Assignment 6: Answers
(April 6, 1998)

1. Basic calculations for corporates.
   (a) Price and yield on the treasury are \( p = 102.16 \) and \( y = 6.467\% \).
   (b) Price and yield on the corporate are \( p = 101.11 \) and \( y = 7.204\% \). The spread is 73.7 BPs.
   (c) We infer “default rates” (really, an amalgam of default rates, recovery rates, and the risk premium on defaults) from ratios of discount factors for treasuries and corporates. The so-called default rates are 0.12\%, 0.48\%, and 1.08\%, resp, over 6, 12, and 18 months.

2. Brady calculations.
   (a) Blended yield is the basic yield-to-maturity: 10.6175\%.
   (b) The PV of the principal is \( 100 / 1.07^{25} = 18.425 \).
   (c) This is the yield on the bond’s sovereign cash flows only — ie, after we’ve stripped off the guaranteed principal. The cash flows are 25 payments of 6 each. The price is 60 − 18.425. The yield is 13.871\%. This yield is a lot higher, since we’re not factoring in the relatively low yield on the guaranteed principal.
   (d) This is the premium added to spot rates on the sovereign cash flows. Since the spot rates are flat at 7\%, this is just the spread between the stripped yield and treasuries: 13.871 − 7.000 = 6.871.

3. Your choice. I look forward to seeing some interesting ones.