EXPERT VIEW

Long-Term Yields: Anatomy of a Rise

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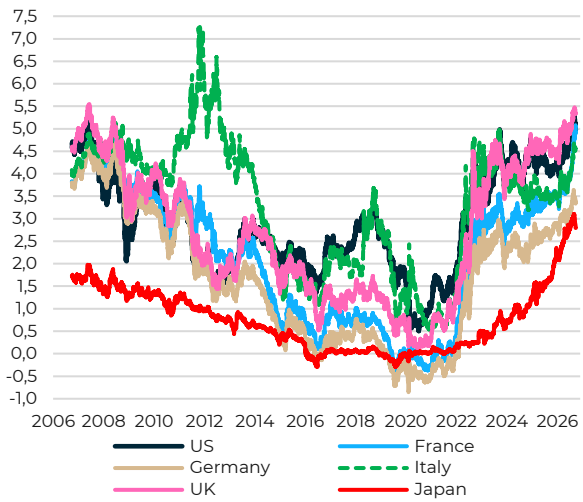
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Sovereign bond yields in most developed countries rose almost continuously from the beginning of the summer. This increase in interest rates accelerated markedly at the end of August, exacerbating several pre-existing vulnerabilities, particularly in France. Since October, a new phase appears to have emerged, with long-term yields beginning to ease. Against this backdrop, and with several months of hindsight, it seems useful to assess these developments, which bring together numerous themes, and then explore possible scenarios.

Between 30 June and 26 October, the US 10-year yield rose from 4.47% to 4.99%, having peaked at 5.30% on 5 October (see Chart 1). Over the same period, the German 10-year yield increased from 2.86% to 3.37%; the French equivalent from 3.65% to 4.90%; and the UK 10-year yield from 4.76% to 5.34%. This global movement stems from a combination of factors.

First, the pressure on long-term yields coincided with a deterioration in the geopolitical environment and an almost $40 increase in oil prices (from around $75 to $115 per barrel for Brent), raising fears of renewed inflationary pressures. Consequently, market expectations for policy rates were revised substantially upwards across the main central banks. At the same time, US economic data released during the period reinforced the prospect of renewed growth momentum, lifting the outlook for nominal growth[1], a macroeconomic variable closely linked to long-term interest rates. The global dimension of this movement must also be understood through the role of the US 10-year yield, which can be likened to the sun around which international asset markets orbit. Meanwhile, competition for capital, intensified by increased debt issuance by companies involved in developing artificial intelligence (AI), may also have weighed on demand for government bonds and constrained the market's ability to absorb new issuance, adding upward pressure on yields. Finally, fiscal challenges and persistent deficits in several countries have compounded these pressures. To compensate for uncertainty and growing risks to public finances, investors demand higher returns when lending to governments over the long term. Before examining the relative easing that began in early October and potential developments over the coming months, one country particularly affected by these issues, where long-term yields have behaved more unusually, deserves closer attention: France.

Chart 1: 10-year yields across a selection of developed countries



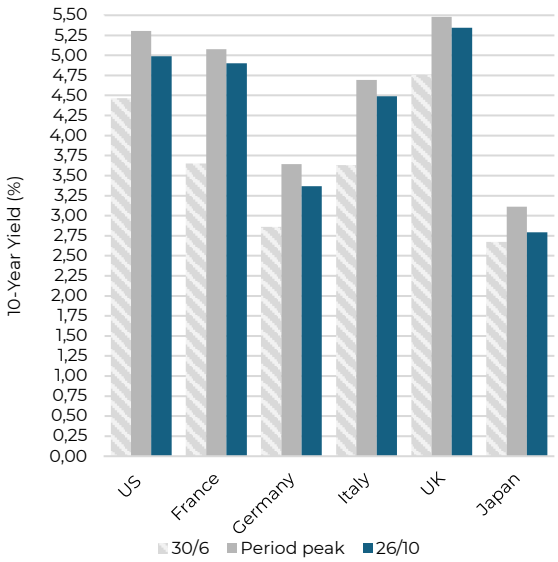
Source: Bloomberg, Daily data as of 26/10/2026.

The spread between French and German 10-year yields has widened sharply in recent weeks, reaching 1.54 percentage points on 26 October, compared with 0.79 at the end of June. This reflects both an entrenched political deadlock preventing a fiscal consensus and the emergence of a vicious circle fuelled by the factors behind the general rise in yields, from which France is not exempt. This situation weighs on already sluggish activity and further complicates the fiscal equation

[1]Combination of real GDP growth and inflation

by increasing interest costs and undermining the deficit-reduction path (the deficit is expected to be around 5.5% in 2026, versus the 3% ceiling under the Maastricht criteria). The worsening outlook in turn prompts investors to demand a higher risk premium. The process becomes self-reinforcing. At the same time, the scale and speed of this development have led several observers and commentators to raise the possibility of ECB intervention to calm the situation.

Chart 2: A closer look at recent developments



Source: Bloomberg, Daily data as of 26/10/2026.

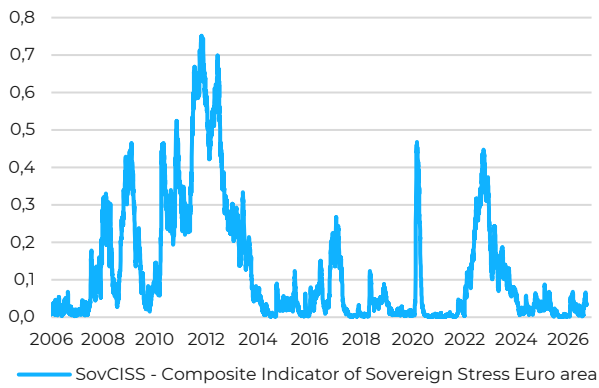
WHAT SCENARIOS CAN WE ENVISAGE?

To be clear from the outset, ECB intervention seems difficult to envisage at this stage. First, because it would create moral hazard.

Taken to its logical extreme, 'rescuing' France would amount to legitimising fiscal indiscipline on the grounds that France is systemically important. Second, the ECB's independence from political authorities raises the debate over fiscal dominance[2]. Third, France remains subject to the European Commission's excessive deficit procedure, complicating activation of the ECB's anti-fragmentation tool (TPI)[3], particularly in view of its eligibility criteria. The OMT programme[4] could, for its part, require France to comply with a strict fiscal consolidation regime. Some might nevertheless argue that rules are sometimes made to be changed. In the meantime, other approaches remain possible. Gradual interventions — first verbal, then through a slower reduction in the ECB's balance sheet or targeted liquidity operations — could be justified if widening French spreads threatened the transmission of monetary policy in the euro area and the inflation trajectory through their negative impact on activity, especially if the movement spread to borrowing costs in other countries (Italy, Spain, Portugal, etc.). At the time of writing, contagion is undeniably greater than in recent months but remains limited by historical standards (see Chart 3), and no critical threshold appears to have been crossed. Rising sovereign yields and the subsequent tightening of financial conditions nevertheless pose a risk to the ECB (see below).

Solving the 'French equation' also requires anticipating a number of domestic and international variables: (1) whether a budget will be adopted soon and when, who will win the 2027 presidential election and on what economic platform, the political balance after the legislative elections and the state of social tensions at that time; (2) how the geopolitical environment, inherently highly uncertain, will evolve; and (3) how the ECB will actually respond. While there are no obvious answers, one simpler conclusion emerges: the next six months are likely to be marked by substantial volatility, with a risk that French spreads widen further or remain around current levels.

Chart 3: Sovereign Stress in the Euro Area



Sources: ECB, ECB Data Portal. SovCISS (Composite Indicator of Systemic Sovereign Stress) is a composite indicator developed by the European Central Bank (ECB), ranging from 0 to 1, designed to measure financial stress in sovereign debt by incorporating not only yield spreads but also volatility and liquidity. Daily data as of 22/10/2026.

Turning to the global outlook, a range of factors will influence the next phase, including geopolitical risk, monetary policy direction, questions surrounding the development of artificial intelligence (AI), and the outcome of the US midterm elections.

Energy prices have risen again recently, with Brent crude now trading close to $115 per barrel (versus around $100 at the start of the month). Gas futures are hovering around €95/MWh (versus approximately €75).

[2]Fiscal dominance: a theoretical situation in which monetary policy becomes subordinated to government financing constraints, at the expense of the price stability objective.
[3]Transmission Protection Instrument: an "anti-fragmentation" tool introduced by the ECB in July 2022, enabling targeted purchases of sovereign securities to counter market tensions—particularly widening yield spreads between countries—that threaten the smooth transmission of monetary policy, subject to eligibility criteria.
[4]Outright Monetary Transactions: a programme announced by the ECB in September 2012, enabling purchases of sovereign securities on the secondary market to preserve the smooth transmission of monetary policy, subject to strict economic and fiscal conditionality under a European financial assistance programme.

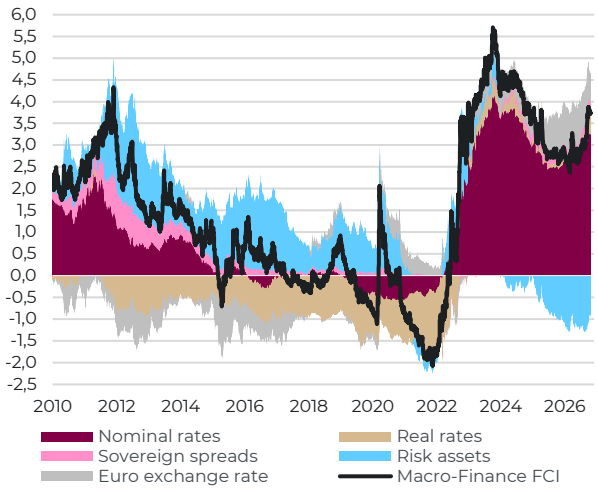
Although crude oil exports from Gulf countries have almost returned to pre-war levels, repeated attacks on vessels passing through the Strait of Hormuz are keeping shipping costs, and ultimately oil prices, under pressure. Visibility remains extremely limited. For central banks, this creates a risk of further inflationary pressure. However, geographical differences must not be overlooked, particularly between the United States and the euro area. As we wrote in September (see our previous Expert view), underlying inflation was already high in the US before the war in Iran and has continued to strengthen since then.

US economic activity remains robust, supported by the healthy financial position of the private sector, investment in AI and household consumption, which is benefiting from the wealth effect associated with rising equity markets. Employment indicators also continue to improve. Although the Fed is unlikely to raise its policy rates on 28 October, in line with its messaging in the media to date (even though macroeconomic conditions could justify another increase), we still consider a return to the position prevailing before the three cuts in 2025 the most likely scenario: an upper bound of 4.5% for the policy rate by the end of the first quarter of 2027.

Conversely, inflationary pressures in the euro area remain driven mainly by energy and, so far, show few signs of spreading to other components of the price index. The labour market remains relatively slack and unlikely to generate wage pressure. Business surveys published in October appear to confirm this but are also beginning to reveal the negative impact on activity of the twin shock of inflation and tighter financial conditions (see Chart 4). In our view, this should continue to limit the scale of ECB rate increases. No change is expected at its 29 October meeting, but our forecast of a 2.75% deposit facility rate, implying one final increase in December, remains valid given the recent rise in energy prices. Beyond the 2.75–3% threshold, we believe tangible evidence of second-round effects would be needed to justify going further.

At the same time, the recent easing in German yields, both short- and long-term, follows several weeks of downward revisions to market expectations for policy-rate increases. This appears to show that investors are better incorporating the factors discussed above, alongside the flight to quality triggered by the French situation. These two central banks, and others across developed economies, are nevertheless converging on one point: no rate cuts are in sight, a factor that could provide a floor for long-term yields in the coming months, barring a recession.

Chart 4: Financial conditions in the euro area by main contributions



Sources: Bletzinger, Martorana and Mistak (2026), 'Looser, tighter, clearer: a new Financial Conditions Index for the euro area'. The ECB Macro-Finance FCI is a composite euro-area financial conditions index combining nine asset prices. It measures the degree of tightening or easing in financial conditions. A rise (fall) in the index indicates tighter (looser) financial conditions. Daily data as of 21/10/2026.

International influences also add to the domestic backdrop. The easing in German yields followed that in US yields (as illustrated in Chart 2), coinciding with mounting concerns about AI. Once again, questions are being raised about whether the massive investment being deployed will generate sustainable returns, even as borrowing costs for the companies involved continue to rise alongside sovereign yields. This has led to particularly pronounced rotation within related sectors, largely hidden beneath the surface of major indices. For example, since 8 October the SOX semiconductor index has fallen 12.2% in US dollars, compared with declines of 4.9% for the US technology sector and 1.1% for the S&P 500. These rotations may have revived risk aversion and prompted a flight to safe-haven assets, contributing to lower sovereign yields. It is also noteworthy, however, that October's rise in oil prices was not accompanied by a further rise in interest rates — quite the opposite. Could this be an early sign that markets are beginning to view the energy shock as a negative demand shock? This probably explains part of the fall in European yields. Other factors, such as portfolio reallocations towards bonds at yield levels now considered attractive, may also have contributed.

Alongside these developments, the midterm elections bring further uncertainty. At present, polls suggest Republicans could lose the House of Representatives, and perhaps the Senate too, pointing to a possible 'Democratic wave' at the ballot box. The economic implications remain unclear, but greater support for tighter AI regulation and increased social spending is conceivable. Questions also remain over how US involvement in the conflict in Iran might evolve.

Overall, weighing these factors suggests that the high-yield environment will persist. Inflation risks remain, the global economic cycle is still relatively supportive, and central banks remain on alert. Fiscal risk premia persist in France, but also in the United States and the United Kingdom.

Of course, some factors could drive sovereign yields lower. ECB intervention is one possibility, but this would presuppose a further deterioration in the French situation. An easing of geopolitical tensions could also alleviate inflationary pressure and interest-rate tensions. Yet this could simultaneously strengthen the economic cycle. Another possibility is the bursting of the (supposed) AI bubble. While AI investment spending contributes to US domestic growth, it also supports the industrial cycle in Asia and Europe. AI development is both a strength and an Achilles' heel. Major disappointments, coupled with a substantial stock-market correction, could therefore lead to recession and central-bank intervention. However, there is no reason to be unduly pessimistic today, as adoption of this technology is still in its infancy. The same applies to the anticipated productivity gains. Many scenarios remain possible. Nor should we overlook the structural transformation of our economies and the resulting increase in investment needs, which could keep interest rates high (see our previous Expert view).

In an environment dominated by so much uncertainty, we believe the most appropriate response is to adopt a few simple principles, summarised below:

- Adopt a flexible approach to bonds in terms of duration risk, while remaining geographically opportunistic;
- Diversify beyond traditional asset classes (equities and bonds), notably by including commodities and real assets;
- Reduce concentration risk relative to major market indices by combining specific themes and complementary investment styles (value versus growth, etc.).

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- **Equity risk: if equity markets decline, the value of a financial instrument may fall,**
- **Interest-rate risk: changes in interest rates may cause the value of a financial instrument to fall,**
- **Credit risk: the risk that the issuer may be unable to meet its obligations,**
- **Currency risk: this arises from** exposure to a currency other than the financial instrument's reference currency.

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