Bond Yield Inversion

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- A **bond** is an instrument to borrow money. A bond could be floated/issued by a country's government or by a company to raise funds.

- The **Bond Yield** is the ***effective rate of* return** that a bond earns. But the rate of return is not fixed as it changes with the price of the bond.
- Suppose a Rs. 100 bond (this is called issue price or Face Value) is issued @ interest rate 10% (which means that interest in the market is around 10%).
- Now if the interest rate in the market decreases (the interest rate is decreasing in the market but the bond which has been issued @10% interest rate → This interest rate is fixed and it will never change) then the new bonds which will be issued at less interest rate (say 8%).
- Now if you want to purchase a previously issued bond of Rs. 100 face value→ the holder of the bond will not give you in Rs. 100, rather he will ask for more Rupees → i.e. the price of the previously issued bond will increase and suppose you purchase this bond in Rs. 125 then for you annual RETURN will be =(Rs. 10/Rs. 125)*100 = 8% . This 8% is yield.
- Since government bonds which are referred to as G-secs in India come with the sovereign guarantee, they are considered one of the safest investments. As a result, they also give the lowest returns on investment or yield.
- On the other hand, investments in corporate bonds tend to be riskier because the chances of failure and the chances of the company not repaying the loan are higher.

- **Bond Yield curve** is a graphical representation of yields for bonds with an equal credit rating over different time horizons.
- If bond investors expect the economy to grow normally, then they would expect to get more yield when they lend for a longer period. This gives rise to a normal upward sloping yield curve.
- The steepness of the yield curve is determined by how fast an economy is expected to grow. When the economy is expected to grow only marginally, the yield curve is “flat”.
- However, **yield inversion** happens when the yield on a longer tenure bond becomes less than the yield for a shorter tenure bond. A yield inversion typically portends a recession. An inverted yield curve shows that investors expect future growth to fall sharply.