

Credit Spreads, Explained: The Number That Tells You How Nervous Bond Investors Really Are

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Beginner – Intermediate	Fixed Income	~5 minutes	Investor Education

You've likely seen us reference “credit spreads” in our Macro Themes as a signal of how much risk the bond market is pricing. It's a simple idea once you strip away the jargon - and it's one of the most useful early-warning signals in all of investing.

What Is a Credit Spread, Really?

A credit spread is the extra yield a bond pays above a comparable, virtually risk-free U.S. Treasury bond of the same maturity. If a 10-year Treasury yields 4.30% and a 10-year corporate bond from a healthy, well-known company yields 5.05%, the credit spread is the difference: 75 basis points, or 0.75%. That spread is the market's real-time price for one thing: the risk that the corporate borrower, unlike the U.S. government, might not pay you back in full.

Every bond issuer that isn't the U.S. Treasury has to pay a spread, and the size of that spread is a direct reflection of how risky the market perceives that borrower to be. A large, stable, highly profitable company will have a small spread. A smaller, more leveraged, or more cyclical company will have a larger one. Widen that lens to an entire market, and the average spread across thousands of bonds becomes a genuine barometer of investor sentiment about corporate health as a whole.

A Quick Example

Imagine three borrowers, all issuing 10-year bonds on the same day, when the 10-year Treasury yields 4.30%:

Borrower	Bond Yield	Credit Spread	What It Signals
U.S. Treasury	4.30%	0 bps (the benchmark)	Considered virtually risk-free
Large, stable company (investment grade)	5.05%	75 bps	Low perceived default risk
Smaller, leveraged company (high yield)	7.30%	300 bps	Meaningfully higher perceived default risk

Illustrative example for educational purposes; actual spreads vary by issuer, sector, and market conditions.

Notice that the dollar cost of borrowing is very different for these three issuers, even though all three bonds mature in exactly 10 years. That gap exists entirely because the market is demanding compensation for different levels of perceived risk - which is precisely what a credit spread measures.

Why Spreads Move — and Why That Matters

Credit spreads widen (get bigger) when investors grow more worried about the economy or about a specific sector, and they narrow (get smaller, or “tighten”) when investors feel confident. This is why credit spreads are often described as a leading indicator: because bond investors are, in a sense, betting real money on whether borrowers get repaid, spreads can start moving before broader economic data or even stock prices reflect the same concern.

It's also why the phrase “spreads are tight” or “spreads are historically low” matters so much in market commentary. Tight spreads mean investors are being paid very little extra to take on corporate credit risk versus lending to the government - which can mean genuine confidence in the economy, or it can mean investors are being complacent about risks that haven't yet shown up in the data. Distinguishing between those two explanations is exactly the kind of judgment call our Macro Theme pieces make when we discuss spread levels.

KEY TAKEAWAYS

A credit spread is the extra yield a bond pays above a comparable Treasury bond, and it exists to compensate investors for default risk.

Wider spreads signal more perceived risk; tighter (narrower) spreads signal more confidence — or, sometimes, complacency.

Spreads are quoted in basis points (1 basis point = 0.01%), and they vary meaningfully between investment-grade and high-yield borrowers.

Because bond investors are directly exposed to default risk, credit spreads often move before broader economic data or stock prices reflect the same underlying concern.

Related Terms

- **Credit Rating:** The classification given to a bond by rating agencies (Moody's, S&P, Fitch) indicating perceived credit quality; “investment grade” (higher quality) and “high yield” or “junk” (lower quality, higher spread) are the two broad categories.
- **Basis Point (bps):** A unit equal to 0.01%, used throughout fixed income to describe small differences in yield or spread precisely - 100 basis points equals 1 percentage point.
- **Duration:** How exposed a bond's price is to interest-rate changes - a related but distinct concept from credit risk. See our companion piece, “Bond Duration, Explained.”

Where to Go From Here

Credit spreads are the fixed income market's way of pricing corporate risk in real time. If you'd like to see how we apply this concept to a live market view, our Macro Theme piece “Credit Markets Are Pricing AI Debt Like It's Ordinary Debt” walks through a current example of spreads sitting near multi-decade lows - and why we think that pricing deserves scrutiny.

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