Does swap-covered interest parity hold in long-term capital markets after the financial crisis?

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ABSTRACT

This paper analyzes swap-covered interest parity by comparing US Treasury bonds with USD denominated foreign assets replicated using cross-currency basis swaps. We find that the deviations of these yield spreads declined substantially after the financial crisis, which is in sharp contrast with the variation in the cross-currency basis. The analysis in this paper also shows the existence of cointegrating relationships between the cross-currency basis and domestic/foreign swap spreads, and conclude that the US swap spread tightening is related to the negative currency basis.

JEL classification: E43, F31, G15

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