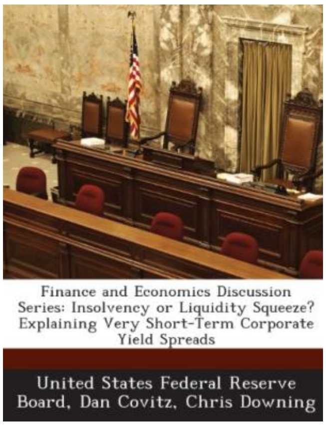




# Finance and Economics Discussion Series: Insolvency or Liquidity Squeeze? Explaining Very Short-Term Corporate Yield Spreads

By Dan Covitz, Chris Downing

Bibliogov, United States, 2013. Paperback. Book Condition: New. 246 x 189 mm. Language: English . Brand New Book ***** Print on Demand *****.In this paper, we first document some stylized facts about very short-term and long-term corporate yield spreads. We find that short-term spreads are sizable, and the correlations between many firms short-term and long-term yield spreads are at times negative. We then develop a structural model that generates levels and correlations of short-term and long-term spreads that are more consistent with what we observe. The model allows for the possibility of payment delays when a firm s liquid asset position deteriorates. Payment delays generate sizable short-term debt spreads because the realized returns on short-term investments are very sensitive to an increase in the holding period. The presence of liquidity risk can also explain negative correlations between short- and long-term spreads because liquidity risk is imperfectly correlated with insolvency risk. Using firm-level data, we provide empirical evidence that liquid assets holdings help predict short-term spreads, but not long-term spreads.