Discussion of "Quantitative Easing, the Repo Market, and the Term Structure of Interest Rates"

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- Deeply respectful to intricacies of the repo market
- Formalizes subtle but important links between the bond and repo markets
- Relating to QE
- A pleasure to read. Awesome.

Great questions of macro-finance

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3. (Why) Is the demand for bonds downwards sloping?

- This paper relates to (3) in a deep and very policy relevant way.

Synopsis

- Vayanos-Villa but preferences are over specific securities rather than maturities
- Naturally related to specialness
- (Specialness depends on distance to predicted yield)
- Repo market is instrumental in arbitrage
- Specialness is instrumental in the repo market (repo using special securities rather than general collateral)
- QE induces specialness, interferes with repo market functioning
- A joint special-general security term structure model using common risk factors
- Also related to SLF
- Great

The yield curve fit is not exact at any time

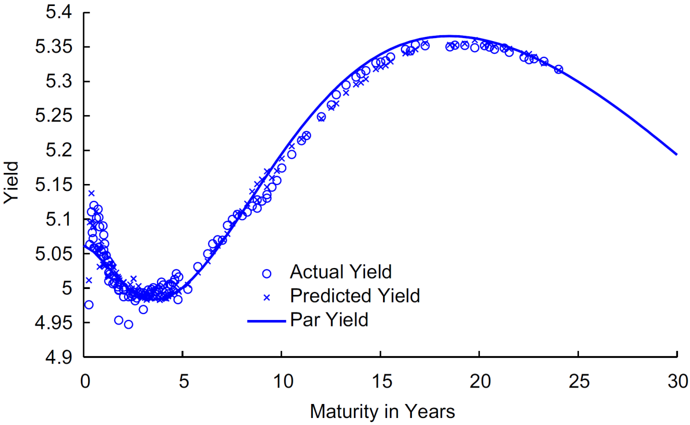

Fig. 1. Par-yield curve on May 9, 2006.

Sometimes it is really terrible

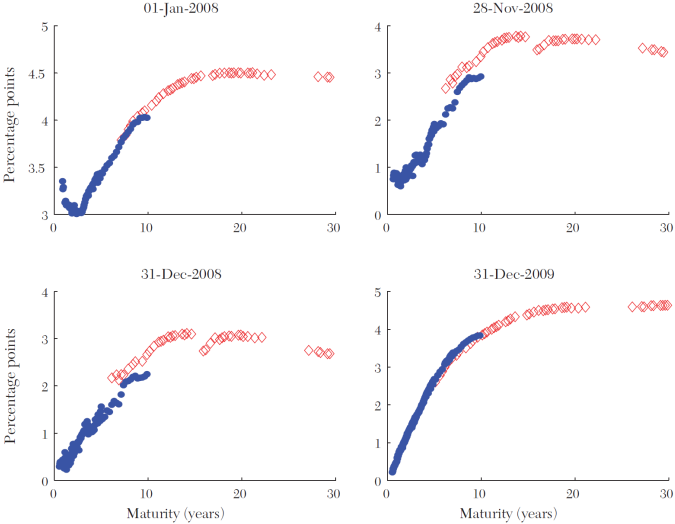

Figure 7. Yields on Treasury Coupon Securities on Selected Dates

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- Worth thinking about the swap curve
- And perhaps modeling it to price liquidity properly

Are there supply effects?

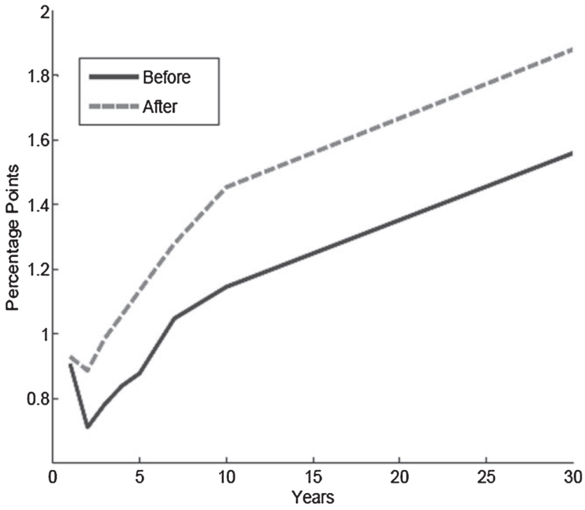

FIG. 1. Swedish Sovereign Yields around the 7 June 2012 Announcement

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- Specialness is exogenous
- Why are some securities special?
- Liquidity is important
- This paper correctly sees QE as a factor creating specialness, that is also important

Next step

- Have a macro framework providing the rule of motion of riskless GC rate
- And generating model-consistent pricing kernel
- Tall order, but worth the effort

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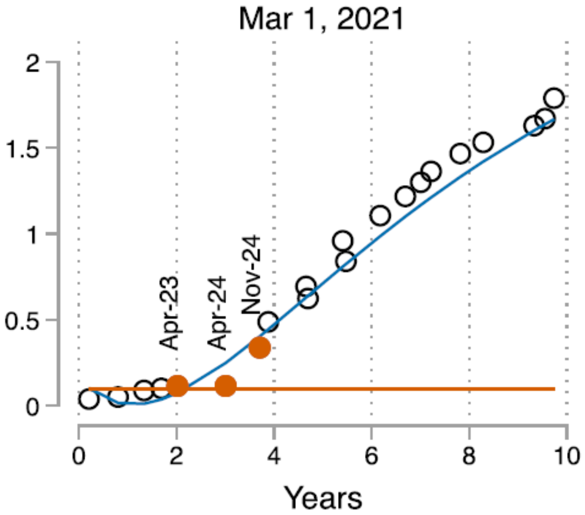
- Paper's proposed solution: SLF
- I am not sure.
- SLF offsets the QE specialness but mechanically offsets QE too
- This paper has the right framework to ask what happens to GC rates under SLF, which is not clearly studied

How not to do QE (Lucca and Wright, JF)



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- To what extent does QE create a general Treasury specialness?
- Is it better to do QE with corporate bonds (political economy notwithstanding)?
- This paper provides the framework to begin studying these issues

While at it

- Think about repo fails as well
- Very important and understudied question
- Appropriate for this framework, once rehypothecation is incorporated

Conclusion

- Truly wonderful paper, a pleasure to read and think about
- Will foster deeply needed research on fixed income market interlinkages
- Obvious next steps are embedding this framework in a macro setting and thinking about QE effects when corporate bonds are distict from Treasuries