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DIRECTOR'S COMMENT

Paul A. Samuelson

DR. KESSEL has made a valuable contribution both on the factual and conceptual side. To a first approximation one can consider the dichotomy between (1) the *expectations* hypothesis, which supposes that people will act to make present prices approximate closely to the arithmetic mean of future prices, independently of the dispersion and higher statistical moments of the possible outcomes; and (2) the *liquidity-preference* hypothesis, which supposes that people act as if they disliked dispersion and uncertainty and will sacrifice something of first-moment of money outcome if they can thereby help hedge uncertainties. From the 1920's through 1936, the name of Keynes could be correctly associated with the second view both in the realm of commodities and securities. But to a second approximation, as a close reading of the literature will show, liquidity-preference analysis becomes more general and admits of a wider variety of empirical patterns. Thus, *before* the period of harvest when the desire to play safe is dominated by the need of producers for *long* hedges, the same Keynes-Hicks-Houthakker-Cootner analysis that leads to "normal backwardation" leads instead to its reverse: during those months, a futures price tends to fall in order to coax out risk-taking on the part of speculators. Similarly, as Modigliani, Wehrle, and others have argued, if insurance companies or other blocs of investors have a strong desire or need to "play safe" in terms of, say, eight-year periods ahead, then the yield curve might be expected to depart from its rising pattern and show a characteristic hump. Or, again, if investors in an age of secular inflation want to play safe in terms of real purchasing power, is it really anomalous that stock dividend yields should begin to fall significantly below the yield of allegedly safer fixed-principal bonds? Hence, a priori reasoning cannot itself settle what are the most

plausible patterns to look for; and except as a simplifying approximation, mere dichotomy between expectation and liquidity-preference hypotheses would seem overly simple. These remarks, I should add, are of course completely within the spirit of Dr. Kessel's analysis.