Flash Economics

N° 96
September 22nd, 2026

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The vicious circle of rising long-term interest rates

Since the beginning of 2022, long-term interest rates (ten-year government bond yields) have risen sharply in the United States, the United Kingdom, Japan, Germany and the other euro zone countries. They have continued to rise since the beginning of 2026.

The difficulty is that the rise in long-term interest rates sets in motion a vicious circle which leads to further increases in those rates. It slows growth, thereby widening the fiscal deficit; it raises the debt-stabilising primary surplus. The need for fiscal consolidation is therefore markedly greater when long-term interest rates rise. This weakens government solvency and confidence in its ability to stabilise the public debt ratio, which in turn pushes long-term interest rates up further. It may prove difficult to escape this vicious circle, in which a rise in long-term interest rates feeds a further rise in those rates.

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The rise in long-term interest rates since 2022 and again since the beginning of 2026

Charts 1A and 1B show developments in **long-term interest rates** in the United States, the United Kingdom, Germany and Japan since the beginning of 2022; **Charts 2A and 2B** show the same developments since the beginning of 2026.

Chart 1A
10-year interest rate on government bonds (as %)

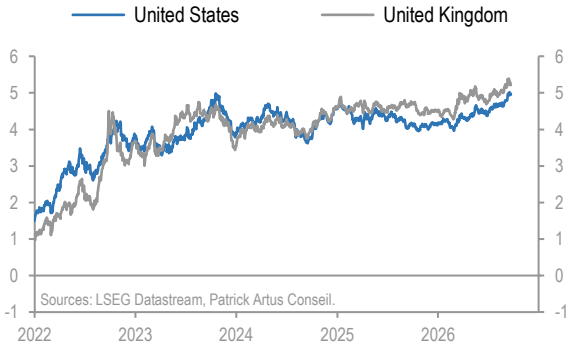


Chart 1B
10-year interest rate on government bonds (as %)

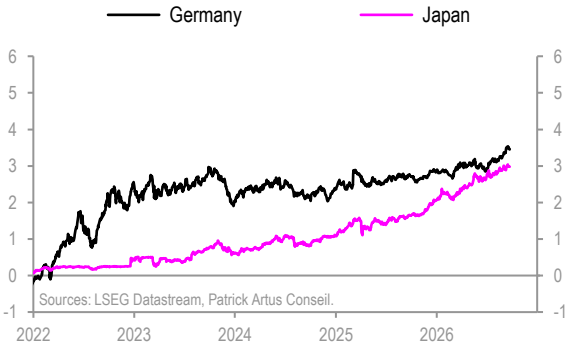


Chart 2A
10-year interest rate on government bonds (as %)

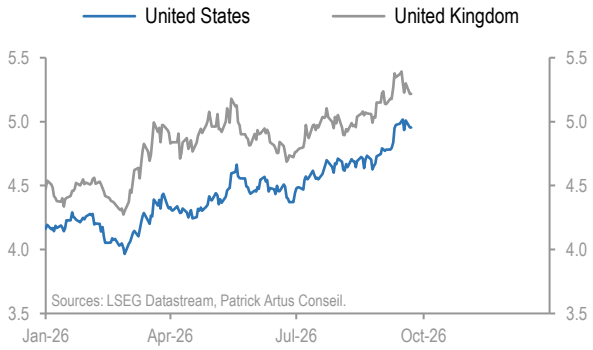
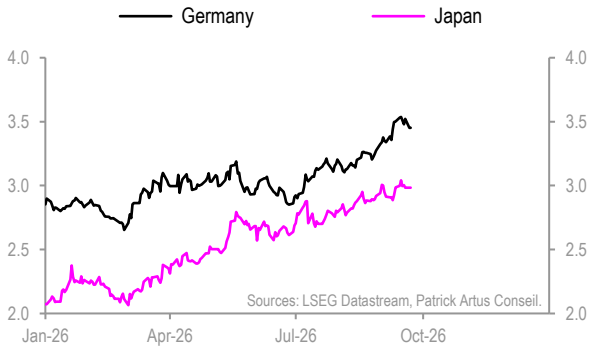


Chart 2B
10-year interest rate on government bonds (as %)



Long-term interest rates have risen in all these countries since 2022 and again since the beginning of 2026; in the other euro zone countries, the increase has been very close to that seen in Germany. This rise may have multiple causes:

- a rise in long-term inflation expectations;
- large fiscal deficits pushing up term premia;
- a loss of central bank credibility.

We seek to show here, however, that **it can set off a vicious circle** leading to a continuous rise in long-term interest rates.

Why can a rise in long-term interest rates lead to a further rise in long-term interest rates?

The first mechanism is that **the rise in long-term interest rates slows growth** by reducing business and housing investment; this in turn **reduces tax revenue and widens the fiscal deficit**. All these countries have recorded weak growth since the end of 2025 (**Charts 3A and 3B**), which may stem in part from the rise in long-term interest rates.

Chart 3A
Real GDP (Q/Q annualised, %)

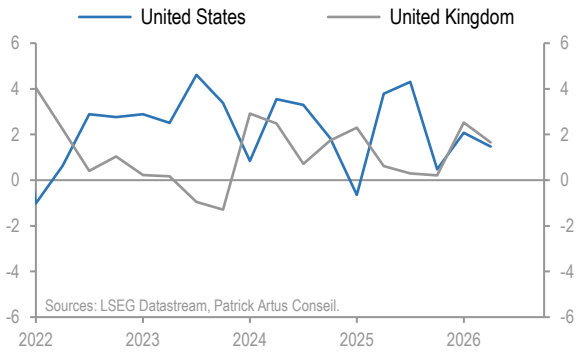
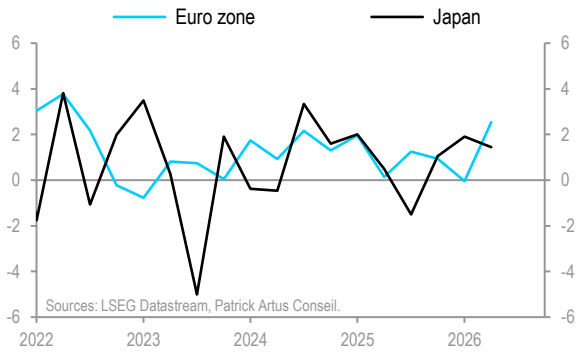


Chart 3B
Real GDP (Q/Q annualised, %)



The second mechanism is that when a rise in long-term interest rates is not matched by a similar increase in the growth rate, **it raises the primary surplus** (the budget balance excluding interest expenditure) **required to stabilise the public debt ratio**. **Charts 4A, 4B and 4C** show that **public debt as a percentage of GDP is rising in all these countries** except Japan.

Chart 4A
General government gross debt (as % of GDP)

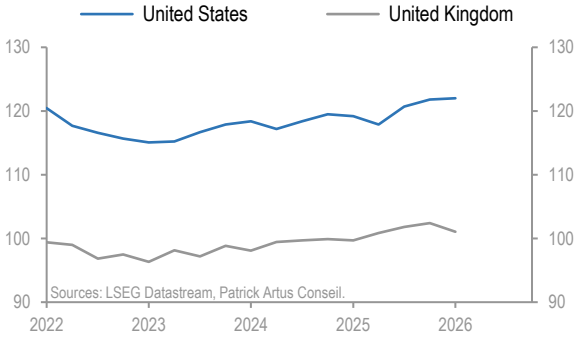


Chart 4B
Euro zone: General government gross debt (as % of GDP)

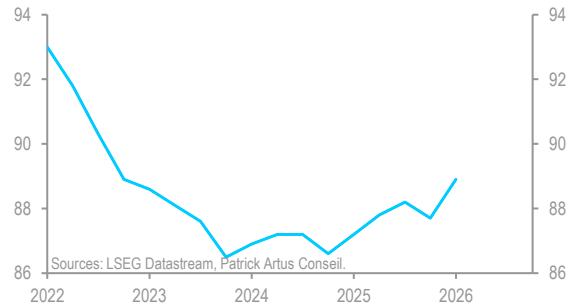
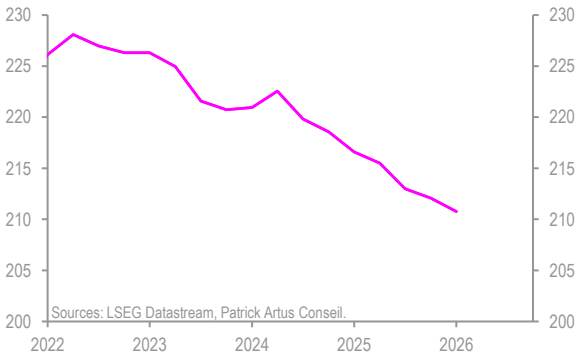


Chart 4C
Japan: General government gross debt (as % of GDP)



Japan, however, will also face a deterioration in its public finances, having decided to implement a large-scale stimulus package.

The increase in the primary surplus needed to stabilise the public debt ratio means that **a larger fiscal consolidation is required**. **The probability that this consolidation will actually be implemented therefore falls**, and **with it the country's fiscal credibility**, which leads to a further rise in long-term interest rates.

Summary: it is difficult to escape this vicious circle

In the situation prevailing today in the major OECD countries, a rise in long-term interest rates not matched by a similar increase in nominal growth:

- slows growth and therefore widens the fiscal deficit;
- raises the primary surplus required to stabilise the public debt ratio.

The result is a deterioration in public finances and a loss of fiscal credibility, leading to a further rise in long-term interest rates and the onset of a vicious circle in which any rise in long-term interest rates triggers a further rise in long-term interest rates.

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