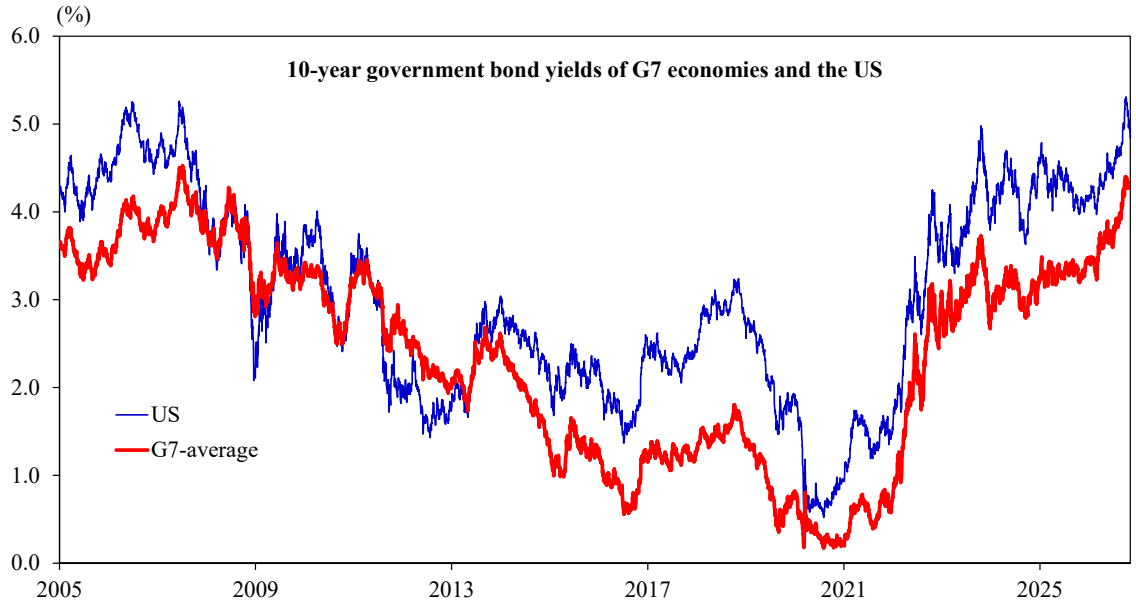
Box 2.1

Elevated long-term sovereign bond yields: A significant downside risk to the global outlook

Higher long-term sovereign bond yields in major advanced economies pose a downside risk to the global economic outlook. Average Group of Seven (G7) long-term sovereign bond yields rose to a near-20-year high in October, reflecting inflation uncertainty, fiscal concerns and shifts in bond supply and demand (***Chart 1***). For example, the 10-year government bond yields of the United States (US), Japan and France once reached the 20-year highs of 5.31%, 3.11% and 5.08% respectively in October. In October 2026, the International Monetary Fund (IMF) highlighted the risk that persistent upward pressure on sovereign bond yields could tighten global financial conditions and weigh on global economic growth. Given the central role of US Treasury yields in global asset pricing, increases in their yields could generate particularly significant international spillovers. Although expectations of greater fiscal restraint following the US midterm elections may ease some upward pressure on US Treasury yields, elevated sovereign borrowing costs, substantial refinancing needs and the risk of renewed increases in "term premiums" continue to threaten global growth and financial stability.

Chart 1 : Average G7 long-term sovereign bond yields rose to a near-20-year high

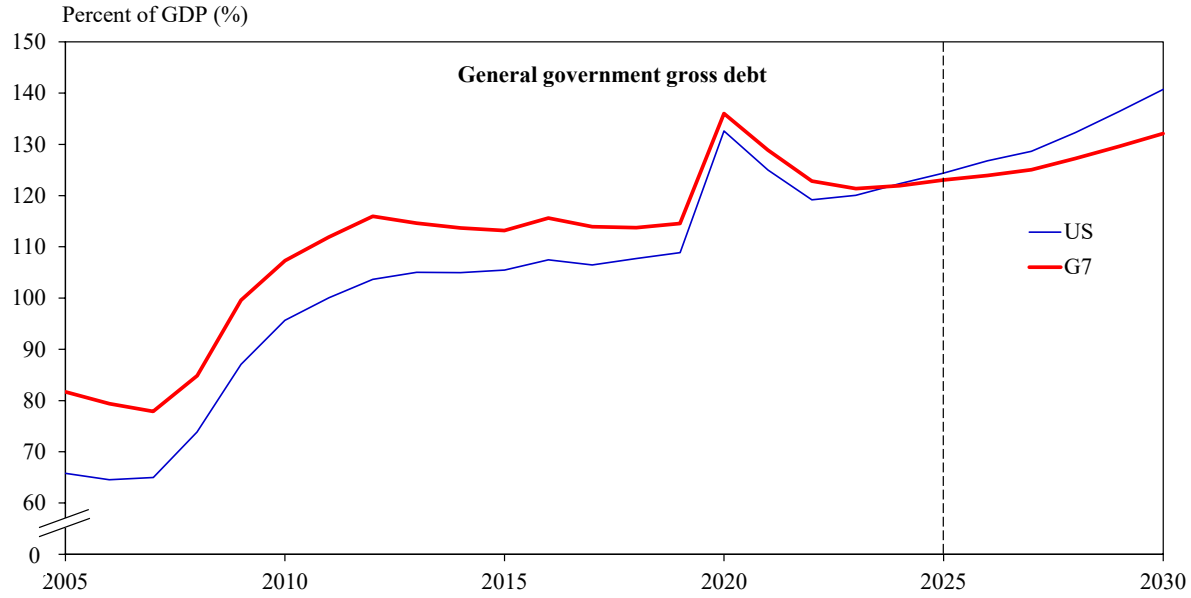


Sources: US Federal Reserve Board, Bloomberg data.
Note: G7 includes the US, Germany, Japan, the United Kingdom, France, Italy and Canada.

Renewed inflation pressures in these economies, partly driven by energy price shocks amid heightened geopolitical tensions since March 2026, have increased uncertainty over inflation and monetary policy. This has prompted investors to demand higher "term premiums" to compensate for the risks of holding long-term sovereign bonds. High government debt and limited progress on fiscal consolidation have compounded these pressures (***Chart 2***). According to the IMF's estimates, average G7 government debt-to-GDP ratio will rise from 107% in 2010 to 124% in 2026, while that in the US will rise from 96% to 127% over the same period.

Box 2.1 (Cont'd)

Chart 2 : Government debt in major advanced economies has risen to an elevated level and is projected to rise further



Source: IMF (data accessed via the IMF data portal in October 2026).
Note: G7 includes the US, Germany, Japan, the United Kingdom, France, Italy and Canada.

In the US, substantial corporate bond issuance by technology firms to finance large-scale artificial intelligence (AI) investment, alongside reduced demand from public-sector buyers, has added to upward pressure on US Treasury bond yields. In France, political divisions and hindered fiscal consolidation have heightened concerns over debt sustainability. To the extent that higher yields reflect greater uncertainty and risk premiums rather than stronger growth prospects, they could tighten financial conditions and weigh on economic activity.

Higher sovereign bond yields in major advanced economies transmit to the global economy through several channels. As key benchmarks for asset valuations and borrowing costs, they can depress equity prices, weaken household wealth and consumption, and raise corporate financing costs, restraining investment, including AI-related investment. These effects could intensify if yield increases extend to shorter maturities or coincide with wider credit spreads.

Falling government bond prices could also reduce collateral values, while weaker risk appetite could trigger capital outflows from vulnerable emerging markets. Higher public debt-servicing costs in major advanced economies could further constrain their public investment, social spending and governments' capacity to respond to downturns. So far, however, the impact on global growth has remained limited, with strong technology-related investment supporting activity. Meanwhile, long-term sovereign bond yields of the G7 economies have retreated somewhat in recent weeks, while still lingering around their highs.

Box 2.1 (Cont'd)

The Hong Kong economy could be affected through tighter global financial conditions and weaker external demand. Higher long-term US Treasury yields could raise local bond financing costs and weigh on asset valuations, but the recent easing in US Treasury yields has provided some relief. The transmission to bank lending rates is less direct. Under the Linked Exchange Rate System, Hong Kong dollar money market rates are influenced primarily by short-term US interest rates and local liquidity conditions. Higher long-term US yields therefore need not necessarily translate into higher local bank lending rates.

Ample banking liquidity should also provide some cushion. The Hong Kong dollar loan-to-deposit ratio stood at a near-record low of 70.3% as at end-September (well below its 10-year average of 82.7%), helping to contain local borrowing costs. Nevertheless, tighter global financial conditions and more volatile capital flows could dampen asset market sentiment, consumption and business investment. Slower global growth, particularly a loss of momentum in global AI-related investment, could also weaken merchandise exports and trade-related services.

Hong Kong's strong fundamentals and resilient financial system should provide buffers against the potential spillovers. Government debt remained low, at 12.3% of GDP in fiscal year 2025/26, while official foreign currency reserve assets amounted to US$433.0 billion at end-September. These buffers, together with banks' strong capital and liquidity position should support financial stability. The Government will closely monitor the developments.