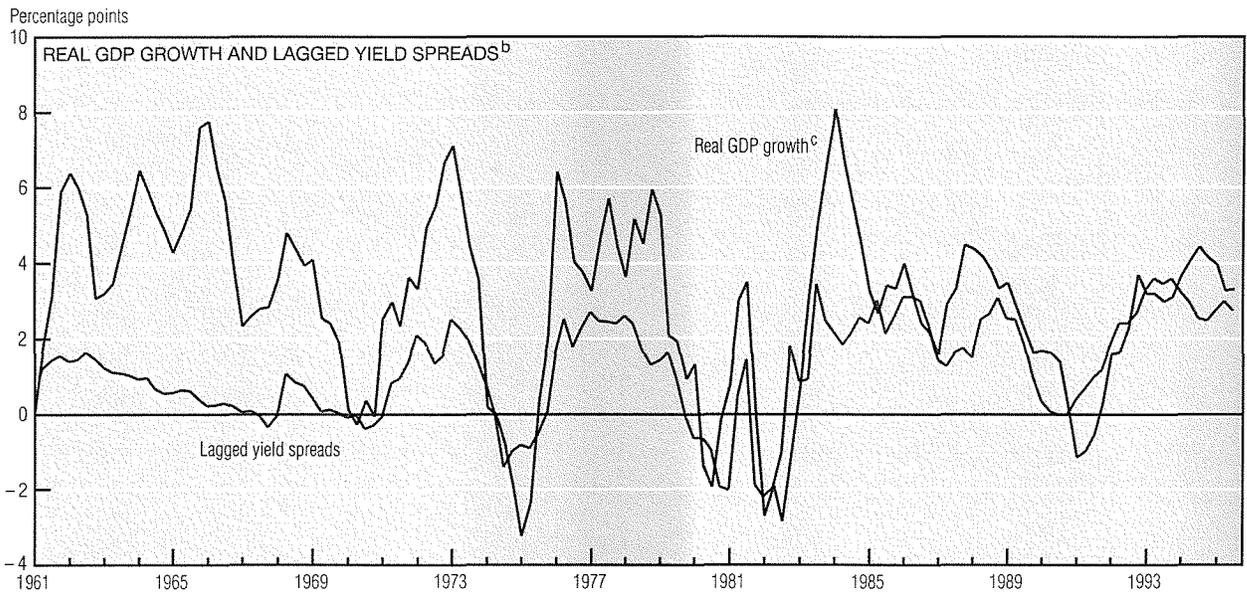
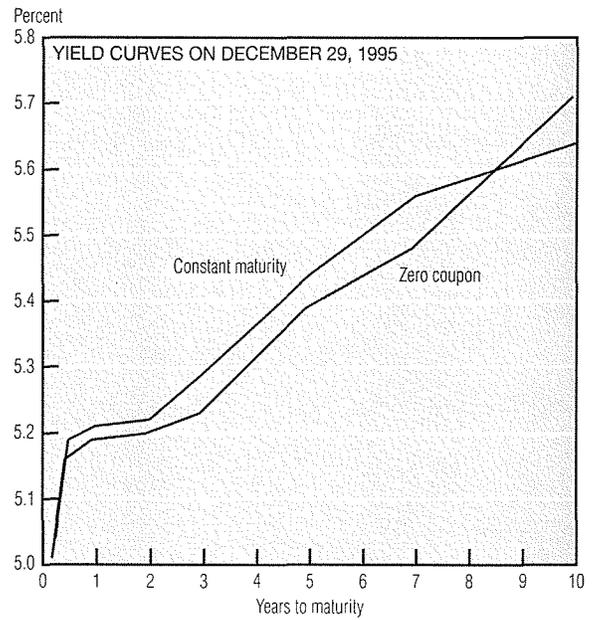
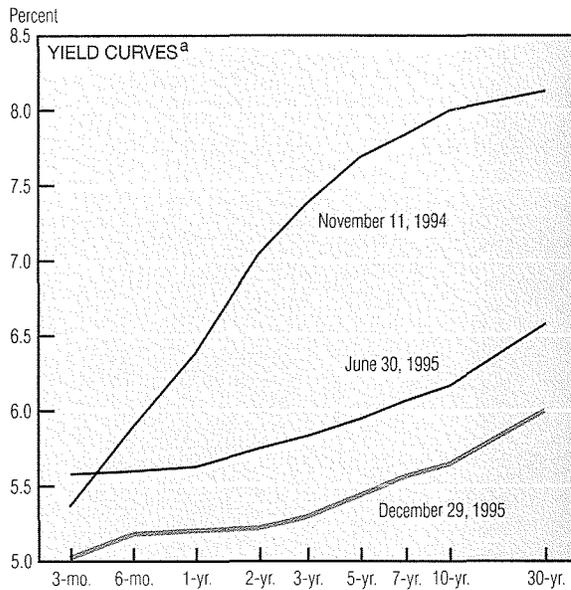


Interest Rates



a. Three-month, six-month, and one-year instruments are quoted from the secondary market on a yield basis; all other instruments are constant-maturity series.
 b. The yield spread is defined as the 10-year Treasury yield minus the 3-month Treasury yield, and is lagged one year.
 c. Year-over-year change.
 SOURCES: Board of Governors of the Federal Reserve System; U.S. Department of the Treasury; and U.S. Department of Commerce, Bureau of Economic Analysis.

Interest rates continue to fall. Rates at all maturities have dropped roughly half a point since late June. Long-term rates have fallen by 2 percentage points since their cyclical peak in November 1994, and more recently, short-term rates have also headed lower. The sharp decline in medium-term rates has not only flattened the yield curve, but has given it an uncharacteristic shape: steeper at the long end.

Care must be taken in interpreting yield curves. The standard constant-

maturity data put out by the Treasury Department are only an estimate of yields, because it is rare to find bonds maturing in exactly seven years, for example. In addition, these yields are for coupon bonds, including twice-yearly coupons. The yields on zero-coupon bonds provide a somewhat cleaner measure, despite the complications of tax differences and lower market liquidity. The two curves are similar, although the zero-coupon curve is somewhat steeper and generally lower.

Yield spreads, particularly inversions, are often used to forecast recessions. Plotting the lagged spread between 10-year and 3-month Treasuries and the growth rate of real GDP shows that inversions often do precede recessions, but that the relationship is also broader. Low spreads indicate low real growth and high spreads indicate high real growth. The relationship is neither one-to-one nor completely precise, however, so caution in using it is warranted.