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Could bond yields be reflecting fundamentals?

Marketing communication

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Higher US bond yields may reflect strong capital demand, inflation, heavy borrowing, and weaker demand for long-term bonds—not poor liquidity. Efforts to suppress yields could therefore fuel inflation.

Scott Bessent appears determined to prevent long-end US Treasury yields from rising further. He has signaled a willingness to intervene directly, but also by supporting other countries' foreign-exchange interventions to reduce selling pressure on US government bonds. Although both Bessent and Warsh have advocated a smaller central bank balance sheet, renewed quantitative easing (QE) could return if market strains intensified. The central question is whether higher yields primarily reflect poor market liquidity or structurally stronger demand for capital, persistent inflation, and heavy government borrowing.

A crucial point in Bessent's statement last week was: *"We believe that the yields don't reflect the underlying fundamentals"* and *"We believe that the liquidity, especially in the 30-year point, is very poor."* That distinction matters for the effectiveness of intervention or QE. During the global financial crisis, QE was introduced amid low inflation, high unemployment, and policy rates at the lower bound; it reinforced rate cuts and supported the recovery. Today's environment is different: unemployment is low, while the latest PCE inflation reading remains above target. If monthly core PCE inflation persists at its recent pace, the annual rate could rise further from the latest 3.3% reading.

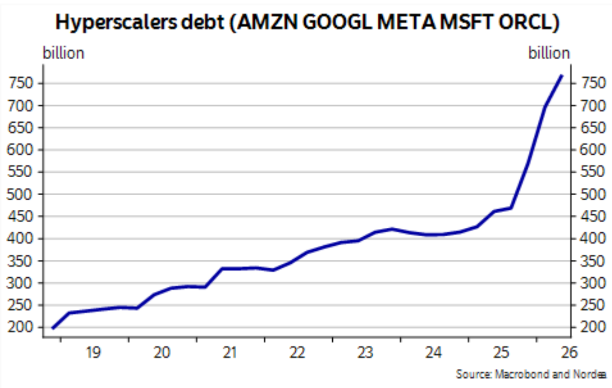
Long-end US yields were last near current levels in the 2003–07 period, when economic growth was also strong. That comparison offers a simple way to frame the fundamentals: with nominal growth around 6.5%, long-term interest rates near 5% may not be especially restrictive.

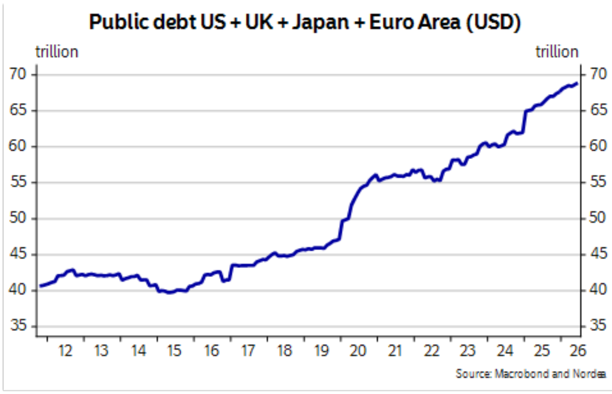
The 2003–07 period also featured an investment boom in emerging markets and US housing. US residential investment rose from roughly 5% to 6.5% of GDP. Some forecasts suggest that AI-related investment could rise from a negligible share to about 3% of GDP, and do so more quickly. As in 2003–07, stronger investment demand could also support commodity prices, particularly if AI infrastructure requires more minerals than the mining industry can readily supply. One important difference is that the earlier cycle included a large build-up in household debt, followed by severe deleveraging.

The yield curve, however, is behaving differently. In 2003–07, the curve flattened as the Federal Reserve raised short-term rates while long-end yields remained subdued—the "Greenspan conundrum." This was later associated with a global savings glut: strong demand for securities held down long-term yields even as policy rates rose. Today, the curve is steepening, suggesting a different supply-demand balance. Rather than excess demand for savings, rising debt issuance is now coming from stronger demand for investment capital, including AI infrastructure, public spending, and defense.

The 2003–07 expansion was also supported by globalization, large current-account imbalances, and favorable demographics, including a rising share of people in their prime saving years. Today, globalization is slowing or partly reversing, while population aging is increasing the share of retirees, who are more likely to consume accumulated savings. These shifts may reduce structural demand for long-duration bonds.

These are fundamental forces. If governments or central banks try to offset them by holding interest rates below an economically sustainable level, inflation may rise. The market reaction last week—higher inflation swaps and a weaker US dollar—was consistent with that concern, although it does not prove causation. If capital demand is structurally too strong, interventions aimed at lowering long-end yields may need to be very large. With labor and commodity supply constrained, the likely consequence would be greater inflation pressure rather than a durable reduction in borrowing costs.





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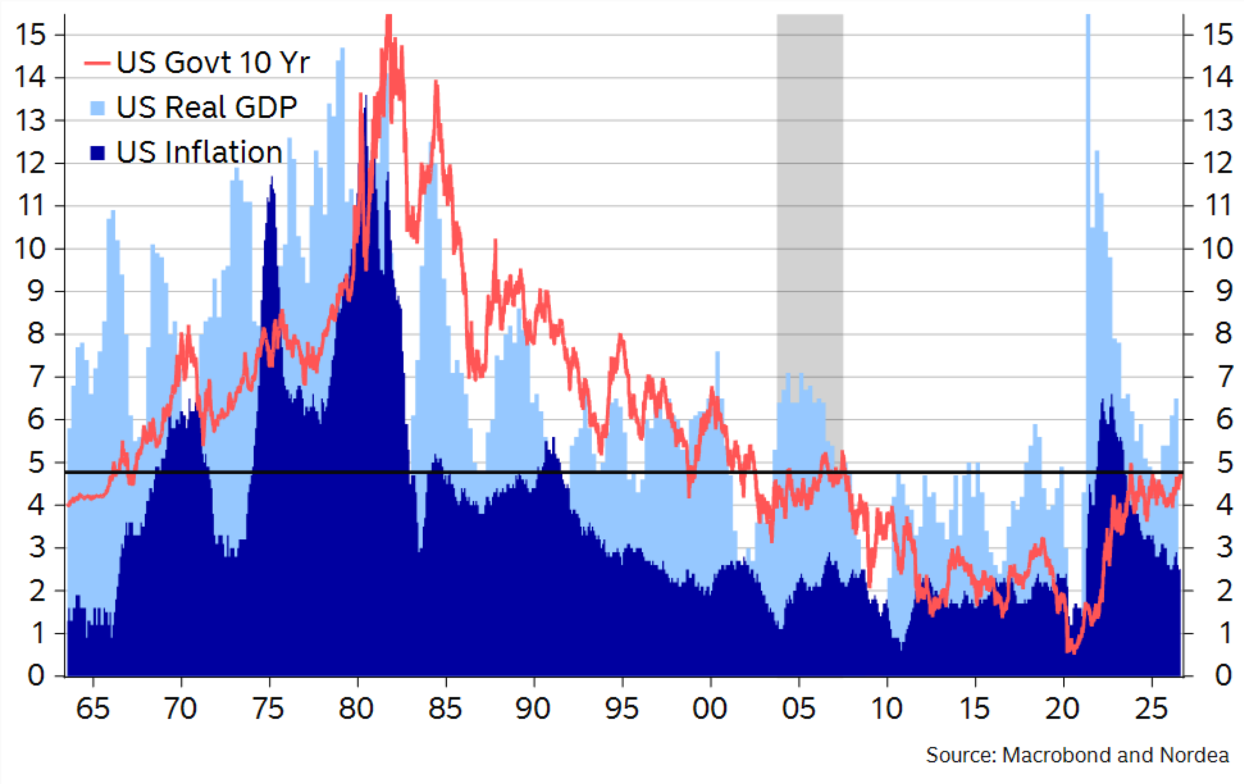
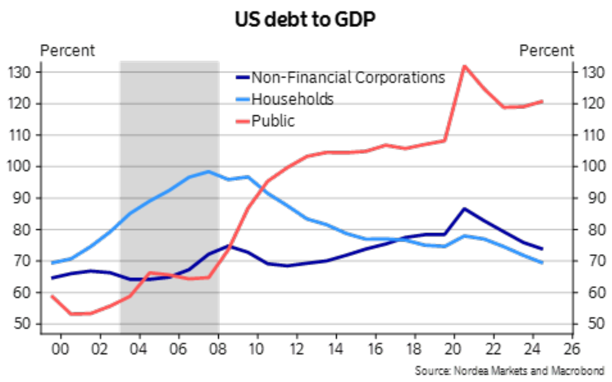
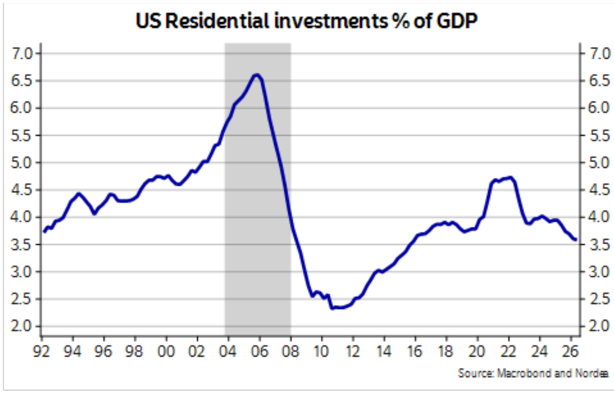
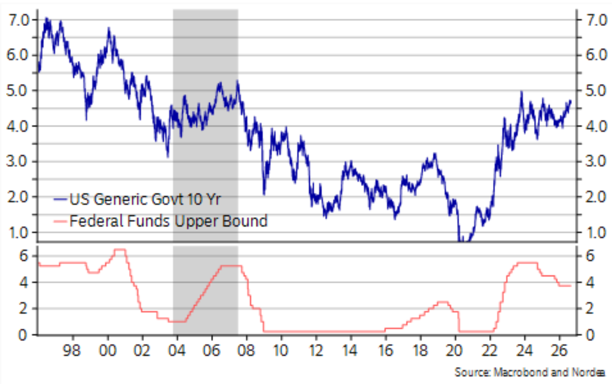

US Govt 10 Yr
US Real GDP
US Inflation
Source: Macrobond and Nordea

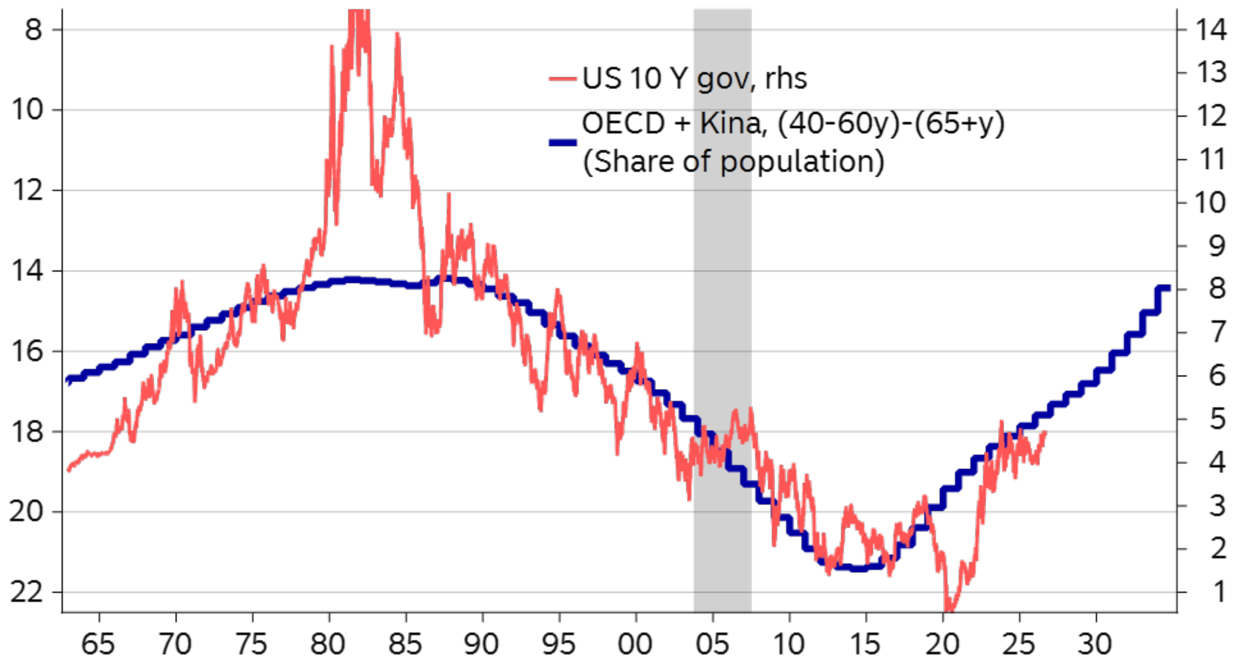

US debt to GDP
Percent
Percent
Non-Financial Corporations
Households
Public
Source: Nordea Markets and Macrobond


US Residential investments % of GDP
Source: Macrobond and Nordea

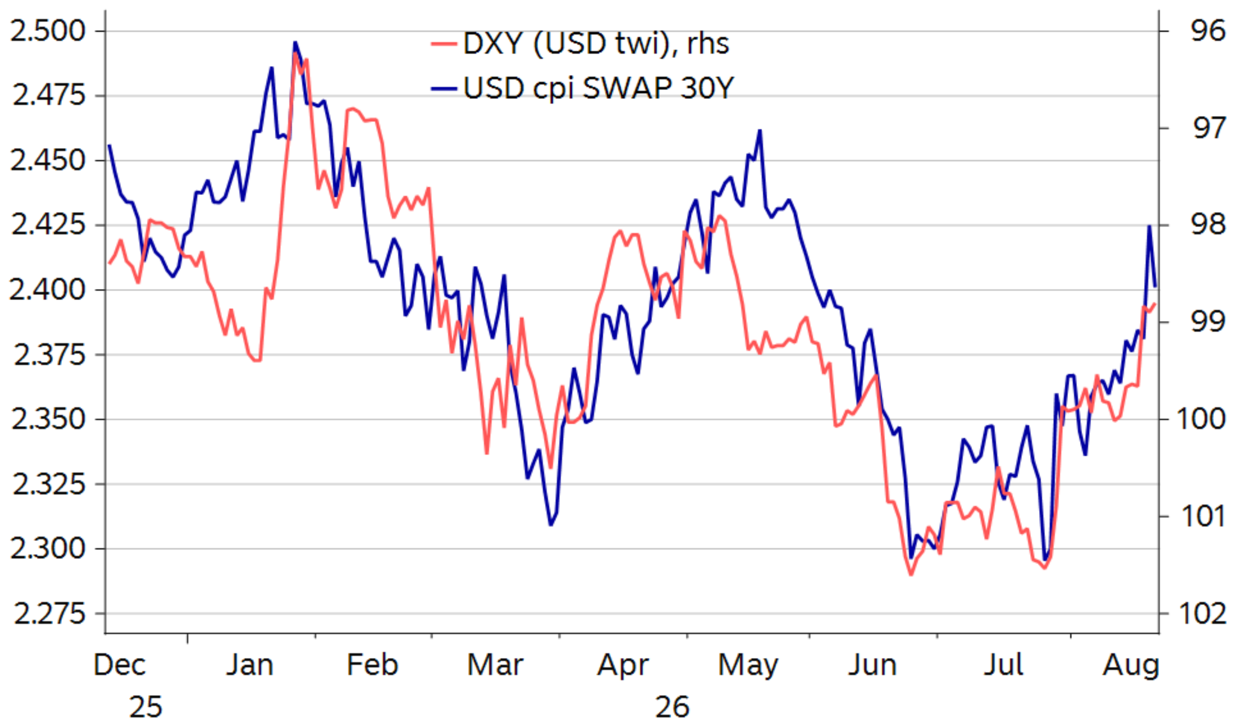

US Generic Govt 10 Yr
Federal Funds Upper Bound
Source: Macrobond and Nordea


US curve steepness 10y - 3m
Source: Macrobond and Nordea

Super savers vs super consumers and long end yields



Kilder: Macrobond og Nordea



Source: Macrobond and Nordea

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