

Teleconference of the ECB's Bond Market Contact Group – 23 September 2020

Summary of the discussion

1) Bond market outlook

Fabio Noacco (Mediobanca) reviewed the main bond market developments since the meeting on 25 June 2020. The focus of the discussion was on fiscal versus monetary dominance. Members agreed that in stark contrast to previous crises the interaction of monetary and fiscal stimulus in the EU contributed to a stabilisation of spreads, with some sovereign spreads even trading tighter compared with pre-COVID levels. For the first time the fiscal stimulus package is meeting expectations not only on national fronts but also at the European level, which has contributed to the stabilisation of euro area sovereign bond yields and IG credit spreads. At the same time this was seen as a decisive factor behind the recent appreciation of the euro, and members agreed that the recent appreciation of the euro was backed by improved fundamentals in the euro area.

One member stressed that at the current stage the economic outlook is deeply uncertain and any deviation from the inflation target should not be over-interpreted.

Going forward, members highlighted Brexit as one of the main risks ahead. Some members raised concerns over market fragmentation and a bifurcation of liquidity.

2) The new normal after Covid-19 – lessons learnt from the impact of the pandemic on the financial markets

Andrew Millward (Morgan Stanley) and **Peter Hegge (Allianz)** shared their views on the “new normal” and potential lessons learnt from the COVID-19 crisis. Members agreed that one of the lessons that can be drawn from the current crisis is that central banks have a quick reaction function and can stabilise markets. At the same time concerns were raised that central banks might become victims of their own success and guide market expectations of ever quicker interventions going forward. One member added a word of caution that extraordinary measures are expected to become normal and that markets may adapt accordingly, with prices decoupling from fundamentals.

There was consensus that the trend of sustainable investment is certainly part of the new normal. Rather than stopping this trend, the current COVID-19 crisis has supported it, with the issuance of green and social bonds accelerating.

3) Primary euro area bond markets and the impact of the upcoming EU issuance on national issuance and the development of a safe asset for the euro area

Michael Krautzberger (Blackrock) and Siegfried Ruhl (ESM) presented on the market impact of the upcoming EU issuance and reviewed the implications of the development of a new safe asset for euro area bond markets. Members had a lively discussion on how to best ensure the secondary market liquidity of the upcoming EU issuance. While some members saw the usage of some sort of primary dealer system as useful, others argued for large issuance volumes per ISIN and a pre-set issuance calendar with auctions in combination with syndicated issuance. Once the EU has established a liquid yield curve, members expect the trading of EU bonds to be moved from the SSA desk to the EGB desks.

One member raised concerns that EU bonds would only be considered as a new safe asset by overseas investors if the EU was perceived as a permanent funding vehicle rather than a one-off COVID-related issuer.