



Prince of Peace?

Will Trump get his wish?

Key points:

- Yields in US fixed income markets remained steady over the week, as the government shutdown continues to limit economic data releases.
- Political instability has risen in France following Lecornu's resignation, with efforts underway to avoid new elections that could benefit National Rally. A downgrade of France's credit rating to A is expected shortly.
- In Japan, Sanae Takaichi's surprise election as LDP leader led to higher JGB yields, a weaker yen, and uncertainty due to her support for looser fiscal and monetary policies.
- Credit markets have remained stable, although the bankruptcy of First Brands has highlighted rising defaults in private credit, causing significant losses for some funds.
- Our meetings in Washington this week suggested the end of US exceptionalism may be overstated, if Fed independence remains intact and the FOMC implements modest rate cuts with the economy showing firm growth.

London, 10 October 2025: Yields in the US fixed income market were little changed over the past week, as the ongoing US government shutdown continues to restrict economic data releases. Yet in meetings with policymakers in Washington DC this week, the tone seems to be very much business as usual, and there is a sense that in many ways, much of what is currently being witnessed is largely performative.

With US military pay restricted from the 15th of the month, this may provide the catalyst to find a compromise towards the end of the month. However, politics in the US remains sharply divided on partisan lines, with the political base in both parties very much convinced that their own side should dig in and stick to their guns.

Aside from this, the broad takeaway from research meetings is that the US economy is in relatively robust health. With tax cuts, rate cuts and deregulation to come, there is an expectation that the economy can grow at, or above, 3% next year.

Although the outlook for job creation is weak, much of this has to do with the reversals on immigration, and in many respects the labour market feels pretty tight. Certainly, it seems that once-famed US standards of customer service have never been as weak. In this context, it is suggested that in the short term, the breakeven rate on jobs, which will keep the unemployment rate stable, could actually be as low as zero net jobs.

This could speak to some upcoming very low payroll prints, which could push some to believe that the economy is in trouble. However, were this to occur, then this will likely be a mis-interpretation and could offer an attractive entry point into a short duration trade.

With respect to inflation, there is satisfaction from within White House that it appears vindicated on a relatively modest inflationary passthrough from tariffs at this point. However, with core PCE at 2.9%, risks remain on the upside and inflation is likely to exceed 3% due to strength in goods prices and sticky inflation in services.

Research suggests that the biggest impact on prices to the imposition of tariffs may come in the 3rd and 4th quarters after their imposition, as their permanence leads producers to reclaim lost margins. Modest inflation in housing and lower oil prices have also helped contain inflation.

That said, it is becoming more noticeable that electricity prices are being bid higher on data centre power demand. But notwithstanding this factor, it is still the case that nobody we meet is expecting a further leg higher in inflation towards a rate up at 4%.

In this context, inflation is seen in a zone that is none too problematic, but one that may limit the speed at which the Fed seeks to bring interest rates back to their neutral rate. However, it is seen as likely that the FOMC will ease again at the end of this month.

Lack of data visibility adds weight to the idea of an insurance cut, in case the labour market is softer than anticipated. In this respect, many of the workers laid off by DOGE cuts earlier in the year may begin to show up in data in the next month, as 6-month benefit payments expire.

Moreover, in cutting rates in September, there was always an intent from the Fed to cut at least once more in this cycle, and with modest downside risks relating to the government shutdown, there is logic in doing this sooner rather than later.

With respect to the Fed, the process for selecting a new Fed Chair has been slowed up by putting 12 individuals onto a long list of candidates, and we may be unlikely to see an announcement before year end.

Those closest to the decision all seem to believe it is very probable that Scott Bessent will ultimately take the job, even if he has previously appeared to have ruled himself out of contention. A much lower probability is given to Kevin Warsh, then Kevin Hassett and Chris Waller in that order.

However, what seems more prevalent is the notion that the Fed will not be unduly swayed from political pressure coming from Trump. It is true that Trump himself really wants lower rates (which real estate developer wouldn't?) However, he really wants to avoid higher inflation and knows that this was a pivotal issue in the last election and may be key at mid-terms as well.

There is also a sense that Stephen Miran isolated himself within the Fed by pushing for such an aggressive path of monetary easing at the last FOMC. His arguments in justification of his views have not been taken that well by others at the Fed who, it seems, are subsequently less interested in what he has to share.

From this standpoint, we think it is no longer appropriate to look for aggressive Fed cuts through 2026 and if the economy evolves as we expect, we may see fewer rates cuts than are currently discounted by markets. In turn, this may also limit gains on yield curve steepening positions. With respect to the deficit, there is some agreement that this is now on a downward trajectory and although likely to top 6% of GDP, it is hoped that stronger growth and lower rates could see this figure decline over the remainder of Trump's term in office.

In Europe, over the past week the focus has remained stuck on French political developments. The resignation from Prime Minister Lecornu at the start of this week raised political risks and the possibility of new Parliamentary elections, which it is widely expected that National Rally would do very well in.

However, the French establishment is keen not to gift this opportunity to Le Pen's party. Consequently, moves have been ongoing to find a new compromise on the role of Prime Minister and a Cabinet that can attract sufficient cross-party support. Ultimately, we sense a desire to muddle through, which will mean little French Budget consolidation. In this context, France remains a deteriorating credit story over time, and we think that Moody's or S&P will confirm a cut in the French rating to A over the coming few weeks.

However, there may be limited catalyst for a materially wider spread for now, in the absence of new elections. On this basis, we have closed our short position in OATs, with a view that we would move back into this trade were spreads to converge in the coming months if volatility drops and political newsflow becomes quieter.

It was also an eventful week in Japan. The election of Sanae Takaichi as LDP leader came as a surprise to markets and to us, who had looked for Koizumi to emerge victorious. Despite claiming that she is determined to bring inflation lower, her policy stance of looser fiscal and monetary policy stands in contradiction to this.

Consequently, JGB yields rose and the yen slumped, though stocks were in buoyant mood. It was also striking how Takaichi presumed to dictate interest rate policy to the Bank of Japan. Although the BoJ has never been independent, policymaking in Japan has always tended to be a consensual exercise.

It is clear that the BoJ feels that it should be continuing to gradually normalise interest rate policy and so, if it is prevented in doing so by the incoming Prime Minister, then this could be damaging for market confidence. That said, since winning office, it appears that Takaichi has sounded more conciliatory in her remarks and may be moderating her position.

Subsequently, there has been more stability in the JGB market over the past few days after a sharp move higher in long-dated JGBs on Monday. We continue to see a lot of value in long-dated yields on a spread versus 10-year maturities and so continue to maintain this position.

However, we have added an outright short position in 10-year bonds to protect this position, should yields continue to climb. On Takaichi's victory, we also closed a small long position in the Japanese yen. The yen remains extremely undervalued, but the policy stance in Tokyo would appear to favour those who want to short the yen and use it to fund carry trades. With intervention unlikely ahead of Y160 versus the dollar, it may be wiser to wait for a more opportune moment before looking to re-engage in the yen on the long side.

More broadly in FX, our takeaways from meetings in the US this week suggest to us that the death of US growth exceptionalism may have been over-played. If Fed independence is not undermined and the FOMC delivers more modest rate cuts against the backdrop of firm growth, then one of the bigger drivers of a weak dollar appears to have diminished.

There remain other factors linked to asset allocation flows and home bias, which may limit prospects for a strong dollar, but reduced conviction on dollar shorts has seen us de-risk in FX positions over the past several days.

Meanwhile there has also been plenty of discussion over what the rise in gold prices mean to financial markets. We think that this is more about portfolio allocation than any sign of impending problems and more a function of ongoing reserve and portfolio diversification from fiat currency.

Credit markets have remained firm. There has been discussion over the bankruptcy of First Brands, which has inflicted heavy losses on a number of funds in private credit. This is a market segment where markets trends are witnessing rising defaults, which may come as a concern to those who thought that valuations never changed in an asset class that is not marked to market. In public market credit, the outlook appears more robust.

In some respects, there is a concern in policy circles that a bullish mindset, lower interest rates, strong earnings, and robust growth could all make for a heady mix for risk assets in the next 6-9 months. Valuations are stretched and there is some fear and talk of bubbles emerging,

For now, leverage in risk assets remains low, but this could accumulate if greed becomes the dominant theme. In this respect, there are echoes of the 2005/6 period in credit markets, and for stocks, what we witnessed in the Nasdaq back in 1999. Of course, in that year, the Nasdaq first doubled, with the index breaching 5,000 only to crash to 1,000 just a few months later.

In this, there is a cautionary tale. However, it also serves to remind that it is difficult to express a strongly opposing view, on the knowledge that the market tops never get bought by those who were long all the way up. Rather the market top occurs when those have been bearish end up stopping out on their view.

We have moved short duration in JGBs over the past week, and cut dollar shorts mitigating these positions, acknowledging the victory of Takaichi took us and others by surprise.

Looking ahead

We should see fewer political surprises over the next few weeks, and markets will focus more on economic fundamentals again. In the US, the lack of data could make for a quiet backdrop though at some point when the shutdown ends, then there will be a deluge of releases to be able to focus on.

Meanwhile the talk in Washington has also been on Trump and his very public desire to be awarded the Nobel Peace Prize. Ostensibly his claims to have personally ended multiple global conflicts over the past year on the back of US intervention have won him plenty of supporters. But as with all things Trump, there is never a shortage of detractors too!

Arguably the Nobel Committee could highlight that the 2025 award is meant to be for actions in 2024, before the period that Trump even took office, and this could mean that an award next year could be more justified.

However, the Committee, and Norway itself, may find itself on the end of some very harsh criticism coming from POTUS if it fails to grant his stated desire. Blessed are the peacemakers. But perhaps it is more inspirational to see those acknowledged who act out of love, humility and self-sacrifice, more than may be the case this time around.

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