The main reason Trump hit the pause on higher tariffs

Trump's 'liberation day' sweep of tariffs left global markets in turmoil. EPA-EFE/JUSTIN LANE

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Bond markets don't often make front-page news but the recent sharp sell-off in US Treasuries appears to have been enough to prompt US president Donald Trump to pause his plans for new tariffs.

Traditionally, US Treasuries are seen as one of the world's safest assets for investors. The United States government has long been regarded as a reliable and responsible borrower. That reputation has allowed the US to borrow at low costs for decades.

But the turbulence triggered by Trump's "liberation day" tariff announcement caused wild swings in the US government's borrowing costs. While some form of trade restrictions were anticipated, the scale and scope of the measures surprised markets and rattled bond investors.

The yield on the 30-year US Treasury, which moves inversely to the bond's price, rose 60 basis points, to above 5%, following the tariff announcement. Rising yields for governments effectively mean they pay more interest on their debt. For the US, this was one of the largest moves within a single week since 1981, when the Federal Reserve (the Fed) implemented sharp interest rate hikes to combat inflation.

The volatility of bond markets and nervousness among investors seems to have been the catalyst for encouraging Trump to pause the higher tariffs for 90 days. Trump himself remarked that bond markets had become "a little bit yippy".

So what exactly spooked them? Several forces seem to have combined to drive this sudden shift in sentiment.

First, bond prices are highly sensitive to inflation expectations. The introduction of broad-based tariffs was widely seen as inflationary. Both the tariffs and the threat of retaliatory measures from trading partners risked pushing up prices on everything from groceries to electronics.

The possibility of rising inflation pushed bond prices down, because inflation makes the fixed-interest payments from bonds less valuable over time.

Second, like any financial asset, bond prices are sensitive to investor demand. There are growing concerns that US Treasuries could face a "buyers' strike" – a scenario where escalating trade tensions and geopolitical uncertainty make investors wary of holding American debt.

Instead, many are turning to politically neutral safe havens like gold and other precious metals. There are also signs that foreign buyers, particularly from Asia and the Middle East, are pulling back from US debt, a shift that could further weaken demand and raise government borrowing costs even more.

Finally, the actions (or perhaps more accurately, the inaction) of the Fed also helped to drag bond prices lower. During previous bouts of extreme market volatility, like in March 2020 at the onset of COVID lockdowns in the US, the Fed stepped in with a raft of measures designed to calm markets.

But this time, with inflation still running above the Fed's 2% target, its options were far more limited. Any attempt to support bond markets risked fuelling inflation. The Fed's silence this time around offered little reassurance to bond investors, who have come to expect soothing interventions during times of stress.

The nerves are here to stay

Bond market volatility is unlikely to be a one-off event. Instead, it may be a sign of deeper, more persistent worry among investors over the US fiscal outlook.

For years, the US has been able to borrow cheaply, even as its national debt climbed, because investors saw Treasuries as safe, reliable and backed by a strong and stable economy. Demand was so steady that interest rates stayed low, allowing the government to finance large deficits without much fuss.

But erratic policy and large fiscal giveaways such as unfunded tax cuts and politically motivated spending increases like massive increases to military spending, mean that confidence is starting to fray. US federal debt currently stands at 100% of GDP and experts expect that figure to rise to 118% over the next decade. This is greater than at any point in the nation's history.

What's more, these forecasts do not yet reflect the budget framework passed by the Senate in early April, which aims at extending and expanding tax cuts introduced in 2017. Senate estimates suggest that these measures will cost an additional US$1.5 trillion (£1.15 trillion) over the next decade.

However, the nonpartisan Committee for a Responsible Federal Budget (CRFB), projects that the plan could increase the national debt by US$5.8 trillion over the same period.

Rapidly rising debt levels, combined with higher borrowing costs, are placing increasing pressure on the government's budget. According to CRFB figures, interest payments have nearly tripled since 2020, rising from US$345 billion to US$949 billion in the 2024 fiscal year.

It's this kind of fiscal strain, and the bond market's reaction to it, that is widely believed to have made Trump jittery enough to pause the latest round of tariffs.

Debt servicing costs now absorb around 14% of the federal budget, making it the second-largest expense after social security payments. These costs exceed national defence and Medicaid spending.

The US has long benefited from being able to borrow at a low interest rate, thanks to strong demand for its bonds. However, growing economic uncertainty and a worsening fiscal position mean that bond markets are likely to be more volatile and less forgiving going forward than they have been in the past.

If Trump remains wedded to tariffs as a key policy tool, this episode has given a clear sense of how bond markets might respond. The pursuit of policies that unsettle inflation expectations or deepen fiscal concerns will likely come at a high price for reckless governments.

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