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Economic Analysis

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**Uncertainty Shocks and the Term Structure of Interest Rate – A Cross-Country Comparison
with Dynamic Latent Factor Approach**

How does the yield curve respond to shocks of financial and macroeconomic uncertainty? I investigate this question by estimating vector-autoregressive models (VAR) on US, Germany, Japan and UK zero-coupon yield data. The smooth curves are obtained with the parsimonious method of Diebold and Li [2006], where the factors represent the level, slope, and curvature. The jumps of both macroeconomic and financial uncertainty - as measured by Jurado et al. [2015] and Jurado et al. [2019] – are associated with a negative and significant response of the entire yield spectrum, but the short-end is found to be more responsive. Rolling-window analysis showed that this curve steepening phenomenon exhibits substantial dynamic variations, which can partly be a consequence of the zero lower bound monetary policy. Incorporating inflation and industrial production revealed that macroeconomic fundamentals account for a large share of yield variations following uncertainty jumps. My findings are consistent with various interpretations, such as with those emphasizing investor's expectations, monetary actions or decreased labor demand in uncertain times. My results remain robust to various data treatments, however, the exogeneity assumption on uncertainty is found to bear large empirical importance.