7.12% Interest? What's the Catch?

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The Treasury Department's Series I bonds are paying a nominal fixed rate of 0%, which is not really very exciting. But what IS kind of exciting is that an additional component of their interest payments are pegged to the inflation rate. For the next six months, the Treasury Department has set that rate at 7.12%—about 5.6 percentage points more than you can currently receive from 10-year Treasury bonds.

There are, of course, some catches to this remarkable rate. One is that any individual can only buy a maximum of $10,000 of Series I bonds through the TreasuryDirect website. Theoretically, people could have each family member buy up to the limit, but it would still make up a limited part of a typical retirement portfolio.

Another 'catch,' if you can call it that, is that the rate only extends for six months, at which point the government resets it. So, the Series I bond purchaser is not locking in 7.12% for the life of the bond; that rate is only valid through next April. At the next reset in May, if inflation goes back down to where it has been over the past 10 years, then these Treasury issues will become much less exciting. And if the investor redeems the bond at any time in the first five years of ownership, he or she would lose the last three months of interest. (The bonds have a 30-year maturity, but they can be redeemed or sold on the open market at any time.)

The Treasury Department created these 30-year instruments for investors who wanted a guaranteed hedge against inflation. You can see the history of Series I inflation-related yields in an online chart here: https://www.treasurydirect.gov/indiv/research/indepth/ibonds/IBondRateChart.pdf; what you see is that the more normal rate, in recent years, has been between 1.5% and 2.5%. But the value of the bond will never decline, and even in a deflationary environment, the interest rate will never drop below zero. For the life of the bond, the owner will be protected from inflation—which, in this day and age, is not a trivial feature.

Sources:

https://www.cnbc.com/2021/11/02/sweating-inflation-this-risk-free-bond-pays-7point12percent-for-next-six-months.html

https://www.kitces.com/blog/federal-series-i-savings-bonds-inflation-712-composite-rate-treasurydirect-compare-fixed-income-investments/

If you have any questions about this article or want to discuss your family finances, investment portfolio, or financial planning advice, please call on me anytime at my number (215) 325-1595 or you can click here to schedule a meeting.

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