Flash Economics

N° 143
November 21, 2025

Determinants of long-term interest rates

There are four key determinants of long-term interest rates (we are looking at long-term interest rates on public debt):

- the expected short-term interest rate, which depends in particular on inflation expectations;
- the variability of long-term interest rates;
- the difference between the level of demand and supply of public debt (since we are talking about interest rates on sovereign debt);
- the probability of default on public debt.

When we look at the 10-year interest rate on US debt, we see that the key determinants today are probably short-term interest rate expectations and interest rate variability. When we examine the long-term interest rate on French debt, we see that the interest rate spread with Germany is probably mainly due to the high level of supply of debt .

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The primary determinant of long-term interest rates: the expected short-term interest rate

We will apply our analysis to the **10-year interest rates in the United States, Germany, and France**.
In the United States, the expected short-term interest rate is lower than the current interest rate (**Charts 1A/B**); when we examine **anticipated long-term inflation** (measured by 10-year inflation swaps), we see that it is stable (**Chart 2**) and therefore that we should not anticipate a rise in short-term interest rates in the future due to inflation.

Chart 1A
United States: Eurodollar contracts (3-month)

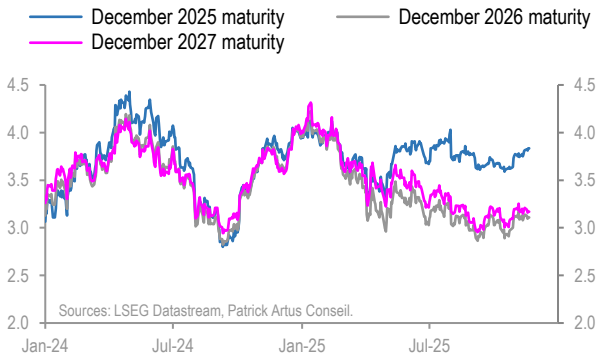


Chart 1B
United States: 1-year, 2-year and 3-year Government bond yields (in %)

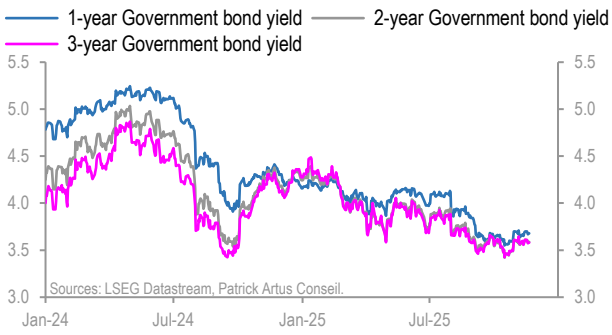


Chart 2
United States: 10-year inflation swaps (as %)



In the euro area, the expected short-term interest rate is roughly at today's level (**Charts 3A/B**), and **expected long-term inflation** is very stable (**Chart 4**).

Chart 3A
Euro zone: Euribor contracts (3-month)



Chart 3B
Euro zone: 2-year, 3-year and 5-year Government bond yields (in %)

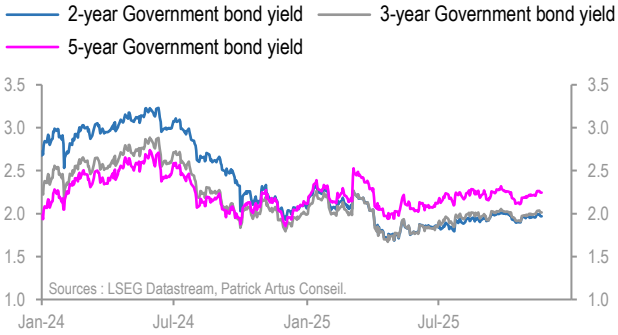
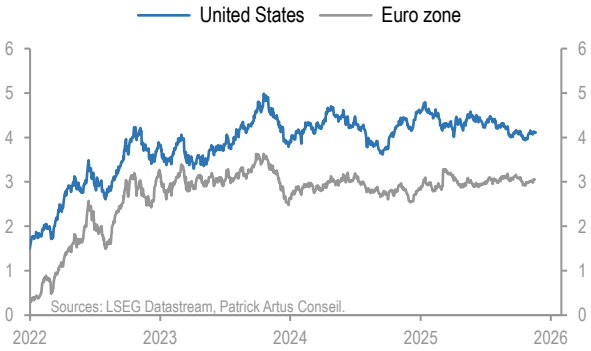


Chart 4
Euro zone: 10-year inflation swaps (as %)



The recent downward trend (since early 2024) in the 10-year interest rate in the United States can therefore be explained by the decline in the anticipated short-term interest rate, a mechanism that is no longer observed in the euro area (**Chart 5**).

Chart 5
Interest rate on 10-year government bonds (as %)



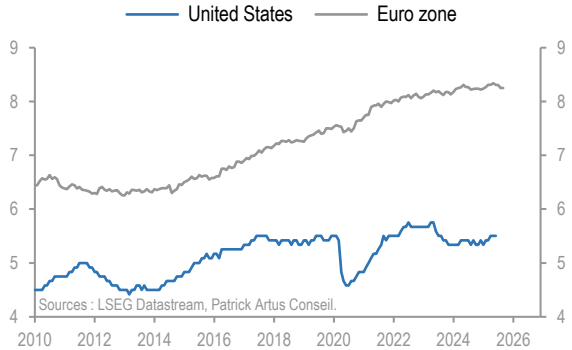
Second determinant of long-term interest rates: the variability of long-term interest rates

If **long-term interest rates are highly variable**, a risk premium emerges, which increases the level of these interest rates. Looking at 10-year interest rates (Chart 5 above), **we see fairly high volatility since the beginning of 2023 in the United States, but not in the euro area**.

Third explanation for long-term interest rates: public debt supply and public debt demand

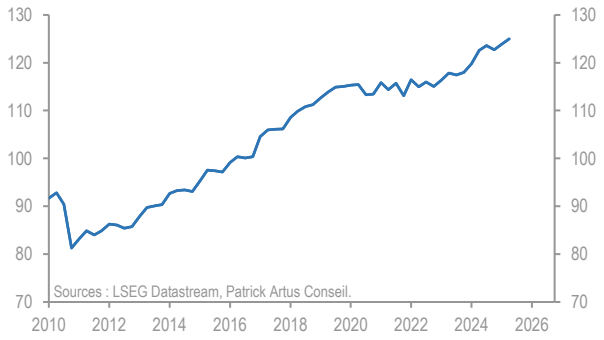
In the United States, the average maturity of public debt is low, but not in the euro zone (**Chart 6**).

Chart 6
Average maturity of public debt (in years)



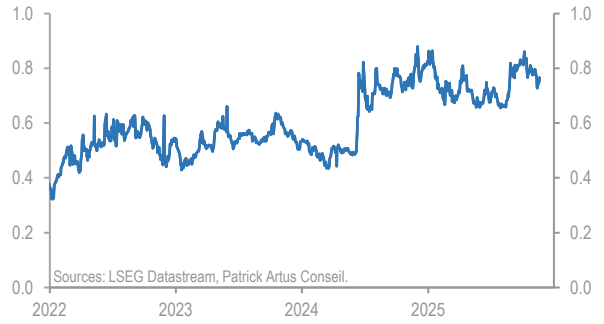
This configuration prevented the rise in the US public deficit from pushing up long-term interest rates on US public debt.
In the euro zone, the most significant development **was the increase in the supply of French debt relative to German debt** (**Chart 7**).

Chart 7
France: Public debt (as % of German public debt)



This resulted, ex ante, **in a situation of excess supply** (relative to demand) **of French debt**, which explains the rise in the spread between 10-year OAT and Bund interest rates (**Chart 8**).

Chart 8
France: Yield spread on country's 10-year government bonds against Germany (as % point)



Fourth explanation for long-term interest rates: the risk of default on public debt

Regardless of how public debt levels evolve in the United States and France, **a default on public debt is unthinkable**, given the central role of US debt in the international monetary system and, in the case of France, because a default would be unacceptable to the ECB, as it would jeopardize demand for all financial assets in the euro zone and the very existence of the euro zone.

Summary: What are the most important determinants of long-term interest rates in the United States, Germany, and France today?

In the United States, two mechanisms are currently at play: the anticipation of lower short-term interest rates and the high variability of long-term interest rates.
Expectations of a fall in short-term interest rates have prevailed since the beginning of 2025, leading to a fall in long-term interest rates.
In Germany, the 10-year interest rate has remained very stable since the beginning of 2025, with the exception of March 2025, when a massive public investment program was announced.
In France, we are seeing the effect of the increase in the supply of government securities relative to other European countries, which explains the rise in the 10-year interest rate spread vis-à-vis Germany, as well as Spain and Italy.

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