Flash Economics

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What is the expected trend in long-term interest rates on US public debt?

Nominal long-term interest rates on public debt depend on:

- The expected trend in short-term interest rates, and hence the outlook for inflation and growth;
- Expected long-term inflation;
- The variability of short-term and long-term interest rates, and hence the variability of the economy;
- The degree to which investors perceive risk;
- Changes in the fiscal deficit and public debt.

We can see that these trends have opposing effects on long-term interest rates:

- Short-term inflation will rise, due to the introduction of tariffs, which will lead to a more restrictive monetary policy, thus pushing up long-term interest rates;
- Expected growth and consumer confidence are falling, due to the inflation outlook, which is pushing long-term interest rates down;
- Interest rate variability is high, pushing up long-term interest rates;
- The perception of risk is increasing, pushing investors towards non-risky assets and driving down long-term interest rates;
- The fiscal deficit is very high, which favours a rise in long-term interest rates.

In theory, the effect on US long-term interest rates is uncertain; in practice, the mechanisms that lead to a fall in long-term interest rates seem to prevail today.

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The global importance of the level of US long-term interest rates

The level of long-term interest rates in the United States **influences the level of long-term interest rates in most countries around the world** (**Charts 1A/B**).

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

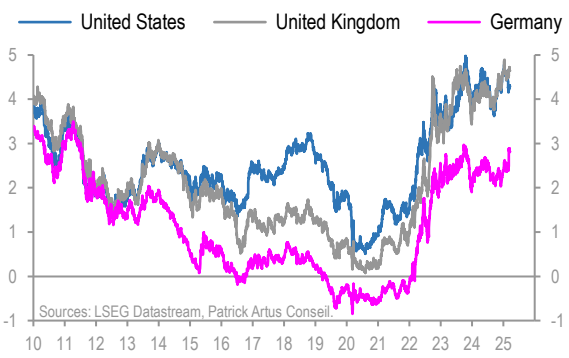


Chart 1B
Interest rate on 10-year government bonds (as %)

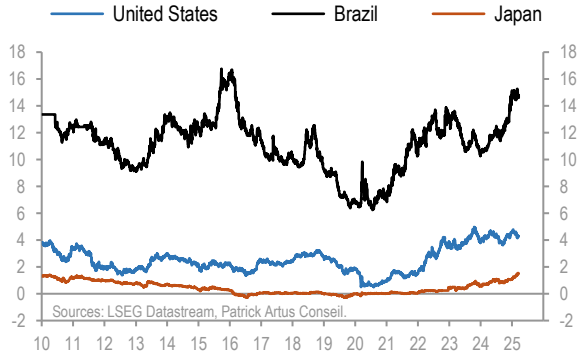
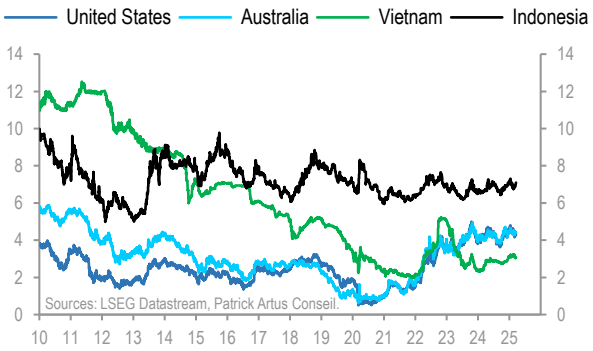
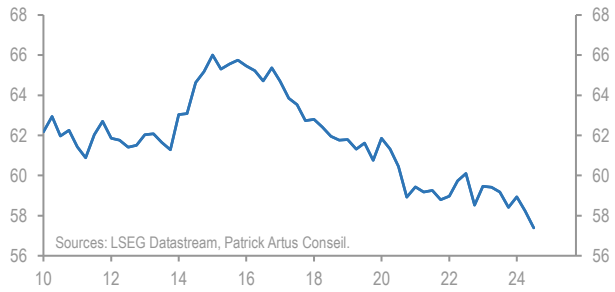


Chart 1C
Interest rate on 10-year government bonds (as %)



Moreover, the large weight of US public debt (Treasuries) in global debt reserves (**Chart 2**), and the large weight of the dollar in international bond issues (70%) and bank loans (60%), show that **the benchmark long-term security is a dollar bond**, which demonstrates the importance of long-term interest rate movements on the dollar.

Chart 2
World: Weight of US dollar in the global foreign exchange reserves (as %)



What do long-term interest rates on the dollar depend on?

Five variables can be identified as having an influence on the level of long-term interest rates on the dollar:

- The expected short-term interest rate, which in turn depends on the outlook for inflation and growth;
- Expected long-term inflation;
- The variability of short-term and long-term interest rates, and hence the variability of the economy (inflation, growth);
- The degree to which investors perceive risk, which determines demand for US Treasury bonds;
- The level of the fiscal deficit and public debt, i.e. the supply of US Treasury bonds.

What are the effects of these drivers of long-term interest rate?

1. **The 2-year interest rate and the expected 3-month interest rate for the end of 2025 and 2026 (Charts 3A/B) have risen sharply since October 2024**.

Chart 3A
United States: Interest rate on 2-year government bonds (as %)

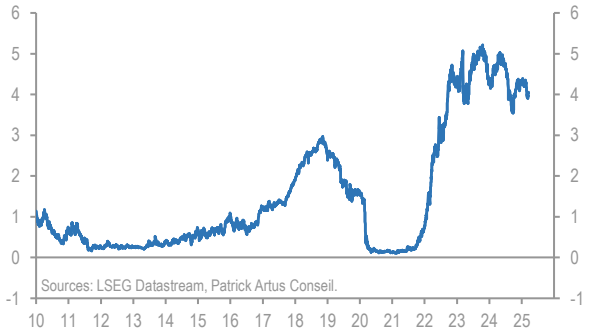
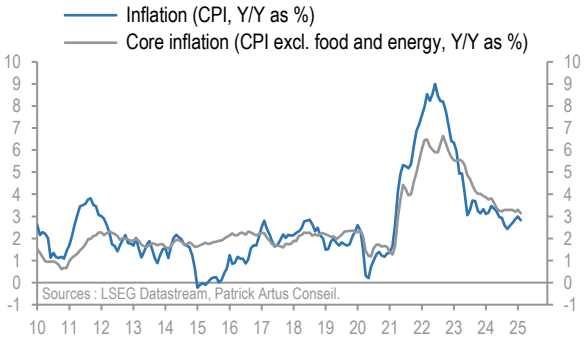


Chart 3B
United States: Eurodollar contracts (3-month)



These trends reflect the **inflationary pressures** that persist in the United States (**Chart 4**), and which will be reinforced by the introduction of tariffs and policies to expel immigrants.

Chart 4
United States: Headline inflation and core inflation (as%)

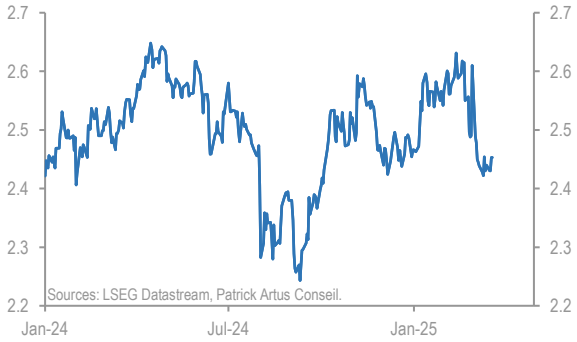


2. **Long-term inflation expectations**, which we represent by 10-year inflation swaps (**Charts 5A/5B**), have risen slightly (from 2.25% to 2.45%) since the summer of 2024.

Chart 5A
United States: 10-year inflation swaps (as %)



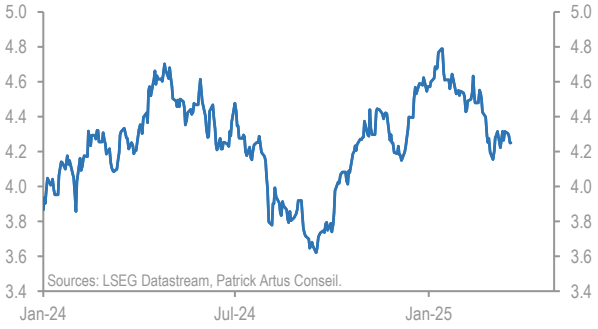
Chart 5B
United States: 10-year inflation swaps (as %)



3. **If the variability of long-term interest rates**, which also reflects the variability of short-term interest rates, is high, **the term premium rises**, as do long-term interest rates.

   The heightened uncertainty about US economic policies that has emerged since the election of Donald Trump has indeed led **to high variability in 10-year interest rates** (**Chart 6**) and expected short-term interest rates (Chart 3b above).

Chart 6
United States: Interest rate on 10-year government bonds (as %)



4. The degree of risk perception **determines demand for US Treasury bonds**. Risk perception has become elevated, with uncertainty over tariff policy, migration policy, foreign policy and institutions in the United States.

   Normally, a high perception of risk pushes investors towards government securities and lowers long-term interest rates. But if the perception of risk relates to US economic and fiscal policy, long-term interest rates rise. Since the summer of 2024 (Chart 6 above), long-term interest rates have risen and since the beginning of 2025 they have fallen significantly.

   The level of demand for US Treasury bonds can be seen by comparing **the 10-year interest rate on US public debt and the 10-year interest rate on dollar swaps** (the swap spread is the difference between the swap interest rate and the interest rate on public debt; it decreases if the systemic risk associated with the deterioration of public debt increases relative to the systemic risk associated with holding private sector or bank bonds, **Charts 7A/B**).

Chart 7A
United States: Interest rate on 10-year government bonds, Interest Rate Swaps 10 Years and swap spread

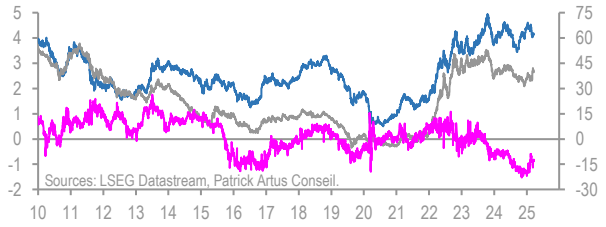
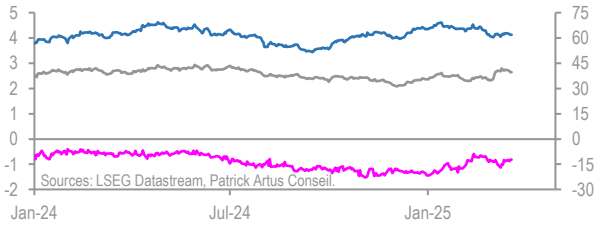


Chart 7B
United States: Interest rate on 10-year government bonds, Interest Rate Swaps 10 Years and swap spread



Charts 7A and 7B show a significant fall in the swap spread since the summer of 2023, which is consistent with a loss of quality in US public debt.

5. **The supply of public debt** is characterised in flow terms by the fiscal deficit, and in inventory terms by the public debt ratio (**Charts 8A/B**).

Chart 8A
United States: Fiscal deficit (as % of nominal GDP)

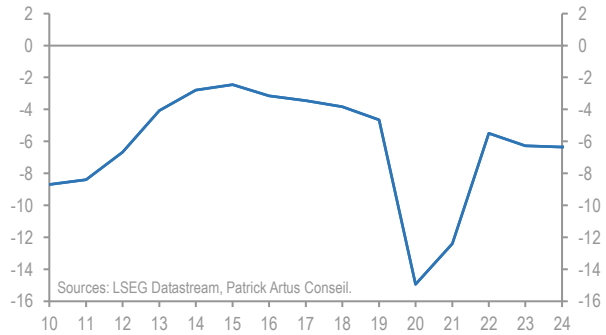
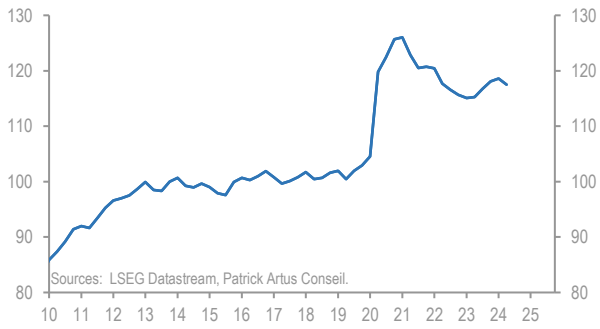


Chart 8B
United States: Public debt (as % of nominal GDP)



Charts 8A/B show the sharp rise in the fiscal deficit and public debt since 2020.

Summary: an ambiguous trend in long-term interest rates in the United States

We have seen that in the United States today there is:

- An increased risk of inflation;
- An increased risk of weak growth;
- A slight rise in expected long-term inflation;
- High variability in short- and long-term interest rates;
- A large fiscal deficit and high public debt.

Risk perception, linked to policy uncertainty, is high. But we do not know whether this encourages the holding of US Treasury debt relative to risky assets (equities, corporate bonds) or whether it discourages the holding of Treasury bonds. Swap spreads show that the quality of US government debt is declining, but not enough for long-term interest rates to rise overall.

All in all, the future trend in long-term interest rates is ambiguous; observation of recent developments shows that the mechanisms that lead to a fall in long-term interest rates (lower growth forecasts, strong perception of risk) now outweigh those that would imply a rise in long-term interest rates (increased risk of inflation, high variability of interest rates, high deficit and public debt).

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