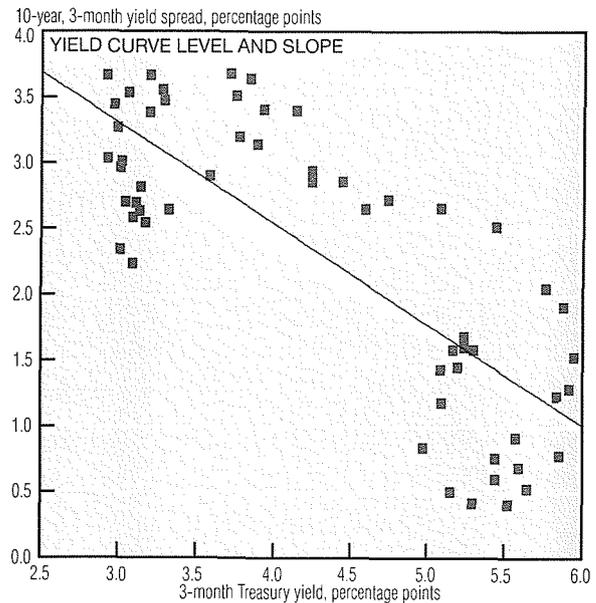
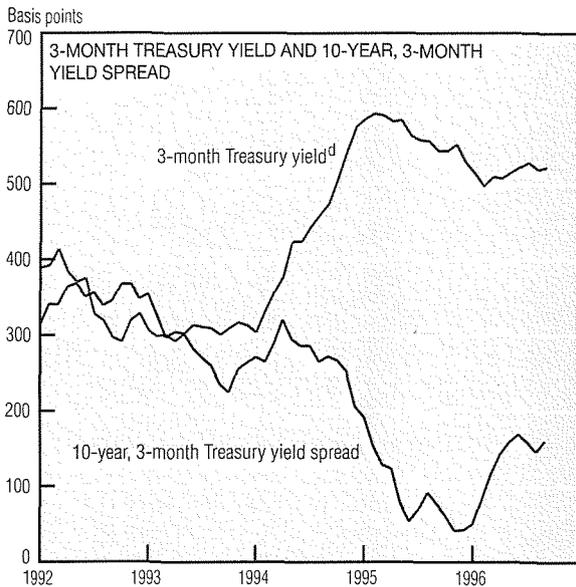
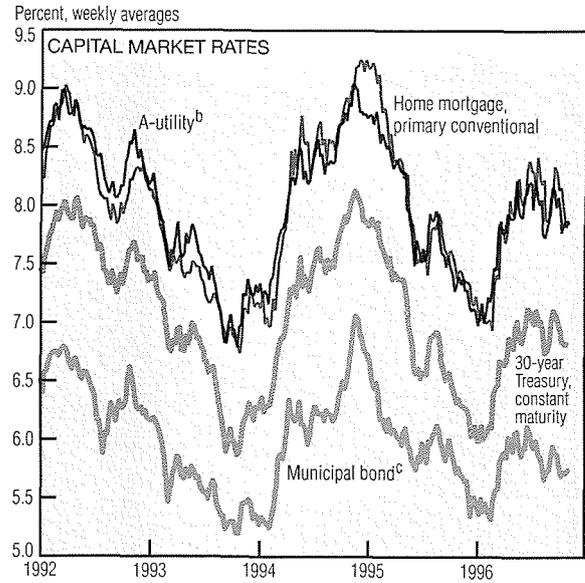
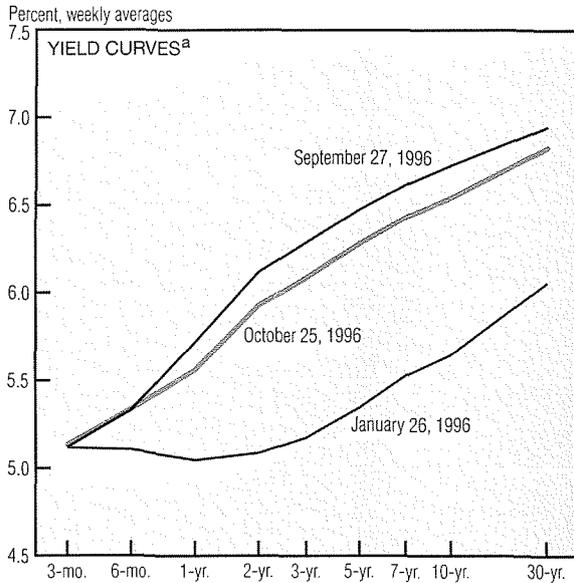


# Interest Rates



a. All instruments are constant-maturity series.  
 b. Estimate of the yield on a recently offered, A-rated utility bond with a maturity of 30 years and call protection of five years.  
 c. Bond Buyer Index, general obligation, 20 years to maturity, mixed quality.  
 d. Three-month instrument is quoted from the secondary market on a yield basis; 10-year instrument is a constant-maturity series.  
 SOURCE: Board of Governors of the Federal Reserve System.

The yield curve has flattened since last month, with all rates falling except those on short-term bills of three and six months. The 3-year, 3-month spread dropped to 95 basis points and the 10-year, 3-month spread fell to 141 basis points. Despite this decline, the yield curve remains steeper and straighter than it was at the beginning of the year.

Longer-term capital market rates have been moving down since early September. At one extreme, utilities have fallen by 30 basis points; at the

other, state and local bonds have dropped by only 11. This has closed the spreads between utilities and other rates, even pushing utility rates below mortgages. A longer perspective confirms the yield curve picture—long rates in the broad market remain significantly above their January level.

Is there any relation between the level of the yield curve and its slope? When the short rate rose in 1994, the yield spread initially rose with it. Market observers attributed this to

predictions of even larger future increases, heightened inflation fears, or greater uncertainty over rates. Soon the pattern reversed, however, conforming to the generally negative relationship between short rates and the yield spread. A higher short rate usually means a flatter yield curve, since long rates do not increase by quite as much. This represents a tendency, however, not an exact relationship, and 1996 saw the spread widen despite little change in short-term rates.