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Global Fixed Income Strategy

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Global macro strategy

Macro conclusions from the IFI Summit

Twice a year, investors from across the Invesco Fixed Income platform gather at the IFI Global Investors' Summit to discuss and debate their views on global macroeconomic trends. Macro themes play an important role in IFI's investment process and our framework of "macro factors" focused on growth, inflation and policy, helps us project macro trends and interpret market movements. At our June Summit, IFI investors provided their views on global macro developments. Below we share their main conclusions.

US: AI is the dominant macro theme, but its effects are uncertain

Executive summary

- US potential growth could rise to roughly 2.6% by the end of 2027, largely because of an expected productivity boost from AI. But the timing, magnitude, and distributional effects of AI remain highly uncertain.
- We expect 2026 growth to moderate below potential to around 1.8%–1.9%, which could create or widen slack.
- Overall, we view the US as a two-speed economy: AI, technology investment and higher-income consumers are supporting activity, while the broader economy is softer.
- We expect the Federal Reserve (Fed) to remain on hold. This year's moderating growth, fading tariff effects, easing shelter inflation, and contained wage growth underpin our view that inflation has likely peaked and should move lower.

AI is the defining macro theme of the second half of the 2020s but history teaches that technological adoption and measured productivity gains don't always occur simultaneously. Personal computers became visible in business and society well before aggregate productivity accelerated; the productivity pickup did not clearly appear until around 1997, roughly 15 years after the PC's introduction. However, AI adoption appears much faster than with past technologies.

The working assumption: AI lifts productivity, but not explosively

Our central forecast assumption is that AI will raise productivity meaningfully but gradually. Recent productivity growth has already improved to about 2%, but that trend began before AI became mainstream around 2022. Looking forward, we assume a roughly 2.5 percentage-point cumulative increase in productivity growth over three years, or about 0.75 percentage points per year.

This leads to our US potential growth estimate of about 2.6%, compared with the Fed's implied estimate of roughly 1.8% and the market's assumption of around 2%. We view this outlook as optimistic but not extreme: we expect a modest productivity lift rather than a transformational boom.

Labor market impact: slower hiring, limited layoffs and some slack

Current labor-market data do not suggest widespread AI-driven layoffs. Layoffs and initial jobless claims are historically low, reinforcing the view that the US remains a "low-fire, low-hire" economy.

Nevertheless, we see evidence of labor-market slack. Wage growth has slowed to around 3.5%, which is viewed as broadly consistent with price stability, given stronger productivity. Other indicators—such as reduced job switching, longer unemployment duration, and long-term unemployment—suggest a softer labor market than the headline unemployment rate alone might imply. This matters for inflation because slower wage growth and lower unit labor costs reduce the risk that services inflation could reaccelerate.

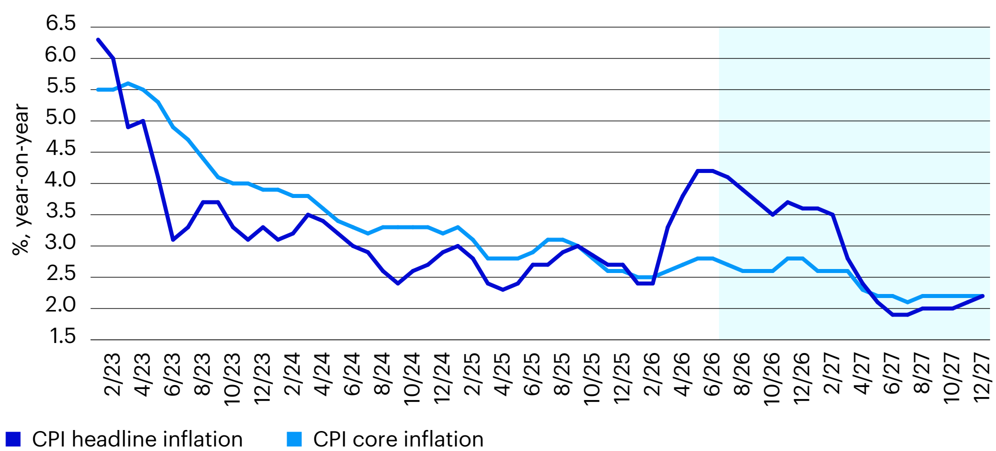
Inflation outlook: peak likely passed, disinflation expected

We believe inflation likely peaked in the second quarter and should decline from July onward, with our forecast for core Personal Consumption Expenditures (PCE) inflation below 3% by year-end, and potentially returning to the Fed's 2% target around the end of 2027. The disinflation case rests on several forces working together:

1. **Potential growth has likely increased, and we expect actual growth to slow below potential, widening the output gap and reducing overheating pressure.**
2. **We believe the tariff pass-through is largely complete.** Core goods inflation rose as tariffs passed through, but that effect has peaked and should fade.
3. **We expect further declines in shelter inflation.** Private-sector rents and house-price measures have declined, and official shelter measures such as owners' equivalent rent tend to follow with a lag of about 12 to 15 months. Because shelter is a large part of CPI and important for PCE, we expect continued rent disinflation to have a significant downward impact on overall inflation.
4. **We do not view wage pressure as inflationary.** Unit labor costs are falling or below historical norms because productivity growth is outpacing wage growth.

Figure 1: US inflation—IFI forecasts

Inflation should rise due to the energy shock, but longer-term inflation is likely contained



Source: Macrobond, Data from Jan. 31, 2023 to May 31, 2026. Invesco forecasts thereafter. There can be no guarantee that stated forecasts will be realized.

Inflation risks: AI-related costs, oil, sticky services, and insurance

Although our baseline outlook is disinflationary, there are several upside risks. AI-related investment could raise prices for electricity, chips, electronics and related inputs. Electricity is an important channel because it affects households broadly. We believe inflation could ultimately settle at closer to 2.4% rather than 2% if these pressures persist.

Oil is another risk, given the Iran-war context. Oil prices pass through quickly to headline inflation through gasoline, airfares and energy-sensitive services, but have only a limited impact on core inflation—roughly only five basis points if sustained for six months to a year. We assume oil prices remain on track to allow the broader disinflation story to hold.

Sticky non-shelter core services are also acknowledged as a risk, especially categories such as health insurance, which are regulated and can remain sticky. However, we are less worried about this factor because wage growth has slowed and the labor market has slack.

Fed outlook: on hold, less easing bias, no near-term hikes

We expect the Fed to remain on hold for the foreseeable future. The Fed has turned more hawkish, as reflected in both the latest dot plot and recent speeches by Fed officials—roughly half of the Federal Open Market Committee expects that the next move could be a hike. While hikes are clearly more plausible than they were a few months ago, they are still not our base case. We judge the risk of Fed hikes to be low because inflation expectations remain anchored, the policy rate is already restrictive, and we expect inflation to decline.

Consumer vulnerability and the two-track economy

The consumer outlook is a vulnerability, in our view. Real disposable income growth is currently negative year-over-year, meaning wages are growing more slowly than inflation and household purchasing power is being squeezed. This dynamic underlies our forecast for a modest slowdown in growth.

We view the US economy as increasingly "two-track" or "two-speed": AI and technology investment, along with upper-income households, are supporting consumption and growth, while the broader household sector is under pressure. However, the baseline assumes that as long as layoffs remain limited and inflation falls, households can manage by delaying discretionary purchases, borrowing modestly, and eventually benefiting from positive real income growth once inflation declines.

Key takeaways

- AI is the defining macro theme, but much uncertainty surrounds its impact. We expect AI to lift productivity and potential growth, but there is a wide range of possible outcomes for productivity and growth, inflation and labor markets.
- We assume US potential growth rises to roughly 2.6% by end-2027, helped by about 0.75 percentage points per year of productivity improvement.
- Inflation is expected to decline because growth is below potential, tariff pass-through is fading, shelter inflation is still falling, and wage/unit labor cost pressures are contained.
- We expect core PCE to move below 3% by year-end and potentially reach the Fed's 2% target around end-2027.
- We expect the Fed to stay on hold, possibly with less easing bias but no hiking bias.
- The biggest macro vulnerabilities are an unbalanced, AI/upper-income-led expansion; negative real disposable income growth; oil/geopolitical shocks; and AI-related electricity/infrastructure inflation.

Europe and UK: ECB and BoE—“Insurance hikes,” not a sustained tightening cycle

Executive summary

- **Policy stance:** European Central Bank (ECB) and Bank of England (BoE) tightening is best viewed as limited “insurance hikes” against upside inflation risks—not the start of a sustained tightening cycle, reflecting a backdrop closer to 2011 than 2022.
- **Inflation outlook:** Conditioned on energy prices as of mid-June, energy-driven inflation is pushing peaks toward 3.5% in the UK and slightly below in the eurozone, but weaker wage dynamics suggest a return to target by 2028.
- **UK-specific risks:** The UK faces greater inflation persistence and credibility challenges, with more aggressive price pass-through, less anchored expectations, and shrinking fiscal headroom, driving higher market risk premia.
- **Macro policy mix:** Rising political fragmentation, constrained fiscal flexibility, evolving trade tensions, and uncertain ECB/BoE reaction functions all reinforce a cautious outlook in which policy tightening remains limited and conditional.

We believe the ECB and BoE policy tightening (or potential tightening) should be understood as “insurance hikes,” not the start of a prolonged hiking cycle. The eurozone and UK have been responding to a renewed energy-driven inflation shock, but today’s environment is more similar to 2011 than 2022: the inflation shock is real, and firms are passing through higher costs, but labor-market conditions are less overheated than in 2022, making a severe wage-price spiral less likely. Food inflation in the eurozone and UK is currently around 2%–3%, far below the roughly 10% pace seen four months after the Russia-Ukraine shock, and wage growth has moderated toward levels broadly consistent with inflation targets. Conditioned on energy prices as of mid-June, we expect inflation to peak at roughly 3.5% in the UK and just under 3.5% in the eurozone, with indirect effects adding just under one percentage point around year-end, but inflation ultimately returning toward target by 2028.

The UK faces the more acute inflation and credibility challenge. UK firms appear more willing than eurozone firms to pass on cost increases, and UK inflation expectations look more unanchored. At the same time, the UK’s fiscal position is not uniquely bad relative to peers on headline debt or primary balance; rather, its problem is the combination of “US-style rates” and “European-style growth,” which makes debt sustainability harder. The UK benefits from a long average debt maturity of about 14 years, reducing near-term refinancing risk, but markets still require a higher risk premium because credibility has weakened and fiscal headroom has shrunk materially.[1]

Watching fiscal and trade policy amid political challenges

Politics is a key source of macro and market risk. Across Europe, political fragmentation is rising as center-left and center-right parties lose support to populist alternatives, complicating coalition formation and fiscal compromise. The UK is the most immediate case study. The Labour government under Prime Minister Starmer is highly unpopular. Andy Burnham’s convincing victory in the Makerfield by-election paves the way for him to become prime minister by the end of July. Burnham’s policy agenda is uncertain and fiscally constrained. He wants to boost social housing, nationalize key services and devolve government, but has also committed to existing fiscal rules and ruled out increases in the major taxes, limiting his room for maneuver. In addition, the fiscal buffer has been eroded by higher inflation and lower growth, with additional pressures for greater defence spending. Measures such as council-tax reform may raise only £3.5–4 billion, and equalizing capital gains and income tax could raise around £14 billion, but many other ideas appear too small to raise sufficient revenue.

In the eurozone, fiscal policy is less aggressive than in 2022, with Germany driving

1. Source: UK Debt Management Office. Data as of Dec. 31, 2025.

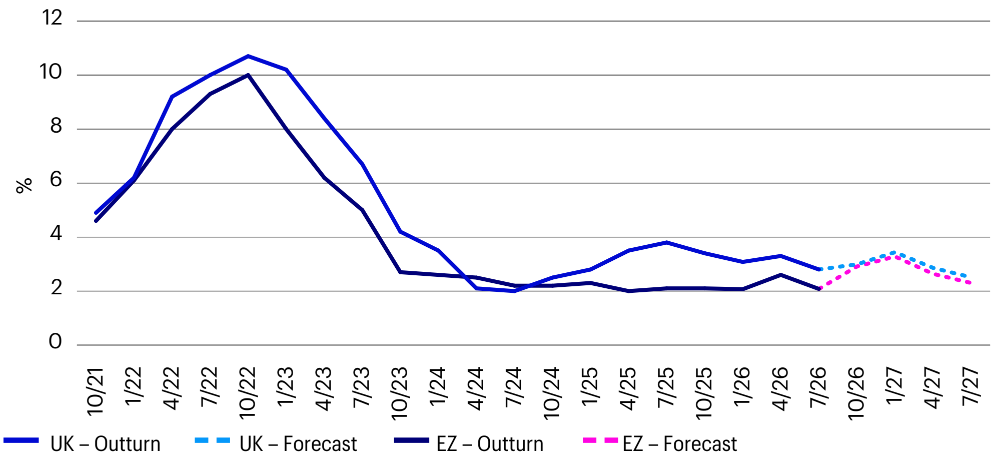
most of the easing and broader European Union (EU) support measures amounting to only around 0.2% of GDP—roughly one-tenth of the scale of the 2022 response.[2] However, the skew is toward more spending if energy prices stay high, and defense spending demands are building across the continent. Trade policy is another source of uncertainty. The EU-US trade deal caps tariffs at 15%, but does not remove uncertainty around future tariff mechanisms or investigations. Meanwhile, the next major trade risk is seen as EU-China tension, especially as Germany has shifted from a roughly €30 billion annual surplus with China in key sectors such as electronics, transport equipment, and medical equipment to a deficit.[3] This shift is driving more EU discussion of anti-dumping measures, tariffs, subsidy investigations, carbon-border mechanisms, economic security and reshoring.

Watching monetary policy amid evolving price pressures

In the UK, earlier optimism about falling inflation, credible fiscal headroom, debt-management adjustments, and potential BoE rate cuts has been replaced by a "vicious cycle" of higher inflation, eroded fiscal headroom and renewed discussion of rate hikes.

In the eurozone, the ECB has raised inflation projections and lowered growth forecasts while embedding roughly three hikes in its baseline. Even with three hikes, the ECB expects core inflation to remain around 2.5% in 2027 and above target in 2028. If the ECB hikes toward 2.75–3.0%, policy may become too tight for the eurozone economy, especially given weakness in Germany. However, the ECB's reaction function is uncertain: a move to 2.5% is viewed as easier because it remains within the perceived neutral range, while going above 2.5% would likely require clearer evidence that restrictive policy is needed. The timing of future hikes may depend heavily on energy prices and whether inflation pressures intensify over the summer.

Figure 2: Europe/UK headline inflation – IFI forecasts



Source: Eurostat, ONS. Data from Oct. 1, 2021 to July 1, 2026. Invesco forecasts thereafter. There can be no guarantee that stated forecasts will be realized.

Key risks

Is Europe undergoing a structural inflation shift?

Inflation expectations and firm pricing behavior may have changed after years of above-target inflation, making pass-through faster and more persistent than historical analogies imply. That is an important question because it would be a challenge to our view that a sustained hiking cycle isn't needed.

The UK looks more inflation-prone than the eurozone, and that matters for policy and markets

UK firms appear more willing to pass through cost increases and inflation expectations look increasingly unanchored. Even though wage growth is moving closer to target-consistent levels, the combination of energy pass-through, inflation psychology and fiscal credibility concerns means the BoE has less room to look through shocks than the ECB.

2. Source: Breugel. Data as of May 31, 2026.
3. Source: Centre for European Reform. Data as of May 31, 2026.

Political fragmentation is becoming a macro-market variable, not background noise

Weakening center-left/center-right parties, unpopular incumbents, coalition instability and a UK leadership change add to fiscal policy uncertainty. The UK case is especially important; a possible Andy Burnham leadership change could create policy uncertainty ahead of the September party conference and November budget, with the Chancellor choice flagged as especially market-relevant. The implication in the UK and Europe is that political developments may directly affect government bond risk premia and fiscal credibility.

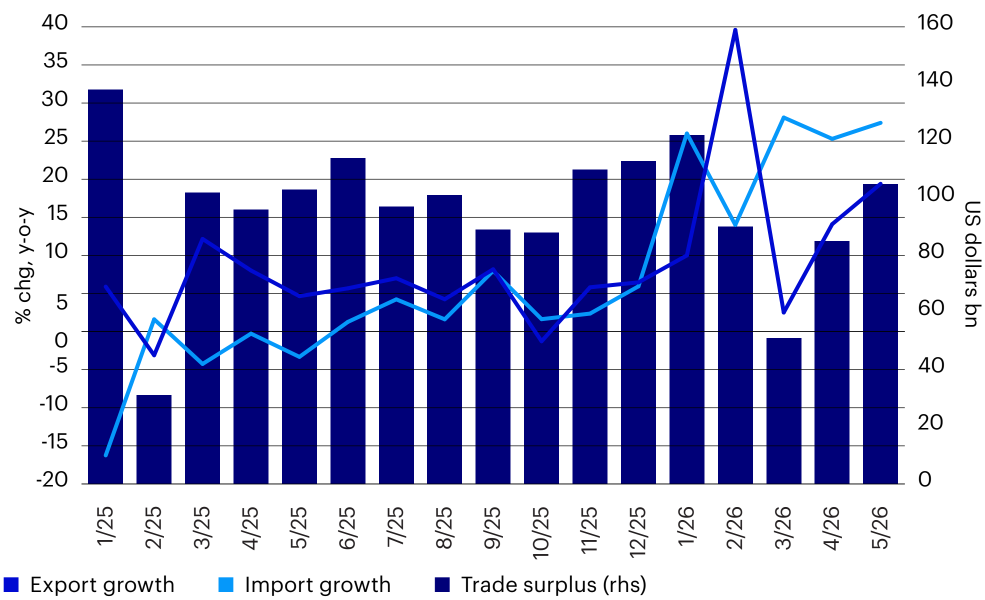
China: Export power offsets lukewarm domestic demand

Executive summary

- China's economic resilience is driven by a surge in exports—especially in tech, electric vehicles, and renewables—while consumption and fixed asset investment remain relatively soft.
- Policymakers are maintaining a restrained stance, with marginal fiscal tightening and rates being held steady, reflecting comfort with current growth levels and less urgent need for stimulus.
- China is exporting integrated supply-chain ecosystems rather than just goods, strengthening its global industrial footprint as production increasingly internationalizes.
- This trend, along with the internationalization of the renminbi and Chinese financial sector, is likely to further reshape global markets in the medium term.

China is operating in a fundamentally "changed world order," with implications across growth, policy, trade, currency, capital flows and geopolitics. First quarter GDP growth surprised to the upside, led by exports—especially in technology, renewables, and electric vehicles. Strong first-quarter GDP was against a backdrop of limited stimulus, lukewarm domestic demand and geopolitical tensions. Year-to-date export growth of 15.5% is strong, roughly triple the pace of 2025, with semiconductors reportedly up 90% and autos, wind turbines, and lithium-related products up around 50% (Figure 3). This export strength is a key factor shaping both policy direction and market behavior, in our view.

Figure 3: Lukewarm domestic activity has been offset by strong export growth



Source: Wind. Data from Jan 31, 2025 to May 31, 2026.

Policy restraint on both the fiscal and monetary front

The official GDP growth target of 4.5%–5% for 2026 provides flexibility, and we expect both monetary and fiscal policy to remain restrained. On fiscal policy, although the headline budget deficit remains at 4% of GDP, a broader measure of the fiscal deficit has declined, fiscal expenditure growth has slowed, and tax revenue growth has picked up—all pointing to marginal fiscal tightening compared to 2025. Monetary policy remains relatively accommodative, while the central bank has been withdrawing liquidity from time to time as inflation indicators recover, with the producer price index moving from nearly -4% in July 2025 to 3.9% in May 2026.[4]

Structural shift in exports: building a global industrial ecosystem

China's export competitiveness is increasingly structural rather than cyclical. Chinese firms are not merely exporting more goods; they are internationalizing industrial ecosystems. Instead of building individual overseas factories, supply-chain clusters across regions are being built up, as suppliers, battery companies, tooling firms, and other component partners have been brought together. This model is likely to improve efficiency, reduce exposure to tariffs and regulatory pressure and support after-sales service in local markets.

Electric vehicles are a clear example of China's competitive edge. China's auto market share in Europe has reportedly risen notably, with expansion also visible in Latin America, other parts of Asia, the Middle East and Africa—and overseas profit margins are substantially higher than domestic margins. The technological sophistication of Chinese electric vehicles, including gesture control, auto-opening doors, self-parking, and advanced in-car automation are popular, which indicates that some of China's export strength is increasingly tied to product quality, technology and value-for-money—not just low costs or currency depreciation.

A structural case for a stronger renminbi and financial internationalization

We expect further renminbi appreciation in the medium term, supported by strong exports and a large trade surplus, even in an environment in which the US dollar has strengthened. Our view is based on several pillars: China's exports are sufficiently competitive to not require currency weakness; purchasing-power-parity metrics imply substantial appreciation potential; and policymakers have a strategic interest in building a stronger financial center and reserve-currency status. A strong currency may also help reduce pressure if trade frictions begin to emerge with other economies.

China's industrial internationalization goes hand-in-hand with its financial sector internationalization. The offshore renminbi bond market has seen deepened market liquidity and lengthened bond tenors over the last few years. Chinese banks, brokers, and fund companies have indicated ambitions to expand overseas or build subsidiaries to capture cross-border two-way flows. We think China's internationalization is no longer confined to goods trade: we expect both industrial supply chains and financial-sector channels to increasingly reshape global markets.

4. Source: Bloomberg L.P. Data as of May 31, 2026.

Emerging markets: Reassessing the oil shock—why this is not 2022

Executive summary

- The EM macro backdrop is stronger than in 2022, with more balanced growth limiting vulnerability to external shocks like higher oil prices.
- Inflation pressures have moderated significantly, with most economies near targets, though residual risks remain.
- Stronger and more credible monetary policy frameworks have enabled central banks to retain restrictive stances and anchor inflation expectations more effectively than in prior cycles.
- Macro imbalances are currently less synchronized than in 2022, creating country-specific differentiation, though risks persist from global rates, terms of trade, and regional vulnerabilities.

A central question for emerging markets (EM) amid current geopolitical uncertainty is, do recent events represent a repeat of the 2022 EM shock—or has the EM macro backdrop improved in a meaningful way? In our view, while some parallels exist (notably the commodity and energy shocks), underlying conditions today are fundamentally different and considerably more supportive for EM economies.

The comparison is framed explicitly by examining two periods: the end of 2021—just before the prior shock—and the end of 2025, which reflects the current setup. This side-by-side analysis highlights how EM economies have evolved structurally over the past several years.

Improved demand conditions and cyclical positioning

One of the most important drivers of our improved outlook is the state of domestic demand and growth relative to potential. During the 2021–2022 period, EM economies were operating with significant positive output gaps—growth was running above potential in many cases, contributing to overheating pressures. At the same time, inflation was well above target, creating a challenging macro environment characterized by simultaneous demand strength and price instability.

In contrast, the current environment shows a much more balanced cyclical position. Output gaps have compressed significantly and are now broadly neutral across most EM economies. This implies that economies are no longer overheating and are less vulnerable to external shocks such as an oil price spike.

Importantly, dispersion across countries has also narrowed. Whereas the earlier period saw a wide distribution of economies with pronounced imbalances, today's environment is far more clustered around equilibrium. This reduces the likelihood of systemic stress spreading across the asset class and reinforces the case for resilience.

Inflation dynamics: from widespread pressures to contained gaps

Inflation is another area where the comparison to 2022 breaks down. Previously, inflation pressures were both elevated and broad-based across EM economies. Today, those inflation gaps have shrunk considerably. Most countries are now much closer to their inflation targets, with only a limited number of exceptions experiencing persistent pressures. This normalization reduces the need for aggressive policy tightening and provides policymakers with greater flexibility in responding to new shocks.

However, the analysis does include an important nuance. While headline inflation appears better behaved, part of this improvement reflects temporary support from non-core components. When focusing on core inflation, convergence toward target is less complete, suggesting that underlying inflation dynamics are still a work in progress. This distinction highlights a key residual vulnerability: while the overall picture has improved, inflation risks have not been fully eliminated.

Stronger policy frameworks and credibility

Perhaps the most important structural shift since 2022 lies in policy frameworks. Both demand conditions and policy settings have contributed to EM's significantly improved ability to absorb shocks.

Monetary policy has played a key role. Although many EM central banks have recently been in easing cycles—as reflected in declining nominal policy rates—they are still operating from a position of relative restrictiveness in real terms.

This reflects a deliberate policy stance: Central banks tightened aggressively earlier in the cycle and have retained credibility in managing inflation. As a result, they have not been forced into reactive or destabilizing policy moves in the face of new shocks.

The broader implication is that policy credibility has improved. Central banks are better anchored in their inflation-targeting frameworks, and markets are more confident in their ability to maintain stability. This stands in stark contrast to earlier periods when policy responses were often pro-cyclical or insufficiently disciplined.

Managing the oil shock: evidence of a more resilient system

The combination of improved demand conditions and stronger policy frameworks has translated into a more effective response to the current oil shock, allowing EM economies to manage the shock much better than in the past.

There are several mechanisms behind this resilience:

- **Stronger starting conditions** have limited the need for abrupt or destabilizing policy tightening.
- **Balanced growth** means that higher energy prices have not amplified already elevated inflation pressures.
- **Credible monetary policy** has reduced the risk of inflation expectations becoming unanchored.

Together, these factors have prevented the kind of negative feedback loop seen in 2022, when rising energy prices fed directly into inflation, forcing aggressive policy responses that ultimately slowed growth and destabilized markets.

Reduced breadth and severity of macro imbalances

In 2021–2022, a large share of countries exhibited significant deviations from both growth and inflation targets. This created a highly synchronized vulnerability: many economies were exposed to the same shocks in similar ways.

Today, both the breadth and magnitude of these imbalances are substantially smaller. Fewer countries are experiencing extreme conditions, and those that are, tend to be isolated cases rather than part of a broader systemic trend.

This difference has important implications for investors; EM performance will likely be less driven by broad risk-on/risk-off dynamics and more by country-specific factors. In other words, the environment is becoming increasingly idiosyncratic.

Regional nuances and exceptions

Despite the overall improvement, not all EM countries are equally well positioned. Certain economies still face elevated inflation pressures or other challenges, but these are identified as exceptions rather than representative of the broader trend. For example, countries such as Brazil, Colombia, and Romania face higher inflation gaps.

However, these cases are outliers. They do not undermine our general conclusion that EM as a whole is entering the current environment from a stronger and more balanced starting point.

Implications for the macro narrative

Taken together, these themes have fundamentally reshaped the macro narrative for EM. Rather than viewing EM through the lens of vulnerability to external shocks—as was common in prior cycles—we currently see resilience, improved policy credibility, and more stable macro conditions.

The comparison with 2022 is therefore instructive not because it highlights similarities, but because it underscores how much has changed. The same type of shock—higher oil prices—in the current instance has produced a very different macro outcome.

This shift has several important implications:

- EM economies are less likely to experience synchronized stress.
- Policy responses are likely to be more measured and effective.
- Market dynamics will likely be driven more by differentiation than by broad trends.

The overarching conclusion is that EM is better equipped today to manage external shocks than it was just a few years ago. The combination of neutral growth conditions, reduced inflation gaps, and stronger policy frameworks creates a more stable macro environment.

While risks remain—particularly around core inflation dynamics and country-specific vulnerabilities—the systemic fragility that defined earlier periods has largely been reduced. This marks a meaningful evolution in the EM investment landscape and provides a more constructive backdrop for investors.

Outstanding risks for EM

Global monetary tightening/real yield shock: A primary macro risk is a shift toward a “tightening impulse” regime, in which both real yields and inflation expectations rise together. EM remains sensitive to global rate volatility—even with improved fundamentals.

Commodity and supply shock persistence: Risks remain for food-driven inflation shocks due to the Iran conflict and El Nino, compounded by the potential for rising inflation expectations.

Understanding EM risk by region

Latin America: Latin America is vulnerable to political and commodity cycle risks, given upcoming elections and commodity export dependence. But strong fundamentals are an offset. Latin America is also vulnerable to a reversal of capital flows given current strong positioning.

Europe: The region combines both commodity and manufacturing-based economies and thus has a mix of winners and losers amid commodity and food price shocks. The main theme for the region is macro structural reforms, put in motion following the electoral cycles of 2025 and 2026, with fiscal policy in focus in South Africa and Romania, and, most recently, a meaningful regime change in Hungary, which is ushering in a full policy revamp, anchored in the euro adoption ambitions of the new government. In Europe, risk is less cyclical, in our view, and more based on policy credibility and the risk of follow-through on structural reforms in countries such as Hungary.

Asia: Asia is the region most vulnerable to energy, food, and external balance shocks, given that it is largely a net energy importer and food has a large weight in consumer price indices. Asia also has the highest macro dispersion among countries when it comes to external financing vulnerabilities and uneven growth and inflation dynamics, so it is important to differentiate within the region. Asian economies, such as Korea, Malaysia and, to some degree, Thailand, benefit from the AI investment boom and, as surplus economies, do not face financing constraints. Fiscal performance may be under pressure but rising fiscal revenues on the back of the export boom help to pay for external supply shocks, such as oil price consumer protection schemes, and will likely help deal with potential El Nino price pressures. Countries such as India, Indonesia and the Philippines are at the opposite end of the spectrum, benefiting less from AI and facing weak balance of payments positions.

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Global credit strategy

Credit trade ideas from the June IFI Summit

At the June Summit, investors from across the Invesco Fixed Income platform discussed their views on credit and where they see opportunities. Discussions included recent trends in US and European investment grade and high yield, including sector-specific insights and investment ideas. We also explored thematic impacts, such as geopolitical events, technological growth and idiosyncratic sector risks.

US investment grade

Q: How has US investment grade performed this year?

Todd: The US investment grade market has been remarkably resilient. Aside from a brief bout of volatility during the Iran conflict, spreads have remained very tight because investors are buying yield rather than spread. With investment grade yields above 5%, demand from retail investors has been strong, along with insurance companies and global buyers.[5]

Q: What is driving the market?

Todd: The key driver has been yield. Investors find 5%-plus investment grade yields attractive, leading to strong inflows and persistent demand. The broader market continues to be supported by the AI-led productivity and capital expenditure story, which has lifted both equities and credit.

Q: Where are the opportunities?

Todd: Despite tight spreads, we believe there is still room for further spread compression. The best opportunities, in our view, are in AI-related investments, including hyperscalers, data-center financing, utilities, and infrastructure supporting the AI buildout. These sectors are benefiting from unprecedented capital spending needs.

Q: What are the risks?

Todd: The biggest risk is that tight spreads leave little cushion if fundamentals weaken. However, we believe the fundamental outlook is stable – including solid growth and declining inflation by year-end—and we expect demand for yield to be strong enough to support the market in the near term.

European investment grade

Q: How has European investment grade performed relative to the US?

Sam: The experience has been very similar. European investment grade spreads are essentially unchanged from six months ago, despite a significant selloff in March. Markets have recovered quickly and spreads remain tight.

Q: What has been the most important development in European investment grade?

Sam: The emergence of the technology sector through hyperscaler issuance. Historically, technology was only about 3% of the ICE BofA Euro Corporate Index. Large euro-denominated deals from Amazon and Google have effectively doubled the sector's size.

Q: Where are the opportunities?

Sam: The growth of AI-related technology issuance is creating long-term investment opportunities, in our view. Telecoms also look attractive as fiber network buildouts near completion, improving cash generation for certain operators across Europe.

Q: What are the risks?

Sam: Traditional sector themes matter less today. We increasingly focus on company-specific opportunities because sector dispersion has become limited.

5. Source: Bloomberg US Corporate Index. Data as of June 30, 2026.

European high yield

Q: What has happened in European high yield?

Matt: The market entered the year at multi-year tight spreads but with attractive yields above 5%. March saw a sharp correction, but spreads subsequently retraced. Today spreads have largely returned to where they started the year, but yields remain attractive at around 5.5%.[6]

Q: What has supported performance?

Matt: Technicals have been very strong. Fund flows recovered following the March volatility, as investors refocused on the asset class's attractive all-in yields, while net issuance has remained manageable despite increasing year-over-year.

Q: What are the opportunities?

Matt: Macro concerns have weighed on UK high yield, but this has created attractive opportunities, in our view. Trading levels for several issuers look compelling relative to their fundamentals.

Q: What are the risks?

Matt: A large merger and acquisition-driven new issue pipeline may test market technicals later in the year. We are watching whether demand can absorb increasing issuance volumes.

Auto sector

Q: What is the outlook for autos?

Ellie: The European auto sector entered 2026 already under pressure. Electric vehicle demand has weakened, Chinese competition has intensified, tariffs have increased, and consumers remain stretched from inflation and high car prices.

Q: How significant is Chinese competition?

Ellie: It is a major issue. Chinese vehicles have rapidly gained share across Europe, rising from virtually nothing a few years ago to meaningful market penetration today.

Q: What impact has the Iran conflict had?

Ellie: Indirect effects have been important. Higher energy prices and rising aluminum prices have added further cost pressure to manufacturers while weakening consumer demand. Production forecasts are being revised downward.

Q: Where are the opportunities?

Ellie: In our view, auto suppliers are preferable to original equipment manufacturers (OEM). Suppliers have cut costs, passed through inflation, and participate in Chinese auto growth rather than compete against it.

Q: What are the risks?

Ellie: More profit warnings are likely, and investors are not adequately compensated for the sector's cyclicality and geopolitical risks, in our view. We favor reducing overall exposure.

Real estate and data centers

Q: What is happening in real estate?

Andre: The European real estate sector is gradually normalizing, despite higher interest rates. Property values have stabilized because operating fundamentals remain relatively healthy.

Q: Which subsectors are favored?

Andre: We favor logistics, retail, and data-center-related assets. These areas benefit from structural trends such as e-commerce, near-shoring and AI-driven digital infrastructure demand. Residential remains defensive due to undersupply.

6. Source: ICE BofA Euro High Yield Index. Data as of June 31, 2026.

Q: What about offices?

Andre: Offices remain highly bifurcated. Prime offices continue to perform well, while secondary offices face declining occupancy and falling rents.

Q: What opportunities exist in data centers?

Andre: Data center build-out in Europe lags the US due to challenges like grid connection delays, high energy costs and regulatory hurdles. Alternative markets such as the Nordics and Southern Europe are emerging as viable locations due to renewable energy availability and easier planning.

Q: What are the risks?

Andre: The biggest constraints are electricity availability, lengthy permitting timelines, and regulatory hurdles.

Technology, media, and telecommunications

Q: What is the outlook for telecoms?

Sam: Our current outlook for European telecoms is stable, supported by GDP-plus pricing and margin improvement, and aided by the near completion of fiber-to-the-home rollouts.

Q: What opportunities stand out?

Sam: To us, company-specific situations matter more than broad sector calls, particularly as consolidation and merger and acquisition activity unfold in different markets, such as the recent consolidation among French mobile operators. These developments have generally been positive for bondholders due to prior restructurings that protect creditor interests.

Q: What are the risks?

Sam: We view risks as increasingly company-specific rather than sector-wide, requiring deeper fundamental research.

Chemicals and industrials

Q: How has the Middle East conflict affected chemicals?

Matt: Chemicals have been one of the biggest beneficiaries because supply disruptions have reduced global capacity and improved pricing dynamics. A supply shock temporarily transformed what had been a structurally challenged sector.

Q: What opportunities exist?

Matt: Rather than chasing broad chemical-sector rallies, we have favored credits we believe to be longer-term survivors alongside niche businesses that have more idiosyncratic drivers.

Q: What are the risks?

Matt: The key question is how quickly the sector normalizes. Management teams and industry experts expect normalization over the next six to nine months, as disrupted capacity gradually returns, but the risk is that the sector stabilizes more quickly.

AI and data-center buildout theme

Q: What is the panel’s highest-conviction investment theme?

Todd: AI-related capital spending. We see trillions of dollars of future AI infrastructure investment, requiring financing across multiple sectors, including hyperscalers, utilities, infrastructure providers, and data-center developers.

Q: Where are the opportunities?

Todd: We can participate directly through hyperscaler financing or indirectly through the "picks and shovels" beneficiaries such as utilities, infrastructure providers, construction financing vehicles, and data-center operators. Many opportunities offer investment grade-quality risk with yields in the 6–7% range.

Q: What are the risks?

Todd: Political opposition to data-center development is growing in the US because of concerns about land use, water consumption, and power demand. However, we generally believe compute demand remains so strong that investment will likely continue, even if projects shift geographically.

Overall market view

Q: What was the overarching conclusion?

Consensus: Credit markets remain fundamentally well supported by strong demand for income, robust technicals and abundant liquidity. While spreads are tight, opportunities still exist in idiosyncratic situations and long-term secular themes—especially AI infrastructure. We reserved our greatest sector-level caution for European autos, while our greatest enthusiasm was directed toward AI, data centers, telecom infrastructure and select special situations in credit.

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Interest rate outlook

US: Neutral

We maintain a neutral stance on US interest rates. The bond market is currently pricing in just over one Fed rate hike over the next year. While we do not expect the Fed to tighten policy further, the modest amount of tightening priced into the curve does not provide sufficient compensation to justify a long duration position. Given the uncertainty surrounding the outlook and the balanced distribution of risks, we remain neutral.

Europe: Neutral

The ECB has delivered the most hawkish reaction among major central banks to the rise in energy prices. This reflects a policy rate closest to its neutral level, and concern that supply shocks and weak productivity growth could keep inflation above target for longer. The ECB's June projections implied an additional 35 basis points of tightening following its June rate hike to 2.25%. Although energy prices have since evolved closer to the ECB's mild scenario, policymakers have emphasized that this does not eliminate the need for further tightening or warrant a rapid policy reversal. President Lagarde stressed that the June rate increase was appropriate across all scenarios, including one where energy prices retreat quickly. Importantly, even that mild scenario still shows core HICP inflation above the ECB's 2% target in 2028, supporting the case for further tightening. Higher energy prices will likely necessitate fiscal support measures from eurozone governments and calls for greater defense and energy transition-related spending have intensified—all of which would likely increase long-end bond risk premia.

China: Overweight

We remain positive on Chinese onshore government bonds, despite recent volatility along the curve, with the front-end outperforming. Supportive macro policies, still relatively lukewarm domestic demand and strong export growth should contribute to demand for central government bonds. The central bank started overnight reverse repo operations at the end of June and has been carefully managing interbank liquidity conditions with limited impact from seasonality factors. The upcoming Politburo meeting will likely be watched closely for indications of the macro policy direction in the second half of 2026.

Japan: Underweight

Japanese government bond yields have declined modestly over the past month, tracking global bond markets and benefiting from lower energy prices. This has occurred despite the Bank of Japan's (BoJ) decision to raise the policy rate by 25 basis points to 1.0% in June, the highest level since 1995. External sources indicate the BoJ continues to view inflation risks as warranting further policy normalization, while underlying inflation remains around its 2% target, once the effects of government subsidies are excluded. Front-end yields offer limited scope to fall further and market pricing for only one additional 25 basis point hike this year appears vulnerable to upside revision. Wage growth remains firm, imported inflation risks persist due to yen weakness, and BoJ communication continues to point toward gradual but ongoing normalization. Policy expectations are skewed towards more, rather than fewer, rate hikes. At the long end, fiscal risks remain an important consideration. The government is pursuing significant industrial and public investment initiatives, while discussion around further fiscal support measures continues. Combined with ongoing BoJ balance-sheet normalization, this argues for sustained term premia over time.

UK: Neutral

Gilt yields have declined over the past month, outperforming many global bond markets as lower energy prices, softer core inflation and wage data, and a reduction in near-term fiscal concerns have supported sentiment. Markets have also responded positively to presumptive Prime Minister Andy Burnham's commitment to retain the existing fiscal framework, reducing fears of an immediate deterioration in fiscal credibility. However, significant uncertainty remains around how the new government intends to finance higher spending ambitions while preserving fiscal headroom. The fiscal buffers have already been eroded by weaker growth, higher inflation and elevated borrowing costs.

The BoE continues to adopt a cautious approach. While some Monetary Policy Committee (MPC) members remain concerned about upside inflation risks, the majority appear reluctant to tighten policy further without clearer evidence that higher energy prices are generating persistent second-round effects. Most policymakers view policy as restrictive and are reassured by the deflationary impact of labor market loosening.

Although further rate hikes remain more likely than cuts until there is greater confidence that inflation has peaked, the scope for additional tightening appears limited. Current market pricing implies less than one additional 25 basis point hike over the remainder of 2026. If services inflation and wage growth continue to moderate, the BoE could plausibly return to considering rate cuts during 2027.

At the long end, some fiscal risk premium is likely to persist until the fiscal strategy of the Burnham administration becomes clearer at the November Budget. Commitment to the fiscal rules has helped stabilize markets, but uncertainty around tax policy, spending priorities and the appointment of a new chancellor suggests investors are likely to demand compensation for ongoing policy uncertainty.

Australia: Neutral

Australian 10-year bond yields are lower over the last month, outperforming both US Treasuries and European markets. A combination of slightly softer domestic growth and inflation data in late May and a general rally in global duration driven by the decline in energy prices following the US-Iran ceasefire has driven the fall in yields. More recently, employment and inflation have shown a bit more upside, potentially limiting the scope for a further fall in yields, particularly as the market is now pricing in 10 basis points of hikes for the rest of 2026, despite the Reserve Bank of Australia's (RBA) hiking bias. The RBA may hike again later this year, making current pricing look broadly fair. Cuts look hard to imagine until at least the middle of 2027, given the current international and domestic backdrop. Rates look likely to range trade from here in the near term, with limited scope for further cross market outperformance. Long-term, Australian interest rates are now the highest in the developed world, giving them scope to decline if global and domestic inflation pressures ease. However, we do not expect this in the short term.

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Currency outlook

USD: Overweight

The shift in relative rate expectations over the past quarter has supported the US dollar, along with the market's continued faith in the AI-linked growth story. We expect the positive growth differential to persist and remain positively positioned toward the US dollar over coming quarters. If the market proves overly complacent on the Iran conflict's resolution, we would expect the US dollar to benefit from safe haven flows.

EUR: Underweight

As the ECB's hawkish scenarios have dissipated due to the shift in energy prices, we expect European currencies to be laggards, as growth in the region continues to be lacklustre, with downside risks.

RMB: Overweight

We are overweight the renminbi over the medium term. Central Bank Governor Pan said at the China Development Forum that China has no need or intention to use currency depreciation to gain a trade advantage. China will likely facilitate more international investment in Chinese capital markets and further improve arrangements for renminbi cross-border use. In our view, this could indicate that China may use the window of US dollar strength to keep the USD/RMB pair relatively stable, while potentially showing strength against other major currencies. This is in addition to the substantial Chinese trade surplus recorded year-to-date.

JPY: Neutral

Despite BoJ tightening and periodic Ministry of Finance intervention, the USD/JPY exchange rate has remained elevated. The currency continues to be driven primarily by US growth and Fed expectations rather than domestic Japanese developments. As a result, BoJ rate hikes alone are unlikely to generate a sustained yen appreciation.

A more durable yen rally will likely require clearer evidence of US economic slowing and a renewed Fed easing cycle—narrowing rate differentials and encouraging Japanese investors to increase currency hedging or repatriate overseas assets. Until then, carry remains a significant headwind.

Relative to European currencies, however, the outlook for the yen is somewhat more constructive. Carry advantages have narrowed materially, while the ECB and BoE may have greater scope to ease policy if disinflation continues. As a result, the yen could outperform several European currencies even if gains against the US dollar remain limited.

GBP: Underweight

Narrowing interest-rate differentials versus both the US and eurozone should become an increasing headwind as the BoE adopts a relatively more dovish stance than the Fed and ECB. While sterling has benefited recently from reduced political uncertainty and short-covering activity, these factors appear largely cyclical rather than structural. The longer-term backdrop remains less supportive, in our view. Sterling valuations remain rich on a trade-weighted basis. The UK is not a creditor nation and remains reliant on foreign capital inflows, making sterling vulnerable when rate support diminishes. Growth prospects remain uninspiring and fiscal risks are unlikely to disappear, even if political headlines become quieter over the summer. The November Budget is likely to refocus market attention on the difficult trade-offs facing the government. Higher defense spending commitments, limited fiscal headroom and uncertainty around future tax measures suggest that a residual political risk premium may remain embedded in sterling assets.

AUD: Neutral

The Australian dollar has weakened against the US dollar over the last month, as the market has repriced the relative interest rate paths for the Fed and the RBA. The sense that the RBA has completed its hiking cycle whereas the Fed might be about to restart its tightening should cap the AUD/USD exchange rate in the near term, particularly as the prospect of Fed hikes could have a significant negative impact on global risk sentiment. The Australian dollar requires a combination of recovering commodities and an end to expectations of Fed tightening to regain its losses against the US dollar, in our view. Relative to the euro, the Australian dollar might be able to hold its gains, helped by relatively attractive carry.

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All information is sourced from Invesco, unless otherwise stated.

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