

Credit Spreads on Corporate Bonds and the Macroeconomy in Japan

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Abstract: Using secondary market data on corporate bonds issued in Japan for the period between 1997 and 2005, this paper explores possible determinants of credit spreads of corporate bond rates over interest swap rates. We find that credit spreads properly reflected financial factors summarized at the level of individual firms, including debt equity ratios, volatility, and maturity, in particular for longer term bonds. In addition, an economy-wide factor common among bond issues, which cannot be captured by firm-level factors, played an important role in determining credit spreads, and such economy-wide effects cancelled out firm-level factors to a large extent for subsample periods. We also empirically identify possible factors responsible for such significant economy-wide effects.

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