

Yield Curve Predictions of Australian Growth and Recession

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The paper estimate the slope of the yield curve using quarterly time-series data on real GDP and the nominal spread measured by the difference of the ten year bond rate and the ninety day bill rate. The yield curve estimated using stationary variables gave the best forecasts on real activity as that over a one year or four quarter ahead horizons. Non-nested tests of rival models of alternative financial indicators revealed that the yield curve outperformed other financial indicators as a robust predictor of future real economic activity.

The probit model forecasts of recessions indicated that the inverted slope of the yield curve 4-quarter horizon gave the best recession prediction for Australia. These predictions also gave probability estimates for the occurrence of recessions for different nominal spreads or yield curve slopes. It was revealed that when a dynamic lag structure was incorporated the probit model forecasts of recession probabilities improved dramatically. Empirical evidence demonstrated that the yield curve outperformed other financial indicators as a predictor of a recessions in Australia. The yield curve emerged as a simple and operational tool for predicting recessions.

Key-words: Yield curve. Recessions. Business cycles. Expectations theory. Non-nested tests. Probit models. Dynamic probit models Australia.

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