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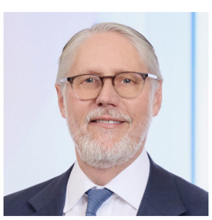
August 2026

PIMCO Perspectives

What's Pushing Long-Term Bond Yields Higher?

A confluence of rising sovereign debt, surging AI-related corporate bond issuance, and inflation concerns has lifted 30-year yields in the U.S. and elsewhere to two-decade highs.



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The 30-year U.S. Treasury yield has touched roughly 5.3% in the past week, a level not seen in nearly two decades. Global counterparts in Europe, the U.K., and Japan have climbed to similar heights.

What's driving the move at the long end of the yield curve? Rising sovereign debt loads, a surge in AI-related corporate bond issuance, and lingering inflation anxiety tied to energy costs – and what that means for central bank policy – all play a role.

Our colleague Lotfi Karoui explored a related question in June amid the influx of bonds tied to the AI buildout (see "The Credit Market Lens: AI Financing Needs Do Not Override Cyclical Drivers of Yield"). AI-linked issuance – much of it longer-dated – has grown large enough to compete with government bonds for investor capital, even if it does not appear to be the dominant driver of yields. A key question is how fully the AI effect is priced into markets at this point.

The recent volatility has largely been a real-yield event. Breakeven inflation rates – market gauges for expected average inflation – have stayed comparatively stable even as nominal yields marched higher. That suggests investors aren't demanding a much larger inflation premium.

The sovereign debt trajectory and the bond vigilantes

The sovereign bond repricing has been global, and rising government debt levels remain central to market concerns. Amid the repricing, German 30-year yields have reached post-2011 highs, and French 30-year yields have risen to their highest since the global financial crisis. In Japan, 10-year yields are the highest in three decades.

Rising deficits are a common problem across developed market (DM) economies. This week, total U.S. government debt crossed $40 trillion, according to the Treasury Department, more than doubling over the past decade. Amid increasing long-term borrowing costs, the Treasury Department said on 19 August that it will at least double its planned buybacks of outstanding 10-year to 30-year debt.

In our most recent Secular Outlook, "Rupture and Resilience," we said we expected episodic volatility – rather than a sudden fiscal crisis – as markets periodically refocus on debt sustainability. That framing remains relevant. We made a related point in this column in December 2024 ("Thoughts From the Bond Vigilantes"), noting that rising deficits had made us less inclined to lend to the U.S. government at the long end.

While capital flows and foreign exchange adjustments could serve as a release valve, deficit reduction is the only durable anchor for long-end yields, in our view. In the U.S., the deficit has become largely inelastic to underlying economic need, rising sharply even in a strong economy. Across DM, we see little appetite for fiscal austerity.

Rising term premium and potential risk factors

Part of the investor caution in the U.S. reflects the 30-year bond's structure: It's a less liquid area of the Treasury market than the 10-year note, and it reacts significantly to shifts in sentiment around fiscal credibility.

The 10-year note, by contrast, is a widely used benchmark anchoring mortgage rates, corporate borrowing costs, and the broader cost of capital. Even as the long bond grabs headlines, the 10-year yield has held within the 3.75%–4.75% range that has served as our reference point for several years.

A few factors help explain why this range has held. One is a recent softening in economic data – including a weaker-than-expected employment report and inflation readings below consensus (for more, see our 5 August Macro Signposts, "Underlying Inflation Gauges: Trimming Noise or Trimming Signal?"). In addition, a large short base in the U.S. rates market may help limit any disorderly rise in yields, while Treasury buybacks appear supportive of bonds at top end of yield ranges.

Key risks that could propel yields to a higher range would include additional fiscal stimulus in an economy that does not need it and further deterioration of expectations around government debt supply.

The relative underperformance of the long bond has steepened yield curves and increased the term premium, the extra yield investors demand to hold longer-dated securities. Barring an unexpected economic downturn, we expect this higher term premium to endure.

A bumpy ride toward improved opportunities

It's worth noting that even after the recent rise, yields on longer-dated Treasuries and other sovereign bonds are essentially back near their long-run historical averages. Today's yields only appear unusually high relative to the artificially suppressed rates of the post–global financial crisis era.

Watching yields grind higher can be a difficult process, but higher yields may ultimately benefit investors through greater potential income generation. In 2022, starting yield levels were too low to offset price declines as rates moved higher at a rapid clip. Today, attractive inflation-adjusted starting yields may provide ample income to offset price declines related to recent market moves, and broader bond market performance remains resilient.

At PIMCO, we've spent more than five decades navigating rate cycles. Our experience has taught us to remain humble, to respect the power of market forces, and to keep a long-term perspective. From our perspective, current yield levels look increasingly appealing by historical standards, offering a compelling entry point for long-term investors. We continue to view bonds as attractive and would look to add if yields continue to rise, given the opportunity higher yields present for income, carry, and rolling down a steeper yield curve.

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