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USD debasement fears are back

FX View: We await US Treasury Secretary Scott Bessent's details on addressing concerns over the fiscal outlook in the US but we along with market participants are very sceptical of anything meaningful coming from an announcement. The focus is more likely to be on attempting to contain longer-term yields without meaningful policy changes that raise risks of a negative reaction in the market. A failure to cap yields would be viewed as a policy misstep that would undermine investor confidence and hurt the dollar while steps to cap yields (further buybacks, tenor changes to funding plans) would also likely undermine the dollar. The US dollar is down close to 3% in the last four weeks, the worst performance since the period following the Liberation Day announcements. Both these periods have a common feature – FX moves instigated by policies in Washington that points to an underlying wish to engineer a weaker US dollar. The only risk holding back further US dollar depreciation is a renewed jump in energy prices that hits Europe and many countries in Asia with another negative terms of trade shock.

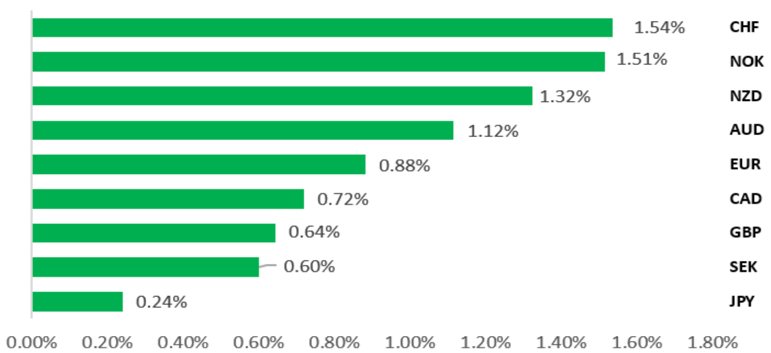
Trade Ideas: We are maintaining a long AUD/JPY trade idea.

IMM FX Positioning: Joint intervention by Japan and the US has seen a further liquidation of yen shorts while NZD shorts have a new record in data back to 2006 suggesting scepticism that the RBNZ will deliver the near 100bps

JPY Flows: This week we analyse the monthly International Transactions in Securities that showed strong NISA-related foreign equity buying and continued foreign asset switching from equities to bonds by Japan Trusts.

The Return of US Duration Risk: In the QE era Treasuries functioned primarily as insurance assets, today, investors increasingly require compensation to hold long-duration debt due to inflation and fiscal risks.

BROAD USD WEAKNESS ACROSS G10



Source: Bloomberg, close on 21st August 2026 (Weekly % Change vs. USD)

USD: Is the dollar debasement trade returning?

Bessent shines a light on probable wish of administration for a weaker US dollar

The US dollar was having a bad week and was down just over 1.0% before reversing the drop. The dollar is still weaker over recent weeks and the turn in performance started really after Japan sold the dollar for yen and the US played a role in portraying the action as joint – although relative to historical examples that wasn't really the case. But as UST Secretary Scott Bessent has stated – these actions are about signalling, and it appears to have played a role in signalling that the Trump administration are concerned about US dollar strength. The US dollar is down around 2.5% over the last four weeks since intervention took place. That's the worst performance for the US dollar since the markets fallout following the Liberation Day tariff announcements in April last year. The common thread we would conclude in these two periods is that it was market moves triggered by policy actions in Washington. The more often these episodes occur with Washington policy involvement, the more market participants will believe that the US administration want a weaker US dollar. That has always been our view given Trump's dislike of trade deficits. There is an ideological focus on reducing trade deficits and key policy advisors advocate this and whether publicly stated or not, the want for a weaker US dollar is entirely consistent with achieving that.

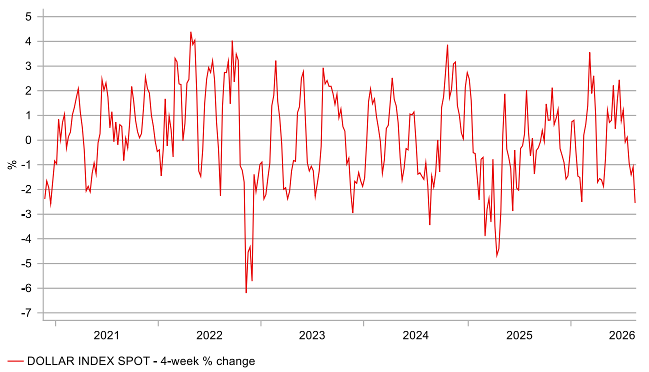
Scott Bessent and Trump are constrained by what they can do

We were led to believe yesterday that the US Treasury will follow up this week's surprise announcement on increased UST bond buy-back plans of an imminent policy announcement addressing fiscal concerns. The prospect of the Trump administration delivering anything meaningful on fiscal consolidation is incredibly slim. The appetite for fiscal consolidation that would move the dial will be very limited ahead of the mid-term elections in November when Trump's popularity has been on the slide. Fiscal consolidation would be seen as necessary due to the cost of an increasingly unpopular war in the Middle East. In any case, the Republicans do not have a big enough majority to get anything of note passed in Congress. The Republicans have 218 seats versus 212 for the Democrats with 4 vacancies and 1 independent. A small number of rebels could scupper any potential legislation.

Optics more than anything significant

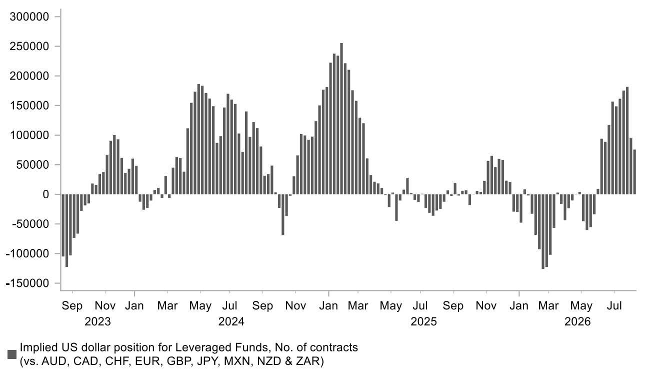
What might Bessent announce? Tinkering at the edges in tackling a budget deficit in the region of USD 2 trillion is the most we can probably expect. The administration could look at agency spending freezes, a federal hiring suspension, procurement reviews, tackling fraudulent activities and DOGE-style efficiency savings are potential initiatives that could be announced. There could be plans announced to sell-off some state assets, but that would only be one-off rather than structural. Bessent will no doubt highlight some increased tariff revenues that will be incoming and may hint at further buybacks and potential issuance changes in November (the next scheduled funding

4-WEEK % CHANGE IN USD – WORST SINCE APRIL 2025



Source: Bloomberg, Macrobond & MUFG

LEVERAGED FUNDS HAVE BEEN CUTTING $ LONGS



Source: Bloomberg, Macrobond & MUFG GMR update). Bessent is also likely to use stronger economic growth as part of the plan to reduce the deficit. This of course has been used numerous times to justify Trump's fiscal spending and has failed to materialise at a level that brings the deficit down. Expectations are understandably low for anything of real substance to be announced

And then it's over the Fed Chair Warsh

We mentioned the 4-week drop for the US dollar since the Japan intervention weakened the dollar but the starting point of the turn for the US dollar was just as much from the day before when the FOMC met. Market participants were disappointed with the communication from Chair Warsh and sensed a possible reluctance to take the decision to raise rates and tackle near-term inflation risks. That then coupled with uncertainty over the Fed's reaction function and how the Fed may address reducing the size of the balance sheet all added together to fuel a steeper yield curve and US dollar selling. In that context and given the UST bond buyback announcement, Warsh's Jackson Hole appearance next week will be key. Warsh must avoid a post-speech sell-off of UST bonds but equally can't pivot too much from his communicated strategy as that would be viewed as Warsh being beholden to the US Treasury and trying to lend support to the efforts to bring down long-term yields. Getting the balance correct will be difficult and hence risks are high of a negative bond market reaction.

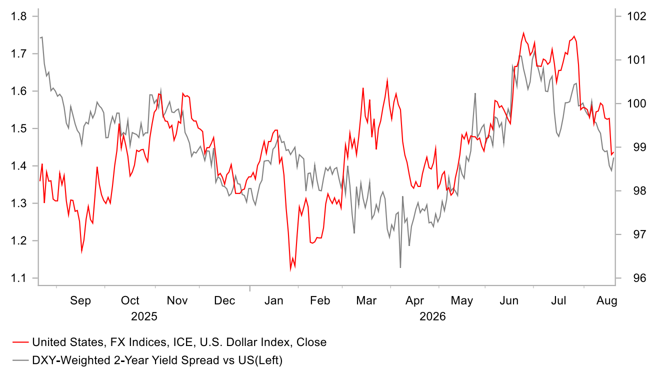
The risks have shifted to further US dollar selling but energy price risks could surtail selling

The last time we had a period where the "debasement trade" was in focus was in January. The US dollar intra-day high-to-low fell 4% and only started to recover in February when Kevin Warsh was confirmed as Fed Chair. Then the Middle East conflict drove the dollar stronger still. We could well be on the cusp of another period of dollar selling as market participants see reason to up the scale of hedging US dollar exposures. One factor that argues against that is the risk to energy prices related to supply from the Strait of Hormuz. Are energy prices set to spike if the status quo persists? Crude oil and natural gas prices have moved higher this month but not yet to levels that are concerning. Further notable gains in natural gas prices would certainly have a negative impact on sentiment. Storage rates are very low in Europe and prices could well move further higher. But there have been reports that tankers getting through the SoH is picking up as the US takes more control of the key channel. If that's correct and energy prices remain more contained than the downside risk to EUR/USD is more contained.

If natural gas prices are contained EUR/USD has further upside

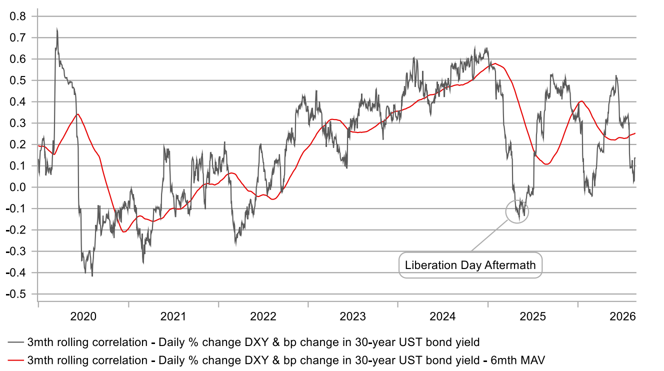
The policy implementation approach by the US administration – the "joint" intervention and the UST bond buyback announcement certainly increases the risk of another period, like January, of USD debasement fears and increased US dollar hedging. The Middle East and a renewed surge in energy prices remains a risk that could curtail a repeat of the scale of dollar selling we saw in January.

SHORT-TERM SPREADS FAVOUR WEAKER USD AS WELL



Source: Bloomberg, Macrobond & MUFG

30Y YIELD / USD CORRELATION IS WEAKENING AGAIN



Source: Bloomberg, Macrobond & MUFG GMR

Weekly Calendar

Ccy	Date	BST	Indicator/Event	Period	Consensus	Previous	Mkt Moving
EUR	25/08/2026	07:00	German GDP SA QoQ	2Q F	--	0.2%	!!
EUR	25/08/2026	07:00	German GDP WDA YoY	2Q F	--	0.9%	!
EUR	25/08/2026	09:00	GermanIFO Business Climate	Aug	--	86.6	!!
USD	25/08/2026	15:00	New Home Sales	Jul	620k	628k	!!
USD	25/08/2026	15:00	Conf. Board Consumer Confidence	Aug	90.2	90.8	!!!
USD	26/08/2026	13:30	Personal Spending	Jul	0.2%	0.3%	!!
USD	26/08/2026	13:30	Real Personal Spending	Jul	0.1%	0.4%	!!
USD	26/08/2026	13:30	Core PCE Price Index MoM	Jul	0.2%	0.1%	!!!!
USD	26/08/2026	13:30	Core PCE Price Index YoY	Jul	3.3%	3.3%	!!!
USD	26/08/2026	13:30	Durable Goods Orders	Jul P	0.5%	0.5%	!!
USD	26/08/2026	13:30	Cap Goods Orders Nondef Ex Air	Jul P	0.9%	1.2%	!!
USD	26/08/2026	13:30	GDP Annualized QoQ	2Q S	1.50%	1.5%	!!!
USD	26/08/2026	13:30	Personal Consumption	2Q S	3.2%	3.2%	!!
USD	26/08/2026	13:30	Core PCE Price Index QoQ	2Q S	--	3.4%	!!
USD	27/08/2026		Jackson Hole Symposium 27th-29th Aug				!!!!!
EUR	27/08/2026	07:00	GfK German Consumer Confidence	Sep	--	-29.6	!!
USD	27/08/2026	13:30	Advance Goods Trade Balance	Jul	-$99.7b	-$101.5b	!!
JPY	28/08/2026	tbc	Speech by BoJ Deputy Gov Himino				!!!!
JPY	28/08/2026	00:30	Tokyo CPI YoY	Aug	1.9%	2.0%	!!!
JPY	28/08/2026	00:30	Tokyo CPI Ex-Fresh Food YoY	Aug	1.7%	1.9%	!!!
JPY	28/08/2026	00:30	Tokyo CPI Ex-Fresh Food, Energy YoY	Aug	2.0%	2.0%	!!!
EUR	28/08/2026	07:45	France CPI EU Harmonized MoM	Aug P	--	0.6%	!!
EUR	28/08/2026	07:45	France CPI EU Harmonized YoY	Aug P	--	2.4%	!!
EUR	28/08/2026	07:45	France GDP QoQ	2Q F	--	0.2%	!!
EUR	28/08/2026	08:55	German Unemployment Change (000's)	Aug	--	6.0k	!!
EUR	28/08/2026	08:55	German Unemployment Claims Rate SA	Aug	--	6.4%	!!
EUR	28/08/2026	10:00	Euro-zone Economic Confidence	Aug	--	96.9	!
CAD	28/08/2026	13:30	Quarterly GDP Annualized	2Q	3.3%	-0.1%	!!
CAD	28/08/2026	08:55	GDP MoM	Jun	--	0.3%	!!
USD	28/08/2026	10:00	Prelim. Benchmark Payrolls Revision	2026	--	-911k	!!!
USD	28/08/2026	10:00	U. of Mich. Sentiment	Aug F	--	51.0	!!
USD	28/08/2026	13:30	U. of Mich. 1 Yr Inflation	Aug F	--	4.3%	!!
USD	28/08/2026	08:55	U. of Mich. 5-10 Yr Inflation	Aug F	--	3.3%	!!

Source: Bloomberg, Macrobond & MUFG GMR

Key Events:

- The primary event in focus next week will be the Jackson Hole Symposium. The annual event is often used by the Fed Chair to send a policy message to the markets. Will that happen next week? The theme of this year's symposium is "Financial Innovation: Implications for Payments and Policy" doesn't sound like an easy segue into any explicit message on the outlook for monetary policy. Of course Warsh isn't bound by the theme necessarily but in any case, Warsh has been clear that he wishes to move away from the use of forward guidance and in that context we might not get much. This speech has taken on greater importance after Wednesday's US Treasury bond buyback announcement and Warsh will not want to speak and then see yields rise in response. Equally though after stating he's not in favour of forward guidance any shift in that strategy to contain yields could see him as beholden to the Treasury.

- Beyond Jackson Hole, there is very little in the way of public speeches and the only one scheduled is by BoJ Deputy Governor Himino on 28th August with the exact time to be confirmed. That could prove important given the pricing for a 25bp hike by the BoJ in September stands at 82%. That speech is also on the same day as the release of Tokyo CPI data for August and could also prove important. The preliminary estimate for the benchmark revision to nonfarm payrolls will be released next Friday and that's a key release. A year ago, the figure was -911k, the largest ever one-year revision. That was revised to -898k in January 2026. The consensus market view is the data is over-reported and hence a negative print is expected.

Open Trade Ideas

LONG AUD/JPY – **OPENED** @ 111.20 (TARGET @ 114.50 & STOP-LOSS @ 109.20)

AUD/JPY to grind higher still

We are maintaining a long AUD/JPY trade idea. The downturn related to the intervention continues to reverse and we see scope for this to continue. The USD/JPY this week was under downward pressure as broader US dollar selling prompted a larger correction as USD debasement fears re-emerged following the Treasury attempts to cap long-term yields in the US through increased UST bond buybacks. There was also a weaker than expected employment report in Australia, but we do not see that data point as altering the bigger picture – that is the bias of the RBA to tighten monetary policy further given the risk to inflation, mainly stemming from international factors. We also had a signal from China that it is planning further fiscal expansion to help support domestic demand. This has helped to provide a lift for AUD/USD. Australia's terms of trade continue to benefit from the ongoing expansion of AI-related investment and infrastructure spending in the global economy (click here). The price of copper reached a new intra-day record high this month, further strengthening our constructive outlook for the AUD and reinforcing our bullish conviction on AUD/JPY.

FX Portfolio

Trade idea	Notional	Entry Date	Entry Level	Current	S/L	Target	Spot P&L	Carry P&L	Portfolio Contribution
Closed Trades									
Long EUR/USD	USD 5mn	10/05/2024	1.0770	1.0840	1.0570	1.1070	32,498	-3,484	29,014
Long MXN/ZAR	USD 5mn	07/06/2024	1.0300	1.0050	1.0050	1.0850	-121,359	1,812	-119,547
Short EUR/JPY	USD 5mn	14/06/2024	168.00	171.10	171.10	162.50	-92,262	-2,194	-94,456
Long AUD/USD	USD 5mn	05/07/2024	0.6735	0.6585	0.6585	0.7035	-111,359	-1,544	-112,903
Long GBP/SEK	USD 5mn	12/07/2024	13.660	13.920	13.360	14.160	95,168	2,149	97,317
Short NZD/CHF	USD 5mn	02/08/2024	0.5170	0.5000	0.5270	0.5000	164,410	-215	164,195
Short NZD/CAD	USD 5mn	09/08/2024	0.8270	0.8430	0.8430	0.8030	-96,735	-1,578	-98,313
Short USD/JPY	USD 5mn	06/09/2024	143.30	142.80	146.30	138.30	17,446	-7,717	9,729
Long AUD/USD	USD 5mn	27/09/2024	0.6890	0.6810	0.6740	0.7100	-58,055	589	-57,466
Long USD/NOK	USD 5mn	11/10/2024	10.720	11.020	10.500	11.020	139,925	530	140,455
Long EUR/USD	USD 5mn	08/11/2024	1.0760	1.0570	1.0700	1.0100	88,290	3,857	92,147
Long USD/CAD	USD 5mn	06/12/2024	1.4090	1.4390	1.3850	1.4550	106,458	1,471	107,194
Long GBP/USD	USD 5mn	10/01/2025	1.2250	1.2550	1.2550	1.1750	-122,449	-885	-123,334
Short EUR/JPY	USD 5mn	07/02/2025	157.60	161.89	163.00	150.00	-171,320	-9,487	-180,807
Long USD/SEK	USD 5mn	14/03/2025	10.120	9.9200	9.9200	10.420	-98,814	5,245	-93,569
Long USD/CAD	USD 5mn	28/03/2025	1.4300	1.4050	1.4050	1.4750	-87,413	1425	-85,988
Long EUR/NZD	USD 5mn	25/04/2025	1.9040	1.9035	1.8700	1.9600	-1,314	-3,305	-4,619
Short USD/JPY	USD 5mn	16/05/2025	145.95	144.00	149.40	138.30	66,804	9,179	57,625
Long USD/ZAR	USD 5mn	13/06/2025	17.910	18.020	17.650	18.350	30,709	- 1,963	28,746
Short USD/NOK	USD 5mn	27/06/2025	10.070	10.060	10.270	9.6000	4,965	104	5,070
Long EUR/GBP	USD 5mn	04/07/2025	0.8625	0.8674	0.8475	0.8850	27,978	-4,894	22,084
Long USD/JPY	USD 5mn	18/07/2025	148.30	147.70	145.70	153.30	-19,335	11,240	-8,095
Long NOK/CHF	USD 5mn	08/08/2025	7.8727	7.9760	7.7520	8.1151	65,607	12,022	77,629
Short USD/JPY	USD 5mn	15/08/2025	147.00	147.80	149.50	143.50	-27,211	-13,990	-41,201
Long NZD/SEK	USD 5mn	12/09/2025	5.5557	5.4449	5.4168	5.6945	-99,717	1,511	-98,206
Short USD/JPY	USD 5mn	07/11/2025	153.40	156.00	156.00	148.50	-84,746	-4,292	-89,038
Long EUR/GBP	USD 5mn	19/09/2025	0.8710	0.8730	0.8550	0.8900	11,481	-15,091	-3,610
Short CAD/CHF	USD 5mn	03/10/2025	0.5705	0.5765	0.5825	0.5525	-53,041	-16,310	-69,351
Long AUD/GBP	USD 5mn	12/12/2025	0.4980	0.5200	0.4980	0.5280	220,884	-1,297	219,587
Long EUR/JPY	USD 5mn	12/01/2026	184.50	181.50	181.50	190.00	-81,301	4,384	-76,917
Short EUR/USD	USD 5mn	09/03/2026	1.1570	1.1750	1.1750	1.1300	-105,877	5,936	-99,942
Long AUD/SEK	USD 5mn	11/05/2026	6.6850	6.6640	6.5700	6.8950	-15,609	7,665	-7,944
Short GBP/CHF	USD 5mn	30/03/2026	1.0600	1.0670	1.0800	1.0200	-32,994	-21,659	-54,603
Long USD/NOK	USD 5mn	19/06/2026	9.6900	9.8500	9.5000	10.100	82,559	-728	81,832
Long EUR/GBP	USD 5mn	17/07/2026	0.8500	0.8575	0.8395	0.8700	44,118	-3,053	41,065
Short USD/BRL	USD 5mn	10/07/2026	5.1150	5.1900	5.2600	4.9600	-73,314	61,095	-12,219
Open Trades									
Long AUD/JPY	USD 5mn	07/08/2026	111.20	113.88	109.20	114.50	104,766.21	5,405	110,171

Source: MUFG GMR; Changes in stops/targets in bold italics. (1) Current levels reflect intraday pricing. (2) The portfolio represents hypothetical, not actual, investments. Furthermore, we do not actively manage these hypothetical positions on a daily basis and changes tend to be made only through this publication on a weekly basis. To reflect the level of conviction of our trades we run trades in two different amounts: High conviction trades = USD 10mn & Basic conviction trades = USD 5mn

FX Positioning

The Commodity Futures Trading Commission (CFTC) publish weekly reports revealing positioning for the following currencies: AUD, BRL, CAD, CHF, EUR, GBP, JPY, MXN, NZD, RUB, USD (implied) and ZAR. We have applied z-scores to the positioning data to provide a signal of how stretched current positions are compared to averages over the last two years.

BREAKDOWN BY INVESTORS

Asset Manager/Institutional

	No. of contracts	Z-Score
AUD	-42,679	-0.53
BRL	61,870	0.59
CAD	-104,545	-0.59
CHF	-38,322	-0.21
EUR	225,389	-0.90
GBP	-119,863	-1.29
JPY	-26,251	-1.00
MXN	34,186	-0.18
NZD	-29,247	-0.04
USD	28,036	1.12
ZAR	11,426	-0.01

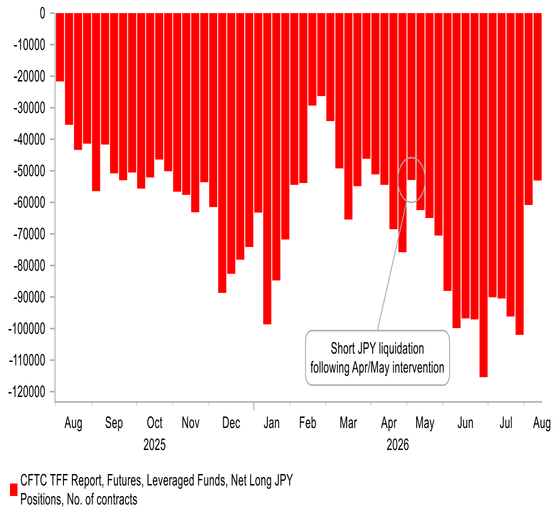
Leveraged Funds

	No. of contracts	Z-Score
AUD	48,541	1.34
BRL	8,333	0.85
CAD	-92,005	-1.63
CHF	-11,432	-1.03
EUR	-60,600	-2.27
GBP	40,670	0.44
JPY	-53,070	-0.47
MXN	76,282	1.82
NZD	-33,461	-2.49
USD	75,677	0.45
ZAR	1,065	-0.03

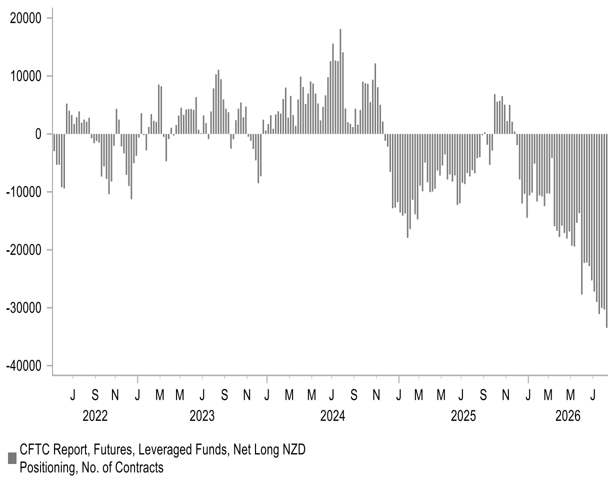
Asset Manager/ Insitutional & Leveraged Funds

	No. of contracts	Z-Score
AUD	5,862	0.47
BRL	70,203	0.71
CAD	-196,550	-0.92
CHF	-49,754	0.44
EUR	164,789	-1.32
GBP	-79,193	-0.96
JPY	-79,321	-0.88
MXN	110,468	1.02
NZD	-62,708	-1.07
USD	103,713	0.95
ZAR	12,491	-0.04

JPY SHORTS CUT FURTHER



RECORD SHORT NZD POSITION



Source: Bloomberg, CFTC, Macrobond & MUFG GMR (as of 11th August 2026)

Key Takeaways:

- The latest IMM positioning data for the week ending 11th August confirmed a further liquidation of Leveraged Funds' short yen positions that had been built up to the largest total since just before intervention in 2024. As can be seen above, the liquidation of shorts has been more substantial than following the intervention earlier this year. A larger yen short position and the fact that this latest intervention involved the US, it has had more success. However, based on the movement of spot, we may not see much further liquidation from here.

- The other stand-out development in the positioning data was in NZD. The Leveraged Fund net short NZD position is in fact a record going back to the start of the series in 2006. The RBNZ is still running a quite loose monetary stance – the policy rate is at 2.50% with the current headline inflation rate at 4.1%. The current OIS pricing points to expectations of 100bps of tightening and inflation falling with the consensus by mid-2027 at 2.3%. That's a dramatic shift in the policy stance but it is not deterring investors from selling perhaps some of whom are sceptical of the RBNZ delivering 100bps of tightening over the next 12mths.

The Return of US Duration Risk

This week we analyse the US Treasury's decision to at least double the size of long-dated bond buyback operations. The decision triggered an initial rally in Treasuries, but the move rapidly faded as investors questioned whether modest purchases could offset the structural forces pushing long-end yields higher.

The market reaction highlights a much larger story. Over the past decade, the Treasury market has transitioned from an environment in which investors were willing to pay for duration exposure to one in which they increasingly demand additional compensation for holding it. This is represented by a rise in the term premium. Our analysis considers term premium through a historical lens, questioning if the current positive term premium appears to be a structural regime change that began after the pandemic.

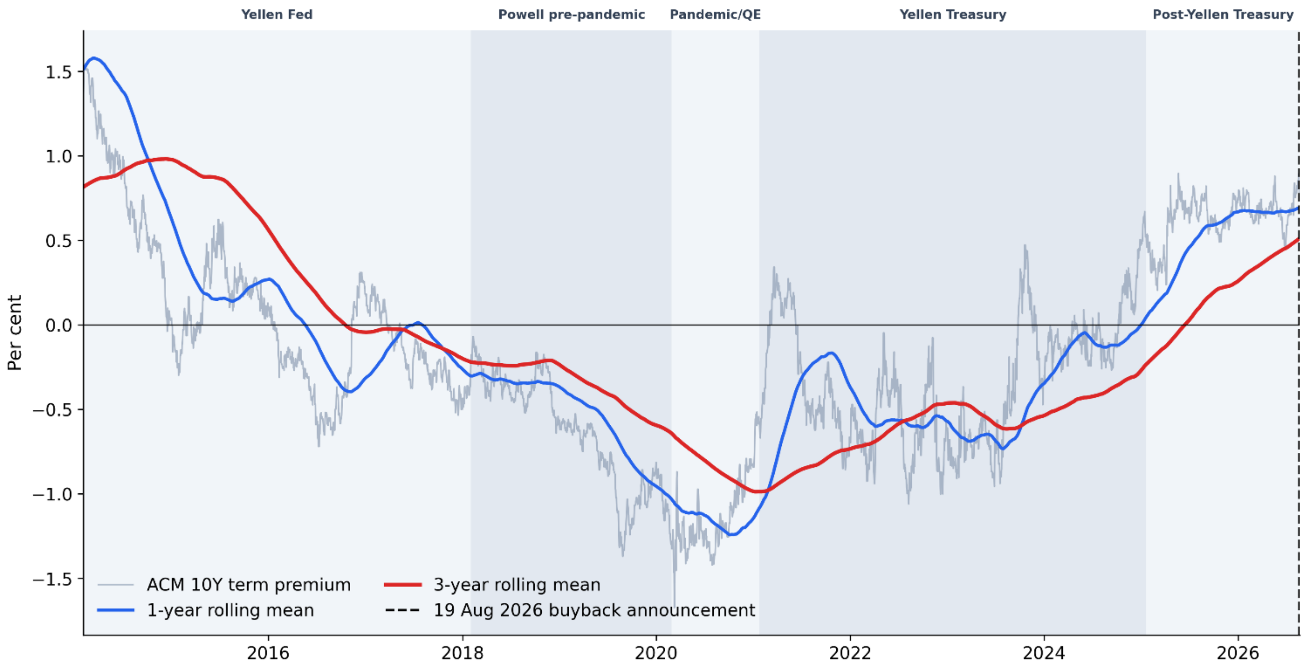
WHAT IS THE ACM TERM PREMIUM?

The Adrian-Crump-Moench (ACM) 10-year term premium measures the **additional compensation investors require to hold a 10-year Treasury** bond rather than rolling over a series of short-term Treasury bills. Conceptually, the term premium captures uncertainty surrounding:

- Inflation
- Fiscal sustainability
- Balance Sheet policy supply
- Monetary policy uncertainty
- and other risks

A rising term premium indicates investors require greater compensation to bear long-term interest rate risk. A falling term premium suggests duration is becoming more attractive or perceived risk is declining.

THE EVOLUTION OF US TERM PREMIUM - REGIMES



Source: Bloomberg, Macrobond & MUFG GMR

YELLEN FED (2014-2018)

Term premium started above 1.4% before steadily declining as low inflation, quantitative easing effects and strong global demand for safe assets compressed duration premium. By the end of the regime term premium had fallen below zero.

POWELL PRE-PANDEMIC (2018-2020)

The combination of recession fears (2s10s compression), trade uncertainty and the Federal Reserve's pivot towards easing reinforced demand for duration. Term premium remained consistently negative throughout the period, averaging -0.64%.

PANDEMIC AND QE ERA (2020-2021)

Unlimited quantitative easing, emergency rate cuts and extreme safe-haven demand generated the most negative term premium readings in recent history. Investors paid a premium to hold Treasuries as insurance.

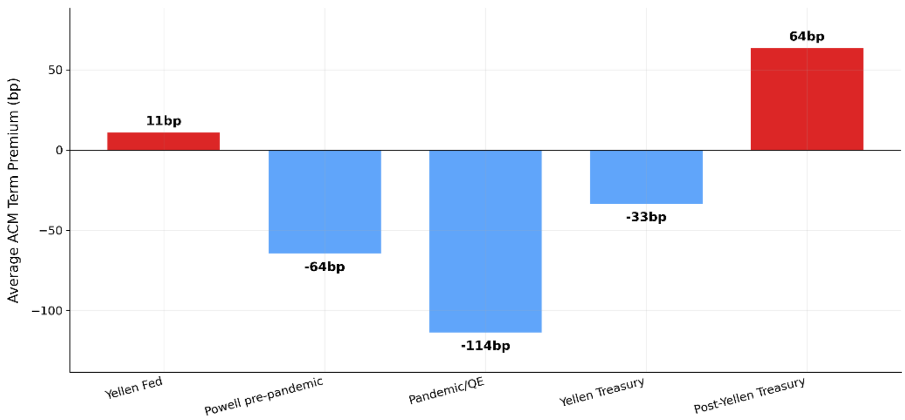
YELLEN TREASURY (2021-2025)

This period marked the transition from an insurance-driven market to a compensation-driven market. Aggressive monetary tightening, elevated inflation and fiscal concerns pushed term premium steadily higher, eventually returning it to positive territory.

POST-YELLEN TREASURY (2025-PRESENT)

Term premium remains firmly positive, averaging approximately 0.64%. Investors are once again being compensated for holding duration risk. Fiscal sustainability concerns reduced Federal Reserve demand and persistent inflation uncertainty remain important drivers.

Duration has moved from insurance to risk asset

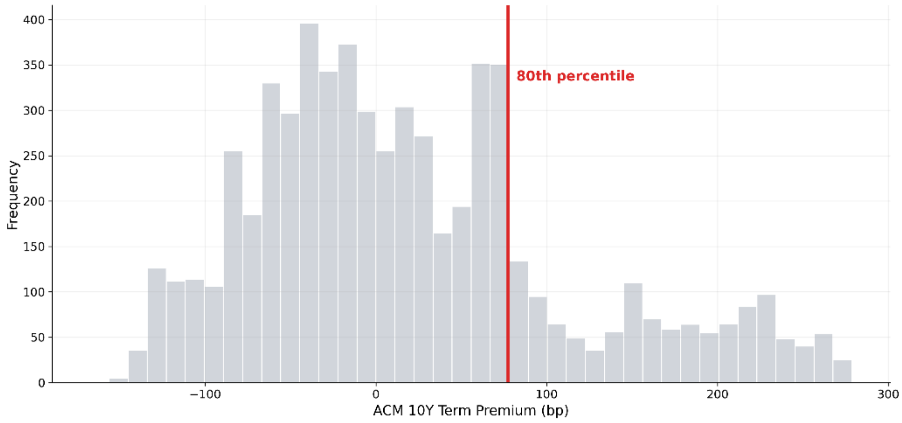


Source: Bloomberg, Macrobond & MUFG GMR

CURRENT TERM PREMIUM IN HISTORICAL CONTEXT

Looking across the entire 2014-present period reveals a clear structural story. For much of the 2014-2021 period, Treasury investors were not being compensated for duration risk. Duration was effectively subsidised by QE, low inflation and demand for safe assets. Today's positive term premium suggests markets have fully unwound the QE-era distortion that characterised much of the last decade. The Treasury market no longer behaves like a pure safe-haven asset class. Instead, investors increasingly view long-dated Treasuries as instruments carrying meaningful inflation, supply and fiscal risks. The chart below shows the current term premium sits at the 80th percentile of all observations from 2014 to present.

Current term premium in historical context (2014 – present)



Source: Bloomberg, Macrobond & MUFG GMR

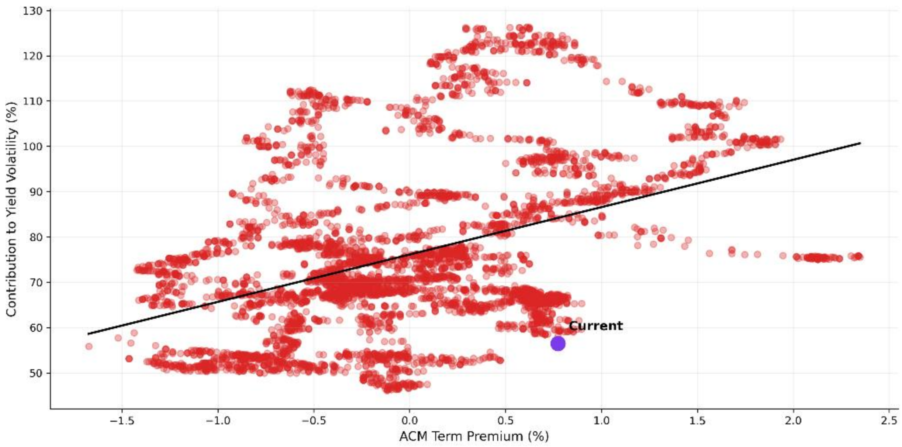
COVARIANCE CONTRIBUTION TO YIELD VOLATILITY

The analysis estimates how much of 10-year Treasury yield volatility is associated with changes in the ACM term premium. Over a rolling one year window, it calculates the covariance between daily changes in the term premium and daily changes in the 10-year yield, then divides this by the total variance of yield changes. We consider periods 2014 to present.

Despite the ACM term premium remaining elevated relative to much of the post-2014 period, its current contribution to 10-year Treasury yield volatility is relatively modest. One explanation relates to the methodology itself. Contribution is calculated using a rolling one-year window, meaning recent fiscal-driven episodes are averaged together with earlier periods in which Fed policy was the dominant driver of yield moves. As a result, the measure may understate the importance of fiscal risks in the current environment.

The positive relationship between the level of the ACM term premium and its contribution to Treasury yield volatility suggests that elevated term-premium regimes are also periods in which duration-risk repricing becomes important. Term premium matters more for the direction of yields. Should term premium rise due to increased fiscal uncertainty or inflation risks we would expect it to be a more important determinant of long-end yields.

High term-premium regimes are also regimes where duration-risk repricing matters



Source: Bloomberg, Macrobond & MUFG GMR

Key Takeaways:

- The Treasury market has undergone a transformation since 2014. During the QE era, investors accepted negative term premiums because Treasuries functioned primarily as insurance assets. Today, investors increasingly require compensation to hold long-duration debt because inflation and fiscal risks have become materially more important. In this context, the Treasury buyback program represents an attempt to improve market functioning rather than a solution to the underlying drivers of duration risk.

- The key takeaway is that the post-Yellen rise in term premium should be interpreted as a structural regime change rather than a temporary market dislocation. Unless accompanied by a credible medium-term fiscal consolidation strategy, buybacks alone are unlikely to reverse the transition from duration as an insurance asset to duration as a risk asset.

- For FX markets, a higher term premium raises the possibility that higher treasury yields increasingly reflect fiscal concerns rather than growth optimism, weakening the relationship between higher yields and a stronger USD.

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