

FIXED INCOME

Fixed income in the new policy order

We see a continuation of the diversification trend seen in 2026. Fixed income investors may be underestimating the risk stemming from US expansionary fiscal policy. We see opportunities in inflation break-evens, and yield curve steepening later in the year. Quality credit becomes a core allocation for fixed income investors, thanks to sound fundamentals and a better risk-return profile compared to Treasuries. European bonds remain a key call for 2026, with a focus on peripheral bonds and investment grade credit, particularly in financials.

Rising US fiscal risks call for a focus on inflation and investment grade credit

Foreign holdings of US Treasuries, at almost \$9 trillion, are close to record highs, but we believe **international investors may be too optimistic about the long-term persistence of US exceptionalism** at a time when US deficits and debt are rising and inflation risk persists. Investment in AI (as discussed previously) could raise US potential growth above 2%, but even if AI does boost productivity, it may not be enough to offset worsening demographics. **US debt is unprecedentedly high, which also adds risk to Fed independence.**

US bond yields have fallen in anticipation of rate cuts. We believe the weakening labour market warrants cuts down to 3.25%, but the market is periodically pricing in cuts to below 3% by the end of 2026. **Monetary policy this dovish, in our view, would increase expected inflation and increase the term premium.**

This backdrop calls for a **disciplined, tactical approach to duration**, as yields will likely stay range-bound throughout the year. Inflation becomes a key call, favouring **break-evens, while steepening opportunities should emerge later in the year**, after rates have been cut. The 2-10Y spread could still widen to 120bp, especially if the Fed proves more dovish than we expect.

To diversify away from US Treasuries, **investment grade (IG) credit is an increasingly relevant asset class** and should benefit from limited supply and disciplined balance-sheet management. We see potential for some further spread tightening against government bonds. We are cautious on US high yield bonds, which may suffer from concerns about private debt, regional banks and the impact of tariffs on operating cash flow.

Balancing US debt issuance ultimately tests Fed independence

US debt strategy leans on short-term issuance, instead of long bonds, reducing the cost within the near term, but rates ultimately roll over risk and could increase pressure to push the Fed into deeper cuts: testing the central bank's independence.

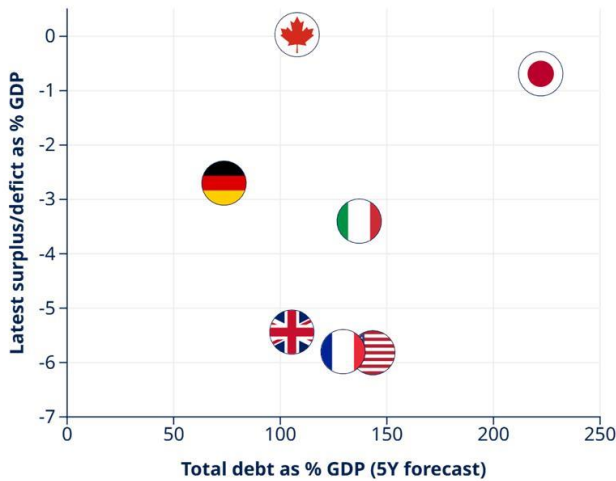
The CBO estimates the One Big Beautiful Bill (OBBB) will add \$3.4tn to the deficit over the next decade. The Treasury says it can hold issuance steady "for at least the next several quarters" – possible if the gap is funded with bills. Bills are 21.5% of debt, near historic averages. In 2026 interest payments will total \$1.1tn (3.2% of GDP) as the average federal debt rate has risen to about 3.5%.

Bills as % of outstanding marketable Treasury debt



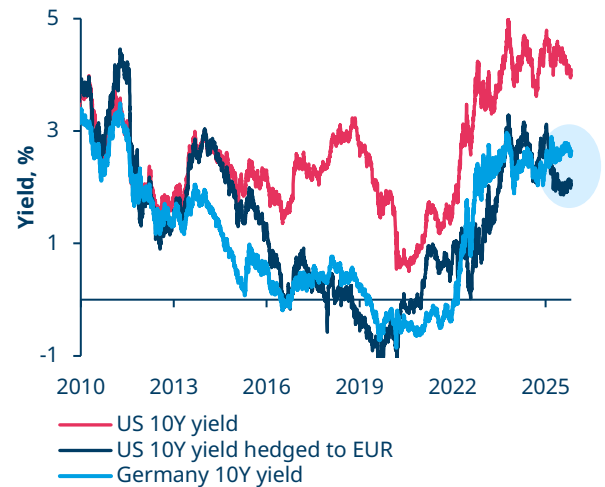
Source: Amundi Investment Institute on US Treasury Department. Data as of 30 September 2026. CBO is the Congressional Budget Office.

Fiscal room is shrinking across the G7



Source: Amundi Investment Institute, Bloomberg, IMF. Total Debt as % of GDP includes all financial liabilities of a government, either central plus local governments debt. Data as of November 2025.

European bonds appealing vs US



Source: Amundi Investment Institute, Bloomberg. Data as of 31 October 2025.

Bond vigilantes will impose fiscal discipline

Elsewhere in the G7, debt levels are also elevated. With the exception of Japan, which does not rely on foreign investors (although we remain cautious on JGB), most other G7 governments are wary of bond vigilantes and reluctant to add fiscal stimulus. The UK shows why; in a higher inflation environment, QE would not be able to deliver lower long rates. Attempts to inflate debt away would result in higher expected inflation, and hence higher long-end yields. **This discipline makes us bullish on Gilts, which are still near their cheapest levels in a decade against Treasuries.**

Rising appeal of European bonds

Germany has ample fiscal space and a pressing need to address both weak economic performance and new security requirements. Germany's sizeable projected debt issuance over the next 5 to 10 years will **expand EU government bond markets and provide a large opportunity set for global investors.**

Support for European bonds will also come from the ECB, which we see has scope to follow the Fed's lead and cut rates to a terminal rate of 1.5% by mid-2026. **A narrowing yield differential between 10Y Bunds and Treasuries and expectations of ECB cuts will favour European bonds versus the US.** This can further support the repatriation of assets by European investors and rising demand from international investors willing to diversify into an expanding market with more predictable fiscal rules. **Within Europe, we are even more optimistic about peripheral governments.**

Fiscal discipline in Italy and Spain could allow spreads relative to Germany to continue narrowing. France's spread is a confirmation of the credibility of the European fiscal framework. While a return to the parity seen before 2007 looks unlikely, it is possible the Italy-Germany 10Y spread could fall below 70bp, while the Germany-Spain spread may reach 40bp. We also see opportunities in euro investment-grade credit, with room for further spread compression, particularly in financials.

KEY INVESTMENT IMPLICATIONS

Positive on US 10Y break-evens

The weaker dollar and tariffs alone could boost prices, while demand will be stimulated by expansionary fiscal and monetary policy and higher investment. The decline in 10Y break-evens to 2.25% should reverse, with a return to the 2.5% peaks of the past two years looking possible.

Positive on EU peripheral debt, German 10Y Bunds, and Gilts versus US Treasuries

We prefer European bonds to US Treasuries: anticipated ECB cuts and an expanding European bond market should draw investor demand. UK Gilts also look attractive relative to US Treasuries, while euro-area peripherals offer the strongest conviction given yield pickup and improving fundamentals.

Continue to favour IG credit

Spreads still offer reasonable value versus swaps, and disciplined issuance means credit will benefit at least from carry, and possibly from further capital gains.

CURRENCIES

USD weakness: stretched but not done

The US dollar caught many investors off guard in 2025, given the prevailing narrative of renewed ‘US exceptionalism’ following the US elections. The assumption that pro-business deregulation and aggressive tariffs would widen the US growth advantage proved misplaced. But now that expectations have reset and momentum outside the US has weakened, the sustainability of the USD correction is being questioned. While macro fundamentals no longer appear as a clear drag on the USD, they remain, in our view, insufficient to reverse the structural forces at play. We continue to position for a weak, albeit non-linear, USD in 2026.

Beyond relative value: the USD’s global dominance still cuts both ways

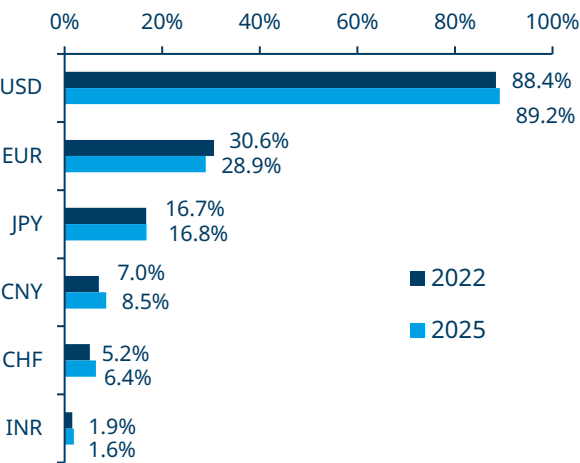
The September BIS Triennial Survey confirmed that ‘de-dollarisation’ remains overstated: the USD still features in about 89.2% of global FX transactions, up from 88.4% in 2022. Yet full de-dollarisation is not required for the dollar to weaken. Four arguments suggest that FX may extend beyond relative value, and this will likely mean depreciation ahead for the USD.

First, weak growth abroad, if contained, will likely offer an opportunity to diversify fixed income exposure beyond US debt. As global yields have normalised – the share of negative-yielding debt has fallen to zero from over 30% in 2019 – a contained decline in the rates differential could paradoxically coincide with FX appreciation.

Second, an increasingly unorthodox policy mix – persistent fiscal deficits, higher inflation tolerance, and measures such as the Genius Act and SLR reform – **risks suppressing US real rates and reviving concerns about financial repression.** As stablecoin issuers and deregulated banks absorb Treasury supply, nominal yields may stay capped despite rising inflation expectations, leaving currency depreciation as the main adjustment mechanism.

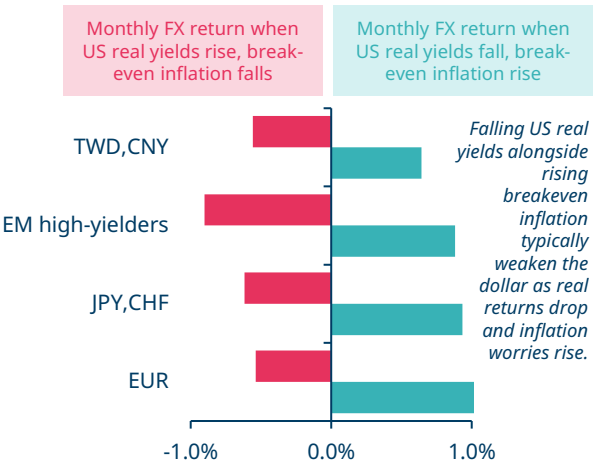
“Structural forces will continue to point to a weaker US dollar, benefitting in particular Asian currencies.”

Foreign exchange market turnover by currency, 2025 vs 2022 (daily averages)



Source: Amundi Investment Institute on BIS 2025 Triennial Central Bank Survey. USD – US dollar, EUR – Euro, JPY – Japanese yen, CNY – Chinese Renminbi, CHF – Swiss Franc, INR – Indian Rupee.

The move in US real rates and inflation expectations is key for FX



Data: Bloomberg, Amundi Investment Institute calculation. Data as of October 24, 2025. USD – US dollar, JPY – Japanese yen, EUR – Euro, CHF – Swiss Franc, CNY – Chinese Renminbi, TWD – Taiwan Dollar.

Third, the USD's safe-haven appeal is less reliable. In a 'growth shock' (not our base case), where US equities and US yields decline together, the dollar's correlation with risk assets would turn positive, limiting its diversification role.

Given the heavy US weighting in global indices, even modest equity outflows may translate into USD sales unless fully reinvested into US Treasuries, which now face greater competition from other sovereign markets. This is a dynamic we see as supportive for core G10 FX, but it requires, at the same time, selection among high-carry FX, whose beta to growth remains dominant.

Fourth, the USD still screens as expensive versus its long-term valuation, and few currencies, like the EUR and EMFX carry, really benefited from its correction in 2025. Asian FX and selected currencies within trade-surplus countries (Euro, Australian Dollar), have the potential to drive the next step.

G10 FX: domestic divergences beneath a USD-led narrative

The outlook for the Eurozone remains weak and largely relies on prospective reforms. Yet the low debt-service burden of the private sector argues against an aggressive ECB rate-cut cycle. A backdrop we see compatible with **stronger EURUSD and EURCHF** but would likely require a lower EUR versus cyclical currencies (the Skandies, Australian Dollar) and the JPY, after the outsized EUR rally in 2025.

In the UK, the upcoming fiscal tightening is likely to restrain growth and reinforce dovish pressures on the Bank of England. With a negative net international investment position, sterling remains dependent on foreign inflows, suggesting **GBP crosses will struggle to outperform** until growth surprises on the upside or fiscal confidence is restored.

Japan remains the clearest case where policy distortions cap FX potential. Despite normalised yields and cheap valuations, the BoJ's reluctance to lift real rates sustains 'debasement risk.' In our view, dislocations should gradually clear, but only a harder landing or a credible signal that policy normalisation will continue can actually translate into sustained JPY appreciation.

EM FX: Carry remains our friend

The winners are likely to remain currencies whose central banks have limited space for rate cuts relative to what is priced in by the market — we like Brazilian real in LATAM and South African Rand

in CEEMEA. Selection, though, remains key. While softening trade tensions between the US and China are somewhat reassuring, countries with weak FX reserves, poor central bank credibility, and high foreign-currency-denominated debt will likely prove vulnerable to pullbacks should risk sentiment reverse.

What could go wrong

The key risk to our bearish USD view would be a repeat of the 2021-2022 pattern and a halt to the US yield-curve steepening process. Then, the US economy overheated, and markets believed the Fed would prioritise inflation control 'at any cost', driving real yields higher and compressing inflation expectations. A similar shift would restore the USD's cyclical appeal and likely mark the turning point in the current downtrend.

DIGITAL ASSETS AND CRYPTOCURRENCIES

Digital assets: anchored dollarisation, structural repricing

USD-backed stablecoins, now above \$300bn, **anchor blockchain activity to the dollar, limiting de-dollarisation but also creating artificial demand for US debt under the GENIUS Act.** By contrast, the ECB's digital euro project keeps monetary control public and debt demand organic, suggesting a less politically managed backdrop and lower macro-risks for the EUR.

Meanwhile, Bitcoin's expanding institutional adoption and growing US policy support reinforce perceptions that the USD's purchasing power is eroding under higher inflation tolerance. While this backdrop could sustain positive momentum into 2026, with prices potentially approaching \$150,000 in H1, the halving cycle that began in April 2024 appears mature, and a **phase of consolidation or correction** is likely to follow.



"Instead of pushing cryptocurrencies to the sidelines, policymakers are now looking for ways to safely integrate them into the broader financial system." Cryptocurrencies Break Into The Mainstream 2025

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Currency abbreviations: USD – US dollar, BRL – Brazilian real, JPY – Japanese yen, GBP – British pound sterling, EUR – Euro, CAD – Canadian dollar, SEK – Swedish krona, NOK – Norwegian krone, CHF – Swiss Franc, NZD – New Zealand dollar, AUD – Australian dollar, CNY – Chinese Renminbi, CLP – Chilean Peso, MXN – Mexican Peso, IDR – Indonesian Rupiah, RUB – Russian Ruble, ZAR – South African Rand, TRY – Turkish lira, KRW – South Korean Won, THB – Thai Baht, HUF – Hungarian Forint.

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