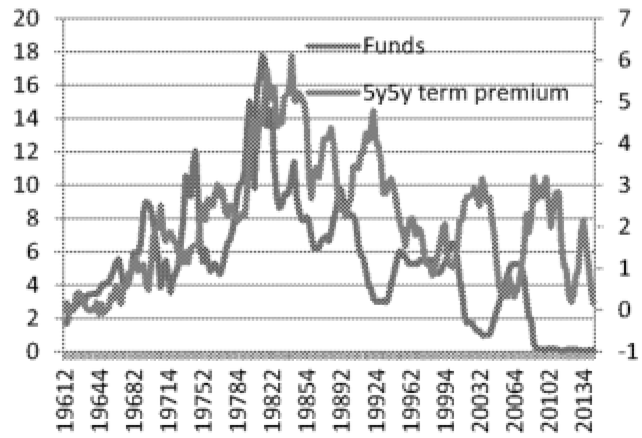
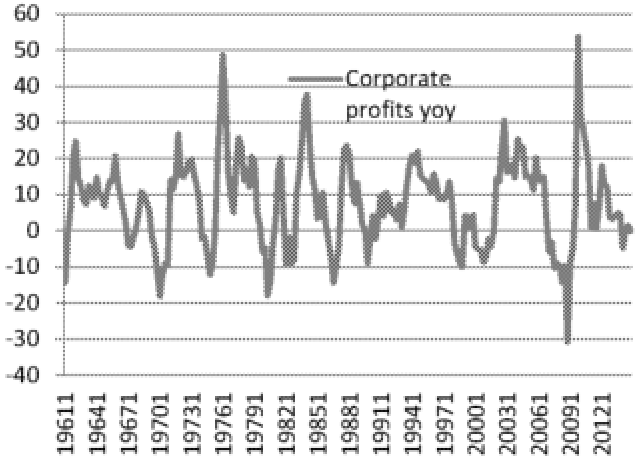
Term premium itself could also adjust even if the terminal funds rate outlook doesn't. In many ways this is probably a bigger risk especially if we link the term premium decline to foreign demand for US rates. We showed the other week the correlation between the decline in the term premium and "overinvestment" by foreign central banks into Treasuries. Note that the term premium enjoyed an accelerated decline in late 2014 but has since been more stable, in line with the collapse in euro yields. Clearly any shift in the Euro outlook could lead to a reversal in the drop in term premium in the US. However in this regard the Fed's own shift in their dot plot should be taken into consideration. The dots have both become less diverse and importantly the lower long term dot outlook – which we think has more to go – serves by definition to reduce market uncertainty around the Fed's normalization process. As such it is not at all clear that term premium should rebound 100 – 150 bps or so i.e. to mid 2014 levels or at least might be confined to a more moderate rise. This is especially likely once normalization begins in that in all the tightening cycles since the late 1980s term premium falls when the Fed tightens.

Funds vs. 5y5y term premium



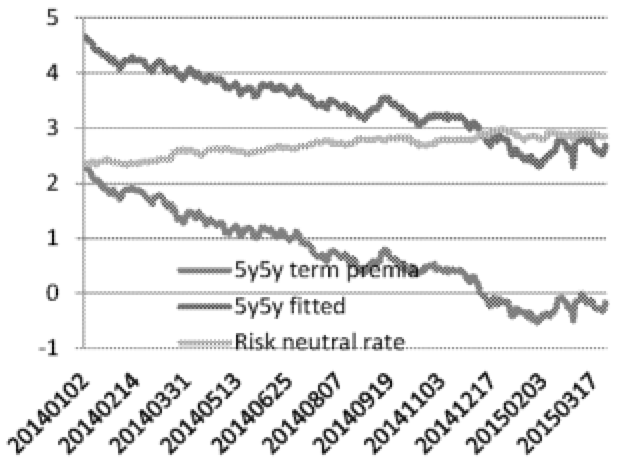
Source: IMF, Bloomberg Finance LP and Deutsche Bank

Corporate Profits yoyo



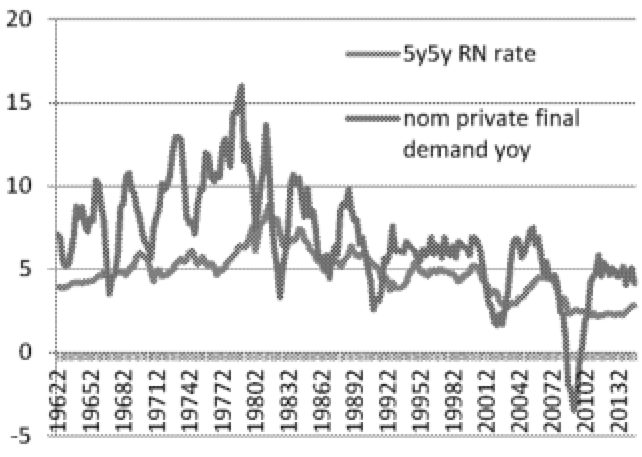
Source: IMF, Bloomberg Finance LP and Deutsche Bank

5y5y term premium, fitted and neutral rate



Source: IMF, Bloomberg Finance LP and Deutsche Bank

Nominal Private final demand vs. 5y5y risk neutral rate



Source: IMF, Bloomberg Finance LP and Deutsche Bank