LOOMIS | SAYLES

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Global Fixed Income Outlook & Strategy

US growth exceptionalism looks over. After a 1.4% GDP growth first quarter, the Atlanta Federal Reserve (Fed) GDP-Now indicator anticipates 1.5% for Q2. This agrees with both recent payroll and consumer expenditure data, which are also showing slowdowns.

Market Recap & Outlook

Citibank's US Economic Surprise indicator, which was buoyant through mid-April, has plunged steeply in the negative. Slower growth has helped the Federal Reserve approach its inflation goal. Inflation as measured by the Federal Reserve's preferred metric, the core personal consumer expenditure price index, has slowed to 2.6% year-over-year, matching the headline personal consumption expenditures (PCE). This is still above the Fed's 2.0% target but not by much, in our view. We expect labor markets to continue to soften slowly, gradually reducing wage inflation and service price momentum. With the unemployment rate edging up to 4.1%, we believe that the path is clear for a policy rate cut at the Fed's September meeting.

Last year, we saw a predicted growth slump that failed to occur, in large part because of the strength of fiscal stimulus. From May to July, the US federal deficit as a share of GDP jumped to 8%, up from 6%. This is not happening this year, at least not yet, as the May deficit of 6.1% is in line with the year to date trend, in our view. Barring a repeat of an unexpected fiscal injection, we look for two policy cuts by year-end.

With former President Trump leading in the polls, markets have begun to speculate on the policies of a Trump Presidency. Much of course will depend on the composition of Congress, but a Republican sweep might favor the Trump policy goals of tariff hikes and tax cuts.

On the face of things, tax cuts at near full employment with still-unresolved inflation issues and a structural primary deficit of 3% of GDP may not seem like wise macro policy, but the same was said of the 2017 Trump tax cuts. These slashed corporate income tax rates, also at full employment, without much impact on the CPI. This was, we believe, largely due to what companies did with the bulk of their windfall. They did not jump to hire more workers or expand capital expenditures; they bought back shares. The inflation was in equity prices. Maybe the same will be true in 2025, but we are skeptical that more fiscal insouciance will prove so benign. Pandemic spending has left the debt to GDP ratio vastly higher than eight years ago. Interest costs are also far higher, given higher yields for Treasuries. The current slowdown in both growth and inflation is yield friendly, but forward markets are pricing a floor for Federal Reserve policy rates at about 3.0%. In our analysis, we believe there is strong potential for positive term premia and a near-term floor for the 10-year yield. We have already trimmed our USD duration overweight as the current rally has progressed.

Elsewhere, the French elections have produced a hung parliament with a left, rather than populist right, tilt. Both political wings would like to spend money France does not have, so coalition politics may be about fiscal symbolism, in our view. The UK elections predictably returned a massive Labour majority, which we believe will seek ways to recharge UK growth that also do not cost too much. Japan is looking at a quantitative easing taper, and markets expect at least one more micro rate hike this year.

Our Strategy

We have trimmed our USD duration overweight, while remaining cautious on credit and currency factors. We remain underweight Japanese duration, and look for yields to gradually edge higher there by autumn.

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Important Disclosures

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