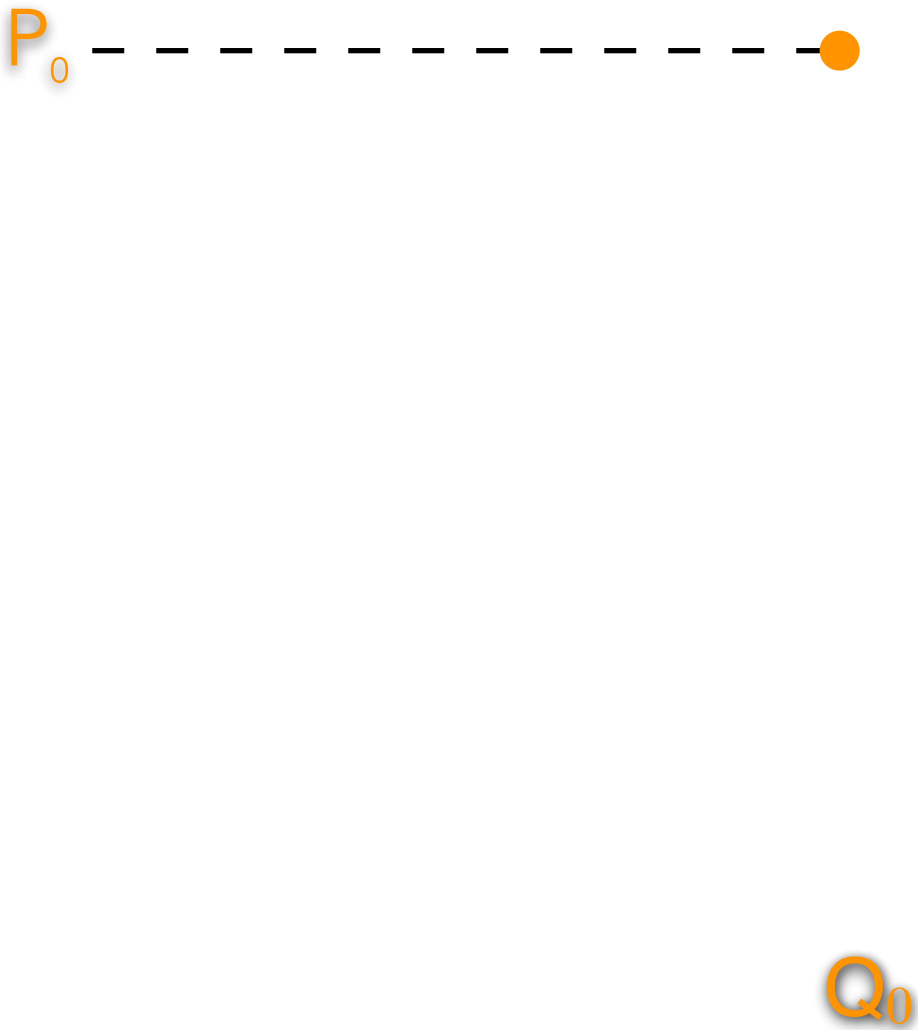
Demand for bonds


P_0
Q_0

Bond Price

Quantity
of Bonds


P_1
Q_1

Supply of bonds

Why does the yield curve get inverted?

There is an inverse relationship between the Yield and the Price of the bond

Assume the market for Short Term Bonds starts at equilibrium at P_0

A

n

i

n

V

e

r

t

e

d

y

i

e

I

d

C

u

r

V

e

O

C

C

u

r

S

b

e

C

a

u

S

e

Y

i

e

I

d

S

O

n

L

O

n

g

T

e

r

m

B

O

n

d

S

f

a

a

n

d

Y

a

n

d

O

n

S

h

O

r

t

T

e

r

m

B

O

n

d

S

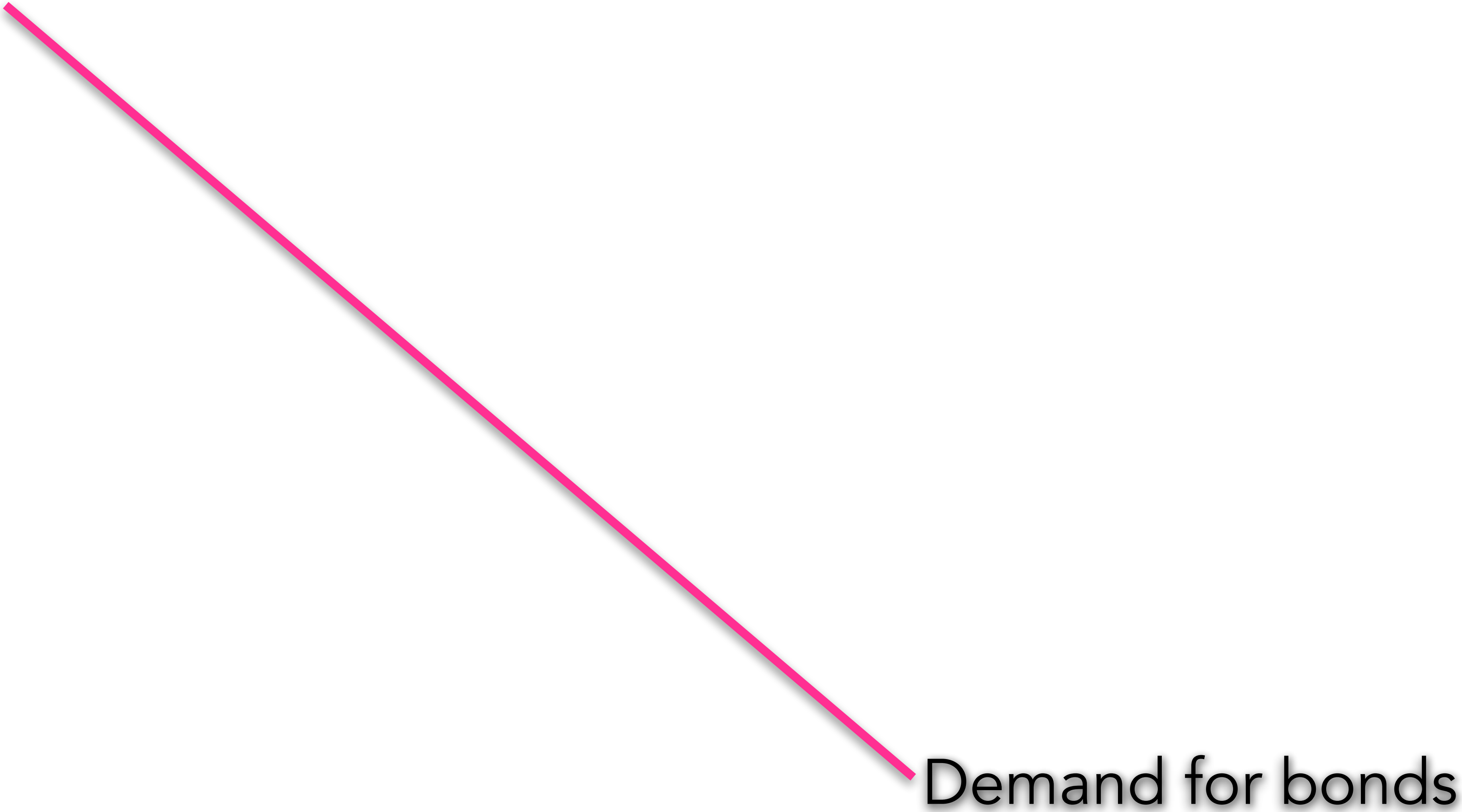
r

i

S

e

If investors are worried about a recession they want to move their money away from stocks and short term bonds to “fail safe” Long Term Government bonds

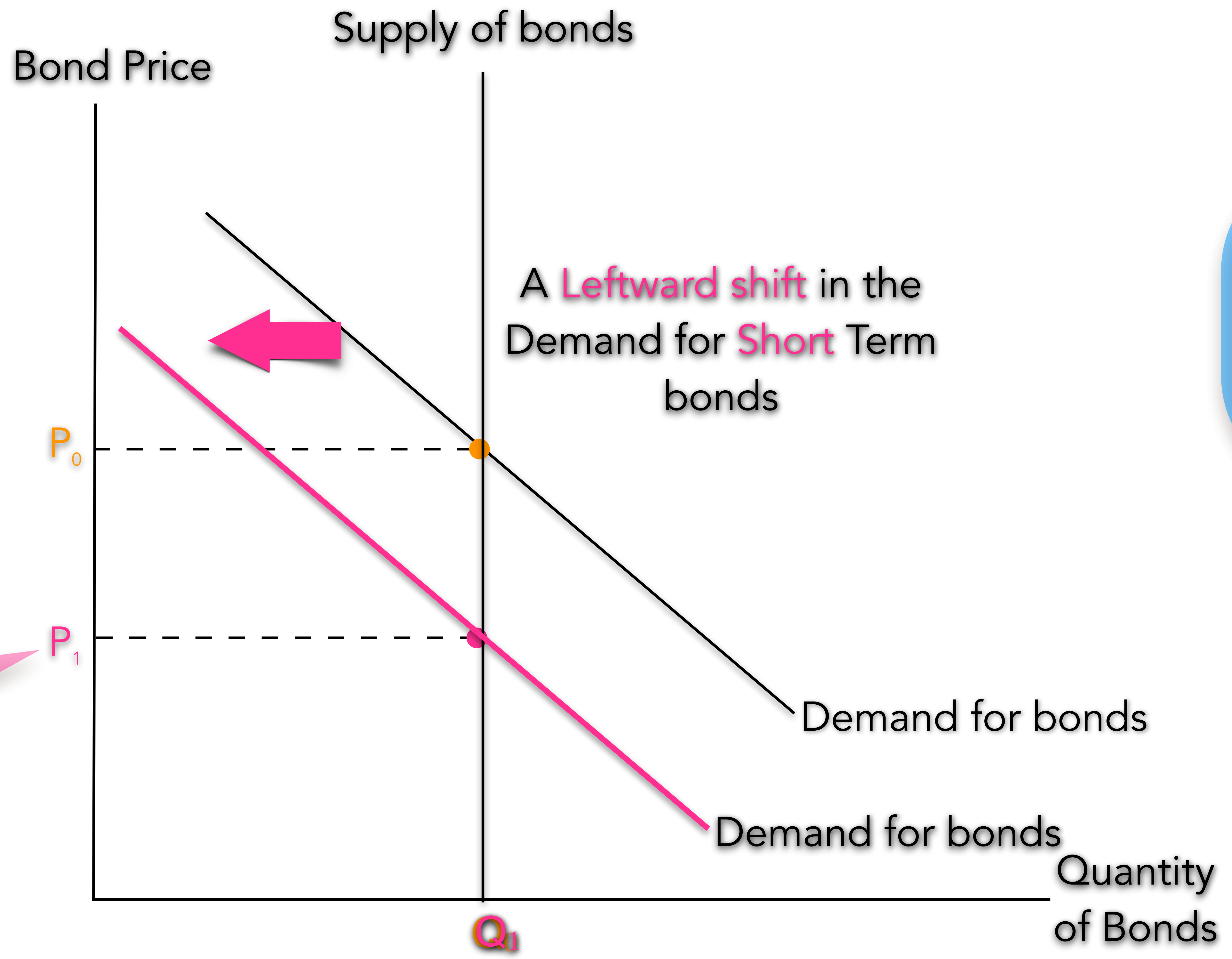

Demand for bonds

A Leftward shift in the Demand for Short Term bonds

The bond price decrease to P_1 and its Yield rise

An inverted yield curve occurs because Yields on Long Term Bonds fall and Yields and on Short Term Bonds rise

There is an inverse relationship between the Yield and the Price of the bond



The bond price decrease to P_1 and its Yield rise

If investors are worried about a recession they want to move their money away from stocks and short term bonds to "fail safe" Long Term Government bonds

Why does the yield curve get inverted?

Historical Yield Spread between 10Year and 1Year Government Bonds