30 August 2026

The Editorial

It’s not a problem until it's a problem

Financial markets have once again had to tackle the question about the US deficit, debt sustainability and indirectly, the role of bond vigilantes. The topic is not new. In fact, the market’s attention returns to it every so often, usually when long-end treasury yields rise, and each time markets rediscover the same thing: debt and deficits are rarely a problem, but markets still like to worry about them from time to time.

In the case of the US, the deficit and debt trajectory is an understandable concern to markets, but when you have the world’s reserve currency, and the most liquid bond market, you have very attractive attributes that complicate the discussion - as has been the case for all our professional lives.

In particular, the discussions intensified in the early 2010s following the GFC (and again following Covid), with the paper by renowned professors Reinhart and Rogoff, who heavily influenced the market and the political discussions globally with their famous 90% debt to GDP threshold. Luckily, given that many countries’ levels exceed that, it was later proven that such a specific number doesn’t exist.

That does not make the question about deficit and debt irrelevant, but it makes the timing of the problem harder. While markets periodically rediscover fiscal risk, they have become more relaxed (and arguably complacent) about it in recent years.

Why now?

The recent turmoil has emerged following the general rise of about 50bp in long-end yields during the past six months, and last week it intensified following Treasury Secretary Bessent’s (failed) attempt to bring the long-end yield level lower through larger buybacks; for more detail on timeline and mechanics, see our colleagues Jens Nærvig and Antti Ilvonen’s piece *here*. However, debt management, changing issuance strategies or an operation twist cannot solve the underlying problem. The root cause of the problem is that the US has been running a fiscal deficit for the past 25 years, with the “norm” in recent years being in the ballpark of 6% of GDP, but also that the recent rise reflects fundamentals and not only fiscal concerns, and thus yields are supposed to rise.

Now, for the US, running a 6% deficit has historically been associated with a recession and not an economy growing close to trend with unemployment near historical lows. So, while President Trump is arguing that the US should have the same yield as Switzerland, the fundamentals are just vastly different. Just take a look at the debt and deficit levels of Switzerland relative to the US, in the scatter plots below – and here you do not even see the evolution over time.

We could naturally discuss the, at face value, less room governments have when they have to respond to recessions, fund new priorities, or absorb higher interest costs, but we will leave that for another time. However, we want to make clear that investors should be careful not to confuse every rise in Treasury yields with the beginning of a debt crisis, and this is not one either.

Chief Strategist, Markets
Piet Haines Christiansen
+45 45 14 15 18
phai@danskebank.dk

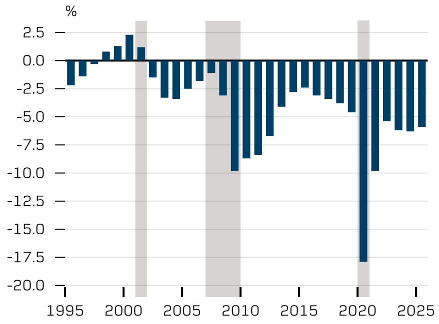
Head of Cross Asset Strategy
Bjarne Breinholt Thomsen
+45 45 14 15 15
bt@danskebank.dk

Senior Strategist
Molly Guggenheimer
+46 76 721 65 11
mogu@danskebank.com

Analyst
Mathias Christiansen
+45 45 14 15 91
mathch@danskebank.dk

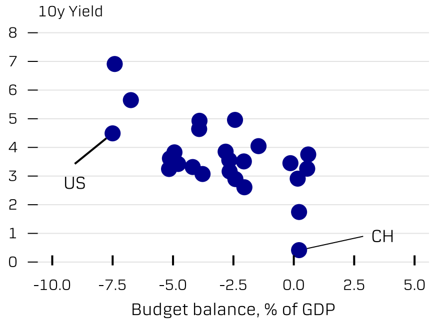
Important disclosures and certifications are contained from page 7 of this report.

US budget balance (% of GDP)



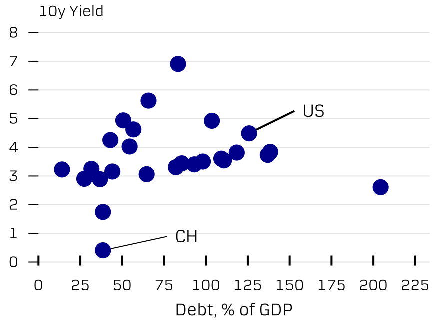
Source: LSEG Data & Analytics, Danske Bank

Deficit vs. yield level among 25 major economies



Source: LSEG Data & Analytics, Danske Bank

Debt level vs yield level among 25 major economies



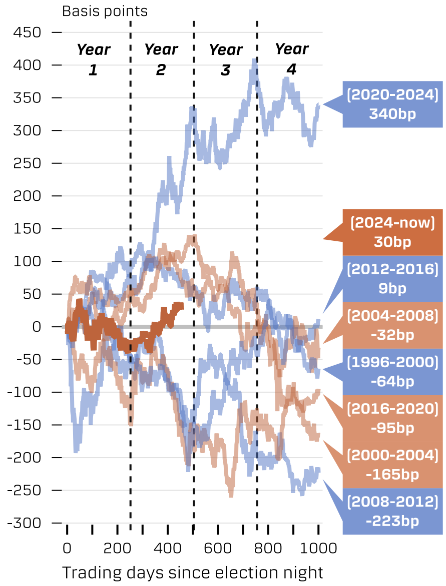
Source: LSEG Data & Analytics, Danske Bank

Put the move into late-cycle context

The claim that higher long-dated Treasury yields prove investors are losing confidence in Washington needs nuance. The past six months have virtually been a string of upward revisions to growth forecasts following positive economic surprises and consequent declining recession risk. A steeper curve, with rising long-end yields, is a very classic late-cycle feature. So why should it be surprising that yields rise when the economy remains resilient? A 10-year yield of 4.7% is not extraordinary, nor is the 30-year yield of 5.2%. They are both only around 40bp above the average since 1990.

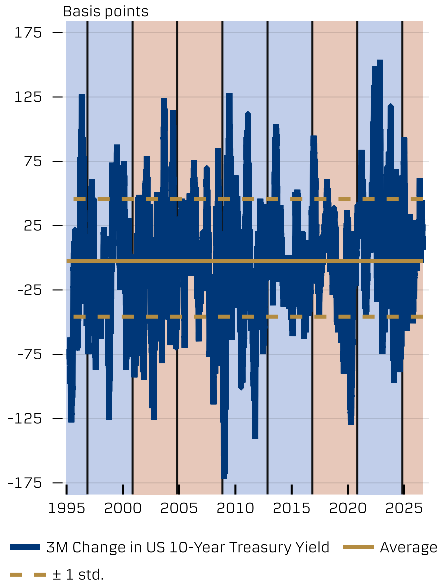
And while the rise in yields is one thing, another is its speed and volatility. We find the three charts below particularly illustrative at this point. Since the presidential election, the 10-year yield has remained within a tight historical range of roughly ±45bp from its starting level. This is the tightest range at this point in the presidential term in the past 30 years. Even three-month changes are barely outside one standard deviation, where even implied volatility has fallen markedly since the knee-jerk surge following the Iran war. Therefore, the burden of proof should be on those calling this a debt crisis or fiscal crisis. So far, the move remains consistent with standard business-cycle dynamics.

Current rate path remains well within historical presidential cycles



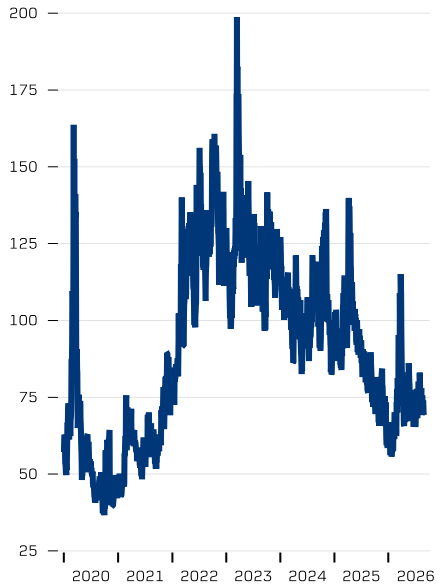
Note: Blue / Red indicate Democratic / Republican President.
Source: Bloomberg, Macrobond, LSEG Data & Analytics, Danske Bank

3M Yield Changes Remain Within ±1 Standard Deviation



Source: Bloomberg, Macrobond, LSEG Data & Analytics, Danske Bank

Implied volatility (MOVE index)



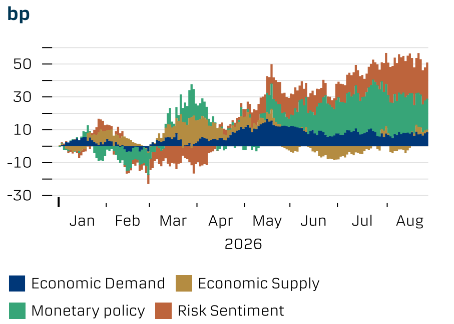
Source: Bloomberg, Macrobond, Danske Bank

The term premium is rising, but this is not uniquely American

While there are multiple reasons for the rise in yields, as discussed above, applying academic frameworks is often useful to steer the discussion, and in particular, two stylised explanations for higher yields are worth highlighting, and they both tell a consistent story about how the compensation investors demand for holding longer-dated bonds has increased. The chart on the left shows a demand, supply, monetary policy and risk-sentiment decomposition, and shows that the residual risk component has risen markedly over the past two months. The ACM framework (right hand chart) shows the same through a higher term premium.

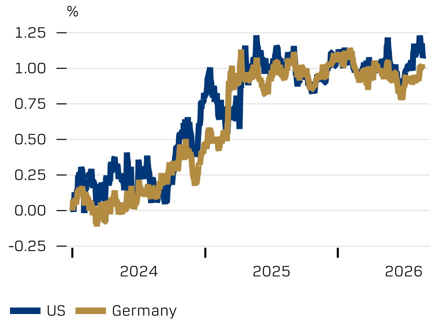
An increase in the risk perception of course deserves attention, as ultimately, as investors we prefer that the asset moves reflect fundamentals, but those changes are not a sign of panic. Yes, investors want more compensation, but it is not visible in the volatility of the assets (move index above). So to us, the question is not whether fiscal concerns matter, but it is whether they have become the dominant market driver.

What drives the 10y US yield?



Source: Bloomberg, Macrobond, Danske Bank

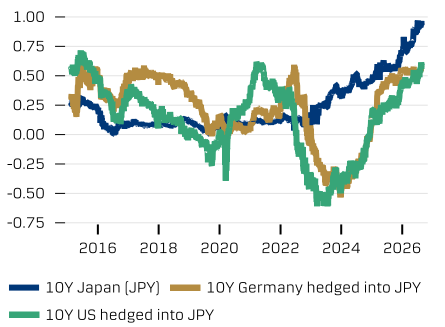
Elevated term premium is not just a US thing (change since Jan 2024)



Source: Bloomberg, Macrobond, Danske Bank

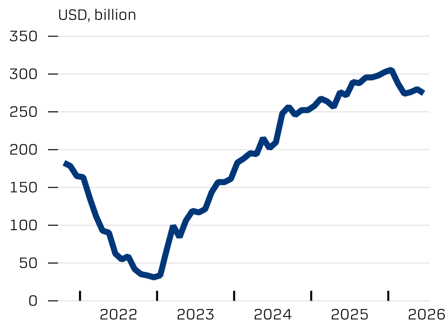
Foreign demand is part of that test, as discussed in more detail in *The Editorial - Wrong way… and who owns what*. Japanese investors matter particularly now that domestic government bond yields have risen. On an FX-hedged basis, Japan offers roughly 40bp more than the US and Germany. Whether this recent turmoil and spread widening has led to capital outflow from the US, cannot be concluded from recent data, as the most recent point is from June. If investors had truly lost confidence in America's fiscal outlook, we would expect to see more than just higher Treasury yields; we would expect also to see significant capital leaving US financial markets triggering declines in US assets, particularly equities. Certainly, the latest data doesn't suggest that global investors are fleeing the US.

10y return, seen from a Japanese investor, incl. 3M FX hedge



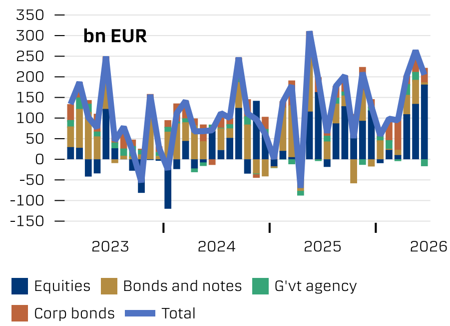
Source: Bloomberg, Macrobond, Danske Bank

Japanese net sovereign bond purchases of UST



Note: Latest observation is Jun26
Source: Bloomberg, Macrobond, Danske Bank

Net flows into US assets



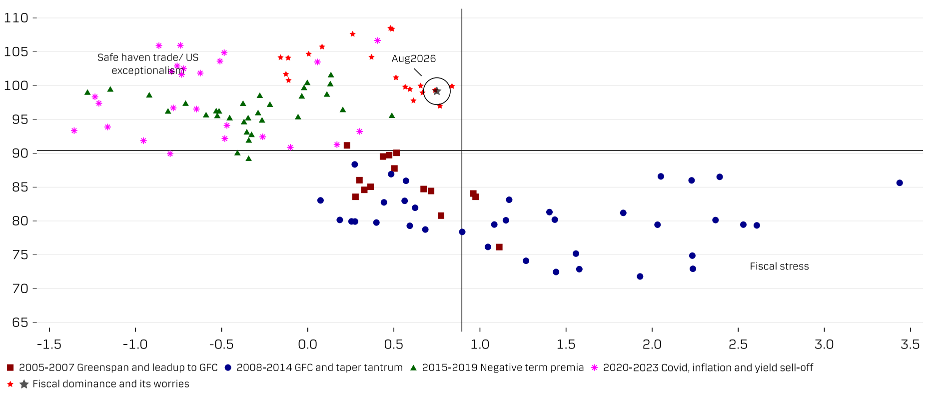
Note: Latest observation is Jun26
Source: Bloomberg, Macrobond, Danske Bank

Debasement risk is a warning

A consequence of the deficit debate resurfacing is the dollar debasement narrative, following the wrong way correlations which re-emerged during this US administration. Heading into this turmoil, the DXY was largely trading sideways while non interest bearing assets such as gold and bitcoin have been trading weaker. Upon the resurgence of the theme, one conclusion stood out: non interesting bearing assets, such as gold and bitcoin, were a hedge for a USD debasement narrative. It's not that surprising given that, if persistently large fiscal deficits ultimately leave policymakers with a choice between painful fiscal adjustment and easier money, investors will naturally begin looking for assets that sit outside the traditional monetary system. Bitcoin is about 25% higher, while gold is 5% higher than before the turmoil.

Certainly, when plotting the US term / risk premium against the DXY, as below, we observe a connection. However, we would be cautious about drawing the firm conclusion that high term premiums necessarily lead to a stronger USD (fiscal stress), and vice versa (safe haven), as it depends on the driver behind. Both "legs" have a strong common driver, namely growth.

US term premium vs. DXY level



Source: Bloomberg, Macrobond, LSEG Data & Analytics, Danske Bank

Market signal vs managed signal

While one can debate the effectiveness of Bessent's announcement to get long-end yields lower, it clearly conflicts with Fed Chair Warch view that markets are at their best when prices are allowed to reflect economic fundamentals, a point he repeated during his Jackson Hole speech on Friday afternoon. If Bessent wants lower long-end yields, without doing fiscal expansion it will either be via the cash balance or higher short-end issuance, see also Jens' / Antti's piece above. But in doing so, the signal from the market will miss the valuable information that Warsh is seeking. Whether lower long-end yields may be achieved via changes in debt management, issuance strategies or an operation twist, the consequence of losing market signal is the same. In other words, Warsh and Bessent can't both have their way at the same time.

A crisis should show up in more than one market

If investors had truly lost confidence in US debt sustainability, we should see capital leaving US equities, materially higher currency hedge ratios, a much weaker dollar and a deterioration in Treasury safe-haven behaviour. While we still do not have the data for August, the price action does give a tell. Most recent data shows that foreign investors still hold substantial US exposure, and specifically, where we have excellent monthly data, it shows that the Danish life and pension funds' dollar hedge ratios have returned towards normal after the surge around Liberation Day last year.

The most important test is not today's yield level though, but rather what happens when growth fears return. Recent (at face value) weak payroll data still pushed Treasury yields lower, suggesting investors continue to treat Treasuries as defensive assets when macro risk rises. That wouldn't happen in a genuine fiscal crisis.

Not a problem until it is

To be frank, we expect further rises in US treasury yields. A gradual rise towards the 5% mark on the 10y UST should be expected, also likely before the year end, given the resilient growth, the late cycle dynamics, as well as Warsh's willingness to tighten policies. But that is not a sign of fiscal distress. As we have argued repeatedly, the reason why yields rise matters more for risk assets than the level itself. So higher yields are not inherently bearish for equities, and at this point in time, we do not think we are en route to that either. One thing is that the speed and catalyst of the move matters more than another 20-30bp, another thing is that the near-term outlook is higher yields for the right reasons. And this without systemic stress in bond or equity markets.

The US fiscal trajectory remains difficult to defend though. Deficits of 5-6% of GDP during steady growth and low unemployment leave less room to absorb the next downturn and justify a higher fiscal risk premium. Gold and bitcoin show that some investors are already considering that tail risk, at least since last week.

But the evidence for a broad market rejection of US assets is weak. The decisive signal will be whether Treasuries still rally when recession fears return, which we believe they will. Investors should watch that safe-haven function rather than declare a debt crisis after every move in the long end. And before going against the Treasuries on a view on fiscal stress, you probably should consider that occasionally, the best trades you make may even be the ones you do not do.

The higher US yields are likely to continue to be a theme in bond markets, but whether the US administration will get their wish for lower rates fulfilled will not be achieved by an operation twist announcement. That will come on either fading risk premia or an economic slowdown / downturn. That we are vigilant of the latter should not come as a surprise to regular readers, not least as we also lowered our scoring in the investment navigator earlier this month. After all, what matters to markets is not the level of activity, but whether it is accelerating or slowing down, see more in *The Editorial - It's not like you think it is*.

General disclaimer and disclosure

The following disclaimer and disclosure apply to all communication as such, including communication to which it is attached, linked to or otherwise referenced (the "Communication"). For the parts that refer to the term "investment recommendation", the disclaimer and disclosure are only applicable as far as the Communication falls under the definition in Regulation (EU) No 596/2014. The Communication has been prepared by personnel in the LC&I's Sales & Trading departments or non-independent Research departments of Danske Bank A/S. The views set forward in the Communication may differ from views or opinions in other departments of Danske Bank A/S. It constitutes a short-term view and is subject to change and Danske Bank A/S does not undertake to notify any recipient of the Communication of any such change. A list of all previous investment recommendations on any financial instrument made in the past 12 months, including all previous investment recommendations made by the producer is available upon request, free of charge.

The LC&I's Sales & Trading departments' or non-independent Research departments' personnel are not independent research analysts, and the Communication is not intended to constitute "investment research" as that term is defined by applicable regulations. The Communication has as such not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of the communication. The personnel in the LC&I's Sales & Trading departments or non-independent Research departments may be remunerated based on investment banking revenues, and may receive bonuses or other remuneration linked to specific investment banking transactions. Danske Bank A/S or its personnel may hold a position in any financial instrument discussed herein. Personnel is subject to a Personal Account Dealing policies. Further, Danske Bank A/S may act as market maker or have performed other services for the entities mentioned, which could include investment banking or other services, leading to payments or promises of payments. Prices and availability are indicative and may change without notice.

The Communication is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments. Danske Bank A/S is not acting as an advisor, fiduciary or agent. Recipients of the Communication should obtain advice based on their own individual circumstances from their own tax, financial, legal and other advisors about the risks and merits of any transaction before making an investment decision, and only make such decisions on the basis of the investor's own objectives, experience and resources. All investments carry risks. The value of any investment may fluctuate, and investors may get back less than they invested. Past performance is not indicative of future results.

The Communication has been prepared independently and solely on the basis of available information that Danske Bank A/S considers to be reliable, but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, ex press or implied, is made as to and no reliance should be placed on the fairness, accuracy, completeness, currentness or reasonableness of the information, opinions and projections contained in the Communication and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on the Communication.

For current disclosures of Danske Bank A/S' interests and potential conflicts of interest regarding issuers and financial instruments subject of investment recommendations please refer to the Danske Bank's Disclosure and disclaimer webpage: https://danskeci.com/ci/research/disclosures-and-disclaimers.

Please note that while information on the great majority of relevant issuers and financial instruments are contained on this website, it may not contain information on all relevant issuers and financial instruments. The absence of information on any relevant issuer or financial instrument should not be seen as an indication that Danske Bank A/S does not have any interests or potential conflicts of interest on the issuer or financial instrument. Please contact your Danske Bank A/S representative for information regarding any issuer subject of investment recommendation that is not mentioned on https://danskeci.com/ci/research/disclosures-and-disclaimers.

Danske Bank A/S is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank A/S is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank A/S on request.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, the Communication is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

The Communication is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the United States

The Communication was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The communication is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this investment recommendation in connection with distribution in the United States solely to 'U.S. institutional investors'. Any U.S. investor recipient of the Communication who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Report completed: 28 August 2026 at 14:45 CET
Report disseminated: 30 August 2026 at 07:00 CET