US Treasury bond yield hits a “line in the sand”

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The yield on the 10-year US Treasury bond went over the 5 percent level yesterday amid a continuing global bond sell-off which shows no sign of abating, fuelled by concerns over inflation, the impact of war on Iran and rising debt. Another factor is the increased borrowing by tech companies to finance the continuing build out of AI.

It rose during the day to reach a high of 5.01 percent, before falling back slightly at the close of trading to 4.98 percent. But the surge seems set to continue with the 10-year yield rising for the seventh month in a row. It has risen by a full percentage point since the start of the Iran war.

The US rise has had a global impact with the yield on UK 10-year bonds, or gilts as they are called, rising to as much as 5.44 percent, their highest level since 2007, before falling back slightly. The yield on Germany government debt also rose.

The last time the rate on the 10-year US bond went over 5 percent was in October 2023. But it stayed at that level for only a day. The rate on the 10-year forms the baseline for all US markets and for their major global counterparts. The last time it was consistently above 5 percent was in 2007 before the global financial crisis.

This has led to some comments that the rise in rates is the “normalisation” of the financial system after the ultra-low rates of close to zero which prevailed in the 2010s and the early 2020s. Such comments, however, ignore the profound changes of the past 20 years – one measure of which is the expansion of the US Treasury market, where government debt is bought and sold.

It is one thing to pay 5 percent when the debt is much lower and quite another when it must be paid on a vastly larger amount as any family trying to payoff a mortgage knows very well.

The Treasury market has ballooned from around $4 trillion in 2007 to more than $32 trillion today. US debt at that time was around $9 trillion. It has now risen to more than $40 trillion, accelerating every year and doubling its level from a decade ago. The annual interest bill of around $1 trillion is fast becoming the biggest item in the US budget—a telling symptom of its mounting economic and financial crisis.

Comments from market analysts and investors indicate they regard the breaching of the 5 percent level as significant.

Speaking to the *Financial Times* (FT), Jack Ablin of Cresset Wealth Advisors said: “The 10-year at these levels trips a signal somewhere. This is a moment to pay attention to.”

He noted that mortgage rates in the US would rise—they have increased to almost 6.8 percent in recent weeks—and would make “capital more expensive” for corporations.

Scott Chronert at Citi, told the FT that the 5 percent level was a “line in the sand” and that he expected some “disruption” to the stock market.

In its report on the rise of the 10-year yield, the *Wall Street Journal* described it as a “pivotal milestone that is forcing investors to confront whether the bond market is entering a new era.”

Greg Peters of PGIM Credit told the WSJ the only catalyst he could see for rates to go lower was what he called a “good old-fashioned recession.”

“The conditions are very much in place for a higher or remaining-to-be-high yield environment.”

There were a number of immediate factors sparking the rise, including the spike in the oil price to around $109 per barrel and the August inflation numbers for the US which showed no movement down to the target rate of 2 percent set by the US Federal Reserve. But the fundamental structural issue is the level of government debt and the rise in interest payments now estimated to be a total of $2 trillion annually in the countries of the 38-member OECD.

The rise of the 10-year yield is a further blow to the efforts by US Treasury secretary Scott Bessent to lower rates at the longer end of the market. Bessant launched a buyback plan to lift Treasury purchases of bonds from the normal level of $2 billion per operation to as much as $6 billion. But bond prices continued to fall, and yields rose, when it was carried out last week.

As Ajay Rajadhyaksha, chairman of research at Barclays told the FT: “This is telling you that steps taken by the Treasury department like the buybacks—that have now increased a lot—have not worked. This is not a liquidity problem. This is a problem of the US issuing too much debt for too long.”

He said the sell-off of long-term bonds puts added pressure on the Fed to lift its interest rate when it meets later this week in what would be the first hike since 2023.

Fed chair Kevin Warsh is caught between the demands of US president Trump for lower rates – Trump again posted on social media this week that the US should have the lowest rates in the world – and the demands of financial markets, above all the bond market, that significant action must be taken by the central bank to bring down inflation.

With his somewhat hawkish address to the Jackson Hole conclave at the end of last month, in which he expressed a determination to fight inflation and that he did not yet see a consistent decline in prices, Warsh seems to have left himself with no way out other than a rate rise.

Market indicators show that traders see a greater than 90 percent chance the Fed will raise its rate on Wednesday.

“If they don’t hike, it’s going to be pandemonium,” Ed Al-Hussainy, a portfolio manager at Colombia Threadneedle told Bloomberg. This was because long-term bond yields would surge on the back of greater inflation risks, he said.