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**The expectations hypothesis: New hope or illusory support?**


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**Abstract**

Recent studies of the expectations hypothesis of the term structure (EHTS) find evidence in favor of the EHTS using post 1980s US data. This has been attributed to the relative macro stability of this period and greater market efficiency. Using a panel of forecasts for 3-month interest rates for ten countries we test separately for EHTS and rational expectations. Assuming rational expectations holds we find support for the EHTS is illusory due to an offsetting time-varying term premia and non-rational expectations. Previous forecast-based studies suggest biased expectations tend to reinforce the effect of a time varying term premium. This change can be understood in the context of Fama's (2006) argument that markets tend to underestimate future spot rates during periods of long-run increases and overestimate during declines. © 2012 Elsevier B.V.

**Author Keywords**

Expectations hypothesis; Rational expectations; Term structure

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