



Central Banks Are Not Out of Ammunition Yet

How the prospect of further monetary easing could impact bond markets.

November 2020

KEY INSIGHTS

- Developed market central banks ready to take new action to support struggling economies.
- Positioning on the curve is important as bond-buying programs vary across central banks.
- Emerging market central banks expected to stay on hold, benefiting local debt.

Central banks are not done yet. With economic recoveries under threat, several developed market central banks, including the European Central Bank (ECB) and the Bank of England (BoE), look set to unveil new supportive measures over the coming weeks and months. What we should expect from these measures and their implications for bond markets in particular were the key discussion points during our latest investment policy meetings.

New Monetary Policy Fire Power Expected to Be Unleashed

Although there may have been welcome progress recently on a vaccine for the coronavirus, it does not change the current state of play—cases have risen rapidly across the world, leading to the reintroduction of lockdowns and restrictions in several countries. This has left economies struggling, particularly those with dominant service sectors.

“In the summer, it looked like we had seen all there was to see from central banks in 2020,” said Quentin Fitzsimmons, a portfolio manager and member of the fixed income global investment team. “Fast-forward to today, and it’s a very different picture—several economies remain under huge strain, and central banks are looking into their toolkits to see what firepower they have left to provide support,” he said.

Among high-quality countries, potential candidates for further monetary easing include Sweden, South Korea, and Israel. The BoE is another contender given that it has made no secret of the fact that it is considering negative rates. Similarly, the ECB has said that with economic risks tilted to the downside, all tools are being reexamined—which we anticipate could result in the expansion of its bond-buying program and possibly a cut to the deposit rate in early 2021.

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.

“A key decision as we head into 2021 is not simply how much duration is needed in fixed income portfolios, but rather which part of the curve is potentially best to overweight...”

— Quentin Fitzsimmons
Portfolio Manager

“EM stands out in the current environment with interesting opportunities in both currencies and local bonds.”

— Quentin Fitzsimmons
Portfolio Manager

“Let’s not forget that the Federal Reserve’s rhetoric has been even more dovish lately, raising the possibility that the world’s largest central bank could also provide additional accommodation,” said Mr. Fitzsimmons. “The current negative impact of surging coronavirus cases on the U.S. economy far outweighs the positive news about a possible vaccine.”

Where to Find Duration Value

In government bond markets, the prospect of further monetary easing provides a broad supportive anchor. But with bond-buying programs varying from country to country, we believe it is important to assess each on an individual basis. “A key decision as we head into 2021 is not simply how much duration is needed in fixed income portfolios, but rather which part of the curve is potentially best to overweight because of a specific country’s central bank behavior,” said Mr. Fitzsimmons.

In the U.S., we favor the short end of the Treasury curve as this area is likely to remain well anchored, thanks to the Fed’s support. The long end, meanwhile, could continue to face volatility as there is the potential for new fiscal stimulus and the possibility of growth rebounding in 2021 when vaccines are rolled out.

By contrast, we prefer the long end of curves in eurozone government bond markets. “The ECB’s bond-buying program is relentless and looks set to be expanded again soon,” said Mr. Fitzsimmons. “Against this backdrop, we feel there’s more value in the long end of curves in the eurozone, where additional issuance will likely be more than compensated by the regular central bank purchases.”

Keeping some flexibility around yield curve management is important, however. Yield curve valuations have been heavily impacted this year by how markets have discounted fiscal easing across different economic regions. With that in mind, any signs of fiscal retrenchment in 2021 may lead to significant readjustments in yield curve shapes.

Emerging Markets Expected to Buck the Easing Trend

Contrary to developed markets, we anticipate that the majority of central banks in emerging markets (EM) will keep monetary policy broadly stable.

“EM central banks have done as much as they can when it comes to monetary easing. While further modest cuts in places can’t be ruled out, largely we expect a pause in 2021,” said Mr. Fitzsimmons. That said, it is possible that many of the EM central banks will decide to retain an easing bias in their communication in the early part of next year because they will want to avoid seeing their currencies appreciating too much against the U.S. dollar. This backdrop makes EM local currency bonds an interesting asset class to consider for foreign investors.

Indeed, the steepness of local government bond curves in select EM countries, such as Indonesia, Israel, and Peru, is likely to remain attractive in the current environment, where interest rate volatility remains shackled by the Fed and the ECB’s ultra-easy policy stances.

“EM stands out in the current environment with interesting opportunities in both currencies and local bonds,” said Mr. Fitzsimmons, noting that the team has been increasing exposure recently in select countries, such as Brazil and Serbia.

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.

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 to 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.