

Bond markets send out a warning

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Bond markets are sending out clear signals of tightening financial conditions as the global inflation surge from the US war on Iran continues and central banks prepare to lift interest rates.

This week at a US Treasury auction of \$25 billion of government debt, the yield on the 30-year bond went above 5 percent for the first time since 2007.

Earlier this month in the UK the yield on 30-year bonds, gilts as they are called, rose to their highest level since 1998 amid predictions that the Bank of England (BoE), which has so far kept its rate on hold, would soon have to start lifting it because of rising inflation.

The British situation is being compounded by the imminent prospect that Prime Minister Sir Keir Starmer will be ousted. Starmer has refused to stand down warning of the “chaos” that could result—a reference to the state of the financial system.

As the *Financial Times* (FT) noted: “Britain’s rising borrowing costs, already the highest among the G7, are an increasing strain on the public finances of a country whose debt interest costs exceed £100 billion a year.”

Before the war on Iran financial traders had been expecting that the BoE would lower borrowing costs to try to boost economic growth. Now they expect the BoE to make two or three quarter point interest rate increases by the end of the year.

In the US the rise in bond yields has come amid a further inflation surge with the annual rate of inflation rising to 3.8 percent in April, from 3.3 percent in March as petrol (gas) prices continue to rise along with a range of other products impacted by the war. And judging by the 6 percent increase in the wholesale price index for the month of April prices for the consumer are set for further major increases.

US economists have warned that there will be upward pressure on prices in every sector of the economy. The Bureau of Labor Statistics has said that the price of freight transportation, which feeds into the cost of

every commodity—from groceries to industrial products—had increased by 8.1 percent in April.

Joseph Brusuelas of the global consultancy firm RSM told the FT this week’s “hot” inflation reading showed that there was inflation “pressure in the pipeline” and that it was going to be “some time” before inflation peaked.

The inflationary surge is also increasing concerns about how long the rise in US debt can continue as it goes over \$39 trillion and the interest bill, now at \$1 trillion, continues to surge, taking up an ever-increasing portion of government spending.

The worsening financial position of the US has set up the conditions for continuing conflict within the political and financial establishment.

After waging a campaign against Federal Reserve Board Chairman Jerome Powell, denouncing him as a “numbskull” and “moron” over his refusal to bring down interest rates—even at one point launching criminal proceedings against him—Trump has secured the appointment of his chosen successor Kevin Warsh.

Warsh received Senate confirmation on Wednesday and takes over the helm of the Fed today.

Trump backed Warsh because he has been an advocate of lower rates and appeared to be toeing the president’s line, issuing his own criticisms of the operations of the Fed. He has been regularly denounced as the “sock puppet” of Trump.

But whether he can carry out the demand for interest rate cuts from his political master—Trump has said they should go to as low as 1 percent—is another question. The rate is not set by the chairman alone but by the 12-member Federal Open Market Committee (FOMC). And here the sentiment is turning to a rate increase, not a cut.

This was reflected in the Fed decision earlier this month which kept interest rates on hold. There were three dissents from members who wanted the excising

of what they said was a bias in the Fed's statement towards the next move being a reduction.

The latest inflation numbers have strengthened the position of those favouring a rate rise. On Wednesday Susan Collins, president of the Fed's Boston branch, said she could "envision a scenario" in which the Fed would need to raise rates. Collins, who is a member of the FOMC, does not have a vote on interest rates. But her views are more widely shared. She said while a rise was not her "baseline" there could be an outcome "that requires some policy tightening."

According to market expectations, the next meeting of the Fed on June 16-17, the first under Warsh, will decide to keep rates on hold at their present level of 3.50-3.75 percent. How Trump reacts remains to be seen—he may decide to avoid an immediate clash with his appointee – but there is no question that he is demanding lower rates to support the Wall Street rise which for him is the key indicator of the "health" of the US economy.

The decision by outgoing chair Jerome Powell to retain his position on the board of governors, means that the Trump appointee Stephen Miran, who has voted for a cut at every meeting he has attended, will have to go. Despite Powell's insistence he will remain in the background, there is an incipient split in the Fed's governing body.

Whatever the machinations in the Fed and the financial establishment, the objective crisis produced by the Iran war continues to deepen. The decision last week of the Reserve Bank of Australia (RBA) to lift its rate indicated the future direction of other, more significant, central banks.

The baseline scenario of the RBA and other central banks and forecasting agencies, is that the oil prices rise would start to ease over the next few months. That is looking increasingly unlikely.

On Wednesday, the International Energy Agency (IEA) warned that global oil reserves, which have so far kept the oil price from going up more than it has, were being run down at a record pace.

It said that stockpiles of crude and refined oil fell by almost 4 million barrels a day in April. This is more than the combined daily consumption of the UK and Germany.

"The world is drawing oil inventories at a record pace as importing countries confront unprecedented

disruptions to Middle Eastern supplies," the IEA said in a statement.

"Rapidly shrinking buffers amid continued disruptions may herald future price hikes ahead."

And the situation may be even worse, because the IEA based its statement on the assumption that the Iran war would end by early June.

Whatever the immediate twists and turns in the war, the working class is confronting an even bigger hit to its living standards than have been experienced so far. This will drive forward wages struggles under conditions where the central banks, the guardians of the interests of finance capital, are demanding that no compensation should be provided.

This global tendency was expressed in the Australian government's budget this week. It carried out the RBA's directive that there be no compensation for price hikes while it increased military spending and set in motion a massive cut in spending—the largest in Australian history—of more than \$35 billion to the country's national disability scheme, impacting the most vulnerable members of society, as the start of what will be an even deeper offensive.



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