

Income Generator: Great Expectations in Fixed Income

After a mid-April “tariff tantrum,” bond markets appear to be moving past trade headlines and turning their attention to upcoming tax policy and budget negotiations.

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Topic

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Key takeaways

- The market focus appears to be shifting from tariff headlines to broader fiscal policy developments.
- Nominal and real bond yields appear attractive in many jurisdictions and sectors, though price volatility remains elevated.
- “Income Is Your Friend” and “Diversify Duration” remain our central high-level investment themes as investors navigate this brave new world.

What lies ahead for fixed income investors?

Tariffs & revenue

President Trump and his administration are now in a 90-day negotiation window with many countries from around the globe. A baseline tariff of 10% appears to be the starting point for most negotiations, with final rates expected to settle at around 16%.¹ Tariff estimates are expected to contribute ~\$200–400 billion per annum¹ to federal receipts, which equates to 1.0–1.5% of gross domestic product (GDP).

Taxes & budget

On May 12, the House Ways and Means Committee released the tax components of its reconciliation bill.² While the bill has yet to be scored against the \$4.5 trillion budget resolution threshold or incorporate tariff revenues, of note for bond investors is that the bill would raise the country’s existing \$36.1 trillion debt limit by ~\$4 trillion—closely aligned with the projected \$3.7 trillion deficit increase over the next decade. Notably, the bill makes no mention of any changes to the tax-exempt status of municipal bonds. Overall, Congress appears poised to increase the deficit by 1.5–2.0%,³ with U.S. Treasury net issuance potentially rising to ~7.5% of GDP.

Growth & inflation

Backward-looking “hard data” continues to show a U.S. economy near full employment with inflation above target. While sentiment-driven “soft data” sentiment indicators remain soft, they are beginning to firm as trade agreements progress. Labor market strength remains the key forward-looking indicator. Consensus forecasts suggest GDP growth will slow to below 1%, while inflation could rise to ~3.5% by year-end 2025.⁴

Federal Reserve policy

The Federal Reserve (Fed) remains in a “wait and see” stance, balancing the interplay between higher tariffs and other shifts in fiscal policy. Fed policy is likely to be slow to respond to growth

concerns with inflation still above target, but it may be quick to respond to financial stability issues, should they emerge. While rate cuts are still on the table, the market now prices in only two 25-basis-point (bp; 100 bps equal 1.00%) cuts by year-end⁵—down from nearly five during the height of tariff fears.

Global landscape

Globally, Europe shows signs of stabilization and is expected to initiate German-led fiscal stimulus of more than 5% of GDP,⁶ China is slowing, and emerging markets are mixed. While many central banks may be inclined to ease policy, most appear to be waiting to assess the full impact of tariffs.

Allspring fixed income perspectives

Despite recent volatility, bond yields—both nominal and real—appear attractive across many markets. For investors willing to endure short-term turbulence, relative value opportunities appear to exist beyond U.S. Treasuries in sectors such as municipals, mortgage-backed securities, asset-backed securities, select corporates, and international debt.

[Allspring's prevailing themes](#)—"Income Is Your Friend" and "Diversify Duration"—remain the cornerstone of our investment strategy as we navigate this evolving and uncertain fixed income landscape.

Key investment themes

- **Cash management.** Investor cash balances appear to be rising as markets await clarity on tariffs, taxes, and economic direction. A holistic approach to liquidity management that incorporates money markets, ultra short duration, and short duration strategies may help preserve capital while generating incremental income.
- **Yield curve positioning.** We believe a steeper yield curve is likely, with the Fed and other central banks, including the European Central Bank (ECB), anchoring short-term rates and inflation concerns pressuring the long end of the curve. Based on this, strategies that benefit from curve steepening may be preferred. Also, an up-channel appears to be developing in longer-dated bonds, with the 30-year U.S. Treasury yield approaching 5% and seemingly trending higher.
- **Yield & income strategies.** "Income Is Your Friend" remains a guiding principle. Credit spreads have normalized following recent volatility, but with spreads returning to pre-tariff levels, incremental yield is becoming more expensive.
- **Foundational fixed income.** "Diversify Duration" continues to be a cornerstone of our approach. High-quality, core-based strategies tend to benefit from up-in-quality orientation with deep liquidity—providing a stable foundation. Multi-sector and credit-oriented strategies that are allocated to international markets and/or move down in quality offer potential opportunities to diversify risk and generate incremental returns.

1. The Budget Lab at Yale, State of U.S. Tariffs: 12-May-25

2. U.S. House Committee on Ways & Means, The One, Big, Beautiful Bill, 12-May-25

3. Allspring estimate, as of 14-May-25

4. Bloomberg Economic Consensus Forecasts, as of 14-May-25

5. Bloomberg futures pricing (WIRP), as of 14-May-25

6. DW, Germany's massive spending spree: How will the EU react?, 13-May-25

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