AFR Americans for Financial Reform

Bond Market Liquidity, Regulation, and The Public Interest

August 3rd Teleconference

Americans for Financial Reform
Marcus Stanley, Policy Director
marcus@ourfinancialsecurity.org

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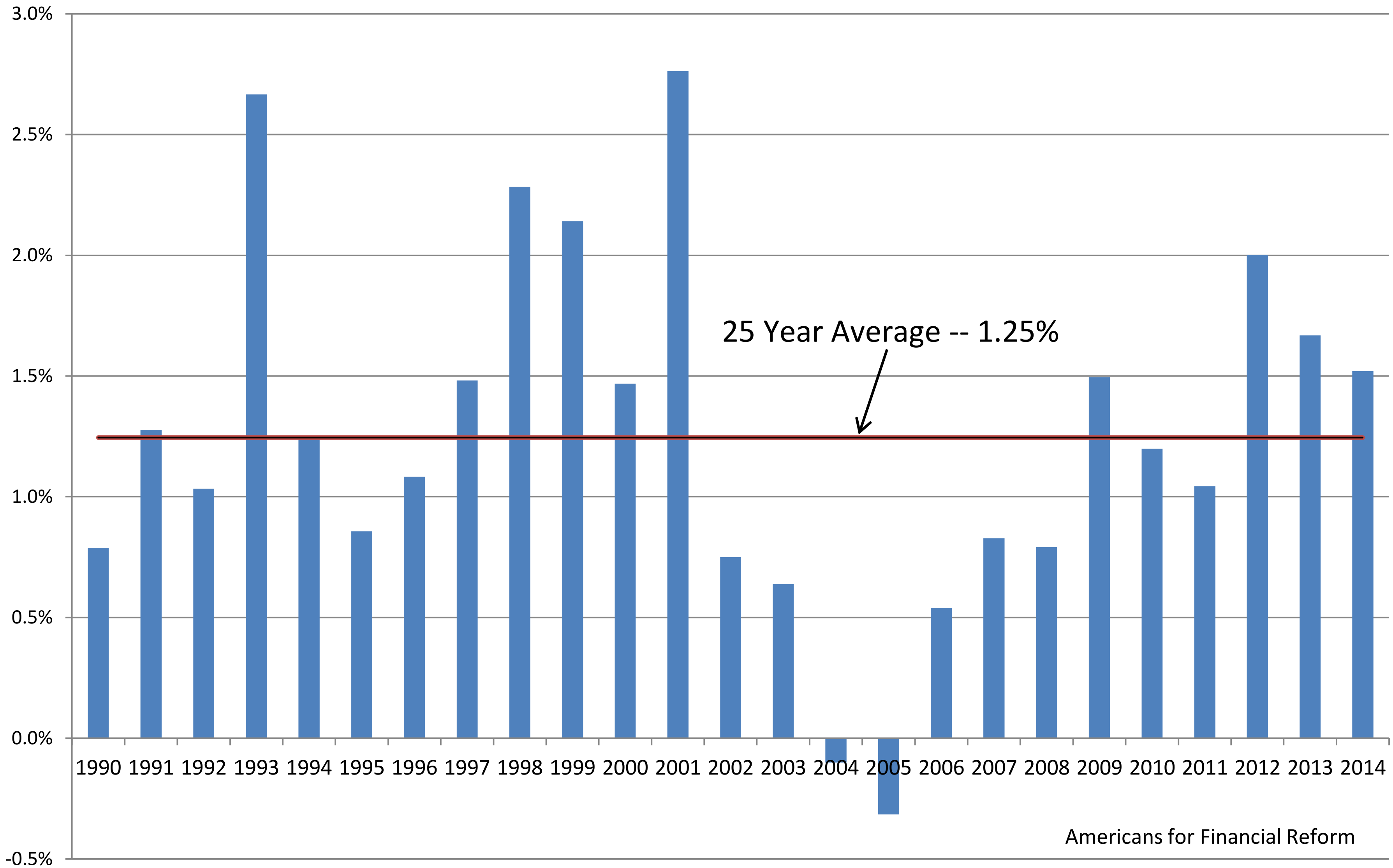
Bond Issuance Looks Healthy….

Net Non-Financial Corporate Bond Issuance As Percent of GDP



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Bond Spreads Look Healthy…

US Corporate BBB Option Adjusted Spread

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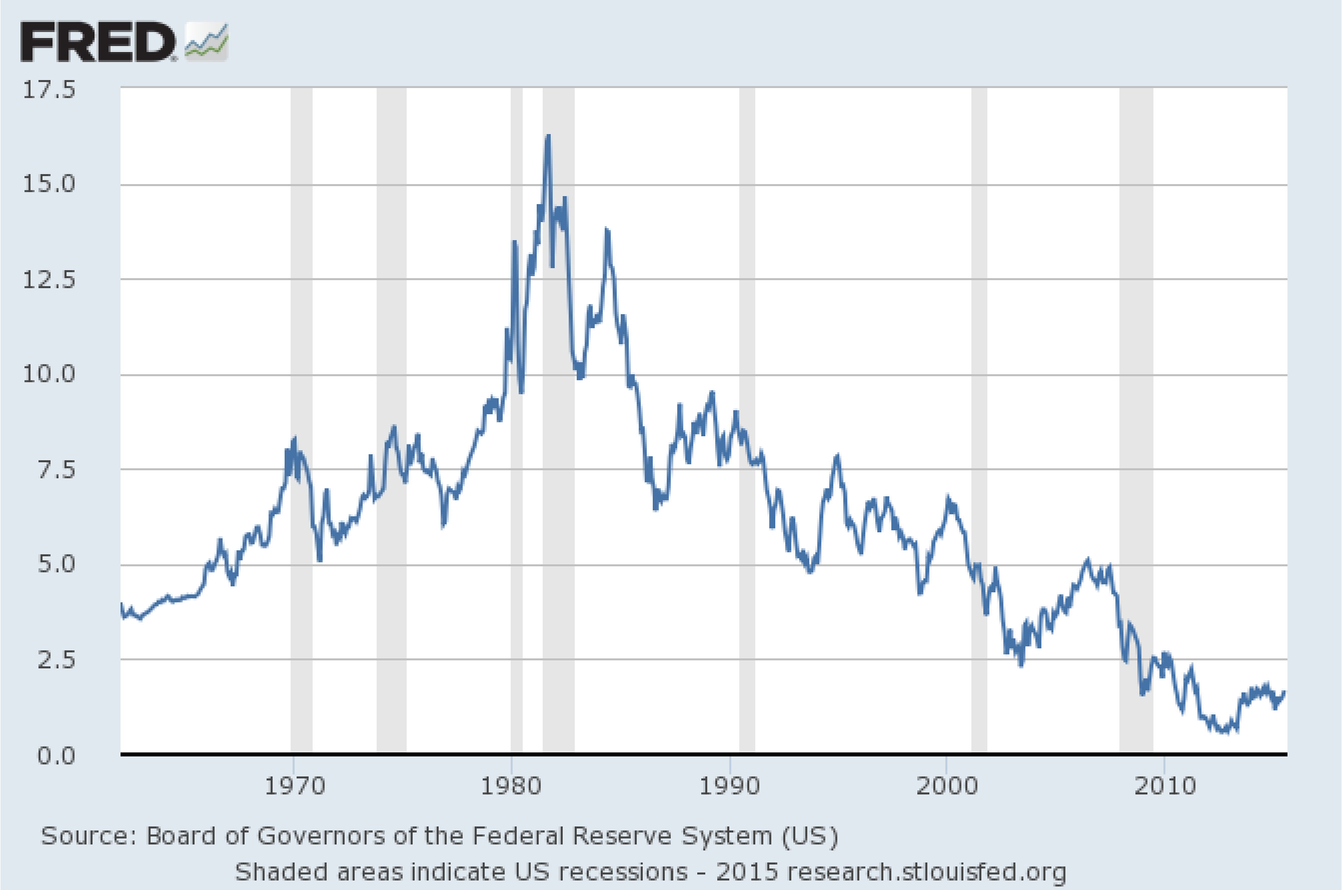
Treasury Rates Lowest In History, On Very High Issuance

5 Year Treasury Constant Maturity Rate



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So What's The Problem?

- Internal market 'plumbing' in some markets
- Some markets show declines in average trade size – more trades to move the same dollar volume.
- No decline in overall secondary market trading – but some decline in the ratio of trades to outstanding.
  - But why should we expect trading volumes to grow with outstanding securities?
- Decline in balance sheet capacity for bank dealers.
- Several anomalous trading days in bond markets.

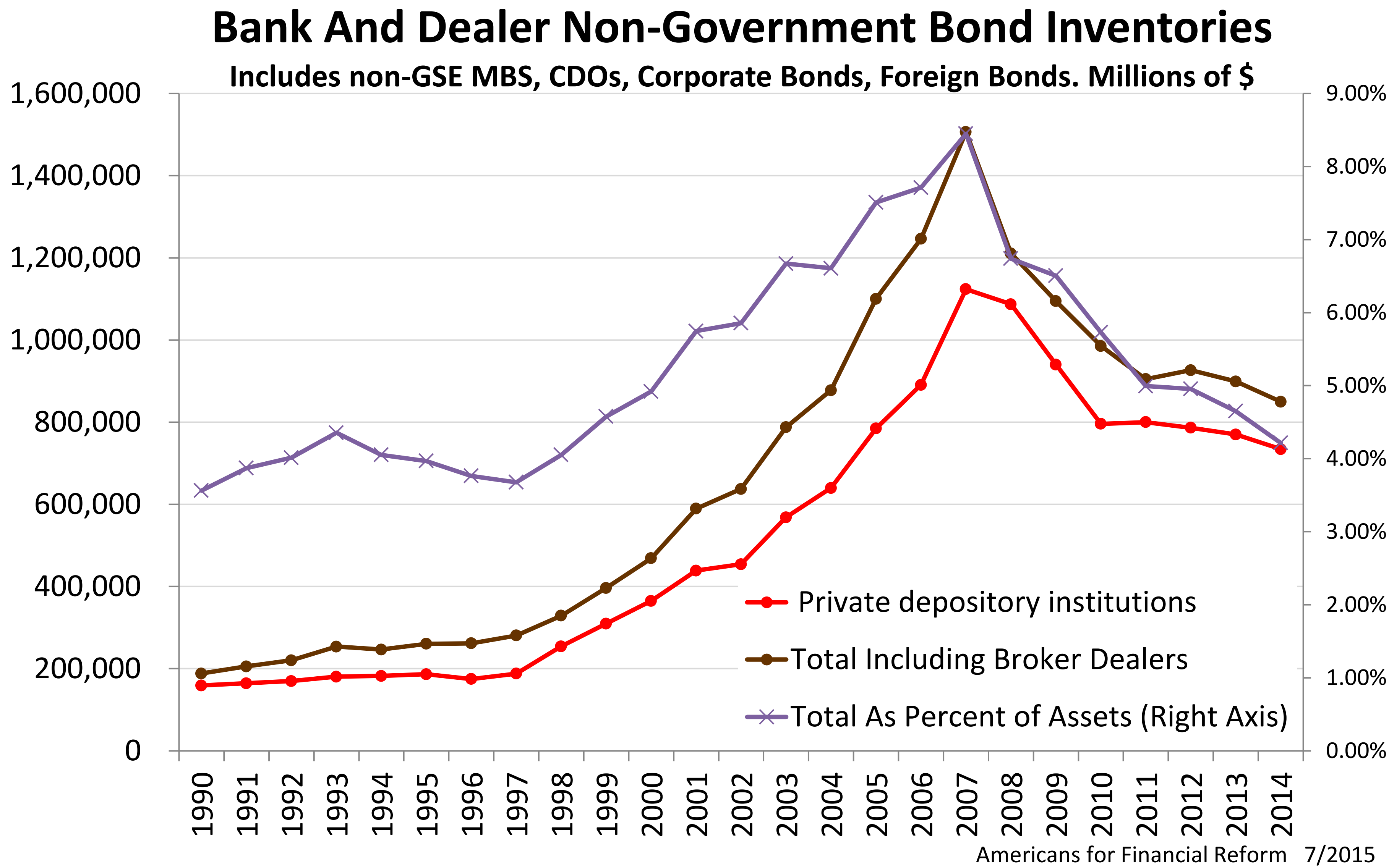
Questions

- Transactional liquidity: Do internal market issues interfere with the flow of credit to the real economy – so far they have not seemed to.

- Systemic liquidity: effects during market stress?
  - Could a lack of 'shock absorption' capacity lead to more rapid price declines during a sell-off?
  - Anomalous trading days -- are these blips driven by electronic trading? How worried should we be given that they did not have a systemic impact?

- What are the implications for regulation?

Regulation: Allow a Return to the 'Good Old Days'?



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Regulation: Or Address Emerging Risks?

- Predatory electronic trading.
- Liquidity management and stress testing by asset managers and funds.
- These are on the regulatory agenda, but we have yet to see results.