

An aerial, high-angle view of a city, likely New York City, with a dense grid of buildings. Overlaid on the city is a large, swirling, teal-colored graphic that resembles a vortex or a storm. Within this graphic, several US dollar bills are visible, appearing to be falling or floating in the air. The overall color palette is dominated by teal and blue tones.

# How Debt, Inflation, and Politics Are Driving Up Borrowing Costs

## The End of Easy Money

### How Fiscal Strain and Inflation Are Changing Markets

Around the globe, borrowing costs are climbing — and not by coincidence. A confluence of entrenched government debt, persistent inflation, and growing political uncertainty is reshaping interest-rate expectations and pushing long-term bond yields to their highest levels since 2009. For investors, the message is clear: the era of cheap money is over, and financial markets are adjusting to a new reality where the cost of capital will stay elevated for longer.

This shift isn't just affecting governments; it's rippling through businesses, consumers, and markets alike. Understanding why borrowing costs are rising — and what it means for your portfolio — begins with exploring the three forces driving the move: debt, inflation, and politics.

#### The Weight of Global Debt

Governments worldwide are grappling with unprecedented levels of debt. According to the **Institute of International Finance**, global borrowing reached a record **\$324 trillion** in early 2025, led by increases in China, France, and Germany. Much of that debt was accumulated after the 2008 financial crisis and again during the COVID-19 pandemic, when record-low interest rates made borrowing both cheap and politically expedient.

For over a decade, ultra-accommodative policy allowed governments to issue bonds with minimal servicing costs. That calculus has changed dramatically. Inflation's persistence and continued fiscal stimulus mean investors are demanding greater compensation for risk. Long-term U.S. Treasury yields — along with those in Europe and Japan — have surged, reflecting higher expectations for both inflation and fiscal strain.

In short, bond markets are sending policymakers a message: bigger budgets now come with a higher price tag.

#### A U.S. Example: Fiscal Fatigue and Market Perception

In the U.S., concerns about fiscal discipline have recently intensified. The cost of President Donald Trump's sweeping **One Big Beautiful Bill Act**, a centerpiece of his administration's tax-and-spending agenda, is amplifying investor caution. According to the **Congressional Budget Office**, the law could add roughly **\$3.4 trillion** to the U.S. deficit over the next decade — even before considering potential “dynamic” effects such as growth or productivity changes.

The timing couldn't be more sensitive. In May, **Moody's Ratings** stripped the U.S. of its last remaining top-tier credit rating, warning that the ballooning national debt and widening deficits could erode America's standing as the world's safest borrowing destination. For bondholders, that downgrade underscores growing unease about the sustainability of U.S. fiscal policy — particularly as interest payments increasingly consume a larger share of federal revenue.

To be sure, Washington has found some short-term relief through **tariff revenue**, which topped **\$240 billion** through November 2025, helping narrow the fiscal deficit for the year. But even if those tariffs withstand ongoing **Supreme Court challenges**, they won't close the structural gap between federal spending and revenue. The broader market concern remains: the combination of tax cuts, elevated spending, and higher borrowing costs could prove a long-term challenge for U.S. creditworthiness.

## Inflation's Lingering Grip

The second key driver is inflation — or, more precisely, the persistence of price pressures across the global economy. Despite hopes that inflation peaked in 2023–2024, it's proving sticky, particularly in services, housing, and wages. Even modest inflation erodes the value of a bond's fixed payments, prompting investors to demand higher yields.

Complicating matters, there's growing skepticism about whether central banks can rein in inflation without derailing growth. As governments continue running large deficits, central bankers face pressure to keep rates lower — potentially compromising their independence. Markets sense this tension. As a result, yields on long-dated bonds now embed a persistent **inflation premium** — a guardrail against both policy hesitation and fiscal excess.

## The Politics of Borrowing

Political dynamics have become a central factor in global debt pricing. In the U.S., questions around **Federal Reserve independence** are adding to volatility, especially as the new administration explores direct influence over monetary policy appointments. In Europe, coalition governments are struggling to maintain fiscal restraint amid voter fatigue with austerity. And in emerging markets, a strong U.S. dollar and rising global yields are complicating efforts to stabilize local debt markets.

Bond investors prize predictability — and the current political environment offers anything but. As policy debate increasingly collides with ideology, markets worry less about “can” governments rein in spending and more about “will” they. That uncertainty is pushing up risk premiums and, by extension, borrowing costs, particularly for long-term sovereign issuance.

## Market Sentiment and the “Disappointment Trade”

This year's surge in yields has been dubbed the **“disappointment trade”** — reflecting markets' frustration that anticipated interest-rate cuts have repeatedly failed to materialize. Investors who positioned for a rapid easing cycle in 2025 misjudged both global growth resilience and fiscal persistence. Instead of moderating, long-term borrowing costs have jumped back to 2009 levels.

Traders now expect fewer, later, and smaller rate cuts across most major economies — with some markets even pricing in the risk of renewed hikes.

That shift has lifted yields on 10- to 30-year government bonds, undermining sentiment and repricing everything from corporate debt to mortgage rates. For corporations rolling over pandemic-era loans, or homeowners looking to refinance, the sting of higher yields is already evident.

## What It Means for Investors

For investors, this reset carries both risk and opportunity. Bond prices fall as yields rise — painful for incumbent holders — but newly issued debt now offers the most competitive income in over a decade. The challenge is managing **duration risk** — the sensitivity of prices to rate changes — and seizing higher yields without overexposing to volatility or credit deterioration.

Equity markets also face headwinds as discount rates rise, compressing valuations, particularly in growth sectors. Real assets, such as real estate and infrastructure, may experience uneven performance depending on leverage and pricing power. Meanwhile, high-quality fixed income — once a dull corner of the portfolio — is regaining relevance as a source of reliable returns and diversification.

The traditional “60/40” mix between stocks and bonds, long out of favor during the zero-rate years, may find new balance in this higher-yield world. But selectivity will matter. Not all bonds are created equal, and not all governments are equally credible borrowers.

## Navigating the New Normal

The global economy is entering a more disciplined era — one in which fiscal prudence, policy credibility, and inflation management will increasingly dictate the cost of money. Debt, inflation, and politics are inseparable threads in this narrative, and their interplay will define the investment landscape for years to come.

For clients and investors, that means positioning portfolios not for a return to ultra-low rates, but for a sustained period of **“normal but higher”** yields. A diversified, income-oriented strategy — balancing quality fixed income, dividend-paying equities, and inflation-sensitive assets — can help navigate this transition with resilience.

Markets are repricing risk, not collapsing under it. The adjustment we're witnessing is a long-overdue recognition that capital has a cost — one that both investors and policymakers must now respect.

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