



How a Recession Will Impact Bond Markets

Treasury yields may hit a bottom and credit spreads could peak very soon.

April 2020

All indications are that the coronavirus pandemic will hit the global economy hard. A worldwide recession has probably already started. However, it will likely be unique for being the deepest in decades while also potentially being the shortest.

In the past, fixed income markets have been reasonably good at locating the bottom of a recession. December 2008, for example, registered the greatest monthly contraction in economic activity during the global financial crisis, and during the same month, U.S. Treasury yields bottomed and credit spreads¹ peaked. Similarly, October 2001 saw the greatest monthly contraction during the 2001 recession, and just a few days into the next month, Treasury yields hit their lowest point and spreads hit their highest.

This time, we are not facing a typical economic slowdown. In the past, the biggest declines in activity tended to occur at the end of recessions; on this occasion, it is likely that the most severe part of the slowdown is already occurring. Essentially, everything is being front-loaded, which for fixed income markets means that core bond yields could reach a bottom and credit



Ken Orchard
Portfolio Manager

spreads may peak in the next few weeks—if they haven't already.

It is important to remember that multiple, big fiscal support packages are on their way and look set to far exceed those launched during the global financial crisis. From the U.S. to Australia, almost all governments in developed markets—as well as several emerging market governments—have unveiled stimulus measures over the past few weeks. While these may take time to be enacted and work through the system, the support is welcome and should help to mitigate the impact of defaults.

Central banks are also doing their bit to support economies with a raft of interest rate cuts and new quantitative easing programs. This combination of central bank easing and government fiscal stimulus is essentially “helicopter money”

This combination of central bank easing and government fiscal stimulus is essentially “helicopter money” as it pumps money directly into the private sector.

¹ Credit spreads measure the additional yield that investors demand for holding a bond with credit risk over a similar-maturity, high-quality government security.



Interest rates at or below zero in most major economies should support the reach for yield in fixed income markets.

as it pumps money directly into the private sector. This should drive a large increase in money supply over the next few months.

While several corporate sectors face severe disruption and might bleed money in the current environment, household cash balances could potentially rise significantly in the next few months. Much of this money will initially be in bank deposits and money funds, but when confidence returns it should make its way into riskier assets, such as credit and emerging markets.

U.S. investment-grade corporate bonds offer attractive investment opportunities as spreads in this sector have widened significantly and, in some instances, curves have inverted. In many cases,

the dislocations appear to be driven by forced selling and not necessarily by fundamentals. The dispersion of traders given “work from home” protocols have contributed to the strained liquidity conditions. On the positive side, the Federal Reserve has announced that it will begin purchasing investment-grade rated corporate bonds, which is supportive for the sector.

Interest rates at or below zero in most major economies should support the reach for yield in fixed income markets over the coming weeks and months. Riskier segments such as credit markets will recover, although this path might not always be smooth given the strained liquidity conditions and the likelihood that volatility might remain elevated for some time.

INVEST WITH CONFIDENCE®

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.

T. Rowe Price®

Important Information

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

The views contained herein are those of the authors as of April 2020 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation, investment advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Investors will need to consider their own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy.

Past performance is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. Fixed income securities are subject to credit risk, liquidity risk, call risk, and interest-rate risk. As interest rates rise, bond prices generally fall. All charts and tables are shown for illustrative purposes only.

T. Rowe Price Investment Services, Inc.

© 2020 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the bighorn sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc.