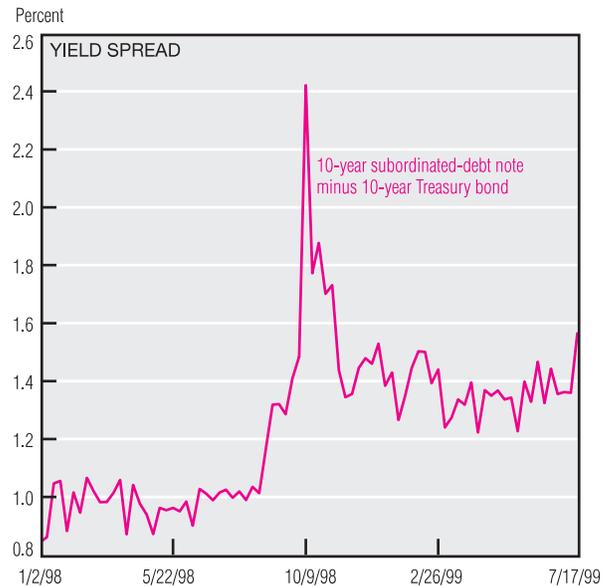
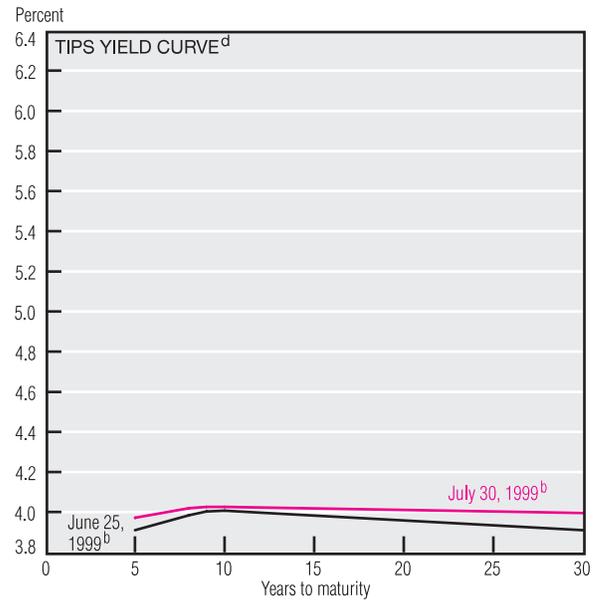
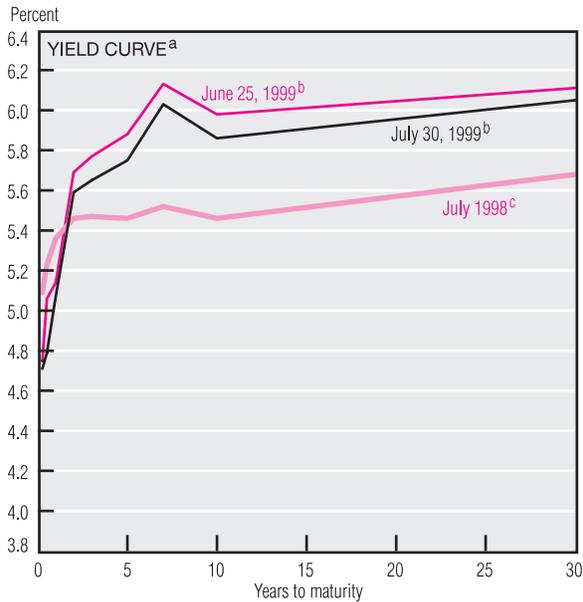


Interest Rates



- a. All yields are from constant-maturity series.
- b. Weekly averages.
- c. Monthly averages.
- d. Treasury inflation-protection securities.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; and Bloomberg Financial Information Services.

The yield curve has flattened slightly since last month. Short rates have fallen a mere nine basis points, but long rates have fallen more: The 3-year, 3-month spread has slipped from 101 to 94 basis points, and the 10-year, 3-month spread has dropped from 122 to 107. The curve retains its recent hump shape, with 7-year rates higher than 10-year rates. Interestingly enough, a yield curve of real rates based on Treasury inflation-protection securities (TIPS) shows no hump at all between five and 10 years. This may

suggest some market concern about inflation at intermediate horizons.

Not all securities are as safe as U.S. Treasuries, and that's why most of them bear higher yields. The spread between the yields is often taken as a measure of private bonds' default risk, and by extension as a measure of the issuing firm's health. Recently, academic economists and others have floated proposals to use the spread as a device for assessing the health of banking organizations.

The idea is that regulators could

use the spread on bank holding companies' subordinated debt (it is "subordinated" to deposits because depositors get repaid first) as a possible early-warning device. The spread between the average subordinated-debt yields on five money-center banks increased after the Russian default in August 1998 and spiked upward shortly after the rescue of Long Term Capital Management in late September. Though currently below last fall's levels, the spread remains approximately 50% higher than it was before those difficulties.