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EE431 Economics of Financial Markets and Institutions
Exercise 3: Debt Market and Structure of Interest Rate

Please submit at the BE office, 5th floor department of Economics building.

Deadline of submission : February 26, 2015, before 15.00 hrs.

1. Use the following information. Answer all parts of this question.

   Government Bond Yield

TTM (Time To Maturity)	January 2015	February 2015
1	3%	4%
2	5%	6%
3	7%	9%

   (a) Sketch the yield curves in January 2015 and February 2015 in the same graph.

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   (b) Use the government bond yield data in January 2015. Suppose the expectation theory of the yield curve holds, what is the expected one-year government bond rate for 2016 and 2017?

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   (c) Use the government bond yield in January 2015. Suppose liquidity premium for 1 year and 2 years are 0% and 0.5% respectively. According to the liquidity premium theory of the yield curve, what is your prediction for the interest rate on one-year bonds in 2016?

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