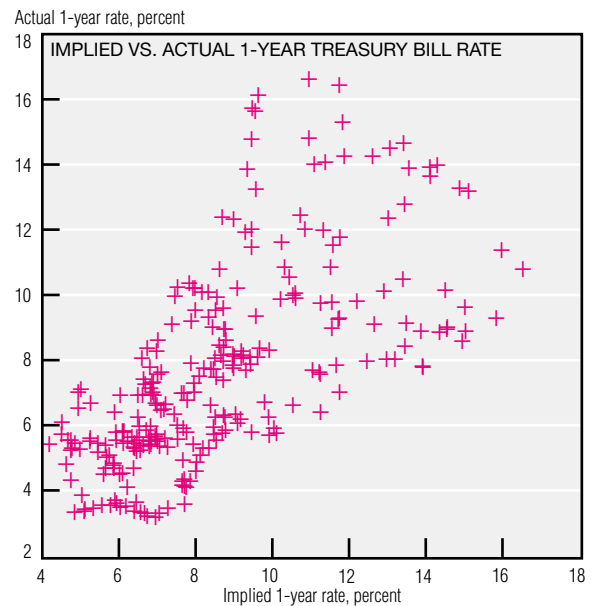
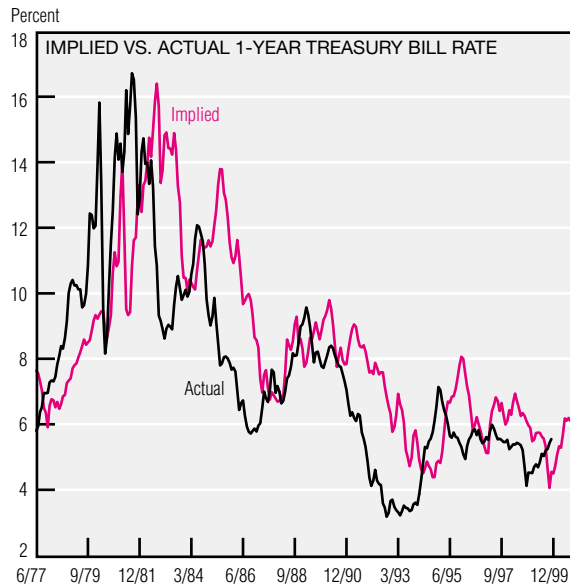
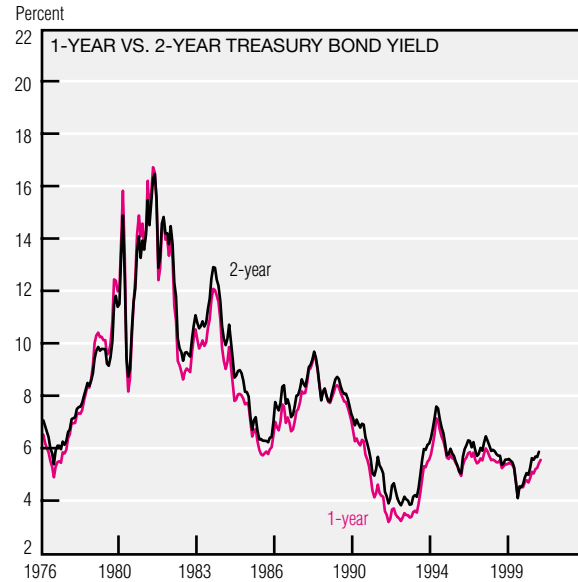
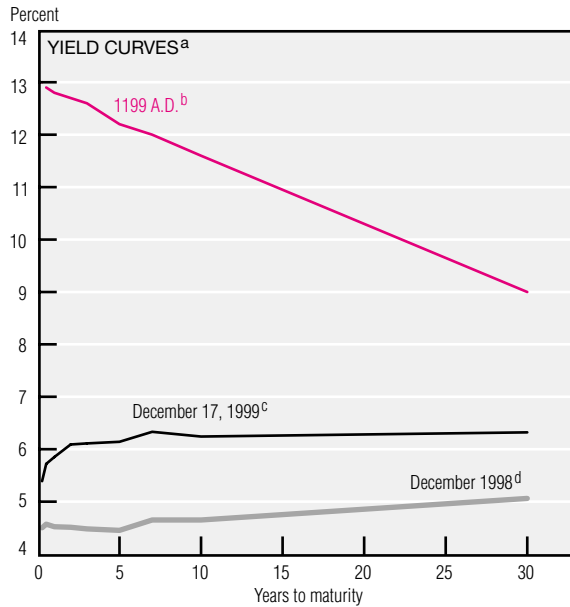


Interest Rates



a. All yields are from constant-maturity series.

b. Yearly averages for 1199 A.D., derived from 3-month and 30-year interest rates in the Netherlands.

c. Weekly averages for the week of December 17, 1999.

d. Monthly averages.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15.; and Sidney Homer and Richard Sylla, *A History of Interest Rates*, 3d ed. New Brunswick, N.J.: Rutgers University Press, 1991.

Over the course of 1999, the yield curve moved higher and steepened, resuming its normal upward slope from a position of relative flatness at the end of 1998. The 3-month yield moved from 4.5% to 5.39%. The 3-year, 3-month spread increased from -2 basis points (bp) to 72 bp, and the 10-year, 3-month spread increased from 15 bp to 85 bp. The extent to which this indicates stronger real growth, higher inflation expectations, or increased uncertainty remains unclear.

January 2000 seems a fitting time

to take a longer-term view of the yield curve as well. The earliest known yield curve of the millennium was recorded in twelfth-century Netherlands. Short-term commercial loans bore rates of 10%–16%, while longer-term loans, mainly annuities and mortgages, bore rates of 8%–10%. Amidst the hype about the Internet and the "new economy," consider that a commercial world without the computer, the light bulb, or even the printing press established interest rates not all that different from our own.

A common question about the term structure of interest rates is how well implied forward rates predict future interest rates. This question arises from the expectations hypothesis of the term structure, which posits that long-term rates are the average of expected future short-term rates. A look at 1- and 2-year Treasury-bond rates shows that the prediction is not very good. Indeed, long rates tend to be high when current short rates are already high, not when future short rates will be high.