ECB Bond Market Contact Group
Market functioning and the monetary policy normalisation of central banks

November 2022
Monetary Policy normalisation and the impact on various asset classes

Market Liquidity conditions from IMF Global Financial Stability Report

Volatility Fear/Uncertainty Gauge – 3m ATM Implied vol, 1yr History - Implied vs Realised Volatility across asset classes

1. Sources: Bloomberg Finance L.P.; Haver Analytics; Japan Bond Trading; JPMorgan Big Data and AI Strategies; MarketAxess; Reuters; Securities Industry and Financial Markets Association; and IMF staff calculations.

Volatility, Market Depth & Liquidity - A Repricing of Liquidity

Bund Market Depth vs Volatility

Bund market depth (€mm equivalent) and Bund daily trading volume (€bn equivalent) since 1 Jan 2020

Treasury market depth vs Volatility

Market depth and average daily volume for German Eurex future

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<th>Market depth (€mm equivalent)</th>
<th>Volume (€bn equivalent)</th>
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<td></td>
<td>Current</td>
<td>YTD Avg</td>
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<tr>
<td>Schatz</td>
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<td>Bobili</td>
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<td>Bund</td>
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<td>Basi</td>
<td>2</td>
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Sources: J.P. Morgan research
Volatility, Market Depth & Liquidity - A Repricing of Liquidity Contd

Average daily notional volume in € Bn

Sources: Tradeweb
Is the liquidity evenly distributed? A multi-tiered approach to liquidity with more concentrated flows

1M MA of yield RMSE for German and French par curves; bp\(^1\)

1M MA of yield RMSE for Italian and Spanish par curves; bp\(^2\)

BondVision Composite Daily B/O Spreads: NON-CORE 10-Yr Benchmarks\(^3\)

Root Mean Square Error (RMSE), a measure of US Treasury Curve Deviations\(^4\)

On-and-off-the-run nominal coupon volumes, share of sector volume
Based on average daily volumes in DV01 in 2022\(^5\)

1. – 2. Sources: J.P. Morgan Research
3. Sources: MTS
4. Sources: J.P. Morgan Research
5. Sources: FINRA TRACE, US Department of Treasury
Price impact of trades increasing – Fixed Income markets getting less resilient

Weighted average Hui-Heubel liquidity ratio for 10y futures on US, German, Japanese, UK, French and Italian government bonds

10-year Treasury price impact, 5-day moving average; 32nds

1. Sources: Bloomberg Finance L.P., J.P. Morgan
2. Sources BrokerTec, J.P. Morgan
Dealer balance sheets may be getting more constrained at the same time as supply is increasing and fund flows turning negative

2023 supply vs ECB Purchase dynamics: material deterioration for Euro area sovereigns, even without QT

Total marketable US Treasury debt outstanding (lhs, $bn) versus absolute value of primary dealer positions in Treasuries (1m moving average, rhs, $bn)

Global equity & bond fund flows

1. Sources: J.P. Morgan
2. Sources Federal Reserve Bank of New York
3. Sources: ICI, EPFR, EFAMA, Bloomberg Finance L.P., J.P. Morgan
Lessons from Sterling Market – Following the broad trend, but with sui generis catalysts and lingering scars

5D rolling standard deviation of daily yield changes; bp\(^1\)

Gilt and bund market depth (contracts 000’s), adjusted by volatility\(^2\)

Levels and changes for selected UK rate market metrics; bp unless levels\(^3\)

Tradeweb liquidity Cost index\(^4\)

BV Composite Daily B/O Spread: GILT 10-Yr Benchmark\(^5\)

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1. – 3. Sources: J.P. Morgan Research
4. Sources: Tradeweb
5. Sources: MTS
Questions

- What are the potential sources of further financial stress?

- Will Central Banks be proactive or reactive in addressing financial market stress? What pre-emptive action can Central Banks take?

- Will liquidity improve as volatility decreases, or is the market permanently scarred?

- Is the uneven distribution of liquidity within individual bond curves a function of policy normalisation?

- What can European Sovereign borrowers do to help ensure market functioning?
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