RBC Global Asset Management

Global fixed income markets

NEW YEAR 2026

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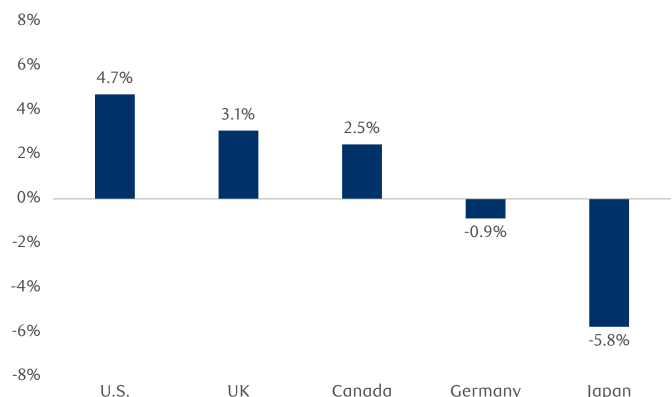
The negativity that stalked the U.S. government-bond market in April masked what will surely be a surprise to many investors: Treasuries have been the best-performing major government-bond market (Exhibit 1) since President Trump's sweeping tariffs were announced on "Liberation Day." The rebound in U.S. government bonds since the spring has reflected falling U.S. bonds yields and expectations that the U.S. Federal Reserve (Fed) will extend interest-rate cuts into 2026, as well as the fact that the worst-case tariff scenario has not come to pass. Investors are, to be sure, still concerned about the sustainability of government finances and inflation, and these worries are at least partly reflected in higher fixed-income risk premiums.

Closer to home, the Bank of Canada worries are at least partly reflected in higher fixed-income risk premiums. (BOC) strongly signaled that it has completed its current round of interest-rate reductions. Meanwhile, updates from the federal and provincial governments indicate that another year of fiscal largesse is in store for Canada, with the combined budget deficit likely to reach at least 4% of GDP. We expect subdued economic growth next year and above-2% inflation to keep yields from dropping precipitously, absent a recession. Fixed-income returns should be on par with cash. A decent backdrop for economic growth, as well as solid corporate profits and balance sheets, lead us to recommend that investors be overweight corporate bonds relative to government bonds. Please read our backgrounder on Canadian corporate fixed income below, as we plan to begin issuing recommendations on this area of the bond market in the near future.

Exhibit 1: Regional bond market performance in 2025



Note: Data as of December 5, 2025. All returns expressed in currency-hedged terms to Canadian dollars.Source: FTSE Russell, RBC GAM calculations

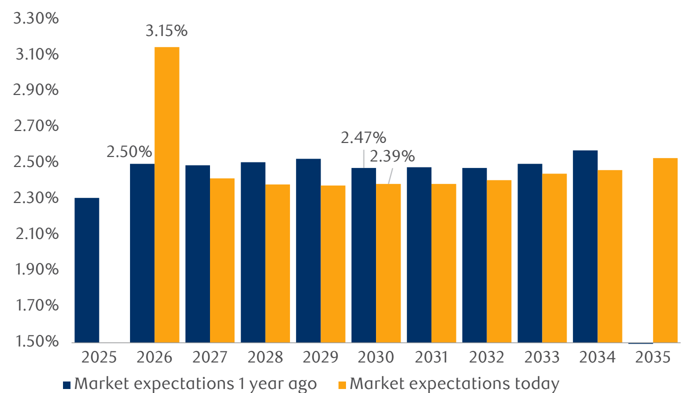
In early 2025, investor concerns were rampant surrounding the sustainability of the U.S. fiscal position, the threat of a re-acceleration of inflation due to tariffs and the erosion of Fed independence as President Trump increasingly and very publicly called for lower interest rates. Meanwhile, economic growth was expected to falter under the pressure of the tariffs. None of these things happened.

Inflation has not accelerated nearly as much as feared after foreign companies offset tariffs by neglecting to fully pass on their higher costs to customers, and trading partners made full use of less-well-publicized tariff exemptions. Investors have believed that inflation from tariffs would be transitory, with Exhibit 2 suggesting that the impact of would not last more than a year. As a result, long-term bond yields did not rise nearly as much as was expected in April. Meanwhile, the U.S. fiscal position appears to have marginally improved as tariff-related revenues have become a significant revenue source for Congress after efforts by the administration's new Department of Government Efficiency to reduce expenses largely fell flat.

The question of Fed independence has also been near and dear to investors' hearts over the past year given that President Trump made increasingly strident calls for lower rates, which the Fed did eventually deliver. Why are investors not more concerned? Because Trump has so far been right: the state of the economy (lower inflation and softer labour markets) merited some easing of policy from a restrictive stance. President Trump's calls may have come via social media, but the majority of pre-Trump econometric models were saying that the economy needed slightly lower interest rates.

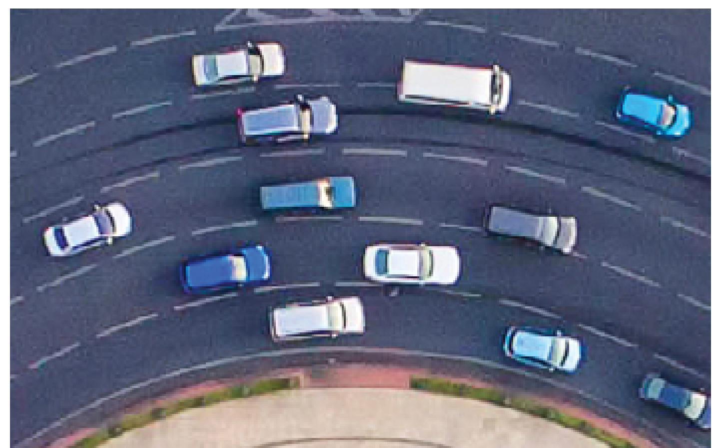
To some, it feels like the market dodged a bullet (or a full broadside volley) in 2025. For 2026, it appears that the tailwinds for bonds (lower-than-expected inflation, easing fiscal concerns and easier money policy) are likely to ebb. This is not a terrible starting point for bond investors. The amount of extra yield that investors demand in exchange for lending over longer periods (the "term premium") has risen consistently over the course of the past year.

Exhibit 2: Market participants considered tariff-related price increases as likely to be transitory



Note: Data as of mid-October 2025. Source: Bloomberg, RBC GAM calculations using zero-coupon inflation swaps

Steeper yield curves across most markets should provide a cushion for returns as the tailwinds from 2025 are unlikely to be repeated. On growth, we expect non-recessionary conditions in all markets. In fact, growth is more likely to accelerate in the first half of the new year, as fiscal stimulus arrives and passthrough from prior policy-rate cuts start to have an impact. Inflation is also likely to remain relatively hot, running at nearly 3%. Better economic growth and higher-than-target inflation mean that central banks are unlikely to embark on further easing programs. Moreover, for central banks that are expected to ease significantly in 2026, such as the Fed, we would anticipate that they deliver fewer rate cuts than market indicators suggest.



We anticipate that the BOC has concluded its easing cycle and foresee that the yield on the Canadian 10-year government bond will trade at 3.25% at some point over the next year.

Canada

The Bank of Canada (BOC) reduced interest rates twice following a six-month pause, with cuts occurring in September and October. These reductions brought the policy rate to 2.25%. The BOC believes it has reached the limit of the support it should provide to the economy amid the trade-war-driven economic restructuring. However, uncertainty continues to weigh heavily on the economy, and the bank has left the door open for further easing if the outlook worsens. The USMCA re-negotiation in July 2026 presents a considerable risk to the Canadian economy, and failure to reach a deal could have a major negative impact. We anticipate that the BOC has concluded its easing cycle and foresee that the yield on the Canadian 10-year government bond will trade at 3.25% at some point over the next year, not far from where it is now.

We expect the Canadian yield curve to continue steepening (that is, for longer-term yields to fall less than short-term yields), driven by the need for fiscal stimulus and higher term premiums. The much-anticipated federal budget was unveiled in early November, and the significant spending and large deficit that it envisions are expected to stimulate the economy. The federal government estimates that the 2025-2026 deficit will be $78.3 billion, or 2.5% of GDP, versus $42.2 billion in December 2024.

We have raised our 10-year gilt-yield forecast by 0.25% to 4.50%, anticipating a trading range of 4.30%-4.70% over the next year.

United Kingdom

The UK gilt market has faced significant headwinds this year, with higher coupon income providing a crucial buffer against price losses stemming from rising yields on longer-term bonds. Persistent inflationary pressures and concerns about government spending, coupled with a lack of productivity growth, have weighed heavily on investor sentiment. The fear of increased supply of long-maturity bonds and eroding purchasing power have driven investors to demand higher yields on long-maturity bonds.

The autumn budget, released on November 26, highlighted the fragility of the UK's fiscal position. Investors remain sceptical about the government's reliance on revised economic-growth projections to bolster revenues. The Chancellor's commitment to a near-balanced budget over a rolling five-year period, while well-intentioned, may inadvertently contribute to yield volatility. The market is now grappling with the uncertainty of less frequent forecast revisions and adjustments.

Uncertainty regarding the speed at which inflation comes down is also keeping investors on edge. Recent data confirms that consumer inflation has peaked and is gradually declining from the current 3.5% headline figure, but elevated labour-cost growth and entrenched inflation expectations suggest that a return to the Bank of England's (BOE) 2% targeted level within the next 12 months is far from guaranteed.

Market indicators point to a 0.60% reduction in the BOE's policy rate of 3.4% in a year's time, and project this level as the bottom of the current easing cycle. Our revised forecast aligns with this view, projecting that the BOE policy rate will fall to 3.5% from the current 4.0%, or 25 basis points higher than in the previous Global Investment Outlook. In the context of developed markets, expectations for policy-rate changes appear broadly in line with peers, many of whose central banks are either on hold or nearing the end of their easing cycles. Reflecting these considerations, we have raised our 10-year gilt-yield forecast by 0.25% to 4.50%, anticipating a trading range of 4.30%-4.70% over the next year.

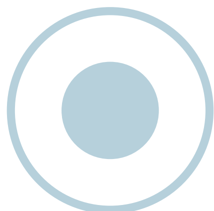
We forecast for 10-year Chinese bond yield to be mildly higher in the next 12 months to 2.00% from current level of 1.83%.

China

In recent years, China's interest rates have been suppressed by a gradual economic slowdown, below-target inflation and surging household savings. Demand for longer-maturity bonds has been damped this year, even with monetary easing by the People's Bank of China (PBOC), given aggressive fiscal stimulus aimed at supporting growth and buttressing the struggling property market and the July announcement of a 6% valued-added tax on interest income from newly issued government bonds.

Our forecast is for Chinese bond yields to gradually rise as expectations for higher inflation increase and the government sticks with pro-growth policies. The government latest longer-term economic plan is built on three pillars. First, it focuses on domestic consumption by offsetting the negative impact on consumers of the property crash. Second, it seeks to restore profitability in sectors that will lift wages, and third it emphasizes the central bank's commitment to currency stability in the face of redefined U.S. trading relationships. All three of these government objectives suggest higher bond yields.

We forecast that the 10-year Chinese bond yield will be higher in the next 12 months at 2.00%, up from current level of 1.83%.



Our forecast is for the policy rate to rise to 1.00%, from 0.50% currently.

Japan

Policymakers at the Bank of Japan (BOJ) maintained the key policy rate at 0.50% in late October. Bond yields have soared this year in Japan on expectations that interest rates would rise faster than investors had expected amid rising inflation. Japan's bond market has been the worst-performing in 2025, with domestic bondholders left smarting from 7% losses. To add insult to injury, the surprise election of Prime Minister Sanae Takaichi in October renewed expectations for fiscal stimulus, a touchy subject for investors against a backdrop of inflation and high debt.

True to historical form, the BOJ has moved slowly to tighten monetary policy, keeping rates on hold since January. Over the same period, inflation has trundled along at an exceptionally rapid (for Japan) clip of just over 3%. Two decades of deflation have, we believe, made the central bank too quick to dismiss the post-pandemic inflation wave. Inflation now appears to have taken root in services and domestically consumed goods, expanding from traditionally transitory sources of inflation such as food. The combination of a slow-moving BOJ in the context of higher-than-expected long-run policy rates and inflation means that the Japanese yield curve has steepened considerably, with long-term yields rising more than short-term ones.

At this point, we view government-bond yields in Japan as offering plenty of compensation for the risks facing long-term investors. Thirty-year yields on Japanese government bonds are around 3.30% at the time of writing, a level that we believe the BOJ is unlikely to reach with policy rates. Market expectations for future bond yields are so extreme that they outstrip those offered on Treasuries. In simpler terms, the extreme relative steepness of the Japanese bond curve suggests that investors are well compensated for future risks in Japan. We believe that the BOJ will gradually raise its policy rate over the coming year, that inflation will ease, and that Japanese bonds will likely outperform other regions. Our forecast is for the policy rate to rise to 1.00% from 0.50% currently. We expect little change in the 10-year Japanese government bond, whose yield is currently at 1.81%.

We expect German 10-year bund yields to reach 3.00% sometime over the next 12 months, up from about 2.70% at the time of writing.

Eurozone

The European Central Bank (ECB) kept its policy rate unchanged at 2.00% at its most recent meeting in October. Furthermore, policymakers signalled that they were likely to remain on hold for an indefinite period, deeming that the decline in interest rates was sufficient in light of the backdrop for growth and inflation. Most forecasts for European growth for the year ahead are fairly lacklustre. Investors believe that Germany's fiscal stimulus should boost economic activity in the country to over 1%. Our view is that the risk of higher inflation is being undercounted in the single-currency area, particularly in services and wages.

We think that investors' assessment of the outlook for growth in Europe is lagging the reality on the ground, which is supported by government spending. To be sure, we expect the ECB to remain cautious, and don't forecast any rate hikes over the coming 12 months. While we don't think that central bankers will raise policy rates, we do expect market-set bond yields to rise. We expect German 10-year bund yields to reach 3.00% sometime over the next 12 months, up from about 2.70% at the time of writing.

Regional recommendation

Within a fixed-income portfolio, we recommend an overweight in corporate fixed income relative to government bonds. We consider corporate bonds with less than five years to maturity particularly compelling.

Within a government-bond allocation, we recommend an overweight allocation to a basket of Government of Canada bonds and provincial securities. For a global bond allocation, which reflects regional preferences, we recommend being overweight Japanese government bonds relative to German bunds.

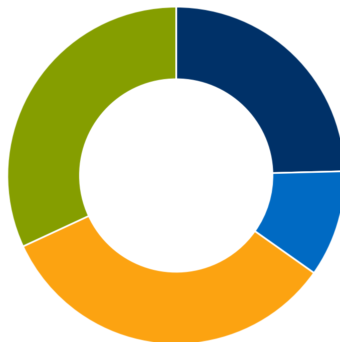
Backgrounder on Canadian corporate bonds

In Canada, the most widely used fixed-income index is the FTSE Universe Canadian Bond Index. This broad Canadian benchmark consists of Canadian-dollar bonds issued by the Government of Canada, provincial governments and corporations. All bonds eligible to be included in the benchmark are rated investment grade, which is BBB- or higher by Standard & Poor's and have a maturity date greater than one year. The corporate part of the index makes up about 25% of Canada's bond universe. The recommendations we make will be relative to the FTSE Universe Canadian Bond Index (Exhibit 3).

The Canadian corporate-bond market is dominated by Financials – banks and insurance; Energy – mostly pipelines but also exploration and production companies; and Infrastructure, which includes electric utilities, transmission companies and airports. There are significant differences in the composition of the FTSE Corporate Index and the S&P/TSX Composite Index. The FTSE Corporate index has greater exposure to the Financials and Energy sectors than the S&P/TSX, while the equity index has higher exposure to the Industrials and Information Technology sectors. The equity index is heavily dependent on the performance of Shopify and precious metals, while the bond index has exposure to neither. Another big difference between the debt and equity indexes is that a company's weight in the FTSE Bond Index is determined by the amount of debt that it has outstanding, while the S&P/TSX Index weight is determined by market capitalization.

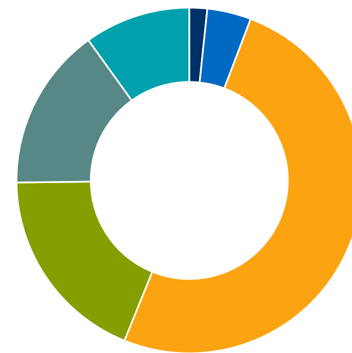
Exhibit 3: FTSE Canada Universe composition

FTSE Canada Universe asset class composition



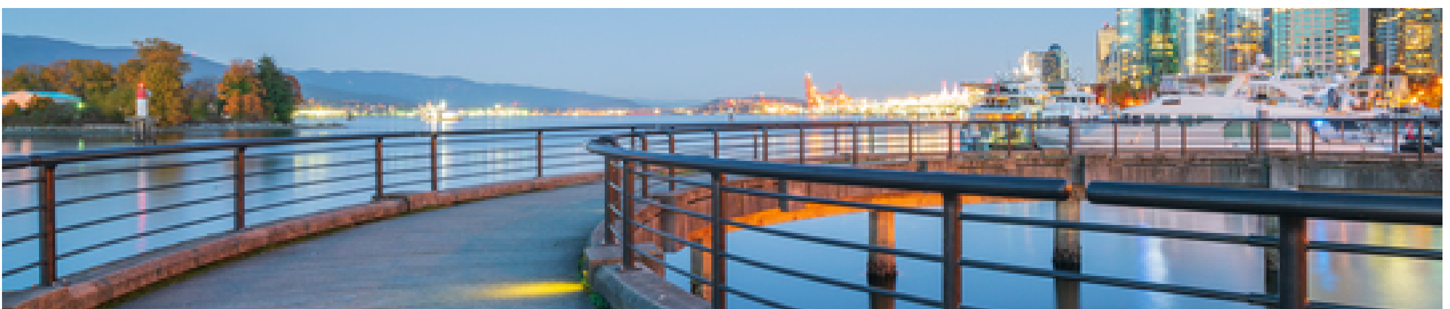
▪ Corporate ▪ Crown/Agency ▪ Provincial ▪ Govt of Canada

FTSE Canada Corporate Universe credit quality



▪ AAA ▪ AA ▪ A ▪ BBB+ ▪ BBB ▪ BBB-

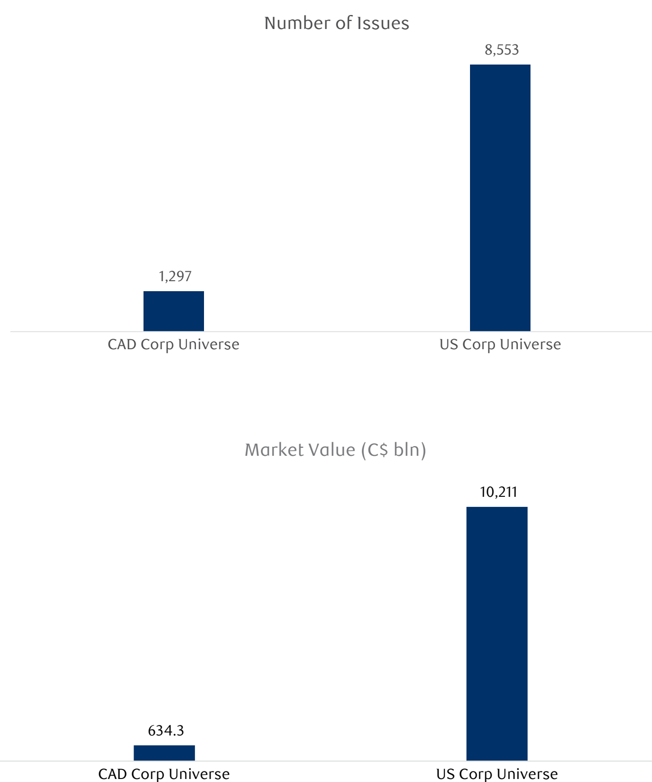
Note: Data as at November 30, 2025. Source: FTSE Russell, RBC GAM calculations



For context, the Canadian corporate market is a fraction the size of the U.S. corporate market with fewer issuers and securities (Exhibit 4). Moreover, all bonds in the Canadian corporate-bond index are investment grade, and the index tends to move in the same direction as the U.S. investment-grade market. This is important because default rates – the risk of permanent loss of capital – are much lower for investment-grade fixed income. Another broad observation is that spreads in the Canadian bond market tend to be less volatile, with U.S. spread peaks being higher in Canada and trough spreads lower.

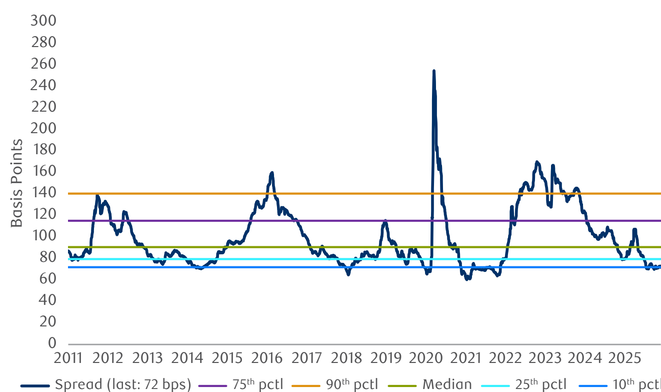
Holding corporate bonds generally pays off over time as the excess yield that investors can earn above yields on like-maturity government bonds (the "spread") accumulates. Credit spreads tend to tighten (be smaller) as bonds approach maturity – a 2-year bond will have a lower spread than a 5- or 10-year bond of the same company. An overweight to corporate bonds versus an underweight to Government of Canada bonds will outperform over a credit cycle. Adding exposure to corporate bonds when spreads are wider and reducing exposure when spreads are narrower will tend to boost relative returns (Exhibit 5).

Exhibit 4: Canadian corporate bond universe relative to U.S. corporate bond universe



Note: Data as of November 30, 2025. Market value converted to C$.
Source: FTSE Russell, Bloomberg

Exhibit 5: FTSE Canada Short Corporate spreads



Note: Data as of December 8, 2025. Starting at January 2011. Source: FTSE Russell

Interest-rate forecast: 12-month horizon
Total-return calculation: November 30, 2025 – November 30, 2026

U.S.

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	3.25%	3.30%	3.70%	4.25%	4.80%	3.51%
Change to prev. quarter	(0.25%)	(0.20%)	(0.05%)	0.00%	(0.10%)	
High	3.88%	4.00%	4.35%	4.75%	5.25%	0.78%
Low	2.13%	2.30%	2.80%	3.50%	4.20%	7.57%
Expected Total Return US$ hedged: 3.7%						

Germany

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	2.00%	2.30%	2.60%	3.00%	3.40%	1.59%
Change to prev. quarter	0.00%	0.10%	0.10%	0.25%	(0.10%)	
High	2.50%	2.90%	3.25%	3.50%	3.90%	(1.98%)
Low	1.50%	1.50%	1.85%	2.25%	2.90%	6.36%
Expected Total Return US$ hedged: 3.1%						

Japan

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	1.00%	1.20%	1.50%	1.80%	3.25%	3.96%
Change to prev. quarter	0.25%	0.00%	0.00%	0.05%	0.00%	
High	1.50%	2.00%	2.25%	2.50%	3.50%	0.00%
Low	0.50%	0.70%	0.85%	1.00%	2.30%	15.46%
Expected Total Return US$ hedged: 7.9%						

Canada

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	2.25%	2.50%	2.85%	3.25%	3.85%	2.14%
Change to prev. quarter	0.00%	(0.20%)	(0.15%)	(0.25%)	(0.15%)	
High	3.00%	3.00%	3.25%	3.50%	4.00%	0.58%
Low	1.50%	2.00%	2.35%	2.85%	3.60%	4.37%
Expected Total Return US$ hedged: 3.5%						

UK

	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	3.50%	3.70%	3.90%	4.50%	5.15%	5.07%
Change to prev. quarter	0.25%	0.60%	0.30%	0.25%	-0.35%	
High	4.00%	4.50%	4.75%	5.25%	5.50%	0.57%
Low	2.50%	2.75%	3.00%	3.75%	4.85%	8.98%
Expected Total Return US$ hedged: 4.0%						

Source: RBC GAM

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