OCTOBER 2025

Fixed Income Focus

Summary

1. **Policy divergence: ECB holds, Fed cuts.** With key data delayed and visibility clouded, we expect the Fed to stick to the median "dot plot" plan for this year, i.e. two rate cuts. We also anticipate two additional cuts in 2026, bringing the terminal rate to 3.25%. In our view, markets are too aggressive in pricing Fed cuts. In the eurozone, we expect the ECB to keep rates on hold for several quarters, with any rate hike occurring no earlier than December 2026.
2. **Bond yield targets:** We maintain our 12-month 10-year yield targets at 2.75% in Germany, 4.40% in the UK, and 4.25% in the US. We remain Positive on core EU, US, and UK government bonds, favouring short-dated maturities in the US and intermediate tenors elsewhere.
3. **Emerging Markets local currency bonds: recommendation raised to Positive from Neutral**, supported by improved macro fundamentals, attractive yields, and favourable currency and policy trends.
4. **Fed independence under scrutiny:** We continue monitoring fading Fed independence, as this may impact both macroeconomic outcomes (higher growth and inflation) and financial markets (higher term premium, steeper yield curve, weaker dollar, increased market volatility).
5. **Credit market update: The recent default of First Brands** underscores the importance of discipline and diversification. We remain Neutral on USD corporate High Yield bonds. Return drivers will predominantly come from carry, rather than spread tightening or gains from falling rates.
6. **Opportunities in Fixed Income:** In addition to the above-mentioned core eurozone, US, and UK government bonds, and EM local bonds, we are Positive on US Agency Mortgage-Backed Securities, US TIPS, and eurozone and UK investment grade corporate bonds.

Drafting completed on 15 October 2025

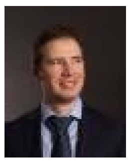
Contents

CHART OF THE MONTH: WE EXPECT OAT TO REMAIN IN A WIDER RANGE (75–90BP) AS RISK PREMIUM REMAINS HIGH IN FRANCE

Source: LSEG Datastream, 14/10/2025

Edouard Desbonnets

Senior Investment Advisor, Fixed Income
BNP Paribas Wealth Management



BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Central banks

Policy divergence: ECB holds, Fed cuts

European Central Bank (ECB)

Easing cycle ends: The Governing Council appears increasingly comfortable with its current stance. Traders agree the ECB has ended its easing phase, even as downside growth risks persist. A stronger euro limits imported inflation but weighs on exports.

Wait and see: The ECB is likely to tolerate inflation temporarily below the 2% target. Its own projections point to 1.7% in 2026 and 1.9% in 2027.

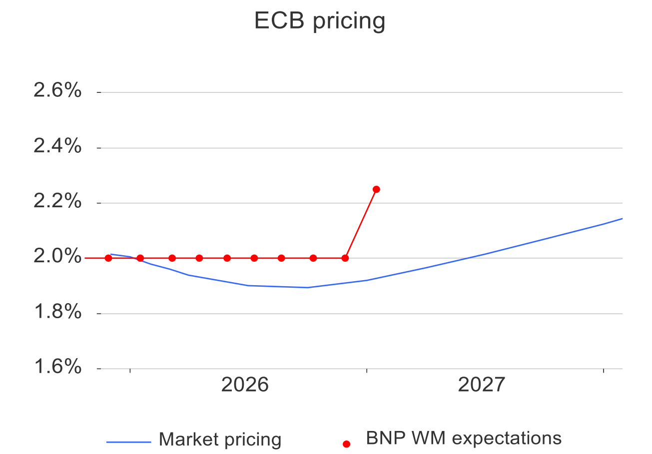
Our view: While near term risks tilt toward cuts, we expect the ECB to keep rates on hold for several quarters. The fiscal impulse should be felt only by late 2026, hence, we see scope for a 25bp hike no earlier than December 2026.

US Federal Reserve (Fed)

Foggy macroeconomic background: The US labour market is experiencing adjustments, with demand for workers easing and supply also constrained, notably due to tighter immigration policies. Inflation dynamics are shifting as well: core goods now contribute positively to CPI inflation, reflecting tariffs' lingering effects.

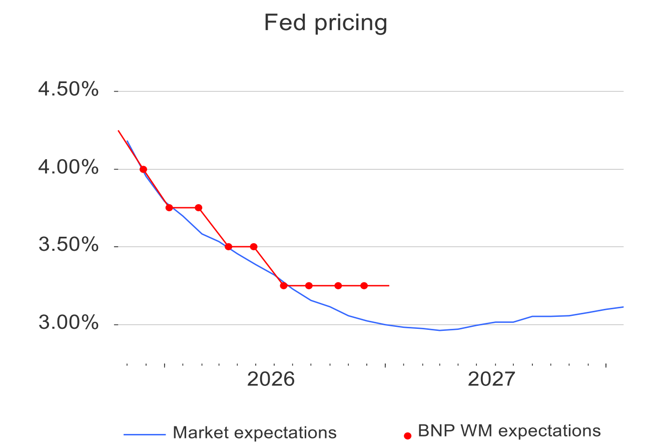
Our view: With key data delayed and visibility clouded, we expect the Fed to stick to its median dot plot path of two rate cuts in 2025 (October and December). We expect two additional cuts in 2026, bringing the terminal rate to 3.25%. Inflation risks should prevent deeper easing, and we do not share market expectations for a policy rate just below 3% by early 2027.

MARKETS EXPECT THE ECB TO BE DONE FOR THIS CYCLE



Source: LSEG Datastream, 15/10/2025

MARKETS ARE TOO AGGRESSIVE ON FED CUTS IN OUR VIEW



Source: LSEG Datastream, 14/10/2025

INVESTMENT CONCLUSION

With key data delayed and visibility clouded, we expect the Fed to stick to the median "dot plot" plan for this year, i.e. two rate cuts. We also anticipate two additional cuts in 2026, bringing the terminal rate to 3.25%. In our view, markets are too aggressive in pricing Fed cuts. In the eurozone, we expect the ECB to keep rates on hold for several quarters, with any rate hike occurring no earlier than December 2026.

Bond yields

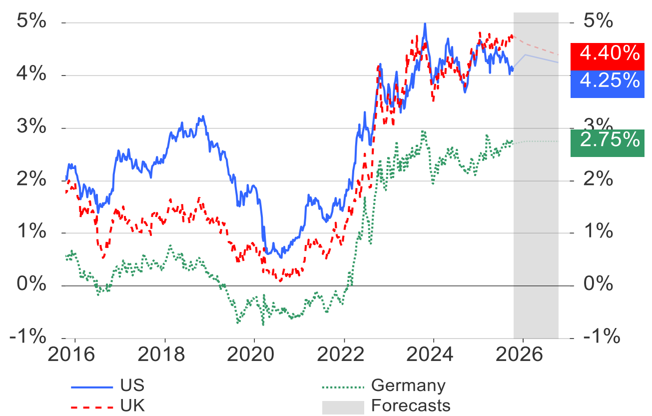
Structural shifts and yield curve dynamics

Recent moves: Since 1 October, long-term US yields have dropped in response to shutdown worries, renewed trade tensions, limited bond supply, and strong demand for Treasuries. German long-term yields have fallen amid weak economic data, and UK long-term yields followed a similar pattern driven primarily by softer labour market data.

Structural transformation: Before the pandemic, expectations of rate cuts usually resulted in bull steepening (short-term yields falling more than long-term yields). Currently, yield curves tend to twist (short-term yields dropping while long-term yields move higher), a reflection of a regime marked by fiscal dominance, where policy rate cuts are pro-cyclical and potentially inflationary, especially in a context of high fiscal deficits and elevated debt-to-GDP ratios.

Our view: We do not expect the US 10-year yield to drop significantly below 4%, supported by tariffs' inflationary effects and fiscal concerns. We favour short-duration US Treasuries (2–5 years), German Bunds for carry, and UK gilts for elevated yields ahead of expected Bank of England cuts.

10-YEAR RATES



Source: LSEG Datastream, 15/10/2025

	Maturity (years)	13/10/ 2025	3-month target	12-month target
USA	Policy rate	4.25	3.75	3.25
	2	3.50	3.75	3.60
	5	3.63	3.75	3.75
	10	4.05	4.40	4.25
	30	4.64	4.75	4.75
Germany	Policy rate	2.00	2.00	2.00
	2	1.94	2.00	2.00
	5	2.22	2.25	2.25
	10	2.63	2.75	2.75
	30	3.22	3.25	3.50
UK	Policy rate	4.00	3.75	3.50
	2	3.95	3.80	3.40
	5	4.10	4.00	3.75
	10	4.66	4.60	4.40
	30	5.46	5.20	5.20
Japan	Policy rate	0.50	0.50	1.25
	2	0.92	0.95	1.25
	5	1.23	1.30	1.50
	10	1.70	1.80	2.00
	30	3.22	3.25	3.40

Source: Refinitiv Datastream, BNP Paribas WM

Investment Conclusion

We maintain our 12-month 10-year yield targets at 2.75% in Germany, 4.40% in the UK, and 4.25% in the US. We remain Positive on core EU, US, and UK government bonds, favouring short-dated maturities in the US and intermediate tenors elsewhere.

Topic in Focus

Emerging Markets local currency bonds: Compelling case

We have raised our recommendation on Emerging Markets Local Currency (EM LC) bonds from Neutral to Positive, reflecting improved macro fundamentals, attractive yields, and favourable currency and policy trends.

Policy rate tailwind: Many EM central banks have initiated easing cycles ahead of the Fed, responding proactively to cooling inflation and deploying credible policy frameworks. We expect more rate cuts than the market currently prices in for 2026, enhancing carry and roll-down opportunities.

Valuation and currency opportunities: EM currencies remain undervalued relative to economic fundamentals, supported by an expected weaker US dollar. We see EM FX as an attractive source of return against the dollar, but not relative to the euro, and recommend considering hedging currency exposure for EUR-based investors.

Yields and fundamentals: EM LC bonds yield around 6%, well above developed market counterparts, providing a substantial income cushion. Several EM countries demonstrate improved fiscal discipline and prudent budget management. We expect greater fiscal sustainability and investor confidence in EM markets overall, supported by relatively low debt-to-GDP ratios compared to many developed economies.

Technicals and positioning: Foreign investor participation in EM LC debt remains below historical averages in many markets, notably Thailand and Malaysia, following years of outflows. This suggests room for renewed inflows as conditions stabilize.

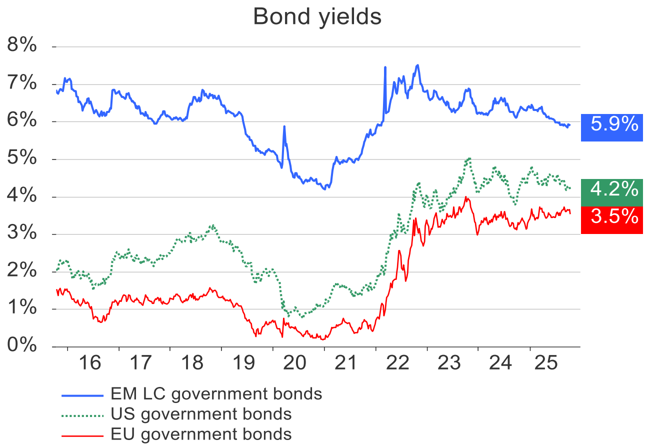
Diversification benefit: EM local bonds offer relatively low correlation to US Treasuries and developed market rates, providing portfolio diversification. In addition, EM rates exhibit lower volatility than developed market (DM) counterparts thanks to credible central bank policies and domestic investor stability.

WE EXPECT MORE RATE CUTS THAN THE MARKET CURRENTLY PRICES IN FOR 2026

	Current policy rate (%)	BNP WM 2026 forecasts (%)	Market pricing for 2026 (%)	BNP WM vs market forecasts (bp)
China	1,4	1,1	1,44	-34
Malaysia	2,75	2,5	2,57	-7
Mexico	7,5	6,5	6,92	-42
Thailand	1,5	1	1,04	-4
South Africa	7	6,25	6,47	-22
Brazil	15	12	12,93	-93
Poland	4,5	3,5	3,75	-25
Czech	3,5	2,75	3,41	-66
Colombia	9,25	8	9,02	-102
Hungary	6,5	5	5,97	-97
India	5,5	5,25	5,30	-5
Chile	4,75	4,25	4,43	-18
Turkey	40,5	26	31,54	-554

Source: Bloomberg, BNP Paribas WM

EM LC YIELDS ARE RELATIVELY HIGH AND WITH RELATIVE LOW CORRELATION TO DM



Source: LSEG Datastream, 14/10/2025

INVESTMENT CONCLUSION

We have raised our recommendation on Emerging Markets Local Currency bonds from Neutral to Positive, supported by improved macro fundamentals, attractive yields, and favourable currency and policy trends.

Topic in Focus

Fed independence under scrutiny

Unprecedented overlap: For the first time in Fed history, a Fed governor (Stephen Miran, appointed by Trump in August) simultaneously holds seats at the FOMC and in Washington, as he has not resigned from his role as Chair of the Council of Economic Advisers, arguing the Fed role is temporary.

Implications for policy governance: This dual appointment raises concerns about the Fed's institutional independence. Miran's term ends in January 2026, and Trump may reappoint him or nominate a successor, pending Senate approval. Trump will also select the next Chair -Powell's term ends in May 2026- and must choose from the Board of Governors, increasing political influence on Fed policy decisions.

Market perspective: The risk of reduced Fed independence is that monetary policy could become less countercyclical, leading to stronger growth, higher inflation, and a steeper yield curve. However, markets currently show little concern: the dollar has not collapsed, and term premiums have not surged.

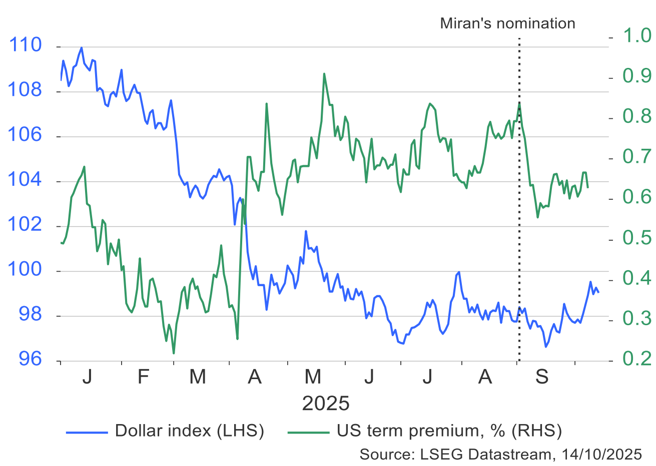
First Brands fallout

A wake-up call in credit markets: The recent default of First Brands, a US auto parts supplier, highlights the consequences of excessive risk-taking and insufficient due diligence. Investors have largely ignored risks in recent years, focusing mainly on yield in the relatively small and crowded high yield (HY) segment.

Is this a turning point? Defaults remain largely confined to smaller issuers. The HY default rate stays low, below 2%, and well under historical averages. We do not expect a sharp rise in defaults given limited distressed exchanges, sound corporate fundamentals, decent economic growth, and strong corporate resilience.

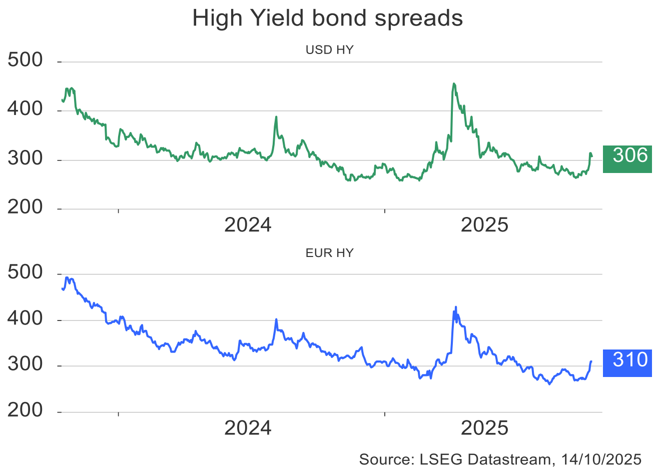
Our view: Spreads have widened by over 30bp since mid-September lows despite light bond issuance, as risk sentiment is reassessed following the First Brands default and renewed tariff tensions. We anticipate greater dispersion in the HY market and maintain a Neutral stance on USD HY bonds, balancing tight valuations against strong technicals.

RISK OF REDUCED FED INDEPENDENCE NOT PRICED IN



Source: LSEG Datastream, 14/10/2025

HIGH YIELD SPREADS WIDENED 30BP+ SINCE 1 OCTOBER



Source: LSEG Datastream, 14/10/2025

INVESTMENT CONCLUSION

- We continue monitoring fading Fed independence, as this may impact both macroeconomic outcomes (higher growth and inflation) and financial markets (higher term premium, steeper yield curve, weaker dollar, increased market volatility).
- The First Brands default underscores the importance of discipline and diversification. We remain Neutral on USD corporate HY bonds. Return drivers will predominantly come from carry, rather than spread tightening or gains from falling rates.

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 2-5 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	+	We have turned Positive from Neutral on EM local currency government bonds.

Market Data

	10-year rate (%)	Spread (bp)	Spread change 1 month (bp)
United States	4,05	---	
Germany	2,63	---	
France	3,47	84	4
Italy	3,46	83	0
Spain	3,18	55	-2
Portugal	3,03	40	-1
Greece	3,34	71	3

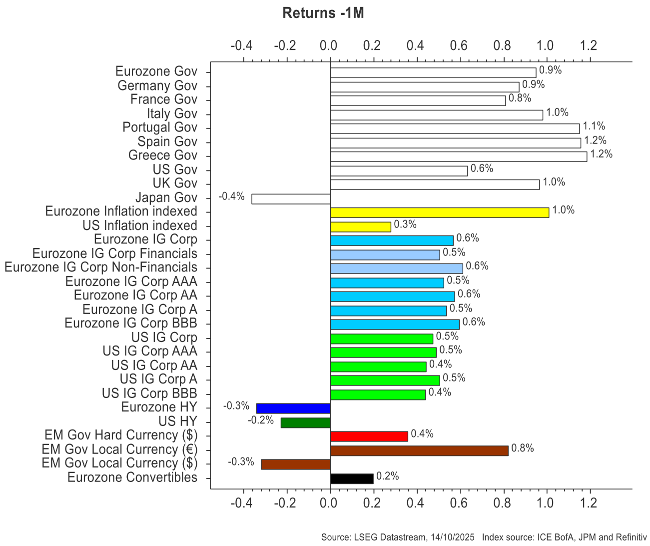
13/10/2025
Source: Refinitiv Datastream

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Global	3,02	80	2
Corporate bonds IG EUR	4,77	81	4
Corporate bonds IG USD	5,29	320	31
Corporate bonds HY EUR	6,96	333	39
Corporate bonds HY USD	6,82	265	1
Emerging government bonds in hard currency	5,90	227	2
Emerging government bonds in local currency	3,02	80	2

13/10/2025
Source: Refinitiv Datastream, Bloomberg

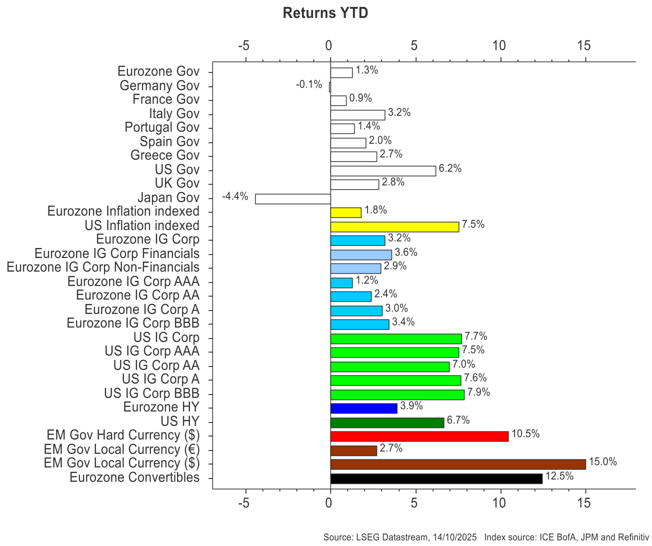
Returns

OVER ONE MONTH



EM = Emerging Markets

SINCE 01/01/2025



THE INVESTMENT STRATEGY TEAM

FRANCE

Edmund SHING
Global Chief Investment Officer

Charles GIROT
Senior 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

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

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