GENERALI ASSET MANAGEMENT

Core Matters

Global imbalances put upward pressure on US Treasury yields

Thomas Hempell, Michele Morganti, Florian Späte, Guillaume Tresca, Martin Wolburg, Paolo Zanghieri

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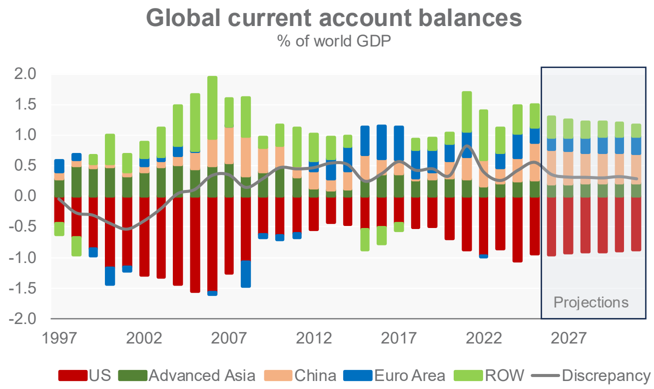
Our Core Matters series provides thematic research on macro, investment, and insurance topics

- Global imbalances are back near the levels seen before the 2008 crisis, but the economic background is different. They widened to around 3% of world GDP in 2025, close to the 3.8% peak in 2006, yet this has occurred alongside a rise in real rates, indicating strong demand, in contrast to the low-rate savings-glut environment of the mid-2000s.
- The US remains the main deficit country, with the current account balance widening from around 2% of GDP before the pandemic to 3.7% expected by the IMF for 2026. The deterioration reflects strong domestic demand, expansionary fiscal policy and a weaker income balance. The US no longer earn on foreign assets more than they pay on foreign liabilities, an indication that the dollar's 'exorbitant privilege" is eroding.



Source: IMF, GenAM

- China and advanced Asia are exporting domestic weakness and manufacturing strength. China's current account surplus is expected at 2.5% of GDP in 2026, while its goods surplus exceeds USD 1.2trn, supported by weak domestic demand, high savings, CNY depreciation and strong Electric Vehicles, battery and solar exports.
- The US can still finance its external deficit, thanks to the appeal of its equity market which may still have legs but is subject to higher volatility than bond inflows. Importantly, the UST buyer base has changed. The Fed and foreign official investors have reduced their role, while private investors now absorb more supply. This makes Treasury demand more price-sensitive, which risks pushing up yields via the term premium. And Treasuries' safe-haven role is less automatic when shocks originate from US policy itself, as shown by the sell-off following "liberation day" tariffs in 2025.
- The dollar remains dominant, accounting for 57% of global FX reserves and appearing on one side of 89% of FX transactions. But the case for diversifying away is gradually emerging.
- Treasuries remain core safe assets, but higher supply, a smaller safe-asset discount and a more yield-sensitive buyer base point to more long-end volatility and better compensation before adding duration.

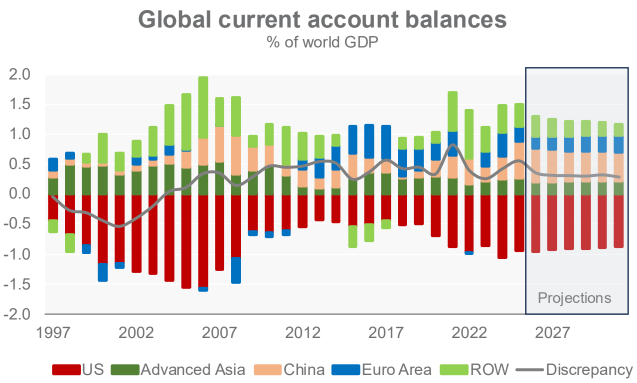
CONTENT

1. Global imbalances are back, but not as before

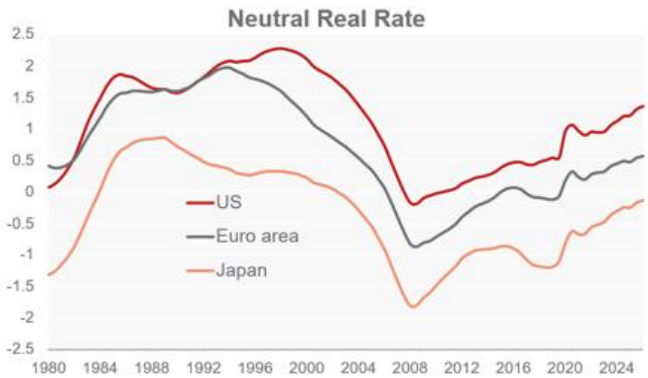
Imbalances have returned, but now push rates higher, not lower.

Global imbalances matter because they affect the price required to clear global saving and investment: the real interest rate. Defined as the sum of absolute deficit and surplus positions, global imbalances peaked at 3.8% of world GDP in 2006, narrowed after the Global Financial Crisis and reached a low of around 1.9% by 2019. They widened again to around 3% in 2025. At first sight, this resembles the pre-Great Financial Crisis (GFC) period. The comparison is misleading.

The mid-2000s imbalance cycle was associated with the global-savings-glut narrative. Excess saving from China, oil exporters and other surplus economies was recycled into US fixed income, compressing yields and allowing the US to finance large deficits cheaply. Today, by contrast, as US external deficits have widened, real rates have increased. That points less to abundant foreign saving and more to US-specific demand, driven above all by fiscal expansion.



Source: IMF, GenAM



Source: Federal Reserve, GenAM

For investors, the question is not whether the US can finance its external deficit in the near term. It can, given the predominant role of the dollar, the depth and liquidity of the US Treasury market and the continuous appeal of its stock market. The more relevant question is how much compensation foreign investors will demand to keep funding US deficits, visible in long-dated Treasury yields, the dollar risk premium and the relative valuation of US assets.

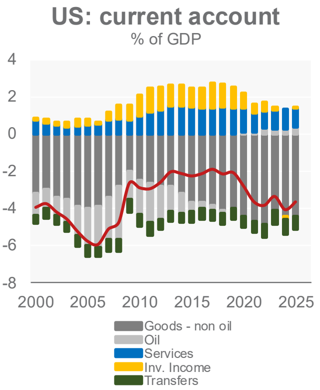
2. Same map, different mechanism

The US remains the main deficit country, China is the dominant surplus region

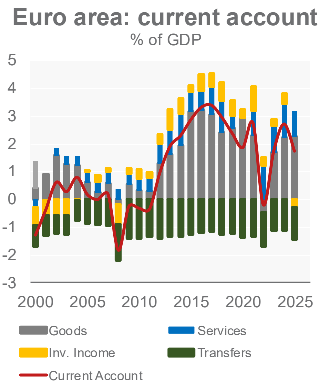
The geography of global imbalances looks familiar. The US remains the main deficit country, while China, Japan, the euro area and oil exporters sit on the surplus side. But the mechanism has changed. Before the GFC, the widening was broader on the deficit side, with Spain, Greece, the UK, Australia and several emerging markets also absorbing foreign saving. In the current cycle, the deficit burden is much more concentrated in the US.

This concentration matters because it makes global imbalances more directly linked to US fiscal policy, US asset prices and US Treasury supply. The US is not simply one large absorber of global saving; it is the central adjustment variable. Strong US demand widens the trade deficit, large fiscal deficits increase Treasury issuance, while deep and broad US financial markets attract foreign capital but also make the financing model more dependent on continued confidence in US assets. The trend is compounded, on the private side, by the strong increase in corporate borrowing generated by the AI boom.

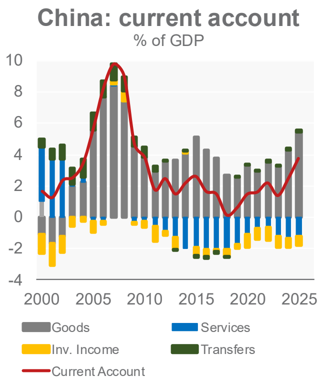
The surplus side has also changed. China no longer runs a current account surplus near the 2007 peak of almost 10% of GDP, but its absolute scale remains systemic because the economy is much larger. Its goods surplus exceeds USD 1.2trn on a 12-month basis, almost 6% of Chinese GDP and around 2% of global GDP. The euro area shifted from broad balance before the sovereign crisis to a persistent surplus after 2011-2012. Japan remains a creditor economy, but its surplus is increasingly supported by primary income from a large net foreign asset position rather than goods trade.



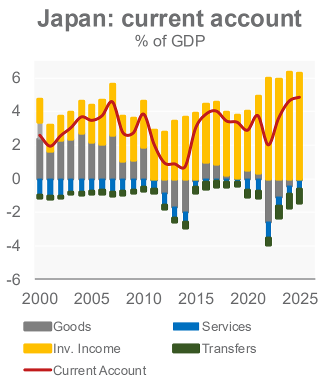
Source: IMF, BEA, GenAM



Source: IMF, Eurostat, GenAM



Source: IMF, Ox. Econ., GenAM



Source: IMF, Ox. Econ., GenAM

The result is a more asymmetric and market-sensitive regime. The US provides demand; China and parts of Asia supply goods; the euro area and Japan recycle savings and investment income; and private capital markets intermediate a larger share of the flows. This is a less stable equilibrium than the pre-GFC model anchored by official reserve accumulation. Treasuries are then becoming more exposed to shifts in risk appetite, hedging costs, volatility, and the perceived credibility of policy (both fiscal and monetary).

3. US: a larger, costlier to finance deficit

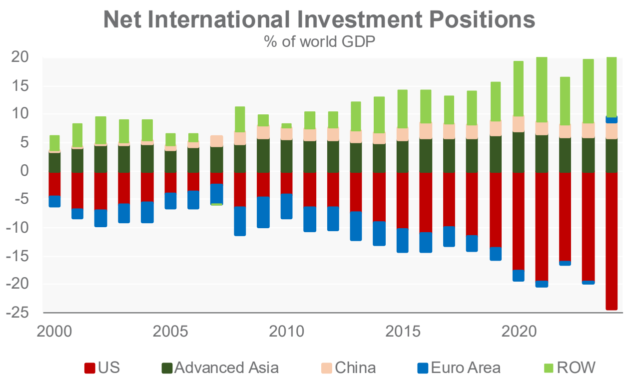
Fiscal largesse triggers external deficit

The US current account deficit widened from around 2% of GDP before the pandemic to 3.7% in 2026, according to the IMF forecast. Strong domestic demand, expansionary fiscal policy, AI-related capex, a strong dollar and a weaker investment-income balance all contributed. The deterioration in the trade balance occurred despite the large improvement in the oil balance, with the US moving from net oil importer to net oil exporter. The non-oil trade deficit now exceeds its 2006 peak. The fiscal backdrop is central. The US government deficit averaged -5.6% of GDP in 2020-25, compared with -0.6% in 2001-06. This makes the external deficit less a story of foreign capital forcing US over-consumption and more a story of domestic policy choices. A larger fiscal deficit raises Treasury supply, and a larger current account deficit raises the need for foreign capital. Together they increase the yield required to attract marginal buyers. Deep political polarisation and limited appetite for unpopular fiscal-consolidation measures make a near-term policy shift unlikely.

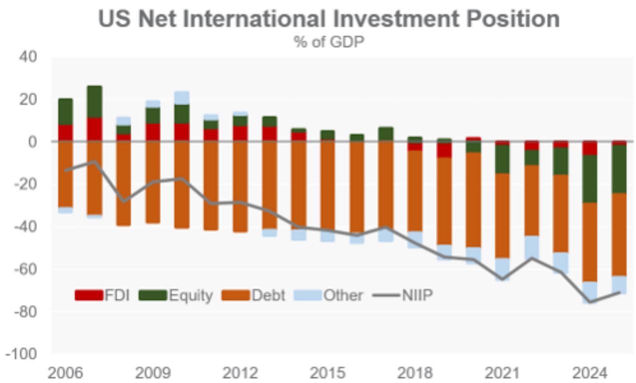
The US is no longer able to finance its deficit at low rates

For decades, the US earned more on foreign assets than it paid on foreign liabilities, an example of its "exorbitant privilege". That reflected the ability to issue safe, liquid liabilities while earning higher returns on foreign investment. This advantage has weakened as the net debtor position has grown and global rates have risen. The primary income balance turned negative in 2024 and was only barely positive in 2025. The deterioration is also visible in the Net International Investment Position. At end-2025, the US NIIP stood near -90% of GDP when FDI is valued at market prices, or around -66% on current-cost valuations. Much of the worsening reflects valuation effects: rising US equity prices increased the value of US shares held by foreigners, while dollar appreciation reduced the dollar value of US assets abroad.

Equity liabilities are more state-contingent than debt: a US equity correction would reduce domestic wealth, but it would also reduce what the US owes abroad and mechanically improve the NIIP. Debt must be serviced regardless of market conditions. The foreign-owned net debt stock, around 50% of GDP, is therefore the more relevant external-risk metric. Equity-heavy financing lowers rollover risk, but it makes the external balance more dependent on the continued global appeal of US corporations.



Source: Milesi Ferretti (2026), GenAM



Source: Bureau of Economic Analysis, GenAM

4. China and advanced Asia: widening trade surpluses

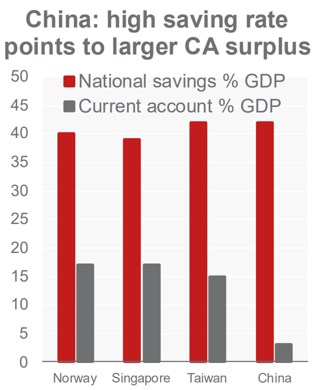
China' current account surplus is expected to reach 2.5% of GDP in 2026 after being barely positive in 2019; it stood at 3.7% in Q1 2026, while some adjusted estimates put it closer to 4.5% of GDP. The headline current account balance understates the trade shock: the goods surplus is much larger.

China's domestic demand weakness is spilling abroad through exports.

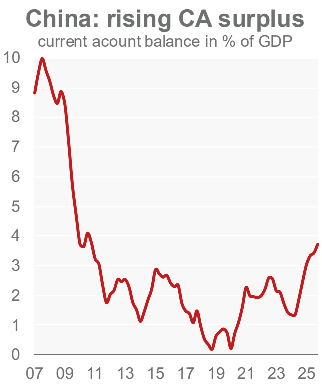
By Q2 the goods surplus exceeds USD 1.2trn on a 12-month basis, almost 6% of GDP and around 2% of global GDP. Export volumes are up a cumulative 40% since end-2019, while imports are up only 1%. Batteries, solar panels and Electric Vehicles account for more than half of annual export growth; car exports are on track to reach 8 million in 2026, from around 1 million in 2020. This is not simply cyclical export strength. It shows that domestic weakness is being absorbed by foreign demand.

Three forces explain this. First, the property bust reduced investment, raised household saving and delayed the rebalancing of the economy toward consumption. Exports therefore act as a safety valve. Second, CNY weakness has supported competitiveness: the renminbi has depreciated by around 11% in real effective terms since early 2022. Third, structurally high saving rates continue to support external surpluses, while policymakers remain reluctant to deliver a 2009-style stimulus focused on household demand.

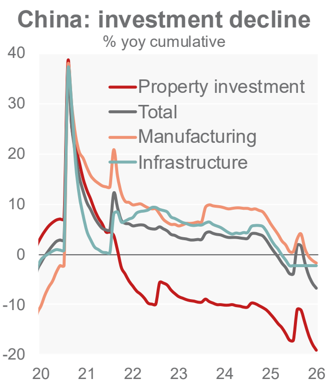
Advanced Asian economies show a similar pattern, with sizeable trade surpluses and export momentum linked to AI supply chains. The surplus side of global imbalances is therefore not only a China story. It is also tied to the technology-investment cycle and to the concentration of manufacturing capacity in Asia.



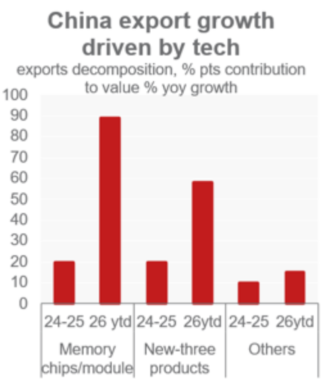
Source: Setser, GenAm



Source: Bloomberg, GenAm



Source: Bloomberg, PBoC, GenAM



Source: China Customs, JP Morgan, GenAM

5. The changing nature of UST buyers

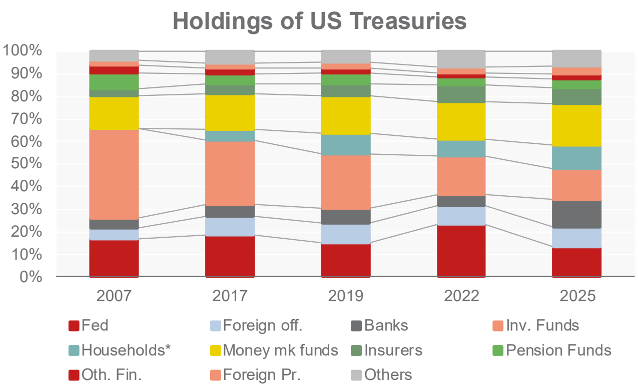
While large and with little hope of shrinking soon, the US external deficit remains financeable, but its financing structure has changed. The key shift is from a world in which foreign official buyers and the Federal Reserve absorbed a large share of US duration to one in which private, more price-sensitive investors play a larger role. This does not imply an imminent funding problem. It means the clearing price of external financing is more sensitive to yields, volatility, hedging costs and confidence in US policy.

The Federal Reserve has stepped back as a marginal buyer. Its share of the Treasury market is down by around 10 percentage points from the post-Covid QE peak, while other price-insensitive holders, including foreign authorities, reduced holdings through 2022. As QT returns duration to the market, households, hedge funds, money-market funds and foreign private institutions must absorb more incremental supply. The BIS estimates that the change in marginal buyers during the second round of QT added 136bp to Treasury yields. The exact number should not be read mechanically, but the direction is clear: when the buyer base becomes more private and price-sensitive, long-dated yields need to offer more compensation.

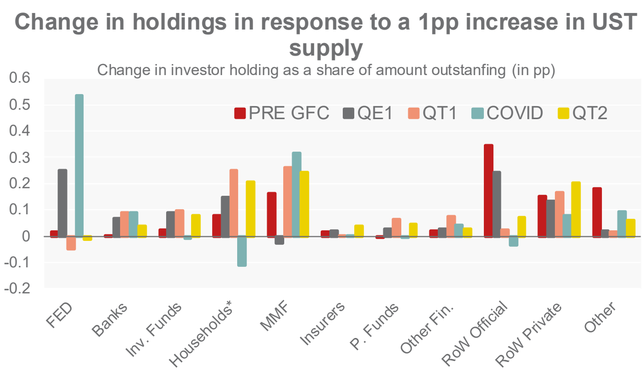
The financing of US deficit relies increasingly on yield-sensitive buyers.

The pre-GFC model was different. Large surpluses in creditor economies were recycled into US fixed income, especially Treasuries. Around 2008, foreign official holdings accounted for more than 40% of outstanding Treasuries, while the total foreign share exceeded 50%. That helped compress yields. Today, the foreign official share has fallen to around 15%, while foreign private holdings have risen. Private foreign Treasury holdings reached USD 5.2trn by end-2025, or around USD 6.7trn after correcting for Cayman-domiciled hedge funds, compared with official holdings of USD 3.9trn.

This is a material change in external financing. Official reserve managers buy Treasuries for liquidity, safety and reserve-management reasons. Private investors buy them for return, relative value, hedging or trading purposes. Their demand is more elastic to yields and more vulnerable to market conditions. Some private demand is also linked to leveraged strategies, which can support Treasury absorption in calm periods but may unwind when volatility rises or funding conditions tighten.



Source: Federal Reserve, GenAM *Includes hedge funds



Source: Federal Reserve, GenAM. *includes hedge funds

6. Foreign buyers are getting more sensitive to yields and FX hedging

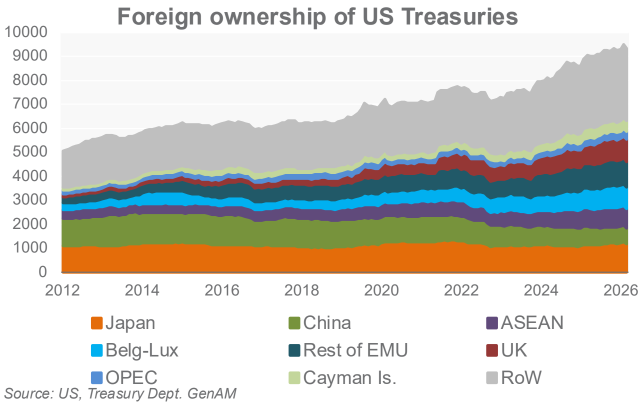
Surplus regions finance the US in different ways. China contributes to the global savings imbalance through a very large trade surplus in goods, but its incremental support to US Treasuries is less automatic than in the 2000s. After adjusting for securities held by custodians, mostly in Belgium and Luxembourg, Chinese bond holdings remain close to 40% of total reserves. Treasuries are still part of China's reserve-management framework, and a large abrupt sale would be in the end self-defeating. The more relevant Chinese policy lever is the exchange rate. A weaker or tightly managed renminbi preserves export competitiveness and shifts part of China's domestic adjustment onto trading partners. For US markets, the implication is indirect but important: China's surplus adds to trade tensions and political pressure around the US deficit, but it does not automatically create stable incremental demand for US long bonds.

Surplus economies keep recycling savings in the US, but less via Treasuries.

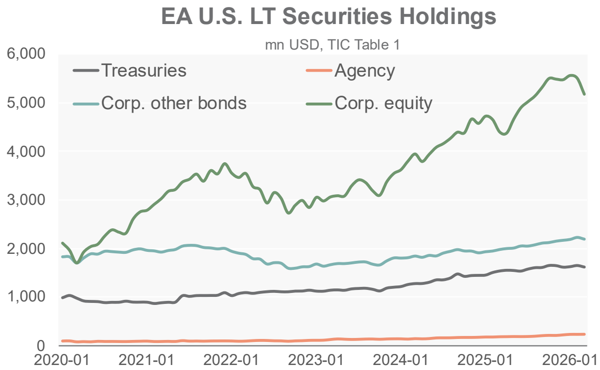
The euro area plays a different role. Its US exposure is dominated by equities, which account for around 55% of holdings, followed by corporate and other bonds at about 21% and Treasuries at roughly 18%. Euro area investors hold only around 6% of marketable US Treasuries. This means euro area capital flows depend heavily on the relative attractiveness of US equities and corporate assets.Hedging costs also matter. For European investors, the relevant return is the FX-hedged Treasury yield, not the headline US yield. ECB research shows that a 1bp widening in the USD-EUR cross-currency basis reduces holdings of the average USD bond by around 0.32% relative to eurozone bonds. Higher US yields therefore do not automatically attract euro area buyers if the extra yield is absorbed by hedging costs.

Japan remains a major creditor economy, but its appetite for Treasuries has weakened. Its share of the foreign Treasury stock has fallen from a peak of 20% to around 12%. Higher JGB yields reduce the need for domestic investors to reach for US duration, FX hedging costs make Treasuries less attractive on a hedged basis, ALM regulation increases demand for JGBs from life insurers, and concerns about the US fiscal trajectory weigh on long-dated Treasury demand. Worries about negative impacts and higher fragility of the UST market may be behind US Treasury Bessent encouragement to Japan to make use of the US FIMA repo facility (and mulled extending its $60bn limit in its July FX intervention. The FIMA facility allows foreign central banks to obtain USD liquidity for intervention purposes without having to sell USTs outright.

The common message is that surplus economies finance the US, with a less stable Treasury channel than in the 2000s. China's surplus is tied to goods exports and currency management; the euro area recycles capital mainly into equities and corporate bonds; and Japan is less willing to buy Treasuries when domestic yields rise and hedging costs are high.



Source: US, Treasury Dept. GenAM



Source: US Treasury Department, GenAM

7. Dollar dominance and the Treasuries' convenience yield

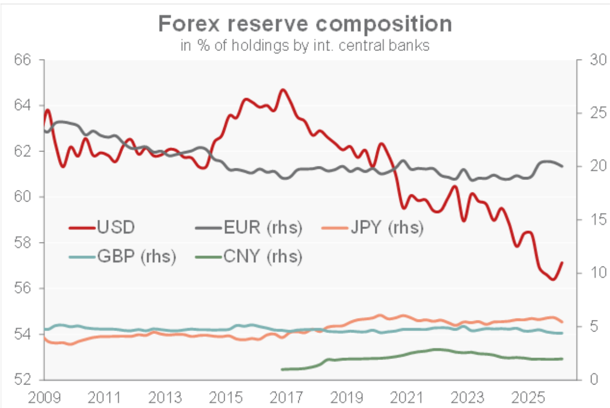
The dollar remains the anchor of the international monetary system. It accounted for 57.1% of global FX reserves in Q1 2026, still dwarfing the euro's 20% share. The dollar appears on one side of 89% of FX transactions and remains dominant in trade invoicing, cross-border lending, debt issuance and offshore funding. The Treasury market is the world's largest pool of liquid safe assets, with marketable debt outstanding around USD 30trn.

> Dollar dominance endures, but safe-haven demand for Treasuries is less automatic.

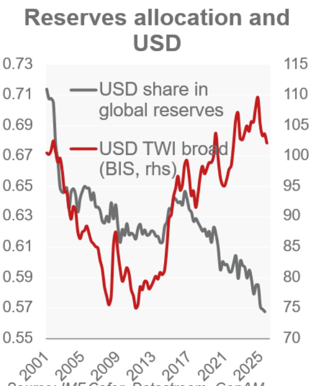
There is still no clear substitute. The euro has institutional credibility and a large economic base, but fragmented capital markets, limited common safe-asset supply and incomplete fiscal integration constrain its global role. The renminbi benefits from China's trade power, but capital controls, limited convertibility and weaker institutional safeguards prevent broader reserve adoption. Dollar dominance is also supported by network effects: the more contracts, invoices, collateral chains and funding markets are dollar-based, the more costly it is to switch.

However, the USD safe-haven role has become more conditional. Geopolitical fragmentation, sanctions, erratic trade policy, fiscal slippage and weaker confidence in institutional safeguards all increase incentives to diversify at the margin. The April 2025 "Liberation Day" episode was a warning sign because it broke the usual risk-off pattern: the dollar weakened and long yields rose.

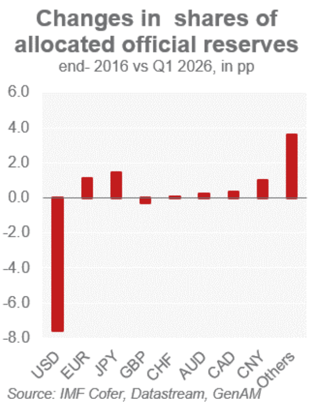
The baseline is slow erosion, not regime change. Dollar markets remain uniquely deep, but the insurance value of the dollar and long-term Treasuries is less reliable when the shock originates from US policy itself. In that scenario, foreign investors may demand more yield compensation rather than paying a premium for safety.



Source: IMF COFER, Datastream, GenAM

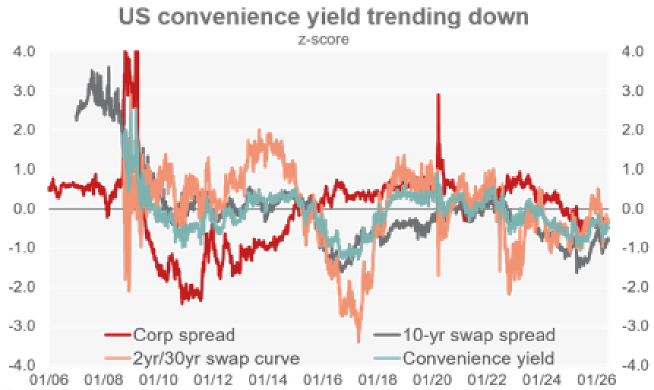


Source: IMF Cofer, Datastream, GenAM

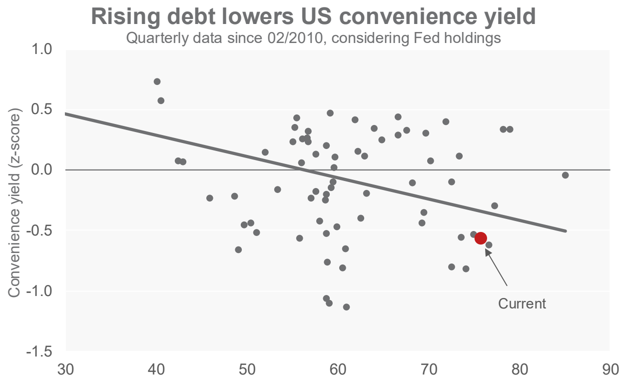


Source: IMF Cofer, Datastream, GenAM

The key question is then how much compensation investors will demand to continue financing the US deficits. This adjustment in the market clearing price is increasingly visible through two concepts that matter for Treasury valuation: the Treasury convenience yield, i.e. the returns foreign investors are willing to forego to invest in USTs and the term premium, the part of bond yields not related to expectations about future monetary policy. The convenience yield has declined across several measures, including Treasury term-premium estimates, swap-spread dynamics and the relative performance of Treasuries versus other high-quality collateral. Heavy supply, dealer balancesheet constraints, fiscal uncertainty and changing reserve management reduce the premium investors are willing to pay for Treasury liquidity and safety. The loss of scarcity is most visible at the long end, where the free float of medium- and long-term Treasuries has risen materially since 2022.

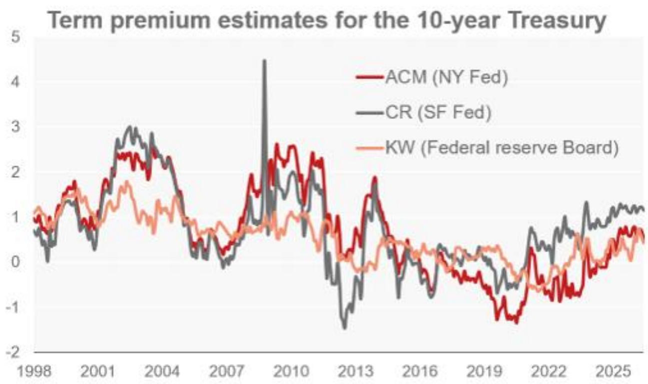


Source: Bloomberg, GenAM



Source: Bloomberg, Datastream, GenAM

The term premium ultimately captures the compensation required to hold duration risk. Expected short rates linked to Fed policy anchor the front end; the term premium measures how much extra yield the long end must offer to absorb supply, uncertainty and a less stable investor base. The main drivers - bond-market volatility, long-term inflation expectations, foreign investor demand and Treasury net supply - are less benign than in the post-GFC period. Our baseline estimate points to a rise in the 10-year term premium of around 15bp per year on average, from a still low level.



Source: Federal Reserve Boars, SF and NY Fed, GenAM

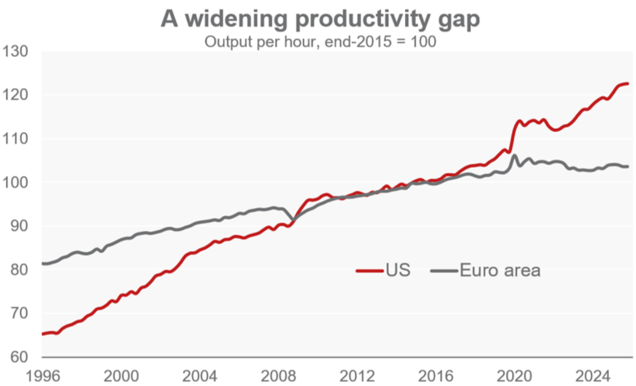
For investors, the implication is two-sided. A gradual erosion of reserve appeal is a mild structural headwind, not a persistent cyclical bear signal. But a less reliable safe-haven bid reduces the diversification value of unhedged dollar duration. For long-only bond investors, this supports smaller automatic allocations to long Treasuries and greater attention to currency hedging, curve position and entry yield.

8. Equities: critical for the financing of the deficit

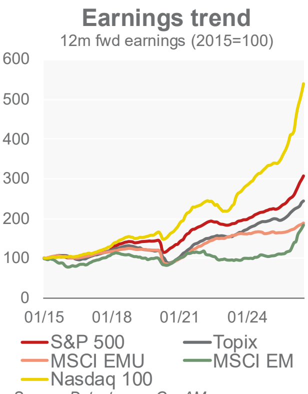
The US external-financing model increasingly depends on continued appetite for US risk assets. This creates a tension. US equities are expensive by market multiples (20% PE premium vs. norm) and the CAPE (cyclically adjusted price earnings) is well above its long-term average. That said, they could still outperform Treasuries over the next 10 years, but by a narrower margin, roughly 2.5% total return per year versus a historical 4-6%. This assumes the US CAPE falls from around 40x to about 26x, closer to historical norms.

> Foreign demand for US equity is crucial, but not at risk for now

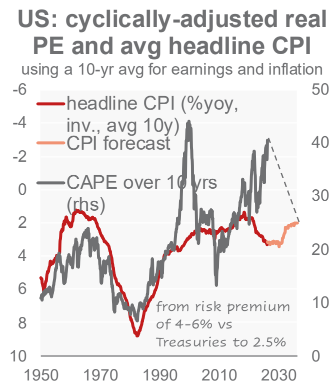
The US equity premium reflects stronger earnings, higher margins, deep capital markets and superior productivity. Since 2015, especially in large-cap technology, the US earnings gap versus Europe, Japan and emerging markets has widened further. Foreign demand for US equities is therefore unlikely to disappear quickly. The risk is not a sudden stop, but a lower return premium and more selective global allocation. That would still matter for Treasuries, because weaker demand for US risk assets would shift more of the external financing burden back toward debt markets.



Source: Datastream, GenAM



Source: Datastream, GenAM



Source: Shiller data, Datastream, GenAM calc.

9. Conclusions

Post-Covid global imbalances are not a replay of the 2000s. They are back near pre-GFC levels, but for different reasons. The US is more central to the deficit side, China and advanced Asia are exporting domestic weakness and manufacturing strength, and financing now occurs in a world of higher real rates rather than abundant cheap foreign saving.

Regional recycling is therefore more market-sensitive than in the pre-GFC reserve-accumulation model. China, the euro area and Japan remain important surplus regions, but their support for US assets comes through different instruments and with different degrees of Treasury appetite.

The US can still finance large deficits, but the price is rising. Treasury demand has shifted away from the Fed and foreign official buyers toward private, yield-sensitive and sometimes leveraged investors, while the convenience-yield discount is eroding, especially at the long end. Dollar dominance and US equity strength still help, but amid increased diversification efforts by investors they no longer eliminate the need for higher compensation.

For bond investors, the conclusion is duration discipline. Curve exposure should be biased toward steepening if policy expectations anchor the front end while the long end needs to absorb more net supply. Long Treasuries and the US dollar can still rally in risk-off episodes, especially when shocks are global rather than US-policy driven, but they are less reliable portfolio insurance than in the 2010s.

Summing up, the imbalance regime is more US-centric, more tightly tied to fiscal discipline, more dependent on private capital and more sensitive to confidence in US policy. For investors, that points to higher-for-longer US yields, greater long-end volatility, a higher term premium and a need for better compensation before adding duration. We will continue to monitor three indicators: the marginal buyer of Treasuries, the Treasury convenience yield and foreign demand for US risk assets.

IMPRINT

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