

Financial Analysts Journal >
Volume 45, 1989 - Issue 5

79 Views | 21 CrossRef citations to date | 9 Altmetric

Research Articles

Forecasts of Economic Growth from the Bond and Stock Markets

Campbell R. Harvey

Pages 38-45 | Published online: 31 Dec 2018

Cite this article <https://doi.org/10.2469/faj.v45.n5.38>CFA Institute [member access](#) to the Financial Analysts Journal.

Sample our
Economics, Finance,
Business & Industry Journals
>> [Sign in here](#) to start your access
to the latest two volumes for 14 days

Citations

Metrics

Reprints & Permissions

Read this article

About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click "Settings". For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

Forecasts of Economic Growth from the Bond and Stock Markets

Although both stock and bond market data contain information relevant for predicting GNP growth, the bond market delivers more accurate predictions. While yield curve measures are able to explain more than 30 per cent of the variation in economic growth over the 1953–89 period, stock market variables explain only about 5 per cent. Furthermore, forecasts based on the yield curve compare favorably with forecasts from leading econometric models, whereas forecasts from stock market models do not.

Inasmuch as firms' earnings are positively correlated with economic growth, one might expect that stock prices would contain information about real economic activity. But variations in stock prices can reflect both changes in expected economic growth and changes in the perceived risk of stock cash flows. Investors' changing perceptions about the riskiness of cash flows can confound the information about expected economic growth.

A yield-based forecast for the third quarter of 1989 through the third quarter of 1990 suggests a slowing of economic growth, but not zero or negative growth.

THE LINK BETWEEN ASSET markets and real economic growth was formalized by Irving Fisher.¹ Fisher suggested that, in equilibrium, the one-year interest rate reflects the marginal value of income today in relation to its marginal value next year. The intuition is straightforward. If a recession is expected next year, there is an incentive to sacrifice today to buy a one-year bond that pays off in the bad times. The demand for the bond will bid up its price and lower its yield. The theory implies that current real interest rates contain information about expected economic growth.

1. Footnotes appear at end of article.

Campbell Harvey is Assistant Professor of Finance at Duke University's Fuqua School of Business.

The author thanks Eugene Fama, Douglas Foster, Jill Fox, Leonard Silk and Robert Whaley for their helpful suggestions.

This article is based on a working paper by the author, "Yield Spreads, Stock Returns and Real Activity." Research for this paper was sponsored by a summer grant in 1984 from the Center for Research in Security Prices at the University of Chicago.

Similarly, the price of a share of stock is the discounted value of expected cash flows. The strength of the economy determines the magnitude of these cash flows. The price of equity thus reflects expectations of real activity, and changes in the value of equity partially reflect revisions in these expectations.

This article measures the relevant information contained in the bond market and the stock market for forecasting real economic activity. Traditionally, the stock market is assumed to contain important information about the future path of economic growth. The Standard & Poor's 500 stock price index (S&P 500) carries an important weight in the Department of Commerce's widely quoted index of leading indicators. Indeed, many forecasters predicted a recession for 1988 solely on the basis of the stock market crash in October 1987. The results presented here suggest that the bond market reveals more information about future economic growth than the stock market. The bond market forecasts also compare favorably with the predictions of seven major econometric forecasting services.

Log in via your institution

About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click "Settings". For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

PDF download + Online access

- 48 hours access to article PDF & online version
- Article PDF can be downloaded
- Article PDF can be printed

USD 53.00

Add to cart

Issue Purchase

- 30 days online access to complete issue
- Article PDFs can be downloaded
- Article PDFs can be printed

USD 162.00

Add to cart

* Local tax will be added as applicable

Related Research

People also read

Recommended articles

Cited by 21



About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All 

Essential Only

Settings

Information for

Authors

R&D professionals

Editors

Librarians

Societies

Opportunities

Reprints and e-prints

Advertising solutions

Accelerated publication

Corporate access solutions

Open access

Overview

Open journals

Open Select

Dove Medical Press

F1000Research

Help and information

Help and contact

Newsroom

All journals

Books

Keep up to date

Register to receive personalised research and resources by email



Sign me up



Copyright © 2024 Informa UK Limited [Privacy policy](#) [Cookies](#) [Terms & conditions](#)

[Accessibility](#)



Taylor & Francis Group
an informa business

Registered in England & Wales No. 3099067
5 Howick Place | London | SW1P 1WG

About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings