Columbia Business School

Capital Markets & Investments

Session 4:
Fixed Income (1) – Bond Pricing & Interest Rates

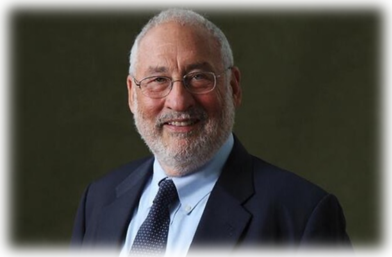
Spring 2025

Professor Simon Oh

Columbia Business School

Bonus: Grossman-Stiglitz Paradox (1980)

- If markets were truly efficient, nobody would bother collecting information.
  - Collecting information (research, analysis, time on Bloomberg terminal) is costly.
  - Why bother if stock prices already reflect all available information?
- But if nobody collected information, markets wouldn't be efficient.
- So the only way markets can stay efficient is if they're a little inefficient.
  - This will allow informed traders to make some money and keep collecting information.



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Bonus: Pierre Yared

School News, Economy & Policy

Pierre Yared appointed as a Member of the President's Council of Economic Advisers (CEA)

We are proud to share that Pierre Yared, the MUTB Professor of International Business, Senior Vice Dean for Faculty Affairs, and Vice Dean for Executive Education at Columbia Business School, has been appointed as a Member of the President's Council of Economic Advisers (CEA) where he will serve as Vice Chairman.

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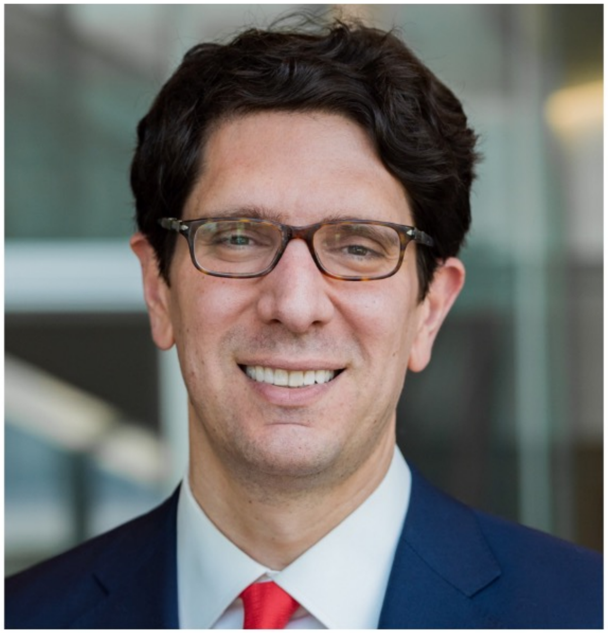

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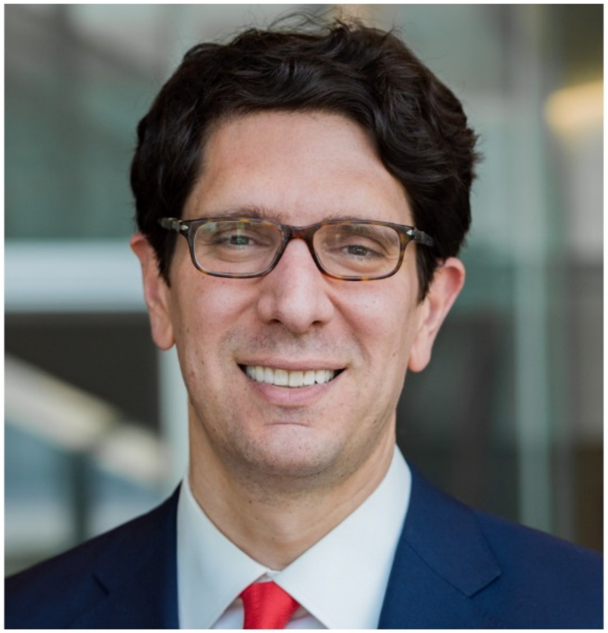

Global Hegemony and Exorbitant Privilege *

Carolin E. Pflueger   Pierre Yared

December 15, 2024

Abstract

We present a dynamic two-country model in which military spending, geopolitical risk, and government bond prices are jointly determined. The model is consistent with three empirical facts: hegemons have a funding advantage, this advantage rises with geopolitical tensions, and war losers devalue their debts more than victors. Higher debt capacity increases the military and financial advantage of the stronger country, but it also gives rise to equilibrium multiplicity and the possibility that the weaker country overwhelms the stronger country with support from financial markets. For intermediate debt capacity, transitional dynamics exhibit *geopolitical hysteresis* with dominance determined by initial conditions. In this case, only the realization of war can induce a hegemonic transition. For high debt capacity, transitional dynamics exhibit *geopolitical fragility*, where bond market expectations drive unpredictable hegemonic transitions even in the absence of war. When debt capacity is asymmetric, this favors a unique steady state with the higher debt capacity country dominating both militarily and financially.

TLDR

A country's ability to borrow isn't just about economics – it shapes global power.

Strongest nation stays on top because their bonds are trusted.

If both countries have similar borrowing power, war might be the deciding factor.

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The Commitment Benefit of Consols in Government Debt Management†

By Davide Debortoli, Ricardo Nunes, and Pierre Yared*

We consider optimal government debt maturity in a deterministic economy in which the government can issue any arbitrary debt maturity structure and in which bond prices are a function of the government's current and future primary surpluses. The government sequentially chooses policy, taking into account how current choices—which impact future policy—feed back into current bond prices. We show that issuing consols constitutes the unique stationary optimal debt portfolio, as it boosts government credibility to future policy and reduces the debt financing costs. (*JEL* E62, G12, H61, H63)

TLDR

Using consols (bonds with no maturity date) can enhance government's credibility in adhering to future fiscal policies.

This credibility also helps reduce debt financing costs.

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State Bank of India aims to raise 50 bln rupees via perpetual bonds, sources say

By **Dharamraj Dhutia** and **Siddhi Nayak**

February 5, 2025 1:51 AM EST · Updated a day ago

A man checks his mobile phones in front of State Bank of India (SBI) branch in Kolkata, India, February 9, 2018. REUTERS/Rupak De Chowdhuri/File Photo Purchase Licensing Rights