

The Price of Future Liquidity: Time-Varying Liquidity in the U.S. Treasury Market

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Abstract

This paper examines the price differences between very liquid on-the-run U.S. Treasury securities and less liquid off-the-run securities over the on/off cycle. Comparing pairs of securities in time-series regressions allows us to disregard any fixed cross-sectional differences between securities. Also, since the liquidity of Treasury notes varies predictably over time, we can distinguish between current and future liquidity. We compare a variety of (microstructure-based) direct measures of liquidity to compare their effects on prices. We show that the liquidity premium depends primarily on the amount of remaining future liquidity.

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