RBC BlueBay
Asset Management

Marketing communication

Gas discomfort

From QE to QT…

Key points:

- **European energy crisis**: TTF gas futures have surged above 70, up almost 140% from pre-war levels, with LNG shipping disruptions continuing to drive inflation concerns across the region.
- **U.S. monetary outlook:** a hawkish Jackson Hole speech has cemented expectations for a September FOMC rate hike, with payrolls data set to make the headlines today.
- **Japanese policy shift:** recent comments from Governor Ueda make a September BoJ hike appear certain, with further monetary policy normalisation at an accelerated rate expected in the months ahead.
- **UK vulnerabilities mount:** gilts underperformed this week on the country's particular exposure to the energy crisis – lacking its own gas storage and bound by the SRMC electricity-pricing formula that ties all power prices to the most expensive fuel source.
- **Macro outlook summary:** rising borrowing costs pose growing threats to balance sheets, whilst geopolitical tensions and energy prices are shaping the path ahead.

London, 4 September 2026: European yields pushed higher over the last week, as gas price futures continue to rise on fears with respect to shortages in supply. European gas inventory levels have been relatively low from a seasonal point of view, as buyers have delayed purchases in the hope that peace in the Middle East will lower prices.

Yet with the regional conflagration continuing to drag on, these hopes appear to have been dashed. Under the status quo, a number of crude tankers have continued to transit Hormuz, though shipping of LNG remains greatly impaired, given the explosive risk attached to any projectile hitting an LNG carrier.

Consequently, TTF gas futures above 70 represent an increase of almost 140% from pre-war levels, and thus energy costs continue to drive inflation concerns from a European perspective.

The ECB is expected to hike in September and then move again at the end of the year. Thereafter, the path of rates appears more uncertain, and much will hinge on how energy prices continue to drive inflation into 2027.

Should TTF gas futures push towards 100 in the weeks ahead, this will be embedded in much higher energy costs through next spring and, in that scenario, the ECB will likely remain on a hiking path.

However, should prices top out around current levels, the peak in euro inflation should remain below 4% and with base effects on energy prices pulling headline inflation lower by next Easter, this could see the ECB on hold after the New Year.

In this respect, much depends on whether we will find ourselves in the ECB's 'adverse' or 'severe' scenario, and events in the Middle East will continue to have a material bearing on this.

However, we would also express confidence that the ECB will seek to ensure that any overshoot in prices is as short-lived as possible.

Indeed, if it is successful in this respect, it would not be at all surprising were the ECB and other European central banks to find themselves reversing course on interest rates later next year.

From this standpoint, we still see value in shorter-dated European yields for the time being, notwithstanding risks related to gas prices.

U.S. Treasury yields also rose over the week on the back of increased Middle East tensions. From a U.S. perspective, it is oil rather than gas that is the predominant driver of inflation concerns, and in this context, it has been noteworthy how little U.S. natural gas prices have risen in the past year. #

A hawkish speech from Kevn Warsh at Jackson Hole has cemented expectations for a September rate hike from the FOMC and unless there is a disappointing U.S. labour market report later today, then we expect this to be delivered later this month, notwithstanding more dovish comments this week from Chris Waller.

The yield curve has continued to flatten over the past month, with the sense that the administration is eager to do whatever it can to prevent further increases in long-dated borrowing costs.

In this context, it may well be that higher short-term interest rates help to underpin bond market confidence further out the curve, at a time when bond yields in the U.S. (and globally) are at multi-decade highs.

We continue to have no strong directional view on Treasuries or the U.S. yield curve, but inflation-linked bonds and derivatives continue to offer value in our eyes. In the U.S., we think that inflation will be slower to return to target than markets appear to discount.

Higher long-dated yields in Japan also appear to be pushing policymakers towards action. Comments from Governor Ueda make a 25bps rate hike at the September BoJ meeting look like a done deal. Some even suggest a larger move could be possible, though this seems unlikely in our view, given how things tend to evolve gradually and in a consensual manner in Japan.

However, we would expect communication to signal further monetary policy normalisation at an accelerated rate, in the months to follow. With Scott Bessent also beating on Takaichi to deliver greater fiscal restraint and act to prevent longer-dated bond yields rising, there is also a sense that Japanese policymakers are taking the sell-off in JGBs seriously, now that 10-year yields have breached 3%.

In the past week, we have also seen increased speculation that the Government Pension Investment Fund (GPIF) will substantially revise upwards its holdings of Japanese bonds within its asset allocation. Meanwhile, on the political front, there is a possibility that Takaichi is being pushed to replace Finance Minister, Katayama, with an individual who is more fiscally conservative, at an upcoming cabinet reshuffle.

These developments have helped long-dated JGBs to rally towards the end of the week, with the yen also making gains in the FX market, down at Y155 versus the US dollar. We continue to highlight attractive structural value in 30-year JGBs above 4%, whereas on the yen, we are more inclined to fade the rally in the short term, even though the Japanese currency is substantially undervalued versus its peers.

Ultimately, we are sceptical that Takaichi will want too much yen strength. In many respects, we think that any forthcoming change in policy is more focussed on avoiding further weakness in the yen and domestic bonds, with this having the potential to further weaken Takaichi’s own position within the ruling LDP.

UK gilt yields have underperformed over the past week, following on from European moves. The UK remains more vulnerable than other European countries in that it lacks gas storage of its own and continues to adhere to the self-damaging Short-Run Marginal Cost (SRMC) formula with respect to pricing electricity generation costs. This binds the price of all electricity to the most expensive fuel source needed to meet demand.

This misguided approach ensures that inflation is guaranteed to overshoot at times of geopolitical crisis, when gas prices spike and with a host of regulated price charges linked to inflation movements, so second round effects can be quickly embedded into prices.

Meanwhile, with higher inflation and higher borrowing costs both undermining the OBR mathematics with respect to fiscal headroom, so it appears the Burnham government may be starting to realise that there is no money left to spend, even if they go ahead with tax increases.

With long-dated gilts approaching 6%, it appears that many entrenched gilt bulls are loathe to capitulate their positions, but unless the UK gets lucky or can take remedial action soon, then CPI could well be headed to 5% in Q1, and this will make it inevitable for the BoE to proceed with rate hikes.

Approving domestic oil and gas production makes clear economic sense in the UK (and would likely be a net benefit to the environment, if we do not need to rely on commodities being shipped from far flung shores). However, in the short term, scrapping the SRMC formula could deliver the greatest short-term relief on the inflation front.

Meanwhile, it strikes us that one day a government in the UK will need to do something about runaway social welfare spending, if the country is not to end up bankrupting itself. Indeed, there is an argument that such a move would actually be much more credible, were this undertaken by a left-leaning government.

For now, we have no position in gilts but remain underweight on the pound. A fiscal accident could see the pound under pressure in the next few months, whilst on the upside, we see few catalysts that would warrant a rally in sterling.

Elsewhere, it has been another quiet week in corporate bonds. In investment grade, index spreads have traded within a 4bps range for the past several months and it is not clear there is much of a catalyst to increase volatility any time soon.

The same is also true in high yield bonds, and with lower-quality issuers these days found in private credit or the bank loan market, the structural improvement in credit quality in high yield means that this asset class almost seems to resemble what we thought of as investment grade in times past.

Moreover, this is something that increasingly seems to be reflected in the spreads on offer for many BB and even B-rated issuers. It also seems apparent that large money managers have established sizeable products programmed to sell volatility on a continuous basis.

This means that vol premia gets crushed, although the risk is that should something cause this to spike, then the subsequent overshoot could be much larger than many would imagine.

Indeed, it is interesting to look back at parallels prior to the GFC. In this context, it now seems odd, wondering who was buying Greek government debt at 25bps over German bunds at a time when credit quality was already deteriorating, or whoever thought a CDO-squared transaction was ever a good investment to plough money into.

Yet the longer the credit cycle extends, so we are witnessing pockets of overvaluation at a time of increased leverage and greed for returns. In light of this, witnessing the problems in private markets that continue to build is a reminder of how painful life is, when leverage gets over its own skis.

In this respect, we should remember the 2010s were a decade of QE and cheap leverage, which favoured debtors and penalised cash savers. We are now living in the opposite of these times as highs reach new highs, and consequently rising funding costs represent a growing threat to balance sheets and financial health if they continue to push higher.

Looking ahead

Payrolls will grab the headlines today and then we will be interested to wait for the next U.S. inflation report in the coming week to shape the backdrop for yields. For now, we continue to see few signs of higher borrowing costs adversely impacting economic growth, but this is something we may need to be attentive towards, particularly with respect to passthrough onto interest rate-sensitive sectors.

In this respect, it seems that house prices are now falling around the world with a number of major cities witnessing double-digit paced declines. Mortgage affordability (or the lack of it) will continue to weigh on housing market activity, and in markets where prices have been incredibly inflated in the years following QE in the wake of the GFC, so there may be a considerable amount of excess in prices needing to unwind.

In this respect, anecdotal evidence from colleagues purchasing London property now sees prices back at 2013 levels. Should these trends persist, it may not just be bad gas that is a source of growing discomfort!

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