# Flash Economics

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# Why are long-term interest rates rising rapidly?

In the United States, the 10-year interest rate rose from 3.64% in mid-September 2024 to around 4.60% in mid-January 2025; in Germany, it rose from 2.03% at the beginning of December 2024 to around 2.50% in January 2025.

This rise in long-term interest rates can be explained by:

- The good health of the US economy, with job creation (256,000 in December after 212,000 in November) leading to expectations of continued fairly high inflation (underlying inflation was 3.2% in December in the US), and short-term interest rates remaining high, especially as the economic policies suggested by Donald Trump (curbing immigration, tariffs) are inflationary.
- In the euro zone, through three mechanisms: the transmission of long-term interest rates from the United States to the euro zone; the rise in inflation (2.4% in December and 2.7% for total inflation excluding energy and unprocessed food); and the halt in reinvestments in securities maturing in the ECB's bond portfolio (more specifically the Pandemic Emergency Purchase Programme). Political uncertainty may also play a role.

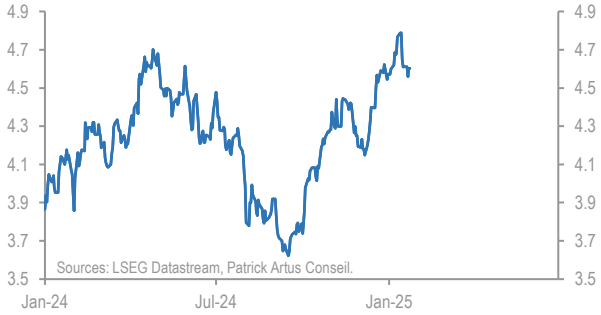
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## Sharp rise in long-term interest rates since autumn 2024

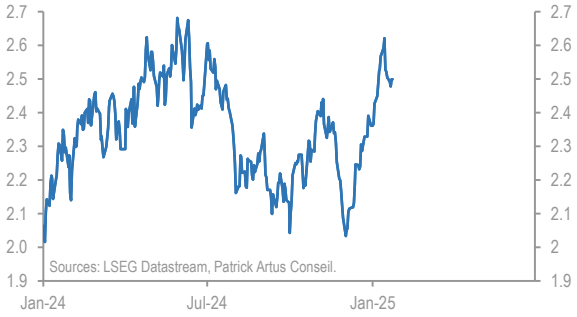
**The 10-year interest rate** on US government debt rose from 3.64% in mid-September to around 4.60% at the end of January 2025 (**Chart 1a**).

Chart 1A
United States: Interest rate on 10-year government bonds (as %)




**The 10-year interest rate in Germany** rose from 2.03% at the beginning of December 2024 to 2.50% at the end of January 2025 **(Chart 1b)**.

Chart 1B
Germany: Interest rate on 10-year government bonds (as %)




We believe **that this rapid rise in long-term interest rates in the United States and the euro zone can be explained and could have been anticipated**.

## Causes of the rise in long-term interest rates in the United States

The US economy is characterised by:

- **fairly strong GDP growth** (3.0% over one year in Q2 2024 and 2.7% in Q3, **Chart 2**), and employment (**Chart 3**).

Chart 2
United States: Real GDP (Y/Y as %)

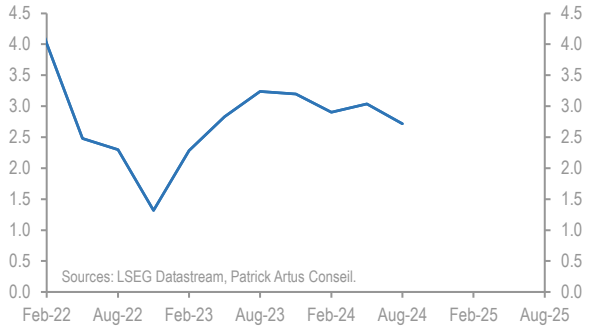
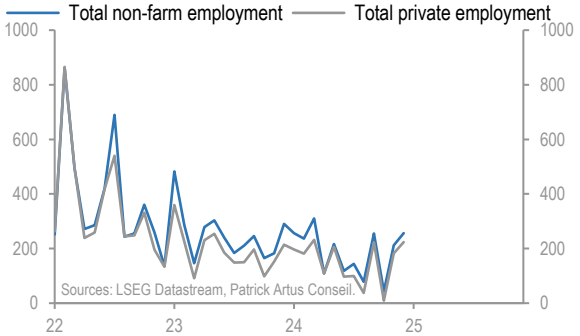



Chart 3
United States: Change in payroll employment (M/M, thousands of person)



- **inflation remaining high** (total inflation over one year was 2.9% in December, and underlying inflation 3.2%), **Chart 4.**

**Chart 4**
**United States: Headline inflation and core inflation**

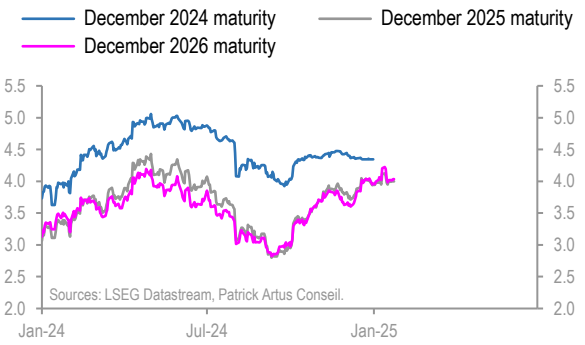



This **prospect of resilient inflation is reinforced** by the anticipation of the inflationary policies that Donald Trump wants to pursue (curbing immigration, sharp rise in customs duties).

As a result:

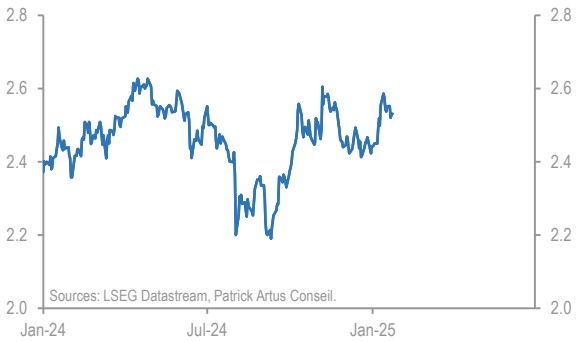
- **Short-term interest rate expectations remain high** and have risen sharply since the summer of 2024 (**Chart 5**);

**Chart 5**
**United States: Eurodollar contracts (3-month)**




- **Long-term inflation expectations** (measured by 10-year inflation swaps) have also risen (**Chart 6**).

**Chart 6**
**United States: 10-year inflation swaps (as %)**




**As a result, short-term interest rates and long-term interest rates have risen, as we have seen.**

## Causes of the rise in long-term interest rates in the euro zone

**The 10-year interest rate on German public debt** rose from just over 2% at the beginning of December 2024 to around 2.50% in January 2025 (**Chart 7**).

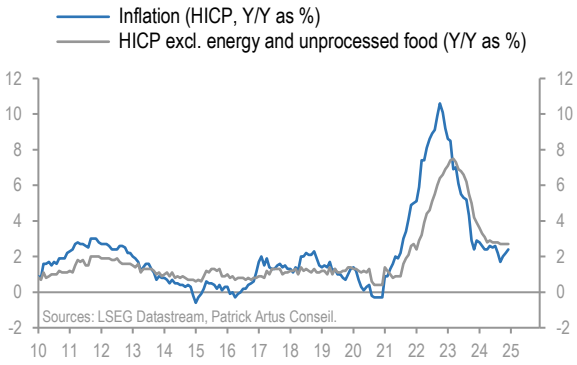
**Chart 7**
**Germany: Interest rate on 10-year government bonds (as %)**




**This rise is due to three mechanisms:**

- **The transmission of the rise in US long-term interest rates to the euro zone;**
- **The upturn in inflation in the euro zone;** in December 2024, total inflation was 2.4% year-on-year (compared with 1.7% in September) and inflation excluding energy and unprocessed food was 2.7% (**Chart 8**).

**Chart 8**
**Euro zone: Inflation and core inflation**



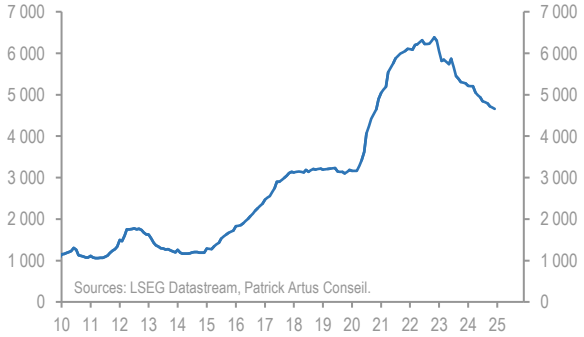

This rise in inflation has led to uncertainty on the part of the financial markets as to the extent of the ECB's interest rate cut, which is reflected **in a rise in short-term interest rate expectations** (**Chart 9**), consistent with the rise in long-term interest rates;

**Chart 9**
**Euro zone: Euribor contracts (3-month)**



- The contraction in the size of the ECB's balance sheet has been visible since the beginning of 2023 (Chart 10).

Chart 10
Euro zone: Monetary base (EUR bn)




But this contraction accelerated from the beginning of January 2025 with the cessation of reinvestments of bonds maturing under the Pandemic Emergency Purchase Programme (PEPP). This halt will reduce the euro zone's monetary base by a further €175 billion in 2025 (note that since 1 July 2024, there has already been a fall in reinvestments from the PEPP of €7.5 billion per month).

It is also likely that the political risk in Germany and France has pushed up long-term interest rates in the euro zone as a whole.

## Summary: the main reason for the rise in long-term interest rates is the risk of inflation

There has been no major contraction in the monetary base (the quantity of central bank money) in the United States, and in the euro zone it has been shrinking rapidly (by almost €80 billion a month) since the start of 2023. The new fact that has emerged is the resilience of inflation (underlying inflation of 3.2% year-on-year in the United States, 2.7% year-on-year in the euro zone), which has caused an upward correction in expectations of short-term interest rates and long-term interest rates. This correction was to be expected.

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