The Relation Between Treasury Yields and Corporate Bond Yield Spreads
Gregory R. Duffee
Additional Information

The body of the paper specified that three items were available on request: A data
appendix, some industry-level results, and some VAR estimates for A-rated bonds.

Data appendix

Mean yields, yield spreads, and monthly differenced yield spreads are constructed for a
number of sets of corporate bonds. There are four business sectors examined: (1) industrial
firms; (2) utilities; (3) financial firms; (4) all of the above. There are also four rating
categories examined: Aaa, Aa, A, and Baa. Three ranges of remaining maturity are consid-
ered: (1) Short (two to seven years); (2) medium (seven to fifteen years); (3) long (fifteen to
thirty years). The time series of corporate bond yields, spreads, and changes in spreads are
constructed as follows.

Fix a business sector, a rating category, and a maturity range. For each month $t$ in
[January 1985, February 1995], I consider all straight bonds (e.g., not convertible or CMO-
like) in the given business sector that have, in month $t$, the appropriate rating and time-to-
maturity. I also require that coupon payments (if any) be made semiannually, instead of,
say, monthly. (This latter restriction excludes very few bonds.) I use the Moody’s rating if
it is available, otherwise I use S&P’s rating. I then exclude all bonds that are callable or
putable at some point in the bond’s life, or that have a sinking fund option. I further exclude
all bonds that do not have “quote” prices (instead of “matrix” prices) in both months $t$ and
$t + 1$. I also exclude bonds that are, in either month $t$ or $t + 1$, not in a Lehman Brothers
index or are about to leave a Lehman Brothers index. Such bonds tend to have more data
errors than other bonds in the Database. To eliminate some obvious errors in the data, I
also exclude bonds that have a reported coupon greater than 25%, a price less than 1/100
of par or a price greater than twice par.

The result is a set of $N_t$ bonds with corresponding month-end $t$ yields. (Note that
there will be a different set of $N_t$ bonds for each combination of business sector, rating category, and maturity range.) These yields are quoted on a bond-equivalent basis, not as continually compounded yields. The mean of these yields is my measure of the month $t$ yield for this sector/rating/maturity. I construct yield spreads for each bond by subtracting an appropriate Treasury yield. The Treasury Department constructs constant maturity yields by interpolating bond-equivalent yields on actively-traded Treasury notes and bonds. I use their reported month-end yields on 2, 3, 5, 7, 10, and 30 year coupon bonds. For each corporate bond $i$, I construct the appropriate Treasury yield by interpolating between the closest constant maturity yields on either side of bond $i$’s remaining time-to-maturity. The month $t$ spread for this business sector, rating, and maturity is the mean (over the $N_t$ bonds) of the individual bond spreads. If $N_t = 0$, the observation is set to a missing value.

These $N_t$ bonds also have month-end $t + 1$ yields. I construct month-end $t + 1$ spreads for these bonds in the manner described above. I then calculate, for each bond $i$, the change in the spread from $t$ to $t + 1$. Finally, I calculate the mean (over the $N_t$ bonds) change in the spread from $t$ to $t + 1$. This mean is my observation of $\Delta \text{SPREAD}_{s,i,m,t+1}$ for the given business sector $s$, rating $i$, and maturity range $m$. Again, if $N_t = 0$, this observation is set to a missing value.
Some industry-level results

Consider equation (1) in the text of the paper:

\[
\Delta SPREAD_{s,i,m,t+1} = b_{s,i,m,0} + b_{s,i,m,1}\Delta Y_{T,1/4,t+1} + b_{s,i,m,2}\Delta TERM_{t+1} + e_{i,m,t+1}. \quad (1)
\]

For a given maturity band and credit rating, I jointly estimated three versions of (1); one for each business sector “finance,” “utilities” and “industrial.” Instead of reporting all 72 estimated coefficients, I report the mean coefficients across the four credit ratings (Aaa, Aa, A, Baa).

<table>
<thead>
<tr>
<th>Maturity</th>
<th>Sector</th>
<th>(b_{s,i,m,1})</th>
<th>(b_{s,i,m,2})</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long</td>
<td>Finance</td>
<td>-0.152</td>
<td>-0.063</td>
</tr>
<tr>
<td>Long</td>
<td>Utility</td>
<td>-0.157</td>
<td>-0.117</td>
</tr>
<tr>
<td>Long</td>
<td>Industrial</td>
<td>-0.103</td>
<td>-0.056</td>
</tr>
<tr>
<td>Medium</td>
<td>Finance</td>
<td>-0.105</td>
<td>-0.024</td>
</tr>
<tr>
<td>Medium</td>
<td>Utility</td>
<td>-0.128</td>
<td>-0.066</td>
</tr>
<tr>
<td>Medium</td>
<td>Industrial</td>
<td>-0.097</td>
<td>-0.061</td>
</tr>
<tr>
<td>Short</td>
<td>Finance</td>
<td>-0.186</td>
<td>-0.080</td>
</tr>
<tr>
<td>Short</td>
<td>Utility</td>
<td>-0.125</td>
<td>-0.053</td>
</tr>
<tr>
<td>Short</td>
<td>Industrial</td>
<td>-0.123</td>
<td>-0.056</td>
</tr>
</tbody>
</table>
VAR results for A-rated bonds

Figure 1 in the paper represents impulse responses for Baa-rated bonds. This figure reports the same impulse responses for A-rated bonds.

Alternative Figure 1. Impulse responses of yield spreads on A-rated bonds, 1985—1995. Each column represents the impulse response of yield spreads on A-rated bonds of a given maturity band implied by a VAR with four lags of three-month Treasury bill yields, the slope of the Treasury structure, and the given yield spread, in that order. Two-standard-deviation bounds on the impulse responses are also displayed.