

High Yields: A Potential Fault Line for Debt Dynamics of Advanced Economies

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Executive Summary

Advanced Economies have had elevated public debt for two decades now. What has changed more recently is the cost of carrying this debt. In previous episodes of high debt, advanced economies benefited from low borrowing costs, which helped contain debt servicing pressures following the global financial crisis.

As economies pursued monetary tightening in 2022 to address the inflationary pressures, yields rose across most of the advanced economies. Most countries have entered easing cycles since then; however, it has not translated into a meaningful decline in long-term sovereign yields. These persistently high yields reflect underlying fiscal concerns faced by advanced economies.

Fiscal pressures are increasingly shaped by a combination of structural and cyclical rigidities, as reflected in widening primary deficits. This is primarily due to four reasons:

- **Demographic pressures:** Most of these economies are facing an unfavourable demographic transition, which has added to fiscal pressures through ageing-related expenditures and persistently rising healthcare costs.
- **Growth concerns:** Additionally, medium-term growth prospects could be weighed down by an external environment shaped by geopolitical tensions, trade fragmentation, and prolonged uncertainty.
- **Higher defence spending:** Further, higher defence and security-related spending, driven by geopolitical tensions that are no longer episodic, carries tangible fiscal costs.
- **Inability to implement reforms:** Meanwhile, the institutional capacity to manage these fiscal and economic headwinds has weakened due to political fragmentation and declining institutional strength. This has reduced policymakers' capacity to manage an increasingly expansionary fiscal stance without undermining fiscal credibility.

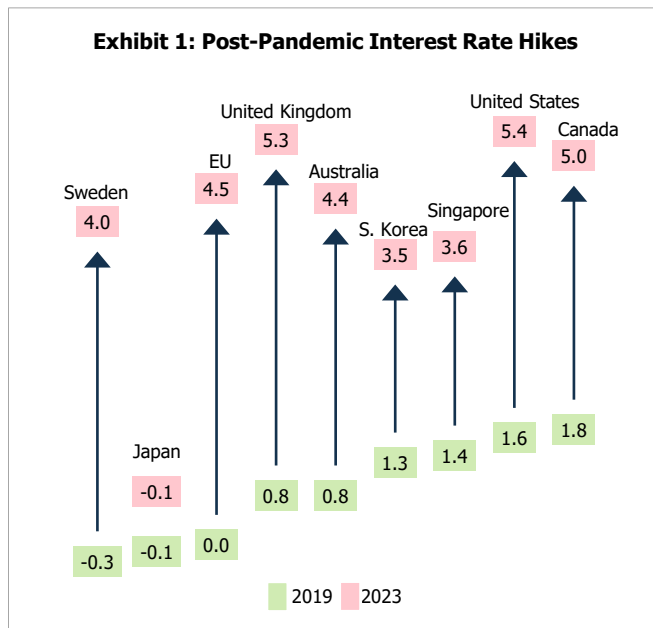
The confluence of these challenges has begun to feed into market concerns over future debt dynamics. Consequently, despite the ongoing cycle of policy rate easing, sovereign yields remain elevated relative to their earlier lows.

As these higher borrowing costs coincide with subdued growth, interest-growth differential ($r-g$), an important metric of debt sustainability, is also expected to turn relatively less favourable across most advanced economies. This could reduce the ability of ($r-g$) to partly or fully offset primary deficits, placing upward pressure on debt ratios, particularly in the context of widening fiscal deficit.

The consequences will not be uniform. There could be differential implications for advanced economies due to differences in their economic structure, growth potential and institutional strength. Further, policy credibility for each country will matter more than ever in determining how individual advanced economies navigate this new environment.

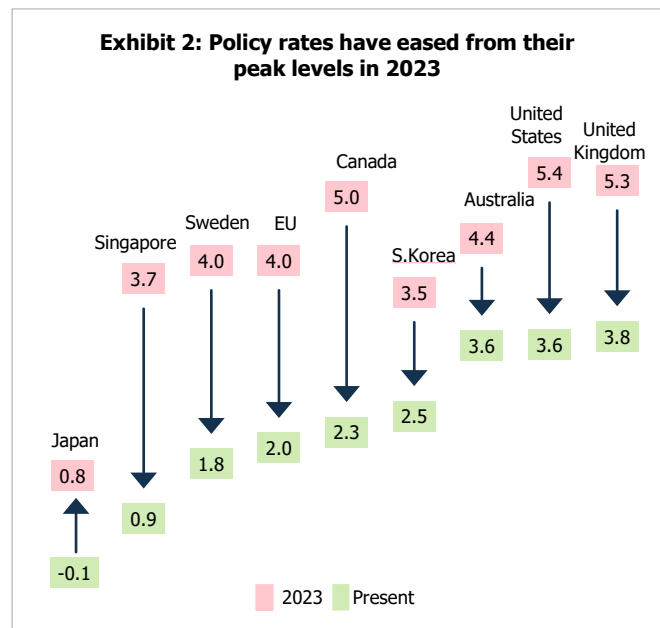
Yields Expected to Remain Higher for Longer

Sovereign borrowing costs across advanced economies have entered a structurally higher regime. Even as central banks have begun easing policy after the post-2022 tightening cycle (Exhibit 1 & 2), long-term sovereign yields remain elevated relative to pre-pandemic norms. This persistence signals a deeper shift in market pricing. Yields are no longer anchored primarily by expectations of policy rates, but increasingly by concerns over fiscal sustainability, growth capacity, and institutional resilience.



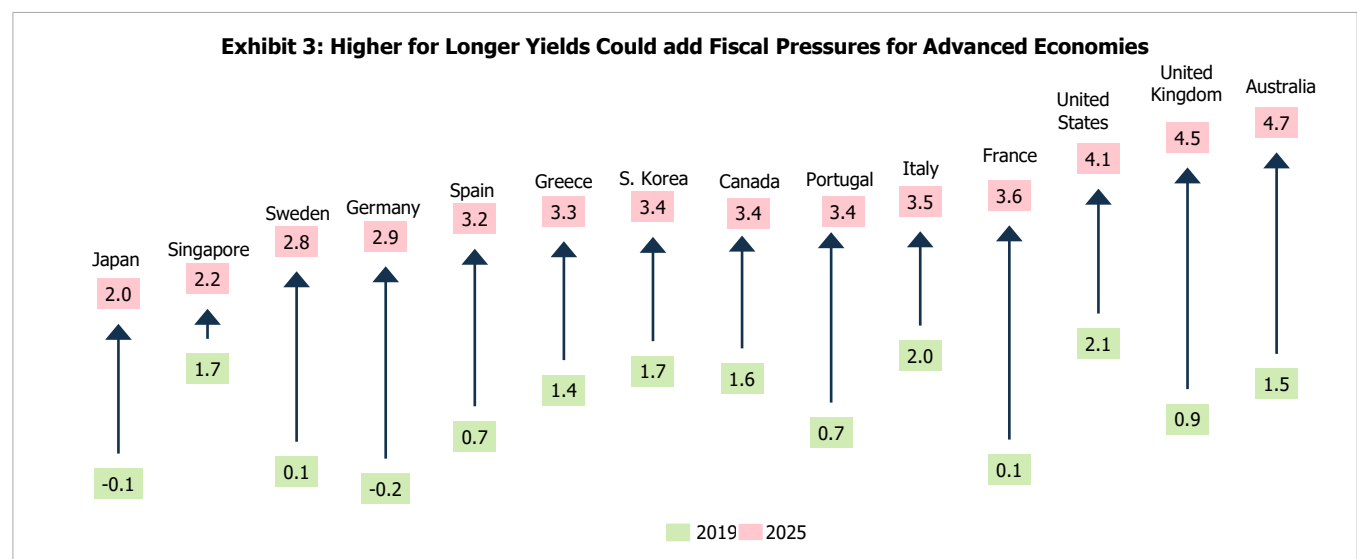
Source: Haver Analytics, CGIL

Note: Data represents policy rates



Source: Haver Analytics, CGIL

Despite this, markets are reassessing the ability of advanced economies to carry high public debt in a world of slower growth, rigid spending structures, and rising structural risks. The result is a higher risk premium embedded in long-dated sovereign debt, keeping yields higher for longer (Exhibit 3).



Source: Haver Analytics, CGIL

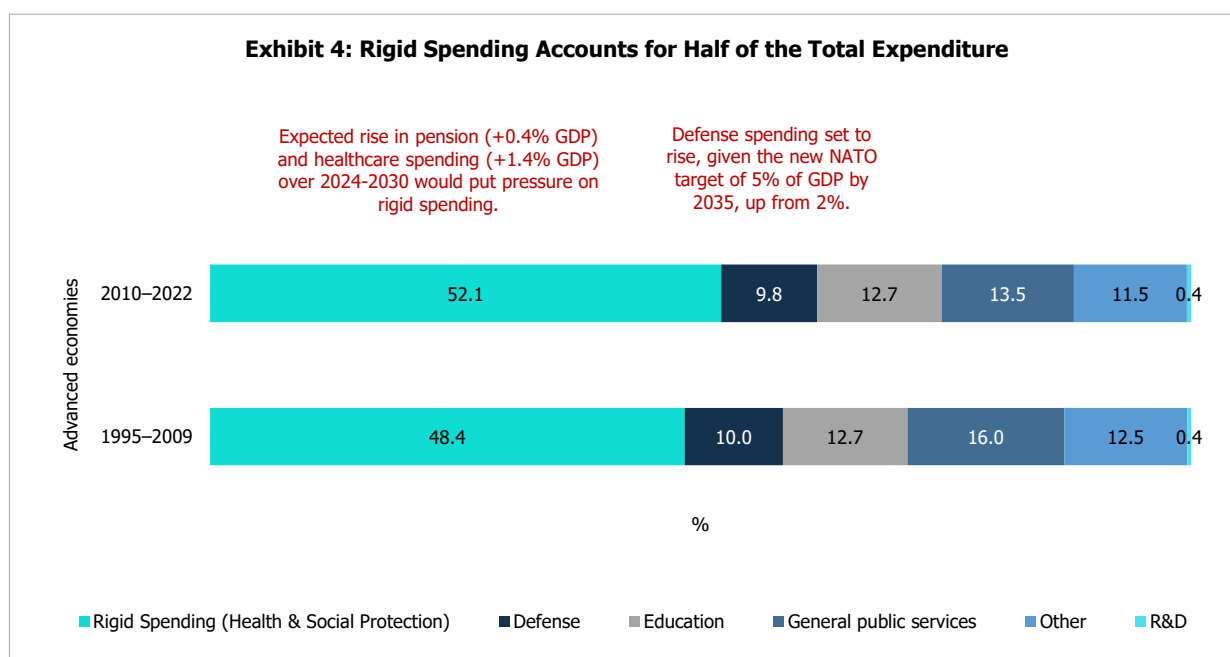
Note: Data represents 10-year government bond yields (%)

The Drivers Behind Persistently Elevated Yields

a) Fiscal challenges prolong for advanced economies (rigid spending & elevated debt levels)

Rigid Spending: A defining fiscal challenge for advanced economies is the growing rigidity of their public spending. Unfavourable demographic trends lie at the core of this shift. Since the early 2010s, the share of the population aged 65 and above has risen sharply, pushing many economies from being 'aged' into 'super-aged' demographic categories.¹

Exhibit 4 shows that inflexible spending has accounted for around half of total expenditure for nearly two decades, highlighting the persistence of fiscal rigidities. These pressures have intensified since the pandemic, as support measures for households and firms have been difficult to unwind, keeping subsidies elevated and public-sector wage bills sticky. As a result, spending in advanced economies has tilted further toward non-discretionary items, particularly health and social expenditure. This persistence suggests that underlying structural pressures are unlikely to ease materially in the near term, and even modest increases in non-discretionary spending can erode fiscal flexibility during economic downturns.



Source: IMF, CGIL

Note: Rigid Spending includes spending on health and social protection

National authorities have also highlighted rising rigid expenditure pressures amid ageing populations.

- For instance, in France, the public audit office has issued a warning regarding the high healthcare, pensions and elderly support costs that could absorb more than 40% of public spending and push overall outlays above pandemic-era highs without reforms.
- Similarly, the Central bank of Germany (Bundesbank) has highlighted the mounting fiscal strain from pension commitments and an ageing workforce, noting that recent policy adjustments are unlikely to alleviate long-term budgetary pressures sufficiently. This dominance of rigid, consumption-oriented

¹United Nations refers to the share of the population over 60 to define how old a country is. For developed countries a line drawn at age 65 is preferred, because this is normally when people can claim social security. Thus, a country is defined as "aging" when the share of people aged 65+ is above 7%, "aged" when it is 14% or more, and "super-aged" when it exceeds 20%.

spending is expected to further crowd out the momentum for private investment. With the rising share of rigid spending in total expenditure in advanced economies, productivity-enhancing public expenditure, such as infrastructure, education, and innovation, has been increasingly constrained.

High Debt: In addition to expenditure rigidities, elevated debt levels are intensifying fiscal pressures. Advanced-economy public debt stood at 109.1% of GDP in 2024 and is projected to rise to around 118.5% by 2030, approaching pandemic-era peaks. Given that advanced economies account for nearly 60% of global sovereign debt, the scale of their indebtedness carries significant global implications.

b) Slower growth continues under broad economic headwinds

In the past three years (2022–24), average growth in advanced economies was around 2.2%, but projections for 2025–27 point to a slower pace of about 1.7%, with elevated uncertainty clouding the medium-term outlook. This uncertainty reflects near-term cyclical pressures, including weaker global demand, trade fragmentation, and ongoing geopolitical developments. These pressures are unfolding against longstanding structural headwinds such as ageing populations, modest productivity gains, and subdued private investment, partly due to fiscal crowding-out effects, which are expected to continue weighing on growth prospects in advanced economies.

c) Policy flexibility constrained by institutional and political factors

Advanced economies have long benefited from strong institutional frameworks, which have enabled them to navigate complex macroeconomic episodes. However, this institutional capacity has moderated from earlier peaks, reflecting rising political fragmentation and increasing polarisation in policy discourse. This has weakened the ability to execute policy reforms, therefore, policies involving tax increases or spending controls, are increasingly met with public resistance. Episodes of social unrest and widespread protests have further complicated reform efforts, weakening regulatory effectiveness and slowing the pace of policy implementation. At the same time, institutional weakness is also reflected in concerns around central bank independence, which is coming under pressure.

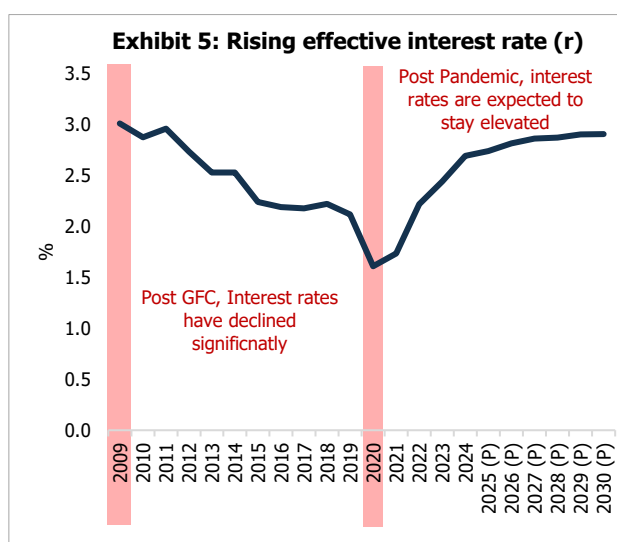
- France and Germany are increasingly facing social and political resistance to pension reforms as ageing populations raise long-term fiscal pressures. Efforts to contain pension spending have met strong backlash, particularly from younger generations who perceive a disproportionate burden in the form of higher contributions and longer working lives. The repeated dilution of reforms amid protests highlights growing institutional constraints in adapting welfare systems to demographic realities.
- In the United States, institutional challenges have taken a different form. Recurrent debt ceiling negotiations have introduced periodic uncertainty around fiscal governance and budget execution, even though ultimate resolution has been consistently achieved. These episodes underscore procedural constraints within the fiscal framework, which can complicate medium-term fiscal planning and heighten market sensitivity during periods of political impasse. Further, central bank independence in the United States has come under pressure from increased political interference in the Federal Reserve (Fed)'s leadership, raising questions about Fed's policy autonomy.
- In Spain, political fragmentation has made it difficult to secure parliamentary approval for new state budgets, with the government operating under the rollover of the 2023 budget provisions into subsequent years, including 2024, 2025 and 2026. This constrained legislative environment has reduced the scope for discretionary policy adjustment.

Consequences of Fiscal Challenges Faced by Advanced Economies: Growing Risk to Debt Sustainability

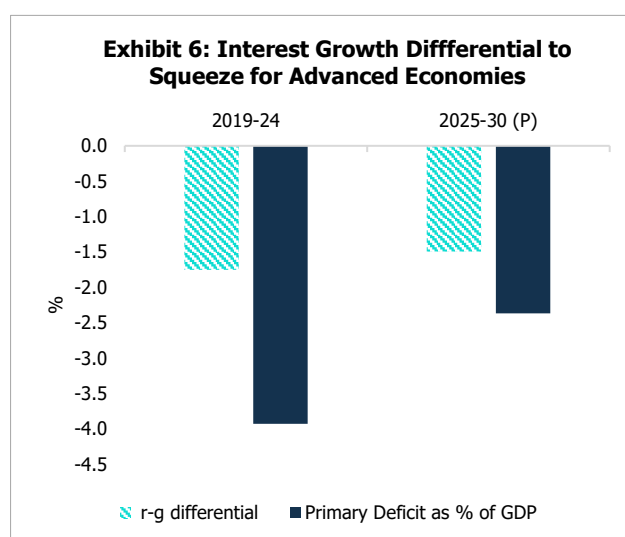
With higher-for-longer sovereign yields, advanced economies are expected to face a new set of challenges, including the narrowing of the interest-rate-growth differential ($r-g$) and the rising burden on debt affordability.

a) Unfavourable interest- growth differential ($r-g$)

The elevated sovereign yields are expected to keep the effective nominal interest rate (r) high, as shown in Exhibit 5. This combined with a weakening growth outlook, is expected to weigh on a key debt sustainability metric- the interest-growth rate differential ($r-g$), which is likely to turn relatively unfavourable across advanced economies. The $r-g$ differential, as shown in Exhibit 6, is a critical determinant of debt dynamics: debt remains manageable when the effective interest rate on government borrowing is lower than the rate of nominal GDP growth, i.e., the interest-growth differential ($r-g$) is negative. This negative differential can partly/ fully offset the impact of primary deficits, thus keeping the debt ratio stable. With the expectation of persistently high interest rates, the ($r-g$) differential is expected to turn relatively unfavourable in a few advanced economies. This is particularly concerning in economies where fiscal deficits are already widened. Therefore, the secular rise in debt levels due to these unfavourable metrics could be irreversible, unless steps are taken to address them.



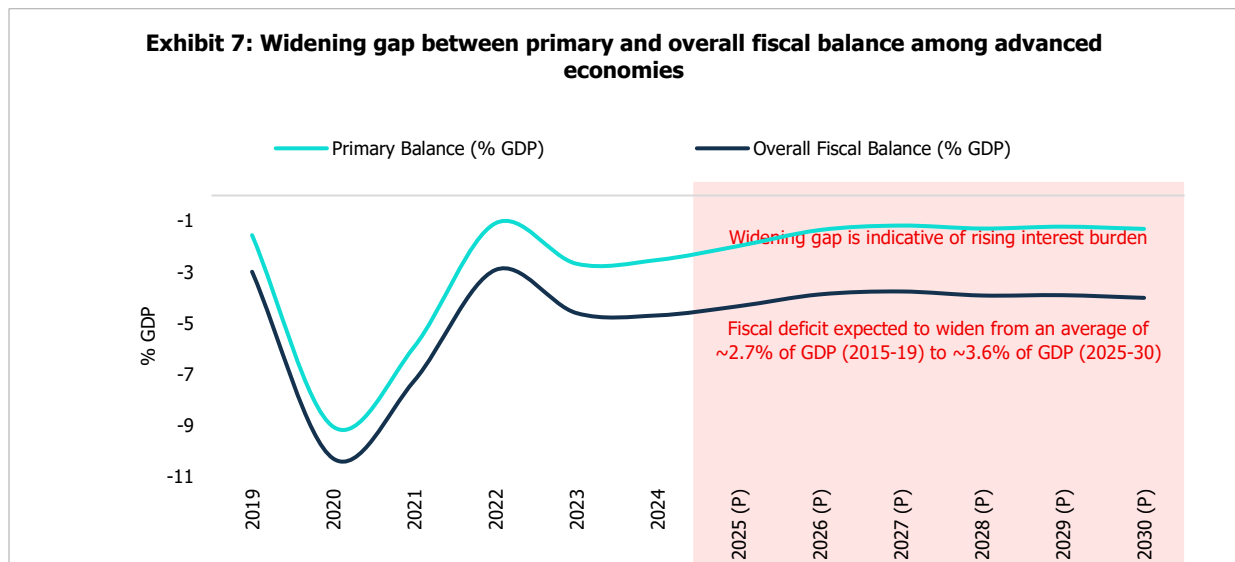
Source: IMF, (P) = IMF Projections, CGIL



Source: IMF, (P) = IMF Projections, CGIL

b) Widening gap between primary and fiscal deficit indicating rising interest burden

The difference between the fiscal balance and the primary balance captures the interest payment burden. While this gap remained relatively narrow in the pre-pandemic period, it is now expected not only to persist but to widen, reflecting a rising interest burden. In a higher-for-longer yield environment, borrowing costs are increasing, pushing interest expenditure higher across advanced economies. As a result, the gap between the fiscal and primary balances is set to widen on a more structural basis than in the pre-pandemic period, as illustrated in Exhibit 7.



Source: IMF; (P) = IMF Projections, CGIL

How the Current Macro-Fiscal Reality Plays Out Across Advanced Economies

While advanced economies face broadly similar fiscal challenges, their scale and impact vary across countries, reflecting differences in extent of existing structural fiscal issues, the pace of change in debt dynamics, and institutional strength to absorb fiscal risks. As a result, the extent to which elevated debt levels translate into sustainability pressures differs materially across sovereigns.

Based on our assessment of debt sustainability metrics, we aim to capture the extent of structural fiscal issues across advanced economies as shown in Exhibit 8.

- This is measured through the stock of public debt (2025) and debt affordability, assessed by interest-to-revenue ratios (2020–24).
- In addition, we assess the expected change and pace of change in debt dynamics, measured through a combination of movements in the interest-growth rate differential ($r-g$), primary fiscal balances, and the resultant impact on public debt levels.
- This fiscal performance is viewed along with reform momentum, as measured through CGIL's assessment of institutional strength within its advanced economies framework. On this basis, advanced economies in our coverage universe are grouped into three distinct categories.
 - **Category 1: Elevated Debt risks** - include economies that could face elevated fiscal risks, driven by the convergence of multiple factors outlined above unless steps are taken to address them.
 - **Category 2: Manageable Debt Burden Supported by Fiscal Discipline** – includes economies where structural fiscal challenges are counterbalanced by fiscal discipline, allowing for better management of fiscal risks.
 - **Category 3: Comfortable Fiscal Position** - comprises economies which have comfortable fiscal position, supported by lower structural fiscal vulnerabilities.

Exhibit 8: Country-wide Analysis

	Fiscal Challenges Sovereign	Structural Fiscal Issues		Expected Direction and Pace of Change			Reform momentum
		Stock of Debt	Debt Affordability	Interest-Growth Differential (2025-30) (P)	Primary Deficit as % of GDP (2025-30) (P)	Change in Debt (2025-30) (P)	CGIL Institutional Assessment
Category 1: Elevated Fiscal Risks	France (A+ /Stable)						
	USA (AA+ /Negative)						
	Italy (BBB /Stable)						
	UK (AA- /Stable)						
	Japan (AA- /Stable)						
Category 2: Manageable Debt Burden Supported by Fiscal Discipline	Greece (BB+ /Stable)						
	Spain (A /Stable)						
	Portugal (A+ /Stable)						
	Canada (AA+ /Stable)						
	Germany (AAA /Stable)						
Category 3: Comfortable Fiscal Position	S. Korea (AA- /Stable)						
	Australia (AA+ /Stable)						
	Singapore (AAA /Stable)						
	Netherlands (AAA /Stable)						
	Sweden (AAA /Stable)						

Unfavourable  Favourable

Source: IMF; (P) = IMF Projections, Haver Analytics, CGIL

Group 1: Elevated Fiscal Risks

Group 1 comprises economies where multiple factors are adverse, thus amplifying vulnerabilities. While these economies retain certain credit strengths, the durability of these buffers will increasingly depend on the pace at which weakened fiscal parameters are addressed. For some, the convergence of high debt levels and rising interest expenditure could gradually erode fiscal flexibility over the medium term unless steps are taken to address them.

- **France (CareEdge A+ /Stable)** faces structurally high fiscal deficits, subdued growth prospects, and a fragmented political environment, which limits ability to introduce and implement reforms. Our recent downgrade of France reflects a weak fiscal track record, compounded by limited capacity to implement durable expenditure consolidation, with policy unpredictability weighing on debt sustainability metrics.
- Similarly, the **United States (CareEdge AA+ /Negative)** remains on an expansionary fiscal path despite already elevated deficits. While robust growth in recent years helped absorb part of the fiscal strain, this support is expected to diminish as economic momentum moderates, even as inflation risks persist. Under current policy settings, the primary deficit is projected to widen to around 3.5% of GDP, one of the highest among advanced economies. At the same time, policy unpredictability and a gradual erosion of institutional credibility are adding to downside risks. Interest payments relative to revenue remain among the highest in the peer group and is also expected to increase over medium term, signalling fiscal risks.
- **Italy (CareEdge BBB /Stable)** continues to face an elevated debt burden, with public debt averaging around 137% of GDP over 2025–30. Weak trend growth and limited reform capacity continue to constrain

fiscal flexibility and underpin our credit assessment. Recent fiscal discipline is a notable offset, with surplus in primary balances for two consecutive years. While this helps moderate future debt-related pressures, sustained and credible consolidation will be required to materially improve debt sustainability.

- In the **United Kingdom (CareEdge AA-/Stable)**, commitments to fiscal consolidation are clouded by uncertainty around fiscal policy, against the backdrop of persistently wide post-pandemic deficits, slowing growth, and ongoing inflationary pressures.
- **Japan (CareEdge AA-/ Stable)**'s economy has reached an inflection point where recent shifts in macroeconomic conditions and policy settings mark a departure from the prolonged period of exceptionally favourable debt affordability. This is accompanied with already high levels of debt and low growth momentum, which raises fiscal risks. While Japan's credit profile has some buffers, including a robust public-sector balance sheet, a strong external position that offsets elevated fiscal risks, and a still-negative interest-growth differential ($r-g$) that helps absorb persistent primary deficits, the durability of these strengths will depend on the pace of fiscal adjustment, trajectory of interest rates and nominal growth trend.

Group 2: Manageable Debt Burden Supported by Fiscal Discipline

Group 2 includes economies where structural fiscal risks are present, amid elevated or rising debt levels, but are partly mitigated by sustained policy discipline, improving growth dynamics, and supportive institutional frameworks.

- **Greece (CareEdge BB+/Stable)** continues to carry very high public debt, but its fiscal performance in recent years has been notable, signalling a clear improvement in its fiscal trajectory. The return to a fiscal surplus in 2024 reflects sustained policy discipline and structural reforms that have strengthened revenue performance and expenditure control.
- **Spain (CareEdge A/Stable)** and **Portugal (CareEdge A+ / Stable)** represent this where continued fiscal prudence, strengthened growth trajectories, and reform-oriented institutional frameworks have translated into a sustained reductions in public debt and improved debt sustainability profiles.
- **Germany (CareEdge AAA/Stable)** also belongs to this category. Its long-standing fiscal discipline and strong institutional credibility continue to offset emerging risks, despite a strategic shift away from the strict debt brake rule toward higher public investment to support medium-term growth.
- **Canada (CareEdge AA+/Stable)** High debt levels are accompanied by a relatively elevated interest burden compared with advanced-economy peers. These pressures are partially offset by a strong balance sheet, which helps temper concerns around the economy's elevated debt levels.

Group 3: Comfortable Fiscal Position

Group 3 comprises economies that benefit from low debt levels, strong debt affordability, and robust institutional capacity, positioning them well to absorb macroeconomic and financial shocks.

- **The Netherlands (CareEdge AAA/Stable)** and **Sweden (CareEdge AAA/Stable)** stand out in this cohort, supported by prudent fiscal management, favourable interest burdens, and strong institutional frameworks. These strengths provide these economies with ample headroom to navigate an environment of heightened uncertainty while preserving fiscal sustainability.
- **South Korea (CareEdge AA-/Stable)** faces rising fiscal pressures from unfavourable demography, although these are meaningfully offset by its currently low public debt levels and a comfortable debt-

affordability profile. Supported by relatively stronger growth prospects, fiscal pressures are expected to remain manageable over the medium term.

- **Australia (CareEdge AA+/Stable)**'s fiscal position remains comfortable, underpinned by low public debt, a track record of fiscal discipline, and forward-looking policy planning supported by strong governance and institutions.
- **Singapore (CareEdge AAA/Stable)**'s high public debt is not a fiscal challenge due to underlying fiscal prudence, as reflected by substantial financial assets and institutional issuances to support domestic capital markets and meet long-term savings needs, rather than budget financing.

Conclusion

Overall, many advanced economies no longer benefit from the comfortable interest–growth differentials that previously helped stabilise debt dynamics. As financing costs normalise and growth remains modest, this narrowing cushion increasingly constrains fiscal space and reduces tolerance for slippages. Against this backdrop, the fiscal outlook will depend on the ability to rebuild buffers through credible consolidation efforts, while advancing reforms that support growth and spending efficiency. The extent to which policymakers can manage this transition will remain a key determinant of debt sustainability and sovereign credit profiles.

Contact

C-Pawan Agrawal	Advisor	C-Pawan.Agrawal@careedge.in
Nitesh Jain	Chief Rating Officer	Nitesh.jain@careedgeglobal.com
Kiran Kavala	Senior Director	kiran.kavala@careedgeglobal.com
Annie Mahajan	Senior Economist	annie.mahajan@careedgeglobal.com
Amya Parmar	Associate Economist	amya.parmar@careedgeglobal.com
Hemasree Tummaluru	Associate Economist	hemasree.tummaluru@careedgeglobal.com
Mradul Mishra	Media Relations	mradul.mishra@careedge.in

CareEdge Global IFSC Limited

(subsidiary of CARE Ratings Ltd.)

Unit No. 501, 5th Floor, FLEXONE, GIFT SEZ, GIFT City, Gandhinagar – 382050, Gujarat, India.

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