A Re-examination of the Predictability of Economic Activity Using the Yield Spread

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This paper revisits the yield spread's usefulness for predicting future real GDP growth. We show that the contribution of the spread can be decomposed into the effect of expected future changes in short rates and the effect of the term premium. We find that both factors are relevant for predicting real GDP growth but the respective contributions differ. We investigate whether the cyclical behavior of interest rate volatility could account for either or both effects. We find that while volatility displays important correlations with both the term structure of interest rates and GDP, it does not appear to account for the yield spread's usefulness for predicting GDP growth.

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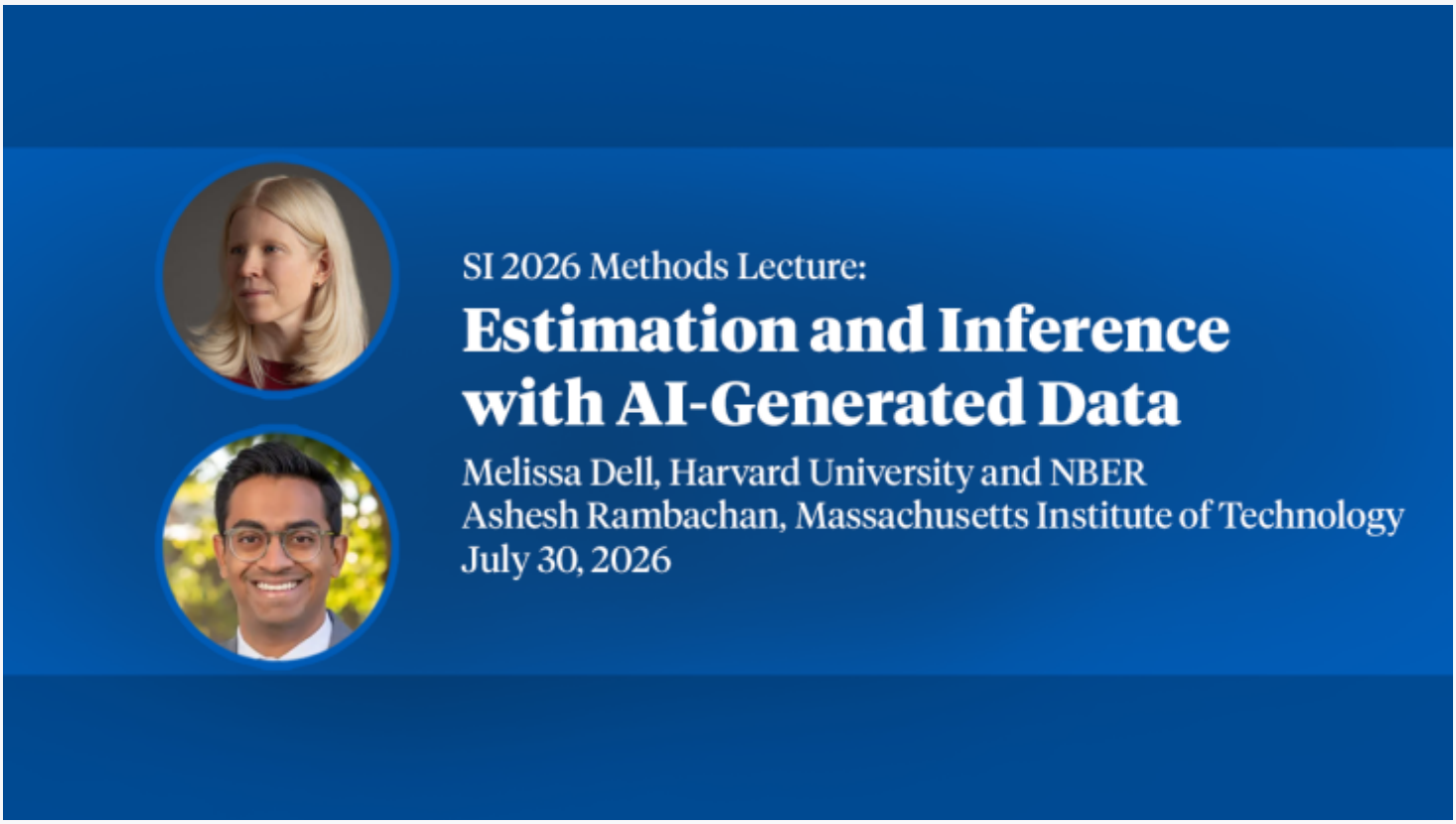


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