How Do Treasury Dealers Manage Their Positions?

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Abstract

Using thirty-one years of data (1990–2020) on U.S. Treasury dealer positions, we find that Treasury issuance is the main driver of dealers' weekly inventory changes. Such inventory fluctuations are only partially offset in adjacent weeks and not significantly hedged with futures. Dealers are compensated for inventory risk by means of subsequent price appreciation of their holdings. Amid increased balance sheet costs attributable to post-crisis regulatory changes, dealers significantly reduce their position taking and lay off inventory faster. Moreover, the increased participation of nondealers (investment funds) in the primary market contributes to diminishing compensation for inventory risk taken on at auctions.

Keywords: Treasury market, dealer, positions, inventory, hedging, issuance

JEL Classification: G12, G20, G24

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