BARCLAYS Investment Bank

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The Eagle Eye

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WHAT'S HAPPENING IN MARKETS & ECONOMIES

Deficit and debt concerns

US Congress is trying to push through what President Trump has called "one big, beautiful bill," which would cut taxes for companies and consumers. Republicans have been arguing over the details of the bill, and their slim majority in both chambers of Congress makes it far from certain they will succeed in passing it. But if they do, the new tax cuts would likely add trillions to the deficit and balloon the government's debt. Last week they leaped the first hurdle when the House of Representatives passed the bill with only a one-vote margin.

What's new?

The bill that the House passed extends the tax cuts passed during Trump's first term and adds new ones, such as eliminating taxes on tips and raising the standard deduction for personal income. It also includes some spending cuts, but even with those offsetting some of the tax cut costs, the bill would add about $2.5 trillion to the deficit over the next decade, according to our economists. That cost is likely to swell further – to $4 trillion – if Congress extends the new tax cuts when they are supposed to expire in 2028, as legislators usually do. Coupled with rising debt interest payments, this will mean the debt-to-GDP profile has no chance of stabilizing for many years.

Why it matters

The US fiscal picture is strained to start with. The government has been running annual deficits of 6.5-7% of GDP regardless of which party has been in power, and the debt level has reached 100% of GDP. Treasury yields have been rising for some time, for many reasons including concerns over inflation, but part of the reason is arguably because of concern about successive US governments failing to rein in ever-rising deficits.

What to watch for

The bill heads to the Senate next where it is likely to be altered, and the deficit forecasts will probably change as details do. Senate Republicans will likely add more tax cuts and eliminate some of the spending cuts that are currently in the bill, which would lead to even bigger budget deficits in the coming years.

Long-term bond yields have been rising in recent months

Source: Bloomberg, Barclays Research

Top

Rekindled tariff jitters

On Friday, President Trump suggested the US might impose 50% tariffs on the EU starting on June 1, rattling markets with renewed trade war concerns. Over the weekend, he said he'd postpone them until July 9, allowing negotiators time to try to hammer out a trade deal between the US and the EU. While the initial threat was likely a negotiating tactic, it highlighted the fragility of trade relations and reminded investors that the US has not turned the page on tariffs yet.

What happened last week?

In addition to the EU threat, last week Trump also said that the US might impose 25% tariffs on Apple products if iPhones are not made in the US, despite estimates that US-made iPhones would cost $3,500. These developments – despite the delay to the threatened EU tariff – suggest that trade disputes might not be as settled as many had thought after the US-China deal earlier this month. Our economists see the EU threat as a negotiating tool and do not expect 50% to be the ultimate tariff for EU goods coming to the US. However, they also think the renewed threats signal it might be too optimistic to expect the 10% reciprocal tariffs to remain in place and that the continent could end up with higher US import duties

Why it matters

A 50% tariff on EU goods would be a significant hit to US consumption and could lead to a sharp decline in trade between the two economies. If they came to pass, such high tariffs would cause a deep recession in the EU and force the European Central Bank to cut interest rates close to zero.

What to watch for

Multiple teams of US and European officials are negotiating to reach a trade deal before Trump's deadline. European officials have indicated they are eager to find common ground.

Top ⬆