RBC BlueBay Asset Management

Marketing communication

Has the 2026 bond bear market reached a turning point?

Diesel, diplomacy, and duration

Key points:

- **Fed policy:** the Federal Reserve's rate hike stabilised U.S. bond yields, and together with a reassuring performance by Chair Warsh, restored policy credibility that had been in question.
- **US inflation:** a scenario of a sideways path for crude could let base effects flatten within six months, pulling CPI toward 3% and the high 2s thereafter – leaving little need to push rates much higher after Q1 unless the data argue otherwise.
- **UK:** BoE keeps policy on hold, having been helped by a slightly more benign than feared inflation report this week. We still see inflation above 4% in Q1, but even if the domestic energy price cap jumps more than 15% in Q1, inflation could still peak below 5%.
- **Japan:** the BOJ hiked rates to 1.25% as widely expected, though dissents from two Takaichi doves on the Board raised concerns with respect to the commitment of the central bank to normalise policy in the months ahead

London, 18 September 2026: This week's rate hike from the Federal Reserve saw U.S. bond yields stabilise, with this move appearing to underpin a narrative of a return to policy orthodoxy, following a period when policy credibility has previously been questioned.

Although the Fed move was widely discounted ahead of the FOMC meeting, a reassuring performance by Chair Warsh at the post-meeting press conference was important in helping to improve market sentiment, in the wake of him appearing to fumble questions at his previous appearance.

Markets now discount a further hike in the coming quarter, though we think a back-to-back move in October will only be required if the next CPI print comes as a negative inflation surprise. A cadence of more gradual tightening at every other meeting appears more likely to us. Moreover, with three more hikes now discounted by this time next year, we feel that odds are now building that less, rather than more, monetary tightening may be warranted over the coming 12 months.

U.S. economic activity will continue to be supported by robust AI driven demand for the foreseeable future and with energy prices remaining elevated, we think that inflation is likely to be slow to decline. However, as long as the direction of travel on price gains can trend lower, we think that the FOMC will be wary of taking rates too far into restrictive territory.

Obviously, there is a sense that inflation and thus policy, remains dependent on the trajectory of energy prices and, by extension, the evolution of the ongoing conflict in the Middle East. However, we are now getting a building sense of the U.S. seeking to disengage from the region, in the absence of viable policy options at this point in time. In this respect, it has been notable how the U.S. response to Houthi attacks on Saudi Arabia, appears to have prioritised a diplomatic dialogue with the Yemeni rebels, rather than coming directly to the aid of the Saudi regime. This may also be explained by depleted weapons stockpiles and mounting war costs, but nevertheless the U.S. disinterest in escalation appears notable.

Oil prices have started to ease over the past week and although it may be premature to call a change in the recent trend, we are inclined to believe that any further material move up in U.S. energy prices, could make a policy pivot more likely. In this respect, it has been notable how diesel prices exceeding $6 per gallon have gained national attention in the U.S. and how this has also resurfaced talk with respect to an embargo on diesel exports, in order to suppress domestic prices.

Such a move would help to contain price pressures in the U.S., whilst exacerbating these in Europe, though Trump's America First agenda is unlikely to pay much consideration to that latter point. A move designed to lower U.S. energy prices may buy Trump more popular support than the $5,000 giveaway gimmick floated last week. Yet any action would probably remain too little, too late, in order to help Republican prospects at this November's mid-term elections.

Although there is precedent for export restrictions, these are unlikely to receive universal support in the U.S. and may be difficult to implement due to regional complexities in supply chains within the USA. On this basis, we would only anticipate such measures if oil prices jump materially further from here, and we are growing more hopeful that that won't come to pass.

Meanwhile, as it pertains to U.S. inflation and monetary policy, a backdrop which sees crude prices trade sideways from here over the coming months (which may seem like a sensible baseline assumption for the time being), will see base effects from price changes flatten out within the next six months and in the absence of evidence of secondary price pressures building then we see CPI trending down to 3% and into the high 2s thereafter. This is a level where we might see inflation levelling out, but with core PCE below 2.5% at this point, we don't see much need to take interest rates much higher after Q1, unless economic data demonstrate a different pathway, over the months ahead.

As and when yields peak, this may also coincide with a peak in the curve flattening trend that has characterized this year's bear market. On this basis, we see some value in 5-year Treasuries as they have approached 5% yields, but we remain more circumspect with respect to longer dated maturities. Ongoing heavy debt issuance volumes from governments and corporates continue to appear to pressure term premia globally and from this point of view, we are disinclined to extend beyond intermediate maturities.

A topping out of energy prices could also be beneficial for European yields, were this to occur, given how closely bund yields have correlated to TTF gas price futures in recent weeks. In this respect, gas contracts declined modestly over the past week and with short-dated euro yields having sold off by 50bps during the past month and from this point of view we are also inclined to look for some stabilisation.

Long duration bets in Europe have been a consensual position among market participants in recent months, and so recent weeks have inflicted a degree of performance pain, with positions being stopped out on a pretty widespread basis. Consequently, market technicals are also now more supportive for Eurozone rates than they have been and with some investor surveys suggesting that positioning has flipped towards a bearish consensus, so it may be a moment when the pain trade is now towards lower, not higher yields, for the majority.

In the UK, the BoE held rates unchanged, having been helped by a slightly more benign than feared inflation report this week. Although UK CPI rose to 3.1%, core service price inflation remains more muted suggesting few secondary effects and it has been noteworthy that UK inflation prints have tended to be lower than many, including ourselves, have feared during recent months.

We still see UK inflation above 4% in Q1, but even if the domestic energy price cap jumps more than 15% in Q1, inflation could still peak below 5%. Although this infers a need for the BoE to tighten policy, a rate cycle taking base rates beyond 5% in the UK seems difficult to imagine, given the impact rate hikes seem set to have on an already weak UK economy. We still see it as risky taking a directional view on UK rates, but as with elsewhere, see more relative value at the front end of the curve than the back end, given what is presently discounted. With respect to long dated gilts, we remain concerned that the government is still committed to raising spending when there is not the money available to do so, and this could put the Burnham administration on a collision course with the markets in Q4.

In Japan, the BOJ hiked rates to 1.25% as widely expected, though dissents from two Takaichi doves on the Board raised concerns with respect to the commitment of the central bank to normalise policy in the months ahead, given that the two most hawkish members will be leaving shortly and the Japanese Prime Minister may replace these with more dovish members of the policy committee. This has seen the yen weaker, though comments from Governor Ueda suggesting the pace of policy normalisation has accelerated, has provided some reassurance. Meetings with domestic investors continue to highlight growing demand for domestic assets and it is interesting to note that although plans to increase JGB holdings are widespread, the extent of money moving into the market so far has been pretty modest. This suggests an improving technical outlook for JGBs ahead and we remain constructive on long-dated JGBs.

In FX markets, the dollar has traded firmer in the wake of the Federal Reserve rate hike, but we are wary of jumping on this trend. We still see asset allocation shifts away from the US over the medium term reducing the appeal of the greenback and its ability to rally very far. As for the yen, we only see BoJ action maintaining the existing interest rate differential to the US and European currencies and remain sceptical that it can rally very far until this starts to close. Elsewhere, it was another pretty quiet week in credit markets with participants much more focussed on the macro events and volatility, which continues to drive markets.

Looking ahead

Elsewhere, it has been interesting to witness the building rapprochement between the EU and Canada in recent weeks, which has culminated in this week's announcement by EU President von der Leyen, of an offer of Associate EU membership. Although this is unlikely to be ratified from a technical point of view, the warmth and friendship are encouraging to witness.

Europe would dearly like access to Canadian energy exports (if only Quebec would help to facilitate). In a number of areas ranging from technology, to space, to defence, there seems to be plenty of scope for closer co-operation and co-ordination between the EU and the 'most European country outside of Europe itself'.

Although Canada faces the prospect of a couple of tough years in the wake of U.S. policy, it has also been interesting to see how the challenge coming from Trump's agenda is fostering greater national solidarity and a desire to get things done. This has been something, which has often been absent over the past decade or two. In this respect, Canada may appear to resemble an improving macro story in the medium term, even if near term risks are in the other direction. Who knows, our Canadian friends could even help out the UK in its attempts to become friends with the EU again.

Meanwhile, it seems these moves have not escaped the attention of Donald Trump, who seems half indignant that his country's neighbours may be turning their back on them, after two years of ongoing hostility from Washington DC. Who knows, a desire to win Canada back could yet see Trump wanting to woo Ottawa again, but not too many there will be holding their breath waiting for this. Notwithstanding that, it certainly does seem like the stock of Prime Minister Mark Carney is currently riding high. Canada is being made great again.

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