NOVEMBER 2024

Fixed Income Focus

Summary

1. **Central banks: the Fed likely to slow its rate-cutting cycle while the ECB accelerates its own.** We have revised our forecasts to account for possible economic changes following the US election results. We now anticipate the Fed will cut rates in December and at a quarterly cadence in 2025, pausing at a 3.75% policy rate in September 2025. In the eurozone, we expect five 25bp cuts, reaching a 2% policy rate by September 2025.
2. **Bond yields:** we expect the US 10-year yield to drop modestly in the coming months and then rise in H2 2025 as the macroeconomic landscape shifts. We have revised our 12-month target for the US 10-year yield upwards to 4.25%. In contrast, we have maintained our 2.25% target for the German 10-year bund. We remain Neutral on both US Treasuries and German government bonds with a 12-month outlook.
3. **Theme in focus: What a Red sweep could mean for bonds.** The US election results triggered a massive knee-jerk reaction in the US, with higher bond yields and fewer Fed rate cuts expected. We believe the major impacts will be:
   - 1) the Fed will be forced to pause its rate-cutting cycle in September 2025 with a policy rate at 3.75%,
   - 2) US bond yields will rise in H2 2025,
   - 3) credit corporate spreads will remain tight and may tighten further,
   - 4) risks will rise for EM bonds, prompting us to shift from Positive to Neutral on Emerging Market bonds.
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.

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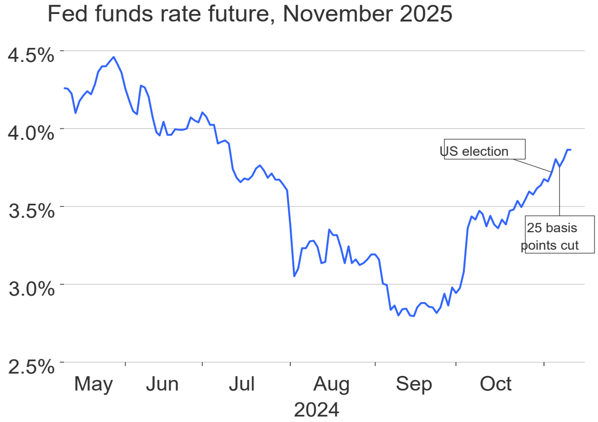
CHART OF THE MONTH: SHORT-TERM RATE EXPECTATIONS ROSE BEFORE AND AFTER TRUMP WIN



Source: LSEG Datastream, 12/11/2024

Drafting completed on 13 November

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Central banks

Synchronised monetary easing (for now)

European Central Bank (ECB)

US election impact: Following the US election result, the market has revised expectations towards more rate cuts, now pricing a terminal rate around 2% by late 2025.

Macro data: The eurozone economy is stagnating, with risks of further slowing, while disinflation remains on track, and inflation expectations have dropped markedly.

Increasing dovishness: Recently, policymakers have clearly pivoted towards prioritising economic growth. Most advocate a return to a neutral rate, while some argue for lowering rates below neutral to stimulate the economy. There is consensus that monetary policy should leave restrictive territory next year.

Our view: With the eurozone likely impacted by potential US tariffs and possible similar retaliation from the eurozone, we foresee a further slowdown in economic momentum by H2 2025. We now anticipate five 25bp rate cuts until the policy rate reaches 2% by September 2025.

US Federal Reserve (Fed)

US election impact: The market has adjusted its expectations to fewer rate cuts (4.6 of 25bp in this cycle), a shift that began before the election due to consistently strong macro data and continued after the results, as Trump's policies are seen as inflationary.

Fed reaction: The Fed bases its decisions solely on incoming data and does not forecast the impact of new administrative policies. It refrains from speculating on political changes.

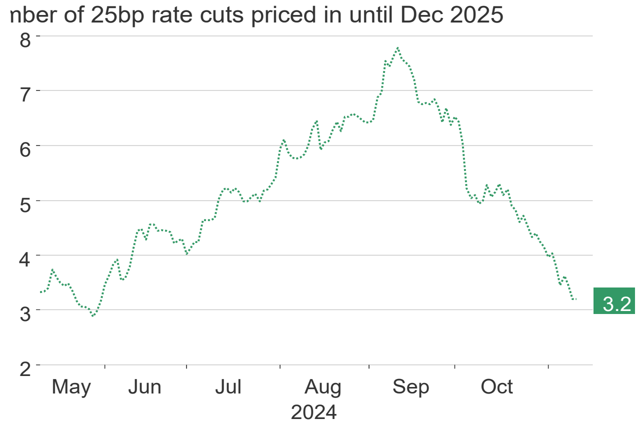
Macro data matters: Economic activity has continued to expand at a solid pace. Inflation has advanced toward the 2% goal but remains elevated, while the labour market shows signs of gradual softening.

Our view: With inflation likely to rise by late 2025, we have removed two rate cuts from our previous forecast. We expect the Fed to cut rates in December and then at a quarterly cadence in 2025, pausing with a policy rate at 3.75% in September 2025.

THE MARKET HAS BEEN PRICING IN MORE RATE CUTS IN THE EUROZONE

Source: LSEG Datastream, 12/11/2024

THE MARKET HAS BEEN PRICING IN LESS RATE CUTS IN THE US



Source: LSEG Datastream, 12/11/2024

INVESTMENT CONCLUSION

The Fed likely to slow its rate-cutting cycle while the ECB accelerates its own. We have revised our forecasts to account for possible economic changes following the US election results. We now anticipate the Fed will cut rates in December and at a quarterly cadence in 2025, pausing at a 3.75% policy rate in September 2025. In the eurozone, we expect five 25bp cuts, reaching a 2% policy rate by September 2025.

Bond yields

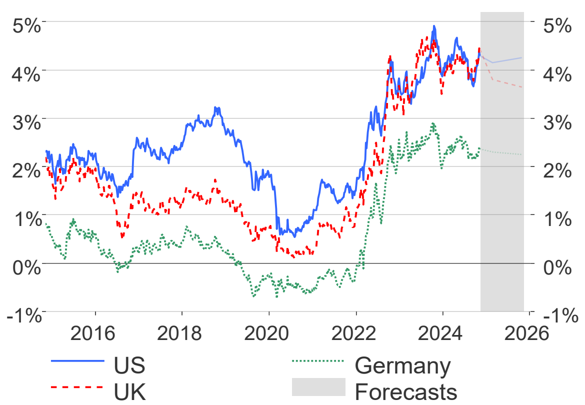
Massive repricing

The Trump trade: higher nominal yields, higher real yields, higher inflation breakevens, higher term premiums, and steeper curves. A massive repricing has occurred in the US, as Trump's policy approach includes tariffs, reduced immigration, and tax cuts—measures that are inflationary and involve increased fiscal spending.

Change in bond yield targets: In the US, we expect fewer rate cuts from the Fed and a higher term premium, reflecting increased uncertainty around inflation. Thus, while the US 10-year yield may decline in the coming months, we anticipate it will rise again as the macroeconomic landscape shifts in H2 2025, prompting us to revise our 12-month target upwards. By contrast, we have maintained our bond yield targets in Germany, where the central bank is expected to stay on course and disinflation continues.

Our recommendation: We maintain a Neutral view on US Treasuries and German government bonds, with a short duration bias in the US (under 5 years) over a 12-month horizon, and a neutral duration bias in Germany (around 7 years).

10-YEAR RATES



Source: LSEG Datastream, 12/11/2024

	Maturity (years)	11/11 2024	3-month target	12-month target
USA	Policy rate	4.75	4.50	3.75
	2	4.26	4.00	4.00
	5	4.19	4.00	4.10
	10	4.30	4.15	4.25
	30	4.46	4.30	4.50
Germany	Policy rate	3.25	2.75	2.00
	2	2.13	2.10	2.00
	5	2.15	2.15	2.10
	10	2.33	2.30	2.25
	30	2.56	2.55	2.50
UK	Policy rate	4.75	4.75	4.00
	2	4.42	3.50	3.25
	5	4.32	3.60	3.40
	10	4.43	3.80	3.65
	30	4.87	4.25	4.10

Source: Refinitiv Datastream, BNP Paribas WM

Investment Conclusion

We expect the US 10-year yield to drop modestly in the coming months and then rise in H2 2025 as the macroeconomic landscape shifts. We have revised our 12-month target for the US 10-year yield upwards to 4.25%. In contrast, we have maintained our 2.25% target for the German 10-year bund. We remain Neutral on both US Treasuries and German government bonds with a 12-month outlook.

Theme in Focus

What a Red sweep could mean for bonds

The recent US presidential election has had significant implications for financial markets, particularly in central bank policies, bond yields, and bond markets.

Central banks: We anticipate monetary divergence, with the Fed likely to slow its rate-cutting cycle due to anticipated higher inflation in late 2025, while the ECB accelerates its cuts given a slowdown in economic momentum.

Government bonds: We expect the US 10-year yield to drop in the coming months and then rise in H2 2025 as the macroeconomic landscape evolves. Although there is an opportunity to lock in current yields, we believe other opportunities will arise in late 2025. As such, we remain Neutral on both US Treasuries and German government bonds with a 12-month outlook.

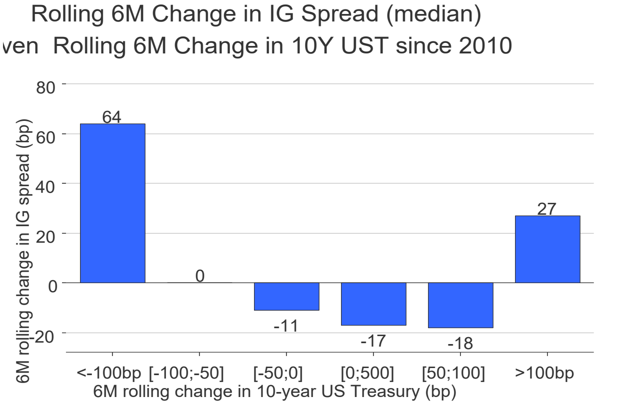
Investment grade corporate bonds: Credit spreads are already tight, particularly in the US, and may tighten further. With deregulation and corporate tax cuts to 15% (from 21%) on the Trump agenda, potentially boosting corporate net income by 6-7%, spreads are likely to remain tight.

Sectors with higher tax rates, including telecoms, banks, energy, and consumer cyclicals, stand to benefit the most from potential tax cuts. For Europe, while tariffs and geopolitical concerns are credit negative, strong technical factors and expected declines in bond yields should support positive returns. We remain Positive on USD/EUR investment grade bonds.

High yield corporate bonds: Credit spreads could reach new cycle lows in the US, supported by deregulation and tax cuts. However, we prefer not to chase the rally and stay Neutral on this asset class, as valuations are already very tight. Sectors likely to benefit most from tax cuts include telecoms, consumer cyclicals, and energy.

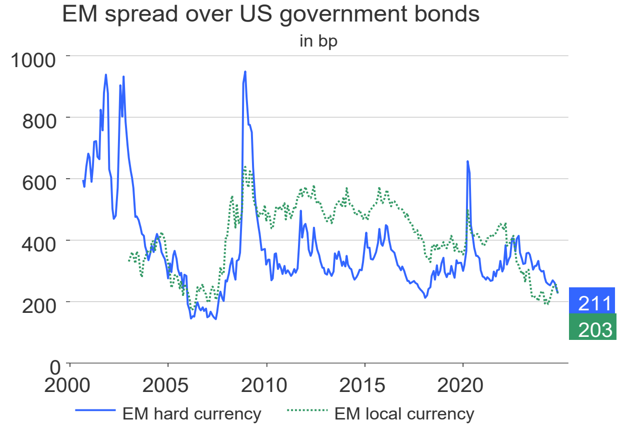
Emerging Market bonds: Fundamentals are positive, the carry is attractive, and EM central banks are expected to continue cutting rates in 2025. However, risks have increased with expected higher bond yields and a stronger dollar. Additionally, tariffs and trade tensions will harm EM exporters. Consequently, we have revised our stance from Positive to Neutral on EM bonds in both hard and local currency.

IG SPREADS TEND TO TIGHTEN UNLESS BOND YIELDS RISE OR DECREASE SHARPLY



Source: LSEG Datastream, BNP Paribas, 12/11/2024

EM VALUATIONS ARE TIGHT



Source: LSEG Datastream, 12/11/2024

Investment Conclusion

The US election results triggered a massive knee-jerk reaction in the US, with higher bond yields and fewer Fed rate cuts expected. We believe the major impacts will be: 1) the Fed will be forced to pause its rate-cutting cycle in September 2025 with a policy rate at 3.75%, 2) US bond yields will rise in H2 2025, 3) credit corporate spreads will remain tight and may tighten further, and 4) risks will rise for EM bonds, prompting us to shift from Positive to Neutral on Emerging Market bonds.

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 United States	+	• 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.
Corporate bonds High Yield	Eurozone and United States	=	• Neutral on HY bonds. • Positive on *fallen angels* and *rising stars.*
Emerging bonds	In hard currency	=	We turn Neutral from Positive on EM hard currency bonds (sovereign and corporate).
	In local currency	=	We turn Neutral from Positive on EM local currency government bonds.

Market Data

	10-year rate (%)	Spread (bp)	Spread change 1 month (bp)
United States	4.30	---	
Germany	2.33	---	
France	3.08	75	-2
Italy	3.59	127	-2
Spain	3.05	73	-2
Portugal	2.83	51	0
Greece	3.22	89	-8

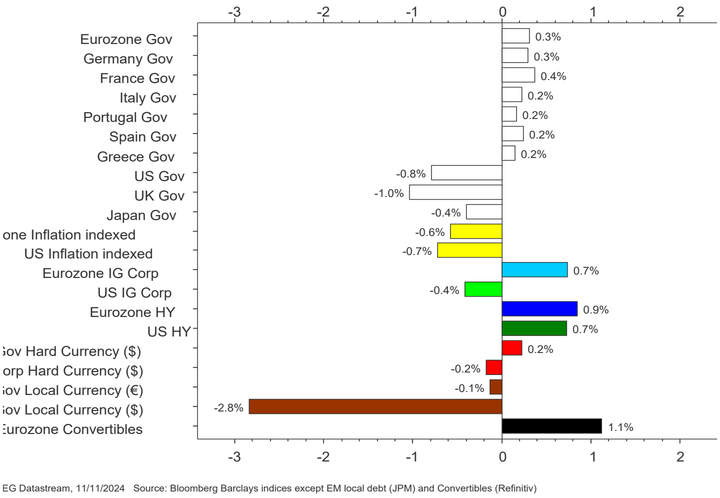
11/11/2024
Source: Refinitiv Datastream

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Global	3.61	34	-2
Corporate bonds IG EUR	3.18	99	-10
Corporate bonds IG USD	5.09	74	-7
Corporate bonds HY EUR	5.81	318	-17
Corporate bonds HY USD	7.12	256	-38
Emerging government bonds in hard currency	6.89	255	-23
Emerging corporate bonds in hard currency	6.34	198	-10
Emerging government bonds in local currency	6.32	213	7

11/11/2024
Source: Refinitiv Datastream, Bloomberg

Returns

OVER ONE MONTH



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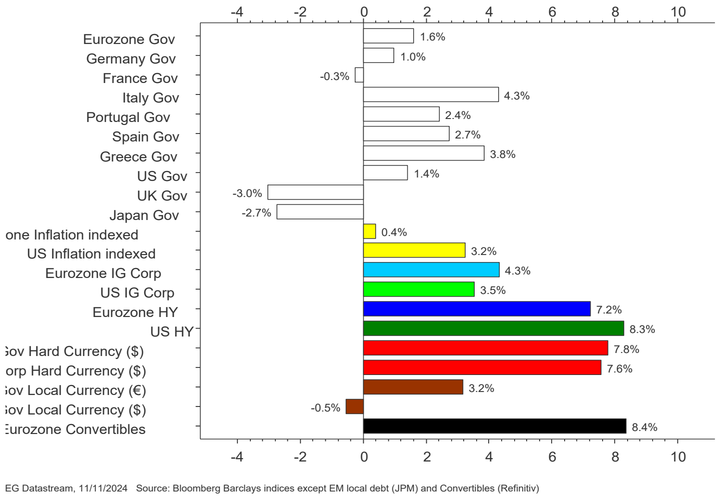

EM = Emerging Markets

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