The FRED® Blog

How to calculate the term premium

Measuring Treasuries to track yield curve inversions

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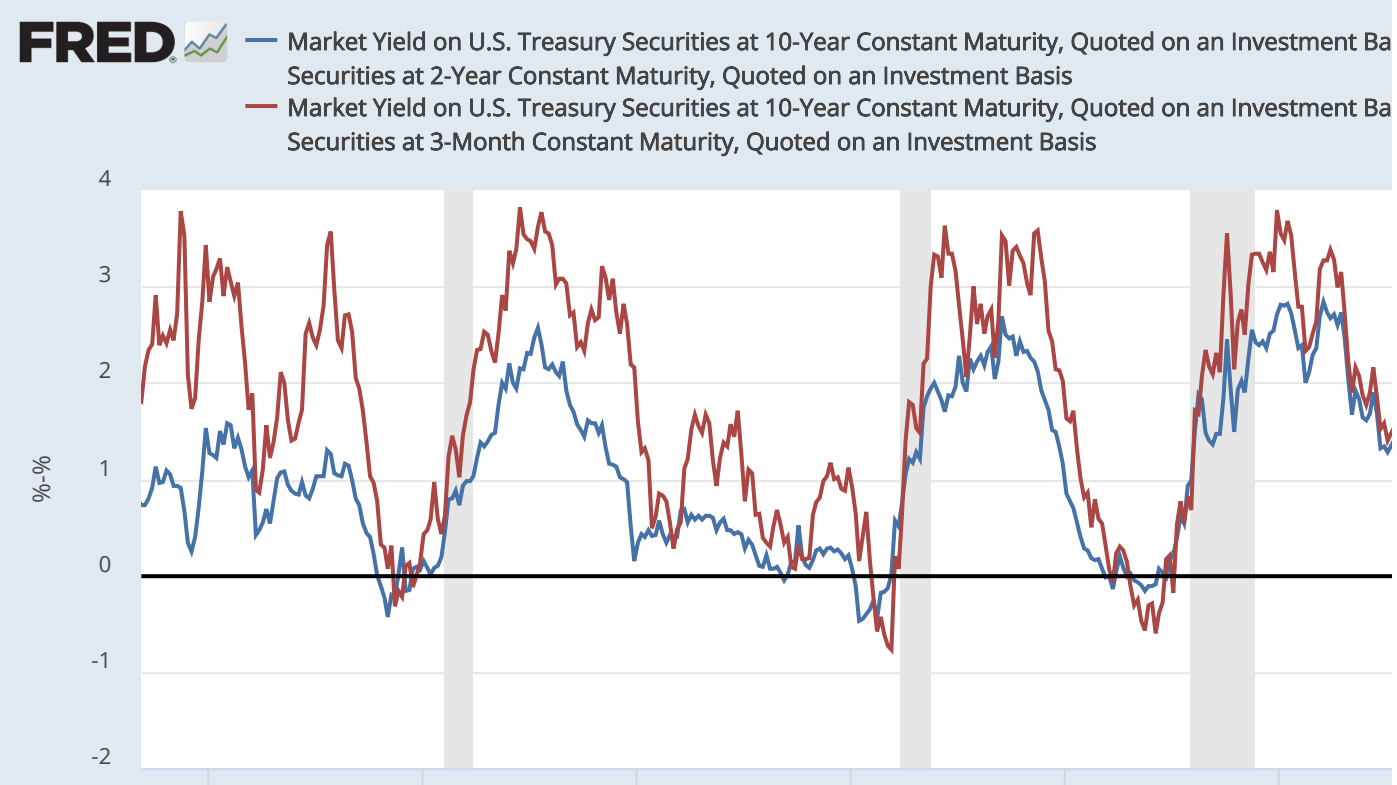

The term premium is the amount by which the yield on a long-term bond is greater than the yield on shorter-term bonds. This premium reflects the amount investors expect to be compensated for lending for longer periods. Because U.S. Treasuries come in a variety of maturities, we can take the differences between the various yields to measure the term premium. Above is a FRED graph with the 10-year Treasury yield less the 2-year Treasury yield and less the 3-month Treasury yield. The 10-year yield is often greater than the 2-year or 3-month yields, usually with a drop preceding recessions. A drop into negative territory, when the 10-year yield is lower than the 2-year or 3-month yields, is often called a “yield curve inversion.” (See, for example, this Economic Synopses essay.)

With FRED’s international data, we can repeat this exercise for other countries. For instance, we can measure the term premium in the United Kingdom by comparing yields on 10-year U.K. government bonds and 3-month U.K. Treasury securities. We see a similar trend, with an increase in the term premium during and after recessions and a fall in the term premium before recessions.

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How these graphs were created: For the first graph, search for and select “10-Year Treasury Constant Maturity Rate” and click “Add to Graph.” From the “Edit Graph” panel, use the “Customize data” tool to search for and add “2-Year Treasury Constant Maturity Rate” and then enter *a-b* in the “Formula” box. Repeat this with “3-Month Treasury Constant Maturity Rate.” For the second graph, repeat the steps above but instead search for “10-Year (Medium-Term) government bond in the United Kingdom.” With the “Customize data” tool, search for and add “3-Month Treasury United Kingdom” and enter *a-b* in the “Formula” box.

Suggested by Mahdi Ebsim and Julian Kozlowski.
View on FRED, series used in this post: DGS10, DGS2, DGS3MO, IR3TTS01GBM156N, MTGB10UKM

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