

How Markets View Government Debt

Structural, institutional and behavioural influences on economic agents' perspectives

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Overview

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- Methodology
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 - Macroeconomic, Political & Structures: An Overview
 - Influence Of Institutions: Some Examples
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How can financial market perspectives help us develop a better understanding of sustainable government debt?

Existing Literature

- “sustainability of public finances [...] is still an imprecise concept [...] there is no generally agreed upon definition of what precisely constitutes a sustainable debt position” Neck and Sturm, 2008
- “there is currently no agreement on the answer [concerning optimal debt levels] and it is the subject of heated academic and political debate.” Pescatori, Sandri, & Simon, 2014
- “Views diverge over the importance of these [economic] drivers of sovereign bond market turbulence.” Cimadomo, Claey's, & Poplawski-Ribeiro, 2016

Theoretical Assumptions

- Economic agents act within a context of institutions and structures
- Economic, political and socio-economic structures shape how the agent assesses government debt but are also shaped by agent's behaviour
- Institutions, particularly rules, norms, and standard operating procedures affect the behaviour of agents due to their effect on the actor's preferences, interpretations and identities

Methodology

Case study: European government debt

Selection of different European government debt markets (Germany, Greece, Italy) over a time period from 2003 to 2018.

Interview Study with economic agents

On-going interview study with economic agents involved in government debt market. Focus on assessment processes of government bonds and central government debt levels.

Financial Media Content Analysis

Examination of financial media publications including newspaper articles and newswires. Quantitative content analysis focused on keywords and keywords-in-context.

Financial Media Quantitative Content Analysis

- See Beetsma, Giuliadori, de Jong & Widijanto (2013), Boffelli & Urga (2015)
- Total of 15848 articles
- Cases from Germany (n=7239, 45.7%), Greece (n=5151, 32.5%), Greece (n=3458, 21.8%)

Value	Frequency	Total percent
2003	346	2,2%
2004	317	2,0%
2005	444	2,8%
2006	501	3,2%
2007	465	2,9%
2008	357	2,3%
2009	632	4,0%
2010	1790	11,3%
2011	2640	16,7%
2012	2370	15,0%
2013	1040	6,6%
2014	732	4,6%
2015	1850	11,7%
2016	872	5,5%
2017	645	4,1%
2018	847	5,3%

Behavioural Aspects: Some Examples

- Use of market frames to select and filter information for relevant factors (see Hardie and Mackenzie, 2007)
 - FMAs subjectively decide how 'deep' they drill down on macro-economic measures
 - With regards to political and socio-economic factors, the level of analysis is also subjective but typically case-by-case dependent
- Comparative assessments based on
 - Categories assigned by geographical location or group membership; as well as categories determined by measurements such as economic development, investment grade, credit rating

Behavioural Aspects: Some Examples

- Comparisons & Measurements
 - Comparison within or between categories are often used to reduce number of factors/information to consider
 - Factors are considered in line with some context, which is selected by individual FMAs or teams
- Use of availability heuristics can impact selection of relevant factors
 - Increases in news releases or coverage is likely to lead to assumptions regarding market behaviour
- Herd behaviour & fear of missing out
 - Assessments include considerations relating to 'trend following' or performance comparisons

Macro-Economic Structures

- Larger variety of factors appear to be considered in assessments of government debt levels and government bond yields
- Economic agents engage with macro-economic structures in an subjective and ad-hoc manner
- Factor relevance is dependent on time and country/country-group, as well as institutional rules and norms

Political & Socio-Economic Structures

- In the developed world the influence of political structures has increased in importance
- Number of factors/concepts considered have increased; not anymore limited to factors which translate into economic structures (e.g. fiscal policy)
- But influence is still lower than expected due to newly developed norms such as large scale central bank bond purchases

Influence of Institutions: Some examples

Market-wide rules & regulations

IMF reserve currencies; collateral pools; liquidity regulations (LCR); HQLA categories

National / market-wide practices

Spread comparisons against benchmarks; focus on debt/GDP; acceptance of safe havens; in-house procedures

National / market-specific norms

Primary dealer agreements with DMOs; national stimulus programs; central bank bond purchases

Conclusions

- Economic agents subjectively select how to engage with structures and institutions
- Heuristics and cognitive shortcuts are used frequently to navigate the complexity of structures and institutions
- Level of depth when engaging with economic structures has increased
- Political and socio-economic structures have gained in importance
- Institutions influence economic agents in their selection and assessment of government bond investments

Thank you

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Interview Sources

Interview Type ¹	Number	Locations
Investor	6	Europe, North America
Consultant	2	Europe, North America
Asset Manager	9	Europe, Australia
Banking	8	Australia, North America, Asia, Europe
Rating Agency	3	North America, Europe
DMO / MoF / Central Bank	4	Europe
Other	1	Europe

¹ Interviewees were located in a variety of departments including (but not limited to) asset liability matching, asset allocation, investment strategy, research, portfolio management, client portfolio management, secondary market trading, primary markets, debt management, debt issuance and investor relations.

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