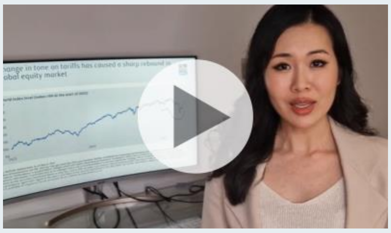
28 May 2025

Markets in a Minute

Key highlights

- **Bond vigilantes return:** U.S. government bonds saw a price fall as investors required higher yields. The rapid expansion of U.S. government debt has started to cause ructions in the bond markets.
- **Output prices are on the rise:** Purchasing managers indices showed a majority of U.S. companies increasing prices, which will weigh on consumers and businesses.
- **A welcome boost to UK retail sales:** Retail sales saw a surprising 1.2% increase in the year to April. Meanwhile, inflation surged to 3.5% in April, driven mainly by government-set price hikes.



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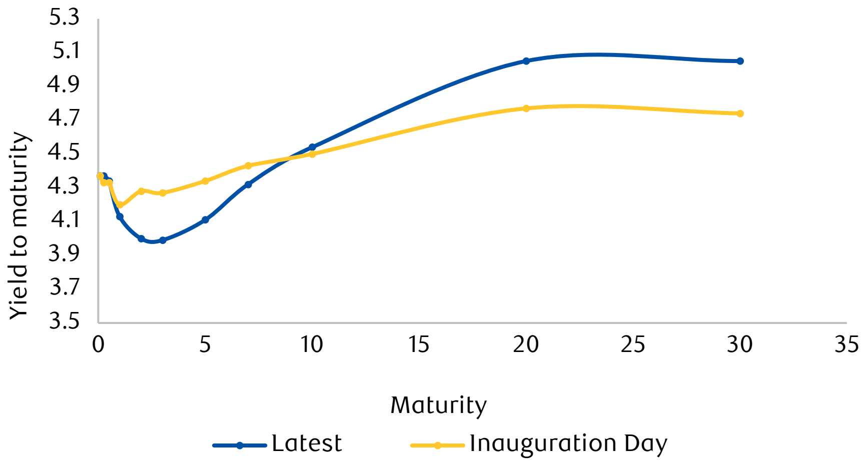
Bond vigilantes return

U.S. government bonds (treasuries) fell in price as investors required higher yields. A 20-year auction (government sale of bonds to investors) saw weak support and a bump up in yields, adding to U.S. borrowing costs.

The rapid expansion of U.S. government debt, which has accelerated in recent years, has started to cause ructions in the bond markets. U.S. President Donald Trump's administration has helped craft a tax and spending bill that's currently under negotiation in Congress. The bill narrowly passed the House of Representatives by a vote of 215 to 214 and is widely expected to increase the federal budget deficit. It still has to pass the Senate, which may require more changes, to become law.

As it stands, the deficit increase is largely mitigated by tariff income, but this is controversial because tariff income doesn't reflect current legislation; instead, it stems from executive emergency powers with an implication that it should be temporary in nature (although seems likely to remain in place).

U.S. long-term borrowing costs have risen



Source: LSEG Datastream

Continued overleaf

Figure of the week

5.3%

UK retail sales volumes (excluding vehicles) rose by an annualised 5.3% to the end of April.

Ultimately, Congress can convince itself that tax cuts can pay for themselves through higher growth, but the bond market is more objective. More issuances seem to be driving the increase in bond yields.

Bond vigilantism occurs when the bond market sells off and borrowing costs rise in response to the government seeming to want to pursue unsustainable policies. It ended Liz Truss's premiership in the UK, and it may have prompted President Trump to reverse course on his 'Liberation Day' tariffs.

One of the inconsistencies of the new trade policy is that by discouraging trade with the U.S., President Trump's also discouraging the use of the dollar as the world's reserve currency and, in doing so, is making it less important for foreign investors to lend to the U.S. government. This has led to a decrease in demand for U.S. treasuries at a time when the government wants to borrow more and therefore sell more treasuries.

Yields are heading towards more attractive levels, but the path of least resistance is for treasury yields to rise.

Inflation could be an additional concern for the U.S. bond market, but when dissecting the movement of the U.S. yield curve into different components, it doesn't seem to be the greatest concern.

Output prices are on the rise

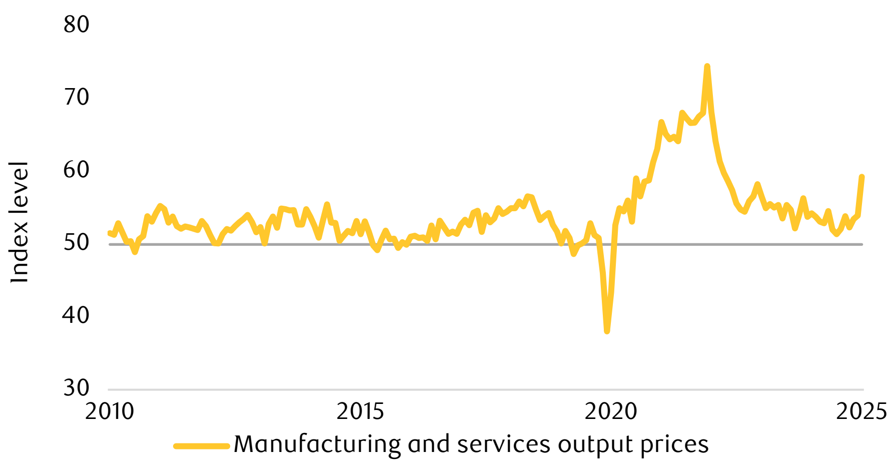
Longer-term inflation expectations have been stable despite alarming results of consumer inflation expectation surveys.

This week's purchasing managers indices (PMIs) suggested that European economies, including the UK's, remain sluggish. More notable was the significant improvement in U.S. business conditions, at least as far as new orders are concerned. But perhaps the most significant series of data was that related to output prices.

According to the PMIs, a significant majority of U.S. companies increased their prices. Since the 'Liberation Day' announcements, that proportion has been increasing sharply. The increase was "overwhelmingly linked to tariffs", according to company responses.

So, while it's been frustrating that surveys continue to suggest that the impact of tariffs has been more meaningful than activity data suggest, here's more compelling evidence that tariffs will weigh on U.S. consumers and businesses in the coming months.

U.S. purchasing manager indices suggest more companies are raising their selling prices



Source: LSEG Datastream

“Congress can convince itself that tax cuts can pay for themselves through higher growth, but the bond market is more objective. More issuances seem to be driving the increase in bond yields.”

A welcome boost to UK retail sales

UK retail sales figures for April were pleasantly surprising, with a 1.2% increase in sales over the month. The sunny weather and late Easter likely played a big role in boosting sales, especially for outdoor goods and Easter treats. However, some of the growth was simply a rebound after a couple of tough months. As a result, it's likely that retail sales will slow down in the coming months.

The underlying trend is still positive though. Retail sales have been steadily increasing since late 2023, driven by growing real wages and consumer confidence. Spending should continue to grow, albeit at a slower pace.

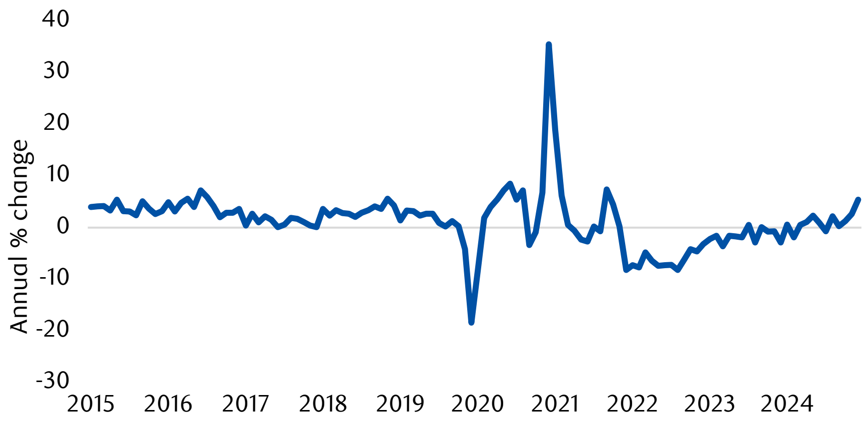
On the inflation front, the news is more mixed. Inflation surged to 3.5% in April, driven mainly by government-set price hikes, such as the 26% increase in water and sewerage bills, and the doubling of Vehicle Excise Duty rates. Airfares and package holidays also contributed to the rise, partly due to the timing of Easter. However, even excluding these one-off factors, underlying inflation pressure remains stubborn.

The Bank of England’s Monetary Policy Committee (MPC) is likely to proceed with caution, and the two additional rate cuts previously expected this year now seem open to question.

Looking ahead, headline inflation will average around 3.5% between April and December, driven by strong wage growth, hikes to the minimum wage, and tax increases. It’s expected to remain above target for an extended period, risking further de-anchoring of inflation expectations and persistent wage pressure. This is what the MPC needs to guard against.

UK bonds weakened over the week. They’ve been buffeted by both inflation and strong sales but also in sympathy with the bond vigilantism in the U.S.

UK retail sales (excluding fuel) grew faster in April



Source: LSEG Datastream

Coming up this week

- **U.S. earnings:** Earnings season is winding down, but Nvidia, arguably one of the most closely watched stocks of all, is left to report.
- **OPEC+:** The oil cartel is hosting a virtual meeting and will potentially expand production again (weighing on oil prices).
- **U.S. inflation:** Although the Consumer Price Index release was benign, the Federal Reserve’s preferred measure of inflation is the core Personal Consumption Expenditures Index, which will be released at the end of the month.

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