

Decoupling Dollar and Treasury Privilege

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Overview

- ▶ The special roles of the U.S. dollar (USD) and U.S. Treasuries (UST) are a defining feature of the international monetary system.
- ▶ We document a divergence in privilege between USD and UST when compared with other currencies and government bonds, particularly post-GFC:
 - ▶ Positive convenience yield on the USD;
 - ▶ Negative convenience yield (inconvenience) on the UST.
- ▶ We examine how government bond supply and intermediary balance sheet constraints affect these convenience yields.

Measurement and Data

Measure USD Convenience

- ▶ **USD Convenience:** CIP Deviations for benchmark interest rates (e.g. Du, Tepper and Verdelhan (2018))

$$x_{i,n,t}^{Rf} = \underbrace{(y_{i,n,t}^{Rf} - \rho_{i,n,t})}_{\text{FX Swap Implied Dollar Risk-Free Rate}} - \underbrace{y_{\$,n,t}^{Rf}}_{\text{Cash Market Dollar Risk-Free Rate}}$$

where $\rho_{i,n,t}$ is the market-implied forward premium to hedge foreign currency i into dollars.

- ▶ $x_{i,n,t}^{Rf} > 0$: USD more convenient than foreign currency
 - ▶ Investors are willing to forgo additional return to hold the U.S. dollar risk-free rate rather than the synthetic dollar risk-free rate.
- ▶ $x_{i,n,t}^{Rf} < 0$: USD less convenient than foreign currency

Measure USD Convenience: Benchmark Reform

- ▶ Pre-benchmark Reform: $x_{i,n,t}^{Rf} = (y_{i,n,t}^{IBOR} - \rho_{i,n,t}) - y_{\$,n,t}^{IBOR}$
- ▶ Since 2021, many major markets have adopted alternative benchmark interest rates with reduced credit risk that more accurately represent actual transactions.
 - ▶ The overnight repo rate collateralized by government bonds is a common choice (e.g. SOFR in the US)
- ▶ Post-benchmark Reform: $x_{i,n,t}^{Rf} = (y_{i,n,t}^{ALT} - \rho_{i,n,t}) - y_{\$,n,t}^{SOFR}$
- ▶ We find that the benchmark reform modestly increases $x_{i,n,t}^{Rf}$, but have little impact on $\rho_{i,n,t}$.

Measure UST Convenience

- ▶ **UST Convenience:** CIP Deviations for government bond yields (e.g. Du, Im and Schreger, (2018))

$$x_{i,n,t}^{Govt} = \underbrace{(y_{i,n,t}^{Govt} - \rho_{i,n,t})}_{\text{Swapped Foreign Government Bond Yield in Dollars}} - \underbrace{y_{\$,n,t}^{Govt}}_{\text{U.S. Treasury Yield}}$$

- ▶ $x_{i,n,t}^{Govt} > 0$: UST more convenient than foreign government bonds.
 - ▶ Investors are willing to forgo additional return to hold U.S. Treasury bonds, rather than synthetic dollar government bonds issued by foreign countries.
- ▶ $x_{i,n,t}^{Govt} < 0$: UST less convenient than foreign government bonds

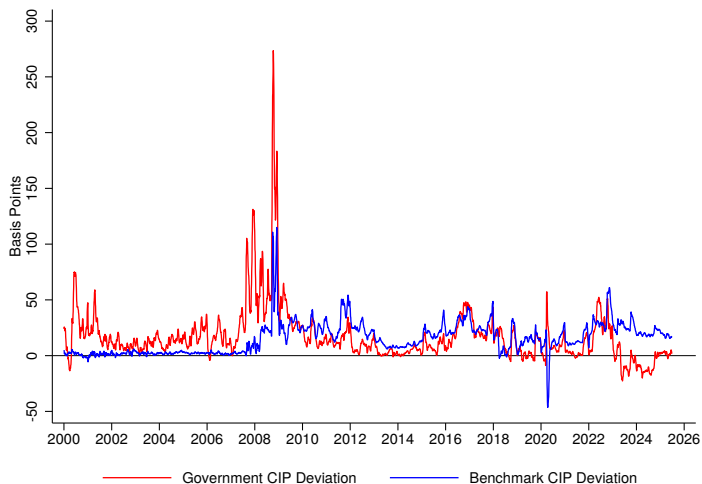
Data and Sample

- ▶ 10 developed markets (G10):
 - ▶ Australia (AUD), Canada (CAD), Switzerland (CHF), Denmark (DKK), Germany (EUR), United Kingdom (GBP), Japan (JPY), Norway (NOK), New Zealand (NZD), Sweden (SEK)
- ▶ 18 emerging markets (EM):
 - ▶ Brazil (BRL), Chile (CLP), China (CNH and CNY), Colombia (COP), Hungary (HUF), Indonesia (IDR), Israel (ILS), India (INR), Korea (KRW), Mexico (MXN), Malaysia (MYR), Peru (PEN), Philippines (PHP), Poland (PLN), Russia (RUB), Thailand (THB), Turkey (TRY), South Africa (ZAR).
- ▶ Sample Period: January 2000 to June 2025.
- ▶ Tenors: 3-month, 1-year, 2-year, 3-year, 5-year, 10-year, 20-year, and 30-year.
- ▶ We have made our calculations, documentation, and Bloomberg tickers publicly available for researchers to use: [Here](#)
 - ▶ A full update of Du, Im and Schreger (2018) to the post-benchmark reform period.

Divergence of the USD and UST Privilege

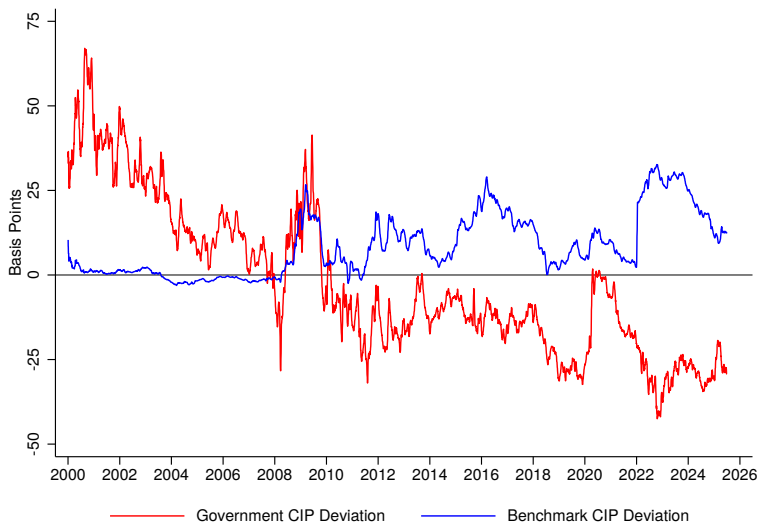
USD vs. UST Convenience: Three-Month Average G10

- ▶ Pre-GFC, $x^{Rf} \approx 0$, $x^{Govt} > 0$;
- ▶ Post-GFC, $x^{Rf} > 0$, $x^{Govt} > 0$ but reached negative 2023-2024.

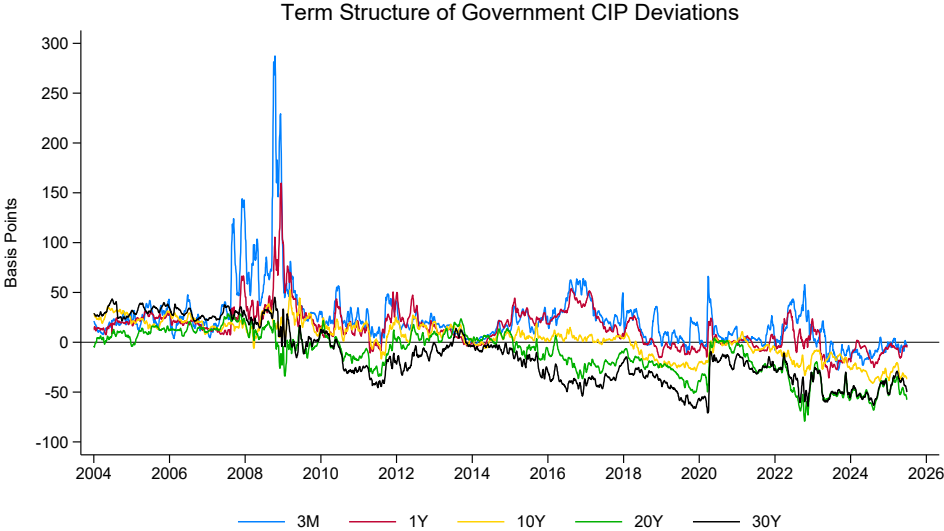


USD vs. UST Convenience: Ten-Year Average G10

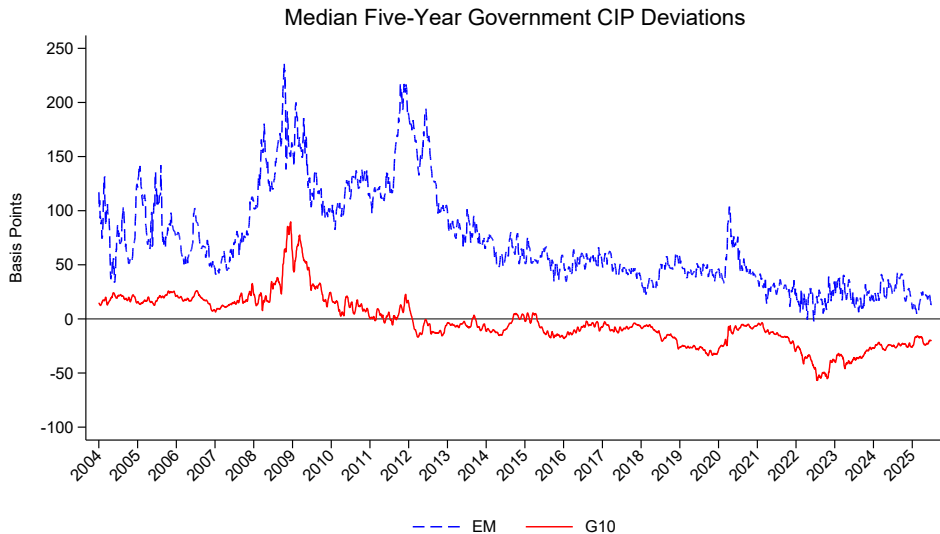
- ▶ Pre-GFC, $x^{Rf} \approx 0$, $x^{Govt} > 0$;
- ▶ Post-GFC, $x^{Rf} > 0$, $x^{Govt} < 0$.



Secular Decline of the UST Convenience Across Maturities



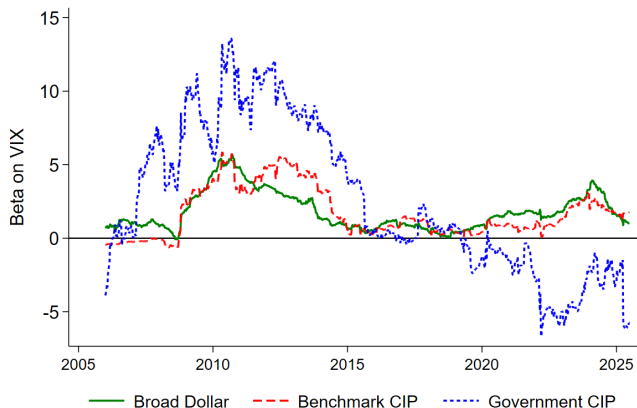
UST Convenience vs G10 and EM



Time-Varying Loadings on Global Risk Factors

- ▶ $\Delta x_{i,t} = \alpha + \beta_t \Delta VIX_t + \epsilon_t$, two-year rolling windows with weekly changes
- ▶ Dollar spot FX and USD convenience offer hedges against global risks
- ▶ UST convenience has become a risky asset with respect to global risk factors

Figure 1: Rolling Betas on VIX



What explains the divergence of USD and UST Privilege?

Decomposition of the UST Convenience

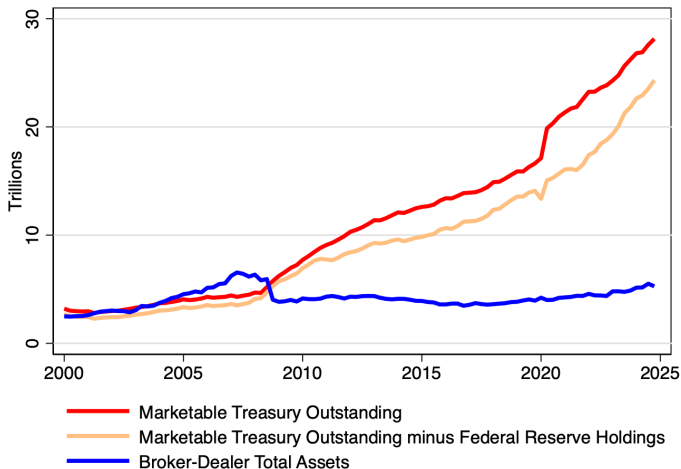
- ▶ We can decompose the UST Convenience into three components:

$$\underbrace{X_{i,n,t}^{Govt}}_{\text{UST Convenience}} = \underbrace{X_{i,n,t}^{Rf}}_{\text{USD Convenience}} + \underbrace{(y_{\$,n,t}^{Rf} - y_{\$,n,t}^{Govt})}_{\text{U.S. Swap Spread}} - \underbrace{(y_{i,n,t}^{Rf} - y_{i,n,t}^{Govt})}_{\text{Foreign Swap Spread}}$$

- ▶ USD convenience reinforces UST convenience.
- ▶ Lower U.S. swap spreads than foreign swap spreads reduces UST convenience.
- ▶ We show that the decline in the UST convenience and its increasing riskiness are primarily attributed to the increasingly negative U.S. swap spread.

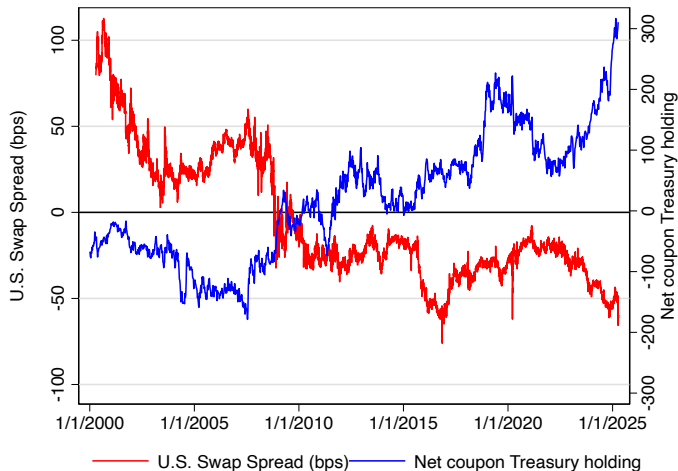
Key Changes Pre/Post GFC

- ▶ Supply of Treasury bonds has increased significantly, dealer balance sheets have contracted.



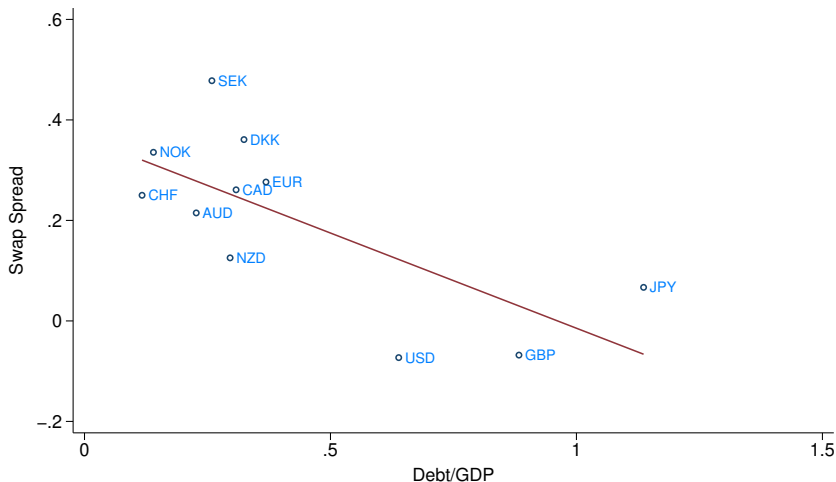
Dealer Position and Swap Spreads (Du, Hébert and Li, 2022)

- ▶ Pre-GFC: positive swap spreads, dealers short
- ▶ Post-GFC: negative swap spreads, dealers long



Cross-Country Swap Spread vs. Government Debt Supply

- ▶ Countries with greater debt/GDP ratios tend to have lower swap spreads.



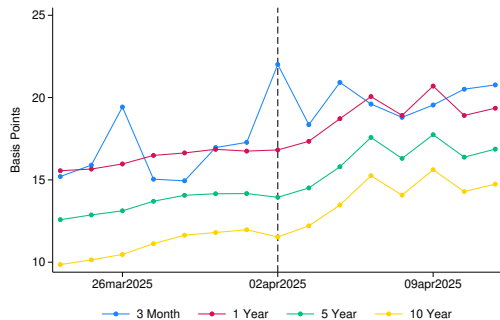
Effects of Relative Debt Supply on UST Convenience

	(1)	(2)	(3)	(4)
	All	00-07	08-24	08-24
$\log\left(\frac{\text{Debt}}{\text{GDP}}\right)_{US}$	-37.10*** (5.75)	-85.89*** (28.24)	-59.28*** (10.67)	-53.46*** (7.27)
$\log\left(\frac{\text{Debt}}{\text{GDP}}\right)_i$	8.69** (3.42)	14.56*** (5.22)	22.70*** (4.26)	23.11*** (4.11)
VIX	1.06*** (0.36)	0.67 (0.45)	0.87** (0.40)	0.71* (0.39)
$CDS_{US,n}$				-0.30** (0.14)
$CDS_{i,n}$				0.33*** (0.06)
Observations	1,000	320	680	676
R^2	0.48	0.30	0.48	0.52

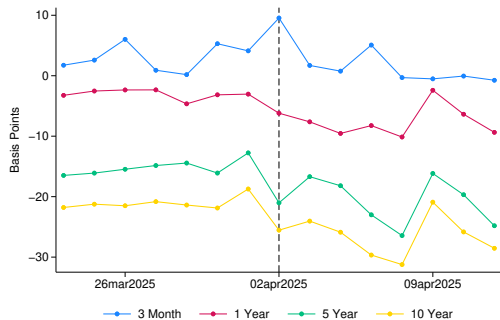
▶ Country fixed effects are included in the regression. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Dynamics Following the Reciprocal Tariffs Announcement

Event Study Around Liberation Day (April 2, 2025)



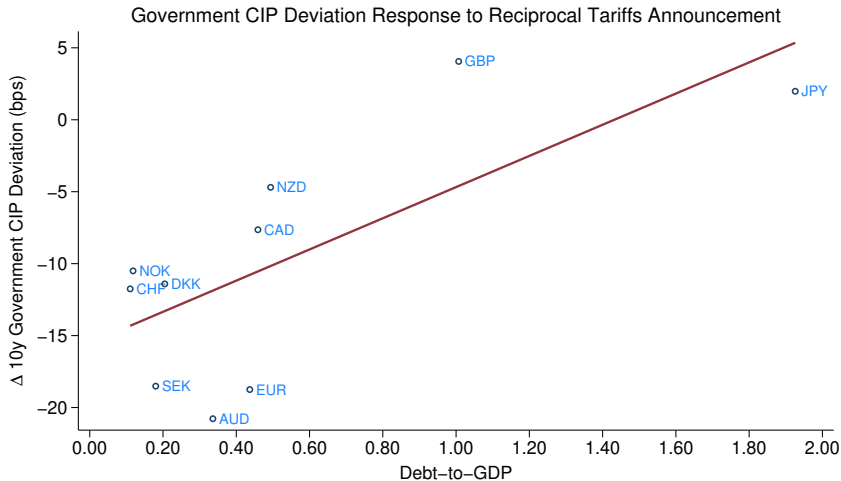
(a) Benchmark CIP Deviations (USD Convenience)



(b) Government CIP Deviations (UST Convenience)

Heterogenous in UST Convenience Response

- ▶ UST convenience declined more against countries with low government debt-to-GDP ratios



Conclusion

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- ▶ USD and UST convenience yields have diverged in international comparison.
- ▶ U.S. Treasuries have lost their convenience premium relative to other G10 government bonds, despite that the U.S. dollar remains convenient.
- ▶ Relative government bond supply is a key driver of the Treasury convenience against foreign government bonds.
- ▶ One manifestation of Treasury specialness may be the sheer volume of debt the U.S. government was able to issue before reaching “inconvenience”.