TwentyFour
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Flash Fixed Income

11 June 2026

Hawkish central banks favour short-term bonds

Markets had expected 2026 to deliver an easing of central bank policy. There is no need to recount the events that have disrupted that narrative, but with energy prices pushing inflation higher, investors have instead been confronted with a hawkish pivot.

Approaching the second half of the year, we have already seen the ECB raise its base rate by 25 basis points (bp) to 2.25%; the market expects a further hike in September, and the central bank's guidance has offered little to dissuade that opinion.

Should investors expect hikes from the BoE and the Fed in the coming months? And what are the implications of tighter monetary policy for fixed income?

Was the ECB hike an overreaction?

The traditional monetary policy answer to an external energy shock is for central bankers to look through it. In our view, tightening policy won't ease the supply constraint, and it also adds to the growth drag of higher production costs. That said, the danger is that this one-off hit to headline inflation from higher oil prices becomes persistent through higher wages and additional price hikes. If inflation expectations shift higher, this can become a self-perpetuating cycle. Central banks must therefore monitor these second-order effects closely and take a view on whether they need to get ahead of them.

The ECB appears to be prioritising the risk of falling behind the inflation curve. Students of economic history will be aware that European policymakers are sometimes accused of being oversensitive to inflation for historical reasons, a sensitivity that we have seen play out in previous cycles. In July 2008, even as the BoE and Fed were cutting rates in response to the global financial crisis, the ECB delivered one last rate hike because headline inflation was above target – this was 74 days before Lehman Brothers filed for bankruptcy, and the ECB would go on to cut rates by 325bp over the following 12 months.

Key takeaways

- Having initially expected central banks to cut interest rates in 2026, investors now face a hawkish pivot after the European Central Bank (ECB) hiked rates at its June meeting.
- Hikes from the Federal Reserve (Fed) and Bank of England (BoE) are far less certain, but the narrative has driven a flattening of yield curves thanks to a rise in short end yields.
- A Trump-appointed Fed chair should not be assumed to favour cuts; Kevin Warsh's record suggests the opposite, and an aggressive move to shrink the Fed's balance sheet could tighten financial conditions even alongside lower rates.
- Short-dated credit looks increasingly compelling to us here, with attractive levels of income offering potential returns that may be less sensitive to rate hikes or spread volatility.

Credit market performance

	Total return YTD (%)	Total return last 30 days (%)	Yield (%)	Duration (yrs)
EUR IG	1.05	1.26	3.6	4.5
GBP IG	0.56	2.71	5.5	5.7
US IG	0.91	1.30	5.2	6.5
EUR HY	1.66	1.00	5.5	3.0
GBP HY	2.71	1.63	8.6	2.9
US HY	1.94	1.10	7.1	3.1
EM HY	3.90	0.54	7.3	4.0
Euro Senior Banks	1.04	1.11	3.4	3.7
COCO	1.74	0.03	6.0	3.7

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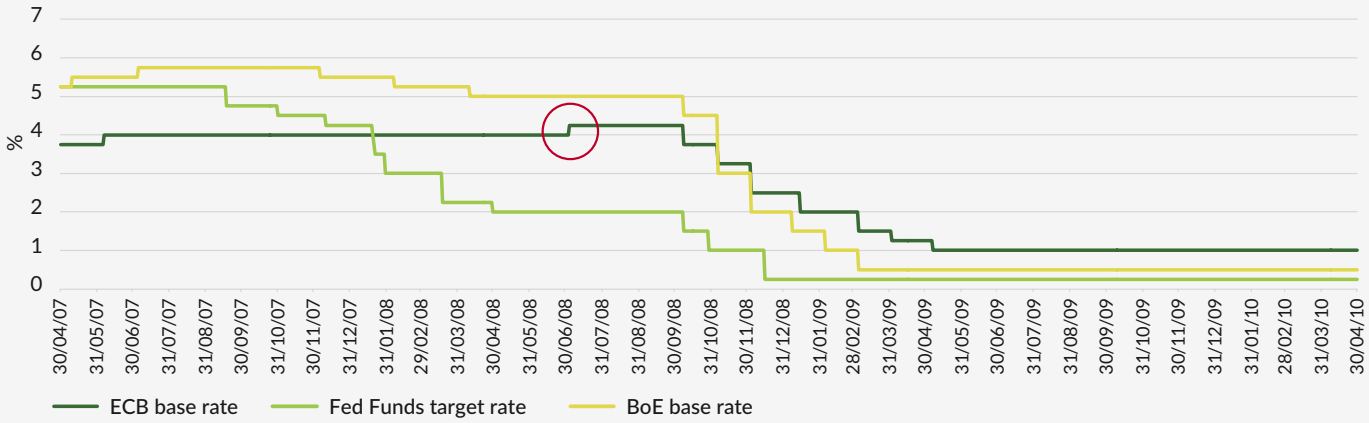
Gordon Shannon
Partner, Co-Head of Investment Grade, industry experience since 2007.

George Curtis
Partner, Portfolio Management, industry experience since 2012.

Exhibit 1: The ECB overreacted to inflation in 2008



Source: Bloomberg, 11 June 2026.

However, its caution today may be justified. While labour markets have shown signs of easing, the population is more sensitive to price increases having recently lived through higher inflation. Both the BoE and the Fed are keeping their options open for hikes later in the year. Credibility is viewed as a precious commodity among institutions that overused the word "transitory" through 2021.

Can the UK economy take a hike?

At the onset of the Iran conflict we said the BoE was stuck **between a rock and a hard place**, with higher (if slowly declining) inflation set against a weak growth outlook which may make the UK economy vulnerable to any tightening in policy. While the **political premium on Gilt yields** has moderated over the last month, the government remains constrained in its ability to increase borrowing and thus offer fiscal support.

Market pricing implies 60bp of hikes from the BoE over the next 12 months. It is worth remembering that this number, the equivalent of 2.8 25bp hikes, is far from an exact projection. Many think the BoE will not hike at all in the next year, but that 60bp reflects what others see as the meaningful possibility of a full hiking cycle involving multiple hikes. Most economists remain sceptical (of 40 polled by Bloomberg, only six expect even a single hike), but the data could change that view quickly.

The debate occurring within the rate-setting Monetary Policy Committee (MPC) is clear from its member's public comments, with the committee aware that the UK base rate is already having a constraining impact on a weak economy. As Alan Taylor highlighted at the beginning of June: "Interest rates don't need to go higher because they're quite restrictive at the moment." On the other side, BoE Chief Economist Huw Pill was the dissenter at the 8-1 vote to hold rates at the April meeting, stating that a "prompt but modest hike" in rates would help mitigate the risk of what he called a "re-emergence of intrinsic inflation persistence."

When Pill says "persistence" he means inflation today is a function of inflation yesterday, because expectations have a historical component. This occurs both via the wage-price feedback loop and via the infrequent resetting of all contracts in the economy that reference an inflation measure. He used "intrinsic" to highlight that the UK wage-setting process had still not returned to pre-Covid normality after the 2022 inflation shock, even before the Iran war.

Ultimately the MPC can only fall back on the logic of looking through this energy shock, if it is confident the economy was already on course to reach its inflation target. That might currently be the BoE's best guess, but there remains considerable uncertainty. On inflation expectations, the BoE Chair Andrew Bailey recently told the Treasury Select Committee: "I don't think they are de-anchored at the moment, but it is something…that we watch very carefully."

Can the Fed tighten even with a rate cut?

When we look at the US over the next 12 months, there's also a stark gap between the market-implied projection of 43bp of hikes and economic commentary, with the median Bloomberg projection for rates to *drop* by 23bp.

Rates dashboard

		Current %	Change (bp) 1w	1m	YTD
US Treasury	2yr	4.06	2	8	61
	10yr	4.46	-1	-1	34
	30yr	4.96	-2	-8	15
UK Gilt	2yr	4.34	1	-14	61
	10yr	4.91	1	-16	41
	30yr	5.59	0	-15	36
German Bund	2yr	2.68	2	-3	56
	10yr	3.03	1	-7	18
	30yr	3.56	0	-6	9

	Market projection	Current %	Change (bp) 1w	1m	YTD
Base rate 3.75%	end-2026	3.89	-7	9	81
	end-2027	3.92	-12	13	69
Base rate 3.75%	end-2026	4.24	1	-19	89
	end-2027	2.71	-3	-9	33
Base rate 2.25%	end-2026	2.74	-3	-11	63
	end-2027	2.71	-3	-9	33

Indicative market indices, data as at 11 June 2026. Past performance is not a reliable indicator of current or future results. Included for illustrative purposes only. Shown in local currency terms. It is not possible to invest directly into an index and they will not be actively managed. Source: Bloomberg, TwentyFour.

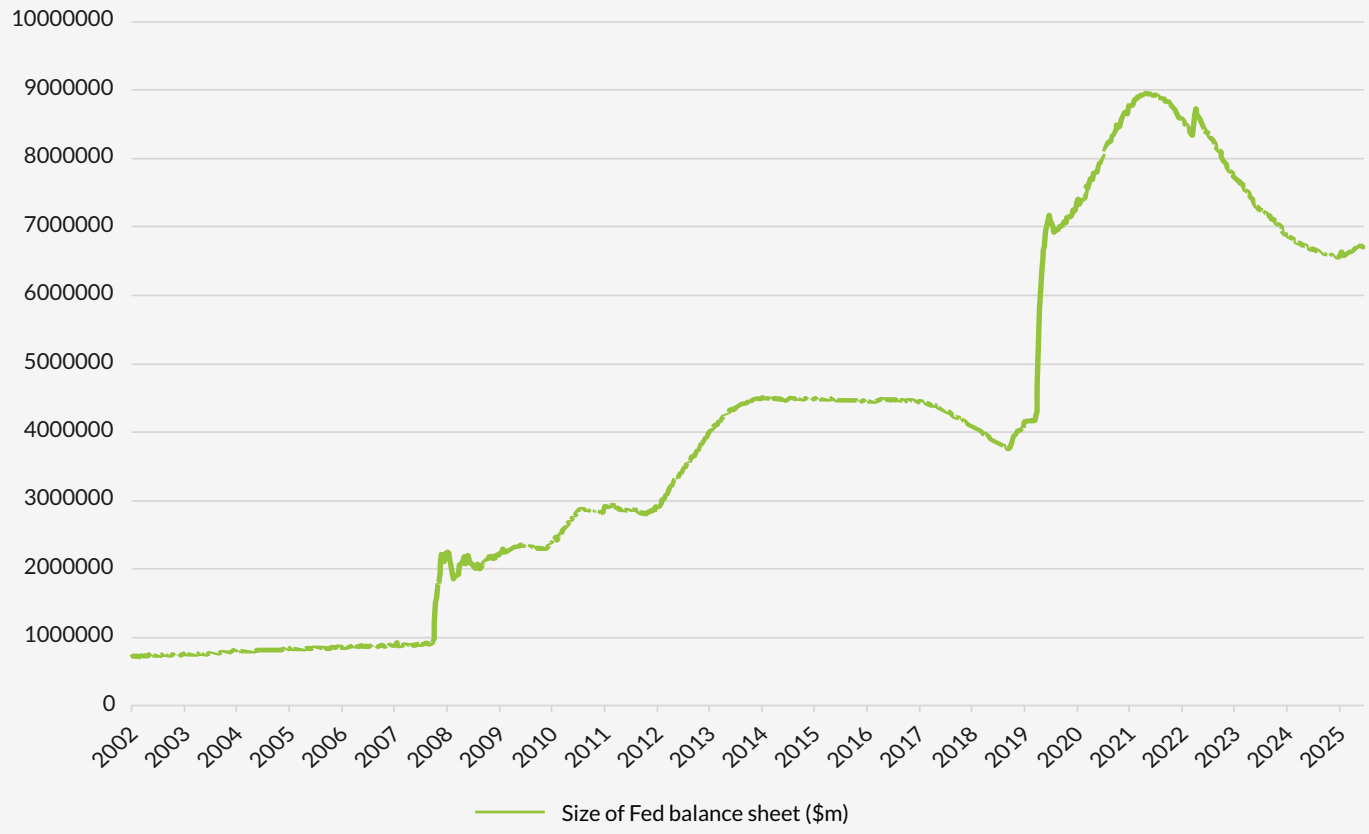
President Trump's involvement in the recent appointment of Kevin Warsh as Fed Chair may have led many to assume a dove is taking over the Federal Open Market Committee (FOMC). We have little doubt Trump's very public calls for rate cuts mean he expects Warsh to deliver them. But while Warsh argued last year that AI productivity gains meant the Fed could ease, his historical record is more hawkish and he remained conspicuously silent in the run-up to his installation. This may have been out of respect for the institution, especially as he plans to rein in its communication style, but it could equally be explained by a reluctance to rock the boat if his view no longer aligns with the President.

We will find out more when Warsh holds his first press conference following the Fed's June 17 meeting. What we do know today, however, is that the new chair appears to be in favour of reducing the Fed's balance sheet. He resigned from the FOMC in 2011 in protest against the second round of quantitative easing (QE). Coming back as the boss, we believe he will favour accelerating quantitative tightening (QT) to reverse what he sees as more than a decade of mistaken policy.

Ultimately, a large enough magnitude of QT can have a net tightening impact on inflation and the economy even if carried out alongside rate cuts. A single 25bp cut, if expected to persist for years, could reduce the yield on 10-year bonds by some amount smaller than 25bp (far less if the market believes rising inflation will cause that cut to be reversed). But the market could be forced to absorb enough long dated US Treasuries (USTs) that reducing the overnight rate does not reduce the yield on those bonds. Term premium has historically moved by 50-100bp as assumptions about long-dated issuance change.

It is therefore not difficult to envisage a QT programme which sees 10-year yields rise enough to offset a single 25bp rate cut, simply through the weight of the Fed balance sheet run-off. Borrowers who care more about the 10-year rate than overnight rates would include companies issuing bonds, the government financing its deficit, and consumers seeking mortgages, all of which would be negatively impacted by the rise in yields despite the headline rate cut. As Exhibit 2 shows, there are still extensive assets for QT and plenty of scope to accelerate their run-off.

Exhibit 2: Warsh has plenty of scope to accelerate QT



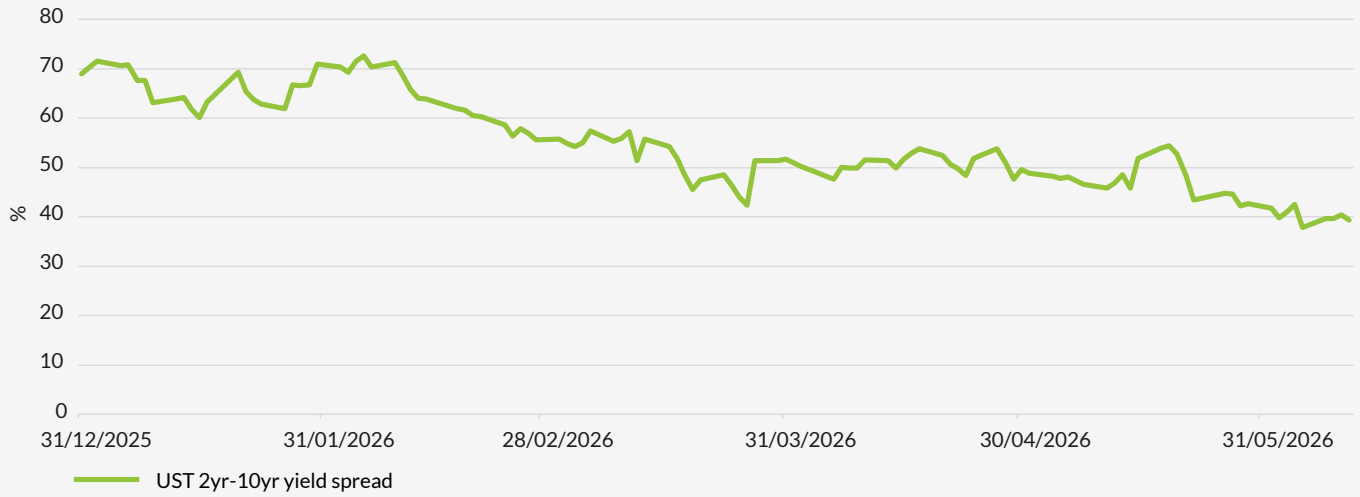
Source: Board of Governors of the Federal Reserve System, FRED, 11 June 2026

Rate hike narrative has contributed to flattened yield curves

Regardless of how many hikes central banks globally have in store for fixed income markets over the next year, investors are faced with a more hawkish backdrop. All else equal, yield curves flatten in this scenario; rate hikes and a higher-for-longer narrative have a similar impact in raising yields at the front end but less so at the long end.

Exhibit 3 shows this yield curve flattening in the form of the shrinking spread between two-year and 10-year USTs. This trend could continue if longer dated inflation expectations stay contained, but that is not assured. Fiscal risk from expanding term premium via government issuance remains, and therefore we see the theme of government bonds being an unreliable risk-off hedge continuing. More QT could add further potential downside to long dated bonds.

Exhibit 3: Shrinking 2s-10s spread reflects higher short-term yields



Source: Bloomberg, 11 June 2026.

In a world where central banks were easing policy, investors felt they had a lot of protection, as slowing growth or various forms of crisis could be met with an acceleration in that easing.

However, higher embedded inflation from the Iran energy shock has contributed to considerable uncertainty into the central bank reaction function. Regardless of where a central bank sees itself on the spectrum of the dual mandate between full employment and stable prices, more growth weakness must be tolerated when the danger of higher inflation expectations becoming embedded hangs over them. As a result, we think the famous central bank "put option" that sees investors expect rate cuts when growth slows must be viewed as less reliable.

While this is not an acute threat for credit markets, which we see as still benefiting from both strong underlying fundamentals and heavy technical demand, it does magnify downside risks.

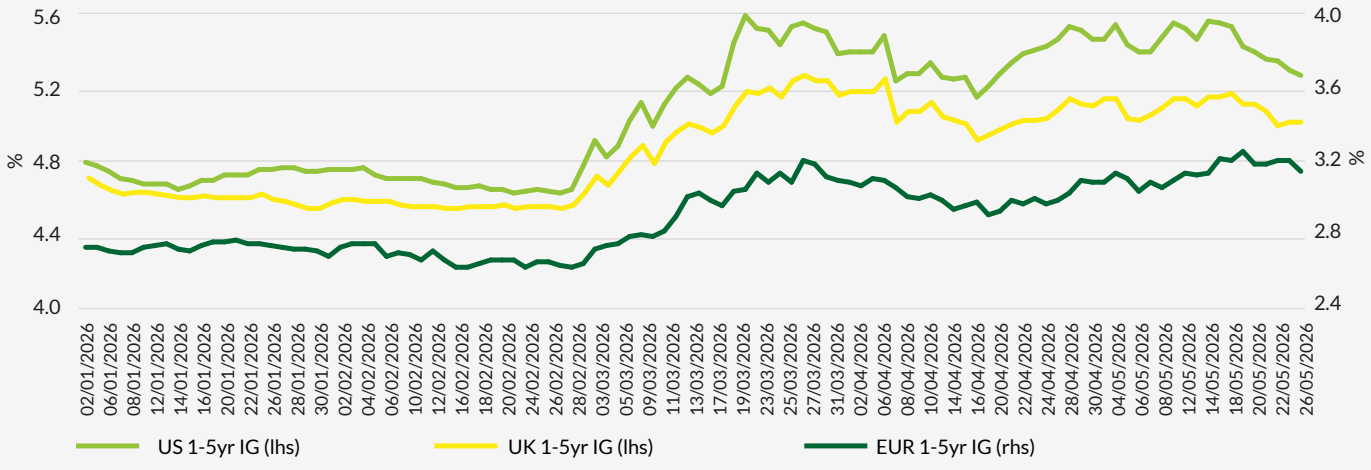
Short-dated credit looks increasingly attractive

Given the skew of risks facing fixed income investors in this new landscape, we prefer short-dated credit here.

Without the benefit of roll-down from upward sloping yield curves, passively owning the long end is less compelling, and flatter yield curves mean the opportunity cost of avoiding the long end is smaller. Shorter dated bonds tend to exhibit less volatility because with less duration, they are less sensitive to shifts in rate expectations. With higher breakeven levels investors are offered greater protection against downside shocks and higher short end yields have enhanced this buffer. Compensation for uncertainty appears more valuable when policy is less protective.

Meanwhile, the repricing of central bank policy has meaningfully improved the all-in yields on offer to investors in short-dated credit (see Exhibit 4). As we **recently argued**, short-dated credit is offering attractive levels of income, and potentially attractive returns that do not rely on rate cuts or credit spread tightening.

Exhibit 4: Short dated credit looks compelling



Source: ICE BofA Indices, Bloomberg, June 2026.

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