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The TIPS Yield Curve and Inflation Compensation

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Abstract

For over ten years, the Treasury has issued index-linked debt. This paper describes the methodology for fitting a smoothed yield curve to these securities that is used at the Federal Reserve Board every day, and makes the estimates public. Comparison with the corresponding nominal yield curve allows measures of inflation compensation to be computed. We discuss the interpretation of inflation

compensation, and provide evidence that it is not a pure measure of inflation

expectations being distorted by inflation risk premium and liquidity premium

components. We attempt to estimate the inflation risk premium and liquidity

premiums using a structural model. JEL Classification: E43, E53, F43, F44

Keywords: Inflation, Treasury Inflation Protected Securities (TIPS), Yield Curve

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JEL Classification

E31 Price Level; Inflation; Deflation

E43 Interest Rates: Determination, Term Structure, and Effects

H63 National Debt; Debt Management; Sovereign Debt

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