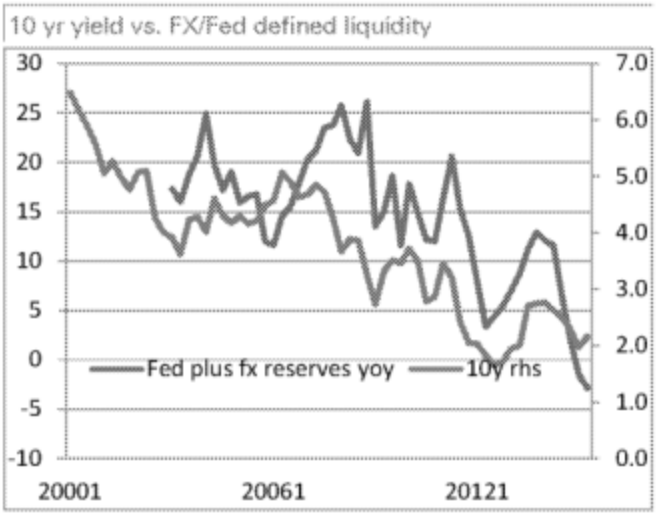
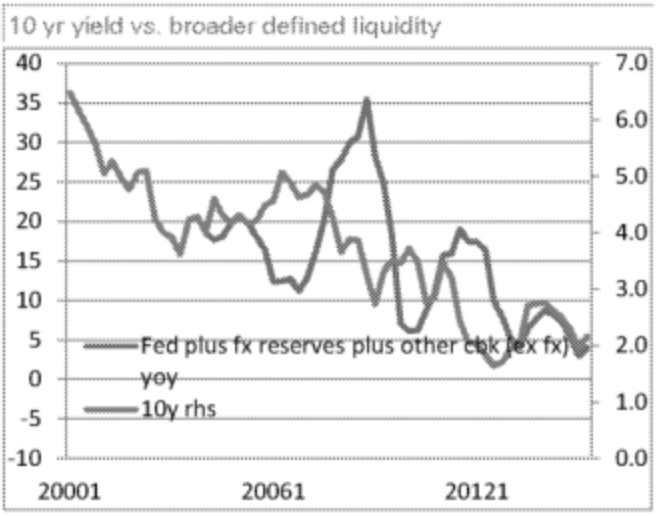
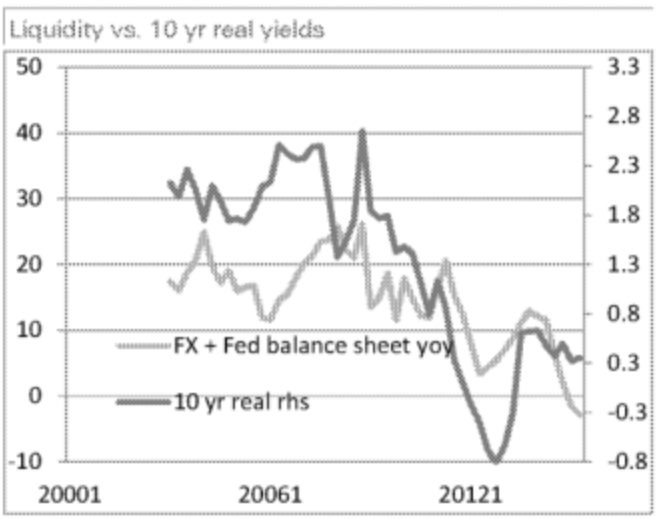


Source: Bloomberg Finance LP and Deutsche Bank

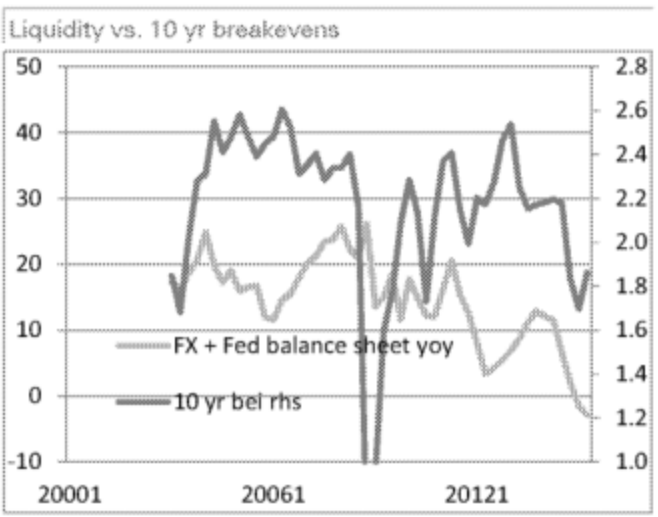


Source. Fed and Deutsche Bank

Breaking down the breakeven and real yield components verifies that central bank liquidity has been more associated with real yields then breakevens, however the relationship is perverse! Real yields have tended to fall when balance sheet expansion is slowing while breakevens have generally been more sticky. This suggests that risk assets drive (real) yields and that breakevens anticipate a (delayed) liquidity injection. This is corroborated by also considering the curve. Like real yields 5s10s is well correlated (positively) with real yields. Note that prior to the crisis the relationship looked more "normal" in that expanding liquidity drive yields lower and vice versa. So something has changed since the crisis—this we think is very important and again, will revisit below.



Source: Bloomberg Finance LP and Deutsche Bank



Source. Fed and Deutsche Bank

The relationship between 5s10s and 10s in real terms screams 5y5y! And indeed we overlay 5y5y to liquidity there is a very tight, almost scary, relationship. The relationship even predates the crisis. Tighter liquidity essentially forces the 5y5y nominal rate lower reflecting some combination of a flatter curve and higher yields with a steeper curve and lower yields. Fundamentally we think this ultimately speaks to a lower terminal policy rate so that it doesn't really matter whether the term structure is trying to shift higher or lower but the curve will more than compensate so that if the trend is towards less central bank liquidity, the terminal rate is falling.