



Market Commentary

Summertime optimism, before the start of a new season

The great Don in Chief

Key points:

- A benign CPI report supports expectations of a 25bp Fed rate cut in September, with risks leaning toward more aggressive easing if hiring weakens and inflation remains subdued. Curve steepening and short-term rate cuts are seen as viable without significant inflationary pressure.
- Nvidia's agreement to export chips to China under a 15% tax raises legal and economic questions, while Trump's trade strategies highlight the dominance of power politics. Prospects for monetary easing and tariff revenues may help mitigate the US Federal deficit, though it remains above 6% of GDP.
- US curve steepening trades and corporate credit spreads continue to perform well, with opportunities in Euro financials and CoCos. A retreat in recession risks has bolstered risk assets, while short US dollar positions are gaining traction amid potential global asset allocation shifts.
- Europe faces rising deficits due to military spending and energy sector bailouts, while the UK struggles with high inflation, weak productivity, and fiscal challenges. Sterling may reflect structural weaknesses as hopes for further BOE rate cuts fade.

15 August 2025 (London) – Short-dated US Treasury yields were supported by a relatively benign US CPI report this week, which did little to change market projections that the Federal Reserve will resume cutting interest rates at its September FOMC meeting.

A dip in headline inflation to 2.7% suggests that headline PCE inflation is now broadly consistent with the Fed's definition of price stability, even if an acceleration in core price inflation to 3.1% year-over-year was a reminder that Powell and colleagues cannot afford to be too complacent on perceived upside inflation risks, as tariff costs are passed onto consumers.

Consequently, a move of 25bp in September followed by similarly sized cuts in the following couple of quarters appears like a reasonable baseline assessment of the likely path for US rates. That said, we think risks are tilted towards more aggressive policy action – particularly if the next payrolls report confirms the recent trend weakening the pace of hiring and the next inflation print ahead of the September FOMC also remains benign.

An announcement from the White House that Nvidia may be permitted to sell advanced chips to China, subject to a 15% tax on revenue, raised a number of interesting questions this week. From a Constitutional perspective, the US Federal government is not empowered to levy tariffs on US firms exporting goods overseas.

However, in the case of Nvidia and AMD, it appears that there has been a voluntary agreement in order to bypass restrictions that the White House has previously imposed in terms of this trade, from a national security perspective. Maybe there is a sense that with Trump, money talks louder than anything else. But this also opens questions of where this administration may go next in pursuit of dollars to bring into its coffers.

From this perspective, we wonder if the tariff rates recently agreed (or imposed) will ultimately be squeezed higher, in the absence of a strong pushback. There has been a sense in which some have likened recent trade negotiations to a mob-based shakedown, with Trump the great Don in Chief.

This may be an unfair characterization, but what has become clear is that economic textbooks need to be re-written. Trump has shown how a dominant economy can effectively win a trade war versus lesser economies, even if the net result is detrimental to global GDP.

This won't be a fashionable view within the liberal elite. However, this idea seems one worth reflecting on, as the socio-economic ideals of our age retreat from an age of woke liberalism towards a world dominated by more aggressive power politics.

Notwithstanding some near-term softness in activity data, prospects for monetary easing, tax cuts and deregulation have all contributed to an upgrading of 2026 US growth forecasts. These prospects, in conjunction with ongoing measures to raise tariff revenues, may also help mitigate the US Federal deficit somewhat, in the coming year.

However, the Federal deficit still seems set to exceed 6% of GDP in the year ahead, unless materially lower interest rates and an overt policy to skew new issuance towards Bills and shorter maturities is able to engineer a more significant reduction in US borrowing costs.

Growth in Stablecoins will undoubtedly create additional demand for Bills, enabling the US Treasury to justify an ongoing shortening maturity profile of outstanding debt. However, interest rate setting policy will be central to any more material reduction in the US Federal deficit.

Consequently, monetary policy decisions will also play a decisive role in determining what is possible in terms of the future path of spending and taxation. This has made the narrative of Fiscal Dominance a prevalent one in the US, especially given concerns at Presidential attempts to interfere with Fed policy.

Federal Reserve independence has been an important cornerstone on which financial market strength and confidence has been founded. Although this is noted in the White House, there is a concern that the Federal Reserve is not held properly to account, and moreover, that it appears closed-minded to new ideas and thinking in a rapidly changing and evolving US economy.

In this context, one recent idea we have discussed with those in the administration is whether inflation is actually sensitive to where cash rates are set, or whether the 10-year yield is a much more important driver, in this respect. If it is the latter and not the former, there is an argument that short-term interest rates can fall materially without having much of an inflation impact, if 10-year yields are not declining by much at the same time.

Noting that 10-year yields have largely tracked sideways in this rate-cutting cycle to date, this could suggest further material easing can be delivered, without an inflationary passthrough, as long as this just manifests in a steeper curve.

With such thinking helping to shape the direction that Trump is eager to see the Fed move towards in 2026, so we continue to hold a view looking for further curve steepening on a 2/30 basis. Here we think that the spread can widen from around 110bp today, to a level in excess of 150bp by the end of the year.

Otherwise, 10-year yields have remained in their recent trading range, and we continue to see greater opportunities in curve trades and relative value trades than in outright directional positions in fixed income markets, for the time being.

A retreat of recession risks has helped to support risk assets, which have also been boosted by robust projections for corporate earnings. This has continued to see demand for corporate credit pushing spreads tighter, though we would note that this technical could turn, were absolute yields levels to decline, as this would see a drop off in demand from yield sensitive buyers.

Also, we don't think spreads can be overlooked and so we have continued to sell and rotate out of names with very little further upside, towards those where more compression appears possible. From this point of view, we remain constructive on Euro financials and more broadly on the outlook for Euro spreads relative to those in the US market.

In bank CoCos we have witnessed further outperformance, but this is fully justified in our opinion, and we see scope for this segment of the market to continue to rally as risks around the asset class continue to be reassessed.

Elsewhere in Europe, the backdrop remains relatively quiet during the summer holiday period. The upcoming Trump / Putin summit in Alaska will be keenly watched for a possible breakthrough with respect to the Ukraine conflict.

However, our sense is that Kyiv will be reluctant to cede much territory, and Europe also remains committed to the idea that Russia should not be rewarded with gains as the result of its policies of aggression.

Increasingly, Ukrainian support costs are falling onto Europe and as fiscal spending in the military sector ramps up, so larger deficits have been weighing on bond yields. Meanwhile, a rescue rights issue of Danish wind generator, Orsted, majority owned by the Danish government, has been another example in the past week of how Europeans are having to pay up, largely as a result of Trump's policy changes.

In the UK, labour market data showed that, despite a material slowdown in the pace of hiring, wage growth remains robust, in line with our thesis that inflation expectations have de-anchored over the past couple of years. With wages growing by 5.0% in an economy devoid of any productivity growth, so we think that rising costs will be passed on in terms of higher prices, sustaining inflation around 4%, even as the economy struggles with negligible economic growth.

Gilt yields have continued to underperform other markets, notwithstanding monetary easing by the Bank of England and in this context borrowing costs are an ongoing source of concern to the UK government.

There is a growing realization that tax hikes alone can't address the fiscal woes in the UK if these policies damage growth and push inflation higher. It will be imperative to rein in runaway government spending before it is too late.

Rachel Reeves will face tough choices in the upcoming Budget this autumn and one only hopes that she can solicit and follow some better advice than she seems to have received from colleagues within the Treasury and Labour Party circles, to date.

We retain a negative view on UK assets, but don't think that Gilts are an attractive short at the time being due to valuation. However, should Sterling continue its recent rally as hopes for further BOE rate cuts fade, then the Pound may be an attractive way to express a structurally negative view on the dynamics within the UK over the months to come.

Looking ahead

The second half of August is relatively quiet in terms of the data calendar. The Jackson Hole meetings hosted by the Fed will be a focal point, but these are still a couple of weeks away. In this context, there are reasons to look for the week ahead to be one of the quieter ones of the year so far.

This weekend marks the start of the new Premier League season, which is often a moment of hope and optimism for all fans alike (apart from those from Newcastle this year, perhaps). Financial markets also seem to be in a moment of some hope and optimism, away from government bonds at least. But just like football, it is intriguing to wonder how long this optimism will last.

When it comes to football, it can be quite telling that by mid-September, most Fantasy Football teams have been scrapped and forgotten and all of a sudden, betting markets will be alive with the question in terms of which manager will win this year's sack race?

Let's enjoy the sunny conditions for now as it may be a question of when, not if, clouds emerge on the horizon once more. As for the football, here's hoping that it is 'Palmer again' but in a Chelsea shirt this year around...

Notes to Editors

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