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» Fisch View

April's topic:
„Globally exploding government debt"

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Globally exploding government debt

– The current environment is characterised by a potentially deflationary economic policy in the US and a simultaneous inflationary expansion of government debt in Europe and China.
– We remain neutrally positioned in terms of both duration and risk exposure.
– In the medium term, however, we see upward pressure on long-term government bond yields as a result of globally rising government debt – including in the US, as long as the debt burden continues to rise.

Overall economic situation

Due to the planned historic spending increase on defence and infrastructure in Europe, which will be at least partially financed by the ECB's money printing press, strong economic and inflationary impulses are to be expected. This trend will also be reinforced globally by the “rigorous stimulus measures” just announced by the Chinese government.

Interestingly, the US government and its Treasury Secretary Scott Bessent are currently working in exactly the opposite direction and are planning a “detox period” for the US.

Recent developments: “Detox period” for the US economy

— US Treasury Secretary Scott Bessent has ordered a “detox period” for the US economy — meaning, above all, reduced government spending and a lower budget deficit. The goal of this measure is to bring down long-term government bond yields, even if it means accepting temporary economic pain in the form of a weaker stock market or even a recession.
— According to Bessent, lower yields will lead to renewed growth and rising stock prices in the medium term — without the help of the Federal Reserve. The new US administration’s approach therefore represents a remarkable and radical shift away from the unsustainable spending policies pursued since the start of the coronavirus pandemic. A comparable “shock therapy” was last seen in 1980–82 under the auspices of the presiding Fed Chair Paul Volcker.
— Europe, by contrast, is significantly increasing its government debt to finance defence spending and infrastructure projects. Germany, in particular, has considerable room to catch up with France and Italy in this regard. However, the ECB is expected to intervene to calm any unrest in the government bond markets.

➲ **On the radar: Europe in a debt frenzy** (page 6)

Overview & outlook: Contrasting global forces

— The new US administration under President Trump and Treasury Secretary Bessent is deliberately accepting a weaker economy – and potentially sharper declines in equity markets – in order to bring government debt, long-term yields, and inflation under control. In doing so, no pressure is being placed on the central bank to ease monetary policy. While this approach, combined with a wave of deregulation, is highly sustainable in the medium term, it could in the short-term lead to heightened volatility in risky assets, temporary liquidity shortages, and resulting stress in money markets. These risks should not be underestimated.

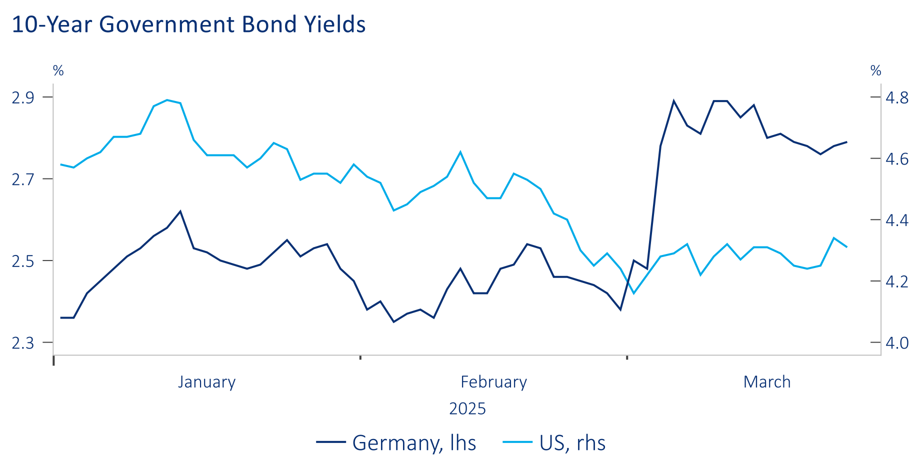
— In the event of a recession, the goal of lower long-term yields could even be temporarily missed, as falling tax revenues might widen the fiscal deficit despite spending cuts. Subsequent deregulation and tax cuts would likely push the deficit even higher, with only a delayed impact on stabilising economic activity.

— In Europe, the situation is entirely the opposite of that in the US. A massive increase in government debt is planned – not only in Germany – to finance extensive defence and infrastructure spending. The amounts involved are substantial, with estimates exceeding EUR 2 trillion in the eurozone over a 10-year period. In addition, the ECB is expected to purchase a portion of the new debt. China, too, is ramping up fiscal stimulus programmes and easing monetary policy.

» A balance of positive and negative forces

— As a result, strongly opposing forces are currently at work on the global stage: In the US, these tend to be deflationary, Y-dampening, and liquidity-reducing – while in Europe and China they tend to be inflationary, yield-boosting, and liquidity-increasing. This creates, for the time being, a balance between positive and negative factors in both global equity and government bond markets, resulting in neutral short-term price expectations. However, this balance is fragile and could tip at any time if, for example, deflationary forces in the US were to gain the upper hand.

Chart: Bessent's deflation path meets Europe's debt offensive



Sources: U.S. Treasury, Macrobond, Fisch Asset Management

Positioning: Global liquidity supports financial markets

— The US Treasury is firmly committed to significantly cutting spending and, by extension, reducing government debt – even at the cost of a recession and a weaker equity market. As a result, strong downward pressure on long-term US Treasury yields could soon emerge. However, concrete action must follow these announcements first. There is also a risk that the planned spending cuts may not be implemented at the intended scale. In addition, US Treasury yields are currently not reacting strongly to weaker economic data – a sign of short-term technical weakness. Overall, a neutral positioning remains appropriate for now.

— In Europe, forces opposite to those in the US are affecting bond markets – namely, planned increases in public debt and a somewhat more favourable economic outlook. However, these forces have yet to fully unfold their impact. As such, we remain positioned in a neutral range in terms of duration. Any deviation from this neutral position will depend on the evolution of inflation, government debt levels, and monetary policy.

» Liquidity shortages expected from mid-year

— For equity and corporate bond markets, government debt is currently less relevant than global liquidity conditions. And here, we are observing a moderate increase – which is a positive for risky assets. However, refinancing needs for both companies and governments are rising sharply. As a result, liquidity shortages could emerge from mid-year and persist well into 2026. These would likely need to be bridged in a timely manner by central banks, particularly the Fed – something we consider highly likely. We thus remain in a neutral range for equity and corporate bonds. We are closely monitoring several early liquidity indicators, including SOFR spreads, the Japanese yen, government bond yields in Europe and the US, and the Fed's Quantitative Tightening (QT) programme.

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA
Return drivers						
Equities	o	+	o	o ↓	o	o
Gov. Bonds	o	o	-- ↓			
Credit IG *(Spreads)*	+ ↑	+ ↑		-	+ ↑	o
Credit HY *(Spreads)*	+ ↑	+ ↑		o	+	o
Total return						
Convertibles	o	+	-	+		
Credit IG	+	+		o	+	+
Credit HY	+	+		+	+	+

	PrecMet	InduMet	Energy
Commodities	++ ↑	+	o

Key:

++	Strong positive market
+	Positive market
o	Neutral
-	Negative market
--	Strong negative market

Notes regarding the table: The table summarises the model results for the total return of convertible bonds and credit investment grade and high yield, which are a function of the listed return drivers. Changes from prior month are indicated with ↓ or ↑, i.e. "O ↓" means that the output has weakened from a prior value of + or ++. The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained here.
Within government bonds, we take German Bunds into account for Europe.

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
Convertible Bonds	– Software (Cybersecurity) – Semiconductor (AI-related) – Healthcare – CBs with high convexity – Bond-like CBs with quality credits and attractive yields – Balanced deep investment grade Chinese tech with high convexity	– Consumer discretionary – Unprofitable, early stage, expensively valued IT and biotech – Weak credit quality and/or liquidity – Cryptocurrency-related names
Global IG Corporates	– Financials, energy, technology – EUR- and USD-denominated issues – BBB-rated bonds	– Transportation, chemicals, capital goods – GBP- and CAD-denominated issues – AA-rated bonds
Global Corporates	– Healthcare, financials – BBB & BB-rated bonds – Developed markets	– Transportation, utilities, chemicals – AA-rated bonds – Emerging markets
Global High Yield	– Capital goods – Basic industry – Telecommunications	– Transportation – Financial services – Electronics
Emerging Markets - Defensive	– LatAm (Chile, Peru, Mexico), Eastern Europe – Utilities, metals & mining, oil & gas – Maturities 7-10 years	– Asia, Middle East – China, Israel, Kuwait
Emerging Markets - Dynamic / Opportunistic	– LatAm (Brazil, Colombia, Mexico) – High yield energy, oil & gas – Short-dated high-yield bonds	– Asia, Middle East – Maturities >10 years – A-rated bonds

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

On the radar: Europe in a debt frenzy

The massive debt buildup planned within the European Union to finance historically unprecedented defence and infrastructure spending is expected to lead, in Germany alone, to an increase in government debt relative to GDP from the current 64% to an estimated 85%. A further significant rise is also highly likely in Italy and France, where debt levels are already high – 135% in Italy and 111% in France.

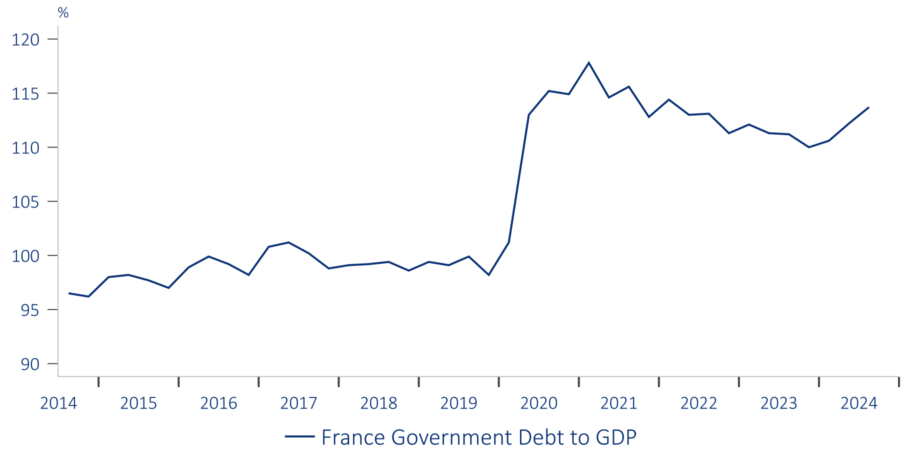
Without the support of the European Central Bank (ECB), Germany could see a noticeable rise in 10-year government bond yields from the current 2.8% to a level between 3.5% and 4%. In Italy, yields could increase from 3.8% to 5% or more, and in France from 3.5% to 4.5% or beyond. Such a sharp rise in yields, against the backdrop of significantly higher debt levels, would be particularly burdensome. Interest payments would reach a scale that could no longer be covered by tax revenues alone.

Who can and will provide relief in this situation? Naturally, the central banks. The ECB has already announced its willingness to assist, following the examples of the US, Japan, the UK, and many other countries. In the event of insufficient market demand, government bonds offered for sale would simply be purchased by the central bank, thereby keeping yields in check. The US and Japan in particular (since 1989) have shown that such an approach can work over very long periods – so long as inflation remains reasonably under control. Additionally, there is hope that the high levels of government spending will spur economic growth and thus lead to higher tax revenues, which would help reduce the deficit. However, this trick was already attempted in the early 1980s by US President Ronald Reagan and his advisor Arthur Laffer – with strongly negative consequences: US government debt exploded at the time.

» Sharp rise in yields can be dampened

Other effective measures to curb a rise in yields would be to spread spending over more than ten years and/or make savings in the annual budget, as the US is currently trying to do. At the moment, it looks as if a very sharp rise in yields in Europe could at least be slowed down with the measures described above and together with the ECB.

Chart: Public debt in France on the rise again



Sources: INSEE, Fisch Asset Management

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