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Why Global Bond Yields Are Surging

George Cole, Head, European Rates Strategy, Goldman Sachs Research

Allison Nathan, Senior Strategist, Goldman Sachs Research

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Allison Nathan: Bond yields around the world have been rising for most of this year and have recently surged. So are interest rates settling into a new higher normal, or is this a temporary dislocation?

I'm Allison Nathan, and this is Goldman Sachs Exchanges.

To understand why bond markets are under pressure—giving rise to higher bond yields—I'm sitting down with my colleague George Cole, who leads European Rates Strategy for Goldman Sachs Research.

George joins me today from London. George, welcome to the program.

George Cole: Thanks very much.

Allison Nathan: So, George, it's easy to look at the headlines and think this is just a US story. We've obviously seen concern about inflation here in the US. There's concern about spending levels. But this bond sell-off is really happening everywhere. Is that right?

George Cole: Yeah. No, that's right. So, as you said, I sit over here in London. I look primarily at the European bond markets, in Germany, in the UK. But when we look at the US, when we look at markets like Japan, we would really think of these four as the major government bond markets, the major benchmarks for the global economy and global fixed income markets, and we're seeing all of these markets move higher in yield.

We're at multi-decade highs as we read about in the financial press. We're seeing yields pressing higher across all of these economies, and it doesn't look obvious that there's a single driver or a single market that is really leading the sell-off or driving it over a long period of time.

From day to day, one move might be bigger in one of those economies, but really over the last few months, all of those markets have been pushing yields higher.

Allison Nathan: Well, that's my follow-up to you, George, because the question is what is driving this? And my intuition would be the rest of the world is just following the US lead, but you're saying that that may not be the case. Every country might be dealing with their own issues?

George Cole: Yeah. So as a rate strategist and as an economist, we'd be looking at yield curves and bond markets to try to think about and find clues what is driving the move? We could look which economy might be driving it.

As I said, you know, it's not that obvious that you can point to just one of those major bond markets as driving the sell-off. You could look at things like the shape of the yield curve. Maybe it's the front end of interest rate curves that is moving. That would be associated with expectations around policy rates that might be on the move, maybe reflecting cyclical conditions, better growth, higher inflation.

It could be maybe the long end of the curve is moving. That could be a term premia type of issue, the price of duration risk, maybe fiscal risks or maybe even long-term growth further out the curve. And what we're seeing across the yield curve is that all the way from the 30-year point on the curve, which has got a lot of attention and yields are much higher there than they have been in recent decades, but all the way down the 10-year point on the curve and even the policy rate expectations or pricing one or two years out is looking much higher, maybe not right at the peak of where we were in 2022, but certainly very high relative to where we've been in recent years. So, it looks like we've got broad-based pressure across a range of different factors.

Allison Nathan: And so what are then the fundamental drivers, or are there not? What do you attribute all of this movement to?

George Cole: I'm glad you asked are there fundamentals behind it, and this is one of the features of this sell-off I think it is a little underappreciated when you might read about it, is that actually the volatility of the moves have been relatively low.

Now, of course, we're dealing with a revision right now of central bank expectations, and we're maybe moving toward an

expectation that rates will be moving higher from central banks. That's now inducing a little bit of volatility in the market. But if we go back to, say, July, and think about the move since then in yields higher, what has been really striking is that volatility has been low, both the realized volatility of the market and also the price of volatility, the implied volatility that is priced into the market as well.

Now, we might be a little bit higher in the range of the year, but If you look at on a multi-year horizon, volatility is actually quite low. And that feature of this sell-off makes it much harder to argue, well, this is a non-fundamental move. This is happening because of some sort of technical reason or a move in the market that has outsized volatility that is not sustainable.

When volatility remains low, it is harder to make that conclusion. What I would say is that there is an overlapping set of fundamentals here that are driving yields up, and that goes all the way from long-running themes like large deficits, fiscal policy that is driving debt level to historic or recent highs.

We've had that since the pandemic. Now, that's not always and everywhere a guide to what markets do, but when you combine

that with something that is operating over the last few years, the borrowing associated with AI CapEx. As more and more of the AI CapEx is financed in debt markets, we are seeing there's some competition now for government borrowing.

And then the final layer this year, we've actually had pretty resilient growth across major economies. And very locally, and this is driving some of the most recent volatility, we are seeing a renewed push higher in energy prices following the ongoing war in Iran that is the last kind of inflationary push that is worrying the market.

Now, what those things are combining to do, we know we've got this backdrop of elevated government supply. We've now got competition from private sector issuance—just at the moment, that bond demand is weaker because of higher inflation and actually resilient growth in the economy. And all of those things combine, we think, fundamentally to push yields up.

Allison Nathan: Right. But when I look at this list of factors, the most recent one, of course, has been the surge in energy prices. And so my question is why now when many of those factors have

been sort of long in the market, long in coming? Is that your answer? It's energy, or it's still a question we're trying to answer.

George Cole: The move very recently, so, if we think about the potential for Bank of England rate hikes or further ECB rate hikes, the potential for the Fed to hike, those things are more determined by the nearer-term inflation considerations, particularly in Europe, where we've got not only rising oil prices, but also European gas prices.

This is creating a real headache for the inflation outlook in Europe. There's no doubt the surge from energy prices should prove temporary, but it feels like the central banks there now are running out of a bit of patience to deal with what should be temporary shocks, and are willing to take a little bit more action to safeguard inflation further down the line.

So you're right. That is what is driving the latest round of interest rate movements, and they have been a bit more volatile. And certainly, when the central bank comes into play, that is when you do see a little bit more of a pickup in rates volatility. But that really hasn't been the story of the entire sell-off, not say if we rewind to something like July, the move has been more gradual,

more orderly, and driven by the long end of the curve, which suggests some of these more longer running factors that you mentioned also are contributing.

But I would certainly stress that it is the overlap and combination of these factors that I think gets us to where we are today.

Allison Nathan: So the other major development in the recent period has been that the US Treasury has been engaged in bond buybacks. Tell us more about that and its implications. Why are they doing that?

George Cole: Yeah. So the bond buybacks is a program that the US Treasury have had for some years now. The idea of the program is to, if you think about the bond market, the most liquid bonds that are out there in the system are the ones that have been issued recently. The bonds that have been issued some time ago are less liquid, there's less turnover in these bonds.

And so the buyback program is designed to take some of those less liquid bonds out of the system and replace them with fresher

bonds. So if you think about that motivation, it's kind of a liquidity operation. It just greases the bond market with these newer, fresher bonds. The announcement some weeks ago that we heard from the US Treasury that they would increase the size of buybacks at the long end of the curve, and the practical effect of that will be to reduce the maturity of the debt stock.

You would be taking out some of these less liquid bonds, maybe over a 10- or 20- or 30-year maturity, and you would be replacing them with bonds that you're issuing usually at lower maturities, and maybe even using Treasury bills. And so, in effect, this is a switch to take longer maturity but less liquid bonds out of the system and replace them with shorter-maturity bonds.

If we think about that in the context of what other Treasuries across the major economies, so the UK Debt Management Office, the DMO, is a good example of this. At the end of last year, the DMO announced that they would be reducing the amount of 30-year bonds that they would be issuing to the market, and that did have some effect to lower the yield in the 30-year part of the curve, but only on a relative basis. A little bit of a curve effect and a little bit of an effect to support 30-year yields lower against,

say, swap rates. What it didn't do was change the macro price of the bond or the level of the yields, only really the fundamentals, expectations around policy, around fiscal policy, around inflation can do that. And again, the UK is a great example here. Despite the fact we haven't seen very many 30-year bonds issued recently, 30-year yields are still near the highs. And so in that sense, it's not going to change the macro fundamentals.

Allison Nathan: Right, George but I do think the market interpretation of this announcement, which I think was somewhat unexpected, please correct me if I'm wrong, was that this was an attempt by the Treasury to reduce long-end yields. But you don't think it will have that effect, setting their motivations aside, that's not your observation.

George Cole: Yeah. So I think that the announcement came in an unanticipated way. It was not in the regular schedule of the communication of the US Treasury to the market via its refunding announcements. And so in that sense, there was initially a bit of ambiguity about exactly what the program was designed to achieve. Part of the rationale subsequently was that there would be some attempt to improve liquidity at the long end

of the curve. And again, following the pattern that we're seeing in the other debt management offices or the other Treasuries and issuers across sovereign markets, it does seem a very natural thing to try to balance the supply and demand dynamics across the yield curve.

There are deficits to finance, and the Treasury in the US and elsewhere need to make a decision, how do we finance that? What's the optimal way to issue that debt? Well, when we have a situation where yields are high, central banks are no longer buying debt, we've got reduced demand from, say, pension funds, other investors that typically buy these longer-dated bonds. There's lower demand because at these higher yield levels, liabilities of, say, pension systems that are being discounted at these higher levels of rates, they are now much lower. And so that demand has actually fallen despite the fact yields have moved higher. And that means that Treasuries and issuers, it makes a lot of sense to think about lowering the amount of longer-dated issuance, and relying on more liquid and lower and shorter maturities, and that's exactly what we've seen across a number of economies.

So if we view that as the pattern that we're seeing across across these sovereign issuers, then this increased buybacks at the long-end is just a different way to do that. You could reduce auction sizes, or you could do these buybacks to get these longer-dated bonds out of the market. In the end the effect will be the same. But I certainly would say the evidence across whether it's the UK, Japan to some extent has made some steps to reduce long-end issuance, that's not really doing much to change the macro price. And we are seeing yields in those markets very much being determined by the deeper fundamentals. Are there worries about inflation or fiscal risks? Are there issuance pressures that are maybe outside of governments that are also leading to those higher yields? Those are the things that are really going determine the level of yields.

Allison Nathan: Understood. Let's get back again to some of these drivers of these long-term bond yields reaching higher levels. We talked about the US dealing with really an unprecedented deficit outside of war times, but there's also rising regional tensions that are forcing Europe and Asia to spend heavily on their own defense.

So, we are seeing sort of fiscal pressures globally. Does that really mean, again, just coming back to the drivers, that higher rates are just really simply the cost or maybe the permanent cost of today's fiscal and to some extent even geopolitical realities?

George Cole: Yeah. So, I think that when we look at the fiscal outlook, what you really want to be paying attention to are what are the non-discretionary elements of the budget spending that are committed to.

Entitlement spending, obviously a big one and has importance across all of the major economies and interest costs, and this is something as we keep rolling over government debt at these higher levels of yields, this is a non-negotiable cost that governments need to pay. So, there is pressure on budgets from that source.

And if you add on that commitments to increase defense spending, which as you mentioned, across a number of geographies, but certainly here in Europe, that is a commitment that you're increasingly seeing governments make, the UK being a great example of that. It does lead to very challenging budget choices.

You need to think, how will that additional spending be financed when the budget's already under pressure? It could be via higher revenue, higher taxation. It could be via reduced spending elsewhere, or it could be by renewed borrowing. And so that's why the bond market is watching fiscal events and wants to understand exactly what priorities governments will be giving.

Of course, we're also in a situation where there is a competition for savings, and I mentioned before, we've got a situation where the private sector is undertaking a very significant uplift of CapEx. Borrowing is being used to finance that. And so just at the moment where governments are attempting this uplift in some areas of spending, there is now a competition for savings.

And if we think about what that does to the savings investment balance globally, we have fewer savings, we have more investment, and the way to clear that market is by raising interest rates. So, it may not be here forever, but it certainly is an environment where at the moment, while those spending pressures or spending commitments are under pressure to expand and there's a competition for those global savings, we should expect that higher rates are part of the environment.

Allison Nathan: Right. Let's zoom out for a moment, George. I'm looking at the screen at over 5% 10-year US yields. That seems so high to me. But if you really think about history, that was much closer to the pre-global financial crisis norm. So, in some sense, is this really just a return to a normal, potentially even healthier environment?

George Cole: Yeah, so if you look at the long time series of yields, you're absolutely right. We haven't seen these levels for many decades, maybe in some cases.

But if you look at the longer history of yields, the levels that we're at are not all that unusual, and I think consistent with some of the big shifts that we've seen, say, over the last five years or so. The most obvious one is the big shift higher in both the level and the distribution of inflation risk.

That, if you compare that to where we were in the decade following the global financial crisis into the pandemic, couldn't be more different. That was when we were worried about weakness in demand, very weak inflation outcomes. Policy couldn't quite generate the inflation re-pressure that it wanted to, and so the distribution of risks in the bond market was to lower yields.

Now we have a distribution of inflation outcomes that looks maybe even more than higher than central bank targets but certainly much more symmetric around central bank targets. And in some sense, that connects us back to something looks a little more normal, relative to the decade following the global financial crisis.

There is one big difference, which is fiscal positions are different to where they were back in a period where yields were higher, both nominal yields and real yields. We now have much bigger debt burdens. We have bigger deficits. So that is something that is much more part of the discussion.

Can you have a normal yield environment this high with fiscal policy as it is currently struck? One of the ways I think you can delay answering that question is high nominal growth as long as growth both on the real side, but if you also have a cushion of inflation is higher, that is something that can sustain yields at these levels.

But those are the questions for the future. How will we bear the rise in interest costs that the current yield curve would imply? And then maybe when I think about some specific markets,

somewhere like Germany, the German yield curve is not yet back to levels that we saw pre-global financial crisis.

There are good reasons for that, I think, as we learned through not only the GFC, but then the European sovereign crisis. The rise of credit spreads in European sovereign markets does create a little bit of a more challenging environment to sustain much higher bund yields. If you have high bund yields plus a credit spread to other sovereign markets in Europe, that creates much tighter financial conditions for borrowing in some of those other economies. And so, there is something that is probably going to keep the distribution of German yields a little lower.

On the flip side of that, we're seeing maybe now the prospect of something like sustainable 2% or something close to it in Japan in inflation, and that's something we haven't seen for several decades. And so it does look like Japanese yields might be at a higher end of the range relative to they've in recent decades.

Allison Nathan: But if you think about the forward, George, what are you expecting in terms of rates? Will they remain at these elevated levels? Where do we go from here?

George Cole: Yeah, so going back to one of the things we mentioned before, this sell-off is broad, it's been across the curve, it's been across economies. And although we are maybe now witnessing something that looks a little bit more volatile as central banks come into play, generally it's been a relatively low-vol sell-off.

That tells you that there are probably fundamental views in the market behind the sell-off. So, my view is it's going to take a fundamental to beat a fundamental, and so if you want to get yields lower, you've got to have some sort of pathway to lower inflation, I think is the most obvious way to think about what would get yields lower.

The proximate source of that, if you wanted to think about a reversal of what's driving yields higher in the very short run, is global energy prices. So both the oil market, refined products, the European gas market. That is really difficult to have a lot of conviction on in the near term, given its link to the geopolitical events, the war in Iran, and so near-term visibility is really hard.

On a six to 12-month basis, our commodity strategists do expect at some point these commodity markets are likely to be better

supplied and see those prices come down. So are we still worried about energy price inflation in six to 12 months' time? We hope not. We forecast not. That would be one way to get lower yields, particularly in the front end of the curve, where central banks don't need to quite be as worried as maybe the market thinks they will be about the energy price inflation.

And then over the longer run, I think an interesting one is to think about what happens to this AI investment cycle. And at some point, you would imagine that investment needs will decrease once the investments begin to bear fruit. And one of the questions for the rates markets is, can you seamlessly go from the borrowing phase to the implementation phase where we transition into this world of higher growth and higher productivity?

That might include a higher cost of capital further down the line. But to the extent there's any bumps in that journey, if investment expectations were to fall, if there was some sort of other growth shock that could see a revision of some of those expectations, if there's maybe some of the disinflationary impacts of AI productivity growth that happen a little faster than

expected, that would be the other way that you could imagine some of the pressure that we're seeing in the bond market is alleviated.

And so, in that sense, those seem to me to be both in the near term and the more medium term, the most plausible drivers. Of course, we'd be watching things like fiscal policy very closely, and if you do see a move toward fiscal tightening or something changes in the fiscal trajectory, that would be also something as a sign for lower yields.

But as it stands, I think near term, energy prices, that's what's delivering a lot of the near-term movement and volatility in markets, and then the forward trajectory of the AI CapEx cycle is really the key thing to watch.

Allison Nathan: So still a lot of uncertainty, of course, around all of those factors. So, what would be your key takeaway, George, for investors right now? Should they be reevaluating the duration of risk profiles within their portfolios or just see how this evolves and hold tight?

George Cole: In the very near term, the risk to bonds is coming from the energy markets, and then I think most importantly, the connection to central bank pricing where central banks, they just run out of road.

They can't tolerate the inflation anymore, and they need to hike. That would be the most plausible proximate risk that would manifest in the front end, and that would be an environment where the yield curve would flatten. In that situation, you probably would see a decline in growth expectations, maybe inflation expectations further out the curve.

That wouldn't necessarily see longer term yields a lot higher. You might see stability out in the forward curve. And if we think about that then in combination with the broader investment outlook whether it's the equity market or credit markets, a huge amount of connection to the AI investment theme, that is when you can maybe start to build a portfolio where bonds have some hedge value, where if we find that the AI CapEx trajectory, undershoots expectations or that there is some sort of disinflationary impact that comes faster than expected and rates need to move lower, that is when you can start to build a case

that although it's very uncertain what happens in the next three months, maybe yields are a little higher, certainly if we don't see any energy relief.

If you start to think about the distribution of outcomes over a two, three, four-year horizon, it may start to be a little bit more asymmetric for the five-year yield part of the curve where yields can move lower and start to hedge some of the exposure that are in global investment portfolios.

Allison Nathan: Thanks, George, for your insights. Happy to have you here.

George Cole: Great. Thanks very much.

Allison Nathan: This episode of Goldman Sachs Exchanges was recorded on Monday, September 14th, 2026. If you enjoyed the show, we hope you'll subscribe to Apple Podcasts, Spotify, or wherever you get your podcasts, and leave us a rating and comment.

I'm Allison Nathan. Thanks for listening.

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