



## Market Commentary

### Ishiba bows down as Trump rides high

#### Is the President's win the rest of the world's loss?

##### Key points:

- President Trump announced a historic USD550 billion trade deal with Japan this week, which he referred to as the “largest deal in history”.
- Following the LDP's election loss, Prime Minister Ishiba faced pressure to secure this deal, strengthening the US's negotiating position.
- The focus has now shifted to Europe, with reports suggesting a similar 15% tariff deal for the EU. In this context, the US seems to have won the war on trade for now.
- This week's ECB meeting was more hawkish than expected. While further rate cuts seem unlikely amidst fiscal easing, markets may still price in accommodation, as cuts remain more probable than hikes in the coming months.
- Divergence among EU member states may hinder a unified negotiating stance, including on reciprocal tariffs. Many in the bloc seem to believe avoiding conflict with the Trump administration is beneficial, especially if other large US trading partners comply.

**25 July 2025 (London)** – Global yields continued to track sideways over the past week, with risk assets continuing to advance on the back of constructive newsflow with respect to trade deals. An announcement that Japan had reached an agreement, which embeds 15% tariffs, was greeted with some relief in Tokyo given that a rise to a 25% rate had been averted.

That said, the optics of this deal look pretty one-sided to us. Here, the US was successful in advancing its demand to open Japanese markets to US imports. It also secured agreement on an LNG investment in Alaska, as well as benefitting from a USD550 billion investment fund, which the White House will be empowered to direct.

Following a loss by the LDP in the Japanese Upper House elections last weekend, it strikes us that Prime Minister Ishiba has been under immense pressure to deliver a trade deal. This has put the US in a strong negotiating position to achieve its aims. Following the announcement of the Japanese deal, attention has shifted to Europe. Reports have suggested a similar 15% tariff deal may also be in sight for the EU.

In this context, it seems that the world has bowed to US pressure on trade, with the US administration playing its hand relatively effectively. It may appear that the narrative of US tariffs representing a pseudo Federal consumption tax, which exempts domestic production, has largely been swallowed by the country's trading partners.

Moreover, there is some understanding that the large US fiscal deficit means that the revenue from tariffs is imperative, in order to stop the debt dynamics of the US getting any worse. Indeed, at a time when many countries find themselves challenged in this respect, as government debt levels rise, it is interesting to speculate whether others may end up following the US lead on trade policy in the years to come.

When the dust around recent news settles, we now think that an average US tariff rate on trade looks likely to settle around 18%. Tariffs on US exports may not be much more than 3% in comparison.

In this context, there can be no doubt that the US looks to have won the trade war, at least for now. Longer-term ramifications with respect to US policy changes under the Trump administration may be slower to emerge. In this way, it is still highly questionable whether the US nation and society will be better or worse off in the medium term.

After all, the US has been a major beneficiary of globalisation over several decades and there is no doubt that recent policy shifts represent a challenge to this.

That said, it appears that Trump can head into a summer break feeling like he is riding high (notwithstanding those pesky Epstein files, of course). US growth estimates for 2026 are trending higher and with the Budget settled and trade deals falling into place, the backdrop over the medium term appears broadly constructive.

Yet in the short term, it remains appropriate to look for economic activity to slow and for prices to rise in the next few months, as tariffs are passed on from producers to consumers. Over the second half of 2025, we look for the US economy to grow at a 1.5% rate, with core CPI peaking close to 4%. This being the case and with unemployment seeming unlikely to rise by very much, so we would typically question whether interest rates need to move much, if at all, in the months ahead.

Yet, these are not normal times for the Federal Reserve. Chair Powell is already under immense scrutiny and attack for failing to deliver the rate cuts that the administration has been buying for. With other members on the FOMC also now dissenting and calling for rate cuts as early as next week, so we think it is likely that the Fed will deliver 25bps cuts in September and December, unless inflation surprises materially to the upside of current projections.

In this respect, the Fed can reflect that current policy remains restrictive, compared to the long-term neutral policy rate. Meanwhile, Treasury Secretary Bessent appears to have prevailed on Trump not to push for Powell's early dismissal but may now look for Powell to calm the waters, by acceding to demands to take rates lower.

An announcement with respect to the next Fed Chair could come as early as September. In this respect, Bessent will be looking for a compromise between a candidate who will take heed of the calls from the White House yet retain the respect of markets with regard to their decision-making integrity.

From this standpoint, it may be better for the Fed and the next Chair that Powell resumes a path of rate cuts later this year, which they will be in a position to continue, rather than inheriting office, needing to push for much larger corrective rates cuts, to make up for Powell's perceived intransigence, during the prior 12 months.

In light of this, we think that forward pricing of interest rates over the coming year remains broadly fair. We think that shorter-term yields can be supported by cuts in the policy rate but are doubtful that longer-dated yields will rally on such moves and may well sell off. Over the past few weeks, overall moves in the yield curve have been relatively contained, with the market trading in a relatively narrow range.

However, looking ahead, next week's Fed meeting could prove a catalyst for short-dated rates to rally, if markets increase the likelihood of a September cut, currently priced with a 60% probability.

In Europe, this week's ECB policy meeting was a bit more hawkish than investors had expected. We think that the ECB is likely done in cutting interest rates, against the backdrop of fiscal easing. However, rates markets will continue to price some further accommodation, given that the Governing Council remains much more likely to cut rates than to hike, depending on economic and political developments over the course of the next several months.

Meanwhile, sovereign spreads in the Eurozone have continued to squeeze tighter in the past week. With Parliaments now on summer recess, this can diminish political risk in the short term. In France, we continue to think there may be renewed political volatility in September/October, around the Budget, as Bayrou seeks to implement measures to reduce the deficit. This leads us towards positioning short of France OAT risk, but we have held off from implementing this view in the short term until later in the summer

In Japan, there has been intense speculation about whether Prime Minister Ishiba will resign, taking responsibility for the LDP's recent election failing. Indeed, one newspaper even went as far as printing copies announcing his departure from office, only for this to be subsequently denied. It occurs to us that Ishiba is mortally wounded within his Party.

Therefore, we think that he is set to depart within the next month or two, triggering a new LDP leadership contest. There has been speculation that this will be a catalyst for renewed fiscal easing, in order to help offset the pain of rising prices on Japanese consumers. This has been weighing on yields, with 10-year maturities posting a 17-year high above 1.60% this week.

Next week, investors in Japan will also focus on the July BoJ policy meeting. In light of inflation remaining at 3%, we think that the combination of a more optimistic US outlook, plus greater clarity on Japan tariffs, will mean that Ueda seeks to guide towards an October rate hike after keeping policy on hold for the time being.

Ultimately, we are sceptical that there will be a major change in the Japanese fiscal stance and continue to project the Japanese debt-to-GDP ratio to fall, thanks to ongoing growth in nominal GDP. Over time, we think that Japanese yields will continue to rise as the BoJ normalises policy and we continue to look for cash rates to approach 1.5% by the end of next year.

At that point, we think fair value on 10-year yields will be around 2.0-2.25%, but we think that 30-year yields may decline to 2.75%-3.0%, as the supply and demand of ultra longs is brought more squarely into balance.

Newsflow in the UK continues to be downbeat. This week, the government announced a jump in government borrowing in the month of June, as spending outlays continue to outpace tax receipts. In this light, it is noteworthy that the recent rise in employer National Insurance taxes seems to have worsened the UK fiscal position, rather than help to improve it.

In part, this is due to the NI rise helping push inflation higher as cost increases are passed on. The UK has a significant share of government debt which is index linked. Consequently, higher inflation feeds directly into higher interest rate expense. Additionally, public sector wage claims, pensions and regulated prices are linked to moves in inflation.

Therefore, inasmuch that inflation is pushing up borrowing costs, this creates a worrying stagflationary dynamic. Feeding into this, it has been recorded that UK food price inflation has accelerated above 5% in the past month.

Although the Bank of England seems determined to cut rates, believing its models that are telling it that inflation should fall as slack in the economy grows, we think that data is increasingly calling this into question. In particular, we would argue that inflation expectations in the UK are now more consistent with persistent 4-5% rates of inflation.

However, in an attempt to say something a bit more cheerful about the UK for a change, at least this week, its trade deal with the US is looking like one positive result that Starmer can reflect on. Yet, the outlook for Starmer appears challenged, with Angela Rayner seemingly readying herself for a leadership challenge in the not too distant future. Meanwhile, polls currently have Labour showing a lower vote share than the Conservatives achieved at the last election. Were an election to be called today, it would be to Nigel Farage and his Reform Party to lose.

In credit markets, spreads continue to tighten on strong technicals, as investor flows into the asset class remain robust. Notwithstanding school holiday season, market activity has been relatively brisk. Indeed, in areas such as bank loans, the past week has seen some of the largest volumes recorded this year as borrowers seek to refinance at lower spreads.

In this context, we have witnessed a compression trade, as higher yielding names outperform high quality. Similarly, we have also seen outperformance of synthetic indices, relative to cash bonds, as hedges are closed as investor fears appear to melt into the background.

At this juncture, we think that generic spread tightening at an index level is likely to cease, with valuations already compressed. For example, CDX IG at 50bps and Itraxx Main at 53bps are within 5bps of the tightest spreads since the onset of the financial crisis at the start of 2008. We would also highlight that strong technicals in credit have been based on yield-targeting buyers who pay less attention to spreads.

This demand could turn were underlying government yields to move lower. From this point of view, we continue to favour relative value trades in credit, focussing on specific issuers and issues that appear mispriced in our eyes.

We have maintained yield curve steepening positions with a positive stance at the front end of the US curve, relative to shorts in 30-year Treasuries and German bunds. In Japan, we have been reducing a net duration short stance as yields rise, with most of our risk continuing to come from a long position in 30-year bonds relative to the 10-year sector. FX risk remains modest, and we continue to look for a dollar rally in the short term, to give entry opportunities into a more explicit short dollar stance.

### **Looking ahead**

Next week's focus will initially be on central bank meetings, but we don't expect too much to come from either the Fed or the BoJ. Risks around Trump tariffs on August 1st appear to be diminishing, though there remains a worry that an EU deal won't be concluded ahead of the deadline date.

In the EU, we would also highlight that divergence between EU member states means that it may also be difficult to agree a unified negotiating stance. This is also relevant with respect to reciprocal tariffs on the US. However, we are getting a sense that many in the bloc have determined that there is little to be gained and much to be lost in provoking a conflict with the Trump administration, especially if other large US trading partners are falling into line.

As long as the August 1st deadline doesn't contain a nasty surprise, it may appear that markets could head into the month in a bull market mindset. Fear is in obedience. Trump has proved many naysayers wrong and looks to be riding higher.

But there is an adage about pride coming before a fall and although all appears calm, there seem to be many risks that lurk not far below the surface. We remained concerned, where we observe greed or complacency. In this light, we remain somewhat sceptical that benign conditions will be able to persist for too long.

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