| Yield Curve 1 | |
|---|---|
| Term to maturity | Treasury yield |
| 1 year | 2.5% |
| 2 year | 3% |
| 3 year | 4.5% |
| 4 year | 5.5% |

| Yield Curve 2 | |
|---|---|
| Term to maturity | Treasury yield |
| 1 year | 5% |
| 2 year | 5% |
| 3 year | 4.5% |
| 4 year | 5% |

| Yield Curve 3 | |
|---|---|
| Term to maturity | Treasury yield |
| 1 year | 6% |
| 2 year | 5% |
| 3 year | 4.5% |
| 4 year | 4% |

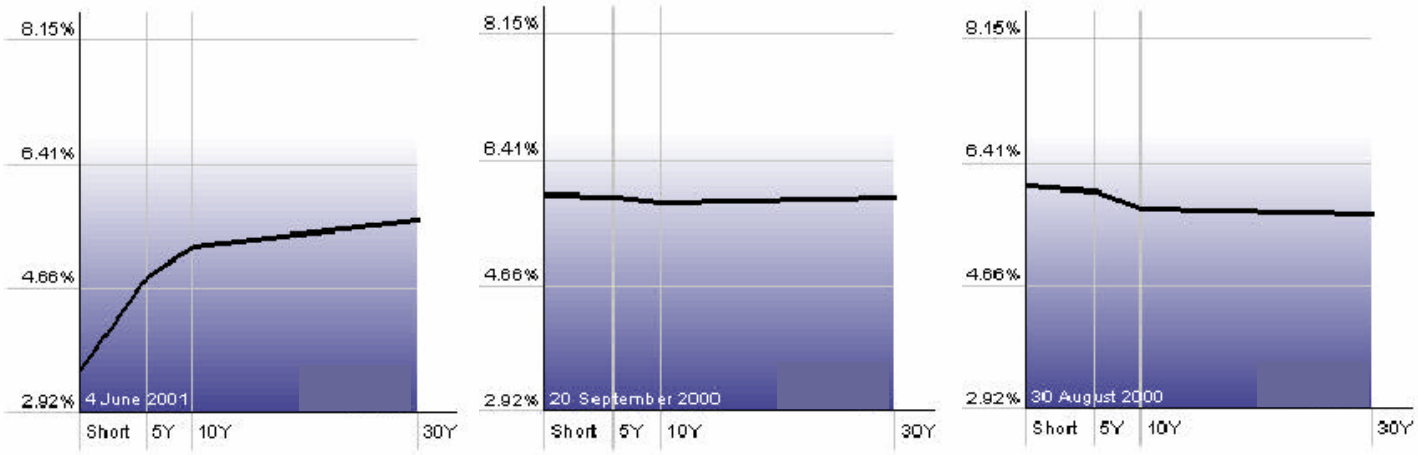
1. Graph each yield curve. Clearly indicate the axes.

2. Identify whether each yield curve is normal, flat, or inverted.

| | |
|---|---|
| Time | Expected 1-year Treasury yield |
| Today | 2.5% |
| 1 year from today | 3.5% |
| 2 years from today | 7.5% |
| 3 years from today | 8.5% |

3. Using the information in the table above, plot how the yield on a one-year T-bill is expected to change over time. Clearly indicate the axes in your diagram.

The yield curves for June 4, 2001, September 20, 2000, and August 30, 2000 are shown below.




What does the expectations theory of term structure predict will happen to interest rates in the yield curves above?

What does the liquidity premium theory predict will happen to interest rates in the yield curves above?

The yield curve for June 4, 2001 has a steep, positive slope. What might explain why interest rates in the short-term are expected to be low while those in the long-run are expected to be high?