



Feedback

Portfolio perspectives | White paper - 6 Min

Fixed Income Outlook – Not as planned



2 AUTHORS - PERSPECTIVES D'INVESTISSEMENT
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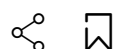
Another higher-than-expected US inflation number means that should be in no rush to cut rates before price pressures subs

In this article:

US – A new quarter, a new outlook

Eurozone – Expect a steeper yield curve

UK – Next step: rate cuts



inflation continuing to surprise to the upside in the near term benchmark 10-year yields to potentially retrace to 4.75%, at likely again go overweight duration.

The prospect for higher energy prices, higher Treasury yields, ge ratchetting up, and a US presidential election where the Republi a series of inflationary policies makes us keep a long position in

In the eurozone, the case for rate cuts looks compelling. We exp first 25bp cut in June, followed by two to three cuts in the secon deposit rate to 3.00-3.25% by the end of the year.

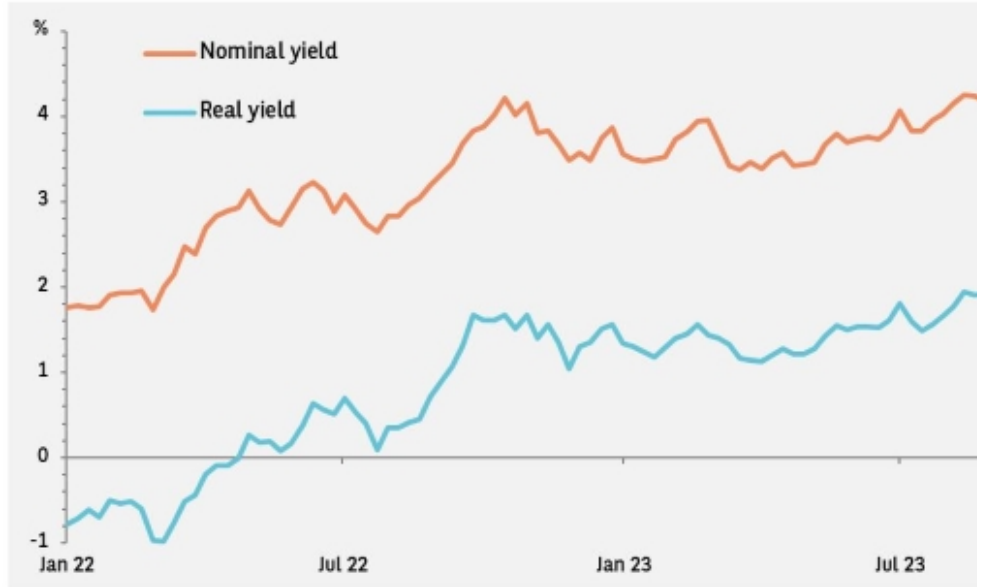
US – A new quarter, a new outlook

Beginning-of-the-year prospects for up to seven Fed rate cuts by morphed into expectations that inflation will remain sticky, grov the Fed might cut rates only twice (or less) by the end of the

We expect the strength of the March payrolls report and hig Feedback to prompt Fed officials to question whether the central banl restrictive' and prompt reminders that the Fed is in no rush

Despite strong momentum in hiring in March, a growing labour j remaining above the Fed's comfort zone, our baseline view is for market. The risk is that rising real wages, solid consumption, an could stall this rebalancing and halt progress on services disinfl

Exhibit 1
Higher yields
US 10-year Treasury yields



Data as at 17 April 2024. Sources: Bloomberg, BNP Paribas Asset Management.

Recent inflation data means the risk of higher and persistent unemployment is the Fed's number one priority, even though inflation is not that far a

The real challenge for the Fed is non-housing services inflation (Feedback "supercore"). The trend in this component, which is the largest worry the Fed. On a six-month annualised basis, supercore i

Correspondingly, with the risk of inflation continuing to surprise on the short term, we expect 10-year yields to potentially bounce to 4.75%, and likely again go overweight duration.

On breakeven inflation (BEI), besides the CPI data, we are watching with the US looking to rebuild its strategic petroleum reserve at a time when tensions between Israel and Iran are rising.

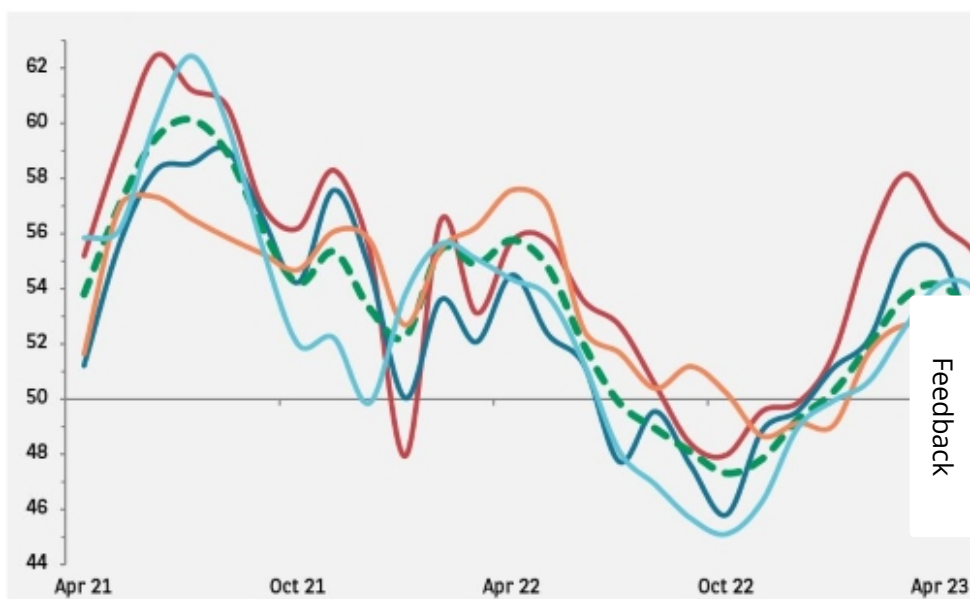
The prospect for higher energy prices, higher Treasury yields, and market tensions heading into a presidential election where the Republican string of inflationary policies — including an immigration clampdown on imports — keep us long BEIs.

Eurozone – Expect a steeper yield curve

With the economy stagnating over the past few quarters and wa risks of a wage-price spiral have largely receded. In the absence conditions, real policy rates would become increasingly restricti inflation undershooting the ECB’s 2% inflation target.

At the same time, sentiment indicators have improved. While ad comfort the ECB and allow it start easing policy rates, resilient e need for aggressive easing.

Exhibit 2
Purchasing Manager Indices are recovering
Composite Index



Data as at 17 April 2024. Sources: S&P Global, BNP Paribas Asset Management.

We expect rate cuts to lower the deposit rate to 3.00-3.25% by t with President Christine Lagarde’s comments that the cutting cy time of writing, front-dated interest rate pricing implied a depos end-2024, and 2.4% by end-2025.

We see both upside and downside risks to the policy path currer

On one hand, the drag from past monetary tightening is expecte started to lift household purchasing power, providing a tailwind inflationary pressures prove stickier during the ‘last mile’ of infl: not need to cut policy rates by as much or as quickly as priced ir

On the other hand, the fiscal stance is beginning to tighten as en

and EU fiscal rules return to focus in the second half of the year. fiscal austerity to return, an easier monetary policy stance might have a negative impact from tighter fiscal conditions.

We expect the yield curve to steepen and believe front-dated yields will be the ECB edges closer to rate cuts. At the same time, long-dated yields are vulnerable to a potential rise in term premium as the bond issuance by governments are still historically high and price-insensitive purchases are coming to an end.

In country selection, we are neutral towards Italy, but overweighted against France. We expect Spain to outperform core countries as the services sector remains dynamic and investment flows from abroad support growth.

Italy should also benefit from NGEU funds, but it has accrued significant losses from the 'superbonus' tax credit scheme; curbing these tax incentives will lead to lower tax revenues which will weigh on the debt burden. These factors are headwinds to Italy's debt-to-GDP ratio in the near term, which could impact government bond performance.

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UK – Next step: rate cuts

The economy should be on track for modest growth in the first half of the year. A consecutive two percentage point cut in National Insurance contributions and the scheduled 10% increase in the National Living Wage should support consumers' pockets and support consumption.

In addition to the rise in real income, with household savings rates at 10%, any normalisation in savings could drive spending. The recovery is modest. Interest rates will remain restrictive in 2024, which should support the personal tax cuts, fiscal policy is expected to tighten by around 0.5%.

CPI headline inflation is on track to fall below 2% in the spring. A decline in core goods inflation has contributed to the disinflation. More is expected as the price cap is reset lower in April and July and surveys point to a continued decline.

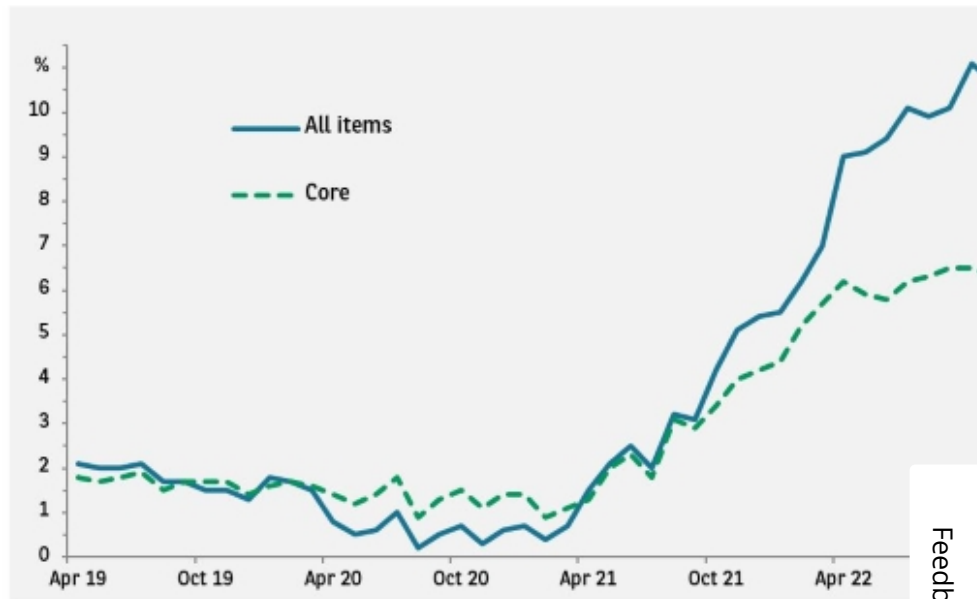
inflation.

Services inflation, however, has been more persistent at 6.1% ye term, administered and index-linked prices and robust wage gro sticky.

Exhibit 3

UK inflation on the way down

Year-on-year change



Data as at 17 April 2024. Sources: FactSet, BNP Paribas Asset Management.

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The outlook for the labour market and implications for infla...

On one hand, at 3.9%, the unemployment rate is well below the of the non-inflationary equilibrium level of 4.5%. A higher Natio lead to higher services inflation.

On the other hand, the decline in job vacancies and rise in redur harbinger of a broader decline in companies' appetite for worke in unemployment.

In the long term, we remain of the view that the impact of Brexit left by the pandemic, and years of weak business investment ha constraints which, in turn, weigh on the economy's growth pote

There are nonetheless factors that could drive UK yields above t values: net Gilt issuance remains at historical highs and the cent

tightening has removed a large, price-insensitive buyer from the pension funds now enjoy a much stronger funding status and he liability-driven activity, which was a major source of demand for declined meaningfully.

The experience of the 'mini budget' debacle in 2022 is still in the investors, and while the current government has limited its fiscal headroom available, uncertainty about the UK's long-term fiscal election will likely keep foreign investors cautious.

This mix of heavier issuance, central bank balance sheet reduction demand led to a significant increase in term premia in 2023 and premia could return in 2024. Currently, the government is forecasting books if growth picks up, inflation and interest rates fall, and substantial unprotected public spending.

If these factors fail to materialise, or public spending cuts prove a framework of fiscal prudence will be challenged.

The debate at the BoE has already shifted from keeping the the degree of policy rate restrictiveness. Headline inflation in spring, and various indicators point to a continued moderation, should give policymakers some confidence that monetary policy inflation back to target sustainably.

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We expect the BoE to begin cutting interest rates in June, followed by cuts, taking the Bank Rate to 4.5% by end-2024. Thereafter, we expect of wage growth and services inflation. If this materialises, we expect faster rate cuts in 2025 to return the Bank Rate to a neutral level at around 2.5%.

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investors will not recover their initial outlay. Past performance is no gua
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the majority of international developed markets. For this reason, service
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