

## Teleconference of the ECB's Bond Market Contact Group – 25 June 2020

### Summary of the discussion

#### 1) Welcome remarks and a review of the ECB's policy response to the COVID-19 crisis

ECB Executive Board member Isabel Schnabel thanked members for their regular participation in the Bond Market Contact Group (BMCG) and the valuable insights they offer to policymakers. She then provided a short review of the ECB's response to the coronavirus (COVID-19) crisis. This review was an updated version of a presentation given on [10 June 2020](#).

**The pandemic emergency purchase programme (PEPP) is a temporary measure introduced to deal with the specific challenges posed by the COVID-19 pandemic. It has the dual objective of closing the medium-term inflation gap that has emerged during the pandemic and countering fragmentation in the euro area.** The programme's embedded flexibility allows the ECB to respond effectively to the challenges posed by the pandemic, thereby ensuring orderly market functioning and the smooth transmission of its monetary policy to all parts of the euro area.

**In addition, the ECB's bank-based policy measures, in particular the third series of targeted longer-term refinancing operations (TLTRO III), are mitigating the potentially adverse impact of tightening market-based funding conditions on lending to firms and households.** Provided that banks maintain their lending to the real economy, they can benefit from highly attractive funding rates under TLTRO-III. The targeted liquidity-providing operations thus ensure that banks remain reliable conduits of the ECB's monetary policy.

**For purchases of public sector securities under the PEPP, the benchmark allocation across jurisdictions continues to be the shares in the ECB's capital key of Eurosystem national central banks.** At the same time, purchases under the PEPP are conducted in a flexible manner. This allows for temporary fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions.

**The COVID-19 pandemic constitutes an unprecedented shock to the global and euro area economy.** The wide-ranging decisions taken by the ECB's Governing Council were based on the assessment that, in the current fragile market environment, the PEPP remains the best and most effective instrument to respond to the dual risk of a shortfall in inflation relative to the ECB's medium-term aim and fragmentation in the euro area.

#### 2) Bond market outlook

**Zoeb Satche (Citigroup)** reviewed the main bond market developments since the meeting on 4 March 2020 and provided an outlook for the upcoming months. He also analysed the impact of the EU becoming a major issuer in the euro area.

**Market liquidity has recovered significantly from the market lows, although not completely back to pre-pandemic levels.** This is evident in the rapid tightening of bid-offer spreads and a reduction in transaction costs. There is more two-way flow across different market segments.

**In the discussion, a few members said that the proposals for an EU recovery fund have contributed to the more positive sentiment in euro area markets.** Some members suggested that market pricing was already reflecting some disappointment about the final parameters – weighted more towards loans than grants; a lower overall size than originally announced. Other members focused more on the symbolical importance of the announcements, which they felt outweighed concerns about the fiscal contribution to individual countries. This will contribute to euro area cohesion in the long term.

**All members agreed that central bank action had contributed to a stabilisation in spreads and a strong rebound in credit markets.** However, some members expressed reservations about how central bank policy action may increasingly be driving market pricing. Market participants nevertheless said that it is useful to know that the central bank will increase its market presence in times of crisis. This serves to stabilise spreads, but also reduces volatility and may potentially weaken market-making capacity. There is also concern that credit market valuations may point to some potential complacency about the prospect of increased downgrades and possible defaults.

### 3) Real money investor strategies in a low-yield environment

**Oliver Eichmann (DWS) and Pauli Mortensen (NBIM)** presented strategies of real money investors in a low-yield environment.

**The risk-return portfolio composition of many investors has changed.** In order to generate a positive real return via fixed income, investors are increasing their exposures to credit, duration and/or currency risks. Some investors have adapted their risk frameworks in response to the need for such investments. However, these frameworks still have binding limits, which implies that there is a cap to such risk-taking. Furthermore, constraints such as value at risk (VaR) imply that a portfolio may sometimes need to mechanically de-risk and sell assets.

**A few members highlighted that investment managers have been confronted by a breakdown in correlations across markets.** The negative correlation between risk assets and risk-free assets is becoming less apparent. This is particularly evident when the yields on risk-free assets are low or negative. The relative performance of German Bunds during the recent bout of market turbulence was cited as an example.

**Members also confirmed that demand for environmental, social and governance (ESG) investments continues to grow.** NBIM stated that it is diversifying its portfolio by investing in renewable infrastructure. There is also increasing focus on social bonds, with, for example, the European Stability Mechanism (ESM) putting a framework in place that allows it to issue social bonds to fund its role in responding to the COVID-19 crisis. Recent [reports from the Network for Greening the Financial System \(NGFS\)](#) detail how central banks and supervisors are confronting the challenge of environmental and climate risk.

### 4) The impact of the CSDR on fixed income markets

**Martin Scheck (ICMA) and Garry Naughton (Goldman Sachs)** provided an analysis of the potential impact of the Central Securities Depositories Regulation (CSDR) on fixed income markets.

**They both voiced concerns that the implementation of the CSDR would have a negative impact on secondary market liquidity.** The impact would be most pronounced in less liquid market segments. Some members were of the view that the provision for mandatory buy-ins had many failings and needed to be revisited. The nature of the fixed income market – request-for-quote (RFQ)

driven and principal-based, where dealers have the ability to offer a security not based on inventory – argues for a less prescriptive regulatory framework. They welcomed the fact that the European Securities and Markets Authority (ESMA) had recently issued a survey on potential amendments to the CSDR, and noted the recent announcement from UK authorities that the United Kingdom would not be implementing the CSDR’s settlement discipline regime.