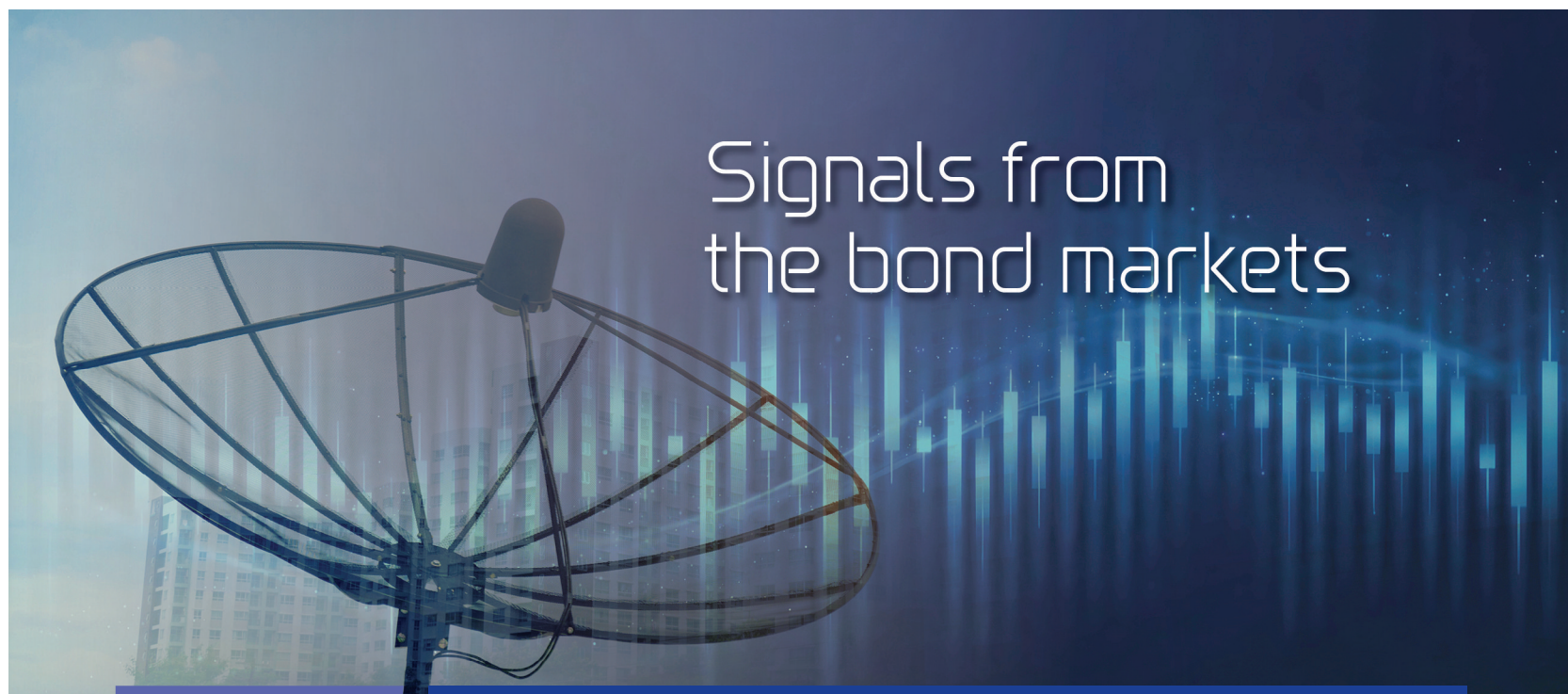




Signals from the bond markets

If the financial markets could talk, then bonds would probably be saying: “We’re not convinced the story is over yet”.

Bond yields have been rising around the world as investors reassess the outlook for inflation, economic growth and government borrowing. The moves have been significant enough to influence mortgage rates, government finances and investment portfolios.

Experienced bond investors will be well aware of what’s been happening. For everyone else, the developments offer the chance to understand why professional investors see the bond market as one of the economy’s most important barometers.

You might never have bought a bond, researched a bond ETF or checked the yield on a government bond. But there’s a good chance that bonds already play a role in your investment portfolio through your superannuation account.

That’s one reason the recent attention on bond markets matters.

Looking back

To understand why bonds are attracting attention now, it helps to take a look back.

From the early 1980s to around 2020, developed economies experienced one of the longest declines in interest rates and bond yields in modern history. Falling inflation, globalisation, technological advances and relatively stable economic conditions helped drive yields steadily lower.

Following the Global Financial Crisis and then the COVID-19 pandemic, many government bond yields fell to historically low levels. In some countries, investors were even willing to accept negative yields.

That changed dramatically from 2022 onwards as inflation surged. Central banks, including the Reserve Bank of Australia, responded by rapidly increasing interest rates.

The rapid increase in yields created short-term pain for existing bond investors but ultimately restored something that had been largely missing from bond markets for years: meaningful income.

Today, many commentators believe the era of ultra-low bond yields may be over. While inflation has eased from its peak, investors are increasingly questioning whether interest rates will return to the unusually low levels that prevailed during the 2010s.ⁱ

What’s happening in Australia?

Australian bond yields have moved higher during 2026 as investors responded to stronger than expected inflation and economic activity, and commentators are not confident that inflation will return quickly to the Reserve Bank’s target range.

Three-year government bond yields moved above 5 per cent, while 10-year bond yields approached levels not seen for more than a decade.ⁱⁱ

Higher yields affect far more than investment portfolios. Governments face increased borrowing costs, businesses pay more to raise capital, and lending rates throughout the economy may come under upward pressure.



The global picture

But Australia is not alone. Across the world, governments are issuing large amounts of debt to fund spending commitments, infrastructure projects and budget deficits.

Earlier this year, the International Monetary Fund (IMF) warned about the risks of geopolitical tensions, inflation uncertainty and rising levels of government debt.

Meanwhile, BlackRock notes that government borrowing is increasingly competing with private-sector demand for capital, helping push long-term yields higher in many countries. Its investment team believes that higher yields have created attractive income opportunities, but investors need to be more selective than in the past.

Understanding duration

‘Duration’ is one of the most important concepts in bond investing.

It measures how sensitive a bond’s price is to changes in interest rates. Generally speaking, the longer a bond’s duration, the more its price will move when rates change.

For example, a 10-year bond will usually experience greater price movements than a two-year bond if market interest rates rise or fall.

That helps explain why some bonds can experience significant short-term losses even when the issuer is considered financially secure. Investors often focus on credit risk, but interest-rate risk can be just as important.

The sharp rise in global yields over recent years has highlighted the importance of duration. Longer-dated bonds, which benefited hugely when rates were falling, were among the hardest hit when yields moved higher.

The bottom line

After years of being overlooked, bonds are once again demanding investors’ attention with higher yields providing more income than for much of the last decade.

At the same time, the rising yields are a reminder that bonds are not risk-free and that issues such as duration, inflation and government borrowing matter.

Although forecasts differ on the precise direction of interest rates, there appears to be broad agreement that investors should prepare for a more complex bond market.

How bonds work

A bond is essentially a loan made by investors to a government or company. Investors receive regular interest payments, known as coupons, and they receive their initial investment back when the bond matures.

The main rule to remember is that bond prices and bond yields move in opposite directions. When market interest rates rise, existing bonds with lower coupons become less attractive causing their prices to fall. On the other hand, when interest rates fall, existing bonds typically become more valuable, driving their prices up.

Government bonds, issued by the Australian government are generally considered among the lowest risk investments because they’re backed by the Commonwealth. Corporate bonds usually offer higher yields but they involve greater credit risk.

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i <https://www.blackrock.com/us/financial-professionals/insights/fixed-income-outlook>

ii <https://www.afr.com/policy/economy/bond-sell-off-punches-10b-hole-in-government-budgets-20260911-p60wi1>