

Applied Economics >

Volume 47, 2015 - [Issue 19](#)

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Corporate yield curves as predictors of future economic and financial indicators

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Pages 1997-2011 | Published online: 19 Jan 2015

 Cite this article  <https://doi.org/10.1080/00036846.2014.1002898>

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Abstract

The government yield curve is known for its ability to predict the future growth rate of the economy. Later studies showed that credit spreads can assist in predicting macroeconomic behaviour as well. We extend this notion by utilizing corporate yield curves and demonstrating that corporate yield curve spreads can predict future economic growth, the future state of the economy and stock market behaviour. In addition, our sample covers the most recent data available, and it also includes the crash year of 2008 and the recovery period following it. Our results reveal a trade-off effect between the government yield curve, which is a better predictor for long-term forecasting, and the corporate yield curves, which are better predictors for short-term predictions. In addition, we show that both the government and corporate yield curves are more effective in predicting negative rather than positive economic changes.

Keywords:

JEL Classification:

E44

E47

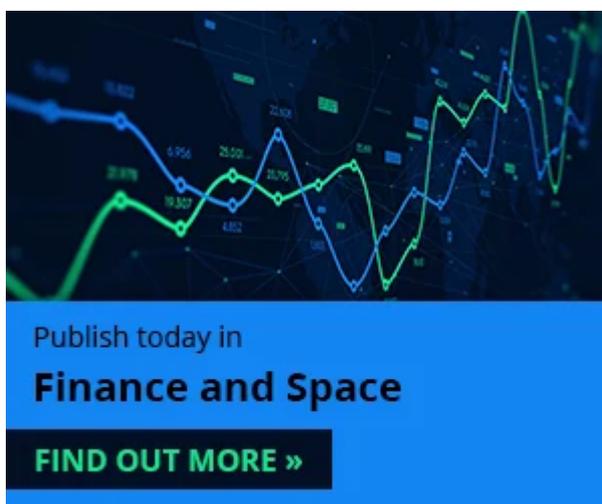
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Notes

¹ Investment grade bonds are considered low risk bonds and are rated BBB-(by S&P or Fitch) or Baa3 (by Moody's) and above.

² Junk bonds are considered high-risk bonds, and are rated lower than BBB-(by S&P or Fitch) or Baa3 (by Moody's).

³ The credit risk represents the probability that the issuer will not be able to pay all obligations when due.



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