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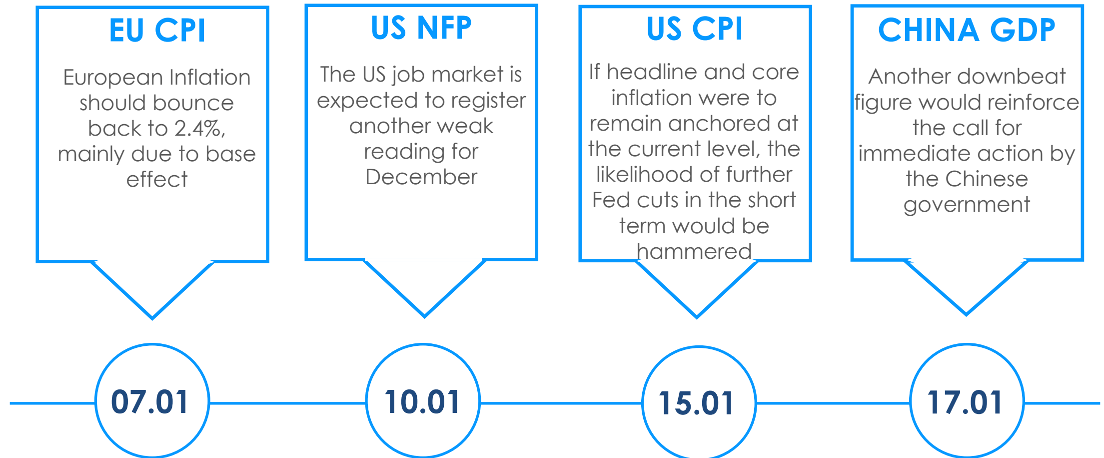
AZIMUT GLOBAL VIEW

06.01.25

Main Events



Azimut Global Network

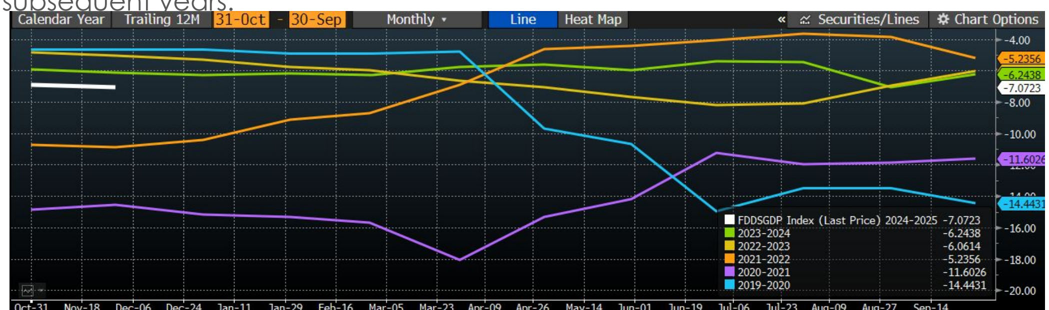
- Milan
- Abu Dhabi
- Austin
- Cairo
- Dubai
- Dublin
- Geneva
- Hong Kong
- Estoril
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- St Louis
- Sydney
- Taipei

A CLOSER LOOK TO U.S. PUBLIC FINANCES

- **At 7%, the U.S. deficit remains near record levels, and debt-to-GDP ratio has reached WWII highs, while the national debt held by the public increased by about $20 trillion in just five years**
- **Trump's economic agenda could result in further expansion of the U.S. deficit, potentially igniting concerns about sustainability**
- **$12 trillion of Treasuries need to be issued this year, likely putting pressure on the US curve, especially at the long-end**

After nearly 15 years of relative obscurity, and more specifically since the European periphery crisis of 2010 - 2011, the year 2025 may be marked by the return to the forefront of the issue of the sustainability of public deficits and debts. Among the countries in the spotlight, quite surprisingly considering the safe haven status it has always been granted, could be the United States.

The Fiscal Year (hereafter "FY") in the United States begins on October 1 and ends on September 30. In the first two months of the FY that has just begun (the latest available data is as of the end of November), the deficit-to-GDP is at 7%. This is a level surpassed only in the FY that began in September 2020 when the world was gripped by the COVID-19 pandemic, and in FY 2021 due to the Biden administration's massive fiscal stimulus, which then led to the inflationary flare-up of subsequent years.



Source: Bloomberg

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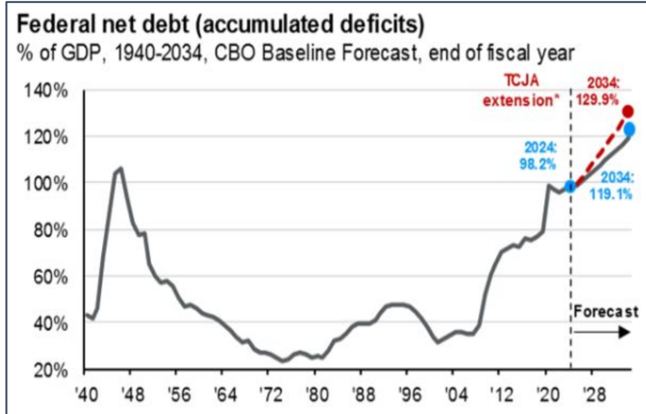
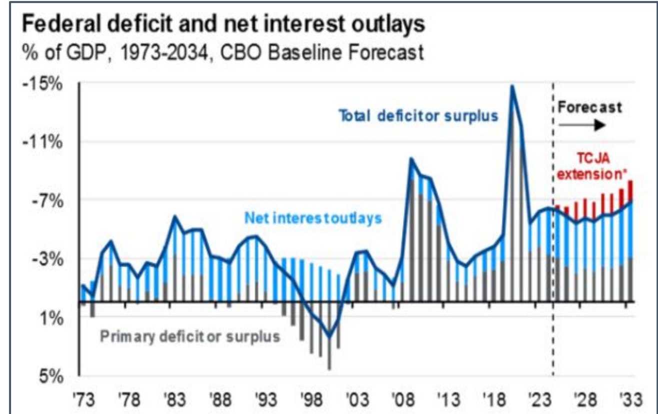




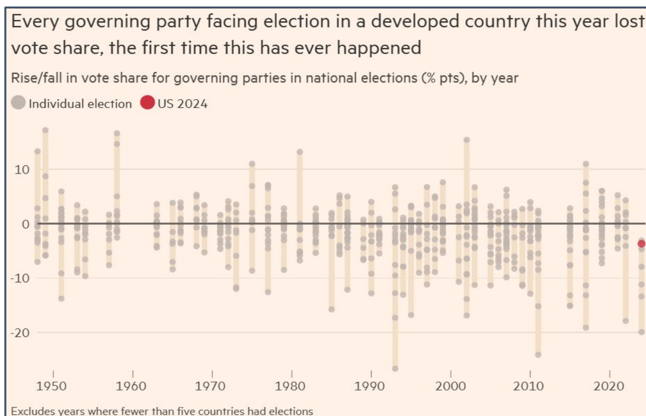
Source: J.P. Morgan Asset Management *Source: J.P. Morgan Asset Management*

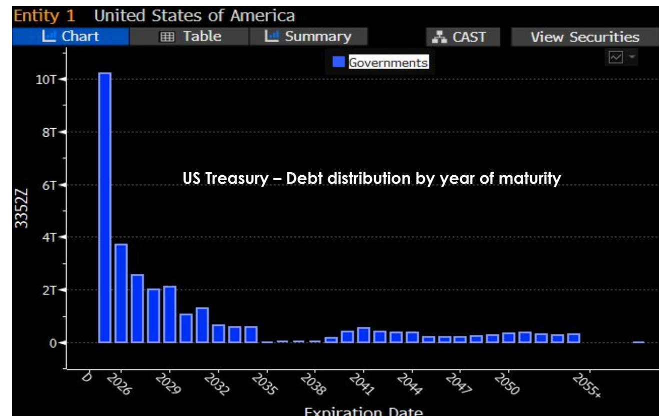
Over the past five years, world governments have resorted to large deficits at levels not seen since World War II. The impact on the debt-to-GDP ratio has been partly mitigated by inflation, which substantially eroded the preexisting stock of debt—fixed in nominal value. Nonetheless, the U.S. debt-to-GDP ratio has returned to the previous record reached during WWII. In absolute terms, U.S. public debt held by the public has soared from about $16 trillion at the end of 2019 to $36 trillion today, more than doubling in just five years.

An ever-increasing public debt, combined with the normalization of interest rates, is fueling a surge in interest expenditures. In FY 2024, net interest spending amounted to $882 billion (with gross interest near $1.2 trillion). Interest payments were the second-largest federal expenditure, behind only Social Security, and exceeded spending on national defense or Medicare.

In this context, it will be crucial to assess how the new administration's economic policies will affect public finances. During the campaign, Trump capitalized on widespread public discontent with the existing ruling class. Notably, 2024 saw the highest number of citizens ever called to the polls. In every country, without exception, the ruling party or coalition lost votes—an unprecedented development. Victorious candidates generally prevailed by promising higher transfers or lower taxes.

Following that strategy, Trump made several pledges that could further strain public finances. These include extending the tax cuts he originally passed when he was president—the Tax Cuts and Jobs Act (TCJA)—which will soon expire unless renewed. Other proposed measures include reducing the corporate tax rate to 15% or reducing/eliminating taxes on social benefits. He also vowed to cut unnecessary government spending, but historically it has proven extremely difficult to implement such cuts.





Source: Financial Times *Source: Bloomberg*

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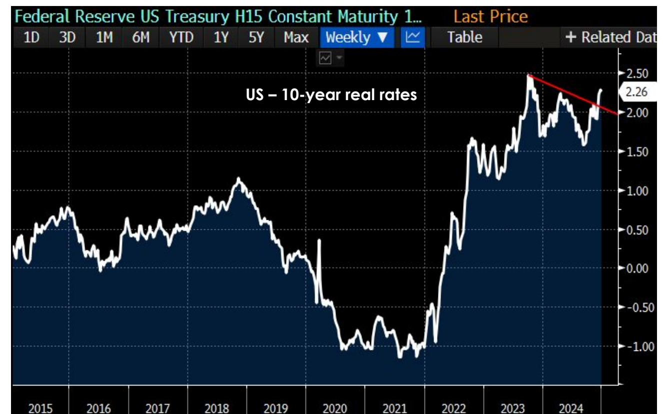

Source: Bloomberg *Source: Bloomberg*

In recent years, it has often been presumed there is no limit to public debts, and no negative consequences associated with it. Countries that spent more enjoyed higher growth, and were praised for it. However, 2025 may test the belief that endless debt expansion is the path to prosperity.

In 2025, $10 trillion of U.S. Treasuries will mature and need to be rolled over. Added to this is the annual deficit, which could be in the range of $2 trillion. In total, the United States will have to issue about $12 trillion in government bonds. This enormous figure suggests the market will likely demand adequate compensation to absorb so much new debt

In recent years characterized by the normalization of interest rates, the U.S. government shortened the average life of debt by issuing new debt that generally had a shorter maturity than the debt that was coming due. The government's implicit bet was that the rise in rates would be transitory. Under this assumption, when newly issued debt with a short maturity would come due again, rates would be lower. Thus, at that point, issuing again debt with longer maturities would have allowed the government to lock-in lower rates for longer, resulting in diminished interest expenditure.

However, inflation has proven stickier than expected, fiscal deficits have ballooned, and now Trump's election—along with a potentially inflationary agenda and larger deficits—threatens to overturn this strategy. U.S. market rates have already started to soar, notably at the long end of the curve. Both nominal and real 10-year interest rates have broken the downward trend in place since late 2023.

Unless the U.S. economy slows substantially, forcing Fed to cut rates aggressively, this year's massive Treasury bond issuance will likely keep pressure on long-term rates. Because U.S. interest rates are critical to the performance of other asset classes—especially higher-risk assets—any further jump in risk-free rates could have wide-reaching consequences.

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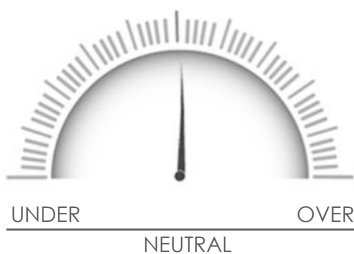
Asset Allocation View

Equity			
Developed Markets			
Emerging Markets			
Fixed Income			
Developed Markets Sovereign			
Developed Markets Corporate			
Emerging Markets			
Commodities			
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

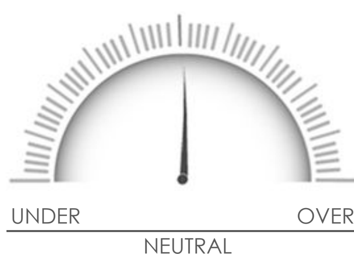
Equity

Developed Markets



We have kept our **Neutral** recommendation on Developed Market Equities. The mild correction at the end of the year cleared overbought conditions, allowing bullish trend to resume – also helped by the "January effect." Over the medium term, further upside will depend on the evolution of interest rates and on the policies announced by Trump once he takes White House. If rumors of a milder implementation of tariffs are confirmed, a relative rebound in the rest of the world relative to the United States is possible.

Emerging Markets



We have maintained our **Neutral** recommendation on Emerging Markets Equities. Emerging markets still trade at a substantial discount relative to developed markets and could also benefit from the January effect. If rumors that the Trump administration may impose lower tariffs than initially announced hold true, China could be one of the primary beneficiaries.

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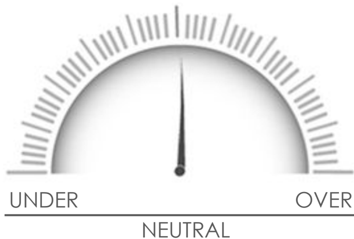
Fixed Income

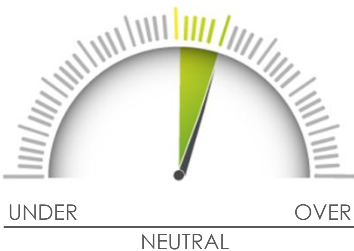
Developed Markets Sovereign



We have maintained our **Neutral** recommendation on Developed Markets Sovereign Bonds. We continue to favor the short end of the U.S. curve but remain cautious about the long end, pending greater clarity on Trump's policies and the government's growing funding needs. Overall, the committee holds a more constructive view on other curves.

EU Core		EU Periphery		US Treasury		Japanese JGB	

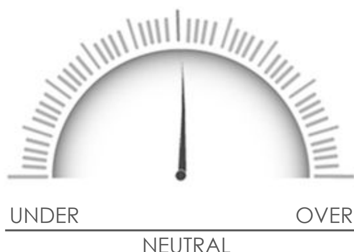
Developed Markets Corporate



We have kept our **Slightly Overweight** recommendation on Developed Markets Corporates. The search for yield in the fixed income market will continue to favor corporate bonds. Within corporates, we maintain a preference for investment-grade bonds over high-yield bonds that are hovering around all-time lows.

IG Europe		IG US		HY Europe		HY US	

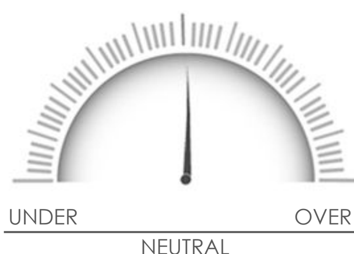
Emerging Markets



We have kept our **Neutral** recommendation for Emerging Market Bonds. The potential risks posed by tariff impositions from the Trump administration are mitigated by the recent widening of spreads on emerging market bonds compared to similarly rated corporate bonds in developed markets.

Local Currency		Hard Currency IG		Hard Currency HY	

Commodities



We maintained our **Neutral** recommendation on Commodities. Despite the recent dollar strength and easing inflation, precious metals remain the most attractive segment within commodities. Bullion often outperforms during periods of monetary policy easing and serves as a portfolio hedge against unexpected geopolitical tensions.

Precious		Energy		Industrial		Agricultural	

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Currencies

The Committee kept the **Neutral** stance on the US Dollar. There is room for a short-term retracement by the US Dollar, particularly in case the rumors of lower tariffs will be confirmed.

The view on the Euro remains **Neutral** as well. The rate differential with the US suggest at current valuations the euro is fairly valued.

The view on the **Chinese Renminbi** remains **Neutral with a bearish bias**. The Chinese currency will continue to remain under pressure until the Chinese government effectively implements long-awaited fiscal measures to support the domestic economy, even if the United States will not impose such high levies as previously speculated.

The outlook for other **emerging market currencies** remains **Neutral** but no longer with a bearish bias, in view of softer tariff by the US government.

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