Department of Banking and Financial Management
University of Piraeus

Research Seminar Series

Thursday, March 12th 2009
Time: 16:00 – 18:00, Room 013

Seminar Title

"Bond Liquidity Premia"

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Summary

Recent models of limits to arbitrage imply that the tightness of funding conditions faced by financial intermediaries is a component of the pricing kernel. In the US, the repo market is the key funding market for traders and arbitrageurs implying in turn that the on-the-run premium shares a common component with the risk premia observed in other markets. This observation leads to the following identification strategy. We measure the value of liquidity from the cross-section of on-the-run premia by adding a liquidity factor to an arbitrage-free term structure model. As predicted, we find that liquidity value affects the cross-section of risk premia at quarterly and annual horizons. An increase in the value of liquidity predicts lower risk premia for on-the-run *and* off-the-run bonds but higher risk premia on Libor loans, swap contracts and corporate bonds. Moreover, the measured impact is pervasive through crisis and normal times. Finally, we find that liquidity value varies with changes in aggregate uncertainty, measured from S&P500 options, and with changes in monetary stance, measured from bank reserves and monetary aggregates. These linkages are consistent with the theory and suggest that different securities serve, in part, and to varying degrees, to fulfill investors' uncertain future needs for cash.

René Garcia received his Ph.D. in Economics from Princeton University in 1992 and joined the Université de Montréal, where he held the Hydro-Québec Chair in Risk Management and was a Research Fellow of the Bank of Canada. In 2007, he became full professor at the EDHEC Business School in Nice (France). He is the scientific director of the Centre for Interuniversity Research and Analysis on Organizations (CIRANO) and the editor of the Journal of Financial Econometrics, published by Oxford University Press. His most recent research focuses on the evaluation of asset pricing models accounting for higher moments, the analytical solution of asset pricing models, the use of simulation methods for computing optimal dynamic portfolios, the analysis of hedge fund returns, and the equilibrium modeling of the term structure of interest rates.