A possible recession signal flashed on Friday. It's called an inverted yield curve. Many economists believe that when yields on long and short term treasury debt invert, a downturn is likely to follow.

AUDIE CORNISH, HOST:

The bond market has been flashing a warning sign in recent days. The interest rate on long-term government debt has dipped below the rate on short-term bills. That's often a signal that a recession could be on the horizon. NPR's Scott Horsley explains.

SCOTT HORSELY, BYLINE: Ordinarily, if you're willing to tie up your money for five or 10 years in a certificate of deposit, for example, you receive a higher interest rate than you would on a three-month CD. The payoff for people who buy government debt usually follows the same pattern. Economists call this the yield curve. The longer you're willing to wait, the higher interest rate, or yield, you can typically expect.

(SOUNDBITE OF WHISTLE)
CAMPBELL HARVEY: The normal behavior of yield curve is that the longer-term rates are higher than the shorter-term rates.

HORSLEY: But Duke University finance professor Campbell Harvey says there are moments when that ordinary pattern turns on its head.

(SOUNDBITE OF WHISTLE)

HORSLEY: That's when the yield on the government's short-term debt is higher than the yield on long-term Treasury notes.

HARVEY: We don't see that occur that often. But when it does, it's almost always bad news.

HORSLEY: That's why warning lights started flashing on Friday when the yield on the 10-year Treasury note slipped below that of the three-month bill. The last time that happened was just before the Great Recession. Harvey's been keeping a close eye on these inverted yield curves for more than 30 years as a kind of early warning signal.

HARVEY: My indicator has successfully predicted four of the last four recessions.

HORSLEY: Now, Harvey only gets really nervous about a looming recession when the yield curve stays inverted for at least three months. This one's only been upside-down for a couple of days. Still, Harvey says even a flat curve can be a signal that the economy is losing steam.

HARVEY: It might be that we dodge a recession, but the economic growth will be lower - much lower.

HORSLEY: In fact, last week, the Federal Reserve lowered its own forecast of economic growth to just over 2 percent for the year. Scott Horsley, NPR News, Washington.

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