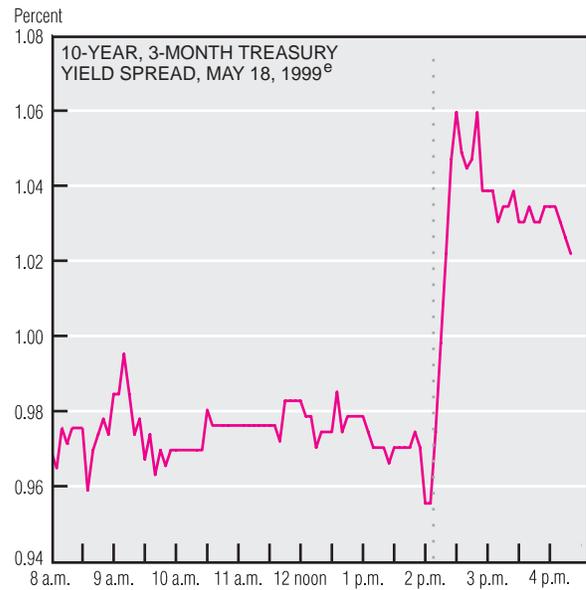
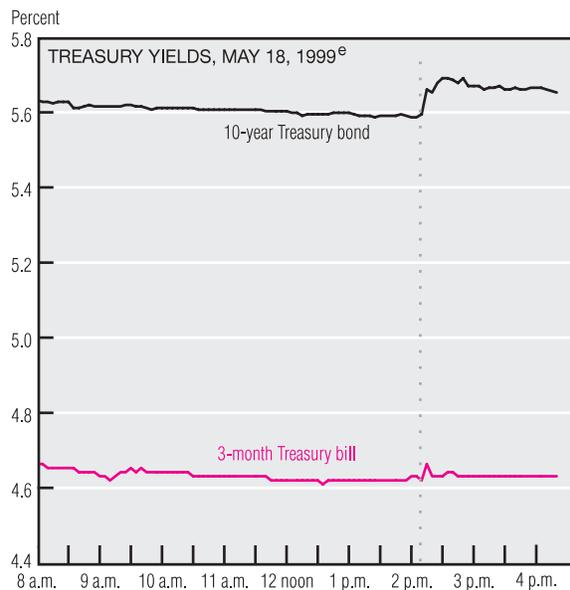
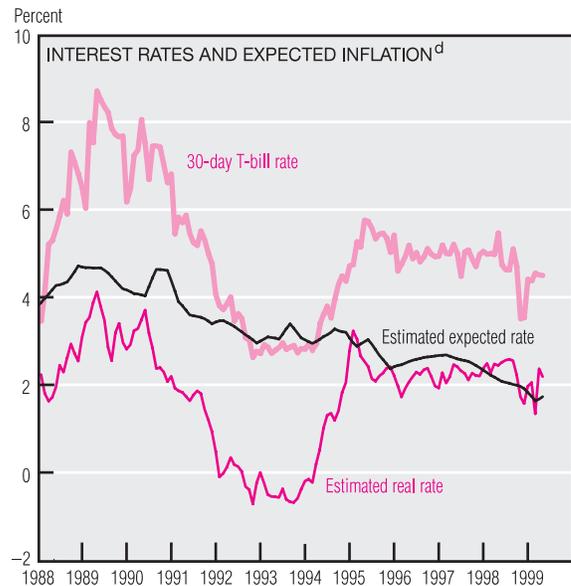
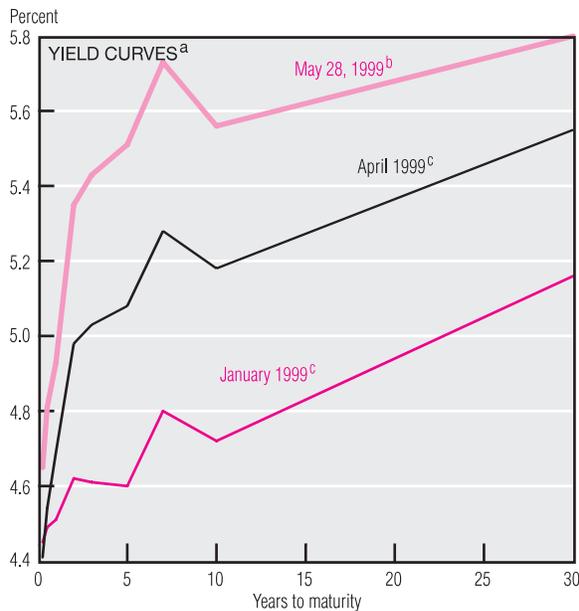


Interest Rates



- a. All yields are from the constant-maturity series.
 b. Weekly averages for the week of May 28, 1999.
 c. Monthly averages.

- d. Real rates and expected inflation are estimated from 30-day market yields and the Survey of Professional Forecasters' inflation projections using a Kalman filter model.
 e. The dotted lines mark the time of the FOMC announcement on May 18 (2:11 p.m., Eastern Daylight Time).

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters*; and Bloomberg information services.

Since April, the yield curve has shifted upward and steepened, but it remains fairly flat by historical standards. The 3-year, 3-month spread increased from 62 to 78 basis points, and the 10-year, 3-month spread from 77 to 91. These remain below the historical averages of about 80 and 120 basis points.

Across the board, rates have moved higher since the turn of the year. A model that uses 30-day rates and professional forecasts attributes much of that change to increases in the real rate of interest. The model's estimate of expected inflation shows a decrease since January and

only a small increase (5 basis points) in recent months. A measure of longer-term inflationary expectations—the spread between yields on 10-year nominal Treasury bonds and Treasury inflation-protection securities—has shown larger gains, moving from 86 basis points in January to 191 on June 1.

On May 18, shortly after 2:00 p.m. (Eastern Daylight Time), the Federal Open Market Committee issued a statement that it had "adopted a directive that is tilted toward the possibility of a firming in the stance of monetary policy." Changes in the bond yields at five-minute intervals

show that this announcement had an immediate impact on bond markets. Yields made a noticeable, if not dramatic, increase at the time of the announcement; the 10-year, 3-month yield spread also jumped. It seems a stretch to attribute this effect solely to expectations of Fed tightening, which should have a larger impact on the shorter rates. Perhaps the announcement created longer-run uncertainty about Fed policy or indicated to the market that the Fed has adverse information about longer-term risks, such as inflation.