Fixed Income Weekly

Credit markets weather a volatile geopolitical and rate environment

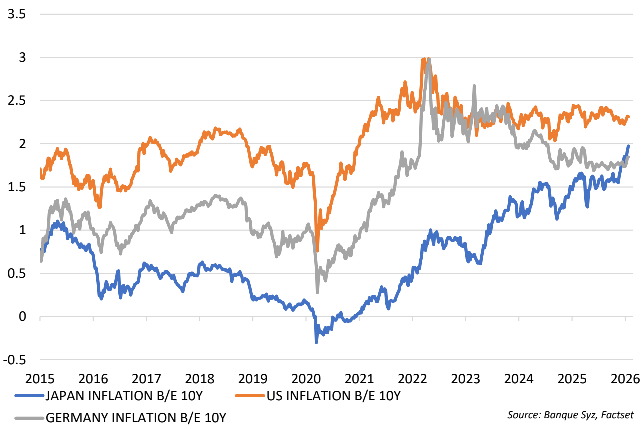
PRIVATE BANKING

Syz Fixed Income Research – Week from 19 to 23 January 2026

Credit markets hold firm while sovereign bonds digest the adjustment in Japanese yields

The Chart of the Week

Inflation expectations in Japan are rising and driving the rise in JGB yields



The rise in Japanese Government Bonds' yield has been one of the major developments across fixed income markets in the recent months. The 10-year JGB yield hit 2.35% last week, its highest level since 1999.

This rise in Japanese yields has been essentially driven by the awakening of inflation expectations in the Land of the Rising Sun. Market-based inflation expectations have been steadily rising and have just reached 2% for the first time in at least two decades. They are now aligned with the BoJ's 2% inflation target and suggest that markets have finally become convinced that the long deflation era was over in Japan.

Real yields (nominal JGB yields minus inflation expectations) are also trending up in Japan in parallel of the rise in inflation expectations, but in a more gradual way: the real yield of JGB 10-year bonds has risen from -0.35% a year ago to close to +0.3% now.

This upward trend in inflation expectations is not visible yet in the US and European markets. Long-term inflation expectations remain broadly anchored around the 2% level (slightly above in the US, slightly below in Europe), suggesting that markets still believe in the Fed's and ECB's credibility for defending their 2% inflation target over the medium and long-term. Profligate fiscal policy and public debt dynamics, along with political interferences around monetary policy in the US, are a potential threat to this anchoring of long-term inflation expectations but they are not yet reflected in market-based inflation expectations.

What happened last week?

Central banks

Markets last week were dominated by shifting expectations around future Fed leadership alongside a steady policy outlook. On prediction markets, Rick Rieder's implied odds of becoming the next Fed chair rose sharply over the weekend, overtaking Kevin Warsh. Investors view Rieder as more market-friendly, particularly given his openness to using the balance sheet to manage longer-term yields. Ahead of Wednesday's FOMC meeting, the Fed is widely expected to keep rates unchanged while upgrading its assessment of growth and acknowledging a steadier labour market. With inflation progress still limited, language is likely to remain cautious. Chair Powell's press conference is expected to focus heavily on institutional independence and governance issues, reinforcing the message that policy is near neutral and data-dependent.

ECB officials struck a message of resilience and flexibility. President Christine Lagarde pushed back against pessimistic narratives of global fragmentation at Davos, emphasizing mutual economic dependence. December meeting accounts showed policymakers broadly comfortable with the current stance, favouring an extended period of stable rates while retaining full optionality. Privately, many see the rate-cutting cycle as likely over absent a major shock.

The BOJ held its policy rate at 0.75%, as expected, while raising its inflation outlook. Although the decision had a hawkish undertone given the upward revision to price forecasts and a dissent calling for a hike, Governor Ueda avoided signaling imminent tightening.

In China, the PBoC left its key rates unchanged last week. The Bank Indonesia, the Central Bank of Malaysia and the Norgesbank also held their key rates steady, while the Central Bank of the Republic of Türkiye cut again its short-term to the lowest level in more than two years.

Rates

Sovereign bond markets experienced volatile but ultimately mixed moves last week, shaped by geopolitical concerns, fiscal uncertainty and shifting policy expectations. The most pronounced action occurred in Japan, where JGBs sold off sharply early in the week. Thirty-year yields surged 26.6bp on Tuesday to 3.84%, the largest daily rise since 1999, before retracing part of the move. By week-end, 30yr yields were still 14.6bp higher, while 10yr yields rose 6.7bp to 2.26%, reflecting both upward revisions to inflation forecasts and lingering uncertainty around the pace of Bank of Japan normalization.

In Europe, core yields moved higher as well. German 10yr bund yields rose 7bp to 2.91%, while UK gilts underperformed, with the 10yr yield jumping 11bp to 4.51%. Markets reacted to heightened geopolitical tensions and growing expectations of increased defence spending, reinforcing concerns about medium-term fiscal pressure across the region. Peripheral spreads were relatively stable but yields still climbed, with Italian, Spanish and Portuguese 10yr yields up 5–6bp on the week.

US Treasuries were comparatively resilient. Despite early-week weakness driven by firm data and global risk headlines, yields ended little changed. The 2yr and 5yr yields rose around 1bp, while the 10yr finished essentially flat at 4.23%, supported by a late-week rally as leadership uncertainty at the Fed increased. In line with higher yields, euro-area government bond ETFs posted modest negative returns, with longer-duration funds underperforming.

Credit

Credit markets remained remarkably resilient, with EUR and USD investment-grade spreads ending the week at fresh cycle tights, despite a highly volatile backdrop.

Global markets were unsettled by the prospect of President Trump seeking to annex Greenland, compounded by the potential EU retaliation through large-scale sales of U.S. Treasuries, alongside mounting fears of a sharp escalation in global trade tariffs.

Sentiment sharply rebounded after President Trump walked back the tariff threats, triggering a relief rally in the credit markets.

The fiscal driven rates shocks have become less disruptive for EUR credit market. A key structural support remains the continued inflows of fixed-maturity credit funds, which mechanically compress spreads. The most encouraging signal, however, is investor positioning for an acceleration in growth, set against a backdrop of accommodative financial conditions expected to persist for longer. This combination has continued to drive spread compression in EUR high yield.

While European growth expectations have not rebounded as sharply as in the U.S., the outlook is gradually improving. Europe has lagged in AI adoption, yet capex trends are turning supportive: more than half of European companies in capital goods, transport and industrials are increasing investment. These sectors are well positioned to benefit from Europe’s renewed focus on defence and infrastructure spending, providing a constructive medium-term backdrop for credit.

Looking ahead, the risk of a potential U.S. government shutdown could once again obscure macroeconomic data releases and reintroduce episodes of market volatility.

Emerging market

Despite the escalated geopolitical tensions, emerging markets (EM) debt proved resilient to the selling pressure in U.S. Treasury yields. EM sovereign USD bonds delivered a solid +0.5% total return last week (iShares EM Sovereign USD Bond ETF), while EM local-currency sovereign bonds posted a stellar +1.4% (The J.P. Morgan EM Local Currency Bond ETF), supported by a sharp weakening of the U.S. dollar.

On the macro front, the IMF revised its 2026 GDP growth forecast for emerging markets upward from 4.0% to 4.2%. Among major EM economies, China’s outlook was lifted from 4.2% to 4.5%, reflecting easing trade tensions and accommodative domestic policies. Saudi Arabia’s forecast was also raised from 4.0% to 4.5%, underpinned by higher planned oil production and continued economic diversification.

In China, following GDP growth of exactly 5% in 2025, the Ministry of Finance announced further interest-subsidy easing for small businesses. Markets now turn their attention to China’s annual “Two Sessions” meetings in early March—a key gauge of policy direction—where investors will assess whether the government lowers its 2026 GDP growth target to a 4.5–5.0% range.

Besides, it is reassuring that S&P expects the GCC (Gulf Cooperation Council) sovereigns and banks to remain resilient amid the episodes of heightened geopolitical risk, thanks to their accumulated financial buffers. In particular, Saudi Arabia's strong net government asset position provides a meaning layer of credit resilience.

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, with opportunities

We advocate for a careful selection of issuers to benefit from attractive absolute yields. Global growth dynamic, a weaker US dollar, contained public debt & corporate leverage along with strong flows are supportive for EM debt 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 and medium-duration opportunities while remaining Neutral on the broad EM debt asset class in a multi-asset portfolio context.