Reading 53

FIXED-INCOME MARKETS FOR GOVERNMENT ISSUERS

1. (A) supranational bonds.

Explanation

Supranational bonds are issued by multilateral organizations such as the IMF.

Quasi-government bonds are issued by agencies established or sponsored by national government.

Non-sovereign government bonds are issued by state, provincial, and local government or municipal entities.

(Module 53.1, LOS 53.a)

2. (C) regulatory requirements, forcing some financial institutions to hold government debt.

Explanation

Some financial institutions may be required to hold government bonds, which can lower their yields relative to nonsovereign debt. Sovereign debt tends to carry less risk than other types of debt (therefore, lower yield), and the requirement to distribute them in an auction format is not a primary cause of the yield differences between sovereign and nonsovereign debt.

(Module 53.1, LOS 53.b)

3. (B) noncompetitive bidders.

Explanation

In an auction of sovereign bonds, the bonds are allocated first to noncompetitive bidders, and then to competitive bidders starting with the highest price (lowest yield).

(Module 53.1, LOS 53.b)

4. (A) lowest price.

Explanation

The cutoff yield is defined as the yield of the successful competitive bid with the lowest price. All investors will pay the price associated with this yield in a single-price auction, whereas in a multiple-price auction, successful bidders will pay the price they bid.

(Module 53.1, LOS 53.b)

5. (A) emerging market bonds.

Explanation

Classifying fixed income securities as developed market or emerging market bonds is an example of classification by geography. Supranational bonds are a classification by type of issuer. Municipal bonds are a classification by type of issuer or by taxable status.

(Module 53.1, LOS 53.a)

6. (B) Expansionary monetary policy through the purchase of Treasury securities.

Explanation

The Federal Reserve Bank of the United States enacts monetary (not fiscal) policy. Primary dealers will serve as counterparties for the purchase (expansionary) or sale (contractionary) of Treasury securities for the purpose of enacting monetary policy. Fiscal policy does involve government spending and taxes, but that is not executed by the Federal Reserve Bank.

(Module 53.1, LOS 53.b)

7. (B) government entities.

Explanation

Public auctions are used by sovereign issuers to issue government debt securities, and primary dealers are financial institutions (like PD Bank, in this case) that make competitive bids, submit bids on behalf of third parties, and act as counterparties to the central bank in monetary policy transactions. Corporations and not-for-profits are not using auction formats.

(Module 53.1, LOS 53.b)

8. (A) cutoff yield.

Explanation

The cutoff yield is defined as the yield of the successful competitive bid with the lowest price. All investors will pay the price associated with this yield in a single-price auction.

(Module 53.1, LOS 53.b)

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