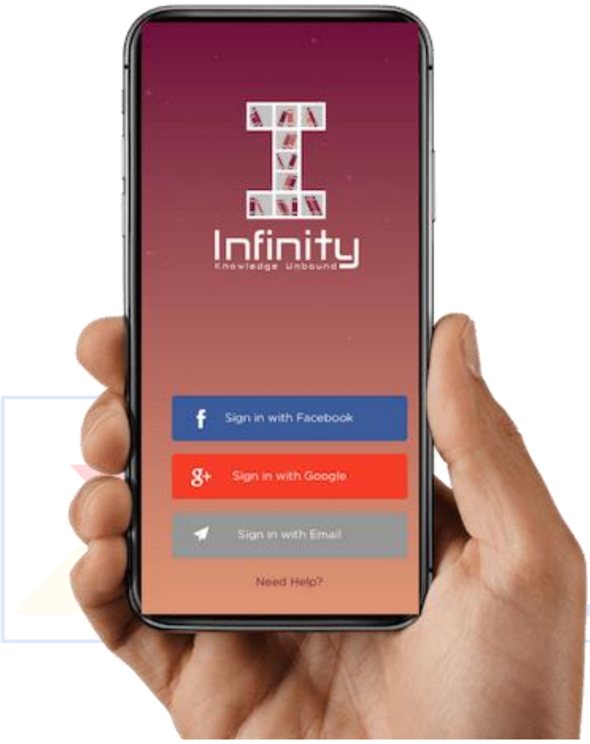

INVERTED YIELD CURVE FUELS FAER OF RECESSION

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Inverted yield curve fuels fear of recession

Content to be covered

1. Current scenario: US facing an inverted yield curve
2. MCQ
3. What is yield curve? Different types of yield curve and how to interpret them?
4. Information conveyed by Yield curve

Why is the yield curve inverting in US?

- Much of the blame has been put on the US-China trade spat. The trade tiff between the two largest economies is creating uncertainty and investors are rushing to buy US bonds, as safe haven.

- An inverted yield curve has been a reliable indicator of impending economic slumps, like the one that started 11 years ago.

- Historically, when yield on the 10-year US government paper has fallen below the 2 year one, recession has followed

- Current scenario: Yield on 10-year note was 1.5708% as against 1.5710% on 2-year note

The inverted yield curve looks set to be a global phenomenon, with major Asian debt markets primed to mirror the moves in treasuries as fears grow that the world economy is teetering on the brink of a recession.

IS INDIA FACING A SIMILAR SITUATION?

No, but India's economy is facing other problems.

- Financial sector is grappling with trillion of rupees in bad debt

- Liquidity crunch

Even as world talks about negative interest rates, India continues to see high interest rates.

Q.1) Yield curve is used to determine current and future strength of the economy. US is witnessing inverted yield curve presently.

Inverted yield curve indicates higher yields for short-term maturity bonds than the longer-term maturity bonds. How?

[a] Supplier of loanable funds demands short-term maturity bonds and Borrower of loanable funds wishes to get funds for long-term

***[b] Supplier of loanable funds demands long-term maturity bonds and borrower of loanable funds wishes to get funds for short-term**

[c] Supplier of loanable funds demands short-term maturity bonds and borrower of loanable funds also wishes to get funds for short-term

[d] Supplier of loanable funds demands long-term maturity bonds and borrower of loanable funds also wishes to get funds for long-term

What is yield curve?

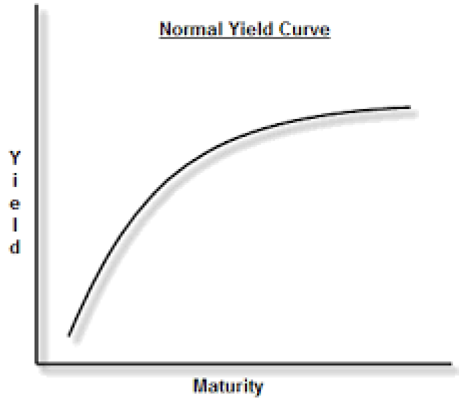
Yield curve shows the relation between the interest rate (cost of borrowing) and the time to maturity. It is a way to measure bond investors' feelings about risk, and can have a tremendous impact on the returns.

Yield curve is generally indicative of future interest rates, which are indicative of an economy's expansion or contraction, yield curve and changes in yield curve can convey a great deal of information.

TYPES OF YIELD CURVE

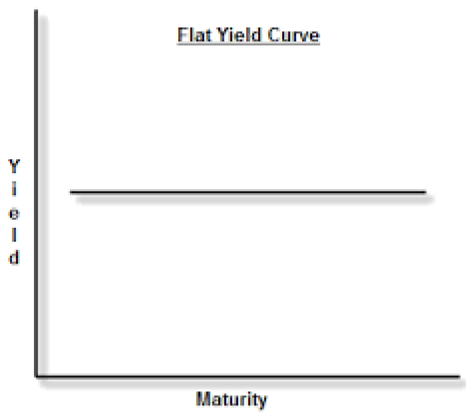
- Normal yield curve
- Flat yield curve
- Inverted yield curve

- **THE NORMAL YIELD CURVE:**
  In which longer maturity bonds have a higher yield compared with shorter-term bonds due to the risks associated with time.



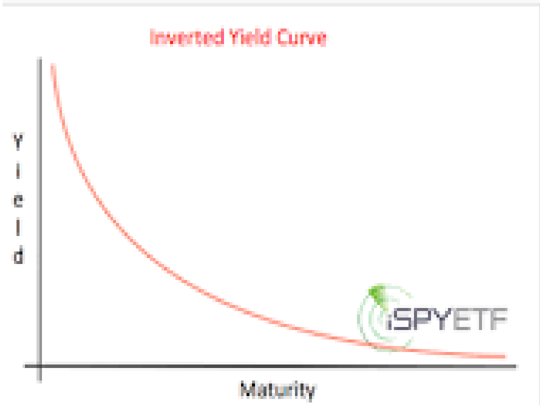
Analysis: Most common and generally reflects a stable and expanding economy. Relative steepness of normal yield curve can provide clues about the current and expected pace of economic activity.

- **THE FLAT YIELD CURVE:**
  It is characterized by similar yields across both short-term and long-term maturities. It reflects uncertain economic conditions.



Analysis: A flat yield curve may arise from normal or inverted curve, depending on changing economic conditions.

- **THE INVERTED YIELD CURVE:**
  It results when short-term yields are higher than longer-term yields.



Analysis: Generally, reflects periods of significant economic slowdown and often recession.

Interesting Ques: Why would long term investors settle for lower rewards than short term investors, who are assuming less risk?

Why does it matter?

- Yield curve is used to determine the current and future strength of the economy
- The yield curve has **historically** reflected the market's sense of the economy
- Yield curve can predict the investing pattern of the investors

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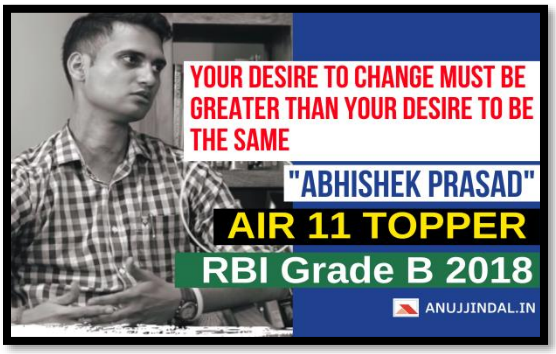

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