

Predicting Dynamic Market Liquidity via Temporal Graph Neural Networks Integrating Limit Order Book Evolution and Cross Asset Spillover Effects

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Abstract

The modern financial ecosystem is characterized by an intricate web of interdependencies where liquidity is no longer a localized phenomenon but a dynamic state influenced by high-frequency order book evolution and cross-asset spillover effects. Traditional econometric models often fail to capture the non-linear, spatial-temporal relationships inherent in these multi-layered systems. This paper proposes a comprehensive framework for predicting dynamic market liquidity through the deployment of Temporal Graph Neural Networks. By conceptualizing the financial market as a dynamic graph—where nodes represent individual assets and edges represent the strength of information and liquidity transmission—we integrate the granular microstructural data of the Limit Order Book with broader systemic spillover indicators. Our analysis focuses on the system-level architectural trade-offs required to balance predictive accuracy with computational latency in a high-frequency environment. We further explore the socio-technical implications of such systems, including infrastructure robustness, algorithmic governance, and the ethical considerations of liquidity provision in automated markets. Through deep explanatory analysis of deployment challenges and sustainability, the research highlights how temporal graph architectures mitigate the risks of systemic contagion while enhancing market efficiency. The study concludes that the future of liquidity management lies in the transition from asset-specific modeling to global, graph-based infrastructures that account for the reflexivity and interconnectedness of modern global finance.

Keywords:

Market Liquidity, Temporal Graph Neural Networks, Limit Order Book, Cross-Asset Spillover, Financial Infrastructure, Algorithmic Governance, Socio-Technical Systems.

1. Introduction

The architecture of global financial markets has undergone a fundamental transformation from human-centric exchange floors to highly automated, decentralized electronic infrastructures. In this new paradigm, market liquidity—the ease with which assets can be exchanged without causing significant price impact—has become the central nervous system of the global economy. However, the nature of liquidity is increasingly ephemeral, prone to sudden evaporation during periods of systemic stress or high-frequency volatility. Traditional modeling approaches, which typically treat assets as isolated entities or rely on static correlation matrices, are progressively inadequate for capturing the reality of "flash crashes" and rapid contagion across divergent asset classes. The challenge for contemporary researchers is to design systems that can interpret the granular evolution of the limit order book while simultaneously recognizing the macro-scale spillover effects that characterize an interconnected global market.

At the heart of this research is the recognition that financial markets are best understood as complex, adaptive socio-technical systems. The interaction between various market participants, ranging from high-frequency market makers to institutional long-term investors, creates a rich data stream within the limit order book. This book is not merely a list of bids and asks but a dynamic record of market intent and perceived risk. When integrated with temporal graph neural networks, this data can be transformed into a predictive signal that accounts for both the temporal depth of order flow and the spatial relationships between assets. Such a system-level approach allows for a more robust understanding of how a liquidity shock in a single sector, such as technology equities, might propagate through the graph to affect distant nodes, such as sovereign debt or commodity futures.

This paper provides an in-depth exploration of the engineering and policy implications of deploying graph-based predictive architectures in financial environments. We emphasize the structural trade-offs between model complexity and the nanosecond requirements of market execution. Furthermore, we address the critical issues of governance and fairness, arguing that as liquidity prediction becomes more centralized in advanced AI systems, the risk of "algorithmic herding" and systemic fragility increases. By focusing on the infrastructure and deployment aspects of these models, we aim to provide a roadmap for the sustainable development of financial AI that enhances rather than undermines the stability of the global socio-technical infrastructure.

2. Theoretical Foundations and Microstructural Dynamics

The theoretical underpinnings of market liquidity have evolved significantly since the early days of the efficient market hypothesis. Modern microstructure theory posits that liquidity is a function of information asymmetry, inventory risk, and order processing costs. Within the limit order book, these factors manifest as the bid-ask spread, the depth of the book at various price levels, and the resilience of the book following large trades. However, the evolution of the book is non-stationary and highly sensitive to the temporal context of preceding events. A sudden influx of cancellations or a shift in the ratio of aggressive market orders to passive limit orders can signal a looming liquidity crisis before price movements occur. This necessitates a modeling approach that can handle the high-dimensional, tick-by-tick nature of

order flow evolution while maintaining long-term historical context.

Parallel to these microstructural developments is the increasing prevalence of cross-asset spillover effects. In a globalized market, liquidity is fungible across borders and asset classes through the mechanisms of collateral management, risk-parity strategies, and cross-market arbitrage. A liquidity squeeze in one asset can force market participants to liquidate positions in unrelated but more liquid assets to meet margin calls, creating a "contagion of the liquid." Previous research has attempted to model these relationships through vector autoregressive models or copula-based methods, but these often struggle with the "curse of dimensionality" and the non-linear nature of modern financial shifts [10]. Temporal graph neural networks offer a superior alternative by providing a flexible framework that can learn the evolving topology of these spillover channels without requiring rigid parametric assumptions.

Integrating these two scales—the granular limit order book and the global spillover network—requires a system architecture that can perform multi-resolution analysis. The temporal component of the network must be capable of capturing the fast-moving dynamics of the book, while the spatial component accounts for the slower, more structural relationships between assets. This intersection is where dynamic market liquidity is truly formed. By utilizing graph-based representations, the system can identify "bottleneck" nodes in the financial network that are critical for overall liquidity stability. This theoretical shift moves the focus from individual asset volatility to the systemic robustness of the entire market graph, aligning with contemporary views on macroprudential regulation and systemic risk management [25].

3. Architecture of Temporal Graph Neural Networks in Finance

The engineering of a temporal graph neural network for liquidity prediction involves several critical architectural layers designed to handle the velocity and variety of financial data. The first layer consists of the graph construction module, where assets are represented as nodes and edges are defined by dynamic similarity measures or latent informational linkages. Unlike static graphs used in social network analysis, financial graphs must be re-evaluated at high frequencies to reflect changing market correlations. The edge weights in this system are not fixed but are themselves the output of a learning process that identifies which assets are currently acting as leaders or laggards in the liquidity cycle. This dynamic topology is essential for capturing the shifting nature of cross-asset spillover during periods of market transition.

The second architectural layer is the temporal encoding mechanism, which processes the evolution of the limit order book for each node. Given the massive volume of tick data, the system must utilize efficient attention mechanisms to focus on the most informative parts of the order flow, such as large block trades or significant shifts in the imbalance between buy and sell orders. By treating the history of the order book as a sequence of graph states, the temporal graph neural network can learn to identify temporal motifs—specific patterns of order activity that historically precede liquidity evaporation. This requires a sophisticated integration of recurrent and convolutional layers adapted for graph structures, ensuring that

the spatial features of the market are informed by the temporal depth of the underlying microstructural data [14].

Deployment of such a system requires a robust computational infrastructure capable of distributed processing. The trade-off here is between the complexity of the graph and the latency of the prediction. In a high-frequency trading environment, a model that takes seconds to compute is of little use. Therefore, the system must be optimized for parallel execution, often involving specialized hardware such as GPUs or FPGAs. The architecture must also account for data heterogeneity, as different assets may have different reporting frequencies or levels of book depth. A successful deployment strategy involves a tiered approach, where a simplified version of the graph is used for real-time alerts, while a more complex, high-fidelity model is used for strategic liquidity management and long-term risk assessment.

4. Systemic Robustness and Deployment Challenges

The transition from academic models to production-ready financial systems is fraught with challenges regarding robustness and reliability. A predictive system for market liquidity must be "anti-fragile," meaning it should not only withstand market shocks but ideally improve its predictive capabilities as it encounters new regimes of volatility. In the context of temporal graph neural networks, robustness is often threatened by data sparsity or the presence of "noisy" edges that represent transient, non-meaningful correlations. To mitigate this, the system must include robust edge-filtering techniques and anomaly detection modules that can distinguish between a genuine liquidity spillover and a localized data error. This is a critical requirement for maintaining the integrity of the predictive signal in an environment where data quality can fluctuate.

Sustainability in this context refers to the model's ability to maintain performance over long periods without requiring frequent manual retraining. Financial markets are notoriously prone to "concept drift," where the underlying relationships between variables change over time due to new regulations, changes in participant behavior, or macroeconomic shifts. A sustainable temporal graph architecture must incorporate online learning or adaptive mechanisms that allow the model to update its weights as new data arrives. This ensures that the system remains relevant across different market cycles, from periods of low-volatility "calm" to high-stress "crisis" modes. Furthermore, the sustainability of the infrastructure itself, in terms of energy consumption and hardware longevity, is becoming a key consideration for institutional investors and regulators concerned with the environmental impact of large-scale AI [31].

From a deployment perspective, the integration of these models into existing financial workflows requires careful coordination between engineering, risk management, and compliance teams. The "black box" nature of deep learning models poses a significant hurdle for regulatory approval, as stakeholders must be able to understand why a certain liquidity prediction was made. This necessitates the development of "explainable AI" (XAI) layers for the graph neural network, providing visual and textual justifications for the model's outputs. For instance, the system might highlight a specific path in the graph where a liquidity shock is

expected to travel. This transparency is essential for building trust among human operators who must ultimately act on the system's recommendations, especially during periods of extreme market stress when the stakes are highest.

5. Algorithmic Governance and Socio-Technical Implications

The deployment of advanced AI for liquidity prediction does not occur in a vacuum; it is embedded within a complex socio-technical infrastructure that includes legal frameworks, social norms, and market incentives. Algorithmic governance refers to the set of rules and oversight mechanisms that ensure these systems operate fairly and do not create unintended systemic risks. One of the primary concerns with graph-based liquidity models is the risk of "information monopolies." If only a few large-scale actors have access to superior predictive models, they may be able to withdraw liquidity more quickly than others, exacerbating market crashes and disadvantaging smaller participants. This raises fundamental questions about market fairness and the democratization of financial data and technology.

Moreover, the use of temporal graph neural networks can lead to "algorithmic herding," where multiple independent models converge on the same predictive signal and trigger simultaneous actions. If several large-market participants use similar graph-based architectures to predict a liquidity drought, their collective withdrawal of liquidity could become a self-fulfilling prophecy, creating the very crisis they were attempting to avoid. This reflexivity—where the act of observation and prediction changes the object of study—is a core feature of financial markets. Effective governance must therefore include macroprudential oversight that monitors the diversity of algorithmic strategies and ensures that the systemic graph does not become overly sensitive to a single type of predictive architecture [6].

Ethical considerations also extend to the "fairness" of liquidity provision. In an automated market, the provision of liquidity is often treated as a technical optimization problem rather than a social good. However, during a crisis, the availability of liquidity can determine the survival of firms and the stability of the broader economy. Policy implications include whether certain high-frequency market participants should be mandated to provide liquidity during periods of stress, or if the "circuit breakers" and "speed bumps" of modern exchanges should be informed by the predictive outputs of systemic graph models. A socio-technical approach to finance recognizes that technology should serve to enhance the overall resilience of the market, requiring a balance between private profit-seeking and public stability.

6. Cross-Asset Spillover and Contagion Management

Managing contagion in modern financial systems requires a deep understanding of how liquidity shocks propagate across the cross-asset graph. Temporal graph neural networks are uniquely suited for this task as they can learn the "hidden" channels of transmission that traditional models miss. For example, a shock in the crypto-asset market may appear isolated, but through the graph, the system can identify how it affects the balance sheets of institutional players who also hold positions in traditional equities or credit markets. By predicting these spillover effects in advance, central banks and systemic risk managers can deploy targeted

interventions, such as providing liquidity to specific "hub" nodes in the graph to prevent the collapse of the entire network.

The integration of spillover effects into liquidity prediction also allows for more sophisticated portfolio management and hedging strategies. Instead of hedging against the volatility of a single asset, institutional investors can hedge against the "graph-based risk" of their entire position. This involves identifying which nodes in the network are most vulnerable to contagion and taking offsetting positions in assets that are historically resistant to those specific spillover paths. This shift from asset-specific risk to network-based risk represents a significant advancement in engineering for financial stability. It recognizes that in a highly connected system, the safety of an individual component is dependent on the health of its neighbors [12].

Furthermore, the study of spillover effects through graph neural networks provides valuable insights into the "global" nature of liquidity. Liquidity is not just a domestic issue but is influenced by international capital flows and the actions of global central banks. The temporal graph can be expanded to include international nodes, capturing how changes in US interest rates or volatility in European energy markets affect the liquidity of emerging market currencies. This global perspective is essential for managing the socio-technical risks of the 21st-century economy, where a localized problem can quickly become a global catastrophe. The forward-looking perspective of this research suggests that future financial infrastructures will be defined by their ability to navigate this global, multi-asset landscape with high-precision AI.

7. Strategic Deployment and Policy Recommendations

The successful deployment of temporal graph neural networks for liquidity prediction requires a strategic alignment of technology, policy, and market design. We recommend that financial regulators transition toward "graph-aware" monitoring systems that can visualize and predict systemic liquidity flows in real-time. This would involve the creation of a shared, anonymized data infrastructure where market participants contribute granular order book data to a common pool, which is then used to train and validate large-scale graph models. While this poses challenges regarding data privacy and competitive advantage, the systemic benefits of a more stable and predictable liquidity environment would likely outweigh the costs.

From a policy perspective, there is a need for a "stability-by-design" approach to financial AI. This means that AI systems should be engineered with built-in constraints that prevent them from taking actions that could harm systemic stability, regardless of their individual profitability. For instance, a liquidity-predicting model could be restricted from withdrawing liquidity too rapidly if the graph identifies a high risk of contagion. This would effectively act as a digital "circuit breaker" that operates at the level of the individual algorithm rather than the exchange. Such policies would require a new level of technical expertise within regulatory bodies, shifting the focus from auditing financial statements to auditing the code and architectural logic of autonomous systems [1].

Furthermore, the issue of "algorithmic fairness" must be addressed through the implementation of transparency mandates. Market participants should be required to disclose the general principles and risk-management frameworks of their AI systems to ensure that they do not systematically disadvantage certain groups or regions. This does not necessarily mean disclosing proprietary code, but rather providing a "socio-technical impact assessment" that outlines how the system contributes to market efficiency and robustness. By fostering a culture of transparency and accountability, we can ensure that the advancement of AI in finance leads to a more inclusive and resilient global economy [29].

8. Conclusion

The prediction of dynamic market liquidity via temporal graph neural networks represents a significant leap forward in our ability to manage the complexities of modern financial systems. By integrating the granular evolution of the limit order book with the spatial-temporal dynamics of cross-asset spillover, this research has provided a comprehensive framework for understanding and predicting the state of the market graph. We have demonstrated that the future of financial stability depends on our ability to engineer systems that are not only high-performing but also robust, sustainable, and ethically grounded. The structural trade-offs between latency and complexity are manageable through advanced engineering, provided that they are guided by a policy framework that prioritizes systemic fairness and resilience.

As the global socio-technical infrastructure becomes increasingly automated, the role of graph-based AI will only grow in importance. The ability to "see" the connections between assets and to predict how liquidity will flow through the network is no longer a luxury but a necessity for the functioning of the global economy. This research highlights the need for continued interdisciplinary collaboration between computer scientists, engineers, economists, and policymakers to ensure that the tools of the future are used to build a more stable and equitable world. The journey toward a fully "graph-aware" financial system is just beginning, and the insights gained from this study provide a foundation for the many challenges and opportunities that lie ahead.

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