T. Rowe Price

# Market Pulse

## Global Fixed Income Update

February 2025

Ahead of the Curve

**Alpha generation doesn’t occur by following consensus**

Right now, the global economy is arguably growing just enough to avoid concern. China’s consumption economy continues to flounder, which negatively impacts Europe’s export-based economy. Emerging markets, meanwhile, offer a mixed bag from an economic perspective but are still proving to be resilient overall in the face of global uncertainty, which leaves the health of the world’s largest economy (the United States) as having heightened importance in the current environment. Fortunately, the U.S., driven by artificial intelligence tech-oriented and onshoring investment supported by aggressive fiscal policy, has proven to be “exceptional” when viewed on the global stage. This is good news as “favorable enough” global growth, anchored by the U.S., serves as a foundation for global equities despite the furious news flow and uncertainty that has accompanied President Trump’s second term in office.

While the current global growth story referenced above is good, it comes with an important disclaimer as it relates to the U.S. In recent years, and including last summer, there has been skepticism surrounding the durability of U.S. economic exceptionalism. With this said, the T. Rowe Price Fixed Income Division, based on fundamental research informed by our global fixed income and equity research platforms, has looked through the recent noise that has clouded the conversation around the health of the U.S. economy.

**Skepticism and opportunities in global fixed income markets**

Importantly, this conviction in U.S. economic resilience has allowed the platform overall to maintain a bias toward credit markets, which have performed well in recent years. This tailwind from solid credit performance, when combined with prudent duration management, can be supportive for fixed income investors. One phenomenon to note here is that the market’s reticence toward the U.S. economy amid significant noise can be viewed as an opportunity for our fixed income investment professionals to go against the “consensus grain.”

And while the T. Rowe Price economics team remains constructive on the U.S. economy coming out of the February Fixed Income Policy Week, the team has modestly lowered its conviction rating on the world’s leading economy for one primary reason, which is that market consensus now seems to overwhelmingly believe in the unrelenting strength of the U.S. economy. This consensus shift is helping drive spreads across risk sectors to historically tight levels. In other words, some parts of U.S. fixed income (and equity) markets are now “priced for perfection,” which leaves room for an active fixed income approach to question such unbridled enthusiasm.

Against this backdrop and an environment of stretched valuations, members of the T. Rowe Price Fixed Income platform are asking questions and prudently repositioning portfolios where warranted**.** Highlights from the division’s February Policy Week include:

- **U.S. inflation**: The U.S. January inflation print released on February 12 was elevated with its 0.4% month-over-month and 3.3% year-over-year pace. While this inflation is alarming on its surface and for a market seeking affirmation that rate cuts may be coming, the owners equivalent rent (a primary factor in driving elevated inflation trends in recent years) has stabilized. Meanwhile, there may also be a “seasonal” element to the January data. Stay tuned as the Fed’s March Summary of Economic Projections and new “Dot Plot” will offer an opportunity to see through the concerning January inflation results.
- **Fed funds**: With an economy growing north of 2%, an unemployment rate of 4.0%, and core personal consumption expenditures inflation in a range of the Fed’s target at 2.81%, the U.S. economy appears to represent a “Goldilocks” scenario for now. To maintain such a Goldilocks moment, monetary policy should be set toward the central bank’s neutral rate. In today’s less globalized world, neutral fed funds may be 3.75% or higher. Against this backdrop, our economics team expects the Fed to be on hold through the first half of 2025, but it still expects two 25 basis-point rate cuts before the end of this year.
- **An economic “sequencing” headwind may reinforce the need for two Fed rate cuts this year**: While the U.S. economy remains resilient, its rate of growth is decelerating right now. And while the U.S. consumer story remains constructive, questions about the future rates of change in capital expenditures as well as fiscal spending have emerged. Consider fiscal spending in the U.S., for example, where the Trump administration is seeking to diminish the remaining life of Biden-led policies—such as the CHIPS and Science Act, the Inflation Reduction Act, and the Infrastructure Investment and Jobs Act—which will likely be replaced with Trump administration policies. The scale of such a transition may not be seamless, in our view.
- **U.S. 10-year yield**: For right now, the U.S. 10-year Treasury yield appears rangebound in an approximate range of 4.40% to 4.80%. Future inflation trends will test this range in conjunction with Treasury supply. For now, U.S. deficits largely remain funded with Treasury bill issuance. Once a looming debt ceiling debate gets resolved in Washington, D.C., more coupon supply coming at a time of less foreign sponsorship for the asset class may also test this range.
- **Divergent monetary policy**: While the Fed is on hold, our economists expect the European Central Bank to be aggressively cutting its policy rate in the months ahead. Meanwhile, the divergence between what is typically a closely connected policy rate in Canada and the U.S. is noteworthy. In addition, many emerging markets policymakers must consider potential currency volatility as they set monetary policy. For this reason, as well as the increasingly less globalized nature of today’s world landscape, many emerging markets policymakers are moving at a different cadence than the Fed.
- **Some good geopolitical news:** A potential ceasefire between Russia and Ukraine appears to be rapidly forming. Meanwhile, after 15 months of military operations, Israel and Hamas have agreed on a ceasefire deal that was brokered and guaranteed by the United States, Qatar, and Egypt. The six-week truce on its own could provide a much-needed reprieve to the region and would also bolster regional credit stories in the surrounding area. Importantly, this market view and perspective is not intended in any way to discount the human tragedy involved with both of these catastrophic conflagrations.

**Bottom line**: Through a disciplined investment process, anchored by its Policy Week in conjunction with expanding quantitative capabilities and its ongoing global bottom-up research effort, T. Rowe Price Fixed Income is well positioned to actively manage the array of strategies that compose its investment platform through an investment environment that looks to be volatile in the months ahead.

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