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Recorded 24 June 2025

Fixed Income

# Inflation Quarterly Update


### Elida Rhenals, Co-Head of Inflation, Senior Portfolio Manager


Liberation day seems like ages ago and despite some correction in risky assets like equities and credit spreads, inflation risk premium has remained muted. In our view, inflation expectations are likely to adjust upward, closing the gap with recent moves in oil.

The US strike on Iran has heightened geopolitical tensions, injecting risk into the oil market and influencing inflation expectations. Despite potential ceasefire, Brent crude prices have risen more than 10% since the start of June. With the situation still uncertain, oil price volatility is likely to stay elevated. We believe this backdrop supports short-term breakevens and front-end inflation-linked bonds. Historically, a 10% increase in oil prices can contribute up to 30 basis points to headline inflation over the first year and that is assuming no second-round effects the years after.

The Middle East situation remains fluid but more broadly, medium-term inflationary pressures persist in advanced economies. First, the 9th of July deadline for tariffs and second, we are still facing the likelihood of higher fiscal spending, not only in the US but also in Europe. We have recently added long inflation exposure to the portfolios, and we have a preference for tactical long breakeven positions, which tend to behave favourably in the summer months.

On a more strategic level, we continue to favour front-end inflation-linked bonds. These instruments should be well-positioned to capture the benefits of higher realised inflation in the near term, while also offering a degree of protection should term premia start to pick up at the longer end of the yield curve. We may now be facing a dual supply shock, rising oil prices on the one hand and new tariffs on the other.

The combined effect of these shocks is likely to be inflationary, even in the absence of significant demand-side pressures. Given that inflation risk premiums remain relatively modest, we believe that holding inflation-linked bonds offers a more resilient and lower-risk profile heading into what we expect to be another bumpy quarter.

Source: AXA IM as of June 2025

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