

Fixed Income Focus

Summary

- 1. Policy divergence: ECB holds, Fed cuts.** We expect the Fed to cut rates in December and twice more in 2026, whilst the ECB will remain on hold and hike rates no earlier than late 2026 as the eurozone outlook gradually improves.
- 2. Bond yield targets maintained, stance turned Neutral:** Our 12-month yield targets are 2.75% in Germany, 4.40% in the UK, and 4.25% in the US. We have turned Neutral from Positive on both Treasuries and EU core bonds, seeing previous yield levels as too low.
- 3. Bank of England: Disinflation is opening the door to easing.** We remain Positive on UK gilts, with inflation likely to fall faster than expected, allowing the BoE to cut rates sooner and support further declines in gilt yields.
- 4. Global Bond Issuance: Record in Gross, Modest in Net.** Global bond sales have already hit an annual record this year. Yet muted net issuance in corporates, dominated by refinancing rather than new capital raising, keeps spreads well-supported. Technicals remain supportive for credit investors.
- 5. US funding markets continue to calm after a volatile October:** Short-term funding stress has eased, but system liquidity is still vulnerable. Investors should monitor repo markets closely. They are the most likely indicator of renewed financial stress or further market turbulence.
- 6. Where to find value in Fixed Income:** We continue to favour UK gilts, US TIPS, Emerging Markets local bonds, US Agency Mortgage-Backed Securities, and investment grade corporate bonds in both the eurozone and the UK.

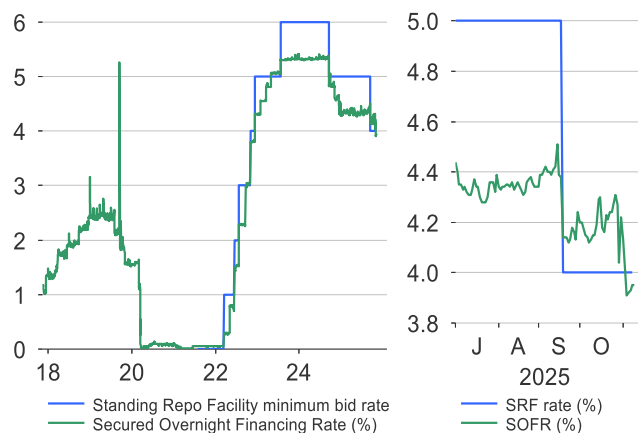
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CHART OF THE MONTH: SOFR OCTOBER SPIKE SIGNALLED ELEVATED USD FUNDING STRESS – MORE ON PAGE 5

SOFR exceeded SRF rate in October



Source: LSEG Datastream, 10/11/2025

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Central banks

Policy divergence: ECB holds, Fed cuts

European Central Bank (ECB)

On hold: The ECB has underscored its comfort with current rates, even as inflation sits at target and medium-term projections suggest a modest undershoot. With rates "in a good place", policymakers are emphasising patience, probably seeking room for manoeuvre should downside risks materialise.

Wait and see: The recent ECB lending survey revealed an unexpected tightening of credit standards for corporate loans (see chart), driven by perceived risks to the economic outlook. This could impart a dovish bias to the Governing Council. However, it may be offset by a pickup in growth, with fiscal spending likely to provide tailwinds through next year.

Our base case: We expect rates on hold for several quarters, followed by a 25bp hike in late 2026 as growth and inflation gather momentum.

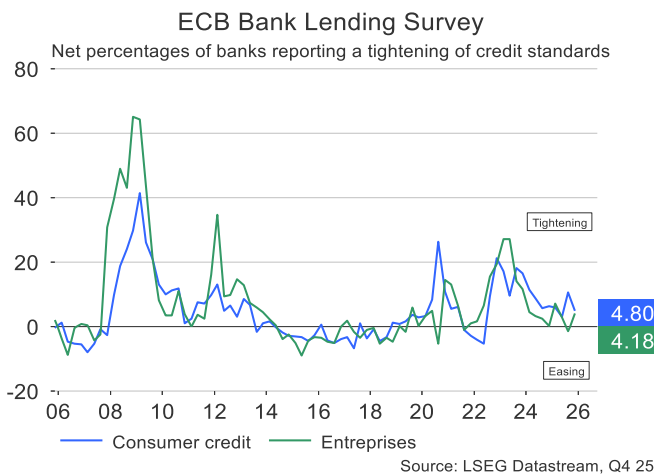
US Federal Reserve (Fed)

Blind Fed (sort of): The government shutdown has created an unusual backdrop: employment reports have not been published and the White House has already flagged that there won't be an October CPI release. The Fed is therefore leaning heavily on private sector data, which paint a picture of a softening labour market (see chart).

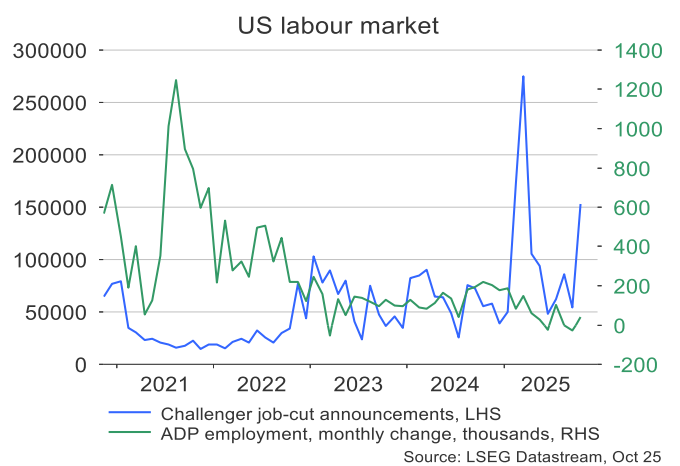
October FOMC: The Fed delivered the expected rate cut to mitigate potential labour market risks. Some policymakers voiced concerns that cutting whilst inflation remains elevated and the economy resilient could prove inflationary and exacerbate inequality.

Our base case: The December FOMC meeting will be politicised, as Trump has indicated his intention to name the next Fed Chair before year-end. We still expect a 25bp cut in December and two further cuts through 2026, bringing the terminal rate to 3.25%.

UNEXPECTED TIGHTENING OF CREDIT STANDARDS FOR CORPORATE LOANS



PRIVATE SECTOR DATA SIGNAL US LABOUR MARKET SOFTNESS



INVESTMENT CONCLUSION

We expect the Fed to cut rates in December and twice more in 2026, whilst the ECB will remain on hold and hike rates no earlier than late 2026 as the eurozone outlook gradually improves.

Bond yields

Change in views and yield curve dynamics

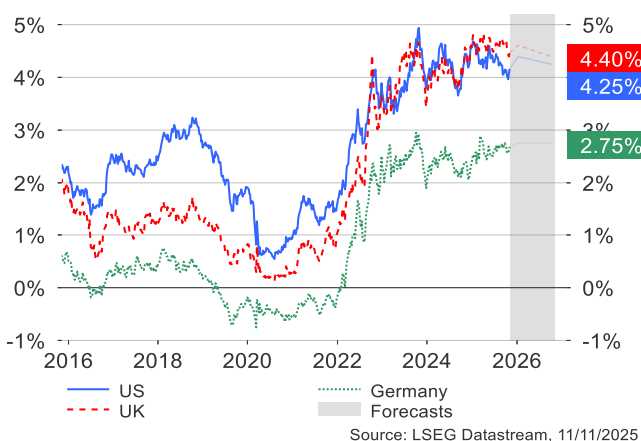
Recent markets shifts have prompted a change in our views on key sovereign bonds.

Treasuries: We turned Neutral from Positive on US Treasuries at the end of last month, as the US 10-year yield dropped below 4% when markets were, in our view, pricing in too many rate cuts. We maintain our 12-month yield target for the 10-year at 4.25%.

Bunds: Range-bound, but risks remain tilted higher. The German 10-year yield has been trading around 2.65%, within a narrow range. We turned Neutral from Positive on EU core sovereigns. We see risks of moderately higher yields as growth and inflation pick should pick up, and bond supply increases, notably due to Germany's €500bn fiscal expansion plan. We maintain our 2.75% target for the bund yield.

Curve dynamics: Steeper trades (which aim to profit when the gap between long and short-term yields widens) have regained traction, with investors favouring the short end of the curve amid expectations of Fed rate cuts. Meanwhile, the US Treasury's auction schedule this week favours long-term issuance.

10-YEAR RATES



	Maturity (years)	13/10/2025	3-month target	12-month target
USA	Policy rate	4.00	3.75	3.25
	2	3.59	3.60	3.60
	5	3.71	3.75	3.75
	10	4.11	4.10	4.25
	30	4.70	4.75	4.90
Germany	Policy rate	2.00	2.00	2.00
	2	2.00	2.00	2.00
	5	2.26	2.25	2.25
	10	2.66	2.75	2.75
	30	3.25	3.25	3.50
UK	Policy rate	4.00	3.75	3.50
	2	3.73	3.60	3.40
	5	3.86	3.80	3.75
	10	4.39	4.40	4.40
	30	5.17	5.20	5.20
Japan	Policy rate	0.50	0.50	1.25
	2	0.94	0.95	1.25
	5	1.25	1.30	1.50
	10	1.69	1.80	2.00
	30	3.18	3.25	3.40

Source: Refinitiv Datastream, BNP Paribas WM

INVESTMENT CONCLUSION

We turned Neutral from Positive on US Treasuries and EU core sovereigns. US and German bond yields are likely to increase moderately in our view. We maintain our 12-month 10-year yield targets at 4.25% in the US and 2.75% in Germany. Curve steepeners remain supported by Treasury auction dynamics.

Topics in Focus

BoE: Towards a Disinflation-Driven Easing Path

Dovish hold : The Bank of England (BoE) maintained Bank rate at 4% on a narrow 5-4 vote, with 4 members backing a cut. Governor Bailey's data-dependent shift now reflects increased confidence that September's 3.8% inflation peak marks the turning point. The 5-4 vote reflected lingering inflation risks and weak growth (Q3 GDP up just 0.2%).

Disinflation to accelerate policy easing: We expect inflation to fall faster than the BoE's base case, opening the door for 25bp cuts in December and Q1 2026, taking the policy rate to 3.50%. With labour market slack building and wage pressures easing, the disinflationary momentum is now self-reinforcing. Markets have moved closer to our view: December cut probabilities have surged to 84%, up from just 25% a month ago, with rates now expected to settle near a terminal rate of 3.4%.

Gilts poised to drop further in our view: We remain Positive on UK gilts, as inflation data should confirm the disinflationary trend and support further BoE rate cuts and lower bond yields.

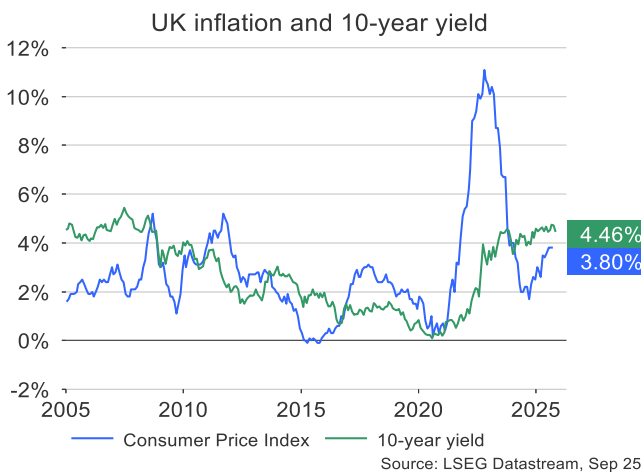
Global Bond Issuance: Record in Gross, Modest in Net

Supply surge breaks records: Global bond issuance has surged to \$5.95 trillion so far in 2025, breaching the prior year's record. Gross supply reflects swollen sovereign borrowing needs (69% of total issuance), AI-driven corporate funding, and resurgent merger activity.

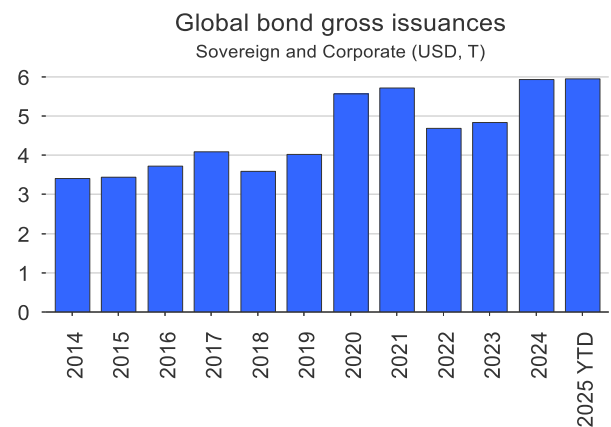
Net supply tells a different tale: Whilst gross issuance was gigantic, net issuance (accounting for maturing bonds and redemptions) was not, particularly in the corporate space. Corporate net supply has remained muted, as firms in the US and Europe mostly refinanced existing debt rather than undertaking growth-driven M&A. In US and EUR high yield, refinancing accounts for 70-72% of proceeds year-to-date.

Technical remain supportive: Record gross supply but modest net flows for high-yield corporates has provided crucial support to valuations, as corporates have maintained solid financial profiles, allowing spreads to remain tight.

WE EXPECT LOWER INFLATION AND LOWER BOND YIELDS IN THE UK



GLOBAL BOND ISSUANCE SETS ANNUAL RECORD



INVESTMENT CONCLUSION

- We remain Positive on UK gilts, expecting lower inflation than the BoE and consensus forecasts are predicting, allowing the central bank to cut rates and bond yields to drop to our 12-month target of 4.40%.
- Global bond sales have already hit an annual record this year. Yet muted net issuance in corporates, dominated by refinancing rather than new capital raising, keeps spreads well-supported. Technicals remain supportive for credit investors.

Topics in Focus

US funding markets continue to calm after a volatile October

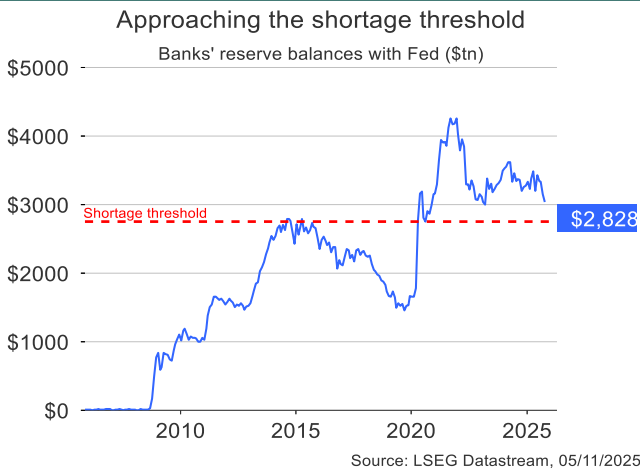
Understanding the Plumbing: The US repo market remains the essential yet often overlooked infrastructure of the global financial system. It allows participants to borrow and lend cash overnight using Treasuries as collateral, ensuring liquidity circulates efficiently across banks, dealers and funds. The Secured Overnight Financing Rate (SOFR), derived from these repo transactions, has become the key reference for short-term dollar funding. When SOFR moves meaningfully, it reflects genuine shifts in underlying liquidity conditions.

Sources of Stress: Through late October, multiple factors combined to tighten conditions in the funding market. Heavy Treasury bill issuance absorbed cash from investors just as the Fed's quantitative tightening (QT) continued to reduce reserve balances (see chart). Simultaneously, the Treasury General Account (TGA) rose sharply due to delayed government spending linked to the partial shutdown, draining liquidity from financial institutions and money market funds. The net effect was a measurable drop in system reserves.

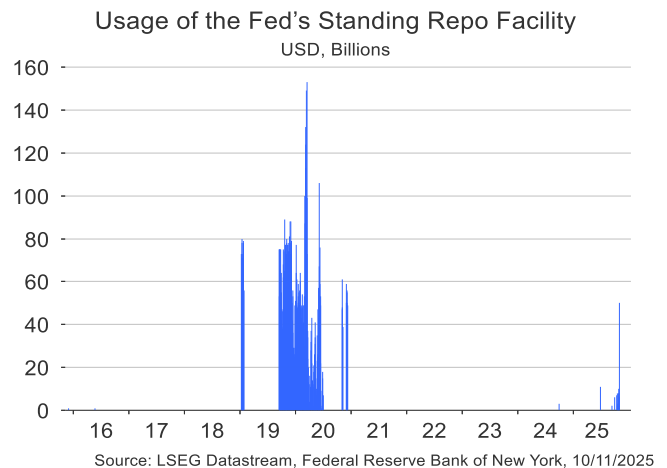
Repo rates, including SOFR, moved toward the upper end of the Fed's target range, prompting banks to draw on the Fed's Standing Repo Facility (SRF) for the first time in size since the pandemic. While the amounts were modest compared to the pandemic peak (see chart), the move signalled a shortage of cash in the system and indicated that the "ample reserves" framework was under pressure.

Recent normalisation: Funding markets improved fast in early November as the Fed's announcement to end QT by 1 December 1 shifted expectations about liquidity. This eased reserve scarcity fears and encouraged dealers and funds to lend at lower rates. In addition, the Fed lowering the SRF rate to 4% created profitable arbitrage, letting banks borrow cheaply and lend in the repo market, pushing SOFR down. Lastly, the Treasury started spending down its high TGA balance, injecting cash back into the system and easing reserve pressures. Together, these calmed funding markets without more Fed intervention, as cash returned where needed.

FED'S QUANTITATIVE TIGHTENING CONTINUED TO REDUCE RESERVE BALANCES



FED REPO FACILITY USAGE SURGES AMID SOFR STRESS



INVESTMENT CONCLUSION

Short-term funding stress has eased, but system liquidity is still vulnerable. Investors should monitor repo markets closely. They are the most likely indicator of renewed financial stress or further market turbulence.

Our Investment Recommendations

Asset class	Zone	Our opinion	
Government bonds	Germany	=	We turned Neutral from Positive 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 turned Neutral from Positive, 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	4.11	---	
Germany	2.66	---	
France	3.42	77	-7
Italy	3.40	75	-10
Spain	3.16	51	-4
Portugal	3.01	36	-5
Greece	3.31	65	-9

11/11/2025

Source: Refinitiv Datastream

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Global	3.46	29	-1
Corporate bonds IG EUR	3.07	81	1
Corporate bonds IG USD	4.85	82	1
Corporate bonds HY EUR	5.07	293	-22
Corporate bonds HY USD	6.87	315	-17
Emerging government bonds in hard currency	6.64	240	-25
Emerging government bonds in local currency	5.93	221	2

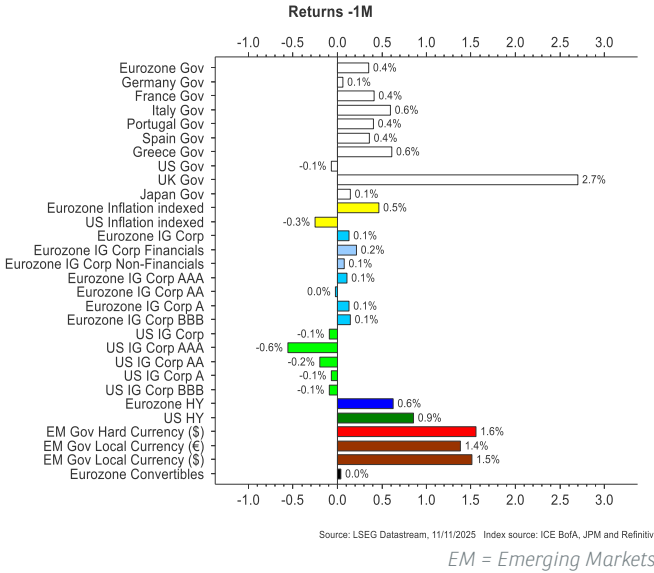
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Source: Refinitiv Datastream, Bloomberg

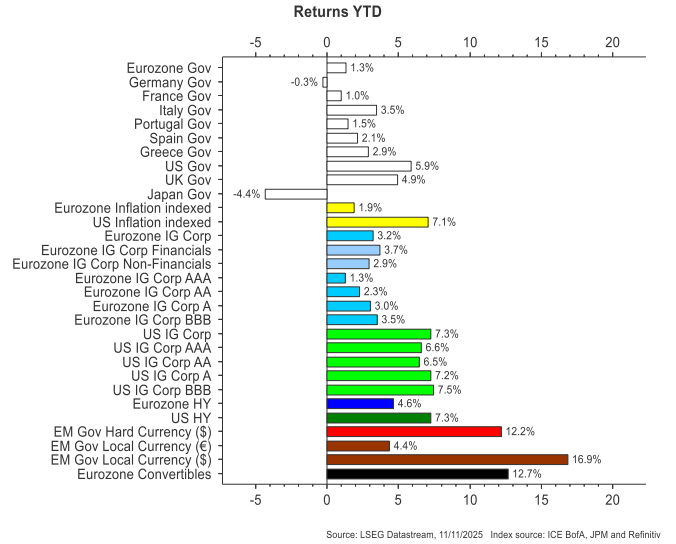


Returns

OVER ONE MONTH



SINCE 01/01/2025



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