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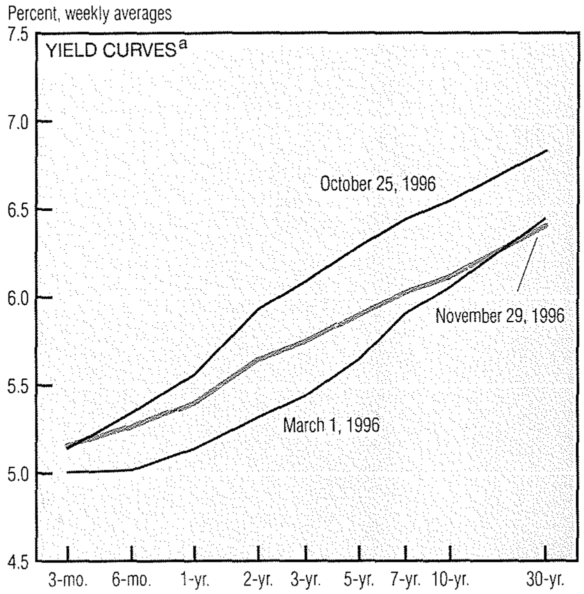
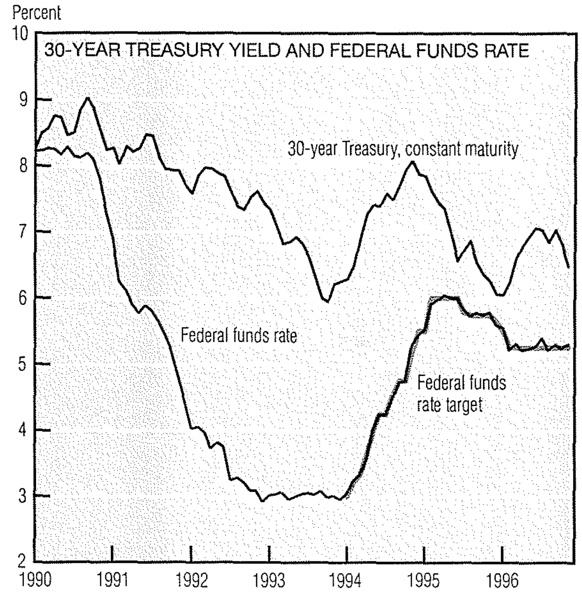
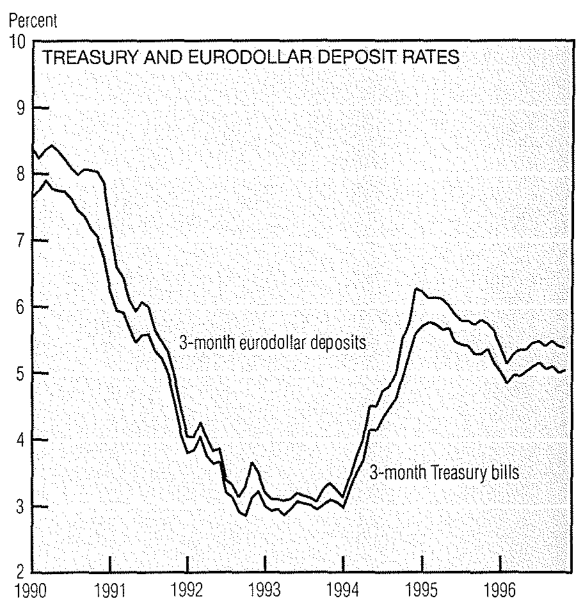
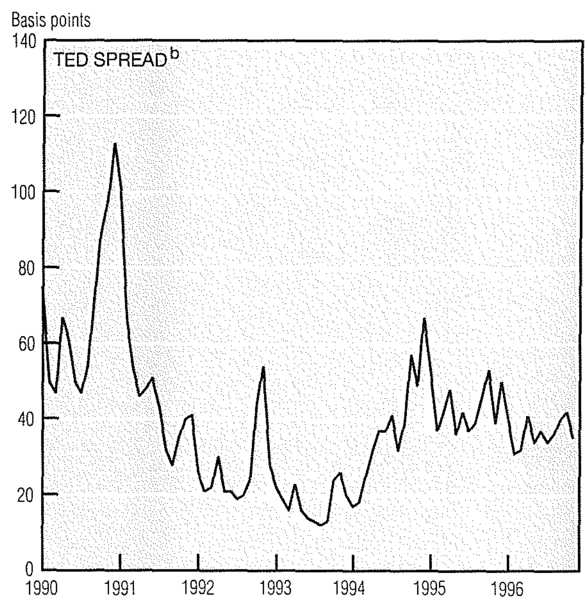
Interest Rates









a. All instruments are constant-maturity series.
b. The TED spread is the 3-month eurodollar rate minus the 3-month Treasury bill rate.
SOURCE: Board of Governors of the Federal Reserve System.

The yield curve on U.S. Treasuries has flattened noticeably since last month, with long rates falling but short rates remaining steady. Among the closely watched spreads, the 3-year, 3-month spread has dropped to 59 basis points, below its 30-year average of 80 basis points, and the 10-year, 3-month spread has fallen to 96 basis points, below its average of 120. The flattening of the 10-year, 3-month spread also portends a slowdown (though not a recession) in real economic growth.

Looking more closely at the extremes of the yield curve—30-year bonds and overnight federal funds—we see the pattern of declining long rates and flat short rates repeated. This occurred despite no change in "policy," if the federal funds rate in fact indicates policy. Of course, expectations about future rates may change even if today's rate doesn't. The recent flattening could also reflect reduced inflation fears, greater confidence that the Federal Reserve will keep rates low, or decreased uncertainty over the future course of the economy.

Another closely watched indicator is the TED spread, the difference between interest rates on Treasury securities and eurodollar instruments of the same maturity. Eurodollar rates are generally higher, since they embed the default risk of the issuing bank. The TED spread thus acts as an indicator of investors' relative confidence, which in turn links it to gold prices and exchange rates, two measures that also reflect concerns about confidence.