Price Formation and Liquidity in the U.S. Treasury Market: The Response to Public Information*

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Abstract

The arrival of public information in the U.S. Treasury market sets off a two-stage adjustment process for prices, trading volume, and bid-ask spreads. In a brief first stage, the release of a major macroeconomic announcement induces a sharp and nearly instantaneous price change with a reduction in trading volume, demonstrating that price reactions to public information do not require trading. The bid-ask spread widens dramatically, evidently driven by inventory control concerns. In a prolonged second stage, trading volume surges, price volatility persists, and bid-ask spreads remain moderately wide as investors trade to reconcile residual differences in their private views.

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