Federal Reserve Bank of New York

Number 1
2005

ResearchUpdate

Research and Statistics Group www.newyorkfed.org/research

New Prize Recognizes Outstanding Papers Published in the *Economic Policy Review*

The Editorial Board of the ***Economic Policy Review*** recently established the Frederic S. Mishkin Prize for Outstanding Paper to promote quality competition among contributors to the Bank's flagship economic journal. The Board is pleased to announce the first winner: "Treasury Inflation-Indexed Debt: A Review of the U.S. Experience," by Brian Sack and Robert Elsasser, published in May 2004.

The Mishkin Prize was established to promote quality competition among contributors to the *Economic Policy Review.*

Sack and Elsasser describe the evolution of Treasury inflation-indexed debt securities (TIIS) since their introduction in 1997. They observe that over most of the period, TIIS yields have been surprisingly high relative to those on comparable nominal Treasuries, with the spread between yields falling, on average, well below survey measures of long-run inflation expectations. The authors attribute this "valuation puzzle" largely to investor difficulty adjusting to a new asset class, divergent supply trends between TIIS and nominal Treasuries, and the lower liquidity of TIIS. However, while TIIS have not yet reduced the Treasury's expected financing costs—a primary goal—the valuation of these securities appears to have improved in recent years.

All papers written or cowritten by current New York Fed authors and published in the ***Economic Policy Review*** in 2003 or 2004 were eligible for the prize. The outstanding paper was determined by an internal round of judging, in which the ***Review***'s Editorial Board selected five candidates, and an external round, in which three academic judges from the ***Review***'s Advisory Board evaluated the five papers.

The Frederic S. Mishkin Prize for Outstanding Paper honors Rick Mishkin, the Alfred Lerner Professor of Banking and Financial Institutions at Columbia University, in recognition of his contribution as the New York Fed's director of research from 1994 to 1997. Future prizes will be awarded biennially.

The paper is available at **www.newyorkfed.org/research/epr/04v10n1/0405sack.html**.

Financing Data Offer New Insight into Dealer Leverage

Data reported to the Federal Reserve by the primary government securities dealers reveal dealer financing activities involving U.S. Treasury, agency debt, mortgage-backed, and corporate debt securities. Some market analysts claim that the financing data point to a significant upswing in dealer leverage in recent years.

A new study, however, finds that dealer borrowing involving fixed-income securities has grown only modestly ("What Financing Data Reveal about Dealer Leverage," ***Current Issues in Economics and Finance***, vol. 11, no. 3). Authors Tobias Adrian and Michael Fleming analyze two measures of dealer leverage: net repo financing, the measure often read by market analysts, and net financing, a broader measure.

Adrian and Fleming acknowledge that net repo financing has risen strongly in recent years, reaching $722 billion in May 2004. Yet they contend that it is an incomplete and potentially misleading gauge of leverage because it fails to account for dealer transactions that are essentially equivalent to repos but not reported as such. By comparison, net financing is a more comprehensive measure because it encompasses all dealer financing transactions. The authors explain that although overall net financing has also risen—to $147 billion in May 2004—the increase has been considerably less than the jump in net repo financing. Furthermore, because the rise in net financing is not associated with an increase in net positions, there is little evidence to suggest greater risk taking by primary dealers.

The study also relates the financing activities of primary dealers to financial market conditions and finds evidence to support the idea that dealer leverage varies with moves in interest rates and interest rate volatility. In particular, financing tends to decline both before and after increases in interest rates and volatility. ■

Publications and Papers

The Research and Statistics Group produces a wide range of publications:

- ***The Economic Policy Review***—a policy-oriented journal focusing on economic and financial market issues.
- ***EPR Executive Summaries***—online versions of selected ***Economic Policy Review*** articles, in abridged form.
- ***Current Issues in Economics and Finance***—concise studies of topical economic and financial issues.
- ***Second District Highlights***—a regional supplement to ***Current Issues***.
- ***Staff Reports***—technical papers intended for publication in leading economics and finance journals, available only online.
- ***Publications and Other Research***—an annual catalogue of our research output.

Recent Disparity in U.S.-Canadian Job Growth Is Subject of New York Fed Conference

The labor markets continue to offer a rich source of research topics. In 2004, two issues were of particular interest to New York business economists. The first, which received wide media attention, centered on the lack of job growth in the current U.S. recovery. The second issue concerned the disparity in job growth between the United States and Canada—namely, while the United States was struggling to create jobs, Canada was creating them at a fast clip.

To shed light on this relatively overlooked issue, the Federal Reserve Bank of New York recently cosponsored the conference "Labor Market Developments in the United States and Canada since 2000" with the Canadian Consulate General in New York, the Centre for the Study of Living Standards, and the New York Association for Business Economics.

"Our goal was to engage key Canadian and U.S. economists to explore the reasons for the lack of job growth in the United States, to contrast the U.S. experience with that of Canada, and to offer potential lessons from these experiences," according to conference organizers Erica Groshen of the New York Fed, Zahir Lalani of the Bank of Canada, and David Murchison of the Canadian Consulate General.

Leading off the conference, Richard B. Freeman of Harvard and William M. Rodgers III of Rutgers examine the operation of the U.S. labor market in the current recovery. In "*The Weak Jobs Recovery: Whatever Happened to the Great American Jobs Machine?*" the authors find that this recovery has been the worst in recent history in terms of job creation. Moreover, the slow employment growth is not due to the weak performance of a particular sector, such as the dot-com sector following its boom-bust cycle. Freeman and Rodgers also find a decline in job growth among groups especially sensitive to business cycle swings, such as African-Americans, new labor-market entrants, out-of-school youth, and less educated workers. Finally, the current recovery is shown to have no particular geographic dimension. The weak job recovery, conclude the authors, represents a major shift in the link between the labor market and the economy over the business cycle, rather than an idiosyncratic break in historic patterns. Lars Osberg of Dalhousie University provided commentary.

René Morissette and Anick Johnson of Statistics Canada then pose the question, "*Are Good Jobs Disappearing in Canada?*" The authors assess whether the relative importance of low-paid (less than $10 an hour) and well-paid ($25 or more an hour) jobs in Canada has changed over the past two decades. They also consider whether well-paid jobs are disappearing in the country by focusing on changes in the share of jobs falling in certain real wage categories over 1997-2004. Morissette and Johnson find little evidence that the relative importance of well-paid jobs has fallen, or that the relative importance of low-paid jobs has risen, over the period examined. Their findings thus suggest that well-paid jobs are not disappearing. Rather, Canadian firms are responding to growing competition within industries and from abroad by reducing wage offers for new employees, making temporary jobs available to a growing proportion of these workers, and providing on a less frequent basis pension plans that guarantee defined benefits at retirement. A discussion by Erica Groshen followed.

In the final paper, "*The Recession of 2001 and Unemployment Insurance Financing*," Wayne Vroman of the Urban Institute observes that in terms of the change in real GDP, the 2001 downturn was one of the mildest in fifty years. Yet during 2002-04, several large states had trouble financing their unemployment insurance (UI) programs. Accordingly, Vroman discusses the recession's effects on states experiencing UI funding problems and the borrowing options available when state trust fund reserves are inadequate. Not only has the size of drawdowns from UI trust funds varied by state, Vroman finds, but so have the types of loans used to address funding problems. The author also concludes that all of the states that had to borrow had low trust fund balances at the end of December 2000—just before the recession began—and that funding problems have been concentrated among the large states. Timothy C. Sargent of Finance Canada concluded by offering his analysis.

The papers will be published in an upcoming issue of the Bank's ***Economic Policy Review***. Preliminary drafts can be found at **www.newyorkfed.org/research/conference/2004/labor_market.html**.

Call for Papers on Antitrust Activity in Card-Based Payment Systems

On September 15-16, 2005, the Federal Reserve Bank of New York and the *Review of Network Economics* will cosponsor the conference "Antitrust Activity in Card-Based Payment Systems: Causes and Consequences."

In recent years, significant antitrust inquiries and actions have focused on credit and debit card systems. Just as antitrust activity among these payment systems has varied around the world, so have the antitrust efforts directed at this activity. "Accordingly, the conference will present a range of research on the causes and effects of antitrust actions, to broaden the information available on the efficiency of the different antitrust remedies mandated by the courts and antitrust authorities worldwide," observes the New York Fed's James McAndrews, an organizer of the conference.

The conference organizers invite the submission of empirical and case-based papers from interested authors, especially those in countries where card-based payment systems have attracted considerable antitrust inquiries or actions. The submission deadline is June 1, 2005, with authors of accepted papers notified by July 15. The conference will be held at the Federal Reserve Bank of New York.

More detailed information can be found at **www.newyorkfed.org/research/conference/2004/antitrust_activity.html**.

SSRN Now Lists New York Fed Research Publications

The Research and Statistics Group recently began listing its research publications with the Social Science Research Network's (SSRN) Government and Public Agency Research Paper Series. The SSRN is a worldwide collaborative of leading scholars devoted to the rapid dissemination of social science research.

Through our arrangement, visitors to the SSRN's website can download papers in the ***Economic Policy Review***, ***Current Issues in Economics and Finance***, and ***Staff Reports*** series as well as subscribe to an electronic journal that provides abstracts of our new postings. To date, our more than seventy papers listed with the SSRN have been downloaded nearly 3,000 times. Additional back issues in these series are being posted on an ongoing basis.

Visit our SSRN page at **www.ssrn.com/link/FRB-New-York.html**.

Browse a Centralized List of Our Economists' Outside Work

Economists in the Research and Statistics Group publish in the top economics and finance journals. Their work is also represented extensively in the leading field journals as well as in conference volumes, scholarly books, and other important outlets.

The wide range of this work, dating back to 1995, is now listed on our website. There, visitors will find papers organized by broad subject category, links to the authors' Bank web pages, and in many cases access to the full-text papers in JSTOR and ScienceDirect.

www.newyorkfed.org/research/outside_journals/index.html

Other New Publications

- ***Publications and Other Research.*** The 2004 edition of our catalogue lists all of the papers published in our research series as well as many papers published by our economists in economics and finance journals, conference volumes, and scholarly books.

  www.newyorkfed.org/research/publication_annuals/por2004.pdf

New Titles in the *Staff Reports* Series

The following new ***Staff Reports*** are available at **www.newyorkfed.org/research/staff_reports**.

MACROECONOMICS AND GROWTH

No. 198, January 2005
Comparing Forecast-Based and Backward-Looking Taylor Rules: A "Global" Analysis
Stefano Eusepi

This paper examines the performance of forecast-based nonlinear Taylor rules in a class of simple microfunded models. It shows that even if the policy rule leads to a locally determinate (and stable) inflation target, there exist other learnable "global" equilibria such as cycles and sunspots. Moreover, under learning dynamics, the economy can fall into a liquidity trap. By contrast, more backward-looking and "active" Taylor rules guarantee that the unique learnable equilibrium is the inflation target. This result is robust to different specifications of the role of money, price stickiness, and the trading environment.

No. 199, January 2005
Central Bank Transparency under Model Uncertainty
Stefano Eusepi

Eusepi explores the effects of central bank transparency on the performance of optimal inflation targeting rules. He assumes that both the central bank and the private sector face uncertainty about the "correct" model of the economy and have to learn. A transparent central bank can reduce one source of uncertainty for private agents by communicating its policy rule to the public. The paper shows that central bank transparency plays a crucial role in stabilizing the agents' learning process and expectations. By contrast, lack of transparency can lead to expectations-driven fluctuations that have destabilizing effects on the economy, even when the central bank has adopted optimal policies.

No. 203, March 2005
A Search for a Structural Phillips Curve
Timothy Cogley and Argia M. Sbordone

The New Keynesian Phillips curve (NKPC), a model of price setting with nominal rigidities, implies that the dynamics of inflation are well explained by the evolution of real marginal costs. This paper analyzes whether this relationship is structurally invariant. The authors estimate an unrestricted time-series model for inflation, unit labor costs, and other variables, and present evidence that their joint dynamics are well represented by a vector autoregression (VAR) with drifting coefficients and volatilities. They then apply a two-step minimum distance estimator to estimate deep parameters of the NKPC. Given estimates of the unrestricted VAR, Cogley and Sbordone estimate parameters of the NKPC by minimizing a quadratic function of the restrictions that this theoretical model imposes on the reduced form. Their results suggest that one can reconcile a constant-parameter NKPC with the drifting-parameter VAR—evidence that the price-setting model is structurally invariant.

No. 204, March 2005
Do Expected Future Marginal Costs Drive Inflation Dynamics?
Argia M. Sbordone

This paper discusses a more general interpretation of the two-step minimum distance estimation procedure proposed in earlier work by Sbordone. The estimator is again applied to a version of the New Keynesian Phillips curve, in which inflation dynamics are driven by the expected evolution of marginal costs. The paper clarifies econometric issues, addresses concerns about uncertainty and model misspecification raised in recent studies, and assesses the robustness of previous results. While confirming the importance of forward-looking terms in accounting for inflation dynamics, Sbordone suggests how the methodology can be applied to extend the analysis of inflation to a multivariate setting.

No. 205, March 2005
The Politics of Central Bank Independence: A Theory of Pandering and Learning in Government
Gauti Eggertsson and Eric Le Borgne

The authors propose a theory to explain why, and under what circumstances, a politician endogenously gives up rent and delegates policy tasks to an independent agency. Applied to monetary policy, this theory 1) formalizes the rationale for delegation and 2) does not rely on the inflation bias that underlies most existing theories of central bank independence. Delegation trades off the cost of having a possibly incompetent technocrat with a long-term job contract against the benefit of having a technocrat who 1) invests more effort into the specialized policy task and 2) has less incentive to pander to public opinion than a politician. Eggertsson and Le Borgne's key theoretical predictions are broadly consistent with the data.

INTERNATIONAL

No. 200, January 2005
Vehicle Currency Use in International Trade
Linda S. Goldberg and Cédric Tille

The forces motivating the *choice* of currency in international trade transactions have long been debated. The authors introduce a model designed to contrast the contribution of macroeconomic variability with that of industry-specific features in the selection of an invoice currency. They show that producers in industries with high demand elasticities are more likely than producers in other industries to display herding in their choice of currency. This industry-related force is more influential than local macroeconomic performance in determining producers' choices. Drawing on data for twenty-four countries, the authors document that the dollar is widely used for most transactions involving the United States as well as for international trade flows not directly involving the United States.

No. 201, February 2005
Productivity Spillovers, Terms of Trade, and the "Home Market Effect"
Giancarlo Corsetti, Philippe Martin, and Paolo Pesenti

This paper analyzes the welfare implications of international spillovers related to productivity gains, changes in market size, or government spending. The authors introduce trade costs and endogenous varieties in a two-country general-equilibrium model with monopolistic competition, drawing a distinction between productivity gains from manufacturing efficiency and those related to firms' lower cost of entry or product differentiation. Their model suggests that countries with lower manufacturing costs have higher GDP but supply a smaller number of goods at a lower international price. Countries with lower entry and differentiation costs also have higher GDP, but supply a larger array of goods at improved terms of trade. Higher domestic demand has macroeconomic implications that are similar to those of a reduction in firms' entry costs.

QUANTITATIVE METHODS

No. 202, March 2005

Reexamining the Consumption-Wealth Relationship: The Role of Model Uncertainty

Gary Koop, Simon M. Potter, and Rodney W. Strachan

Lettau and Ludvigson's influential work on the consumption-wealth relationship finds that while consumption responds to permanent changes in wealth in the expected manner, most changes are transitory with no effect on consumption. This paper investigates the robustness of these results to model uncertainty using Bayesian model averaging and finds that uncertainty exists. Whether this uncertainty has important implications depends on the weight the researcher places on economic theory. If Koop, Potter, and Strachan work with Lettau and Ludvigson's exact model, their findings are very similar. However, working with a broader set of models, they find that the exact magnitude of the role of permanent shocks is difficult to estimate precisely. ■

Recently Published

Michele Braun. 2005. "**Opportunities to Improve Payments Services: Results from a Federal Survey of Large Corporations**," with Sandy Krieger. Association for Financial Professionals *AFP Exchange* 25, no.1 (January-February): 28-9.

Paolo Pesenti. 2005. "**International Dimensions of Optimal Monetary Policy**," with Giancarlo Corsetti. *Journal of Monetary Economics* 52, no. 2 (March): 281-305.

João Santos. 2005. "**Banking and Commerce: A Liquidity Approach**," with Joseph Haubrich. *Journal of Banking and Finance* 29, no. 2 (February): 271-94.

Asani Sarkar. 2005. "**An Empirical Analysis of Stock and Bond Market Liquidity**," with Tarun Chordia and Avanidhar Subrahmanyam. *Review of Financial Studies* 18, no. 1 (spring): 85-129.

Cédric Tille. 2005. "**The Welfare Effect of International Asset Markets Integration under Nominal Rigidities**." *Journal of International Economics* 65, no. 1 (January): 221-47. ■

Papers Presented by Economists in the Research and Statistics Group

"**Stock Returns and Volatility: Pricing the Permanent and Transitory Components of Market Risk**," Tobias Adrian. University of Massachusetts finance seminar, Amherst, Massachusetts, February 18. With Joshua Rosenberg. Also presented at the Adam Smith Asset Pricing conference, cosponsored by the London Business School, the London School of Economics, and Oxford University, held at the London Business School, London, England, March 11.

"**Finance as a Barrier to Entry**," Nicola Cetorelli. Conference cosponsored by the World Bank and New York University's Stern School of Business, Washington, D.C., January 10. With Philip Strahan.

"**Establishing Credibility: Evolving Perceptions of the European Central Bank**," Linda Goldberg. Allied Social Science Association meetings, Philadelphia, Pennsylvania, January 7. With Michael Klein. Also presented at a conference cosponsored by the *Journal of International Money and Finance*, the Frank J. Petrilli Center for Research in International Finance at Fordham University, and the Trans-Atlantic Finance Institute (Erasmus University, Rotterdam/Fordham University), San Juan, Puerto Rico, March 17.

"**Was the 2001 Recession Different in the Labor Market? Comparing Measures**," Erica Groshen. Conference cosponsored by the American Economic Association and the Allied Social Science Association, Philadelphia, Pennsylvania, January 18. With Simon Potter and Rebecca Sela.

"**A Decomposition of the Sources of Incomplete Cross-Border Transmission: The Case of Beer**," Rebecca Hellerstein. International Monetary Fund, Washington, D.C., March 22.

"**Has the Response of Investment to Financial Market Signals Changed?**" Jonathan McCarthy. Eastern Economic Association conference, New York City, March 4.

"**Board Committee Structure, Incentives, and Firm Performance**," Hamid Mehran. University of Alabama, Tuscaloosa, Alabama, March 11. With Rachel Hayes and Scott Schaefer.

"**Evidence on Outside Directors from Japan**," Hamid Mehran. Vanderbilt University, Nashville, Tennessee, March 18.

"**Productivity Spillovers, Terms of Trade, and the 'Home Market Effect,'**" Paolo Pesenti. American Economic Association Annual Meeting, Philadelphia, Pennsylvania, January 7. With Giancarlo Corsetti and Philippe Martin. Also presented at the NBER International Finance and Macroeconomics meeting, Cambridge, Massachusetts, March 18.

"**A General Approach to Integrated Risk Management with Skewed, Fat-Tailed Risks**," Til Schuermann. Global Association of Risk Professionals, New York City, February 2. With Joshua Rosenberg.

"**The Consumption-Wealth Effect**," Charles Steindel. Eastern Economic Association conference, New York City, March 4.

"**Stabilization, Competitiveness, and Risk-Sharing: A Model of Monetary Interdependence**," Cédric Tille. International Monetary Fund, Washington, D.C., February 1. With Paolo Pesenti.

"**Current Avenues of Research in New Open Economy Macroeconomics**," Cédric Tille. Yale University Department of Economics, New Haven, Connecticut, February 22.

"**Financial Integration and the Wealth Effect of Exchange Rate Fluctuations**," Cédric Tille. Yale University Department of Economics, New Haven, Connecticut, February 22. Also presented at City University of New York Graduate Center, New York City, March 1, and the NBER, Cambridge, Massachusetts, March 18.

"**Regulation, Capital, and the Evolution of Organizational Form in U.S. Life Insurance**," George Zanjani. NBER conference, Cambridge, Massachusetts, February 18. ■

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Research and Statistics Group Publications and Papers: January-March 2005

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CURRENT ISSUES IN ECONOMICS AND FINANCE, VOL. 11

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The Predictive Abilities of the New York Fed's *Empire State Manufacturing Survey*
Richard Deitz and Charles Steindel

Second District Highlights

No. 2, February 2005
The Treasury Auction Process: Objectives, Structure, and Recent Adaptations
Kenneth D. Garbade and Jeffrey F. Ingber

No. 3, March 2005
What Financing Data Reveal about Dealer Leverage
Tobias Adrian and Michael J. Fleming

STAFF REPORTS

Available only online.

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