



The continuous march of the Welfare State

It was the week of the long-awaited – and leaked – UK Budget!

Key points:

- US bond yields moved lower in the week, with markets anticipating an 80% chance of a 25bps rate cut in December. This will likely be Powell's last move before his term ends in May 2026, with Kevin Hassett favoured to succeed him.
- European bond markets have remained calm, with the proposed US peace plan in Ukraine closely watched. There are fears that a weak deal could cause a political backlash and migration strains in the EU.
- The long-awaited UK Budget was delivered on Wednesday. The measures deliver additional government spending in the near term, offset by higher taxes thereafter, with the majority of fiscal pain only coming beyond the date of the next General Election.
- In Japan, the yen retraced some recent losses on increased pricing for a December BoJ rate hike. We think the bank is likely to stay on hold in its December meeting, but if this pushes the yen towards 160 versus the dollar, it could act as a catalyst for a January move.
- Markets will focus on the next Fed meeting as the key catalyst, in the face of limited data and speeches from Fed participants. Away from this, equity sentiment is improving, and December's lower liquidity should be favourable for owners of risk assets.

London, 28 Nov 2025: US bond yields continued to move lower during the past week, as market pricing of a December rate cut rose to 80%, in the wake of dovish Fed comments. With the Fed's blackout period commencing this weekend, ahead of the FOMC meeting on 10th December, and without many material data releases in the interim, we doubt that Powell will want to surprise markets in the run-up to Christmas. Consequently, it appears likely that a cut will be delivered.

However, as data series such as weekly jobless claims continue to dispel concerns for a more pronounced slowing in the US labour market, we have been inclined to look for a somewhat hawkish commentary to accompany any monetary easing.

Moreover, with the US economy set to benefit into 2026 from tailwinds thanks to tax cuts, past rate cuts, deregulation, and booming AI investment spending, so we think that Powell may make December his last policy move, before leaving office at the end of his term in May.

Comments this week from US Treasury Secretary Scott Bessent have hinted that a decision on the appointment of a new Fed Chair is now close to being finalised amid suggestions that Kevin Hassett has emerged as the leader, within the possible frontrunners for the job. Relatively speaking, market participants are inclined to look at Hassett as a potentially more dovish choice than Warsh, Waller or Bessent himself might be. However, a dovish bias should probably not be overstated. Hassett is well respected, and we expect any of the likely candidates to continue to deliver an orthodox approach to making monetary policy decisions.

It should also be remembered that a Fed Chair serves for a 4-year term (which can stretch to eight years for those who serve for two terms). In this context, President Trump will only be in the White House for two of those years and much of that period will comprise the lame duck portion, of a second-term Presidency.

From this standpoint, a new Fed Chair won't want to make decisions just to please a boss in the very short term, if this comes to overshadow the legacy for the entirety of his term. Moreover, with Republicans needing to focus on affordability as a key electoral issue, this means that preventing inflation from rising will be an imperative policy priority as we head towards next November's midterm elections. This suggests a quieter stance on interest rates coming from inside the White House, over the course of the months ahead.

European bond markets remained largely rangebound over the past week. The principal point of focus and discussion related to the proposed US peace plan in Ukraine. The proposed 28-point plan saw some guarded optimism that an end to conflict could be in sight, but also plenty of concern within European capitals.

The notion that US Special Envoy Steve Witkoff has been helping aid Russia in working on a plan that has won President Trump's backing has troubled allies in Kyiv and across Europe. Yet the reality is that in the absence of US support, Ukraine is left in an untenable position.

A reluctant appreciation of this fact appears to be helping to drive progress towards a peace-deal being agreed. There remain a number of scenarios looking forward from here and there is much at stake as discussions progress over the next few days.

However, our own sense is that a bad deal for Kyiv could ultimately lead to negative political fallout within Ukraine and could end up with increased migration placing an elevated strain on its neighbours and across the broader EU.

In the UK, Chancellor Rachel Reeves delivered her Budget, following a prolonged period of leaks and speculation. Intrinsically speaking, the measures deliver additional government spending in the near term, offset by higher taxes in the period that follows, with the majority of the fiscal pain only coming beyond the date of the next General Election.

In aggregate, a £73bn increase in the welfare budget to £406bn over the next five years, is being paid for through ever higher taxes. This additional spending may help quell disquiet on the Labour backbenches, but the reality is that it does very little to benefit economic growth and would appear to reaffirm the stagnation in UK labour productivity growth, which is one of the important factors underlying the country's recent economic struggles.

Long-dated gilt yields rallied on the day of the Budget, though this appeared to be more in response to the DMO changes cancelling long-dated issuance into the end of the year and making moves to shorten the average maturity of the national debt.

Arguably, sentiment was also helped by a reduction in the political risk premia attached to Starmer and Reeves, whose political survival seemed to have been growing increasingly doubtful over the past several weeks.

A change in leadership appears less likely in the near term, though it seems difficult to project a more optimistic trajectory in the country any time soon and so concerns may resurface that a new approach may be needed following local elections next May, if current opinion polls fail to register any improvement for Labour.

We continue to maintain a neutral duration stance on gilts for the time being. Shorter-dated yields may benefit if more substantive progress can be made in lowering inflation. However, longer-dated maturities may continue to be impacted by the market's pricing of risk premia, in order to account for a perceived lack of policy credibility, in the absence of any desire, or plan, to address runaway welfare spending. Meanwhile, we think it makes sense to remain short in the pound, on the notion that the UK economy will continue to underperform on a relative basis compared to other countries.

Credit markets have been relatively quiet, owing much to a Thanksgiving holiday shortened week. In FX, the yen retraced some recent losses, on increased pricing for a December BoJ rate hike. It is possible that BoJ

Governor Ueda uses a speech next week in order to lean towards this idea, though this is something we have a degree of scepticism about, noting that Prime Minister Takaichi will also have sight of any major speech Ueda gives and will reserve the right to edit its content. For now, we think the BoJ is likely to stay on hold in its December meeting, but if this pushes the yen towards 160 versus the dollar, this could then act as a catalyst for a January move, at the BoJ's next policy meeting at the start of 2026.

Looking ahead

We expect the focus on the next Fed meeting is likely to build as we move through the coming week. In the absence of data and speeches from Fed participants, it appears that markets need a new catalyst to drive price action, and we see this coming from the next gathering of the FOMC.

Away from this, it may appear that equity market sentiment has been healing after a few bumpy weeks. As we move into December, so we will transition into a period of reduced market liquidity, which seasonally tends to be favourable for owners of risk assets.

Meanwhile, we are left reflecting on the economic and political malaise that seems the destiny not just of the UK, but of most of Northern Europe, at the current time. The narrative of welfare dependency, higher taxation and economic stagnation is self-reinforcing when this causes a mindset of negativity, which is a disincentive for future investment and consumption.

Against this backdrop, it is also notable that with nearly 700,000 individuals leaving the UK during the past year, this marks the highest level of emigration for the country in over 100 years, since the aftermath of the First World War.

The economically young, ambitious and productive are pursuing their futures overseas and it is hard to see this wave returning in the near future. Policy and political choices can define the future path of financial markets and also shape the future of the societies in which we all live.

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