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The Yield Curve and Predicting Recessions

FEDs Working Paper No. 2006-7

21 Pages

Posted: 3 May 2006

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Date Written: March 2006

Abstract

The slope of the Treasury yield curve has often been cited as a leading economic indicator, with inversion of the curve being thought of as a harbinger of a recession. In this paper, I consider a number of probit models using the yield curve to forecast recessions. Models that use both the level of the federal funds rate and the term spread give better in-sample fit, and better out-of-sample predictive performance, than models with the term spread alone. There is some evidence that controlling for a term premium proxy as well may also help. I discuss the implications of the current shape of the yield curve in the light of these results, and report results of some tests for structural stability and an evaluation of out-of-sample predictive performance.

Keywords: Interest rates, forecasting, GDP growth, term premiums, probit**JEL Classification:** C22, E37, E43[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN_ID899538_code358088.pdf?abstractid=899538&mirid=1\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID899538_code358088.pdf?abstractid=899538&mirid=1)[Open PDF in Browser \(Delivery.cfm/SSRN_ID899538_code358088.pdf?abstractid=899538&mirid=1&type=2\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID899538_code358088.pdf?abstractid=899538&mirid=1&type=2)

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