

# Term premiums: We've seen this movie before

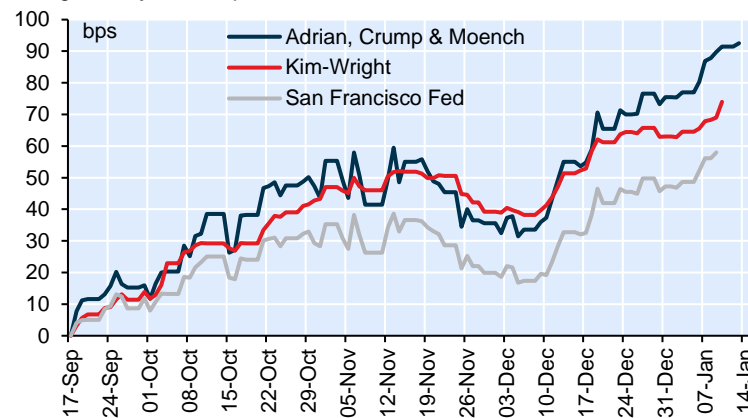
By Taylor Schleich & Ethan Currie

It wasn't that long ago that there was a widespread belief that inflation would ease back to target thanks to softening economic conditions which would lead to steady Fed easing. Resilient economic data and stickier-than-expected inflation have since dealt repeated blows to that narrative, save for an encouraging CPI release today. Meanwhile, the election of Donald Trump, his fiscal policy pledges and constant tariff threats have together contributed to a repricing of the policy rate path as well, helping send Treasury yields decisively higher in recent months. The President-elect's commitments have also introduced tremendous uncertainty, leading to volatility that investors are increasingly demanding compensation for. Indeed, the term premium, no matter how you model it, has been jolted higher since the late summer. This isn't the first time we've seen this movie though.

Back in late 2016 and early 2017, similar uncertainty brought about a similar increase in the term premium as Trump secured election victory and inauguration day approached. Scan the headlines eight years ago and you could easily mistake them for something published in recent weeks: "Array of uncertain outcomes under Trump prompting selloff", "Increased debt issuance assumed to finance spending plans".

### Chart 1: Term premiums have been rising in recent months...

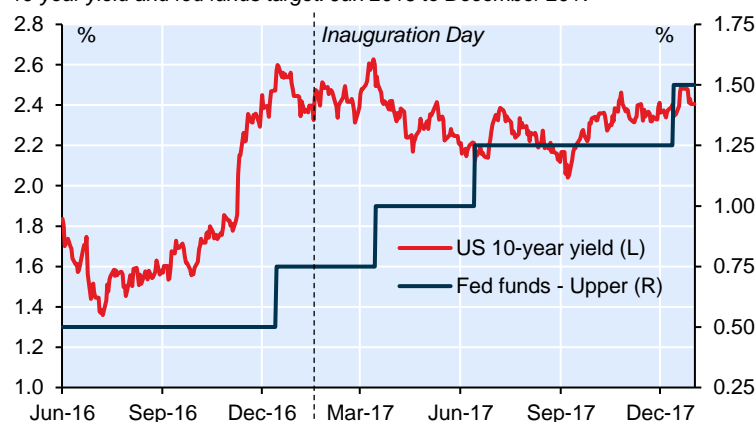
Change in 10-year term premium since the Fed's first rate cut



Source: NBC, BBG | Note: Model data published with a lag. Latest data span 9-Jan to 13-Jan.

### Chart 3: 10-year yield didn't rise in 2017 despite rate hikes

10-year yield and fed funds target: Jun 2016 to December 2017



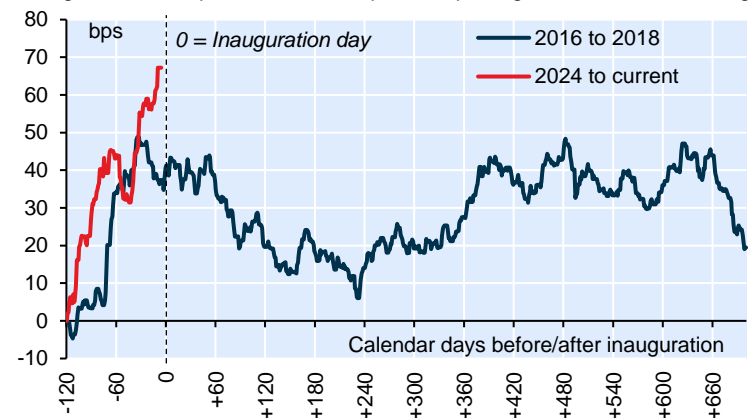
Source: NBC, BBG

So, the pre-inauguration period didn't look that different than today but what did it all amount to after Trump took office? Not much. Ultimately, the term premium steadily moderated after the first few months of 2017 as uncertainty resolved and markets tempered expectations on the President's policy action. While the term premium did rebound the next year, it never meaningfully surpassed the level it resided at in the weeks leading up to his presidency. 10-year yields edged down in 2017 too despite the Fed steadily hiking throughout the year.

To be sure, this is a rather simplistic lookback to one single historical episode. The world in 2025 is not the same as it was in 2017. For one, the U.S. fiscal trajectory is more alarming than it was nearly a decade ago. This alone argues for structurally more compensation for duration risk. Meanwhile, Trump's affinity for tariffs appears to have only grown over time. So yes, there's a world in which he plunges the deficit further while imposing tariffs on anyone brash enough to run a trade surplus against the U.S. But there's at least some empirical evidence to suggest he won't. For now, we remain very cautiously optimistic that cooler heads will (mostly) prevail. That creates scope for (further) long-end rate relief in the not-too-distant future even with a very cautious Fed.

### Chart 2: ...which is not unlike what happened in 2016-17

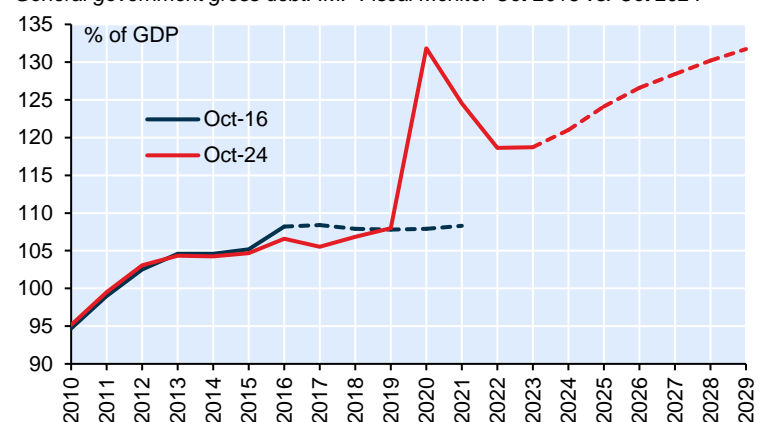
Change in 10Y term premium vs. 120D pre-Trump inauguration: Current vs 8Y ago



Source: NBC, BBG | Note: Term premium per the Kim-Wright model

### Chart 4: The fiscal backdrop is entirely different vs 8Y ago

General government gross debt: IMF Fiscal Monitor Oct-2016 vs. Oct-2024



Source: NBC, IMF Fiscal Monitor | Note: Dotted line refers to projections as of FM publication



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