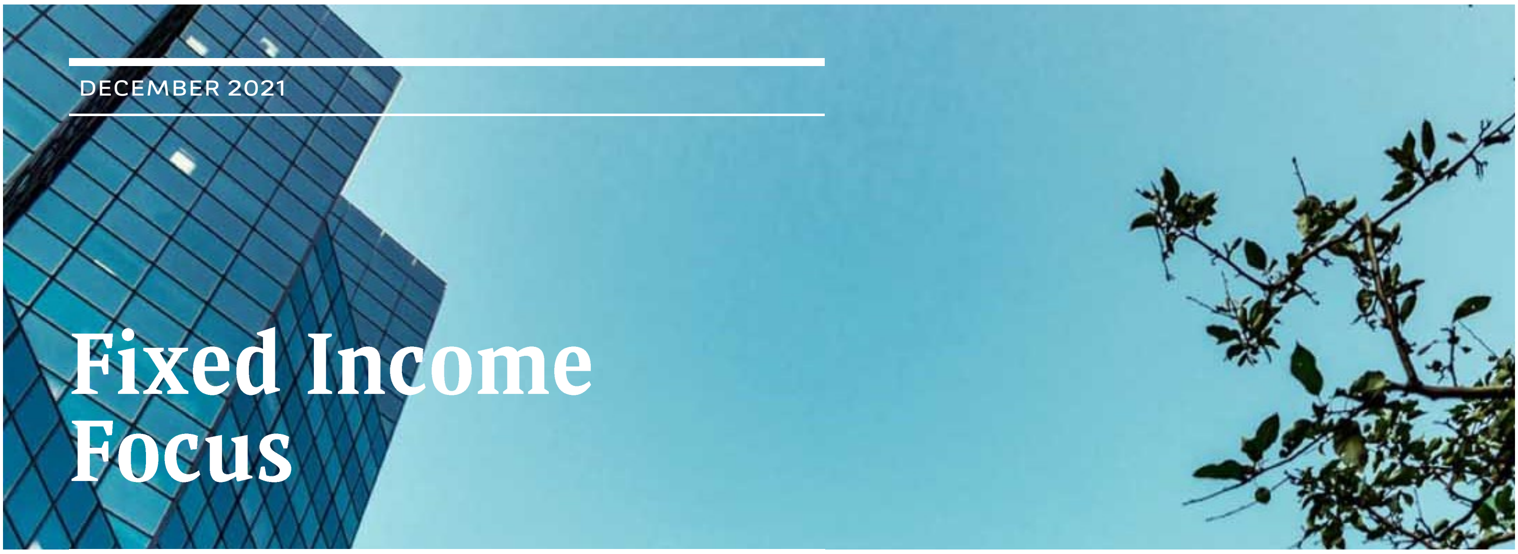


Fixed Income Focus

DECEMBER 2021

Summary

1. **The normalisation of US monetary policy has begun. The Fed could announce in mid December that it will reduce its asset purchases faster than expected in order to give itself the possibility of raising rates earlier.** We expect 3 rate hikes in 2022, with the first in June, and 4 rate hikes in 2023, which is more aggressive than market expectations.

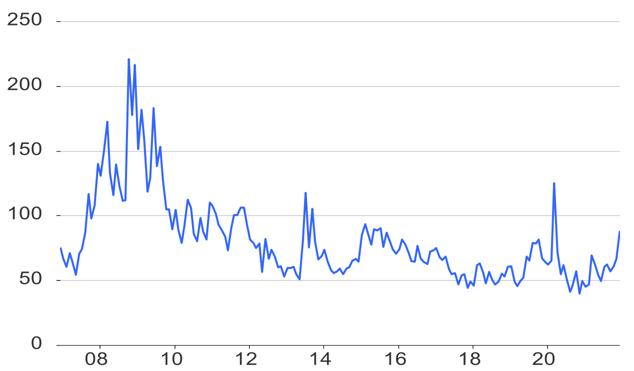
2. **The ECB will remain dovish and should formalise the end of the pandemic emergency asset purchase programme (PEPP) in mid December. The traditional asset purchase programme (APP) could be strengthened to ensure a smooth transition.** We expect a first rate hike in June 2023. The ECB should keep rates fairly anchored, but the end of the PEPP could add volatility to peripheral spreads.

3. **Short term interest rates have risen in the US and the trend is likely to continue. Target 1.25% in 12 months on the US 2-year rate.** We moved from Neutral to Negative on US short dated government bonds.

4. **The year 2022 should be characterised by high inflation, the turning point in monetary policies, the outperformance of rising star corporate bonds and the surge in green and sustainable bond issues.**

Contents

RISING VOLATILITY ON INTEREST RATES IN CONNECTION WITH UNCERTAINTY ABOUT THE NORMALISATION OF MONETARY POLICY AND OMICRON



Source: Refinitiv Datastream, 07-12-21

Edouard Desbonnets

Investment Advisor, Fixed Income
BNP Paribas Wealth Management

BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Central banks

Divergence

European Central Bank (ECB)

The resurgence of Covid cases in the eurozone gives the ECB a good reason to remain dovish.

Having said that, the emergency measures put in place just after the outbreak of the pandemic are no longer necessary because the economic shock has passed.

The ECB is expected to outline its new monetary policy at its meeting on 16 December. It is expected to announce the end of the emergency quantitative easing programme (PEPP) in March 2022. The traditional asset purchase programme (APP) could be strengthened to ensure a smooth transition so as not to destabilise markets, especially peripheral countries. The parameters of the APP could be temporarily modified in order, for example, to make Greek debt eligible for the APP as it was with the PEPP.

The new ECB inflation projections for 2023 and 2024 will provide a better assessment of the timing of the first rate hike. We estimate it for June 2023, with a 10 basis point increase in the deposit rate.

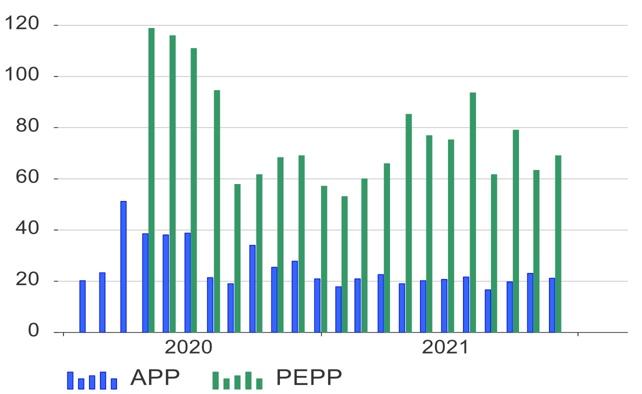
US Federal Reserve (Fed)

The 14-15 December meeting will certainly mark the turning point in the Fed's monetary policy. Inflation is accelerating and becoming more widespread. The Fed's 'transitory' inflation thesis is being undermined. Indeed, the tone of US central bankers is changing. They are less patient with high inflation figures.

It is highly likely that the Fed will accelerate its tapering (reduction in net asset purchases), so that its asset purchase programme ends in March 2022 rather than June 2022. This is risk management. Indeed, the Fed will only tighten rates once its net purchases are complete. A faster tapering leaves the Fed with an opportunity to tighten rates earlier if necessary.

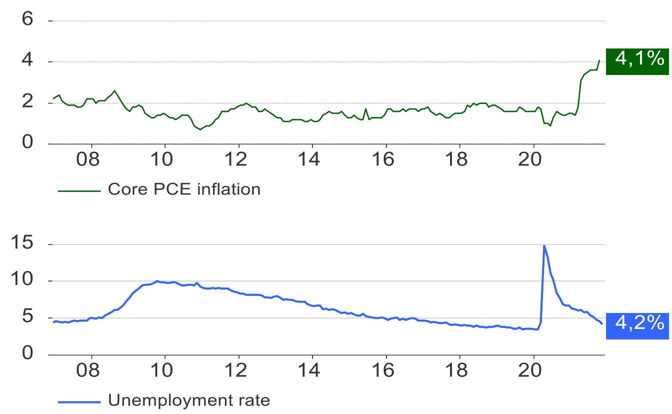
Inflation is less transitory than expected and the labour market is recovering quite quickly. As a result, the Fed could revise its expectations and raise rates more quickly than expected. We have revised our scenario and expect three rate hikes in 2022, the first in June, followed by four more in 2023.

ASSET PURCHASE PROGRAMMES
MONTHLY PURCHASES IN EUR BILLIONS



Source: Refinitiv Datastream, nov. 21

THE FED'S DUAL MANDATES: INFLATION CLOSE TO 2% AND MAXIMUM EMPLOYMENT



Source: Refinitiv Datastream, oct. 21

CONCLUSION

The upcoming Fed and ECB monetary policy meetings in mid December will mark the end of pandemic emergency support policies. The Fed has already begun tapering and could accelerate it. The ECB will start tapering one of its two quantitative easing programmes. The next step will be the rate hike, in June 2022 for the Fed and in June 2023 for the ECB in our view.

Bond yields

Rising US short-term rates

Rates have become significantly more volatile since mid September due to the uncertainties associated with monetary policy developments and the new Omicron variant.

The yield curves flattened in most developed countries. This is particularly true in the United States due to the rise in short term rates, driven by expectations of monetary tightening by the central bank.

Hence, we raised our 12-month target to 1.25% for the US 2-year rate.

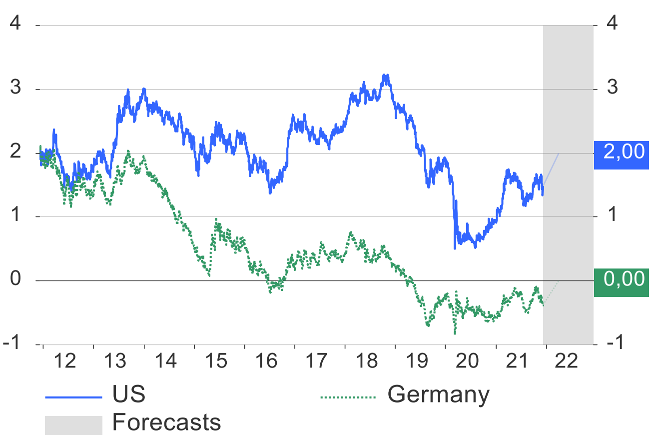
Long term rates have tended to fall in Germany recently with the resurgence of Covid cases.

We are maintaining our targets at 2% for the US 10-year rate and 0% for its German equivalent. We expect long term rates to be higher, especially real rates which are at historic lows, as the economy is doing well, inflation is high and central banks are preparing to normalise their monetary policies.

	Maturity (in years)	07/12/2021	12-month targets
United States	2	0.69	1.25
	5	1.26	1.75
	10	1.48	2
	30	1.80	2.60
Germany	2	-0.70	-0.50
	5	-0.60	-0.30
	10	-0.37	0
	30	-0.09	0.50
United Kingdom	2	0.46	0.60
	5	0.57	0.80
	10	0.73	1.20
	30	0.80	1.50

Source: Refinitiv Datastream, BNP Paribas WM

10-YEAR RATES



Source: Refinitiv Datastream, 08-12-21

CONCLUSION

We raised our 12-month target to 1.25% for the US 2-year rate to better reflect the upcoming monetary policy change.
We are maintaining our targets at 2% for the US 10-year rate and 0% for its German equivalent.

Theme in Focus

Outlook 2022

The year 2022 should be characterised by inflation, the turning point in monetary policies, the outperformance of rising star corporate bonds and soaring green and sustainable bond issues.

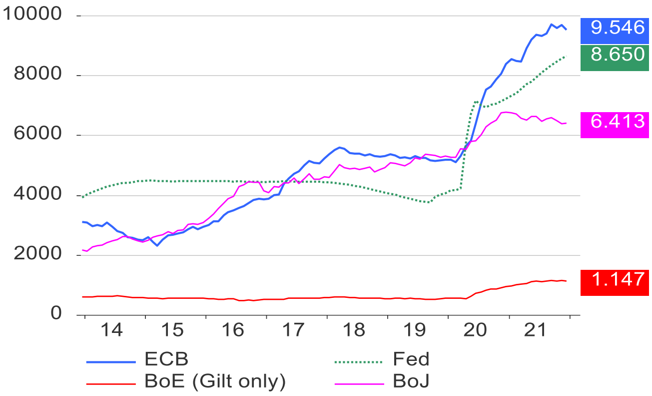
Inflation: it will remain high in 2022, above the target of around 2% of central banks. According to our forecasts, inflation in the eurozone is expected to peak in Q4 this year and trend towards 2% by the end of 2022. In the United States, it could rise to close to 7% in Q1 2022 before falling back below 3% in Q4 2022.

Turning point in monetary policy: inflation, coupled with the economic recovery, will push central banks to end the emergency measures put in place at the beginning of the pandemic. 2022 will be the beginning of a return to normal. The Fed will end its asset purchase programme and hike rates 3 times in our view. The ECB will end its pandemic asset purchase programme, leaving only the traditional asset purchase programme in place.

Rising stars: corporate fundamentals are very good. On average, they have healthy balance sheets, high margins and record cash. They were able to refinance themselves easily and cheaply this year thanks to very favourable financial conditions. Default risk is very low. The wave of improvement in the outlook and credit ratings could continue into 2022 if growth remains strong and balance sheets don't deteriorate. The risings stars (companies whose rating is upgraded from High Yield to Investment Grade) are expected to be numerous: 70 € in bonds in Europe and 130 $ in the United States. They are currently trading at attractive levels compared to BBB- (the last investment grade category).

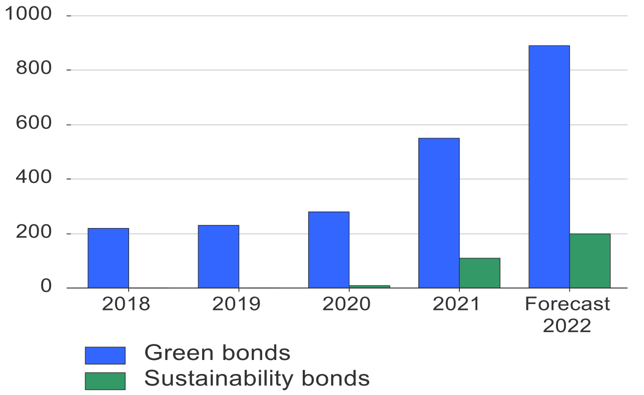
Green and sustainable bond issues: they are expected to grow further strongly in 2022, largely due to the development of renewable energy. European institutions and governments should be important issuers, as should companies, and also emerging countries. The yields offered could be low due to the expected high demand.

CENTRAL BANK BALANCE SHEETS ARE EXPECTED TO STABILISE IN 2022 (BN $)



Source: Refinitiv Datastream, 03-12-21

GREEN AND SUSTAINABLE BOND ISSUANCE ($ BN)



Source: Refinitiv Datastream, Bloomberg, BNP Paribas, 07-12-21

CONCLUSION

The year 2022 should be characterised by high inflation, the turning point in monetary policies, the outperformance of rising star corporate bonds and the surge in green and sustainable bond issues.

Our Investment Recommendations

Asset classes	Zone	Our opinion	
Government bonds	Germany	-	Negative on German sovereign bonds, irrespective of their maturity.
	Peripheral countries	=	Neutral on peripheral debt (Portugal, Italy, Spain, Greece) with a "buy on dips" strategy.
	United States	-	• We moved to Negative from Neutral on US short-term Governement bonds. • Negative on long-term debt.
Corporate bonds Investment Grade	Eurozone United States	=	• We prefer corporate bonds to sovereign bonds. • Neutral view on corporate bonds. Focus on duration at benchmark for EUR bonds (5 years) and lower than benchmark for US bonds (less than 9 years). • Positive on convertible bonds in the eurozone.
Corporate bonds High Yield	Eurozone and United States	=	• Neutral on HY bonds. • Positive on *fallen angel* and *rising stars.*
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 (bps)	Spread change 1 month (bps)
United States	1.48	---	
Germany	-0.37	---	
France	-0.02	35	+1
Italy	0.92	129	+14
Spain	0.34	71	+2
Portugal	0.26	64	+5
Greece	1.25	163	+25

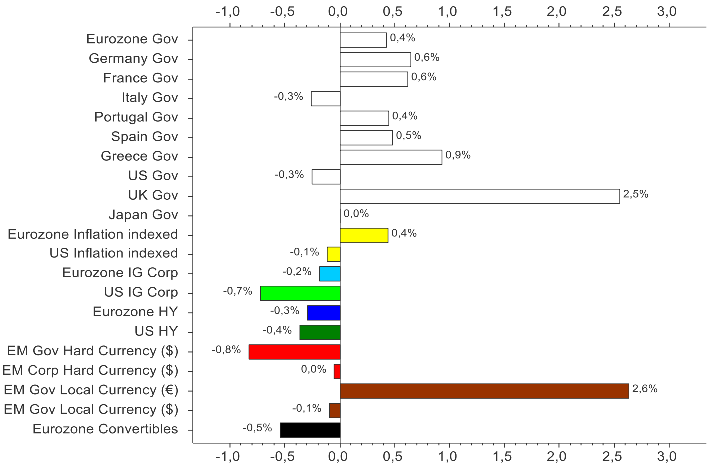
07/12/2021
Source: Refinitiv Datastream

	Yield (%)	Spread (bps)	Spread change 1 month (bps)
Global	1.26	37	+3
Corporate bonds IG EUR	0.41	98	+9
Corporate bonds IG USD	2.32	95	+9
Corporate bonds HY EUR	3.40	325	+12
Corporate bonds HY USD	4.34	290	+6
Emerging government bonds in hard currency	4.79	335	+18
Emerging corporate bonds in hard currency	5.34	417	+1
Emerging government bonds in local currency	3.84	258	-26

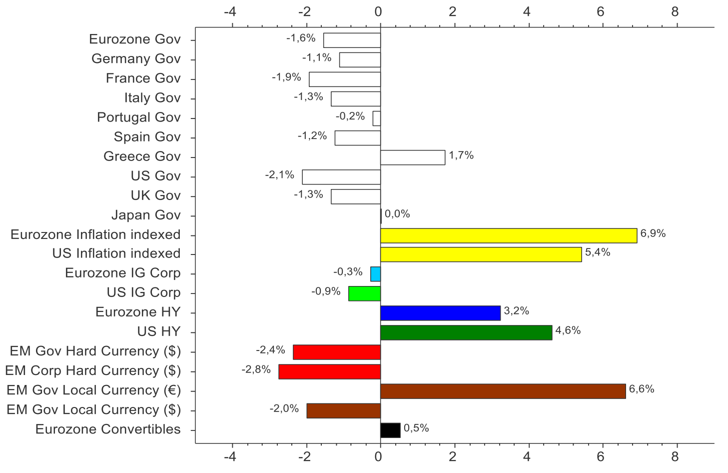
07/12/2021
Source: Refinitiv Datastream, Bloomberg Barclays

Returns

OVER ONE MONTH



SINCE 01/01/2021



EM = Emerging Markets

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