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WS Global CIO Office
1 July 2025

Market Watch

The big, beautiful US budget

Summary

Event: The US Senate is negotiating the "One Big Beautiful" budget bill. If approved, the bill will go to the House of Representatives for approval before President Trump signs it into law by his self-imposed 4 July deadline. The Senate bill is estimated to add USD 3.3tn to the US deficit over a decade, providing a significant fiscal boost. Separately, the Fed is seeking to ease bank capital requirements.

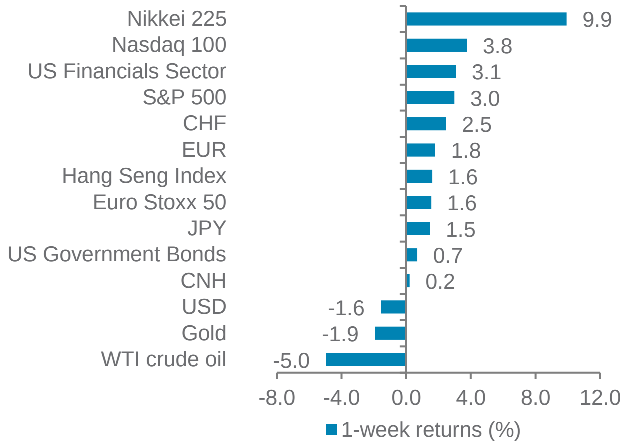
Market reaction: Equities are likely to get a boost from the fiscal stimulus, while the USD is likely to weaken. The S&P 500 index rose 3% over the past week, while the US 10-year bond yield fell 12bps.

Investment strategy: The bill, if approved, will provide a significant fiscal boost to a slowing economy. Concerns about a severe bond market reaction to the fiscal largesse are overblown. Proposed changes to regulatory capital requirements for banks should raise the structural demand for US government bonds by large US banks.

Therefore, we remain pro-risk and see value in US banks amid deregulation, an economic soft landing and a steeper yield curve. Any rebound in bond yields will be an opportunity to add.

Market reaction over the past week

Asset class returns between 23-Jun and 30-Jun 2025



Source: Bloomberg, Standard Chartered

The sum of fiscal boost and bank deregulation

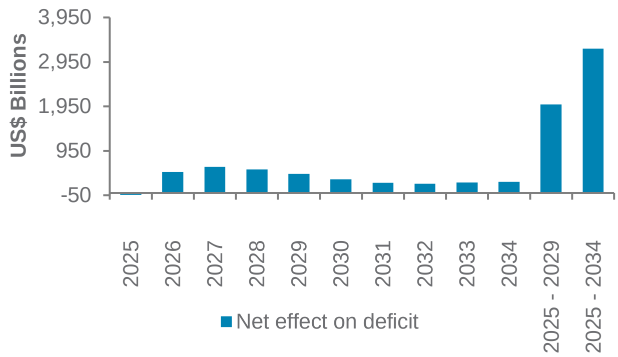
A potentially big fiscal boost. The Senate bill, if approved in its current form, will increase the US fiscal deficit by USD 3.3tn over a decade, according to the independent Congressional Budget Office estimates. This includes a USD 4.5tn of tax cuts (including extension of Trump's 2017 tax cuts) and USD 1.2tn of spending cuts, including cuts to healthcare, food and clean energy subsidies. The bill also proposes to raise the debt ceiling by USD 5tn before the government runs out of funds to pay its dues sometime in July or August.

Regulatory boost. In parallel to the fiscal boost, the Fed has proposed to ease the "enhanced supplementary leverage ratio", which would ease capital requirements for large banks. Feedback on the proposal is due by end-August. We believe the proposal augurs well for further banking regulatory changes ahead. We remain bullish on US major banks; they also passed their annual stress test recently.

Narrow path to 4 July deadline. The bill faces legislative hurdles before it can be signed into law by President Trump before his self-imposed 4 July Independence Day deadline. The Republicans have a 53-47 majority in the Senate, which means they can lose at most three senators and still pass the bill with Vice President Vance's deciding vote in the event of a tie. At least two Republican senators have said they will vote against the bill. After that, the bill needs to be approved by the House, where Republicans remain divided. The House had earlier passed a smaller bill with a single Republican vote.

The US budget for next fiscal year would add more than USD 3tn to the fiscal deficit over the next decade

Net effect on the US fiscal deficit from the "One Big Beautiful" bill



Source: US Congressional Budget Office, Standard Chartered

What does this mean for investors?

Bonds

Our View: 1) We believe the relaxation of supplementary leverage ratio (SLR) for banks and excluding US government bonds would increase banks' capacity to hold risk assets and limit the impact on long-term bond yields. We would add to bonds on any yield spikes, potentially on inflation and fiscal concerns. 2) The net impact of SLR relaxation on major US financial sector bonds is neutral but should create room for more DM IG corporate bond relative value ideas .

Rationale: The Fed proposal lowers the leverage requirements for the eight US global systemically important banks. Additionally, US government bonds will be excluded from the calculation of SLR.

While these measures enable banks to hold more US government bonds (UST), we believe the net impact on longer term bond yields will be smaller. Banks will still be wary of holding long-term bond amid inflation and fiscal concerns. That said, with improved capacity to hold US government bonds, banks are incentivised to step up intermediation activities, and that will improve UST market liquidity.

With major US banks operating with capital surpluses, the lower SLR requirements will mean lesser need for extra capital. This should limit new supply of their bonds, capping yield premiums. However, as premiums are already near the tight end of their historical range, we believe the net impact on bonds from major US financial institutions will be neutral. We see relative value rotation opportunities within DM IG corporate bonds as banks will have greater capacity to hold risk assets, enabling them to take on more relative value investments.

Equities

Our View: 1) Within US equities, focus on US major banks, 2) Trim excessive positioning in US equities and rotate into global equities.

Rationale: The Fed's proposal to ease SLR requirements would release around USD 200bn in additional excess capital for the large banks. We believe the proposal augers well for further regulatory changes, with lower bank capital requirements the likely result. With the US banks clearing the Fed's annual stress test recently, we believe this relaxation would boost bank share buybacks and dividends. Thus, we remain bullish on US major banks. Investor rotation into US financial sector equities can take some steam out of the growth stocks, which have been rallying sharply since mid-April.

Historically low investor positioning in US equities counteracts pressure from possible weakness in US macro data. This limits the downside to US equities, but investors should take this opportunity to rotate into cheaper markets, such as Asia ex-Japan, Euro-area and Japan. **The removal of section 899 from the budget bill also adds relief to European and Japanese companies with US operations, as they could have faced larger tax bills under section 899.**

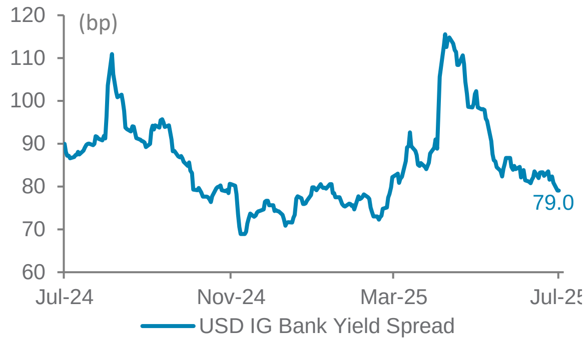
FX

Our view: The projected rise in US fiscal deficit because of the budget is likely to **sustain the weak USD narrative.** Add to JPY or EUR.

Rationale: The broad dollar index (DXY) has broken below its three-year range amid concerns about US policy uncertainty and rising government debt. The budget, if approved in its current form, is likely to add to those concerns. Although US bond yields are likely to be contained by regulatory easing of bank capital requirements, the US government will need to continue to rely on foreign investors to fund its debt. This may add to the USD's risk premium. As of December 2024, foreigners held 30% of US publicly-held debt.

The yield premium on US investment grade banks are back to the tight end of the range

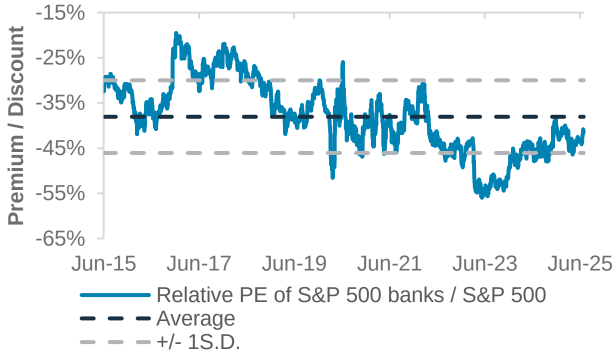
Bloomberg investment grade banking index, yield spread



Source: Bloomberg, Standard Chartered

The S&P 500 Banks index is trading at a discount to the S&P 500 index

Relative P/E ratio of S&P 500 banks / S&P 500 indices



Source: Bloomberg, Standard Chartered

The US dollar index has fallen below its 200-week moving average for the first time since 2021

US dollar index (DXY) and its 200-week moving average

Source: Bloomberg, Standard Chartered

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