

## Slow export of deflation must widen the Treasury-Bund spread

A widening in the Treasury-Bund spread is a classic recovery outcome. It reflects a scenario where the US takes the lead role in pulling developed markets out of slowdowns and recessions. This has started to happen, which is good. And there is more to come in 2021. Watch for a 175bp spread as a target. A 200bp spread would be super positive and not impossible



### US market rates tend to be more volatile and a lead for European ones - hence the wider spread

We see 2021 as a year in which the spread between the German and the US 10yr continues to re-widen. This is a classic deflation/recovery type occurrence. US rates volatility is typically higher than that of eurozone rates, and during periods of rising markets rates, the US tends to do most of the heavy lifting to begin with, which would result in a wider spread between US market rates and eurozone ones.

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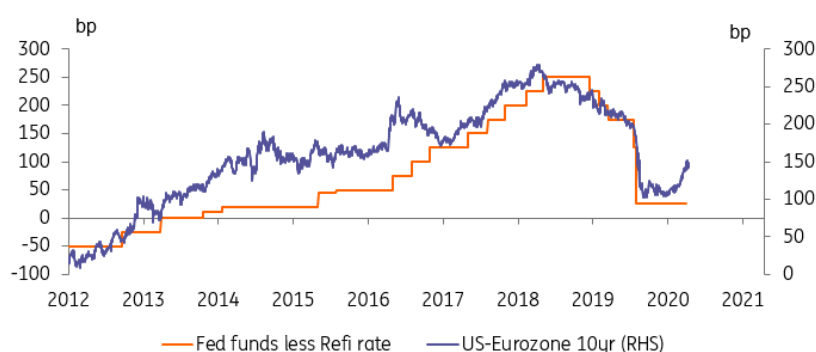
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And this is important for eurozone yields, as higher US yields can help to pull the eurozone ones up too; which is a good thing. The German 10yr yield at -50bp does not paint a positive picture for the eurozone medium-term outlook. In contrast to that, the ambition for the US 10yr to nudge above 1% takes it clear of the depths that German yields find themselves in.

While negative rates have served the purpose of providing ultra-low financing conditions, they are also not a desired outcome as higher yields usually mean better things in terms of underlying macro circumstances.

We don't see this as being a consequence of more supply. That might come. But for now, the dominant pull on market yields is a reflationary 2021.

## Treasury-Bund spread



Source: Macrobond

### A wider Treasury-Bund spread will mean that US rates help to pull up German ones, eventually

While this reflation mood can coax eurozone yields up too, the dominant impulse is to widen the Treasury-Bund spread. Pre-crisis this was at 2%-plus. It dipped to the 1% area as Covid struck, which saw the Fed cut by 150bp. Fair value would be around 2%. We will get there provided we remain on track. But our intermediate call is to get to 175bp, with the US 10yr likely at 1.25%.

This would leave the German 10yr yield in the -50bp area, but the discussion then would be centred on the US heading for 1.5% while the German 10yr slowly moves out of deeply negative territory. A lot of positive things need to happen first, but 2021, hopefully with a vaccine, is stacking up in a positive fashion.

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