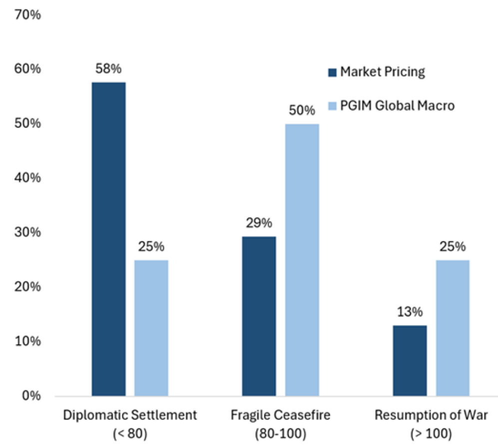
The Macro Uncertainties Driving Long-Term Rates

WEEKLY VIEW FROM THE DESK | August 17, 2026

LINK TO WEEKLY RETURNS TABLE

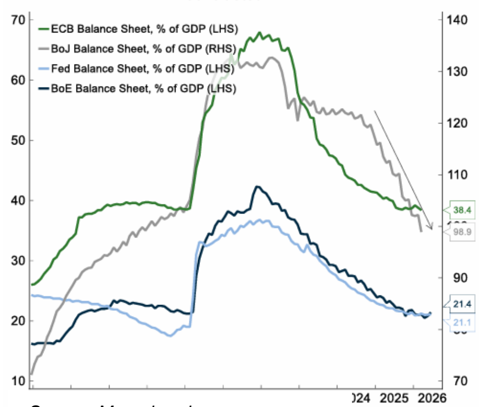
MACRO

- Although short-term policy rates remain an important driver of government bonds, long-term DM yields have continued to move higher even without active central bank tightening. This suggests other forces are at play in helping to push long-term yields higher and yield curves steeper.
- As a reminder, under our “overheating” U.S. economic base case, we currently expect three 25 bp rate hikes from the Fed in 2026—more than what the market is currently pricing in. Under the same economic scenario, we forecast a U.S. 10-year Treasury yield of 4.65% (not far from the current 4.71%) and a 2/10s curve of 20 bps (well below the current 54 bps).
- Under our “muddle through” European economic base case, we expect one 25 bp hike by the ECB—one fewer than the market is currently pricing in—and a German 10-year bond yield of 3.00% and a 2/10s curve of 40 bps.
- While components of the term premium are difficult to pin down, we see several important macro uncertainties contributing to higher long-end rates. One pertains to inflation uncertainty. Whereas the market is currently expecting oil prices to fall below $80/barrel, we anticipate a “fragile ceasefire” in the Middle East keeping oil prices between $80-100/barrel (*see chart*). Climate-related disruptions (e.g., extremely low water levels in the Rhine River as a risk to European industry) could become another inflation driver.
- Other risks to the long-end of government yield curves include, supply/demand imbalances (e.g, global central banks are now buying fewer bonds, *see chart*), increasingly large fiscal deficits, and significant IG corporate issuance (i.e., hyperscalers) competing with sovereign debt.
- While higher long-term yields and steeper curves are not necessarily negative for fixed income investors (e.g., carry and roll opportunities have improved), investors should prepare for volatility and potential repricing as inflation and supply-demand dynamics continue to evolve.



Source: PGIM

Central banks balance sheets (as % of GDP) have contracted



Source: Macrobond

DEVELOPED MARKET RATES

- The July CPI data were roughly in line with market expectations for a moderate report following an exceptionally weak set of inflation readings in June. Core CPI inflation ran at +0.22% MoM, and U.S. Treasuries reacted only modestly with a small (8 bps) amount of steepening. At around 4.71%, the U.S. Treasury yield is now at the higher end of the range seen in recent years.
- After the CPI release, markets priced out much of the expected September rate hike. Only 10 bps is now priced for September, with just 25 bps in aggregate of hikes expected through the remainder of 2026. As the latest inflation data did not settle the debate over the Fed’s next move, attention now turns to September’s report as we expect inflation to remain the main market catalyst.
- Mortgage spreads widened modestly late last week as rates moved higher but recent performance has been stable. We remain constructive and continue to expect mortgages to perform reasonably well if rates remain around current levels or decline. We also expect mortgage supply dynamics to remain favorable as lower mortgage origination provides technical support.

IG CORPORATES

- Last week saw new issuance of $56 billion, with deals 3.3x oversubscribed and coming with a 4.1 bp concession.
- August is likely to wind up being the largest new-issue month on record, and September is shaping up as another strong month with an estimated $230B on tap.
- In company-specific news, rumors have swirled that Silver Lake is in talks to acquire Workday. It would mark one of the largest software buyouts in history if it were to take place.
- In Europe, primary markets were fractionally busier last week, with three financial deals bringing just over €2B of issuance. Supply is expected to pick up somewhat this week, concentrated to the financial sector, with €7.5-12.5B expected.

LEVERAGED FINANCE

- U.S. high yield spreads tightened modestly last week amid solid earnings and strong technicals. Two-thirds of the way into the earnings season and 3.8 times as many companies have beaten expectations than missed and 2.3 times as many companies have provided positive forward guidance that have provided negative guidance. Meanwhile, $9.5B of calls, tenders, maturities, and coupon payments supported the technical backdrop.
- Total returns were mixed across high yield sectors, with the best performers being containers (0.49%), energy (0.34%), and gaming (0.32%). Returns across credit tiers were also mixed, with higher quality outperforming. Inflows persisted, with HY funds reporting an inflow of $167M, bringing YTD inflows to $2.5B. New issuance picked up, with 11 high yield bond deals pricing last week for $21.8B.
- U.S. bank loans posted positive returns last week with higher quality outperforming. Inflows continued, with $210M bringing YTD outflows to -$3.5B. The market remains relatively busy, with 19 deals pricing for $15.4B. We expect a quiet rest of August in terms of new issuance. As a result, we expect the technical strength to continue over the short term.
- European HY and loan spreads were slightly tighter last week, with both BBs and Bs tightening together. There were no new issues in the loan market and just one in the bond market. We generally remain defensively positioned against the backdrop of elevated macro complexity and heightened geopolitical risks but expect technicals to remain healthy amid a continued lack of supply.

EMERGING MARKETS

- EM hard currency sovereign spreads were essentially flat last week, with the exception of select B and CCC names that widened on geopolitics, positioning, and idiosyncratic stories. With an uncertain geopolitical backdrop, macro crosswinds, and cloudy central bank policies, the theme going forward will still be about positioning and country-specific fundamentals.
- EM corporate spreads were tighter as Q2 earnings and weaker economic data from the U.S. came into focus. Raizen reported strong earnings with the fuel distribution business doing well. Bonds have been well bid in the mid $50s and still pricing the equity at a heavy discount. Braskem also reported better-than-expected results, although petrochemical spreads have normalized since the end of the quarter.
- In EM rates, last week was mixed amid higher oil prices and softer U.S. data. The market exhibited wide dispersion across countries. South Africa, Brazil and Czech were the biggest underperformers. Indonesia rallied after underperforming for many months. Irrespective of short-term relief from U.S. yields, elevated prices of crude and distillates remain headwinds for EM local rates, particularly in CEEMEA and Asia. With noisy oil moves in the background, we expect rangebound trading of local rates ahead of the Jackson Hole Symposium.
- It was a muted week for EMFX where the index returned +15 bps, led by Europe. It was surprising to see that EMFX didn't do better despite the move lower in UST yields and a bull steepening that occurred from Monday to Thursday. There weren't any idiosyncratic developments driving individual currencies last week, although BRL fell apparently on expectations around the upcoming election. The next potentially impactful event for the FX market is Jackson Hole at the end of August. Until then, we would expect rangebound markets to continue. We expect select high-carry currencies will continue to outperform low-carry currencies.

SECURITIZED PRODUCTS

- CMBS conduit AAA spreads were slightly wider in the mid +70s in the secondary market last week. Subordinate tranches were marginally tighter, with As in the +170 context and BBB-'s in the mid +400s. The SASB spread curve continued to flatten, led by outperformance of lower-rated tranches. Top-tier AAA floaters are clearing in the +120-130 area. Fixed-rate seniors are trading in the +80s. CRE CLO spreads were little changed, with AAA new issue in the +130-140 area, while tier-two issuers were 5-25 bps wider. Eleven deals priced—five conduit, four SASB, one small balance, and one agency.
- In RMBS, non-QM spreads were largely unchanged, with first-tier AAAs at T+130, five bps wider on the week. Credit curves remain flat, with AA/A/BBBs at T+140/150/170, respectively, and just 10/20/40 bps above AAAs. CRT trading was quiet, leaving spreads largely unchanged.
- U.S. CLO spreads for benchmark issuers had a firmer tone last week. The pace of tightening slowed at the senior tranches as spreads begin marketing inside 3M SOFR+120. IG mezzanine spreads are approaching YTD tights. The flatness of both the credit and manager perceived tiering curves has reduced the benefit of taking incremental risk, leading us to shift higher in the capital structure and concentrate exposure among benchmark managers. U.S. issuance was $10.4B across 24 deals and European issuance was €4.0B across nine deals.
- ABS spreads were generally unchanged near YTD tights, with demand remaining most robust in subordinate risk with secondary holding in and new issue continuing to price through initial guidance. We remain constructive on both sides of the ledger, continuing to add higher value/higher quality securities across the ABS spectrum.

MUNICIPALS

- Despite rate fluctuation spurred by lighter inflation data and an evolving situation in the Strait of Hormuz, munis were mostly unchanged on the week. Positive weekly flows continued, at $759M, and YTD flows of $65B are the second-highest on record, trailing only 2021.
- As most of August reinvestment has been exhausted, the new issue calendar continues to be elevated, flows moderate, and relative value remains challenged, munis will face new performance obstacles as the calendar transitions from summer to fall. That said, our short-term rating remains positive, as the market continues to feel well supported.
- President Trump said he would examine whether the federal government can stop New York City Mayor Zohran Mamdani's new pied-à-terre tax, which was temporarily blocked by a state court, but stayed by an appeals court.

THE RETURNS TABLE AS OF AUGUST 14, 2026

					Yield / OAS change (bps)						Total return (%)		
	Duration	YTM	OAS	WTD	MTD	QTD	YTD	Prior year	WTD	MTD	QTD	YTD	Prior year
Sovereign rates													
U.S. 2-Year	1.85	4.17	---	-2	-12	0	70	44	0.12	0.34	0.47	0.97	2.69
U.S. 5-Year	4.40	4.37	---	1	-9	14	64	55	0.03	0.45	-0.19	-0.37	1.39
U.S. 10-Year	7.91	4.69	---	5	-4	23	52	41	-0.25	0.39	-1.34	-1.32	1.15
U.S. 10-Year Breakeven	--	2.28	---	3	0	5	4	-11	---	---	---	---	---
U.S. 10-Year TIPS	4.38	2.41	---	2	-4	18	51	52	-0.19	0.12	-0.98	0.12	2.09
U.S. 20-Year	12.14	5.26	---	5	-3	30	47	41	-0.55	0.35	-3.20	-2.77	-0.53
U.S. 30-Year	15.02	5.26	---	6	-1	31	42	39	-0.89	0.08	-4.30	-3.28	-1.32
U.S. SOFR	---	---	---	0	-4	-6	-25	-72	0.07	0.14	0.45	2.31	3.94
UK 10-Year	7.22	5.04	---	12	-1	28	56	40	-0.68	0.29	-1.18	-0.43	2.32
Germany 10-Year	8.47	3.20	---	7	0	35	35	49	-0.42	0.17	-1.82	-0.41	-0.57
Switzerland 10-Year	8.60	0.38	---	2	-4	11	10	13	-0.11	0.40	-0.85	-0.20	-0.50
Japan 10-Year	7.61	2.87	---	9	9	20	81	133	-0.56	-0.55	-1.11	-3.70	-6.77
Australia 10-Year	7.97	5.01	---	0	8	28	27	80	0.14	-0.11	-0.93	1.50	-0.77
Canada 10-Year	8.22	3.68	---	4	2	30	25	27	-0.15	0.06	-1.58	0.60	2.06
Major fixed income multi-sector indices		**YTW**											
Global Aggregate Unhedged	6.24	3.98	28	0	0	1	1	-1	-0.14	0.53	-0.01	-0.22	0.92
Global Aggregate Hedged	6.24	3.98	28	0	0	1	1	-1	-0.18	0.28	-0.74	0.40	2.05
U.S. Aggregate	5.95	4.92	28	1	-1	2	1	-2	-0.14	0.46	-0.85	-0.24	2.39
Euro-Aggregate (Unhedged)	6.17	3.43	44	1	0	0	1	-3	-0.36	0.13	-1.34	-0.06	0.29
Japanese Aggregate	7.79	2.53	0	0	0	0	0	0	-0.48	-0.43	-1.05	-3.80	-6.34
Major fixed income credit indices		**YTW**											
Mortgage-Backed (Agency)	5.66	5.21	27	1	-4	2	5	-10	-0.13	0.69	-0.74	0.24	3.89
Global IG Corporate Bonds	5.87	4.92	80	1	0	2	1	2	-0.13	0.57	-0.51	-0.33	1.81
U.S. IG Corporate Bonds	6.76	5.42	79	2	1	5	2	4	-0.29	0.37	-1.31	-0.47	2.05
European IG Corporate	4.52	3.67	77	0	-2	-3	-2	-2	-0.15	0.29	-0.68	0.64	1.19
U.S. High Yield Bonds	3.18	7.20	266	2	-14	-4	-1	-15	0.15	0.87	0.62	2.59	5.55
European High Yield Bonds	3.05	5.88	279	-6	-8	-4	-2	0	0.16	0.51	0.27	2.15	3.05
U.S. Leveraged Loans	0.3	9.17	481	-5	-12	-19	26	24	0.24	0.51	1.31	2.69	4.75
European Leveraged Loans	0.3	8.03	472	-3	-13	-9	-2	11	0.18	0.29	0.54	2.31	3.40
EM Hard Currency Sovereigns	6.21	7.15	236	-1	-9	0	-18	-53	0.03	0.97	-0.46	2.91	8.30
EM Corporates	4.35	6.67	213	-2	-2	0	-25	-32	0.15	0.61	0.13	2.34	5.07
EM Currencies	---	5.38	---	0	-1	-1	0	-1	0.15	0.80	2.24	3.46	6.04
EM Local Rates	5.28	6.21	6	0	0	0	0	0	-0.03	0.44	0.10	1.79	4.37
CMBS	3.66	4.99	65	0	-1	0	-10	-14	0.07	0.48	0.09	0.86	3.31
ABS	3.00	4.71	43	0	1	0	-9	-8	0.07	0.35	0.24	1.31	3.54
CLOs	3.96	5.31	126	0	-1	-1	-5	-8	0.10	0.21	0.59	2.99	5.00
Municipal Bonds	6.35	3.81	---	-1	-11	24	22	-8	0.12	0.80	-1.06	1.23	5.37

				Total return (%)		
	Level	WTD	MTD	QTD	YTD	Prior year
Equity / volatility indices						
S&P 500 Index	7,786	0.4	4.0	3.9	14.5	21.8
DAX	26,440	0.5	3.2	5.8	8.0	8.5
Stoxx 600	658	-0.3	1.5	2.8	14.1	22.6
Nikkei 225	68,714	4.7	6.8	-1.9	37.7	63.9
Shanghai Composite	3,927	-0.3	2.6	-3.5	0.5	9.5
MSCI ACWI Index	1,160	0.7	3.6	3.7	15.7	24.0
FTSE 100	10,750	-1.1	-0.5	3.1	10.9	20.9
MOVE Index	70	-3.4	-16.2	-3.3	8.8	-9.4
VIX Index	14	-4.4	-10.9	-13.4	-4.7	-3.9

				Change (%)		
	Spot	WTD	MTD	QTD	YTD	Prior year
FX / commodities						
EUR / USD	1.2	0.1	0.4	1.3	-1.5	-0.7
USD / JPY	159.3	1.0	1.2	-2.0	1.7	7.8
GBP / USD	1.4	0.3	0.4	2.1	0.5	0.0
EUR / CHF	0.9	0.8	1.1	1.9	1.1	0.0
USD / CHF	0.8	0.7	0.7	0.6	2.6	0.7
USD (DXY)	99.7	0.1	-0.2	-1.5	1.4	1.4
Oil	82.4	5.4	-2.7	18.6	43.5	28.8
Gold	4376.4	0.8	8.2	9.2	1.3	31.2

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Source(s) of data (unless otherwise noted): PGIM as of August 17, 2026.

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