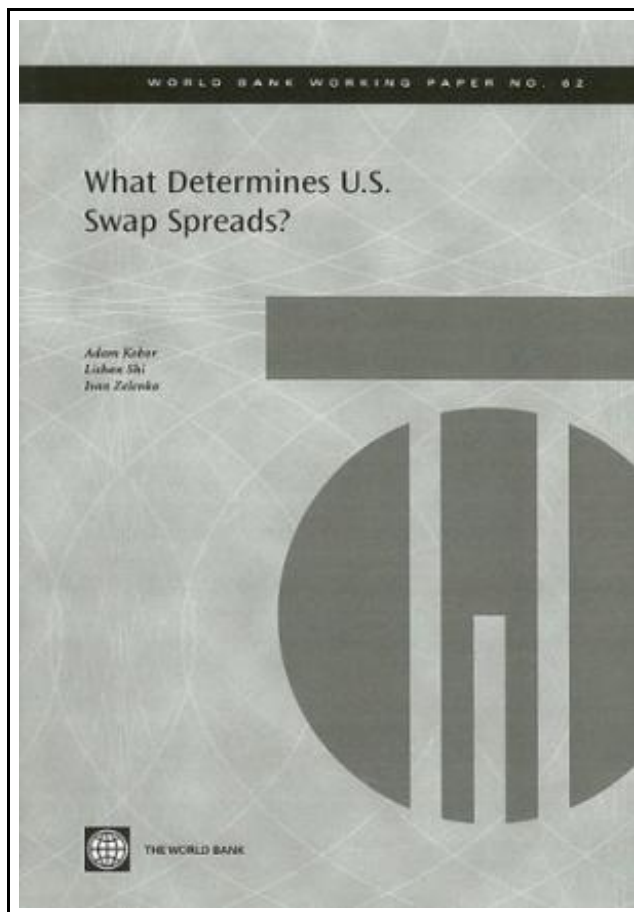# What Determines U.S. Swap Spreads?

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Reviews

This book is wonderful. It really is writter in easy words and never difficult to understand. I am quickly can get a satisfaction of reading a created ebook.
(Carley Huels)

WHAT DETERMINES U.S. SWAP SPREADS?

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World Bank Publications. Paperback. Book Condition: new. BRAND NEW, What Determines U.S. Swap Spreads?, Adam Kobor, Lishan Shi, Ivan Zelenko, This title examines the evolution of the U.S. interest swap market. It reviews the theory and past empirical studies on U.S. swap spreads and estimates an error correction model for maturities of 2-, 5- and 10-year over the period 1994-2004. Financial theory depicts swaps as contracts indexed on Libor rates, rendered almost free of counterparty default risk by mark-to-market and collateralization. Swap spreads reflect the Libor credit quality (credit component) and a liquidity convenience premium present in Treasury rates (liquidity component). Multifactor models which were estimated on observed swap rates highlighted the central role played by the liquidity component in explaining swap spread dynamics over the past fifteen years. They also found, however, some puzzling empirical results. Statistical models, on the other hand, mainly based on market analysis, faced technical difficulties, arising from the presence of regime changes, the non-stationarity in swap spreads, and the co-existence of long-term and shorter-term determinants. Against this background, the authors applied the error correction methodology based on the concept of co-integration. They find that U.S. dollar swap spreads and the supply of U. S. Treasury bonds are co-integrated, suggesting that the Treasury supply is a key determinant on a long-term horizon. They then estimate an error correction model which integrates this long-term relationship with the influence of four shorter-term determinants: the AA spread, the repo rate, the difference between on-the-run and off-the-run yields, and the duration of mortgage backed securities. The error correction model fits observed swap spreads quite well over the sample period. The authors then illustrate how the same model can be used to carry out scenario analysis.

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