

In the Buy Zone: Why Eurozone Bonds are Back in Play

Guillermo Felices, PhD, Global Investment Strategist

Robert Tipp, CFA, Chief Investment Strategist, Head of Global Bonds

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

Aaron Sosnader, CFA, Investment Strategist

Key Takeaways

- Best combination of fundamentals and hedged yields among developed market peers
- Broad and deep opportunity set for adding value through active management
- Bloc stands out with a solid fiscal framework in a world of fiscal laxity

Amid the shifting sands of the \$145 trillion global fixed income markets, Eurozone debt stands out as a solid rock anchoring investor confidence.¹

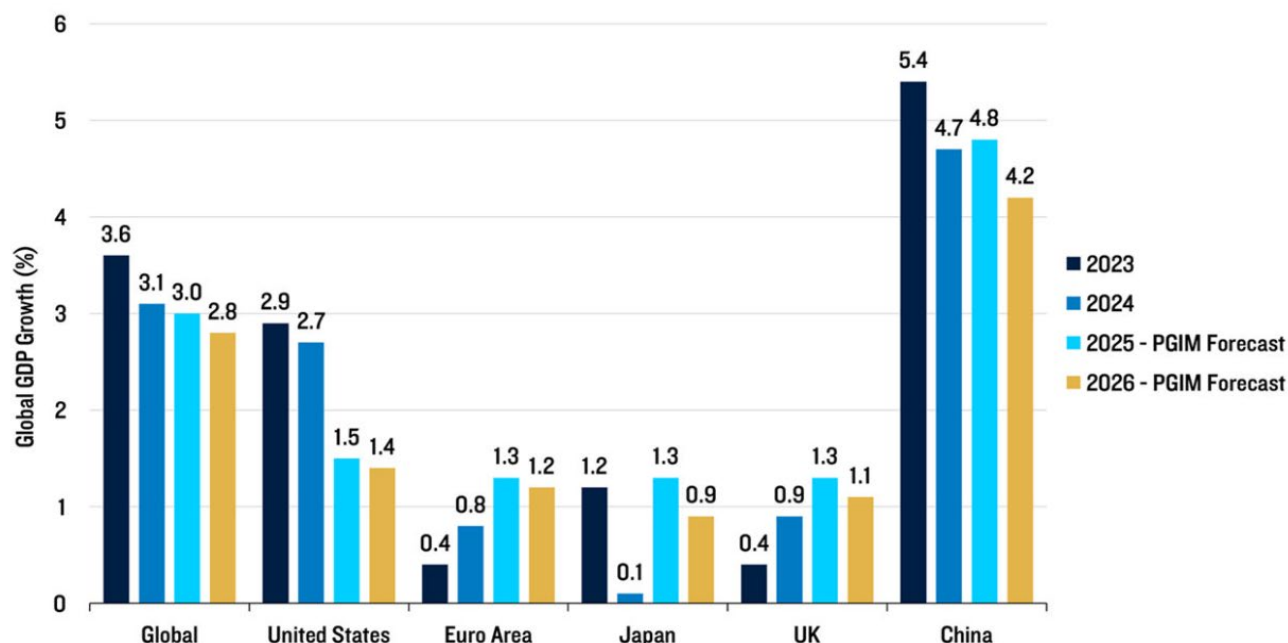
The bloc's fixed income offers a broad and deep opportunity set for adding value through active management, supported by strong macroeconomic fundamentals and highly attractive hedged yields - perhaps the best combination among its peers. Additionally, in a world of fiscal laxity, the Eurozone stands out with a comparatively solid fiscal framework.²

In addition to providing an opportunity for domestic buyers, for non-Eurozone investors it is worth considering that global diversification in fixed income on a currency-hedged basis has historically been a solid play resulting in higher risk adjusted returns. For example, hedged global bonds posted superior risk-adjusted returns over the last two decades compared with most domestic benchmarks.³

The current state of play in the region's bond markets highlights an opportunity for non-Eurozone investors to diversify and potentially improve their investment outcomes. This sets the stage for a constructive outlook, especially when compared to the relatively unpredictable policy environment in the United States.

Macro Backdrop

The macro backdrop for Eurozone bond markets is turning increasingly supportive as policy frameworks and fiscal dynamics evolve. Structural guardrails, expansive national spending plans, and a potentially transformative European Union (EU) budget are reinforcing stability and liquidity, creating conditions for deeper and more resilient bond markets.

FIGURE 1: Global GDP Growth

Source: Macrobond, September 2025

Unlike the United States, which benefits from a unified fiscal framework and a common safe asset, the euro area relies on institutional guardrails to mitigate fragmentation risks. Mechanisms such as EU fiscal rules and the European Central Bank's Transmission Protection Instrument (TPI) serve as "second-best" solutions, offering stability in the absence of deeper integration. For France, which is undergoing a turbulent period in domestic politics, these safeguards are particularly valuable.⁴ Compliance with EU fiscal rules signals fiscal discipline, while the TPI provides a backstop against erratic market moves, reducing volatility in sovereign bond spreads.

Germany's decision to implement a substantial fiscal stimulus also marks a pivotal development for the euro area.⁵ The planned deficit, projected at around 5%, is unprecedented for Germany, but lesser than some of its developed market peers like the U.S. This front-loaded spending is expected to deliver a meaningful boost to German growth starting in 2026, with high conviction that the scale of expenditure will support near-term economic activity.

The fiscal expansion has also opened value in German bunds. The spillover effects to the broader euro area will be notable, concentrated primarily in Central and Eastern Europe due to strong supply-chain linkages and in Italy, given its significant manufacturing base, offering a growth-friendly boost to the region's debt.

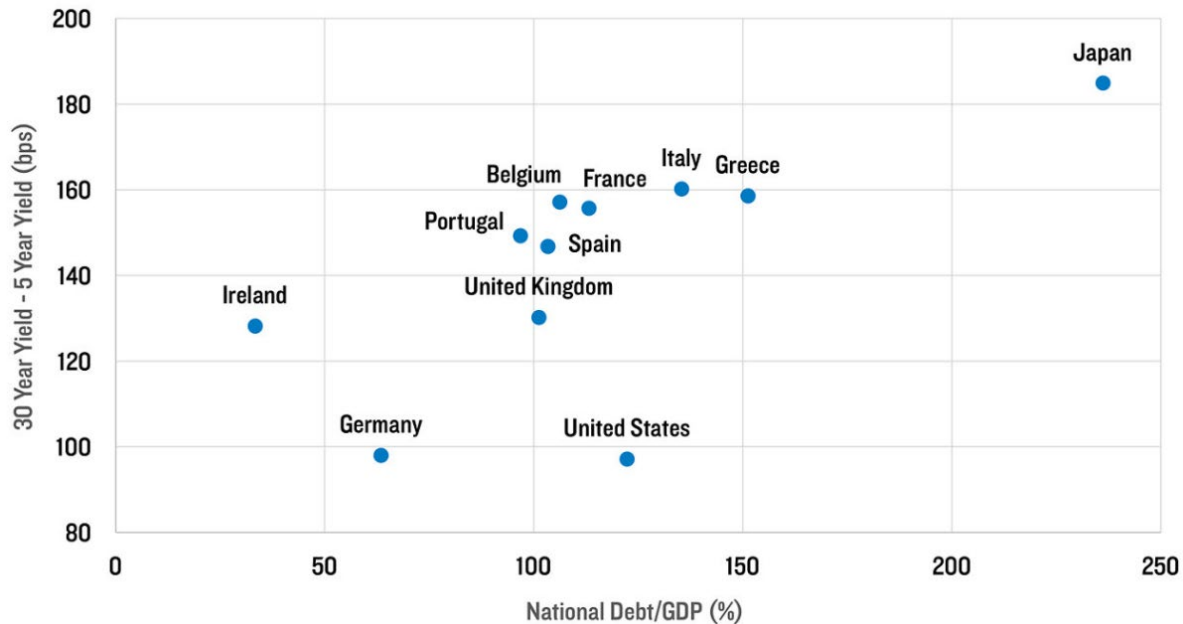
Moreover, the latest economic data are holding up better than expected, prompting ECB President Christine Lagarde to reiterate her message that the ECB is in a good place. Economic activity is solid and inflation is moderating, offering a sound backdrop for investors.⁶

Sovereign Debt Dynamics

Sovereign debt levels in the Eurozone surged following the global financial crisis and rose further during the pandemic. While progress in reducing these elevated debt levels has been uneven, several peripheral countries have made meaningful strides in fiscal consolidation. For instance, nations such as Portugal, Spain, and Ireland have reduced their debt-to-GDP ratios from pandemic highs, reflecting stronger growth trajectories and disciplined fiscal management. In contrast, France and Belgium continue to grapple with high debt levels and have yet to demonstrate significant improvement.

Germany, the EU's biggest economy, stands out with a debt profile that remains virtually unchanged since before the financial crisis, but its debt-to-GDP ratio is substantially lower than most of its peers and the U.S.

FIGURE 2: Developed Market Yield Curves and Debt/GDP



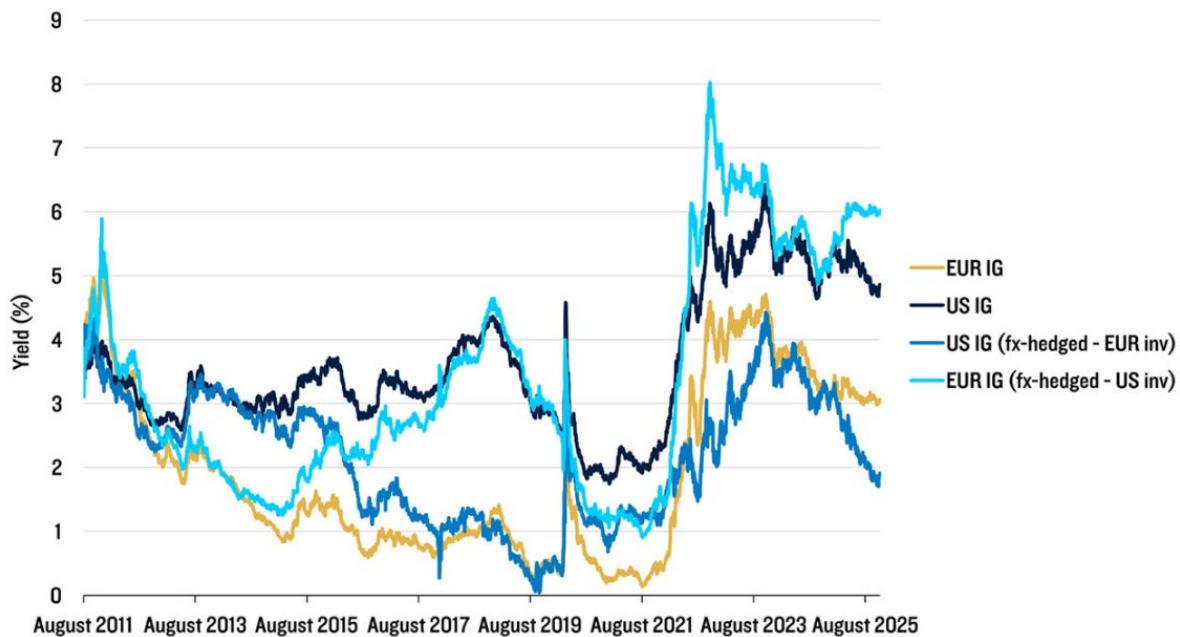
Source: Bloomberg, November 2025

Relative Value and Market Structure

For institutional investors, the relative value proposition of Eurozone bonds is compelling. The ECB's rate cuts have brought the policy rate down to 2%, while longer-dated debt yields have risen year-to-date, resulting in attractive valuations and leading to materially steeper yield curves than those observed in the U.S. On a currency-hedged basis, U.S.-based investors benefit from Europe's steeper yield curve, resulting in a substantial ex-ante yield pickup when hedging euro exposure back to U.S. dollars thanks to lower front-end rates in the euro area compared to the U.S.

Active management is important. Fiscal risks vary significantly across the euro area, with France and Belgium presenting less reassuring profiles compared to peripheral countries that have made progress on debt reduction.

In the corporate bond space, spreads are tight, but all-in yields remain attractive both historically and relative to other developed markets. In terms of return per unit of credit risk, European bonds offer similar spread to U.S. corporates, but generally with shorter average lives, and therefore less volatility.

FIGURE 3: Eurozone hedged bonds may offer an additional spread pickup for U.S. investors

Source: Bloomberg, November 2025

Asset Allocation and Portfolio Diversification

The implications for asset allocation are clear: diversifying bond portfolios regionally can enhance risk-adjusted returns over the long run. The combination of steeper yield curves, attractive carry opportunities, and institutional support mechanisms positions Europe as a standout destination in the global fixed income universe.

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2. PGIM, Fourth Quarter 2025 Market Outlook, October 2025
3. PGIM, The Case for Going Global, in Pictures, October 2024
4. PGIM, September 2025, France's reform paralysis adds to market uncertainty
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6. PGIM, ECB holds and signals confidence in 2% rate stability

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