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Macro Insights Weekly

Soaring bond yields and the global economy

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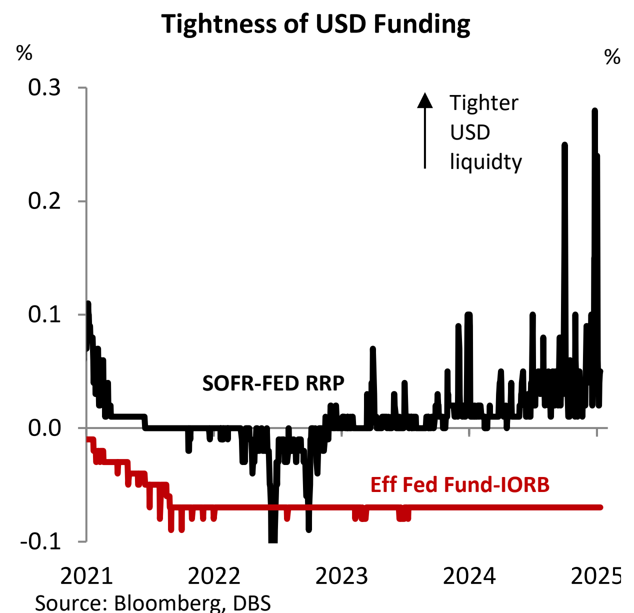
- *2025 has begun with a striking rise in bond yields. This reflects a worrisome combination of inflation risks returning and rates market demanding a higher premium from heavily indebted sovereigns.*
- *France, Germany, UK, and US 10-year government bond yields have risen appreciably.*
- *Even typically stable Singapore bond yields have jumped.*
- *Room for central bank support to manage ballooning debt burdens in parts of EM and DM has shrunk.*
- *Interest payments to service 100%+ debt/GDP can become onerous swiftly.*
- *Interest in duration risk may remain weak.*

Chart of the Week: Uptick in funding costs

The Federal Reserve's steady quantitative tightening is beginning to have an impact. Cash parked at the Fed's reverse repo facility (RRP) has been declining, from USD2.2trln in May-23 to USD168bn now. USD funding cost, measured by us as the gap between Secured Overnight Financing Rate (SOFR) and the RRP rate, has begun to rise a tad. Financial conditions are by no means tight, especially given the sharp the rise in asset prices, but the era of plentiful liquidity seems to be fading, in our view.



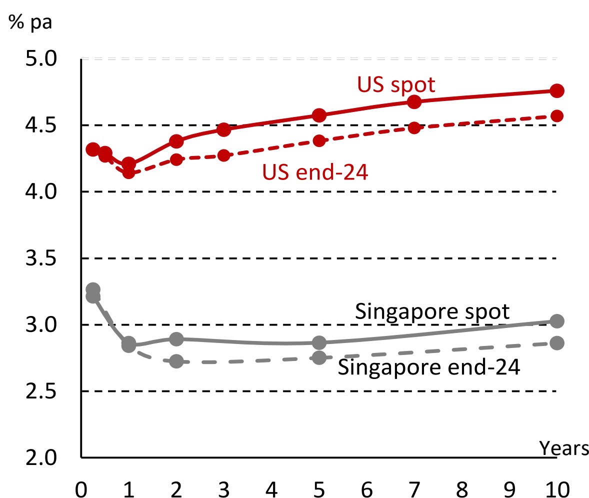
Source: Bloomberg, DBS

Commentary: Soaring bond yields and the global economy

2025 has begun with a striking rise in bond yields. In the US, recession and unemployment fears have disappeared, inflation fears have reappeared, and public debt outlook has darkened. The strong economic numbers may be largely out of the US, but their impact has been widespread. In the span of seven trading days in the new year, France, Germany, UK, and US 10-year government bond yields have risen by 20, 10, 28, and 19 basis points respectively. Even the typically stable Singapore 10-year bond yield has moved up by 14bps.

Recent US dataflow points to a substantial narrowing of rate cut path for the Fed. Inflation concerns have returned with ISM non-manufacturing price pressure gauge at a 22-month high. The labour market is getting tighter, with the unemployment rate falling to 4.1%, labour force participation rate remaining high, and December nonfarm payrolls exceeding expectations by over 100k. Last year's 100bps of rate cuts have been followed by a curve steepening, a striking indictment of Fed credibility, in our view.

US and Singapore Treasury yield curves

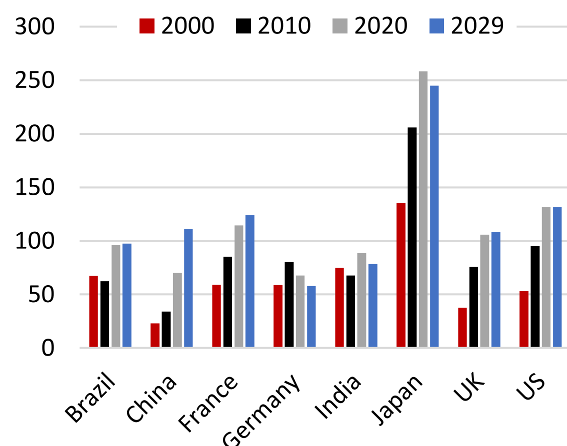


Source: Bloomberg, DBS

Short-term rates remaining elevated due to price and jobs considerations is par for the course. What troubles us is the synchronised rise in long-term bond yields in so many major markets. This development points to the fiscal situation. An historic build up in debt over the past decade and a half has left the global economy vulnerable to high interest rates. Is 2025 the year when this risk rises appreciably?

A world of debt

Gross public debt/GDP



Source: IMF WEO Oct 2024, DBS

Key economies in the developed and emerging markets are characterised by very high debt ratios. Brazil, China, France, Japan, UK, and the US are looking at 100%+debt/GDP to deal with for years and decades to come. Germany and India are not in particularly comfortable positions either. We think the curve steepening taking place right now is a message from the markets that debt and deficit consolidation don't seem to be around the corner. The result could be a destabilising one—as markets come to terms with the end of easy liquidity owing to inflation considerations, and related to that, no central bank purchase of bonds, they will demand higher and higher premium from the sovereign issuers. There could be plenty more pain ahead.

Taimur Baig

FX: An eventful week ahead for the USD

We have revised our currency outlook to reflect a more rapid appreciation in the USD in the first half of this year. Implied currency volatility has increased over the past month, particularly for the GBP and the major currencies. The DXY Index's upward momentum, fuelled by the Trump Trade rally, has remained intact after it broke above its two-year range.

The US economy continues to show remarkable resilience compared to the stagnation in Europe and the lacklustre Chinese economy amid heightening global uncertainties driven by the incoming Trump administration's unpredictable trade and foreign policies. **The Fed has adopted a cautious stance on disinflation and rate cuts**, with the futures market pricing in only one cut this year, now delayed to June. Meanwhile, **markets anticipate other central banks will implement more aggressive rate cuts than the Fed**, further widening the US yield differentials against its peers. In China, the government temporarily halted government bond purchases after yields fell to record lows due to strong demand outpacing supply.

Following last Friday's stronger-than-expected US nonfarm payrolls, **surprises in this Wednesday's US CPI inflation could further lift the USD**. Consensus expects headline inflation to rise to 2.9% YoY in December from 2.7% in November and core inflation to stay unchanged at 3.3% for a third month. US equities continued their sell-off after the University of Michigan's one-year inflation expectations increased to 3.3% in January vs. consensus to stay unchanged at December's 2.8%.

This week will be eventful because US Senate has scheduled confirmation hearings for several of President-elect Donald Trump's cabinet nominees. **Scott Bessent's hearing as Treasury Secretary on January 16 will be of particular interest to financial markets**. Bessent's "3-3-3" economic plan aims to 1) reduce the budget deficit to 3% of GDP within Trump's term through fiscal reforms; 2) stimulate 3% economic growth through deregulation and reshoring initiatives; and 3) achieve energy independence by increasing daily domestic oil and gas production to 3 million barrels. Markets will closely watch for indications of a pragmatic and measured approach to implementing Trump's agenda.

During his hearing as Secretary of State on January 15, **Marco Rubio**, known as a leading China hawk in Congress, will align with Trump's confrontational and assertive stance on foreign policy, particularly against major geopolitical adversaries. Similarly, **Pete Hegseth**'s hearing as the Secretary of Defense on January 14 will be monitored, especially in light of Trump's recent controversial comments about potentially using military force to acquire Greenland and control the Panama Canal.

Trump's inauguration as the 47th President of the United States **on January 20 looms large**. His immediate plans include imposing a 25% tariff on goods from Canada and Mexico and an additional 10% tariff on imports from China. All three countries have indicated their intentions to retaliate with tariffs on US goods, raising the risk of a trade war unless all sides engage in diplomatic negotiation to de-escalate tensions.

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