

Information in Financial Asset Prices

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Yield and Inflation Differentials between Canada and the United States

Ben Fung and Eli Remolona

General Discussion

Anderson and Flood's critical comments on the Fung and Remolona paper concerned issues such as: the empirical specification and identification of the model; the justification of the zero correlation between the two factors; and the possible estimation bias from cubic-spline approximation.

In response, Remolona emphasized the main objectives of the paper—to find the simplest model that would allow the authors to extract useful information from the yield curve and help researchers better understand the inflation-risk premium. It is certainly true that researchers need more than two factors to fit reasonably well the yield curve in a model. However, a research program should start with a tractable framework. Remolona said that as the research develops, the problems raised can be solved accordingly. He admitted that the U.S. part of the model needs more work. The authors also intend to examine the data more carefully to determine if the two factors within a country are uncorrelated. In addition, Remolona proposed to use Canadian indexed-bond data to solve the existing identification problem.

Pierre Duguay asked how large the cubic-spline approximation errors are. Remolona replied that some errors, such as approximation errors and measurement errors, do exist in the model. However, it is difficult to determine to what extent these errors affect the estimates in this model.