

# Weekly CIO Letter

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## The Price of Monetary Sovereignty

The U.S. debt approaching \$40 trillion and the rare intervention in the Japanese yen reveal the same underlying reality: sovereign issuers can create liquidity, but they cannot eliminate the price markets demand for confidence.

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# Executive Summary

A round number is approaching in U.S. public finance.

Gross U.S. federal debt stood at approximately \$39.83 trillion on August 5, of which \$32.10 trillion was debt held by the public and \$7.73 trillion was intragovernmental debt. The Treasury's daily debt series has since advanced through August 13 and remains just below the \$40 trillion threshold. The average interest rate on marketable Treasury debt reached 3.443% in July, more than twice its level five years earlier.

The number is large enough to generate two opposing narratives.

One treats government debt like household debt and assumes that a sufficiently large stock must eventually become impossible to repay.

The other argues that a government issuing debt in a currency it controls cannot run out of that currency and therefore does not face a conventional solvency constraint.

Both contain part of the truth. Neither is sufficient for investors.

Under the existing U.S. institutional framework, the Treasury borrows when authorized spending exceeds federal revenues. The Federal Re-

serve does not purchase newly issued Treasury securities directly from the Treasury, and the Fed explicitly states that its purchases of Treasury securities from the public are not a mechanism for financing federal deficits.

The relevant constraint is therefore not simply whether dollars can exist.

It is the economic and institutional price of creating, borrowing and holding those dollars.

That distinction became unusually visible in another market this month.

Japan and the United States conducted a rare coordinated intervention to support the yen after the currency approached 164 per dollar, its weakest level in roughly four decades. The intervention pushed the yen toward 155 before it subsequently weakened again toward 159.

The U.S. participation was small relative to Japan's operation, but symbolically important. Goldman Sachs estimates Japan may have deployed as much as \$85 billion over July 30 and 31, while U.S. participation appears to have been much smaller.

Why should Washington care about

the value of the yen?

Because Japanese reserves, U.S. Treasuries, dollar liquidity and the global collateral system are deeply connected.

The intervention illustrates a broader point: U.S. government debt is simultaneously an American fiscal liability

and one of the principal reserve and collateral assets of the international financial system.

That dual role gives the United States extraordinary monetary flexibility.

It also gives the world a direct interest in the quality and liquidity of U.S. sovereign debt.

## 1. A Sovereign Issuer Is Not a Household — But Debt Still Has a Price

A government that issues debt in its own currency should not be analyzed in exactly the same way as a household or corporation.

Households must obtain the currency they owe.

The United States sits at the center of the system that creates and distributes dollars.

This materially reduces conventional foreign-currency and liquidity risk.

It does not, however, make the fiscal arithmetic irrelevant.

The Congressional Budget Office projects a federal deficit of 5.8% of GDP in 2026, rising to 6.7% by 2036. Debt held by the public is projected to increase from 101% of GDP to 120% over the same period.

More important than the headline debt stock is what happens to the

cost of carrying it.

CBO projects net federal interest outlays to increase from 3.3% of GDP in 2026 to 4.6% in 2036, while the primary deficit actually becomes slightly smaller. By 2036, interest payments would account for nearly one-fifth of federal spending.

This is the distinction that matters for investors.

A government does not need to reduce its nominal debt balance to zero.

It usually refinances maturing obligations with new debt.

The relevant question is whether the economy, tax base and financial

system can support the growing interest bill without forcing a destabilizing combination of higher inflation, higher taxes, lower spending, financial repression or persistently higher borrowing costs.

The fiscal constraint is therefore less likely to arrive as a conventional inability to produce dollars and more likely to appear through the price of those dollars and the yield required to hold government liabilities denominated in them.

This also explains why the level of long-term Treasury yields matters more than a debt-clock milestone.

At very low rates, a large debt stock can remain relatively inexpensive.

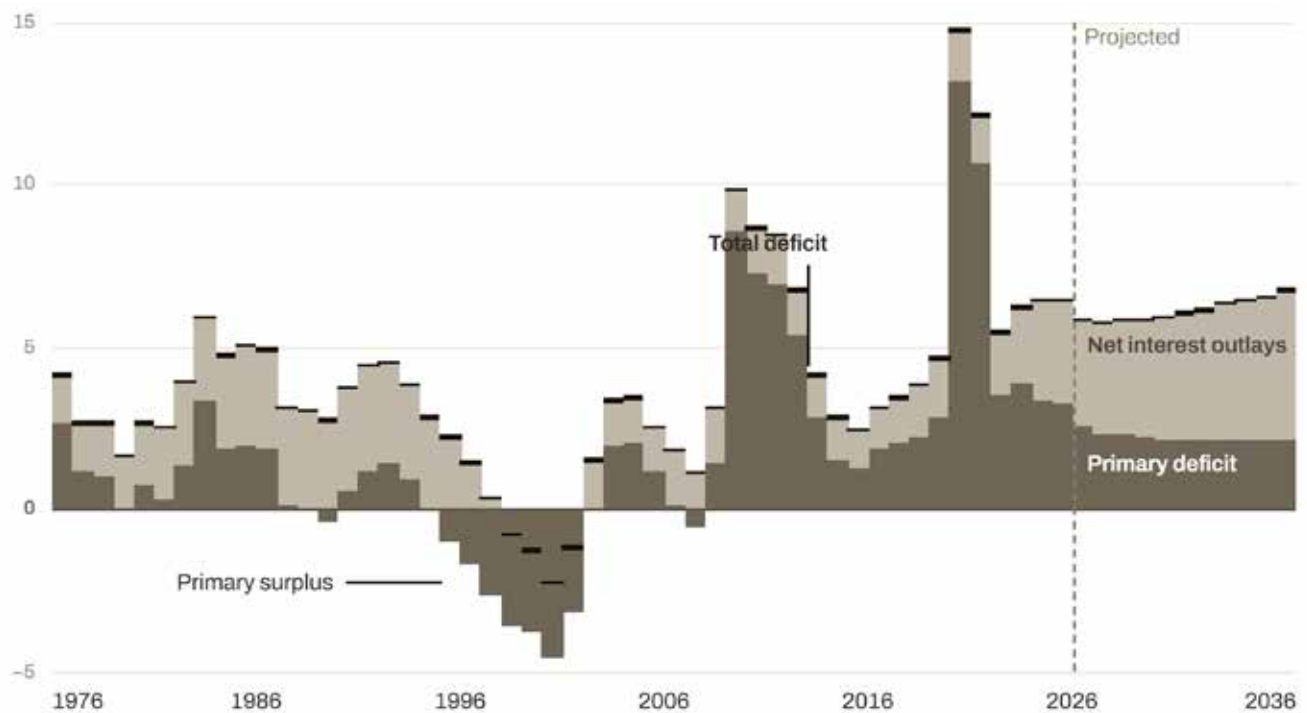
As maturing debt is refinanced at higher yields, interest costs become progressively more sensitive to the market.

That process is already visible.

#### UNITED STATES

### Total deficits, net outlays for interest, and primary deficits

Percentage of GDP, fiscal years 1976 to 2036.



Data sources: Congressional Budget Office; Office of Management and Budget. Projections from The Budget and Economic Outlook: 2026 to 2036 (February 2026). Primary deficits exclude net outlays for interest.

## 2. The Yen Intervention Was About More Than the Yen

Japan provides a useful real-world example of why monetary sovereignty and debt sustainability cannot be reduced to a single ratio.

The Bank of Japan currently maintains its overnight policy rate around 1.0%. Even after several rounds of normalization, Japanese rates remain well below U.S. rates. That differential, combined with Japan's fiscal stance and relatively low domestic returns, has encouraged investors to borrow or fund positions in yen and allocate capital abroad.

The result has been sustained pressure on the currency.

A weaker yen helps exporters, but it also raises the local cost of imported energy, food and other goods. As the currency approached historically weak levels, intervention became politically and economically more attractive.

Japan's intervention was therefore understandable.

The unusual part was Washington's participation.

The United States reportedly joined the operation by buying yen, with the U.S. leg apparently financed partly through sales of euros rather than dollars. The operation was small compared with Japan's purchases, but the signaling effect was substantial.

Goldman Sachs argues that one explanation for U.S. participation is the potential spillover from Japanese currency management into the Treasury market.

Japan remains the largest foreign holder of U.S. Treasury securities, with approximately \$1.14 trillion as of May according to the latest Treasury International Capital data.

To buy yen on a large scale, Japan needs foreign currency.

One way to obtain dollars is to sell dollar reserve assets, including Treasuries.

Large, abrupt Treasury sales could place upward pressure on U.S. yields.

The Federal Reserve's FIMA Repo Facility provides an alternative. Approved foreign monetary authorities can temporarily exchange Treasury securities for dollars through the Federal Reserve rather than selling those securities into the market. The Fed has explicitly described the facility as a mechanism that can help reduce forced Treasury sales during periods of global dollar stress.

This changes the interpretation of the intervention. It was not merely an

attempt to manage one exchange rate.

It also highlighted the infrastructure surrounding the dollar system: reserves, collateral, repo markets, central-bank liquidity and Treasury-market functioning.

Treasury securities are not simply IOUs accumulated by the U.S. government.

They are also part of the plumbing through which global dollar liquidity moves.

That role is one reason the dollar system has proven much harder to replace than many de-dollarization narratives imply.

### 3. Japan Demonstrates Why the Structure of Debt Matters

Japan is often cited as evidence that very high government debt can coexist with financial stability.

That observation is correct.

The explanation requires more detail.

As of March 2026, the Bank of Japan held approximately 47.9% of outstanding JGBs. Foreign investors held only 8.1% of JGBs. When Treasury bills are added, the BOJ still represented 42.2% of the combined market, while foreigners represented 13.7%.

That ownership structure matters.

A country whose sovereign debt is held largely within its own monetary and financial system can behave very differently from a country dependent on foreign-currency credi-

tors or unstable external funding.

Japan also possesses another important characteristic.

It is a major net creditor to the rest of the world.

Japan ended 2025 with a net international investment position of approximately ¥562 trillion. Germany and China had even larger positive positions in yen-equivalent terms, but Japan remained one of the world's largest external creditors.

A country can therefore simultaneously possess:

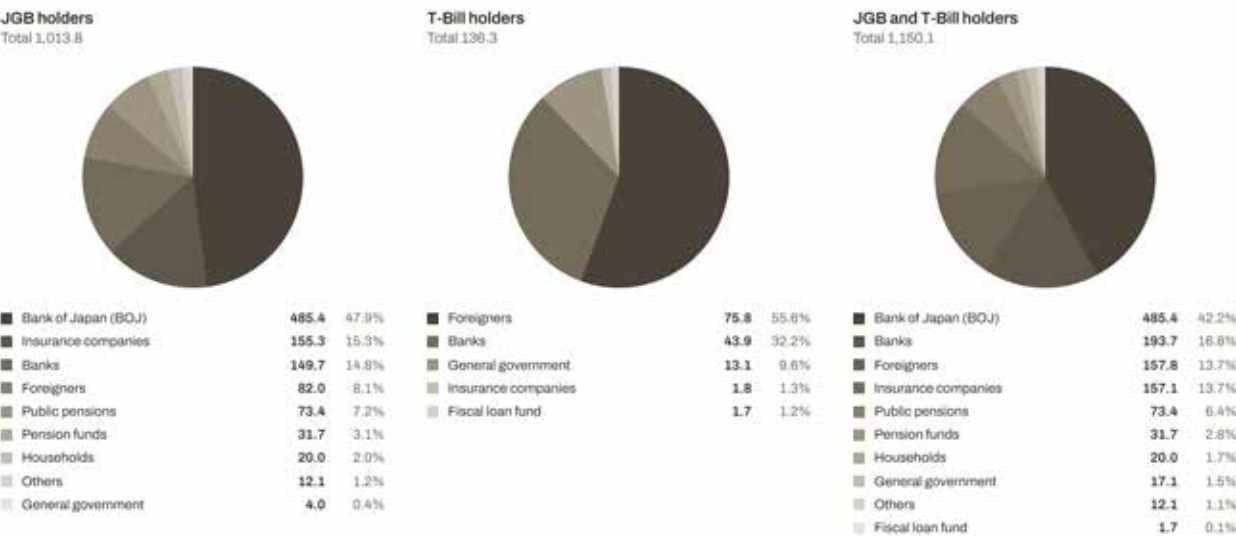
a very large gross government debt;

a central bank that owns a significant portion of that debt;  
large private-sector foreign assets;  
and a substantial positive external

investment position.  
  
These characteristics cannot be captured by a single debt-to-GDP ratio.

Breakdown by JGB and T-Bill holders

March 2026, preliminary figures. Unit: trillion yen.

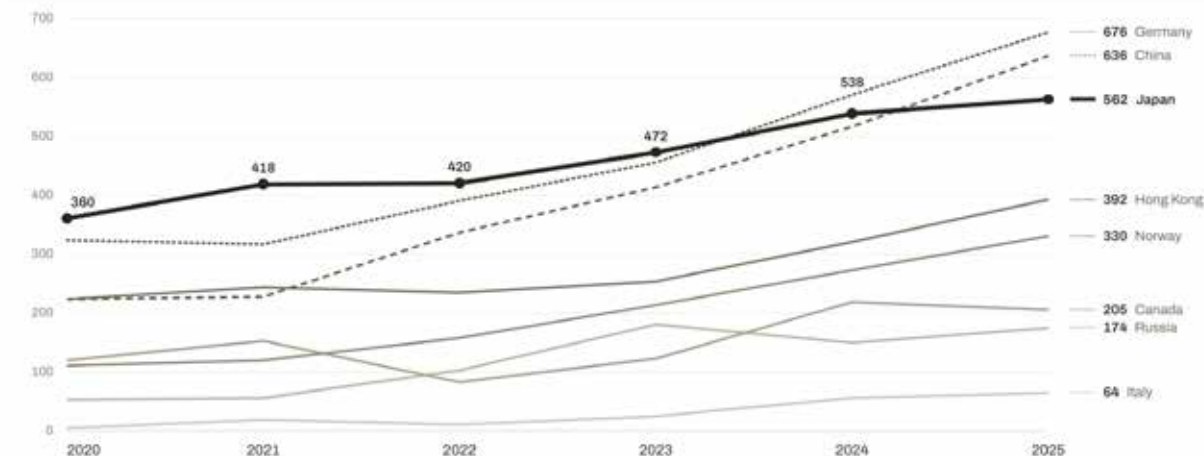


Source: Bank of Japan, Flow of Funds Accounts (preliminary figures), June 25, 2026. "JGB" includes FILP bonds. "Banks" includes Japan Post Bank, securities investment trusts and securities companies. "Insurance companies" includes life, nonlife and mutual aid insurance. "General government" excludes public pensions.

JAPAN

Net international investment position, end of 2025

International comparison, trillion yen.



Source: MOF (Japan), Bank of Russia (Russia), IMF (others). Figures for countries and regions except Japan are converted into yen at the year-end exchange rates published by the IMF. Figures for certain countries and regions are not disclosed.

Yet Japan also demonstrates the limitation of the argument that monetary sovereignty makes debt irrelevant.

If fiscal and monetary settings suppress domestic returns for long enough, capital may move abroad.

The currency may weaken.

Imported inflation may rise.

Domestic savers may demand higher yields.

The government may then face a choice between supporting the currency, accepting higher interest rates or allowing the loss of purchasing power to continue.

Monetary sovereignty can change the form of the adjustment.

## Implications for Markets and Portfolios

### Sovereign Bonds: Default Risk Is Not the Only Risk

The employment report strengthens the case for maintaining exposure to high-quality duration, but it does not justify positioning for an aggressive rate-cut cycle before inflation data confirm the thesis.

The most attractive part of the curve

will depend on how inflation evolves.

The mistake would be to treat one weak employment report as confirmation that the entire monetary-policy cycle has changed.

### The Dollar: Privilege Is Infrastructure, Not Immunity

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## Yen and Carry Trades

The yen intervention also offers a practical lesson about carry.

A low-volatility currency financed at a low interest rate can become an attractive funding source for leveraged investors.

The trade appears stable until the exchange rate moves abruptly.

Goldman estimates that USD/JPY moved roughly 3% during the initial Japanese intervention and another

2% after indications of U.S. participation. A move of that magnitude can erase an entire year of carry in a matter of days.

Carry is income earned in exchange for accepting a risk that is often invisible during calm periods and concentrated during stress.

The relevant portfolio question is therefore not only the size of the yield differential.

## Multi-Currency Portfolios

The episode also reinforces the case for separating currency diversification from currency forecasting.

A diversified portfolio does not require a categorical prediction that the dollar will collapse, the yen will recover or any alternative reserve asset will replace Treasuries.

Its purpose is to reduce dependence on a single monetary regime.

Currency diversification is most useful when treated as a structural risk-management decision rather than a tactical forecast about the next central-bank intervention.

# Risks to the Central Thesis

The principal counterargument is that global demand for U.S. financial assets remains extremely large.

Foreign investors held more than \$35 trillion of U.S. securities at the latest comprehensive annual Treasury survey date, including equities and debt instruments. The existence of fiscal deterioration has not prevented the United States from attracting enormous quantities of foreign capital.

A second risk is that U.S. fiscal policy changes materially. Tax increases, spending restraint or stronger nominal economic growth could stabilize the debt trajectory and reduce the future interest burden.

A third is that Japan successfully normalizes its domestic policy mix. Faster Bank of Japan tightening, stronger domestic investment returns or capital repatriation could produce a more durable yen appreciation and reduce the need for repeated intervention.

A fourth is that intervention proves largely temporary. The yen has already surrendered part of its initial appreciation, supporting the historical observation that foreign-exchange intervention is generally most durable when accompanied by changes in underlying monetary or fiscal policy.

The opposite risk also deserves attention.

If inflation or fiscal uncertainty causes investors to demand structurally higher long-term yields, the interest burden can increase even without any loss of nominal payment capacity.

The most important risk is therefore not a binary choice between "default" and "no default."

It is a gradual repricing of sovereign credibility.

# Our Perspective

At Astro Wallenius, we believe the public debate around government debt frequently asks the wrong question.

The United States does not need to eliminate its federal debt.

Government securities are rolled continuously and play a central role in global financial markets.

Nor should the federal government be analyzed as if it were a household that must accumulate dollars before it can spend them.

But the opposite conclusion — that debt therefore carries no meaningful constraint — is equally incomplete.

The Federal Reserve operates under institutional and legal limits.

The Treasury finances deficits through securities issuance.

Investors determine the yields at which a substantial portion of those securities trades.

Inflation determines their real value.

Currencies determine their value to foreign holders.

And confidence determines how much compensation markets demand for duration and policy uncertainty.

Japan reinforces the same lesson from another direction.

Its enormous domestic sovereign-debt market has remained functional because of its creditor base, central-bank holdings and external assets.

Yet those advantages have not prevented substantial currency depreciation or the need for extraordinary intervention.

Monetary sovereignty provides room to maneuver.

It does not remove trade-offs.

For investors, the relevant question is therefore not:

Can the United States create the dollars required to meet a dollar obligation?

It can.

The better question is:

What return will investors require to continue holding those dollars and the securities denominated in them?

That question connects fiscal policy, inflation, currencies and bond markets more directly than the headline debt number itself.

# Final Thoughts

The approaching \$40 trillion U.S. debt milestone will attract attention.

The intervention in the yen already has.

Neither should be interpreted in isolation.

Together, they show how deeply sovereign debt, reserve currencies and global liquidity are connected.

U.S. Treasuries finance the federal government.

They also serve as reserves.

They serve as collateral.

They support dollar funding.

And, through facilities such as FIMA, they form part of the international financial safety net.

That system gives the United States exceptional monetary capacity.

Its durability ultimately depends on something that cannot be created by an accounting entry:

the willingness of investors and institutions to continue treating those liabilities as reliable stores of liquidity and value.

That is the constraint worth watching.

# Glossary

**CBO:** Congressional Budget Office.

**FIMA Repo Facility:** Federal Reserve facility through which approved foreign monetary authorities can temporarily exchange U.S. Treasury securities for dollars.

**JGB:** Japanese Government Bond.

**NIIP:** Net International Investment Position — a country's external financial assets minus its external financial liabilities.

**Primary deficit:** Fiscal deficit excluding net interest expense.

**Term premium:** Additional compensation investors may demand for holding longer-maturity bonds rather than repeatedly investing in short-term securities.

**Carry trade:** Strategy that borrows or funds in a lower-yielding currency and invests in a higher-yielding asset or currency.

**Monetary sovereignty:** The ability of a government and its monetary institutions to operate in a currency they issue, subject to their legal and institutional framework.

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