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Bonds Brace For Tariff Impact, Just Like Last Time

Spoiler alert: no one really knows how tariffs are going to impact the market yet. Much is left to be decided, and the outcomes can vary depending on the details.

Markets were certainly willing to react to tariff headlines this week with Thursday and Friday overshadowing Wednesday's Fed announcement. In general, both stocks and bonds are treating tariffs the same way they treat the Fed Funds Rate. Lower is better. Higher is worse.

The result: stock prices and bond yields (aka "rates") moved in opposite directions. In this case, each new dose of news brought stocks lower and rates higher, but if the news had been good, stocks would have rallied and rates would have fallen.

Contrast this to the pattern we saw at the beginning of the week when markets were reacting to news of the new kid on the AI block, DeepSeek. The story goes that DeepSeek was built much faster than ChatGPT, cost much less, and is just as good. This made investors fear that domestic AI stocks were overvalued. Heavy selling ensued, pulling the entire market down. But as that money fled the stock market, it found a home in bonds, thus helping rates move lower and making for the directly correlated movement between stocks and bonds.

MBS and Treasury

	Price / Yield	Change
MBS UMBS 6.0	99.55	+0.04
10 YR Treasury	4.9462	+0.0059
30 YR Treasury	5.3089	-0.0235

Pricing as of: 11/23 5:59PM EST

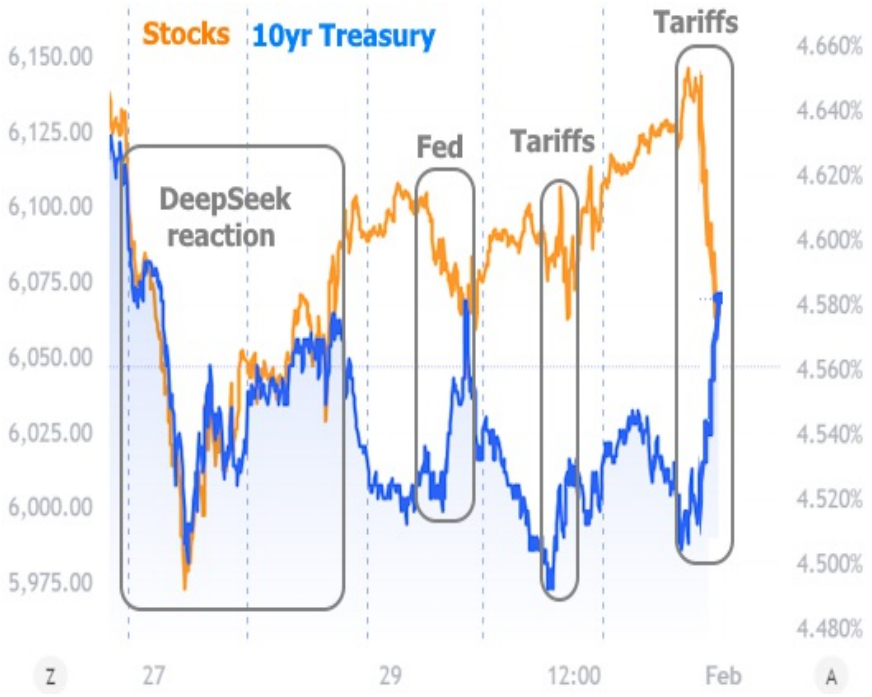
Recent Housing Data

		Value	Change
Mortgage Apps	Nov 11	199.8	-2.35%
Building Permits	Oct	1.3M	-7.5%
Housing Starts	Oct	1.31M	+7.21%
New Home Sales	Sep	676K	-1.17%
Pending Home Sales	Oct	63	-4.69%
Existing Home Sales	Oct	3.99M	+0.25%
Builder Confidence	Nov	25	-13.79%

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Friday's tariff reaction was obviously the bigger deal, but keep in mind that we're looking at relatively small movement in the bigger picture. Here's how this week compared to the past few months:



Still, tariffs are a hot topic of conversation. So what do we know?

First off, we don't yet know exactly how they'll look. Even though the White House said it would roll out 25% tariffs on both Mexico and Canada on Saturday, there are questions as to how sweeping the implementation could possibly be in light of current laws and the interpretation of the Emergency Economic Powers Act (which Trump claims permits him to impose sweeping tariffs, although some legal scholars say it could be challenged in court).

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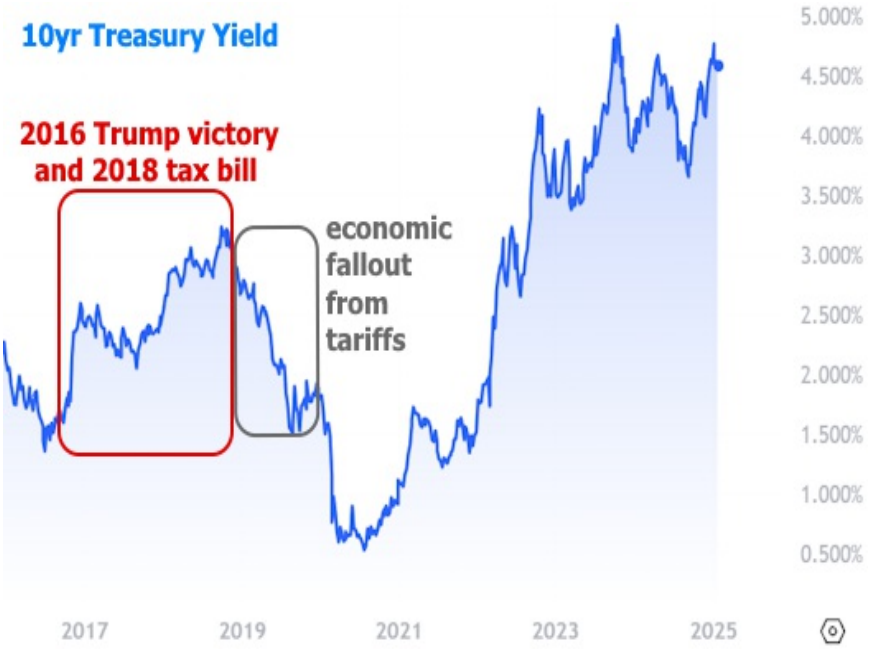
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But let's forget the legal "what ifs" and assume we get sweeping tariffs in short order. What people really want to know is whether tariffs are good or bad.

The answer is nuanced and certainty is impossible without the benefit of hindsight. Markets certainly think tariffs are bad and/or that they will put upward pressure on prices/rates in the short term. That said, history suggests tariffs are a double-edged sword that could come with an economic cost.

Granted, the economy is always acting under multiple influences, but in 2019, few could argue that the US/China tariff-driven trade war was a key consideration. At that time, the most obvious consequence was the economic malaise rather than a noticeable increase in inflation. It ultimately resulted in rates moving down whereas traders initially pushed rates up as they braced for impact from tariffs and the tax bill.



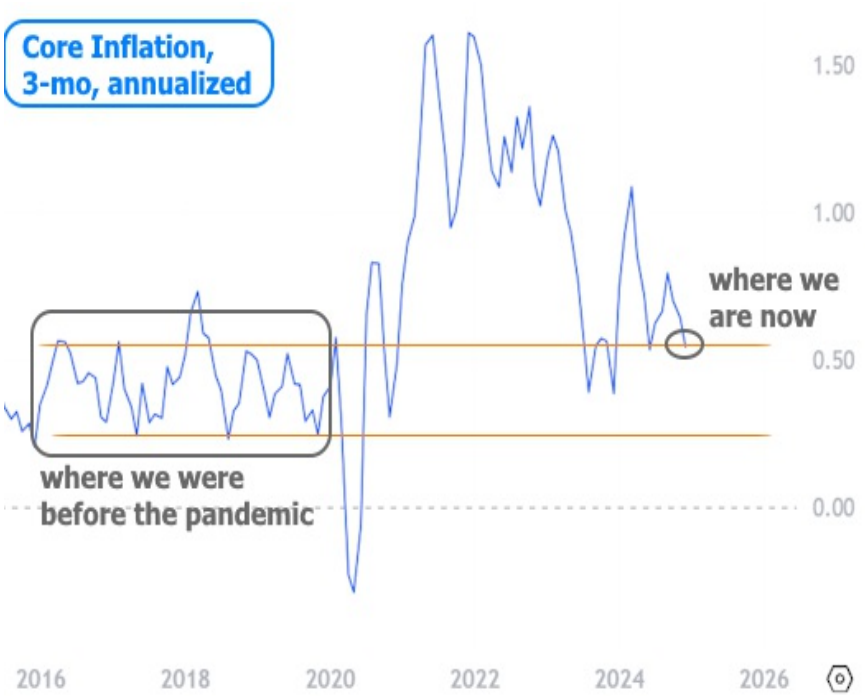
To be sure, this time could be different, but again, we won't really know until we see the specifics and have some track record of actual impacts showing up in economic data. It could easily be another case of markets bracing for impact only to find that economic fallout outweighs the inflationary impulse. Either way, we won't be able to draw any ironclad conclusions for many months, and the overall assessment will take several years.

In the meantime, we're in the same position as ever, waiting for economic data to inform the path of rates and the housing market. Inflation remains critical and this week's key report--The PCE Price Index--didn't offer any strong arguments in either direction. Over shorter time horizons, the data show ongoing progress back toward target levels. But clearly, the recent trend isn't as good as the pre-pandemic era.

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A chart of year-over-year inflation makes it clear just how much we've paused on the way back to the 2.0% target. To be fair, this line should move lower simply because higher inflation readings from 11-12 months ago will be falling out of the 12 month calculation over the next 2 months. Even so, this is not the annual chart the Fed was hoping to see when it began considering rate cuts in the middle of 2024.



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Recent Economic Data

Event Importance:

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Date	Event	Actual	Forecast	Prior
Monday, Jan 27				
10:00AM	Dec New Home Sales (ml)	0.698M	0.67M	0.664M
Wednesday, Jan 29				
2:00PM	Fed Interest Rate Decision	4.5%	4.5%	4.5%
2:30PM	Fed Press Conference			
Thursday, Jan 30				
8:30AM	Q4 GDP (%)	2.3%	2.6%	3.1%
8:30AM	Jan/25 Jobless Claims (k)	207K	220K	223K
10:00AM	Dec Pending Home Sales (%)	-5.5%	0%	2.2%
Friday, Jan 31				
8:30AM	Dec Core PCE (m/m) (%)	0.2%	0.2%	0.1%
8:30AM	Dec Core PCE Inflation (y/y) (%)	2.8%	2.8%	2.8%
8:30AM	Q4 Employment costs (%)	0.9%	0.9%	0.8%
9:45AM	Jan Chicago PMI	39.5	40	36.9
Monday, Feb 03				
10:00AM	Jan ISM Manufacturing PMI	50.9	49.8	49.3
10:00AM	Dec Construction spending (%)	0.5%	0.2%	0%
Tuesday, Feb 04				
10:00AM	Dec USA JOLTS Job Openings	7.6M	8M	8.098M
Wednesday, Feb 05				
8:15AM	Jan ADP jobs (k)	183K	150K	122K
10:00AM	Jan ISM N-Mfg PMI	52.8	54.3	54.1
Friday, Feb 07				
8:30AM	Jan Non Farm Payrolls	143K	170K	256K
8:30AM	Jan Unemployment rate mm (%)	4%	4.1%	4.1%

No Stars = Insignificant
☆ Low
★ Moderate
★★ Important
★★ Very Important

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