Fixed Income Weekly

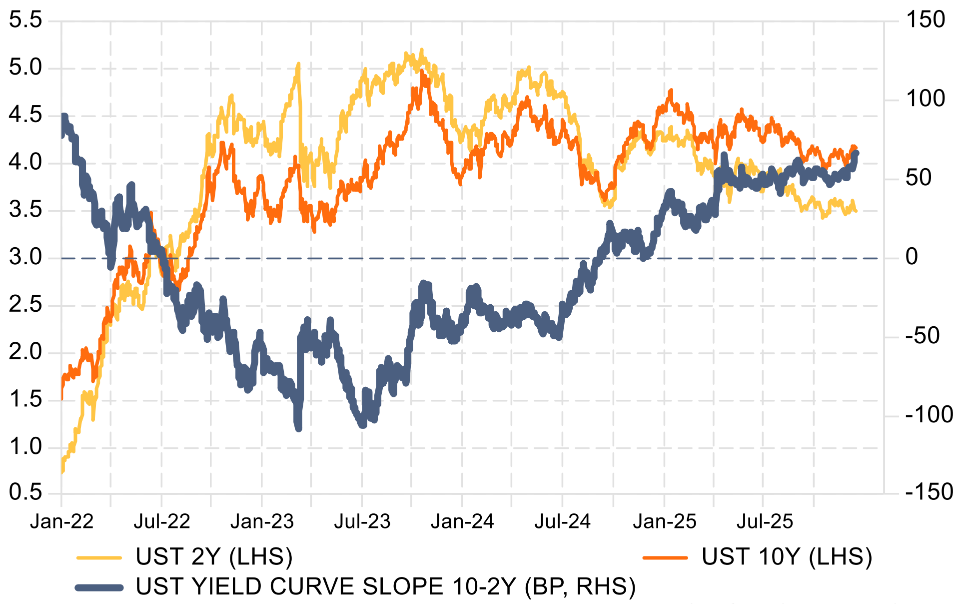
Long-term rates rise after the Fed and Schnabel

Syz Fixed Income Research – Week from 08 to 12 December 2025

A "not so hawkish" Fed rate cut and ECB Schnabel's comments drove a yield curve bear steepening last week.

The Chart of the Week

The US Treasury yield curve at its steepest since early 2022



Banque Syz, @FactSet Research Systems

After the Fed delivered a balanced message along with the expected rate cut last week, USD short-term rates have remained anchored close to their recent 3-year lows, around 3.5%. In the meantime, long-term rates have drifted up to their highest level since early September, close to 4.2%.

As a result, the slope of the USD yield curve (the difference between 10y and 2y rates) has extended further its upward dynamic and now stands close to 70bp, a level last seen in early 2022.

This positive yield curve slope and the steepening witnessed in December reflect an increase in term premium fueled by rising uncertainties around the medium-term inflation outlook, in a context of strong fiscal support across all major regions.

As the Fed is nearing the end of its rate cut cycle, short-term rates may have found a floor while long-term rates increasingly factor in the prospect of buoyant nominal growth.

What happened last week?

Central banks

Last week opened the last round of central banks' meetings for 2025. The Fed delivered a third consecutive 25bp rate cut, bringing the Fed Funds target range to 3.50/3.75%. Chair Powell struck a less hawkish tone than expected, emphasising labour market risks and noting recent inflation stabilization. Guidance points to a "wait-and-see" stance, with the median projection showing only one cut in 2026, while future markets currently price slightly more than two 25bp cuts for next year. On the same day, the BoC held its policy rate at 2.25%, judging rates to be "about the right level" if the economy evolves as projected. One day before, the RBA had kept the AUD cash rate at 3.60%, displaying a hawkish tone as policymakers consider a hike as early as February.

The SNB kept its key rate unchanged at 0.00% and clearly signaled that the bar for further easing is high. President Schlegel stressed that a move below zero remains unlikely, and the most likely policy path in 2026 is stable short-term rates at 0%. The Banco Central do Brasil kept its Selic rate unchanged at 15.0%. With inflation back into the target range, the BCB eased its previously hawkish tone and opened the door to potential rate cuts in 2026.

The ECB is expected to keep its key rate unchanged this week, but Isabel Schnabel struck a hawkish tone last week, expressing comfort with expectations of a future hike and warning that inflation risks remain skewed to the upside. Several other central bank meetings are also due this week: the Bank of England is expected to cut its base rate by 25bp to 3.75%, the Riksbank and Norgesbank should keep their rates unchanged while the Bank of Japan is set to deliver a second 25bp rate hike this year that would raise JPY short term rates to 0.75%.

Rates

Government bond markets experienced a pronounced curve steepening over the week, driven primarily by developments in US monetary policy after the Fed's rate cut and raising uncertainties around the medium-term inflation outlook.

As a result, in the US Treasury market, front-end yields declined modestly, with the 2yr yield falling 4bps to 3.52%. Further out the curve, yields rose, reflecting higher term premia. The 10yr yield increased 5bps to 4.18%, while the 30yr rose a similar amount to 4.84%, both marking their highest levels since September. As a result, the 2s10s slope reached its steepest level since January 2022. Performance mirrored these moves, with short-dated Treasury ETFs posting small gains (iShares Treasury 1-3y +0.1%), while long-duration funds underperformed sharply (iShares Treasury 7-10y down -0.3%, 10-20y down -0.7%, 20y+ down -0.9%).

European government bonds also sold off amid rising global yields and hawkish comments from ECB Executive Board member Isabel Schnabel. German 10yr bund yields rose 6bps to 2.86%, their highest weekly close since March. French OATs, Italian BTPs and other euro area sovereigns moved higher in tandem, although France modestly outperformed after parliament approved the social security budget. Euro-denominated government bond ETFs delivered negative weekly returns across maturities (iShares EUR 3-7y Government Bond -0.3%, iShares EUR 10-15y Government Bond -0.5%).

Credit

Credit spreads widened modestly last week, following ECB comments highlighting the resilience of the European economy and renewed concerns over the future independence of the U.S. Federal Reserve. Rising U.S. Treasury yields, alongside higher German Bund yields ahead of the ECB meeting on 18 December, weighed on credit performance and resulted in negative total returns across most credit segments.

U.S. investment grade declined 0.4% for a second consecutive week, while U.S. high yield also fell by-0.3%. In Europe, investment grade slipped further by -0.3%, with high yield proving slightly more resilient, down 0.1%, supported by coupon carry.

The only outperformance came from AT1 (Additional Tier 1 capital of banks) segment amid the market attention on the ECB's High-Level Task Force on Simplification. The regulator is exploring potential reforms to the AT1 framework, including a possible phase-out or increased loss-absorption features. Importantly, any reform will apply only to new AT1s and would not be retroactive to the existing AT1s. Markets expect a lengthy implementation timeline, and potential the phase-out could reduce the extension risk on existing AT1s, as banks may be incentivised to redeem these existing AT1s. That said, regulatory uncertainty remains.

Concerns around AI-related capex have, by contrast, positioned European investment grade relatively favourably. Technology accounts for roughly 8% of the U.S. investment-grade index, versus only 2% in EUR investment grade, leaving European credit less exposed to AI capex risks at this stage.

As the year draws to a close, market activity has softened, and flows have become more muted. The dominant theme of this year has been the persistent inflows into EUR investment grade, particularly at the front end of the curve, with short-dated investment-grade funds attracting significantly more inflows than longer maturities or government bond funds.

While credit demand should remain strong in 2026, as many investors continue to view coupon carry as king, inflows are likely to moderate. Credit spreads are at historical tight levels, and the ECB appears approaching the end of its easing cycle.

Emerging market

Emerging market (EM) sovereign USD bonds were down last week, driven by higher US Treasury yields. Latin American credits notably underperformed, led by Colombia, Mexico and Brazil. On the other hand, Egypt and Oman were more resilient to the broader downside. Fitch upgraded Oman to BBB-, a rising star, citing the sustained improvement in debt-to-GDP to 36% in 2025, from 68% in 2020. Oman should maintain its prudent policy stance in a lower oil price environment.

The U.S. imposed new tariffs on Mexico, India, Thailand and Indonesia to eliminate the transshipment bus by Asian exporters to circumvent U.S. tariffs. The new Mexican measures mainly target auto, textile, apparel, plastics and appliances with most items facing rates between 20-35%. Auto carries the highest tariff at 50%. China is Mexico's largest auto importer, accounting for 20% of the Mexican car market.

Fitch upgraded Côte d'Ivoire by one notch to BB, following a largely peaceful October presidential election. The upgrade reflects strong growth prospects, with GDP expected to expand by 6.4% in 2025, 6.5% in 2026, and 6.6% in 2027, while inflation is projected to remain below 2% over the same period.

Global EM debt funds continue to see inflows, only one week of outflows the past 34 weeks.

Performance was again mixed across EM asset classes: EM hard-currency debt declined marginally (iShares EM Sovereign USD Bond ETF -0.1%), local-currency bonds outperformed again (J.P. Morgan EM Local Currency ETF +0.2%), EM corporates rose +0.1%, while Asian high yield gained +0.3%.

EM credits will enter 2026 against a backdrop of resilient corporate balance sheets and positive GDP growth across emerging markets.

Our view on fixed income

Rates

NEGATIVE in current environment

We maintain a Negative stance on government bonds. Positive global growth dynamics, price pressures in the US and profligate fiscal policies reduce the attractiveness of long-term government bonds as a potential hedge for economic downturn and increase the risk of higher long-term yields. Limited prospects of further central banks' rate cuts and unattractive yield curve slopes at the front-end also reduce the attractiveness of government bonds on short-to-medium term maturities.

Investment Grade

NEUTRAL, harvest the carry

We find Investment Grade corporate bonds attractive in the current environment, given their yield level and our constructive economic scenario. However, tight credit spreads reduced the margin for safety in credit and make the asset class expensive from a valuation standpoint. As a result, we keep a Neutral stance on Investment Grade credit from an asset allocation perspective. The credit market's overall health is supported by robust demand and strategic maturity management.

High Yield

NEUTRAL, favor short maturities

We like High Yield bonds with short maturity for their attractive combination of yield and low sensitivity to interest rate movements. HY spreads have tightened, signaling economic stability and contained default risk in the short run. However, those tight spreads are not attractive for medium-to-long term maturities as they do not compensate adequately for a potential deterioration in the economic environment. As such, we hold a Neutral view for High Yield in an allocation, with a clear preference for short-duration investments. We continue to find value in subordinated debt.

EM

NEUTRAL, be selective

We advocate for a careful selection of issuers to benefit from attractive absolute yields. Substantial inflows into EM debt this year have been fueled by a weak dollar along with EM corporates' solid credit metrics and support the asset class. However, risks persist, with rich valuations and unpredictable Trump's trade policies. Idiosyncratic risks also remain, notably in Brazil and India. Given this backdrop, we stay selective, favoring short-duration opportunities while remaining Neutral on the broad EM debt asset class.