

# Bond Market Outlook

---

**Katharine Neiss, PhD, Deputy Head of Global Economics  
and Chief European Economist**

The comments, opinions, and estimates contained herein are based on and/or derived from publicly available information from sources that PGIM Fixed Income believes to be reliable. We do not guarantee the accuracy of such sources or information. This outlook, which is for informational purposes only, sets forth our views as of this date. The underlying assumptions and our views are subject to change. Past performance is not a guarantee or a reliable indicator of future results.

**June 1, 2023**

The Global Fixed Income Business of Prudential Financial, Inc. Prudential Financial, Inc. of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom.

**For Institutional Investors Only – Not for Use with Retail Investors.  
All investments involve risk, including possible loss of capital.  
Please see Notice Page for important disclosures regarding the information contained herein.**



## Calm Before the Storm or Persistent Resilience...

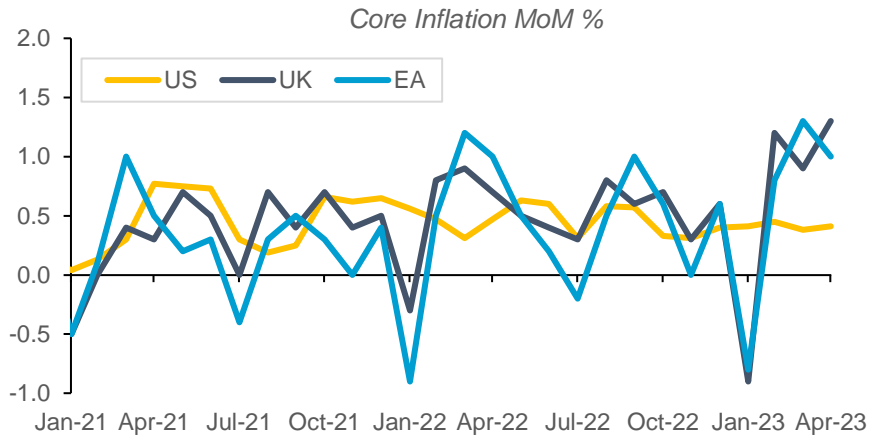
- Near-term policy uncertainty remains high given the conflicting signals from lags in the transmission mechanism and uncomfortably high core inflation...
- ...and we could see a repricing as views regarding the long-term neutral rate shift
- European bond markets are currently benefitting from technicals...
- ..but fragilities, especially around liquidity, remain
- Fundamentals in Europe have proven to be more resilient than expected, but contagion and spillover risks from the US remain
- The prospect that the issuer of the world's dominant reserve currency chooses to default may be long lasting

Source: PGIM Fixed Income. Provided for discussion purposes only. The comments, opinions, and estimates contained herein are based on and/or derived from publicly available information from sources that PGIM Fixed Income believes to be reliable. We do not guarantee the accuracy of such sources or information. This outlook, which is for informational purposes only, sets forth our views as of this date. The underlying assumptions and our views are subject to change. Does not constitute a recommendation regarding the merits of any investments. Does not constitute investment advice and should not be used as the basis for any investment decision. Does not constitute a representation that PGIM Fixed Income has purchased or would purchase any of the investments referenced or that any such investments would be profitable. **Past performance is not a guarantee or a reliable indicator of future results.**

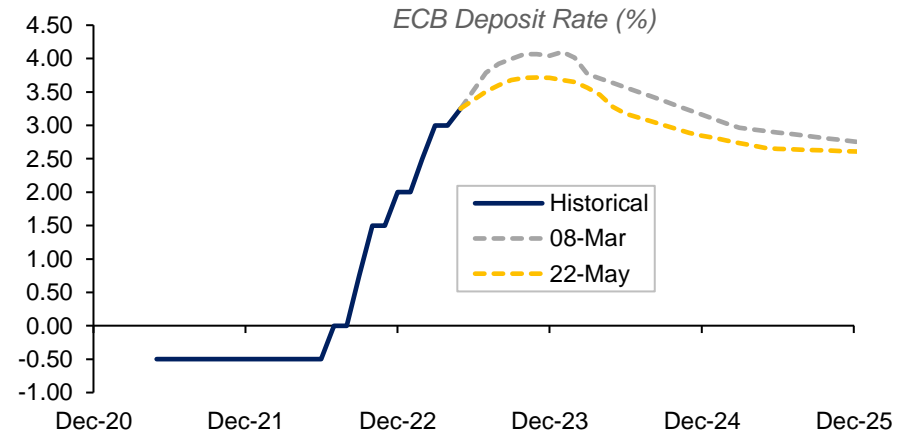


## Policy Uncertainty Remains High, Pointing To Continued Volatility

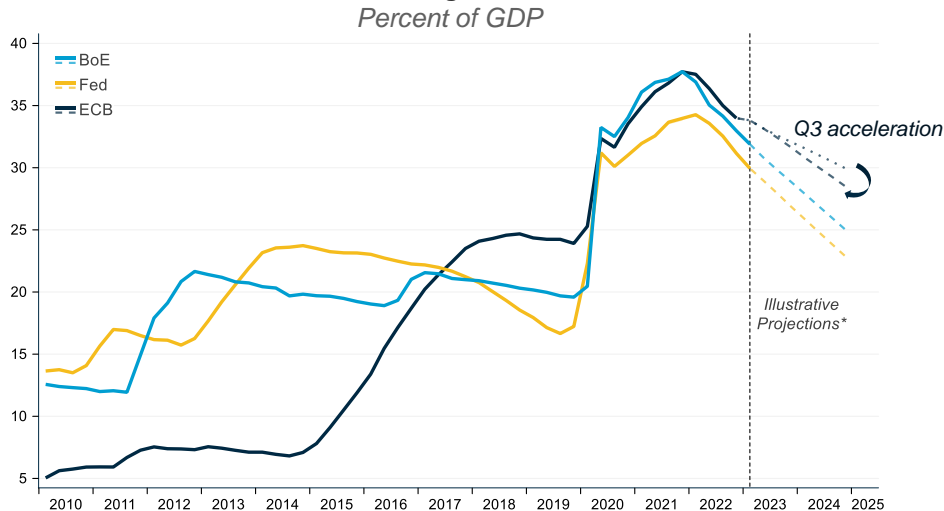
**Core inflation in Europe Has Accelerated...**



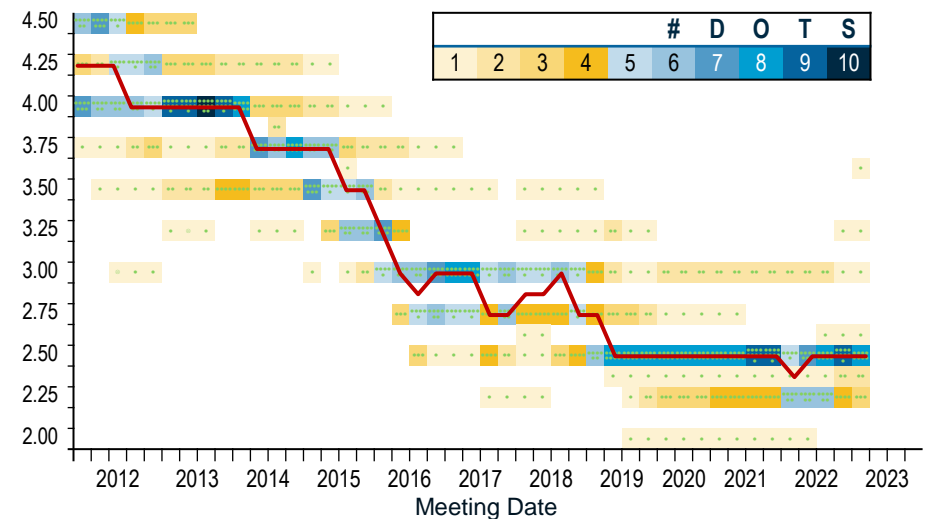
**...but Transmission Lags and FS Risks Point to a Shallower Path**



**The Impact of Accelerated QT Remains Unknown**  
**Central Bank Holdings of Debt Securities**



**...and Estimates of the Long-term Rate are Rising**  
**Federal Reserve longer Run Dot (%)**



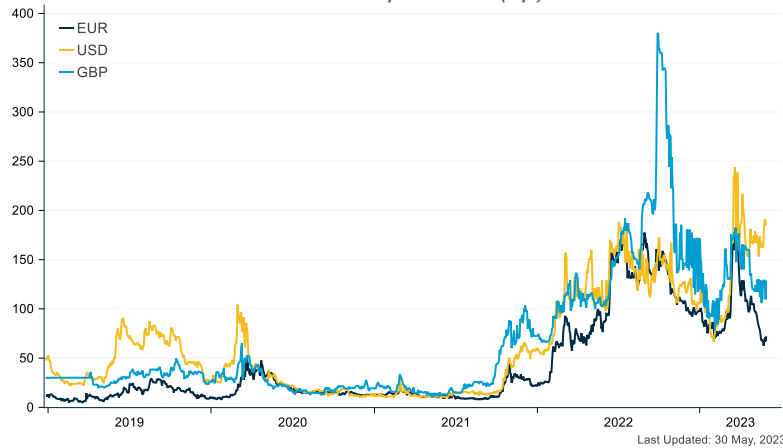
Sources: Top left Macrobond as of April 30, 2023. Top right Bloomberg as of May 22, 2023. Bottom left Macrobond as of May 18, 2023. Bottom right Bloomberg as of March 22, 2023. The forecasts presented herein are for informational purposes. There can be no assurance that these forecasts will be achieved.



## European Sovereign and Corporate Bond Markets are Currently Benefiting From Technicals, but Fragilities Around Liquidity Remain

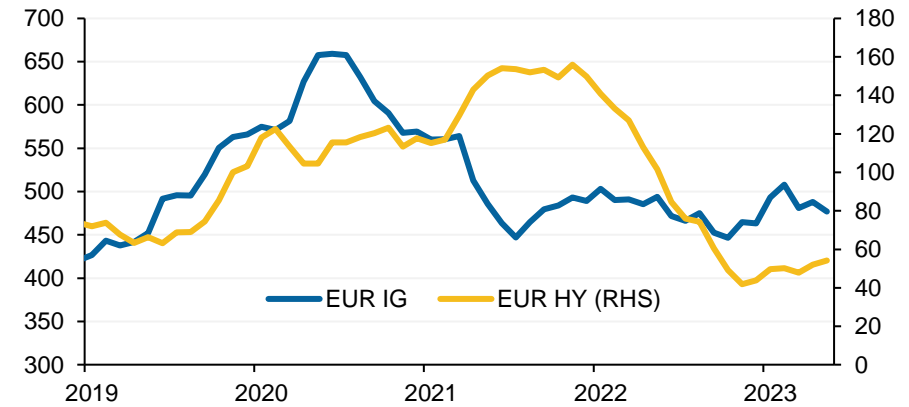
### Short-term Rates Volatility Remains Elevated

1M1Y Swaption Vol (bp)

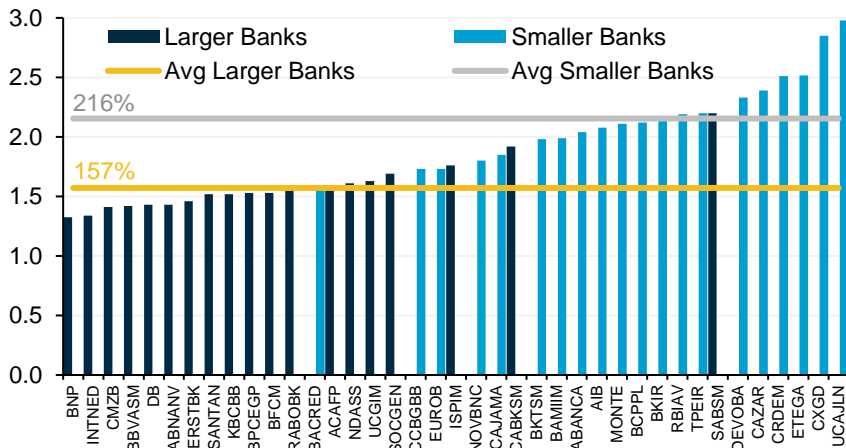


### HY Issuance has Been Compressed

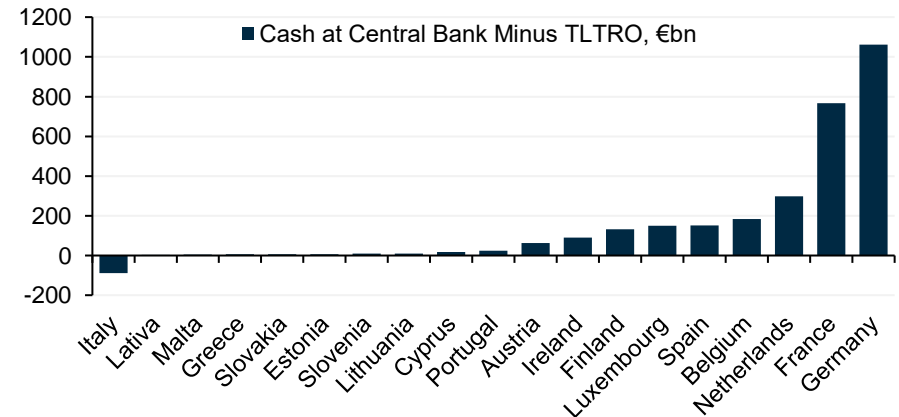
Trailing 12-Month Issuance (EUR Bn)



### LCRs are Comfortable, but Set to Decline



### (Smaller) Banks in Italy Have Less Cash at Central Bank Than TLTRO Borrowing



Sources: Top left Bloomberg as of May 30, 2023. Top right Bond Radar and Morgan Stanley Research as of May 1, 2023. Bottom left Banks, BofA Global Research as of May 17, 2023. Bottom right ECB, BofA Global Research as of March 2023.

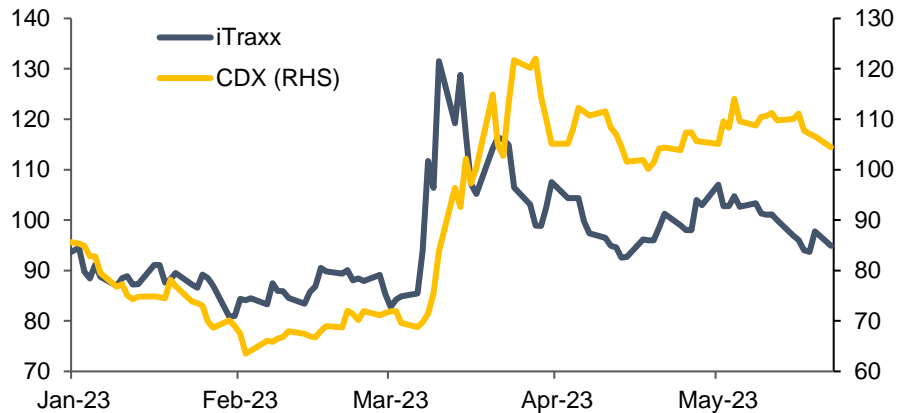


# Contagion and Spillovers

## Contagion Risk and Spillovers From the U.S. Cloud the Outlook

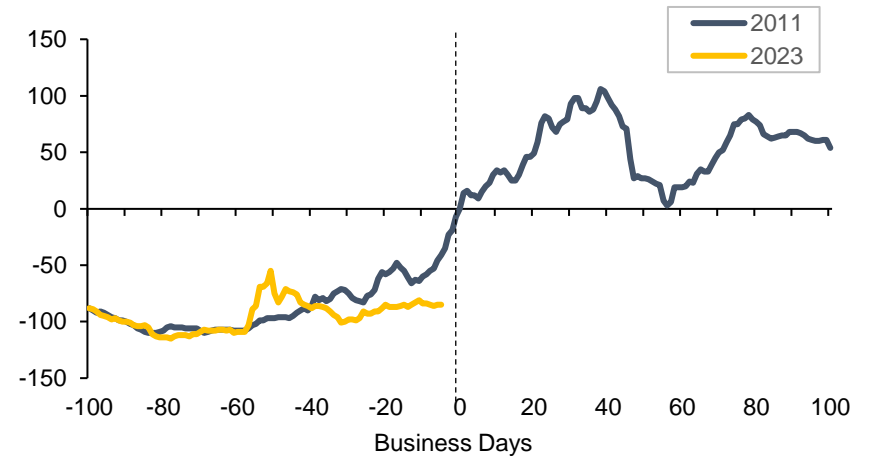
### US Banking Stress Spillovers Have Subsided...

Financials (bp)

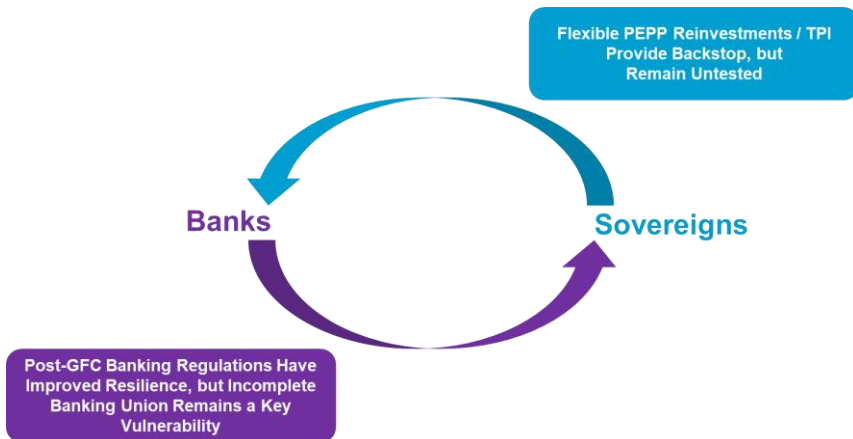


### ... but Concerns Around the Debt Ceiling Remain

Euro IG Spread (bp, 0 = Aug 10, 2011)

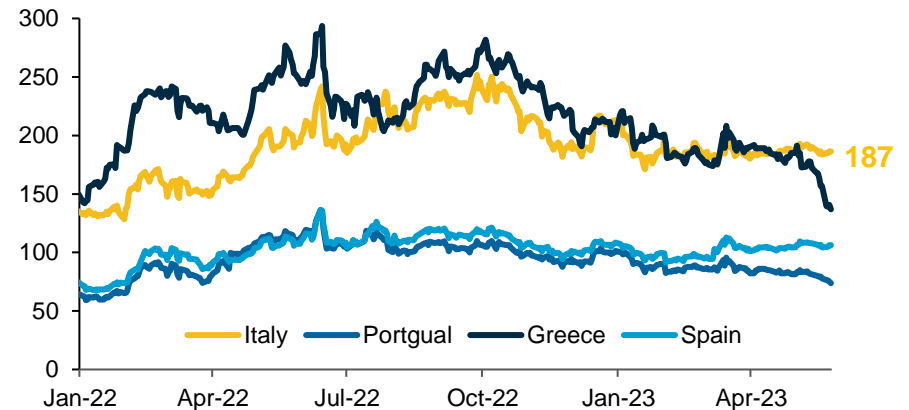


### Market Focus on Banks Could Shift to Sovereigns—With Italy a Weak Link



### Italian Fundamentals Have Improved, but Markets Remain Nervous...

Spread to 10Y Bund (bp)



Sources: Top left Bloomberg as of May 22, 2023. Top right Bloomberg as of May 30, 2023. Bottom left PGIM Fixed Income as of April 25, 2023. Bottom right Bloomberg as of May 25, 2023.



# Market Stress Will be a Positive Indicator for a Deal, but Reputational Damage may be Longer Lasting

- Scenario #1:  
Orderly resolution before X-date (5%)
- Scenario #2:  
Nail-biter, with associated market pain and US sovereign downgrades (40%)
- Scenario #3:  
Prioritisation of payments, with associated impact due to abrupt fiscal squeeze (50%)
- Scenario #4:  
Outright default (5%)

Source: PGIM Fixed Income. Provided for discussion purposes only. The comments, opinions, and estimates contained herein are based on and/or derived from publicly available information from sources that PGIM Fixed Income believes to be reliable. We do not guarantee the accuracy of such sources or information. This outlook, which is for informational purposes only, sets forth our views as of this date. The underlying assumptions and our views are subject to change. Does not constitute a recommendation regarding the merits of any investments. Does not constitute investment advice and should not be used as the basis for any investment decision. Does not constitute a representation that PGIM Fixed Income has purchased or would purchase any of the investments referenced or that any such investments would be profitable. **Past performance is not a guarantee or a reliable indicator of future results.**



- Will demand for European sovereign bonds hold up in the face of uncertainty and stresses?
- How might spillovers from U.S. Debt Ceiling impact the European IG and HY bond market?
- Can the European Banking Sector adjust to the end of TLTROs? Or is a new tool needed?
- How confident can we be that QT will remain broadly neutral in the face of an accelerated and lumpy redemption schedule?
- How can we judge that tightened credit conditions will return inflation to target?

# Reference





**Katharine Neiss, PhD**, is Deputy Head of Global Economics and Chief European Economist for PGIM Fixed Income, based in London. Ms. Neiss covers the macro-economic outlook in the UK and euro area, including Bank of England and ECB policy. Her own research focuses on thematic issues, such as monetary strategy and trade, with a particular emphasis on their relevance to Europe. Ms. Neiss has appeared as an expert witness on monetary policy for Parliament's Treasury Select Committee. Prior to joining the Firm in 2020, Ms. Neiss held a variety of roles at the Bank of England. Most recently, as Head of the International Surveillance Division, she was responsible for advising Committee members on the global macro-economic and financial stability outlook and was part of a small group of economists directly supporting the Monetary Policy Committee. Other roles Ms. Neiss held at the Bank of England include Head of the Policy, Strategy and Implementation Division, covering regulation of major systemic U.K. banks, and senior manager roles in the Structural Economic Analysis and Monetary Assessment and Strategy Divisions, covering the U.K. economy. Ms. Neiss has been published in the Journal of Money, Credit, and Banking, the Review of Economic Dynamics, Macroeconomic Dynamics and the Oxford Bulletin of Economics and Statistics. She received a BA Honours in Economics from Queen's University and a Masters and PhD in Economics from the University of British Columbia.

*For purposes of the biographies, the "Firm" is defined as Prudential Financial, Inc. ("PFI"). All PGIM and PFI named entities are subsidiaries or affiliates of PFI. PFI of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom.*



**For Professional Investors only. All investments involve risk, including the possible loss of capital.**

PGIM Fixed Income is a global asset manager primarily focused on public fixed income investments whose U.S. business operates as a unit of PGIM, Inc. PGIM, Inc. is an investment adviser registered with the U.S. Securities and Exchange Commission (the "SEC"), and is a Prudential Financial, Inc. ("PFI") company. Registration with the SEC as an investment adviser does not imply a certain level or skill or training. PGIM Fixed Income is headquartered in Newark, New Jersey and also includes the following businesses globally: (i) the public fixed income unit within PGIM Limited, located in London; (ii) locally managed assets of PGIM Japan Co., Ltd., located in Tokyo; (iii) the public fixed income unit within PGIM (Singapore) Pte. Ltd., located in Singapore; and (iv) the public fixed income unit within PGIM Netherlands B.V., located in Amsterdam. PFI of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom. Prudential, PGIM, their respective logos and the Rock symbol are service marks of PFI and its related entities, registered in many jurisdictions worldwide.

**These materials are for informational or educational purposes. The information is not intended as investment advice and is not a recommendation about managing or investing assets. In providing these materials, PGIM Fixed Income is not acting as your fiduciary. Clients seeking information regarding their particular investment needs should contact their financial professional.**

This document may contain confidential information and the recipient hereof agrees to maintain the confidentiality of such information. Distribution of this information to any person other than the person to whom it was originally delivered and to such person's advisers is unauthorized, and any reproduction of this document, in whole or in part, or the divulgence of any of its contents, without PGIM Fixed Income's prior written consent, is prohibited. This document contains the current opinions of the manager and such opinions are subject to change. Certain information in this document has been obtained from sources that PGIM Fixed Income believes to be reliable as of the date presented; however, PGIM Fixed Income cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. PGIM Fixed Income has no obligation to update any or all such information; nor do we make any express or implied warranties or representations as to its completeness or accuracy. Any information presented regarding the affiliates of PGIM Fixed Income is presented purely to facilitate an organizational overview and is not a solicitation on behalf of any affiliate.

**These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services. These materials do not constitute investment advice and should not be used as the basis for any investment decision.**

This material may contain examples of the firm's internal ESG research program and is not intended to represent any particular product's or strategy's performance or how any particular product or strategy will be invested or allocated at any particular time. PGIM's ESG policies and procedures, rankings and factors may change over time, in PGIM Fixed Income's discretion. ESG investing is qualitative and subjective by nature; there is no guarantee that the criteria used or judgment exercised by PGIM Fixed Income will reflect the beliefs or values of any investor. Information regarding certain ESG practices may be obtained through third-party reporting, which may not be accurate or complete, and PGIM Fixed Income depends on this information to evaluate a company's commitment to, or implementation of, ESG practices. ESG norms differ by region. Accounts managed by PGIM Fixed Income may or may not hold instruments issued by any of the issuers that may be discussed herein. Nothing contained herein should be construed as limiting the investments or strategies that PGIM Fixed Income can pursue when managing a client account. There is no assurance that PGIM Fixed Income's ESG investing techniques will be successful.

These materials do not take into account individual client circumstances, objectives or needs. No determination has been made regarding the suitability of any securities, financial instruments or strategies for particular clients or prospects. The information contained herein is provided on the basis and subject to the explanations, caveats and warnings set out in this notice and elsewhere herein. Any discussion of risk management is intended to describe PGIM Fixed Income's efforts to monitor and manage risk but does not imply low risk. No risk management technique can guarantee the mitigation or elimination of risk in any market environment. Any risk metrics or portfolio characteristics provided are not, and should not be construed as, the past or projected performance of the strategy presented or any investment, which will be impacted by a number of factors not reflected herein. These materials do not purport to provide any legal, tax or accounting advice. These materials are not intended for distribution to or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation.

Any financial indices referenced herein as benchmarks are provided for informational purposes only. The use of benchmarks has limitations because portfolio holdings and characteristics will differ from those of the benchmark(s), and such differences may be material. You cannot make a direct investment in an index. Factors affecting portfolio performance that do not affect benchmark performance may include portfolio rebalancing, the timing of cash flows, credit quality, diversification, and differences in volatility. In addition, financial indices do not reflect the impact of fees, applicable taxes or trading costs which reduce returns. Unless otherwise noted, financial indices assume reinvestment of dividends.

Any forecasts, estimates and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument. Forecasts and estimates have certain inherent limitations, and unlike an actual performance record, do not reflect actual trading, liquidity constraints, fee. These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services and should not be used as the basis for any investment decision. PGIM Fixed Income and its affiliates may make investment decisions that are inconsistent with the recommendations or views expressed herein, including for proprietary accounts of PGIM Fixed Income or its affiliates.



**Any performance targets contained herein are subject to revision by PGIM Fixed Income and are provided solely as a guide to current expectations. There can be no assurance that any product or strategy described herein will achieve any targets or that there will be any return of capital.** Target annualized excess returns are presented on both a gross and net basis solely for the purpose of detailing the anticipated risk and reward characteristics of the strategy in order to facilitate comparisons with other investment types. Gross targets do not reflect the deduction of fees and other expenses to be borne by accounts using the strategy, which will reduce returns and, in the aggregate, may be substantial. Net targets reflect the deduction of model fees and expenses equal to the highest fees borne by a portfolio utilizing the strategy. The target returns presented herein are not a prediction, projection, expectation or guarantee of future performance. There are significant risks and limitations in using target returns, including targets that are based upon assumptions regarding future events and situations, which may prove not to be accurate or may not materialize. Further, the target returns stated herein are based on an assumption that economic, market and other conditions will not deteriorate and, in some cases, will improve. The target returns are also based on models, estimates and assumptions about performance believed to be reasonable under the circumstances, but actual returns of the strategy and its investments will depend on, among other factors, the ability to consummate attractive investments, future operating results, the value of the assets and market conditions at the time of disposition, any related transaction costs and the timing and manner of sale, all of which may differ from the assumptions and circumstances on which the targeted returns are based. PGIM Fixed Income believes that the target returns for the strategy and each investment type reflect in part a measure of the risk PGIM Fixed Income will be taking with respect to the strategy and investments in that investment type. There can be no assurance that any investments, any of the investment types or the strategy will achieve comparable returns to those targeted herein or that PGIM Fixed Income will be able to implement its investment strategy and investment approach or achieve its investment objectives. Target returns do not take into account cash flows into and out of the portfolio, as well as other factors, which could have an impact on actual performance of a client utilizing the strategy. Accordingly, target returns should not be used as a primary basis for an investor's decision to invest in the strategy.

**Tracking Error (TE)** is one possible measurement of the dispersion of a portfolio's returns from its stated benchmark; it is the standard deviation of such excess returns. TE figures are representations of statistical expectations falling within "normal" distributions of return patterns. Normal statistical distributions of returns suggests that approximately two thirds of the time the annual gross returns of the accounts will lie in a range equal to the benchmark return plus or minus the TE if the market behaves in a manner suggested by historical returns. Targeted TE therefore applies statistical probabilities (and the language of uncertainty) and so cannot be predictive of actual results. In addition, past tracking error is not indicative of future TE and there can be no assurance that the TE actually reflected in your accounts will be at levels either specified in the investment objectives or suggested by our forecasts.

In the **United Kingdom**, information is issued by PGIM Limited with registered office: Grand Buildings, 1-3 Strand, Trafalgar Square, London, WC2N 5HR. PGIM Limited is authorised and regulated by the Financial Conduct Authority ("FCA") of the United Kingdom (Firm Reference Number 193418). In the **European Economic Area ("EEA")**, information is issued by PGIM Netherlands B.V., an entity authorised by the Autoriteit Financiële Markten ("AFM") in the Netherlands and operating on the basis of a European passport. In certain EEA countries, information is, where permitted, presented by PGIM Limited in reliance of provisions, exemptions or licenses available to PGIM Limited including those available under temporary permission arrangements following the exit of the United Kingdom from the European Union. These materials are issued by PGIM Limited and/or PGIM Netherlands B.V. to persons who are professional clients as defined under the rules of the FCA and/or to persons who are professional clients as defined in the relevant local implementation of Directive 2014/65/EU (MiFID II). In **Switzerland**, information is issued by PGIM Limited, London, through its Representative Office in Zurich with registered office: Kappelergasse 14, CH-8001 Zurich, Switzerland. PGIM Limited, London, Representative Office in Zurich is authorised and regulated by the Swiss Financial Market Supervisory Authority FINMA and these materials are issued to persons who are professional or institutional clients within the meaning of Art.4 para 3 and 4 FinSA in Switzerland. In certain countries in **Asia-Pacific**, information is presented by PGIM (Singapore) Pte. Ltd., a regulated entity with the Monetary Authority of Singapore under a Capital Markets Services License to conduct fund management and an exempt financial adviser. In **Japan**, information is presented by PGIM Japan Co. Ltd., registered investment adviser with the Japanese Financial Services Agency. In **South Korea**, information is presented by PGIM, Inc., which is licensed to provide discretionary investment management services directly to South Korean investors. In **Hong Kong**, information is provided by PGIM (Hong Kong) Limited, a regulated entity with the Securities & Futures Commission in Hong Kong to professional investors as defined in Section 1 of Part 1 of Schedule 1 of the Securities and Futures Ordinance (Cap.571). In **Australia**, this information is presented by PGIM (Australia) Pty Ltd ("PGIM Australia") for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). PGIM Australia is a representative of PGIM Limited, which is exempt from the requirement to hold an Australian Financial Services License under the Australian Corporations Act 2001 in respect of financial services. PGIM Limited is exempt by virtue of its regulation by the FCA (Reg: 193418) under the laws of the United Kingdom and the application of ASIC Class Order 03/1099. The laws of the United Kingdom differ from Australian laws. In **Canada**, pursuant to the international adviser registration exemption in National Instrument 31-103, PGIM, Inc. is informing you that: (1) PGIM, Inc. is not registered in Canada and is advising you in reliance upon an exemption from the adviser registration requirement under National Instrument 31-103; (2) PGIM, Inc.'s jurisdiction of residence is New Jersey, U.S.A.; (3) there may be difficulty enforcing legal rights against PGIM, Inc. because it is resident outside of Canada and all or substantially all of its assets may be situated outside of Canada; and (4) the name and address of the agent for service of process of PGIM, Inc. in the applicable Provinces of Canada are as follows: in **Québec**: Borden Ladner Gervais LLP, 1000 de La Gauchetière Street West, Suite 900 Montréal, QC H3B 5H4; in **British Columbia**: Borden Ladner Gervais LLP, 1200 Waterfront Centre, 200 Burrard Street, Vancouver, BC V7X 1T2; in **Ontario**: Borden Ladner Gervais LLP, 22 Adelaide Street West, Suite 3400, Toronto, ON M5H 4E3; in **Nova Scotia**: Cox & Palmer, Q.C., 1100 Purdy's Wharf Tower One, 1959 Upper Water Street, P.O. Box 2380 -Stn Central RPO, Halifax, NS B3J 3E5; in **Alberta**: Borden Ladner Gervais LLP, 530 Third Avenue S.W., Calgary, AB T2P R3.

© 2023 PFI and its related entities. 2023-4083