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To the point!

Cross-Asset- and Strategy-Research

The long end of the yield curve is surging

Public finances under scrutiny

Stock markets usually dominate financial headlines. Right now, fueled by AI-euphoria, one record high had been chasing the next. That is particularly true in the U.S., but also in markets such as Korea or Taiwan, where tech stocks carry substantial weight. There is a lot of risk appetite on display – perhaps even overconfidence.

By contrast, investors view another corner of capital markets with far less confidence: global bond markets. And it is a rather large corner. According to estimates by the Institute of International Finance (IIF), global debt exceeded USD 350trn in the first quarter of this year. That is more than three times global economic output – and rising rapidly, especially in the U.S. and China. Global equity markets are less than half that size.

Long maturities under pressure

A significant share of outstanding bonds are government securities. Rating agency S&P Global puts the stock of central-government debt with an S&P rating at USD 83trn – about one third higher than five years ago. More than half of that is accounted for by the U.S. and China alone. Debt levels in advanced economies – as classified by the International Monetary Fund (IMF) – have increased sharply in recent years (see fig. 1).

The pattern is familiar: a crisis hits, fiscal policy cushions the blow via higher deficits, and the debt ratio rises. Once the economy emerges from the crisis, the ratio fails to retreat. The only exception has been the bout of high inflation at the beginning of this decade. Deleveraging via surprise inflation is hardly an attractive prospect for investors – they incur losses and subsequently demand higher yields. As they do now. Inflating away debt is not a viable option and no substitute for fiscal prudence.

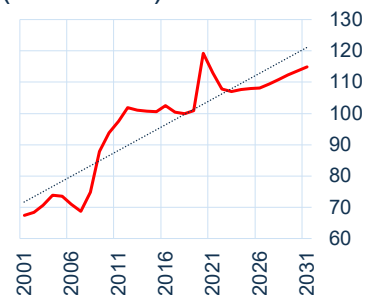
Moritz Kraemer -- Chief Economist

LBBWResearch@LBBW.de

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Stocks and bonds out of sync

Fig. 1: Advanced economies: Public Debt (% of GDP)



Source: IMF, LBBW Research
From 2026 onwards: IMF estimates

The rise of public debt has been particularly extreme in the U.S. And will remain so. The independent Congressional Budget Office (CBO) projects that, absent policy changes, the U.S. debt ratio will climb to more than 190% of GDP over the next 30 years. In the age of ultra-low interest rates, vast debt burdens were relatively easy to bear. Now, however, it appears that the interest burden will roughly double in the coming decade (see fig. 2).

Investors are getting nervous – with good reason

Since the start of the year, the yields demanded by investors on government bonds have risen significantly – especially at the long end, with maturities between ten and thirty years (see fig. 3 and 4). Many observers explain this by pointing to the war between the U.S. and Iran, which is driving up energy and food prices, thereby fueling inflation and possibly prompting central banks to raise rates more aggressively than signaled before the war. LBBW Research, for instance, currently expects the ECB to deliver three rate hikes over the course of 2026 – compared with zero in its projections back in February.

Alas, that explanation is not particularly convincing. Over a horizon of one to three decades, what a central bank did or did not do in 2026 largely fades into insignificance. It may move rates at the short tenors, but not at the ultra-long end.

No – the reason for rising long-term yields, I fear, is far more serious. It seems increasingly likely that investors are starting to worry about the long-run sustainability of public debt.

Japan as a potential game changer

Nowhere has the rise in long-term yields been as pronounced as in Japan – a country long synonymous with ultra-low interest rates. That is precisely why Japanese investors have parked so much money abroad. No country holds more U.S. Treasuries: at the end of last year, Japanese holdings stood at almost [USD 1.2trn](#) – nearly twice the Chinese total. If yen-denominated bonds at home now offer reasonably attractive yields – without exchange-rate risk for Japanese investors – a reallocation from dollar to yen securities becomes an obvious move.

This could add further pressure to the U.S. Treasury market and push long-term U.S. yields higher still. Driven into such a defensive position, Donald Trump might be tempted to resort to unorthodox interventions such as the so-called [Mar-a-Lago Accord](#) – a de facto expropriation of foreign creditors. All the more so as Stephen Miran, the architect of the idea, is returning to the White House as chief economic adviser after his short stint at the Fed, where he kept the seat for the new Chairman, Kevin Warsh.

There is, in other words, ample reason for nervousness. And I expect long-term yields to remain elevated for some time. Until such time that a fiscal policy U-turn towards prudence happens. Right now, this is correction nowhere in sight, on neither side of the Atlantic, nor in Japan. Borrowing binges rule supreme.

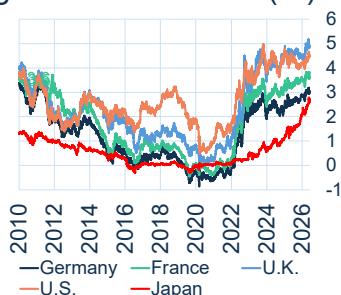
Inflation is no cure for excessive debt

Fig. 2: U.S.: Defense and interest expenditure (Trn USD)



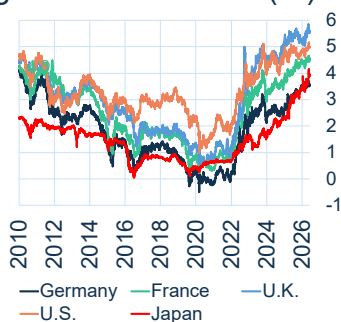
Source: CBO, LBBW Research

Fig. 3: Yield 10-year government bonds (%)



Source: Bloomberg, LBBW Research

Fig. 4: Yield 30-year government bonds (%)



Source: Bloomberg, LBBW Research

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