

Global Fixed Income Strategy

MAY 2026

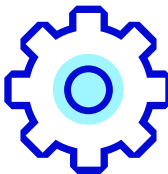
In this issue



2 Global macro strategy

Revising our US macro outlook: Resilient growth, sticky inflation and the Fed on hold

We've revised our 2026 US macro outlook: Higher energy prices will likely push headline inflation higher, growth should remain resilient. We expect no Fed cuts in 2026.



5 Global credit strategy

Choke point: Second-order shocks of the Gulf conflict (that markets may be underestimating)

While oil market disruption and price volatility have grabbed headlines, disruption to other energy-related products and commodities will likely have significant economic impacts.



9 Rates and currency outlook

Major rates and currencies 3-month outlook

We are neutral on US, European, Chinese and UK rates. We are underweight Japanese rates and overweight Australian rates. We are overweight the Japanese yen, Chinese renminbi and Australian dollar. We are neutral on the US dollar and euro and underweight the British pound.



13 The bottom line

What's driving munis and where is there value?

It's been a solid year for munis, with high yield munis a standout. CIO Mark Paris highlights which sectors could perform best going forward.

Global macro strategy

Revising our US macro outlook: Resilient growth, sticky inflation and the Fed on hold

Executive summary

- **We have revised our 2026 US macro outlook in the wake of the Iran war ceasefire.** While higher energy prices are likely to push headline inflation higher than we previously estimated in the near term, we've downshifted our growth outlook, though growth should stay around potential, bolstered by resilient domestic demand and structural buffers in the US economy.
- **Our expectation of sticky core inflation at around 3% complicates the Federal Reserve's (Fed) path to normalization and reinforces a cautious policy stance.** In this environment, we expect the Fed to remain on hold this year, with scope for gradual easing only once inflation risks clearly recede.
- **This baseline view rests on the assumption that geopolitical tensions do not re-escalate.** Markets appear to place little weight on more adverse scenarios, even though the economic costs of renewed disruption—particularly through energy markets—would likely be nonlinear and significant.

Growth at potential

We have revised down our US growth projections amid the conflict in the Middle East—but our growth outlook remains resilient. Our revision mainly amounts to reducing the odds that growth could accelerate and reach above-potential levels—at least for a couple of quarters. We now expect GDP growth to remain around potential, still slightly above consensus. In the weeks following the ceasefire, oil prices have stabilized and incoming March data have been broadly consistent with our outlook.

Inflation and the Fed

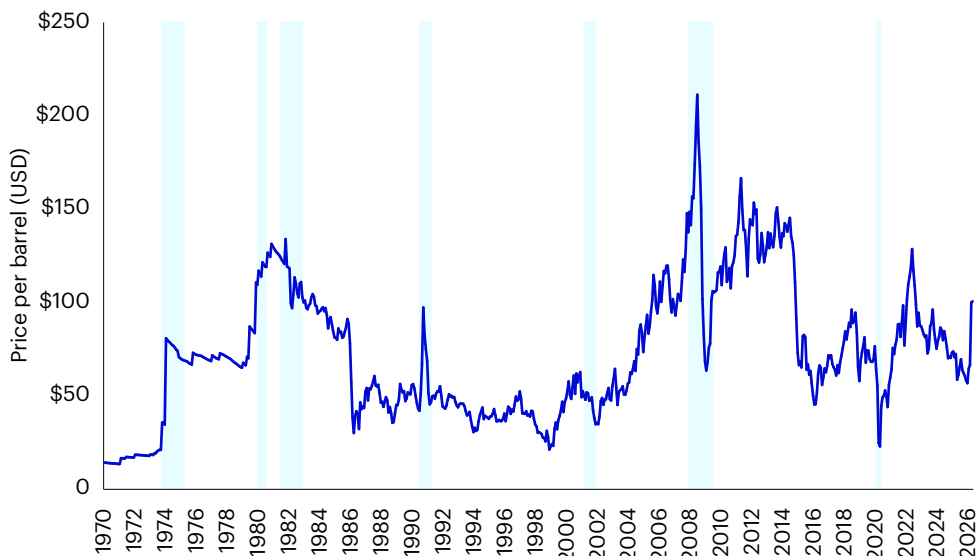
We expect headline inflation to rise in the near term due to higher energy prices and expect core inflation to remain around or above 3% for much of the year—longer than we had previously expected. Rising risks of second-round effects will likely delay any Fed easing toward its estimate of the neutral rate. The timing of the next move is highly uncertain; we tentatively assume that policy will remain on hold this year and have penciled in two cuts for the first half of next year.

Oil shock a potential growth drag, not a recession trigger

While elevated oil prices represent a genuine headwind to growth, they are not at levels historically associated with recessions (Figure 1). In real terms, crude remains well below the non-recessionary peaks reached in 2011–12 and again in 2022, suggesting that the current price environment, though uncomfortable, is not recessionary. Importantly, this assessment is not based on oil prices alone; broader macro conditions also matter. The 2011–12 episode is particularly instructive: Oil prices were higher in real terms than they are today, and the economy was arguably more vulnerable—households were deleveraging in the aftermath of the global financial crisis, and banks were raising capital and repairing their own balance sheets. Even under those fragile conditions, elevated oil prices did not tip the economy into recession.

Figure 1: Oil prices are elevated but not likely to trigger recession

In May 2026 dollars



Source: Bloomberg L.P., Invesco. Jan. 31, 1970 to May 31, 2026.

We believe there are structural buffers currently in place that support this view: the US is now a net energy exporter and the amount of energy required to generate a dollar of GDP has declined meaningfully over time, both of which dampen the transmission of oil shocks to broader economic activity. Household and corporate leverage is also not elevated today, removing what has often been a key precondition for a downturn. Even if oil prices were to rise to USD120–140 per barrel, that alone might not trigger a recession. That said, higher levels would surely be painful, and the risk that markets react sharply to such moves should not be dismissed.

Market pricing vs geopolitical risk: a fragile equilibrium

Most forecasters seem to assume that the Middle East conflict will not get worse from here. In our view, that is a big if. If the market is wrong, the alternative scenarios and downward risks could be severe. April's annual IMF–World Bank Meetings in Washington, DC, were, as always, an excellent gathering of policymakers, investment analysts and experts from think tanks and international institutions—a great forum for global macro discussions and a way to gauge market sentiment.

The mood among participants varied, but the baseline view among market participants this year appeared to be that the current conflict with Iran would not escalate further. Market pricing reflects a similar consensus: the ceasefire is expected to hold, and oil prices are expected to stabilize and gradually ease from current levels. Oil price futures point in that direction, and equity markets appear aligned with this view.

However, discussions with political and energy analysts suggested more fragile dynamics. Downside scenarios, such as further damage to energy infrastructure, production shutdowns, declining strategic reserves and broader supply chain disruptions raise the risk of significantly higher energy prices and potential shortages. These developments could lead to meaningful slowdowns or even recessions across many economies.

Markets are clearly not pricing in such adverse outcomes. Perhaps these scenarios are difficult to price before they materialize, but the probabilities are not negligible. We believe the costs would be high, with nonlinear dynamics potentially amplifying the impact. In our view, this potential risk calls for caution.

The inflation outlook: higher for longer but not a replay of 2022

A natural concern is whether the current oil shock will trigger another round of high inflation. Headline inflation will likely rise—energy prices will likely feed through quickly,

pushing headline Personal Consumption Expenditures (PCE) inflation toward 3.5%—but the more important story is core inflation, which was already sticky at around 3% before the oil shock and is likely to remain elevated for longer. The oil shock therefore complicates the Fed’s job by creating an even more prolonged period of above-target core inflation.

Crucially, however, this is not 2022. The conditions that produced that high inflation episode were far more severe. Supply chain disruptions were broad-based and global—factories were shut down, shipping capacity was severely constrained, and there were shortages of everything from transportation equipment to truck drivers. The New York Fed’s Global Supply Chain Pressure Index hit a four-standard-deviation shock at that time; today, the index is higher than, but close to its historical average. The labor market was very tight, with wage growth running at 6%–7% for private-sector workers and a high quits rate, signaling abundant outside opportunities.¹ On top of that, multiple rounds of fiscal stimulus and curtailed spending on services had left households flush with excess savings, while demand—particularly for goods—was surging against a supply-constrained backdrop as the economy was still emerging from the pandemic.

Today’s starting conditions are fundamentally different. The labor market is performing well but there is some slack—closer to 2017-2018 levels than to the overheated conditions of 2022. Wage growth has moderated to below 4%, and the quits rate has fallen—workers are not leaving their jobs, suggesting fewer opportunities and lower confidence.² There is some fiscal stimulus hitting household purses in the first half of this year, but it will likely be largely offset by higher energy prices, and there is no tailwind comparable to the massive pandemic-era transfers. The household savings buffer has been largely depleted outside of high-income groups. Against this backdrop, inflation will likely rise, but the increase should be more contained and shorter-lived than in the prior episode. This is a world of persistently firm core inflation, not a repeat of the 2022 surge.

The Fed can afford to wait

In this environment, we believe the Fed is in a good place to wait. First, inflation has remained above target for nearly four years and has proven sticky. Tariffs have contributed, though their impact is one-off. Net of tariffs, there has been disinflation but we now face another supply-side shock, with oil prices likely to keep inflation elevated. This sequence of shocks raises the risk of de-anchoring expectations and altering price-setting behavior.

Second, the labor market has stabilized after last summer’s worrisome slowdown. That episode reflected a lack of demand for labor, not a supply problem. Since November, however, hiring has been decent. Risks to the labor market are falling while risks to inflation are rising—a very different balance from last summer and early fall, when the story was the other way around. Finally, the tightness of monetary policy is not merely a function of the policy rate; what matters is the transmission to the economy through broader financial conditions. Financial conditions eased in 2025, supporting the case that policy may be less restrictive than headline rates suggest—we disagree with the Fed’s characterization that their policy rate is restrictive.

If conditions permit in 2027, two cuts may materialize. For now, however, we believe “wait and see” is the appropriate posture—we will re-evaluate this call once the Middle East dust settles.

1. Source: Bureau of Labor Statistics. Dec. 31, 2022.

2. Source: Bureau of Labor Statistics. March 31, 2026.

Global credit strategy

Choke point: Second-order shocks of the Gulf conflict (that markets may be underestimating)

Executive summary

- **Scale and timeline of disruption:** The Iran conflict has inflicted severe damage on Middle East downstream energy infrastructure and choked transit through the Strait of Hormuz, taking millions of barrels per day of refining and export capacity offline. The key risk is prolonged repair timelines, which could turn a short-term price shock into a structural repricing across energy, commodities, and industrial sectors.
- **Second-order commodity shocks:** Refinery outages and logistics disruptions are driving extreme dislocations in refined products and petrochemical feedstocks—diesel, jet fuel, LPG, bunker fuel, naphtha, and methanol—pushing crack spreads and prices to record levels. These effects extend well beyond energy into aviation, shipping, plastics, manufacturing, and consumer goods, with rising risks to global inflation.
- **Supply-chain and macro implications:** The conflict is disrupting fertilizers, pharmaceuticals, aluminum, and critical refinery by-products such as helium and sulfur, threatening agriculture, healthcare supply chains, semiconductors, and mining. As outages persist, pressure on corporate margins, household costs, and inflation expectations is likely to intensify, especially without a timely resolution.

The Iran conflict has damaged the Middle East's downstream energy infrastructure on a scale not seen in recent times. And with Iran in control of the Strait of Hormuz, there is a significant tail risk for disruption that could impact supply chains beyond energy. Crude oil and liquefied natural gas (LNG) may be dominating headlines, but second-order impacts present tail risks that the market has not fully appreciated, in our view. These second-order effects could pressure a range of commodity prices that impact corporate margins and household bills and will likely become increasingly difficult to avoid as a resolution to the current situation becomes more protracted.

Energy supply: getting worse, not better

First, we look at the status of the energy supply situation, which continues to deteriorate. Since the blockade began, tanker traffic has been minimal; 120-140 vessels³ normally transit through the Strait but this has fallen to about five⁴ on average daily. Refinery capacity directly offline exceeds 3.0 million barrels⁵ per day, (bpd) a significant portion of the world's most strategically critical product export infrastructure.

3. Source: Reuters graphics based on Kpler and Marine Traffic data, April 29, 2026.

4. Source: Windward March 20, 2026.

5. Source: Reuters via Pipeline & Gas Journal, March 10, 2026.

Table 1: Impact of Gulf conflict on energy and commodity trade

Metric	Transiting through Hormuz
Global oil supply	~20% (~20 million bpd)
Qatar LNG supply	~20% currently offline, 4% needs three to five-year repair
Daily tanker transits (pre vs. post-closure)	129+ reduced to <10
Iran's damaged gas production capacity	~12%
Global ammonia exports	~27%
Global phosphate exports	~22%
Global sulfur exports	~45%
Globally traded ammonia fertilizer	~30%
Asian naphtha routed	60–70%
Middle East share of global petrochemical trade	>30%

Source: International Energy Agency (IEA), Reuters, Qatar Energy, LSEG ship-tracking data, CRU Group, International Fertilizer Association. Data as of April 29, 2026.

Recovery timelines

In assessing the impact of the energy disruption, we believe the most important variable is not the headline damage but the restoration timeline. A refinery returning online in six weeks delivers a price spike and a potential recovery trade. A refinery offline for a year, on the other hand, represents a structural shift that potentially reprices term contracts and equity multiples across downstream sectors. Recovery timelines vary significantly by facility type and damage severity.

Among the oil, natural gas and LNG fields with disclosed repair windows, the average recovery timeline is around two years, though this is heavily skewed by Qatar's North Field (it is expected to take three-to-five years to restore full downstream LNG capacity), with South Pars at 12–24 months, or more.

For refineries and petrochemical plants, only two assets have explicit repair estimates: Ras Laffan LNG (three-to-five years⁶, tied to the North Field rebuild) and Pearl GTL (nine–18 months). The remaining 11 major refinery assets are listed as partially operational or offline with no disclosed repair timelines, suggesting the true refinery average timeline is likely longer.

Key second-order impacts to watch

While the disruption to energy infrastructure and oil price volatility are key first order effects of the conflict, several secondary economic impacts are emerging. The downstream effects are far-reaching and encompass refined products, natural gas, freight, power, food and basic manufacturing with potentially material consequences for inflation expectations. The products below are the ones we are watching most closely, as the timeline for a resolution of the Middle East conflict remains unclear.

Refined products

The most revealing market signal of the refinery disruption has been the behavior of "crack spreads"—the margin between crude oil prices and refined product prices. Normally, crack spreads move directionally with crude. In a refinery-destruction event, however, crack spreads diverge sharply from crude, as product prices are driven not by the cost of the raw material but by the scarcity of processing capacity and the specific products it generates. Below is a breakdown of the impact of the war on key refined products.

Diesel and gasoline

The Gulf is a structural net exporter of diesel to Europe and Asia. Asian and European diesel cracks have widened materially. The price pass-through hits trucking, rail, agriculture, marine bunkers, and winter heating simultaneously.

6. Source: Qatar Energy. Data as of March 19, 2026.

The damage to Ras Tanura, Ruwais, Satorp, and Sitra has removed approximately two million barrels per day of diesel⁷ production capacity—the specific output of these modern, hydrocracking-equipped export refineries. Diesel and gasoline crack spreads have more than doubled in Northwest Europe and appear likely to remain elevated through the second half of 2026 if the Strait remains closed longer.

Jet fuel

The jet fuel disruption has a particular structural driver: the UAE's Ruwais complex was the primary source of jet fuel for long-haul aviation operating out of Gulf hubs and was the marginal supplier for European aviation fuel imports at volumes of 373,000 metric tonnes per month.⁸ Its near-complete shutdown has removed an irreplaceable volume of jet fuel from global markets that are already capacity-constrained on the refining side. Crack spreads for jet fuel have reached record levels—above USD90 per barrel in Asia and Europe. The main sector affected is aviation.

Liquefied petroleum gas (LPG)

The Ju'aymah disruption plus export chokepoints have tightened LPG globally. LPG is a cooking fuel in emerging markets like India, Indonesia and Africa, and a petrochemical feedstock. The combined shutdown of UAE, Qatar, and Iranian LPG export capacity—representing approximately 1.9 million barrels per day⁹—against a South Asian import dependency of approximately 90%¹⁰ from Gulf sources has created a crisis.

Bunker fuel

Very low sulfur fuel oil (VLSFO) used by the commercial shipping fleet—has experienced one of its most extreme price movements on record with prices surging since January. The Gulf had been a primary bunkering corridor for vessels on Asia-Europe trade routes. With Fujairah and Dubai bunkering disrupted, vessels are re-routing to Atlantic Basin ports for fuel, adding voyage lengths, costs and carbon emissions.

Naphtha and petrochemical feedstocks

With Ruwais offline and Hormuz transit disrupted, the supply of naphtha to Asian steam crackers—facilities that convert it to ethylene and propylene and form the basis of the global plastics and chemicals industry—has collapsed. Naphtha prices have surged to around USD1,000 per metric tonne.¹¹ Polyvinyl chloride (PVC) prices in India rose 78% in March alone.¹² Major Asian producers have reduced their utilization of propylene units by around 30%¹³; Chinese ethane imports from the US surged to record levels to an all-time high of 800,000 tons in April to offset feedstock disruptions from the Gulf. In February, 50% of China's naphtha and 40% of LPG came from the Persian Gulf.¹⁴ The downstream consequences will likely continue flowing through the packaging, construction, automotive, pharmaceutical and agriculture sectors for multiple quarters.

Petrochemicals and plastics

The Middle East region is a major exporter of petrochemicals and polymers. Iran is the number one global exporter of methanol and number three of urea. Facilities are currently not operating, which is impacting China, the biggest consumer of methanol from the Middle East. Methanol is used as a feedstock along with other petrochemicals as precursors for manmade fibers and polymers. This disruption impacts many consumer sectors, including packaging and autos. Products such as urea and ammonia are important inputs into fertilizers and explosives used in mining.

The near-term impact is positive for Europe in terms of raising production needed to meet local demand, but once the situation is resolved, the over-capacity issues existing before the conflict will likely again become a headwind for European chemical manufacturers. The length of time it takes to return to pre-war levels is debatable and depends on the extent of damage to facilities but will likely be at least two-to-three months. US producers are largely insulated from feedstock availability but the increase in global pricing benchmarks will likely add to costs and ultimately price inflation, which could be significant given the broad sector impact.

7. Source: Rystad Energy. Data as of April 14, 2026.

8. Source: Reuters. Data as of Mar 11, 2026.

9. Source: CNBC Hormuz coverage. Data as of April 23, 2026.

10. Source: United Nations Conference on Trade and Development. Data as of April 1, 2026.

11. Source: Bloomberg K11 COMB Comodty. European Naphtha Swap. Data as of April 29, 2026.

12. Source: Bloomberg PLASVCR Index. NNS Plastics PVC Resin DSI Price INR/kg India. Data as of April 29, 2026.

13. Source: Independent Commodity Intelligence Services (ICIS). Data as of March 26, 2026.

14. Source: Bloomberg L.P. China Turns to US Ethane After Iran War Hits Naphtha, LPG Supplies. Data as of March 3, 2026.

Fertilizers and agricultural inputs

The Gulf region's contribution to global fertilizer supply chains is structurally underappreciated by markets that focus on energy, in our view. The disruption statistics are striking: Approximately 27% of globally traded ammonia, 22% of phosphate exports and 45% of global sulfur exports transit or originate from the Gulf. Around 30% of globally traded ammonia-based nitrogen fertilizer is now effectively offline.¹⁵

The timing of the disruption is potentially dangerous from a humanitarian standpoint. The Northern Hemisphere's 2026 spring planting season is now underway. Nitrogen fertilizer availability—and correspondingly, its price—directly determines planted area, application rates and crop yields. We would expect India and Southeast Asia to be importing fertilizers now in time for the June planting season, and Brazil's peak demand is May to September in preparation of the main planting season which begins in September.¹⁶

Pharmaceuticals

In our view, the most underappreciated supply chain vulnerability is pharmaceuticals. Approximately 99%¹⁷ of pharmaceutical active ingredients and their precursors are derived from petrochemical feedstocks. India, which supplies 50% of US generic drug prescriptions¹⁸ and is a dominant global supplier of generic medications, depends on Hormuz for approximately 40%¹⁹ of its crude imports. The chemical inputs to Indian pharmaceutical manufacturing are frequently consolidated in Dubai and the UAE before shipment.

Aluminum

The Gulf region produces around 6.8 million tons (mt) per year, around 9% of global primary aluminum metal production.²⁰ This is supported by cheap energy from plentiful natural gas available to power the smelters. Over 50% of the raw material needed, bauxite and alumina, is imported to the region. Most of the aluminum production is exported, with major markets being the European Union and the US. Japan sources around 25% of its aluminum imports from the region.²¹ It is estimated that around 3.8 mt of capacity is currently offline and what is currently being produced cannot be shipped out easily. Restarting smelters could take six-to-twelve months in what was already a tight market before the conflict started.

Important industrial refinery by-products

Helium

Approximately one third of global helium production comes from Qatar²², of which one third comes from the Ras Laffan LNG Complex that was damaged at the onset of hostilities. One of the most important uses of helium is in the manufacturing of many of the most complex semiconductor chips using ultraviolet lithography. Lack of helium can result in a halt to production with little scope to tap alternative sources in the near term. Helium is also used in magnetic resonance imaging (MRI) scanners and other temperature-sensitive devices using cooled superconductor magnets.

Sulfuric acid

The Middle East exports around 50% of global traded sulfur.²³ It is produced from refining the sulfur-rich sour crude produced in the area. Sulfur is important in the production of sulfuric acid, which is widely used in industrial processes, including the production of phosphate fertilizers and mining applications to recover nickel and copper metal by leaching processes. Fertilizers consume around 60% of the world's sulfuric acid production.²⁴ Mining uses may not be as large but some regions, such as Chile, rely on China for 20% of its sulfuric acid demands²⁵ and imports for March were already zero. The latest US sulfur prices are now well over USD600 per ton²⁶ from around USD270 a year ago.

15. Source: Industrial Info Resources (IIR). Data as of July 19, 2022.
16. Source: UBS research. Data as of April, 23 2026.
17. Source: Industrial Info Resources (IIR). Data as of July 19, 2022.
18. Source: Reuters. Data as of February 21, 2025.
19. Source: Reuters via CNBC TV18. Data as of April 17, 2026.
20. Source: Bloomberg Intelligence Data as of March 2, 2026.
21. Source: S&P Global. Data as of March 6, 2026.
22. Source: CNBC.com. Data as of March 19, 2026.
23. Source: Bloomberg News. Data as of March 3, 2026.
24. Source: HSBC Economic research. Data as of April 22, 2026.
25. Source: Morgan Stanley Research. Data as of April 10, 2026.
26. Source: Bloomberg US Tampa Sulphur contract spot price. Data as of April 30, 2026.

Rob Waldner
Head of IFI Strategy and
Macro Research

James Ong
Senior Portfolio Manager

Gareth Isaac
Head of Multi-Sector
Portfolio Management

Tom Sartain
Senior Portfolio Manager

Michael Siviter
Senior Portfolio Manager

Yi Hu
Head of Asia Credit
Research

Interest rate outlook

US: Neutral

We maintain a neutral position on US interest rates, as the market is no longer pricing in Fed cuts this year, a position that appears reasonable, given the inflationary pressures from higher energy prices due to the Iran war. Looking ahead, the balance of risks is likely to be more symmetric: An end to the conflict or a shock to economic growth could push rates lower, while continued inflationary pressure, especially if energy prices rise further, could drive rates higher.

Europe: Neutral

The rapid rise in energy costs has upended the outlook for eurozone growth and inflation and raised the prospect that the European Central Bank (ECB) will be forced to hike policy rates to prevent inflationary effects from spreading. At the April ECB meeting, President Lagarde seemed comfortable with the notion of a June hike, unless there is a significant change to the outlook. However, the market has already priced a very front-loaded hiking cycle, with some 80 basis points of hikes priced in for the next 12 months.²⁷ This seems overly aggressive, as policymakers will likely be cautious given the growth implications of the conflict. The short end of the yield curve, therefore, has value, in our view, especially relative to the US curve, which is still pricing the Fed to remain on hold or even cut rates. Despite attractive value in the very front end of the yield curve, we maintain a neutral stance on longer-term European sovereign yields because the longer-term outlook for European fixed income is more mixed. 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: Neutral

We maintain a neutral stance on onshore Chinese rates but expect a relatively flatter yield curve in the months ahead. Inflation expectations among local households and investors are likely to recover further, on the back of higher oil and gas prices, and the international market has recently started to scale back its expectations for the timing of rate cuts. Since late last year, we have been expecting a price-level recovery and more restrained monetary policy relative to market expectations.

Japan: Underweight

The Bank of Japan (BoJ) kept interest rates unchanged at 0.75% at its April meeting, as widely expected. However, the decision can be characterized as a “hawkish hold”. In an unprecedented split, three members of the BoJ’s Monetary Policy Committee voted in favor of raising rates. Although Governor Ueda was cautious on the outlook due to geopolitical risks, he emphasized a determination not to fall “behind the curve” on inflation. In addition, the BoJ’s new forecast now shows core inflation remaining above 2% into fiscal year 2028. In the absence of a meaningful escalation of the Middle East crisis, the BoJ will likely hike at either the June or July meeting toward a neutral setting of 1.5%-2% (i.e., 0% real rate) over the next 18 months. This will likely maintain upward pressure on short-dated Japanese government bond (JGB) yields and increase flattening pressure on the yield curve. Long-dated JGB forwards are already very elevated, but they may rise further if fiscal policy offsets the terms of trade shock from higher energy prices.

27. Source: Bloomberg L.P. Data as of April 30, 2026.

UK: Neutral

Front-end UK rates have closely tracked movements in crude oil prices since the onset of the Iran war, reflecting market concern that higher energy costs will keep UK inflation sticky and force the Bank of England (BoE) to tighten policy further. As oil prices returned to late April highs, the UK rates market priced around 85 basis points of cumulative BoE tightening by year end, with 50 basis points expected by September.²⁸

Australia: Overweight

The Reserve Bank of Australia (RBA) hiked 25 basis points in May to 4.35%, matching the post-Covid peak in interest rates. Resilient inflation and labor markets are keeping the RBA focused on price risks. Higher energy prices will likely reinforce policymakers' caution around inflation but weakening domestic confidence indicators likely limit the scope for further tightening. The market is already pricing 62 basis points of cumulative rate hikes this year, with long-dated forward rates trading over 5%.²⁹ Even taking account of recent upside inflation surprises, these valuations now look attractive, in our view, on an absolute and relative basis versus US Treasuries. Australia has solid fiscal fundamentals, which should limit long-end risk premia. In addition, the appreciation of the Australian dollar over the last 12 months should curb imported inflation.

28. Bloomberg L.P. Data as of April 30, 2026.

29. Source: Bloomberg L.P. Data as of April 23, 2026.

Rob Waldner
Head of IFI Strategy and
Macro Research

James Ong
Senior Portfolio Manager

Gareth Isaac
Head of Multi-Sector
Portfolio Management

Tom Sartain
Senior Portfolio Manager

Michael Siviter
Senior Portfolio Manager

Yi Hu
Head of Asia Credit
Research

Currency outlook

USD: Neutral

Last month we upgraded to a neutral stance on the US dollar in the short term. The current level of uncertainty has driven a flight into the dollar, and the US economy is less exposed to energy market disruptions. However, we maintain a structural negative view of the US dollar relative to a broad spectrum of developed and emerging markets. Once the path of the conflict becomes clear, we think investors will be further catalyzed to diversify their US dollar exposure.

EUR: Neutral

The eurozone is particularly exposed to energy market disruptions if the current uncertainty persists, with inflation likely to be higher and growth challenged. The ECB is attentive to inflation risks and the chance of rate hikes is now high. We think the euro could remain under pressure versus the US dollar while markets remain at such a high level of uncertainty but we maintain a positive view of the euro on a cross basis versus smaller currencies like the British pound.

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 investors to invest 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: Overweight

The negative terms of trade shock caused by higher energy prices is negative for the yen relative to energy exporter currencies like the US dollar. However, we believe the yen can potentially outperform the currencies of smaller Asian economies and European economies, which are also exposed to higher energy prices but lack the strategic energy reserves and fiscal buffers to offset the shock. A large shock could also result in flight to quality flows which could support the yen relative to higher-beta currencies. The threat of intervention has capped the USD/JPY exchange rate at 160. However, a bigger down move in USD/JPY will probably require more evidence that the US economy is moving toward recessionary dynamics than is currently evident.

GBP: Underweight

The persistent strength of sterling against both the US dollar and the euro is difficult to reconcile given the UK's deteriorating terms of trade and rising concerns over fiscal sustainability, especially given the sharp increase in gilt yields. Interim support for sterling may have come from seasonal April dividend related inflows and still restrictive interest rate differentials, but these influences look temporary.

The underlying outlook for sterling remains bearish, in our view. While the growth impact from higher energy prices is not yet evident—recent GDP, labor market and Purchasing Managers' Index data have remained resilient—this is unlikely to persist. Second quarter growth is increasingly at risk of turning negative, as the drag from higher energy costs feeds through. Slowing growth should cap the extent to which markets can continue to extrapolate a more aggressive UK rate path.

At the same time, fiscal risk premia are likely to become more salient if interest rates remain at current or higher levels. Political uncertainty could amplify this risk, particularly if Prime Minister Starmer is replaced following the May local elections by a more left leaning and fiscally permissive leadership. In this context, sterling appears vulnerable, especially against currencies with stronger external balances and clearer fiscal anchors.

AUD: Overweight

The Middle East crisis has boosted Australia's terms of trade, supporting the Australian dollar relative to the currencies of energy importers in Europe and Asia. In addition, the RBA's hawkish stance has made the currency the highest yielder in the developed market universe. A sufficiently large jump in oil prices could raise global growth concerns, which could generate flight to quality flows that could weigh on the Australian dollar, but at current oil prices, we believe recession risks are still relatively moderate.

Panelist



Mark Paris
CIO and Head of
Municipals

The bottom line

What's driving munis and where is there value?

We speak with Mark Paris, CIO and Head of Municipals, about the factors behind muni market performance this year and where he currently sees value.

Q: How has the municipal market been performing this year, and where do you see value today?

Mark: Overall, it's been a solid year for munis, though the story really depends on which sector we are talking about. Tax-exempt investment-grade munis have held up well and have recovered nicely from the March volatility, ultimately outperforming most other fixed-income sectors year-to-date.³⁰ Performance has been strongest in the intermediate-to-long part of the curve, where declining rate volatility and renewed demand have pushed yields lower and muni-Treasury ratios lower.³¹

High-yield munis have actually been the standout from a headline return perspective. They're leading other fixed-income asset classes this year, helped by a benign credit environment and their higher yields.³² That said, much of the move is likely already behind us, and spreads now look fairly tight. In contrast, taxable munis have been less appealing to domestic investors, but they continue to look attractive on a cross-currency basis, particularly for overseas buyers searching for high-quality yield.

From a valuation standpoint, muni-Treasury ratios have richened somewhat, especially in the belly of the curve, but they're still not at levels we'd consider extreme. We do think there's room for potential incremental outperformance in high-grade tax-exempts, particularly in areas that were hit harder during the March sell-off and haven't fully recovered. Given how strong high yield has already been, we see better risk-adjusted value today in higher-quality, longer-duration tax-exempt bonds rather than broadly adding high yield beta at this stage.

Q: What have been the primary drivers of the muni market over the past several months?

Mark: A handful of factors have been working together to support the market. First, technical conditions have been a major tailwind. While headline issuance has been elevated, it's been more than offset by heavy principal redemptions and coupon payments. That imbalance has kept cash levels high and demand resilient, even during periods of rate volatility.

Second, fund flows have been consistently positive. Mutual funds and exchange traded funds (ETFs) have taken in a meaningful amount of money year-to-date, which has provided steady secondary-market support—particularly for higher-quality, more liquid parts of the market.

Third, the macro backdrop has stabilized after a volatile first quarter. The March sell-off, driven by geopolitical concerns and oil price fears, created a temporary risk-off environment for munis. Since then, declining rate volatility and a more stable Treasury trading range have allowed investors to refocus on munis' core appeal: defensive income and strong after-tax yield.

Finally, credit fundamentals remain broadly healthy. Defaults have been limited and well below historical norms, and distress levels in high yield remain near multi-year lows.³³ While there are certainly idiosyncratic challenges in specific sectors—such as parts of healthcare or transportation—there's little evidence of broad-based credit stress across the muni market.

Q: How do you see these drivers evolving, and what does that imply for munis going forward?

Mark: Looking ahead, we think the near-term setup for munis remains constructive, particularly through late spring and early summer. Seasonal reinvestment flows should continue to support demand, and although supply will likely remain elevated, it doesn't appear overwhelming relative to expected redemptions.

30. Source: Bloomberg Municipal Bond Index. Data as of April 30, 2026.

31. The muni/Treasury ratio divides the yield of a municipal bond by the yield of a similar maturity US Treasury bond, and is used to assess the relative attractiveness of tax-exempt muni bonds. A higher ratio indicates that municipal bonds are "cheaper" and offer better value relative to taxable Treasury bonds.

32. Source: Bloomberg Muni High Yield Index. Data as of April 30, 2026.

33. Source: Barclays Research, dated April 24, 2026.

On the macro side, as long as interest rate volatility stays contained and geopolitical risks don't re-intensify, munis should continue to benefit from their defensive positioning within fixed income. Historically, May and early June tend to be reasonably supportive periods for the asset class, and this year looks consistent with that pattern.

From a credit perspective, we expect more stability than spread tightening from here. With high yield already having performed so well, we think selectivity matters more than ever, and we're increasingly focused on issuer-level fundamentals rather than broad sector exposure.

Putting it all together, we remain constructive but disciplined. We favor high-quality tax-exempt munis in the intermediate-to-long part of the curve, are comfortable adding exposure during bouts of rate-driven volatility, and prefer a selective approach to high yield. In our view, municipals continue to offer a compelling combination of income, technical support, and relative value—especially for US taxable investors—while providing a measure of downside resilience in an uncertain macro environment.

Invesco Fixed Income Team contributors

Senior Editor—Ann Ginsburg

Atlanta

Rob Waldner

Head of IFI Strategy and Macro Research
+1 404 439 4844
robert.waldner@invesco.com

James Ong

Senior Portfolio Manager
+1 404 439 4762
james.ong@invesco.com

Sidhant Mattha

Associate Credit Analyst
+1 404 439 3166
sidhant.mattha@invesco.com

Ann Ginsburg

Head of Strategy and Insights Fixed
Income
+1 404 439 4860
ann.ginsburg@invesco.com

New York

Turgut Kisinbay

Chief US Economist
+1 917 574 4165
turgut.kisinbay@invesco.com

Mark Paris

CIO and Head of Municipals
+1 212 652 4290
mark.paris@invesco.com

London

Gareth Isaac

Head of Multi-Sector Portfolio
Management
+44 20 7959 1699
gareth.isaac@invesco.com

Tom Sartain

Senior Portfolio Manager
+44 20 7034 3827
thomas.sartain@invesco.com

Michael Siviter

Senior Portfolio Manager
+44 20 7959 1698
michael.siviter@invesco.com

Yin Wu

Credit Analyst
+442079591624
yin.wu@invesco.com

Hong Kong

Yi Hu

Head of Asia Credit Research
+852 3128 6815
yi.hu@invesco.com

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Non-investment grade bonds, also called high yield bonds or junk bonds, pay higher yields but also carry more risk and a lower credit rating than an investment grade bond.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The performance of an investment concentrated in issuers of a certain region or country is expected to be closely tied to conditions within that region and to be more volatile than more geographically diversified investments.

Important information

All information is sourced from Invesco, unless otherwise stated.

All data as of April 30, 2026, unless otherwise stated. All data is USD, unless otherwise stated.

This document is intended only for professional investors in Hong Kong, for Institutional Investors and/or Accredited Investors in Singapore, for certain specific sovereign wealth funds and/or Qualified Domestic Institutional Investors approved by local regulators only in the People's Republic of China, for certain specific Qualified Institutions and/or Sophisticated Investors only in Taiwan, for Qualified Professional Investors in Korea, for certain specific institutional investors in Brunei, for Qualified Institutional Investors and/or certain sp specific institutional investors in Thailand, for certain specific institutional investors in Malaysia upon request, for certain specific institutional investors in Indonesia and for qualified buyers in Philippines for informational purposes only. This document is not an offering of a financial product and should not be distributed to retail clients who are resident in jurisdiction where its distribution is not authorized or is unlawful. Circulation, disclosure, or dissemination of all or any part of this document to any unauthorized person is prohibited.

This document may contain statements that are not purely historical in nature but are "forward-looking statements," which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.

This document is issued in the following countries:

- in Hong Kong by Invesco Hong Kong Limited 景順投資管理有限公司, 45/F, Jardine House, 1 Connaught Place, Central, Hong Kong.
- in Singapore by Invesco Asset Management Singapore Ltd, 9 Raffles Place, #18-01 Republic Plaza, Singapore 048619.
- in Taiwan by Invesco Taiwan Limited, 22F, No.1, Songzhi Road, Taipei 11047, Taiwan (0800-045-066). **Invesco Taiwan Limited is operated and managed independently.**