Bonds
Weekly

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Bond markets: Caught between Middle East concerns and softer U.S. inflation

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Our View

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Bond Market Movers – Review and Outlook

What drove the bond markets last week?

- The military conflict between the U.S. and Iran is intensifying. Iran has once again declared the Strait of Hormuz closed, while the U.S. has reinstated its blockade of Iranian ports. U.S. President Trump has threatened to escalate the attacks even further.
- Fed Chairman Warsh reiterated that the Fed would not tolerate persistently high inflation. His colleague Chris Waller suggests that interest rates may be raised soon if underlying inflationary pressures continue to rise.
- U.S. inflation fell much more than expected in June. This is due not only to falling energy prices, but also to a surprisingly sharp decline in the core rate. Producer prices reinforced the picture of significantly easing price pressures.
- Growth in U.S. retail sales slowed noticeably in June, while “core sales” continued to rise at a solid pace.
- China's economic growth fell short of expectations in the second quarter. Key economic data for the month of June, on the other hand, came in better than expected.

What could drive the market next week?

- The dire situation in the Middle East remains the focus of market participants. Will the recent escalation continue, or will the U.S. make a new diplomatic push to halt the latest rise in energy prices?
- The ECB Governing Council meeting is the monetary policy highlight of the week. Despite the recent turmoil in the Middle East, the European Central Bank is likely to stay put for the time being. ECB President Lagarde is set to avoid providing forward guidance.
- The ECB is releasing the latest survey on consumer inflation expectations. Moreover, inflation data for June will be released from the United Kingdom. The latter are unlikely to put any immediate pressure on the BoE to take monetary policy action.
- In the eurozone, the S&P Global Purchasing Managers' Indices and the ZEW Economic Sentiment Survey are set to be released. The key factor will be whether the recent escalation in the Middle East is already having a negative impact on sentiment.
- In the primary market for U.S. Treasury securities, the focus next week will be on the tap of the 20-year T-bond. Meanwhile, activity in the primary market for euro-denominated government bonds is likely to see a sharp decline compared with last week. We expect gross supply of only EUR 8bn, down from just over EUR 30bn the previous week. Despite only moderate reflows from maturities, net cash flows are set to remain just in positive territory.

Bond markets: Caught between Middle East concerns and softer U.S. inflation

Hostilities between the U.S. and Iran are escalating

Are the U.S. and Iran now in a new "hot" phase of the war that broke out in late February? There are some indications, although the situation does not seem entirely clear. The parties to the conflict did hold further talks last weekend about a targeted permanent peace agreement, However, there apparently was no progress. On the contrary, the military conflict in the Persian Gulf has been gradually intensifying since U.S. President Trump declared the ceasefire, which had been renewed in June, to be over a week ago. The risk of a spiral of escalation is growing, especially since Trump recently threatened to carry out a massive bombing campaign against civilian infrastructure if the mullah regime continues to undermine U.S. efforts to normalize traffic in the Strait of Hormuz. Last weekend, the Iranian Revolutionary Guard declared the strait closed once again. In response, the U.S. reinstated the blockade of Iranian ports, which had already been in place prior to the June interim agreement. According to publicly available data on ship movements in the Persian Gulf, the blockade appears to be more porous than it was during the first phase of the war. Compared to two weeks ago, however, the number of crossings has decreased significantly. In our view, the level of concern among financial market participants regarding a continued escalation in the Middle East presents a mixed picture. The price of Brent crude oil briefly surged to over $85 per barrel this week, reaching a four-week high. However, oil prices are still lower than they were before the provisional U.S.-Iran agreement was reached.

Traffic in the Strait of Hormuz has fizzled out

Chart of the Week

Yield on 10-Year U.S. Treasuries and Brent Crude Oil Price (in USD/barrel)

Source: Bloomberg, LBBW Research

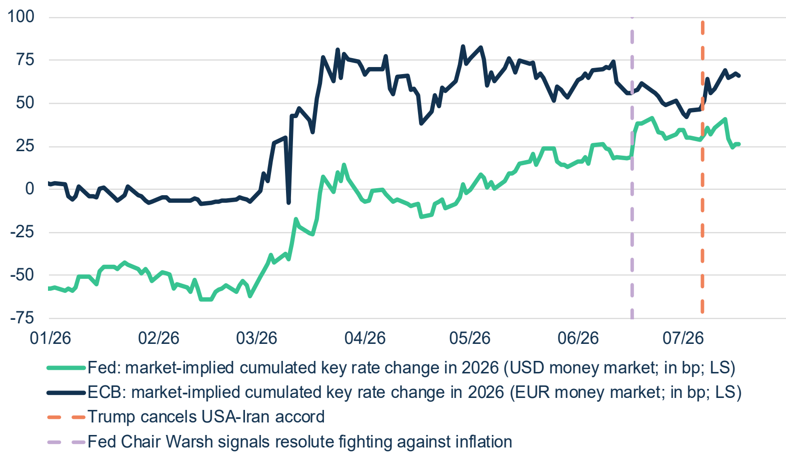
Oil prices push up bond yields

ECB rate hiking speculation is gaining momentum

To date, the degree to which stock markets have seen declines from their recent all-time highs varies significantly across regions; with the U.S. market, in particular, showing resilience in the face of concerns about the Middle East. Meanwhile, on the euro-denominated government bond market, the recent rise in commodity prices has fueled speculation that the ECB will implement more than one further rate hike. Heading into the next ECB Governing Council meeting on July 23, the market consensus is almost entirely convinced that the second tightening step in total will be implemented by the September meeting (see the article on page 11). As of the end of 2026, the expectations are increasingly pointing toward a third hike (see the chart below).

Market consensus, once again, leaning towards a total of three ECB rate hikes

Rate hiking speculation continues to mount in the eurozone
Market-implied expectations for cumulative changes in key interest rates by the Fed and the ECB in 2026

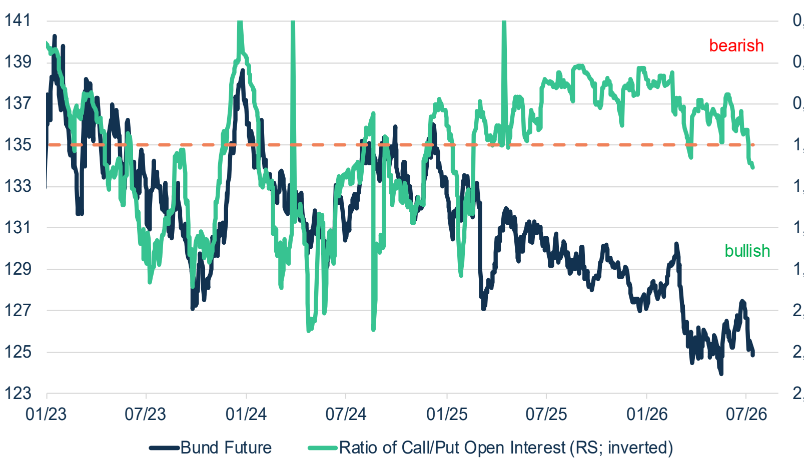


Source: Bloomberg, LBBW Research

Driven by rate hiking speculation, the yield on 10-year German government bonds climbed as high as 3.15%, coming within just a few basis points of the annual high set in May. In our view, this calls for investors to be increasingly vigilant about the risk of a continued downward price spiral, as a break above this key yield resistance level could trigger another sharp sell-off. However, since market participants' rate hiking speculation has now gone too far, if our ECB forecast is taken as a yardstick, this also opens up the potential for a price recovery. At the very least, the chances of the market bottoming out are increasing.

10Y Bund yield comes close to annual high

Are the bulls gaining the upper hand in the options market?
Bund future and the call-to-put ratio in the options market



Source: Bloomberg, LBBW Research

Shift in positioning might lay the ground for a price recovery

First, we think the market has been moving into modestly oversold territory in the short term. Second, positioning in the market for options on the Bund future now shows a slight overweight on the "bullish" side – that's only the second time this has happened since the spring of 2025 (see chart above).

U.S. inflation eases concerns about imminent Fed hike

The bond-negative impact caused by rising oil prices was offset this week by price-supporting factors stemming from U.S. inflation data. In our view, this has held back bearish sentiment from getting even more entrenched, particularly in the U.S. Treasury market. Inflationary pressure in the U.S. economy eased much more sharply in June than the market consensus had expected. This applies to both consumer and producer prices. As expected, sharply falling gasoline prices were the main driver behind the decline in inflation. The message of détente that this conveys does come with a major downside in the form of yet another escalation of the situation in the Middle East. After all, the inflation data for August, at the latest, is likely to show a renewed increase in upward price pressure, unless diplomacy regains the upper hand soon.

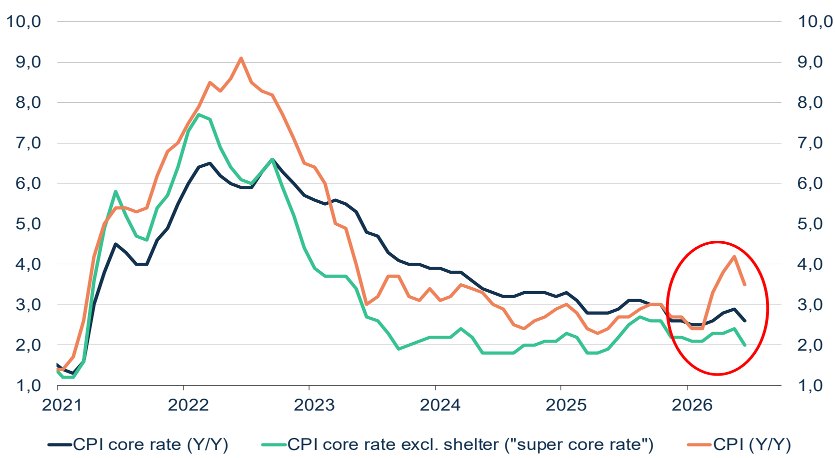
U.S. inflation has taken the wind out of the bears sails

However, aside from the impact of gasoline prices, U.S. core inflation also came as a downside surprise, falling sharply to 2.6% (Y/Y) from 2.9%. Underlying inflationary pressure was thus back to roughly the same level as before the start of the Iran War. There are therefore still no signs of widespread second-round effects resulting from the recent energy price shock. If we disregard the temporary statistical distortions caused by the government shutdown in the fall of 2025, it appears that the disinflationary trend that began in 2023 has indeed remained intact. The "super-core rate," which also excludes shelter costs, hit the 2% mark in June for the first time since spring 2025 (see the chart below). In our view, this strengthens the position of the monetary policy doves within the Federal Reserve. Given this context, there is little to suggest that U.S. monetary policymakers will decide to raise the benchmark interest rate at their next meeting on July 28-29. Although Fed Chairman Warsh sought to reaffirm his role as a resolute fighter against inflation during his recent testimony before the U.S. Congress.

Second-round effects remain largely absent

"Super core rate" down at 2% for first time since spring 2025

Core inflation is now only slightly above prewar levels
U.S. CPI (Y/Y) with selected subcomponents



Source: Bloomberg, LBBW Research

Financial market participants have also scaled back their speculation about an imminent Fed rate hike compared with the previous week. Based on forward rates in the U.S. money market, the market consensus shifted the timing of the still-expected monetary tightening to the fall. Against this backdrop, prices of short-term U.S. Treasury securities received a boost. By contrast, the yield on 10-year U.S. Treasuries moved largely sideways on a week-over-week basis, caught between the escalation in the Middle East and inflation data. For the time being, the price data have reinforced our forecast that the Fed will ultimately continue to keep its monetary policy on hold in the coming months. If this forecast proves accurate, U.S. short-term bonds, in particular, can look forward to further price tailwinds.

A tailwind for the Fed's doves

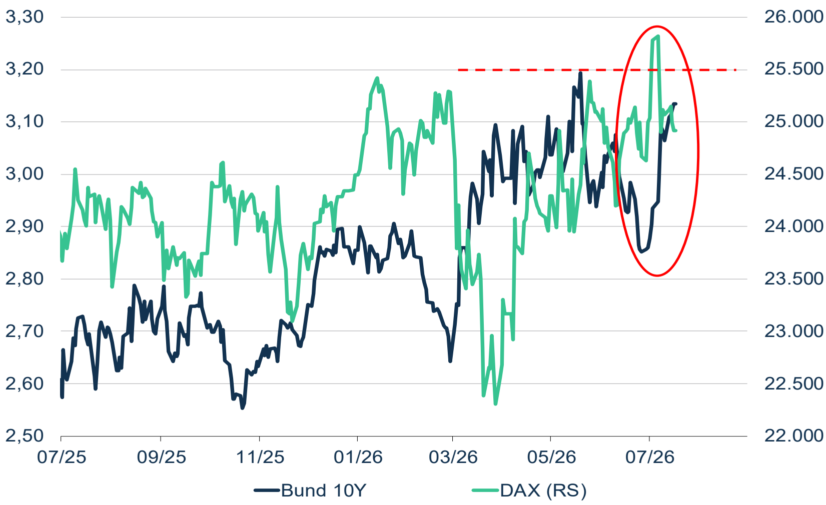
Outlook: Middle East remains in the spotlight – ECB to keep its feet still

In the short term, however, news from the Middle East – through its impact on energy prices – is set to remain the most important driver for the major bond markets. Market prices are largely driven by the sentiments of Donald Trump and his counterparts in Iran. Has the escalation been taken far enough to make you believe you've earned sufficient respect from the opposing side? In our view, developments over the past few months have shown that the prospect of signs of détente has often been favorable precisely when further escalation seemed all but inevitable. The intensity of the rhetoric could therefore serve as a kind of counter-indicator – though it carries the risk of being wrongfooted by a self-reinforcing spiral of escalation.

Will the Bund yield reclaim its annual high from May?

10Y Bund yield approaching annual high

Yields on 10-Year German Bunds and DAX



Source: Bloomberg, LBBW Research

A "hawkish" ECB has likely been priced in by the market

As far as monetary policy developments and the macroeconomic data calendar are concerned, the focus next week will be on the eurozone in both areas. The ECB Governing Council will in all likelihood take a wait-and-see approach at its upcoming meeting, even though the renewed rise in energy prices is likely to cause concern among central bankers. In the view of the majority of monetary policymakers, we believe that a sufficient data set for adjusting monetary policy will not be available until September. Given the developments in the Middle East, we expect Ms. Lagarde to strike a somewhat more "hawkish" tone than she has in her most recent statements. However, this is likely already reflected in the EUR bond market given the recent downward price trend.

PMIs provide macro highlights

The macroeconomic highlights of the coming week – which will be relatively light on data overall – are the S&P Global Purchasing Managers' Indices for the eurozone (July 24). We expect the recent trend toward a tentative improvement in sentiment to continue, assuming that the latest escalation in the Middle East is only being digested partially.

Forecasts at a Glance

Euro Area	Spot	30.09.26	31.12.26	30.06.27
ECB Main Refinancing Rate	2,40	2,65	2,65	2,65
ECB Deposit Rate	2,25	2,50	2,50	2,50
Overnight Rate (€STR)	2,18	2,45	2,45	2,45
3M Euribor	2,49	2,55	2,55	2,55
Swap 2Y	2,96	2,80	2,85	2,75
Swap 5Y	3,01	2,85	2,90	2,85
Swap 10Y	3,18	3,05	3,10	3,15
Bund 2Y	2,77	2,60	2,70	2,65
Bund 5Y	2,86	2,70	2,80	2,80
Bund 10Y	3,15	3,00	3,10	3,20
Swap/Bund 2Y	19	20	15	10
Swap/Bund 5Y	15	15	10	5
Swap/Bund 10Y	3	5	0	-5
Spread BBB Corporates/Bund	90	100	110	120

USA	Spot	30.09.26	31.12.26	30.06.27
Fed Funds Target Rate	3,75	3,75	3,75	3,75
Overnight Rate (SOFR)	3,64	3,65	3,65	3,65
3M Money Market	3,75	3,75	3,75	3,65
Swap 2J (SOFR-OIS)	4,03	3,95	3,90	3,65
Swap 5J (SOFR-OIS)	4,02	3,85	3,85	3,75
Swap 10J (SOFR-OIS)	4,17	3,95	4,00	4,00
Treasury 2Y	4,17	4,10	4,10	3,85
Treasury 5Y	4,30	4,15	4,20	4,10
Treasury 10Y	4,59	4,40	4,50	4,55

G5		Spot	30.09.26	31.12.26	30.06.27
Japan	*Overnight Rate (TONAR)*	0,98	1,05	1,05	1,30
Japan	*10Y Government Bond*	2,72	2,75	2,80	2,85
UK	*Overnight Rate (SONIA)*	3,73	3,70	3,95	3,95
UK	*10Y Government Bond*	4,98	4,80	4,90	4,90
Switzerland	*Overnight Rate (SARON)*	-0,04	-0,05	-0,05	-0,05
Switzerland	*10Y Government Bond*	0,45	0,35	0,40	0,45

FX	Spot	30.09.26	31.12.26	30.06.27
EURCHF	0,9254	0,92	0,93	0,94
EURCNY	7,7516	8,01	7,91	7,62
EURGBP	0,8477	0,85	0,85	0,85
EURJPY	185,91	187	186	182
EURUSD	1,1446	1,17	1,18	1,19
USDCHF	0,8085	0,79	0,79	0,79
USDCNY	6,7742	6,85	6,70	6,40
GBPUSD	1,3502	1,38	1,39	1,40
USDJPY	162,42	160	158	153

Economic Development		2024	2025	2026e	2027e
Germany	*GDP*	-0,5	0,4	0,5	0,8
	Inflation	2,3	2,2	2,7	2,3
Euro Area	*GDP*	1,0	1,5	0,8	1,0
	Inflation	2,4	2,1	2,9	2,4
UK	*GDP*	1,0	1,3	0,8	1,3
	Inflation	2,5	3,2	2,8	2,4
USA	*GDP*	2,8	2,1	2,2	1,6
	Inflation	3,0	2,7	3,6	2,2
Japan	*GDP*	-0,2	1,1	0,6	0,8
	Inflation	2,7	3,2	2,0	1,8
China	*GDP*	5,0	3,7	3,5	3,2
	Inflation	0,2	0,0	1,2	1,5
World	*GDP*	3,2	3,3	2,7	2,8
	Inflation	3,5	3,4	3,8	3,0

Changes to the foregoing week are marked by a (*)

Sources: LSEG, Bloomberg, LBBW Research

Main Events of the Past Week

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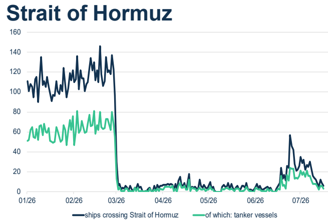
- *Middle East Conflict:* The U.S. military continued to strike targets in Iran, while Iran attacked ships in the Strait of Hormuz and fired on U.S. military bases in the Gulf region – Iranian Revolutionary Guard declares the Strait of Hormuz closed again for now – U.S. President Trump disputes this and simultaneously announces the reinstatement of a blockade on Iranian ports – Trump also raised the possibility of a 20% "protection fee" for militarily secured passage through the strait, but withdraws the idea following widespread criticism from Gulf states – U.S. president threatens even harsher attacks on civilian infrastructure in Iran if the mullah regime does not back down regarding the Strait of Hormuz.
- *Middle East Conflict:* Politicians from various parties are warning of a growing threat of attacks by networks linked to Iran in Germany – This comes amid reports of an Iranian "retaliation list" that includes, among others, U.S. President Trump, Chancellor Merz, and other top Western politicians – Meanwhile, Trump is threatening Iran with total annihilation in the event of an attack on him.
- *Middle East Conflict:* Clashes between Saudi Arabia and Yemeni Houthi rebels have flared up again – Houthis fired on a Saudi airport and called it a "retaliatory strike" – observers fear for the survival of the ceasefire agreed upon in 2022.
- *Monetary Policy – Fed:* In his testimony before the U.S. Congress, Kevin Warsh reiterated that the Federal Reserve would not tolerate persistently high inflation – current period of high inflation would end once monetary policy was properly calibrated – Warsh otherwise largely reiterates the macroeconomic assessment from the latest FOMC meeting – no guidance regarding future interest rate moves.
- *Monetary Policy – Fed:* Governor Waller fuels speculation about a possible tightening of U.S. monetary policy – says that higher interest rates may be necessary in the near future if there are further signs of rising underlying inflationary pressures.
- *Fed – Beige Book:* The Federal Reserve's latest economic report points to slight to moderate economic growth – employment has remained largely unchanged in most regions – with regard to inflation, the Beige Book notes a moderate overall rise in prices – outlook described as mixed; some respondents expect inflation to remain elevated, while others anticipate a slowdown due to falling fuel prices.
- *EU – Trade Policy:* Chancellor Merz is increasingly signaling support for a tougher EU stance on trade policy toward China – Brussels is preparing measures to address the rapidly growing trade deficit with China, particularly in light of allegations of export dumping.
- *EU – Financial Stability:* The European Systemic Risk Board (ESRB) warns of increased risks to financial stability – geopolitical conflicts such as the war in Iran could shake markets and strain the financing of the real economy – financial institutions could face more severe bottlenecks in refinancing and liquidity supply.
- *Germany – Economy:* Concerns are growing in the industry over impending production restrictions due to low water levels in the Rhine – as a result of massively lower water levels, ships can now only operate with significantly reduced cargo loads.

- *U.S. – Inflation:* Consumer prices fell more than expected in June, by 0.4% (M/M) – first decline since June 2024, driven

Fighting in the Middle East is intensifying

Strait of Hormuz



Sources: Bloomberg, LBBW Research

Merz hints at a tougher stance toward China

Concerns about low water levels are growing

primarily by lower gasoline prices – annual rate fell from 4.2% to 3.5%, the lowest value since March – Core rate falls from 2.9% to 2.6%, with price pressures easing across the board.

- *U.S. – Inflation:* Rise in producer prices also slowed surprisingly sharply in June, to 5.5% (Y/Y), down from 6.0% in May – core PPI rate remained virtually stable at 4.7% (Y/Y), with the previous month's figure revised downward.
- *U.S. – Economy:* Retail sales rose by 0.2% (M/M) in June, following a 1.0% increase in May – declining gasoline sales dampened sales growth, while "core sales" grew at a solid rate of 0.4%, down from +0.8%.
- *U.S. – Economy:* The Philadelphia Fed Index posted an unexpectedly sharp rise in July, jumping from 10.3 to 41.4 points – highest level since November 2021 – while the Empire Manufacturing Index also improved significantly, rising from 5.7 to 15.6 points.
- *United States – Labor Market:* Weekly ADP report shows that employment growth slowed slightly further for the four-week period ending June 27 – with an average increase of 19,750 jobs, down from 21,000 in the previous period.
- *China – Economy:* GDP growth slowed more sharply than expected in the second quarter, to 4.3% (Y/Y), down from 5.0% in the first quarter – lowest growth rate since Q4 2022 – Foreign trade has been supporting the economy, while investment continued its downward trend.
- *China – Economy:* Industrial production posted a surprisingly positive result in June, rising by +5.3% (Y/Y), following a 4.5% increase in May – retail sales returned to growth territory with a 1.0% increase (Y/Y), following a 0.6% decline in May.
- *Germany – Debt:* Chancellor Merz states that there are "significant hurdles" to implementing the further adjustment to the debt brake enshrined in the Basic Law, as agreed upon in the coalition agreement – Merz signals a preference for keeping the debt rules unchanged and describes the previous relaxation as a "significant burden" on his personal credibility.
- *Eurozone – Debt:* IMF warns Europe that public debt is increasingly spinning out of control – three-step plan proposed to address the issue – While "moderate reform packages" could solve part of the problem, some highly indebted countries would have to consider "more drastic measures," such as a reassessment of government benefits – without adjustments, the IMF warns, debt risks heading down an "unsustainable path," with the debt-to-GDP ratio potentially rising to 130% by 2040.
- *Europe – Free Trade:* After three years of negotiations, the United Kingdom and Switzerland have reached an agreement on a new free trade agreement – Improvements are expected primarily in the services sector, the digital economy, the mobility of businesspeople, and patent protection.
- *Japan – Government Bond Market:* Finance Minister Katayama is considering incentives for Japanese investors to invest more money in the struggling domestic government bond market – government hopes this may also provide a boost to the Japanese yen – Government bonds could thus be incorporated into a tax-exempt investment program for retail investors – Katayama also discusses a possible adjustment to the portfolio allocation of the Government Pension Investment Fund (GPIF).

U.S. retail sales and leading indicators are showing resilience

China's growth has slowed significantly

Switzerland and the UK sign a trade agreement

Next Week's Data

TIME	COUNTRY		PERIOD	LBBW FORECAST	CONSENSUS FORECAST[1)]	LAST VALUE[2)]	IMPORTANCE
FRIDAY, 17.07.2026							
11:00	EMU	HICP (Y/Y) (final)	Jun	2,8	2,8	2,8	*
14:30	USA	Housing Starts (thous.)	Jun	1350	1310	1177	**
14:30	USA	Building Permits (thous.) (prelim.)	Jun	1400	1403	1410	**
14:30	USA	Import Price Index (M/M)	Jun	-	-0,7	1,9	*
15:15	USA	Industrial Production (M/M)	Jun	0,0	0,2	0,1	**
15:15	USA	Capacity Utilization (in %)	Jun	76,1	76,2	76,2	*
16:00	USA	Uni Michigan Consumer Confidence (prelim.)	Jul	52,0	51,0	49,5	***
	SPA	Rating Review Spain (Moody's®)					**
	FIN	Rating Review Finland (Fitch)					**
SUNDAY, 19.07.2026							
21:00	USA	FIFA Football World Cup Final: Spain vs. Argentina					
MONDAY, 20.07.2026							
08:00	GE	PPI (M/M)	Jun	-0,2	-0,3	0,3	**
16:00	USA	Index of Leading Indicators	Jun	-	-0,1	0,1	*
	UK	Andy Burnham set to take over as Prime Minister					**
TUESDAY, 21.07.2026							
10:00	EMU	ECB publishes Bank Lending Survey					**
11:00	GE	ZEW Index	Jul	15,0	18,0	10,5	**
THURSDAY, 23.07.2026							
14:15	EMU	ECB Main Refinancing Rate		2,40	2,40	2,40	***
14:15	EMU	ECB Deposit Facility Rate		2,25	2,25	2,25	***
16:00	EMU	Consumer Confidence (prelim.)	Jul	-16,0	-17,4	-17,7	*
FRIDAY, 24.07.2026							
01:30	JPN	National CPI (Y/Y)	Jun	1,8	1,7	1,5	*
08:00	GE	GfK Consumer Confidence	Aug	-27,5	-28,5	-29,2	**
09:30	GE	PMI Manufacturing (prelim.)	Jul	50,6	50,6	50,3	***
09:30	GE	PMI Services (prelim.)	Jul	49,0	49,5	48,6	***
09:30	GE	PMI Composite (prelim.)	Jul	50,0	-	49,5	***
10:00	EMU	ECB publishes Consumers' Inflation Expectations (1 Year, 3 Years)					**
10:00	EMU	PMI Manufacturing (prelim.)	Jul	51,5	51,7	51,4	***
10:00	EMU	PMI Services (prelim.)	Jul	50,0	49,8	49,4	***
10:00	EMU	PMI Composite (prelim.)	Jul	50,3	-	50,0	***
16:00	USA	New Home Sales (thous.)	Jun	600	615	580	**

1) Consensus forecast according to Bloomberg/Reuters

2) Should a provisional estimate be available, it is stated instead of the reference figure of the previous period

Sources: Bloomberg, LBBW Research

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Rates

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EUR Money Market: Waiting for what comes next from the ECB

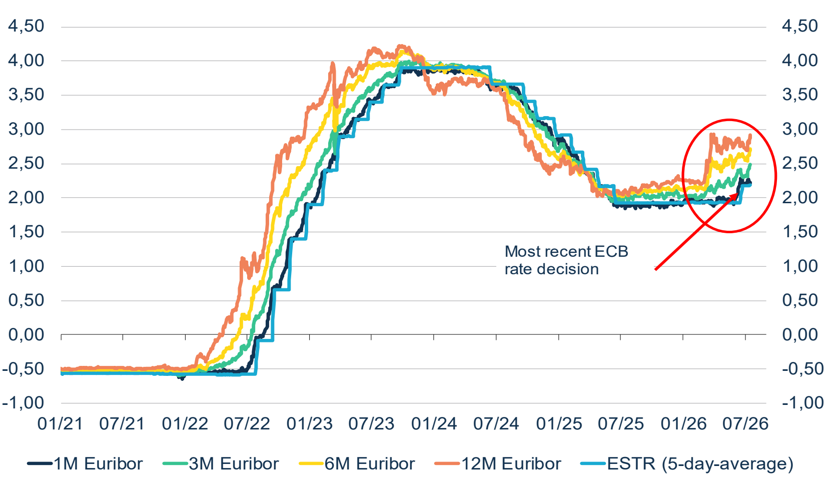
Euribor rates showing a sideways trend for now

Starting from a situation of relatively stable interest rate expectations, the euro money market had to readjust following the energy price shock of March 2026, which resulted from the Iran war. The subsequent phase of consolidation has, in principle, continued to today. Longer-term Euribor rates surged upward when the war broke out, in anticipation of a shift in the ECB's interest rate policy. Monetary policy has recently been catching up with reality, as demonstrated by the eurozone central bank's interest rate hike in June. The sideways consolidation of the 12M Euribor just below the 3% mark suggests that, on balance, the market consensus regarding the cumulated extent of monetary tightening has changed little since March (see below). Meanwhile, the short end of the money market curve gradually shifted upward, resulting in a decrease in the steepness of the money market curve. The spread between the 12M Euribor and the €STR overnight rate narrowed from a peak of about 1% points to roughly 70 bp points most recently.

12M Euribor has moved sideways since March on balance

Spread between 12M Euribor and €STR is around 70 bp

The money market curve has tended to flatten recently
€STR overnight rate and selected Euribor rates



Source: Bloomberg, LBBW Research

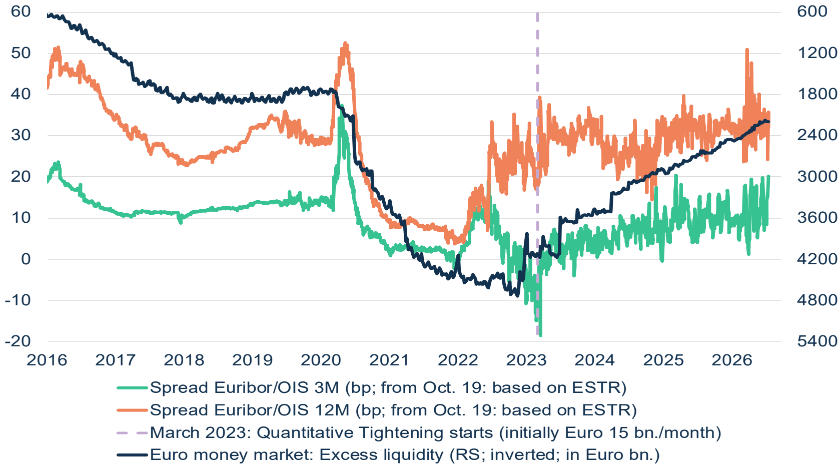
Quantitative tightening has been causing a gradual rise in liquidity spreads – still on “autopilot” for now

Meanwhile, the quantitative aspect of the ECB’s monetary policy has affected the development of money market rates only marginally. In our view, visible effects are only emerging over longer stretches of time, such as quarters or years. The fluctuations caused by market expectations regarding key interest rates are compounded by a very gradual upward trend in Euribor rates. With the €STR, this “quantitative impact” is even smaller. In our view, the effect of the ECB’s quantitative tightening – that is, the gradual reduction of its balance shee – can be gauged by the difference between the Euribor rates and the OIS rates with matching maturities. The following chart shows a correlation between these “liquidity

Liqui spreads have remained largely stable spreads" and excess liquidity in the euro money market. The latter has roughly halved as the ECB's bond holdings have shrunk, compared with the historic highs of 2022.

Liqui spread is trending upward, but only very slowly

Difference between selected Euribor rates and OIS rates, and excess liquidity in the EUR money market (in billions of EUR)



Source: Bloomberg, LBBW Research

Excess liquidity currently at about 2.2 billion EUR

When will the ECB launch its strategic portfolio?

To date, the ECB has shown no signs of reconsidering its quantitative tightening. As long as there are no significant disruptions in the euro money market – such as those that occurred in the U.S. dollar money market last fall – we believe there will be no rush for monetary authorities to slow down or halt balance sheet reduction. In the medium to long term, the ECB has set its sights on transitioning to a strategic bond portfolio. However, for the next twelve months, we do not currently expect such plans to materialize or any associated changes in balance sheet policy.

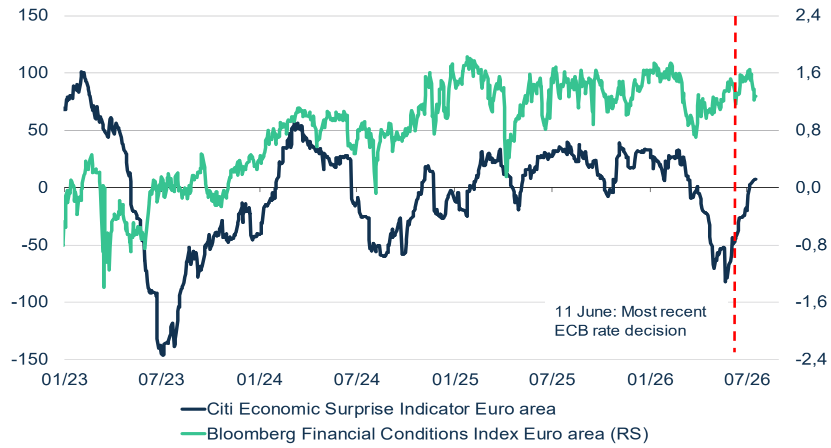
ECB Council Meeting on July 23: For now, a wait-and-see approach is again the order of the day

No signs of broad second-round effects, thus far

With an eye toward next week's upcoming ECB Council meeting, the focus will once again be on the appropriate monetary policy response to the consequences of the "Iran shock." Among all the major central banks, the ECB was the first to move ahead with a key interest rate hike in June. In our view, this preemptive tightening measure has given the eurozone monetary authorities some breathing room, which for now relieves them of immediate pressure to act. Admittedly, the situation in the Middle East has recently deteriorated again. However, crude oil prices have still remained below their levels at the time of the most recent ECB meeting, while financial markets have remained stable overall – despite an acute threat to peace efforts (see the chart below). ECB President Lagarde's statement that inflation risks are "more broadly balanced" than they were at the time of the June meeting has therefore remained valid, in our view. In recent statements, ECB representatives have also noted on several occasions that the feared second-round effects have not yet become apparent on a broad scale. Not to mention signs of a price-wage spiral. The first "post-Iran war" indicator of wage trends in the eurozone will not be released until mid-August. At its June meeting, the ECB's leadership sought to signal to market participants that it had not given the green light for a series of interest rate hikes. An interest rate hike this coming Thursday would run counter to that statement. In our view, such a course of action on the part of the ECB would be justifiable only if the risks of inflation had become more serious in the meantime. We therefore consider it virtually certain that the ECB Governing Council will leave its key interest rates unchanged next week.

Financial market conditions have improved slightly since the June meeting

Citigroup Economic Surprise Index for the Eurozone and Bloomberg Financial Conditions Index



Source: Bloomberg, LBBW Research

Fewer negative surprises than in June

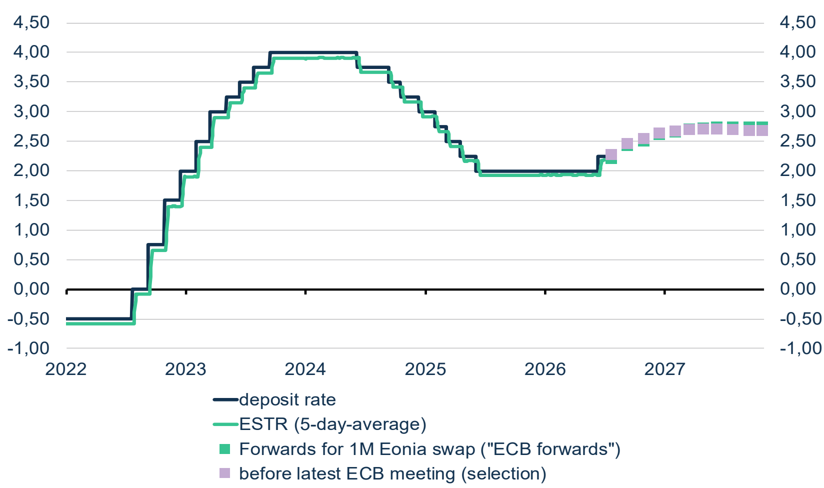
Forwards: A rate hike in September is the most likely scenario

Ms. Lagarde is also likely to be careful to avoid making any commitments regarding further monetary policy adjustments. The ECB president recently celebrated the shift away from a forward guidance policy at the Sintra Symposium, in a sort of unity with Fed Chairman Kevin Warsh. Any bias toward further tightening of monetary policy is likely to be conveyed to the public only between the lines. Conversely, however, we believe this also means that Ms. Lagarde is unlikely to actively contradict market participants' current interest rate expectations.

Central bankers back away from forward guidance

Forward rates imply a moderate further rise in interest rates

ECB Deposit Rate and €STR with ECB Forwards



Source: Bloomberg, LBBW Research

As evidenced by forward rates on the euro money market, investors currently generally agree with our forecast over the short term. The market-implied probability of a 25-basis-point increase in the deposit rate on July 23 is at about 10%. For the September meeting, at which the ECB will present new staff projections for growth and inflation, the market has priced in such a hike almost in full. For the fourth quarter, the consensus sees a clear bias toward another rate hike; this would be the third overall for this year. The currently expected interest rate path differs hardly from the market's outlook at the time of the ECB Governing Council's June meeting (see chart above).

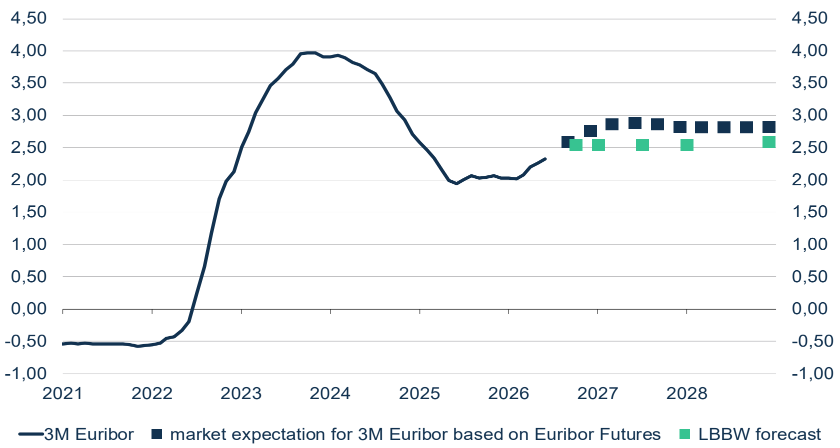
10% chance, only, of a rate hike as of July 23

Medium-term expectations for key rates have modestly overshot the mark

We expect that the upcoming interest rate decision and the subsequent press conference by the ECB President, taken by itself, will not substantially alter market participants' assessment of future interest rate trends. Expectations are likely to be shaped to a greater extent by how events unfold in the Middle East. Especially since the monetary authorities have adopted a retrained communication strategy. In our view, the current forward rates reflect an assessment of the situation that is somewhat too "hawkish." We expect only one more interest rate hike by the end of 2026. From a risk-management perspective, however, we believe that the increased danger of renewed escalation in the Middle East currently justifies giving greater weight to the scenario of more aggressive tightening than to the "dovish" scenario of unchanged ECB policy rates in the medium term.

Market consensus: Top formation from spring 2027

3M Euribor (monthly data) and market expectations based on futures



Source: Bloomberg, LBBW Research

Medium-term expectations are a bit above our forecast

Meanwhile, longer-term expectations for key interest rates in the euro interest rate market – as measured by 3-month Euribor futures – have remained largely unchanged on balance in the period since the most recent ECB meeting. The forward rates imply that EUR money market rates will rise moderately through spring 2027, after which they will peak.

3M Euribor futures: At 2.8% over a three-year horizon

Over the longer term (three years), the yield curve currently implies a rate of just over 2.8% for the 3M Euribor. In our view, this level is consistent with an ECB deposit rate of 2.75%. In our opinion, market participants' expectations for key interest rates over the medium to long term have somewhat overshot the mark.

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U.S. Treasury Market: Foreign buyers' appetite for long-term bonds has rebounded

TIC data: Foreign holdings of U.S. Treasuries rose modestly in the spring – Japan sold heavily in May

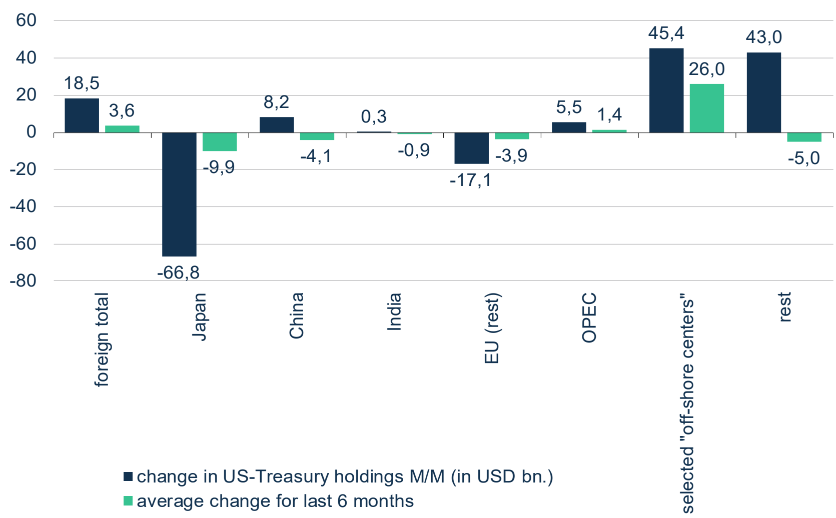
According to the U.S. Department of the Treasury's monthly TIC (Treasury International Capital) database, Japan remains the United States' largest foreign creditor. According to recently released data for May 2026, investors from the private and public sectors of the Asian country held U.S. Treasury securities worth approximately 1.14 trillion USD. This represents a good 12% of the Treasury holdings that, according to TIC statistics, are attributed to foreign investors in total (as of May: 9.37 billion USD). Late last week, the Japanese government suggested that the country's major institutional investors allocate a larger portion of their investments to the domestic capital market in the future. It is primarily targeting Japan's largest government pension fund, the GPIF, where foreign bonds currently account for one quarter of its USD 1.6 tn. total assets. Given the high international weight of the U.S. bond market, a large chunk of this is likely to be accounted for by U.S. Treasuries.

Japan accounts for 12% of foreign holdings

Looking at the most recent TIC data set, one might think that Japanese asset managers had already gone out of their way to comply with their finance minister's request. Accordingly, Japan stood out in May with a USD 67 billion (month-over-month) drop in its Treasury holdings. It was the largest decline since the fall of 2022, while foreign holdings of U.S. Treasury securities rose moderately overall in May for the second consecutive month (see the chart below).

Have investors already anticipated the finance ministers wishes?

Foreigners moderately increased their Treasury holdings in May
Change in holdings of U.S. Treasuries by selected creditors (in billions of USD, M/M and 6-month average)



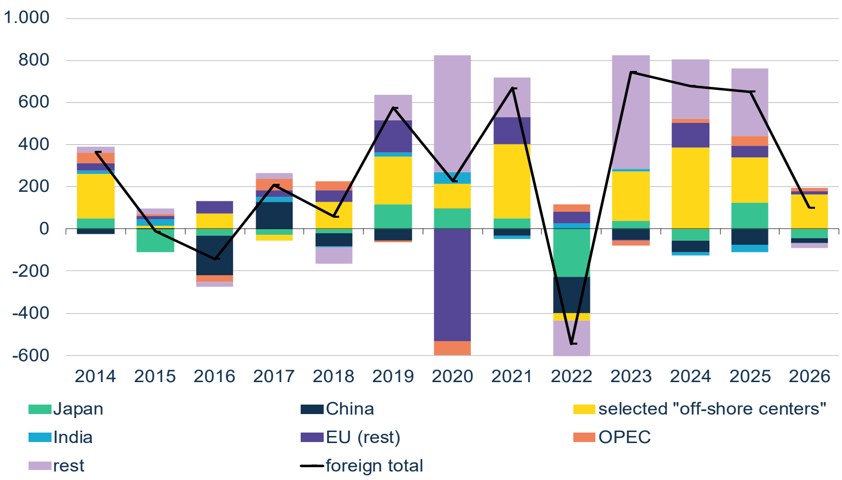
Source: TIC, Bloomberg, LBBW Research

Assets in "off-shore" accounts continue to rise strongly

The month-over-month change in Japan's holdings of U.S. Treasuries is indeed very striking. Especially since, unlike in the fall of 2022, the holdings data for May is unlikely to be distorted by drastic movements in market value. The change in holdings thus turned negative for Japan even on a cumulative basis for the year 2026 (see the chart below). In our view, however, it would be premature to interpret this striking monthly change as a sign that Japanese investors have begun to strategically reallocate their portfolios at the expense of the U.S. Treasury market. In our view, the historical volatility of the time series would only allow for such a conclusion after a prolonged period of a stable downward trend, as has been observed in China's Treasury holdings since 2019. Furthermore, the steady, sharp increase in holdings of U.S. Treasury securities allocated to traditional offshore locations brings to mind the well-known problems with regional allocation in the TIC data.

It would be premature to conclude that Japan has entered a downward trend

Japanese Investors Reduce Their Treasury Holdings
Cumulative Change in Holdings of U.S. Treasuries by Selected Creditors by Calendar Year (in billions of USD)



Source: TIC, Bloomberg, LBBW Research

Taking a broader view, meanwhile, we see an encouraging sign in the most recently released TIC data. Specifically, regarding fears that foreign investors are turning their backs on the U.S. Treasury market in droves as a result of the Trump administration's policies. In the first five months of 2026, U.S. government securities held in foreign portfolios did increase by only about USD 100 billion in total. If this trend continues, holdings growth for the full year 2026 would be significantly lower than the average for the years 2023 through 2025. And this is against the backdrop of the U.S. Treasury's persistently high net borrowing needs. However, the sharp decline in prices that has, on balance, taken hold in the U.S. Treasury market since the outbreak of the war in Iran has distorted the reported holding changes downwards.

TIC data allays concerns about an exodus of foreigners

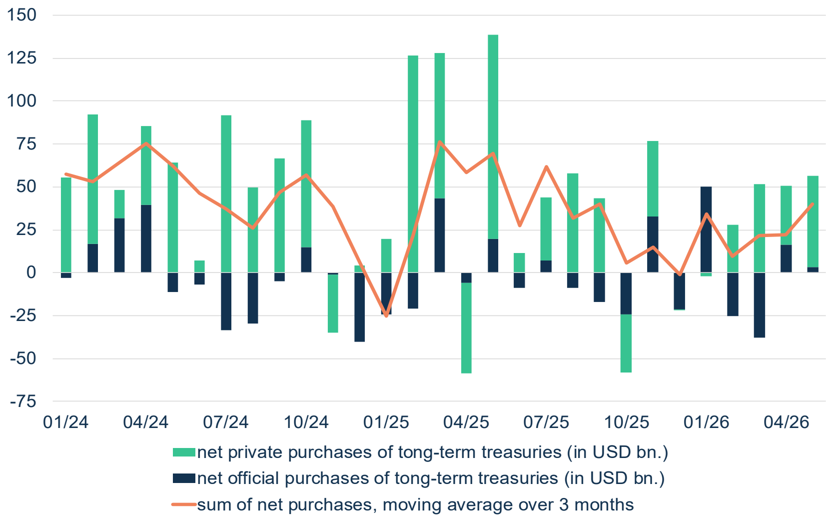
Net foreign purchases have been on the rise since the outbreak of the Iran War

A look at the net purchases of long-term U.S. government securities, which are reported separately in the TIC statistics, makes it possible to exclude the price effects mentioned above. According to the report, foreign investors purchased long-term U.S. Treasuries worth just over USD 56 billion in May. This was the highest figure since November 2025. In addition, net purchases were positive for the fifth consecutive month, as private-sector investors have consistently made net purchases in the mid-double-digit billion range since March (see the chart below). For the time being, it appears that foreign investors from the private sector have returned to the role they have played for many years as stable net buyers. In our view, the latter was temporarily in doubt during the second half of 2025 – that is, in the aftermath of U.S. President Trump's so-called "Liberation Day" (see the February 20, 2026, issue of *Bonds Weekly*). We get the impression that the increased global uncertainty in the financial markets in the wake of the war in Iran has reanimated the role of U.S. Treasuries as a safe haven, for now at least. This finding is consistent with the sharp appreciation of the U.S. dollar relative to other major currencies since the end of February 2026.

Net purchases exclude price effects

Foreigners posted significantly positive net purchases in May

Net purchases of long-term U.S. Treasuries by foreign investors per month (in billions of USD) and 3-month moving average



Source: TIC, Bloomberg, LBBW Research

Against this backdrop, the U.S. Treasury Secretary can breathe a sigh of relief for now: An exodus of foreign investors from the U.S. Treasury market is not currently on the agenda. In the spring, net purchases of long-term government securities actually showed a slight upward trend again. However, it remains to be seen whether this trend will hold once investors' increased demand for safety – driven by the war in Iran – has subsided. In our view, the risk that U.S. government funding will become even more expensive in the medium term due to rising term premiums is by no means off the table.

Net purchases have been up since March

But it's still too early to send the all-clear

03 I

Credit Strategy

Rates Take Centre Stage

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Spreads Remain Remarkably Resilient

Further escalation in the Gulf

Tensions between the U.S. and Iran have continued to escalate in recent days. The renewed rise in oil prices weighed on global equity markets and pushed government bond yields higher. Against this backdrop, however, European credit markets remained comparatively resilient. Although credit spreads widened modestly, both the iTraxx Europe and iTraxx Crossover indices continue to trade at historically tight levels. Compared with the initial market reaction at the onset of the Gulf conflict, the latest escalation has had only a limited impact on credit risk premia.

Credit spreads show only a limited reaction
iTraxx Crossover vs. Oil Price (Brent)

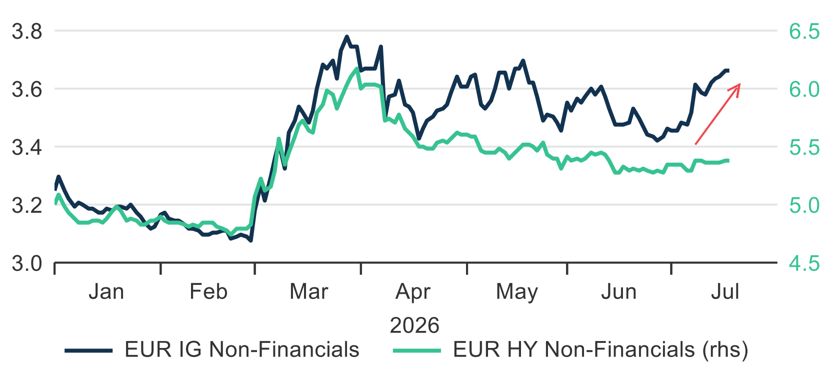
Spreads remain stable

Source: LSEG, LBBW Research

Rates drive market direction

The more pronounced market move occurred on the rates side. Investment-grade corporate bond yields moved higher broadly in line with German Bund yields, whereas high-yield bond yields remained largely unchanged. This divergence primarily reflects the higher duration of investment-grade bonds. In other words, recent market moves have been driven mainly by interest rate risk rather than credit risk. As a result, the absolute yield level of investment-grade corporates remains attractive despite historically tight spreads.

Interest rate risk weighs mainly on investment grade
EUR Investment-Grade vs. EUR High-Yield Yields (Yield-to-Worst in %)



IG more rate-sensitive than HY

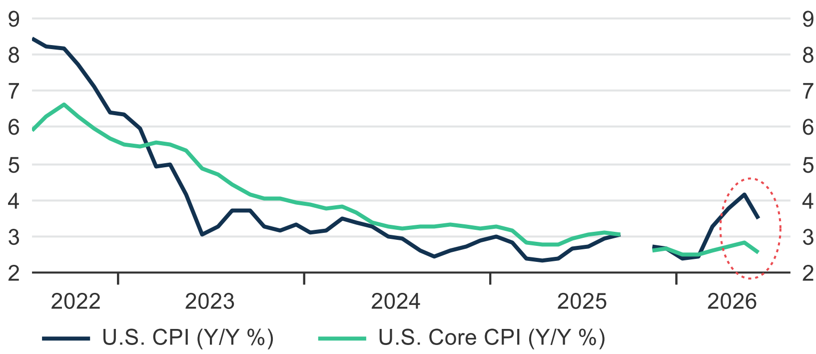
Source: LSEG, LBBW Research

Inflation Pressures Continue to Ease

US consumer price inflation came in below expectations, with both headline and core inflation continuing their gradual decline. While inflation remains above central bank targets, the latest data suggest that the risk of a renewed inflation surge has eased. For financial markets, this represents an important signal that the need for additional monetary tightening in the US may be diminishing.

U.S. inflation rate surprises positively

US inflation continues to moderate
U.S. Consumer Price Index (Headline vs. Core Rate in %)



Source: LSEG, LBBW Research

Core rate down, as well

The improvement in inflation data was quickly reflected in market pricing. Expectations of a Fed rate hike at the upcoming meeting declined sharply, with the implied probability falling from more than 40% to roughly 10% within only a few days. Investors are therefore shifting their attention back to the broader inflation outlook and whether the current disinflation trend will prove sustainable.

Rate fears receding

Markets scale back rate hike expectations
Market-implied probability of an interest rate hike on July 29, 2026

Source: Bloomberg, LBBW Research

Rate hike unlikely in the short term

CONCLUSION – Rates Remain in Focus

Developments in the Persian Gulf and the outlook for monetary policy are likely to remain the key drivers of credit markets over the coming weeks. Although easing US inflation reduces the immediate pressure for policy tightening, uncertainties surrounding energy prices and geopolitical risks remain elevated. Against this backdrop, current credit spreads still appear relatively tight and leave limited room for further compression. At the same time, higher underlying government bond yields continue to support attractive absolute yield levels. We therefore maintain our preference for investment-grade corporate bonds, which continue to offer the most compelling balance between return potential and risk.

IG offers attractive returns

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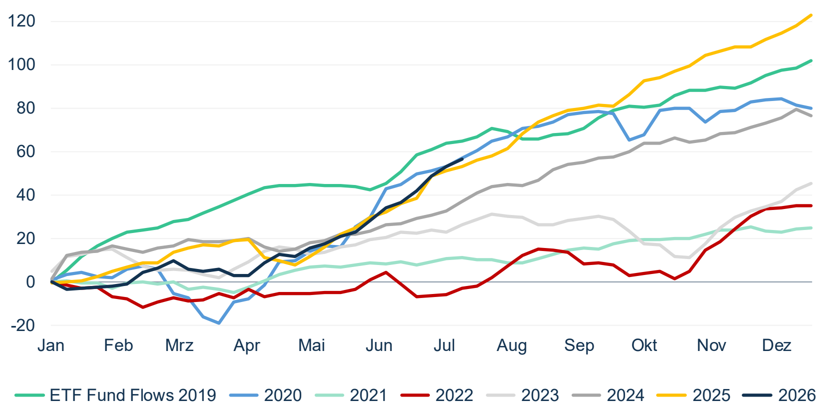
Record demand for corporate bonds continues

Record inflows in June

In 2025, investors poured a record amount of money into corporate bonds. After a slow start, this trend has continued into the current year. This is demonstrated by the global inflows into corporate bond ETFs, which we use as an indicator. Through mid-July, net inflows were even higher than during the strong same period last year. In June 2026, a new monthly record volume of funds flowed into corporate bond ETFs.

Higher inflows YTD

Annual Fund Flows into Corporate Bonds
Global Corporate Bond ETFs, Cumulative Net Inflows (in billions of USD)

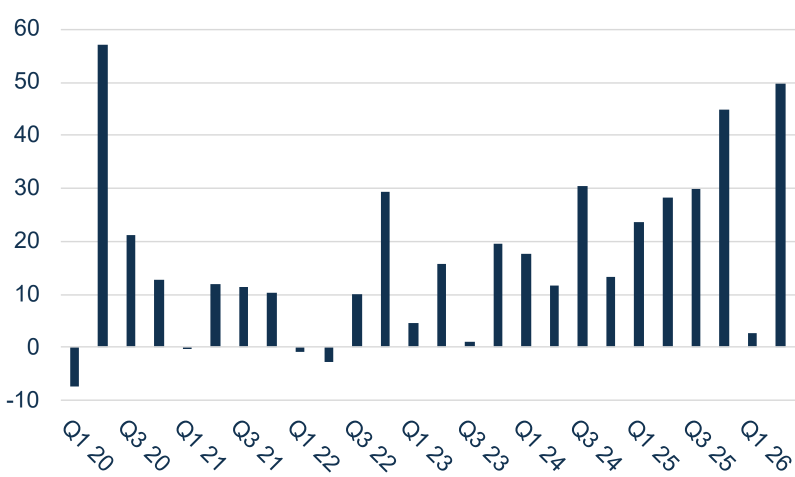


Source: Bloomberg, LBBW Research

The war in Iran led to significant outflows for a time: In March 2026, investors withdrew funds from this asset class at an accelerated pace. As a result, the first quarter of 2026 saw only a low volume of fund flows. This was followed by a rebound in Q2 2026, which saw nearly the highest quarterly net inflows on record. It was in the exceptional quarter of Q2 2020, only, driven by the COVID-19 pandemic, that investors did invest more in corporate bonds.

Q2 2026 was second-best quarter ever

Fund Flows by Quarter
Global Net Inflows into Corporate Bond ETFs (in billions of USD)



Source: Bloomberg, LBBW Research

The trend is likely to continue

We expect demand for corporate bonds to remain strong, as we believe they continue to offer attractive yields and a favorable risk-reward profile compared to other asset classes.

04 I

Calendar/Analytics

Developed Markets Overview

	2 Years			10 Years		
Euro Area	**Yields**	**Spread**	**Change***	**Yields**	**Spread**	**Change***
Bund	2,76			3,13		
Jumbo	3,00	23	-2	3,51	38	2
Swap	2,95	19	-1	3,16	3	0
Netherlands	2,75	-2	-3	3,22	9	0
Austria	2,79	3	-1	3,36	23	0
France	2,93	17	-1	3,93	80	4
Belgium	2,80	3	-3	3,67	55	2
Italy	2,96	19	1	3,94	82	8
Spain	2,82	6	-1	3,59	46	2
Ireland	n.a.	n.a.	n.a.	3,29	16	1
Portugal	2,75	-2	-2	3,49	36	2
Greece	n.a.	n.a.	n.a.	3,85	72	7
EX. EURO AREA	**Yields**	**Spread**	**Change***	**Yields**	**Spread**	**Change***
USA	4,12	136	-20	4,54	141	-9
Canada	2,83	6	-11	3,53	40	-4
Japan	1,44	-133	-11	2,72	-41	-9
UK	4,34	158	0	4,97	184	3
Switzerland	0,16	-261	-6	0,44	-268	-4

* Weekly change of the spread w.r.t. Bund w/w

Sources: Bloomberg, LBBW Research

Issuing Calendar Government Bonds

Date	Country	Type	Maturity	Coupon	Size	Comment
21.07.2026	Germany	OBL	10/31		€ 6 bn.	New
21.07.2026	UK	UKT	3Y		GBP 5 bn.	Tap
22.07.2026	Japan	JGB	40Y		JPY 500 bn.	
22.07.2026	Germany	Bund	15Y/20Y		€ 2 bn.	Tap
22.07.2026	USA	T-Bond	05/46	5.00%	USD 13 bn.	Tap
23.07.2026	USA	TIPS	07/36		USD 21 bn.	New

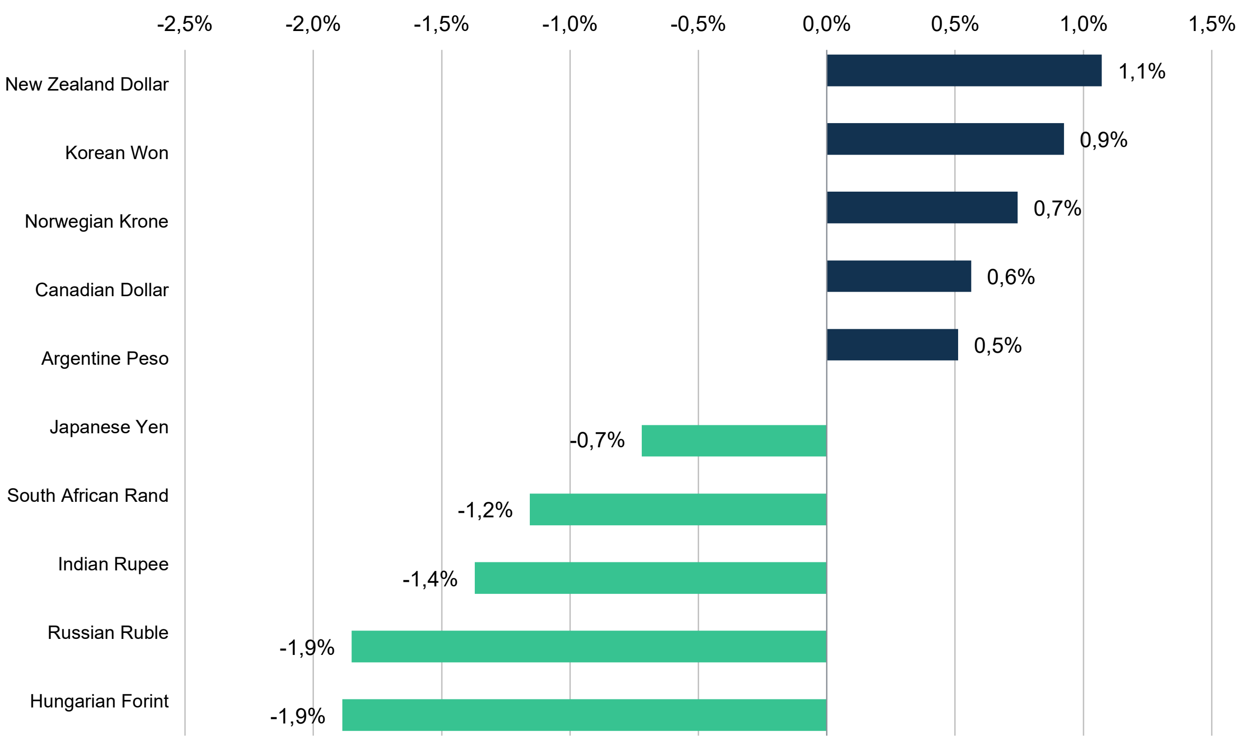
Sources: Bloomberg, LBBW Research

Central Banks and FX Monitor

Country	Next meeting	Current key rate	Latest change	Previous key rate	CPI YoY	6M trend	6M FX change ag. EUR	EUR-FX	6M EUR-FX Forward
Euro Area	23.07.26	2,25%	11.06.26	2,00%	2,8%	↗			
United States	29.07.26	3,75%	10.12.25	4,00%	3,5%	↗	1,7%	1,1450	1,1533
United Kingdom	30.07.26	3,75%	18.12.25	4,00%	2,8%	↘	2,1%	0,8499	0,8564
Japan	31.07.26	1,00%	16.06.26	0,75%	1,5%	↓	-1,0%	185,93	184,48
China	***	2,00%	25.09.24	2,30%	1,0%	▪	4,6%	7,75	7,72
Switzerland	24.09.26	0,00%	19.06.25	0,25%	0,5%	↗	0,4%	0,9251	0,9129
Argentina	***	29,00%	31.01.25	32,00%	32,6%	↘	-1,8%	1.687,74	1.893,43
Australia	11.08.26	4,35%	05.05.26	4,10%	3,2%	↗	5,9%	1,64	1,66
Brazil	05.08.26	14,25%	17.06.26	14,50%	4,6%	▪	6,7%	5,84	6,12
Canada	02.09.26	2,25%	29.10.25	2,50%	3,2%	↑	0,5%	1,61	1,61
Czech Republic	06.08.26	3,75%	18.06.26	3,50%	1,5%	↘	0,3%	24,22	24,34
Denmark	***	2,00%	12.06.26	1,75%	1,9%	▪	-0,1%	7,48	7,46
Hong Kong	***	4,00%	08.11.24	4,25%	2,0%	↑	1,1%	8,98	9,00
Hungary	21.07.26	6,00%	23.06.26	6,25%	1,7%	↓	6,4%	362,49	367,35
India	05.08.26	5,25%	06.02.25	5,50%	4,4%	↑	-4,2%	110,33	113,07
Indonesia	22.07.26	5,75%	18.06.26	5,50%	3,3%	↗	-3,9%	20.520,96	20.969,03
Mexico	06.08.26	6,50%	07.05.26	6,75%	3,4%	↘	2,5%	19,96	20,41
New Zealand	02.09.26	2,50%	08.07.26	2,25%	3,1%	▪	2,5%	1,96	1,96
Norway	13.08.26	4,25%	07.05.26	4,00%	2,7%	↘	5,7%	11,08	11,19
Poland	09.09.26	3,75%	04.03.26	4,00%	2,5%	▪	-2,5%	4,33	4,36
Romania	10.08.26	6,50%	07.08.24	6,75%	10,4%	▪	-2,9%	5,24	5,33
Russia	24.07.26	14,25%	19.06.26	14,50%	6,0%	▪	1,0%	89,42	95,60
Singapore	***	1,73%	n.a.	1,65%	1,8%	↗	1,3%	1,48	1,47
South Africa	23.07.26	7,00%	28.05.26	6,75%	4,5%	↑	1,3%	18,84	19,26
South Korea	27.08.26	2,75%	16.07.26	2,50%	3,2%	↑	1,2%	1.695,25	1.699,38
Sweden	20.08.26	1,75%	23.09.25	2,00%	0,7%	↗	-2,9%	11,04	11,01
Turkey	23.07.26	37,00%	22.01.26	38,00%	32,1%	▪	-6,7%	54,04	63,16

Sources: Bloomberg, LBBW Research

The Strongest Currency Appreciations and Depreciations Against the Euro This Week

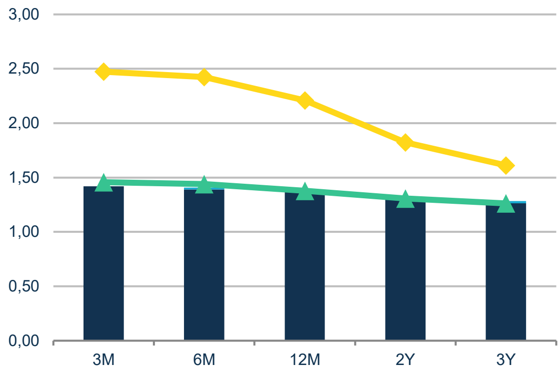


Sources: Bloomberg, LBBW, Research

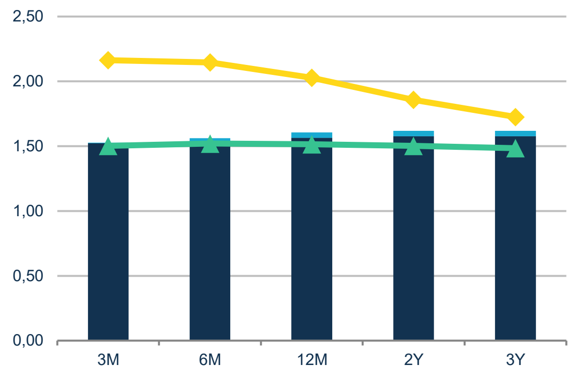
Interest rate differential and FX insurance costs vs. the Euro for selected currencies

interest rate differential, basis swap rates and insurance costs

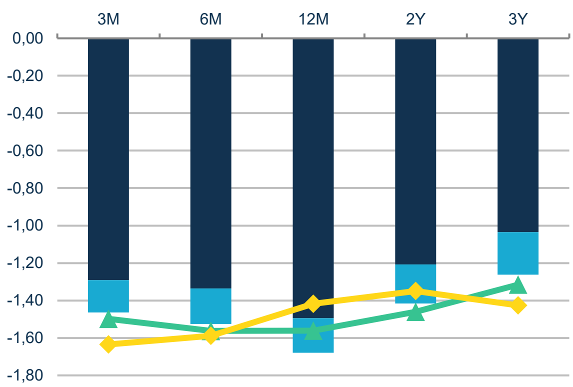
US dollar



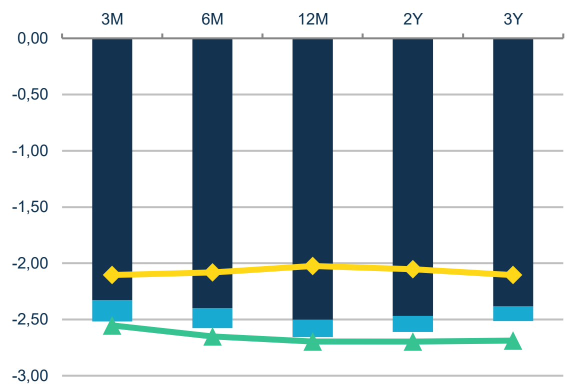
British pound



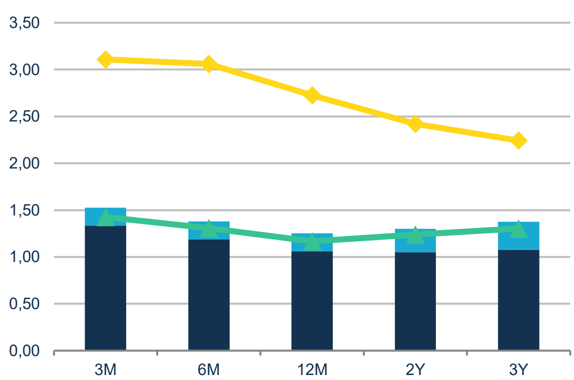
Japanese yen



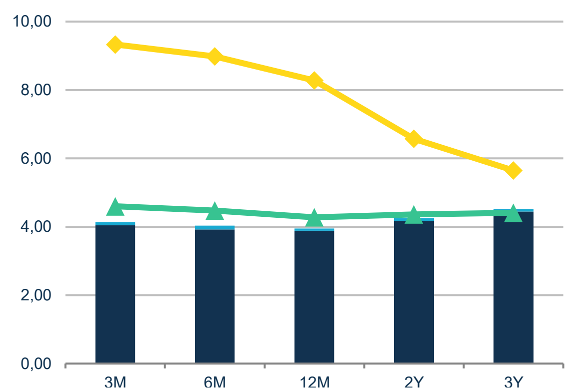
Swiss franc



Polish zloty



Mexican peso



■ interest rate differential ■ basis swap rates
▲ insurance costs (p.a.; current) ◆ insurance costs one year ago

Sources: Bloomberg, LBBW Research

LBBW

Credit Spreads

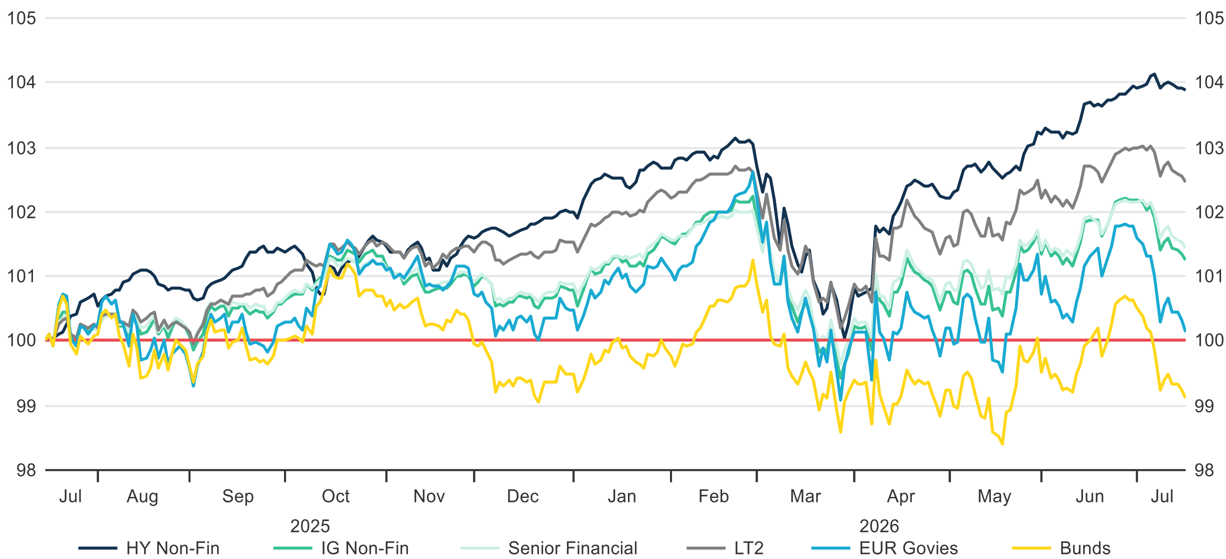
5Y CDS Spreads	Current	Changes 1W	1M	3M	6M	1Y
IG Corporates	52	1	1	-3	2	-2
HY & NR Corporates	251	5	0	-25	7	-28
Senior Financials	55	0	0	-5	1	-5
Sub Financials	89	0	0	-10	-3	-10

EUR Indices	Current	Changes 1W	1M	3M	6M	1Y
Non-Financials	73	1	-1	-3	-1	-10
Banks Senior Preferred	51	1	0	-5	-5	-13
Banks Senior Bail-in	70	3	0	-3	-1	-13
Banks Subordinated	102	2	-5	-7	-4	-28

*time lag of one day, Asset Swap Spreads 17.07.2026

Sources: LSEG, LBBW Research

Performance Credits vs. Bunds



Quellen: LSEG, LBBW Research

Allocation recommendations (Credits vs. Bunds)

Under observation of 6 – 12 months

	Recommendation		Segments		Regions	Strategies
Rates	0	0	0-3 years	0/+	Euro periphery	Multi-Callables
		0/+	4-7 years	0	German Bunds	Inflation-linked bonds
		0/-	8-10 years	0/-	USD-Bonds	
Credit	0/+	0/+	Corporate Inv. Grade	0/-	Emerging Markets Debt	
		0	Corporate High Yield			
		0/+	Corporate Hybrids (IG)			
		0/+	Senior Financials			
		0/+	Covered Bonds/SSAs			
		0	Tier 2 Inv. Grade/ Sen. Non-Pref.			

Sources: LBBW Research

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Disclaimer

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