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Bond Risk Premia vs. Term Premia: Why the Distinction Matters

Abstract

Bond risk premia and term premia measure different aspects of compensation for interest-rate risk. We show that their relationship involves not only maturity averaging but also convexity and duration adjustments. Using estimates from a stochastic volatility term structure model, we illustrate how these effects can generate substantial differences between expected excess bond returns and conventional term premia, particularly at long maturities.