Figure 1.2.1. Policies Have Led to Compressed Term Premiums and Market Abnormalities

Quantitative easing programs in the United States have compressed term premiums (10-year Treasury) well below historical averages...

1. U.S. 10-Year Treasury Risk Premium (Percent)

Accommodative policies have led to signs of overvalued sovereign bonds.

3. Sovereign Bond Valuations (Standard deviations)

...dampening market expectations of the terminal federal funds target.

2. Terminal Federal Funds Rate Projections (Percent)

Corporate leverage in the United States has risen but credit spreads have diverged in recent years.

4. Corporate Leverage and Spread

Sources: Kim and Wright (K and W) (2005, updated); and IMF staff estimates.
Note: K and W estimates as of end-June 2015. The upper bound of the blue bar indicates the average K and W term premium from 1990 to 2007, while the lower bound indicates the average term premium from 2000 to 2007.

Sources: Bloomberg, L.P.; Kim and Wright (K and W) (2005, updated); and IMF staff estimates.
Note: The market-implied terminal rate is derived from the 10-year Treasury rate, the 10-year term premium (Kim and Wright 2005), and the expected months to liftoff in the federal funds rate. The pace of rate hikes is assumed to be 100 basis points per year until the terminal rate is reached. Market-implied terminal rate as of June 2015; FOMC projection as of September 2015. FOMC = Federal Open Market Committee.

Sources: Bloomberg, L.P.; and IMF staff calculations.
Note: Five-year-five-year sovereign bond yield in local currency terms minus five-year-five-year survey-based expectation of real GDP growth and inflation. Z-score computed as mean-adjusted return, scaled by the standard deviation: (y – y bar)/σ. Inverted, up = overvalued.

Sources: Bank of America Merrill Lynch; Federal Reserve, Flow of Funds; National Bureau of Economic Research (NBER); and IMF staff calculations.