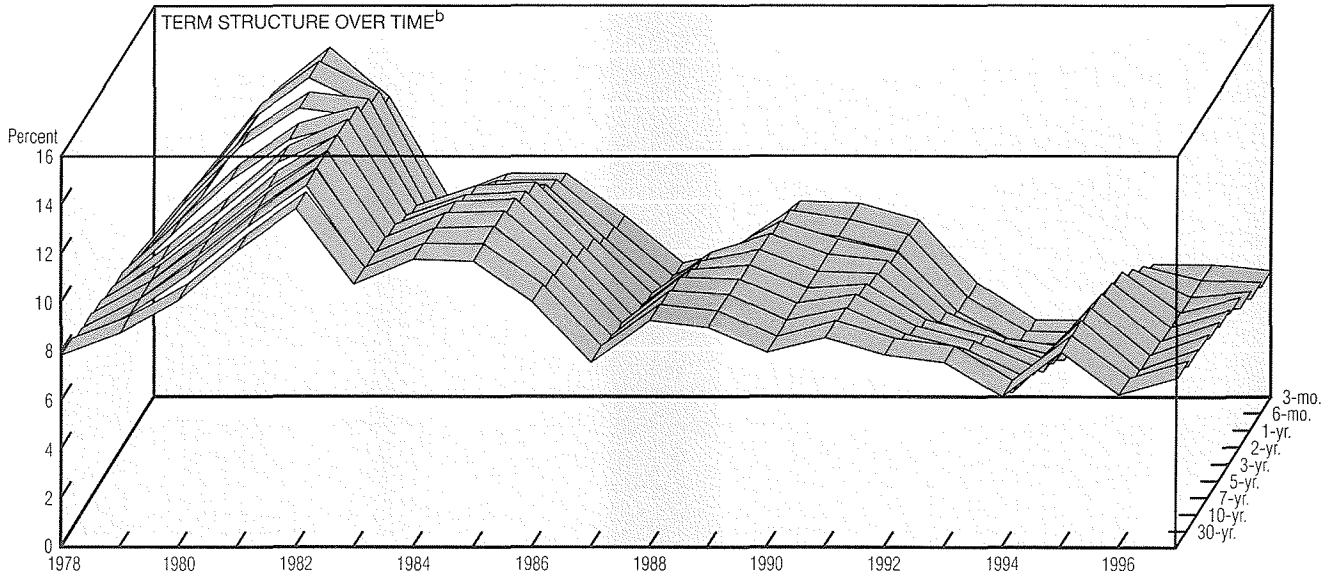
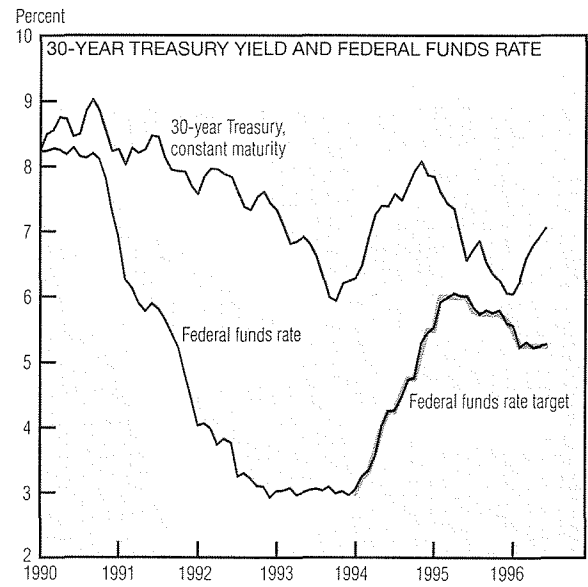
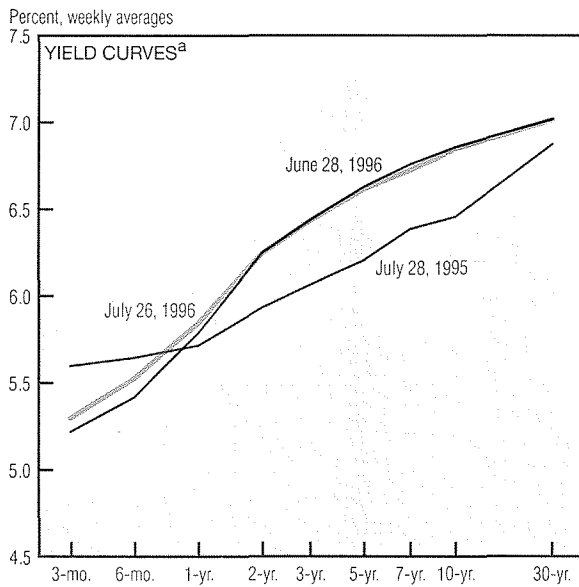


Interest Rates



a. Three-month and six-month instruments are quoted from the secondary market on a yield basis; other instruments are constant-maturity series.
 b. End-of-period quarterly averages of daily data. All observations are fourth-quarter data except 1996, which is for the second quarter.
 SOURCE: Board of Governors of the Federal Reserve System.

The yield curve has flattened slightly in the past month, with short rates rising and long rates unchanged. The rate on 3-month Treasury bills moved up seven basis points to 5.3%, but 30-year bonds showed no change. The closely watched 3-year, 3-month spread stands at 114 basis points, well above the historical average of 80, and the popular 10-year, 3-month spread stands at 155, also above its mean of 120. As a rough indicator of future economic growth, the relatively steep yield curve is

consistent with above-average activity over the next four quarters. Although the yield curve has steepened since 1995, it may still look flat in relation to the extreme values reached earlier this decade, as the chart comparing 30-year Treasury yields and the federal funds rate (literally the long and the short of it) shows. It's worth noting that in contrast to much of the decade, when the federal funds rate was positively associated with the long rate, in 1996 the rates have diverged.

Tracking the yield curve is fundamentally a three-dimensional problem, because the curve both twists and shifts up and down over time. A 3-D perspective indicates that the big rise in 1994 was not a parallel shift. It also shows how the high but inverted curve of 1981 first steepened in 1982 and then dropped downward. On the other hand, it allows us to see how inversions occurred as a result of short rates rising, not long rates falling.