

# Discussion of Yang Liu: Government Debt and Risk Premia

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# Preliminaries – Thanks

Nice work on a fascinating question

# Preliminaries – Think About Small-Sample Inference Issues

## **DRAWING INFERENCES FROM STATISTICS BASED ON MULTIYEAR ASSET RETURNS\***

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*Harvard University, Cambridge, MA 02138, USA*

*(Journal of Financial Economics, 1989)*

- Is this paper immune?
- Overlapping returns *always* reduce effective sample size
  - Or do they? Same number of business cycles!

# Preliminaries – Think about Existing Policy Uncertainty Measures


EDITOR'S CHOICE

## Measuring Economic Policy Uncertainty\*

Scott R. Baker, Nicholas Bloom, Steven J. Davis


Q J Econ (2016) 131 (4): 1593-1636. DOI: <https://doi.org/10.1093/qje/qjw024>


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### Abstract

We develop a new index of economic policy uncertainty (EPU) based on

# Measurement and Theory

Measurement  
(Getting the facts straight; reduced form)

One key thing to do:

- Include the key missing control

Theory  
Nice job

Measurement  
(Assessing theory; structural)

One key thing to do:

- Do it
- Calibration fine (and desirable) for “Theory”  
but does not pass muster for serious measurement



## Measurement (Getting the Facts Straight)

*Q. What should drive the equity premium?*

The classic insight:

*A. Expected future real activity*

Fama and French,

“Stock Returns, Expected Returns, and Real Activity,” *J. Finance*

First-wave empirics (financial-flavored proxies):  
Term premium, default premium, dividend yield

Second-wave empirics (real-flavored):  
CAY (Lettau-Ludvigson *JF*)  
Expected real growth (Campbell-Diebold *JBES*)

—  
Debt/GDP (Liu – this paper)

## Expected Business Conditions are Crucially Important They Must be Controlled For...

	(1)	(7)
$g_t^e$	-0.22 (0.08)	-0.20 (0.10)
$DP_t$	-	0.12 (0.11)
$DEF_t$	-	0.00 (0.09)
$TERM_t$	-	0.11 (0.09)
$CAY_t$	-	0.15 (0.10)