PREFERRED HABITATS AND TIMING IN THE WORLD'S SAFE ASSET

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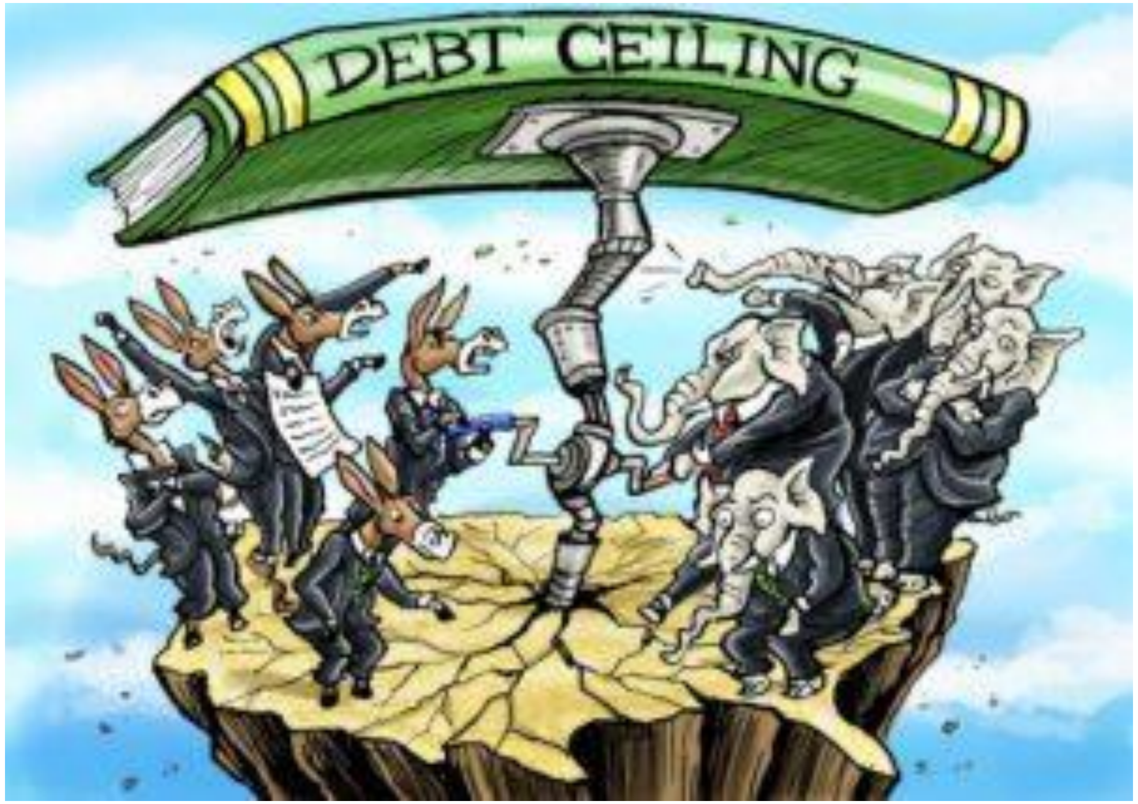
A paper about the demand for the world's safe asset

- determine Treasury yields
  - impact loan prices
- how U.S. monetary policy is transmitted domestically and abroad
- determines U.S. fiscal space

- affects patterns of global capital flows
  - flight to safety
- affects demand for the dollar
- used as reserve/FX management

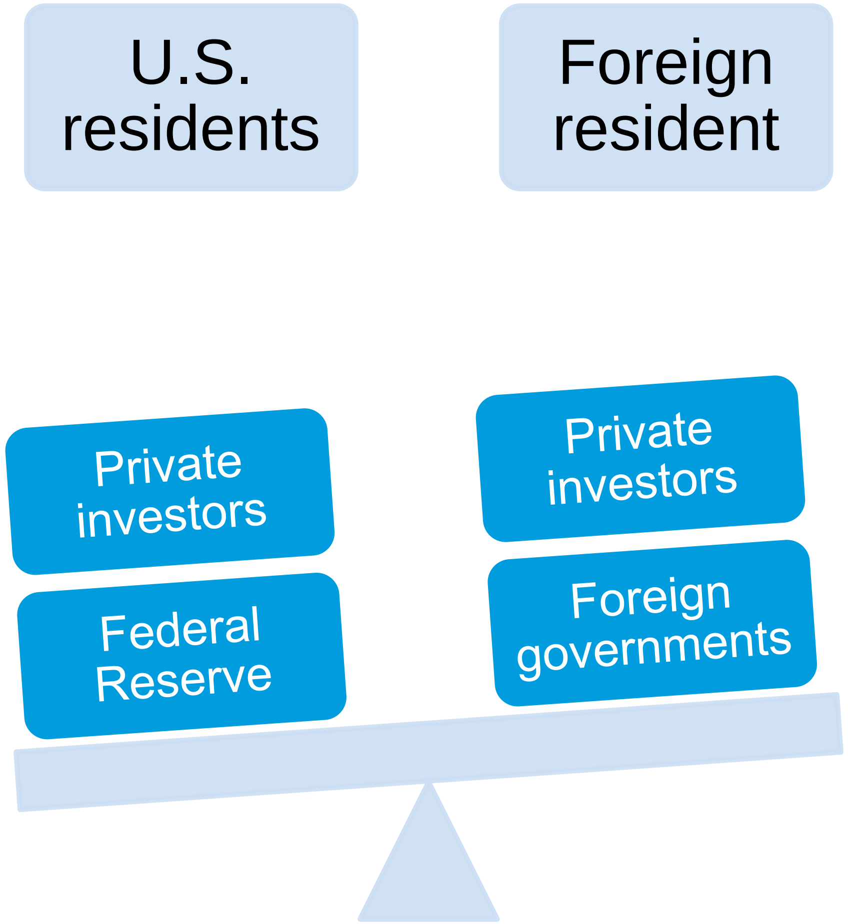


Contribution

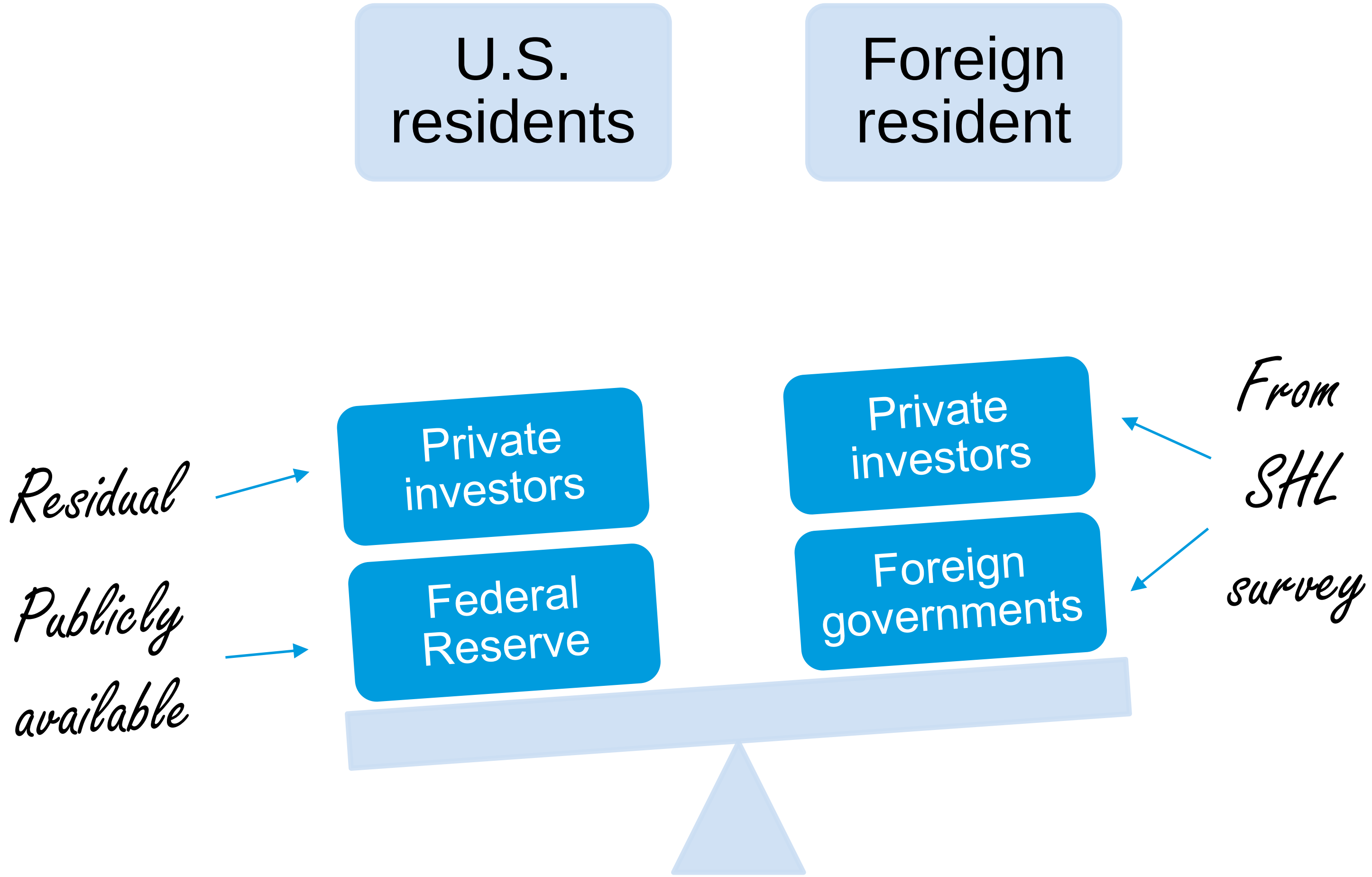
- Dataset at the security level
  - relies on SHL survey from custodians
  - contains market value and face value to disentangle valuation effects from purchases

- Calculation of returns
  - RoR (buy-and-hold rate of return)
  - Sharpe Ratios (volatility adjusted returns)
  - IRR to take into account both the composition of portfolios and the market, plus the timing and magnitude of purchases

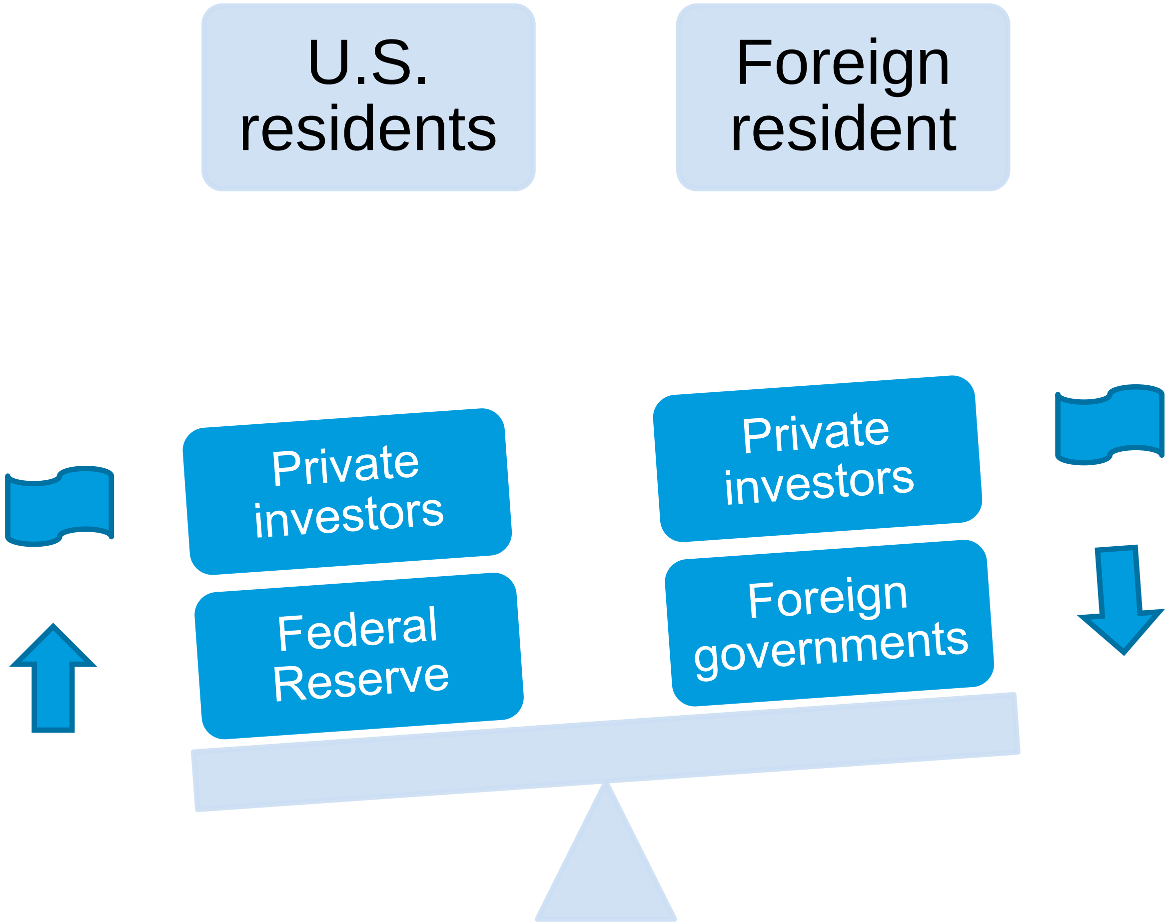
Who is demanding this asset?



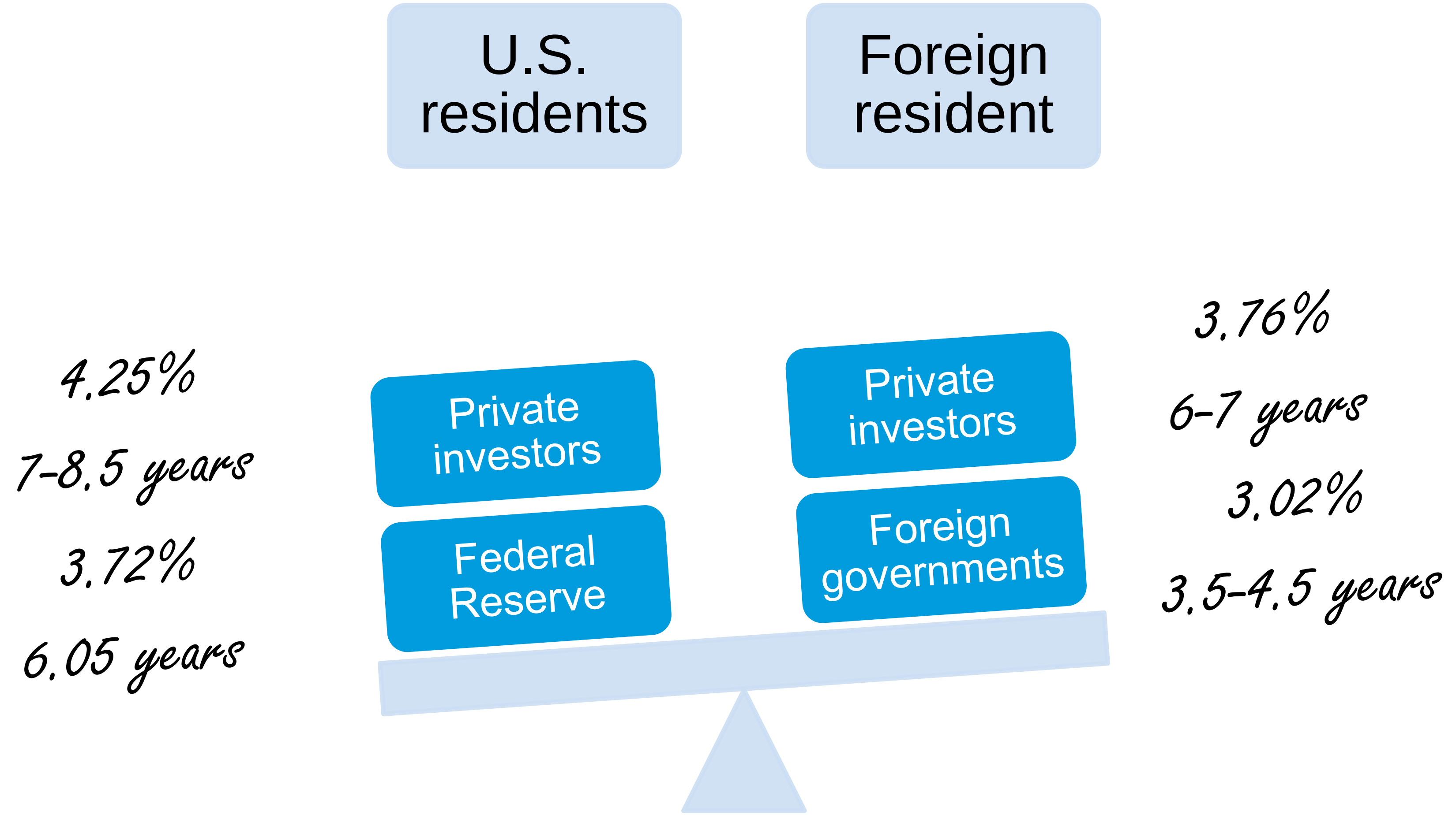
How do we measure this?



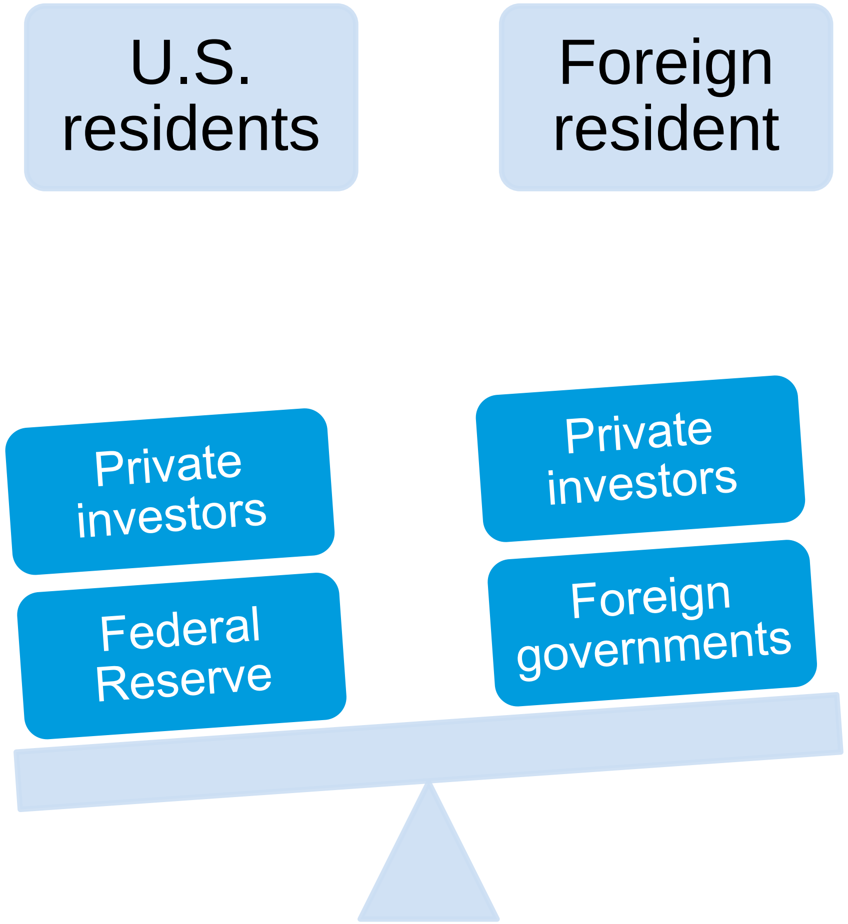
How has this developed?



RoR and duration?



IRR and timing?



2,27%

7-8,5 years

2,42%

6-7 years

2,66%

3,5-4,5 years

Relationship between investor flows and past spreads between foreign and U.S. yields

- Private investors (foreign or U.S.) purchase when the synthetic dollar yield is low (or has fallen) relative to the Treasury yield, i.e. when treasuries are relatively cheap

- Foreign officials do not seem to adjust their net purchases based on the levels of or changes in CIP deviations

- Same goes for duration

Who buys from the Fed?

- Seems to be private investors
  - Also the ones who hold long duration
  - Foreign governments have shown almost zero net purchases since 2014
- BUT - and let me start my comments - preferred habitat means that there is a threshold for which investors invest outside of their preferences.
  - Not tested in the paper

Can we find out more about demand functions?

$$\text{Flow}_t/\text{Position}_{t-1} = \alpha + \beta(\text{CIP}_t - \text{CIP}_{t-k}) + \epsilon_t$$

- How can we best exploit the security level data?
- How does this differ from demand for the German Bund?
- How do purchases react to different events apart from CIP deviations
  - Global uncertainty?
  - Country specific developments?
  - Bilateral movements in exchange rates?
- Country heterogeneity

How to connect to the literature

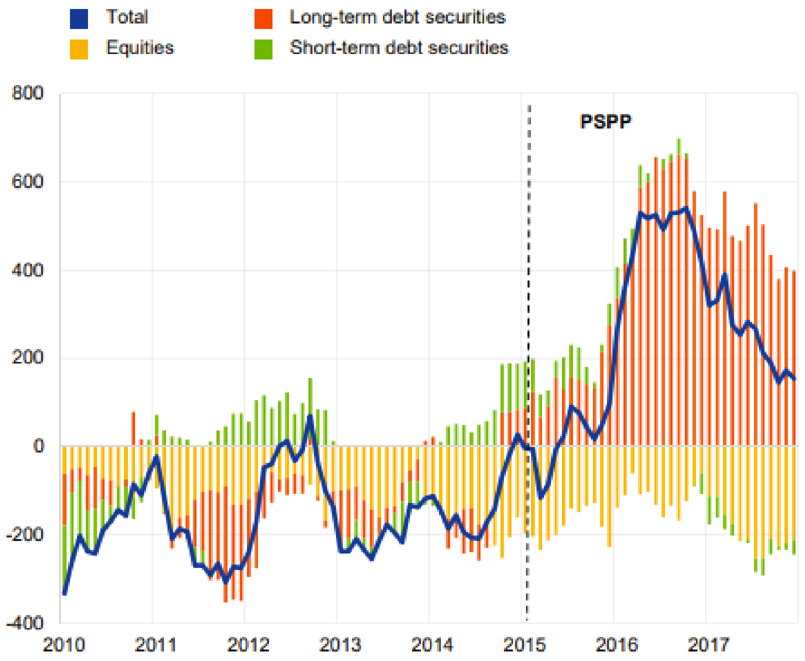
- Very well connected to strand of literature that finds the opposite (mainly Krishnamurthy and Lustig (2019) and Jiang et al. (2021, 2022)).

Literature	This paper
Convenience yield on U.S. Treasuries from 500 - 200 basis points	No convenience yield (or just not different for foreign vs. domestic)
Foreigners have poor timing	Foreigners do not have poorer timing than private U.S. investors
Foreigners buy treasuries when they are expensive	Foreigners buy when treasuries are cheap (yields high relative to synthetic yield)

How to connect to the literature

Could be more connected to other strands of literature:

- Determinants of capital flows
- Risk of sudden stops



Bergant et al. (2021), ECB and IMF WP

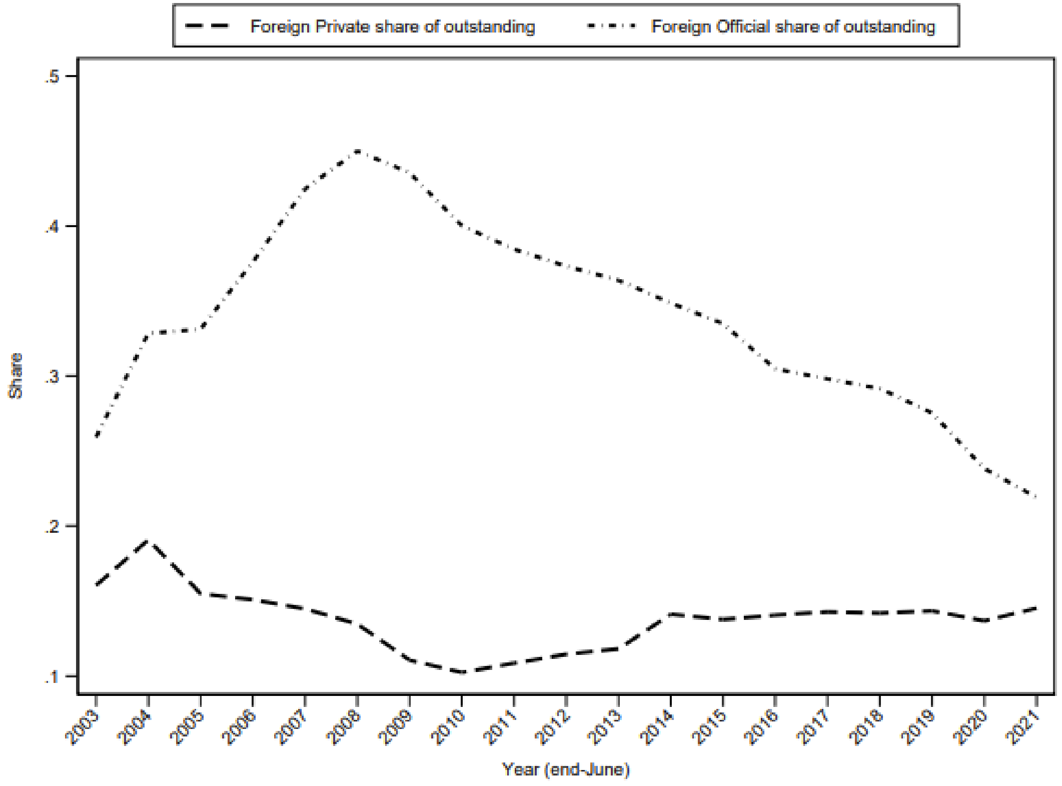
- International Spillovers
  - What happens when other major CBs conduct QE?
    - Euroarea investors clearly invested abroad after 2015 QE

What about privilege?

- Large literature that assets held by U.S. residents outperform their liabilities
  - Gourinchas and Rey (2007), Gourinchas and Rey (2014), Gourinchas et al. (2019) or Eichengreen (2011), Obstfeld and Rogoff (2005), Meissner and Taylor (2006) and Lane and Milesi-Ferretti (2004).

- "Global misallocation of capital" (Bertaut et al., 2023)
  - "U.S. assets earn a positive excess return of 1.8 percent, on average."

On the data: what if governments don't hold treasuries directly?



vs.

from Follow the Money *and* Greenberg Center for Geoeconomic Studies

China Isn't Shifting Away From the Dollar or Dollar Bonds

Other comments

- Nationality vs. residents
  - Private might buy U.S. treasuries in the U.S.
  - Can governments go through private firms abroad?
- Periods driving this relationship
  - In the graphs, some patterns change around GFC or Covid-19 – calls for robustness without those periods
- Policy recommendations? Beyond the US?

Conclusion

- This is a great paper, providing not just insightful but very important dynamics of the demand for the world’s safe asset

- Implications for fiscal policy, asset pricing, international economics, political economy and probably more fields

- Ground for a lot of future research