

## Rates go back to the future

A key theme in our vision for 2025 is the maintenance of a 'normal' for rates, with some important nuances. Neutral in the US is the Fed at 3% plus a 75-100bp curve, while it's 2% plus a 50-75bp curve in the eurozone. For 2025, the US curve targets neutral rates plus a c.50bp spread, while the eurozone curve dips to its neutral minus a c.50bp spread



It's back to the future for rates

### Chuck and Jurgen walk into a bar...

Picture Chuck and Jurgen walking down the road. Chuck, who's been keeping it real, is busy making America great again and tends to naturally walk faster than Jurgen. Jurgen has found himself walking slower than most over the years, partly burdened by ageing. But also by a multi-personality complex that most of the time is a hindrance. Jurgen's few moments of joy have come when Europe beats the US at the Ryder Cup. Otherwise, Jurgen is mostly in awe of Chuck. Chuck is seen as the biggest and best at most things.

Recently Chuck has been helping out Jurgen's close friend Ivan, who has been bullied by Mikhail. In fact, an additional reason for Jurgen's slower pace of late has been on account of Mikhail's behaviour, which has caused Jurgen to cut ties with Mikhail, who used to supply Jurgen with some cheap energy pills. One of Jurgen's more dominant personality complexes, Karl, has been particularly badly hit by the impact of Mikhail's behaviour. When Jurgen's Karl complex is down,

then Jurgen is very down.

Chuck has a higher walking heart rate than Jurgen. Both enjoy staying active and dislike being in a state of rest, as it implies stagnation. If they remain inactive, they risk being overtaken by others. The worst-case scenario is their heart rates dropping below resting levels, which poses serious health risks. The best bet is to keep on moving as best they can. Not too fast, as that can't be sustained. But definitely no stopping, as that risks bigger problems.

"Chuck" here, of course, is a parody of America. A 2% normal growth rate, and a normal fed funds rate of around 3%. "Jurgen" is the eurozone. A 1% normal growth rate and a 2% normal ECB deposit rate. The heartbeat represents a complex combination of inflation and interest rates. Walk too fast for too long and the heartbeat elevates, which is good for a bit, but not for too long. At the other extreme, a heartbeat below resting is not desirable at all. Most of the time the central objective is to keep on walking, typically at respective normal paces.

Going into 2025, not only is Chuck moving faster than Jurgen, but Chuck has changed his view of the world. Chuck now wants to pay fewer taxes and does not seem to be concerned about the credit card bill he's running up. He's also weirdly keen to pay more for the wine that Jurgen supplies him, just to spite Jurgen, as he feels that Jurgen is too successful at selling wine to him. Chuck feels upbeat though. Jurgen less so. Jurgen does not quite understand why Chuck is being so mean. Chuck is also threatening to not help Jurgen's friend Ivan any more.

## ... to find America and the eurozone in a bit of a tussle

Okay! Enough of the Chuck / Jurgen malarky. The point here, from a rates perspective, is to view the US and the eurozone as being on quite different paths as we progress through 2025. The US has a better growth profile, and the policy mix is at the margin inflationary. That means the Fed will not get its funds rate down to a neutral level, and the 10yr rate should by the same token end up at above its neutral level. That translates to higher longer-term rates, and a preference to shorten duration and/or set fixed rate payers.

The eurozone is different. There is a sub-trend growth underpinning, with little prospect of that improving through 2025. That is liable to see the ECB cut its deposit rate to below normal, and longer tenor rates are also liable to be pressured to trend below normal. One rationale for eurozone longer tenor rates rising is on account of correlation with higher US rates. The other centres on the fact that they're actually quite low, with the 10yr Euribor rate already knocking on the door of a mere 2%. For that reason, we prefer fixed-rate payers in euros too.

The spreads environment in consequence is stark. US market rates are being pressured higher as a theme through 2025. Eurozone rates will feel some of the same pressure as they are already so low. But the end game is the maintenance of high spreads, with a bias if anything for even wider spreads. This presents an opportunity. The challenge is to get the best entry point, specifically on the FX rate.

A silver lining here is spreads within the eurozone are not primed to widen in a generic dramatic sense, as Karl in the core is where the real stress is. And Francois is not much better. Moreover, Alessandro is sitting pretty for a change. Consequently, there is no EMU-breakup worry here. Rather, Karl gets to cosy up with Francois and Alessandro for a bit and take in some of that warm periphery feeling.

## Now for the serious stuff...

For the rest of this report, I promise no more Chucks or Jurgens. We now turn to serious analysis, where we'll churn out specific levels to chime with the narrative above. We'll be specific about curve shapes, the detailed spreads environment in derivatives and the eurozone SSA space. We'll also go deep into US debt dynamics and funding pressures, and dip into the Dutch pension fund rule changes and why they are important. So much so that maybe, just maybe, you'll end up pining for more Chuck and Jurgen analogies. Enjoy!

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