Cracks opening in long-term bond market

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While stock markets continue to be at near-record highs, seemingly oblivious to the enormous geo-political and economic turmoil—war, tariffs, massive uncertainty and a slowing world economy—this upheaval is being registered in the very foundations of the global financial system.

Its clearest expression is in the bond markets, where governments raise money to finance their budget deficits and where debt is traded. It is most pronounced in the $29 trillion US Treasury market—one of the foundations of the global financial system—but is present in the bond markets of all the major economies.

This week, the *Financial Times* (FT) published an article noting that investors were "fleeing long-term US bonds at the swiftest rate since the height of the Covid-19 pandemic five years ago as America's soaring debt load tarnishes the appeal of one of the world's most important markets."

The article did not go into detail about what happened then, but it should be recalled that in March 2020 the Treasury market froze—for several days there were no buyers for US debt, supposedly the safest financial asset in the world. The US Federal Reserve had to intervene to the tune of several trillion dollars to halt a meltdown of the entire US and global financial system.

According to the FT's research, net outflows from long-dated bonds, both government and corporate, have reached almost $11 billion in the past three months. The second quarter is on track to be the heaviest "since the severe market turbulence in early 2020" and marked a "powerful shift" from average monthly inflows of $20 billion over the previous 12 months.

The central issue of concern in the US bond market is the growth of government debt, now at $36 trillion and rising. It has been building rapidly since the global financial crisis of 2008. At that time the Treasury market was around $5 trillion. It is now $29 trillion.

The worsening long-term financial position of the US is being compounded by the Trump administration's policies—the tariff wars which threaten to boost inflation, regarded as poison by bond investors, and the "big beautiful budget," which according to all independent analysts will add around $2.4 trillion to US debt.

This is disputed by the White House, which claims that the maintenance of massive tax cuts for the wealthy and corporations will more than cover it. That is a regurgitation of the infamous Laffer curve used by the Reagan administration in the 1980s to justify its tax cuts but which set debt and deficits on an upward path.

The major operatives in the financial world are not buying it. In a comment on the FT's findings on the long-bond outflow Lotfi Karoui, chief credit strategist at Goldman Sachs, said it "reflects concerns over the longer-term outlook for fiscal stability."

JPMorgan Chase CEO Jamie Dimon recently warned of a "crash" in the bond market, prompting the response from US Treasury Secretary Scott Bessent that the US would "never, never" default on its debt. Of course, if no such concerns existed, then there would have been no need for the reassurance.

The long developing debt crisis in the US and globally has been brought to the surface by the escalation of interest rates over the past three years. Under the quantitative easing policies of the Fed, followed to one degree or another by central banks around the world, interest rates were kept to historic lows and debt did not appear to be an immediate problem.

The major shift in the interest rate environment was highlighted in a comment by former International Monetary Fund chief economist and now professor of Economics at Harvard University, Kenneth Rogoff, in the FT this week.

Since the last balanced budget at the end of the 1990s, he wrote, "both Republican and Democratic leaders have tripped over themselves to run ever larger deficits, seemingly without consequence. And if there is a recession, financial crisis or pandemic, voters count on the best recovery that money can buy. Who cares about another 20 to 30 percent of GDP in debt?"

But now the situation had changed and "long-term interest rates today are far higher than they were in the

2010s … Real interest rates are far more painful today than they were two decades ago when US debt to GDP was half what it is now.”

The arithmetic of the debt to GDP relationship brings into focus the developing crisis. If interest rates are less than 1 percent, or close to zero, then even a relatively slow growth of around 2 percent means the interest bill is manageable.

But if the interest rate on long-term debt rises to 4 percent, or even goes as high as 5 percent, then major payment problems rapidly emerge. The interest bill in the US is fast approaching $1 trillion, around the same level as annual military outlays.

Emerging out of the debt-ridden real estate market of New York, where his often-dubious operations were highly leveraged, this may be one of the reasons for the continuous war of words waged by US President Trump against Fed chair Jerome Powell, labelling him a “numskull” and a “moron” for his refusal to cut the Fed rate and threatening to sack him.

The relationship between debt, the overall US economy and the crisis it could produce were the subject of remarks by Larry Fink, the head of the giant BlackRock hedge fund, to a Forbes conference in New York earlier this month.

Pointing to the $36 trillion debt, he said: “We have a tax bill that’s going to add $2.3 trillion, $2.4 trillion on the back of that. If we don’t find a way to grow at 3 percent a year … we’re going to hit the wall. If we cannot unlock the growth and if we’re going to stumble along at a 2 percent economy, the deficits are going to overwhelm this country.”

The US growth rate may not even hit 2 percent as forecasts by the IMF put it at between 1 percent and 2 percent, with the possibility it could be lower if the Trump tariffs have a recessionary impact.

There is a kind of economic scissors process at work: Debt and interest payments are rising while the underlying economy is declining.

The worsening situation is not confined to the US. Bond markets the world over are coming under increasing strain.

In comments to the FT earlier this month, Amanda Stitt of the $1.6 trillion asset manager T Rowe Price, said: “It’s a classic supply-and-demand mismatch problem, but on a global scale. The era of cheap long-term funding is over.”

And many countries face a situation where they confront a rising bill for interest payments on the debts they have already incurred.

The UK government lives in fear of a repeat of the “Liz Truss moment” in 2022, when the attempt of her short-lived Tory government to finance major tax cuts for corporations and the ultra-wealthy through debt led to a financial crisis, only staved off by intervention from the Bank of England.

France, the third largest economy in Europe, is one of the more indebted. It is expected to spend around €62 billion on debt interest this year which is roughly equivalent to its combined spending on the military and education.

In Japan, where purchases by the central bank ensured that the rate on long term bonds remained below 1 percent, the interest rate on 30-year debt is now around 3 percent. Last month, Japan’s Prime Minister Shigeru Ishiba said the country’s fiscal situation was “extremely poor, worse that Greece’s”—a reference to the “debt crisis” of the 2010s.

The debt mountain, estimated to be $100 trillion worldwide, and the interest bill on it will rise still further because of the slowing of the global economy. On top of this is the increase in military spending by all the major economies amid the escalation of war.

The response of the ruling classes, in the US and in countries around the world, is to deepen the onslaught against the working class, to make it pay for the debt burden by cutting wages, jobs and social conditions imposed through ever-more authoritarian and fascistic regimes.

The response of the working class must be no less profound and far reaching. It cannot push back the offensive by measures which seek in one way or another to pressure the ruling elites because, in the final analysis, they are being driven by objective economic forces, lodged within the profit system itself. This means the only way forward is the overturn of the capitalist system based on the fight for an international socialist program.