EUROPEAN CENTRAL BANK
EUROSYSTEM

18 December 2020

Teleconference of the ECB's Bond Market Contact Group – 14 December 2020

Summary of the discussion

1) Review of bond market developments

Nathalie Fillet (BNP) reviewed the main bond market developments since the last Bond Market Contact Group (BMCG) meeting on 23 September 2020.

The discussion highlighted a pattern of increased inflows into euro area sovereign bonds from foreign investors. Members stressed that in the eyes of foreign investors, the euro area government bond market has become more homogenous. As a consequence, these investors are spreading their investments more evenly across euro area sovereigns, including peripheral sovereigns. The successful launch of the EU's temporary Support to mitigate Unemployment Risks in an Emergency (SURE) programme was perceived as a sign of a dynamic European Project and proof that funds can be transferred from one European country to another. This also supported inflows into lower rated euro area sovereign bonds.

Looking ahead some members warned that the current environment of low volatility might reflect not only the expectation for an economic recovery and improvement of fundamentals, but also the extraordinary fiscal and monetary support measures. Those members expect that an orderly exit from the current support measures could become a major challenge and risk for financial markets in the medium term.

Commenting on the decisions taken at the last Governing Council meeting, a few members called for the ECB to provide markets with further details on what is meant by "maintaining favourable financing conditions" and how this approach differs from Yield Curve Control (YCC). In particular, it was discussed to what extent this would suppress market volatility linked to changes in economic fundamentals.

2) First experience on the impact of EU issuance on euro area bond markets

Christoph Rieger (Commerzbank) shared his views on the first EU issuance related to the SURE programme.

There was consensus that the first issuances under the EU SURE programme were a remarkable success in terms of performance and order book size. Among the factors behind the strong demand mentioned were: (i) the emergence of a new, attractive issuer in the field of economic, social and governance (ESG) investment, as all SURE bonds are labelled as social bonds; (ii) the high level of cash holdings prevailing in the financial system; and (iii) the cheapening of the supranational sector ahead of the issuance.

While the high interest in the SURE bonds was perceived as a sign of confidence in the "European project", one member added a word of caution on the recent trend of ever rising order book sizes. This development makes the allocation process in primary market transactions challenging and increases the risk that future transactions may disappoint if orderbooks do not achieve similar sizes.

Finally, some members called for more transparency, including on ESG metrics, with regards to SURE/Next Generation EU bonds.

3) Outlook 2021

Andy Chaytor (Nomura) presented an outlook for euro area bond markets in 2021. Members were of the view that market developments will be driven by two factors: (i) the widespread take-up of an effective vaccine against COVID-19 improving the outlook for fundamentals, triggering an economic recovery with a normalisation in saving rates and consequently a rise in inflation rates, which is most likely to happen in the second half of 2021; (ii) markets will be supported by ECB monetary policy in 2021, but speculation about a future exit from these support measures might nevertheless have an impact on volatility and interest rates during the second half of the year.

Some members were of the view that the “COVID-19 savings glut” will reverse in 2021, leading to increased spending and possibly a rise in inflation. This increase in inflation – in combination with continued asset purchases by the Eurosystem, which contribute to anchoring nominal yields – will result in declining real yields during an economic upswing. Under such circumstances those members would expect equity markets and high yield bonds to be in high demand and outperform.

One member stressed the unprecedented and extraordinary uncertainty about long-term inflation expectations. Other members pointed also to other sources of uncertainty: the impact of digital currencies on the velocity of money; the procyclical behaviour of retail investors, which might contribute to a rise in volatility; and the increased risk taking by asset managers in credit markets in an attempt to generate value in the current low yield environment.