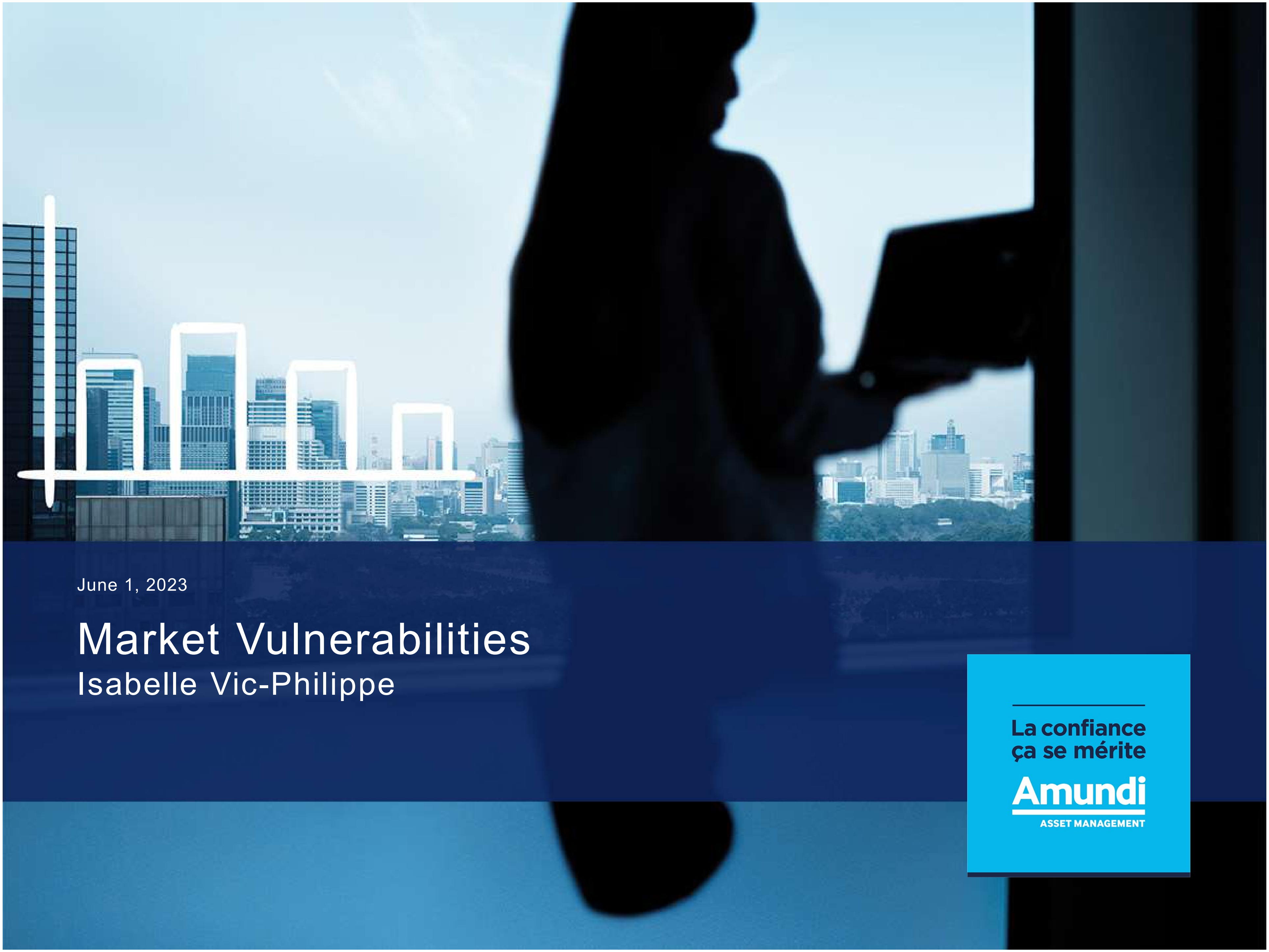

June 1, 2023

Market Vulnerabilities

Isabelle Vic-Philippe

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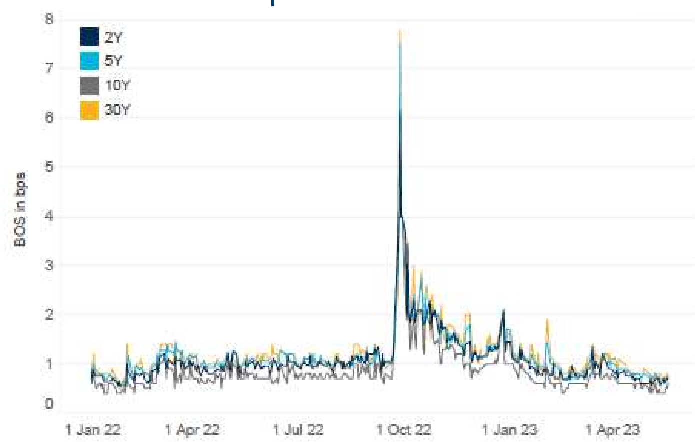
Markets vulnerabilities & Central banks tools

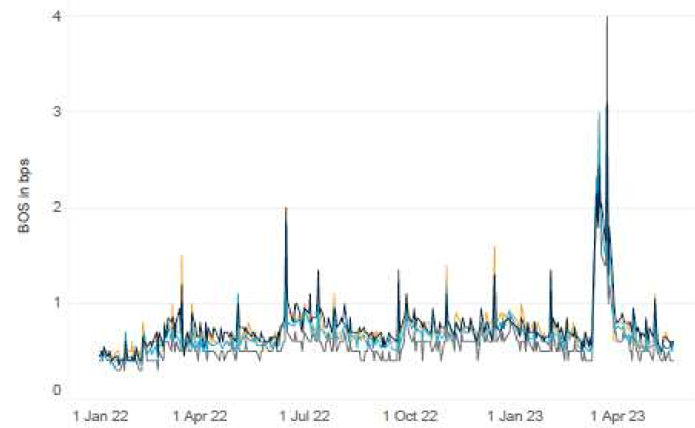
Sudden increase in yields triggered unforeseen events

Recent market stress in a context of still high volatility: Gilt market crisis and US regional banks failures

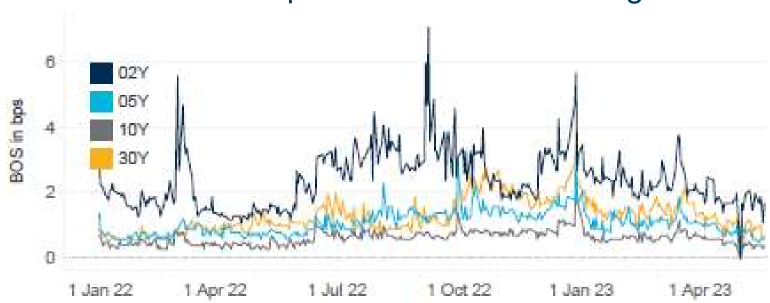
Bid Offer spreads IRS GBP SONIA



Bid Offer spreads IRS USD SOFR



Bid Offer spreads German Sovereign



Source : Tradeweb

Market volatility

Source : Amundi; Bloomberg

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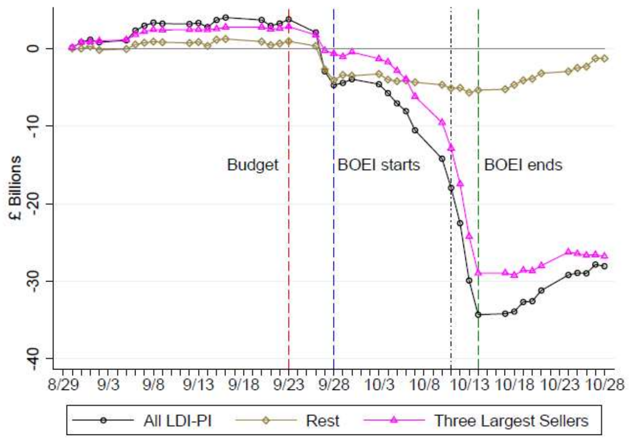
Markets vulnerabilities & Central banks tools

Weaknesses identified from the 2022 Gilt market crisis

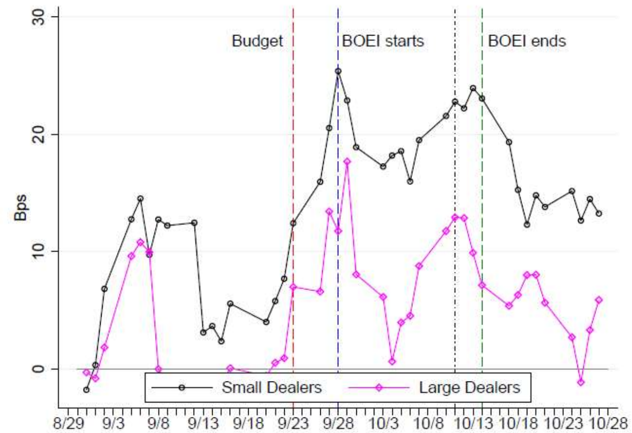
- Concentration risk
  - Same tools implies same investment ➔ similar leverage (swap / bonds + repo) ➔ Margin call requirements ➔ forced selling having a significant impact on Gilt prices ➔ soaring transactions costs = illiquidity spillover whatever the maturity or size of the trade

- Liquidity risk
  - related to intermediation capacities; balance sheet & regulatory constraints (leverage ratio in particular)
  - Limited liquidity provision by real money & hedge funds

Gilt market volumes



Transaction costs



Source : "An anatomy of 2022 gilt market crisis" Gabor Pinter - BOE Staff working Paper March 2023

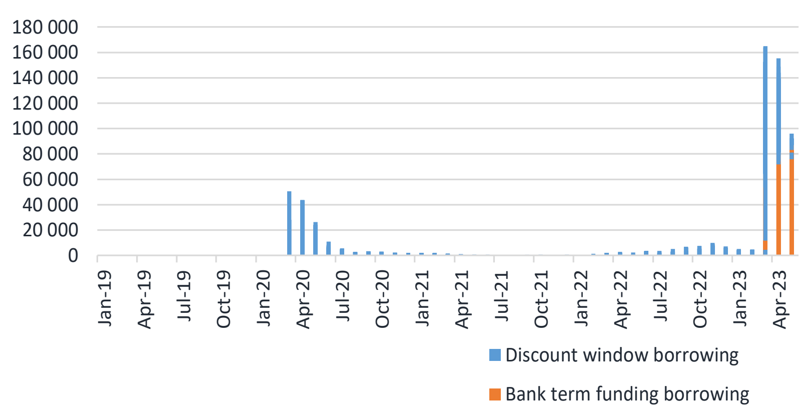
➔ BOE reopening Gilt purchases (while already being engaged in reducing its balance sheet via QT)

Markets vulnerabilities & Central banks tools

Banking sector : market feared whether it was idiosyncratic

- Confidence : “first mover advantage” may trigger bank runs
  - Above deposit guarantee scheme, customers have switched to safer & attractive alternative
  - Digitalization as an accelerator
  - Efficiency of liquidity ratios ?
- Bank refinancing / Liquidity and capital level are framing Banks balance sheet capacity
  - Liquidity access (crisis mode)
  - Liquidity cost : reduction of CB liquidity / active primary market

FED emergency lending rises



Source: Amundi Institute, Bloomberg

Spreads versus Germany

Source : Amundi; Reuters

➔ FDIC : explicit deposit guarantee on the stressed banks & implicitly for other banks
FED : BTFP = one year loan facility for Banks collateral at face value

Central banks tools

Central Banks tools used during these market stress episodes

- Bank liquidity : FED BTPF 1 year lending facility ~ LTRO, TLTRO
- Targeted Bond purchases ~ QE infrastructure
- Collateral at face value for the Fed BTFP facility

Coordination between Governments / Central Banks / Regulators enforcing credibility and promptness

Questions to be discussed

- What was the market impact ?
- Were the tools used by central banks efficient/effective ?
- Did they stop the adverse market dynamics ?
- Were they effectively communicated
- Which regulatory signals can help ?

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Date of first use: 26 May 2023.

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