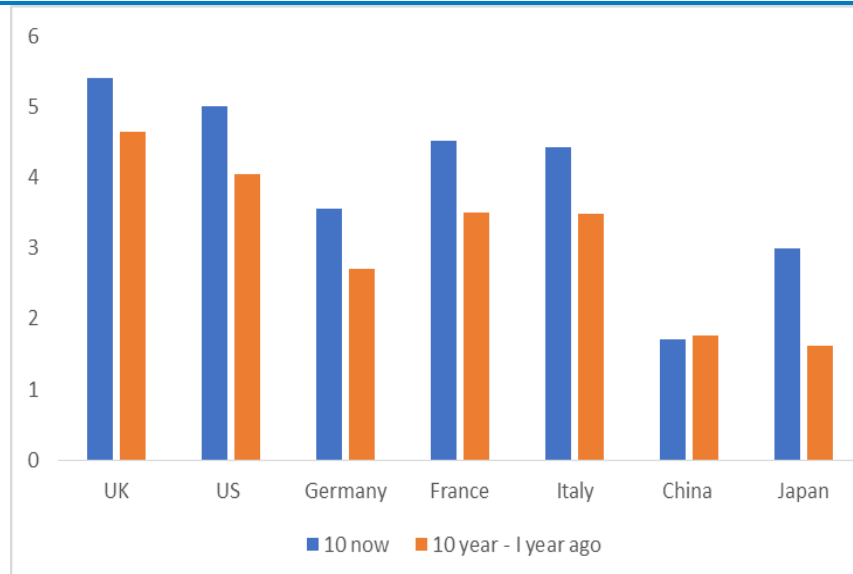


Yields are now generally back, at the medium and long end of the curve, to where they were before the global financial crisis and in the case of Japan the highest yields in a generation.

10 year sovereign benchmark bond yield % current and 12 months ago



Source Market sources

What has caused the sell off?

There is not one factor but multiple ones including increasing concern over the scale and sustainability of fiscal deficits, expectations of higher central bank interest rates, a deepening of hostilities in the Middle East and Ukraine adding to both energy price instability and political pressure to structurally increase defence budgets and the sheer scale of global issuance both through money markets and conventional bonds increasing supply at a time where, particularly in the US, corporates too are increasing bond issuance materially.

Further, confidence is perhaps not helped by a perceived lack of seriousness about the importance of controlling deficits with, as an example, Trumps suggestion, at a potential cost of \$1.3t. of a \$5000 cheque for every adult American should the Republicans hold Congress at the mid-terms. Such a 'gift' of course, should it happen, would be at the expenses of raising the deficit yet further.

Concern at Governmental level in the selloff in bonds is clearly deep. Scott Bessent attempted to support the long end of the US market with \$4b. of asset purchases. Such operations risk being counterproductive as they confirm institutional concern while attempting stabilisation on a near irrelevant scale - \$4b. on \$40t. of outstanding debt isn't exactly going to move the dial. Besides the history of market interventions is seldom a happy one.

While the US has made some strides in stabilising the rate of growth in the deficit the risk is, especially as anticipated if the Democrats win a majority in both houses in the Midterms, efforts to control spending will likely prove illusive. Trumps comment on his 'Truth' platform even suggested that US interest rates should be 1% or less because 'we are the best credit in the world' is I trust tongue in cheek. (link here <https://x.com/cryptovizart/status/2100437396974162024?s=43>)

In Q1 the seasonally adjusted annual US debt repayment bill increased to \$1247b. against \$1160.9b. to the same point a year earlier. Much of the increased borrowing is being funded at the short end of the curve through money markets with, for example, 3 month money costing 4.1%. This contrasts with the long end yielding 5.54%. (30 year). Arithmetically the blended cost of all Federal borrowing is current 3.1% somewhat below the current yield curve, thus over time, if the yield curve stays where it is, simple mathematic will result further substantial increases in debt servicing costs as debt is gradually refinanced.

Indeed with public debt to GDP at a current 126% this is set, according to the IMF's World Economic Outlook, to rise to 139% by 2030. Debt interest payments already account for 15.7% of all Federal spending. This compares with under 10% as recently as 2021. Mathematically without corrective action this will rise further. Relative to GDP debt interest is now eating up 3.8% of resources. Expect this to rise further perhaps to 5% GDP by 2030, a level which begins to risk longer term stability.

The problem is does Congress or the President notice? There is little sign they do. Unfunded tax cuts, promises of increased defence expenditure, the risk of Democrat led public health and welfare increases, and the requirement to meet debt obligations risk further undermining the picture. It is in this light bond markets have sent a warning.

Moreover, sovereign debt is hardly a scarce commodity. There is barely a major jurisdiction globally where the scale of issuance relative to GDP have not increased and in some cases markedly relative to GDP. This is now happening as the US corporate debt market is also seeing substantial increases in issuance.

Year to date US bond corporate bond issuance has reached \$1899b. an increase of 29.8% on the same period last year after a 12.6% rise in 2025. Much of this debt is funding a substantial AI and technology capex infrastructure programme where, given the novelty of spend, returns are clearly subjective. Increased overall bond supply may be one of the factors behind the shift in the yield curve.

Source <https://www.sifma.org/research/statistics/us-corporate-bonds-statistics>

These are troubled times. Sovereign indebtedness has increased markedly over the last 20 years and even Germany, the one major country that practiced fiscal prudence, now has, for reasons of national security and substantially increased defence expenditure agreed to allow its public debt to GDP ratio to deteriorate.

This is not a happy place for substantial unfunded deficits risk crowding out private enterprise and they risk baring pressure on central banks to ameliorate the weight of debt with commensurate longer term inflationary risk.

The next few months will likely be critical. The outcome of the mid-terms will be known and with it some indication on the likely spending path, the UK's Budget is a couple of weeks off with again political pressure to 'protect' already very generous welfare spending and increase defence budgets while the next rather polarised French presidential election is less than a year off. The Trajectory of Japanese debt too will become clearer after highly disappointing Q1 data it shall become more apparent if that was a blip, or as we fear a trend. Fiscal prudence seems in short supply.

