



The Fed and the Fall

Is Trump walking on (autumn) sunshine?

Key points:

- US Treasury yields remained rangebound this week after the Fed's 25bps rate cut, with Powell's decision emphasising data dependency, and dissent from Stephen Miran.
- Lower inflation projections in the Eurozone support euro duration, though bund rallies may be limited by bond supply, and French OAT spreads face fiscal and political challenges.
- The BoE holds rates steady, with potential cuts dependent on inflation easing and fiscal tightening, while political uncertainty weighs on the pound.
- The BoJ meeting overnight saw the committee hold rates at 0.50% but two members dissent for a change to 0.75%. With core inflation still running at 3.3% year-on-year, some members are starting to openly voice concerns that the BoJ is behind the curve.
- The euro hit a four-year high against the dollar ahead of the FOMC meeting this week, while credit markets stayed stable despite isolated concerns in US subprime lending.

London, 19 Sept 2025: US Treasury yields remained largely rangebound over the past week as markets digested the outcomes of the latest FOMC meeting. The Committee delivered a widely anticipated 25bps rate cut, leaving the effective Fed Funds rate just above 4%. Powell's commentary offered little in the way of surprises, with a continued emphasis on data dependency and acknowledgment of downside risks to the employment mandate in the months ahead. However, with a new Fed Chair set to take over in 2026, the weight of SEP projections and economic forecasts appears increasingly diminished at this stage.

One notable development was the dissent from new FOMC member Stephen Miran, who advocated for a more aggressive 50bps cut. This divergence highlights the growing tension between the Fed's policy stance and the White House's preferences, as Miran's alignment with the administration raises concerns about the potential erosion of the Fed's independence.

Powell's resistance to political pressure underscores this dynamic, yet the perception of a fault line between the Fed and the executive branch will only be exposed further. It leaves the current environment in which rates rally modestly, curve a little steeper and trending weaker dollar. All are relatively constructive for risk assets.

Euro yields have followed moves in Treasuries over the past week. In recent days, we have been inclined to revise our projections for Eurozone inflation somewhat lower into the year ahead, and this is seeing us turn a bit more constructive with respect to euro duration. Fiscal deployment remains somewhat slow across Europe, for all of the plans previously announced to increase spending on defence and infrastructure.

Meanwhile, a stronger euro can act as a deflationary force, especially as Eurozone tariffs have been declining, not rising, as is the case across the Atlantic. Any rally in bunds may be constrained

by abundant bond supply and waning duration demand coming from Dutch pension funds. That said, it may appear, for the time being, that the risk/reward favours somewhat lower, not higher, German yields.

French spreads have remained stable around 80bps in 10-year OATs over the past week, with the appointment of Lecornu as Prime Minister helping to dampen volatility for now. However, concerns persist regarding the feasibility of reaching consensus on fiscal tightening measures in the context of the upcoming Budget.

Fitch recently downgraded France's credit rating from AA- to A+, and it appears likely, if not inevitable, that Moody's and S&P could follow suit in their forthcoming reviews over the next couple of months, particularly if fiscal consolidation efforts remain absent. While the French sovereign rating is still five notches above Italy's, the trajectory of the two countries remains divergent.

This raises questions about whether OATs can trade significantly better, especially if both the French public and government continue to resist market pressures for greater fiscal discipline. Against this backdrop, it seems plausible that OATs will remain rangebound, though they could experience further widening if the government were to collapse, potentially leading to new Parliamentary elections.

Looking further ahead, the Presidential elections in 2027 are likely to be far more consequential. As we progress through the coming year, it is difficult to envision significant outperformance in OATs unless there is a notable shift in opinion polls, indicating a viable path to victory for a centrist candidate. This political uncertainty, combined with fiscal challenges, underscores the constrained outlook for OATs in the near to medium term.

UK unemployment and inflation data were broadly in line with expectations. For now, the Bank of England maintains policy on hold. We think that Bailey and colleagues may want to cut rates if they can, but this will be contingent on prices moderating or a more rapid cooling in job numbers. Next month is likely to see another rise in inflation due to base effects.

However, if data in Q4 can improve and the Fed lowers rates more aggressively, then the BoE could yet decide to act in December, particularly if the government announces a material tightening on the fiscal side in order to address the shortfall in the OBR fiscal estimates. We continue to think that stagflation risks are present in the UK, and so it will be difficult for the BoE to act.

Meanwhile, political risks keep us cautious with respect to the pound. Certainly, were Starmer to suddenly exit at some point, we think this could lead to material pressure on UK assets and FX, on fears of a harder leftwing alternative.

The BoJ meeting overnight saw the committee hold rates at 0.50% but two members dissent for a change to 0.75%. It seems with core inflation still running at 3.3% year-on-year, some members are starting to openly voice their concerns that the BoJ is behind the curve. However, it seems plausible that the BoJ may wish to wait for greater certainty surrounding Japan's political leadership, following Ishiba's departure.

Should the LDP leadership contest deliver a "business as usual" candidate, such as Koizumi, this could pave the way for a potential rate hike as early as October – a scenario that could also see the yen strengthen further. A renewed commitment to curbing inflation would likely provide support to the long end of the curve, as markets recalibrate expectations. For now, Koizumi appears to hold a lead in polls ahead of the October 4th vote, with his closest rival, Takaichi, representing more of an unknown quantity for markets.

In FX, the euro traded to a four-year high versus the USD ahead of the FOMC meeting. Following a 10% drop in the value of the dollar in March and April, the greenback has traded in a sideways pattern over the summer. Consequently, active risk-taking has diminished markedly in FX over the past few months, with momentum-based models failing to deliver any strong signals.

However, a breakthrough in support may see renewed interest with respect to the next leg of dollar weakness. Looking at movements in US Treasury and euro yields over the past few weeks, it has

felt that such a move may have been overdue, as carry in the dollar was eroded. Federal Reserve rate cuts may now further cement this.

Meanwhile, it appears there is increased interest in hedging US equity exposure. Consequently, we think that the euro could sustain a rally above USD1.20, and elsewhere, we think there is reason to expect the yen to push towards 140 versus the dollar. We have continued to add to short USD exposure, having already positioned for this move. Although many investors we meet may express sympathy with a short dollar view, the truth seems that this is not something expressed with much conviction by many at this juncture in time.

Credit markets continued to trade well driven by continued positive flows and perhaps slightly underwhelming primary market activity in what is seasonally one of the busiest periods. Spreads are back close to multi-year highs and show no sign of relenting. French credit has behaved surprisingly well pretty much ignoring the sovereign downgrade last week.

The stable backdrop has not been impacted by warning signs in more troubled areas of credit: the bankruptcy of Tricolor Holdings, a US auto subprime lender, raised some eyebrows about collateral practices and delinquency trends in lower-credit tiers but is being viewed as a one-off idiosyncratic event.

Credit markets remained broadly stable over the week, with sovereign and corporate spreads showing little movement. Notably, there were few detractors over the period, reflecting a relatively calm market environment and supportive risk sentiment.

Looking ahead

Now that the September FOMC is behind us, the focus for markets will turn back towards the data. However, the next couple of weeks are relatively quiet on that front, ahead of the September US labour market report, due on October 3rd.

In the wake of the Fed's moves, a lot will hinge on upcoming jobs and inflation prints in the weeks to come. Meanwhile, we will be on alert for the possible announcement of a new Fed Chair to replace Powell in 2026. It appears that interviews may be ongoing, and there are suggestions that more candidates are being assessed at a point when we thought that Trump had already narrowed the field.

In this respect, we get a sense that the administration is seeking to appoint a candidate seen as a monetary policy heavyweight who will be respected in financial markets. Yet, at the same time, it is clear that Trump wants and expects to install a new Fed Chair who will follow his agenda first and foremost.

Elsewhere, it is striking to reflect that today marks the vernal equinox, the traditional start of fall. With the leaves turning, the landscape around us will look very different in a few months. It appears that we are at a point marking a renewed fall in US interest rates. The question is where this, and the upcoming events of the next couple of months, will leave us by the end of 2025.

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