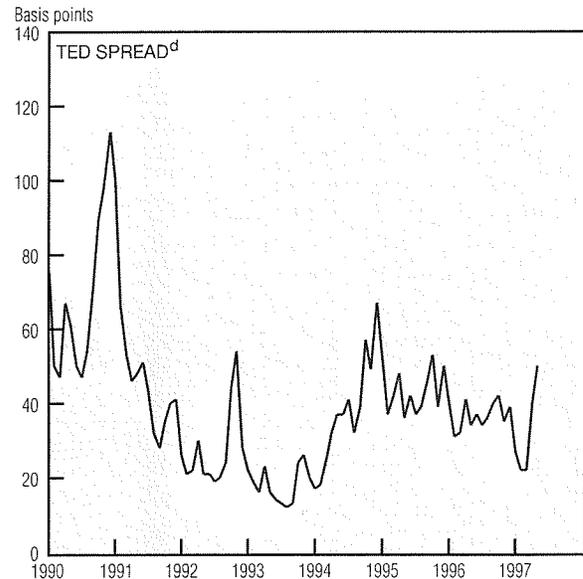
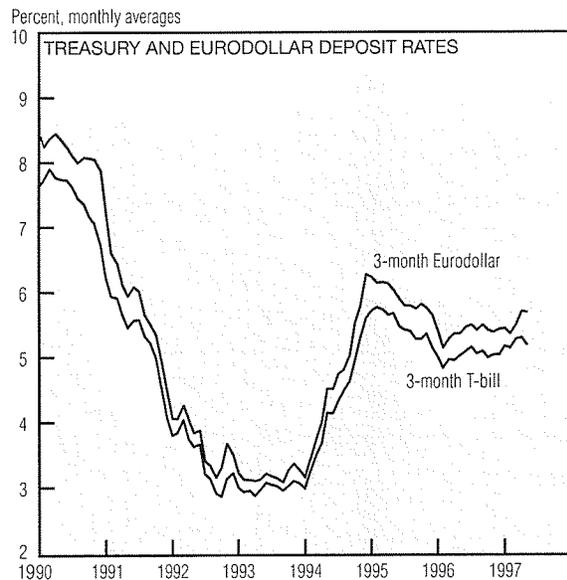
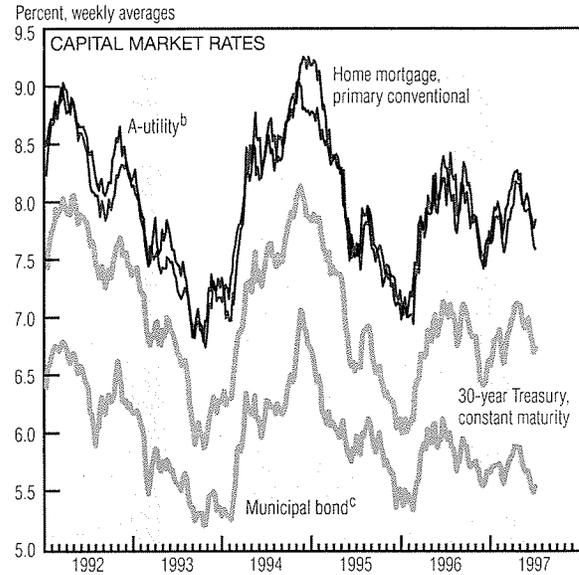
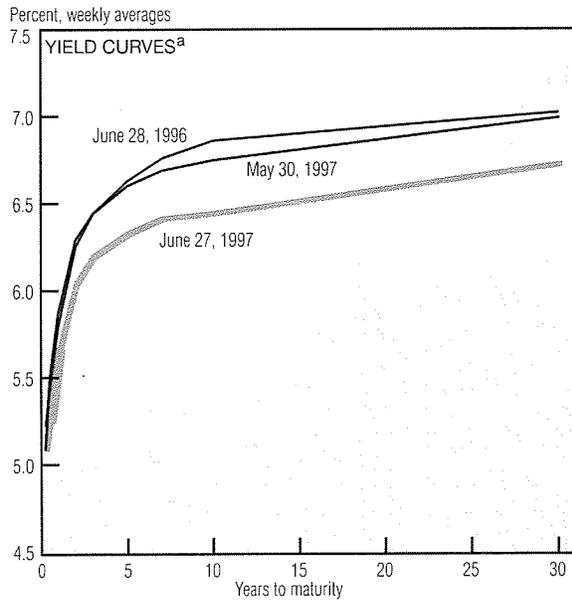


Interest Rates



- 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. The TED spread is the 3-month Eurodollar rate minus the 3-month Treasury bill rate.
SOURCE: Board of Governors of the Federal Reserve System.

The yield curve has flattened noticeably since last month. Although rates have fallen at all maturities, longer rates have dropped more, tightening up spreads. The 3-year, 3-month spread declined from 135 to 110 basis points, and the important 10-year, 3-month spread fell even further, from 166 to 135 basis points.

Longer-term capital market rates have also headed down, with mortgage, utility, and 30-year Treasury bond rates all falling roughly 30 basis points and narrowing their spreads against municipal bonds. One possible explanation for the

decline in long rates is reduced inflation expectations, but lower long-term real rates could also be caused by decreased uncertainty about future economic growth.

In addition to term spreads, or differences in the yields on bonds of different maturities, investors and market analysts also watch risk spreads, or differences between bonds with different risks. One of the most closely watched risk spreads is between Treasury and Eurodollar rates, known as the TED spread. Part of this measure's attractiveness is that it reflects risk and un-

certainty about overseas deposits without the complication of exchange rate risk. A casual glance suggests that Treasury and Eurodollar rates track each other closely, but a more thorough examination of the data reveals an active spread. (Note, for instance, the large spike around the onset of the Gulf War.) The TED spread has been widening in 1997, perhaps reflecting the international financial uncertainty caused by disputes over the introduction of the Euro or the transfer of Hong Kong to Chinese rule.