A Forward-looking Model of the Term Structure of Interest Rates

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We build dynamic term structure models using a generalized structure of observable, forward-looking factors, where the dynamics of multi-horizon survey forecasts of inflation, output growth and monetary policy are modeled jointly with the physical process driving their realizations. When multiple-horizon forecasts drive the short rate, it takes on the novel interpretation of a forward-looking multiple-horizon monetary policy rule, which facilitates a decomposition of monetary policy and the yield curve into short and long horizon expectations. Although short horizon expectations of real output growth are obscured in the cross section of yields, longer horizon growth expectations are strongly manifest in the yield curve's slope. We conclude by exploring the models' implications linking expectations with bond risk premia. Our models provide central bankers and market participants with a tool for linking the dynamic properties of the yield curve with the multiple horizon structure of market expectations, including those possibly imputed to forward guidance.