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The US government bond market is wobbling – is it falling too?

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Abstract

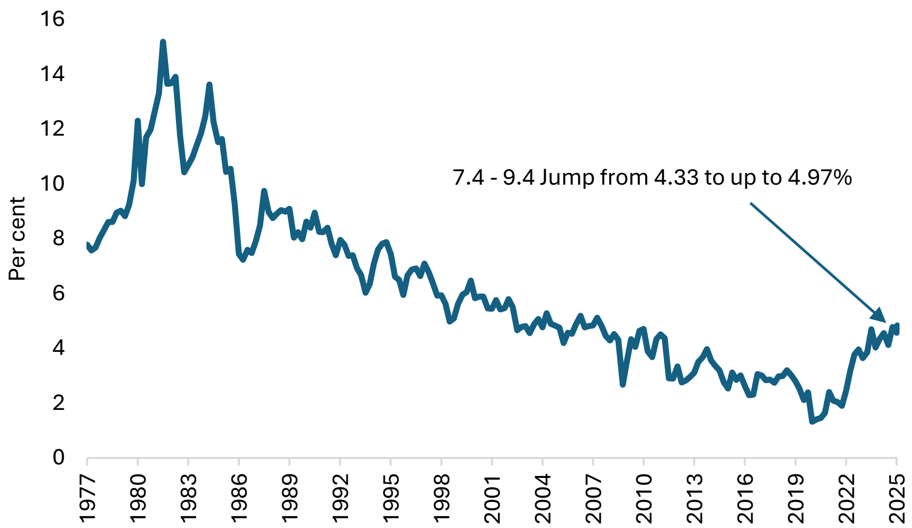
Doubts about the security of dollar investments are growing. A current survey shows that problems could increase rather than decrease.

Zusammenfassung

Die Zweifel an der Sicherheit von Dollar-Anlagen steigen. Eine aktuelle Bestandsaufnahme zeigt, dass Probleme eher zu- als abnehmen könnten.

The longer the capital markets exist, the rarer records are. But this April, some old hands who thought they had seen it all are rubbing their eyes in disbelief. In the second week of April, for example, yields on 30-year US government bonds recorded their biggest weekly increase since 1982, rising by a good 0.6 percentage points from 7 to 9 April alone (Figure 1), one of the biggest jumps in history.

Figure 1: Yield on the 30-year US government bond



Source: Bloomberg, Flossbach von Storch Research Institute, as at April 2025**. Historical performance is not a reliable indicator of future performance.**

A lot is at stake: namely confidence in the most important currency by far, the dollar, and the most important part of the bond market, that for US government bonds. This is traditionally seen as a refuge in the event of turbulence of all kinds: in the event of bank failures, stock market crashes or major geopolitical unrest, investors worldwide prefer to fall back on securities guaranteed by Uncle Sam.

At least that was the case in past decades. But nothing lasts forever. So, doubts about security are slowly beginning to arise. A recent survey shows that problems could increase rather than decrease.

1. debt of more than 36 trillion dollars

The regularly updated debt level of the USA has exceeded the DOLLARS 36 trillion mark this year. Measured against the gross domestic product of 29.7 trillion dollars (as at 31 December 2024), the debt ratio is therefore a good 121 percent. This is more than a third higher than the cumulative debt ratio of all eurozone countries.

As at 31 March, 28.6 trillion dollars of marketable securities (longer-term Treasury ("T") notes, long-term T-bonds, inflation-linked and floating-rate securities, and short-term T-bills) were outstanding (Figure 2).

Figure 2: Outstanding market-listed US debt

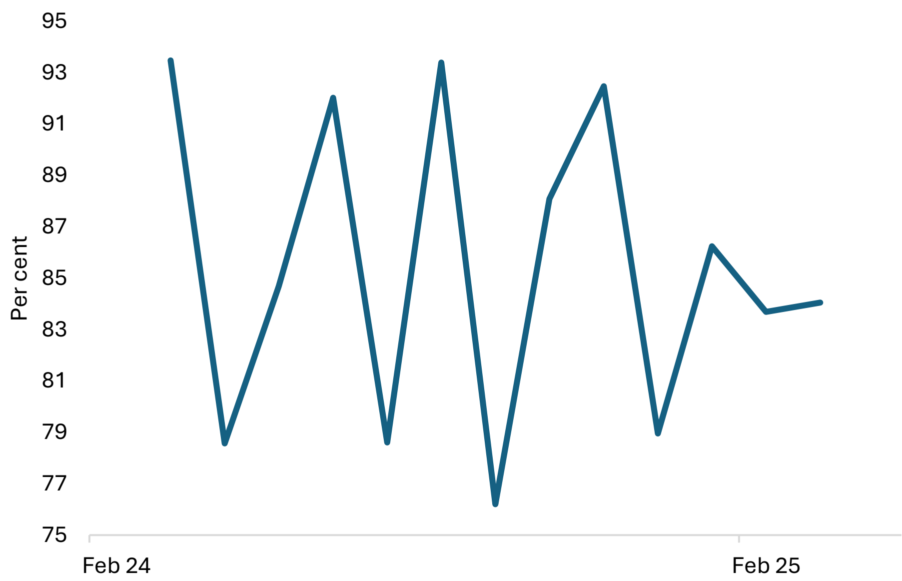
Bond instrument	Trillions of dollars
T-Bills	6.2
T-Notes	14.8
T-Bonds	4.9
TIPS (inflation-linked)	2.0
Floating rate notes	0.7

as at 31 March 2025, source: US Treasury, Flossbach von Storch Research Institute, as at April 2025.

The difference to total debt is explained by debt held by other government agencies, such as social security or healthcare (Medicare).

From March 2024 to March 2025, the USA financed an average of 2.42 trillion dollars in debt on the capital market per month. An average of 2.04 trillion dollars of this, or 84 per cent, was accounted for by T-bills with a maturity of 4 to a maximum of 52 weeks (Figure 3).

Figure 3: Share of short-dated T-bills in the financing of US debt*



*Only financing via marketable securities, source: sifma, Flossbach von Storch Research Institute, as at April 2025.

As the interest rates on T-bills are closely linked to the key interest rates of the US Federal Reserve (Fed), this explains the pressure that Donald Trump is exerting on Fed Chairman Jerome Powell. The US president wants him to cut interest rates as soon as possible. Measured against the current volume of 6.2 trillion dollars, a one percentage point lower interest rate would reduce interest payments from T-bills by 62 billion dollars per year. Due to the short maturities of the T-bills, relief would materialise quickly.

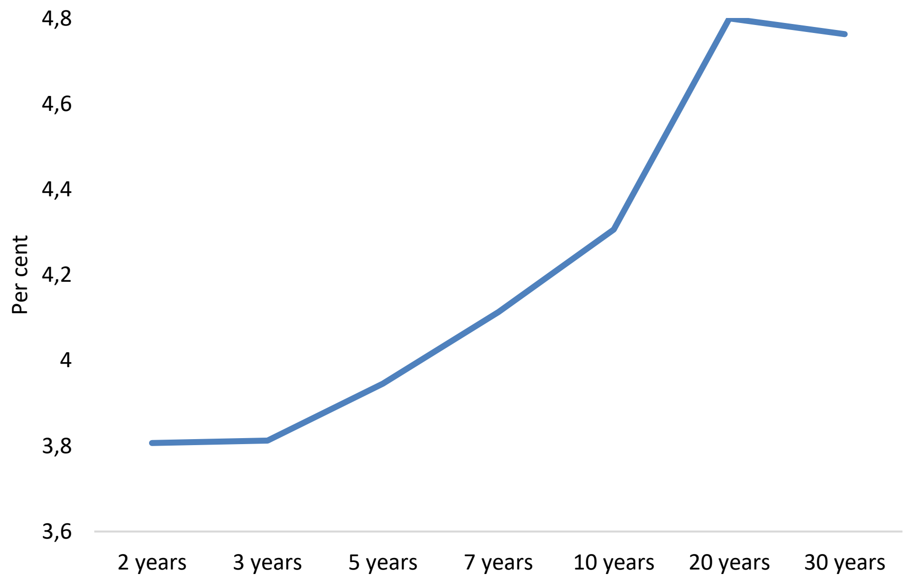
For T-notes and T-bonds, a one percentage point lower yield would result in interest savings of as much as 197 billion dollars per year - but the effect can only unfold over years due to longer maturities.[1] Additional new borrowing and interest on non-marketable US debt are not taken into account.

Moreover, it is not a law of nature that lower short-term interest rates also depress long-term levels. This is because creditworthiness issues play a much greater role in the latter. There is no doubt that the USA will repay a four-week T-bill. This is more uncertain for a bond maturing in 20 years.

2. financing costs and requirements increase

After net new borrowing of 823 billion dollars in the second quarter of the current fiscal year (as at the end of March), the US Treasury is expecting significantly less for the current quarter (as at the end of June), namely 123 billion dollars. From April to June, a good 1.1 trillion dollars in bonds with maturities of 2 to 30 years are expected to be issued. Depending on the term, refinancing currently costs between 3.8 per cent (two-year bonds) and 4.8 per cent (30-year bonds, Figure 4).

Figure 4: Current yields on US Treasuries by maturity



Source: Bloomberg, Flossbach von Storch Research Institute, as at April 2025.

According to Bloomberg, the average interest rate on all US debt recently stood at 3.28 per cent. It is therefore likely to become more expensive for the USA.

[1] According to the latest information from the US Treasury Department as at 31 January 2025, the average remaining term was 70.6 months

For the fiscal years 2025, 2026 and 2027, the financial institutions that are officially tasked with coordinating the US government bond market (banks and securities firms that act as primary dealers.[2]) assume that the USA will have to refinance significantly more debt on a net basis than the amount of securities maturing. For 2025, the primary dealers expect the increase in borrowing to be a good 2.2 trillion dollars, for 2026 just under 2.1 trillion dollars and for 2027 just under 2.2 trillion dollars.

The Office of Management and Budget (OMB) expects emissions to be around 400 billion dollars and 500 billion dollars lower in 2026 and 2027 than the primary dealers estimate. The Congressional Budget Office (CBO), the budget office of the US Congress, expects issuance activity in 2026 and 2027 to be around 300 billion dollars and 400 billion dollars lower than the primary dealers.

What is certain is that the supply of US Treasuries will increase significantly - which in isolation will lead to higher interest rates if demand does not grow accordingly. From the beginning of April 2024 to the end of March 2025, the US issued an average of 406 billion dollars in longer-term bonds per month (including floating rate notes and inflation-linked TIPS). This figure is likely to continue for the time being. In the first six months of the fiscal year, the USA has already placed a total of 2.2 trillion dollars in longer-term Treasuries on the market.

3. debt ratio like Italy?

Projections assume that under President Trump, the public debt mountain will increase significantly by 2035. US debt could then exceed 50 trillion dollars, with the debt-to-GDP ratio at more than 135 per cent, assuming an annual GDP growth rate of two per cent by then. Italian conditions: Rome has been struggling with a debt ratio of this level for years and therefore regularly must pay an interest premium on its bonds compared to German government bonds, for example, which are considered much safer.

Even a manageable average interest rate on US debt of four per cent would mean two trillion dollars in annual interest expenditure (gross, before interest income) on 50 trillion dollars of debt. At five per cent, it would be 2.5 trillion dollars - or up to 36 per cent of the budget if it remained constant.

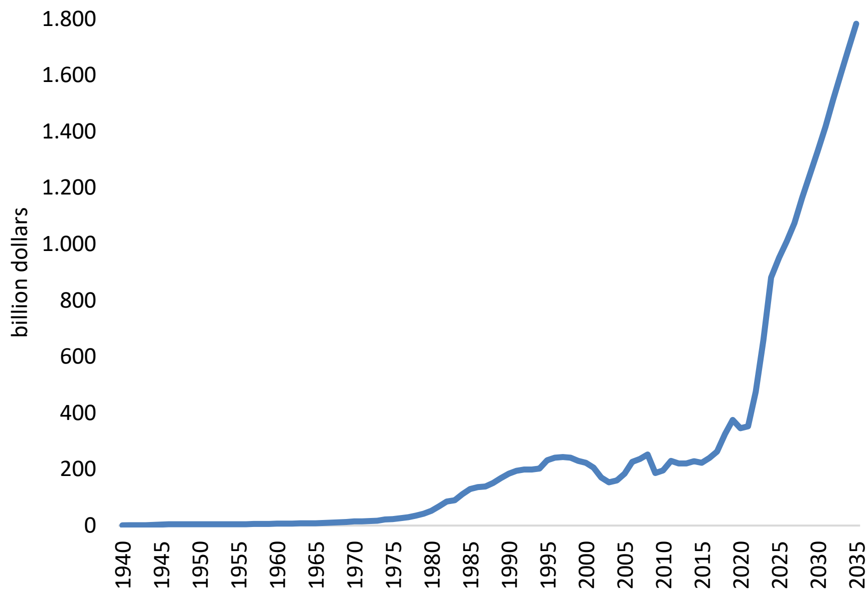
4. budget deficits increase

In any case, the budget deficits in the USA are continuing to increase. In the first half (as at 31 March) of the current fiscal year (as at 30 September), the deficit was a good 1.3 trillion dollars, which is largely attributable to the old US administration. This amount is 245 billion dollars higher than the deficit in the same period of the previous financial year.

[2] An overview can be found at https://www.newyorkfed.org/markets/primarydealers.html

Net interest expenditure rose from 440 to 497 billion dollars (gross from 522 to 582 billion dollars) in the first half of the 2025 financial year.[3] By comparison, net interest expenditure in the entire 2020 fiscal year was 345 billion dollars. That was just under 1.7 per cent of GDP at the time. Current projections assume net interest expenditure of just under 1.8 trillion dollars in 2035 (Figure 5). This would correspond to 4.2 per cent of GDP estimated up to that point.

Figure 5: Annual net interest expenditure in the USA



Fiscal years: until 1976 until 30 June, since then until 30 September, source: Federal Reserve of St. Louis, Congressional Budget Office, Peter G. Peterson Foundation, Flossbach von Storch Research Institute, as at: April 2025.

A US budget deficit of 1.83 trillion dollars was recorded for the entire 2024 fiscal year. For this fiscal year, 1.9 trillion dollars are expected. This is likely to be missed. Even if the deficit does not increase in the second half compared to the same period last year (730 billion dollars), the deficit will jump to more than two trillion dollars in the 2025 fiscal year. That would be 28.5 per cent of the total budget, which is expected to amount to seven trillion dollars.

Measured against the gross domestic product of the USA, which is estimated at 30.3 trillion dollars in 2025, the deficit was 6.6 per cent. By way of comparison, the Maastricht criteria for the euro once stipulated budget deficits of a maximum of three per cent for reasons of stability. Germany had a deficit ratio of 2.8 per cent in 2024, as did Spain. Switzerland recorded a budget deficit of just 0.1 per cent of GDP.

[3] Net interest payments = interest on marketable debt instruments plus interest on debt held by government funds less interest credited to federal agencies

The Trump government and its aide Elon Musk want to endeavour to reduce government spending. But it remains to be seen whether this will succeed. The so-called Department of Government Efficiency (DOGE) set up by Musk lists alleged savings of 155 billion dollars to date. Former employees, on the other hand, report that the DOGE itself is a prime example of incompetence and waste. Trump, on the other hand, is trying to increase the revenue side of the national budget through customs revenue, while at the same time promising far-reaching tax cuts. The latter could boost the economy and lead to additional revenue overall. But this is uncertain.

As things stand, it is by no means impossible that the US budget deficit could continue to rise in the second half of the year, as it did in the first half of the fiscal year. If US GDP turns out to be lower than hoped, a budget gap of around eight per cent in terms of GDP could quickly emerge - and doubts about the dollar and debt sustainability would increase.

In the next two fiscal years 2026 and 2027, the primary dealers expect median budget deficits of 1.98 and 2.08 trillion dollars. OMB and CBO are below this with deficit expectations of 1.60/1.54 trillion dollars (2026/2027) and 1.71/1.69 trillion dollars (2026/2027).

The extent to which such projections will materialise is uncertain, as is the future interest rate level, which may be higher or lower than at present.

5. pressure on foreign countries?

However, it should be clear that without budget consolidation, interest costs can probably only be reduced with outside help, for example through further massive bond purchases by the Federal Reserve or at least would not escalate any further.

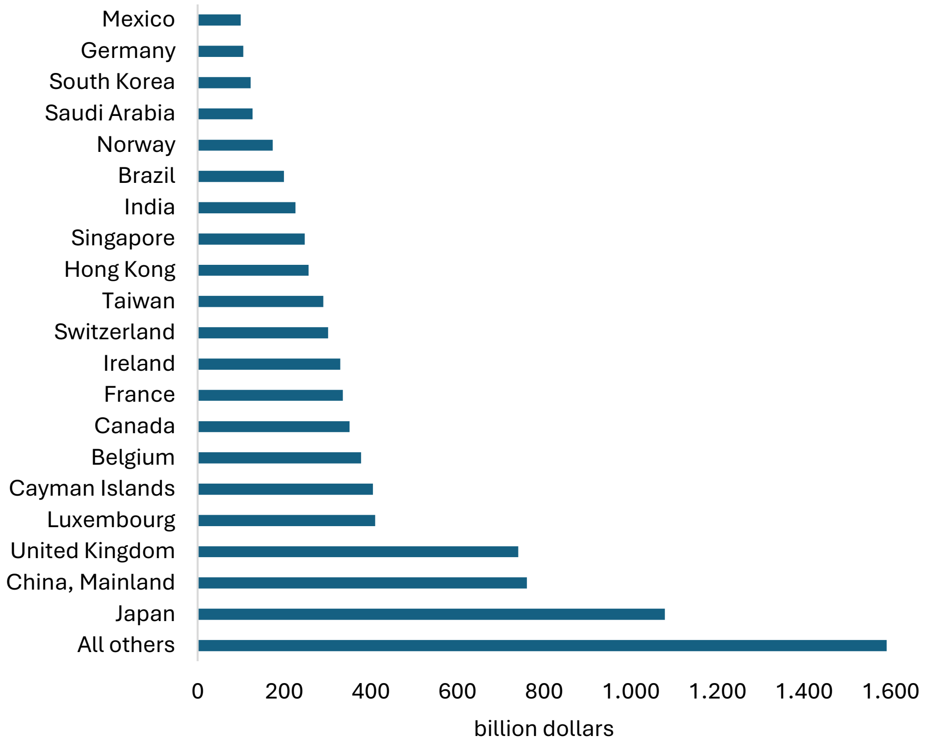
Unless plans by the Trump administration to force foreign countries to buy long-dated US Treasuries with zero coupons could be realised.

This can therefore be described as a very vague idea at best. This so-called Mar-a-Lago plan envisages foreign states exchanging their US government bonds for non-interest-bearing or low-interest-bearing securities with maturities of up to one hundred years. The idea is that the USA would then have to issue fewer new bonds in future, which would weaken the demand for dollars and therefore the US currency. However, this would initially only reduce the necessary volume of bonds to be revolved. Demand for US government bonds could fall if confidence in the dollar is lost in the course of the exchange. The plan is to be emphasised with tariff threats or the withdrawal of military protection, as no one would voluntarily agree to an exchange.

According to the US Treasury Department, foreign countries hold around 30 per cent of all US government securities, totalling a good 8.5 trillion dollars. Official bodies, i.e. governments, central banks, or government-related institutions, hold a good 3.8 trillion dollars of this, including just under ten per cent T-bills, which would not be affected by an exchange.

At 1.1 trillion dollars, Japan holds the largest volume of US government bonds, followed by China (761 billion dollars) and the United Kingdom (740 billion dollars, Figure 6).

Figure 6: Origin of holders of US government securities

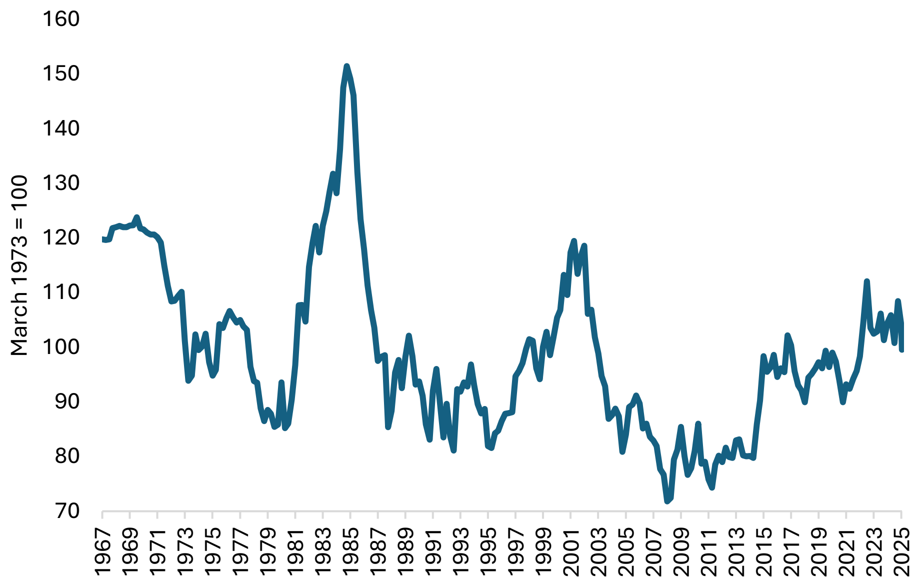


as at 31 January 2025, source: US Treasury Department, Flossbach von Storch Research Institute, as at April 2025.

In the wake of falling share and bond prices, the dollar has also recently depreciated rapidly. Measured by the dollar index[4] , the greenback is at a three-year low but is not in uncharted territory (Figure 7).

[4] The dollar index is currently composed of the following currencies, with the following current weightings: Euro (57.6%), Yen (13.6%), Pound Sterling (11.9%), Canadian Dollar (9.1%), Swedish Krona (4.2%), Swiss Franc (3.6%)

Figure 7: Dollar index



Quarterly figures, source: Bloomberg, Flossbach von Storch Research Institute, as at April 2025. Falling value = dollar depreciates against currency basket. Rising value = dollar appreciates. **Historical performance is not a reliable indicator of future performance.**

Rumours that the weakness of the dollar is also due to sales of US government bonds by Chinese or Japanese holders cannot be confirmed due to a lack of very timely data. In addition, both countries would strengthen their own currencies in such a case, which is not in their interest.

Conclusion

The erratic trade policy of the US administration and so far barely visible efforts to get the budget out of its imbalance are a mortgage for US government bonds and the dollar. There is no doubt that the USA will not lose its currency dominance in the foreseeable future. Its deeply integrated capital markets and a currency that is impossible to replace in its entirety speak against this.

However, the USA has already lost much of its solidity before 2025, as can be seen from the ever-increasing national debt in the absence of budget consolidation. Dollar investments, especially dollar-denominated interest-bearing securities, have therefore become riskier. Investors are therefore likely to demand higher interest rates for long-term bonds.

If the current, still manageable crisis of confidence continues, the markets are likely to be shaken further. Experience shows that a weak dollar is not a good signal.

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