Faculti Summary
https://faculti.net/dollar-reserves-and-u-s-yields/

This video discusses the interest rate conundrum first identified by former Federal Reserve Chairman Alan Greenspan in the early 2000s, highlighting how adjustments to the Fed fund rate did not produce expected responses in medium to long-term U.S. Treasury yields. Bernanke later framed this issue in terms of excess global savings, particularly from emerging markets like China, which affected the demand for U.S. Treasuries.

The document explores the impact of foreign official purchases and sales of U.S. Treasury securities, especially during periods of market stress, such as the disruption witnessed in March 2020. It notes that these foreign transactions can significantly influence Treasury yields, underscoring the complexities introduced by foreign accumulation of reserves and the use of the dollar in international sanctions.

The research aims to challenge conventional beliefs about foreign purchases of Treasuries being price-insensitive, utilizing publicly available data to support the analysis. The methodology includes vector autoregression to examine the interactions between foreign flows and Treasury yields and finds a substantial price impact from foreign official flows on Treasury yields, with rates dropping significantly for large-scale purchases or sales.

The study concludes that this price impact is larger than previously estimated, with immediate effects that decay over time, suggesting the dynamics of market reactions to foreign transactions have changed, particularly since the global financial crisis. The findings indicate a growing vulnerability in the U.S. Treasury market, especially in the context of potential geopolitical tensions and the challenging landscape of U.S. monetary policy normalization. The document emphasizes the need for further research into the implications of low elasticity within capital markets, particularly relating to fixed income markets and U.S. Treasuries.

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