EUROPEAN CENTRAL BANK
EUROSYSTEM

15 November 2022

Meeting of the Bond Market Contact Group (BMCG) on 10 November 2022

Summary of the discussion

1) Review of bond market developments

Nathalie Fillet (BNP) provided an outlook for bond market developments in 2023, which triggered a discussion on the major challenges ahead. The most frequently mentioned concern was the high net supply in euro area bond markets in 2023, against the background of uncertainty on the monetary policy normalisation pace for rates and balance sheet and potential financial stability concerns. However, some members expected that a shift out of private credit investments, into more liquid public sector debt instruments, might help to absorb supply in EGB markets going forward. Issuance in 2022 has been challenging due to high volatility, and the presence of Asian investors has been lower than in previous years. Some members called for issuers to be more agile and more attentive to investor demand to ensure smooth primary market activity. This would imply to be open, whenever possible, to select the right issuance window and/or to adjust issue sizes and be more active in managing secondary market liquidity via an increase in repo market or buyback activity, if needed. Real money representatives confirmed that heightened volatility has also complicated their trading and contributed to keep them on the sidelines. Signs of a peak in inflation and rates were seen as pre-requisite for a turn-around in volatility and return to more orderly trading conditions.

Members also exchanged views on the high level of leverage in the system, which was seen as a potential risk to financial stability. An increase in customer haircuts by banks was mentioned as a potential measure to address the issue, if applied systematically throughout the banking industry.

2) Market functioning and the monetary policy normalisation of central banks

Julian Baker (JP Morgan) presented an assessment of the impact of monetary policy normalisation on various asset classes and liquidity. Members broadly agreed that liquidity has deteriorated in response to a higher volatility regime but is still considered resilient and sufficient to transact. The most recent widening of bid-offer spreads was interpreted as an illustration of a repricing of the cost of liquidity, while the daily trading volumes in many segments held up well as they were higher or remain broadly unchanged.

However, it was widely acknowledged that there are some pockets of illiquidity in the market (credit, inflation linkers, off-the run bonds in the US), in which it is more challenging to transact. Members highlighted that those asset classes have a smaller and more concentrated group of active market makers.

Some members expected that higher yields would progressively bring back some investors to fixed income markets which were lost during the low yield period and stressed that bank bond trading desks will have to gain more experience on how to manage and recycle inventory in a context of lower central bank purchases.

3) Latest developments in the ESG market

Bryan Pascoe (ICMA) presented the role of bond markets to finance energy transition and innovation and provided an update on the EU taxonomy. The discussion of the group revealed, even in the absence of a greenium, a persistently high interest in ESG products both from an investor and issuer perspective. Several members stressed that robust and consistent regulation as well as transparent disclosures are seen as crucial to maintain the momentum.

4) MiFIR Review - Balancing liquidity and transparency

Victoria Webster (AFME) presented an update on the current data driven concerns around proposed changes to the post-trade transparency requirements around the final stages of the MiFIR review. It was highlighted that bond post-trade transparency requirements, in particular deferral timeframes, which protect liquidity providers from adverse market movements before being able to effectively manage their position risk, should be determined by detailed data analysis to ensure they are flexible enough to account for the liquidity and size of the traded instruments before details of the trade are made public.