Learning from the market

Q 9-01. How can market information improve planning?

Debt is issued into a market. It does not matter if the issuance is through a private placement or an auction. The price that the ministry of finance can obtain for a debt security reflects the alternate uses of the funds at a given level of risk and return that the economy offers.

The response of the market to an offering – the number of bids, the spread of the bids, the range of bidders – all say something about the market and its willingness to absorb more debt. This feedback can be used to reduce the risk of disappointing issuance in the future.

Q 9-01.01.   What can be learned from auctions or other activities?

Every debt sale provides information about the demand for your securities. There is also a large business in market commentary. These are often ad hoc explanations for every market movement. Several academic studies have suggested that these are of little explanatory or informational value.

One should use, however, key data in innovative ways to understand the market. For example, one may look at the demand curve if auctions are used. If there are sufficient bidders, one may calculate the slope or elasticity along the curve to understand the dynamics of demand. In this case, a look at the stability of the underlying demand function is helpful to grasp how firm the market is for state debt.

Q 9-01.02.   What other data from auctions may be useful?

If one has access to the bidding data and there are sufficient bids, one should study the coverage and bidding strategies to get a sense of the size of each benchmark's support.