of long-term, low-interest debt in years with extremely low interest rates prevented a significant deterioration in the interest coverage ratio, the ratio of operating profit to interest expense that is important for ratings. Although the interest coverage ratio has been on a downward trend since interest rates began to rise (in July 2022), it has stabilized in recent quarters despite the still relatively high level of refinancing costs and a slow economic recovery. In Q3/25, the interest coverage ratio rose to 4.9x, which is the second-highest level since Q3/23. At the same time, however, there is still room for improvement compared to the 5-year average of 6.2x. Within the HY rating categories, the BB segment has by far the best credit metrics.

Interest coverage improved, debt repayment term stable
HY segment: Historical development of key figures



BB segment with the highest interest coverage
Interest coverage by HY rating categories



Source: Bloomberg, Erste Group Research (own calculations)

Further decline in refinancing costs limited by end of interest rate reduction cycle

We believe that a further decline in refinancing costs (the difference between yields and coupons) is likely to be limited in the course of 2026. This is because the cycle of interest rate cuts should already be over. The significantly reduced downside risks for the European economy due to the rapprochement between the US and the EU in August 2025 and the low inflation rate (below 2%) indicate that the ECB will leave key interest rates unchanged for an extended period, as it has done since June 2025. At the last central bank meeting on December 18, 2025, the key deposit rate was left unchanged at 2%, as expected. Both inflation and growth forecasts were revised slightly upward compared to September 2025. ECB President Lagarde emphasized that economic development in the eurozone was solid.

Primary market momentum to continue in 2026

HY emissions increased significantly in 2025

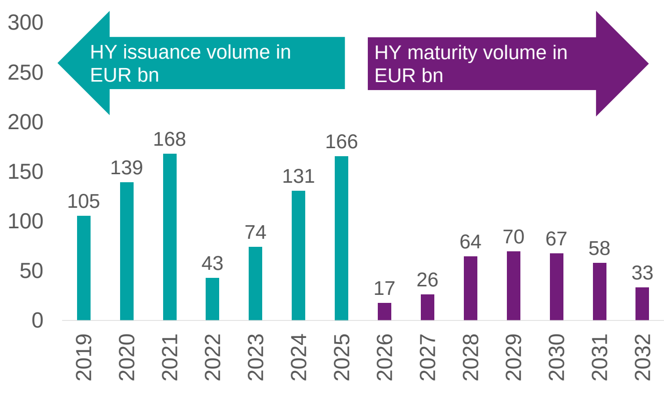
The EUR HY primary market volume (including unrated bonds, crossovers, and real estate) of non-financial companies has been recovering steadily since 2022, when issuance activity almost came to a standstill with the outbreak of the war in Ukraine and its consequences (including the energy crisis and the exacerbation of supply chain problems). While bonds worth only EUR 43bn were placed by HY issuers in 2022, the issuance volume increased several times over by 2025. In 2025, approximately 1,200 HY bonds with a total value of EUR 166bn were issued. Compared to 2024, this represents an increase of +26.7% year-on-year and compared to 2022, an increase of more than +285%.

The HY share of total issuance (EUR IG + EUR HY) has risen steadily since 2022. Historically, it was high in 2025 at around 29%, well above the long-term average of around 25%.

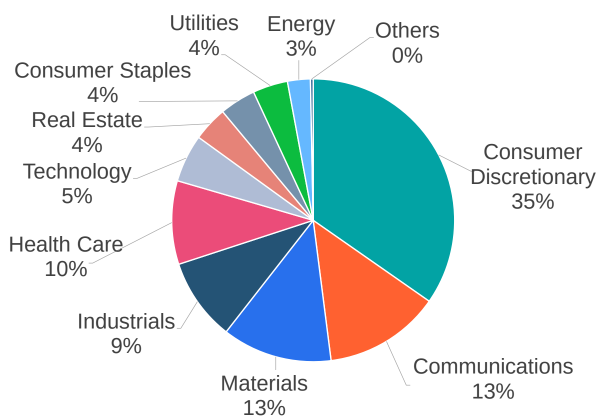
Refinancing requirements will only increase from 2028 onwards

One positive factor for spreads is that refinancing requirements in the HY segment will be relatively low over the next two years, at around EUR 17 billion and EUR 26 billion respectively. This is because companies already took advantage of the more favorable conditions on the primary market during the years of extremely low interest rates and were thus able to successfully extend the maturity profiles of their financial liabilities. Nevertheless, we expect the momentum of recent years on the primary market to continue in 2026. Several factors support this view. First, Moody's expects M&A and leveraged buyout (LBO) activity to accelerate in 2026. Second, the trend toward opportunistic transactions is likely to continue, driven by maturities in 2028–2030 and the pull-forward effect. This is because the market environment is currently characterized by relatively low financing costs and credit spreads. In addition, investor demand for corporate bonds is high. In 2025, for example, newly issued HY bonds were oversubscribed by an average of almost three times (2024: 2.5x).

Increased refinancing requirements not expected until 2028
HY issuance volume in EUR bn



Cyclical consumer goods will have by far the highest refinancing requirements over the next five years
5-year share of HY maturity volume by sector, in %

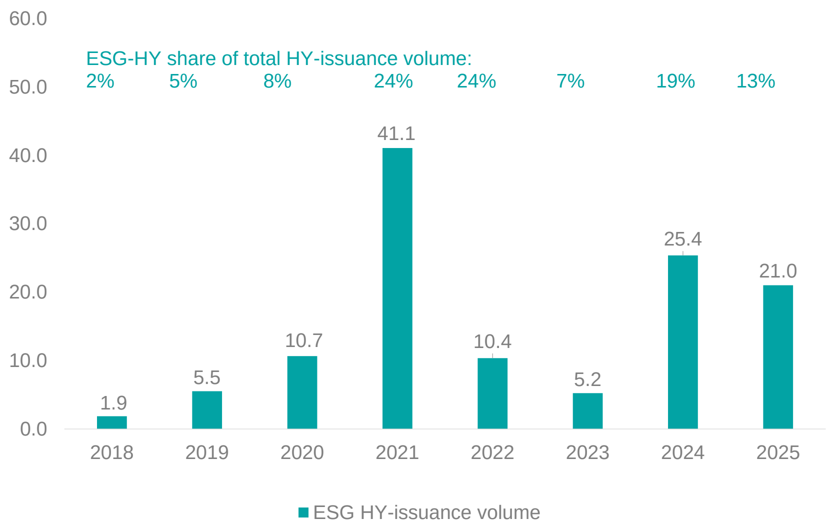


Source: Market data providers, Erste Group Research (own calculations)

ESG HY issuance on the rise

The ESG trend in the high-yield segment has gained momentum in recent years. The strongest year for ESG issuance to date has been 2021, when more than 130 ESG-related high-yield corporate bonds with a total value of EUR 41bn were placed. Although 2025 was significantly weaker, with an ESG issuance volume of EUR 21bn, this was still well above the long-term average of around EUR 14bn.

Higher ESG HY share over the last five years
Historical development of ESG HY-issuance volume



Source: Market data providers, Erste Group Research (own calculations)

Green bonds as the most common form of ESG

The most common types of ESG bonds are green bonds and sustainability-linked bonds, which together accounted for the majority of new HY ESG-issues. Most ESG bonds in 2025 had a minimum denomination of EUR 100,000 or more and were therefore aimed at institutional investors.

As in previous years, utilities (36% of the HY ESG-issuance volume), followed by industrials (26%) and cyclical consumer goods (13%), were the most active sectors on the ESG HY-primary market.

Declining default rate in 2026, risks remain

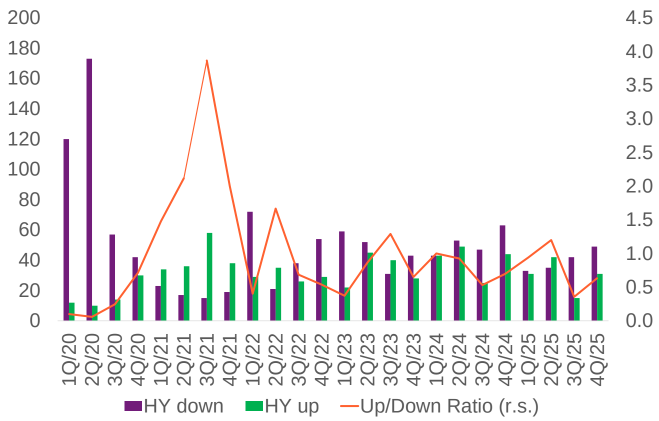
Downgrades at lowest level since start of Ukraine war

The positive development of European companies' fundamentals is reflected in the rating trend. According to our research, Moody's downgraded the ratings of around 160 high-yield issuers in 2025, the lowest number since the start of the war in Ukraine. Compared to 2024, this represents a decrease of 23%, and compared to the pandemic year of 2020, when over 390 companies were downgraded, it represents a decrease of as much as 60%.

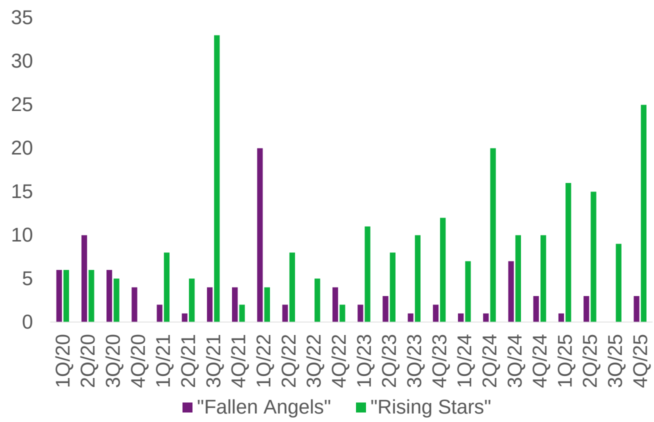
By 2025, the number of rising stars and fallen angels will reach its best level since 2019

Although the environment in 2025 was marked by geopolitical tensions, caused primarily by the erratic US tariff policy under President Trump, the positive momentum among "rising stars" (companies whose credit ratings were upgraded from high yield to investment grade) continued. Over the year as a whole, the ratings of 65 HY issuers, the highest number since 2019, returned to investment grade (at least BBB-). At the same time, the number of "fallen angels" (companies whose credit rating has been downgraded from investment grade to high yield) remained at its lowest level since 2019, with only seven negative adjustments in 2025.

HY Up/Down Ratio in the good mid-range
Number of company downgrades or upgrades



Positive trend continues for "Rising Stars"
Number of "Fallen Angels" or "Rising Stars"



Source: Market data providers, Erste Group Research (own calculations)

Customs issues gradually losing importance for European companies

The tariff issue will continue to affect capital markets in 2026. However, according to Bloomberg, European companies have mentioned the tariff issue less frequently in their earnings presentations and conference calls since Q1/25. This is because European non-financial companies are less affected by US tariffs than companies in North America and Latin America. According to an analysis by Moody's[1], tariffs pose a higher risk for approximately 10% of the 900 EMEA[2]-rated companies, compared to 18% in North America and 14% in Latin America. These companies tend to have weaker ratings and are

[1] "EMEA companies only moderately exposed to US tariff risks, limiting credit effect"
[2] Companies from Europe, the Middle East, and Africa

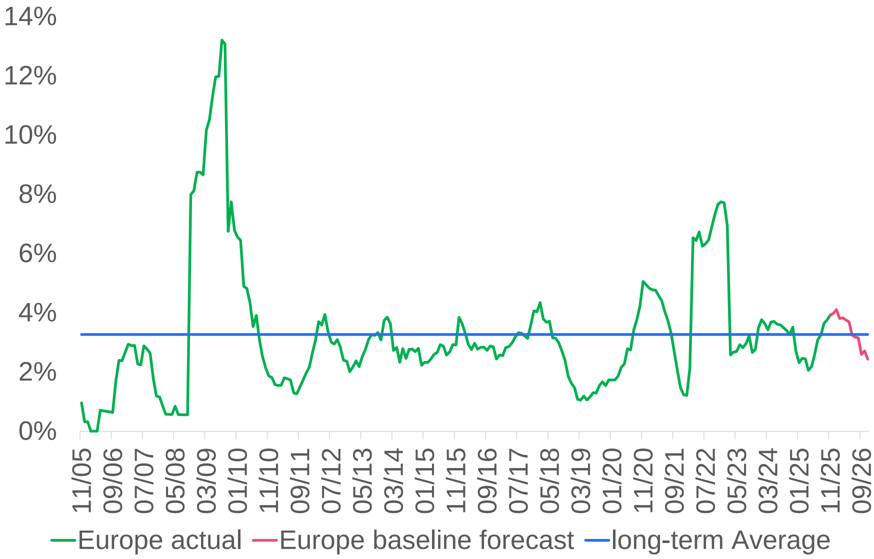
therefore more affected by a possible deterioration in financing conditions on the capital market.

Default rate showing a slight upward trend

The default rate among speculative-grade European corporate bond issuers has been on a slight upward trend since June 2025, according to current statistics from Moody's. In November 2025, five companies from the EMEA region were unable to meet their payment obligations. In 2025 as a whole (up to and including November), the figure was 31 (+40% y/y). Most defaults came from the chemicals, plastics and rubber, healthcare, and pharmaceuticals sectors. The speculative default rate rose to 3.9% in November, 1.3 percentage points higher than in June 2025 and only slightly above the long-term average of 3.3%.

HY default rate expected to decline in 2026

Historical development of the speculative default rate in Europe



Source: Moody's, Erste Group Research (own calculations)

Default rate expected to fall from February 2026 according to Moody's baseline forecast

Despite the rise in the default rate over the last six months, Moody's assumes in its baseline scenario that it will fall again from February 2026 and reach 2.4% at the end of November 2026. While credit conditions remain largely stable, a possible escalation of tariffs between the US and China and geopolitical tensions could weigh on the default rate. In this case, economic performance would suffer, and so would corporate cash flows. If market volatility increases, access to the capital market would become more difficult for financially weaker issuers.

Outlook

2026: Slightly declining HY spreads expected; recommendation remains BB-bonds

We believe that performance in line with current average high-yield yields or slightly above is realistic for 2026. Although the high-yield spread level is currently relatively low and the cycle of key interest rate cuts has ended, thereby eliminating this positive influencing factor, we anticipate a slight decline in high-yield spreads for 2026. Apart from the progress of US trade talks, spread development in the medium term depends on economic developments. The eurozone economy proved surprisingly resilient in the second half of the year, recording solid growth of +0.3% Q/Q in Q3 2025. Key sentiment indicators (including the EZ Purchasing Managers' Index and the German ifo Index) continued to weaken slightly in December, but have been on an upward trend for around a year. We expect solid economic growth in the eurozone of +1.1% in 2026 (2025e: +1.4%). Support is likely to come from the substantial spending packages at EU level for defense (the EUR 800bn “Readiness 2030” Europe program) and infrastructure in Germany (EUR 500bn).

Within the HY-rating categories, we continue to recommend BB-bonds. These have the strongest credit metrics. However, if geopolitical risks escalate, increased spread volatility is to be expected.

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