Ostrum ASSET MANAGEMENT

# MyStratWeekly
Market views and strategy

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This document is intended for professional clients in accordance with MIFID

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## Topic of the week: Sovereign bonds: Peripheral countries will continue to outperform core and semi-core countries

**by Aline Goupil-Raguénès**

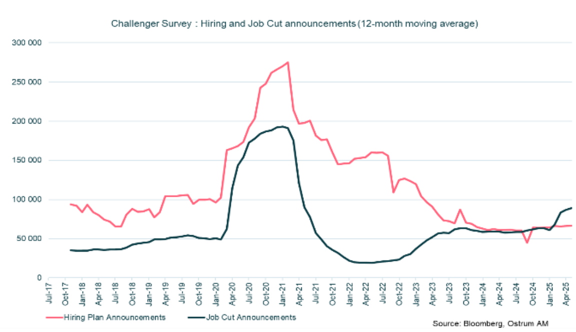
- A 180-degree turn has taken place in the eurozone. Peripheral countries are experiencing stronger growth and a marked improvement in their public finances, in contrast to slower growth and rising budget deficits in core and semi-core countries. Ireland, Portugal, Greece, and Italy are in primary surplus;
- In Germany, the reform of the debt brake and the infrastructure plan will result in a significant increase in the public deficit starting in 2026 (to 3.6% and then 4.2% in 2027 according to the Bundesbank) and an increase in the debt-to-GDP ratio to 66.1% in 2027 (compared to 62.5% in 2024);
- The highest German issuances will thus contribute to narrowing peripheral spreads. They are also expected to tighten further due to the continued improvement in their public finances, the acceleration of NextGenerationEU disbursements, and investors' carry strategies;
- They should also benefit from the influx of foreign investors who are turning away from U.S. assets due to concerns over Trump's policies: trade war and, above all, a significant worsening of the U.S. public deficit;
- The Italian spread is expected to converge in the coming months towards the French spread, given the likely tensions on the latter during the autumn, when discussions on the 2026 budget take place, and the tightening of the Italian spread due to political stability and the government's willingness to bring the deficit below 3% of GDP in 2026.

## Market review: Markets overlook signs of weakness

**by Axel Botte**

- U.S. job growth at 140k in May, however the drop in the participation rate is a source of concern;
- The ECB’s rate cycle is close to the end;
- U.S. 10-Yr yield hovers about 4.50 %;
- Risk assets remain upbeat.

## Chart of the week




Layoff announcements appear to be accelerating in the United States since the beginning of the year. These monthly announcements consistently total over 90,000, while the average has been around 60,000 since 2023. Public layoffs initiated by the DOGE are gradually giving way to job cuts in the private sector. The services sector is experiencing an increase in restructuring plans, particularly in retail. Budget cuts in education and the nonprofit sector are also leading to job losses. Meanwhile, announcements of hiring plans are decreasing, falling below the level of layoffs.

## Figure of the week

**10**

According to the first report from the European Commission on trade diversification, the EU is facing a significant increase in imports of certain goods following the rise in U.S. tariffs. Imports of stainless steel bars and rods have increased more than tenfold since January, and prices have fallen by 86%, prompting calls for action from the Commission to limit this influx.
Source: European Commission.

Topic of the week

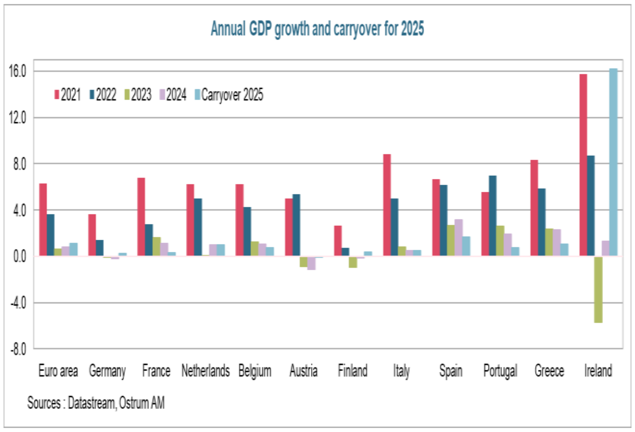
# Sovereign bonds: Peripheral countries will continue to outperform core and semi-core countries

**Within the eurozone, a 180-degree turn has taken place in recent years between peripheral countries and core and semi-core countries. Peripheral countries are experiencing stronger growth and a marked improvement in their public finances, in contrast to slower growth and rising public deficits in other countries such as France and Belgium. This divergence is expected to persist and result in the continued tightening of peripheral country spreads relative to Germany.**

## Stronger growth in peripheral countries

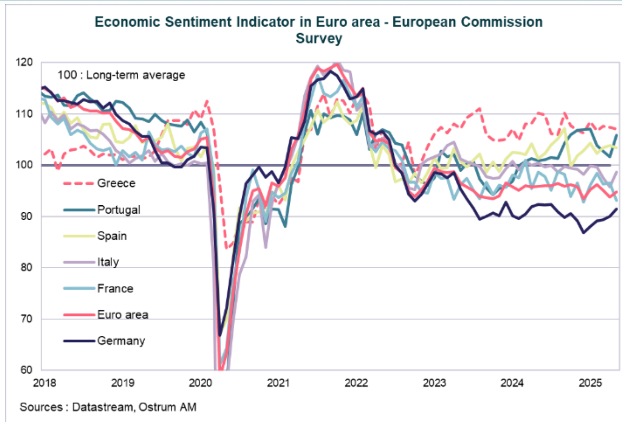
**A post-COVID recovery stronger than in the rest of the eurozone, particularly in services, a lower dependence on Russian energy, and support from NextGenerationEU are resulting in more dynamic growth in peripheral countries.**

The growth of peripheral countries is proving to be more robust than that of core or semi-core countries, as shown in the following graph. Several factors contribute to this. Peripheral countries were more significantly affected by the COVID-19 crisis than the rest of the eurozone, so the rebound with the reopening of economies has been stronger. This has particularly impacted the tourism sector, which plays a significant role in their growth. Additionally, peripheral countries have been less affected by the energy crisis than some eurozone countries, especially Germany, due to their limited dependence on Russian energy. They are also the largest beneficiaries of the NextGenerationEU plan, which includes grants and loans from the European Union on the condition that countries meet certain investment and reform targets. Furthermore, the growth of certain countries, particularly Spain, benefits from a significant increase in their working-age population and employment rate due to the influx of migrants.




**Surveys are positive in peripheral countries, unlike those in core and semi-core countries.**

After the strong growth figure of 0.6% for the eurozone in the first quarter, driven notably by a significant increase in exports to US before the implementation of U.S. tariffs and an uptick in investments, growth is expected to slow for the remainder of the year due to the impact of tariffs on exports and declining consumer and business confidence. The growth of peripheral countries is likely to remain relatively stronger than that of the rest of the eurozone. Their growth carryover is relatively higher (average growth in 2025 assuming GDP stability in Q2, Q3, and Q4), and surveys conducted among business leaders show more favorable sentiments than in countries such as Germany and France. This is particularly illustrated by the European Commission's survey: the economic sentiment index is well above its long-term average (100 on the graph) in Greece, Portugal, and Spain, approaches this average in Italy, while it remains significantly below that average in France and Germany.



Economic Sentiment Indicator in Euro area - European Commission Survey

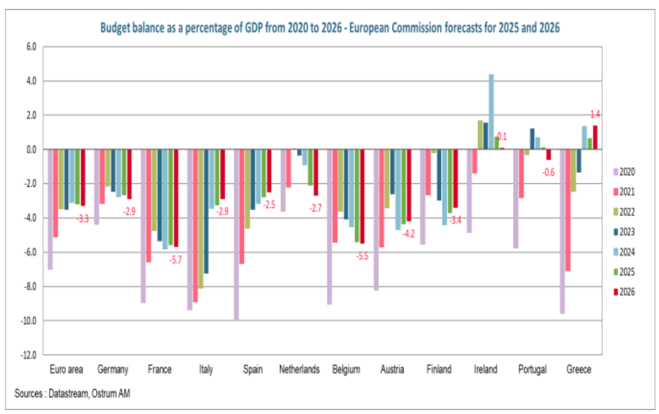
Sources : Datastream, Ostrum AM

## Marked improvement in the public finances of peripheral countries contrasting with core and semi-core countries.

### Budget surplus in Ireland, Portugal, and Greece.

**Stronger growth and prudent fiscal policies are resulting in budget surpluses in Ireland, Portugal, and Greece...**

This stronger growth and the continuation of prudent fiscal policies have allowed peripheral countries to rapidly reduce their budget deficit and public debt ratios relative to GDP since the COVID-19 crisis. This crisis had led governments to adopt large-scale support measures to mitigate the unprecedented shock to growth. Ireland, Portugal, and Greece have thus returned to budget surplus. Italy and Spain have significantly reduced their deficits, and this trend is expected to continue according to European Commission forecasts. The Italian government has committed to bringing the public deficit below 3% of GDP as early as next year.



Budget balance as a percentage of GDP from 2020 to 2026 - European Commission forecasts for 2025 and 2026

Sources : Datastream, Ostrum AM

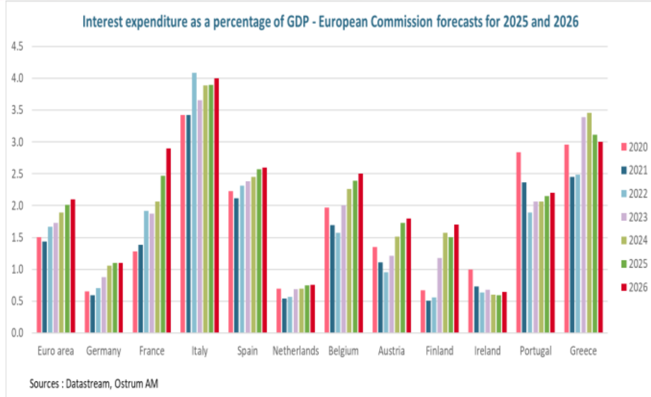
**...contrasting with the rise in deficits in core and semi-core countries.**

This contrasts with the rise in deficits in core and semi-core countries, particularly in France and Belgium. In France, the government aims to reduce the public deficit to 4.6% by 2026, down from the expected 5.4% in 2025. This requires an effort of €40 billion, which proves to be particularly challenging in a context of low growth and a highly divided Parliament, limiting the government's ability to adopt the necessary consolidation measures. Consequently, the deficit is expected to remain high, as anticipated by both the European Commission and the IMF.

### Increase in interest burdens everywhere except in Greece.

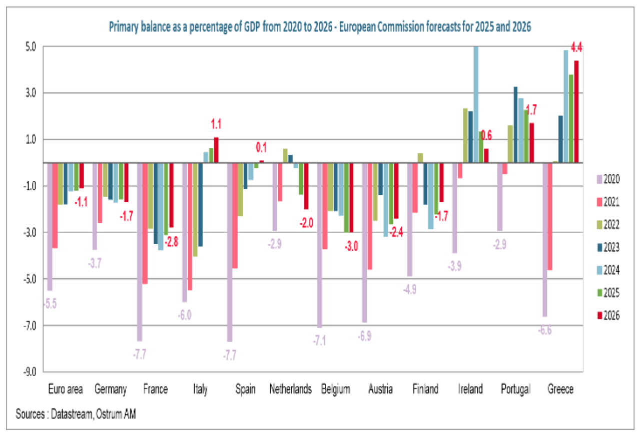
**The increase in the interest burden is more pronounced in France. Greece stands out.**

The interest burden is increasing in the wake of rising bond yields and as the debt is refinanced at a higher rate. This increase is set to continue across all countries and is expected to be particularly pronounced in France. In contrast, the interest burden is expected to remain low in Ireland and is anticipated to decrease in Greece.




**Only peripheral countries show a primary balance surplus.**

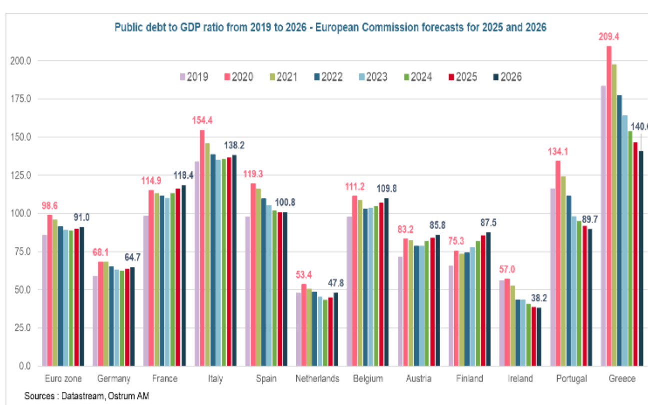
Given the previous elements, the primary balance relative to GDP (budget balance excluding interest charges) is in surplus in Ireland, Portugal, Greece, Italy, and nearly balanced in Spain. This trend is expected to continue, unlike in core and semi-core countries, except for Luxembourg, particularly in France and Belgium where primary deficits are expected to remain significant: -2.8% of GDP in France and -3% in Belgium, as projected by the European Commission for 2026.




**Rapid reduction of the public debt-to-GDP ratio.**

**Significant decrease in public debt-to-GDP ratios in Greece and Portugal.**

The marked improvement in the budget balances of peripheral countries has resulted in a significant decrease in the public debt-to-GDP ratio, as shown in the following graph. The decline is particularly dramatic in Greece and Portugal, where public debt-to-GDP ratios are at levels much lower than those that prevailed before the COVID-19 crisis, in contrast to other countries. This also reflects the significant savings measures implemented by these countries since the eurozone sovereign debt crisis and the continuing commitment to fiscal prudence.



## Peripheral countries will benefit from the acceleration of NextGenerationEU

**Acceleration of EU disbursements under the Recovery and Resilience Facility by the end of 2026.**

The NextGenerationEU plan, launched in 2021 to address the COVID-19 crisis, is set to conclude at the end of 2026. By the end of May, only 49% of the Recovery and Resilience Facility had been utilized. This means there are still €335 billion available to be requested from the European Commission, provided that countries adopt the necessary reforms and implement investments in green and digital transitions, in accordance with their recovery and resilience plans. There are still 4,300 milestones and targets to be submitted for evaluation by the member states out of a total of 7,105. The European Commission published a communication last week urging member states to revise their recovery and resilience plans to accelerate the implementation of NextGenerationEU. The aim is to prioritize investments and reforms that can be completed by August 31, 2026, given that payment requests can be made until September 30, 2026, with a final payment scheduled for December 31.

To this end, the European Commission calls on the European Parliament and the Council to quickly finalize the legislative negotiations on the regulation of the European Defence Industry Programme (EDIP) and to introduce a provision that facilitates voluntary contributions supported by the Recovery and Resilience Facility to the EDIP.

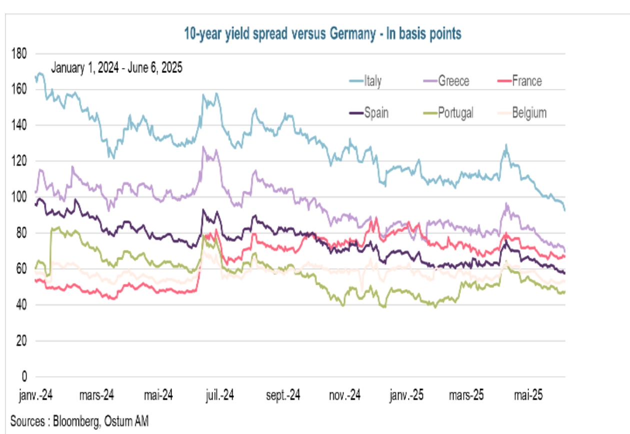
The acceleration of NextGenerationEU disbursements will support the growth of peripheral countries. It is noteworthy that Italy is the most advanced, having received the sixth payment from the Commission, followed by Greece and Portugal (fifth disbursement) and then Spain (fourth tranche).

## Towards a continued tightening of peripheral country spreads.

**The spreads of peripheral countries are holding up well against tensions in long-term U.S., British, and Japanese rates.**

After widening significantly in early April following the announcement of a substantial increase in U.S. tariffs on all trading partners, the sovereign spreads in the eurozone have tightened considerably since April 9, coinciding with the announcement of a 90-day truce regarding reciprocal tariffs. They have shown strong resilience to tensions in long-term U.S., British, and Japanese rates since then, linked to budgetary concerns, which are particularly high in the United States due to the policies implemented by Donald Trump.

The Italian 10-year bond spread relative to Germany is at its lowest since February 2021, at 92 basis points. This also reflects the upgrade of Italy's sovereign debt rating by S&P (from BBB to BBB+ with a stable outlook) and the improvement of Fitch's outlook (from stable to positive, with the rating unchanged at Baa3). Spain's spread is also at its tightest level since February 2021, at 58 basis points. Greece is at its lowest since September 2008 (70 bp), and Portugal stands at 47 basis points, the lowest since February 2025.



**The spreads of peripheral countries are well-valued, except in Spain.**

According to our spread valuation model, developed with the help of our intern Yasser Djerboua, the spreads of peripheral countries are currently well-valued, with the exception of Spain, which appears somewhat expensive. This is due to the fact that despite significant progress in public finances, rating agencies are slow to upgrade Spain's rating, unlike the markets that have already factored this in.

Investors are expected to continue favoring peripheral countries over core and semi-core countries, considering the prospects for further improvement in their public finances and to benefit from carry strategies.

**The potential for narrowing the spread of Portugal is higher in the short term.**

The spread of Portugal clearly has the potential to tighten further compared to the other peripheral countries for three reasons. The center-right party of outgoing Prime Minister Luis Montenegro came out on top in the early legislative elections on May 18. Lacking an absolute majority, the government will remain a minority and will continue its prudent fiscal policy. Portugal is also one of the most advanced countries within the eurozone in its issuance program (61% completed by the end of May). This aligns with Ireland, Belgium, and Spain. Finally, Portugal's sovereign debt rating is expected to be upgraded again, potentially as early as September 12 by Fitch, which currently rates it at A- with a positive outlook.

**Larger upcoming issuances from Germany.**

**The increase in military spending and public investments in infrastructure will significantly raise the public deficit in Germany starting in 2026.**

The announcement of a €500 billion infrastructure plan over 12 years and the reform of the debt brake to increase defense spending will lead to a rise in the German budget deficit and more issuances in the coming years. In its forecasts published last week, the Bundesbank anticipates an increase in the public deficit to 3.6% in 2026 and 4.2% in 2027, compared to an expected deficit of 2.2% this year. This results from increased military spending and public investment, as well as measures aimed at significantly reducing corporate taxes (€48 billion). This is expected to generate tensions in German rates and further support the tightening of spreads within the eurozone, particularly concerning peripheral countries.

## Conclusion

**The continued improvement in the public finances of peripheral countries, the acceleration of NextGeneration EU disbursements, and investors' carry strategies are all factors favoring a new tightening of peripheral spreads. This contrasts with the significant upcoming increase in the German public deficit and the difficulties faced by other core and semi-core countries in reducing their deficits in a context of low growth. Peripheral countries are also expected to benefit from an influx of foreign investors who are moving away from U.S. assets due to concerns over Trump's policies regarding trade wars and, especially, the substantial worsening of the public deficit. Given the tensions expected to arise concerning the French spread starting in the autumn during discussions on the 2026 budget, with a highly divided Parliament greatly limiting the government's ability to adopt necessary budgetary consolidation measures, it is highly likely that the Italian spread will converge towards the French spread in the coming months, the latter benefiting from political stability and the government's commitment to bring the public deficit below 3% of GDP by 2026.**

**Aline Goupil-Raguénès**

Market review

# Markets overlook signs of weakness

**Risk assets remain buoyant as investors anticipate signs of easing in the trade war despite the ongoing uncertainty over the U.S. budget. Long-term rates continue to exhibit volatility but without a trend.**

Financial markets are being buffeted by uncertain budgetary directions in the U.S., signals of a slowdown in the U.S. labor market, and a European Central Bank (ECB) that appears content with inflation returning below 2%. Despite this, risk assets are advancing, while long-term rates continue to concentrate financial volatility. Additionally, the weakness of the dollar has shown signs of abating by the end of the week.

The implications of tariff announcements are becoming more tangible for the U.S. economy, as surveys and leading indicators have declined since the beginning of the second quarter. The ISM Services Index has fallen below the 50 threshold, mirroring the decline seen in the manufacturing sector. Trade with the U.S. is contracting, raising the prospect of impending shortages for businesses and consumers. Under pressure from automakers, both Donald Trump and Xi Jinping have discussed export quotas on rare earths, an area where China holds near-monopoly control. Early signs of restructuring are emerging, highlighted by a surge in layoff announcements. The 139,000 jobs created in May should be interpreted cautiously, given revisions that wiped out 95,000 jobs from March and April. The unemployment rate remains steady at 4.2%, but the participation rate has decreased by 0.2 percentage points.

In the Eurozone, first-quarter growth was revised upward to 0.6%, spurred particularly by Germany. Overall, household consumption remains subdued, although investment is showing signs of recovery. Against this backdrop, the ECB has signaled that the deposit rate at 2% could be maintained for some time. This may be seen as Christine Lagarde's strategy to retain ammunition for further easing should trade negotiations yield unfavorable results. According to the Frankfurt institution, inflation is expected to decrease from approximately 2% this year to 1.6% next year, despite slightly stronger growth projected at 1.1%.

On financial markets, cautious optimism is settling in among investors. Equity volatility has diminished with signals indicating de-escalation in the trade conflict. The S&P 500 is currently trading within 3% of its all-time highs from February 2025, while European stocks are at their peak. Sector performance remains mixed, with banks, technology, and certain cyclical stocks leading the market, while defensive sectors lag behind. In the bond markets, labor market data is moderating the heavy trend towards flattening. The Federal Reserve is giving itself time, allowing investors concerned about a sharp landing to favor longer maturities, with the T-note trading around 4.50%. In Asia, sovereign bond auctions beyond 10 years are proving difficult, and rising local yields may reduce Treasury purchases by Asian accounts. In the Eurozone, the Bund is hovering around 2.50%, but the volatility of German debt appears to have little effect on sovereign spreads, with peripheral debts in demand. The tightening of the BTP continues, moving towards 90 basis points. Credit markets remain robust, with the spread of investment-grade against swaps narrowing below 90 basis points. Meanwhile, high yield remains well-positioned despite tight valuations, such as spreads per leverage ratio.

**Axel Botte**

## Main market indicators

| G4 Government Bonds | 10-Jun-25 | 1wk (bp) | 1m (bp) | 2025 (bp) |
|---|---|---|---|---|
| EUR Bunds 2y | 1.85% | +7 | +7 | -23 |
| EUR Bunds 10y | 2.54% | +2 | -2 | +18 |
| EUR Bunds 2s10s | 68.9 bp | -5 | -9 | +41 |
| USD Treasuries 2y | 3.99% | +4 | +10 | -25 |
| USD Treasuries 10y | 4.46% | +0 | +8 | -11 |
| USD Treasuries 2s10s | 46.1 bp | -4 | -2 | +14 |
| GBP Gilt 10y | 4.58% | -6 | +1 | +1 |
| JPY JGB 10y | 1.48% | -2 | +5 | +1 |
| **€ Sovereign Spreads (10y)** | 10-Jun-25 | 1wk (bp) | 1m (bp) | 2025 (bp) |
| France | 68 bp | +1 | +2 | -15 |
| Italy | 84 bp | -13 | -14 | -31 |
| Spain | 58 bp | 0 | -1 | -11 |
| **Inflation Break-evens (10y)** | 10-Jun-25 | 1wk (bp) | 1m (bp) | 2025 (bp) |
| EUR 10y Inflation Swap | 1.93% | +3 | -1 | +0 |
| USD 10y Inflation Swap | 2.49% | -1 | +1 | +2 |
| GBP 10y Inflation Swap | 3.17% | +0 | -8 | -36 |
| **EUR Credit Indices** | 10-Jun-25 | 1wk (bp) | 1m (bp) | 2025 (bp) |
| EUR Corporate Credit OAS | 95 bp | -5 | -11 | -7 |
| EUR Agencies OAS | 49 bp | -2 | -3 | -13 |
| EUR Securitized - Covered OAS | 47 bp | -1 | -2 | -9 |
| EUR Pan-European High Yield OAS | 315 bp | -20 | -45 | -3 |
| **EUR/USD CDS Indices 5y** | 10-Jun-25 | 1wk (bp) | 1m (bp) | 2025 (bp) |
| iTraxx IG | 56 bp | -1 | -2 | -2 |
| iTraxx Crossover | 289 bp | -7 | -18 | -25 |
| CDX IG | 54 bp | -1 | -3 | +4 |
| CDX High Yield | 339 bp | -7 | -18 | +27 |
| **Emerging Markets** | 10-Jun-25 | 1wk (bp) | 1m (bp) | 2025 (bp) |
| JPM EMBI Global Div. Spread | 321 bp | -12 | -25 | -5 |
| **Currencies** | 10-Jun-25 | 1wk (%) | 1m (%) | 2025 (%) |
| EUR/USD | $1.138 | 0.088 | 2.661 | 9.9 |
| GBP/USD | $1.346 | -0.400 | 2.178 | 7.6 |
| USD/JPY | JPY 145 | -0.573 | 2.528 | 8.6 |
| **Commodity Futures** | 10-Jun-25 | -1wk ($) | -1m ($) | 2025 (%) |
| Crude Brent | $67.2 | $1.6 | $3.8 | -7.8 |
| Gold | $3 326.1 | -$27.3 | $89.7 | 26.7 |
| **Equity Market Indices** | 10-Jun-25 | -1wk (%) | -1m (%) | 2025 (%) |
| S&P 500 | 6 006 | 1.18 | 6.11 | 2.1 |
| EuroStoxx 50 | 5 421 | 0.85 | 2.10 | 10.7 |
| CAC 40 | 7 802 | 0.49 | 0.75 | 5.7 |
| Nikkei 225 | 38 212 | 2.04 | 1.89 | -4.2 |
| Shanghai Composite | 3 385 | 0.68 | 1.28 | 1.0 |
| VIX - Implied Volatility Index | 17.16 | -3.00 | -21.64 | -1.1 |

Source: Bloomberg, Ostrum AM

## Additional notes

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