

Quarterly Money Market Credit Trends by Sector

April 2025

The “Liberation Day” tariffs announced by the US administration on April 2 have injected a level of uncertainty relative to the strong credit conditions that persisted over the course of 2024. Announced tariffs of 10% for all countries and the additional 10% to 49% reciprocal tariffs levied against 90 countries could potentially slow down economic growth to a point where recession is not out of the question while also exerting upward pressure on inflation. That said, we expect the impact of the tariffs will likely evolve as they are open to negotiation, subject to retaliation and may be responded to in some mitigating ways as issuers contemplate strategic solutions.

So far, issuers have provided limited guidance on the potential impact of tariffs, but as the first quarter of 2025 earnings season begins in mid-April, we expect issuers will provide more details on potential implications. In terms of the sectoral impacts of tariffs, we expect corporate issuers will be most directly impacted to varying degrees with the largest impact being amongst autos, industrials, certain technology issuers such as hardware companies and the consumer sector. The overall impact will depend to what extent corporate issuers can raise prices and pass on additional costs to suppliers and consumers and their ability to shift global supply chains. While we view the global banking and insurance sectors to be well insulated from the direct impact of tariffs, second-order effects on economic growth, inflation, interest rates and financial markets could present a more challenging operating environment for banks, insurers and corporates.

Fortunately, the high-grade financial and corporate issuers common to money market funds entered 2025 on solid footing with strong credit fundamentals. A string of increased earnings, sound asset quality, reduced leverage—debt to earnings before interest, taxes, depreciation and amortization (EBITDA)—and management of capital and liquidity metrics that exceed regulatory requirements have fortified balance sheets. As such, we believe the high-grade credit universe is well-positioned with sufficient financial flexibility to navigate the evolving landscape commensurate with minimal credit risk.

GLOBAL BANKS

During the most recent quarterly earnings reporting season, banking issuers generally benefitted from solid profitability. Fee-based income trended higher with trading a particular bright spot. Spread-based revenue performance was mixed toward a positive trend in which net interest margins were either pressured to a lesser degree, stabilized or improved. Credit costs were less of a headwind for banks globally as prior signs of normalization reversed or stabilized in the most recent quarter. Some banks moderately increased loan loss reserves based on pre-Liberation Day tariff-related stress test scenarios with expectations that these will be adjusted upwards in the first quarter. Overall, sound credit quality conditions persisted in 2024 as most underlying loan portfolios continued to perform well, while manageable commercial real estate (CRE) exposures displayed minimal weakening. While there were some declines in capital ratios, most banks continued to operate with significant excess capital and liquidity buffers above regulatory requirements. We believe this provides global banks with an ample buffer to absorb potential second-order impacts from the recently imposed tariffs.

US Banks

US banks reported strong fourth quarter of 2024 earnings driven by economic growth, policy rate cuts and improved market sentiment that initially followed the US elections. Fee-based income increased, particularly in capital markets-related businesses. Net interest margins were stable to improving, despite tepid loan growth. Asset quality remained strong, with large US banks well-positioned to handle moderate weakening in commercial real estate portfolios. The banks are expected to be insulated from the direct impact of US tariffs but may face challenging operating conditions should tariffs weigh on the economy, consumer sentiment and financial markets. In preparation for potential regulatory changes around Basel III Endgame (rules focusing on the amount of capital that banks must have against credit, operational, and market riskiness of their businesses), US banks have been built robust levels of excess capital and liquidity beyond current requirements, which we believe puts them in a strong position to navigate the evolving impact of tariffs on the operating environment.

Canadian Banks

Canadian banks started their new fiscal year with improved profitability for the period ending January 31, 2025, driven by higher revenues from strong capital markets activity. Record trading revenues and moderate wealth management growth offset slower personal and commercial activity. Earnings were tempered by higher expenses, but asset quality remained solid despite higher delinquencies. Loan loss provisions increased, with banks expecting this trend to continue due to macroeconomic challenges, including tariffs. The increased loan loss reserves factored in tariff expectations as of December 2024 into their stress tests, which at the time were manageable. Capital levels remain a strength as all banks were well-positioned against regulatory requirements with favorable buffers. In December 2024, the Office of the Superintendent of Financial Institutions (OSFI) maintained capital requirements on the view that banks had adequate capital cushions to manage the risks and vulnerabilities facing the Canadian banking system, but that they would be proactive in adjusting if conditions warranted.

European Banks

European banks reported solid fourth quarter results, with most banks showing improved performance. Regionally, Norwegian and Dutch banks benefited from a rebounding mortgage market. French banks caught up with peers on net interest income, indicating improved fundamentals. From a balance sheet perspective, French banks in our view are well-positioned to manage headwinds presented by its changing political climate and challenged budget negotiations. Swedish banks delivered strong returns with exceptional asset quality. Key trends include mixed net interest income, growing fee and commission income and solid asset quality. However, non-performing loan ratios are increasing, and credit costs are normalizing. Initial earnings guidance for 2025 provided by European banks in February and March indicated a modest decline in bottom-line performance due to softer revenues, expense inflation and growing credit costs. While European banks should be insulated from the direct impacts of the US tariff policies, second-order impacts on the economy, interest rates and foreign exchange rates could influence asset quality and net interest margins. Conversely, adjustments in European policy toward increased defense spending in addition to increased market volatility could provide some opportunities for European banks. European banks remained well capitalized with some banks having reduced their excess capital toward internal CET1 targets will remain comfortably above regulatory requirements.

Japanese Banks

Japanese banks reported strong results for the first nine months of their fiscal year 2024, driven by higher net interest income, robust fee income and realized gains on equity sales. Loan and deposit growth was robust with The Bank of Japan's (BOJ) decision to lift its negative interest rate policy and hike rates expected to benefit banks

through net interest margin (NIM) expansion and improved spread income. As of February, when Japanese banks last reported earnings, the Japanese banks were on track to beat their FY targets and were well-positioned to benefit from additional interest rate hikes; however, the rollout of US trade policy and the impacts the tariffs may have for the Japanese economy serves to cloud this outlook. Asset quality remained strong, with low credit costs and declining non-performing loans. Capital ratios declined due to increased risk-weighted assets and share repurchases but remained well above regulatory requirements.

Australian Banks

Australian banks reported mixed results, driven by higher financial markets revenue and volume growth, but offset by higher credit impairment charges and net interest margin compression. Cost of living pressures and high interest rates remain challenging for some customers. The recent Reserve Bank of Australia (RBA) policy rate cut, and potential further cuts, should provide relief to households and support business activity. Asset quality remained strong, although with some weakening in business lending portfolios and an increase in mortgage arrears. Australian banks have limited direct exposure to commodities or mining and are viewed as well insulated from the direct impact of tariffs; however, the broader Australian economy could face headwinds from the US tariff policy as it relates to a potential economic slowdown in key trading partners such as China. Capital adequacy metrics remained well above the Australian Prudential Regulatory Authority (APRA) regulatory requirements for Australian banks to have “unquestionably strong” capital, which places the Australian banks in a formidable position.

INSURANCE

The insurance sector produced mostly good results in the most recent quarter with life insurers as well as property and casualty companies reporting solid results while healthcare companies experienced headwinds related to government programs. We view the insurance sector to be relatively immune to the direct impact of tariffs, but secondarily, some insurers may be sensitive to the associated impact on interest rates and financial markets. While insurance companies hold large bond portfolios, their stable funding levels and sound asset liability management practices allow them to hold bonds until maturity and avoid selling at a loss due to interest rate increases. Overall, high-grade insurance companies benefited from solid balance sheets with high-quality and well-diversified investment portfolios, strong capital and liquidity levels. The US insurance sector continued to be highly rated with broadly stable outlooks from the rating agencies during the fourth quarter.

Life Insurance

Life insurance companies reported solid results driven by strong equity markets, favorable reinvestment rates and solid underwriting profitability. Group and individual life insurance sales experienced strong growth in 2024, while annuity sales reached record levels in 2024 despite lower demand in the fourth quarter following interest rate cuts. Investment portfolios maintained strong asset quality as exposure to below-investment-grade securities remained manageable while notable exposure to conservatively underwritten commercial mortgage loans continued to perform well. The current interest rate environment and strong balance sheets are supportive of life insurance performance going forward, but the potential impact on the economy and financial markets related to US tariff policies could present some headwinds for life insurers. That said, the major life insurers maintained robust risk-based capital in 2024 with solid asset liability management practices that offer significant protection for potentially more volatile market conditions.

Health Insurance

Health insurers reported disappointing results due to challenging fundamentals in government business, including higher medical loss ratios related to Medicare Advantage plans and declining Medicaid enrollment. Pressure on government programs and reimbursement levels is expected to continue. Growth in commercial market enrollment and healthcare services was a bright spot in the quarter.

Property and Casualty Insurance

Property and casualty insurance companies reported solid results driven by higher investment income, premium growth and strong underwriting profitability. They are expected to absorb significant losses from the California wildfires and other catastrophes such as hurricanes, but the impact is expected to be manageable in the context of sufficient earnings capacity and capital strength to absorb potential losses. While tariffs may present some headwinds for property and auto insurers on rising auto part and building material costs, this is expected to be manageable, as insurers have indicated that some costs will be passed on to customers.

CORPORATES

High-grade corporate issuers also showcased broad-based improvement in credit metrics during the most recent quarter. Most sectors reported decent revenue growth except for energy and other commodity-related issuers. This contributed to bottom-line earnings before interest, taxes, depreciation and amortization (EBITDA) growth and better margins. While there was some evidence of a moderate increase in corporate debt and capital expenditures, the growth in EBITDA served to improve leverage metrics.

We believe the impact of tariffs will be varied for the corporate sector with the auto, industrial, consumer sector and certain aspects of technology such as hardware to be amongst the most directly impacted by tariffs. Other sectors, such as pharmaceuticals that have large manufacturing capabilities in the US or large diversified energy companies, may see lesser headwinds from imposed tariffs. In general, high-grade corporate issuers maintained a conservative approach to balance sheet management with considerable flexibility to adjust financial policies in protection of their high-grade ratings.

Pharmaceuticals

Large pharmaceutical companies reported solid fourth quarter results, driven by sales growth and well-managed operating expenses. Revenue growth came from innovative medicines and stable sales of branded drugs. Companies are focused on managing patent expirations by increasing research and development investments and pursuing acquisitions. However, pharmaceutical companies may face increasing drug pricing pressure, including through Medicare price negotiations. Many large pharmaceutical companies have significant manufacturing footprints in the US, and several have recently announced capital investment plans to build research and production facilities in the US, which will mitigate impact from tariffs. The sector is viewed as defensive, with stable ratings and strong credit profiles supported by robust profitability and moderate leverage.

Industrials

Industrials reported mixed fourth quarter results due to weaker demand in construction and agricultural equipment sectors, partially offset by higher infrastructure spending and healthy demand in aerospace, energy

and transportation. The sector faces event risk from acquisitions and strategic repositioning. We believe tariffs will increase production costs and negatively impact demand, with some margin pressure expected as companies try to pass on higher input costs to customers.

Energy

Major integrated energy companies reported mixed fourth quarter results as volatile oil prices stabilized during the fourth quarter while natural gas prices rose. While credit metrics remained strong for the large high-grade integrated sector, the oil majors have maintained significant share repurchases, capital expenditures and acquisitions despite lower cash flows and an increase in leverage. As an offset, some companies completed non-core asset sales to bolster liquidity. This sector faces headwinds as oil price forecasts have been revised lower due to a weaker macro backdrop and OPEC's decision to increase oil supply. The impact of tariffs could also add to the pressures but is generally expected to be manageable for major integrated energy companies due to their size and diversification.

Automotive

The auto sector produced mixed results in the most recent quarter as the US market remained resilient with strong growth, the Chinese market had surprising higher growth fueled by government incentives while earnings in Europe and Asia (Ex-China) were challenged by slower demand. Challenging market conditions in China have led foreign automakers to pursue restructuring actions. The global electric vehicle market continues to grow, albeit at a slower pace, with regulatory constraints easing in the US and Europe. Going forward, the focus will shift to tariffs as the auto sector is one sector most likely to be directly impacted, albeit to varying degrees. While the additional tariffs to be imposed on Chinese imports is expected to be manageable for the auto sector, potential tariffs imposed on imports from Canada and Mexico could have a more meaningful impact, as a quarter of US vehicles sold are imported from these two countries. Automakers will likely take a measured approach near-term and wait until there is further clarity on the magnitude and duration of tariffs before moving forward with specific actions.

Technology, Media and Telecom (TMT)

TMT results were strong, driven by artificial intelligence (AI) demand. AI boosted growth in cloud services and semiconductor manufacturing. Software vendors' revenue growth was slower, but increasing AI adoption is expected. The semiconductor industry is divided, with AI-driven demand surging, while traditional markets such as PCs, automotive and industrial segments face headwinds. US Telecommunication companies showed steady growth, while competition for broadband accelerated. Going forward, key risks for the TMT sector include protectionist trade policies and export restrictions, which could impact consumer demand and company profitability. Sustained tariffs would particularly affect hardware companies given high exposure to China and Mexico and might drive them to invest in localizing production.

Consumer

Consumer-based companies had mixed earnings, with growth in the low to mid-single-digit range and lower margins. Companies are focused on rejuvenating volumes and trimming costs to support margins. Value-seeking behavior continued, with consumers spending when they find value. The key challenge is to maintain margins amid a promotional environment, commodity re-inflation and the need to invest in brands. Regarding tariffs, the overall impact will depend on the magnitude and duration of tariffs with some variation depending on the subsector with food and beverage along with durable goods likely to be most impacted. Most consumer companies acknowledged that the situation is highly dynamic and uncertain, but they suggested that they could raise prices as needed and pass on the additional costs to suppliers and consumers. The consumer sector balance sheets are well-positioned to absorb further margin compression and provide consumer-based companies with a solid footing amidst the uncertainty presented by the tariffs.

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