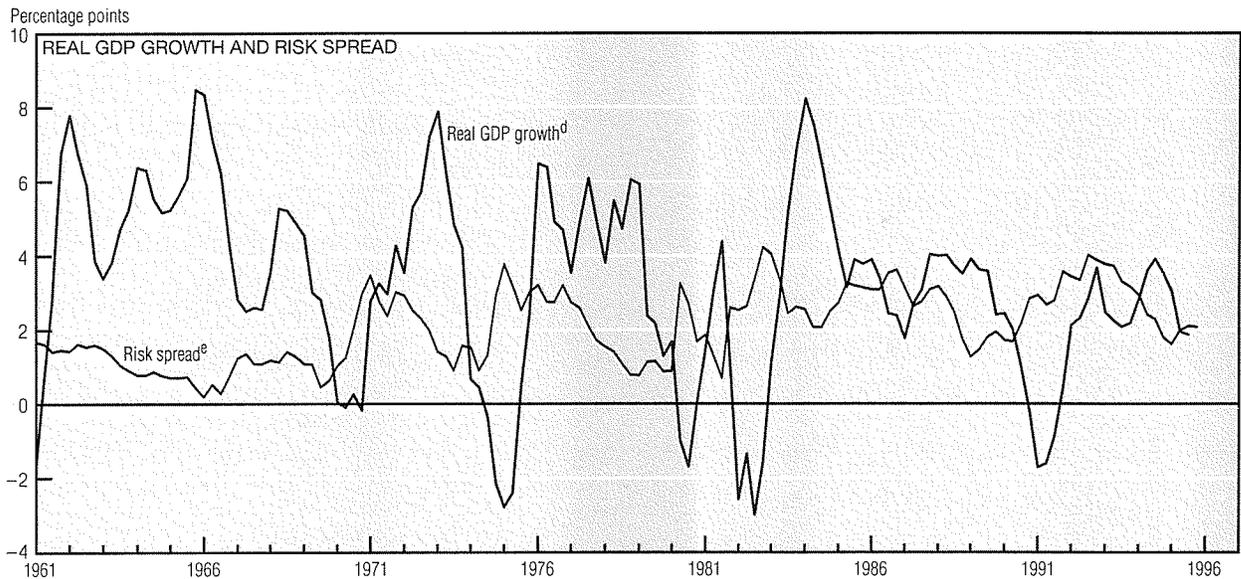
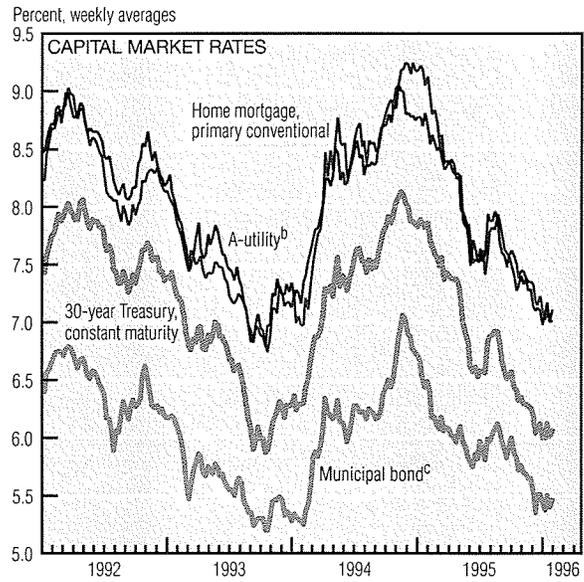
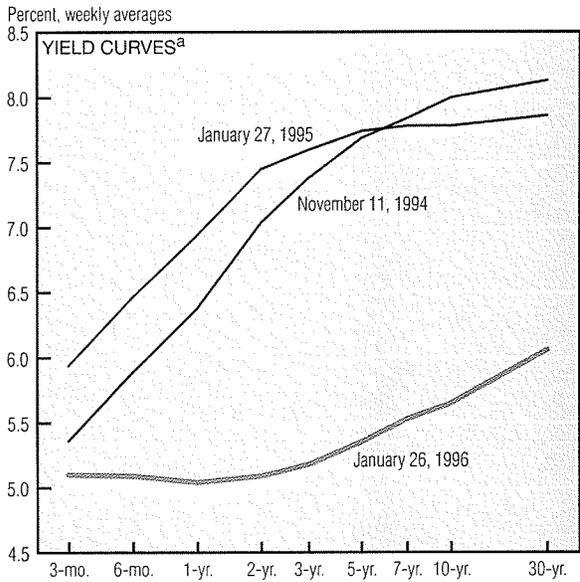


Interest Rates



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. 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. Percent change from corresponding quarter of previous year.
 e. Yield on Moody's seasoned Baa-rated corporate bonds minus yield on three-year Treasury, constant maturity.
 SOURCES: Board of Governors of the Federal Reserve System; and U.S. Department of Commerce, Bureau of Economic Analysis.

Interest rates across the board have come down sharply in the past year, but this drop has not been completely even, as the flattening of the yield curve shows. Medium-term rates have dropped more than long- and short-term rates. The extreme steepness of the yield curves of late 1994 and early 1995 dramatizes the flatness of the current yield curve: The spread between 10-year and 3-month yields is now 55 basis points, less than half the 35-year average of 120 basis points, and far below the

264 points of November 1994. The slight inversion at shorter rates has some people worried about a recession and others happy about successful inflation control.

Rates have fallen across asset classes as well as maturities. Rates on home mortgages, utility bonds, and municipal bonds have all dropped in step with the long Treasury bond. Again, although the drop looks dramatic, a similar one occurred in 1992-93.

Along with the term structure, an-

other useful indicator is the risk structure of interest rates—the difference in yield between bonds of differing riskiness. The bottom chart plots the spread between Baa-rated corporate bonds and 3-year Treasury notes, as well as real GDP growth. The so-called “risk spread” serves more as an indicator of recessions and negative growth than as a predictor. In the 1990s, even this relation has become suspect, perhaps because of deepening in the financial markets.