

Keep in mind

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#### AUTHOR OR EDITOR

Juan Manuel Julio Roman

In order to assess the credibility of their targets and policies, inflation targeting central banks always keep an eye on market expectations of the future inflation rates and short maturity interest rates. In economies with developed financial markets the prices of financial assets are a prime source of expectations. In the absence of options market, the spot curve is thought to contain a great deal of information on market expectations. In this paper we study the possibility of obtaining market expectations on short maturity interest rates, that is, on the future monetary policy. A natural starting point in the program of deriving expectations from the spot curve is the Expectations Hypothesis of the Term Structure of the Interest Rates. According to this hypothesis the forward curve represents the

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market expectations on interest rates aside from a negligible or at least time invariant forward term premium. For this note we developed a unique database of spot curves spanning the period from Nov-1999 to Sep-2006 in order to test the validity of the Expectations Hypothesis for short maturities in Colombia. Our results indicate that the spot curve contains information on the future behavior of short maturity interest rates only for very short horizons. However, we found that the forward term premium tend to be time varying. These results comprise in the rejection of the Expectations Hypothesis. Although these results imply that market expectations on future short maturity interest rates can not be obtained applying the prescription of the Expectations Hypothesis.

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