RBC BlueBay Asset Management

Marketing communication

Trillion dollar "dividend"

Hike or go take a hike

Key points:

- **Bond Pressure:** government bonds remained under pressure this week as higher commodity prices and the perception of aggressive central bank hiking drove a rapid move higher in yields.

- **U.S. CPI:** markets await the U.S. August CPI report later today. Fed Chair Warsh's hawkish Jackson Hole speech cemented a September hike call, with markets pricing 70% probability – we believe a number in line with consensus will push Warsh and the board to hike rates by 0.25%.

- **ECB tightening:** the ECB hiked by 25bps to 2.50%, while shifting to a meeting-by-meeting, no-forward-guidance stance; there are now more than three further hikes priced into the ECB forward curve out to the middle of 2027, taking the terminal rate well above 3.00%.

- **Japan:** a much-anticipated government reshuffle will likely leave Takaichi's core team in place, with Katayama staying on as finance minister. Meanwhile, recent media leaks mean a 25bps rate hike at next week's BoJ meeting looks like a done deal.

- **Brazil election:** opinion polls ahead of October's presidential election have tightened as market-friendly Flavio Bolsonaro gains on incumbent Lula; a substantial risk premium is already priced in.

London, 11 September 2026: Government bonds remained under pressure over the past week, with higher commodity prices and the perception that central banks are going to hike rates aggressively causing a rapid move higher in yields.

The situation in the Middle East has not improved, with Brent crude back above $100pb and TTF natural gas prices in Europe making new cycle highs. Stock market volatility has begun to rise in recent days but sentiment around the tech/AI sector remains relatively upbeat and risk assets in general are holding up well (for now).

Markets are on tenterhooks ahead of the August U.S. CPI report later today. Recall, a hawkish speech from Kevin Warsh at Jackson Hole has cemented expectations for a September rate hike, and with markets currently assigning a 70% chance of a hike at next week's FOMC, we believe a number in line with consensus will push Warsh and the board to hike rates by 0.25% to 3.75-4.00%. The latest U.S. employment report showed the economy adding 162k jobs in August, materially above the consensus estimate and further evidence that U.S. economic activity remains relatively robust.

The ECB meeting this week delivered a 25bps hike to 2.50%. Christine Lagarde called the hike a no brainer but was at pains to emphasise that the ECB are taking the rates decision meeting by meeting and nothing is certain or decided. Inflation projections for 2027 have increased but it is interesting that Lagarde made the point that growth has been more resilient and inflation has been more benign than they anticipated.

The ECB is attempting to follow the Fed into a no forward guidance world. In response, European yields (particularly in the front end of the curve) have moved rapidly higher. There are now more than three further hikes priced into the ECB forward curve out to the middle of 2027, taking the terminal rate well above 3.00%. The move higher in yields has not been contained to the shorter dated maturities, as the 10-year bund yield has risen 10bps in the last week.

The market is in capitulation mode, and these moves are taking yields into overshoot territory. We find current levels attractive but for now hold back from adding more duration as technicals are poor and the moves could extend further depending on how inflation data and the Fed meeting next week pans out.

In the U.K., Bank of England (BoE) members testified in front of MPs ahead of a crucial MPC meeting next week. For now, the BoE seems content holding policy rates steady, while monitoring incoming data on the second-round effects of higher energy and commodity prices.

The recent DMP survey, of U.K. CFOs, provided some comfort in that respect, with wages on a forward-looking basis projected to decline over the next year. However, upside risks to inflation continue to rise, as evidenced by the recent report from the Food and Drink Federation, which expects food prices to rise to 6% year-on-year by mid-2027.

So, it remains to be seen how long second-round inflation effects can remain subdued, and by extension how long dovish leaning members, including the governor, can hold out before finally realising market expectations for rate hikes.

Politically, higher inflation, higher interest rates and higher spending needs (defence) continue to give Chancellor Healy a headache as we move closer the Budget. His current strategy for now seems to be 'say less, do less' ahead of the Budget, so as not rock the boat, but at the risk of sounding much like his predecessor, who was an expert in kicking the (politically difficult decisions) can down the road. 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.

In Japan, a much-anticipated government reshuffle will likely leave Takaichi's core team in place, with Katayama staying on as finance minister. Her position was under scrutiny, given the construction and market narrative of the FY2027 budget. For now, its rather Takaichi herself who has taken to public domains such as X to sell her ideas of 'responsible proactive fiscal policy'.

Recent media leaks mean a 25bps rate hike at next week's BoJ meeting looks like a done deal. Further comments from U.S. Treasury Secretary Bessent and position capitulation have pushed the yen higher. Suggestions of a 50bps hike 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, opening the prospect of every meeting being 'live' in the months to follow. 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 on stabilisation.

In EM markets, polling for the Brazilian presidential election in October has started to tighten up, with more market friendly candidate, Flavio Bolsonaro gaining on the incumbent Lula. Up until recently, the polls had been decisively in favour of Lula winning a 4th electoral victory, and the market has priced substantial risk premium into FX and rates markets for this outcome.

We have a fairly benign view on how fundamentals evolve in the event of a Lula victory and believe there is too much risk premium built into Brazilian assets, whether Lula wins or not. The kicker is if Flavio Bolsonaro continues to gain on Lula, there will need to be a big catch-up trade similar to what played out in Colombia earlier in the year. Brazil remains one of our favourite stories.

Looking ahead

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.

We await the U.S. inflation report later today which will provide a more decisive read on the Fed next week and has the potential to shape the backdrop for yields and risk assets in the coming weeks. One thing is for sure, after a few early hiccups, Warsh's credibility is still up for debate, and it could be a case of hike or go take a hike!

There is no such doubt around President Trump's latest policy announcement or his credibility. Surely the last thing his beleaguered Treasury secretary wanted to hear was Trump's promise of a deficit sponsored "dividend" of $5,000 for every U.S. citizen if the Republican's retain control of Congress in the coming mid-term elections.

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