



Timely Insights—Fixed Income Policy Week Takeaways

March 2025

Addressing “Triffin’s Dilemma” is disruptive, but fundamentals remain sound for now...

Testifying before Congress in 1959 and 1960, Belgian-American economist Robert Triffin argued that there was a long-term crisis brewing for the country serving as host to the world’s reserve currency. In Triffin’s view, while the post-World War II Bretton Woods system that established the U.S. dollar, backed by gold, as the world’s reserve currency was an appropriate arrangement to get the economy back on its feet, it should have only been a temporary global currency framework. Importantly, what Triffin understood is that the world’s reserve currency is held by other nations as foreign exchange (FX) reserves to support international trade. And as the global economy continued growing there would be an insatiable natural demand for the reserve currency. To meet this voracious demand required the host of the reserve currency to run persistence trade deficits to make the arrangement work. Inevitably, the longer the trade imbalance persisted, the more severe the credit quality degradation of the reserve currency host over time would be. This paradox, known as “Triffin’s Dilemma,” exposed the inherent contradictions in a global system where one currency served as both a national and global reserve currency.

The flaws of the global financial system identified within Triffin’s Dilemma over 60 years ago has, among other considerations, driven the current U.S. debt-to-gross domestic product (GDP) profile to higher levels than seen coming out of World War II, which raises questions around sustainability. In terms of why this story matters now is that in analyzing Treasury Secretary Scott Bessent’s remarks at the Economic Club of New York on March 6, it appears that the Trump administration is seeking to address Triffin’s Dilemma as part of its ambitious agenda where Bessent noted, “The United States also provides reserve assets, serves as a consumer of first and last resort, and absorbs excess supply in the face of insufficient demand in other country’s [sic] domestic models. This system is not sustainable.”

Resilience in Fundamentals Despite Market Uncertainty

Radical change often represents uncertainty. Regime change to a system that largely has been in place for the past 80+ years exacerbates such concern. It is within this current environment of heightened uncertainty that the T. Rowe Price Fixed Income Division just finished its March Policy Week where one high-level key takeaway emerged. For right now, while dire headline risk has accelerated as the U.S. economy shows signs of slowing and equity volatility escalates, the underlying key fundamentals remain generally sound across most sectors in the view of our research analysts.

Credit spreads have widened in recent weeks but fundamentally remain generally supported. Many in the Fixed Income Division hold a broadly sanguine view on spread sectors if the economy remains strong enough to support demand for attractive absolute yields. Our sector specialists continue to weigh the risk and return trade-offs for credit sectors in the current environment as spreads remain historically compressed. Still, active security and sector selection should gain importance from here amid rising uncertainties.

Other Policy Week Highlights

One aspect of Policy Week is to identify concerns that our investment professionals have within the existing investment environment. Following increased volatility driven by higher-than-expected inflation data to start the year and significant policy shifts seen from the Trump administration, the largest concern coming out of Policy Week was around future growth. Growth concerns narrowly eclipsed inflation worries last month, but this month the gap between the two widened considerably.

While the U.S. economy has materially slowed, its longer-term growth trajectory remains positive for now. There is also divergence between the service and manufacturing sectors that drive the U.S. economy, with services growth trending below neutral while manufacturing activity has accelerated in recent months and now screens well above neutral. A point raised during Policy Week was that tariff uncertainty factors may be driving some of the recent strength in manufacturing as companies front-load shipments ahead of potential tariffs.

In China, weak economic data driven by continued struggles in the property sector and weakness in consumption activity appear to be stabilizing. This stabilization is now bolstered with fiscal support. Meanwhile, the eurozone saw a significant shift, with the U.S. signaling its intent to wind down its global defense spending, as Germany announced new economic policies that include around EUR 500 billion focused on defense spending. This additional spending could lead to a 20% rise in Germany's debt-to-GDP ratio over a 10-year horizon. The scale of this policy shift is historic and has not been seen since German reunification late last century.

Domestic Inflation

The March 12 consumer price index (CPI) print surprised to the downside. Some of this deceleration represented a reversal of January's elevated inflation trend. Overall, core CPI was up only 0.23% month over month and 3.1% year over year. Interestingly, shelter prices seem to be trending lower where nationwide property prices have not only stalled nationally but are

retreating in popular housing market states such as Texas and Florida. Outside of shelter, most of the deceleration in services came from transport services and its volatile airfares component. Goods price pressures were broadly unchanged as a slowing in used car prices was offset by an uptick in other categories.

The Fed and 10-Year Rate Perspective

While the recent CPI print was benign and trended lower, the translation from core CPI to core personal consumption expenditures (PCE) counterintuitively points to a slightly firmer core PCE (the Fed's preferred inflation measure) for February, which is one reason for the Fed to be cautious in cutting policy rates too soon from here. With the Fed's existing policy rate being restrictive, our economist team still expects two Fed rate cuts in the second half of 2025.

And while future policy easing is anticipated, 10-year and longer-maturity U.S. rates are expected to rise from current levels as questions remain on who will buy the elevated U.S. Treasury supply that is expected to follow the eventual resolution of the U.S. debt ceiling. To this point, it was telling on March 12 when longer-maturity U.S. Treasury yields rose in the face of a benign inflation print. Our economics team expects a potential range of 4.00% to 4.50% or higher for 10-year U.S. Treasury yields in the near term but maintains a bias that yields could be materially above 4.50% beyond the next 12 months.

A Weaker U.S. Dollar

The narrative of the continuation of U.S. exceptionalism and strong domestic growth that this year opened with has reversed. Against the backdrop of slowing growth and increased uncertainty, the U.S. dollar has materially weakened since mid-January and has room to weaken further, in our view.

As an aside, from a theoretical perspective, if the Trump administration understands the holes in the global financial system that exist because of Triffin's Dilemma, it is interesting to see the administration's support in the cryptocurrency space. This connection is accompanied by a swift push for regulatory inclusion of cryptocurrency within financial infrastructure, including the banking system. These developments are being watched closely at T. Rowe Price by Blue Macellari and the digital assets strategy team she leads.

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, the T. Rowe Price Fixed Income Division is qualified 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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