8 July 2025

Markets in a Minute

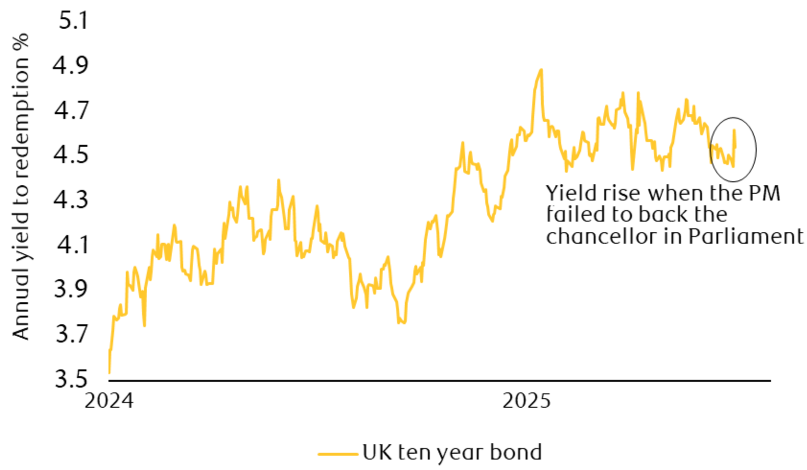
Key highlights

- **UK bond market sheds temporary tears:** The UK government's welfare reform U-turn exposed political tensions, briefly unsettled bond markets, and raised questions about leadership and policy direction.
- **Big bad bill:** The U.S. One Big Beautiful Bill was passed by the Senate, extending tax cuts while raising concerns over fiscal sustainability.
- **U.S. labour market signals**: Strong job numbers mask a cooling labour market with slower hiring and wage growth, aligning with the Fed's 'wait and see' approach to interest rate cuts.

Watch the latest Markets in a Minute video with **Guy Foster**
Chief Strategist

Bond vigilantes take on rebels in support of government

UK borrowing costs rose when Rachel Reeves' job seemed in danger



Source: LSEG

Last week, the UK government was forced into yet another humiliating U-turn on its welfare reforms. The objection to this policy is that reform is a euphemism for cuts.

While the government has rightly recognised the need for fiscal restraint, the challenge – as is always the case with politics – lies in reaching consensus on how to achieve deficit reduction.

Many Labour MPs, particularly those in marginal seats, face a difficult balancing act. Cuts to benefits or the desertion of Labour values could cost them at a future election. If spending cuts can't be made, the chancellor may have no choice but to raise taxes this autumn, given the limited fiscal headroom available.

The bond markets remained calm over the welfare cuts, perhaps because the changes themselves are fairly modest. However, bond yields rose when the prime minister missed the opportunity to publicly support his chancellor. Investors will be concerned about the prospect of Rachel Reeves being replaced because it could signal a shift in policy which may place less importance on balancing the books. However, the bond market's reaction should serve as a significant boost to the chancellor's cause.

With the UK holding nearly £3 trillion in government debt, just that one-day rise in yields, triggered by doubts over the chancellor's position, could theoretically cost around £4 billion if sustained during debt refinancing. Fortunately, a belated endorsement from the prime minister saw yields fall again, minimising the damage. These kind of sell offs are ascribed to so called bond vigilantes because their actions can drive changes in government policy. In this instance, the government should use the action of these bond vigilantes as an endorsement of the government's cost cutting, but whether that brings the rebels back into line remains to be seen.

Figure of the week

147,000

New jobs created in the U.S. during June

Big beautiful bill creates bulky bond behemoth

The U.S. budget bill, also known as the One Big Beautiful Bill Act (OBBBA), has now been passed by the Senate and House of Representatives.

The bill extends the original Trump tax cuts that were due to expire at the end of the year. It also includes new tax cuts, such as no taxes on tips and overtime pay, and an increase in the personal tax exemption for retirees. Some of these are due to phase out in future years to make the costs of the bill seem less, but seeing as OBBBA's primary objective is to make previous temporary tax cuts permanent, it would be naïve to rely upon planned austerity in the future.

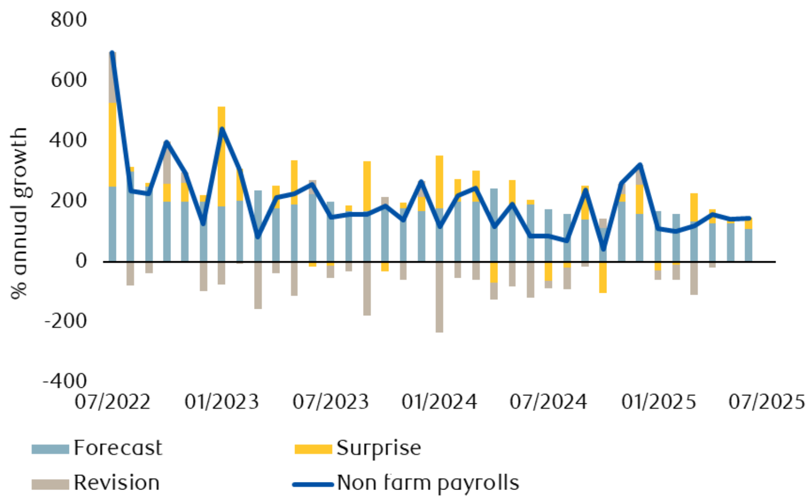
In fact, the final version of OBBBA means the boom time budget deficit will remain around 6% of GDP, with a cumulative value projected to reach $3.3 trillion over the coming decade. However, the non-partisan Committee for a Responsible Federal Budget estimates that the cumulative increase in debt could exceed $4 trillion over that decade - or even $5 trillion if temporary measures are made permanent, as history suggests they might be.

Overall, the bill is expected to have a limited impact on the economy, with the deficit remaining close to 6% of GDP over the next few years and the economy currently running close to capacity. However, other recent policies like the clamp down on undocumented migrants, restrict capacity growth at a time when demographics limit natural labour force growth. Furthermore, the trade policy and apparent endorsement of a weaker dollar suggest that the U.S. may increase borrowing while reducing its own earning capacity and discouraging foreign lenders – factors that typically result in higher real interest rates.

The U.S. cannot go bankrupt, as its debts are denominated in a currency which it prints. However, it could default, though this would essentially be a political decision – most likely the result of the brinksmanship between Democrats and Republicans over raising the debt ceiling.

Most plausibly, the sheer volume of bond issuance could gradually push bond yields higher, complicating the effectiveness of monetary policy. While it has been speculated that the Federal Reserve might intervene to suppress those yields, doing so would result in higher inflation. Therefore, although the costs of fiscal largesse may not be intuitive, they are nonetheless very real.

Headline jobs growth remains stable in the U.S.



Source: LSEG

The U.S. bond market sold off last week, driven more by the strong headline employment report than by immediate concerns over the unsustainable path of U.S. government debt. While the headline growth rate suggests that the economy is still strong, it was somewhat inflated – perhaps ironically by a pick-up in public sector hiring.

"If spending cuts can't be made, the chancellor may have no choice but to raise taxes this autumn"

Trump plans Liberation Day reprise

9 July is approaching, marking the end of the deferral individual tariff rates announced on Liberation Day. However, the relevance of this date seems to be diminishing.

A trade arrangement has been reached with the UK, a truce has been agreed with China, and Vietnam may have secured a deal too. However, talks with Japan are fractious, negotiations with the Eurozone are logistically challenging, and the Trump administration continues to suggest that a trade deal with India is close.

For the majority of countries, there will be no deal, and the president has begun sending letters outlining their new tariff rates. He had previously suggested that these could rise as high as 60% or 70% but there are no signs of that so far. For example, on Liberation Day, Laos was hit with a tariff of 48%, but in its letter, this has dropped to 40%. For the largest trading partners, the rates are little changed (Japan and South Korea being the most significant examples).

Notable by its absence was the European Union (EU). The bloc has never seemed to be very high on the president's priority list despite being a significant trading partner. An unnamed source told Politico that the U.S. has offered the EU a 10% baseline tariff with certain key sectors excepted. Depending upon the breadth of, and the rate applied to the excepted sectors, that could be a significant improvement on the 20% rate announced on Liberation Day, but it was not widely reported.

Markets had been expecting a face-saving compromise from the Trump administration. There's only limited evidence of this in the letters themselves but the new rates will take effect on 1 August, in effect a further deferral, and the president did acknowledge that this leaves more time to reach agreements. Having been chastened by his initial approach of declaring a trade war on all countries simultaneously, the president may opt for a more targeted strategy in this second attempt to raise tariffs.

Coming up

- **Liberation Day 2.0:** A major focus will be on the ongoing outcomes of trade negotiations or unilateral U.S. tariff decisions.
- **OPEC+:** The oil cartel will consider a further expansion of production as it seeks to raise revenue amidst a market which is already broadly oversupplied.
- **The Allen & Company annual conference:** The tech-focussed investment bank's conference is expected to feature Sam Altman, Jeff Bezos, Tim Cook and Mark Zuckerberg.