

# The Effects of Quantitative Easing on Interest Rates\*

Arvind Krishnamurthy<sup>1</sup> and Annette Vissing-Jorgensen<sup>2</sup>

February 10, 2011

**Abstract:** We evaluate the effect of the Federal Reserve's purchase of long-term Treasuries and other long-term bonds ("QE1" in 2008-2009 and "QE2" in 2010-2011) on interest rates. Using an event-study methodology that exploits both daily and intra-day data, we find a large and significant drop in nominal interest rates on long-term safe assets (Treasuries, Agency bonds, and highly-rated corporate bonds). This occurs mainly because there is a unique clientele for long-term safe nominal assets, and the Fed purchases reduce the supply of such assets and hence increase the equilibrium safety-premium. We find only small effects on nominal (default-adjusted) interest rates on less safe assets such as Baa corporate rates. The impact of quantitative easing on MBS rates is large when QE involves MBS purchases, but not when it involves Treasury purchases, indicating that a second main channel for QE is to affect the equilibrium price of mortgage-specific risk. Evidence from inflation swap rates and TIPS show that expected inflation increased due to both QE1 and QE2, implying that reductions in real rates were larger than reductions in nominal rates. Our analysis implies that (a) it is inappropriate to focus only on Treasury rates as a policy target because QE works through several channels that affect particular assets differently, and (b) effects on particular assets depend critically on which assets are purchased.

---

<sup>1</sup> Kellogg School of Management, Northwestern University and NBER

<sup>2</sup> Kellogg School of Management, Northwestern University, NBER and CEPR

\* We thank Olivier Blanchard, Charlie Evans and participants at a Chicago Fed seminar for their suggestions. We thank Kevin Crotty and Juan Mendez for research assistance.

## 1. Introduction

The Federal Reserve has recently pursued the unconventional policy of purchasing large quantities of long-term securities, including Treasuries, Agency bonds, and Agency Mortgage Backed Securities (quantitative easing, or “QE”). The stated objective of quantitative easing is to reduce long-term interest rates in order to spur economic activity.<sup>3</sup> There is significant evidence that QE policies can alter long-term interest rates. For example, Gagnon, Raskin, Remache, and Sack (2010) present an event-study of QE1 that documents large reductions in interest rates on dates associated with positive QE announcements. Swanson (2010) presents confirming event-study evidence from the 1961 Operation Twist, where the Fed/Treasury purchased a substantial quantity of long-term Treasuries. Apart from the event-study evidence, there are papers that look at lower frequency variation in the supply of long-term Treasuries and documents causal effects from supply to interest rates (see, for example, Krishnamurthy and Vissing-Jorgensen (2010)).<sup>4</sup>

While it is clear from this body of work that QE lowers long-term interest rates, the channels through which this reduction occurs are less clear. The main objective of this paper is to evaluate these channels. We review the principal theoretical channels through which QE may operate and then examine the event-study evidence with an eye towards distinguishing among these channels. We furthermore supplement previous work by adding evidence from QE2 and evidence based on intra-day data. Studying intra-day data allows us to document price reactions and trading volume in the minutes after the main announcements, thus increasing confidence that any effects documented in daily data are causal.

It is necessary to understand the channels of operation in order to evaluate the success of policy. Here is an illustration of this point: Krishnamurthy and Vissing-Jorgensen (2010) (hereafter, KVJ) present evidence for a channel whereby changes in long-term Treasury supply work through altering the safety premia on near zero-default-risk long-term assets. That is, under their theory, QE works particularly to lower the yields of bonds which are extremely safe, such as Treasuries or Aaa bonds. But, even if a policy affects Treasury interest rates, such rates may not be policy relevant. Most economic activity is funded by debt that is not as free of credit risk as Treasuries or Aaas. For example, only a small fraction of corporate bonds are rated Aaa or Aa, with the majority of corporate debt being A, Baa, or lower. If the objective of QE is to

---

<sup>3</sup> <http://www.newyorkfed.org/newsevents/speeches/2010/dud101001.html>

<sup>4</sup> Other papers in the literature that have examined Treasury supply and bond yields include Bernanke, Reinhart and Sack (2004), Greenwood and Vayanos (2010), D’Amico and King (2010), and Hamilton and Wu (2010).

reduce interest rates paid by the majority of corporations and households which may then spur spending and economic growth, then examining supply effects on Treasury rates could be misleading.<sup>5</sup> One of the principal findings of this paper is that a Treasuries-only QE policy will have significant effects on long-term Treasury rates and rates on highly-rated corporate bonds, but much smaller effects on lower-rated corporate bonds, and mortgage rates, both of which are very policy relevant. The large reductions in mortgage rates due to QE1 appear to be driven by the fact that QE1 involved large purchases of agency MBS. For QE2, which involved only Treasury purchases, we find a substantial impact on Treasury rates, but almost no impact on MBS rates. Clouse, Henderson, Orphanides, Small, and Tinsley (2000) make similar arguments in their discussion of the theoretical channels for quantitative easing, but do not offer empirical evidence distinguishing among the channels. A principal contribution of the present paper is to use a variety of asset market data, including derivatives data, to distinguish among the channels of QE.

The next section of the paper lays out the channels through which QE may be expected to operate. We then present an event study of QE1 and evaluate the channels. Section 4 presents a similar event study and evaluation of channels for QE2. Section 4 revisits the Swanson (2010) evidence for Operation Twist, with an eye towards discerning channels. Section 5 presents regression analysis building on the work from KVJ to provide estimates of the expected effects of QE on interest rates.

## **2. Channels**

### **a. Duration Risk Channel**

Vayanos and Vila (2009) offer a theoretical model for the duration risk channel. The model produces a risk premium on a bond of maturity  $t$  that is the product of the duration of a maturity  $t$  bond and the aggregate amount of duration risk borne by the marginal bond market investor. By purchasing long-term Treasuries, Agency debt, or Agency MBS, policy can reduce the duration risk in the hands of investors and thereby alter the yield curve, particularly reducing long-maturity bond yields relative to short-maturity yields. To deliver these results the model departs

---

<sup>5</sup> A good example to illustrate this point is to consider the behavior of Treasury Bill rates in the fall 2008 period. Such rates were close to zero and substantially below most of other corporate borrowing rates. It would have been incorrect to look at the low Treasury Bill rate and conclude that credit was easy – the low rates reflect an extremely high investor preference for extremely safe and liquid assets.

from a frictionless asset pricing model. The principal departure that generates the duration risk premium result is the assumption that the bond market is segmented and that there is a subset of risk-averse investors who bear (all or a lot of) the interest rate risk in owning bonds.

An important but subtle issue in using the model to think about QE is to ask whether the model applies narrowly to a particular asset class (e.g., only the Treasury market) or whether it applies broadly to all fixed income instruments. For example, if the segmentation is of the form that some investors had a special demand for 10 year Treasuries, but not 10 year corporate bonds (or mortgages or bank loans), then the Fed's purchase of 10 year Treasuries can be expected to affect Treasury yields, but not corporate bond yields. More broadly, if segmentation assumptions describe activity in only the Treasury market, then the model has implications for Treasury market yield curves, but not other fixed income yield curves. Vayanos and Vila (2009) do not take a stand on the issue. Greenwood and Vayanos (2010) offer evidence for how a change in the relative supply of long-term versus short-term Treasuries affects the spread between long-term and short-term Treasury bonds. This evidence also does not settle the issue, because it only focuses on Treasury data.

Recent studies on QE have interpreted the model as being about the broad fixed income market (see Gagnon, Raskin, Remache, and Sack, 2010), and that is how we proceed. Under this interpretation, the duration risk channel has two principal predictions:

- i. QE decreases the yield on all long-term nominal assets, including Treasuries, corporate bonds, and mortgages.
- ii. The effects are proportional to the duration of a bond, with larger effects for longer duration assets.

## **b. Liquidity Channel**

The QE strategy involves purchasing long-term securities and paying by increasing reserve balances. Reserve balances are a more liquid asset than long-term securities. Thus, QE increases the liquidity in the hands of investors and thereby decreases the liquidity premium on the most liquid bonds. There are many theoretical references for the liquidity channel. Almost all of the work on the effects of open market operations describes a liquidity channel.

It is important to emphasize that this channel implies an *increase* in Treasury yields. That is, it is commonly thought that Treasury bonds carry a liquidity price premium, and that this

premium has been high during particularly severe periods of the crisis. An expansion in liquidity can be expected to reduce such a liquidity premium and increase yields. This channel thus predicts that:

- i. QE raises Treasury yields, rather than lowers them.
- ii. QE produces large effects for liquid assets, and no effects for illiquid assets.

### **c. Safety Premium Channel**

Krishnamurthy and Vissing-Jorgensen (2010) offer evidence that there are significant clienteles for long-term safe (i.e., near zero-default-risk) assets that lower the yields on such assets. The evidence comes from relating the spread between Baa bonds and Aaa bonds (or Agency bonds) to variation in the supply of long-term Treasuries, over a period from 1925 to 2008. They report that when there are less long-term Treasuries, so that there are less long-term safe assets to meet clientele demands, the spread between Baa and Aaa bonds rises.

The safety channel of KVJ is not the same as the risk premium of a standard asset pricing model; it reflects a deviation due to clientele demand. A simple way to think about investor willingness to pay extra for assets with very low default risk is to plot the price against the expected default rate. KVJ argue that this curve is very steep for low default rates, with a slope that flattens as the supply of Treasuries increases. Figure 1 illustrates the distinction. The bottom line is the C-CAPM value of a risky bond. As default risk rises, the price of the bond falls. The distance from this line up to the middle (solid) line illustrates the safety premium of KVJ; for bonds that have very low default, the bond price rises as a function of the safety of the bond. The figure also illustrates the dependence of the safety premium on the supply of long-term Treasuries. The distance from the bottom line to the top line is the safety premium for a smaller supply of safe assets. The clientele demand shifts the premium up. This dependence on the premium on the supply of long-term Treasuries is how KVJ distinguish a standard risk premium explanation of defaultable bond pricing with the clientele-driven safety demand.

This same effect may be expected to play out in QE. However, there is a subtle issue in thinking about different asset classes in QE: Treasury and Agency bonds are clearly safe in the sense of offering an almost sure nominal payment; however Agency MBS has significant prepayment risk which means that it may not meet clientele safety demands. The safety channel thus predicts that:

- i. QE involving Treasuries and Agencies lowers the yields on safe assets.
- ii. The largest effects should occur for the safest assets, with no effects on low-grade debt such as Baa bonds or bonds with prepayment risk such as MBS.

We expect Baa bonds to be the relevant cutoff for these safety effects. First, such bonds are the boundary between investment grade and non-investment grade securities, so that if driven by safety clientele demands, the Baa bond forms a natural threshold. More rigorously, Longstaff, Mithal and Neis (2006) use credit default swap data from December 2000 to October 2001 to show that the component of yields that is hard to explain by purely default risk information is about 50 bps for Aaa and Aa rated bonds, and about 70 bps for lower-rated bonds, suggesting that the cutoff for bonds whose yields are not affected by safety premia is somewhere around the A/Baa rating.

#### **d. Commitment to Keep Rates Low Channel**

Eggertson and Woodford (2003) argue that non-traditional monetary policy can have a beneficial effect in lowering long-term bond yields only if such policy serves as a credible commitment by the central bank to keep interest rates low even after the economy recovers (i.e., lower than what a Taylor rule may call for). Clouse, et. al. (2000) argue that such a commitment can be achieved when the central bank purchases a large quantity of long duration assets in QE. They argue that if the central bank raises rates, it takes a loss on these assets. To the extent that the central bank weighs such losses in its objective function, purchasing long-term assets in QE serves as a credible commitment to keep interest rates low.

This channel affects all bond market interest rates, since lower future fed funds rates, via the expectations hypothesis, can be expected to affect all interest rates. But it has a more specific maturity prediction:

- i. This channel should lower intermediate maturity rates more than long maturity rates, since the commitment to keep rates low only lasts until the economy recovers and the Fed can sell the accumulated assets. Given forecasts of the duration of the current recession, such intermediate maturities will be in the 2 to 5 year range.

#### **e. Prepayment Risk Premium Channel**

QE1 involved the purchase of \$1.25tn of Agency MBS. Gabaix, Krishnamurthy, and Vigneron (2007) present theory and evidence that mortgage prepayment risk carries a positive risk premium, and that this premium depends on the quantity of prepayment risk borne by mortgage investors. The theory requires that the MBS market is segmented and that a class of arbitrageurs who operate predominantly in the MBS market are the relevant investors in determining the pricing of prepayment risk. This theory is similar to the Vayanos and Vila (2009) explanation of the duration risk premium, and more broadly fits into theories of intermediary asset pricing (see He and Krishnamurthy, 2010).

This channel is particularly about QE1 and its effects on MBS yields, which reflect a prepayment risk premium:

- i. QE1 lowers MBS yields relative to other bond market yields.
- ii. QE2, which does not involve MBS purchases, does not affect MBS yields.

#### **f. Default Risk Channel**

Lower grade bonds such as Baa bonds carry higher default risk than Treasury bonds. QE may affect the quantity of such default risk as well as the price (i.e. risk premium) of the default risk. If QE succeeds in stimulating the economy, we can expect that the default risk of corporations will fall, and hence Baa rates will fall. Moreover, standard asset pricing models predict that investor risk aversion will fall as the economy recovers, implying a lower default risk premium. Finally, extensions of the intermediary pricing arguments we have offered above for pricing prepayment risk can imply that increasing health/capital in the intermediary sector can further lower the risk premium on default risk.

#### **g. Inflation Channel**

To the extent that QE is expansionary, it increases inflation expectations, and this can be expected to have an effect on interest rates. In addition, some commentators have argued that QE may increase tail risks surrounding inflation.<sup>6</sup> That is, in an environment where investors are unsure about the effects of policy on inflation, policy actions may lead to greater uncertainty over inflation outcomes. Others have argued that aggressive policy decreases uncertainty in the

---

<sup>6</sup> See Calomiris and Tallman, 2010, op-ed, "In Monetary Targeting, Two Tails are Better than One."

sense that it effectively combats the possibility of a deflationary spiral. Ultimately, this is an issue that can only be sorted out by data. We propose looking at the implied volatility on interest rate options, since a rise in inflation uncertainty will plausibly also lead to a rise in interest rate uncertainty and implied volatility. The inflation channel thus predicts:

- i. QE increases the rate on inflation swaps as well inflation expectations as measured by the difference between nominal bond yields and TIPS.
- ii. QE may increase or decrease interest rate uncertainty as measured by the implied volatility on swaptions.

### **3. Evidence from QE1**

#### **a. Event Study**

Gagnon, et. al., (2010) provide an event study of QE1 based on the announcements of long-term asset purchases by the Federal Reserve in the late-2008 to 2009 period (“QE1”). These policies included purchase of mortgage-backed securities, Treasury securities and Agency securities. Gagnon, et. al., (2010) identify eight event dates beginning with the 11/25/08 announcement of the Fed’s intent to purchase \$500 bn of Agency MBS and \$100bn of Agency debt, and running into the summer of 2009. We focus on the first five of these event dates (11/25/2008, 12/1/2008, 12/16/2008, 1/28/2009, and 3/18/2009), leaving out three later event dates on which only small yield changes occurred.

There was considerable turmoil in financial markets in the period from the fall of 2008 to the spring of 2009, which makes inference from an event-study somewhat tricky. Some of the assets we consider, such as corporate bonds and CDS, are less liquid. During a period of low liquidity, the prices of such assets may react slowly in response to an announcement. We deal with this issue by presenting two-day changes for all assets (from the day prior to the day after the announcement). In the data, for high liquidity assets like Treasuries, two-day changes are almost the same as one-day changes. For low liquidity assets, the two-day changes are almost always higher than one-day changes; there appears to be a continuation pattern in the yield changes.

The second issue that arises is that we cannot be sure that the identified events are in fact important events, or the dominant events for the identified event day. That is, other significant economic news arrives through this period and potentially creates measurement error problems



for the event-study. To increase our confidence that QE1 announcements were the dominant news on the five event dates we study, Figure 2 presents graphs of intraday movements in Treasury yields and trading volume for each of the event dates. The figure is based on data from BG Cantor and the data graphed is for the on-the-run 10 year Treasury bond at each date. Yields graphed are averages by the minute and trading volume graphed is total volume by minute. The vertical lines indicate the minute of the announcement, defined as the minute of the first article covering the announcement in Factiva. These graphs show that the events identify significant movements in Treasury yields and Treasury trading volume and that the announcements do appear to be the main piece of news coming out on the event days, especially on 12/1/2008, 12/16/2008 and 3/18/2009. For 11/25/2008 and 1/28/2009, the trading volume graphs also suggests that the announcements are the main events, with more mixed evidence from the yield graphs for those days.

Table 1 presents data on two-day changes in Treasury, Agency, and Agency MBS yields around the main event-study dates, spanning a period from 11/25/08 to 3/18/09. Over this period it became evident from Fed announcements that the government intended to purchase a large quantity of long-term securities. Across the five event dates, interest rates fell across the board on long-term bonds, consistent with a contraction of supply effect. Now consider the channels through which the supply effect may have worked.

#### **b. Duration Risk Channel**

Consistent with the duration risk hypothesis, the yields of longer term bonds in Table 1 fall more than the yields of shorter maturity bonds. The only exception here is the 30 year Treasury bond, where the yield falls less than the 10 year bond. However, long Treasury and agency bond yields may fall more than shorter Treasury and agency bond yields because of clienteles for long-term safe assets (our safety premium channel). For MBS, long rates may fall more than short rate via the pre-payment risk premium channel affecting long MBS more than shorter MBS.

Note also that there are dramatic differences in the yield changes across the different asset class. Agency bonds, for example, experience the largest fall in yields. The duration risk channel cannot speak to these effects as it only prescribes effects that depend on bond maturity.

To determine if a duration risk channel is operative, Table 2 presents data on corporate bond yields of intermediate duration (around 4 year duration) or long duration (around 10 year

duration), as well as these same yields with the impact of changes in CDS rates taken out. We adjust the yield changes using CDS changes to remove any effects due to a changing default risk premium and thereby isolate duration risk premium effects. The CDS rates used are for 5-year tenor. The CDS adjustment makes a substantial difference in interpreting the evidence. In particular, there is a large fall in CDS rates for lower grade bonds on the event dates, suggesting that default risk/risk premia fell substantially with QE, consistent with the default risk channel (we discuss this further below).

Given the CDS adjustment, there is only a small change in the yields of Baa and lower bonds. Moreover, there is no apparent pattern across long and intermediate maturities in the changes in CDS-adjusted corporate bond yields. Both of these observations suggest that the duration risk channel is not operational.<sup>7</sup>

### **c. Liquidity Channel**

The most liquid assets in Table 1 are the Treasury bonds. The liquidity channel predicts that these yields should *increase* with QE. They do not increase; however, note that they fall much less than the yields on Agency bonds which are less liquid. That is the Agency-Treasury spread falls with QE. For example, the 10 year spread falls by  $199-107=92$  basis points. This is an interesting comparison because 10 year Agencies and Treasuries have the same default risk (especially since the government placed FNMA and FHLMC into conservatorship in September 2008), and are duration matched. Thus this spread isolates a liquidity premium. Consistent with the liquidity channel, we see that the equilibrium price premium (yield discount) for liquidity falls substantially.

### **d. Safety Channel**

The Agency bonds will be particularly sensitive to the safety effect. These bonds are not as liquid as the Treasury bonds, but do have almost the same safety as Treasuries. The fall in 10 year Agency yields is 199 bps, which is the largest effect in the table. This suggests that the safety channel is one of the dominant channels for QE1. As we have just noted, Treasuries fall less than the Agencies because the liquidity effect runs against the safety effect.

---

<sup>7</sup> We show below that there is no tenor effect in CDS rates so using CDS rates of different tenor for long and intermediate corporate bonds is unlikely to change our conclusion about the absence of a duration risk channel.

The corporate bond evidence is also consistent with a safety effect. The CDS-adjusted yields on Aaa bonds, which are close to default free, fall substantially, while there is close to no effect on the non-investment grade bonds. Finally, since Agencies are safer than Aaa corporate bonds, the safety channel prediction that the former bond yields fall more than the latter is also confirmed in the data.

**e. Commitment to Keep Rates Low**

This channel predicts the largest effects in bonds with maturities between 2 and 5 years. This is clearly rejected by the data. Longer term Treasuries and Agencies fall more than the 5 year (and shorter) bond yields. In the corporate bonds of Table 2, there is no apparent maturity effect. Thus, this effect likely played a limited role in QE1.

**f. Prepayment Risk Channel**

Agency MBS yields fall by 128 for 30-year bonds and 98 bps for 15-year bonds. There are two ways to interpret this evidence. It is possible that this is due to a safety effect – the government guarantee behind these MBS may be worth a lot to investors so that these securities carry a safety premium. The safety premium then rises, as with the Agency bonds, decreasing Agency MBS yields. On the other hand, the Agency MBS carry significant prepayment risk and are unlikely to be viewed as safe in the same way as Agency bonds or Treasuries (where safety connotes the almost certainty of nominal repayment). In empirically analyzing Agency MBS rates as well as the rate on 30-year conventional household mortgages (using historical data going back to the 1960s, but not reported here for brevity) we have found no effects of Treasury supply on the spreads between Baa rates and Agency MBS, which leads us to conclude that Agency MBS rates, like Baa rates, do not carry safety or liquidity premia.

Yet, Agency MBS fall more than Agency bonds. We think that a more likely explanation is market segmentation effects as in Gabaix, Krishnamurthy and Vigneron (2007). The government purchase of MBS reduces the prepayment risk in the hands of investors, and thereby reduces MBS yields. The effect is higher for the 30 year than the 15 year because the longer bonds carry more prepayment risk.

Additionally, Fuster and Willen (2010) show that the large reductions on agency MBS rates around 11/25/2008 were quickly followed by reductions in mortgage rates offered by mortgage lenders to households.

#### **g. Default Risk Channel**

We have noted earlier from Table 2 that QE appears to reduce default risk or default risk premia, which particularly affects the interest rates on lower grade corporate bonds. Table 3 offers more data on this observation, presenting two-day changes in CDS rates for each event day. The CDS rates are for approximately 440 firms for each of the five event dates. We compute the CDS rate as the equally weighted average across firms.

The table shows that CDS rates of the lowest risk firms (quintile 1, with average CDS rates of 82 basis points) do not change appreciably with QE. There is a clear pattern across the quintiles, going from Q1 to Q5, whereby higher credit risk firms experience the largest fall in CDS rates. This evidence suggests that QE had a significant effect through default risk and default risk premia.

Table 3 also presents the CDS changes sorted by underlying CDS tenor. There does not appear to be any tenor effect on the CDS changes. This evidence is further confirmation that there is no “duration” effect on corporate bonds. That is, we earlier showed that CDS-adjusted corporate bond yields do not reflect a duration risk premium effect. We adjusted the corporate bond yields, at all maturities, using the 5 year CDS (which is the most liquid contract). Table 3 shows that our conclusions would likely have been the same had we maturity-matched the CDS to the corporate bond yields.

#### **h. Inflation Channel**

The above analysis focuses on nominal rates. To assess effects on real rates, one further needs information about the impact of QE1 on inflation expectations. Table 4 presents the relevant data.

The first columns in the table are for inflation swaps. The 10-year inflation swap is the fixed rate in the 10-year zero coupon inflation swap, and thus a market-based measure of expected inflation over the next 10 years (see Fleckenstein, Longstaff and Lustig (2010) for

information on the inflation swap market). This data suggests that inflation expectations increased by between 36 and 95 basis points, depending on maturity.

The second set of columns present data on TIPS yields. We compare these yield changes to those from nominal bonds to evaluate the change in inflation expectations. Based on the evidence of the existence of significant liquidity and safety premia on Treasuries, it is inappropriate to compare TIPS to nominal Treasuries. Instead we compare the TIPS to the CDS-adjusted Baa bond. From Table 1, the CDS-adjusted long maturity Baa bond falls in yield by 31 bps, while the intermediate maturity bond falls in yield by 26 bps. Matching the 31 bps change to the 187 bps change in the 10 year TIPS, we find that inflation expectations increased by 156 bps at the 10 year horizon. At the 5 year horizon, based on the 26 bps change in CDS-adjusted intermediate maturity Baa bond and 144 bps change in TIPS, we find that inflation expectations increased by 118 bps.

Together these two sets of data suggest that the impact of Fed purchases of long-term assets on expected inflation was large and positive.

We also evaluate the inflation uncertainty channel. The last column in Table 4 reports data on implied volatilities from interest rate swaptions (i.e., the option to enter into an interest rate swap). The data is the Barclays implied volatility index. The underlying tenor for the swap ranges from 1 year to 30 year, involving options that expire from 3 months to 20 years. The index is based on the weighted average of implied volatilities across the different swaptions.

The average volatility measure over the QE time period is 103 bps, so that the fall of 37 bps is substantial. Thus, it appears that QE reduced rather than increased inflation uncertainty.

The other explanation for this fall in volatility is segmented markets effects. MBS have an embedded interest rate option that is often hedged by investors in the swaption market. Since QE involved the purchase of MBS, investors have a smaller demand for swaptions and hence implied volatility on swaptions fall. This latter explanation is often the one given by practitioners for changes in swaption implied volatilities. Notice, however, that volatility is essentially unchanged on the first QE1 event date, which is the event that drives the largest changes in MBS yields. This could indicate that the segmented markets effects are not important, with volatility instead driven by the inflation uncertainty channel.

## **i. Summary**

QE1 significantly reduced yields on safe assets, including Treasuries, Agencies and highly-rated corporate bonds, with liquidity effects working in the opposite direction. For the rates such as the Baa corporate bond or MBS yields, QE has effects through a reduction in default risk/default risk premia and a reduced prepayment risk premium. There is little evidence for the duration risk premium channel. There is evidence that QE increased inflation expectations, but reduced inflation uncertainty. This latter point implies that real rates fell for a wide variety of borrowers.

Finally, note that these effects are all sizable and probably much more than we should expect in general. This is because the November 2008 to March 2009 period is an unusual financial-crisis period in which the demand for safe assets was heightened, segmented market effects were apparent across many markets, and intermediaries suffered from serious financing problems. In such an environment, supply changes should be expected to have a large effect on interest rates.

## **3. Evidence from QE2**

### **a. Event Study**

We perform an event study of QE2 similar to that of QE1. There are two relevant sets of events in QE2. First, in the 8/10/2010 FOMC statement, the committee announces:

*“the Committee will keep constant the Federal Reserve's holdings of securities at their current level by reinvesting principal payments from agency debt and agency mortgage-backed securities in longer-term Treasury securities.”*

Prior to this announcement, market expectations were that the Fed would let its MBS portfolio runoff,<sup>8</sup> thereby reducing reserve balances in the system and allowing the Fed to exit from its non-traditional monetary policies. Thus, the announcement of the Fed's intent to continue QE revised market expectations. Moreover, the announcement indicated that the QE would shift towards longer-term Treasuries, and not Agencies or Agency MBS as in QE1. As a back-of-the-envelope computation, suppose that the prepayment rate for the next year on \$1.1tn of MBS was

---

<sup>8</sup> See Fed Chairman Bernanke's Monetary Policy Report to Congress on July 21, 2010, discussing the "normalization" of monetary policy. The issue is also highlighted in Bernanke's testimony on March 25, 2010 on the Federal Reserve's exit strategy.

20% (a typical rate). Then the announcement indicated that the Fed intended to purchase \$220bn of Treasuries over the next year.

The 9/21/10 FOMC announcement reiterates this message:

*“The Committee also will maintain its existing policy of reinvesting principal payments from its securities holdings.”*

The second type of information for QE2 pertains to the Fed’s intent to expand its purchases of long-term Treasury securities. The following announcement is from the 11/3/2010 FOMC statement:

*“The Committee will maintain its existing policy of reinvesting principal payments from its securities holdings. In addition, the Committee intends to purchase a further \$600 billion of longer-term Treasury securities by the end of the second quarter of 2011.”*

The 11/3 announcement was widely anticipated. According to the Wall Street Journal, a WSJ survey of private sector economists in early October of 2010 found that the Fed was expected to purchase about \$750 billion in QE2.<sup>9</sup> Based on this, one would expect the 11/3/2010 announcement to have little effect (estimates in the press varied widely, but the actual number of \$600 bn was in the range of numbers commonly mentioned). The two prior announcements are more likely to have been among the main events changing market expectations about QE2.

Figure 3 presents intraday data on the 10-year Treasury bond yield around the announcements times of the FOMC statements. The 8/10 announcement appears to be significant news for the Treasury market, reducing the yield in a manner that suggest that market expectations over QE were revised up. The 9/21 announcement is qualitatively similar. At the 11/3 announcement, Treasury yields increased by then fell some. The reaction suggests that markets may have priced in more than a \$600bn QE announcement.

In our event study, we aggregate across the 8/10 and 9/21 events, which appear to be driven by upward revisions in QE expectations. We do not add in the change from the 11/3 announcement as it is unclear whether only the increase in yields after than announcement or

---

<sup>9</sup> WSJ, Oct 26, 2010, "Fed Gears Up for Stimulus".

also the subsequent decrease was due to QE2 (furthermore, the large two-day reaction to the 11/3 announcement may not be due to QE2 since a lot of it happened the morning of 11/4 around the time new numbers were released for jobless claims and productivity).

Additionally, we present information for both 1-day changes and 2-day changes, but focus on the 1-day change in our discussion. This is because market liquidity had normalized by the fall of 2010, and looking at the 2-day changes would therefore likely add noise to the data.

## b. Analysis

Table 5 provides data on the changes in Treasury, Agency and Agency MBS yields over the event dates. Table 5 provides data on changes in corporate bond yields, CDS, and CDS-adjusted corporate yields. For this window, we did not obtain CDS data by rating category, and instead relied on the Markit investment grade and high yield CDS indices, matching these indices with corporate bond yields for the relevant category.

Here are the main conclusions we draw based on this data, in terms of the channels we have discussed earlier:

- There does not appear to be a duration risk premium channel. It is not the case that longer term Treasuries, Agencies, Agency MBS, or the CDS-adjusted corporate bonds move more in yield than shorter term securities. In addition, while the CDS-adjusted investment grade corporate bond yield falls, that of the high yield corporate bond rises.
- There does not appear to be a liquidity channel. Treasury and Agency yields fall by nearly the same amounts, so that their spread, which can measure liquidity, appears unchanged. This result is plausible because liquidity premia in markets were quite low in late 2010, as market liquidity conditions had normalized. Consider the following data (on 10/22/2010):

	<u>Treasury Bill</u>	<u>Tier 1 Non-Financial CP</u>
1 week	10bps	19bps
1 month	12	21
3 month	12	23



The premium on the more liquid 1 week bill relative to the 3 month bill is only 2 basis points. The premium on the more liquid 3 month bill relative to 3 month CP is only 11 basis points. The latter premium also reflects some credit risk and tax effects. Part of the reason why liquidity premia are so low is that government policy had already provided a large supply of liquid assets to the private sector. Consider that the Fed had already increased bank reserves substantially. In June 2007, reserve balances totaled \$44bn. As of September 2010, reserve balances totaled close to \$1,040bn. Furthermore, the government had increased the supply of Treasury bills from \$865bn to \$1783bn over this same period. These arguments suggest that the effects on liquidity premia should be negligible via the liquidity channel.

- There is significant evidence for a safety channel. Agency yields and Treasury yields, which are both near zero-default risk fall in yield. Agency MBS which carries prepayment risk and hence is not safe in the sense of Treasuries, does not fall appreciably in yield. Moreover, the CDS-adjusted investment grade bond yield also falls, but only 7 bps (intermediate) and 12 bps (long) compared to the 18 bps for the safer Treasuries and Agencies. Finally, the CDS-adjusted high yield bond rises in yield rather than fall.
- There is some evidence for a credit risk channel as the high yield CDS falls by 21 bps.
- There is no evidence of the commitment to keep rates low channel as most of the movement is in longer term yields.

Table 6 provides data on inflation swaps and TIPS yield for the event dates to analyze effects on inflation expectations.

- Inflation expectations rise with QE2. The 10 year inflation swap rises by 5 bps. The 10 year TIPS falls by 25 bps. Comparing this number to the CDS-adjusted rise in high yield bonds of 11 bps, we find that inflation expectations rise by 36 bps. While the inflation swaps and the TIPS both point to a rise in inflation expectations, there is a dramatic difference in the numbers from each asset market. We are unsure as to why this happens.
- The implied volatility on swaptions falls by 3 bps, indicating a slight decrease in inflation uncertainty.

### **c. Summary**

The QE2 data strongly suggests that the primary channel for the Treasuries-only policy is through the safety channel causing Treasury, Agency and highly-rated corporate bond yields to decline. This is a negative note for the policy as it indicates that nominal rates that are highly relevant for household and many corporations -- mortgage rates and rates on lower-grade corporate bonds were largely unaffected by the policy. On the other hand, there is significant evidence for an increase in inflation expectations, suggesting that real rates fell for all borrowers. This is a more positive note for the policy.

### **4. The Safety Channel in Operation Twist**

Swanson (2010) describes the Kennedy administration's 1961 Operation Twist (OT) and notes that it is qualitatively similar to QE2 in that both operations purchase long-term Treasuries and issue short-term government obligations. QE has the government purchasing long-term securities funded by expanding interest bearing reserve balances ("overnight T-bills"), while OT had the government purchasing long-term Treasuries and issuing short-term Treasuries. Swanson reports that the size of OT at 4.7% of the outstanding stock of Treasury debt was similar to QE2, which represented 7% of outstanding debt.

Swanson provides an event study for OT and detects effects on Treasury rates in the range of -10 to -17 bps, for maturities from 5 years to 30 years. Table 7 presents Swanson's finding for the 10 year Treasury, with this yield falling by 16 bps. Using his event dates and computing changes over the same dates as Swanson, we also analyze effects on the FNMA 10 year Agency bond as well as the Moody's long-term Aaa and Baa corporate bond index.

The comparisons are interesting from the standpoint of the safety channel which we have found to be important in QE1 and QE2. The table indicates that the FNMA bond fell 10 bps, while the Moodys indices fell 3 bps (Aaa) and 5 bps (Baa). Note that FNMA is a government sponsored enterprise in 1961 (as opposed to being fully "owned" by the government as during QE1 and QE2), so it does not carry the same safety as Treasuries. Thus, consistent with the safety channel, the FNMA bond moves less than the Treasury. We would expect the Moodys Baa index to fall less than the FNMA/remain the same. It falls by 5 bps. The only data point which is surprising from the view of the safety channel is that the Aaa bond yield only falls by 3 bps. It is possible that the corporate bonds during these period are particularly illiquid (typical

bid-ask spreads are 10 bps) and given the small moves in yields, the illiquidity adds enough noise to complicate inference.

## **5. Regression Analysis of the Safety Channel**

The event-study evidence is useful in identifying channels for QE. While it provides some guidance on the magnitudes of the effects through QE, it is hard to precisely interpret the numbers because event study measures are dependent on the dynamics of expectations through the event. That is, the asset market reaction depends on the change in the expectation of QE over the event. We do not have any direct way of precisely measuring such an expectations change, nor determine whether the event study is likely to over- or understate the effects of QE. In addition, the QE1 event occurs in highly unusual market conditions, so that it is hard to extrapolate numbers from that period to more normalized conditions. As such, it is valuable to find alternative approaches to estimating the impact of QE. In this section, we use regression analysis to provide such estimates.

### **a. KVJ regressions**

We build on the regression analysis from KVJ to estimate the effect of a purchase of long-term securities via the safety channel. We focus on the safety channel because it appears to be a dominant effect from the event studies.

The KVJ regression approach can be explained through Figure 1. Consider the yield (or price) difference between a low default risk bond, such as a Treasury, and a Baa bond. This yield difference includes both a default risk premium due to standard risk considerations and a safety premium component due to clientele demands for particularly safe assets. We disentangle the default risk and safety premium by observing that the safety premium is decreasing in the supply of safe assets, including Treasuries, while the default risk component can be controlled for using empirical default measures. The empirical approach is to regress the Baa-Treasury spread on the supply of Treasuries as well as standard measures of default.

In KVJ, we mainly focus on the effect of changes in the total supply of Treasuries, irrespective of maturity, on bond yields. For evaluating QE, we are interested more in asking how a change in the supply of long-term Treasuries will affect yields. Accordingly, we construct a maturity-based measure of debt supply as follows. For each Treasury issue, we compute the

market value of that issue multiplied by the duration of the issue divided by 10.<sup>10</sup> We normalize by 10 to express the supply variable in “ten-year equivalents.” We then sum these values across Treasury issues with remaining maturity of 2 years or more. Denote the sum as LONG-SUPPLY. We also construct the (unweighted) market value across all Treasury issues (TOTAL-SUPPLY), including those with a remaining maturity of less than 2 years.

We then regress the spread between the Moody’s Baa corporate bond index and the long-term Treasury yield (Baa-Treasury) on the  $\ln(\text{LONG-SUPPLY}/\text{GDP})$  instrumented by  $\text{TOTAL-SUPPLY}/\text{GDP}$ , and squares and cubes of  $\text{TOTAL-SUPPLY}/\text{GDP}$ . The regression includes default controls of stock market volatility (i.e., standard deviation of weekly stock returns over the preceding year) and the slope of the yield curve (10 year Treasury yield minus 3-month yield). The regressions are estimated via OLS, with standard errors adjusted for an AR(1) correlation structure. It is important to instrument for LONG-SUPPLY because the maturity structure of government debt is chosen by the government in a way that could be correlated with spreads. TOTAL-SUPPLY is a good instrument for LONG-SUPPLY and plausibly exogenous to the safety premium. See KVJ for further details of the estimation method. The regressions are estimated using annual data from 1949 to 2008. The regression is:

$$\text{Spread}_t = \text{Default Controls}_t + \beta \ln(\text{LONG} - \text{SUPPLY}_t/\text{GDP}_t) + \epsilon_t$$

instrumented by  $\text{TOTAL-SUPPLY}/\text{GDP}$ , and squares and cubes of  $\text{TOTAL-SUPPLY}/\text{GDP}$ . The term  $\beta \ln(\text{LONG} - \text{SUPPLY}/\text{GDP})$  is the premium of interest in this regression. We evaluate the effect of a QE by evaluating this premium term at the pre-QE and post-QE values of LONG-SUPPLY.

The  $\beta$  coefficient is -0.83 ( $t$ -statistic = -5.83). If we construct the spread as Aaa-Treasury, the result is -0.51 ( $t$ -statistic = -4.64). For the Baa-Aaa spread, the result is -0.31 ( $t$ -statistic = -4.64).

As we explain in KVJ, the Baa-Treasury spread reflects both a liquidity premium and a safety premium. The coefficient from the Baa-Aaa regression is a pure read on the safety premium, because Baa bonds and Aaa bonds are equally illiquid. However, it is an

---

<sup>10</sup> We use monthly data on prices and bond yields from the CRSP Monthly US Treasury Database base to empirically construct the derivative of price with respect to yield. The derivative is used to compute the duration.

underestimate of the safety effect as may be reflected in Treasuries or Agencies because while Aaa are safe, they still contain more default than Treasuries or Agencies. For example, Moody's reports that over 10 years, the historical average default probability of a bond that is rate Aaa today is 1% (while it is likely close to 0% for Treasuries and is close to 10% for Baa bonds).

The Baa-Treasury spread is likely an overestimate of the safety premium. That is, it has the advantage that the Treasury yield is close to default free. However, Treasuries are an order of magnitude more liquid than Baas, so that the spread also contains a substantial liquidity premium. We discuss estimates using both the Baa-Aaa regression and the Baa-Treasury regression.

#### **a. Estimates for QE1**

Gagnon, et. al, (2010) report that in 10-year equivalents the Fed had purchased \$169bn of Treasuries, \$59bn of Agency debt, and \$573bn of Agency MBS by Feb 1, 2010. The total purchase up to this date was \$1.625tn and the anticipated total was \$1.725tn. We scale up the numbers up to Feb 1, 2010 by 1.725/1.625 to evaluate the effect of the total purchase.

Agency debt and Treasury debt are equally safe during the QE period, while Agency MBS carries prepayment risk. Thus, if we consider only the Treasuries and Agencies purchased, and ask what effect this will have on the Baa-Aaa spread using the regression coefficient of -0.31, we find that the effect is 4 bps (we also use the fact that the end of 2008 LONG-SUPPLY/GDP = 0.140 for this computation). As we have noted, this is smaller than the true safety effect because Aaa corporate bonds are not as safe as either Agencies or Treasuries. As an upper bound, even if we use the Baa-Treasury coefficient (which includes a liquidity premium), the estimate is 11 bps. Although the event study may not identify the precise economic impact of QE for reasons we have discussed earlier, our regression estimates still appear quite small.

However, we have neglected an important aspect of the crisis. The regressions coefficients are estimates of an "average" demand for safety; for evaluating QE we are more interested in the demand function as of the Fall of 2008 and Winter of 2009. It is likely that demand during the crisis was elevated relative to an average period. One way of seeing this is to note that the CDS-adjusted Baa spread minus the CDS-adjusted Aaa spread averages 1.87% in the sample from 11/25/08 to 3/23/09. This number is an estimate of the relative safety value of the Aaa bonds over the Baa bonds. We can also estimate the historical average safety premium

by evaluating  $\ln(\text{LONG-SUPPLY}/\text{GDP})$  at the 2008 level and multiplying by the -0.31 coefficient. This computation yields 0.61%. That is, the safety premium over the QE period was roughly 3 times the average level. The larger effects obtained from the QE1 event study than the regression approach suggest that changes in Treasury supply have much larger impact on the safety premium in times of unusually high safety demand than they do in average times.

## **b. Estimates for QE2**

In QE2, the Fed announced that it will purchase \$600bn of Treasuries and rollover the maturing MBS into long-term Treasuries. We suggested earlier that the latter effect translates to a purchase of \$220bn over the next year.

The impact of an \$820bn Treasury purchase can have a large effect on safety premia. However, QE2 occurs during normalized market conditions, so that the -0.31 coefficient estimates are appropriate during this period. For example, as of 10/22/2010, the spread between Baa rates and Aaa rates was 107 bps and the spread between Aaa rates and the 20 year Treasury bond was 111 bps. Averages for 1919-2008 are: Baa-Aaa=118 bps and Aaa-Treasury=81 bps. Thus the premia during QE2 are large and similar to historical averages.

The \$820bn of Treasuries translates to \$511bn of 10-year equivalents, based on the planned maturity breakdown provided by the Federal Reserve Bank of New York.<sup>11</sup> The LONG-SUPPLY/GDP ratio at the end of 2009 was 0.165. Based on these numbers, using the -0.31 coefficient, we find that QE2 should increase the safety premium by 7 bps. Using the upper bound coefficient of -0.83, we estimate an effect of 21 bps. These numbers seem in line with those from the event study.

## **6. Conclusion**

We document that QE1 and QE2 significantly lower nominal interest rates on Treasuries, Agencies and highly-rated corporate bonds, driven mainly by an increase in the safety price premium of assets with near-zero default. We estimate that the impact of QE1 on the safety-premium reduced yields by more than 100 bps (based on agency yields), with QE2 having an effect of about 20 bps. However, we show that QE1 and (announced) QE2 purchases of long-term Treasuries (and other long-term bonds in the case of QE1) have had a smaller (default-

---

<sup>11</sup> [http://www.newyorkfed.org/markets/lttreas\\_faq.html](http://www.newyorkfed.org/markets/lttreas_faq.html)

adjusted) effect on lower-grade corporate bonds. Furthermore, the impact of quantitative easing on MBS rates is large when QE involves MBS purchases (QE1), but not when it involves only Treasury purchases (QE2), indicating that a second main channel for QE is to affect the equilibrium price of mortgage-specific risk. Finally, evidence from inflation swap rates and TIPS show that expected inflation increased substantially due to QE1 and modestly due to QE2, implying that reductions in real rates were larger than reductions in nominal rates.

By analyzing the differential impact of QE on a host of interest rates, our findings shed light on the channels through which QE affects interest rates and shows that which interest rates will be affected the most depends crucially on which assets are purchased. Methodologically, we show that derivatives prices from credit-default swaps and inflation swaps can provide central inputs to macroeconomic policy assessment.

## References

Bernanke, Ben S., Vincent R. Reinhart, and Brian P. Sack, 2004, "Monetary Policy Alternatives at the Zero Bound: An Empirical Assessment", *Brookings Papers on Economic Activity*, (2), pp. 1-78

Clouse, James, Dale Henderson, Athanasios Orphanides, David Small, and Peter Tinsley, 2000, "Monetary Policy when the Nominal Short-Term Interest Rate is Zero," *Topics in Macroeconomics*, 3(1), article 12.

D'Amico, Stefania, and Thomas B. King, 2010, "Flow and Stock Effects of Large-Scale Treasury Purchases," Finance and Economics Discussion Series 2010-52. Washington: Board of Governors of the Federal Reserve System, September.

Eggertson, Gauti and Michael Woodford, 2003, *Brookings Papers on Economic Activity*, (1), pp. 139–233.

Fleckenstein, Matthias, Francis A. Longstaff, and Hanno Lustig, 2010, "Why does the Treasury Issue TIPS? The TIPS-Treasury Bond Puzzle", working paper, UCLA.

Fuster, Andreas and Paul S. Willen, 2010, "\$1.25 Trillion is Still Real Money: Some Facts About the Effects of the Federal Reserve's Mortgage Market Investments", working paper, Federal Reserve Bank of Boston.

Gabaix, Xavier, Arvind Krishnamurthy and Olivier Vigneron, 2007, "Limits of Arbitrage: Theory and Evidence from the Mortgage-Backed Securities Market," *Journal of Finance*, 62(2), pages 557-595, 04.

Gagnon, Joseph, Matthew Raskin, Julie Remache, and Brian Sack, "Large-Scale Asset Purchases by the Federal Reserve: Did They Work?" Federal Reserve Bank of New York Staff Report no. 441, March 2010.



Greenwood, Robin and Dimitri Vayanos, 2010, "Bond Supply and Excess Bond Return," working paper, LSE.

Hamilton, James D., and Jing Wu, 2010, "The Effectiveness of Alternative Monetary Policy Tools in a Zero Lower Bound Environment," working paper. San Diego: University of California, San Diego.

He, Zhiguo and Arvind Krishnamurthy, 2009, "Intermediary Asset Pricing," working paper, Northwestern University.

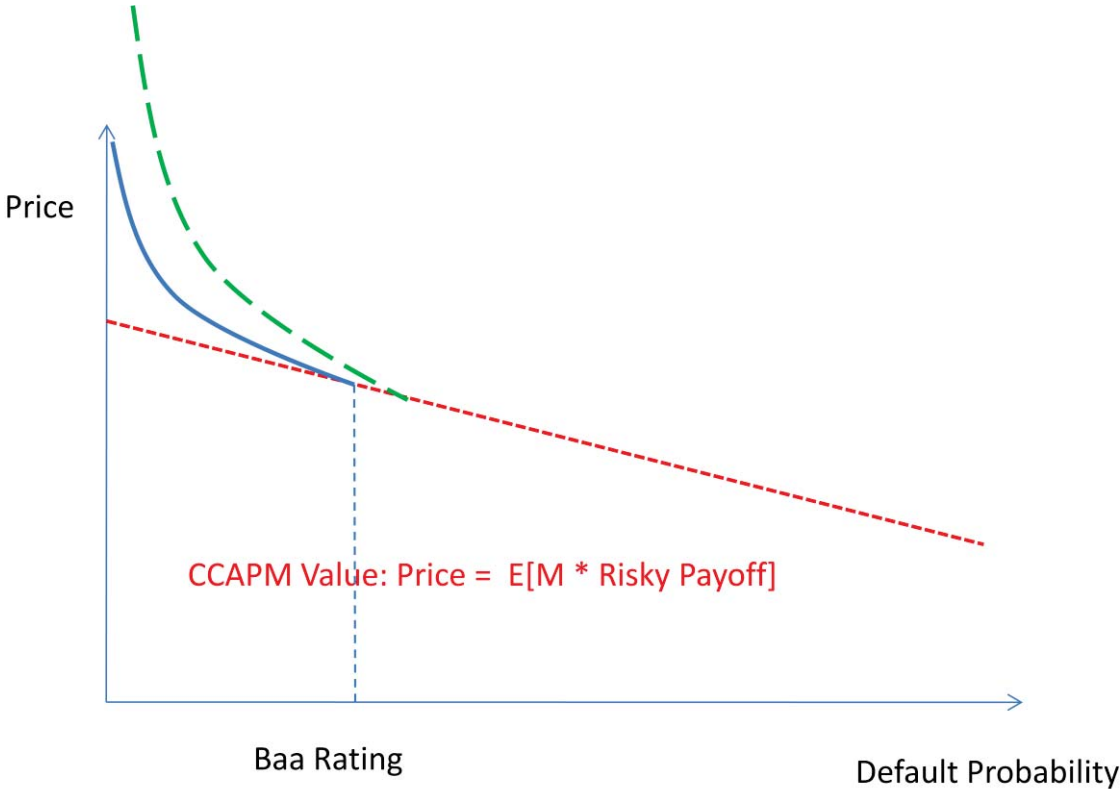
Krishnamurthy, Arvind and Annette Vissing-Jorgensen, 2010, "The Aggregate Demand for Treasury Debt," working paper, Northwestern University.

Longstaff, Francis A., Sanjay Mithal and Eric Neis, 2005, "Corporate Yields Spreads: Default Risk or Liquidity? New Evidence from the Credit-Default Swap Market," *Journal of Finance*, 60(5), pages 2213-2254.

Swanson, Eric, 2010, "Let's Twist Again: A High-Frequency Event-Study Analysis of Operation Twist and Its Implications for QE2," working paper, Federal Reserve Bank of San Francisco.

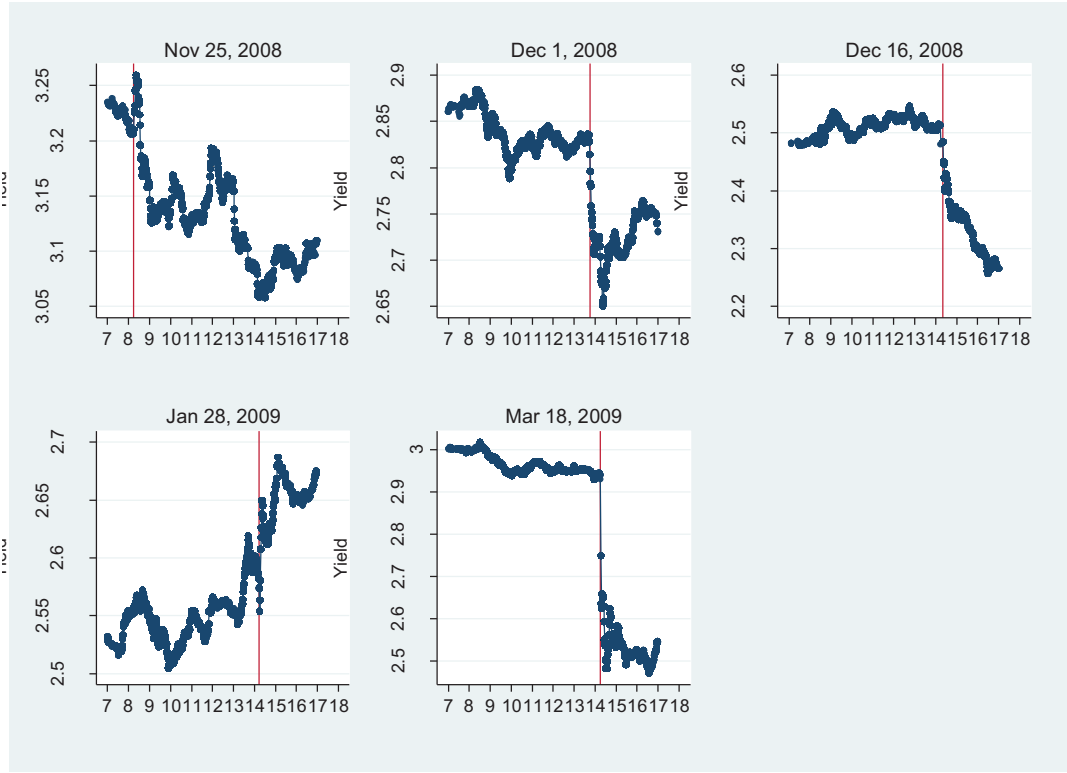
Vayanos, Dimitri and Jean-Luc Vila, 2009, "A Preferred Habitat Model of the Term Structure of Interest Rates," working paper, LSE Financial Markets Group.

Figure 1. Safety Premium on Bonds with Near-Zero Default Risk

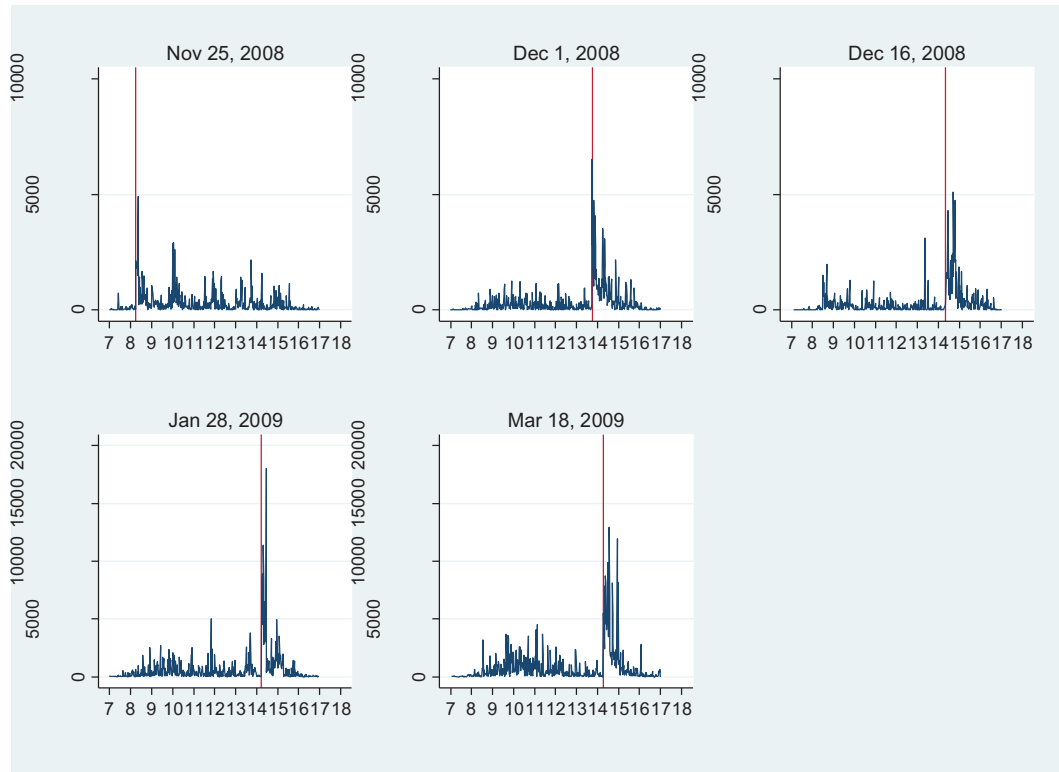


**Figure 2. Intra-day Yields and Trading Volume on QE1 Event Days**

**Panel A. Yields**



## Panel B. Trading Volume



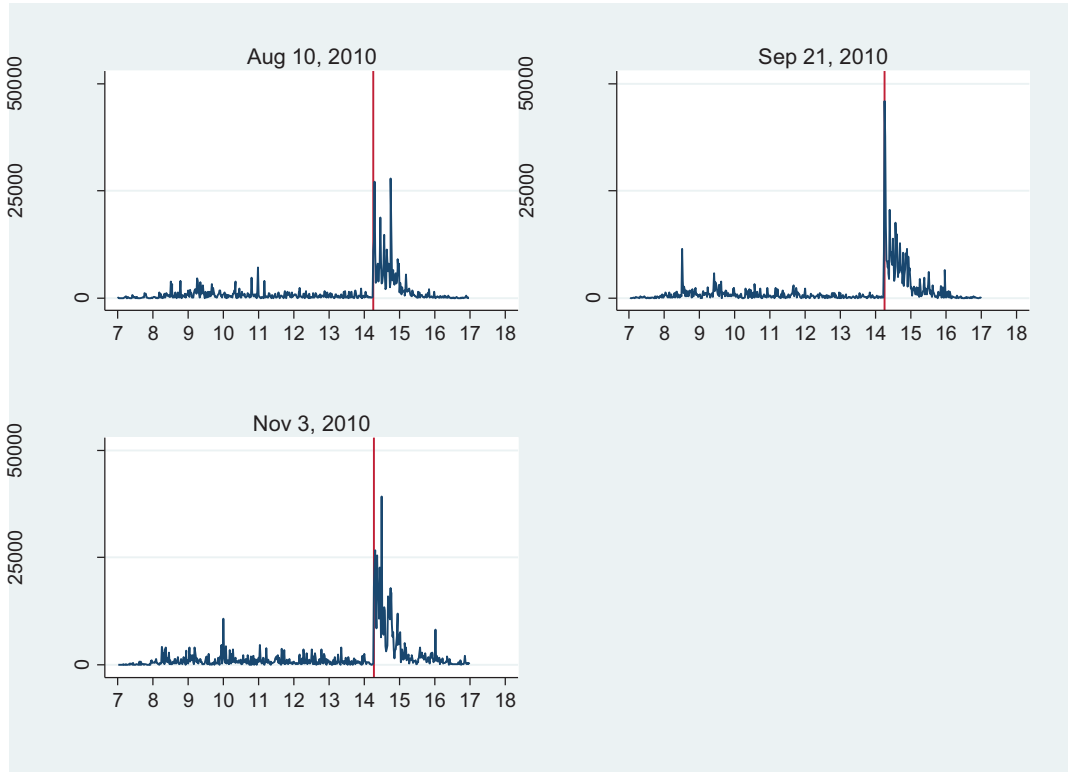
Note: This figure is based on data purchased from BG Cantor and the data graphed is for the on-the-run 10 year bond at each date. Yields graphed are averages by the minute and trading volume graphed is total volume by minute. The vertical lines indicate the minute of the announcement, defined as the minute of the first article covering the announcement in Factiva.

**Figure 3. Intra-day Yields and Trading Volume on QE2 Event Days**

**Panel A. Yields**



**Panel B. Trading Volume**



Note: See note to Figure 2.

**Table 1. Treasury, Agency and Agency MBS yields on QE1 event dates**  
**Two-day changes (in basis points)**

<u>Date</u>	<u>Event</u>	Treasuries yields (constant maturity)				Agency yields			Agency MBS yields	
		30 year	10 year	5 year	1 year	10 year	5 year	3 year	30 year	15 year
11/25/2008	Initial announcement	-24	-36	-23	-2	-76	-57	-42	-75	-147
12/1/2008	Bernanke speech	-27	-25	-28	-13	-67	-50	-28	-10	58
12/16/2008	FOMC statement	-32	-33	-15	-5	-39	-26	-28	-30	-7
1/28/2009	FOMC statement	31	28	28	4	28	27	16	6	16
3/18/2009	FOMC statement	-21	-41	-36	-9	-45	-44	-38	-19	-18
Above 5 dates	Above 5 events	-73	-107	-74	-25	-199	-150	-120	-128	-98

Note: The Treasury yields are from FRED (the constant maturity series). The agency yields are for FNMA bonds and the MBS yields are for the current coupon GNMA. Both are from Bloomberg.

**Table 2. Corporate Yields, and Corporate Yields Adjusted by CDS on QE1 Event Dates**  
**Two-day changes (in basis points)**

<u>Corporate Yields</u>												
	Aaa long	Aa long	A long	Baa long	Ba long	B long	Aaa int	Aa int	A int	Baa int	Ba int	B int
11/25/2008	-28	-18	-23	-19	-4	4	-17	-15	-18	-18	1	-47
12/1/2008	-24	-24	-21	-17	-13	28	-21	-15	-18	-8	-5	6
12/16/2008	-43	-37	-45	-39	1	-11	-19	-21	-24	-27	-28	-42
1/28/2009	34	17	17	14	-16	-25	12	8	7	3	-32	-25
3/18/2009	-16	-21	-21	-20	-28	-39	-43	-50	-39	-26	-18	-22
Above 5 dates	-77	-83	-93	-81	-60	-43	-88	-93	-92	-76	-82	-130
<u>Credit Default Swaps (5 year tenor)</u>												
	Aaa	Aa	A	Baa	Ba	B						
11/25/2008	3	-1	-5	-19	-35	-32						
12/1/2008	2	7	12	1	0	124						
12/16/2008	5	-4	-5	-17	-15	13						
1/28/2009	-3	-5	-8	-9	-17	-118						
3/18/2009	-1	-2	-4	-7	-14	-45						
Above 5 dates	6	-5	-10	-50	-81	-58						
<u>Corporate Yields-Credit Default Swaps</u>												
	Aaa long	Aa long	A long	Baa long	Ba long	B long	Aaa int	Aa int	A int	Baa int	Ba int	B int
11/25/2008	-31	-17	-18	0	31	36	-20	-14	-13	1	36	-15
12/1/2008	-26	-31	-33	-18	-13	-96	-23	-22	-30	-9	-5	-118
12/16/2008	-48	-33	-40	-22	16	-24	-24	-17	-19	-10	-13	-55
1/28/2009	37	22	25	23	1	93	15	13	15	12	-15	93
3/18/2009	-15	-19	-17	-13	-14	6	-42	-48	-35	-19	-4	23
Above 5 dates	-83	-78	-83	-31	21	15	-94	-88	-82	-26	-1	-72

Note: The corporate yield indices are from Barclay's and downloaded from Datastream. The CDS rates by ratings are Moody's indices.



**Table 3. CDS Rates on QE1 Event Dates, by Quintile of Credit Risk and Tenor**  
**Two-day changes (in basis points)**

QE1 event day	Tenor	Mean 2-day change, by quintile of 5-year CDS rate (level) as of day before the particular QE1 event day				
		Q1 (lowest)	Q2	Q3	Q4	Q5 (highest)
11/25/2008	10 years	-3	-8	-14	-23	-182
11/25/2008	5 years	-3	-8	-14	-24	-157
12/1/2008	10 years	3	6	8	8	-149
12/1/2008	5 years	2	6	10	11	-102
12/16/2008	10 years	-5	-8	-13	-27	-184
12/16/2008	5 years	-4	-8	-13	-30	-187
1/28/2009	10 years	0	-7	-11	-26	-37
1/28/2009	5 years	1	-5	-11	-25	-38
3/18/2009	10 years	-2	-4	-9	-15	-88
3/18/2009	5 years	-2	-3	-10	-18	-106
All 5 days	10 years	-7	-22	-38	-84	-640
All 5 days	5 years	-6	-18	-39	-86	-591
		Mean 5-year CDS rate level as of day prior to the QE1 event day:				
		Q1 (lowest)	Q2	Q3	Q4	Q5 (highest)
All 5 days		82	159	318	669	3395

Note: The CDS rates are obtained from Datastream. The number of firms covered is around 440 for each of the five event dates.

**Table 4. Inflation Swaps, TIPS, and Implied Interest Rate Volatility on QE1 Event Dates**  
**Two-day changes (in basis points)**

Date	Event	Inflation swaps				TIPS real yields (constant maturity)			Interest rate volatility
		30 year	10 year	5 year	1 year	20 year	10 year	5 year	
11/25/2008	Initial Announcement	1	-6	-28	48	-22	-43	5	1
12/1/2008	Bernanke speech	15	27	11	-40	-38	-34	-51 <sup>12</sup>	-7
12/16/2008	FOMC Statement	4	37	35	-17	-45	-57	-83	-20
1/28/2009	FOMC Statement	14	15	-6	5	15	6	13	0
3/18/2009	FOMC Statement	2	22	24	45	-45	-59	-43	-11
Above 5 dates	Above 5 events	36	95	36	41	-135	-187	-144	-37

Note: Inflation swap rates and interest rate volatility (ticker BBOX) is from Bloomberg. TIPS yields are from FRED.

<sup>12</sup> The constant maturity TIPS data from the Federal Reserve website indicates that the 5 year TIPS fell by 244 bps on the 12/1/2008 event. We think this is a data error. We examined the yield movements in the underlying TIPS bonds, with maturities ranging from 2013 to 2015. These bonds change in yield from -39 bps to -58 bps, with an average change of -51 bps. We report the -51 bps number in the table.

**Table 5. Treasury, Agency and Agency MBS Yields on QE2 Event Dates  
One and two-day changes (in basis points)**

Date	Event	Changes	Treasury yields (constant maturity)				Agency yields		Agency MBS yields	
			30 year	10 year	5 year	1 year	10 year	5 year	30 year	15 year
8/9/2010 to 11/4/2010	Day before 8/10 FOMC statement to day after 11/3 FOMC statement)		3	-33	-50	-5	-41	-53	-36	-26
8/10/2010	FOMC meeting	1-day	-1	-7	-8	-1	-7	-9	1	-5
		2-day	-8	-14	-10	-1	-13	-9	-8	-4
9/21/2010	FOMC meeting	1-day	-8	-11	-9	0	-11	-9	-7	1
		2-day	-13	-16	-10	-1	-16	-10	4	5
11/3/2010	FOMC meeting	1-day	16	4	-4	0	5	-5	-5	-2
		2-day	11	-10	-11	-1	-10	-14	-13	-3
8/10 and 9/21		1-day	-9	-18	-17	-1	-18	-18	-6	-4
		2-day	-21	-30	-20	-2	-29	-19	-4	1

Note: Data sources are as for QE1.

**Table 6. Corporate Yields, and Corporate Yields Adjusted by CDS on QE2 Event Dates  
One and two-day changes (in basis points)**

Date	Changes	Corporate yields				Credit default swaps		Corporate yields-CDS			
		Inv grade long	Inv grade inter-mediate	High yield long	High yield inter-mediate	Inv. grade	High yield	Inv grade long	Inv grade inter-mediate	High yield long	High yield inter-mediate
8/9/2010 to 11/4/2010		-11	-51	-58	-120	-13	-70	2	-38	12	-50
8/10/2010	1-day	2	-3	-5	3	-2	-11	4	-1	6	14
	2-day	-6	-6	-3	17	1	2	-7	-7	-5	15
9/21/2010	1-day	-9	-9	-5	-3	3	-10	-12	-12	5	7
	2-day	-13	-10	-10	0	4	-4	-17	-14	-6	4
11/3/2010	1-day	11	-2	17	-4	-2	-6	13	0	23	2
	2-day	2	-13	10	-19	-3	-15	5	-10	25	-4
8/10 and 9/21	1-day	-7	-12	-10	0	0	-21	-7	-12	11	21
	2-day	-19	-16	-13	17	5	-2	-24	-21	-11	19

Note: The corporate yield indices are from Barclay's and downloaded from Datastream. The CDS rates are from the Financial Times and are for 5-year tenor.

**Table 6. Inflation Swaps, TIPS, and Implied Interest Rate Volatility on QE2 Event Dates  
One and two-day changes (in basis points)**

Date	Event	Changes	Inflation swaps				TIPS real yields (constant maturity)			10 year interest rate volatility
			30 year	10 year	5 year	1 year	20 year	10 year	5 year	
8/9/2010 to 11/4/2010	Day before 8/10 FOMC statement to day after 11/3 FOMC statement)		37	17	16	19	-53	-60	-54	-1
8/10/2010	FOMC meeting	1-day	5	-1	-3	0	-10	-9	-8	-2
		2-day	-2	0	-3	-4	-6	-9	-5	-3
9/21/2010	FOMC meeting	1-day	6	6	6	-1	-14	-16	-14	-1
		2-day	6	4	7	9	-17	-20	-18	-2
11/3/2010	FOMC meeting	1-day	6	-3	2	1	4	1	-6	-2
		2-day	1	-10	4	14	2	-5	-14	-3
8/10 and 9/21		1-day	11	5	3	-1	-24	-25	-22	-3
		2-day	4	4	4	5	-23	-29	-23	-5

Note: Data sources are as for QE1.

**Table 7. Various Yield Changes around Operation Twist (in basis points)**

10 Year Treasury	-16 bps
10 Year FNMA Agency bond	-8 bps
Moodys Corporate Aaa index	-3 bps
Moodys Corporate Baa index	-8 bps

Note: The Treasury change is taken from Table 3 of Swanson (2010). The FNMA Agency bond is from the Wall Street Journal, on the event dates. The Moody's corporate bond yield data is from Moody's Bond Survey.