



## Bond Market Liquidity

**MS Sales and Trading (Research reports used are clearly referenced)**

**December, 2021**

**[Ben Lewis, EMEA Head of Linear Rates Trading](#)**

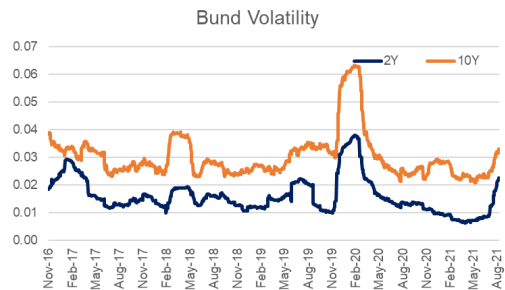
**[Ben.Lewis@morganstanley.com](mailto:Ben.Lewis@morganstanley.com)**

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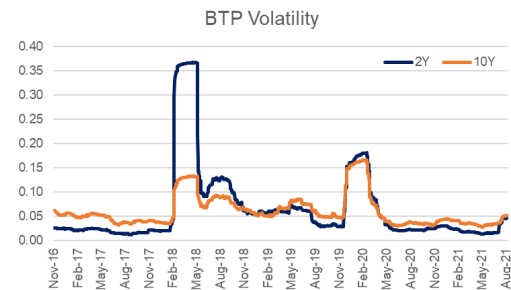
## Context and Causes (1)

- **Global Asset Market Volatility has picked up over recent months although rates and FI have been at the centre of the moves**
- **Within FI space though we've seen a differentiation with periphery vol being surprisingly muted vs. core and front end volatility elevated vs. rest of the curve.**

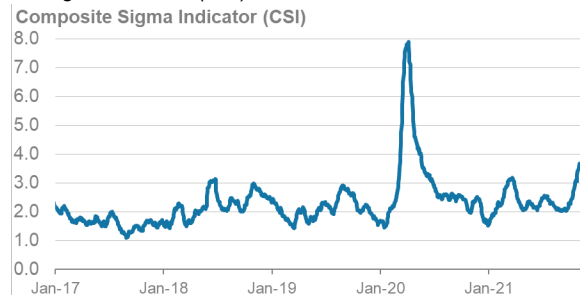
Recently saw an increase in bund volatility ...



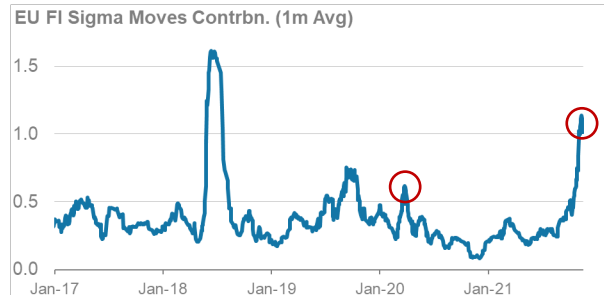
... and BTP volatility



Composite Sigma Indicator (CSI) across ~250 assets increased recently ...



European FI CSI saw a notable uptick



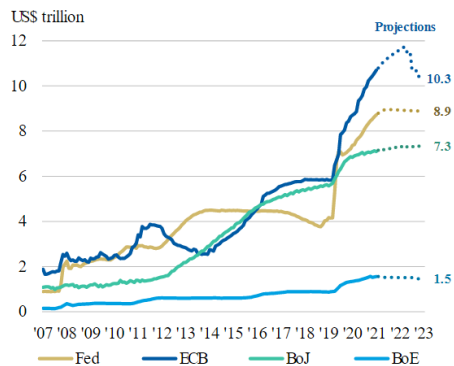
Source: BBG, [A Duck of A Market](#) (MS Research); Volatility calculated as standard deviation of 60d yield daily change

## Context and Causes (2)

1. Coordinated CB Liquidity Slowdown
2. Central Bank Communication on Front End Rates
3. Positioning and Leverage

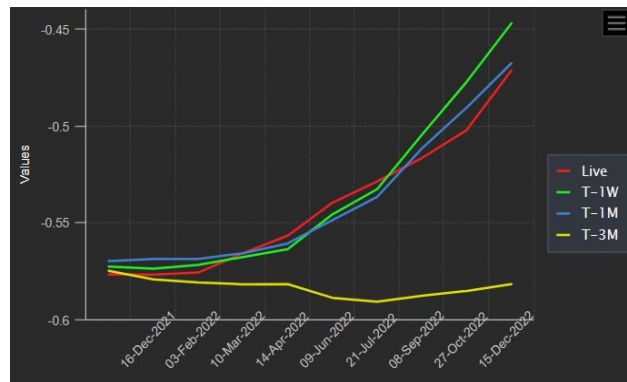
### 1. Coordinated CB Liquidity Slowdown:

G4 central bank balance sheet sizes & MS forecasts



### 2. CB Communication:

Euribor market pricing evolution over the past 3 months



### 3. Positioning:

The desk estimate an average gross leverage of ~4.2x for CTAs in fixed income\*

#### Estimated Interest Rate Leverage in Trend Following CTAs



Note: Across global bond futures contracts, adjusted to TY-equivalents  
Source: Morgan Stanley QDS and Futures desks

Source: BBG, [The Journey Toward Tighter Financial Conditions](#) (MS Research), MS Rates Sales & Trading; \*Latest CTA data: early November 2021

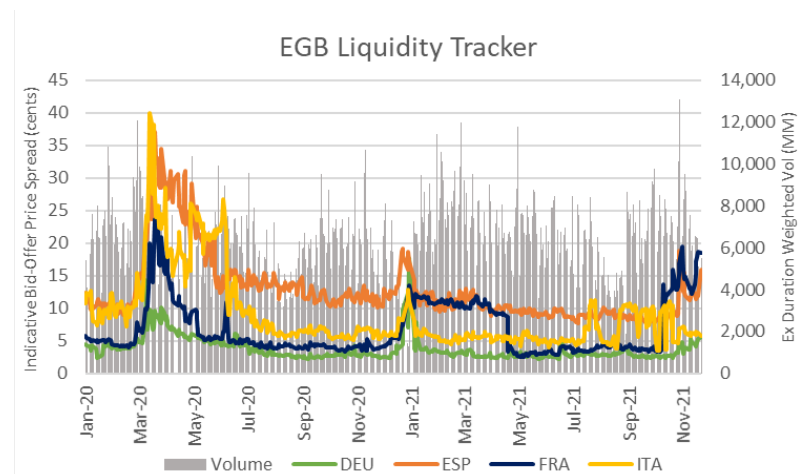
## What Did Volatility Mean for Market Liquidity?

- Did high volatility lead to poor liquidity or vice versa?
- Volumes picked up as bid-offer spreads widened especially in France and Spain
- Europe has struggled more than the US to recover liquidity

Futures average available size remained lower vs YTD average ...

Futures	Avg. Available Size as of 19 Nov	Lowest Avg. Available Size Over Past 30 Trading Days (since 07/10)	Date of Lowest Available Size (2021)	19 Nov Available Size vs YTD Avg.
Euro-Schatz (DU)	3,813	2,533	05-Nov	-75%
Euro-Bobl (OE)	911	767	12-Nov	-70%
Euro-Bund (RX)	436	235	28-Oct	-26%
Euro-Buxl (UB)	55	47	11-Nov	-18%
2-Year UST (TU)	4,107	2,410	05-Nov	-96%
5-Year UST (FV)	1,539	1,111	28-Oct	-34%
10-Year UST (TY)	3,284	2,409	03-Nov	-14%
Ultra 10-Year UST (UXY)	469	306	28-Oct	22%
30-Year UST (US)	603	400	03-Nov	19%
Ultra UST (WN)	104	72	03-Nov	5%

... and there are wider bid-offers across the EGB complex

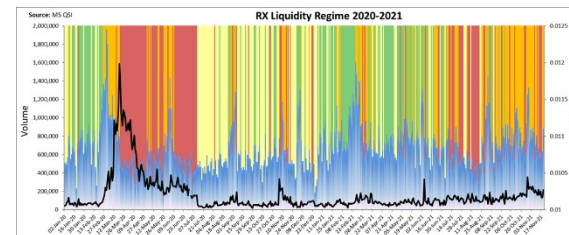
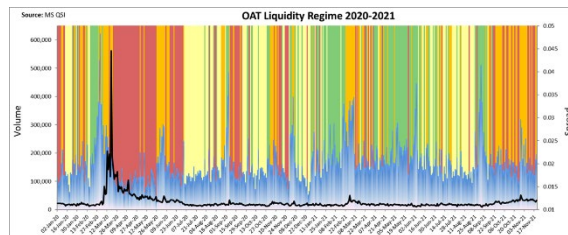
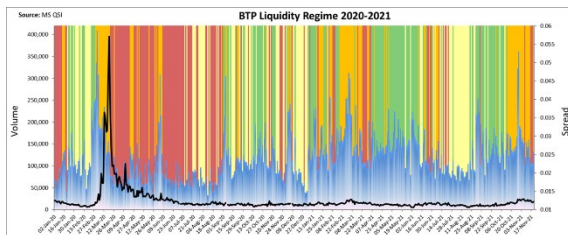


Source: BBG, MS Fixed Income Sales & Trading, Tradeweb; \*Data as of 22 Nov 2021; 5 years of history not available

## What Did Volatility Mean for Market Liquidity?

The charts show the total daily volume and daily time-weighted average top-of-book spread for each active futures contract. The background colour is the liquidity regime, which shows if volume/cost was above (high) or below (low) the median value over this time range as follows:

- **Green:** High volumes, low costs (good liquidity)
- **Orange:** High volumes, high costs (can indicate elevated volatility)
- **Yellow:** Low volumes, low costs (fairly liquidity but quiet)
- **Red:** Low volumes, high costs (poor liquidity)

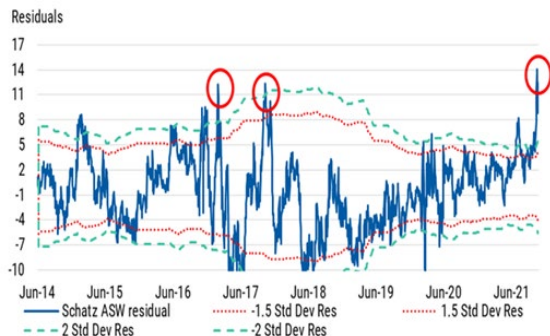


Source: MS QSI, Tradeweb; 5 years of history not available

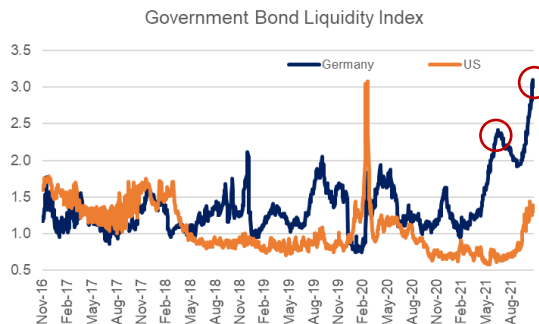
# Market Dislocations

- Repo and Funding Market Stress Contributing to the Narrative
- RV is becoming increasingly challenged into YE
- Primary markets are requiring larger concessions within the Corporate Credit Space

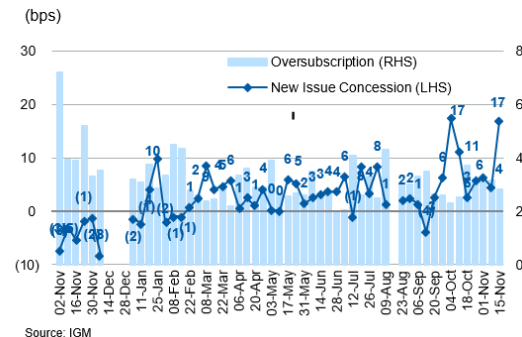
Schatz ASW residuals are now above +2 STD ...



... with liquidity index in Germany being more dislocated vs March 2020



Volatility causes elevated EU IG credit NIP

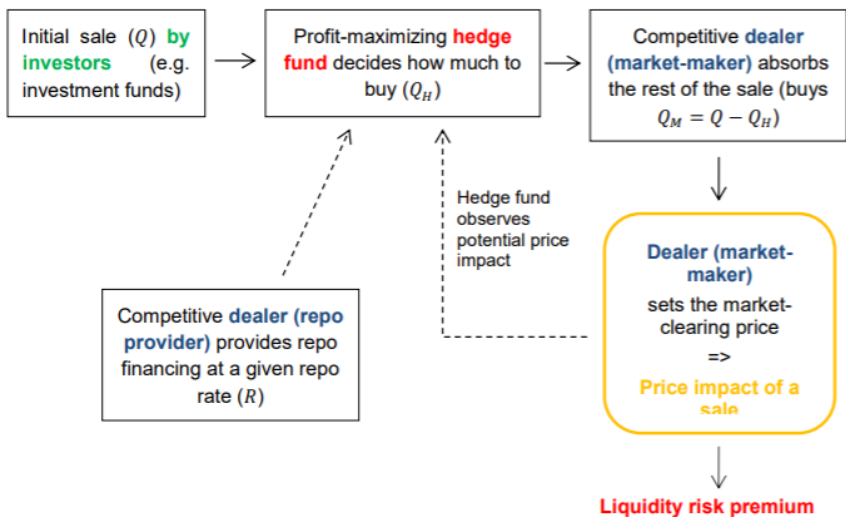


Source: BBG, MS Fixed Income Sales & Trading, IGM, [Back in the High Life Again](#) (MS Research); \*5 years of history not available

# Points for Discussion

**Bond market liquidity: analysis of recent deterioration, role of leveraged investors, dealer intermediation capacity, interaction between volatility and liquidity**

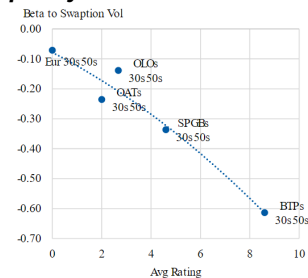
## 1. Are there structural changes to the market over the past few years?



## 2. What does this mean for auctions and issuance in 2022 and beyond?

Country	2022					2021				
	(A)	(B)	(A-B)	(C)	A-B-C	(A)	(B)	(A-B)	(C)	A-B-C
	GI	R	NI	QE	Issuance Net of R, QE	GI	R	NI	QE	Issuance Net of R, QE
Germany	243	168	75	78	-3	242	152	90	173	-83
France	280	146	134	80	54	285	123	162	160	3
Italy	310	229	81	67	14	315	210	105	149	-44
Spain	128	63	65	52	13	163	93	70	105	-35
Netherlands	50	31	19	26	-6	55	16	39	49	-11
Austria	35	26	9	13	-4	39	16	23	26	-3
Finland	14	10	4	7	-4	16	6	10	17	-7
Belgium	49	28	21	15	6	39	15	23	31	-8
Ireland	27	12	15	7	8	20	0	20	16	4
Portugal	18	12	6	10	-5	15	11	4	22	-18
Total	1154	724	430	355	74	1189	643	546	749	-203

## 3. Does withdrawal of Central Bank stimulus mean permanently higher volatility and lower liquidity?



Beta of 30s50s to 2y30y Swaption vol vs Avg. Credit rating

Source: [BoE Staff Working Paper, The Journey Toward Tighter Financial Conditions](#) (MS Research)

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