Series I Bonds: What You Need to Know

What is a Series I Bond?

A Series I Bond is an interest-bearing U.S. government savings bond that earns a combined fixed interest rate and variable inflation rate, the latter adjusted semi-annually. Colloquially referred to as "I Bonds," these bonds are non-marketable, meaning these bonds are not traded on any major secondary markets like the New York Stock Exchange (NYSE) and the NASDAQ.

I bonds are part of the U.S. Treasury savings bond program that is designed to offer low-risk investments. The objective of these bonds is to provide investors with a return plus inflation protection on their purchasing power, meaning the dollar amount put towards the bond purchase. Because of this, I bonds are considered a low-risk investment. I bonds have a 20-year initial maturity with a 10-year extended maturity period for a total of 30 years. This means I bonds are due to be paid out after an initial period of 20 years, but bond owners can extend the maturity for an additional 10 years if desired.

Purchasing an I Bond

These bonds are typically issued electronically via the Treasury Direct website because these bonds are not bought or sold on an exchange market. You can also purchase these bonds in paper form when you file your federal tax return. I bonds are issued and sold at face value, meaning $1,000 will buy you a $1,000 I bond. You can purchase electronic I bonds in any amount between $25 and $10,000, and you can purchase paper bonds in increments of $50, $100, $200, $500, and $1,000. The maximum purchase for electronic I bonds in a calendar year is $10,000, while the maximum purchase for paper I bonds in a calendar year is $5,000. That being said, you can purchase up to $10,000 of electronic I bonds and up to $5,000 of paper I bonds every year, for a combined maximum of $15,000 in electronic and paper I bonds.

Given their 30-year maturity, I bonds can earn interest for 30 years; however, you can cash these bonds before the 30-year maximum. You can cash I bonds a minimum of one year from the purchase date, but if you do cash these bonds earlier than five years, you lose the previous three months of interest. In other words, if you cash an I bond at four years (48 months), you will only collect the first 45 months of interest. There is no interest penalty for cashing I bonds after five years.

Two Types of Interest

The two types of interest that an I bond earns are:

- A fixed interest rate that is fixed for the life of the bond, and
- A variable inflation rate that is adjusted semi-annually, every May and November.

The fixed rate is determined and set by the Treasury, and this rate is announced semi-annually, on the first business day in May and on the first business day in November. The fixed rate set by the Treasury applies to all I bonds issued throughout the next six months – until the next fixed-rate announcement – and it is compounded semi-annually, meaning earned interest is added to the bond's principal value every six months, and then interest for the next six months is calculated with the new principal amount. This rate remains unchanged – as its name suggests – and does not vary throughout the life of the bond.

The variable rate, also referred to as the inflation rate, is based on changes in the Consumer Price Index for All Urban Consumers – the CPI-U – which measures changes in U.S. consumer prices based on a representative basket of goods and services that denotes consumer spending. The U.S. Bureau of Labor Statistics (BLS) collects the prices of around 94,000 items from a scientifically selected sample of goods and services to comprise the basket of goods for this index to track the changes in the prices of consumer goods and services over time with inflation factored in. This variable inflation rate is calculated and set twice a year based on the CPI-U values in March and September, and the rate is applied to the bond semi-annually.

Overall, the interest rate an I bond earns is represented as a combination of the fixed rate and the inflation rate, compounded semi-annually. In other words, you are accruing interest on your bond principal every month, but you will not see that interest until the end of every six-month period for the duration you own the bond. For I bonds issued between May 2024 and October 2024, the combined rate is 4.28%. Given the variable rate component of the interest paid on I bonds, it is challenging to forecast how much the bond's principal will be worth in the future (for example, at the peak of I bonds, between May 2022 and October 2022, the combined rate was 9.62%).

What About Taxes?

The interest you earn on your I bonds is exempt from state and local income taxes but subject to federal income taxes and any federal estate, gift, and excise taxes, as well as any state estate or inheritance taxes. You can elect to pay taxes on the interest earned annually, at maturity, or whenever the bond is cashed. If you cash out these bonds and use the funds to pay for qualified higher education expenses, you may be exempt from paying federal income tax on the interest earned.

Diving Deeper: A Way to Hedge Against Inflation

In a high-inflation environment, the purchasing power of your money goes down. Your money is essentially becoming less valuable because it is not keeping up with the rate of inflation, meaning the costs of items you buy are increasing faster than your money is growing in a bank account because the interest rate is so low and being out-paced by the high inflationary environment. I bonds can be an answer to what you can do with your money to help it grow at a level that matches inflation. In 2022, after the highest rates of inflation in 40 years, a cycle of rate hikes has begun. We have already experienced interest rate increases with more anticipated on the horizon, and this higher-interest-rate environment has been a huge factor in pushing the overall stock market down, leaving investors seeking an investment vehicle where they can put their money so that it grows at a level that matches inflation. Enter, Series I bonds.

When we are in an inflationary period, as we are currently now, the variable inflation rate of I bonds is positive, meaning you will accrue interest. In periods of deflation, where prices are dropping and the CPI-U is negative, the Treasury limits the combined rates of the bond to zero, so you do not have to worry about losing money by continuing to hold the bond; you just will not be earning any interest during such a period.