



Another week, another deadline

Troubled times in UK politics

Key points

- The US economy continues to show strength, supported by job growth and the 'big, beautiful bill', though inflation is expected to rise as tariff price hikes are passed on to consumers.
- Bund yields are rising due to upgraded growth forecasts and fiscal easing, while demand for long-dated bonds declines. In the UK, gilts are under pressure following Labour's welfare reform climbdown, with fiscal challenges looming.
- Japanese long-dated bond yields remain volatile due to excessive issuance amid weak demand, raising concerns about debt sustainability. Globally, credit markets are tightening, but caution is advised given limited compensation for risks.
- Steeper yield curves and a softer dollar are dominant themes, though a short-term US dollar rally is possible. Curve trades are viewed as the best macro opportunity in terms of risk and reward.

London, 11 July 2025: Treasury yields were little changed during the past week, with markets trading in relatively listless summer conditions. The July 9th Trump tariff deadline came and went, with the administration announcing a new 'final' deadline on August 1st, by which time trade deals need to be concluded.

Trump has vowed there will be no further extensions to this date, but for the time being, it seems that investors are tending to look through the hyperbole coming out of the White House. In this context, it won't be a surprise to see the can kicked down the road once again, when we get to the end of the month.

Last week's US jobs report pointed to the ongoing health of the US economy. The passage of the 'big, beautiful bill' is also viewed as growth supportive into 2026. However, we are expecting to see some softer data prints over the course of the summer.

Inflation is also expected to increase, as tariff price hikes get passed on to consumers, though the sense is that this is yet to occur, and this could mean that next week's US CPI report remains relatively benign. This being the case, we fully expect the chorus of calls from the Trump administration for the Fed to lower interest rates to continue to grow louder over the next few weeks.

We can see how this can support shorter-dated yields. Prospects for the next Fed Chair being selected on the basis of installing a compliant individual who will deliver the rate cuts which the President is calling for can also be supportive of 2-year maturities. This same narrative has the potential to unnerve longer-dated bonds.

However, it also seems clear that issuance will continue to skew shorter, as debt levels increase, with the US Treasury adopting a 'bill and chill' issuance policy.

In the Eurozone, bund yields have been edging higher on the back of upgrades to growth forecasts, as markets continue to digest the extent of planned fiscal easing across the EU. As well as mitigating the need for monetary easing, this policy initiative will be adding materially to supply over the next several years.

Yet this is coming at a time when demand for longer-dated bonds appears to be continuing to wane. Upcoming Dutch pension fund changes have been spoken about in this context and it is noteworthy to reflect that a segment of the market that had been responsible for a material volume of long-end demand is now poised to turn a net seller.

With this being the case, we see a case for long-end curve steepening in the EU, in line with moves we expect in the US, even if the German fiscal position continues to remain considerably healthier than is the case in the US.

In the UK, gilts have continued to struggle in the wake of Labour's recent climbdown with respect to welfare reform. Ironically, it may be that it was the negative market reaction as Reeves fought back the tears in the House of Commons last week that has been the catalyst for her to keep her job – at least for the time being.

Yet, as it now dawns that Reeves (or her successor) will need to balance the books in the autumn Budget, so it appears that prior promises on income tax, VAT and the 'triple lock' on state pensions will all need to be up for debate.

Meanwhile, the bulging UK welfare crisis is exemplified by the fact that the state-funded Motability scheme is set to account for around 25% of all new UK car registrations in the course of the current year. There was a time when this scheme helped provide access for vehicles for those with profound disabilities, yet more lately eligibility criteria appear to have been subverted so that minor injuries such as constipation or tennis elbow seem to qualify!

As a result, Motability has risen to become the number one issuer in the UK corporate debt market, representing an off book contingent liability on the UK state, and not even showing up in UK debt statistics. In this context, it may not be surprising to find that some of the NGOs that Motability is supporting are the groups which have been most vocal in persuading Labour MPs to revolt against Labour's proposed welfare reforms.

In Japan, long-dated yields have remained volatile, as the Ministry of Finance continues to issue too many longer-dated bonds at a time when there is little demand for this sector from domestic investors. We expect this error to be corrected over time.

However, we would caution Japanese policymakers that a laissez faire attitude to the level of long-dated yields can end up feeding into more broad-based concerns that Japan is facing issues with respect to its debt sustainability.

Inviting such concerns would represent a spectacular own goal and noting how proficient Japanese authorities have been in terms of Yield Curve Control in the past, so would seem that this is not a problem that would be difficult to address.

Ultimately, issuing authorities should understand that if there is no demand for 30-year bonds, then perhaps issuance of long-dated securities can be scrapped altogether.

In FX, the dollar has been relatively rangebound. The Brazilian real suffered on the back of a 50% tariff threat coming from the US. Additionally, the US has been suggesting additional tariffs for Brics countries, if they adopt policies towards the US that the Trump administration determines as hostile to its own interests.

Meanwhile, credit markets have continued to gradually grind tighter. With recession risk at bay and markets looking through potential risk events, we are at a seasonal point where investors will look to embrace a summer of carry. Market technicals remain strong and it seems difficult to stand in the way of this.

However, we remain cautious in terms of adding to overall market beta at a time when there is limited compensation, should the macro backdrop suddenly begin to sour.

As our thinking has evolved over the week, we have added to duration exposure at the front end of the US curve, with a corresponding short position added at the long end of the euro curve.

Looking ahead

We may think that once next week's US CPI report is behind us, so the second half of the month promises to be relatively quiet. With the US Budget in the rearview mirror and only the next FOMC on 30th July and US tariff deadline on 1st August to focus on, it is tempting to think that summer market conditions may persist for a time, absent any new and material shocks.

It strikes us that few global investors and allocators who we are currently meeting with are expressing strong convictions, with the two dominant themes being those relating to steeper curves and a softer dollar. Although we are wary of adopting positions in line with a consensus, we feel that both trades are justified over the medium term. In many respects, these two positions are relatively correlated.

Yet, in the near term, we think that if there is a reversal, there is more scope for a short-term counter-trend US\$ rally than there is a move to a much flatter yield curve. The curve view would be more vulnerable if both growth and inflation surprise materially to the upside, though in the short term we would see this as relatively unlikely. Consequently, we believe that curve trades continue to offer the best macro opportunity with respect to risk and reward.

Returning to the topic of the UK, it does seem rather depressing that we may need Nigel Farage to win an election in four years' time, before we can get on top of the benefits crisis. Maybe we will all have signed up to receive a subsidy by then....

Contact:

Lydia Cambata
lcambata@bluebay.com

About RBC BlueBay Asset Management

RBC BlueBay Asset Management ("RBC BlueBay") represents RBC Global Asset Management outside of North America and is an active asset manager with expertise across fixed income, equities and alternatives.

RBC BlueBay's solutions-driven approach means it endeavours to empower clients with the knowledge they need to help shape their investment decisions. It works and evolves with clients, creating and customising investment products that meet their needs.

Responsible investment is embedded across RBC BlueBay's business. This means it is not just an investment focus but is also ingrained in its client service experience and work to deliver solutions that support real-world impact.

The information contained in this email has been sent by a member of the RBC Group ("RBC BlueBay"). This email is confidential and may be privileged, and does not constitute a request, offer, recommendation or solicitation of any kind to buy, subscribe, sell or redeem any investment products. Unless expressly indicated to the contrary, this email does not constitute an offer or acceptance of contract, or indicate an intention to enter into legal relations. RBC BlueBay cannot accept responsibility for the completeness or accuracy of this email or its attachments. Unauthorised copying, disclosure, modification, and/or distribution of this email may be unlawful. If you have received this email in error, please notify the sender immediately and delete it from your system. RBC BlueBay may monitor email communications in accordance with applicable law and regulations.

RBC Global Asset Management (UK) Limited (RBC GAM UK), is a Royal Bank of Canada Business which is authorised and regulated by the UK Financial Conduct Authority, a registered adviser with the US Securities and Exchange Commission and a member of the

National Futures Association as authorised by the US Commodity Futures Trading Commission. Registered office 100 Bishopsgate, London EC2N 4AA, registered in England and Wales number 03647343. All rights reserved.