

# Treasury Yield Curve

There are four elements in interest rate: zero coupon rates (or zero rates), discount factor, par yields, and forward rates. The derivation of one of these element is conveniently sufficient for the determination of the other three elements. Each interest rate definition is derived from specific representations of bond price.

The zero coupon rate or zero rate, the most common form of interest rate, is the yield implied by the difference between a zero coupon bond's current purchase price and the value it pays at maturity. A given zero rate applies only to a single point in the future and, as such, can only be used to discount cash flows occurring on this date. Zero rates can have different compounding: continuously, semi-annually, annually, etc. The continuously compounded zero rate has the simplest expression and computation mathematically.

The discount factor for a corresponding term to maturity is equal to  $\exp(-Z \cdot T)$ , where  $Z$  is the continuously compounded zero rate from 0 to  $T$  and  $T$  is the maturity date. The calculation of zero rates and their associated discount factors is essential for asset pricing.

Unfortunately both zero rates and discount factors prevailing in the market are not observable for all maturities. You need to bootstrap treasury benchmark curves to generate treasury yield curves (or treasury zero rate curves).

Treasury yield curve or treasury zero coupon yield curve is the term structures of treasury yields-to-maturity. The yield is also called the zero coupon rate or the implied forward rate.

Treasury yield curves are bootstrapped from treasury benchmark curves that contain the most actively traded treasury bills or bonds at some maturities.

A standard bootstrapping process is employed, while in the program, a hybrid of the basic bootstrapping method for short and medium instruments such as cash Libor rates and Libor futures, and an enhanced method for long term instruments such as Libor swaps, is adopted. This hybrid is referred to as the semi-enhanced method hereinafter.

There are two steps involved in creating a yield curve. First, a series of underlying indices are to be created in the Sector's application package for traders, each of which comprises a maturity date. Second, selected indices are filled in a yield curve set-up and simple spot rates for corresponding indices are input in the curve. This setting requires pre-process of raw market data. And that is the reason it is named a set-up, not an engine.

Reference:

<https://finpricing.com/lib/IrBasisCurve.html>