Fixed Income Weekly

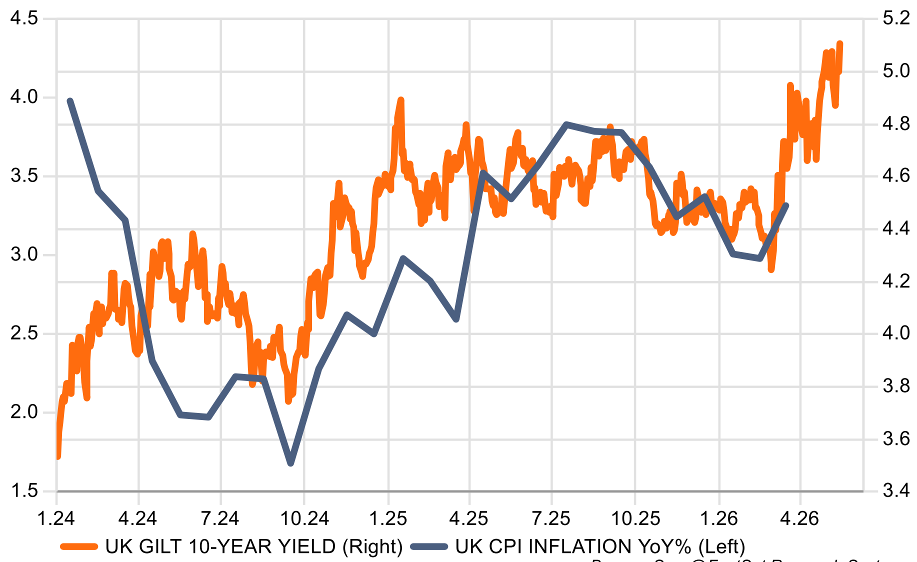
UK rates surge as political uncertainty adds to inflation dynamics

Syz Fixed Income Research – Week from 1 to 8 May 2026

Global rate markets are driven by oil price fluctuations, credit and EM debt remain very resilient

The Chart of the Week

Gilts are pricing political risk again, on top of inflation acceleration



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UK government bond yields just surged to their highest levels since 2008, with the 10-year gilt hitting 5.1% as investors confront a deteriorating mix of inflation pressures and political uncertainty. The interest rate rise in March and April reflected global factors: rising oil prices, persistent inflation and a reversal in expectations for the path of BoE rates, from two rate cuts to almost three rate hikes by the end of 2026.

But domestic politics are now adding a clear UK-specific risk premium to rates. Following Labour's poor local election results and growing speculation over Prime Minister Starmer's future, investors are increasingly worried that a weakened government, or a future Labour leadership contest, could lead to looser fiscal policy and higher public borrowing.

This matters because the UK already faces elevated deficits and heavy gilt issuance needs. Investors remain highly sensitive to any threat to fiscal discipline after the 2022 Truss crisis, when unfunded policies triggered a violent gilt selloff. As a result, political headlines are feeding directly into borrowing costs, particularly at the long end of the curve.

The message from markets is clear: in an environment of persistent inflation, bond investors are demanding a higher premium to finance UK debt amid rising fiscal and political risks.

What happened in the last ten days?

Central banks

Federal Reserve officials generally confirmed last week the message conveyed at the April 29th FOMC. Several policymakers, including Neel Kashkari, Susan Collins and Beth Hammack, dissented against the idea of an "easing bias," arguing the next move could still be either a hike or a cut depending on incoming data. Meanwhile, Austan Goolsbee and Alberto Musalem warned that persistent services inflation, tariffs and stronger productivity-driven demand could keep inflation elevated for longer. In this context, future markets are now pricing a still small (30%) but rising chance of a rate hike by the end of the year, a stark reversal from previous rate cuts expectations surrounding the nomination of Kevin Warsh as new Fed Chair.

The rhetoric also shifted further toward tightening among ECB members last week. Peter Kazimir, Joachim Nagel or Isabel Schnabel suggested a June rate hike is increasingly likely if higher energy prices persist and feed into broader inflation dynamics. President Christine Lagarde nevertheless emphasized the need for additional data amid heightened geopolitical uncertainty and stagflation risks across the euro area. Future rate markets continue to price in around three 25bp rate hikes from the ECB by the end of 2026.

In a context of rising uncertainties around the UK's political and fiscal outlook, BoE Megan Greene warned that the Iran conflict has created a new inflationary energy shock that could push prices higher while weakening growth, increasing the risk of stagflation in the UK. Greene stressed that inflation risks are "entirely on the upside". Future rate markets continue to price close to three 25bp BoE rate hikes by the end of the year.

Rates

Global sovereign bond markets rallied modestly last week as easing geopolitical tensions in the Middle East and lower oil prices supported risk sentiment and reinforced disinflation expectations. Brent crude declined 6.4% to USD 101.22/bbl, providing a supportive backdrop for duration globally.

US Treasury moves remained relatively contained as stronger-than-expected macro data offset the decline in inflation expectations. April payrolls rose by 115k, well above consensus expectations, while wage growth moderated slightly. Against this backdrop, the US curve bull-flattened modestly, with 10-year and 30-year Treasury yields both declining 2bps to 4.35% and 4.93%, respectively, while the 2-year yield was unchanged at 3.88%. US 10-year breakevens narrowed 4bps to 2.46%, while real yields edged higher.

European government bonds outperformed US Treasuries, led by peripheral markets. Italian 10-year BTP yields fell 13bps over the week, while Spanish and Portuguese 10-year yields each declined 8bps. Core markets also strengthened, with German bund yields down 3-4bps across the curve and French OAT yields lower by 5-7bps. UK gilts rallied 5bps last week despite political uncertainty following local election results.

The decline in yields translated into positive fixed income returns, particularly in longer-duration strategies. iShares Treasury 20+ Year and 10-20 Year ETFs gained 0.55% and 0.51%, respectively, outperforming shorter-duration Treasury indices. In Europe, duration exposure also benefited performance, with the iShares EUR 10-15 Year Government Bond ETF returning 0.68%, ahead of broader EUR government bond benchmarks.

Credit

Last week, the combination of tighter credit spreads and broadly lower U.S. Treasury and German Bund yields created a supportive backdrop for positive total returns across both U.S. and EUR credit segments. This came despite elevated tensions in the Middle East and renewed tariff threats from the U.S. toward the EU. The U.S. administration set a July 4 deadline for the EU to implement previous trade agreement commitments before potentially increasing tariffs on European exports.

Within EUR investment grade (IG), bank subordinated debt outperformed as interest rate volatility declined. EUR IG funds continued to attract inflows, primarily in medium-term maturities, although longer-duration segments also started to see inflows last week.

Within EUR high yield (HY), the chemicals sector continued to outperform on a total return basis. Chinese chemical exports to Europe are currently constrained by disruptions linked to the Strait of Hormuz situation. EUR HY recorded a fourth consecutive week of inflows following seven weeks of outflows.

U.S. HY spreads tightened despite strong primary market activity, with last week marking the second most active issuance week since December. This follows the highest monthly net issuance for April in the past six years. We are now roughly two-thirds through the U.S. HY first-quarter earnings season: nearly half of issuers have exceeded EBITDA consensus expectations and provided constructive guidance for the remainder of the year, while only 17% reported below consensus.

In the coming weeks, history suggests caution may be warranted. We can be entering into a seasonally weaker period for credit markets.

Over the past ten years, EUR IG spreads have generally widened during May. This seasonality has largely been driven by technical factors, as bond supply typically accelerates once companies exit blackout periods following first-quarter earnings releases.

Year-to-date, reverse Yankee issuance in the EUR market has reached €78 billion, setting a new record. Issuers of last week included Alphabet, Booking Holdings and Kraft Heinz.

Emerging market

EM credit markets posted positive returns across sovereign USD debt, local currency debt and EM corporates. EM corporates have been less volatile, while delivering a comparable year-to-date total return of 1.5% versus EM sovereign USD (+1.4%) and local currency debt (+1.6%), despite the duration headwind from higher U.S. Treasury yields compared with pre-U.S.–Iran conflict levels. Crude prices declined last week as peace proposals were exchanged.

The strongest performers were Angola and Nigeria, supported by higher oil prices and increased demand for alternative crude supply into Europe amid the Strait of Hormuz disruption. The main underperformer was Romania, while Poland also modestly lagged.

Saudi Arabia spreads still trade relatively wide. Higher oil prices are indeed supportive for the Kingdom's trade balance and public finances, while the East-West pipeline to Yanbu provides an alternative export route, albeit with lower capacity than through the Strait of Hormuz. Investors also take comfort from Saudi Arabia's substantial international reserves, which provide a strong buffer against external shocks. In addition, analysts see a renewed escalation by the Houthis in the Red Sea as unlikely unless Iran's regime comes under severe pressure, given the degradation of Houthi military capacity in previous conflicts.

Fitch's one-notch upgrade of Argentina is a milestone, reflecting structural improvements in fiscal and external balances, as well as progress on economic reforms. However, with Argentina still rated CCC by S&P and Moody's, many high yield funds remain restricted from adding exposure. President Javier Milei's austerity policies have reduced monthly inflation from 25.5% in December 2023 to 3.4% in March 2026. If GDP growth continues into 2027, with the IMF forecasting +3.5% in 2026 and +4.0% in 2027, Argentina could achieve three consecutive years of expansion following the 2024 recession.

Overall, EM corporates have been remarkably resilient since the onset of the U.S.–Iran conflict, with performance rebounding strongly after the March sell-off. Spread tightening has more than offset the duration drag from higher U.S. Treasury yields. Commodity outperformance, solid earnings momentum and prudent corporate balance sheets should continue to support selective EM corporates, while also driving wider dispersion across issuers.

Our view on fixed income

Rates

NEGATIVE in current environment

We maintain a Negative stance on government bonds. Renewed price pressures from the surge in oil & gas prices and prospects of more profligate fiscal policies reduce the attractiveness of long-term government bonds as a potential hedge for economic downturn. Reduced prospects of further central banks' rate cuts and unattractive yield curve slopes at the front-end also lower the attractiveness of government bonds on short-to-medium term maturities.

Investment Grade

NEUTRAL, harvest the carry

We continue to find Investment Grade corporate bonds attractive, given their yield level and our still constructive economic scenario over the medium term. However, tight credit spreads reduced the margin for safety. 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 remain tight, and 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 dynamics, contained public debt & corporate leverage in many EM economies along with strong flows are supportive for EM debt However, risks persist, with rich valuations and unpredictable Trump's 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.