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Why the bond market is flexing its muscles

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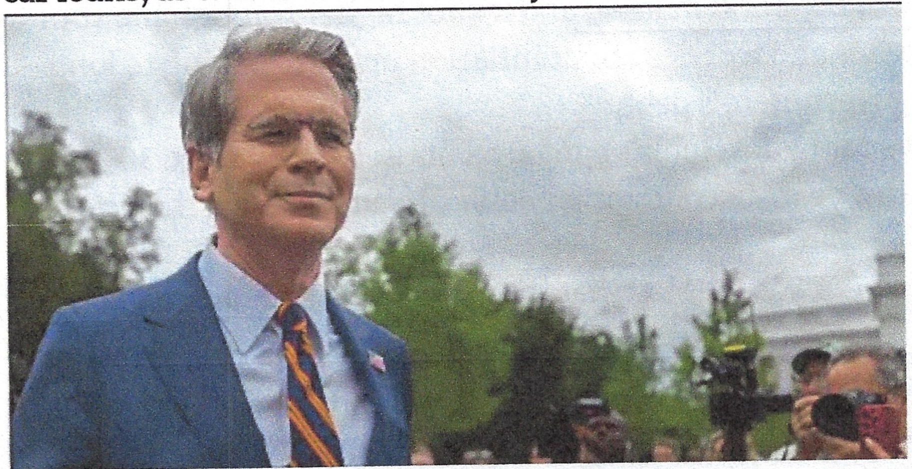
Note

NEW YORK · The bond market is one of the few forces in the world strong enough to get politicians to snap to attention. It also helps dictate how much ordinary people have to pay on their mortgages and car loans, as well as how much they earn from their savings accounts and 401(k) plans.



Note

This week rising bond yields forced the U.S. Treasury Department into an unusual intervention and raised the specter of higher borrowing costs putting the brakes on consumer spending, the lifeblood of the economy. It also sparked concerns that investors might finally be thinking twice about financing a seemingly endless flow of government borrowing.

Here's a look at what's going on and how it affects everyone:

The bond market

When governments and big companies borrow money, they don't ask a bank for a loan. Instead, they sell IOUs to investors and promise to repay the money with a certain interest rate. If those IOUs are set to be repaid many years from now, they're called bonds. (IOUs the U.S. government will repay more quickly are more often called bills or notes.)

Note

Investors in the bond market often buy and sell these bonds after they're issued, and they continue to pay the same interest rate. But if the bond starts to look less attractive, a buyer can get bonds that were earlier worth $100 for less than that. Such a drop in price means the new buyer will get a bigger return, percentage-wise, on their money than the interest rate the bond pays on its face value. Those payments are called the bond's yield.

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Other options

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The world's biggest and most important bond market is for IOUs from the U.S. government, which are called Treasurys. The total size of it was $31.5 trillion, as of July, according to the Securities Industry and Financial Markets Association.

Yet Treasurys are facing more competition from higher-yielding bonds overseas than in recent decades. After years of near-zero interest rates, even 30-year Japanese government bonds are now paying

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more than 4%. Yields on U.K. bonds have reached 5.81%, and German bonds are also paying 3.76%, versus 5.27% for a comparable U.S. bond. It's a big reason U.S. rates have been drifting higher.

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Ira Jersey, chief U.S. interest rate strategist at Bloomberg Intelligence, said that large global investors such as pension funds and life insurers used to have little choice to invest in Treasurys because most other overseas bonds paid so little interest.

"Now the U.S. 30-year yield has to compete with all these other sovereign bonds," Jersey said. "The U.S. is not the only game in town anymore."

Helps set interest rates for regular people

The easiest example is mortgage rates. Rates for these loan tend to follow the path of yields for Treasurys that will get repaid in 10 years.

Note

The 10-year Treasury yield is the centerpiece of the bond market, and it shot higher through the summer after the war with Iran sent oil prices higher and worries about inflation upward, adding to long-standing concerns about the size of the U.S. government's debt.

That in turn made mortgages more expensive for people looking to buy a house. The average 30-year fixed-rate mortgage is near its highest level in a year, discouraging people already worried the price of homeownership may be too high.

Treasury Secretary Scott Bessent's announcement Wednesday that the government would double its buybacks of longer-term bonds was intended to bring down the 10-year Treasury yield and lower mortgages. Yet the move brought only temporary relief, with the 10-year yield rising back to 4.74% Friday, matching its highest point in more than a year.

Thierry Wizman, global rates strategist at Macquarie Group, said higher mortgage rates will likely discourage some consumers from buying homes. At the same time, higher yields generally should draw more investment into bonds issued by large tech firms investing in AI infrastructure.

Note

"The private sector wants to have the AI revolution," Wizman said. "Who's going to take a step back? It's going to be the consumer. And higher yields are going to do that a little bit."

Other parts of the market, including where the Federal Reserve sets its interest rate for very short-term overnight loans, affect rates for everything from credit cards to savings accounts to auto loans.

Generally, higher yields and rates benefit people who are savers. It means they are earning more from lending money to the U.S. government or sticking their cash in a high-yield savings account.

Higher yields and rates, meanwhile, tend to hurt people who are borrowing money. They also drag on prices for stocks, gold and even cryptocurrencies. The thought is: Why should anyone pay high prices for riskier investments when U.S. Treasurys, which are supposed to be safer, are paying more than before?

More for government bills

Washington continues to spend far more than it brings in through revenue, so it has to borrow money to cover the gap. That has sent its total debt over $40 trillion, a staggering record, and the number keeps climbing by the day.

When yields are rising, the U.S. government has to pay higher interest rates to entice buyers for its bonds when it auctions off Treasurys.

The federal government has already paid $931 billion in interest on its debt through the first 10 months of its fiscal year, which ends in September. That's more than it spent on health, national defense or veterans benefits and is just behind Social Security and Medicare.

Concerns have been brewing

It's no secret that the U.S. government has a lot of debt. Officials at the Federal Reserve, economists, investors and many other voices have been saying for years that the U.S. government is on an unsustainable path with how much it spends versus what it brings in.

Everything from tax cuts to increased military budgets adds to the deficit.

The unknown has always been when or if a tipping point would arrive that turns the worries about the U.S. government's debt into a panic. That would cause investors to quickly dump their Treasurys, which would sent yields surging.

And while yields have climbed this summer, they haven't done so at such a pace to suggest a tipping point is here. The climb in yields for government bonds has also been worldwide. It's not just Washington feeling pressure but also bond markets in Japan, France, Germany and elsewhere.

Importantly, a measure in the bond market that shows how worried bond investors are about potential defaults by several big economies' governments on their bonds has not risen excessively, according to strategists at Macquarie.