RBC BlueBay Asset Management

Marketing communication

Working 9 to 5

Chelsea fans and Japan: reasons for optimism

Key points:

- **U.S. Treasury buybacks:** the recent announcement has flattened yield curves, with long-dated bond issuance expected to be materially reduced at the next refunding.
- **European gas prices:** TTF futures have continued to edge higher despite a quieter week in the Middle East, with peak prices likely still ahead for the region.
- **Iceland convergence trade:** a potential 'yes' vote in this weekend's referendum on re-starting EU talks could create a catalyst, with Brussels eyeing 2028 Eurozone entry for the country.
- **Takaichi's political struggles:** Japan's Prime Minister, Sanae Takaichi, has seen her net approval rating slide to single digits, making her increasingly vulnerable to party opponents.
- **Monetary policy crossroads:** U.S. rate decisions remain finely balanced on upcoming economic data, while the ECB and BoJ pursue divergent tightening paths.

London, 28 August 2026: Global markets were not much changed over the past week, though yield curves have remained flatter since the U.S. Treasury buyback announcement last week. In the wake of this move, it appears likely that long-dated bond issuance will be materially reduced at the next quarterly refunding announcement, as the administration tries to limit upward pressure on long-dated yields. Consequently, this has put pressure on consensually owned curve steepening trades.

In the interim, should Bessent’s buybacks act to ease financial conditions, there is a risk that this needs to be offset by somewhat more restrictive monetary policy, in order to mitigate the risk of this feeding into inflation.

Nevertheless, as we head towards Kevin Warsh’s Jackson Hole speech later today, we think it is unlikely we will hear much about interest rates from the Fed Chair, given his stated desire to eschew forward guidance.

With the Fed Task Forces also conducting their research and not yet releasing any findings, it is thus unsurprising to note that the topic of this year’s conference appears to steer away from monetary policy and is centred around Financial Innovation and the development of digital currencies.

In light of this, it may appear that those looking for a cue from Warsh, ahead of the September FOMC meeting, could well be left frustrated.

Our own assessment is that the debate over whether to hike by 25bps next month is finely balanced and may well hinge on the next payrolls and inflation prints. Should both of these data points be released on the strong side of expectations, then a hike looks very likely to be delivered. By contrast, weak releases next month may rule out such a move.

However, in-line releases, or an outcome where one print is strong and the other is soft, could well end up leaving markets close to a 50/50 outcome, pending comments from respective Fed participants, in the run-up to the meeting.

In our view, since we are inclined to think that inflation data are more likely to surprise on the upside, so we have tended to think that a rate hike in September is more likely than is currently discounted. That said, we do not express a directional view on Treasuries with any conviction, seeing more value and opportunity in maintaining positions in inflation-linked bonds and derivatives.

European yields have remained at their highs, as August inflation data underlines the case for the ECB to hike at its next policy meeting. Christine Lagarde has appeared to want to distance herself from giving any forward guidance on rates beyond this point, though her colleague, Isabel Schnabel continues to advocate the need for further policy restraint to come.

TTF European gas futures have continued to edge higher, even as crude oil moderates somewhat, in the wake of a quieter week in the Middle East. We doubt that we have seen the peak in gas prices just yet and this may continue to keep some pressure on bunds.

However, in looking at 2-year interest rate swaps in the Eurozone, we now see these offering value above 3.05%. Even if the ECB hikes twice more in the months ahead, this will leave cash rates at 2.75%. Meanwhile, in 2027, base effects are set to pull inflation materially lower, as year-over-year changes in energy prices flatten out. Against this backdrop, it is possible that the ECB starts steering cash rates in the opposite direction later next year.

We continue to be more cautious owning longer-dated European government bonds, at a time when an excess of supply still seems to be exerting some upward pressure on term premia globally. Within Europe, we continue to highlight relative value in Hungary, where lower inflation has seen the NBH cut interest rates during the past week.

We also highlight Iceland, where a potential ‘yes’ vote in this weekend’s referendum on re-starting EU talks could create a catalyst for a convergence trade. Brussels has been indicating that it could be happy to welcome Iceland into the Eurozone as early as 2028, when Montenegro is already scheduled to join.

As an EEA and Schengen member, Icelandic membership talks could be expedited quickly, though any final decision would still be contingent on domestic support at a further referendum. Yet with interest rates at 8% and a strong external position, it is not at all surprising to us to see the Icelandic krone rallying over the past few weeks.

In Japan, new polls have shown declining popular support for Sanae Takaichi as Prime Minister, with her net approval rating sliding to its lowest level since her appointment last year. Although this indicator still remains in positive territory, this rating has fallen from an impressive +50 earlier this year to levels in single digits. This has seen faction leaders, such as Aso, taking an active stance behind the scenes.

With Takaichi lacking a strong power base in her own party, this makes her politically vulnerable. As a result, her popular approval rating had acted as a strong force field, shielding her from political opponents, but this is now weakening. Meanwhile her position has not been helped by media interviews casting Takaichi as an isolated figure, who recently quipped that she had become so lonely that she befriended a cockroach!

Takaichi’s recent policy initiatives, including the recent consumption tax cut, have proven to be politically unpopular, as fiscally responsible Japanese voters ask how this will be paid for. As she turns more on the defensive, this suggests to us that Takaichi is less likely to be fiscally expansive in her comments going forward.

It is possible that she may also be more inclined to pay attention to bond markets, seeking to ensure that both long-dated government bond yields and the yen are able to perform more strongly in the months ahead. Were she to step aside, an even greater refocus on fiscal orthodoxy could give an even bigger boost to JGBs and the yen, though such a dramatic change appears unlikely at this point.

Moreover, as we look towards the upcoming BoJ meeting in September, we think there is little to prevent Governor Ueda from endorsing an interest rate hike, with indications of further steps towards monetary policy normalisation to come in the months ahead. This is likely to help to flatten the Japanese yield curve and we continue to highlight value in long-dated bonds, at a time when it appears that both inflation and fiscal risks have been somewhat overstated.

Movements in corporate spreads have remained subdued over the past week and continue to trade in a narrow range, notwithstanding ongoing volatility in tech and hyperscaler names. Over the past month sovereign credit spreads have underperformed and these now look cheap relative to corporate bonds.

In this context French OATs now trade close to spread levels for Euro corporate bonds and although France remains a structurally deteriorating credit, we would be surprised to see the 10-year OAT spread hit 100bps this side of the 2027 French Presidential elections.

In emerging markets, credit spreads have also been relatively stable, though assets in Brazil are seeing increased attention ahead of the October presidential elections. Although a win for incumbent Lula is discounted, we would highlight the scope for a material rally in Brazilian assets should Flavio Bolsonaro deliver a surprise victory.

A long position in short-dated UK rates was closed this week, following some recent gains. Although this position has been helped by a more dovish stance from the Bank of England, we are concerned that the news with respect to UK inflation continues to deteriorate. Ofgem announced a 4% rise in domestic energy bills from October and a gain of as much as 9% may follow in January. Energy and food inflation seem set to lift UK inflation above 4% by early next year and against this backdrop, we think that the BoE will be reluctantly forced into monetary tightening.

Looking ahead

Once the Jackson Hole meetings are out of the way, market attention will be on next week's U.S. jobs report. The July data was surprisingly soft and contained downward revisions to prior data. However, we struggle to see much evidence of weakening in the U.S. labour market at the current point in time, and so we would be surprised if next week is a further soft number.

Meanwhile, in the week we have said goodbye to music icon and legend, Dolly Parton, it's perhaps a reminder that life is better if we can all take ourselves a bit less seriously, treat others with kindness, and keep a smile on our face. Perhaps Takaichi is one who really would benefit from this advice and from looking more on the bright side of life.

After all, there is almost as much to feel optimistic about in Japan at the moment as there is as a Chelsea fan, at the start of the Premier League season! Perhaps Takaichi needs to work less hard, return to a 9-to-5 lifestyle and embrace leadership with a lightness of spirit, at a moment when there really is much to rejoice in Japan.

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