

How Well Does the Yield Curve Predict Recessions? An International Comparison

Abstract Over the last couple of decades, the yield spread has emerged among economists as perhaps the single most popular predictor of recessions, based mostly on U.S. data. Yet, by the early 2000s, concerns were beginning to be expressed about the structural stability of the yield spread as a recession predictor. In the lead-up to the Great Recession, Wright (2006-07) added additional variables to univariate yield spread models in an effort to improve their forecasting performance, but the real-time results turned out to be poor. Using ECRI's international business cycle chronologies as benchmarks, we investigate the robustness of both univariate and multivariate models incorporating the yield spread as a predictor of recessions in several major economies, in addition to the U.S. The results, indicating that the yield spread is not a reliable leading indicator of international recessions, serve to bolster the earlier concerns about structural stability.