



Moving the goalposts?

Trump's defending poorly in the Middle East, while Warsh is playing the long game....

Key points:

Middle East geopolitics: President Trump late on Thursday appeared to signal an imminent deal with Iran, helping yields and risk assets to rally, recovering from weaker price performance earlier in the week.

- **U.S. monetary policy:** the Fed has maintained rates despite inflation exceeding target, with September now seen as a potential tightening opportunity.
- **UK political uncertainty:** the Makerfield by-election continues to raise concerns about a potential leadership change, with UK assets appearing calm but vulnerable to shifts.
- **Japan rate hike imperative:** the BoJ is expected to raise rates this month to prevent further yen weakness and to maintain credibility amidst political pressure.
- **Macro outlook:** higher inflation expectations, diverging central bank policies, and unresolved geopolitical risks continue to shape the investment landscape ahead.

London, 12 June 2026: Comments from President Trump late on Thursday appeared to signal an imminent deal with Iran, which helped yields and risk assets to rally, recovering from weaker price performance earlier in the week. Prior to this, regional tensions had been escalating with a series of tit-for-tat attacks. We are still yet to see whether a compromise agreement is reached, noting that it feels like we have been here before, on a number occasions over the past several weeks.

Ultimately, it may be hard for Trump to shake off the impression of a humiliating defeat, which leaves the Iranian regime in a stronger position in the region than it held prior to the onset of Operation Epic Fury. Yet, although his will be hard to swallow, it has been increasingly clear for some time, that Trump wants to move on from the Middle East and put this episode behind him.

Yet when any peace deal comes, we think that this may prove to be something of an unstable equilibrium. Prospects for renewed conflict will persist, with Israel and countries in the GCC left compromised if the administration in Tehran is able to prevail, and it seems very likely to us that the region will be subject to further volatility over the months and quarters to come and this will risk ongoing disruption to global supply chains. From this perspective, we are inclined to see more upside than downside risk to oil prices going forwards, compared to today's price levels.

A firm US CPI print had earlier continued to add upward pressure on Treasury yields over the past week. A building body of evidence in economic data is starting to suggest that Federal Reserve policy is currently

more accommodative than restrictive, though we think it is unlikely that the FOMC will seriously debate hiking rates for the time being.

However, with further upside risk to prices over the summer, we envisage that the September FOMC may be a meeting very much alive with respect to possible policy tightening.

We continue to affirm a view that Kevin Warsh is not as dovish as some would perceive him to be. Naturally he 'sounded' dovish in order to secure a job he has long coveted, earlier this year. However, on taking on the role as Fed Chair, it strikes us that he will want to be much more explicit in seeking to return inflation to target with a focus on delivering price stability, at a time when affordability is a key political issue.

We retain a short bias in U.S. Treasuries and also believe that inflation-linked yields offer a compelling opportunity on a breakeven basis. U.S. inflation has exceeded target for more than five years and is set to continue to do so for the foreseeable future. Moreover, we continue to highlight that the AI infrastructure boom is adding to inflationary pressures, and consequently it is surprising that the market's confidence in a move back to materially lower levels of inflation hasn't yet been tested.

In the Eurozone, the ECB hiked the base rate by 0.25% at its June meeting, but is fighting shy of pre-committing to further policy tightening moves. We are doubtful it will go for back-to-back hikes, however, with inflation remaining well above the ECB's target, it seems likely to us that Lagarde may seek to hike again in September.

Yet with a much weaker growth backdrop in the Eurozone than the U.S., so this should see regional inflation come back to target more quickly and this should allow for a reversal of rate hikes in 2027.

On this basis, we remain more comfortable with short-dated yields in the Eurozone and continue to look for outperformance of bunds versus Treasuries on a relative basis. Meanwhile in the UK we retain a more cautious view ahead of the Makerfield by-election later this month.

On the assumption that Andy Burnham prevails, we might anticipate abstaining from UK assets on the assumption that he subsequently replaces Keir Starmer as UK Prime Minister. In this respect we feel UK yields and the pound may currently appear untroubled, but the calm backdrop at the current time seems unlikely to be able to persist in our view.

Meetings with Japanese investors and policymakers over the past week helped reinforce our expectations of an upcoming BoJ rate hike this month with a further move expected later in 2026. Japanese monetary policy remains accommodative with cash rates at 0.75%, some way off a perceived neutral rate for R^* , around 2%.

A decline in inflation from elevated levels last year has given the BoJ space to pursue a policy of gradual normalisation, though it is seen as important that political interference does not impact on the bank's ability to adjust policy on a timely basis.

A failure to hike this month could weigh on longer-dated JGBs, on concerns that the BoJ is behind the curve. Meanwhile, this could also be a catalyst for renewed weakness in the valuation of the yen and a clean break of the current range, with FX intervention destined to fail if it is not supported by consistent monetary policy adjustment. With rates overseas rising, it is thus imperative that the BoJ delivers a hike, in order to prevent rate differentials from increasing, and this is acting as a catalyst for yen selling.

In this regard, additional weakness in the currency would be badly received domestically, given ongoing dissatisfaction at the undervaluation of the yen across Japanese society. Consequently, if Prime Minister

Takaichi were to be blamed for this, then it would hurt her approval rating and weaken her position within the LDP.

Although Takaichi herself is not always very forthcoming with her thoughts, it is very clear that she puts a lot of value on this approval rating and from this perspective, it would seem very unlikely that she would want to stand in the way of the BoJ tightening policy as it determines appropriate.

A BoJ hike in itself may not be enough to help the yen to strengthen, and yen bulls may have to wait until 2027 before interest rate differentials start to narrow. Consequently, we are happy to maintain exposure around Y160 looking for intervention to push the Japanese currency lower but would target Y155 as a level to exit this position.

Meanwhile, Japanese domestic investors all appeared to affirm the narrative that they plan to increase allocations for domestic fixed income exposure over the months ahead, with yields haven risen substantially over the past year. However, we see this shift as slower and steadier, with few investors seemingly prepared to back a stronger view, or move more decisively, such is the consensual thinking that can be found across Japanese society.

From our perspective we continue to note the steepness of the JGB curve as offering protection against higher yields, and we continue to find the valuation of 30-year bonds attractive on a relative basis compared to other maturities.

The supply versus demand balance is slowly improving at the long end of the Japanese curve and, as issuance of super-longs declines at a time when more domestic investors start to add to their exposure, we think the fair value for the 10/30 spread is much closer to 75bps rather than the 125bps spread seen in the market today.

In risk assets, credit spreads remained stable despite a more volatile week in equity markets, with chip stocks under notable pressure. Further equity IPO issuance coming from Open AI may continue to test retail enthusiasm for new floats and, in this respect, it will be interesting to monitor the performance of Space X in the wake of its oversubscribed book.

Looking ahead

With Eurozone Q1 GDP revised to -0.2% quarter-on-quarter on the back of very weak Irish data, so there is a fair chance we will see a technical recession in H1, and should supply chain disruptions in the Middle East remain unresolved, so we might see the risk of additional downside in the second half of this year.

Higher yielding credit spreads will always be sensitive to recession risks building where this has the capacity to herald credit rating downgrades and higher default rates. Consequently, we feel that we can afford to be patient with respect to this positioning, with the backdrop for additional spread tightening unfavourable, noting that spreads are at tighter levels than prevailed at the start of 2026, notwithstanding a material change in the prospective economic outlook.

And so, as the football World Cup begins and we look forward to Warsh's first Fed press conference next week, we hope neither he – nor the controversial VAR systems – will result in a moving of the goalposts....

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