



Teleconference of the ECB's Bond Market Contact Group – 4 March 2020

Summary of the discussion

1) Bond market outlook

Maria Cannata (MTS) reviewed the most recent bond market developments and provided an outlook for the risks ahead, with a focus on the increase in market volatility related to the international outbreak of the coronavirus disease (COVID-19).

Despite the increase in market volatility in recent weeks, overall bond market functioning was not severely disrupted. From a primary market perspective issuers reported orderly book building, although investors showed high sensitivity to headlines. Owing to the increased market volatility, credit market issuers needed to look more carefully at windows for issuance. Some members also mentioned careful management of inventory and avoidance of shorting bonds because of the heightened risk of losses.

With regard to secondary market trading, there was a consensus that sovereign bond market segments with liquid bond futures tended to trade with a liquidity premium and were being used as proxy hedging for other markets. Smaller markets without liquid futures markets were temporarily affected by wider bid-offer spreads, a decline in trading frequency and a decline in hit ratios on trading platforms. Some members highlighted that real money accounts in particular had become cautious, but there was no sign of widespread “risk-off” behaviour.

Following the Federal Reserve System's interest rate cut, market participants were now closely monitoring forthcoming policy meetings by the ECB and other central banks.

Several members confirmed that contingency planning and testing due to the international coronavirus outbreak was well under way. Financial institutions had activated their recovery sites and tested other teleworking capabilities. Some members cautioned that market liquidity could be severely impacted if widespread teleworking became necessary at dealer banks.

2) A review of central banks' strategies and monetary policy tools

Andy Chaytor (Nomura) and Christoph Rieger (Commerzbank) presented a review of central banks' strategies and monetary policy tools.

Members welcomed the ECB's strategy review exercise, including the outreach to the public. Some members feared that the outcome of the review could make the ECB less reactive to adverse inflation developments. Overall, market participants' expectations of the ECB's strategy review seemed to be relatively limited at this stage, not least because similar exercises in the past by the Federal Reserve System and the Bank of Japan did not result in major changes. There was a general wish to keep all options and instruments available and preserve the flexibility to act in all circumstances.

Several members believed that the review should focus on the definition of price stability and the measurement of inflation. In particular, the ECB should define a target that it could better and more credibly control. This would require deep analysis of factors which drive both inflation and inflation expectations. Some members wondered how environmental, social and governance (ESG) and financial stability considerations could be incorporated into the monetary policy strategy without jeopardising the ECB's primary mandate. In particular, focusing too much on financial stability considerations would send a hawkish signal to the market. Others thought that the inclusion of sustainability considerations into the ECB's monetary policy framework was challenging, but nevertheless important.

3) Update on the euro area corporate bond market

Christian Kopf (Union Investment) provided an overview of euro area corporate bond market developments.

It was noted that the euro area corporate bond market had become increasingly relevant for the funding of non-financial corporations in recent years. Corporate leverage ratios had remained stable in aggregate, although an increasing number of lower-rated corporations with higher leverage had gained market access. Several members voiced the concern that some of these lower-rated corporations could be downgraded below investment grade and then confronted by a discrete rise in their borrowing costs.

Members reported that outflows from the European credit market had been limited despite the widening in credit spreads. The repricing of markets that followed the COVID-19 outbreak was mainly driven by an adjustment of indicative pricing levels. Some members were of the view that the market had become somewhat complacent prior to the outbreak. It was suggested that this complacency might have been compounded by the corporate sector purchase programme and the ongoing search for yield. Other members characterised the recent repricing as a healthy development, with investors now differentiating more between the credit quality of different corporate names.

Members reported that liquidity conditions in the corporate market had been challenging, particularly during “risk-off” days. Smaller flows were having a bigger price impact than normal but the market position was assessed to be relatively neutral overall. The ability of the dealer community to intermediate during these days was reduced, and avoiding the shorting of bonds entirely during volatile trading days seemed a desirable stance. Some members highlighted this as a concern in the event of substantial outflows from the credit market. In the near term, the market is expected to remain somewhat volatile, with windows of relative calm being used for new issuances. Overall, members were for the time being relatively sanguine about the outlook for the European credit market, with investor demand expected to remain strong and support spreads. This was evident from the good demand attracted by the first primary market issuances since the COVID-19 outbreak. The issuance windows were reportedly shorter and the situation fluid, though, implying that it is too early to make an overall assessment.