Working papers-economics - Public Debt, Fiscal Deficit Expectations, and Their Transmission to the Cyclical Component of Long-Term Interest Rates

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Deteriorations in public debt and in the expected fiscal deficit generate statistically significant increases in the cyclical component of the long-term real interest rate and a steepening of the yield curve.

Publication Date: Wednesday, 27 of May 2026 **Approach**
This study examines the role of public debt dynamics and fiscal deficit expectations in determining the cyclical component of Colombia's 10-year TES real interest rate and the slope of the yield curve. Drawing on FocusEconomics surveys of local and international analysts, we construct a series of fiscal deficit expectations for the period 2005–2025 and estimate Bayesian VAR models with exogenous variables and time-varying parameters (TVP-BVARX), which allow us to document variations in the intensity of transmission throughout the sample.

Contribution
Empirical evidence on the effect of fiscal expectations on long-term interest rates is scarce for small, open emerging economies such as Colombia. This study contributes to the literature on two fronts. First, it constructs a consistent series of fixed-horizon fiscal deficit expectations from the FocusEconomics survey, enabling the identification of shocks to the expected fiscal stance. Second, it provides evidence on the mechanisms through which public debt and fiscal expectations are transmitted to the cyclical component of long-term real rates and to the slope of the TES yield curve, documenting changes in the intensity of this transmission in the post-COVID-19 period.

Deteriorations in public debt and in the expected fiscal deficit generate statistically significant increases in the cyclical component of the long-term real interest rate and a steepening of the yield curve.

Results
The paper presents three main findings. First, deteriorations in public debt and in the expected fiscal deficit generate statistically significant increases in the cyclical component of the long-term real rate and a steepening of the yield curve. Second, the magnitude of the transmission has intensified in the post-COVID-19 period, consistent with an environment of higher debt levels and persistently elevated deficits. Third, the historical and variance decompositions indicate that fiscal shocks account for a relevant share of recent fluctuations in both variables, underscoring the importance of fiscal credibility in determining the cost of public borrowing.

Fuente: https://d1b4gd4m8561gs.cloudfront.net/en/publications-research/working-papers-economics/public-debt-fiscal-deficit-expectations