



Comments on the paper by Linas Jurksas and Hector Carcel
“Monetary policy interaction with government bond yields and liquidity”

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- **PURPOSE:** Identify the underlying factors of euro area government bond yields spreads.
- **FOCUS:** Liquidity components as well as the monetary policy perspective on liquidity-yield dependence for a sample with six biggest Eurozone economies, Germany, France, Italy, Spain, Netherlands and Belgium.
- **MECHANISM:**
 - Use cross-country and cross-maturity dimensions by covering 500 different government bonds over the period June 2011 – March 2018.
 - Use various methodological approach, which consists of different liquidity indicators, model specifications and different time spans. **BUT**, too many things may shift the focus;
 - Use different estimation techniques:
 - Panel least square with fixed effects, to avoid multicollinearity and heterogeneity in the micro unit. I would have preferred the GMM approach by Arrelano and Bond (1991);
 - Run OLS (not panel) regressions separately for each bond. **BUT**, too many things may shift the focus;
 - The authors declare at the beginning “...euro-area government bond converged significantly since the inception of Economic and Monetary Union, ... yields and dynamics are relatively heterogeneous across different countries...” the applied panel techniques with fixed is one possible relatively good estimation approach, **BUT**, I would have rather prefer, probably as a future objective, the IRF of a VAR on individual cases, while the issues of insufficient number of data may be solved by Bayesian estimation technique.

- The paper enriches our knowledge by providing:
 - A dynamic model, of Euro area cross-country and cross-maturity dimensions, on the liquidity matters of sovereign bond market, which is also important for the transmission of the monetary policy.
 - Empirical findings on how different liquidity component as well as the monetary policy perspective on liquidity-yield dependence effect yields spreads during particular periods.
- The paper is readable, has clear motivation and a structure that supports the aim of this research. **BUT**, sometimes the value added of a paper is determined also by how policy-makers can draw on those results too address properly their related concerns;
- MAIN RESULTS:
 - “...changing illiquidity score is positively linked to the dynamics of yields spreads...different liquidity indicators have very similar effect on yields spreads as it is the baseline...implying that different liquidity dimensions and sides of liquidity are linked with yield spreads rather homogenously...”
 - “...the important of credit risk remained almost the same through all periods, meaning that this type of risk is always priced by bond investors...”
 - **BUT**, it seems the authors commented their empirical analysis from the sign and the value of t-statistics, while the size of the respective coefficient is very small, unless there is a technical specification issue that influence such patterns.

- The dependent variable is the government bond yields spread over German maturity-matched yield. “...we wanted to separate the flight-to-safety” component from the yields, because German government bonds are regarded as the “safe-heaven” asset class...”. **BUT:**
 - Not sure how did you calculated the yields spread for Germany, which is also part of the sample.
 - I would instead prefer the **overnight index swap (OIS)**, even though you have your reasons for not using it based on its limitations. **At least try it as a robustness check exercise.**
 - It might be even better to use the PCA approach to construct a dependent variable that is based on a composite interest rate index that consists of all the government bond yield including the OIS. That would account for LR and SR side effects.
- “...only minority of authors use different liquidity indicators in the same study...” there might be a reason ... **possible due difficulty to compress results in case there is big differences, e.g. in the size and sign of coefficients...**, as it is the case in Table 3. **Try the Amihud or/and an execution-based liquidity indicator already mentioned by you in other materials.**
- Try to explore more:
 - Other potential macroeconomic factors, e.g. **output**, **exchange rate**, etc., and banking and financial, e.g. **banking competition**, **financial liberalisation**, etc., or other indicators from balance sheet, e.g. **capital risk**, or other indicator linked to case episodes, e.g. **political events**. **These are also indicators that are considered and priced by bond investors.**
 - Develop a dynamic model of a limit order market populated by strategic liquidity traders of varying impatience, given that in equilibrium patient traders tend to submit limit orders, whereas impatient traders submit market orders.
 - The results with regards to the variable of your interest, (il)liquid indicator in terms of policy implications and extend the section related to final conclusion, which is relatively very short.

Thank you for your attention!!!
I am looking forward to see the final version
of the paper.

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