



A 'cold' moment for Trump

Expect the unexpected

Key points

- President Trump has expressed frustration with Fed Chair Jerome Powell over interest rate policy, raising concerns about the Fed's independence and potential market impacts, including a steepening yield curve.
- US inflation remains moderate but could rise due to tariffs. The Fed is unlikely to lower rates immediately but may ease later in the year. Global central banks, including the BOJ and Bank of England face challenges in balancing growth and inflation.
- Japan faces political uncertainty and economic softness due to trade tensions, while the UK struggles with weak growth, rising inflation, and political instability. In Europe, political risks are increasing, particularly in France and Germany.
- Looking ahead, the coming week should see increased focus around trade negotiations. While the White House is suggesting deals are imminent, discussions with several large trading counterparts remain stalled.

London, 18 July 2025: Speculation with respect to Trump and Fed Chair Powell proved the major talking point over the course of the past week. The US administration has been growing increasingly frustrated that the Fed has not been lowering interest rates more aggressively over the past several months. In the past week, this saw the President sharing a draft letter calling for Powell's dismissal on trumped up charges relating to cost overruns on the refurbishment of the Fed DC headquarters, which have been dubbed 'Powell's Palace'. Although the White House subsequently rowed back on the idea that it had imminent plans to dismiss the Fed Chair, it seems that the administration is likely to make Powell's position as uncomfortable as possible, as it continues to ratchet up pressure over the weeks ahead.

Meanwhile, the assumption that Trump will seek to appoint a new Fed Chair, who will deliver the rate cuts he wants to see, has helped steepen the yield curve. Shorter-dated maturities have rallied, just as longer-dated yields have moved higher, as markets express concern with respect to the Fed's independence and its inflation mandate.

Medium-term inflation concerns have seen breakeven rates on US TIPS rise over the past several weeks. Nevertheless, the June CPI report was relatively benign, with core prices up 0.2% month-on-month and up 2.9% year-on-year. Thus far, there has been limited evidence of exporters passing on higher costs to consumers, notwithstanding the US recording USD26 billion in tariff revenues during the past month, compared to just USD6 billion a year earlier.

Over the coming months, we expect inflation data to rise by approximately 1% from current levels, as exporters rebuild their margins. However, there remains plenty of uncertainty surrounding this. This is not just because tariff rates are still very much open to debate, but also as it is unclear the extent that producers may be able to achieve efficiency savings or pass cost hikes on to consumers in other markets, in order to limit the inflationary pass-through to US consumers.

We think it is very unlikely that the FOMC will act to lower rates at the end of this month. However, on the assumption that there is more clarity with respect to tariff rates and inflation by September, we continue to think that it is probable that Powell will be inclined to deliver a 25bps easing at that time, with a further move to come at the end of the year.

This view remains broadly in line with what markets are expecting and so we have little conviction in expressing directional views on interest rate duration. Where we continue to maintain more confidence is with respect to curve shape, where we see further steepening pressure in the months ahead.

We think that cash rates will be coming down in the coming 12 months and that this should support the front end and the belly of the US curve. The outlook for longer-dated bonds looks much more challenged, given fiscal concerns.

Moreover, we seem to observe limited appetite or investor requirement for long-dated government bonds, on a global basis. Suddenly, it seems few investors are expressing much need to own 30-year bonds.

Increased debt issuance is a theme on both sides of the Atlantic for the foreseeable future, as bulging government deficits push debt levels higher. We expect that debt management agencies will skew issuance towards shorter-dated maturities, shortening the profile of government debt with a growing proportion of financing via Treasury bills.

Yet, even with proactive steps taken to match supply to investor demand, we still see curves steepening to reflect increased term premia. We have also seen in the example of Japan how steep yield curves can become, when policy failure fails to account for changing investor demand. In this respect, we see the 10/30 slope in Japan as structurally far too steep, in excess of 150bps, when compared to a level of 50-60bps seen in the US and Eurozone today.

This weekend sees Upper House elections in Japan. There is a risk, which we would place around 65%, that the LDP will lose its majority and be forced into a coalition. Prime Minister Ishiba may need to stand down to take account for this poor showing, though this may not occur in the very short term, given that trade discussions with the US are at a critical point ahead of Trump's 1st August deadline. Failure to lower tariffs for auto producers is seen weighing on Japanese GDP and softness can already be seen in the past two months of disappointing Japanese export data.

These concerns mean that the BoJ looks to be on hold, notwithstanding firmer inflation, until October, or more likely, January next year. This narrative has been weighing on the yen. Meanwhile, a push to support consumers with fiscal measures, in the wake of higher prices, is weighing on JGB yields.

Economic problems also continue to mount in the UK. Inflation and wage data have added to concerns over the past week, even as growth weakens. Meetings with UK policymakers suggest to us that the Bank of England remains very eager to cut rates, on the basis that they expect inflation to fall as economic slack increases. However, we think this assessment overlooks a general de-anchoring of inflation expectations in the UK, which we think we have witnessed over the past couple of years.

With politicians in Westminster floundering around on how to balance the fiscal books, we think that tax hikes and spending cuts will also weigh on the forward-looking outlook. On this basis, we remain structurally negative of gilts and the pound, though maintain no active risk in the UK for the time being.

Elsewhere in Europe, Germany has voted down the EU Budget, though we still expect this to pass by the end of the month. In France, Bayrou's proposals to cut two days of public holiday in France have been met with the derision and contempt that one might expect. Political risks in the country are rising again and we

could be getting towards the point where Le Pen triggers a vote of confidence, which collapses the government and leads to new elections.

However, it is possible that this is delayed until later in the autumn, given that the summer recess is now just ahead of us. On this basis, we still think there is some time to be patient, before we enter short France trades.

In FX, the past week has seen a retracement rally by the US dollar. In part, we think this is explained in the wake of short-term positioning, which has skewed overly dollar bearish in the past month. This is a factor that has seen us limit short dollar exposures of late. We continue to see asset allocation shifts ahead, which can lead to a weaker dollar. This could be exacerbated by a dovish Fed delivering rate cuts and, in this context, were Powell to be ousted by Trump, this could lead to a more rapid shift to a weaker greenback.

Yet at the same time, many will continue to highlight the strong US competitive position in critical sectors, such as AI. A combination of tax cuts and rate cuts in 2026 could also create a backdrop for robust economic growth. In this respect, calls for an end to secular US growth exceptionalism may prove to have been premature. In this case, we think that shorting the dollar requires discipline with respect to entry levels on specific crosses and, in this context, we would target an entry around 1.15 for the euro versus the US dollar.

Credit markets remain firm on the back of strong technicals, with respect to investor demand. IG indices are now at levels at which further gains are likely to be limited, but constructive sentiment could still point toward some compression in spreads, with higher yielding credits outperforming, on a relative basis.

We would also observe that demand from insurance investors in credit tends to be yield sensitive. On this basis, if underlying government bond yields push higher, we see support for corporate credit, even as spreads continue to converge.

Similarly, this support could wane, were absolute yield levels to decline materially. All of this said, we are content to keep directional risk levels in credit at relatively low levels. Focussing on relative value trades between sectors and issuers appears much more appealing at this current point in time.

Overall risk positioning continues to be muted, and we note that 1st August could well be a risk event, which could trigger some volatility – especially given that many have given up trying to pre-empt what policy gets delivered.

Looking ahead

The coming week should see increased focus around trade negotiations. The White House is suggesting a number of deals are imminent. However, discussions with a number of large trading counterparts remain stalled for the time being.

The Trump administration is in an ebullient mood, on a sense that it is showing signs of winning the trade war it started in a global economy, which operates a more of a 'hub and spokes' model, with the US at the centre of everything. So, it seems like the TACO narrative has been replaced by an assessment, that ultimately, it will be the rest of the world, not the US, who 'chickens out', with respect to ongoing negotiations. On this basis, we see scope for volatility around the August 1st deadline, should the benign status quo suddenly be called into question.

Meanwhile, as a Chelsea fan, it was pleasing to see the side crowned as FIFA World Club Champions for the next four years, with Donald Trump on the pitch, enjoying his part in the celebrations. As team talisman, Cole Palmer, collected his trophy, it was a satisfying 'cold' moment, in what has been a hot, sticky summer.

But perhaps it also serves as a timely reminder to expect the unexpected. After all, few would have imagined this result when The Blues were on a sad, winless run just a few short months ago.

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