



EUROPEAN CENTRAL BANK

EUROSYSTEM

DG/MARKET OPERATIONS

17 March 2015

**Bond Market Contact Group
Ad-hoc teleconference**

Frankfurt am Main, Monday, 16 March 2015, 11:00-11:30 CET

SUMMARY OF THE DISCUSSION

1. Public sector purchase programme

The Bond Market Contact Group (BMCG) held an ad-hoc teleconference to share its views on the early days of the Eurosystem's public sector purchase programme (PSPP) and its market impact.

Members generally described the first week of implementation of the PSPP as very smooth, with no discernible impact on market functioning. Bilateral purchases were working smoothly, supported mostly by market-makers' balance sheet inventories amid low levels of activity from end-clients. Given the dependency on dealers' inventories, the situation might change in the coming weeks or months, depending on the involvement of other market participants and the ability of market-makers to rebuild their inventories.

Liquidity remained ample, and the potential for market distortions was lower owing to the confluence of several factors: (1) increase in market-makers' inventories between the announcement of the PSPP and the start of the purchases; (2) comparatively low average ticket size of PSPP purchases, which was generally welcomed; (3) the Eurosystem's bond selection also seemed to be taking into account demand/supply factors, including market-makers' inventories, which limited the extent of short-selling. The latter was seen as particularly relevant for PSPP purchases in agencies and in international and supranational institutions, where the secondary market liquidity was rather low.

Most BMCG members were surprised about the rapid pace of the decline in euro area long-term government bond yields (bull flattening move), which was described as going beyond the sole impact of the PSPP purchases or liquidity conditions in that sector of the curve. Rather, some members attributed the move in part to speculation about reports on the potential implications that a further decline in short-term yields could have for the PSPP-eligible universe in some jurisdictions. The rapid pace of decline in long-term yields was also observed in the EUR/USD cross-currency basis swap, which was evidence of an increasing appetite on the part of investors to diversify their holdings outside of the euro area (e.g. the ten-year cross-currency basis swap had moved to -38 on 11 March from -10 in early January 2015).

Some members reported that, in their view, the average maturity of the PSPP purchases was comparatively longer than that of the universe and mentioned that this could lead to some difficulties for market-makers to source bonds. The ECB recalled that the average maturity of the PSPP-eligible universe is higher than that of all the outstanding securities of the relevant issuers, because of the minimum two-year residual maturity restriction under the PSPP. This notwithstanding, the ECB confirmed the presumption that the Eurosystem aims at market neutrality and mentioned that the average maturity of the PSPP purchases was broadly in line with that of the eligible universe.

2. Repo market activity and PSPP impact

The BMCG reported that, for now, repo activity of the eligible PSPP segments remained orderly, although there were some emerging signs of specialness in the long-end of the German curve. BMCG members recommended a prompt start of repo operations within the PSPP, which was seen as relevant

for maintaining the smooth functioning of the euro area government bond market going forward. More detailed communication on the start of the securities lending going beyond that included in the document “Implementation aspects of the PSPP”¹ would contribute to easing market participants’ concerns about potential collateral scarcity and implications for market functioning. The ECB confirmed that preparations were ongoing and that it would provide further details on this aspect in the near future.

¹ See link to report: <http://www.ecb.europa.eu/mopo/liq/html/pspp.en.html>