



T.RowePrice



Market Pulse

Global Fixed Income Update

April 2025

Ahead
of the
Curve

Confirmation bias and the challenge of a “tariffs first” approach

In November 2021, The World Economic Forum proactively leaned into behavioral finance when it penned its article, “24 cognitive biases that are warping your perception of reality,” as a reminder that human brains are “hard-wired to make all kinds of mental mistakes...” that can impact human judgment. Among the vulnerabilities highlighted was confirmation bias; in other words, the tendency to latch on to news or ideas that myopically confirm existing beliefs even when uninformed. Such a behavioral perspective appears to have been on display in recent months. For example, in the lead-up to President Trump’s inauguration, markets quickly reflected growing optimism surrounding deregulation and tax cuts on an already sound U.S. economy. In the weeks that have passed since, and especially in the wake of President Trump’s “Liberation Day” announcement, markets have grappled with increased uncertainty and the complexities of this “tariffs first” approach that, in our view, escalates execution risk for an ambitious agenda when you consider the following:

- **Tariffs weren’t first during Trump 1.0**—The first Trump administration (Trump 1.0) didn’t pursue tariff policy until after the tax cuts of 2017. As a result, when capital markets and the U.S. economy needed Federal Reserve (Fed) assistance in late 2018 when the S&P 500 dropped approximately 19%, Fed Chair Jerome Powell was able to provide policy help.
- **Tariffs during Trump 1.0 were limited in comparison**—Trump 1.0 tariffs were limited and targeted, focusing on specific products and regions, unlike today’s broader proposals.
- **Trump 2.0 introduced tariffs first**—Tariff policy under the second Trump term (Trump 2.0) has been the economic focus of the first 90 days of the administration, and in its current form it is more encompassing and punitive from a historical perspective. In addition to a baseline tariff of 10% being unilaterally applied across the world, reciprocal tariff enhancements also exist, which may be bilaterally negotiated down on a country-by-country basis. While the Trump 1.0 tariffs were generally absorbed by corporations, American consumers could see more inflationary effects with the announced tariff policy even if some reciprocal tariffs are negotiated down. Interestingly, even with the possibility of worst-case tariffs potentially being reduced, in contrast to the relatively benign impact of tariffs during the Trump 1.0 years, when corporations absorbed much of the related costs, the impact of Trump 2.0 tariffs could be more significant. As proposed, these tariffs would represent one of the largest tax increases in American

history. Note: The Trump administration announced a 90-day pause for tariffs on all countries except China on April 9.

“Sequencing” risk for the U.S. economy

To the extent that tariff policy could represent a material cost hike for U.S. consumers, a resilient and consumer-driven U.S. economy now suddenly faces headwinds and rising concerns surrounding recession. Meanwhile, today’s Fed, in contrast to 2018, faces aggressive tariff policy that, while restrictive to growth, also introduces heightened inflationary pressures from a near-term perspective. As a result, the Fed’s typical reaction function to economic weakness may be diminished, potentially increasing the need for domestic stimulative fiscal policy.

The good news is that ambitious budget legislation is being worked on in Congress. Part of this encompassing legislation intends to not only permanently extend the Tax Cuts and Jobs Act of 2017 but also seeks to add an additional USD 1.5 trillion in tax reductions along with other economic inducements. However, this legislation needs to pass quickly (before Congress’s August recess) as such policy will likely have a lagging impact on the economy.

April Fixed Income Policy Week

In the wake of capital market volatility that immediately followed President Trump’s “Liberation Day” announcement and against the backdrop described above, the T. Rowe Price Fixed Income Division held its April Policy Week. Highlights from the week’s meetings include:

From a sum of the parts perspective, concerns exist for the global economy—An important component within Policy Week is to identify strengths and weaknesses among the major economies of the world, with highlights provided below:

- **U.S. economy**—Is currently viewed as neutral in the near term. While headwinds continue to form, U.S. service and manufacturing Purchasing Managers’ Indexes (PMIs) remain above 50 (anything 50 and above is viewed as being expansive) while the unemployment rate remains constructive at 4.2%. Medium term, the U.S. economy is also viewed as neutral in anticipation of stimulative fiscal policy being delivered in the next few months. While neutral, prospective concerns remain for the U.S. economy as the Fed is unlikely, in our view, to be able to deliver the four 25-basis-point rate cuts the market had quickly priced in before year-end. **After all, the brewing trade war has been started by the U.S., meaning that the U.S. will experience elevated inflation risk relative to the rest of the world, which handcuffs the Fed to some extent.** Additional concern exists regarding potential fiscal policy being an effective offset to the recent growth weakness that is expected to result from heightened tariffs as well as the diminished contribution of the Biden administration’s fiscal policies.
- **Eurozone economy**—Heightened tariff risk is expected to have a negative and immediate impact on manufacturing PMIs in the near term. While near-term growth prospects appear weakened, the European Central Bank (ECB) is a deflation beneficiary of diminished global trade prospects. This leaves the ECB, in contrast to the Fed, free to methodically reduce its 2.65% policy rate toward the 1.25% range by year-end. Meanwhile, aggressive fiscal policy recently introduced by Germany to address defense and infrastructure needs may be a future tailwind for the eurozone economy. As a result, while our view is weaker for Europe’s economy in the near term, it is more constructive from a medium-term perspective.
- **China economy**—Escalating tariff risk with the U.S. now serves as a near-term headwind to what had been promising recent trends in its Manufacturing PMIs, which moderates our view in the near term. The outlook for China is more constructive over the medium term as its fiscal policy, which has been moderately expansionary in recent months, is likely to expand in the event of a worsening trade war with

the U.S. And to the extent that it is deemed necessary, China may also seek a controlled devaluation of its currency as a countermeasure to its worsening trade relationship with the U.S.

U.S. Inflation—Interestingly, as referenced above, the U.S. has the worst near-term inflation expectations among the world’s primary economies directly as a result of a brewing trade war of its own making. To this end, the core consumer price index in the U.S. is currently forecast to increase, which is being driven by an anticipated tariff shock. Our fixed income investment professionals acknowledged that this inflation path is uncertain due to questions about how much of the increased costs that corporations will absorb as well as unknowns around potential bilateral trade deals that could alter the future path of tariff policy.

The Fed and 10-year Treasury rate perspective—Uncertainty regarding tariff policy and its inflationary impact is likely to have the Fed cautious from a near-term policy perspective. Nevertheless, with the Fed’s existing policy rate being restrictive, based on internal consensus views on the neutral fed funds rate, our U.S. economist continues to expect two 25-basis-point rate cuts in the second half of 2025 as the economy has showed signs of slowing. Between uncertainty stemming from tariffs as well as prospective fiscal policy, much remains unknown as to where domestic inflation settles by year-end.

And while future policy easing is anticipated, 10-year and longer-maturity U.S. rates are expected to rise from current levels as questions exist on who will buy elevated U.S. Treasury supply that is expected to follow the eventual resolution of the U.S. debt ceiling. Moreover, rising inflation and expansive fiscal policy may put upward pressure on longer-term Treasury yields.

While credit markets remain open and supported at higher spread levels, “cracks” are forming—As Treasury yields have climbed in recent days, so have credit spreads, with some sectors approaching spread levels not seen since 2009. Often, rising spreads can bring opportunities for active managers, supported by fundamental credit analysis, to identify mispriced issuers in credit sectors.

Neutral on the U.S. dollar—In the wake of what has been a materially weaker U.S. dollar in recent weeks, the expectations for accommodative fiscal policy point toward a near-term neutral view on the U.S. dollar. One additional point of caution in the current environment is that the phenomenon of higher U.S. Treasury yields and a weaker U.S. dollar is a potential indicator of foreign capital flight, which has occurred in recent days.

Bottom line—Through disciplined investment processes, anchored by our Policy Week in conjunction with expanding quantitative capabilities and global bottom-up research efforts, T. Rowe Price’s fixed income investment professionals are qualified to actively manage the array of strategies through an investment environment that looks to be volatile in the months ahead.

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