Abstract

Economists often use complex mathematical models to forecast the future path of the economy and the likelihood of recession. But more simple indicators such as interest rates, stock price indices, and monetary aggregates also contain some relevant information about future economic activity. In this thesis we revisit the usefulness of one such indicator, the yield curve or, more specifically, the spread between the interest rates on the ten-year Treasury note and the three-month Treasury bill. By using four different models we examine whether the yield spread has still some predicitve power for future real GDP growth in selected european countries. What is more, we are comparing the predictive power of the yield spread with different variables, both in– sample and out–of–sample. We decompose the yield spread into expectations effect and term premium effect in order to investigate which factor contributes more to predicting real GDP growth. Using modified definition of recession we conclude that that yield spread still contains some useful information for predicting future economic activity, although its predictive power deteriorates.