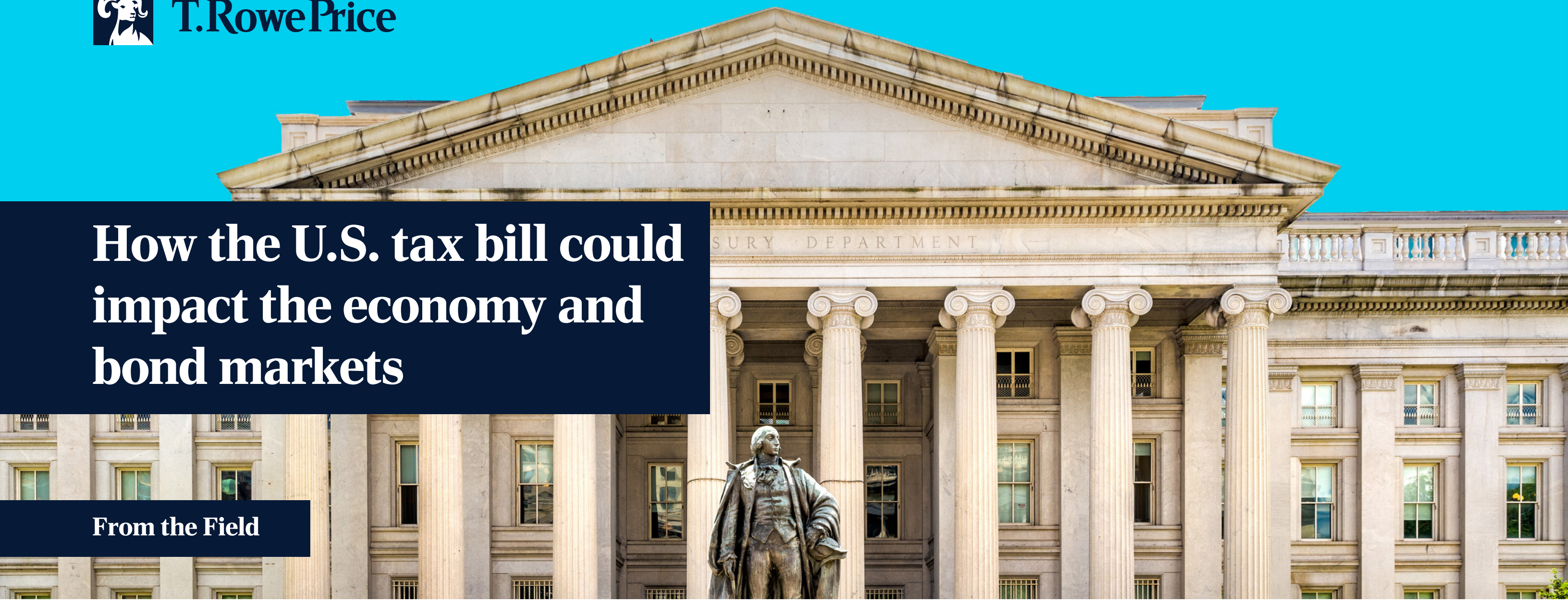

How the U.S. tax bill could impact the economy and bond markets

From the Field

Key Insights

- The landmark tax and spending bill is attracting significant attention in financial markets due to concerns about its potential impact on the U.S. government's financial health.
- Passing the bill would diminish uncertainty about future tax policy and help to stabilize an economy that has been buffeted by many shocks this year. However, it also poses upside risks to inflation.
- Volatility is expected to continue in the U.S. Treasury market due to fiscal concerns stemming from the lack of plans to address the deficit in the near term.

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Donald Trump's landmark tax and spending bill is sharpening the focus on the country's challenging fiscal position for financial markets. This bill could be passed as soon as this summer, and here we explore the potential implications for the deficit, economy, and bond markets.

Fiscal implications: Deficit expected to remain high

The tax and spending bill, which President Trump refers to as the "big beautiful bill," aims to extend many of the non-permanent corporate and individual tax cuts enacted during his first presidency in 2017. As these are due to expire at the end of this year, the bill's passage would help avoid one of the largest nominal tax hikes in U.S. history. This, in itself, should reduce uncertainty about the business climate in the U.S. to some extent.

Unless there are major changes in the final legislation, the bill is expected to add more than USD 2 trillion to the deficit over the next decade according to Congressional Budget Office estimates.[1] This is because the savings from reductions in federal spending, such as on health care, are unlikely to offset the fall in revenue resulting from the bill's

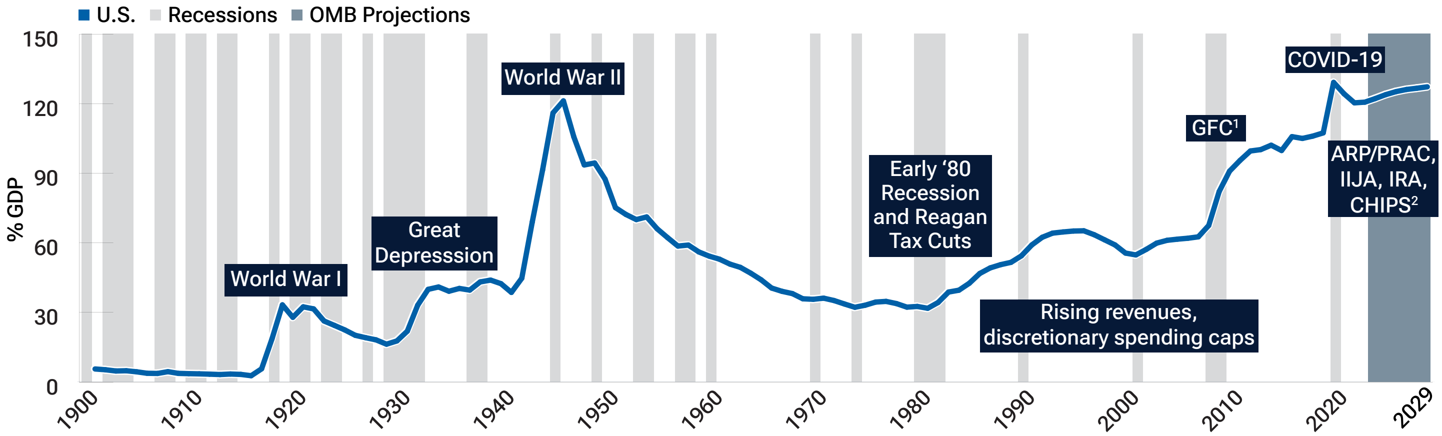
USD 2 trillion+

Amount the bill is expected to add to the deficit over the next decade.

[1] The Congressional Budget Office's estimate is as of June 17, 2025, and reflects data from the bill passed by the House of Representatives. cbo.gov/publication/61486

U.S. government debt expected to remain high

General government debt as a percentage of GDP



As of April 23, 2025.
[1] GFC = the global financial crisis.
[2] ARP/PRAC is the American Rescue Plan/Pandemic Response Accountability Committee, IIJA is the Infrastructure Investment and Jobs Act, IRA is the Inflation Reduction Act, CHIPS is Creating Helpful Incentives to Produce Semiconductors Act.
For illustrative purposes only.
Source: U.S. Office of Management and budget (OMB)/Haver Analytics. T. Rowe Price analysis.

tax cuts. These cuts are expected to include an increase in the state and local tax (SALT) deduction cap, increased child tax credits, and a range of corporate tax breaks.

With the bill's stimulus expected to be frontloaded and the spending cuts coming later, any near-term improvement in the U.S. government's fiscal deficit seems unlikely. In 2024, the deficit stood at 6.4% of gross domestic product (GDP), which was the largest ever in peacetime and outside of a recession. Given the lack of plans to address the deficit, it is likely to remain elevated at current levels over the next two to three years.

Economic implications: Growth supportive, upside inflation risks

The prospect of a new fiscal stimulus package should provide a timely boost to an economy that has been slowing this year. Consumer spending and business confidence, in particular, could receive a much-needed lift. While the bill will be supportive of economic activity, growth is still expected to be below-trend this year due to the effects of tariffs. However, in our baseline forecast a recession will be avoided.

Looking ahead to next year, economic growth should improve as fiscal stimulus typically takes time to feed through into the real economy. Firms may react more quickly than consumers if tax breaks on capital expenditure spending are made retroactive to January 2025 as they would aim to maximize the benefits of the tax break. However, there is uncertainty on whether they would be able to move fast enough. Nonetheless, the improvement in the growth rate is unlikely to offset the effect of lower tax revenues on the fiscal deficit.

Regarding inflation, risks to the outlook have shifted significantly to the upside based on a combination of dollar weakness, a historic rise in the effective tariff rate, and the possibility of higher energy prices stemming from the Israel-Iran conflict. A new fiscal stimulus package would likely add to these upside pressures but may take more time than some of the other factors to filter through into prices. Overall, the net effect is likely to be higher inflation in the second half of this year and into 2026.

> “With the bill's stimulus expected to be frontloaded and the spending cuts coming later, any near-term improvement in the U.S. government's fiscal deficit seems unlikely.

What could this mean for the Federal Reserve? The central bank's latest projections showed at least two interest rate cuts for this year,[2] but the window to deliver these would be very short if inflation pressures start to pick up and the labor market stays resilient.

Bond market implications: Volatility in U.S. Treasury markets set to persist

Recent bond market moves indicate a shift in focus toward fiscal policy and away from tariffs. Given the absence of plans to address the deficit in the near future, volatility in Treasury markets due to fiscal concerns is likely to persist. Ultimately, deficits need to be financed through debt issuance, but this comes at a time when other developed markets also need to issue more debt to finance deficits, creating competition for buyers. This, together with rising inflation risks, is likely to drive Treasury yields higher and the U.S. Treasury yield curve steeper. However, the move higher in yields is unlikely to happen in a straight line, and we are bracing for more volatility in this highly uncertain market environment.

Overall, the "big beautiful bill" looks set to have meaningful economic, fiscal, and financial market implications. While the bill could support growth, it also poses an upside risk to prices, coinciding with several other factors, such as tariffs, that could drive inflation higher. Combined with the lack of near-term plans to address the deficit, fiscal concerns are likely to remain elevated, potentially driving yields higher and curves steeper.

> "Given the absence of plans to address the deficit in the near future, volatility in Treasury markets due to fiscal concerns is likely to persist.

[2] As of June 18—Federal Open Market Committee median interest rate projections.

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