



Market Commentary

Making Conclave Great Again

Is Trump destined for the bright lights of Hollywood?!

Key points:

- Treasury yields were rangebound this week as the Fed held rates steady, with Chair Powell offering little clarity on future adjustments.
- A US/UK trade deal seems positive although detail was lacking. Agreements are expected soon with India, Israel, Australia, Japan, and Korea, but progress with the EU is not expected until summer.
- Germany's new Chancellor, Merz, had a shaky start, however fiscal expansion should give cause for optimism.
- In the UK, the Bank of England cut rates amidst a backdrop of weak growth, whilst Nigel Farage's Reform Party gained in local elections, putting pressure on Labour.
- We believe markets have been overly optimistic in relation to Trump's April trade pivot, and challenges ahead have meant hedging and reducing risk exposures.

9 May 2025 (London) – Treasury yields were largely rangebound over the past week, as the Federal Reserve maintained policy on hold, with Chair Powell offering few hints in terms of the timing of possible future rate adjustments.

The FOMC sees clear upside risks to inflation and downside risks to growth, on the back of Trump's trade policies, but there remains elevated uncertainty, and, in many respects, it seems doubtful that the picture will be much clearer by the time of the next meeting in the middle of June. That meeting will be a chance for the committee to update its economic projections and the 'dot plot', which had factored 50bps easing in 2025 at the time of the March FOMC.

However, the problem with any point forecast is that it is attempting to probability weight a number of discrete scenarios. This being the case, we continue to see fair value for 10-year Treasuries around 4.5% and remain content to retain a neutral duration view, for the time being. Over time, we look for the 2/30 curve to steepen further, though with this being a very consensual trade, we would look for a retracement in the spread, below 90bps, as an opportunity to add an active position.

There has been some optimism around the US/UK trade deal announced yesterday, but in truth there were few details beyond initial headlines. Agreements are likely to be reached with several other countries, including India, Israel, Australia, Japan, and Korea, in the coming few weeks. However, we expect no real progress to be made in any trade discussions with the EU before the start of July. With respect to China, it may be hoped that some de-escalation in tariffs is agreed, but even in a very hopeful scenario, it seems unrealistic to project tariff rates declining below 60%, as the US administration seeks to end the country's dependency on Chinese imports.

We would also highlight that Trump's recent suggestion that tariffs be applied to non-US made movies is just the latest example that highlights an unswerving desire to re-orient the global economy back towards the US. Inasmuch as this marks a potential broadening of trade disputes beyond goods and into services, it also bears paying some attention to.

Ongoing disruption in trade and upheaval in trading relationships leads us to continue to lower US growth projections to around 0.5%, on an annualised basis. For now, we still think that recession will be avoided, although it will be important to pay attention to labour market developments, as were unemployment to rise

more quickly than we expect, it would not be hard to foresee an economic contraction. Inflation may top 4%, though this may depend on what happens with respect to food and energy prices, given that US food prices could soften as these exports to China grind to a halt.

In Germany, Friedrich Merz appeared to suffer a bit of a false start in his role as German Chancellor, requiring two votes to secure his position. That said, we expect the CDU leader to hit the ground running and believe that fiscal expansion may end up exceeding many expectations. We look for positive news out of Germany in the days ahead, and it appears there is intent across the EU to stand united in the face of US policy changes.

We also think that near-term EU economic data may be supported by orders ahead of a potential increase in tariffs. In this case, we believe that some near-term economic pessimism in the EU may be overdone, and it seems likely to us that the EU economy will now expand at a faster rate than the US in 2025.

Elsewhere in the EU, elections in Romania saw a surprisingly strong vote in favour of right-wing candidate George Simion from AUR. This has seen a collapse in the government coalition ahead of a second-round run-off on 18th May. Romanian assets fell sharply on the news, as a victory for Simion could threaten political and fiscal stability and potentially up-end the country's relationship with the rest of the EU.

Yet we think that some of these fears are overstated. Romania remains a large beneficiary of EU funds and support for the EU within the country remains very strong. Although Simion is a right-wing populist, we think that the template of Georgia Meloni in Italy (who Simion is allied to), is potentially instructive.

In our estimation, with Romania debt spreads at a level consistent with 'B' rated credits, too much bad news is already in the price, given that overall debt levels remain modest in an international context, even if twin deficits do make it clear that there needs to be a period of economic adjustment.

Meanwhile, the Bank of England cut UK interest rates at its MPC meeting this week, against a backdrop of weak UK economic prospects. However, with inflation set to jump in the next couple of months, further rate cuts look unlikely, in our opinion. UK local elections last week recorded strong success for Nigel Farage's Reform party. We remain a long way from a general election, though disquiet in Labour ranks is mounting.

The natural desire among Labour activists is to boost spending (or avert cuts), and this may mean tax rises are on the agenda in the autumn as Chancellor Reeves risks breaching her own fiscal rules. Ideally, she would not be subject to this framework, but any attempts to discard this will be met with even greater concern from markets, which have remained sensitive to debt sustainability worries ever since the Truss tantrum in 2022.

In Japan, much of the domestic attention has been on progress towards a US trade deal. Meanwhile, long-dated JGBs have continued to be under selling pressure on the back of overseas investor capitulation. 30-year JGBs now yield more than 30-year bunds, and at a spread 160bps over 10-year maturities, represent outstanding value on a relative basis, in our assessment.

Investors in Tokyo are only just returning from the annual Golden Week holidays, and the coming weeks typically see domestic investors deploying new cash into the market at the start of the current fiscal year. We have thought that life insurance companies would be attracted by the yields on offer, noting plans to increase domestic holdings within their asset allocation.

In the short term, volatility can keep buyers on the sidelines, but as soon as volatility starts to drop, we are confident that more buyers will emerge and, consequently, we have been happy to continue to steadily build exposure in 30-year JGBs over the past several weeks, as yields have approached 3%.

Looking ahead

We feel that financial markets have been too ready to buy into a narrative that Trump's April pivot means that the administration has changed course and is now more focussed on a pragmatic deal-making path, which will help underwrite economic growth and financial asset prices. Following a more benign period, we expect further problems ahead, and so have been adding hedges to risk assets and flattening exposure, which we added at the start of April.

Meanwhile, at a time of political upheaval on a global scale, the relatively seamless selection of Pope Leo XIV provided a happy distraction from what is happening in the US. That said, Donald Trump seemed unable to resist trying to grab headlines earlier in the week, positing an AI image of himself as the next pontiff.

You can half imagine how Trump might have fancied himself as the first American Pope and you wonder – if the Conclave movie had been produced in Hollywood – whether the producers would have received a call from the White House! We can be relieved to have been spared that!

Notes to Editors

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