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## Tips from TIPS: The Informational Content of Treasury Inflation-Protected Security Prices

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### Abstract

Treasury Inflation-Protected Securities (TIPS) are frequently thought of as risk-free real bonds. Using no-arbitrage term structure models, we show that TIPS yields exceeded risk-free real yields by as much as 100 basis points when TIPS were first issued and up to 300 basis points during the recent financial crisis. This spread reflects predominantly the poorer liquidity of TIPS relative to nominal Treasury securities. Other factors, including the indexation lag and the embedded deflation protection in TIPS, play a much smaller role. Ignoring this spread also significantly distorts the informational content of TIPS breakeven inflation, a widely-used proxy for expected inflation.

**Keywords:** TIPS, breakeven inflation, deflation floor, expected inflation, indexation Lag, inflation risk premium, liquidity premiums

**JEL Classification:** G12, G01, E43, E44

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