Notes on the Merrill Lynch 10-Year Bbb Corporate Bond Rate Forecast

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Moody's Analytics has introduced a new forecast for the Merrill Lynch 10-year Bbb corporate bond rate (FRBBBQ.IUSA). The equation was respecified to ensure greater consistency in the Moody's Analytics corporate bond spread forecasts. While our other corporate bond yields were modeled as spreads, the BBB was not.

The Bbb corporate bond rate differs from the others that Moody's Analytics forecasts for two reasons: 1) The average duration is 10 years instead of 20 years, and 2) The ratings scale pertains to S&P and not the Moody's ratings methodology. In the Moody's terms, a Bbb S&P bond has comparable quality to a Baa Moody's rated bond. This aspect of the BBB provides some ambiguity but also flexibility for us to develop and test a forecast equation.

The new specification models the BBB as a spread relative to the Baa. Thus, the Baa will affect the Bbb forecast. And since the Baa depends on the performance of higher-rated corporate maturities such as the AAA, the AA and the A, changes to those higher-quality offerings will also be reflected in the BBB spread. The regressors of the forecast equation include the TED spread, the change in the unemployment rate, the change in the four-month moving average of corporate profits, and a negative constant term. The coefficients on the TED spread and the unemployment rate term are positive, and the corporate profits term is negative. The specification essentially says that in normal times, the BBB yield is lower than the Baa, largely because of the difference in bond maturities. But in stress times, the other three coefficients push the Bbb higher than the Baa. This makes sense intuitively, since in stress situations securities with longer maturities fare better than those with shorter maturities.

New equation specification

Dependent Variable: FRBBBQ_US-FRBAAC_US
Method: Least Squares
Date: 08/03/17 Time: 13:53
Sample: 1987Q1 2017Q1
Included observations: 121

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.551592	0.041324	-13.34800	0.0000
FRILIBOR3M_US-FRTB3M_US	0.161374	0.052156	3.094056	0.0025
DLOG(@MOVAV(FZ_US,4))	-1.759234	0.834654	-2.107739	0.0372
D(FLBR_US)	0.415265	0.076582	5.422455	0.0000

R-squared	0.400446	Mean dependent var	-0.492885
Adjusted R-squared	0.385073	S.D. dependent var	0.277753
S.E. of regression	0.217806	Akaike info criterion	-0.177921
Sum squared resid	5.550436	Schwarz criterion	-0.085498
Log likelihood	14.76423	Hannan-Quinn criter.	-0.140385
F-statistic	26.04836	Durbin-Watson stat	0.867838
Prob(F-statistic)	0.000000		

Mnemonics referenced in the above equation, e.g. FET, can be defined using the Mnemonic 411 feature on DataBuffet. Please contact Help@economy.com for assistance.

Previous equation specification

Dependent Variable: D(FRBBBQ_US)
Method: Least Squares
Date: 09/24/15   Time: 14:12
Sample (adjusted): 1985Q1 2015Q1
Included observations: 121 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(FRBAAC_US)	1.126852	0.039550	28.49217	0.0000

R-squared	0.867536	Mean dependent var	-0.075785
Adjusted R-squared	0.867536	S.D. dependent var	0.450083
S.E. of regression	0.163810	Akaike info criterion	-0.771983
Sum squared resid	3.220064	Schwarz criterion	-0.748878
Log likelihood	47.70500	Hannan-Quinn criter.	-0.762599
Durbin-Watson stat	2.170902		

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