



**INTERNATIONAL INTERDISCIPLINARY BUSINESS-
ECONOMICS ADVANCEMENT CONFERENCE**

(IIBA)

CONFERENCE PROCEEDINGS

July 16-19, 2014

Istanbul, Turkey

Co-Editors:

Prof. Dr. Cihan Cobanoglu

Prof. Dr. Serdar Ongan

ISSN: 2333-4207

Authors are fully responsible for corrections of any typographical, technical and content errors.

Table of Contents

An Empirical Analysis of the Role of Import Percentage in Merger Activities in International Capital Market: A Study of the Policy Implications.....	8
<i>David Chih-Hsiang Chen.....</i>	<i>8</i>
Term Structure of Russian Credit Rates and Arbitrage Theory	13
<i>Victor Chetverikov^a, Vadim Ajevsky^b and Mariya Bondareva^a.....</i>	<i>13</i>
The Impact of the Euro Area Macroeconomy on Global Commodity Prices	23
<i>Monika Papi��z^a, Slawomir Smiech^b and Marek A. Dabrowski^c.....</i>	<i>23</i>
Determinants of FDI into the Central and Eastern European Countries: A Componentwise Study ..	34
<i>Burcak Polat</i>	<i>34</i>
The Impact of Increase of Tourist Shoppers on the Pricing of Street Level Retail Shops in Hong Kong	47
<i>Yan Liu^a and K. W. Chau^a.....</i>	<i>47</i>
Content Analysis: Application of E-Business among SMEs	48
<i>Sushma Kumari ^a and Steve McGuire^b.....</i>	<i>48</i>
The Effect of Corporate Governance on Firms’ Financial Performance: An Empirical Study on Egyptian Stock Exchange	56
<i>Sarah Ali Elkholy.....</i>	<i>56</i>
The Quick Way to Search for Worldwide M&A (Mergers & Acquisitions) Target: The Concept of one M&A Computer Software Patent	67
<i>David Chih-Hsiang Chen.....</i>	<i>67</i>
The Status of Trade between Jordan and Palestine from the Perspective the Palestinian Business People, Importers and Exporters.....	73
<i>Khalid Mohammed Sweis and ^aAhmed "Mohammed Akram" Shwaika^b.....</i>	<i>73</i>
Competition and Risk Management Practices in the Bulgarian Banking System.....	89
<i>Andrey Gurov^a and Didar Erdinc</i>	<i>89</i>
Revisiting Chaotic Interest Rate Rules	90
<i>Vivaldo M. Mendes^a, and Diana Aldea Mendes^b.....</i>	<i>90</i>
The Distribution of ISE-100 Index Returns and Historical Performance Analysis; “What’s Past is Prologue”	91
<i>Amir Hossein Seyyedi</i>	<i>91</i>
The Interrelation among Faithful Representation (Reliability), Corruption and IFRS Adoption: An Empirical Investigation.....	92
<i>Alexios Kythreotis</i>	<i>92</i>
Abolition of Regional Development Agencies and its Impact on Tourism in England	102
<i>Emma Wong.....</i>	<i>102</i>
Types of Asymmetries in Exporter-Importer Relationships and Alignment Behaviour	103

<i>Cagri Talay^a and Dianne Dean^b</i>	103
Institutionalization and Myths	114
<i>Nevra Baker</i>	114
Don't Think Twice, It's All Right: Towards a New Copyright Protection System	115
<i>Pedro Letai</i>	115
Greeks' Consumer Behaviour in Tourism	129
<i>Nektaria Tziora^a, Charalabos Panagiotis Papacharalabous^b</i>	129
Knowledge Management and Employee Perception	138
<i>Parag Sanghani</i>	138
Factors Effecting the Development of Islamic Finance in Turkey	139
<i>Suna Akten Curuk</i>	139
Benefits and Value of Investments in Information Systems: The Case of Enterprise Resource Planning (ERP) Systems in the Hospitality Industry	148
<i>Paula Serdeira Azevedo^a, Carlos Azevedo^a, Mario Romao^b</i>	148
An Empirical Study of the Relationship between Store Access Convenience, Customer Satisfaction and Word of Mouth	156
<i>Yasser Mahfooz</i>	156
Does control-ownership disparity matter to foreign investors in Korea?	166
<i>Yoo Kyung Lee^a and Myeong Hyeon Cho^a</i>	166
On Competitive and Comparative Advantage: Towards a Unified Theory of International Trade .	177
<i>Bernard C. Beaudreau</i>	177
The Feasibility of Voice Controlled Guide Phone for Senior Tourists	178
<i>Kun I Chiu</i>	178
Does industry illiquidity matter for IPO underpricing? Evidence from China	179
<i>Sibo Liu</i>	179
The Significance of the Definition of “Consumer” in Consumer Protection: A Comparison between the Australian Consumer Law (Australia)	180
<i>Andrew Coleman and Mark Bender</i>	180
Government Stability, Accession to EU and Foreign Direct Investment in Turkey: A GMM Approach	181
<i>Bulent Esiyok</i>	181
Analysis of Online Customer Complaints on Travel Trade	182
<i>Sehna Demirkol^a, Dilbar Guliyeva^b and Gurel Cetin^c</i>	182
A Catastrophic Failure of Risk Management: The Case of BP Oil Spill	183
<i>Sevim Oztimurlenk</i>	183
Forecasting the Iberian Electricity Market Demand by Using Nonlinear Time Series Tools	184

<i>Diana Aldea Mendes^a, and Vivaldo M. Mendes^b</i>	184
An Evaluation of the Victorian Football League’s ‘Coulter Law’	185
<i>Peter Schuwalow^a, Lionel Frost^b and Luc Borrowman^c</i>	185
The Relationship between Mobbing and Job Satisfaction in Workplace	186
<i>Meltem Uygun</i>	186
Wealth Accumulation by Means of Homeownership and Its Effects on Housing Prices in Urban China	195
<i>Zheng Linzi</i>	195
Corporate Governance and Returns on Investments of Pakistani Listed Companies	212
<i>Nouman Afgan^a, Klaus Gugler^b and Robert Kunst^c</i>	212
The New Net Generation and Social Media: How Do the Youth Use Twitter in Turkey	229
<i>Mihalıs Kuyucu</i>	229
A Reconsideration of the Inflation and Inflation Uncertainty Relationship for the Turkish Economy: New Evidence from the 2003-2014 Period	241
<i>Pelin Karatay Gogul^a and Levent Korap^b</i>	241
The Role of Meeting Space Capacity on the Hotel Performance Measures	250
<i>Ozgun Ozdemir^a and Melih Madanoglu^b</i>	250
Individual and Organizational Antecedents of Safety Behaviors and their Relationships with Occupational Accidents: An Empirical Research on Blue-Collar Workers	251
<i>Pelin Kanten</i>	251
The Antecedents and Consequences of Consumers’ Need for Uniqueness in Luxury Restaurant Business	261
<i>Eunji Lee^a, Joohyun Jung^b, Sanghee Park^c, Insin Kim^d and Sunghyup Sean Hyun^e</i>	261
Saudia Arabia Internet Banking: A Conceptual Framework of the Relationship between E-Banking Service Quality and E-Customer Satisfaction	270
<i>Muslim Amin</i>	270
Comparison of Ethical and Conventional Portfolios with Second-Order Stochastic Dominance Efficiency Test	276
<i>Murat Isiker^a, Oktay Tas^b, Kaya Tokmakcioglu^c and Umut Ugurlu^d</i>	276
How do credit ratings influence investors’ behavior in Turkish stock markets?	288
<i>Gonul Cifci</i>	288
Quality of Accounting Profession In Accordance With International Standards	289
<i>Hatice Illez^a and Saban Uzay^b</i>	289
Analysis of Tourism Development in Adiyaman: Social Approach	295
<i>Abdulkadir Corbaci^a and Caner Caliskan^b</i>	295
Experimental Study of Nonprofessional Investors’ Use of the MD&A Disclosures	298
<i>Wei Li</i>	298

The Effect of Social Media on Buying Decision Process of Tourists	299
<i>Onder Yayla^a, Mustafa Sandikci^b and Muhittin Cavusoglu^c</i>	<i>299</i>
Turkish Soap Operas' Impact on Growing Familiarity with Turkish Culture and Language: An Exploratory Study in Examining Motivations of the Travelers' in Language Learning	306
<i>Mehmet Ergul^a and Saadet Ebru Ergul^b</i>	<i>306</i>
The Link between Internal and Financial Brand Performance in Hotel Industry: The Role of Brand Affiliation	308
<i>Ezgi Erkmen</i>	<i>308</i>
Electronic Business Models, Adopted by the Hospitality Industry in Bulgaria	311
<i>Silvena Dencheva</i>	<i>311</i>
Followership Qualities and Models	317
<i>Silvena Dencheva</i>	<i>317</i>
The Impact of Brand Personality on Brand Experience: A Comparison between the Perceptions of Facebook, Twitter and Instagram Users	323
<i>Oylum Korkut Altuna</i>	<i>323</i>
The Impact of Social Media on Hotels in Bulgaria	338
<i>Elena Zheynova</i>	<i>338</i>
The Impact of Foreign Direct Investment on Economic Growth	344
<i>Noha Emara^a, Orhan Coskun^b and Faraz Soomro^c</i>	<i>344</i>
Gauging the Ethicality of Students in Turkish Institutions of Higher Education	352
<i>Rafik I. Beekun^a, Nihat Alayoglu^b, Ali Osman Ozturk^c and Mehmet Babacan^d</i>	<i>352</i>
Impact of Cash Conversion Cycle on Corporate Performance	366
<i>Baijun Liang^a and Xia Pan^b</i>	<i>366</i>
Transgenerational Entrepreneurship through Knowledge Transfer in Family Business Context	374
<i>Ascension Barroso Martinez^a and Ramon Sanguino Galvan^b</i>	<i>374</i>
The Effects of Employee's Adversity Quotient, Emotional Intelligence and Creativity on the Employee's Counterproductive Work Behavior	385
<i>Chien-Wen Tsai^a and Chung-Kai, Lee^b</i>	<i>385</i>
Inappropriate Recreational Behaviors of Visitors at Leisure Farms	389
<i>Chien-Wen Tsai^a and Chung-Kai, Lee^b</i>	<i>389</i>
Ethnocentricity and Consumer Animosity: How different are consumers in the Middle East?	397
<i>Selima Ben Mrad^a, Laura Kozloski Hart^b and Jana Rutherford^c</i>	<i>397</i>
A Study on Reporting Comprehensive Income in Performance-Based Financial Statements and Its Usefulness	398
<i>Hikmet Uluhan^a, Murat Kocsoy^b and Mehmet Emin Karabayir^c</i>	<i>398</i>
Microenterprises Innovation in Baja California, Mexico: A Case of Study in Mexicali Valley	411
<i>Roberto Burgueno Romero^a, Ana Maria Vazquez Espinoza^b and Griselda Guillen Ojeda^c</i>	<i>411</i>

The Effects of Transformational Leadership Behaviors on Organizational Identification: An Application in Hotel Enterprises.....	418
<i>Ahmet Baytok^a, Hasan Huseyin Soybalı^b, Sabri Celik^c, Ozcan Zorlu^d and Cezdim Ozdemir^e.....</i>	<i>418</i>
The Impact of Digital Advertising on Consumer Purchase Decisions	432
<i>Ebru Enginkaya^a and Dilaysu Cinar^b</i>	<i>432</i>
Effects of Corporate Entrepreneurship Orientation on Export Performance: Three Cases from a Traditional Turkish Company	442
<i>Nevra Saniye Gul and Ahu Tugba Karabulut</i>	<i>442</i>
The Regulatory, Logistical and Economical Impacts of International Ballast Water Policies.....	452
<i>Sharon Roy^a and Curt Weber^b.....</i>	<i>452</i>
Innovative Subjective Evidence-Based Ethnography Applied to Food Consumer’s Behavior: The Case of Wine	453
<i>Philippe Fauquet-Alekhine^a, Elena Fauquet-Alekhine-Pavlovskaya^b and Andrea Gobbo^c</i>	<i>453</i>
Profiling the Turkish Anti-Consumers.....	459
<i>Elif Yolbulan Okan^a, Cem Ozaykun^b and Senem Gol Beser^c.....</i>	<i>459</i>
Food, Travel and the Capturing of Mindshare and Heart Share: A Study on Japan’s Domestic Food Tourism	467
<i>Caroline S.L. Tan.....</i>	<i>467</i>
Quality Improvement of Hair Mask Product Using Quality Method at Home Industry in Bandung Regency	476
<i>Dinar Imansari^a, Juli Trisna Aisyah Sinaga^b, Syahrul Mubarak^c and Arga Nur Pratama^d.....</i>	<i>476</i>
Feasibility Analysis of “Kuliner Nusantara” Restaurant in Indonesia.....	477
<i>Syahrul Mubarak</i>	<i>477</i>
Online Marketing Using Data Mining Based Website to Learn the Food Tastes Telkom University Students Based Time Ordering	478
<i>Arga Nur Pratama^a Dinar Imansari^b, Juli Trisna Aisyah Sinaga^c and Syahrul Mubarak^d.....</i>	<i>478</i>
Long-Term Capital Market Effects of Strategic Divestments.....	479
<i>Visar Krasniqi^a, Jurgen Weigand^b and Lutz Kaufmann^c.....</i>	<i>479</i>
Education System Seen as an Organization.....	491
<i>Ana Maria Restrepo^a, Maria Camila Herrera^b, Yaromir Munoz^c.....</i>	<i>491</i>
Effective Supply Chain Management: A Review of Wal-Mart	501
<i>Meltem Uygun.....</i>	<i>501</i>
On the Optimal Selection Problems with Monotone Thresholds	509
<i>Mitsushi Tamaki.....</i>	<i>509</i>
The Influence of Emotional Intelligence on the Adjustment and Performance of Exchange Students	510
<i>Brandon William Soltwisch^a, Vish Iyer^b and Yuliya Frolova^c.....</i>	<i>510</i>

Global Readymade Garment Supplier Selection Practice: A Cloud Computing Technology Based Framework.....	511
<i>Md. Mamoon Al Bashir^a and Nishikant Mishra^b.....</i>	<i>511</i>
The Mediating Effects of Career Satisfaction in Relationship between Work Family-Family Work Conflict and Life Satisfaction: Research on Employees Working in Turkish Travel Agencies	518
<i>Guney Cetin Gurkan^a, Hakki Aktas^b.....</i>	<i>518</i>
Impact and Red Flags in Fraud in Inventories Applicable to Small and Medium Manufacturing Enterprises in Colombia	525
<i>Maria Victoria Uribe Bohorquez^a and Natalia Andrea Baracaldo Lozano^b.....</i>	<i>525</i>
The Evaluation of Onboard Advertising as an Outdoor Advertising Media in Turkey	526
<i>Mihalıs Kuyucu.....</i>	<i>526</i>
Developing New Market Entry for ABOFARM SMEs (Small and Medium Enterprises) in Indonesia	541
<i>Juli Trisna Aisyah^a and Husni Amani.....</i>	<i>541</i>
How do different kinds of personal goods on the dest influence perceptual competency characteristics?	542
<i>Chien-Huang Lin^a and Hsiao-Mei Chung^b.....</i>	<i>542</i>
Analysis of the Tourism Image in the Turkish Series ‘Magnificent Century’	543
<i>Ziyad Guliyev^a and Dilbar Guliyeva^b.....</i>	<i>543</i>
An approach to Inequalities beyond Gini Coefficients in Case of Turkey	545
<i>Emine Tahsin.....</i>	<i>545</i>
Storytelling in Tourism: Opportunities for the Marketing and Branding of Adana Destination	557
<i>Mehmet Cihan Yavuz.....</i>	<i>557</i>
A Model of Consumers’ Impulsive Ordering Behaviors in Luxury Restaurant Business.....	558
<i>Eunji Lee^a, Joohyun Jung^b, Sang Hee Park^c, Insin Kim^d and Sunghyup Sean Hyun^e.....</i>	<i>558</i>
How do income elasticities of exports and imports explain trade performance? A Panel Data Analysis for Turkish Manufacturing Industry	559
<i>Nurtac Yildirim^a and Ferda Karagoz^b.....</i>	<i>559</i>
Does the euro really need political union to survive?	560
<i>Secil Suner Cecan.....</i>	<i>560</i>
Analyzing Tourism Investment Incentives in Turkey: Strategies and New Incentive Framework ...	568
<i>Destan Kirimhan.....</i>	<i>568</i>
Determinants of Official Development Assistance in Lebanon: a Pre- and Post-War Assessment....	573
<i>Roula Al Daia^a, Irna Van Der Molen^b, and Manal Nader^c.....</i>	<i>573</i>
Collaborative Consumption: Definition and Dimensions of Interactional / Relational / Social Analysis	581
<i>Beatriz G. Matos^a, Maria De Lourdes De Azevedo Barbosa^b and Celiane Camargo-Borges^c.....</i>	<i>581</i>

The Role of Visit Duration on the Satisfaction and Customer Behavioral Intentions of Repeat Festival Attendees.....	587
<i>Manuel Rivera^a and Mathilda van Niekerk^b</i>	<i>587</i>
The Macro-Effectiveness of Unconventional Monetary Policy: Comparing FED, ECB, BoE and BoJ	588
<i>Emin Erturk^a, Derya Yilmaz^b and Isin Cetin^c</i>	<i>588</i>

Term Structure of Russian Credit Rates and Arbitrage Theory

Victor Chetverikov^a, Vadim Ajevsky^b and Mariya Bondareva^a

^aNational Research University Higher School of Economics, Moscow, Russia,
vchetverikov@hse.ru

^bJSC VTB Bank, Moscow, Russia
ajeovsky@msk.vtb.ru

Abstract

The credit market can be considered as a certain analogue of the zero coupon bond market, where credit granting is like bond purchasing, and receiving the credit is like the short sale of bonds. Of course, there is no perfect analogy because the operational procedures on these markets are rather different. However, it is assumed in this article that term structures of these rates of return are similar. For zero-coupon bonds in a time-discrete model there is a known affine temporal structure of yield to maturity that depends on the current short-term rate. In this article the one week interest rate was used as the yield to maturity for one-period bonds. An autoregressive scheme AR (1) for a one week rate of interest was taken as a Vasiček discrete model for the short rate of interest. Using a latent scalar parameter which exists in the model allows constructing adequate term structure of interest rates on the Russian market of interbank credits.

Keywords: Lending Rates, Yield to Maturity, Term Structure, Stochastic Discount Factor

Introduction

In the theory and practice of asset pricing, the main approach is based on the assumption that it is arbitrage-free, i.e., on the *arbitrage-free principle* (AFP) (Shiryayev, A.N. (1998); Follmer, H. & Schied, A. (2004); Safarian Mher & Kabanov Yuri. (2010)). It means that two portfolios with equal future random payments (*equivalent* portfolios) must have the same current price. Otherwise, arbitrage becomes possible (i.e., it is possible to earn a «free breakfast»), namely, the owner of the portfolio with a higher price can sell it and buy an equivalent portfolio with a lower price and thus obtain an income equal to the difference between the prices, because the expected future payments in both portfolios are the same. According to the AFP, the price of the financial portfolio is determined as the price of the equivalent portfolio with simplest assets whose prices can easily be calculated.

In the present paper, the authors followed Cochrane's approach (Cochrane, J. (2005)), whose main idea is that the determining factor of pricing (its kernel) is the *stochastic discount factor*. But, in contrast to Cochrane, the main attention was paid to the term structure and pricing of interest rates in the framework of the so-called Duffie-Kan affine models (Duffie, D. & Kan, R. (1996)) with discrete time. It is allowed to find temporary structure yield to maturity zero-coupon bonds if one uses a discrete Vasiček model for the short-term rate (Vasiček, O. (1977); Ajevsky, V.V. & Chetverikov, V.M. (2012)). In this structure, there is one free parameter, hereinafter referred to as latency. These issues are discussed in the first section of this paper.

In the second section there is a discussion about the relationship between the observable variables of this model and the latent variable characterizing the investor attitude to the risks due to variations in the stochastic discount factor.

Further the relations obtained for the yield to maturity of zero-coupon bonds are used for the interest rates on the Russian credit market. Obviously, the yield to maturity of one-period bonds in a discrete time model looks like the lending rate for the same period. It is assumed that interest rates for any period are subject to the same laws as the yield to maturity zero-coupon bonds for the same period. Strictly speaking, this is only a hypothesis about *the equivalence of temporary structures of credit rates and yield to maturity*. In reality, bonds and loans are not the same so as the loans cannot generally be sold before the deadline, unlike the bonds traded on the secondary market.

In the third section, it was shown how the model in question can be used to analyze the lending rates on the Moscow market of interbank credits (MMIBC, «MosPrime»). The data for these rates are presented in the Appendix. Five figures show that using a single latent variable as the "gauge parameter", we can achieve a

good agreement between the calculated yield of loans (deposits) and the observed rates. Note that only a single value of "gauge parameter" was used for five different credit durations at a time.

Remark. In the case of continuous models, the econometric estimation of interest rates was performed in 2003 on the basis of the MMIBC data by Anatoliev and Korepanov (Anatolyev, S. & Korepanov, S. (2003)). Bjork's monograph (Bjork, T. (2004)) contains a detailed survey of the last achievements in the field of continuous time models. A rather complete econometric investigation of statistical properties of GKO maturing yield was performed by Drobyshevskii (Drobyshevskii, S. (1999)).

Construction of a Pricing Model

Consider a pricing model on the zero-coupon market based on the following hypotheses and theorems.

Proposition 1. For any t , the logarithm of the price of one-period bond is given by the formula

$$\ln b_t^1 = -r_t, \quad \ln b_{t+1}^1 = -r_{t+1}, \quad (1)$$

where r_t is the so-called short-term rate whose dynamics is described by the following hypothesis.

Proposition 2. The short-term rate varies in discrete time by the formula

$$r_{t+1} = \varphi \cdot r_t + \theta \cdot (1 - \varphi) + [w_0]^{1/2} \cdot \varepsilon_{t+1}, \quad (2)$$

where $w_0 \geq 0$, and all ε_{t+1} are independent identically distributed variables for distinct t and $\varepsilon_{t+1} \in N(0, 1)$. In financial mathematics, Eq. (2) is called the Vasiček discrete model (Vasiček, O. (1977)), but in the physical literature it is usually called the Ornstein-Uhlenbeck discrete model (Klyatskin, V.I. (1975); Pitovranov, S. E. & Chetverikov, V. M. (1978); Pitovranov, S. E. & Chetverikov, V. M. (1980)).

Proposition 3. The condition that the bond market is one-period arbitrage-free is satisfied if the prices of an n -period bond at time t are determined by the conditional mathematical expectation of the discounted price of an $n-1$ -period bond at time $t=1$, i.e.,

$$b_t^n = E_t \{ m_{t+1} \cdot b_{t+1}^{n-1} \}, \quad b_t^0 = 1 \quad \forall t. \quad (3)$$

Here $E_t \{ \dots \}$ means averaging over a measure related to the realization ε_{t+1} , and m_{t+1} is a stochastic discount factor depending on ε_{t+1} .

Proposition 4. The stochastic discount factor is determined by the short-term rate r_t , the random variable ε_{t+1} , and two constants δ and λ by the formula

$$-\ln m_{t+1} = \delta + \gamma \cdot r_t + \lambda \cdot [w_0]^{1/2} \varepsilon_{t+1}. \quad (4)$$

Proposition 4 implies the following obvious corollary.

Corollary 1. The random variable m_{t+1} has a log-normal conditional distribution

$$\ln m_{t+1} \in N(-\delta - \gamma \cdot r_t, \lambda^2 \cdot w_0), \quad (5)$$

and hence direct calculations easily prove that the logarithm of the mean is determined by the logarithm mean plus half the logarithm variance:

$$\ln E_t \{ m_{t+1} \} = E_t \{ \ln m_{t+1} \} + \frac{1}{2} \cdot D \{ \ln m_{t+1} \} = -\delta - \gamma \cdot r_t + \frac{\lambda^2}{2} \cdot w_0. \quad (6)$$

Corollary 2. Since Proposition 3 and Corollary 1 imply

$$\ln b_t^1 = \ln E_t \{ m_{t+1} \cdot b_{t+1}^0 \} = \ln E_t \{ m_{t+1} \cdot 1 \} = -\delta - \gamma \cdot r_t + \frac{\lambda^2}{2} \cdot w_0,$$

the following relation between the constants is required for the consistency with Proposition 2:

$$\delta = 0,5\lambda^2 \cdot w_0, \quad \gamma = 1. \quad (7)$$

Corollary 3.

$$\begin{aligned} \ln b_t^2 &= \ln E_t \{ m_{t+1} \cdot b_{t+1}^1 \} = \ln E_t \{ \exp(-\delta - \gamma \cdot r_t - \lambda \cdot [w_0]^{1/2} \cdot \varepsilon_{t+1} - r_{t+1}) \} = \\ &= 0,5 \cdot (\lambda + 1)^2 \cdot w_0 - (\delta + \theta \cdot (1 - \varphi)) - (\gamma + \varphi) \cdot r_t \end{aligned}$$

or with Corollary 2 taken into account,

$$\ln b_t^2 = -\theta \cdot (1 - \varphi) + (\lambda + \frac{1}{2}) \cdot w_0 - (1 + \varphi) \cdot r_t \quad (8)$$

Theorem. If the assumptions of Propositions 1-4 are satisfied, then the price of an n -period bond b_t^n depends on the time t only through the value of the short-term rate r_t :

$$-\ln b_t^n = A_n + B_n \cdot r_t, \quad (9)$$

and the coefficients A_n, B_n are independent of time.

These coefficients satisfy the system of recursive equations

$$\begin{aligned} A_{n+1} &= A_n + [\theta \cdot (1 - \varphi) - w_0 \cdot \lambda] \cdot B_n - 0,5w_0 \cdot B_n^2, \\ B_{n+1} &= 1 + \varphi \cdot B_n, \\ A_0 &= A_1 = 0, \quad B_0 = 0, \quad B_1 = 1. \end{aligned} \quad (10)$$

This theorem is proved by the method of mathematical induction on n . By formula (8), assertions (9)-(10) hold for $n = 0$ and $n = 1$. It is assumed that they hold for n and prove them for $n + 1$. By Proposition 3 stating that the bond pricing is arbitrage-free, one has

$$\begin{aligned} \ln b_t^{n+1} &= \ln E_t \{ m_{t+1} \cdot b_{t+1}^n \} = \\ &= \ln E_t \{ \exp(-0,5\lambda^2 \cdot w_0 - r_t - \lambda \cdot [w_0]^{1/2} \cdot \varepsilon_{t+1} - A_n - B_n \cdot r_{t+1}) \} = \\ &= -[A_n + B_n \cdot (\theta \cdot (1 - \varphi) - \lambda \cdot w_0) - 0,5w_0 \cdot B_n^2] - [1 + \varphi \cdot B_n] \cdot r_t = -A_{n+1} - B_{n+1} \cdot r_t. \end{aligned}$$

Comparison of the last two rows shows that recursive relations (10) are satisfied. \square

For a short-term rate r_t whose dynamics is modeled by Eq. (2), the following relations for the conditional means and variances of the variable r_{t+n} are correct:

$$E_t \{ r_{t+n} \} = \varphi^n \cdot r_t + \theta \cdot (1 - \varphi^n), \quad (11)$$

$$D_t \{ r_{t+n} \} = w_0 \cdot B_n, \quad (12)$$

where the coefficients BB_n are determined by the relations

$$BB_n = \sum_{k=0}^{n-1} \varphi^{2k} = \frac{1 - \varphi^{2n}}{1 - \varphi^2}. \quad (13)$$

Formulas (11)-(13) are proved by the method of mathematical induction.

In relations (9), (10) determining the arbitrage-free prices of the bonds, all variables except the constant λ are determined by Eq. (2) for the short-term rate, which is quite natural. The constant λ first appeared in the stochastic discounting coefficient (4). With (7) taken into account, the logarithm of this coefficient is determined by the formula

$$-\ln m_{t+1} = r_t + \frac{\lambda^2}{2} \cdot w_0 + \lambda \cdot [w_0]^{1/2} \varepsilon_{t+1}. \quad (14)$$

Formula (14) means that the constant λ together with the conditional variance $D_t\{r_{t+1}\} = w_0$ and the random variable ε_{t+1} determine the stochastic discounting coefficient m_{t+1} deviation from the «natural» quantity $E_t\{m_{t+1}\} = \exp(-r_t)$ depending only on the short-term rate r_t .

It follows from formulas (2) and (14) that $COV_t\{\ln m_{t+1}, r_{t+1}\} = -\lambda \cdot w_0$, hence

$$corr_t\{\ln m_{t+1}, r_{t+1}\} = -\lambda \cdot |\lambda|^{-1}. \quad (15)$$

In other words, the modulus of the logarithm of the correlation of stochastic discount factor and the short rate is equal to one, and the sign is determined by the sign of the constant λ

Observable Variables and a Latent Parameter λ .

To test the hypothesis of the equivalence of temporary structures stated in the introduction, let us consider the temporal structure of zero-coupon bonds yield to maturity, following this model of pricing bonds.

It follows from the meaning of continuous rates used in the present paper that the maturing yield of an n -period bond at time t is given by the formula

$$y_t^n = -\frac{1}{n} \cdot \ln b_t^n. \quad (16)$$

In the proposed model of arbitrage-free pricing (9), the yield is determined by the formula

$$Y_t^n = -\frac{A_n + B_n \cdot r_t}{n}, \quad (17)$$

where A_n, B_n are determined by the recursive relations (10).

In formulas (10), all values except constants λ have a very definite economic meaning as a defined econometric model of the short-term rate (2).

In the general initial model, the parameter λ first appears in (4) and determines the value of the linear influence of the random factor ε_{t+1} on $\ln m_{t+1}$. For $\lambda = 0$, the stochastic discounting factor (4) has the form $m_{t+1} = \exp(-r_t)$; in this case, the discounting at time t of the future price at time $t+1$ depends only on the current short-term rate r_t without taking account of its possible variations under the action of the random factor ε_{t+1} . By formula (15), the correlation factor between $\ln m_{t+1}$ and r_{t+1} is equal to $sign(-\lambda)$ and

hence it is equal to one for all negative values of λ . Since this parameter does not belong to directly observable (measurable) variables, it will be called a latent parameter of the model under study which characterizes the investor attitude (or, as is usually said, the bond market) to the risk of variation in the short-term rate in the future period. The meaning of the latent parameter manifests itself most clearly in the formula of the forward short-term rate $f_t^1(n, n+1)$ connecting the prices of n - and $n+1$ -period zero-coupon bonds at time t

$$f_t^n(n, n+1) = \ln b_t^n - \ln b_t^{n+1}. \quad (18)$$

To form a notion such as the forward short-term (one-period) rate $f_t^1(n, n+1)$ in terms of n periods, consider the hypothetic buying and selling of n - and $(n+1)$ -period zero-coupon bonds at time t . We divide the entire procedure into three steps.

Step 1. We sell an n -period bond at time t at the price b_t^n and buy several $(n+1)$ -period bonds at the price b_t^{n+1} in the amount of $b_t^n \cdot (b_t^{n+1})^{-1}$.

Step 2. We pay a money unit at time $t+n$ for an n -period bond.

Step 3. At time $t+n+1$, we obtain an income in the amount of $b_t^n \cdot (b_t^{n+1})^{-1}$ money units for the bought $(n+1)$ -period bonds. Thus, we have spent one money unit at time $t+n$ and obtained $b_t^n \cdot (b_t^{n+1})^{-1}$ money units at $t+n+1$ time. This operation can be associated with the one-period yield $f_t^1(n, n+1)$ starting from the relation $1 \cdot \exp[f_t^1(n, n+1)] = b_t^n \cdot (b_t^{n+1})^{-1}$ which implies formula (18).

According to (2)-(5), in the considered model of arbitrage-free pricing, the value of short-term forward rate can be represented as

$$f_t^1(n, n+1) = r_t + B_n \cdot (\theta - r_t) \cdot (1 - \varphi) - w_0 \cdot B_n \cdot [\lambda + 0,5 \cdot B_n]. \quad (19)$$

The role of the parameter λ in the initial model is completely clarified precisely if we write down (19) in the form

$$f_t^1(n, n+1) = E_t\{r_{t+n}\} - w_0 \cdot (1 - \varphi^n) \cdot (1 - \varphi)^{-1} \cdot [\lambda + 2^{-1}(1 - \varphi^n) \cdot (1 - \varphi)^{-1}] \quad (20)$$

The first term in (20) has the form of conditional mathematical expectation for the short-term rate over n periods and the second term can naturally be interpreted as the risk premium for the one-period rate over n periods. An analysis of formula (20) shows that the risk premium is positive for $\lambda < [-2 \cdot (1 - \varphi)]^{-1}$ and the asymptotics of the short-term forward rate over a large number of n periods is greater than the average current short-term rate θ .

In this case, if $\lambda < -(1 - \varphi)^{-1}$, then the difference $f_t^1(n, n+1) - E_t\{r_{t+n}\}$ is proportional to $w_0 = D_t\{r_{t+1}\}$ and monotonically increases with n .

The current maturing yields of the n -period bond (17) in the model under study is given by the formula:

$$Y_t^n = (\theta - w_0 \cdot (1 - \varphi)^{-1}(\lambda + 2^{-1} \cdot (1 - \varphi)^{-1})) - w_0 \cdot (1 - \varphi)^{-2} \cdot (2n)^{-1} \cdot BB_n + (r_t - \theta + w_0 \cdot (1 - \varphi)^{-1} \cdot (\lambda + (1 - \varphi)^{-1})) \cdot n^{-1} B_n \quad (21)$$

The quantity Y_t^n monotonically increases with n in the range of the parameters

$$\theta - r_t > w_0 \cdot (1 - \varphi)^{-1} \cdot (\lambda + (1 - \varphi)^{-1}) \quad (22)$$

In this inequality, all parameters of the model except r_t are constants, but r_t is a time dependent variable. If the investors determine the risk parameter by the inequality

$$\lambda < -(1 - \varphi)^{-1} - w_0^{-1} \cdot (1 - \varphi) \cdot (\max_t r_t - \theta),$$

then this results in the monotone increase in the maturing yield of zero-coupon bonds in time not only for the mean yields $E\{Y_t^n\}$ but also for the current yields Y_t^n .

The preceding analysis of the influence of the latent risk parameter λ only allowed one to obtain several estimates from above in the situations that are often met on the market. Since in the model under study, the parameter λ is determined by investors, it can be interpreted as an adjustable parameter for matching the calculated arbitrage-free and actually observable yields of zero-coupon bonds for all maturity dates.

This program can easily be realized in our model. Consider the goal function $\Phi(\lambda)$ for adjusting the latent variable λ to the observed yield data y_t^n :

$$\Phi(\lambda) = \sum_{n=1}^N \sum_{t=1}^T (Y_t^n - y_t^n)^2 = \sum_{n=1}^N \sum_{t=1}^T \left(\frac{A_n + B_n \cdot r_t}{n} - y_t^n \right)^2. \quad (23)$$

Since Y_t^n is a linear function of the latent parameter λ , the function $\Phi(\lambda)$ is a positive definite quadratic function of λ whose minimal value is attained at $\lambda = \lambda^*$:

$$\lambda^* = w_0^{-1} \cdot (1 - \varphi) \cdot (\mu_1 - \mu_2) - [2 \cdot (1 - \varphi)]^{-1} \cdot (1 - \mu_3), \quad (24)$$

where

$$\mu_1 = \theta - \frac{1}{T} \sum_{t=1}^T y_t^1, \quad \mu_2 = \sum_{n=2}^N h_n \cdot \frac{1}{T} \sum_{t=1}^T (y_t^n - y_t^1), \quad \mu_3 = \sum_{n=2}^N h_n \cdot n^{-1} \cdot (B_n - BB_n),$$

$$h_n = (1 - n^{-1} \cdot B_n) \cdot \left[\sum_{k=2}^N (1 - k^{-1} \cdot B_k) \right]^{-1}$$

Analysis of «MosPrime» Credit Rates

As a data example, it was considered the credit rates of the Moscow Market of Interbank Credits, MosPrime. The MosPrime Rate, i.e., the Moscow Prime Offered Rate, is the indicative rate of rouble credits (deposits) on the Moscow money market.

This indicator is formed by the National Currency Association (NCA) on the basis of the deposit rates of «overnight» terms of 1 week, 2 weeks, and 1, 2, 3, 6 months announced by 8 banks which are the leading operators on the Interbank Credit Market. In our notation, the symbols w1, w2, m1, m2, m3, and m6 denote the deposit rates in percents per annum for 1 week, 2 weeks, 1 month, 2 months, 3 months, and 6 months, respectively. All data are taken from the site <http://www.nva.ru> and are presented in the Appendix. These data refer to the period January-August 2013.

A credit contract on the interbank market can be considered as a zero-coupon bond, because it is standardized with respect to its volume and terms. These contracts are quoted according to their credit rates, but these quotations can easily be converted to the bond prices by using the price-rate dependence.

The weekly rate as a short-term rate was chosen. When choosing a week as the shortest duration, it is necessary that all of other durations were divisible by this shortest duration. For uniform harmonization of such requirements, the year was divided into 48 weeks, a month, into 4 weeks. The following initial data were used to construct the observable yields y_t^1 :

$$y_t^1 = \ln\left(1 + \frac{w1_t}{a}\right), \quad y_t^2 = \frac{1}{2} \ln\left(1 + \frac{2 \cdot w2_t}{a}\right), \quad y_t^4 = \frac{1}{4} \ln\left(1 + \frac{4 \cdot m1_t}{a}\right), \quad a = 4800$$

$$y_t^8 = \frac{1}{8} \ln\left(1 + \frac{8 \cdot m2_t}{a}\right), \quad y_t^{12} = \frac{1}{12} \ln\left(1 + \frac{12 \cdot m3_t}{a}\right), \quad y_t^{24} = \frac{1}{24} \ln\left(1 + \frac{24 \cdot m6_t}{a}\right).$$

Naturally the value y_t^1 was taken as a short-term rate r_t used to construct regression (2). Table 1 presents the results of the regression construction.

Table 1. Results of the regression

Notation	Estimate	T statistics	p-level
φ	0,531604	4,54	0
$\theta \cdot (1 - \varphi)$	0,000622	4,03	0
θ	0,001327		
w_0	1,10661E-09		

For 32 observations $R^2 = 0,41$, the White test does not disprove the variance homogeneity hypothesis and the t-statistic of the unit root for the equality $\varphi = 1$ is equal to minus 4,00, while the critical Dickey-Fuller statistic at the 5% significance level is equal to minus 2,93 for this model. Since the Durbin – Watson statistic value $DW=1,98$, which is close to 2, is not a reliable value in the autoregression models, it is necessary to present the data of the sample autocorrelation remainder function. The error autocorrelation tests (Ljung&Box statistics) show that the hypothesis H_0 of the error autocorrelations equal to zero cannot be rejected at the 5% level of significance.

The calculated optimal value for latent variable is $\lambda^* = -62295,6$; the value of the goal function is $\Phi(\lambda^*) = 2,07 \cdot 10^{-7}$. For comparison, the value of the corresponding «discrepancy» obtained in the construction of regression (2) is equal to $3,32 \cdot 10^{-8}$, and calculated for five yields, the value of the goal function is only 1,24 times greater than the «discrepancy» for one short-term rate, which is a rather good result. The optimal value λ^* for the data under consideration corresponds to the following expression for the stochastic discount factor (14):

$$-\ln m_{t+1} = 2,147 + r_t - 2,072 \cdot \varepsilon_{t+1}.$$

The general comparison picture of the calculated and observed yields for different durations of the loan represented in Fig. 1, where the horizontal axis represents the standard deviation and the vertical axis - the time average of the yields.

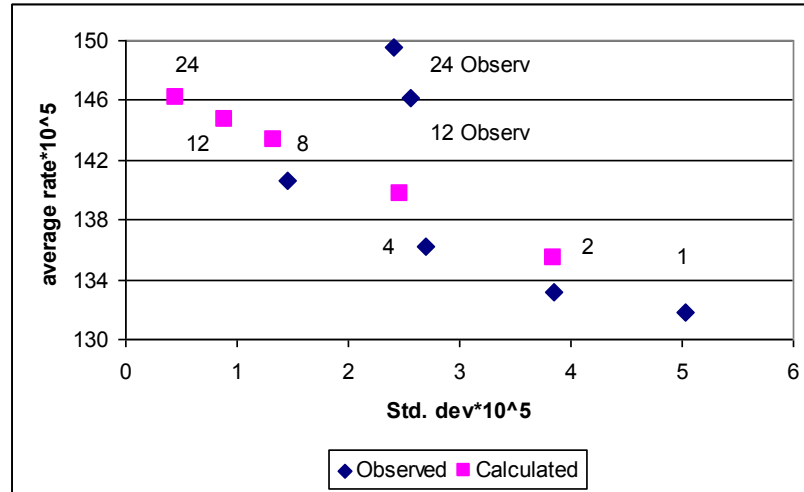


Fig. 1. The time averages and the standard deviations of the observed and calculated rates of return for different durations of the loan. Separate figures indicate the duration of the loan in weeks.

An analysis of the results showed the following. A steady increase in the rates of return with increasing duration of credit is observed in both the observed and calculated values. For a period of two, four and eight weeks, the calculated values exceed the average observed values (the relative excess is about 2%). On the contrary, for credit rate of return for periods of twelve and twenty four weeks, the observed values are higher than the calculated values with a relative error of 2%.

Conclusion

It was considered the term structure of credit rates on the Moscow Market of Interbank Credits in the period of nine months in 2013. It was shown that the application of the proposed model of arbitrage-free pricing of zero-coupon bonds to the MosPrime data of the credit market exhibits a good consistency with observations. A similar result was obtained with the data for 2010 (Ajevsky, V.V. & Chetverikov, V.M. (2012)). All results refer to short interbank loans up to six months.

In the proposed model, there is a latent free parameter characterizing the bonus for the risk per unit of volatility. This parameter is not directly measurable, and characterizes the attitude to risk all investors in general. The value of this parameter largely determines the temporal structure of interest rates. It can be interpreted as a *single* adjustable parameter for matching the calculated and actually observable yields *for all credit durations*. Additional studies show that the direct regression of n - week's rate on a one-week rate of return gives an unsatisfactory result.

Appendix

Table 2. Data of «MosPrime» credit rates

date	w1	w2	m1	m2	m3	m6
15.01.2013	5,58	5,96	6,48	6,98	7,38	7,63
22.01.2013	6,03	6,16	6,49	6,89	7,27	7,5
29.01.2013	6,25	6,28	6,45	6,81	7,1	7,34
05.02.2013	5,83	6	6,37	6,78	7,12	7,33
12.02.2013	5,76	5,97	6,28	6,75	7,13	7,32
19.02.2013	6,21	6,23	6,4	6,74	7,06	7,33
26.02.2013	6,4	6,35	6,4	6,71	7,04	7,31
05.03.2013	6,14	6,21	6,32	6,64	6,97	7,22
12.03.2013	6,36	6,41	6,5	6,72	7,15	7,31
19.03.2013	6,25	6,36	6,45	6,7	7,05	7,25
26.03.2013	6,34	6,37	6,5	6,72	7,09	7,32
02.04.2013	6,31	6,38	6,59	6,88	7,26	7,49
09.04.2013	6,3	6,37	6,53	6,82	7,24	7,49
16.04.2013	6,31	6,35	6,5	6,8	7,13	7,38
23.04.2013	6,45	6,46	6,51	6,8	7,16	7,4
30.04.2013	6,56	6,59	6,64	6,81	7,18	7,4
07.05.2013	6,54	6,61	6,65	6,8	7,18	7,4
14.05.2013	6,55	6,56	6,65	6,81	7,16	7,4
21.05.2013	6,56	6,6	6,72	6,84	7,19	7,34
28.05.2013	6,59	6,6	6,74	6,84	7,12	7,36
04.06.2013	6,58	6,6	6,74	6,83	7,09	7,33
11.06.2013	6,38	6,49	6,61	6,76	7,04	7,28
18.06.2013	6,46	6,52	6,7	6,83	6,99	7,23
25.06.2013	6,54	6,63	6,78	6,88	7,03	7,28
02.07.2013	6,59	6,64	6,76	6,88	7,03	7,25
09.07.2013	6,18	6,29	6,59	6,78	7	7,22
16.07.2013	6,44	6,5	6,7	6,82	7	7,2
23.07.2013	6,45	6,5	6,64	6,79	7	7,19
30.07.2013	6,5	6,5	6,64	6,77	7	7,2
06.08.2013	6,37	6,42	6,53	6,73	6,9	7,17
13.08.2013	6,23	6,33	6,49	6,69	6,88	7,14
20.08.2013	6,39	6,43	6,5	6,72	6,85	7,14
27.08.2013	6,41	6,46	6,49	6,7	6,8	7,05

References

- Shiryayev, A.N. (1998). Foundations of Stochastic Financial Mathematics. Vol.1. Facts, Models. Vol. 2. Theory. Moscow, Fazis.
- Follmer, H. & Schied, A. (2004). Stochastic Finance: An Introduction in Discrete Time Walter de Gruyter.
- Safarian Mher & Kabanov Yuri. (2010). Markets with Transaction Costs.. Mathematical Theory Series: Springer Finance., XIV.
- Cochrane, J. (2005). Asset Pricing. Princeton University Press, Princeton, New Jersey.
- Duffie, D. & Kan, R. (1996). A yield-factor model of interest rates. *Mathematical Finance* 6: 379 – 406.
- Vasiček, O. (1977). An equilibrium characterization of the term structure. *Journal of Financial Econometrics*, Vol.5: 177-188.
- Ajevsky, V.V. & Chetverikov, V.M. (2012). A generalization of a discrete profitability model for “short” obligations// Analysis and Modeling of economic processes. Collection of articles edited by Professor Belenky V.Z. In Russian./ M.:CEMI RAS: 79-102.

- Anatolyev, S. & Korepanov, S. (2003). The term structure of Russian interest rates. *Applied Economics Letters* 10(13): 867–870.
- Bjork, T. (2004). *Theory of Arbitrage in Continuous Time*. Oxford University Press.
- Drobyshevskii, S. (1999). Analysis of the GKO market on the basis of studying the time structure of interest rates. Institute for Economics of Transient Period. Collection of Scientific Works № 17P. Moscow.
- Klyatskin, V.I. (1975). Statistical description of dynamical systems with fluctuating parameters. M.: Nauka.
- Pitovranov, S. E. & Chetverikov, V. M. (1978). Corrections to the diffusion approximation in stochastic differential equations. *Theoretical and Mathematical Physics* 35(2): 415–422.
- Pitovranov, S. E. & Chetverikov, V. M. (1980). On a class of boundary value problems for differential stochastic equations. *Theoretical and Mathematical Physics* 43(2): 431–445.