Disappearing Dollar Convenience?

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Disclaimer: The views expressed herein are those of the author; they do not necessarily reflect those of the Federal Reserve Board or the Federal Reserve System.

What is dollar convenience?

- Convenience yield: Yield discount relative to a “basic” asset pricing model

- Convenience yields come from features investors value that are not in basic asset pricing models
  - Liquidity: Saved transactions costs
  - Collateral value: Cheap funding
  - Safety: Saved information costs (no need to assess default risk)

- Dollar convenience = [Convenience yield on $ assets] - [Convenience yield on non-$ assets]

  = [Yield on inconvenient $ assets (risk-adj.) - Yield on convenient $ assets]

  - [Yield on inconvenient non-$ assets (risk-adj.) - Yield on convenient non-$ assets]

What is dollar convenience?

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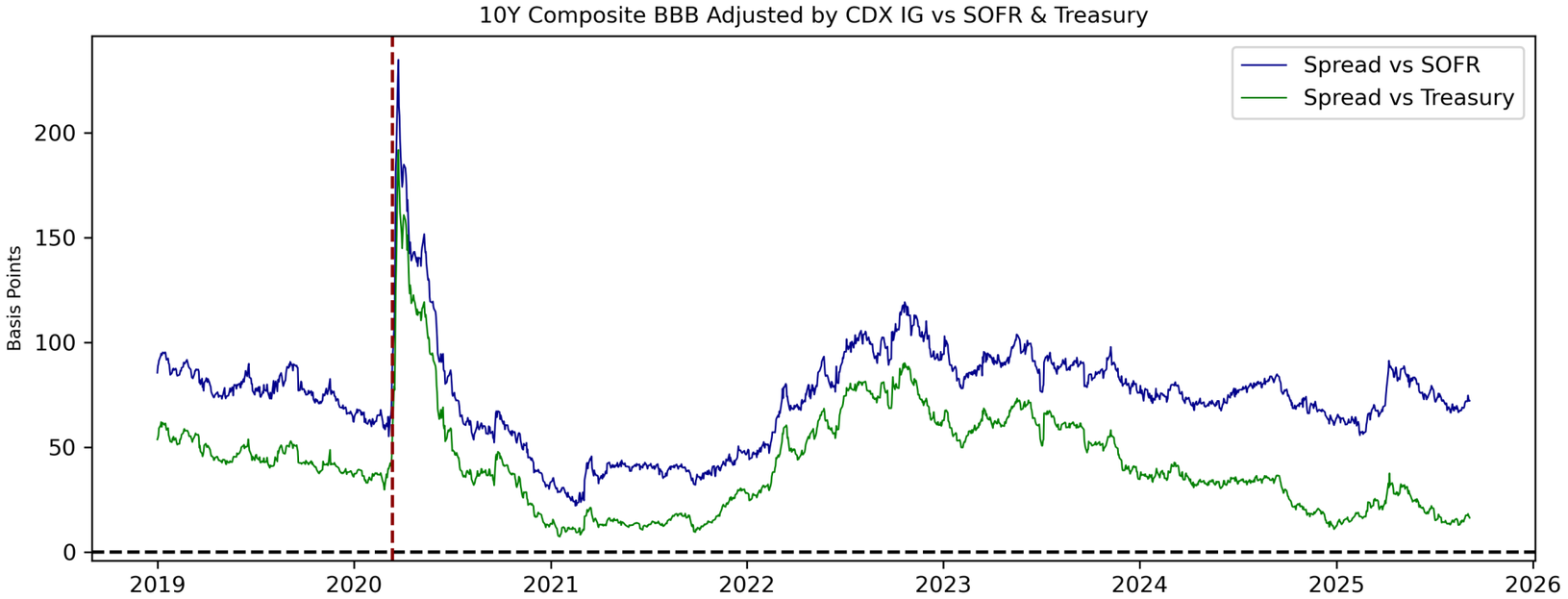
- Dollar convenience IS NOT ABOUT the $ per se, like whether you can borrow cheaply in $ if the dollar appreciates during crisis:
  - This will also affect the yield on inconvenient $ assets (risk-adj.)

- Dollar convenience IS ABOUT whether $ denomination drives liquidity, safety, collateral value
  - Does issuing in $ make your bonds more liquid because $ markets are more liquid in general?
  - Does issuing in $ mean you issue under US law which makes your bonds extra safe?
  - Do people really want short-term $ assets so you can get a low repo rate to fund $ assets?

Main finding 1: [Convenience yield on $ assets] has *not* fallen

Dollar convenience = [Convenience yield on $ assets] - [Convenience yield on non-$ assets]

- [Convenience yield on $ assets] = Corporate yield (cds-adj.)-SOFR swap
- "Within the U.S., safe asset convenience yields are about the same in 2025 as they were in 2019"



Main finding 2: *Dollar convenience* is down

Dollar convenience = [Convenience yield on $ assets] - [Convenience yield on non-$ assets]

- (Synthetic $ yield) - (Yield on convenient $ assets) (CIP deviation)

  = [Yield on convenient non-$ assets (risk-adj.)+s-f] - [Yield on convenient $ assets (risk-adj.)]



Why does (Synthetic $ yield) - (Yield on conv $ assets) capture dollar convenience?

(Synthetic $ yield) - (Yield on convenient $ assets)

= CY($) - CY(synthetic $) (to make investors indifferent)

= CY($) - [CY(non-$) + β*Dollar convenience] (assumption from Jiang et al, 2021)

= (1-β) * Dollar convenience

Dollar convenience = [1/(1-β)] * (Synthetic $ yield - Yield on convenient $ assets)

10, Jiang et al (2021) and Table 1, 2

COMMENT 1. Do the two facts add up to a coherent story?

Suggest a possible alternative interpretation of the data

Dollar convenience = [Convenience yield on $ assets] - [Convenience yield on non-$ assets]

Paper:

- [Convenience yield on $ assets] is flat, yet *dollar convenience* is down substantially

Concerns:

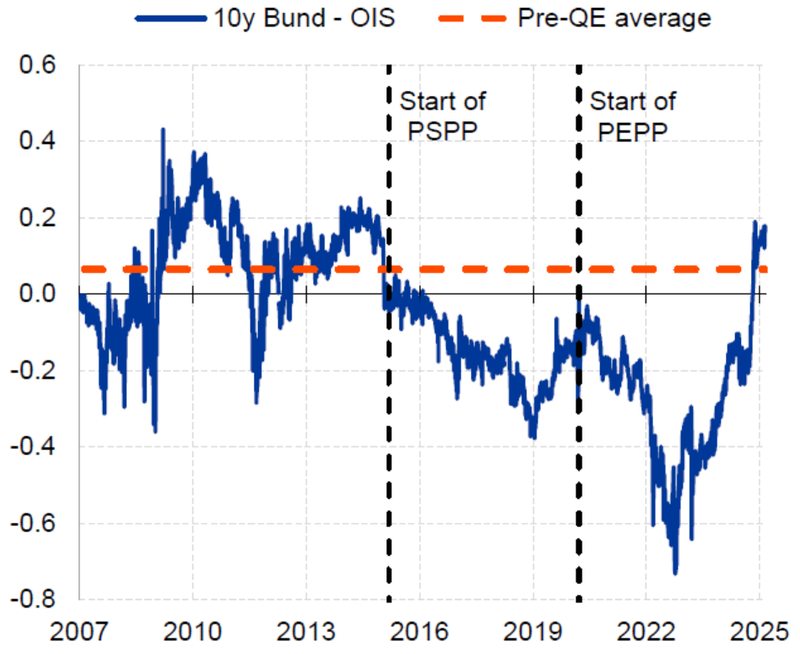
1. Is it plausible that [Convenience yield on $ assets] is flat with all the extra dollar debt and QT?
2. Story only adds up if [Convenience yield on non-$ assets] is *up*
   Is that plausible with all the extra debt and QT abroad?

Isabel Schabel speech Feb 25, 2025: "No longer convenient? Safe asset abundance and r*"

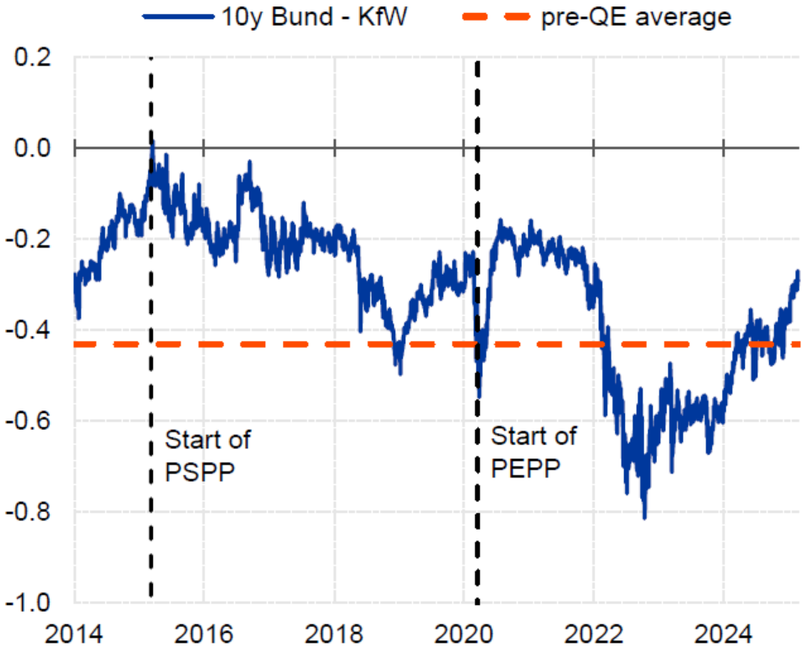
- Charts show measure of *minus* [Convenience yield on non-$ assets] (Bunds)
- Higher value means bunds are *less* convenient

Convenience yield has declined measurably over the past two years

10-year Bund – OIS spread
(percentages)



10-year Bund – KfW spread
(percentages)



Dollar convenience = [Convenience yield on $ assets] - [Convenience yield on non-$ assets]

Another possibility:

1. Data could be consistent with a lower [Convenience yield on $ assets]
2. Then *dollar convenience* can fall *without* higher [Convenience yield on non-$ assets]

Dollar conv. is down *because* [Convenience yield on $ assets] is down, *not despite* it being flat

Recent years: Marginal Treasury buyer is levered investor → Intermediation spreads

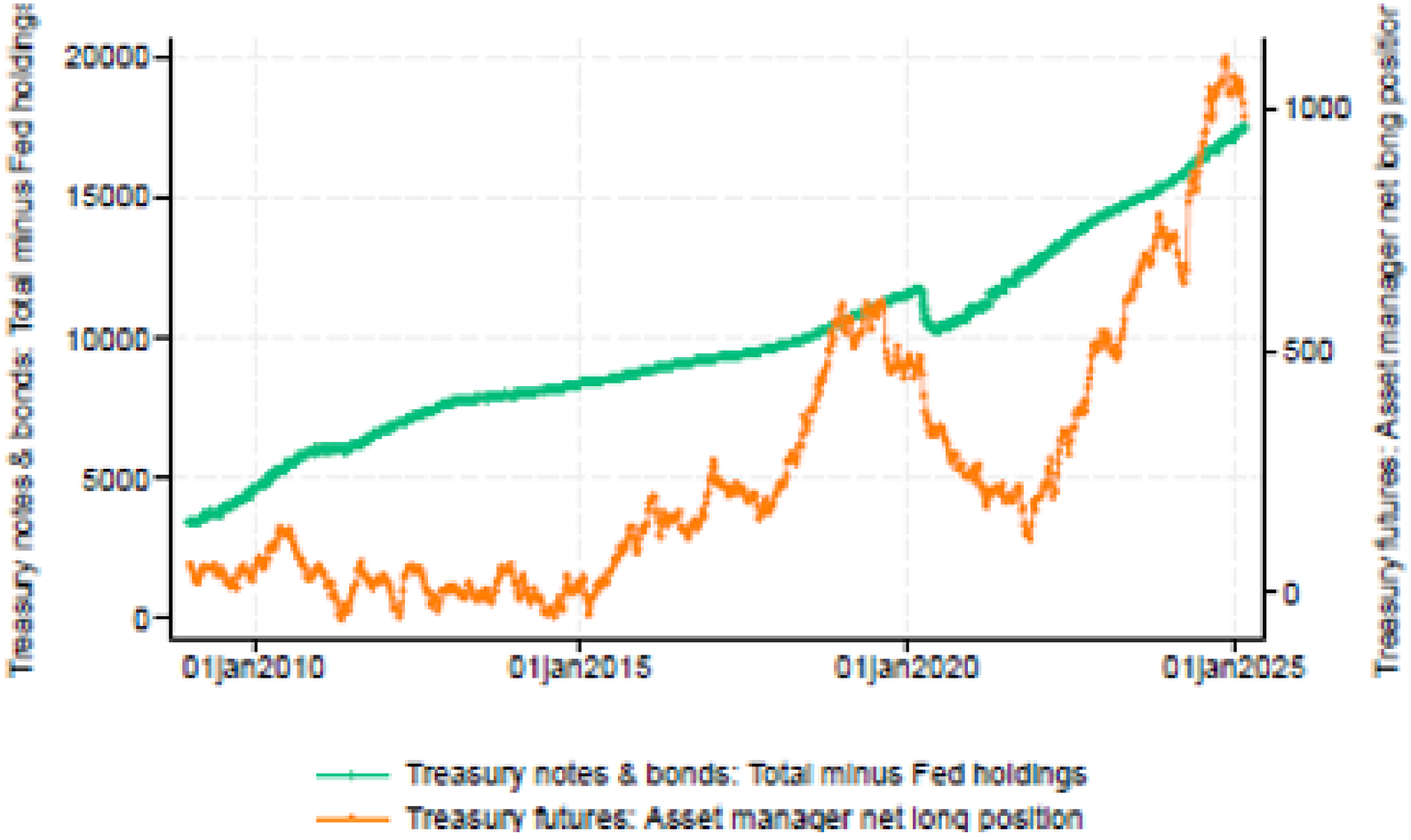
- Treasury supply is high
- Marginal Treasury held by levered investor (hedge fund, dealer): Treasury basis trade, swap trade

  y(Treasury)-y(Swap) = Intermediation spread
- This allows asset managers get some of their Treasury exposure via futures and swaps, and invest more of their AUM in MBS, corporate debt etc.
- Marginal corporate bond still held by an asset manager

  y(Corporate(risk-adj)) = Yield on inconvenient $ assets (risk-adj.)

Recent years: Marginal Treasury buyer is levered investor → Intermediation spreads

Treasury basis trade is now around $1T



Substantial increase in intermediation spread in recent years: Around 30 bps

y(Treasury)-y(Swap) = Intermediation spread

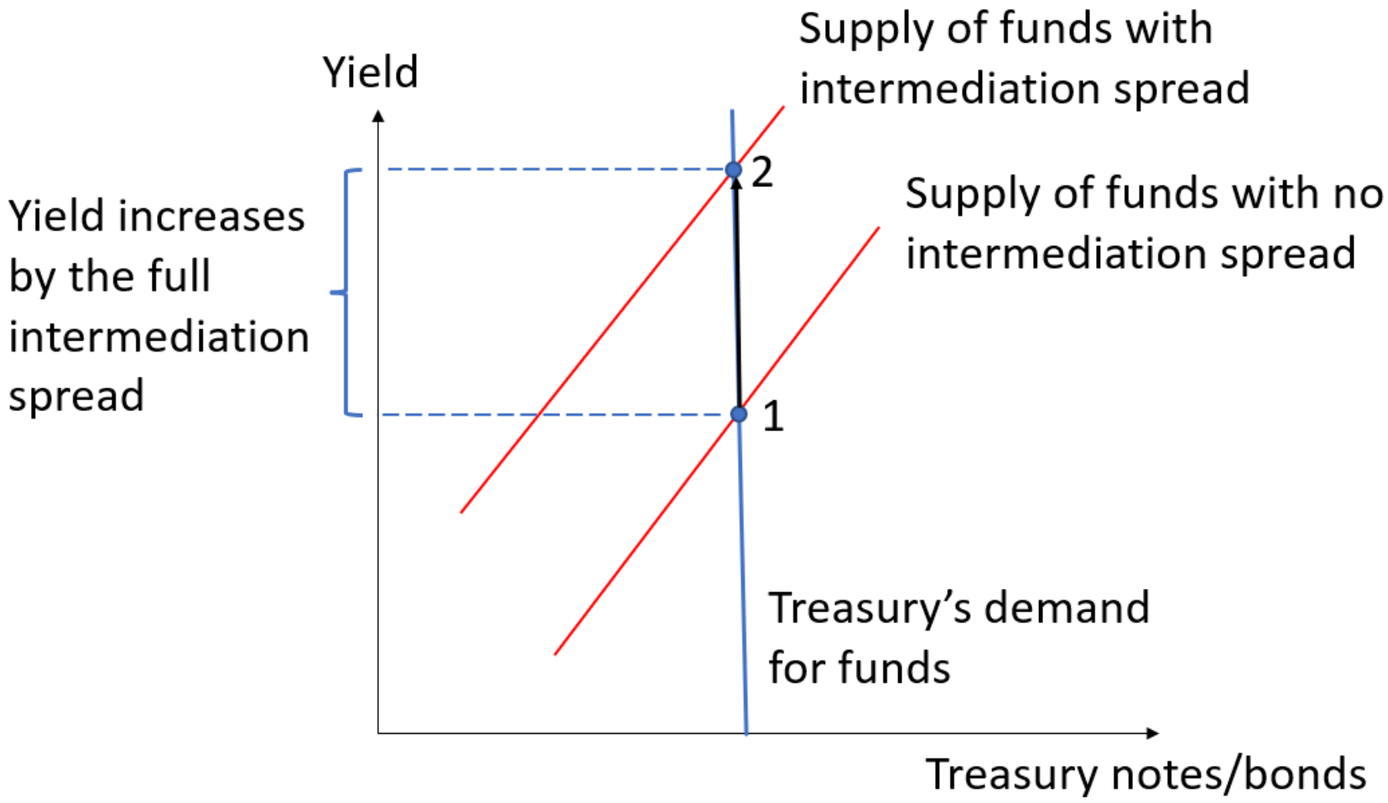
10-year



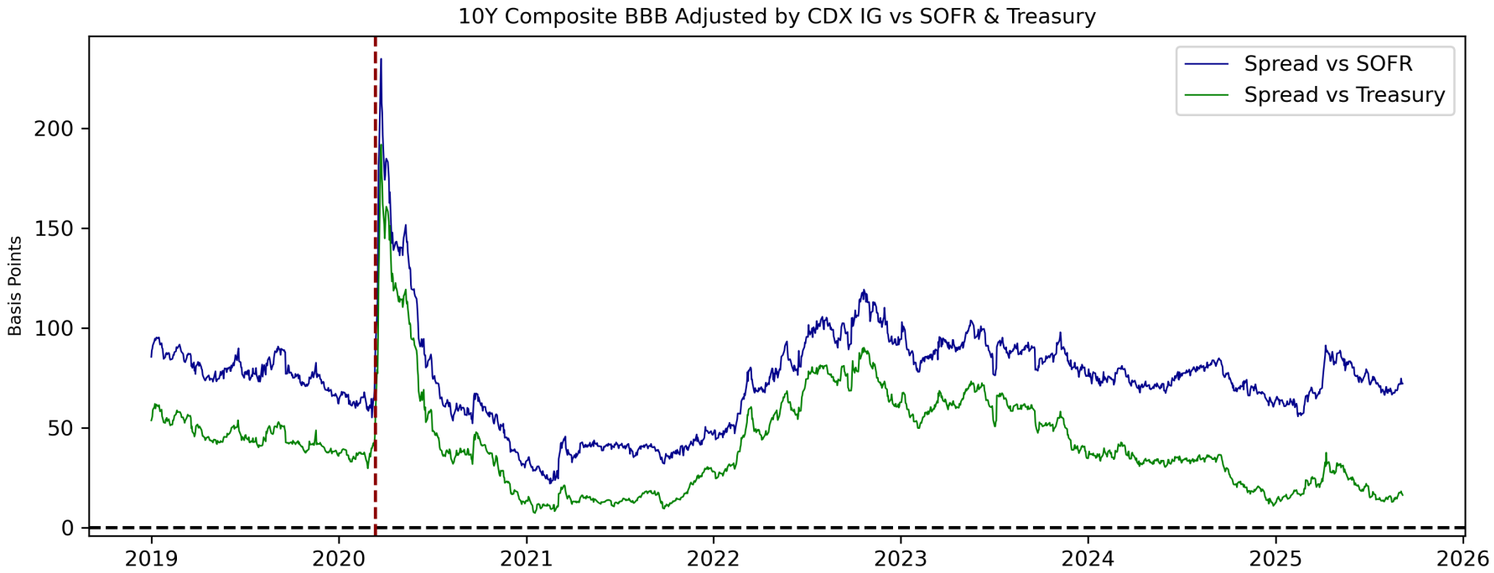
Paper assumes: Intermediation spread is paid 100% by Treasury, not asset managers

y(Treasury)= [Yield on convenient $ assets] + [Intermediation spread]

y(Swap) = [Yield on convenient $ assets]



Paper assumes: Intermediation spread is paid 100% by Treasury, not asset managers



y(Corp(risk-adj.))-y(Swap) = [Convenience yield on $ assets]

y(Corp(risk-adj.))-y(Treasury) = [Convenience yield on $ assets] – [Intermediation spread]

y(Corp(risk-adj.))-y(Swap) remains high → [Convenience yield on $ assets] is flat,

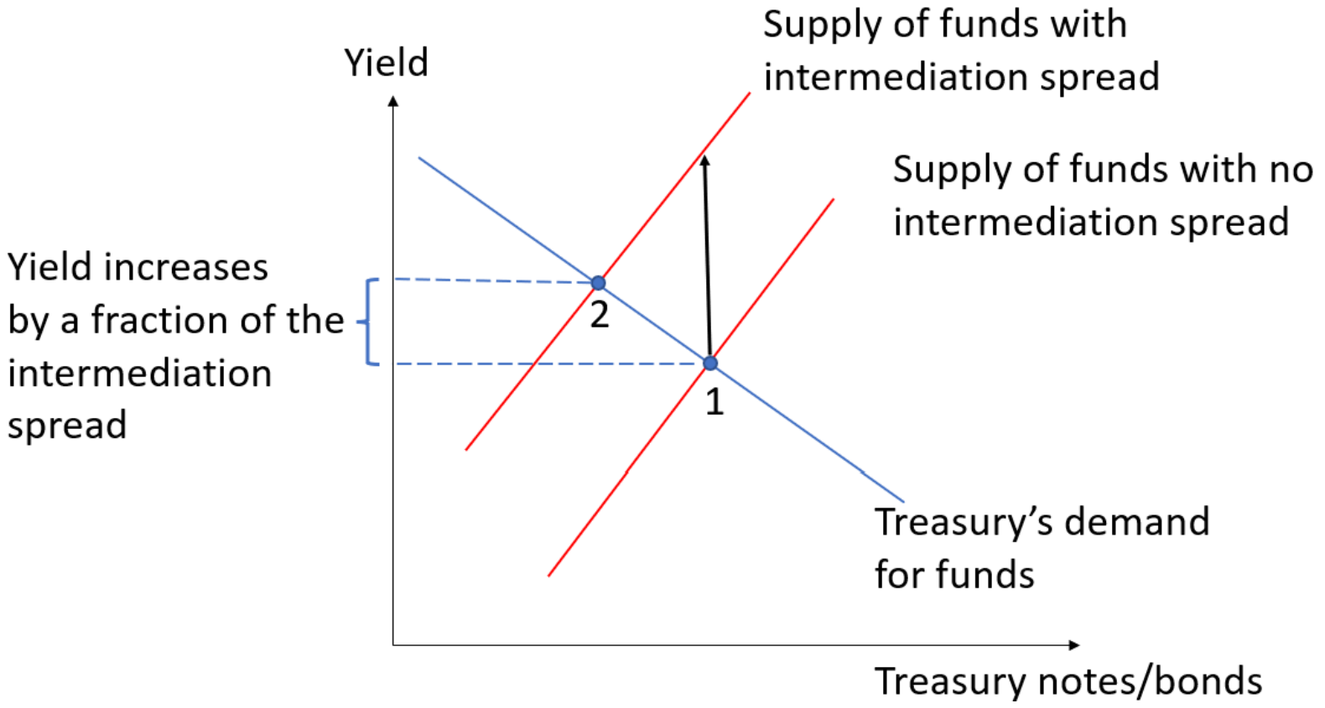
“somewhat surprising given the deficits and the large increase in the stock of Treasurys”

More realistic: Intermediation spread is split between Treasury and asset managers

Say the split is in fractions φ, 1-φ

- y(Treasury)= [Yield on convenient $ assets] + φ*[Intermediation spread]
- y(Swap) = [Yield on convenient $ assets] - (1-φ)*[Intermediation spread]

Treasury does not have vertical demand (example: can substitute to bills)



More realistic: Intermediation spread is split between Treasury and asset managers

Now, [Convenience yield on $ assets] is in between the two corporate spreads

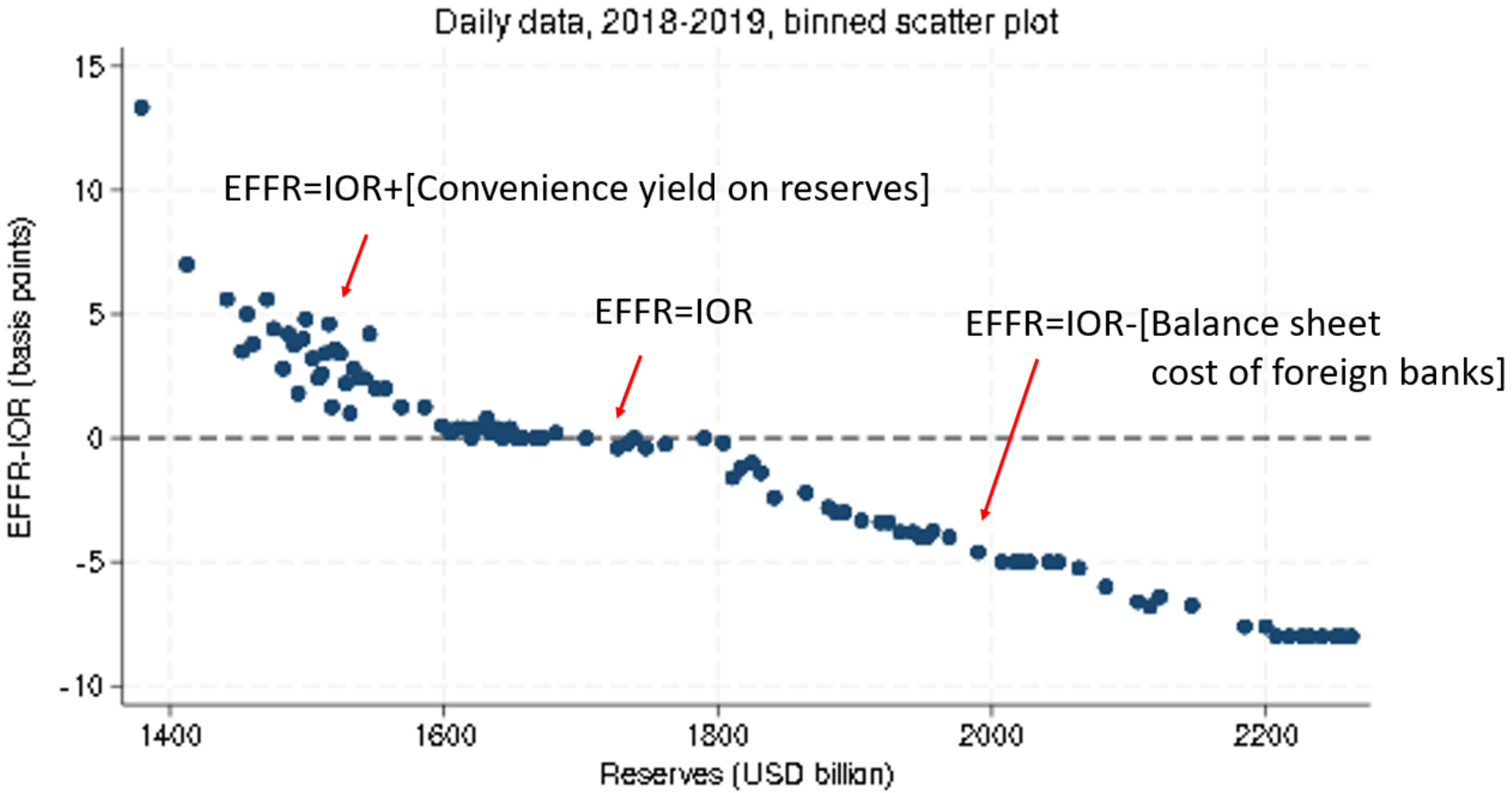
y(Corp(risk-adj.))-y(Swap) = [Convenience yield on $ assets] + (1-φ)*[Intermediation spread]

y(Corp(risk-adj.))-y(Treasury) = [Convenience yield on $ assets] – φ*[Intermediation spread]

y(Corp(risk-adj.))-y(Swap) flat → [Convenience yield on $ assets] has fallen 0 to 30 bps

- As you'd expect given more debt,
- Related, why would the marginal Treasury be held by a levered investor earning a substantial intermediation spread if [Convenience yield on $ assets] had not fallen?

Example from reserves: Switch to IOR arbitrage only after conv yield went to zero



Which convenience yield is more important: Raw or net of intermediation spreads?

Agents care about the relevant net convenience yields

- We should define two net convenience yields (related to Du, Hebert and Li (2023))

- Net issuance convenience yield: The good deal to issuers
  y(Corp(risk-adj.))-y(Treasury) = [Convenience yield on $ assets] – φ*[Intermediation spread]

- Net investing convenience yield: What investors willingly give up
  y(Corp(risk-adj.))-y(Swap) = [Convenience yield on $ assets] + (1-φ)*[Intermediation spread]

COMMENT 2. Large cyclicality. Is dollar convenience just at a cyclical low?

Current paper: Mostly about the last 5 years

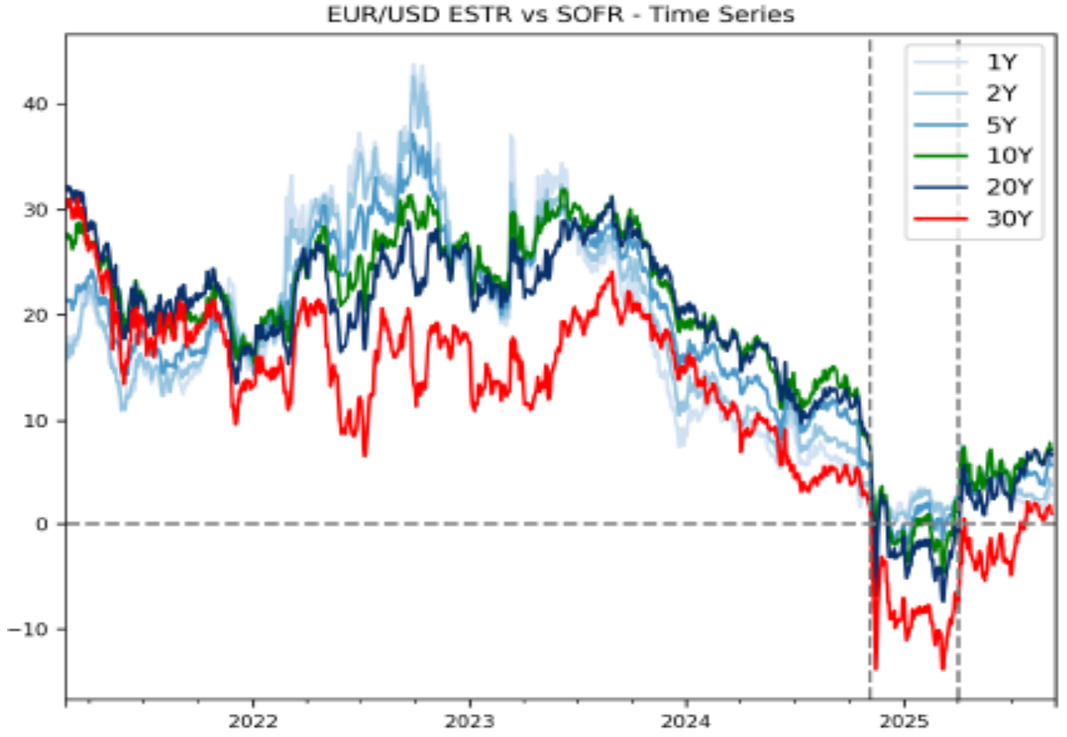
Du, Keerati and Schreger (2025): Longer sample back to 2000

(Synthetic $ yield - Yield on convenient $ assets) LONG MATURITIES

Current paper:

- Various tenors, rel. to euro

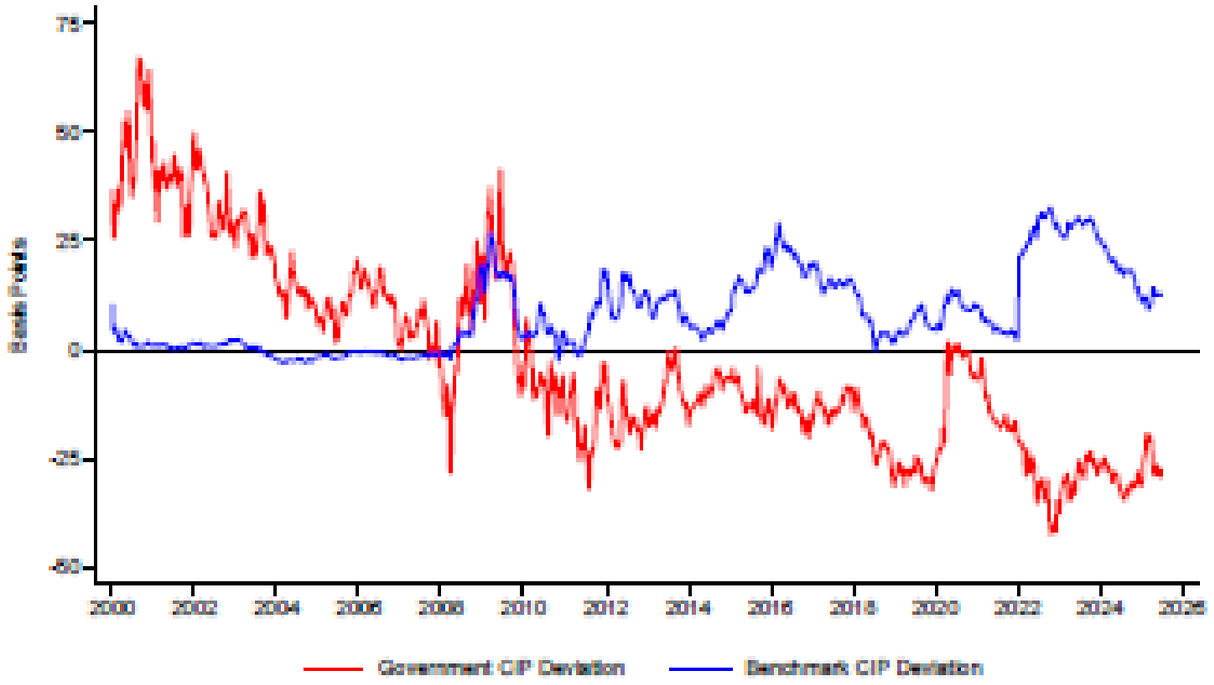
All lines based on swaps



Du, Keerati and Schreger (2025):

- 10 yr, relative to G10

Blue: Swaps. Red: Government bonds



(Synthetic $ yield - Yield on convenient $ assets) SHORT MATURITIES

Current paper:

- 1 yr tenors, rel. to euro

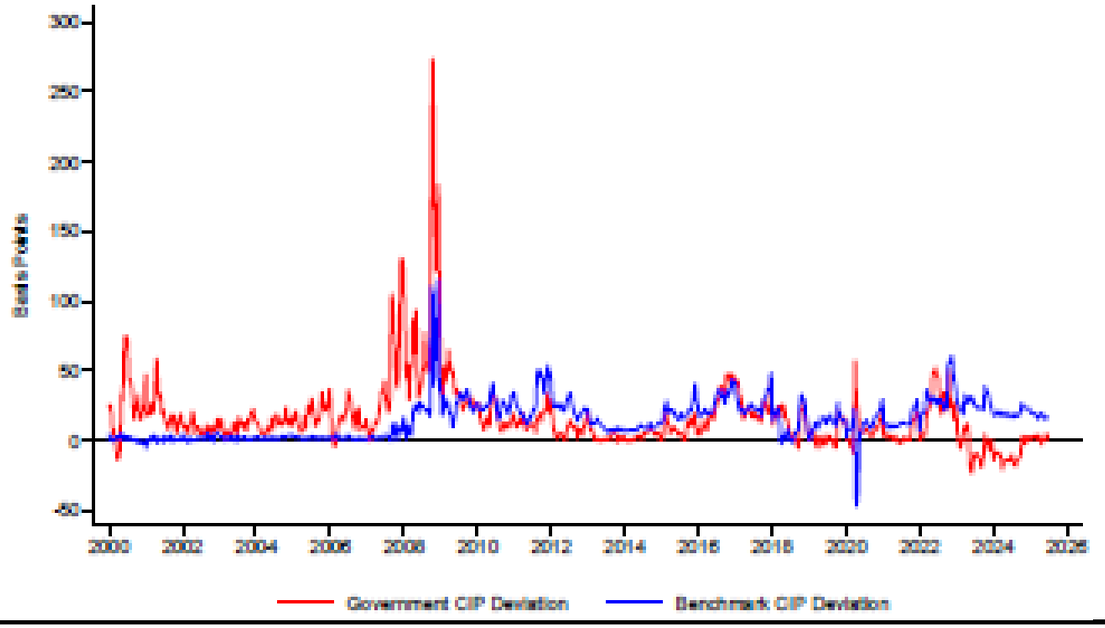
Red: Swaps



Du, Keerati and Schreger (2025):

- 3 month tenor, relative to G10

Blue: Swaps
Red: Government bonds



Conclusion

Dollar convenience = [Convenience yield on $ assets] - [Convenience yield on non-$ assets]

Paper:

- [Convenience yield on $ assets] is flat, yet *dollar convenience* is down substantially

Possibility:

- Dollar convenience is down *because* [Convenience yield on $ assets] is down, *not despite* it being flat

But dollar convenience measurement is hard, and cycles are large