Rates Strategy

Taking stock of our EGB strategic views

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We switch to a POSITIVE strategic stance on Bunds *(from NEUTRAL with a positive outlook previously), for the following reasons:*

1) *At current levels, Bund real yields have priced in all the positive news regarding growth and most of the increase in supply pressure expected going forward (mainly from Germany).*

2) *Our baseline view is that energy prices have reached their peak, and this should cap any additional increase in breakeven rates.*

3) *We expect EA inflation to decline to target in 2027, with the ECB delivering one to two rate cuts in H2 to reverse some of the monetary policy restriction implemented during 2026.*

Within EGBs, we see OATs as the riskiest bet from a medium-term perspective and would consequently underweight them within an EGB portfolio*. Despite the fact that they have recently underperformed the rest of the EGB market, we expect the substantial fiscal and political risks to weigh further in the medium-term.*

We would position ourselves OVERWEIGHT on SPGBs. *Spain will remain one of the fastest growing economies in the EA in 2027, with growth expected to average 1.9%, making fiscal discipline a much easier political objective to achieve.*

Strategically, we remain NEUTRAL on BTPs, with a positive outlook, *supported by our constructive view on Bunds.* ***Within EGBs, however, we remain somewhat more cautious on BTPs than on SPGBs, as the upcoming electoral cycle could introduce some downside risks.***

Bund: We turn strategically CONSTRUCTIVE

We switch to a strategically CONSTRUCTIVE stance (from NEUTRAL with a positive outlook previously).

This is driven by the following considerations:

1) Bunds have priced in most of the positive news

Since the start of the Middle East war, the EA economy has performed better-than-expected, showing considerable resilience to the increase in energy prices (Figure 1). Against this backdrop, monetary policy expectations have remained relatively hawkish, with around two rate hikes still priced by the end of Q1 2027. This, coupled with upward revisions to fiscal deficits (mostly from Germany) and spillover from rising UST yields has kept long-end real yields above 1%.

We believe that at current yield levels, Bunds have priced in most of the positive news on growth and most of the increase in supply pressure going forward, especially considering that we do not expect a further increase in growth potential.

While we do not expect Bund to rally in the near-term, once it will be clear that the ECB will not deliver the third rate hike currently priced in by the market and may instead move policy rates back towards a neutral level at some point in 2027, we would expect yields to decline.

2) Little additional lift for yields from energy prices

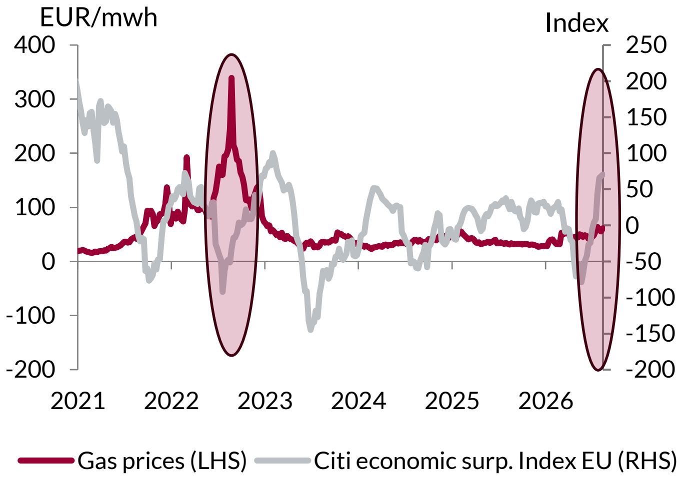
We think that further upside for German yields stemming from energy prices should be fairly limited.

This view is based on the following considerations:

1) We believe that geopolitical tensions between the US and Iran have peaked. Accordingly, we do not expect an aggressive and sustained rally in oil prices.
2) We note that the sensitivity of Bund yields to energy prices is declining (Figure 2).
3) We do not expect the recent increase in energy prices to trigger second-round effects on inflation.

Figure 1

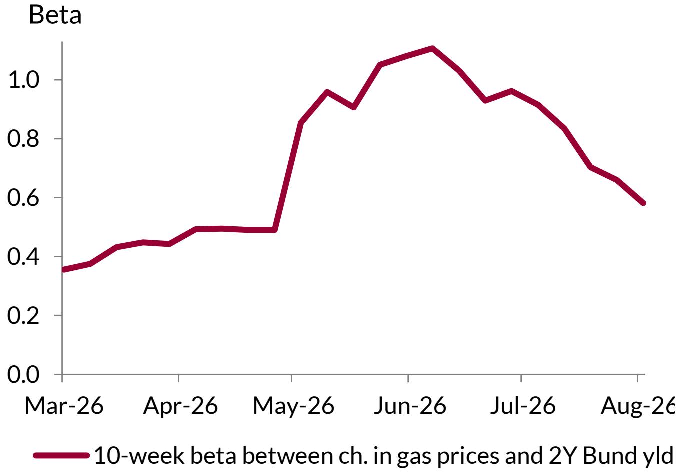
EA economy resilient to surging energy prices



Source: Bloomberg, ANIMA Research

Figure 2

Declining sensitivity of Bund to energy prices



Source: Bloomberg, ANIMA Research

3) Markets do not price any ECB rate cuts in 2027

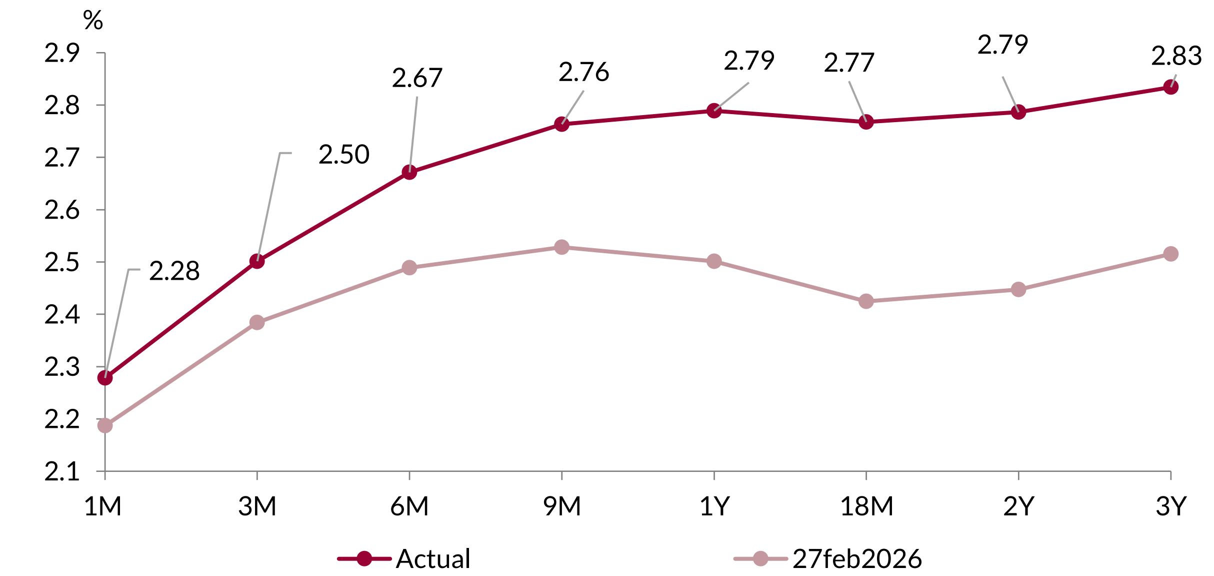
While we expect growth to remain around current levels on a quarterly basis in 2027, we expect euro area (EA) inflation to decline to target by the first half of 2027.

With inflation back at target and growth still moderately below potential, we do not rule out the possibility that the ECB could deliver one to two rate cuts in H2 2027 to reverse part of the monetary policy tightening implemented in 2026 and bring the deposit rate back to a neutral level.

This scenario is not currently reflected in market pricing, as markets still imply a neutral policy rate well above 2.5% (Figure 3).

Figure 3

Markets are still pricing a neutral rate well above 2.5% in EA



Source: Bloomberg, ANIMA Research

EGBs: navigating 2027 elections

In 2027, nine EU countries will hold general elections. Of these countries, the most market-relevant are France, Italy, and Spain.

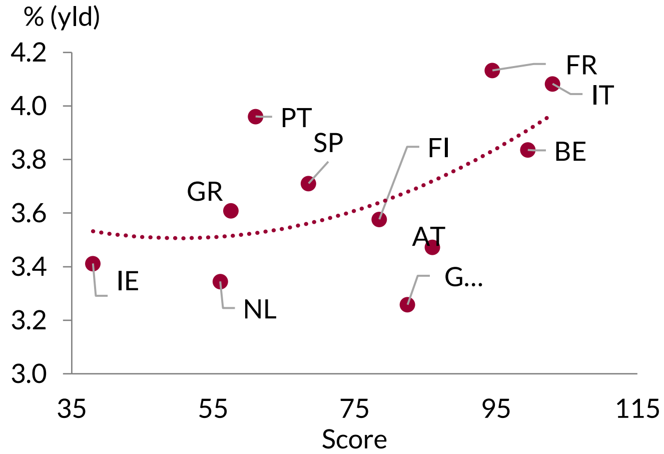
Our eurozone scorecard[1] indicates that the sovereign bonds of all three countries trade at valuations that are cheap relative to their fundamentals compared with the rest of the EGB universe (Figure 4).

That said, from a strategic allocation perspective, any assessment of EGB markets next year needs to include an evaluation of both political and fiscal risks.

Once these factors are taken into account, our recommendation would be **to underweight OATs, take a positive stance on SPGBs, and maintain a neutral to moderately constructive stance on BTPs.**

Figure 4

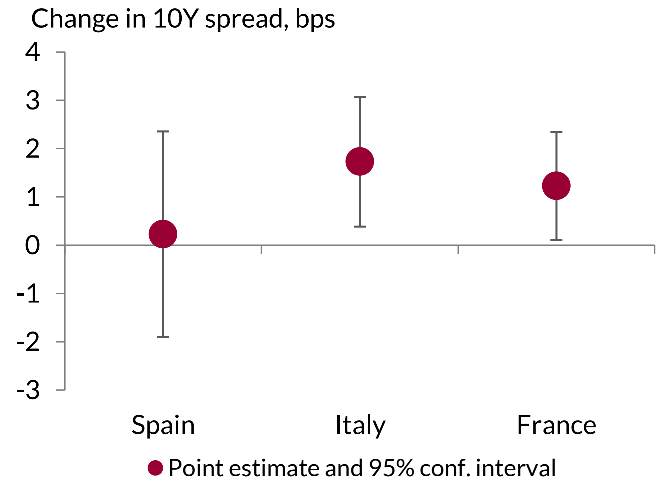
Periphery and France trade cheap compared to their fundamentals



Our scorecard assigns a score to the major eurozone countries based on their ranking in terms of macro fundamentals, fiscal variables and valuation. Source: Bloomberg, Haver Analytics, IMF, ANIMA Research

Figure 5

SPGBs are the most insensitive to political noise



Three monthly regressions estimate the relationship between changes in Spanish, Italian, and French 10-year spreads to Bunds and standardised changes in each country's domestic Economic Policy Uncertainty (EPU) index, controlling for euro-area-wide spread movements and changes in equity-market volatility. The estimates use Newey-West standard errors with three lags. The coefficient measures the basis-point impact of a one-standard-deviation increase in monthly EPU log growth. The regressions are estimated using monthly data from 2011 to the present.

Source: Bloomberg, Haver Analytics, ANIMA Research

[1] *Our scorecard assigns a score to major eurozone countries based on their ranking in terms of macro fundamentals, fiscal variables and valuation.*

Figure 6

Major elections in EA and possible market impact

Country	Election type	Dates	Likely outcome	Market impact
France	Presidential	18 April – 2 May	Parliament not aligned with the President	Negative
Spain	Parliamentary	July – August	Left-wing minority govt. or right-wing govt. (VOX as second party)	Neutral
Italy	Parliamentary	April – October	Left-wing govt. or right-wing (with Futuro Nazionale)	Neutral to moderately negative
Greece	Parliamentary	Spring	Hung parliament	Neutral

Source: ANIMA Research.

OAT

Within EGBs, **we see OATs as the riskiest bet from a medium-term perspective and would consequently underweight them within an EGB portfolio**, despite the fact that they have recently underperformed the rest of the EGB market.
This view is based on the following considerations:

1) The approval of the 2027 budget will not be an easy task politically, as the government will have to seek the support of the opposition parties, which will likely result in less ambitious fiscal consolidation. That said, if the government fails to pass a budget for 2027, or loses a vote of no confidence after invoking Article 49.3, a special law would roll over the previous year's budget. In this case, the deficit/GDP ratio will materially increase in 2027, mainly due to the expiry of the surcharge on corporate taxes. In its May 2026 projections, the European Commission expected France's deficit to reach 5.1% of GDP in 2026, rising to 5.7% of GDP in 2027 under unchanged policies. A report submitted to the Ministry of the Economy pointed to an even wider deficit estimate in case of unchanged policies, at close to 5.9% of GDP (Figure 8).

   If the government manages to pass a budget, this could bring some relief to OATs, with the OAT/Bund spread narrowing back to the 70/75bp area, but we would see it as temporary, before pre-election volatility intensifies once again. For reference, OATs started to come under pressure towards the end of Q4 2016 ahead of the April-May 2017 Presidential elections.

2) We expect presidential elections in 2027 to trigger volatility on OATs, taking into account that market consensus at the moment is for a contest between Marine Le Pen, leader of the Rassemblement National, and Édouard Philippe, the centrist former prime minister and that Marine Le Pen is perceived as less market-friendly than Jordan Bardella.

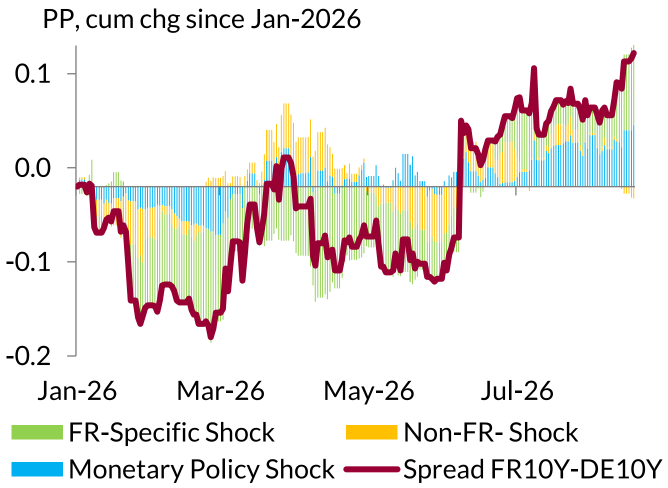
3) There is a reasonable chance that legislative elections will be called following the presidential election. This would, on the one hand, prolong volatility in OATs and, on the other, raise the possibility that the next President could face a fragmented

and potentially hostile lower house, making the approval of the budget and the implementation of key fiscal reforms a highly challenging process.

4) Against this backdrop, Japanese investors have already started showing reduce appetite for OATs, (Figure 9), favouring other EGBs, such as SPGBs and BTPs.

Figure 7

Idiosyncratic component increasingly weighing on OATs



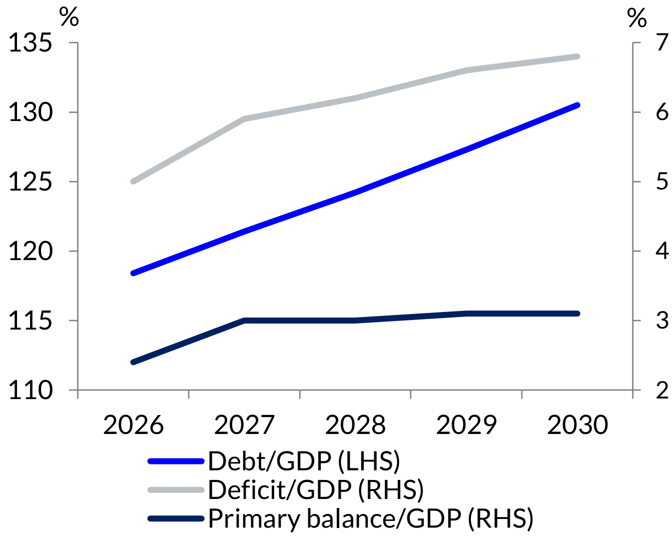
We use a BSVAR model to decompose domestically induced spread dynamics from movements due to foreign events and monetary policy. The SVAR model comprises the change in the spread of the 10-year BONOS yield versus the German bund yield, the change in the Spain stock market relative to the German one, and the change in the 10-year euro-area OIS rate. Our sample includes daily observations starting January 1999. The model expresses every variable as a function of its own past and the past of other variables, plus a new information component. We split each day's new information component into the effects of the three underlying drivers based on an assumed sign pattern of the effects of the drivers on the variables, using the algorithm of Rubio-Ramirez et al. (2010).

Monetary Policy Shock: FR_DE_spread: (+), FR_DE_STOCK (0), EA_10Y_OIS (+). NON-FR Shock: FR_DE_spread: (+), FR_DE_STOCK (+), EA_10Y_OIS (-). FR-specific Shock: FR_DE_spread: (+), FR_DE_STOCK (-), EA_10Y_OIS (-).

Source: Bloomberg, Haver Analytics, ANIMA Research

Figure 8

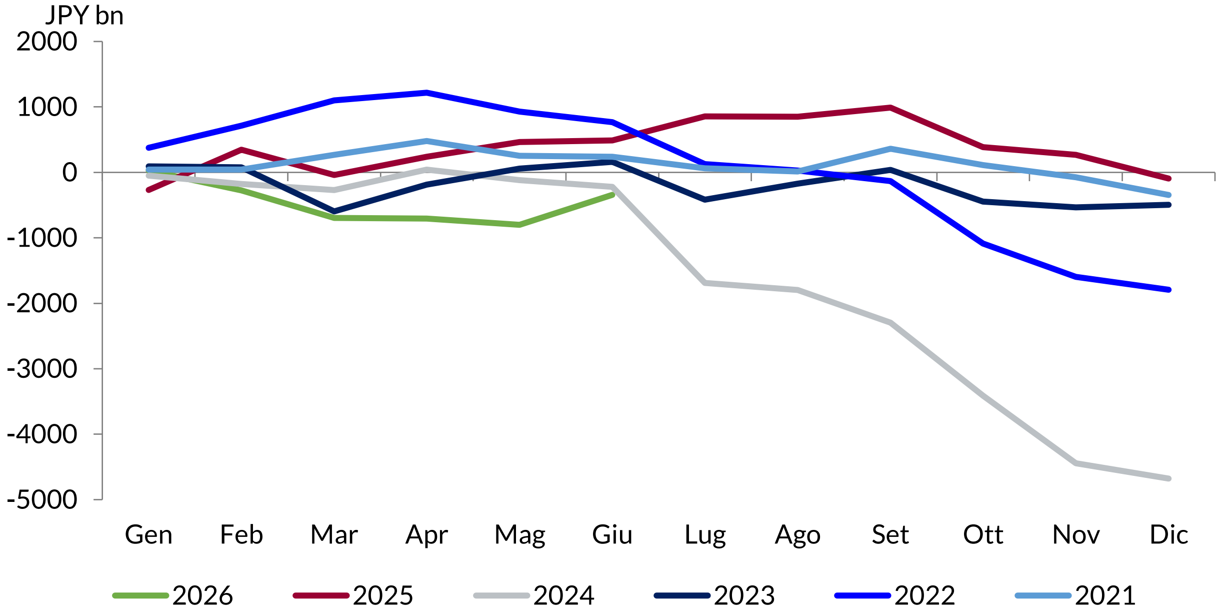
Fiscal developments with unchanged policies



Source: Bloomberg, MIssion, ANIMA Research

Figure 9

Japanese are buying less French bonds compared to previous years



Source: Bloomberg, Japanese MOF, ANIMA Research

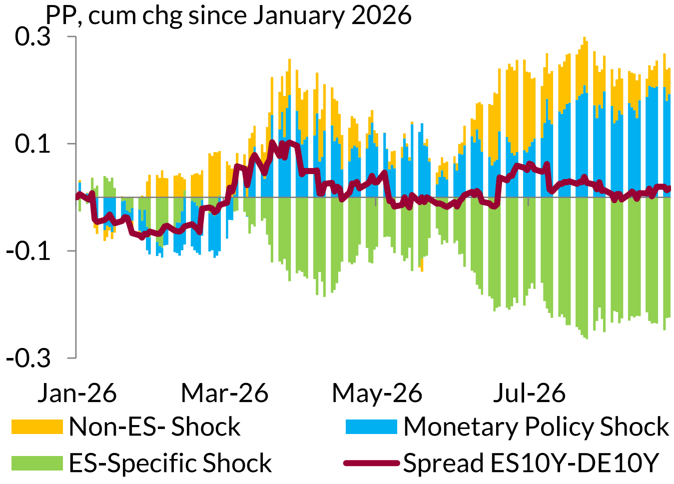
SPGB

We maintain our positive view on SPGBs despite the 2027 general elections and would continue to overweight SPGBs within an EGB portfolio.

Excluding Ireland, according to the European Commission, Spain is expected to remain the fastest-growing economy in the euro area in 2027, with growth projected to average 1.9%. This makes fiscal discipline politically easier to maintain than in countries where growth is more subdued, as there is less need for significant fiscal consolidation packages. Last but not least, SPGBs have historically been relatively resilient to political noise and uncertainty (Figure 11).

Figure 10

Idiosyncratic premium very positive for SPGBs



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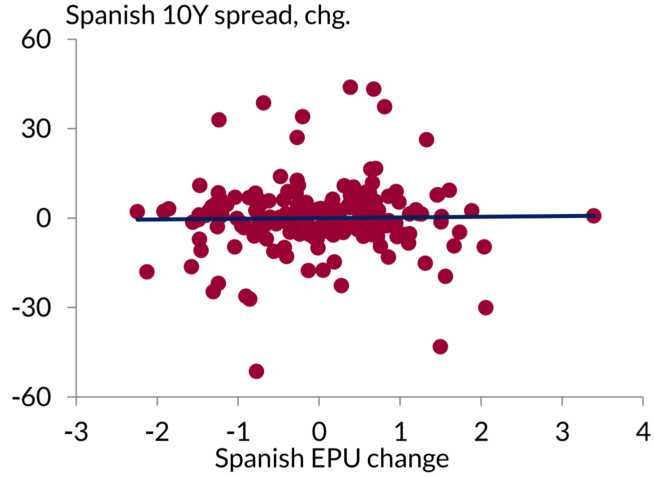
Source: Bloomberg, Haver Analytics, ANIMA Research

Figure 11

SPGBs are fairly insensitive to political risk



Sample start in 2011 until present, data are monthly.

Source: Bloomberg, Haver Analytics, ANIMA Research

BTP

Strategically, we remain NEUTRAL, while maintaining a positive outlook overall, supported by our constructive view on Bunds. **Within EGBs, however, we remain somewhat more cautious on BTPs than on SPGBs**, as the upcoming electoral cycle could introduce some downside risk for the following reasons:

1) While we expect the next government to remain broadly committed to fiscal discipline, the outcome could result in greater political uncertainty and potentially reduce the degree of stability that has supported BTPs in recent years (Figure 12).

2) The French electoral cycle, with presidential and potentially parliamentary elections next year, could generate moderate spillover into Italian sovereign spreads, particularly given that current spread levels remain historically tight.

3) Italy's relatively high sensitivity to gas prices (Figure 13) represents an additional source of risk, especially in an environment of renewed energy-price volatility.

Overall**, we see the election cycle as neutral to moderately negative for BTPs, but not sufficient to alter our strategically neutral stance, particularly given our positive outlook on Bunds.**

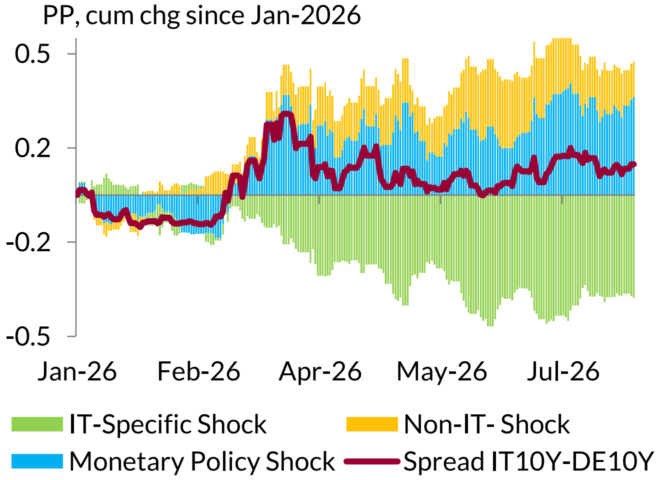
Meanwhile, volatility on BTPs could temporarily increase this autumn, on the approval of the 2027 budget. The first source of attention is Italy's intention to request activation of the National Escape Clause. The government is reportedly planning to ask the European Commission for cumulative flexibility of around 0.6% of GDP over the 2026-

2028 period, equivalent to roughly EUR 14bn, for energy security. It is also seeking cumulative flexibility of around 0.9% of GDP over the period covered by the clause, equivalent to approximately EUR 21bn, for defense and security spending. While this does not automatically imply a deterioration in fiscal credibility, especially because the government has declared that it intends to use the flexibility requested only in case of exit from the Excessive Deficit Procedure (EDP), it introduces an additional layer of uncertainty, as the fiscal space created for energy, defence, and security spending could indirectly free up resources for more politically attractive spending measures elsewhere.

That said, we do not expect the 2027 budget to result in a permanently wider BTP-Bund spread.

Figure 12

Idiosyncratic premium still very positive for BTPs



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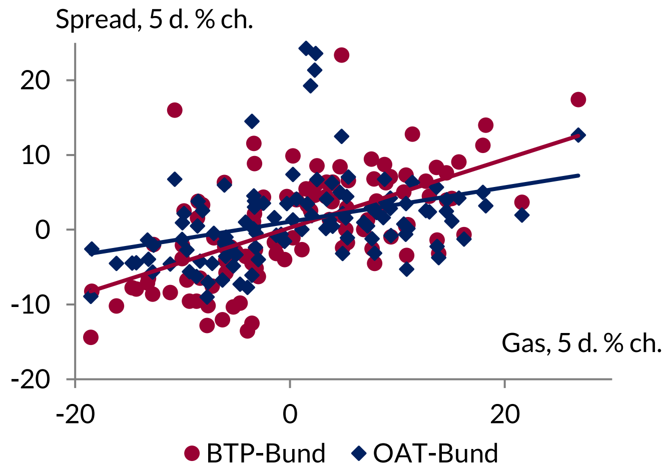
Source: Bloomberg, Haver Analytics, ANIMA Research

Figure 13

Italy is more sensitive to gas prices vs. the rest of EGBs



Source: Bloomberg, ANIMA Research

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