Reflation Dashboard: No need for a full unwind

Markets have tempered their reflation optimism. But there are enough supporting factors to prevent a full post-election unwind.

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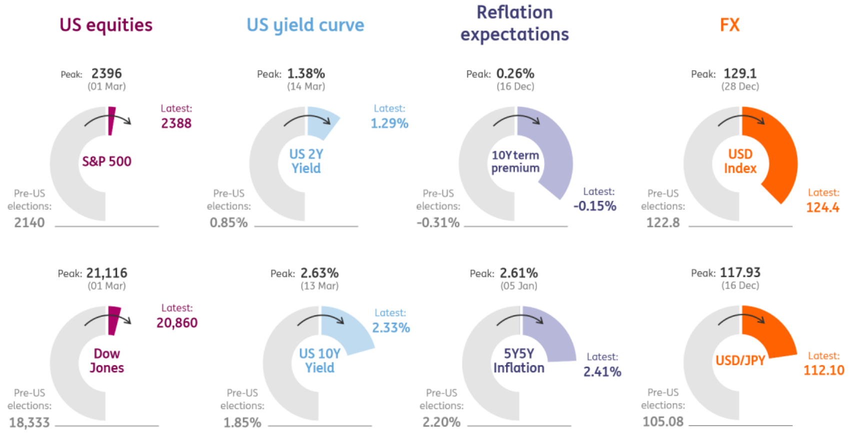
The first 100 days of Trump have been clouded with regime uncertainty, which has seen markets temper their reflation optimism. But in the absence of a spike in global risk aversion, we see enough supportive factors to prevent a full post-election unwind.

- Since the inauguration there have been three main rates implications: (1) the 2/10yr curve is 30bp flatter; (2) the terminal Fed funds rate is 50bp lower and (3) the 10yr yield is 25bp lower. Therefore there's been a strong unwind of the Trump effect.
- The election effect also manifested in a significant duration short built by market participants, with market talk centred on a target of 3% for the 10yr yield. But the theme the since inauguration has been a failure to get much above 2.6%.
- The path of least resistance has been slowly but surely to test in the direction of lower rates.
- The first 100 days have concluded with the notion that the Fed could severely undershoot its "dots" in the coming years. If so, and PCE inflation remains subdued, then US 10yr rates could in principle move back below 2%.
- But this also depends on the Trump policy agenda over the next 100 days.

- US macro data – a story which has largely been ignored in recent months – point to a solid base for US assets. More attention will be paid on the state of US economy as we get clarity on tax reforms – which even if watered down are a net stimulus.
- The other key point to bear in mind is that there is no term premium in the 10yr yield now. In other words the 10yr yield only discounts future rate hikes. With the term premium moderately negative, investors are not being compensated for extensions out the curve – another argument for why 10yr rates should be higher.

Rise and fall in markets shows fading fiscal stimulus hopes



Source: Bloomberg, ING