Briefing Note

September 2026

Rising sovereign bond yields – what are the risks for investors?

Several explanations have been offered for the recent rise in sovereign bond yields, including concerns about debt sustainability, inflation and AI-related demand for capital. No single explanation can be isolated with confidence. Government bond yields reflect expectations for growth, inflation and interest rates, alongside bond supply, investor demand and the compensation investors require for uncertainty.

At this point, we turn to the data. They provide some clues as to which explanations appear most consistent with recent market moves – which is important, if we're to avoid interpreting every rise in yields as evidence that government debt has become unsafe.

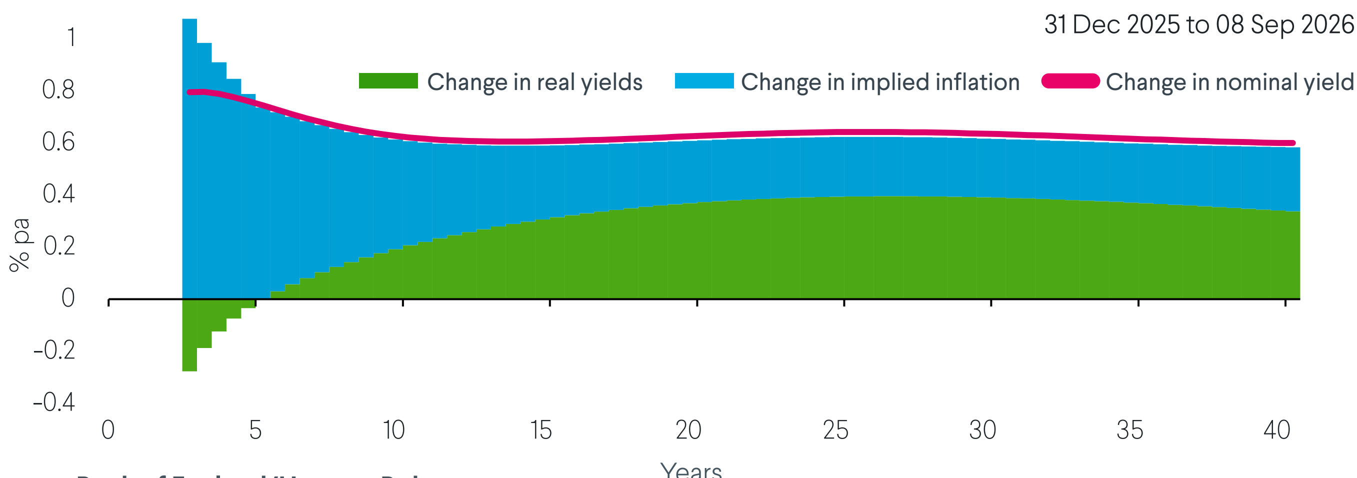
Looking at the data

Government bond yields can rise for several reasons, many of which are not inherently negative. Elevated yields may reflect stronger expected growth, higher inflation expectations, greater uncertainty, or stronger demand for capital.

To better understand recent market moves, we decompose changes in nominal gilt yields in two ways: first into real yields and implied inflation, and second into expected future interest rates and a simplified estimate of the term premium. Our term-premium estimate is based on movements in the spread between nominal gilt and swap yields – we treat this as indicative, rather than a pure measure of sovereign risk.

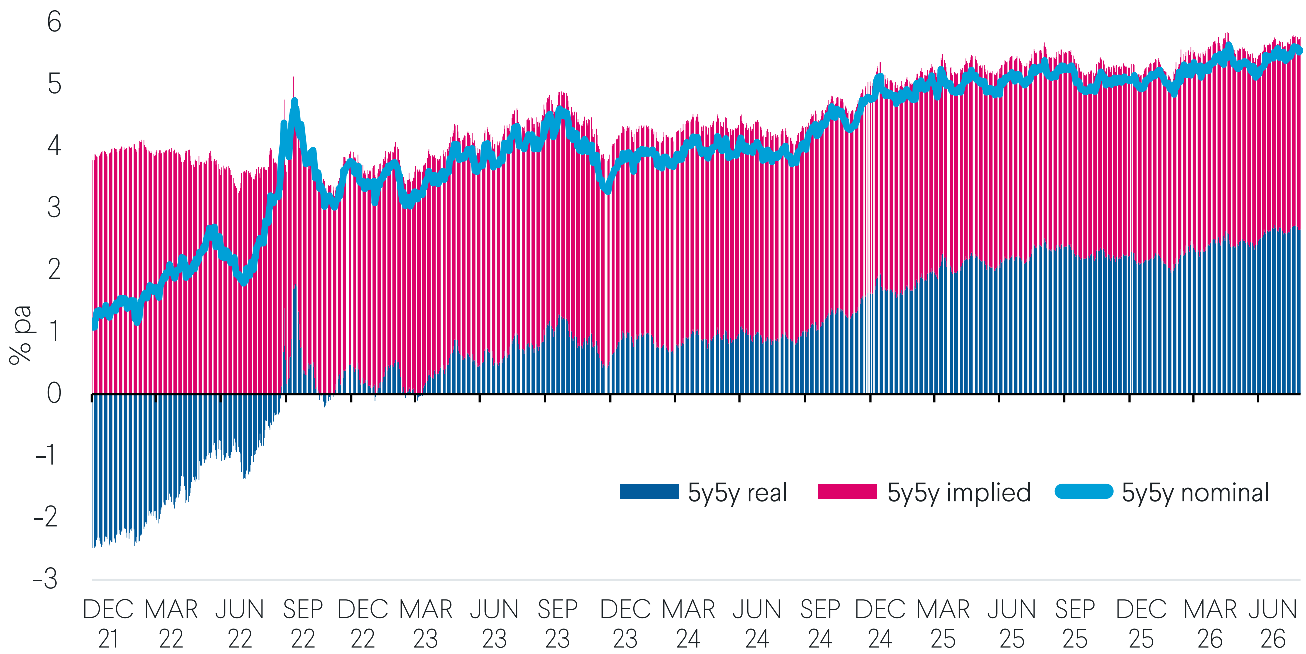
Chart 1 shows that higher implied inflation contributed to rising yields this year, particularly at shorter maturities. But Chart 2 shows that forward inflation expectations have remained relatively stable and that most of the increase in nominal yields since 2022–23 reflects rising real yields, rather than inflation expectations.

Chart 1: Implied inflation has risen, but real yields have risen more



Source: Bank of England/Hymans Robertson

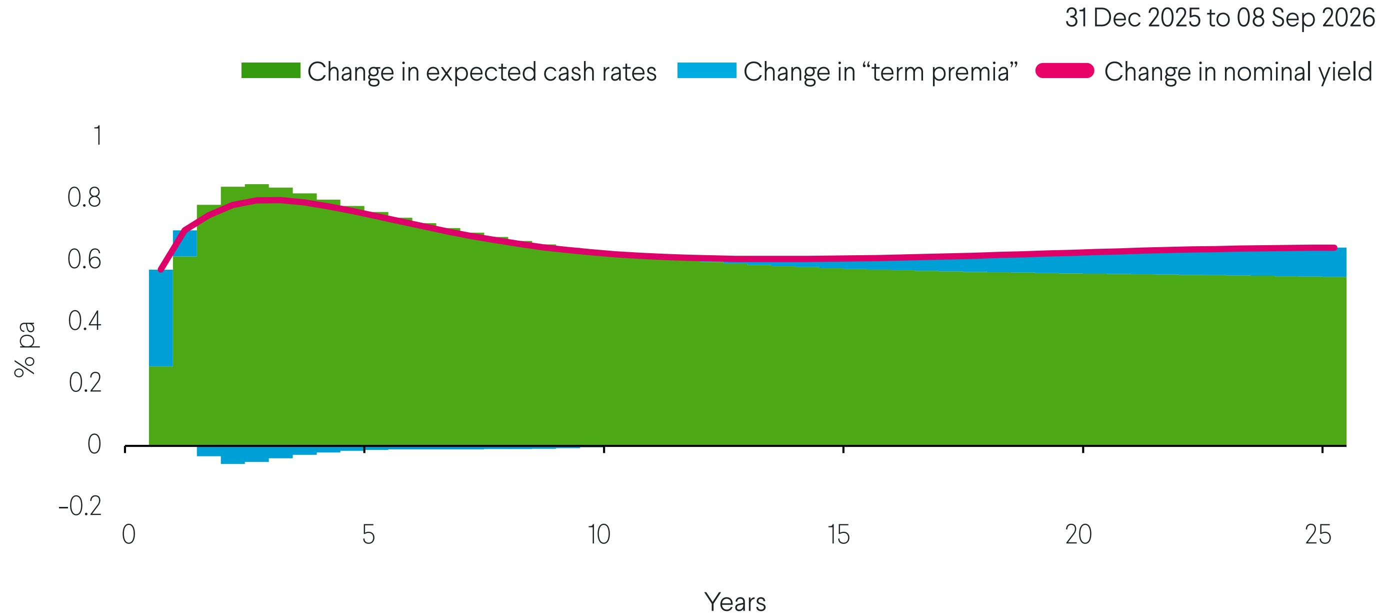
Chart 2: Rising real yields have been the primary driver of rising nominal yields post 2022–23



Fiscal concerns could eventually affect gilt valuations through higher inflation expectations. A government that borrows in its own currency can be more likely to reduce the real value of debt through inflation than to default outright. However, the limited movement in forward inflation expectations suggests this has not been a major driver of gilt yields this year.

Chart 3 points in a similar direction. Our simplified estimate for the term premium has only risen modestly this year, with the majority of rise in nominal yields due to the change in expected interest rates.

Chart 3: Term premia have not risen dramatically in 2026



Source: Bank of England/Hymans Robertson

Taken together, these observations provide limited evidence that investors are increasingly concerned about UK sovereign default risk.

Why have real yields risen?

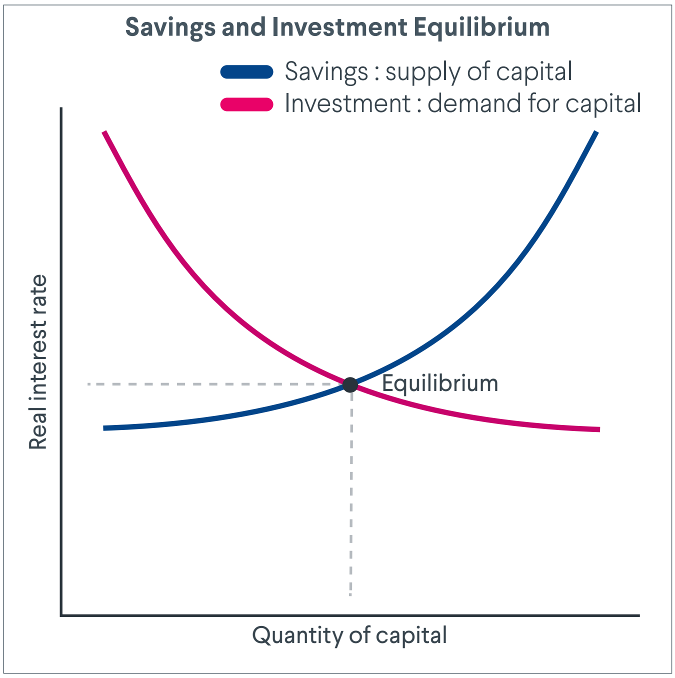
The more immediate question is why real yields have increased.

One plausible explanation is stronger demand for capital. Governments continue to borrow heavily, central banks are reducing their balance sheets, and substantial investment is being directed towards AI-related infrastructure and technology. Together, these developments increase the amount of capital that private investors are being asked to absorb.

Changes in the investor base may also be relevant. As defined-benefit pension schemes mature and the market evolves, shifts in demand across different parts of the gilt curve may result in greater price sensitivity than in the past.

In economic theory, stronger demand for capital raises the real interest rate required to balance saving and investment. Chart 4 illustrates this relationship. The rise in real yields is therefore consistent with increased demand for capital, although the available evidence cannot determine the relative importance of individual drivers.

Chart 4: An increased demand for capital raises the neutral real rate of interest



What else might be in the gilt price?

Gilts also play an important role as collateral within the financial system. As a result, their yields may reflect not only expected cashflows but also investor perceptions of uncertainty, volatility and market functioning.

For investors able to hold bonds to maturity, higher yields may improve prospective returns. For leveraged investors, however, higher volatility can increase collateral requirements, reduce capital efficiency and create liquidity pressures during periods of market stress.

The additional yield associated with these risks is not conventional compensation for default risk. It's perhaps more usefully viewed as compensation for uncertainty and volatility. Higher gilt yields may signal greater policy uncertainty or less efficient leveraged exposure, but they do not, by themselves, imply a material likelihood of UK government default.

Would switching from gilts to swaps remove the risk?

Gilts and interest-rate swaps are both widely used liability-hedging instruments. Their relative attractiveness varies over time according to pricing, liquidity, implementation costs and collateral requirements.

> Replacing gilts with swaps is not a simple way of avoiding UK fiscal or inflation risk.

While the legal structure differs, both instruments derive their value from the same sterling interest-rate environment and broader UK financial system.

If concerns centre on inflation, interest rates or market volatility, moving from gilts to swaps changes the nature of the exposure rather than removing it. Schemes are still exposed to sterling interest rates and, in the case of swaps, collateral and liquidity requirements.

However, the case for using swaps should rest on whether they offer better relative value, more precise maturity exposure or greater capital efficiency – not the assumption that they sit outside the risks affecting the UK gilt market.

Different risks for different investors

It's also worth remembering that the same gilts can represent very different risks to different investors.

For leveraged investors, higher volatility may create immediate liquidity and collateral pressures. For investors who may need to sell in the near term, mark-to-market losses matter. And for unleveraged investors able to hold to maturity, lower prices and higher yields may improve prospective returns.

For pension schemes with long-dated interest-rate and inflation-linked liabilities, gilts may also provide a close hedge for the risks that matter most. Looking at the asset in isolation, without considering the corresponding behaviour of liabilities, can therefore be misleading.

This is why describing gilts simply as 'safe' or 'unsafe' is rarely helpful. Investors should instead identify the specific risk being discussed, how alternative assets would behave under the same scenario and what additional return those alternatives offer.

Summing up

- While inflation concerns and fiscal considerations may have contributed to higher yields, rising real yields have been the main driver of recent moves.
- Forward inflation expectations and our simplified estimate of term premia provide limited evidence that markets are pricing a material risk of UK government default.
- Stronger demand for capital, driven by government borrowing, quantitative tightening, private-sector investment and a more price-sensitive investor base, provides one plausible explanation for higher real yields.
- Higher volatility and reduced collateral efficiency may matter for leveraged investors, but these risks are distinct from sovereign default risk.
- Gilts are neither entirely safe nor fundamentally unsafe. Investors should identify the specific risk being considered, assess how alternatives would behave under the same scenario and compare expected returns against the yields available in government bond markets today.

Next steps

To discuss these themes in the context of your portfolio, reach out to your usual Hymans consultant

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