



Greenpeace

A deal at Davos?

Key points:

- President Trump dropped tariff threats over Greenland this week, although further damage to transatlantic relations has undoubtedly been done.
- The Greenland crisis has accelerated the urgency for European defence spending, which may suggest upside risks to deficits and potential upward pressure on longer-dated yields.
- Japanese yields spiked as election promises stoked fiscal fears, however in our view, Japan's finances are not in an excessively unhealthy condition.
- In contrast to other markets, credit spreads stayed calm amidst this week's macro volatility, however a trade war could fundamentally change the market backdrop.
- There is a sense that macro risks are rising, and as a result, investors are increasingly demanding higher spreads on risk assets to justify their ownership in portfolios.

London, 23 January 2026: Global markets recovered from losses at the start of the week, following Donald Trump's announcement that he would be imposing additional 10% tariffs on a number of European countries, subject to their acquiescence to his demands to permit the US to take control of Greenland.

From a US perspective, it might seem that these plans are something of a Presidential vanity project, recalling how this idea was initially floated in Trump's first term. After all, in the context of its NATO membership, there is already little to hinder the US from adding to its military presence in the country, and any narrative around rare earths would appear to overlook that there are many sites where materials could be extracted much more readily in locations in the US and also Australia, if required.

Meanwhile, from a European perspective, strong feelings were aroused in the wake of an open attack on European territorial integrity, which led little room for any negotiation. This ignited the threat that the EU would pull back from ratifying last year's US trade deal and would also look to enact its Anti-Coercion Instrument in order to direct additional tariffs on the US, exposing a material share of global trade to the risk of an open trade war.

Ultimately, it appears that Trump bowed to reason at Davos, though further damage to the transatlantic relationship has undoubtedly been done. Herein, there is a sense that the US is looking like a very unreliable friend and partner, through European eyes. As Russia laughs on from the sidelines, there could be material longer-term geopolitical consequences from the past week's events.

With the US potentially trying to legitimise a landgrab in the North Atlantic, this helps lend legitimacy to Putin's stance in the Donbas, or for that matter, Beijing's ambitions for Taipei. Yet for now, financial markets seem relieved in the short term, and risks seem to have been contained. In this context, the economic outlook has not changed much, and yields can resume their sideways trajectory within recent trading ranges.

That said, this week's events add to the sense of urgency with respect to the need to accelerate defence expenditure in Europe, which may suggest upside risks to deficits and potential upward pressure on longer-dated yields.

Recent developments also serve as a reminder against complacency in financial markets, which seem to have been impervious to building geopolitical risks of late, and this may help keep risk appetite in check, for a time at least. We continue to express no strong directional view on US yields.

In the Eurozone, we maintain a modest curve steepening bias. Meanwhile, in the UK, political risk reared its ugly head again, although Andy Burnham's path to challenge the PM faces some very high obstacles. For now, we continue to run a long duration stance in the UK, in anticipation of further soft economic data in the weeks ahead.

Elsewhere, the past week saw further pronounced volatility in Japanese yields. Going into a snap election, which Prime Minister Takaichi has called for 8th February, both the ruling LDP and the opposition alliance are calling for fiscal easing.

This has led to pressure on yields linked to worries around debt sustainability, leading to a weak 20-year bond auction that saw a jump in yields to new highs, with 30-year yields approaching 4%. This led to calls for calm in the market from senior policymakers, leading to a subsequent retracement rally.

In our assessment, Japan's finances are not in an excessively unhealthy condition. The economy is growing and even after any mooted fiscal easing, the likely government deficit is projected to be much smaller in 2026 than is recorded in many other countries this year.

Moreover, although Japan has a high level of debt-to-GDP, it has large savings, meaning that the country's net debt position is very manageable. Furthermore, Japan is not exposed to a twin crisis in its current account as well as fiscal accounts, in the way that countries exposed to sovereign debt crisis typically experience.

Consequently, we have formed the view that absolute yield levels in long-dated yields in Japan are now too high and this favours taking an outright long position at the long end of the Japanese curve, on a risk-reward basis. With such a steep curve, carry is attractive.

Furthermore, we are above yield levels required by long-term Japanese investors and so it will be surprising if entities such as the Government Pension Investment Fund don't look to add to their domestic fixed income allocation at these levels.

There is concern that Takaichi will go down more as Japan's answer to the British Prime Minister, Liz Truss, rather than her role model Margaret Thatcher. But this seems to be unnecessarily unkind. Moreover, there is no need for a JGB tantrum to occur here, just as long as policymakers can demonstrate a degree of responsibility and a willingness to keep market participants onside.

In FX, the week's events saw renewed chatter of a 'sell the US' trade, mimicking what was witnessed last April. A de-escalation of tensions saw the dollar recoup earlier losses and ultimately, we doubt that many European investors are inclined, or able, to sell down US asset holdings at a time when the US economy remains abundantly more dynamic than its European equivalent.

Arguably, were it not for Trump's recent actions, the dollar would likely be stronger versus the euro than is currently the case. That said, it would appear foolhardy to back the dollar, looking for it to rally with any real conviction at this point, on the hope that POTUS can resist throwing tape bombs that serve to undermine confidence in the greenback.

Elsewhere, USDJPY at 160 remains as a potential intervention trigger in Japan and we might wonder if we are approaching a moment in which Japan, Korea and the US may combine their force with a view to strengthen the won and the yen versus the US currency, given policymakers' desire to achieve this outcome.

In contrast to other markets, credit spreads were largely nonplussed by this week's macro volatility. Arguably, a trade war, which could ignite fears of global recession, could fundamentally change the market backdrop in credit markets.

However, the truth seems that nobody really expected this outcome to unfold, on the basis that some compromise would be found before we confronted such a scenario. In this context, it is not that markets necessarily view Trump through the lens of t**o, but rather that they are now desensitised to the way in which the commander-in-chief feels he can playbook the Art of the Deal, using tariff tweets as negotiating leverage, rather than definitive policy action.

Looking ahead

The past week has demonstrated that it can be hard to foretell future events, even one week in advance of the fact! We have witnessed something of a rollercoaster journey over the past few days.

Although markets seem to be back close to where we started the year, there may be a building sense that macro risks are rising and that it is increasingly important to ensure that sufficient spread is being earned on risk assets in order to justify their ownership in portfolios, lest prospective forward-looking return profiles not appear heavily skewed with a negative left tail.

Retaining market discipline around levels to buy and sell remains important. Additionally, this week can be a bit of a reminder that when markets become hysterical or overshoot, that is when there are the very best of buying opportunities. This may go down as one such week in JGBs.

As for other riskier assets, it seems there was never much of a dip to even try to buy into, and in a number of markets, even more extreme events will be required to upend any deeply entrenched complacency. You almost shudder to think what such events might need to be!

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