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Bonds

Why Higher Bond Yields Aren't Going Away

THE OUTLOOK |

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Some economic shocks look like bumps in the road—tariffs, to which businesses adjust, or a war with Iran that raises oil prices temporarily. But economists increasingly believe that higher U.S. interest rates will define the rest of the decade.

So concludes The Wall Street Journal's latest survey of forecasters. The surveyed analysts don't see the recent surge in long-term yields to quarter-century highs as a temporary blip that will fade as inflation cools. Instead, they expect higher long-term yields to be sustained.

Treasuries set the tempo for borrowing costs across the economy. Higher yields mean higher mortgage rates and more expensive borrowing for companies. They also increase the burden on the federal budget, where interest on the national debt now exceeds military spending.

The 71 analysts who submitted projections in the survey from Oct. 2-7 now expect the benchmark 10-year yield to end 2026 at 5.1%, up from 4.4% the last time we asked, in July. Not all respondents answered every question.

Higher yields are expected to persist. Forecasters see a 10-year yield of 4.96% halfway through 2027 and 4.78% at the end of 2027, up from 4.3% and 4.26% in July projections.

A mix of improving growth, inflation and concerns about the U.S. fiscal trajectory have pushed bond yields higher since the start of the summer. Many economists said the cocktail has forced them to re-evaluate assumptions about demand for Treasuries, whose yields rise when their prices fall.

"It has been a sea change in the fundamentals underlying the fixed-income market and the economy," Allen Sinai, president of consulting firm Decision Economics, said in an interview.

He said even after the Federal Reserve's interest-rate increase last month, the central bank has fallen behind in the battle to tame inflation. Sinai said it would take more than one hike to smother inflation, which the Fed appeared to acknowledge with its

September projections. Those showed the Fed's short-term interest-rate target, the federal- funds rate, topping 4% this year and staying there through 2027.

Sinai forecasts the 10-year yield could rise to nearly 6% next year and remain above 5% through the 2020s. Yields on Treasury securities are heavily influenced by investors' expectations for how the Fed will set interest rates in coming years.

Much of the recent increase in inflation is because of higher oil prices, which economists expect to recede: They forecast the U.S. oilprice benchmark will end the year at \$88 a barrel, compared with \$91.85 on Friday, and slip below \$80 by July.

As a result, they expect inflation as measured by the consumer-price index of 3.5% in December, 2.6% next June, and 2.3% at the end of 2027. That has changed little from three months ago. The inflation gauge that the Fed tracks, the personal-consumption expenditures price index, is forecast to cool to 2.4% by the end of 2027, from 3.5% at the end of this year.

Carl Tannenbaum, chief economist at Chicago-based Northern Trust, said factors beyond the inflation outlook have pushed up expected yields. Inflationary pressure from the Iran war could abate if the conflict winds down, which would help ease yields, all else equal, he said. But investors will remain nervous about the large and growing debt burden, while the AI infrastructure build-out could lift growth expectations and demand for capital, Tannenbaum said. He sees the 10year yield around 5.2% through 2028, before falling to 5% by the end of 2029.

Yields at that level would strain the federal budget. In February, the Congressional Budget Office projected the 10year Treasury yield won't exceed 4.3% for the rest of the decade. The White House Office of Management and Budget is even more optimistic, projecting yields falling into the mid-3% range later this decade.

Economists penciled in higher expected growth this year. They expect GDP to increase by 2.4% in 2026, up from their 2.1% July projection. That reflects upward revisions to second-quarter growth and interim data suggesting the economy might have grown by an annualized rate of more than 3% in the third quarter. Respondents see growth slipping back thereafter, to 2.1% or 2.2% for the rest of the decade.

Likewise, forecasters don't anticipate much drama in the labor market. On average, they think unemployment will hang around 4.2% through 2029, little changed from the 4.2% unemployment rate in September. They put the probability of recession in the coming 12 months at 24%, barely budged from 25% in July.

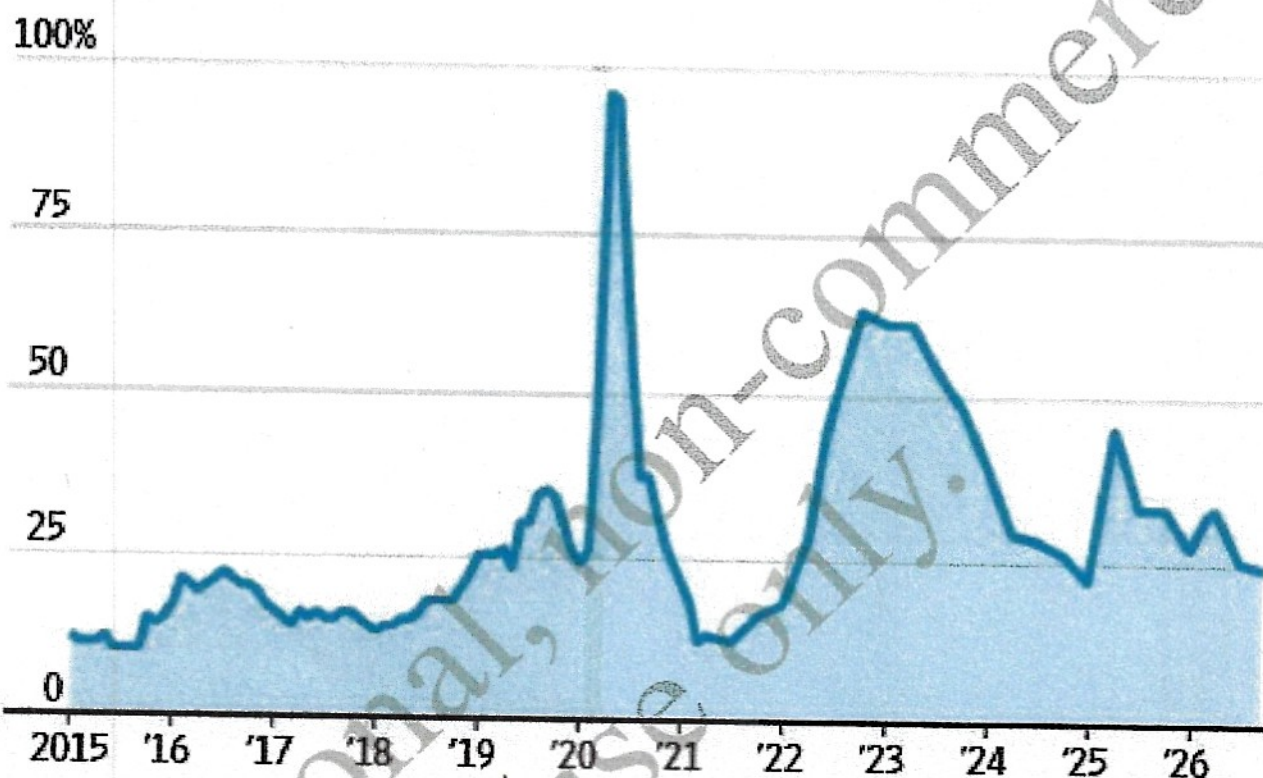
Not all forecasters agree yields will stay high. Rajeev Dhawan, an economist at Georgia State University, thinks the labor market is more fragile than it appears. Over the past six months, the economy has added a solid 66,000 jobs a month on average, but few have been in the most lucrative fields, he said.

In Dhawan's view, a weaker labor market could force the Fed to bring rates lower again, which could pull down yields.

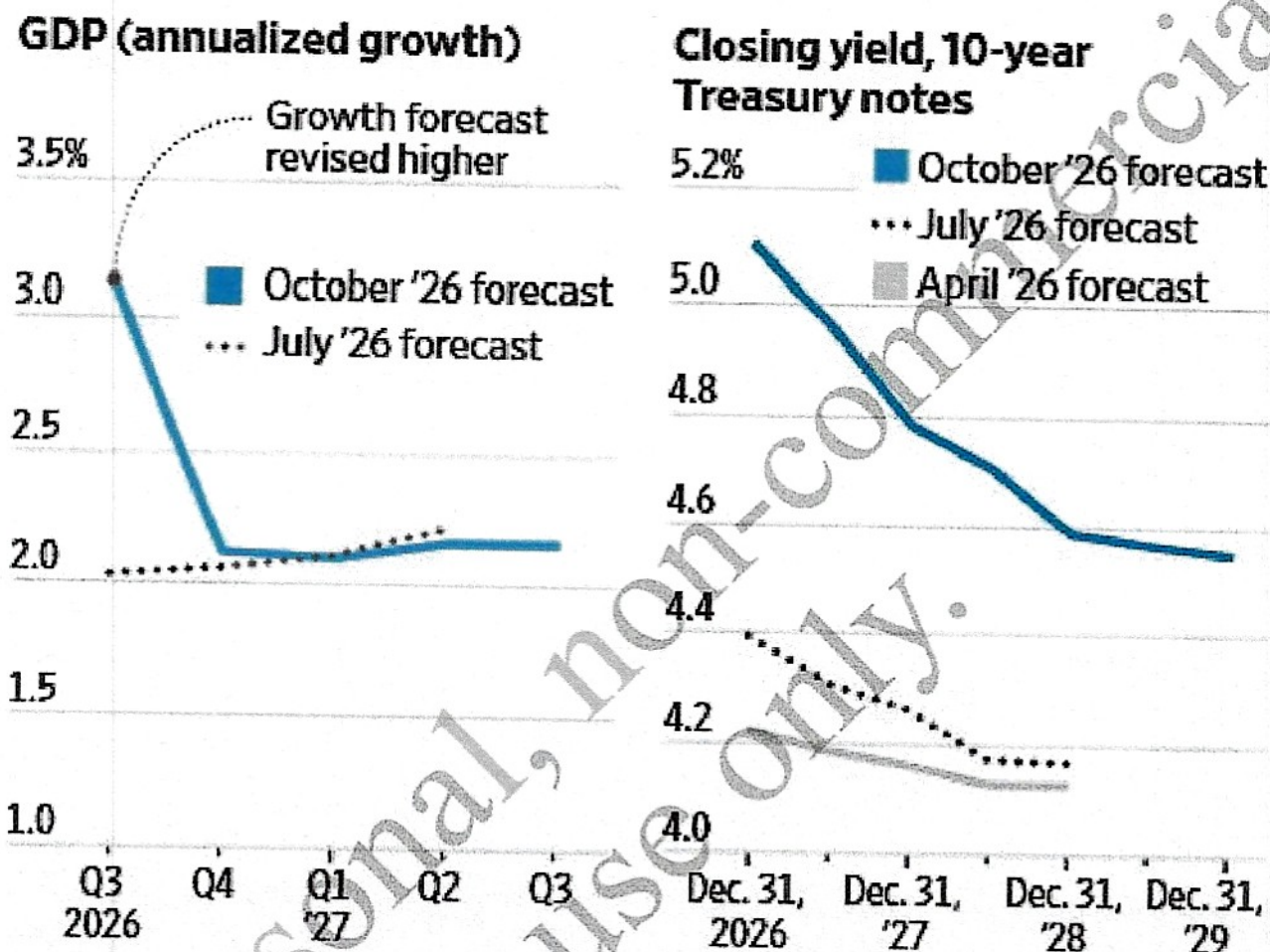
"The labor market's got a white-collar job malaise," Dhawan said. "Once the Fed realizes it isn't as strong, they will pivot to rate cuts."

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Probability the U.S. is in a recession in next 12 months, including today



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Note: Recession probability is an average of economists' answers. GDP forecasts are for inflation-adjusted GDP.
Source: Wall Street Journal surveys of economists

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