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THE EFFECTS OF US MONETARY POLICY ON THE YIELD CURVE

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The central bank of the U.S., the Federal Reserve, oversees the financial system in the country and is in charge of maintaining monetary and financial stability. Its main purpose is to dampen economic business cycle fluctuations and ensure optimal functioning of different financial institutions. The policy tool it uses in this process is termed monetary policy. This is conducted by the Fed through purchase and sale of U.S. Treasury securities with the public – a procedure referred to as open market operations. U.S. Treasury securities are classified in three categories, bills, notes and bonds, with maturity periods varying from less than a year to thirty years. A yield curve shows the plot of interest rates of these securities with their corresponding time to maturity. The yield curve of treasuries is important because it holds forecasting powers about expected inflation rates, interest rates and economic growth. Using quarterly data spanning over the last four decades, this study examines the impact of monetary policy on the slope of the yield curve. Fed policy making is captured by using different measures – size of the Fed's balance sheet, money supply growth rate.