In September, the yield curve on government securities moved noticeably lower (about 20 basis points), but retained its general shape. The weekly average of the 3-month constant-maturity series moved below 5%. The 5-year, 3-month spread moved from 85 basis points to 91, while the other closely watched spread, the 10-year, 3-month, held steady at 110 basis points. Longer-term capital market rates also headed down, returning to the low levels seen last December, and spreads were little changed.

Two important and complementary indicators of the economy’s direction are the spread between the 10-year and 3-month Treasuries, a term spread, and the spread between Baa-rated corporate bonds and the 10-year Treasury, a risk spread. The common wisdom is that term spreads predict future economic activity, signaling recessions by inverting. The risk spread serves as a more contemporaneous indicator, since corporate bonds presumably become riskier than government bonds as the economy worsens.

Certainly, these connections are not precise: No recession materialized until long after the term-spread inversion of 1966, and risk spreads in the 1980s often exceeded recession levels of even the 1950s and 1960s. Both types of spreads currently indicate a healthy economy—now and in the immediate future.