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What is yield curve?

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WHAT DOES IT MEAN?

A yield curve is a graphical representation of yields for a collection of bonds similar in credit quality but with different maturities. It can be considered as overall annual interest rate earned by investors who buy the bond today at the current price and receive all coupon and principal payments of the bond at maturity.

WHY IS IT IMPORTANT?

A yield curve is a very useful signal for assessing investors' expectation about future interest rates as reflected in the curve's shape.

It can be flat, upward sloping, inverted or humped. In a normal market condition, an upward yield curve is expected as investors would usually demand compensation for the loss of liquidity and flexibility while investing in long-term rather than short-term bonds.

An inverted or downward sloping yield curve may indicate slower economic growth as reflected in lower interest rate in a longer time horizon.

The yield curve of government bonds is usually considered as the benchmark interest rates for the financial market, allowing other financial instruments to be priced accordingly (that is, mortgage-backed securities, municipal bonds, infrastructure bonds, and corporate bonds and so on).

The yield curve of Singapore Government Securities (SGS) provides the yields from one year to 30 years to maturity. SGS with different maturities are issued regularly to maintain the timeliness of the benchmark yield curve.

This issuance motivation is very different from the dire need for funding by many governments such as the United States to cover the Budget deficit and/or pay back the principal amount of matured government bonds.

IF YOU WANT TO USE THE TERM, JUST SAY:

"The yield curve is useful for investors to infer the market expectation for future interest rates at different time horizons."

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