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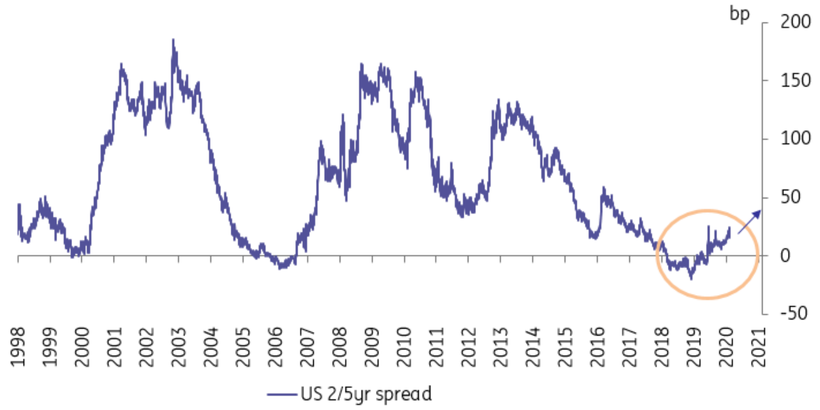
# USD: That stretchy feeling for the curve

The shape of the curve is all about direction in 2021. By 2022 that will likely change as the debate on possible Fed hikes by 2023 will be live, unnerving the jumpy 2yr. But for now, even the vaccine moment did not radically impact the fed funds strip, and by extension the 2yr. Given that, watch the 2/10yr curve stretch to 100bp, driven by back end direction


## It's a directional curve for 2021 with the front end anchored

We'll see the reflation discount in the shape of the curve; it should steepen. Watch the US curve here more than the eurozone one, as the latter has a strange front end that can go as deeply negative as it likes it seems, bringing long end rates with it. The US curve is more anchored at zero. When it stretches steeper, it means something.

## US 2-5 yr spread




Source: Macrobond

## The 2/5yr anticipated a recession back in 2019, but now it is stretching steeper; a reflation story

As it does stretch steeper, it further moves clear of the inversion episode seen in mid-2019. Remarkably back then the curve was already discounting a recession. Well, we got one. And we'll likely get a Covid-induced a double-dip. Beyond that, a steepening bias should dominate as a theme for 2021. As the 10yr marks a 1-handle, we'd see the 2yr remaining in sub-25bp territory. Hence a 100bp 2/10yr curve targets the 10yr in the 1% to 1.25% range.

*The debate on the Fed hiking rates will be a live one by the time we get to 2022*

Even in the wake of the vaccine announcement, there was very little shift in the Fed funds strip. Implied rates in 2021 and 2022 did ease higher a tad, but not significantly so. This maintains a firm footing for the 2yr to remain anchored in 2021. That said, the debate on the Fed thinking about hiking rates will be a live one by the time we get to 2022 - any sense that the Fed could hike in 2023 would be reflected in the 2yr by 2022.

For 2021 though, there should be less discussion on Fed hikes as a live issue. In fact, this is one of the reasons underpinning the rich valuation attached to the 5yr on the curve. That is highly correlated with the money market curve and by extension rate expectations; these remain dampened down, and will likely remain so for the bulk of 2021.

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