Bond market concerns over Trump tax bill

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22 May 2025

The passage of US President Trump’s “big beautiful bill” through the House of Representatives yesterday has added to fears in financial markets that the US is further on the road to a debt crisis.

The major concern in financial markets is that the extension of tax cuts for corporations and the wealthy, introduced during the first Trump administration in 2017, will add to the federal deficit and increase the US government debt pile, which is heading towards $37 trillion. The Congressional Budget Office (CBO) said this week that the bill would add more than $3 trillion to the deficit.

The bill aims to cut around $700 billion from Medicaid and hundreds of billions from the food stamp program, but even these devastating hits to social spending are considered insufficient to halt the debt escalation.

The determination of the administration to continue with tax cuts, come what may, is an expression of one of the most fundamental features of the US economy—the dependence of corporations and finance capital on money from the state under conditions where speculation and parasitism, rather than productive activity, have become a key source of profit accumulation.

The Trump administration claims the boost to the economy from the tax cuts, coupled with the revenue from increased tariffs, will provide the necessary economic growth to finance the debt. But this is one of the many economic fictions that it is promoting.

There are, in fact, many warnings that the tariff hikes, whatever funds they may generate, will create the conditions for a recession, leading to a far bigger decline in government revenue.

There are also discussions in the financial world that the Trump administration could be on the same road as the ill-fated Liz Truss Tory government in the UK in September 2022 when its “pro-growth” tax cuts, based on increased debt, produced a financial crisis requiring the intervention of the Bank of England.

The situation has not reached that stage yet, but the direction is clear and is reflected in the fall in bond prices leading to an increase in their yield (interest rate). (Prices and yields have an inverse relationship.)

In early April, the yield on the 10-year Treasury bond was below 4 percent. It then shot up after the massive tariff hikes announced by the administration—145 percent against China and rates well above 40 percent for others—to fall back again when Trump announced a 90-day pause for negotiations and was forced to back down for 90 days on the hikes against China.

But yields have now started to rise again, with that on the 10-year Treasury back up to 4.6 percent. A level of 5 percent is regarded as signifying a major turning point.

One of the significant features of the turmoil last month was that it was accompanied by a fall in the value of the dollar—contrary to what happens in “normal” circumstances when there is a move into the dollar in conditions of instability. Instead, the theme in financial markets became “sell America.” This movement has continued, with the value of the dollar losing around 8 percent against a basket of major currencies since the start of the year.

The moves in the 30-year Treasury bond market this year have also been “stark,” in the words of a report in the *New York Times*.

On Wednesday, it noted, the yield on the 30-year bond “rose above 5 percent to its highest level since October 2023, after an auction of new 20-year Treasury bonds received tepid demand from investors, amplifying a sell-off in the market.”

The downward movement was fuelled by Moody’s cutting the US credit rating from triple A to Aa1 last Friday and changing the outlook to negative from stable. The move by Moody’s, following earlier

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downgrades by Fitch and S&P, meant that for the first time in history, the US did not enjoy a top-grade rating from any agency.

A comment today by *Financial Times* columnist Gillian Tett began with the observation that some of Trump's advisers had dubbed the "big, beautiful bill" as "Triple B."

"Future historians," she wrote, "might well chuckle at the irony—and/or Trump's lack of self-awareness. 'Triple B,' after all, is also the tag that credit ratings groups use to designate the lower threshold of investment-grade assets, before they become 'junk,' with rising default risks."

The issue, she continued, was not just the projection by the CBO that the debt-to-GDP ratio is set to rise from 98 percent to a record 125 percent over the next decade, nor that Moody's forecast that the annual deficit will increase from 6.4 percent of GDP to 9.4 percent in the next decade.

Of even greater concern was the rise in the interest bill on US debt, which hit $880 billion last year—greater than the outlay on Medicare and the military and second only to Social Security.

The interest bill is set to rise sharply. This is because most Treasury bonds were sold when interest rates were at historic lows. Now they must be refinanced at much higher rates, creating the possibility, as Tett noted, of a "vicious circle." That is, a situation where more debt has to be raised just to pay the interest bill on previous debt.

The US debt market is dependent on international finance—above all from Japan, China, and the UK. But there are shifts taking place. China, which used to be the largest investor, has slipped to third place behind Japan and the UK.

The dependence of the US debt market on international sources of finance could intersect with the conflict over Trump's tariff war. Earlier this month, the Japanese finance minister, Katsunobu Kato, warned in a television interview that Japan's holding of more than $1 trillion of US debt could be a "card" in negotiations over the 24 percent reciprocal tariff imposed on it.

The debt market is also becoming increasingly dependent on hedge funds, which can shift their funds rapidly. Their operations played a significant role in the freeze of the Treasury market in March 2020.

Summing up her analysis, Tett said the "key point" was that "the tectonic plates in markets are shifting, as fiscal unease swells; indeed, some investors are now braced for 10-year yields of 5 percent. And since [Treasury Secretary Scott] Bessent confronts a new debt ceiling drama soon—and must sell over $9 trillion of debt in the next year—jitters could escalate."

Given the rapidity of the debt growth, already characterized by all and sundry, including the chair of the US Federal Reserve, Jerome Powell, as "unsustainable," there may well be more than jitters.

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