

Rising Bond Yields: A Warning Sign for the Economy Explained

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Rising Bond Yields Latest News

- Governments across the world are finding it **increasingly costly to borrow money**, with interest rates demanded by lenders reaching their highest levels since the Global Financial Crisis of 2008.
- What makes this particularly alarming is not just the level of these rates but the sharpness of the rise — a sudden spike in borrowing costs that has cascading consequences for governments, businesses, and ordinary citizens alike.

Why Do Governments Borrow

- In most countries, governments cannot meet their expenditures through taxation and other revenue sources alone. The gap between what a government earns and what it spends is called the **fiscal deficit** — and it is bridged through borrowing.

- This borrowing need is typically higher in developing countries because poorer countries do not have enough people in the well-off bracket to generate sufficient tax revenues.
- However, repeated crises have pushed even developed countries into higher levels of borrowing — not just in absolute terms but also as a percentage of their GDP — as economic growth has slowed and welfare expenditures have risen.

How Do Governments Borrow — The Bond Market Explained

- Governments borrow in a unique and standardised way — by issuing bonds.
- A government bond is essentially an “I Owe You” (IOU) statement — the government borrows a fixed sum of money for a fixed period of time and promises to pay a fixed annual return (called a coupon) and repay the principal at maturity.

A Simple Example

- Suppose a government issues a bond — borrowing \$100 for 10 years with an annual coupon of \$5. The yield (effective annual return) on this bond is 5%.
- Now, if the government launches a war — inflation rises, economic prospects decline, and the government needs to borrow more. Investors now perceive higher risk and demand a higher return — say \$10 per year on new bonds.
- This makes the old bonds (paying only \$5) look unattractive. Holders rush to sell old bonds — but to sell them, the price must fall enough to make the effective yield equal to the new rate of 10%.
- So, the old bond price falls from \$100 to \$50. This illustrates the fundamental inverse relationship between bond prices and bond yields — when yields rise, bond prices fall, and vice versa.

What Government Bonds are Called in Different Countries

- USA – Treasurys
- UK – Gilts
- Germany – Bunds
- India – G-Secs (Government Securities)
- Japan – JGBs (Japanese Government Bonds)

Why Are Bond Yields Rising Now

- Across the world, several factors are simultaneously pushing government bond yields higher.
- War and geopolitical uncertainty — particularly the West Asia conflict — are raising risk perceptions.
- Rising inflation is eroding the real value of fixed coupon payments, making investors demand higher yields as compensation.
- Higher government borrowing needs — as governments spend more on defence, energy security, and welfare — are flooding markets with new bonds, pushing prices down and yields up.
- The sharpness of the rise is itself a problem — sudden spikes in borrowing costs leave governments and businesses with little time to adjust.

What Rising Yields Mean — The Real-World Impact

- **For Governments**

- Higher bond yields mean governments must spend more of their annual budgets on interest payments — leaving less money for everything else.
- This creates a painful choice between cutting spending in areas like welfare schemes and defence or raising taxes — both of which are politically and economically costly.
- Countries that have large existing debt stocks are particularly vulnerable because they must refinance old debt at new, higher rates — creating a debt servicing spiral.

- **For Common People and Businesses**

- Government bonds are the least risky loans in any economy.
- All other interest rates — for home loans, car loans, business loans, and personal credit — are priced above government bond yields.
- When government yields rise, borrowing costs for everyone rise — often by an even greater degree.
- This means higher EMIs on home and car loans, more expensive business credit, and reduced consumer spending — all of which slow economic growth.

- **For Developing Countries Like India**

- Developing countries face a double burden.
- Rising global yields attract capital away from emerging markets to safer developed-country bonds — causing capital outflows, currency depreciation, and further inflation.
- This forces their own central banks to raise interest rates defensively — slowing domestic growth even further.

Source: IE

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