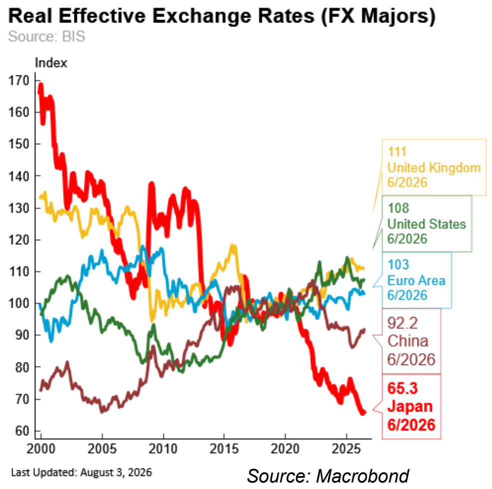
From the Fed to the Yen

WEEKLY VIEW FROM THE DESK | August 3, 2026

LINK TO WEEKLY RETURNS TABLE

MACRO

- The market response to last week's Fed meeting was rapid with the selloff at the back of the U.S. curve likely concerning officials. While tighter financial conditions can accomplish some of the Fed's work, as Fed Chair Warsh suggested, they are not a full substitute for rate hikes, particularly if they call the Fed's inflation-fighting credibility into question. At this point, the Fed may become more aggressive in upcoming meetings than it may have initially intended prior to last week's meeting.
- Ultimately, the direction of U.S. monetary policy will depend on data, which may continue to show inflation is moderating, but unlikely to the point of returning to 2% with the current policy backdrop.
- At this point, there are several items to watch before the September 16 FOMC meeting: two CPI reports, one PCE report, two employment reports, one GDP report (Q2 second estimate), and Warsh's Jackson Hole speech. We continue to expect 75 bps in policy tightening this year, starting in September. Our base case of three 25 bp moves remains intact, but markets may increasingly price in the possibility of a 50 bp hike in September.
- Concern about the selloff at the back of the U.S. curve may have also played a role in the first U.S.-Japan joint intervention in the yen since the Fukushima disaster in 2011. Japan is by far the largest non-domestic holder of Treasuries, and some believe Japan was poised to sell longer duration USTs after depleting its dollar cash and deposits held at the Fed. After conducting record-size solo interventions in April and May, Japan's Ministry of Finance reportedly sold another $40-60B in U.S. dollars to buy yen on July 30, which was then followed by $5-10B of yen buying from the U.S. on July 31 (for context, the U.S. intervention in 2011 was on the order of $1B).



- Normally, an FX intervention to strengthen a currency works if the central bank is adjusting rate policy to reinforce the direction of the intervention. In this case, it would require the BoJ to hike in tandem with buying yen. As for the potential path for the Bank of Japan, while the faster pace we set out early this year was paused on the back of the Middle East crisis, the pace of normalization can now accelerate to a 25 bp hike about every four months, putting the next rate rise in frame for October. The BoJ assess nominal neutral to be between 1-2.5%, therefore the next three hikes should take them to the mid point of neutral (1%-2.5%, midpoint 1.75%). However, this will happen against a backdrop of potentially higher rates at the Fed, which suggests that this latest yen intervention may provide limited relief.

DEVELOPED MARKET RATES

- While last week's press conference with Fed Chair Warsh was characterized as perplexing—the market reaction was apparent in several ways, including the continued increase in U.S. 5y5y inflation swaps as observed in the accompanying chart—some perspectives see his altered approach as justified.

- Indeed, raising rates to tighten monetary policy, especially the way it's been done since 2004, has produced mixed results. For example, in the 2004-2006 and 2022-2023 rate hiking cycles, short rates went up, but central bankers were so busy calming markets—keeping long rates low, spreads tight, and facilitating robust credit growth—that they contributed to the configuration of demand running hot, markets staying ebullient, and inflation remaining above target.
- MBS spreads underperformed into last week's Treasury selloff, and the sector traded long as a result. Bid/ask spreads widened as rates rose. Elsewhere, average gross production remains light at about $2.5B per day. Prepayments remain slow as mortgage rates remain elevated.

IG CORPORATES

- Last week saw about $30B in new issuance, with deals 2.3x oversubscribed and coming with an 11.1 bps concession. Second-quarter earnings have been exceptionally strong, with estimates on average beating by about 31%, the largest margin on record. Hyperscaler capex estimates also continue to climb.
- In Europe, it was another quiet week in the IG primary market, with only one deal on the week, as AT&T brought €5B across four EUR tranches and one GBP tranche. Light volumes are expected to continue, with syndicates reporting little to no pipeline for the first two weeks of August.

LEVERAGED FINANCE

- U.S. high yield spreads widened modestly last week as investors absorbed curve volatility tied to the Fed. Meanwhile, earnings for HY companies are off to a strong start, with far more companies have beaten EBITDA expectations than missed. Caution remains around lower-rated and AI-adjacent credits but demand for the rest of the market remains steady.
- Total returns were mixed across high yield sectors, with the best performers being consumer products (1.11%), air transportation (0.89%), and cable (0.53%). The three worst performing sectors were telecom (-0.52%), paper (-0.10%), and chemical (-0.10%). Returns across credit tiers were positive, with Bs outperforming. Outflows resurfaced, with HY funds reporting the second outflow in nine weeks of -$640M for the week ending July 29th. Only three high yield bond deals priced last week for $3.0B, wrapping up July's issuance at $17.5B.
- U.S. bank loans posted modestly positive returns last week with higher quality outperforming. We expect a quiet August in terms of new issuance but expecting one of the busiest Q4s seen in years.
- European HY and loan spreads were slightly wider last week, with CoreWeave and Virgin Media bonds weighing on the index. 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 flat but trended higher through parts of last week. There was spread compression among lower-quality segments, especially in CCC and defaulted names. Given the move lower in oil prices from the July highs, some outperformers were oil importers, but there was a mix of outperformance by oil exporters as well. There were small outflows in EM HC from ETFs.
- Otherwise, the sector is more about positioning and country-specific fundamentals, not necessarily only credit related with the market watching El Nino impacts, among other factors. In the short term, there is likely to be continued market tension between geopolitical pressures, broader derisking/deleveraging, and what seems to be resilient fundamentals.
- EM corporates were largely range bound in a macro-focused week with the Fed and U.S. tech earnings. Corporate earnings in EMs continued to trickle through with strong reports from Totalplay, Veon, Kingston Airport and Parex. Turkish banks reported higher NPLs, but capital ratios were stable. CSN bonds were higher with the company announcing a liability management for the 2028 bonds, including a partial prepayment (we own CSN in corporate and high-risk accounts). Banco Multiva from Mexico is looking to issue a subordinated bond, but potential pricing of 100 bps above Banorte does not feel compelling.
- EM local rates witnessed a relief rally last week after being under pressure for most of July, outperforming DM rates as oil prices retreated and U.S. yields rose. High yielders, such as Brazil, South Africa and Colombia, were the biggest outperformers. In the five-year swap space, only the Chilean swap yield was higher. The Chilean Central Bank kept its policy rate unchanged at 4.5%, while Banrep in Colombia unexpectedly kept rates on hold when the market had priced in a 50 bps hike. We reduced our underweight in the five-year swap in Chile and two-year in South Africa. We added to our underweight in two-year Colombia.
- Last week’s rally in EM rates is unlikely to last unless the broad USD continues to decline. In the last few central bank meetings, almost all have surprised to the dovish side, so it seems that the bar to hike rates is much higher than their communications seemed to suggest.
- The EMFX index gained on the week amid broad USD weakness and higher long-end Treasury yields following the Fed meeting. KRW continued to do well on the back of KOSPI volatility and exporters converting USD to KRW. COP was among the outperformers, but Banrep’s decision to hold rates steady could take the wind out of the currency’s sails. Some oil importers were among the outperformers. By and large, high carry outperformed low carry.
- Going forward, the short term is a bit muddied for USD. We are of the view that financial conditions need to tighten in order for inflation to have a chance to move to target. Fed governors are likely to sound hawkish in their upcoming public appearances, which should result in USD stabilizing and steadily strengthening. If this doesn’t materialize, we would reduce our small long USD bias. We continue to think high carry currencies will outperform.

SECURITIZED PRODUCTS

- CMBS conduit AAA spreads were 1 bp tighter in the low to mid +70s in the secondary market last week. Subordinate tranches were little changed, with As in the +180 context and BBB-'s in the mid +400s. SASB spreads held steady after recent moves tighter. Top-tier AAA floaters are clearing in the +120-130 area. Fixed-rate seniors are trading in the +80s amid increased dispersion by property type and sponsor. CRE CLO spreads were framed tighter, with AAA new issue in the +130-140 area, while tier-two issuers were 5-25 bps wider. Six deals priced-two CRE CLOs, three SASB, and one agency.
- In RMBS, non-QM spreads tightened slightly across the stack, with first-tier AAAs at T+125, five bps tighter on the week. Credit curves remain flat, with AA/A/BBBs at T+140/150/180, respectively, and just 15/25/55 bps above AAAs. Second-lien CES spreads widened, with AAAs at T+125. CRT spreads remained stable, with investors focused down the stack where B1/B2 traded slightly tighter.
- U.S. CLO spreads were generally unchanged. Mezzanine tranches were mixed as investors are increasingly willing to pay up for cleaner portfolios. Overall, both the credit curve and perceived manager tiering curve remains flat. We continue to rotate up the capital structure and into more benchmark managers. U.S. issuance was $11.9B across 27 deals and European issuance was €2.8B across six deals.
- ABS spreads were generally unchanged near YTD tights. While deals experienced slower book builds, lower subscriptions, and less aggressive tests on deals, demand remained steady. U.S. primary remains active with five deals for $3.8B in this week's pipeline. Europe/UK/Australia is quiet. Broker dealers net purchased $300M last week but have still net reduced $2.4B so far this year. We remain constructive on both sides of the ledger, continuing to add higher value/higher quality securities across the ABS spectrum.

MUNICIPALS

- Munis began last week recovering some of the underperformance from the prior week, but performance stalled after Fed Chair Warsh’s press conference sent longer rates spiraling higher.
- Munis experienced less of a steepener than treasuries and outperformed on the long end (underperforming in the front end), pushing the long end of the muni curve back into “rich” territory.
- Credit quality and integrity continue to be upheld in the market, with a PE sale to a not-for-profit behavioral health firm getting pulled because of investor pushback.

THE RETURNS TABLE AS OF JULY 31, 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	1.89	4.29	---	-4	12	12	82	33	0.20	0.13	0.13	0.63	2.89
U.S. 5-Year	4.44	4.45	---	2	22	22	72	48	0.10	-0.64	-0.64	-0.81	1.71
U.S. 10-Year	7.78	4.74	---	6	27	27	57	36	-0.14	-1.72	-1.72	-1.70	1.59
U.S. 10-Year Breakeven	--	2.28	---	4	5	5	4	-11	---	---	---	---	---
U.S. 10-Year TIPS	4.40	2.45	---	2	22	22	55	47	0.15	-1.10	-1.10	0.00	2.92
U.S. 20-Year	12.21	5.29	---	11	33	33	50	39	-0.82	-3.54	-3.54	-3.11	-0.32
U.S. 30-Year	14.99	5.27	---	12	32	32	43	37	-1.22	-4.38	-4.38	-3.36	-1.08
U.S. SOFR	---	---	---	2	-2	-2	-21	-73	0.07	0.31	0.31	2.16	3.97
UK 10-Year	7.27	5.05	---	2	29	29	57	48	-0.01	-1.47	-1.47	-0.72	1.71
Germany 10-Year	8.51	3.21	---	3	35	35	35	51	-0.12	-1.99	-1.99	-0.58	-0.77
Switzerland 10-Year	8.64	0.42	---	-5	15	15	14	8	0.42	-1.24	-1.24	-0.59	-0.29
Japan 10-Year	7.70	2.79	---	-1	11	11	73	124	0.22	-0.57	-0.57	-3.17	-6.13
Australia 10-Year	7.63	4.93	---	-16	20	20	19	67	1.28	-0.82	-0.82	1.62	-0.08
Canada 10-Year	8.26	3.66	---	6	28	28	23	21	-0.33	-1.64	-1.64	0.54	2.54
Major fixed income multi-sector indices		**YTW**											
Global Aggregate Unhedged	6.22	4.00	29	0	1	1	1	-1	0.63	-0.53	-0.53	-0.75	1.60
Global Aggregate Hedged	6.22	4.00	29	0	1	1	1	-1	0.02	-1.02	-1.02	0.12	2.20
U.S. Aggregate	5.90	4.98	29	0	2	2	2	-2	-0.12	-1.30	-1.30	-0.69	2.71
Euro-Aggregate (Unhedged)	6.19	3.44	44	0	0	0	1	-4	0.03	-1.47	-1.47	-0.19	0.20
Japanese Aggregate	7.85	2.43	0	0	0	0	0	0	0.12	-0.62	-0.62	-3.39	-5.87
Major fixed income credit indices		**YTW**											
Mortgage-Backed (Agency)	5.63	5.30	31	2	7	7	9	-9	-0.24	-1.42	-1.42	-0.45	4.13
Global IG Corporate Bonds	5.86	4.96	80	-1	2	2	0	1	0.34	-1.07	-1.07	-0.90	2.43
U.S. IG Corporate Bonds	6.74	5.46	78	-1	4	4	1	2	-0.06	-1.67	-1.67	-0.83	2.53
European IG Corporate	4.55	3.70	79	0	-1	-1	0	0	0.07	-0.97	-0.97	0.35	1.03
U.S. High Yield Bonds	3.30	7.41	279	-1	10	10	13	2	0.18	-0.25	-0.25	1.71	5.17
European High Yield Bonds	3.13	6.00	287	6	3	3	6	-3	-0.02	-0.23	-0.23	1.64	3.01
U.S. Leveraged Loans	0.3	9.42	493	2	-7	-7	38	43	0.08	0.80	0.80	2.17	4.27
European Leveraged Loans	0.3	8.20	485	5	4	4	11	32	-0.04	0.25	0.25	2.02	3.11
EM Hard Currency Sovereigns	6.20	7.26	244	0	9	9	-9	-55	-0.06	-1.42	-1.42	1.84	8.81
EM Corporates	4.37	6.74	214	2	2	2	-23	-30	-0.03	-0.48	-0.48	1.72	5.35
EM Currencies	---	5.93	---	0	0	0	0	-1	0.92	1.42	1.42	2.64	6.49
EM Local Rates	5.30	6.26	6	0	0	0	0	0	0.35	-0.34	-0.34	1.34	4.49
CMBS	3.67	5.07	66	1	1	1	-9	-14	0.09	-0.38	-0.38	0.38	3.63
ABS	3.01	4.78	42	0	-1	-1	-10	-8	0.13	-0.11	-0.11	0.95	3.76
CLOs	3.98	5.40	127	0	-1	-1	-5	-8	0.09	0.38	0.38	2.78	5.03
Municipal Bonds	6.41	3.93	---	-1	35	35	33	-5	0.13	-1.85	-1.85	0.43	5.27

		Total return (%)				
	Level	WTD	MTD	QTD	YTD	Prior year
Equity / volatility indices						
S&P 500 Index	7,490	1.1	-0.1	-0.1	10.1	19.6
DAX	25,629	2.1	2.5	2.5	4.7	6.5
Stoxx 600	649	0.7	1.3	1.3	12.4	22.7
Nikkei 225	64,362	-0.4	-8.1	-8.1	28.9	59.4
Shanghai Composite	3,832	0.6	-5.9	-5.9	-2.0	9.7
MSCI ACWI Index	1,121	1.4	0.1	0.1	11.6	22.6
FTSE 100	10,868	1.2	3.6	3.6	11.5	22.8
MOVE Index	83	8.1	15.4	15.4	29.8	4.0
VIX Index	16	-13.9	-2.8	-2.8	7.0	-4.4

		Change (%)				
	Spot	WTD	MTD	QTD	YTD	Prior year
FX / commodities						
EUR / USD	1.2	1.4	0.9	0.9	-1.9	1.0
USD / JPY	157.4	-3.9	-3.2	-3.2	0.4	4.4
GBP / USD	1.3	1.2	1.7	1.7	0.1	2.1
EUR / CHF	0.9	0.0	0.8	0.8	0.0	0.3
USD / CHF	0.8	-1.3	-0.1	-0.1	1.9	-0.6
USD (DXY)	99.9	-1.5	-1.3	-1.3	1.6	-0.1
Oil	84.7	-7.0	21.8	21.8	47.5	22.2
Gold	4046.2	-0.2	1.0	1.0	-6.3	23.0

Past performance is not a guarantee or a reliable indicator of future results. Sources: Bloomberg except EMD (J.P. Morgan), HY (ICE BofAML), Bank Loans (S&P), and CLOs (Palmer Square). European returns are unhedged in euros unless otherwise indicated. An investment cannot be made directly in an index.

NOTICE: IMPORTANT INFORMATION

Source(s) of data (unless otherwise noted): PGIM as of August 3, 2026.

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