JUNE 2024

Fixed Income Focus

Summary

1. **Monetary policy decoupling has begun:** the ECB has started the cycle of rates cuts before the Fed, as it cut rates in June while the Fed is delaying. We expect two more rate cuts for the ECB (September and December) and only one for the US (September). In 2025, we expect three rate cuts in the eurozone and four in the US.
2. **We expect the US 10-year yield to fall to 4.25% over the next 12 months, while the German equivalent should reach 2.25%.** We are Positive on US government bonds and Neutral on German government bonds. We favour intermediate maturities (up to 10 years) in Germany, and we prefer to wait before adding duration in the US (3-5 years for now).
3. **French political risk:** we are cautious on French government bonds for the time being, given the risk of wider spreads before the elections, which turn into opportunities after the elections.
4. **Spotlight on India: Recent elections and upcoming index inclusion.** Indian Government Bonds (IGBs) will be included in major indices such as the JP Morgan GBI-EM Global Diversified and Bloomberg indices from 2024, boosting capital inflows. We believe this inclusion, along with a favourable economic outlook, high yields and low currency volatility, will increase the attractiveness of IGBs for investors over the medium term.
5. **Opportunities in Fixed Income:** we are Positive on US Treasuries, US inflation-linked bonds, US Agency Mortgage-Backed Securities, UK gilts, as well as European and US investment grade corporate bonds. We are also Positive on Emerging Market bonds in hard and local currency.

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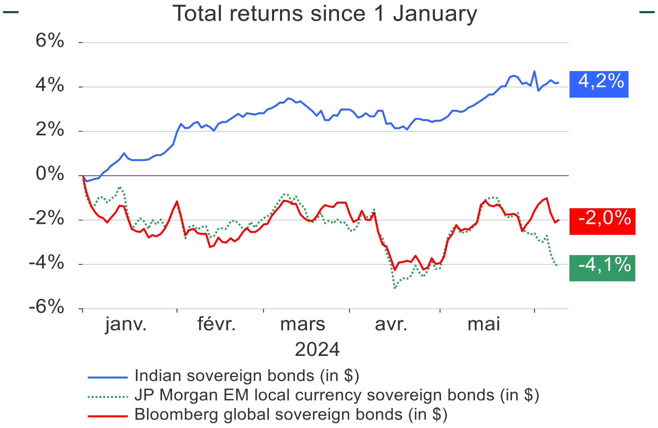
INDIAN SOVEREIGN BONDS OUTPERFORMED BOTH EM AND GLOBAL SOVEREIGN MARKETS SINCE THE BEGINNING OF THE YEAR

Total returns since 1 January



Source: LSEG Datastream, 11/06/2024

Drafting completed on 13 June

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BNP PARIBAS WEALTH MANAGEMENT

The bank for a changing world

Central banks

Monetary policy decoupling has begun

European Central Bank (ECB)

The ECB cut rates by 25bps in June. This did not come as a surprise. The decision had been telegraphed to the markets for weeks. The ECB felt it was necessary to moderate the degree of monetary restriction.

An unusual cut in many respects: first, it is the first time in history that the ECB has cut rates before the US Federal Reserve. Second, because they are cutting rates when growth is accelerating, and unemployment is at record lows. Third, because they are cutting rates while revising up their forecasts for both headline and core inflation for this year and next.

Our view: the timing of the subsequent rate cuts will depend on the data (watch negotiated wages, productivity and unit labour costs and profits). Our base case is that the ECB will cut rates in September and December this year, followed by three more cuts in 2025. We forecast the end of the rate cut cycle at the end of 2025, when the deposit rate reaches 2.50%.

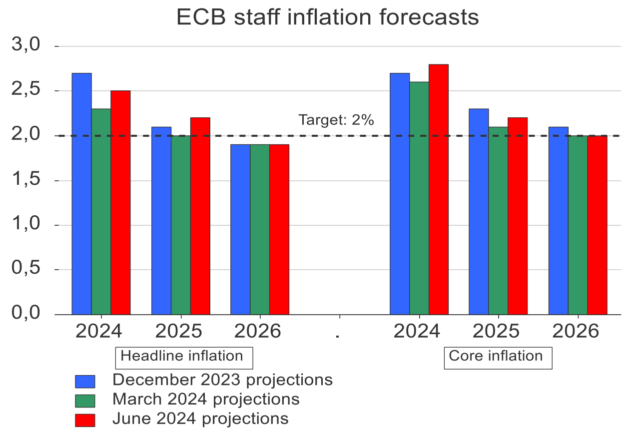
US Federal Reserve (Fed)

High for longer: the Fed's mantra is still alive. Policymakers decided not to cut rates in June as widely expected and they signalled that rate cuts will be delayed again.

Dot plot: in the absence of rate cut guidance from the Fed's economic projections (unchanged growth, unchanged unemployment, and inflation revised higher in 2024 and 2025), investors can only speculate based on the dot plot, i.e. the projections of each individual policymaker. The median policymaker now expects fewer cuts this year (1 vs 3 in March) and more next year (4 vs 3 in March).

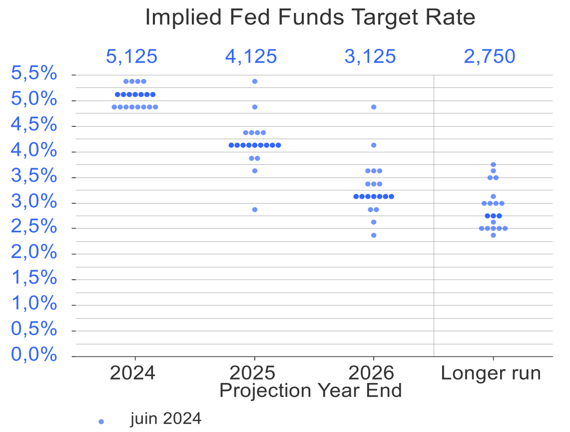
Our view: the Fed remains data dependent and in no hurry to cut rates, even though the latest inflation report was encouraging. We believe that the Fed will gain enough confidence in the disinflation process to cut rates by 25bps in September, and we expect four 25bps cuts in 2025 and two in 2026, bringing the Fed funds rate down to 3.75%.

THE ECB REVISED ITS INFLATION PROJECTIONS HIGHER



Source: LSEG Datastream, 28/09/2018

THE FED'S DOT PLOT IMPLIES ONE RATE CUT THIS YEAR AND FOUR NEXT YEAR,



Source: LSEG Datastream, 12/06/2024

Investment Conclusion

The ECB has started the cycle of rates cuts before the Fed, as it cut rates in June while the Fed is delaying. We expect two more rate cuts for the ECB (September and December) and only one for the US (September). In 2025, we expect three rate cuts in the eurozone and four in the US.

Bond yields

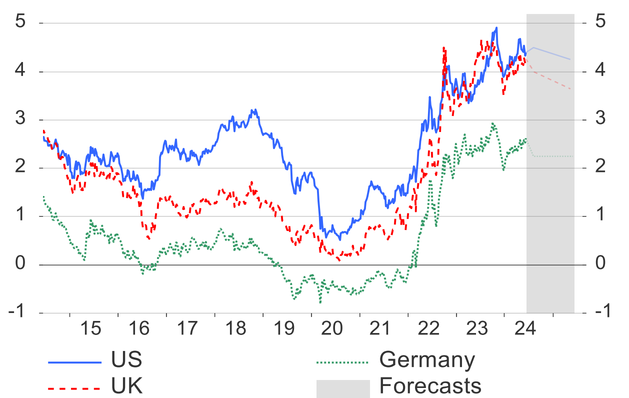
Bond yields getting closer to our target

US and German long-term bond yields have experienced significant fluctuations in recent weeks, with shifts alternating between macro-driven and technical-driven moves.

Recent US auctions have been weak, suggesting supply-indigestion when investors worry about deficit projections. The upcoming US elections are expected to bring more volatility and upward pressure on yields.

Another notable development is the increase in French yields and spreads due to political risk. The French 10-year spread has risen to 65bps, almost matching the level of Portugal, despite France's better credit rating and lower CDS. The 10-year spread may revisit the highs seen during the 2017 election (80bps), but this time to due to deficit concerns rather than Frexit worries. While there is a risk of the French spread widening, it is unlikely to cause global tensions. We anticipate volatility and spread to decrease following the second round of elections, as markets stabilise post-elections.

10-YEAR RATES



Source: LSEG Datastream, 13/06/2024

	Maturity (years)	12/06 2024	3-month target	12-month target
USA	Policy rate	5.50	5.25	4.75
	2	4.77	4.75	4.25
	5	4.33	4.50	4.25
	10	4.33	4.50	4.25
	30	4.49	4.75	4.40
Germany	Policy rate	3.75	3.50	2.75
	2	2.97	2.50	2.25
	5	2.57	2.25	2.25
	10	2.54	2.25	2.25
	30	2.69	2.40	2.50
UK	Policy rate	5.25	5.00	4.25
	2	4.21	4.00	3.50
	5	4.01	4.00	3.50
	10	4.13	4.00	3.65
	30	4.62	4.30	4.00

Source: Refinitiv Datastream, BNP Paribas WM

Investment Conclusion

We are Positive on US government bonds and Neutral on German government bonds. We favour intermediate maturities (up to 10 years) in Germany, and we prefer to wait before adding duration in the US (3-5 years for now). We are cautious on French government bonds for the time being, given the risk of wider spreads before the elections, which turn into opportunities after the elections.

Theme in Focus

Spotlight on India: Recent elections and upcoming index inclusion

Election: Prime Minister Modi was re-elected, albeit by a narrow margin, as several pressing issues such as inflation, unemployment, and rural distress took centre stage. Consequently, Modi will now face a stronger opposition. Nevertheless, the election results are likely to have a positive impact on India's medium-term economic growth and business climate, as companies will welcome continued certainty.

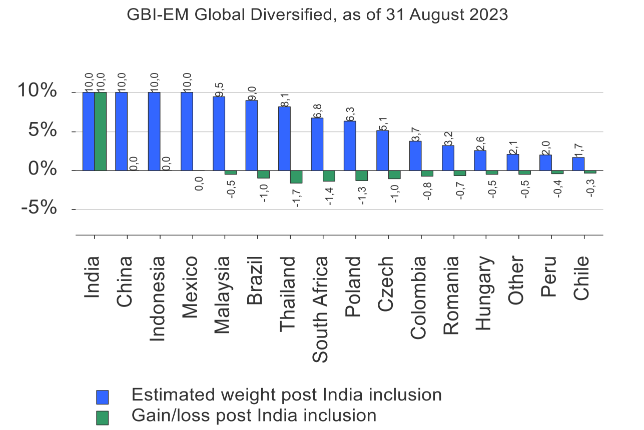
Economy: India has been experiencing robust economic growth, with a 7.5% increase in 2023, which we anticipate will rise to 8.1% this year. We project a solid growth rate of 7.1% for 2025. Inflation is trending downwards, from 6.7% last year to a potential 5.5% this year, and we forecast it to be 4.8% next year. This downward trend in inflation will enable the central bank to reduce rates by 25 basis points this year to 6.25%, and further to 5.75% next year.

Index Inclusion: Indian Government Bonds (IGBs) will progressively be included in several indices that investors closely monitor. For instance, IGBs will be incorporated into the JP Morgan GBI-EM Global Diversified index from 28 June 2024, reaching 10% of the index by 31 March 2025. IGBs will also be included in the Bloomberg index from January 2025 to October 2025.

Implications: The inclusion in the index should trigger a massive wave of capital inflows into IGBs over several years, as investors such as mutual funds, pension funds, and passive investors adjust their portfolio holdings to track the updated index. Additionally, the increased demand for bonds should help push down government and corporate yields. On the other hand, IGBs, which previously had a very low correlation with other indices, will now be more vulnerable to global market fluctuations.

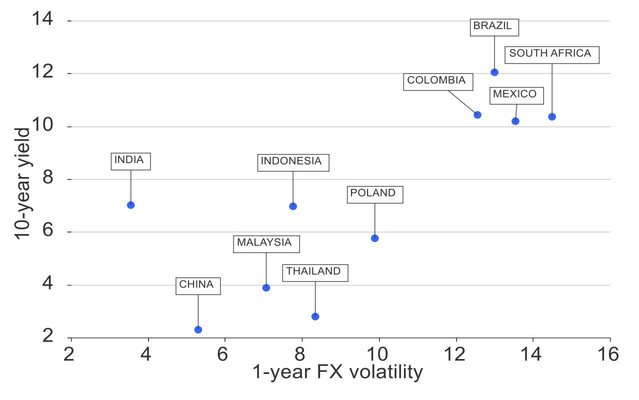
Our view: Indian rates have been volatile due to the election results, and this volatility may persist in the short term as uncertainty around the cabinet and new budget remains. Over the medium term, we are Positive on IGBs. The improving fiscal picture, low core inflation and upcoming inflows from GBI EM index inclusion support our view. Furthermore, the Indian yields are high (7.0% for the 10-year yield) and currency volatility is low. Both together should attract real money investors.

COUNTRY WEIGHT PROJECTIONS POST INDIA INCLUSION



Source: LSEG Datastream, JP Morgan, 10/06/2024

10-YEAR YIELD VS AVERAGE CURRENCY VOLATILITY



Source: LSEG Datastream, 10/06/2024

INVESTMENT CONCLUSION

Indian Government Bonds (IGBs) will be included in major indices such as the JP Morgan GBI-EM Global Diversified and Bloomberg indices from 2024, boosting capital inflows. We believe this inclusion, along with a favourable economic outlook, high yields and low currency volatility, will increase the attractiveness of IGBs for investors over the medium term.

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	+	Positive on US government bonds and US TIPS.
Corporate bonds Investment Grade	Eurozone United States	+	• Eurozone and US: Positive opinion. Prefer maturities up to 7 years 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	+	Positive on EM hard currency bonds (sovereign and corporate).
	In local currency	+	Positive on local currency government bonds.

Market Data

	10-year rate (%)	Spread (bp)	Spread change 1 month (bp)
United States	4,33	---	
Germany	2,54	---	
France	3,16	62	13
Italy	3,92	139	8
Spain	3,37	83	10
Portugal	3,19	65	5
Greece	3,63	110	5

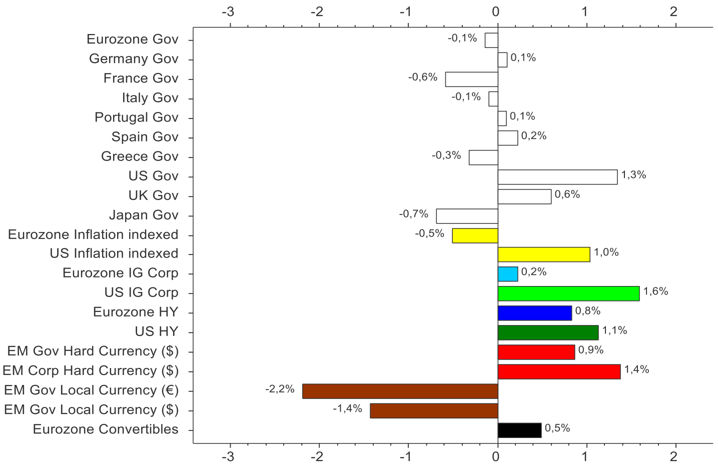
12/06/2024
Source: Refinitiv Datastream

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Global	3,88	38	1
Corporate bonds IG EUR	3,85	112	2
Corporate bonds IG USD	5,40	88	0
Corporate bonds HY EUR	6,65	339	10
Corporate bonds HY USD	7,82	302	-9
Emerging government bonds in hard currency	7,68	321	-6
Emerging corporate bonds in hard currency	6,75	216	-1
Emerging government bonds in local currency	6,63	229	3

12/06/2024
Source: Refinitiv Datastream, Bloomberg

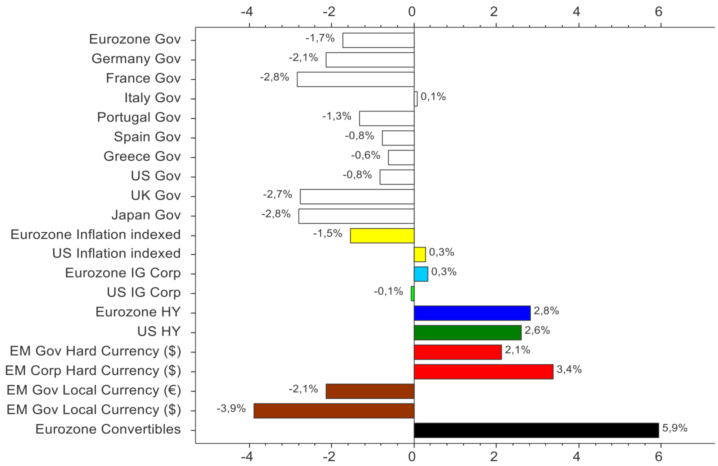
Returns

OVER ONE MONTH



Source: LSEG Datastream, 12/06/2024 Source: Bloomberg Barclays indices except EM local debt (JPM) and Convertibles (Refinitiv)

SINCE 01/01/2024



Source: LSEG Datastream, 12/06/2024 Source: Bloomberg Barclays indices except EM local debt (JPM) and Convertibles (Refinitiv)

EM = Emerging Markets

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