JULY 2025

Fixed Income Focus

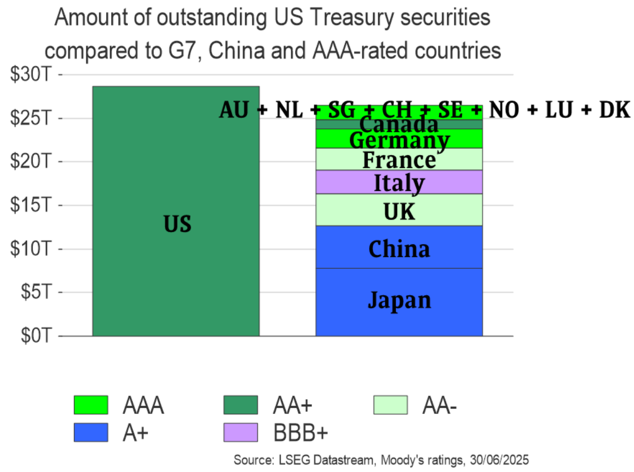
Summary

1. **ECB: Easing cycle nears end.** The ECB delivered another 25bp cut in June, bringing the deposit rate to 2%, within its estimated neutral range. With inflation near target but growth risks rising, one final cut to 1.75% is likely this year in September before a long pause. Rate hikes may return in late 2026 as fiscal expansion boosts growth and inflation.
2. **Fed: Poised to ease as signs of labour market cooling should emerge.** The Fed held rates steady in June, balancing political pressure and tariff-driven uncertainty. Policymakers are split, but with softer inflation and labour market signals, 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: Gilt turbulence, opportunity amidst the storm.** UK government bonds saw sharp yield swings on political and fiscal developments early July. Although political and fiscal risks persist, we expect the Bank of England to cut rates and lower bond yields within the next 12 months. We remain positive about UK government bonds. Also on UK investment grade corporate bonds, which remain resilient, with tight spreads and elevated yields providing a buffer against shocks.
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.

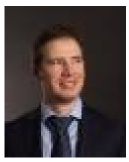
Drafting completed on 8 July

Contents

CHART OF THE MONTH: INVESTORS CAN'T IGNORE US TREASURIES, A UNIQUE MARKET DISTINGUISHED BY ITS SIZE, DEPTH, AND STRONG CREDIT RATING



Edouard Desbonnets
Senior Investment Advisor, Fixed Income
BNP Paribas Wealth Management



BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Central banks

ECB likely to stop cutting soon, Fed likely to start cutting soon

European Central Bank (ECB)

Another cut, nearing Neutral: The ECB delivered a further 25bp cut in June, bringing the deposit rate to 2%. This places the rate within the ECB's estimated neutral range of 1.75%–2.25% and signals that the central bank is close to ending its tightening cycle. From here, policy adjustments will focus on fine-tuning and will be closely tied to incoming data. As the rate approaches neutral, hawkish members of the Governing Council are warning against further easing, given the uncertainty surrounding US tariffs.

Navigating a stronger euro and downside risks: ECB Vice President Guindos stated that the current level of the euro (1.175) is not problematic, though a rapid rise to $1.20 could present challenges for policymakers. We believe risks to economic growth have increased, and inflation will likely remain around target, justifying a final rate cut this year and leading to a terminal rate of 1.75%. After a prolonged pause, we expect interest rate increases in late 2026, driven by fiscal spending that will boost both growth and inflation.

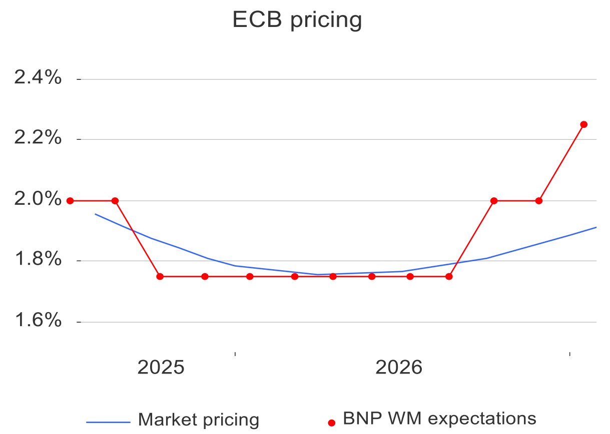
US Federal Reserve (Fed)

The courage to do nothing: At the June FOMC meeting, the Federal Reserve kept its policy rate unchanged, despite intense political pressure from President Trump, who has publicly called for lower rates. Chair Powell made it clear that, were it not for the recent wave of tariffs, the Fed would likely have already begun to ease policy.

Division: Policymakers are split, with half favoring no rate cuts this year due to inflation uncertainty caused by tariffs, while the other half support two rate cuts, perceiving a deterioration in the labour market.

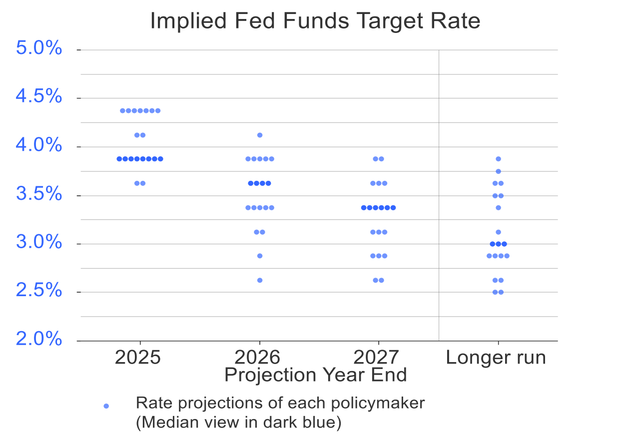
Balancing a conflicted mandate: In recent history, when faced with a conflicting mandate, the Fed has tended to prioritize employment over inflation. Therefore, we continue to anticipate rate cuts of 25bp in September and December, followed by two further cuts in 2026. This would bring the terminal rate to 3.5% by mid-2026, compared with market pricing indicating a terminal rate of 3.24% in Q3 2026.

WE ARE ALIGNED WITH MARKET PRICING UNTIL MID-2026



Source: LSEG Datastream, 08/07/2025

POLICYMAKERS HAVE VERY DIFFERENT VIEWS ON WHERE RATES SHOULD GO



Source: LSEG Datastream, 18/06/2025

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 see one more cut possible this year, bringing the deposit rate to 1.75%, before a long pause and eventual hikes in late 2026 as growth and inflation recover.

Bond yields

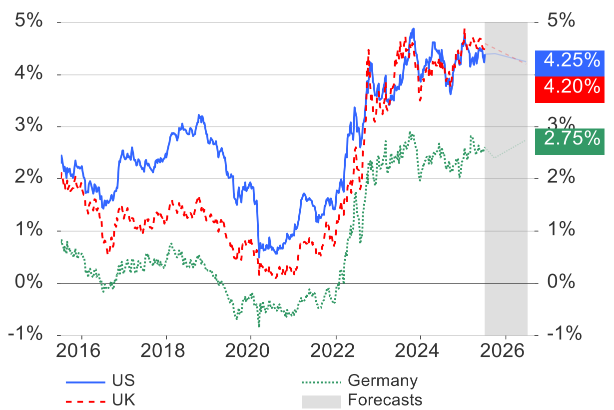
Mixed

US yields have fallen from recent highs as markets reassess the direction of monetary policy. Softer inflation data, signs of a cooling labour market, and pressure from the US President have increased expectations of Fed rate cuts this year, pushing down both US short- and long-term yields.

In contrast, German yields increased in June due to fiscal developments and NATO spending commitments, despite the widely expected eighth consecutive rate cut by the ECB.

In the first part of the year, bond yields were driven by tariffs and fiscal risks. In the second half of the year, the focus should shift back to fundamentals such as growth, inflation, and global demand. US yields may come under pressure in the coming months as the US government must refinance USD 7 trillion of debt before year-end. We anticipate the US 10-year yield will then decline to 4.25% by mid-2026. We expect German yields to remain within a certain range before beginning to rise in 2026, to 2.75% by mid-2026, driven by higher growth, inflation, and significant bond issuance.

10-YEAR RATES



Source: LSEG Datastream, 08/07/2025

	Maturity (years)	07/07/2025	3-month target	12-month target
USA	Policy rate	4.50	4.25	3.50
	2	3.90	3.75	3.60
	5	3.96	3.75	3.75
	10	4.39	4.40	4.25
	30	4.92	4.75	4.50
Germany	Policy rate	2.00	1.75	1.75
	2	1.84	1.75	2.00
	5	2.16	2.00	2.15
	10	2.61	2.50	2.75
	30	3.12	3.00	3.25
UK	Policy rate	4.25	4.00	3.50
	2	3.87	3.80	3.60
	5	4.02	4.00	3.75
	10	4.59	4.50	4.20
	30	5.39	5.20	4.75

Source: Refinitiv Datastream, BNP Paribas WM

INVESTMENT CONCLUSION

For now, we remain positive on core EU, US, and UK government bonds, favouring intermediate maturities. The current yield levels offer both attractive income and the potential for capital gains should economic growth slow more than anticipated or if central banks accelerate their easing cycles. Policy uncertainty and market volatility are likely to persist throughout the year.

Topic in Focus

Gilt turbulence: Opportunity amidst the storm

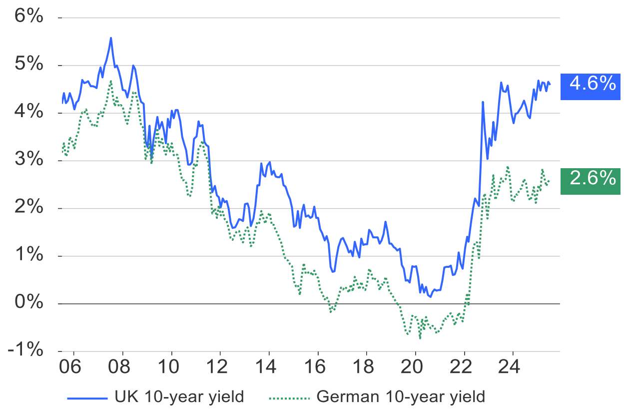
A volatile summer for UK yields: The UK government bond market has experienced significant volatility. On 2 July, 10-year gilt yields posted their sharpest rise since the Truss mini-budget crisis of 2022, driven by political uncertainty and fiscal concerns. Tensions over contentious welfare reform within Labour added to the pressure. Although the reform passed, significant concessions reduced the projected £5 billion in savings. While this does not meaningfully alter the UK fiscal outlook, it reinforces concerns about the credibility of planned spending cuts.

Political risk and fiscal discipline: Markets are increasingly alert to signs of weakening fiscal discipline. The government's U-turns on welfare and internal divisions have fueled fears of further slippage. While PM Starmer's reassurance that Reeves remains in post has calmed markets slightly, the shift in sentiment is clear. Investors now want more than just pledges; they are demanding credible and detailed plans to rebuild fiscal headroom. We believe tax rises are the most likely option. Major spending cuts appear politically challenging, particularly as other spending needs, such as defense, are rising. Furthermore, loosening fiscal rules could undermine investor confidence.

Market positioning: Despite volatility, UK gilts offer a yield premium over their European counterparts, with 10-year yields well above Bunds (see chart). We expect the UK 10-year yield to fall to 4.2% within 12 months. With the BoE likely to cut rates - we expect quarterly rate cuts from August until the policy rate reaches 3.50% -, economic growth to slow, inflation to decline, and a higher likelihood of a Quantitative Tightening slowdown, current levels offer a compelling entry point for long-term investors. Volatility may persist ahead of the autumn budget, but gilts remain attractive in our view.

Corporate bonds: We prefer quality. The investment grade corporate bond market has held up well, with tight spreads and elevated yields. Although fundamentals have softened slightly, all-in yields (see chart) provide a buffer against shocks.

UK AND GERMAN 10-YEAR YIELDS



Source: LSEG Datastream, 07/07/2025

ALL-IN YIELDS ON UK IG CORPORATE BONDS PROVIDE A BUFFER AGAINST SHOCKS

Source: LSEG Datastream, 07/07/2025

INVESTMENT CONCLUSION

We remain positive about UK government and investment grade corporate bonds. Although political and fiscal risks persist, we expect the Bank of England to cut rates and lower bond yields within the next 12 months. Elevated all-in yields provide a buffer against shocks.

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	4.39	---	
Germany	2.61	---	
France	3.33	72	5
Italy	3.52	91	-3
Spain	3.26	66	8
Portugal	3.09	49	0
Greece	3.36	75	3

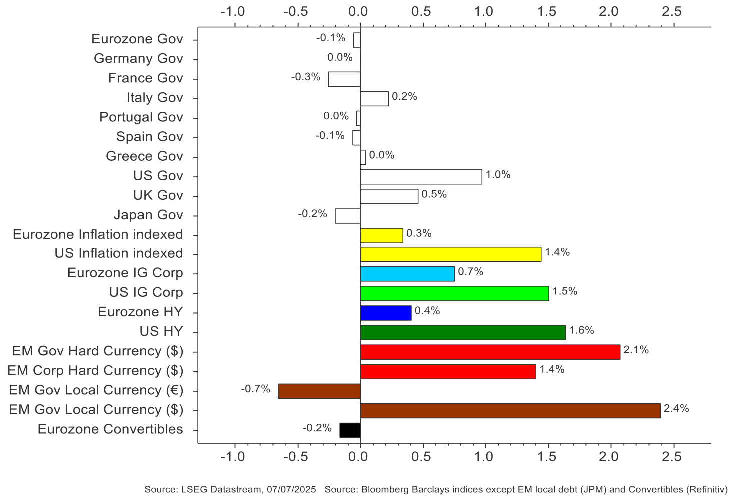
07/07/2025
Source: Refinitiv Datastream

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Global	3.53	31	-2
Corporate bonds IG EUR	3.03	86	-10
Corporate bonds IG USD	5.11	79	-6
Corporate bonds HY EUR	5.45	298	-3
Corporate bonds HY USD	7.05	274	-26
Emerging government bonds in hard currency	6.64	230	-10
Emerging corporate bonds in hard currency	6.39	217	-18
Emerging government bonds in local currency	5.98	202	-8

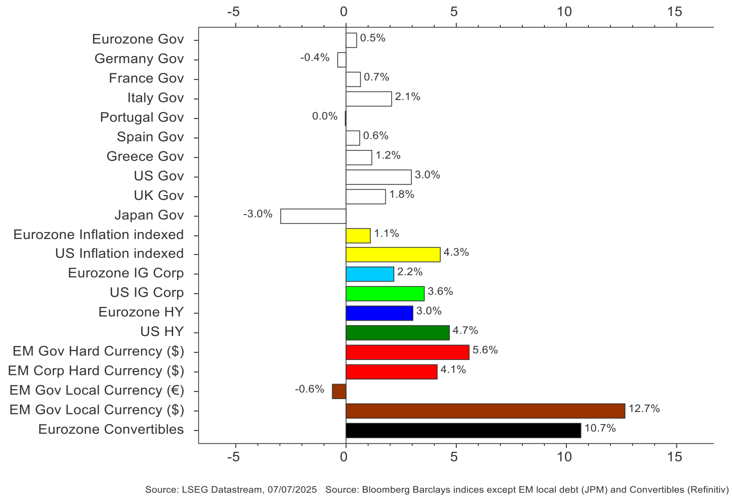
07/07/2025
Source: Refinitiv Datastream, Bloomberg

Returns

OVER ONE MONTH



SINCE 01/01/2025



EM = Emerging Markets

THE INVESTMENT STRATEGY TEAM

FRANCE

Edmund SHING
Global Chief Investment Officer

Jean-Roland DESSARD
Chief Investment Advisor

Isabelle ENOS
Investment Advisor

ITALY

Luca IANDIMARINO
Chief Investment Advisor

BELGIUM

Philippe GIJSELS
Chief Investment Advisor

Alain GERARD
Senior Investment Advisor, Equities

Patrick CASSELMAN
Senior Commodities Strategist

GERMANY

Stephan KEMPER
Chief Investment Strategist
Stefan MALY

LUXEMBOURG

Guy ERTZ
Chief Investment Advisor – Deputy Global CIO

Edouard DESBONNETS
Senior Investment Advisor, Fixed Income

ASIA

Prashant BHAYANI
Chief Investment Officer, Asia

Grace TAM
Chief Investment Advisor, Asia

CONNECT WITH US

wealthmanagement.bnpparibas

DISCLAIMER

This marketing document is communicated by the Wealth Management Métier of BNP Paribas, a French Société Anonyme, Head Office 16 boulevard des Italiens, 75009 Paris, France, registered under number 662 042 449 RCS Paris, registered in France as a bank with the French Autorité de Contrôle Prudentiel et de résolution (ACPR) and regulated by the French Autorité des Marchés Financiers (AMF). As marketing material, it has not been prepared in accordance with legal and regulatory requirements aimed at ensuring the independence of investment research and is not subject to any prohibition on dealing ahead of its dissemination. It has not been submitted to the AMF or any other market authority.

This document is confidential and intended solely for the use of BNP Paribas SA, BNP Paribas Wealth Management SA or their affiliates ("BNP Paribas") and the persons to whom this document has been delivered. It may not be distributed, published, reproduced or disclosed by any recipient to any other person, nor may it be quoted or referred to in any document, without the prior consent of BNP Paribas.

This document is provided solely for information and shall not constitute an offer or solicitation in any state or jurisdiction in which such an offer or solicitation is not authorized, or to any person to whom it is unlawful to make such offer, solicitation or sale. It is not, and under no circumstances is it to be construed as, a prospectus.

Although the information provided herein may have been obtained from published or unpublished sources considered to be reliable and while all reasonable care has been taken in the preparation of this document, BNP Paribas does not make any representation or warranty, express or implied, as to its accuracy or completeness and does not accept responsibility for any inaccuracy, error or omission. BNP Paribas gives no warranty, guarantee or representation as to the expected or projected success, profitability, return, performance, result, effect, consequence or benefit (either legal, regulatory, tax, financial, accounting or otherwise) of any product or transaction. Investors should not place undue reliance on any theoretical historical information regarding such theoretical historical performance. This document may contain or refer to past performance; past performance is no guarantee for future performance.

The information contained in this document has been drafted without prior knowledge of your personal circumstances, including your financial position, risk profile and investment objectives.

Prior to entering into a transaction each investor should fully understand the financial risks, including any market risk associated with the issuer, the merits and the suitability of investing in any product and consult with his or her own legal, tax, financial and accounting advisors before making his or her investment. Investors should be in a position to fully understand the features of the transaction and, in the absence of any provision to the contrary, be financially able to bear a loss of their investment and willing to accept such risk. Investors should always keep in mind that the value of investments and any income from them may go down as well as up and that past performance should not be seen as an indication of future performance. Any investment in a product described herein is subject to the prior reading and understanding of the legal documentation concerning the product, and in particular the one which describes in details the rights and obligations of investors as well as the risks inherent to an investment in the product. Save as otherwise expressly agreed in writing, BNP Paribas is not acting as financial adviser or fiduciary of the investor in any transaction. The information, opinions and projections expressed herein reflect the opinion of their author at the time of writing; they are not to be relied upon as authoritative or taken in substitution for the exercise of judgment by anyone, and are subject to change without notice. Neither BNP Paribas nor any BNP Paribas Group entity accepts any liability whatsoever for any consequences that may arise from the use of information, opinions or projections contained herein.

As distributor of the products described herein, BNP Paribas may receive distribution fees on which you can obtain more information upon specific request. BNP Paribas, their employees or administrators may hold positions in these products or have dealings with their issuers.

By accepting this document, you agree to be bound by the foregoing limitations.