



Decoding the World's Bond Markets

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Interest rates are the most important signal in a market-based economy and the universal price affecting all others.

— Edward Chancellor, author of *The Price of Time*

What the Curves Say Now

In June 2025, we published [Decoding the Bond Market](#), showing how a single day's yield curve, rather than a historical time series, can be used to extract the market's long-horizon expected short-term interest rate and the risk premium on offer for taking interest rate risk. Applied to U.S. rates on June 9th, 2025, the method implied a long-horizon expected nominal short rate of 3.85% and a real rate of 1.75%, for expected inflation of 2.1%, and a Sharpe ratio of 0.1 for bearing nominal interest rate risk.

¹ Past performance is no indication of future results.

We promised follow-up notes. Here, we revisit the U.S. and extend the analysis to the Euro-zone, the U.K. and Japan (yield curves as of September 16).

Fifteen months ago, the U.S. curve was inverted out to three years, pricing roughly 50 basis points of cuts. Today, the six-month rate is essentially unchanged at 4.18%, while the three-year sits 87 basis points higher than it was. The market has gone from expecting the Fed to cut by 50 basis points to expecting it to tighten by a similar amount. What a difference a year makes.

Further out, the moves are smaller. The 30-year rate is 0.56% higher, and the long-horizon expected short rate has risen only 0.26%, to 4.11%. In other words, most of the recent repricing has been in the next few years of the curve, rather than in the market's view of where rates settle long-term.

The expected long-horizon real rate is 2.05%, putting expected inflation at 2.06%, within a whisker of the 2.1% we found in June 2025. For all the movement in nominal rates, the market's long-run inflation view has not budged.

The Risk Premium

Table 1 shows interest rates for different maturities in U.S. dollars, Euros, U.K. Pounds and Yen, and what those yield curves imply in terms of a long-horizon short-term rate and the risk premium on offer for taking nominal interest rate risk in those currencies. The yield curves are the rates on interest rate swaps indexed against a safe, secured overnight rate, such as that on Treasury Bills or investments in overnight government bond repurchase agreements. For all of these markets, the swap rates are below government bond yields in each market, which we'll discuss later in this note.

The Sharpe ratio on U.S. nominal interest rate risk is 0.12, up from 0.10. Neither is an enticing reward for taking long-term bond risk.²

The final column of Table 1 puts that premium in more tangible terms: how many basis points of the 10-year par yield exist only to compensate for interest rate risk. For the U.S., the answer is 42. That figure sits below the U.K.'s 62 and Japan's 56, and modestly above the Euro-zone's 26.

² The third from right column of Table 1 labeled "annual volatility" is the market's implied volatility of 10-year options on 10-year interest rate swaps expressed in percentage points per year of normal volatility.

Table 1 — Nominal Yield Curves Decoded

Curve	Term Rates				Long-horizon expected short-term rate	Annual volatility (normal p.a.)	Sharpe ratio of rate risk	10 yr par rate risk premium impact (bp)
	6mo	3yr	10yr	30yr				
US Interest Rates	4.18%	4.61%	4.63%	4.67%	4.11%	0.85%	+0.12	+42
Euro Interest Rates	2.69%	3.14%	3.30%	3.34%	3.10%	0.69%	+0.09	+26
UK Interest Rates	4.06%	4.61%	4.85%	5.16%	4.24%	0.94%	+0.16	+62
Japanese Interest Rates	1.37%	2.00%	2.84%	3.62%	2.89%	0.76%	+0.18	+56

Interest rates are Observed, Overnight, Secured, derived from swap rates

Table 2 repeats the exercise on real yields. As with nominal rates, we use rates consistent with the interest rate swap market, so that the credit quality and balance sheet characteristics of government bonds do not enter the interest rate itself.

The U.S. real term structure again embeds a risk premium close to that of nominal rates — 0.10 against 0.12 — which remains a puzzle. If the purpose of wealth is to support consumption, an inflation-protected long bond is the closest thing to a riskless asset, and ought to command no excess compensation, rather than roughly the same as its nominal counterpart.

For France and Japan, we have reliable real rates only out to ten years, so those fits have no long-dated anchor, and hence the implied risk premium is a much less robust measure of the true risk premium.

Table 2 — Real Yield Curves Decoded

Curve	Term Rates				Long-horizon expected short-term rate	Annual volatility (normal p.a.)	Sharpe ratio of rate risk	10 yr par rate risk premium impact (bp)
	6mo	3yr	10yr	30yr				
US Real Rates	2.05%	2.16%	2.29%	2.42%	2.05%	0.60%	+0.10	+25
Euro (French) Real Rates	1.00%	1.44%	2.10%	n/a	1.84%	0.48%	+0.23	+46
UK Real Rates	0.25%	0.44%	1.43%	1.76%	1.69%	0.66%	+0.09	+25
Japanese Real Rates	0.00%	0.15%	0.74%	n/a	0.29%	0.53%	+0.26	+60

Interest rates are Observed, Overnight, Secured, derived from swap rates

Swap Spreads and Sovereign Credit

Finally, Table 3 shows the spread of government bond yields above interest rate swaps representing future overnight secured rates — SOFR, €STR, SONIA and TONA for Dollar, Euro, Sterling and Yen interest rates.

The U.S. 30-year spread has narrowed from 0.84% a year ago to 0.69%, which is welcome but still wide. The most striking number is France: 1.17% at ten years and 1.78% at 30, against Germany's 0.21% and 0.53%. Two markets sharing a currency and a central bank should not differ by a full percentage point on anything other than credit.

As we wrote in June 2025, these spreads concern us. Many observers explain them as arising from balance-sheet constraints and other market technicals, and that may be most of the story – but the French figure is hard to read as a technical phenomenon when the German one, subject to the same plumbing, is a quarter of the size. We can't help thinking some of it represents a real risk of sovereign default or restructuring.

Table 3 — Government Bond Spreads

Market	10 yr swap spread	30 yr swap spread
US	0.39%	0.69%
German	0.21%	0.53%
French	1.17%	1.78%
UK	0.45%	0.70%
Japan	0.17%	0.51%

Government bond spreads above overnight secured interest rate swaps

Connecting the Dots

The market is offering a Sharpe ratio of 0.12 for bearing U.S. nominal interest rate risk and 0.10 for bearing real rate risk alone. The difference is what you're being offered to take inflation risk, and it rounds to nothing.

The U.S. inflation breakeven rates sharpen the point. Long-run implied expected inflation is 2.06% in the U.S., which also pushes us away from wanting to own long-term U.S. nominal interest rate risk. That view is consistent with what you see in Elm portfolios, where our long-term U.S. rate exposure is primarily inflation-protected.

Perhaps the most ominous number in this note isn't an interest rate at all. It's the 1.78% between 30-year French government bonds and euro swaps, and 1.25% spread to German Bunds.

None of this argues for heroics. It argues for holding long-term rate exposure in inflation-protected form, for preferring the cleanest sovereign credit available in each currency, and for not confusing a steep curve (measured from the shortest to longest maturity interest rates) with one offering a generous risk premium.