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Analysis of Latin American Spot Curves: What can we get from the Colombian Spot Curve?

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Some authors have worked on the relationship between macroeconomic variables and the term structure of interest rates. In particular, theory says that the shape of the curve reveals valuable insights regarding the behavior of the macro variables such as inflation and growth expectations. Nonetheless, other studies have proven to be effective in the development of forecasts for inflation and growth just based on the information of other economic variables. This paper shows how the forecast for macroeconomic variables can be improved if financial information implicit in the structure of interest rates is included. In particular, we forecast the Colombian inflation with an economic VAR complemented with the spot curve, which is estimated using Nelson and Siegel's model for interest rates. Additionally, the paper studies the factor decomposition for the spot curve estimated with Nelson and Siegel's model for Brazil, Chile, Colombia, Mexico, and Peru, and the correlations for the curve slope among these countries. This analysis reveals two things: i) correlations between empirical and theoretical values for the Nelson and Siegel's model hold over the pre-crisis period and after the crisis those correlations are broken, and ii) when the slopes' correlation among the countries is high, part of it is driven by external factors.