Weekly commentary

BlackRock

March 10, 2025

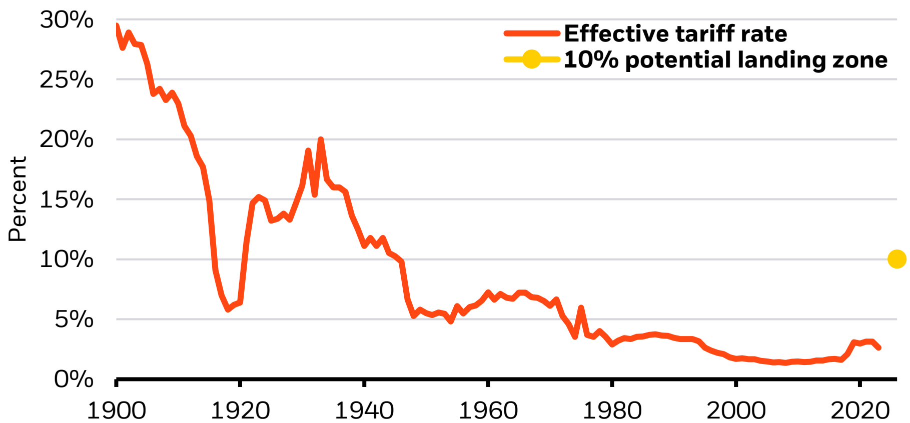
Big policy shifts reinforce higher rates

- U.S. tariffs and Europe boosting fiscal stimulus reinforce our view of policy rates staying higher versus pre-pandemic levels. We go underweight euro area bonds.
- U.S. stocks slid 3% last week on market concerns about policy uncertainty. German bond yields jumped the most since 1990 on big fiscal spending plans.
- We think solid, if slowing, job growth and persistent wage pressures should show sticky core inflation in next week's February U.S. CPI data.

Germany's planned fiscal boost and the U.S. starting to levy hefty tariffs are major policy shifts. Policy uncertainty and bond yield spikes pose risks to growth and stocks near term. We see more upward pressure on European and U.S. yields from sticky inflation and rising debt levels, even as lower U.S. yields suggest markets expect a typical Federal Reserve response to a downturn. Yet we think mega forces like AI can offset these drags on stocks, keeping us positive over six to 12 months.

Return of tariffs

U.S. effective tariff rate, actual and potential, 1900-2025



Forward looking estimates may not come to pass. Source: BlackRock Investment Institute, U.S. Bureau of Economic Analysis, Historical Statistics of the United States, with data from Haver Analytics, March 2025. Note: The chart shows the effective rate of tariffs – total tariff revenue divided by total import value. The dot shows our estimate of where the effective tariff rate could ultimately end up.

The U.S. briefly rolled out the largest tariffs in nearly a century on March 4: 25% tariffs on most Canadian and Mexican imports and an extra 10% on China. While most North American tariffs were later put on ice for another month, we think an average effective tariff rate of about 10% could be the eventual landing zone – with volatility along the way. See the chart. What matters more for near-term growth: any pain due to elevated uncertainty, including a potential U.S. government shutdown. Markets expect weaker U.S. growth to push the Fed to cut policy rates as in a typical business cycle. Yet we see a tough trade-off between supporting growth and curbing sticky inflation, limiting how much the Fed can cut. That reinforces our expectation of rates above pre-pandemic levels and higher bond yields. Germany's plans for big defense and infrastructure spending mark a major fiscal policy shift.

Jean Boivin
Head – BlackRock Investment Institute

Wei Li
Global Chief Investment Strategist – BlackRock Investment Institute

Glenn Purves
Global Head of Macro – BlackRock Investment Institute

Tuan Huynh
Chief Investment Strategist for Germany, Austria, Switzerland and Eastern Europe – BlackRock Investment Institute

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Our scenarios framework – mapping potential outcomes for different mixes of growth, inflation and policy responses – helps us navigate this evolving market and economic landscape. In the past few weeks, markets have been increasingly pricing in a potential recession. We disagree. Why? Job creation has slowed slightly but the labor market remains strong in contrast to soft survey data showing declining consumer confidence. U.S. corporate earnings are also holding up. We still think earnings strength can broaden out beyond tech and to other regions as the buildout and adoption of artificial intelligence progresses. While heightened policy uncertainty will drive near-term market volatility, these other drivers keep us overweight U.S. stocks.

Long-term U.S. Treasuries have rallied as recession fears grip markets. Yet they don't reliably buffer against equity selloffs given persistent inflation. And yields could spike suddenly. One reason: Higher-for-longer Fed policy rates and persistently large fiscal deficits – even with tariff revenue and spending cuts – could push investors to demand more compensation for the risk of holding long-term bonds. We stay underweight long-term Treasuries, preferring short-term notes for income.

This pressure on yields is global. German bunds suffered their sharpest selloff since 1990 after the parties set to lead Germany's next government agreed to a €500 billion infrastructure fund and axed deficit limits on defense spending. These plans – to be voted in parliament next week – come as the U.S. says Europe is no longer a top security priority. The European Union also proposed amending its budget rules to up defense spending. Europe could face higher-for-longer rates like the U.S. as greater government borrowing and spending stoke inflation. Plus, the European Central Bank is nearing the end of rate cuts. That's all why we think euro area sovereign bond yields can rise further and go underweight. We trim our underweight to Japanese government bonds: yields have surged to 16-year highs. Yet we still see room for JGB yields to keep rising in a world of elevated debt levels and higher inflation.

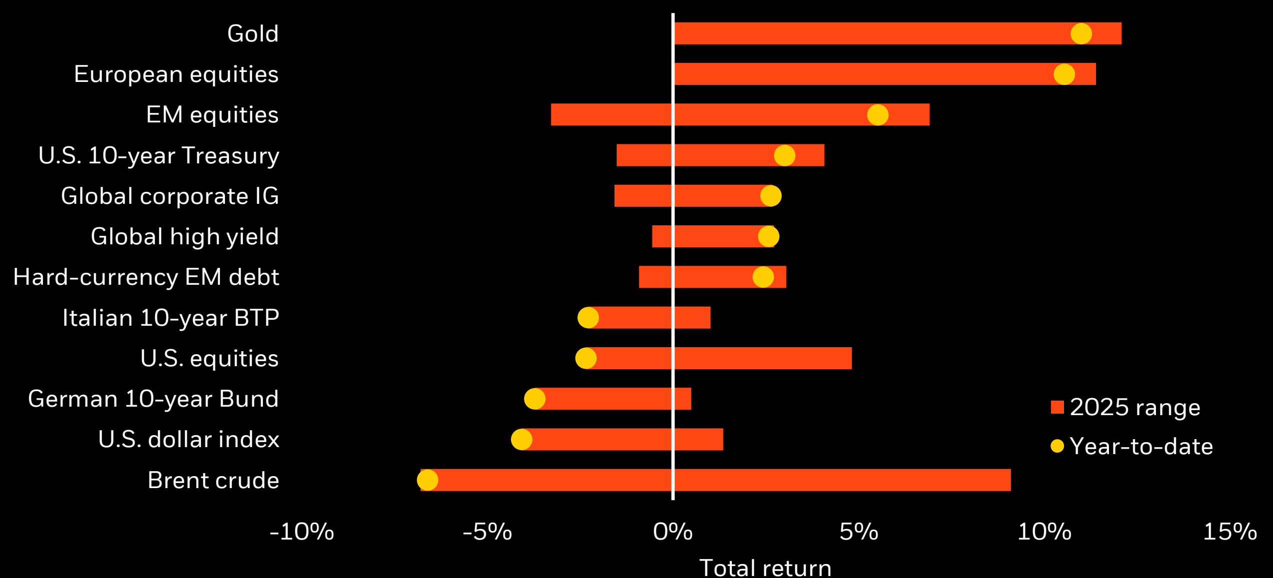
Bottom line: U.S. tariffs and Europe's plans for a fiscal boost reinforce our expectation of higher-for-longer interest rates and bond yields. We go underweight euro area bonds. Policy uncertainty could keep weighing on U.S. stocks near term.

Market backdrop

The S&P 500 slid 3% last week, its biggest weekly drop in six months and dragging the index into negative territory for the year. Ten-year U.S. Treasury yields were flat on the week but about 50 basis points below the year's high, while 10-year German bund yields jumped about 45 basis points last week – the largest surge since German reunification in 1990. U.S. payrolls data showing slower but still solid job gains suggests market concerns about a recession are overdone, in our view.

Assets in review

Selected asset performance, year-to-date return and range



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

Sources: BlackRock Investment Institute, with data from LSEG Datastream as of March 6, 2025. Notes: The two ends of the bars show the lowest and highest returns at any point year to date, and the dots represent current year-to-date returns. Emerging market (EM), high yield and global corporate investment grade (IG) returns are denominated in U.S. dollars, and the rest in local currencies. Indexes or prices used are: spot Brent crude, ICE U.S. Dollar Index (DXY), spot gold, MSCI Emerging Markets Index, MSCI Europe Index, LSEG Datastream 10-year benchmark government bond index (U.S., Germany and Italy), Bank of America Merrill Lynch Global High Yield Index, J.P. Morgan EMBI Index, Bank of America Merrill Lynch Global Broad Corporate Index and MSCI USA Index.

Week ahead

March 10	Japan trade balance	**March 13**	U.S. PPI
March 12	U.S. CPI; Japan corporate goods	**March 14**	U.S. University of Michigan sentiment survey; UK GDP

We're focusing on the U.S. CPI for February out this week. We expect inflation pressures to remain elevated given strong job growth and persistent wage pressures that suggest core inflation will stay above the Fed's 2% policy target. Now U.S. tariffs could potentially boost inflation pressures depending on their scope and implementation. We think that makes the Fed unlikely to cut interest rates as much as markets are pricing in.

Big calls

Our highest conviction views on tactical (6-12 month) and strategic (long-term) horizons, March 2025

Tactical	Reasons
U.S. equities	Policy uncertainty may weigh on growth and stocks in the near term. Yet we remain overweight as we see the AI buildout and adoption creating opportunities across sectors and driving equity strength over our tactical horizon. We tap into beneficiaries outside the tech sector. We see valuations for big tech backed by strong earnings, and less lofty valuations for other sectors.
Japanese equities	A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet the potential drag on earnings from a stronger yen is a risk.
Selective in fixed income	Persistent deficits and sticky inflation in the U.S. make us underweight long-term U.S. Treasuries. We also prefer European credit – both investment grade and high yield – over the U.S. on more attractive spreads.
Strategic	**Reasons**
Infrastructure equity and private credit	We see opportunities in infrastructure equity due to attractive relative valuations and mega forces. We think private credit will earn lending share as banks retreat – and at attractive returns.
Fixed income granularity	We prefer DM government bonds over investment grade credit given tight spreads. Within DM government bonds, we favor short- and medium-term maturities in the U.S., and UK gilts across maturities.
Equity granularity	We favor emerging over developed markets yet get selective in both. EMs at the cross current of mega forces – like India and Saudi Arabia – offer opportunities. In DM, we like Japan as the return of inflation and corporate reforms brighten the outlook.

Note: Views are from a U.S. dollar perspective, March 2025. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular funds, strategy or security.

Tracking five mega forces

Mega forces are big, structural changes that affect investing now – and far in the future. As key drivers of the new regime of greater macroeconomic and market volatility, they change the long-term growth and inflation outlook and are poised to create big shifts in profitability across economies and sectors. This creates major opportunities – and risks – for investors. See our web hub for our research and related content on each mega force.

1. **Demographic divergence:** The world is split between aging advanced economies and younger emerging markets – with different implications.
2. **Digital disruption and artificial intelligence (AI):** Technologies are transforming how we live and work.
3. **Geopolitical fragmentation and economic competition:** Globalization is being rewired as the world splits into competing blocs.
4. **Future of finance:** A fast-evolving financial architecture is changing how households and companies use cash, borrow, transact and seek returns.
5. **Transition to a low-carbon economy:** The transition is set to spur a massive capital reallocation as energy systems are rewired.

Granular views

Six- to 12-month tactical views on selected assets vs. broad global asset classes by level of conviction, March 2025

Our approach is to first determine asset allocations based on our macro outlook – and what's in the price. **The table below reflects this and, importantly, leaves aside the opportunity for alpha, or the potential to generate above-benchmark returns.** The new regime is not conducive to static exposures to broad asset classes, in our view, but is creating more space for alpha.

Underweight | **Neutral** | **Overweight** | ● Previous view

	Asset	View	Commentary
Equities	**Developed markets**		
Equities	United States	+2	We are overweight as the AI theme and earnings growth broaden. Valuations for AI beneficiaries are supported by tech companies delivering on earnings. Resilient growth and Fed rate cuts support sentiment. Risks include any long-term yield surges or escalating trade protectionism.
Equities	Europe	Neutral	We are neutral, preferring the U.S. and Japan. We see room for more European Central Bank rate cuts, supporting an earnings recovery. Rising defense spending, as well as potential fiscal loosening and de-escalation in the Ukraine war are other positives.
Equities	UK	Neutral	We are neutral. Political stability could improve investor sentiment. Yet an increase in the corporate tax burden could hurt profit margins near term.
Equities	Japan	+1	We are overweight. A brighter outlook for Japan's economy and corporate reforms are driving improved earnings and shareholder returns. Yet a stronger yen dragging on earnings is a risk.
Equities	**Emerging markets**	Neutral	We are neutral. The growth and earnings outlook is mixed. We see valuations for India and Taiwan looking high.
Equities	China	+1	We are modestly overweight. We think AI and tech excitement could keep driving returns, potentially reducing the odds of much-anticipated government stimulus. We stand ready to pivot. We remain cautious given structural challenges to China's growth and tariff risks.
Fixed Income	Short U.S. Treasuries	Neutral	We are neutral. Markets are pricing in fewer Federal Reserve rate cuts and their policy rate expectations are now roughly in line with our views.
Fixed Income	Long U.S. Treasuries	-2	We are underweight. Persistent budget deficits and geopolitical fragmentation could drive term premium up over the near term. We prefer intermediate maturities less vulnerable to investors demanding more term premium.
Fixed Income	Global inflation-linked bonds	Neutral	We are neutral. We see higher medium-term inflation, but cooling inflation and growth may matter more near term.
Fixed Income	Euro area govt bonds	-1	We are underweight. We see room for yields to climb more as Europe moves to ramp up defense and infrastructure spending. The European Central Bank is also nearing the end of rate cuts.
Fixed Income	UK gilts	Neutral	We are neutral. Gilt yields are off their highs, but the risk of higher U.S. yields having a knock-on impact and reducing the UK's fiscal space has risen. We are monitoring the UK fiscal situation.
Fixed Income	Japanese govt bonds	-1	We are underweight. Yields have surged, yet stock returns still look more attractive to us.
Fixed Income	China govt bonds	Neutral	We are neutral. Bonds are supported by looser policy. Yet we find yields more attractive in short-term DM paper.
Fixed Income	U.S. agency MBS	Neutral	We are neutral. We see agency MBS as a high-quality exposure in a diversified bond allocation and prefer it to IG.
Fixed Income	Short-term IG credit	+1	We are overweight. Short-term bonds better compensate for interest rate risk.
Fixed Income	Long-term IG credit	-1	We are underweight. Spreads are tight, so we prefer taking risk in equities from a whole portfolio perspective. We prefer Europe over the U.S.
Fixed Income	Global high yield	Neutral	We are neutral. Spreads are tight, but the total income makes it more attractive than IG. We prefer Europe.
Fixed Income	Asia credit	Neutral	We are neutral. We don't find valuations compelling enough to turn more positive.
Fixed Income	Emerging hard currency	Neutral	We are neutral. The asset class has performed well due to its quality, attractive yields and EM central bank rate cuts. We think those rate cuts may soon be paused.
Fixed Income	Emerging local currency	-1	We are underweight. We see emerging market currencies as especially sensitive to trade uncertainty and global risk sentiment.

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