

Fixed Income Focus

Summary

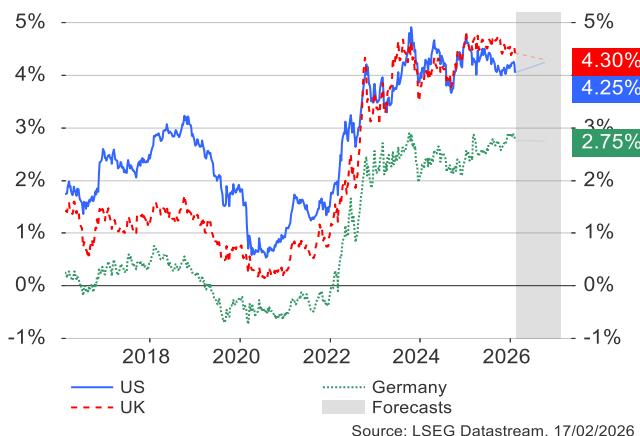
- The nomination of Kevin Warsh:** We believe Kevin Warsh is committed to achieving 2% inflation over time and to preserving the Fed's institutional credibility. His nomination (if confirmed by the Senate) to lead the central bank is entirely consistent with our optimistic outlook for U.S. economic growth in the coming years. We still expect two more rate cuts (June and September) and a terminal rate of 3.25%.
- ECB should keep the policy unchanged:** Inflation is expected to fall below 2% in the first half of 2026 but to accelerate again later this year as economic activity gains momentum. In real terms, the policy rate is near zero, which appears appropriate for the coming months.
- BoE more dovish-than-expected:** The Bank of England's more-dovish-than-expected rate hold on Thursday reinforces our conviction that policy remains on a downward trajectory. We expect a cut in March, followed by an extended pause, with further rate cuts only likely in 2027. We pencil in a terminal rate of 3.00% by mid-2027.
- Limited opportunities for govies:** Our 12-month targets for 10-year yields are 2.75% for Germany, 4.25% for the U.S., and 4.30% for the U.K. We maintain a Positive view on UK gilts and a Neutral stance on both U.S. Treasuries and German bunds, as each is trading close to its target.
- Selective opportunities in corporate bonds:** We prefer EUR and GBP IG corporate bonds (Positive view) over USD IG bonds (Neutral view) given the supply dynamics and the level of spreads. For high-yield, valuations are stretched, with spreads near or below historical lows. They are more likely to widen modestly in 2026 as re-leveraging could be a theme.
- EM local currency bonds still attractive.** EM local currency bonds offer compelling yields around 6%, rate cut potential and should benefit of the weaker dollar.

Drafting completed on 16 February 2026

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CHART OF THE MONTH: MOST YIELDS ARE CLOSE TO OUR TARGETS



Source: LSEG Datastream, 17/02/2026

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Central banks

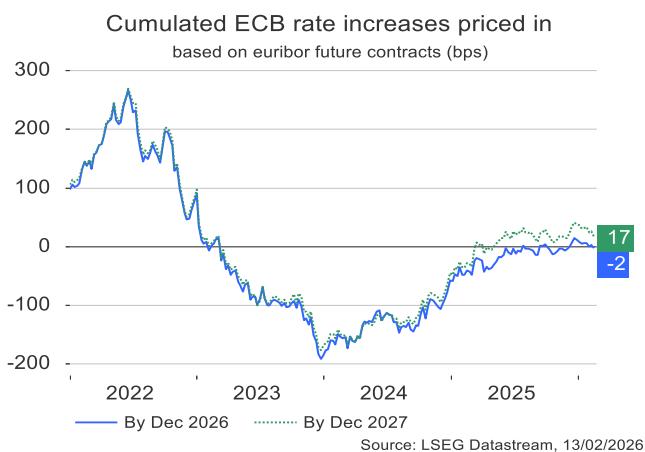
Diverging path

European Central Bank (ECB)

Message broadly unchanged: The ECB's February meeting suggests that the Governing Council remains comfortable with the current policy setting and sees bi-directional risk for policy rates from here. We continue to think that the threshold for deviation is high and expect the ECB to stay on hold throughout 2026, pivoting to hikes only in the second half of 2027, by which stage we anticipate clearer evidence of building price pressures driven by higher defence and infrastructure spending. The ECB kept its global message unchanged despite the rise in geopolitical risk, the tightening of credit conditions revealed in the latest BLS survey, and the recent strength of the euro, which was on the hawkish side of our expectations heading into the meeting. Risks are viewed as broadly balanced at present, and the statement itself emphasised resilience over uncertainty.

Outlook: We expect policy rates to remain unchanged this year and forecast the first hike in mid-2027.

NO RATE CHANGE EXPECTED IN THE EUROZONE THIS YEAR, IN LINE WITH MARKETS



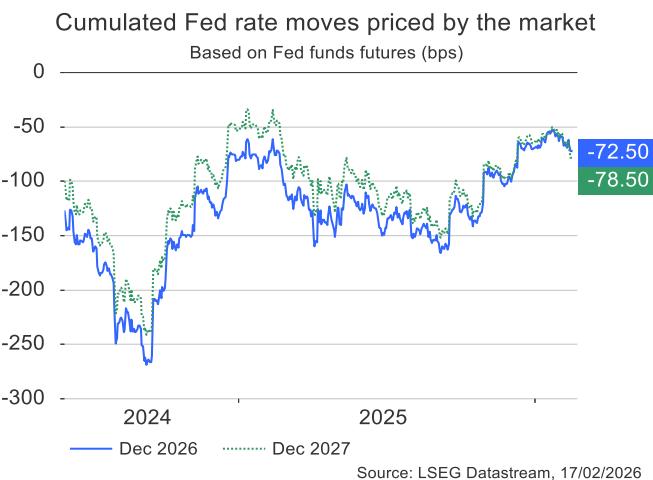
US Federal Reserve (Fed)

Kevin Warsh is back: We still expect monetary policy to be determined by the economic outlook and by the Fed's existing policy goals and framework. Over the past year, Warsh has argued that there is room to ease monetary policy, given expectations of a disinflationary, AI-driven productivity boom. He holds one vote among the 12 members of the Committee. We see scope for eventual Fed agreement on reducing the balance-sheet size and shifting it to a Treasury-only portfolio, although these changes will likely take time to implement. The January jobs report was stronger-than-expected. The revision to non-farm payrolls shows better momentum in the back half of 2025 and early 2026 than many had feared, while inflation came in somewhat lower than expected.

Outlook:

We retain our forecast of two rate cuts this year, scheduled for June and September, which would bring the terminal rate to 3.25 %.

WE EXPECT TWO RATE CUTS IN THE US THIS YEAR, IN LINE WITH MARKETS



INVESTMENT CONCLUSION

In our view, the Fed will cut rates twice this year to 3.25 %. We expect inflation to peak in the second quarter. Political pressure is intense, and the new Chair will need to demonstrate strong leadership by persuading colleagues to cut rates at the June FOMC meeting. We must monitor upcoming job reports and inflation data closely to determine whether less rate cuts are warranted. In the eurozone, inflation is near target and growth should accelerate. We predict the ECB will keep rates at 2 % this year, with a potential hike in Q3 2027.



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Government Bond yields

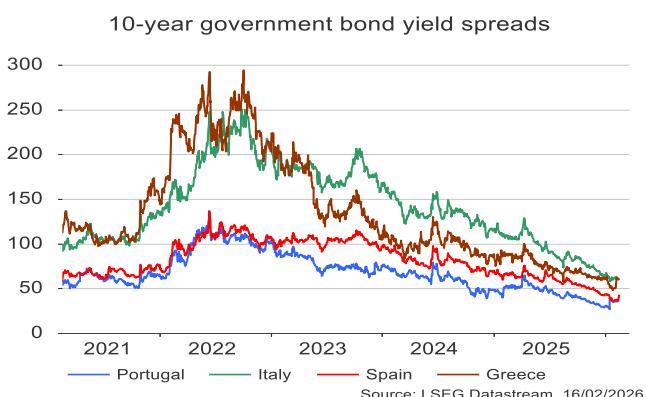
Few opportunities

Yields lower over the past month: That was the case for most maturities, with a parallel shift of the curve. In the euro-zone, peripheral spreads rebounded but remain low (see chart below).

Most yields are close to our targets: Both Treasuries and Bunds yields trade near our forecasts, justifying a neutral stance. Yields on UK Gilts are the exception, as they remain above target, offering room for appreciation in addition to attractive carry. The recent dovish shift in the Bank of England (BoE) message, combined with softening growth momentum, supports our constructive view.

Upward revision in Japanese yields: The election outcome in Japan did not produce a major change in the 10-year yield. However, we believe government-bond yields still have upside potential, especially if the planned consumption-tax cut proceeds. Together with an expected rise in the bond-risk premium, this should keep yields elevated. Accordingly, we raise our 12-month target for the 10-year government-bond yield from 2.10 % to 2.40 %.

PERIPHERAL SPREADS



	Maturity (years)	16/01/2025	3-month target	12-month target
USA	Policy rate	3.75	3.75	3.25
	2	3.41	3.60	3.60
	5	3.60	3.75	3.75
	10	4.05	4.10	4.25
	30	4.70	4.75	4.90
Germany	Policy rate	2.00	2.00	2.00
	2	2	2.00	2.00
	5	2.34	2.25	2.25
	10	2.76	2.75	2.75
	30	3.44	3.50	3.60
UK	Policy rate	3.75	3.50	3.50
	2	3.59	3.60	3.30
	5	3.81	3.80	3.75
	10	4.40	4.40	4.30
	30	5.21	5.20	5.10
Japan	Policy rate	0.75	0.75	1.25
	2	1.27	1.30	1.40
	5	1.66	1.70	1.80
	10	2.21	2.30	2.40
	30	3.50	3.5	3.60

Source: Refinitiv Datastream, BNP Paribas WM

INVESTMENT CONCLUSION

Positive view on UK gilts, which offer an attractive risk-reward relative to our 4.30 % year-end target. We remain Neutral on both US Treasuries and German bunds, as both markets trade close to—or below—our 12-month forecasts of 4.25 % and 2.75 % respectively. We raise our 12-month target for the 10-year government-bond yield in Japan from 2.10 % to 2.40 %. No opportunities are seen in peripheral spreads.



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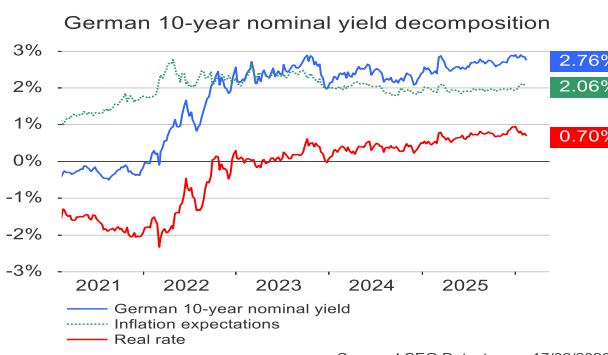
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Topics in Focus

Nominal versus Real yields

Real yields close to fair value: In the US, the real 10-year yield peaked at about 2.30 % in late 2023 and has been below 2 % since mid-2025. Our fair-value estimate is around 2 %. The 10-year inflation breakeven rate has been trading in a narrow range of 2.20 %-2.45 %. The Fed's long-term projection for core PCE is 2 %. With the current Fed policy rate at 3.75 %, this implies a real rate of roughly 1.75 %. In the eurozone, the real 10-year yield peaked late last year at about 0.95 %. The inflation breakeven rate has remained close to 2 % in recent months. The ECB policy rate stands at 2.15 % with an inflation target of 2 %, suggesting a real rate near zero.

NOMINAL VERSUS REAL YIELDS

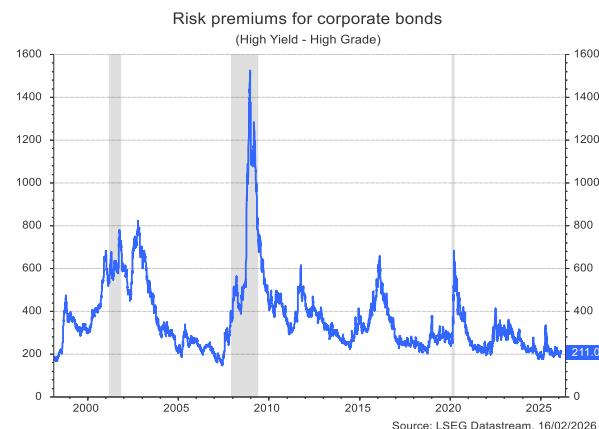


Risks related to AI boom

Rising risks but low corporate spreads: The US corporate-bond market remains driven by the emerging AI theme and its potential to disrupt other sectors. At the same time, the technology sector as a whole is under stress, as investors question the extreme equity valuations. Nevertheless, spreads are still close to, or even below, historical lows. In this environment we see more value in high-quality investment-grade corporates than in high-yield issuers, especially in the eurozone and the U.K.

What do we need to monitor? The key indicator to watch is the relative spread between high-yield (HY) and investment-grade (IG) bonds in the US. (see chart below). An increase in debt-raising by some tech firms, or doubts about the returns from AI-related investments, could push this spread higher. Although the EU has less direct exposure to AI, the disruptive effect may still materialise, so the situation should be monitored closely.

HIGH YIELD VERSUS INVESTMENT GRADE SPREADS STILL VERY LOW



INVESTMENT CONCLUSION

Real yields have passed their peak - they are now near fair-value levels when judged against potential GDP growth and bond-premium estimates. At this stage there are no attractive opportunities in the inflation-indexed space.

US corporate bond market activity continues to be driven by the emerging AI theme and its potential to disrupt other sectors. We see more value in high-grade corporate bonds than in high-yield issuers, with a particular focus on the eurozone and the U.K.



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2026 Top Conviction

Emerging Market Local Currency bonds have more potential

Monetary policy tailwinds create carry opportunity:

Inflation in many EM economies is on a downward trend. This is giving central banks room to cut rates creating an attractive carry environment. With our policy targets, we expect more rate cuts than currently priced into markets for both 2026 and 2027. Colombia, Brazil, and Turkey's central banks stand out as having more cutting potential, in our view. The JPM GBI-EM index currently yields around 6%, whilst real yields remain well above developed market equivalents, providing attractive income and a cushion against volatility (see chart below).

Currency valuations attractive against the dollar:

We continue to expect the dollar to weaken over our 12-month horizon. We expect a broad-based move including against most EM currencies. Many EM currencies remain undervalued relative to fundamentals, offering potential for appreciation and an additional source of return beyond the attractive yield level. Euro-based investors may want to consider hedging due to expected depreciation.

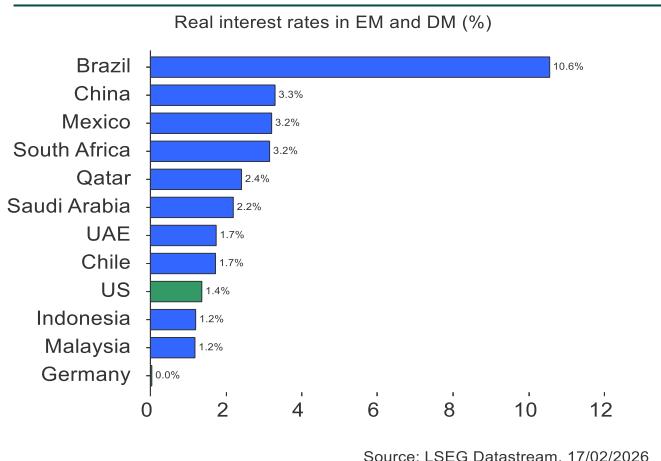
USD investors can benefit from potential appreciation, enhancing total returns.

Stronger fundamentals: Several EM countries have consolidated their budgets and improved policy credibility. Debt-to-GDP ratios are under 60%. This is notably lower than the over 110% seen in advanced economies. There have been no defaults in 2025, for the second year in a row. In our view, Middle Eastern countries have the best fundamentals. This fiscal discipline has created a more stable investment environment than in previous Emerging Market cycles.

Technical support from under-ownership:

International investors remain underweight EM local bonds compared to historical allocations, leaving room for further inflows. Thailand, Malaysia, and Egypt are the most under-owned by funds and ETFs. Growing domestic institutional ownership from pension funds creates additional support. Also note that EM local bonds offer low correlation relative to US Treasuries, providing improved portfolio diversification.

REAL YIELDS REMAIN HIGH IN EM COUNTRIES



EM CURRENCIES ARE REBOUNDING AGAINST THE DOLLAR



INVESTMENT CONCLUSION

EM local currency bonds offer compelling yields around 6%, a rate cut potential exceeding market expectations and a potential for currency appreciation against the dollar. Euro-based investors should consider exposure with currency hedging. Technical support from under-ownership and strong fundamentals support our Positive view.



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Our Investment Recommendations

Asset class	Zone	Our opinion	
Government bonds	Germany	=	We are Neutral on German sovereign bonds. Prefer 2-5 years maturities.
	Peripheral countries	=	Neutral on peripheral debt (Portugal, Italy, Spain, Greece).
	United Kingdom	+	Positive on UK government bonds.
	United States	=	We are Neutral and prefer 2-5 years maturities. Positive on TIPS.
Corporate bonds Investment Grade (IG)	Eurozone United Kingdom United States	+	<ul style="list-style-type: none"> 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	=	<ul style="list-style-type: none"> Neutral on HY bonds. Positive on <i>fallen angels</i> and <i>rising stars</i>.
Emerging bonds	In hard currency	=	Neutral on EM hard currency bonds (sovereign and corporate).
	In local currency	+	Positive on EM local currency government bonds.

Market Data

	10-year rate (%)	Spread to bund (bp)	Spread change 1 month (bp)
United States	4.05	---	
Germany	2.76	---	
France	3.34	59	-9
Italy	3.38	62	4
Spain	3.19	44	5
Portugal	3.13	37	-1
Greece	3.37	61	9

16/01/2026

Source: Refinitiv Datastream

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Corporate bonds IG EUR	3.08	75	0
Corporate bonds IG USD	4.71	79	4
Corporate bonds HY EUR	4.92	274	10
Corporate bonds HY USD	6.63	306	29
Emerging government bonds in hard currency	6.41	225	-4
Emerging government bonds in local currency	5.82	221	11

16/01/2026

Source: Refinitiv Datastream, Bloomberg

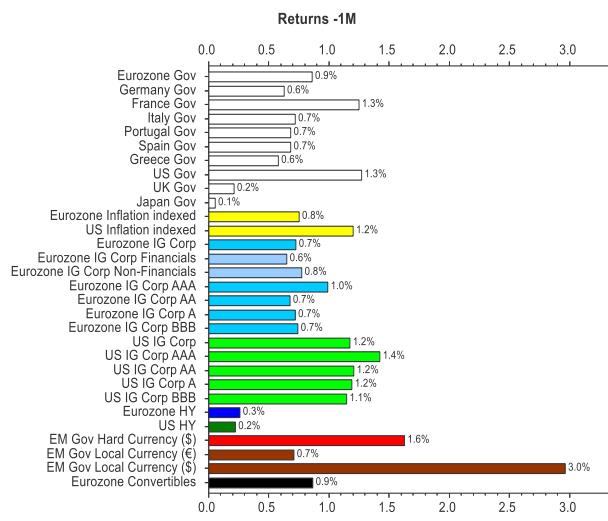


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Returns

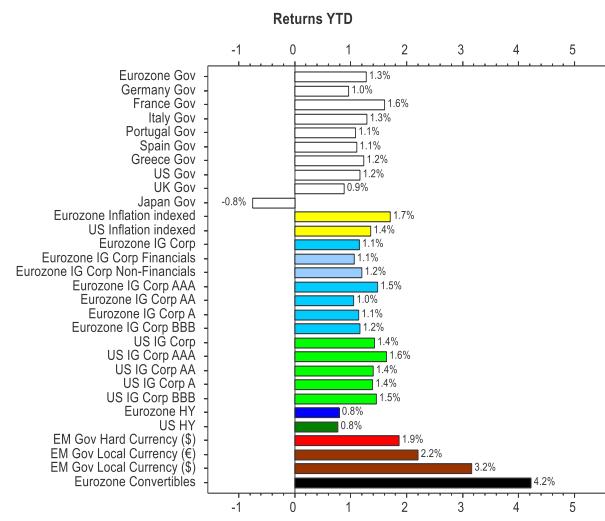
OVER ONE MONTH



Source: LSEG Datastream, 16/02/2026 Index source: ICE BoFA, JPM and Refinitiv

EM = Emerging Markets

SINCE 01/01/2026



Source: LSEG Datastream, 16/02/2026 Index source: ICE BoFA, JPM and Refinitiv

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