

Back to school: Bond markets face an Economics 101 problem

Summer is over, and markets are returning to familiar themes. Governments are borrowing more, hyperscalers keep spending and central banks are confronting renewed inflation risks. With that back-to-school feeling, it shouldn't surprise that markets are confronting the oldest lesson in Economics textbooks: supply and demand.

Amid burgeoning fiscal deficits and significant spending needs, governments have rarely needed so much capital. The problem is that everyone else needs it too. That competition for capital is showing up at the long end of global yield curves, challenging policymakers while creating opportunities for investors willing to be compensated for it.

Heavy debt issuance, from governments to hyperscalers, is helping to push long-dated yields to multi-year highs. The U.S. 30-year Treasury yield climbed above 5.3% this summer, its highest level since 2007¹. Long-end yields have also moved sharply higher across developed markets including Germany, Japan and the U.K. Investors are demanding greater compensation to absorb it, with term premiums rising as markets confront rising global risks.

Governments continue to compete for capital

In the U.S., federal debt just crossed \$40 trillion and the Congressional Budget Office estimates the annual deficit will climb above \$3 trillion within the next decade, after tracking \$2.1 trillion for this fiscal year². Globally, public debt rose to roughly 94% of GDP last year, and the IMF expects it to reach 100% by 2029, as governments face growing spending demands from defence, ageing populations and infrastructure³.

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While the amount of debt is staggering, just as significant are the debt servicing costs. Net interest expense now exceeds \$1 trillion a year in the U.S. and is projected to roughly double over the coming decade⁴. That would amount to roughly two-thirds of every dollar the federal government borrows being used to service the outstanding debt.

As existing debt rolls over, higher borrowing costs feed into interest expense, putting more pressure on deficits and requiring more issuance, with governments adding to the supply of bonds.

The AI buildout needs long-term capital too

Alongside this fiscal challenge, the AI investment cycle is also creating enormous demand for capital. Hyperscalers and other AI-related issuers, including chipmakers and data-centre developers, have already raised close to \$400 billion in US markets this year⁵.

The tenure of that borrowing matters as much for rates as the amount being issued. AI-related borrowing skews toward longer maturities than the market average. Analysis from the Dallas Federal Reserve estimates that \$300B of AI-related investment grade (IG) issuance could generate as much as \$360B of duration supply in 10-year U.S. Treasury equivalents in 2026. This is roughly an eighth of the duration supply coming from Treasury issuance itself⁶.

While hyperscaler capital spending growth may moderate, the AI buildout still leaves governments and some of the world's strongest corporate borrowers competing simultaneously for long-term capital.

Buybacks can ease the pressure, not the supply

Government debt buybacks also alter supply and demand of different maturities. The rates selloff prompted the U.S. Treasury to step in. The Treasury funds buybacks with new issuance, mostly at the front end, meaning it changes the outstanding debt's maturity profile rather than eliminating the government's overall financing requirement. In August, the U.S. Treasury announced it would at least double the size of some buybacks of 10-year to 30-year securities, from \$2B to at least \$4B per operation, to drive down yields⁷. The announcement pushed yields roughly 10 basis points lower with long-end term premium compressing modestly, but this relief rally proved short-lived⁸.

While such activity can improve liquidity and temporarily relieve pressure in targeted parts of the curve, it rarely impacts medium- to -long-term supply and demand. It signals to investors, however, that policymakers are paying close attention to the long end.

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How will policy rates affect long-dated yields?

For much of the period after the global financial crisis, governments benefited from central banks willing to hold quantities of government debt. Today's dynamics are materially different. Central banks that once absorbed large quantities of government debt through quantitative easing no longer play that role.

The retreat of those price-insensitive buyers affects policymakers and is partly why markets need greater clarity on central banks' actions: how to respond when structural forces are pushing long-term yields higher rather than policymakers' own policy rate. U.S. Fed Chair Kevin Warsh gave one signal this summer, noting that the rise in nominal and real yields had already done "quite a bit" of the Fed's work for it⁹, a comment that suggests policymakers may be content to let the long end do some of their tightening.

Policy rate decisions still dominate the front end, but the long end tends to be shaped by the volume and composition of debt supply alongside broader global forces such as demographics, infrastructure and defence.

A more price-sensitive buyer base

If markets are being asked to absorb longer-dated bonds, investors may need to rethink what counts as adequate compensation. As such, we believe term premium is likely to stay elevated and volatile.

We prefer taking yield in short and intermediate maturities rather than extending duration at current levels, particularly against a still resilient growth backdrop. Our forecast sees the U.S. 10-year yield trading in a wide range around 4.75% through year-end, with the German 10-year yield above 3% and Japan hovering near a similar level of 3%.

For longer-term exposure, municipal bonds are particularly attractive due to the relative steepness of their yield curve. And for European investors, heavy U.S. IG issuance has driven a supply-related widening in U.S. credit spreads relative to Europe this summer, but on an FX-hedged basis the picture looks more favourable. The US dollar yield pickup relative to euro-denominated credit, after accounting for hedging costs, is at its highest level since the era of European Central Bank quantitative easing, meaning European buyers are still being paid more to hold US credit¹⁰.

The lessons of Economics 101 tell us that markets will reach equilibrium with supply and demand equal. The open question is the price it will take to reach that point.

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For more information, please visit nuveen.com.

Endnotes

Sources

- 1 Bloomberg, as of 24 August 2026.
- 2 Congressional Budget Office, February 2026.
- 3 IMF Fiscal Monitor, April 2026
- 4 Congressional Budget Office, February 2026.
- 5 Barclays 'Tracking Issuance Across Asset Classes', 20 August 2026
- 6 The Federal Reserve Bank of Dallas, 'How AI debt financing impact duration supply and interest rates', February 2026.
- 7 U.S. Department of the Treasury, 19 August 2026.
- 8 Bloomberg, as of 21 August 2026
- 9 Federal Reserve Press Conference, 29 July 2026.
- 10 Bloomberg, as of 9 September 2026

All market and economic data from Bloomberg, FactSet and Morningstar.

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