

# Fixed Income asset class overview

July 2025

July saw the Trump administration announce several trade agreements with key trading partners. Japan, the EU and South Korea accepted tariff rates of 15%, while some Asian countries saw slightly higher rates, including Vietnam at 20% and Indonesia and Philippines at 19%. The month also saw the US Senate pass the “One Big Beautiful Bill”, which brought clarity to the future policy backdrop, supporting the risk-on sentiment in markets.

## Month in review

In the US, June’s consumer prices index (CPI) report came in better than expected, with core inflation surprising to the downside. Early signs of tariff effects are beginning to emerge, but remain limited so far. On a year-on-year (YoY) basis, the headline CPI climbed 2.7% and core CPI rose 2.9%. Positive data continued with a stronger-than-expected Q2 GDP print in late July (3.0% versus 2.6% expected). Treasury yields moved higher in July, reflecting the improving growth outlook but also the growing uneasiness of markets with the fiscal situation.

Investment grade (IG) spreads continued to tighten in July. Global IG spreads finished the month at 79 (9 bps tighter). European spreads led the way, tightening 13 bps to 78 bps, while US dollar spreads tightened 7 bps to 79 bps, and sterling spreads tightened 8 bps to 91 bps.

In high yield (HY), markets remained strong over July, extending the positive momentum from June. The combination of tighter spreads and lower interest rates proved favourable for the global HY market, delivering 0.8% during the month. The global HY floating rate note (FRN) market also saw spreads narrowing which, together with carry, translated into positive returns (0.5%). HY spreads tightened across all regions supported by a continued risk-on sentiment and consistently positive technical. European HY outperformed, helped by better performing German bunds (vs US Treasuries) and a sentiment boost post the US-Europe trade deal.

Emerging market (EM) debt posted mixed results in July, with hard currency sovereigns returning 1.3%. Similarly, hard currency corporates gained 0.9%; meanwhile, local currency sovereigns declined -0.8%.

## Inflation

This month's US inflation figures were mixed. On the one hand, headline inflation surprised slightly to the upside; on the other, core inflation came in softer than anticipated.

Overall, there has been a modest reacceleration in inflation compared to previous months, with investors generally attributing this to tariffs. However, that’s not the full story.

Although tariffs continue to exert some upward pressure on core goods, their impact has been relatively limited and largely countered by service inflation. We believe the primary catalyst for the recent uptick in YoY inflation rates is the ‘base effect’. The inflation figures from May, June, and July of the previous year were notably low. As these figures are now dropping out of the calculation, inflation appears to be rising. Moreover, a significant portion of last year’s subdued inflation prints was due to lower prices in core goods, where tariffs predominantly manifest, suggesting that the base effect will be more accentuated in this area.

So, in our view it’s important to understand that the rise in YoY inflation, driven mostly by core goods, is not solely related to tariffs – rather, it is mostly a ‘base effect’ story, which is well known among inflation investors. Therefore, there is no immediate cause for alarm regarding the anticipated rise in inflation over the coming months, in our opinion. Rather, we believe that attention should be directed towards the underlying inflation dynamics to see whether genuine inflationary pressures are building up.

At present, we see no substantial evidence of genuine inflationary pressure, and this is likely to continue as long as money supply growth remains within current ranges. What we are witnessing is a familiar pattern: core goods prices are rising, yet lower service inflation helps keep overall inflation in check.

Looking ahead, we would expect this trend to persist. Tariffs will continue to exert slight upward pressure on core goods prices, yet service inflation is likely to counterbalance this effect. Service inflation can be divided predominantly into two segments: the first is rents, which are closely correlated with house prices; the second is core services excluding rents, often referred to as ‘super-core inflation’, which is substantially influenced by wages and therefore by labour market conditions. There seems to be no immediate reason to worry about services inflation; if anything, we might continue to witness some downward pressure in this category, as a weakening labour market is likely to impact wage inflation, while lower house prices will likely translate into lower rent inflation.

In conclusion, inflation was mixed in June, with headline numbers surprising to the upside and core numbers to the downside. Overall, inflation appears to have reaccelerated slightly, and while tariffs are seen as the primary factor, a more significant cause of the YoY increase can simply be attributed to the 'base effect'. Tariffs are having an impact, but at present, their effect is less pronounced than feared and is broadly offset by reductions in service inflation—a trend we believe is likely to persist.

## Developed market sovereigns

US President Trump delayed the original 9 July tariff deadline to 1 August, then announced higher tariffs than those set on 2 April. Deals were struck with Japan, EU, and South Korea at 15%, Vietnam at 20%, and Indonesia and Philippines at 19%. Mexico faced a 90-day extension of current tariffs (25% for non-USMCA goods and autos), while higher tariffs were imposed on non-deal countries like India (25%) and Brazil (50%). On 31 July, Canada was hit with 35% tariffs (USMCA-compliant goods exempt). Questions remain about investment commitments in these deals.

The Senate passed, and Trump signed, the "One Big Beautiful Bill", a package of tax cuts and measures. Economists project a federal deficit of 6.5-7% of GDP over the next few years.

The Federal Reserve held interest rates with a hawkish tone; Chair Jerome Powell signalled a "wait-and-see" approach, with only 33bps of interest rate cuts priced by year-end. Two Fed governors dissented for a 25bps cut.

In the euro area, the European Central Bank (ECB) held its deposit rate at 2%, with President Lagarde indicating June's rate might mark the end of easing. A rate cut is possible, but economists now expect a hike in late 2026.

Germany's draft budget included front-loaded stimulus, pushing bond yields up.

Eurozone inflation eased to 2% in June – the lowest rate in years – with core inflation just above 2%. Prices slowed notably in Germany (2.0%) and Italy (1.7%).

Mid-month indicators were mixed: manufacturing remained soft, but services PMIs showed continued expansion. Bank lending surveys indicated credit conditions tightening only gradually.

In the UK, with inflation persistently high, Bank of England (BoE) officials indicated deep concern. Markets now expect the BoE to delay rate cuts; some pricing even implied a potential further hike if price pressures don't abate.

June UK CPI came in around 3.6% year-on-year (up from 3.4% in May), far above other G7 nations. Core and

services inflation showed no improvement, staying troublingly high (4.1%). Nearly all major price categories rose faster than desired.

Labor market data showed the unemployment rate creeping up to 4.7%, but wage growth running hot at 5–6% YoY. Pay growth remained well above pre-pandemic norms, reflecting worker shortages and cost-of-living raises.

In Japan, 10-year Japanese Government Bond (JGB) yields hit 1.6% (highest since 2008) before easing slightly.

Japan's core consumer price inflation (ex-fresh food) came in at 3.3% YoY – among the highest Japan has seen since the early 1990s. Importantly, even the 'core-core' measure (ex food & energy) was 3.4%, above the Bank of Japan's 2% goal, signalling broad price pressures.

Past performance is not a guide to future performance.

### Government bond total returns (in local currency)

	10-year yield %	Total return % (1m)	Total return % (ytd)
<b>Treasuries</b>	4.4	-0.4	3.4
<b>Bunds</b>	2.7	-0.3	-0.9
<b>Gilts</b>	4.6	-0.3	2.2

Source: Bloomberg, 31 July 2025

## Investment grade credit

July was a month of renewed volatility across global markets, with macroeconomic and geopolitical developments once again taking centre stage. The dominant theme was trade, as the 90-day tariff pause expired early in the month. While initial uncertainty weighed on sentiment, the eventual announcement of a series of bilateral trade agreements between the US and key partners – including the EU, Japan, and South Korea – helped to stabilise risk assets. However, the imposition of higher tariffs on countries such as Brazil, India, and Canada served as a reminder that trade tensions remain a live risk.

In the US, the 'exceptionalism' narrative regained traction. Strong Q2 GDP growth (3.0% versus 2.6% expected), robust earnings, and a tech-led equity rally all contributed to a risk-on mood. However, this came at the cost of higher yields, with the 10-year Treasury yield ending the month 15 bps higher, driven by hawkish Fed commentary and the passage of a large fiscal stimulus package. In Europe, the ECB also struck a more hawkish tone while gilt yields similarly rose, with UK markets reacting to a government U-turn on welfare spending.

Against this backdrop, IG credit spreads continued to tighten.

The outlook remains finely balanced. While the macroeconomic data has surprised to the upside, central banks are in no rush to ease monetary policy, and the full impact of restrictive policy is still feeding through. Meanwhile, the trade landscape remains fluid, and further developments could quickly shift market sentiment. In this environment, we continue to believe that active management – across both duration and credit risk – is essential to navigating the cross-currents of policy, politics, and growth.

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#### Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	79	0.1	4.4
Euro IG	78	0.5	2.4
UK IG	91	0.3	3.8

Source: Bloomberg, 31 July 2025

## High yield credit

HY markets remained strong, extending the positive momentum from June. The combination of tighter spreads and lower interest rates proved favourable for the global HY market, which delivered 0.8% in July. The Global HY FRN market also saw spreads narrow which, together with carry, translated into positive returns (0.5%).

HY spreads tightened across all regions, supported by continued risk-on sentiment and consistently positive technicals. European HY outperformed, helped by better performing bunds (versus US Treasuries) and a sentiment boost post the US-Europe trade deal.

By month-end, HY yield-to-worst levels were roughly 7.1% in the US (USD), 5.0% in Europe (EUR) and 7.0% for HY FRN (USD) offering a robust income cushion.

The risk-on mood was evident in the relative performance of credit qualities: lower-rated credit segments outpaced higher-rated. For instance, US CCC rated HY returned 1.4% in July versus single Bs (0.4%) and BBs (0.2%). A similar pattern held in Europe (CCC +1.5% versus 1.2% for B and BB). These moves reflect growing confidence that defaults will likely remain contained.

Sector performance in July was broadly positive, with some clear standouts and a few laggards. Cyclical and industrial sectors led the pack. Notably, automotive and Steel surged with the announcement of a US-EU trade

deal. On the flip side, more defensive or rate-sensitive sectors underperformed. For example, Utilities actually saw a mild widening of the spread and Financials, especially HY Banking names, also lagged.

Primary market remained active in July, driven largely by refinancing activity as issuers capitalised on tighter spreads and robust investor demand. HY FRN issuance was also firm, with various deals pricing globally. Floating rate paper continues to attract investors particularly after this month's Fed's hawkish message.

#### What we think from here:

Following the recent rally, HY spreads are now at or near 12-month lows and well through historical averages, meaning future compression will likely require either continued fundamental improvement or a significant risk-on catalyst.

Having said that, we do not foresee a major correction barring a big macroeconomic shock. We believe that the support pillars for HY remain in place: default rates are low (and expected to stay below ~3% over the next year), most issuers have termed-out debt, and yields (5–7%) still attract income-focused buyers. Looking ahead, a few factors will be crucial:

- **Central Banks:** as economic data continue to soften only gently, the next policy moves are likely to be to ease monetary policy – which historically benefits HY by reducing financing costs. However, any hawkish surprise (ie from an inflation resurgence) could hurt HY by pushing up base yields and stressing weaker credits.
- **The economy and default cycle:** thus far, the economy has been resilient (more a slowdown than a recession) and corporate earnings should broadly cover interest costs and keep defaults low. However, if growth were to downshift more sharply, we'd expect HY spreads to widen to price in higher default risks. Sectors like Consumer and CCC rated names would be hurt.
- **The technical picture** – supply versus demand – remains supportive, in our view. HY funds have seen steady inflows as investors seek income. Flow reversal could pressure spreads, but there's no sign of that yet.

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#### High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	286	0.4	5.0
Euro HY	284	1.2	4.2

Source: Bloomberg, 31 July 2025

## Emerging market bonds

EM debt posted mixed results in July, with hard currency sovereigns returning 1.3%, driven by a strong 1.8% contribution from spread compression, which more than offset the -0.6% drag from interest rates. Hard currency corporates gained 0.9%, with spreads contributing 1.2% and rates detracting -0.3%. By contrast, local currency sovereigns declined -0.8%, as a positive 0.8% from carry was outweighed by a significant -1.5% impact from currency depreciation. July saw a continuation in the very broad-based rally seen in the hard currency market, with only a few countries seeing spread widening, most of which were CCC rated, including Lebanon, Argentina and El Salvador.

EM fundamentals remain robust, in our view, across both sovereign and corporate sectors. Many economies are benefiting from contained inflation and the easing of monetary policy. While the prospect of new tariffs has led to downward revisions in global growth forecasts, EMs are still expected to outpace their developed counterparts. We remain fairly constructive on the pace at which trade agreements are being put into place, allaying fears over a broader and deeper economic growth slowdown. A softer US dollar is supportive of local currency returns, and historically, the resumption of a Fed interest rate-cutting cycle has provided a meaningful tailwind for EM debt. As investors seek to diversify away from US assets, EM debt is increasingly viewed as a relatively stable refuge.

Although spreads continue to compress, yields remain elevated, offering an appealing entry point for those looking to rotate out of lower-yielding, safer assets. A compelling, yet sometimes underappreciated feature of the asset class is its ability to deliver yields comparable to, or even exceeding, those found in high-yield markets, while maintaining superior credit quality. With approximately half of the market rated IG and a high degree of diversification, we believe EM debt is well-positioned to attract investor interest.

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### Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
<b>LCY government</b>	n/a	-0.8	11.4
<b>HCY government</b>	303	1.3	7.0
<b>HCY corporate</b>	244	0.9	5.0

Source: Bloomberg, 31 July 2025

## Currencies

After experiencing its steepest monthly decline since 1973 in June, the US dollar rebounded in July, gaining 3.0% as measured by the Dollar Index (DXY). Despite this recovery, the index remains down 8.1% year-to-date. The dollar's resurgence was supported by resilient US economic data, the Fed's decision to hold rates steady in July, and a flurry of new trade agreements with the 1 August tariff deadline looming large. With this, traders have dialled back their expectations for US interest rates cuts, particularly after the latest Fed review.

This strength weighed on major currencies, all of which depreciated against the dollar on a spot basis. The Chilean peso, Japanese yen, and British pound were among the weakest performers. In contrast, several frontier market currencies bucked the trend, with the Paraguayan guarani, Zambian kwacha, and Tajikistani somoni posting gains.

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### Key currency pairs

	Change % (1m)	Change % (ytd)
<b>GBP/USD</b>	-3.8	5.5
<b>GBP/EUR</b>	-0.7	-4.3
<b>EUR/USD</b>	-3.2	10.2

Source: Bloomberg, 31 July 2025

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