



COVID-19 and Fixed Income Markets

How the coronavirus outbreak could impact bond investors.

February 2020

KEY INSIGHTS

- Major central banks unlikely to respond with interest rate cuts in the short term.
- Asian local bonds to outperform, while the region's currencies face the risk of further depreciation.
- Diverse impact expected within the corporate bond universe.

The outbreak of the coronavirus (COVID-19) has upended financial market forecasts for 2020. During our policy meetings, the investment team discussed the latest developments and outlined the three key investment implications for fixed income markets.

1. Major Central Banks Unlikely to Respond With Interest Rate Cuts in the Short Term

Although there is little doubt that global growth will be adversely affected by the coronavirus outbreak, it remains uncertain how long or severe the impact will be. It will take time to work through the data, so the real impact may not be known for some time. Against this backdrop, it is likely that major central banks will adopt a wait-and-see approach while keeping a close eye on how Chinese authorities respond.

"So far, China's policy response has been about crisis management," said Kenneth Orchard, a portfolio manager and member of the global fixed income

investment team. "But we could see a wave of new measures over the medium term to support growth." These measures could take the form of additional interest rate cuts, loans to support small and medium-sized businesses, or even targeted fiscal stimulus in areas such as infrastructure, Mr. Orchard added.

Within global fixed income, the outbreak of the virus has driven markets to quickly move from pricing in the possibility of reflation to pricing in emergency rate cuts. This has pushed yields down sharply, with the front end of the U.S. curve now reflecting expectations that the Federal Reserve will lower interest rates by September.

Mr. Orchard did not agree with the market consensus, however. "It is too early at this stage for markets to imply that major central banks will start delivering interest rate cuts in 2020," he said. "The inversion of curves in the U.S. and Germany makes holding government bonds in these core markets an expensive value proposition at present."

Global Fixed Income Team



Arif
Husain



Andrew
Keirle



Kenneth
Orchard



Quentin
Fitzsimmons



Ju Yen
Tan



Saurabh
Sud

Each month, our portfolio managers, analysts, and traders conduct an in-depth review of the full fixed income opportunity set. This article highlights a key theme discussed.

“It is too early at this stage for markets to imply that major central banks will start delivering interest rate cuts in 2020.

— Kenneth Orchard
Portfolio Manager

“Asia high yield looks appealing, but it will be on a case-by-case basis that we add a position and only when our bottom-up research identifies an attractive company from a medium-term perspective.

— Kenneth Orchard
Portfolio Manager

2. Asian Local Bonds to Outperform, While the Region’s Currencies Face the Risk of Further Depreciation

The ripple effects from the expected growth slowdown in China will be felt across Asia. To cushion the blow, several central banks in the region are likely to relax their monetary policy and supply liquidity in the market. “With inflation broadly subdued in surrounding Asian countries, there is room for central banks to take action to support growth,” said Mr. Orchard. “Central banks in Thailand and Indonesia have already cut interest rates, and we expect more in the region to follow suit in the coming months.”

These could include South Korea and Malaysia, as their economies have links with China through trade and tourism. From a fixed income perspective, the combination of well-behaved inflation and the likelihood of interest rate cuts in the future is conducive for local currency bonds and should likely drive outperformance of the region.

Aside from interest rate cuts, some countries may also announce fiscal stimulus measures. Singapore, for example, recently unveiled a USD 4.5 billion package to help weather the economic impact stemming from the virus. More countries may follow, including South Korea and Malaysia, according to our sovereign analysts.

Despite these measures, the region’s currencies are at risk of further depreciation. “We could see weakness of certain Asian currencies continue in the short term as a result of the virus threat,” added Mr. Orchard. This includes the Japanese yen, which has traditionally acted as a safe haven but has recently come under pressure because of Japan’s proximity to the epicenter of the virus.

3. Diverse Impact Expected Within the Corporate Bond Universe

The impact of the coronavirus will vary from industry to industry. Our credit and equity analysts believe that the auto sector looks vulnerable as the closure of factories in China will interrupt its supply chain, particularly for companies that have parts produced in the Hubei province. Meanwhile, the effect on technology companies is expected to be varied depending on their supply chains.

For commodity companies, the sharp fall in prices in anticipation of slowing global growth has been a significant headwind. “Commodity companies have been hit hard, but if the virus is contained, there could be some attractive opportunities in this space,” said Mr. Orchard, adding that this would also be the case for Chinese property development companies.

Broadly, the Asian high yield sector looks attractive for investors willing to look beyond short-term volatility. Curves are steep and valuations attractive in this space relative to Asian investment-grade and other segments of the high yield market, including emerging markets. The technical backdrop is also supportive as gross supply is expected to trend downward in 2020, while the investor base is largely domestic with a longer-term investment time horizon in mind.

“Asia high yield looks appealing, but it will be on a case-by-case basis that we add a position and only when our bottom-up research identifies an attractive company from a medium-term perspective,” said Mr. Orchard.

INVEST WITH CONFIDENCESM

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

T.RowePrice®

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.

Important Information (Continued)

Australia—Issued in Australia by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. For Wholesale Clients only.

Brunei—This material can only be delivered to certain specific institutional investors for informational purpose upon request only. The strategy and/or any products associated with the strategy 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.

China—This material is provided to specific qualified domestic institutional investor or sovereign wealth fund on a one-on-one basis. No invitation to offer, or offer for, or sale of, the shares will be made in the People's Republic of China ("PRC") (which, for such purpose, does not include the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the PRC. 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 PRC. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the PRC that are expressly authorized under the laws and regulations of the PRC to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the PRC. Potential investors who are resident in the PRC are responsible for obtaining the required approvals from all relevant government authorities in the PRC, 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 PRC, or nationals with permanent residence in the PRC, or to any corporation, partnership, or other entity incorporated or established in the PRC.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA ex-UK—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 upon specific and unsolicited request and may not be reproduced in whole or in part nor can they be transmitted to any other person in the Republic of Korea.

Malaysia—This material can only be delivered to specific institutional investor upon specific and unsolicited request. The strategy and/or any products associated with the strategy has not been authorised for distribution in Malaysia. 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 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 in New Zealand by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, 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 document 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—THE STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING OFFERED OR SOLD 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 in Singapore by T. Rowe Price Singapore Private Ltd., No. 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—T. Rowe Price International Ltd ("TRPIL") is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (FSP Licence Number 31935), authorised to provide "intermediary services" to South African investors.

Switzerland—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, 60 Queen Victoria Street, London, EC4N 4TZ 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.

© 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.