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Federal Reserve's View of Bond Market Liquidity

“Despite these increased market discussions, a variety of metrics of liquidity in the nominal Treasury market do not indicate notable deteriorations.

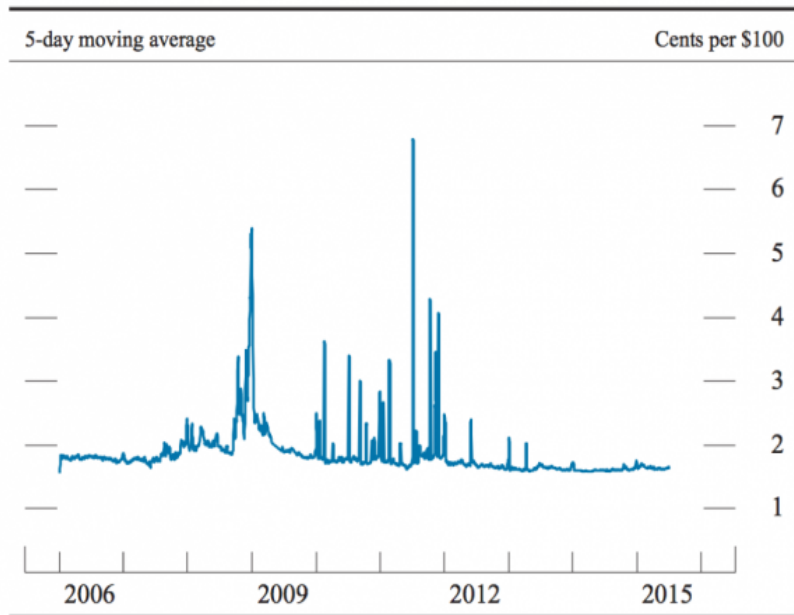
For example, bid-asked spreads for the on-the-run 10-year Treasury security have remained at levels comparable with or even slightly narrower than those observed before the recent financial crisis (figure A).

A measure of market depth has shown notable variation since the data became available in 2010 and is currently around its average level in 2010 and 2011 (figure B).”

Board of Governors of the Federal Reserve System, Monetary Policy Report, July 15, 2015 http://www.federalreserve.gov/monetarypolicy/files/20150715_mprfullreport.pdf

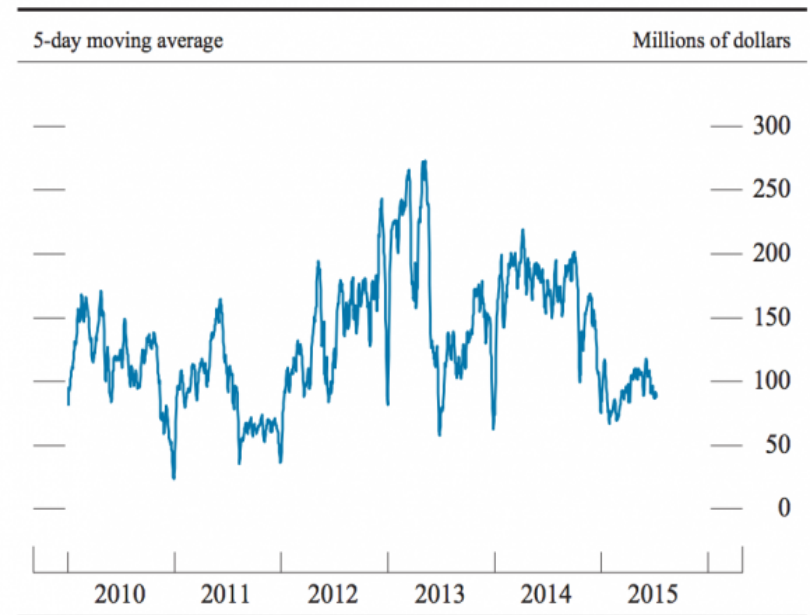
Bid/Ask Spread and Market Depth Charts from Fed Monetary Policy Report

A. Bid-asked spreads for 10-year on-the-run Treasury notes



SOURCE: Staff calculations using data from EBS BrokerTec.

B. Market depth for 10-year on-the-run Treasury notes



NOTE: Market depth is defined as the average top three bid and asked quote sizes.

SOURCE: Staff calculations using data from EBS BrokerTec.

Transactional Liquidity vs Market Integrity Liquidity

“It is important not to confuse investment risk with systemic risk. While price moves may be more disjointed — and prices may have to decline more significantly for a market price to be established — price declines are not the same as the system failing.”

Low Bond Liquidity Presents Little Risk

by Douglas Hodge (CEO, Pimco), Financial Times, July 22, 2015, <http://www.ft.com/intl/cms/s/0/a0513f08-1c23-11e5-a130-2e7db721f996.html#axzz3hJ0qf7cp>

Transactional Liquidity Small Transaction

Bonds to be purchased

\$10 million



Market Selling Interest

Price Level

Depth

95%

\$7.5 million

96%

\$12.5 million

97%

\$30 million

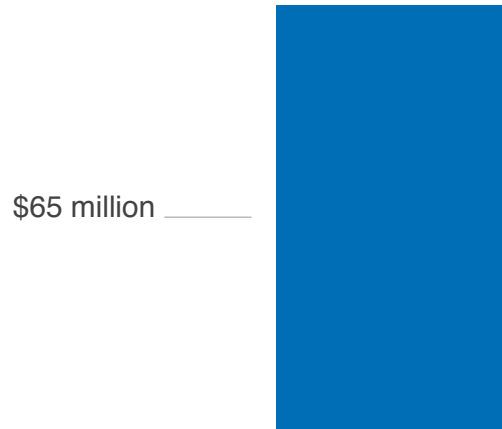
100%

\$150 million

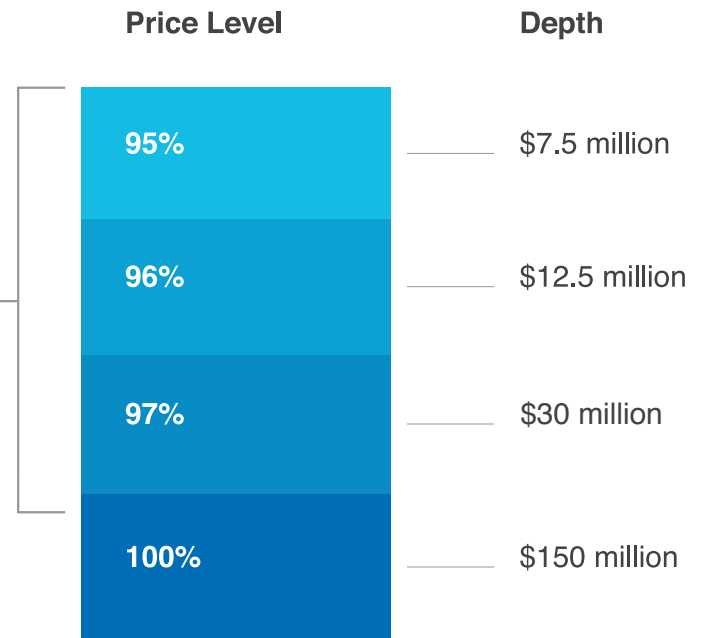
Transaction Price: 96%

Transactional Liquidity Large Transaction

Bonds to be purchased



Market Selling Interest



Transaction Price: 100%

Market Integrity Risk: **The Machines Exit the Market**

“It was still early in the New York trading day on Oct. 15 and investors were already pouring into U.S. government bonds as global financial markets from Asia to Europe buckled. Because yields were falling so fast, Comiskey, the head Treasury dealer at Bank of Nova Scotia, realized that he ran the risk of being stuck with losses or unwanted inventory if his computers automatically generated quotes to buy and sell with customers.”

Treasury Liquidity Squeezed as Dealers Shut Off Machines

by Anchalee Worrachate and Susanne Walker Barton, Bloomberg Business, October 27, 14, <http://www.bloomberg.com/news/articles/2014-10-26/treasury-liquidity-squeeze-seen-in-dealer-who-shut-off-machine>

Market Integrity Liquidity

