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Market Pulse

Global Fixed Income Update

June 2025

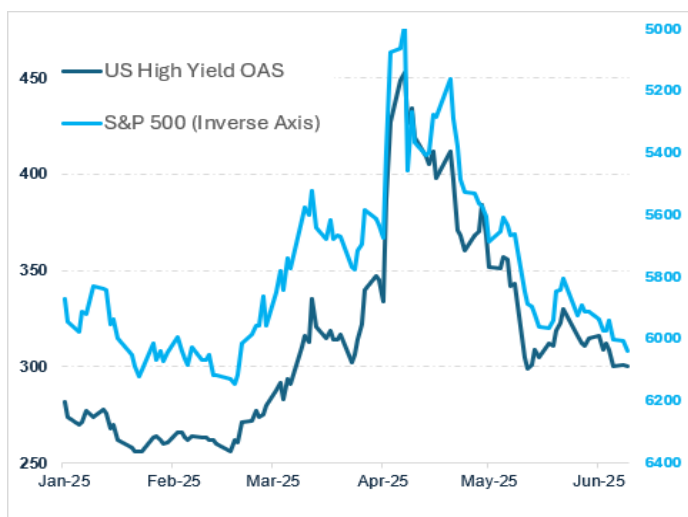
Ahead
of the
Curve

Retracement and what's next...

Delayed and recalibrated U.S. tariff policy in conjunction with resilient U.S. economic and corporate fundamentals have allowed risk assets to largely retrace to levels that existed in late February before the worries of a looming Liberation Day began to be fully priced into markets. As seen in Chart 1 below, the option-adjusted spread for the Bloomberg U.S. High Yield Index has tightened as equity markets have rallied. Helping this retracement in risk asset narrative further in recent weeks have been:

- Constructive (but still not conclusive) trade talks between the U.S. and China.
- Benign U.S. inflation data, which quells concerns for tariff policy serving as a catalyst for driving higher prospective near-term U.S. inflation for now. More on this topic below.
- Recent successful U.S. Treasury auctions, which followed tepid demand for recent long-maturity sovereign debt auctions in Japan as well as in the U.S.

Chart 1.



Source: Bloomberg Index Services Limited. As of June 12, 2025.

Past performance is not a guarantee or a reliable indicator of future results.

Away from capital markets, despite the constructivism referenced above, all is not necessarily well. Consider oil prices, for example, that had been rising in the weeks leading up to Israel's recent attack on Iran, now look to remain elevated for an indeterminate amount of time from late May levels as this conflict has potential to extend longer than current consensus projects.

Meanwhile, social unrest is unfolding in the U.S. as integral fiscal policy is being hammered out in the form of a "Big Beautiful Bill" (BBB) in Washington, D.C., which looks to only add to concerns around debt sustainability for the world's largest economy. While tariff concerns have abated somewhat since early April, tariff-driven revenue still remains an important part of the Trump administration's fiscal agenda as the administration, and its Department of Government Efficiency, has fallen short of identifying large-scale savings in government spending.

It is against this mixed environment of capital market retracement versus other developing material concerns that the T. Rowe Price Fixed Income Division held its June Policy Week with a focus on identifying what's next for the global economy as well as for global fixed income markets. Highlights from this month's Policy Week include:

A tepid global economy driven by the following highlights

A possible technical recession in the U.S.: In the first half of 2022, the U.S. economy experienced a technical recession when it posted two straight quarters of negative gross domestic product (GDP) growth, but still avoided a recession as defined by the National Bureau of Economic Research. The firm's economics team expects a similar outcome in the U.S. during the first half of this year as a slowing U.S. economy is expected to get fiscal relief but on a lagged basis that carries into next year. The team also believes that that markets are too complacent about the near-term downside risks to growth from U.S. tariff policy. This perspective highlights the importance of Congress getting the BBB passed before their August recess.

China muddles through: Expected 4.5% GDP growth masks a mixed economic story in China. Export activity, for example, while appearing resilient on its surface, is compositionally changing as China diverts trade from uncertain U.S. trade policy to other destinations. Away from trade, overall economic momentum in China remains soft as weak housing markets continue to dampen overall consumer activity. And while fiscal policy remains reactive, it is stimulative nevertheless, which introduces hope for China's economy next year.

Eurozone: While lifting the region's first-half growth profile, front-loaded trade activity ahead of punitive U.S. tariffs will abate and could lead to a weaker growth trajectory in the second half of the year. Beyond 2025, stimulative fiscal policy such as the large-scale defense and infrastructure spending measures introduced by Germany earlier this year serves as an economic tailwind in future years.

A broad global easing cycle now slows down

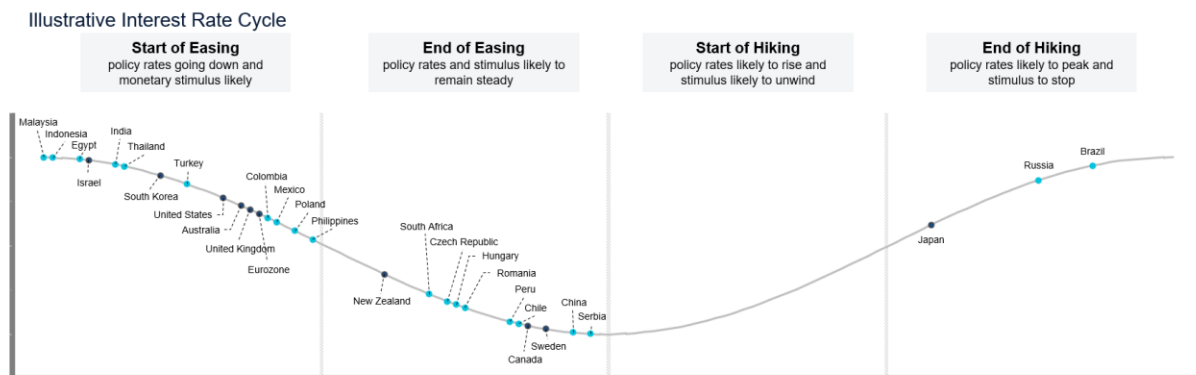
U.S. tariff policy will likely be inflationary going forward, potentially driving current benign inflation data higher. Even with this view, our global economics team still expects two 25-basis-point rate cuts by the Federal Reserve before year-end as a neutral fed funds rate in a less globalized world is likely to be in the 3.75% range.

Outside of monetary policy, U.S. interest rates have fluctuated across the yield curve. Long-term rates are caught between the opposing forces of weaker growth and the possibility of higher inflation. For now, 10-year U.S. Treasury yields appear range-bound in the 4.25% to 4.50% range. Over the longer term, 10-year U.S. Treasury yields could revisit the 5% range and beyond with the potential confluence of inflationary tariff policy, elevated U.S. Treasury supply later this year, and fiscal stimulus coming from BBB legislation moving through Congress that comes at a time when the U.S., arguably, remains at full employment.

Beyond the U.S., the global monetary policy easing cycle, illustrated below, may begin to slow as uncertain U.S. trade policy creates room for pause from certain policymakers. Consider the European Central Bank (ECB), for example, which has raised its bar for further rate cuts by adopting a wait-and-see approach from here. Even so,

our economics team still expects two more 25-basis-point rate cuts before year-end from the central bank's current 2.15% policy rate, which has been reduced from its 4.50% stance that existed this time last year.

Chart 2.



Sources: IMF, CB Rates. Analysis by T. Rowe Price.
For illustrative purposes only.

Regarding spread sectors, resilient fundamentals and tight spreads have driven a mostly neutral stance across from the Fixed Income Division. Nevertheless, global spread sectors remain attractive on a fundamental and on an absolute yield basis.

Bottom line in terms of what's next

While global markets have seemingly moved on from tariffs being a primary risk (even though tariff risk remains) to now focusing on prospective expansionary fiscal policy in the U.S. that is coming at a time of full employment, it is interesting to see a continuing year-to-date trend in U.S. dollar weakness that has followed Moody's downgrade of U.S. Treasuries on May 16.

Against the uncertain environment described above, active management in global fixed income takes on heightened importance. 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's Fixed Income Division is qualified to actively manage the array of global strategies that compose its investment platform through the uncertain times ahead.

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