Interest Rates

In the last month, the yield curve has shifted upward and steepened somewhat, with long rates pushing to 6.95%. Since the beginning of the year, the curve has become noticeably steeper; in fact, two-year rates have increased more than 30-year rates. The 3-year, 3-month spread has increased from six basis points to 117 (the average is 80), and the 10-year, 3-month spread has increased from 43 basis points to 161 (the average is 120). The fears expressed early this year about a sustained inversion have not been confirmed.

Not unexpectedly, the coupon yield curve and the zero-coupon yield curve continue to track one another closely. Zeros generally have the higher rate, because the coupons give the other bonds a shorter duration—and hence a lower yield, given the upward tilt to the term structure. For shorter maturities, where this is less of a problem, the coupon yields exceed the zero yields, though only by a few basis points. Even at 10 years, however, the spread is no more than 10 basis points.

This year’s increase in the 10-year, 3-month yield spread contrasts with another spread that is often looked to for predictions—the one between corporate Baa bonds and 10-year Treasuries, which has narrowed by nearly 30 basis points since January. Overall, this risk spread shows less volatility than the yield spread, partly because it does not turn negative. Its most pronounced historical feature is a tendency to spike upward in recessions, reflecting the heightened chance of corporate bankruptcy and default on the bonds in times of stress.