Decoupling Dollar and Treasury Privilege
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Intro

Convenience yield, exorbitant privilege, safe asset demand:

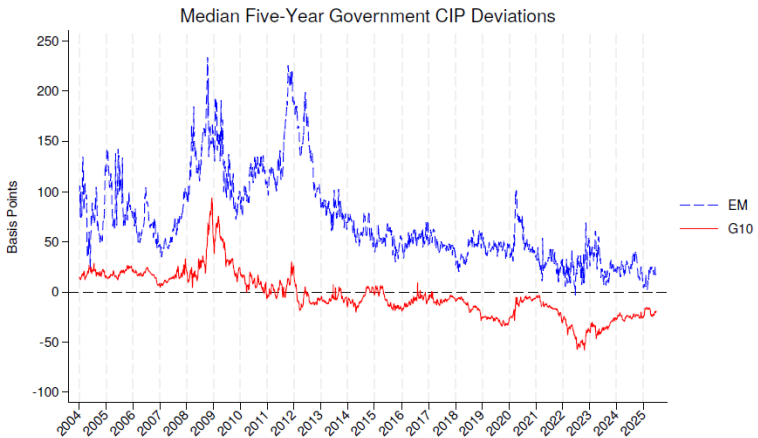
- Is this about all U.S. dollar-denominated assets, or specifically U.S. Treasury securities?
- Historically, all dollar safe assets enjoy a premium, and Treasurys enjoy even more.
- More recently, Treasury is losing its premium over other dollar assets.
  - Requires us to further distinguish “dollar privilege” vs. “Treasury privilege”.

Comparison

- We cannot directly compare yields on a dollar-denominated asset with that on a foreign currency asset — differences in currency risk premia, expected exchange rate movement, etc.
- An apple-to-apple comparison converts foreign currency yields into "dollar terms," using cross-currency basis swaps to hedge out currency risk (Du-Im-Schreger).
  - Example: Japanese government bond (JGB) yield = 1% (invest 100 yen, earn 1 yen); if we hold this bond and hedge currency risk using basis swaps, we obtain a synthetic dollar yield of 3% (invest 100\$, earn 3\$).
  - If the U.S. Treasury yield = 2.5% (invest 100\$, earn 2.5\$), it has a premium of 0.5% over the synthetic dollar yield based on JGB.
  - $3\% - 2.5\%$ measures the Treasury premium, not $1\% - 2.5\%$. The dollar premium is compatible with yen having a lower interest rate.

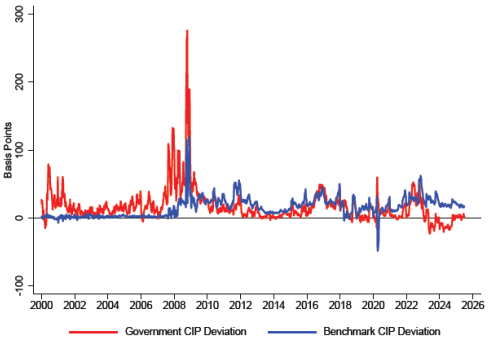
Government CIP

Figure 2: The Decline of the U.S. Treasury Convenience

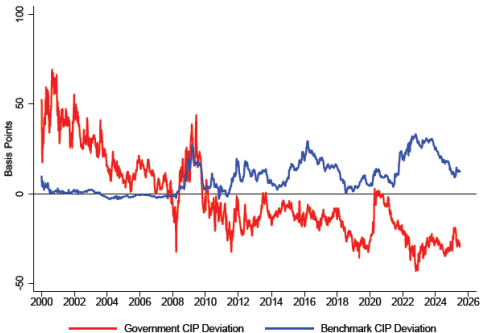


Government CIP vs. SOFR/ESTR CIP

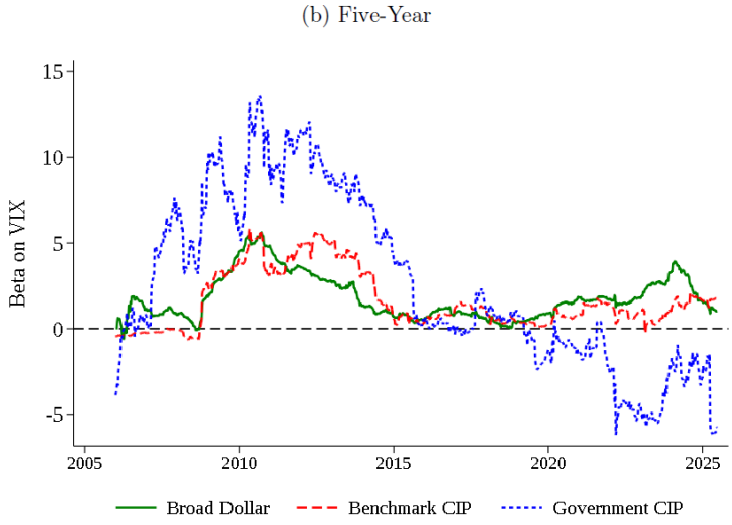
(a) Three-Month



(b) Ten-Year



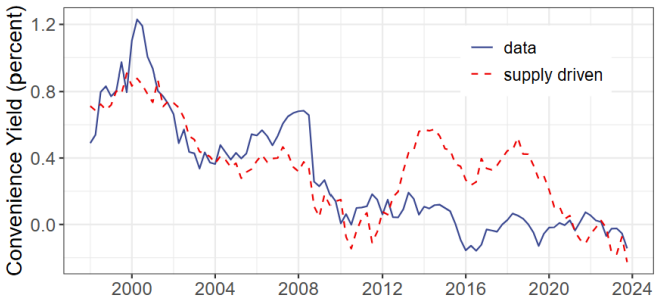
Risk Properties



Supply Is Key

FIGURE 2
TREASURY CONVENIENCE YIELDS IMPLIED BY CHANGES IN SUPPLY

(A) LONG-TERM



- (From Jiang-Richmond-Zhang, Convenience Lost.)

My Thoughts

- The authors ask a very important question: how to understand the potential decoupling of dollar and Treasury privilege?
- Right now,
  - Treasury premium $<$ synthetic dollar bond based on foreign Treasury.
  - Dollar funding premium $>$ synthetic dollar rate based on foreign premium rates.
- My comment centers on the interpretation.
  - Further developing the theme of "dollar privilege" vs. "Treasury privilege".

Treasury Premium vs. Dollar Premium

- We observe #1 from spreads like Treasury-Libor (TED), Treasury-synthetic dollar bond (Treasury CIP).
- This paper is about how #1 evolved, comparing dollar yields to dollar yields.
- #2 may exist for a broad set of dollar-denominated assets; however, it is not directly observable.
- What does the decline in Treasury premium in #1 tell us about the evolution of dollar premium in #2?

CIP Spreads Are Tip of the Iceberg

- Jiang-Krishnamurthy-Lustig: we can back out #2 from how the dollar exchange rate responds to shocks to #1.
- Intuition: the dollar's currency value prices in both #1 and #2.
- Suppose a flight-to-safety shock increases #1 by 0.2%, but the dollar exchange rate appreciates by 2%, then #2 must have increased by 1.8% to rationalize the exchange rate movement.
  - Requires auxiliary assumptions on currency risk premia.
- Empirically, we find that #2 is much larger than #1, about 9:1.

Example: April 2 Tariff Announcement

$$e_t - \mathbb{E}_t[e_{t+10}] = \underbrace{\sum_{j=0}^{9} \mathbb{E}_t[r^{US}_{t+j} - r^{EU}_{t+j}]}_{0.48\%\times 10 = 4.8\%} + \underbrace{\sum_{j=0}^{9} \mathbb{E}_t[cy_{t+j}]}_{-1.07\%\times 10 = -10.7\%} - \sum_{j=0}^{9} \mathbb{E}_t[rp_{t+j}].$$

- April 1–21, 10-year yield differential between U.S. and Germany increased by 48 bps.
- The 1-year U.S. Treasury basis against the Euro widened by 10.7 bps. Given the 9:1 ratio, the overall dollar convenience yield declined by around 1.07% over the period.
- Together, $+4.8\% - 10.7\% = -5.9\%$ implies that the dollar should depreciate by 5.9%; in reality, the dollar depreciated by 6.5%.
- (From Jiang-Krishnamurthy-Lustig-Richmond-Xu, Dollar Upheaval: This Time is Different.)

CIP Spreads Are Tip of the Iceberg

- I encourage the authors to exploit their rich data and bring in more structure to answer: has the dollar premium (#2) also declined along with the Treasury premium (#1)?
- One possible approach is to compare the dollar's cyclicality along with the Treasury CIP's cyclicality; to learn from the dollar's behavior.
- A more structural approach would be to take in quantity data and model how constrained investors and financiers trade off between different dollar and foreign currency assets.
- Both sound exciting to me!

A Technical Comment

- I would advocate using Treasury-ESTR basis instead of Treasury-foreign Treasury basis.
- Since Eurozone sovereign debt yields are heavily influenced by ECB policies, ESTR might provide a cleaner benchmark for measuring Treasury premium.

Thank You!