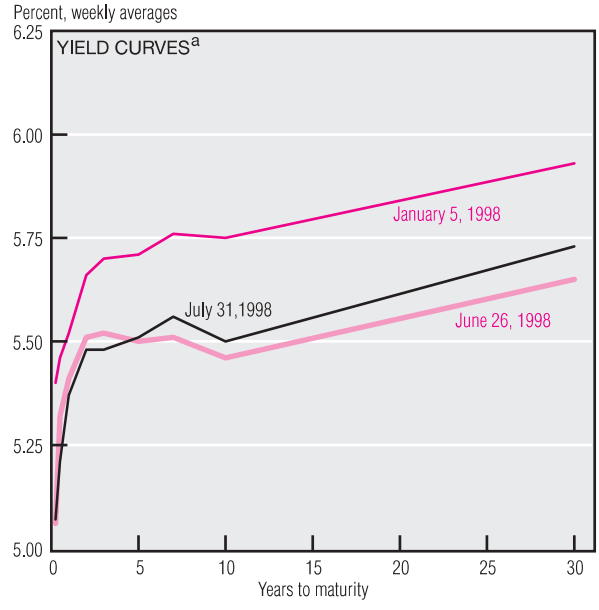
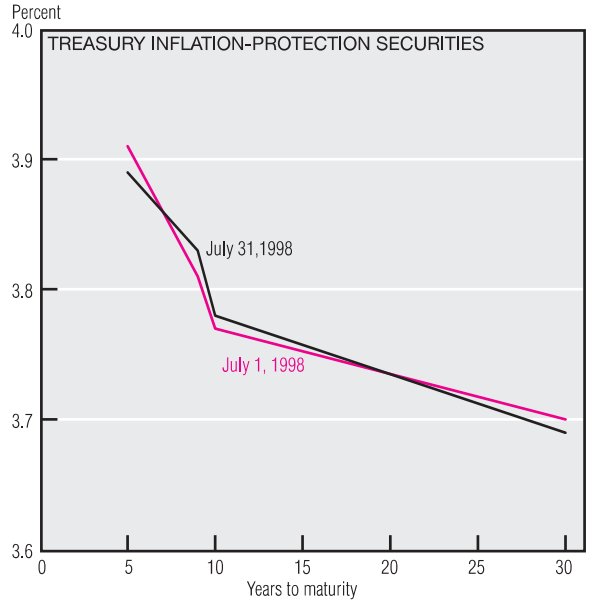
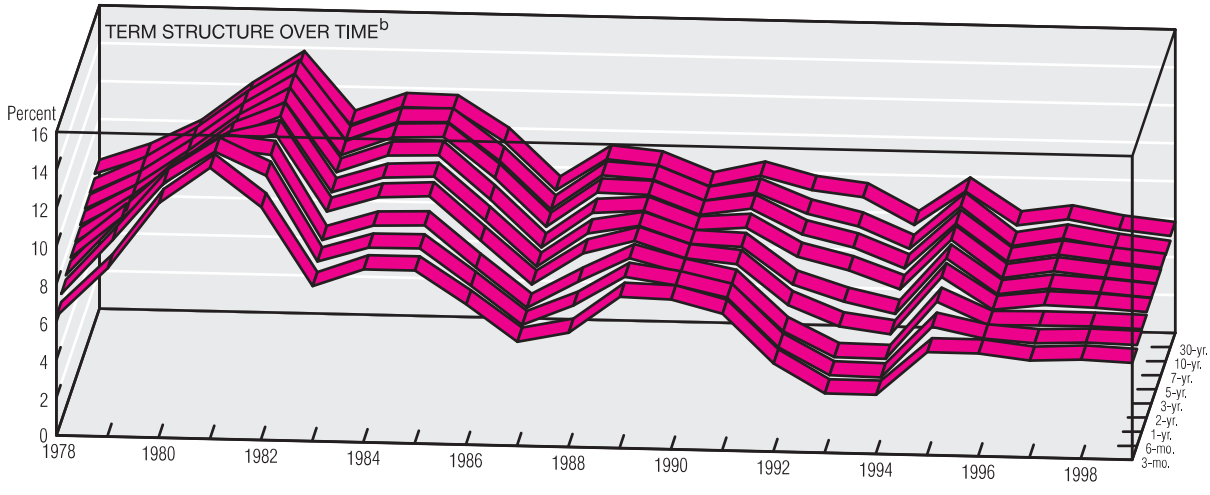
Interest Rates







a. All instruments are constant-maturity series.
b. End-of-period quarterly averages of daily data. All observations are fourth-quarter data except the final one, which is for 1998:IIQ.
SOURCE: Board of Governors of the Federal Reserve System.

The yield curve has moved only slightly since last month, the biggest shift being a decrease of 11 basis points in the 6-month yield. Spreads are mixed, with the 3-year, 3-month spread falling from 46 to 41 basis points, and the 10-year, 3-month spread increasing from 40 to 43 basis points. Both remain well below their historical averages of 80 and 120 basis points.

The traditional yield curve plots nominal interest rates. With the advent of Treasury Inflation-Protection Securities at maturities of 5, 9, 10, and 30 years, it is now possible to plot a yield curve for real interest rates, that is, for bonds whose payout is indexed to the inflation rate. Real interest rates are not available for all maturities, but comparing the real and nominal yield curves remains instructive. The real yields are uniformly lower than the nominal yields; as they are protected against inflation, real yields show no "inflation premium," the extra return required by investors who worry that a dollar will buy less in 2028. The real yield curve also slopes downward, suggesting that the upward slope of the nominal curve derives from investors' expectation that their purchasing power will deteriorate more in 30 years than in 5 or 10.

A bird's-eye view of the yield curve's shifts over the past two decades emphasizes the relative placidity of the recent bond market. Compared to the beginning of the year, the yield curve seems to have made some significant drops and twists, but the movement looks much less impressive when placed in its historical context.