

Global fixed income markets



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The bond market is offering investors a premium in exchange for the risk of lending for longer investment horizons. With a bit of extra yield to start with compared to cash, we expect global government-bond returns will be in the mid-single digits – compared with just 2.30% likely to be earned investing in cash. Most markets outside of Canada offer higher overall yields, leading us to recommend that investors hold overweight positions in non-Canadian bonds. We also recommend being overweight investment-grade corporate bonds relative to government bonds as corporate balance sheets remain strong.

In the scenario of a deep downturn in equities or the economy, we forecast government-bond returns would be higher. Implicit in this forecast is the assumption that bonds provide a buffer to balanced-portfolio returns, something we believe is much more likely now that the rate of inflation has fallen back toward 2%. Central banks appear to have more leeway to cut interest rates in support of economic growth given that prices are rising more slowly and domestic labour markets are less frothy thanks to slower immigration, and amid uncertainty about the impact of artificial intelligence (AI).

Financial markets, however, are not currently expecting much in the way of interest-rate cuts from central banks. In fact, investors expect most central banks to keep rates on hold for a significant period. The European Central Bank (ECB) and the Bank of England (BOE) are not expected to change interest rates for at least two years. Meanwhile, investors expect

the Bank of Canada (BOC) to do nothing for about a year. In the U.S., where policy rates are arguably still above neutral and policymakers are under political pressure to cut interest rates further, a scant two cuts are priced by next February. An outlook of little to no change in policy rates aligns with what policymakers have communicated to investors: inflation is lower, labour markets are stable, and policy rates are at or near levels that are neither stimulative nor restrictive – a safe place to be if you don't have a strong view on how the economy will evolve over the next few years. Given the scale and speed with which investments are being made to support AI, as well as the widespread disruption to trade networks, we think the idea that central banks will do nothing for up to two years is fanciful. We should have a much clearer view of the actual impact of these forces on the economy well before then.

Considering uncertainty over the path of inflation and short-term interest rates, investors demand greater compensation for lending to governments over longer periods – what is commonly referred to as the term premium. Bond yields across all maturities are higher than what is implied by expectations for future central-bank interest rates. It's fair to say that bond investors are worried about the future.

It's not just the economy that worries bond investors – policy risks have risen too. Central banks are under increasing pressure to support government efforts to keep borrowing rates low. The incoming Chair of the U.S. Federal Reserve (Fed), Kevin Warsh, favours some sort of accord between the Fed and the Treasury Department. One of his goals, to shrink the size of the Fed's balance sheet, would require changes to laws that currently restrict the capacity of domestic banks to hold Treasuries. This kind of policy support is very different from that which occurred in the aftermath of the global financial crisis. Back then, central banks launched large-scale purchases of government bonds, which were in high demand because their attraction as safe-haven assets offset their very low yields. Policymakers were trying to coerce investors to take more risk by forcing them out of super-safe government bonds. Importantly, central bankers were doing so while politicians cut back spending.

The better historical parallel of policy coordination during periods of high yields is probably the European Central Bank's (ECB) massive purchases of government debt in the 2010s, which helped keep borrowing costs under control in the eurozone and contain the sovereign-debt crisis then afflicting Greece, Italy and other southern European countries. Of course, the ECB has never had to answer the question of what it would have done if inflation hadn't been effectively zero or negative for much of that period. To be sure, the U.S. government does not face an imminent fiscal crisis. However, the long-term prospects are very poor, even compared with other developed nations. The U.S. government faced a similar fiscal quandary after the Second World War, when it had a very high debt-to-GDP ratio and mounting borrowing costs. At the time, the Fed agreed to cap long-term bond yields to manage the debt. Ironically, the 1951 Treasury-Fed Accord, which ended this arrangement of extreme policy coordination, is the inspiration for Warsh's plan.

Our concerns about the fiscal state of affairs in the U.S. and Europe have led us to highlight our call to overweight Japanese bonds. It is becoming clear that the UK, the U.S. and France have supplanted Japan as the developed world's riskiest credits. Take Japan's fiscal balances: the government's projected 2026 budget deficit before interest payments rests at 1.4% of GDP - significantly lower than 3% in the U.S. Investors who fixate on Japan's 250% gross debt-to-GDP ratio are overlooking the high level of domestically owned debt and the country's large pot of assets owned abroad. In fact, Japan maintains the largest net international investment position in the G7, effectively funding cheaply at home to earn significantly higher returns elsewhere over the years.

The recent additional fiscal stimulus from the prime minister is relatively marginal. Although the package is roughly 3.5% of GDP, much of it is non-fiscal or spread over multiple years, meaning it adds only a tiny amount to the overall deficit. Japan's government budget deficit has been narrowing rapidly, with some estimates suggesting a surplus may even be reached this year or next.

We recognize that Japan's long period of disinflation and low bond yields is passing. However, the current steep yield curve is compensating investors for debt-supply concerns, the growth premium from positive fiscal impulse and a fading disinflation impulse as core-core inflation is expected to remain above 2% for a considerable period.

In short, economies are growing at a decent rate, governments are running large deficits, and the world recently experienced a huge surge in inflation. Investors are much more skeptical about the long-run safety of government debt. In turn, they've rightly demanded higher compensation, and global yield curves have steepened. This is a much more difficult environment for central banks to justify further easing and they are in wait-and-see mode. Bond investors should not expect to earn much in the way of capital gains over the next 12 months. Absent a much more significant downturn in the economy than we currently expect, bonds should offer slightly higher returns than cash given that fixed-income securities are offering higher returns as maturities extend.

Direction of rates



we anticipate 10-year Treasury yields to gradually rise to match our forecast of 4.50% for the 10-year yield, from around 4.00% currently.

United States

The second year of President Trump's term arrives with more evidence of the U.S. economy's resilience. Even as the labour market has cooled and trade relationships have been upended, economic activity has continued to exceed expectations. Trump's penchant for ignoring long-standing rules has extended to the Fed, which he has publicly put under immense pressure to cut interest rates. Luckily, falling inflation made it easy for the Fed to oblige. Additionally, Trump has introduced two handpicked dovish candidates to the Federal Open Market Committee (FOMC), including Warsh as the new chairman.

With the economy doing well, inflation likely to pick up a bit in the first half of the year and Fed rate cuts still expected at some point this year – it appears unlikely that the Fed will make a surprise rate cut in the next month or two. Indeed, even with pressure from the White House, the FOMC members have become increasingly vocal about the idea of pausing rate reductions. Policy uncertainty will be a large headwind for the Fed yet again, as the U.S. could elect to make major changes to the USMCA free-trade pact. Considering Trump's track record, we view the odds of a major trade disruption as low.

War has again broken out in the Middle East with a U.S.-led attack on Iran. Prices of Treasuries and other government bonds anticipated the conflict with gains in the week leading up to the outbreak of hostilities. Provided the war does not escalate into a wider global conflict between major powers, our view is that the more pressing impact for bond markets will be higher energy prices and a global shipping shock. Such an uptick in inflation would throw a wrench into investors' expectations that the Fed might cut interest rates substantially this year, especially as inflation is already hovering nearer to 3% than 2%.

Looking ahead, our base case scenario is for the Fed to deliver 0.50 percentage point of rate cuts over the next year. These cuts would take the Fed into modestly accommodative territory. With our growth outlook relatively rosy, we anticipate 10-year Treasury yields to gradually rise to match our forecast of 4.50% for the 10-year yield, from around 4.00% currently.



We foresee that the BOC will keep its policy rate at 2.25% over the next year, and that the yield on the Canadian 10-year government bond will trade at 3.5% at some point during the same period.

Canada

The BOC returned to holding rates steady after implementing two reductions in last year's fourth quarter. The central bank continues to express caution regarding Canada's economic trajectory, projecting modest GDP expansion of 1.1% in 2026 and 1.5% in 2027. The BOC has also indicated that it will maintain its current policy stance unless confronted with significant economic disruptions or material changes to the economic outlook. That said, Canada's economy faces headwinds from U.S. tariff measures and the inherent unpredictability of evolving trade partnerships. The status of Canada's trade agreement with the U.S. and Mexico is subject to ongoing uncertainty, and the pending review could result in outcomes ranging from minor adjustments to major economic disruption for Canada. Trade conflicts are also constraining provincial economic growth, leading to widening budget deficits in the upcoming fiscal year. This challenge is expected to be partially offset by stimulative government spending from both federal and provincial governments.

We foresee that the BOC will keep its policy rate at 2.25% over the next year, and that the yield on the Canadian 10-year government bond will trade at 3.5% at some point during the same period. Significant spending and large provincial deficits will lead to a higher borrowing requirement in 2026 and 2027. We expect longer-term bond yields to rise faster than short-term yields, driven by the need for fiscal stimulus and higher term premiums.



For 10-year gilt yields, we maintain our forecast of 4.50%, with an expected trading range of 3.50%–4.80% over the coming year.

United Kingdom

The UK gilt market is being shaped by a weakening economy and the prospect of slowing inflation. However, the government still faces significant borrowing needs, with gross gilt issuance estimated at £250 billion for 2026. As a result, investors are likely to keep demanding higher returns to compensate for holding gilts, particularly longer-dated bonds. Near-term volatility is likely between early March's fiscal update and May local elections, as markets react to potential increases in government spending.

Recent economic data presents a mixed picture. Retail sales and manufacturing activity remain solid, but wage growth and persistent services inflation should limit how quickly the BOE can cut rates. We expect inflation to keep declining gradually as unemployment rises, and January's drop in CPI inflation to 3.0% was a continued move in the right direction.

Markets expect a 0.50% reduction in the BOE's policy rate to 3.25% over the next year, which we believe represents the bottom of this easing cycle. We align with this market view, forecasting the base rate at 3.25% by this time next year, 25 basis points lower than in the previous Global Investment Outlook. For 10-year gilt yields, we maintain our forecast of 4.50%, with an expected trading range of 3.50%–4.80% over the coming year.

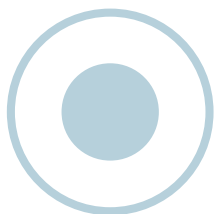


Our forecast is for Chinese bond yields to gradually rise.

China

Chinese bond yields continue to be remarkably low – reflecting both a dour outlook for the demographic future of the country, but also a domestic shortage of safe assets.

Our forecast is for Chinese bond yields to gradually rise. We believe continued fiscal stimulus and domestic reforms will eventually bear fruit in the form of stronger growth, leading to higher yields. China has pivoted its trading partnerships strongly over the past several years in the face of pressure from the U.S., and a period of disinflation due to excess capacity and insufficient domestic demand appears to be finally waning. 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 a redefined U.S. trading relationship. All three of these government aims suggest higher bond yields.



We expect 10-year Japanese government bond yields to fall over our forecast horizon, eventually reaching 2.00%, from 2.12% at the time of writing.

Japan

We view Japanese government bonds (JGBs) as attractive for long-term investors. Thirty-year yields on JGBs 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 significant premiums offered on longer-term bonds relative to those on shorter-term bonds suggest 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, the curve will flatten, inflation will ease, and that Japanese bonds will likely outperform those of other regions. We have increased our expectations for the likely peak in the policy rate, expecting it to rise to 1.50% from 0.75% currently. Our earlier peak forecast was 1.00%. We expect 10-year Japanese government-bond yields to fall over our forecast horizon, eventually reaching 2.00%, from 2.12% at the time of writing.





We maintain our view that German 10-year bunds will trade at 3.00% sometime over the next 12 months, up from approximately 2.70% at the time of writing.

Eurozone

German bund yields are likely to remain relatively stable, or even fall slightly, in the near term given the ECB's accommodative policy stance and falling inflation. With the ECB maintaining policy rates at 2.0% throughout 2026 and core inflation tracking around the ECB's 2% target, longer-dated bond yields are expected to remain range-bound. However, bond yields could rise as government fiscal programs flow through the economy with full force in the second half of our forecast horizon.

Our view centres on improving eurozone growth momentum, particularly in Germany, where fiscal stimulus is already translating into stronger industrial orders. We anticipate this trend will persist, pushing economic growth above its long-run potential rate and lifting yields on longer-dated bonds. Additionally, elevated German government-bond supply, combined with the ECB's continued passive quantitative tightening at €42 billion per month, will increase supply and compound pressure on yields. The combination of these factors creates a scenario where growth-driven yields rise at a time of persistent monetary accommodation.

We expect the ECB to remain cautious and do not forecast any rate changes over the coming 12 months. While near-term falls in inflation may spark expectations of rate cuts, our upbeat economic outlook suggests the ECB will look through these near-term concerns and hold rates steady. We maintain our view that German 10-year bunds will trade at 3.00% sometime over the next 12 months, up from approximately 2.70% at the time of writing.

Recommendation

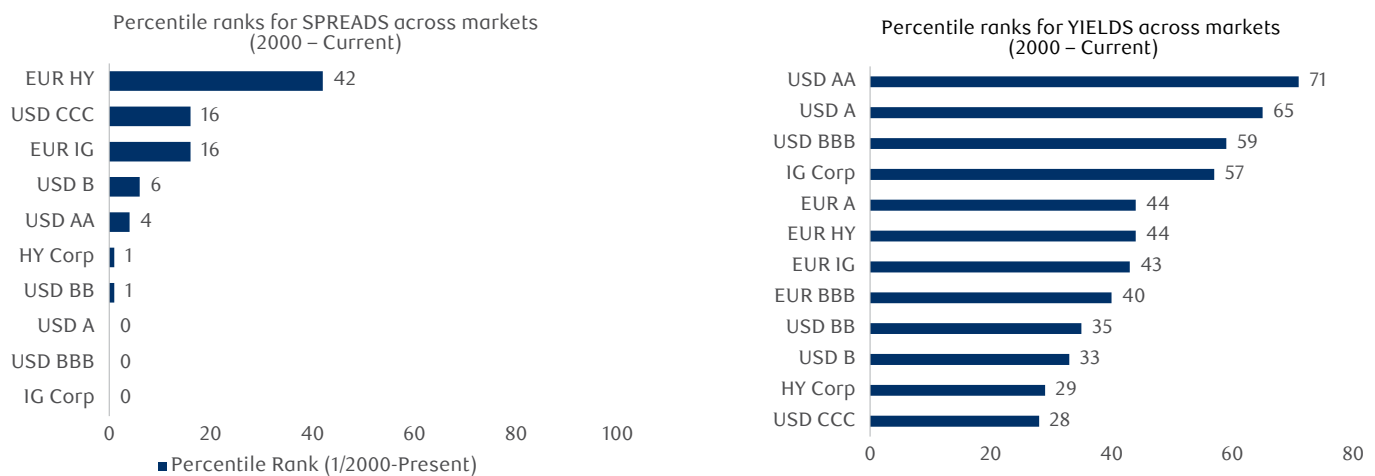
We recommend being overweight government bonds of countries and regions outside Canada, as yields and the potential for price gains are higher internationally. Regionally, we recommend being overweight JGBs relative to German bunds. We recommend being overweight corporate bonds relative to government bonds, particularly corporate bonds with less than five years to maturity.

Canadian corporate bonds

Over the past two years, strong demand for corporate bonds drove credit spreads to multi-year tights. Investors continually purchased fixed-income funds and ETFs, attracted by higher all-in yields. Higher yields on the benchmark government securities off which a corporate all-in yield is based mean that, despite corporate credit spreads being near their tightest levels over the past 25 years, the all-in yields rank much more favorably (Exhibit 1).

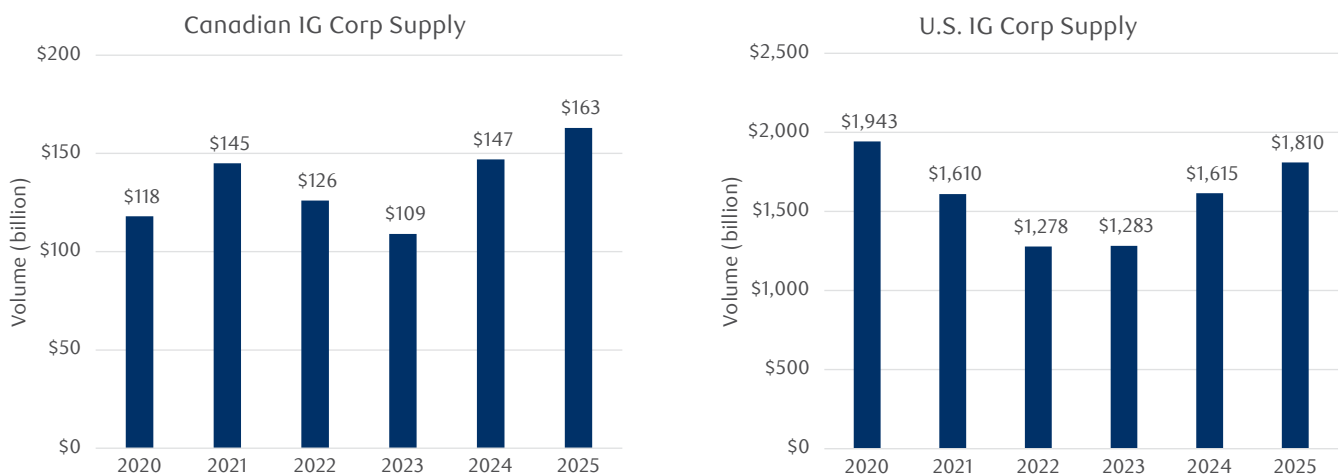
While demand for corporate bonds has been robust, the supply in the new-issue market rose as well. For 2025, the Canadian investment-grade market saw a record \$169 billion issued, while the U.S. investment grade market registered US\$1.81 trillion, its second-highest tally ever (Exhibit 2). Large bond issuance often occurs during periods of market strength when companies are confident they will find receptive lenders.

Exhibit 1: Credit spreads are tight, but the all-in yields rank much more favourably



Note: As of January 31, 2026. Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 2: Investor demand supported elevated bond issuance



Note: As of January 31, 2026. Source: Scotiabank, Morgan Stanley Research

Looking forward, there is the risk that the technical backdrop turns into a headwind, potentially leading to wider spreads. Demand for corporate bonds could be impacted by a more volatile interest-rate environment, with meaningfully higher or lower overall interest rates resulting in lower inflows into bond funds. On the supply side, there are expectations that volumes will remain elevated for the upcoming few years. There will be higher refinancing needs, as we see increased maturities from bonds issued in 2020 and 2021. We might also see elevated net new issuance tied to the hyper-scalers (Google, Meta etc.), which have been issuing with increased frequency in the U.S. market. There is a wide range of forecasts for total hyper-scaler issuance in 2026, but if it ends up in the range of US\$200 billion to US\$250 billion, it will significantly exceed previous highs for the sector that were closer to US\$40 billion annually. This issuance would impact the Canadian investment-grade market, either directly if the hyper-scalers consider issuing bonds in Canada, or indirectly by the influx of issuance weighing on global investment-grade markets.

We recommend investors own a higher share of corporate bonds and be ready to increase exposure if spreads widen. Given our sanguine outlook for the economy and relatively healthy corporate balance sheets, we believe the effect of softer bond supply-demand balance would push spreads wider only gradually, rather than portending a sharp move higher in credit risk and spreads.



Interest-rate forecast: 12-month horizon

Total-return calculation: March 5, 2026 – March 5, 2027

U.S.						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	3.13%	3.50%	4.00%	4.50%	5.00%	3.01%
Change to prev. quarter	0.00%	0.20%	0.30%	0.25%	0.20%	
High	4.13%	4.35%	4.70%	5.00%	5.30%	0.60%
Low	2.4%	2.5%	2.9%	3.5%	4.25%	7.83%

Expected Total Return C\$ hedged: 3.0%

Germany						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	2.00%	2.25%	2.50%	3.00%	3.60%	1.70%
Change to prev. quarter	0.00%	(0.05%)	(0.10%)	0.00%	0.20%	
High	2.50%	2.80%	3.25%	3.50%	4.00%	(1.17%)
Low	1.50%	1.50%	1.80%	2.25%	3.00%	6.97%

Expected Total Return C\$ hedged: 2.1%

Japan						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	1.50%	1.50%	1.80%	2.00%	3.20%	4.86%
Change to prev. quarter	0.50%	0.30%	0.30%	0.20%	(0.05%)	
High	2.00%	2.25%	2.40%	2.50%	4.00%	(2.81%)
Low	0.75%	1.00%	1.50%	1.70%	3.00%	7.55%

Expected Total Return C\$ hedged: 5.5%

Canada						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	2.25%	2.70%	3.00%	3.50%	4.00%	2.44%
Change to prev. quarter	0.00%	0.20%	0.15%	0.25%	0.15%	
High	3.00%	3.40%	3.60%	4.00%	4.30%	(0.06%)
Low	1.50%	1.90%	2.25%	2.75%	3.50%	6.20%

Expected Total Return C\$ hedged: 2.4%

UK						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	3.25%	3.40%	3.75%	4.50%	5.00%	6.79%
Change to prev. quarter	(0.25%)	(0.30%)	(0.15%)	0.00%	(0.15%)	
High	4.00%	4.00%	4.30%	4.80%	5.25%	3.59%
Low	2.25%	2.40%	2.80%	3.50%	4.70%	11.23%

Expected Total Return C\$ hedged: 5.6%

Source: RBC GAM

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