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OBBBA RIPPLE EFFECT: HOW THE BIG BILL SHAPES BONDS

Executive Summary

- The One Big Beautiful Bill Act (OBBBA) introduces broad fiscal measures, including expanded government spending and extended tax cuts, which are projected to increase the federal deficit by ~$3.4 trillion over the next decade. These provisions have meaningful implications for fixed income markets, with varying degrees of impact across sectors.
- **Treasuries:** Larger budget deficits mean increased federal borrowing which likely means increased Treasury issuance. That would put modest upward pressure on yields across the curve over time. Short-term market reactions have been muted so far.
- **Corporate Credit:** Accelerated expensing and other tax incentives improve corporate cash flow and financial flexibility, supporting strategic investments, debt reductions, and share buybacks. The initial impacts are expected to become clearer in upcoming earnings cycles.
- **Municipals:** The federal tax-exemption for municipal bonds is preserved and expanded to new sectors, supporting infrastructure financing. Some fiscal pressures will arise from reduced federal Medicaid funding and higher endowment taxes on select private universities.
- Overall, the OBBBA presents both challenges and opportunities across fixed income. Higher Treasury supply, targeted corporate sector tailwinds, and municipal sector divergence create an environment where active investors can both diversify and outperform market indices through smart security selection.

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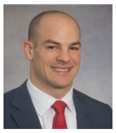

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Few legislative events have the potential to transform fixed income markets quite like the One Big Beautiful Bill Act (OBBBA). At its core, OBBBA increases government spending while extending and expanding tax cuts. It also continues the pattern of chronically unbalanced U.S. budgets over the past 24 years.

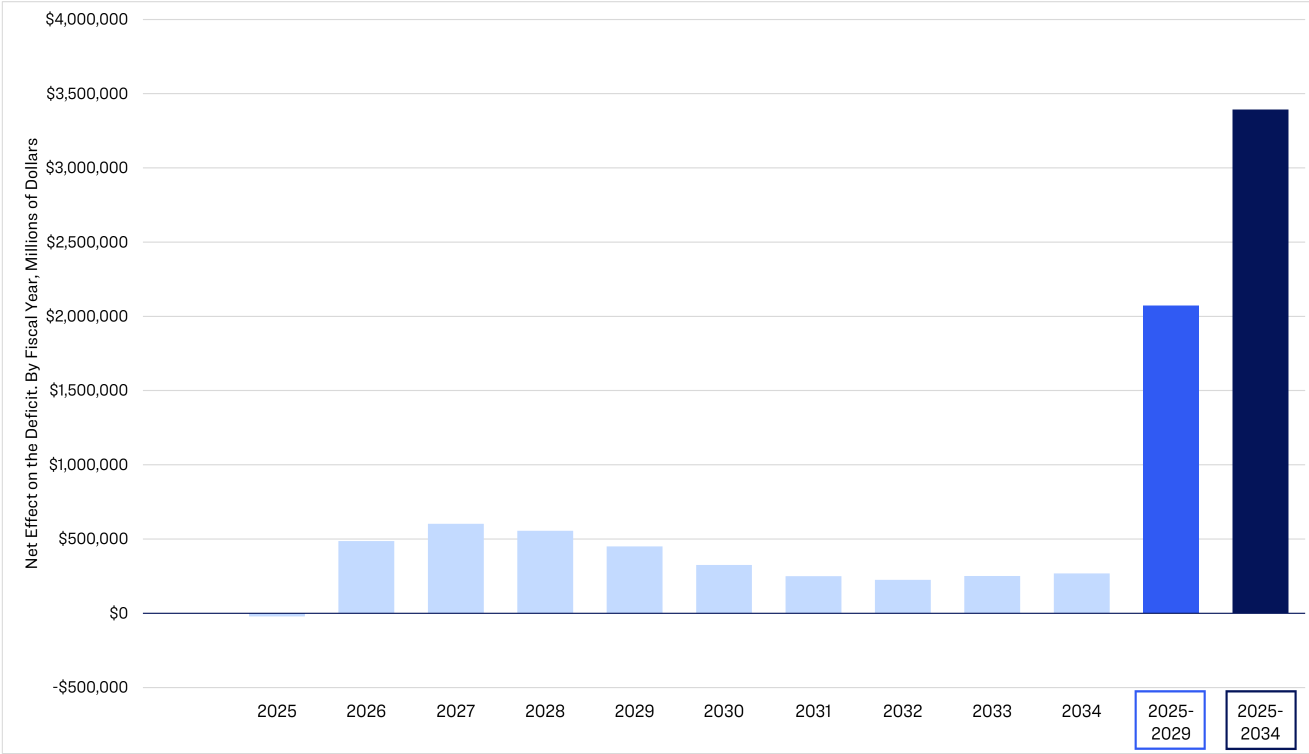
The Act's spending priorities align with the Trump administration's key policy agendas— including bolstering defense, border, and immigration enforcement spending—while its cuts to entitlement programs like Medicaid, Supplemental Nutrition Assistance Program (SNAP), and federal health grants offer sizable offsets.

However, the Congressional Budget Office (CBO) estimates that the Act will still increase the federal deficit by $3.4 trillion over the next decade, primarily due to an array of tax cuts (Figure 1).

These tax measures include making the 2017 Tax Cuts and Jobs Act (TCJA) income tax rates permanent, increasing the standard deduction, permanently extending the gift and estate tax exemptions, temporarily increasing deductions for the State and Local Tax (SALT), and offering a new federal deduction for qualified tips. As the ink dries on this landmark legislation, investors are looking to assess how this sweeping bill will ripple through all areas of fixed income, especially within Treasuries, corporate credits, and municipal bonds.

FIGURE 1

Net effect of the OBBBA on the Federal Deficit over the next decade, in millions of dollars.



Source: Congressional Budget Office, TIAA Wealth Chief Investment Office

Treasuries

OBBBA's most immediate effect on Treasuries—and a top concern for investors—comes from the government's increased borrowing needs. If the supply of Treasury bonds increases meaningfully, it will likely put downward pressure on Treasury bond prices (and upward pressure on yields since yields move in the opposite direction of prices.) The Act increased the federal debt ceiling by $5 trillion to $41 trillion, supporting Treasury funding needs for the next three to five years, as per most estimates. To meet these needs, the Treasury is expected to increase both short-term and long-term bond issuance. Given the elevated yields of longer-term bonds (i.e., the 10-year Treasury above 4.25%), Treasury Secretary Scott Bessent has indicated that near-term funding will likely come from larger issuance of Treasury bills—i.e., bonds with maturities of a year or less (Figure 2). However, nominal coupon auctions (2-year through 30-year) will also need to increase by 2026 or early 2027 to meet financing needs.

The Treasury Borrowing Advisory Committee (TBAC) has historically recommended keeping T-Bill issuance to between 15–20% of total outstanding Treasuries. However, current levels are already around 21% and are expected to rise to between 23–25%. As a result, it will be necessary to rebalance more debt into longer-term bonds to maintain healthy market functioning.

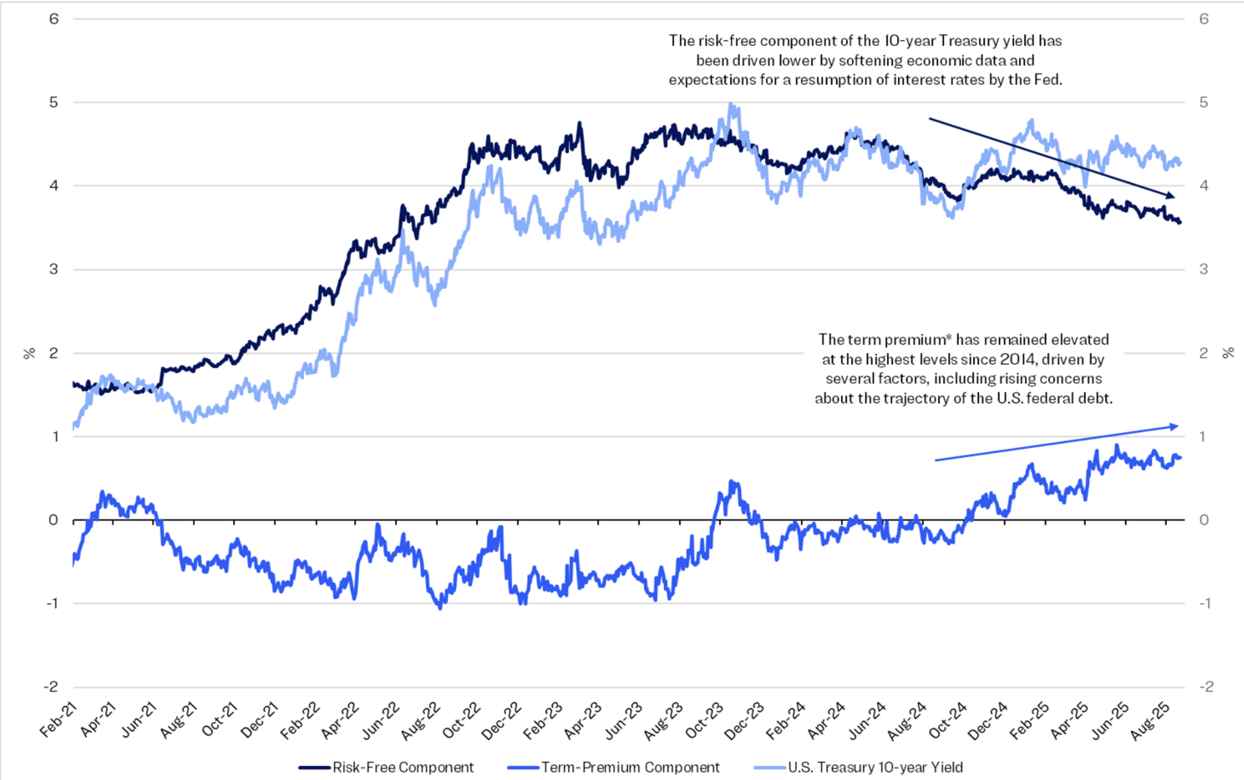
Since OBBBA was signed into law on July 4, 2025, the 10-year Treasury yield has remained rangebound despite weaker economic data and increasingly dovish Fed messaging (Figure 2). This apparent disconnect is largely explained by the term premium, which remains at cycle highs due to several structural factors, including the swelling federal debt and elevated uncertainty about the long-run fiscal outlook.

At the same time, tariff revenues have provided some support to Treasury yields. According to the CBO, tariffs are expected to reduce deficits by around $4 trillion over the next decade. However, with the recent rulings against tariffs by Court of International

Trade and the Court of Appeals and the pending appeal before the Supreme Court, the durability of tariff revenues and their ultimate impact on deficits and Treasury yields remains uncertain.

FIGURE 2

10-year Treasury yields remain rangebound, while term premium* edges higher.



Source: Source: Federal Reserve Bank of New York, TIAA Wealth Chief Investment Office. Data through August 26, 2025.
*Term premium: Additional yield compensation for holding longer dated Treasuries, reflecting risk and uncertainty.

The net long-term effect of increasing Treasury issuance across the yield curve is upward pressure on yields. While other forces—such as economic growth and inflation expectations—also influence yields, overall yield levels should gravitate higher due to increased issuance versus where they'd be under a balanced-budget scenario. That said, Treasury yields declined modestly in the weeks following the passage of OBBBA, with substantial downward revisions to the recent jobs data and Chair Powell's subsequent dovish shift at the Jackson Hole symposium serving as the primary catalyst. Barring a more extreme "bond vigilante" scenario (where investors push back on unsustainable government spending by demanding higher yields), **OBBBA's influence on 10- and 30-year Treasury yields will likely be gradual and relatively muted, with other economic factors having a more direct impact.**

Corporate Credit

OBBBA delivered sweeping changes to business tax incentives. For fixed income investors, these changes have the potential to represent a critical turning point, one that could fundamentally alter how corporations in multiple sectors manage their finances, allocate capital, and issue debt. As corporations begin digesting these new provisions, we are already seeing early indications of how this legislation will reshape corporate balance sheets. OBBBA provisions most relevant to the corporate bond market include:

- The option for corporations to fully expense domestic research and development costs.
- 100% bonus depreciation for qualified property acquired and placed in service after January 19, 2025.
- Temporary 100% expensing of certain non-residential real property used in a qualified production activity within the U.S.

These provisions are designed to stimulate domestic investment and manufacturing and are particularly beneficial for capital-intensive domestic businesses. The biggest winners are businesses with large capital expenses relative to revenue, including IT companies, domestic telecommunications companies, utilities, and pharmaceutical companies with domestic production and development. The ability for a company to expense these investments in year one, versus a more elongated depreciation schedule, reduces taxable income and lowers their effective tax rate, which means corporations will pay less taxes and have more cash.

A number of companies have already started to communicate expectations for significant increases in free cash flow. This cash will increase their financial flexibility and will be used for strategic investments and buybacks of stock and debt. While some companies may use the excess cash to shore up their balance sheets and de-lever or increase shareholder returns, it's highly likely that many will issue debt to finance new investments to take advantage of OBBBA's tax benefits. Since we are still in the early stages of the Act's passage—and since capital allocation decisions take time to develop—we expect to get more clarity on the impact from third-quarter earnings calls later this year.

Municipal Bonds

OBBBA carries meaningful implications for the municipal market, shaping the outlook for infrastructure financing, state budgets, healthcare, and higher education. While certain provisions introduce fiscal pressures, the legislation also preserves and broadens opportunities for new issuance across emerging sectors.

The federal tax exemption for municipal bonds was preserved in the final legislation, alleviating pre-passage concerns about its potential repeal. In fact, the Act expanded the municipal bond tax advantage by extending it to additional sectors. Notably, the Act expands the scope of private activity bonds (PABs) to include new infrastructure categories such as spaceports and select energy projects.

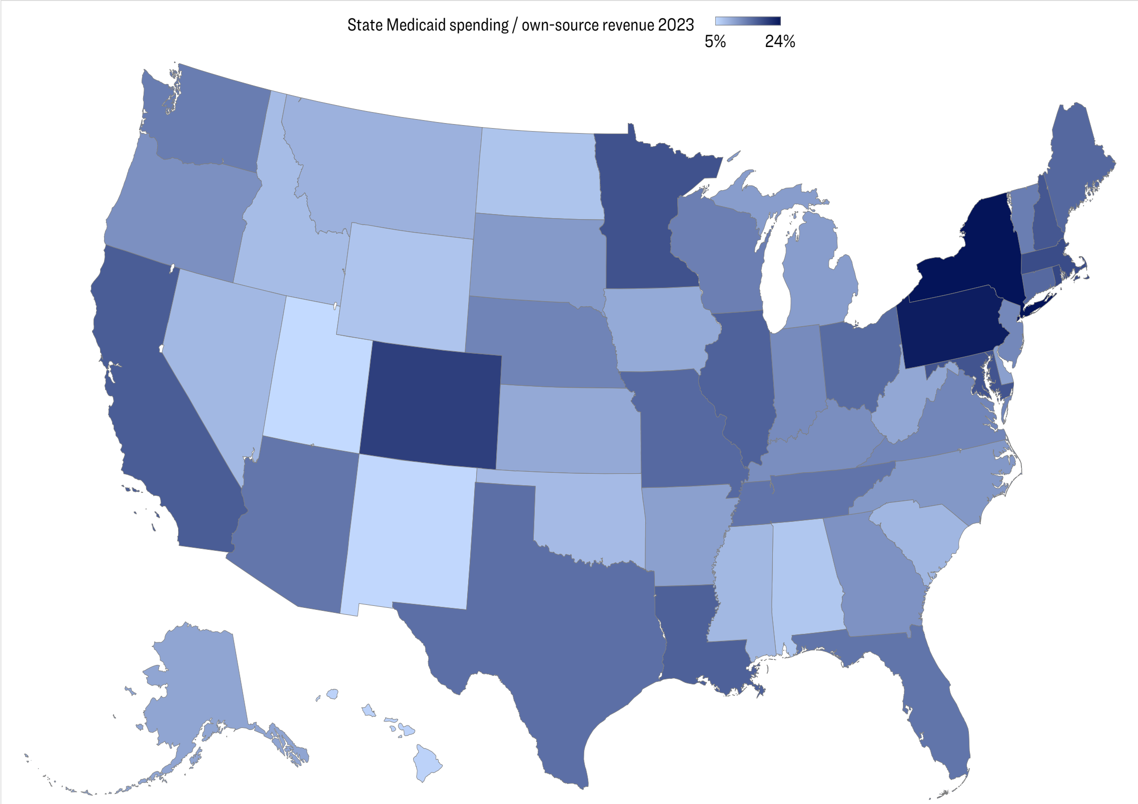
Higher education faces a complex outlook under OBBBA. The significant increase in the endowment excise tax creates a tiered impact across the sector. Universities with endowments exceeding $2 million per student will now face an 8% tax (up from 1.4%), while those with $750,000 to $2 million per student will be taxed at 4%. Public universities and smaller private colleges remain exempt. Elite private institutions with substantial financial resources will likely absorb the 8% tax (increased from 1.4%) without major disruption to operations. However, mid-sized private colleges may encounter tighter margins and added financial stress in an already challenging operating environment.

Healthcare provisions represent one of the largest fiscal shifts in the bill. The Act reduces federal spending on healthcare by up to $1.1 trillion through fiscal 2034, with Medicaid cuts accounting for the majority. This figure is significant given that, on average, the federal government covers approximately 69% of state Medicaid costs, leaving states responsible for the remainder.[1] Other key measures include a moratorium on new and existing Medicaid provider taxes, caps on state-directed payments, and stricter eligibility requirements. These changes are likely to push states to increase their own funding to sustain healthcare access, creating budgetary headwinds. Hospitals—particularly safety-net and rural providers—face heightened strain, with not-for-profit facilities already pressured by rising costs and thin margins potentially seeing higher levels of uncompensated care. Although a $50 billion rural hospital support fund is included in the Act, it is unlikely to fully offset these impacts (Figure 3).

1 www.Commonwealthfund.org

FIGURE 3

Medicaid spending, as a portion of a state's own-source revenue, refers to the proportion of state-generated tax dollars (like income and sales taxes) and other state funds used to finance the state's share of Medicaid costs. The darker shades of blue indicate states that spend significantly more of that share .



Source: Pew.org, TIAA Wealth Chief Investment Office

Conclusions

OBBBA introduces a combination of fiscal stimulus, targeted tax changes, and spending cuts that are likely to impact fixed income markets. We expect a modest increase in bond issuance, varying pressures across sectors, and shifting demand dynamics. Treasury yields may gradually rise as government borrowing needs increase. In the corporate bond market, certain issuers—specifically domestic manufacturers and businesses with large capital expenses relative to revenues—should benefit from the Act's corporate tax incentives. Municipal bonds will likely see financial strains in specific sectors such as hospitals and higher ed. All this highlights the importance of diversification. In this changing landscape, active investors who can adapt to these cross-sector shifts will be better positioned to identify relative value opportunities and generate above-market returns through careful security selection.

TIAA Wealth Management's CIO team sees three key factors now shaping the bond-investor landscape: increased Treasury bond issuance, enhanced cash flow generation in specific corporate sectors, and a mixed bag of policy changes affecting municipal bonds. These developments underscore why thoughtful, strategic selection of fixed income securities is especially important in today's market environment.

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