

OTC Frictions In Stressed Markets: Evidence From The UK Sovereign Bond Market

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Abstract

We examine the impact of over-the-counter (OTC) market frictions on liquidity within the UK gilt market, utilising a comprehensive MiFID II dataset spanning from September 2019 to November 2020. This period encompasses the critical phase of the COVID-19 pandemic, offering a unique context to analyse the dynamics of inventory, search, and bargaining frictions that are characteristic of OTC markets. The findings reveal a substantial relationship between the exacerbation of these prevalent OTC frictions and the observable decrease in market liquidity during the heightened stress of the COVID-19 crisis. The study provides a deeper understanding of the resilience of financial markets under stress and offers insights for both policymakers and market participants on market functioning and stability.

Keywords: Government bonds; OTC markets; Liquidity; Transparency.