Post-Elections US Treasury scenarios for 2025

Fiscal policy, inflation, and yield projections

The 2024 U.S. election has set the stage for a significant policy shift, with Donald Trump's return to the White House and a likely Republican-controlled Congress. Markets are now anticipating aggressive fiscal measures, such as large tax cuts and increased federal spending on infrastructure and defence. These policies, however, carry potential inflationary pressures that could disrupt the Federal Reserve's current approach to rate cuts. In this outlook, three primary scenarios for the U.S. 10-year Treasury yield are presented, capturing how fiscal expansion, inflation expectations, and Federal Reserve adjustments could shape bond returns through the end of 2025.

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Comprehensive scenario summary

This analysis provides a structured view of potential 10-year Treasury yield trajectories across three fiscal policy scenarios for 2025. The scenarios reflect differing probabilities, based on economic policy initiatives, projected inflationary pressures, and anticipated shifts in investor demand and Federal Reserve policy.

Scenario (yield)	Projected Yield	Probability	Treasury Issuance Increase	Real Growth Estimate (2025/2026)	Inflation Estimate (2025/2026)	Fed Policy	Expected Return (worst case)	Expected Return (Best case)
Rise	4.75 - 5.35%	35%	$500 - $750 bn	2.5% - 2.75% / 2.0%	2.5% - 3.0%	Pause or hawkish stance	**-3.2%**	**1.6%**
Stabilization	4.20 - 4.70%	40%	$100 - $250 bn	2.2% - 2.4% / 2.0%	~2.5%	Gradual rate cuts	**2.0%**	**6.0%**
Decline	3.65 - 4.15%	20%	< $100 bn	2.0% / 1.8%	Flat to 2.3%	Dovish, continued cuts	**6.4%**	**10.4%**
Tail-Risk	5.50 - 6.25%	5%	> $ 750 bn	> 2.75%	> 3%	Hawkish, new hike cycle	**-4.4%**	**-10.4%**

Comprehensive scenario summary

The projected scenarios are built on a set of key assumptions and observed relationships in fiscal economics, inflationary trends, and bond market dynamics. Here's a breakdown of the primary factors driving our analysis:

- **Federal debt and deficit:** U.S. federal debt exceeds $34 trillion (approximately 122% of GDP), which presents challenges for debt sustainability, especially with rising issuance needs. A rise in the federal deficit leads to an increase in Treasury issuance, expanding supply in the bond market. This supply increase, combined with investors' inflation expectations, can significantly affect yields, as greater borrowing can require higher compensation through elevated term premiums. The 2024 fiscal deficit is around $1.8 trillion (approximately 6.4% of GDP), projected to increase under fiscal expansion policies.
- **Current 10-Year Treasury yield:** The 10-year yield has stabilised around 4.4%.
- **Federal Reserve policy:** The Fed has shifted toward rate cuts, with recent reductions of 50 basis points in September 2024 and 25 basis points in November, leaving rates in the 4.50% - 4.75% range, with further cuts anticipated. The Fed's monetary policy stance is heavily influenced by inflation dynamics and labour market conditions. In the face of rising inflation, the Fed may halt or slow its rate cuts to prevent an overheating economy.
- **Oil prices stability and inflation moderator:** The new administration's plans to maintain stable oil prices through increased domestic production and supply agreements play a pivotal role in moderating inflation. By keeping one of the key drivers of production costs stable, the administration aims to offset some of the inflationary pressures that would otherwise accompany fiscal expansion. Stabilised energy costs would support industrial productivity and reduce the impact on inflation, which is particularly critical as oil prices factor into broader economic costs and inflation expectations.

This multi-factor approach allows for a comprehensive assessment of the potential paths for 10-year Treasury yields. Each scenario explains the dynamics at play, providing a nuanced understanding of how different policy outcomes could shape the U.S. bond market.

Key policy impact analysis: corporate tax cuts, tariffs, immigration controls, and oil prices

Corporate tax cut to 15%

Reducing the corporate tax rate from 21% to 15% is a cornerstone of Trump's economic agenda. This policy aims to boost U.S. business competitiveness and stimulate capital investment. By lowering tax liabilities, corporations retain more profit, which can be reinvested in growth initiatives, such as R&D, capital expenditures, and productivity improvements.

- **Growth impact:** Lowering the corporate tax rate from 21% to 15% is expected to provide a modest boost to real GDP in the short term, as businesses increase investments in capital and productivity. This reduction could lift GDP growth by up to 0.5% in 2025, resulting in potential real growth of 2.5% - 2.75%.
- **Inflation:** The stimulus effect could modestly increase inflation due to demand pressures, although the primary inflationary effects are likely to be contained if growth remains within potential output.
- **Supply impact:** The tax cut could reduce corporate tax revenue, increasing Treasury issuance needs by $200 - $350 billion to fund deficits.

Broad-based tariffs: China, Europe, and global imports

Tariffs on imports from China and Europe (up to 50-60%) and a potential blanket 10% tariff on all imports aim to boost U.S. domestic production but could disrupt supply chains and raise input costs.

- **Growth impact:** Tariffs could dampen U.S. economic growth by increasing the cost of imported goods, with an estimated reduction of growth by 0.4% - 0.6% by 2026. Retaliatory tariffs may impact U.S. exports, further affecting growth.
- **Inflation:** Projected increase in Core PCE inflation by 1% - 2.5%, adding cost-push inflation across goods sectors. Recent exit polls suggest that the GOP's focus on inflation resonated strongly, highlighting the impact inflation has on consumer sentiment and political outcomes.
- **Treasury market impact:** The increased inflation risk from these tariffs could lead investors to demand a higher term premium on Treasuries as compensation for holding assets

in an inflationary environment. Additional Treasury issuance, estimated at $150 - $300 billion to fund the broader fiscal deficit, would likely be required as the government faces reduced trade revenue and increased borrowing needs.

This broader tariff approach, if implemented, would have widespread effects on the U.S. economy, introducing both inflationary pressures and a drag on growth, which could impact the Fed's rate decisions and contribute to higher Treasury yields.

Immigration controls

Restrictive immigration policies are expected to reduce the labour supply, especially in sectors reliant on lower-wage workers, such as agriculture, construction, and services. This policy aims to increase domestic job availability but may also exacerbate labour shortages, leading to wage-driven inflation.

- **Growth and labour market:** Stricter border controls are expected to reduce labour supply growth, potentially adding pressure on wages. With fewer available workers, particularly in labour-intensive sectors, this policy may reduce long-term productivity and slow growth by approximately 0.2% - 0.3% by 2026. Restricted immigration could exacerbate wage-driven inflation, putting additional pressure on the labour market.
- **Inflation impact:** Rising wages driven by tighter labour market conditions may increase inflation by 0.1% - 0.2%, particularly in labour-intensive industries. However, stable oil prices could mitigate some of these pressures, especially in sectors where energy costs constitute a significant portion of expenses.

Given the emphasis on restoring domestic job growth, the tightening of immigration aligns with broader fiscal policies focused on U.S. job creation. The cost implications for cities and states managing asylum seekers and other immigration-related expenditures are likely to remain a significant budget consideration, affecting regional economic conditions.

Oil prices

Trump's commitment to maintaining low oil prices serves as a counterbalance to some of the inflationary pressures of his policies. Increased domestic energy production and potential agreements to stabilise supply could help keep energy costs down, providing relief to both producers and consumers.

- **Inflation and growth impact:** By maintaining stable or lower oil prices, Trump's policy could help moderate inflation. Lower energy costs reduce production costs across industries and support consumer spending, especially on non-energy goods, potentially sustaining modest growth and containing inflation. A restrained oil price could keep inflation at 2.5% in 2025 and mitigate some of the inflation impact from tariffs, immigration, and tax cuts.
- **Fed policy implications:** With contained inflation, the Fed may have greater flexibility to pursue a gradual path of rate reductions, supporting Treasury stability. However, if inflation expectations from other sources persist, the Fed may still adopt a more cautious approach.

Scenario analysis: Potential trajectories for 10-Year Treasury yields

Three primary scenarios emerge for the 10-year Treasury yield, with varying implications based on inflation expectations, changes in term premiums, and Federal Reserve responses.

Scenario	Baseline Yield	Issuance Impact	Inflation Impact	Term Premium	Fed Stance Impact	Projected Range
1	4.40%	0.1-0.2%	0.1-0.3%	0.3-0.4%	0.05%	**4.75 - 5.35%**
2	4.40%	0.10%	0.10%	0.10%	Neutral	**4.20 - 4.70%**
3	4.40%	0.00%	0.00%	-0.10%	-0.15%	**3.65 - 4.15%**
4	4.40%	> 0.2%	> 0.3%	> 0.4%	> 0.1%	**5.50 - 6.25%**

Scenario 1: Rise in yields (4.75% - 5.25%)

Probability: 35%

In this high fiscal expansion scenario, aggressive tax cuts and increased spending on infrastructure and defence drive a deficit increase of $800 billion to $1 trillion. The likelihood of this scenario reflects a strong fiscal policy push by the administration to stimulate growth, potentially pushing issuance needs to an additional $500-$750 billion. This rise in issuance, coupled with inflationary effects from both demand-side stimulus and tariff impacts, justifies the anticipated yield increase.

Detailed breakdown:

- **Growth and inflation impact:** Projected real growth could rise to 2.50-2.75% in 2025, with inflation climbing to 2.8%-3.1% by 2026 due to tariffs, reduced labour supply and demand pressures.
- **Term premium:** With increased Treasury issuance to fund the deficit, investors may demand a term premium of 0.30% to 0.40% as compensation for inflation and heightened supply risk.

- **Fed policy response:** The Fed may pause or halt rate cuts to manage inflation expectations. A more hawkish stance could counteract rising inflation, pushing yields higher.

Projected yield: Under these conditions, we project the 10-year Treasury yield to reach 4.75% - 5.25%.

- Higher issuance, inflationary effects from fiscal stimulus, and tariff-induces price pressures would likely drive yields up.
- Demand factors: Despite issuance pressures, structural demand factors (foreign interest, institutional demand, and safe asset status) may cap yields, making a rise above 5.25% unlikely.

➡ **Expected return:** Given this yield increase, the **total one-year return would likely be around -1% on average,** as the price decline largely offsets the coupon income.

Scenario 2: Stabilisation in yields in the range of [4.20% - 4.70%]

- **Probability: 40%**

This moderate fiscal expansion scenario involves a controlled approach to spending and tax cuts, aiming to balance stimulus with fiscal responsibility. The anticipated increase in the deficit—$250-$500 billion, with additional issuance of $100-$250 billion—is expected to be manageable, leading to minimal inflationary pressures. The balanced nature of this approach, combined with global demand for U.S. Treasuries, supports stable yields within this range.

Detailed breakdown:

- **Growth and inflation impact:** Modest spending growth would have a minimal impact on inflation, which remains manageable within the Fed's inflation target. GDP growth remains at 2.2%-2.4%.
- **Term premium:** With a limited issuance increase, the term premium adjustment would likely be minor (~0.10%).
- **Fed policy response:** The Fed would likely maintain a neutral stance, with minimal adjustments to its rate-cutting path, assuming inflation remains steady.

Projected yield: We expect the 10-year Treasury yield to stabilise around 4.25% - 4.75%.

- Moderate inflationary impact from controlled fiscal spending would support a stable yield environment, with the Fed likely maintaining a neutral stance on rate cuts.
- Demand factors: Strong global demand for Treasuries due to yield differentials and currency benefits for foreign investors, alongside resilient domestic demand from pension funds and insurers, reinforces stability within this range.

➡ **Expected return:** In this scenario, **the one-year total return would be approximately 4.0% on average,** reflecting stable yield conditions with no significant price impact.

Scenario 3: Yield decline (3.65% - 4.15%)

- **Probability: 20%**

In this conservative fiscal policy scenario, limited tax cuts and restrained spending increases keep the deficit and issuance expansion under $100 billion. This cautious stance reflects a scenario where fiscal policy is constrained, possibly by economic headwinds or a preference for fiscal sustainability, resulting in minimal inflationary impacts. The conservative fiscal measures, coupled with strong structural demand for Treasuries, create a favourable environment for yields to decline.

Detailed breakdown:

- **Growth and inflation impact:** With limited fiscal impact on growth and inflation. Inflation pressures are unlikely to materialise, potentially remaining flat or even declining in case of economic slowdown.
- **Term premium:** Economic uncertainties could increase demand for safe-haven assets, reducing the term premium by 0.10% to 0.20%.
- **Fed policy response:** The Fed may continue to cut rates if growth slows, adopting a dovish approach that could further lower yields.

Projected yield: Lower term premium and stable inflation outlook could bring yields down to the 3.75% - 4.25% range.

- Economic slowdown or a dovish Fed response to weaker growth could reduce demand pressures and push yields down.
- Demand factors: Strong structural demand, safe-haven status, and attractive yields compared to other regions support lower yields. The Fed's large balance sheet could also act as a backstop, potentially supplemented by additional accommodative policies if economic conditions weaken.

➡ **Expected return:** In this scenario, **the total one-year return could reach approximately 8.5% on average,** benefiting from price appreciation as yields decline.

Scenario 4: Tail risk – bond market panic (5.50% - 6.25%)

- **Probability: 5%**

In this extreme scenario, a combination of aggressive fiscal measures could trigger a loss of confidence in U.S. Treasury markets, mirroring the turmoil seen in the UK bond market after the Truss "mini budget".

Potential Catalysts:

- Deficit explosion and lack of fiscal discipline: Unchecked fiscal expansion and record deficits could erode market confidence in U.S. debt, triggering a sudden increase in yields.
- Aggressive tariff policies: Broad and steep tariffs could disrupt global trade and lead foreign holders of U.S. debt to reduce purchases, weakening demand for Treasuries.
- Debt issuance surge: High Treasury issuance to fund the deficit could oversaturate the bond market, prompting higher yields as compensation.
- Fed policy uncertainty: Inflation expectations could become unanchored, forcing the Fed to halt rate cuts or even tighten policy in a way that destabilises bond markets.

Projected yield and expected return: 10-year Treasury yields could spike to 5.50% - 6.25%, triggering capital losses and increasing bond market volatility, with total returns potentially falling to -10% or more.

Investment implications

This analysis suggests an **expected weighted return within a range of 0.5% and 4.5% for a 10-year Treasury bond purchased at current yields,** factoring in coupon income and projected price movements across different yield outcomes over a one-year horizon.

- **Stabilisation scenario:** Yields between 4.20% and 4.70% offer a stable **return of 4.5%,** appealing to income-focused investors who prefer low price volatility.
- **Rise in yields scenario:** A yield increase to **4.75% - 5.35%** may result in a **lower return of up to 3.2%** due to price declines. Investors may find better entry points at higher yields in this case.
- **Yield decline scenario:** Anticipating **yields to drop to 3.65% - 4.15%** would yield an attractive **8.5% return** via price appreciation.
- **The "tail-risk scenario":** In the event of a market panic, investors face significant downside risk, with potential capital losses.

Conclusion

The anticipated fiscal policies under the new administration could significantly impact the U.S. bond market, with increased deficit spending likely exerting upward pressure on yields. However, stabilising oil prices and strong structural demand could moderate these pressures, while any economic slowdown or dovish Fed response might keep yields lower. Investors should remain attuned to fiscal policy developments and inflation dynamics, as these factors are likely to drive yield fluctuations through 2025. Diversification across fixed-income assets and strategic flexibility will be key to navigating potential volatility.

For further information

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