Dollar Erosion

What would the loss of reserve currency status look like, and where would we see it first? What would the financial world look in the aftermath?

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Outline

1	What is special about the dollar	World money and the convenience yield
2	Where dominance is housed	Liquidity size and currency dominance
3	What erosion looks like	Prices move before quantities: 2021–2026 and the 2025 tariff episode
4	The endpoint of full erosion	Exchange rate, safe rate, and the present value at stake

ONE

What is special about the dollar?

Safe dollar debt is an export good. The United States sells liquidity services to the rest of the world and is paid in a convenience yield.

Convenience yield on dollar safe assets

How much yield will a world investor forgo for the safety and liquidity of a dollar safe claim, relative to foreign-currency assets? E.g. Treasury vs Canadian corporate bond

UIP $$E_t\left[y_t^{\$} - y_t^f + \Delta e_t\right] = \lambda_t^{\$}$$

CIP $$\left[y_t^{\$} - y_t^f + fp_t\right] = (1-\beta)\lambda_t^{\$}$$

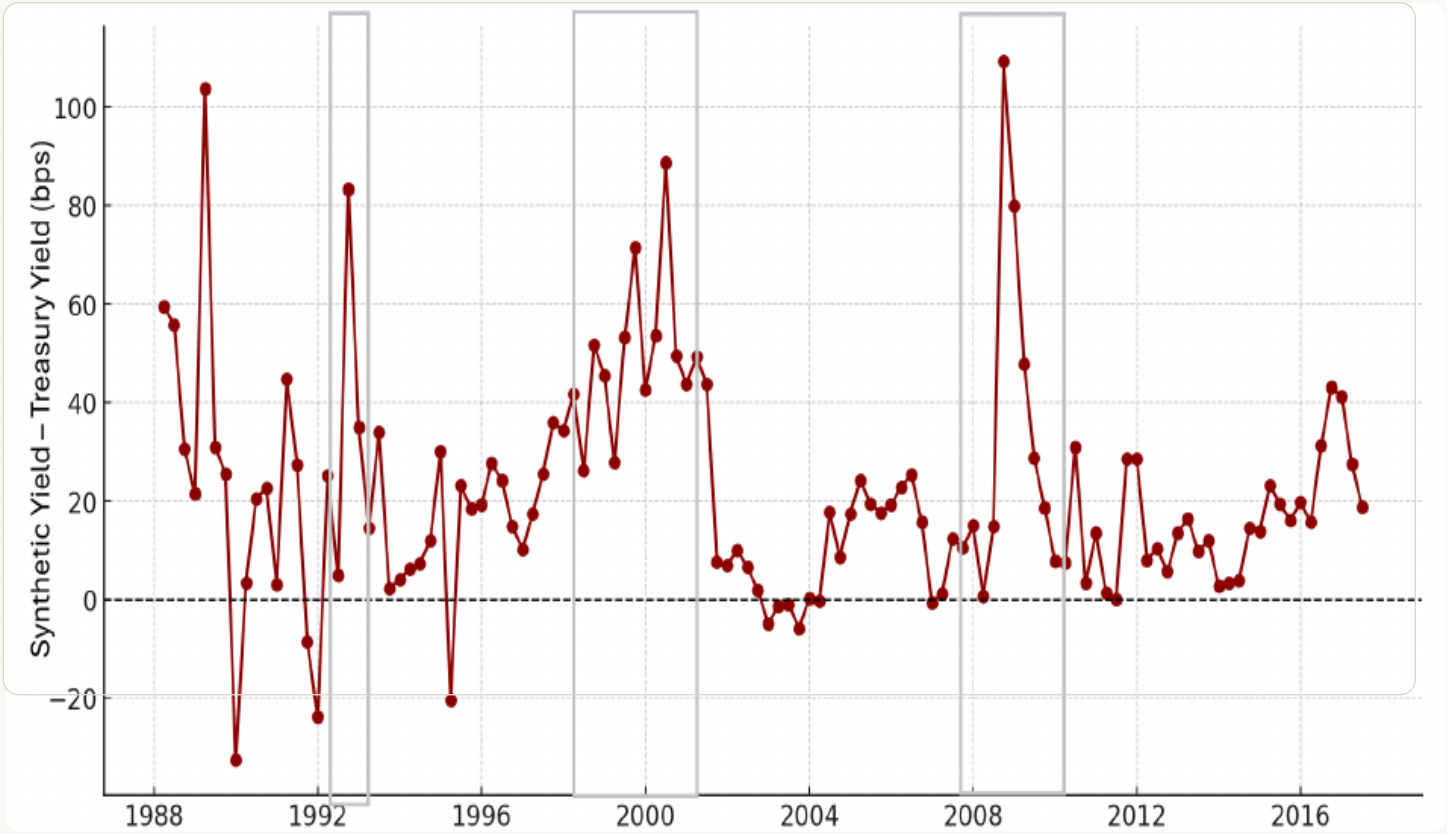
The CIP wedge

synthetic yield *minus* Treasury yield

Build a synthetic dollar Treasury from foreign government bonds by swapping the cash flows into dollars. Compare its yield with the actual Treasury.

Measurement follows Du, Tepper and Verdelhan (2018) and Jiang, Krishnamurthy and Lustig (2021)

Historically, dollar safe assets are special: 1y Treasury vs G10 govts



Positive on average

Foreign investors have persistently paid for cash dollar safe assets; 22 bps on average in sample.

Counter-cyclical

The wedge widens when volatility spikes — 1998, 2000, 2008 — and the dollar appreciates with it.

Dollar comovement

Changes in the wedge and the dollar co-move, with an R^2 of about 40%.

Synthetic yield minus Treasury yield, basis points. Shaded bands mark NBER recessions. Jiang, Krishnamurthy and Lustig (2021)

Why 2%? CIP is only part of the premium

Comparison	What it isolates	Estimate
Treasury vs. synthetic dollar bond	Cash-over-synthetic safety premium	CIP basis — tens of basis points
Dollar bond vs. foreign bond	Dollar-over-foreign liquidity premium	UIP basis — roughly 9× the CIP basis
	Total premium on the dollar	**20bp CIP basis: 2% dollar premium**

Krishnamurthy–Vissing-Jorgensen (2012)

About 75 basis points on Treasuries relative to U.S. corporates, 1920–2012.

Jiang–Krishnamurthy–Lustig (2021)

About 200 basis points on Treasuries relative to non-dollar safe claims. This is the calibration target.

Chumbo-Krishnamurthy (2026)

About 90 basis points on USD repo relative to U.S. corporates, 2019-

Safe dollar debt is world money ⇒ Dollar Dominance

Foreign investors, central banks and financial institutions hold Treasuries and other dollar safe assets for their service as payment instruments, collateral and stores of value — not for their return.

Dollar convenience yield

Driving down the yields on safe dollar bonds

Dollar debt

Banks, firms and governments tap into this demand, tilting borrowing decisions towards dollars

Dollar invoicing

Ample supply of dollar finance from banks; exporters borrow in dollars and invoice in dollars

Exorbitant privilege

The U.S. supplies safe debt to the rest of the world and earns “convenience seigniorage”

Global financial cycle

Tightening terms on dollar credit spills over to the rest of the world

Jiang, Krishnamurthy and Lustig (2024)

Exorbitant Privilege: How much liquidity does the U.S. export?

Flow of Funds, 2016Q4	Stock, % of US GDP	Share held abroad	Exported, % of US GDP
Public — Treasuries, agency debt	94%	39%	37%
Private — commercial paper, IG corporates, net short-term bank liabilities	111	14	15
Total safe dollar debt	about 205%	about 26%	about 50%

The seigniorage arithmetic

50% of GDP in foreign-held safe dollar claims, at a 2% convenience yield, is about **1% of GDP per year**.

Who receives it

Taxpayers through the government budget; banks through franchise value; households through mortgage finance and collateral values.

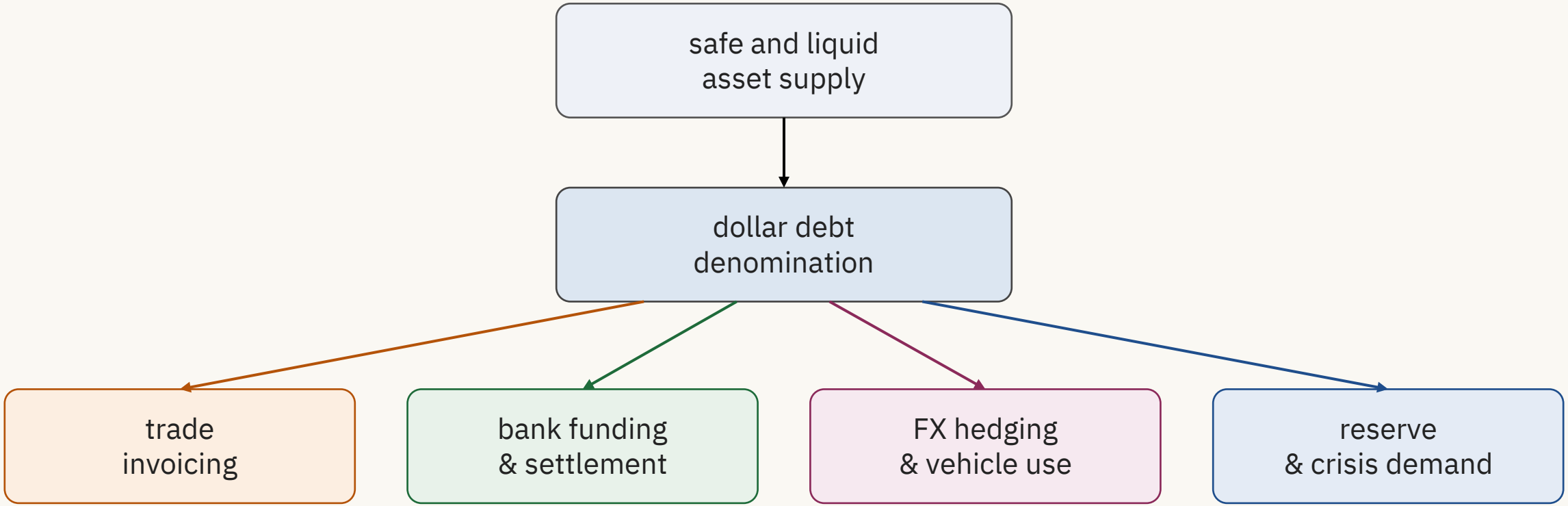
Baseline calibration of Jiang, Krishnamurthy, Lustig and Richmond (2026)

TWO

Where has dominance been housed, and why does it move?

Coppola, Krishnamurthy and Xu (2025): the dominant currency is the one with the largest stock of safe, liquid debt — and the complementarity that creates is why transitions are slow and then sudden.

Safe and liquid asset supply is foundational



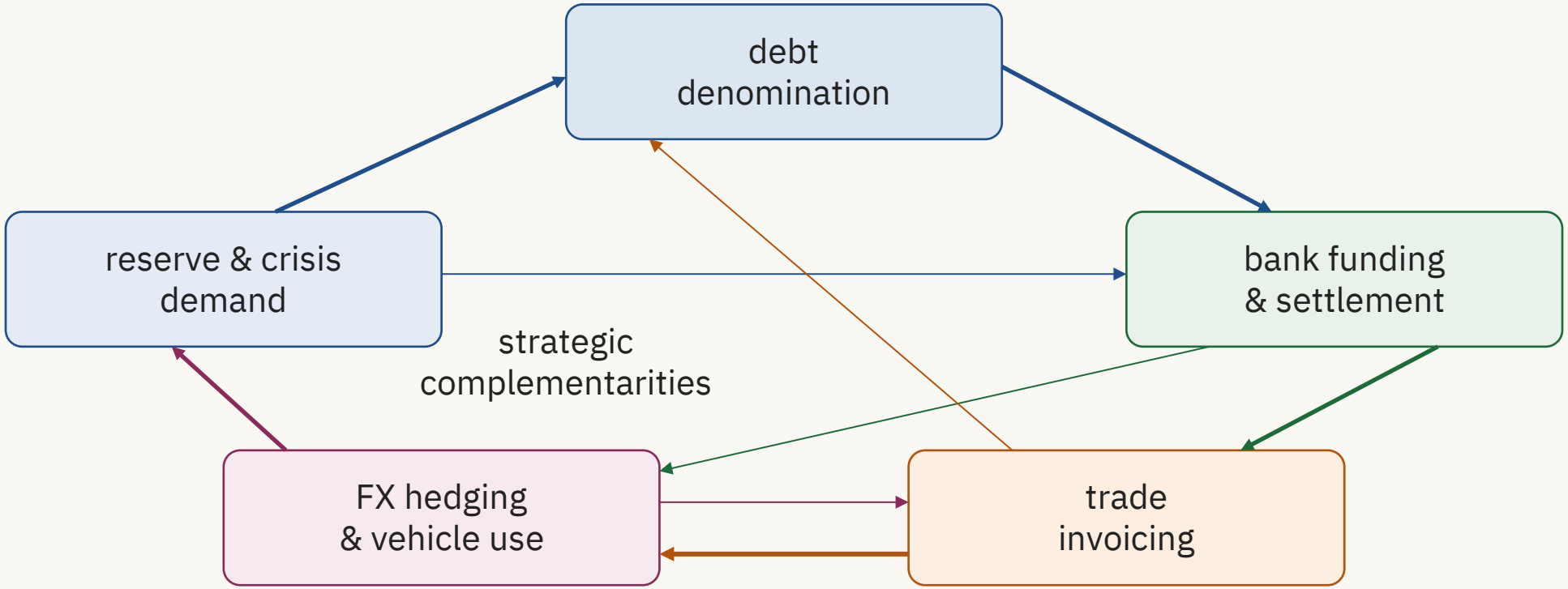
– The domains are organized by safe and liquid asset supply.

⇒ Liquid/safe dollar asset supply makes dollar denomination attractive.

⇒ Denomination feeds into dollar invoicing, funding, hedging, reserves, crisis demand...

Coppola, Krishnamurthy and Xu (2025)

The system is self-reinforcing



– The system is not a single chain, but a set of reinforcing causal margins centered on liquidity and denomination.

– Once in place, strategic complementarities make the system self-reinforcing.

⇒ A rival currency has to replicate an entire mutually supporting ecosystem.

Coppola, Krishnamurthy and Xu (2025)

Dominance follows financial depth, not economic size only

In each historical episode the dominant currency was not the one belonging to the largest economy or the largest trader. It was the one with the deepest and largest stock of safe, liquid claims.

Era	Dominant unit	Larger economy at the time
17th–18th century	Amsterdam bank florin	Spain — larger, wealthier, about six times the trade volume
19th–20th century	Pound sterling	The United States, from the turn of the 20th century
21st century	U.S. dollar	???

Each transition followed a collapse or an expansion in the **stock of safe/liquid claims,** not a crossover in GDP.

Coppola, Krishnamurthy and Xu (2025); see also Quinn and Roberds (2014, 2019), Eichengreen (2008, 2017)

Erosion first, then possibly a switch

Step 1 — Erosion

Reserve-currency liquidity falls. Firms and investors in countries around the world at the margin shift back toward their home currencies; the stable point drifts and prices adjust.

Step 2 — Dominance shift

If the weakening is large enough *and* a credible alternative exist, the economy crosses the threshold and selection flips.

Dominance strengthens as the rival's safe debt stock, its liquidity technology, or its private issuance rise — and, once a currency is dominant, even growth in the challenger's private sector can reinforce the incumbent.

A sufficiently large safe debt stock in the dominant country selects a unique equilibrium. Coppola, Krishnamurthy and Xu (2025)

Taking stock

FROM PART ONE

The U.S. as safe asset provider

Reserve status is a quantity of exported liquidity times a price. Its measurable.

FROM PART TWO

Erosion, not a quantity shift

Adjustment runs through the price of liquidity and portfolio quantities.

What this implies for where to look

Asset prices will register erosion before holdings do. So, we should examine convenience yields and correlations first, and foreign shares second.

THREE

What erosion looks like in the recent data

Three observations from 2021 to 2026 suggest erosion in trust in US public debt

1/ The US Treasury-vs-Euro safe convenience yield has fallen



What is plotted

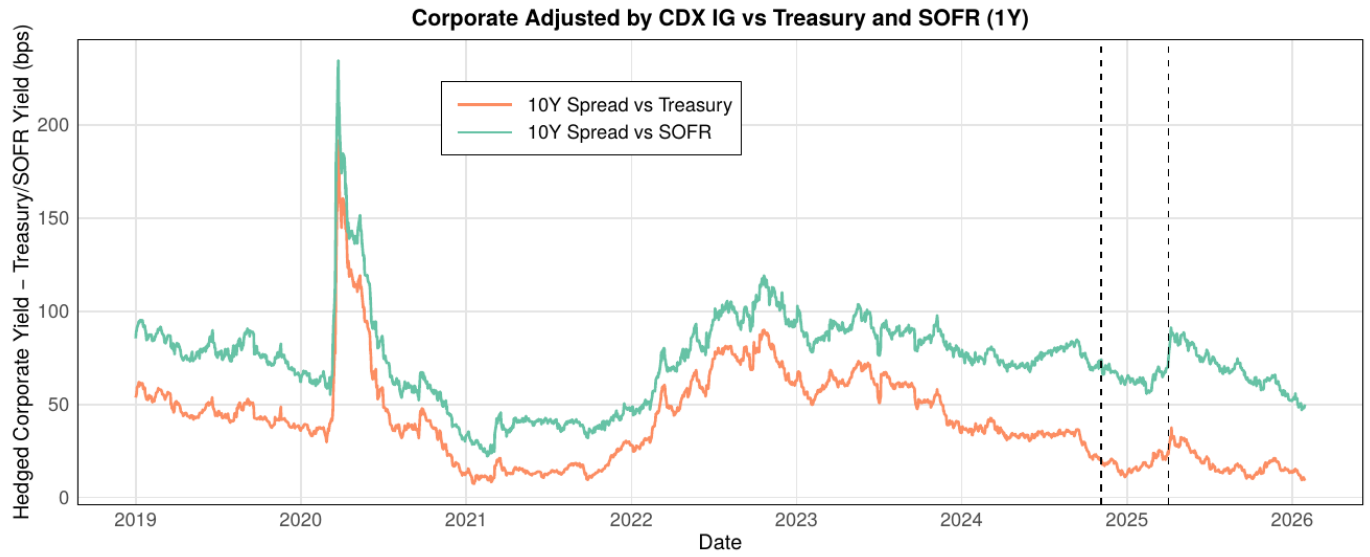
Treasury bill premia relative to the currency-hedged euro safe rate (ESTR)

The movement

From roughly 60 basis points in 2022 to approximately zero, and at times negative, by 2025.

Basis points. Jiang, Krishnamurthy, Lustig and Richmond (2026); magnification estimate from Jiang, Krishnamurthy and Lustig (2021)

2/ The loss is concentrated in public debt



The comparison

A CDS-hedged corporate bond yield measured against the Treasury yield, and against the Repo based swap rate (SOFR).

The divergence

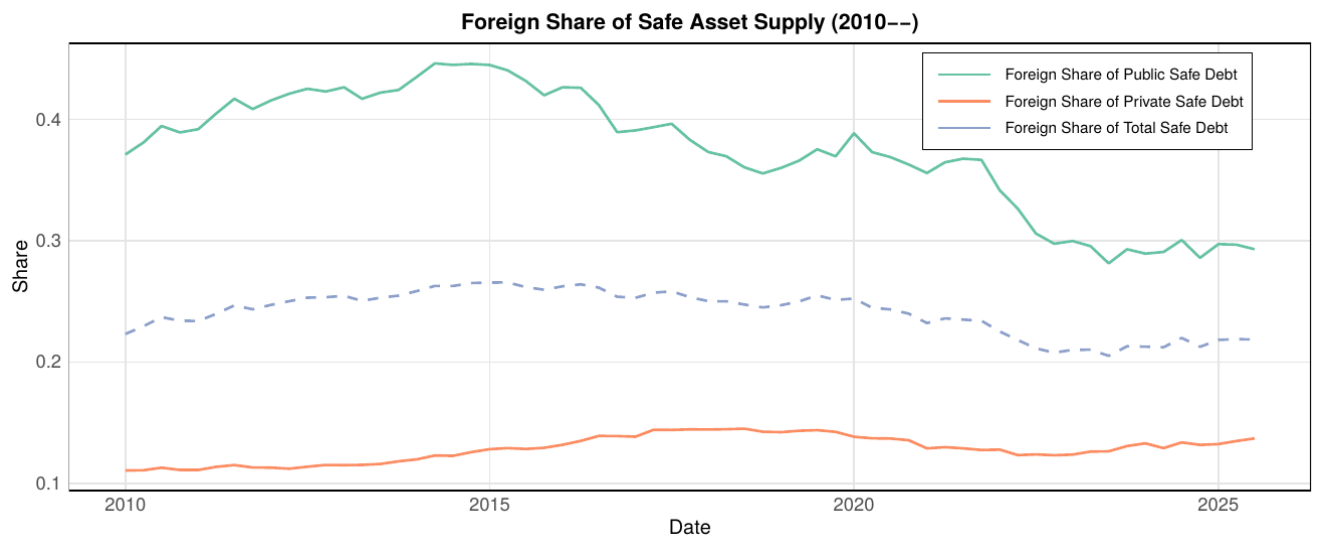
The Treasury spread has compressed. The repo spread has not — private dollar safe asset premia are broadly stable.

Why it matters

The loss is specific to the sovereign claim, which points at fiscal and institutional capacity rather than at dollar liquidity in general.

Hedged corporate yield minus Treasury or SOFR yield, basis points. Jiang, Krishnamurthy, Lustig and Richmond (2026)

3/ Foreign ownership of public debt fell too



Public claims

The foreign-held share of Treasuries and agency debt has fallen from about 45% to about 30%.

Private claims

The foreign-held share of private safe dollar debt has stayed close to 15% throughout.

Same asymmetry, different margin

Quantities corroborate the price evidence and point the same way: at the sovereign claim specifically.

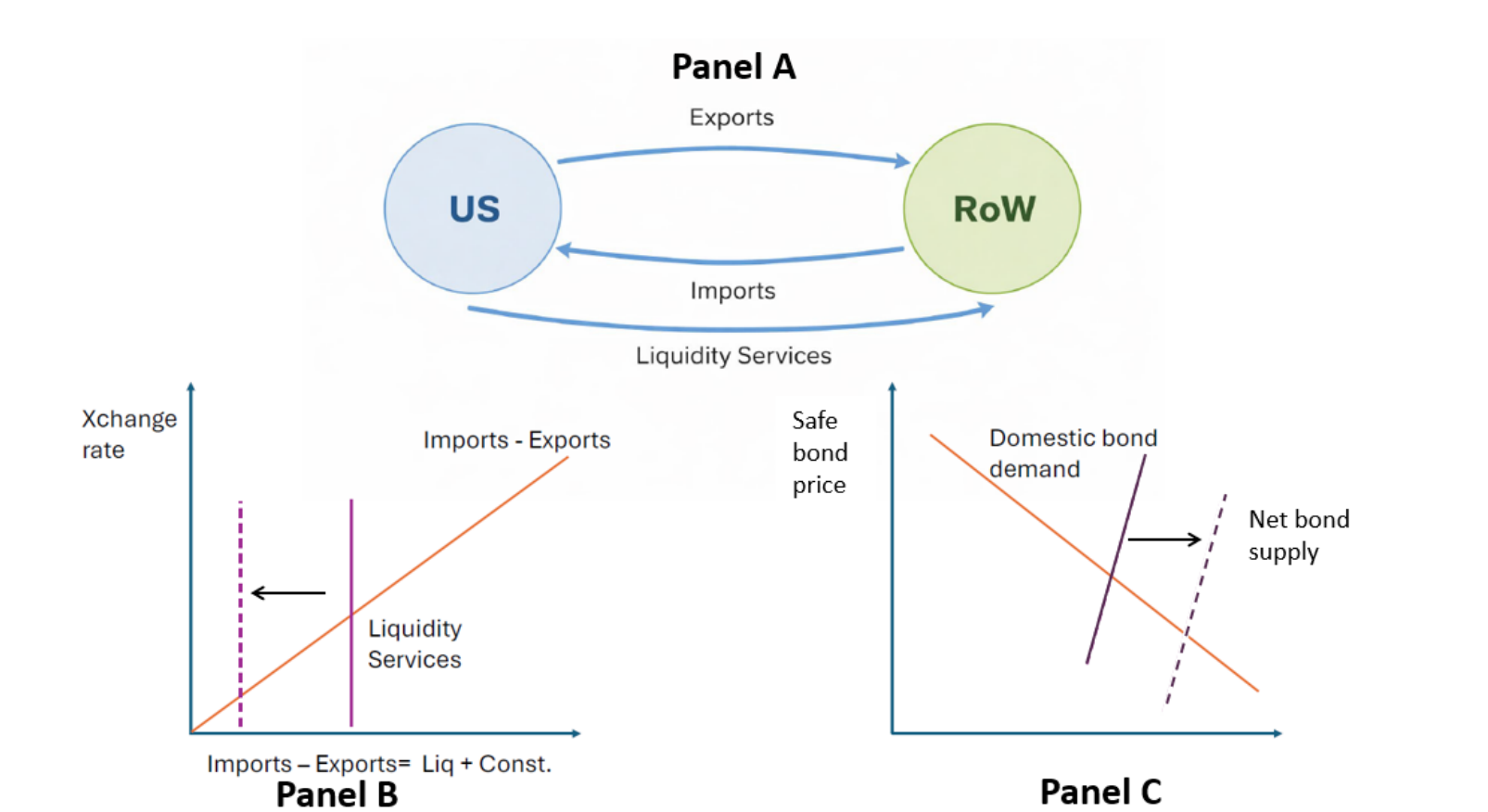
Foreign share of safe asset supply. Public: Treasuries and agency debt. Private: commercial paper, investment-grade corporates, net short-term bank liabilities. JKLR (2026)

FOUR

Full Erosion

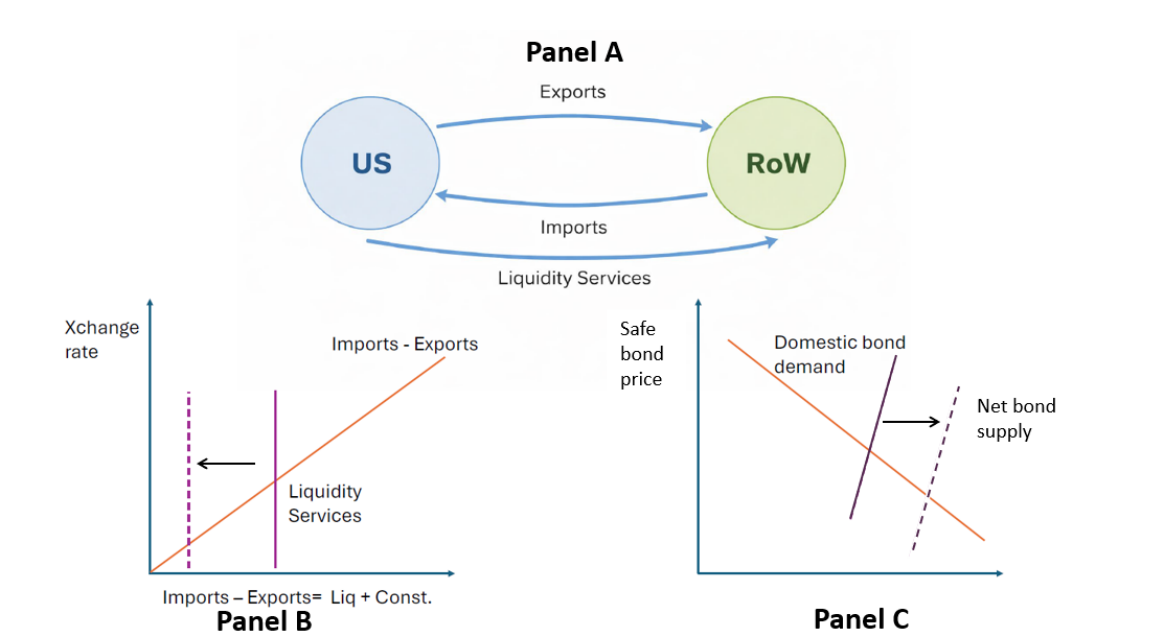
A two-country model with convenience benefits on dollar bonds, calibrated to 2016, and the foreign preference for dollar safety set to zero.

Mechanism



Panel A: the U.S. exports liquidity services. Panel B: external balance. Panel C: the safe bond market.

Calibration



- U.S. safe bond/GDP ratio (2016) 150%
- Share held by foreign investors 30%
- Convenience yield on dollar safe assets: 2%
- Export, import elasticities: trade literature 0.3
- Bond demand curve elasticity: Krishnamurthy–Vissing-Jorgensen (JPE 2012)

Baseline steady state is 2016Q4. Bond demand elasticity from Krishnamurthy and Vissing-Jorgensen (2012); trade elasticities from the trade literature

Full erosion: the steady-state comparison

	Baseline	Convenience Loss	Difference
Debt Held Abroad / GDP (%)	45.00	0.00	-45.00
Seigniorage / GDP (%)	1.05	0.00	-1.05
Trade Balance / GDP (%)	-1.05	0.00	1.05
Import / GDP (%)	5.44	5.14	-0.30
Export / GDP (%)	4.39	5.14	0.74
Log Dollar FX (%)	**8.81**	**0.00**	**-8.81**
Conv Yield Public (%)	2.00	1.13	-0.87
Govt Dollar Interest Rate (%)	**0.53**	**1.40**	**0.87**

Note: Baseline steady state is 2016; Convenience loss is a future date where debt held abroad goes to zero.
Jiang, Krishnamurthy, Lustig and Richmond (2026)

The present value of lost seigniorage

50%

Seigniorage base

Foreign holdings of about 50% of GDP in dollar bonds, at a 2% convenience yield

1.05%

Annual flow

Seigniorage loss of 1.05% of GDP on full erosion of reserve currency status

Jiang, Krishnamurthy, Lustig and Richmond (2026); discount rate r – g from the AQR model, with a GDP beta of two-thirds of the equity premium

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PV = seigniorage / (r – g) ≈ $33 trillion

Asset values

Private

Franchise values of safe asset issuers (banks) and collateral values (housing)

Tax

Public

The future tax burden on U.S. households rise as debt service costs rise

Jiang, Krishnamurthy, Lustig and Richmond (2026); discount rate r – g from the AQR model, with a GDP beta of two-thirds of the equity premium

Summary

Modest for the dollar

Reserve status supports an appreciation of about 8.8%. Miran's hypothesis — that reserve status has priced U.S. manufacturing out of world markets — gets little quantitative support here.

Substantial for rates

About 90 basis points on U.S. safe borrowing costs, public and private alike — a standing subsidy to every dollar borrower.

Very large in present value

Roughly $33 trillion. Which is also the prize on offer to whichever currency dethrones the dollar.

The recent data are consistent with **erosion**: convenience yields down, the loss concentrated in the sovereign claim, foreign ownership of public debt falling, and the safe-haven correlation inverting in spring 2025. In a multiple-equilibria framework erosion comes first; a dominance shift requires both a sustained weakening and a credible challenger — and no current candidate clears the size, safety and investability tests.

Jiang, Krishnamurthy, Lustig and Richmond (2026), “Dollar Erosion: Understanding the Loss of Reserve Currency Status” · Coppola, Krishnamurthy and Xu (2025), “Liquidity, Debt Denomination, and Currency Dominance” · Jiang, Krishnamurthy and Lustig (2021), “Foreign Safe Asset Demand and the Dollar Exchange Rate” · Krishnamurthy and Vissing-Jorgensen (2012) · Quinn and Roberds (2014, 2019)