Flash Economics

N° 82
July 10, 2025

Evolution of long-term interest rates: in the United States, conflict between short-term interest rate expectations and those of the public deficit; in the euro area, conflict between short-term interest rate policy, quantitative tightening, and public deficit expectations

In the United States, long-term interest rates have been trending downwards since autumn 2023. Going forward, the anticipated decline in short-term interest rates will be offset by the rise in the public deficit and public debt ratio. Once short-term interest rates stabilise, this increase in public debt will exert upward pressure on long-term interest rates.

In the euro area, long-term interest rates have remained stable—ignoring short-term fluctuations—since autumn 2022. This stability reflects a conflict between the anticipated decline in short-term interest rates, on the one hand, and quantitative tightening and public deficit expectations (particularly with rising expectations in Germany), on the other. Looking ahead, if inflation and growth remain weak, one might expect an end to quantitative tightening. However, public finances will remain degraded once the decline in short-term interest rates is complete, and the dominant effect should be an increase in long-term interest rates.

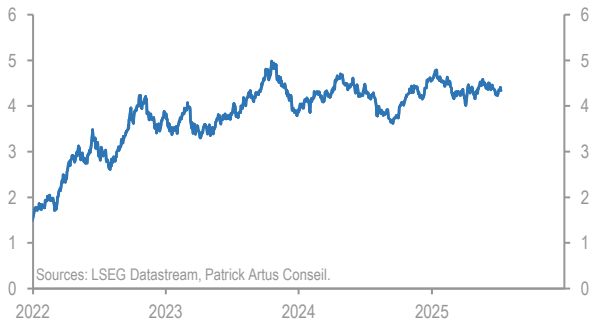
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Outlook for long-term interest rates in the United States

Long-term interest rates have been trending downwards in the United States since autumn 2023 (**Chart 1**).

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



In recent months, particularly since early 2025, the dominant driver has been the **anticipated decline in short-term interest rates** (**Charts 2a/b**), prompted by falling inflation and the change in leadership at the Federal Reserve in mid-2026. The new chair, appointed by Donald Trump, is very likely to favour lower interest rates.

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

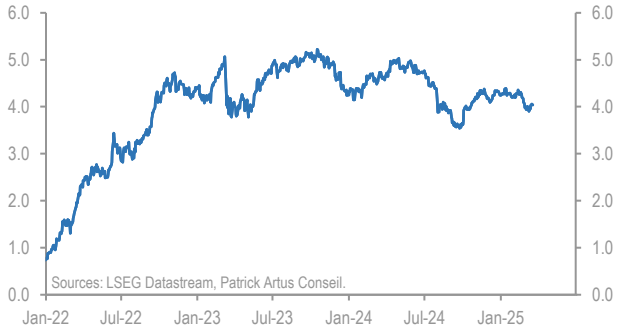


Chart 2B
United States: Eurodollar contracts (3-month)



However, **long-term interest rates are expected to come under upward pressure in the future due to the accumulation of public debt**, resulting from very large fiscal deficits caused by the substantial tax cuts implemented by the Trump administration (**Charts 3a/b**).

Chart 3A
United States: Public debt (as % of nominal GDP)

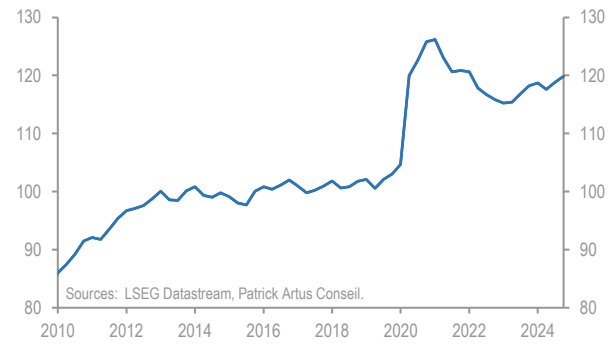
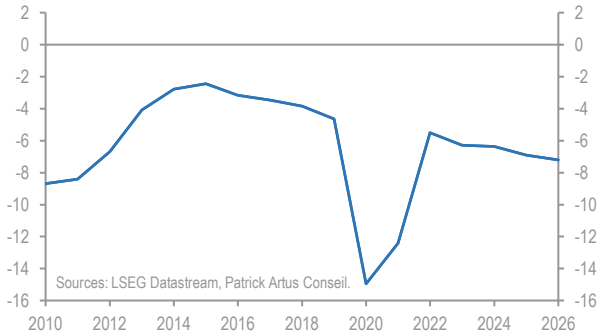


Chart 3B
United States: Budget deficit (as % of nominal GDP)

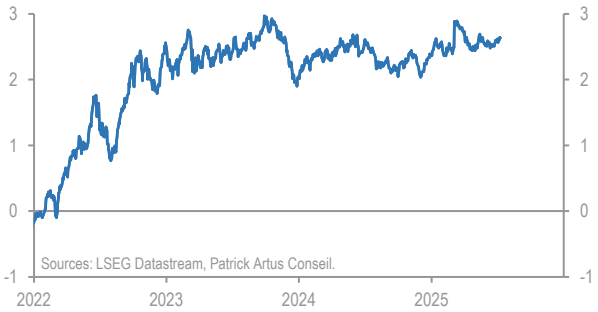


One can therefore anticipate, once short-term interest rates have stabilised, **a gradual rise in long-term interest rates in the United States.**

Outlook for long-term interest rates in the euro zone

Notwithstanding short-term fluctuations, **the long-term interest rate in the euro zone has remained stable since autumn 2022** (**Chart 4**).

Chart 4
Germany: Interest rate on 10-year government bonds (as %)



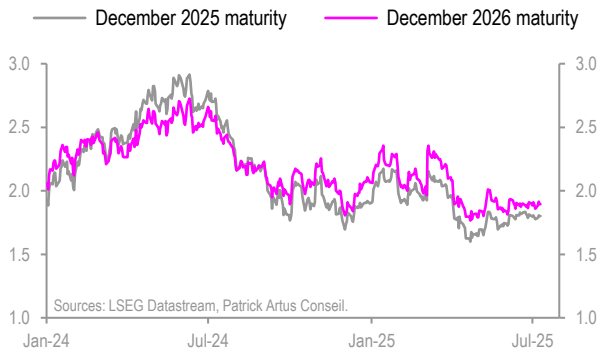
This stability stems from **a conflict between**:

- **The anticipated decline in short-term interest rates**, associated with falling inflation (**Charts 5a/b**);

Chart 5A
Germany: Interest rate on 2-year government bonds (as %)



Chart 5B
Euro zone: Euribor contracts (3-month)



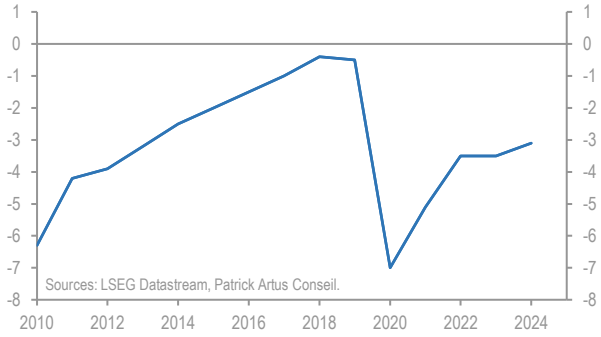
- **Quantitative tightening since the end of 2022** (**Chart 6**); ECB research estimates that a €1 trillion reduction in the size of the ECB's balance sheet leads to a 35-basis-point increase in euro zone long-term interest rates;

Chart 6
Euro zone: Monetary base (EUR bn)



- **Expectations of a higher-than-previously-forecast public deficit in the euro zone** (**Chart 7**), particularly in Germany, where Chancellor Merz has decided to significantly increase military spending and infrastructure investment. As a result, Germany's public deficit is expected to rise above 4% of GDP.

Chart 7
Euro zone: Fiscal deficit (as % of nominal GDP)



Looking ahead, once short-term interest rates have stabilised (which is nearly the case), and quantitative tightening comes to an end (due to weak growth and inflation), **large public deficits are likely to persist and push long-term interest rates higher**.

Summary: Long-term interest rates likely to rise in the United States and the euro zone

Once other drivers of long-term interest rates—such as short-term interest rates and the size of the ECB's balance sheet—have stabilised, the remaining factor in the United States and the euro area will be the effect of large public deficits and rising public debt levels, which would lead to a gradual increase in long-term interest rates relative to current levels.

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