Fixed Income Weekly

Yield curve steepens as the Fed leaves markets guessing

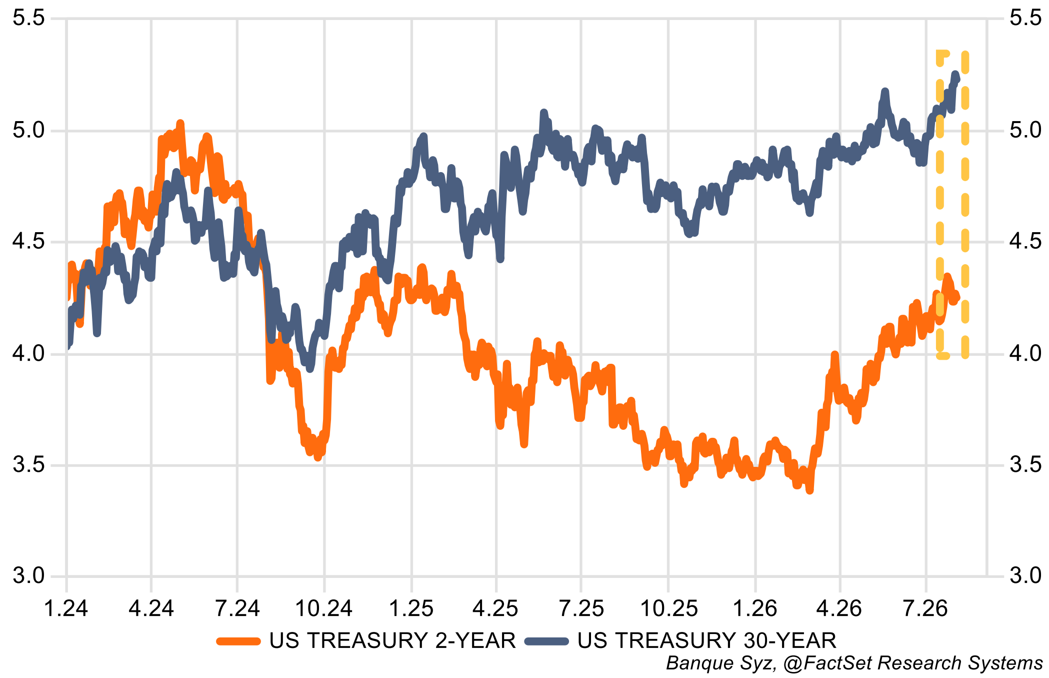
Syz Fixed Income Research – Week from 27 to 31 July 2026

Central banks stood still, but bond markets did not

The Chart of the Week

US yield curve steepens as long-end yields surge

US Treasury rate 2-year and 30-year since 2024



The divergence between US Treasury 2-year and 30-year yields has become spectacular since 2025. While front-end yields have broadly tracked shifting expectations for Federal Reserve policy, long-dated yields trended higher, reflecting persistent inflation concerns, elevated fiscal borrowing needs and rising term premia.

Last week's FOMC meeting reinforced this trend. Although the Fed left rates unchanged, Chair Kevin Warsh provided little additional clarity on the reaction function, prompting markets to scale back expectations for further near-term tightening. The 2-year Treasury yield ended the week down -4bp at 4.29%, while the 30-year yield climbed +12bp to 5.27%, its highest level since 2007. The resulting steepening of the yield curve was the sharpest since April.

For fixed income investors, the move highlights the importance of duration positioning: short-duration bonds have remained relatively resilient, whereas long-duration Treasuries have faced renewed price pressure as investors demand greater compensation for holding long-term debt.

What happened in the last ten days?

Central banks

The Federal Reserve left rates unchanged at 3.50–3.75%. While the policy statement was unchanged compared to the June's statement, three FOMC members dissented in favour of a 25bp hike, highlighting growing concern over persistent inflation. Chair Kevin Warsh described the decision as one of "watchful thinking", rather than "watchful waiting", stressing the Committee's unwavering commitment to its 2% inflation target and arguing that higher Treasury yields have already tightened financial conditions. While the overall tone was slightly more firm on inflation risks than in June, this FOMC meeting was perceived as less hawkish than feared or expected, as Kevin Warsh didn't himself vote for a hike, and didn't shed more light on the reaction function of the Fed and what to expect in the coming months depending on the evolution of macroeconomic data. As a result, market expectations for rate hikes fell following the Fed's meeting: future markets still price at least one 25bp rate hike by the end of the year, but the probability of seeing two hikes declined from 80% to 40%.

The Bank of England also kept Bank Rate unchanged last week (at 3.75%), although the split widened to 6-3 in favour of holding rates. Policymakers judged underlying disinflation to be continuing, but warned renewed Middle East tensions could reignite inflation through higher energy prices. Following the meeting, rate hike expectations declined. Future rate markets continue to expect at least one 25bp rate hike by the end of the year, but now price only a 20% chance of two 25bp hikes (vs 70% before the BoE meeting).

The Bank of Japan left rates at 1% in an 8-1 vote, signalling that further tightening remains likely as underlying inflation approaches target despite moderating price risks. As a result, rate hike expectations rose, with future markets now assigning a 25% probability for two 25bp hikes by the end of 2026.

Rates

US Treasury yields steepened sharply last week as markets digested the latest central bank decisions, with long-end yields reaching fresh multi-year highs. The Federal Reserve left rates unchanged, but Chair Kevin Warsh offered few clues on the reaction function or timing of future policy moves, prompting investors to reduce expectations for further tightening. The 2-year Treasury yield fell 4bps to 4.29%. By contrast, the 10-year yield rose 6bps to 4.74%, while the 30-year climbed 12bps to 5.27%, its highest level since 2007, producing the sharpest weekly steepening in the 2s10s curve since April.

European sovereign bond markets also weakened, albeit less dramatically. The 10-year Bund yield rose 3bps to 3.20%, its highest level since 2011, while the 2-year yield was little changed. UK gilts outperformed, with the 10-year yield rising only 2bps after the Bank of England pushed back against expectations of an imminent rate increase, reducing September hike pricing.

Against this backdrop, sovereign bond ETFs posted mixed returns. Short-duration US Treasury ETFs outperformed as front-end yields declined, while long-duration Treasury funds came under pressure from the sharp rise in long-dated yields. In Europe, short-maturity government bond ETFs proved relatively resilient, whereas long-duration Bund ETFs recorded modest losses as higher yields weighed on prices.

Credit

Brent crude fell on Monday and core government bond yields declined after President Trump said fresh U.S.-Iran talks would begin, easing immediate geopolitical concerns. Nevertheless, market volatility remains elevated.

Corporate credit spreads were remarkably resilient notably in investment grade (IG) last week. U.S. IG delivered negative total returns, entirely driven by higher U.S. Treasury yields, even as spreads tightened modestly. By contrast, U.S. HY and Euro HY spreads widened slightly amid softer macroeconomic data.

U.S. HY and Euro HY widened modestly amid softer macroeconomic data.

During July, corporate credit yields continued to rise as U.S. Treasury and German Bund yield curves steepened. U.S. IG yields now stand at 5.4%, 63 basis points (bp) higher year-to-date, leaving total returns in negative territory. Excess returns, however, remain positive at +63 bp, underscoring resilient corporate fundamentals. In U.S. HY, lower-quality issuers underperformed, with CCC spreads widening significantly year-to-date.

Fund flows remained supportive, with continued inflows into Euro IG and Euro HY. Strong second-quarter revenue growth from Microsoft, Meta and Alphabet was overshadowed by higher AI capex guidance, weighing on U.S. IG technology. Primary market demand also softened, with July oversubscription falling to 3.6 times from 3.9 times year-to-date.

For the first time ever, the Euro IG market is projected to pay €100 billion in coupon payments over the next 12 months, a very supportive technical.

Looking ahead, resilient fundamentals and elevated all-in yields should continue to support excess returns, although persistent rate volatility is likely to remain a headwind for total returns.

Emerging market

Emerging market (EM) corporate bonds remained broadly resilient despite renewed geopolitical tensions, while EM local-currency debt outperformed as the U.S. dollar weakened sharply following the FOMC meeting. EM debt nonetheless recorded its first weekly outflow after six consecutive weeks of inflows.

Renewed U.S.-Iran tensions lifted oil prices and supported energy exporters. Saudi Aramco's second quarter EBITDA jumped 24% year-over-year. Management highlighted that, beyond the Strait of Hormuz and the Red Sea, Aramco can access Mediterranean exports via the SUMED pipeline through Egypt.

Agricultural commodities rallied amid growing concerns that the super El Niño could develop across the Southern Hemisphere in late 2026 and early 2027. In July, Wheat prices already rose 10% and corn 7%. The economic impact would vary significantly across countries. El Niño typically brings wetter conditions to parts of Peru, Chile and southern Brazil, while increasing drought risks in Colombia. In Brazil as an example, El Niño could add to inflationary pressures and delay monetary easing.

In Venezuela, the recent earthquake would substantially increase reconstruction financing needs, with damage estimates of US$20–37 billion (18–33% of GDP). This could further postpone sovereign debt restructuring and increase reliance on IMF and multilateral development bank support.

Looking ahead, we expect EM credit spreads to remain near the tighter end of their historical range, given the higher credit quality compared to historical average. BBB- and BB-rated EM corporates should continue to be supported by resilient fundamentals and attractive all-in yields.

Our view on fixed income

Rates

NEGATIVE in current environment

We maintain a Negative stance on government bonds. Government bonds remain under pressure from volatile energy prices, public debt dynamics and questions on the commitment of central banks to take necessary actions to contain inflationary pressures. They continue to appear less attractive than IG credit in a scenario of rangebound or rising rates. Government bonds still don't bring true diversification in multi-asset portfolios.

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, still tight credit spreads reduce the margin for safety, especially in a more uncertain macro-economic environment. As a result, we keep a Neutral stance on Investment Grade credit from an asset allocation perspective.

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 still find value in subordinated debt.

EM

NEUTRAL, with opportunities

EM debt remains our favored segment of the Fixed Income market. EM debt faces some geopolitical uncertainties and the impact of lower oil prices on Energy producers, but it remains supported by robust fundamentals. Global growth dynamics, contained public debt & corporate leverage across most EM countries are supportive for EM debt. This is largely reflected in current tight spreads' levels. In this context, we stay selective, favoring short and medium-duration opportunities within EM Debt.