FSB FINANCIAL STABILITY BOARD

Press release

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FSB analyses liquidity in core government bond markets

The Financial Stability Board (FSB) published today a report on liquidity in core government bond markets.[1] The report forms part of the FSB's work programme to enhance the resilience of non-bank financial intermediation (NBFI).

Changes in core government bond markets over the past decade may have made them more prone to liquidity imbalances in times of stress. The severe dislocations experienced in those markets during the March 2020 turmoil were the outcome of large spikes in the demand for liquidity by various market participants, especially non-banks. Unlike the typical case of being a 'safe haven' in periods of stress, government bond markets experienced a 'dash for cash' as investors scrambled to sell highly liquid assets to fulfil their cash needs. This included sales of bonds to meet redemptions and/or margin calls, as well as to unwind leveraged positions.

Bank dealers increased their trading activities to some extent, but this was not enough to counterbalance selling pressures. Other liquidity providers did not appear to sufficiently increase their intermediation activities, while the behaviour of other market participants varied across FSB member jurisdictions. Central bank interventions were effective in alleviating market strains, but they are not without cost and should not substitute for the obligation of market participants to manage their own risks appropriately.

The report outlines policies to consider for enhancing the resilience of core government bond markets, including measures to:

- mitigate unexpected and significant spikes in liquidity demand by non-bank investors. This involves assessing and mitigating factors that give rise to such spikes, e.g. liquidity mismatches, margining practices or the build-up of leverage.

- enhance the resilience of liquidity supply in stress. This involves exploring potential ways to increase the availability and use of central clearing for government bond cash and especially repo transactions, as well as the use of all-to-all trading platforms.

- enhance market oversight, risk monitoring and the preparedness of authorities and market participants. This involves increasing the level of transparency in government bond markets and closing some of the substantial data gaps identified in the report.

[1] Core government bond markets are defined as markets for government-issued securities denominated in major foreign exchange reserve currencies (i.e. US dollars, Euros, Japanese Yen and Pounds Sterling) and held by investors in multiple jurisdictions. Relevant markets include cash, repurchase agreements (repo), and futures.

Notes to editors

The report published today follows up on the Holistic review of the March 2020 market turmoil, published in November 2020, which laid out a comprehensive and ambitious work programme to enhance the resilience of the NBFI sector. This work is being carried out within the FSB as well as by its member standard-setting bodies and international organisations, to ensure that relevant experiences and perspectives are brought to bear.

The FSB published a progress report on its NBFI work programme in November 2021. The report highlighted that the FSB would conduct work to examine the structure and drivers of liquidity in core bond markets during stress. IOSCO published a discussion paper in April 2022 on drivers of liquidity in corporate bond markets during the COVID-19 stresses. The FSB will deliver its next progress report to the G20 Summit in November 2022, which will include the main findings across NBFI initiatives and policy proposals to address systemic risk in NBFI.

The FSB coordinates at the international level the work of national financial authorities and international standard-setting bodies and develops and promotes the implementation of effective regulatory, supervisory, and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB also conducts outreach with approximately 70 other jurisdictions through its six Regional Consultative Groups.

The FSB is chaired by Klaas Knot, President of De Nederlandsche Bank. The FSB Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, www.fsb.org.