

Global fixed income markets



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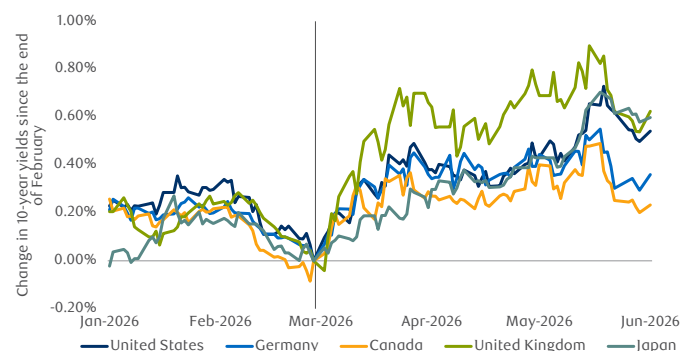


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Since the last edition of the *Global Investment Outlook*, investors have experienced a sea change in the outlook for global monetary policy and, by extension, government bonds. The rise in global energy prices due to the war with Iran has spurred bond investors to expect the bias for central bankers will be toward rate hikes, rather than toward unchanged or lower rates over the next year or so. In many global markets, yields are at or near multi-decade highs, offering significant cushions to bond returns. Over the next 12 months, we see bonds providing returns slightly better than those offered by shorter-term cash investments. Of course, a faster-than-expected end to the war with Iran and lower energy prices as a result would provide a strong jumping-off point for bond returns. Given the broader context of a strong economic backdrop, we also recommend owning corporate bonds in lieu of government bonds.

Indeed, we can mark the launch of the U.S. attack on Iran at the end of February as the turning point for bond yields to head higher (Exhibit 1) across the globe. With the post-COVID rise in inflation still fresh in the minds of policymakers and citizens alike, investors were quick to anticipate that central banks might have to respond with higher interest rates. Policymakers should be keenly aware of the risk that currently elevated energy costs may broaden outwards into price increases across non energy-related sectors of the economy. In line with this, market-implied policy rates for later in 2026 and 2027 have moved upward. The difference for some markets has been quite stark. For example, whereas before the war the U.S. Federal Reserve (Fed) was expecting as many as three cuts by the end of 2026, investors now

Exhibit 1: Change in 10-year government bond yields since the end of February



Note: Data as of May 29, 2026. Source: Bloomberg

anticipate rate hikes by the Federal Open Market Committee (FOMC) over the same period. This change alone goes a long way to explaining why the 30-year bonds freshly issued by the U.S. Treasury last November tumbled by nearly 10% between late February and mid-May.

Of course, it is not only the threat of a rise in energy prices that has forced bond yields higher. Economic growth has also been surprisingly good, driven by budgets from governments that are expanding again. The consumer tailwind from the tax cuts in the Big Beautiful Bill passed by the Trump administration in 2025 is expected to peak in the first half of this year, as tax refunds are processed. Governments are also moving to offset the expected impact of higher energy prices on consumers by announcing price freezes or gas tax holidays. This should shield or at least delay the most negative impacts of energy prices on economic activity, in the hope that the war with Iran is resolved quickly. The rush to implement artificial intelligence (AI) also appears to have provided a fillip to economic activity, with the huge amount of investment driving infrastructure spend and demand for materials and labour. While it is hard to determine today exactly what impact AI will have on long-run economic growth prospects, it is immediately obvious that these companies are spending enormous amounts of money, a significant portion of which is being financed with the sale of bonds.

Another source of bond supply comes from central banks, as policymakers continue to shrink their COVID-swollen balance sheets. Mechanically, this involves private sector investors agreeing to allocate a greater share of their capital to government bonds compared to other assets. It logically follows, then, that those investors should demand lower prices (and higher yields) in exchange for accepting this additional supply of government bonds to the market.

Against this backdrop, it is easy to see a relatively poor outlook for bonds – perhaps one that is like the last time inflation surged across the globe and bondholders suffered significant losses. However, several things are different this time. First and foremost, bond yields are substantially higher, providing a solid jumping-off point for returns – if yields do not change, investors in the current 10-year Government of

Canada bond should expect one-year returns of about 3.50%. Even if yields were to rise significantly, there is still a good chance returns would be better than owning cash. Moreover, investors have already built in substantial expectations for future inflation and policy rate rises – those expectations are already in the price of bonds. As such, should the war with Iran be resolved more quickly than anticipated, bond returns could be better than we expect. Moreover, AI has spurred enormous issuance of corporate bonds and propelled technology-heavy stocks to record highs despite the expected impact to consumer spending from higher energy prices. AI has even increased expectations for real economic growth. Skeptics of this narrative should reasonably expect to be rewarded for owning bonds at these higher yields if this narrative starts to falter. While our base case for bond returns envisages returns closer to, but better than, cash, our bullish case for bond returns looks for high-single- to low-double-digit returns for bondholders.

Across regions, we prefer to be overweight bond markets where expectations for economic growth and/or inflation are too rosy, and underweight those markets where perhaps investors are underappreciating the risk of a positive growth surprise. We continue to think Japan and Germany, respectively, fit this bill. We think the sea change in the fiscal outlook for Europe – driven by Germany's expansion of public spending – is an underappreciated upside risk to European growth and inflation. In Japan, while the COVID shock to consumer prices absolutely has jolted wage growth from its long slumber, we believe that Japan is now starting to find it difficult to generate more inflation than what is implied by the rise in oil and food prices and the rapid depreciation in the yen. In simpler terms, domestically generated or self-sustaining inflation – a key prerequisite for hikes by the Bank of Japan (BoJ) – is proving harder to come by. Nevertheless, investors continue to price substantial policy normalization by the BoJ via hikes of the policy rate, but also via very high long-term bond yields. For currency-hedged global government bond investors, Japanese government bonds offer amongst the highest yields. We continue to recommend being overweight Japanese government bonds versus German bunds.



We forecast the U.S. 10-year Treasury yield to reach 4.75% at some point over the next 12 months, up from 4.44% currently.

Direction of rates

United States

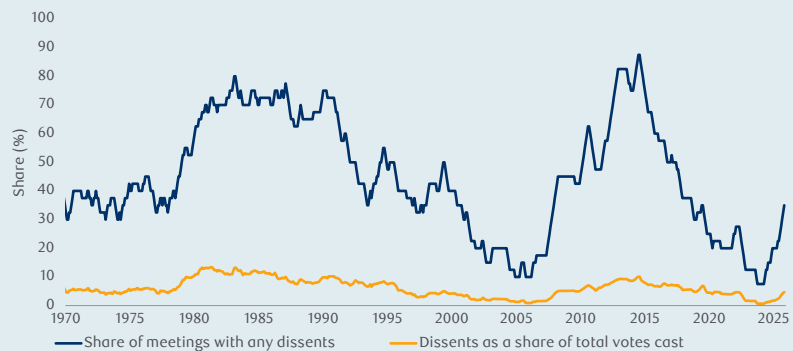
For the first time since 2018, the Fed's rate setting committee will have a new chairman when the group meets again on June 17. Make no mistake: the appointment of Kevin Warsh is an orthodox one, as he previously served as a governor from 2006 to 2011. He is a long-time critic of the Fed's balance sheet policy, through which the central bank has purchased enormous quantities of U.S. government bonds. He has also expressed strong views that a smaller balance sheet would permit policy interest rates to be lower. Finally, he has strong views on the ability of AI to make the economy much more efficient, which would lower inflation. Again, this train of thought leads one to believe that Fed Chair Warsh will be a strong proponent of lower interest rates as he begins his new role.

That said, while Warsh is assuming the Fed's titular position, his vote is just one of 12 that will be cast on whether to change the Fed's policy stance. Despite his beliefs on the balance sheet and AI supporting lower interest rates, he may find it difficult to recruit fellow members of the rate setting committee on this basis alone. In the case of a significantly smaller balance sheet, this will likely be a multi-year project for the Fed. In the case of AI, there is unlikely to be definitive evidence one way or the other on its impact on inflation in the short-to-medium term. In our view, the massive amounts of investment that are currently projected to be required are more likely to be inflationary at first via stimulating demand for raw materials and labour.

To that end, it does not seem obvious that the U.S. needs lower interest rates based on economic activity or inflation. Even setting aside the impact of the war with Iran, it appears that inflation was already starting to pick up toward the end of last year and continued to exceed the Fed's 2% target. While the economy appears to be generating very few new jobs, the Fed's governors and staff economists seem comfortable attributing this to a change in immigration policy enacted by the Trump administration rather than a signal of economic malaise.

The voting record of the FOMC over the past several meetings reflects this uncertainty over the appropriate path for monetary policy – with dissents rising (Exhibit 2). These dissents have come hand-in-hand with acquiescence that higher policy rates will be appropriate at some point, if inflation continues to be above target. Investors, for their part, have been slow to price in future interest rate rises by the Fed. We expect the Fed will ultimately remain on hold for the next year as uncertainty regarding the outlook for inflation and the labour market keeps the FOMC from taking a strong stand on the future path of policy rates. At the same time, we believe investors will continue to push up the premium demanded for lending for longer – and we forecast the U.S. 10-year Treasury yield to reach 4.75% at some point over the next 12 months, up from 4.44% currently.

Exhibit 2: Dissents are becoming more common for U.S. policymakers



Note: Data as of May 29, 2026. Source Federal Reserve



We forecast that the BoC will increase its policy rate by 50 basis points to 2.75% within the next 12 months, with the Canadian 10-year government bond yield reaching 3.75% over the same period.

Canada

The Bank of Canada (BoC) has maintained its policy rate at 2.25% since October, adopting a cautious stance despite modest upward revisions to its 2026 growth projections. The central bank has downplayed the positive economic effects of elevated energy prices while emphasizing concerns around trade policy uncertainty and labour market weakness. The outlook for both inflation and economic growth remains highly uncertain, with outcomes largely dependent on how events in the Middle East evolve.

Should global oil prices remain elevated for an extended period, broader cost pressures could emerge across the economy, raising the risk that high inflation will persist. Rising costs for gasoline, diesel, and jet fuel have already prompted businesses to implement fuel surcharges on various goods and services. Additionally, fertilizer price increases and potential supply shortages may drive food costs higher over time, while elevated oil prices reduce household purchasing power by leaving consumers with less disposable income for other expenditures.

BoC Governor Macklem has outlined a clear conditional policy framework in which escalating Canada-U.S. trade tensions would warrant monetary easing, while sustained elevated energy costs could prompt a series of rate increases.

Canada's economy faces additional headwinds from U.S. tariff measures and the inherent unpredictability of evolving trade partnerships. These trade conflicts are also constraining provincial economic growth, leading to widening budget deficits and higher borrowing requirements in the upcoming fiscal year.



We are aligning with the bearish gilts outlook, raising our 10-year gilt yield forecast to 5.0% over the next year, 50 basis points higher than our previous forecast.

We forecast that the BoC will increase its policy rate by 50 basis points to 2.75% within the next 12 months, with the Canadian 10-year government bond yield reaching 3.75% over the same period. Significant federal spending on infrastructure and defence, combined with large provincial deficits, will result in more bond issuance this year. We expect the Canadian yield curve to continue steepening, driven by fiscal stimulus and higher term premiums.

United Kingdom

The UK gilt market faces conflicting pressures and substantial disagreement on the path forward, with yields surging from April through mid-May before reversing rapidly. We expect this volatile pattern to persist as investors rotate between two extreme narratives. The bullish camp hinges on geopolitical de-escalation reducing energy prices, coupled with sustained disinflation – evidenced by April's 2.8% Consumer Price Index (CPI) reading as the start of a downtrend – and the Bank of England (BoE) maintaining rates unchanged against 50 basis points of hikes priced in the interest rate market. The bearish camp points to structural headwinds: fiscal concerns and political uncertainty surrounding the leadership of the governing Labour Party, surging capital expenditures by the so-called AI “hyperscalers”, elevated defence spending, and inflation releases persistently above the BoE's 2% target – all of which necessitate higher risk compensation to hold gilts.

We are revising our BoE policy rate forecast to an increase of 50 basis points over the next year, bringing rates to 4.25% from the current 3.75%, a significant revision from our prior publication, which had anticipated 50 basis points of easing. We foresee material risks of second-round inflation effects and de-anchoring of long-term inflation expectations. Correspondingly, we are aligning with the bearish gilts outlook, raising our 10-year gilt yield forecast to 5.0% over the next year, 50 basis points higher than our previous forecast.



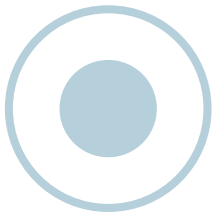


We anticipate a mild upside bias to yields, with 10-year government bond yields likely drifting toward 1.85% to 2.00% over the coming quarters.

China

Chinese bond yields continue to be remarkably low and sheltered from the global bond sell-off since our last publication – reflecting both a dour outlook for the demographic future of the country and a domestic shortage of safe assets. However, emerging signs suggest this insulation may gradually erode. The People’s Bank of China (PBOC)’s recent shift to targeting overnight money market rates, while not signalling imminent tightening, indicates that the extended period of “super easy liquidity” is moderating. This subtle policy recalibration, combined with rising global inflation pressures stemming from the war with Iran and energy price shocks, creates a cautiously challenging backdrop for further yield compression.

While the PBOC’s accommodative stance and the Ministry of Finance’s yield-suppression bias remain supportive near-term, the deeply suppressed yield environment, with 10-year yields trading near 1.70%, has limited room for further compression and may face modest upward pressure as global valuations reprice. We anticipate a mild upside bias to yields, with 10-year government bond yields likely drifting toward 1.85% to 2.00% over the coming quarters as global inflation dynamics stabilize at elevated levels. The PBOC’s policy rates, however, are likely to stay unchanged over our forecast horizon.



We expect 10-year Japanese government bond yields to fall over our forecast horizon, eventually reaching 2.50% from 2.66% at the time of writing.

Japan

Our view remains that Japanese government bonds (JGBs) are an attractive investment for long-term investors. The 30-year JGB yield of 3.9% (at the time of writing) is at a three-decade high and is higher than comparable-maturity bonds in Canada and Germany. On a currency-hedged basis, 30-year JGBs are the highest yielding among developed market peers, yielding in excess of 5.50%. Surging JGB yields reflect investors seeking high inflation compensation and fiscal pressures from the Iran war, as the government is expected to issue bonds to fund energy subsidies. We continue to believe that elevated yields in long-maturity bonds offer generous risk compensation, as we believe the BoJ is unlikely to raise policy rates anywhere close to those levels over the long run.

We are expecting the BoJ to raise policy rates by 75 basis points over the course of the next 12 months, to 1.5% from 0.75% currently, with hikes occurring roughly every four months. While the BoJ may delay reacting to surging energy prices, the broadening inflation pressures suggest a measured pace of policy tightening is much needed. As BoJ tightening is underway, this should reduce the risk premium investors demand for holding long-maturity bonds; the JGB curve is expected to flatten, and Japanese bonds will likely outperform those of other regions. We expect 10-year Japanese government bond yields to fall over our forecast horizon, eventually reaching 2.50% from 2.66% at the time of writing.



We forecast German 10-year bund yields to rise to 3.25%, from 2.94% currently.

Eurozone

As shown in Exhibit 1, the surge in energy prices due to the war with Iran has been most consequential for the European Central Bank (ECB)'s outlook for monetary policy. The ECB delivered a 25-basis-point hike on June 11 and policymakers are expected to follow through with two further hikes by the end of the year. This policy path represents the most aggressive adjustment of policy expectations to the energy supply shock among the major central banks we cover in the *Global Investment Outlook*.

Taken alone, we would not expect a negative supply shock from a one-time increase in energy prices to generate such a strong response from central bankers. On the contrary, such one-time supply-driven surges in commodity prices are exactly the type of inflation shocks that central banks should look through. This appears to be the expected course of action for central bankers at the Fed and the BoC. However, the ECB's single-mandate focus on inflation means that such surges in inflation are very hard to ignore. Moreover, the recent memory of the post-COVID surge in prices – driven by both a negative supply shock and substantial government spending at the same time – suggests policymakers will be more sensitive than usual to any uptick in inflation above target.

We think a more convincing argument for higher interest rates in Europe comes from last year's sea change in the fiscal outlook for the single currency area's most important economy: Germany. Despite a generational commitment to increase public spending, investors were largely skeptical that this increase would boost long-run economic prospects and, in turn, expectations for higher policy rates. We think the re-rating of policy rates in response to the energy shock better aligns ECB pricing with what is appropriate for a realistic updraft in the economic outlook. As it happens, German politicians – by delivering substantial public spending initiatives – have proved their skeptics wrong, with public investment spending up over 15% year on year. Aside from public infrastructure, it also appears likely that more serious commitments to NATO defence spending targets should provide an uplift to the German industrial base.

Over the next 12 months, we expect the ECB to raise its policy deposit rate by at least 0.25%, from 2.25% currently to 2.50%. Over the same timeframe, we forecast German 10-year bund yields to rise to 3.25%, from 2.94% currently.

Canadian corporate bonds

Since April 2025, the Canadian corporate bond market has experienced several periods of spread widening (risk-off), and each time has bounced back to return to previous levels (Exhibit 3). This resiliency resulted in corporate bonds performing well relative to Government of Canada bonds.

There are two significant sources of support for the credit market: corporate fundamentals, including earnings growth, and demand for corporate debt. Corporate credit markets are well supported by strong balance sheets of issuers. Both leverage (Exhibit 4) and interest coverage at companies in our corporate benchmark are at healthy levels. With positive economic growth and corporate earnings growing, the chances that these ratios will deteriorate over the next few quarters are limited. This is supportive of spreads.

The investing environment is good for credit, but this is somewhat countered by the fact that credit spreads are close to post global financial crisis lows – indeed, spreads have rarely been lower than they are now. As such, the potential for larger excess returns over government bonds is low. If earnings are growing and GDP growth is positive, we think credit spreads will remain near current levels.

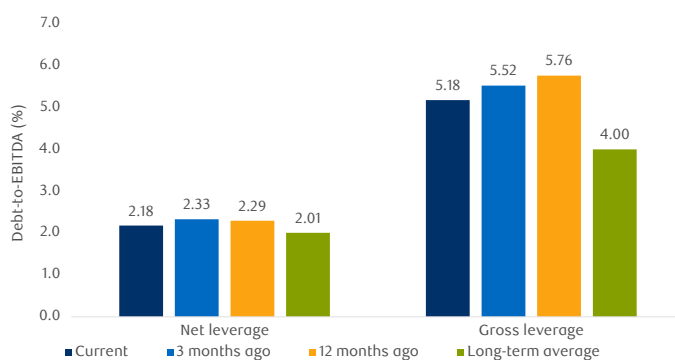
Despite tight spreads, all-in yields are attractive for many yield-driven investors who show solid demand for new corporate issues. What is unusual this time, however, is that all-in yields on corporate bonds are attractive because of the level of government yields, while compensation for credit risk is very skinny. That is why our recommended allocation to corporate bonds is entirely in investment grade and set at a lower level of the allowable range. We know spreads will widen a great deal if the economy slows down, but at this point, recession is considered a low-probability outcome. Choosing investment grade over high yield also means we can add incremental yield to the portfolio in the least volatile way.

Exhibit 3: Corporate bond spreads are low
Investment Grade Canada – BofA ML Index



Note: Data as of May 29, 2026. Source: Bank of America Merrill Lynch

Exhibit 4: Leverage in Canadian corporates



Note: Data as of May 29, 2026. Source: Bloomberg, RBC GAM calculations

Recommendation

Regionally, we continue to recommend being overweight Japanese government bonds against their German counterparts. We also recommend being overweight high-quality investment-grade corporate bonds relative to government bonds of similar maturity, particularly those maturing between 2027 and 2031.

Interest-rate forecast: 12-month horizon

Total-return calculation: May 29, 2026 – June 1, 2027

U.S.						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	3.63%	4.00%	4.40%	4.75%	5.40%	2.85%
Change to prev. quarter	0.50%	0.70%	0.70%	0.50%	0.60%	
High	4.13%	4.60%	4.75%	5.00%	5.50%	1.73%
Low	2.63%	2.70%	3.00%	3.50%	4.25%	9.51%

Expected Total Return C\$ hedged: 2.52%

Germany						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	2.50%	3.00%	3.10%	3.25%	3.65%	1.07%
Change to prev. quarter	0.50%	0.70%	0.50%	0.25%	0.25%	
High	3.00%	3.50%	3.55%	3.60%	3.90%	(0.73%)
Low	1.75%	2.15%	2.25%	2.50%	3.10%	6.28%

Expected Total Return C\$ hedged: 1.39%

Japan						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	1.50%	1.90%	2.10%	2.50%	3.75%	5.06%
Change to prev. quarter	0.50%	0.70%	0.60%	0.70%	0.50%	
High	2.00%	2.40%	2.50%	2.80%	3.65%	4.92%
Low	0.75%	1.25%	1.60%	2.00%	3.10%	12.02%

Expected Total Return C\$ hedged: 7.55%

Canada						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	2.75%	3.30%	3.50%	3.75%	4.05%	1.56%
Change to prev. quarter	0.50%	0.80%	0.65%	0.50%	0.20%	
High	3.25%	3.80%	3.80%	4.00%	4.30%	(0.05%)
Low	1.75%	2.50%	2.80%	3.15%	3.55%	5.12%

Expected Total Return C\$ hedged: 1.69%

UK						
	3-month	2-year	5-year	10-year	30-year	Horizon return (local)
Base	4.25%	4.60%	4.70%	5.00%	5.50%	4.66%
Change to prev. quarter	0.75%	0.90%	0.80%	0.50%	0.35%	
High	4.75%	5.00%	5.10%	5.20%	5.65%	2.25%
Low	3.00%	3.30%	3.45%	4.00%	5.00%	10.42%

Expected Total Return C\$ hedged: 3.61%

Source: RBC GAM

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