SPEECH

The Important Role of the Foreign Investor in the U.S. Treasury Market

November 16, 2023

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Remarks at 2023 U.S. Treasury Market Conference, Federal Reserve Bank of New York, New York City

As prepared for delivery

Good afternoon. It is a pleasure to speak with you today at the 2023 U.S. Treasury Market Conference. I appreciate the opportunity to engage with so many thought leaders across the industry. This is a unique forum for the diverse set of Treasury market investors to engage with the official sector and academics.

In my remarks today, I would like to discuss the important role of one subset of that diverse investor base: the foreign investor. I will explain how the key properties of Treasury securities, specifically their liquidity and safety, attract foreign official and private investors alike, and how this relates to the role of the U.S. dollar as a primary international reserve and investment currency. I'll then conclude by reviewing the Federal Reserve's repo facility for the foreign official sector and how it supports Treasury market functioning.

Before I begin, I would like to note that the views I express today are my own and do not necessarily reflect the views of the Federal Reserve Bank of New York or the Federal Reserve System.[1]

Foreign Holdings of U.S. Treasury Securities

According to Treasury International Capital (TIC) data, foreign investors hold about $8 trillion of Treasury securities, which is about 30 percent of the market—a large share. This high degree of foreign interest reflects the liquidity, reliability, and insurance value of Treasuries in a diversified portfolio.

Foreign Treasury holdings are split nearly equally between the official sector—mostly central banks and sovereign wealth funds—and the private sector, which includes institutions such as banks, insurers, hedge funds, and pension funds.

So, why are these various foreign investors drawn to U.S. Treasury securities?

This diverse set of foreign institutions are attracted to Treasuries for an equally diverse set of reasons.

For one, the liquidity of the Treasury market is critical for reserve managers and is highly valued by all investors that seek to maintain a diverse securities portfolio. Many reserve managers have liquidity as the primary objective for their foreign reserves to ensure ready access to funds.

Trading conditions in the Treasury market have been front of mind this past year as high levels of market volatility have resulted in intermediaries adjusting how they provide liquidity. Even so, it is important to recognize that this adjustment appears largely commensurate with the increased level of market volatility and without interruption to market functioning. Investors have been able to transfer risk effectively across both on- and off-the-run securities.

In addition to trading liquidity, Treasuries offer safety since they are backed by the full faith and credit of the United States government, with recourse to the independent U.S. legal system. For reserve managers, maintaining a high degree of safety is essential for ensuring foreign reserves are reliably available to meet liquidity needs.

Lastly, U.S. Treasuries provide a diversification benefit and insurance value to investors that pays out in an uncertain world. The future is ultimately unknowable, and time and again we are reminded that allocating to safe and liquid assets can protect portfolios from the unexpected.

Trends in the Foreign Allocation to U.S. Treasury Securities

The liquidity and safety provided by Treasuries to investor portfolio is real. To this, I want to highlight that during recent periods of high market volatility, foreign investors as a group actually increased their allocations to U.S. Treasuries.

For example, we can see that the foreign private sector has increased its share of U.S. Treasury holdings for the last three years after controlling for market valuations. This high degree of interest is occurring despite FX hedging costs eroding most of the yield gain earned by buying Treasuries. We think that this is a testament to the fundamental value of Treasuries within a well-diversified portfolio.

While the share of U.S. Treasuries held by the foreign official sector has declined slightly in recent years, this change appears to largely reflect idiosyncratic factors—with some reserve managers decreasing and others increasing their holdings as global FX reserve levels have plateaued.

The Federal Reserve's Relevant Backstop Tools

The Federal Reserve plays a key role in promoting financial stability and supporting the smooth global use of the dollar. To this end, the Fed maintains a repurchase facility for foreign and international monetary authorities, also known as the FIMA Repo Facility, in part to support a well-functioning Treasury market. These foreign account holders can temporarily exchange Treasury securities for dollars to meet potential liquidity needs through repo transactions with the Fed rather than relying solely on the market.

Despite limited and sporadic usage, there is evidence that the facility demonstrates its capacity to effectively serve as a timely liquidity backstop and minimizes the need for asset sales to address dollar liquidity needs.[2] This facility also expands the reach of the Federal Reserve's provision of U.S. dollar liquidity overseas beyond its network of dollar liquidity swap lines.

Conclusion

As I wrap up, I want to emphasize that the liquidity and safety of the Treasury market is what makes it unique within the investment world, and the strong presence of the foreign investor is a testament to those qualities. The large-scale participation of foreign private and official investors helps make the market resilient across many states of the world.

Thank you very much.

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[1] I would like to thank Max Dunn and Fabiola Ravazzolo for their assistance in preparing these remarks.

[2] Linda S. Goldberg and Fabiola Ravazzolo, The Fed's International Dollar Liquidity Facilities: New Evidence on Effects, NBER Working Paper 29982, April 2022, and Colin R. Weiss, Foreign Demand for U.S. Treasury Securities during the Pandemic, FEDS Notes, Board of Governors of the Federal Reserve System, January 28, 2022.