## **EDWARD CONARD**



## **Macro Roundup Article**

Headline: Can U.S. Treasury Markets Add and Subtract?

Article Link: <a href="https://conference.nber.org/conf">https://conference.nber.org/conf</a> papers/f195593.pdf

Author(s)	Roberto Gomez Cram, Howard Kung, and Hanno Lustig
Publication	National Bureau of Economic Research
Publication Date	July 12, 2024

**Tweet:** Market reaction to CBO scoring of legislative proposals with large negative cash flow projections implies an estimated  $57\phi$  of each dollar in major fiscal expansions is unbacked by future surpluses and passed through to Treasury valuations. @HannoLustig

**Summary:** The CBO cost releases of U.S. spending and tax [legislative] proposals contain valuable news about future primary surpluses priced in by U.S. Treasury investors. Using daily event windows, we find that cost releases with large negative cash flow projections have lowered the valuation of all outstanding Treasurys by more than 20% between 1997 and 2022. The valuation effects are concentrated at longer maturities, with an overall increase of 4% in long-term nominal yields driven by an increase in nominal term premia and inflation expectations and a decrease in convenience yields. We account for these valuation effects in a model with Bayesian [rationally updating] bond investors who use the cost releases to learn about the long-run dynamics of U.S. deficits. Using the estimated model, we infer that 57 cents of every dollar in the fiscal expansion is unbacked and passed through to Treasury valuations. Our estimates imply that a one percentage point surprise increase in the expected supply of Treasurys, expressed as a fraction of GDP, corresponds to an increase of the 10-year nominal yield by 31 bps and a drop in the convenience yield of 7.5 bps.

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**Primary Topic:** Financial Markets

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