SEPTEMBER 2025

Fixed Income Focus

Summary

1. **ECB: No more rate cuts.** The ECB's July meeting delivered a more hawkish communication than we had expected. The tariff deal with the US also allowed reducing the risk of a major slowdown. As a result, we no longer expect the ECB to cut rates in September. We think the cycle is over, and the next move is a hike, in Q4 2026.

2. **Fed: Pressure to cut is rising.** The last employment reports were very weak, and this points to a rebalancing of risks surrounding the dual mandate due to increased concerns about the 'full employment' component. We expect 25bp cuts in both September and December, and further easing in 2026, targeting a 3.50% terminal rate.

3. **Bond yield targets:** We keep our 10-year yield targets over the next 12 months at 2.75% in Germany, 4.20% in the UK, and 4.25% in the US. For now, we remain Positive on core EU, US and UK government bonds, favouring intermediate maturities for both resilience and income.

4. **Topic in focus: Bond yield decomposition and inflation indexed bonds.** Earlier this year, the German real yield increased by around 20 basis points to about 0.75% and has remained around this level over recent months. Real yields could push a bit higher but that would be temporary. We do not see the recent rise to be sufficient to come back to EU inflation linked bonds. We see opportunities in US inflation indexed bonds (TIPS) as long as real yields remain close 2% or higher.

5. **Opportunities in Fixed Income:** In addition to core eurozone, US and UK government bonds, we are Positive on US Agency Mortgage-Backed Securities, US TIPS, and eurozone and UK investment grade corporate bonds.

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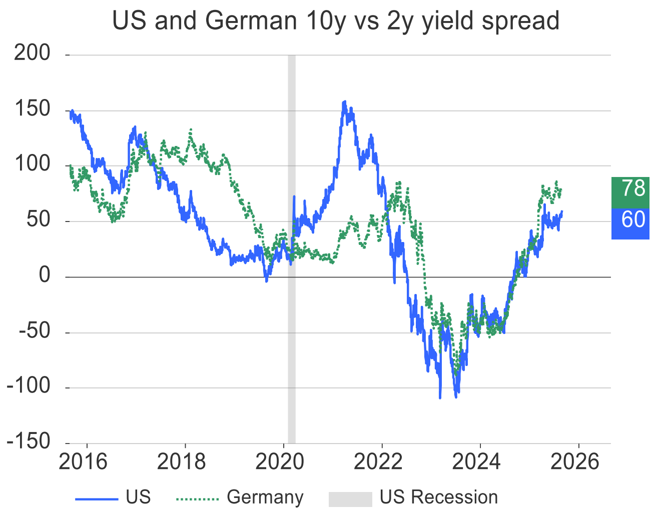
CHART OF THE MONTH: NO FURTHER CURVE STEEPENING OVER THE SUMMER



Source: LSEG Datastream, 27/08/2025

Drafting completed on 29 August 2025

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BNP PARIBAS
WEALTH MANAGEMENT

The bank for a changing world

Central banks

The ECB is probably done while the Fed will be cutting

European Central Bank (ECB)

The ECB's July meeting delivered a more hawkish message than we expected and suggests a more cautious stance. The new staff projections in September will probably show a visible and prolonged undershooting of the 2% inflation target. Resilient growth, fiscal developments and the recent US-EU trade deal limit any downside for economic activity.

As a result, we no longer expect the ECB to cut rates in September. The European defence and German infrastructure spending will lift growth and inflation over the medium term. With the negative effects of trade tensions starting to fade through 2026, we continue to see the ECB raising rates.

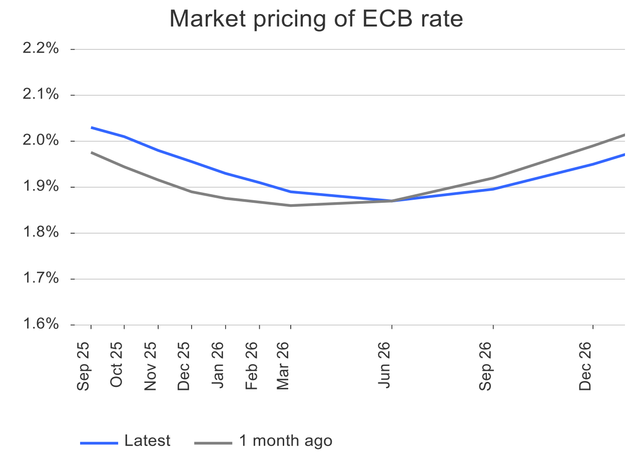
US Federal Reserve (Fed)

We look for a period of slower economic growth due to a transitory negative shock from tariffs and a temporary rise in inflation. Economic will slow but we expect no recession.

At the July meeting, Powell introduced a balanced approach based on unemployment and PCE inflation. The Fed committee has shifted its attention to the risks related to the labor market and seems confident that inflation pressures due to tariffs are a transitory phenomenon. The market pricing has gradually shifted towards pricing a rate cut in September. The inflation data for July surprised to the upside and cooled somewhat the expectations.

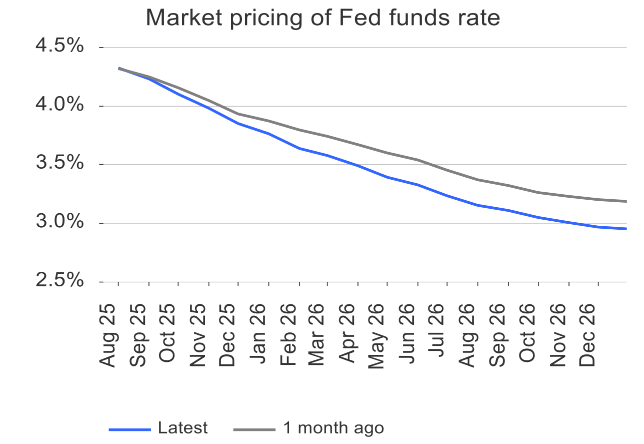
We expect 25bp cuts in both September and December, and two further easing in 2026, targeting a 3.50% terminal rate.

MARKETS EXPECT THE ECB TO BE DONE FOR THIS CYCLE



Source: LSEG Datastream, 26/08/2025

MARKETS NOW PRICE A FED RATE CUT IN SEPTEMBER



Source: LSEG Datastream, 26/08/2025

Investment Conclusion

We expect the Fed to begin cutting rates in September and December, with further reductions in 2026, ultimately reaching a terminal rate near 3.50%. For the ECB, we changed our forecast and do not expect any rate cut anymore for this cycle We expect a hike in late 2026 as growth and inflation recover.

Bond yields

No major trend except for peripheral spreads

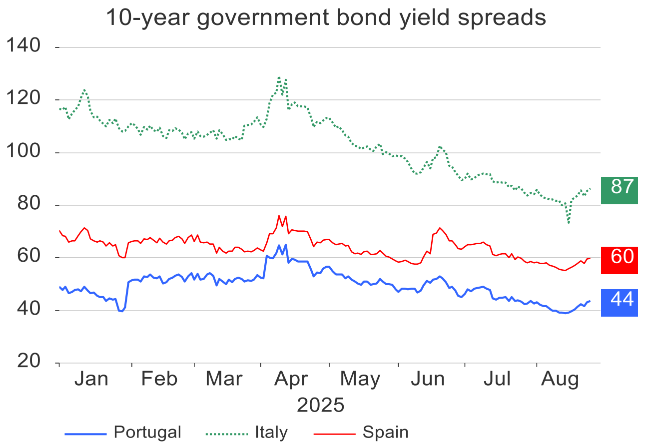
We saw no further steepening during the summer months. That was the case both US and German yields.

The US mortgage rate (30-year) peaked late October 2023 around 7.90%. It stabilized recently around 6.80% versus 4.85% for the 30-year government bond. The spread remains somewhat higher than on average over the last 35 years. In the eurozone, lending rates for house purchases have peaked late 2024 but the fall was quite moderate.

Peripheral spreads were generally down, continuing their remarkable downward trend after the peak early April. The biggest move was seen for Italy with a spread reduction from around 130 to almost 80 basis points. The announcement of the European defence and German infrastructure spending program certainly helped.

For now, we remain Positive on core EU, US and UK government bonds, favouring intermediate maturities for both resilience and income.

PERIPHERAL SPREADS



Source: LSEG Datastream, 26/08/2025

	Maturity (years)	28/08/ 2025	3-month target	12-month target
USA	Policy rate	4.50	4.25	3.50
	2	3.63	3.75	3.60
	5	3.69	3.75	3.75
	10	4.20	4.40	4.25
	30	4.87	4.75	4.50
Germany	Policy rate	2.00	2.00	2.00
	2	1.93	1.75	2.00
	5	2.25	2.00	2.15
	10	2.69	2.50	2.75
	30	3.30	3.00	3.25
UK	Policy rate	4.00	3.75	3.50
	2	3.94	3.80	3.60
	5	4.10	4.00	3.75
	10	4.70	4.50	4.20
	30	5.57	5.20	4.75

Source: Refinitiv Datastream, BNP Paribas WM

INVESTMENT CONCLUSION

For now, we keep our 10-year yield targets over the next 12 months at 2.75% in Germany, 4.20% in the UK, and 4.25% in the US. For now, we remain Positive on core EU, US and UK government bonds, favouring intermediate maturities for both resilience and income.

Topic in Focus

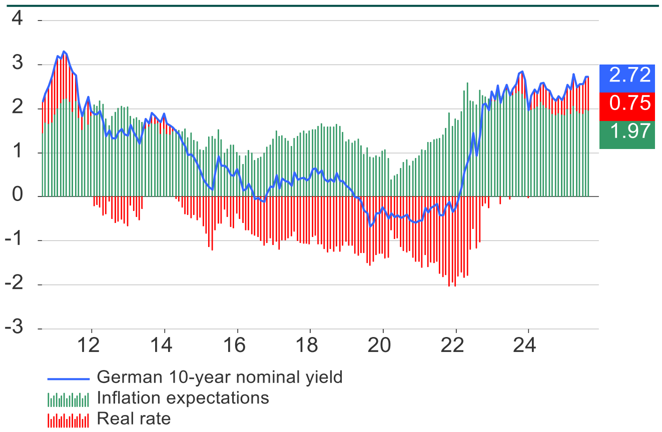
Bond yield decomposition and inflation indexed bonds

The bond yield can be broken down to separate expected inflation and real yields (or 'purchasing power') economic growth compensation. At this stage, German long term inflation expectations measured on the basis of inflation linked bonds have stabilized at around 2%. This is not surprising because the European economy is not at full employment and an acceleration in growth will not necessarily generate inflation above the ECB's target. The European monetary authority has established a remarkable credibility especially in terms of inflation as expectations remained well anchored. This year's rise in bond yields can therefore be explained primarily by a rise in real yields. The German real yield increased by around 20 basis points to about 0.75% and has remained around this level over recent months. Indeed, the German government's economic stimulus announcements and the potential for deregulation at the European level suggest higher real potential growth. This is the maximum growth compatible with stable inflation. It is estimated around 1%.

Looking at supply and demand, the additional supply of bonds is not expected to put a lot of upward pressure on yields as the demand for high rated government bonds is very large. Real yields could push a bit higher but that would be temporary. We do not see the recent rise to be sufficient to come back to EU inflation linked bonds.

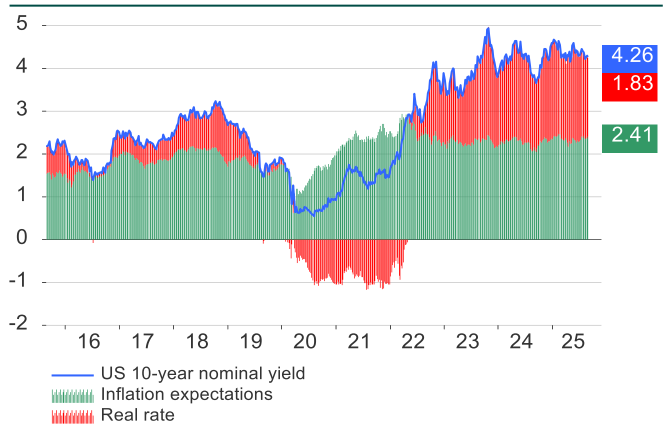
In the US, the situation is somewhat different. Looking at inflation and inflation expectations, they moved somewhat higher, and we could see these levels sustained over the coming months. Real yields have become positive since 2022 and have broken 2% late 2023. This is quite remarkable as it exceeds our estimate of the real potential growth in the US. This level is estimated at around 2%. We are concerned about the negative effects of the new immigration policy in the US on labor supply and potential growth. We do not share the optimism that AI would have a meaningful impact on that estimate. We see opportunities in inflation indexed bonds (TIPS) as long as real yields remain close 2% or higher.

DECOMPOSING GERMAN YIELDS



Source: LSEG Datastream, 27/08/2025

DECOMPOSING US YIELDS



Source: LSEG Datastream, 27/08/2025

INVESTMENT CONCLUSION

Earlier this year, the German real yield increased by around 20 basis points to about 0.75% and has remained around this level over recent months. Real yields could push a bit higher but that would be temporary. We do not see the recent rise to be sufficient to come back to EU inflation linked bonds. We see opportunities in US inflation indexed bonds (TIPS) as long as real yields remain close 2% or higher.

Topic in Focus

Renewed political uncertainty in France

Another political drama

The French Prime Minister will ask for a "confidence vote" on September 8th. The President will therefore have to call for an extraordinary parliamentary session. The government has no majority and low popularity in the polls. There is thus a high risk that the government will be defeated just ahead of the debate on the budget policy, starting in early October. The Prime Minister's rationale was probably to regain control ahead of the budget discussions.

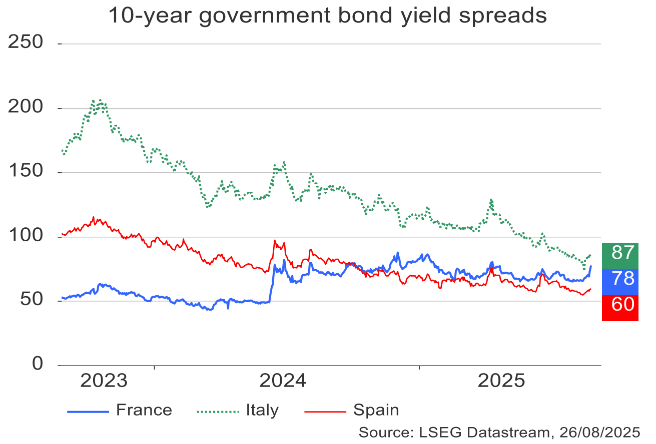
The Prime Minister will probably keep the door open for negotiations on the budget. President Macron suggested recently that if the government collapses, his preferred option would be to avoid new snap parliamentary elections and appoint a new prime minister. Persistent political blockade at the national assembly could however force the president to call for new parliamentary elections. In that case, recent polls suggest that the Far-right party might be leading, with RN leader Jordan Bardella or Marine Le Pen being seen as among the most popular MPs.

Things to monitor

The main risks to monitor is related to rising government bond yields and thus the cost of the debt. A possible trigger could be a rating downgrade. We do not expect a rating downgrade in the coming months. There are several rating decisions this year with Fitch (September 12), Moody's (24 October) and S&P (28 November). Risks of a downgrade will likely rise next year.

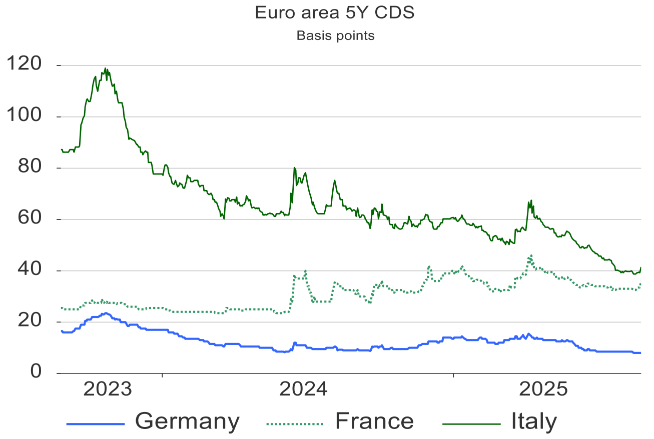
As we can see in left chart, the rise in the yield spreads (difference in yield compared to a similar bond of the German government) has been quite modest compared to the recent political crisis. In chart on the right, we see the evolution of the so-called credit default swap. This is an insurance premium against the default of the issuer. It thus reflects the perceived probability of default. Both charts suggest that the risk perception has increased but only moderately and remains quite low. To be monitored.

SOVEREIGN SPREADS



Source: LSEG Datastream, 26/08/2025

CREDIT DEFAULT SWAPS



Source: LSEG Datastream, 26/08/2025

Investment Conclusion

The French Prime Minister will ask for a "confidence vote" on September 8th. There is a high risk that the government will be defeated. In that case, the President will probably appoint a new prime minister and avoid new elections. Yield spreads have risen but only mildly. We need to monitor the evolution closely, but it is too early to evaluate whether the current spreads levels are attractive.

Our Investment Recommendations

Asset class	Zone	Our opinion	
Government bonds	Germany	+	Positive on German sovereign bonds. Prefer 5-10 years maturities.
	Peripheral countries	=	Neutral on peripheral debt (Portugal, Italy, Spain, Greece).
	United Kingdom	+	Positive on UK government bonds.
	United States	+	Positive on US government bonds, prefer 5-10 years maturities. Positive on TIPS.
Corporate bonds Investment Grade (IG)	Eurozone United Kingdom United States	+	• Positive on eurozone and UK IG corporate bonds, and Neutral on US corporate bonds. • We prefer maturities up to 7 years in the eurozone and up to 5 years in the US. • Positive on convertible bonds in the eurozone.
Corporate bonds High Yield (HY)	Eurozone and United States	=	• Neutral on HY bonds. • Positive on *fallen angels* and *rising stars*.
Emerging bonds	In hard currency	=	Neutral on EM hard currency bonds (sovereign and corporate).
	In local currency	=	Neutral on EM local currency government bonds.

Market Data

	10-year rate (%)	Spread (bp)	Spread change 1 month (bp)
United States	4.20	---	
Germany	2.69	---	
France	3.48	78	12
Italy	3.57	87	3
Spain	3.29	60	2
Portugal	3.15	45	3
Greece	3.36	71	3

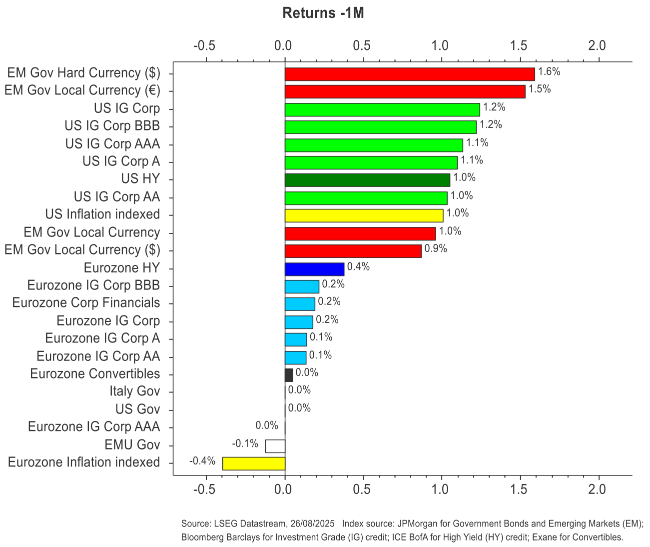
28/08/2025
Source: Refinitiv Datastream

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Global	3.49	20	-5
Corporate bonds IG EUR	3.06	82	3
Corporate bonds IG USD	5.86	79	1
Corporate bonds HY EUR	5.03	282	7
Corporate bonds HY USD	6.60	270	-8
Emerging government bonds in hard currency	6.64	225	-5
Emerging corporate bonds in hard currency	6.10	209	-8
Emerging government bonds in local currency	5.89	219	17

28/08/2025
Source: Refinitiv Datastream, Bloomberg

Returns

OVER ONE MONTH



EM = Emerging Markets

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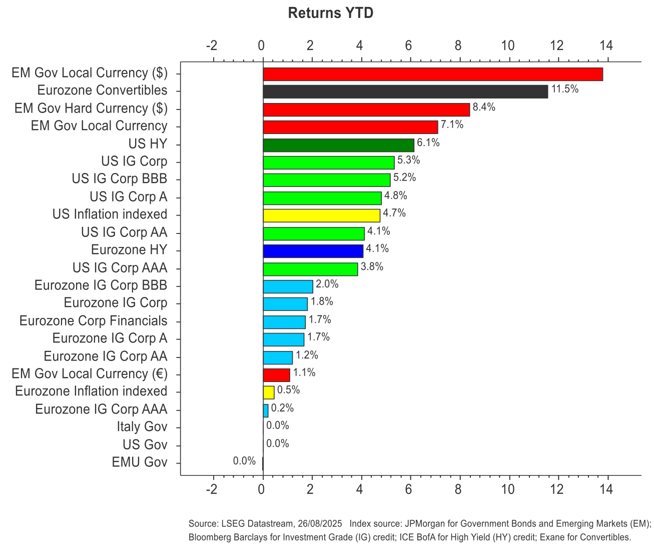

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