4 things you need to know about the yield curve

MATTHEW GOLDBERG  @MATTATBANKRATE  SEPTEMBER 25, 2018 in INVESTING

Forecasts are everywhere.

In the morning, you wake up and check the weather. On the way to work, you check the traffic.

In economics, there’s also an important barometer – and it could be signaling a recession. If short-term yields surpass the yields of longer-term notes, it represents an inverted yield curve.
“The inverted yield curve has predicted every recession dating back to the late ’60s,” says Greg McBride, CFA, Bankrate’s chief financial analyst. “... So it’s worth paying attention to.”

Here are four things to know about the yield curve.

1. A flattening yield curve may be a warning sign
The flattening of the yield curve occurs when increasingly there is little difference between a short-term Treasury and a longer-term note. A flat yield curve is when a short-term Treasury has a similar yield compared with a long-term Treasury.

The popular comparison is between the 10-year Treasury and the two-year Treasury. About a year ago, there was a 79-basis-point spread between the two, with the 10-year treasury at around 2.22 percent and the two-year treasury around 1.43 percent. Today, there is only a 27-basis-point difference, with the 10-year treasury near 3.08 percent and the two-year note around 2.81 percent.

The flattening yield curve represents the tightening of credit. As the difference between short-term rates and long-term rates disappears, it’s more profitable for banks to buy investments than to lend the money, McBride says.

“And credit is really the lifeblood of an economy, as we learned in 2008,” McBride says.

2. An inverted yield curve has predicted the past seven recessions

If the two-year Treasury is higher than the 10-year Treasury, this is an inverted yield curve. Under normal circumstances, a longer-term Treasury should have a higher yield than one with a shorter time horizon.

“It’s a warning sign,” McBride says. “... As the yield curve flattens — as short-term interest rates come up, that makes it more likely that you could see an economic slowdown. If the bond market’s already expecting slow economic growth above inflation, what kind of headwind do rising short-term rates present to that?”

Even though comparing the 10-year Treasury and the two-year Treasury is a common comparison, there are other comparisons to use.

“The real sort of tell in terms of recession predictor is the difference – the spread between three-month and 10-year,” McBride says. “I mean, that too is narrowing.”
An inverted yield curve is important because it precede the past seven recessions, according to Campbell Harvey’s research. Harvey, a professor of finance at Duke University, says the model of comparing the 90-day bill to the five-year Treasury has an excellent track record for identifying recessions.

“This model, over the time span I’ve looked at it, has not had a false signal yet,” Harvey says. “And ‘yet’ is a very important word because this is only a model. And we know models are just models – they’re simplifying the world.”

3. If the yield curve is inverted – on average – for a quarter, that might be a concern

If there is an inversion for a few days during a quarter – but the quarterly average isn’t inverted – then Harvey’s model wouldn’t forecast a recession.

Harvey says he wrote his 1986 doctoral dissertation at the University of Chicago about the yield curve, focusing on the comparison between the spread between the five-year note and the 90-day Treasury bill. The latter length is key, because it equals the time in a quarter.

“In my model I’ve matched a quarterly GDP, so I’m very careful when I calculate my interest rates — I want a rate that’s the average over the quarter,” Harvey says.

4. There are more economic indicators than just the yield curve

No matter which long-term and short-term Treasury you’re comparing, past results don’t guarantee future outcomes.

Since models are imperfect, Harvey says you never want to put all of your eggs in one basket.

Harvey says macroeconomic data or interest data, such as credit spreads, can offer a look at forward guidance, such as looking at the spread between corporate bond yields and a government bond yields.
“Some people get nervous; maybe orders aren’t coming in at the same rate and people within firms know this,” Harvey says. “The spreads head up. So a widening spread is bad news.”

Risk increases because in a recession the firm is not as likely to be able to meet its obligations, Harvey says. New orders for capital equipment, measuring construction orders or permits are also forward-looking items to look at.

“So the permits go down, then you know the construction is not gonna be happening,” Harvey says.

Learn more:

- [What this savvy investor learned from the last recession](https://www.bankrate.com/investing/what-to-know-about-the-yield-curve/)
- [Best brokerage bonuses](https://www.bankrate.com/investing/what-to-know-about-the-yield-curve/)
- [Bankrate’s brokerage reviews](https://www.bankrate.com/investing/what-to-know-about-the-yield-curve/)
- [Roth IRA calculator](https://www.bankrate.com/investing/what-to-know-about-the-yield-curve/)
- [401(k) retirement calculator](https://www.bankrate.com/investing/what-to-know-about-the-yield-curve/)
# Best Savings Accounts & Rates – October 2018

**Account:** Minimum: APY:

<table>
<thead>
<tr>
<th>Bank</th>
<th>Minimum</th>
<th>APY</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIT Bank</td>
<td>$100</td>
<td>2.15%</td>
</tr>
<tr>
<td>Marcus* Goldman Sachs</td>
<td>$1</td>
<td>1.90%</td>
</tr>
<tr>
<td>Synchroeny Bank</td>
<td>$0</td>
<td>1.90%</td>
</tr>
</tbody>
</table>

**CIT Bank**

- 2.15% APY requires a Deposit of $100+/month or $25k+ balance.
- Savings Account
- **Oct 5, 2018**

**Marcus* Goldman Sachs Bank USA**

- No minimum deposit and no transaction fees. Easy online access.
- Savings Account
- **Oct 5, 2018**

**Synchroeny Bank**

- Great Rates + Safety = Peace of Mind
- Savings Account
- **Oct 5, 2018**

---

# Recommended
Two Savings Accounts That Pay 10 Times What Your Bank Pays
This Incredible Card Offers 0% APR Until Nearly 2020
Here's How You Can Maximize Your Returns, Without Risk

You may also like

https://www.bankrate.com/investing/what-to-know-about-the-yield-curve/
Should you sell home without agent?

How to buy silver
How to become a millionaire in 7 easy steps

8 fantasy island homes for sale

Move over, Bitcoin. The world of virtual currencies is getting crowded with altcoins.

These days, there are about 20 types of cryptocurrency that sell for more than $1, according to CoinMarketCap.com. Even more are in penny-stock range.

Here are 12 cryptocurrency alternatives to Bitcoin. Prices
12 cryptocurrency alternatives to bitcoin

5 ways to create a passive income stream

Related Articles

Billionaire list -- the 10 youngest billionaires in the world

Promising places to buy rental properties

5 tips to investing in and buying gold coins
5 alternative investments for fat returns

Passive income streams - how to make passive income

Recommended

Two Banks That Pay 10 Times the Interest on Your Savings
An Outrageous Card Offering 0% Interest Until Nearly 2020

Here's How You Can Maximize Your Returns, Without Risk
How we make money

Bankrate.com is an independent, advertising-supported publisher and comparison service. Bankrate is compensated in exchange for featured placement of sponsored products and services, or your clicking on links posted on this website. This compensation may impact how, where and in what order products appear. Bankrate.com does not include all companies or all available products.


You have money questions. Bankrate has answers. Our experts have been helping you master your money for four decades.

Our tools, rates and advice help no matter where you are on life's financial journey.