Government Bond Issuance Boom to Pressure Yields Higher
A flood of new global sovereign debt will affect market dynamics.
October 2023

Our last blog discussed my belief that a soft landing is a fairy tale. However, many of our portfolios have been positioned short duration. That may not seem logical at first glance.

Simply put, while we believe that short-dated fixed income is attractive in many places, we hold serious concerns about the long end of many global government bond markets. Thinking back to “The Four U.S. Treasury Yield Phases of a Fed Tightening Cycle,” phase three will be longer and more painful.

Supply Generally Doesn’t Matter for an Individual Government Market

The supply of high-quality global government bonds doesn’t generate much attention because it generally doesn’t matter for an individual market. Because these bonds are the true “core” of the fixed income market, with other types of bonds priced in relation to these developed market high-quality sovereigns, there is almost always enough demand to more than offset additional issuance. As some learned in Finance 101, the markets in these government bonds are the broadest, deepest, and most liquid in the world.

But what will happen when almost all developed market governments need to simultaneously boost sovereign debt issuance? Yields will need to increase across the board to attract buyers to take up the flood of supply. Investors in U.S. Treasuries, for example, will no longer be able to dodge the glut of new issuance in that market that has followed the debt ceiling standoff earlier in 2023 by moving into the gilt market if the UK is also selling an increasing volume of new debt to fund its spending.

Ballooning Fiscal Deficits
Governments around the globe will need to boost their sovereign debt issuance to pay for ballooning fiscal deficits, largely as a result of their COVID-era policies. A lot of private sector leverage moved to the government balance sheet. Now the debt collector is at the door.

The U.S. deficit is likely to end 2023 at about 6% of gross domestic product (GDP), while the UK deficit will probably be more than 5% of GDP. Total government debt-to-GDP ratios in the UK and the U.S. are already at or near 100% and could easily go higher, while the debt-to-GDP ratio in traditionally profligate fiscal spender Italy is over 120%. This has come at a time when the biggest buyers of bonds—global central banks—are stepping away. Many central banks are in the midst of quantitative tightening. More recently, the Bank of Japan similarly started stepping away from yield curve control, which is the last significant quantitative easing-like program in the world.

1 Source: Bloomberg consensus projections as of September 5, 2023.
2 Source: International Monetary Fund as of December 31, 2022 (annual data).
The U.S. is also shifting the composition of its new Treasury issuance away from short-term bills and into longer-term “coupon” supply as the T-bills issued after the resolution of the debt ceiling mature. Coupon issuance should account for about 39% of net Treasury supply this year before rising to approximately 86% in 2024. With the yield curve still very inverted, longer-term yields will need to move meaningfully higher to entice buyers away from the attractive short-term rates.

Action to Shift to Long End of Yield Curves

As a result of these supply dynamics, much of the action could move to the long end of yield curves, while in 2022 shorter-term yields were more volatile as curves sharply inverted. The two-year U.S. Treasury yield increased 370 basis points (bp) last year, while the 30-year Treasury yield “only” climbed 207 bp. German government yields followed a similar course, with the two-year yield rising about 335 bp (from deeply negative territory at the end of 2021) and the 30-year bund yield increasing only 62 bp. This should result in a “twist” in yield curves, with long-end rates most likely increasing and curves steepening. In 2011, the Federal Reserve purposely targeted lower long-term yields in “Operation Twist” by selling short-maturity Treasuries and buying longer-end securities. Today, however, I think that we may be entering a period where central bank actions don’t have much effect on long-term rates because of the distortions caused by the flood of supply.

Ominous Potential to Crowd Out Corporates

Most ominously for the economy, a huge boost in high-quality government bond issuance could also crowd out many other borrowers, or at least force up funding rates for corporate borrowers and others that need to refinance. This would raise the cost of funds for corporations and make them less likely to spend on capital projects or hiring more employees, removing a vital source of support for the global economy just when it needs it most. Also, remember that long-end yields act as the discount rate for many other purposes, so this twist could have far-reaching impacts.

T. Rowe Price cautions that economic estimates and forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual outcomes could differ materially from those anticipated in estimates and forward-looking statements, and future results could differ materially from historical performance. The information presented herein is shown for illustrative, informational purposes only. Any historical data used as a basis for analysis are based on information gathered by T. Rowe Price and from third-party sources and have not been verified. Forecasts are based on subjective estimates about market environments that may never occur. Any forward-looking statements speak only as of the date they are made. T. Rowe Price assumes no duty to, and does not undertake to, update forward-looking statements.


4 Source: Bloomberg Finance L.P.
T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

Important Information

This material is being furnished for general informational and/or marketing purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. Past performance is not a reliable indicator of future performance. The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources’ accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

DISCLOSURE CONTINUES ON THE FOLLOWING PAGE.
Important Information (cont.)

Australia—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. For Wholesale Clients only.

Brunei—This material can only be delivered to certain institutional investors for informational purpose only. Any strategy and/or any products associated with the strategy discussed herein has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.’s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd which is regulated by the Dubai Financial Services Authority as a Representative Office. For Professional Clients only.

EEA—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Indonesia—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

Korea—This material is intended only to Qualified Professional Investors. Not for further distribution.

Mainland China—This material is provided to qualified investors only. No invitation to offer, or offer for, or sale of, the shares will be made in the mainland of the People’s Republic of China (Mainland China), not including the Hong Kong or Macau Special Administrative Regions or Taiwan) by any means that would be deemed public under the laws of the Mainland China. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the Mainland China. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the Mainland China that are expressly authorized under the laws and regulations of the Mainland China to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the Mainland China. Potential investors who are resident in the Mainland China are responsible for obtaining the required approvals from all relevant government authorities in the Mainland China, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the Mainland China, nor nationals with permanent residence in the Mainland China, or to any corporation, partnership, or other entity incorporated or established in the Mainland China.

Malaysia—This material can only be delivered to specific institutional investor. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

New Zealand—Issued by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 28, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering documentation or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Philippines—ANY STRATEGY AND/or ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING DISCUSSED HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/or ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

Singapore—Issued by T. Rowe Price Singapore Private Ltd. (UEN: 201021137E), 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

South Africa—Issued in South Africa by T. Rowe Price International Limited (TRPL), Warwick Court, 5 Paternoster Square, London EC4M 7DX, an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide “intermediary services” to South African Investors. TRPL’s Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: www.faisombud.co.za, Email: info@faisombud.co.za

Switzerland—I s issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

Taiwan—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

Thailand—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to “institutional investors” as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

UK—This material is issued and approved by T. Rowe Price International Ltd, Warwick Court, 5 Paternoster Square, London EC4M 7DX which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

USA—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2023 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.