

Markets shrug off trade conflicts

Global financial markets maintained a risk-on tone during the review period,¹ shrugging off concerns over mounting tariff and policy uncertainty. Despite short-lived bouts of volatility triggered by incoming data and political developments, market sentiment remained upbeat, defying mounting challenges, including unease over the longer-run fiscal outlook in several key jurisdictions.

Equity markets in particular delivered strong returns, led by US stocks, which reached all-time highs. Large cap technology stocks outperformed, buoyed by enthusiasm around artificial intelligence (AI) and strong earnings, despite high valuations. Japanese stocks also posted gains. After having rallied earlier this year, European stocks remained flat, on the back of relatively weaker earnings growth. As is typical during risk-on phases, the rally was accompanied by subdued volatility, with the VIX receding. Credit spreads remained compressed and declined to lows not seen in a decade in spite of default rates ticking up.

The US dollar paused its depreciation after a significant step down in the second quarter of 2025. While dollar depreciation has historically been a marker of risk-on phases in financial markets, the dynamics over the review period did not match historical patterns. The risk-on tone was accompanied by an appreciation of the currency following the unveiling of the US fiscal package in early July. Overall, global financial conditions eased significantly, driven by equity gains and compressing credit spreads in the United States and benign conditions in emerging market assets. Conditions in Europe remained more subdued following a strong half-year.

The risk-on environment was underpinned by expectations of further monetary policy easing in the US and several other jurisdictions, coupled with expected fiscal largesse in the US and Germany. This policy cushion supported investors' optimism by reducing their perceived likelihood of adverse scenarios. Central banks in major advanced economies (AEs) continued reducing policy rates. The ECB, Sveriges Riksbank, the Swiss National Bank and the Bank of England implemented rate cuts. The Federal Reserve kept rates on hold, but some Federal Open Market Committee (FOMC) participants signalled a preference for an easier stance in the future, and signs of a cooler labour market fuelled expectations of rate cuts.

Such sanguine market assessments sit oddly with concerns about fiscal sustainability, which are arising from the dynamics of long-term government bonds. Long-run yields remained elevated in the risk-on environment, with yield curves showing significant steepening at the ultra-long end. This trend was probably driven by mounting unease about the fiscal outlook in certain jurisdictions and lingering concerns over a potential resurgence of inflation.

Emerging market economies (EMEs) capitalised on the global risk-on sentiment, benefiting from a softer US dollar and from market participants tuning out trade conflicts. EME currencies appreciated broadly, supported by both developments in the real economy and technical factors related to hedging activities. Local currency bonds saw modest positive returns, while EME bond issuance picked up. EME equity markets rallied, with notable gains in China, Colombia and Korea.

¹ The review period is from 1 June to 4 September.

Key takeaways

- Equity markets rallied as markets shrugged off trade tensions and policy uncertainty and focused on robust corporate earnings, while credit spreads compressed further.
- Short-term bonds priced in greater policy easing, but long-term yields stayed high and yield curves steepened at the very long end on fiscal and inflation concerns.
- Emerging market assets saw gains, benefiting from the risk-on environment and the weakening of the US dollar.

Risk assets plough ahead

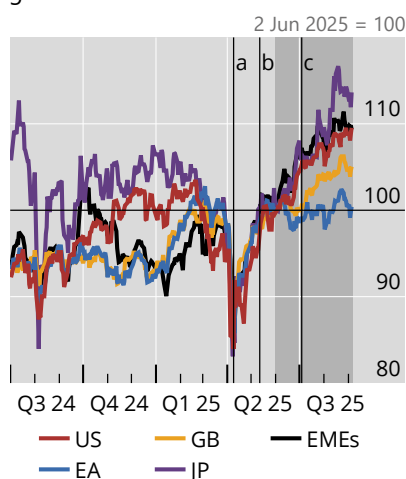
During the review period, risk assets showed remarkable resilience, defying the trade conflict and policy uncertainties. Despite occasional volatility due to macroeconomic data surprises, positive sentiment held sway, reinforced by strong corporate earnings and an outwardly resilient macroeconomic outlook.

Global equity markets delivered robust returns, with US stocks setting the pace. US equity markets surged to all-time highs (Graph 1.A, red line), supported by better than expected corporate earnings. US stocks, particularly those of large cap technology companies (the so-called “Magnificent 7”) reported solid earnings

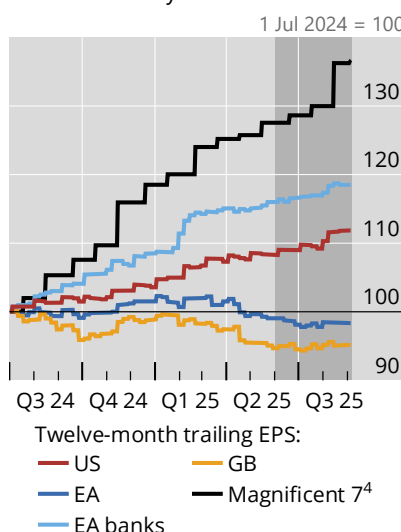
Equity markets remained resilient, with a strong rally in US technology stocks

Graph 1

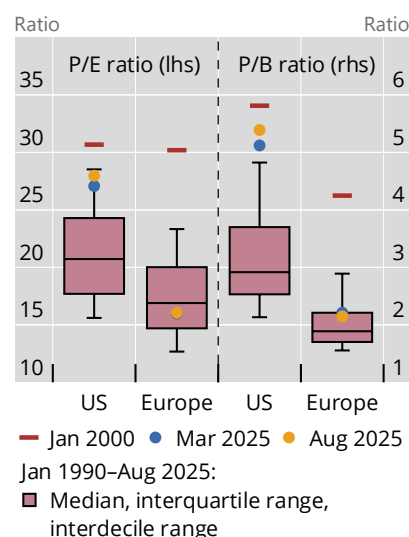
A. Equity markets posted solid gains^{1, 2}



B. Earnings of large US technology firms were hefty^{1, 3}



C. Elevated US equity valuations⁵



EPS = earnings per share; P/B = price-to-book; P/E = price/earnings.

The shaded area indicates 1 June–4 September 2025 (period under review).

^a Ninety-day tariff pause announced (9 April 2025). ^b The United States and China agree to 90-day tariff reductions (14 May 2025). ^c Signing of the Big Beautiful Bill (4 July 2025).

¹ EA = EURO STOXX 50; GB = FTSE 100; US = S&P 500. ² EMEs = MSCI EM; JP = Nikkei 225. ³ EA banks = EURO STOXX Banks; Magnificent 7 = Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla. ⁴ Simple average. ⁵ Europe = MSCI Europe; US = MSCI US.

Sources: Bloomberg; LSEG Datastream; BIS.

(Graph 1.B), which further fuelled investors' optimism. Japanese stocks also performed strongly (Graph 1.A, purple line). EME equities joined the rally (black line), outperforming those of many AEs. European equities performed more modestly and finished the period flat (blue line), reflecting weaker earnings growth and a pause in the recalibration of international portfolio allocations that prevailed in the first half of the year.

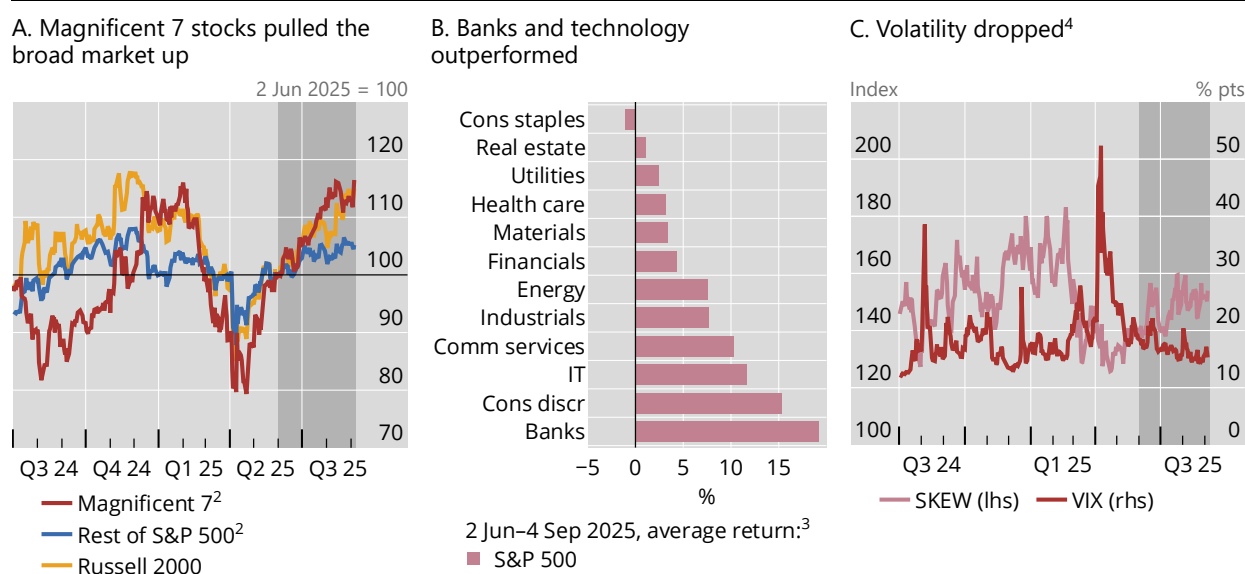
As a result of the stock market rally, equity valuations rose, overtaking their levels before the April shock. In the US, aggregate valuations were close to the top 10% of the historical distribution, and not far from the levels touched at the peak of the dotcom bubble (Graph 1.C). By contrast, European stock valuations were more in line with historical norms.

The rally in US equities was fuelled by large cap technology stocks and banks. The Magnificent 7 reported strong earnings and outperformed the rest of the S&P 500 index by about 11 percentage points (Graph 2.A). The AI trade boosted investor enthusiasm, with these companies capitalising on heightened demand for technology-driven solutions, in turn pushing the S&P 500 to all-time highs in August and overshadowing concerns over the future profitability of investment in AI. Other outperforming sectors included consumer discretionary and banks (Graph 2.B), which benefited from tailwinds from the early July fiscal package and a pause in the US-China trade conflict, as well as the upward-sloping yield curve in the case of banks. Investor confidence was further underpinned by resilient economic readings and consumer spending in the US, as well as expectations of policy easing, which offset increasing signs of weakness in the labour market.

The rally took place amid notably subdued volatility, which typically accompanies risk-on environments. Measures of equity market volatility such as the VIX declined

The Magnificent 7¹ pulled the market higher on decreasing volatility

Graph 2



Comm = communication; cons discr = consumer discretionary; IT = information technology.

The shaded area indicates 1 June–4 September 2025 (period under review).

¹ Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla. ² Median. ³ Simple average of the respective index constituents' returns. ⁴ SKEW = Cboe SKEW Index; VIX = Cboe Volatility Index.

Sources: Bloomberg; LSEG Workspace; BIS.

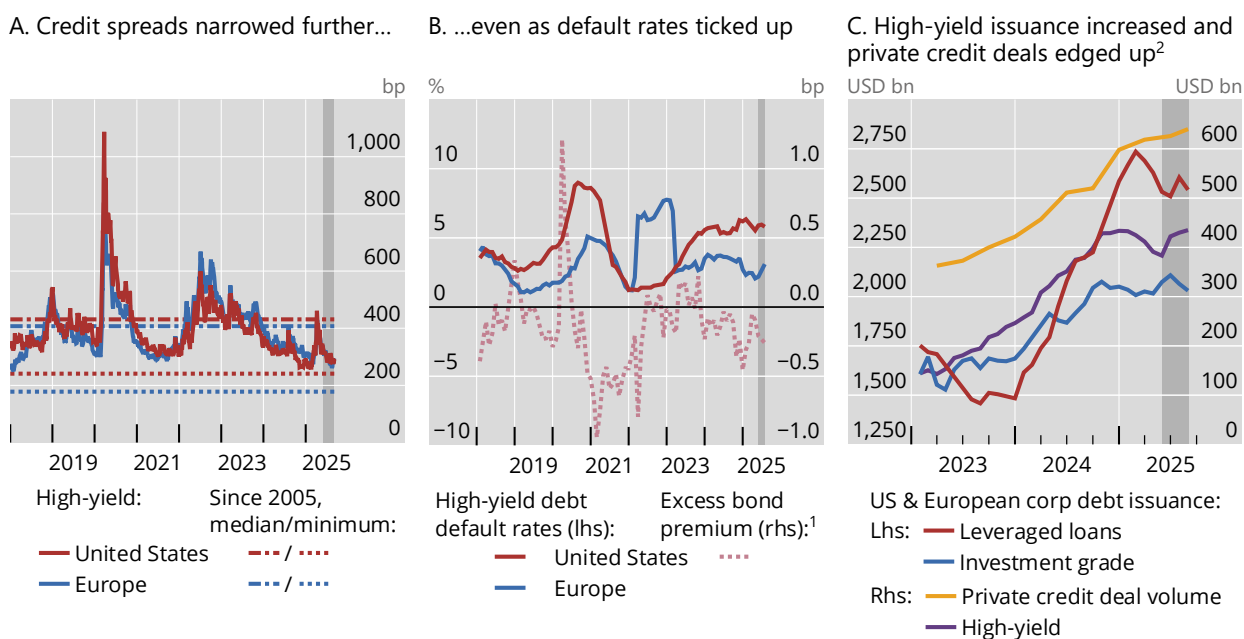
(Graph 2.C, red line). Volatility spikes during the period were mostly tied to macroeconomic data releases hinting at a possible slowdown, but ultimately proved short-lived. For example, the disappointing US non-farm payrolls data released in early August and September led to drops in the S&P 500. Another short bout of volatility coincided with higher than expected US and euro area inflation releases in June. Tariff news, by contrast, had an increasingly muted impact, as markets seemed to become less attentive to lingering trade tensions and focused more on factors other than tariffs, such as relatively positive macroeconomic readings and expectations of easier monetary policy (Box A).

Other signs of aggressive risk-taking were visible in options markets. The SKEW index turned more positive after 2 April and remained so over the review period, meaning that prices for upside exposure increased whereas those for downside protection decreased (Graph 2.C, pink line). These price moves may have also amplified the overall equity price increases via shifts in option dealers' hedging activities, as dealers presumably had to rebalance their downward protection hedges by buying equities during the June–July rally.

Broad risk-on sentiment was also evident in credit markets. Credit spreads in the high-yield segment compressed significantly in both the US and Europe, to be well below historical norms, and even close to historical lows in the US (Graph 3.A). The narrowing of spreads was associated with rising yields on government bonds, but such compression of spreads is at odds with default rates of high-yield bonds being elevated and marginally ticking up, especially in the US (Graph 3.B, red line). As such, narrow spreads mainly reflected reduced credit risk compensation by investors (pink line). In line with a risk-on environment, high-yield issuance also rebounded and private credit deals edged up (Graph 3.C, purple and yellow lines).

Credit markets remained buoyant

Graph 3



The shaded area indicates 1 June–4 September 2025 (period under review).

¹ Financial indicator introduced by Gilchrist and Zakrajšek (2012). ² Twelve-month moving sum.

Sources: G Favara, S Gilchrist, K Lewis and E Zakrajšek, "Updating the recession risk and the excess bond premium", *FEDS Notes*, 6 October 2016; S Gilchrist and E Zakrajšek, "Credit spreads and business cycle fluctuations", *American Economic Review*, vol 102, no 4, 2012; Board of Governors of the Federal Reserve System; Dealogic; ICE Data Indices; Moody's; PitchBook Data Inc; BIS.

Understanding the swift market recovery after the April 2025 tariff shock

Marco Lombardi, Gabor Pinter and Karamfil Todorov ^①

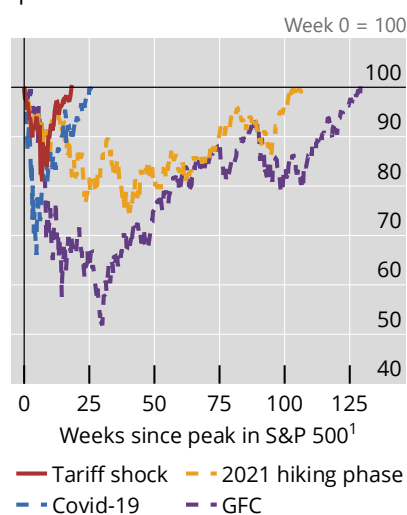
After the turmoil triggered by the tariff announcements on 2 April, market conditions across the globe stabilised remarkably quickly. In the United States, the S&P 500 resumed its upward trajectory, recovering losses and posting strong gains. Similarly, the VIX, which had more than doubled in the immediate aftermath of the tariff shock, retreated and fell below its pre-announcement levels, despite lingering political and trade uncertainty. This box shows that the market rebound through mid-May was mainly due to backtracking from the initial tariff shock, which offset the impact of the 2 April announcement. The protracted equity rally and compression in volatility from mid-May onwards were largely influenced by non-tariff-related news and developments. The box also illustrates that, in contrast with past episodes, retail investors, rather than institutional ones, bought into the rally.

The market recovery from the 2 April tariff announcement was notably faster than the one following the start of the Covid-19 pandemic and other recent market stress episodes (Graph A1.A, red line). For instance, the S&P 500 recovered all early-April losses by the end of the same month and surpassed its pre-stress peak in just under 20 weeks, setting new all-time highs. This stands in contrast to shallower recoveries following other crises, eg the Great Financial Crisis (GFC) (purple line).

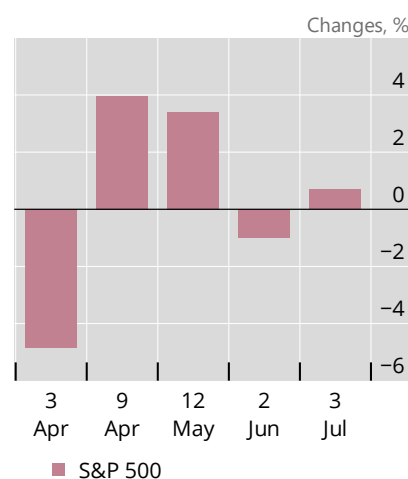
The 2025 market recovery was remarkably quick as tariff shocks faded

Graph A1

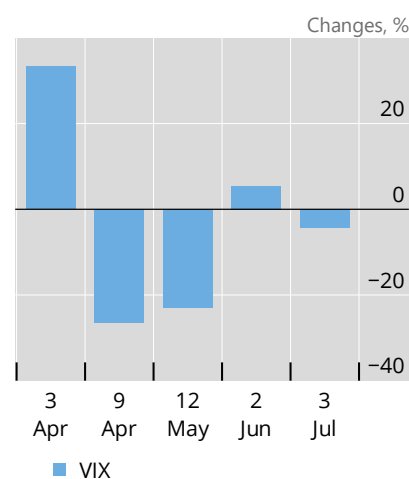
A. The 2025 recovery was remarkably quick



B. Tariffs had a diminishing impact on the S&P 500...²



C. ...and the VIX²



GFC = Great Financial Crisis.

¹ The peaks represent the end-of-month index level recorded in the month prior to each episode. ² The bars measure the contribution of the estimated tariff shocks to the S&P 500 and VIX, respectively, on selected dates, as identified using the event-targeted vector autoregression (ETVAR) methodology.

Sources: Pinter et al (2025); Federal Reserve Bank of St Louis; Bloomberg; authors' calculations.

The apparent disconnect between lingering uncertainty and market optimism raises questions about what drove the rebound. To shed light on this issue, we use a statistical model of movements in financial market variables.^② Assuming that a tariff shock was the only driver of the joint movements of financial market variables from 2 to 3 April, we can use the model to decompose subsequent asset price movements into two parts: (i) the impact of the initial tariff shock and subsequent (possibly offsetting) tariff announcements; and (ii) all other unrelated news and drivers. These "other shocks" are residual movements in the data that cannot be explained by the tariff shock; they reflect a multitude of factors such as macroeconomic and monetary policy surprises, corporate earnings news and fluctuations in risk appetite. The decomposition relies on a vector autoregression (VAR) model, estimated using daily data from January 2021, which features seven financial variables: the S&P 500, the VIX, copper prices, the one-year inflation swap rate, the one-year Treasury yield, the term spread (10 years minus one year) and the USD-EUR exchange rate.

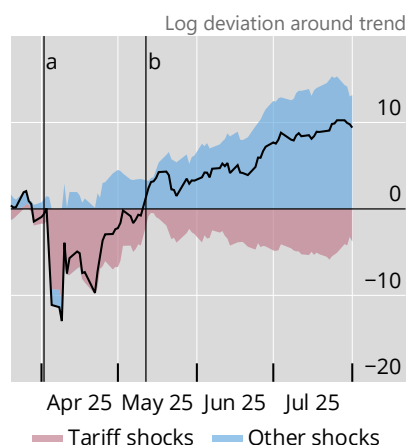
The tariff shocks identified by the model can be plausibly linked to market movements on the days of key tariff news (Graphs A1.B and A1.C). For instance, when tariffs were rolled back or paused, such as on 9 April or 12 May, the tariff shock led the S&P 500 to post large positive gains (Graph A1.B) and the VIX to compress (Graph A1.C).

A full historical decomposition of movements in the S&P 500 and the VIX reveals that the initial market rebound through mid-May can be primarily attributed to subsequent revisions of the initial tariff shock, which ended up offsetting the negative effect of the 2 April announcement (Graphs A2.A and A2.B, red area). These include the 9 April pause on tariff implementation and the 12 May China–US truce, both of which contributed positively to equity prices and lowered the VIX.

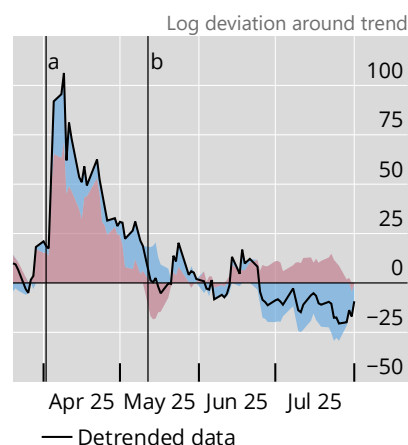
The negative effects of tariff shocks were offset by other shocks

Graph A2

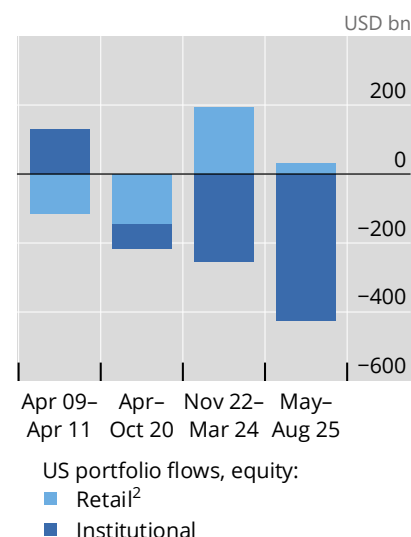
A. Decomposition of the S&P 500 index¹



B. Decomposition of the VIX¹



C. Retail investors were net buyers, in contrast to institutional ones



^a “Liberation Day” (2 April 2025). ^b China–US truce (12 May 2025).

¹ The graph shows the results from a historical decomposition applied to the event-targeted vector autoregression (ETVAR) model of Pinter et al (2025) with a tariff shock identified assuming that movements in the variables during 2–3 April were due only to this shock. The black solid line shows the time series of the S&P 500 index (in panel A) and of the VIX index (in panel B) around the trend estimated by the VAR. The log deviations are multiplied by 100. ² Retail is everything other than institutional.

Sources: Pinter et al (2025); Federal Reserve Bank of St Louis; Bloomberg; LSEG Lipper; authors’ calculations.

The continued rally in equity markets and decline in volatility from mid-May onwards appear to have been driven largely by news unrelated to tariffs (Graphs A2.A and A2.B, blue area), for instance, resilient macroeconomic readings and a better than expected earnings season. In contrast, tariff shocks turned increasingly adverse again during June and July, exerting renewed pressure on markets. These effects probably stemmed from news related to tariff negotiations and the 1 August deadline, marking the end of the 90-day pause. Yet these adverse effects appear to have been dominated by non-tariff-related news triggering renewed optimism in risky asset markets. They may have also been amplified by retail investors. Even as institutional investors withdrew from equity markets, retail investors were on net “buyers of the dip”, as visible from fund flows (Graph A2.C). These dynamics were somewhat unusual compared with past stress episodes (eg the GFC), when retail investors were net sellers and institutional investors were net buyers.

Overall, our analysis indicates that about 75% of the rise in the S&P 500 between the trough on 9 April and end-July was driven by positive surprises unrelated to tariffs. While policy reversals helped markets look through the initial shock, other factors, such as corporate earnings and the strength of macro fundamentals, ultimately underpinned the resilience of stock markets and risk sentiment.

① The views expressed are those of the authors and do not necessarily reflect the views of the BIS or its member central banks. ② For further details on this event-targeted vector autoregression (ETVAR) framework during the April 2025 shock, see G Pinter, F Smets and U Üslü, “Market whiplash after the 2025 tariff shock: an event-targeted VAR approach”, *BIS Working Papers*, no 1282, August 2025.

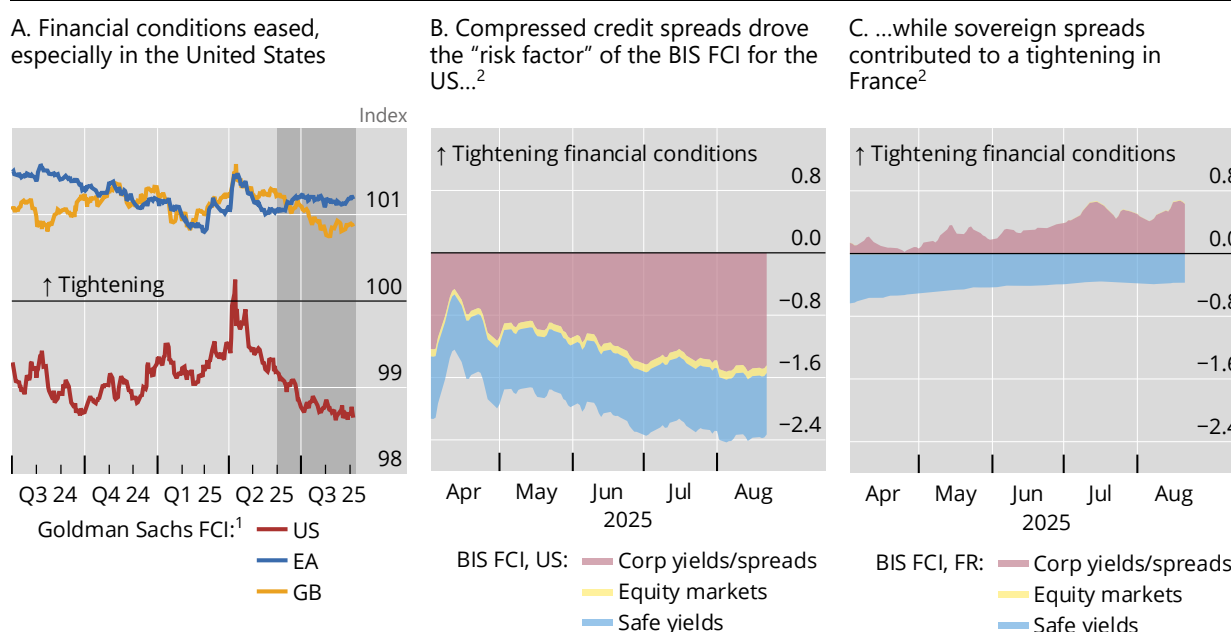
The prevailing risk-on sentiment was a key ingredient of generally easing financial conditions. Conditions relaxed significantly in the US, as well as in the United Kingdom (Graph 4.A). Those in the euro area remained broadly unchanged, with more lacklustre equity performance. Narrower credit spreads and buoyant corporate bond markets were the key drivers of the easing in the “risk factor” underlying the BIS measure of financial conditions.² In the US, corporate yields and spreads led the risk factor to ease further, despite the relatively high level of government bond yields (Graph 4.B). In France, an increase in credit and sovereign spreads, not only vis-à-vis German bunds but also Italian treasuries (also see below), contributed to a steady tightening of the risk factor (Graph 4.C).

The risk-on environment was also evident from the dynamics of digital assets and gold. Cryptoassets rallied, aligning with the risk-on mood (Graph 5.A) and supported by the GENIUS Act, which provided further tailwinds. In the first part of the review period, gold’s appreciation paused, consistent with optimistic investors shifting portfolio flows towards growth-oriented assets, while the demand for safe haven assets waned. Yet towards the end of August gold prices resumed their march upwards, in line with emerging signs of unease about longer-run prospects.

Another unusual development in the general risk-on environment was the dynamics of the US dollar. Initially, the dollar stayed on the depreciation path entered in April owing to shifts in investors’ hedging practices and some rebalancing of

Financial conditions eased on the back of compressed spreads

Graph 4



FCI = financial conditions index.

The shaded area indicates 1 June–4 September 2025 (period under review).

¹ A value of 100 indicates average conditions. A higher (lower) value indicates tighter (looser) conditions. ² Decomposition of the “risk factor” according to the methodology by Lombardi et al (2025).

Sources: M Lombardi, C Manea and A Schrimpf, “Financial conditions and the macroeconomy: a two-factor view”, *BIS Working Papers*, no 1272, June 2025; Goldman Sachs Global Investment Research.

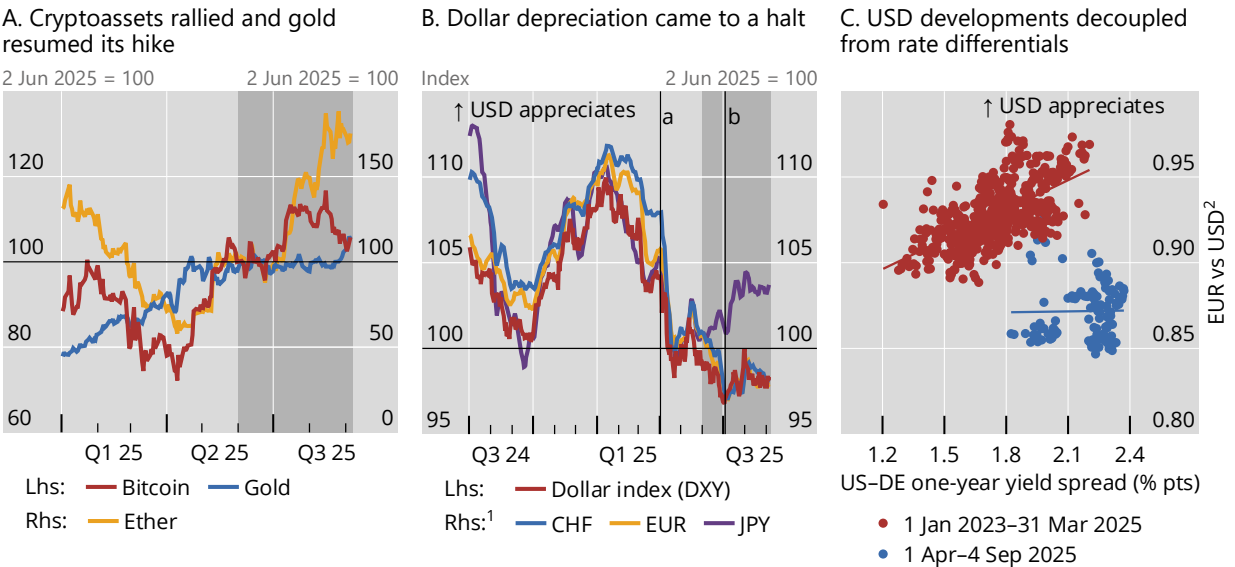
² See M Lombardi, C Manea and A Schrimpf, “Financial conditions and the macroeconomy: a two-factor view”, *BIS Working Papers*, no 1272, June 2025.

portfolio flows away from dollar assets (Graph 5.B, red line). The depreciation was sustained against the Swiss franc and the euro (blue and yellow lines), while the Japanese yen diverged from other currencies and lost ground against the dollar (purple line). Yet the greenback’s depreciation came to a halt after the unveiling of the fiscal package in July: the dollar appreciated while equity markets were posting strong gains. This appreciation is somewhat at odds with the dollar’s tendency to soften in periods of heightened risk-taking.³

US dollar dynamics during the review period also did not square well with interest rate differentials. Typically, higher differentials between short-term yields on US Treasuries and German bunds have been associated with an appreciation of the dollar against the euro (Graph 5.C, red dots). Yet this historical pattern broke down in the aftermath of the April 2025 tariff-related turbulence (blue dots) when positive and widening yield differentials went hand in hand with dollar depreciation. As US rates declined after July while those in the euro area edged up, the interest rate differential narrowed, but the dollar actually firmed. While inflows into US equity and bond funds probably supported it (Box B), the appreciation in this phase might also be related in part to some unwinding of hedging activity that had taken place in April and May.⁴

The dollar behaved unusually for a risk-on phase

Graph 5



The shaded area indicates 1 June–4 September 2025 (period under review).
 a “Liberation Day” (2 April 2025). b Big Beautiful Bill signing (4 July 2025).
¹ Five-day moving average. ² EUR for 1 USD.

Sources: Bloomberg; CoinDesk Data; LSEG Datastream; national data; BIS.

³ See S Avdjiev, V Bruno, C Koch and H S Shin, “The dollar exchange rate as a global risk factor: evidence from investment”, *IMF Economic Review*, vol 67, no 1, pp 151–73, March 2018.
⁴ See H S Shin, P Wooldridge and D Xia, “US dollar’s slide in April 2025: the role of FX hedging”, *BIS Bulletin*, no 105, June 2025.

The safe haven properties of US Treasuries and portfolio flows of global investors

Frederic Boissay and Wenqian Huang ①

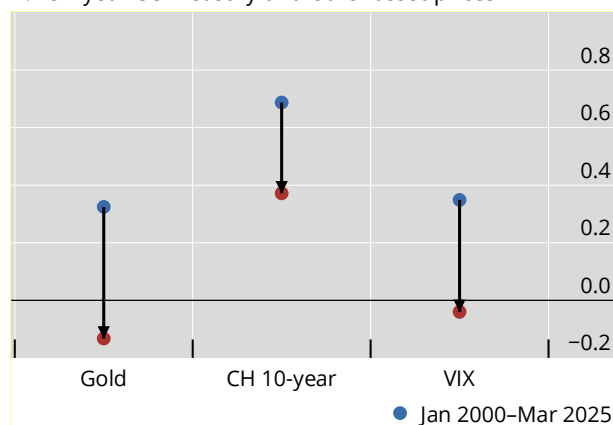
The US tariff announcements in early April 2025 marked a shift in long-established relationships involving US Treasuries. Historically, as safe haven assets, US Treasuries tended to exhibit positive correlations with other safe assets – eg bonds issued by highly rated sovereigns or gold – as well as with gauges of uncertainty and risk appetite – such as the VIX (Graph B1.A, blue dots).② However, these correlations have approached zero since April (red dots), possibly indicating a weakening of US Treasuries' safe haven properties. By contrast, the prices in other core bond markets have not been subject to similar shifts. Notably, the positive correlation between the price of the German bund and the VIX has (if anything) increased (Graph B1.B).

Shifts in asset price correlations¹

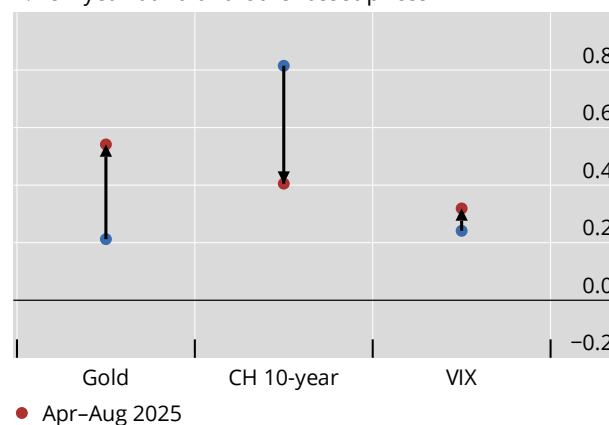
Correlation

Graph B1

A. Ten-year US Treasury and other asset prices



B. Ten-year bund and other asset prices



¹ Dots show the median of pairwise correlations of the changes in log prices over a two-month rolling window. Sovereign bond prices are based on the corresponding 10-year zero coupon yields. For Aug 2025, data until 21 Aug 2025.

Sources: Bloomberg; authors' calculations.

The fading correlations coincided with elevated policy uncertainties in the United States, prompting broader questions about a potential structural repositioning by global investors away from US assets, for both bonds and equities. Also, discussions intensified on which other countries and assets might benefit from any rotations in portfolio flows.

However, the evidence available – at least so far – does not show signs of a material portfolio reallocation away from US assets. While some non-US investors sold significant volumes of US assets in April, most of these flows reversed in May and June (Graph B2.A). Strong underlying fundamentals continue to anchor global demand for US assets, providing additional support for their momentum, as described in the main text. The favourable sentiment towards US assets aligns with the resilience of US corporate earnings and the unmatched depth of US financial markets. It may have also been bolstered by diminishing concerns about the long-term effects of trade conflicts (Box A). The outsize holdings of US assets by global investors, coupled with the slow pace of strategic asset allocation decisions and mandates, indicate that any significant portfolio shift away from US assets is likely to be gradual.

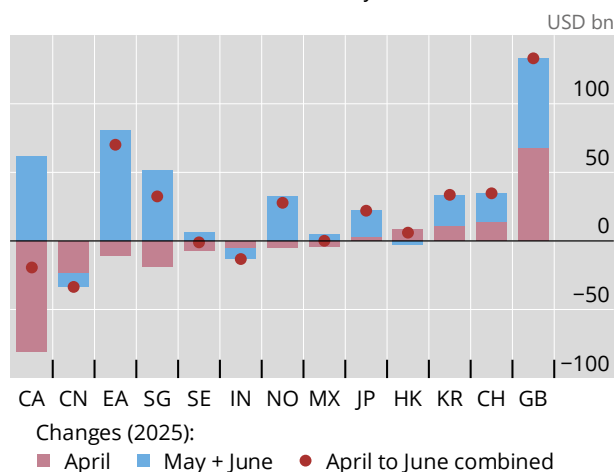
That said, global investors have been showing signs of adjusting their geographical exposures. During the second quarter of 2025, flows into sovereign bond funds targeting euro area countries and other advanced economies surpassed those targeting the United States (Graph B2.B, bars versus red and yellow lines). Since the

respective assets are seen as close substitutes, this development would be consistent with global investors seeking greater portfolio diversification. In addition, fund flows to sovereign bonds of Asian emerging market economies (EMEs) were particularly strong in June and July (purple line). The recent fund flows to Asian EMEs were probably fuelled by a combination of factors, including relatively low global interest rates, a persistently weaker US dollar^② and strong domestic macroeconomic fundamentals.

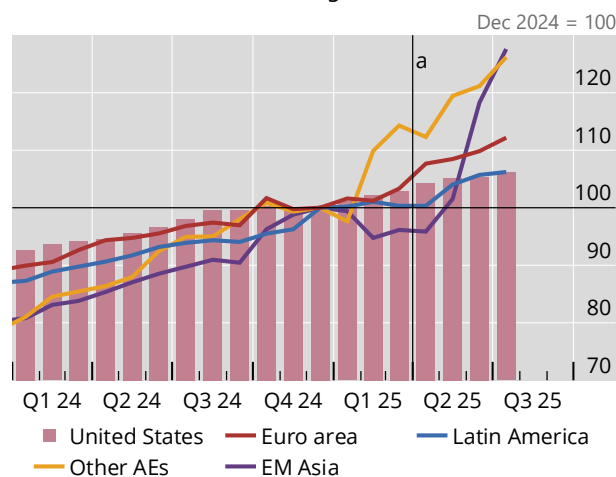
US asset holdings: stable overall despite geographical diversification

Graph B2

A. Overall sales of US assets swiftly reversed¹



B. Cumulative fund flows into government bonds²



^a "Liberation Day" (2 Apr 2025).

¹ Change in foreign investor holdings of US securities (including equity investments). ² Cumulation since January 2011. Emerging (EM) Asia = CN, HK, IN, KR, SG and TH; euro area = BE, DE, ES, FR, IT and NL; Latin America = AR, BR and MX; other AEs = AU, CA, CH, JP and SE.

Sources: US Treasury International Capital (TIC) System; EPFR; authors' calculations.

① The views expressed are those of the authors and do not necessarily reflect the views of the BIS or its member central banks. ② The US dollar weakened significantly against a broad basket of currencies in early April. The weakening persisted beyond April as global investors reportedly increased their hedge ratios for dollar exposures ex post via foreign exchange derivatives (see H S Shin, P Wooldridge and D Xia, "US dollar's slide in April 2025: the role of FX hedging," *BIS Bulletin*, no 105, June 2025). Thus, while global investors by and large held on to US assets, approaches towards the management of the inherent currency risk appear to have become more cautious.

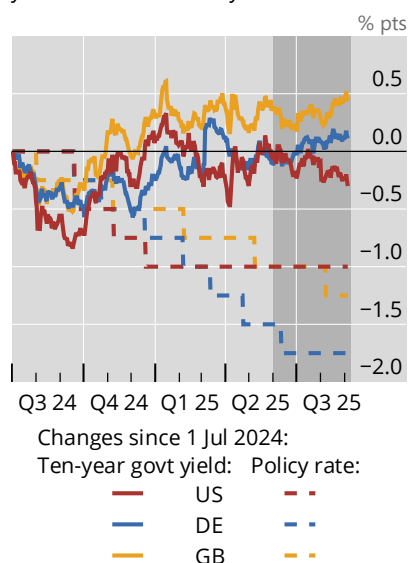
Bond markets await further policy easing

The risk-on sentiment was also encouraged by actual and expected monetary easing. In the short segment of the yield curve, market pricing seemed consistent with investors' eyeing policy rate cuts, and more broadly being confident that policy interventions could mitigate the likelihood of adverse scenarios. At the same time, long-term yields remained elevated and the yield curve even steepened at its very long end, possibly reflecting unease over the outlook in the longer run.

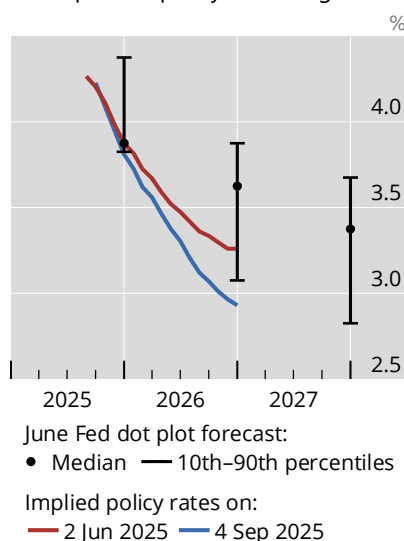
Markets expected more aggressive easing

Graph 6

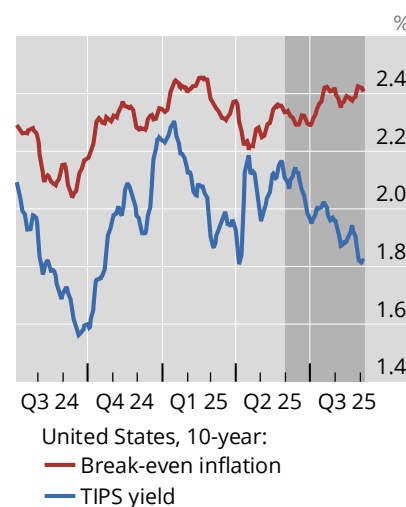
A. As policy rates were cut, long-term yields moved sideways



B. Market participants expected a faster pace of policy loosening...



C. ...reflected in lower real yields¹



The shaded area indicates 1 June–4 September 2025 (period under review).

¹ Five-day moving average.

Sources: Board of Governors of the Federal Reserve System; Bloomberg; LSEG Datastream; national data; BIS.

Amid emerging concerns of an economic slowdown, and with inflation apparently in check, central banks in major economies continued lowering policy rates. The ECB and the Bank of England cut their policy rates by 25 basis points (Graph 6.A), and other central banks followed suit. The Federal Reserve kept the federal funds rate on hold at its July policy meeting. Yet US non-farm payrolls releases in early August and September surprised on the downside, while previous readings were also revised downwards, hinting at a cooling of the labour market. In mid-August, the CPI release seemed to at least temporarily dispel concerns over the inflationary effects of tariffs, as core goods prices increased only marginally.

Increasing evidence of a slowdown and subdued inflationary pressures from tariffs so far also led market participants to price more aggressive rate cuts in the near future (Graph 6.B). The dovish tone of the Jackson Hole meeting at the end of August fuelled expectations of upcoming rate cuts and supported further risk-taking. Overall, market participants progressively revised their expectations on the policy stance downwards, relative to FOMC members' own projections made in June.

Notwithstanding the policy easing in major AEs, long-term bond yields stayed elevated across those economies (Graph 6.A). In the US, 10-year government bond yields were dragged in different directions by expectations of an easier policy stance and longer-term concerns over fiscal prospects. While the former was the key driver of a decline in real rates, the latter may have been reflected in break-even inflation rates ticking up (Graph 6.C). Long-term rates generally rose in other AEs, including the euro area and the UK.

Yield curves steepened considerably at the very long end in all major AEs. This could also reflect structurally weaker demand from long-term investors such as

pension funds and insurers. Term spreads between 30- and 10-year government bonds increased steadily over the review period, especially in the UK, France and Germany (Graph 7.A). In the UK, yields on longer-term gilts were particularly affected by weaker demand by institutional investors, following the UK government's liability-driven investment (LDI) reform. In Japan, longer-term rates rose steadily after their spurt in the second quarter, reflecting political uncertainty clouding the fiscal outlook.

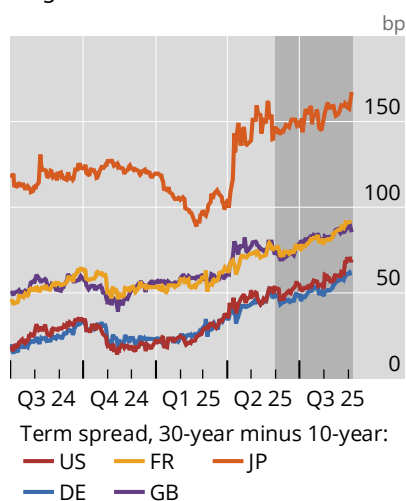
In the euro area, fiscal developments also took centre stage. On top of tariff-related uncertainties, the increase of longer-term rates in Germany may reflect expectations of a larger supply of government bonds, given the fiscal expansion plans. Fiscal concerns led the yields on French government bonds to increase even faster, as mounting political challenges could thwart the fiscal outlook. This led to an increase in the spread of French over German government bonds (Graph 7.B, red line). At the same time, other sovereign spreads in the euro area continued to compress. For example, the spread of Italian versus German bonds reached levels not seen since 2010, settling close to the French sovereign spread in August (blue line).

Pressures on long-term rates also reflected rising inflation concerns in the medium to long run. In the US, the entire term structure of market-based inflation expectations shifted upwards by around 10 basis points over the review period, a move that gained further impetus in August after the Jackson Hole meeting (Graph 7.C).

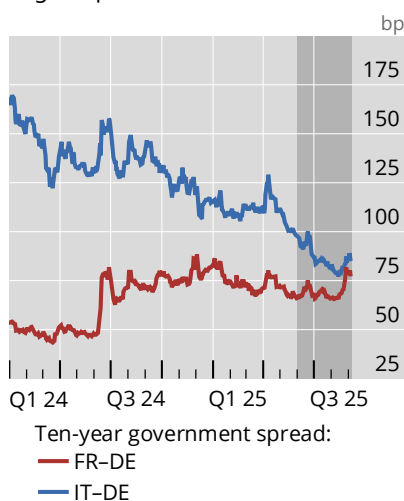
The ultra-long end of yield curves signals unease

Graph 7

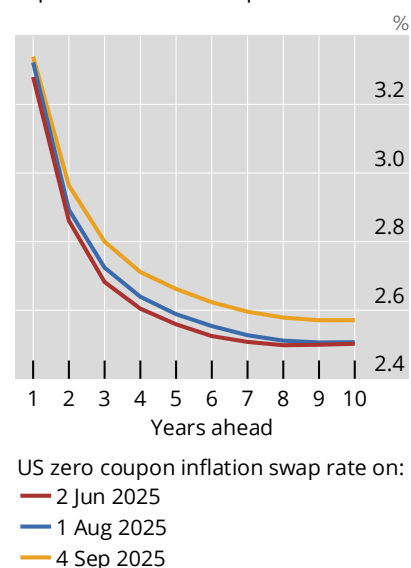
A. Yield curves steepened at the very long end



B. Sovereign spreads of France edged up



C. US market-implied inflation expectations shifted upwards



The shaded area indicates 1 June–4 September 2025 (period under review).

Sources: Bloomberg; BIS.

EMEs joined the risk-on rally

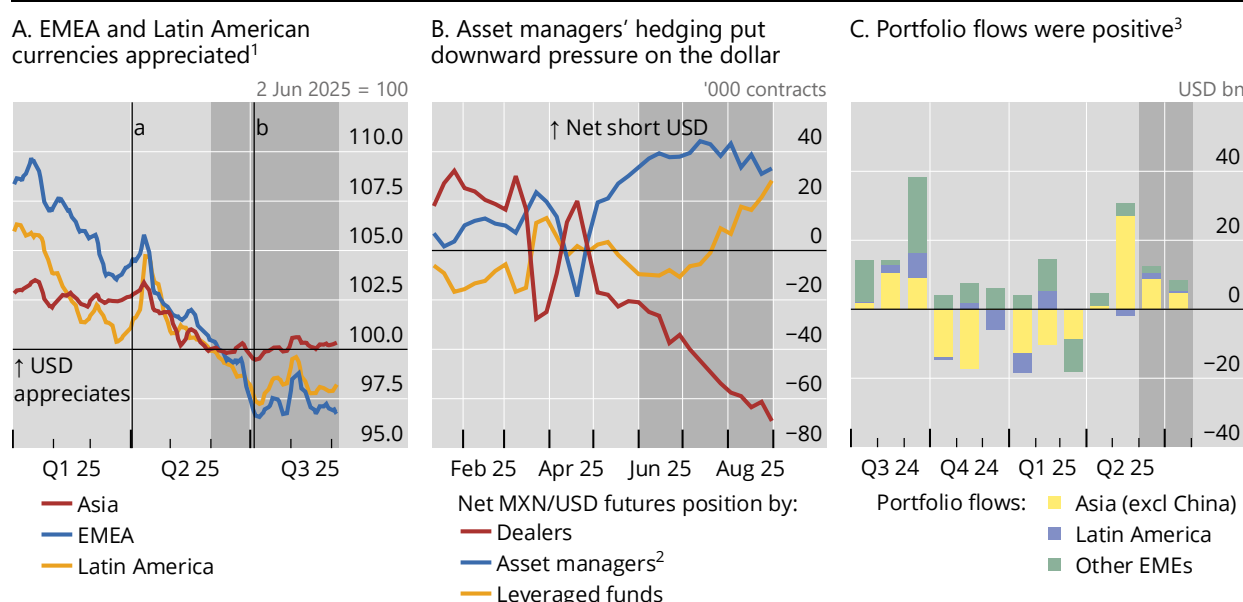
EMEs capitalised on the global risk-on sentiment, benefiting from US dollar weakness, subdued corporate bond yields and markets paying less attention to lingering trade tensions. EME currencies, bonds and equities saw gains, with regional variations reflecting differences in local economic dynamics.

The risk-on environment went hand in hand with the appreciation of several EME currencies. Currencies in Latin America and Europe, the Middle East and Africa (EMEA) led the appreciation, whereas Asian currencies were mostly flat, with some exceptions (Graph 8.A). The appreciation of some EME currencies partly indicated large asset managers raising currency hedge ratios on their US dollar asset holdings after April. Public data on currency futures show that asset managers increased their long positions in EME currencies such as the Mexican peso, effectively shorting the US dollar vis-à-vis these currencies (Graph 8.B). Portfolio flows maintained their momentum from the second quarter and were positive on net (Graph 8.C).

Long-term yields in EMEs showed regional divergence and bond issuance picked up. In Latin America, yields ticked lower, reflecting uneven growth and a generally higher sensitivity to the waxing and waning of US trade policy uncertainties (Graph 9.A, yellow line). Brazil, which was hit by a hefty 50% US tariff, was an exception, even though a policy rate increase aimed at countering inflationary pressures also contributed to higher yields. In Asia and EMEA, yields remained

EME currencies appreciated amid portfolio inflows

Graph 8



EMEA = Europe, the Middle East and Africa.

The shaded area indicates 1 June–4 September 2025 (period under review).

^a "Liberation Day" (2 April 2025). ^b Big Beautiful Bill signing (4 July 2025).

¹ Simple average. Asia = CN, HK, ID, IN, KR, MY, SG and TH; EMEA = CZ, HU, IL, PL and ZA; Latin America = BR, CL, CO, MX and PE. Five-day moving average. ² An increase in long futures positions in MXN/USD indicates that asset managers are shorting the US dollar. ³ Asia = ID, IN, KR, LK, MN, MY, PH, PK, TH, TW and VN; Latin America = BR, CL, CO and MX; other EMEs = BG, CZ, EE, GH, HU, KE, LB, LT, LV, MK, PL, QA, RO, RS, RU, SA, SI, TR, UA and ZA.

Sources: Commodity Futures Trading Commission; IIF; national data; BIS.

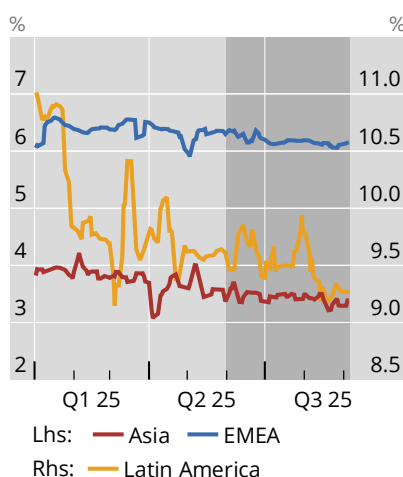
broadly flat, reflecting less monetary policy easing and stable investor sentiment (red and blue lines). EME sovereign bond issuance picked up pace after lacklustre performance in the first quarter, echoing the improved risk sentiment (Graph 9.B, pink bars) as global investors sought higher yields in EME debt markets. Dollar-denominated EME bonds were also supported by the risk-on environment and saw a notable compression in spreads (red line).

In line with the broad risk-on sentiment, EME equity markets rallied. In Asia, markets in China, Indonesia and Korea led the gains, driven by the 90-day US-China tariff pause in June, which temporarily eased trade tensions (Graph 9.C). China's markets also benefited from stabilising economic data and stimulus measures, such as infrastructure spending, which boosted investor confidence. Equities in Hong Kong SAR rose in tandem, supported by its linkage to Chinese markets, and strong financial sector performance. There was some regional divergence in Latin America, with Colombian equities outperforming those in Brazil and Mexico, even though Colombia faced headwinds amid fiscal and tariff uncertainty.

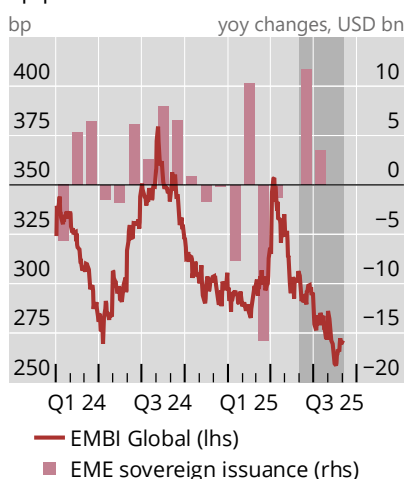
EME yields were stable and stocks joined the risk-on rally

Graph 9

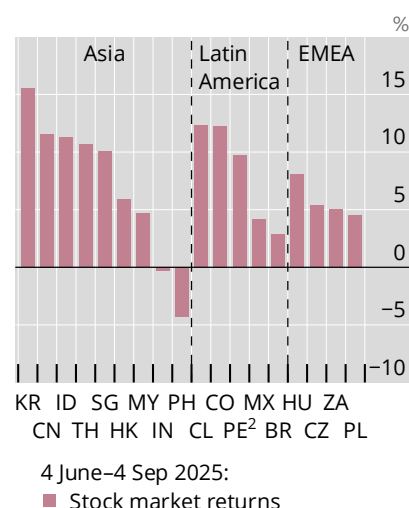
A. Long-term yields were broadly flat in Asia and EMEA¹



B. EME public debt issuance picked up pace



C. Asian EMEs led the gains



EMEA = Europe, the Middle East and Africa.

The shaded area indicates 1 June–4 September 2025 (period under review).

¹ Simple average. Asia = CN, HK, ID, IN, KR, MY, SG and TH; EMEA = CZ, HU, IL, PL and ZA; Latin America = BR, CL, CO, MX and PE. Five-day moving average. ² For PE, stock market return between 4 June and 29 August 2025.

Sources: Bloomberg; Dealogic; JPMorgan Chase; national data; BIS.