

US bond sell-off sparked by inflation worries



Month in brief

The US Treasury took measures to tackle rising Treasury yields

Natural gas prices have risen sharply

UK Government borrowing rose unexpectedly, building pressure ahead of the October Budget

Equity markets rebound from July lows while credit spreads remain tight

Aggregate UK DB pension scheme funding was flat over August

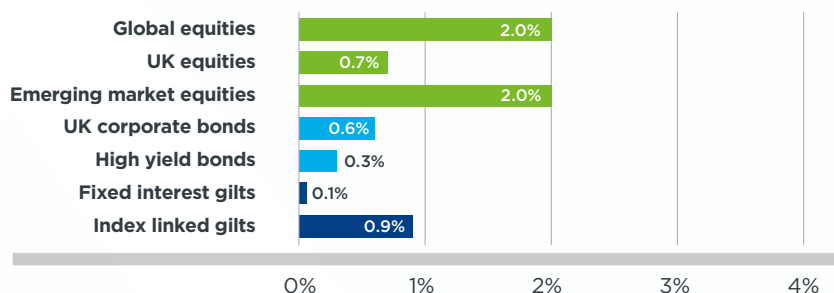
In August, the US Treasury announced measures to stabilise a sell-off in bond markets by committing to doubling its purchases of long-term Treasury bonds in an effort to combat the rising cost of servicing government debt. It is estimated that G7 nations have suffered \$16bn of additional financing costs since the US-Iran conflict began in February with the US bearing the brunt of the burden.

The sell-off deepened in the final days of the month as investors priced in rising expectations that the Federal Reserve (Fed) would need to take action in September to combat the eruption of inflationary pressure triggered by the ongoing US-Iran conflict. UK and European natural gas prices have spiked reflecting anticipation of winter demand. Fed Chair Kevin Warsh warned in his annual Jackson Hole conference speech that inflation is expected to remain above target, and markets are now pricing in a more than 50% probability that US interest rates will rise in mid-September at the next Fed meeting.

With the October Budget looming, the new Chancellor of the Exchequer John Healey faces pressure to improve the UK fiscal position and rectify a growing deficit. The UK recorded an unexpected budget deficit of £1.8bn in July, underpinning concerns that October's Budget will add to an already challenging economic backdrop. The UK economy continues to run hot in the face of wider geo-political concerns, with CPI inflation rising to 2.9% in the 12-months to July, unemployment above forecasts and household energy bills set to hit a 3-year high from October when the new Ofgem price cap kicks in. While the UK economy actually grew by 0.4% in the second quarter of the year, forecasts expect growth to slow substantially in the remainder of 2026.

In Japan 10-year government bond yields reached their highest level in 30 years. Japan has been struggling with a weakening domestic currency which triggered an unprecedented joint intervention by the US and Japan at the end of July.

Global equity market performance was choppy but positive in August One month to 31 August 2026



Click to watch Cindy's two-minute video.

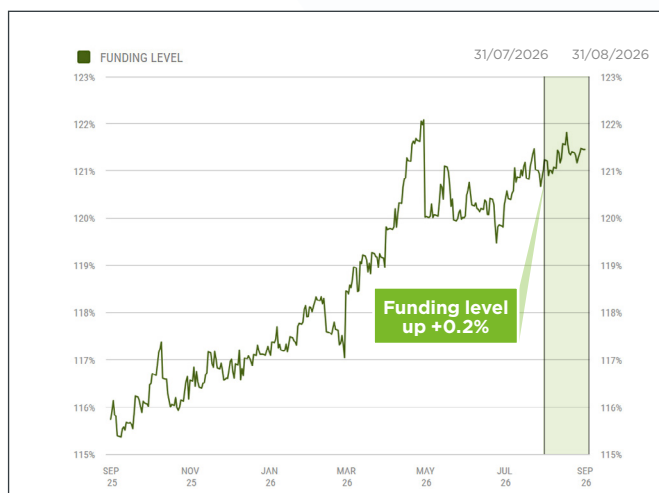
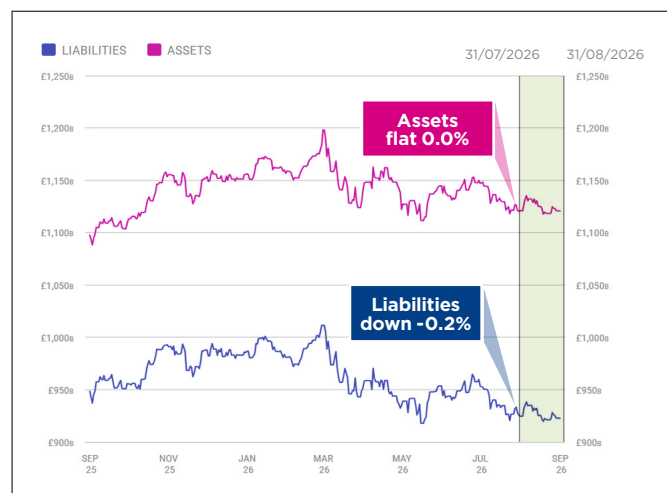
Cindy Lo

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Global equity market performance was choppy but positive in August. A fresh wave of AI-related optimism triggered by some strong earnings reports saw investors flood back into stocks in the first half of the month. However, bond market pressures cast a gloomier shadow over performance in the second half of the month to temper overall performance. Sterling credit spreads remained broadly flat and still well below long-term averages.

Despite the struggles of the US bond market, UK fixed interest gilts posted marginally positive performance. Index-linked gilts benefitted from a marginal increase in inflation expectations. On a low-risk basis, the aggregate funding level of UK defined benefit pension schemes was broadly flat over August.

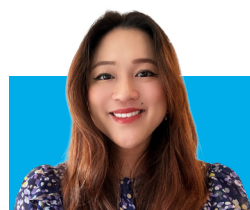


Source: XPS DB:UK xpsgroup.com/DBUK

The charts above are based on data from The Pensions Regulator, the PPF 7800 Index and the XPS data pool. The assumptions used in the UK:DB long-term target basis include a discount interest rate of gilt yields plus 0.5%. The assumed asset allocation is 16.9% equities, 20.0% corporate bonds, 6.9% multi-asset, 5.1% property, 3.8% private markets and 47.3% in liability driven investment (LDI) with the LDI overlay providing a 60% hedge on inflation and interest rates.

Find out more

To discuss any of the issues covered in this edition, please get in touch with **Cindy Lo**. Alternatively, please speak to your usual XPS contact.



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