RBC BlueBay Asset Management

Marketing communication

# Shutdown blame game

## Some politicians are enjoying a moment in the sun

**Key points:**

- US yields declined over the week and reversed prior moves, in the absence of new catalysts to drive price action.
- Labour market softness and rising unemployment risks may prompt the FOMC to cut rates later this month.
- Eurozone CPI matched expectations at 2.2% year-over-year, while political uncertainty continues in France and the UK.
- The LDP leadership election is imminent in Japan and regardless of the outcome, a new Prime Minister could usher in a more assertive policy direction.
- A prolonged US government shutdown could heighten economic uncertainty and market volatility, increasing the likelihood of further policy easing.

**London, 3 October 2025**

US yields have declined over the past week, largely reversing moves seen in the week before, as most markets continue to sit in a trading range in the absence of a strong new catalyst to drive price action.

The US government shutdown means that a number of economic releases will be delayed, although with respect to the labour market, Wednesday's ADP survey release marked a surprise to the downside with a 32,000 contraction in jobs.

It is notable that 6-month payments made to those laid off in the DOGE job cuts earlier this year are now starting to expire. This could explain some additional softness in recent jobs data.

Meanwhile, Republican moves to fire workers in roles deemed unnecessary to the administration's priorities in the context of the shutdown could also contribute to an upcoming tick up in unemployment over the next couple of months.

Consequently, we think that the FOMC will be inclined to cut rates again at the end of this month, on the basis that risks to the downside are outweighing those to the upside, at the current point in time.

Elsewhere, risk assets continue to trade with a strong tone. A deal enabling employees to sell shares in OpenAI has driven the company's valuation to USD500 billion, reaffirming the appetite for all things linked to the AI theme. Meanwhile in credit, at 75bps, the US IG index spread is at its tightest valuation versus Treasuries at any point over the past 20 years.

That said, this partly reflects the intrinsic cheapening of government bond collateral at a time of abundant supply. In this case, corporate bonds trade 115bps over swaps, having traded inside 100bps during much of 2021, and at similar levels at the end of 2018.

On this basis, there is still an argument that corporate index spreads still have 15-20bps of room to tighten versus swaps, even if government spreads might suggest that valuations are already too compressed. In this respect, we struggle to find too much that excites us in credit, though we are happy to remain modestly long in spreads on the basis that strong technicals can continue to drive some spread compression.

In the Eurozone, CPI data was in line with expectations at 2.2% y-o-y. Despite further talk around more rapid deployment of defence fund spending, overall economic activity remains relatively muted across the region for the time being.

Further protests in France have done little to help drive a political breakthrough with respect to the Budget that Lecornu is trying to put together. However, we continue to sense limited appetite for fresh Parliamentary elections, so expect some compromise to prevail.

OAT spreads continue to trade in line with Italian BTPS, around 80bps in 10-year maturities, which we feel is probably close to fair value at the current time. That said, we continue to feel that the balance of risks could still favour wider spreads, should Lecornu be forced to step down.

In the UK, politics have also remained in focus, with Starmer and Reeves seeking to attack the Reform Party, as Labour's standing continues to slide in the polls. Were an election to take place right now, there is every indication that this would produce a victory for Nigel Farage's political party, per models on electoralcalculus.co.uk.

Meanwhile, 10-year gilt yields remain above 4.7% on fears that a tax hiking budget and a weakening commitment to the OBR report do little to assuage fiscal debt concerns. In dialogue with policymakers, we continue to urge the Bank of England (BoE) to ease market pressures by immediately stopping QT, and for the DMO to issue fewer longer-dated bonds.

We have also been making the point that in continuing to issue more inflation-linked bonds at a time when the breakeven rate of inflation is above 3%, this appears a tacit admission on the part of the DMO (and the government by extension) that it doubts the BoE will fulfil its remit in getting inflation back to its 2% target.

Arguably, it would be better for confidence for the UK to materially shorten its debt profile, even going as far as buying back long-dated bonds and inflation-linked securities in exchange for shorter-term bonds and bills, if this can help mitigate concerns relating to debt sustainability and simultaneously lock in lower government borrowing costs for UK taxpayers.

In Japan, we await the outcome of this weekend's LDP leadership election to determine the identity of the next Japanese Prime Minister. Shinjiro Koizumi appears to be in the lead in the polls and were he to win the vote, we expect the yen and JGBs to rally somewhat.

Conversely, a victory for his opponent Sanae Takaichi could see JGBs and the yen under pressure, based on her past preference for tax cuts, which could add to debt sustainability concerns. LDP elections are known for sometimes having surprising results, and so it is possible that neither of these two ends up winning, behind closed doors.

However, we think that a new Prime Minister could set the stage for a more assertive period for policy in the country. Meanwhile, we continue to look for comments from the BoJ to support a narrative pointing towards a rate hike from the central bank at the end of this month.

Currency markets have remained broadly rangebound over the past week. However, gold prices have continued to climb on solid demand. Diversification away from the dollar can also be seen in digital assets, as well as physical commodities.

Although recent tech performance has supported US equities, helping to stabilise dollar demand, we think that global and EM stocks may be poised to outperform on a relative basis to the US. From this perspective, we still think we remain in a regime tilted towards a weaker dollar over the medium term.

We also see this supported by a more domestic bias in investor portfolios. Policymakers in the UK, Europe and elsewhere have been discussing how they can tax incentivise a greater share of investment in their domestic economy at a time of elevated domestic levels and muted domestic growth and investment. This also speaks to an asset allocation shift over time away from the existing reliance on US assets.

In sovereign credit, we have added exposure in Romania, having recently reduced our position size following a period of underperformance. On a valuation basis, we continue to look at Romania as extremely undervalued from a medium-term perspective and in a landscape appearing to offer few bargains across credit asset classes, a spread >350bps in long-dated bonds appears very appealing when the crossover index sits just above 250bps.

**Looking ahead**

The dynamics of a US government shutdown mean that macro investors are left in some limbo with respect to what economic data may be released and when. In many respects, it may appear that both Republicans and Democrats are eager to dig in, hoping to shift blame on their political opponents.

However, with the US starkly divided on partisan lines, it seems highly likely that any assessment on the part of voters is equally tainted by political bias. This can create a dynamic where both camps feel vindicated in their position and fear a cost in being perceived as weak. On this basis, a shutdown could drag on for some time.

It is also true that this period will be used opportunistically by some politicians seeking to make a bigger name for themselves and in this respect, it may appear that Hakeem Jeffries is enjoying his moment in the sun, having spent the past few years in relative anonymity as House minority leader.

Having seen a number of shutdowns before, financial markets appear relatively nonplussed by the dramas taking place in the US capital. However, we would infer that the longer any lockdown persists, the greater the potential disruption to services and the economy may be.

Moreover, inasmuch that this can create some near-term economic downside risks, one can only infer that the FOMC will be more likely, rather than less likely, to endorse additional policy easing.

Otherwise, the other implication of an extended shutdown is that it makes for a relatively foggy outlook, in which uncertainty can increase. This could lead to an increase in volatility at some point.

That said, it is perhaps also noteworthy that in a crowded schedule of policymaker meetings in Washington DC next week, none have been impacted – save for the risk that a couple of catch-ups may need to relocate to coffee shops (which actually will help save a lot of the time that is often taken up clearing through security in various Federal buildings).

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**About RBC BlueBay Asset Management**

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