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Understanding the Rise in US Treasury Yields

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Executive Summary

Why Long-Term Treasury Yields Are Rising

- Long-term Treasury yields have reached near two-decade highs amid fiscal pressures, Fed tightening expectations, inflation risks and growing competition for capital.
- Bessent's expanded buybacks aim to improve long-end liquidity, but critics argue higher yields reflect fundamentals rather than market dysfunction and the initial market impact has been limited.
- Persistent deficits and rising debt are creating a growing supply of Treasuries, while buybacks can only temporarily reduce pressure at particular maturities.
- Treasury faces a stock-versus-flow problem as finite buybacks cannot offset continuous borrowing needs, leaving higher yields or weaker demand as key fiscal risks.

Growing Competition for Capital

- Treasury increasingly competes with record corporate borrowing and long-dated AI debt for capital from more price-sensitive private investors.
- Growing investment alternatives and renewed oil-driven inflation risks could require higher Treasury yields to attract long-term demand.

What If Higher Yields Are Good News?

- Miran argues higher yields largely reflect stronger expectations for future real rates rather than deteriorating inflation or fiscal credibility.
- Rising investment in AI, defence, energy and infrastructure may be creating a structurally higher demand for capital and therefore higher equilibrium interest rates.
- Resilient US growth, renewed Fed tightening expectations and rising global bond yields suggest a broader repricing of capital rather than an exclusively US fiscal problem.

The Risk of Persistently Higher Yields

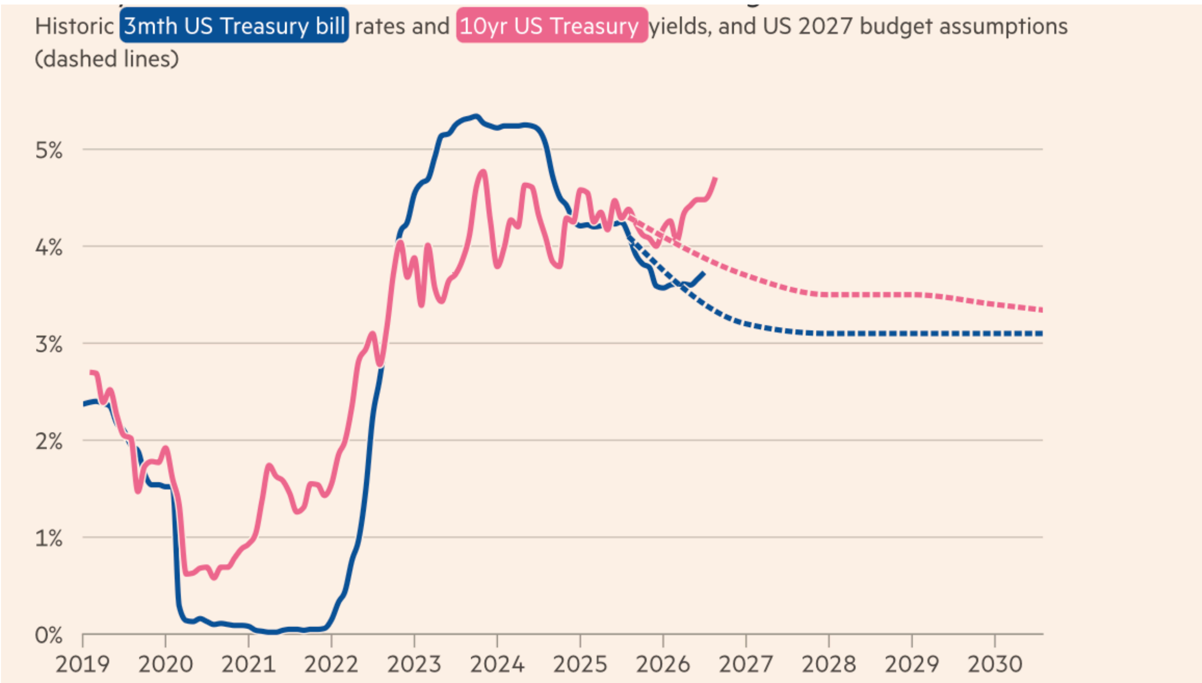
- Stronger growth may justify higher real rates, but persistently higher borrowing costs pose growing fiscal risks for a heavily indebted US government
- Bessent's buybacks can improve liquidity but cannot offset structural forces keeping yields elevated or eliminate Treasury's financing needs
- Dalio warns that rising debt-service costs and refinancing needs could reinforce higher yields, even without an outright buyers' strike

What Is Driving the Rise in Long-Term Yields?

Long-term US borrowing costs have climbed to levels not seen in almost two decades. The 30-year Treasury yield peaked at 5.34% in mid-August, its highest since 2007, and remained around 5.28% at the beginning of September, roughly 65 basis points above its low for the year. The move reflects several overlapping pressures: persistent fiscal deficits and Treasury issuance, expectations of further Fed tightening, renewed inflation concerns following the rise in oil prices, and increasingly intense competition for capital from corporate borrowers.

The rise in long-term US Treasury yields has become significant enough for Treasury Secretary Scott Bessent to push back publicly against the market's interpretation. Bessent argues that these yields do not reflect underlying economic fundamentals and that poor liquidity, particularly at the 30-year point, is amplifying market moves. Furthermore, Treasury has responded by announcing that purchases of securities maturing in 10 to 30 years will at least double, from $2bn to $4bn per operation, with Bessent suggesting they could increase further.

Figure 1: Bond Yields Haven't Rallied Like the White House Budgeted For



Source: Financial Times

Stanley Druckenmiller, a former mentor to both Bessent and Warsh, has sharply criticised Treasury's intervention, arguing that it represents price management rather than liquidity management. He notes that the Treasury market showed few signs of genuine dysfunction—auctions continued normally, trading remained orderly and there were no forced unwinds comparable to March 2020. Instead, he argues that higher yields reflect economic fundamentals, including above-target inflation, full employment and a fiscal deficit near 6% of GDP. More fundamentally, Druckenmiller warns that suppressing yields weakens the bond market's role as a constraint on fiscal policy and risks blurring the boundary between debt management and government efforts to control borrowing costs.

So far, however, markets have proved difficult to persuade. The 30-year yield initially fell nine basis points after the announcement, but subsequently reversed most of that decline. Analysts have questioned whether interventions of this scale are large enough to make a lasting difference. The deeper question is therefore not simply whether Treasury should buy more bonds, but why long-term yields are high in the first place. The answer determines whether Bessent is addressing a temporary market malfunction or pushing against a more structural repricing of US debt.

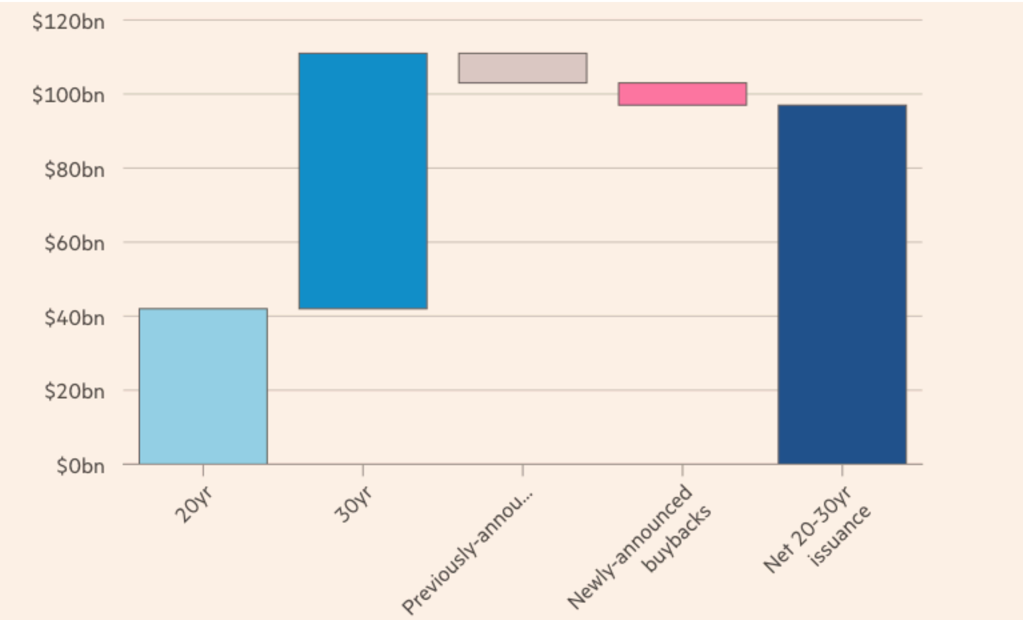
A Growing Supply of Government Debt

The bearish interpretation starts with increasingly uncomfortable fiscal arithmetic. US national debt has reached a record $40tn, while deficits have consistently run at around 6% of GDP in recent years. Large deficits mean a continuing flow of new Treasury securities that investors must absorb, while higher yields themselves progressively increase the government's interest burden.

This is particularly relevant when assessing the scale of Bessent's intervention. Even as Treasury buys back more existing long-dated securities, new government borrowing is expected to outpace those purchases. Buybacks can therefore reduce the supply of particular securities or maturities without eliminating the underlying financing requirement created by the fiscal deficit.

Robin Brooks describes this as a fundamental stock-versus-flow problem. Treasury can temporarily support the long end of the market by using cash accumulated in the Treasury General Account (TGA) to repurchase outstanding bonds, or by issuing more short-term bills and using the proceeds to buy back longer-dated securities. Both approaches can reduce the amount of duration that private investors need to absorb and, at least temporarily, ease upward pressure on long-term yields. But neither changes the underlying fiscal arithmetic. The TGA is a finite stock of cash, currently around $1tn, while persistent budget deficits create a continuous flow of new borrowing requirements. As long as government spending exceeds revenues, Treasury must repeatedly return to the market to finance the gap, adding new debt even as it buys back part of the existing stock. Buybacks can alleviate market pressure at particular maturities, but cannot permanently offset the much larger supply of debt generated by persistent deficits. The problem becomes more pronounced as higher yields themselves raise federal interest costs, potentially requiring still more borrowing in the future.

Figure 2: Published Issuance and Buy-Bank Plans for 20-30yr US Treasuries in the August-October Quarter



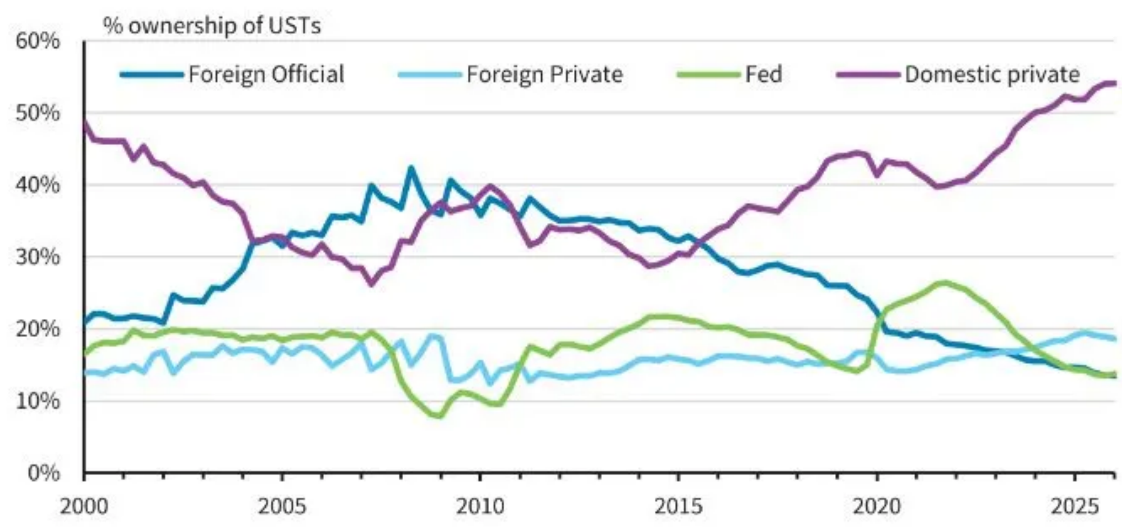
Source: [Financial Times]

This becomes particularly important if foreign investors become less willing to absorb US debt at previous yields. With publicly held debt approaching 100% of GDP and deficits remaining large, foreign willingness to hold US assets will become an increasingly important issue. Ultimately, the US would have to tighten fiscal policy, tolerate higher borrowing costs or accept a weaker dollar. Yet interpreting every rise in Treasury yields as evidence of an emerging fiscal crisis would go too far.

Treasury Is Not The Only Borrower

The supply problem is also broader than government debt. Treasury is seeking enormous amounts of financing at precisely the moment when American companies are doing the same. [Corporate bond issuance reached a record in August], with companies expected to issue a further $215bn through September, partly to finance investment in AI infrastructure. This competition is becoming more important as the composition of Treasury buyers also changes. Private, price-sensitive investors now account for a growing share of Treasury ownership, replacing some of the demand historically provided by foreign official institutions and the Federal Reserve. Unlike official reserve managers, private investors have no structural need to hold Treasuries and are therefore more sensitive to the returns available on competing assets.

Figure 3: Private Investores Now Dominate Treasury Owenershiip



Source: [Bloomberg]

At the same time, those competing assets are expanding. The AI investment boom is generating a growing supply of highly rated, long-duration corporate bonds that compete more directly with long-dated Treasuries. The share of investment-grade issuance with maturities above 10 years has risen from 13% in 2025 to 20% in 2026, which Barclays estimates will add around $190bn of long-dated corporate debt this year—equivalent to almost 70% of annual 30-year Treasury issuance. Investors deciding whether to purchase a 10- or 30-year Treasury are therefore increasingly being offered alternative long-duration assets at the same time as Treasury itself needs to place large quantities of debt. The combination of more price-sensitive buyers and greater competition for their capital could require Treasury to offer higher yields to attract demand.

This structural pressure is being compounded by shorter-term inflation risks. Renewed hostilities with Iran have pushed Brent crude above $92 a barrel amid concerns over disruptions to energy shipments through the Strait of Hormuz. Higher energy prices have added to inflation uncertainty, which is particularly relevant for long-duration bonds because inflation erodes the real value of payments extending decades into the future.

What If Higher Yields Are Actually Good News?

Stephen Miran offers a sharply different reading. A nominal Treasury yield can broadly be separated into expected inflation and a real component, with the latter reflecting expected future short-term interest rates plus compensation for holding longer-duration securities. Miran argues that market-based inflation expectations remain consistent with the Federal Reserve's 2% target, while the term premium has also remained relatively stable. On this interpretation, rising long-term yields have predominantly reflected higher expectations for future real rates not deteriorating confidence in the Fed or US fiscal sustainability.

Nominal US incomes and spending are currently growing at around 7% annually. Against such an economic backdrop, a 5% yield on long-duration government debt does not necessarily look excessive. Rates would appear obviously too high only if investors expected inflation and economic growth to slow substantially.

More fundamentally, the extraordinarily low interest rates following the global financial crisis were themselves abnormal. They reflected a world with abundant capital but relatively few compelling investment opportunities. That environment may now be disappearing. AI and data centres are creating enormous investment requirements, alongside rising expenditure on defence, critical-goods production and energy infrastructure. If attractive investment opportunities are multiplying faster than available capital, interest rates should naturally rise.

Federal Reserve Chair Warsh's recent Jackson Hole message is consistent with this interpretation. Warsh highlighted booming profits and business investment, loose financial conditions and a labour market consistent with full employment, while warning that underlying inflation trends had not meaningfully improved. Markets responded by raising the implied probability of a September rate increase from 35% to 62%. Higher yields may therefore reflect economic resilience rather than a simple vote of no confidence in US debt.

Nor is the rise in long-term yields exclusively American. British long-term borrowing costs have reached levels not seen since the late 1990s, German and French yields have risen, and Japan's benchmark rate has moved above 3% for the first time in three decades. The synchronised move lends some support to the idea that financial markets are undergoing a broader repricing of long-term capital rather than reacting solely to America's fiscal position.

The Risk of Persistently Higher Yields

The relatively benign interpretation of higher yields nevertheless intersects with a more difficult fiscal reality. Stronger investment and growth may justify structurally higher real rates without signalling an imminent debt crisis. But a higher cost of capital is itself consequential for a government carrying roughly $40tn of debt and persistent deficits of around 6% of GDP. The risk, therefore, need not be a sudden loss of confidence in US debt, but a persistently higher price for financing it.

This distinction is crucial for evaluating Bessent's expanded buybacks. Treasury describes them as liquidity-support operations, with purchases of long-dated securities increasing from $2bn to at least $4bn per operation. If poor liquidity is amplifying moves at the long end, such intervention can improve market functioning. Miran argues that liquidity is particularly poor in this part of the market. But if yields instead reflect stronger investment demand, expectations of higher policy rates and large financing requirements, buybacks can alleviate market frictions without fundamentally reversing those forces.

The scale and initial market response underline this limitation. New borrowing is expected to outpace Treasury's purchases, while Natixis's John Briggs has called the programme a “drop in the bucket.” The initial decline in the 30-year yield was subsequently largely reversed. This does not mean the buybacks have failed—their stated purpose is liquidity support, not a particular yield—but suggests they cannot easily offset the broader forces keeping borrowing costs elevated.

In the article in TIME, Dalio takes this concern further, interpreting recent Treasury pressures as signs of a worsening US debt cycle. As deficits increase debt and interest costs, ever-larger issuance and refinancing needs must compete for investor capital. He points to interest costs approaching $1tn annually and roughly $10tn of maturing debt requiring refinancing. With private-sector demand for capital also rising, Dalio argues that an increasing imbalance between debt supply and demand could push yields higher, further raising debt-service costs. Dalio's crisis prognosis may be more pessimistic than the evidence currently warrants. But his underlying mechanism captures the central risk: even without a buyers' strike, persistently higher financing costs can become increasingly difficult to absorb as debt and refinancing needs grow.