What is the TED Spread Trying to Tell Us?

TED Spread

Unfortunately, the TED spread is not named for a brilliant economist or a famous investing icon named Ted. The TED spread actually got its name from the two financial instruments is compares—the 3-month Treasury Bill (T-bill) and the eurodollar 3 month LIBOR contract. Investors simply took the "T" from T-bill and combined it with "ED," which is the ticker symbol for the eurodollar (ie 3 month $LIBOR) contract and they came up with "TED."

The TED spread measures the difference between the yield on the 3-month Treasury Bill (T-bill) and the value of the £ moth $LIBOR contract—which is based on the 3-month LIBOR rate. To calculate the TED spread, you simply subtract the yield on the 3-month T-bill from the value of the £ month $LIBOR contract. For instance if the value of the 3 moth $LIBOR contract is at 3.75 percent and the yield on the 3-month T-bill is at 2.25 percent, the TED spread is 1.50 percent, or 150 basis points (3.75 - 2.25 = 1.50).

What Does the TED Spread Tell Us?

When the TED spread is **increasing**, it tells us either that banks believe the other banks they are lending to have a **higher** risk of defaulting on the loans so they are charging a **higher** interest rate to offset this risk or that investors are flocking to buy T-bills because they believe the stock market is faltering. It also tells us that the credit markets are not functioning as smoothly as they could be—which is sign of potential economic contraction.

When the TED spread is **decreasing**, it tells us either that banks believe the other banks they are lending to have a **lower** risk of defaulting on the loans so they are charging a **lower** interest rate to offset this risk or that investors are selling T-bills because they believe their money will perform better in the stock market. It also tells us that the credit markets are functioning smoothly—which is sign of potential economic expansion.