"Public Debt, Fiscal Deficit Expectations, and Their Transmission to the Cyclical Component of Long-Term Interest Rates"

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Summary

- Deterioration in public debt and upward revisions in fiscal deficit expectations:
  - Increase cyclical component of 10-year real interest rate: 20-40 bps to 1 s.d. shock
  - Steepen the yield curve (10Y-1Y): 10-25 bps to 1 s.d. shock
- **Contributions:** Deficit expectations from surveys and TVP-BVARX for Colombia
  - Transmission intensified after the Covid-19 pandemic
  - Fiscal shocks account for about 30% of fluctuations
- **Implication:** Fiscal credibility is key in determining sovereign borrowing costs

Comments on Data

- Focus is on cyclical component of **real** rate and slope of **nominal** yield curve
  - Cyclical component requires an estimate of the **unobserved** neutral rate
- Real rate subtracts core inflation from nominal rate
  - What inflation is used (expected or actual)? Ex-ante or ex-post real rate?
- Fiscal deficits can affect short-term inflation
  - Why focus only on real rates?
- Nominal rates allow to analyze the mechanism behind the response
  - Real yields and break-even inflation expectations
  - Expected short rate and term premium (and other premia)

Comments on Methodology

- Recursive identification, from fast- (real FX gap) to slow-adjusting variables (fiscal)
  - Public debt deterioration indicator is ordered before fiscal deficit expectations
  - But expectations "incorporate new information more quickly"
  - Are the results robust to changing the order of these two variables?
- Why not use or complement with other **fiscal shocks** (in LPs or IV-SVAR)?
  - Garda and Koelle (2026) fiscal shocks for Colombia using sovereign CDS
  - Chen (2025) fiscal shocks for Colombia using IMF WEO forecasts
  - Fritsch and Mazlish (2026) fiscal shocks for US using LLMs
  - Some of these shocks would even allow to compute effects at daily frequency

Comments on Results

- Relate results to the literature (against AEs and/or EMs)
  - Discuss magnitudes, duration and shape of the responses
  - Literature generally uses percentage points vs standard deviations here
- Link results to previous findings
  - Laubach ('09): Markets react stronger to projected than to current deficits
  - Furceri et al. ('25), Nose-Menkulasi ('25): Effects strengthened post-pandemic
  - What is similar, confirmed or rejected?
- Figures: Ensure same quality and report units (basis points)

Comments on Robustness

- How many lags are used?
  - Are results robust to different lags?
- Small sample (83 quarters) and potential variation in intensity of transmission
  - TVP-BVARX model addresses both issues
  - Are pre-Covid results consistent with a standard VAR for 2005-2019?
- Alternative controls (to US yield curve slope, VIX, financial conditions)?
  - Literature: Population growth, risk aversion, real GDP growth, foreign holdings

Conclusions

- Relevant paper for the Colombian economy
  - Fills a gap in the literature
  - Early version but on the right track
- Comments on data, methodology and results (robustness)
- Policymakers in Colombia should be looking forward to the next iteration