RECONSIDERING THE LINK BETWEEN FISCAL POLICY AND INTEREST RATES IN AUSTRALIA

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ABSTRACT

This paper examines the empirical relationship between government debt and the real interest margin between Australian and US 10-year bond yields. Results for the period 1990-2009 suggest that Australian general government debt has no impact on the short-run interest margin, and only modest effects in the long run. Further, the estimates suggest that movements in US government debt have a considerably larger effect — implying that international influences take greater prominence in explaining the real interest margin. This conclusion is supported by the results of an unrestricted regression that focuses solely on the long-term determinants of the interest margin.

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* Macroeconomic Policy Division, The Treasury. The views expressed in this paper are the authors’ and do not necessarily reflect those of The Treasury or the Australian Government.