Summary of "Inflation and Treasury Convenience" by Cieslak, Li, and Pflueger (2025)

We investigate the relationship between inflation and the "convenience yield" of Treasuries—a premium investors pay for the safety and liquidity of the US government debt. We uncover a striking fact: the sign of the inflation-convenience relationship changes across time, reflecting shifts in the dominant macroeconomic shocks. In the second half of the twentieth century, inflation and Treasury convenience rose together. Before World War II and again in the twenty-first century, the correlation turned negative: inflation fell while convenience yields surged.

Revisiting Keynes and Friedman

The paper breathes new life into a theme rooted in long-standing economic debates. Keynes argued that financial crises spark a rush for liquid assets. Friedman, in contrast, contended that inflation acts as a tax on money and near-money assets, including Treasuries.

We put these views to the test with a century of monthly US data. We track short-term convenience using the spread between repo rates and T-bills and approximate the long-term convenience with a high-quality corporate bond yield spread over Treasuries. Our analysis spans three key periods: the interwar deflation (1926–1939), the great inflation and the following disinflation (1952–1999), and the low-inflation twenty-first century (2000–2020).

Two Channels, Three Eras

What explains the shifting relationship between convenience and inflation? It depends on which economic force dominates — liquidity demand or the cost of holding money.

1. **The Liquidity Demand Channel** (pre-WWII, post-2000): In times of financial stress, investors flee to convenient assets and reduce aggregate consumption demand. Thus, Treasury convenience yields spike while inflation sinks, just as Keynes anticipated.
2. **The Money Channel** (1952–1999): When inflation is driven by supply cost-push shocks (think of oil shocks or supply-chain bottlenecks), the cost of holding money and near-money assets rises. Investors pay higher convenience yields to hold Treasuries, so both inflation and convenience move upward in tandem, consistent with Friedman's view.

We corroborate this narrative with structural evidence. Using decompositions of inflation into supply- and demand-driven components, we find that supply-driven inflation tends to raise Treasury convenience. In contrast, higher convenience predicts lower demand-driven inflation.

A Theory That Holds Together

To make sense of these historical shifts, we develop a New Keynesian model in which agents derive utility not just from consumption but also from liquidity service flows of deposits and Treasuries. In the model, shocks to liquidity demand depress inflation while boosting Treasury value. Inflationary

cost-push shocks, instead, simultaneously lift inflation and convenience. Estimated parameters show that liquidity demand shocks were dominant in the Great Depression and post-2000, while cost-push shocks prevailed in the second half of the twentieth century. Notably, in the model, Treasury convenience need not decline with inflation.

Lessons for Today

The COVID era provided a natural test of these predictions. In early 2020, as the economy seized up, demand weakened, inflation fell, and convenience yields spiked, suggesting that liquidity demand initially amplified the economic woes. By 2022, however, with supply-chain bottlenecks and war-driven energy shocks, inflation and convenience moved upward together, mirroring the patterns of the 1970s.

The Broader Takeaway

The relationship between inflation and Treasury convenience isn't static—it depends on the underlying macroeconomic shocks. In this light, Treasury convenience yields are not merely benchmarks for financial markets. They also serve as barometers for the source of shocks driving the economy.