

Comments on “The Interest Rate Effects of Government Debt Maturity” by Chadha, Turner, and Zampolli

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* The views expressed are personal and do not necessarily represent those of the IMF or IMF Policy.

Overall Impression

- A very interesting and provocative paper
- Diligent empirical work
- Three main comments on:
 - Theoretical underpinnings
 - Relevance post-2008
 - Endogeneity

Theoretical Underpinnings

- Portfolio balance theory – well known
 - Scarcity and duration channels
- NK models question relevance - arbitrage kills effect
- Frictions suggest that regressions are bound to find an effect of average maturity on interest rates
- Just random arbitrage opportunities? (small effect)
- Large estimates suggest more than that
- But a systematic money-making opportunities on one of the largest and most liquid markets?

Relevance post-2008?

- Regression sample: 1976-2008 H1, or 1986-2008H1
- Clearly, post-2008 coefficients are not the same
 - Lucas critique
 - Structural break
- Two possibilities post-2008:
 - Same relationship, different coefficients – estimate?
 - New relationship (section 4.4.c) – troublesome
- Large forecast errors out of sample (Graph 4) cast doubts over relevance

Endogeneity – Key Empirical Issue

- Good job in modeling the effects of endogeneity on estimates (Annex 3)
- Agree that the likely bias is to overstate effect of average maturity on forward rates/term premium
- Can this be dealt with econometrically?
- Two offsetting effects post-2008:
 - PB effects likely stronger, as arbitrage more likely to fail given market disruptions;
 - Bias likely to rise as expected higher future interest rates induce lengthening of average maturity (Graph 3).
- Discussion about the net effect may be useful