RBC BlueBay Asset Management

Marketing communication

No clear plan?

Is Warsh all talk and no walk…?!

Key points:

- Fed policy confusion: Chair Warsh talked tough on inflation this week but failed to justify why rates were held, risking Fed credibility at a time when US debt levels are at record highs.

- European policy clarity: the ECB has maintained clear forward guidance with a September hike expected, contrasting sharply with the Fed's communication approach.

- UK political transition: Prime Minister Burnham has enjoyed a brief media honeymoon since taking office, but sterling has underperformed as testing times loom.

- Japan policy delayed: the BoJ has postponed decisive action following the Kumamoto earthquake, but ultimately tightening must accelerate in order to anchor USDJPY and contain yen weakness.

- Macro outlook uncertain: energy prices and AI costs are keeping inflation risks more to the upside than downside, while Warsh's 'cool customer' approach risks unsettling markets.

London, 31 July 2026: The outcome of this week's FOMC meeting, with rates on hold but three dissenters calling for a hike, did not come as much of a surprise to financial market participants, with markets little changed in the wake of the initial policy announcement.

However, the yield curve subsequently bear steepened as new Fed Chair Kevin Warsh delivered a weak performance at the following press conference, in which he sought to talk tough on inflation, without offering any clear explanation as to why the Fed chose not to hike at this meeting, if growth is as strong as he describes and inflation is something that needs to be decisively addressed.

Indeed, in suggesting that rising bond yields are doing the Fed's policy tightening job on its behalf, this gave a sense of abrogation of responsibility and the lack of a clear plan to bring inflation down, in the absence of decisive leadership.

In eschewing forward guidance, Warsh may thus learn that markets may be more at risk of losing confidence in the Fed. In this respect, the prior forward guidance era under previous Fed Chairs has seen the institution afforded high levels of trust and credibility. But in more of an information vacuum, doubts may become elevated and trust in the Fed may start to erode.

Of course, Warsh could rebut that the most important task is that the Fed delivers its mandate and is judged on its results, noting how, under prior leadership, inflation has overshot the central bank's target for the past 64 months. In this regard, real economy outcomes are more important than pandering to the needs of fickle financial market participants.

However, at a time when US debt levels are at record levels and continue to grow at an alarming rate, thus being too laissez faire with respect to market outcomes could well be an approach that embeds a high degree of risk, should market confidence be suddenly lost.

Nevertheless, notwithstanding the fact that US long-dated yields are at a 20-year high, we are still a long way from such a bearish situation. Moreover, the fact remains that the FOMC is very likely to hike rates by 25bps at its next meeting in September.

Following last month's more benign inflation print, higher oil prices infer that the next couple of months are likely to see a renewed pick-up in price data, and it seems probable that by September, a decision to raise interest rates could well be made on a unanimous basis.

That said, the fact that there is no forward guidance may well mean that there remains some speculation of a dovish Fed wanting to hold, whereas frustrated hawks could even look to dissent with a vote in favour of a 50bps hike.

We continue to hold no strong view on the outlook for Treasuries at this point, with risks appearing very much two-way in nature. However, we have continued to highlight value in inflation-linked bonds and swaps on the view that realised inflation in the US is likely to stay elevated for longer than is discounted in financial market pricing.

Recent events in the Middle East remain consistent with ongoing disruption to trade through the Strait of Hormuz for some time yet to come, and with respect to oil products, even if crude oil prices decline, we see no quick reversal in crack spreads and this means that energy prices will remain elevated.

The AI gold rush is also continuing to drive up prices, as exemplified in the skyrocketing profits and margin growth for the manufacturers of silicon chips. Although these factors may abate in the course of time, it still means that for the foreseeable future, so inflation risks lie more to the upside than the downside.

In this respect there may be little that the Fed Chair can actually do to deliver on his promise to re-anchor price stability and failure to make any tangible progress in this direction over the next several months could well come to weigh further on his credibility.

Movements in European yields have been more modest than in the US over the past week, and it is tempting to contrast the performance of an experienced and trusted central banker in Christine Lagarde last week with that of Warsh, who had plenty of hubris and arrogance without a lot of humility or substance.

In the Eurozone, forward guidance is pretty clear, with a September hike evidently expected to be delivered by the ECB. In the absence of a peace deal in the Middle East, we still see further upside risk to natural gas prices, notwithstanding the doubling of TTF futures prices since the end of February.

In this way, it will be hard to argue that September will be the last rate hike in the current cycle, though with more than two further hikes already discounted, our views don't diverge much from the market consensus.

The Bank of England also kept policy on hold this week, however, the number of dissenters looking for a hike in rates rose from two to three. The majority of the members on the MPC continue to favour holding off from hiking rates and are hoping that the situation in the Middle East eases. What is clear is that if the current status quo in the Gulf is maintained, whereby the Strait of Hormuz is for all intents and purposes closed and low-level conflict continues without a sustainable ceasefire, higher rates will almost certainly be required in the UK.

In the adverse scenario, a rise in energy prices in October could end up pushing inflation towards 5%, and although we think that the UK economy will struggle and house prices will remain under downward pressure, the elevated level of CPI will mean that Bailey and colleagues will be forced to react.

Nevertheless, noting that policy in the UK has started from a more restrictive setting than was the case in the Eurozone, and given there are already two hikes priced into the forward rate market curve, we continue to see value in short-term UK interest rate futures.

We remain more hesitant with respect to longer-dated UK gilts and continue to worry with respect to the impact of higher inflation and borrowing costs on the net UK fiscal position, at a time when new Prime Minister Burnham would dearly like to be ramping up spending.

We also retain a more cautious outlook on the pound, with sterling underperforming somewhat in the days since Burnham has taken office. There has been something of a honeymoon period in the media for the new man in charge, but we think that more testing times lie ahead very shortly.

In Japan, this week's BoJ meeting was overshadowed by the recent Kumamoto earthquake. Currency intervention by the Ministry of Finance dragged the level of USDJPY lower but only set the scene for continuation of dovish monetary policy stance by the BoJ at its policy meeting earlier today.

The policy ambitions of the Takaichi government remain unashamedly reflationist, but ultimately, the bank will be forced to accelerate the pace of monetary tightening and the perception of where the terminal rate will be if it wants to control the destination of USDJPY.

It is notable, however, to observe an increase in domestic investment appearing to get underway, and we continue to look for 30-year bond yields to attract support around 4% so remain constructive on the spread between10-year and 30-year JGBs.

At a time of national solidarity, the bank has been careful not to communicate new or decisive changes in strategy as some may have hoped for. This is not to say that it won't look to accelerate the pace of monetary policy tightening in the next several months, but it would not be seen as respectful to communicate a move in this direction at a sensitive time.

Although the lack of new policy impetus from the BoJ this week saw some renewed pressure on the yen and bond yields, it has been notable to observe an increase in domestic investment appearing to get underway, and we continue to look for 30-year bond yields to attract support around 4%.

Moreover, the threat of FX intervention continues to loom and can continue to be a healthy deterrent to those wanting to speculate with respect to further yen weakness.

Credit markets have seen spreads leaking wider over the past week, driven in part by concerns with respect to AI spending plans, which have seen spreads from hyperscalers remaining under material pressure as stocks also reprice.

Renewed conflict in the Middle East has also impacted sentiment and although higher absolute yields have attracted yield-targeting purchasers, market conditions appear noticeably softer for the first time in a few months.

We would also observe that the global bond market backdrop has been awash with both corporate bond supply and government bond supply in recent months and projected forward-looking issuance volumes continue to be revised higher.

At a time when liquidity is abundant, then absorbing this incremental demand does not appear to be problematic, and this has been the case against a backdrop of relatively accommodative financial conditions indices.

However, with policy needing to be tightened to lower inflation, then this tightening naturally infers that a tightening in financial conditions will also need to take place, with the taps on liquidity squeezed in the process.

In this case, declining liquidity could meet more abundant supply, and this can result in wider spreads and weaker credits becoming crowded out of the market altogether. In this context, although we remain a long way from needing to worry about recession risks and an elevated default cycle, we can still see some pressure wider, rather than tighter, on spreads on a more general basis, over the months ahead.

Looking ahead

It will be interesting to see if markets test Warsh's resolve when it comes to abandoning forward guidance, and we also wonder whether dissent within the Fed could start to grow if it appears that the Fed's credibility is being questioned. Fed insiders have noted how a number of Warsh's ideas and principles diverge from the mainstream consensus.

Whether it is with respect to the Fed's balance sheet or its approach to market communication and forward guidance, there is a sense that Warsh wants to be bold and won't be easily swayed in his beliefs – though it may be telling how he might start to respond to criticism, if this starts to build.

He has wanted to give an impression of a cool customer who won't be pushed into needing to justify himself. However, the reality could end up looking different to the theory should markets start to wobble.

Financial stability globally is anchored by the Fed and consequently it will be important for Warsh to get it right and instill confidence that he is a man with a plan, not someone who is happy to shrink the Fed and allow the market to decide all on its own.

In this respect, the lessons from history are that markets left to their own devices cannot be trusted. Indeed, this appears to have been exemplified in a market such as Korea over recent weeks.

A sharp unwind of leverage saw an improbable one in every 30 Koreans recently being stopped out of speculative trades in an overheated stock market, which has started to resemble more of a casino than a rational functioning market of late.

It is hard to remember a time when a stock market has fallen by more than 40% in value, at a moment when earnings growth remains well into double digits. Yet, for all the recent losses as leverage unwinds, so the Kospi is still up 30% in 2026 and has still doubled in the past year.

Yet, the point here is to demonstrate that policy has a role to play. Insufficient regulation can undermine confidence in the financial foundations, and if confidence erodes then it won't quickly be restored. This is a lesson that past policymakers have often needed to learn over the years, sometimes to their own personal cost.

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