Teacher's Key

Interest Rates, Inflation, and Bonds: Who Sets Long Yields? (Level C2)

Vocabulary Matching

1 conundrum = **N**
2 maturity = **A**
3 premium = **H**
4 erode = **L**
5 credibility = **G**
6 sovereign = **M**
7 fiscal = **I**
8 accommodative = **E**
9 hawkish = **D**
10 dissent = **O**
11 reprice = **J**
12 outflows = **K**
13 spillover = **B**
14 volatile = **C**
15 entrenched = **F**

Fill in the Blank

1 conundrum
2 maturity
3 premium
4 erode
5 credibility
6 sovereign
7 fiscal
8 accommodative
9 hawkish
10 dissent
11 outflows
12 spillover
13 volatile
14 entrenched

True or False

1 **True.** It cut by a full point over three meetings.
2 **False.** He used it in February 2005.
3 **False.** They set only the shortest rate directly.
4 **False.** It can only be estimated with models.
5 **True.** Growth and uncertainty explained most of the rise.
6 **True.** It cut to 5.25 percent.
7 **False.** It followed a budget with large unfunded tax cuts.
8 **True.** The reading gives this date.
9 **False.** Two board members registered dissent.
10 **True.** Not from the term premium.

Language Focus: Cleft Sentences: It is … that and What … was

Example answer: **It was** expected growth, not deficits, **that** explained most of the rise in yields. (Or: **What** explained most of the rise in yields **was** expected growth, not deficits.)

Comprehension Questions: Model Answers

1 In both cases, long-term yields moved against the policy rate: in 2024 the Fed cut and the ten-year yield rose, and in 2004 to 2005 the Fed raised rates while the ten-year yield fell.

2 It divides the yield into the average short rate that investors expect over the next ten years and a term premium for tying up money for so long. Expected inflation feeds into both parts, because inflation can erode fixed payments.

3 Because the term premium cannot be observed directly. It can only be estimated with models, which often disagree.

4 Markets had already priced much of the easing. J.P. Morgan attributed roughly half of the rise to stronger US growth than expected and much of the rest to uncertainty about rates and inflation, and it found little role for deficit worries.

5 The popular explanation, heavy buying of Treasuries by foreign central banks, was estimated at up to 0.4 percentage points, but Tao Wu's 2005 San Francisco Fed analysis found little solid evidence of a lasting effect, so the case remains unsettled.

6 They show that yields reflect a state's fiscal position. In India, yields rose after a rate cut because of heavy bond supply and foreign selling; in Britain in 2022, unfunded tax cuts sent long yields soaring. In both, government debt rather than policy rates moved yields.

7 The Bank of Japan has stepped back after years of accommodative policy, private investors must absorb bonds from a government whose debt is more than twice the size of the economy, and a weak yen added pressure.

8 Because markets had begun to reprice the path of policy weeks earlier, so the decisions were largely expected. Schwab's estimate also suggests that most of the 2026 rise in the US yield came from higher expected short rates.

9 Emerging-market bonds lose part of their return advantage, and outflows can weaken currencies and raise local yields. The example is India, where DSIJ linked the climb of the ten-year yield toward 7 percent in September 2026 to oil prices and US rates.

10 Not Given. The reading reports only that the Reserve Bank of India cut its rate during 2025; it says nothing about a rise in 2026.

11 No. The writer states that the policy rate anchors short-term borrowing, but expectations, credibility, public finances, and global flows decide where long yields settle.

12 The puzzles create a question that the reader wants answered, so the framework that follows has a clear purpose. The reader then applies it to the later cases from India, Britain, Japan, and September 2026.

Notes on the Evidence

- Sources checked (27 September 2026). US 2024: Wolf Street (27 December 2024: ten-year yield up about 100 basis points since September as the Fed cut 100) and J.P. Morgan (17 January 2025: about 48 basis points of the rise from stronger growth expectations, about 40 from uncertainty, about 15 from policy expectations; deficits not a major driver). 2005: San Francisco Fed Economic Letter by Tao Wu (29 April 2005: ten-year yield down about 50 basis points during tightening from mid-2004; Greenspan's 'conundrum' testimony of 16 February 2005; foreign official purchases estimated by some at up to 40 basis points; little solid evidence of a persistent relationship). India: Business Standard (10 December 2025: repo rate cut to 5.25 percent on 5 December, 125 basis points of cuts since February 2025; ten-year yield up 14 basis points to 6.63 percent; unnamed dealers cite supply and foreign unwinding) and DSIJ headline (early September 2026: ten-year yield nears 7 percent on oil and US rate concerns). Japan: Bloomberg headline (1 September 2026: ten-year yield hits 3 percent, first time since 1996) and UPI (18 September 2026: rate raised to 1.25 percent, highest since 1995, vote 7 to 2; core CPI 1.7 percent in August; record 15.4 trillion yen of intervention between late July and late August). ECB press release of 10 September 2026 (deposit rate 2.50 percent from 16 September; Middle East conflict cited; inflation projections 3.0, 2.5, and 2.1 percent for 2026 to 2028). Fed decision of 16 September 2026 (CNBC, NPR, Fox Business: 3.75 to 4 percent, first rise since 2023). Charles Schwab (23 September 2026: US ten-year yield up about 80 basis points in 2026 to 17 September, near 5 percent at publication; Adrian, Crump, and Moench model, published by the New York Fed, attributes most of the rise to expected short rates). CNBC headlines of 17 and 18 September 2026 for the fall in US and Japanese long yields after the decisions.
- Evidence limits. The two-part reading of a yield is a textbook framework; term premium estimates differ by model. The CNBC reports on falling yields after the September decisions and the DSIJ, Wolf Street, and Bloomberg items were checked from headlines and snippets, not read in full. The British 2022 episode (the 23 September 2022 budget and the Bank of England's temporary purchases of long-dated gilts announced on 28 September 2022) is stated from well-documented general knowledge and was not re-read for this revision. Japan's debt of more than twice GDP is a widely reported IMF-based figure, not re-verified for 2026. The statements that markets had already priced much of the 2024 easing and had repriced the policy path before the September 2026 decisions are standard market interpretations consistent with the J.P. Morgan and Schwab analyses, not direct findings. The claim that a cut can lift long yields through doubts about credibility is a standard mechanism, not a finding from the 2024 case. Market figures are dated to the sources above and will change.
- Revision (27 September 2026). The previous version was a news snapshot of the September 2026 rate decisions and record yields, which would date quickly, and its Yes/No/Not Given item was built on a point where the writer gave no view. The reading was rebuilt around a durable question (why long yields often move against policy rates), with the 2024 and 2005 US cases, India and Japan as non-US and non-UK perspectives, Britain in 2022, and the September 2026 decisions as a dated illustration. Removed: the Bank of England's September 2026 vote, the German, British auction, US 30-year, Korean, and Indonesian yield figures, the Korean mortgage rate, Japanese debt-service estimate, the stagflation debate, and unnamed analysts' views. Every figure kept was re-checked. Vocabulary: stagflation dropped, conundrum added. New Language Focus (cleft sentences), new comprehension, IELTS, True/False, speed, and discussion items.
- Scope. This unit is general information, not investment advice. Level C2. The Hindi and Arabic translations have not been checked by a native speaker; the Arabic for fiscal (مالي) is the general word for financial and may need a more specific term.