Why the global bond wobble signals a new world order

Gilt yields upstaged Andy Burnham last week, but the UK is not alone in its debt woes: market turmoil could be the shape of things to come

Jim Armitage
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Krystal Polk's family have been quietly farming their two-acre smallholding in the Memphis suburb of Southaven for four generations. Now, the 52-year-old Tennessee resident says, the sound of birdsong has been drowned out by the "constant roaring" of a very 2026 phenomenon: the vast data centre that Elon Musk has built in the once-sleepy town. "It's like you're in the middle of the airport where the planes are taking off," she told CBS News.

Musk's xAI tech giant is spending some $20 billion (£15 billion) building out his "Colossus" data centres in the town. When completed, they will form effectively the world's biggest AI supercomputer, powering his Grok AI chatbot as well as Tesla and the social media platform X.

However, the implications of this go far beyond the impact on Polk's living conditions. They are also a key contributor to the fiscal headache facing Andy Burnham, which reached its crescendo with a bond market rout right in the middle of his first Prime Minister's Questions last week.

How? Because to help fund his outlandish data centre building programme, SpaceX raised about $25 billion on the markets in late June. It did so by issuing new bonds in the company. This, along with the other $180 billion of "data centre bonds" issued this year by AI hyperscalers such as Google-owner Alphabet, Amazon, Meta and Oracle, has dented demand for the old-fashioned sovereign bonds issued by nation states — US Treasuries, UK gilts, German bunds and the rest.

Where once the world's banks, insurance companies and pension funds were pretty much obliged to buy government bonds for long term, low risk, guaranteed interest income, nowadays they have options. Governments have to offer a higher rate to tempt them.

Add that to a world where inflation lurks constantly around the corner and the stage is set for a major interest rates problem.

At one stage last week, 30-year gilts hit 5.94%, their highest level in 28 years — and even higher than during the spectacular fallout from Liz Truss's mini-budget in 2022.

The underlying trigger for that blowout on Tuesday and Wednesday was the impact of new hostilities in America's war on Iran and the resultant impact on oil, gas and other crucial imports through the Strait of Hormuz. So important is this supply route that any disruption triggers higher oil prices, resulting in inflation and pressure on central banks to increase interest rates.

So, when President Trump renewed hostilities, global bond yields, which track central bank rates, leapt.

None of this would matter so much if governments like Britain's had not built up so much debt over recent decades. As Sir Jeremy Hunt, appointed chancellor to sort out the mess from the Truss mini-budget, put it: "We had the global financial crisis, then we had Covid, then the energy-price shock from Ukraine, each of which meant the government had to suddenly borrow a lot of money.

"Broadly, that was £350 billion for Covid, just under £100 billion to help people with their energy bills, and we put £1 trillion on the line for the financial crisis [although, in the end, not all of that was paid]."

During Covid, interest rates were kept low to keep the economy on life support, but when Russia launched its full-scale invasion of Ukraine, inflation surged to beyond 11% and the Bank of England reacted by putting up the cost of borrowing. Those higher interest rates meant the cost of servicing all that government debt soared.

Hunt recalled: "This was a dramatic change. I was the first chancellor to have to deliver a fiscal statement in the new world where our debt interest payments were £110 billion a year. That's massive — £3,900 per household. And that's not paying down the debt — that's just repaying the interest. That is the world we're living in today.

"I, along with Rachel Reeves and now John Healey, are the only three chancellors who have ever had to deal with this."

It is not just the day-to-day interest repayments that are a problem for the government. As Simon French, an economist at Panmure Gordon explained, bonds issued in previous years at lower rates are constantly expiring and have to be refinanced with new bonds issued at the current, higher market rate.

Not only that, he said, but the new bonds add further supply to the glut already on the market, putting further upwards pressure on how much interest Britain has to offer to tempt investors.

Meanwhile, the Bank of England is also selling off the £875 billion or so of government bonds that it bought during the quantitative easing programme after the financial crisis. On September 17, it will announce how many tens of billions of pounds worth it is planning to sell this year.

"Yet again, the private sector is expected to mop it all up, but the rate will have to go up if the Bank releases too much into the marketplace," said French.

Once a country's debt increases, it is hard to stop it rising. Kristina Hooper, the New York-based chief market strategist at London hedge fund giant Man Group, compared it to investors' holy grail of compound interest, where interest earns interest, causing a sum to grow ever faster. "New finance students are introduced to the concept of the magic of compounding; I think this is the black magic of compounding."

Sovereign debt yields have increased this year across the world. Michael McMahon, economics professor at Oxford University — speaking from Stanford University in California where he was, fittingly, addressing a symposium on global risk and uncertainty — said: "This is certainly not a UK-specific phenomenon. From the start of the year, yields have generally drifted up in most advanced economies. In fact, it's Japan that has increased by the most.

"That's only a moderate comfort, I know, but most countries have questions to answer."
That has not stopped the Conservative leadership, and some investors, blaming the government and demanding action to cut welfare spending. The efforts of Sir Keir Starmer and Rachel Reeves on this were comprehensively defeated by the left of the party last year, leaving big doubts over Burnham's ability, or willingness, to tackle the benefits bill.

Shadow chancellor Andrew Griffith said: "If you unpick it, the comparative increase in UK rates in the last two years is significantly higher than France … and the US. And that's down to continued uncertainty and lack of confidence that the government is serious about making the right choices [on taxes and spending].
"Talk to investors in the UK market and those are the fears they have: when push comes to shove, who calls the shots? The leadership or Labour's backbenchers?"

The US will be the most influential actor by far, though. Much of the recent volatility in bond markets has been down to the contrary actions of two of America's most powerful policymakers: Scott Bessent, Treasury secretary since January last year; and Kevin Warsh, the new chairman of the Federal Reserve. The pair have some things in common. Both are extremely rich (Warsh's wife, Jane Lauder, is an heiress to the Estée Lauder fortune); both were handpicked by Donald Trump; and both have worked for the billionaire investor Stanley Druckenmiller.

But in their current roles, they are pulling in different directions. Bessent has been doing everything in his power to get interest rates down so America can fund its ballooning spending for less. When US Treasuries last month headed towards 5% — heights not seen since 2007 — Bessent announced plans for the government to buy $4 billion of long-dated bonds in an attempt to lower the yield.

Warsh, on the other hand, has been talking hawkishly on inflation and has signalled that the Fed might have to put up interest rates to keep a lid on inflation.

The Fed governor is also of the view that the central bank should not interfere in the markets, and should stop the established practice of giving out regular hints and clues about how it is minded to set rates. Some investors are finding the adjustment discombobulating.

There are further fears about America that are rattling some corners of the markets. Its troubles in the bond markets are adding to an increasing worry that the US dollar might be losing some of its status as the world's reserve currency. Increasingly, particularly in Asia, companies are trading commodities with each other using the Chinese yuan instead — a generational shift.

Oxford professor McMahon said while he does not think "de-dollarisation" is likely to spread too far, it is no longer completely unthinkable. "I used to joke about it, but it's not such a joke now.

Just imagine a world where big holders of US dollars just decided they didn't want them any more. You'd get a sell-off and the yield is going to have to go through the roof."

The US economy could be plunged into recession, which would damage all the western economies, including Britain's.

That said — as April LaRusse, fixed-income product specialist at one of the UK's biggest bond investors, Insight, put it — there is no need to panic yet. Governments around the world have been able to sell their bonds relatively easily despite the price turmoil.

Besides which, while Bessent's $4 billion of bond buying in a $40 trillion market has been likened to taking a peashooter to a gunfight, governments can take action to combat rising bond yields without making tough decisions on cutting public spending. They could, as Italy does, encourage retail investors to buy them by making sovereign bonds exempt from inheritance tax. They could — as European regulators have done — insist banks buy more sovereign debt to prop up their safety buffers.

None of these actions is easy. Markets take a dim view of countries that take such unilateral action against them, and the UK and US are unlikely to do so any time soon.

Which means weeks like last week are ever more likely to happen. For grey-haired bond fund managers such as Dave Chappell, 57, managing millions of people's life savings at Columbia Threadneedle, that is not good news. "It is nerve-wracking, of course, and this year in particular has been pretty difficult, primarily because of the Iran conflict."

For younger rivals, though, it's all in a day's work. James Novotny, a baby-faced 30-year-old fund manager at the $1.8 billion Jupiter Strategic Absolute Return Bond fund, said: "Most of my career has been after Covid, so these kinds of volatile markets feel completely normal. It's just the way markets are."

Back in Tennessee, Polk was trying to figure out whether to stay on her land in Tennessee, or quit. "We are a casualty of the whole data centre race," she told reporters.

Without the help of the bond market, it is a race that might not have been running so fast.

