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Abstract

In this article, we study the impact of exchange rate depreciation and volatility on the sovereign yield curve during the 2008 - 2020 timeframe. We do this by estimating univariate and multivariate time series models and a threshold vector autoregressive model. Our findings support the presence of nonlinearities in the relationship between the exchange rate risk and the yield curve level and slope. The bearish steepening resulting from a depreciation shock is doubled when the depreciation and volatility are above the threshold, however when the volatility is high the impact is bigger and lasts longer. Contrary to linear models, an increase of the level of the public debt has a significant impact on the yield curve level as sovereign bonds have been devalued during periods of high exchange rate volatility. Besides, our results suggest that in presence of a risk aversion shock, investors appreciate low volatility rather than low exchange rate depreciation.