DISCUSSION OF "An Empirical Decomposition of Risk and Liquidity in Nominal and Inflation-Indexed Government Bonds"

-Matthew Richardson,

Roundtable on Treasury Markets and Debt Management, November 18, 2011

Thoughts on debt management – TIPS

- Breakeven inflation (T-Notes minus TIPS yields)
  - Liquidity premium
    - What is liquidity?
    - Clientele effects?
  - Inflation risk premium
    - What dos it mean to have risk priced?

Thoughts on debt management – TIPS continued…

- Compelling reasons for TIPS
  - Completing the market
  - Provide regulators/market participants measures of expected inflation based on traded prices as opposed to professional forecasters.

Specific comments

- Plethora of recent papers looking at same thing
  - Pflueger-Viceira (2011) try to measure liquidity more directly.
  - Highlight their contribution relative to others.

- Properties of breakeven inflation
  - 10yr inflation forecasts, 10 yrs of data, highly persistent against liquidity measures / inflation surveys also highly persistent.
  - Why not contemporaneous changes?

Specific comments continued

- What is liquidity?
  - Convert TIPS to cash w/o market impact?
  - Is there something special about Treasuries?
  - Pflueger-Viceira use many measures; there are many more… principal components?
  - Or would a structural model be better?

- Some concerns about estimation methodology
  - Estimate *L* from *BEI* over entire sample; then, over same sample, use *L^* to analyze relation between *R(L^)* against *X(L^)*.