

Global Market Liquidity Trends

SAFE Investment Center , Mar 2017



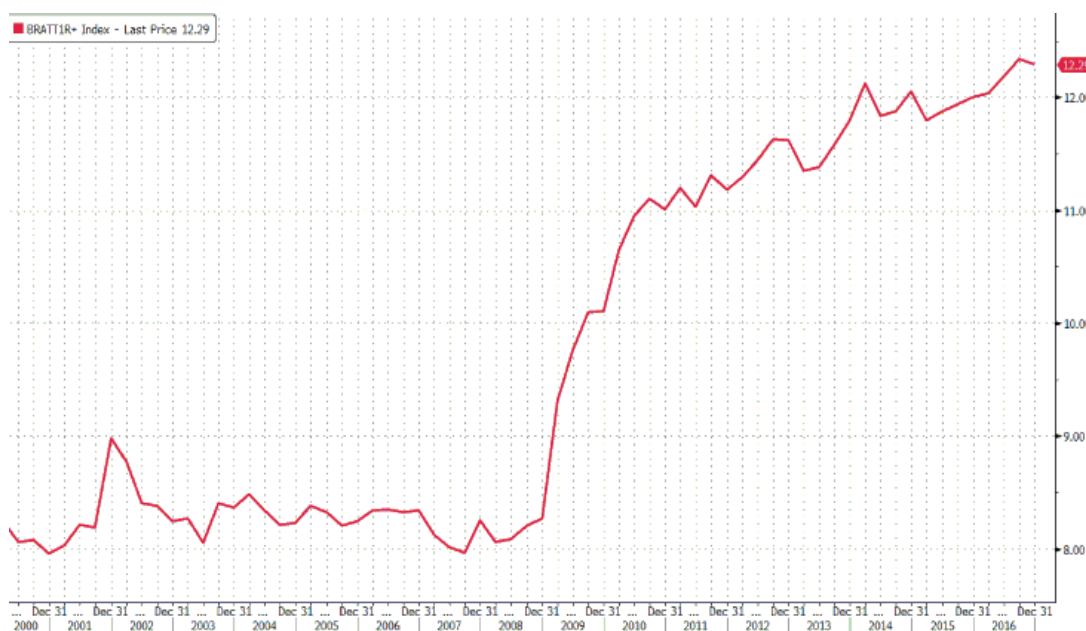
SAFE Investment Center
国家外汇管理局中央外汇业务中心

Key Points

- Liquidity generally worsened due to financial regulation reforms and market structural changes post 2008 crisis.
- Buy side firms were less impacted by new regulation, and started playing bigger roles as liquidity providers than before.
- We have closely and consistently monitored the liquidity trend, and kept exploring new sources of liquidity.

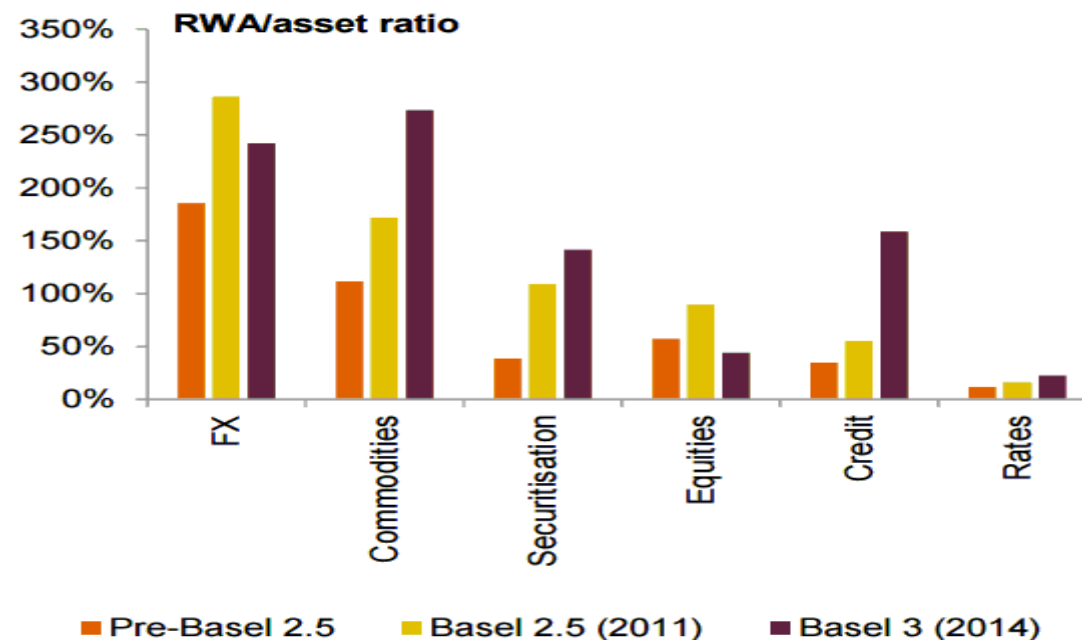
Regulatory Reforms (Basel III , Dodd-Frank Reforms , Liquidity requirement for banks) have negatively impacted market making capability

Bank tier 1 capital ratio spiked due to stricter regulations



Source: FDIC , Bloomberg

Capital cost for market making has risen



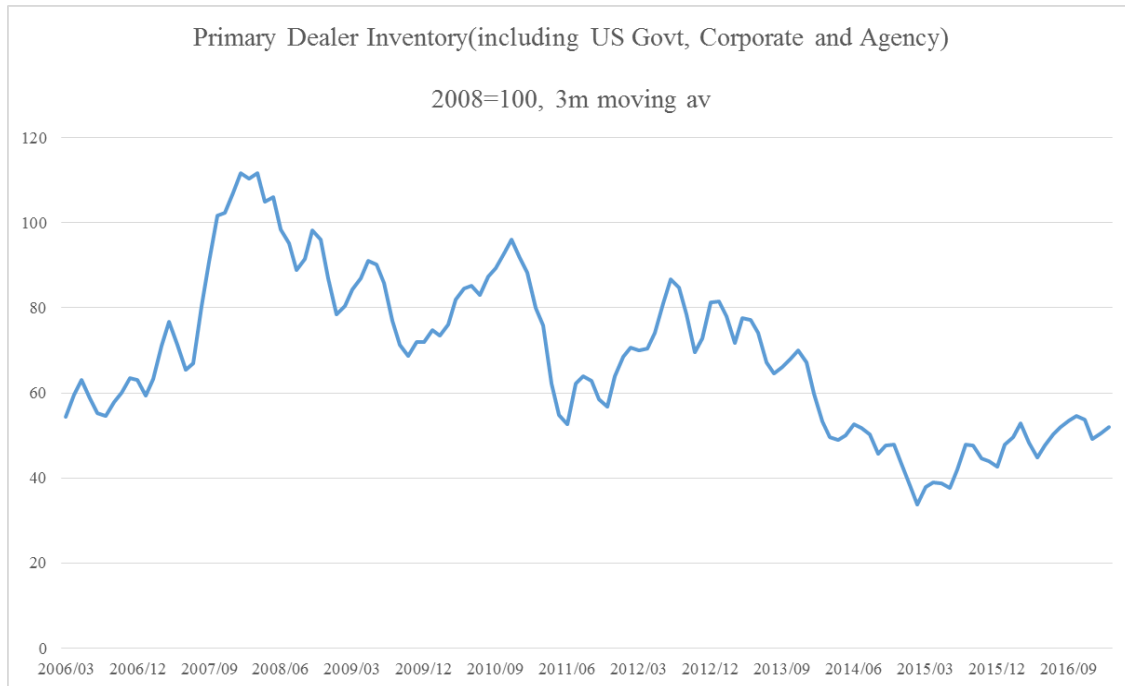
Source: Global financial market liquidity study



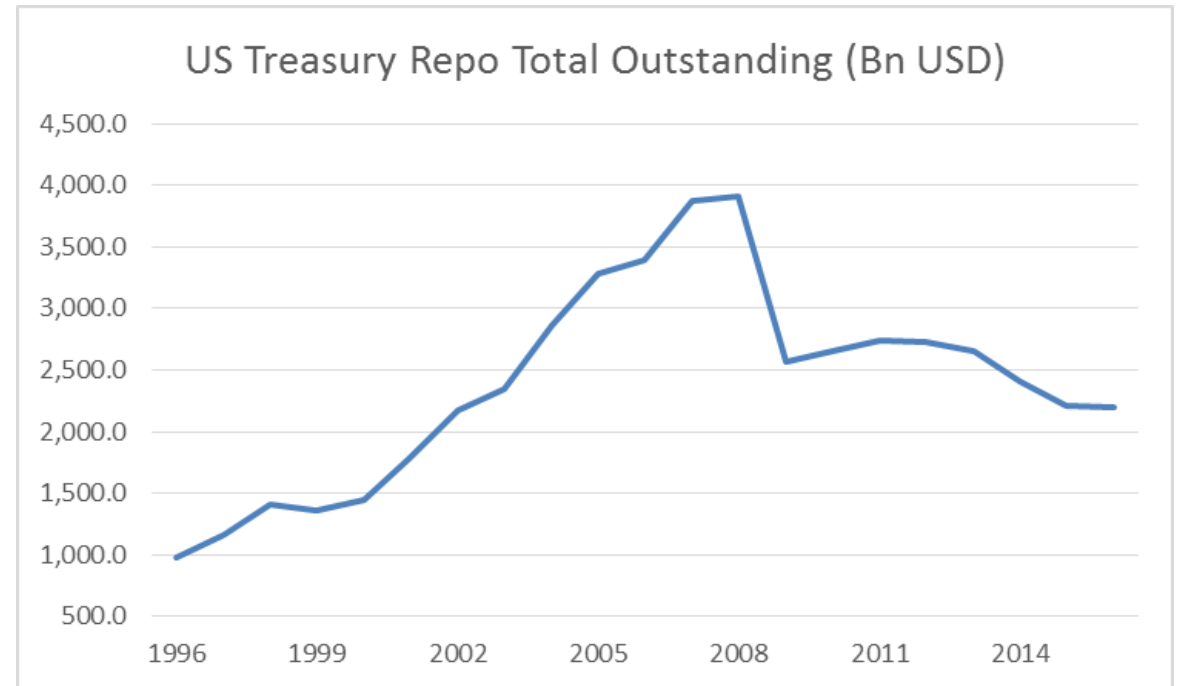
Sell side firms have cut balance sheet commitment

US primary dealer inventory has fallen 50% compared to 2008

UST repo outstanding has fallen 45% compared to 2008



Source: Haver



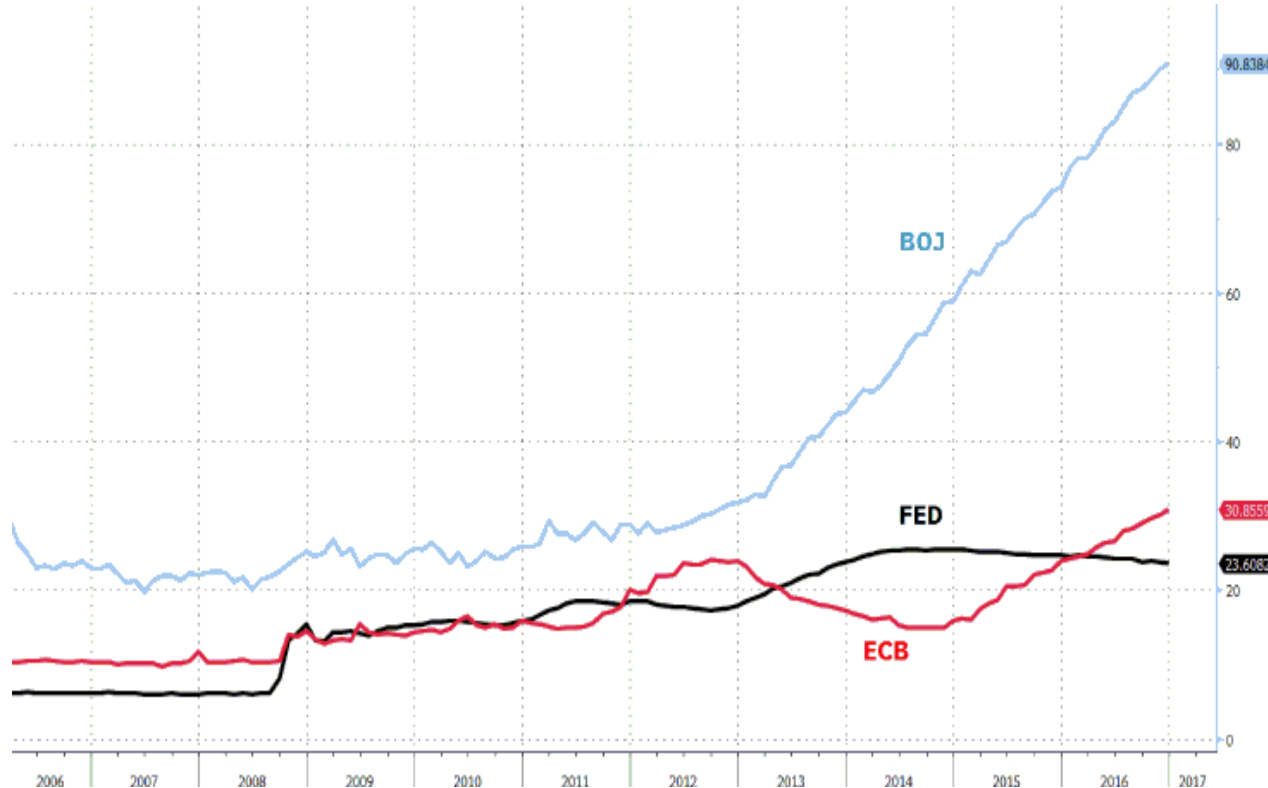
Source: SIFMA



Key central banks have been deeply involved in fixed income market recently

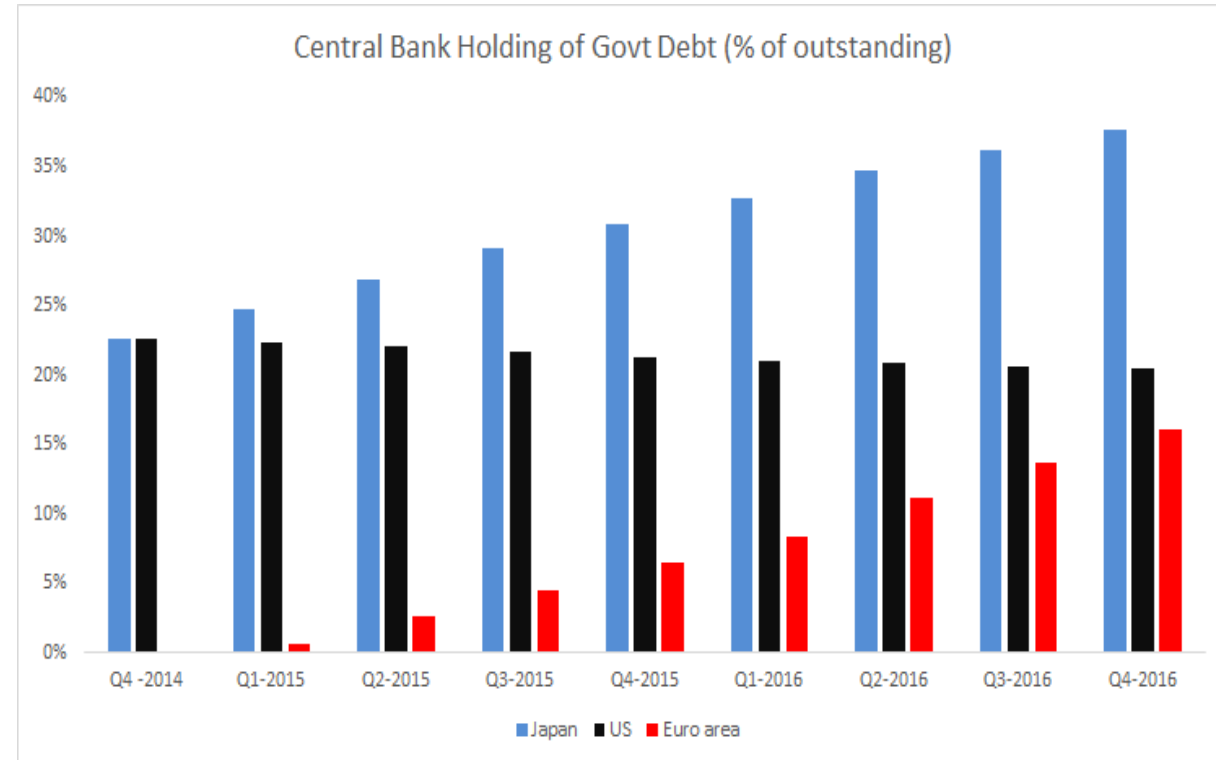
Key Central Banks deployed huge QE program post 2008 crisis

Balance sheet % GDP



Source: Bloomberg

Key Central Banks sovereign holding % of outstanding

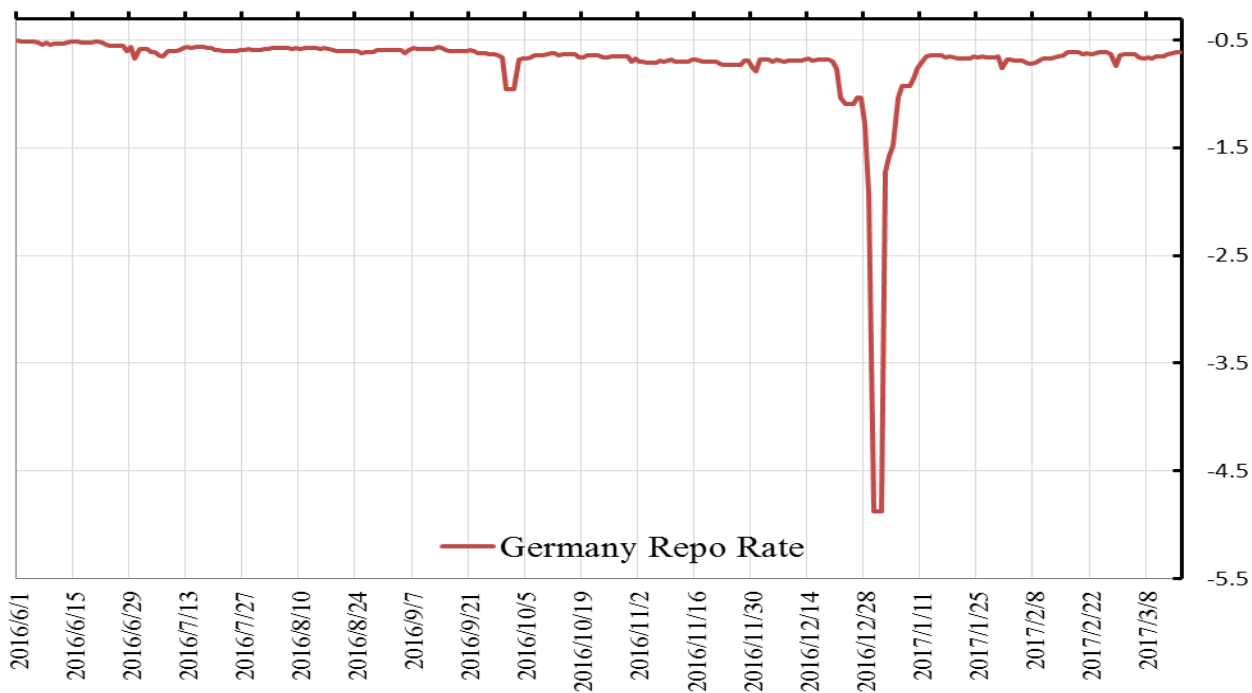


Source: Bloomberg



EU core country government bond scarcity

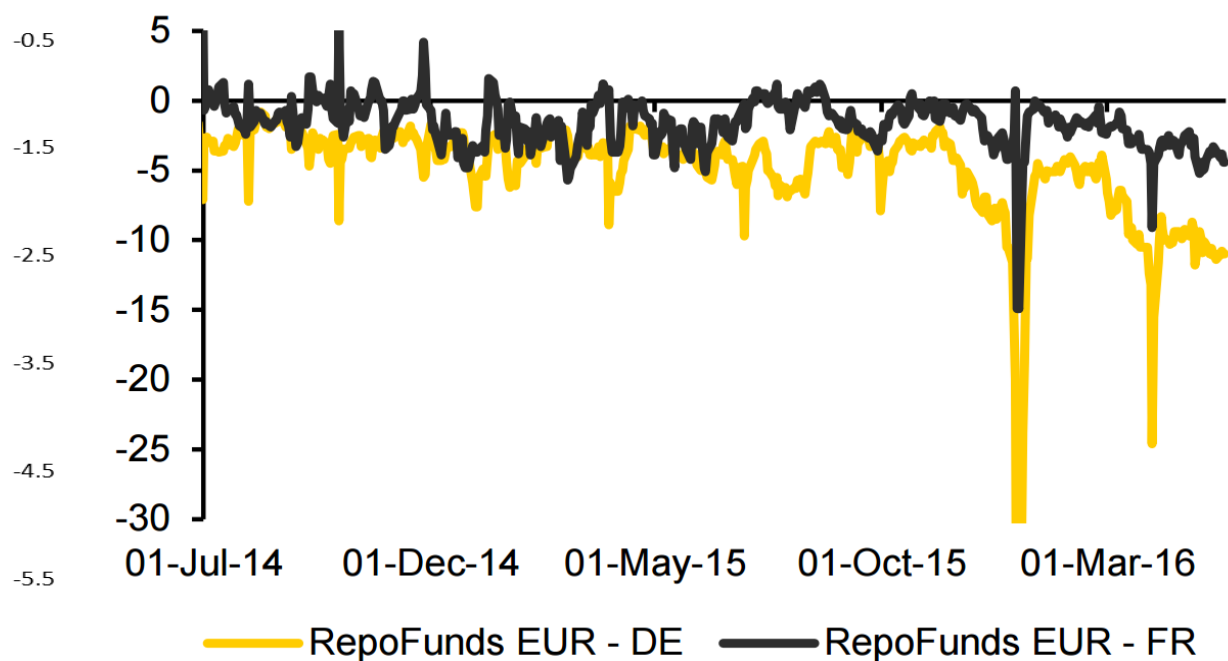
German 3m repo rate (%)



Source: Bloomberg

Scarcity effects emerging in Bund repo markets ...

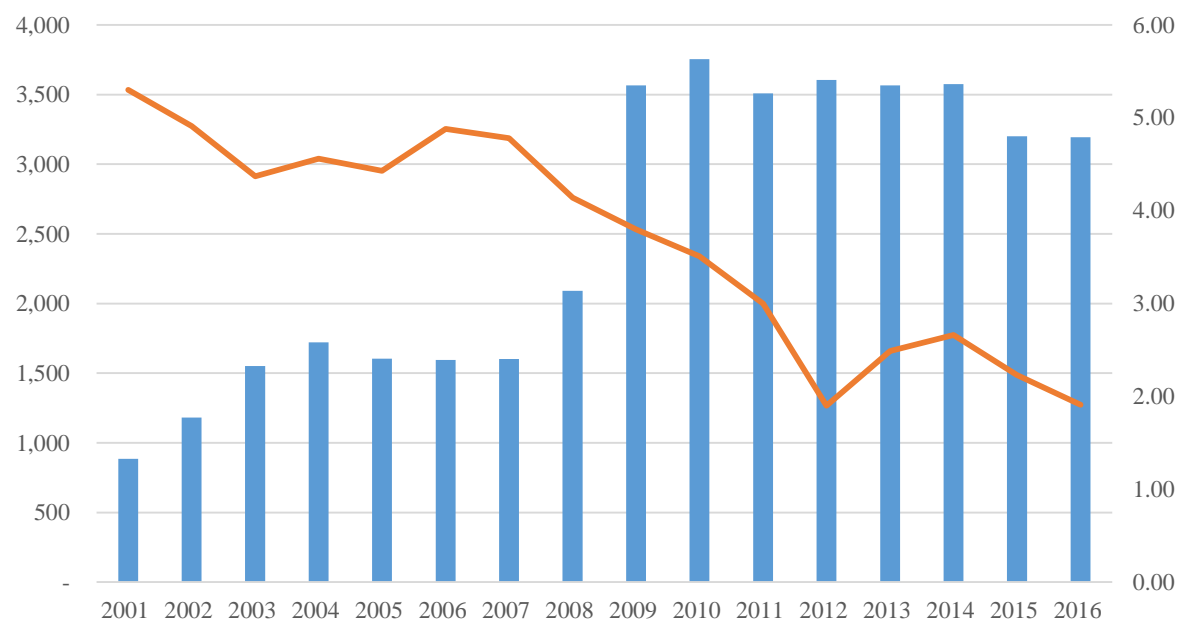
Single sovereign vs EUR sovereign RepoFundRates spreads, in bp



Source: Bloomberg, RepoFundsRate, Commerzbank Research

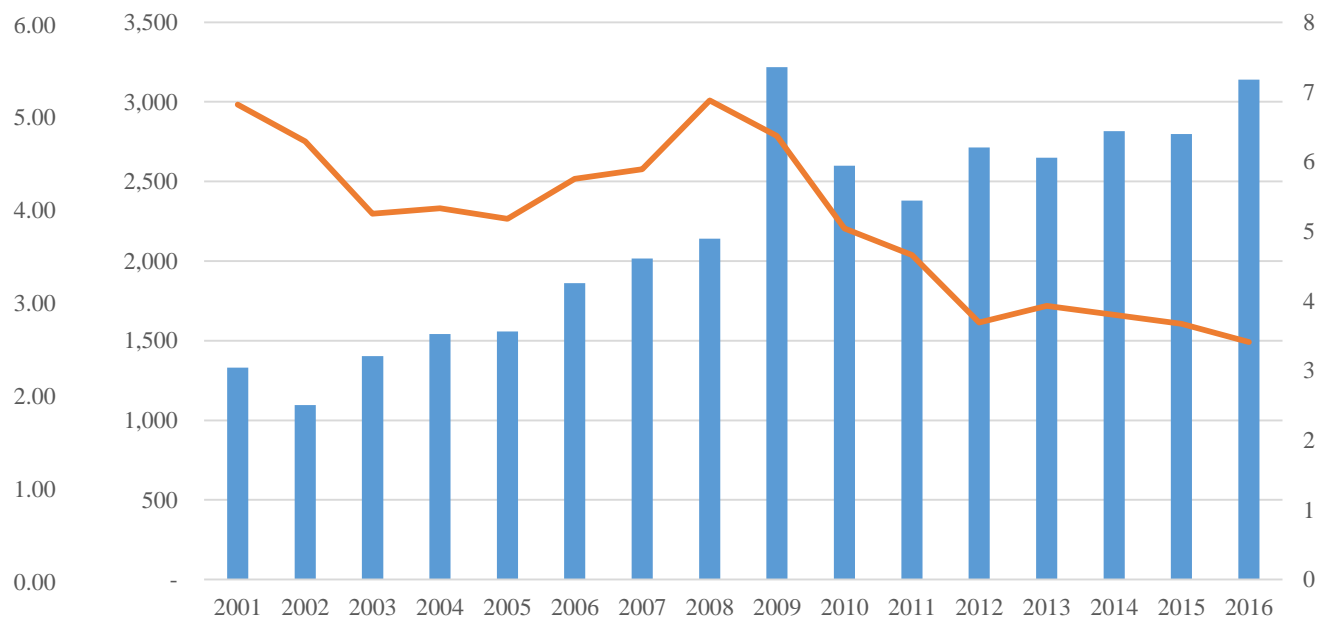
Elevated government and corporate new issuance in the low yield environment changed liquidity dynamics further

US&EU Govt Gross Supply (Yearly, bn\$)



Source: Haver ■ US&EU Govt Supply(LHS) — UST 10yr Rate(RHS)

US&EU IG Corp Gross Supply (Yearly, bn\$)



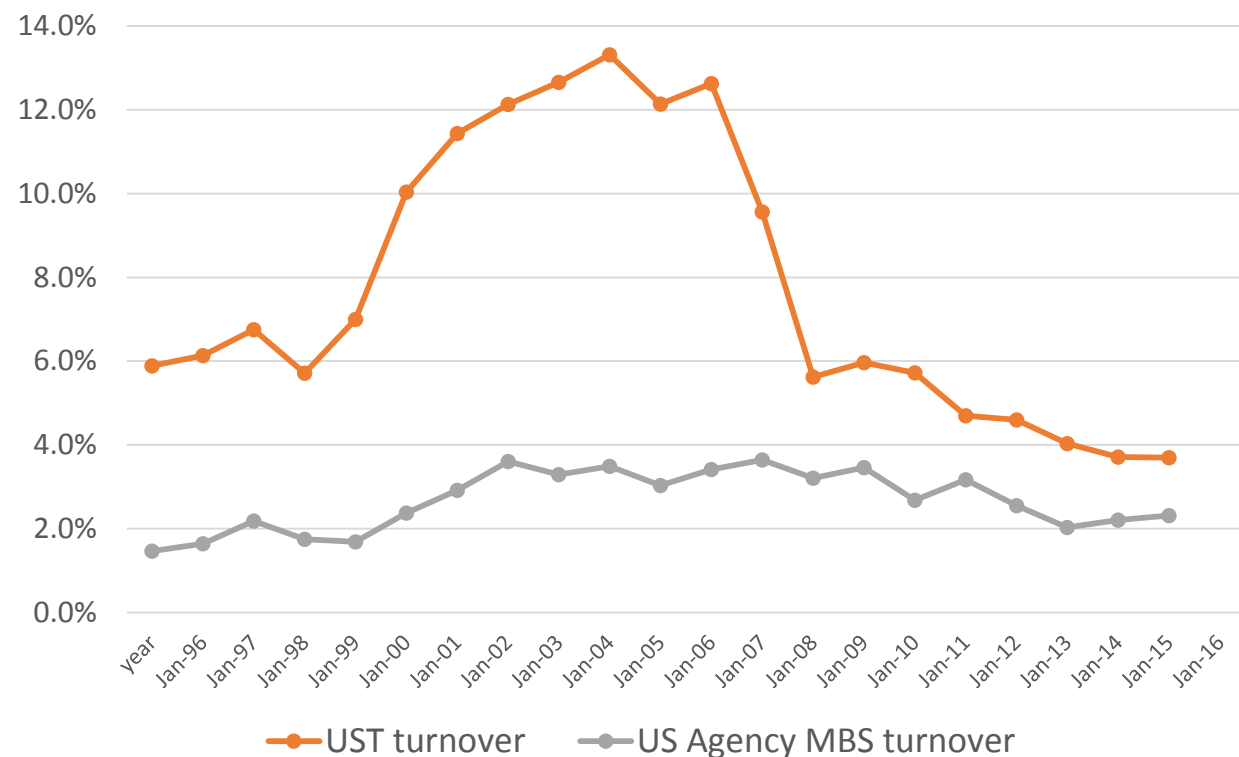
Source: Dealogic, Haver ■ US&EU IG Corp Supply(LHS) — US IG Bond 10Y yield(RHS)

The daily market liquidity could be seriously affected by these activities.



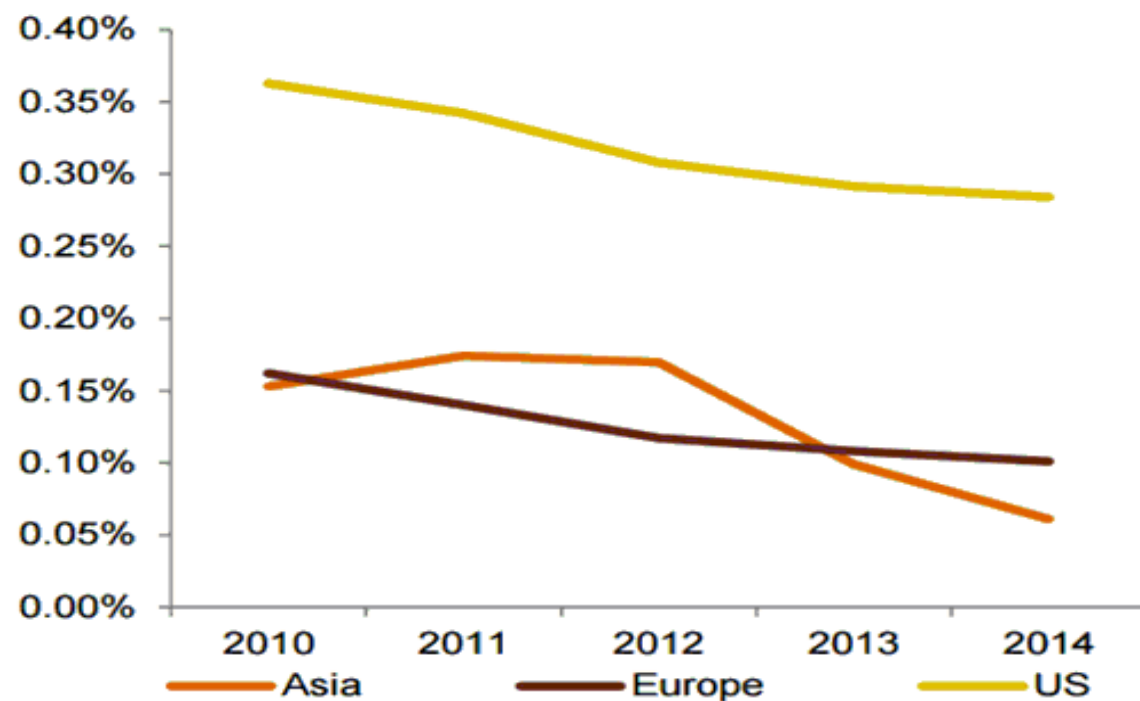
Downtrend in fixed income market turnover continues

US key bond market turnover ratios (average daily volume/outstanding)



Source: SIFMA

Corporate bond turnover ratios (average daily volume/outstanding)

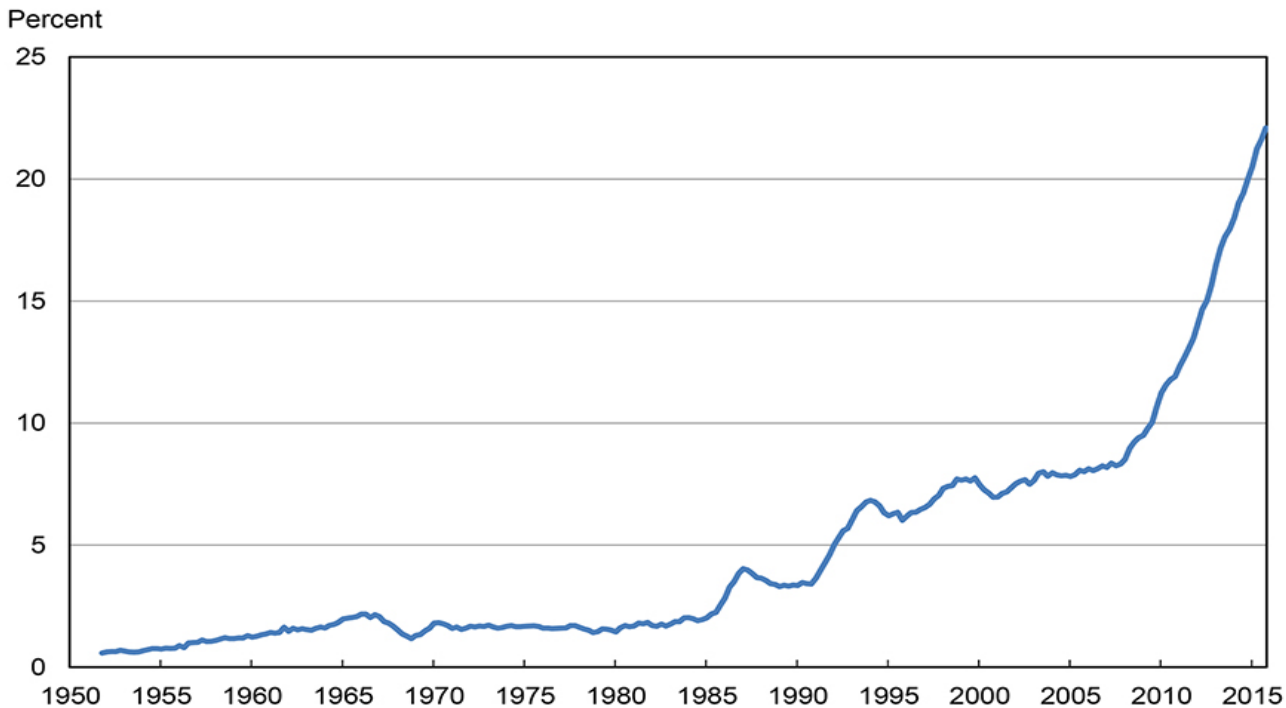


Source: Asian Development Bank, Trax, SIFMA, PwC analysis



Buy side firms started playing bigger roles as liquidity provider

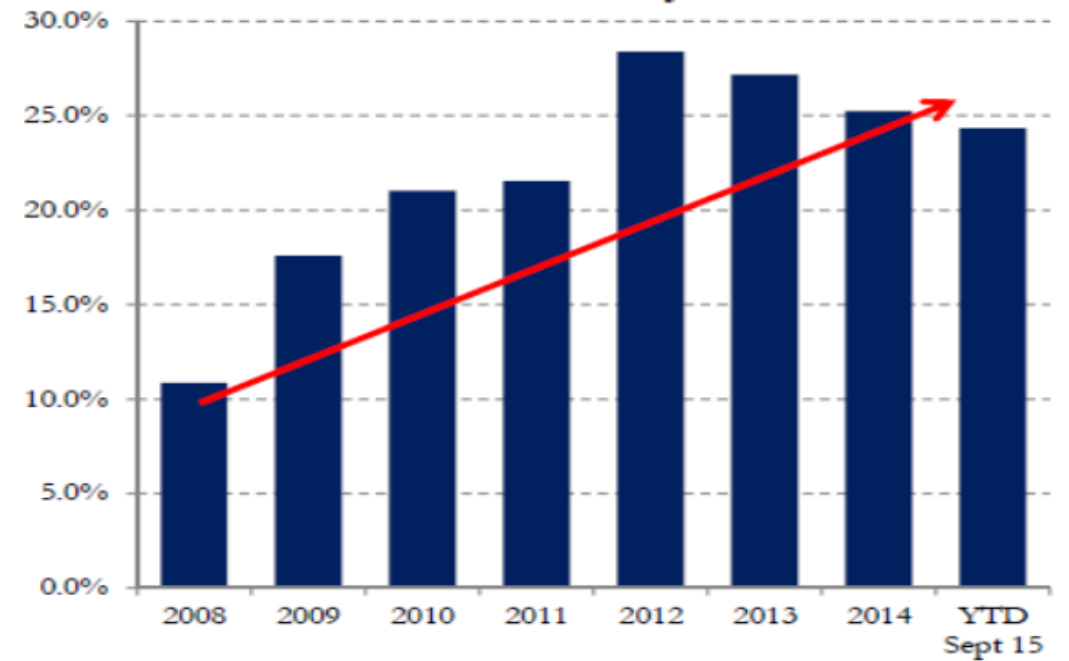
US mutual fund holding % of corporate bond outstanding



Source: FRBNY staff calculations, based on data from the Financial Accounts of the United States (Flow of Funds), obtained through Haver Analytics.

Note: The exhibit plots mutual fund holdings of corporate and foreign debt as a percent of total corporate and foreign debt outstanding.

US mutual fund holding % of high yield bond outstanding

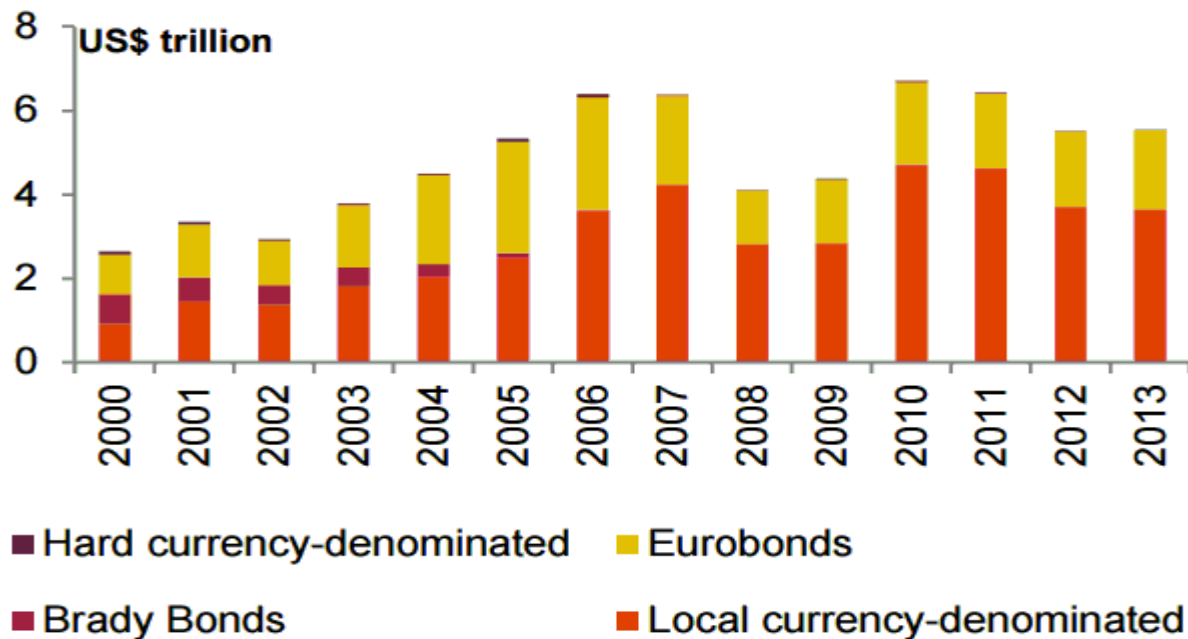


Sources include: JP Morgan, NY Fed. Please see Notes & Disclosures.



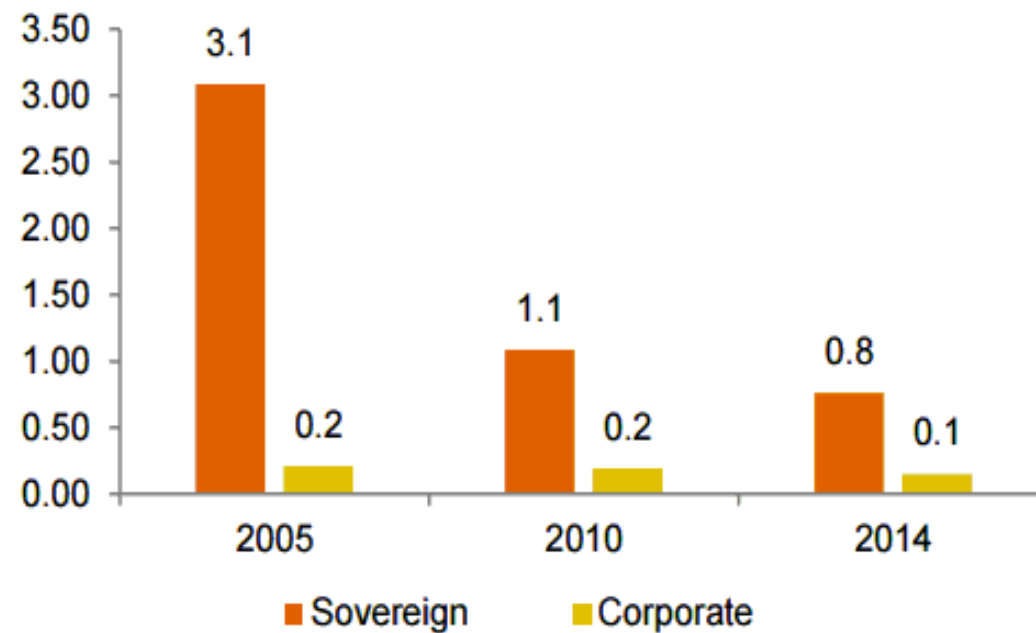
EM bond market liquidity has moved from where it was

EM fixed income trading volume is down from peak level



Source: EMTA

Turnover ratio declined in key EM countries like Brazil, Turkey, Mexico and India (daily volume % of outstanding)



Source: BIS, EMTA

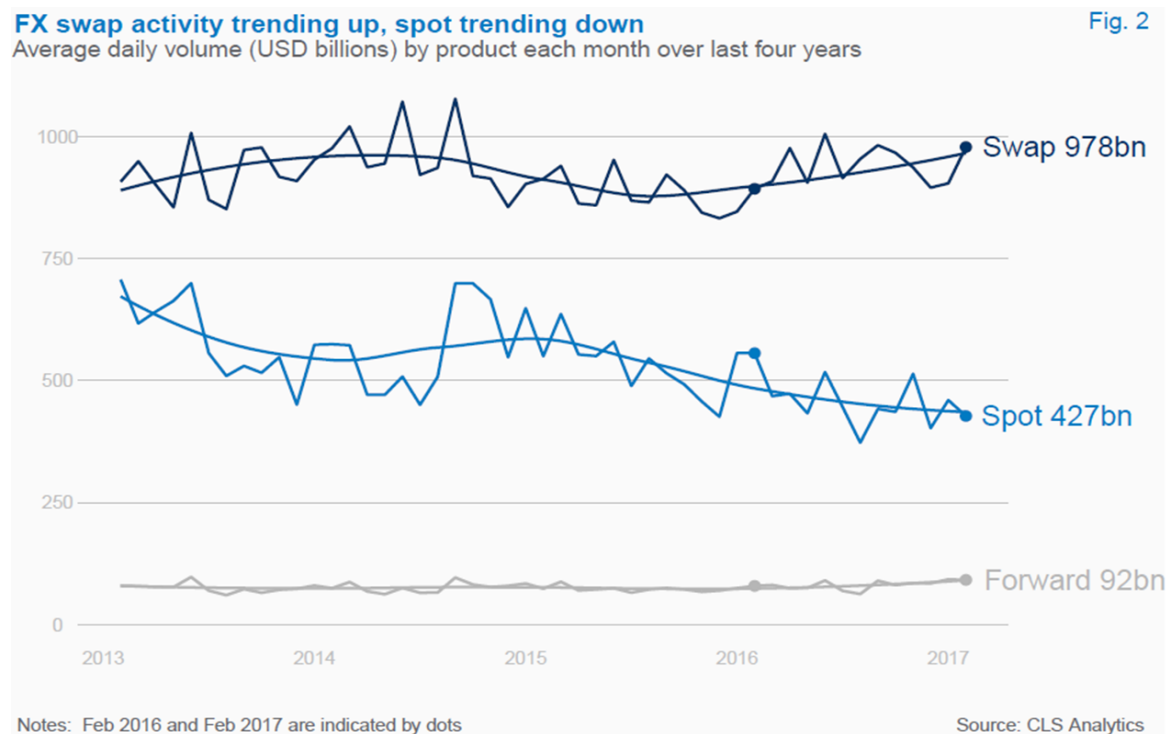
Fixed income market liquidity trends

- Fixed income market has experienced diminishing liquidity mainly due to shrunk commitment from traditional market makers
- Unconventional monetary policy from key central banks and heavy bond supply have distorted the daily market liquidity balance.
- While buy side institutions have become more active in liquidity providing than before.

FX spot transaction volume is falling

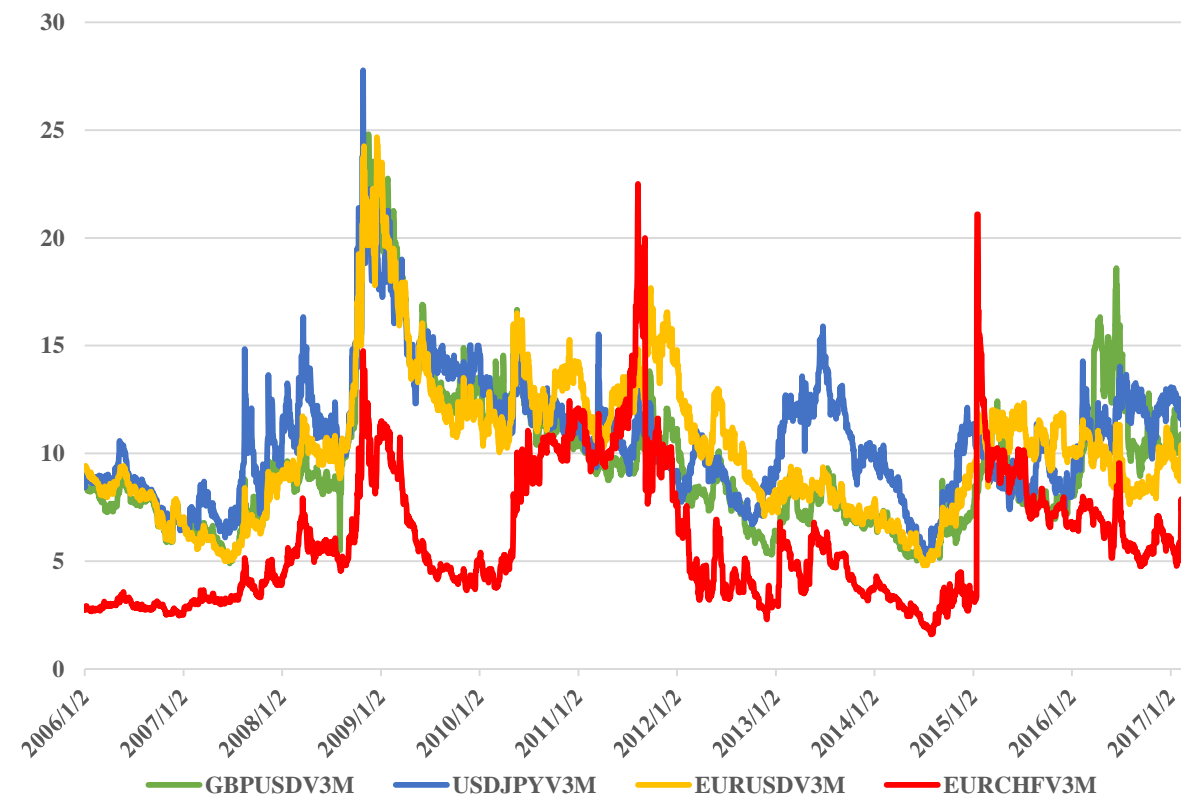
Key reason: Banks reassessing the profitability of prime broker business under additional regulation

FX swap, FX spot transaction volume trend



Source: BIS

Event risks caused sudden spikes of FX volatility, and damped the risk appetite of Primary FX Brokers

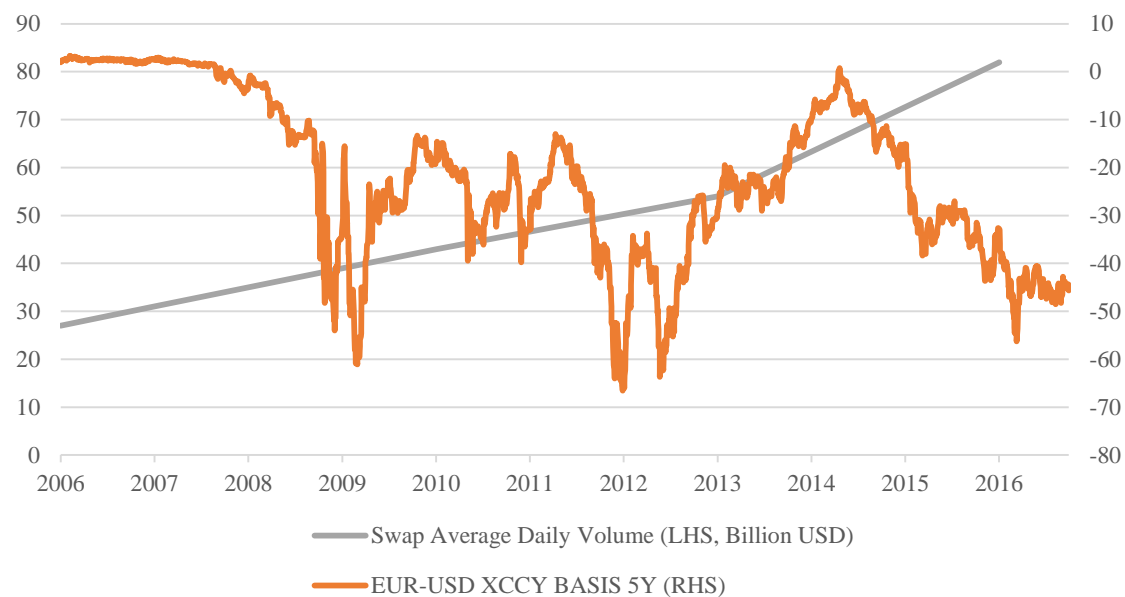


Source: Bloomberg



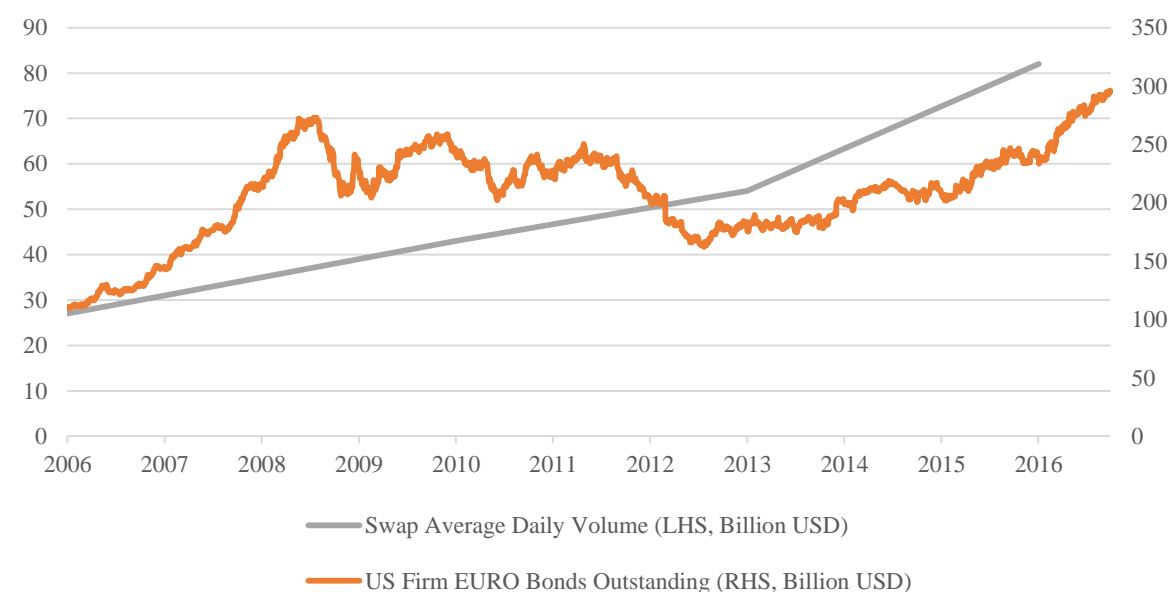
FX swap volume picked up due to rising FX hedged bond new issuance and active currency basis trading

XCCY basis vs Swap Volume



Source: BIS, Bloomberg

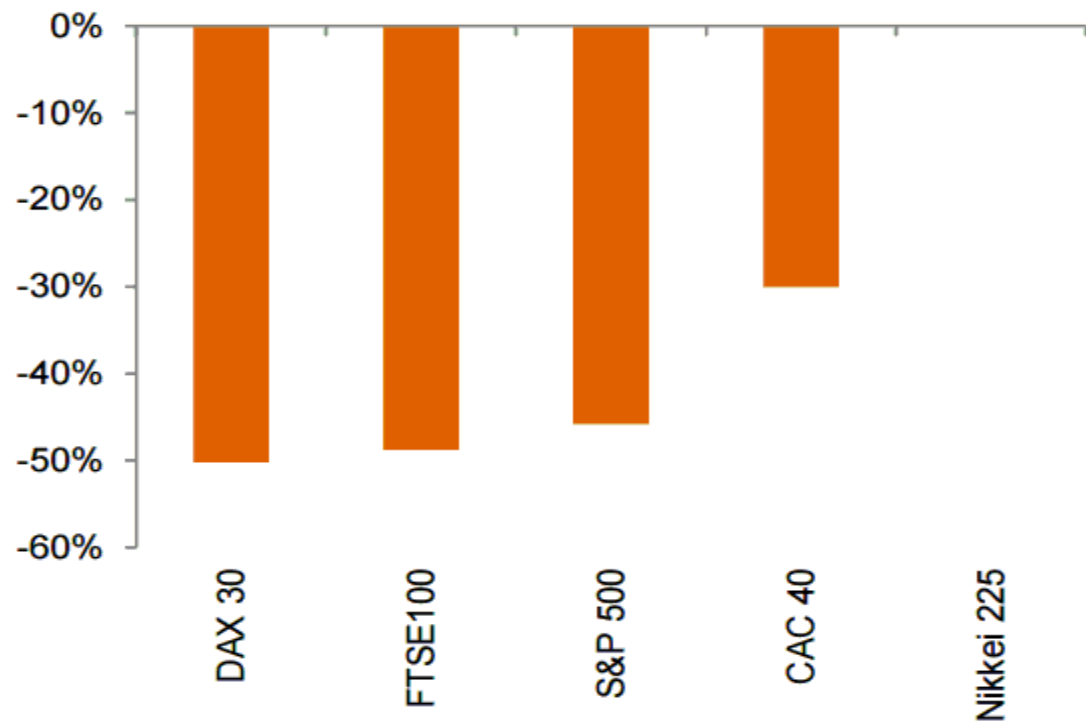
Corp Cross Currency Bond vs Swap Volume



Source: BIS, Barclays Point

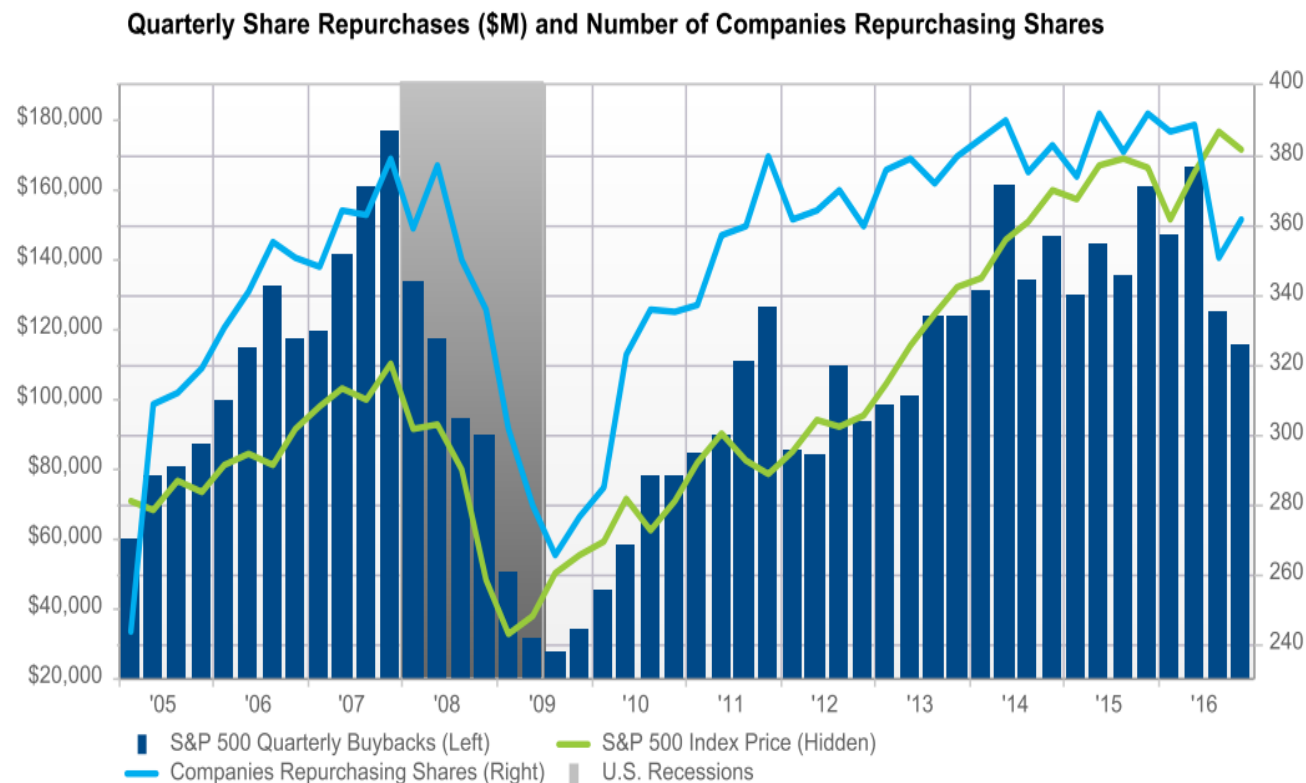
Equity Market liquidity conditions generally worsened

Declining trading volume of major equity indices (from 2008 to 2015)



Source: Thomson Reuters

US Corporates prefer stock buyback program



Source: FactSet

