

## Three calls for rates: German angst versus US oomph

We see wider spreads being driven by higher US yields next year. Eurozone yields should rise by less and could even fall back in the end



Euro versus dollar spreads are set to maintain a widening bias

### 1 Call 1: Euro versus dollar spreads to maintain a widening bias

There has already been a significant re-widening in SOFR versus ESTR rates across the curve. Spreads are around 2% in short tenors and approximately 1.7% in the 10-year range. The front end is already pricing in the European Central Bank's deposit rate dropping to 1.75% alongside the Fed funds rate at 3.75%. But we think there will be pressure for the 10yr spread to widen by some 30-50bp through the early quarters of 2025.

This reflects upward pressure on US longer-tenor rates coming from the US fiscal deficit, tax cuts, and inflationary effects from tariffs. In contrast, the eurozone remains troubled by a weak domestic economy, particularly in Germany. German angst versus US oomph equals wider spreads between the two.

### 2 Call 2: Can the US 10yr Treasury yield top 5.5%?

Our vision is for the US 10yr Treasury yield to be in the 5-5.5% range as we progress through 2025. That equates to 10yr SOFR hitting at least 4.5%. One way of viewing this is relative to a neutral

curve, which we see mapped out as a 3% funds rate and a 4% 10yr SOFR rate (a 100bp curve).

Donald Trump's tax-cutting agenda likely means the Federal Reserve lands above neutrality by some 50bp. Specifically, the Fed lands at 3.5-3.75%.

Given the inflation risk from tariffs and issues relating to the fiscal deficit, logic suggests that the 10yr rates should also land at around 50bp above neutrality. In turn, we should see a 4.5% 10yr SOFR rate. The 10yr Treasury yield is currently 50bp above that, meaning we hit 5%. A widening in this SOFR spread can push the 10yr yield as high as 5.5% – in part as the 10yr SOFR rate too is being pressured up in tandem.

### 3 Our bold call: Can the 10yr Euribor rate slip back to 2%?

While our central view sees upward pressure on eurozone rates due to the influence of Treasuries, there is also countervailing pressure from macroeconomic weakness, leading to some inverse correlation with US rates. Government bond yields, including German yields, could face upward pressure due to various political and deficit-related factors.

That can act as a separation from the ESTR curve, which, in its purest sense, is a fair value extrapolation out of the curve of the ECB's deposit rate. In the extreme, if the ECB's deposit rate were to hit 1.75% (or lower, say 1.5%) and the macro prognosis did not improve, then 10yr Euribor could well hit 2% (now 2.25%). The central view is for it to be pulled up. But a subsequent break back down presents a potential wild twist.

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