

# Australian Credit: Strong Fundamentals, Superior Yields, Global Appeal

*Australian investment grade (IG) credit looks to be an attractive risk/reward opportunity heading into 2026. It still appears to be an environment whereby investors don't need to take a lot of risk to generate quality returns. Australia credit remains well placed to generate inflows given its superior yield versus global peers.*

By Roy Keenan, Co-Head of Australian Fixed Income

## 2025 recap: Strong capital flows amid geopolitical uncertainty

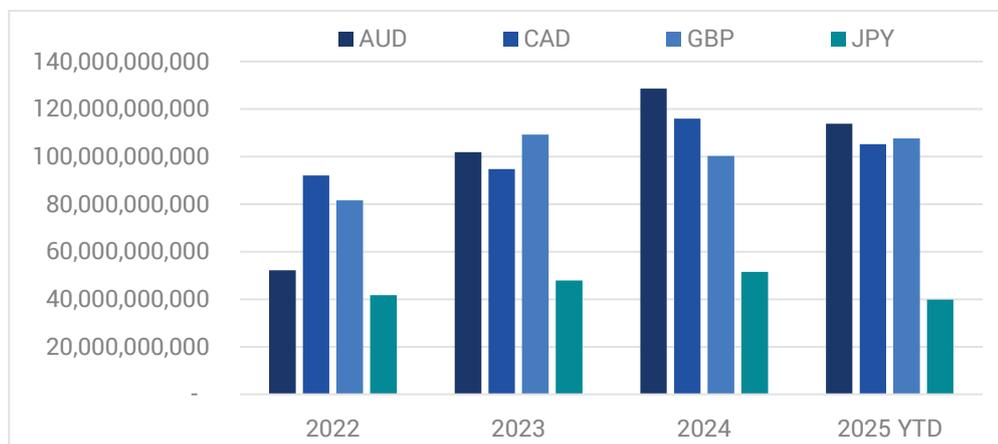
The year has been positive for IG credit, with a range of themes ranging from geopolitics, de-dollarisation, to interest rates driving capital flows and yield.

Heading into 2025, we anticipated a positive year but were also concerned that the market had underestimated the impact of US President Trump's election. Ahead of Liberation Day, we increased our cash position and lengthened our interest rate duration. We were able to take advantage of rising credit spreads by deploying cash to take profits on our interest rate positions. This allowed us to generate positive returns during a negative period for markets.

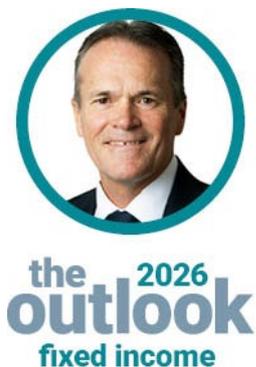
On the whole, Trump's activities have been a positive for risk assets. Despite the US economy having moved into a period of slower growth, with rising inflation and record indebtedness, we've seen a focus for foreign investors on moving away from USD denominated assets.

The Australian credit market has benefitted from this move, with Asian investors increasing their exposure to AUD assets. We've seen a notable increase in Asian investors participating in primary deals which has resulted in new Foreign and Domestic issuers coming to the market. We are now the third largest credit market (by issuance) behind the US and Europe (refer Chart 1).

Chart 1. Major Credit Market Issuance (2022-2025)



Source: YCM/Bloomberg – Dec 2025.



Performance across the year has been largely driven by credit spread contraction and interest rates. There were three Australian interest rate cuts across 2025, although we did expect four at the start of the year. 2025 proves again that investors don't need to take a lot of risk to generate quality returns in the current environment.

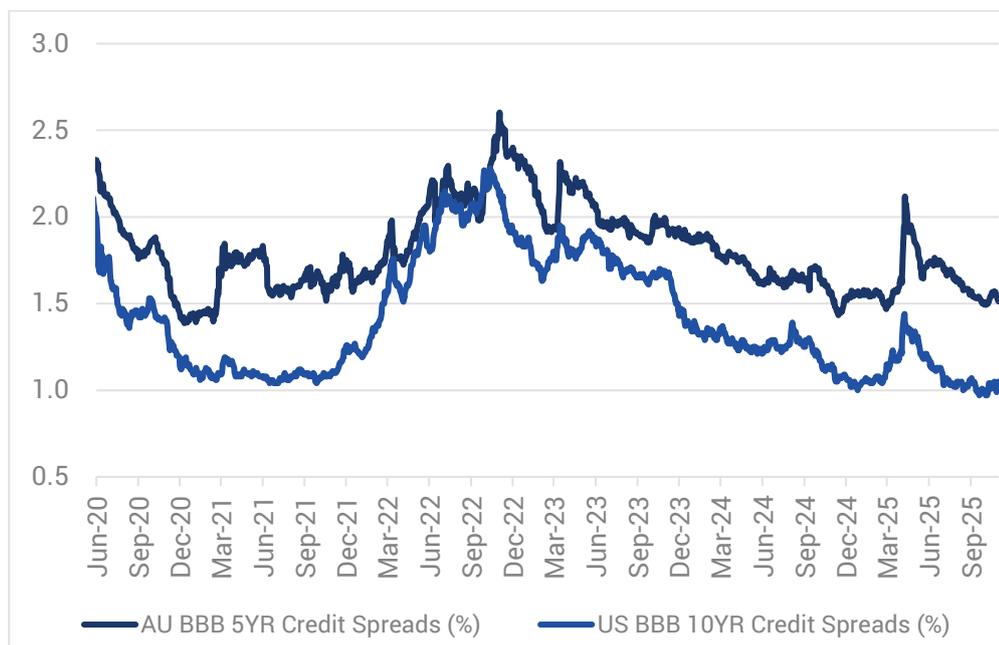
## 2026 outlook: diverging central bank policies, high credit quality and capital flows

There's much to be positive about heading into 2026, with performance continuing to be driven by interest rates and the flow of capital.

Growing divergence in central bank policy will be a key feature for the year ahead, with the US continuing to focus on cuts while the market is pricing for some level of tightening in Australia. We expect this divergence to flow through to the macro data, with Australian GDP likely to be higher than the US by around 60bps. It's a similar story with Australian inflation, which we expect will trend back to the middle of the RBA's range across 2026, leaving room for a cut, though we continue to operate in a higher-for-longer rates environment.

On the whole, the Australian investment environment is highly attractive. Australian short-term rates are likely to be higher than the US which will be supportive for the AUD. We have a stable political environment, higher growth and a lower inflation range compared with the US. This should be supportive for capital flows into Australia, with domestic IG credit a likely recipient of these flows given our high-credit quality and the attractive credit spreads on offer. Australian IG credit offers superior risk-adjusted returns compared to offshore IG markets; for example, BBB rated credit offers an extra 46bps in credit spread compared to the US for half the term risk (refer Chart).

Chart 2. US/AU Credit Spreads to Bonds (%)



Source: YCM/Bloomberg – Dec 2025.

There's also a growing trend towards demand for income, particularly as Australia's baby boomers continue to transition into retirement, a theme that will continue for many years. It will underpin support for products like high quality IG credit that can offer solid risk/return attributes within a broader portfolio.

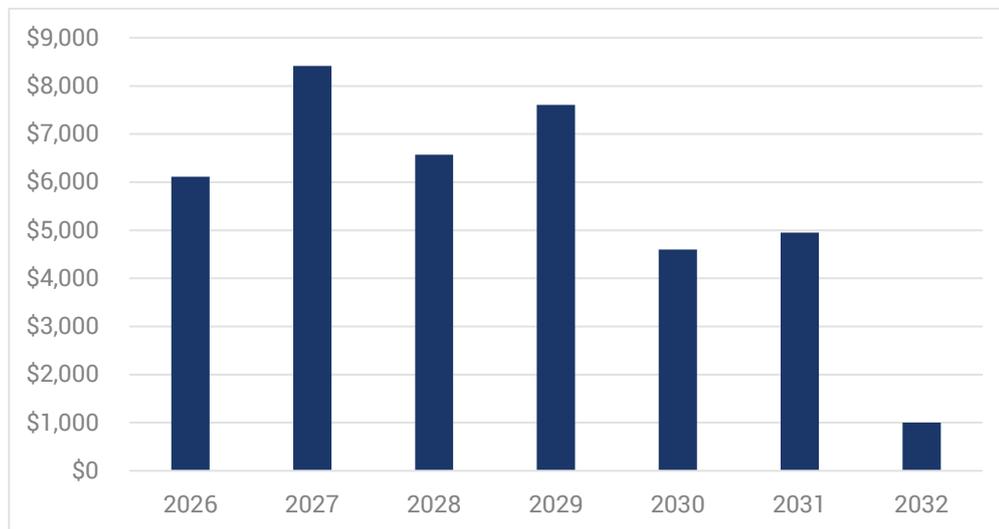
## The ongoing phase out of AT1 hybrids

In the wake of APRA's AT1 bank hybrid phase out there have been no domestic issuance of these securities in 2025, although Australian Banks have increased their issuance of T2 in preparation for the implementation of this policy in 2027. Foreign banks have filled the AT1

void, however, with UBS and BNP Paribas issuing into the Australian market in 2025. We expect more foreign banks to enter this market in 2026 to satisfy investor demand for AT1 and the higher yields these securities offer.

The ASX listed AT1 market today is around \$39 billion and will still be in existence until 2032. While the secondary market for these securities has been trending tighter over the past year, we still regard it as an investable universe that will offer opportunities over time.

**Chart 3. AT1 Redemption Profile**

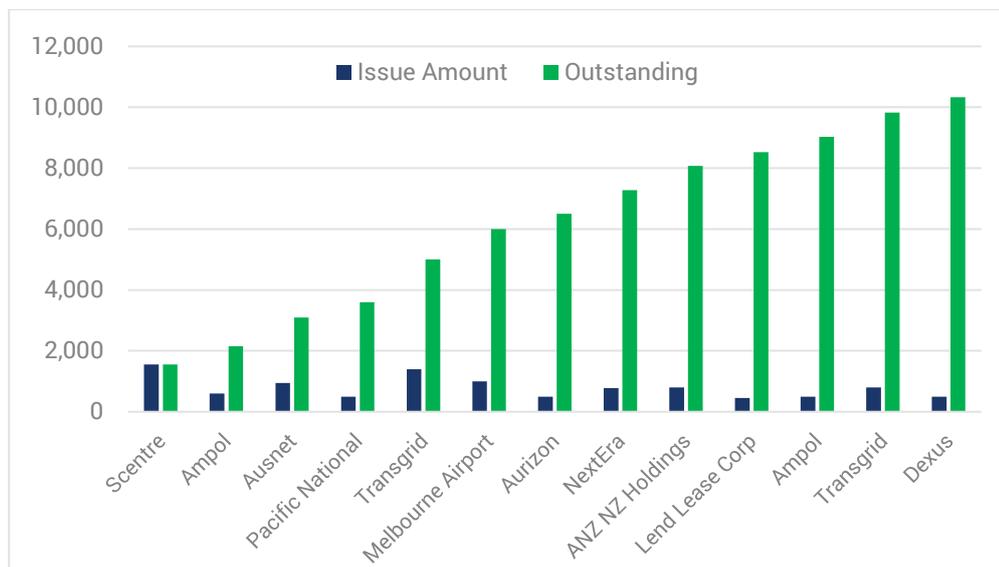


Source: YCM/Bloomberg – Dec 2025.

### Continued appeal of the hybrid market

Australian Corporate Hybrid issuance continues to fill the void of the AT1 phase out. In the last 16 months, there has been \$11bn of issuance into this market. With new issuers including **Macquarie Airports**, **Aurizon**, **Lendlease** and **Dexus** (refer Chart 4), these securities offer an increase in diversification while offering an enhanced return compared to the equivalent senior securities. We expect this trend to continue, particularly for those companies linked to the energy transition which requires extraordinary capital expenditure to support connectivity to existing infrastructure.

**Chart 4. Corporate Hybrids Issuance since August 2024**



Source: YCM/Bloomberg – Dec 2025.

As this market continues to develop, we expect foreign issuers to emerge such as **NextEra Energy**, a US company that issued into Australia in 2025. While we haven't seen US AI-hyperscalers enter the Australian market as yet, it will be one to watch given this is another area requiring significant capital raising to meet demand.

## The best risk/reward opportunity in the market today

As with 2025, Australian IG credit offering upwards of 6% yield/income is an attractive starting point leading into 2026.

While we see value in the market, we still believe now is not the time to head down the risk curve, and remain happy to run slightly higher levels of cash heading into 2026. Our expectations of lower rates in 2026 remain in place. We are happy to maintain some exposure to lower rates, and still believe that yield curves will steepen in the coming years as long dated bond yields move higher off the back of the US debt position and the likely bond issuance that will follow.

***Australian IG credit is well positioned for strong returns in 2026. It offers one of the best risk/reward opportunities in the market today and, accordingly, capital flows are now starting to follow.***



### Contact us

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2026: quality returns without needing to take excessive risk.

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