

Fixed Income Focus

Summary

1. Central banks: still too much front-loading priced in.

The market is pricing in consecutive rate cuts for both the Fed and the ECB over the next five meetings. While we believe that these central banks will cut rates at each of the next two meetings, we expect them to return to a more traditional quarterly pace of cuts in 2025. We anticipate the ECB will conclude its rate-cutting cycle in September 2025, with a deposit rate of 2.25%, and the Fed will do so in Q1 2026, with a policy rate of 3.25%.

2. We maintain a Neutral stance on both US and German government bonds, believing that i/the central banks' repricing is largely completed, but not entirely, ii/high levels of bond issuance persist, and iii/the US election typically brings rate volatility. We favour short maturities for US Treasuries (3-5 years) and intermediate maturities for German bonds (up to 10 years).

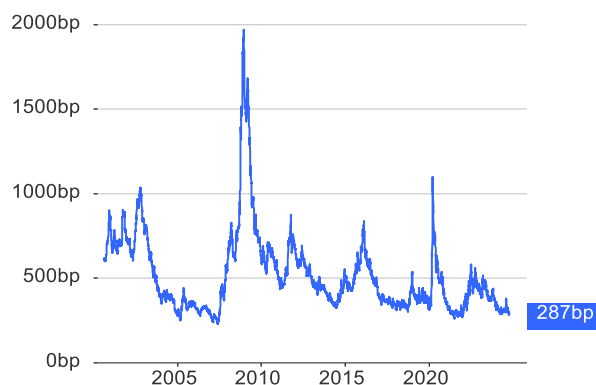
While a sovereign rating downgrade to single-A would be the biggest risk, we consider this unlikely. We keep a Neutral stance on French government bonds despite attractive yields, anticipating volatility due to execution risks, and limited benefit from the expected spread compression.

4. Opportunities in Fixed Income: we are Positive on US Agency Mortgage-Backed Securities, UK gilts, as well as European and US investment grade corporate bonds. We are also Positive on Emerging Market bonds in hard and local currency.

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CHART OF THE MONTH: THE SPREAD ON US HIGH YIELD BOND HAS REACHED VERY LOW LEVELS



Source: LSEG Datastream, 17/10/2024

Drafting completed on 16 October

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WEALTH MANAGEMENT

The bank
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Central banks

The global synchronised monetary easing

European Central Bank (ECB)

Growth concerns: Recent leading indicators (PMI surveys) in the manufacturing sector point to a contraction in activity. The services component, however, has flattened out in modest expansion territory and represents the largest share of the economy. Crucially, the ECB does not seem to believe that a recession is likely, and neither do we.

Inflation easing: Disinflation is “progressing well and becoming more robust”. In addition, the ECB has gained more confidence in its forecasts and foresees a return to the 2% inflation target in 2026.

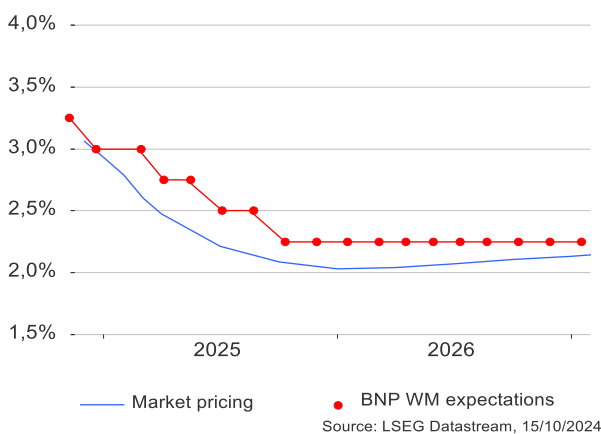
Our view: Given the risks to the growth outlook, we expect the ECB to front-load its rate cuts, with 25bp cuts at each of the two remaining meetings this year. We then anticipate a quarterly pace of cuts in 2025 (March, June, September) until the deposit rate reaches 2.25% in September. The market is pricing in a deeper rate-cutting cycle, with a terminal rate of 2% reached in Q3 2025.

US Federal Reserve (Fed)

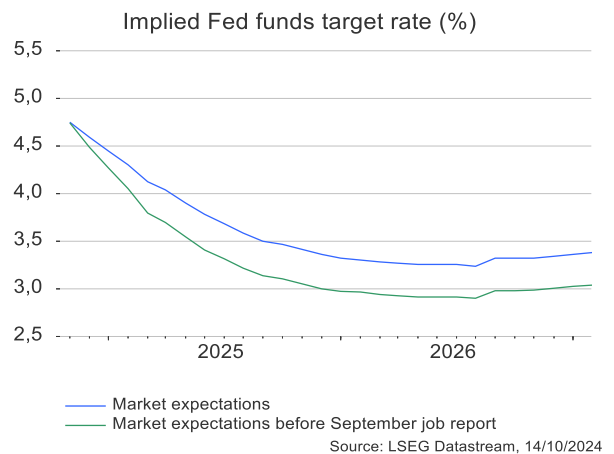
50bp cut is not the norm: The 50bp cut in September surprised us, as we expected 25bp, and the FOMC Minutes revealing tension around the decision. Recent data shows a resilient labour market (notably strong job creation) and modest inflation surprises. While the September CPI report doesn’t change our view of ongoing disinflation, it highlights continued resilience, and reaching the Fed’s 2% target will take time.

Our view: The firmer inflation in September supports a more measured pace of cuts, unlike the 50bp decision. We expect the Fed to cut by 25bp at each of the last two meetings in 2024, followed by quarterly cuts. We foresee a terminal rate of 3.25% in Q1 2026. Market pricing has shifted closer to our view, with a terminal rate of 3.27% by Q1 2026, but it still anticipates too much front-loading, expecting consecutive cuts over the next five meetings.

THE MARKET IS PRICING IN A DEEPER RATE-CUTTING CYCLE THAN US



DRAMATIC REPRICING OF FED CUTS FOLLOWING THE LAST JOB REPORT



INVESTMENT CONCLUSION

The market is pricing in consecutive rate cuts for both the Fed and the ECB over the next five meetings. While we believe that these central banks will cut rates at each of the next two meetings, we expect them to return to a more traditional quarterly pace of cuts in 2025. We anticipate the ECB will conclude its rate-cutting cycle in September 2025, with a deposit rate of 2.25%, and the Fed will do so in Q1 2026, with a policy rate of 3.25%.

Bond yields

Massive repricing

Stronger-than-expected macro data in the US has forced market participants to revise their expectations for rate cuts, causing bond yields to surge significantly. The US 10-year yield has risen by 50bp since its low point a month ago, while its German counterpart has increased by 25bp in the past 15 days.

The sharp rising in long-term inflation expectations, in particular in the US, is also behind the rise in long-term bond yields.

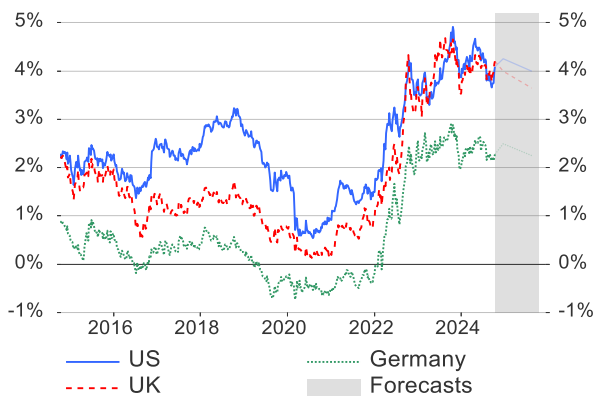
We maintain our Neutral stance on both US and German government bonds. In our view, most of the repricing has occurred, but it is not yet fully complete. Also, high levels of bond issuance persist, and the proximity of the upcoming US election is typically a source of uncertainty, which triggers volatility in rates.

Given these conditions, we favour short maturities for US Treasuries (3-5 years) and intermediate maturities for German government bonds (up to 10 years).

	Maturity (years)	16/10 2024	3-month target	12-month target
USA	Policy rate	5.00	4.50	3.75
	2	3.94	4.00	3.50
	5	3.84	4.00	3.75
	10	4.01	4.25	4.00
	30	4.30	4.50	4.25
Germany	Policy rate	3.50	3.00	2.25
	2	2.17	2.25	2.00
	5	2.03	2.25	2.25
	10	2.18	2.40	2.25
	30	2.47	2.75	2.50
UK	Policy rate	5.00	4.50	3.75
	2	4.02	3.50	3.20
	5	3.93	3.60	3.30
	10	4.07	3.80	3.50
	30	4.60	4.25	4.00

Source: Refinitiv Datastream, BNP Paribas WM

10-YEAR RATES



INVESTMENT CONCLUSION

We maintain a Neutral stance on both US and German government bonds, believing that i/the central banks' repricing is largely completed, but not entirely, ii/high levels of bond issuance persist, and iii/the US election typically brings rate volatility. We favour short maturities for US Treasuries (3-5 years) and intermediate maturities for German bonds (up to 10 years).

Theme in Focus

No screaming opportunity in French OATs

Risk perception in France has increased, driven by political uncertainty and a rising deficit pushing the French 10-year spread above 80bp this summer, far higher than the 10-year average of 40bp. As of 14 October, spreads had retraced to 76bp, but volatility remains high.

Debt concerns and latest budget proposal : France's debt-to-GDP ratio is expected to continue rising. The public deficit, initially expected to improve to 4.4% of GDP in 2024, will now widen. The government's budget proposal aims to reduce the budget deficit from 6.1% of GDP this year to 5.0% next year, and down to 2.8% by 2029. This would require fiscal consolidation of 1.3% of GDP next year, the strongest effort since 2011, excluding the post-Covid period. Despite these efforts, debt is forecast to rise through 2027, peaking at 116.5% of GDP. France would be the only eurozone country to have a higher debt-to-GDP ratio than during the Covid period.

Funding programme: Agence France Trésor (AFT) has outlined its 2025 funding programme, planning to issue €285bn of medium- and long-term government

bonds net of buybacks, in line with market expectations. This provided relief to the market, which had feared a larger issuance to cover the rising deficit. However, some risk remains that the parliamentary budget debate could lead to amendments that increase the issuance. AFT has already flagged this possibility.

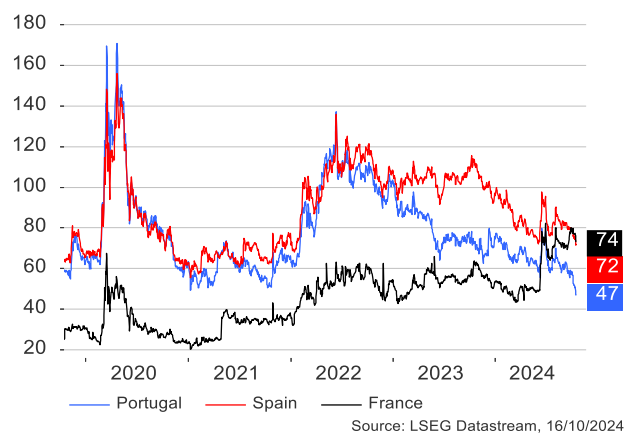
Outlook: We expect the OAT-Bund spread to remain in the 70-80bp range until early November, as political parties struggle to agree on spending cuts and new taxes. After that, the reduction in net supply and a shift away from short and under-weight positions should support OATs against Bunds, with the spread potentially narrowing to 65bp by year-end. We expect the 10-year spread to hover around 70bp in 2025. We keep a Neutral stance on French OATs despite attractive yields, anticipating volatility due to execution risks, and limited benefit from the expected spread compression.

Rating agencies: Fitch recently revised France's outlook to Negative and reaffirmed AA-. Moody's, which currently rates France Aa2/Stable, is due to review the country's rating on 25 October. While a downgrade to single-A would be the biggest risk, we consider this unlikely.

FRANCE'S 10-YEAR YIELD (%)



DIVERGENCE OF SPREADS BETWEEN FRANCE AND PERIPHERAL CRIES (BP)



INVESTMENT CONCLUSION

We expect the 10-year OAT-Bund spread to remain in the 70-80bp range until early November, and to hover around 70bp in 2025. While a sovereign rating downgrade to single-A would be the biggest risk, we consider this unlikely. We keep a Neutral stance on French government bonds despite attractive yields, anticipating volatility due to execution risks, and limited benefit from the expected spread compression.

Our Investment Recommendations

Asset class	Zone	Our opinion	
Government bonds	Germany	=	Neutral on German sovereign bonds.
	Peripheral countries	=	Neutral on peripheral debt (Portugal, Italy, Spain, Greece).
	United States	=	We tactically move to Neutral from Positive on US government bonds. We intend to re-enter the asset class with a better starting yield in a few months as we remain constructive on US Treasuries strategically. We also move to Neutral from Positive on US TIPS.
Corporate bonds Investment Grade	Eurozone	+	<ul style="list-style-type: none"> Eurozone and US: Positive opinion. Prefer short maturities in the US and up to 10 years in the eurozone Positive on convertible bonds in the eurozone.
	United States		
Corporate bonds High Yield	Eurozone and United States	=	<ul style="list-style-type: none"> Neutral on HY bonds. Positive on <i>fallen angels</i> and <i>rising stars</i>.
Emerging bonds	In hard currency	+	Positive on EM hard currency bonds (sovereign and corporate).
	In local currency	+	Positive on local currency government bonds.

Market Data

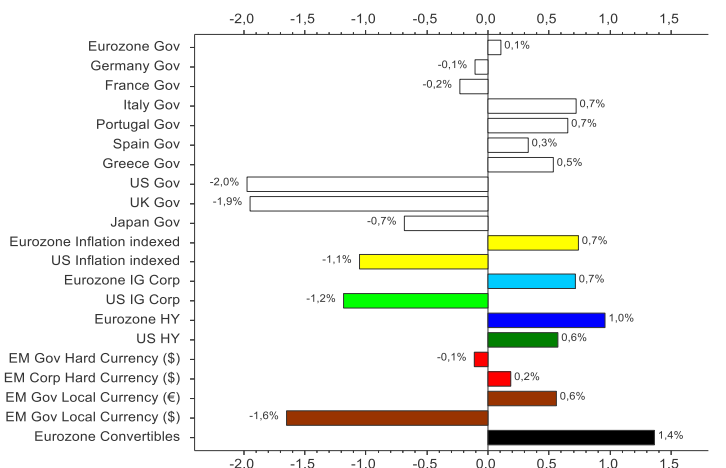
	10-year rate (%)	Spread (bp)	Spread change 1 month (bp)
United States	4,01	---	
Germany	2,18	---	
France	2,91	74	3
Italy	3,41	123	-13
Spain	2,90	72	-8
Portugal	2,64	47	-12
Greece	3,07	90	-11
16/10/2024 Source: Refinitiv Datastream			

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Global	3,46	36	-3
Corporate bonds IG EUR	3,20	108	-12
Corporate bonds IG USD	4,87	80	-16
Corporate bonds HY EUR	5,94	336	-30
Corporate bonds HY USD	7,14	287	-33
Emerging government bonds in hard currency	6,81	275	-38
Emerging corporate bonds in hard currency	6,13	207	-35
Emerging government bonds in local currency	6,28	244	15
16/10/2024 Source: Refinitiv Datastream, Bloomberg			



Returns

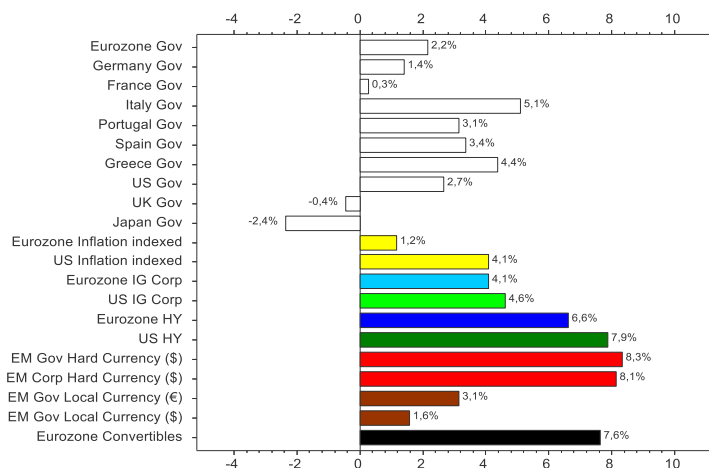
OVER ONE MONTH



Source: LSEG Datastream, 16/10/2024 Source: Bloomberg Barclays indices except EM local debt (JPM) and Convertibles (Refinitiv)

EM = Emerging Markets

SINCE 01/01/2024



Source: LSEG Datastream, 16/10/2024 Source: Bloomberg Barclays indices except EM local debt (JPM) and Convertibles (Refinitiv)

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