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

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WORKING PAPER 7954

DOI 10.3386/w7954

ISSUE DATE October 2000

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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Acknowledgements and Disclosures



Citation and Citation Data



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Hamilton, James D. and Dong Heon Kim. "[A Reexamination Of The Predictability Of Economic Activity Using The Yield Spread](#)," *Journal of Money, Credit and Banking*, 2002, v34(2,May), 340-360. citation courtesy of [RePEc](#)

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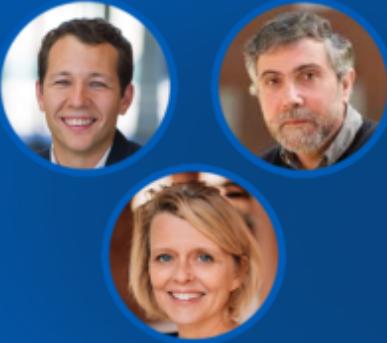
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Supported by the Alfred P. Sloan Foundation grant #G-2023-19633, the Lynde and Harry Bradley Foundation grant #20251294...

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