Government Debt Management at the Zero Lower Bound

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Main message: you can't have it both ways

- There is a national interest in the maturity structure, influenced by
  - Fiscal cost
  - Fiscal risk
  - Aggregate demand
  - Financial stability & liquidity
- We now appreciate liquidity more => should lean shorter
- But how, given the various actors and objectives?
  - Two instruments and four objectives
- Consolidate and Coordinate

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"At the zero lower bound, a fully coordinated policy … should be the norm."

Beneath the sound of the alarms

- Academic-policy hybrid research
  - Strip away institutions to see the issue with clarity, then add back most relevant frictions
  - "most relevant" is always the issue
- Measurement
  - we only know what we can measure
  - Attempt to quantify and add evidence to the discussion
- Institutional structure

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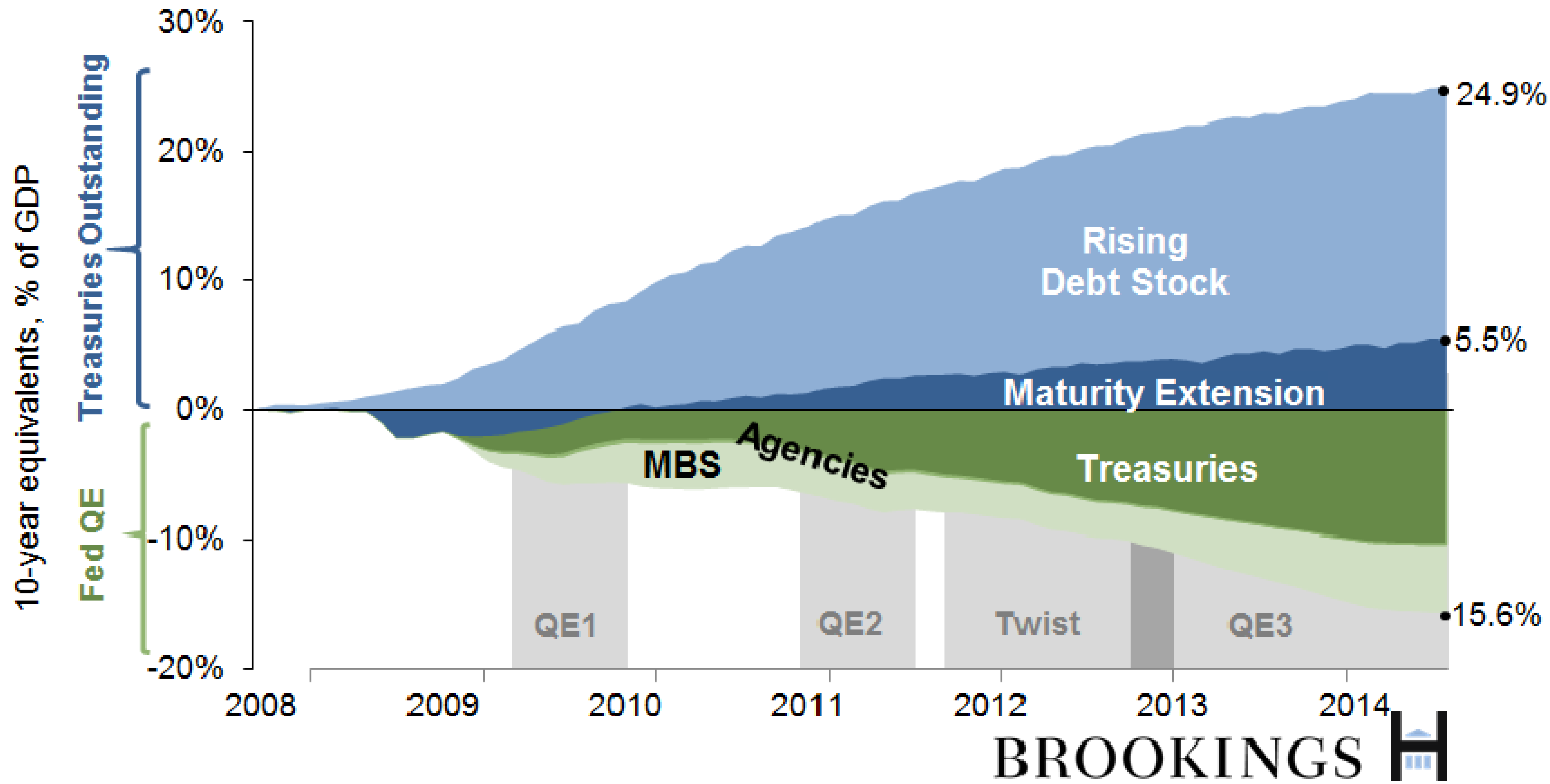
Policies to promote aggregate demand try to lower private long term interest rates – the Fed buys long term assets to *reduce supply held by private investors*

Policies to lengthen the maturity of government debt *increase the supply* of long term Treasuries to the private market

These policies work at cross-purposes.



10-year equivalents, % of GDP
Treasuries Outstanding
Fed QE
30%
20%
10%
0%
-10%
-20%
2008
2009
2010
2011
2012
2013
2014
24.9%
5.5%
15.6%
Rising
Debt Stock
Maturity Extension
MBS
Agencies
Treasuries
QE1
QE2
Twist
QE3
BROOKINGS

Suggests a consolidated/netting approach

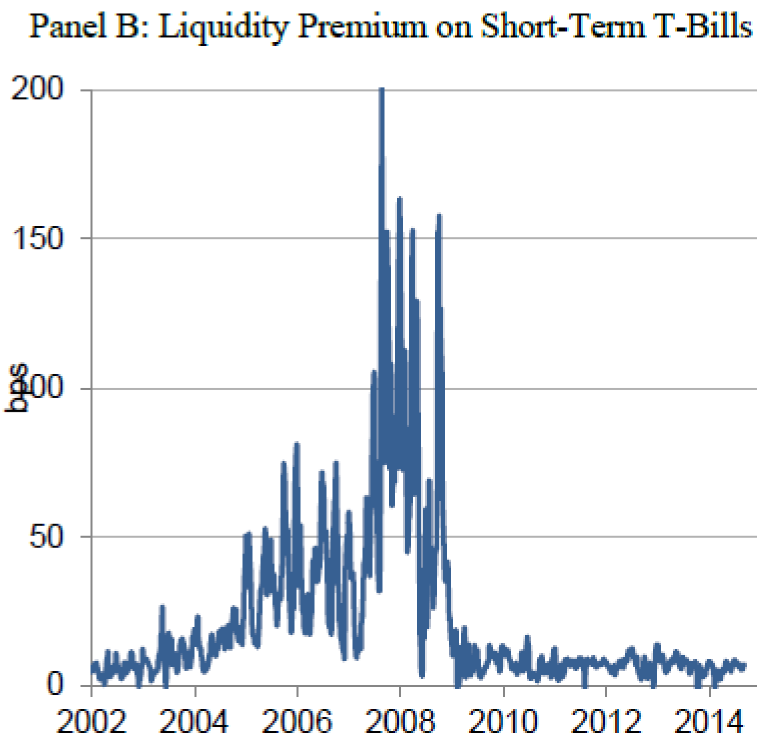
When is the consolidated approach in/appropriate?

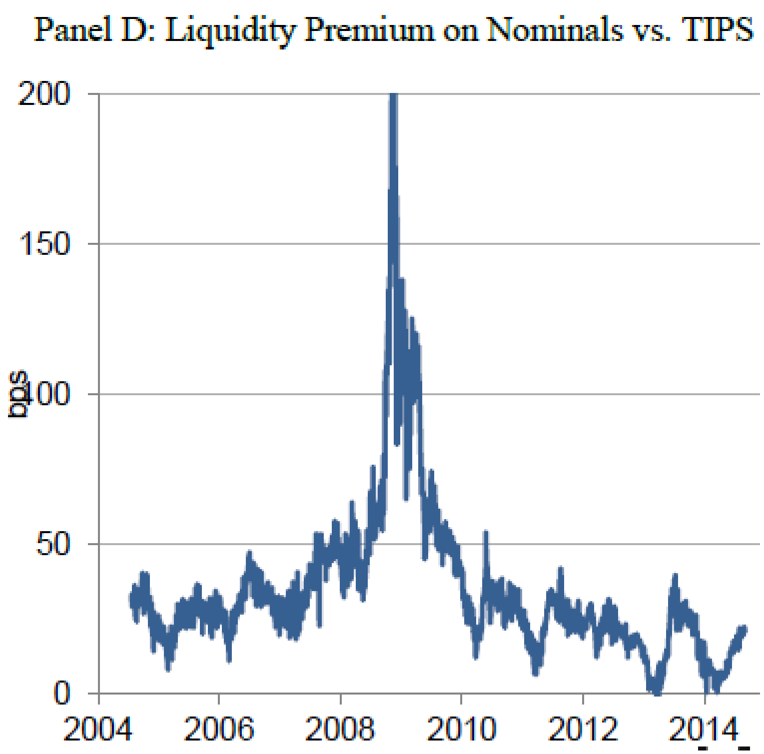
The main objectives don't all lend themselves to consolidating Treasury issuance and (independent) Fed holdings

1. Fiscal cost (why are some securities on "special"?)
2. Fiscal risk (refunding/rollover risk, budget risk)
3. Aggregate demand (net to private holdings)
4. Financial Stability, Liquidity (net to private holdings?)

Quantifiable for policy?

- If we were comfortable with previous maturity structure, then there is a new force to go short
  - So we should be shorter than before
  - Were we right before? What else has changed?
  - Greater demand for Treasuries with regulatory changes
- “Fill in the cracks” with bills
  - Other arrangements to provide liquidity?
    - Segregated reserve accounts? On-the-run LT bonds?
  - How do these affect the consolidated policy and cost?
- Open economy and crisis considerations around cost minimization and hedging argument –
  - Should we always expect rates to be low in a crisis?
  - Recent reversals in stock-bond correlations suggest interest rate risk is larger => reducing term premia


Panel B: Liquidity Premium on Short-Term T-Bills
200
150
100
50
0
bps
2002
2004
2006
2008
2010
2012
2014


Panel D: Liquidity Premium on Nominals vs. TIPS
200
150
100
50
0
bps
2004
2006
2008
2010
2012
2014

Institutions

Many institutions have partial mandates, and government regularly divides responsibility among them.

Political economy gives reasons for this, though it is certainly not always well-founded or efficient in practice.

Are the Fed and the Treasury different?

- Congress has the power to tax
- Treasury – The Secretary has full authority to administer and enforce the internal revenue laws and finance the debt
- Fed – monopoly on money creation

Main message: can't have it both ways

Policymakers can't both extend maturity to obtain debt management objectives and take maturity out of the market to support aggregate demand objectives.

But… debt management is a quantitative exercise. Even if the qualitative arguments are compelling, implementation by policymakers is quantitative.

And… institutional arrangements reflect many priorities. Consultation seems less controversial, but mandates and instruments can be fragmented by design.