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# Interest Rates under Falling Stars

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### Article Information

#### Abstract

Macro-finance theory implies that trend inflation and the equilibrium real interest rate are fundamental determinants of the yield curve. However, empirical models of the term structure of interest rates generally assume that these fundamentals are constant. We show that accounting for time variation in these underlying long-run trends is crucial for understanding the dynamics of Treasury yields and predicting excess bond returns. We introduce a new arbitrage-free model that captures the key role that long-run trends play in determining interest rates. The model also provides

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## Additional Materials

[Replication Package](#)

[Online Appendix \(380.00 KB\)](#)

[Author Disclosure Statement\(s\) \(135.99 KB\)](#)

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## JEL Classification

**E31** Price Level; Inflation; Deflation

**E43** Interest Rates: Determination, Term Structure, and Effects

**E47** Money and Interest Rates: Forecasting and Simulation: Models and Applications

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