

Spreads to the US to widen for most of 2025

Spreads to US rates have shot wider, and we see little reason for them to narrow any time soon. In fact, the trend suggests even wider spreads. This presents an opportunity to engage with these spreads, such as receiving USD and paying EUR or JPY amongst others. However, timing may depend on achieving more favourable FX levels



US market rates will find it hard to avoid discounting the price risk coming from the tariff story

The oomph coming out of the US has manifested in wider spreads across the board

Even though market rates have been trending lower into the turn of the year, the dominant theme following the first Fed rate cut in September has been a material ratchet higher in US market rates. This reflected: 1. A firm September payrolls report, 2. An edge higher in some inflation metrics, and 3. The discount and delivery of a Trump election win. This also acted to downsize expected Fed rate cuts, while at the same time macro malaise in the eurozone and elsewhere upsized expected cuts there. Consequently, spreads to the US marched materially higher, coinciding with US dollar strength.

Not only has there been a widening in spreads in the past number of weeks, but spreads are significantly wider versus their 5yr averages. For example, in the 5yr area, eurozone spreads are 50bp wider versus the 5yr average, Canada is 100bp wider, and Japan is 80bp wider, to name a few. The latest absolute spreads are identified in the table below using risk-free rates (where available), where positive spreads are pick-ups to SOFR rates. The question now is where we are going to go from here.

The simple answer is spreads are liable to remain wide as a theme through 2025, with, if anything, a bias to widen further. The central antagonist here is the Trump administration and the reaction to it, from the Federal Reserve and international players of all guises. The Fed's first issue centres on the stimulative effect coming from proposed tax cuts, which will go through a legislative process in 2025 for full enactment from January 2026. To the extent that the tax cuts include ending taxes on tips, overtime and social security, there is a stimulative effect on the type of consumer that has a high propensity to spend.

The wide gaps that have opened up between low yielders and the US

The spreads are based on risk-free rates (and include the cross-currency basis)

	2yr	3yr	4yr	5yr	7yr	10yr
Switzerland	408	395	385	378	370	367
Japan	375	362	353	348	339	324
Taiwan	300	290	282	278	268	247
Denmark	244	230	220	212	201	186
Sweden	237	226	216	206	190	176
Eurozone	223	214	205	182	189	180
S Korea	198	188	181	177	174	172
China	188	178	170	167	162	161
Singapore	165	164	163	162	160	162
Canada	123	114	109	105	95	82
Czech	95	91	84	79	64	50
Hong Kong	55	61	68	72	74	75
Norway	52	53	56	53	54	64
Australia	3	-4	-11	-19	-37	-70
UK	-9	-6	-4	-3	1	-1
Poland	-92	-80	-79	-84	-92	-103
Hungary	-202	-208	-215	-220	-232	-245
Indonesia	-241	-261	-271	-279	-276	-267
Mexico	-491	-474	-470	-471	-470	-461

Source: Macrobond, ING estimates

Tariff price risks are an additional factor, while the eurozone simultaneously goes through macro malaise

An additional concern is the tariff policy. While we remain far from a settled outcome on this, there are some key observations to be made. First, US imports are less than 15% of US GDP. In that sense, they are not dramatically impactful. Second, low import propensity also reduces the size of the impact of tariffs on average economy-wide prices. Third, there is still a likely price rise/inflation effect to be concerned with, and likely something to watch for in 2026, and perhaps through late 2025. We simulate an aggregate price impact of something like 0.5% to 1% on a broad 10% tariff.

This may or may not be 'inflationary', but US market rates will find it hard to avoid discounting the price risk coming from the tariff story. Essentially, we have a tax-cutting/tariff combination that will concern longer tenor rates, specifically to the extent that these price rises eat into the value of a fixed rate coupon paid out on any given bond. This also limits the appetite for the Federal Reserve to cut by too much as we move through 2025. That's the argument for US market rates

remaining elevated. And then there is also the fiscal side to consider (see the previous articles in this bundle for more on this).

From the non-US perspective, there is outsized angst coming from the Trump administration's tariff ambitions and the isolation threat to boot. The eurozone economy is already weak and suffering a degree of political vulnerability e.g. the forced holding patterns ongoing in Germany and France. Meanwhile, Meloni's right-leaning Italian administration is remarkably looking more like a picture of stability. Fundamentally, eurozone inflation is proving stubbornly sticky, just a tab above where it needs to be. But the European Central Bank will be minded to cut rates by enough to ensure no return to a dis-inflationary spiral that might come from macro malaise. That continues to argue for far more rate cuts from the ECB than from the Federal Reserve, in turn keeping the spreads differential wide.

The wide spreads theme presents opportunity in the classic positive carry play

This presents an opportunity to engage with these spreads. For liability managers, the opportunity is there to receive USD and pay EUR, or say JPY amongst others, for a significant reduction in funding costs. The same trade obtains for asset managers where the outcome is a pick-up in yield from lower yielders into US dollars. The challenge is that EUR and JPY are quite weak relative to long-term history, and any mean reversion in the years ahead would eat into the value of this positive carry trade.

The way to deal with this risk is to set out with a view to taking profit in the coming few months (say as the EUR/USD FX rate heads towards parity), or set the trade in a long enough tenor where the forward FX rate offers a tolerable implied breakeven level. For example, on a 7yr tenor there is FX comfort to 1.2 in EUR or 120 in JPY. Either way, get used to a wider-spread environment as an ongoing theme for 2025.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

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