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The Effect of Transaction Size on Off-the-Run Treasury Prices

David F. Babbel, Craig B. Merrill, Mark F. Meyer and Meiring de Villiers

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The Effect of Transaction Size on Off-the-Run Treasury Prices

David F. Babbel, Craig B. Merrill, Mark F. Meyer, and Meiring de Villiers*

Abstract

This paper examines intra-day trading data from the inter-dealer broker market for U.S. Treasury securities and measures the degree of price pressure in the off-the-run Treasury market. As is well known, securities that would appear to be very close substitutes, i.e., on-the-run and off-the-run Treasury bonds, behave as if there is some degree of market segmentation. This is the first systematic study of the off-the-run Treasury note and bond market focused entirely on a price pressure effect using intra-day data. The paper analyzes price pressure through matched pairs of securities that differ only in liquidity.

I. Introduction

This paper examines intra-day trading data from the inter-dealer broker market for U.S. Treasury securities and documents the size of the price pressure effect in the off-the-run Treasury market. Price pressure is implied by a segmentation effect in the market for a security. The market for a security is said to be segmented if substitution to other securities with similar characteristics is limited. An empirical property of a segmented market is that the price of the security is sensitive to supply and demand conditions for that specific security, absent changes in risk and absent any new information. A security with many close substitutes, on the other hand, has a flat demand curve and will not exhibit a price pressure effect. Thus, securities that would appear to be very close substitutes, i.e., on-the-run and off-the-run Treasury bonds, behave as if there is some degree of market segmen-

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