Chart of the Day

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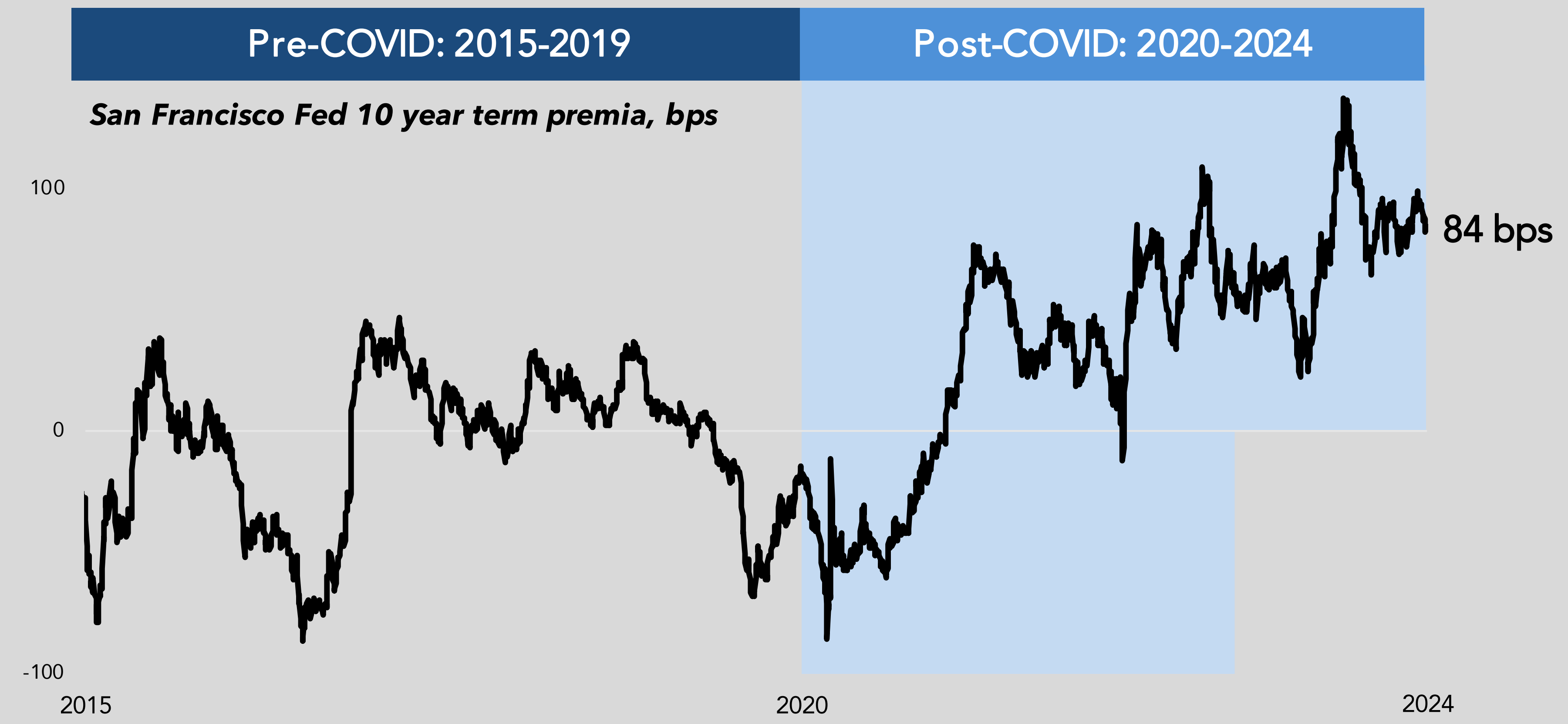
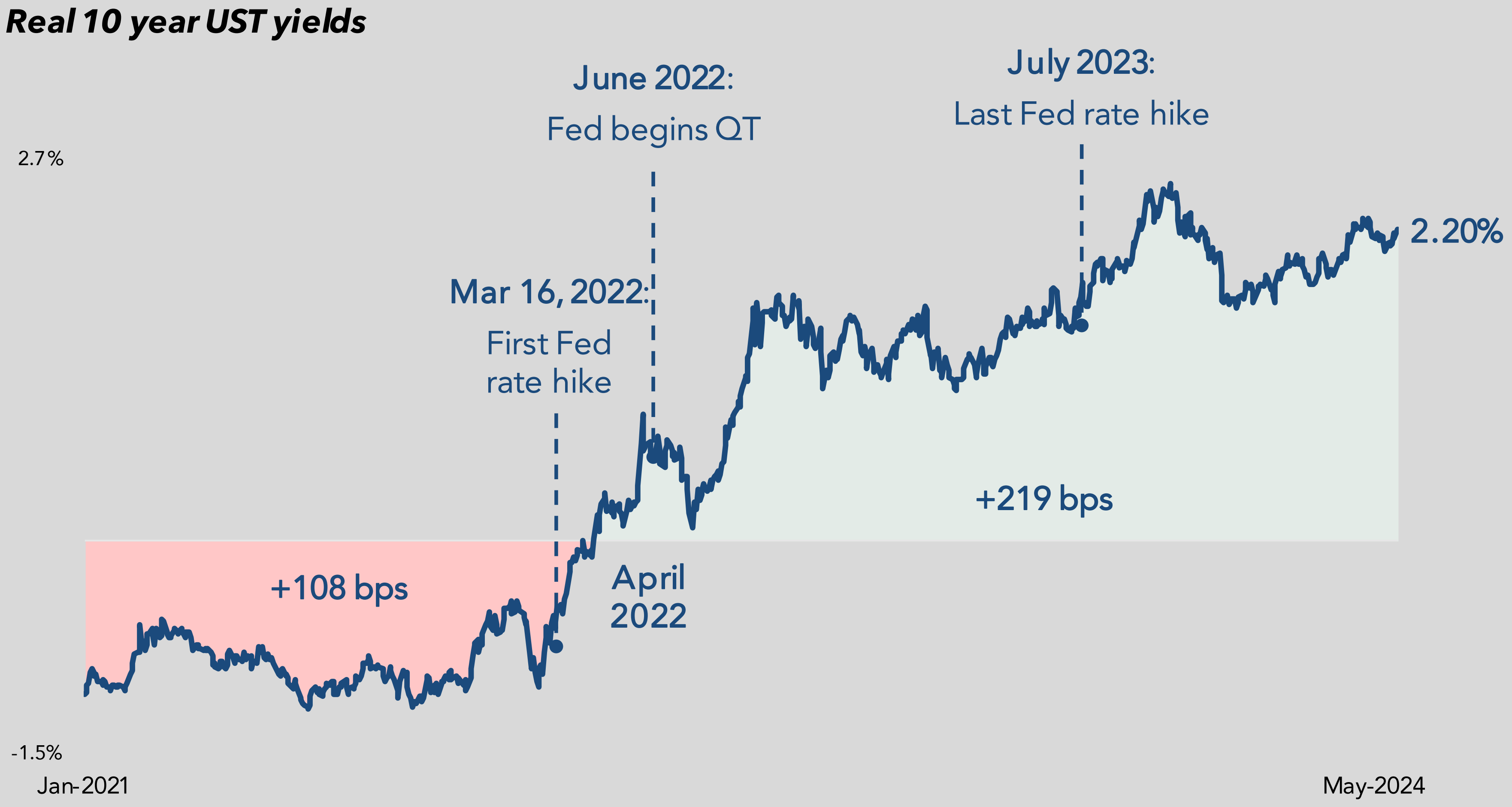
New Era of Higher Term Premia

Post COVID, we have entered a new era of fiscal dominance, with elevated structural deficits likely to continue for the rest of the decade. This, in turn, will complicate the Fed's reaction function, contributing to higher rate volatility and elevated term premia. According to Oxford Economics, term premia, as measured by the Federal Reserve Bank of San Francisco's index, is now set to trade in a higher 75-100 bps range in the post-pandemic era, up from the 25-50 bps range in the prior "secular stagnation" period.



New Period of Higher Real Rates

Since the Fed began its accelerated "double tightening" (raising rates, reducing balance sheet) in March 2022, and as the economy has shown resilience with inflation declining, US "real" rates have moved more firmly positive. With "real" rates elevated during a "higher for longer" Fed pause, assessing the impact of "sufficiently restrictive" becomes more challenging.



Source: (1-2) Oxford Economics. Bloomberg. Data as of May 28, 2024. Term premia is San Francisco Fed 10 year Treasury yield zero coupon.

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"Macro stability isn't everything, but without it, you have nothing."