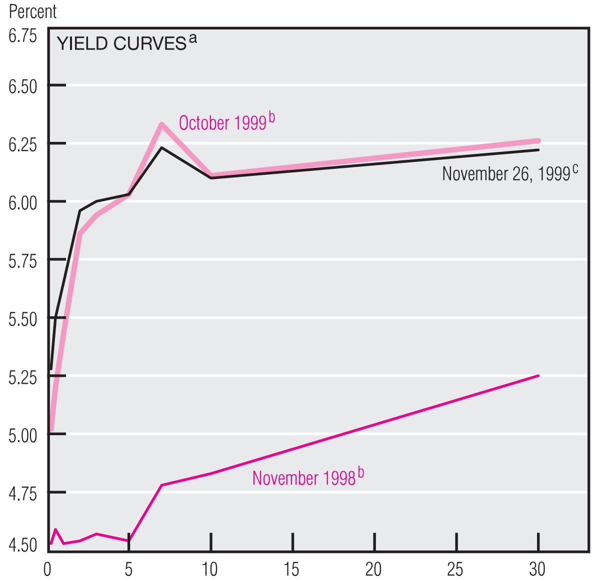
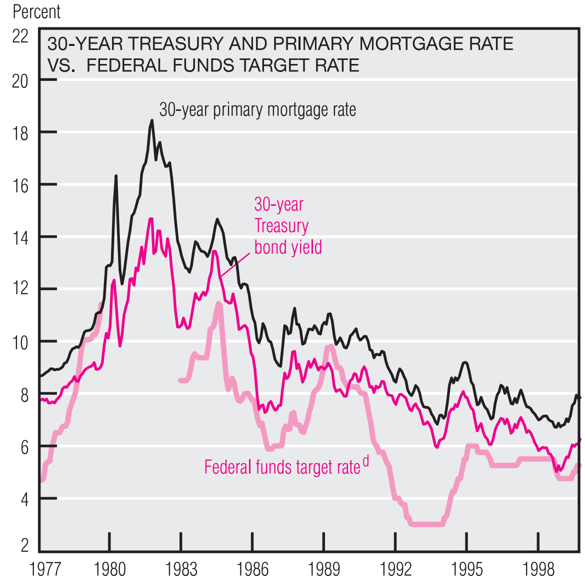
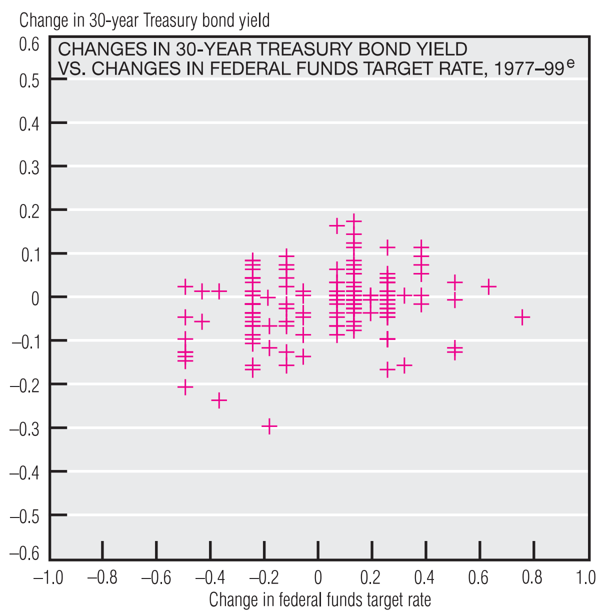
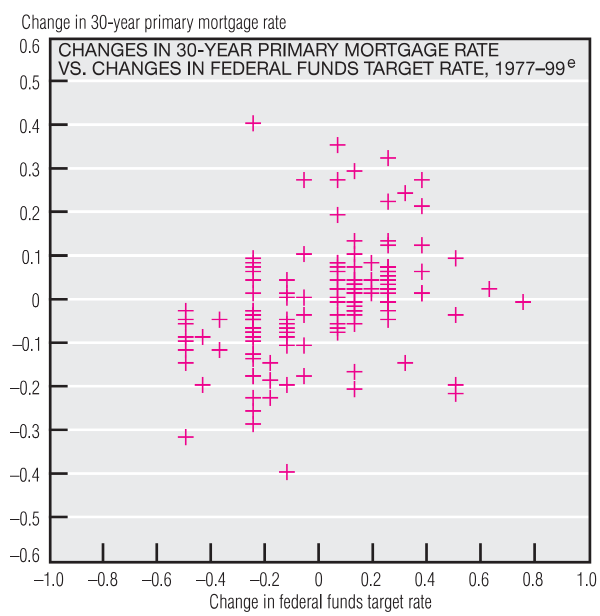
Interest Rates









a. All yields are from constant-maturity series.
b. Monthly averages.
c. Average for the week of November 26, 1999.
d. Between October 1979 and January 1983, the policy target was a quantity of money, not an interest rate.
e. Percentage point change for the week in which the federal funds target rate was changed.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases,* H.15; and Glenn D. Rudebusch, "Federal Reserve Interest Rate Targeting, Rational Expectations, and the Term Structure," *Journal of Monetary Economics,* vol. 35, no. 2 (April 1995), pp. 245–74.

The long end of the yield curve has shifted downward slightly since last month, whereas the short end has shifted upward. For the last full week of November, the 3-month and 6-month Treasury bill rates were 26 and 30 basis points (bp) higher than their October values. The 3-year, 3-month spread is down to 72 bp from 92 in October, and the 10-year, 3-month spread is down to 82 bp from 109. Although their predictive power is somewhat limited, these spreads indicate some concern about inflation over the short run.

On November 16, 1999, the Federal Open Market Committee announced an increase of 25 bp in the federal funds target rate. Many commentators argue that increases in the target rate cause long-term capital market rates to rise, thus driving out potential borrowers. Since April 1977, the FOMC has raised the target rate 99 times and lowered it 65 times. To these 99 increases, the 30-year Treasury bond rate responded positively 51 times and negatively 34 times; the 30-year primary mortgage rate responded positively 63 times and negatively 18 times. In response to the 65 rate cuts, the 30-year Treasury bond rate moved in the same direction 41 times and in the opposite direction 24 times; the 30-year primary mortgage rate moved in the same direction 52 times and in the opposite direction 13 times.

Thus, although these rates show a moderate tendency to move together, the numbers do not support the argument that a higher target rate always means higher long-term capital market rates.