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## The Bond Yield 'Conundrum' from a Macro-Finance Perspective

*FRB of San Francisco Working Paper No. 2006-16*

42 Pages

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Federal Reserve Bank of San Francisco; Federal Reserve Bank of Dallas

Date Written: May 2006


### Abstract

In 2004 and 2005, long-term interest rates remained remarkably low despite improving economic conditions and rising short-term interest rates, a situation that former Fed Chairman Alan Greenspan dubbed a conundrum. We document the extent and timing of this conundrum using two empirical no-arbitrage macro-finance models of the term structure of interest rates. These models confirm that the recent behavior of long-term yields has been unusual - that is, it cannot be explained within the framework of the models. Therefore, we consider other macroeconomic factors omitted from the models and find that some of these variables, particularly declines in long-term bond volatility, may explain a portion of the conundrum. Foreign official purchases of U.S. Treasuries appear to have played little or no role.

**Keywords:** Treasury bonds, Federal funds rate

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2. the values differ across the BRS and RW models because the BRS model uses monthaverage yield data while the RW model uses end-of-month data. Lines 2-4 are the decompositions implied by the BRS and RW macro-finance models, graphed in Figures 1 and 2. Lines 5-10 are the changes implied by the regression coefficients in Table 7 applied to the change in each independent variable from , volume 60 Posted: 1986

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