Yield curve and the business cycle in conventional times

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Recent advances in macroeconomics and finance describe a world in which the central bank operates in efficient bond markets but faces financially constrained hand-to-mouth house-holds. This paper explores the properties of such an economy with respect to macro and yield curve data. A parsimonious asset pricing structure, in which only one factor is priced, accounts for a number of stylized facts. The key restrictions are that volatility is welfare neutral and bond-trading agents use financial markets mainly to hedge consumption risk, not move resources across time. Intertemporal substitution thus describes neither household behavior nor (approximately) asset pricing