Press Release

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PwC Report Reviews State of Global Financial Market Liquidity

WASHINGTON, 12 August 2015 – The Global Financial Markets Association (GFMA) and the Institute for International Finance (IIF) today released a comprehensive new report from PwC on the state of global market liquidity, produced on behalf of both Associations.

"The findings from our research suggest early warning signals that regulation and other market factors are contributing to a reduction in certain aspects of secondary market liquidity that is likely to be exacerbated by the unwinding of quantitative easing or another stressed market situation," said the report's author, Nick Forrest, Director in PwC UK's Economics and Policy Practice. "Our analysis suggests it is important for policymakers to consider the aggregate impact of current regulation and weigh the incremental financial stability benefits of new rules against the incremental costs of diminishing market liquidity to ensure regulation is not counterproductive."

The Associations commissioned PwC to undertake a broad review of market liquidity data given the importance of liquidity to an efficient financial system and increasing concerns from market participants and policymakers regarding the impact of financial regulation on liquidity. PwC's analysis focuses on available data regarding the tightness, immediacy, breadth and depth of liquidity and concludes that there are grounds for policymakers to review the calibration of reforms to date and the ongoing regulatory agenda, in order to properly understand the effects of regulatory initiatives by asset class, and to consider whether upcoming regulatory initiatives could likely exacerbate the trends in liquidity with no incremental benefits to safety and soundness.

"Robust market liquidity is essential to efficient capital markets that can drive capital formation, investor opportunity and economic growth. PwC's findings indicate the need for policymakers to engage in further analysis of the cumulative impact of the rules implemented before moving forward with any new rules that could impede the markets from fulfilling this role," said GFMA CEO Kenneth E. Bentsen, Jr. "A tremendous amount of regulation has already been implemented over the past five years in response to the financial crisis. While the intent to improve financial stability is entirely appropriate, regulators must also consider the impact to market liquidity."

"PwC's report takes an important snapshot of recent market conditions and identifies key factors that are contributing to reduced liquidity in some financial markets," said Tim Adams, President and CEO of the IIF. "This is the beginning of an intensive effort to better understand and evaluate this complex and rapidly evolving issue and to periodically present our findings to policymakers worldwide. As the study illustrates, the cumulative impact of all recent financial reforms is not yet known. Regulators should take this opportunity to assess the total impact of recent reforms on market liquidity and consider it carefully before moving forward on any new rules."

PwC's analysis finds that notwithstanding the benign market environment encouraged by monetary stimulus, a combination of several factors, including banks reducing risk following the introduction of new regulatory frameworks, have contributed to a measurable reduction in financial market liquidity across various asset classes. For instance, according to the report, European corporate bond trading volumes have declined by up to 45% between 2010 and 2015. Evidence suggests that block trades are becoming more difficult to execute without affecting prices. Banks' holdings of trading assets have decreased by more than

40% between 2008 and 2015, and dealer inventories of corporate bonds in the US have declined by almost 60% over the same period, finds PwC's report. This has accompanied a decline in turnover ratios in corporate bond markets, where trading volumes have failed to keep pace with the increase in issuance.

The analysis indicates an early warning that this withdrawal of dealer liquidity to date has not caused measurable economic damage due to quantitative easing programs and extraordinary monetary policy that are reducing liquidity pressures, and because market participants are adapting by trading some instruments less frequently and in smaller sizes. However, following the unwinding of QE or in a stressed environment, liquidity risks and market fragilities are likely to be revealed, potentially resulting in higher volatility in financial markets.

PwC's report highlights the important role and underlying economics of market-making, and the roles played by different market participants which contribute to resilient market functioning, including the vital role of dealer market makers as a source of liquidity.

The report concludes that it would be helpful for all stakeholders to better understand liquidity conditions and the link between regulation and market liquidity so that future regulations strike the right balance between promoting stability and maintaining financial markets liquidity. Further, it is important to review the global regulatory landscape to ensure coherence and to avoid detrimental financial markets liquidity effects or fragmentation that could disrupt the financial system.

The full report, including an executive summary, is available here.

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Contact

Krishna Rao, PwC	+44 207 804 3765, krishna.chilmakurthi.rao@uk.pwc.com
Katrina Cavalli, GFMA	+1 (212) 313-1181, kcavalli@gfma.org
Rebecca Hansford, AFME	+44 (0)20 743 9367, rebeccca.hansford@afme.eu
Vijay Chander, ASIFMA	+852 2531 6521, vchander@asifma.org
Andrew DeSouza, IIF	+1 (202) 857-3602, adesouza@iif.com

Notes:

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2. The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit www.gfma.org.
3. The Institute of International Finance is the global association of the financial industry, with close to 500 members from 70 countries. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. Within its membership IIF counts commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks. For more information visit www.iif.com.