

Exchange traded funds are a threat to market liquidity

Published: January 13, 2026, 9:25 am

In 2017 [I wrote a blog](#) on an obscure subject: Japanese Exchange Traded funds. I said at the time:

ETFs are quoted funds that are in effect tracker funds of other quoted investments. So what's the issue? There are two.

The first is the folly of the Bank of Japan: QE may have a role buying government bonds (although even that can be questioned unless the funds are used to create new asset investment) but it definitely has none in my view in buying corporate bonds, let alone shares. This is just market game playing and I cannot see any role for a central bank in doing that. The BoJ position is artificial and distortionary as a result and I can see no benefit from that.

The second is broader, and is a liquidity issue. If there is a run on these funds in the event of a stock market downturn I can see them adding to liquidity pressure as they effectively leverage the underlying assets by double quoting them. This could ratchet a downturn in market sentiment and add to instability, effectively reflecting the burst of a double bubble. Anything that can do that is dangerous. The fact that ETFs have had a good track record simply says they have reflected the market recovery (as opposed to the real market recovery) from 2008. Nothing suggests that they add real value, and I strongly suspect that in a period of instability they would do the exact opposite.

I was roundly criticised by many on the right for supposedly not understanding these funds. It was claimed they could never create illiquid situations or cause market disruption.

Move on to this morning's FT, and [they report](#):

The Bank of Japan has launched an unusual lending facility for exchange traded funds as it tries to mitigate the market impact of its ultra-aggressive monetary policy.

Under the new facility, brokers will be able to borrow some of the central bank's ¥28tn (\$256bn) holdings in equity ETFs for up to a year, at interest rates to be determined by

auction.

The new facility, first announced in April, is intended to boost liquidity in a Japanese ETF sector dominated by the central bank, which owns two-thirds of the total outstanding stock and has come under fire for allegedly distorting the market.

So, they admit the policy was a mistake.

And they admit that there is a real problem with liquidity.

I rest my case.

Those who devote themselves to dogma cannot see real issues arising. Thankfully, some of us can.