Public Affairs 974-1
Monetary and Financial Policy in the Wake of the Financial Crisis
(9/27/12)

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UW Madison
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Debt and Interest Rates

Ten year Treasury, % [right scale]

3 month Treasury, % [right scale]

Federal debt held by public to GDP [left scale]
Debt and Real Interest Rates

Federal debt held by public to GDP [left scale]

Ten year Treasury adjusted by expected infl., % [right scale]

Ten year TIPS, % [right scale]
Crowding Out?

Ten year-3 mo Treasury spread, %

Federal government budget deficit to GDP

[Diagram showing trends over time]
Econometric Analysis

\[
\text{SPREAD}_t = \beta_0 + \beta_1 \text{UNGAP}_t + \beta_2 \text{INFL}_t + \beta_3 \text{STRSURP}_t + \beta_4 \text{FOROFFICIAL}_t + \beta_5 \text{FEDLT} + \epsilon_t
\]

- **SPREAD**: 10 yr-3 mo Treasury
- **UNGAP**: unemployment gap
- **INFL**: inflation gap, PCE inflation – 1.8%
- **STRSURP**: structurally adjusted budget balance
- **FOROFFICIAL**: Official purchases of Treasurys
- **FEDLT**: Fed purchases of long term Treasurys
Estimates

Table 1
Regression Results for the Treasury Interest Rate Term Spread, 10-Year - 3 Month
Ordinary Least Squares, Sample 1979-2010

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<tr>
<th></th>
<th>C</th>
<th>UNGAP</th>
<th>INFL</th>
<th>STRSURP</th>
<th>FOROFFICIAL</th>
<th>FEDLT</th>
<th>DISCMPOL</th>
<th>Adj. R²</th>
<th>DW</th>
<th>SE</th>
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<td>-0.276**</td>
<td>-0.190*</td>
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<td>0.553</td>
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<td>(0.143)</td>
<td>(0.072)</td>
<td>(0.106)</td>
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<td>(0.080)</td>
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<td>(0.237)</td>
<td>(0.189)</td>
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Standard errors in parentheses; ** denotes significant at the 0.05 level; * denotes significant at the 0.10 level.

Okun’s Law
Oil Shocks

Acceleration in PCE inflation, y/y

Oil price inflation, y/y