

Tariffs and other stuff pushing rates around

So far, deals made to help avoid tariffs are deemed good for risk exposure and growth, and result in upward pressure on yields. The reverse holds true when tariff threats are deemed a real and present danger. But don't assume that these simple correlations will hold as a constant – in the end, an environment of material tariffs should force yields higher



Tariffs are a complicated story, and could force rates down initially – but we think they'll cumulatively end up higher

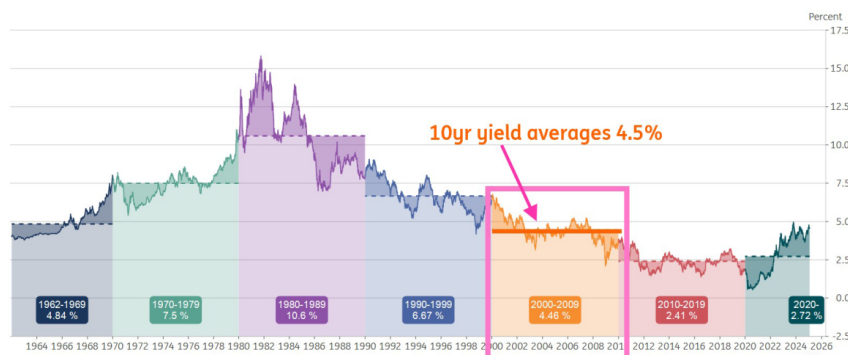
The 4.5% area for the 10yr Treasury yield is broadly neutral, and poised

The US 10yr Treasury yield at 4.5% is flat to our [estimate of neutrality](#). It feels from here it's likely to trade in a 50bp range around that – effectively 4.25% to 4.75%. And breaks above or below these extremes would result in practically inevitable tests of either one of 4% or 5%. Structurally, and as a call for 2025, we maintain the view that a trek towards 5% is most likely. We've already hit 5% in this cycle, some three months after the Federal Reserve had peaked (July 2023), before easing back down to below 4%. The initiation of Fed cuts (September 2024) coincided with a rise back up towards 5% (stopped short at 4.8%). And here we are now back down at 4.5% and poised

for the next big move.

We think 4.5% for the US 10yr is and area of neutrality

As seen in the noughties (when inflation averaged 2.5% and the funds rate averaged 3%)



Source: Macrobond

Right now, there is a drag lower on a narrative that adds tariffs to eurozone angst

In the very near term, the pressure is biased toward a break lower in yields. The angst story out of Europe is a pull factor that cannot be ignored. The prospect of the European Central Bank cutting rates on an ongoing basis in the coming number of months is one that should drag longer rates lower, or at least keep them under wraps. In the eurozone, the ECB is aiming to get deposit rates down to 1.75%. That's below the 2% area that we deem to be neutral. In contrast, the Federal Reserve is not expected to cut the funds rate down to its area of neutrality (the 3% area). The funds rate is likely to end the rate cutting cycle at closer to 4% than 3%.

In the end, The ECB depo rate ends up lower than neutral, while the Fed funds rate lands above

The rationale for the ECB landing below neutrality while the US lands above largely centres on relative fundamentals. Germany continues to act as a drag in the eurozone – and typically when Germany is not working, the eurozone is in trouble. On top of that, the US tariff bullets being aimed at Europe are the last thing that the eurozone needs – partly as they would be rebuffed by counter-tariff, so everyone loses. But the contrast between the two regions is stark as US growth remains more lively, and the Trump administration has stimulus at its core at practically any cost. That, plus an already bloated US fiscal deficit, rationalises why the Fed will stop cutting at well above the 3% neutral area.

Ultimately, the tariff story is a painful one with a notable price-rise tint – in the end hurting Treasuries

It also rationalises why the US 10yr yield, even if pulled lower initially, will ultimately be prone to re-testing higher again. We think it will get back up to the 5% area, and if we're right, we'd suggest it lands in the 5% to 5.5% area. This is not necessarily a call for the here and now. It's a call for the coming number of months, and in fact it could be something more for later in the year. By that time, US tariffs will begin to actually show up on CPI readings, and tax cuts will finally be through

Congress for execution from 2026. And if the fiscal deficit remains untamed, the route into the 5% to 5.5% range will look that bit less of a dramatic call.

This likely drags the 10yr Bund yield back up to the 2.5+% area, coinciding with a steepening process on both the US and eurozone curves, and ultimately with even wider longer-dated spreads between US and eurozone rates. What could change this is a failure in the sequencing above that forces the US 10yr above 5% in the first place.

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