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THE U.S. TERM STRUCTURE AND STOCK MARKET VOLATILITY: EVIDENCE FROM EMERGING STOCK MARKETS

Abstract:

Decomposing the term structure of U.S. treasury yields into two components, the expectations factor and the maturity premium, we examine whether the U.S. term structure contains predictive information over emerging stock market volatility. Based on data from 20 emerging markets, we provide positive evidence that holds even after controlling for country specific factors including turnover and market size. Our findings indicate the market’s expectation of future short term rates, implied by the expectations factor, serves as a stronger predictor of stock market volatility compared to the maturity premium component of the yield spread. Moreover, the predictive power of the U.S. term structure increases following the global financial crisis.

Keywords:

Term structure of interest rates, Stock market volatility, Expectations factor, Maturity premium.

JEL Classification: G14, G15