CLARITY

Higher for longer? What's driving rates

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EXECUTIVE SUMMARY

- **Long-end yields are repricing on structural, not cyclical, grounds.** The recent selloff is concentrated in 10-, 20-, and 30-year maturities, while short-term rates remain stable, signaling a shift in how investors view deficits and debt sustainability, not a reaction to next month's Fed decision.
- **Rising deficits and heavy issuance are driving yields higher globally.** U.S. debt surpassed $40 trillion in mid-August, just five months after crossing $39 trillion, and last week's 30-year bond auction priced at 5.216%—the highest since 2001. Similar dynamics are unfolding in Germany, the UK, France, and Japan, where the BOJ's withdrawal is removing a key buyer.
- **The traditional buyer base for long-term government debt is shrinking, likely for years.** China's Treasury holdings hit an 18-year low in June, Japanese institutions are repatriating capital as domestic yields rise, and U.S. corporate pensions—largely fully funded—have curtailed long-duration purchases, leaving more price-sensitive investors to fill the gap.
- **AI-driven corporate borrowing is now competing directly with sovereign debt for capital.** August investment-grade issuance hit a record above $160 billion, adding further pressure on long-term rates and highlighting a multi-year trend unlikely to reverse soon.
- **Implications are mixed: elevated risk alongside a genuine income opportunity.** Weaker stock-bond diversification, elevated mortgage rates, and a self-reinforcing deficit-yield feedback loop pose risks to portfolios and growth. At the same time, high-quality bonds now offer their best income potential in nearly 20 years—an opportunity investors should weigh carefully against the risk of further yield increases.

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Government bond yields have climbed to their highest levels in decades across most developed countries, driving bond prices lower as a result. This recent selloff has been concentrated almost entirely in longer-term maturities—10-, 20-, and 30-year bonds—while shorter-term rates under 10 years have remained relatively stable (Figure 1). That distinction matters: this is not a reaction to next month's Federal Reserve (Fed) decision, but reflects a deeper shift in how investors view long-term deficits, inflation, and future buyer demand for government debt.

Yields have pulled back modestly from their most recent peaks. The 30-year U.S. Treasury yield briefly touched 5.31% on August 17 before retreating lower as the Treasury's buyback intervention and a partial easing of oil prices provided some relief. The broader trend, however, remains firmly toward higher long-term rates.

FIGURE 1

Longer-term bond yields have risen significantly since the onset of the pandemic.

Source: Bloomberg, TIAA Wealth Chief Investment Office. Data through 8/25/2026.

What triggered recent volatility

On August 19, 2026, the U.S. Treasury Department announced plans that it would at least double the size of its program to buy back long-term bonds from the market,[1] sparking a sharp one-day rally in long-dated bonds. That relief proved short-lived; within 24 hours, yields had given back nearly all their gains, as investors concluded the move addressed a symptom rather than the root cause. This kind of buyback can temporarily improve how smoothly the bond market functions by reducing available supply, but it doesn't change the underlying pressures that historically move yields higher: deficits, borrowing needs, and debt sustainability.

Markets do seem to have identified an informal comfort threshold, with the 10-year yield near 4.75% appearing to prompt policymaker attention. Markets are also closely watching remarks from Treasury officials and the Fed, which could shape near-term direction.

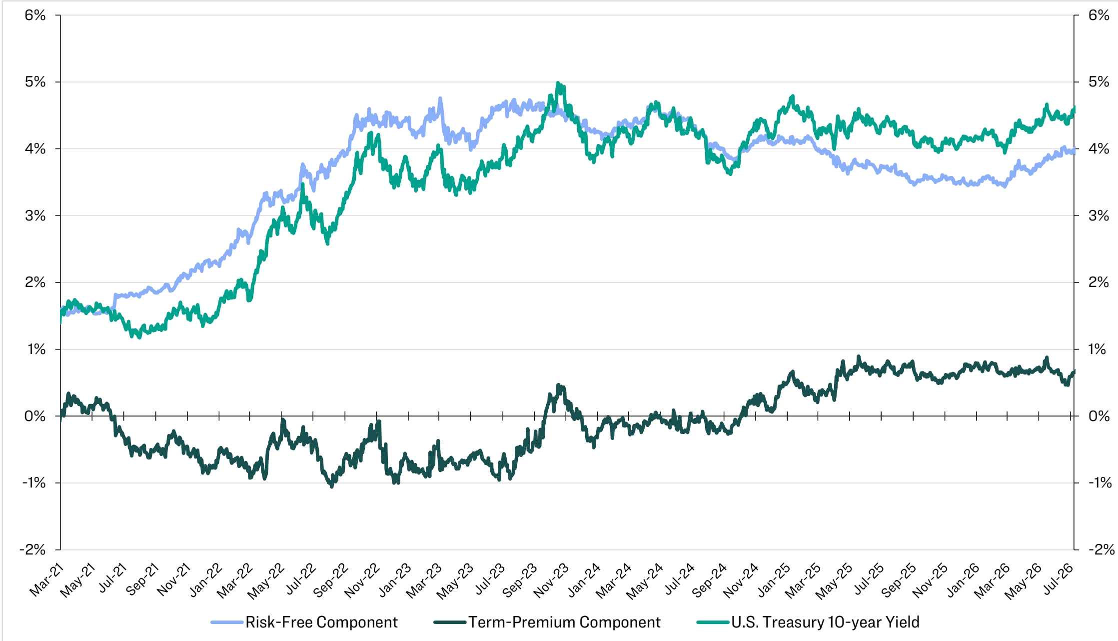
Why this is happening: Four key drivers

1. Government deficits and the growing supply of debt

The U.S. national debt crossed $40 trillion in mid-August, a milestone reached just five months after hitting $39 trillion in March, illustrating the pace at which the debt load is compounding. Governments regularly sell new bonds to the public to raise money and fund their operations, a process known as a bond auction. Last week's 30-year Treasury bond auction was priced at 5.216%, the highest financing cost since 2001, with additional sales on the way and no signal that the pace of borrowing will slow through 2027. The Treasury has also raised its third-quarter 2026 borrowing estimate meaningfully above its prior forecast. In response, investors are demanding more compensation to hold long-term debt (term premium) as deficits show no sign of narrowing, and a newly announced fiscal consolidation initiative has so far been met with market skepticism (Figure 2).

FIGURE 2

Factors influencing the 10-Year Treasury Note.[2]



Source: Bloomberg, NY Fed, TIAA Wealth Chief Investment Office. Data through 8/25/2026.

This pattern isn't unique to the U.S. as similar pressures are emerging elsewhere across the globe.

- **Germany's** defense and infrastructure spending is adding bond supply that the market is only absorbing at higher yields.
- **The UK** posted a surprise budget deficit in July ahead of its autumn budget, raising questions about future borrowing needs.
- **France** faces the risk of a wider deficit if political gridlock delays its 2027 budget.
- **In Japan,** the central bank's gradual withdrawal from the bond market is removing a longtime buyer, exposing yields to levels not seen in decades.

2. Persistent inflation, made worse by Middle East tensions

Inflation has remained above target in every major economy for five straight years. The ongoing U.S.-Iran conflict continues to weigh on energy markets and inflation expectations. However, the picture shifted marginally in late August when Brent crude fell below $90 per barrel, easing fears of an imminent supply shock after the latest round of U.S. sanctions on Iran stopped short of targeting its major trading partners. The pullback in oil prices has been providing modest support to bonds.

The geopolitical situation remains fluid, with diplomatic efforts underway to ease tensions and reopen the Strait of Hormuz, a critical waterway for global oil shipments. Strategists believe the broader bond move is being driven more by rising real yields—the actual return investors get after subtracting impacts from inflation—than inflation expectations alone. In other words, markets are pricing in structurally higher interest rates over the long run, not simply reacting to a temporary spike in energy costs.

3. A shrinking pool of traditional buyers

This may be the most significant driver, and one that could take years to reverse. Three major categories of U.S. bond buyers that have historically absorbed large volumes of long-term debt are all pulling back simultaneously.

- **Foreign central banks are deliberately diversifying away from U.S. Treasuries.** China's holdings fell to an 18-year low in June, continuing a multi-year trend that has seen holdings drop from over $1 trillion in 2014 to pre-financial crisis levels (2007) of roughly $600 billion. As official buyers step back, they are being replaced by more price-sensitive investors who demand higher yields to compensate for inflation risk.

- **Japanese institutions are bringing money home.** For decades, near-zero domestic yields pushed Japan's life insurers, pension funds, and banks toward foreign bonds. Not anymore. Japanese 30-year yields are up roughly 9 basis points in the past month and near record highs, allowing institutions to find solid returns at home—without the added cost of hedging currency risk.[3] Several major insurers expect yields to rise further, reinforcing their reluctance to return to foreign bonds.

- **U.S. corporate pension funds** have meaningfully pulled back from buying bonds. After years of strong stock market gains, many of these funds now have enough assets to cover what they owe retirees, so they no longer need to buy as many long-term bonds as before.

4. A wave of corporate borrowing tied to AI investment

Companies are issuing enormous amounts of new debt—much of it to finance artificial intelligence (AI) infrastructure, including data centers—competing directly with government bonds for the same investor dollars. U.S. investment-grade corporate bond issuance reached an all-time record for the month of August above $160 billion, with one large technology company alone raising $25 billion in a single offering. The surge in borrowing among large technology companies has drawn increased attention from investors, particularly as AI-related spending continues to accelerate.

What this means for investors

- **Bond values have declined,** with the longest maturity bonds experiencing the sharpest losses. Stock prices have also come under pressure, since higher long-term rates reduce the value of future earnings and weigh on equity valuations. However, equities are finding some footing as oil prices ease and yields pull back slightly.

- **Corporate borrowing costs are elevated.** The extra yield investors demand to hold corporate bonds over government bonds, known as credit spreads, has remained relatively stable, but the sheer volume of new corporate debt is absorbing significant investor demand and creating pricing pressure for new issuers. Lower-rated, higher-risk corporate bonds are a notable exception, with yields climbing for several consecutive sessions to multi-year highs, suggesting stress is building at the lower end of the credit spectrum.

- **Mortgage rates, which closely track 10-year Treasury yields, remain elevated** and continue to weigh on housing affordability. At the government level, a concerning feedback loop has emerged: higher yields increase interest costs, which widens deficits, which requires more borrowing, which can push yields higher still.

- **One traditional feature of balanced portfolio construction—bonds moving inversely to stocks—has weakened** in this environment, meaning long-duration bonds are providing less cushion than investors might expect during periods of equity declines.

However, there is a silver lining for savers and income-focused investors: Higher yields mean high-quality bonds now offer their best income potential in nearly 20 years—creating an opportunity to build portfolios with attractive, dependable income (Figure 3). Still, investors should weigh this opportunity carefully against the risks. Further deterioration in the U.S. fiscal picture or another run higher in yields could erode the value of existing bond holdings before that income advantage is fully realized. Perhaps most importantly, if yields continue climbing, the cumulative effect of higher borrowing costs across the economy could eventually tighten financial conditions enough to weigh on corporate profits and economic growth, posing a risk to credit and equity markets more broadly.

FIGURE 3

Rising bond yields act as a drag on short-term fixed income performance, but boost the long-term attractiveness of bonds.[4]

Source: FactSet, TIAA Wealth Chief Investment Office. Data through 7/31/2026.

Is this temporary, or something more lasting?

Our view is it's a bit of both. Some catalysts, including geopolitical tensions, the pace of government bond sales, and short-term investor positioning, could resolve relatively quickly. But deeper structural forces are unlikely to reverse soon. The investor base that has historically purchased large volumes of government debt at low yields has fundamentally changed its calculus, and that shift will take years, not months, to unwind. Deficits remain structurally wider than before the pandemic across most major economies, and heavy corporate borrowing tied to AI investment is likely a multi-year trend.

Given how quickly yields have moved, sharp reversals are also possible. Current yield levels present compelling buying opportunities for long-term investors, and many investors remain positioned for yields to keep rising. A more durable, positive shift in sentiment could trigger a meaningful, if temporary, rally.

What to watch next, and what could bring lasting relief?

Three variables will most directly shape the direction of yields in the near term.

1. **Geopolitical developments in the Middle East** remain the single most consequential near-term driver. Diplomatic efforts remain active, and any credible progress toward reopening the Strait of Hormuz would ease oil-driven inflation concerns and remove one of the primary arguments for structurally higher long-end yields. Conversely, an escalation would add significant upward pressure.

2. **Upcoming Japanese government bond sales** in September represent the next concrete stress test for global sovereign markets, with 30-year bond sales scheduled for September 3. Poor demand could signal that higher yields are needed to attract buyers, with spillover effects into Treasuries and European sovereign debt.

3. **Incoming growth and inflation data** will determine whether the Fed's waiting posture holds through year-end. July core inflation reading came in at its slowest pace since March 2021, and retail sales softened, both of which reduce the near-term probability of a rate hike and help keep short-term rates anchored. The easing in oil prices, if sustained, would reinforce that picture. A reversal, particularly if energy costs feed through to broader prices, would reignite pressure on shorter-term rates and steepen the yield curve further.

For long-term yields to come down in a lasting way, one or more of the above variables would likely need to be resolved—or at least investors would need to feel confident a resolution is on the way. None of that looks likely in the near term. However, the recent pullback in oil, moderating but still elevated core inflation, and signs of investors finding value at higher yield levels suggest the market may be starting to stabilize—a shift worth watching closely, even as the risk of a sudden yield spike remains. For now, long-end yields are likely to stay under pressure and could climb further. We're closely tracking geopolitical developments, demand for government debt, and key economic data for clues on where rates head next.

Endnotes:

[1] Bond buyback program: The government's purchase of previously longer-term issued bonds from investors to reduce the supply of bonds available in the market.

[2] The "risk-free" label for 10-year Treasuries primarily refers to their low default risk due to the backing of the U.S. government. This is because the U.S. government can tax, borrow, or print currency to meet its debt obligations.

[3] Hedging currency risk is a financial strategy to reduce or eliminate potential financial losses caused by shifting foreign exchange rates. It acts like insurance, protecting money from market moves so returns depend on the actual asset instead of currency swings.

[4] Yield to worst represents the lowest yield a bondholder might receive if the bond is redeemed before maturity while still complying to agreement terms.

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