Bond market liquidity

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Liquidity microstructure: Syndication is still important

- Market access in some cases depends on syndication or private placements rather than the usual auction process
- Note that auction supply that is tailored to domestic bank demand is not very different from a syndication process
- Overall, there is no cause for excessive optimism regarding the degree of market access for weaker issuers

Total quarterly supply from Spain, Italy, Portugal, Ireland by type (EUR bn)



Liquidity microstructure: Peripherals have shrunk supply duration

• As international market access for some peripheral countries declined, newly issued debt became more tailored to the needs of the domestic banking systems

• New issuance duration in Spain fell from around 9.5 years to 4.5 years, Italy from 7.5 years to 5 years before recovering in 2013

- The asymmetry of this development is obvious when compared to France and Germany
- Liquidity as such is not the issue, but liquidity across the curve is no longer a given

Average years to maturity for newly issued coupon debt



Liquidity microstructure: Listed derivatives grow and change

- New clearing and capital regulations mean more option strategies are being expressed in listed derivatives
- Listed options are gaining in importance relative to swaptions
- Over the last year, Bobl and Schatz options have gained in importance relative to Bund options
- If the trend in Schatz options was purely related to ECB rates outlook, Bobl options would not be benefiting to the same degree
- Instead, the shift also reflects changes in the cash market

Total option open interest over futures open interest on Eurex



Secondary Electronic Client Traded Volume

- In EGBs, the electronic market has recorded execution of
- -€2.9Trn in 2010
- -€3.3Trn in 2011
- -€3.5Trn in 2012
- –€1.9Trn YTD (May end)
- Margins in 2013 have contracted considerably.
 - The average margin from TradeWeb mid on trades (executed by MS) in EGB's in 2013 (ytd) is approx 50% smaller than in 2012.
 - E.g. BTP -51%, DBR -36%, FRTR -59%, SPGB -60%
 - This points to more aggressive competition and, perhaps, better secondary trading conditions for clients this year versus last.

January 2010 – May 2013



Source: Tradeweb, Bloomberg, BondVision

$OTC \rightarrow Listed Futures$

• Futures and block trading will become increasingly important as a liquidity source on the back of new regulations. Cost (fees & margin) coupled with additional market risk (as a result of business conduct rules) is likely to push the market in this direction

• This dynamic is already visible in the US where there have been substantial increases in OI on CME since mandatory clearing began



- Will Syndication become more important?
- Challenging refinancing hump ahead for peripherals?
- Any message in heavy frontend options growth? Hedging, speculation or both?
- Secondary market volume growth and margin collapse suggests a healthy market?
- Will 'Futurisation' be as profound in Europe as regulations are making it in the US?

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