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Fiscal Concerns Put Pressure On Dollar and Bond Market

Yields on long-term Treasuries rise further after nation loses AAA rating

BY SAM GOLDFARB AND HANNAH ERIN LANG

The U.S.'s deteriorating fiscal situation is threatening to spoil Wall Street's good mood.

Investors sold U.S. government bonds and the dollar on Monday, after Moody's Ratings stripped the U.S. of its last triple-A credit rating late last week, citing large budget deficits and rising interest costs. Adding to the nervousness about the U.S.'s debt trajectory, the House Budget Committee advanced a tax-and-spending bill Sunday that is projected to add trillions of dollars to those deficits.

Though stocks ended the session higher, selling pushed up yields on longer-term Treasuries, which rise when bond prices fall. The yield on the 30-year bond briefly topped 5% before settling just below that threshold, still near its highest level of the year.

The yield gains extended a weeklong climb, fueled by a mix of receding recession fears, persistent worries about inflation and growing concerns that wider deficits will necessitate ever-larger bond auctions. A bigger supply of Treasuries can outstrip demand, forcing the government to pay higher interest rates to attract investors.

The size of recent budget deficits have been particularly alarming for investors. That is because they have come while the economy is strong, rather than in a recession, when tax revenue typically plunges and the government ramps up spending to revive growth and help the unemployed.

"If we're putting up deficits of this type now, what might it be like when the economy does run into any form of trouble?" said Christopher Sullivan, chief investment officer for the United Nations Federal Credit Union.

The yield on the 30-year Treasury bond settled at 4.937%, according to Tradeweb. That was up from 4.786% at

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the end of last year. The yield on the 10-year note settled at 4.473%, up from 4.437% Friday and less than 4.2% at the end of April.

The rise in yields has hardly slowed stocks, which have rebounded in recent weeks after the Trump administration walked back some aggressive tariff policies and investors' fears of a recession eased.

Still, investors are keeping a watchful eye on Treasury yields, which play a major role in determining borrowing costs across the economy. The S&P 500 rose 0.1% Monday, while the Dow Jones Industrial Average increased 0.3%, and the tech-heavy Nasdaq Composite was flat.

Heading into this year, many analysts argued that one of the biggest risks to stocks would be a jump in Treasury yields if Republicans passed tax cuts without offsetting their cost.

Those worries faded to the background when President Trump announced huge new tariffs on April 2, raising immediate concerns that the economy could be driven into a recession. But they have resurfaced lately, even before the Moody's downgrade, while the long-awaited tax-cut legislation has taken shape in Congress. After clearing its latest hurdle on Sunday, the House is expected to vote as soon as this week on a proposal that would extend expiring tax cuts, add some new ones and reduce spending on Medicaid and nutrition assistance. It is expected to increase budget deficits by about \$3 trillion over the next decade, compared with a scenario where the tax cuts expire as scheduled Dec. 31.

The U.S. has a longstanding imbalance between the money it spends and what it collects from taxes. Publicly held federal debt stands at about \$29 trillion, nearly double the level when Trump signed his original tax cut in 2017. Nearly \$1 in every \$7 the U.S. spends goes toward paying interest, more than the country spends on defense.

Fiscal concerns threaten to revive the "Sell America" trade that emerged last month, when investors worried that isolationist trade policies could lead to a global capital war that would result in foreign investors dumping U.S. assets, including Treasuries.

"It adds further fuel to the 'Sell U.S.' trade, and you're seeing that reflected," said Michael Arone, chief investment strategist at State Street Global Advisors.

"Investors are waiting and seeing what happens with policy; they're waiting and seeing what happens with interest rates," Arone said. "That's uncomfortable, and I think that's ultimately what is being reflected in markets."

Several investors noted that concerns about the U.S.'s fiscal standing have plagued investors for years without causing extended disruptions to stocks. They said factors including changes in trade policy are more likely to move markets in the short term.

"The market has no idea what to focus on, and it keeps having to shift," said Kevin Gordon, senior investment strategist at Charles Schwab. "Tariffs will probably still be number one on that list."

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